



THE JACOBSON GROUP
Commercial Real Estate

CONSULTANT REPORT FOR THE SEATTLE CENTER
REDEVELOPMENT OFFICE
401 MERCER STREET, SEATTLE, WA “BEST USE”

INTRODUCTION

The site, 401 Mercer St. in Seattle, WA, is owned by the City of Seattle and managed by its Seattle Center Department. Since 1984, the site has been in use as the headquarters and primary broadcasting facility for KCTS 9, which holds a long-term ground lease with the City of Seattle. The tenant designed, constructed, and maintained all site improvements according to the terms of the lease. Since the 1980s, advances in media production have rendered the existing building largely obsolete for the television station and KCTS (now part of Cascade Public Media [CPM], which includes Crosscut.com and other entities) has elected to move out of the building at the end of 2023. The property and the building will be returned to the City on December 31, 2023 and will be managed and maintained by Seattle Center.

Seattle Center’s long term plan, which reflects support from community and stakeholder outreach, is to pursue a redevelopment strategy for the site that will generate revenue to support Seattle Center, and contribute to the overall vitality of the campus and the neighborhood. In the interim period, Seattle Center is evaluating possible uses that will replace annual rental revenues in the short term, keep the building safely maintained, and/or help address some short-term space needs for the campus.

In 2022, Seattle Center engaged The Jacobson Group to perform a market analysis of 401 Mercer St. to help the City identify the building’s position in the current commercial real estate rental market. The objective of this study is to provide Seattle Center with current market conditions and recommendations to help Seattle Center formulate a timeline for realizing its long-term development goals and create a strategy for marketing and leasing or otherwise utilizing the building in the interim period.

EXISTING CONDITIONS

Per the King County Assessor 401 Mercer Street building contains 66,240 square feet and is comprised of two floors. The first floor is densely built out and is comprised of recording and editing rooms, a television studio, a warehouse with two dock high and one grade level loading bays, offices, storage rooms, kitchen, dining area, conference rooms, server rooms and a large reception area. The second floor is comprised of open office work areas, server room, conference rooms, storage, and fulfillment rooms on two levels separated by a distance of 4 stairs. The building has an original elevator (capacity 4,000 lbs/26 persons) serving the first floor, second floor, and mezzanine level of the second floor. See Exhibit A for floor plans and photos of existing conditions.

The building sits on an 89,000 square foot lot with 11 parking stalls and a back-up generator in an outside enclosed area. There are landscaped and grassy areas surrounding the building with Memorial Stadium just to the south, the opera house to the east, Gates Foundation to the west and Gates Archives to the north. The site is zoned SM-UP 95 (M), Seattle Mixed - Uptown with a base height of 95' and a mandatory housing affordability suffix.

PHYSICAL BUILDING CONSTRAINTS

Since the building was built in 1986 there have been no updates including seismic upgrades, space reconfigurations and systems upgrades. Systems are defined as HVAC, electrical and data communications. The physical state of the building creates constraints to re-leasing it, to include:

- Dense build out on the first floor
- Outdated lighting, ceiling and raised floors
- HVAC that runs hot in the summer and cold in winter
- Large reception area with elevator access to the second floor down a long corridor towards the back of the building
- Onsite Parking ratio of 1 stall per 5,900 square feet of building area
- Limited access for semi-trucks
- Substantial alteration to the building would require a cost prohibitive seismic upgrade

INTANGIBLE CONSTRAINTS

- Only short-term leases being offered other than a ground lease
- The building will not show well to prospective tenants until CPM moves out, cleans to broom clean condition, and limited demolition can be completed. This is a constraint on revenue as there will be some down time with an empty building before lease-up occurs.

- Seattle Center lacks the budget for substantial demolition of obsolete broadcast infrastructure and upgrades including cosmetic updates, HVAC ducting, and ADA improvements to get the building to a competitive market-ready condition.
- No tenant improvement allowance for incoming tenants

BENEFITS

- The recording/editing rooms and large television studio can be repurposed for daily room rentals
- Storage and warehouse space is in strong demand with zero availability of this size in Queen Anne, South Lake Union and downtown neighborhoods and in limited supply in SODO
- Seattle Center painters and carpenters can do some demolition and market ready painting after CPM moves out.
- Revenue expectations are below the current market rents for office, warehouse and storage space
- Monthly parking is available across the street to the north and east from Seattle Center for below market rates. The site is also served by the Monorail and public transit.

MARKET POSITION

The Jacobson Group identified potential user groups for the building and included nearby offices, radio and television companies, music production studios, field offices for contractors working in the immediate area, colleges, larger companies in Queen Anne and 20,000 to 65,000 square foot users currently in the market for space. The Jacobson Group contacted CEO's and facilities managers in these user groups and assessed the level of interest in the building.

In addition, The Jacobson Group studied vacancy rates of surrounding office buildings, tenant activity, absorption rates and rental rates to help determine the building's position in the market.

In summary, the lasting effects of the Covid-19 pandemic in Seattle's urban core, followed by nationwide economic uncertainty in 2022 has taken a toll on the Seattle office space market. Vacancy rates in Queen Anne and South Lake Union remain higher than normal with negative absorption for Queen Anne (meaning that more commercial space was vacated than leased in this submarket in the last 12 months). Please see Exhibits B, C, and D. The Jacobson Group focused its research on tenants needing at least 20,000 square feet because the existing building has an open office layout and exiting issues that would require substantial interior renovation to accommodate multiple small tenants. The demand for 20,000 to 65,000 square feet of office space is almost nonexistent. Long term implementation

and timeline of return-to-office plans remains to be seen. Companies in the market for short-term office space currently have many options available to them, including ready-built spaces such as WeWork, and partial floors or subleases in newer buildings. Without improvements, 401 Mercer is unlikely to be competitive with modern, cleaner spaces.

Per conversations with office and industrial brokers to include CBRE, NAIP Puget Sound Properties, Newmark, JL and Martin Selig Real Estate, there is more demand for warehouse and storage space than for Class B office. Warehouse requirements will require less improvements to the building than office users will. Warehouse space close to the urban core is scarce. This product type also shows negative absorption in Queen Anne in the last 12 months, however, the Jacobson Group observes that this is due to warehouse users leaving the market as developers assemble warehouse blocks for high rise development. Supply is primarily warehouse space along Elliott Avenue. The KCTS location has better access to I-5 and Highway 99. Please see Exhibits E. and F. Logistics companies and local office users have increasing demand for close-in warehouse space.

LEASING OPTIONS

STUDIO AND RECORDING ROOM RENTALS

Seattle also has a music and theatre production niche where there is moderate demand for studio and recording room rentals. The Jacobson Group's cold calling efforts generated interest in studio and recording room rentals. The following is a quote from Hall of Justice Recording:

"I'm not personally interested, but small soundproofed studios are in very short supply in Seattle! I know more than a few working composers, musicians, and producers who would definitely be interested."

Several other recording studios voiced the same sentiment. The first floor has 4 recording rooms and one television studio. There could be a need for the editing rooms and the television studio could be used for theatre production. Our research indicated that \$1,000 per day is a reasonable market rate for daily rental of a recording or broadcast studio. See figure on page 9. for a range of revenue scenarios from daily studio rentals. A potential drawback of this plan is that Seattle Center may need to invest in new state-of-the-art equipment for the recording rooms and studio in order to realize maximum revenue. Seattle Center's existing partner Theatre Puget Sound or another similar organization could potentially be responsible for equipping and booking the rooms and studio for a fee.

OFFICE SPACE

The existing condition and constraints of the building makes leasing to a typical office user unlikely. Office tenants are embracing remote work and downsizing where they are. Pre-Covid the demand for office space was for wide-open build outs, and if the office market comes back that will continue to be the case. A Class B general office space in the Queen Anne submarket could command an asking rate of \$15.00 per rentable square foot triple net. 401 Mercer is not currently competitive with Class B office spaces because of the condition of the building's HVAC, overall finishes, and the outdated build-out of the first floor. The second floor of 401 Mercer is more conducive to office users with the cubicles, power infrastructure, storage, and conference rooms. The building systems would need to be upgraded to a Class B office market standard for both floors and substantial demolition done on the first floor in order to make the building attractive for general office tenants . Class B. is defined as building finishes are fair to good for the area and systems are adequate for comfortable occupancy, but the building does not compete with Class A at the same price. Leasing all or a portion of the building to lease as office space in its current condition will be difficult. Tenants paying market Class B. rates will also require funds for tenant improvement.

WAREHOUSE/STORAGE SPACE

The building in its current condition is more conducive to warehouse and storage uses. The two-dock high and one ground level loading docks are a plus in a location and economy where logistics facilities are in demand. The Jacobson Group's conversations with local warehouse brokers indicated that 3 – 4 warehouse users, both local and national companies, are in the market right now with requirements in the range of 20,000-65,000 square feet. It is anticipated warehouse demand will be steady into 2023 and 2024. Although 10-year lease terms are generally preferred, 5-year terms would likely still attract tenants. Some demolition would be required on the first floor to accommodate warehouse needs including security and access for trucks, forklifts, etc., but the Jacobson Group anticipates that modifying the existing first floor for warehouse use would require less investment than modifying to office use. A portion of the second floor would likely be useful as accessory office space for warehouse administration. The second-floor cubicles would mostly need to be disposed of The existing elevator is undersized for a typical warehouse, but is still usable for transporting boxes and smaller items. The asking rental rate for warehouse storage is \$16.80 per rentable square foot per year triple net and the entire building could potentially be leased.

OTHER CONSIDERATIONS

The Seattle Center Maintenance Shop is currently leasing space offsite and paying \$500,000 annually in rent to an outside owner. If a more optimal permanent solution can be identified for shop space – such as permanent relocation to Memorial Stadium after renovation – the City may consider temporarily moving this use to 401 Mercer to reduce this significant annual operating cost. An up-front capital investment would be required to modify the building for that temporary use.

The City of Seattle has decreased its overall real estate portfolio in the years since the Covid-19 pandemic began, and departments such as FAS, Seattle Schools, Seattle Housing Authority, Police, Utilities, SDOT or Parks may need temporary storage space. The Jacobson Group recommends that Seattle Center contact other City departments to see if a temporary rental agreement is mutually desirable.

MANUFACTURING

Manufacturing is a less desirable use not unlike office with the building condition not conducive to light or heavy manufacturing; however, a Queen Anne printer that considers themselves heavy manufacturing is interested in touring 401 Mercer. There are many obstacles to having this company as a tenant such as demolition costs, system costs and tenant improvements all for only a short lease term, but it may be worth exploring and getting feedback from a prospective tenant.

GROUND LEASE FOR DEVELOPMENT

The site is ideally located for a mixed-use development. Arts and culture and retail on the ground floor, hotel, affordable housing, and other residential uses above ground would all be desirable for the neighborhood. Public transportation is good and improving in the neighborhood making the site very desirable. The location is good for freeway access and proximity to South Lake Union, Seattle Center, and lower Queen Anne amenities. Rising interest rates have cooled the development market somewhat but is still healthy.

A formal valuation is outside the scope of this analysis, but an informal back-in calculation using the King County Assessor's estimated value of the land in 2022 at \$46 million and the current expected rate of return on investment at 5% approximates that annual rental income from a ground lease could exceed \$2 million. The site could be marketed for a ground lease/redevelopment in 2023 before the current tenant moves out of the building. The Jacobson Group recommends that an appraisal be done for the site to confirm the rent range for a ground lease before moving ahead with this strategy.

RECOMMENDATIONS

The Jacobson Group recommends that the City pursue a ground lease first, as the option that will realize the greatest revenue. Marketing a ground lease for development can happen while CPM is occupying the building. If the process is successful, a ground lease can be effective as early as January 1, 2024. Leasing the building in 2024 can be a contingency plan if the climate is not right for development.

CPM will vacate the property by the end of 2023. If the City moves ahead with an interim marketing/leasing strategy, the cleaning, repairs, and wall demolition that can be done by Seattle Center staff should be completed in January 2024 and the building placed on the market for rent in February 2024. There will be a loss of rental income for a few months in 2024, but it is the opinion of The Jacobson Group and NAI Puget Sound Properties that the building will not show well enough to lease with CPM in place. Tenants that cannot visualize the space when CPM is in the building will not come back for a second tour after CPM has moved out and the building shows better. During the few months in 2024 that the building is not leased, the recording rooms and the television studio could be rented out on a daily basis. This would not negatively impact showings for office and warehouse uses and will be a positive as it shows interesting activity.

The building should be advertised as a warehouse and office opportunity. The likelihood of an office tenant is low but many warehouse users need a small portion of office space. Disposal of most of the CPM cubicles and reception furniture before advertising is recommended but staging small portions of the middle of the 2nd floor and mezzanine area with cubicles may be useful for showing. To lease the space to multiple users an architect would need to be engaged to determine access and exiting code requirements, security and the cost thereof.

The building would be listed with a commercial real estate brokerage firm. An RFP process is recommended to select a firm. An informal solicitation among several firms may also be acceptable, depending on anticipated total commissions. The selection method will affect Seattle Center's project timeline.

The following is a list of required marketing materials and commission rates. Often, marketing materials are paid for and coordinated by the brokerage company, but estimated costs of materials are listed below for reference.

- ❖ Signage with size and placement to be clearly visible from cars and public transportation traveling on Mercer Street and 5th Avenue North with a budget estimate of \$2,000.00

- ❖ The building should be remeasured to the most current BOMA standard of measurement at a budget estimate of \$6,600.00 (BOMA consultant will be retained by owner at owner's expense)
- ❖ A video marketing piece which includes an overview of the building, map of surrounding amenities (including public transportation), and interior building walk through for distribution on a regular basis to commercial real estate brokers in the Puget Sound area and target users. Budget estimate \$2,000.00
- ❖ A building eflyer with a link to the video, floor plans, map and a summary of the important features and benefits of the building. Paper flyers will be made available for building tours.

Commissions for office space would be at market with procuring brokers paid \$1.50 per rentable square foot per year of the lease term and listing brokers paid \$0.75 per rentable square foot per year. Without a procuring broker the listing broker would be paid \$1.50 per rentable square foot per year.

Commissions for warehouse space would be at market with procuring brokers paid 3% of the gross payable rent over the lease term and listing brokers paid 1.50% of the gross payable rent over the lease term. Without a procuring broker the listing broker would be paid 3% of the gross payable rent over the lease term. Based on the asking rental rates, the total cost of commissions is estimated to be about half of that for an office use.

401 MERCER SAMPLE IMPLEMENTATION TIMELINE

2023

- If ground Lease RFP is desired:
 - Engage a consultant to complete an appraisal (approx. 6-8 weeks)
 - Use RFP process to select commercial listing broker to public and advertise the land RFP. (approx. 8-12 weeks)
 - Determine City process and team for RFP development and evaluation of responses.
- Interim leasing:
 - Q1-Q2: Seattle Center to explore opportunities for interim leasing with other City departments. Plan to reserve sufficient square footage for Seattle Center's own storage needs related to relocation of the warehouse below the Memorial Stadium north stands, and work out a plan to subdivide and secure the remaining space in the building.

- Q2-Q3: Work with potential partners such as Theatre Puget Sound for managing/marketing the studio space for daily rentals, if desired. Identify capital upgrades needed and plan for this work.
- May 2023: Informal solicitation or RFP for a commercial broker team
- July 2023: Selected broker to begin preparing marketing materials for leasing the space for office/warehouse use.
- Q4: Make final decisions regarding any cubicles or other furniture or equipment that will be left behind by CPM.

2024 Q1

- Interim leasing:
 - January: Seattle Center trades will make needed repairs, and paint and clean the building to prepare for showing. Recommended to strip carpeting if the floor beneath is in good condition.
 - February-March: Selected broker team will work with the City to finalize marketing materials and begin outreach.

ATTACHMENTS

Exhibit A: Floor Plans and Photographs, King County Assessor Data 2022

Exhibit B: Seattle Office Market

Exhibit C: Queen Anne-Magnolia Office Submarket 2022-08-18

Exhibit D: Lake Union Office Submarket 2022-08-18

Exhibit E: Queen Anne Industrial Submarket 2022-08-18

Exhibit F: Lake Union Industrial Submarket 2022-08-18