ECONorthwest
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DATE: October 17, 2023
TO: John Czarnezki, City of Soldotna
CC: Jason Graf, First Forty Feet
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SUBJECT: Soldotna Riverfront Redevelopment, Feasibility Analysis Results - FINAL

The City of Soldotna aims to transform an 85-acre downtown area into a vibrant mixed-use, waterfront, appealing to both locals and visitors. To achieve this vision, the City has partnered with a team of consultants led by First Forty Feet to create a Master Plan, which will guide future development. While the initial market analysis identified demand for various amenities including retail, restaurants, lodging, and housing, it is essential to note that this analysis did not assess the financial feasibility of constructing buildings to accommodate these uses.

It is important to understand that the presence of demand for these amenities, as identified in the market analysis, does not necessarily translate to people being able or willing to pay the necessary amounts to build and support new development. Even if there is a demand for a particular amenity, it may not materialize if businesses cannot afford the rent needed to support the costs of a newly developed space.

The Master Plan provides a long-term vision for the waterfront redevelopment project. ECONorthwest, a sub-contractor working with First Forty Feet, has been tasked with exploring catalytic opportunities in the near term. During this process, several crucial questions need answering, including: What scale of development is currently feasible in the project area, and what level of City support will be required to facilitate development that is not-quite financially viable without City participation?

> **Why is development feasibility and pro forma analysis important?**
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> Development can be costly and risky. Getting funding to construct new development requires lenders and investors to be reasonably confident they will earn enough financial return to justify the risks.
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> Economic or market feasibility is generally assessed by comparing the expected revenues (home sales, net income from rents, room rates) against the costs of development. If a development is not feasible, it will not be built. While some of the factors that determine market feasibility are outside a jurisdiction's direct control (e.g., labor and materials costs, interest rates, market rents), local jurisdictions can provide incentives (such as tax exemptions, land donations); or adjust building, utility, and zoning fees, zoning, programs, and other regulations that can have a substantial impact on whether development could be feasible or not.

To address this, ECONorthwest conducted a high-level feasibility study on four development types based on the Master Plan and discussions with the City. These development types include mixed-use, multifamily, townhomes, and hotel. The purpose of this study is to provide insights into the feasible scale and types of development for the initial "catalytic" phase, which is intended to kickstart future development of the desired scale. It is important to note that the findings from this study do not preclude the possibility of future phases of development achieving the scale that may be currently infeasible. On the contrary, the catalytic phase is intended to stimulate future development at the desired scale.

Methods and Data

Although we conducted a quantitative feasibility analysis, observations of new construction for these uses are limited in Soldotna and on the Kenai Peninsula as a whole. Limited observations mean less data to inform a quantitative analysis. We therefore relied equally on a qualitative analysis (e.g., interviews with stakeholders) to inform our recommendations.

Given the limited local observations that align with the scale of development outlined in our Master Plan, we needed to expand our review scope to identify comparable benchmarks (rents and sales prices) for new residential and mixed-use developments to include the broader Kenai Peninsula area and Anchorage. This broader perspective is a common practice when a city seeks to develop projects for which there are limited local examples. For the hotel sector, our data encompasses the entire Peninsula, reflecting the fact that tourists generally explore the entire Peninsula during their visits, making the specific location of their stay less critical. Therefore, Soldotna's competitive positioning within the Peninsula as a whole becomes a key consideration.

It is also important to highlight that some of our assumptions are based on industry standards. We derived operating costs for hotels from Anchorage due to data availability, while construction costs are based on national averages with an Alaska-specific multiplier to account for the unique building conditions in the state. Additionally, industry standards were applied to factors such as fees and operating costs, adjusted to align with the Alaskan context. For more detailed information on data and methods please refer to Appendix A.

Recommendations and Findings

Achieving a balance between fostering new development that yields higher rents and ensuring affordability and accessibility for existing residents is paramount. The success of this project hinges on its ability to benefit current Soldotna residents as well as new residents and tourists. Key findings are included below.

- Mixed use and multifamily are *currently* not feasible.

- Townhomes are more feasible, especially with lower cost land.

- A hotel could be feasible but would need enhancements such as riverfront views, a restaurant/bar in the hotel, or broader riverfront redevelopment that enhances the attractiveness of the area.

- City participation and phasing will be necessary to stimulate desired development and ensure affordability and accessibility for Soldotna residents.

Proposed phasing that balances attracting private market investments and preserving affordability for residents is included in the Conclusion and Next Steps. Additional details on implementation will be included in the Master Plan, the next phase of this project.

Residential and Mixed-Use Feasibility Analysis

ECONorthwest completed a financial analysis for residential and mixed-use development that models a developer's decision-making process and cash flow equation for multiple prototypical developments, or *prototypes*. We created a pro forma model to test the financial feasibility to understand how the City could incentivize housing production. We drew our initial market and construction cost insights from sources such as Costar, Redfin, and Craftsman, and then vetted those assumptions with local developers and brokers. Ultimately, this type of assessment will help the City understand the likelihood of developers producing residential and mixed-use development under different scenarios.

Market Analysis

The market analysis showed demand for retail and restaurant space as well as housing for both ownership and rental. However, it raised questions of whether current market rents in Soldotna could sustain new development. Stakeholder interviews echoed this concern, highlighting worries about paying higher rents for commercial space and rental housing. The market analysis also highlighted that the project area lacks entertainment, services, and retail options which could make it more challenging to attract mixed-use and higher end development.

What types of development did we analyze?

To begin, ECONorthwest modeled three prototypes: townhomes, multifamily apartments, and mixed-use apartments (with ground-floor retail), as shown in Exhibit 1. We based the prototypes loosely off various, recent developments on the Kenai Peninsula and in Anchorage. Some recent development that informed these prototypes are shown in Exhibit 2. Though the scale of development ranges substantially in these areas, we triangulated an approximate prototype development that might be possible in Soldotna and could deliver on City goals.

Exhibit 1. Development Prototypes Evaluated
Source: ECONorthwest

#	Type	Description	Tenure
1	Townhomes	2-story with garage	Ownership
2	Multifamily Apartments	3-story with surface parking	Rental
3	Mixed-Use Apartments	3-story with surface parking and retail	Rental

Exhibit 2. Comparable Developments
Source: Redfin, Loopnet, Costar, Apartments.com

| Townhomes	Multifamily	Mixed-Use
Anchorage	Seward	Anchorage

Financial Analysis

How do we measure development feasibility for residential and mixed-use?

To model development feasibility, we employed a pro forma model and used a residual land value (RLV) metric, which measures the land budget a developer would be left with after accounting for potential development costs and revenues.

Exhibit 3: Example of Feasible Development using Residual Land Value (RLV) Model
Source: ECONorthwest.
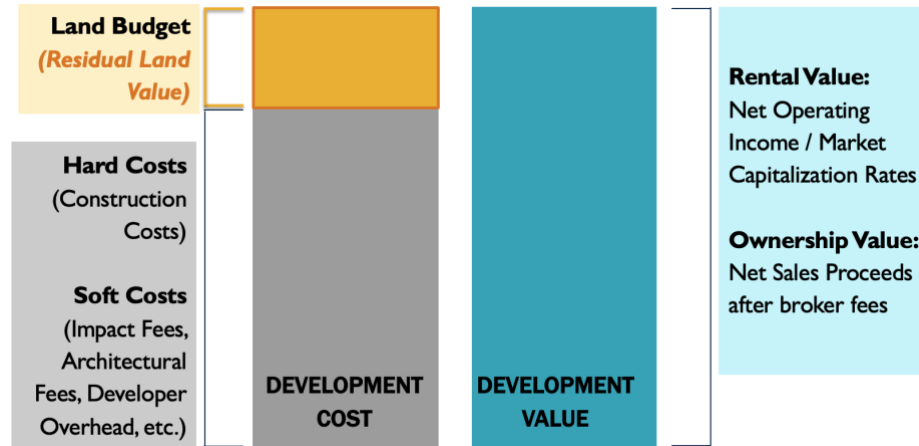
If the RLV is equal to or above land prices in the potential development area, the development is considered feasible at market rate. If the RLV is zero dollars, the development could be feasible if the land were donated for free. However, if the RLV is less than zero, the development is likely infeasible unless a developer receives additional subsidies or incentives, including free land. Please note that results from this method describe a general analysis of prototypes and does not consider the many potential unique conditions that could be factors in development feasibility (e.g., increased predevelopment costs, low land basis from longtime land ownership). For these reasons, residual land value analyses should be thought of as a strong indicator of the relative likelihood of development, rather than an absolute measure of return to the investor or developer.

Baseline Pro forma

In our feasibility analysis, we used key financial data like rent, operating costs, and development expenses for each prototype. To evaluate rental prototypes, we determined the leasable square footage, calculated revenue, deducted vacancy and operating costs (such as taxes, insurance, maintenance, management, select utilities) and arrived at the annual net operating income (NOI). For the ownership prototype, we calculated gross sales price and subtracted commissions.

We calculated development costs by applying the cost per square foot values to different product types (e.g., residential, retail) and adding parking costs. We then summed those values to a total hard cost and calculated the soft cost, contingency, and developer fees to arrive at the total development cost.

To evaluate rental prototypes, we used a debt service coverage ratio (DSCR) to arrive at the supportable land budget (residual land value). DSCR, a financial indicator frequently used by lenders, gauges available cash flow for loan payments and potential profit. This ratio, expressed as net income (after vacancy and operating expenses like property taxes) relative to debt payment, ensures a revenue buffer to minimize the risk of default and foreclosure (i.e., 1.25 DSCR).

For the ownership prototype, we determined the land budget by subtracting total development costs from gross sales less commission and a spread on cost to account for profit. Both rental and ownership prototypes were subjected to a calculation dividing the total land budget by site square footage, arriving at a residual land value per square foot. See Exhibit 4 for detailed assumptions.

Exhibit 4. Assumptions for Development Prototypes Evaluated
Source: ECONorthwest based on market research

Assumption	Townhomes	Multifamily Apartments	Mixed-Use Apartments
Total units	4	60	65
Lot size	10,000 sf	65,000 sf	65,000 sf
Retail area	N/A	N/A	5,000 sf
Unit mix	100% 3-bedroom	20% studio, 45% 1-bedroom, 35% 2-bedroom	20% studio, 45% 1-bedroom, 35% 2-bedroom
Average unit size	1,750 sf	690 sf	690 sf
Average market rent per month*	N/A	$1,200 ($1.75 per sf)	$1,250 ($1.80 per sf)
Average sales price*	$615,000 ($350 per sf)	N/A	N/A
Vacancy expense	N/A	10%	10%
Operating expenses per unit	N/A	$2,400	$3,300
Construction cost per square foot	$190	$250	$250
Total construction cost	$1,650,000	$16,480,000	$19,550,000
Debt service coverage ratio	N/A	1.25	1.25
Spread on cost	10%	N/A	N/A
Residual land value	$95,000	($2,150,000)	($2,640,000)
Residual land value per square foot	$9	($33)	($41)

*This assumption is inclusive of modest market escalation during construction

Predicting a price that a landowner would sell property for development is an imperfect science – each landowner has reasons to sell or hold their land. Some property owners are willing to develop their land without selling. For the purposes of this analysis, we assumed the value of the property (i.e., the price of the land at which an owner would be willing to sell) could be observed through assessed values according to the Kenai Peninsula Borough 2023 assessor data (accessed via the KPB GeoHub). Therefore, this memo compares the feasibility of housing development to current average assessed values, which may present more favorable feasibility results depending on market dynamics.

We identified vacant and improved land in Soldotna according to use type in the assessor data. Most of the parcels are considered improved – approximately 72% of Soldotna is improved. In these cases, redevelopment will not only need to generate enough revenue to cover the costs to build and provide a return to financial partners, but it will also need to generate more revenue than an existing use. The price for improved land is substantially higher than vacant land – improved land averaged approximately $17 per square foot of land and vacant land averages approximately $3 per square foot of land. These values are based on Soldotna properties.

In the riverfront redevelopment area specifically, there is a mix of vacant and improved land. We therefore compare the feasibility results to the average value of vacant land (on the low end) and improved land (on the high end). On column charts showing feasibility results, two dashed lines are shown to represent this range of average land value (per square foot of land). These dashed lines can be viewed as a hurdle for development to exceed – the financial feasibility (the residual land value) must be at least somewhere between these lines, if not above the average improved land line.

Findings and Considerations

Current rents do not support mixed-use or multifamily development.

Average observed rents on the Kenai Peninsula, and even as far as Anchorage, are less than $2 per square foot for recent construction. Most of the observed comparable developments are achieving rents closer to $1.50 per square foot. Assuming rents in this range, multifamily and mixed-use developments are not financially feasible as shown in Exhibit 5. When RLV is negative, which is the case here, a developer would need the land for free and a subsidy to justify development.

Exhibit 5. Multifamily and Mixed-Use Apartment Results
Source: ECONorthwest
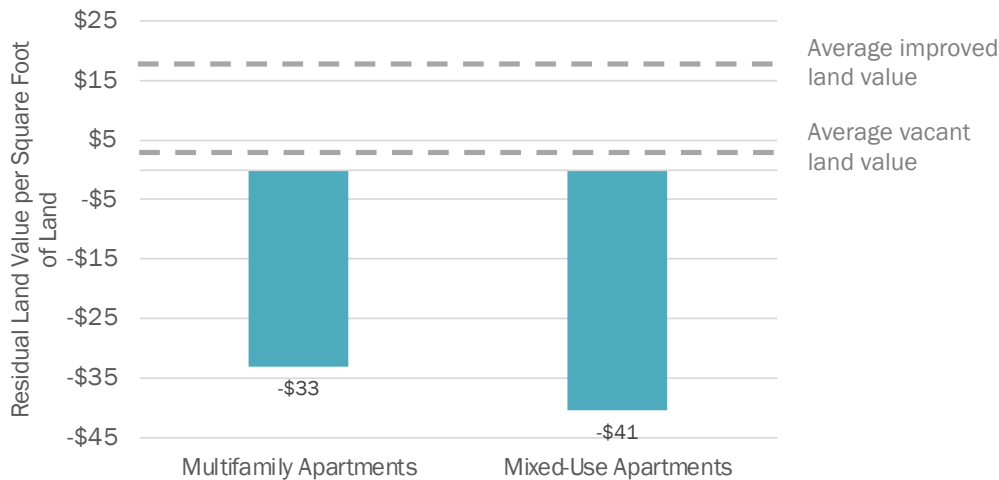
Based on our sensitivity analysis, rents would likely need to increase substantially, to at least $2.30 per square foot, for mixed-use or multifamily development to be financially feasible.

Townhomes are more feasible, especially with lower cost land.

Relative to the apartment prototypes, townhomes are substantially more feasible. Average observed sales prices for new construction townhomes are around $250 to $325 per square foot in Soldotna, Kenai, and Anchorage. Townhomes in Homer are selling for even higher, with a couple currently listed around $1 million per unit.

Assuming the average comparable sales price, this prototype achieves a positive residual land value of approximately $9 per square foot of land meaning that townhomes likely do not need an additional subsidy if land is available at this price. The City could offer land at this price to help catalyze new housing development.

Exhibit 6. Comparison of Townhome Results to other Prototypes
Source: ECONorthwest
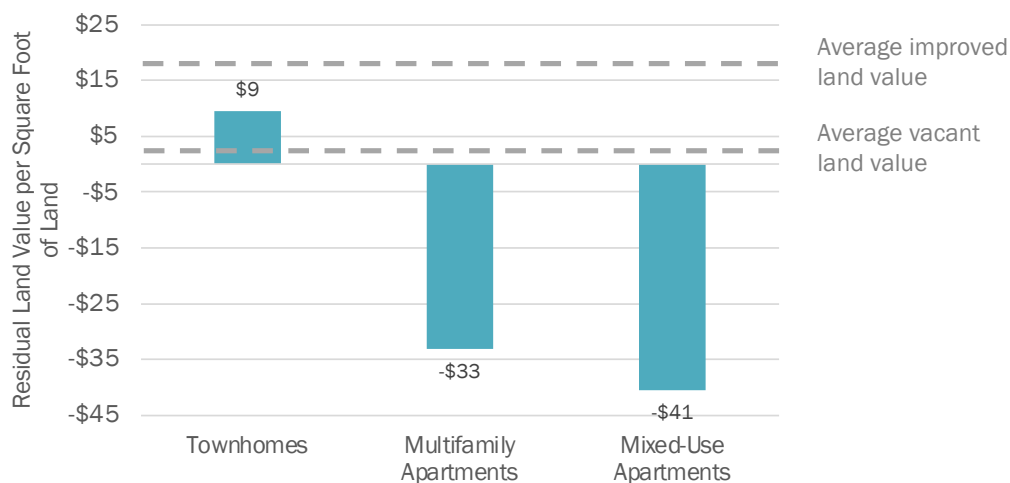
There are ways to make development more feasible.

- **The City could offer land for free, as part of a development agreement, to attract residential developers.** Multifamily / mixed-use development is far from feasible, but free land will help if conditions change or if paired with other incentives. Donated land can be catalytic for townhome development. Subsidizing cost of land signals to development partners the City is invested in stimulating development.

- **Advertise fast-track permit review time for development proposals in this area.** Faster permit review can reduce costs and risk and increase feasibility.

Soldotna Hotel Feasibility Analysis

ECONorthwest completed a financial analysis for a hotel development in Soldotna. We modeled the baseline cash flows for a new hotel from construction through its first 15 years of operations. It is a baseline because we modelled a basic hotel. We made assumptions using limited data on the market and construction costs. Also, we did not include potential enhancements that may improve future cash flows.

The result of our analysis is a baseline financial forecast or pro forma. Investors often use pro formas to decide whether to build a new hotel. It also helps us understand the prospects for a new hotel in the redevelopment area.

Feeding into the pro forma is an analysis of the local hotel market. For this, we used historical market data for the Kenai Peninsula. The data originate from Costar. They, through their subsidiary, STR Global, obtain operating data from hotels.

Market Analysis

The data show that the hotel market in the Kenai Peninsula rebounded strongly after the COVID-19 pandemic. Both room rates and occupancy rates rose. However, recent uptrends are not predictive of higher future rates. Markets are dynamic. Higher room rates bring in higher profits. The industry responds by building more rooms. This causes occupancy rates (number of room nights sold as a percentage of room nights available) to decline. Competition compels hoteliers to offer lower rooms rates to attract more guests. The average daily room rate (ADR) in the market drifts lower. ADR is the average room rate charged before taxes and amenities. This process takes time. While ADRs change daily, it can take years to build a new hotel so that supply adjusts. That timing difference is why the hotel business is cyclical. Currently, in the Kenai Peninsula, we are amid an upcycle.

While trends are not predictive, an analysis of historical hotel data can be. We use that data to find the level at which the long-run supply and demand for hotel rooms are in balance. It is called the natural occupancy rate. Natural occupancy rates vary by market based on factors like climate and visitor mix. When doing a forecast looking out many years, it is prudent to assume the market will trend towards the natural occupancy rate.

In the market analysis, ECONorthwest estimated the historical ADRs and occupancy rates of local hotels. ECONorthwest's analysis shows the Kenai Peninsula market has an annual average natural occupancy rate of 66.2 percent at a real ADR of $169.40.[1] At those rates, there is no undue upward or downward pressure on room rates (excluding effects of inflation). Currently, according to Costar, the market is running at 68.6 percent occupancy and an ADR of $180.[2] It is higher because the market in in the middle of an upcycle. Conditions favor the addition of some more hotel rooms.

Based on this analysis, we estimate the market can absorb 62 more hotel rooms and remain suitably profitable. The addition would bring the long-term supply and demand of the market in balance.[3] Therefore, we built a pro forma for a 62-room hotel in Soldotna.

Financial Analysis

How do we measure development feasibility for hotels?

To gauge the feasibility of hotel development, we use the internal rate of return (IRR). An IRR is the compound annual rate of return an investor should expect to make on the hotel project over many years. If the calculated IRR meets or exceeds the required rate of return, the development is deemed feasible; otherwise, additional financial support may be needed. This IRR-based analysis provides an understanding of potential returns and overall project viability.

The required rate of return is influenced by factors like investment risk, market conditions, and investor expectations. It reflects the minimum acceptable return for the project and typically considers aspects such as cost of capital, anticipated inflation, and risk level in comparison to alternative investments.

Why use IRR instead of Residual Land Value (RLV) for hotels?

A cash flow model that solves for an IRR is a more robust analysis of feasibility than RLV, but it requires additional assumptions. Unlike residential and mixed-use development, hotels have a longer stabilization period to achieve their desired occupancy rate. Hotels also have more complex operating costs with more variables. A cash flow model that results in an IRR allows us to better approximate these conditions.

A pro forma that solves for an RLV is often a first step in gauging initial feasibility for development like residential and mixed use. Based on initial findings a developer may then pursue the more robust IRR analysis later.

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[1] $169 is expressed in January 2023 dollars. ADRs of past months were adjusted for inflation in the analysis.

[2] We caution that too few hotels participated in Costar's survey to provide us with statistically significant results However, while the Costar survey data had limitations in terms of statistical significance, conversations with city staff and relevant stakeholders, along with data from sources like Placer.ai, confirmed a growing trend in tourism and increased hotel occupancy and room rates.

[3] This is based on market data through January 2023. However, the 35-year demand growth rate was 1.7 percent. Therefore, each year the market would need an additional 26 hotel rooms to remain in balance. That assumes demand grows at the historical rate. In addition, old hotel rooms may be removed in the market because of closures or conversions. These too would need to be replaced.

Developing a brand-new hotel is risky. Investors face challenges related to construction, uncertain timing, cost overruns, and the complexities of starting, staffing, and making a new hotel profitable. For these ventures, an appropriate IRR is around 14% (currently) although some hoteliers may be satisfied with less. A quick rule of thumb for estimating good returns is to double the mortgage rate.

Baseline Pro forma

Our financial analysis starts with an estimate of the cost to open. These costs are based on constructing an upper midscale to upscale hotel with 62 rooms. This is based on construction data for Alaska and information from comparable hotel developments nationally. It is important to note that there is great variability in opening costs. Local conditions, the style of the hotel, the availability of construction supplies and labor, and shipping costs all affect costs. Our estimate serves as a starting point. Ultimately, the cost may be substantially different than shown below in Exhibit 7.

Calculating IRR

The IRR is the value that makes the sum of the future cash flows, when adjusted for time and interest rates, equal to the initial investment. This is essentially finding the interest rate that makes the project's cash inflows and outflows balance out.

Since this formula involves solving for an unknown rate (IRR), it's often more convenient to use financial calculators, software, or spreadsheet functions to calculate IRR rather than solving it manually.

Exhibit 7. Cost to Open the Soldotna Hotel
ECONorthwest analysis utilizing HVS Hotel Cost Estimating Guide (2021)

Component	Cost
Land	$ 1,496,082
Building site & improvements	$ 12,452,397
OSE (Operating supplies and equipment)	$ 2,102,604
FFE (Furniture, fixtures & equipment)	$ 1,763,126
Preopening & working capital	$ 549,320
Developer fees	$ 519,310
Cost to open	**$ 18,882,839**

We forecast the cash flow for the hypothetical hotel using industry average operating costs for hotels in Alaska. The data for this came from STR Global. The number of participants captured in the STR data were sufficient to assure a statistically significant result. The participants were branded hotels in the mid to upscale categories. A branded hotel is one that operates under a major flag, such as Marriott. In exchange for branding, the hotel operator pays management and franchise fees. They receive marketing support, access to hotel loyalty programs, training, and other forms of support in exchange.

The pro forma covers the construction period (2025) and 15 years of operations (2026 – 2040). The first eight years of operations are shown in Exhibit 8. Note that the forecast include inflation. ECONorthwest projects inflation of 4.2 percent in 2025 with it gradually falling to 3.4 percent per year in later years. Room sales at new hotels typically take 36 months to stabilize; starting off slow and gradually building. The pro forma assumes the Soldotna hotel is branded and reaches a stabilized occupancy rate of 66.2 percent in the third year. We assume a room rate of $169.40 in 2023 dollars, which is adjusted for inflation in the pro forma. The ramp up explains why the expected cash flow or "earnings before interest, taxes, depreciation, and amortization" (EBITDA) rises quickly between 2026 and 2028, but after the third year merely rises with inflation.

Exhibit 8. Operating Cash Flow Projection, 2026-2033
ECONorthwest analysis utilizing STR and Costar data

	2026	2027	2028	2029	2030	2031	2032	2033
Revenue:								
Room sales	$ 2,237,064	$ 2,741,761	$ 3,120,302	$ 3,216,053	$ 3,323,790	$ 3,435,137	$ 3,559,926	$ 3,669,147
Hotel F&B	$ 136,580	$ 167,394	$ 190,505	$ 196,351	$ 202,929	$ 209,727	$ 217,346	$ 224,014
Other operating departments	$ 39,604	$ 48,539	$ 55,241	$ 56,936	$ 58,843	$ 60,815	$ 63,024	$ 64,957
Misc. income	$ 10,850	$ 13,298	$ 15,134	$ 15,599	$ 16,121	$ 16,662	$ 17,267	$ 17,797
Total Revenue	$ 2,424,098	$ 2,970,992	$ 3,381,182	$ 3,484,939	$ 3,601,683	$ 3,722,341	$ 3,857,563	$ 3,975,915
Operating Costs:								
Departmental	$ 569,697	$ 698,224	$ 794,624	$ 819,009	$ 846,445	$ 874,801	$ 906,580	$ 934,395
Undistributed	$ 1,100,777	$ 1,138,431	$ 1,176,823	$ 1,216,253	$ 1,256,998	$ 1,299,107	$ 1,342,627	$ 1,387,605
Total operating expenses	$ 1,670,474	$ 1,836,655	$ 1,971,447	$ 2,035,262	$ 2,103,443	$ 2,173,908	$ 2,249,207	$ 2,322,000
Fixed Charges:								
Management fees	$ 80,022	$ 98,076	$ 111,617	$ 115,042	$ 118,896	$ 122,879	$ 127,343	$ 131,250
Fixed charges	$ 134,387	$ 138,984	$ 143,671	$ 148,485	$ 153,459	$ 158,600	$ 163,913	$ 169,404
Total operating expenses	$ 214,409	$ 237,060	$ 255,288	$ 263,527	$ 272,355	$ 281,479	$ 291,256	$ 300,654
EBITDA	$ 539,215	$ 897,277	$ 1,154,447	$ 1,186,150	$ 1,225,885	$ 1,266,954	$ 1,317,100	$ 1,353,261

Using the costs to open (Exhibit 7) and the operating cash flow model in Exhibit 8 (extended out to 2040) and a terminal value discount rate of 7 percent, we calculated the that the IRR is 7.3 percent.[4,5] We consider this a baseline pro forma. With enhancements and changes in assumptions, higher rates of return are potentially achievable.

Findings and Considerations

While a new hotel would be positive cash flow positive, a low rate of return may deter developers.

We conclude from our market and financial research that a new hotel in Soldotna would be cash flow positive once operating. However, development costs are high, and the IRR is 7.3 percent as a result. This return is lower than would be considered ideal (14%).

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[4] The terminal value assumes the hotel will continue operating past the 15th year. This approach acknowledges that many assets have enduring worth beyond the immediate timeframe under consideration. The terminal value, therefore, captures the long-term perspective by estimating the potential future earnings or resale value of the investment.

[5] The seven percent discount rate is based on the "investment rate" which is the average long-term rate of return on a mix of corporate and noncorporate assets. This is generally considered a leading discount rate for conducting cost-benefit analysis.

Enhancements that may boost the IRR

While the IRR is lower than one would hope, it is based on conservative assumptions. Further, there are possibilities that could work in Soldotna's favor such as:

- Our analysis does not include cash flows from a bar and restaurant. These may be substantial. Notable is that Alaskan liquor control rules would afford the hotel market power. That is economic-speak for an ability to operate with few competitors and thereby earn higher profit margins.

- Room demand is highly seasonal. A way to improve the profitability of a hotel in such a market is to design it in a way that allows you to close off a section of the building during the off-season and thereby save money on utilities and housekeeping.

- Ascertaining the actual cost of developing the hotel is critical. Modest reductions in the development costs would improve the IRR. We suggest reaching out to firms that have built comparable properties and are very familiar with the site in Soldotna for their estimates.

- We included management fees in our cash flow on the assumption that this would be a branded hotel. Under those circumstances the developer may have support including ready-to-use architectural plans, staff training, branded supplies, marketing support, software, and systems. These accelerate ramp-up and typically result in higher occupancy and room rates compared to unbranded competitors. The market on the peninsula is currently dominated by unbranded properties. The ADRs and occupancy rates forecast for Soldotna are based largely on those unbranded properties.

- We also need to emphasize that the broader development of the waterfront will enhance the attractiveness of Soldotna as a tourist destination. If successful, the hotel will likely enjoy higher occupancy and room rates than forecast here. If the hotel had riverfront views, it could also charge more. Premium rates would directly flow to the bottom line.

  For example, raising the ADR from $169 to $199 (2023 dollars) and the occupancy rate by another 2 percent, all possible with a more attractive than average property, the IRR would rise to 12%. Add a bar and restaurant for another $125,000 in EBITDA and the project would nearly double the IRR forecast in the baseline pro forma.

Conclusion and Next Steps

Undoubtedly, realizing the City's envisioned development scale in the redevelopment area presents substantial challenges. Currently, mixed-use and multifamily developments are not financially viable. Among residential options, townhomes are the most feasible, contingent on favorable land costs. A borderline feasible option is a hotel, particularly if the riverfront offers amenities that appeal to upscale hotels. This situation presents a dilemma. To stimulate desired development in the near term, it is likely the City will need to facilitate redevelopment through participating in public private partnerships (e.g., market hall, subsidized land costs for private development, etc.), constructing infrastructure improvements (e.g., streets and sidewalks, trails, and open space), and carefully considering the timing of both public and private investment.

Despite these challenges the City has options that it could pursue to bring its vision to life for the project area. We recommend a phased development approach as follows:

Phase 1:

- **Establish a market hall.** The City could focus on developing a market hall which would support the community's desire for affordable retail/restaurant space for local businesses that the private market cannot support in the near term. This strategic move could lay the groundwork for future private development phases by building and supporting a pipeline of retail businesses to tenant new development and creating a "place" that can serve as a focal point of activity to stimulate additional development in later phases.

- **Encourage townhome development.** Townhomes are the most feasible residential type, offering a promising means to reinvigorate the area through private investment.

- **Partner to develop affordable multifamily housing.** Private three-story multifamily development is unlikely in the current market. The City could instead pursue an affordable multifamily development, which does not rely on market debt and equity like market rate apartment developments. This approach could help the City begin achieving the Master Plan's desired density in the near term rather than waiting for later phases assuming market conditions will change. It will also provide needed affordable housing for residents.

- **Improve trails, streets, and public space.** Trail, street, and public space enhancements will serve as foundational elements for subsequent stages of development by creating developable parcels near public amenities.

Phase 2:

- **Introduce a hotel.** As area improvements take shape, a hotel becomes a logical progression. These enhancements assure upscale hotel developers that the necessary amenities for long-term success are in place.

- **Adaptive reuse.** Consider ways to enhance buildings that already exist. It is likely that larger scale development may not be feasible right away. Adaptive reuse could be one way to continue the momentum of redevelopment in a more cost-effective way.

Phase 3:

- **Three-story mixed-use development.** Initial investments are designed to enhance future phases by enabling developers to command higher rents, potentially making future stages more feasible. Balancing affordability with redevelopment remains a crucial consideration.

ECONorthwest will provide additional details on implementation as a part of the final Master Plan. This approach and phasing could shift after additional discussion with the City.

Appendix A. Assumptions

ECONorthwest completed a financial analysis for residential and mixed-use development that models a developer's decision-making process and cash flow equation for multiple prototypical developments, or *prototypes*. We created a pro forma model to test the financial feasibility to understand how the City could incentivize housing production. We drew our initial market and construction cost insights from sources such as Costar, Redfin, and Craftsman, and then vetted those assumptions with local developers and brokers. Ultimately, this type of assessment will help the City understand the likelihood of developers producing residential and mixed-use development under different scenarios.

The table below show the details of the pro forma model.

Exhibit 9. All Pro Forma Assumptions
Source: ECONorthwest, CoStar, Redfin, Craftsman, Stakeholder Interviews

Assumption	Townhomes	Multifamily Apartments	Mixed-Use Apartments
Building program			
Total units	4	60	65
Lot size	10,000 sf	65,000 sf	65,000 sf
Retail area	N/A	N/A	5,000 sf
Unit mix	100% 3-bedroom	20% studio, 45% 1-bedroom, 35% 2-bedroom	20% studio, 45% 1-bedroom, 35% 2-bedroom
Average unit size	1,750 sf	690 sf	690 sf
Revenue / Operating Assumptions			
Average market rent per month*	N/A	$1,200 ($1.75 per sf)	$1,250 ($1.80 per sf)
Average sales price*	$615,000 ($350 per sf)	N/A	N/A
Vacancy expense	N/A	10%	10%
Operating expenses per unit	N/A	$2,400	$3,300
Retail rent per sf	N/A	N/A	$18 per year / $1.50 per month
Development Costs			
Construction cost per sf	$190	$250	$250
Parking garage cost per stall	$25,000	N/A	N/A
Surface parking cost per stall	N/A	$7,000	$7,000
Total hard cost	$1,140,000	$12,580,000	$14,920,000
Other development costs	Soft costs: 20%; Contingency: 4%; Developer fee: 5%		
Total development cost	$1,650,000	$16,480,000	$19,550,000
Return Assumptions and Results			
Debt service coverage ratio	N/A	1.25	1.25
Spread on cost	10%	N/A	N/A
Residual land value	$95,000	($2,150,000)	($2,640,000)
Residual land value per sf	$9	($33)	($41)

* This assumption is inclusive of modest market escalation during construction

Appendix B. Hotel Assumptions

ECONorthwest completed a financial analysis for a hotel development in Soldotna. We modeled the baseline cash flows for a new hotel from construction through its first 15 years of operations. This model serves as a baseline representing a basic hotel. Feeding into the pro forma is an analysis of the local hotel market. For this, we used historical market data for the Kenai Peninsula which originate from Costar. They, through their subsidiary, STR Global, obtain operating data from hotels. We use industry standards and current market conditions to determine development costs and required rate of return.

The table below shows the details of our assumptions.

Exhibit 10. Baseline Pro Forma Assumptions for Hotel
Source: ECONorthwest, Costar, STR Global, HVS
Note: All costs are adjusted for inflation. ECONorthwest projects inflation of 4.2 percent in 2025 with it gradually falling to 3.4 percent per year in later years.

Variable	Assumption
Hotel scale	Upper mid-scale to upscale
Room count	62
Average daily room rate (ADR) (Jan 2023 $)	$169.40
Construction year	2025
Opening year	2026
Last operating year of forecast	2040
Net Occupancy Rate (NOR)	66.2%
Occupancy rate ramp-up year 1	.77
Occupancy rate ramp-up year 2	.91
Occupancy rate ramp-up year 3	1.00
CPI January 2023	300.5
Terminal value discount rate	7%
Required IRR	14%
Development Costs	
*Based on HVS Hotel Cost Estimating Guide 2021 and 1.26 construction cost escalation for Alaska	
Land	$1,496,082
Building site & improvements	$12,452,397
OSE (Operating supplies and equipment)	$2,102,604
FFE (Furniture, fixtures, and equipment)	$1,763,126
Preopening & working capital	$549,320
Developer fees	$519,310
Operating Costs and Revenues	
*Based on STR P&L 2022/2021 data for Anchorage	
Operating costs	Varies by year due to inflation and ramp-up
Fixed charges	Varies by year due to inflation and ramp-up
Revenue (aside from room sales)	Varies by year due to inflation and ramp-up
Results – Projected IRR	
Projected IRR w/baseline assumptions	7.3%
w/higher room rate ($199.40) and occupancy (68.2%)	12%
w/higher room rate and occupancy and restaurant w/$125,000 EBITDA	13%