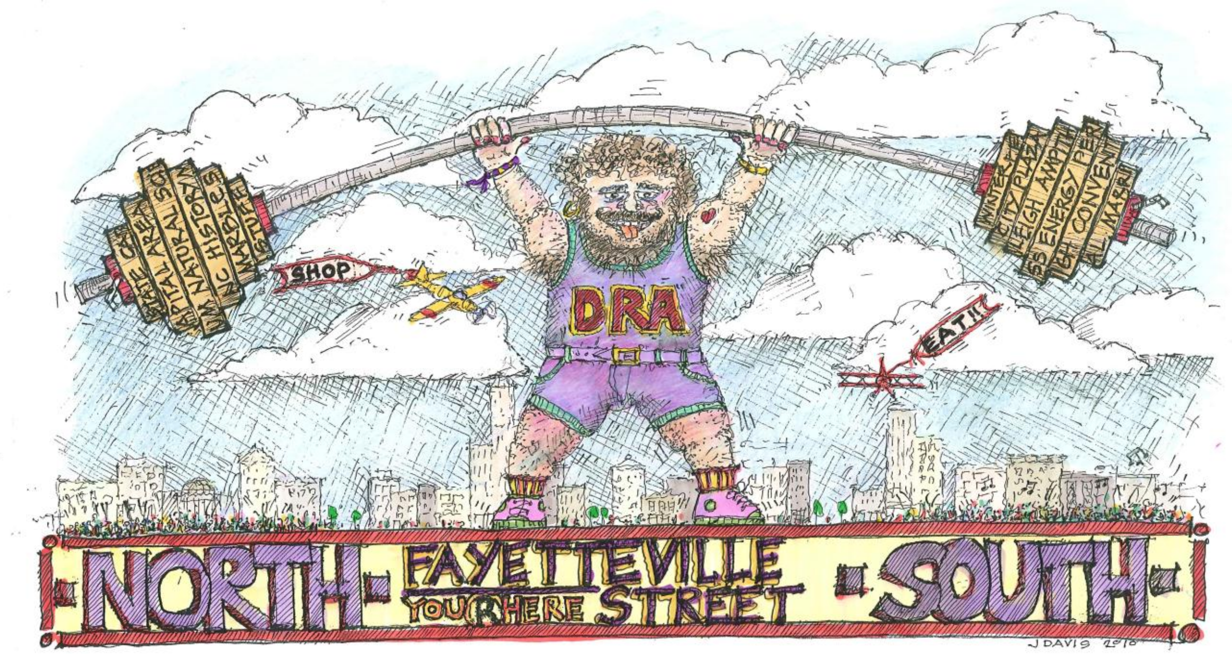
Urban Land Institute
Triangle

Technical Assistance Panel Report on the Economics of Ground Floor Retail in Downtown Raleigh



Prepared for the Downtown Raleigh Alliance

Triangle District Council of the Urban Land Institute

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Executive Summary

The Technical Assistance Panel (TAP) program is a smaller-scale version of the larger technical assistance programs run by ULI-national, adapted for implementation and administration at the District Council Level. In the summer of 2010, the Downtown Raleigh Alliance (DRA) became the first organization to apply for and to sponsor a Technical Assistance Panel (TAP) as part of a new program organized by the Triangle District Council of the Urban Land Institute. A panel comprised of experts in development, financing, leasing, and retail design was recruited and organized by the District Council's TAP committee, and the TAP exercise took place on October 26 and 27 of 2010.

The Panel's task was to examine the economics of putting ground floor retail space into active use. The panel was provided with a detailed briefing book by the DRA, and supplemented this information with site visits and interviews with property owners and brokers active in the downtown marketplace. The panel assessed the prospects and tradeoffs between three common types of ground floor tenants—retailers, restaurants and bars, and office users. The panel's findings are intended to serve as a supplement to DRA's recently completed market study for downtown retail and inform future retail recruitment efforts. The major findings of the panel are as follows:

- Almost all the available spaces require significant investments in TIs for any sort of user, as few of the available storefronts are "second generation" spaces with reusable TIs already in place. Asking terms appear to lack any relationship to the size, characteristics and TI costs associated with the various spaces.
- Demand for space still primarily comes from restaurants, and everyone interviewed believed there was still significant room in this space for additional operators with the right concept and management. Demand from more traditional retail categories has been low and sporadic.
- Spaces suitable for restaurant use are most in demand, and second generation restaurant spaces are the most desired. The high demand for second generation space is a barrier to more restaurants and retail in downtown Raleigh, as so many of the available spaces in the downtown are in poor or raw condition, having either never been leased or having sat vacant for an extended period of time, sometimes even decades.
- Both landlords and brokers active in downtown Raleigh are working within a marketplace where there are few norms and comparables. Each operator, each space, and hence each deal is unique and requires flexibility and creativity on the part of all parties involved.
- Downtown Raleigh already has the classic "dumbbell" shape favored by regional shopping malls, with anchors at the ends connected by a corridor of in-line tenants. In Raleigh's case, however, the "anchors" are not retailers, but are the museums and state government complex on the north end, and the Convention and Performing Arts centers at the south end. Collectively, these destinations produce 2.7 million visits to downtown each year.
- With its non-traditional anchors, downtown Raleigh will be less attractive to traditional retail anchors and tenants, and more attractive to unique concepts that add vitality and uniqueness but that may or may not be commodity retailers.
- The problem of more fully activating downtown's ground level is real but manageable. Downtown ground floor space is in demand today, and when leased, it generates reasonable rents. The amount of vacant space in the downtown core totals less than 40,000 square feet. The major barrier standing in the way of getting this space into active use is not a lack of demand, or excessive rents, but the cost of making the initial round of tenant improvements.

- While the gap between the needed TI investment and available capital varies greatly from space to space, in general the costs to get downtown retail spaces into minimally workable condition falls within the range of \$20 – 50 per square foot to "white box" the space with walls, lighting, HVAC and plumbing (typically the landlord's responsibility) and anywhere from \$30 – 200 per square feet to do tenant-specific improvements. Financing for these TI's can come from traditional sources—tenant equity, property owner financing—or non-traditional sources such as economic development programs.
- The past three years of job losses, business failures, and household retrenchment have had a negative impact on rents and occupancy rates, with the office economy especially hard hit in downtown. Expectation for downtown expansion must accordingly be kept in check.

Buildings off of these findings, the panel recommends the following:

- Retail recruitment should target any interesting use that can activate a ground floor space. In addition to traditional retail, such uses may be short-term, such as pop-up shops, or they might be such things as workshops/ateliers with a retail components, or even office users who can activate the street with a gallery or multi-media presence. The panel specifically recommends that the DRA back-burner efforts to attract a blockbuster tenant such as a chain bookstore or movie theater.
- Many downtown retail spaces sit empty because neither the landlord nor the prospective tenant has the resources or credit to finance the necessary TIs. A capital bridge or subsidy is therefore needed, targeting the first generation spaces requiring the most expensive up-front investments. An estimated \$4 million is sufficient to redo all of the currently available spaces in the downtown core, and if structured as a loan fund, the capital could be recycled over time to start reactivating older spaces on the edge of the downtown core as momentum builds and downtown's worker and resident population grows. The money can come from two potential sources: the downtown business and property owner community (the private sector), and/or the City of Raleigh (the public sector).
- Tenant retention needs an equivalent emphasis as recruitment. This requires that tenants be able to operate profitably year after year, which requires that they effectively address the downtown marketplace as it exists and work to tap into the existing sources of demand. A downtown-specific merchant's and/or restaurant association can serve as a vehicle to pool marketing dollars, share information, and advocate for merchant's interests.
- The DRA has a successful track record of both initiating and partnering with others on high-traffic events, such as the three-day Hopscotch Music Festival, SparkCon, Raleigh Wide Open, Artsplosure, and WinterFest. Building off existing efforts, more can and should be done to create opportunities for merchants and restaurants to tap into the spin-off benefits of these high-traffic events.

Downtown Raleigh continues to build its three target niches as an employment center, event destination, and livable neighborhood. A vibrant ground floor economy plays an important role for all three niches. At a time when households continue to deleverage and consumer confidence remains depressed, downtown Raleigh continues to see new business openings. Momentum has been sustained during the recession and will pick up as the economy recovers. The current vacancy rate within the core is relatively low, and therefore the amount of space that needs to be filled to fully tenant Fayetteville, Wilmington and Hargett Streets is modest. While achieving the goal of a fully activated ground floor will be difficult, it is both doable and worth doing.

Introduction

In the summer of 2010, the Downtown Raleigh Alliance (DRA) became the first organization to apply for and to sponsor a Technical Assistance Panel (TAP) as part of a new program organized by the Triangle District Council of the Urban Land Institute. A panel was recruited and organized by the District Council's TAP committee, and the TAP exercise took place on October 26 and 27 of 2010. This report summarizes the results of the exercise, including the findings of the panel and the key information points in support of those findings. It concludes with a set of recommendations for the DRA.

THE TAP PROGRAM

The Technical Assistance Panel (TAP) program is a smaller-scale version of the larger technical assistance programs run by ULI-national, adapted for implementation and administration at the District Council Level. Like the national-level programs, the TAP program focuses on mobilizing impartial and expert advice to solve identified problems. Distinguishing features of TAP include:

- A short time frame: panels typically last no more than one or two days.
- A focus on a discrete, well-defined problem
- Modest costs for the applicant, whether cash or in-kind contribution, making the TAP program particularly accessible for smaller governments and non-profits.

The mission statement for the Triangle TAP program reflects the overall mission of ULI, focuses on the three guiding principle that emerged from Reality Check 2009, and embodies the purpose of the TAP program, which is to provide seasoned and objective advice on discrete planning and development issues.

> "The Triangle District TAP program brings together applicants and experienced professionals from the private, public and non-profit sectors to develop solutions to specific land use and development problems related to enhancing transit and the transportation-land use connection; growing and sustaining vibrant centers; and conserving the region's agricultural and natural areas. The Triangle District TAP program embodies the core ULI principles of objective advice, free from conflicts of interest; the open exchange of ideas, information and experience; and leadership in the responsible use of land."

Triangle District Council TAP exercises are conducted over one to one-and-a-half days, depending upon the nature of the request. One day TAPs are recommended for problems that do not require a detailed site visit, while the longer format is designed to permit site visits and orientation to occur the afternoon prior to the full day of sessions, interviews and brainstorming. All TAPs include the creation of a briefing booklet compiling background data and information for the panel to review prior to the TAP. The TAP concludes with a presentation of findings and recommendations to the project sponsor. Components of the TAP process include the following:

- Briefing session with the sponsor
- Site visit (optional)
- Stakeholder briefings/interviews

- Panel working session
- Presentation drafting
- Final presentation

All TAPs result a PowerPoint presentation and a final, written report.

THE ASSIGNMENT

The DRA's question concerned the economics of ground floor retail space in downtown Raleigh, and sought to provide clarity regarding the prospects for filling this space with activity-generating uses. While the DRA had recently taken delivery of a detailed retail study for downtown that suggested the appropriate overall market direction for downtown retail and some likely tenant prospects, the study did not directly address the building stock, the characteristics of the spaces available for rent, and the realities of getting tenants into these available spaces. The TAP assignment therefore represented a logical next phase of work for catalyzing downtown retail.

Ground floor space in downtown Raleigh currently resides in one of three states—it is leased to a retail or restaurant business; it is leased to a non-retail business, such as an office user; or it is vacant. The DRA's first formulation of the question was specific to the economics of leasing ground floor space to an office tenant rather than a retail user, with the implicit assumption that office tenants offered a less risky and more attractive option to downtown landlords. Upon further investigation, it was determined that this office versus retail formulation was too simplistic—the rent differential between restaurant and office is a function of both the rental rate (typically higher for restaurants) and the cost of the TIs (typically much higher for restaurants) such that the effective gap may be positive or negative depending on the peculiarities of the space and its suitability for particular uses.

The question was therefore reformulated as follows:

> "Buildings on Fayetteville Street have a mix of office and dining tenants on the ground floors. The retail analysis concluded that Fayetteville Street should be marketed to attract destination tenants (bookstore, movie theater), fast-casual dining, and fine-dining for the signature RBC Plaza building. Real estate professionals have reported difficulties in securing a retail tenant for ground floor spaces due to a gap between what tenants are willing to pay what landlords are willing to accept, the lack of credit worthy retail tenants, and the inability of tenants to finance their own TIs. Faced with these difficulties, many landlords have either left ground floor space vacant or leased it to office or other non-retail users. To the extent that a lively and diverse ground floor economy drives rent and price premiums for upper floor commercial and residential space, this outcome could be limiting the overall economic performance of downtown real estate. Therefore, DRA requests ULI to conduct a TAP that examines this issue further by asking the questions: What is the typical financial gap between what a retail tenant can afford in terms of rents and TIs, and what landlords need to make the numbers work on their property? How have other property owners dealt with this gap when leasing space to restaurants and retailers? How much do downtown retailers need to gross in sales to afford normative downtown rents? Finally, and generally, how important is ground floor retail to the overall office and residential market?"

THE PANEL

To answer this question, the Triangle District Council TAP Committee sought out panelists with expertise in mixed-use development, development finance, commercial leasing, business and real estate lending, and the upfit of retail spaces.

The TAP process was overseen by the TAP Committee Chair Kenneth Bowers, Deputy Director, City of Raleigh Department of Planning. Ken also recruited the Chair for the Downtown Raleigh Alliance (DRA) TAP, John J. Healy, Jr.

As Chair of the DRA TAP, John in turn recruited four TAP panelists. Each panelist was chosen to represent a different discipline involved in commercial developments, and to bring relevant expertise to the issue of downtown revitalization.

The DRA TAP committee included:

- **John J. Healy, Jr, Chair, Principal, Hyde Street Holdings, ULI Trustee**
  John's expertise lies in real estate investment, advisory services (including valuation and consulting), and asset management (rated-special servicer) services. John brought an understanding of different investment and financing structures available to lower financial risk and create incentives for downtown developers, paving the way for financial feasibility.

- **Mike Harris, Panelist, Executive Vice President & COO, Highwoods Properties**
  Mike's company, Highwoods Properties, owns and manages Country Club Plaza in Kansas City, a mixed-use entertainment, retail, office and living complex. Mike contributed an understanding of the drivers of successful downtown retail along with his expertise in the development, acquisition and management of commercial real estate, with principal emphasis on office, industrial/distribution and retail properties.

- **Andy Holland, Panelist, Senior Vice President & Manager, Wells Fargo Middle Market Real Estate Group**
  Andy's strengths lie in comprehensive short-term financing for middle-market commercial real estate investors and developers. His Middle Market Real Estate Group provides financing for a wide range of properties and objectives including building, acquisition, expansion, repositioning and rehabilitation.

- **Scott Selig, Panelist, Associate Vice President, Capital Assets & Real Estate, Duke University**
  Through Scott's work with Duke University Real Estate's investments in downtown properties, downtown Durham is being transformed. Scott understands perfectly the types of investment and public/private partnerships needed for downtowns to be revitalized, and brings a wealth of experience from Durham.

- **Jeff Davis, Member, Founder, JDavis Architects**
  Jeff's firm brings vast experience in all types of properties including multifamily, office/corporate, mixed use/retail and urban infill – many in the downtown Raleigh market. Jeff knows firsthand the initial investments necessary to make projects feasible.

The panel was assisted by several ULI Members and staff including Holly Fling, Managing Principal, ECO Systems Analysis; Steve Vinson, Principal, Glenwood Development Company; and Julie Paul, ULI Triangle Council Executive.

THE EXERCISE

The panel convened on the afternoon of October 26 and received a briefing from the project sponsor. Paul Reimel, who is in charge of the DRA's retail recruitment efforts, gave an overview of the major findings in the briefing book and his perspective on downtown retail. Paul then led the team on a tour of several representative retail spaces ranging from raw, unshelled space in a new office tower, to partially finished space in historic buildings. The panel had the opportunity to talk to the leasing agents and brokers for most of these spaces. Following the tour, DRA CEO David Diaz outlined his expectations for the TAP exercise, after which the panel shared dinner at a downtown restaurant.

The remainder the TAP took place on October 27. The team convened in the morning to share ideas and questions from the previous day's activities. From 9 to 11 AM, the team interviewed in more detail several downtown retail brokers regarding their experiences leasing downtown retail space.

Panel deliberations continued through lunch, after which the panel began assembling its findings in a presentation. The presentation was delivered to the DRA at about 4 PM. The presentation was well received by the project sponsor with no major disagreements with the panel's findings arising.

Summary of Findings

The panel's findings have three sources: the briefing book, the site tours and broker interviews and conversations, and the deliberations where the diverse experience and expertise of the panel members was shared. This chapter summarizes the major findings by source.

FINDINGS FROM THE BRIEFING BOOK

The DRA compiled a comprehensive briefing book serving as the primary data source for the panelists. The briefing book was provided to the panelists a week in advance of the TAP exercise so that they could familiarize themselves with the relevant data prior to the interviews and deliberations.

The following are major findings from the briefing book:

Office Worker Market

While a detailed census of employment was not provided, approximate figures for the largest office towers in or near the study area were given. These figures totaled about 6,700 workers. Not included were City and County workers at the Courthouse, County office building, and One Exchange Plaza. Assuming these total approximately 1,000 workers, and that another 300 workers are scattered in small buildings, then there are 8,000 workers conveniently located to retailers on Fayetteville, Hargett and Wilmington streets. Office workers typically spend $2,000 a year near their workplace, mostly on food and convenience items. These workers therefore provide $16 million in spending power, sufficient to support about 60,000 square feet at $250 in sales per square foot.

Parking

In round terms, there are about 9,000 parking garage spaces that serve the study area. While downtown workers dominate the use of these spaces during the workday, occupancy figures and past parking studies indicate significant availability of hourly public parking in each and every one of these facilities at all times, including peak morning and afternoon hours. After working hours, occupancy rates plunge and the downtown is awash in parking capacity. However, the daytime parking charges of $2/hour provide a significant disincentive for people to drive to downtown Raleigh specifically for the purpose of shopping. On street rates are lower, at $1 per hour, but availability is limited, and current occupancy rates indicate that demand for on-street parking is in a reasonable equilibrium with supply at the current price level. All City decks offer free parking after 7 PM weeknights and on non-event weekends, and on-street parking is free after 5 PM and on weekends, supporting the dining and nightlife economy.

Because of the downtown parking situation, retail and restaurant demand during business hours is mostly created by downtown workers and people who are in downtown for other reasons, such as business meetings, jury duty, or visits to governmental offices. After hours and on weekends, the abundance of free parking permits downtown to function as a welcoming destination for people driving in.

Demographics

Downtown Raleigh has a modest number of apartments and condominiums at its core, and is surrounding by historic low-density neighborhoods that range from prosperous districts such as historic Oakwood to some of the City's poorest areas.

Housing within the downtown core totals about 1,200 units. The people who live in these units form a natural market for downtown retail and services—many are within in walking distance, and those that are not can avoid parking charges by biking or using the City's free R Line bus circulator. Many of these units, corresponding to condominiums that came on line concurrent with the collapse of the housing market, are currently unoccupied and therefore not contributing to retail demand. In spite of the unsold inventory, the current value of downtown for-sale multifamily is about $240 per square foot, which is healthy for this market. New rental units current fetch $1.50 per square foot per month, compared with $1.00 – 1.10 for high quality suburban garden apartments. In spite of the downturn, downtown housing continues to occupy a luxury niche, but the number of occupied units remains too small to be a significant source of retail demand.

Retail Rents and Leasing Terms: Asking Conditions

A summary of the current asking rates and terms for selected retail spaces was provided in the briefing book. The following table summarizes the figures:

Table 1: Summary of Asking Terms for Available Spaces

Address	Size	Type	Rent	CAM	Notes
203 Fayetteville	5,000	Unfinished	$14	--	Was once in white box condition but has aged out.
207 Fayetteville	1,200	Active office	$20	--	Active office tenant
301 Fayetteville	6,846	Cold, dark shell	$22.50	$5.10	RBC Plaza
301 Fayetteville	1,930	Cold, dark shell	$22.50	$5.10	RBC Plaza
301 Fayetteville	2,300	Cold, dark shell	$22.50	$5.10	RBC Plaza
401 Fayetteville	1,401	Former retail	$25	--	Includes taxes, insurance & utilities
414 Fayetteville	4,000	Former office	$15.75	--	Full service
111 E. Hargett	3,000	Unfinished, historic	$25	--	NNN
112 E. Hargett	2,300	Finished, retail	$18.68	--	Full service, no bathrooms, restaurant not desired
199 E. Hargett	3,800	Unfinished, historic	$25	--	NNN
19 W. Hargett	4,800	Partial TI for restaurant	$25	--	NNN
131 S. Wilmington	1,500	Unfinished, retail	$25	--	NNN

Asking rents range from a low of $14 to an effective high of $27.60 per square foot for the raw shell spaces in the RBC Plaza ground floor. Most rents are triple net (i.e. the tenant pays all expenses), but some include basic operating expense items. Of the spaces listed above, only one is in close to move-in condition: 112 E. Hargett, which was recently vacated by an apparel store. One former restaurant space at 19 W. Hargett has some restaurant fittings and equipment left the last tenant, an Italian restaurant. The remaining spaces fall into three general categories:

- Cold, dark shells lacking floors, HVAC, lighting, and any sort of interior finishes. The RBC Plaza spaces are in this condition.
- Unfinished or partially finished retail spaces in historic buildings. Basic mechanical services such as HVAC and bathrooms may be provided, but otherwise the space lack interior finishes and have not seen a tenant in a number of years.
- Spaces which have seen more recent use and are equipped with HVAC and bathrooms but which still require significant improvements.

In short, almost all the available spaces require significant investments in TIs for any sort of user, and especially so for restaurants. Few of the available storefronts are “second generation” spaces with reusable TIs already in place. Asking terms appear to lack any relationship to the size, characteristics and TI costs associated with the various spaces. Rather, they seem to be a starting point for negotiations that will necessarily involve landlord assistance with TI financing in addition to possible rent concessions (these considerations are discussed in more detail under the section summarizing the broker interviews).

FINDINGS FROM THE BROKER INTERVIEWS

The TAP panel met with commercial brokers active in downtown both during the site visits of available spaces, and as part of four half-hour sit-down interviews conducted the following morning. These brokers included the following:

- Jack Kimball, Kimball & Company (site visit and interview)
- Carter Worthy and Tom Worthy, Carter Worthy Commercial (interview)
- Ben Steel and Holten Wilkerson, Empire Properties (site visit and interview)
- Christina Coffey, Hunter & Associates (site visit and interview)

Brokers shared their insights regarding downtown retail leasing, including tenant demand, what sort of arrangements were necessary to close deals, and where the downtown market is headed. As the downtown market is currently characterized by such eclectic tenants that every deal is in some way unique, these interviews were essential in understanding the downtown market dynamics.

Tenant Demand

Demand for space still primarily comes from restaurants. While the increasing number of downtown restaurants raises questions regarding market saturation, everyone interviewed believed there was still significant room in this space for additional operators with the right concept and management. Further, the concentration and variety of restaurants and bars has been essential to turning downtown Raleigh into a nighttime destination, where people feel comfortable going without having a specific dining option in mind, preferring to “decide when we get there.”

The brokers from Empire Properties also noted a significant number of inquiries from convenience stores. These users seem to be drawn to a location close to the Moore Square bus station. Empire has been turning away such inquiries as convenience store tenants are seen as incompatible with the overall vision for Empire’s portfolio of downtown properties. A new convenience store did open on Wilmington Street shortly after the conclusion of the TAP exercise, right at the pedestrian entryway into the bus terminal. No other interviewees expressed similar opinions regarding convenience stores.

Demand from more traditional retail categories has been low and sporadic. Some of the more unique retailers in downtown, such as Stitch, have been the result of landlord-driven recruitment efforts. Efforts to bring a food retailer to one Hargett Street space fell through due to an inexperienced and undercapitalized operator.

When an office user and a restaurant user compete for the same space, the restaurant will typically pay higher rent, but the restaurant will require a much higher upfront expenditure, and the rate of turnover is likely to be higher. Office users offer lower upfront costs and less volatility, but will also demand lower rents as ground floor spaces are not ideal for most office users. On a profit/return basis, rents must be adjusted based on the landlord’s investment and TIs and collection risk. If the landlord expects a 10 percent return, each $10 that landlords invest in TIs must result in an additional dollar in rent. If landing a restaurant requires that the property owner contribute $100 per square foot for upfit, the restaurant would need to outbid the office tenant by at least $10 per square foot in rent, or more, if increased risk is factored in.

Types of Spaces Demanded

Spaces suitable for restaurant use are most in demand, and second generation restaurant spaces are the most desired as the more expensive TI elements such as grease traps and kitchen exhaust and equipment are already in place. Restaurant spaces rarely stay vacant for long, and often the transition from one tenant to the next can happen seamlessly with minimal changes and no interruption in rent, such as was the case when the BuKu took over from Fins in the corner of the Progress Energy II tower, or when the Duck and Dumpling changed head chefs and themes. Moreover, the outgoing restaurant tenant sometimes even helps find a replacement tenant due to the desire sell such items as the tables, chairs, and removable kitchen equipment to the new operator and to avoid penalties from breaking the lease.

This insight is important, as the sheer cost of the TIs for restaurants going into first generation spaces has been a significant stumbling block to getting spaces leased. Because of their inability to get bank financing, restaurants typically need assistance with these costs, yet landlords have been reluctant to finance restaurant TIs because of the high failure rate in the restaurant industry. The fact that such spaces typically find new tenants quickly after a restaurant failure means that investments in restaurant TIs may be somewhat safer for landlords than the failure rate for individual restaurants would suggest.

The high demand for second generation space also illustrates an overall barrier to more restaurants and retail in downtown Raleigh, as so many of the available spaces in the downtown are in poor or raw condition, having either never been leased or having sat vacant for an extended period of time, sometimes even decades.

Unique Nature of the Deals

Both landlords and brokers active in downtown Raleigh are working within a marketplace where there are few norms and comparables. Each operator, each space, and hence each deal is unique and requires flexibility and creativity on the part of all parties involved. This was illustrated when one broker described her satisfaction over the recent leasing of a three-level building on Martin Street to an “experienced operator.” This “experienced operator” consisted of four friends who had run a music club called “Kings” on a shoestring while still holding day jobs, a club which had been closed for two years. However, this broker’s instincts appear to have been correct, as the reopened Kings and associated downstairs bar have been attracting crowds and doing a healthy business.

FINDINGS FROM THE PANEL DELIBERATIONS

The panel’s deliberations started with a simple question: “why do we care about retail in downtown Raleigh?” A variety of reasons were given: the need to fill vacant ground floor space, the need for street-level activity and vibrancy, and the need to provide convenience and amenities to support the upper floor residential and office economies, among others. In the long term, retail is essential to the health of downtown. However, the briefing book reveals that downtown currently lacks the rooftops and foot traffic to support traditional retailers. Therefore, the panel discussed whether the benefits of retail could be had by other means. Ideas include more galleries, which require minimal TIs yet are a high image use; non-profits and arts groups, such as Raleigh Ensemble Players; and pop up shops—temporary retail uses that can open in vacant spaces for special events. Such pop ups have already made an appearance, typically featuring products from local craftspeople and boutique manufacturers.

If the original question from the DRA could be summarized as:

> What does the gap look like for ground floor retail in downtown Raleigh? And what mechanism can DRA promote to help along the retail development?

The panel’s reframing of the question that guided the rest of the discussion would read as follows:

> How can we create a “vibrant center” through increased street-level activity in downtown Raleigh?

The next major observation regarding downtown retail was that downtown Raleigh already has the classic “dumbbell” shape favored by regional shopping malls, with anchors at the ends connected by a corridor of in-line tenants. In Raleigh’s case, however, the “anchors” are not retailers, but are the museums and state government complex on the north end, and the Convention and Performing Arts centers at the south end. In between is the business district centered on the Fayetteville Street spine with secondary retail locations on Wilmington and Salisbury streets. These are proven, successful anchors that generate significant visitation to the downtown, as shown in the **Table 2**, compiled following the conclusion of the panel exercise.

While unlike a shopping mall where shoppers may visit both anchors to comparison shop, downtown’s anchors do not necessarily share a common base of patrons. However, a location between the major anchors, rather than close to one or the other, allows a business to access both sources of demand. Combined with other nearby anchors such as Marbles, the Fayetteville Street spine is in the best position to capture spending from these visitors (see **Figure 1**).

Figure 1: Relationship of Downtown Anchors to Fayetteville Street

Table 2: Visitors to Downtown Attractions

Attraction	Visitors (rounded)
Downtown North Anchors	
NC Museum of Natural Sciences	656,700
Capital Area Visitor Center	324,900
NC Museum of History	324,700
NC State Capitol	100,000
NC Legislative Building	57,700
Governor's Mansion	6,400
Total, Downtown North	**1,470,400**
Downtown South Anchors	
Progress Energy Center for the Performing Arts	512,800
Raleigh Convention Center special events	264,600
Raleigh Convention Center conventions & trade shows	63,000
Total, Downtown South	**840,400**
Other attractions	
Marbles Kids Museum/IMAX®	324,700
Artspace	100,000
Raleigh City Museum	18,000
Total, other	**442,700**
Grand Total	**2,753,500**

Based on these two observations, a key theme of the deliberations was that downtown neither supports traditional retail anchors, nor does it need them to thrive. Yet in spite of these existing demand generators, retail in downtown faces a physical constraint, in that the retail spaces in downtown are not suitable in their current configuration for commodity retail, and require additional investment to be useable for any retail. The types of tenants that will find these spaces usable will be unique concepts, both retail and non-retail, and can differentiate downtown Raleigh from the suburban competition.

A third major insight is that the scale of the problem is not that large. Downtown ground floor space is in demand today, and when leased, it generates reasonable rents. The restaurant market continues to grow and operators with the right concept have exhibited considerable resiliency in the face of both the economic downtown and increased competition. Further, the amount of vacant space in the downtown core totals less than 40,000 square feet. The major barrier standing in the way of getting this space into active use is not a lack of demand, or excessive rents, but the cost of making the initial round of tenant improvements. The panel referred to the difference between the magnitude of the investment needed and what could typically be shouldered by the combination of the landlord and tenant not as a “gap,” but as a “crack” that could be filled by a relatively modest infusion of capital.

While the size of the “crack” varies greatly from space to space, in general the costs to get downtown retail spaces into minimally workable condition falls within the range of $20 – 50 per square foot to “white box” the space with walls, lighting, HVAC and plumbing (typically the landlord’s responsibility) and anywhere from $30 – 200 per square feet to do tenant-specific improvements, with a gallery representing the low side and a fine dining restaurant representing the high side. Financing for these TI's can come from traditional sources—tenant equity, property owner financing—or non-traditional sources such as economic development programs.

With 40,000 square feet of retail space to upfit at a conservative average of $200 per square foot, the total cost is $8 million. Assuming that some sort of gap financing is needed to financing about half of this, a retail improvement program capitalized to $4 million is sufficient to provide the necessary resources to fully tenant all of this space. Such a fund could be generated through public or private resources, or a mix of the two, as described in the next chapter.

The Panel's findings, while generally optimistic, must be tempered by recognizing the larger economic downtown that has impacted real estate everywhere, including downtown. The past three years of job losses, business failures, and household retrenchment have had a negative impact on rents and occupancy rates, with the office economy especially hard hit in downtown. Although there are positive signs of economic growth, the national economy may still be years away from recovering all the jobs lost in the recession, much less returning to trend, and household deleveraging may take even longer, if household debt levels are to return to their historical norms. Expectations for downtown expansion must accordingly be kept in check.

SUMMING UP: THE BIG PICTURE

At the outset of the TAP exercise, DRA Chief Executive David Diaz outlined the DRA's three goals for downtown:

- A major employment center.
- An event destination for people throughout the region and beyond.
- A livable neighborhood.

While retail is not central to any of these goals, it plays an important supporting role in each of them. Retail and dining provides a significant convenience and amenity to both downtown workers and residents, and is conjectured to be one source of the rent premium for downtown office and residential space. Retail is also crucial to creating a great experience for people who come downtown for events (although traditional anchor retailers would likely take a dim view of events that clogged the downtown streets and parking decks with event-goers during prime shopping hours).

While commodity retail will likely remain out of reach for downtown Raleigh until a much larger residential base has been developed, the success of downtown as an entertainment, dining and event destination helps create the opportunity both build on these niches and to branch out into specialty retail. The focus should be on uses of all kinds that contribute to the vibrancy of downtown; provide amenities for downtown workers, residents and visitors; and contribute to great experiences downtown.

The costs of achieving this will be modest, and the potential payoff significant in terms of creating additional value for the upper floor office and residential uses which comprise the vast majority of downtown floor space. The strategy outlined in the previous sections and in the specific recommendations that follow leverages existing anchors and assets, focuses on promising niches rather than long shots, and represents a realistic way forward for downtown retail.

Recommendations

The previous section presented the major findings of the TAP panel. This section presents the specific panel recommendations that flow from the findings. It addresses three major areas: tenant recruitment, funding, and capacity. It closes with a discussion of next steps for carrying the recommendations forward.

TENANT RECRUITMENT STRATEGY

Consistent with the findings of the MJB Consultants retail report, the tenant recruitment strategy for downtown Raleigh should focus less on big tenants or anchors—the downtown already has its anchors in the museums, attractions, and government offices—and more on local specialty niches. The emphasis should be on any interesting use that can activate a ground floor space. In addition to traditional retail, such uses may be short-term, such as pop-up shops, or they might be such things as workshops/ateliers with a retail components (Raleigh Denim, Stitch), or even office users who can activate the street with a gallery or multi-media presence (Design Box, Fragment). The panel specifically recommends that the DRA back-burner efforts to attract a blockbuster tenant such as a large chain bookstore (a business that is likely on its way out) or a movie theater (which may bring more problems than it solves).

Many of these uses will be experimental in nature, driven by young entrepreneurs with cool ideas but limited capital—in short, the very opposite of a "credit" tenant. Increased turnover can therefore be anticipated, and creative lease arrangements will be the norm. Landlords will need to focus on preserving the value of the TIs through several cycles of tenants, and should therefore focus on the types of improvements that can be reused and recycled. Open, flexible spaces; exposed services; and the use of temporary or movable partitions should be common.

Dining and drinking establishments will continue to be a major source of demand for ground floor space. All indications are that there is still room in this space for well-conceived concepts that hit the right price points and don't tap an already saturated niche. The MJB report identified fast casual dining as one such concept; likely, there are many others. Increasing the breadth and depth of downtown's dining options will enhance downtown's destination status, and the increased foot traffic will help create value for other types of retail.

CAPITAL TO FILL THE GAP

Many downtown retail spaces sit empty not because there is no demand, but because neither the landlord nor the prospective tenant has the resources or credit to finance the necessary TIs (particularly when financial feasibility is not all that clear). A capital bridge or subsidy is therefore needed to reactivate these spaces, and given the demand for second-generation space, this capital injection can be a one-time intervention that targets first generation spaces requiring the most expensive up-front investments. The issue of financial feasibility is then addressed by the risk taken by the bridge loan.

As noted above, given the size of downtown Raleigh, the amount of capital needed is relatively modest: $4 million would likely be sufficient to redo all of the currently available spaces in the downtown core, and if structured as a loan fund, the capital could be recycled over time to start reactivating older spaces on the edge of the downtown core as momentum builds and downtown's worker and resident population grows.

The money can come from two potential sources: the downtown business and property owner community (the private sector), and/or the City of Raleigh (the public sector). On the private side, money can be raised through simple fund-raising, or the DRA can appeal to its membership to support an enhancement to its taxing power to provide the capital investment. A special assessment district could be used to underwrite a bond issue that would provide the initial capitalization, which would spread the burden over time. On the public side, a case would need to be made that a taxpayer contribution to a downtown fund would represent a valid public objective. The City already has made this leap, albeit on a small scale, with its downtown façade grant program and small business loan fund. The City of Durham has been more aggressive in this regard than Raleigh, making loans of $75,000 available for business startup expenses in its downtown.

Whatever the source of capital, the resulting loan or grant fund will need an entity to manage it effectively. The funds will quickly be depleted if not wisely deployed to uses that make economic sense. The same level of due diligence that would accompany a traditional bank loan should be applied to each application for the funds, although different criteria would be employed. A committee formed by the DRA with members drawn from the financial and real estate sector could be one vehicle for overseeing the use of the funds.

Even with the best due diligence, any financing vehicle that is meeting the goal of filling downtown retail spaces is going to occasionally underwrite improvements for a tenant that later goes out of business. To the extent public money is involved, this will be seen by some as a waste and proof of government incompetency or overreaching. This view would be short sighted. Because the intervention targets the physical property and not operations, it has a life and value beyond the initial tenant. Many of the spaces are in historic buildings—the preservation of historic properties is a well-established public goal, and keeping old buildings economically viable is the best preservation strategy. Moreover, a successful downtown has significant positive spill-over impact of the rest of the community. A modest intervention in insuring success downtown represents sound public policy.

BUILDING CAPACITY IN THE MERCHANT COMMUNITY

As important as tenant recruitment is tenant retention. If the prior two recommendations were about how to get tenants into spaces, this recommendation is about keeping them there. This requires that tenants be able to operate profitably year after year, which requires that they effectively address the downtown marketplace as it exists and work to tap into the existing sources of demand. Even tenants that have lasted a few years in downtown may benefit from assistance that helps them move to the next level and become an evergreen business.

As an entity, the DRA represents the property owners who pay the assessment that keeps the organization afloat. It does not and cannot directly represent the interests of the tenants who lease space from the DRA's members. Therefore, the panel recommends the formation of a downtown-specific merchant's and/or restaurant association. A merchant's association serves as a vehicle to pool marketing dollars, share information, and advocate for merchant's interests (which may or may not be aligned with landlord interests, depending on the issue).

The DRA has a successful track record of both initiating and partnering with others on high-traffic events, which serve as a third anchor for downtown. In just the past year, the downtown has hosted such events as the three-day Hopscotch Music Festival, SparkCon, Raleigh Wide Open, Artsplosure, and WinterFest. While many downtown restaurants and retailers were able to take advantage of these events through street vending and kiosks, still others saw a drop in business as their traditional customers were driven away by the crowds and lower parking availability. More should be done to create opportunities for merchants and restaurants to tap into the spin-off benefits of these high-traffic events.

NEXT STEPS

The recommendations above include:

- Where to focus tenant recruitment efforts.
- The need for funding to help finance first generation tenant improvements.
- Ideas for building capacity within the merchant and restaurant communities so as to sustain success over time.
- Formally developing the conveyor belt between the two barbell ends.

These are big picture recommendations, the implementation of which should begin with a few specific actions. The immediate next steps for downtown retail should begin with selling the vision to the relevant players, and organizing support from key public and private sector actors for moving forward. To this end, the panel recommends that the DRA:

- Work with the property owners of vacant retail space to develop a more sophisticated cost estimate of the first generation TIs for all vacant retail space in the downtown core area, and to determine what percent of these needs an external financing source.
- Begin reaching out to all major property owners and corporate tenants regarding the importance of filling ground floor retail space and the potential return on investment from an intervention in the marketplace.
- Organize meetings between the DRA's members and City officials to discuss their willingness to help fund a vehicle to finance first generation TIs.

If the concepts generated by this report gain traction, the next step will be to determine what form the financing vehicle should take—grant program, loan fund, or some other structure or hybrid. This could be a topic for a future TAP or consultant study. The goal should be to gain the maximum impact for the minimum up-front investment, and to design a program that can be sustained over time so that the benefits can spread beyond the core area as the downtown grows.

While retail in downtown Raleigh faces considerable hurdles, a good news message is at the core of this report. In the midst of a significant economic downturn, when households continue to deleverage and consumer confidence remains depressed, downtown Raleigh continues to see new business openings. Momentum has been sustained during the recession and will pick up as the economy recovers. The current vacancy rate within the core is relatively low, and therefore the amount of space that needs to be filled to fully tenant Fayetteville, Wilmington and Hargett

Streets is modest. While achieving the goal of a fully activated ground floor will be difficult, it is both doable and worth doing.