



 City of Spokane
University District
Integrated Planning Study

Market Assessment Market Opportunities & Challenges

December 2014

HEARTLAND

Page Left Blank Intentionally

Table of Contents

Introduction	1
Study Area Land Use Profile	2
Study Area Context	2
Land Use Patterns	2
Historical Delivery	4
Development Capacity	4
Real Estate Fundamentals	6
Commercial	6
Multifamily	7
Study Area Redevelopment Scenarios	10
Analysis Approach	10
Adaptive Reuse	11
Multifamily	12
Office	14
Summary	17

Page Left Blank Intentionally

Introduction

PREFACE ON PLANNING STUDY

Historically an industrial and commercial center, the area east of Downtown Spokane (“Study Area”) has emerged into a distinct University District that is rapidly changing. While Gonzaga University was founded in 1887, the Eastern Washington University and Washington State University presence on Riverpoint Campus began in 1995. Community Colleges of Spokane relocated their administration offices to the Riverpoint Campus in 2000. The growth and success of Riverpoint campus institutions, including Washington State University Spokane, Eastern Washington University, Whitworth University, the Community Colleges of Spokane, Innovate Washington (formerly the Spokane Intercollegiate Research and Technology Institute or, “Sirti”), and increased prominence of Gonzaga University, are transforming this part of town into an intellectual and creative center for Spokane and the region.

The City of Spokane (the “City”) is working with partners at the federal, state, and local levels to make major investments to revitalize the University District into a vibrant, sustainably designed regional center for research and innovation employing adaptive reuse strategies. The establishment of the Riverpoint Campus for Washington State University, Eastern Washington University, Whitworth University, and the Community Colleges of Spokane has created the opportunity for significant redevelopment of this area. The Sprague Corridor, immediately south of Riverpoint Campus is poised for redevelopment, but uncertainty about legacy contamination from historical uses is a barrier to new investment.

This Market Assessment report is a stand-alone document that supports the broader planning and technical analyses conducted for the City in its effort to promote redevelopment throughout the University District. This planning effort has been conducted within the context of the City’s Comprehensive Plan and previous neighborhood scale plans, including the University District Strategic Master Plan and the Sprague Corridor Investment Strategy. The Market Assessment is a component of the University District Integrated Planning Study, which will create a model for how brownfield properties can be positioned for redevelopment in the area of the University District south of the BNSF railroad. The planning process involved the following major elements:

- **MARKET ASSESSMENT**—*analysis of real estate trends and opportunities*
- **ENVIRONMENTAL DUE DILIGENCE**—*assessment of the historical sources of potential impacts and nature and extent of contamination and evaluation of cleanup options*
- **PUBLIC INVOLVEMENT**—*stakeholder interviews and community meetings to listen to the concerns and ideas of the public and provide opportunities to review study findings*
- **CONCEPTUAL PLANNING**—*incorporating the information developed in the study to illustrate a conceptual site plan for redevelopment at a catalyst site*
- **IMPLEMENTATION STRATEGY**—*work program for successfully accomplishing the redevelopment*

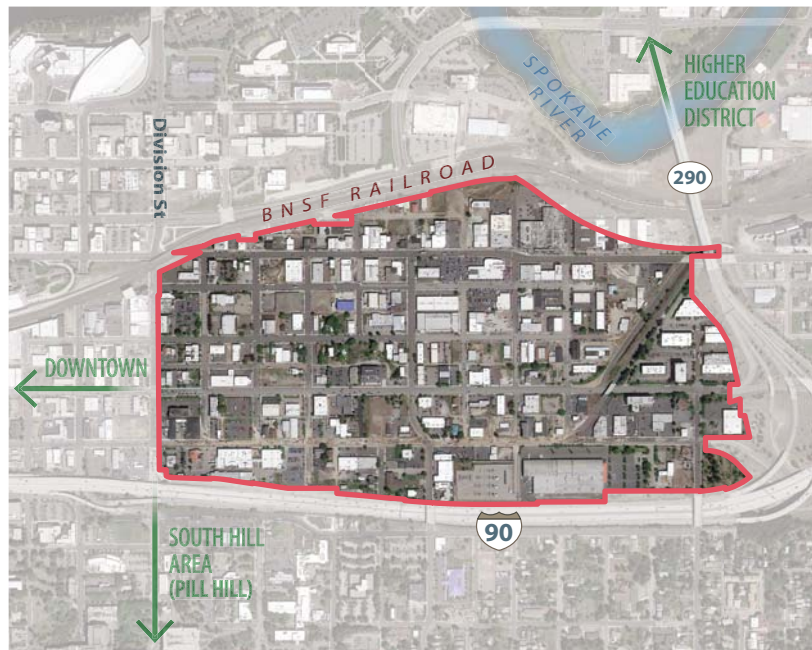
This planning effort was funded by a grant from the Washington State Department of Ecology, Toxics Cleanup Program, Integrated Planning Grant Program (Grant number G1400031).

The Study Area is uniquely positioned to accommodate growth given its location within the City of Spokane and its current land use. However, there are several challenges that will need to be addressed before redevelopment occurs. This report assesses the existing conditions and historical development of the Study Area and summarizes the real estate fundamentals influencing the office and multifamily markets. Based on this analysis, potential redevelopment scenarios were evaluated to illustrate the opportunities and to identify the challenges with realizing each alternative.

Study Area Land Use Profile

STUDY AREA CONTEXT

The Study Area is bound by South Division Street to the west, the BNSF railroad to the north, SR-290 to the east, and I-90 to the south. It has strong regional access with the two adjacent highways and excellent proximity to the regions employment and education centers. The Study Area is well connected to downtown, the higher education district to the north, and the South Hill area – commonly referred to as Pill Hill – to the south. Understanding the Study Area’s regional access and connectivity to the City’s major employment and educational centers is important in contextualizing its current land uses and what it could be in the future given this central location.

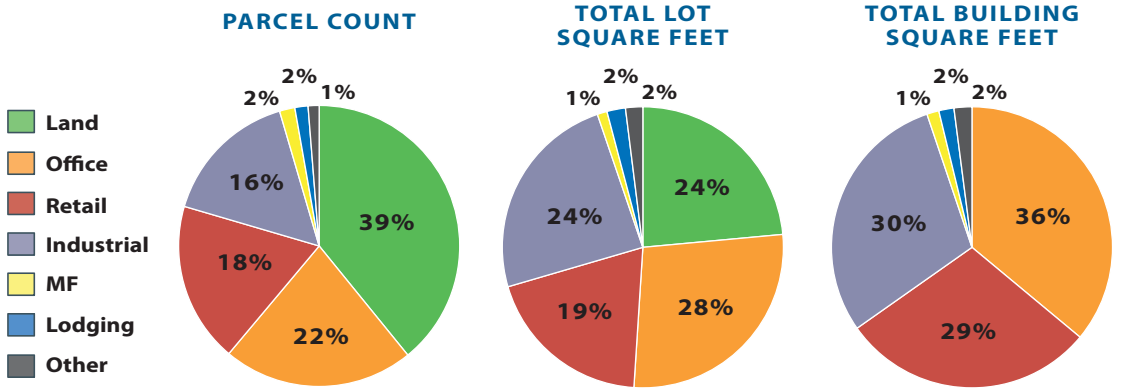
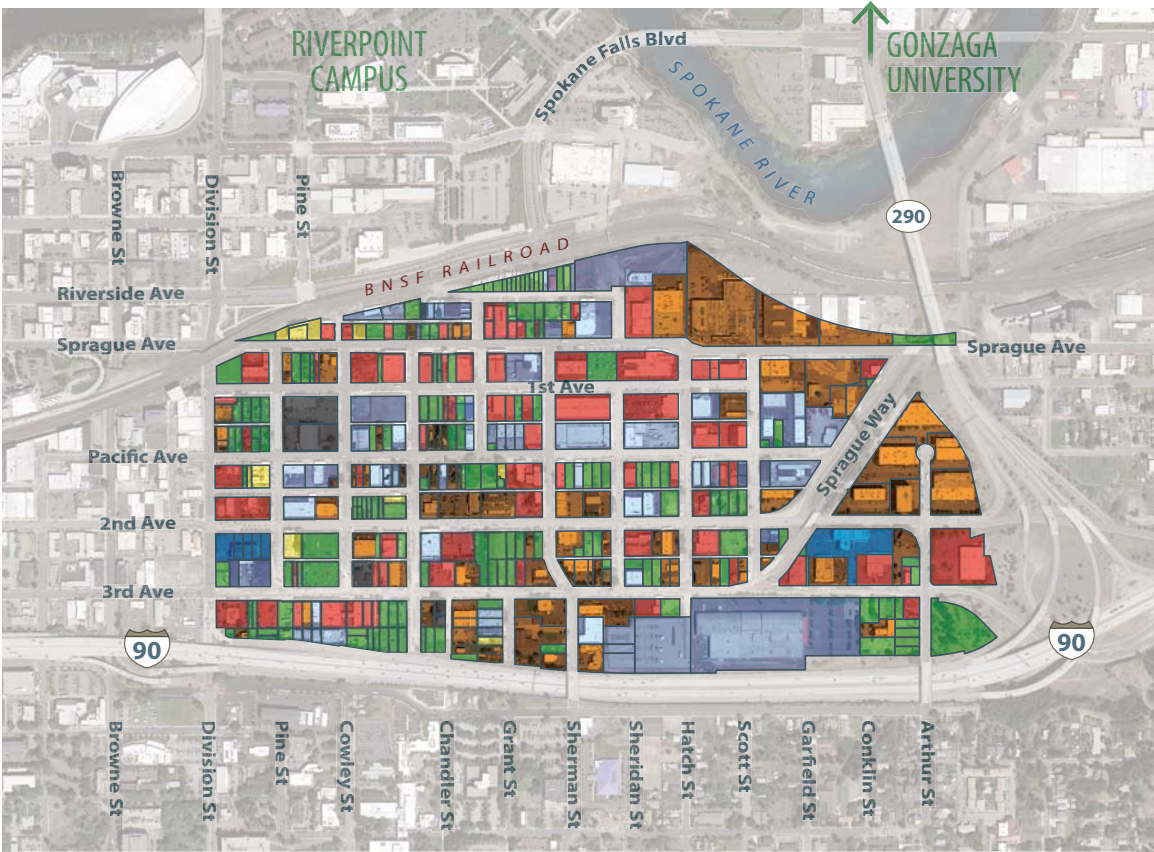


Downtown is only one-mile from South Sherman Street and East Pacific Avenue, roughly the center of the Study Area. This distance is just a four-minute drive, an eight-minute bus ride with 15 minute headways, or a 20-minute walk. North of the railroad tracks is the Washington State University’s expanding Spokane Campus at Riverpoint. The WSU campus is anchored by the Medical Sciences, Pharmaceutical Sciences, and Nursing programs. Eastern Washington University, Whitmore University, and the Community Colleges of Spokane also have a presence at Riverpoint. The University of Washington has recently indicated its plans to expand its presence in Spokane as a result of WSU’s bid to establish its own Spokane-based medical school. UW’s expansion is currently envisioned to occur in or around the University Study Area. Finally, just beyond the Spokane River across from Riverpoint is Gonzaga University. The higher-education centers at Riverpoint are one-third of a mile from the Study Area’s center point; however, getting there currently requires a longer 1.2 mile drive or one-mile walk. This underscores the value a pedestrian bridge at the north central point of the Study Area would have in connecting it to the Spokane’s higher education hub. Finally, the region’s medical center is located just south of the Study Area across I-90 in the South Hill neighborhood that is anchored by hospitals, clinics, senior care centers, and hospice services provided by Providence Health. Getting here from the Study Area is a one-mile drive that takes roughly three-minutes or a walk that would take less than 20-minutes.

LAND USE PATTERNS

While there is significant activity around it, the Study Area can generally be characterized as under-utilized. The Study Area is occupied by commercial business that range from light industrial uses, auto shops and general retail to health and social services. Nearly 25 percent of the total land area is classified as vacant by the Spokane County Assessor; however, much of that vacant land is being used as surface parking that supports the local businesses. This is a highly fragmented area in terms of parcelization and ownership. There are 396 parcels in the Study Area with an average size of 14,650 square feet and a median size of 7,000 square feet. Only 163 of the 396 parcels, or 40 percent, are improved with an average building size of 10,000 square feet and a median size of 6,600 square feet. In terms of ownership, there are 199 unique property owners in the Study Area. The graphic, charts, and table in Figure 1 further detail the Study Area’s land use patterns.

FIGURE 1: Study Area Land Use Pattern Summary



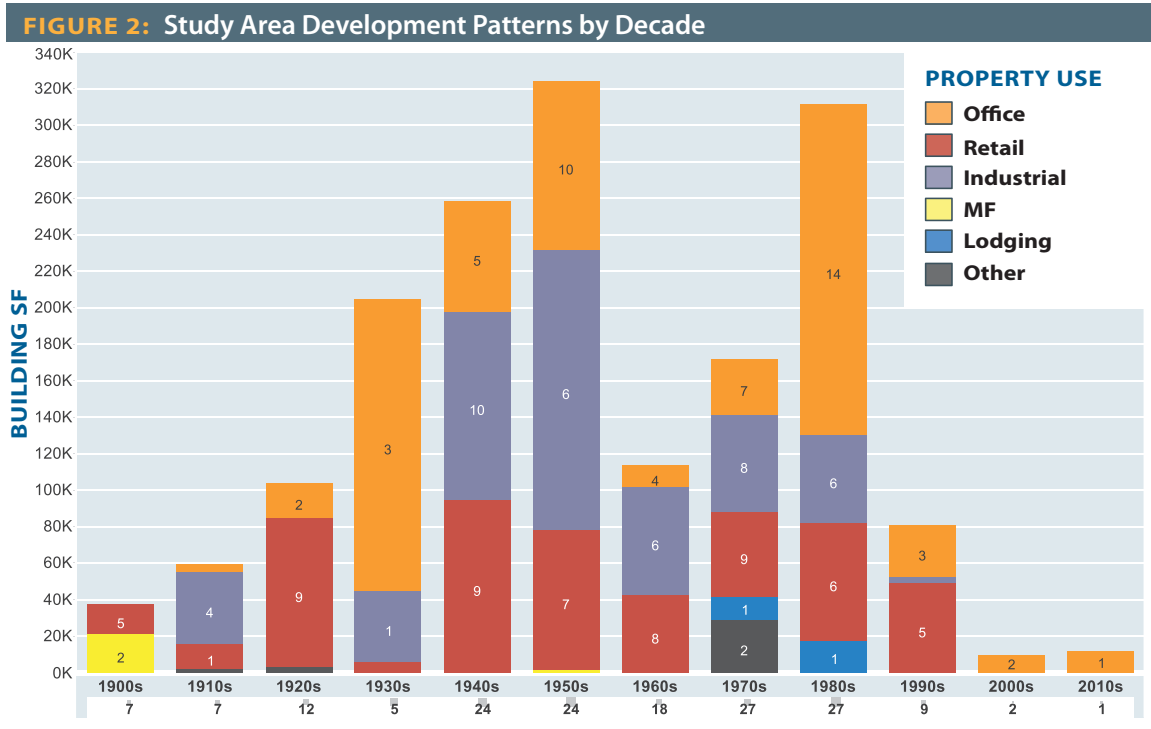
LAND USE	PARCEL COUNT	TOTAL LOT SQ FT	PARCELS W/BLDGS	TOTAL BLDG SQ FT	AVG YR BUILT	AVG F.A.R.
Land	155	1,351,022	0	0		
Office	87	1,577,743	52	608,069	1967	0.39
Retail	73	1,116,878	60	492,753	1955	0.44
Industrial	63	1,393,920	42	499,015	1958	0.36
MF	7	64,904	3	23,479	1921	0.36
Lodging	6	122,404	2	29,408	1980	0.24
Other	5	113,692	4	34,631	1947	0.30
TOTAL	396	5,740,563	163	1,687,355	1959	0.29

SOURCE: Spokane County Assessor

41%

HISTORICAL DEVELOPMENT PATTERNS

The historical development pattern of the Study Area is also telling. As illustrated in Figure 2, the majority of construction occurred prior to 1990. Just under 60 percent of the total building square footage in the Study Area was delivered prior to 1960 and another 35 percent delivered during the 1960s, 1970s, and 1980s. New construction during the past 20 plus years has been historically slow with only 6 percent of the Study Area’s building stock being delivered during this period. There is ample development capacity in the Study Area, so this development lull may be attributed to weak localized market fundamentals that do not support new construction and the market’s desire to develop in other parts of the City and region that have been in the path of growth.



DEVELOPMENT CAPACITY

The Study Area has ample development capacity to support new construction. To support this finding, we observe that the average floor area ratio (“FAR”), or the total building square footage divided by total land area, across the entire Study Area is 0.29. This FAR calculation includes land that is vacant and not associated with a building. If only improved land and its supporting parcels (used typically for parking) are included, the FAR increases to 0.37. The highest FAR in the Study Area is 1.0. The current General Commercial zoning that dictates land use and development capacity in the majority of the Study Area permits a maximum FAR of 2.5 and building heights up to 70-feet or 150-feet. The existing improvements are only utilizing 15 percent of the allowable FAR. This excess capacity would suggest there to be ample land primed for redevelopment; however, when considering market fundamentals it appears that the highest and best use at this moment in time for many properties is at the current use.

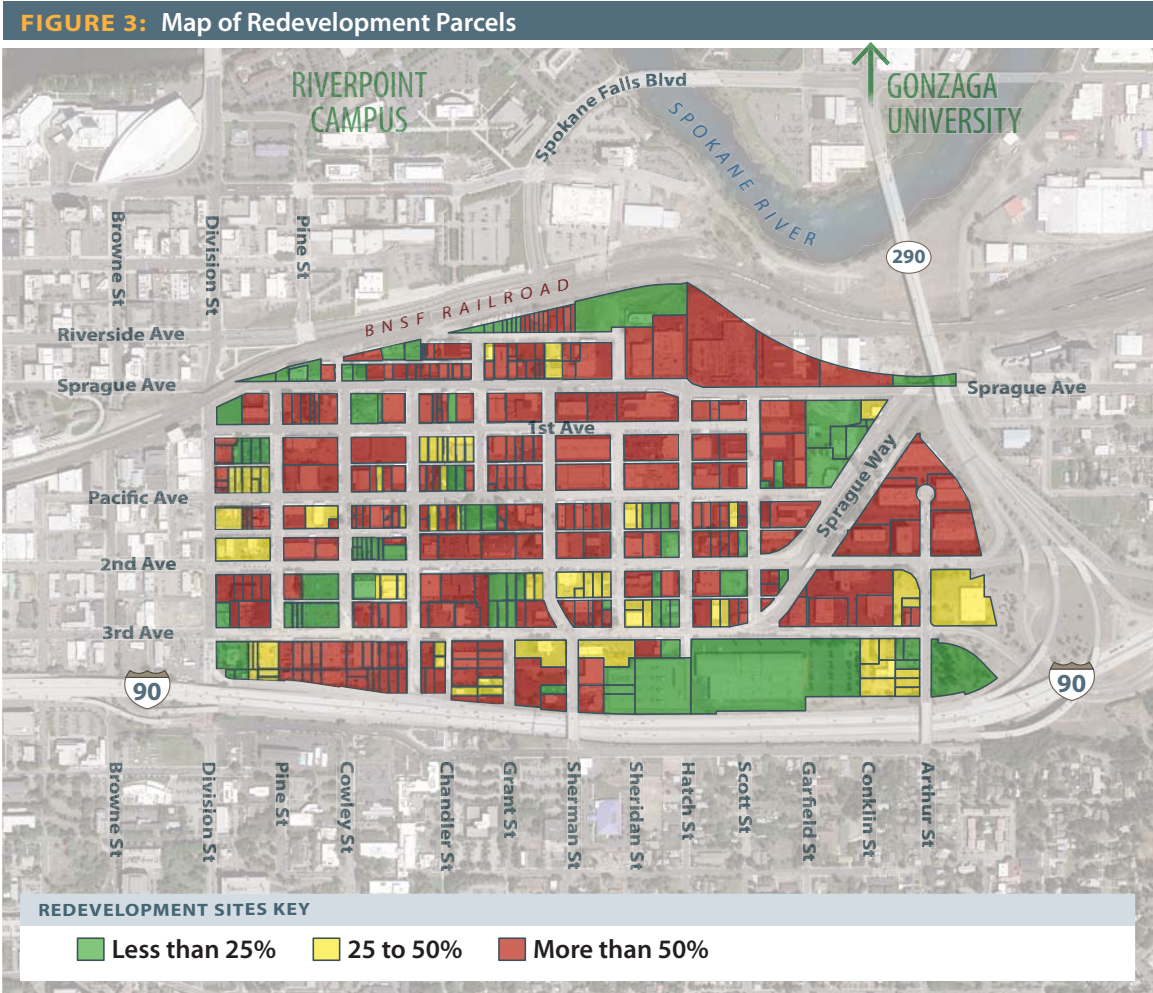
The graphic in Figure 3 and Table 1 illustrates the parcels in the Study Area that may be considered redevelopable based on the assessed value ratio (“AV ratio”), or the assessed improvement value divided by the total assessed value. This analysis was applied to assemblages and not necessarily individual parcels. For example, if the Assessor’s records indicated that two adjacent parcels were under the same ownership, then the AV ratio was calculated on the combined assessed values of those two parcels. Based on this analysis, 22 percent of the parcels in the Study Area are considered most likely to redevelop in the near term. These parcels have buildings that contribute 25 percent or less to the property’s total value. Those parcels where the redevelopment potential is marginal based

on the property's current use represent 17 percent of the total. Finally, parcels where the building contributes at least 50 percent of the total value are considered the least likely to redevelop under the current market conditions comprised 62 percent of the Study Area's parcels.

TABLE 1: Redevelopment Parcel Distribution

ASSESS VALUE RATION RANGE	PARCEL COUNT	DISTRIBUTION
Less than 25%	86	22%
25% to 50%	66	17%
More than 50%	244	62%
TOTAL	396	

SOURCE: Spokane County Assessor, Heartland



The FAR analysis and AV ratio analysis illustrate that the Study Area has capacity, but that market fundamentals do not support redevelopment at this time. The following sections provide support for these observations and provide suggestions for how the City may assist the market with transforming the Study Area.

Real Estate Fundamentals

Relative to the City of Spokane, the Study Area's market fundamentals are weak. This finding suggests that alternative locations and/or the quality of the space are keeping renters in other parts of the City in order to meet their space needs. This is in spite of the Study Area's strong location and low rental rates. That said, commercial real estate is driven in large part by a growing economy and the City of Spokane's employment has been declining at a slow rate since 2008. Since the peak, Spokane has lost 5,000 jobs at an average annual rate of one percent per year. Considering how other regional economies were affected by the Great Recession, Spokane response has been less severe; however, there has been no rebound in employment numbers since the decline began in 2008. This is a key indicator as to why the City's overall commercial market can generally be described as flat, but it has been declining at a relatively slow rate. The following analysis summarizes the real estate fundamentals in the Study Area relative to the City.

COMMERCIAL

OFFICE

Since 2008, the City has seen a 6.5 percent increase in the office supply, or an additional 973,000 square feet. While this new supply is not an insignificant amount, this construction, coupled with a reduction in overall jobs City-wide, has created a market with limited upward pressure on rental rates while vacancies have remained relatively flat. The Study Area comprises approximately 656,000 square feet of office space. This represents only 4.1 percent of the City's total supply.

As the figures in Table 2 illustrate, the Study Area's current full service rental rate is \$11.6 per square foot per year or 33% lower than the City-wide average rental rate of \$15.6 per square foot. Comparing the current asking rates to the five-year average, we see that the current rate in the Study Area is slightly lower than the five year average, however there has been growth in the rental rate since five-years ago when rental rates were \$10.8 per square foot. City-wide office rental rates followed a similar, relatively flat trajectory with the current rental rate below the five year average as well as a below the asking rate of \$16.3 per square foot five-years ago. The Study Area's vacancy rate is currently at 13.0 percent, well over the 5.5 percent rate observed during the same period in 2010. This is well above the City-wide vacancy rate of 8.5 percent. These summary statistics highlight the market's perception of the existing office stock within the Study Area.

TABLE 2: Office Market Summary Statistics

	RENTAL RATE (FULL SERVICE)			VACANCY RATE		
	5-YR AVG	ANNUAL RATE OF CHANGE	CURRENT	5-YR AVG	ANNUAL RATE OF CHANGE	CURRENT
STUDY AREA	\$11.8	1.6%	\$11.6	8.4%	-18.8%	13.0%
CITY WIDE	\$16.1	-0.9%	\$15.6	8.0%	-2.4%	8.5%

SOURCE: CoStar

City-wide, there is nearly 390,000 square feet of office product in the development pipeline in nine projects. There is currently one proposed office development in the Study Area. This project, located at 627 E 2nd Ave., is programed for 29,000 square feet in a four-story building that would be parked at three stalls per 1,000 square feet of office space. The asking rents were listed at \$17.00 per square foot triple net ("NNN"), which is well above typical asking rates for this area. The project had been listed for sale on the market, but was recently pulled from the market due to a lack of interest.

RETAIL

Since 2008, the City has seen a 1.8 percent increase in the retail supply, or an additional 323,500 square feet. The City accounts for roughly 54 percent of the total retail inventory in the County; however, since 2008, 70 percent of new retail construction in the region has occurred outside the City limits. The Study Area comprises approximately 747,000 square feet of retail space. This represents only 4.0 percent of the City's total supply.

As the figures in Table 3 illustrate, the Study Area's current NNN rental rate is \$9.7 per square foot per year, or 38% lower

than the City-wide average rental rate of \$12.5 per square foot. The current Study Area rental rate is \$0.70 per square foot less than the five-year average and \$3.2 per square foot less than the peak rate of \$12.2 per square foot observed in 2008. The asking rental rate in the Study Area has declined at an average annual rate of 6.4 percent. City-wide retail rental rates have trended relatively flat with the current rental rate below the five year average, as well as a below the asking rate of \$13.1 per square foot five-years ago. The Study Area’s vacancy rate is currently at a very high 19.4 percent, but this a slight improvement from the 20.8% vacancy rate observed during the same period in 2010. The Study Area’s vacancy rate is significantly above the City-wide vacancy rate of 7.1 percent.

TABLE 3: Retail Market Summary Statistics

	RENTAL RATE (NNN)			VACANCY RATE		
	5-YR AVG	ANNUAL RATE OF CHANGE	CURRENT	5-YR AVG	ANNUAL RATE OF CHANGE	CURRENT
STUDY AREA	\$9.7	-6.4%	\$9.0	20.3%	1.4%	19.4%
CITY WIDE	\$12.5	-1.1%	\$12.4	6.5%	-4.6%	7.1%

SOURCE: CoStar

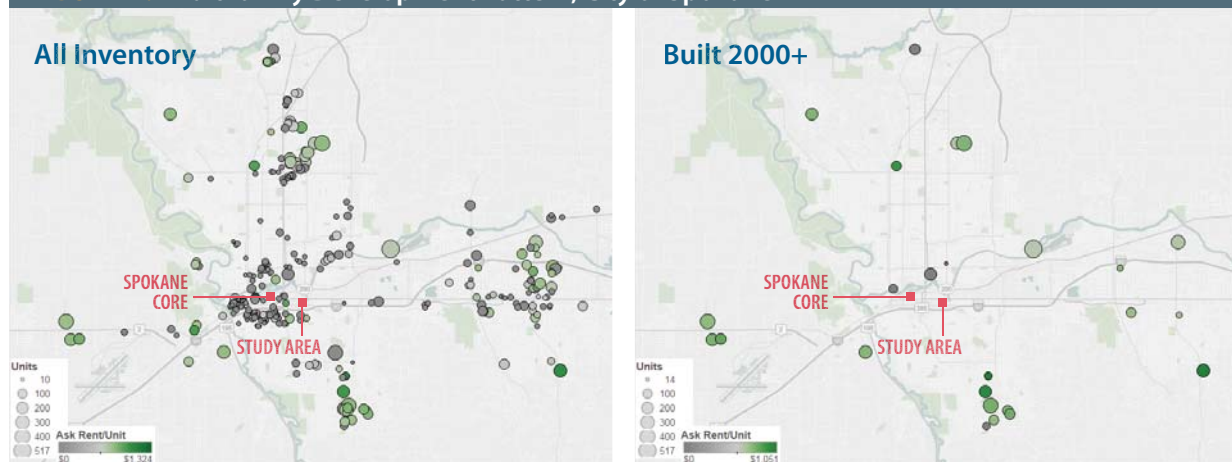
City-wide there are 29 projects in the development pipeline comprising approximately 657,000 square feet. There are currently no proposed retail developments in the Study Area.

MULTIFAMILY

The Study Area currently is home to a limited number of multifamily units. There are two projects in the Study Area with 10 units or more; The Edge condos and Kensington Court. The Edge Condos comprise 19 units in a building that was built in 1904 and renovated in 2007. The units have 13-20’ foot ceilings and are between 800 and 1,300 square feet. Spokane Housing Ventures owns the 33 unit Kensington Court. This building was constructed in 1903 and is available to households earning 80 percent or less of the area median income for Spokane County.

City-wide, the Spokane multifamily market can be characterized as relatively flat. The image in Figure 4 illustrates the development pattern of multifamily projects built in the City since the turn of the 20th century (left panel) and just those projects built in 2000 and after (right panel). As this figure clearly illustrates, there has been no new construction in Spokane’s core since 2000 and limited development elsewhere in the City. This underscores the likelihood that much of the regions multifamily development is occurring in other areas where land is less expensive and in the path of population growth.

FIGURE 4: Multifamily Development Pattern, City of Spokane



SOURCE: CoStar

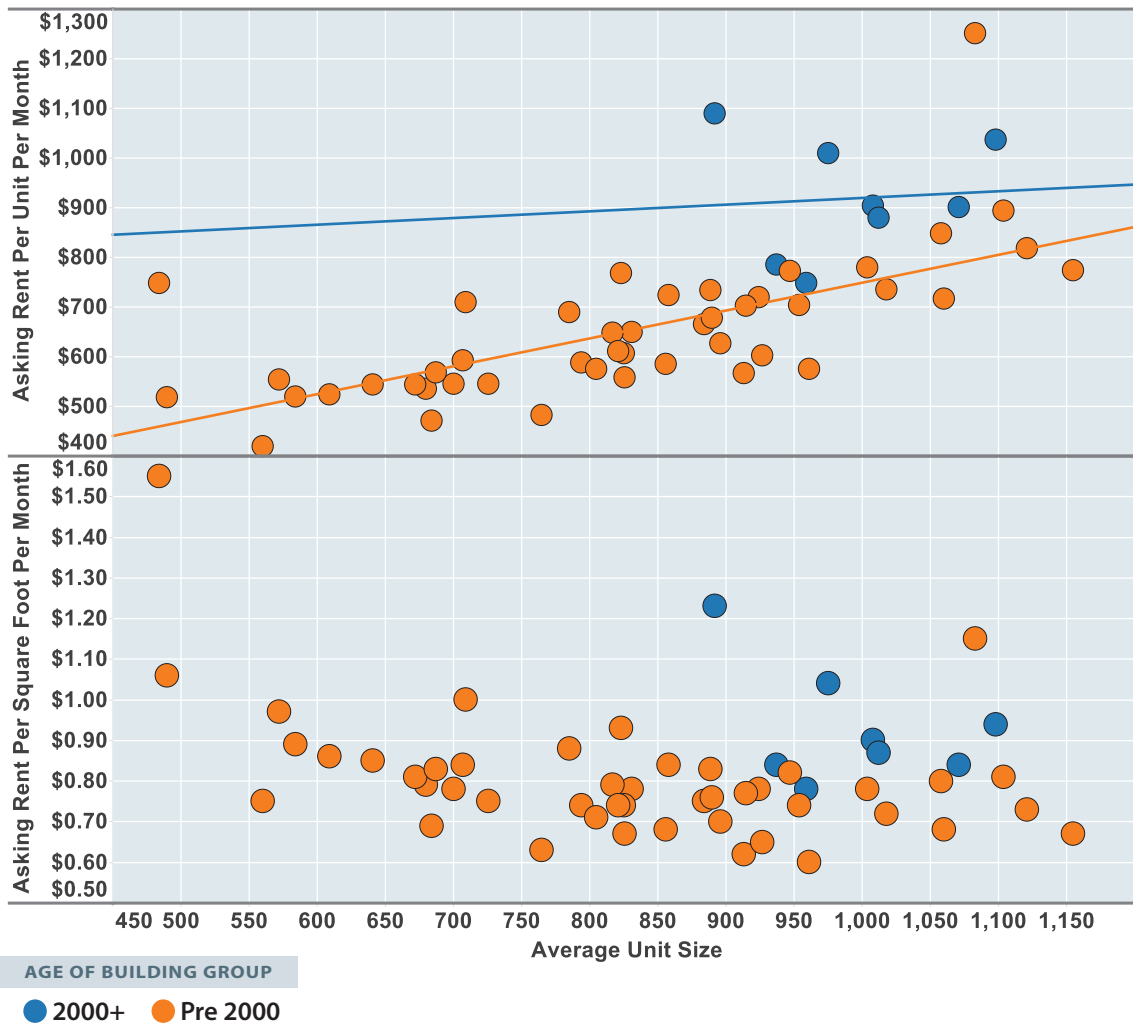
Overall, the vacancy City-wide is very low with a current rate of 4.3 percent. The newer product, described as “Garden” in Table 4 has the highest vacancy rate of 4.9 percent. This product type has an average year of construction of 1985 and an average rental rate of \$710 per month, or \$0.82 per square foot. These complexes typically have larger unit counts than complexes described as low-rise or mid-rise and are generally located beyond the Spokane core area around the Spokane River. The low-rise and mid-rise product is found in older buildings with an average age of 1958 and 1941, respectively. As Table 4 shows, the vacancy rates are below 3.0 percent for these product types. The rental rates are less than the garden style apartments, but the average unit sizes are also smaller. The trade-off between these product types are urban walkability, on site amenities (garden style apartments have more to offer), and age of construction.

TABLE 4: City-Wide Multifamily Summary Statistics

	GARDEN	LOW-RISE	MID-RISE	TOTAL
PROJECTS	54	73	19	146
TOTAL UNITS	5,952	2,087	1,101	9,140
AVG PROJECT SIZE	110	29	58	63
AVG \$/SF	\$0.82	\$0.84	\$0.90	\$0.82
AVG \$/UNIT	\$710	\$650	\$688	\$688
YEAR BUILT	1985	1959	1941	1966
CURRENT VACANCY	4.90%	2.90%	2.50%	4.30%

SOURCE: CoStar

FIGURE 5: Multifamily Rental Rate Scatter Chart



The scatter chart in Figure 5 shows current asking rents on a dollar per month basis (top) and a dollar per square foot per month basis (bottom) for all the market rate and mixed market rate/affordable projects. This illustrates how even the Spokane multifamily market is across product types. There are two projects of note that stand out in the scatter chart. The project with the highest asking rent per square foot per month is the recently completed 84-unit Highlands at Kendall Yards. This project is situated along the Spokane River within the Kendall Yards master planned development. This project has asking rates around \$1,100 per month and with the typical unit size around 900 square feet the average asking rate per square foot is approximately \$1.22 per month. The other top of the market project in the City is the 98-unit Riverfalls Tower apartment located at the western edge of the commercial core with park and river views. This project was completed in 1973 and is 11-stories. This project has asking rates around \$1,250 per month and with the typical unit size around 1,085 square feet the average asking rate per square foot is approximately \$1.15 per month.

Given the low City-wide vacancy rate it could be presumed that there should be pent up demand for apartment units and this should drive new construction. Indeed there is some moderate development activity in the pipeline with four low-rise projects under construction comprising 258 units. There are three other proposed projects that if completed will introduce another 308 units into the City. Two of the projects are in the Kendall Yards development with all the other projects in the periphery of the City. Two key factors tempering development at this moment are slow job growth in the City and rental rates that make new construction financially challenging. That said, there is job growth as well as an increase in the student population occurring in the Riverpoint Campus. As there is no student housing currently planned to be developed in Riverpoint, a tight supply of off-campus housing for students already present in this area as well as Gonzaga students, there could be strong demand for new units near these campuses to support this population growth.

Study Area Redevelopment Scenarios

Based on the market assessment, existing conditions generally do not support new office and multifamily development in the near term. The following analysis bears this out; however, this analysis also illuminates some measures the City may make in helping to close the development gap.

The City is currently investing in a pedestrian bridge that would connect the Study Area to the higher education campuses at Riverpoint and Gonzaga University. This major investment will help make the entire University District function better with improved accessibility, and may help encourage new development beginning around the bridge landing area in the northern portion of the Study Area. The focus area for our redevelopment analysis is generally bound by the BNSF railroad to the north, South Hatch St. to the east, East Sprague St. to the south and South Sherman St. to the west. This portion of the Study Area is referred to as the Landing Area.



FIGURE 6: The Landing Area Concept

A vision for the built out Landing Area is depicted in Figure 6 and could include a mix of adaptively reused buildings for commercial use, multifamily, office, and a parking garage that would support development in the Landing Area as well as on the other side of the pedestrian bridge. This area will not likely develop in a single phase, but rather in several phases over time. The following redevelopment economics and pro forma gap analysis tests the feasibility for each potential land use to illustrate how certain City measures and market changes may influence new development.

A vision for the built out Landing Area is depicted in Figure 6 and could include a mix of adaptively reused buildings for commercial use, multifamily, office, and a parking garage that would support development in the Landing Area as well as on the other side of the pedestrian bridge. This area will not likely develop in a single phase, but rather in several phases over time. The following redevelopment economics and pro forma gap analysis tests the feasibility for each potential land use to illustrate how certain City measures and market changes may influence new development.

ANALYSIS APPROACH

To assess the feasibility of different redevelopment scenarios in the Landing Area we used a static pro forma that we populated with market based income, cost, and debt inputs. The income assumptions are grounded in the analysis presented in Section 2.2 of this report. The key output metric used to assess feasibility is the cash on cash return, or the rate of return of the net cash flow from the income property relative to the equity invested.

Our financial model compares the pro forma cash on cash return to target cash on cash return. Based on our experience, this return should reach at least a 10.0 percent risk adjusted return for a development such as one that may occur in the Landing Area. If the modeled baseline assumptions resulted in a cash on cash return below 10.0 percent we then tested the impact of certain City measures or other market adjustments that could positively impact the pro forma. This approach helps evaluate what actions may help make an infeasible project feasible.

Figure 7 is a chart that will be repeated in each of the following subsections. This depicts the pro forma cash on cash return using the baseline assumptions (red bar) to the target cash on cash return (green bar) with the

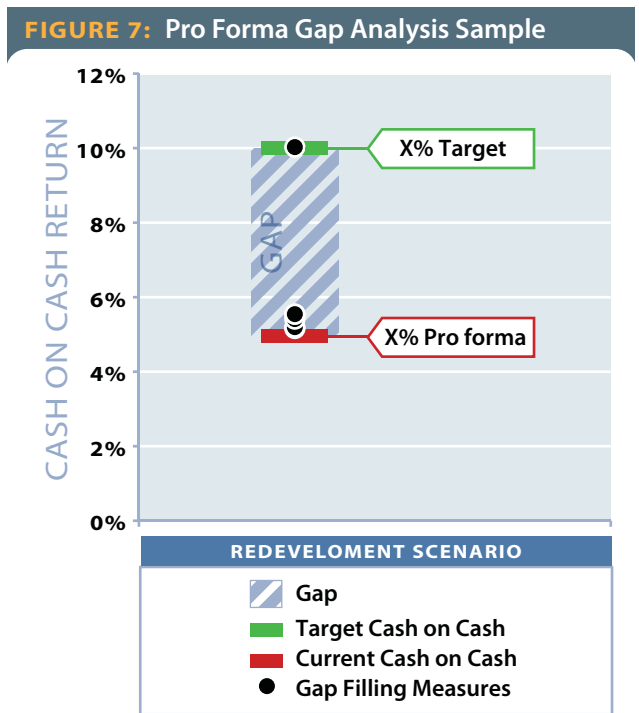


FIGURE 7: Pro Forma Gap Analysis Sample

feasibility gap represented by the hatched area in between. The black dots in the chart represent the impact measures or changes in the market may have on the project’s cash on cash return.

ADAPTIVE REUSE

The adaptive reuse of existing buildings is a common redevelopment approach throughout the Spokane Core where there is a good stock of historic buildings with character. There are many adaptive reuse examples in the downtown area as well as in and around the Study Area. The Edge Condos (a three-story brick building on East Sprague Ave. that was home to Western Soap among other manufactures), Jones Radiator (a former radiator shop also on East Sprague Ave.) and McKinstry’s Spokane innovation center in the Spokane & Inland Empire Railroad Building (the repair depot for the city’s first electric railway system) are three recent examples of adaptive reuse near the Landing Area. In the Landing Area there are three buildings fronting E Sprague Ave. that could be good candidate buildings for adaptive reuse: the 15,000 square foot Hutton Settlement building located on the northwest corner of North Sheridan St. and E. Sprague Ave., the 17,000 square foot S&C Enterprises building east of the Hutton Settlement building, and the 35,600 square foot DBSI building on the northwest corner of North Hatch St and E Sprague Ave. While these buildings may not be designated historic, which would provide additional incentives for building improvements; they each appear to have structural elements that could make for compelling adaptive reuses. Figure 8 uses the Hutton Settlement building as a template to illustrate the range of potential owners/tenants for an adaptively reused building. Uses could range from co-office and creative spaces to recreation and bar or restaurant uses to innovation centers to highlight and encourage new ideas in emerging fields.



PRO FORMA PERFORMANCE

Based on our market assessment and conversations with developers and contractors that work on similar projects, the pro forma model for an adaptive reuse scenario was supported with the inputs in the bullets below. These inputs formed the baseline assumptions for the pro forma and produced a cash on cash return of 8.2 percent, or 1.8 percent below the target threshold. The sensitivity table in Figure 9 shows the range of the cash on cash return if conditions affecting asking rents or land costs change.

KEY PRO FORMA INPUTS

- NNN rents: \$15/sf/yr
- Construction costs: \$100/GBSF
- Land cost: \$20/sf
- Environmental: \$50,000 (minimum)

FIGURE 9: Cash On Cash Sensitivity Table

		ASKING RENT (NNN \$/SF/YR)			
		\$12.00	\$14.00	\$16.00	\$18.00
LAND COST (\$/SF)	\$16	5.5%	7.7%	10.0%	12.2%
	\$18	5.2%	7.4%	9.6%	11.8%
	\$20	5.0%	7.1%	9.3%	11.4%
	\$22	4.7%	6.8%	8.9%	11.0%
	\$24	4.5%	6.5%	8.6%	10.7%

Next the pro forma assesses the potential impact that City measures and changes in market conditions or project design may have on the project performance. The following bullets summarize these modifications and how each affected the baseline assumptions.

CITY MEASURES

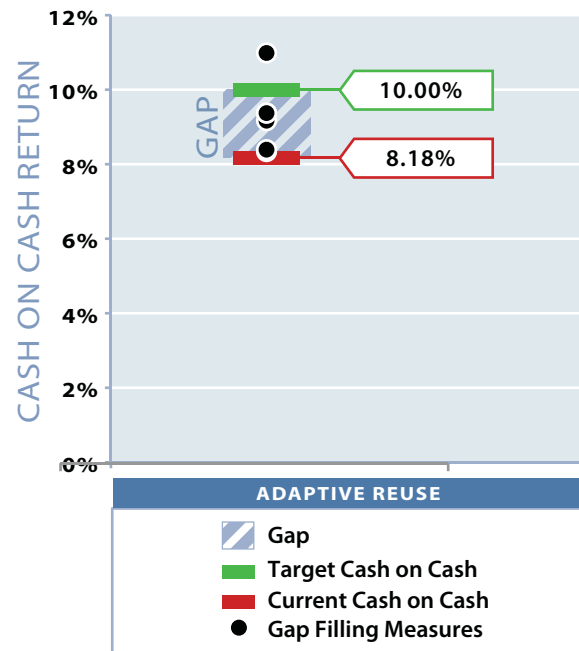
- Eliminate offsite costs in adjacent rights of way reduces hard costs (5% reduction of direct costs)
- Streamline process provides marginal soft cost benefit (1% reduction of soft costs)
- Allow low cost surface parking lots (\$7k to \$1k/stall reduction)

OTHER MEASURES

- Value engineer construction costs (5% reduction of direct costs)
- Leverage City investments to drive rents (\$15 NNN to \$15.50 or a 3% increase)

Figure 10 illustrates how these measures affect the pro forma performance. The first two City measures (eliminate offsite costs and streamline process) do not appear to have a significant direct impact on the cash on cash return; however, these are important measures for the City to take. Both would signal to the development community that the City is willing to make the process more predictable, which is important for underwriting risk in a project as well as competing with other jurisdictions assuming the owner or developer has alternatives. Allowing lower cost surface parking lots such as fewer curbs and less landscaping can have a more significant impact. This action would move the cash on cash return up towards 9.0 percent. In order to push this project towards the target return, the direct costs could be lowered by 5.0 percent and rents would only need to increase by 3.0 percent. Overall, all of these measures seem reasonable illustrating why most development in the area occurs in existing buildings.

FIGURE 10: Cash On Cash Measure Impact



MULTIFAMILY

As indicated in the market assessment, multifamily units are scarce in the Study Area. However, as this City evolves with the growth of the Riverpoint Campus, the continued strength of the health sector on South Hill, and the Study Area's proximity to downtown, this area could be an attractive in-City location for new multifamily development. Residential development in the Landing Area would likely draw from the students, employees based in South Hill, or downtown workers. The strong regional connections that the Study Area enjoys could also attract tenants that seek quality housing in an emerging area.

The two types of multifamily projects that were modeled were low-rise and mid-rise complexes. The following bullets summarize the general characteristics of these two types of complexes. Two important notes regarding the assumptions have to do with phasing and retail. For phasing, a low-rise project would likely be completed in a single phase due to its lower density per acre while a mid-rise project in the Landing Area would likely be done in two phases. The first phase would be surfaced parked while the second phase would be developed on the former surface parking lot and parking demands would be met using the structured garage. Sample images of low-rise (bottom) and mid-rise (top) complexes are shown in Figure 11.

LOW-RISE (GARDEN STYLE) COMPLEX CHARACTERISTICS

- Garden or townhome style
- Stick frame construction
- No elevators
- Surface parked
- Approx. 50 units per acre

MID-RISE (STACKED FLAT) COMPLEX CHARACTERISTICS

- Stick frame construction
- Elevators
- Approx. 110 units per acre at build out

PRO FORMA PERFORMANCE

Based on our market assessment and conversations with developers and contractors that work on similar projects the pro forma model for multifamily scenarios was supported with the inputs in the bullets below. These inputs formed the baseline assumptions for the pro forma and produced a cash on cash return of 3.3 percent and 5.0 percent for stacked flat and garden style complexes respectively. Using these baseline assumptions the cash on cash returns for these two complex types are both below the target threshold. The sensitivity table in Figure 12 shows the range of the cash on cash return if conditions affecting asking rents or land costs change.

FIGURE 11: Sample Multifamily Concept Images



KEY PRO FORMA INPUTS

- Rental rates: Garden \$1.10/sf/mo Stacked Flat: \$1.15/sf/mo
- Construction costs : Garden: \$88/GBSF Stacked Flat: \$90/GBSF
- Land cost: \$16/sf
- Environmental: \$0

FIGURE 12: Cash On Cash Sensitivity Table

Stacked Flat (MID-RISE)		ASKING RENT (\$/SF/MO)			
		\$1.00	\$1.20	\$1.40	\$1.60
LAND COST (\$/SQ FT)	\$14	1.8%	4.0%	6.2%	8.5%
	\$16	1.7%	3.9%	6.1%	8.3%
	\$18	1.6%	3.8%	6.0%	8.2%
	\$20	1.5%	3.7%	5.8%	8.0%
	\$22	1.4%	3.6%	5.7%	7.8%

Garden Style (LOW-RISE)		ASKING RENT (\$/SF/MO)			
		\$1.00	\$1.20	\$1.40	\$1.60
LAND COST (\$/SQ FT)	\$14	1.8%	4.0%	6.2%	8.5%
	\$16	1.7%	3.9%	6.1%	8.3%
	\$18	1.6%	3.8%	6.0%	8.2%
	\$20	1.5%	3.7%	5.8%	8.0%
	\$22	1.4%	3.6%	5.7%	7.8%

Next the pro forma assesses the potential impact that City measures and changes in market conditions or project design may have on the project performance. The following bullets summarize these modifications and how each affected the baseline assumptions.

CITY MEASURES

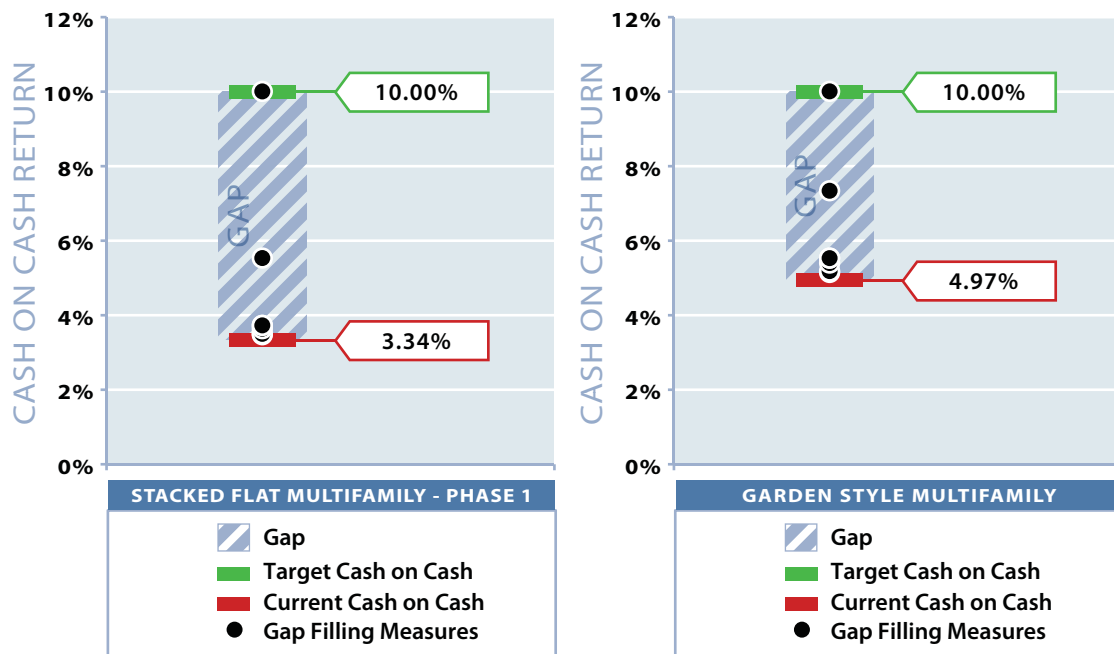
- Eliminate offsite costs in adjacent rights of way reduces hard costs (5.0 percent reduction of direct costs)
- Streamline process provides marginal soft cost benefit (1.0 percent reduction of soft costs)
- Allow low cost surface parking lots (\$7k to \$1k/stall reduction)

OTHER MEASURES

- Value engineer construction costs (5.0 percent reduction of direct costs)
- Employ a Multifamily Tax Exemption (MFTE) program
 - Requires a portion of a project to provide affordable housing for either eight or 12-years and in return, real property taxes are exempt during that period lowering operating costs and improving the project's value.
- Leverage City investments to drive rents
 - Garden Style: \$1.15/sf/mo to \$1.30 or an 18.0 percent increase
 - Stacked Flat: \$1.10/sf/mo to \$1.45 or a 26.0 percent increase

Figure 13 illustrates how these measures affect the pro forma performance. As with the adaptive reuse scenario, the first two City measures (eliminate offsite costs and streamline process) do not appear to have a significant direct impact on the cash on cash return. For reasons stated in the previous section, these are important measures for the City to take. Allowing lower cost surface parking lots such as fewer curbs and less landscaping can have a more significant impact; however, due to the relative scale of the overall cost of multifamily projects compared to adaptive reuse projects, this action would not have as great an effect. In order to push this project towards the target return, the direct costs could be lowered by 5.0 percent and more importantly the MFTE program would need to be encouraged for the Study Area AND rents would need to increase by 18.0 percent or 26.0 percent. At rents of \$1.45/sf/mo a stacked flat project in the Landing Area appears to not be feasible when looking at the existing market rental rates. This is a significant leap. Pushing garden style up to \$1.30/sf/mo is reasonable when looking at asking rents at Kendall Yards.

FIGURE 13: Cash On Cash Measure Impact



OFFICE

The market assessment found there to be limited office product in the Study Area relative to the City's total inventory. Further, there is a planned office development in the Study Area that was marketed for well over a year, but there was no sufficient interest from potential tenants or owner/users and the listing was recently removed. This case indicates that any new office uses in the next five to ten years will be driven by an owner user and/or developed speculatively. Likely owners or users of an office building that might be developed in the

Landing Area would be related to activity at the Riverpoint Campus medical office/lab uses that may spill over from South Hill. This would either be administrative support space and/or lab/research space.

The two types of office projects that were modeled are general office and lab/research and development office. The following bullets summarize the general characteristics of these two types of complexes. There is enough land in the Landing Area to supported two office building that fit the characterization below; however, these would need to be support by an adjacent, City-owned parking garage. The pro forma shows only the first phase of a two building concept where a single building is constructed with the remaining land used for surface parking. Sample images of the office buildings contemplated are show in Figure 14.

Figure 14: Sample Multifamily Concept Images



Innovate Washington SIRTl Concrete Tilt-Up Office: Under Construction Concrete Tilt-Up Office: Completed

OFFICE BUILDING CONCEPT SUMMARY

- 2 or 3 levels (2 levels modeled)
- 40,000 to 60,000 gross sf (40,000 square feet modeled)
- 3 stalls/1,000 rentable sf
- Tilt up concrete construction

PRO FORMA PERFORMANCE

Based on our market assessment and conversations with developers and contractors that work on similar projects, the pro forma model for office scenarios was supported with the inputs in the bullets below. These inputs formed the baseline assumptions for the pro forma and produced a cash on cash return of 4.2 percent and 5.1 percent for office and lab/research buildings respectively. Using these baseline assumptions the cash on cash returns for these two buildings are both below the target threshold. The sensitivity table in Figure 15 shows the range of the cash on cash return if conditions affecting asking rents or land costs change.

KEY PRO FORMA INPUTS

- Rental rates: Office: \$15/sf/yr NNN Lab: \$20/sf/yr NNN
- Construction costs : Office: \$120/GBSF Lab: \$150/GBSF
- Land cost: \$20/sf
- Environmental: \$0

FIGURE 15: Cash On Cash Sensitivity Table

General Office		ASKING RENT (\$/SF/YR)				Lab/Research		ASKING RENT (\$/SF/YR)			
		\$15.00	\$17.00	\$19.00	\$21.00			\$18.00	\$20.00	\$22.00	\$24.00
LAND COST (\$/SF)	\$16	4.7%	6.4%	8.1%	9.7%	LAND COST (\$/SF)	\$16	4.1%	5.5%	6.8%	8.2%
	\$18	4.5%	6.1%	7.8%	9.4%		\$18	3.9%	5.3%	6.6%	7.9%
	\$20	4.2%	5.9%	7.5%	9.1%		\$20	3.8%	5.1%	6.4%	7.7%
	\$22	4.0%	5.6%	7.2%	8.8%		\$22	3.6%	4.9%	6.1%	7.4%
	\$24	3.8%	5.4%	6.9%	8.5%		\$24	3.4%	4.7%	5.9%	7.2%

Next the pro forma assesses the potential impact that City measures and changes in market conditions or project design may have on the project performance. The following bullets summarize these modifications and how each affected the baseline assumptions.

CITY MEASURES

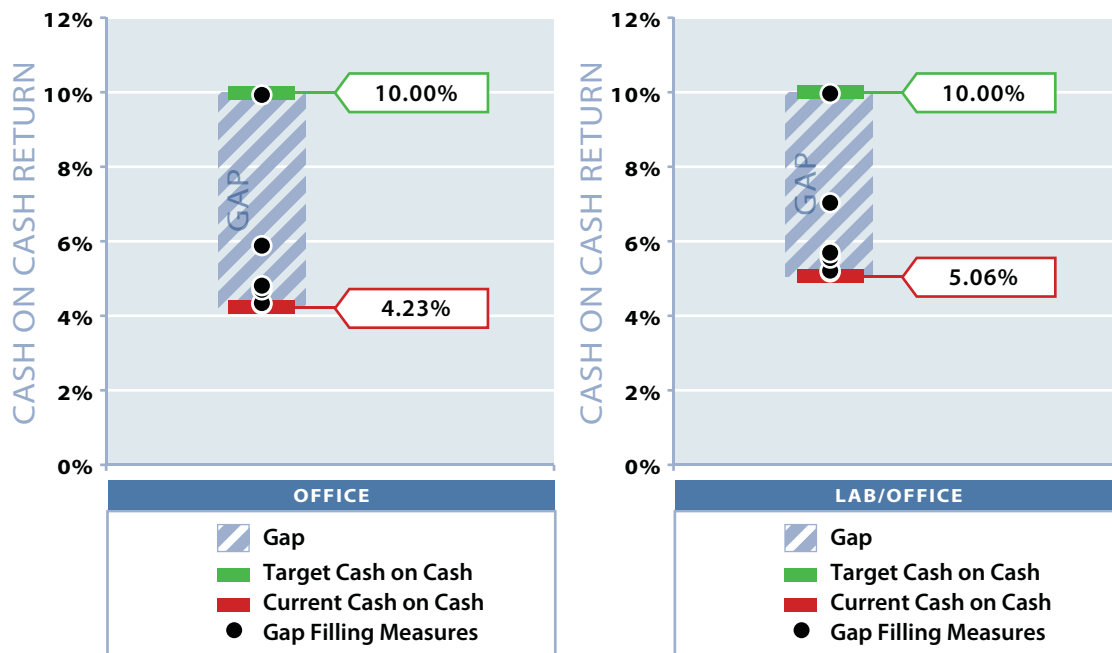
- Eliminate offsite costs in adjacent rights of way reduces hard costs (5.0 percent reduction of direct costs)
- Streamline process provides marginal soft cost benefit (1.0 percent reduction of soft costs)
- Allow low cost surface parking lots (\$7k to \$1k/stall reduction)

OTHER MEASURES

- Value engineer construction costs (5.0 percent reduction of direct costs)
- Attract New Market Tax Credits (NMTC)
 - The NMTC program matches investors with eligible projects and provides the developer with a source of low cost equity.
- Leverage City investments to drive rents
 - Office: \$15/sf/yr to \$20/sf/yr or a 33.0 percent increase
 - Lab: \$20/sf/yr to \$24.50 or a 22.0 percent increase

Figure 16 illustrates how these measures affect the pro forma performance. As with the previous scenarios, the first two City measures (eliminate offsite costs and streamline process) do not appear to have a significant direct impact on the cash on cash return. For reasons stated in the previous sections these are important measures for the City to take. Allowing lower cost surface parking lots has a similar slight impact on the overall performance as it does with new multifamily development. In order to push this project towards the target return, the direct costs could be lowered by 5.0 percent and more importantly the NMTC program would need to be implemented for the Study Area AND rents would need to increase by 33.0 percent or 26.0 percent. Based on this sensitivity testing, a market driven office development does not appear feasible under any circumstance unless it is driven by an owner/user that is making decisions based on other non-market decisions.

FIGURE 16: Cash On Cash Measure Impact



SUMMARY

Based on the market assessment and pro forma analysis there is a significant financial gap for all scenarios. This gap is driven by rental rate projections that are not high enough to provide a sufficient return on the cost of new construction. However, adaptive reuse of an existing structure is less costly and therefore represents the most feasible near-term opportunity. The financial analysis also identified several strategies and opportunities the City may consider to help spur development in the Study Area. First, City investments may help create a more aesthetic and better functioning Study Area. For example, direct access to the Riverpoint Campus via the proposed pedestrian bridge would make development in the Landing Area considerably more attractive as students and others will have an easier time moving between these two areas. This infrastructure improvement would likely have a positive impact on rents, which may close the feasibility gap and potentially generate attractive returns. Two other useful incentives the City may offer to encourage new development is the application of NMTCs for commercial projects and/or the MFTE for multifamily projects. Finally, the City may leverage the University District Public Development Authority (UDPDA) or its relationship with University District Development Authority (UDDA) as a conduit to facilitate development.

Based on our analysis the most likely near-term investments in the Landing Area will be commercial uses in repurposed existing building, multifamily that is supportive of the growing Riverpoint Campus and/or lab or medical office users that benefit from the proximity to South Hill and the Universities. Another financial tool that the private sector may utilize to help bridge the financing gap is EB-5 financing. Projects that use EB-5 financing typically have lower return requirements than traditionally financed projects because a significant portion of the equity is sourced from investors primarily motivated by the opportunity to obtain a Green Card. To help attract potential users and capital action on the strategies noted above are very important; however, commitment that the pedestrian bridge will be completed is critical.

Looking ahead, key marketing messages for the Study Area should focus on the City's commitment to funding and constructing the pedestrian bridge and making other infrastructure investments, as well as the district's advantageous location between the Riverpoint Campus, Downtown and South Hill.