APPENDIX III
EMPLOYMENT AND ECONOMIC CONDITIONS

Appendix III

Information Contained within:

Economic Sector Tax Analyses

Gruen Gruen+Associates Reports

- The Market for Retail and Office uses and Strategic Recommendations for the Enhancement of Southern Scottsdale, December 2007; and
- Real Estate Economic Analysis of use Options in Southern Scottsdale August 2009

Each report's table of contents and executive summary are recorded here. For the complete report please see the City of Scottsdale Economic Vitality Department's website.

Economic Sector Tax Analyses

Retail and Service Activity

Southern Scottsdale retail and service sectors continue to contribute to the City's overall economic activity. The following tables developed by the City's Accounting and Tax Audit staff illustrate the variations in economic conditions over time and the taxes generated in the Southern Scottsdale Community Area Plan region. Additionally, all of the data complied below contains the most currently available 2007 economic numbers.

Table 1.1 tracts the annual amounts of taxable sales generated by the economic categories that comprise the Southern Scottsdale business community over the last five year period. Sector trends illustrate that that General Merchandise and Food Stores sales increased; while Apparel, Eating &Drinking, Building Materials, Home Furnishings, Auto Dealers decreased.

Table 1.1: Southern Scottsdale Taxable Sales

Southern Scottsdale Taxable Sales

Category	2007	2006	2005	2004	2003	2002
General Merchandise	137,310,979	118,493,264	123,248,718	122,841,595	112,290,355	116,604,359
Apparel	2,054,693	2,317,504	1,738,912	1,185,739	1,213,739	1,672,686
Food Sores	77,199,376	73,713,240	71,398,817	68,495,300	74,454,219	72,628,294
Eating & Drinking	84,586,684	85,583,042	81,790,897	75,977,724	68,495,300	66,272,857
Building Materials	6,688,521	8,807,744	7,341,136	6,290,440	6,095,909	5,655,629
Home Furnishings & Electronics	11,162,352	12,059,626	11,994,488	11,856,108	11,580,698	10,809,717
Auto Dealers	603,046,352	670,692,570	659,377,856	594,454,127	572,235,056	612,610,516
Total	922,049,305	971,666,989	956,890'824	886,217,277	846,365,056	886,254,057

Source: City of Scottsdale 2008

Table 1.2 illustrates the annual sales taxes generated by the Privilege Tax (1.65 percent) and the Use Tax (1.45 percent) over the past five year period. Except for increases in General Merchandise and Food Store taxes, all other economic categories decreased in 2007 in comparison to the previous year of 2006.

Table 1.2: Total Tax Collected (Privilege & Use Tax)

Total Tax Collected (Privilege & Use Tax)

Category	2007	2006	2005	2004	2003	2002
General Merchandise	2,248,362	1,948,785	2,011,702	1,859,249	1,561,072	1,631,541
Apparel	33,902	35,935	28,692	18,023	16,992	23,418
Food Sores	1,226,945	1,184,823	1,176,656	1,122,434	1,041,369	1,015,949
Eating & Drinking	1,390,780	1,403,875	1,347,334	1,155,181	948,085	919,000
Building Materials	110,164	145,239	121,111	95,663	85,318	79,106
Home Furnishings & Electronics	183,342	197,750	198,447	180,419	159,838	151,102
Auto Dealers	10,052,566	11,002,693	10,874,997	9,054,198	8,007,571	8,584,821
Total	15,246,061	15,919,100	15,758,939	13,485,166	11,820,246	12,404,935

Source: City of Scottsdale 2008

Table 1.3 illustrates the annual sales taxes generated by the Transportation Tax (.2 percent) over the past five year period. The trend in tax revenues collected by the City increased in General Merchandise and Food Store taxes, and decreased in all other economic categories when comparing 2007 and 2006 data.

Table 1.3: Transportation Tax Collected

Transportation Tax Collected

Category	2007	2006	2005	2004	2003	2002
General Merchandise	266,099	233,271	241,792	243,150	221,976	232,210
Apparel	4,109	4,356	3,478	2,369	2,427	3,345
Food Sores	148,576	145,334	142,472	147,000	148,565	144,408
Eating & Drinking	167,396	169,257	162,849	151,081	134,926	130,979
Building Materials	13,320	17,540	14,666	12,514	12,167	11,239
Home Furnishings & Electronics	22,212	23,964	24,011	23,570	22,754	21,531
Auto Dealers	1,214,076	1,329,935	1,316,072	1,186,158	1,141,017	1,224,161
Total	1,837,790	1,921,658	1,905,340	1,765,842	1,683,832	1,767,873

Source: City of Scottsdale 2008

Table 1.4 illustrates the annual sales taxes generated by the Public Safety Tax (.1 percent) over the past five year period. The revenue trends for the Transportation Tax continue the trends established in other taxation data with increases in General Merchandise and Food Store taxes, and decreased in all other economic categories when comparing 2007 and 2006 economic numbers.

Table 1.4: Public Safety Tax Collected

Public Safety Tax Collected

Category	2007	2006	2005	2004	2003	2002
General Merchandise	136,570	117,661	122,063	59,529	ND	ND
Apparel	2,055	2,178	1,739	570	ND	ND
Food Sores	74,370	71,824	71,323	36,837	ND	ND
Eating & Drinking	84,371	85,146	81,689	36,955	ND	ND
Building Materials	6,679	8,807	7,341	3,065	ND	ND
Home Furnishings & Electronics	11,112	11,985	12,030	5,973	ND	ND
Auto Dealers	609,551	667,690	659,229	294,238	ND	ND
Total	924,708	964,690	955,414	437,166	ND	ND

Source: City of Scottsdale 2008

THE MARKET FOR RETAIL AND OFFICE USES AND STRATEGIC RECOMMENDATIONS FOR THE ENHANCEMENT OF SOUTHERN SCOTTSDALE

A Report to

THE CITY OF SCOTTSDALE

From

GRUEN GRUEN + ASSOCIATES
Urban Economists, Market Strategists, and Land Use/Public Policy Analysts

December 2007

C1220

THE MARKET FOR RETAIL AND OFFICE USES AND STRATEGIC RECOMMENDATIONS FOR THE ENHANCEMENT OF SOUTHERN SCOTTSDALE

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APPLYING KNOWLEDGE
CREATING RESULTS
ADDING VALUE

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CHAPTER I

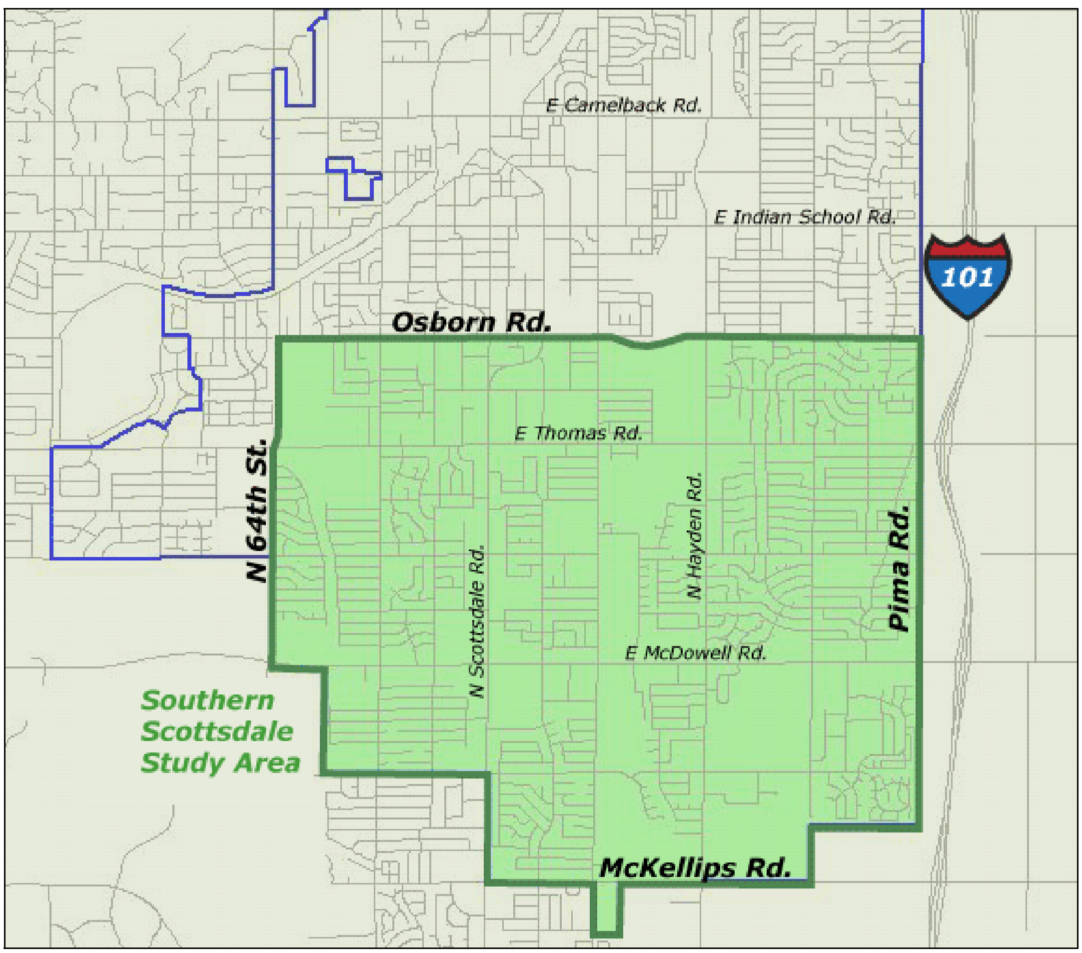
INTRODUCTION AND PRINCIPAL CONCLUSIONS AND RECOMMENDATIONS

INTRODUCTION AND WORK COMPLETED

This report summarizes the assessment and forecast Gruen Gruen + Associates ("GG+A") conducted of the market for retail and office uses in the Southern Scottsdale study area. Map I-1 shows the boundaries of the Southern Scottsdale study area. The study area is bounded by Osborn Road on the north, Pima Road on the east, McKellips Road on the south, and 64th Street on the west. The Southern Scottsdale study area does not include any part of Downtown Scottsdale.

MAP I-1

Southern Scottsdale Study Area



The primary purpose of the study summarized in this report is to forecast the potential market support for commercial uses and to identify potential strategic actions that will facilitate the enhancement of Southern Scottsdale. GG+A directed the retail market research to estimating the relationship between the potential demand for retail space and the potential supply of space within smaller (as described below, an approximately five-minute drive-time) and wider (as described below, an approximately 12-minute drive-time) geographic market areas. We estimated the potential existing and likely future retail demand within the smaller, five-minute, drive-time and wider, 12-minute drive-time market areas in terms of available dollars from residents and workers in and visitors to the market areas for the purchase of retail goods and services. We converted estimated retail demand or expenditure potential into estimates of the amount of retail space the identified demand could support, given research-based assumptions about the required average sales per square foot of retail space. We then compared the estimated supportable space within the smaller, five-minute drive-time and wider, 12-minute drive-time market areas to the estimated supply of retail space in the same market areas. We identified the relationship between potential retail demand and estimated retail supply to reach judgments about the relative intensity of competition for the sale dollars of consumers within the smaller and wider market areas and the potential for study area to capture additional retail space.

The retail market research included a review of taxable sales trends. The retail market research also included interviews directed to obtaining information about the relative advantages and disadvantages of Southern Scottsdale as a convenience and shopper or comparison good retail location as well as a location for automobile dealerships. The interviews were also used to obtain perspective on relevant market areas and competing locations with retail space and automotive dealerships in Southern Scottsdale.

To provide a framework for the office space demand-supply assessment, GG+A conducted field research and interviews with real estate brokers, office space developers, and office building owners as well as large office space users. We directed these interviews toward gaining information and insights needed to define the relevant primary market area and to identify: (a) the likely origins and types of prospective users, (b) the alternative locations prospective users will consider, and (c) the relative advantages and disadvantages of Southern Scottsdale as an office location. We studied office space supply conditions within Southern Scottsdale and the broader office market. We assessed the demand for office space by: (a) analyzing historic employment levels by economic sector for Scottsdale and Southern Scottsdale, (b) reviewing forecast employment by primary land use (provided by Maricopa Association of Governments), and (c) comparing the estimated present and future supply of office space in Southern Scottsdale to forecast demand. We synthesized these office market research tasks to reach conclusions about the potential for office space development in Southern Scottsdale.

The information and insights gained from the market reconnaissance have been used to identify an enhancement strategy for Southern Scottsdale. The recommended strategy is summarized in the next section.

CONCLUSIONS AND RECOMMENDATIONS

Decline in Relative Position of Southern Scottsdale

Because much of the growth in retail, office, and residential uses has occurred outside of the Southern Scottsdale study area, Southern Scottsdale has not shared in the growth of Scottsdale taxable sales. The overall sales decline in the Southern Scottsdale study area reflects the limited growth in new retail space and the reduction in the penetration into demands by the existing stores and other businesses operating in the Southern Scottsdale retail space inventory. Overall, due to combinations of supply additions in competing locations, shifts in population distribution, and aging, smaller, less-consumer responsive, and in some cases obsolete, retail space, the penetration into demands by Southern Scottsdale retail facilities has declined.

As a consequence of both supply additions in North Scottsdale, Mesa, Tempe, Chandler and Gilbert in locations with visibility and even better accessibility to freeways and shifts in other retail and population bases, the size and magnetism of the McDowell Road-Southern Scottsdale automotive dealership agglomeration has declined.[1] Domestic brands which confront significantly greater amounts and locations of supply competition have been more adversely affected by these shifts than luxury automotive dealerships.

The retail agglomerations in Mesa, Tempe, and Downtown Scottsdale include a substantial amount of community center, power center, regional mall and specialty retail space in contemporary shopping formats. The increase in the supply of major retail centers in Tempe and Mesa with dominant retailers in categories such as general merchandise, apparel, and electronics categories makes it challenging to arrest and reverse the decline in Southern Scottsdale's market share.

Estimated Relationship Between Retail Demand and Retail Supply

Using a typical regional standard of $350 per square foot sales threshold produces a small positive unmet or excess demand balance of 89,000 square feet of space within the smaller, five-minute drive-time trade area.[2] In 2012, assuming the addition of 215,000 square feet of new retail space at the SkySong and Los Arcos Crossing projects, using the $350 per square foot sales threshold, demand (including growth in demand due to projected population growth) and supply will be in balance. The demand-supply model construct excludes approximately 420,000 square feet of older, smaller, unanchored retail space in Southern Scottsdale, much of which is competitively obsolete.

[1] Chapman BMW is moving from the Motor Mile to Chandler to build a four-level, 300,000-square-foot dealership on 6.6-acres of land, including 800 parking spaces, 70 service bays. Lexus, Mercedes-Benz, and Audi are other dealerships that will operate from the Chandler auto row complex. According to Mesa Economic Development Department, Scott Toyota and Scottsdale Nissan are relocating to the Mesa Riverview development from the Motor Mile.

[2] The estimate of $350 per square foot sales threshold for the viable operation of retail tenancies to support new retail development reflects the review of area rents, sales per square foot productivity for a sample of major retailers, review of shopping center sales data, and the interviews.

In 2007, the existing supply of community, power and regional-center space within the larger 12-minute drive-time trade area is estimated to exceed the supportable space demand from residents, workers and visitors by approximately 1.5 million square feet of space. By 2012, the surplus of community shopping, power center, category killer, big-box space, regional mall and specialty retail space is estimated to decrease by approximately 743,000 square feet to 731,000 square feet of space. (Unique retailers without an ubiquitous presence in the region will tend to have wider trade areas than the overall 12-minute drive-time trade area definition). The decline in the estimate of excess or surplus space relative to demand is attributable to the lack of identified future supply additions in the trade area and the expected growth in the expenditure potential of households, workers and visitors.

Intensely Competitive Retail Market Conditions and Primary Strategic Implications for Retail and Automobile Dealership Uses

The results of the demand-supply analysis for both the smaller, five-minute drive-time and wider, 12-minute drive-time trade areas suggest retail market conditions are likely to be intensely competitive for the foreseeable future and that new retail space cannot succeed without siphoning off sales from existing centers. Those merchants and retail centers unable to adapt to the constantly changing retail environment and unable to respond to contemporary consumer preferences will lose sales. This is part of the natural evolution and inherent creative destruction and reinvention of the retailing and retail real estate industries.

The primary strategic retail use implication is that Southern Scottsdale needs to reduce the amount of smaller, older, obsolete unanchored centers that by their very nature serve limited trade areas, do not encourage multi-purpose trips, do not generate significant sales spillover for adjoining tenancies, and are not positioned to accommodate larger-sized tenants or create dynamic shopping and dining environments through size, tenant mix, and physical improvements.

In addition, the City must proactively work with the automobile dealers to not only promote the Motor Mile but also to facilitate land and building expansions, remodeling, and the addition of complementary automotive-service related uses. The City should also support the introduction of additional eating and drinking establishments so that luxury dealers in particular continue to find the Motor Mile a productive and efficient location from which to operate.

Retail Planning Policy Strategy

Smaller obsolete retail centers will either need to be combined with adjoining property to create larger and stronger retail developments and/or converted to higher density residential uses. Residential uses will augment demand for retail goods and services, including automotive-related goods and services. Increased residential uses, including multi-family apartments, should have great appeal to Scottsdale Healthcare and other major employers (including automobile dealers) and the talented labor force they need, which will benefit from a greater supply of multi-family and comparatively lower-priced housing near their workplaces.

Because of the positive image of Scottsdale, high property prices, and in some cases, relatively high income stream to landlords given limited expenditures on capital improvements, we believe based on our interviews, past research for Scottsdale, and the experiences of numerous other first tier suburban cities that in many cases, the reuse or redevelopment residential density will need to be higher than the current regulations permit. In addition, because higher density residential uses will typically require some form of structured parking in order to be able to build significantly more revenue-producing space, the costs of structured parking will offset at least a portion of the financial benefits of the higher density. Accordingly, municipal assistance with the provision of necessary parking may also be needed to encourage the feasible reuse or redevelopment of smaller, obsolete retail properties. This will serve to reduce the number of smaller, older centers in Southern Scottsdale. The creation of fewer but larger centers will be better positioned to compete for the expenditures of households in the trade areas. The encouragement of higher density residential uses will improve jobs-housing linkages. In addition, retail planning regulations need to reflect the fact that the depth of parcels south of Thomas Road typically are shallow, while the parcels north of Thomas Road tend to be deeper. The shallow parcels may be more suitable for residential uses than retail uses as larger retail uses typically need deeper parcels.

Retail Tenanting Strategy

Eating and drinking sales in Southern Scottsdale have held up well. The interviews suggest businesses and households, including automobile dealerships would respond well to additional food service options. The growth in eating and drinking establishment food sales, the planned office space development in SkySong, the trend of consumers spending a greater proportion of their dollars on food away from home, and the projected growth in trade area population, including growth related to the expansion of the housing base in Downtown suggest potential support for additional food service options. One strategy to explore is a restaurant row, which needs to be placed in a highly-visible location with landscaping and signage techniques that serve to attract residents and workers as well as travelers through the corridors. We use the term restaurant row because one restaurant by itself cannot serve to attract a significant number of patrons from an extended area. A cluster of restaurants, however, can typically penetrate a deeper area because consumers have the added confidence that if they cannot get into one restaurant, option options will be available. A cluster of restaurants can also engage in greater promotional activity. A restaurant row would also generate traffic and in turn be reinforced by the automobile dealers agglomeration on McDowell Road.

An effort should be made to attract a dominant retailer offering a wide variety of general merchandise or home furnishings or other goods related to the home such as a Kohl's store or a R.C. Willey store. Kohl's is located in North Scottsdale, and in Mesa but not yet Tempe. R.C. Willey is a Utah-based furniture and appliance store chain that has expanded into Nevada, and California and is not yet operating stores in Arizona. Efforts should be made to attract a Kohl's store or a higher-quality furniture or other home-related store or other major retailer near the new Lowe's store. Kohl's and R.C. Willey, for example, would complement the Lowe's store, reduce leakage out of the study area, and represents an example of a size and type of tenant that will expand the trade area served. As indicated above, higher-quality furniture and other home-related stores needing relatively large amounts of space at prices lower than rates for which retail space is available in Downtown and North Scottsdale should be encouraged in order to serve the expanding Downtown household base and new households entering Southern Scottsdale neighborhoods.

Southern Scottsdale is "Betwixt and Between" Two Core Office Locations

Southern Scottsdale is "betwixt and between" the dynamic and appealing office space locations of Downtown Scottsdale and Downtown Tempe/Tempe Town Lake. Downtown Scottsdale and Downtown Tempe/Tempe Town Lake provide the following advantages for office space uses:

- Central and accessible locations with positive images;
- Proximity to a diverse set of housing uses;
- Proximity to retail, lodging, and other support services and amenities, including eating and drinking establishments;
- Market responsive product types with appropriate physical characteristics including adequate infrastructure and parking; and most important,
- Locations within office agglomerations or a "critical mass" that help businesses attract and retain labor and operate cost effectively and productively. Agglomeration economies refer to a spatially concentrated development and capital base that from increasing returns to economies of scale, gives cost and revenue advantages to a geographic area's expanding and new firms. These advantages are "external to the firm" because they benefit all the companies engaged in a given range of activities within a particular place, without firms having to shell out extra resources.

Southern Scottsdale is not so close that it can be readily linked to potential expansion of the Downtown Scottsdale or Downtown Tempe/Tempe Town Lake office space agglomerations. Southern Scottsdale, however, is close enough to these agglomerations such that prospective non-price sensitive users considering office space options in either Downtown Scottsdale or Downtown Tempe/Tempe Town Lake will typically not choose to locate in Southern Scottsdale. However, the potential opportunity exists to capture office space users that are priced out of these adjacent areas because of the availability of lower-priced office space in Southern Scottsdale.

SkySong Likely to Capture Most of Obtainable Office Space Demands

SkySong is a mixed-use project planned to consist of 1.2 million square feet of office, research, retail, and hotel/conference center space at full build-out. The project is located on the site of the former Los Arcos Mall at the intersection of Scottsdale and McDowell roads. SkySong is planned to include approximately 600,000 square feet of office space. SkySong has primarily attracted firms either seeking to enhance their business relationships with Arizona State University ("ASU") or entities affiliated with ASU. The first 150,000-square-foot building is 93 percent leased. ASU will occupy 80,000 square feet or 53 percent of the space. Canon, which does business with ASU, will occupy 13,000 square feet, while a variety of smaller, incubator tenants, many of which have connections with ASU, will occupy 37,000 square feet. The second 150,000-square-foot building has pre-leased 35,000 square feet to Ticketmaster, which handles ticket sales for ASU events for their research and development, technology support, and information technology operations.

SkySong may improve the image of Southern Scottsdale as an office location and develop agglomeration advantages. In the interim, SkySong and other office space in Southern Scottsdale will need to compete on price, particularly for corporate or professional services users serving geographically broad markets. SkySong will need to build further upon the advantage of the presence and support of ASU by attracting firms wanting access to firms already doing business with or sponsored by ASU.

As SkySong establishes Southern Scottsdale as a desirable and productive office space location, most demand for office space in Southern Scottsdale in the foreseeable future will be captured at SkySong because of the price advantages and sense of place and agglomeration advantages tenants will derive from the location at project build-out. In the long-run, a differentiated commercial office space product type, including smaller floor plates oriented to smaller owner-occupants, or a live-work product would complement SkySong office product and benefit from economic spill-over from the project.

ENCOURAGE HIGHER-DENSITY RESIDENTIAL USES

The most important recommendation supported by both the results of the retail and office market analyses is to rezone obsolete uses, including smaller, older, currently unsuccessful shopping centers for relatively high density residential uses. Zoning changes accompanied by appropriate design and other regulatory revisions to encourage assemblage of older obsolete retail or other property into moderately priced higher density housing will bring in more residents who will provide both the employment base for offices, healthcare, and research and development activities as well as patrons for Southern Scottsdale stores and restaurants. Additional residents are needed to provide support for a greater selection and quality of restaurants and retail goods and services that will appeal to both office workers and residents.

The availability of an expanded workforce as the result of encouraging the development of relatively higher density residential uses will be attractive to tenants of SkySong, and other area employers including Scottsdale Healthcare and General Dynamics. Some of the new residents of such housing may become sources of demand or labor for firms that occupy other types of office space products eventually built in southern Scottsdale as the result of SkySong improving the image of Southern Scottsdale as a location for office space. Improving the linkages between locations of jobs and housing opportunities and the resulting shorter commute potential will improve the competitive position of Southern Scottsdale as an office location.

The interviews suggest high reservation prices (the minimum prices for which property owners will sell their properties) for Southern Scottsdale property constrain feasible redevelopment or reuse projects under current zoning regulations. To avoid high reservation prices causing stagnation, any zoning changes that will tend to cause owners to justify high reservation prices should be subject to "performance zoning" or a "sunset clause". Under these clauses, either the property would not be zoned unless specific development parameters are in place, or if the property is not developed for new residential, retail, or office users within a certain time, the zoning permitting higher-density uses would revert to a lower-density zoning classification.

ARRESTING AND REVERSING THE DECLINE OF SOUTHERN SCOTTSDALE

From a real estate economics point of view, the downward trend or stagnation of Southern Scottsdale corridors has been caused by the gap between what owners will accept for property and what current uses can support. Revitalization will be made more difficult by the development of competition from locations such as Downtown Scottsdale and northern and DowntownTempe which have experienced upward quality improvements and which have benefited from specific and substantial municipal efforts to upgrade those areas (well over $140 million for each community). The increased competition from nearby locations and decline in the quality and productivity of Southern Scottsdale retail and office properties relative to other areas of the community create a reinforcing feedback mechanism that can lead to further decline.

As one of many examples of such a downward cycle, GG+A found an applicable to another community for which GG+A did research, includes smaller neighborhood retail centers in an affluent and California prestigious community. Neighborhood retail centers in that community became increasing obsolete and blighted due to regulations that limited the size of grocery stores and imposed constraints on adapting properties to serve contemporary demands, including conversion to residential uses. Supply competition with modern grocery stores and larger, more dynamic anchor tenants arose in nearby communities. The development of dominant supply in nearby competitive communities shifted consumer shopping patterns that caused further deterioration in neighborhood shopping centers in the community whose owners given regulatory and market factors had little incentive to invest in maintaining the status quo. Revitalization begins when creative new projects and uses serve to create desirable places able to charge more than currently-prevailing rates, and spill-over their value-enhancing benefits to adjoining properties. To facilitate the feasibility of such projects in Southern Scottsdale, higher density can be provided to buyer-developers which will not maintain the status quo, but will create image and rent-enhancing developments.

Given these market realities, the City of Scottsdale (like any other community facing these issues) is left with a difficult choice:

(1) Let market forces prevail and do not support comprehensive redevelopment or reinvestment through municipal actions, such as the intensification of zoning or the use of financial incentives. Under this scenario, it will likely take five to 10 years before reservation prices or property values decline to the point where purchase and redevelopment of those properties is financially feasible for private investors to undertake, given current development standards and constraints (such as low height restrictions, shallow lots, and zoning that doesn't

easily facilitate mixed-use development). In the interim, however, further stagnation and decline of Southern Scottsdale can be expected to occur; or

(2) The City can proactively intervene by using financial and regulatory incentives, including permitting more intensive use of land to stimulate private feasible investment and redevelopment. This is what Scottsdale elected to do with its Downtown through the creation of the 1984 Downtown Plan with ordinance changes in 1986 that allowed increased heights, density and mixed-use in the area. The Downtown Overlay Districts, approved in 2003, helped the smaller lots improve through various incentives such as the façade program, changes to parking requirements, fee reductions for some building permits, creation of the Specialty Retail District incentive. Additionally the Canal Parkway improvement plan, the Marshall Way bridge, various plazas with public art, abandoning some alleys and ROW's, the Infill Incentive District, and building four public parking garages helped to facilitate redevelopment. The City also undertook a series of infrastructure improvements that included undergrounding, relocating, upsizing and upgrading electric, gas, water, storm sewer, and sewer lines. With these changes, many envisioned over 20 years ago, the area is now booming. Between January 2003 and July 2007, the City's public investment in completed and budgeted projects of $140 million in the downtown area was matched by $1.76 billion in private investments; almost a 13 to 1 return on the public investment. Proactive City intervention, however, in order to avoid the downward cycle of Southern Scottsdale will also entail high costs in terms of both financial resources and political capital.

In the absence of a clear signal on which policy direction the City will steer, property owners may maintain their high reservation prices because of expectations that the City will intervene in the future. This will reinforce the status quo and prevent either path to revitalization outlined above from occurring in the foreseeable future.

REPORT ORGANIZATION

Chapter II presents an analysis of historical taxable sales trends in the City of Scottsdale as a whole and in the Southern Scottsdale study area. Chapter III presents an assessment of the competitive position of Southern Scottsdale and sources of competition to and demand for retail space in Southern Scottsdale. Chapter IV describes the relevant market areas and supply of retail space. Chapter V presents estimates of retail expenditure potential and the potential demand for space in the smaller and wider market areas. Chapter VI presents estimates of the relationship between estimated supply and demand within the smaller and wider market area and the share of the market demand that can potentially be captured in Southern Scottsdale.

Chapter VII reviews the primary geographic areas within which Southern Scottsdale office sites compete for office space users and the primary geographic areas from which office space users are attracted. Chapter VII also reviews the competitive position or relative advantages and disadvantages of Southern Scottsdale for attracting office space users. Chapter VIII reviews the office space inventory and supply trends for the City of Scottsdale and Southern Scottsdale. Chapter IX reviews current employment by economic sector and forecast office space demand based on employment growth. Chapter IX presents a comparison between the relationship between forecast office space demand and existing and likely future available Class B and Class A office space in Southern Scottsdale.

REAL ESTATE ECONOMIC ANALYSIS
OF USE OPTIONS IN SOUTHERN SCOTTSDALE

A Report to

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REPORT HIGHLIGHTS

KEY FINDINGS

- Most of the existing properties with frontage along Scottsdale and McDowell roads encompass less than one acre of land. Approximately 40 percent of all frontage parcels are smaller than ½ acre, while an additional 25 percent are between ½ and one-acre in size. Fewer than 25 parcels contain more than four acres of land along Scottsdale and McDowell roads.

- Site coverage for small parcels less than one acre in size generally ranges from 30 to 40 percent. Site coverage for larger parcels averages between 23 to 28 percent. These coverage ratios are considered relatively low density compared to coverage ratios of 50 to 75 percent typical of an urban, higher-density environment.

- Smaller commercial properties along Scottsdale and McDowell roads are assessed at values of $30 to $40 per square foot of land.

- Many smaller properties are purchased at prices higher than justified by the current real estate economics or income property owners derive. Reservation prices (the minimum price at which a seller is willing to sell) are higher than what can be justified solely by the income the properties yield.

- Current net rent levels of small, older properties do not facilitate owners completing significant remodeling or updating. One option some existing property owners may be encouraged to adopt is to reduce maintenance or other expenditures on improvements. Real estate economics explain the deterioration that has been observed in the land use patterns and associated real estate in Southern Scottsdale and the relatively limited amount and frequency of redevelopment not subsidized by the City of Scottsdale.

- Prices of all real estate have been under pressure as a result of the recession. The asking prices of $150 to $300 per square foot of building space, or the equivalent of $40 to $60 per square foot of land for smaller commercial properties and $14 to nearly $38 per square foot of land for improved larger properties, and prices around $9.00 per square foot of land for unimproved larger properties provide indications of reservation prices.

- Under existing regulations, multi-family residential development may obtain between 22 and 30 percent site coverage if the building is three stories in height. Under the existing setback, open space and parking requirements, a height limit of two stories for Class A office or retail uses results in retail and office buildings that can obtain approximately 20 to 30 percent site coverage. However, office and retail buildings may obtain approximately 40 to 50 percent site coverage if the building is single story.

- The PUD regulations result in multi-family buildings of four stories that cover between 30 and 45 percent of land area.

- Obtainable site coverage for commercial uses under the adopted PUD are no different from those achieved under existing zoning regulations because setback, parking and open space requirements are the same. Higher densities (floor-area-ratios) may be obtained, however, due to increased building height restrictions.

- Under existing or PUD regulations and given current development cost and market conditions, apartment uses, especially those which require the development of structure parking rather than surface parking, are unlikely to support high enough land values to induce redevelopment. For larger sites, assuming above market rents, retail and restaurant uses appear closer to being able to support land values close to reservation prices for large sites, but not for smaller sites.

- The value created by a new retail or restaurant use on a small site would not be sufficient to induce the owner of a typical existing smaller property to redevelop the property into new retail and restaurant uses.

- Under the current relationships between development costs, operating revenues and costs, and capital values, even assuming the regulations are altered to permit hotel development of six stories, limited service and extended stay hotel products are unlikely to support land values high enough to encourage redevelopment of sites with existing income producing uses.

- For smaller sites, most property owners will be better off wringing whatever income can be produced by existing small, older commercial properties than redeveloping the properties into townhouse or live-work uses.

- While the income produced frequently cannot support the reservation prices for many smaller properties, the relatively high reservation prices make it challenging for properties to be assembled and redeveloped. Because the reservation prices of many owners are higher than what can be supported by obtainable multi-family and retail space rents, developers will have to either use different assumptions to justify buying the property needed for redevelopment of new residential and retail uses under the existing or newly adopted PUD regulations, or elect to accept a lower return now in anticipation of higher rents in the future.

- Southern Scottsdale will need to establish a more desirable and distinct image for multi-family residential, townhouse/live-work, retail, office and tech-service uses with a pattern of development products, infrastructure and amenities that permit competing effectively with alternative locations. Under the present market, cost and regulatory relationships most smaller properties with somewhat obsolete building space will not be redeveloped into new residential and retail uses. This likelihood suggests that the market on its own is not likely to cause in the near term the type of changes needed to make Southern Scottsdale a more desirable and competitive location capable of supporting higher prices from increased obtainable demands.

- The current recession and poorly functioning capital markets will make it more challenging for the needed evolution of Southern Scottsdale to occur. Retail rents have declined significantly; office vacancy rates have increased, while office rents have declined; and average daily room rates and occupancy rates at hotels in and near Southern Scottsdale have also declined.

CONCLUSIONS AND RECOMMENDATIONS

For the private land use market in Southern Scottsdale to become sufficiently vigorous to support improving and sustainable economic and social conditions will require municipal entrepreneurial actions. The results of the real estate economic analysis and interviews suggest the following strategies and tactics for reinventing Southern Scottsdale corridors to increase their competitive magnetism and demands that sustain private feasible development and enhancements:

- Clarify and simplify the PUD for Southern Scottsdale to include effective by-right development standards because many developers for relatively small sites will not have the wherewithal to comply with the time and cost requirements of the PUD;

- To avoid high reservation prices causing stagnation, subject any zoning changes that will tend to cause owners to justify high reservation prices to "performance zoning" or a "sunset clause". Under these clauses, either the property would not be zoned unless specific development parameters are in place, or if the property is not developed for new residential, retail, or office users within a certain time, the zoning permitting higher-density uses would revert to a lower-density zoning classification;

- Facilitate private feasible development including land assembly and use changes in the corridors to accommodate recommended changes in land use (for example, from obsolete retail to higher density residential). For example, eliminate or modify regulations that reduce the amount of building space that can be created. Permit increases in site coverage, especially for smaller lots intended to be redeveloped for townhouse or live-work uses;

- Given the findings that the cost of structure parking discourages feasibility of higher density development alternatives associated with the proposed PUD, municipal assistance with the provision of necessary parking (or modification of parking requirements) may also be needed to encourage the feasible reuse or redevelopment of smaller, obsolete properties;

- Reduce impact fees, especially for small lot residential projects, to improve feasibility;

- Encourage a pedestrian-friendly environment with appropriate traffic signalization and crosswalks and landscaping and pedestrian-scaled streetscape amenities;

- Identify in the Community Area Plan for Southern Scottsdale locations for new General Plan activity areas of mixed-use, higher-intensity development at key intersections such as Scottsdale and McDowell roads. These core areas should accommodate a critical mass of activity and create a distinctive sense of place and encourage pedestrian and street-level activity. Until the economy turns around considerably and the real estate markets recover, insufficient demand is likely to exist to create mixed use, high density developments at all key intersections. The intersection of Scottsdale and McDowell is one place where higher intensity would be best positioned to work, given the City's past public investment in SkySong and its location as a gateway to the City's Downtown; and

- Given the presence of General Dynamics and SkySong, the proximity to the Phoenix Sky Harbor International Airport and highway and transit connections, proximity to the Arizona State University campus in Tempe, and existing nodes of technology and service space users near the General Dynamics campus and near Papago Park, provide in the Southern Scottsdale Community Area plan the potential for additional research and development and technology and service uses. The Plan should also provide for public and private educational and healthcare activities.