



*Repositioning  
The  
North Valley Center*

"TO BE RETAIL, OR NOT TO BE RETAIL?"

*Is that the question?*

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UNIVERSITY OF DENVER

## **NORTH VALLEY CENTER**

Larry Lacrosse was recently re-hired by the Second City REIT as the Asset Manager of the North Valley Center (NVC) located in the north end of the Denver metropolitan area in the city of Thornton. Larry had earlier worked for Second City after earning a BSBA degree from the University of Denver (DU). In total, Larry had spent ten years in commercial real estate (office, industrial, and retail) working for a variety of firms, including the Trammell Crow Company and CB Commercial. Larry had recently completed the MBA in Real Estate and Finance at the Daniels College of Business at his alma mater, DU. Larry's new assignment as asset manager of the NVC would require his drawing upon both his education and experience to recommend a plan to maximize the value of the NVC asset.

Larry's assignment was in accordance with the asset management program envisioned by the Chairman, President and Chief Executive Officer of Second City, Mr. Lax Coach. As stated by Mr. Coach in the Second City annual report:

**"My first priority will be to focus on the existing portfolio and maximize the intrinsic value of our properties, set and attain targeted return on shareholders' equity, and consistently work to improve both operating earnings and funds from operations."**

Hence, Larry was to determine how to meet the portfolio requirements by maximizing the value from this asset:

- 1. The cash flow from operations; and**
- 2. The sale value as a marketable asset.**

The scope of Larry's assignment as requested by Second City was as follows:

- 1. Thorough review and understanding of the property;**
- 2. Understanding of the characteristics of the various market segments;**
- 3. Preparation of an alternative uses analysis; and**
- 4. Preparation of a feasibility study for the site.**

Larry envisioned his assignment as the determination through qualification and quantification of the most feasible use of this asset in a redevelopment program. His conclusions and recommendations for a redevelopment concept would be based upon:

- 1. existing conditions;**
- 2. market research of retail, office, industrial, and industrial market segments;**
- 3. financial analysis; and**
- 4. a management and marketing implementation program.**

## EXISTING CONDITIONS

**Ownership.** The NVC is a 452,013 (including common areas) square foot sub-regional mall situated on 37 acres. The NVC, built in 1967, was acquired by Second City REIT in 1969 for \$3,258,630.

**Location.** The NVC is located ten (10) miles north of Downtown Denver at the Southeast corner of 84th Avenue and Interstate 25 (I-25), City of Thornton, County of Adams, Colorado within an Adams County Enterprise Zone (see map, aerial photo, Adams County Enterprise Zone, site plan, and floorplan exhibits on pages 3-7).

There is an exit ramp from I-25 in both a north and south direction onto 84th Avenue. The site has frontage along the northbound exit ramp from I-25 on the west, along 84th Avenue on the north, and along Washington Avenue on the east. The location is approximately 1.25 miles north of the I-25/US 36 (to Boulder) interchange and 4.5 miles north of I-70.

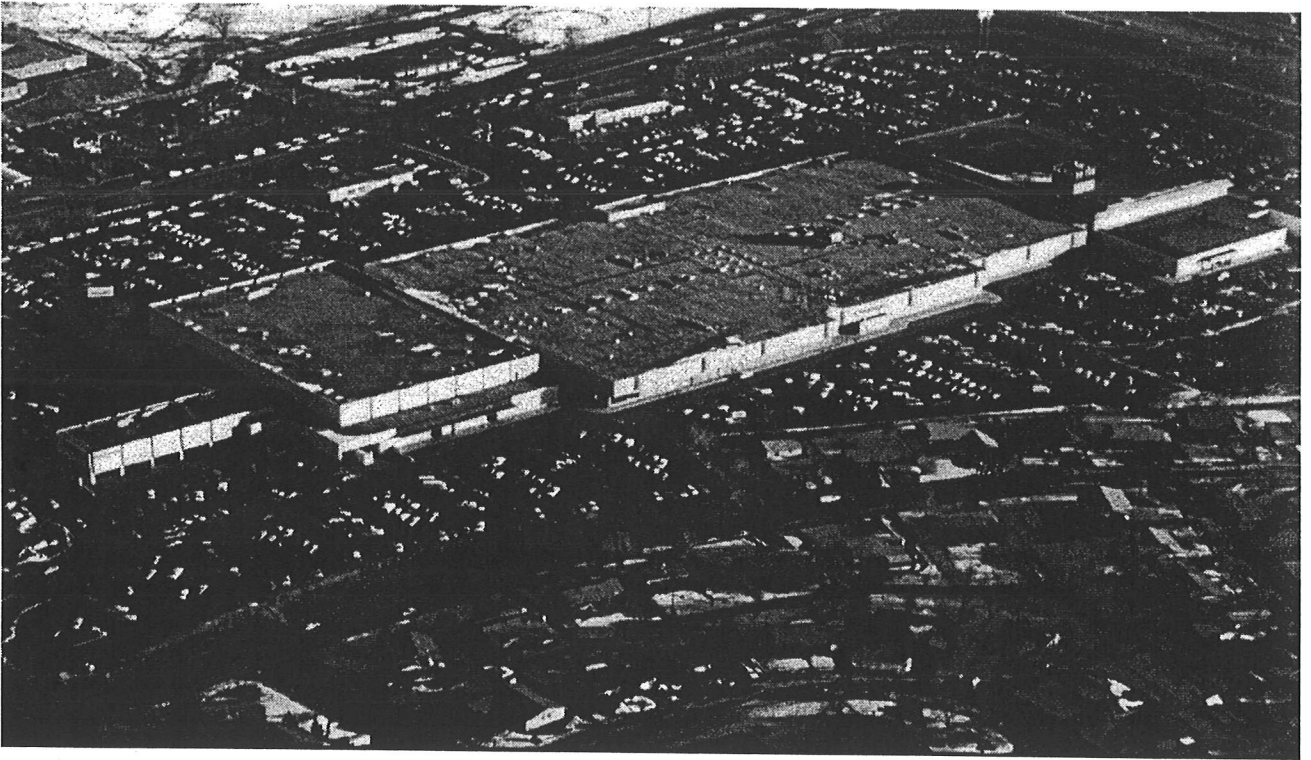
**Access.** The main entrance to the site is at the north boundary, at the intersection of Grant Street and 84th Avenue. This intersection is controlled by traffic lights and includes left-turn lanes. There are two entrances from Washington Street. The access on the north has right-in, full-out access, and the south entrance has right-out, full-in access.

**Site.** The site is comprised of approximately 37 acres of gently sloping (north and east) land. Most of the site has a lower elevation than the surrounding properties, up to 30 feet in some places. The northeast corner of the site is the only place where the parking lot is on the same level as street grade. The parking lot on the west slopes downward toward the east, while the south lot varies from level to northerly sloping. The north parking lot slopes gradually north. There is a large drainage system which collects runoff from various points on the site. The runoff empties into a large concrete culvert which flows easterly under Washington Street. It also serves as a control channel for Niver Creek. Finally, there are two (2) outparcels owned by others: (1) the Texaco site has been leased to a furniture retailer (Beds, Beds, Beds); and (2) the Conoco service station at 84th and Washington (see the site plan).

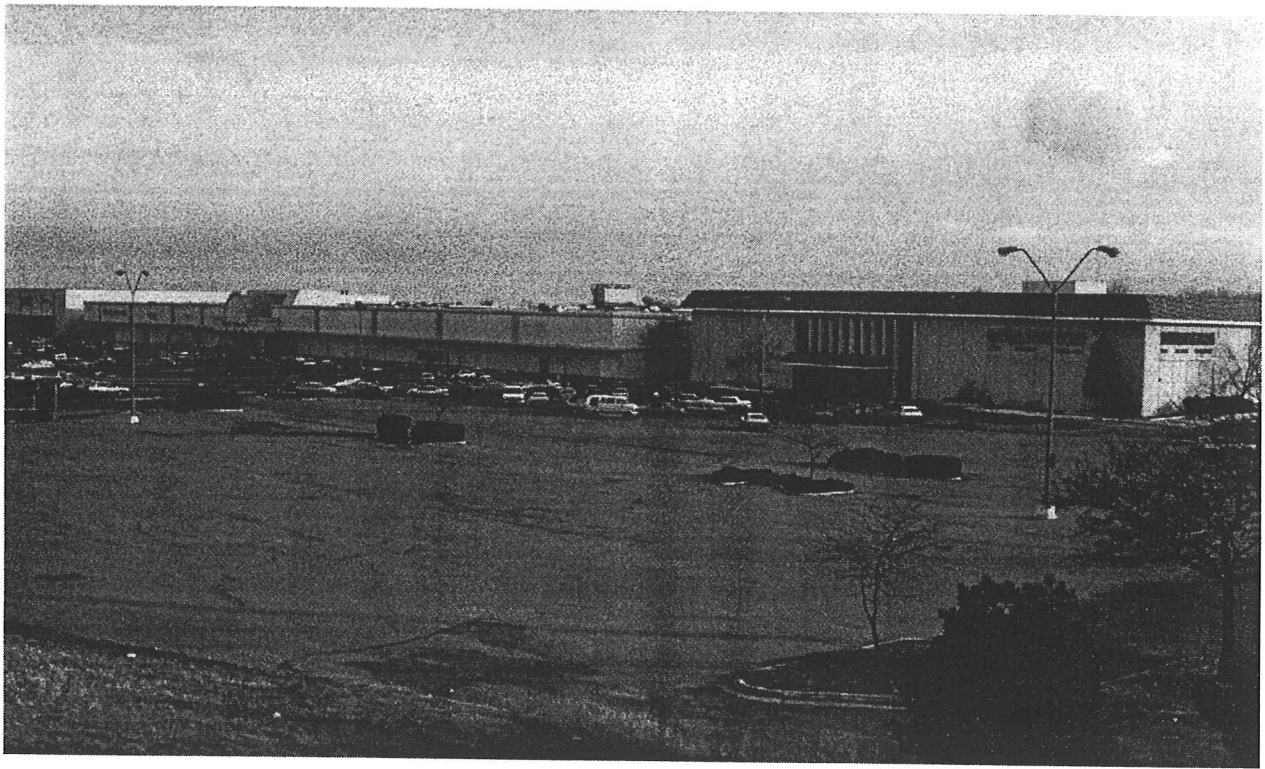
**Site Leasehold.** The site is held under a ground lease that expires in 2063, with no further renewal nor purchase options. The lease is non-participating with the ground rent fixed at \$50,000 per annum for the remainder of the term without any further rental increases.

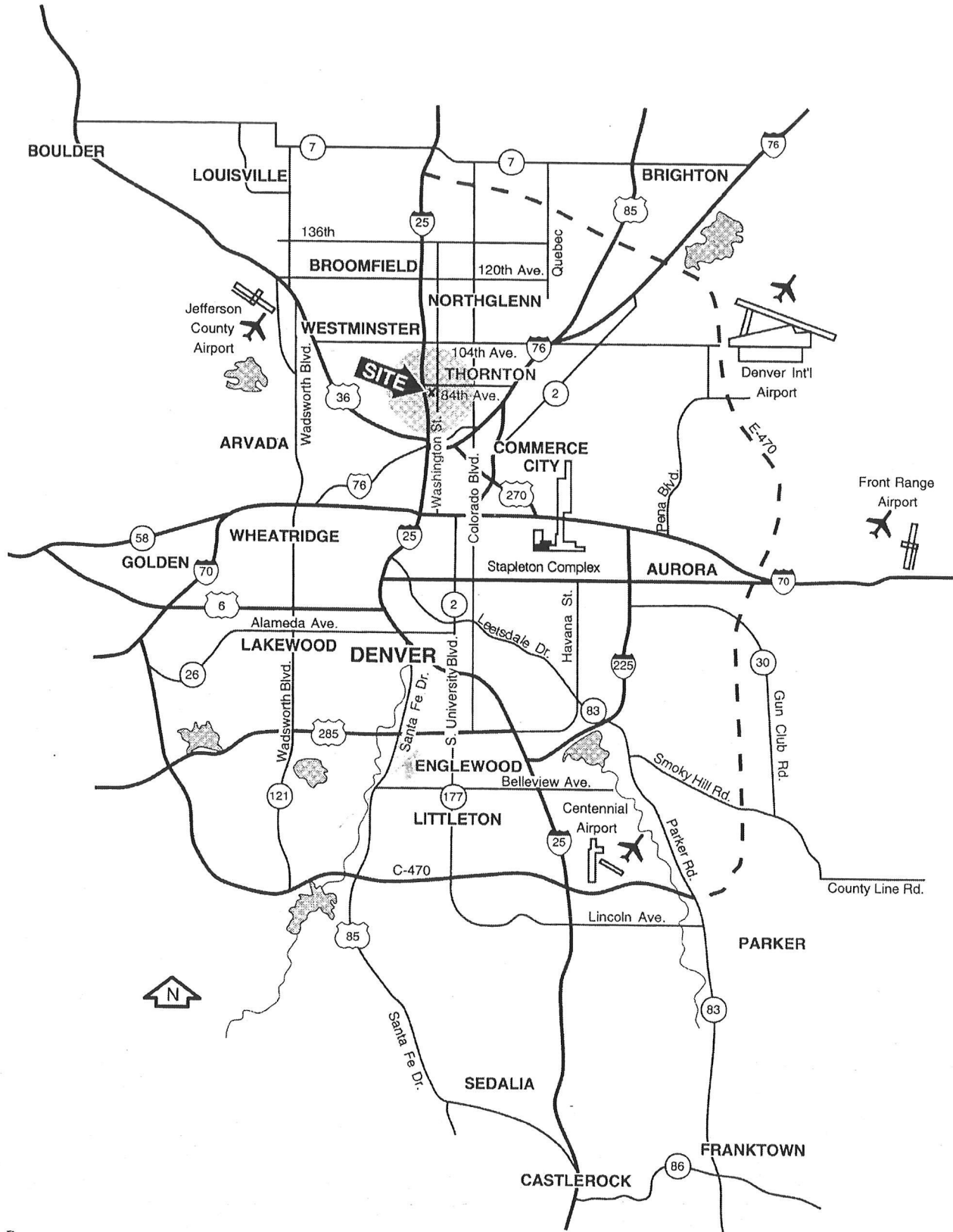


# The North Valley Center



# The North Valley Center





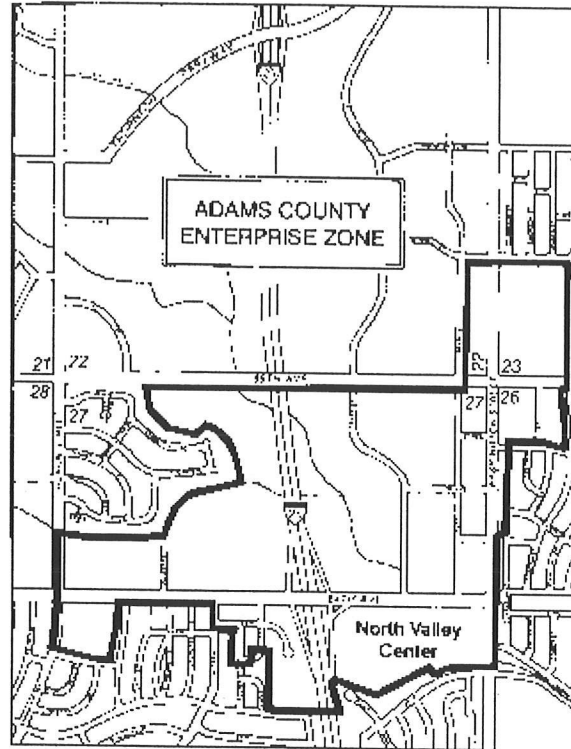
# ADAMS COUNTY ENTERPRISE ZONE



**ADAMS COUNTY**  
ENTERPRISE ZONE

Businesses that make capital investments in equipment, hire new employees, contribute to economic development plans, rehabilitate old buildings and do research and development in Adams County Enterprise Zone have the potential to save thousands of dollars on their Colorado income tax bill each year. The Zone includes First Union's North Valley Center redevelopment project. A brief description of the tax incentives in this designated area follows:

- **Three Percent Investment Tax Credit**
- **New Business Facility Job Tax Credits**
- **Exemption from State Sales and Use Tax for Manufacturing Equipment**
- **Research and Development Tax Credit**
- **Credit for Employer-Sponsored Health Insurance**
- **Tax Credit for Private Contributions to Zone Projects**
- **Tax Credit to Rehabilitate Vacant Buildings**



For more detailed explanation of the Enterprise Zone tax credits and certification procedure, please call Jean Lundy in Adams County Economic Development directly (970) 450-5105 for a comprehensive information packet.

## TAXES

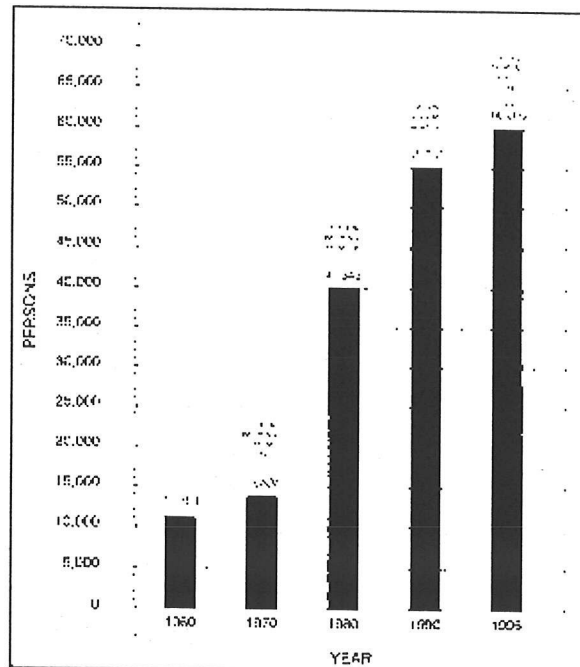
### Corporate Income Tax

Taxable Income	<u>Tax</u>
Flat Rate	5.0%

### Retail Sales Tax

State	3.0%
RTD	0.6%
City of Thornton	3.5%
County	0.5%
Baseball	0.1%
Cultural Facilities	0.1%
<b>Total</b>	<b><u>7.8%</u></b>

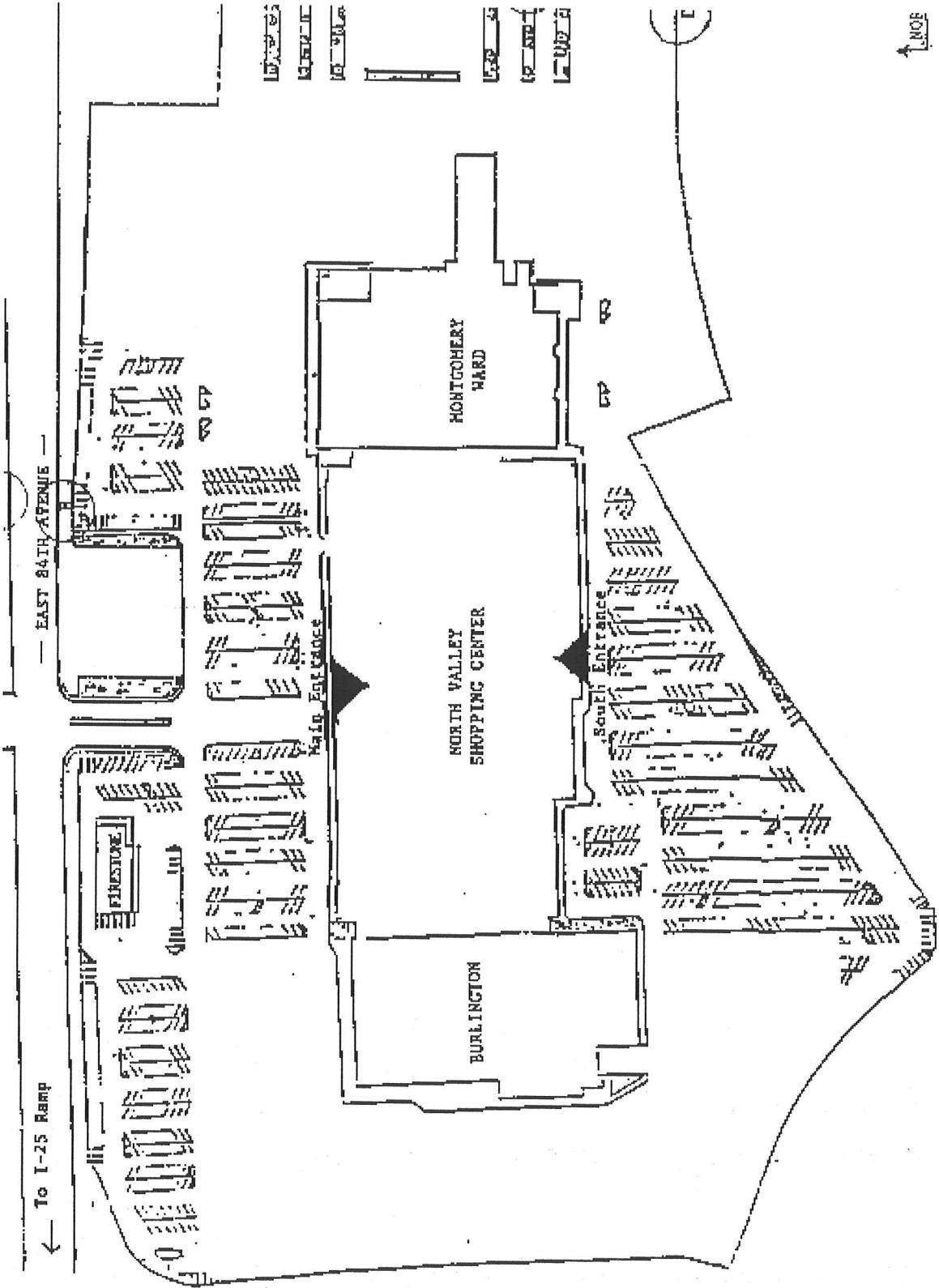
## POPULATION



Source: 2000 Census, U.S. Census Bureau and City of Thornton, 1990 Census.

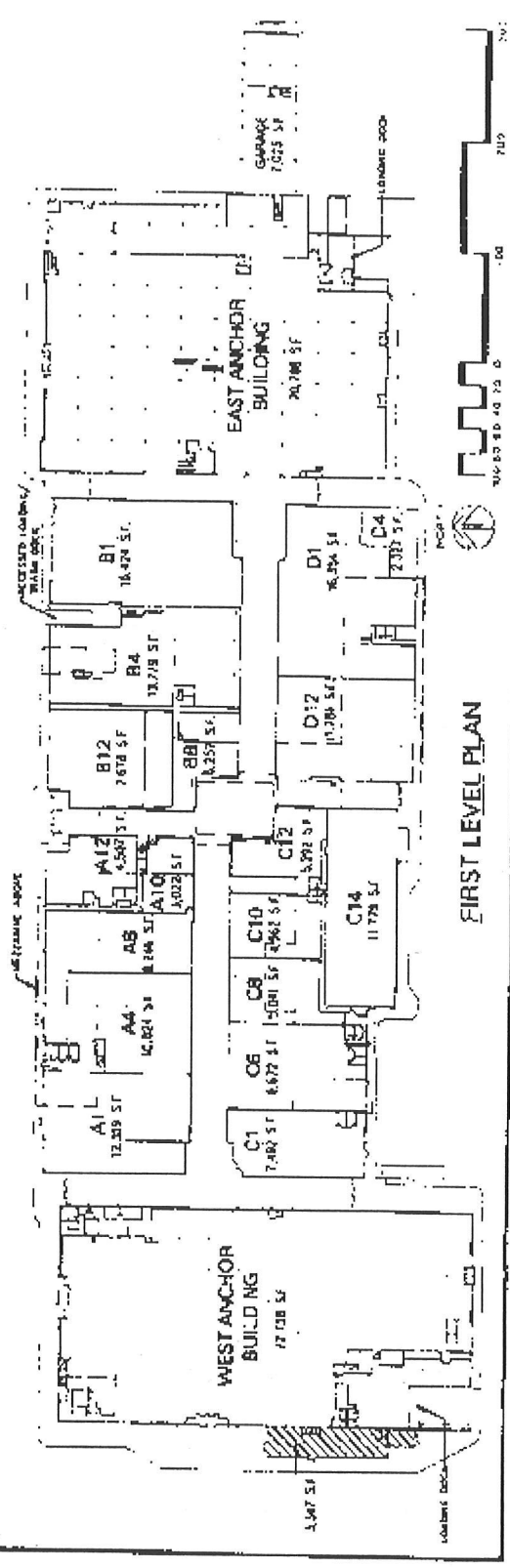
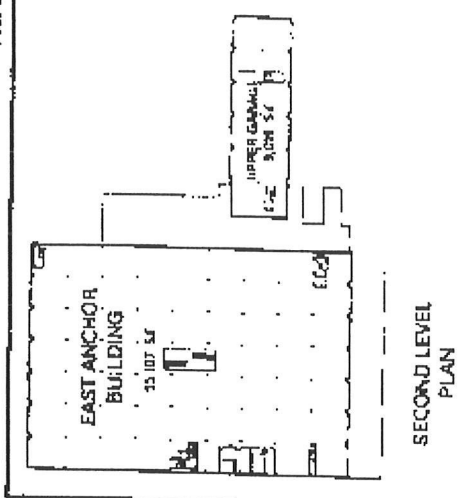
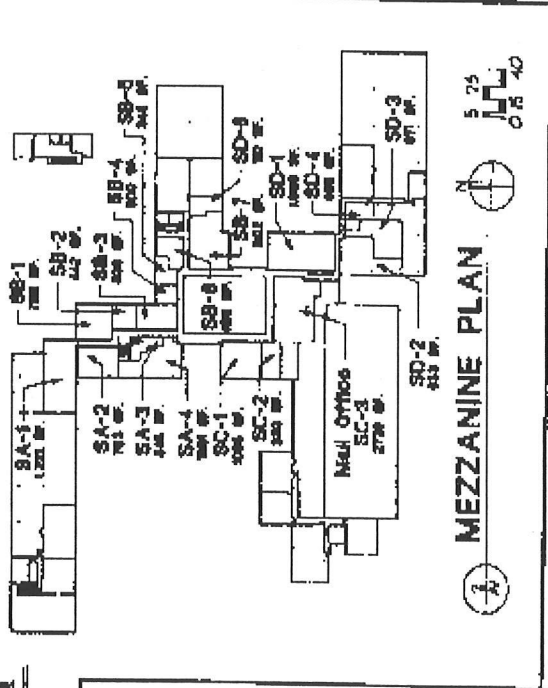
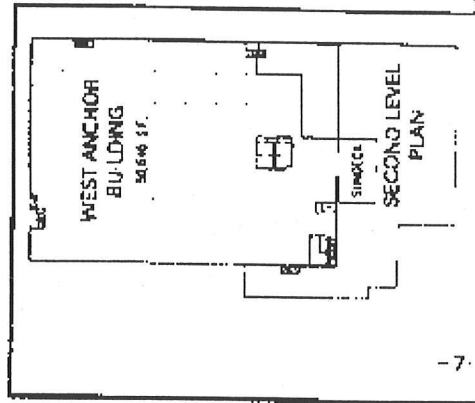






# NORTH VALLEY CENTER

Total Sq. Ftg.: 452,100  
 Parking: 2,550 spa  
 Acres: 15.23



**Tenants.** The credit tenants include Montgomery Ward, Burlington Coat Factory (originally May Co. space), Walgreen's Drugs, Deb Shop, Firestone, and Radio Shack. Current occupancy is approximately 65% (below break-even) and has been declining since the May Company left in 1986. All of the credit tenants have less than five years remaining on their leases; some tenants have options to renew.

**Financial.** Financial returns have been declining along with the tenant occupancy. Currently, operations are unprofitable, and the losses have been increasing. Quoting the appraisal report performed by Acme Appraisal Company:

"If the site was unimproved on the date of the valuation, it would be a reasonable conclusion that the existing buildings would not be economically feasible to build. They do not have contributory value to the site. I conclude that the existing shopping center mall buildings do not represent the highest and best use of the land."

**Parking.** The current parking ratios are approximately five square feet of parking area for every square foot of retail area or 5.64 parking spaces per 1,000 square feet of rentable space. All of the land surrounding the center has been surfaced into a parking lot with minimal landscaping. Parking areas surround the center in a basically equal proportion, with slightly more parking in the rear.

**Zoning.** The site is zoned for commercial use and the city officials of Thornton have stated their willingness to support redevelopment of the property that requires some rezoning. The principal control on land use is the City of Thornton Zoning Regulations. The current classification under the City of Thornton's Redevelopment zoning designation, according to the Thornton Planning Department, is as a City Center Area, exclusions include "storage and warehousing." However, a recent publication of the City of Thornton Community Development states:

"Intense competition over the years from regional malls has left the North Valley Center with an overall vacancy rate of approximately 35%. In an attempt to generate a greater usage of this facility, the center owner, Second City REIT, and the City of Thornton have discussed the possibility of converting a portion of the present vacant retail space to a light industrial or office usage, such as electronic device assembly and other types of non-offensive manufacturing operations."

The City of Thornton recognizes the necessity of permitting non-conforming uses to the zoning regulations in an attempt to prevent further deterioration of the property value and as an asset to the community. It is reasonable to anticipate that Thornton would permit any use that was deemed to be "non-offensive"; and that they would support a redevelopment program and a rezoning effort.

Improvements. The building was originally constructed in 1967 and underwent a \$1 plus million renovation in 1987. The site is improved with a single pad site and a main building actually comprised of three (3) separate buildings that are "joined" to the mall with large common area entrances.

The building areas, totaling approximately 494,013 square feet (including common areas) are as follows:

1. Montgomery Ward Outlet Store: a 141,939 square foot two-story facility and an auto service center on the east side of the centrally located mall building;
2. Burlington Coat Factory Store: a 126,751 square foot two-story facility (originally a May Co. store) on the west side of the centrally located mall building, plus its 5,800 square foot out-parcel auto center (leased to Firestone) located adjacent to and on the west side of the main entry from 84th Avenue; and
3. Mall Building: a 199,791 square foot single-story structure (approximately twenty-four feet of clear height under the roof), separated into four (4) quadrants, including about 42,000 square feet of common areas. There is a mezzanine floor within the mall of about 15,294 square feet, currently being leased for offices and used for mechanical operations. The mall's main entrance is located at the mid-point of the mall. This entrance leads to an atrium in the center of the structure. Here the building is two stories with the office space on the upper floor (mezzanine), which has a walkway encircling the atrium. From the center atrium, on the main floor, there are two main mall corridors (going east and west) forming the mall tenants leased areas leading to the anchor stores on each end. At the entrances to the anchors are additional corridors and exits to the north and south.

In summary, the nearly 30 year-old center appears in reasonably good physical condition due to the 1987 \$1,000,000 renovation work having improved its appearance. The parking lots have almost no landscaping and are in average condition. The mechanical systems are experiencing losses both physically and functionally due to aging and design inefficiencies.

## MARKET ANALYSIS

"To be retail, or not to be retail?" Is that the question?

Larry Lacrosse was reviewing a Denver real estate markets study commissioned by Second City in order to make his asset management recommendations to Mr. Lax Coach for the North Valley Center. His findings were as follows.

**RETAIL MARKET.** The overall Denver retail market, consisting of 56 million square feet of space, had experienced positive net absorption for the previous year, with year-end vacancy down to 11.95% from 13.2% two years ago. Approximately 140,000 square feet of retail space had been converted into an alternate use during last year, including the Beau Monde Fashion Mall which is now a church complex. In addition, the owners of the 1.3 million square foot Cinderella City Mall built in 1968 in a strategic "downtown" location in Englewood were considering giving their property to the city because of lack of tenancy. The approaching "midnight" hour of "Cin City" can be attributed to the age and obsolescence of the building and to the over-building of retail space in the Denver metropolitan area.

The north market (in which the NVC competes), consisting of 5.6 million square feet had experienced negative net absorption of 25,600 square feet during last year and ended at 22.4% vacancy. Approximately 40,000 square feet of retail space was converted to an alternate use last year. The NVC is approximately 35% vacant, well below the market average.

The shopping centers that generate the most competition for the NVC are as follows:

1. Huron Plaza - 152,000 square feet at the SE corner of 84th and Huron Street (West of I-25). Tenants include Sears Service Center, Fantastic Sam's and Screenplay Videos.
2. Thornton Shopping Center - 166,478 at the NE corner of 88th and Washington. This an older center in below-average condition. Space available ranges from 1,000 to 10,000 square feet. An Albertson's supermarket is the anchor tenant; there are three pad sites.
3. Pinnacle at Horizon Center - 227,000 square feet at the SW corner of the Thornton Parkway and Washington Street. The anchors include Hobby Lobby, U.S. Factory Outlet, and Super Saver Cinema.

4. Thornton Town Center - 667,000 square feet at the SE corner of 100th and I-25. Anchors include Bigg's Hypermarket, Home Base, United Artists (8 screens) and Jackson's Hole Saloon.
5. Northglenn Mall - 865,000 square feet at the NW corner of 104th and I-25. Sears and Mervyns remain as surviving anchors; May D&F and J.C. Pennys have vacated. Redevelopment has been announced as a conversion and new construction of a "Big Box - Category Killer" project.
6. Westminster Mall - 1,200,000 square feet at the NW corner of Sheridan Blvd. and 88th Avenue. Recently renovated, the anchors include Foley's, Joslins, Mervyns, J.C. Penney, Broadway Southwest, and Montgomery Ward.

The NVC's circle of influence has radically changed in the past decade. To the south is a major industrial area. The east is restricted by the U.S. government's Rocky Mountain Arsenal land. The west is impacted by the Westminster Mall and other retail. The north is being cut off by new retail development along 104th Avenue, the major north-metro access to the new Denver International Airport (DIA). The most significant development in the immediate NVC area is the new American Furniture Warehouse (AFW) Superstore and the soon to be completed Soundtrack Superstore (see aerial photo). The AFW is an industrial use of that property and sets the standard for the nature and quality of future development in the immediate area.

Since 104th is being promoted as the access to DIA, as well as the new commercial corridor and growth area, discount retailers like Wal-Mart and K Mart have located up there since they envision this area as the "bull's-eye" of the population, since population is expected to continue north. The NVC is too far south and does not meet this criterion. Furthermore, most discounters want "big-box" power center formats which would require, in the case of the NVC, a major demolition and reconfiguration on the 37 acre parcel. In fact, K Mart was offered the opportunity to move to the NVC with Second City agreeing to demolish and then build-to-suit a strip center to K Mart's specifications, yet K Mart built at 104th.

Department stores have also chosen other alternatives, namely the Westminster Mall. The population growth rate of the last decade within the same distance of the Westminster Mall was double the population growth rate around the NVC. Finally, a publication of the Community Development Department of the City of Thornton describes the Thornton Enterprise Zone (see map) in which the NVC is located. The thrust of the publication is

that much (if not all) of the land in the enterprise zone is best suited for some use other than retail, such as office or industrial uses.

**OFFICE MARKET.** The overall office market in Denver has been steadily improving for the past several years, with the overall vacancy rate down to 12.2% from 22.6% a few years ago. Most of the office space is located in the CBD and in the Denver Technology Center (DTC) ten miles south of Denver. The northeast market currently has the highest vacancy in the Denver market at 42.9%, coupled with the lowest weighted average rental rates of \$8.21. Since this market has only 880,892 square feet of space, it is difficult to assess the reasons for the high vacancy rate.

The Adams County Economic Development Department reports that there are only six (6) Class B office buildings in the county with over 20,000 square feet available. Lease rates range from \$8.25 to \$13.00. Average contiguous square feet available is 17,500, with a low of 10,000 and a high of 32,000.

At the national level, the future demand for office space is undergoing significant structural shifts. As explained by Cognetics, the causes of the immense demand in the 1980's, when almost 50% of all office buildings in the U.S. were built, will also be the causes of the declining demand throughout the 1990's. This does not mean that all the office buildings in the U.S. are going to be vacant in ten years. However, on average, office building rental rates will not reach the levels seen in the 1980's in order to curb vacancy. In other words, office space providers must adjust to the demand shift by becoming competitive with lower rental rates.

Based on these national shifts in demand, now is not the time to be building traditional office space, except in rare situations. The rare situation in Denver, if there is one, would be in the southeast corridor where rental rates are the highest and vacancy rates are the lowest. The northeast side of Denver does not even compare.

**INDUSTRIAL MARKET.** There are four distinct types of space included in the generic heading "industrial" according to Cushman & Wakefield as follows:

1. High Tech Space (R&D/Flex Space) - Buildings which are primarily used for research and development, engineering, bio-technology or electronic assembly. Buildings are characterized by landscaped office park type construction,

state-of-the-art amenities, with an emphasis on office and common area, plus wiring for heavy amps.

2. Office/Service Center Space - Primarily buildings with storefront/showroom areas, grade level loading, lower ceiling heights and service/repair areas. The buildings generally contain a higher showroom/office versus warehouse build-out ratio. They may have a quasi-office or quasi-retail function.

3. Warehouse/Distribution Space - Buildings that contain high-cubed ceilings, dock high and/or grade level doors which would accommodate a distribution or warehouse user. These facilities usually feature concrete construction, ample warehouse space, and a relatively low ratio of office build-out, and often paved, fenced yards and storage areas.

4. Manufacturing Space - Facilities used for manufacturing and fabrication purposes with some warehousing/storage capabilities. Building features may include craneways, heavy power and grade level doors.

Using the broader definition, the Denver industrial market consists of 137.1 million square feet of inventory, of which 9.46 million square feet was vacant year-end last year, for a 6.9% vacancy rate. Net absorption for last year was almost eight (8) times that of the previous year and totaled approximately 5 million square feet. Overall market weighted average asking rates increased from \$3.07 to \$3.43 per square foot triple net during last year.

The northeast submarket experienced 1.8 million square feet of absorption during last year, the strongest absorption reported throughout the Denver metro area. The northeast submarket consists of 57.4 million square feet of which 52.8 million was occupied by year-end last year, for a vacancy rate of 8%. Overall, the weighted average market rate increased to \$2.79 from \$2.39 per square foot triple net during last year.

In the northeast submarket, high tech inventory consists of approximately 100,000 square feet, of which 94,000 is leased, for a vacancy of 6%. The triple net asking rental rate for available space is \$3.85 per square foot. Office/service center inventory totals approximately 5 million square feet, of which 4.53 million square feet is leased, for a vacancy rate of 8%. The triple net asking rental rate for available space is \$3.57 per square foot. The NVC could compete in this market on an availability basis.



In the northwest submarket, high tech inventory totals 1.7 million square feet, of which 1.48 million is leased, for a vacancy rate of 12.9%. The triple net asking rental rate for available space is \$8.08 per square foot. Office/service center inventory consists of 5,781,871 square feet, of which 243,048 is vacant, or 4.2%. The triple net asking rental rate is \$5.26 per square foot. The NVC could compete in this market on a cost basis.

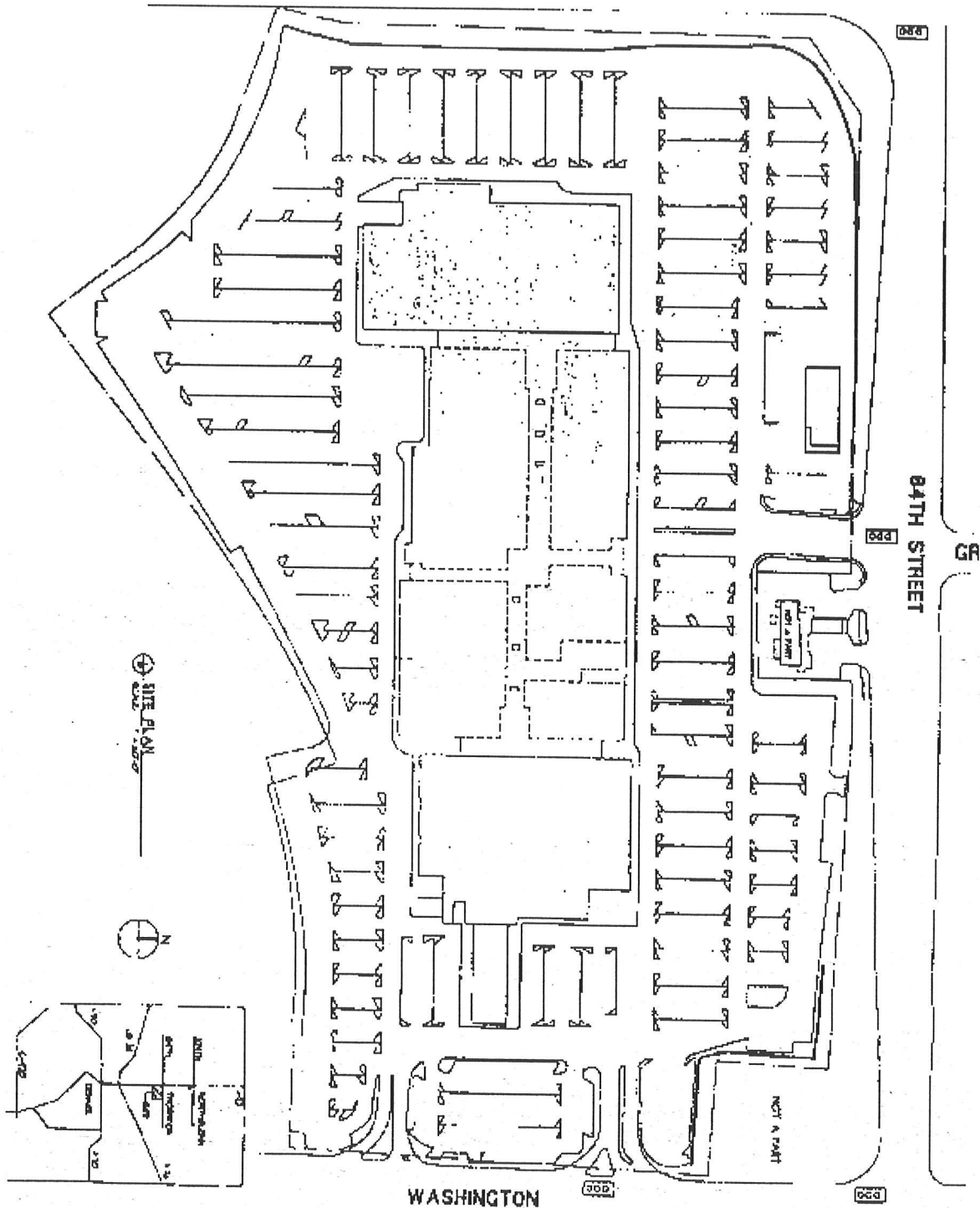
**APARTMENT MARKET.** Since 1988, the overall Denver apartment market has demonstrated consistent strength, as indicated by decreasing vacancy and increasing rental rates. From 1988 to last year, vacancy rates decreased from 12.2% to 3.8%, and average rental rates increased from \$395 to \$585.

This demand is being met with new construction plans for 35 apartment projects representing over 7,500 units. The Thornton apartment market is as strong, if not stronger, as the Denver metro area market. Vacancy is approximately 2.2%, and rental rates have increased between 10 and 40 percent over the last three years. No new construction is planned in Thornton. The NVC's 37 acres, if rezoned, would allow 925 apartment units.

Larry realized that his mandate was to determine a re-development plan that would take advantage of the property and market opportunities, as well as mitigate the existing and re-development constraints, in order to maximize the asset value of the NVC through effective asset management. He further thought that the re-development concept should ensure that there would be a balanced and complementary use of the property that is consistent with the continued presence of the existing retail tenants. Whatever Larry's recommendation was to be, he also knew that it would have to be subject to evolution and refinement over time. The ultimate test would be the results produced from this non-performing asset into one that would be acceptable to the corporate standard of the Second City REIT - both in terms of financial return and aesthetic presentation.

Having studied the real estate markets and noting the importance of his ideas and recommendations, Larry Lacrosse wished he was back in college trying to decide who to take to Friday night's hockey game. Nonetheless, Larry began to review three re-development scenarios, the site plans of which were on his desk.

INTERSTATE 25



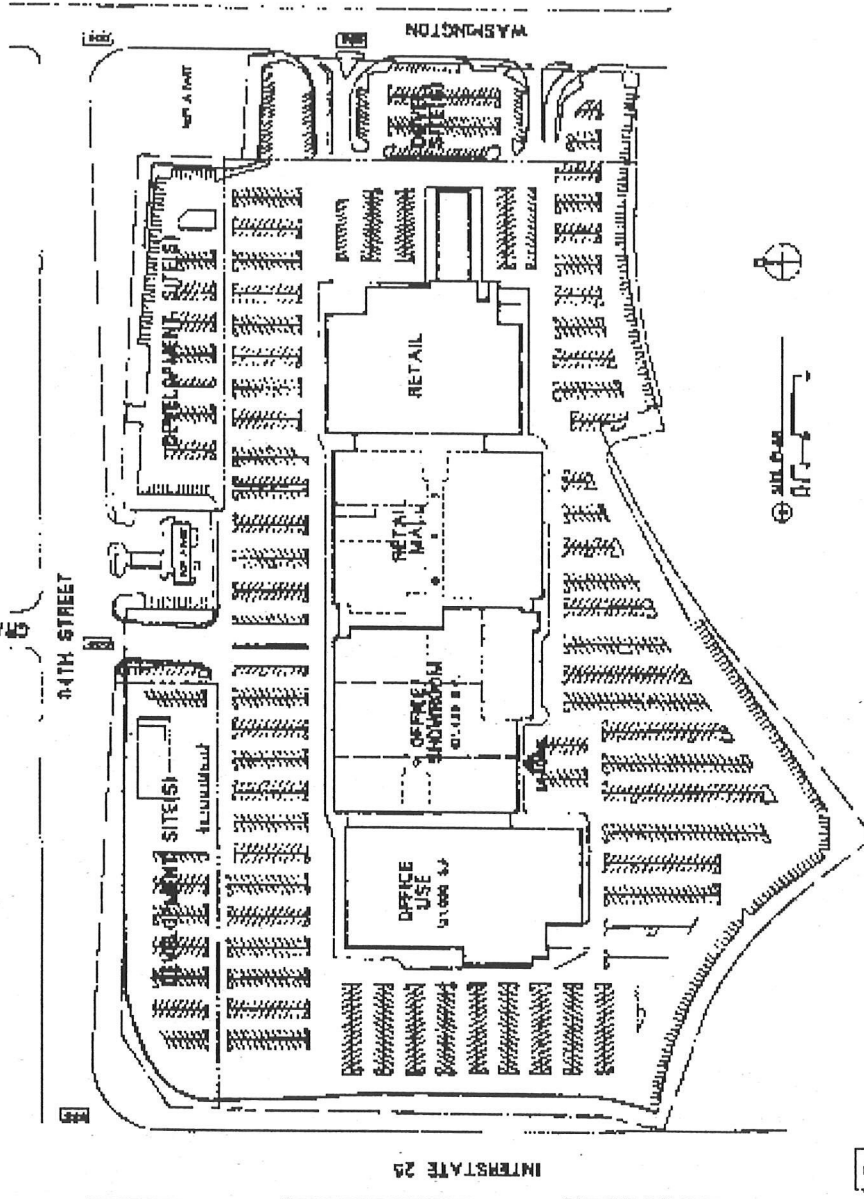
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**NORTH VALLEY CENTER**  
Thornton, CO

**RE-DEVELOPMENT PLAN**

2005



**NORTH VALLEY CENTER**  
Thornton, CO

**RE-DEVELOPMENT PLAN**

