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PORTLAND'S PROGRESS

By Patricia L. Kirk

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The Portland retail market might not be very deep, but it is interesting. "There's only a few power centers here," says Mason Frank, president of Oregon-based MBK Northwest, a division of Irvine, Calif.-based developer MBK Real Estate Ltd. that specializes in redevelopment and repositioning of underperforming retail centers. "We are really a town, and basically we have been a neighborhood market."

What makes the region's retail market interesting though is the role growth restrictions have played in boosting retail real estate values, encouraging redevelopment of infill properties. "The underlying zoning issue is simply: Oregon doesn't have a sales tax, and retail doesn't provide quality jobs, so the city isn't motivated to encourage retail development," explains Dave Moore, MBK senior vice president.

Developers traditionally grumble about growth limits. But since the region's Urban Growth Boundary (UGB) land use plan has constrained supply to deter urban sprawl, retail vacancy rents have remained low, while rents and property values rise, according to **Tom Hanacek**, Sperry Van Ness' senior advisor in Portland.

The retail vacancy rate is expected to drop to 6.2 percent by year's end from 7 percent at the start of the year, according to a report by Marcus & Millichap, which predicts that rents will rise by 0.7 percent, to an average of \$18.78 per square foot, by the end of the year. While cap rates have remained stable at 8.2 percent overall, **Hanacek** notes that well-located strip centers are now selling at cap rates under 8 percent and commanding rents of \$18 to \$25 per square foot. "Single-tenant, triple-net properties with tenants like Walgreens are going in the 7 percent to 7.5 percent range, and anything grocery-anchored now on the market will command a 7.5 percent cap," he adds. Five years ago, the rate for similar properties was 9.5 percent to 10 percent.

What's more, because of the UGB limitations, redevelopment has helped shape the city's core. Neighborhoods with a sense of place have emerged, enhancing the region's desirability. More redevelopment is planned in the city's River and Waterfront districts. In fact, Safeway chose Portland as the site for its first real urban store as part of the revival of the Cultural district. (See story on page

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The People of Portland

Portland's reputation as a hip city, along with the emergence of high-tech and biomedical industries, has resulted in an influx of 376,000 new residents in 10 years, mostly from California and the East Coast — bringing the population count to 1.8 million.

A demographic profile of highly educated, high-income professionals is luring new national retailers to the market again, according to David Demers, a senior associate on CB Richard Ellis' Portland retail team. At the height of the recession, unemployment exceeded 9 percent. It's now 7.8 percent.

"Most major retailers have now landed in Portland," agrees MBK's Moore. "But there were almost none here in the mid-'90s." The newest retailers are Kohl's, which plans to build 15 stores in the Northwest by spring 2006; Crate & Barrel, which is opening its first store in a new lifestyle center in Tigard, and Loews and Century theaters.

The region also is getting its first major open-air lifestyle centers this fall: Bridgeport Village and the Streets of Tanasbourne. Although a few small open-air centers have been successful, like Lake Oswego's 84,000-square-foot Lake View Village, Demers is uncertain if the concept will fly on a large scale in a region where the average monthly rainfall is 40 inches. "We haven't seen it up and running yet," he comments. "Four months out of the year we're a rain-based society. They have rain protection in place, but we'll see if that works, if it's accepted here."

Bridgeport Village, a \$100 million, mixed-use project, built on a defunct quarry southwest of Portland in Tigard, will consist of 465,000 square feet of shops, restaurants and entertainment venues, and 350,000 square feet of office space. The Streets of Tanasbourne, a \$55 million, 368,000-square-foot retail project, is the final component of Tanasbourne Town Center. This 858-acre, master-planned development with 2 million square feet of office space, 4,000 residential units and 550 hotel rooms is located about 30 minutes from downtown.

Nearby Vancouver, Wash., will be home to the new Hazel Dell Town Square, with plans for a Target and the first Kohl's in the region. Target, Costco and Wal-Mart also are "driving big deals in Vancouver up against the urban-rural line and promoting pad development around them," according to Demers.

Big-box and power center developers are also going into outlying communities, which until fairly recently had been farmland. A former truck stop in Wilsonville, 18 miles south of Portland, for example, is being converted to a 400,000-square-foot power center, known as Argyle Square.

Investors love Portland. "This is a product-starved market," says Hanacek, "and it's difficult to find retail properties people are willing to part with." He says that prospective buyers are offering property owners lower and lower caps rates. "That's how deals are getting done here."

"The UGB makes zoned land very valuable," agrees Frank. Lack of motivation makes it difficult to get new projects through the entitlement process, which has created a shortage of quality retail product in the market, says Greg Mickelson, managing member of Newport Beach, Calif.-based GM Realty Advisors, LLC. GM Realty, a real estate advisory and development firm that is developing Phase II of Wood Village Town Center, a mixed-use project about 15 miles east of Portland that includes 200,000 square feet of retail space and 130 single-family homes. Consequently, "retail investors are aggressively chasing anything that comes available," he adds. "As usual, grocery-anchored neighborhood centers are the hottest category."

"Because of the barriers to entry that exist, good retail space in Portland is worth that much more," emphasizes John Bucksbaum, chairman of General Growth Properties Inc., a Chicago-based real estate investment trust. General Growth is getting ready to sink more than \$100 million into renovating and expanding Clackamas Town Center, adding 300,000 square feet of shop space,

restaurants and a lifestyle component to the 1.2 million-square-foot existing mall located southeast of Portland.

"A lot of people want to live in Portland," Frank continues, "just where to put them is the problem. So the word in Portland is densification to satisfy demand, which has resulted in a lot of upgrading of properties." He points to the Pearl District, a former industrial area north of downtown that has been transformed into a live-work-play neighborhood, as an example.

Often compared to New York's SoHo, the Pearl District's transformation began in the early 1990s with an influx of artists looking for cheap studio space. As the neighborhood's hip reputation grew, redevelopment money began pouring in and empty-nesters and young single professionals moved in.

Today, the district is a combination of restored early 20th century structures and new infill development designed to conform to the area's historical ambience, including locally based Hoyt Street Properties' 30-block development on land formerly occupied by Burlington Northern Railway's rail yards, and Gerding/Edlen Development Co.'s five-block Brewery Blocks project in the southwest section of the district.

At build out, the Hoyt Properties project, which involves new infill construction, will total 15,000 residential units and 150,000 square feet of commercial space. This project, which is partially in the River District, includes nine residential structures up to 14 stories tall, eight of which have ground-floor retail space, and three parks that encompass a full city block. So far, about 1,400 residential units and 60,000 square feet of retail space has been delivered, of which about 45,000 square feet is leased.

The Brewery Blocks involves adaptive reuse of two historical structures, the Blitz-Weinhard Brewery and old Portland Armory building, and new infill construction. When completed, this project will include 220,000 square feet of upscale retail shops and restaurants, 600,000 square feet of office space, 124 loft condominiums and 224 luxury apartments. It will also include a 1,100-seat performing arts center and a 75,000-square-foot Portland Art Institute facility, according to John Kellogg, of H.S.M. Pacific Realty, the exclusive leasing brokerage for the retail component.

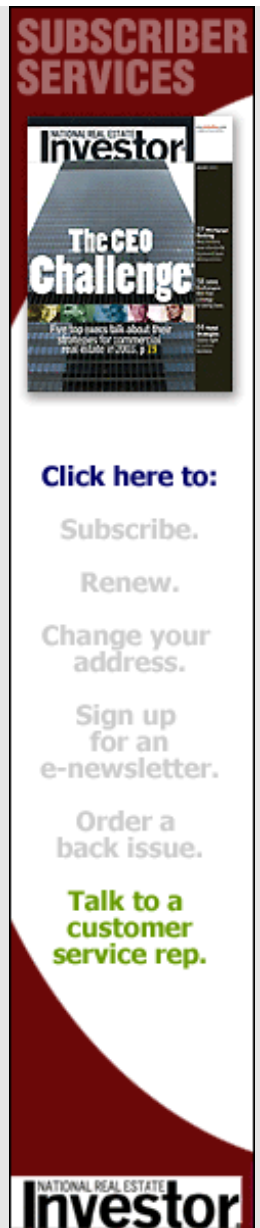
The Brewery Blocks is adjacent to Portland's first Whole Foods Market, which covers an entire block, and the 75,000-square-foot Powell's Books landmark. Additionally, Safeway has announced plans to build a new supermarket in the district.

A renaissance in the city's downtown core began about 15 years ago. Today, downtown Portland has vibrant residential neighborhoods and several retail districts, including a 17-block retail core at the center of which is Maryland-based The Rouse Co.'s 1.1 million-square-foot Pioneer Place mall, anchored by Saks Fifth Avenue, and two other freestanding department stores, Nordstrom and Meier & Frank.

City planners are currently working on revitalizing the city's Waterfront District by encouraging retail development along Southwest Morrison and Yamhill streets, which run between downtown and the Waterfront and are served by MAX, the city's light-rail transportation system. Additionally, a new 5.8-mile extension of MAX, known as Interstate MAX, will open in May, connecting downtown to Hoyt Properties' development and the Portland Metropolitan Exposition Center in the River District.

Since the UGB sets limits on developable land, "the Portland mantra is more and more density in all urban planning," says Hanacek. "We're like a cannonball in a Jacuzzi," comments Frank. He says development has pressed outward, spawning new communities on the outer edges of the UGB, like Happy Valley to the east in Clackamas County and Sherman to the south. "But the mantra here is up, not out," he emphasizes, noting that new projects in suburban communities are taking on an urban look, with developments three stories tall. "We will see more urbanization of the suburbs, more townhouses and multi-level buildings go up."

MAX is also helping to move city life to the suburbs, seeding development along



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its 38-mile stretch. Two new transit-oriented mixed-use developments (TODs) have sprung up on both ends of the line, 18 miles to the east in Hillsboro and 16 miles to the west in Gresham.

Orenco Station, an award-winning 190-acre, multi-level TOD in Hillsboro that opened in 1999 has been lauded as a leading example of the New Urbanism architectural movement and "smart growth" principles. The project is designed around a town center and includes 450 lofts, live-work townhouses and single-family cottages and 30,000 square feet of Class A office space atop 25,000 square feet of street-level retail space. "This was strange in Hillsboro, which up until 20 years ago was a farm community," says Hanacek.

Gresham Station, a TOD at the end of MAX's eastern route, will total 1.8 million square feet of commercial and residential space at build-out, including 200,000 square feet of retail, 150,000 square feet of office space, 800 residential units and a high school for gifted children. Phase I of the retail component opened in 2000 with national retailers, such as QFC, Gap, Old Navy, Cost Plus World Market, Borders, Bed Bath & Beyond, Eddie Bauer, Ann Taylor and others. Phase II, which will include additional retail, as well as the office and residential components, is scheduled for completion this fall.

The UGB, however, has slowed power center and big-box development because "it is difficult to assemble enough land, and there's a general dislike among planners for big-box retailers," says Frank, noting that junior boxes are preferred over big boxes.

"There's selective development because of the growth boundary," agrees Demers. "We're not Phoenix, paving every freeway exit with a power center." But he notes that it has not stopped big boxes like Wal-Mart, Target, Lowe's, Home Depot and Costco from entering or expanding in this market, even if it means crossing the river into Vancouver, Wash., where it is easier to find sites and get entitlements, or developing in outlying areas.

Looking forward, experts agree that barriers will prevent overbuilding and ensure this retail market's viability. Mickelson says the trend of concentrating retail development in larger, mixed-use sites and emphasis on the quality and selection of retailers will continue. "With an already high quality of life, combined with strong prospects for job growth, the region will continue to demand additional quality retail development," he says. "The challenge will be for the development community to survive the rigorous government approval process."

Market Profile/ Portland

DEMOGRAPHIC OVERVIEW

- Population: **1.4 million (Portland-Vancouver)**
- Median Household Income: **\$39,016 (Portland only)**
- Unemployment Rate: **7.8%**
- Median Home Price: **\$194,000**

Source: U.S. Census Bureau

MARKET OVERVIEW

- Average Retail Rent: \$18.78 per sq. ft.
- Average Vacancy: 7%
- Total Inventory: 40 million sq. ft. (projection 2004)
- Under Construction: 1.2 million sq. ft.

Source: Marcus & Millichap, Q1 2004

Safeway's New Downtown Digs

Grocer Safeway has shown its commitment to downtown Portland by designing, with help from GBD Architects, its first store specifically created for a city center. The 47,000-square-foot Safeway, with apartments above and parking below, opened in the reenergized Cultural District last year, replacing a run-down, traditional store across the street.

Safeway wanted to compete with high-end grocery stores locating there without being too stuffy, pricey or exclusive for its traditional mid-market customers, according to King Retail Solutions of Eugene, Ore., which designed and created many of the store's components. The store's openness and use of natural light is key and use of metal reflects the hip downtown location, King says. Metal mesh dominates the design, with few solid materials cutting off the storewide vistas. It features 300 linear feet of windows allowing pedestrians to look in and shoppers to peer out. The store even features a cozy fireplace.

"We wanted an urban store with a vibrant streetscape," a Safeway official said when the store opened last fall.

THE MALLS OF PORTLAND

Supply constraints, a strong economic outlook and geographically segmented submarkets keep most of Portland's regional malls strong. All the city's strongest malls are REIT-owned. Macerich's Washington Square and Pioneer Place are the market leaders, followed by Clackamas and Lloyd Center. Privately owned Mall 205 is what Friedman Billings Ramsey analyst Paul Morgan calls a "fixer-upper" — a well-tenanted mall in a strong market that is under-managed and has a lot of competition. Such malls provide great acquisition targets for opportunistic asset managers such as Macerich or General Growth, he says.

Portland Mall Market Analysis

Mall Name	Owner	2003 Pop	Avg. HH Income
Washington Square	Macerich	410,000	\$79,000
Pioneer Place	Rouse	541,000	\$64,000
Clackamas Town Center	General Growth	394,000	\$58,000
Lloyd Center	Glimcher Realty Trust	531,000	\$62,000
Westfield Shoppingtown Vancouver	Westfield	256,000	\$62,000
Mall 205	Center Oak Properties LLC	531,000	\$56,000
Portland Market Average		444,000	\$63,000

Source: Claritas, MapInfo

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