

MEMO

DATE: November 2, 2022

TO: HD McMinnville LLC

FROM: Jerry Johnson, Johnson Economics

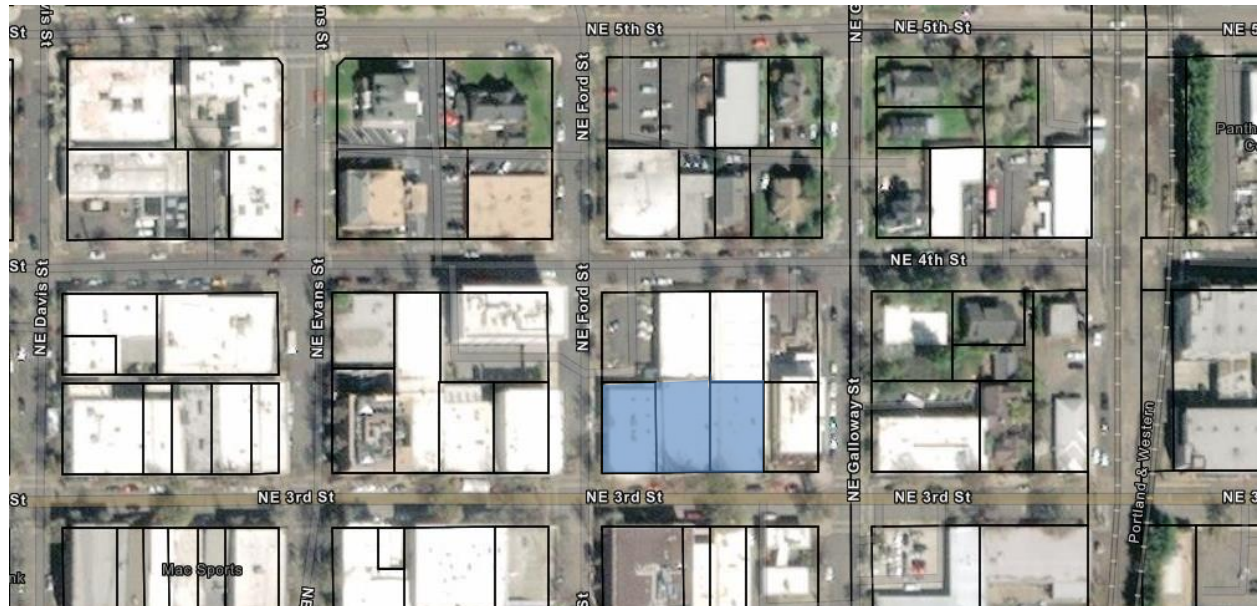
SUBJECT: Economic Value of Structures in Downtown McMinnville, Oregon

Johnson Economics was asked to provide an assessment of the economic value of existing structures on a site in downtown McMinnville, Oregon. The property is expected to be redeveloped as a full-service hotel, necessitating demolition of the existing structures. The site contains three structures at the following addresses:

- 609 NE 3rd Street
- 611 Ne 3rd Street
- 619 NE 3rd Street

Alternatives to removal of the buildings and construction of a new hotel on the property include retaining the existing buildings and constructing a new hotel above the current structures, retaining the existing buildings, and relocating the buildings.

FIGURE 1: SUBJECT SITE



SOURCE: Google Earth, JOHNSON ECONOMICS

The three existing buildings are unreinforced masonry, and the current physical condition of the building is poor. The following is a summary of structure issues documented during a visual inspection by Harper Houf Peterson Righellis Inc., an engineering firm.

609 NE 3rd

- Deteriorated roof framing over the original 2nd floor offices
- South brick wall is deteriorating, and the mortar is no longer sound
- A roof truss is displaced, ends of roof framing rotten at bearing locations
- The original exterior brick work has been plastered over

611 NE 3rd

- Built up beams supporting roof columns do not appear to align with the beam lines in the floor below
- Perimeter wall is unreinforced brick
- Shared wall with the 609 building
- Deteriorated inside face of walls

619 NE 3rd

- Roof trusses rotten at ends, mitigated by built up supports added later
- Perimeter wall is unreinforced brick
- Shared west wall with the 611 building
- The east wall exterior has significant deterioration

Bringing unreinforced buildings into compliance with current structural codes is both difficult and costly. To be compliant with current codes would effectively require that new structures be built, with the existing exteriors treated as veneers. The cost of completing this type of work is significantly higher than new construction. The buildings have shared walls and physical contact and upgrading to current seismic standards would require a joint structure within the three buildings.

Keeping the buildings in their current use would negate the requirement to upgrade the structures but would also limit the amount of investment that could be made within triggering the requirement. The buildings have structural deficiencies and obvious deterioration that would need to be addressed prior to re-tenanting in any of the buildings.

Building the hotel above the existing structures would require a complete seismic upgrade of the structures, and new columns to support the hotel would need to penetrate the structures. The cost of this type of structure would be substantially higher than new construction and the resulting development would be significantly less efficient.

As a result of these myriad factors, the retention of the existing structures would cause substantial financial hardship to the owners. Based on our previous experience, the likely cost of the necessary improvements and upgrades would render the cost of space to likely be hundreds of dollars more per square foot than new construction. If the redevelopment was not done and the buildings were kept in their current use without significant upgrades, they would pose a life safety hazard and may not be insurable. The structures are depreciated to a point in which investments in the structures would be unlikely over time as they would not yield an economic return. As a result the properties would be likely to face an extended period of declining condition and underutilization for the foreseeable future.

The proposed new hotel would provide significant economic value on the site, supporting the ongoing positive investment patterns in downtown McMinnville. Keeping the existing structures would effectively preclude new investment on the site, and result in underutilization of the parcels while yielding no economic return.

I. ASSESSMENT OF ECONOMIC RETURNS

Renovating the existing structures for hotel use would yield a highly inefficient structure. The anticipated yield would be as follows:¹

- 5,600 SF of Retail Space
- 3,800 SF of Restaurant Space
- 3,200 SF Hotel Lobby/Lounge
- 3,790 SF Hotel Back of House
- 7,950 SF of Guestrooms
- 3,560 SF of Circulation
- 600 SF Hotel Amenity

Removing the retail and restaurant space from the calculation, the leasable guestroom space would account for only 41.6% of the hotel.

Renovation of the site for lodging uses would require a significant investment in restoration to bring the structure into conformance with current code. The estimated current costs to develop this program is just under \$20 million in current dollars (excluding acquisition), with an overall cost of roughly \$25 million. The projected net operating income at stabilization is estimated at \$580,500, representing a 2.3% return on cost.

The estimated capitalization rate for this type of project is likely in the 6.5% to 7.5% range. Assuming a 7.0% cap rate, the estimated value of the project would only be \$8.3 million in this configuration, roughly a third of estimated costs. While the assumptions may shift, renovation of the current structure for retail and hotel space is highly unfeasible.

Renovation of the structure does not provide the owner with a “reasonable economic use”. There would be no expectation that the property owner or a rational developer would pursue this project as a renovation.

¹ OTAK