

DEFINING THE 'TIPPING POINT' FOR DOWNTOWN ROCKY MOUNT

by

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INTRODUCTION

Rocky Mount, North Carolina continues to embrace its motto as “a city on the rise.” In particular, the city has sought to redevelop its historic downtown given the decline of businesses and residents over several decades. Since Hurricane Floyd devastated many community assets in 1999, the City of Rocky Mount has initiated and implemented local public sector investments for the redevelopment of historic properties using federal and state resources to incite development. The development of the Douglas Block and Streetscape renovations, more recently, have signaled a belief in the potential redevelopment of downtown Rocky Mount. However, investment from the public sector, in the long-term, is an unsustainable strategy to pursuing economic development for all of the city center. Rather, public investment should incite private-sector interest.

From my previous work in Rocky Mount, it is evident that single-site strategies for market-rate development are not feasible in Rocky Mount’s downtown region. When the private-sector has been involved, 1-2 parcels are purchased but do not demonstrate a change in the market that would prompt additional interest. As a result, an alternative model for provoking real estate development is warranted. This Masters Project assesses the viability of redevelopment of select properties in downtown Rocky Mount, NC as a catalyst for economic development. The analysis attempts to identify the critical mass, or scale of acquisition and operation, needed to make private investment feasible through an acquisition fund. Two case studies on the downtown development trends in Durham, NC and Richmond, VA inform the redevelopment strategy. **Implementation of an acquisition fund will spur the process for comprehensively changing the market dynamics, as a “tipping point” for real estate and economic development.**

To address this statement, the following report will be separated into three sections that provide the context for the strategy, review case studies, and offer recommendations based on an original financial model. Part 1 will provide context for the strategy by detailing the background on the project and project area; situating the acquisition fund model in literature on downtown redevelopment; and describing the current market for development in Rocky Mount. Part 2 will review case studies in peer cities that influence the assumptions within the acquisition model. Part 3 will provide an overview of the financial model and provide recommendations on using the acquisition fund as a tool for future development.

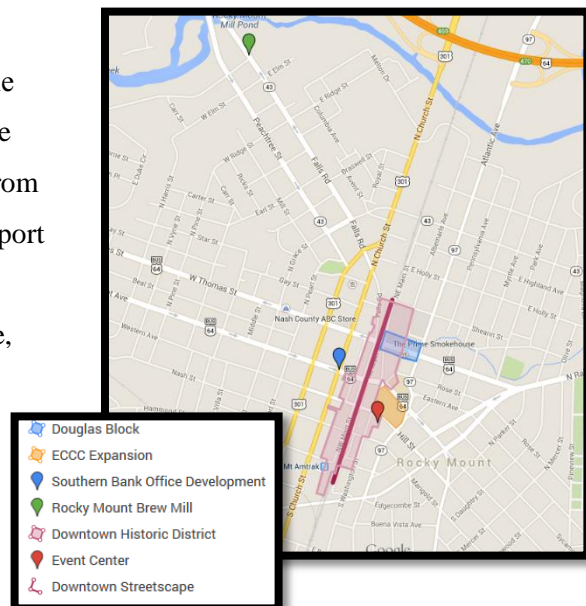
PART 1: CONTEXT FOR THE ACQUISITION FUND STRATEGY

PROJECT BACKGROUND

The City of Rocky Mount is on the cusp of several catalytic investments that can transform the city, specifically the downtown corridor. However, the scale of distressed properties has hampered broader reinvestment in the past and requires innovative strategies to reap the potential for redevelopment in the future. This report explores how a strategy for site control of several properties can make development feasible in distressed areas.

The project builds on previous work with a property owner in downtown Rocky Mount, located at 218-224 SW Main Street. I analyzed the financial feasibility of redeveloping the properties as mixed-use units. Given the market analysis and estimated development costs, the project did not meet the underwriting and equity investment criteria typically required for debt and equity capital. The analysis reaffirmed a common trend throughout the downtown—redevelopment of single properties are unlikely to be supported by traditional private investment mechanisms. While the City of Rocky Mount has used public sector investment for rehabilitation of the Douglas Block¹, the City is not, nor should be, interested in funding the entire downtown redevelopment strategy. An acquisition fund is an alternative to public investment where acquiring a critical mass of properties will create enough operating income to meet the criteria for interest from the private-sector through debt and equity investments.

While Rocky Mount’s downtown has seen considerable disinvestment in the past decades, the recent years have signaled the potential for development. Key projects from the public- and private-sector have the potential to support the incremental rehabilitation of downtown. From the public sector, investments in the downtown streetscape, completed in 2013, and redevelopment of the Douglas Block, completed in 2011, provide examples of the local potential.² In the fall of 2014, the City Council



¹ The Douglas Block is the renovation of the historically African American business district on the edge of Rocky Mount’s Main Street. Located in Edgecombe County, the redevelopment of historical buildings and location of local business is significant for future development in the predominately African American county.

² Stephen, Anisha. 2013. *Downtown Redevelopment-Rocky Mount’s Douglas Block*. February 13. Accessed September 2014. <http://ced.sog.unc.edu/?p=4413>.

approved development of an event center in downtown.³ The \$37 million investment from the City will be a 125,000 square foot multipurpose facility that will seat 3,000-5,000 visitors, enjoying events that range from basketball tournaments to trade shows.⁴ Simultaneously, the Edgecombe County Community College is constructing a Biotechnology and Simulation Center expansion with tax revenue, New Market tax credits, and private- and public-sector donations.⁵ From the private-sector, Southern Bank, currently located downtown, is expected to construct a new business center two blocks from its current location.⁶ Additionally, the Rocky Mount Brew Mill project, an incubator for craft brewers, signals the potential for a new and likely younger population coming to the City and has the potential to expand to 300,000 square feet of interior building space and 30 mill houses.⁷ As a result, redevelopment of Rocky Mount's downtown historical district can build and solidify the development momentum.

LITERATURE REVIEW

Rocky Mount's long-term disinvestment warrants a comprehensive redevelopment strategy of downtown, providing important context for promoting an acquisition fund as a strategy for economic development. This economic development strategy has its roots in understanding the central business district as a hub of economic activity for primary and secondary cities.

Specifically for secondary cities, like Rocky Mount, revitalization of the urban center has been the response to decentralization trends. In 2001, Burayidi argues that since the 1920s, the decentralization of downtowns has created spatial disconnect between work and home, especially for low-income residents.⁸ As residents begin to work and live on the urban fringe, and outside of city boundaries, there is a decrease

³ Handgraaf, Brie. 2014. *City moves ahead with event center plans*. September 23. Accessed October 2014. <http://www.rockymounttelegram.com/news/city-moves-ahead-event-center-plans-2660071#comments>.

⁴ City of Rocky Mount. 2014. "Frequently Asked Questions: Rocky Mount Event Center & Market/Feasibility Study." *RockyMount.gov*. Accessed September 2014. <http://www.rockymountnc.gov/documents/EventCenterFAQs.pdf>.

⁵ Edgecombe Community College. 2012. "Community Would Benefit from New ECC Facility for Health Science Education." *Edgecombe Community College*. September. Accessed October 2014. <http://www.edgecombe.edu/vote-yes/quarter-cent-sales-tax-article-pigg.pdf>.

Joint Legislative Committee on Local Government. 2014. "Proposed Local Government Financing." *NCLEG*. August 11. Accessed October 2014. <http://www.ncleg.net/DocumentSites/Committees/JLCLG/Local%20Government%20Debt%20Submission%202014%20Debt%20Submissions/2014LocalGovernmentDebt43.pdf>.

Carson, John. 2014. *County board approves biotech lab funds*. July 15. Accessed October 2014. <https://www.rockymounttelegram.com/tarboro/county-board-approves-biotech-lab-funds-2536821>.

⁶ Rocky Mount Chamber of Commerce. 2014. *Southern Bank to Build New Business Center*. March 3. Accessed September 2014. <http://www.rockymountchamber.org/news/newsarticledisplay.aspx?ArticleID=2604>.

⁷ Baverman, Laura. 2014. *The Rocky Mount Brewmill: Crafting North Carolina's Future in Beer*. July 28. Accessed October 2014. <http://exitevent.com/article/the-rocky-mount-brewmill-crafting-north-carolinas-future-in-beer-14729>.

Rocky Mount Brew Mill. 2014. *Rocky Mount Brew Mill*. Accessed September 2014. <http://brewmill.com/>

⁸ Burayidi, Michael. 2001. "Preface." In *Downtowns: Revitalizing the Centers of Small Urban Communities*, edited by Michael Burayidi. Psychology Press.

in tax revenue for public services, loss of agricultural land, and increase in the costs of transportation. Redevelopment of city centers seeks to mitigate these factors, returning to a monocentric model of cities that improves social interaction and improves societal wellness. This approach is especially poignant as the City of Rocky Mount is the economic node of the broader Rocky Mount Metropolitan Statistical Area.⁹

Dagney Faulk offers additional context for understanding the “process and practice of downtown revitalization.”¹⁰ She describes seven revitalization approaches common in secondary cities: 1) making the area more pedestrian friendly; 2) developing indoor shopping centers; 3) preserving historic buildings; 4) developing along the waterfront; 5) developing office space; 6) pursuing special activity generators (i.e. sports complex or convention center); and 7) improving transportation. Rocky Mount has implemented many of these strategies in an effort to spur economic development, including streetscape redevelopment, construction of indoor shopping centers, historic preservation, and development of the Event Center and Imperial Center. Specifically in small cities, Faulk cites the barriers to downtown revitalization as: 1) the inability to attract new development; 2) difficulty in attracting people on the evenings and weekends; 3) competition from discount stores and malls; 4) clusters of vacant space; and 5) parking infrastructure.

Rocky Mount currently experiences these barriers to development, especially dealing with high vacancy rates across the city center. Many of the current properties would fall under Faulk’s term of a “white elephant” where large, underutilized or vacant properties are difficult to develop yet define the inherent nature of the downtown environment. As a result, Rocky Mount is at Stage 6 of Faulk’s process for downtown revitalization. Rocky Mount developed as a commercial and retail center (stage 1), yet experienced significant decline in the residential population that surrounded the area (stage 2). Subsequently, there was a decline in the retail and commercial space (stage 3) that led to high levels of vacancies and underutilized properties (stage 4). To address these trends the local government and non-profit organizations have advocated and redeveloped significant properties in downtown (Steps 5 and 6) as primarily infill developments; but their efforts over the past 20+ years have left the area to continuously look for other strategies for development.¹¹

As a result, an alternative strategy to downtown redevelopment (stage 6) lies in redefining the downtown market as a whole, rather than continuing with urban-infill development with the hope that interest will

⁹ Brueckner, Jan K.. 2011. Lectures on Urban Economics. Cambridge, MA, USA: MIT Press. Accessed October 31, 2014. ProQuest ebrary.

¹⁰ Faulk, Dagney. 2006. "The Process and Practice of Downtown Revitalization." *Review of Policy Research* 23 (2).

¹¹ Ibid.

grow and be feasible due to the low cost of land. Redefining the market takes the position that acquiring enough land that makes redevelopment profitable at a larger scale creates a new market demand that is feasible. McCormack Baron Salazar, a national real estate development company in distressed communities, aligns with this view arguing that the conglomeration of distressed neighborhoods requires a large-scale development to successfully revitalize the neighborhood.¹²

*To create lasting change, revitalization efforts must achieve **Critical Mass** – the scale needed for a development effort to change people’s perceptions of an area and to cause a shift in the market in the area. When this critical mass is reached, a “**tipping point**” occurs in the market leading to additional investment and new development in the community. Smaller stand alone projects that exist as islands rarely reach critical mass and therefore cannot create lasting change.*

(pg. 15)

From this perspective, assembling a critical mass of properties begins the process for revitalizing a distressed neighborhood and building lasting change.

For example, Galster, Tatian, and Accordiano look to answer the question of using public investment as a trigger for revitalization of distressed neighborhoods. The authors use a post-intervention, absolute-change approach of assessing the target areas of the Richmond Neighborhood Revitalization Strategy, in Richmond, Virginia. Among the findings that strong city and community leadership helped realize success in the 20-year plan, comes the assertion that a critical mass of public investment resources can help spur growth. Additionally, “even more critically, these initiatives were spatially focused so they reached a threshold concentration that stimulated private market activity.”¹³ As a result, the combination of public and private investment helped the city reach a critical mass of resources (in land and in capital) that spurred continued revitalization.

Employing the above strategies raises the question: What threshold of resources and land assembly is sufficient to create a critical mass, or ‘tipping point,’ that changes the local market? The Brookings Institution’s Bruce Katz argues that a critical mass is seen when at least two percent of the metropolitan area’s population lives downtown.¹⁴ However, most would argue that there is not a strict model for

¹² McCormack Baron Salazar. 2012. *A New Paradigm: Strategies for Revitalizing Dallas' Distressed Neighborhoods*. Report for The Real Estate Council, St. Louis: McCormack Baron Salazar.

¹³ Galster, George, Peter Tatian, and John Accordiano. 2006. "Targeting Investments for Neighborhood Revitalization." *Journal of the American Planning Association* 72 (4): 457-473.

¹⁴ Katz, Bruce. 2006. *The 2% Solution: Drawing a Critical Mass of Residents Downtown is Key to Urban Revival*. November 26. Accessed September 2014. <http://www.brookings.edu/research/opinions/2006/11/26newyorkstate-katz>.

development of downtowns. Rather successful downtowns are categorized by varying institutional strengths that provide targeted services for the community.¹⁵

Without a specific model for downtown development, the potential for negative externalities and barriers to implementation must also be considered. For example, realizing a community's vision for downtown development is often a long-term process, and for some can be seen as a barrier for implementation. While implementation can span over several decades, key factors that frame the vision can change, including: local leadership, economic feasibility, and the availability of capital. These changes may also lead to a shift from the original vision for the area. Additionally, the literature, specifically on downtown development, is limited in discussing the negative externalities. As seen in many downtowns, development and increased density is not always a community-oriented process. Often early investors and the local government must pursue long-term strategies that can mitigate the potential for gentrification. So while these barriers and negative externalities exist, the research and financial model presented offer a strong approach that acknowledges the potential impact on the process.

Overall, the literature offers a framework for understanding cities and the benefits and barriers of downtown revitalization. Reinforcing these benefits in Rocky Mount requires employing a critical mass of resources (financial and physical) to realize large-scale and long-term change. Identifying the level of acquisition for a critical mass has yet to be discussed in the literature, demonstrating the need for this project as an example of an acquisition model for one community. Finally, understanding the factors needed to employ these strategies is an iterative process that will be taken through this report.

ROCKY MOUNT'S DEVELOPMENT MARKET

Although Rocky Mount has employed different strategies to incite economic development, there are two persistent issues that limit the viability of development on a small-scale.

1. *Limited Market Feasibility.* Currently, development of individual properties does not offer a profitable return to potential investors.
2. *Scattered Ownership.* This becomes a barrier as multi-site development is contingent on a critical mass of site control.

¹⁵ Ferguson, Gary. 2005. *Characteristics of Successful Downtowns: Shared Attributes of Outstanding Small & Mid-Sized Downtowns*. Draft Research for Cornell University Civic Fellows Program, Ithaca Downtown Partnership.

Limited Market Feasibility

From my work with different public and private-sector property owners in downtown Rocky Mount, I discovered their well-intentioned efforts to redevelop a single property or block of properties has not incited long-term development interests from the private-sector.¹⁶ One tangible example was evident through my work with a downtown property owner in the summer of 2014, as cited above. The owner's 12,000 square foot property was located in the heart of downtown on SW Main Street, on the same block as Citi Trends, a national retailer that saw relatively frequent business in this area. I conducted an assessment of the financial feasibility of development by:

- Analyzing the retail, residential, and short-term housing residential markets;
- Estimating of the development costs and operating income for a recommended program;
- Determining the estimated scale of risk-adjusted returns needed to attract private investment; and
- Evaluating potential financial and structuring options including the use of historic tax credits and other funding options.

In working with the property owner, there was market potential and risks for development, which included:

Market Potential	Market Risks
Several potential developments in Downtown Rocky Mount: South Bank Building, Edgecombe Community College, Event Center	Stagnant growth outside of the Douglas Block
Success of the Douglas Block residential and some retailers	Low market rents to support historic redevelopment
City's infrastructure investment: Streetscape	Proximity to distressed properties
Proposed Brewery Mill project	Limited amenities in immediate area

¹⁶ I was a Graduate City Management Intern with the City of Rocky Mount in the summer of 2013. Additionally, I worked with a property owner in the summer of 2014 to provide recommendations on the financial feasibility of redevelopment.

The potential and the risks framed the analysis of the feasibility of this single site. **After researching the market for residential, retail, or short-term housing uses it was evident that the potential net operating income would not cover the costs of redevelopment.** As a result, the market analysis and financial model, based on conservative assumptions, demonstrated that redevelopment was not financially feasible. The required returns to finance the project could not be met by the market. Specifically, the model showed a 3 percent internal rate of return,¹⁷ where the benchmark is typically 15-20 percent. Also when assessing the equity multiple,¹⁸ the project only saw a 20 percent increase on the equity investment (or 1.2x equity multiple), where the benchmark is typically 1.8x -2.0x.

From this analysis, it was evident why development of a single site was not a strong financial investment in the past. The potential income generated by the property, would not cover the costs of development. **In fact, to make the project feasible and redevelopment a profitable investment, the rental rates would need to increase by more than double.**¹⁹ Given the demographics and location of development, charging 2-3 times the market-rent, especially on a single-site, would be unrealistic on a small property adjacent to other distressed properties.

My research was also substantiated by a CoStar report on recent sales and availability of commercial properties across the City of Rocky Mount. While the CoStar report only looks at a segment of the real estate described in this project, it is important to note this data that is nationally available on the real estate market in Rocky Mount. From Chart 1, the asking rent per square foot declined dramatically during the Great Recession, but has leveled off from its peak in 2012 and 2013. As a result, the five-year average rent per square foot is \$6.22, well below the \$10-\$13 rent per square foot for some commercial (office and retail) properties in downtown Rocky Mount. Additionally, the five-year average of available property is 950,000 square feet, signaling there is an oversupply of available properties and potentially minimal demand for new construction.

Chart 1. CoStar Data for the City of Rocky Mount



While CoStar’s report demonstrates select trends for the entire Rocky Mount market, it also highlights how the data can impact an outsider’s perspective on the profitability of investment. Therefore, it is

¹⁷ The internal rate of return measures the profitability of an investment.

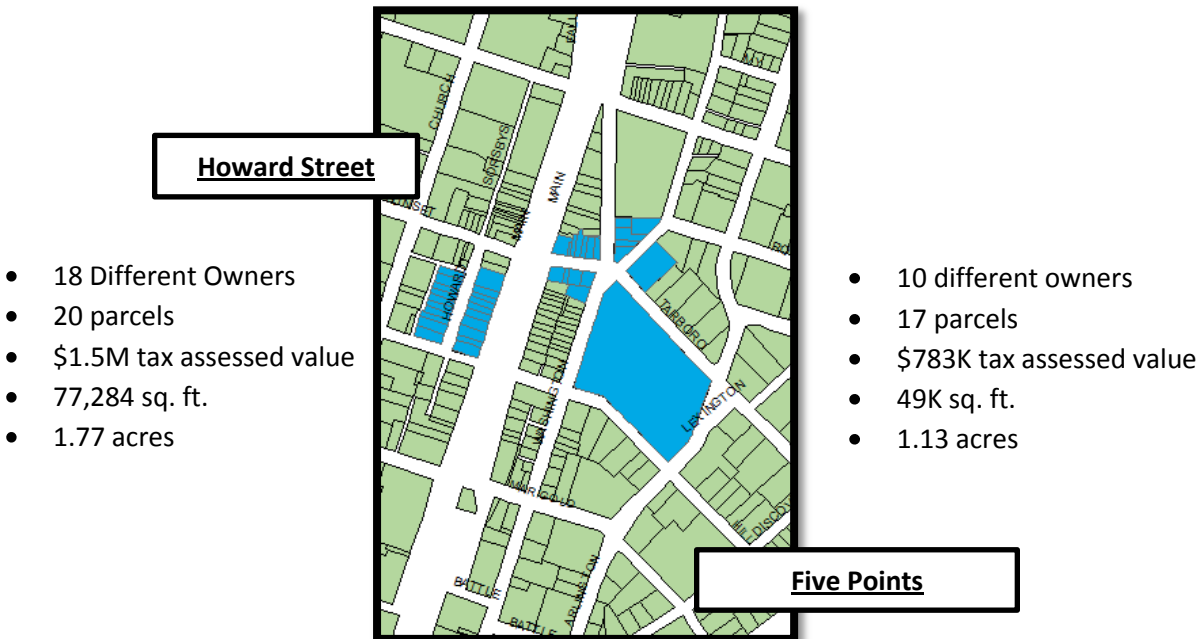
¹⁸ The equity multiple is the ratio of cash flow to equity invested in the projects, measuring how the equity investment is leveraged.

¹⁹ I used a sensitivity analysis to see how increases in the residential price per square foot would affect the IRR of the project.

necessary to *create a market* to improve the feasibility and provide a “**tipping point**” for local and regional private-sector investors to take interest.

Scattered Ownership

Creating a “tipping point” for development is contingent on acquiring a critical mass of property for site control. The process of acquisition is time consuming and can be costly, when looking to acquire a significant portion of the area that would 1) make redevelopment financially feasible and 2) signal a new market for development. A barrier to achieving critical mass is the scattered ownership across downtown, specifically for small parcels. For example, I looked at two key sites for the downtown area, identified by the City of Rocky Mount Downtown Coordinator – Howard Street and Five Points. On Howard Street, to acquire only 77,284 square feet of property one would have to coordinate with 18 different owners. Similarly, in Five Points acquiring only 49,000 square feet of property would require coordination with 10 different owners.



This trend represents ownership across downtown Rocky Mount and presents a major barrier in acquiring critical mass. The returns to investors in the acquisition fund will be impacted by a longer acquisition period to obtain a significant number of built square feet.

PART 2: COMPARISON CASE STUDIES

A number of cities join the City of Rocky Mount in their quest to return to the prominent days of its city center. Acknowledging this economic development goal across many south eastern cities, I looked at two case studies where portions of downtown had a significant number of distressed properties, yet experienced redevelopment due to anchor private-sector investments. Durham, NC and Richmond, VA, two southern cities, both experienced growth due to the tobacco and manufacturing industries. Both communities offer the perspective of how downtowns that thrived on their industrial base have been redeveloping in response to the desire for urban living and due to investments from both the private- and public-sectors.

These case studies will serve as examples of downtown revitalization, while also providing benchmarks for assumptions in the acquisition fund model. An overview of development in these areas will address the context of development, discuss one of several primary (private-sector) stakeholders in development, and assess tax record parcel data regarding the increase in property value over time.

METHODOLOGY

The case studies rely on both qualitative and quantitative methodologies to provide benchmarks for the Rocky Mount acquisition strategy. For both case studies I used recent news articles, local downtown development plans, and interviews with key stakeholders to provide background and context on the acquisition and redevelopment process. I used ArcGIS to outline the study area, then reviewed property tax data in ArcGIS and excel from the local government to provide context on the value and recent sale of properties.

For the Durham case study, I was able to benchmark trends on the sale price per square foot from my interviews with a primary development partner. I analyzed the tax assessed value per square foot of the built square foot and applied a benchmark of \$40 (based on information from interviews) to assess the change in distressed properties. Additionally, I relied on the tax data to summarize the trends in the tax assessed value and vacancy. For the Richmond case study, I analyzed the data on recent sales within the project area in terms of frequency and the average price per square foot. Trends in land prices were analyzed based on the real estate cycle from 1989-2006.²⁰ Noting the timing of the sale in the real estate cycle accounts for the valuation of land nationally and the availability of capital to purchase. Purchasing land after a peak in the real estate cycle often signals an opportunity to acquire land at a lower price.

²⁰ Hanke, Steve. 2014. *The Great 18-Year Real Estate Cycle*. April.
<http://www.cato.org/publications/commentary/great-18year-real-estate-cycle>.

DURHAM, NC

Durham, North Carolina is one of three anchor downtown communities in the Research Triangle Region. However, strong growth in the region did not initially equate to a resurgence of downtown. Specifically, before the 2000s, the majority of downtown's estimated 5 million square feet was distressed.²¹ At that time, minimal public and private investments signaled a disinterest in the downtown area, meaning it soon became an area that was perceived as 'unsafe'. However, over the next decade Durham saw nearly \$1 billion in public and private investments. According to the 2008 update of the Downtown Durham Master Plan, between 2000 and 2007 there were over \$775 million in private-sector investments. Projects like the American Tobacco Campus by Raleigh-based Capital Broadcasting Company, West Village mixed-use developments, and several projects lead by the Greenfire Development represented significant private-sector investments and became anchors for future development from smaller developers in the future.²²

Further information on downtown Durham's investments was offered in interviews with Michael Lemanski, a partner with Greenfire Development.²³ As cited in the Downtown Durham Master Plan, Greenfire Development was one of several private-sector developers that acquired a significant area of downtown Durham (roughly 900,000 built square feet) over a four-year period. Purchasing the properties at an estimated \$40 per square foot, the development company was able to sell several properties for \$100 per square foot over a six-year period. As a result, Greenfire's acquisition of nearly 20 percent of downtown Durham saw an estimated 250% price mark-up over the hold-period. The company's long-term investment in downtown Durham provided an unlevered internal rate of return of ~20 percent and a levered return of ~28 percent. As a result, the company's financial and development investment in the Downtown area helped to signify a turning point in the downtown market.

These trends are substantiated by analysis of property tax data from Durham County.²⁴ From 2001 to 2010, the percentage of distressed buildings, using a benchmark of \$40 per square foot, declined by nearly 30 percent. Additionally, underutilized or vacant parcels declined by 5 percent. Overall development across downtown increased the aggregate tax assessed value by 220%. From these data points, it is evident that Durham experienced significant development over the decade, prompting an increase in downtown's property values.

²¹ UNC School of Government Development Finance Initiative. 2014. "Redevelopment of Downtown Durham."

²² Development Concepts, Inc. 2008. *Downtown Durham Master Plan: Seven Year Review & Updated Work Plan*. Master Plan, Downtown Durham, Inc.

²³ Lemanski, Micheal, interview by Maggie Parker. 2015.

²⁴ Durham County. 2001. "Property Tax Records." GIS Data.; Durham County. 2010. "Property Tax Record." GIS Data.

RICHMOND, VA

The City of Richmond has a long history as an industrial anchor for the southern states, especially as the capital city of Virginia. However, like in many cities the real estate market has fluctuated in the downtown core. In this case, shifts in the transportation for industrial products and the decline of manufacturing had a major impact. For Richmond, one area named Shockoe Bottom experienced this decline as a former industrial core along the James River and adjacent to the various railroad lines. Shockoe Bottom is east of downtown's central business district, nestled between Interstate 95. In an effort to learn more about Richmond's downtown development Jack Betty, Executive Director of Venture Richmond, argued that the visionary for redevelopment in this area was William H. Abeloff. He "got out far in front of the market and took a big risk to create a residential market [in] Tobacco Row ... in the mid-90s."²⁵ My analysis on the Tobacco Row investment, in the context of the Shockoe Bottom area, provides insight into the how private-sector investments can build confidence in the real estate market of a distressed area.

According to the City of Richmond's tax records, William Abeloff purchased Tobacco Row in 1981 with plans to convert the empty tobacco warehouses into a mixed-use development. Abeloff's acquisition proved to be significant, as it represented ~17% of the privately built square feet in the Shockoe Bottom.²⁶ After several years of holding the properties and unsuccessful attempts for redevelopment of the project, he sold the properties to Forest City, a national developer that specializes in public-private partnerships in urban areas.²⁷ Once Forest City acquired the properties in 1989, Tobacco Row opened in 1991 as "a thriving mixed-use, residential district with five multifamily residential buildings with a total of 730 units; [and] one, 137,000-square-foot office building."²⁸

Redevelopment of Tobacco Row has been called the anchor for development of Shockoe Bottom. Analysis of the trends in property values demonstrates the impact of acquiring a 'critical mass' of properties to build confidence in the local market. The analysis reviews the change in property valuation from the City of Richmond's property tax data, and also accounts for an understanding of the real estate market during the time of acquisition. Forest City purchased the property at the peak of the real estate cycle, yet also during a decline in recent sales in the Shockoe Bottom. (Appendix, Table 1) As a result, it is likely that the property value for Tobacco Row was at the lower end of the spectrum because there

²⁵ Betty, Jack, interview by Maggie Parker. 2015. *Venture Richmond* (February).

²⁶ City of Richmond. 2015. "Historic Property Tax Data." GIS Data.

²⁷ Abeloff eventually went into another deal named Rockett's Landing, which was anticipated to be a \$250M waterfront investment in 2004.

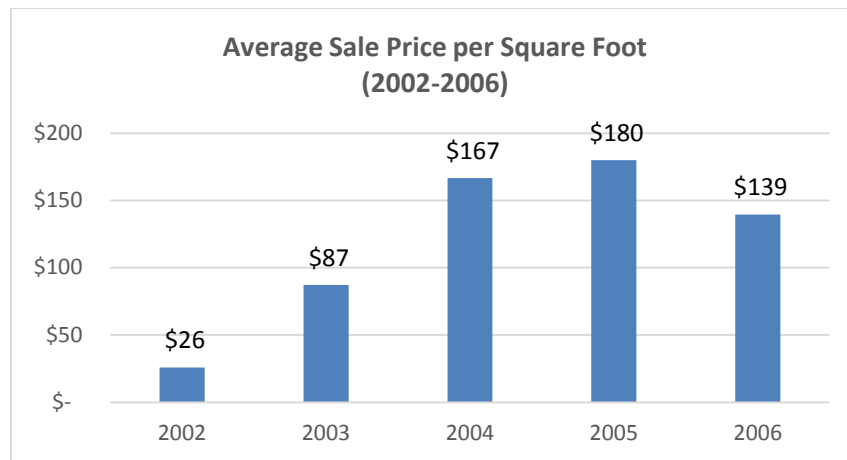
Johnson, Gregory J. and Nicole Gilligan. 2004. "Developers' big plans rolling on the river." *Richmond Times-Dispatch*. July 30. Accessed April. <http://www.kampkewanee.org/articles/abeloff/>.

²⁸ Forest City Enterprises. 2015. *Tobacco Row*. Accessed March 2015.

http://www.forestcity.net/properties/mixed_use/property_listing/Pages/tobacco_row.aspx.

would be less demand to acquire properties during this time. In that year, 1989, the average sale price per square foot was \$44. (Appendix, Table 2) Given the timing of their purchase and renovation in 1991, we see the most significant increase in property values into the peak of the next real estate cycle in 2006.²⁹ Chart 2 shows an increase in property values at their highest levels before the Great Recession. The average sales per square foot increased by nearly 700% from 2002 to 2005.

Chart 2. Shockhoe Bottom Sales Price per Square Foot Trends



These trends signal a greater interest and valuation, particularly in the years after redevelopment of an anchor property, Tobacco Row. As a result, Abelhoff’s vision for the area and Forest City’s later redevelopment of the property signaled confidence in the downtown neighborhood.

KEY FINDINGS

From the analysis of downtown development in both Durham, NC and Richmond VA we see how acquiring a ‘critical mass’ of properties equated to purchasing 17-20% of the built square feet in the project area. The key acquisitions by Greenfire Development and William Abelhoff /Forest City signaled confidence in the real estate market, as the developers took the role of visionaries within downtown. Not only did these initial investors acquire land, likely at a low cost, but their acquisition strategies also set the context for future development. By setting this context, they were able to see significant returns estimated to be 2.5 to 7 times their original investment.

²⁹ Additionally, during this real estate cycle Shockoe Bottoms experiences the most aggregate sales in comparison to other time periods. In fact, most of those sales were adjacent to other recently sold properties, signaling a shift of interest in the Shockoe Bottom market. (Appendix, Map 1)

PART 3: MODELING THE ACQUISITION FUND

In order for Rocky Mount to realize similar development as Durham, NC and Richmond, VA, acquiring a critical mass of properties through an acquisition fund is a strong strategy to catalyze a “tipping point” in downtown. The final section provides an overview of the acquisition model and the overall assumptions that affect the model.

Please see Appendix 2 for the acquisition timeline, cash flow assumptions, and cash flow model that demonstrate the financial feasibility of acquiring nearly 20 percent of the built square feet in the project area. **The model assumes that over a 10-year period, overlapping four years for acquisition and eight years for disposition, investors will see an estimated before-tax internal rate of return of ~25 percent.** As a result, there is potential for a profitable investment to provide a catalyst for development in downtown.

Several assumptions in the financial model account for the potential of a financially profitable acquisition fund. The remainder of this section will address the primary assumptions in the acquisition timeline and the pro forma model. These assumptions affect the opportunity and the risk for development.

- Key Assumptions for the Acquisition Timeline
 - *Project Area to Acquire:* 1.8M privately-owned built square feet
 - *Percentage of Square Feet to Acquire:* 18-20%
 - *Timeline for Acquisition:* 4 years
 - *Estimated Price of Acquisition:* \$10 per square foot
 - *Estimated Cost of Stabilization:* 20% of the acquisition price
 - *Estimated Increase in Property Values at Disposition:* \$20 - \$50 per square foot
- Key Assumptions for the Pro Forma Model
 - *Estimated Debt Leveraged:* 40% of the fund’s value
 - *Additional Revenue*
 - *Estimated Operating Expenses*

KEY ASSUMPTIONS FOR THE ACQUISITION TIMELINE

Project Area for Acquisition

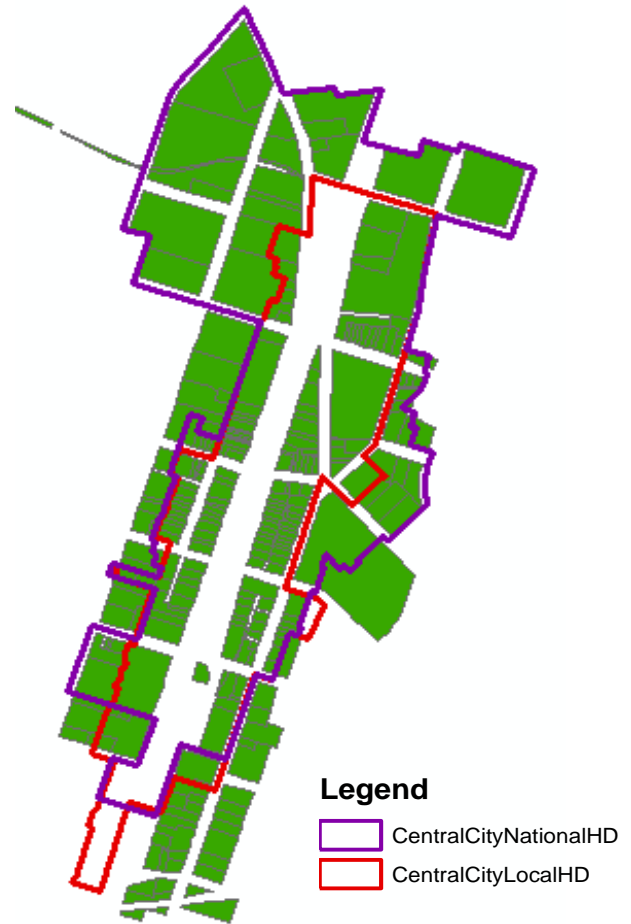
The acquisition fund will target Rocky Mount’s Main Street and adjacent streets within both Nash and Edgecombe counties, as seen in Map 1. The total project area **accounts for 188 properties within 72 acres of downtown. Additionally, 66 percent of the 2.7 million built square feet is privately**

owned.³⁰ These streets encompass the core of downtown, where individual property owners and tenants have demonstrated an interest in redevelopment, but where effort has been scattered. Selection of this project area accounts for the ongoing public sector investments, including the Event Center and the streetscape improvements, location of parcels within the Local and National Historic Districts, and an understanding of the area as the center of Downtown Rocky Mount. Using the historic districts as a boundary for the project area accounts for the potential to use federal historic tax credits on properties within those districts. North Carolina’s state historic tax credits are currently being reevaluated by the General Assembly, with the potential to revamp the once dismantled program.³¹

Percentage of Square Feet to Acquire

The fund assumes that about **~18-20% of the targeted project area** would be acquired, as the estimated critical mass of properties. This target accounts for between 325,000 - 375,000 square feet, where the number of properties to acquire can range from 35-45 depending on the size of the properties. The target of 20% derives from our case studies in Durham, NC (~20%) and Richmond, VA, (~17%) where key acquisitions and development of properties signaled strong confidence in the real estate market. Although the case studies in this report substantiate this estimate, other factors like the assumed access to capital, timeline for acquisition, and assumed growth in price per square foot were additional benchmarks throughout the financial model.

Map 1. Acquisition Project Area



³⁰ The analysis of the project area used only the privately-owned built square feet, where properties that were either vacant or publicly-owned were removed from the calculation of potential properties to acquire.

³¹ Woolverton, Paul. 2015. *House to vote Historic Property Tax Credit bill on Wednesday, could help Prince Charles Hotel*. March 24. Accessed 2015 March . http://www.fayobserver.com/blogs/news/peoples_business/house-committee-passes-historic-property-tax-credit-bill-could-help/article_3cfaf9d0-d22c-11e4-bf1d-033084becaef.html.

It is important to note that other acquisition strategies discussed in this research have acquired roughly 10-30 properties during the same time period, or less. Unlike in the case studies described above, the median built square feet in Edgecombe County is 28,000 and in Nash County is 41,000. As a result, a significant number of properties must be acquired to reach a critical mass, which in this case is defined as 20% of the privately owned built square feet.

Timeline for Acquisition

The model assumes that properties will be acquired over a **four-year period**, within the 10-year duration of the fund. This timeline must account for the scattered ownership across the project area, where ownership of only 20,000 – 30,000 square feet requires a thorough and lengthy process of due diligence to close on the property. This will prove to be a lengthy process, and will also increase the anticipated value of the property from the owners. The model accounts for this increase in valuation (by the property owner) through an assumption of a 5 percent annual increase in both Nash and Edgecombe counties.

Estimated Price of Acquisition

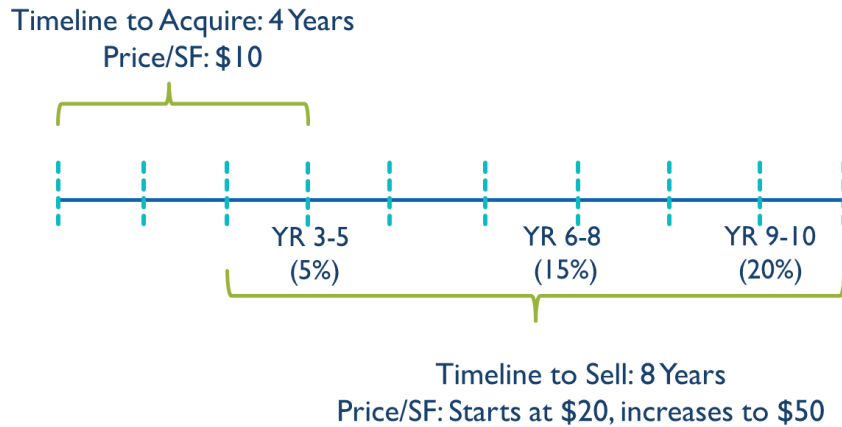
Properties are estimated to be acquired at **\$10 per square foot**, with an anticipated 5 percent increase in valuation as noted above. The estimation is derived from property tax data from the City of Rocky Mount, Nash County, and Edgecombe County to determine the current tax assessed value and recent sales. In the project area located in Edgecombe County, the average tax assessed value per square foot was \$11.63 where recent sales averaged \$7.77 per square foot. In Nash County, the average tax assessed value was \$12.07 per square foot, and recent sales averaged \$13.41 per square foot. Using \$10 accounts for these trends in recent trends and tax assessed value, while also acknowledging that the specific properties to be acquired within the project area are currently unknown.

Estimated Cost to Stabilize Properties

The cost of acquiring properties is also based on the need to stabilize properties to be able to sell in the future. After meeting with leadership of Rocky Mount's Downtown Renaissance Inc., the analysis assumes that 20% of the original cost to acquire must also be accounted for in addition to the acquisition price. These funds will pay for capital expenses like new roofs or structural upgrades to manage the buildings in the short-term.

Estimated Increase in Property Values at Disposition

During the eight years of disposition, the value of the properties are estimated to grow between 2-5 times. The estimated sale prices increase \$5 annually, while also increasing in the percentage of square feet that is sold over the eight-year period, as demonstrated in the timeline below.



Growth in the sale price of properties in both Durham (250%) and Richmond (700%) substantiate the estimated 500% price mark-up. Additionally, when looking at similarly sized downtowns in North Carolina recent sales demonstrate key benchmarks for sales of distressed properties in Rocky Mount. For example, less than 20 miles from Rocky Mount, in Wilson, NC the community of about 49,600 has roughly 3.3 million built square feet in downtown. According to the property tax research, recent sales in their downtown average \$25 per square foot.³² Additionally, in Burlington, NC there at about 51,500 residents with a smaller downtown of about 1.5 million built square feet. In an interview with the Downtown Burlington Corporation, the recent sales of distressed buildings have averaged \$35 per square foot.³³ In fact, a property in bad condition sold for \$13 per square foot, a property in good condition but empty sold for \$24 per square foot, and a two-story property with only one floor renovated sold for \$63 per square foot.

In comparison, Rocky Mount has a population of ~ 57,000 with a downtown of over 2.7 million square feet (which only accounts for the project area). Similarly, to Burlington and Wilson, these communities are on the edge of the Research Triangle region, where a high-growth in jobs and population have signaled strong demand for the growth of downtown. Rather, Wilson and Burlington signal an interest the resurgence of small-town downtowns where the value per square foot sets a benchmark for the potential for an increase in property values, and increased demand, in downtown Rocky Mount.

Sensitivity Analysis

As discussed, the key assumptions impact the feasibility of seeing ~25 percent investment returns. The following analysis demonstrates the sensitivity of these assumptions on the overall financial feasibility of the acquisition fund.

³² School of Government's Development Finance Initiative; City of Wilson, NC. 2014. "Property Tax Data." GIS Data.

³³ Morris, Anne, interview by Maggie Parker. 2015. *Downtown Burlington Corporation* (March 24).

Percentage of Square Feet to Acquire

As the fund acquires more property, or a higher percentage of the built square feet, there is the potential for higher returns. Simultaneously, if the fund acquires less built square feet, there is still potential for a 16 percent return on investment.

SF to Acquire	IRR
235,000	16%
265,000	19%
295,000	22%
<u>325,000</u>	<u>24%</u>
355,000	26%
385,000	30%
415,000	35%

Estimated Increase in Property Values at Disposition

Financial returns are also contingent on the growth in the price per square foot over the 8 years of disposition, which is currently estimated at \$50 per square foot in the final two years of disposition. If the properties are not able to sell at the estimate property value, then the expected returns decline.

Growth in Price per SF	IRR
<u>\$ 50.00</u>	<u>24.0%</u>
\$ 45.00	23.0%
\$ 40.00	22.0%
\$ 35.00	20.0%
\$ 30.00	17.0%
\$ 25.00	14.0%
\$ 20.00	8.0%

KEY ASSUMPTIONS FOR THE PRO FORMA MODEL

Estimated Debt Leveraged

It is estimated that the fund can leverage 40 percent of the total equity raised, \$3 million. This assumption accounts for the high risk of the project, which may discourage traditional lenders. In market-rate deals, it is common to see a 65-75% loan to value ratio for the debt that can be leveraged on the equity in the project.

Estimated Additional Revenue

As properties are acquired, it is likely that a percentage of those properties will be rented for commercial uses. The model accounts for this potential for additional revenue, where 10% of the properties are leased at \$8 per square foot. This additional revenue increases the overall operating income available to investors.

Estimated Operating Expenses

At this stage in estimating the overall costs to manage the fund, the model accounts for maintenance expenses, fund management, and the cost of property taxes. Maintenance expenses would total \$340,000 over the ten-year period to cover expenses like utilities and minor repairs, increasing as more properties are acquired. Management of the fund includes a \$65,000 annual salary to pay for one full-time employee to oversee acquisition, disposition, and overall asset management. Finally, the estimated property taxes use an average of the rates from Nash and Edgecombe counties, also accounting for an increase in the total taxes owed as more properties are purchased.

Sensitivity Analysis

Estimated Additional Revenue

The estimated percentage of properties acquired with additional revenues has an impact on the overall returns to investors, signaling an interest for the fund manager to consider properties that can increase returns.

% of SF with Additional Revenue	IRR
13%	25.9%
12%	25.0%
11%	24.3%
<u>10%</u>	<u>24.0%</u>
9%	23.7%
8%	23.0%
7%	22.1%

KEY FINDINGS

An overview of the key assumptions of the model allows for a strong critique of the feasibility of the acquisition fund strategy. Additionally, acknowledging the sensitivities within the model allow for potential investors to assess their risk in the investment.

IMPLEMENTATION OF THE MODEL

Implementation of the acquisition fund strategy is contingent on selling the validity of the assumptions to key stakeholders in Rocky Mount. To date, I have coordinated two meetings with the President and Treasurer of Rocky Mount's non-profit downtown interest group, Downtown Renaissance Inc. During this time we reviewed the case studies and acquisition model, but also discussed the reality of the acquisition fund as a long-term strategy. Primarily we discussed the additional risks that can be associated with any development, which may include: the timing of the market, surrounding development trends, and the timing of future real estate development. These risks can be significant, but are always unknown in long-term strategies. Additionally, we strategized on options for land owners to participate, particularly discussing how property owners can put their property as equity into the deal. Given these considerations,

our conversations continue to look towards next steps of implementing the acquisition strategy. Our next steps are to continue conversations with a select group of potential investors.

As the community leadership looks towards implementation of the model, it is also important to consider the target areas for acquisition. While acquisition is an iterative process, properties that serve as gateways to downtown or are currently aligned with public sector investments. For example, both the Howard Street corridor and Five Point areas have spurred ideas for an artist-in-residency program and may align with an effort for a greenway connecting downtown to residential neighborhoods.

CONCLUSION

Development and justification of the acquisition fund demonstrates the opportunity for Rocky Mount to use a redevelopment strategy that supports private-sector interest and involvement. Analysis of redevelopment in downtown Durham, NC and in Shockoe Bottom in Richmond, VA reveals concrete findings on estimating the required critical mass of properties for redevelopment. If community leaders continue to pursue this strategy, there is an opportunity to build confidence in the downtown real estate market. Through the process of acquiring and managing properties that inform an overall vision and master plan that spurs redevelopment as the “tipping point” for downtown Rocky Mount.

These findings not only have a local implication, but further inform how secondary cities can apply this strategy within their economic development toolbox. Faulk discusses many strategies led by the local government or non-profit organizations, but this research suggests that downtown development may also employ strategies that cater to private-sector investment interests. As other downtowns look to redevelop, this work has defined a ‘tipping point’ that can be used to benchmark further economic development strategies.

APPENDIX 1

Chart 1. Sales per Year in Shockoe Bottom, Richmond, VA

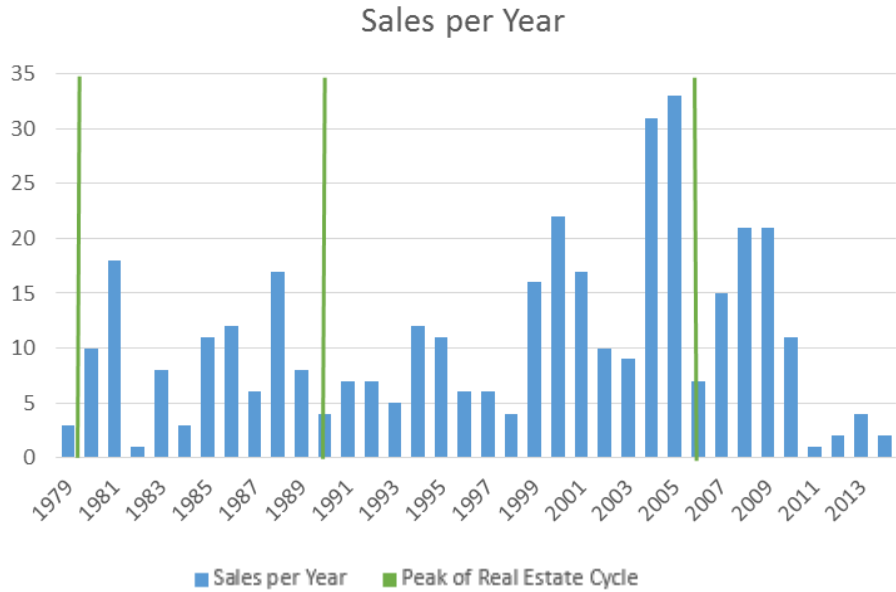
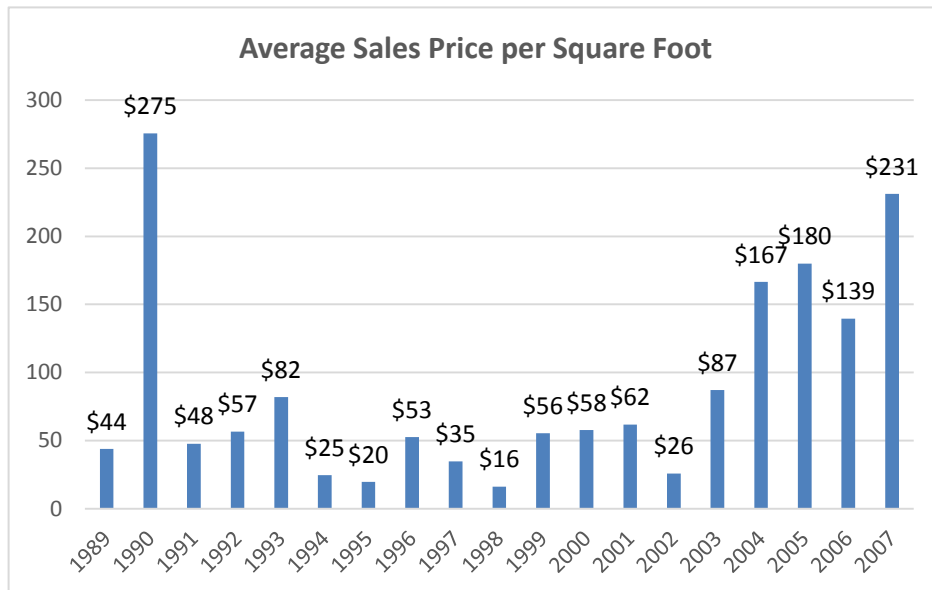
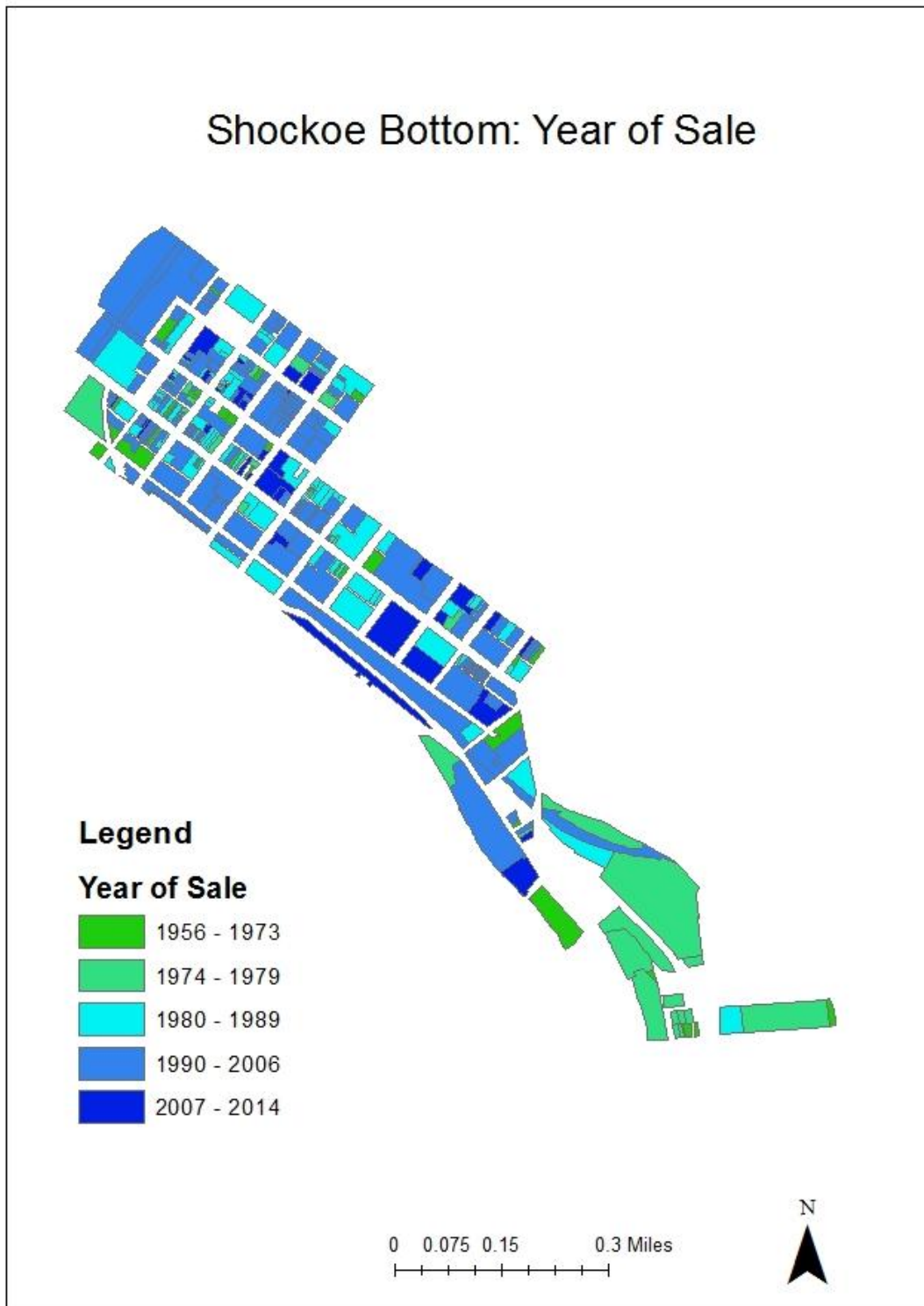


Chart 2. Average Sales Price per Square Foot in Shockoe Bottom, Richmond, VA



Map 1. *Spatial Analysis of Year of Sale in Shockoe Bottom, Richmond, VA*



CASH FLOW ASSUMPTIONS

Cash Flow Assumptions	
Revenue	
Total Build SF	325,000
% of Built SF w/Rents	10%
Estimated Rent/SF	\$8
Expenditures	
Assessed Value (Edgecombe)	\$ 4,317,352
Taxes (Nash)	1.25
Taxes (Edgecombe)	1.475
Average Tax Rate	1.36
Assessed Value Change (2017 Revaluation- All)	4%
Maintenance	\$ 40,000
Fund Management (per YR)	\$ 65,000
Sources of Funding	
Total Cost of Acquisition	\$ 3,000,000
Loan to Value	40%
Loan Amount	\$ 1,200,000
Ammortization Period	30
Interest Rate	5%
Annual Payment	\$78,062
Debt	\$ 1,200,000
Equity	\$ 4,202,372
IRR	24%

ACQUISITION FUND PRO FORMA

	YR1 2016	YR2 2017	YR3 2018	YR4 2019	YR5 2020	YR6 2021	YR7 2022	YR8 2023	YR9 2024	YR10 2025
Disposition Revenue										
Disposition Proceeds			\$325,000	\$406,250	\$487,500	\$1,706,250	\$1,950,000	\$2,193,750	\$3,250,000	\$3,250,000
Additional Revenue										
Net SF (Acquired & Disposition)	81,250	162,500	227,500	293,500	276,250	227,500	178,750	130,000	65,000	-
Estimated SF w/ Rents	8,125	16,250	22,750	29,250	27,625	22,750	17,875	13,000	6,500	-
Estimated Rental Revenue	\$65,000	\$130,000	\$182,000	\$234,000	\$221,000	\$182,000	\$143,000	\$104,000	\$52,000	\$0
Gross Effective Income	\$65,000	\$130,000	\$507,000	\$640,250	\$708,500	\$1,888,250	\$2,093,000	\$2,297,750	\$3,302,000	\$3,250,000
Expenses										
Operating Expenses (Maintenance)	-\$10,000	-\$20,000	-\$30,000	-\$40,000	-\$40,000	-\$40,000	-\$40,000	-\$40,000	-\$40,000	-\$40,000
Fund Management	-\$65,000	-\$65,000	-\$65,000	-\$65,000	-\$65,000	-\$65,000	-\$65,000	-\$65,000	-\$65,000	-\$65,000
Combined Property Taxes	-\$15,920	-\$33,114	-\$49,671	-\$63,681	-\$63,681	-\$63,681	-\$63,681	-\$63,681	-\$63,681	-\$63,681
Net Operating Income	-\$25,920	\$11,886	\$362,329	\$471,569	\$539,819	\$1,719,569	\$1,924,319	\$2,129,069	\$3,133,319	\$3,081,319
Debt Service	\$0	\$0	\$0	-\$78,062	-\$78,062	-\$78,062	-\$78,062	-\$78,062	-\$78,062	-\$78,062
Before Tax Cash Flow	-\$25,920	\$11,886	\$362,329	\$393,507	\$461,757	\$1,641,507	\$1,846,257	\$2,051,007	\$3,055,257	\$3,003,257
Initial Fund Contribution	\$ (3,000,000)									
Cash Flow	\$ -	\$ -	\$ 362,329	\$ 393,507	\$ 461,757	\$ 1,641,507	\$ 1,846,257	\$ 2,051,007	\$ 3,055,257	\$ 3,003,257
Final Mortgage Balance										\$ (972,822)
Total	\$ (3,000,000)	\$ -	\$ 362,329	\$ 393,507	\$ 461,757	\$ 1,641,507	\$ 1,846,257	\$ 2,051,007	\$ 3,055,257	\$ 2,030,436
IRR										
										24%