

PORT OF EDMONDS
Harbor Square
Redevelopment Analysis



DRAFT NOVEMBER 2 2009

ACKNOWLEDGEMENTS



Port Commission Property Committee
Bruce Faires, Port Commission Secretary
Marianne Burkhart, Port Commission President

Bob McChesney, Executive Director

Bev Borth, Executive Assistant



Urban Design

Mark Hinshaw, FAIA, FAICP

Mike Kimelberg, AICP, LEED AP

Brianna Holan, AICP



Financial Analysis

Kapena Pflum

Allegra Calder

November 2, 2009

TABLE OF CONTENTS

Introduction	1
Section I: Current Conditions	
1. Site Conditions	3
2. Property Value.....	4
3. Existing Regulations.....	5
Section II: Redevelopment under Existing Code and Contract Rezone	
1. Office Baseline Scenario.....	8
2. Financial Analysis Over Time.....	10
Section III: Redevelopment under New Contract Rezone	
1. Alternative 1.....	13
a. Economic viability	
b. Flexibility	
c. Consistency	
2. Alternative 2.....	15
a. Economic viability	
b. Flexibility	
c. Consistency	
3. Alternative 3.a Land Swap Option	17
a. Economic viability	
b. Flexibility	
c. Consistency	
4. Financial Analysis Assumptions.....	21
5. Financial Analysis and Sensitivity Analysis.....	24
6. Final Assessment and Considerations.....	25
7. Residual Land Value Analysis.....	27
8. Phasing.....	29
Section IV: Fiscal Impact Analysis	
1. Tax Revenue.....	30
2. Cost Implications to the City.....	33
Section V: Conclusions	
1. Conclusions.....	35
2. Next Steps.....	36
3. Other Considerations.....	37



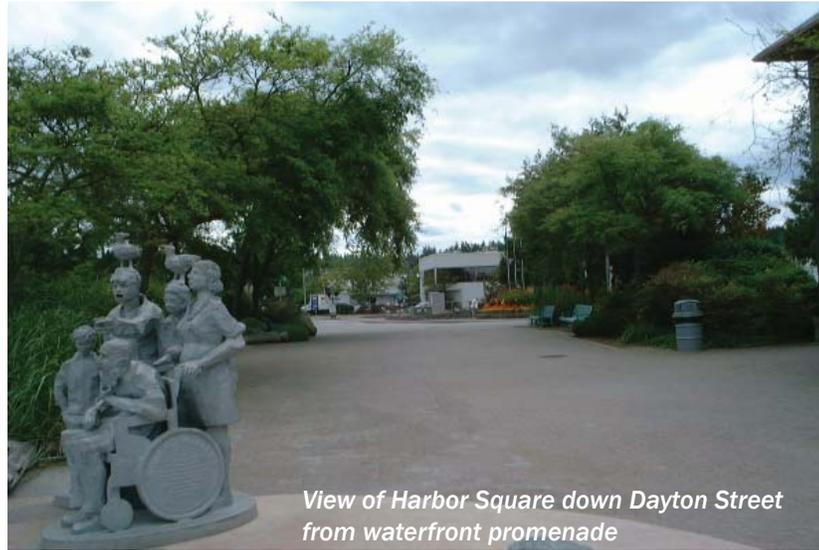
Over the last several years, the Port of Edmonds has been assessing its holdings at Harbor Square, a 14.6- acre site (3.6 acres of which is undeveloped wetlands/marsh described in more detail on page 9) bounded by Dayton Street on the north, Edmonds Way/SR 104 on the east, wetlands to the south and the mainline railroad tracks to the west. Clearly, the property has a greater potential than what is currently seen on the ground, with older, modest, low-slung buildings that reflect an earlier era of commercial real estate development. Vacancies are high and the development does not compete well in a market filled with other more contemporary buildings and site amenities. Furthermore, with shifts in the economy, there is less demand for the type of space offered by Harbor Square.

Although some major uses occupying the site are doing reasonably well, the property is in need of a substantial re-purposing so that the Port can realize a healthy stream of income to meet its many objectives related to serving the community and the region. Already, its loss of standing and income generation is beginning to present difficulties for the Port in managing its portfolio of investments in a balanced and productive manner for the future. The current recessionary period provides an opportunity to re-evaluate this valuable asset for future economic development.

A few years ago, the Port participated in a planning effort for the entire area between Sunset Ave S. and the tracks – an area that involves multiple ownerships, as well as a planned Sound Transit commuter rail station. While efforts to produce a coordinated plan for the area were valuable and uncovered many interesting subjects, ultimately the joint effort did not proceed and individual owners are now pursuing projects independently. While from one perspective, this represents an unfortunate missed opportunity, the Port can examine its own holdings free of the objectives and preferences of other parties.

The Port retained two firms to provide advice on the development of Harbor Square. LMN Architects, which was involved in previous master planning endeavors, examined the configuration of streets, buildings, and public spaces, as well as a possible phasing plan. Berk & Associates (BERK) examined market conditions, land value, financial performance, and tax revenue impacts. Both studies together provide a solid set of choices and directions for the Port Commission to consider.

Current recessionary conditions would not warrant any action in the near future, other than to perhaps re-configure lease terms and conditions as they expire. But the fundamental approach indicated by this study should be able to set in motion actions that will prepare the property for development proposals and disposition as the market begins to recover.



View of Harbor Square down Dayton Street from waterfront promenade



Existing office/distribution buildings and surface parking



Tennis facilities of the Harbor Square Athletic Club

SECTION I: CURRENT CONDITIONS

This section of the report is intended to convey baseline information regarding the current site. This includes physical conditions, relationships, regulatory issues, along with market conditions and assumptions about development potential. It looks at how the current development is positioned and how it is performing. This allows a comparison with alternatives that are described in the subsequent sections. Basic site condition and regulatory data relied upon in this analysis was taken from existing reports and sources.

1. Site Conditions
2. Property Value
3. Existing Regulations



1. SITE CONDITIONS

Harbor Square is located between Highway 104 (Edmonds Way) to the east and Admiral Way to the west with Dayton Street to the north. It is a walkable distance to many amenities, including: Downtown Edmonds, the Ferry Terminal, the waterfront promenade and recently renovated train station. A trail and platforms overlooking the Edmonds Marsh is located along the southern edge of the property. The Burlington railroad right-of-way, carrying a mix of commercial cargo and commuter trains everyday, parallels the west edge of the property.

Harbor Square houses 11 buildings with uses including: office, warehousing, restaurant, hotel, and an athletic club with a variety of facilities. Most of the buildings were constructed in the 1980's, except the hotel which was built in the late 1990's. Surface parking takes up a large portion of the site to serve the daytime uses. Current occupancy rates vary among the office and distribution buildings; many of which are under performing even under today's lower market standards.

The physical planning and financial analysis in this report primarily focuses on the northwest portion of the site that contains buildings 1-5. Briefly, since the hotel and athletic club portions of the site are under long-term leases, the Port would like to focus its attention now on redevelopment scenarios that could begin to happen in the nearer term. So, while the entire Harbor Square property is 14.6 acres, the area primarily studied in this report is approximately 7.5 acres (roughly 50% of the larger site), and contains a total of 102,450 square feet of building space. Additionally, the southern most portion of the site is briefly discussed as a possible "Land Swap" option with the existing athletic club facilities.

Current Operations and Valuation

Exhibit 1.1

Space Characteristics

	"Current Operations"
Building Floorspace (SF)	
Leased Space	71,345
Space Available	31,105
Total Space	102,450
Percent Vacant	30%

Cost Summary

Estimated Total Annual Operating Expenses	\$534,754
Operating Expenses as % of Total Revenue	49%

Income Summary

Rent Rates	
Average for all Tenants	\$15.40
Gross Monthly Income (as of May 1, 2009)	\$91,551
Estimated Annual Income	\$1,098,617
Net Operating Income (NOI)	\$563,863

Valuation

Cap Rate	Capitalized Value
7.0%	\$8.1 M
7.5%	\$7.5 M
8.0%	\$7.0 M

Source: BERK, 2009

2. VALUE OF THE HARBOR SQUARE PROPERTY TODAY

Using information obtained from the Port and Northwest Country Management, BERK reviewed the current operations for Buildings 1 through 5 of the Harbor Square property. The hotel and the athletic club were excluded from redevelopment scenarios being developed by LMN, and it is assumed that these properties will continue to operate as currently configured. As shown in Exhibit 1.1, Buildings 1-5 in Harbor Square include 102,450 square feet of available space, 30% of which is currently vacant. Operating expenses were averaged over a 4-year period and found to be 49% of total revenue, producing an estimated total annual operating expense of \$534,754. Rents average \$15.40 per SF producing an annual income of just over \$1 million. Factoring in expenses produces a net operating income (NOI) of 563,863.

The property was valued using the NOI and three separate cap rates, 7%, 7.5%, and 8% resulting in capitalized values ranging from \$7.0 million to \$8.1 million.

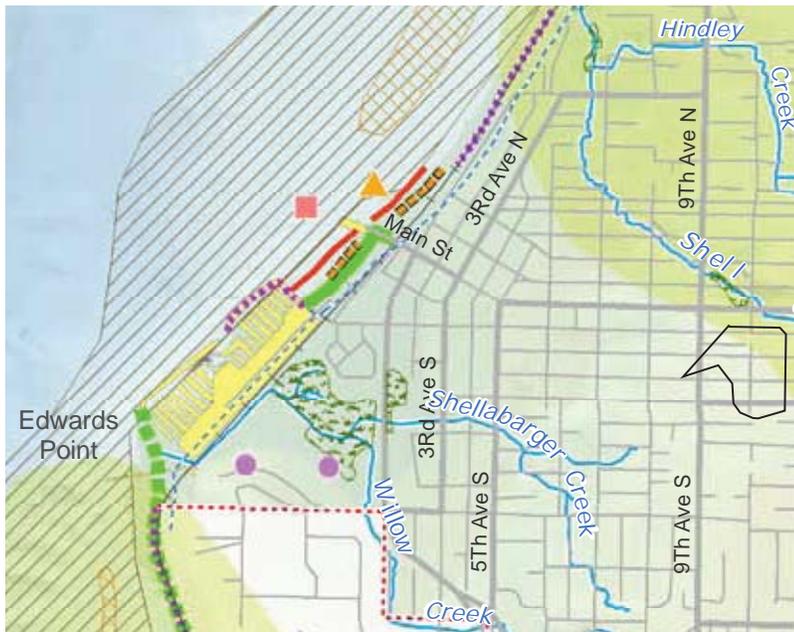


3. EXISTING REGULATIONS

site plan showing existing conditions

The existing Harbor Square development was created by a contract rezone in 1980. The rezone established standards for maximum building square footage, use, lot coverage setbacks, building height, and open space. Additional regulations governing the site are found in the current Edmonds development code, and standards relevant to this analysis can be found in Exhibit 1.2 below.

Existing Standards	
Exhibit 1.2	
Category	Standard
Maximum Height	35 ft
Lot Coverage	32 % (+/-)
Ground floor Building Area	Maximum 190,000 sf allowed on ground level
Total Building Area	218,000 sf (established by the original environmental document traffic analysis, this is the total amount of building area allowed on the site)
Allowed Uses	Manufacturing, Warehouses, Laboratories and Research, Retail and Business uses, Municipal and Public utilities, Business/professional Office
Setbacks	25 ft building setback from Dayton and Sunset 10 ft parking setback from Dayton and Sunset 25 ft from Edmond's Marsh property line
Parking Ratios	Retail 1 space : 300 sq ft Restaurant 1 space : 200 sq ft Office 1 space : 800 sq ft
Other requirements	A walkway paralleling SR 104 (Sunset) from the interior looped street to the south east corner and proceeding there along the edge of the marsh to intersect with the existing path along the marsh in the central portion of the site.



Critical Areas Map. source: City of Edmonds SMP Draft Update 6/06

Environmental Regulations

Draft soil maps from the City website indicate the property is in a high liquefaction hazard area but has no specific regulations on this condition.

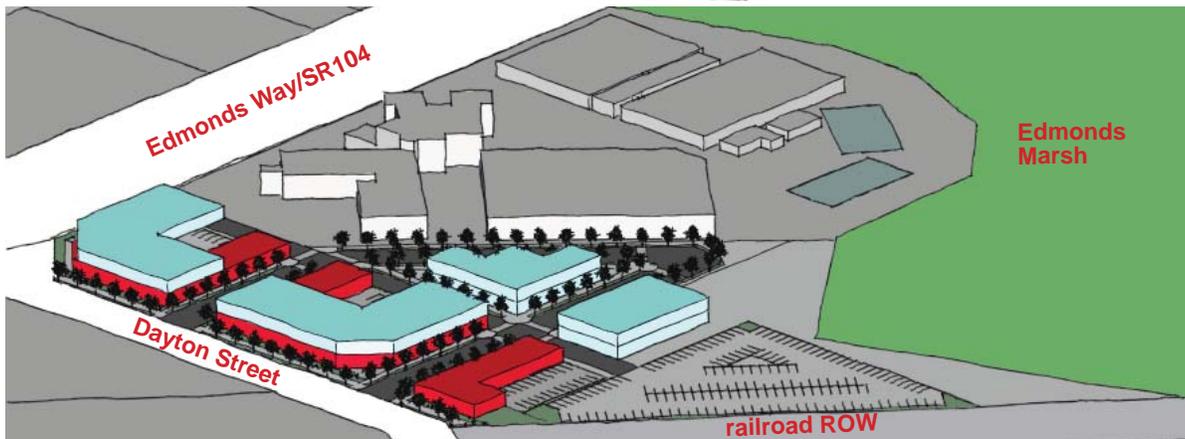
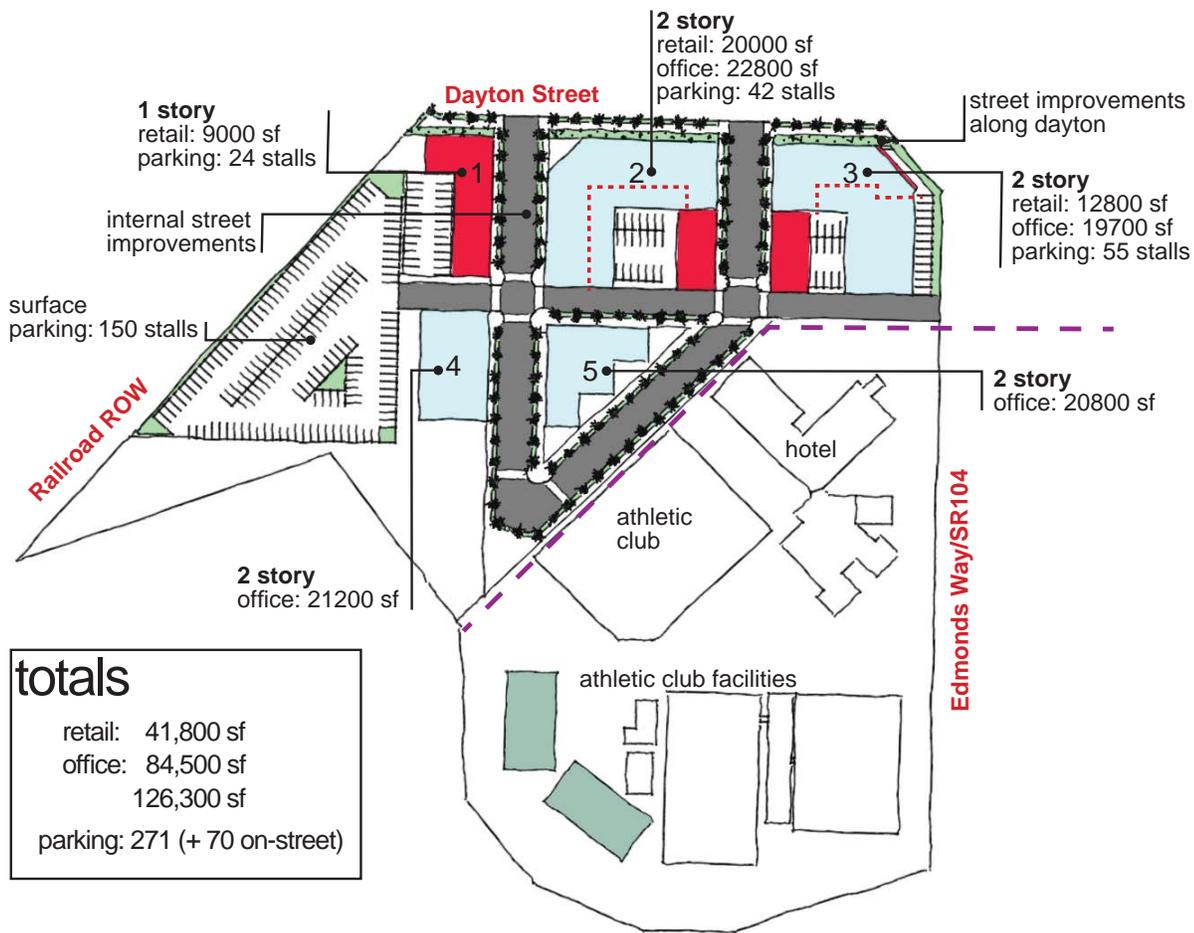
The most noteworthy potential environmental issue in regards to permitting with the City is the proximity to the Edmonds Marsh, a large wetland to the south. This wetland is likely a Category I or II and has significant buffer requirements (100-200 feet) for new development. However, since existing conditions of the property are already disturbed with urban development, there is likely some flexibility with the required buffers. The Critical Areas Ordinance (CAO) does allow additions to existing structures within wetlands buffers under certain criteria, but the code is unclear on what regulations would apply with a redevelopment and new use of a previously disturbed site.

In addition the property is located in proximity to Shellabarger/Willow Creeks which, support anadromous fish population. This proximity may require a special Critical Areas report to determine appropriate buffer distances and/or mitigation.

To determine the likely buffer/mitigation requirements, this issue should be discussed with the City in a pre application consultation. Consult Edmonds Development Code Section 23.40.070 for details of process.

SECTION II: REDEVELOPMENT UNDER EXISTING CODE AND CONTRACT REZONE

This section explores redevelopment as permitted by the current City code and contract rezone requirements that apply to site. This exercise seeks to address the following question: If the current buildings were removed, would it make economic sense to develop a new set of buildings that conform to the requirements and limitations imposed on the site? It is important to note that while much of the debate concerning redevelopment in this area has focused on height limitation, there are, in fact, numerous regulations that present severe restrictions on how the property could be used, some of which could have greater implications than height. This section will depict and discuss what could theoretically be developed, along with the economic feasibility of these options.



1. OFFICE RETAIL BASELINE SCENARIO

The Office Retail Baseline Scenario, developed by LMN, increases the square footage of office and retail available by about 25,000 SF and improves the circulation patterns on the property. Exhibit 2.2 shows preliminary financial analysis of redevelopment on Harbor Square following specifications in the Baseline Scenario.

In the Baseline analysis, average rent rates were assumed to be slightly higher than rates currently achieved at Harbor Square to reflect the effect of new construction and improved site layout. Vacancies were set at 10%, an improvement over the current Harbor Square vacancy rate of 30%.

BERK's rent and vacancy assumptions represent a best case scenario when market conditions improve. With the additional square footage, higher rents, and improved occupancy rates, the estimated value of Harbor Square ranges from \$18.0 M to \$20.6 M, about double its estimated value today. However, when the cost of construction is factored into the equation, the final value created is exceeded by construction costs (\$26.2 M) by \$5.6 M to \$8.2 M. Under this development scenario it is unlikely that a developer would consider redevelopment of Harbor Square as an office-retail mixed use development.

Baseline Redevelopment Analysis

Exhibit 2.2

Space Characteristics

Building Floorspace (SF)

Office	84,500
Retail	41,800
Total Space	126,300

Construction Costs

	\$/SF	Total
Estimated Land Acquisition Cost	\$20.00	\$3,205,580
Land Development and Demolition	\$3.00	\$718,740
Building Construction Costs		
Office	\$192.00	\$16,224,000
Retail	\$118.80	\$4,965,840
Total Construction Costs		\$25,114,160

Revenue Summary

Rent Revenue	\$/SF	Total
Office	\$20.00	\$1,690,000
Retail	\$18.00	\$752,400
Vacancy		
Office	10%	-\$169,000
Retail	10%	-\$75,240
Total Net Revenue		\$2,198,160
Operating Expenses		
Office	\$6.00	\$507,000
Retail	\$6.00	\$250,800
Total Operating Expenses		\$757,800
Net Operating Income (NOI)		\$1,440,360

Valuation

Cap Rate	Capitalized Value
7.0%	\$20.6 M
7.5%	\$19.2 M
8.0%	\$18.0 M
Total Costs	\$25.1 M
Value Creation/Loss (Value minus Const. Costs)	-\$4.5 M to -\$7.1 M

Source: BERK, 2009

2. FINANCIAL ANALYSIS OVER TIME

In addition to the snapshot perspective of Exhibit 2.2, BERK developed a detailed pro forma to estimate the costs of development, cash flow, debt and returns for the Office Retail Baseline Scenario over ten years of operations.

Given the current development and financial climate, financing at 8% was assumed with a loan-to-value ratio of 50%, requiring a substantial developer/investor contribution. For the purposes of this pro forma it was assumed that the property would be sold in year ten. Under this set of assumptions, the Baseline Scenario under current zoning standards produces the following Internal Rates of Return (IRRs):

- **Retail 7.1%**
- **Office 5.0%**
- **Project Total 5.6%**

The IRR is an annual average rate of return that is the most common measure of financial performance for an income property such as Harbor Square. Typically an IRR of over 15% is desirable but with threshold-level assessments, some developers would study a project further with IRRs of 12%.

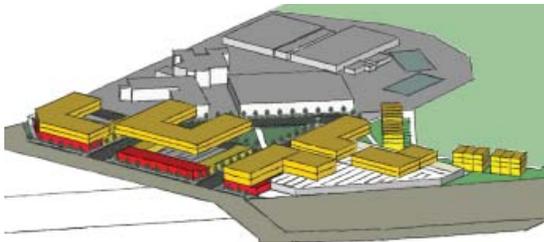
It is unlikely that the Baseline Scenario would be feasible for development due to the low IRRs. In addition, some risks involved with this scenario have not been factored into the analysis and may reduce the feasibility, including:

- The scenario basically replaces what exists today, presumably in an upgraded form. Upgrades would require higher rents than are currently collected and creates the risk that the current tenants would not renew their leases and the new space would be subject to higher vacancy rates.
- Financing is a limiting factor in today's market. A significant equity contribution was assumed in this preliminary assessment. Eventually, a developer/investor might be able to increase their leverage, but the increase in debt will reduce cash flow, which depending on the interaction of other factors could lower the IRR.
- It is not clear that the City of Edmonds has a market demand for additional office and commercial space. Studies such as the 2004 Heartland Redevelopment Analysis, which included Harbor Square in their findings, concluded that there is limited market potential for new office space in Edmonds.

SECTION III: REDEVELOPMENT UNDER NEW CONTRACT REZONE

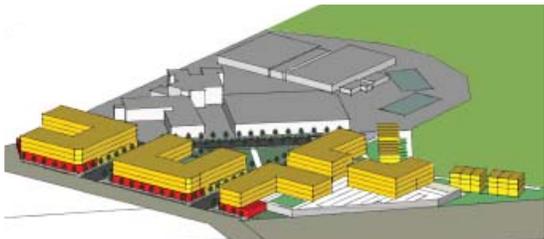
Based on the economic and market assessment, this section examines three redevelopment alternatives for Harbor Square, both of which require different rezone considerations. The first would request to modify current zoning and land use regulations to allow residential use, greater lot coverage, and lower parking ratio (but not height). The second alternative includes those changes plus an increase in building height. Financial analysis is provided for each and site plan and the overall arrangement of buildings, street, amenities, and possible phasing are shown in site plan and massing drawings. This analysis brackets possible strategies for phasing of regulatory changes and development over time. A potential “land swap” internal to the development is also examined to allow for a different arrangement of uses in recognition of the adjacency to a busy rail line with noise and vibration impacts.

This phase of financial analysis addresses all three redevelopment scenarios:



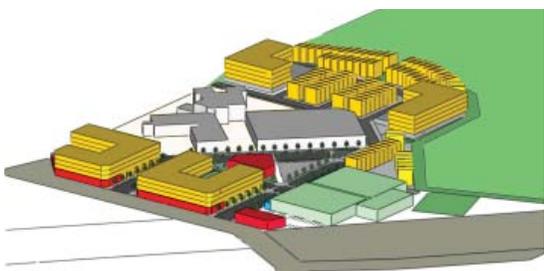
Alternative I:

1. 35' Mixed-use Residential Option – a condominium/retail configuration that stays within the existing 35' height limits on the property.



Alternative II:

2. 3-5 Story Mixed-use Residential Option – a condominium/retail configuration that exceeds the 35' height limit with a mix of three to five story buildings.



Alternative III:

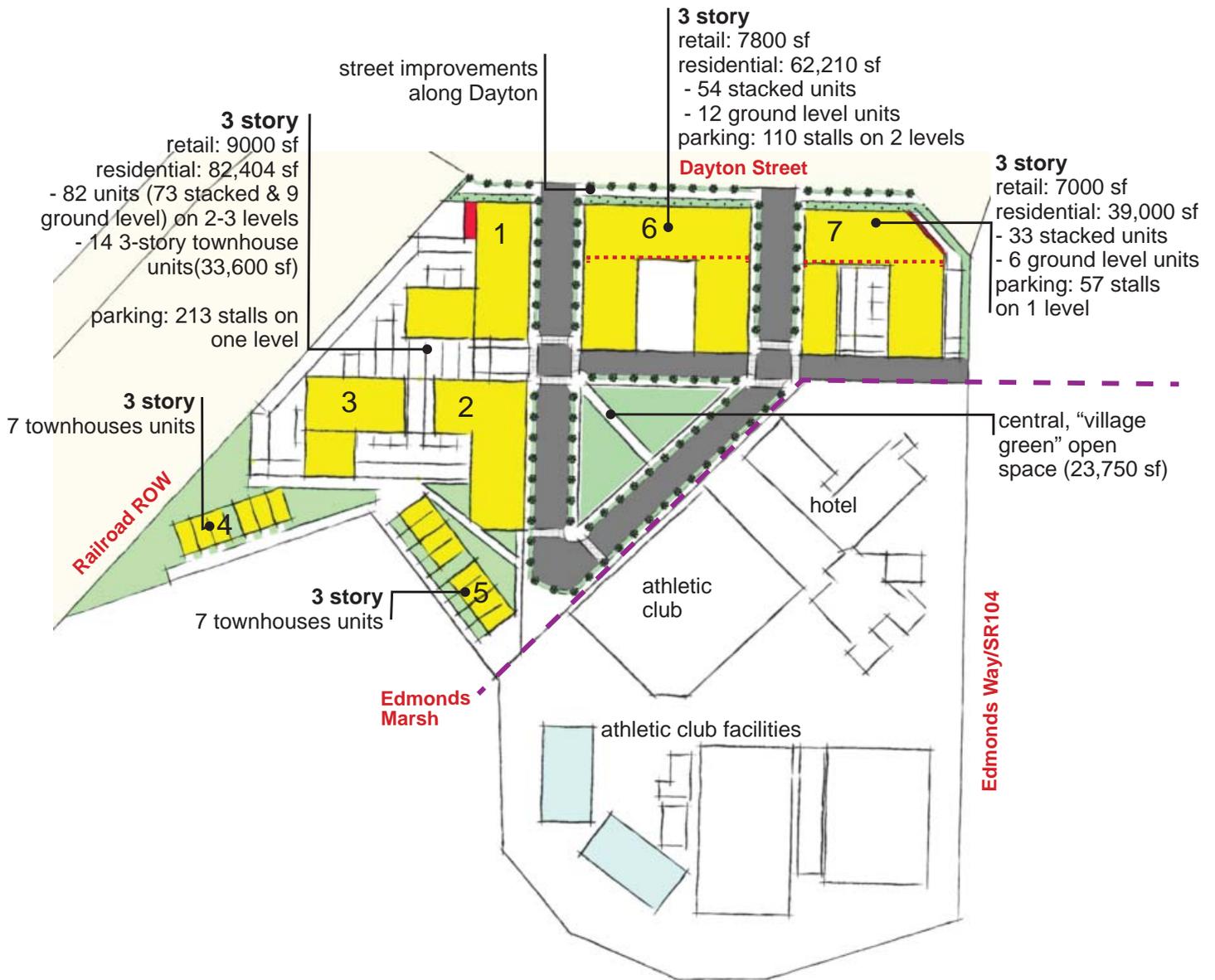
- 3.a Land Swap Option – a condominium/retail/townhouse configuration that exceeds the 35' height limit with a mix of three to five story buildings. The defining characteristic of this scenario is a land swap whereby the existing Harbor Square tennis courts are moved adjacent to the railroad and a cluster of townhouses are built adjacent to the marsh at the south end of the property.



- 3.b A second variation is also shown on the Land Swap Option that substitutes additional stacked condominiums for the townhouses. The financial performance of this scenario was not explicitly modeled in this analysis.

These scenarios are considered to be Transit Oriented Developments (TOD). TODs locate housing, jobs, and other services close to transit (like the newly revitalized Edmonds Station). This type of development can help reduce reliance on automobiles by creating walkable access to and from transit. It lessens traffic impacts on the City and helps meet several environmental, social, and economic objectives.

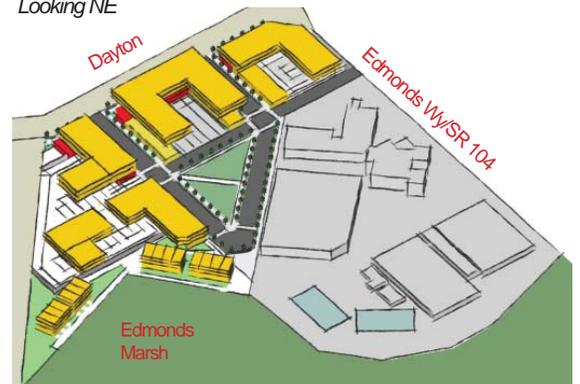
35' MIXED-USE



Looking SE



Looking NE



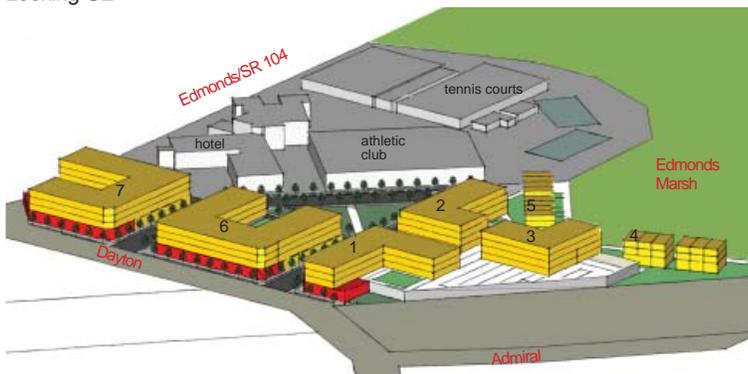
1. 35-FT MIXED-USE RESIDENTIAL OPTION

A. Economic Viability	
<u>Pros</u> <ul style="list-style-type: none">• Under the right market conditions, this scenario can be financially feasible.• As a smaller project, this option could be seen as a safer investment.• According to the Urban Land Institute (ULI), residential properties for sale near commuter rail stops consistently enjoy price premiums. For example, San Diego experienced a 17% boost in property values. commuter rail.	<u>Cons</u> <ul style="list-style-type: none">• The 35' option's potential return is slimmer and not buffered from market uncertainties and other risks.• The property with a 35' height limit is less valuable to a developer than a property with a higher height limit.
B. Flexibility to adapt to future market conditions, to new infrastructure (e.g., potential ferry terminal overpass), and to address site conditions unknown at this time (e.g., water table, hazardous clean up).	
<u>Pros</u> <ul style="list-style-type: none">• The site's proximity to multimodal transportation facilities makes a mixed-use transit-oriented development more appropriate in the future than the current one- and -two story auto-oriented commercial uses.	<u>Cons</u> <ul style="list-style-type: none">• Precludes opportunity to provide more housing units should the market support a higher density on the site in the future.• Building 6 depends on the ability to provide subterranean parking w/o complete assurance of its feasibility.
C. Consistency with City Goals and Policies for the Area (Comprehensive Plan, Downtown Master, etc.)	
<u>Pros</u> <ul style="list-style-type: none">• Consistent with Downtown Waterfront Plan Policies (mixed-use development, pedestrian oriented Dayton Street, support more active retail, design-driven master planned development.• Pedestrian-scale development should be implemented through zoning regulations and design guidelines.• Encourage a variety of housing to serve a diverse community Transit-oriented development (TOD)	<u>Cons</u> <ul style="list-style-type: none">• Downtown Master Plan Waterfront District suggests taller buildings outside current view corridors at the bottom of the "bowl" could be appropriate. This option does not take advantage of this possibility.
Required Changes to the Zoning Code	
<ul style="list-style-type: none">• Permitted Use (multi-family residential)• Maximum Square Footage (218,000 sf currently allowed)• Lot Coverage (32% currently allowed)• Setbacks: 25 ft building setback from Dayton and Sunset; 10 ft parking setback from Dayton and Sunset.• Parking Ratios<ul style="list-style-type: none">- Retail - existing code: 1/300 sf; proposed: 1/1000 sf + on-street parking- Restaurant-existing code: 1/200 sf; proposed: 1/1000 sf + on-street parking	

3-5 STORY MIXED-USE



Looking SE



Looking NE



2. 3-5 STORY MIXED USE OPTION

A. Economic Viability

Pros

- Potential returns increase with denser development options.
- Taller 3-5 story buildings would provide more views and potentially higher sales prices.

Cons

- Risk of putting more units on the market at a faster pace than market can absorb.
- Risk reducing “uniqueness” of development if too much of the same type of product is offered.

B. Flexibility to adapt to future market conditions, to new infrastructure (e.g., potential ferry terminal overpass), and to address site conditions unknown at this time (e.g., water table, hazardous clean up).

Pros

- Commuter rail station can support higher density and range of households. Mix of housing types and retail could appeal to a younger commuter demographic.
- Increased height makes it more attractive to potential developers.
- Does not require 5’ below grade for parking podium.

Cons

- Building height is a very sensitive issue in the community

C. Consistency with City Goals and Policies for the Area (Comprehensive Plan, Downtown Master Plan, etc.)

Pros

- Downtown Master Plan Waterfront District suggests taller buildings outside current view corridors at the bottom of the “bowl” could be appropriate.
- Consistent with Downtown Waterfront Plan Policies (mixed-use development, pedestrian oriented Dayton Street, support more active retail, design-driven master planned development.
- Pedestrian-scale development should be implemented through zoning regulations and design guidelines.
- Encourage a variety of housing to serve a diverse community.
- Transit-oriented development (TOD): Encourage transit service and access
- Provides public benefit in the form of improved public realm (streetscapes, central plaza)

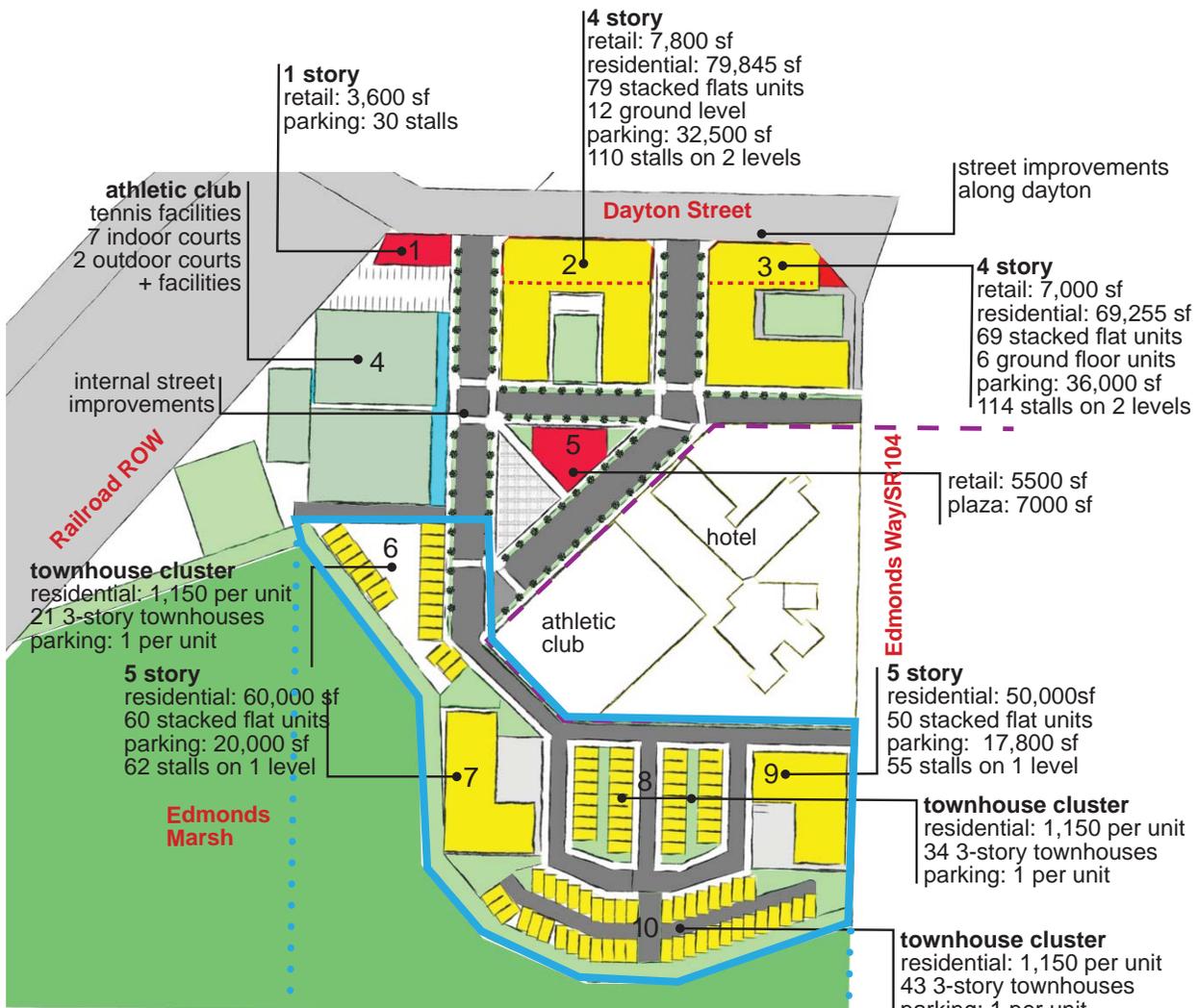
Cons

- Policy E.14: “Height limits that reinforce and require pedestrian-scale development ...” : this can be a subjective judgment in the contract re-zone process.
- Meeting 16.60.005.E., “sensitive to surrounding neighborhoods” could present a challenge, again given the subjective nature of this criterion.

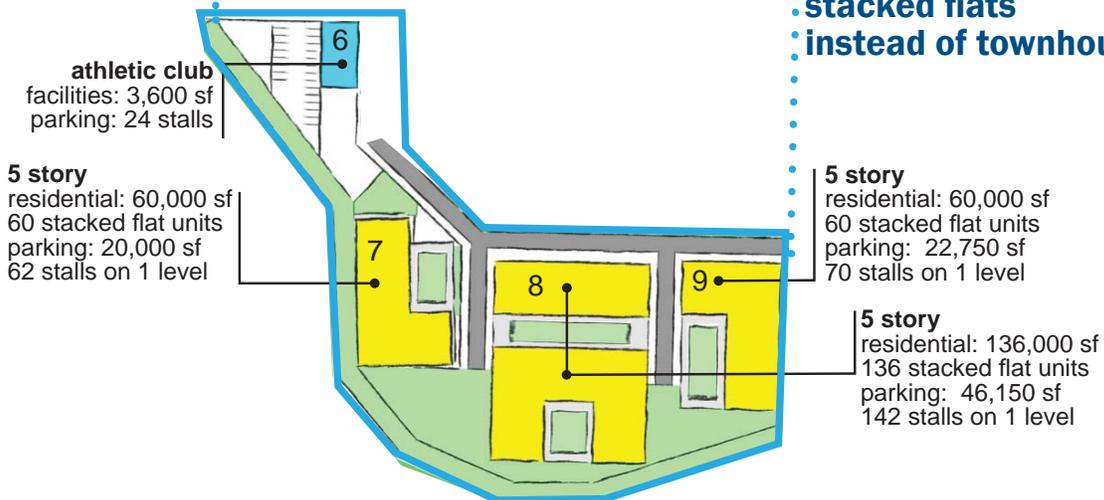
Required Changes to the Zoning Code

- Increase Maximum Height from 35’ to approximately 55-60’
- Permitted Use (multi-family residential)
- Maximum Square Footage (218,000 sf currently allowed)
- Lot Coverage (32% currently allowed)
- Setbacks: 25 ft building setback from Dayton and Sunset; 10 ft parking setback from Dayton and Sunset.
- Parking Ratios
- Retail - existing code: 1/300 sf; proposed: 1/1000 sf + on-street parking
- Restaurant-existing code: 1/200 sf; proposed: 1/1000 sf + on-street parking
- Residential – existing code: 1.2 – 2.0 spaces/unit (studio to 3 br); proposed: 1/unit

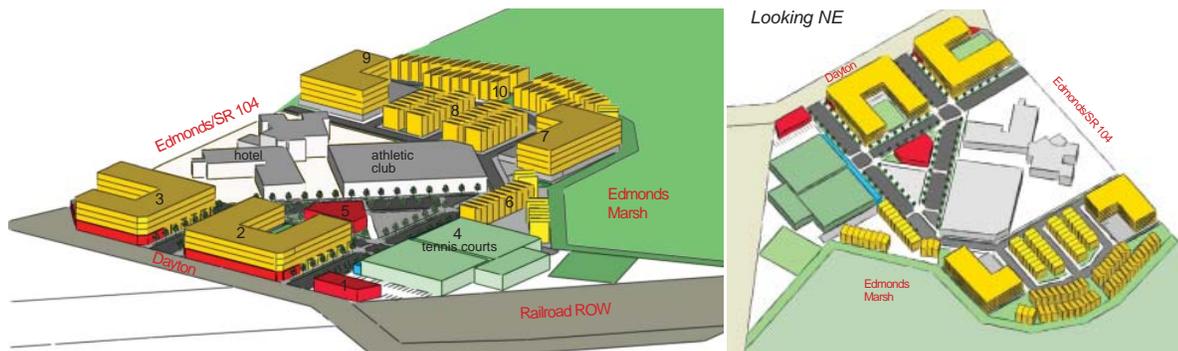
LAND SWAP OPTIONS



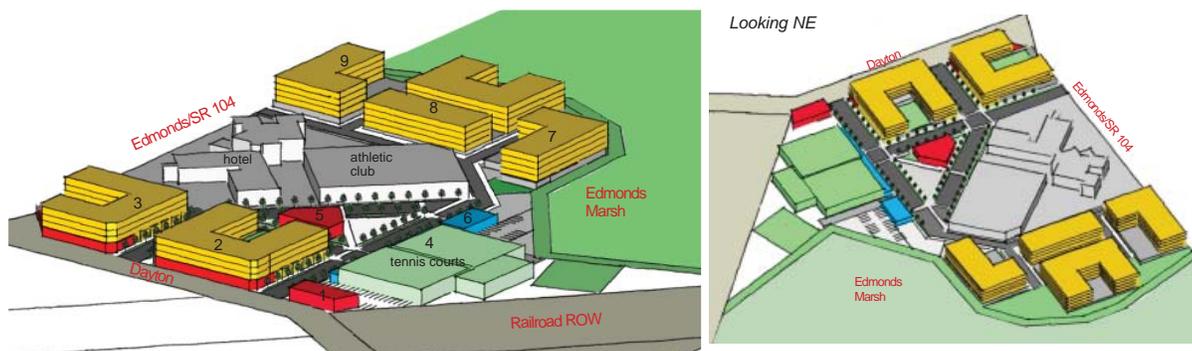
alternative configuration with stacked flats instead of townhouses



3.A. LAND SWAP OPTION – TOWNHOUSE EMPHASIS

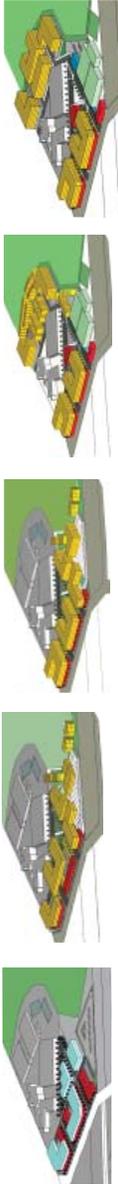


3.B. LAND SWAP OPTION- STACKED FLATS



3.A. LAND SWAP OPTION – TOWNHOUSE EMPHASIS

A. Economic Viability	
<u>Pros</u> <ul style="list-style-type: none"> • Highest potential number of units. Potential returns increase with denser development options. • Taller 4-5 story buildings would provide more views and potentially higher sales prices. • Majority of units oriented to the Marsh - a unique natural setting and amenity. • More fully integrates Athletic Club and Tennis Courts into a new mixed-use community. • Potential for a restaurant in central plaza as a higher rent retail option. • Moves residential components away from the railroad to mitigate noise concerns. 	<u>Cons</u> <ul style="list-style-type: none"> • Risk of putting more units on the market at a faster pace than market can absorb • Three-level townhouses may not appeal to retiree market • Contingent on agreement with athletic club owner.
B. Flexibility to adapt to future market conditions, to new infrastructure (e.g., potential ferry terminal overpass), and to address site conditions unknown at this time (e.g., water table, hazardous clean up).	
<u>Pros</u> <ul style="list-style-type: none"> • Commuter rail station can support higher density and range of households. Mix of housing types and retail could appeal to a younger commuter demographic. • Taller building heights and greater development capacity gives flexibility to provide more housing units. • Does not require 5' below grade for parking podium. 	<u>Cons</u> <ul style="list-style-type: none"> • Development feasibility of area adjacent to the Marsh has not been studied.
C. Consistency with City Goals and Policies for the Area (Comprehensive Plan, Downtown Master Plan, etc.)	
<u>Pros</u> <ul style="list-style-type: none"> • Same as 2.C., above 	<u>Cons</u> <ul style="list-style-type: none"> • Same as 2.C., above
Required Changes to the Zoning Code	
<ul style="list-style-type: none"> • Increase Maximum Height from 35' to approximately 55-60' • Permitted Use (multi-family residential) • Maximum Square Footage (218,000 sf currently allowed) • Lot Coverage (32% currently allowed) • Setbacks: 25 ft building setback from Dayton and Sunset; 10 ft parking setback from Dayton and Sunset. • Parking Ratios • Retail - existing code: 1/300 sf; proposed: 1/1000 sf + on-street parking • Restaurant-existing code: 1/200 sf; proposed: 1/1000 sf + on-street parking • Residential - existing code: 1.2 - 2.0 spaces/unit (studio to 3 br); proposed: 1/unit 	



Alternative Development Scenario Comparisons

Current Conditions		Redevelopment under Current Regulations	Redevelopment under Amended Regulations			
			Amend Uses, Setbacks, Lot Coverage and Parking Ratios	Amend Uses, Setbacks, Lot Coverage, Parking Ratios, and Height		
		35' Office Mixed Use	35' Mixed Use	3-5 Story Stacked Flats	Land Swap Townhouses	Land Swap Stacked Flats
Commercial Space	102,450 sf (buildings 1-5)	41,800 sf 84,500 sf (office)	48,180 sf	23,800 sf	23,900 sf	23,900 sf
Residential Units	none	none	155 units 155,000 sf	333 units 333,000 sf	374 units 372,000 sf	422 units 422,000 sf
Parking Stalls	195 surface stalls (buildings 1-5)	341 surface	221 structured	430 structured	341 structured	496 structured
Building Height	35'	35'	70 surface/on street	70 surface/on street	198 surface/on street	84 surface/on street
Public Open Space	none	none	20,000 sf* 25K sf sidewalks	20,000 sf* 25K sf sidewalks	7000 sf plaza* 36K sf sidewalks	7000 sf plaza* 36K sf sidewalks

*Note: Not factored into the costs considerations are the open space and plaza improvements, estimated at about \$20 per SF and \$30 per SF respectively.

4. FINANCIAL ANALYSIS ASSUMPTIONS

BERK conducted financial analysis to estimate internal rates of return, net present value, and project costs associated with the three redevelopment alternatives developed by LMN.

The timing of development is a fundamental issue in this analysis. It made little sense to model a redevelopment assuming today's weak market conditions and financial markets assumptions that reflect a recovered market, at least 3-4 years from now, if not longer, were used.

Several variables, including construction cost, unit sales price, sales pace (the number of sales per month), and project financing are critical inputs into the project feasibility analysis. It is particularly difficult to estimate these variables in a market several years in the future given the recent economic downturn and volatility in the real estate market. That said, listed below are some assumptions that can be reasonably made using market data from today and recent years.

Construction Costs

We used Quarterly Construction Cost Reports from Rider Levett Bucknall (RLB) for construction cost estimates and also spoke to Simon Squire, principal in the RLB Seattle office, to get his insights. RLB compiles per square foot construction cost data each quarter by metro area (Seattle) and by project type (Multifamily Residential, Class A Office Space etc.). A few things to note about the Q2 09 data and our final construction cost assumptions:

- Compared to Q2 08, residential construction costs for single family and multifamily homes are down 11%.
- According to RLB, costs may be down by as much as 20-25% over the prior year on projects with multiple bids.
- No one knows exactly how construction costs will shift in the coming years, but the general expectation in the market is that costs will continue to decline over the next year and may stabilize for a period of several years.
- For cost assumptions in this analysis, we decided to take current cost estimates and discount them by 10% based on RLB's projection for the next 4-5 years to reflect the expected construction slow down and possible stabilization for the near- and mid-term market.

Condominium and Retail Mixed-Use

- Multifamily residential cost estimates include an average cost for retail space and covered parking
- Current estimates for a typical "five-over-one" mixed-use multifamily project are \$165 per SF made up of the following components:
 - Retail at \$110 per SF
 - Residential units at \$197 per SF
 - Covered parking at \$60 per SF

Townhouses

The scenarios examined in this second phase of the project include townhouse units in addition to condominiums.

- RLB estimates for single-family residential construction were used as a basis for estimating townhouse construction costs.
- Differences between the estimates for this property type are primarily driven by site preparation costs, roofing materials and external cladding materials. Interior finishes have little impact on overall costs per square foot. The lack of elevators is one factor differentiating townhouse construction costs from multifamily costs.

Exhibit 3.1 summarizes the basic construction cost assumptions used in the pro forma analysis of Harbor Square development scenarios.

Summary of Construction Cost Assumptions

Exhibit 3.1

	Cost Base (\$ per SF)	Reduction Factor	Final Cost Estimate
Building Type			
Stacked Condo	\$197.00	10%	\$177.30
Townhouse	\$182.50	10%	\$164.25
Retail	\$110.00	10%	\$99.00
1-Level Parking	\$60.00	10%	\$54.00
2-Level Parking	\$65.00	10%	\$58.50

Source: Rider Levett Bucknall 2Q 2009 Quarterly Construction Cost Report and BERK, 2009

Unit Sales Price

Using sales data from the Snohomish County Assessor's Office BERK reviewed condominium sales prices from 2006 through 2009. Exhibit 3.2 shows average costs per square foot for all condominium sales in Edmonds as well as the number of units sold each year. Sales in the Point Edwards condominium project are highlighted separately because this project represents a higher-end product with view, and on-site amenities and because the Port of Edmonds has indicated that it is interested in a higher-end product if Harbor Square is redeveloped.

- Sales data indicate that after strong price increases in 2007 and 2008, the condo market has crashed and prices have dropped significantly in the past year.
- The weighted average sales price between 2006 and 2009 is \$296 per SF for all Edmonds condos and \$466 per SF for Point Edwards condos. These values served as reference points when deciding on the baseline sales prices to assume for the Harbor Square scenarios.
- The number of units sold data show that the Edmonds market can support about 250 condo sales per year in a healthy market and much less in today's market (2009 sales are on pace for fewer than 100 condo sales).

Edmonds Condominium Sales Characteristics, 2006-2009

Exhibit 3.2

Year	All Condos (Including Pt Edwards)			Point Edwards Condos Only		
	Number Sold	Avg. Sale Price (\$/SF) (2009\$)	% Change in Sale Price	Number Sold	Avg. Sale Price (\$/SF) (2009\$)	% Change in Sale Price
2006	263	\$267	-	31	\$380	-
2007	255	\$309	15.9%	39	\$464	22.0%
2008	160	\$327	5.7%	32	\$573	23.6%
YTD 2009	35	\$278	-14.8%	9	\$395	-31.2%
Weighted Avg. Sale Price (06-09)		\$296			\$466	

Source: BERK, 2009 Note: Average unit sale price rounded to nearest \$1000

Based on the historical sales data a baseline sales price assumption of \$400 per SF for condominiums was used in the analysis. Townhouses, which are often larger than condominiums, typically sell for a lower price per SF. For this analysis, a baseline assumption of \$275 per SF was used, which is about two-thirds the condo price per SF. Exhibit 3.3 shows the average unit size in each scenario and the average total sales price per unit.

Average Unit Size and Sales Price Assumptions

Exhibit 3.3

Scenario	Unit Type	"Avg Unit Size (SF)"	"Sale Price (\$ per SF)"	"Avg Unit Sale Price"
35' Mixed-Use	Condominiums	982	\$400	\$393,000
	Townhouses	2,400	\$275	\$660,000
3-5 Story Mixed-Use	Condominiums	991	\$400	\$397,000
	Townhouses	2,400	\$275	\$660,000
Land Swap Townhouses	Condominiums	939	\$400	\$376,000
	Townhouses	1,150	\$275	\$316,000

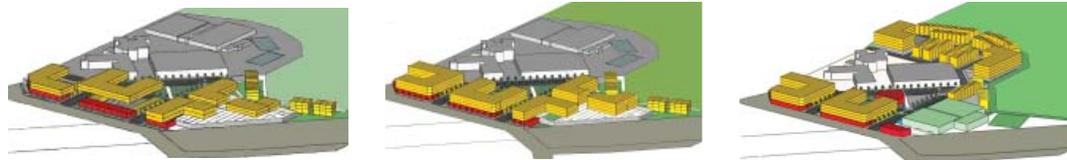
Source: BERK, 2009

Financing

Just as it is difficult to predict what the future will hold for construction costs or sales prices, financing is subject to multiple factors. Even in stable economic times, loan rates and terms will vary based on the borrower, the lender, and the project specifics. This analysis assumed a typical financing structure for residential for-sale projects – a two year interest-only, variable rate construction loan (often subject to a one year extension) that is paid off using the sales proceeds. For the retail portion of the project an initial construction loan that converts to permanent, fixed rate amortized financing was assumed. Specific financing assumptions include the following:

Interest Rate	6%
Loan to Value	80%
Fees	1% of loan amount
Loan Term (permanent financing)	10 years

There is no guarantee that a developer would get the rate and terms assumed for this analysis. However, they represent a favorable, post recession financing assumption.



Internal Rate of Return of Vertical Development by Use

Exhibit 3.4

Internal Rate of Return

Use Type	35' Mixed-Use	3-5 Story Mixed-Use	Land Swap Townhouses
Retail	15.9%	15.9%	15.9%
Stacked Condominiums	39.2%	29.0%	32.6%
Townhouses	38.1%	38.1%	18.7%

Source: BERK, 2009

5. FINANCIAL ANALYSIS FINDINGS AND SENSITIVITY ANALYSIS

Relative Returns – Individual Uses

Exhibit 3.4 shows the internal rate of return (IRR) of each individual use (retail, condominiums, and townhouses) in each scenario under baseline assumptions. For comparison purposes, these return metrics are based only on the basic development costs and revenues of the vertical development (i.e. the buildings excluding land acquisition and site preparation costs, which are shared by all components of the project). These metrics are meant to show the relative returns contributed by each use type to the development.

- The retail configurations in each scenario are essentially the same and have very similar IRR.
- The condominium and townhouse components bring in the highest rates of return.
- The time value of money concept is demonstrated well by the townhouse IRR values. In the 35' and 3-5 Story scenarios there are only 14 townhouses that sell in the first year after construction. In the Land Swap scenario 98 townhouses are sold over the course of three years. Spreading the sales over time drives the IRR down (from 38.1% to 18.7%).

Estimated Returns and Sensitivity Analysis– Entire Development

In order to understand the relative risk inherent in each of the development options a threshold-level sensitivity analysis was conducted by varying two assumptions driving the performance of each scenario: the average sales price (\$ per SF) and the average pace of sales (units sold per month) for residential units. Other variables including construction costs, financing terms, and retail rents were held constant. The difference in \$ per SF between townhouses and stacked condominiums is based in part on comparables in the market, where the 2/3 ratio between the sales price townhouses and condos held true for developments in North Seattle, such as Haller Lake and Northgate. Also, construction costs play a role, since condos require elevators and typically demand higher end finishes in this tier of the market.

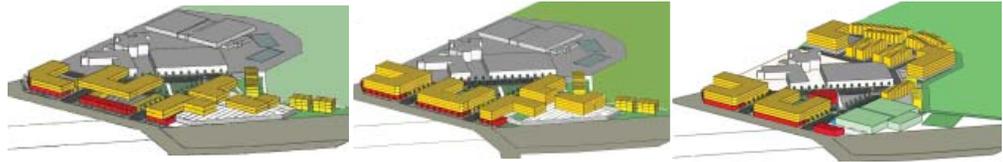
For a pro forma analysis of a prospective project not feasible for several years, this threshold-level of sensitivity analysis is likely sufficient to get a sense of the opportunities and risks involved with redevelopment. If the Port decides to pursue any of these alternatives seriously once the real estate market recovers, it will need to push the pro forma and sensitivity analysis further and truth-check more of the market, development, and financial assumptions.

Sensitivity Analysis Assumptions			
Exhibit 3.5			
Sensitivity Analysis Range of Assumptions			
Assumption	Baseline	High	Low
Sales Price (\$ per SF)			
Stacked Condominiums	\$400.00	\$450.00	\$350.00
Townhouses	\$275.00	\$300.00	\$250.00
Sales Pace (Units sold per month)			
Stacked Condominiums	6.0	8.0	4.0
Townhouses	3.0	4.0	2.0

Source: BERK, 2009

Exhibit 3.5 shows the range of sales price and sales pace assumptions used in the sensitivity analysis.

Exhibit 3.6 shows how final IRR and NPV estimates for each development scenario vary depending on the price and pace of residential units. Project costs, loan amount, and equity contribution are also included. Unlike the values presented earlier in Exhibit 3.4, these return metrics incorporate the cost of land acquisition and site preparation.



IRR, NPV, and Project Costs for Entire Development by Sensitivity Scenario

Exhibit 3.6

Internal Rate of Return			
Sensitivity Scenario	35' Mixed-Use	3-5 Story Mixed-Use	Land Swap Townhouses
Baseline Price and Pace	18.9%	20.5%	20.7%
High Sales Price	30.0%	28.3%	29.2%
High Sales Pace	22.1%	24.5%	25.3%
High Sales Price and Pace	34.4%	34.9%	36.7%
Low Sales Price	7.8%	11.6%	11.2%
Low Sales Pace	15.4%	15.5%	15.9%
Low Sales Price and Pace	6.7%	9.2%	8.8%
Net Present Value			
Sensitivity Scenario	35' Mixed-Use	3-5 Story Mixed-Use	Land Swap Townhouses
Baseline Price and Pace	1.9 M	5.2 M	5.0 M
High Sales Price	7.5 M	13.5 M	13.1 M
High Sales Pace	3.0 M	7.8 M	7.4 M
High Sales Price and Pace	8.6 M	16.8 M	16.2 M
Low Sales Price	-3.7 M	-3.1 M	-3.1 M
Low Sales Pace	0.3 M	0.6 M	1.0 M
Low Sales Price and Pace	-4.8 M	-6.4 M	-6.2 M
Total Project Costs and Equity Contribution			
Total Project Cost	62.3 M	91.7 M	93.7 M
Loan Amount	49.9 M	73.4 M	74.9 M
Equity Contribution	12.5 M	18.3 M	18.7 M

Using baseline assumptions, both scenarios have reasonable IRR values and would be worth considering as a possible investment. The larger scenario provides a greater return above the threshold discount rate (about \$5 M NPV) than the 35' Mixed-use scenario (about \$2 M NPV).

Sales price has the strongest effect on potential returns and financial feasibility of all three development scenarios. The pace of sales has a less pronounced effect. Under the low sales price assumption, the 35' Mixed-use scenario is not feasible and the 3-5 story is a borderline project.

The project costs and equity contribution are included as a reference to the relative size of these scenarios and the relative level of financial commitment required for redevelopment. The 3-5 Story and Land Swap Options are both larger projects with costs over \$90 M and equity contributions over \$18 M, while the 35' Mixed-use Option costs about \$62 M with an equity contribution of \$12.5 M.

6. FINAL ASSESSMENT AND OTHER CONSIDERATIONS

The threshold level pro forma analysis indicated that under the right market conditions both development scenarios are potentially feasible. As the Port moves forward with additional analysis of development options for the Harbor Square property, there are several major unknowns and risk factors that should be kept in mind and studied further.

1. Geological and Environmental Factors. There are significant unknowns regarding the geotechnical constraints on redevelopment presented by potential soil contamination or environmental impact issues related to the adjacent protected marsh area. These issues have particular impact on the 35' Mixed-use scenario because the plans call for excavation five feet underground to make space for two floors of condominiums above a first floor of retail. If the excavation is cost-prohibitive, redevelopment of this scenario becomes much less feasible.

The Land Swap scenario could also be significantly affected by environmental constraints since the development feasibility on the areas adjacent to the marsh has not yet been studied sufficiently

2. Market Uncertainties and Risks. There are several market factors that feed into the likelihood that each of the redevelopment scenarios will achieve assumed sale prices and volumes. As shown in the sensitivity analysis, a \$50 per SF swing in sales prices can make or break any of the development options. A few of the important market factors to highlight include:

- Market Segment – The market segment most often mentioned as an opportunity in Edmonds is the retiree market. Harbor Square's proximity to the waterfront and Downtown Edmonds and proposed mix of amenities and retail options will appeal to this market segment. However, other aspects of the proposed scenarios, such as three-floor townhouses with stairs may not appeal to the retiree market. Another market segment that could be targeted with this development is a younger demographic that would utilize the nearby multi-modal transit hub and commute to employment centers by train. This market of working professionals and families would be more amenable to the townhouse units and smaller condominium units.
- Other Factors (Views, Noise, etc.) – The pro forma analysis does not differentiate significantly between the scenarios based on other market factors such as views and noise impacts. It is likely that the taller buildings in the 3-5 Story Option and the Land Swap Option would provide more attractive views and justify higher sales prices. On the flip side, the noise impacts on any development near the railroad have not been factored explicitly into this analysis.
- Pipeline Development – Both proposed development scenarios are large for the Edmonds market and it is important to understand what else is being built in the area in order to estimate the likelihood that an appropriate sales pace and price can be maintained.

4. Land Swap Uncertainties. The Land Swap scenario is contingent on an agreement with the property owner of the tennis courts. At this point it was impossible to model the potential sale and swap agreements required for this scenario. These issues should be revisited if negotiations proceed further with this property owner.

5. Importance of Flexibility on Market Value and Financial Feasibility. One factor that is not adequately reflected in the threshold pro forma analysis is the effect that additional height allowances in the zoning code would have on the financial feasibility of redevelopment. If the Port were successful in increasing the height allowance on the property, the project becomes much more attractive to potential developers. The additional height provides flexibility to vary the mix and configuration of uses on the property, mitigate unforeseen environmental or regulatory constraints, and react appropriately to market shifts.

6: Impact of Phasing on Financial Analysis. The initial development scenarios were modeled at a threshold level without factoring in likely phasing of construction. This approach has a particularly strong effect on the larger 3-5 Story and Land Swap scenarios because the residential units would be sold over the course of five to six years. If construction and sales were phased, the financial returns for this scenario would improve since the developer would not have to hold on to construction debt for as long.

7. RESIDUAL LAND VALUE ANALYSIS

The previous sections presented financial returns for each development scenario from the perspective of a developer purchasing the Harbor Square property from the Port of Edmonds. An important determination for the Port to consider is which scenario presents the greatest potential financial return if it did sell Harbor Square. The Port must also consider the value of the property today and under what conditions it makes financial sense to sell the property.

Exhibit 3.7 shows the same information on current Harbor Square operations presented earlier in Exhibit 1.1. According to this analysis, the Harbor Square property is worth between \$7.0M and \$8.1M under current operations.

An “Improved Operations” scenario was created to show what the property could be worth if the Port invested in tenant improvements and other amenities. Under this scenario, vacancies are reduced to 20%, average rent is increased to \$18.00 per SF, and the value of the property increases to \$9.5M - \$10.8M. Initial tenant improvement costs to achieve these improved rents and occupancy rates could range from \$2M-\$3M (\$20-\$30 per SF).

The valuation estimates of current and improved operations at Harbor Square are useful reference points to use when evaluating the residual land value under each redevelopment scenario.

Harbor Square Valuation: Current and Improved Operations		
exhibit 3.7		
Space Characteristics		
Building Floorspace (SF)	Current Operations	Improved Operations
Leased Space	71,345	81,960
Space Available	31,105	20,490
Total Space	102,450	102,450
Percent Vacant	30%	20%
Cost Summary		
Estimated Total Annual Operating Expenses	\$534,754	\$718,095
Operating Expenses as % of Total Revenue	49%	49%
Income Summary		
Rent Rates		
Average for all Tenants	\$15.40	\$18.00
Gross Monthly Income (as of May 1, 2009)	\$91,551	\$122,940
Estimated Annual Income	\$1,098,617	\$1,475,280
Net Operating Income (NOI)	\$563,863	\$757,185
Valuation		
Cap Rate	Capitalized Value	
7.00%	\$8.1 M	\$10.8 M
7.50%	\$7.5 M	\$10.1 M
8.00%	\$7.0 M	\$9.5 M
Source: BERK, 2009		



Residual Land Value: Net Present Value of Vertical Development

exhibit 3.8

Net Present Value

	35' Mixed-Use	3-5 Story Mixed-Use	Land Swap Townhouses
Scenario			
Retail	0.1 M	0.1 M	0.1 M
Stacked Condominiums	7.8 M	10.8 M	10.3 M
Townhouses	0.5 M	0.5 M	0.5 M
Total Development	7.9 M	10.9 M	10.6 M
Residual Land Value (\$/Lot SF)	\$25.56	\$35.26	\$34.39

Source: BERK, 2009 Note: NPV calculated using discount rate of 15%

Residual land value analysis is basically the calculation of what a developer or owner occupant can afford to pay for the underlying dirt, considering the value of the completed project as proposed.

Exhibit 3.8 shows the Net Present Value (NPV) for each scenario when land acquisition costs are removed from the pro forma and only vertical development is modeled. A 15% discount rate is used in the NPV calculations to represent the developers expected profit. The value of vertical development, minus the developer's profit, leaves the residual land value. In other words, the NPV residuals shown in Exhibit 3.8 represent the theoretical maximum a developer would be willing to pay for land and other associated costs not included in the base vertical development pro forma (e.g. entitlement costs, environmental cleanup, etc.).

The residual NPV ranges from \$7.9M in the 35' Mixed-Use Scenario to almost \$11 M in the 3-5 Story and Land Swap Scenarios. Assuming the land is already entitled and no unforeseen additional site preparation costs emerge, the implied residual land value is about \$25 per SF for the 35' Mixed-Use Scenario and \$35 per SF for the larger scenario.

If the Port were to sell the property to a developer to redevelop, they would realize a sale price of roughly the residual land value. Comparing the results in Exhibit 3.8 with the current value of the property (shown in Exhibit 3.7), it does not make sense for the Port to sell the property if the 35' height limit is in place since its current operations are worth more (\$7.0M - \$8.1M) than the residual land value (\$7.9M).

The residual land value of the 3-5 Story and Land Swap Scenarios could potentially exceed the value of the property today, in which case the Port could consider selling the property for redevelopment. However, with improvements in the current buildings, the value of the property could increase to the point that selling the property for redevelopment does not make financial sense. As the Port gets closer to a final decision on its Harbor Square options, this is an area of analysis it will want to explore further.

8. PHASING OPTIONS

35' Mixed-Use Alternative

phase 1



Construct first mixed-use building, village green, and related street improvements.

phase 2



Construct three stacked flats buildings above a large parking podium flanking the railroad tracks, with ground level retail at Dayton, ground level units facing the new interior street, and townhouses overlooking the marsh.

phase 3



Construct a mixed-use building at Dayton and Sunset and complete Dayton streetscape enhancements.

Land Swap Alternative with 2 Options

phase 1



Construct first mixed-use building, village green, and related street improvements.

phase 2



Relocate tennis and other Athletic Club facilities to western edge of the site.

phase 3



Construct stacked flats and/or townhouses.

phase 4



Construct mixed-use building and complete Dayton streetscape enhancements.



SECTION IV: FISCAL IMPACT ANALYSIS

This section assesses the likely fiscal impact of the Harbor Square redevelopment scenarios on revenues and costs for the City of Edmonds. This information should be valuable for the Port and the City of Edmonds as they engage in discussions about a potential contract rezone application for the Harbor Square property.

1. Tax Revenue

BERK's approach to the fiscal analysis was to model all the major tax revenue streams generated by Harbor Square operations under the three scenarios the Port could pursue with the property:

- 1. Current Buildings with Improved Operations.** If the Port were unable to pursue redevelopment because of market conditions or the inability to obtain a contract rezone, the most likely scenario is continued operations of existing buildings. BERK has modeled a scenario where operations are improved slightly assuming the Port invests in tenant improvements and amenities to make the property more attractive.
- 2. 35' Mixed-Use Scenario.** If the Port were to obtain a contract rezone allowing for residential uses on the property but not additional height, the 35' Mixed-Use Scenario is most likely. It should be noted that the residual land value analysis in the previous section has shown that although this scenario may be feasible from a developer's perspective, it does not likely make sense from the Port's perspective because Harbor Square is worth more to the Port today than what a developer would be willing to pay for the property.
- 3. 3-5 Story Mixed-Use Scenario.** If the Port were to obtain a contract rezone allowing for residential uses as well as additional height, the 3-5 Story Mixed-Use Scenario is most likely.

The fiscal analysis only considers the tax revenues generated for the City of Edmonds from activity at Harbor Square. The following major tax revenue streams were estimated:

- 1. Leasehold Excise Tax.** In the Current Operations Scenario the property is subject to leasehold excise tax based on the lease revenues generated by occupants renting space at Harbor Square. Only the local portion of leasehold excise tax that is distributed to the City of Edmonds is included in the analysis.
- 2. Property Tax.** In the 35' Mixed-Use and 3-5 Story Mixed-Use scenarios it is assumed that the property is sold to a developer and becomes subject to property tax based on the assessed value of the property.
- 3. Utility Tax.** City of Edmonds utility tax revenues generated by residents and businesses occupying Harbor Square.
- 4. Sales Tax.** Ongoing sales taxes generated by residents and businesses occupying Harbor Square. One-time sales taxes generated by construction in the redevelopment scenarios are also estimated.

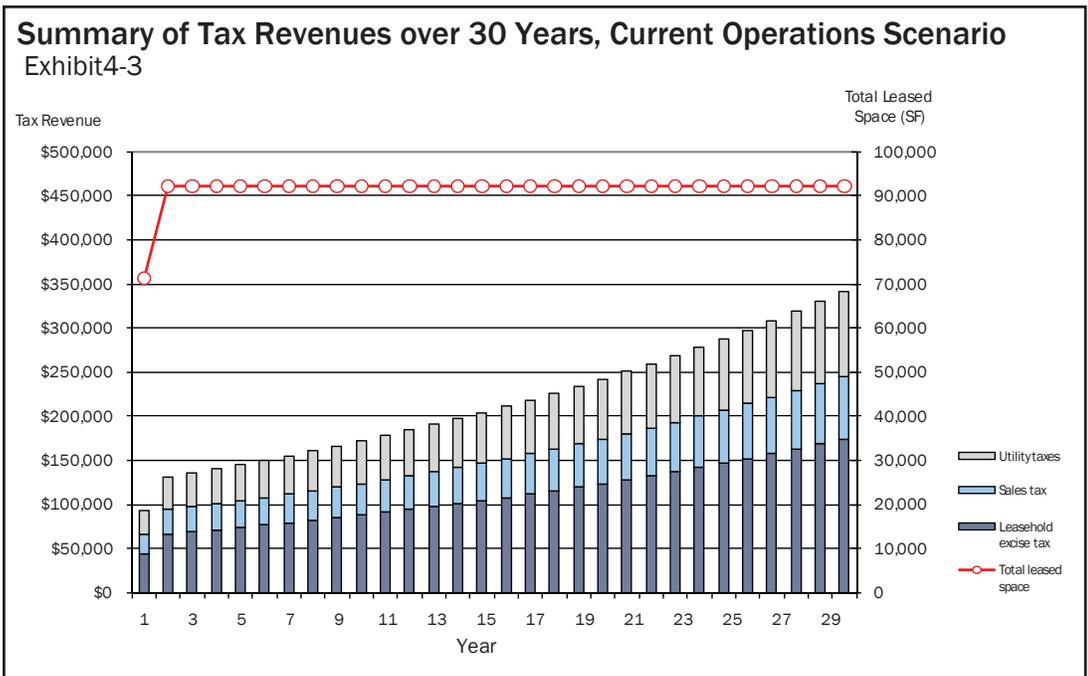


Exhibit 4-3 shows the projected tax revenues from operations of existing Harbor Square buildings with improved occupancy and rents. Leasehold excise tax is the largest contributor of tax revenues, followed by utility taxes, and sales taxes. Sales taxes are relatively small since the majority of Harbor Square occupants are office users as opposed to retailers or restaurants.

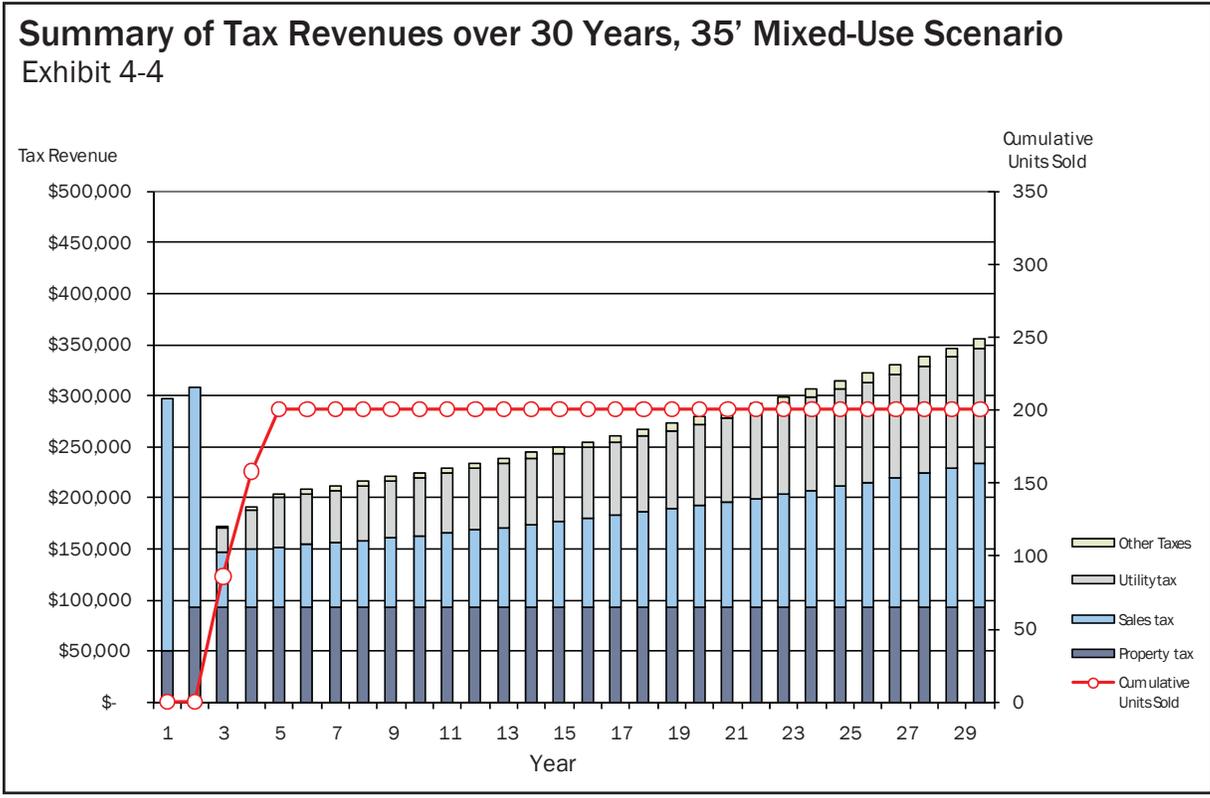


Exhibit 4-4 shows the projected tax revenues under the 35' Mixed-Use Scenario. The primary sources of tax revenues in this scenario are property tax, sales tax, and utility taxes. Property tax revenues remain flat over time because of restrictions on property tax growth and no assumption of a property tax levy lid lift. One-time sales taxes on construction drive significant initial sales tax revenues (about \$462,000 over two years) but stabilize once construction is complete. If the retail portion of the use mix (only 23,800 SF) were increased, increases in sales tax revenues would be realized.

Summary of Tax Revenues over 30 Years, 3-5 Story Mixed-Use Scenario Exhibit 4-5

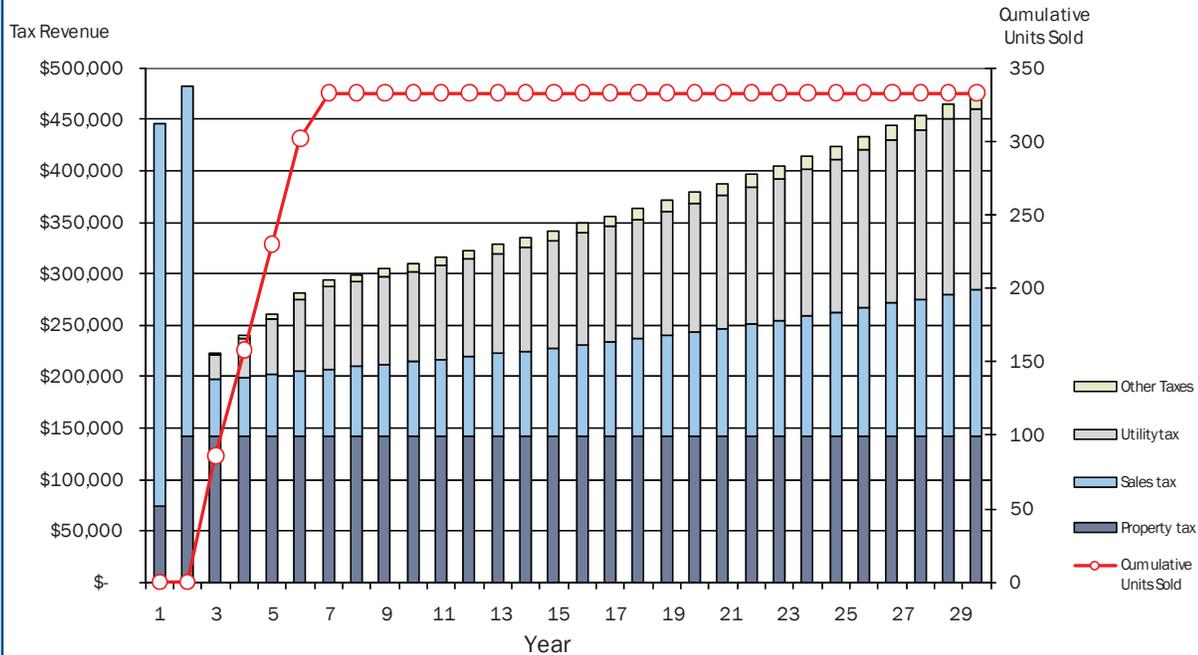


Exhibit 4-5 shows the projected tax revenues under the 3-5 Story Mixed-Use Scenario. The tax revenues in this scenario are similar to the 35' Mixed-Use Scenario but at a greater magnitude.

One-time sales taxes on construction drive significant initial sales tax revenues (about \$712,000 over two years) but stabilize once construction is complete.

Annual Tax Revenue and One-Time Construction Related Revenue by Scenario

Exhibit 4.6

Taxes in Year 8 (First year of stabilized income from 3-5 Story Mixed Use Scenario)

	Current Buildings (Improved Operations)	35' Story Mixed-Use Scenario	3-5 Story Mixed Use Scenario
Leasehold Excise Tax	\$81,607	-	-
Property Tax	-	\$92,334	\$142,299
Sales Tax	\$33,445	\$65,867	\$66,866
Utility Tax	\$44,982	\$52,990	\$82,386
Other Tax	\$25.56	\$4,516	\$7,426
Total All Taxes	\$160,034	\$215,707	\$298,977
One-time Construction-related Sales Tax (Year 1 and 2)	*	\$461,697	\$711,535

Source: BERK, 2009

Notes:

- Year 8 is the year after all units are sold in the 3-5 Story Mixed-Use Scenario. This is the first year all three scenarios have stabilized income.
- *One-time construction-related sales tax revenue was not explicitly modeled for the Current Improved Operations Scenario. If significant tenant improvements (\$20-\$30 per SF) were included in this scenario, there would be about \$17,000-\$26,000 in sales tax revenue for the City of Edmonds.

Exhibit 4-6 shows a snapshot of annual tax revenue generated under each scenario in year 8, the first year of stabilized operations for all three scenarios. Total revenues range from \$160K in the Current Buildings Improved Operations Scenario to \$299K in the 3-5 Story Mixed-Use Scenario. One-time construction-related sales tax revenues for the two redevelopment scenarios are also shown in Exhibit 4-6. The 35' Mixed-Use Scenario generates \$462K and the 3-5 Story Mixed-Use Scenario generates \$712K over the two years of construction.

Net Present Value of Future Tax Revenues for City of Edmonds			
Exhibit 4.7			
NPV of Future Tax Revenues			
Scenario	10-Year	20-Year	30-Year
Current Buildings - Improved Operations	1.1 M	2.1 M	2.9 M
35' Mixed-Use Scenario	1.8 M	2.9 M	3.9 M
3-5 Story Mixed-Use Scenario	2.5 M	4.1 M	5.3 M
Incremental Difference (Current NPV minus 3-5 Story NPV)	1.4 M	2.0 M	2.4 M

Source: BERK 2009
Note: NPV calculated using a 5% discount rate.

Exhibit 4-7 shows the 10-, 20-, and 30-year NPVs of future tax revenues for the City of Edmonds generated by each development scenario. These values represent what the future tax revenue streams generated by each development scenario are worth to the City of Edmonds in year one of development dollars.

The Current Buildings – Improved Operations scenario represents a reasonable prediction of what would occur if the Port were unable to redevelop the site. The incremental difference between the current operations NPV and 3-5 Story NPV represents what the tax revenue stream from larger development scenario is worth to the City. The incremental difference ranges from \$1.4M over 10 years to \$2.4M over 30 years.

2. Cost Implications for City Services

Cost implications for City services will depend on the degree to which new activity generated by any redevelopment triggers the need for additional City services. In general, the level of activity generated by a development of this size in an area that is already developed is unlikely to have any significant net impacts to the cost of providing City services. The City will likely meet the needs of the development using existing staffing and resources. Listed below are initial high-level assessments of cost impacts to specific City services.

- Fire and Police services are two of the largest cost centers for City services. Existing police and fire services are likely sufficient to address the incremental increase in calls for service related to activity at the site. The higher-quality development expected in the Harbor Square redevelopment scenarios makes it less likely that the additional housing and commercial activity will generate significant calls for police service.
- The higher-quality, higher density, for-sale development expected in the these redevelopment scenarios most likely would attract households with fewer children than single-family residential and other lower density development patterns, adding less burden on the school system.
- In general, cities have a great deal of fixed capacity already in place for many services (e.g. key positions in leadership and management, and existing City service systems and infrastructure) that do not necessarily change in a linear fashion as the city grows. The increase in population under any of the Harbor Square redevelopment scenarios is unlikely to be sufficient to have any impact on parks or general government costs (administration, finance, etc).

- Any costs associated with permitting and plan review will largely be covered through direct fees from the project.
- Any impacts to the utility enterprise funds will likely be more than offset by utility costs paid by the occupants of the development.
- Existing uses at the Harbor Square site (hotel, health club, offices, and restaurants) already generate a certain amount of traffic. There may not be a significant incremental increase in traffic generated by residents and businesses under a redevelopment scenario and any traffic increase should be offset by traffic impact fees imposed by the City of Edmonds.

To summarize, smaller households with fewer children, higher densities on already developed land, and the demand for high quality, mixed-use developments in walking distance to shops, parks, and other community attractions, have combined in recent years to challenge one of the long-standing assumptions held by many cities and towns throughout the country - that only commercial development can strengthen a community's fiscal health.

Some cities have been discovering in the last decade that high quality, denser residential development commands higher land values than commercial uses. Many communities have actually over-zoned for commercial development, as compared with actual demand, and that over-supply has had the effect of depressing values. Of course, studies and findings supporting this shift in the market need to be considered in light of current economic conditions. However, trends in household composition and the demonstrated desire to live in close proximity to retail, transit, and other aspects of daily life indicates that in the long run, compact, higher density, mixed-use development at relatively high values and much less cost on services and infrastructure than its lower density counterparts could provide a fiscal benefit - or at least not present a drain on municipal revenue.

SECTION V: CONCLUSION

Following the analysis reported in the previous sections and discussions with the Port staff and Commission, we are prepared to offer these conclusions:

1. CONCLUSIONS

The Harbor Square property's economic potential is hindered by regulatory limitations. A 1980 contract rezone placed significant constraints on the property by prohibiting residential uses, mandating low lot coverage and high parking ratios, and to a lesser extent, limiting the building height to 35'. As a result, redevelopment of the property is limited to commercial uses and can only accommodate a small increase in density.

Redevelopment of Harbor Square under current zoning is unlikely. Given the property's zoning limitations, an office and retail commercial redevelopment scenario was modeled for financial feasibility. Under current market conditions, specifically related to lending and leasing, estimated IRRs for this redevelopment scenario are very low. Even if financing and market conditions improve, redevelopment is unlikely since estimated construction costs exceed the final project's value by \$5 to \$8 million.

Assuming a contract rezone, a mixed-use project limited to 35' in height is probably not feasible. The 35' Mixed-use development scenario assumes a contract rezone that allows residential uses and additional density on the site, but maintains the 35' height limit. From a developer's perspective, this redevelopment may be financially feasible under certain market conditions. However, from the Port's perspective, the estimated price a developer would be willing to pay for the property (residual land value of \$7.9M) is less than what current operations of Harbor Square buildings 1-5 are worth (\$7.0M - \$8.1M). If the 35' height limit is kept, it is unlikely that a redevelopment scenario will generate a sales price high enough that it makes sense for the Port to sell the property to a developer.

Assuming a contract rezone, two scenarios (3-5 Story and Land Swap) developed during this process may be feasible. These two mixed-use scenarios incorporate higher densities and heights that exceed 35'. The residual land value of the two scenarios could potentially exceed the value of the property today, in which case the Port could consider selling the property for redevelopment. As the Port gets closer to a final decision on its Harbor Square options, it will want to analyze these scenarios further along with the option of investing in tenant improvements and amenities in its current buildings.

Regardless of which option makes the most financial sense for the Port, the contract rezone will most likely need to incorporate an increase in height limit to make redevelopment feasible for both developers and the Port.

Redevelopment of Harbor Square will result in increased tax revenue for the City of Edmonds. Both the 35' Mixed-use and 3-5 Story Mixed-use redevelopment scenarios would generate more tax revenues for the City of Edmonds than current operations at Harbor Square. One-time construction-related sales tax revenue ranges from \$462,000 in the 35' Mixed-Use scenario to \$712,000 in the 3-5 Story Mixed-Use scenario. On an ongoing basis¹, annual tax revenue is estimated at \$160,000 (current buildings with improved operations), \$216,000 (35' Mixed-Use scenario), and \$299,000 (3-5 Story Mixed-Use scenario). On an NPV basis, the 30-year tax revenue stream from the property is worth \$2.9M (current buildings with improved operations), \$3.9M (35' Mixed-Use scenario), and \$5.3 M (3-5 Story Mixed-Use scenario) to the City.

¹ *In year eight, the first year of stabilized operations in the 3-5 Story Mixed-use scenario.*

The incremental increase in fiscal revenues generated by the redevelopment scenarios is a net fiscal benefit for the City of Edmonds. This analysis should be shared with the City of Edmonds and could provide useful context for contract rezone discussions.

PLANNING, PHASING AND DESIGN RECOMMENDATIONS

Retain Some of the Buildings on the Property. The hotel and health club continue to be vibrant enterprises. They can remain as key pieces of a revitalized Harbor Square, although perhaps with more efficient arrangements and physical and landscape enhancements. Moreover, Building #3, at the corner of Dayton and Sunset, is performing well; any redevelopment plan should defer any replacement or remodel of that structure to later years. Phased redevelopment would also ensure some lease income would be generated from existing businesses.

Plan for a New Configuration and Image. As a freestanding, suburban-style “business park” with little relationship to downtown Edmonds or the waterfront and structures that lack urban character, Harbor Square looks outdated, which is a liability. Harbor Square would benefit from a system of streets and blocks that would help it integrate into the long standing pattern of the downtown.

Consider a Tailored Approach to Building Height. Amending the contract rezone to allow for residential uses, greater lot coverage, and lower parking ratios would allow for reasonable redevelopment of parcels in the north portion of the site. The issue of height could lend itself to a building envelope that allows varied or transition zones of height, with greater height oriented away from Dayton Street where consideration for human scale is most important.

2. NEXT STEPS

The Port should pursue a contract rezone. As discussed above, the opportunity for redevelopment by either the Port or a developer is severely limited without a contract rezone. Working with the City on a contract rezone would open up opportunities for redevelopment with residential uses and more productive use of the property and help support comprehensive plan and other goals and objectives for the area, such as Transit Oriented Development.

The Port should meet with City Staff to present and get feedback on the fiscal impact findings and the approach to site development, in particular the requested amendments to permitted uses, parking, and coverage. The Port should also seek the City’s input on the height increase issue: either deferring it until a later time, or developing a stepped height envelope. Inquire if deferring the height issue would simplify SEPA review or any decision-making process and discuss the effect/status of the Dykes’ proposal.

Assuming a contract rezone is accomplished. The Port should begin to work on tasks that will help achieve redevelopment. These might include the following:

- Discuss the land swap proposal with the health club owner. Topics should include the motivation for the swap, the proposal, timing, cost-sharing, parking location and configuration, the proposed street network (with on-street parking), and the number of open or enclosed courts.
- If the health club owner is amenable to the swap, investigate the likely costs of rebuilding the tennis courts closer to the railroad tracks.
- Additional financial and fiscal analysis could be conducted for the land swap proposal, focusing on the effects of phasing and multiple property transactions.
- Consider Soils Testing. The conceptual planning relied upon analysis conducted by Sound Transit for the commuter rail station across Dayton to the north. That analysis indicated that it would be possible to excavate roughly five feet down before running into problems

with the water table. It is reasonable to assume that this condition is similar for land that abuts Dayton on the south. Providing some of the parking in a partially below ground story, enables the site to more cost-effectively accommodate multistory development. However, this depth is likely to decrease away from Dayton closer to the wetlands. Further soils testing and environmental analysis will be needed to determine where and whether below grade parking can be constructed along with any other developmental limitations.

- Talk to the City and local brokers about potential redevelopment interest. The City's economic developer manager could speak to interest in office or commercial space and local brokers could provide insight into current demand and sales of condominiums.
- Consider re-platting the property. It is possible that the Port would need to initiate a re-platting of the Harbor Square property through the City's subdivision process. This would enable the Port to retain some portions of the property under leasehold agreements, while selling off others. It would also be useful to indicate the arrangement and dimensions of streets, whether the Port retains ownership of them or dedicates them to the City.

In the meantime, while assessing redevelopment options, the Port should consider taking a more active role in asset management to improve upon current operations. If the Port could lower vacancies and increase rents, both capitalized value and income would increase. This would put the Port in a better financial position while it waits for the market to return.

3. OTHER CONSIDERATIONS

The items summarized here are longer-term considerations that may warrant further discussion from the Port as they move forward with a redevelopment project.

1. Soliciting Interest

Issue a prospectus to development companies, soliciting interest in portions or all of the property. This could take several forms:

Request for Interest (RFI)

All this might consist of is an expression of serious interest in the form of a letter. The letter would include some brief information about similar projects and references. The response time would probably be on the order of 2-3 weeks. The Port would quickly be able to determine a field of interested parties. One consideration is whether to place an ad in national publication, such as *Urban Land*, or just in the *Daily Journal of Commerce*, which is aimed at a more regional audience.

Request for Qualifications (RFQ)

This is a more elaborate response than an RFI. It would involve submittals that would include not only the information in an RFI, but also the complete development team. Firm profiles, resumes of individuals, an identified project manager, information of several relevant projects, and an indication of financial partners. The document might be on the order of 15-25 pages and include photos and data on other similar projects.

The turnaround time for this would be on the order of 3-4 weeks.

Request for Concepts (RFC)

This variation includes all of the elements of an RFQ, but asks for one or more conceptual development schemes for the property – either an initial phase or all potential phases. The Port may wish to convey to the proposers the concepts already developed and discussed as a baseline, or allow submitters to develop their own concepts. Regardless, the RFQ should make the development parameters (uses, parking, coverage, height, etc.) clear so that useful comparisons can be made. Despite the concepts developed to date, there may be variations in use, type of residential units, sales vs leasing, amount of commercial, phasing and build-out, and so forth. The turnaround time for this should be on the order of 4-6 weeks. In this variation, the Port should hold a pre-submittal meeting to clarify objectives, the timeline, and the selection process and to answer questions. A tour of the site should also be included.

One question that might arise is whether this is the best time to solicit developers. An argument could be made that it would be better for the Port to first secure basic amendments before marketing the property. While this has some merit, its also necessary to realize that any developer understands the entitlement steps and the time involved. Moreover, any sizable project would require several years from securing the property, for design, for permitting, and for construction. So from that perspective many developers may want to start that sooner than later, in order to hit the upswing in the recovery of the market. It might also help the City in appreciating that there would be tangible benefits to the Port having a development partner that is prepared to deliver project once amendments are approved.

2. Public vs Private Ownership of Public Spaces and Streets

Another issue is how any public space is paid for, with respect to improvements, as well maintenance, over time. It could be treated as a common amenity, with various private owners or tenants paying proportionate amounts. Or it could be solely owned and maintained by the Port. Or it could be deeded to the City, assuming the City is a willing recipient. (An estimate of \$ per SF cost for the proposed plaza and open space noted in the Alternative Comparison Chart on page 23 of this report).

There is a similar set of issues with regard to the streets. Are segments constructed along with each project? Or does the Port take this on and charge pro-rated costs to future purchasers or leaseholders? Who actually owns and maintains them? Are they public or private? Even if private, they will need to meet City standards for fire protection and other standards. Would it be best to simply dedicate them to the City?

3. Project Management

Yet another issue is how the project might be managed. As with any complex project that unfolds over time, with multiple parties – developers, designers, tenants – The Port will need to make sure that process proceeds smoothly. While the project management role could be provided in-house, such projects often benefit from the expertise and experience of an outside consultant. There are individuals and firms that provide such assistance on a contract basis. Initially, this would not necessarily be a full-time role. But having a PM devoted to permitting, schedule, tenants, and the development team while representing the Port's interest, would ensure a positive outcome.

APPENDIX:

ASSESSMENT OF PREVIOUS GARDNER JOHNSON WORK AND FINDINGS

In 2007, Gardner Johnson prepared project summaries and pro formas illustrating annualized cash flows for several development scenarios for its client, the Stratford Company. Since one of the scenarios focused on the 11 acre Harbor Square property, we reviewed their assumptions, program mix, and results and made some revisions based upon current economic and development conditions.

Methodology

In an effort to leverage previous work and not duplicate efforts, we updated the work done by Gardner Johnson to test whether their findings held in the current environment. The program mix, which includes condos and a hotel in addition to office and commercial space, is not possible under current zoning standards, but we wanted to revisit this concept as a proxy for the alternative upzone scenario to be developed by LMN in the next phase of work.

Since we only had access to hard copy materials, we were unable trace all calculations and estimates. Thus, the discussion below should be viewed as a threshold level assessment and not a precise update of the Gardner Johnson work. The analysis below uses a series of assumptions to estimate the value and financial feasibility of an intensive development scenario for the property under current market conditions.

Gardner Johnson Program Mix and Conclusions

As a reminder, Concept B for the Harbor Square site, included the following program mix with an estimated IRR of 14.7%:

Type	Gross Square Feet	Net Rentable/Units/Rooms
Commercial	56,000	44,800
Office	48,000	38,400
Condos	326,700	363 units
Hotel	56,785	160 rooms

Discussion

At just under 15%, the IRR points to the project's feasibility. However, proceeds from the sale of condos were a major driver in the project's feasibility at the time. The sales price per square foot was relatively high at over \$500 and the financing terms were assumed to be favorable with a 10% equity contribution or some form of mezzanine financing. In the current environment sales velocity has slowed considerably making a 363 unit project very ambitious. In today's market, sales prices would be lower than assumed by Gardner Johnson and condo lending would be difficult to secure. A developer would likely be required to contribute a large share of equity, probably as much as 50%.

On the commercial and office analysis, income was affected by the annual escalation rate of 6%, twice the 3% for expenses. Escalation for revenue and expenses are typically presumed to be equal at best, except in very favorable market circumstances.

Revised Assumptions

In the Gardner Johnson analysis, several key assumptions were made that have since been revised to reflect current market conditions. Construction costs have decreased since 2007. We opted to use the high values for Seattle from the Rider Levett Bucknall Quarterly Construction Cost Report for Second Quarter, 2009.

Pro Forma Assumptions Comparison		
Factor	Gardner Johnson	BERK
Construction Cost: Commercial	\$125	\$120
Construction Cost: Office	\$107	\$160
Construction Cost: Condo	\$235	\$235
Construction Cost: Hotel	\$210	\$195
Tenant Improvements per SF	\$11	\$30
Contingency	5% of hard costs	10% of hard costs
Expenses/escalation rate	3%	3%
Lease rates/escalation rate	6%	3%
Total Development costs	\$203,234,432	\$196,133,618
Condo Sales Proceeds	\$183,789,827	\$120,513,096
Condo price per SF	\$562.56	\$368.88
Commercial rent per SF/month	\$29.68 (NET \$26.86)	NET \$18.00
Office rent per SF/month	\$26.12 (NET \$23.72)	NET \$20.00
Vacancy rate – commercial and office	8%*	10% (comm.) 15% (office)
Loan-to-Value	90%	50%
*NOTE: 8% was the rate used for vacancy and collection losses Source: BERK, 2009		

Final IRR Comparison		
Space Type	IRR	Gardner Johnson IRR
Commercial	7.5%	
Office	4.2%	
Condo	5.2%	
Total	5.4%	14.7%
Source: BERK, 2009		

Given current lending, sales, and leasing conditions, the scenario shown above would not currently be attractive to a developer. As stated earlier, this is largely due to the influence of condos on this scenario, but there is also reason to believe that office vacancies may remain high for the near future, increasing the risk of this program mix to a developer. While it does not make sense currently, eventually the market will rebound and condos with some ground floor retail and/or office space to increase daytime vibrancy, may once again be the best option for redevelopment of the site.

In the next phase of analysis, when an alternative upzone scenario is studied, it is likely that we will have to assume more favorable market conditions, given our review of the previous Gardner Johnson work and the Port's long-term objectives.