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CITY OF ANACORTES RETAIL MARKET STUDY

April 15, 2008
Updated April 22, 2008

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1.0 INTRODUCTION

Pursuant to recommendations in the 2006 Berk & Associates Anacortes Economic Study and policies adopted in the 2007 Anacortes Comprehensive Plan, the City of Anacortes is now exploring a coordinated economic development strategy comprised of four main elements: retail development, tourism, a convention center, and support for the maritime industry. To inform its development of the retail element of the strategy the City has contracted with Berk & Associates for an assessment of retail opportunities and risks associated with various commercial areas in the City. This report summarizes that assessment.

The 2006 Berk Economic Study included selected analyses of demographic trends and retail spending patterns in Anacortes. This study builds on that analysis, updating many of the exhibits from the 2006 study and extending the analysis by taking a closer look at the retail landscape in and around Anacortes.

This report assesses the retail market in Anacortes using the following approach:

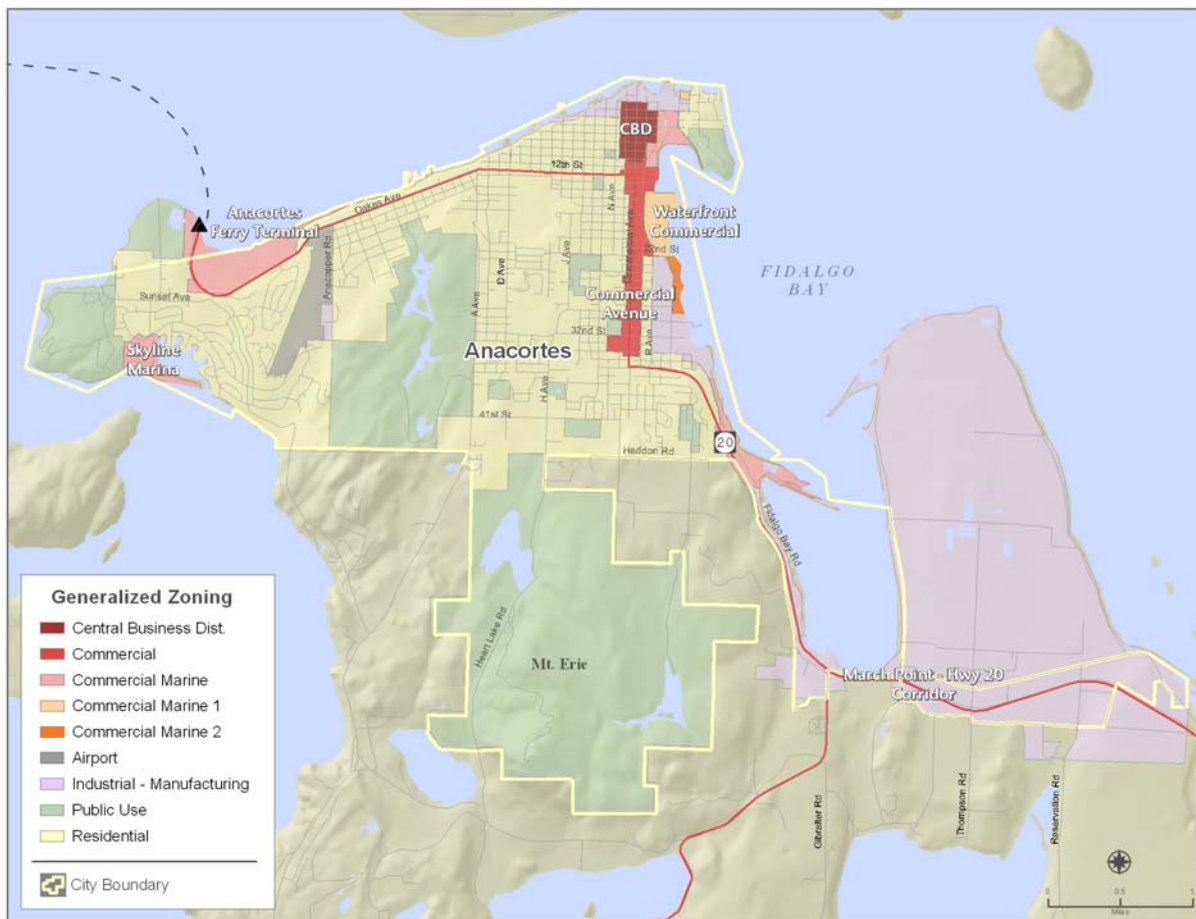
- 1. Current Competitive Assessment.** We describe the current retail landscape in Anacortes, examining who lives in Anacortes today, who shops in Anacortes, where the commercial hubs of activity are, and what are the relative strengths and weaknesses of the retail market in Anacortes.
- 2. Summary of Informational Outreach.** A summary of findings from selected interviews with real estate brokers operating in the area supplements the current competitive assessment and provides additional insight into market trends in Anacortes today.
- 3. Future/Potential Competitive Assessment.** Trends in population growth and other demographic shifts are used to identify the future demand for retail in Anacortes and potential opportunities and risks the City needs to consider as it plans for an economically sustainable future.
- 4. Recommendations and Strategic Options.** A set of recommendations and strategic options take into account earlier findings and highlight opportunities the City may want to consider as it develops a City-wide retail strategy.

2.0 CURRENT COMPETITIVE ENVIRONMENT

This section describes the various commercial areas in Anacortes, where Anacortes customers are coming from, how local demographics compare with other jurisdictions, and how spending patterns in Anacortes compare to those in neighboring cities.

2.1 Commercial Areas in Anacortes

Exhibit 1
Anacortes Generalized Zoning and Commercial Areas



Source: City of Anacortes and Berk & Associates, 2008

Anacortes has several distinct commercial areas delineated by geography, underlying zoning, and current land use. **Exhibit 1** shows generalized zoning in Anacortes and includes labels for areas with commercial development today or potential development in the future. These five commercial areas are described below.

Central Business District – Downtown

The Central Business District (CBD) is the heart of old downtown Anacortes with a mix of locally-owned specialty retailers, restaurants, small offices and hotels primarily clustered on Commercial Avenue north of 10th St. The district is intended to be a pedestrian-oriented retail and commercial activity hub for the City.

Commercial Avenue

Commercial Ave. south of 10th St. to 34th St. is a commercial zone intended for more of the auto-oriented retail and services outside the central business district. This stretch of Commercial Ave. experiences moderate to high levels of auto traffic from local residents as well as motorists on their way to or from the Anacortes Ferry Terminal to the west. A wide range of professional service offices and convenience-oriented retail establishments can be found on Commercial Ave including several chain retailers, fast food restaurants, vehicle repair shops, and two grocery stores.

Waterfront Commercial Marine

Along the Fidalgo Bay waterfront east of Commercial Avenue is an area north of 22nd St. to about 14th St. that is zoned Commercial Marine 1 (CM1). The property in this area is owned by MJB Properties and a portion is currently being used by the Northern Marine shipbuilding company. The CM1 zone is a sensitive area linking the central business district and commercial areas with the shoreline and ship building/marina activity to the south. It is intended that this area be developed as a pedestrian-friendly area with a mix of residential, small-scale marine-related retail, and other marine commercial uses consistent with the pedestrian scale and character envisioned for the zone.

The CM1 zoned property does not currently have any retail uses but potential retail opportunities will be discussed later in **Section 5.0**.

March Point Highway 20 Corridor

On the far east end of the City is the SR 20/March Point light manufacturing/industrial zone, which currently includes several auto dealerships and light industrial users. This zone does not allow for retail uses except for boat and vehicle dealerships and is intended primarily to accommodate industrial uses that do not need water access or proximity to the central business district or the Commercial Avenue corridor.

Recently, large-scale retailers have expressed interest in developing along the March Point Highway 20 Corridor to take advantage of traffic going to Anacortes and the San Juan Islands as well as traffic headed south towards Whidbey Island. A change in zoning would be required to allow retail uses in this area and this topic is discussed later in **Section 5.0**.

Anacortes Ferry Terminal

On the west end of the City, the area surrounding the Washington State Ferries Anacortes Terminal is zoned Commercial Marine, a zone intended to serve the needs of marine-oriented and tourist activity. The ferry terminal area has a small number of businesses including a couple of restaurants and a small inn. The retail development potential in the area is limited by steep slopes, difficult access, and

geographic isolation from the majority of Anacortes residents and the rest of the City's commercial activity to the east. Capturing sales from ferry passengers is a market opportunity but reports from the broader Anacortes community and previous studies on the terminal suggest that current congested conditions around the ferry terminal deter local residents from frequenting the terminal area and limit retail market potential.

Skyline Marina

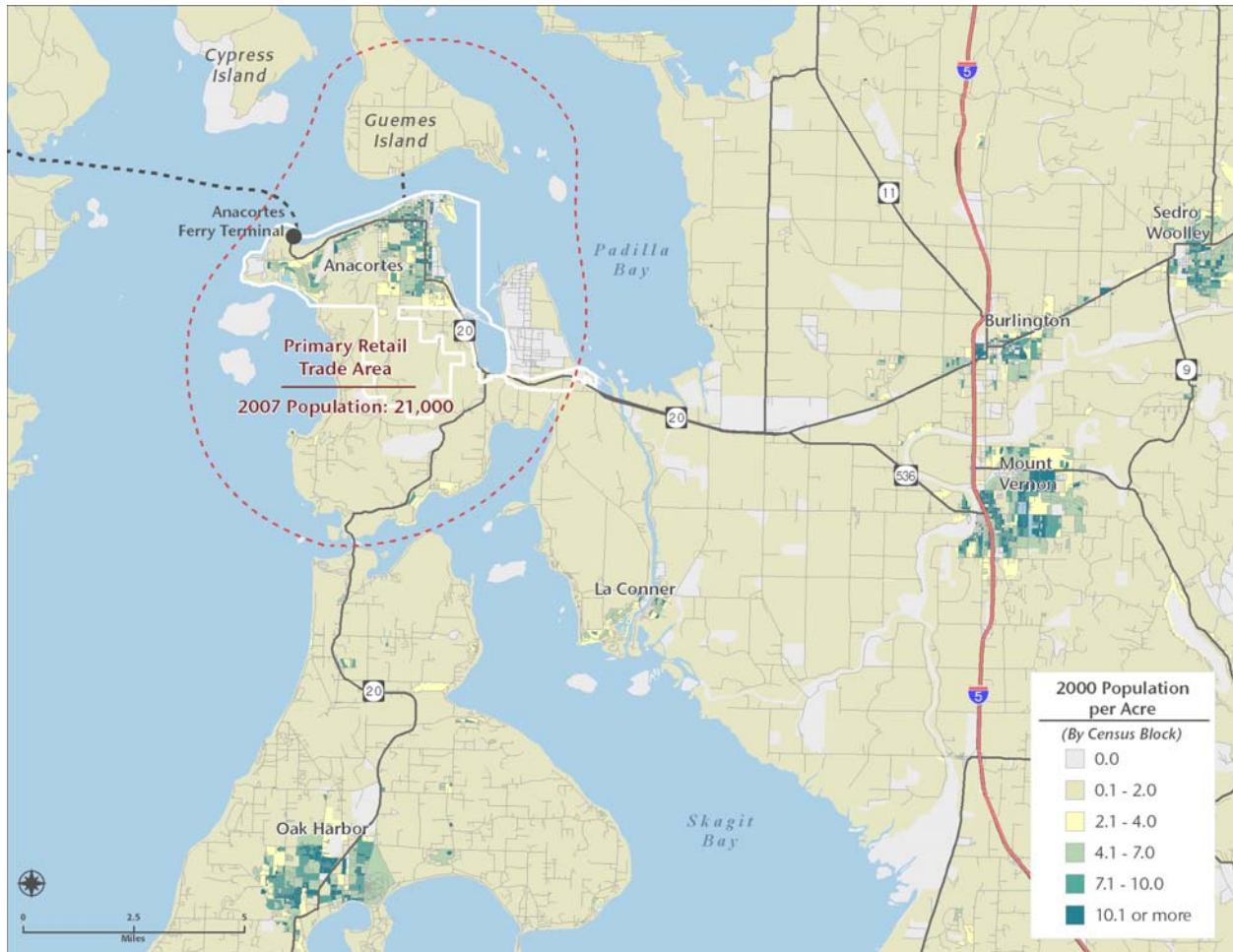
On the west side of the City, the Skyline Marina has a small Commercial Marine zoned area, which has a small market and deli (Old Salt's Deli), the Flounder Bay Cafe, and a boat repair yard. The retail market potential at Skyline Marina is limited by the area's geographic isolation from the rest of the City. The natural beauty of the area, marina traffic, and potential housing development along the waterfront will support a modest amount of commercial activity but it is unlikely to grow significantly in the near future.

2.2 Retail Trade Area

Primary Retail Trade Area

The Primary Retail Trade Area for a retail development is typically the area within which a retail center can reasonably compete for the bulk of its customers and sales. The trade area for a large regional retail center with multiple anchor stores could range from a 30 minutes drive to over an hour. For a smaller neighborhood shopping center anchored by a small grocery store or drugstore, the trade area could be as small as a 5-minute drive-time contour in urban areas or 10 to 15 minutes (or more) in more rural areas.

Exhibit 2 Anacortes Primary Retail Trade Area



Source: U.S. Census Bureau, 2000; WA Office of Financial Management, 2007

Exhibit 2 shows population concentrations in Anacortes and surrounding areas and the Primary Retail Trade Area used in this study. The Primary Trade Area includes the City proper, the rest of Fidalgo Island to the south, and Guemes Island to the north. This area, which is roughly a 15-minute drive contour from the Anacortes CBD, was defined by taking into account the types of retail offerings in Anacortes, the proximity of major retail competition, and information on shopping behavior gathered during informational outreach interviews with local commercial real estate professionals.

It is important to note that the retail trade area for the March Point Highway 20 Corridor auto dealerships is much larger than the trade area for retail in the Anacortes CBD and along Commercial Avenue. Consumers will typically drive much farther for large ticket purchases like automobiles and the March Point auto dealerships are likely drawing customers from Anacortes, Whidbey Island, the San Juan Islands, and points east.

Secondary Retail Trade Area

The Secondary Retail Trade Area for Anacortes includes a portion of north Whidbey Island and persons living in the San Juan Islands. Anacortes retailers have a smaller capture of spending by residents in these areas due to distance and competition.

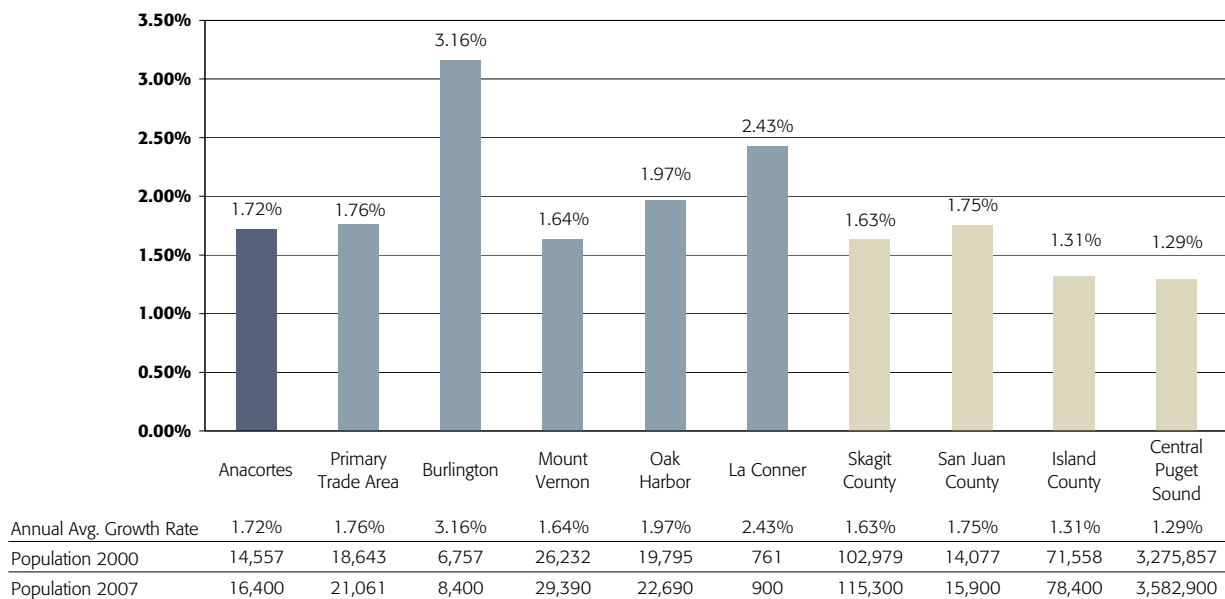
Tertiary Retail Trade Area and Other Pass-Through Traffic

Spending by residents who live outside the Primary and Secondary Retail Trade Areas is limited to only a few retail categories such as the City’s boat dealerships that draw sales from a much larger trade area. This Tertiary Trade Area is difficult to define and not a significant source of demand for most retail sales in Anacortes, so it has not been included in the following demographic analysis or the retail space projections later in **Section 4.0**.

Another source of demand that needs to be considered is pass-through traffic from out-of-town visitors on their way to the San Juan Islands. This source of potential retail demand is heaviest in the summer travel season. Seasonal variations in retail sales driven by pass-through visitors is analyzed in greater detail later in **Section 2.4**.

2.3 Demographic Analysis

**Exhibit 3
Annual Average Population Growth, 2000-2007**



Source: Washington Office of Financial Management, 2007

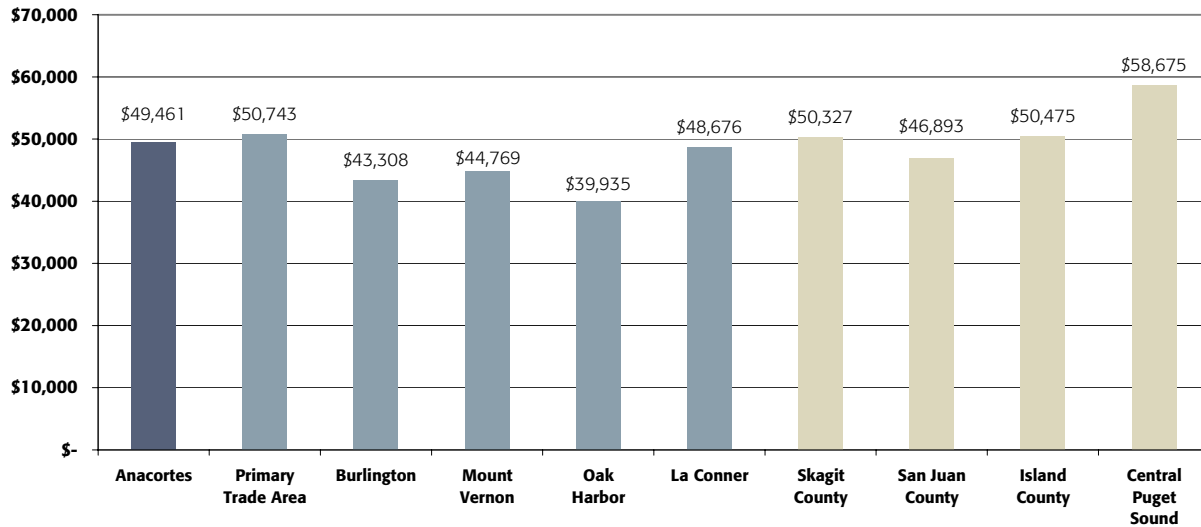
Note: The “Central Puget Sound” region consists of King, Kitsap, Pierce, and Snohomish Counties combined.

Anacortes had a population of about 16,400 as of April 2007 and has grown by almost 2,000 people since the last Census in 2000. The Primary Trade Area has an additional 4,500 residents for a total of

21,061. The nearest population concentrations are located in Oak Harbor to the south (22,690 pop.) and Burlington (8,400 pop.) and Mount Vernon (29,390 pop.) to the east along the I-5 corridor.

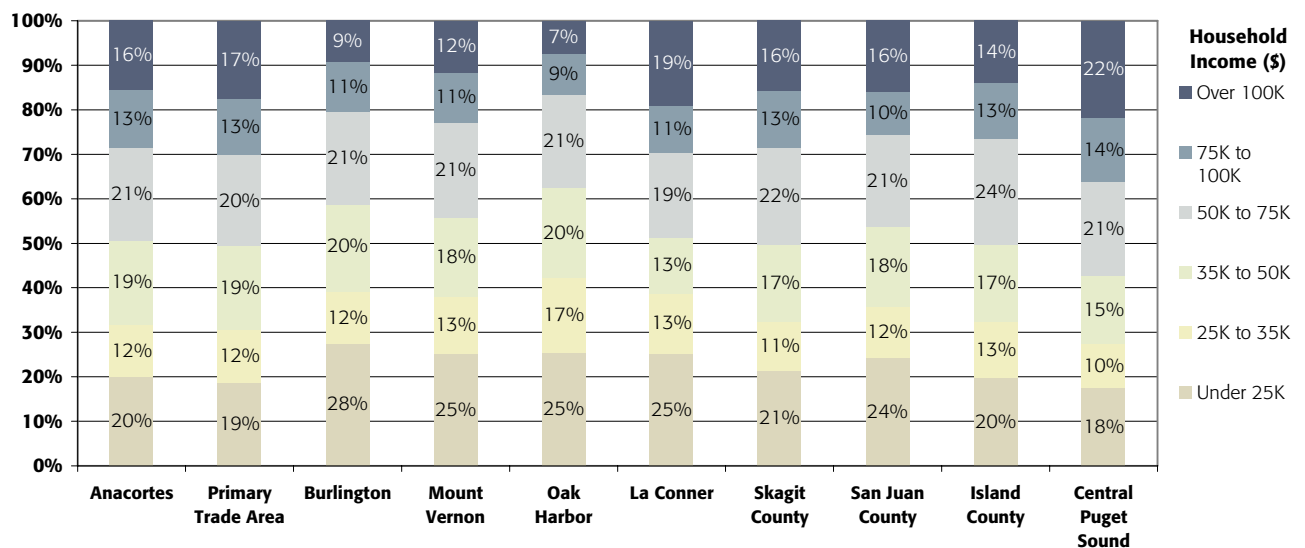
Anacortes and Fidalgo Island have grown at a pace close to the Skagit County average but slower than several neighboring cities including Burlington (3.16% annual average growth rate), La Conner (2.43%), and Oak Harbor (1.97%).

**Exhibit 4
Median Household Income, 2007**



Source: Claritas, 2007

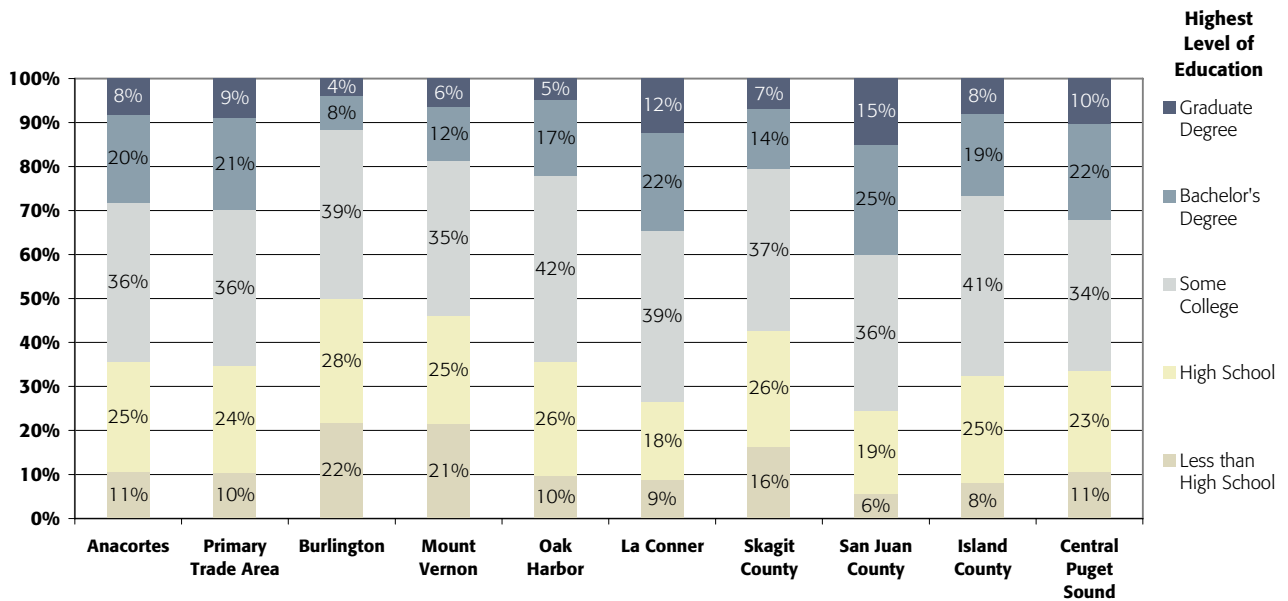
**Exhibit 5
Percentage of Total Households by Household Income Category, 2007**



Source: Claritas, 2007

Anacortes and the trade area have higher median household income levels than all neighboring cities and about the same as the Skagit County average. The higher income levels shown in **Exhibit 4** and **Exhibit 5** are good indicators of disposable income and spending power to support retail.

Exhibit 6
Distribution of Educational Attainment, 2007



Source: Claritas, 2007

Note: Percentages based on population aged 25 and over.

Anacortes and the trade area have education levels higher than all neighboring cities except La Conner. About 28% of the City's population aged 25 and over have a bachelor's degree, compared to 22% in Oak Harbor, 18% in Mount Vernon, and 12% in Burlington. Higher education levels in the consumer base are attractive to certain specialty retailers.

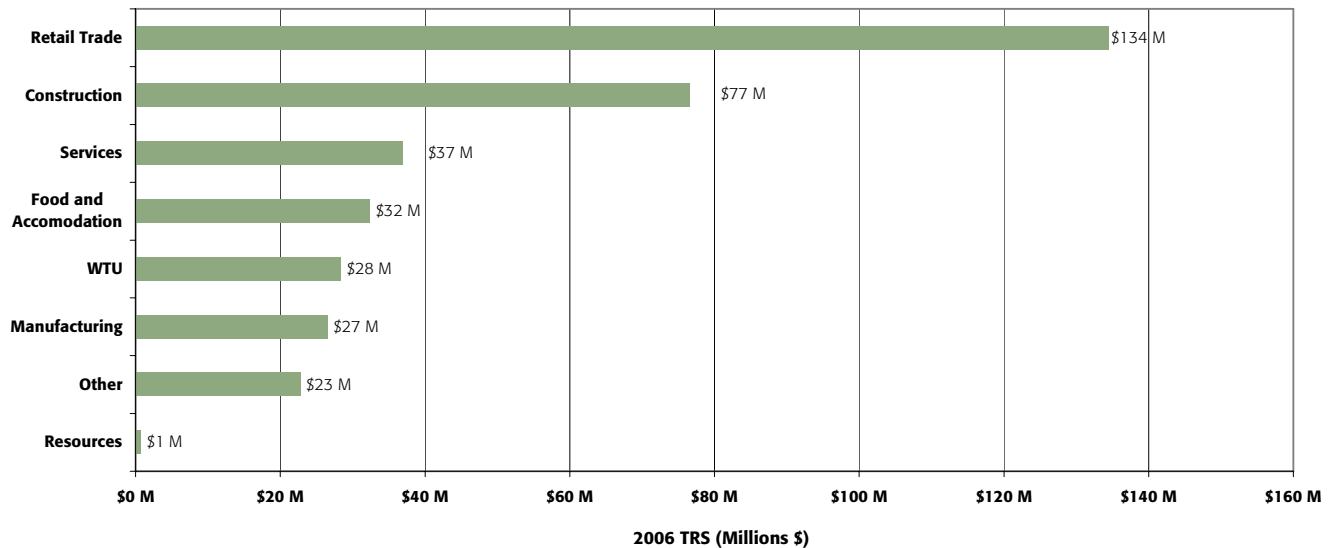
2.4 Retail Spending Patterns in Anacortes and Neighboring Cities

Taxable Retail Sales Base

The 2006 Economic Study provided taxable retail sales (TRS) analysis based on the older Standard Industrial Classification (SIC) industry code categories. Since then, the Washington Department of Revenue has transferred over to the North American Industry Classification System (NAICS). This study updates the previous study's numbers with 2006 values based on NAICS categories.

TRS is a critical component of fiscal sustainability for cities because of the tax structure in Washington State. Cities whose competitive position provides higher TRS per capita will generally have more resources to meet their community's service needs. In addition, because sales taxes apply on a wide range of goods and services, TRS analysis provides valuable insight into the economic composition of a community.

**Exhibit 7
Anacortes Total Taxable Retail Sales, All Industries, 2006**

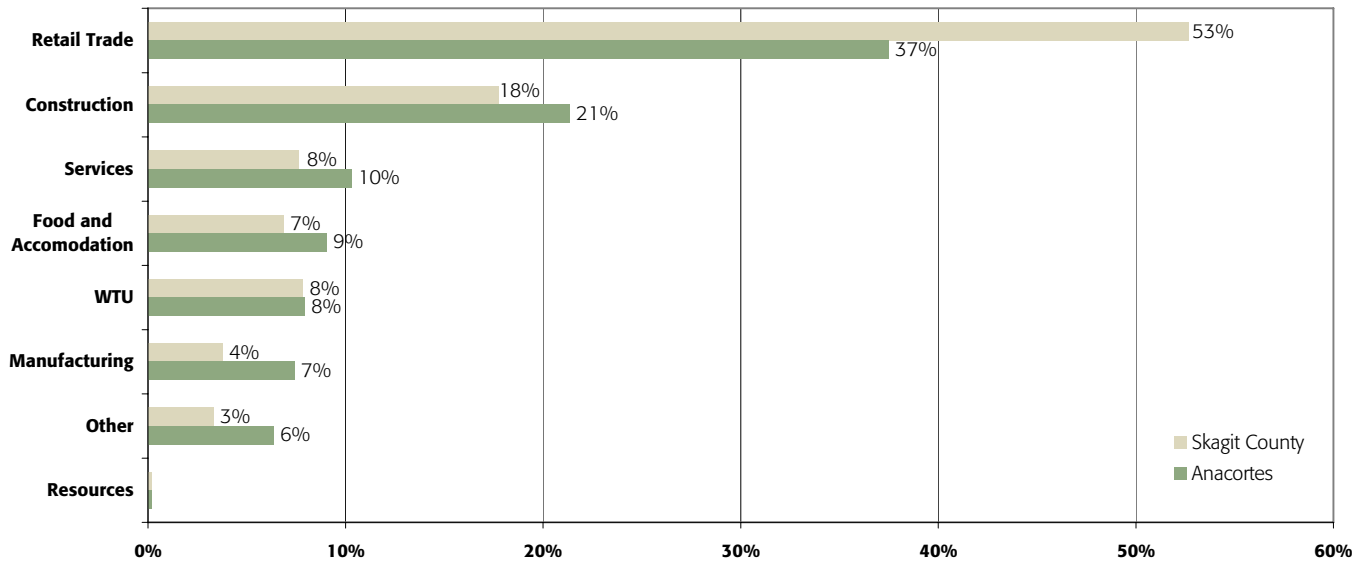


Source: Washington Department of Revenue, 2007

Note: WTU = Wholesale Trade, Transportation, Warehousing, and Utilities; Resources includes agriculture, forestry, fisheries, and mining

The largest component of Anacortes' TRS base in 2006 was the Retail Trade category (NAICS codes 44-45), which comprised 37% of the City's retail tax base, followed by Construction (21%), Services (10%), and Food/Accommodation (9%). TRS in the Construction category can be fairly volatile depending on trends in the real estate market and is expected to slow when the City approaches full buildout of developable land in coming years.

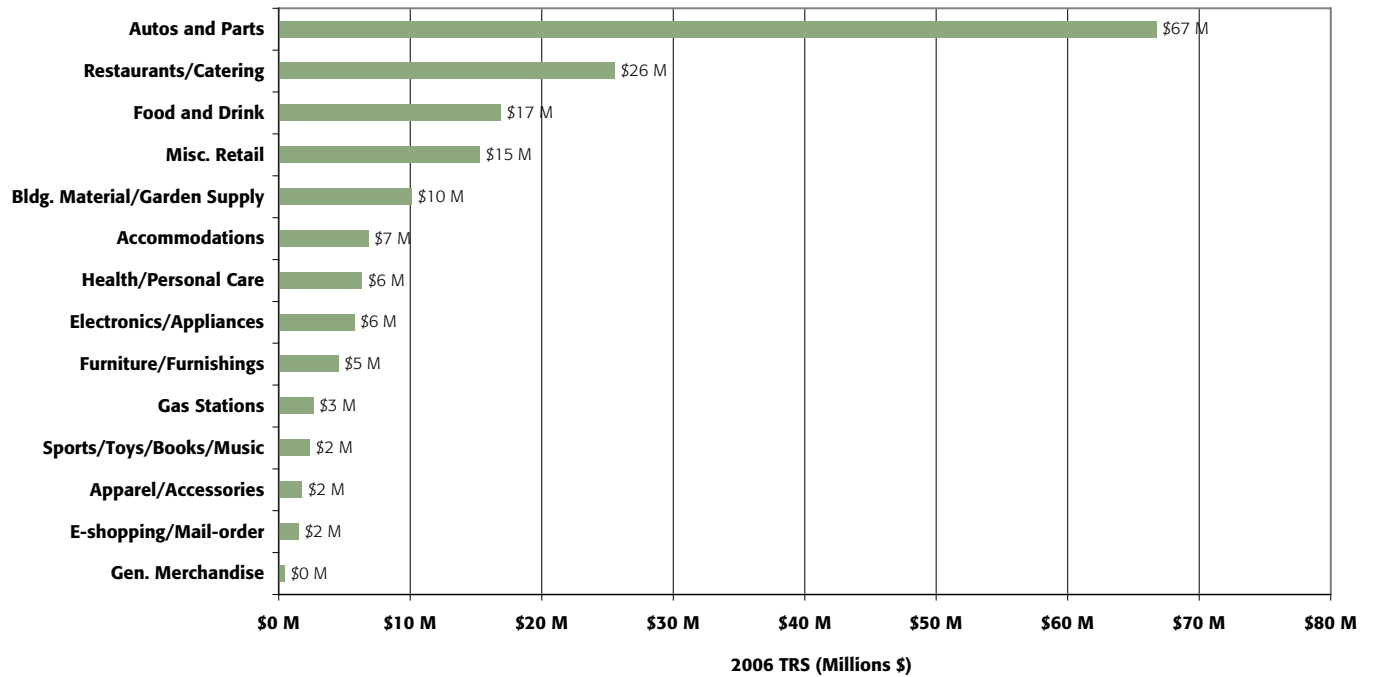
Exhibit 8
Percentage of Total Taxable Retail Sales, All Industries, 2006



Source: Washington Department of Revenue, 2007

On a percentage basis, the Anacortes TRS base is not as concentrated in the Retail Trade category (37% of total TRS) as the Skagit County average (53%). Part of the reason for this smaller concentration of Retail Trade is the City's lack of destination-oriented general merchandise stores and weakness in certain retail categories like apparel. The relative strength of Anacortes' retail sub-categories is explored further in the next few exhibits. The strength of the City's boat building sector is reflected in the higher than average share of TRS in the Manufacturing category.

Exhibit 9 Anacortes Taxable Retail Sales by Retail Sub-Category, 2006



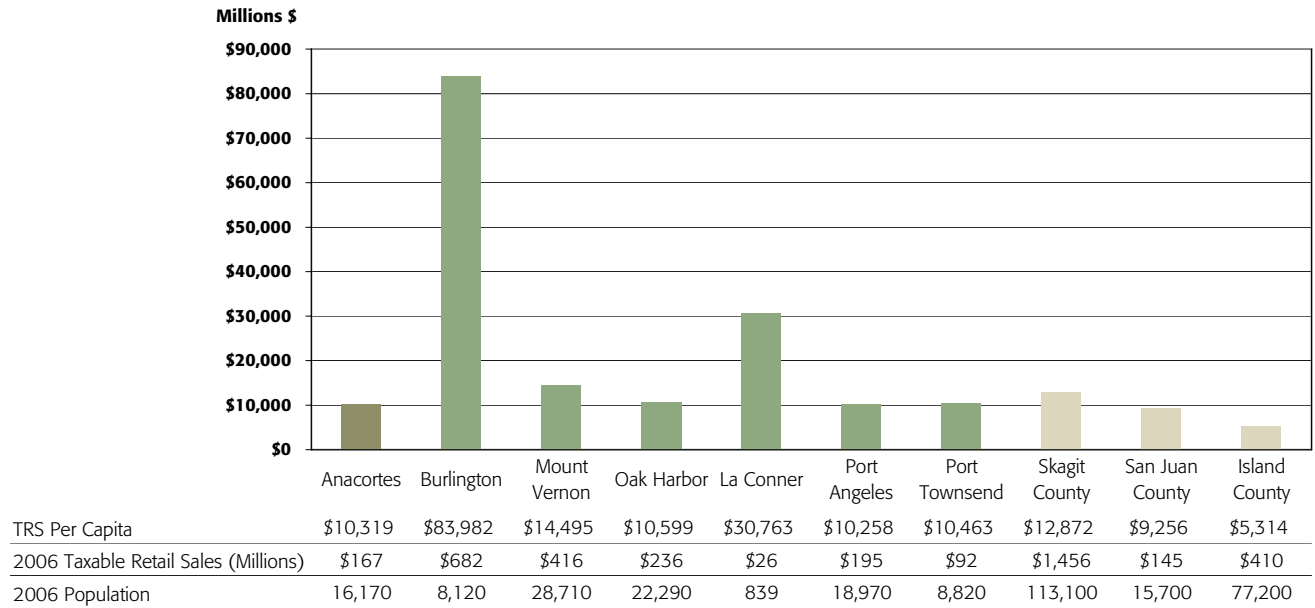
Source: Washington Department of Revenue, 2007

Within the Retail Trade and Food/Accommodations categories, Autos and Parts (which includes both auto and boat sales) is the most significant component of the City’s TRS tax base, bringing in almost \$70 M in taxable sales in 2006. Restaurants and Food and Drink (which includes grocery stores) are also important contributors to the Anacortes retail mix, comprising 15% and 10% of total retail/restaurant/hotel TRS respectively.

Taxable Retail Sales Per Capita

While it is important to understand where the overall TRS contributions are coming from, when looking to compare one community to another or when trying to understand the character of a local economy the TRS per capita is a better metric. By accounting for cities’ populations, it is possible to determine if Anacortes’ sales base for each TRS category is in line with those of neighboring communities.

Exhibit 10 Taxable Retail Sales per Capita, 2006



Source: Washington Department of Revenue and Washington Office of Financial Management, 2007

Anacortes averages about \$10,000 of TRS per capita, which is about the same as Oak Harbor and the two peer cities Port Angeles and Port Townsend. On both a total and per capita basis, Burlington has the largest retail base of the comparable communities. With about half the population of Anacortes, Burlington has almost five times the retail sales due to the large concentration of large-scale retailers and the Prime Outlets at Burlington, which draw customers from the entire region. La Conner has relatively strong TRS per capita (\$30,763) due to its visitor-oriented retail base (restaurants and specialty retailers) and very small population.

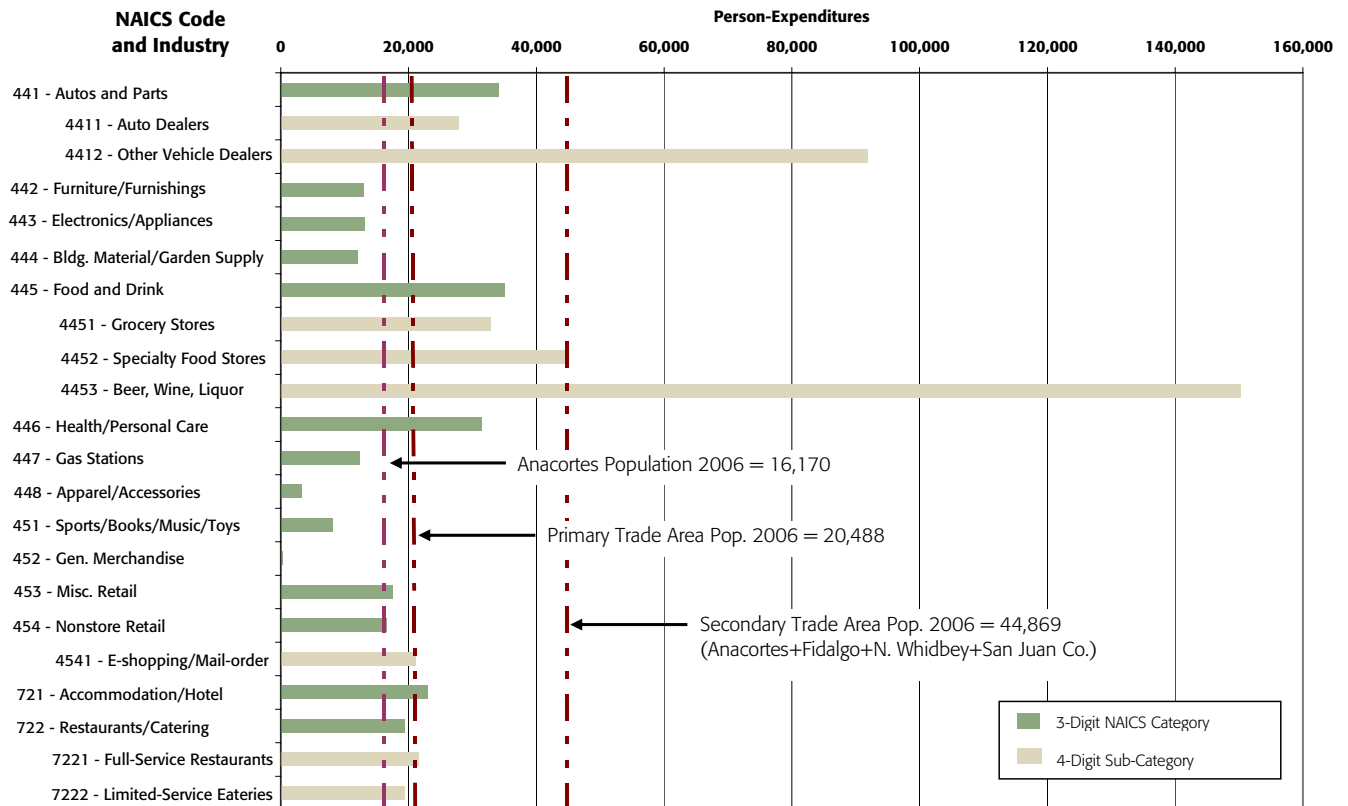
Person-Expenditures

One way to assess the relative strength of a city’s retail sector is in terms of “person-expenditures.” For example, if a typical household in Washington spends \$1,000 annually on grocery store purchases, and if grocery stores in Anacortes take in \$10 million in grocery sales per year, then Anacortes stores are taking in the equivalent of 10,000 people’s expenditures (\$10 million of expenditures divided by \$1,000 per person = 10,000 person-expenditures).

Person-expenditures are essentially a measure that estimates the market size being served by a particular retail sector. High-performing retail sectors will typically draw in more person-expenditures than the surrounding population because they capture retail sales from persons outside the immediate community. Inversely, less successful retail sectors will have fewer person-expenditures than the surrounding population because trade area residents are “leaking” elsewhere to do their shopping.

This section presents person-expenditures for Anacortes and the two largest neighboring retail centers in Burlington and Mount Vernon. By looking at the volume of sales in the Anacortes retail market and its main competitors, one can identify opportunities to develop strategies that build off existing strengths or shore up weaker sectors.

Exhibit 11 Person-Expenditures in Anacortes by Retail Category, 2006



Source: Washington Department of Revenue and Washington Office of Financial Management, 2007

Exhibit 11 shows Anacortes’ 2006 person-expenditures in all 3-digit NAICS retail, accommodations, and restaurant categories as well as selected 4-digit sub-categories. As reference points, the population levels for Anacortes, the Primary Trade Area (Anacortes+Fidalgo Island+Guemes Island), and the Secondary Trade Area (Primary Trade Area+North Whidbey Island+San Juan Islands) are shown.

Overall, when looking only at the 3-Digit categories, Anacortes has a relatively balanced mix of retailers – most categories have person-expenditures close-to or above the City’s population level indicating that most types of products can be purchased in the City. The exceptions to this observation are the Apparel, Sports/Books/Music, and General Merchandise categories.

- **Apparel and Sports/Books/Music/Toys.** These two retail categories include specialty retailers underrepresented in Anacortes and often difficult to attract in smaller retail markets. In particular,

apparel stores typically locate in larger retail nodes with major anchors and other complementary clothing stores in close proximity. Anacortes does have a few smaller locally-owned specialty clothing stores but it will be difficult for a city of Anacortes' size and isolated location to attract typical national chain apparel retailers.

- **General Merchandise.** This category, which includes large-scale general retailers like Costco or Fred Meyer, is noticeably non-existent in the Anacortes retail mix. These stores typically want to locate in high-traffic areas with good transportation access and high surrounding population density. Location options in Anacortes for general merchandise retailers are discussed later in **Section 5.0**.

Although Anacortes has no major general retailers, the local assortment of specialty retailers are supplying many of the goods and services typically offered by these large-scale stores. Aside from apparel, the Anacortes retail mix is supplying many of the basic goods and services desired by consumers.

The four 2-digit categories with strong person-expenditures in excess of the Primary Market Area population are Autos and Parts, Food and Drink (grocery stores), Health/Personal Care (drug stores), and Accommodation/Hotel. Sales in these categories are driven by unique strengths of the Anacortes economy and geographic location.

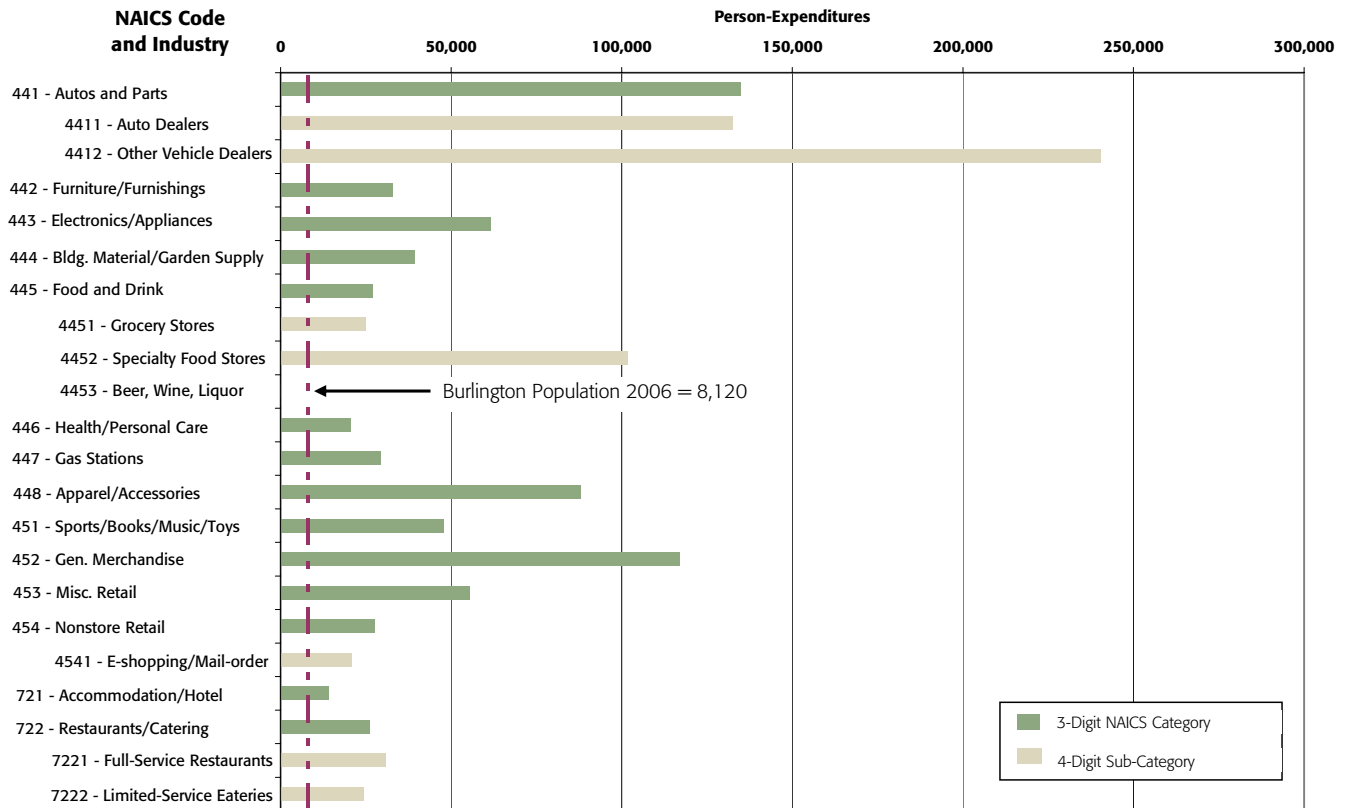
- **Autos and Parts.** With about 34,000 person-expenditures, this retail sector is clearly serving a market larger than Fidalgo Island. The automobile dealerships along the SR 20 March Point corridor (represented by the 4411 NAICS code in **Exhibit 11**) generate about 64% of the TRS (\$42.4 M) in the Autos and Parts category. These dealerships are likely attracting customers from Whidbey Island, the Skagit Valley, and the San Juan Islands in addition to the Fidalgo population.

Boat dealerships and sales (NAICS code 4412) generate about 30% of the Autos and Parts TRS (\$19.2 M), which works out to an astounding 92,000 person-expenditures. As described in a recent *2007 Northwest Washington Marine Industry Cluster Study*, the boat and ship building industry in Anacortes and other nearby communities is serving a global market for watercraft and marine services. The strength of this industry in Anacortes is reflected in its extremely high person-expenditures.

- **Food and Drink.** Grocery store, specialty food, and liquor store sales generate about 35,000 person-expenditures. The strength in this retail category is driven by Anacortes' unique location as a hub of marine and boating activity in the region. Many boaters stock up for longer trips at stores in Anacortes. This pattern of activity is indicated by the City's beer, wine, and liquor person-expenditures (150,000) – the highest of any retail sub-category. Despite the high person-expenditures for liquor sales, this category still only makes up a small portion of overall Food and Drink TRS (\$1.1 M or 11% of all food and drink sales).
- **Health and Personal Care.** Sales in this category are equivalent to about 31,400 person-expenditures and are likely driven by Anacortes' location as a gateway to the San Juan Islands. Many San Juan Island residents and visitors will fill prescriptions and stock up on convenience-oriented goods at Anacortes drug stores before traveling out to the Islands.

- Accommodations and Hotels.** With about 23,000 person-expenditures, the lodging sector in Anacortes is relatively strong. Sales in this category are driven during the peak travel months of summer when many travelers will stay at Anacortes before or after trips to the San Juan Islands. The next section on seasonal variations in TRS will explore this industry category further.

Exhibit 12 Person-Expenditures in Burlington by Retail Category, 2006

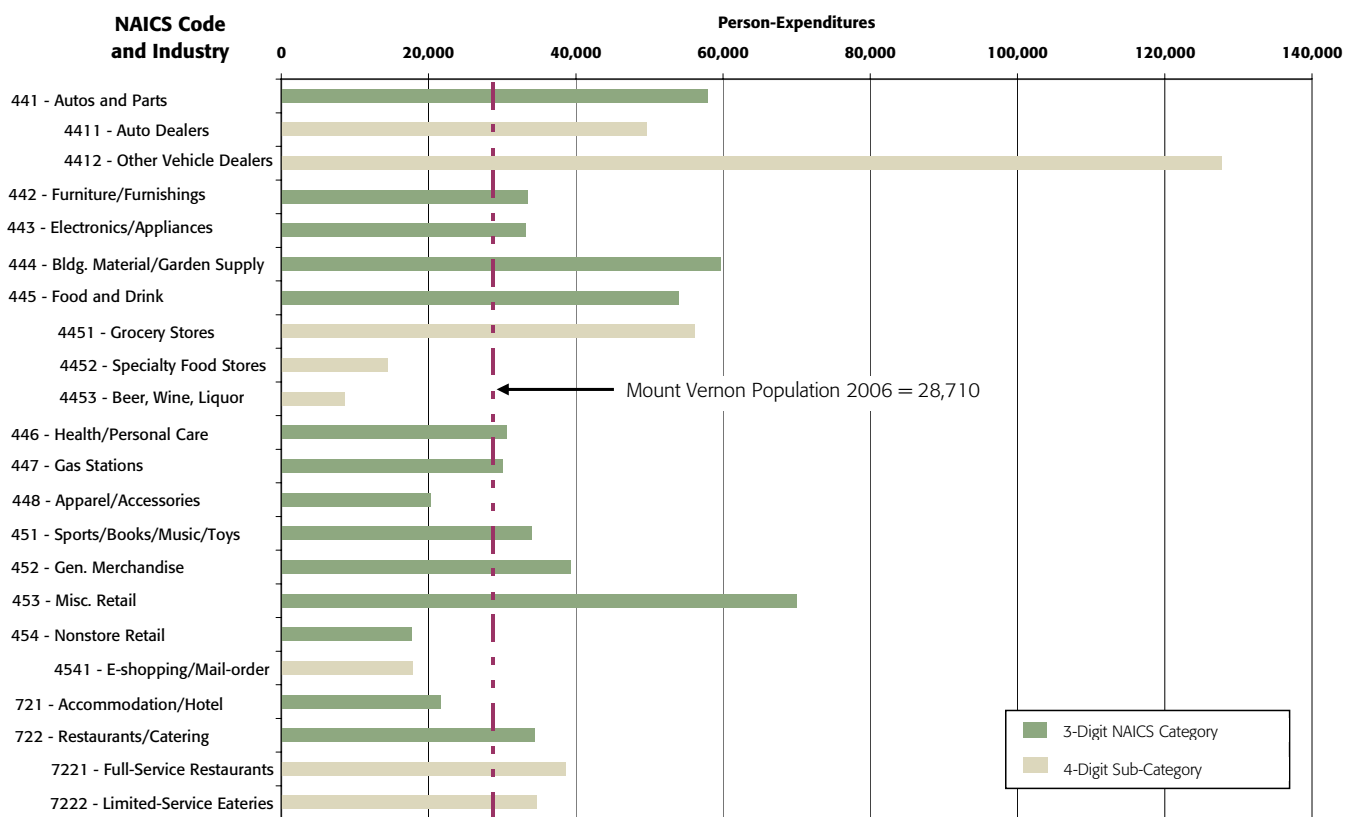


Source: Washington Department of Revenue and Washington Office of Financial Management, 2007

Exhibit 12 shows the person-expenditures for Burlington retailers in 2006. The retail sector in Burlington is particularly strong in almost all categories due to its I-5 access and power retail centers that draw consumers from a large trade area. **Exhibit 13** shows that person-expenditures for Mount Vernon retailers exceed the City's population in most categories but sales are not nearly as strong as those in Burlington. Combined, the retail offerings in Burlington and Mount Vernon are significant competition for current and potential retailers in the City of Anacortes.

Two of the Burlington retail sector’s greatest strengths are the Apparel/Accessories and General Merchandise categories. It is clear that the large-scale retailers and apparel store options in Burlington are drawing customers from a large regional trade area. These same categories were the weakest in Anacortes, indicating that Anacortes residents are driving to Burlington and Mount Vernon for these types of purchases. These findings are corroborated by the consumer survey conducted by the City for the 2006 Economic Study (see Appendix A – 2006 Consumer Survey Findings), which showed that residents rarely make apparel purchases in the City.

Exhibit 13
Person-Expenditures in Mount Vernon by Retail Category, 2006



Source: Washington Department of Revenue and Washington Office of Financial Management, 2007

Seasonal Variations in Retail Sales

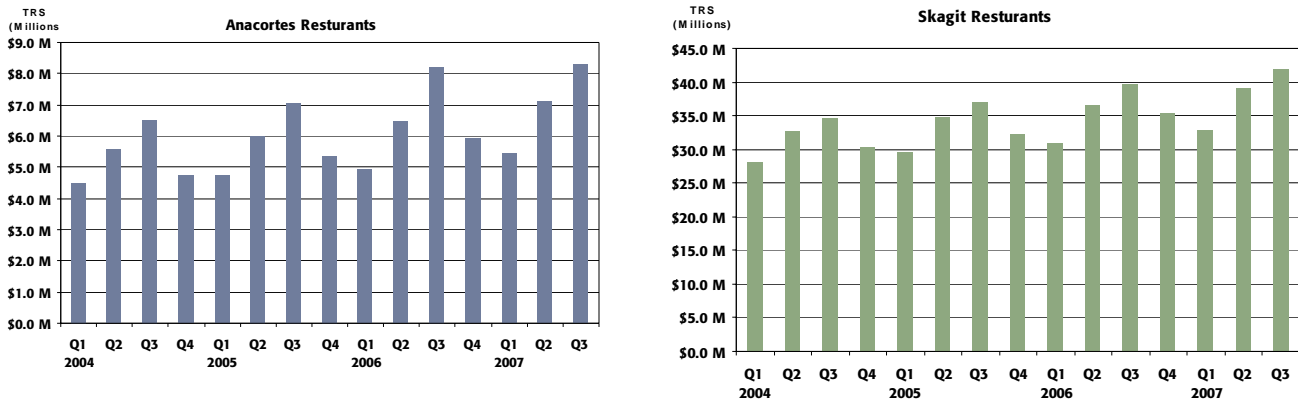
Anacortes is located in a picturesque waterfront location at the gateway to the San Juan Islands. During the summer and fall the City experiences significant increases in traffic from tourists and owner's of second homes in the City and in the San Juan Islands. Seasonal increases in retail sales are a benefit for local retailers but extremely large fluctuations in sales can be a challenge for businesses during the slow season. Understanding the magnitude of seasonal fluctuation in sales and in what sectors this fluctuation is the strongest will help the City identify strategies to address the problem.

Seasonal variation is also a topic that binds the City's retail strategy to its tourism strategy. Ideally, the tourism strategy will not only attract visitors during the peak periods, but also minimize the negative impact of slow periods on retailers by boosting tourism during the shoulder and down seasons.

In this analysis we have gathered quarterly TRS data for three sectors likely to be affected by seasonal shifts in sales: restaurants, food and beverage stores, and hotels/motels. For all three of these categories, seasonality is generally observed as a period of growth in TRS that starts in spring (Q1), peaks out in autumn (Q3) and slows in winter (Q4).

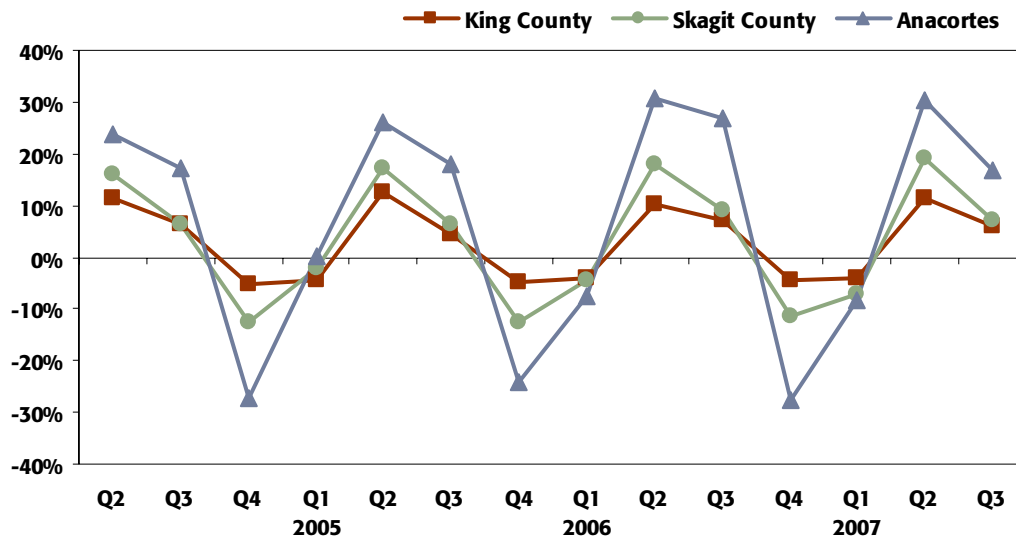
Seasonal variation in retail sales is occurs to some degree in all locations across the State, even those without a significant tourism component to their economy. In order to provide context for the Anacortes TRS data, we have compared the City's seasonal shifts to the seasonal shifts in Skagit County to identify sectors exhibiting above or below average fluctuations.

Exhibit 14 Total Restaurant TRS by Quarter, 2004-2007



Source: Washington Department of Revenue, 2007

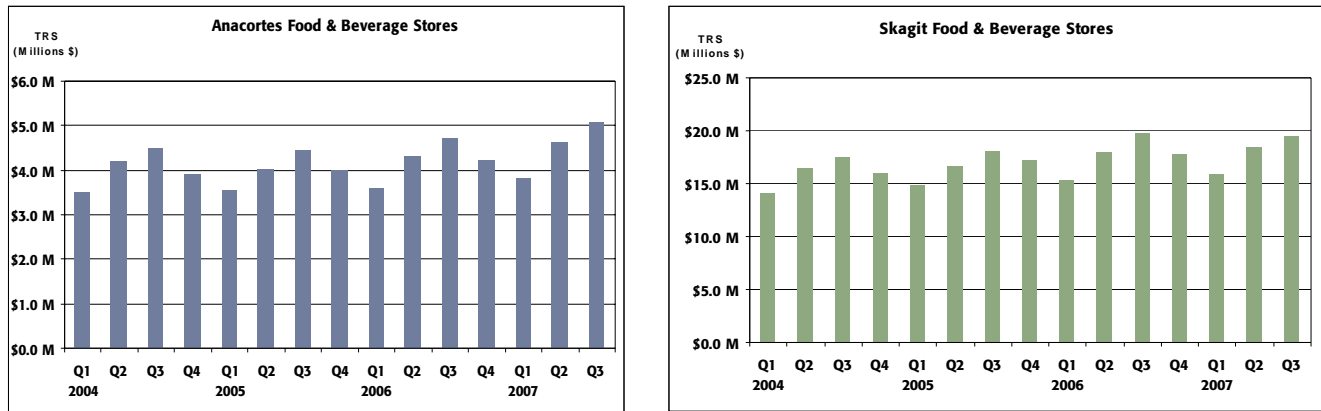
Exhibit 15 Percentage Change in Restaurant TRS from Previous Qtr, 2004-2007



Source: Washington Department of Revenue, 2007

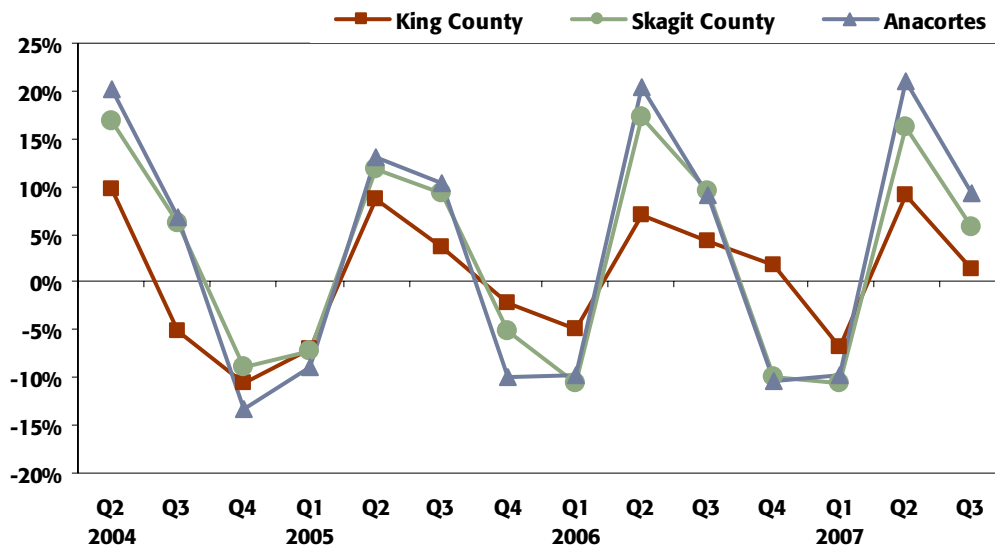
In Anacortes, the seasonal variation in restaurant TRS peaks at about a 30% quarterly increase in high seasons and a -30% quarterly decrease between Q3 and Q4. The seasonal shift is on average around 10% higher than the seasonal variation in restaurant TRS in Skagit County and 20% higher than the seasonal variation in King County. This suggests that restaurants in Anacortes deal with more seasonal fluctuation in sales and may struggle with slow periods during the winter and extremely busy peak periods.

Exhibit 16 Total Food & Beverage Store TRS by Quarter, 2004-2007



Source: Washington Department of Revenue, 2007

Exhibit 17 Percentage Change in Food & Beverage Store TRS from Previous Qtr, 2004-2007

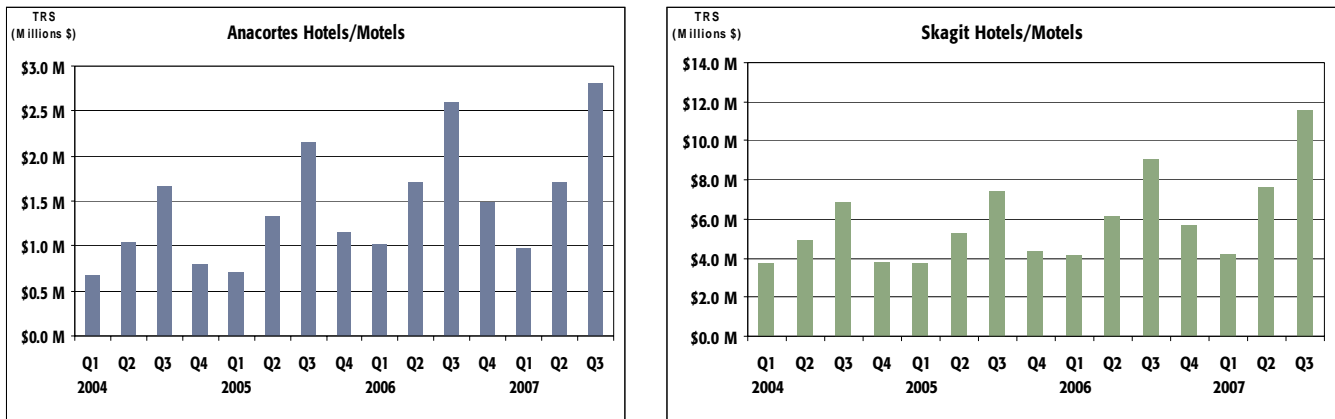


Source: Washington Department of Revenue, 2007

The percentage changes between quarterly Food & Beverage Store sales in Anacortes are nearly identical to the fluctuations seen in Skagit County overall. The largest percentage gains in TRS between Q1 and Q2 peak at about 20% and the largest drops in TRS between Q3 and Q4 average about -10% to -15% for both the City and County. King County shows less seasonal variation with percentage gains and drops about half as extreme as Skagit County and Anacortes. Unlike the restaurant seasonal TRS patterns, Anacortes and Skagit County Food & Beverage stores have very

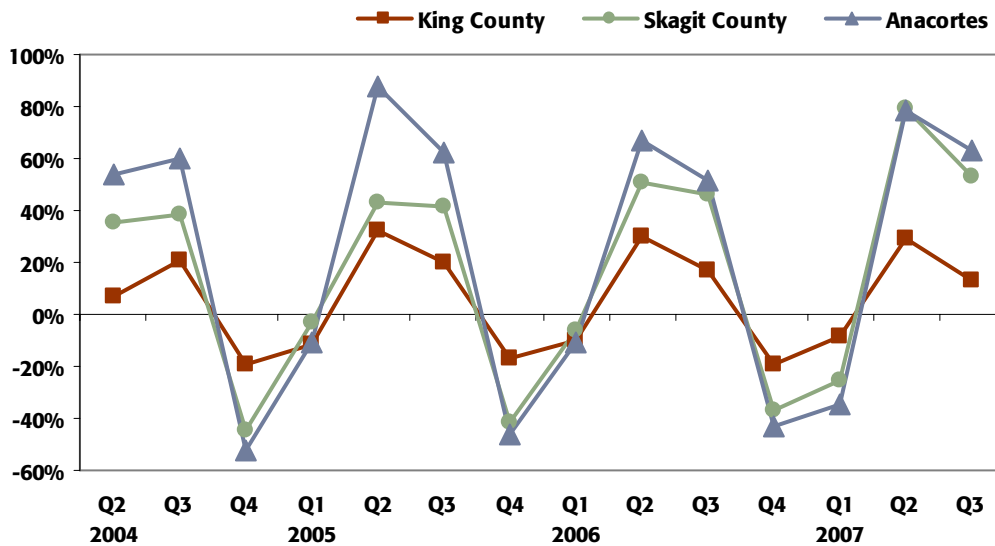
similar seasonal TRS variations. Due to the higher concentration of tourist-related activities in Anacortes and Skagit County, Food & Beverage TRS variation is higher than in King County.

Exhibit 18 Total Hotel & Motel TRS by Quarter, 2004-2007



Source: Washington Department of Revenue, 2007

Exhibit 19 Percentage Change in Hotel & Motel TRS from Previous Qtr, 2004-2007



Source: Washington Department of Revenue, 2007

As expected, sales in the tourism driven Hotel and Motel sector exhibit pronounced seasonal variation. The largest percentage gains in TRS between Q1 and Q2 peak at 60%-80% and the largest drops in TRS between Q3 and Q4 average about -40% to -50%. Between 2004 and 2006 Anacortes hotels saw a larger boost in hotel TRS during the peak quarters than the Skagit County trend. 2005 stands

out in particular when Anacortes saw an 88% increase in TRS between Q1 and Q2, followed up by a 62% increase in TRS between Q2 and Q3. In comparison, Skagit County only experienced quarterly increases of about 40% during the same time period.

During the down seasons, Anacortes does not seem to drop in TRS any more severely than the County average on a percentage basis. This suggests that challenges lodging operators in Anacortes face during the off-peak season are not particularly more extreme than those faced by hotels throughout the County. In fact, the Anacortes lodging sector has seen increasing total TRS during off-peak periods in recent years. TRS increased from about \$700K in 2005 Q1 to over \$1M in 2006 Q1.

While the amplitude of seasonal shifts for Anacortes hotels has held steady over the past few years, the Skagit County pattern shifted in 2007. In previous years, Skagit County hotels and motels saw quarterly increases of about 40% in Q2 and Q3 but in 2007 these increases jumped to 79% and 53% respectively. It is unclear if this is a one-year surge or if the accommodations industry in other areas of Skagit County is becoming more successful at capturing spending by summer travelers.

As with Restaurants and Food & Beverage stores, King County displays much less seasonal variation in lodging TRS, ranging from 30% increases in peak quarters to -20% drops in the low seasons.

3.0 INFORMATIONAL OUTREACH

In order to supplement the demographic and quantitative retail market analysis, a series of interviews were conducted with real estate professionals and members of the development community in Anacortes and surrounding areas. The purpose of these interviews was to gather information on the commercial real estate market in Anacortes and identify strategic opportunities available for the various commercial areas of the City. This section breaks out key interview findings by topic area, starting with regional market trends and moving into specific City and commercial area comments.

3.1 Regional and Skagit County Retail Market

In general, respondents felt that the Northwest and Skagit County retail markets are still relatively strong, despite recent upheavals in financial markets. Interest in new projects in the region has not died and several recent projects such as the new Sportsman's Warehouse, Kohl's, and Walmart were mentioned as signs of continuing activity in the area. The region is not immune to the effects of the recent economic downturn. Citi Financial recently shut down 500 stores nationwide and some national chains like Office Depot have pushed back openings from 2008 to 2009 to meet mandates coming from the financial markets.

Recent difficulty in obtaining financing was cited by one respondent as one of the more significant challenges facing new commercial developments. Lenders are tightening standards and want to see loan-to-value ratios of 70% and debt service coverage ratios of 1.2.

Retail Market in Neighboring Communities (Burlington, Mount Vernon, Oak Harbor)

The Burlington and Mount Vernon retail markets are very strong due to I-5 and SR 20 highway access and are expected to continue growing. Burlington still has buildable land north of the I-5 Auto World, east of the Sportsman's Warehouse, and in other scattered pockets. Mount Vernon has a more constrained land supply with some land south of the City more appropriate for warehousing and light industrial development.

Oak Harbor is a unique tertiary market with strong retail demand being driven by the Whidbey Island Naval Air Station, local population, and strong traffic counts on SR 20. Oak Harbor's retailers draw customers from the south, and similar to Anacortes, ferry riders going to and from the Olympic Peninsula. One respondent described the success of a recent retail project in Oak Harbor that includes a fitness center, Starbucks, and other small eateries. Rents in this new development were higher than some of the vacant class B space in the market but the quality of development and good location resulted in strong sales for current tenants. One challenge in tertiary markets like Oak Harbor and Anacortes with a lot of older commercial space is establishing higher lease rates that can be paid for higher quality new developments. The master plan on the Oak Harbor waterfront was cited as one barrier to entry into the market.

3.2 Anacortes Retail Market

Anacortes Retail Strengths

The City's economy, anchored by strong marine industries, excellent marinas, and the port has enough industrial and commercial development to support the tax base and provide necessary services. This has allowed the City to provide necessary infrastructure to support economic development.

Anacortes residents have a very high quality of life with access to great parks, trails, views, and water. This has attracted many retirees and higher income residents that form the City's retail consumer base. One respondent pointed out that Anacortes will not become a retirement community like those seen in Florida or Arizona because Anacortes has an active working class economy that residents appreciate.

In general, respondents felt that the City was working to provide a welcoming business climate and was supportive of development in line with City plans.

When asked about successful businesses in Anacortes, most respondents mentioned the growing restaurant and pub cluster in the Downtown CBD. The newer restaurants have tended to be more upscale establishments. There is enough variety in restaurants Downtown that one can just drive there and decide what to eat once you're there. One respondent pointed out that reputation in smaller markets like Anacortes is particularly important.

Another type of successful business cited was specialty retailers that have a good business plan and find a niche that attracts local customers, San Juan residents, and other pass-through traffic. Examples of these types of businesses included the Upstage Boutique apparel shop and the Epicure kitchen store.

Anacortes Retail Challenges

The primary challenge to retailers in Anacortes is competition from Burlington and Mount Vernon. Anacortes has a limited selection of retail offerings and many people travel to Burlington and Mount Vernon for shopping trips. In addition, planned highway improvements are expected to soon make it even easier to travel to Burlington for shopping trips.

Recovering retail leakage would be ideal but most respondents pointed out the limited population and market area of Anacortes and expressed skepticism that larger destination-retailers would locate in Downtown Anacortes.

Another challenge to efforts to expand retail offerings in Anacortes is the resistance of some stakeholders to bringing in retail competition that could draw sales from existing locally-owned businesses. Plans to ban format or franchise retail would be a challenge to retail development in the City.

One respondent pointed out that the winter season is very slow for Anacortes retailers and constrains the retail market.

Anacortes Retail Opportunities

Several respondents indicated that there are opportunities to build on tourism and increasing wealth in the community to grow boutique retail, arts-related shops and galleries, restaurants, and hotels. There was a general feeling that there was still room to grow these retail sectors and create a critical mass of activity that attracts more customers. One respondent pointed out that locally-owned retailers in Anacortes could do a better job of merchandising and advertising. There is an opportunity to develop a retail image of a fun place to shop with interesting specialty retailers so that Anacortes becomes more of a retail destination.

When asked about retail opportunities at the Anacortes ferry terminal or the Skyline Marina, some felt there was underutilized commercial land there but others felt the market was limited because of geographic isolation and the small pool of potential customers.

Market Area

The size of the Anacortes retail trade area for most retailers is limited to Fidalgo Island. Some of the popular restaurants or niche stores may draw customers from as far away as north Whidbey Island, Burlington, Mount Vernon, and the San Juan Islands. Several respondents noted that military personnel often visit local restaurants and pubs.

Burton Jewelers was mentioned as a long standing retailer with a regional market area.

The boater population was cited as a major customer group for Anacortes grocery and drink stores.

3.3 Comments on Specific Commercial Areas

Commercial Avenue

- **Redevelopment Activity and Impact on Land Price.** Commercial Avenue is seeing a fair amount of redevelopment activity and the supply of available property is becoming scarce. Most projects involve demolition of old buildings and new construction rather than adaptive re-use or renovation.

The demand for property along Commercial Ave. has driven land prices up to about \$40 per lot SF with some attractive properties selling for up to \$50-\$60 per lot SF. As land prices rise, market pressure is expected drive the purchase and redevelopment of remaining small residential lots in the commercial zone.

- **Types of Retail Demand.** One respondent pointed out that many soft goods and automotive retailers would like to locate along Commercial Ave. on a hard corner at a traffic light. However, there aren't many parcels like this left on Commercial Ave. If R Avenue opened up for commercial development there is probably potential for additional retail development there.

One respondent noted that development towards the south end of Commercial Ave is starting to attract more general office tenants.

- **Feasibility of Mixed-use.** When asked about the feasibility of mixed-use and higher-density projects along Commercial Ave., most respondents felt that the CBD area would be more appropriate for this type of development and one pointed out that underground parking has only been feasible on a project that already had pre-existing excavation on the original site.

Downtown

- **Successful and Growing Restaurant and Pub Cluster.** As mentioned earlier in the Anacortes Retail Strengths section, several respondents pointed out the growing cluster of restaurants and pubs Downtown. Restaurants like the Star Bar, Adrift, Brown Lantern, Majestic, and Bellisima were all mentioned as part of the evolving restaurant cluster that is becoming an anchor for the CBD. There was general agreement that the Downtown selection of restaurants and pubs is becoming more upscale and vibrant, and has the potential to grow. The customer base for Downtown restaurants is coming from local residents, owners of second homes, ferry travelers, and tenants at the Majestic.
- **Specialty Niche Retailers.** Another type of successful business cited was specialty retailers that have a good business plan and find a niche that attracts local customers, San Juan residents, and other pass-through traffic. The Upstage Boutique apparel shop, Epicure kitchen store, Bayshore Office Products, Burton Jewelers, and Watermark Book Company were all mentioned as examples of successful Downtown specialty retailers.
- **Older Buildings Need Improvement.** One respondent pointed out that many older buildings in the CBD need electrical upgrades and significant tenant improvements to become viable for successful business operations. These investments can be very expensive and are a constraint on new business development in the CBD.
- **Feasibility of Mixed-use.** Even though height limits were raised to encourage mixed-use development, parking requirements were not changed and these were cited by several respondents as a barrier to the feasibility of mixed-use. Adjustments of these requirements will be necessary to allow for development of smaller more affordable units and apartments.

There were several mixed-use multifamily developments in the planning stages before the recent downturn in the condominium market. One respondent predicted that strength in the condominium market would not return until about 2010.

MJB Property (Waterfront Commercial Marine 1 Zone)

- **Potential Uses.** Several potential uses were mentioned for the north portion of the MJB property including condominiums, marine-related offices, restaurants, a marina, a hotel, and a convention/meeting facility. Some felt that traditional retail would not be appropriate for the site and others felt that some specialty retail could be supported if a hotel or other anchor use was incorporated into the site.
- **Linkage with Downtown CBD.** There was general agreement among respondents that creating a walkable linkage from development on this property to the CBD would increase the

attractiveness of both sites. The City's effort to extend the Tommy Thompson trail and link it to the Guemes Channel trail through Downtown was cited as an excellent idea.

The linkage between the Commercial Ave. and the MJB Property was not felt to be as important. However, some respondents pointed out that development on the MJB Property could create the opportunity to develop commercial frontage along Q Avenue.

- **Compatibility of Uses.** One respondent pointed out the need to include some type of buffer between residential uses and the industrial uses to the south. Another pointed out that some residents may actually be attracted to the marine activity they can watch from their windows.

March Point Highway 20 Corridor

- **Perspectives of National Retailers.** Several respondents were asked about the perspectives of larger-scale national retailers to gauge the potential for this type of development in Anacortes, particularly in the March Point Highway 20 Corridor.

One respondent pointed out that stores like Costco, Fred Meyer, Target, and Home Depot do extensive market research and have well-defined formulas that determine location decisions. Attributes these types of retailers value include population, income levels, education levels, transportation access, traffic counts, and proximity to competitors. Once these anchor retailers decide to build a store many other companies follow them to capitalize on the anchor's built-in retail draw.

- **Feasibility of Large-scale Retail.** There were mixed opinions amongst respondents about the feasibility of large-scale retail in the March Point Highway 20 Corridor. Some felt that the high traffic counts on SR 20 going to Whidbey Island and Anacortes would support large-scale retail at Sharpes Corner. One respondent pointed out that national retailers would only want to locate on SR 20 and there is not much available commercial land along SR 20 today.

Others felt that large national retailers would not want to locate at March Point due to the lack of population around the site and that many potential customers would pass retail offerings in Burlington, Mount Vernon, Oak Harbor, or Anacortes before getting to the site.

In general, most agreed that if the City removed zoning restrictions on retail in this area, many developers would be interested in working with the City to fully explore the site's potential.

- **Opportunity to Recapture Leakage.** There was general agreement that retail development in the area was a great opportunity for the City to recapture leakage, particularly if the development included a general merchandise store like Costco, Target, or Fred Meyer.
- **Potential Impact on Downtown Retail.** Most respondents pointed out that the biggest risk to opening the area up to large-scale retail development was the potential cannibalization of sales from existing Commercial Ave. and Downtown retailers. Some respondents pointed out that there are a lot of retailers that would not overlap significantly with products offered by current Anacortes retailers and the negative impacts could be minimized.

- **Lost Development Opportunities.** The types of development opportunities that have been missed due to the area's light industrial zoning include a gas station and a local glass company that wanted to move there and have a retail operation to complement its light industrial activities.
- **Industrial Land Demand.** When asked about the need to preserve the light industrial land to support the City's long-term marine industry needs, one respondent questioned whether there was already enough space in other Commercial Marine zones in the City.

4.0 FUTURE/POTENTIAL COMPETITIVE ASSESSMENT

In the long run, retail development in a given market is driven by three factors:

1. **Increases in spending** within the area’s existing market area—which in turn is driven by increases in population and/or household income;
2. **Increases in penetration** of the existing market (i.e. capturing a larger share of local dollars); and/or
3. **Expansion of market area** by attracting shoppers from areas that have historically fallen outside a node’s retail trade area.

In terms of increases in spending, the City has been growing at a steady pace in recent years with an influx of higher income population but will soon face challenges associated with a dwindling supply of buildable land. In terms of market penetration, the City has relatively strong capture of local retail spending in daily goods categories like groceries and drugstores but faces challenges in trying to expand capture of destination-retail goods such as apparel and general merchandise. In terms of market area expansion, the City’s separation from other population centers makes it difficult to expand market areas except in selected retail sectors. The following section will discuss potential implications that these three drivers of growth will have for the City of Anacortes retail market.

4.1 Population Growth and Demographic Trends

Exhibit 20
Population Growth in Retail Trade Areas, 2007-2025

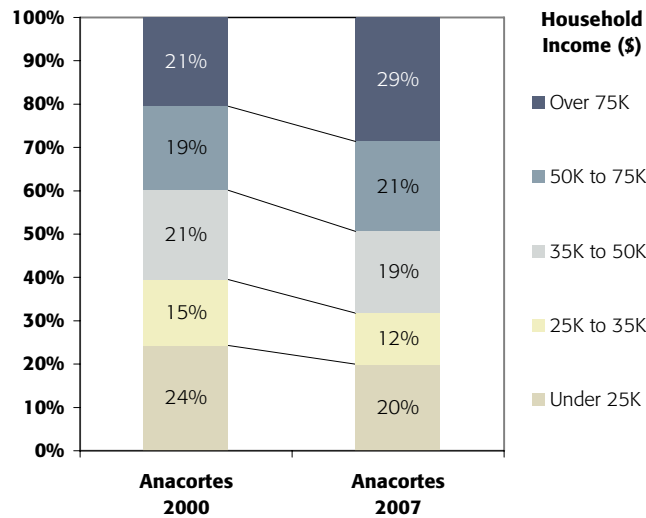
Area	Population			Annual Avg. Growth Rate 2007-2025
	2007	2025	Growth 2007-2025	
Anacortes	16,400	19,300	2,900	0.91%
Unincorporated Fidalgo and Guemes Island	4,661	5,537	876	0.96%
Total Primary Trade Area	21,061	24,837	3,776	0.92%
Secondary Trade Area (N. Whidbey, San Juans)	24,689	32,954	8,265	1.62%
Skagit County	115,300	149,080	33,780	1.44%

Source: WA Office of Financial Management 2007; Skagit County Population and Employment Allocation Final Report, 2003

Exhibit 3 earlier in the report showed that Anacortes and the Primary Trade Area have been growing slightly faster than the Skagit County average since 2000 (over 1.7% annually). In the long term this growth rate is expected to slow due to a lack of developable land in the City and growth management policies intended to focus population growth in urban areas along the I-5 corridor. Based on Skagit County’s long-term population forecast allocations, growth in the primary trade area is predicted to grow by about 3,800 persons by 2025. The secondary trade area, which includes north Whidbey

Island and the San Juan Islands, is projected to grow at a faster pace and add over 8,000 population by 2025.

Exhibit 21
Anacortes Income Distribution Change, 2000-2007



Source: U.S. Census Bureau, 2000; Claritas, 2007

The spending power of local residents has grown significantly in the past seven years as indicated in **Exhibit 21**. The most significant shift is in the share of households with incomes more than \$75,000, increasing from 21% in 2000 to 29% in 2007. Many wealthier households are being attracted to the natural beauty and amenities of Anacortes and this is increasing the spending power of the local residential base. In addition to additional spending, if the shift in income levels continues, this will also have an impact on the types of retail options demanded by local residents. The wealthier the local population becomes, the greater the demand will be for additional specialty grocery, restaurant, and retail options.

4.2 Projections of Demand for Retail Space

Demand for retail space in a particular area is driven by increases in population and household income. The spending power of a trade area’s population can be converted into estimates of retail square footage by using assumptions about the average spending per capita in various retail categories and the average sales per square foot generated at typical retailers in those same categories.

For example, if a trade area comprised 1,000 persons who spent on average \$2,000 per person annually on groceries, and grocery stores in the area average \$400 of sales per square foot, one could calculate the square footage of grocery store space supported by these residents to be 5,000 SF. **Exhibit 22** below shows a detailed representation of this sample calculation for demand generated by population growth in the Anacortes Primary Retail Trade Area.

Exhibit 22

Estimates of Retail Space Demand from Primary Trade Area Population, 2007-2025

How many people will move into the Primary Trade Area in the next 18 years?				
1	Population in 2007 (within Primary Trade Area)	21,061		
2	Annual average population growth rate 2007-2025	0.92%		
3	Estimated population in 2025	24,837		
4	Estimated population growth between 2007 and 2025	3,776	persons	

How much new retail space will these new residents support?					
	Restaurants	Groceries/ Drugstores	Other Retail (no auto)	Total	
5	Income adjusted retail revenue (GBI) per capita, 2006 <i>(The average amount each resident in the trade area spends annually)</i>	\$1,510	\$3,380	\$12,610	\$17,500
6	Estimated increase in retail revenue due to population growth <i>(Line item 4 multiplied by line item 5)</i>	\$5,702,000	\$12,763,300	\$47,617,000	\$66,082,300
7	Dollars per s.f. of retail space <i>(Assumption based on regional averages)</i>	\$390	\$400	\$320	--
8	Total increase in retail space demand (s.f.) <i>(Line item 6 divided by line item 7)</i>	15,000	32,000	149,000	196,000

Source: Berk & Associates, 2008

Note: Some totals may not add up exactly due to rounding.

Exhibit 22 shows that the 3,776 persons expected to move into the Primary Trade Area over the next 18 years will generate enough spending power to support about 196,000 SF of additional retail and restaurant space. These same calculations were carried out for population growth in the Secondary Trade Area (8,265 additional population by 2025), which added another 469,000 SF of future retail demand.

4.3 Potential Retail Market Capture

It is important to note that **Exhibit 22** is estimating the *entire* pool of retail demand in the primary trade area. Retailers in Anacortes can only expect to capture a portion of this new demand since much of the spending, particularly in the “other retail” category, will be captured by the regional retail competition in Burlington and Mount Vernon.

Typically, increases in retail market penetration or capture are driven by the emergence of compelling retail centers that are large enough to attract nearby consumers and compete with other retailers in the area. The most significant challenge facing retail development in Anacortes is distance from the major I-5 transportation corridor and large population centers. Without more traffic and “rooftops,” it will be difficult to attract large-scale regional anchor retailers to the Anacortes CBD. On the positive side, this same geographic challenge is also an advantage for more locally-oriented retailers that serve the Primary Trade Area and do not have to compete with any nearby retail centers.

Based on our understanding of the relative strengths and weaknesses of the Anacortes retail market and knowledge of existing retail spending patterns, two possible scenarios of retail “capture” were developed. These scenarios, shown in **Exhibit 23**, assume that Anacortes maintains its current pace and scale of retail development without any significant projects that would trigger a market expansion.

These types of market-changing scenarios, such as large-scale retail development in the SR 20/March Point Corridor, are discussed later in **Section 5.0**.

Exhibit 23 Sensitivity Analysis of Retail Space Estimates

Low Capture Scenario	Restaurants	Groceries/ Drugstores	Other Retail (no auto)	Total
Demand for Retail Space (SF)				
From Primary Trade Area	15,000	32,000	149,000	196,000
From Secondary Trade Area	35,000	77,000	357,000	469,000
Capture Rate Assumption				
Primary Trade Area	60%	70%	30%	39%
Secondary Trade Area	20%	25%	10%	13%
Possible Capture of Future Retail Development (SF)				
From Primary Trade Area	9,000	22,000	45,000	76,000
From Secondary Trade Area	7,000	19,000	36,000	62,000
Total	16,000	41,000	81,000	138,000
High Capture Scenario	Restaurants	Groceries/ Drugstores	Other Retail (no auto)	Total
Demand for Retail Space (SF)				
From Primary Trade Area	15,000	32,000	149,000	196,000
From Secondary Trade Area	35,000	77,000	357,000	469,000
Capture Rate Assumption				
Primary Trade Area	70%	80%	35%	45%
Secondary Trade Area	30%	30%	20%	22%
Possible Capture of Future Retail Development (SF)				
From Primary Trade Area	11,000	26,000	52,000	89,000
From Secondary Trade Area	11,000	23,000	71,000	105,000
Total	22,000	49,000	123,000	194,000

Source: Berk & Associates, 2008

Note: Some totals may not add up exactly due to rounding.

Both the low and high capture scenarios assume a fairly strong capture of restaurant and convenience-oriented retail demand (groceries and drugstores) – assumptions supported by the person-expenditure analysis presented earlier and the 2006 consumer survey results attached in Appendix A. The Other Retail category, which includes several of the weaker retail segments in Anacortes (apparel, general merchandise, furniture, and electronics), has much lower assumed capture rates to reflect the fact that many trade area residents now travel to Burlington and Mount Vernon to take care of these shopping needs.

Based on the projections of future demand for retail space and a range of capture rates for the primary and secondary market areas, Anacortes can expect to see between 138,000 and 194,000 SF of retail development over the next 18 years. To put this in context, this is the equivalent of about 5-

10 additional restaurants (@ 1,500 to 2,000 SF each), one additional grocery store (@ 25,000 to 40,000 SF), possibly an additional drugstore (@ 10,000 SF) and several additional specialty retailers.

About half of the projected retail demand (76,000 SF – 89,000 SF) is coming from population growth in the City's Primary Trade Area and can more-or-less be counted on. The other portion of demand coming from the Secondary Trade Area is retail development the City might see if Anacortes retailers are successful at increasing market penetration and/or improving their ability to attract more visitors.

Two important additional sources of potential demand not estimated in **Exhibit 23** are 1) recapture of retail sales currently leaking to Burlington and Mount Vernon and 2) additional tourist spending that is coming from outside the Primary and Secondary Trade Areas. If Anacortes were to attract a large-scale general merchandise retailer to March Point or elsewhere in the City it would recapture a significant portion of sales leakage. If Anacortes retailers were able to capture more tourist spending or if the City's tourism strategy boosts visitor counts above existing levels, a larger retail base would be supported.

The next section will discuss strategies and options for the City to best leverage the expected demand for retail to enhance the attractiveness of its commercial areas and attract the types of development that fits the City's vision and ensures a fiscally sustainable future.

5.0 RECOMMENDATIONS AND STRATEGIC OPTIONS

Anacortes is a unique tertiary retail market limited by geographic isolation but bolstered by its position as a gateway to the San Juan Islands, a strong employment base, and high quality of life for local residents. As the City explores a coordinated economic development strategy, the fundamental challenge the City faces is how to leverage projected local demand for new residential, retail, and commercial space in a way that enhances the amenity value of its Downtown CBD, Commercial Avenue, and other important commercial areas in the City. If this is done successfully, the City will be able to support existing local businesses, increase the diversity of retail options available, and attract the types of investment the City desires. The following recommendations and strategic options are organized around the specific commercial areas of interest and focus on how best to address challenges and take advantage of opportunities in each area.

General Recommendations

- **Consider Partnership with Leasing Professional.** Anacortes is a unique market that may not be as well-understood by national retailers or others in the development or leasing community. The City may want to consider working with a retail leasing professional to help refine the City's vision for its commercial areas and then actively market Anacortes retail opportunities to appropriate developers and business owners.

If a formal relationship with a leasing professional is not feasible, the City should continue supporting initiatives by local business groups and pursue opportunities to collaborate with the development community and land owners on projects that increase the attractiveness of retail areas in the City.

- **Integrate All Components of Economic Development Strategy.** The retail component of the City's economic development strategy should not operate independently. It should be incorporated into a strategy that takes advantage of other efforts to encourage tourism, support marine industries, and develop a convention center.
- **Continue Efforts to Maintain a Healthy Business Climate.** The City should continue working with and communicating regularly with the local business and development community to ensure that quality retail opportunities are not missed or discouraged. When passing new development standards or regulations, potential adverse impacts or unintended disincentives to quality development should be considered.
- **Monitor Actual Impacts of Streamlined Sales Tax Change.** In July 2008, the Washington State Department of Revenue will implement a change to sales tax sourcing rules that should result in a positive impact on Anacortes sales tax revenues. Due to uncertainty regarding the magnitude of these impacts, the City should monitor actual revenue impacts and use these findings to inform any major land use decisions related to the City's retail or economic development strategy. If the sourcing rules change results in a significant increase in sales tax revenue, it may reduce the need to take more aggressive actions to address the City's fiscal sustainability challenges, which were highlighted in the 2006 Berk Economic Study. A more detailed description of the Streamlined Sales Tax changes is included at the end of this Section.

Central Business District – Downtown

- **Promote and Support Restaurants and Specialty Retailers.** Informational outreach interviews and TRS analysis identified restaurants and specialty retailers as a core strength of the Downtown CBD. These businesses support the local population but also attract tourists and visitors to the CBD from a larger trade area.

A retail district's anchor does not have to be a national retailer. For an area like the Anacortes CBD, the mix of locally-owned and operated restaurants, specialty stores, art galleries, and service providers can collectively provide the draw that makes the CBD a successful and vibrant Downtown. The recent growth and clustering of restaurant activity Downtown has started to create a draw and synergy that supports all businesses in the CBD. Another positive effect the restaurant cluster has on the CBD is extending the hours of activity on Commercial Ave. into the night. Even if other retailers currently do not stay open into the night, this may change in the future if enough activity is generated by the growing restaurant cluster in Downtown Anacortes.

- **Explore Linkages with Tourism Component of Economic Development Strategy.** There are clear linkages between tourism and retail activity in Anacortes, particularly in the restaurant and lodging sectors. As the City explores the tourism component of its economic development strategy, it should consider linkages to CBD promotion not only during the peak travel seasons but also opportunities to attract visitors in the shoulder and off-peak seasons to lessen the impact of seasonal swings in sales.
- **Encourage Redevelopment or Renovation of Older Structures.** Much of the building stock in the CBD is older and in need of significant systems upgrades and tenant improvements to become viable for a successful business. This was brought up in the interview process as a barrier to new business starts. The City could explore ways to encourage and incentivize renovation of older buildings through technical assistance programs or building code educational outreach.
- **Encourage Mixed-use Multifamily Projects.** The addition of more residences in the CBD will increase foot traffic and vibrancy Downtown. Mixed-use multifamily developments are not common in Anacortes but there are some market indicators that mixed-use development could be feasible in the CBD. Before the recent slow down in the housing market, there were several Downtown mixed-use residential above commercial projects in the planning stage. These projects have since been tabled but may return if market conditions improve.

In addition to the unproven market for Downtown condominiums, an additional challenge to mixed-use developments Downtown is the feasibility of underground parking. Land values in the CBD have been climbing but they are still not high enough to justify the high cost of underground parking construction. As a result, mixed-use projects must rely on surface parking options, which limits the scale and mix of feasible uses. The City's current parking code¹ generates pressure for

¹ Between 4 and 5 stalls per net rentable SF for mixed retail and office and 1.2-1.8 stalls per multifamily residential unit. Code does allow for in lieu payments to an off-street parking fund to satisfy parking requirements.

larger-unit condominium projects that can more easily satisfy parking requirements and still be profitable. Some interviewees indicated that parking requirements are a significant barrier to mixed-use developments in the CBD.

It is unclear whether Mixed-use projects could be incentivized through City policies in the current housing market climate but the City may want to revisit parking requirements and other mixed-use zoning provisions if desired types of new developments do not emerge in the near future.

Commercial Avenue

Commercial Avenue is seeing a fair amount of redevelopment and property values are quite high for the area. The strip of commercial activity currently offers a wide variety of retail and professional services and is developing in a manner consistent with the City's designation of the area as an auto-oriented commercial zone. In many ways, the market pressures and expected redevelopment patterns identified in the 2006 Berk Economic Study have been playing out as expected.

- **Monitor Commercial Land Supply.** There currently appears to be sufficient redevelopable land along Commercial Avenue but the City should monitor buildable lands to ensure retailers have space to expand and move into the Anacortes market as the area grows. Some interviewees mentioned the possibility of opening up frontage along Q Avenue at some point for additional retail development opportunities.
- **Targeted Business Recruitment.** The spending patterns analysis in this report identified several retail sectors leaking sales to neighboring shopping areas. The City should consider working with a retail leasing professional to explore targeted recruitment efforts of retailers that would meet local demand and fit appropriately along Commercial Avenue. Possible retail categories to pursue would be sports, books, music, and toy stores, which had relatively low person-expenditures and may be appropriate for Commercial Ave.
- **Mixed-use Development.** Mixed-use development along Commercial Ave. is not supported by current market dynamics. From the City's perspective, it would be more worthwhile to focus mixed-use development incentives and support on the CBD rather than Commercial Ave.

Waterfront Commercial Marine

- **Continue Trail Improvements.** The City should continue its Tommy Thompson Trail improvements and other projects that increase the linkage between Downtown, the Commercial Marine property, and the Fidalgo Bay waterfront. When development occurs on the MJB property or Port property, the City's CBD will be prepared to take advantage of new traffic and activity.
- **Continue Collaboration with MJB.** City staff should continue efforts to collaborate with MJB in developing the CM1 zoned property as a mixed-use, pedestrian-friendly, transitional zone.
- **Consider Additional Market Analysis.** Feasibility of some of the special uses being considered for the MJB site such as a hotel or conference/meeting facility could be determined through additional targeted market analysis. The City should consider supporting this type of analysis if it could advance planning and development efforts on the site.

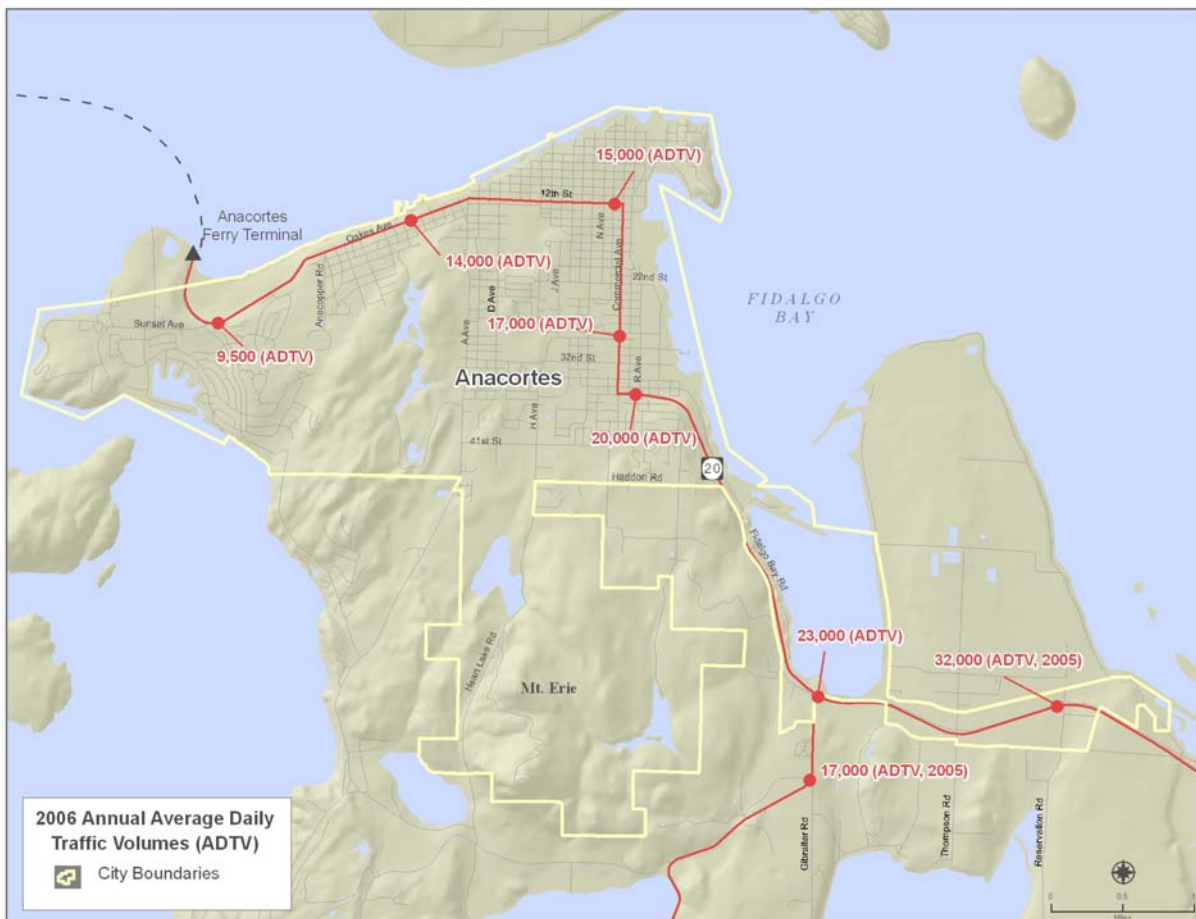
March Point Highway 20 Corridor

The SR 20/March Point Corridor presents a unique set of strategic choices regarding potential retail development. The City could leave the area with its current light manufacturing/industrial zoning and limit retail development to auto and boat dealerships. Alternatively, the City could adjust zoning to allow for more retail uses and take advantage of retail market demand for this attractive location. Each of these choices is accompanied by a set of risks and opportunities that should be considered before making a policy decision.

Opportunities if Retail Allowed

- Market Feasibility and Proven Interest.** From a retailer’s perspective, the greatest strength of the SR 20/March Point Corridor is the high traffic intersection where traffic to and from Whidbey Island, Anacortes, the Skagit Valley, and the San Juan Islands all comes together. **Exhibit 24** shows the Annual Average Daily Traffic Volumes (ADTV) for selected road segments along SR 20.

Exhibit 24
Annual Average Daily Traffic Volumes, 2006



Source: WSDOT Annual Traffic Report, 2006

The section of SR 20 near Reservation road and the eastern border of the City sees 32,000 daily trips. This traffic splits at the SR 20 intersection where a portion heads north towards Anacortes and a portion heads south towards Oak Harbor.

According to interviews with local real estate brokers and developers, there has been some interest by large scale retailers to develop along the March Point Highway 20 Corridor to take advantage of the high traffic counts and potential customer base in Anacortes, Oak Harbor, and the San Juan Islands.

- **Recapture of Sales Leakage.** If the City were to allow this type of development it would create an opportunity to recapture sales currently leaking to retail centers in Burlington and Mount Vernon and improve the City's long-term financial situation.
- **Improved Retail Offerings.** New retail development at March Point has the potential to improve the diversity of retail offerings in Anacortes and make shopping much more convenient for local residents.

Risks of Allowing Retail

- **Potential Impact on Downtown Retail.** The biggest risk to opening the March Point Highway 20 Corridor up to large-scale retail development is the potential cannibalization of sales from existing Commercial Ave. and Downtown retailers. The retail spending analysis in this report shows that Anacortes has a fairly diverse range of retail offerings except for a few categories like Apparel and General Merchandise. If a large general merchandise retailer like Costco, Target, or Fred Meyer were to locate in the City, several of the specialty retailers along Commercial Ave. and the CBD would likely experience a loss of sales.

However, many other niche retailers in Anacortes offer specialized products or services and would not overlap significantly with most types of large-scale retail. It is possible to minimize the negative impacts by working with land owners and developers to recruit retailers that don't compete as directly with current City businesses.

- **Market does not Materialize.** The March Point Highway 20 Corridor has favorable traffic counts but lacks any significant population concentrations in its immediate vicinity. This may deter national retailers from locating in the area and City may not get the desired development by changing the zoning.
- **Loss of Industrial Lands.** The Anacortes economy has a strong foundation in marine related activities and shipbuilding. As prime waterfront industrial lands are used up over time, the March Point Corridor provides industrial land these businesses can use for storage or other activities that do not require waterfront access. If the City gives up this land to retail development, it runs the risk of running out of land in the future to support the City's important shipbuilding sector. In order to minimize this risk, the City should conduct a buildable lands and industry needs assessment to determine how adequate the City's long-term industrial land supply is.

Risks of not Allowing Retail

- **Emerging Retail Centers.** If the City preserves the light industrial zoning along the March Point Corridor it runs the risk of losing market position to potential large-scale retail development on Swinomish Tribe property or in Oak Harbor. Retailers prefer to locate in existing retail nodes and near other complementary anchor retailers. If a neighboring jurisdiction establishes a significant market presence in the same trade area as the March Point Corridor, it will be that much more difficult to create a retail development at March Point in the future.

The City should monitor plans for significant retail developments in the area to determine potential risks to existing retailers and future development opportunities.

Overall, retail development along the SR 20/March Point Corridor offers the potential to recapture sales leakage and increase the diversity of retail offerings in Anacortes but risks harming Downtown retailers and upsetting emerging vibrancy Downtown and along Commercial Avenue. If the City chooses to consider retail options in this area, it should take a cautious approach to any major land use decisions and take steps to minimize risks and ensure that changes support the City's broader fiscal needs and the community's desired vision for the future.

Sales Tax Streamlining – Sourcing Rule Changes

In addition to the analysis of retail strategies and options for commercial areas in Anacortes, the City has also requested an analysis of potential impacts of new changes to Washington State sales tax sourcing rules. This section describes these changes and potential impacts to City of Anacortes sales tax revenues.

In recent years, representatives from Washington State have participated in a cooperative effort among states and private industries to create more uniform sales tax structures, referred to as the Streamlined Sales Tax Project. The Project's mission is to simplify the rules surrounding the levying of sales taxes, paving the way for taxation of delivered goods (such as catalog and Internet sales) whose sales originate out-of-state.

To position itself for inclusion in the interstate sales tax project, Washington has changed its retail sourcing rules, changing the so-called "point of sale" of many delivered goods from the delivery's *point of origination* (as it is now) to its *point of delivery*. The rule change will take effect in July 2008.

What this means for Washington cities is that the generation of sales tax revenues will shift *away* from points of origination (e.g. lumber yards, mattress-delivery warehouses, or pizza delivery stores), shifting *to* the place where goods are delivered (houses and a wide variety of businesses). For many largely residential cities, this shift will result in a net increase in sales tax revenues flowing in.

Since Washington's Department of Revenue (DOR) has never tracked where delivered goods go, no hard data exist to tell us how the sourcing rule changes will impact a given city. DOR has developed models to try to predict revenue impacts to counties and cities, but it is not clear how accurate those estimates will turn out to be.

Having talked with the DOR about their estimation methods, and having worked with a number of cities to estimate the specific impacts they would be likely to see, we believe that cities should think about likely impacts in light of a few key considerations:

- **Auto and boat sales are excluded from sourcing rule changes.** This is good news for Anacortes, which has about 40% of its retail sales tax base in these categories.
- **Higher income households are likely to generate more delivery sales than lower income households.**
- **Cities with delivery warehouses will tend to be negatively impacted.**
- **Cities with offices that house internet sales will be negatively impacted.** (E.g. Under current rules, a relatively small office that sells sunglasses via the internet can generate a lot of sales tax revenues for a city. With the rule changes, sales taxes from those sales will flow to the place where orders are delivered.)

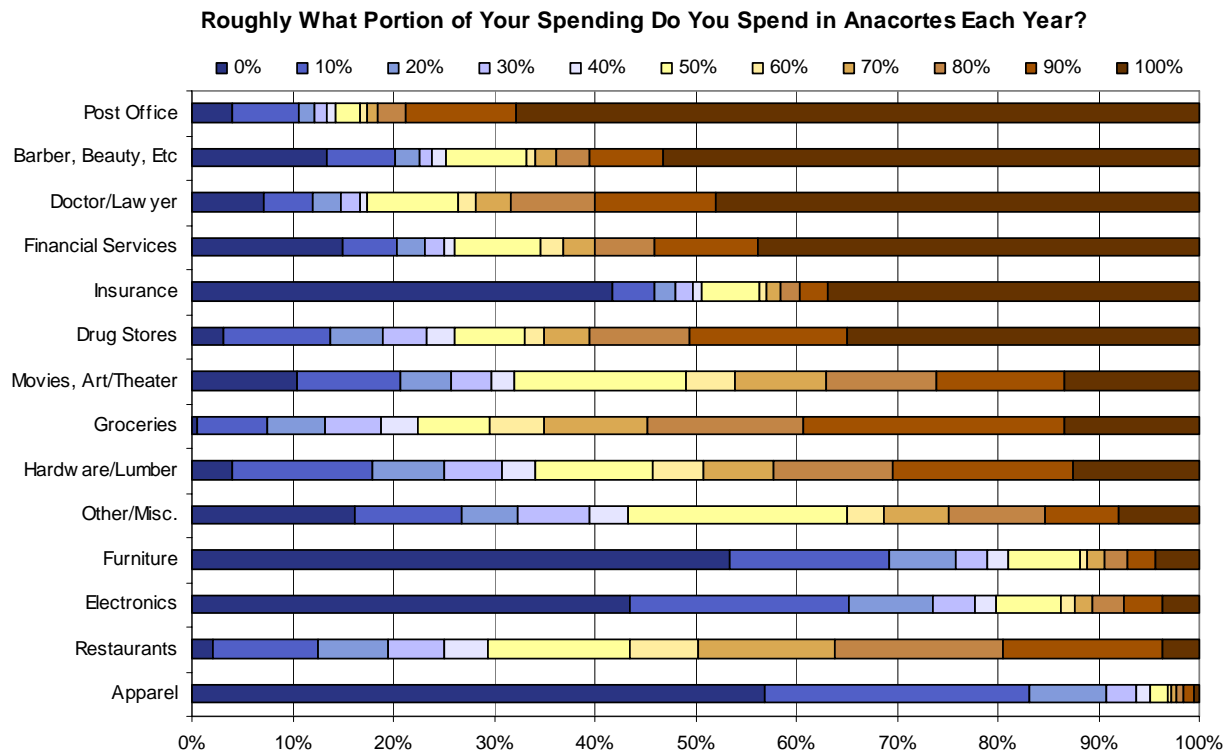
In light of these considerations, it appears that Anacortes should be well positioned to benefit from the sourcing rule changes. It is also worth noting that the City may want to take actions to improve its position vis-à-vis delivered goods over time. For example, the City may want to raise awareness among its constituents that having purchases delivered to homes or offices offers a fiscal boon to the City. To the extent that the City can tie gains in these revenues to investments or services the community cares about, residents and businesses may feel highly motivated to shift their buying habits.

From a land-use-planning/retail-development perspective, however, sales tax sourcing rule changes are unlikely to influence a city's actions beyond the obvious. All else being equal, adding new housing or new offices to a city becomes marginally more attractive (from a fiscal perspective), and adding warehousing becomes marginally less attractive. For a city like Anacortes, however, most other retail outlets will still be desirable.

Given the uncertainty regarding the magnitude of actual sales tax revenue impacts of the new sourcing rules, the City should closely monitor sales tax revenues after the program is implemented later this year. The actual revenue impacts and their fiscal implications could inform major land use decisions related to the City's retail or economic development strategy. If the sourcing rules change results in a significant increase in sales tax revenue, it may reduce the need to take more aggressive actions to address the City's fiscal sustainability challenges, which were highlighted in the 2006 Berk Economic Study.

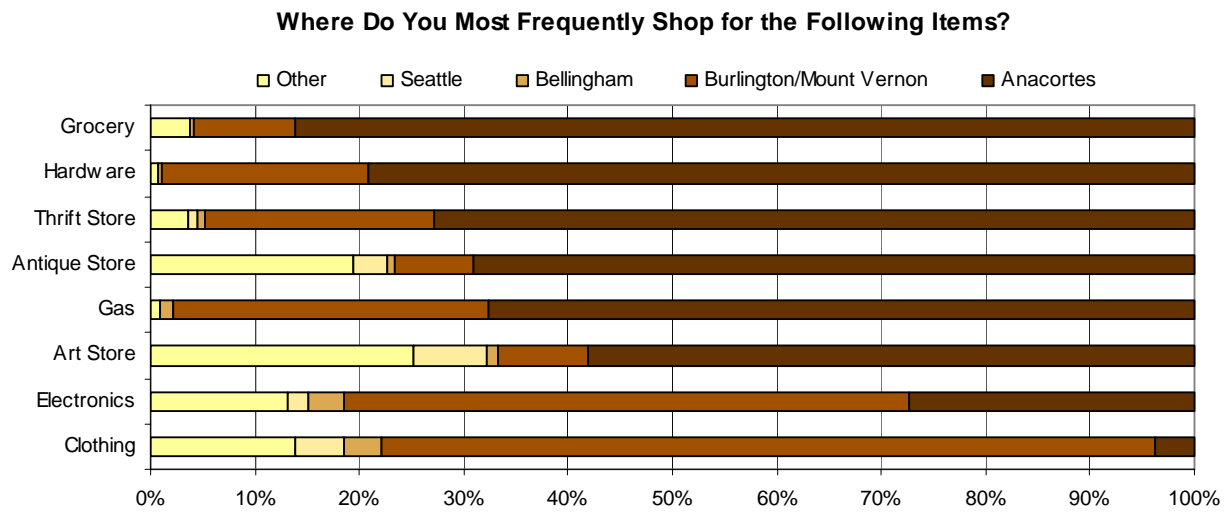
APPENDIX A – 2006 CONSUMER SURVEY FINDINGS

Exhibit A- 1
Portion of Annual Spending in Anacortes by Category



Source: City of Anacortes Consumer Survey, 2006

Exhibit A- 2 Most Frequent Shopping Destination by Category



Source: City of Anacortes Consumer Survey, 2006

APPENDIX B – INTERVIEW CONTACT LIST

The following is a list of individuals interviewed as part of the real estate market informational outreach process.

- John Prosser, Windermere Real Estate
- Jim Clarke, John L. Scott Real Estate
- Jim Koetje, Windermere Real Estate
- Troy Muljat, KT Development, The Muljat Group
- Marc Estvold, Architect and Consultant
- Duncan Frazier, Anacortes Financial Associates