

Office Market Analysis

Prepared for:

The Town of Chapel Hill, North Carolina

Prepared by:

Strategy 5 LLC

April, 2010

Table of Contents

Section	Page
Section 1: Executive Summary	3
Section 2: Introduction and Methodology	10
Section 3: Site Analysis	11
Section 4: Public Process Discussion	22
Section 5: Supply Analysis	24
Section 6: Demand Analysis	31
Section 7: Opportunity / Surplus Gap Analysis	39
Section 8 Findings and Recommendations	41

Section 1: Executive Summary

Key observations, findings and recommendations of the Office Market Analysis include the following:

Site Analysis

- There are pockets of office space scattered throughout Chapel Hill, most space is concentrated within seven primary clusters. These are: 1 - Weaver Dairy Road Commercial Area; 2 - Eastowne Drive Commercial Area; 3 - East Franklin Street; 4 - Estes Drive Commercial Area; 5 - Highway 54 East / Raleigh Road Commercial Area; 6 - Downtown Commercial Area; and, 7 - Southern Village Commercial Area
- The physical character of office buildings in Chapel Hill is generally very high in quality. Most office buildings appear well activated (leased) although a few newer developments remain only partially occupied. The site analysis took into account the location of proposed new projects and determined there is a limited amount of land remaining available for office development. The extensive infrastructure which the Town presents to office developers, the physical attractiveness, convenience of well designed retail centers, service areas, etc. all add to a competitive edge that may exerted on other markets if properly leveraged.

Public Process

- The input was generally positive with regard to the office market, but also evidentiary of frustration; much of this apparently directed at the development approvals process which seems to inhibit developer (i.e. investor) interest. There appears to be a pent up demand/interest in developing additional office space by the real estate community based on input received in stakeholder interviews, the public workshops, discussions with commercial real estate professionals etc.

Supply Analysis

- There are approximately 2.2 million square feet of office space within the Town limits spread through approximately 100 separate properties. This includes approximately 1.7 million square feet of space in blocks over 10,000 square feet as typically tracked; plus 500,000 square feet of smaller space as identified through County tax records by the Town of Chapel Hill Economic Development Office. The latter, smaller category of space therefore equals about 22% - 23% of total office space.

- The individual square footage of office properties ranges from about 2,000 square feet to about 180,000 square feet. Most properties range from about 10,000 square feet to about 30,000 square feet. The average office property therefore includes about 20,000 square feet of leasable space. Properties are primarily comprised of Class A and Class B space. Current (spring 2010) vacancy rates are about 14% totaling approximately 300,000 square feet of untenanted space, mostly located within three projects including one that has only just opened (i.e. 54 East).
- Total office space within the Research Triangle is estimated to include approximately 50 million square feet. This figure includes about 40 million square feet in blocks over 10,000 square feet in size as typically tracked; and, an estimated 10 million square feet of smaller office spaces. Therefore it is estimated that Chapel Hill has only about 4% -5% of the total office market supply in the Research Triangle region.
- Based on data provided by the County and organized by the Chapel Hill Economic Development office, approximately 70,000 square feet of office space has been absorbed on an average annualized basis during the period 1969 – 2007, within the Town limits. This does not include individual spaces smaller than 10,000 square feet that have been absorbed, as this information has not been historically tracked.
- Based on planned and forecast projects, it is reasonable that the Town of Chapel Hill office market may see the addition of approximately 500,000 to 700,000 square feet of leasable space over the next 5-10 years given typical development cycles. The forecast supply is also based on the assumption that demand will eventually exceed the current supply vacancy, and that overall economic conditions improve.
- Considering Chapel Hill's relatively small share of the office market supply within the Research Triangle (4% - 5%) a modest incremental gain in share could dramatically influence the local environment and further contribute to the fiscal base of the Town. For example a 1% supply-share increase within the Research Triangle (from 5% to 6% of the market supply) could mean an estimated additional 400,000 square feet of office space; another 1% equals another 400,000 square feet, and so on. In actuality, even if Chapel Hill's relative share remains the same it will have 4% - 5% of a *growing* market. Therefore, an *actual* increase in share could mean substantially greater incremental gains in supply.

Demand Analysis

- Demand for office space in the Town of Chapel Hill is a function of many factors including macroeconomic trends (the national and international economic climate); growth and policies of the University of North Carolina; trends in the technology sector; cost of space; availability and character of office developments; and, importantly, the overall “package” that Chapel Hill presents to prospective office users including the quality-of-life experience (schools, neighborhoods, shopping and entertainment, recreational opportunities, etc.)
- Demand for office space in Chapel Hill emanates from several sources that represent a diversified economic base, yet which has the stability and resilience associated with a major University as an anchor; advantageous characteristics associated with technology transfer; entrepreneurship; and, other positive attributes. A summary of demand sources discussed in the report include: University Related; Health Care / Medical; Non-profits; Research / Technology; Professional; Financial Services.
- Chapel Hill could see the addition of 500,000 to 700,000 square feet of office space (including projects/properties which are both over and under the 10,000 square foot threshold) based on current and forecast additions to supply of office space, slow but steady growth in demand, etc Based on the historical rate/amount of office space absorption within the Town limits (70,000 square feet per year) it will take approximately 5-10 years to absorb planned and/or anticipated office space in the Town of Chapel Hill. This coincides roughly with the anticipated development implementation process (building) for currently planned projects, understanding that timelines can be accelerated or slowed based on various economic and individual financial circumstances. It is critical to note that the pace of absorption, hence growth, can be influenced by a similar range of factors.

Future demand for office space in Chapel Hill will be influenced by several factors including, but not limited to opportunities and constraints described in this analysis such as:

- Ability/interest of the State of North Carolina, the Research Triangle, and the Town of Chapel Hill in capturing demand (including demand for office space, but also residential growth, recreational and life-style opportunities) from other markets including those elsewhere in the U.S. (e.g. the Northeast and Midwest) but also potentially international markets.
- Maintaining and/or increasing the competitiveness of Chapel Hill relative to the other office centers within the Research Triangle. Opportunities to exploit apparent weaknesses in the regional market such as aging buildings, suburban design (lack of proximal support amenities such as restaurants, service retail,

STRATEGY 5

etc.) and those weaknesses evidenced in other sub-markets should be explored in the context of crafting a competitive capture strategy for Chapel Hill. Conversely, competitive advantages of these sub-markets such as lower cost, access to fiber optics and other technology infrastructure need to be recognized. The Town can benefit from the University/Medical/Research community by working to anticipate, and proactively adapt to, shifts in the technology sector (including bio-technology and related sub-sectors) in order to capture entrepreneurial endeavors, expansions, relocations, etc.

- The ability/interest of the Town in hosting wet labs and other research uses has been anecdotally cited in the public process as a way to capture additional demand for office space. Currently there is a perception that ordinance and code restrictions severely limit or prohibit these types of uses, which then have an apparent tendency to locate in the RTP or elsewhere in the Triangle. However wet labs can be approved by Council if desired.
- The ability/interest of the Town in providing or facilitating development of office infrastructure such as fiber optic cable to users and/or offsetting costs associated with technology upgrades through various means. Similarly, consideration may have to be given to provision of parking support on an individualized basis in order to incentivize business development as well as continuing to enhance public transit opportunities to serve office populations.
- Constraints to inducing and capturing demand include the relatively limited amount of land which is available and/or approved for this type of use which is further constrained for development by associated zoning and regulatory restrictions, an apparently complex and time (cost) consuming approvals process, etc. Property tax rates are high relative to competitive office markets elsewhere in the Research Triangle. Land prices are high relative to competitive office markets elsewhere.
- The addition of attractive/cost effective space into the market elsewhere will continue to be a constraint as competition from other communities will likely increase. This also raises the issue of “leakage” of demand from Chapel Hill, and the converse opportunity of “retention” which both figure strongly in the overall market context. Increased marketing efforts by other competitive jurisdictions including international, national, and regional activities elsewhere will continue to be a factor. More locally, competitive marketing/capture efforts by Alamance, Chatham, Durham and Wake Counties need to be particularly recognized.
- The Town of Chapel Hill appears to have many competitive advantages over other office markets, particularly as it is an integral component of a highly recognized international brand – The Research Triangle” – which in turn offers an array of interwoven infrastructure from which the Town benefits. This infrastructure includes the concentration of academic institutions, research facilities, transportation and climactic elements which make it an attractive place

 **STRATEGY 5**

- to live and work. By extension the infrastructure also includes a depth of human capital constituted by a highly educated demographic that few regions can match.
- There are some essential questions raised by the demand discussion: Will demand continue to filter into the Chapel Hill market and manifest itself in new construction, additional tax base, and ensure low vacancy rates into the future? Or, will aggressive competition from outside areas erode Chapel Hill's demand base, weaken the existing office market, slow development of planned projects and impede overall absorption? The answer offered by the study is that the future of office demand and related occupancy, development etc. can – and possibly should - be influenced through a variety of means.
 - Based on the various economic and market perspectives advanced in this report; the Town of Chapel Hill proactively seeking to maintain and increase its competitive advantages over market rivals; ability to foster a development environment that further encourages office growth; and a strategy of capturing demand from “foreign” markets; Strategy 5 projects that the local market can support the introduction of an additional 1 million square feet of office space over the 5 -10 years. This is roughly consistent with combining current vacant space inventories with planned projects, leaving about 300,000 additional square feet of “net supportable” space to be conceived, located, built and occupied during this period.
 - Given the variety of market characteristics associated with the Town of Chapel Hill, the Research Triangle, regional, national and international arenas etc. it is clear that there is significant, but not overwhelming, potential for future office business activity as a component of the local economic development environment. The ability of the Town to capture its fair share of this market hinges on key business/political principles that will influence the presence, sustainability and future vitality of the office community. These principles can be roughly categorized and described as follows: Policy, Positioning and Promotion.
 - Policy decisions could include review the development approvals process and overall business environment with a close eye on the opportunities and constraints as delineated in this and other studies; Consideration of the economic and fiscal implications of sustaining the office community that currently exists, and those associated with planned projects as well as those which may come to fill the opportunity gap that the consultant believes can be created; and, acting through resolution and other means to embed decisions and policies that will foster growth in this sector in the foreseeable future, and over the timeframe associated with the forecasts included in this analysis 5-10 years.

- A positioning strategy could include working to ensure that existing office projects receive the highest level of consideration in encouraging occupation of vacant space, continued tenancy of space, and demand for space that is in the development pipeline; Identification of development opportunities sites that coincide with site selection criteria, current Town zoning and regulatory framework, synergy with the existing office clusters and corridors, etc.; Preparation of small areas plans that further define and conceptualize office projects on the opportunity sites, as well as site-specific corridor plans, transit-oriented development (TOD) plans, etc.; Undertaking proactive developer/investor solicitations for these projects.
- A promotion strategy needs to recognize the reality of a global market with technology transfer, transportation links, and increasing co-dependence between nations, industries, etc. There is already a sophisticated promotion and marketing system in place that can (and does) benefit Chapel Hill. There are a myriad of organizations at the national, state, regional and local levels that are designed to focus interest and economic activity. Some particular suggestions for the promotions element of an office market capture strategy include, but are not limited to the following: Mandating that local departments and organizations which perform promotional activities for the Town coordinate efforts with a clear leadership hierarchy in terms of pursuing capture of the office market (in this case); Merging the objectives of the Town with regard to office prosperity and development (as evidenced by the policy and positioning actions) with those of the Research Triangle Partnership especially. If they are already considered merged, then we suggest a higher level merger; and, funding these efforts through traditional and creative revenue streams – possibly tied to results in some fashion – that enable the promotional team to do its job effectively, and to enable competition at the global level. This will involve an investment, but the anticipated economic and fiscal impacts should easily offset the cost.
- The logic for pursuing additional office development in Chapel Hill is based on this sector's ability to contribute to the economic and fiscal base of the community through contributions of property and personal property taxes, job creation, expenditure of wages and salaries, spending by operations, etc. Using the net additional office supply projection of 1 million square feet, a net new taxable base of \$200 million (estimated) can be derived. This would generate approximately \$2.68 million annually in net-new property taxes alone. New office development would generate approximately 2,100 FTE construction jobs with more than \$140 million in wages and salaries paid to these workers who will in turn purchase goods and services, pay mortgages and rent, etc. The space will provide job space for about 5,000 workers who could pump \$350 million into the economy annually. Leases will generate in excess of \$28 million annually that will be spent by property management companies and developers to pay interest on loans, maintain staff, conduct maintenance and other services on the property,

 **STRATEGY 5**

and likely provide capital for further investment in the Chapel Hill and local/regional economy.

Office development can have a significant economic and fiscal impact on the community. These and other economic development benefits that can accrue from policy decisions, positioning, and promotion that are strategically oriented to growing this sector of the local economy should be considered along with the other observations, findings and recommendations contained in this Office Market Analysis.

Section 2: Introduction and Methodology

The Town of Chapel Hill retained Strategy 5 LLC in January of 2010 to prepare an analysis of the local office market, with attention paid to regional and other dynamics affecting supply and demand for office space within the Town limits. The methodology for the study included completion of a series of tasks and sub-tasks including:

- Task 1: Preliminary Research / Data Collection
- Task 2: Site Analysis / Workshops
- Task 3: Stakeholder Interviews
- Task 4: Supply/Demand Analysis
- Task 5: Technical Report

The methodology also consisted of a combination of top-down and bottom-up analysis; the former approach relating to available data (demographics, tax records, census tract data etc.) and the latter relating to the influence of location, long-term planning by the Town of Chapel Hill and University of North Carolina, changes in the technology sector, perceptions of the local market and development environment, etc.

Emphasis is placed on the bottom-up portion of the methodology which is oriented toward forecasting (and possibly influencing) alternative futures as opposed to simply documenting past and current conditions. Therefore the Strategy 5 approach is a non-traditional market analysis – a think piece - designed to provide the Town of Chapel Hill and the Economic Development Office with insights and perspectives to be used in crafting policy decisions that will help ensure future vitality of the office market in the Town, and importantly, the vitality of the tax base and fiscal strength of local government.

Where appropriate, technical tables, graphics, photographs, etc. have been inserted to further illustrate observations, findings or recommendations. Where appropriate, other studies, reports and secondary materials are sourced. In some cases quantitative assessments and projections are expressed as ranges to reflect the fluid nature of real estate and unknown influences on future supply and demand. Unless where otherwise stated, all observations, findings, projections, forecasts, conclusions and recommendations found in this report represent the professional opinion of Strategy 5 LLC.

This Technical Report is organized in a format that coincides with the bulleted Tasks above; and the sub-tasks which were further delineated in the Scope of Work and associated contract with the Town of Chapel Hill.

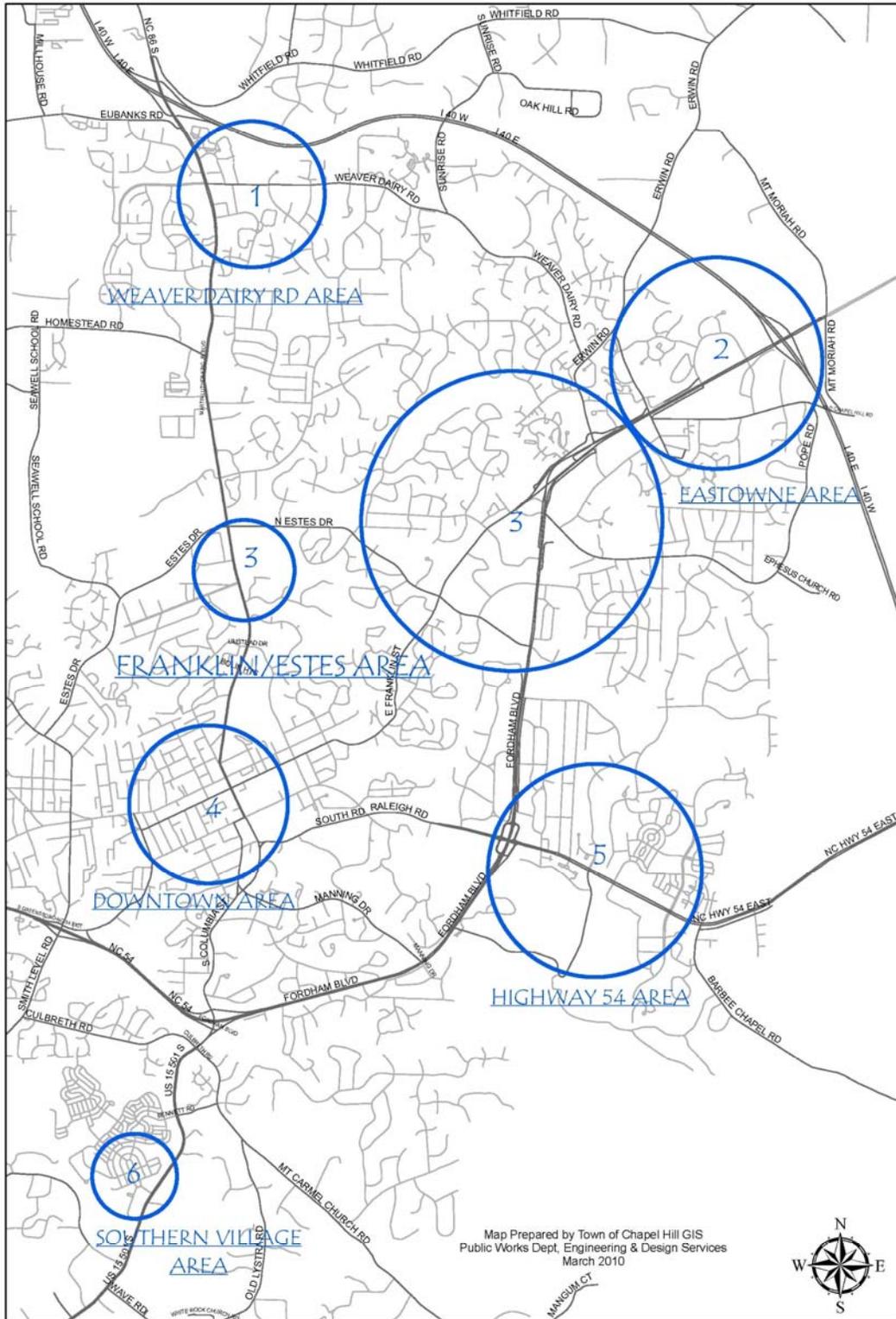
Section 3: Site Analysis

The geographical market which is the focus of this analysis is located strategically within the Research Triangle of North Carolina that is comprised roughly of the City of Raleigh, the City of Durham, and the Town of Chapel Hill. The concept of the Research Triangle dates to the 1950's when the Research Triangle Park was begun – hosting the development of numerous high-tech companies and related office users.

The region has approximately 2 million residents and is defined, in part, by the presence of the University of North Carolina at Chapel Hill, North Carolina State University and Duke University. The Triangle originally referred to these universities. The concentrated presence of these and other institutions of higher learning (15 in all) and associated research facilities have led to a demographic base that is well educated, and collectively serves as a magnet for business.

During the week of January 11, 2010 the Strategy 5 Project Manager conducted a windshield survey of the principal office clusters with the Town of Chapel Hill boundaries and nearby areas. This was done with the assistance of the Economic Development Officer and included commentary and information on a variety of historical elements, input regarding future development plans, transportation and access, and other matters of importance to understanding and interpreting the office market in Chapel Hill. There are pockets of office space scattered throughout Chapel Hill, but most space is concentrated within seven clusters. See Location Map.

- 1 - Weaver Dairy Road Commercial Area
- 2 - Eastowne Drive Commercial Area
- 3 - East Franklin Street
- 4 - Estes Drive Commercial Area
- 5 - Highway 54 East / Raleigh Road Commercial Area
- 6 - Downtown Commercial Area
- 7 - Southern Village Commercial Area



Office Market Analysis Location Map

These nodes of office development have evolved over time in response to a combination of factors: access, available land, zoning and regulatory ordinances, demand for space, development policies, etc. The office space found in the seven nodes would generally be considered “Class A” and “Class B” with a mix of campus-like complexes joining stand-alone buildings, and mixed-use locations.

In its Office Development Handbook, the Urban Land Institute defines office classifications used in this report as follows:

- “Class A space can be characterized as buildings that have excellent location and access, attract high quality tenants, and are managed professionally. Building materials are high quality and rents are competitive with other new buildings.”
- “Class B buildings have good locations, management and construction, and tenant standards are high. Buildings should have very little functional obsolescence and deterioration.
- “Class C buildings are typically 15 to 25 years old but are maintaining steady occupancy.”

The character, square footage and other elements of office space supply in the market is further discussed in Section 5 – Supply Discussion.

Some of the larger properties viewed during the windshield survey (and the approximate office square footage associated with them) included the following:

The Europa Center	180,000 square feet
The Exchange at Meadowmont	135,000 square feet
Bank of America Center	100,884 square feet
Dawson Hall	70,000 square feet
University Square	70,000 square feet

Significant properties viewed as either recently completed or under construction included:

East 54	113,000 square feet
Greenbridge	16,000 square feet

There were four primary objectives of the windshield survey:

1. Gain a visual sense of the office buildings in Chapel Hill including their physical character, design, materials, surrounding environment, parking solutions, etc.

2. Gain a practical sense of what projects are mature and fully leased; and, what projects are new entries to the market - some with high vacancy rates, and others with apparent low vacancy.
3. Gain a future-looking sense of what projects may be planned for entry into the market over the next several years.
4. Gain an understanding of infrastructure that can and will influence the office market including: proximity of neighborhoods and life-style opportunities; retail; restaurants and commercial support businesses; roads and public transportation routes; and, parking, etc.

Summary Observations

The site analysis resulted in the following observations pertaining to the objectives as summarized above:

1. The physical character of office buildings in Chapel Hill is generally of very high quality. Design tends to be of a traditional nature, although modern architecture and highly creative design elements are also in evidence. Materials tend to be high-quality and traditional in nature as well- brick and masonry construction for the most part – in keeping with Chapel Hill’s overall design theme. Offices are well merged into the environment, either in campus like settings with extensive landscaping; or, in more urban settings in which structures appear well suited.
2. Most office buildings appear well activated (leased) although a few newer developments remain only partially occupied. In the latter cases the impression of the consultant is that it could take the capture of only a few key tenants to fully lease up these properties. Evidence of new offices under construction appear smartly planned in their particular environment, properly parked, oriented in most cases toward support infrastructure such as service retail, banks, shops, restaurants, etc. The importance of the University as an economic driver is never far from the business consciousness of the community. The importance of location in this regard – either through physical linkage, or less defined connections – is apparent.
3. The site analysis took into account the location of proposed new projects such as the future redeveloped University Square that will clearly have a significant role in defining the office development climate and supply of space in the coming years. That particular project will have a multiplier role as a mixed-use project that adds to the critical mass of activity in downtown Chapel Hill, and bolsters the synergistic relationship between the University itself and the Town.
4. Another observation arising from the site analysis was the fact that there is a relatively limited amount of land remaining available for office development (or other uses) within the Town limits. Land that does remain available for opportunity sites appears often constrained by the existence of hard edges that limit potential growth (e.g. existing buildings, parks and recreational areas, roads, etc.) environmental and conservation

STRATEGY 5

issues, transportation and/or access issues, terrain challenges, etc. These constraints may suggest a future that includes more dense office development in downtown.

5. The extensive and attractive infrastructure which the Town of Chapel Hill presents to office developers and tenant businesses should be considered one of the Town's greatest market strengths, and be given significant weight as a positioning and marketing tool if the policy decision is made to pursue more office development. Within the urban planning and design disciplines much is made of creating: A) A sense of place. Chapel Hill has it; and, B) Creating and fostering a place to live, work, and play. Again, Chapel Hill offers these attributes as well as being a place to achieve higher learning status, retain relationships with university colleagues and alumni, and to build business relationships using the university culture, etc. The physical attractiveness of the Town, convenience and well designed retail centers, service areas, etc. all add to the competitive edge that Chapel Hill may exert on other markets if properly leveraged.

The following photographs and captions constitute an existing conditions survey as conducted during multiple site reconnaissance activities:



The East 54 project is nearing completion (Spring 2010) on Raleigh Road (NC54) just outside of downtown. It will feature approximately 113,000 square feet of “Class A” office space along with retail shops, restaurants, residential, etc.



Iconic architectural features are also a recognizable element of East 54 making it stand out in the mix of office and other development projects.



High quality materials and exterior finish details are a hallmark of many Chapel Hill properties. This building at the Exchange at Meadowmont is characteristics of the high standards for building.



In some cases there has been significant private investment in support infrastructure such as the parking deck shown here at the Exchange at Meadowmont.



This professional building on Rosemary St. is an excellent example of infill development that can occur in downtown, merging well with the design, materials and other elements of the existing built environment.



The Europa is a large office complex that offers one of Chapel Hill's largest concentrations of "Class A" space at approximately 180,000 square feet.



The Greenbridge project undergoes construction on West Rosemary St. The mixed-use building will contain approximately 16,000 square feet of office space, along with residential and retail components.



The Center Offices on E. Franklin are characteristic of the medical and professional offices found in the “healthcare corridor”.



The Center Offices also offer some unique architectural and space variations that add to the comfortable campus feel.



The Eastowne Office Park contains a mix of small and medium business that include professionals, non-profits, etc.



The existing University Square will be redeveloped in the next several years and is expected to offer approximately 125,000 square feet of market rate office space over several development phases. Another 125,000 square feet may be built to host University uses. This project in the heart of downtown will include a mix of other uses that are expected to add to the attractiveness and overall drawing power of the downtown area.



Meadowmont Village is a “new urbanist” development that includes mixed-use buildings that feature retail, restaurants, etc. on the first floor, residential above, with small offices interspersed at key locations.

Section 4: Public Process Discussion

As part of the non-traditional market analysis approach employed in this study, Strategy 5 and the Economic Development Office conducted a public process to both gather input and information; and, to inform office development and management companies, business and property owners; stakeholders and the general public about the study and its objectives.

On January 20th a public workshop was held that attracted approximately 25 participants from the commercial real estate sector, public officials, representatives of various Chapel Hill organizations, etc. The input and discussion ranged widely concerning: the office market, constraints and advantages that are experienced by the market in Chapel Hill (and the Research Triangle generally). The workshop, which was organized by the Economic Development Office, provided an excellent platform for an exchange of information and opinions, as well as an opportunity to gain contact information for industry participants.

On February 12th a second public workshop was held in which preliminary observations, finds and recommendations of the study were presented for discussion. Approximately 30 participants were involved in this interchange and a second round of valuable input was received.

In addition to the public meetings a series of one-on-one stakeholder interviews were conducted either in person or on the telephone. These interviews provided added depth to the understanding of nuances and subtleties in the local office market and the forces which influence it.

4.1 Summary of Observations

In general the input from the public process was positive with regard to the office market, but also evidentiary of frustration; much of the latter apparently directed at the development approvals process which seems to inhibit developer (i.e. investor) interest. Frustration aside, there is obviously a great deal of pride in Chapel Hill, and there was a conveyed sense that the Town commands a certain pinnacle status within the Triangle: “You may have to pay a premium, but it’s worth it,” is the message received.

On a different level the public process also revealed some business models that seem to be succeeding where others are not. There appears to be a trend toward demand for smaller office space requirements (e.g. 5,000 square feet as opposed to 10,000 square feet) predicated in part on advances in technology and concurrent reductions in workforce needs, desire for flex space and highly flexible lease agreements, and a demand driver which is proximity to support infrastructure by walking – even though the perception of some complexes in this regard (i.e. I have to drive anywhere) is not necessarily the reality (i.e. It’s really not that far).

Other competitive advantages that were cited included:

- Historically low vacancy rates
- Technology transfer opportunities
- High barrier to market entry (creating a selective environment)

Other competitive disadvantages that were cited included:

- Impact on required rent cost due to taxes
- Parking requirements/cost
- High barrier to market entry (creating a restrictive environment)

There appears to be a pent up demand/interest in developing additional office space by the real estate community based on input received in stakeholder interviews, the public workshops, discussions with commercial real estate professionals etc. However, the input received also suggested that this demonstrated demand from the development sector seeks direction, guidance, and facilitation in order for it to be manifested in new or expanded projects and plans that offer a commensurate amount of additional office space supply.

Section 5: Supply Analysis

5.1 Introduction

The supply analysis was conducted by merging the observations of the site reconnaissance, public input, research into the Research Triangle, and data provided by Orange County and further compiled and organized by the Town of Chapel Hill Economic Development Office.

5.2 Existing Supply

Key office supply characteristics include the following:

- There are approximately 2.2 million square feet of office space within the Town limits spread through approximately 100 separate properties. This includes approximately 1.7 million square feet of space in blocks over 10,000 square feet as typically tracked; plus 500,000 square feet of smaller space as identified through County tax records by the Town of Chapel Hill Economic Development Office. The latter smaller category of space therefore equals about 22% - 23% of total office space located within the Town limits.
- The individual square footage of office properties included in this estimated total range of office supply in Chapel Hill ranges from about 2,000 square feet to about 180,000 square feet.
- Most properties range from about 10,000 square feet to about 30,000 square feet. The average office property therefore includes about 20,000 square feet of leasable space. See Table.
- Properties are primarily comprised of Class A and Class B space (See definition in Section 3).
- Current (spring 2010) vacancy rates are about 14% totaling approximately 300,000 square feet of untenanted space, mostly located within three projects including one that has only just opened (i.e. East 54).
- Total office space within the Research Triangle is estimated to include approximately 50 million square feet of space hosting varying uses such as technology, professional, etc. This figure includes about 40 million square feet in blocks over 10,000 square feet in size as typically tracked; and, an estimated 10 million square feet of smaller office spaces using a modified percentage extrapolated from the supply mix seen in Chapel Hill (approximately 20% as opposed to 23%) given the greater prevalence of “big box” office buildings that

characterize much of the supply in the Research Triangle Park and other large clusters in the greater Research Triangle.)

- Therefore it is estimated that Chapel Hill has only about 4% -5% of the total office market supply in the Research Triangle region.

5.3 Historical Absorption

Based on data provided by the County and organized by the Chapel Hill Economic Development office, approximately 70,000 square feet of office space has been absorbed on an average annualized basis during the period 1969 – 2007, within the Town limits. This does not include individual spaces under 10,000 square feet as this information has not been historically tracked. Therefore actual absorption may be higher.

5.4 Forecast Supply

The forecast supply of office space is predicated on data pertaining to building permit applications, publicly known projects that are in the planning stages, etc. Forecast demand which may affect future supply is covered in the following Section 6 – Demand Discussion.

Key components of the forecast supply of office space in Chapel Hill include the following:

- **Woodmont** - According to the Town of Chapel Hill approximately 450,000 square feet of office space (primarily in the Woodmont development project) has been applied for and approved, but is as yet un-built.
- **University Square** – Approximately 125,000 square feet of market rate space is expected in several development phases. Another 125,000 square feet of space that will host University uses may also be introduced. This mixed use project will also include retail and residential components. To be located on the site of the current University Square (therefore not entirely additional space, but rather new space) the project is expected to further define downtown Chapel Hill as a center for commerce and business activity. Likewise, it will add to the “supply pull” market dynamic of the Town.
- **Assorted smaller infill projects**, conversions, etc. that may be planned, but not officially applied for through the Town’s development approvals process may add another 50,000 – 100,000 square feet over the next several years.

Based on planned and forecast projects, it is reasonable that the Town of Chapel Hill office market may see the addition of approximately 500,000 to 700,000 square feet of leasable space over the next 5-10 years given typical development cycles. The forecast

supply is also based on among other things that demand eventually exceeds the current supply vacancy and overall economic conditions improve.

5.5 Summary Conclusions

In order to place Chapel Hill's relative position in the regional market into context, the following illustrative example is provided:

Considering Chapel Hill's relatively small share of the office market supply within the Research Triangle (4% - 5%) a modest incremental gain in share (assuming demand to support it) could dramatically influence the local environment and further contribute to the fiscal base of the Town. For example, an approximate 1% supply-share increase within the Research Triangle (from 5% to 6% of the market supply) could mean an estimated additional 400,000 square feet of office space; another 1% equals another 400,000 square feet, and so on. In actuality, even if Chapel Hill's relative share remains the same it will have 4% - 5% of a *growing* market. Therefore, an *actual* increase in share as illustrated above could mean substantially greater incremental gains in supply.

Given the projected growth for the Mid-Atlantic region of the U.S., North Carolina and the Research Triangle, allied growth in the overall office market is expected as well. Therefore, Chapel Hill should consider targeting its fair share of this growth in order to expand its office base, and by extension, the additional tax base and associated revenue it will afford the Town.



Town of Chapel Hill, NC - Office Market Analysis

<u>TRACT &</u>			<u>Year</u>	<u>Square</u>	<u>Street</u>		<u>Zip</u>	<u>BuildingDescription</u>	<u>Rate</u>
<u>BUILDING</u>	<u>PIN</u>	<u>Known Use</u>	<u>Built</u>	<u>Feet</u>	<u>Number</u>	<u>Property Street</u>			<u>(PSF)</u>
738432.1	9880353529.000	Office		13087	110	BANKS DR	NC 27514	OFFICE-G	
775728.1	9798546749.001	Castilia	2009	45000	301	BARBEE CHAPEL RD W		OFFICE-G (Condo)	\$39
735264.2	9788274180.000	NC Pharmaceutical		5700	109	CHURCH ST	NC 27516	OFFICE-G	
752358.1	9890813919.001	Office		6500	101	CLOISTER CT		OFFICE-MED (condo)	
739380.1	9890824151.001	Eastowne Office		13000	111	Cloister Ct		OFFICE-G (Condo)	
775093.1	9890815720.001	Eastowne Office		20000	401	Cloister Ct		OFFICE-MED (condo)	
763231.1	9890827103.002	Eastowne Office		15000	211	Cloister Ct 211-215-222		OFFICE-G (Condo)	
706436.1	9788372336.000	Inv Title		2064	113	COLUMBIA ST N		OFFICE-G	
705186.1	9788371399.000	Inv Title		5854	121	COLUMBIA ST N	NC 27516	OFFICE-G	
713305.1	9788372875.000	Stormwater		4900	208	COLUMBIA ST N	NC 27514	OFFICE-G	
703262.1	9788372914.000	corner bldg		7854	210	COLUMBIA ST N	NC 27514	OFFICE-BSMT-FIN	
736348.1	9799038088.004	Office		25000	101	Conner Dr		OFFICE-M (condo)	
737654.1	9799035187.001	Office		28000	109	Conner Dr		OFFICE-M (condo)	
749050.1	9799131396.001	Office		20000	110	CONNER DR		OFFICE-MED (condo)	
769812.1	9799133556.001	Office		19000	120	CONNER DR		OFFICE-M (condo)	
774294.1	9799580455.000	Cosgrove		15862	101	COSGROVE AVE		OFFICE-G-SHELL	
727056.1	9799268800.001	Office		24000	1829	Dobbins Dr		OFFICE-G (Condo)	
733390.1	9799371243.001	Office		12500	1829	Dobbins Dr		OFFICE-G (Condo)	
751175.1	9890800195.000	BCBS		60000	100	EASTOWNE DR		OFFICE-G	
772448.1	9890715045.001	Office	2006	38000	501	Eastowne Dr	NC 27514	OFFICE-G (Condo)	\$22
751176.1	9890800643.000	BCBS		15469	600	EASTOWNE DR	NC 27514	OFFICE-G	
720488.1	9890719233.000	Office	1984	11734	605	EASTOWNE DR	NC 27514	OFFICE-G	\$16
720489.1	9890811331.000	Office		5989	615	EASTOWNE DR	NC 27514	OFFICE-G	
733943.1	9890802764.000	BCBS		12972	700	EASTOWNE DR	NC 27514	OFFICE-G	
726234.1	9890803947.000	Office		23102	800	EASTOWNE DR	NC 27514	OFFICE-G	
758913.1	9799151409.001	Office		5828	104	Elliott Rd N		OFFICE-G (Condo)	
725724.2	9799145239.000	Office		7000	200	ELLIOTT RD S	NC 27514	OFFICE-G	
723082.1	9799343950.000	Office		7200	101	EPHESUS CHURCH RD	NC 27517	OFFICE-G	

743955.1	9789929831.000	Office		2400	102 ESTES DR S	NC 27514	OFFICE-MED	
719257.1	9789929673.001	Chamber		16140	104 ESTES DR S	NC 27514	OFFICE-G (Condo)	
712551.1	9799022504.000	Office Estes		9000	110 ESTES DR S	NC 27514	OFFICE-MED	
757988.1	9799024880.000	Pro Village	1972	29000	121 ESTES DR S	NC 27514	OFFICE-G	\$17
	9799468987.000	Office	2008	38000	100 EUROPA DR	NC 27517	OFFICE-G	sale
715329.1	9799464897.000	Office - Europa Ctr	1990	180000	101 Europa Drive			\$24
770071.1	9798441243.001	TR A UNIVERSITY VILLAGE		21282	194 Finley Golf Course Rd		OFFICE-G (Condo)	
714359.3	9799891121.000	Office		55000	1830 FORDHAM BLVD		OFFICE-G	
732314.2	9799250069.000	Office		1288	1700 FRANKLIN ST E		OFFICE-G	
761723.1	9789920182.000	Office		1653	1217 FRANKLIN ST E	NC 27514	OFFICE-MED	
761724.2	9789922209.000	Office		2556	1229 FRANKLIN ST E	NC 27514	OFFICE-G	
761725.2	9789923308.000	Office		2160	1301 FRANKLIN ST E	NC 27514	OFFICE-G	
766783.1	9799032224.002	Office		14708	1504 FRANKLIN ST E		OFFICE (Condo)	
739530.1	9799032207.004	Office		29344	1508 FRANKLIN ST E	NC 27514	OFFICE-G (Condo)	
752726.2	9799032779.000	Office		14868	1512 FRANKLIN ST E	NC 27514	OFFICE-G	
752727.1	9799034445.000	Office	1986	20000	1516 FRANKLIN ST E	NC 27514	OFFICE-G	?
752728.1	9799044076.000	Office		7200	1520 FRANKLIN ST E	NC 27514	OFFICE-MED	
753034.1	9799045771.001	Office		20000	1525 Franklin St E		OFFICE-G (Condo)	
705848.1	9799046232.000	Office		12000	1526 FRANKLIN ST E	NC 27514	OFFICE-G	
728319.1	9799048307.000	Office		4920	1600 FRANKLIN ST E	NC 27514	OFFICE-G	
728319.3	9799048307.000	Office		2568	1600 FRANKLIN ST E	NC 27514	OFFICE-BSMT-UNFIN-STRG	
701399.1	9799046830.000	Office		4168	1603 FRANKLIN ST E	NC 27514	MANUAL ARTS-BLDG	
706446.1	9799261213.000	Office		5412	1721 FRANKLIN ST E	NC 27514	OFFICE-G	
722832.1	9799264478.001	Franklin Square		20000	1829 Franklin St E		OFFICE-G (Condo)	
702963.3	9788372285.000	Attorney's		6934	100 FRANKLIN ST W		OFFICE-G	
754378.1	9788268572.000	Univ Sq	1969	70000	123 FRANKLIN ST W		OFFICE-G	\$23
757990.1	9788265985.000	Aveda (Pavilion I)	1999	10327	200 FRANKLIN ST W	NC 27516	OFFICE-G	\$24
747280.1	9788264981.000	Kildare's (Pavilion II)	1999	10500	206 FRANKLIN ST W	NC 27516	OFFICE-G	\$25
706365.1	9788153958.000	The Courtyard	1977	27000	431 FRANKLIN ST W	NC 27516	OFFICE-G	
747435.1	9788150842.000	N&O Bldg		8518	505 FRANKLIN ST W	NC 27516	OFFICE-G	
772179.1	9787044829.002	Ent build So Vill		3809	301 Kildaire rd		OFFICE-G (Condo)	
730779.1	9880542910.001	AMERICAN BOARD OF PEDI,		15000	123/125/ Kingston Dr		OFFICE-G (Condo)	
712513.1	9799355461.000	Office		7492	1703 LEGION RD	NC 27517	OFFICE	
775572.1	9799450934.001	Office		14000	1709 LEGION RD	NC 27517	OFFICE-G	

769792.1	9799570157.003	office		12000	1717 LEGION RD		OFFICE-G (Condo)	
740520.1	9788267431.000	Durham Herald		2994	106 MALLETTE ST	NC 27516	OFFICE-G	
754876.2	9787053252.000	So Vill Bldgs	1999	36134	300 MARKET ST	NC 27516	OFFICE-G	\$24
763053.1	9787056725.000	So Vill Bldgs	2001	11463	400 MARKET ST	NC 27516	SECOND FLOOR OFFICES	\$24
763055.1	9787055943.000	So Vill Bldgs	2005	31633	410 MARKET ST	NC 27516	OFFICE-BSMT-PARKING	\$24
763424.1	9787051878.000	So Vill Bldgs		9685	600 MARKET ST	NC 27516	BSMT-OFFICE-FIN	
730329.1	9789338610.001	Office Bldg ar Barclay Dr		12752	900 MARTIN LUTHER KING JR BLVD		OFFICE-G (Condo)	
724788.1	9789338263.000	Three girls Vent		2500	870 MARTIN LUTHER KING JR BI	NC 27514	OFFICE-G	
748100.1	9789348060.000			4432	930 MARTIN LUTHER KING JR BI	NC 27514	OFFICE-G	
731871.1	9789346156.000	Chapel Hill Internal Med		6268	940 MARTIN LUTHER KING JR BI	NC 27514	OFFICE-MED	
705173.1	9789345652.000	Frank Elmore Real Estate		3448	976 MARTIN LUTHER KING JR BI	NC 27514	OFFICE-G	
765831.1	9798647228.003	100-700 Meadowmor	2002	37000	100 MEADOWMONT VILLAGE CIR		OFFICE-G (Condo)	?
739459.1	9799158920.000	Office		11000	1801 MILTON AVE		OFFICE-G	
770705.2	9798647228L1	Meadowmont	2002	26016	MEADOWMONT VILLAGE CIR		OFFICE	?
770705.4	9798647228L1	Meadowmont	2002	19816	MEADOWMONT VILLAGE CIR		OFFICE	?
740800.1	9789929684.001	med office		5212	No address - vacant lot/Parking		OFFICE-G (Condo)	
774908.1	9880362277.001	Office		10348	112 Perkins Dr		OFFICE-G (Condo)	
703282.4	9788356004.000	Emp Credit Union		5422	310 PITTSBORO ST	NC 27516	OFFICE-G	
720477.1	9890811981.000	Office		39000	301 Providence Rd		OFFICE-G-SHELL	
758934.1	9890719411.001	Office		8500	120 Providence Rd		OFFICE-G (Condo)	
766341.1	9890715570.100	Office		13000	141 Providence Rd		OFFICE	
757864.1	9890810552.002	Office		8500	150 Providence Rd		OFFICE-MED (condo)	
738255.1	9890812508.001	Office		13000	180 Providence Rd		OFFICE-G (Condo)	
723172.1	9890719843.001	Office		17000	201 Providence Rd (odd)		OFFICE-G (Condo)	
706361.2	9798254529.000	Glen Lennox		12421	1201 RALEIGH RD		OFFICE-G	
762614.1	9798531950.000	Exchange	2001	60000	1414 RALEIGH RD	NC 27517	OFFICE	\$31
762615.1	9798529521.000	Exchange East	2001	135000	1450 RALEIGH RD	NC 27517	OFFICE	\$29
706399.3	9788372791.000	Centura Bank		5988	101 ROSEMARY ST E	NC 27514	OFFICE-BSMT-UNFIN-STRG	
769226.1	9788388082.000	Inv Title	2005	12000	151 ROSEMARY ST E	NC 27514	OFFICE-G	\$22
704515.1	9788481015.000	Dentist		5000	201 ROSEMARY ST E		OFFICE-BSMT-UNFIN-STRG	
706265.3	9788377517.000	NCNB Plaza	1973	100000	136 ROSEMARY ST E (and E Franklin)		OFFICE-G	\$20
760963.1	9788272240.001	Kaplan Ed/CHDP		30000	308 Rosemary St W		OFFICE-G (Condo)	
705491.1	9788165834.000	Tate Realty		1556	341 ROSEMARY ST W	NC 27516	OFFICE-G	
765516.1	9890506664.000	Office	2003	37000	201 SAGE RD	NC 27514	OFFICE-G	\$24

774327.1	9799599053.000	Office	15732	100 SAGE ROAD		OFFICE-G	
775186.1	9880553482.000	AMERICAN BOARD OF PEDI	22000	111 SILVER CEDAR CT	NC 27514	OFFICE-BSMT-FIN-MED	
722614.1	9880550045.000	AMERICAN BOARD OF PEDI	8500	201 SILVER CEDAR CT		OFFICE-G	
730488.1	9880552089.000	Office	14000	300 SILVER CEDAR CT		OFFICE-G	
741553.1	9880554345.000	AMERICAN BOARD OF ORTH	25000	400 SILVER CEDAR CT	NC 27514	OFFICE-BSMT-FIN-MED	
756440.1	9880257940.001	UNC and Adjacent (off Perki	32000	200 Timberhill Pl		OFFICE-G (Condo)	
775895.1	9880469322.002	Office (Dawson) 2007	72000	77 VILCOM CENTER CIR	NC 27514	OFFICE-G-SHELL (condo)	\$26
770645.1	9880560070.000	Office (Boyd) 2001	50000	55 VILCOM CENTER DR		OFFICE	\$23
770648.1	9880465246.000	Office (McClamroch) 1981	43000	88 VILCOM CENTER DR		OFFICE-G	\$20
728609.1	9799131048.001	Medical Arts Bldg	17000	891 Willow Dr		OFFICE-G (Condo)	
		<u>TOTAL</u>	<u>2,203,182</u>				

Section 6: Demand Analysis

6.1 Introduction

Demand for office space in the Town of Chapel Hill is a function of many factors including macroeconomic trends (the national and international economic climate); growth and policies of the University of North Carolina; trends in the technology sector; cost of space; availability and character of office developments; and, importantly, the overall “package” that Chapel Hill presents to prospective office users including the quality-of-life experience (schools, neighborhoods, shopping and entertainment, recreational opportunities, etc.)

This view of demand constitutes one aspect of the “non-traditional” market analysis methodology referenced in Section 2, but is critical to understanding the opportunities and constraints that the Town faces in crafting policies and marketing efforts that are designed ultimately to sustain and/or increase the tax base so that the high level of services in the Town and other important infrastructure can be maintained.

6.2 Existing Demand

Demand for office space in Chapel Hill emanates from several sources that represent a diversified economic base, but also has the stability and resilience associated with a major University as an anchor and advantageous characteristics associated with technology transfer, entrepreneurship, and other positive attributes. A summary of primary demand sources is provided below.

- **University Related** – According to University of North Carolina officials, the institution currently utilizes and maintains about 300,000 square feet of office space off-campus that blends affiliated non-profits, research organizations, management, administrative, and other uses. Tenants of this privately leased space are further spread within the categories noted below. There are approximately 125 Centers and Institutes of the University that include the Center for Economic Development Research and Policy, the Center for International Business Education and Research, the North Carolina Institute for Private Enterprise, and the Office of Technology Development. These and other centers and institutes have a high level of connectivity to research and other entities which constitute related demand potential as well

- **Health Care / Medical** – Hospitals of the UNC Health Care System (North Carolina Cancer Hospital, North Carolina Children’s Hospital, North Carolina Memorial Hospital, North Carolina Neurosciences Hospital, North Carolina Women’s Hospital) drive demand for a variety of medical/technical providers, out-patient service providers, insurance companies, etc. The Blue Cross / Blue Shield organization maintains a regional headquarters in Chapel Hill that further contributes to the identification of Chapel Hill as a healthcare hub. It is understood anecdotally that the National Institutes of Health (NIH) pumps more than \$50 million into the Chapel Hill economy each year through grants and other funding and research activities.
- **Non-profits** – There are approximately 500 non-profit organizations located in the Research Triangle, with about 200 listed as having a Chapel Hill office presence. These include a wide variety of associations, many of which have global links to affiliated groups.
- **Research / Technology** – There is no reliable data available as to how many research and/or technology companies are located within the Town of Chapel Hill, due in part to cross over business definitions and strategies. Analysis done for this report indicates that Chapel Hill itself has relatively few research and technology companies as office tenants relative to the concentrations found elsewhere such as Durham, Raleigh and of course the Research Triangle Park itself.
- **Professional** – Other office demand includes legal, accounting, real estate, engineering, architecture, advertising, marketing, consulting and other professional service providers.
- **Financial services** – This sector had been expanding for decades, but has shrunk under the weight of the global recession. Demand for other professional services related to this sector (consumer banking, etc) has been static due to the relative cap on residential growth in the Town.

6.3 Absorption

As noted elsewhere, the Town could see the introduction of 500,000 to 700,000 square feet of office space using current and forecast additions to supply of office space, etc Based on the historical rate/amount of office space absorption within the Town limits (70,000 square feet per year) it will take approximately 5-10 years to absorb planned and/or anticipated office space in the Town of Chapel Hill. This coincides roughly with the anticipated development implementation process (building) for currently planned projects, understanding that timelines can be accelerated or slowed based on various economic and individual financial circumstances.

It is critical to note that the pace of absorption, hence growth, can be influenced by a similar range of factors. Basically, these are the factors delineated in the following sub-section 6.4 Forecast Demand.

6.4 Forecast Demand

Future demand for office space in Chapel Hill will be influenced by several factors including, but not limited to opportunities and constraints described herein. The consultant has taken the opportunity to merge observations and findings with preliminary recommendations that coincide with the concept of influencing market demand

Opportunities for Increasing / Capturing Demand

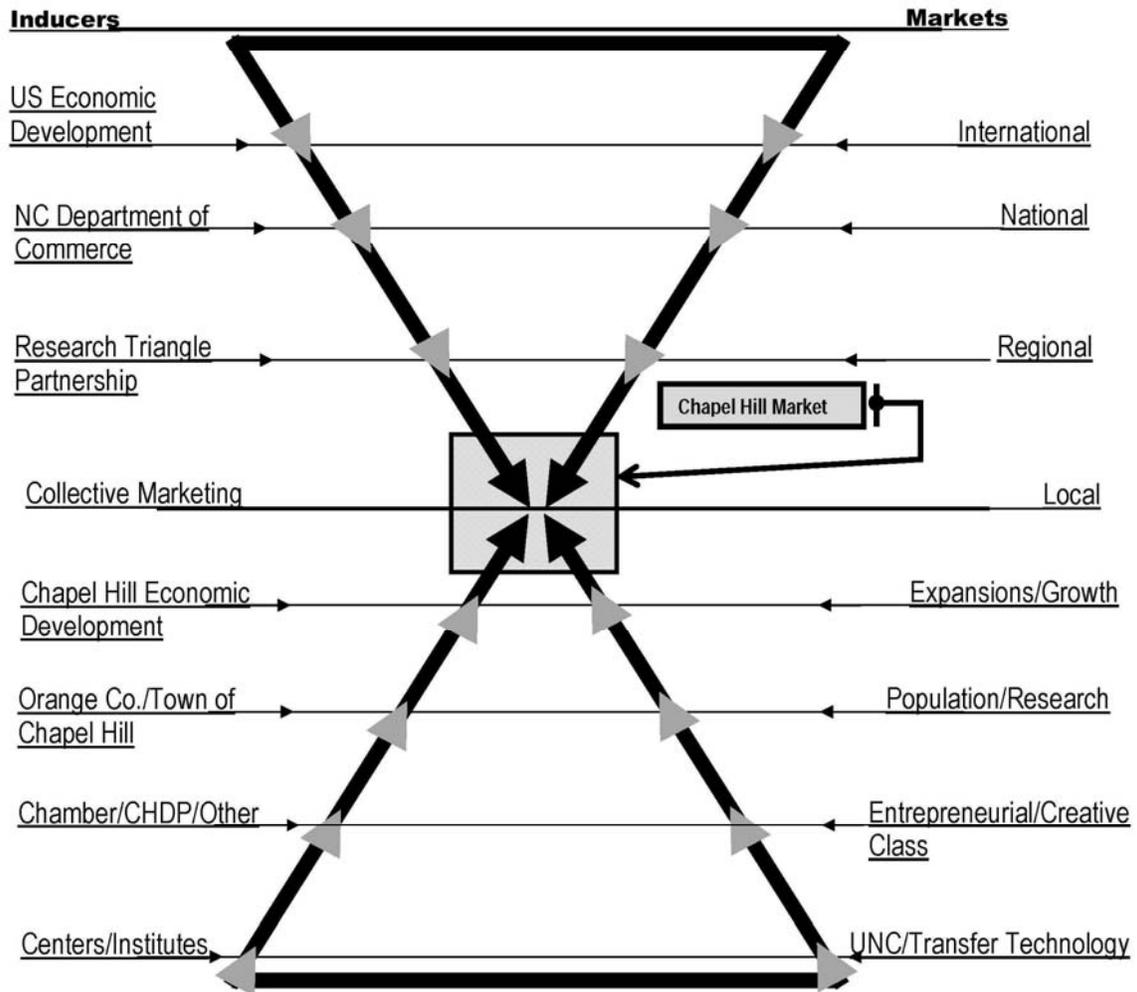
- Critical to the demand equation is the interest/ability of the State of North Carolina, the Research Triangle, and the Town of Chapel Hill in capturing demand (including demand for office space, but also residential growth, recreational and life-style opportunities) from other markets including those elsewhere in the U.S. (e.g. the Northeast and Midwest) but also potentially international markets. Success in capturing additional market share hinges heavily on the joint efforts of organizations like the Research Triangle Partnership (which serves a 16 county constituency), Orange County Economic Development, and the Town of Chapel Hill Economic Development Office. In the consultant's opinion, these and other organizations can not only influence demand at a macro level over time, but could facilitate capture of tenants for existing vacant space by matching particular building characteristics (e.g. large floor plate suburban campus environment) with needs of a potential user (e.g. relocating corporate user with a desire for added security environment).
- Maintaining and/or increasing the competitiveness of Chapel Hill relative to the other office centers within the Research Triangle are also critical to capturing demand. Opportunities to exploit apparent weaknesses in the regional market such as aging buildings, suburban design (lack of proximal support amenities such as restaurants, service retail, etc.) and those weaknesses evidenced in other sub-markets should be explored in the context of crafting a competitive capture strategy for Chapel Hill. Conversely, competitive advantages of these sub-markets such as lower cost, access to fiber optics and other technology infrastructure need to be recognized.
- The Town can benefit from the University/Medical/Research community by working to anticipate and proactively adapt to shifts in the technology sector (including bio-technology and related sub-sectors) in order to capture entrepreneurial endeavors, expansions, relocations, etc.

- Harnessing the future growth and influence of UNC including plans for Carolina North – a 1,000 acre complex that is set to host an expansion of the law school and location for the Innovation Center. These and other strategic plans for growth in the coming years will yield a range of spin-off opportunities, entrepreneurial ventures, and other demand that could be captured by the Town’s office market.
- Growth and capture of the “creative class”. Economist and social scientist Richard Florida coined this phrase to identify a socioeconomic class that he sees as a key economic development driver for post-industrial cities in the U.S. In his book *The Rise of the Creative Class* (2002), *Cities and the Creative Class* (2004), and others, Florida has described and analyzed two basic sections of the class: a Super-Creative Core which includes occupations such as engineer, scientist, educator, research, arts, design and media. The other main group: Creative Professionals are knowledge-based workers including those engaged in healthcare, legal services, business and finance, etc. The Research Triangle and the Town of Chapel Hill specifically have been cited by Florida as places with high creative class populations, and therefore potential to tap into the resources they generate.
- The Research Triangle is one of the fastest growing region in the U.S. and positive demographics including highly educated workforce, strong healthcare and education sectors, etc. Home-grown demand for office space in Chapel Hill can be drawn from this population-based source.
- The ability/interest of the Town in hosting wet labs and other research uses has been anecdotally cited in the public process as a way to capture additional demand for office space. Currently there are a variety of ordinance and code restrictions which severely limit or prohibit these types of uses, which then have an apparent tendency to locate in the RTP or elsewhere in the Triangle.
- The ability/interest of the Town in providing office infrastructure such as fiber optic cable to users and/or offsetting costs associated with technology upgrades through various means. Similarly, consideration may have to be given to provision of parking support on an individualized basis in order to incentivize business development.
- Continuing to enhance public transit opportunities to serve office populations. Plans are being discussed to add a regional Bus Rapid Transit (RBT) system to augment the current bus service. This could obviously increase access from outlying suburbs (including those located in other sub-markets thus increasing “in-flow” of workers), soften demand for additional parking, and contribute other positives to the office market climate over time.

- Development of additional/allied institutions of higher learning such as a community college or Chapel Hill campus of other college/university can add mass to the already rich educational environment and build on the institutional/business/research dynamic that constitutes a demand driver.
- According to “Analysis of Orange County’s Site Selection Attributes” (Ashley Yingling – 2009) 10 commonly used criteria for business location in the region are: 1) Ease of permitting; 2) Transportation infrastructure; 3) Existing workforce skills; 4) State and local tax scheme; 5) Utility infrastructure; 6) Land/building prices and supply; 7) Workers’ comp rates; 8) Flexibility of incentives programs; 9) Higher education resources; and, 10) Availability of incentives. In addition, the report commissioned by the University of North Carolina, identified additional important criteria in the site selection (capture) process: Existing clusters or related businesses including suppliers and customers; Assistance from economic development agencies; Research collaboration; Living conditions; and, Start up considerations including costs and availability of capital. The study also cited statewide and regional advantages including recognition by numerous periodicals and journals; the presence of growing high-tech clusters that enable retraining of workers; and, the fact that the state of North Carolina provides incentive packages and active recruitment. Merging Town of Chapel Hill planning and development policies with the findings and recommendations of this report (which Strategy 5 LLC endorses) could help focus demand that has evolved to the point where companies are actively seeking sites for office development.

Various demand dynamics including markets from which the Town may capture business, and “inducers” or entities and organizations that may play a role in marketing, promotion and the capture process, are reflected in the Office Market Demand Paradigm illustration on the following page.

Office Market Demand Paradigm



Constraints to Increasing / Capturing Demand

While opportunities for increasing and or capturing demand outweigh the constraints to the same objective there are practical obstacles to be acknowledged. These include:

- The ability of Chapel Hill to capture demand for office space may be eventually limited by its capacity to provide a commensurate supply of building space given the relatively limited amount of land which is available and/or approved for this type of use.
- Limited land resources are further constrained for development by associated zoning and regulatory restrictions, an apparently complex and time (cost) consuming approvals process, etc.
- Property tax rates are high relative to competitive office markets elsewhere in the Research Triangle. An in-depth comparative tax analysis was beyond the scope of this report but available data and input from local real estate professionals, property developers, etc. seems to support this contention.
- Land prices are high relative to competitive office markets elsewhere. As with a tax analysis, in-depth comparative land valuation was beyond the scope of this assignment but input and anecdotal information suggests it is essentially true.
- Cost differential – the cost of second generation space in RTP is significantly lower and the added costs of taxes and land noted above contribute to the cost differential and constitute a constraint to capturing demand.
- The addition of attractive/cost effective space into the market elsewhere will continue to be a constraint as competition from other communities will likely increase. This also raises the issue of “leakage” of demand from Chapel Hill, and the converse opportunity of “retention” which both figure strongly in the overall market context.
- Increased marketing efforts by other competitive markets including international, national, and regional activities elsewhere. More locally, competitive marketing/capture efforts by Alamance, Chatham, Durham and Wake Counties need to be particularly recognized.

6.5 Summary Conclusions

The Town of Chapel Hill appears to have many competitive advantages over other office markets, particularly as it is an integral component of a highly recognized international brand – The Research Triangle” – which in turn offers an array of interwoven infrastructure from which the Town benefits. This infrastructure includes the concentration of academic institutions, research facilities, transportation and climactic elements which make it an attractive place to live and work. By extension the infrastructure also includes a depth of human capital constituted by a highly educated demographic that few regions can match.

Chapel Hill’s individual competitive advantages are cited at various points in this section and elsewhere in the report and do not bear repeating here. However, these advantages have had an impact on demand, which in turn have fueled growth in the office market over time and contributed to historically low vacancy rates, high lease rates, etc. Constraints noted herein have also had, and will continue to have, their effect

There are some essential questions raised by the demand discussion: Will demand continue to filter into the Chapel Hill market and manifest itself in new construction, additional tax base, and ensure low vacancy rates into the future? Or, will aggressive competition from outside areas erode Chapel Hill’s demand base, weaken the existing office market, slow development of planned projects and impede overall absorption?

The answer is that the future of office demand and related occupancy, development etc. can – and possibly should - be influenced through a variety of means that are further discussed in the final chapter of this report. However, they can be summarized by three words: Policy, Positioning, and Promotion.

Section 7: Opportunity / Surplus Gap Analysis

7.1 Introduction

An opportunity / surplus gap analysis is generally a calculation of either net unsatisfied demand (opportunity) and/or net un-leased supply (surplus). This type of analysis is typically used in retail studies – not office studies – because retail demand is usually locally driven and the stores that capture said demand are also in an easily defined market area (often a zip code, census tract or Metropolitan Statistical Area (MSA). Therefore the surplus / gap can be quantified through sales tax receipts, business licenses, retail space inventories, etc.

By comparison, demand for office space (particularly in a market like the Research Triangle) can, and does, come from local, regional, national and even international sources. Therefore, while existing demand can be quantified in the simplest terms as leased space and the rates it commands, *potential demand* is impossible to quantify. We know it is there in large amounts – again especially given the market characteristics of the Research Triangle – but how large?

In this section an attempt has been made to conduct a surplus / gap analysis for the Town of Chapel Hill office market as an illustrative tool that may shed some light on the supply/demand dynamics that have been presented discussed so far.

7.2 Opportunity

As stated elsewhere in the report, there is an opportunity in capturing demand from within the Research Triangle, the Mid-Atlantic region, other regions of the U.S., and from within the international marketplace. Other opportunities to grow the office market from within by tapping into the creative class, cultivating and mining the links to the University and the entrepreneurial and business development climate it purposely fosters, and working through the other opportunities for increasing and capturing demand as summarized in the previous section can all have their effect.

The closest we can come to quantifying potential demand comes from backing in to the projection by using the example shown in Section 5 relating to the capture of a relatively small additional share of the Research Triangle market, of which Chapel Hill currently only has about 4% - 5%. Increasing Chapel Hill's fair share to 6% - 7% could mean an additional 1 million square feet of office space (estimated). Even if its share remains the same (4% - 5%) it will be of a growing market and serve to match the expected additional growth in supply as discussed in Section 5. All indicators suggest that there is sufficient demand in the marketplace to support this – over time – if various efforts, trends, and motivations combine to answer it.

7.3 Surplus

By definition (un-leased space inventory) there is a current (spring 2010) surplus of approximately 300,000 square feet of office space in Chapel Hill.

7.4 Net Supportable Square Footage Discussion

Based on the various economic and market perspectives advanced in this report; the Town of Chapel Hill proactively seeking to maintain and increase its competitive advantages over market rivals; its ability to foster a development environment that further encourages office growth; and, a strategy of capturing demand from “foreign” markets; Strategy 5 projects that the local market can support the introduction of an additional 1 million square feet of office space over the 5 -10 years. This is roughly consistent with combining current vacant space inventories (300,000 square feet) with planned projects, leaving about 300,000 additional square feet of “net supportable” space to be conceived, located, built and occupied during this period. Numerous factors will determine whether this space ultimately falls into the surplus category, or the opportunity gap category, and for how long.

As a further illustration that may put these numbers in context is as follows:

If the average amount of leased space in Chapel Hill remains at about 20,000 square feet, the 1 million square feet of additional space equates with about 50 companies being attracted to Chapel Hill over the development/absorption period (5-10 years); or, between roughly 3 and 5 new tenants per year.

Section 8: Summary of Findings and Recommendations

Given the variety of market characteristics associated with the Town of Chapel Hill, the Research Triangle, regional, national and international arenas etc. it is clear that there is significant, but not overwhelming, potential for future office development as a component of the local economic development environment. The ability of the Town to capture its fair share of this market hinges on key business/political principles that will influence the presence, sustainability and future vitality of the office community. These principles can be roughly categorized and described as follows: Policy, Positioning and Promotion.

8.1 Policy

Increasingly, economic development and its associated spin-offs: capital investment, construction, FTE jobs, wages and salaries, tax revenue and other beneficial fiscal impacts, are tied to policies that are enacted, implemented and enforced by government bodies. An array of federal, state and local government entities influence economic conditions. So too does the free market and associated decisions by corporations, small businesses, individuals, and both large and small trends affecting countries, regions, cities and towns. For the Town of Chapel Hill to reach its full potential in cultivating and capturing office demand as a component of a fiscal policy that recognizes the need for revenue, it must make the conscious decision to pursue this segment of business/economic activity. This decision (if made) should then manifest itself in the implementation of recommendations referenced or implied throughout this analysis, including but not limited to consideration of the following:

- **Review** the development approvals process and overall business environment with a close eye on the opportunities and constraints as delineated in this and other studies.
- **Consider** the economic and fiscal implications of sustaining the office community that currently exists, and those associated with planned projects as well as those which may come to fill the opportunity gap that the consultant believes can be created.
- **Act** through resolution and other means to embed decisions and policies that will foster growth in this sector in the foreseeable future, and over the timeframe associated with the forecasts included in this analysis (5-10 years).

8.2 Positioning

If an essential finding of this analysis is accepted; that there is sufficient market demand to support 1 million square feet of additional office development in the Town of Chapel Hill over time; and, the policy framework is honed to facilitate its introduction and sustainability, then the Town may choose to take steps to position itself for this market strategy. Among those steps the Town might consider in the positing strategy include:

- **Ensure** that existing office projects receive the highest level of consideration in positioning the market to encourage occupation of vacant space, continued tenancy of space, and demand for space that is in the development pipeline. Functionally full occupancy is probably the best advertisement for future investment.
- **Identify** development opportunities sites that coincide with site selection criteria, current Town zoning and regulatory framework, synergy with the existing office clusters and corridors, etc. These may be inventoried, quantified, photographed and placed into the context of this and other studies to provide the investment community with confidence that the Town supports private investment in this type of real estate development. These efforts can compliment, and be complimented by, local real estate brokers and other real estate professionals.
- **Prepare** small areas plans that further define and conceptualize office projects on the opportunity sites suggested above. These can provide a platform for imbuing projects with community values, local design preferences, and solving physical development hurdles in advance – thus facilitating and encouraging investment by the real estate industry. Similar to small area plans, site-specific corridor plans, transit-oriented development (TOD) plans, etc. can be used in a like fashion.
- **Undertake** proactive developer/investor solicitations for these projects. The realm of investment interest need not exceed the local/regional boundaries, but consider that Chapel Hill and the Research Triangle have international recognition and desirability.

8.3 Promotion

Given the reality of a global market with technology transfer, transportation links, and increasing co-dependence between nations, industries, etc. it is not unreasonable to view the potential for office in Chapel Hill with something of a world view. If this view is accepted then the objective becomes capture. If capture is the objective, promotion becomes the essential tool. There is already a sophisticated promotion and marketing system in place that can (and does) benefit Chapel Hill. There are a myriad of organizations at the national level (e.g. U.S. Department of Commerce), state level (e.g.

North Carolina Department of Economic Development), regional level (e.g. Research Triangle Partnership), and local level (e.g. Town of Chapel Hill Economic Development Office, Orange County Office of Economic Development, Visitors Bureau, Chamber of Commerce, etc.) that are designed to focus interest and economic activity. It is the consultants opinion that if policy and positioning strategies are put into place, a more aggressive and result-oriented promotional strategy can be put into effect through increased communication and shared tactical efforts with these and other organizations.

Some particular suggestions for the promotion element of an office market capture strategy include, but are not limited to the following:

- **Mandate** that departments and organizations which perform promotional activities for the Town coordinate efforts with a clear leadership hierarchy in terms of pursuing capture of the office market (in this case).
- **Merge** the objectives of the Town with regard to office prosperity and development (as evidenced by the policy and positioning actions) with those of the Research Triangle Partnership especially. If they are already considered merged, then we suggest a higher level merger.
- **Fund** these efforts through traditional and creative revenue streams – possibly tied to results in some fashion– that enable the promotional team to do its job effectively, and to enable competition at the global level. This will involve a public investment, but the anticipated economic and fiscal impacts should easily offset the cost.

8.4 Economic and Fiscal Impact Potential

The logic for pursuing additional office development in Chapel Hill is based on this sector's ability to contribute to the economic and fiscal base of the community through net-new property and personal property taxes, job creation, expenditure of wages and salaries, spending by operations, etc. A complete economic and fiscal impact analysis of future office potential in Chapel Hill was beyond the scope of this assignment however some illustrative projections may be useful. The Statistical Abstract of the U.S. and U.S. Census Data are the primary sources for these projections. All numbers are expressed as 2010 dollars.

- Using the current Effective Combined Rate in Chapel Hill, each \$100,000 of property value generates approximately \$1,338 dollars in total tax property revenue (distributed to various entities).
- Using the net additional office supply (Section 7) projection of 1 million square feet and a unit cost of construction of \$200 per square foot (2010 dollars), and market valuation/assessment using those variables, a net new taxable base of \$200 million is derived.

 **STRATEGY 5**

- Applying the tax rate as above, the new office projects would generate approximately \$2.68 million annually in net-new property taxes alone.
- Approximately 2,100 FTE construction jobs would be created, with more than \$140 million in wages and salaries paid to these workers who will in turn purchase goods and services, pay mortgages and rent, etc.
- The space will provide job space for about 5,000 workers who could pump \$350 million into the economy annually.
- Leases will generate in excess of \$28 million annually that will be spent by property management companies and developers to pay interest on loans, maintain staff, conduct maintenance and other services on the property, and likely provide capital for further investment in the Chapel Hill and local/regional economy.

Office development can have a significant economic and fiscal impact on the community as revealed by the summary projections above. These and other economic development benefits that can accrue from proactive policy decisions, capture-oriented positioning, and coordinated promotion activities that are strategically designed to grow this sector of the local economy should be considered along with the other observations, findings and recommendations contained in this Office Market Analysis.