



INTRODUCTION

Leland Consulting Group, Real Estate Economists, Development Advisors and Project Managers, was retained by the City of Newcastle to assist a team lead by Makers Architecture+Urban Design in the evaluation of local real estate market conditions influencing recommendations for development and redevelopment of Community Business Center.

This memorandum presents information regarding the demographic and economic determinants that influence real estate investment decisions. An understanding of the existing demographic and economic conditions is a fundamental step towards formulating a cohesive and successful plan for the specific areas addressed in this assignment. This memorandum also addresses current information about economic and real estate conditions.

METHODOLOGY

The demographic analysis described in this report was developed using official U.S. Census data, Washington State data, and information from CACI Marketing Systems and Claritas, Inc., (national demographic and consumer database services commonly used by the real estate industry).

The real estate market analysis was developed with the assistance of national and local industry publications, input from important community stakeholder interviews¹ and Leland Consulting Group's extensive experience with similar assignments in the Puget Sound region.

UNDERSTANDING REAL ESTATE MARKET CONDITIONS

Real estate development is relatively straightforward. Markets are people. Real estate and the activities within real estate, respond to people's needs and desires for a specific quality of life in a defined environment. In a real estate context, development projects respond to the needs and desires of people in the form of housing, places to work, places to shop, places to learn and places for recreation.

The market is smart—it knows what it likes and does not like—and with the exception of where subsidy or poverty is involved, developers know the market can and will reject a real estate product that is not responsive to those needs and desires.

Real Estate Market Behavior

Real estate markets are cyclical due to the lagged relationship between demand and supply for physical space. The market cycle can be divided into four phases:

¹ See *"Focused Growth Alternatives: Summary of Stakeholder Interviews."* Leland Consulting Group, July 1999.

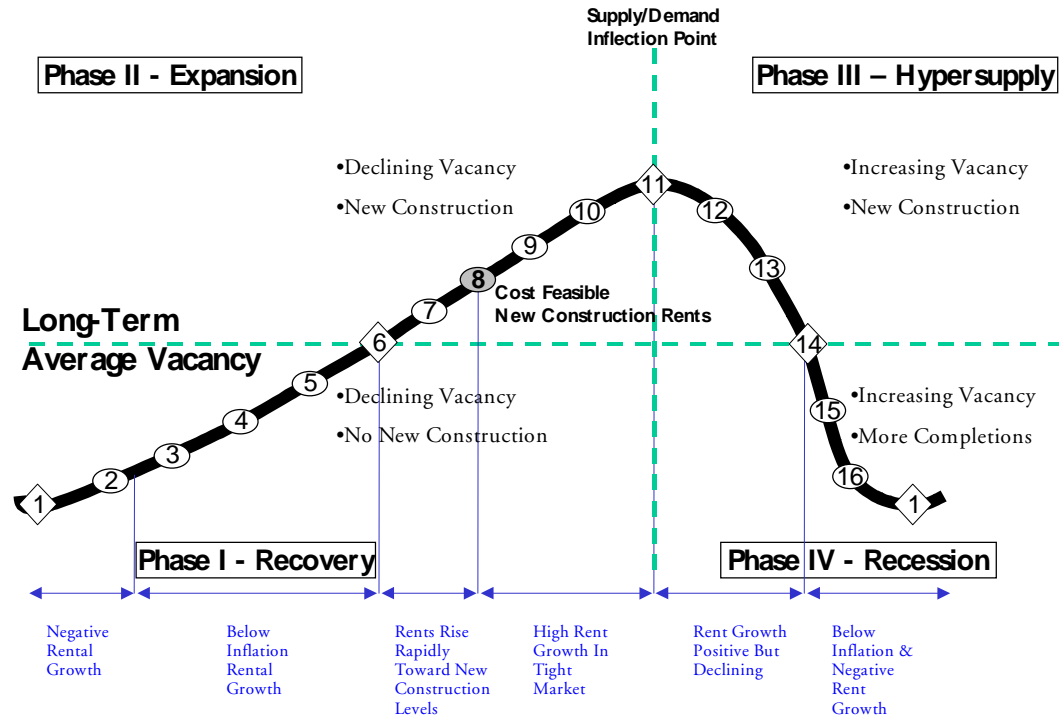
recovery, expansion, hypersupply, and recession. Long-term equilibrium is different for each market and each property type. Equilibrium is a key factor in determining growth rates for new development and redevelopment and the levels at which development performs, two of the key factors that affect real estate investment returns.

Market cycle research is used to produce more accurate estimates of future market vacancy and rental rate growth in order that developers and investors can make informed strategic decisions. Many investors and developers will pursue new opportunities in property types that are in the expansion phase, because this is where the greatest opportunity for short-term income return occurs. Others will pursue “bargain basement” deals in the recession phase, but with the expectation that returns will be long-term.

When a market enters the hypersupply phase, investors and developers generally hurry to complete projects in an effort to capitalize on remaining surplus demand or wait for the market to reach recovery again. The recovery phase occurs when investors and developers identify, plan, and position themselves for opportunities. Figure 1 illustrates the real estate cycles within which investors make strategic investment decisions.



Figure 1
Model of the Real Estate Market Cycle



Source: Legg Mason Wood Walker Incorporated and Leland Consulting Group.

Table 1
Legg-Mason Real Estate Cycle Point Comparison
Seattle Metropolitan Area Market

Cycle Period	Office	Retail	Industrial	Multi-Family	Hotel
4th Q 1996	9	12	12	9	na
4th Q 1997	11	12	11	10	11
2nd Q 1999	11	12	14	12	14

Source: Legg Mason Wood Walker Incorporated and Leland Consulting Group.

As shown in Table 1, with the exception of the office market, in the 2nd Quarter of 1999, all of Seattle’s markets have moved into the hypersupply phase. This would generally indicate increasing vacancies prompting cautious developers to take a “wait and see” approach to future investment decisions.

This trend may not be as strong on the Eastside where real estate development is particularly strong. Newcastle, in particular, continues to see extensive residential development with many new permit applications in the second half of 1999.

POPULATION

According to a June 1999 report by the Washington Office of Financial Management, the state's population will continue to grow at a faster rate than the nation as a whole. This means that a significant number of people will be moving to Washington, especially to popular towns like Newcastle. However, as Table 1 shows, the overall *growth rate* for the state is expected to begin to initially decline and then increase again as we move into the twenty-first century.

Table 1
Annual Population Growth Rates
United States and Washington

Year	United States	Growth Rate (%)	Washington	Growth Rate (%)
1995	262,755,270	1.05%	5,429,900	1.79%
2005	285,981,000	0.81%	6,200,375	1.17%
2015	310,134,000	0.82%	7,056,933	1.27%

Source: Washington Office of Financial Management and Leland Consulting Group.

The Region

King County's Eastside, which includes the city of Newcastle, is growing at a rapid pace. Since the mid-1980s, the county's population has swelled and is expected to continue to grow well into the next century. This growth trend was, and continues to be, fueled by strong local economic conditions (especially in high tech industries), immigration, and a high quality of life.

Table 2 provides a comparative view of population growth in the State of Washington, King County, the City of Seattle, and the City of Newcastle.

Table 2
Regional Population Growth Comparison

	1990 (Census)	1999 Estimate	% Change 1990-1999	2004 Projection	% Change 1999-2004
City of Newcastle	na	8,700	na	13,000	49.0%
King County	1,507,319	1,670,458	10.8%	1,753,906	5.0%
City of Seattle	516,259	536,652	4.0%	551,106	2.7%
Washington State	4,866,692	5,749,374	18.1%	6,132,888	6.7%



Source: City of Newcastle, Claritas, Inc. and Leland Consulting Group.

Newcastle's population growth projection was provided by the city and is based in part on the number of building lots in platted subdivisions. Given continued strong economic conditions, it is possible that growth may exceed the city's 2004 projection.

HOUSEHOLD INCOME & CONSUMER SPENDING

The City of Newcastle

Household income is the most important determinant of residential choice and overall consumer spending potential. Income variations in different areas in Newcastle have important implications for long-range public- and private-sector planning decisions. Table 5 details current and projected income statistics for the city. Table 6 provides data on household consumer spending in retail establishments.

Table 5
Individual and Household Income
City of Newcastle

Income	1999 Estimate	2004 Projection	Annual % Change 1994- 2004
Per Capita	\$34,440	\$43,296	4.68%
Av. Household	\$91,039	\$113,120	4.85%
Median Household	\$77,263	\$87,554	2.66%

Source: CACI Marketing Systems and Leland Consulting Group.

Table 6
1998 Estimated Average Household Spending for Selected Items
City of Newcastle

Expenditure Category	Average Household Spending
Groceries	\$3,555
Apparel	\$1,597
Automotive Aftermarket	\$705
Barbers & Hair Salons	\$363
Child Care	\$2,496
Entertainment	\$567
Film Processing	\$106
Home Improvement	\$2,516
PC Hardware/Software	\$2,063
Pets & Supplies	\$303
Restaurants	\$1,314
Sporting Goods	\$685
Toys & Hobbies	\$555

Source: CACI, Claritas, Inc. and Leland Consulting Group

REAL ESTATE CONDITIONS

RESIDENTIAL

Another important gauge of population growth is reviewing housing trends. Population growth is reflected by corresponding data on the growth in total housing units.

Home Sales

Real estate sales activity in Newcastle has been brisk in the past several years. Table 7 provides an overview of 1998 sales activity for single-family residential properties in Newcastle. According to interviews with local real estate brokers, single family homes are the most popular with buyers, although condominiums also sell quickly. Brokers noted that activity has slowed somewhat in 1999 due to declining inventory and rising interest rates.



Table 7
Single-Family Home Sales Survey
Newcastle, Washington

Transactions Reported	135
Average Sales Price	\$317,000

Source: Newcastle Chamber of Commerce and Leland Consulting Group.

Prices vary from neighborhood to neighborhood within Newcastle, with the average house selling for more than \$317,000 in 1998. For 1999, home sales prices have increased approximately 10 percent. Real estate brokers said that there is a demand for large luxury homes and prices are rising quickly. New homes are starting at \$700,000; golf course homes are starting at \$1 million.

Rentals

The high cost of home ownership in the Newcastle area forces many families into the rental market. Tables 8 & 9 provide data on apartment complexes in the Newcastle CBC. Rents range from \$725 to \$1,450 depending on number of bedrooms, bathrooms and amenities (in-unit laundry facilities, cover parking, pools, etc.).

Table 8
Multi-Family Rental Rates
Newcastle CBC

1 Bedroom	\$725 to \$885 per month
2 Bedroom	\$875 to \$1,065 per month
3 Bedroom	\$1,300 to \$1,450 per month

Source: Leland Consulting Group.

The Newcastle CBC contains a number of multi-family residential complexes. Leland Consulting Group surveyed a sample of these complexes to learn more about rental rates and amenities. The following table provides information on several notable multi-family complexes.

Table 9
Multi-Family Housing
Central Newcastle

Apartment Complex	Rental Rates	Amenities
Castle Creek Apartments	216 units 1-bd / \$810 to \$885 2-bd / \$995 to \$1,065 3-bd / \$1,300 to \$1,450 5% vacancy	Indoor pool, basketball court, weight room, tanning booth, play areas
Coal Creek Apartments	105 units Studios / \$580 1-bd / \$665 to \$710 2-bd / \$780 to \$820	Some washer/dryer hook-ups, parking
Archstone Newport Crossing	192 units 1-bd / \$790 2-bd / \$985 3-bd / \$1,025 to \$1,300 No vacancy	Pool, hot tub, fitness center
Del Mar Village Apartments	30 units 1-bd / \$725 to \$800 2-bd / \$875 to \$895 Normally no vacancy	Parking

Source: Leland Consulting Group.

OFFICE

The Puget Sound Region has experienced several years of “red hot” office market conditions (low vacancies and rising rents). Beginning in late 1998, the region’s office market activity began to level off, however, it is still considered one of the top five office markets in the country with very low vacancy levels.



The majority of the Eastside office market is located in the Bellevue central business district and along the I-405 corridor. Presently, Newcastle does not have any significant office complexes.

Interviews with commercial and residential real estate brokers identified a need for office space in Newcastle. The general opinion was that local residents would consider locating businesses in the city if space was made available. Office space could be combined with retail and residential in integrated horizontal and vertical mixed-use projects.

Table 10
Puget Sound Office Market
2nd Quarter 1999

Eastside

Net Rentable Area	19,095,242 sq. ft.
Vacancy Rate	4.39%
Average Class A Lease Rate	\$24.52

Puget Sound Market / Total

Net Rentable Area	59,980,242 sq. ft.
Vacancy Rate	5.00%
Average Class A Lease Rate	\$24.53

Source: CB Richard Ellis and Leland Consulting Group.

INDUSTRIAL

Newcastle has a small but significant industrial enclave to the east of the CBC. Currently, this area is occupied by a handful of moving and storage warehouses, service businesses and light manufacturing companies. Additionally, the 40-acre Mutual Materials brick factory is just north of the CBC. Although currently active, all of these sites represent future development opportunities for the city.

When the economics make it possible to redevelop these sites, careful consideration must be given to providing ample pedestrian connections to the existing CBC.

RETAIL

The Puget Sound region, and especially the Eastside, is in one of the longest running real estate “up cycles” in recent memory. This has fueled new retail development in all categories (i.e., shopping centers, strip centers, and regional malls). Table 10 provides data regarding the current condition of the retail market.

Consumer confidence in the Puget Sound region is at an all time high—sales are expected to grow 6 percent this year. Yet, rising interest rates and threats of inflation may begin to suppress retail sales beginning in the last half of 1999.

Table 10
Puget Sound Retail Market
2nd Quarter 1999

Eastside

Net Rentable Area	12,340,471 sq. ft.
Vacancy Rate	3.71%
Average Overall Lease Rate	\$19.92

Puget Sound Market / Total

Net Rentable Area	60,597,201 sq. ft.
Vacancy Rate	5.59%
Average Overall Lease Rate	\$21.82

Source: CB Richard Ellis and Leland Consulting Group.

Currently, Newcastle is served for consumer necessities by two shopping centers—Coal Creek Market Place and Coal Creek Town Center. Nearby Factoria provides additional shopping with a large community shopping center and multiple strip centers. To the south, Renton also has numerous shopping opportunities.

As the city's population and consumer demand grows, additional local businesses and services will be needed. This is especially true for businesses that cater to an upscale market. New restaurants, a health club/day spa, boutique gift shops and other businesses not currently found in Newcastle should do well as the population and consumer demand grows.



SUMMARY OF FINDINGS

- Newcastle’s population will continue to grow well into the next decade. Growth may slow somewhat during economic downturns, but will accelerate once economic cycles stabilize. As long as economic conditions are positive the only apparent slowing effect will be a diminishing supply of available building sites.
- The projected median household income for 2004 is \$87,554. This indicates a potential for higher levels of consumer spending, especially for specialty goods and services.
- The new Golf Cub at Newcastle is having a significant influence on the community, the local housing market and the region. The city should explore opportunities to work with the golf course to market future town amenities (e.g., hotel, conference center and day spa).
- Market-rate rentals are in good supply; however, affordable units may not be available in the quantity necessary to meet current or future demand. New multi-family construction will be needed for low- and moderate-income households.
- While single-family housing sales have been strong during the past several years, there are good opportunities for well-designed, lower-priced homes (e.g., small lot detached homes, townhomes and condominiums).
- The Eastside office market is very strong; however, Newcastle has very few office spaces. Some residents may consider locating businesses in Newcastle if office space were made available in the CBC area.
- The two existing neighborhood shopping centers appear to be serving the community well. However, to remain competitive the respective owners and tenants must stay at the “cutting edge” of retail to compete with shopping centers in nearby Factoria and Renton, and the growing number of discount “big box” outlets in the region.
- Population growth forecasts indicate a growing demand for additional retail. Given the fact that successful retail relies on location (i.e., visibility and access), sufficient parking and “pass-by” traffic—due to the limited supply of land and the impact of nearby competition, future retail development proposals should be carefully scrutinized by the city to ensure success.
- As land prices rise and development intensifies, the city may want to consider developing a structured parking garage to free-up additional development opportunities in the CBC. Structured parking should be one element of an overall transportation demand management (TDM) plan for the CBC.

CBC OPPORTUNITIES & RECOMMENDATIONS

The community of Newcastle is in a unique and envious position. It currently enjoys a stable real estate market where demand is driving supply. More significant than the current health of the local market, decisions made today concerning the direction of future CBC development will shape the city's livability for decades to come.

Capitalizing on opportunities will depend on assembling multiple stakeholders who will need to work closely together to find the best solutions for both new development and appropriate redevelopment. The City of Newcastle will need to be proactive in its pursuit of the highest and best use of the few remaining parcels in the CBC. Experience in other communities indicates that public/private partnerships are the most effective model for realizing innovative development opportunities.

Based on this market survey—and discussions with the project team, members of the community and local real estate professionals—Leland Consulting Group recommends the following mixed-use development opportunities (preferably in mixed-use designs) in the CBC:

- Additional multi-family housing and townhomes (both ownership and rental);
- One or more office buildings—from small corporate centers to one- and two-person service businesses;
- Retail—restaurants, a specialty grocery store, various boutique shops, service and repair businesses;
- An upscale hotel and conference center coordinated with the Golf Club;
- An athletic club and day spa for both local residents and visitors; and
- A small cinema and/or performing arts complex (two to six screens);

The city should also consider creating an independent development coordinator position specifically designated to work with the private sector development community. The development coordinator would work on an “as needed” basis with potential developers with interest in the CBC. It is unrealistic to think that the currently overburdened planning staff has the time necessary to devote to the many nuances of shaping the quality of development the community desires for the CBC.