

Developers warn of multifamily slowdown

By: [Chuck Slothower](#) in [Real Estate and Development](#) April 26, 2019 1:53 pm



Modera Nicolai is proposed by Mill Creek Residential Trust, which is one of the few developers planning large projects that are subject to inclusionary housing regulations. (SERA Architects)

The next wave of multifamily development in Portland may be in trouble. With inclusionary housing rules narrowing margins and raising questions from investors, some developers are waiting on the sidelines. Others are testing the waters, talking with major equity investors about what returns they'll accept, and with their architects and contractors about how to control costs.

Developers who are watching the post-inclusionary housing pipeline said multifamily deliveries will slow dramatically in 2020 and 2021. The slowdown could worsen Portland's supply issues, and cause another housing crisis, they warn.

There are a number of reasons why multifamily projects aren't penciling out.

Construction costs are still rising faster than inflation, although they have leveled off from dramatic jumps a couple of years ago. Rents are stagnant, limiting the income developers can draw from new buildings. And new regulations, including inclusionary housing and rent control, are limiting profit and causing investors to move more cautiously, developers said.

“I’ve actually run numbers on two dozen deals, and I can’t make them work,” said Brad Schnell, managing director of development at **Greystar**.

Others developers are finding the same thing.

“We’re all in the same boat,” Schnell said. “We’re all just scratching our heads trying to make sense of this market.”

National equity investors are not interested in accepting the lower returns Portland’s market is now offering, developers said. Equity investors are looking to other fast-growing cities that have fewer question marks.

“To find equity, you’ve got to have somewhere between 5.75 percent or 6 percent return on cost or yield, and we’re sub-5 (percent) on everything we’re looking at,” Schnell said. “It doesn’t come close to penciling. We wouldn’t even want to bring it to an investment committee.”

Portland’s regulatory approach is not helping, developers said. Inclusionary housing reduces revenue, and new rent control rules, while not overly punitive, raise questions of whether the City Council and state Legislature will further tighten the screws.

“We try to play ball, but I think they need to know that the level of complexity that they’ve added in the last two years to deals is not conducive to increasing supply,” said Sam Rodriguez, senior managing director of **Mill Creek Residential Trust**, a Dallas-based developer that has built prolifically in Portland during the economic expansion. The development pipeline is collecting an increasingly curious backlog of major projects that have received design approval from the city of Portland, but haven’t moved forward with building permits.

“Projects just don’t pencil,” said Noel Johnson, a principal with multifamily developer **Cairn Pacific**.

If projects don’t move forward, housing supply will dry up, developers warned. “It is going to be a problem,” Schnell said. “It’s probably 24 months away.”

A number of mixed-use projects with multifamily components appear to have slowed, if not stalled. Eleven West, a 24-story tower from **Gerding Edlen Development** and **Downtown Development Group**, has not moved forward after receiving Design Commission approval in December 2017. The multifamily portion of

the **Press Blocks** in Goose Hollow is waiting, but the developers are moving ahead with the office buildings, for which building permits have been issued, city records show.



Construction has yet to begin on a 250-foot residential tower at the Press Blocks development in Goose Hollow, which was approved by the Portland Design Commission two years ago. Crews began work on a half-block office portion last year. (Mithun/GBD Architects)

Mill Creek is one of the few developers that has proposed new, sizable multifamily projects under inclusionary housing rules. The merchant developer, backed by national equity investors, has three major multifamily projects in development:

- At 4804 S.E. Woodstock Blvd., Mill Creek is proposing a five-story building with 185 to 195 multifamily units at the site of the Joinery building, which would be demolished. There would be 0.75 parking spaces per apartment. Neighbors have vociferously objected to the project, but the site is not subject to design review.
- At 1120 S.E. Morrison St., Mill Creek wants to build a seven-story building with approximately 234 units and a 0.75 parking ratio.
- At 2135 N.W. Nicolai St., between Slabtown and the Northwest Industrial District, Mill Creek is planning Modera Nicolai, a six-story building with approximately 200 units and a 0.55 parking ratio. A design advice hearing has taken place.

Taken together, the projects would add more than 600 units to Portland's multifamily market if all were built.

"Our theory is if you do full blocks, you get some economies of scale," Rodriguez said. "It's really hard to make it work, and the only thing we think that might help us is just the size of the deals. That's the only somewhat advantage that we have."

Rodriguez pointed to forecasts showing rent growth of 2 percent a year, or slightly more, after the current round of pre-inclusionary housing projects is absorbed into the market in 2020-21.

"We're hoping that the new increases in rent that we'll see once a lot of this stuff gets absorbed, with construction costs, economies of scale and so forth, are going to put us on a good gliding path to a successful deal," he said. "That said, it's not panning out so far. The construction cost numbers are still pretty impactful in the overall deal, and then the city just doesn't seem to stop with the additional regulations."

Some projects have gone back to the drawing board, as developer **Alamo Manhattan** has done with a portfolio of South Waterfront properties owned by **Prometheus Real Estate Group** of San Mateo, California. The project received city design approval, but instead of breaking ground, Alamo Manhattan is going back through design review with a redesigned project that would be subject to inclusionary housing rules.

"We are trying to make it work," said Wade Johns, vice president at Alamo Manhattan, a Dallas-based developer.

It's unclear if the project will move forward, Johns said.

"We don't know yet," he said. "We are in a due diligence period. We had a (design advice) meeting with Portland Design Commission, which went well. We have been meeting with the Housing Bureau, which we have found to be very collaborative and eager. We are trying hard to understand it to try to make it work."

Johns predicted developers would eventually adapt to Portland's market conditions. "It's going to take a while for people to figure this out, but I think that they will," he said. "Portland is such a dynamic, wonderful city. People want to be there so badly. I think they're going to figure it out."