

HEARTLAND

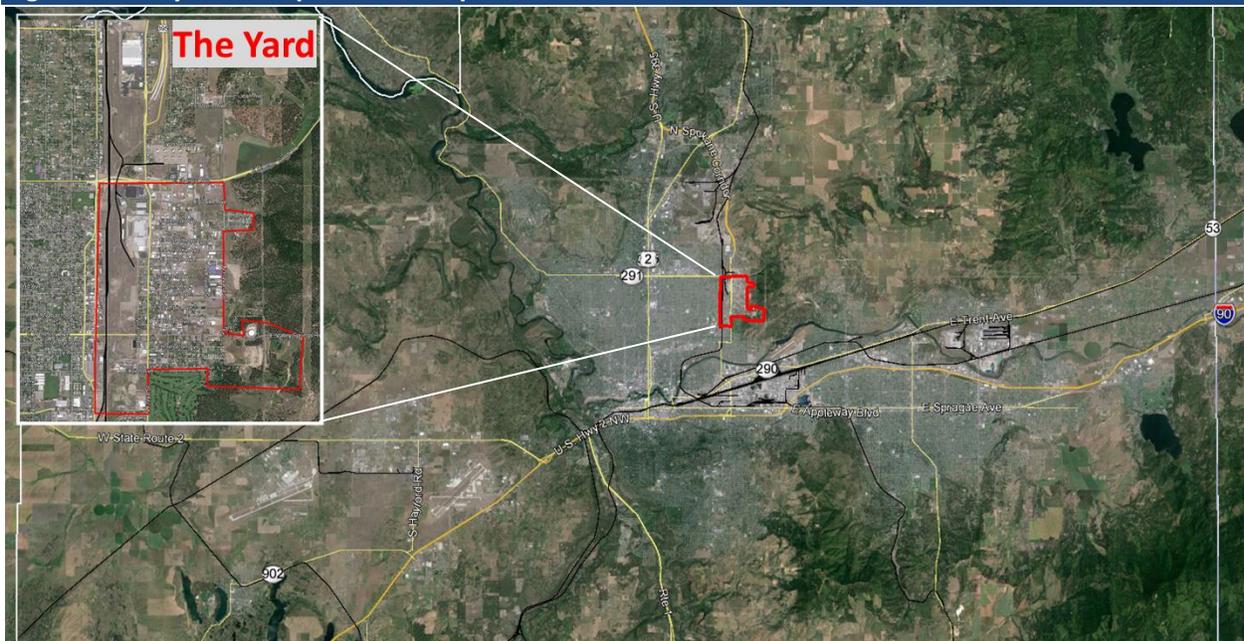
TO: Teri Stripes, City of Spokane
CC: ECONorthwest, Maul Foster Alongi
FROM: Heartland LLC
DATE: November 14, 2014
RE: The YARD: Market Conditions & Real Estate Opportunity Assessment

Introduction

The City of Spokane (“City”) has contracted with Heartland, ECONorthwest, and Maul Foster Alongi (“Consultant Team”) to evaluate redevelopment strategies for the Hillyard neighborhood (“YARD”). The purpose of this memorandum is to provide a baseline understanding of the existing market conditions influencing land use in the YARD to inform the SWOT workshop and analysis.

Historically, the YARD was developed as housing for railway workers in the early 20th century who lived and worked in this area supporting rail operations. Significant new development in this area has been absent for decades, with relatively few new businesses of note choosing to locate here. This is due to several key factors including the area’s location relative to interstate highways, land impacted with actual or perceived environmental contamination, fragmented ownership, an existing building stock that is dated and in many cases functionally obsolete for today’s major industrial users, and the ample availability of industrial land in other parts of Spokane County that is generally less expensive and located along the I-90 corridor, or near Spokane International Airport in the West Plains submarket. The map in Figure 1 illustrates the location of the YARD, which is generally described as northeast of downtown Spokane and roughly 3-miles north of I-90 via North Freya Way.

Figure 1: Study Area Map Context Map



Existing Conditions in the YARD

Existing land uses are comprised of a mix of low-density residential, commercial and industrial properties. As shown in Figure 2, 73 percent of the YARD's land is classified as vacant (41 percent) or industrial (32 percent). The remainder of the land in the area is commercial, residential, or other uses (park, public assembly, or recreational). Commercial buildings in the YARD are skewed heavily towards industrial uses with 82 percent of the commercial building stock in the YARD located on industrial land. There is a strong residential mix here as well, with approximately 373 units located throughout the YARD.

Figure 2: the YARD Acreage & Building Square Footage Distribution by Land Use

	Acres	% of Total		Total Building Square Feet	% of Total
Vacant Land	345	41%	Industrial	1,620,531	83%
Industrial	275	32%	Retail/Office	341,079	17%
Residential	106	12%	Total	1,961,610	100%
Other	83	10%			
Commercial	41	5%	Approximate Residential Units		373
Total	850	100%			

Source: Spokane County Assessor

The fragmentation of ownership and the typical building size in the YARD is also notable. The four property owners (Beacon Hill Properties, BNSF Railway, the City, and Safeway) comprise 354 acres or 50 percent of the parcel area in the YARD. The remaining land is made up of nearly 680 unique assemblages averaging 0.75 acres each. An assemblage is defined as one or more contiguous parcels under the same ownership group.

As for the existing building stock, there is approximately two million square feet in 289 buildings translating to an average building size of 6,845 square feet. Over half of the YARD's building stock is in the 29 buildings that total 10,000 square feet or more as illustrated in Figure 3 below. The remaining buildings average 3,505 square feet.

Figure 3: The YARD Building Square Footage Summary

	Building Sq Ft	Share	Buidings	Avg Sq Ft
Less than 10k Sq Ft	911,342	46%	260	3,505
10k Sq Ft +	1,066,908	54%	29	36,790
Total	1,978,250		289	6,845

Source: Spokane County

Demographics

The YARD is comprised of a single US Census Block Group, and is less than one percent of Spokane County's population and employment with the Block Group, which comprises 758 people and 1,789 employees. This is also a low-income Block Group with a median household income of \$27,675 compared to the County's median household income of \$48,485 and that of households within 5-miles of the YARD at \$38,500. Finally, the educational attainment for people in the YARD is also well below the County's attainment and the attainment for people within 5-miles of the YARD. Approximately 54

percent of the YARD's population has achieved no higher than a high school education compared to 32 percent for the county and 38 percent for those within 5-miles of the YARD.¹

Influential Developments In and Around the YARD

There are several planned developments that will influence the YARD upon completion. These are the Northern Spokane Corridor highway improvement and the 200-acre Beacon Hill residential development property.

The Northern Spokane Corridor

The YARD is expected to benefit from the proposed expansion of the Northern Spokane Corridor ("NSC"), which when completed will connect U.S. Route 395, a freeway that carries an estimated 7.2 million tons of freight annually (\$13 billion in value), to I-90. This major infrastructure improvement will effectively close the gap that currently exists between the northern and southern portions of the freeway. When completed, the NSC will travel through the western portion of the YARD with two interchanges providing access to and from it. While the NSC is intended to improve the movement of goods to and through Spokane, it may also serve as a catalyst for new commercial development for areas with new highway interchanges and shorter travel times from I-90.

As of October 2014 the NSC is approximately half complete, with 5.7 miles of the NSC open to traffic as illustrated in Figure 4. Construction is underway to realign 7.5 miles of BNSF railway tracks and subsequently build two freeway bridges. This portion of construction is partially funded by the TIGER Grant awarded to Spokane in 2012. In total to date, the project has received \$615 million in funding (state and federal) and will require an additional estimated \$1.3 billion for completion.

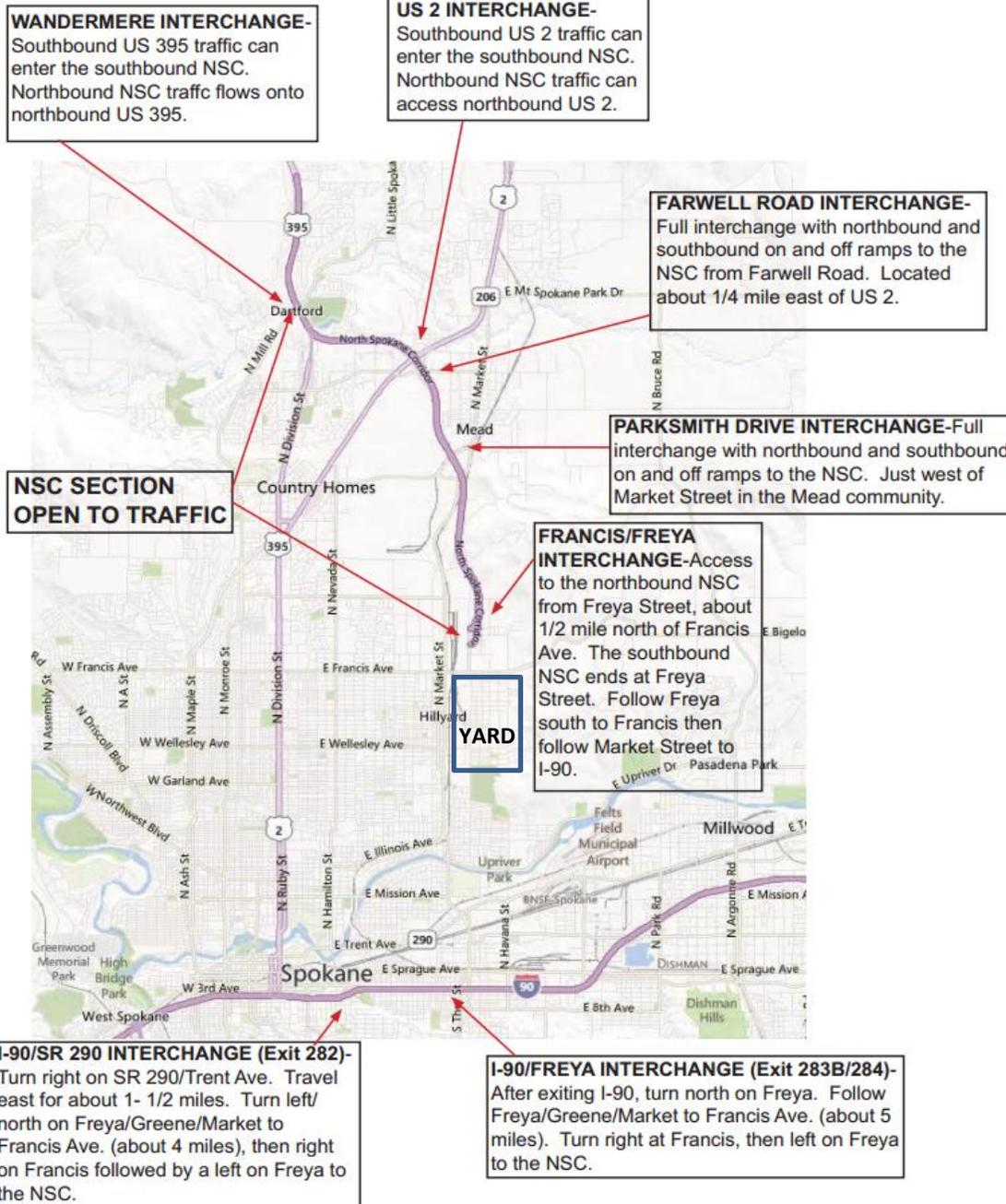
Analysis for the portion of the project funded by the TIGER Grant (the completion of the southbound lanes between Francis Avenue and Farwell Road) stated that job creation accounted for 28% of the project budget, which amounted to 410 jobs for the \$35 million section. It should be noted however that these job creation estimates were primarily in regards to the creation of construction jobs. Overall, the projected benefits of the project are difficult to measure given the long construction timeline that is expected before the freeway is complete. The full build out of this connector freeway may take another 20 years due to uncertain levels of future funding. Upon its completion, the freeway as it is proposed will establish an alternative north/south highway corridor through Spokane, by way of the YARD, easing traffic from surrounding local arterials – saving an estimated 1.7 million gallons of fuel annually – and creating new opportunities for industrial, manufacturing and distribution operators in the region.

¹ 2014 estimates from Alteryx

Figure 4: Northern Spokane Corridor Map, Completed Portion

NORTH SPOKANE CORRIDOR ACCESS POINTS

The north half (5.7 miles) of the NSC is fully complete and open to traffic.



Source: WSDOT

Beacon Hill

The only other development of note in the YARD is Beacon Hill Properties LLC's development plan on more than 200 acres of property northeast of Esmeralda Golf Course for a residential area. This development would be accessed via Wellesley Avenue. At completion the project is projected to have 1,500 to 3,000 residential units and will be developed in 10 phases. The development would include a golf cart path to Esmeralda Golf Course, community gardens, walking trails, and an outdoor amphitheater. The first phase of that project is to include two 140-unit apartment buildings, 130 townhomes, and 40 lots for residential units. Pending approval of the access road by the City, the first phase likely will not start until July 2015 at the earliest.

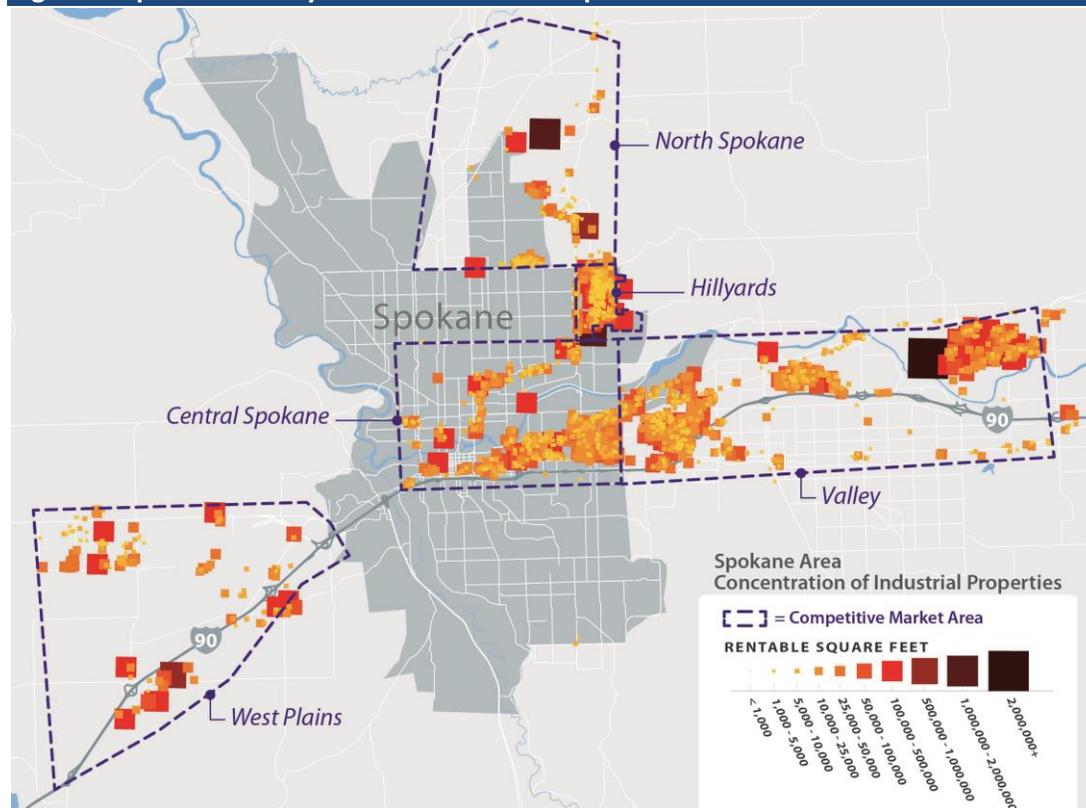
Other Developments

There are currently no other new developments planned for the YARD. There has been one new construction project in the area since 2010: a 6,400 warehouse building on 0.82 acres in 2012 that is located near the southeast intersection of North Freya Street and East Sanson Avenue. The property is currently vacant and listed for sale. The asking price is \$499,000, or \$78 per building square foot.

Industrial Market Conditions

For this portion of the analysis, the Spokane County industrial market was grouped into five submarkets: West Plains, Central Spokane, Spokane Valley, North Spokane, and the YARD. The graphic in Figure 5 illustrates the general location of these submarkets and identifies the location of industrial properties.

Figure 5: Spokane County Industrial Market Map

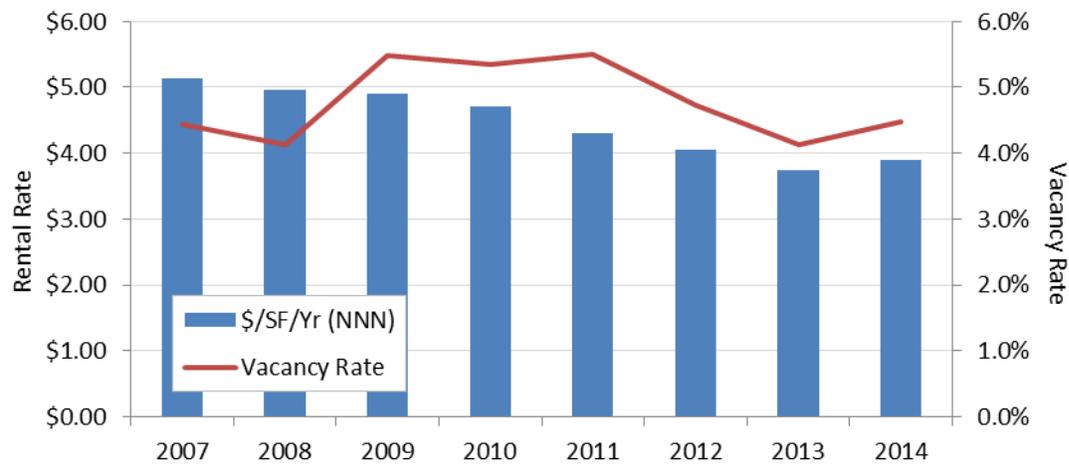


The 1.6 million square feet of industrial space in the YARD represents 4.3 percent of the County's total inventory, which is just over 39.0 million square feet. The Spokane Valley comprises the most square footage at 17.0 million or 43.5 percent of the County total. This submarket is followed by Central Spokane and North Spokane at 25.8 percent and 14.2 percent of the County total.

In terms of growing submarkets, the West Plains is outpacing the rest by a wide margin. Since 2007 this submarket has added nearly 762,000 square feet, or a 24.2 percent total increase. Most of this space has been warehouse and distribution. The added industrial space in the West Plains submarket accounted 79.0 percent of the County's total industrial space growth between 2007 and 2014. The YARD, in comparison, lost just over 52,000 square feet during that same period.

The market fundamentals for the countywide industrial market is relatively flat with a consistently low vacancy rate, but with rental rates struggling to achieve 2007 levels. Figure 6 illustrates these trends.

Figure 6: County Wide Industrial Market Fundamental Trends



Source: CoStar

Industrial rental rates for the County are currently averaging \$3.87 per square foot per year triple net with a vacancy rate of 4.5 percent. This compares to an average asking rental rate of \$4.03 per square foot per year in the YARD submarket with a very low reported vacancy rate of 1.2 percent. As Figure 7 shows, the average size of industrial buildings in the YARD is at least half of the average building in other submarket. This suggests there are fewer existing buildings in the YARD that are suitable for reuse by regional or national industrial users.

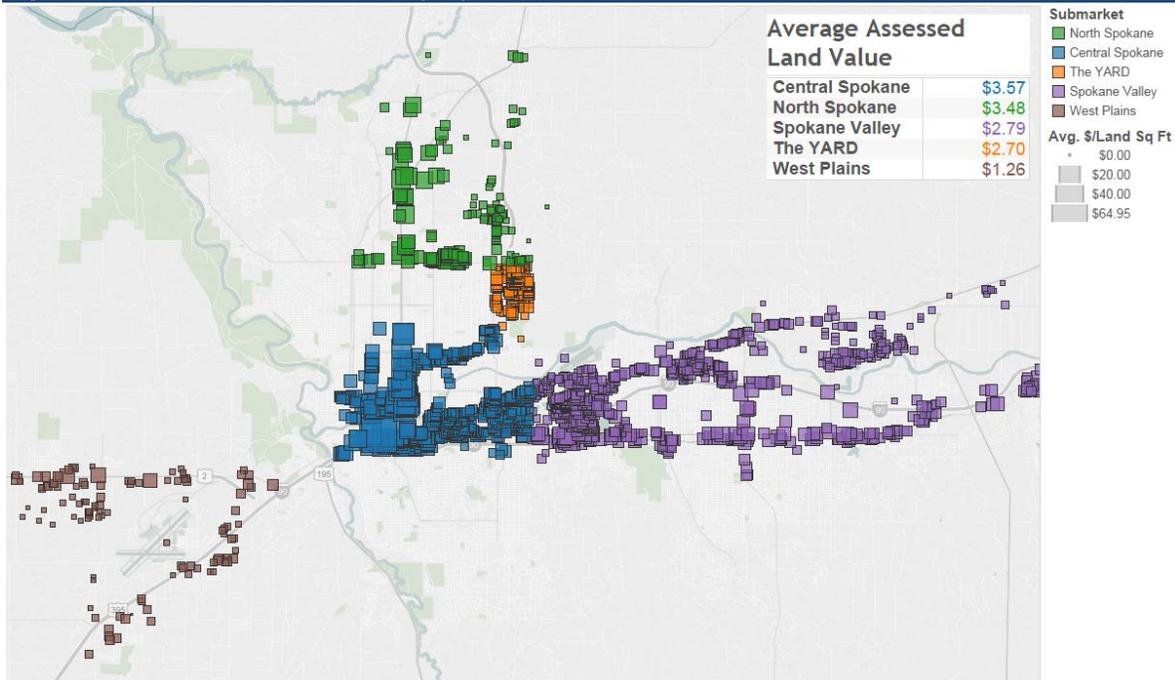
Figure 7: Industrial Market Fundamentals Snapshot (Nov 2014) by Submarket

Submarket	Buildings	Total Rentable Square Feet	Average Building Sq Ft	Vacancy Rate	Average Asking Rent Per Sq Ft (NNN)
The YARD	176	1,690,000	9,602	1.2%	\$4.03
Spokane Valley	549	17,000,000	30,965	5.0%	\$3.88
West Plains	144	3,910,000	27,153	2.7%	\$3.38
Central Spokane	547	10,060,000	18,391	5.8%	\$4.03
North Spokane	246	5,550,000	22,561	0.8%	\$4.38
Spokane County	1,745	39,060,000	22,384	4.5%	\$3.87

Source: CoStar

Another major factor influencing industrial development in the county is land values. In the West Plains submarket the cost of the land, coupled with ample land supply, strong highway access, rail and airport access, infrastructure capacity, and low cost power with Inland Power & Light, is attracting many new industrial users. In general, land in the West Plains submarket ranges from \$1.00 per square foot for users looking for over 100 acres, to \$2.00 to \$2.50 per square foot for smaller plots in the 10-acre range. The YARD, has a similar land price at around \$2.50 per square foot; however, land in the YARD has the disadvantages of scale (difficult to assemble large tracts), perceived contamination, unimproved local infrastructure, and inferior access and visibility from the highway. Figure 8 depicts the average industrial land prices in the County based on Spokane County Assessor records.

Figure 8: Industrial Land Value Map by Submarket



Source: Spokane County Assessor, Heartland LLC

Recent developments in the past year generally demonstrate the county's industrial development patterns shifting to the west. There has been one new industrial building delivered in 2014: the 200,000 Odom Distribution Center and cold storage facility built on 43 acres and located at Thorpe Rd near Hwy 395 in the West Plains submarket. There were two large distribution centers built in 2012: the 560,000 square foot Caterpillar distribution plant in West Plains and the 110,000 square foot distribution building in Spokane Valley that is home to American Tire Distributors. While there has not been any major out-of-market tenant lease up news in the past year, there have been several tenants changing location, including the Odom Corporation, Unicep Packaging Inc, Grow Op Farms LLC and Laird Plastics. One new development project is Exotic Metals, a Kent based fabrication company, that is expanding its operations to Airway Heights in the West Plains submarket. Exotic Metals bought the 56.6 acre property for \$743,000, or \$0.30 per square foot from the Spokane International Airport. When completed expansion will result in a new 150,000 square foot manufacturing building and 150 new jobs. It chose to locate here because of the strong workforce, the available tax incentives, economic development grant funding, public participation in sewer infrastructure, and roadway infrastructure improvements to be made by the City. There has also been recent news of Infinity Transportation's launch for a new

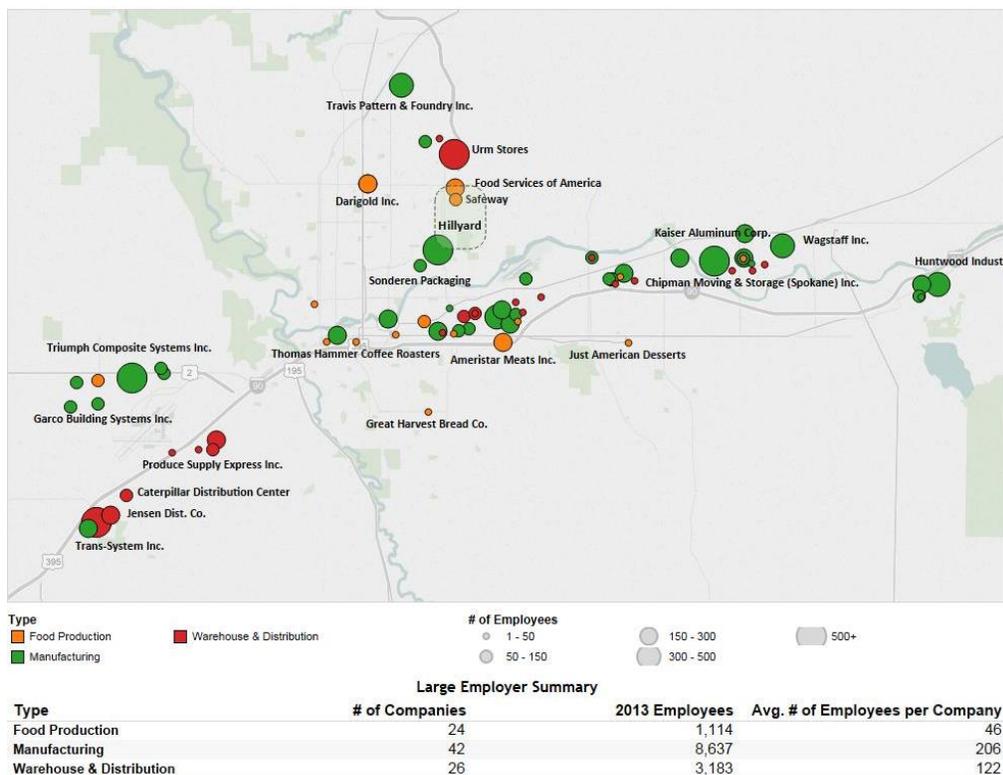
expedited refrigerated domestic intermodal service to and from the Pacific Northwest that will run through Spokane.

Major Industrial Employers

The City is home to a wide range of industrial users comprised of companies focused in food production, manufacturing and the distribution of goods. Figure 9 illustrates the location of the major employers within the County. This figure shows a clear clustering of industrial businesses in close proximity to I-90 and State Route 395.

A majority of the largest industrial companies² in the County are manufacturing in nature, accounting for about 45 percent of the 92 industrial companies listed. Several of these were large employers such as Triumph, Kaiser Aluminum, and JubilantStier. Manufacturing businesses accounted for 66 percent of the industrial employees reported by companies on the list; these companies on average employed about 206 people each, and all but one had more than 50 employees. Food production and warehouse and distribution users accounted for 26 percent and 28 percent of large industrial companies listed by the Journal. Of the large companies, food production and distribution companies generally had fewer workers than the numerous manufacturers, collectively employing 33 percent of the industrial labor force that comprised the list, with averages of 46 and 122 workers per business respectively. With the exception of a few businesses such as URM Stores, Jensen Distribution Co., Trans System Inc. Caterpillar, Darigold, Food Services of America, and Safeway to name a few, most food production and distribution business employed less than 50 workers.

Figure 9: Major Employer Locator Map



² Based on data from the 2014 Book of Lists published by the Spokane Business Journal and Heartland primary research.

Conclusions

The focus of this market assessment has been on the industrial market and how the YARD is currently positioned to attract new users. While there may be other commercial business locating to or developing in this area or residential developments happening here, the most likely significant land uses are anticipated to be industrial in nature. That said, the Spokane County industrial market is relatively stable with low vacancies and reasonable rents. New business continue to locate within the County as there is a compelling business case given the region's location along the I-90 corridor, its high quality workforce, low power costs, ample affordable land, and a well-coordinated economic development effort between the county and cities.

At the submarket level, each area has its own set of unique drivers that make it more or less attractive to industrial users depending on its business needs. The YARD currently has more challenges when it comes to attracting new businesses relative to other local industrial submarkets. In preparation for the SWOT (Strengths, Weaknesses, Opportunities, and Threats) workshop the following bullets summarize our current assessment of the YARD relative to attracting future industrial users.

- Strengths
 - Existing users proving a viable industrial location
 - Adjacency to the BNSF railroad
 - Available of federal, state and local incentives
 - State warehouse and manufacturing incentives
 - HUB zone and Community Empowerment Zone
- Weaknesses
 - Fragmented ownership
 - Actual and perceived contamination
 - Infrastructure deficits
 - Obsolete existing stock
 - Long travel times to I-90
 - Higher land values compared to the West Plains
- Opportunities
 - The promise of the Northern Spokane Corridor
 - Brownfield Redevelopment Opportunity Zone
 - Renewed focus on an infrastructure plan
 - Potential attraction of creative financing programs such as EB5 financing
- Threats
 - Competitive submarkets have:
 - Land supply
 - Less expensive land
 - Existing utilities or willing public partners to contribute
 - Same state incentives
 - Status quo
 - NSC funding uncertainty