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# Regional Spotlight - Pacific Northwest

By Mike Sheridan

*Because the Pacific Northwest was one of the last regions to experience the effects of the economic recession, it likely will be one of the last to fully recover. Read why the impact of the recent downturn was not as severe as in most other areas and was not felt for nearly as long in markets like Portland, Seattle, and Vancouver.*

**Like the proverbial tortoise, the Pacific Northwest area of North America is experiencing slow and steady economic growth, having avoided the wild real estate sector swings felt in other areas of the nation. The region-northern California, Oregon, Washington, British Columbia, and Alberta-was one of the last to feel the recession, points out Jordan Schnitzer, president of Portland-based Harsch Investment Properties, a privately held real estate development and management company that owns 21 million square feet (2 million sq m) of space in leading western cities.**

"Because the Northwest was one of the last regions to go into the recession, we generally are one of the last regions to recover from recessions. Other markets in the West got stuck with substantial excess inventory of retail, office, and industrial property," Schnitzer continues. "Portland, which has a well-defined urban growth boundary, did not have the incredible highs of 2001 to 2007 and now is not experiencing incredible lows, because we do not have the amount of land for additional growth that areas such as San Bernardino County, Phoenix, or Las Vegas have."

In Vancouver, geographic constraints imposed by the surrounding mountains, oceans, and rivers make developable land scarce and put a premium on its value, says Michael Ferreira, principal at Vancouver-based Urban Analytics Inc., a research and advisory firm focusing on urban multifamily residential development. "Thus, the impact of the recent recession was not as severe and was not felt for nearly as long as in most other Canadian jurisdictions," he says. "As a result, there was little to no downward movement in land values."

Seattle's well-diversified economy-aerospace, technology, biotech, and retail-helped cushion the fallout from the global economic downturn, points out Alex Quilici, loan analyst at Seattle-based HomeStreet Capital, one of 25 licensed Fannie Mae delegated underwriting and servicing (DUS) lenders nationwide. The area is beginning to experience pent-up demand in the multifamily segment, he says. "Key factors driving this sector include population growth; demographic shift, including generation Y coming into the rental market and baby boomers making stage-of-life changes; and a reduction in homeownership," he says. "This increase in demand, coupled with a constrained supply of new units on the market, will spur development in this sector."

The year 2011 is expected to be a transitional year, says Dan Safier, president of the Prado Group Inc., a San Francisco–based, privately held real estate development and investment management company.

"Debt and equity [are] coming back," says Safier. "The market is bifurcated. There is investor appetite for Class A product in A markets. Class B and C product in B and C markets will likely suffer, but investors should start to pursue B and C markets and product due to larger spreads in cap rates to debt. Urban and suburban infill markets in San Francisco and Silicon Valley are likely to rebound faster. Retail sales are improving, but virtually no new retail development is expected until empty boxes are filled. Exceptions are grocery stores and large users like Target, which are using this opportunity to get into high-barrier-to-entry markets."

Technology, medicine, and biotech are bright spots, Safier says. "Salesforce.com will build a new headquarters campus at Mission Bay on one of the last remaining prime parcels in the 303-acre [122-ha] redevelopment area," he continues. "University of California at San Francisco and California Pacific Medical Center [CPMC] are leading the way with the new CPMC Van Ness hospital and the Benioff Women's and Children's hospital at Mission Bay."

Safier notes that 2001 Market Street, a mixed-use project with 82 residential units over a flagship Whole Foods, is finalizing entitlements, with construction scheduled for late 2011 and early delivery in 2013. "1401 California Street is a mixed-use development with 100 residential units above a 30,000-square-foot [2,800-sq-m] grocery store at California and Hyde," he says. "This project is anticipated to be entitled and constructed by 2014. 1266 Ninth Avenue-a mixed-use project with 15 residential units and retail in the Inner Sunset District-is approved and anticipated to break ground in second-quarter 2011 with a late-2012 delivery."

Regions in the Pacific Northwest that were affected by the global downturn are seeing more rapid improvement than are other regions. Already, northern California has begun a nice recovery, says Kim B. Snyder, senior vice president and managing director, west region, of San Francisco–based AMB Property Corporation. "The Bay Area is a robust market, which presents opportunity for landlords with suitable space," says Snyder. "A recovering economy, combined with growing demand for innovative products, has the potential to continue to drive investment upward for the sector. With over half of the venture capital firms focusing on life sciences residing in the Silicon Valley, Bay Area companies are poised to receive a major share of venture capital dollars to fund their growth and fuel the demand for more space."

Clean technology, biosciences, and the renewable energy industries are bright spots in the reemergence of research and development demand, he adds. In San Jose, AMB recently developed AMB TriPoint, an R&D facility certified Silver under the Leadership in Energy and Environmental Design (LEED) system and meeting the sustainability requirements of higher-end, environmentally sensitive tenants. "As technology firms resume hiring, the real estate markets will improve with the take-up of the still-plentiful supply of buildings for nearly all product classifications," Snyder says. "At AMB, we have been fortunate to absorb vacancy and renew many existing tenants who until recently were displaying a wait-and-see strategy. From manufacturing to R&D, science, cleantech, biotech-keeping the jobs and venture capital money local is a sustainable model for everyone."

With northern California developers and real estate financiers looking for more ways to establish a competitive advantage or increase marketing appeal, sustainable design-particularly design that emphasizes energy and resource efficiency-will become a key factor in their strategies, says Christopher Clement, a LEED-accredited professional and sustainable economist, Design + Planning practice, at AECOM's San Francisco office. "Most energy efficiency or other sustainable design–oriented retrofits will be voluntary, though programs such as Energy Upgrade California and the California Solar Initiative are catalyzing more activity in these areas than in the recent past," he says. "However, given the volatility of the housing and office markets, many home and building owners are reticent to invest too much money in retrofits. But for home and building owners that are looking to exit their current investments, implementing energy efficiency retrofits or installing on-site renewable-energy generation capacity may be a necessary step in order to generate market interest."

AECOM-a Los Angeles–based global provider of technical and management support services to the transportation, facilities, environmental, energy, water, and government markets-is working on a number of projects in northern California, including a proposal for Pier 70 redevelopment in San Francisco, area planning for downtown Berkeley, an economic development strategy for San Francisco's Fillmore District, and high-speed rail station area planning at multiple locations in the San Francisco Bay Area.

In Oregon, the real estate industry is recovering at a solid, steady pace. There had been downward pressure on office, retail, and industrial rents in the Portland area, though the multifamily market-with occupancy in the 90 percent range-has held up well, says Schnitzer. "Portland Class A office occupancy is reasonably healthy, and rents are in the $27 to $28 per square foot [$291–$301 per sq m] range for Class A office, but need to be in the $33 to $34 per square foot [$355–$366 per sq m] range for any new construction to start," he says. "The industrial market is soft but not terrible, with about 12 percent vacancy; rents are down about 20 percent. Retail, which was very strong, with rents [in the] $22 to $28 per square foot [$237–$301 per sq m] range two years ago, . . . now [has rents] in the $14 to 19 per square foot [$151–$205 per sq m] range. With high occupancy, multifamily rents declined only 5 to 7 percent from the peak and seem to be stabilizing, with projections of 2 to 4 percent rent increases for 2011."

Looking ahead, Schnitzer expects construction of a new office building to begin in Portland this year, if a tenant can be signed. "Retail is firming and has come off the bottom, with rents beginning to move up a little," he says. "Industrial will be slower to come back, and rents will probably stay flat for the first six months of 2011, with 4 to 6 percent increases in the latter half of the year. Housing prices, which have been down 15 to 25 percent, will increase 5 to 8 percent in 2011."

New-build real estate development will remain slow this year in the Portland market, particularly in the urban condominium sector, which is overbuilt, says Don Hanson, principal and deputy CEO at Portland-based design firm Otak. "There are a few bright spots locally," says Hanson, who is chair of the city's Planning and Sustainability Commission. "Our firm has been designing several urban infill rental apartment projects that are transit oriented with no off-street parking. These infill/redevelopment sites are located in established urban neighborhoods with excellent transit service and walk-to amenities and services."

One such project designed by Otak is the 50-unit, four-story Irvington Garden Apartments in northeast Portland, now under construction. The development, with a mix of affordable and market-rate units, has a central courtyard, an abundance of bicycle parking, and an on-site bike repair shop for residents. "The Irvington's wood-frame construction keeps the rents affordable, and the traditional design features fit in with the historic neighborhoods," says Hanson.

In Washington state, the real estate market has finally hit bottom, with 2011 offering some hope of a slow recovery, says Quilici. With vacancy rates still in double digits, retail and office properties will struggle this year, but may experience modest reductions in vacancy rates, he predicts, with the critical factor for recovery being job growth. "The strongest asset class in Washington state for 2011 will be multifamily market-rate apartments, with a focus on Seattle urban infill," he says. "Overall fundamentals have already improved over the last six to nine months, despite lackluster job growth during the same period."

With Seattle's strengthening real estate market, sustainability has become the "price of entry" for any new commercial project, says Bert Gregory, CEO of Mithun, a locally based design firm. "Real estate prices are coming down to a point where lots of deals are starting to happen," he says. "There will likely be new design work focused on repurposing projects that are already designed or entitled, such as switching condos to apartments. Sustainability will continue to be seen as providing a competitive advantage in attracting a well-educated workforce and responsible business to the region. Deep-green projects such as LEED Platinum/Living Buildings/net zero will be the next focus for market leaders. Well-located infill and transit-oriented sites are preferred, with the first wave of new development to occur in these locations."

In British Columbia, the Vancouver real estate market is very healthy, with substantial pension fund and private capital looking for opportunities, says Gino Nonni, president of Wesgroup Properties, a family-owned real estate company based in the city. There is a trend toward infill; urban nodes; mixed uses around transit infrastructure, such as the city's SkyTrain and Canada Line; and diverse uses along transit corridors, he adds.

"Vancouver is seeing mixed use being designed in nontraditional ways, including office and residential, and even institutions seeing the emergence of new concepts," he says. "The city is experiencing a strong sustainable development pattern-diverse mixed uses, higher density. The medical sector is a growth industry due to aging population and funding constraints forcing institutions and health authorities to get innovative in new requirements."

TransLink, metropolitan Vancouver's regional transportation authority, has selected the Brewery District in New Westminster-British Columbia's oldest urban neighborhood-as the site of its head office and transit police facility. Construction of the new facility, developed by Wesgroup, is expected to begin early this year, with completion in 2013. "TransLink sought to reduce costs and increase operational efficiencies by amalgamating office space and transit police functions," Nonni says. "Their new location needed to be along the regional transit system. The Brewery District is a mixed-use development providing on-site amenities for their staff, a key driver in retaining and attracting employees. Our master plan and site location met design and metric requirements and was selected by TransLink."

The Vancouver area is also seeing increased density in transit-oriented hubs, former industrial lands, and traditionally suburban communities in Vancouver. "Planning officials and developers in regional core-oriented municipalities are working toward creating comprehensive developments adjacent to or in close proximity to existing rapid transit lines or planned transit expansion," says Ferreira. "Real estate values in planned transportation corridors were not affected by the downturn of 2008–09."

Vancouver's regional real estate market has not suffered the losses that other North American markets have experienced over the past two years, notes Chris LeTourneur, president and CEO of MXD Development Strategists Ltd., a Vancouver-based global commercial land development consulting firm. "This resilience hinges on the role of Vancouver International Airport [YVR] as the Asia Pacific bridge to North America and on Vancouver's deep embrace of being a sustainable city," he says. "YVR has become the catalyst for real estate development at and around the airport. Premiums on property values and rental rates have resulted, particularly for office and cleantech industrial park development in proximity to the airport. As a result, the prospects for growth of development as measured by absorption, price point, and product diversity are strong for the Vancouver region."

Neighboring Alberta also is experiencing a robust real estate sector, thanks to its plentiful natural resources. A large amount of the province's economic activity-including that of energy capital Calgary-is driven by the oil and gas resource industry, explains Micheal Dal Bello, senior vice president, real estate, at Edmonton-based Alberta Investment Management Corp. (AIMCo). "Prices for both these commodities are coming off cyclical lows that were reached when demand slumped with the worldwide economic downturn 18 months ago," he says. "In Alberta and Calgary-where all the head office, financing, and engineering work is based-the economy has been on a rebound. Drilling activity in the province is growing again, and new phases of oil sands projects placed on hold are now being restarted. All this renewed economic activity has resulted in steadily growing demand for commercial space in Calgary and Alberta overall."

Dal Bello notes that in Calgary, AIMCo is a one-third owner of the Eighth Avenue Place office project, which has as it first phase a 1 million-square-foot (93,000-sq-m) LEED Gold office tower that is 60 percent leased and was scheduled to open at the end of 2010. The firm is also 70 percent owner of the TD Square–Holt Renfrew CORE shopping center, a major downtown retail redevelopment project just finishing construction. "It is part of the refurbishment and remerchandising of a three-block, four-level retail project at the center of Calgary's business district," he says. "TD Square–Holt Renfrew has created a spectacular sky-lighted indoor shopping environment for the city." In the industrial market, AIMCo's Stonegate project in northeast Calgary has delivered 1.1 million square feet (102,000 sq m) of distribution space, and construction is expected to start soon to provide an additional 400,000 square feet (37,000 sq m) of space at the same site.

Thanks to cautious development even during the good times, the Pacific Northwest real estate market is recovering, and at a pace faster than that seen in the flashier areas of the United States and Canada where development boomed during the good times. For now, the slow and steady pace of development in northern California, Oregon, Washington, British Columbia, and Alberta suits the region just fine.