Council Packet Memo DRAFT

Date	May 9, 2022
To	Chris Green, HHPR
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Economic Analysis Preliminary Findings

Summary of Methods

LCG is preparing an Economic Analysis memo that analyzes economic data and industry trends in the Portland metro region and the southwest I-5 corridor submarket. This information is being used to develop recommendations for the City to implement to enhance development prospects and create jobs in the area zoned Manufacturing Park in Basalt Creek. Methods include an assessment of the real estate market dynamics (construction and absorption trends, vacancy rates, rental rates, land values, building costs, etc.), a high-level evaluation of buildable industrial land in the SW Metro submarket, and case study research.

Additionally, LCG is conducting interviews with local and regional stakeholders as a core element of this methodology. These stakeholders include local agency partners, such as neighboring city staff, county staff, and economic development agency staff, and key players in the industrial development community, such as landowners, prominent developers in the submarket, and brokers. These interviews are intended to provide candid information regarding barriers to future development and opportunities for industrial and employment growth.

LCG shared baseline materials and asked the following questions of each stakeholder:

- What is your experience with the Basalt Creek area and the Manufacturing Park zoning?
- What are some of the regional industry trends that impact development prospects in Basalt Creek?
- Are there specific opportunities or industry trends that could be capitalized on in Basalt Creek? How will these change in the next 5, 10, 20 years?
- What do you perceive as some of the barriers to development? What can the City do to address these?
- What are some important zoning considerations for attracting development and growing jobs in Basalt Creek?
- Are there other ways the City could further support industry growth in Basalt Creek?

The answers to these questions inform the information provided below.

Industrial Market Overview

The Portland metro area is an attractive market for new and expanding industrial businesses, including manufacturing, warehousing, and logistics. The Portland Metro area, like much of the United States, has experienced historic levels of demand for industrial warehouse, distribution, and logistics space driven by ecommerce demand. Additionally, most industrial users have remained open throughout the pandemic as there is no virtual substitute for physical product creation and fulfillment.

Recent leasing activity, rent and price growth, and historically low vacancy rates indicate near-term demand for new development. Highlights are listed below.

- New leasing over the past year totaled 9.4m square feet, about 50% more than the 6.7m square feet of new leasing activity recorded in 2020.
- The average industrial vacancy in the metro region now stands at 3.7%, significantly lower than the historical average of 6.6% and lower than the 10-year annual average of 4.7%.
- Pricing has more than doubled over the past decade and continues to rise. Portland's industrial assets have increased from a historical high of around $65 per square foot in 2010 to $169 per square foot today.
- Cap rates have compressed below 6.0%, signaling that developers are willing to take more risks to deliver industrial products to market.
- Annual rent growth over the past three years has exceeded 8.0%, significantly higher than the 10-year average of 5.2%.

However, competition and strong demand are exacerbated by the already-constrained land supply in the market, which is, in turn, increasing land pricing, building pricing, and lease rates. Despite strong demand fundamentals, only 1.4m square feet of industrial space was developed in the last year, compared to an annual 10-year average of 2.5m square feet—a sign of the lack of available land to develop. This industrial land constraint has caused a push toward parcels that require more time and money due to issues such as zoning constraints, utility service issues, and topography challenges. It has also seen secondary markets like Salem, Woodburn, and Newberg, which have historically experienced minimal land sale activity, especially for speculative industrial land projects, experience a boost in activity.

SW Metro Submarket

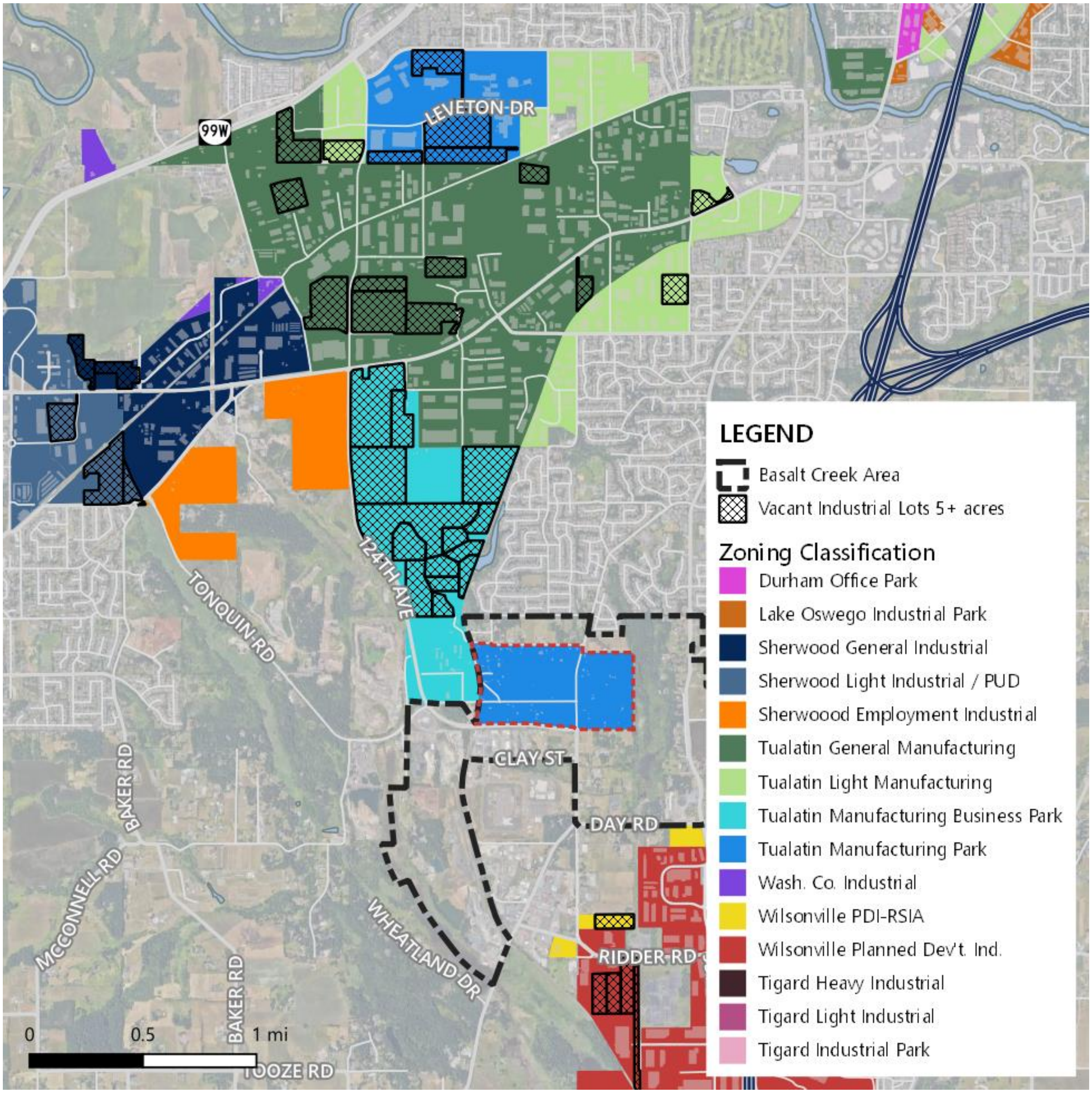
Tualatin is part of the Southwest Metro submarket—sometimes called the South I-5 Corridor by brokers and others in the development community—is considered one of the most diverse industrial submarkets in the state of Oregon. It has historically accounted for approximately one-quarter of the metro's industrial construction and absorption and is a particularly attractive submarket for speculative industrial development. Historically a light industrial manufacturing submarket, Tualatin has now become one of the major industrial nodes within the metro with a wide range of industrial developments and tenants.

Buildable Land

Tualatin boasts regionally significant industrial land in a highly constrained market. Stakeholders consistently highlight the increasing difficulties in finding sites in the Portland area, especially large, contiguous, developable sites. As high-quality industrial sites become increasingly scarce in the Portland region, industrially-zoned land costs and rental rates for existing industrial space have surged.

The following map demonstrates the importance of Tualatin's industrial land in the South I-5 Corridor. Of the almost 1,400 industrial-zoned parcels shown on this map, just 45 are vacant and larger than five acres (3%). Of those 45, 29 are in the City of Tualatin. This translates to 640 vacant acres (472 in Tualatin) of more than 3,900 (14%).

Buildable Industrial Lands, South I-5 Corridor



Source: LCG

The City of Tualatin may continue to capture a significant share of industrial-focused employment growth over the next 20 years. Potential development types include multitenant and build-to-suit industrial buildings with a focus on tech, manufacturing, and warehousing. Many of the proposed uses in the Tonquin Employment Area (profiled below) would be likely development types in the Basalt Creek area. These developments tend to house relatively job-dense tenants from a broad spectrum of the market.

Case Study: Tonquin Employment Area

Given its proximity to Basalt Creek, the timing of development, and site conditions, Sherwood's Tonquin Employment Area (TEA) is a good comparable for Tualatin's Basalt Creek Manufacturing Park Zone. The TEA was brought into the Urban Growth Boundary by Metro in 2004 and the City of Sherwood completed a concept plan for the area in 2010.

The City of Sherwood initially targeted offices and industries supporting high-tech manufacturing and traded sector jobs in the TEA. The area remained largely unincorporated and undeveloped for many years (like Basalt Creek), and properties within the Tonquin Employment Area will be annexed into the City of Sherwood upon request by the property owners. Upon annexation, the properties will be zoned Employment Industrial (EI).

Stakeholders interviewed for this project highlighted the challenges of developing in the TEA following the concept plan and UGB activity, citing a narrowly defined set of allowed uses in the zoning code, site constraints, and relatively restrictive development standards as reasons for the lack of initial development in the area.

Stakeholders also cited amendments to the EI zone that involved broadening the number of allowed uses as instrumental in facilitating the recent wave of new investment activity in the TEA. The City of Sherwood broadened the uses while also adding additional restrictions (including size limitations) that balanced their goals with the opportunities in the market.

Several industrial buildings totaling 535,000 square feet are now in various phases of planning and development at the T-S Corporate Park—the first project since the creation of the concept plan in 2010. Other projects are in the early stages of planning in the TEA, per the City, including plans for multi-tenant industrial buildings totaling 900,000 square feet on 60 acres and project interest on 30 acres that was recently annexed and an adjacent 20 acres. Between these prospects and additional interest in new development in the TEA, there is reason to believe that most of the 200 acres of usable land in the TEA will be accounted for sooner than was originally anticipated in the 2018 EOA.

Findings from interviews

LCG has so far conducted five interviews with brokers and developers with various levels of interest in the Basalt Creek area. A summary of the key takeaways from those conversations is listed below.

- Basalt Creek should reflect the economic diversity of the South I-5 Corridor market. The industrial market is dynamic and moves quickly, so flexibility in the zoning code is critical to mitigate risk and attract investment over the long term. For example, most of the new tenants in the T-S Corporate Park are manufacturing-based companies but the zoning code also allowed warehousing and distribution space that allowed developers to build more speculative developers that could cater to the broadest spectrum of the market as possible.
- Land supply is critically constrained. Land value has increased five times over since 2018 as a result and it is becoming increasingly difficult to develop in the Portland metro. Many industrial users now moving out of the Portland metro to Ridgefield, Salem, etc.
- The Manufacturing Park Zone is narrowly defined and needs to be more inclusive. The existing code is misaligned with the market and the current demand drivers for industrial development.
- Developers assume the risk of development and need to be able to build property that appeals to the widest variety of tenants. Use restrictions exclude vast chunks of the market and can add years to the timing of development by heightening the risk of development and discouraging investment.
- Developers could start the development process now if there was a concrete plan for infrastructure provisions and annexation.
- There is strong demand for multi-tenant industrial buildings that tend to be smaller (around 120,000 square feet and below) and accommodate Suppliers, wholesalers, services, contractors, etc.

- Model codes include Tualatin's MG zone and Portland's IG1 and IG2 codes. Sherwood's EI and Beaverton's BP zones are also notable. In Portland's IG zones there is no design review, the code is easy to understand and implement, and the uses are easily described that help a developer understand what can and cannot be done.
- Codes to avoid include Wilsonville's PDI zone, which is seen as an extreme example of use restrictions and design overlays. One stakeholder highlighted the example of DWFritz, which approached Wilsonville around 2019 for a potential 80,000 square foot development but instead chose the Tonquin area because of the restrictions. DWFritz now employs 120 people.