

IS THE COMMERCIAL REAL ESTATE MARKET BEGINNING TO LAG?

By Howard Friedman, CCIM

It's not hard to hear the warnings of an impending downturn in commercial real estate if you pay attention to economic prognosticators. And if you are old enough to have seen the cycles of real estate, you know that another downturn is inevitable. One question is...when? And the other, will Central Oregon be insulated from it all?

Some caution signs may be looming, even though it appears all is currently rosy. If you look at our Q2 quarterly survey results, the current state of the market certainly seems positive. And maybe that is the problem. What factors could change all this? Here are a few.

One nationwide factor is the slow rise of interest rates, while cap rates are historically low. The result is a narrowing gap between a borrower's interest rate and their rate of return from investments. Commercial rates are now in the 4.75-5.10% range, while cap rates for quality product in our area are hovering around the 5.5% rate or less, not leaving much cushion for unforeseen expenses.

Another indicator is the leveling off of lease rates. We are still in a landlord's market, with low vacancies and scarcity of new construction starts (due to high land and building costs), seeing rents in the commercial markets begin to slow in their increases. Investors on the other hand, are seemingly more cautious in their purchases, with more due diligence requirements requested in their offers.

Are we at the same point in the real estate cycle as 2006 prior to the dramatic downturn from 2007-2012? The classic bell curve for real estate shows four phases of the cycle. Phase 1 is a recovery from the previous recession with high vacancies. Phase 2 is where vacancies decline, rents increase, and new construction takes place. The top of the curve is an equilibrium point of supply and demand, and the market is stable. Buyers and sellers, landlords and tenants all feel confident. Phase 3 is a result of new construction in a market with high values and rents. Finally, Phase 4 sees an oversupply of property, resulting in increasing vacancies and declining rents, ultimately leading to the next recession.

One could argue there is not enough new construction in Central Oregon to cause Phase 3 to exist, but there are currently many new projects on the drawing board, some significantly larger than we have seen in the area to date. The impending rebuild of the Ray's Westside complex, the Robal Road expansion, and 193,000 square feet of new industrial buildings in Redmond are just a few of the very large plans currently on the drawing board in Central Oregon that will change the supply vs. demand equation, and could contribute to an eventual downturn in the cycle.

Many outside factors help to shape real estate cycles, including global influences and political changes within the U.S., and for a time prior to the previous recession it seemed that Central Oregon was immune to those impacts. However, those who lived here from the mid-2000s to the mid-2010s know it will affect us all. 'When' is the looming question?

To read the full article please go to: www.compasscommercial.com/Q2.

Bend OFFICE Market

Compass Commercial surveyed 208 buildings for the second quarter 2018 office report. The buildings in the sample totaled just under 2.6 million square feet. Positive net absorption of 7,319 sq. ft. was recorded during the quarter. The vacancy rate fell as a result from 4.22% in Q1 to 3.85% in Q2 2018. There is now 100,089 sq. ft. available for lease, down from 107,707 sq. ft. in the previous quarter.

One submarket recorded negative net absorption and two were positive in Q2. Downtown gained 2,888 sq. ft. of occupancy, lowering the vacancy rate once again from 2.61% to 2.02% in Q2. Two buildings reported gains and one reported a loss in the Downtown submarket. There is now only 9,927 sq. ft. for lease in that area.

The Highway 97/3rd St. corridor recorded 5,534 sq. ft. of positive absorption in the second quarter. Five buildings reported positive change

while two were negative during the quarter, lowering the vacancy rate from 3.14% to 2.34%. The largest transaction was a 2,596 sq. ft. lease in

 ABSORPTION  VACANCY

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BEND OFFICE Net Absorption					BLDGS. OVER 3,000 SQ. FT.	
Market Area	No. Bldgs.	Total Sq. Ft.	Vac. % 2nd Qtr.	2nd Qtr. Absorption	Total 2018 Absorption	Total 2017
Downtown	49	490,261	2.0%	2,888	10,286	1,847
Hwy 97/3rd St.	56	688,917	2.3%	5,534	965	24,753
West Side	103	1,417,257	5.2%	(1,103)	(13,422)	45,183
TOTAL	208	2,596,435	3.9%	7,319	(2,171)	71,783

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Bend OFFICE Market | CONTINUED

the Deschutes Business Center off of Empire Ave. A total of 16,112 sq. ft. is now for lease in that submarket, down from 21,646 sq. ft. in Q1.

The west side submarket recorded 1,103 sq. ft. of net negative absorption in Q2, but the vacancy rate dropped from 5.33% to 5.22% due to the addition to the survey of a 7,614 sq. ft. building on Nancy Way. Although six buildings reported positive net absorption and only one reported a loss, that building was the former High Desert Bank Building at 1000 SW Disk Dr., vacated due to the bank's merger with Mid-Oregon Federal Credit Union, and the consolidation no longer requiring that building. The 7,808 sq. ft. vacancy was the largest recorded in the west side submarket. Currently there is 74,050 sq. ft. available on the west side, of the 1,417,257 sq. ft. submarket.

Bend RETAIL Market

Compass Commercial surveyed 253 retail buildings totaling 4,471,489 square feet for the second quarter of 2018. The citywide vacancy rate fell slightly from 3.22% at the end of Q1 to 3.18% at the end of Q2 2018. A total of 2,009 sq. ft. of positive net absorption took place in the second quarter of the year.

Three out of the seven retail submarkets in Bend recorded negative net absorption, three were positive and one remained the same.

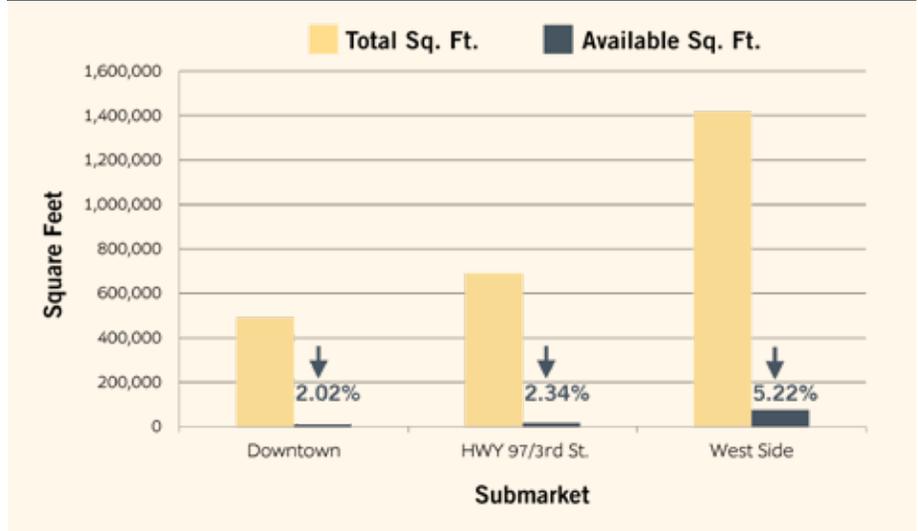
The south 97 submarket recorded 2,856 sq. ft. of positive net absorption in the quarter. Reed Lane Plaza gained 2,970 sq. ft. of leased space and the Bend Factory Stores recorded 1,140 sq. ft. of positive absorption, and there was only one small negative absorption transaction recorded. The south Hwy 97 submarket finished at 5.0% vacancy, down from the previous quarter's 5.3%.

The central 97 submarket also gained ground, recording 4,420 sq. ft. of net positive absorption, with two buildings gaining occupancy and one building losing. The former Erickson's shopping center at 725 NE Greenwood Ave. gained another 5,200 sq. ft. of occupancy in the quarter when Autry's 4 Seasons Florist moved in, leaving just 4,100 sq. ft. vacant in that building. The vacancy rate in the area fell from 3.3% to 2.6% as a result.

The north 97 submarket was the third gainer in the quarter, recording a 2.9% vacancy rate, down from the previous quarter's 3.2%, with 35,347 sq. ft. available. Just one lease of 2,745 sq. ft. took place in Cascade Village Shopping Center.

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BEND OFFICE Vacancy



ABSORPTION



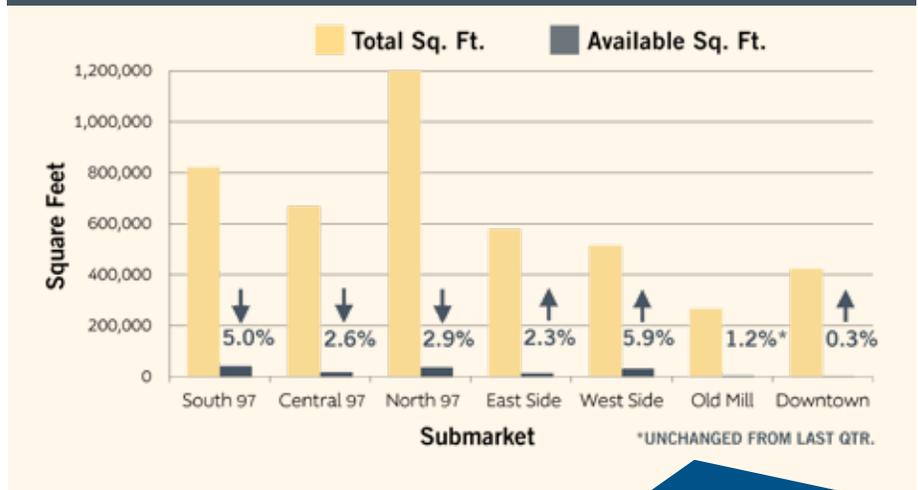
VACANCY

BEND RETAIL Net Absorption

BLDGS. OVER 3,000 SQ. FT.

Market Area	No. Bldgs.	Total Sq. Ft.	Vac. % 2nd Qtr.	2nd Qtr. Absorption	Total 2018 Absorption	Total 2017
South 97	20	820,696	5.0%	2,856	(564)	6,396
Central 97	41	669,172	2.6%	4,420	135	4,700
North 97	28	1,200,712	2.9%	2,745	2,745	3,744
East Side	28	578,336	2.3%	(5,532)	(7,474)	4,100
West Side	53	514,732	5.9%	(1,026)	(794)	(22,312)
Old Mill District	19	265,502	1.2%	0	2,131	5,311
Downtown	64	422,339	0.3%	(1,454)	(1,454)	0
TOTAL	253	4,471,489	3.2%	2,009	(5,275)	1,939

BEND RETAIL Vacancy



INDUSTRIAL Market

BEND

Compass Commercial surveyed 308 buildings for the first quarter industrial report, totaling over 4,290,000 square feet. The industrial market gained another 37,187 sq. ft. of positive net absorption in Q2, and the vacancy rate dropped for the fifth quarter in a row, from Q1's 1.82% to an astounding 1.03%, once again the lowest industrial vacancy rate we have recorded since 1994! There is now just 44,288 sq. ft. of industrial space available for lease in Bend, compared to 77,959 sq. ft. in Q1. At this rate, there is just over three months of inventory available city-wide in the industrial lease market. Two of the four submarkets again recorded positive net absorption, one was negative and one remained the same.

The southeast and northeast submarkets recorded 9,444 and 29,069 sq. ft. of positive absorption in Q2 respectively. The vacancy rate is now 1.6% in the southeast and just 0.8% in the northeast submarket. Four buildings recorded positive results and one was negative in the southeast submarket, while the northeast submarket recorded two buildings with positive results in the quarter. The Murray Road Industrial Park in the former Fuqua Homes facility is now fully leased, and welcomed FamilyWise Digital Inc, Fastenal, Cascade Steelworks and Zamp Solar in the quarter, for a total new lease-up in the building of nearly 25,000 sq. ft.

The central submarket recorded just one vacancy of 1,326 sq. ft. in the former Bend Iron Works complex on Scott St., raising the vacancy rate slightly to 0.4%, while the west side submarket remained fully leased, with the vacancy rate at 0.0%.

REDMOND

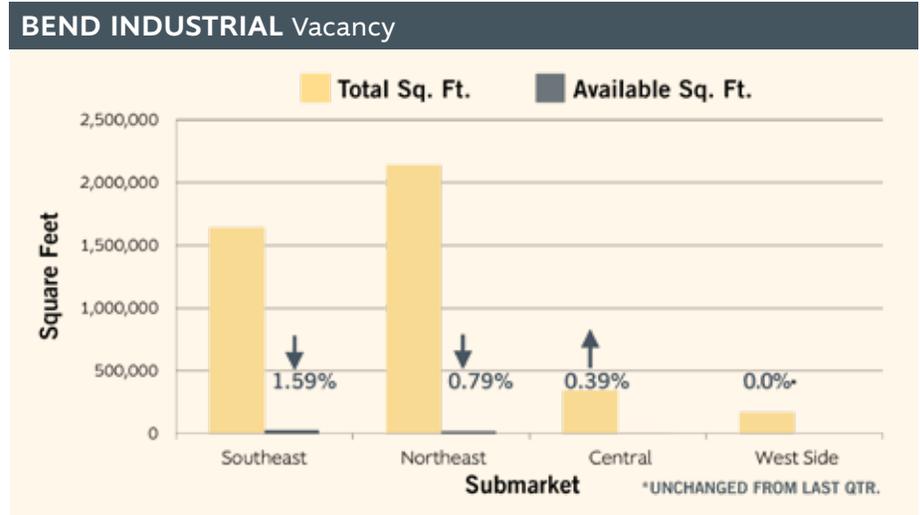
The Redmond Industrial market recorded net negative absorption in Q2, resulting in the vacancy rate rising from 2.7% in the first quarter of 2018 to 3.5% in Q2. 11,728 square feet of net negative absorption was recorded and there is now 53,627 sq. ft. available in the 79 building, 1,544,227 sq. ft. industrial market.

One building recorded positive absorption and two were negative. The Dimeo Industrial Plaza lost 9,000 sq. ft. of occupancy during the quarter, and there was also a vacancy of 5,800 sq. ft. at 1104-B SE Lake Rd.



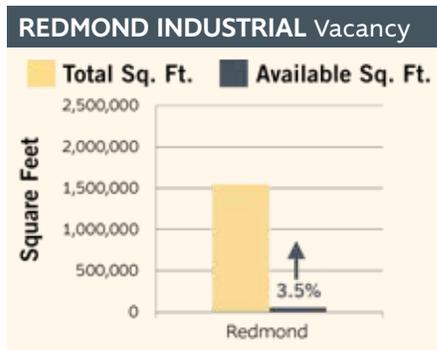
ABSORPTION VACANCY

BEND INDUSTRIAL Net Absorption						BLDGS. OVER 3,000 SQ. FT.
Market Area	No. Bldgs.	Total Sq. Ft.	Vac. % 2nd Qtr.	2nd Qtr. Absorption	Total 2018 Absorption	Total 2017
Southeast	138	1,640,510	1.59%	9,444	15,835	(160)
Northeast	126	2,139,766	0.79%	29,069	104,896	135,537
Central	35	342,037	0.39%	(1,326)	(1,326)	0
West Side	9	168,240	0.00%	0	0	0
TOTAL	308	4,290,553	1.0%	37,187	119,405	135,377



ABSORPTION VACANCY

REDMOND INDUSTRIAL Net Absorption						BLDGS. OVER 3,000 SQ. FT.
Market Area	No. Bldgs.	Total Sq. Ft.	Vac. % 2nd Qtr.	2nd Qtr. Absorption	Total 2018 Absorption	Total 2017
Redmond	79	1,544,227	3.5%	(11,728)	932	24,588



Bend **RETAIL** Market | CONTINUED FROM PAGE 2

The eastside submarket lost ground in Q2, recording 5,532 sq. ft. of negative net absorption, moving the vacancy rate from 1.3% to 2.3%. Two buildings lost vacancy in the eastside submarket in the quarter.

The west side submarket vacancy rate also rose in the quarter. A small space of 1,026 sq. ft. became available at the 1444 College Way complex, resulting in

a vacancy rate rise from 5.7% to 5.9%. There is now 30,528 sq. ft. available for lease in the 53 building submarket.

The Old Mill District still has just one space for lease, leaving the vacancy rate unchanged at 1.2% with 3,139 sq. ft. available in that submarket.

The Downtown submarket lost one space to vacancy in the former Thump Coffee

Roaster location at 744 NW Bond St. The 1,454 sq. ft. vacancy brought the rate up slightly from 0.0% in Q1 to 0.3% in Q2.

There is currently 142,004 sq. ft. available for lease city-wide, down from 143,921 sq. ft. in Q1. The city-wide vacancy rate is now just 3.18%, down from 3.22% in Q1.

Notable **TRANSACTIONS**

Compass Commercial Real Estate Services negotiated the following notable transactions in the second quarter of 2018. 85 transactions (16 sales and 69 leases) were closed totaling \$33.2 million in consideration. For more details about our monthly transactions, please visit Compasscommercial.com/Transactions.

SALES

TYPE	PROPERTY	BUILDING/LOT SIZE	PRICE	COMPASS COMMERCIAL REPRESENTED
Land	63613 O.B. Riley Rd., Bend	100 acres	Price Undisclosed	Gardner Williams / Seller
Land	181 NE Franklin Ave., Bend	1.76 acres	Price Undisclosed	Gardner Williams, Graham Dent / Seller
Industrial	2751 SW Airport Way, Redmond	14,000 SF / 1.19 acres	Price Undisclosed	Steve Toomey / Seller
Office	40 NW Greenwood Ave., Bend	7,037 SF / 0.42 acres	\$1,580,000	Howard Friedman, Jay Lyons & Grant Schultz / Seller & Buyer
Office	420 W Martin Luther King Hwy, Maysville, KY	3,600 SF / 9.43 acres	\$1,379,000	Jay Lyons & Grant Schultz / Buyer

LEASES

TYPE	PROPERTY	SF LEASED	LESSEE	COMPASS COMMERCIAL REPRESENTED
Office	525 SW Umatilla Ave., Redmond	7,790 SF	Shasta Admin. Services	Jay Lyons & Grant Schultz / Tenant
Retail	SEC of Combs Flat & 3rd St., Prineville	1,500 SF	Domino's	Joel Thomas / Landlord & Tenant Russell Huntamer / Landlord
Office	775 SW Bonnett Way, Bend	3,083 SF	Longlet Dental Works	John Keba / Landlord
Office	595 SW Bluff Dr., Bend	2,686 SF	Monarch Medial Weight Loss Group	Krista Polvi / Landlord Russell Huntamer / Tenant
Retail	727 NE Greenwood Ave., Bend	5,200 SF	Organic Cosmetics, LLC	Robert Raimondi / Tenant