Sperry Van Ness | Bluestone & Hockley held its 3rd Annual Investor Forum in February. The well-attended event, titled "Recognizing Opportunity in Portland's Dynamic Marketplace," was co-sponsored by Wells Fargo Bank and featured expert speakers with deep knowledge of the Portland and Southwest Washington region. The presentations, followed by a Q&A with the audience, focused on development trends, current risks and rewards in investment real estate, and where to find opportunity.

The following pages capture the heart of this year's Forum. If you were unable to attend and want more information about the event, please contact one of our Advisors.

Our Speakers:

Mark Doiron, SVP
Wells Fargo Bank

Mark has more than three decades of banking experience. He currently serves as the President of Wells Fargo Bank's Community Banking Real Estate Group for California and Oregon. The Group's primary focus is construction and investor real estate lending.

Jonathan Malsin
Principal
Beam Development

Beam Development currently focuses on the Central Eastside and Industrial Adaptive Reuse projects. Jonathan is responsible for overseeing property management, negotiating contracts, and assisting with pre-development and project management for new projects. Beam's projects, all placed on the National Historic Registry, have helped redefine the Central Eastside as a creative office district.

Chris is a co-founder of Capstone Partners LLC, a Northwest-focused commercial real estate development and advisory firm with offices in Portland and Seattle. Chris has personally sourced and directed the development, investment and management of over seven million square feet of industrial, multi-family, retail and office properties in the Pacific Northwest and Northern Nevada for institutional partners and clients.

Chris Nelson, Principal
Capstone Partners, LLC

Christian is an Economist specializing in the Portland area. He provides data analysis and advice relating to the Portland economy to local businesses, business associations and government agencies with the goal of facilitating intelligent decision making.

Christian Kaylor
Economist
Oregon Employment Department

Chris Nelson:

Grant Park Village is the largest project that we've ever done as a company here, also one that's been a real challenge but also a fun opportunity. It's the former Albina Fuels site at 32nd and Broadway in Northeast Portland. It's a three phase project. The largest phase is phase 1, which is a mix of 211 market-rate apartment buildings in five separate structures on top of a podium that covers parking and ground floor commercial. We were fortunate enough to have New Season's match up with us as our anchor retailer. So it's actually one of the first examples here in Portland where we actually have a grocery store underneath housing.

……So far, the focus groups that we've done, the people that we've talked to, they think it's great—whether they're young and single or an empty-nester looking to move into a community that has a great grocery store on the ground floor. We turn over the shell to New Season's for their improvements late April, and they want to be open by Thanksgiving this year. And we'll start moving our first apartment tenants in in November as well.

> ***"We started the company in 2002. All four of us partners were formerly with the Trammell Crow commercial group. ….Portland and Seattle have land and other constraints, and it's difficult to be focused on one product line. And so we decided to focus geographically. We had a pretty good run from early 2002 until the downturn. And right now we're about as busy as we've ever been."***

The PDX Logistics Center is a two-phase state of the art logistics park on a 50-year prepaid ground lease from the Port of Portland. It's a site actually worked on 10 years ago, and the port had pulled back and wasn't able to transact then. We loved the site ten years ago and like it even better now that Cascade Station has been largely built out. And the infrastructure's better. We've got hotels nearby and—not that warehouse workers typically take light rail to work—but here's one example in the Metro area where East county employees could actually take light rail to their jobs. We're not banking on that, but it's kind of a nice extra feature.

We're asked, "Why would you take a risk like this in today's market?" From our perspective, it's a supply-constrained market on industrial land and in the Airport way corridor, where a lot of these types of tenants want to be, there are zero spaces over 200,000 square feet that are new. And there's good activity in the marketplace for modern state-of-the-art space. We have an additional option, so in aggregate, about 850,000 square feet when we're all said and done.

The market has seen a couple of years of really positive absorption. Last year finished up about at about 1,500,000 SF net, vacancy rates about 6%, and rents are starting to move up. So we're hoping that our delivery this fall is sort of meeting an improving market in that regard.

GRANT PARK VILLAGE
- 211 Apartment Units
- 48,000 SF retail Including 35,000 SF New Seasons
- $59.5 MM Project Cost
- Completion: November 2014

D STREET VILLAGE
- **Phase I**
  - 30,000 SF adaptive re-use of three buildings and former Nature's NW Fresh Grocery Store
  - $4.5 MM Project Cost
  - Completion July 2013
- **Phase II**
  - 85 Class-A Urban Apartments
  - 9,000 SF of ground floor retail
  - $15 MM Project Cost
  - Completion July 2014

PDX LOGISTICS CENTER
- 491,200 SF Industrial Park
- $28.5MM Project Cost; 100% Speculative
- Completion October 2014

Chris Nelson:

I look at risk and concerns on an external basis. In this cycle we've gone into lower leverage on all of our projects. There's more equity in front of our projects so that, if things do slow down, we can ride through the storm a little bit better. And the lenders are more diligent about underwriting projects. We like to think that each of our projects, whatever they are and wherever they are, are in intrinsically strong locations. We're not going to do a project on the twenty or thirty yard line like some were in the last cycle. We're focused on A-plus locations. A great location, in our view, is really the best contingency for a project.

Why Portland vs. other places? We love Portland. It's a great place to live. But at the bigger level: why Portland? Why would you want to build apartments? Why would you want to build mixed use? People want to live here, and people are moving here in pretty good numbers. So at sort of the higher level without doing a lot of analysis, we want to be in a place where people want to work and live.

And then you take that down to your project level. You say: Where do you want to build? Well, you want to build where people want to live. And now you have this migration. In the old days, you built an office building and it was sort of located where the executives who made the decisions wanted to be. Today, the executives want to locate their offices where the employees are because they know they can't attract good employees without being in the right place. So you have this intersection of where people want to live and where people want to work, and it's the same place. And that same place is these great neighborhoods that are the hallmark of Portland.

Apartment Cycle Chart

Q: ***Any predictions on cap rates?***

A: I won't make a prediction, but I will say that we are planning—at least on our multifamily—for a movement of 50 basis points up. We underwrote our E Street Village Project with a 7.5 CAP value. I think if we took that to market we would see a lower cap rate. Our investors look at Portland as paying a little more yield. I think we track behind the Seattle and San Francisco markets on every asset class. And if our cap rates are a little higher, that's an appropriate risk adjustment… I think industrial cap rates are likely to go down a little bit. They've been higher in this market. Office, I would say the same. It is really product specific. Finding good projects in Seattle and San Francisco with attractive cap rates is difficult, and Portland still provides value.

Q : ***What is a successful RE strategy given today's economy?***

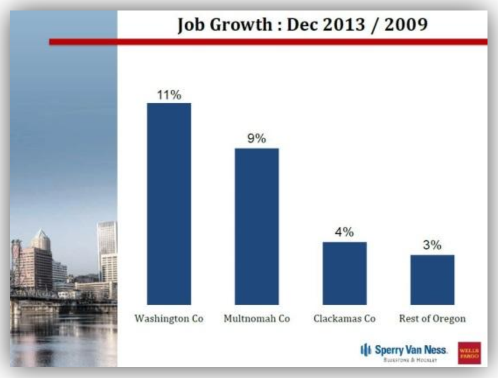
A: Saying "no" is a good strategy sometimes. We had a hard time making deals in the 2006-2007 timeframe. And we just said: "we can't make sense of these valuations. We've got to get paid for risk." So if we think we can build to a yield of whatever, we want to have a healthy cushion. And I think the cushion is shrinking right now. So we're going to be picky about projects. We're little, and we can get wiped out with a really bad deal, so saying "no" sometimes – and it sounds kind of simple – but sometimes it's the right thing to do.

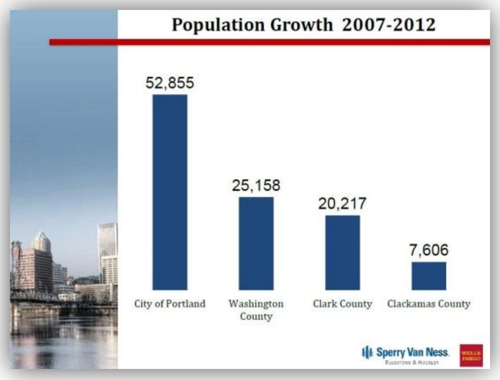
Q: ***When will condos come back to the market?***

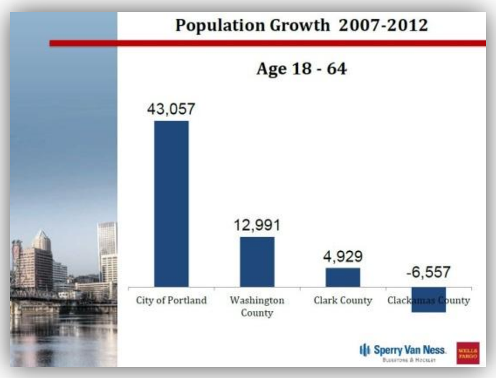
A: There's a lot of risk from a construction perspective in the condo market. Although if people are willing to structure around that risk, I think there's a great opportunity here. People aren't going to rent always as a first choice. Some are going to move to a more suburban larger-home format. I think there's a great opportunity to build for-sale product in great neighborhoods. For the same reason people want to live in apartments in a great neighborhood, they want to live in a great home. And I think that's one of the challenges, but one of the great opportunities in this market, is finding sites in close-in good neighborhoods for for-sale housing.

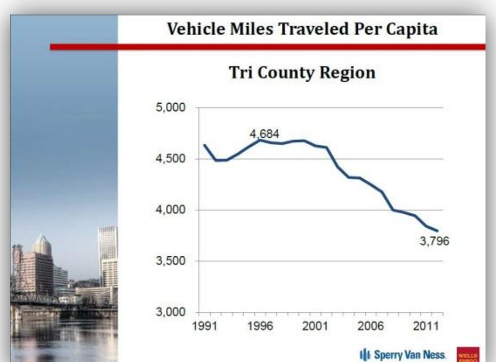
As for apartments, there's a lot of talk about where we are in the marketplace. I think the chart (at left) from Integra Realty is close to where I would peg Portland. It puts us in the third stage of growth and expansion. Portland has done well without a lot of job growth over the last years, and the job growth is now starting to kick in. There's a lot of new business formation, companies moving here, people moving here. So I think that while we may still be kind of in the middle of that expansion phase, my assessment is we're not quite at the third stage yet.

Christian Kaylor:









When we talk about Portland, we're talking about the entire seven-county region. We have the city of Portland, but we also have Washington County, Clackamas County, Clark County, Skamania, Yamhill, and Columbia Counties. That gets us up to a pretty large region of 2.3 million people. The city of Portland's only a little more than a fourth that—the actual city of Portland. And the city of Portland is also about 86% of Multnomah County.

… 75% of all jobs created in the state of Oregon in the last four years were in three counties: Multnomah (where we sit today), Washington County to the west (The Silicon Forest), and Clackamas County. Really 70% of that was Multnomah and Washington counties. Those were the big drivers. So we see Washington County just bouncing out. In fact, it was about a year ago that Washington County recovered all jobs that it lost in the recession. And it was only a few months ago that Multnomah County also recovered all jobs it lost in the recession.

…None of us has ever seen a chart where Multnomah County was growing three times faster than the rest of the state of Oregon. There's something unusual going on where Washington County, but now for the first time, the city of Portland, is driving economic growth and recovery in the state of Oregon.

…So what's driving population growth? From 1950 to 1980, the city of Portland did not grow at all. Over that period of time, Clackamas County, Clark County, and Washington County doubled or tripled or quadrupled their populations. All the population growth in the region was in these more suburban, better communities. The city of Portland's population was totally stagnant.

...Over the last five years, 45% of all population growth in the region has occurred in the city of Portland. …What's driving this is a certain demographic shifting. Portland is doing a very, very good job of attracting a certain type of person. Generally, it's being driven by college graduates in their 20s and 30s. The majority of new residents are college graduates with a Bachelor's degree or more, large numbers of them in their 20s and 30s. The vast majority of the people moving to the city of Portland are in that age demographic. Washington County, less so. Clark county, very much less so. And Clackamas County is actually shrinking in the percentage of its population that's 18 to 64, as the vast majority of population growth that Clackamas County is seeing is over 65.

…Something unusual happened in 2002. And that is: people start driving less. Nationally, this occurred as well in 2007. So it took a few more years nationally. But beginning in 2002, you sort of see this flattening off. Since 2002, the last 10 years, per capita driving has dropped almost 20% in the tri-county area. This is true also statewide and also nationally to a lesser degree. But people in the city of Portland, only 59% of workers who live in the city of Portland, drive a car to get to work. And that number is dropping quite a bit. Meanwhile, the suburbs still have high numbers of people driving to work, 75% or 80%, while the city of Portland has a disproportionate number of people biking, walking, taking mass transit, or telecommuting to their jobs. So it's an interesting demographic shift. But again it's one that the city of Portland is capturing and the suburbs don't seem to be doing a very good job with.

Christian Kaylor:

"We're still coming out of a deep recession. It was just late last year that the city of Portland got back to where it was before the recession. But I think we've got really strong momentum going forward. Anything could happen, especially as we talk about interest rates. …but I'm optimistic."

The city of Portland is putting up above average permit numbers. The average across the region is five permits per capita, per 1000 people, and Portland is about 6.2. So it's above average, but the majority of that is multifamily. It's healthy now, but in a few years, the prices are going to be challenging. There are so many great opportunities for infill for multifamily, particularly in North Portland and hopefully someday in East Portland, that I'm pretty optimistic. And again at some point, the suburbs will play along. Oregon City and Hillsboro—they're already doing quite well. The city of Vancouver is doing well. I think there are some really overlooked markets in some of these smaller towns…

"There's a lot of discussion about there being a national, perhaps generational shift by the millennial generation, towards condos and apartments, renting away from those 30 year mortgages…that may be permanent here."

Q: ***What are your thoughts on recent and future trends relating to demographics?***

A: Portland has this great positive cycle going with job growth feeding population growth and more population growth feeding that job growth. Businesses want to locate where their skilled workforce lives. The workforce doesn't want to own a car and is renting in the Pearl District or similar… At some point – and I think we're already starting to see it – those housing prices go up, especially multifamily, close in, Pearl District, South Waterfront. And at some point the suburbs are going to start seeing some of that demographic add in, too. When you turn 30 or 35 and decide you want kids, and you're tired of renting, you're going to want a mortgage, and you're going to look closer at the suburbs. But I do worry that there are suburbs that are sticking with what they know from the 70s and 80s and sort of doing this tract housing, single-family, cul-de-sac, strip mall, no mass transit, no bike lanes… There are great dynamic suburbs out there. Hillsboro is one of them. It is looking forward and saying it wants to attract a skilled and diverse workforce... It is working toward transit-oriented and density. I think that positions them very well for the future.

Q: ***How do you compare Portland to other major West Coast cities?***

A: I'm very optimistic about Portland. I get asked a lot to compare Portland to Seattle and San Francisco. San Francisco is the second densest city population per square mile in the United States. New York is number one. Seattle is a fine city north and they have Microsoft, Boeing and Amazon. And so it's legitimate to compare us to these other West Coast cities, but these are internationally competitive cities. These are globally known cities, and they are tough to compete against. Portland has a nice niche, where we have the cultural amenities that people look for in Seattle and San Francisco. We have mass transit. We have dense urban housing. We have world class restaurants and bars. We have what the educated workforce wants. And we have an international airport. We have these great amenities, but we do come in at a much lower price point than Seattle or San Francisco if you're looking to buy as a resident or if you're looking for commercial real estate. I got asked last week by a city of Portland commissioner: can we compete with the level of city of Seattle? And I don't think we can, but we shouldn't worry about it. I think we have this niche where we can be a friendlier, less expensive version of Seattle or San Francisco if you like, but a place you could actually afford to live, a place you could actually afford to open a business. And I think that that's a great place to be. The Bay Area's really built out. Seattle's really built out. There is not a lot of room to grow. So Portland really has this sweet spot of having the amenities, being on the West Coast, having an international airport. I'm quite optimistic about the next five to ten years.

Jonathan Malsin:

Our focus has been adaptive reuse. We look at developments in terms of community and not so much in terms of commodity. We feel that it's important to start with some initial questions regarding community, such as: what type of community are we trying to build? Who will tenant it? And what makes it authentic? And these questions really inform our investment decisions, ensure that we're responsive to the market demands and the tenants that will fill out buildings, and also ensure compatibilities with the districts and neighborhoods that we're developing in, which is critically important if you're going to be successful in communities like Portland and Eugene.

We also take a very high touch, integrative approach to development, leasing, and property management, and we keep these lines of business in-house. This allows us to know the market, know the tenants, know how to build and operate buildings efficiently, and also know how to retain tenants. We also take a very long-term approach to real estate investment, always with an eye towards both the near and long term returns. We're not your typical merchant developer, so we do like to hold onto our properties long-term. We use our own capital alongside investor capital and also have developed a nice niche in working with both historic tax credits and new markets tax credits to fill gaps in our projects.

Our original creative work space project was the Eastbank Commerce Center. It was a full renovation of a mostly abandoned warehouse in the central Eastside. We were able to accomplish this project at a very reasonable $5 million. We wouldn't be able to do that today with where construction prices are. We're currently 100% occupied.

We like to think that we pioneered the creative work space market in the central Eastside. An important component of the Eastbank Commerce Center is what we like to call a granular rent roll, in that we have many small to medium size tenants. That has performed very well through the downturn and we think that the mix of sizes is very critical to the success of the Center. We also learned at Eastbank early on that creative work space typically means fewer interior finishes or more simple interior finishes. This results in initially lower TI costs, then lower second generation TI costs and costs to turn over spaces for second, third, fourth generation tenants. That significantly bolsters our cash flow over the long term.

…Our most recent adaptive reuse project is the Eastside Exchange, finished in October 2013.We innovated by focusing our leasing efforts on technology-oriented companies… Tech companies, whether they're clean tech, software, or digital media companies, are in growing industries with deep tenant pools. Filling our building with this specific type of company has helped us create desirable community. And we're confident that this will differentiate us from other office products or office projects in the market and also ensure long-term success and a stable rent roll. We are greatly outperforming our proforma rents almost across the board. In some instances, we're seeing a 30% increase over what we had proforma'ed…

EASTBANK COMMERCE CENTER
- Renovation Completed: 2003
- Total SF: 82,000
- Total Renovation Cost: $5.0MM
- Current Occupancy: 100%
- Avg. Occupancy: 98%

EASTSIDE EXCHANGE
- Core/Shell Completion: Fall 2013
- Total Project SF: 97,000
- Total Renovation Cost: $17.5MM
- Current Lease-Up: 80%
- Projected Stabilization: Q3 2014

Jonathan Malsin:

Q: ***How would you describe Beam Development?***

A: Beam is a real estate development company headquartered here in Portland's Central Eastside that we like to think specializes in establishing and developing authentic projects that really enhance the neighborhoods and districts in which we develop. We've been focused primarily on the adaptive reuse of historic properties into creative work space, which is another name for creative office space. But we have developed other properties and other product types including multifamily. Since the downturn in 2008, we've delivered over 470,000 square feet of new projects to market at an aggregate project cost of around $75,000,000. Our current occupancy across our creative office, or workspace, portfolio is around 98%, which we're really happy about.

"We believe strongly that authentic developments fitting within neighborhoods and districts are more immune to market downturns and better primed to capitalize when the market returns. There's an investment advantage when you take the community vs. commodity approach to analyzing real estate investments. And our goal as we go forward is to capitalize on previous experience and maintain our authentic, hands-on approach to development. We'll continue to develop projects with some combination of our own capital, investor capital, tax credits, strategic public partnerships, and, of course, commercial debt. Our goal is to grow our portfolio using these capital sources."

Q: ***There seems to be an air of anti-developer sentiment in some neighborhoods, particularly on the east side. How do you address this?***

A: I think you have to be proactive with reaching out to the community stakeholders and actually doing more than the minimum. For instance, a project with an historic overlay or design overlay district, you have to go through design review, so there's notification sent out to all the community groups and neighborhood associations. We try to take a very proactive approach so, before the neighborhood learns of a project in the press or through some kind of city notification, we're reaching out to those community stakeholders to build support from those folks so we're not on the wrong end of that negative development sentiment… And it doesn't mean you necessarily have to change your project to please all stakeholders, but as long as they feel you have included them in the process, I think you're going to avoid a lot of the problems.

Q: ***What do you see as your biggest challenge?***

A: For us, it's always been buying right. We put a fair amount of money into our projects. And when we're competing for undeveloped land or with developers who are looking for similar returns—let's say it's in multifamily—it puts a lot of pressure on our creative workspace model. So as the market becomes more frothy and investors push up land prices and property prices for us, when we start getting a little further out there on what we're acquiring property for, we feel like we're taking more risk. So, the challenge for us is to continue to find quality properties at the right price.

Q: ***And your biggest opportunity?***

A: We see phenomenal opportunities to develop more creative work space. And some of this will be the adaptive reuse of historic properties as we've primarily done in the past. And some of this will have to be new construction. We are currently working on a project of a somewhat innovative design that will integrate creative work space and residential in a large format, new-construction project. And we think that this type of project will be easier to finance than your more traditional speculative office. There's still a fair amount of resistance from the capital markets and financing of speculative office.

Sperry Van Ness
BLUESTONE & HOCKLEY

National Reach with Local Expertise

Sperry Van Ness® is an international commercial real estate brand founded in 1987. The company has 180 affiliated offices across the nation with 1,200 advisors and staff. Sales in 2013 exceeded $8.01B.

The Portland and Vancouver offices of Sperry Van Ness | Bluestone & Hockley are comprised of a team of advisors having more than a century of combined real estate experience. Our mission is to create unprecedented value for our clients.

Our services include:

Consulting | Brokerage | Commercial Leasing | Valuation Advisory

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