

MARKET ANALYSIS:
OVERVIEW of DEVELOPMENT PROSPECTS
in the
LOWER NORTH LOOP
Minneapolis, MN

Prepared for:

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INTRODUCTION AND SUMMARY OF FINDINGS

DOCUMENT SCOPE, PURPOSE AND LIMITATIONS

This document presents an initial, overview-level analysis of real estate market conditions in the Study Area, which comprises the portion of Minneapolis's North Loop district that is situated to the southwest of 7th Street North (and which may be referred to herein as the "Lower North Loop Study Area").

**MAP 1: LOWER NORTH LOOP STUDY AREA
(SHADED)**



The purpose of this document is to inform a broader planning process for the overall North Loop district. This broader process may produce specific and/or

broad policy recommendations for various parts of the North Loop. This document, however, is limited to an overview of the development potential that is provided by known or reasonably foreseeable conditions and factors that will shape development viability.

SUMMARY OF KEY FINDINGS

- The Study Area's most important asset is its proximity to Minneapolis's downtown core.
- Future assets that will exert important positive influences on the Study Area's development prospects include a potential LRT station serving the Southwest LRT Corridor, and a prospective large-scale development that anticipates a new Lund's grocery store at the edge of the downtown core, just one block from the Study Area.
- The Study Area's development constraints include (1) its prevailing uses, which include primarily industrial and social service providers, (2) its perceived access barriers to downtown, (3) its difficult internal circulation systems, and (4) an absence of buildings with the character desirable for conversion to higher-value uses.
- Prospective developments in the Study Area would most likely encounter ample competition among residential projects and weak market prospects for retail and office projects. Despite these obstacles, the Study Area may be able to offer opportunities among:
 - Lower-priced (but market-rate) multi-family residential developments;
 - Entertainment-related businesses;
 - Ongoing industrial tenancies; and
 - Small-scale renovations for office/industrial users.
- In seeking to enhance development potential, properties at or near the Royalston Avenue/Glenwood Avenue intersection present key locations for public improvements and private developments. With the construction of a new Southwest Corridor LRT station and additional circulation improvements, this area can provide potential sites that (1) maximize access to downtown and (2) can serve as potential catalysts for other developments in the surrounding area.

- Timing will present an important consideration in weighing City decisions. Public infrastructure such as a new Southwest LRT station would provide an important asset for future projects, as would other circulation improvements and new private developments anticipated on the southern edges of downtown. Such improvements, however, are not likely to be completed within the next 3-4 years. At the same time, if new developments are not ready to move forward within the next ten years, they may lose the opportunity to capitalize on the broad demographic trends that have provided the impetus for the recent wave of multi-family development in and around downtown Minneapolis.

ORGANIZATION OF DOCUMENT

Following this general summary and introduction, this document begins with discussions of existing conditions (Section I), as well as anticipated improvements and their likely impacts (Section II). The document concludes in Section III with a qualitative overview of long-term outlooks among the various development types, along with a summary of potential niches and key locations.

I. PREVAILING CONDITIONS and GENERAL OUTLOOK

This section describes the Study Area's market context, with an overview of dominant features and trends in downtown Minneapolis and the North Loop area.

A. DOWNTOWN MINNEAPOLIS: ROLES AND NICHE

The following characterize downtown Minneapolis real estate markets:

- The downtown office market contains a total of roughly 30 million square feet of public and private space.¹ This accounts for the dominant share (47 percent) of the Twin Cities' overall office market inventory as well as its Class-A market (56.5 percent). While some suburban office buildings may attain rents that are comparable or even higher in some cases, downtown Minneapolis occupies the dominant niche for high-end office tenants. This inventory is heavily concentrated in the core area bounded by Washington Avenue, 5th Avenue South, Hennepin Avenue, and 12th Street. Within this core area, the prime blocks along Nicollet Mall maintain greater health than the overall downtown market; brokers report that the most strategically located properties achieve a 6-7 percent vacancy rate and the highest lease rates in the market.

¹ See *Downtown Commercial Market Analysis* prepared for the City of Minneapolis Dept. of Community Planning and Economic Development by ZHA, Inc. 2007.

TABLE 1

**CBD SHARE OF TWIN CITIES
OFFICE SPACE AND CLASS-A OFFICE SPACE
(millions sq. ft.)**

	<u>Twin Cities</u>	<u>CBD Submarket</u>	<u>CBD Share</u>
Total Inventory	71.3	25.6	35.9%
Class-A Inventory	33.5	14.5	43.1%
Class-A Share	47.0%	56.5%	

Source: Northmarq Commercial Real Estate Services; W-ZHA, LLC

- Downtown Minneapolis occupies the dominant location for upscale hotels and conventions. Downtown Minneapolis contains 25 hotel properties, with a collective supply of nearly 6,400 rooms.
- The downtown retail market comprises nearly 3.25 million square feet, of which roughly 2.2 million are located within the office core². Office workers comprise the primary market for retailers in the office core. Outside the office core, restaurants, bars and nightclubs are concentrated along First Avenue in the Warehouse District as well as the northern parts of the North Loop.
- Other cultural venues and entertainment venues are concentrated in the Warehouse District and the riverfront; these occupy a broad range, encompassing art museums, theatres and other performing arts venues, nightclubs, and adult entertainment establishments.

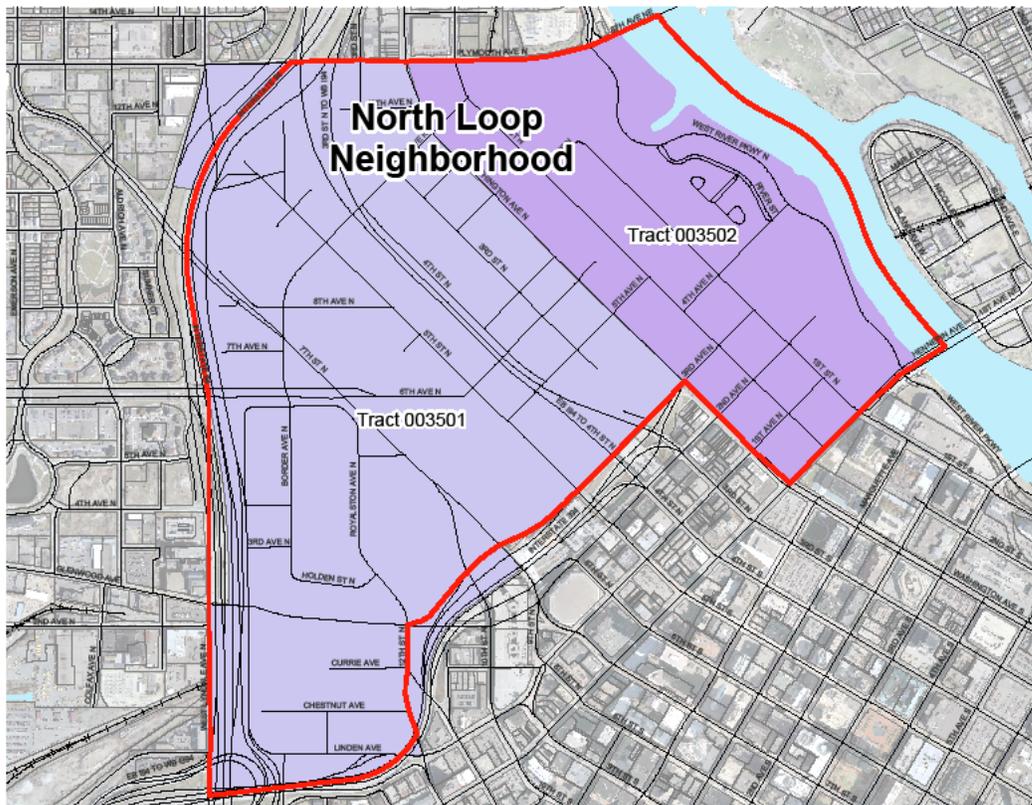
² The City of Minneapolis 2000 *Downtown Transportation Study* estimated downtown retail space at 4.55 million square feet. This supply, however, encompasses substantial spaces devoted to entertainment venues, car dealerships, office uses in retail properties (Macy's) and adult-oriented businesses. Without a precise estimate, a reasonable adjustment based on block-by-block estimates reduces this estimate by 1.5 million square feet, bringing the total estimate to roughly 3.05 million square feet. Further adjustments involve the significant changes that have occurred since 2000: these include the additions of Block E (130,000 square feet, excluding its 88,000 square foot cinema) and the downtown Target store, and the elimination of roughly 100,000 square feet from City Center (3rd floor). These changes have added a net total of 200,000 square feet to the market, bringing the total inventory to an estimated 3.25 million square feet.

- Residential development: Since 2000, multi-family developments have increased downtown Minneapolis households from approximately 12,460 to 14,650. Most of these developments have offered market-rate units in new buildings or renovated industrial buildings. These developments have concentrated most notably in the areas around the riverfront, in old industrial buildings in the North Loop, and in parts of the downtown core and its immediate surroundings.

B. NORTH LOOP AND LOWER NORTH LOOP STUDY AREA

The North Loop occupies the northern and western portions of downtown Minneapolis, bounded by Plymouth Avenue on the north, I-94 on the west and south, and Hennepin Avenue on the southeast. Situated just northwest of the downtown core, the North Loop has been characterized recently by conversions of old industrial warehouse buildings to office, residential and entertainment-related uses, concentrated primarily in its eastern portions.

MAP 2: NORTH LOOP NEIGHBORHOOD



1. Redevelopment in the Upper North Loop

As shown below, since 2000 the North Loop (as defined by census tract #s 3501 and 3502) has grown by more than 2,000 households, with most of the growth attributable to new market-rate condominiums and apartment buildings. As a result of this growth, the owner/renter mix has changed substantially, with renters declining from 68.3 percent to 41.6 percent in 2008. Median household income in the North Loop is estimated at approximately \$69,000, which is higher than in the larger downtown area or the overall city.

TABLE 2

Demographic Indicators: Selected Areas, 2000-2013					
	2000	2008	Avg. Ann. Change	2013	Avg. Ann. Change
Households					
Minneapolis	162,352	168,788	0.5%	172,174	0.4%
Rental %	46.8%	47.1%			
Downtown	12,460	14,649	2.0%	15,533	1.2%
Rental %	74.9%	69.8%			
North Loop	640	1,961	15.0%	2,481	4.8%
Rental %	68.3%	41.6%			
Median Household Income					
Minneapolis	\$38,172	\$52,443	4.1%	\$66,554	4.9%
Downtown	\$27,264	\$41,532	5.4%	\$56,372	6.3%
North Loop	\$50,771	\$68,997	3.9%	\$87,790	4.9%

Source: ESRI; stdb, inc.

In addition to new residential uses, North Loop properties have also been redeveloped as office space. Properties listed in the Northmarq Compass report show that, of downtown Minneapolis's 30.3 million square feet of private, multi-tenant office space, the North Loop contains 2.6 million square feet, or 8.6 percent of the total. Most of this space is in the Warehouse District portion of the North Loop; none is located in the Study Area.

Other types of businesses that have established themselves in the North Loop over the last 15 years include new restaurants, a small number of specialty or convenience retailers, and a Marriott Towne Place hotel. Again, virtually all of this business activity has occurred in the Warehouse District or in the Upper North Loop, northeast of the 5th Street viaduct.

2. Study Area Conditions

The Study Area has not participated in the North Loop redevelopment trend. In the Study Area, in approximately the last 10 years the only substantial investments in new development or redevelopment have been limited to one small industrial property (33,000 square feet) remodeled for office use, the City of Minneapolis's construction of a new Public Works facility, and the general maintenance and continued use of most existing properties.

In the Study Area the pre-dominant land uses include shelters and service providers for indigent and homeless persons, City public works storage and maintenance operations, and a broad range of industrial uses that encompasses engineering- or design-related businesses, manufacturing operations, storage and warehouse operations, and the Excel Energy facility.

At this time, market-rate residential uses are limited to one small building on Linden Avenue; Lee's Liquor Lounge constitutes the only thriving retail business.

Other notable features include the City Farmers' Market, occupying the block bounded by Border Avenue, Cesar Chavez Avenue, 3rd Street and Lakeside Avenue; and the International Market Square, a furniture design center located just west of the Study Area on Glenwood Avenue.

Overall, even as upscale redevelopments have taken hold in the Upper North Loop over the last 15 years, despite its proximity to downtown Minneapolis, the Study Area retains its status as a relatively obscure industrial area with limited prospects for new development.

II. KEY INFLUENCES and ANTICIPATED IMPROVEMENTS

This section presents qualitative discussions of the key existing and anticipated factors that will influence the prospects for new development in the Study Area.

A. KEY ASSETS AND CONSTRAINTS (EXISTING)

In attracting new development, the Study Area's strongest assets are its:

- **Proximity to downtown Minneapolis:** Among all the areas flanking downtown Minneapolis, the Study Area is arguably the closest to the downtown core, as measured from the IDS Tower block on the Nicollet Mall. While the interstate highway acts as a significant barrier, and the Study Area's existing image creates a mental disconnection from the CBD, the Study Area is physically closer to the downtown core than most parts of Loring Park, Elliott Park, Northeast Minneapolis, Downtown East, and the Upper North Loop.
- **Low costs (relative to downtown):** While current costs are unavailable, assessed (2008) land values in the Study Area generally range from \$7 to \$15 per square foot.³ In comparison, assessed per-square-foot land values range from roughly \$30 to \$50 in the other downtown fringe areas (e.g., Upper North Loop, Downtown East, Loring Park), from \$75 to \$110 in the Warehouse District, and from \$140 to a high of \$220 in the downtown core.

The following constraints counter these assets:

- **Existing land uses:** As alluded to in the preceding discussion, existing land uses in the Study Area are predominantly industrial or social-service oriented. This creates a low-end image, which presents a barrier to new investment.
- **Access, circulation, topography:** In addition to its low-end mix of uses, other constraints to new development include the Study Area's constrained access to downtown Minneapolis, its confusing internal

³ City of Minneapolis Assessors Office, Jan. 2008 values.

- circulation systems, and an irregular topography that can contribute to a sense of disorientation.⁴
- Security: Some parts of the Study Area – most notably along Royalston Avenue – have been the subject of reported security issues that are linked to nearby social service facilities.
 - Building character: In contrast to the Upper North Loop, the Study Area lacks buildings that offer the historic character that can drive successful redevelopments. Even in relatively undesirable locations, the historic significance or other unique charms can overcome unfavorable location issues. For instance, the market has supported new condominium units -- the Sears building along Lake Street and the IMS building on Glenwood Avenue present two notable examples -- despite locations that are otherwise unremarkable locations. The Study Area, however, contains few if any such buildings; most are one-or two story industrial buildings offering little or no historic amenity.

B. STADIUM AND LIGHT RAIL TRANSIT IMPROVEMENTS

Two major improvements near the Study Area may influence its development potential.

- Target Field, the new Minnesota Twins' Major League Baseball stadium, will open in 2010 on a site just east of the Study Area. With a seating capacity of 40,000, this venue will host (at a minimum) 81 regular-season baseball games per year, drawing crowds of roughly 2 to 3 million spectators.
- A new light rail transit station will be constructed at 5th Street and 5th Avenue North, just north of Target Field. This multi-modal station will serve bus transit routes and will serve as the rail terminus for: (1) the existing Hiawatha light rail line, (2) the anticipated Central Corridor light rail line linking downtown Minneapolis with downtown St. Paul, and (3) the Northstar Commuter Rail line extending northwest into Sherburne County, and eventually to St. Cloud. In addition, Hennepin County is currently studying the possibility for additional LRT lines as well as intercity commuter rail services to connect at this station.

⁴ Preparation of this document did not include any investigations of soil qualities or environmental contamination issues.

- An additional light rail transit station will serve the Southwest Corridor line, which is anticipated to provide service to the southwestern suburbs including St. Louis Park, Hopkins, Edina, Minnetonka and Eden Prairie. This line will include one station in the Study Area; the specific location has not been determined.

This document does not present in-depth analysis of the impacts of these anticipated improvements; it does, however, provide an outlook regarding potential impacts, based on a review of articles, studies⁵, past experience, and anecdotal evidence focusing on such improvements in the Twin Cities and in other cities.

1. Key Lessons: Target Field

Sports stadiums are often expected to serve as catalysts for new development in their immediate surroundings. Actual results, however, vary widely. For instance, the existing Metrodome facility has spawned little if any new development in its surroundings; similar results have occurred in cities such as Baltimore, Phoenix, Philadelphia and others. On the other hand, stadiums built in downtown Denver and Cleveland have been credited for substantial contributions in generating new development activity in their surroundings. The nature and extent of such enhancement is determined in large part by the following:

- **Competitive Locations:** where crowds flow easily and naturally to other locations, ballpark environs are placed a relative disadvantage. This is illustrated in the area around Baltimore's Oriole Park at Camden Yards; Baltimore's Inner Harbor and its neighboring Fells Point district offered established locations containing restaurants, nightlife and (in Fells Point) an historic urban character. Similarly, in the areas around the Metrodome, new retail or restaurant establishments would have faced direct competition with locations in the downtown core and the warehouse district. In both of these cases, the stadiums generated little new private development activity.

Conversely, the areas around Jacobs Field in Cleveland enjoyed relatively successful redevelopment; much of this success involved businesses moving to the area from the Flats District, which is located in a relatively inaccessible part of downtown Cleveland. Perhaps the largest successes occurred in the area around Coors field in Denver, which is credited with substantial contributions to redevelopment in

⁵ Informal case studies are presented in *Neighborhood Impacts of the Proposed San Jose Stadium*, prepared for the San Jose Redevelopment Agency by Bay Area Economics in 2006.

the “Lower Downtown” warehouse district situated between the downtown core and the stadium.

- **Suitable Redevelopment Opportunities:** New stadiums have spawned redevelopment where surrounding properties have offered attractive opportunities. Such opportunities have featured (1) relatively low costs that allow for relatively low-rise developments rather than compelling large-scale high-rise investments; and (2) properties such as former warehouse buildings that contribute to a “trendy” urban character. In Denver, the advent of Coors Field coincided with the growing popularity of urban “loft” living in converted warehouses, making Lower Downtown a popular redevelopment location even without the new stadium.

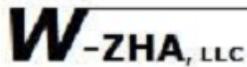
In contrast, in Baltimore the areas around Oriole Park at Camden Yards contained surface parking lots, bordered by neighborhoods in which historic preservation laws and ongoing economic viability prevented new development activity. Similarly, development of the properties around the Metrodome would have involved either large-scale new developments or relatively difficult conversions of large properties such as the Minneapolis Armory.

- **Parking and Pedestrian Orientations:** In Denver, the lack of surface parking around the new Coors Field, combined with a free (and permanent) transit shuttle to the area, helped generate pedestrian traffic through the Lower Downtown district, which featured pedestrian-friendly urban neighborhoods.

Applying these factors to the current situation, the Study Area is not likely to derive significant new business activity directly from the new Target Field. The primary entrances and pedestrian flows to Target Field will come from the downtown core on the east, and from the northern parts of the North Loop and the Light Rail transit station on the north. These areas would offer prime locations even without the new stadium, and older properties for redevelopment remain available in these areas.

In comparison, new developments in the Study Area would be separated from the stadium and its entrances by the Hennepin County Energy Recovery Center on the west, as well as by highway and topographical barriers on the south.

Moreover, the Study Area properties closest to the stadium are occupied by uses such as the City of Minneapolis Royalston and Olson Public Works facilities and the Mary’s Place and Sharing and Caring Hands properties serving homeless and indigent populations. Given the ongoing existence of



these uses and institutions, and given the competition from other properties in the North Loop and in the downtown core, the Lower North Loop Study Area will probably not capture substantial redevelopment opportunities generated by the stadium and the multi-modal transit station.

2. Key Lessons: Transit Stations

The multi-modal transit station on the north side of the stadium will improve access between the downtown core and Target Field and the northern parts of the North Loop. To the south of this station, however, the Hennepin County Energy Resource Center and Target Field present substantial visual and physical barriers between the station and the Lower North Loop Study Area.

An LRT station serving the Southwest Corridor, however, could offer substantial benefits to the Study Area.

The Twin Cities' experience with the initial Hiawatha Light Rail line has established that LRT stations are sufficient in and of themselves to attract residential development to locations that would not otherwise attract such projects. Outside of downtown Minneapolis, examples of such projects include the Hi-Lake Flats near the Lake Street station; Oaks Hiawatha (I and II) near the 46th Street Station; Olin Crossings and others near the 54th Street station area; and Reflections near Bloomington Central Station. The anticipated Southwest LRT line is likely to generate similar development opportunities, and may generate more attractive opportunities, since it will link downtown Minneapolis with suburban locations containing relatively upscale businesses and affluent communities.

Given these considerations, the Southwest Corridor LRT station, if appropriately situated, can help generate multi-family and possibly other types of developments as well.

C. OTHER ANTICIPATED DEVELOPMENTS

While Target Field and LRT stations are identified as the primary catalysts for the North Loop area, other anticipated events could also exert positive influences on development potential in the Study Area. These include:

Alatus Development: While construction is not imminent, a new development on the blocks bounded by Hennepin Avenue, I-94, and 10th and 11th Streets – just east of the Study Area -- would most likely feature high-density office and residential development, along with a new Lund's grocery store on the ground floor. This improvement could exert a strong influence;

the presence of a local grocery store has been perhaps the most important residential convenience/amenity absent in downtown Minneapolis and its environs. While I-94 would separate the prospective grocery store from the Study Area, the Study Area would be closer to this store than any existing residential neighborhood.

Depending on its final mix of uses, this project would present formidable competition to any project targeting a high-end, downtown-oriented market. Despite this, the presence of nearby high-end businesses and residents may enhance development prospects in the Study Area, which would gain from increased exposure, and from proximity to downtown workers and residents.

Ryan Companies Bassett Creek Redevelopment project: At this time, the City of Minneapolis and Ryan Companies have entered into an agreement whereby the City would sell the City's automobile impound lot property – located just west of the Study Area in the northwest quadrant of the I-394 and I-94 interchange -- to Ryan Companies for a redevelopment project. This major undertaking would require extensive environmental remediation and new infrastructure construction; development plans envision 300-500 multi-family dwelling units and three or four buildings containing 700,000 to 1 million square feet of office space. The project has targeted a 2010 start date, with subsequent development phases extending into a 2015-2020 time frame.

Like the Alatus Development, this project would present additional competition for potential development projects in the Study Area. Such competition, however, would most likely target high-end office and/or residential tenants. Consequently, the successful development of this project may enhance rather than constrain development prospects in the Study Area, which would gain opportunities to serve new workers and residents.

Hennepin Energy Recovery Center (HERC): Located at the intersection of 5th Street and Olson Parkway – on the west side of Target Field – this facility uses state-of-the-art technologies to convert garbage into new energy and other resources. HERC plans new improvements involving educational displays, pedestrian/park improvements, and circulation improvements that will maximize its attractiveness while minimizing noxious emissions.

While the facility will present a physical barrier between the Study Area and the ballpark-driven pedestrian flows, these improvements will help to minimize any potential negative perceptions of the facility and its surroundings.

D. LIKELY IMPACT SUMMARY

The Lower North Loop Study Area will face significant barriers in deriving development potential from the Target Field or the 5th Street multi-modal transit station. Such barriers include the Hennepin County incinerator, the topography, the Mary's Place property, and substantial competition from other developments to the north and east.

The Lower North Loop Study Area could derive more important benefits from the Southwest LRT station and the proposed Alatus development with its Lund's grocery store. Improved access to the southern end of the downtown core (rather than to the stadium and multi-modal station) will maximize prospects for new development in the Lower North Loop Study Area.

III. LONG-TERM OUTLOOKS and CONTINGENCIES

This section presents overview analyses of the development outlooks for the Study Area, as well as discussions of the Study Area's key issues and locations.

A. RESIDENTIAL DEVELOPMENT

The Study Area's residential development prospects are shaped by the following considerations.

1. Key Market Considerations

Location Amenities: As discussed in the preceding section, the Study Area's proximity to downtown, a station on the Southwest LRT Corridor, and other improvements such as Target Field and a nearby grocery store (Lund's) will generate interest in residential developments near the prospective Southwest LRT station.

Broad Demographic Trends have provided a primary force driving much of the recent wave of downtown condominium development. These trends have featured (1) a growing "empty nester" (primarily 50-64-year-old) household component, and (2) an increased level of affluence, as the regional economy has increased its base of professional, high-compensation jobs.

Hennepin County is likely to furnish most of the market support for prospective residential developments in the Study Area. As shown in Table 4, Hennepin County households with annual incomes above \$75,000 account for all of the County's household growth; households with incomes below this level have been declining.

Then, among households with annual incomes above \$75,000, the 45-to-54-year old age group is the County's largest cohort; the 55-to-64 is projected to achieve the highest growth over the next five years.

In addition to the empty-nester cohorts, strong growth is also projected in the 25-34 age group. This group typically features new households attracted to the area by new employment, and the group experiences relatively high turnover rates, with householders moving as they change their employment, marital status, and income levels.

TABLE 4

Selected Household Growth Sectors, Hennepin County, 2000-2013					
	2000	2008	2013	2008-2013 Change	
				#	ann. %
Total Households	456,278	483,159	496,282	13,123	0.5%
Incomes <\$75,000	314,930	256,746	210,008	-46,738	-3.9%
Incomes \$75,000 +	141,348	226,413	286,274	59,861	4.8%
25-34	23,250	31,512	42,468	10,956	6.1%
35-44	41,865	54,017	59,257	5,240	1.9%
45-54	42,518	63,521	76,012	12,491	3.7%
55-64	19,915	42,344	56,583	14,239	6.0%
65-74	7,522	15,181	23,415	8,234	9.1%
75+	4,237	13,250	19,172	5,922	7.7%

Source: ESRI, STDB, Inc., W-ZHA LLC.

Long-Term Demographic Trends and Development Timing: Notwithstanding the foregoing, “empty nester” age groups will reach a plateau in the period between 2010 to 2020, and will decline thereafter. As shown below, long-term forecasts prepared by the State of Minnesota Demographic Center project that in Hennepin County the 45 to 64 age group will decline after 2015. It should also be noted that, while households without children will continue to increase after 2015, virtually all of this increase will be attributable to the senior (65+) segment. This anticipated decline among empty nesters will weaken the primary force underlying the recent condominium boom (which may resume as the national and regional economies recover from the current recession). As this demographic force declines, even new projects that do not target this demographic group will face increased competition from other well-situated projects. Thus, if improvements such as the Southwest LRT station, a new grocery store (and accompanying development) and other improvements are not implemented by 2015, the potential for multi-family residential development in the Study Area will become increasingly limited.

TABLE 5

Hennepin County Household Projections by Age & Type of Household 2005-2030						
	2005	2010	2015	2020	2025	2030
Total	462,759	472,630	482,120	490,560	496,400	501,000
W/o Children	330,268	347,470	363,240	374,430	381,110	387,250
15 to 24	28,212	29,710	28,210	26,350	27,310	27,900
25 to 44	187,683	174,750	172,440	173,950	175,140	171,970
45 to 64	171,323	188,850	192,200	185,240	170,700	161,960
65+	75,541	79,320	89,270	105,030	123,250	139,160

Source: Minnesota State Demographic Center.

Ample Market Competition: Over the next ten years, developers will be able to identify competitive multi-family residential sites at new LRT stations along new corridors, as well as locations in the Upper North Loop, Downtown East, Northeast Minneapolis, Loring Park, Elliott Park and others. Given competition from these locations, it is likely that prospective developments in the Study Area would have to target relatively low-end market tiers.

2. Study Area Development Outlook

With potential access to LRT transit, excellent proximity to employment and entertainment amenities of downtown Minneapolis, and relatively low acquisition costs, the Study Area may offer opportunities for multi-residential development. This potential, however, will be constrained by:

- **Timing:** as discussed above, while some Study Area improvements may not be in place until approximately 2015, some segments of the market will begin to weaken after this time.
- **A limited ability to compete in mid-high market tiers:** Projects would not likely compete with upscale or even middle-market projects in price ranges above \$250,000. Rather, projects would target a less affluent market that would include renters and younger “urban pioneers” seeking convenience and entertainment rather than security or upscale features. Prospective developments targeting this niche would face significant economic challenges, which might require innovate cost-saving designs and other measures.

B. OFFICE DEVELOPMENT

1. Key Market Considerations

General Market Context: The *Downtown Minneapolis Commercial Market Analysis* prepared for the City of Minneapolis Department of Community Planning and Economic Development (2007) finds that:

- Through the year 2020, the downtown market is likely to support 6.4 to 7.7 million square feet of new office absorption, and 5.4 to 6.6 million square feet of new development.
- Remaining underutilized properties in the central core area (bounded by Washington Avenue, Hennepin Avenue, 5th Avenue South, and 12th Street South) will continue to offer prime redevelopment opportunities.

The report also anticipates that office developments will prove feasible in outlying parts of downtown, such as the North Loop. Given the overall (approximately) 6 million square foot envelope, however, new office space in locations such as the North Loop are not likely to capture significant shares of new office development, which will continue to seek high-amenity, high-image locations. Within the North Loop, locations such as the site of Hines Development's proposed North Loop Green development are well positioned to capture this market.

Competitive Low-Cost Niche: The Study Area does offer a relatively low-cost location in close proximity to downtown but it must be noted that the downtown office market – currently and historically – is weakest in its lower-cost Class B and C tiers. At this time, for instance, brokerage firms estimate overall downtown office vacancy at 13 to 15 percent. Within this envelope, however, brokers estimate lower vacancies of just 6 to 7 percent in prime properties in the 600 through 1000 blocks of the Nicollet Mall. In contrast, Class-B and C properties maintain considerably higher vacancies, estimated in the range of 20 to 21 percent in both categories. Moreover, this pattern has generally persisted through strong and weak cycles of the downtown market. Given this pattern, new low-cost space in the Study Area would face ample competition from a persistent supply of available Class-C space closer to the downtown core.

2. Study Area Development Outlooks

Given the limited prospects for substantial office developments outside the downtown core area, the Study Area is not likely to attract substantial high-rise or Class-A office development. Moreover, in seeking lower-end office development, the Study Area would face formidable competition not only

from other locations in the Upper North Loop or Downtown East, but also from available space in existing Class-B and Class-C office properties close to the downtown core.

Notwithstanding its limitations, the Study Area may prove attractive to some small office users and other businesses seeking space for a mix of office and industrial operations. Such tenants would not need to project high-end images for customers or employees, but may simply enjoy proximity to downtown and its various amenities. In addition, the available surface parking at existing buildings in the Study Area can provide another competitive amenity⁶. Cosmetic improvements to some of the Study Area's existing structures can effectively serve a small niche for this type of small-scale businesses.

C. RETAIL DEVELOPMENT

1. Key Market Considerations

Current Downtown Retail Market: Most retail brokers estimate the prevailing downtown retail vacancy rate at roughly 15 to 20 percent (Colliers Turley Martin Tucker, Northmarq), as compared with 7 to 8 percent in the overall metropolitan area. While downtown vacancies are actually lower than in past years, the downtown has continued to sustain losses of several major national retail franchises, with recent departures by Crate & Barrel, Polo Ralph Lauren, Borders Books, Williams Sonoma and others.

Office Worker Support: Downtown workers comprise the largest source of demand for downtown retail space, and the primary retail locations in downtown Minneapolis are heavily concentrated at the center of the skyway system in the core office area. The table below illustrates the consistent pattern followed by downtown office and retail vacancy rates; this illustrates the relationship between office worker spending and the retail market.

⁶ New developments with surface parking are currently prohibited in the entire "downtown" area defined as the area within interstate highways 94, 394, and 35.

TABLE 6

CBD Commercial Vacancies: 2000-2009		
	CBD Vacancies	
	Office	Retail
2000	10.1%	10.5%
2006	20.3%	23.7%
2009	15.5%	17.6%

Source: United Properties, Northmarqcompass.com

While residential development over the last 15 years has substantially increased the downtown population, downtown neighborhoods are scattered among several different locations around the downtown core, and no single neighborhood is likely to contribute substantial support for new downtown retail tenancies.

2. Study Area Development Outlooks

Absent substantial market-rate office and residential development, the Study Area is not likely to attract substantial numbers of general retail businesses. While new retailers will occupy space when the office market improves, they will seek to fill vacancies in the downtown core. And while new multi-family housing development may resume in the Upper North Loop, increased retail activity serving these developments will seek nearby locations in the Warehouse District and/or groundfloor spaces in mixed-use developments in the Upper North Loop.

Notwithstanding the negative outlook for general retail development, the Study Area may be able to provide suitable locations for entertainment-related destinations. Such destinations encompass a wide variety, but could include nightclubs, music venues, theatres, and other such entertainment venues. The Study Area may prove attractive for such uses because of it's:

- Relatively low costs for land and buildings in close proximity to downtown – in comparison with rising costs in the Warehouse District;
- Potential availability of low-rise buildings with large floorplates appropriate for conversion to such uses.
- Proximity to other entertainment-related uses, including professional sports venues (hosting a minimum of 122 sports events/year),

- performing arts theatres, bars and restaurants in the Upper North Loop;
- Availability of surface parking as well as light rail transit; and
 - Potential ease of permitting, which may face greater obstacles in areas with greater residential concentrations.

It should also be noted that the popularity of downtown Minneapolis for eating/drinking/entertainment functions has increased steadily over a long-term period. As shown below, restaurant (non-liquor) revenues have increased at an average annualized rate of nearly 5 percent since 1996; liquor revenues have increased even more rapidly, at 6.7 percent per year.

TABLE 7

Downtown Minneapolis Sales/Use Taxes 1996-2007		
	<u>Restaurant (non-liquor)</u>	<u>Liquor</u>
1996	\$6,255,616	\$1,900,700
1997	\$6,506,351	\$1,970,855
1998	\$7,145,563	\$2,372,985
1999	\$7,492,664	\$2,520,098
2000	\$8,192,127	\$2,769,212
2001	\$7,769,374	\$2,773,742
2002	\$7,963,195	\$2,908,520
2003	\$8,063,313	\$3,111,367
2004	\$8,961,302	\$3,483,046
2005	\$9,870,400	\$3,626,226
2006	\$10,258,407	\$3,674,404
2007	\$10,607,021	\$3,879,329
Avg. Ann. Change	4.9%	6.7%

Source: Minnesota Dept. of Revenue

D. INDUSTRIAL

For the most part, the Study Area is already built-out with industrial uses. Notwithstanding existing conditions, this discussion addresses the Study Area's future outlook for continued industrial use.

1. Key Conditions

Demand for industrial property with central locations and good highway access: The Study Area offers a strong location for industrial tenants seeking a central location in the region, access to the interstate highway system, and/or proximity to downtown customers and amenities. These issues comprise the most important factors in Minneapolis industrial tenants' location decisions, as indicated in the *Industrial Land Use Study and Employment Policy Plan* prepared for the City of Minneapolis in 2006. This study also indicated that, while conversions to other uses have caused the supply of centrally-located industrial land to dwindle, industrial tenants will continue to demand such property.

2. Study Area Development Outlooks

New industrial development is unlikely in the Study Area. New industrial development is most attractive where property is undeveloped and relatively inexpensive. In the Study Area, most parcels are developed with permanent structures. In regard to costs, the above-referenced *Industrial Land Use Study and Employment Policy Plan* identified a median value of \$3.26 per square foot in Minneapolis; in comparison, assessed values in the Study Area range from \$7 to \$15 per square foot in most cases.⁷ The Study Area's relatively high land costs, combined with the added costs of demolition and redevelopment would limit the financial viability of redevelopment for industrial use. In general, redevelopment of industrial properties occurs in response to opportunities to capture the higher values derived from condominiums or office space.

Notwithstanding its limited prospects for new construction, many of the Study Area's existing buildings should be able to maintain industrial occupancies over at least a ten-year span. The following factors contribute to this likelihood:

- With the exception of manufacturers seeking large-scale or highly specialized operations, most industrial tenants seek space in existing buildings. Given its central location and highway access, the Study Area's existing buildings should be attractive for industrial tenants.
- As residential redevelopment resumes in the Upper North Loop, this will continue an ongoing displacement of industrial uses. Many of these industrial tenants will prefer to maintain their general orientations, and will most likely find relatively less-expensive properties in the Study Area desirable.

⁷ See footnote 3.

- The availability of surface parking areas at the Study Area's existing buildings provides a competitive advantage for businesses seeking "flex" industrial space, many of which use relatively high portions of their space for office uses. Such businesses prefer onsite, off-street parking. In downtown Minneapolis, zoning regulations prohibit new developments from providing new onsite surface parking lots. Given the scarcity of properties near downtown Minneapolis with surface parking lots, the Study Area's existing buildings provide an advantage for any businesses seeking proximity to downtown.

E. SUMMARY AND OUTLOOK

The following summarizes key niches and issues for future development potential in the Study Area.

1. Potential Niches

Existing assets and constraints will be favorably enhanced by currently anticipated improvements, but compared to other locations around downtown Minneapolis and along light rail corridors, the Study Area's niche for new development will be defined not by its amenities or image, but rather by its relatively low costs and proximity to downtown.

Likely niches include:

- Industrial uses in existing buildings: many of the Study Area's existing properties are likely to remain viable for industrial uses. While such uses will not affect changes to the area, the ongoing viability of existing buildings helps to (1) maintain occupancies and thereby guard against severe deterioration of conditions; (2) decrease the likelihood of sudden conversions and dislocations.
- Low-Middle-Market Residential: While Study Area developments would face formidable competition in the market's upscale or middle-market tiers, the Study Area may provide opportunities for "urban pioneer" households that place high values on proximity and access to downtown. Such households value access to employment, transit, and entertainment features; lower priorities are given to noise issues, neighborhood image, sophisticated architecture, etc. This niche will be narrow, and will present difficult financial challenges to developers, but innovative developers may be able to offer open-floor formats, innovative parking arrangements, and other cost-saving measures that can assist in targeting this market.

- Entertainment-related uses: The Study Area offers relatively low-cost land nearly adjacent to professional sports and other entertainment venues. As costs and residential components rise in other downtown-adjacent areas, this niche may provide opportunities.
- Very small-scale renovation projects: While the Study Area is likely to remain obscure and thus “below the radar” of many investors, small-scale renovations and other improvements may prove viable for small-scale developers, existing property owners, and other innovative investors; such projects could involve virtually any type of use.

2. Locations and Issues

While this document does not recommend redevelopment strategies (or even objectives), in enhancing the Study Area’s future development potential the City would need to create development sites and opportunities that would:

- Offer optimal access to downtown. Close proximity to downtown is the Study Area’s strongest asset, and should be maximized to stimulate initial projects. This can be achieved by (1) controlling a site close to downtown access points on either on 10th, 11th, 12th Streets (which extend from Royalston) or Glenwood Avenue, close to downtown; and (2) siting a light rail transit station adjacent or nearby. If situated close to the Study Area’s downtown access points, the LRT station would give the Study Area a southern access point to downtown, as an alternative to the access points through the Upper North Loop and the anticipated multi-modal station.
- Influence the development potential in its surroundings. To achieve a greater influence, better internal circulation within the Study Area is needed. While Glenwood and Olson Parkway provide reasonable East-west circulation, improved north-south connections would increase the area’s isolation from the Upper North Loop as well as to -- and from -- the Stadium area. Circulation improvements might involve changes in the street system, improvements to existing streets, and possibly the use of a new LRT station to bridge physical or perceived gaps.

Royalston/Glenwood Intersection: All of the key access points from the Study Area to downtown pass through or intersect with Royalston Avenue and/or Glenwood Avenue. Therefore, the area around the intersection of these streets presents the best opportunity to achieve the two above objectives. In promoting new development, development sites in this area can target one or more of the niches described above.

Timing Issue: In seeking to enhance new development opportunities, appropriate City actions must be timed so that: development opportunities will benefit from (1) public infrastructure improvements (including the anticipated LRT station as well as additional internal circulation improvements), and (2) new private developments anticipated on the southern edges of downtown. At the same time, new developments should be ready for implementation within the next ten years. This will enable them to capitalize on the broad demographic trends that have provided the impetus for a two-decade wave of multi-family development. While Study Area residential projects are not likely to target upscale empty-nester niches, a recession in this market niche will cause developments at other sites around downtown Minneapolis to target the market's remaining niches; this will diminish development prospects for locations in the Study Area.