PREDICTIONS

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OVERVIEW

Based on our analysis of historical figures and recent market trends, we believe the office market will see an increase in vacancy rates over the next one to three years. This will be true for both the downtown and suburban office markets. However, we believe downtown Portland will fare better.

The significant increase in office space availability we see developing is primarily due to the residual effects of the pandemic. Most office workers were encouraged or required to work remotely during the pandemic. Doing so was appealing to many, who could save on commute time and gas expenses, and slip away from work to walk the dog or prep for dinner.

Having spoken to a number of CEOs, most have said the productivity of remote workers did not decrease and, in some instances, increased. Given this and the shortage of available workers in the market, employers are reluctant to force employees back to the office full-time. As a result, a hybrid model in which workers spend two to three days a week in the office and the rest of the time working remotely remains popular. What was once thought of as a temporary accommodation due to the pandemic has developed into a longer-term phenomenon.

Consequently, companies are rethinking the size of the office space they need when their leases approach expiration. We have seen a variety of strategies taken by business leaders—from the radical decision to eliminate office space entirely to a more typical reduction in the size of their office space footprint. Others have gone a different route, trying to increase the appeal of their office to encourage attendance. However, reduced square footage seems to be the trend, and it's contributing significantly to the increase in office vacancies in downtown Portland and its suburbs.

- In downtown Portland the upper floors of older office buildings with smaller footprints were converted to residential condominiums or apartments. With office market demand weak and the demand for housing high, this can make sense for many buildings. This is illustrated by the conversion of 178 Middle Street; the partial conversion of 482 Congress Street, 50 Monument Square, and 121 Middle Street; and the conversion of the top floors at 136 Commercial Street and 111 Commercial Street, just to name a few. However, it's more difficult for larger Class A office buildings to be converted to residential due to the size and depth of their floor plates, making the economics less feasible.

  We don't see this phenomenon happening in the suburbs to any great extent, as suburban office buildings tend to have larger floor plates, making conversion impractical.

- Due to the anticipated office space vacancies, we do not expect developers to break ground on new office buildings in the near future. This will certainly be the case for any speculative office construction.
- The combined Class A and B downtown office vacancy rate is 6.41% and is expected to increase over the next two years.
- In the suburbs, the combined Class A and B office vacancy rate is 7.59%. We have no doubt the vacancy rate in the suburbs will increase, with leases expiring and the occupants vacating or significantly reducing their presence.
- We have shifted to an office tenant's market, which allows tenants to negotiate rates and obtain flexible terms and build-out concessions that were not available pre-pandemic. Landlords will continue to be incentivized to provide larger tenant improvement allowances and more competitive lease rates in exchange for financially strong tenants and long-term leases.
- While multiple offers for office space were never the norm, such bidding wars will be extremely rare in the next two to three years.
- The sublease vacancy rate in the market will be less of a factor in the overall rate because the lease term of the sublease spaces will either have expired or will soon expire, putting spaces once available for sublease on the market for direct lease.

IN SUMMARY

Tenants in downtown Portland, as well as the suburbs, should give serious consideration to renegotiating their existing leases now to take advantage of the weak market and an increasing supply. If tenants want to stay in their current space, it makes sense to approach the landlord and offer an extended term in exchange for reduced rent and some tenant improvement dollars. This will likely appeal to most landlords. Having an experienced commercial real estate broker who knows the market handle these negotiations can create savings for the tenant, which should cover the cost of the broker's fee many times over.

PHOTOS: *Corey Templeton Photography*