

Speculative Building Feasibility Study



Prepared for the
Greater Fremont Development Council

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Fremont, Nebraska

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Executive Summary

Introduction, Project Purpose and Background

The purpose of this project is to provide the Greater Fremont Development Council (GFDC) an independent and objective understanding of the need for and feasibility of developing one or more speculative buildings in Fremont or elsewhere in the GFDC service territory. This analysis was prepared by Garnet Consulting Services, Inc., a Connecticut-based consulting firm that specializes in the real estate aspects of the economic development field.

A speculative building – often abbreviated to “spec building” and sometimes also called a shell building – is one where construction is started without knowing who the long-term occupant(s) will be.

The development of speculative buildings occurs throughout the United States, although it is a more common occurrence in some states compared to others. Appendix A provides a list of speculative buildings collected by Garnet over the past 16 years. The list was begun when Garnet was undertaking a similar feasibility study for James City County, VA and is not based on any deliberate research; rather, it contains listings of speculative buildings that appeared in marketing in economic development trade publications, and more recently, websites. Appendix A includes 382 buildings in 35 states, of which 380 are in the United States.

The topic of “virtual speculative buildings” – an approach in which a building design is created in the computer using computer-aided design (CAD) but no construction is undertaken until a prospect commits to the building – is addressed but is not recommended for GFDC due to a lack of demonstrated success of this approach.

In 2016, Garnet prepared an analysis of GFDC’s available real estate inventory to evaluate its suitability for meeting the space needs of prospect companies, particularly in GFDC’s identified target industries. Selected excerpts from that project report germane to this Speculative Building Feasibility Study are:

- The vast majority of GFDC prospects are looking for an existing building rather than a site for construction.
- The majority of prospects seen by GFDC’s economic development allies are looking for an existing building, with 50,000 square feet a common size although there is a fair amount of interest in larger buildings.
- While Fremont receives a healthy level of prospect inquiries of a broad range of sizes, the small inventory of available buildings in the size ranges sought by prospects is limiting success.
- There are [at the time this was written in 2016] only three buildings of adequate size and other characteristics to meet target sector prospect needs in the Fremont area, and two of these are

in North Bend, a considerable distance from an Interstate-quality highway. **This lack of available buildings is a significant competitive disadvantage for Fremont in recruiting new manufacturing or distribution operations to the area.**

- Note: Since this was written, the one available industrial building in Fremont (805 Union Street) has been committed to the Hansen-Mueller Co., leaving Fremont with no inventory suitable to meet most industrial or warehouse needs.

- Note: In its 2016 publication *A New Standard: Achieving Data Excellence in Economic Development*, the International Economic Development Council (IEDC) listed available buildings and sites as the most critical factor reported by corporate real estate executives and site selection consultants in meeting their data needs for the projects they were working on. Current data on Fremont would not show any available industrial buildings.

- The Greater Omaha region has a limited supply of available buildings suitable to meet modern production needs and very few shovel-ready sites; the region is considered risk-averse when it comes to speculative real estate development.

This analysis ended with a series of conclusions and recommendations, the first two of which were:

1. The Fremont area has an extremely limited inventory of available buildings and “ready-to-go” sites for industrial use (manufacturing and/or distribution). Availability of good quality buildings is particularly limited, which is a competitive disadvantage when the vast majority of prospect companies are looking for an existing building.

2. GFDC should consider development of one or more speculative buildings to improve its inventory of available buildings. Given the risk-averse character of the entire Omaha region with regard to speculative development, this will require a more detailed market analysis and/or development prospectus than is contained in this report to determine the ideal size of the building to be developed and the underlying site size.

Market Demand Summary

- As shown in *Site Selection* magazine’s most recent “Governor’s Cup” analysis of project announcements in 2016, the state and region in which Fremont is located receive a great deal of annual project activity (highest in the country on a per capita basis), some of which should be suitable for a Fremont location. Currently Fremont is not the site of these projects, although the Costco project will put Fremont on the list in the future. This situation is not expected to improve if the City cannot offer vacant buildings for occupancy.

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- The Greater Omaha region experiences a significant level of industrial project activity, including both manufacturing and warehouse operations. If Fremont could capture even one more of these projects a year than it currently gets, it would be a good level of success.
 - Prospect and project information provided by the Greater Omaha Economic Development Partnership (GOEDP) shows that the number of manufacturing and warehouse projects looking for a building (167) is greater than those looking for a site to build on (128). It is likely some projects are included in both categories.
 - More than half (88 or 53%) of GOEDP's industrial prospects over the five and one-quarter year period evaluated were less than 50,000 square feet and another 8 were exactly 50,000. Therefore, 57% of the prospect requirements were for 50,000 square feet or less.
 - For a relatively small area, GFDC receives a sizeable number of prospect inquiries each year.
 - Of the 105 GFDC prospects that reported a specific site or building size need during the 2013 – February 2017 period, the preponderance (73%) were looking for an existing building. This is consistent with national experience with prospect requirements where the vast majority (generally 75 – 80%) is looking for an existing building.
 - The most common size range for an existing building for GFDC's industrial and office prospects is 20,000 to 40,000 square feet.
 - The "sweet spot" for development of a speculative building in the Fremont area for industrial or office use is in the 20,000 to 45,000 square foot range where there were 23 prospects (30% of the total). A building at the high end of this range could be subdivided for two occupants.
 - During the time frame analyzed, GFDC had 17 prospects (22% of the total) looking for space less than 20,000 square feet in size. A possibility is the development of a "flex-space" building specifically intended for multiple occupants where the overall building can be custom subdivided to meet a variety of space needs. However, the recent announcement of the intended development of two buildings aimed at smaller users (one in the Christensen Business Park and one on East 1st Street) may meet this need for the near term.
 - The vast majority of GFDC prospects (44 or 57% of the total) looking for a building or space in a building are manufacturing operations. GFDC also receives inquiries from a significant number (13 or 17% of the total) for warehouse/ distribution facilities.
 - A secondary focus could be for those businesses seeking an office environment, either in a building specifically designed and developed for that use, or as occupants of a multi-tenant building.

- Of the 77 GFDC industrial or office prospects looking for an existing building, 33 are shown as having been lost because no suitable building was available. In 29 of the 33, GFDC did not submit on the project because of the lack of an available building.
- It is likely that other projects were lost because of the lack of a suitable building, but this reason was not reported to GFDC. It is also likely that GFDC is not being contacted by other prospects because it is well-known there are almost no available buildings in GFDC's service territory.

Summary: Multiple sources of information underscore the importance of an inventory of available building space in order to be competitive for meeting the real estate needs of economic development prospects. Fremont is very uncompetitive in this regard. There is a demonstrated need for development of new space, particularly for manufacturing and warehouse/distribution uses, in the 20,000 to 45,000 square foot range. While there is also a demand for smaller blocks of space, this market may be served in the near term by the recently announced "small user" buildings to be developed at the Christensen Business Park and on property on East 1st Street.

Market Supply Summary

- This is a simple consideration: while there is some land on which to build, there is essentially no supply of available industrial buildings or space in GFDC's service territory.
- Similarly, there are no freestanding office buildings or large blocks of space to meet office needs. GFDC reports that most small blocks of vacant office space are reoccupied within a short time of becoming available.

Summary: For all intents and purposes, Fremont is out of existing building space for industrial and office uses. As discussed in the section on market demand, this is already curtailing the City and region's ability to locate new companies. Until new buildings are developed, Fremont's competitiveness will not improve and few successes in business recruitment or expansions that require a new location should be expected.

Speculative Building Design Summary

- A rectangular, pre-engineered metal building of 35,000 to 40,000 square feet on a lot that will allow a doubling of space under Fremont's Zoning Ordinance (approximately 2.5 to 3 acres). Architectural and/or landscaping treatments to provide an attractive building at low cost.
- A clear span building or one with minimal interior columns with a clear height of 24 feet.
- A pitched roof to accommodate snow loads typical for the Fremont area. No floor slab poured until user needs are known but planning in place for both a 6-inch unreinforced or 4-inch reinforced concrete deck.

- Utilities stubbed at the exterior building wall until internal utility distribution needs are known. Budget should include an allowance to complete normal utility installation.

- Two sets of docks and drive-in doors should be designed, one at each end of the building in the event the building is occupied by two companies. One set should be installed during construction with the second deferred to determine if they are needed. Truck docks should have levelers. Drive-in doors should be 14' by 14'.

Possible Sites for Speculative Building Development

Fourteen sites were considered as possible locations for a speculative building in Fremont.

For the purpose of siting a speculative building, the City-owned 5.8 acre parcel in the Nelson Business Park is considered the preferred location with a site in the Fremont Business Park a close second. The Nelson Business Park has the slight advantage of having a General Industrial Zone, while the Fremont Business Park's Business Park Zone may restrict some types of industrial operations. The Nelson Business Park also has slightly better access from US 275. However, locating a speculative building in the Fremont Business Park has the added advantage of starting development of the park and demonstrating the level of quality desired there. Both sites have the advantage of City-ownership that can be used to control the land cost for development.

Project Costs

An estimate of major cost categories for building construction, based on use of a pre-engineered metal building, results in a project budget of \$72.45 per square foot. Therefore, a building of 35,000 square feet will have a high end cost of approximately \$2,735,750 while a building of 40,000 square feet will have a high end cost of approximately \$2,898,000. These estimated costs are purposely conservative and likely higher than will actually occur.

Comparables

The real estate website LoopNet (www.loopnet.com) was used to obtain information on industrial buildings in the 30,000 to 50,000 square foot range currently available in the greater Omaha area. An average asking price of \$63.55 was found for the two comparable buildings on the market. An average asking rental price of \$6.45 per square foot per year triple net was found for 26 available buildings. At this average rental rate, a 35,000 square foot building would generate \$225,750 in annual lease revenues to the building owner; a 40,000 square foot building would generate \$258,000 in annual lease revenue.

Cash Flow Analysis

The following table summarizes equity and cash flow requirements during the construction period under normal lending arrangements. GFDC may be able to obtain more preferential rates and terms.

Fremont Speculative Building Construction Period Financial Needs Estimates

Building Size (SF)	35,000		40,000
Building Cost/SF	\$72.45		\$72.45
Building Cost	\$2,535,750		\$2,898,000
Construction Loan			
Loan-to-Value Ratio	0.8		0.8
Maximum Loan Amount	\$2,028,600		\$2,318,400
Equity Requirement	\$507,150		\$579,600
Interest Rate	7.9%		7.9%
Monthly Interest Only Payment*	\$13,371.86		\$15,282.12

*Note: Interest payments were calculated using the Financial Industry Regulatory Authority's website <http://apps.finra.org/Calcs/1/Loan>

An analysis of post-construction permanent financing shows the following:

Fremont Speculative Building Permanent Loan Financial Needs and Revenues Estimates

Building Size (SF)	35,000		40,000
Building Cost/SF	\$72.45		\$72.45
Building Cost	\$2,535,750		\$2,898,000
Permanent Financing			
Loan-to-Value Ratio	70%		70%
Max Loan Amount	\$1,775,025		\$2,028,600
Equity Requirement	\$760,725		\$869,400
Interest Rate	5.40%		5.40%
Amortization Period	25 years		25 years
Monthly Loan Payment*	\$11,645.84		\$12,336.52
Annual Payment	\$139,750.08		\$148,038.24
Lease Rate/SF	\$6.45		\$6.45
Annual Lease revenue @ \$6.45/SF NNN	\$225,750		\$258,000
Cash flow required for Debt Coverage Ratio of 1.48	\$206,830.12		\$219,096.60

*Note: Loan payments were calculated using the Financial Industry Regulatory Authority's website <http://apps.finra.org/Calcs/1/Loan>

Building Sale

The building can be sold at a breakeven price, or priced in order to generate a profit. In a survey of GFDC Board members, 7 of 10 respondents indicated a break-even sale price was acceptable. At the development costs estimated above, the building would have to be sold for \$72.45 per square foot unless actual development costs are lower (or higher, although we do not believe this is likely) to break

even. While this is higher than the current average asking price for Omaha area industrial buildings, some justification for this premium comes from the added value of obtaining a new, modern building with a longer lifespan than the older buildings that are available.

Building Lease

The average industrial building lease in the Omaha area is \$6.45 per square foot per year triple net. As noted earlier, the construction of a 35,000 to 40,000 square foot speculative building offers two options: the building can be occupied by one business needing the entire building, or subdivided into two sections for two businesses needing 20,000± square feet each.

At the currently typical permanent financing interest rate and amortization period, the annual lease revenue at \$6.45 per square foot per year exceeds the cash flow necessary to amortize the loan and is adequate to cover the required debt coverage ratio.

Vacancy Period

A legitimate question is “If we build a speculative building, how long should we plan on it being vacant before it is sold or leased?” The “conventional wisdom” answer in the economic development field is that the most common vacancy period before initial sale or leasing of the building is three years. While development of a speculative building in Fremont cannot be made risk free, we believe the market research reported in this feasibility study justifies the opinion that with aggressive marketing, the building will be sold or fully leased within a 12 to 18 month period.

Implementation Recommendations

This report concludes with a series of recommendations to convert this feasibility study into action that will benefit Fremont. The following is a list of those recommendations which are explored in more detail in the body of the text.

1. Make the commitment to move forward - the time is right to do this NOW
2. Put the GFDC Real Estate Task Force in charge
3. Establish a GFDC – City of Fremont Speculative Building Development Team
4. Determine how GFDC and the City can assist in this project
5. Select a site and get it committed to the project
6. Decide on the exterior building material
7. Pick a building size
8. Research various providers of metal buildings
9. Add a private sector developer to the GFDC – City team
10. Engage an architect to provide final design details
11. Finalize the budget and research available funding sources
12. Prepare a final Fremont Speculative Building Development Plan
13. Design and implement an aggressive marketing program
14. Pull the trigger – DO IT

Conclusion

The evidence is clear that Fremont’s economic development efforts are being impeded by a lack of available industrial buildings. Fremont is located in an active area that attracts significant interest by business prospects – but the vast majority is looking for an existing building. This problem impacts both companies considering Fremont as a new location as well as local companies needing a new building. If the City and region’s investment in economic development is to generate the return on investment it should, real estate product must be developed. This Feasibility Study demonstrates how this can be done at reasonable risk through the development of one or more speculative buildings. Risk sharing – and increased economic development success – are possible through a partnership of GFDC, the City of Fremont and one or more private developers.