Are Those Cranes or an Inventory Glut on the Horizon?
Portland's condo market faces the future
By Ellen Lewis

Boston. Miami. Chicago. Las Vegas. San Diego. The mere mention of these markets is enough to strike fear in the heart of any real estate agent or developer specializing in condos. Since 2006, the national condo market has softened, and in many overly optimistic cities where demand has exceeded supply, the condo bubble has downright popped. Of course, when it comes to issues related to livability, Portland is used to being a national exception. But as market after market topples ever westward, is the Portland metro condo market doomed?

First, let's look at some quick numbers. In 2004, the average price of a Portland condo increased 16 percent over 2003. In 2005, the price increased more than 27 percent over that. Then in 2006, the price increased just 400 dollars — a less than 2 percent gain.

If that number alone isn't off-putting enough, consider the fact that new condos currently under construction number roughly 3,500, which is *more than four times* the normal market supply. No wonder some in the industry are prompted to reminisce about the dot-com bust of 2001.

Certainly Portland has not been as hard-hit as some other cities, but some say it's just a question of time. Brian Richards, a broker, developer, and builder in Columbia County, says, "Oregon is the end of the trend line because we're the last place money has flowed. Places like San Diego and other places ahead of the curve have already gotten there. We're at the end of the national cycle. We haven't reached a point yet where we're saturated with inventory, but by this fall the game will be over."

Everyone can agree the market has softened over last year, says Jerry Johnson, a land-use economist with Johnson-Gardner. "If you bought last year, you're not in a good position."

Some observers believe the market has reached a precarious point. Steve Wong, senior vice president at Scanlan Kemper Bard, and a real estate banker who has financed construction projects such as The Westerly, reports, "The investment funding is waiting to decide. Last year, I'd hear of maybe half a dozen significant new projects gearing up. Now there's one. Or none. Now, developers are spending more on advertising and holding potential buyers' hands. Those projects ready for occupancy are selling better."

Are those cranes or an inventory glut on the horizon?

While inventory is approaching an all-time high, the construction of new units, fueled by the market's high prices of last summer, shows no signs of slowing. The completed units have given depth and maturity to the market that didn't exist a few years ago, but the demand has yet to keep pace. "Trammel Crow, Opus and Homer Williams are all sitting on the sidelines waiting to see what will happen with the current situation," notes Brad

Meyer, a multi-family investment broker with CB Richard Ellis. “In 18 months, the activity will pick way up, and my prediction is that they’ll sell well.”

Whether a developer has white knuckles or is inclined to shrug and smile depends on that developer’s projects, says Bob Ball, a historic developer and citizen activist whose projects have included Marshall-Wells Lofts and The Avenue Lofts in Northwest Portland’s Pearl District, as well as the renovation and conversion of the historic apartment building The Embassy into condominiums. “There’s a supply being absorbed in a steady fashion. The best developers will be fine,” Ball says.

How did we get here?

Johnson names a few contributing factors. “The trend of 05-06 was an anomalistic trend of pre-sold units. We’re out of the period of pre-sells. We’ve got more product on the market. Prices are rising along with construction costs. The percent of ownership is going up to 70 percent, and I’d say half of that is attributable to subprime debt.”

Subprime loans have been the dirty words of the industry, causing belief among some homebuyers that they can afford a property that might be out of reach. In last year’s market Richards says, “Subprime loans allowed people to buy more property than they could afford. There are a lot of unethical people out there, and the mortgage industry looks the other way. When people can’t qualify, it doesn’t matter what the price is.”

“Portland is not Miami,” says Ball. “We thought we saw large gains, but they are really small compared to the national market. Our market reflects our values system in that it isn’t so reckless.”

What has made the condo market so vulnerable is that outside investors were allowed to buy large percentages of condo properties with the intention of turning them over quickly, or “flipping” them. With the goal of making as much money as possible, these investors created a sense of artificial demand, “surfing the wave,” Richards says. “That pushed the prices up.”

Revisiting his theme of quality development, Ball says, “The best developers didn’t allow too many outside investors anyway. In San Diego, they were buying up blocks of 30 units at a time.”

Now however, observers say, with fewer outside investors snapping up properties, the market has normalized. “Outside investors buying the individual units have pretty much gone away. For a while they were putting money down and then looking to get out. In some cases, they’d walk away, leaving their money on the table,” says Wong.

What happens next?

“If we hold pricing, that’s a victory,” says Johnson. “We need to work the inventory off. The market used to be so hot, you could put condos anywhere. We’re about to reach the point where subprime mortgages aren’t going to be viable.”

Asked about Portland Development Commission’s possible future actions, Johnson says, “They’ll protect their investments, and they may restructure debt on some projects. But they shouldn’t bail people out, because no one gets bailed out in a good market.”

Richards believes there is a bigger issue on the horizon — the possibility that some major local lending companies may go bankrupt. “The Federal Accounting Standards Board allows lending companies to declare interest they haven’t received yet as income. That means they’re turning losses into income, which inflates the value of the company. If enough people default, they might not get that income at all. The whole time, the companies are experiencing declining earnings across the board while increasing the deferment of interest, and properties are going down in value.”

Calls to local lender Washington Mutual for a comment on this issue were not returned.

Renters beware

The National Association of Realtors reports that Portland’s real estate market is slowly joining the national trend, with large national investment funds beginning to avoid financing condo projects, instead turning their focus to apartments to increase the possibility for income over appreciation.

The Ladd Tower, an $85 million high-rise on the South Park blocks will be placed on the market as luxury apartments rather than condos, as the principals had originally planned. Johnson explains, “Because the rental market is weak, rents are inexpensive compared to ownership. It will normalize, and rental rates will go up.”

Portland’s unique future

Fortunately, there are big differences between the burst-bubble markets and Portland’s. The big one, livability, is still a big lure to newcomers from California and the rest of the country.

Johnson comments on one other way Portland is unique: “Portland is slower to downturn in part because it’s difficult to get things done here. Over-building is hard.”

Ball says, “Our urban growth boundary keeps our focus on density growth and our quality of life is so good, people keep wanting to move here. There’s a supply being absorbed in a steady fashion.”

Ball has reason to be optimistic. As one of the most successful developers in Portland, he points out, “Location plus great living spaces equals value. People feel comfortable where they feel their investment will be solid. The buildings that will always do well have a strong team of architects and builders. When you're in a difficult market, you need to know what you're doing."

Even with all its strengths, Portland could be doing more to increase its marketplace health and future livability, claims Ball. "We need to invest in a future transportation plan with our regional partners, along with the Port of Portland and Metro. What needs to happen is for government to understand where we need to go, develop a framework to keep citizens safe, provide after-school programs, good paying jobs. We're poised if we do the right things."

Richards predicts, "Just like the dot-com market, this market will take off again and hit a normal growth rate."

Nevertheless, he does say there is still a good reason to buy in today's market. "If you want to buy a house and you can afford it, with 5 percent and a 30-year fix — and you'll stay in it for 10 years, buy. Your house is not an investment; that's a fallacy. You need something to live in. Rates are good today, so if you can afford it, go ahead."

What's hot, what's not

Current market conditions mean that even if prices haven't dropped, buyers now have choices that didn't exist just a few short months ago. And the experts have weighed in on where buyers and the financers are putting their money. Meyer says, "The high-end units are doing well. The lower-end ones are done. Those condos in the hot neighborhoods downtown — Mississippi, Hawthorne and Alberta — priced in the $400,000-$600,000 range will continue to sell."

Demand is steady for his high-end properties in the Pearl, says Ball. "Mature developments have bars, galleries, yoga, shopping, and transportation just outside your door."

However, he adds, "The South Waterfront will take a number of years to realize the vision."

Other areas of value include, "Sellwood, Alberta and Mississippi, and the big sleeper is St. John's. That area could be unbelievable," says Ball.

Johnson, like Ball, believes that select properties in the secondary market, close-in on the Eastside will do well. But Johnson says, "Some of the projects were not well conceived, and those are the quarter-, half- and full-block sites in areas that are not close to the commercial centers. The absorption rates are very slow at these sites, and 3-6 months from now, some will sell one a month and maybe one per quarter."

And what about that flock of cranes, South Waterfront? "The area," Johnson projects, "will take longer than PDC thinks. I don't know how they're going to do transportation.

But their feet are held to the fire by PDC, so I am worried that they'll try to beat the market by delivering faster than the market can absorb."

Portlanders caught in the middle

With so many Portland residents having already downsized to condos, new residents may be the best hope for creating that demand. For-sale signs are staying up on the million-dollar homes in the West Hills, historically a seller's market, giving buyers more of a choice than they've had in the recent past. Unfortunately for those buyers, prices have remained mostly steady, while interest rates have started to climb.

"I don't think there are any deals," says Richards. "Right now I'm talking people out of buying. A client wanted an investment house to sell in three years, and I said, 'What happens if it's worth less in three years?' We're going to have to go to buy and hold as a strategy."

Subsidies for affordable housing, even in the hottest neighborhoods, have allowed low-income people to own condos. On the other end of the scale, luxury condos are playing to newcomers who arrive with built-in incomes from other states. The people in the middle are wondering where this leaves them. A 2006 PDC study shows "developers need to build condominiums with … options that are affordable to younger families but also remain financially viable to developers."

That may not be possible, CB Richard Ellis' Meyer says. "In order to make a project tensile, or financially practical, it must be priced at $300-$350 a square foot. I don't think people who live and work in Portland can afford that."

PDC's Larry Brown admits that without tax credits and federal funds, mid-range buyers have a more difficult time. But he counters that a great example of workforce housing is The Civic on Burnside. With prices beginning at $175,000, The Civic has presented an option, though units at that level were quickly snapped up.

And then are those lured from out of state, but who haven't cashed out a California home. Many of these young newcomers still hope to be able to afford Portland's quality of life, says Richards. "I can understand that, *if* you can get a job here."