City of Edmonds
Downtown Plan Assessment

Source: City of Edmonds Comprehensive Plan Map, 12/2003

Redevelopment Analysis
October 2004

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BACKGROUND

The City of Edmonds is in the process of revising its Downtown Waterfront Plan as part of its 2004 Comprehensive Plan Amendment update. The Downtown Waterfront Plan has guided public and private development since its initial adoption in 1995.

The Downtown Waterfront Plan covers approximately 630 acres, bound by Caspers Street on the north, Pine Street on the south, and 9th Avenue on the east. Approximately 170 acres of the plan area is zoned Commercial Business (BC) and General Commercial (CG).

Source: City of Edmonds Comprehensive Plan Map, 12/2003

As part of the update process, the Planning Board has identified several general principles that build upon the existing vision and provide the policy framework to guide future development within the downtown. Those that relate most directly to the focus of this analysis are paraphrased below:

1. Protect the existing identity of the central downtown;

2. Define the retail core along streets having strongest pedestrian links and design elements;

3. Identify "arts" and "mixed-use" districts that support and complement the retail core; and

4. Explore alternative development opportunities in the waterfront area, such as arts-related uses.

BACKGROUND

Based upon these principles, several potential implementation strategies have been identified by the Planning Board for public review and discussion, including:

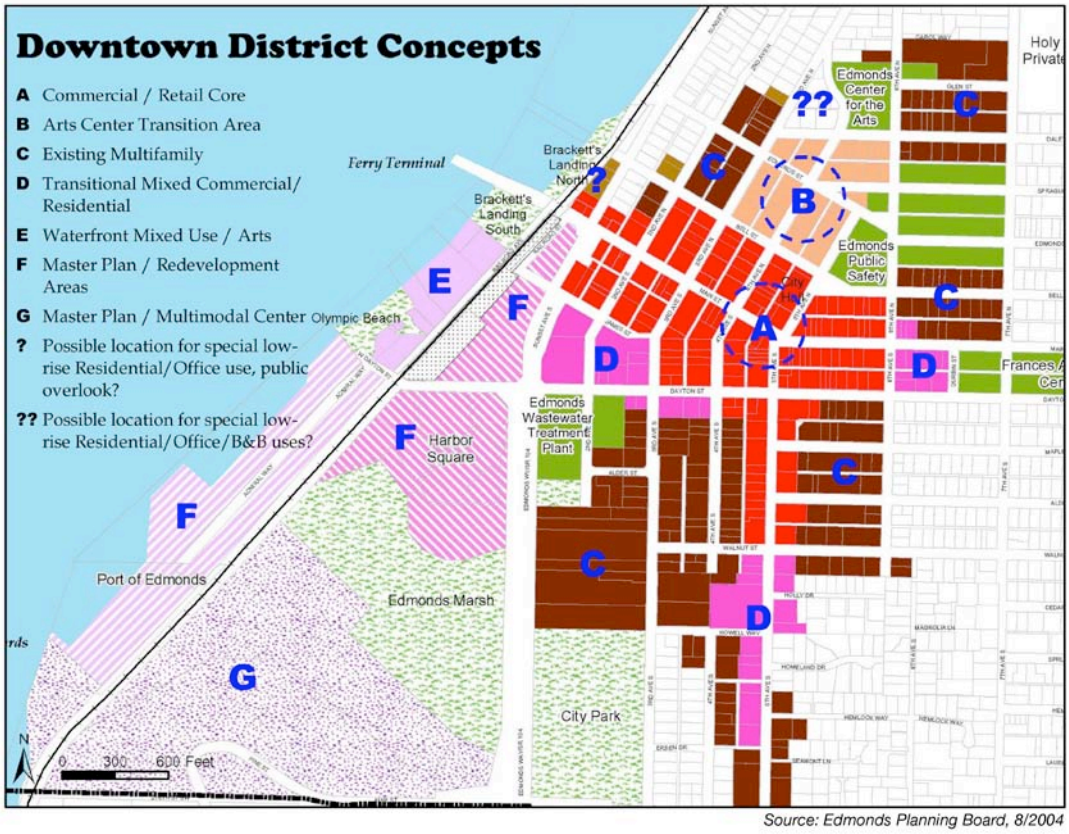
- Clearly identifying the downtown "retail core," and limiting uses on the first-floor to retail or pedestrian-oriented service uses;

- Establishing first floor development standards that support successful commercial spaces;

- Ensuring that buildings are pedestrian-scale, but evaluating the visual and economic impacts of increasing the 30-foot height limit to a maximum of 35 feet;
- Considering upper-level setbacks for all new development one block around the central fountain, to protect the special character of this space; and

- Considering building setbacks from property lines within the arts center corridor along 4th, to emphasize the pedestrian scale of the neighborhood.

The City's goal of encouraging quality redevelopment within the larger Downtown Waterfront planning area has led to the idea of creating distinct "districts" such as the retail core, the arts corridor, mixed use areas, and the waterfront.



Source: Edmonds Planning Board, 8/2004

BACKGROUND

The City recognizes that some of the proposed code changes and implementation strategies may apply more directly to a particular district, while others may be encouraged throughout the downtown area. For example, increased ground-floor height requirements and limited ground-floor uses may be appropriate within the heart of the retail core, but not necessarily throughout the downtown area. Alternately, upper-level setbacks may be considered an appropriate requirement to protect the areas immediately around the central fountain, but may otherwise be unnecessary. Entirely different planning principles and development standards may be appropriate within redevelopment areas outside the downtown core, such as Harbor Square.

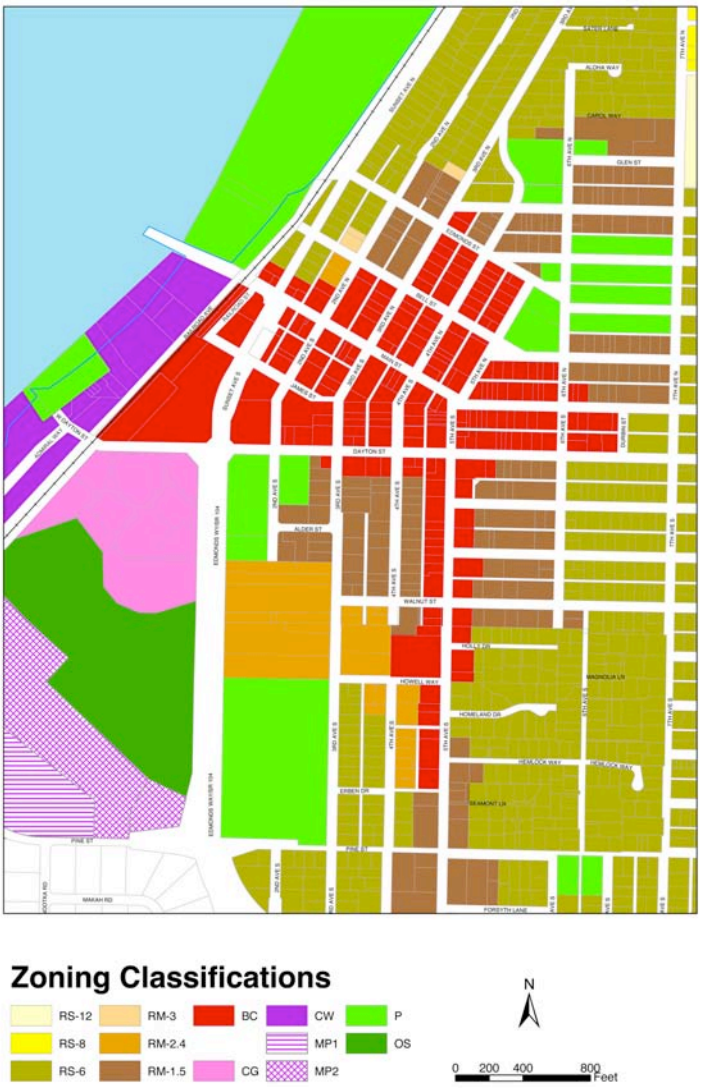
To support the City's broader policy evaluation of these potential changes, Heartland has been engaged to test the feasibility of several redevelopment alternatives that might result from the implementation of these new policies and regulations proposed for the City's downtown. Both the market and financial feasibility analyses have been framed to highlight and address distinctions between the proposed sub-areas within the planning areas and the specific code changes being considered.

Downtown Zoning

The majority of the area considered within this analysis is zoned BC by the City of Edmonds. The BC zone is a fairly flexible designation, that allows a broad range of uses, including single-family residential, retail, office, service uses, and multifamily residential (on upper levels only). Ground-floor uses must be commercial for a minimum depth of 30 feet, except for pedestrian access to upper-level multifamily units.

Development standards do not limit lot area or lot width, and require no street setbacks. Side and rear setbacks of 15 feet are required only if adjacent to residential uses. Maximum building heights of 25 feet are required, with an allowance to 30 feet to the top of a pitched roof. A maximum floor area ratio (FAR) of 3.0 is also imposed. There are no residential density limitations.

Parking requirements have recently been reduced within this zoning designation; currently, parking must be provided at a ratio of at least one per unit for multifamily and two per 1000 square feet of gross commercial floor area.



Harbor Square

Unlike the rest of the areas evaluated within this analysis, the Harbor Square property is currently zoned CG by the City of Edmonds. As with the BC zone, the CG zone is very flexible, allowing a broad range of permitted uses, with development standards that do not limit lot area or width. There are required street setbacks within the CG zone of 15 feet, with additional side and rear setbacks if adjacent to residential uses.

The most significant difference within the CG zone is the maximum height limit of 35 (rather than 25) feet, with no FAR maximum.

The additional height permitted within the CG zone would allow for three-story development without compromising ceiling heights or partially submerging the first floor.

While the zoning designation provides some additional flexibility, the Harbor Square property's development potential is also influenced by the existing ground lease between the Port of Edmonds and Dick Beselin, the developer of Harbor Square. The table below summarizes the key ground lease terms:

HARBOR SQUARE GROUND LEASE SUMMARY	
Lease Date	Last amended 1988
Term	45 years
Expiration	2033
Area	10.98 acres
Commercial Area	4.4 acres – gross; 5.3 acres – net (Parcels 1 – 3)
Industrial Area	6.5 acres – gross; 5.3 acres – net (Parcels 4 – 9)
Permitted Uses/Purpose	Business Park, to promote the development of facilities and services needed by the public.
Commercial Rent	Greater of $0.35 per square foot for land, or 13% of rental receipts (with periodic adjustments)
Industrial Rent	$0.30 per square foot for land (with periodic adjustments)

Any renovations to the existing structures or redevelopment of the property would need to comply with both the City's zoning and the terms of the existing ground lease. In recent years, portions of the property have been developed with a hotel and athletic club facilities, suggesting that the Port is willing to consider a broad range of potential uses for the property. The remaining term of the ground lease (29 years) poses the most significant limitation on the property's redevelopment potential, since most developers and lenders would require property control for 50 to 75 years to effectively amortize investment costs and to reduce development risk.

Economic Study Areas

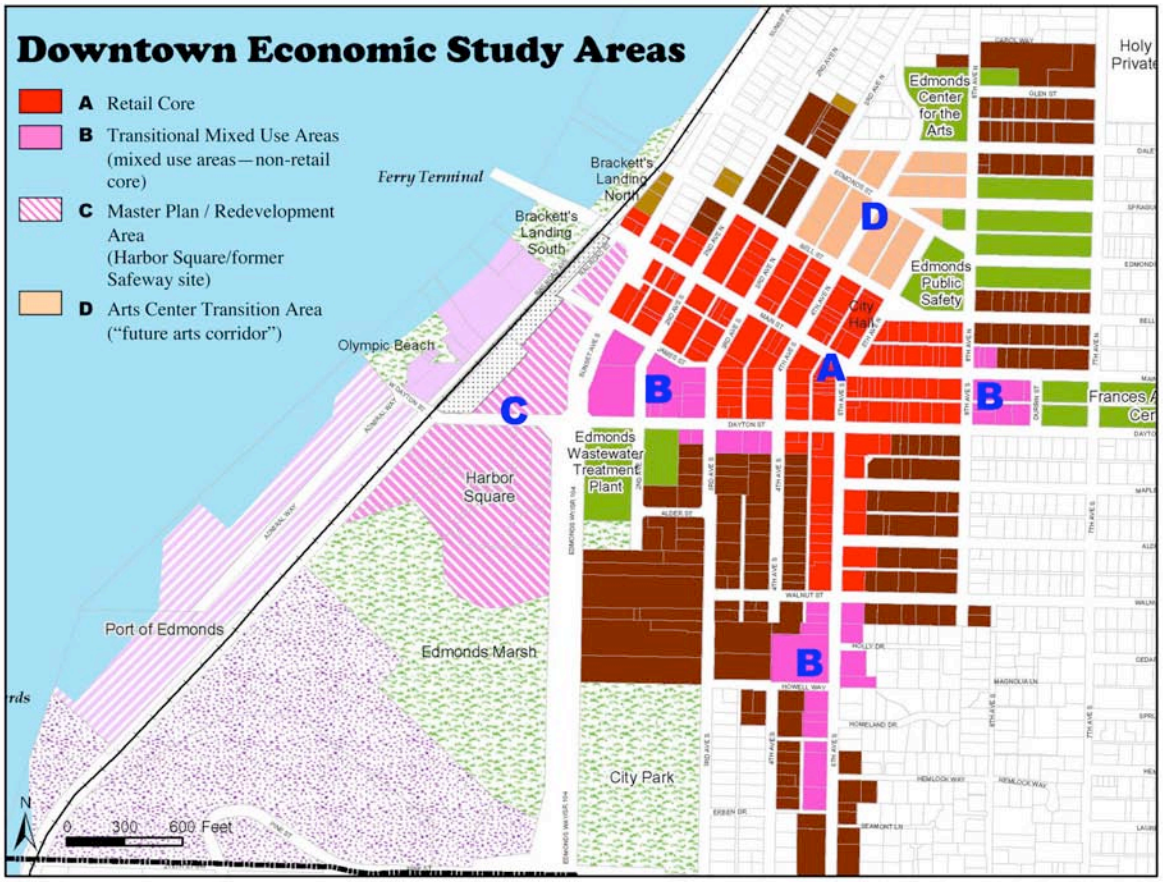
As illustrated on the accompanying map, the City identified four distinct areas within the Downtown Waterfront planning boundaries, around which we focused our market review and applied our findings:

Area A: The "Retail Core" in downtown Edmonds, running a block deep along 5th Avenue South and Main Street.

Area B: Mixed-use areas, on the fringes of the retail core.

Area C: Master plan/redevelopment areas, comprised of large parcels located at the hinge between the waterfront and downtown.

Area D: The "Arts Center" transition area, connecting downtown to the planned Edmonds Center for the Arts.



Multifamily Residential - Condominiums

Condominiums represent the strongest product type within the downtown Edmonds marketplace. Most new construction within the area is primarily composed of condominium units, with commercial ground-floor uses where required by code.

Several projects, highlighted below, are currently under construction or have recently been completed that typify the type of condominium development in the area:

The Copperstone, located at 130 4th Avenue South in the heart of the Retail Core (Area A), has just been completed. The project contains eight units, ranging between 1,310 and 2,489 square feet. Units are priced between approximately $350,000 and $975,000 ($262 to $442 per square foot). Eastern-facing units, without views to the water, are priced between $262 and $305 per square foot; western-facing units are priced between $300 and $442 per square foot. According to the developer, units are selling above their asking prices. Four of the eight have already sold, and one is under contract, at a rate of approximately one per month. The project is three stories, with 8- to 9-foot ceilings in the residential units. The ground floor also has an 8-foot ceiling height, and is partially submerged to comply with the 30-foot height limit allowed by code for projects with a pitched roof. The ground-floor space is being marketed to retail and service commercial tenants for lease or for sale. To date, there has been only limited interest in the space.

The Dayton is also located within the Retail Core, at 530 Dayton Street. Construction was completed in early 2004, with sales beginning in January. The project contains a total of five large condominium units, each approximately 2,000 to 2,100 square feet. The units sold at a rate of 1.67 units per month, with pricing between $500,000 and $1.1 million ($237 to $527 per square foot). Four of the units sold in the first quarter of 2004.

MacGregor Place is located at 437 5th Avenue, at the southern edge of downtown, in one of the Transitional Mixed-Use areas identified by the City (Area B). The project was completed in June 2003, and 9 of its 10 units have sold over the last 15 months (.6 per month) at prices ranging from $385,000 to $749,000 ($229 to $339 per square foot). Units range between 1,682 and 2,151 square feet.

The developer of MacGregor Place is currently constructing a second project immediately to the south, known as 505 Fifth Avenue that will contain 28 units, between 900 and 1,800 square feet (an average size of 1,400 square feet). The smaller size of the units in this project has been made possible in part because the City has recently reduced parking requirements within the BC zone, allowing more units to be located on a given site. The development community has viewed these recent changes as valuable revisions that will facilitate market-based development. Units at 505 Fifth Avenue will be priced between $325,000 and $550,000, at an average price of $275 per square foot.

Other projects, such as The Belmont (600 Bell Street) and Bell Street Cottages (610 through 618 Bell Street) are located outside the Retail Core, on the eastern edge of downtown. The underlying zoning for these projects is Multifamily Residential (RM – 1.5), requiring 1,500 square feet of lot area for each unit. There is no ground floor commercial requirement in this zone, and therefore the projects are being built out as 100 percent residential developments. These ground-related residential projects are within walking distance of downtown, and offer similar views from their third floors. While the Bell Street Cottages project is designed as a zero lot-line single-family product (no common walls between the units), The Belmont is designed as a six-unit stacked flat project, with units ranging between 927 and 1,911 square feet. Each unit contains private garage parking for one or two vehicles, and is appointed with very high-end finishes and appliances. Of the total, both ground floor units had sold, and the remaining second- and third-floor units were priced at $600,000 to $735,000 ($317 to $384 per square foot). Third-floor units, with views of the Sound, were both the largest and most expensive.

The following table summarizes the findings from our market survey:

Project	List Price	SF	$/SF	# Units	Units Sold	Start of Sales	Sales/ Month
Copperstone	$350,000 - $975,000	1,310 – 2,489	$263 - $442	8	4	6/04	1
Dayton	$495,000 - $1,100,000	2,036 – 2,198	$237 - $527	5	5	1/04	1.67
MacGregor Place	$385,000 - $749,000	1,682 – 2,151	$229 - $339	10	9	6/03	.6
505 Fifth	$325,000 – $550,000	900 – 1,800	$275	28	N/A	N/A	N/A
Belmont	$259,000 - $735,000	927 – 1,911	$279 - $384	6	2	N/A	N/A
Bell Street Cottages	$369,000 - $375,000	1,587	$230 - $251	6	6	5/03	.5

Source: New Home Trends, 9/2004

The siting and performance of these condominium projects seems to be more influenced by the view potential and general proximity to downtown, rather than zoning or location within a particular sub-market. In general, view units command sales values in the range of $350 per square foot or more, while units with no views are selling for $250 to $300 per square foot.

In addition to these smaller projects being developed within the downtown, Triad Development is currently planning a major condominium project on the former Unocal Tank Farm site. In November 2003, construction began on Phase I of the six-phase project known as Point Edwards. Prices for the homes will range from the $300's to over $1 million, with the average size being 1,230 square feet. This first phase consists of two, 3-story residential buildings consisting of 55 units and the 8,000-square-foot clubhouse and amenity center. The project is designed to accommodate a total of 297 residences. It is difficult to anticipate the impact that such a large project will have on the overall condominium market in Edmonds. While it is being marketed as a unique, village community, there is undoubtedly some

overlap between the potential buyer pools at Point Edwards and in other condominium view units throughout Edmonds.

Multifamily Residential - Apartments

Although very little apartment development is occurring in the downtown Edmonds area, we reviewed *Dupre + Scott Apartment Advisors'* most recent data to estimate current rent levels that would most likely be achievable in the downtown marketplace. Rent levels for the newest buildings that were surveyed (1985 to 1993 construction) ranged between $0.83 and $0.97 per square foot, or $670 to $1,008 per month. Vacancy rates of approximately 5.2 percent were evidenced within these same buildings. These rent levels are fairly consistent with 2004 data obtained for all of Snohomish County, which indicates average rental rates of $773 to $855 per month (or $0.85 to $0.94 per square foot) for smaller buildings containing less than 99 units.

The last reported new construction occurred in 2002, when 31 new units were added to the Edmonds inventory. No pending projects were identified by Dupre + Scott.

The apartment market is so dramatically overshadowed by the strength of the condominium market that we have not anticipated any demand for multifamily residential units being satisfied by rental product.

Retail

The majority of our data for the retail storefront market in downtown Edmonds was provided by a recent survey completed by the City of Edmonds Department of Economic Development. Some of the information obtained was supplemented through conversations with area brokers, developers and business owners. A table summarizing active listings within the downtown can be found on the following page.

Rental rates for well-located and well-designed buildings generally range between $15 and $18 per square foot. There are few vacancies along 5th Avenue and Main Streets, and available spaces in key locations lease quickly.

	Address/Suite	Study Area	Square Feet	Annual $/SF	Expenses	Notes
Storefront Listings						
1	Old Milltown 201 – 5th Avenue S	Retail Core				
	Suite 1		1,301	$12	$6.60/ft/yr	
	Suite 22		1,033	$5	Included	Merchant dues $75
	Suite 23		1,330	$5	$6.60/ft/yr	
	Suite 18		1,484	$10	$6.60/ft/yr	High ceilings
	Suite 19		649	$10	$6.60/ft/yr	High ceilings
	Ground Floor		559	$10	$6.60/ft/yr	
2	Arista Wine Cellars 502 Main Street	Retail Core	3,000	$14	NNN $2.50/sf	1,500 square feet at ground floor; 1,500 square feet in basement; not actively listed yet, but multiple LOI received; terms typically 3 to 5 years with annual CPI
3	C'est la Vie 105 – 5th Avenue S	Retail Core	1,150	$14 - $18	NNN $2.50/sf	Not actively listed yet, but multiple LOI received; terms typically 3 to 5 years with annual CPI
4	Odyssey Books 515 Main Street	Retail Core	800	$24	Prorata taxes and utilities	1960s vintage, 25-foot ceilings, current tenant signed last year at $22.50 per square foot; one story with upper loft; 3-year term

Source: City of Edmonds and Area Market Participants

Beyond the storefront listings illustrated on the preceding table, there are also examples of poorly configured "retail" spaces that remain vacant though they are actively marketed. In most instances, these new spaces are located in the ground floor of new condominium projects, and are either too deep or partially submerged to meet current zoning regulations without compromising the strong demand for the upper-level uses. Our conversations with local leasing agents and brokers confirmed that many of these ground-floor spaces have been provided out of necessity and are considered more of a "podium" to support second- and third-floor residential uses, than viable retail spaces.

Some of these ground-floor spaces are being simultaneously marketed for lease and for sale, and are listed at prices equating to $200 per square foot if purchased as a commercial condominium unit. We speculate that this pricing is only achievable if the buyer is also a business owner who would fully occupy the available space, or would not close until the space were fully leased to stable tenants.

The retail "storefront" market within Edmonds is fairly healthy, albeit very concentrated within a few blocks of the downtown fountain. Developers of new, mixed-use development projects, when required to provide ground-floor commercial spaces, have focused much less on the quality of these spaces, since the economics of the projects are driven by the high sales revenues attainable from the condominium uses on the upper floors.

Office

As with the retail market information, the majority of our data for the office market in downtown Edmonds was provided by a recent survey completed by the City of Edmonds Department of Economic Development. Some of the information obtained was supplemented through conversations with area brokers, developers and business owners. A table summarizing active listings within the downtown and along the waterfront can be found on the following page.

	Address/Suite	Study Area	Square Feet	Annual $/SF	Expenses	Notes
Office Listings						
1	Copperstone 130 – 4th Avenue S	Retail Core	2,189	$12	NNN	First floor has 8-foot ceilings, sunken 3 feet below sidewalk; new condos above; also available for sale at $240 per square foot ($525,000)
2	115 – 2nd Avenue N	Retail Core	3,382	$17	G	First floor with views; has been available for more than one year
3	123 – 4th Avenue N	Retail Core	1,600	$18	FS	
4	250 – 4th Avenue S	Retail Core	2,000 – 4,000	$18	$3/ft.	Wired high-tech, kitchenette, build to suit allowance, parking on-site, quiet
5	Mariner Plaza 114 – 2nd Avenue	Retail Core	3,000	$18	None	
6	111 Main Street	Retail Core				
	Suite 106		1,146	Negotiable	FS	
	Suite 104		1,920	Negotiable	FS	Can be combined with Suite 106
7	525 – 5th Avenue S	Transitional MU	3,500	N/A	N/A	First floor recently put on market at $157 per square foot ($550,000) after being vacant and available for lease for two years (lowest at $13 per 50 gross); ceiling is below window line
8	209 Dayton Street First Floor	Transitional MU	1,680			Divided into four offices, conference room, copy room, and utility room with shower
9	Harbor View Plaza 3rd and Dayton	Transitional MU	9,310	$18	NNN	
10	Edmonds Bay Building 51 West Dayton	Waterfront				
	Suite 207		515	$26-$30		Water views, decks
	Suite 208		1,160	$26-$30		Water views, decks
	Suite 302		715	$26-$30		Newly renovated, water views
	Suite 305		1,323	$26-$30		Newly renovated, water views, divided into three offices with reception area
	Suite 306		605	$26-$30		Newly renovated, good windows, small water view

Source: City of Edmonds and Area Market Participants

In general, ground floor spaces that are suitable for “service commercial” tenants and office spaces within mixed-use structures are leasing at rates equivalent to retail storefront rents, in the range of $15 to $18 per square foot. In fact, ground floor spaces in many of the new, mixed-use development projects are better designed to meet the needs of an office tenant than a retail business. This trend suggests that there will be an increasing inventory of new office space created in an ad hoc way as development occurs throughout downtown.

In addition to this ancillary office market, there are a number of 3- to 5-story office buildings located outside of downtown, along the waterfront and in Harbor Square. High-quality, single-purpose office structures with views command higher rents, in the mid-$20s per square foot. The lower density, “business park” spaces available in Harbor Square average $15 per foot.

We believe there is limited market potential for new office space in the Edmonds area, and that the most successful projects would be found on unique sites that benefit from great views and other amenities. In those mixed-use zones, however, where either multifamily residential or office uses could be developed, the condominium market far surpasses the potential for office development.

REDEVELOPMENT SCENARIOS AND FINDINGS

Methodology

The feasibility of each development scenario was analyzed with a discounted cash flow (DCF) model similar to those used by developers when they are considering a new project. The model brings together all of the anticipated income and expenses for a project based on the most likely timing of each. The results of a typical cash flow model describe the financial performance of a project in terms that can be compared to other opportunities available to the investor.

The section below summarizes the primary model components and the assumptions that influence the results. Hard copies of all of the components of each model are attached.

Project Program

The first section of the proforma estimates the development capacity of a hypothetical site under specific zoning standards. Key assumptions used in this section include a lot size of 20,000 square feet (100-feet wide and 200-feet deep) and a parking ratio for mixed-use buildings of one space per residential unit and two spaces per 1,000 square feet of retail space. The Project Program is also influenced by the development standards included in the zoning. Altering the assumptions for ceiling heights, setbacks and number of floors changes the amount of revenue-generating building area and therefore changes performance of the project.

Costs

The second section of the model calculates development cost for the building program being analyzed. Building costs are estimated as a cost per square foot and are broken down between residential space (apartment or condominium), ground-floor commercial space, office space, under-building parking and underground parking. Since there is no specific design for the project being evaluated, construction costs are approximate and will vary for an actual project.

Revenue

The third section of the model calculates the income stream generated by the development project. The sale prices and rent level estimates are the result of the market assessment described above. Because this is a planning exercise intended to inform zoning standards throughout a district, revenue assumptions are averages that represent typical market performance.

Financing

The financing component of the DCF model integrates one or two bank loans depending on the type of project. For condominium projects where units are being sold, revenue from unit sales is used to pay off the construction loan. For "income" properties such as an apartment, retail or office building, a permanent loan or mortgage is used to pay off the construction loan after the project is sufficiently occupied. Typically, construction loans have a slightly higher interest rate and shorter term (12 to 36 months) than permanent financing (20 to 30 years). Equity is the developer's cash contribution to the development project. Akin to a homebuyer's down payment, equity requirements can range significantly depending on the relationship between the developer and the lender, but for the purposes of this analysis, we are assuming an equity requirement that is equal to approximately 25 percent of the total project cost including the land.

Performance

Several standard metrics allow the performance of a development project to be compared to other opportunities available to an investor. The Internal Rate of Return (IRR) is the most common overall measure of an investment which requires an initial cash investment which is paid back through a series of payments over time. For a real estate development project, an IRR of approximately 20 percent is desirable. The discount rate reflects the amount of risk an investor associates with a particular investment opportunity. Real estate development is generally considered to be a higher risk investment, therefore, a discount rate of 20 percent is typically used. The Net Present Value (NPV) is the discounted value of the cash flow generated by a project. A positive NPV means a project is meeting or exceeding return requirements (as indicated by the discount rate chosen) while a negative NPV is falling short of those expectations. When the IRR equals the Discount Rate, the NPV is zero.

Redevelopment Scenarios

The following section analyzes the details of each redevelopment scenario considered. The narrative preceding each cash flow summary table highlights the pertinent facts and conclusions related to each scenario.

REDEVELOPMENT SCENARIOS AND FINDINGS

Scenario 1: 3-Story, Condo over Retail, Current Zoning

Scenario 1 generally replicates the types of condominium projects currently being built in downtown Edmonds. In order to fit two stories of residential over the required retail under the 25-foot (30-foot with pitched roof) height limit, most developers put the retail a few feet below grade (sidewalk level) and build the space out with only 8-foot ceilings. Even well-located space of this type will not achieve premium rents so the retail rent in this scenario is reduced to $10 per square foot per year on a triple net basis. The retail space, however, has very little impact on the overall project economics which rely entirely on the sale of the 24 residential units at an average price of $434,000 or $310 per square foot. As evidenced by the construction activity in downtown, these projects are attractive to the development community with an IRR of almost 22 percent.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO 1

PROGRAM

Lot Size (SF)	20,000
Residential Units	24
Average Unit Size (Net)	1,400
Parking Stalls	32
Parking Stalls/Unit (inc. retail pkg)	1.3
Net Ground Floor Retail Space	4,160
Net Residential Space	34,000
Net Building Area (SF)	38,160

ZONING SCENARIO

1	CURRENT MU

MARKET SCENARIO

2	RETAIL CORE CURRENT

NUMBER OF FLOORS

3

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,600,000
Land Cost/SF	$80
Land Cost/Unit	$66,667
Residential Costs (inc. parking)	$6,871,738
Per SF (hard only)	$120
Retail Costs	$586,192
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$7,457,930
Total Costs/GSF	$165
Total Costs/Unit	$310,747

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ -	$ -
Condos	$ 310.00	$ 434,000
Retail- NNN Lease Rate (SF/Yr.)		$10
Net Operating Income (Annual NOI)		$37,440
Net Sales Revenue		$10,980,889

FINANCING

Construction	
Total Equity Inc. Land	$2,345,793
Interest Rate	6.50%
Max Loan Amt.	$6,712,137
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	$108,297
Discount Rate	20.00%
Internal Rate of Return (IRR)	21.83%
Feasible Project?	Yes

Scenario 2: 2-Story, Condo over Retail, 12-Foot Retail Ceiling Height

Scenario 2 modifies the Scenario 1 building program by eliminating the third-floor residential units and using the space under the existing height limit for an at-grade retail space with a 12-foot ceiling height and a second story of residential condominiums. Two key assumptions influence the analysis of this scenario. First, because the retail space is at-grade with a more attractive ceiling height, we project that achievable rents will increase from $10 per square foot to $15 per square foot per year. Secondly, we reduce the average price of the residential units on the second floor because of the likelihood that the majority of units that were lost from the third floor were the view units that increased the average sale prices of the condominiums overall. The average sale price for a condo in Scenario 2 is $378,000 or $270 per square foot, compared to $434,000, or $310 per square foot, in Scenario 1. The slight increase in retail rent, however, is not nearly enough of a financial gain to offset the impact to the residential portion of the project resulting in negative IRR and an infeasible redevelopment project.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO 2

PROGRAM

Lot Size (SF)	20,000
Residential Units	12
Average Unit Size (Net)	1,400
Parking Stalls	20
Parking Stalls/Unit (inc. retail pkg)	1.7
Net Ground Floor Retail Space	4,160
Net Residential Space	17,000
Net Building Area (SF)	21,160

ZONING SCENARIO

2	CURRENT MU W/12' GF

MARKET SCENARIO

1	RETAIL CORE LESS VIEW

NUMBER OF FLOORS

2

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,600,000
Land Cost/SF	$80
Land Cost/Unit	$133,333
Residential Costs (inc. parking)	$3,894,812
Per SF (hard only)	$120
Retail Costs	$586,192
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$4,481,004
Total Costs/GSF	$178
Total Costs/Unit	$373,417

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ -	$ -
Condos	$ 270.00	$ 378,000
Retail- NNN Lease Rate (SF/Yr.)		$15
Net Operating Income (Annual NOI)		$57,200
Net Sales Revenue		$4,686,848

FINANCING

Construction	
Total Equity Inc. Land	$2,048,100
Interest Rate	6.50%
Max Loan Amt.	$4,032,904
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	($1,038,084)
Discount Rate	20.00%
Internal Rate of Return (IRR)	-11.93%
Feasible Project?	No

Scenario 3: 3-Story, Condo over Retail, 12-Foot Retail Ceiling Height

The third scenario blends the building programs from the first two scenarios and exceeds the current height limit in the BC zone by 3 to 4 feet, for a total building height of 33 to 34 feet. The improved ground- floor retail space topped by two floors of residential space containing 24 units, drives the IRR up to 24.27 percent.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO 3

PROGRAM

Lot Size (SF)	20,000
Residential Units	24
Average Unit Size (Net)	1,400
Parking Stalls	32
Parking Stalls/Unit (inc. retail pkg)	1.3
Net Ground Floor Retail Space	4,160
Net Residential Space	34,000
Net Building Area (SF)	38,160

ZONING SCENARIO

2	CURRENT MU W/12' GF

MARKET SCENARIO

3	RETAIL CORE FUTURE

NUMBER OF FLOORS

3

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,600,000
Land Cost/SF	$80
Land Cost/Unit	$66,667
Residential Costs (inc. parking)	$6,871,738
Per SF (hard only)	$120
Retail Costs	$586,192
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$7,457,930
Total Costs/GSF	$165
Total Costs/Unit	$310,747

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ -	$ -
Condos	$ 310.00	$ 434,000
Retail- NNN Lease Rate (SF/Yr.)		$15
Net Operating Income (Annual NOI)		$57,200
Net Sales Revenue		$10,980,889

FINANCING

Construction	
Total Equity Inc. Land	$2,345,793
Interest Rate	6.50%
Max Loan Amt.	$6,712,137
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	$263,369
Discount Rate	20.00%
Internal Rate of Return (IRR)	24.27%
Feasible Project?	Yes

Scenario 4: 3-Story, Condo over Retail, 12-Foot Retail Ceiling Height, Upper-Level Setbacks

Scenario 4 is the same as Scenario 3 except that the top two floors have been stepped back from the street by 5 and 10 feet respectively. The setbacks are one potential way to mitigate the impact that the increased height of this building program might have on the pedestrian experience. The setbacks reduce the gross floor area of the building by 2,000 square feet resulting in one less unit for sale. The loss of a unit results in a $500,000 reduction in net sales revenue which ultimately reduces the IRR for the project by approximately 0.5 percent to 23.75 percent. This project performs slightly better than the building in Scenario 1 (which has three floors, 24 units and fits under the current height limit) because of the increased rents that are achievable with a 12-foot, at-grade retail space.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO

PROGRAM

Lot Size (SF)	20,000
Residential Units	23
Average Unit Size (Net)	1,400
Parking Stalls	31
Parking Stalls/Unit (inc. retail pkg)	1.3
Net Ground Floor Retail Space	4,160
Net Residential Space	32,321
Net Building Area (SF)	36,481

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,600,000
Land Cost/SF	$80
Land Cost/Unit	$69,565
Residential Costs (inc. parking)	$6,577,767
Per SF (hard only)	$120
Retail Costs	$586,192
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$7,163,959
Total Costs/GSF	$166
Total Costs/Unit	$311,476

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ -	$ -
Condos	$ 310.00	$ 434,000
Retail- NNN Lease Rate (SF/Yr.)		$15
Net Operating Income (Annual NOI)		$57,200
Net Sales Revenue		$10,507,260

FINANCING

Construction	
Total Equity Inc. Land	$2,316,396
Interest Rate	6.50%
Max Loan Amt.	$6,447,563
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	$223,207
Discount Rate	20.00%
Internal Rate of Return (IRR)	23.75%
Feasible Project?	Yes

ZONING SCENARIO

2 CURRENT MU W/12' GF

MARKET SCENARIO

3 RETAIL CORE FUTURE

NUMBER OF FLOORS

3

UPPER LEVEL SETBACKS

Scenario 5: 3-Story, Condo, No Retail

Scenario 5 demonstrates the financial feasibility of a ground-related residential building without retail space. With only 16 units, each with 1,800 square feet of living space, this project achieves a better return (30 percent) than all of the previous scenarios. The performance of this project underscores the strength of for-sale residential in and around downtown Edmonds. This project is improved further in that fewer units require less parking area. For transitional areas around the retail core, the Planning Board may want to consider a live/work redevelopment scenario that allows for individual townhomes to include storefront retail or service space on certain streets.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO 5

PROGRAM

Lot Size (SF)	20,000
Residential Units	16
Average Unit Size (Net)	1,800
Parking Stalls	16
Parking Stalls/Unit (inc. retail pkg)	1.0
Net Ground Floor Retail Space	-
Net Residential Space	29,750
Net Building Area (SF)	29,750

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,200,000
Land Cost/SF	$60
Land Cost/Unit	$75,000
Residential Costs (inc. parking)	$5,643,756
Per SF (hard only)	$120
Retail Costs	$0
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$5,643,756
Total Costs/GSF	$161
Total Costs/Unit	$352,735

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ -	$ -
Condos	$ 295.00	$ 531,000
Retail- NNN Lease Rate (SF/Yr.)		$12
Net Operating Income (Annual NOI)		$0
Net Sales Revenue		$8,839,303

FINANCING

Construction	
Total Equity Inc. Land	$1,764,376
Interest Rate	6.50%
Max Loan Amt.	$5,079,381
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	$410,837
Discount Rate	20.00%
Internal Rate of Return (IRR)	30.65%
Feasible Project?	Yes

ZONING SCENARIO

4 GR RES

MARKET SCENARIO

4 GROUND RELATED RES

NUMBER OF FLOORS

3

UPPER LEVEL SETBACKS

Scenario 6: 3-Story, Office over Retail

As discussed in the market assessment portion of this report, there is little or no market for new office construction on infill lots in downtown Edmonds. Like much of the Puget Sound, office rents have fallen well below the level required to make new office construction viable. This is particularly true on infill lots which typically require under building or underground parking, significantly increasing costs. At rents of $18 per square foot (full service), the office over retail scenario generates an IRR of only 5 percent. Holding all other assumptions constant, if rents were increased to $28 per square foot, then this same project would generate a 21 percent IRR, suggesting that market demand would need to increase significantly to make new construction for office product feasible.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO 6

PROGRAM

Lot Size (SF)	20,000
Residential Units	-
Average Unit Size (Net)	1,400
Parking Stalls	118
Parking Stalls/Unit (inc. retail pkg)	#DIV/0!
Net Ground Floor Retail Space	4,160
Net Residential Space	-
Net Building Area (SF)	40,160

ZONING SCENARIO

5	OFFICE OVER RETAIL

MARKET SCENARIO

2	RETAIL CORE CURRENT

NUMBER OF FLOORS

3

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,600,000
Land Cost/SF	$80
Land Cost/Unit	N/A
Residential Costs (inc. parking)	$0
Per SF (hard only)	$120
Retail Costs	$586,192
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$9,967,203
Total Costs/GSF	$221
Total Costs/Unit	#DIV/0!

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ -	$ -
Condos	$ 310.00	$ 434,000
Retail- NNN Lease Rate (SF/Yr.)		$10
Net Operating Income (Annual NOI)		$478,080
Net Sales Revenue		$0

FINANCING

Construction	
Total Equity Inc. Land	$7,063,158
Interest Rate	6.50%
Max Loan Amt.	$4,504,045
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	($3,719,821)
Discount Rate	20.00%
Internal Rate of Return (IRR)	5.06%
Feasible Project?	No

Scenario 7: 3-Story, Apartments over Retail, Current Zoning

Much like the office redevelopment analyzed in Scenario 6, market conditions do not currently favor new apartment construction in downtown Edmonds. Given the same building envelope as was analyzed in Scenario 1, an apartment developer could build 37 units at an average size of 900 square feet. Unfortunately, market rents of approximately $1.00 per square foot per month (±$900 per month) fall far short of the $1.55 per square foot per month (±$1,400 per month) needed to achieve a 20 percent IRR.

CITY OF EDMONDS DOWNTOWN PLAN ASSESSMENT REDEVELOPMENT SCENARIO 7

PROGRAM

Lot Size (SF)	20,000
Residential Units	37
Average Unit Size (Net)	900
Parking Stalls	49
Parking Stalls/Unit (inc. retail pkg)	1.3
Net Ground Floor Retail Space	4,160
Net Residential Space	34,000
Net Building Area (SF)	38,160

CONSTRUCTION COSTS

Estimated Land Acqusition Cost	$1,600,000
Land Cost/SF	$80
Land Cost/Unit	$43,243
Residential Costs (inc. parking)	$6,203,225
Per SF (hard only)	$110
Retail Costs	$586,192
Per SF (hard only)	$80
Total Project Costs (Excl. Land)	$6,789,417
Total Costs/GSF	$150
Total Costs/Unit	$183,498

REVENUE

Residential Revenue	Per/SF	Per Month/ Total
Apartments	$ 1.00	$ 900.00
Condos	$ -	$ -
Retail- NNN Lease Rate (SF/Yr.)		$10
Net Operating Income (Annual NOI)		$298,944
Net Sales Revenue		$0

FINANCING

Construction	
Total Equity Inc. Land	$5,214,845
Interest Rate	6.50%
Max Loan Amt.	$3,174,572
Permanent	
Interest Rate	7.00%
Financing Costs	0.50%
Amortization (years)	30

PERFORMANCE

Net Present Value (NPV)	($2,992,079)
Discount Rate	20.00%
Internal Rate of Return (IRR)	3.90%
Feasible Project?	No

ZONING SCENARIO

1 CURRENT MU

MARKET SCENARIO

2 RETAIL CORE CURRENT

NUMBER OF FLOORS

3

APARTMENTS

Scenario 8: Existing Retail vs. Mixed Use Redevelopment

Irrespective of the age or condition of the buildings that house them, the shops and restaurants that line our downtown streets provide identity and a sense of place. Scenario 8 is designed to compare the typical economics of an existing retail building to a mixed-use redevelopment. Using the same discounted cash flow model, we have created a building program that is similar to many of the older retail properties found along Main Street in Edmonds. The lot in this hypothetical case measures 70 feet wide and 100 feet deep, or approximately 7,000 square feet. We also assume that the existing building covers the full width of the lot and is 75 feet deep for a total size of approximately 5,250 square feet of gross leaseable area. Some properties like this might have a limited amount of parking behind the building, but many rely solely on the patron's ability and willingness to park on the street. If this property is in a good location (e.g. around the fountain) and is in reasonable condition it should be able to achieve a lease rate of approximately $15 per square foot per year on a triple net basis. After accounting for vacancy and lease expenses this property generates a net operating income (NOI) of approximately $70,000. Capitalizing[1] this income stream at a rate of 7.5 percent results in an estimated value of approximately $870,000. If the owner were to put this property on the market today, it would likely be priced at or around $900,000.

Redevelopment Scenarios 1 through 7 include a land acquisition cost of $80 per square foot of lot area. In order to redevelop the property described above, a developer would have to purchase it and tear down the building. A price of $900,000 equals a land acquisition cost of approximately $130 per square foot to the developer – a substantial increase over our previous assumption. Using the same zoning and market assumptions as Scenario 2, redevelopment of this site with a land cost of $80 per square foot generates an IRR of almost 19 percent (close enough to 20 percent to be considered "feasible"). If the land acquisition cost is increased to $130 per square foot, the resulting IRR drops to 6.4 percent which is well below what most developers would be willing to accept given the risk associated with new construction.

Just like single-family homes, as buildings age they require reinvestment to maintain their value. If an older building falls into disrepair, achievable rents typically decrease. If the existing building in our example above were leased for $10 per square foot per year, the capitalized value would be reduced to approximately $570,000, or roughly $81 per square foot of land area. At this price the economics of the property open the opportunity for redevelopment to occur.

[1] The Capitalization Rate or "cap rate" converts future income into a present value. The cap rate which typically ranges from 5 to 10 percent represents the investor's return expectation and risk tolerance.

It should be noted that the exercise above is only relevant if there is a willing seller, someone interested in optimizing the potential of his or her investment. This is not always the case with long-time or absentee building owners. If the property has been held by the same individual or family for ten years or more it is likely debt free meaning the entire NOI goes to the owner. Even when the economy is strong and the stock market is soaring, it would be hard to replicate this type of cash flow with a similarly low risk profile. The strength of the cash flow and the circumstances of the building owner is why even the most sought after neighborhoods include numerous seemingly “under built” properties.

Harbor Square

As discussed above, Heartland also reviewed the opportunities and obstacles associated with redevelopment of Harbor Square. The table entitled Harbor Square Redevelopment Analysis, included on the next page, compares the overall economics of redeveloping the site to its existing financial performance.

Redevelopment Scenario

While a residential condominium development has the greatest market potential, the fractured ownership structure of condominiums preclude them from being built on leased land. As we have highlighted previously, the suburban apartment market is as depressed as the suburban office market although that might change as interest rates increase over the next 12 to 24 months. Given these regulatory and market realities, we have assumed that the redevelopment scenario with the highest potential for Harbor Square is a three-story office space with some ground-level retail space. We have also assumed a 30- to 50-year extension of the ground lease with the Port of Edmonds that currently expires in 2033. With only 29 years left on the lease, we believe that it would be very difficult for the lessee to secure construction financing for anything more than minor building upgrades.

While suburban office vacancies currently exceed 15 percent in portions of the Puget Sound, to allow for comparison to existing performance, this redevelopment calculation assumes that the market is stabilized and that rents have climbed to $28 per square foot per year on a full-service basis. The development capacity of the "redevelopable" portions of the site (approximately 4.7 acres) totals approximately 200,000 square feet of office space in a three-story format with surface parking and ground-floor retail.

At an estimated cost (hard and soft) of $180 per square foot of building area, and approximately $230,000 for the demolition of existing structures, the total cost of the redevelopment scenario is approximately $36.1 million. After accounting for expenses, vacancy and a ground rent payment to the Port of Edmonds, the project's NOI is approximately $3.2 million per year. At a capitalization rate of 8 percent, this project would likely be valued at $39.7 million. The gross profit on this redevelopment project would therefore be approximately $3.6 million.

Existing Performance

The right half of the table on the next page outlines the current performance of the "redevelopable" portion of the Harbor Square property, as currently improved. The existing buildings contain 78,000 square feet of office and service commercial tenants that pay an average rent of $18 per square foot. After subtracting for the current vacancy of 15 percent, as well as the ground rent payment to the Port and leasing expenses, the existing buildings generate a NOI of approximately $558,000

per year. Because these improvements are built on leased land a capitalization rate of 10 percent is used to estimate an overall value of $5.6 million.

HARBOR SQUARE REDEVELOPMENT ANALYSIS

Redevelopment Scenario				Existing Performance			
Lease Areas 1 – 4							
Land Area		205,255	SF - Land				
		4.71	Acres				
Coverage @	32%						
Est. Building Footprint		65,682	SF				
Potential Stories @	3						
Total Redevel. Potential		197,045	Gross SF	Existing Imp.	77,827	SF	
Req'd Parking/1000 @	2.00	394	Stalls				
Land Req'd for Parking @	350	137,931	SF				
Total Site Area Req'd		203,613	SF – Land				
Load @	7.00%	13,793	SF	7.00%	5,448	SF	
NRA		183,252	SF		72,379	SF	
Revenues							
Estimated Rent	$28.00			$18.00			
Est. Gross Inc.		$5,131,047			$1,302,824		
Costs							
Demo @	$3.00	233,481					
Land Devel. Costs @	$2.00	410,510					
Building Costs @	$180.00	35,468,064					
Total Costs		$36,112,055					
Gross Income		5,131,047			$1,302,824		
Vacancy	5.00%	256,552		15.00%	10,857		
Ground Rent @	13.00%	513,341		13.00%	112,911	$9,409	/mo
Operating Expenses @	$6.00	1,182,269		$6.00	434,275		
NOI		$3,178,884			$558,043		
Cap Rate		8.00%		10.00%			
Est. Value		$39,736,054					
Total Costs		36,112,055					
Profit		$3,623,999		Capitalized Value	$5,580,429		

Conclusion

Based on the above analysis, if the owner of Harbor Square were able to find a buyer for the improvements, he would retain $5.6 million (assuming there were no debt) versus a profit of just $3.6 million for redeveloping the property. Furthermore, the risk associated with earning the $3.6 million profit is likely in the range of $9 million, assuming a 25 percent equity requirement (leveraging the $36 million in costs). The comparative analysis of risking $9 million to earn $3.6 million versus risking much less (the necessary cost of tenant improvements and any deferred maintenance) to earn $5.6 million suggests that Harbor Square is not a candidate for redevelopment.

Antique Mall

Heartland also evaluated the opportunities and obstacles associated with redevelopment of the Antique Mall site to the north of Harbor Square. Like Harbor Square, this property is unique to the downtown area, given its large size and location at the hinge between the waterfront and the retail core. The site is 4.28 acres in size, and currently improved with 53,000 square feet of unanchored, high-bay retail space. The buildings were constructed from 1966 through 1985 and appear to be nearing the end of their useful life. Like the majority of downtown Edmonds, the Antique Mall site is zoned "BC," allowing for the development of a wide range of uses up to 30 feet in height, with a pitched roof.

Redevelopment Scenario

Based upon the previous redevelopment scenarios completed based upon BC zoning standards, the most viable development program would include residential condominium development with some ground-floor retail uses. As highlighted previously, however, current building heights limit the development potential here to two stories, given the presence of a high-water table that likely precludes the ability to partially submerge the ground floor (and certainly makes underground development infeasible). Our earlier financial feasibility assessment concluded that this two-story development program was not feasible given today's economics. Therefore, we believe that the most likely redevelopment program for this site given its existing zoning would be similar in square footage and use to the existing improvements; that is, high-bay, medium-format retail covering approximately 30 percent of the site, with surface parking. This results in a total capacity of approximately 60,000 to 65,000 square feet of retail space.

Conclusion

The physical and regulatory limitations of the property narrow the range of feasible redevelopment alternatives, and likely result in no immediate change of use, until the existing structures become functionally obsolete and provide no meaningful cash flow to the landowner. When this occurs, the existing zoning and market conditions suggest that new, single-story retail would likely provide the highest return. The property's large size and location, however, make this an important site in downtown Edmonds, suggesting that some consideration should be given to allowing for alternative uses and development standards to be allowed here, perhaps through a contract rezone or planned development approach. Concepts that could be considered include: allowing development to occur at varying heights on the site, but averaging at no higher than 30 feet; permitting ground-floor residential; or potentially rezoning to CG. It might also be beneficial to evaluate whether additional redevelopment opportunities would emerge if the Antique Mall's redevelopment were jointly planned with Harbor Square, creating a 10+ acre redevelopment site.

Findings Summary

Based on the analyses detailed above, Heartland has formulated the following overall findings:

1. Condominium sales drive financial performance of mixed-use projects.

2. Values (sales or rental) associated with ground-floor commercial uses are less significant.

3. Eliminating the third floor makes mixed-use redevelopment infeasible.

4. Upper-level setbacks have a slight negative impact on returns, but not project feasibility.

5. Maintenance and minor renovation by existing owners of high-quality retail structures provides better returns than redevelopment.

6. Acquisition and reuse of existing structures is feasible, but less likely to occur given redevelopment values.

7. New single-story retail construction cannot compete with mixed-use redevelopment.

Harbor Square

1. In the near future, three-story office building(s) with ground-floor retail space is the highest and best use.

2. No significant redevelopment will happen on the site until the ground lease with the Port of Edmonds is extended.

3. Given today's office market, the existing improvements on the site and the terms of the ground lease, redevelopment is a less profitable option than continued management.

Antique Mall

1. Medium-format retail and supporting shops are likely the highest and best use given parcel size and zoning.

2. Maximum height of 25 feet and proximity to rail limit potential for multifamily residential uses.

3. Absent a significant change in zoning, the property owner will likely continue to manage the property and make periodic renovations to attract stronger tenants as the market permits.

4. A contract rezone to allow for building height averaging across the site may encourage the property owner to more intensely develop this important property.