



MEMORANDUM

Date: March 8, 2006

To: **Ann Arbor Downtown Development Authority**
Partnerships Committee

From: Wells Lawson, Robert Hickey

Project: Kline's Lot RFP

Subject: Development and RFP Timing

This memo summarizes research and analysis performed by Strategic Economics to better understand ideal timing for condominium and office development on the Kline's Lot site.

Housing

To estimate the ideal timing for issuing an RFP from the perspective of the condominium market, we synthesized two sets of information:

1. projected new downtown housing demand over the next five years, and
2. expected competition for this demand, based on projects currently in the pipeline.

By looking at the relationship between projected supply and demand, we can gain insight into the market conditions that a new condominium project would face at various points in time. This analysis is presented in Tables 1,2 and 3 (following page).

We ultimately found it more helpful to look at the relationship between projected supply and demand than to estimate ideal project timing by extrapolating from historical rates of project absorption. One of the issues with absorption statistics, at least those derived from the Multiple Listing Service (MLS), was that they did not appear to reflect recent, pre-sold condominiums (i.e. sold before completion of construction). For example, we know that 48 (of the 68) units at Liberty Lofts have sold in the past year, but these sales are not reflected in the MLS. According to the MLS data, annual downtown condo sales have only ranged from 7 to 36 units per year (see Table 5). The MLS data apparently understates recent sales volume and project absorption. The greater absorption suggested by Liberty Lofts conforms with our research on national downtown housing preferences and our case studies analysis, which looked at 5 comparable downtowns elsewhere in the US.

MLS-derived absorption statistics are presented then at the end of this memo, along with additional data that gives insight into condominium market conditions for both downtown and the city as a whole.

Projected Relationship Between Supply and Demand

Table 1 below creates a picture of demand and supply over the next five years. This table looks at the interaction of *new* supply (from new construction) with *new* demand (from expected capture of regional growth and filtering of existing Ann Arbor condo owners into the downtown.) Table 1 indicates that in the next five years demand is unlikely to catch up with supply.

Table 1: Projected Inventory and Sales - Moderate Scenario					
	2006	2007	2008	2009	2010
Supply Carryover	34	0	177	270	148
Expected New Units [1]	22	298	214	0	0
Total Supply	56	298	391	270	148
Demand Carryover	0	65	0	0	0
Demand from Outside the City [2]	77	77	77	77	77
Demand from Internal Turnover [3]	44	44	44	44	44
Total Demand	121	186	121	121	121
Excess Supply (Demand)	(65)	177	270	148	27
Total Sales	56	186	121	121	121

[1] based on projects currently in the pipeline, summarized in Table 4.
 [2] based on estimated capture percentage of regional growth
 [3] assuming downtown captures 20% of citywide condominium turnover

Our estimation of future housing demand is partly based on Downtown Ann Arbor's projected share of regional growth – an analysis presented in an earlier memo and evaluated by a panel of Ann Arbor real estate experts.

This analysis yields a total condominium demand of 121 units per year, which conforms with our experience working with other downtowns.

Currently there are 534 units in the pipeline that will come on line between now and 2008. On this basis alone, we may expect that this supply would not be exhausted until 2012.

National literature and experience suggests that the downtown housing demand may be higher than this moderate scenario presents. Under a more aggressive growth scenario (based on the faster growing downtowns in the case study segments), supply is absorbed by 2008 (see Table 2). This tells us that the current rate of construction is perhaps more optimistic than our long-term growth projections imply. Building booms are natural features in the development cycle, and this is not cause for alarm. However, if anything this suggests that caution is in order in understanding the best timing for the completion of the Kline's Lot.

Table 2: Projected Inventory and Sales - High Scenario

	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Supply Carryover	34	0	125	166	0
Expected New Units [1]	22	298	214	0	0
Total Supply	56	298	339	166	0
Demand Carryover	0	117	0	0	8
Demand from Outside the City [2]	129	129	129	129	129
Demand from Internal Turnover [3]	44	44	44	44	44
Total Demand	173	290	173	173	181
Excess Supply (Demand)	(117)	125	166	(8)	(173)
Total Sales	56	290	173	166	0
[1] based on projects currently in the pipeline, summarized in Table 4.					
[2] based on estimated capture percentage of regional growth					
[3] assuming downtown captures 20% of citywide condominium turnover					

Table 3 below uses the high growth scenario and recalculates the supply-demand interaction with the introduction of the Kline's Lot in 2009. The scenario uses the "scaled back" condo above office above retail scenario developed with the DDA in February (see memo dated February 12th, 2006), which featured 108 condominium units.

Table 3: Projected Inventory and Sales - Kline's Lot Scenario					
	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>
Supply Carryover	34	0	125	166	100
Expected New Units [1]	22	298	214	108	0
Total Supply	56	298	339	274	100
Demand Carryover	0	117	0	0	0
Demand from Outside the City [2]	129	129	129	129	129
Demand from Internal Turnover [3]	44	44	44	44	44
Total Demand	173	290	173	173	173
Excess Supply (Demand)	(117)	125	166	100	(73)
Total Sales	56	290	173	173	100
[1] based on projects currently in the pipeline, summarized in Table 4					
[2] based on estimated capture percentage of regional growth					
[3] assuming downtown captures 20% of citywide condominium turnover					

Currently there are at least 1,600 residential units in downtown Ann Arbor. Normal vacancy explains some residual amount of supply that is carried over from one year to the next. However, levels in excess of 10% of the total housing stock may be cause for concern. By bringing the Kline's lot on line in 2009 excess supply is controlled. This analysis assumes that no further additions (i.e., new construction) are made to supply.

Table 4: Downtown Ann Arbor Condo Projects in the Pipeline (as of March 8, 2006)

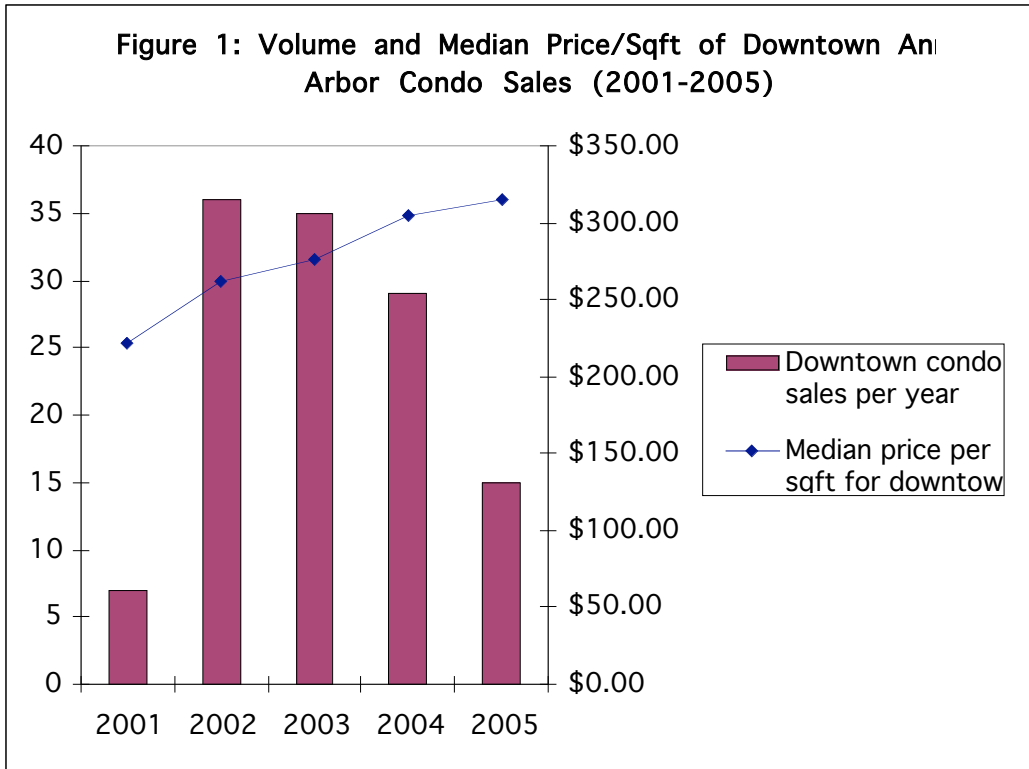
Project	General Details	Units	Status	Expected Completion Date
<i>Mayer Schairer</i>	2-story condo on top of existing historic building	1	Permit issued. Construction almost completed. Asking for certificate of occup.	June, 2006
<i>Loft 322</i>	322 Liberty St. townhouses	21	Permit issued. Sold out. Under construction.	November, 2006
<i>Liberty Lofts</i>	Liberty and First St.	68	Permit issued. Construction well underway. 48 sold; 20 left	January, 2007
<i>Ashley Terrace</i>	10-story mixed use Huron & Ashley Flagstar bank will be below	94-98	Got permits. Beginning grading and sales.	March, 2007 (rough guess)
<i>Kingsley Lane</i>	4-9 story mixed use building 6 units will be affordable	42-54	City Council approval	June, 2007
<i>1st and Washington</i>		60-100	RFP issued (city has development program in mind)	September, 2007
<i>The Gallery</i>	8 stories in Kerrytown. At least 18 of units will be lofts	124	Under staff review	January, 2008
<i>Washington Terrace</i>	10 stories mixed use Range from 812 sqft 1-beds to 1450 sqft 2-beds	90	Plans just filed with planning dept.	March, 2008

Total units (approx.) **534**

Table 5: Historical Performance of Condominiums in Downtown and Ann Arbor as a Whole*

	2001	2002	2003	2004	2005	Total	5-Year Avg.
Downtown condo sales	7	36	35	29	15	122	24
Citywide condo sales	281	338	392	390	391	1792	358
Downtown condo sales as % of citywide condo sales	2%	11%	9%	7%	4%	7%	7%
Citywide home sales (condos and detached units)	983	1126	1220	1188	1130	5647	1129
Condos as a percentage of total home sales (citywide)	29%	30%	32%	33%	35%	32%	32%
Median days on market for condos downtown	73	51	46	40	61		
Median days on market for condos citywide	21	27	37	40	52		
Median days on market for all homes citywide	21	26	30	31	37		
Median price per sqft for <i>downtown</i> condos	\$221.93	\$262.50	\$276.69	\$304.29	\$315.52		
Median price per sqft for <i>citywide</i> condos	\$124.19	\$133.39	\$138.95	\$141.94	\$141.39		

* calculated from MLS data



Office

Grubb and Ellis report a vacancy rate of 14.4% for the Downtown Ann Arbor office market for the Fourth Quarter of 2005. They calculate a total net absorption of 14,261 square feet for 2005. This is significantly lower than the 50,000 square feet of office space that a developer would build under the “scaled back” condo above office above retail scenario (Alternative 7). However, regional absorption rates are on the rise, following a second straight year of positive net absorption. Accordingly, the office market gives further reason to bring a Kline’s Lot development on line in a few years rather than immediately.

Project Timing

Our research shows that housing units in the downtown and citywide sell most quickly during the summer months. Therefore we anticipate that the project developer would ideally deliver the Kline’s Lot to the market for occupancy in June 2009. The following is a recommended timeline for development and the issue of a Request for Proposals:

Issue RFP	March 2007
Developer Selection.....	September 2007
Begin Planning Approvals Process	November 2007
Negotiation on sale of land.....	March 2008
Begin Construction	June 2008
Certificate of Occupancy.....	June 2009

Final Thoughts

This analysis assumes that no new units will come onto the pipeline between now and 2008, which is unrealistic. In reality the Kline’s Lot will face ongoing supply competition, regardless of when it is introduced to the market. Transferring the property in the most expedient way possible, while interest rates remain relatively low and demand is strengthening (after 2010, demand is expected to decrease slightly) may best serve the interests of the DDA, the incumbent developer and the community. If the market for housing softens substantially in the next five years, the likelihood that the lot will remain “vacant” until the next construction cycle remains regardless when the land is transferred to the developer.