Downtown Chattanooga Study

Housing, Retail, and Office Market Opportunities

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Objectives

- Assess market opportunity in downtown Chattanooga (which excludes Northshore but includes Westside and Highland Park) for real estate development
- Quantify market depth to support development of new for-sale and for-rent housing
- Characterize market conditions, current and future supply, and demand for residential, retail, and office spaces in each district
- Identify barriers and/or incentives needed to enhance interest from the development community by surveying local key stakeholders and by referencing case studies of successful downtown revitalizations
- Analyze the impact of economic and demographic trends regionally, in the City of Chattanooga, and specifically in the downtown area on future real estate activity
- Identify the types and prices of housing that is currently demanded and will be in demand over the next 10 years
- Translate research and analysis into market-driven development recommendations

Key Findings

Downtown Chattanooga sits on an accessible and active riverfront lined with a park, aquarium, museums, and an expanding state university. The greater downtown area is positioned to become the heart of Chattanooga's dining, retail, entertainment, and office markets, much of which is due to strategic planning and vision over the past decades. However, a lack of downtown residential housing options has kept the downtown district from reaching its full potential. RCLCO found the key opportunity, and a major factor to improving the retail and office environments of downtown, is to attract more residents. Although the most significant opportunity centers around UTC student housing, the greater downtown area has opportunity sites, and household demand, to provide single-family, attached, and multifamily product.

NEXT STEPS

- Attract residential amenities to make City Center and other downtown neighborhoods more livable for students and new residents.
- Identify and market potential student housing and rental apartment sites to address immediate opportunities and increase the residential base in downtown
- Strengthen and revitalize current retail offerings
- Identify underperforming retailers that may not be viable long-term and plan strategically for opportunities to re-tenant or reuse the space before it becomes vacant
- Implement business attraction incentives that proactively position Downtown Chattanooga to capture new office employers in existing space

Key Findings (continued)

RESIDENTIAL

Today, Chattanooga and Hamilton County have undiversified suburban housing options that do not provide the breadth of housing locations and types that new and future residents may desire. As one of the only dense locations in the MSA, downtown Chattanooga can aspire to capture a significant segment of the market seeking city mixed-use living. RCLCO estimates that ultimately, downtown will be able to support approximately 125-195 new for-sale units each year (including rehabilitated SFD, new SFD, and townhomes), 40-60 new for-sale condos, 250-350 new rental units, and 200 new student housing units annually.

However, downtown Chattanooga is still evolving and will need to continue to strategically encourage development that provides basic retail and community services (grocery, schools, etc.) contributing to the liveability of downtown.

UTC provides a huge opportunity to build the residential base today by building student-oriented housing, particularly for the MLK district. Incorporating the growing student body into the downtown area will add vitality and life to what otherwise is often a "daytime downtown." Students support retail demand and offerings that will in turn attract more downtown residents.

OFFICE

The existing office supply in downtown Chattanooga will likely meet the needs of office-using employment until 2020, unless a significant shift in the market occurs, such as residential conversion, to reduce the supply of vacant and underutilized office buildings.

Another opportunity to enliven underutilized office buildings is to consider non-traditional office tenants such as an institution/university, and more creative opportunities, such as renovating space to attract a new type of tenant (aka shared office space, loft-type space).

RETAIL

Downtown Chattanooga boasts a few clusters of retail and restaurants, particularly centering around the Riverfront as well as scattered throughout City Center. Much of this retail serves a rather transient population of visitors or employees, and while a benefit to residents, does not fulfill their day-to-day retail needs. One exception of this is the small retail district in Southside, which likely helps to explain developers' success in selling new SFD and townhome product nearby.

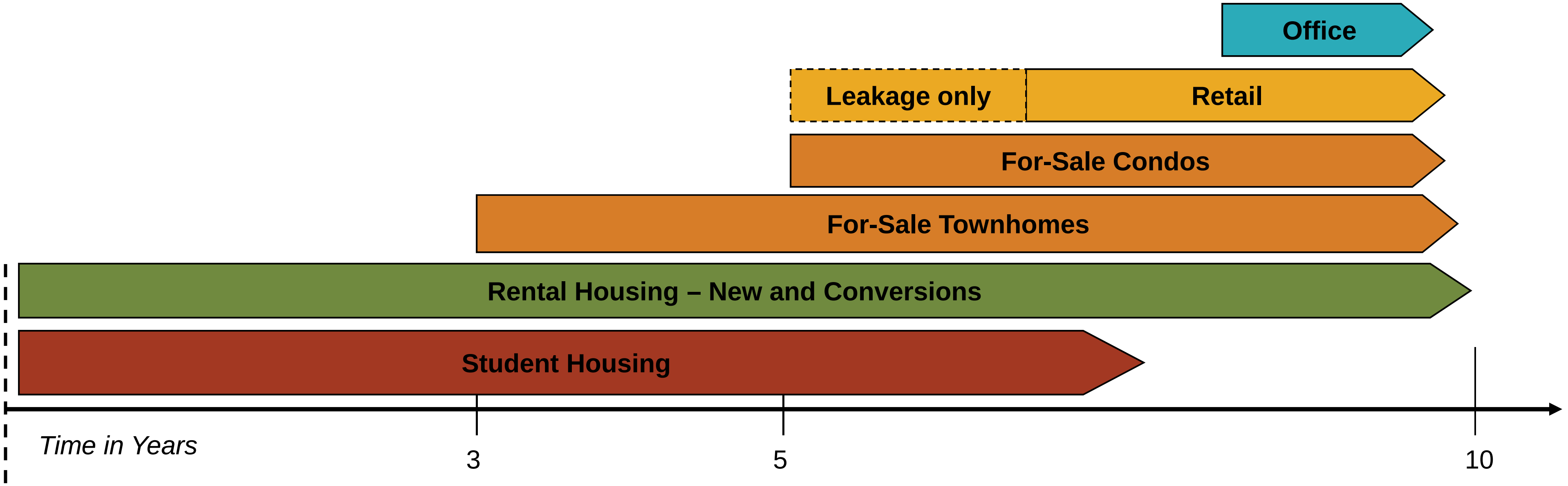
Top "wish list" household-serving retailers in the core of downtown, include a grocer and a drug store. Today, these stores all skirt the border of downtown—adequately serving downtown residents from a retailer's perspective. While a major grocer may be challenging to attract due to the two major stores located on Northshore, attracting a pharmacy presents a realistic near-term objective for City Center.

New retail downtown will primarily be supported by new residents, UTC students, and tourists. Downtown employees, while strong support for retail today, are not projected to be a growing demand source. Over the next 10 years, the full potential for retail from all potential market segments could include: 50,000 SF of grocery and pharmacy, 70,000 SF of restaurants, and 30,000 SF of boutique/soft goods retailers.

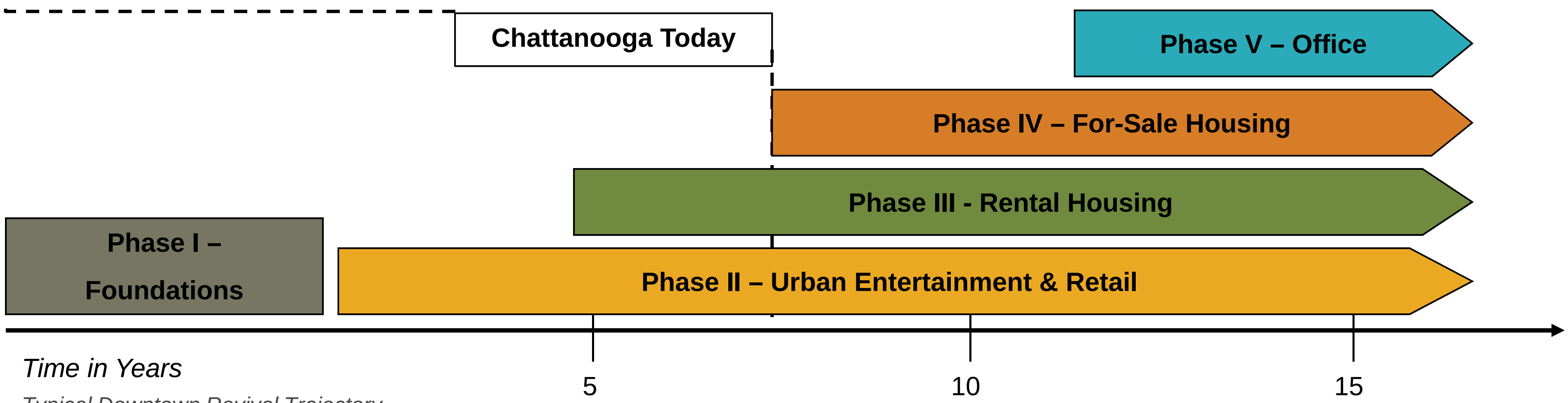
In the near term, Chattanooga should focus on strengthening and revitalizing the current retail offerings and identifying key locations that are currently underperforming. Re-tenanting should be a very strategic process accounting for new growth and which tenants would be appropriate for which neighborhood, particularly as retail tends to cluster together.

Typical Downtown Revival Trajectory

Chattanooga Has the Foundations, Now in the Iterative Process of Growing Residential and Retail



Chattanooga's Trajectory of Opportunities 2013, Source: RCLCO



Typical Downtown Revival Trajectory Source: RCLCO

Unique Positioning Opportunities Among Districts

District	Opportunity
Riverfront	**Retail and restaurants** targeted to visitors as well as a destination for MSA residents; top-of-market, high-density residential, including **multifamily rental**, some for-sale townhomes and condos targeted towards empty-nesters on appropriate sites.
City Center	Primarily **office, retail, and rental residential conversions** with a focus on attracting more than just daytime activity/users. Some small-scale infill sites for new development, but that will likely require off-site parking solutions.
Southside	Already emerging as a new district that appeals to young couples and families, likely to have strengthening household retail and entrepreneurial office space; continued infill of single-family homes and townhomes, as well as small-scale rental residential on larger Main St. parcels.
Westside	Assuming CHA's parcel becomes available for redevelopment, mixed-income **single-family detached** and **townhomes** for sale. With access to an extended Riverwalk, market-rate housing could become feasible, including both condos and apartments.
UTC	On-campus **student housing** development (multifamily rental), with **retail and restaurants** targeted towards students; some for-sale townhomes and single-family in existing neighborhoods to the northwest and east of campus.
MLK	Chattanooga's "**University Main Street**", this should be the primary area for large-scale **student housing** development (multifamily rental), with **retail and restaurants** targeted towards students; some for-sale townhomes and revitalized single-family in existing lower density neighborhoods.
Highland Park	Already many single-family homes, new and refurbished single-family and townhomes targeted towards **first-time homebuyers**; residential redevelopment at the Tennessee Temple site would be a game-changer for the neighborhood.

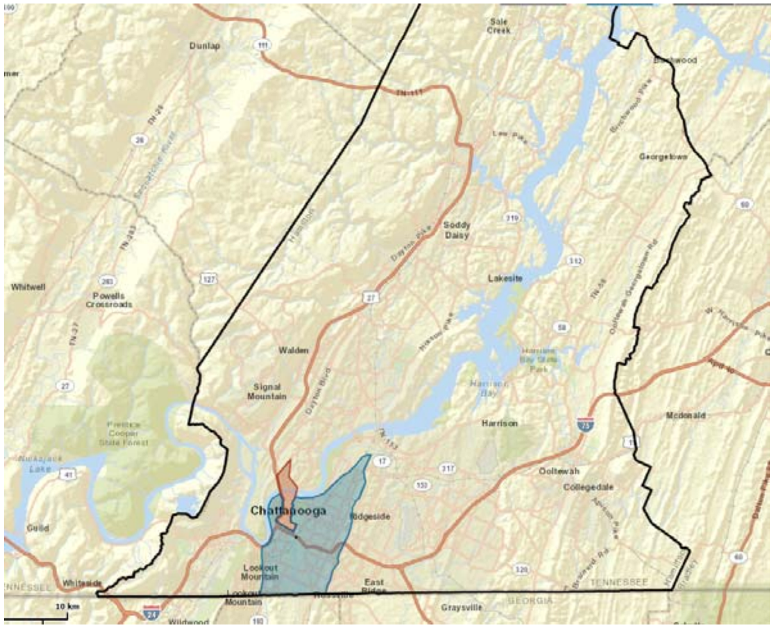
Residential

Current State of Chattanooga Residential Market
Demonstrated and Preferred Locations

Today, Chattanooga and Hamilton County provide undiversified, relatively suburban, housing options that have only just begun to offer the breadth of housing locations and types that new and future residents may desire. Currently, downtown and Northshore provide one of the only opportunities to live in a mixed-use, walkable environment. In order to determine active renter and owner location and product type preferences in spite of the offerings of today's housing market, RCLCO looked at stated preferences by generation from the NAR Homebuyer Survey.

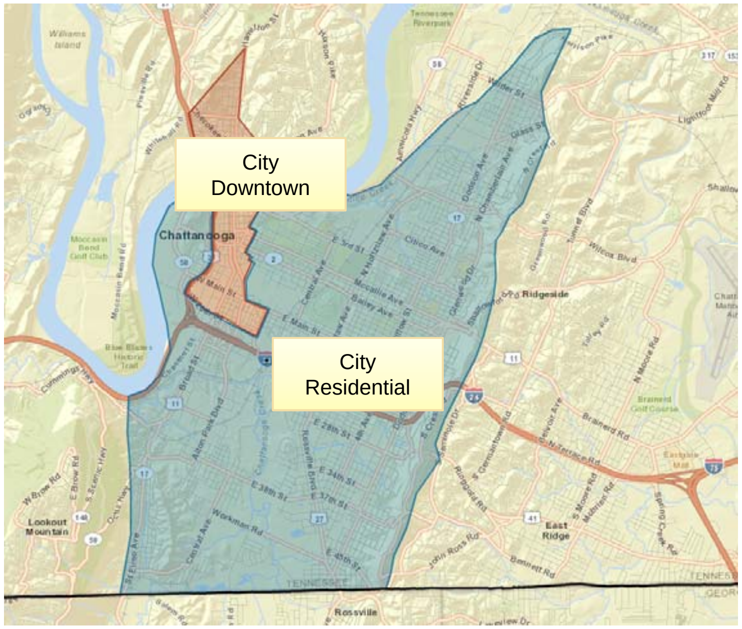
The NAR survey divides geography into six distinct types: city downtown, city residential (houses only), suburban mixed-use, suburban residential, small towns, and rural areas. The geographies defined in the NAR survey have been applied to Chattanooga as seen in the map below, with the remainder of Hamilton County being considered suburban neighborhood, as Chattanooga currently has no suburban mixed-use development. RCLCO then looked at the current distribution of renters and owners by geographic type, and compared this distribution to their stated preference from the NAR survey. As seen on the next page, there is a large gap between actual location distribution and stated preferences.

Suburban Neighborhood,
NAR Residential Demand Designations



Source: NAR Survey; Esri

City Downtown and City Residential,
NAR Residential Demand Designations



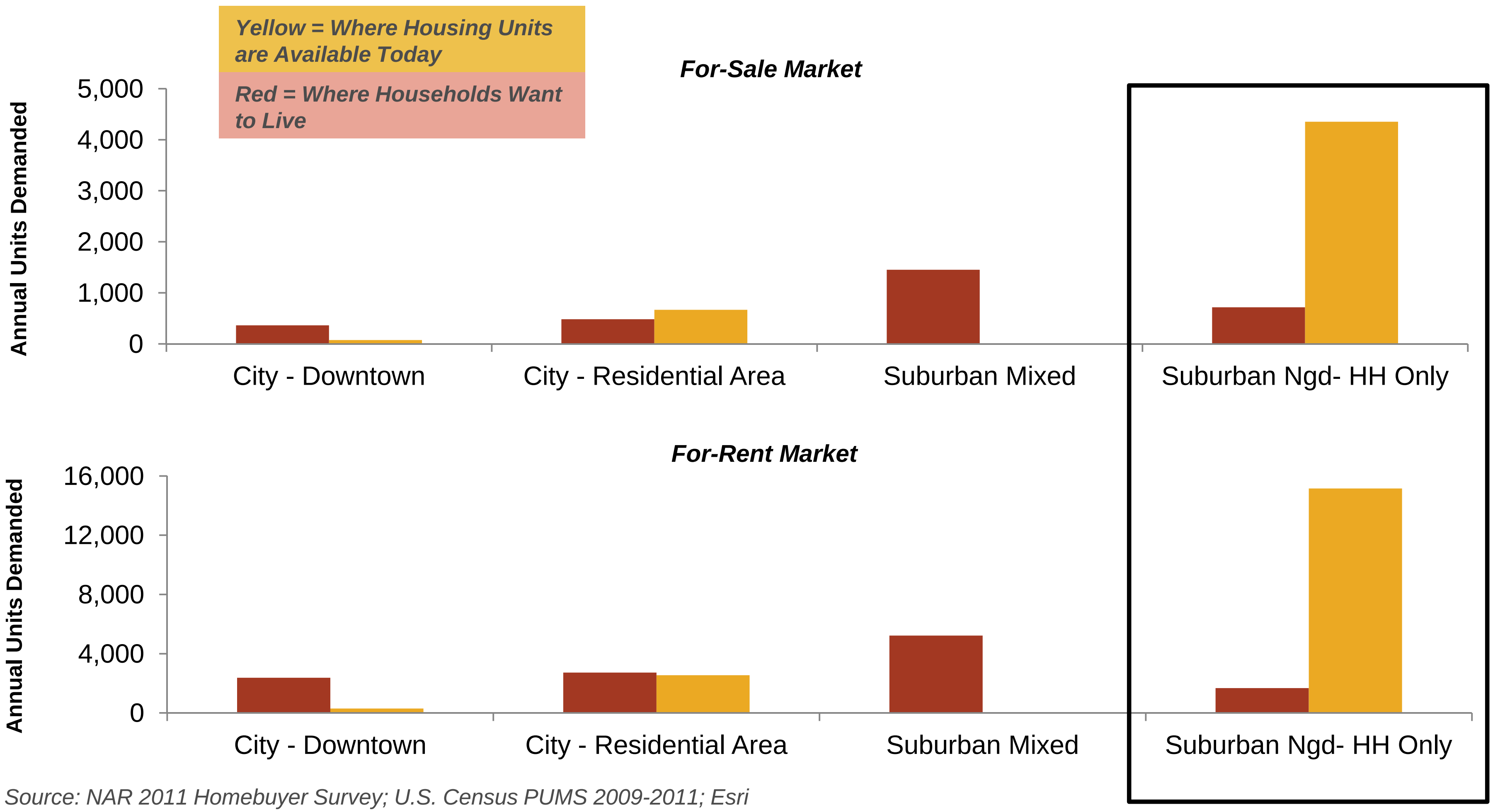
Source: NAR Survey; Esri

RCLCO

Preference for Downtown and Mixed-Use Locations

Oversupply of Suburban Housing in Today's Market

Looking at demonstrated locations chosen by the "active market" (both renters and buyers) in comparison to their stated preferences according the NAR Homebuyers Survey, there is a significant gap in housing availability in mixed-use urban and mixed-use suburban locations. Downtown Chattanooga is well situated to capitalize on this opportunity as an established and revitalizing dense area, and aspirationally can capture both the urban mixed-use market as well as a portion of the market that prefers suburban mixed-use locations, particularly in the near-term as only one suburban mixed–use center is currently proposed.



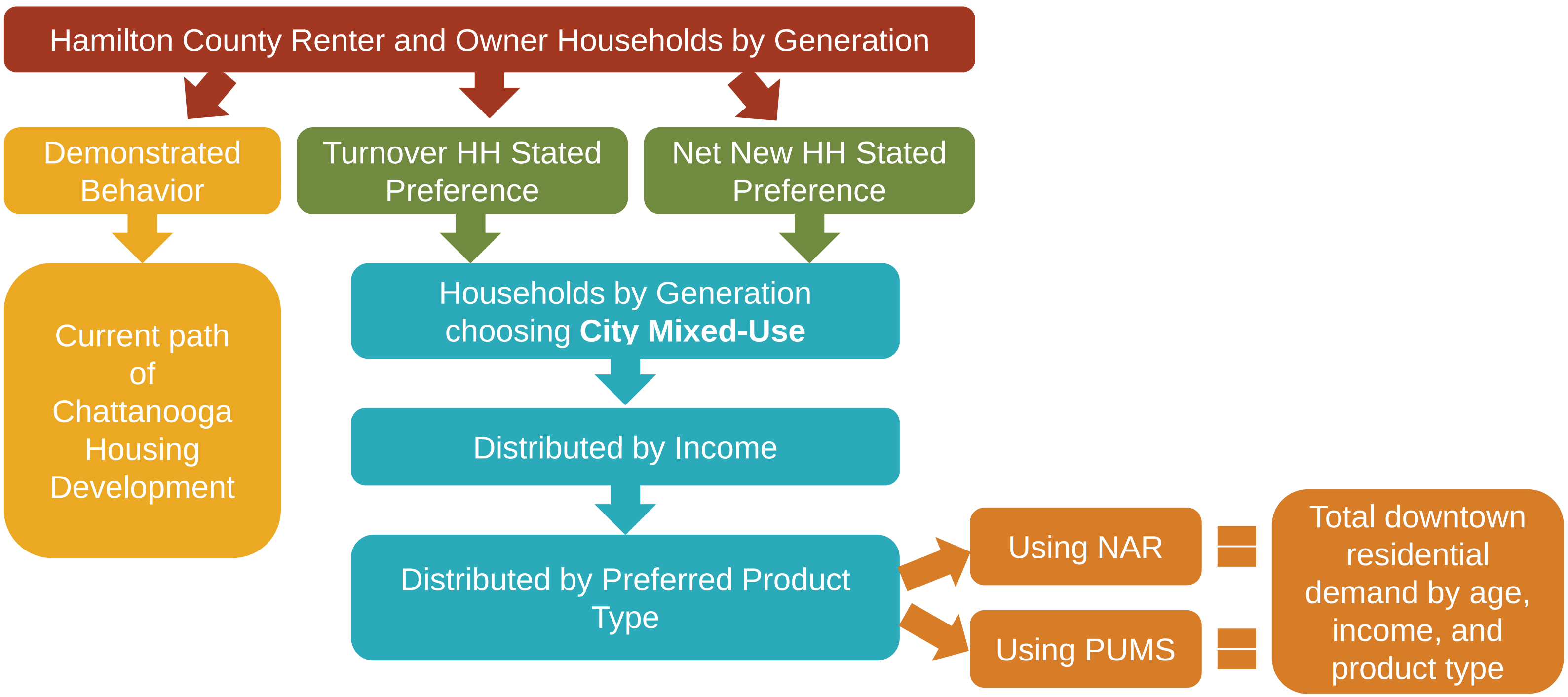
Source: NAR 2011 Homebuyer Survey; U.S. Census PUMS 2009-2011; Esri

Annual Residential Demand Methodology

Considering this gap in Chattanooga's housing supply, RCLCO evaluated residential demand by looking at active turnover and net new renters and owners by generation in Hamilton County. NAR survey preferences were applied to determine the preferred location. Finding that almost 2,800 households annually prefer to live in a city downtown location, we then distributed this pool of people by income and stated preference for product type to determine the number of renters and owners by age, income, and product type preference. Using the 2,800 households that prefer a city downtown location as our main pool of demand, we assumed product type preference would determine whether a household chooses a dense city downtown (City Center, Riverfront) or a city neighborhood (Highland Park, Southside). This complete pool is shown on the chart on the next page.

According to NAR preferences (which does not cross questions for location preference and product type), a significant amount of respondents, most notably Gen Y renters, would like to live in a single family home in downtown—a unfeasible request in terms of land use and income level. To mitigate this, PUMS data was used to look at actual behaviors of the Chattanooga housing market when forced to choose between product type preference and location preference. The difference between the PUMS data and NAR product preferences was taken into consideration when determining feasible development in downtown and making recommendations for annual absorption potential per product type.

Residential Demand Methodology

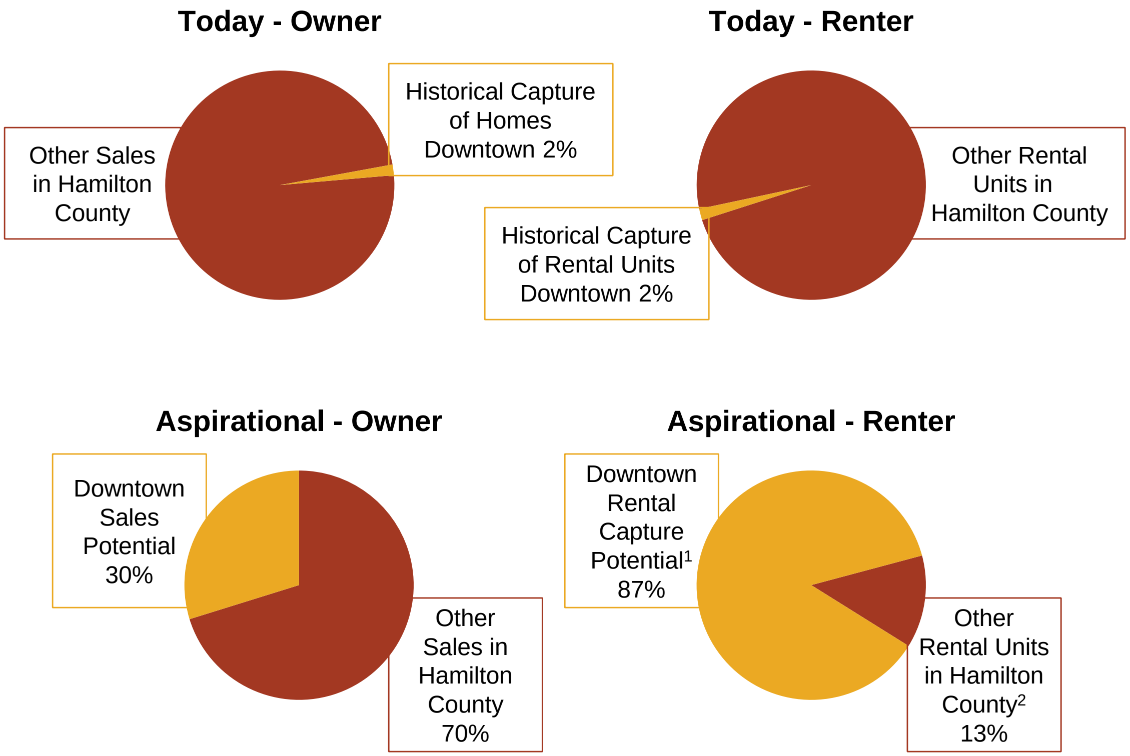


Downtown Chattanooga Residential Development Potential

An Aspirational Capture of Chattanooga's Housing Market

Overall, the broader downtown area should aspire to capture 125-195 new for-sale single-family detached and townhome units each year (including rehabilitated SFD), 40-60 for-sale condo units, 250-350 new rental units, and 250-300 student housing units annually, for a total of 665-905 units. Of this total, 165-255 units are recommended to be new for-sale units. As seen below, these units would account for approximately 15% of annual new home sales in Hamilton County over the past seven years.

Historical Annual New Home Sales in Hamilton County and "Aspirational" Downtown Demand, 2006 – 2012



[1] *New multifamily rental units*
[2] *Average County MF permits since 2001*
Source: Real Quest; NAR; RCLCO

Considering that downtown Chattanooga is still an evolving residential downtown, we qualify this residential capture as an "aspirational" demand as downtown currently provides some, but not all, of the amenities that residents typically seek as part of urban living. These include:

- Grocery/pharmacy/convenience retail within walking distance
- "Third places" or public spaces that serve as community gathering points
- Quality schools, specifically elementary schools
- A range of retail and restaurant options

Total City Downtown Annual Demand Pool Feeding Development Recommendations

Income	Gen Y	Gen X	Baby Boomers	Eisen-howers	Total
<$35,000	75 Owners 872 Renters	7 Owners 172 Renters	7 Owners 176 Renters	6 Owners 57 Renters	**95 Owners 1,277 Renters**
$35,000 - $75,000	101 Owners 411 Renters	25 Owners 122 Renters	18 Owners 63 Renters	5 Owners 4 Renters	**148 Owners 601 Renters**
$75,000+	29 Owners 15 Renters	26 Owners 34 Renters	20 Owners 39 Renters	5 Owners 2 Renters	**90 Owners 80 Renters**
Total	**205 Owners 657 Renters**	**58 Owners 328 Renters**	**45 Owners 278 Renters**	**16 Owners 63 Renters**	**324 Owners 1,326 Renters**

Source: RCLCO

Residential Demand Summary by Income and Product Type

"Aspirational" Annual New Units in Downtown

Following current trends in pricing for the Chattanooga housing market, RCLCO estimates that housing options in downtown will range from $100,000 for a refurbished home up to $500,000+ for new top-of-the-market construction. On average, new rental apartments will be able to achieve top-of-the-market rents in the local market, with converted units at a slight discount. This pricing is consistent with broader market affordability as indicated by income, particularly attending to rental conversions and rehabbed houses that address workforce housing concerns in Chattanooga.

Residential Demand and Market Characteristics, 2013

Product Type	Home Price Range/ Monthly Rental Rate	Target Household Income Range	Annual Unit Demand	Target Market Audience
FOR-SALE PRODUCT				
Single Family Detached				
Rehab	$100,000 - $150,000	$35,000 - $75,000	60-90	58% Gen Y first time buyers
New	$300,000 +	$75,000 +	50-75	42% Gen X; 26% Baby Boomers
Townhome/Attached				
First-Time Buyer	$200,000 - $250,000	$35,000 - $75,000	10-20	Gen Y first time home buyers
Move-Down Buyer	$400,000	$75,000 +	5-10	Baby Boomers
Multifamily Condo				
New	$200,000 - $500,000	$50,000 +	39-45	Gen Y; possibly lifestyle preference
Total Units			**155-240**	
RENTAL PRODUCT				
Multifamily Apartment				
Workforce / Conversion	$700 - $1,000	$35,000 - $50,000	110-215	Gen Y
Market Rate / New	$1,000	$50,000+	150-250	Gen Y, Gen X, Empty nesters
Total Units			**260-465**	
STUDENT HOUSING			**200**	UTC students

Source: RCLCO

RCLCO

Likely Housing Opportunities by Neighborhood (Annually)

Each district in downtown Chattanooga provides unique opportunities to develop housing at different product types and price points. While there is a strong demand for housing right now, that demand is not infinite, and River City can best spur development downtown by focusing on the strongest locations initially rather than trying to develop a little bit everywhere.

The most compelling near-term opportunity is for additional multifamily rental housing (both student and market-rate). Today, Riverfront, Southside, and City Center are best positioned to capture new market-rate development due to land values and available opportunity sites. While multifamily development is feasible in neighborhoods such as Highland Park, UTC, and Westside, these locations are likely at a competitive disadvantage to any city center sites for market-rate downtown renters. At least initially, these locations probably serve more of a workforce band of the market that has a greater focus on affordability rather than location. MLK should be very appealing for student-oriented housing, but less so for market-rate rentals.

New single-family and townhome product can be appropriately accommodated in less-dense districts such as Highland Park, Southside, with new development in Westside dependent upon redevelopment of the housing authority site.

The following chart depicts a segmentation strategy with the likely target markets and product type capture for each study area district. See Exhibit IV-1 for additional detail.

District	Likely Market Appeal	Caveats	SFD (New)	SFD (Rehab)	Town-homes	Multifamily (incl. student housing, for-sale, rental)	Total
Riverfront	Top of market location for dense housing	Ideal sites will require partnership with UNUM to develop	0	0	5	128	132
City Center	Unique historic reuse; discount to Riverfront	Smaller infill sites will need to identify nearby, off-site parking solutions	0	0	0	185	185
Southside	First-time buyers, young families,	Few opportunity sites	8	31	6	58	102
Westside	Mixed-income community	No available land – assumes redevelopment of CHA site	0	6	5	10	21
UTC	Faculty and staff of university; on-campus student housing	Land surrounding university primarily single-family detached neighborhoods	8	0	2	20	30
MLK	Student-oriented district	Most sites will require assemblage; redevelopment	4	3	0	120	127
Highland Park	First-time homebuyers who want a SFD home	No available land—assumes redevelopment at Tennessee Temple	23	6	3	10	42

UTC Student Housing Demand

Downtown's Greatest Immediate and Impactful Opportunity

The most immediate opportunity for new residential development is student housing, as UTC is a growing university with limited on-campus housing, and few off-campus housing options near campus. Attracting students to live in or near downtown has proven to be a successful strategy for revitalizing smaller cities and towns across the country. If Chattanooga were able to accommodate the full demand for student housing near UTC's campus (approximately 13,500 enrolled students in 2017 and 16,000 students in 2022), the population of the downtown study area would almost *double* from 13,000 to 24,000 over the next decade, even if no other residential development occurs.

To determine future housing demand, RCLCO looked at UTC's current students and projected 10-year growth as well as the supply of on- and off-campus housing. Considering that 90% of off-campus undergraduate students (excluding commuters) likely would prefer to live near campus if housing were available (currently about 25% of off-campus students live near UTC), and UTC's goal to have 35% of undergraduate students in on-campus housing, RCLCO estimates that over the next 10 years there is unmet demand for about 4,100 additional beds in the vicinity of UTC.

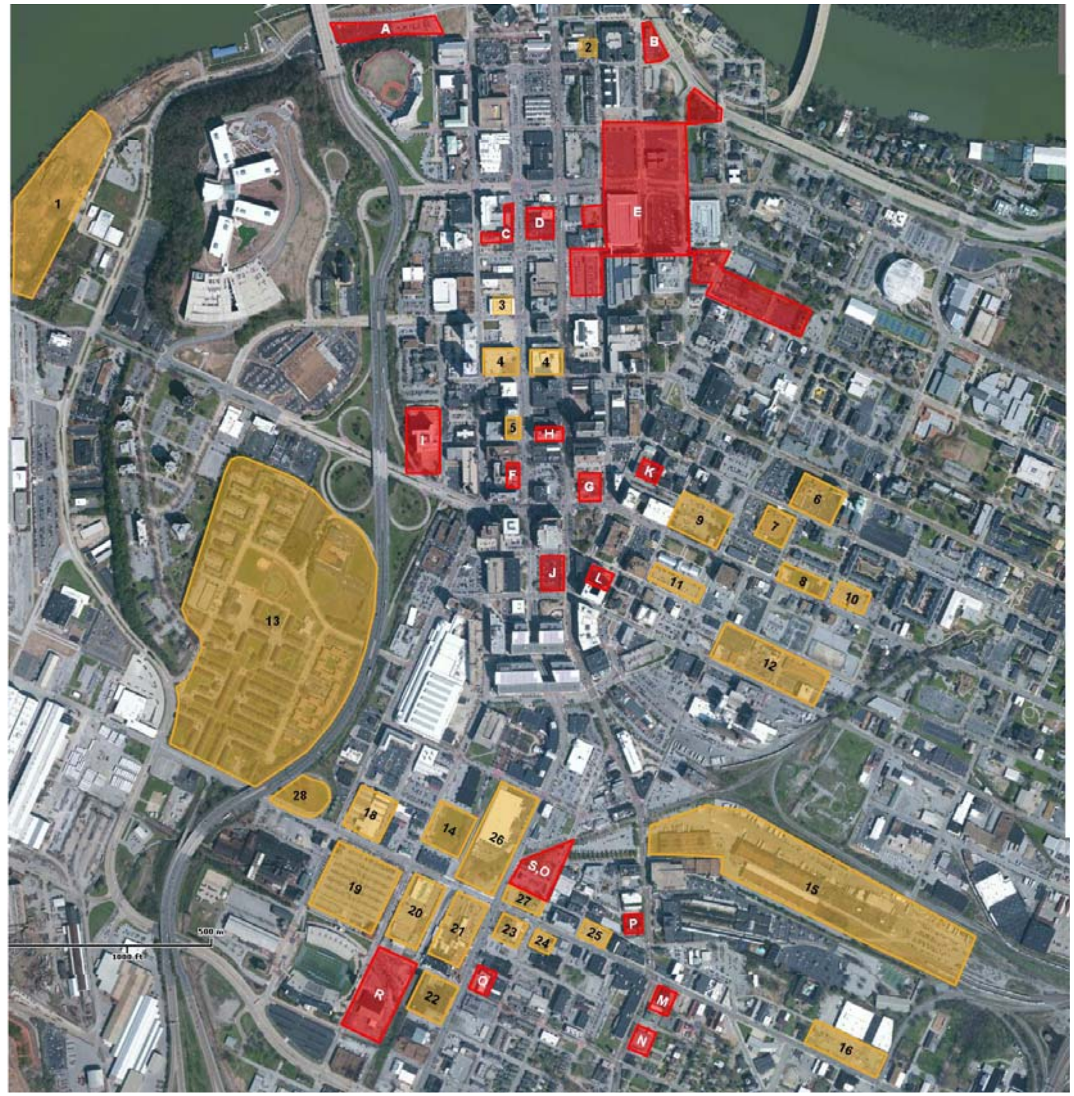
Student housing is typically measured in beds instead of units, since there are many options for unit configurations to accommodate multiple students, and beds are typically leased to individual students rather than signing one lease for the entire unit as is customary in conventional multifamily. RCLCO converted demand for beds to unit demand based on an average of three beds per unit. 4,100 new beds would be about equivalent to 1,400 new units through 2022.

	2012		2017		2022	
	On-Campus	Off-Campus	On-Campus	Off-Campus	On-Campus	Off-Campus
Current Full-Time Students	3,146	1,500	3,665	1,500	4,344	1,500
Housing Gap	20	2,155	220	2,735	600	3,520
Total Unmet Demand	2,175		2,955		4,120	

Opportunity Sites and Planned Development

While the pipeline of residential development, specifically rental housing, demonstrates that the market recognizes the strong opportunity to provide additional housing downtown, many identified opportunity sites face critical challenges to being developed—especially in a form that will contribute to a vibrant downtown. Chattanooga lacks significant structured parking and currently does not have a location or program that makes it economically viable for a private developer to construct residential in a form that incorporates structured parking. Furthermore, many of the available parcels are too small for new buildings, if they are required to accommodate parking on-site.

The map to the right outlines both planned development (in orange) and potential opportunity sites (in red). In order to achieve the aspirational residential development program outlined on page 13, much if not all of these sites will need to be opened up for development over the next decade. See Exhibit I-1 for a description of each opportunity site.



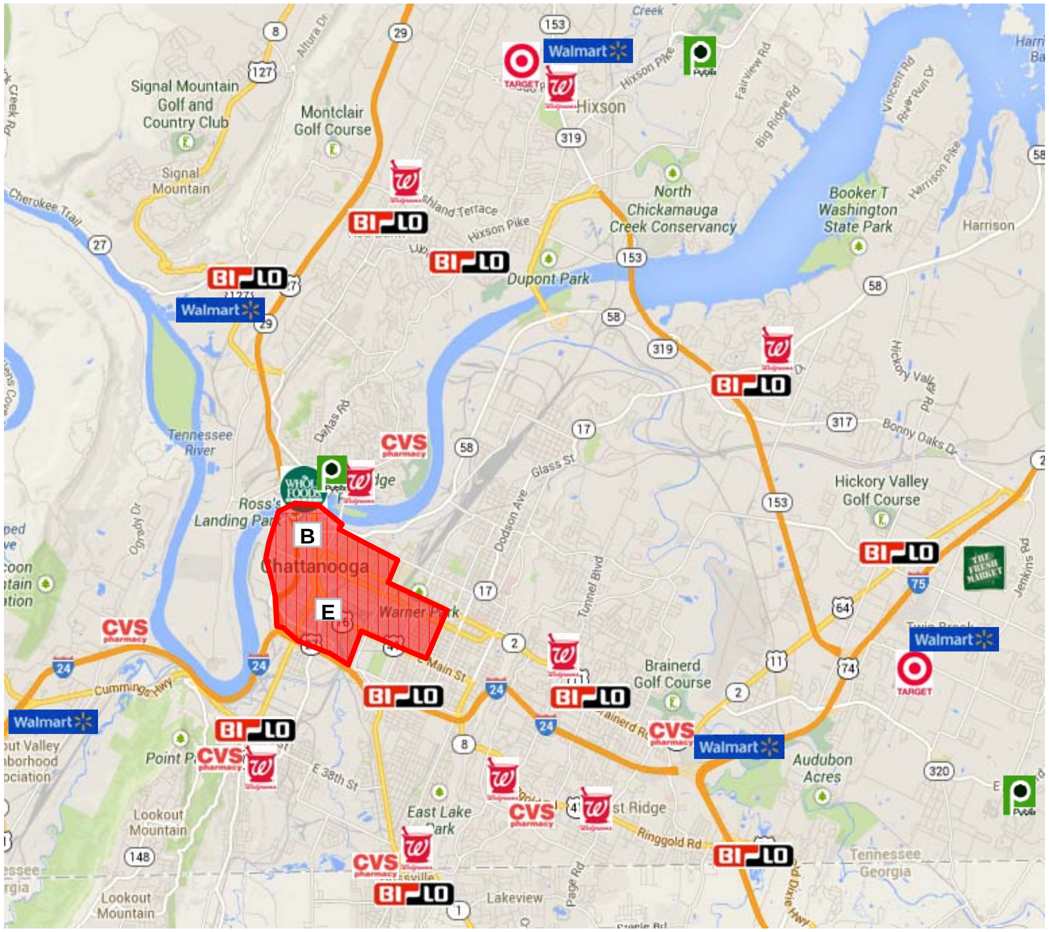
Planned Development Sites
Potential Opportunity Sites

Retail

Key Household-Driven Anchor Tenants Ring Downtown Today

Downtown Chattanooga, particularly the Riverfront district, has a variety of restaurants and small stores that serve a tourist population well, but is less conducive to downtown residents or employees. Significant anchor tenants surround the downtown, and until more residents and students live near downtown it will be challenging to support another large tenant, such as a grocer.

Major retailers not currently present in the Chattanooga market will likely need to be sold on an evolving residential downtown that has strong growth potential. The downtown area captures about 10% of total Chattanooga MSA retail and has relatively low vacancy.



NAME OF RETAILER
Publix
Whole Foods
The Fresh Market
Bi-Lo
Target
Walmart
CVS
Walgreens
B Buehler's Market
E Enzo's Market
Study Area

Households to Support
New Retail Store by Type:

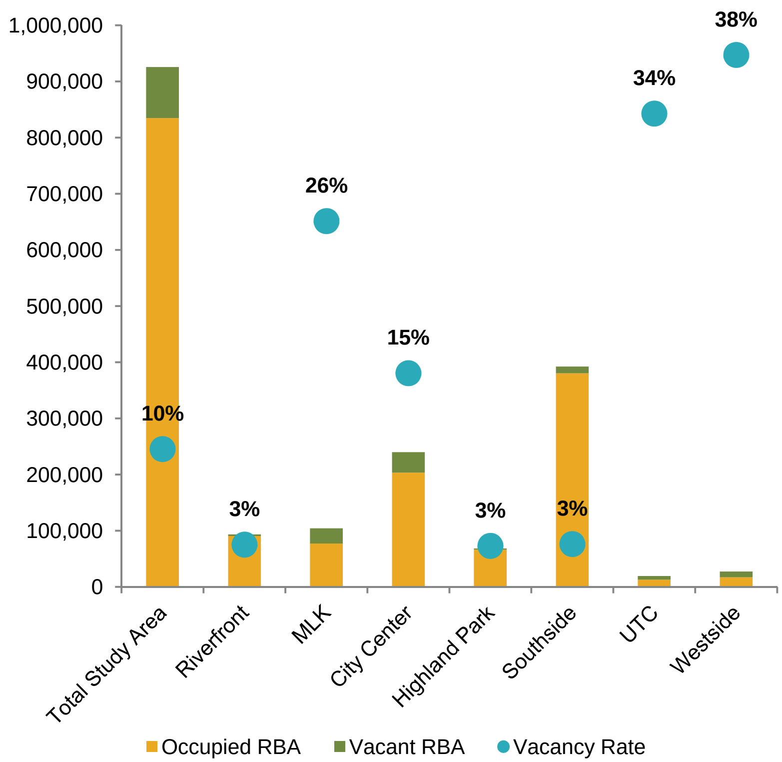
Grocery (20k SF)
5,700 households

Pharmacy (10k SF)
3,800 households

Downtown Retailers Supported Mostly by Non-Resident Spending

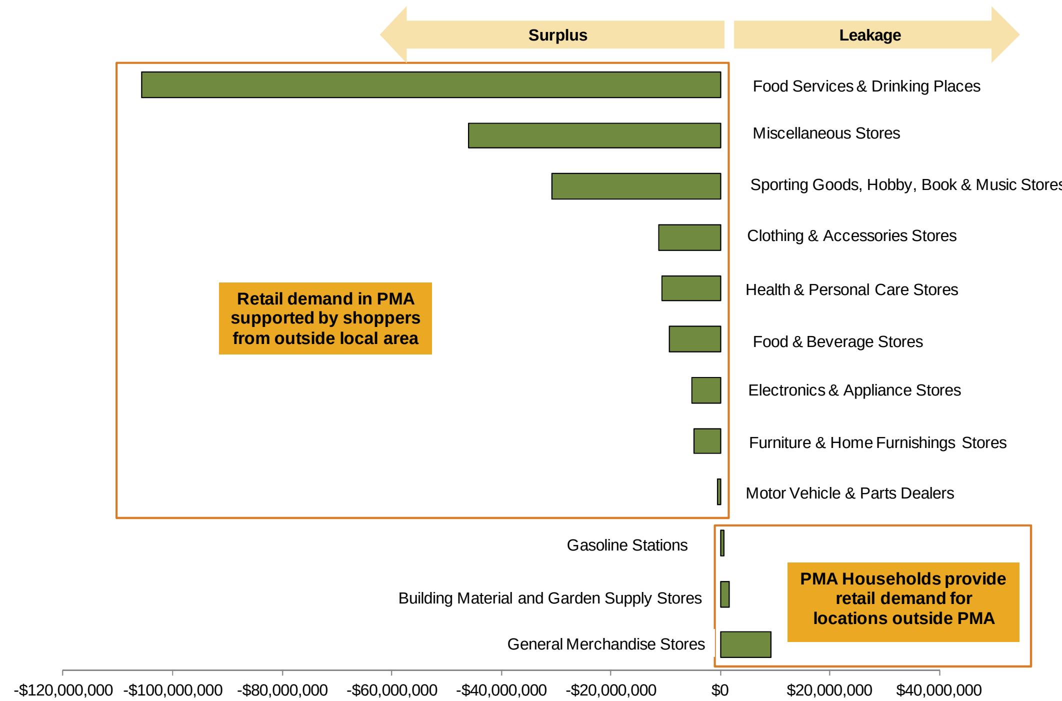
Currently, the retail market is somewhat oversupplied relative to primary demand sources, and includes many active retail uses that provide little amenity benefit for nearby residents or employees. Though downtown Chattanooga captures significant restaurant spending from destination patrons, households, employees and visitors in downtown must shop outside of the neighborhood for basic services such as a drug store, grocery, or general merchandise store.

Retail Rentable Building Area and Occupancy by District 2013



Source: CoStar

Retail Surplus and Leakage 2012



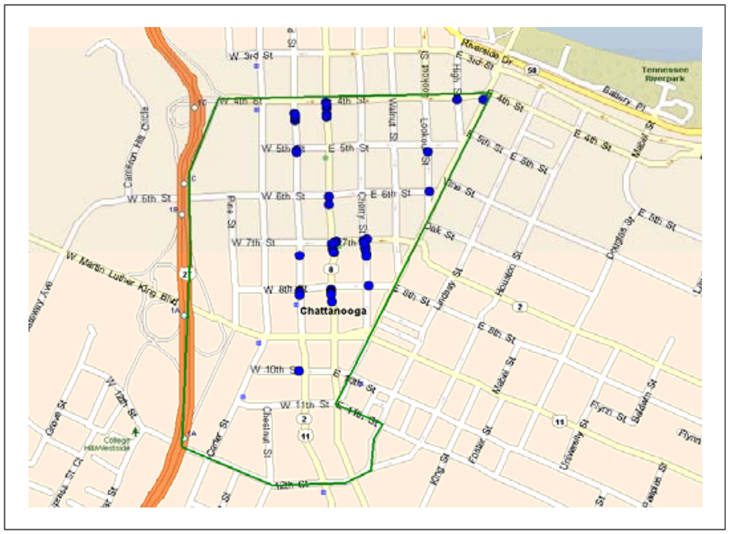
Source: ESRI

RCLCO

City Center and Riverfront Retail Locations

For the near term, the focus should be on strengthening current retailers, and identifying underperforming retail locations that are well positioned, both in size, visibility, and location, to accommodate target retailers in the future. City Center and Riverfront currently have the most potential to establish strong retail offerings due to significant foot traffic from visitors and employees. These two areas already have a critical mass of retail and restaurants that will help in attracting other quality tenants. Strategically tenanting vacant space to contribute to the liveability and uniqueness of downtown will be key to improving the overall retail environment of downtown and attracting residents.

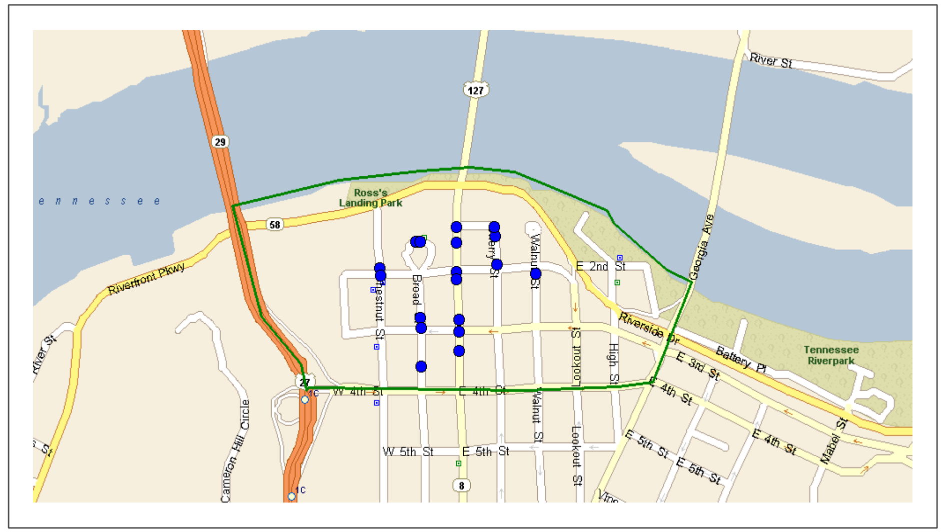
City Center Retail Locations, 2013



TOTAL RBA[1]	239,894
TOTAL OCCUPIED SPACE	203,370
OCCUPANCY	85%

Source: CoStar

Riverfront Retail Locations, 2013



TOTAL RBA[1]	98,475
TOTAL OCCUPIED SPACE	91,973
OCCUPANCY	97%

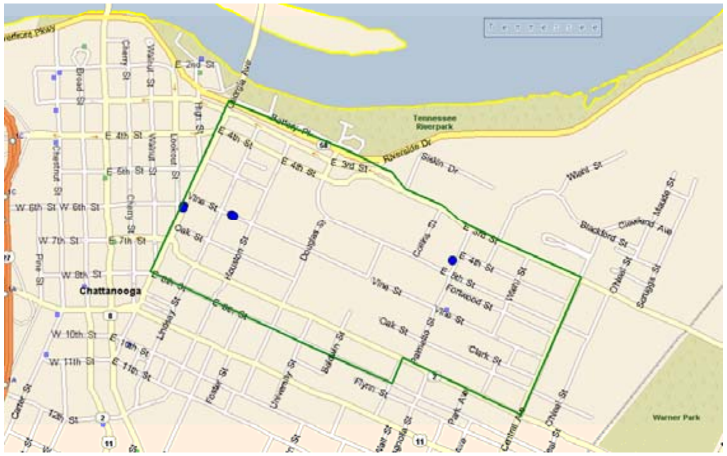
Source: CoStar

UTC Provides Strong Retail Potential

The impact of additional students living near downtown cannot be understated. Students provide a built-in market to support existing retailers today, and are often the “starter fuel” that helps a community to become a vibrant retail destination. Students are a captive market of repeat customers who prefer to shop close to campus and frequent a wide range of retail offerings. A strong retail street near campus is an amenity for the university as it recruits a generation of students increasingly drawn to an urban environment. Furthermore, near campus retail can strengthen campus-community relations and contributes to an active downtown both during the day and night. To make a significant impact, retail efforts near UTC should be clustered, with a likely focus on existing MLK retail spaces.

The Corner, Retail Street, UVA

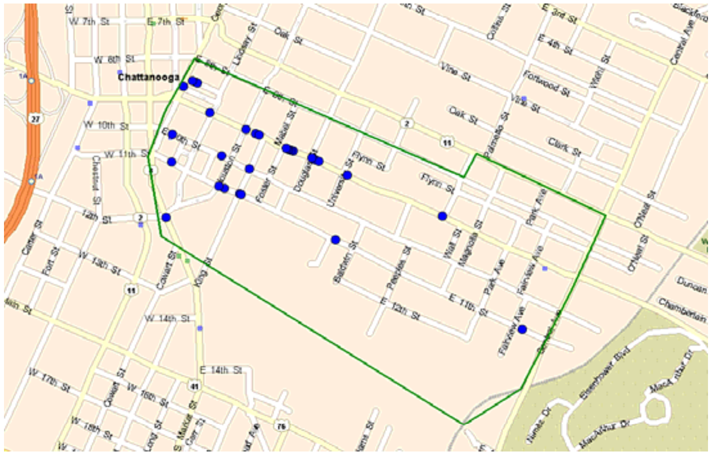
UTC Retail Locations, 2013



TOTAL RBA[1]	**19,403**
TOTAL OCCUPIED SPACE	**12,861**
OCCUPANCY	**66%**

Source: CoStar

MLK Retail Locations, 2013



TOTAL RBA[1]	**104,363**
TOTAL OCCUPIED SPACE	**77,166**
OCCUPANCY	**74%**

Source: CoStar

Future Retail Demand and Methodology

Future retail demand will primarily be supported by new downtown residents, students living near campus or downtown, and growth in tourism. The full potential for additional retail may include:

- 50,000 SF of grocery and pharmacy uses, with pharmacy presenting the most immediate opportunity
- 70,000 SF of restaurant space
- 30,000 SF of boutique or soft goods retail space

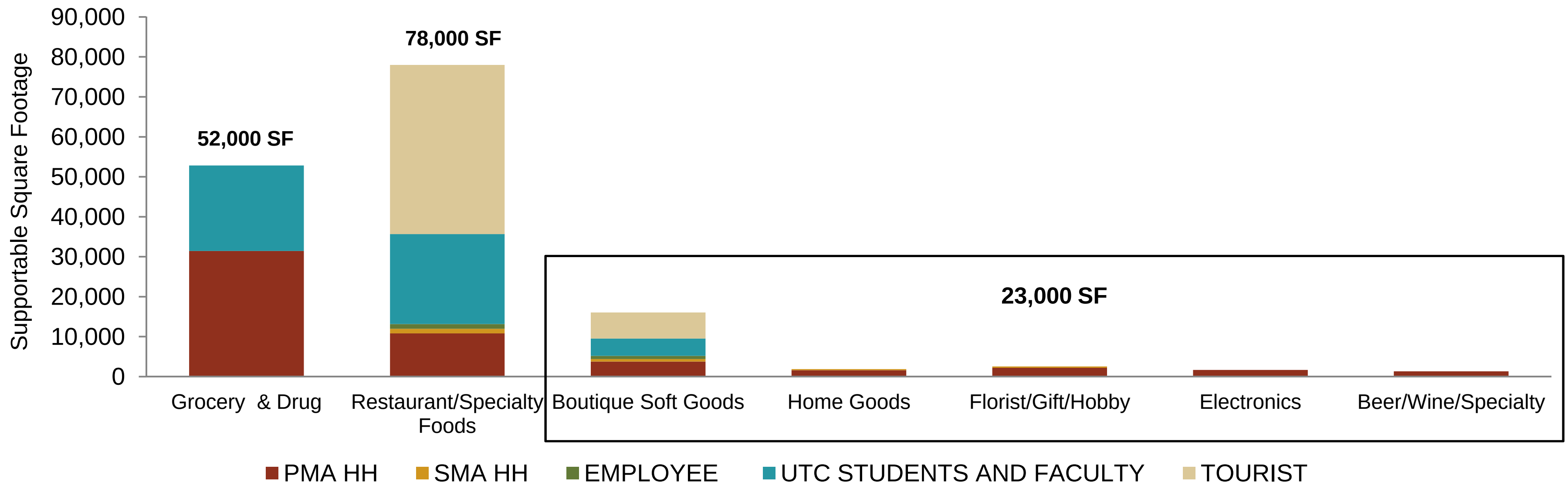
2012 Current Demand
400,000 SF

2012 – 2022
Incremental New Retail Demand
150,000 SF

2022 Total Demand
550,000 SF

Note: Statistical demand based on projected spending and typical supportable square footage by retail type
Source: RCLCO

Retail Demand by Consumer and Retail Type, 2013



Source: CoStar, RCLCO

Office

Office Demand Summary

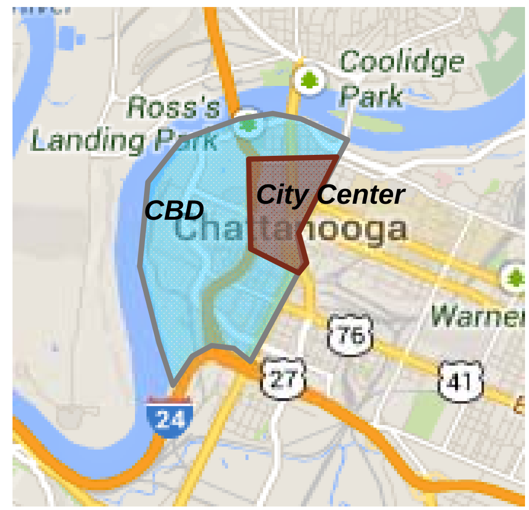
The existing multitenant office supply in downtown Chattanooga is likely sufficient to accommodate future office-using employment growth until 2020. This could be sooner if some obsolete office buildings are converted to other uses such as residential. As the historical office core of Chattanooga, City Center has captured the "core demand" from new office tenants locating in the CBD, which RCLCO estimates as approximately 75% of total office demand. Recently, owner-occupant office space has been located in surrounding neighborhoods with more land availability such as Westside and Southside. In addition, more creative office tenants have been attracted to non-traditional office spaces that may be challenging to provide in City Center, such as renovated warehouse/loft space.

Projected Office Demand (in SF), 2013

	2012 - 2017	2017 - 2022
Scenario 1: Today's CBD Market		
New Office Space (SF) Demanded in CBD	0	130,000 SF
Cumulative New Office Space in City Center (75% capture of CBD)	0	98,000 SF
Scenario 2: Some Office Supply Conversions to Residential		
New Office Space (SF) Demanded in CBD	0	203,000 SF
Cumulative New Office Space in City Center (75% capture of CBD)	0	152,000 SF

Source: CoStar; Moody's; RCLCO

Incremental New Office Demand Map, 2013



Source: CoStar; Moody's; RCLCO

RCLCO

Office Demand Summary

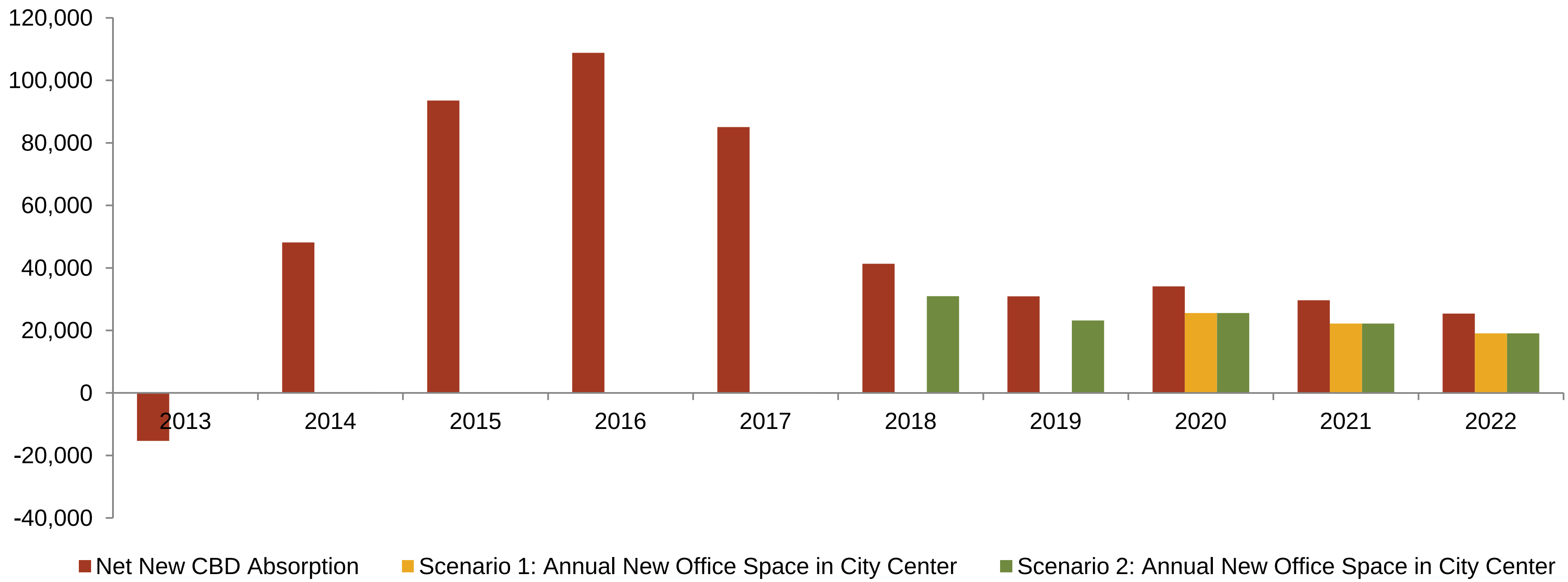
Scenario 1 – Today's CBD Market

Scenario 2 – Some Office Conversions to Residential

As Chattanooga, particularly the CBD, is a relatively small market, changes in one or two buildings can augment the landscape of the commercial real estate market. For this reason, RCLCO evaluated future office demand based on two potential scenarios:

- Scenario 1 assumes that today's existing office space will remain on the market until it is absorbed by new tenants
- Scenario 2 demonstrates the impact of converting one vacant office building, the Chattanooga Bank Building, to residential space, thus decreasing the vacant office space and total size of the office market. The impact of this change is demonstrated clearly below, as the City Center office market begins to support new office development two years early that it might in Scenario 1.

Projected Office Demand (in SF), 2013

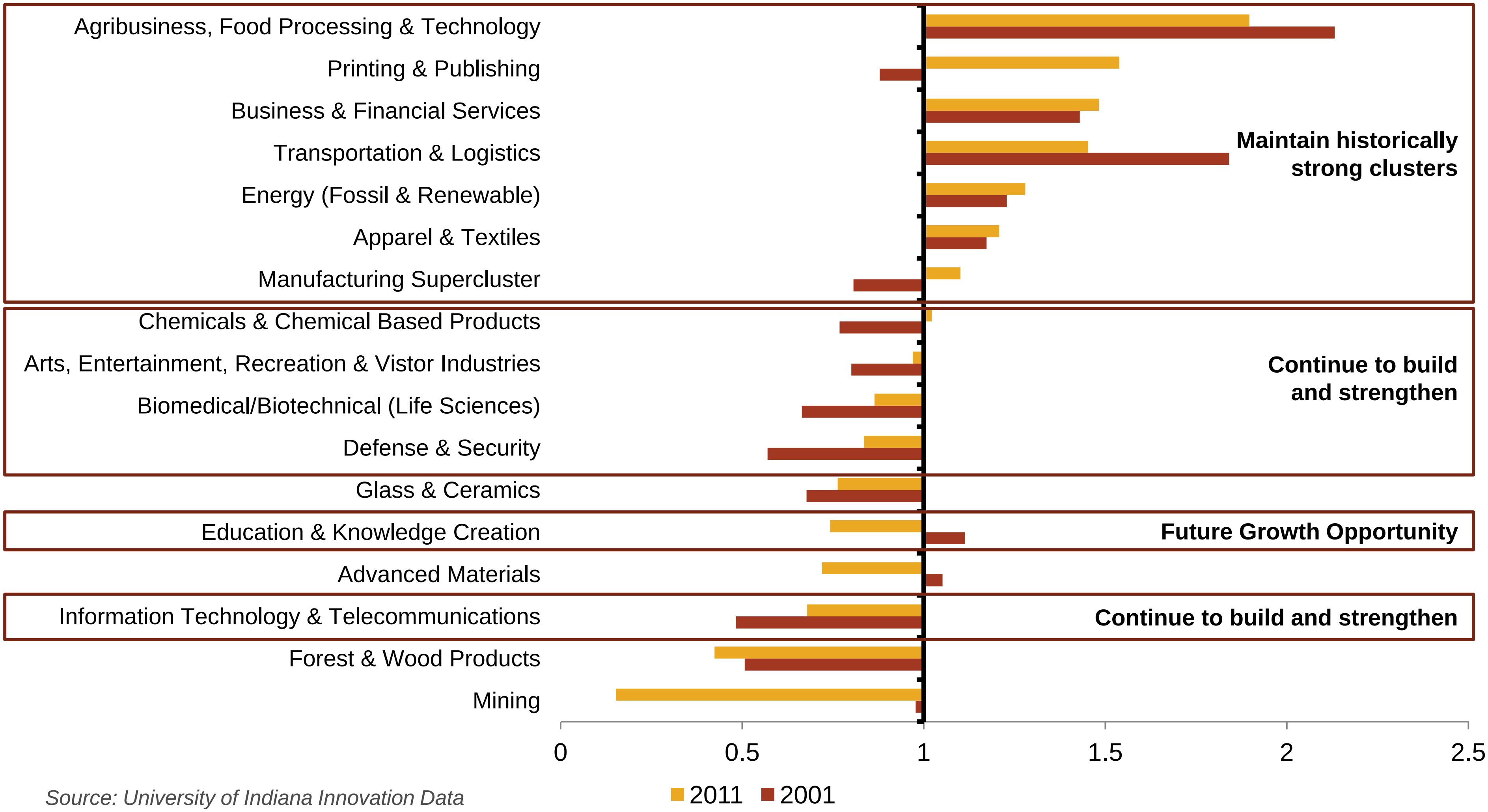


Source: CoStar; Moody's; RCLCO

Industry Cluster Analysis

Clusters with Improving Location Quotient May Benefit from Tenant-Focused Incentives

A location quotient of one indicates that Hamilton County has experienced growth in a particular industry cluster at the same rate as the state of Tennessee. Higher location quotients are indicative of industries in which local growth outpaces the state comparison. In industries with a location quotient below one, but that increased from 2001 to 2011, it indicates that Hamilton County is increasing its growth relative to the state's growth—these are the industries to build and strengthen.



Source: University of Indiana Innovation Data

Downtown Chattanooga Office Inventory

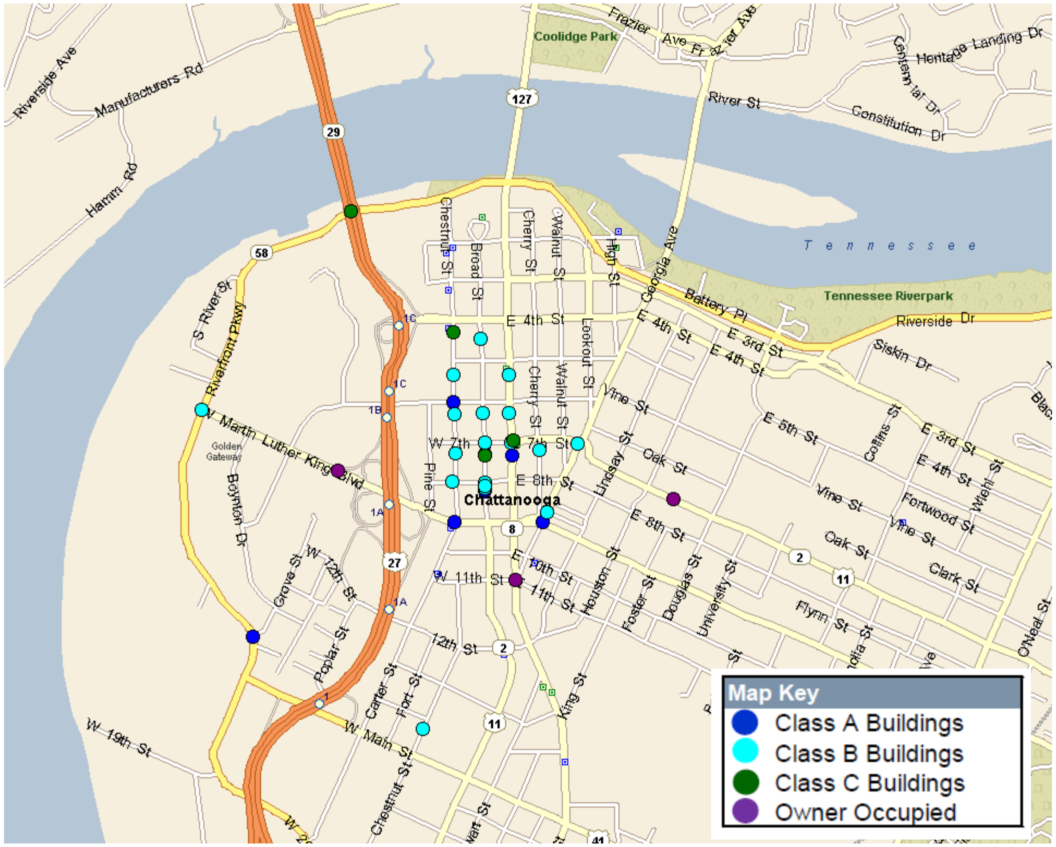
While new office development in City Center may sound like a distant opportunity, enhancing the residential and retail environment of downtown will distinguish it from suburban locations and increase appeal for office tenants. Given the varied conditions of office space in City Center, different strategies are necessary for old versus newer office buildings in terms of determining an appropriate use, whether that implies renovating office space or converting as adaptive re-use. The map and chart below show the distribution of office space in and near downtown, color-coded by building class.

Existing Downtown Inventory by District and Class, 2013

District	Class	RBA	Avg. Occ.
City Center	A	665,000	76%
	B	1,553,000	76%
	C	188,000	16%
	Owner-occupied	1,445,000[1]	92%[1]
Westside	A	112,500	38%
	Owner-occupied	950,000[1]	100%[1]
Riverfront	B	28,000	88%
	C	22,000	0%
Southside	B	23,000	100%
	C	16,000	0%

Source: CoStar

Map of Major Office Buildings by Class 2013



[1] Based on employment and RCLCO estimates

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The Next Generation of Creative Office Space

Think Beyond the Office Tower – Local Examples

- Newer buildings will be the most appealing options for traditional office tenants either relocating or expanding into downtown. These buildings primarily need to be effectively marketed as modern, tenant-ready office space.

- One option for older office space, beyond conversion to residential, is to attract educational or other institutional office users to downtown, whether this is a new institution or UTC expansion.

- Buildings ripe for residential conversion likely have the following characteristics:
  - Central elevator cores
  - Small, rectangular floor plates

- Additionally, new office users may demand more unique, differentiated office spaces than available in the current office stock.
  - Ad agency Johnson Group houses its office in a two-story creative loft space at 436 Market Street.
  - Business incubator Lamp Group Post occupies the second floor of Loveman's on Market building, Chattanooga's first department store.
  - Southern Surgical Arts, a new three-storey, 27,000 square foot medical office building in Southside, is the biggest to break ground in decades. The building will hold two certified operating rooms, a medical clinic and spa, waiting rooms and consultation rooms. Older multitenant office space would never have accommodated these specialized uses.

The Johnson Group Office


Lamp Post Group Office/Incubator

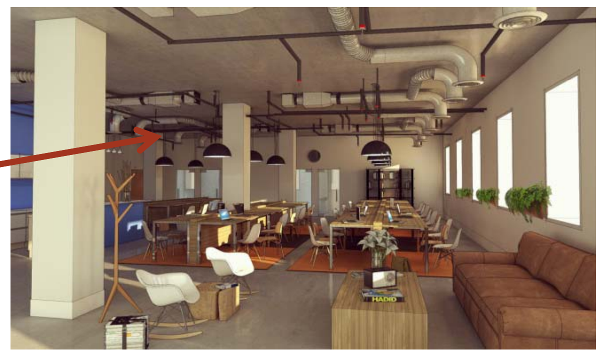

Southern Surgical Arts

The Next Generation of Creative Office Space

Think Beyond the Office Tower – Local Examples

Access America in Warehouse Row

First Tennessee "Society of Work"



Riverfront Professionals Medical Office

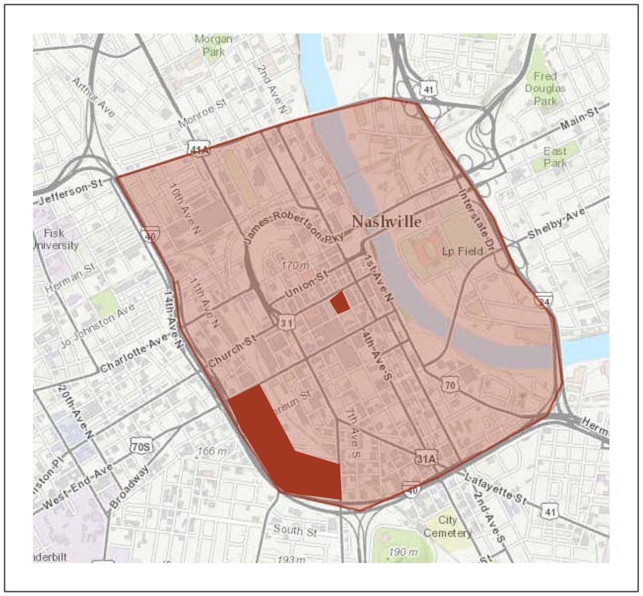
- Society of Work, a new collaborative workspace for start-ups and small companies, is located on the 13th floor of the First Tennessee Bank Building.
- The Riverfront Professionals Medical Office Building, located near the Tennessee River, was recently awarded LEED Gold status for its precast concrete building frame, solar energy system, and reflective roof.
- Access America, a rapidly expanding freight brokerage, opened a 3,500-square-foot executive office in Warehouse Row and is expanding its offices within the Market Street office and retail complex.

Case Studies

Few Catalytic Developments were “Simple”

Private Sector Needs Public Leverage to Make Early Developments Pencil

Nashville, TN



Key Strategies

- *Tax Increment Financing (TIF) distributed by Metropolitan Nashville Housing Authority (MDHA) in exchange for moderately-priced units*
- *Business Improvement Districts (BID): one in downtown, one in The Gulch*

Business Incentives

- *Cash Grants: significant corporate headquarters or technology firm relocation that adds 500+ jobs to Nashville in first five years*
- *Fast Track Permitting & One Stop Business Assistance: streamlined structure and access to all departments; also expedites permitting, licensing, and regulatory processes.*

Source: Market Street Enterprises; Giarratana Development, Multi-Housing News Article July 2009; ULI Case Study Database; MDHA; ESRI; RCLCO

	The Viridian	The Gulch
Description	• First condominium tower built in downtown Nashville in 2006. • 31-story high-rise with 305 units priced from $130k to $400k. • Full service grocery on first floor • Built on small infill lot, only 100’ x 235’ • 430 above-ground parking structure stacked below residential floors	• 60 acre LEED-ND certified neighborhood on a former rail yard • 6 residential and 4 office buildings; 17 restaurants • 80% of existing building renovated and repurposed
Financing	• Received $6 million in TIF from MDHA Nashville, in exchange for allocating 20% of units as “moderately priced”	• $25M in TIF has been used total, split among 6 individual projects. City denied most recent project’s application based on amount of funding already in neighborhood.
Key takeaway	• Low land value ($3.1M, or only $10k per unit) helped in making an expensive project development-feasible	• Only privately-controlled master plan in downtown. Promotes quality, controlled development while streamlining process and coordinating vision
Impact	• Proved market for downtown living extended beyond young professional renters. • Demonstrated effective use of TIF, which has become a strong tool for the City to encourage redevelopment	• Revitalized an underutilized industrial neighborhood on the edge of downtown • Created neighborhood identity and brand separate from broader downtown by maintaining industrial character and attracting one-of-a-kind restaurants.

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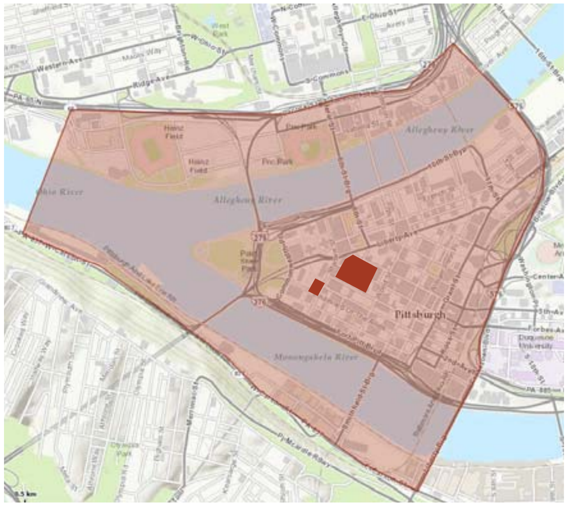
Few Catalytic Developments were “Simple”

Private Sector Needs Public Leverage to Make Early Developments Pencil

Pittsburgh, PA



Key Strategies

- *New Market Tax Credits (NMTC)*
- *Historic Tax Credits*
- *Urban Redevelopment Authority (URA), which administers multiple low-cost loan programs*
- *Business Improvement District (BID)*
- *Centralized development resources*
- *Active community development corporations (CDCs)*
- *Strategic deployment of public investment to leverage private capital*

Business Incentives

- *City loans from $100,000 - $250,000 (Business Growth Fund, Tax exempt industrial development note, Urban Development Fund)*

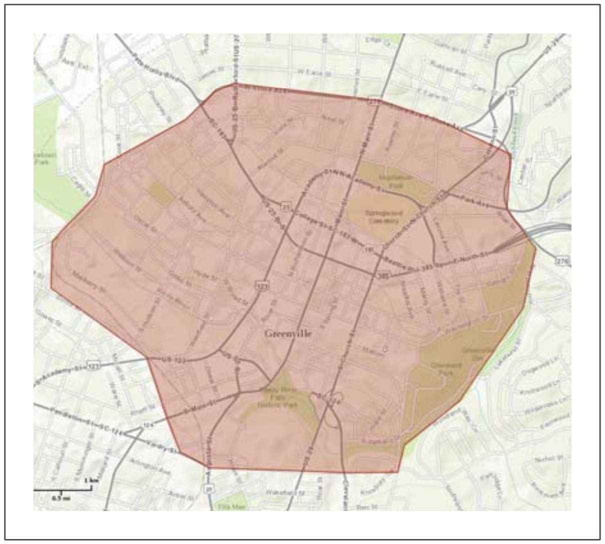
Source: Pittsburgh URA; ULI Global Awards for Excellence; Millcraft Investments; PMC Property Group; ESRI; RCLCO

	Market Square	**201 Stanwix**
Description	• 3 individual projects leveraged public reinvestment in Market Square • Market Square Place: combined 7 adjacent, but separate buildings into 250k SF of retail, 50 loft apartments, and a 44k SF YMCA. • Market at 5th: combined 2 historic buildings into 2 retail storefronts and 7 apartments. Parking garage next door offers discount monthly leases for residents • Fairmont Hotel: 185-key	• Former Bell Telephone office building converted to 158 rental apartments and a charter high school in 2012 • Leases parking in nearby private parking garage • Total gut of
Financ-ing	• $5 million in public investment in the square • New Market tax credits • Historic tax credits	• HUD Financing
Key takeaway	• Public investment in placemaking and programming matters • Historic buildings present challenges beyond infill development that often require assistance	• Office conversion to residential is a viable market strategy. • Rectangular footprint and central elevator core made building attractive for conversion.
Impact	• Proved residential market in downtown • Reinvigorated original central square	• Reused former vacant office building • Demonstrated that market does not require on-site parking

Few Catalytic Developments were “Simple”

Private Sector Needs Public Leverage to Make Early Developments Pencil

Greenville, SC



Key Strategies

- *City builds/finances public infrastructure, including:*
  - *Parking garages*
  - *Parks*
  - *Streetscape*
- *Historic Tax Credits*
- *New Market Tax Credits*
- *Focus on downtown cultural institutions and educational users*

Business Incentives

- *Business License Tax Abatement: a graduated 3-year abatement of City business license tax for new corporate offices, manufacturing, R&D, high technology companies*
- *State-based Incentives:*
  - *Jobs Tax Credit: rewards specific types of companies for job creation by reducing their corporate income tax liability.*
  - *Corporate HQ Credit: income tax credits for real or personal property expenditures related to new jobs*

Source: Davis Property Group; City of Greenville; Greenville Economic Development; ESRI; RCLCO

100 East

Description	• 2 individual residential buildings: one condo, one rental • Sites bookend a mid-block public parking garage. City built the garage and then sold the “end cap” sites to developers
Financing	• Conventional (for residential uses)
Key takeaway	• Adjacent public parking removed cost to developer to provide parking on-site
Impact	• Site supported denser housing development than otherwise would have feasible with on-site surface parking.

Recommendations for Chattanooga

Key challenges are similar across revitalizing downtowns.

- Parking is both expensive and hard to accommodate on-site.
- High land values and improvement costs for infill sites and historic buildings narrow profit margins.
- Lack of clarity and consistency in development process makes development costs hard to predict and requires extra contingency.
- Capital markets are risk averse and hesitant to fund the first project in an unproven market.
- Rigid land use regulations or master plans make it hard for developers to meet an evolving market.

Chattanooga development community consistently identified 5 opportunities to address issues:

- **PILOT** (payment in-lieu of taxes) is effective because property values are exceptionally high in Tennessee, and land values are not lower accordingly.
- **Build structured parking** in locations where residential development can best leverage it, and address on-site parking requirements on a case-by-case basis.
- Create a **development "ombudsman"** at the city who can streamline the approvals, permitting, and inspection process. This reduces uncertainty and risk to developers, and therefore decreases the amount of money they need as contingency.
- **Review infrastructure requirements** – requirements for redevelopment significantly different from new development.
- Implement **office tenant-based incentives**, such as cash grants or business tax abatements, that will proactively position downtown to capture new office tenants when they are active in the market.

Effective Strategies, Categorized by Type/Goal:

1. *Zoning/Policy Intervention*

- Allow for flexibility within master plans and sites
- Realign zoning code to market realities
- Create small area plans
- Design guidelines
- Minimum densities
- Planned densification
- Streamline regulatory/entitlement process ("green taping")

2. *Public Finance Options*

- Tax increment financing (TIF)
- Tax credits (New market tax credit, historic preservation tax credit)
- Tax abatements
- Payment in lieu of taxes (PILOT)
- Tenant incentives for property improvements
- Low-interest loans (HUD financing)
- Site specific: brownfield programs, enterprise zone, HUBzone

3. *Public Private Partnerships*

- Land swaps/donations
- Joint development/development assistance
- Parking strategies

4. *Incentivize Development*

- Density bonuses
- Reduced impact fees
- Tiered incentives
- Land acquisition/land banking
- Establish development selection criteria
- Transfer of development rights (TDR)
- Prioritize catalyst projects

5. *Attract Business*

- Fast track permitting & one stop business assistance
- State-based incentives: Job or Corporate HQ Tax Credits
- Cash grants for job creation
- Abatement of city-controlled taxes and fess
- Empowerment zones

Critical Assumptions

Our conclusions are based on our analysis of the information available from our own sources and from the client as of the date of this report. We assume that the information is correct, complete, and reliable.

We made certain assumptions about the future performance of the global, national, and local economy and real estate market, and on other factors similarly outside either our control or that of the client. We analyzed trends and the information available to us in drawing these conclusions. However, given the fluid and dynamic nature of the economy and real estate markets, as well as the uncertainty surrounding particularly the near-term future, it is critical to monitor the economy and markets continuously and to revisit the aforementioned conclusions periodically to ensure that they stand the test of time.

We assume that the economy and real estate markets are close to bottoming out for the current cycle, and that they will grow at a stable and moderate rate starting in 2012, more or less in a straight line on average for the duration of the analysis period (to 2020 and beyond). However, history tells us that stable and moderate growth patterns are not sustainable over extended periods of time, and that the economy is cyclical and that the real estate markets are typically highly sensitive to business cycles. Further, it is very difficult to predict when the current economic and real estate downturns will end, and what will be the shape and pace of growth once they are recovered.

With the above in mind, we assume that the long term average absorption rates and price changes will be as projected, realizing that most of the time performance will be either above or below said average rates.

Our analysis does not take into account the potential impact of future economic shocks on the national and/or local economy, and does not necessarily account for the potential benefits from major "booms," if and when they occur. Similarly, the analysis does not necessarily reflect the residual impact on the real estate market and the competitive environment of such a shock or boom. Also, it is important to note that it is difficult to predict changing consumer and market psychology.
For all the reasons outlined, we recommend the close monitoring of the economy and the marketplace, and updating this analysis as appropriate.

Further, the project and investment economics should be "stress tested" to ensure that potential fluctuations in revenue and cost assumptions resulting from alternative scenarios regarding the economy and real estate market conditions will not cause failure.

In addition, we assume that once the current cycle is over, the following will occur in accordance with current expectations:

- Economic, employment, and household growth.
- Other forecasts of trends and demographic and economic patterns, including consumer confidence levels.
- The cost of development and construction.
- Tax laws (i.e., property and income tax rates, deductibility of mortgage interest, and so forth).
- The availability and cost of capital and mortgage financing for real estate developers, owners and buyers, at levels present in the market before the most recent run up (i.e., early 2000s levels).
- Competitive projects will be developed as planned (active and future) and that a reasonable stream of supply offerings will satisfy real estate demand.
- Major public works projects occur and are completed as planned.

Should any of the above change, this analysis should probably be updated, with the conclusions reviewed accordingly (and possibly revised).

General Limiting Conditions

Reasonable efforts have been made to ensure that the data contained in this study reflect accurate and timely information and are believed to be reliable. This study is based on estimates, assumptions, and other information developed by RCLCO from its independent research effort, general knowledge of the industry, and consultations with the client and its representatives. No responsibility is assumed for inaccuracies in reporting by the client, its agent, and representatives or in any other data source used in preparing or presenting this study. This report is based on information that to our knowledge was current as of the date of this report, and RCLCO has not undertaken any update of its research effort since such date.

Our report may contain prospective financial information, estimates, or opinions that represent our view of reasonable expectations at a particular time, but such information, estimates, or opinions are not offered as predictions or assurances that a particular level of income or profit will be achieved, that particular events will occur, or that a particular price will be offered or accepted. Actual results achieved during the period covered by our prospective financial analysis may vary from those described in our report, and the variations may be material. Therefore, no warranty or representation is made by RCLCO that any of the projected values or results contained in this study will be achieved.

Possession of this study does not carry with it the right of publication thereof or to use the name of "Robert Charles Lesser & Co." or "RCLCO" in any manner without first obtaining the prior written consent of RCLCO. No abstracting, excerpting, or summarization of this study may be made without first obtaining the prior written consent of RCLCO. This report is not to be used in conjunction with any public or private offering of securities or other similar purpose where it may be relied upon to any degree by any person other than the client without first obtaining the prior written consent of RCLCO. This study may not be used for any purpose other than that for which it is prepared or for which prior written consent has first been obtained from RCLCO.