

Larkin Hoffman Daly & Lindgren Ltd.

1500 Wells Fargo Plaza
7900 Xerxes Avenue South
Minneapolis, Minnesota 55431-1194

GENERAL: 952-835-3800
FAX: 952-896-3333
WEB: www.larkinhoffman.com

September 4, 2014

Mr. Larry Lee
Community Development Director
City of Bloomington
1800 West Old Shakopee Road
Bloomington, Minnesota 55431-3027

Re: Southtown Center Rezoning Impact Analysis and Mitigation
Our File # 36,977-00

Dear Mr. Lee:

We represent Kraus Anderson, Incorporated, the owner Southtown Shopping Center ("Southtown") and Kraus Anderson Realty Company the manager of Southtown (referred to together in this letter as "Kraus Anderson"). This letter is to respond to your recent email to my client and to summarize the negative consequences of the rezoning of Southtown proposed by the City of Bloomington (the "City").

At the July 10, 2014 meeting between Kraus Anderson representatives and City staff, we agreed to provide the City with a summary of concerns regarding the proposed rezoning. We have commissioned a report from the McComb Group, Ltd., one of the state's leading retail consultants, to provide a comprehensive analysis of the proposed rezoning actions associated with the Penn American District Plan (the "Penn American Plan" or the "Plan") on Southtown. We have summarized below a number of the significant negative impacts that would result from the rezoning. The report, titled Penn American District Plan: Impact on Southtown Center, (July 2014) (the "McComb Report" or the "Report") is enclosed.

We have also summarized our concerns regarding the City's continued action in concert with Metro Transit to effect significant regulatory takings to accommodate the future Orange Line Bus Rapid Transit (the "Orange Line") that is intended for alignment through Southtown. The City's ongoing efforts to push forward the Penn American Plan implementation and collaborate with Metro Transit to accommodate the Orange Line will cause a significant diminution in value to Southtown for an intended public benefit, and will constitute a regulatory taking under the Minnesota Constitution.

THE MCCOMB REPORT

The Report provides a comprehensive analysis of the existing state of Southtown, a review of the proposed changes associated with the Penn American Plan, and a summary of the impacts of the proposed changes on Southtown. The Report also draws comparisons between the City's vision for

Mr. Larry Lee
September 4, 2014
Page 2

Southtown and case studies of similar retail center redevelopments in the state. We have highlighted some of the most relevant conclusions from the report below.

The Ongoing Viability of Southtown

1. Southtown is a Viable Regional Shopping Center

Unlike many similar regional shopping centers in the Twin Cities, Southtown has been successful and remains viable. The current vacancy rate is 0.6 percent, which is far below the average vacancy of 7.2 percent for shopping centers in the metro area. While Kraus Anderson has made ongoing improvements in Southtown, and will continue to do so in the future if allowed under the City Code, the proposed zoning changes will result in most of the site becoming nonconforming and will limit the viability of Southtown as a regional retail center.

2. Significant Investments Have Been Made in Southtown

Southtown has been continuously improved over its nearly sixty year history. More recent investments include the two-story Kohl's building and small-scale shops such as Bruegger's and Starbucks. Approximately twenty-five percent of Southtown is less than twenty years old. Long-term leases for many of the newer tenants run another thirty years.

3. The Viability of the Penn American District Retail Depends on the Draw of Southtown Tenants

The major anchor tenants of Southtown draw regional customers to the Penn American District. Both the smaller Southtown tenants and the surrounding retail businesses depend on the draw of these larger tenants to bring customers to the area. Disrupting or eliminating the flexibility for tenants to change and grow will have significant impacts on other surrounding businesses, not only those located at Southtown. In addition, a healthy and vibrant commercial district requires a balance of uses. Discouraging the continuation of Southtown through highly restrictive zoning scheme does not promote a balanced land use strategy.

Constraints to Redevelopment

1. Xcel Energy Owns a 50' Easement Across the Entire Southtown Site

The entire Southtown site is transected by a fifty foot easement for Xcel Energy, which carries an electric transmission line with five towers between Penn Avenue and I-35W. See Figure 2-12. The easement prohibits any further building additions or additional structures in the easement location. Estimates for burial of the electric transmission lines are approximately \$9.0 million. To simply install more attractive transmission towers and amend the easement is estimated to cost about \$2.0 million. Both scenarios are cost-prohibitive and the added expense would greatly hinder future redevelopment.

Mr. Larry Lee
September 4, 2014
Page 3

2. Existing Tenants Have Leases More than 30 Years into the Future, Which Will Prevent Redevelopment

Many of the larger existing tenants have leases or lease options that extend in to the late 2030s and as far as 2045. These existing leases will ensure long-term viability of the center, and will preclude redevelopment at least thirty years. As with any shopping center, Southtown's interest in maintaining a viable regional shopping center will likely require continuation of leases that will extend beyond this period. The potential buy out of such leases would be exceedingly expensive and cost prohibitive and will prevent redevelopment.

3. Existing Major Tenants Have Approval Rights that Will Preclude Future Redevelopment

In addition to existing leases and lease options that extend to 2045, six of the largest tenants have contractual approval rights to control certain types of development or changes that would affect the Southtown properties. These rights generally relate to changes in number and location parking spaces, entrances and exits to Penn Avenue and American Boulevard, sidewalks, locations where new construction can occur, and other changes to common areas of Southtown. Tenants have historically exercised these rights to prevent increased density in Southtown. These tenant approval rights will prevent most, if not all, of the proposed development contemplated in the Penn American Plan.

Penn American Plan Rezoning and Proposed Zoning Code Amendments

1. The Penn American Plan is Hostile to Retail

The Plan includes a number of key elements that are inconsistent with the design, operation, and redevelopment of a regional shopping center. These elements include excessive 35 foot setbacks, which are wholly inconsistent with pedestrian friendly retail; as well as minimum floor area ratios, which effectively mandate two-story development. Moreover, the Plan's proposed street grid, intended to accommodate the Orange Line, in conjunction with the minimum lot area requirements, would create seven new blocks that would be nonconforming as to the minimum lot size, and therefore undevelopable. *See* Figure 2-11. This would cause a significant decrease in property values and hinder the marketability of retail space.

2. The Effect of the Rezoning Will Make Southtown Nonconforming

The effect of the proposed amendments to implement the Plan will simply restrict and discourage ongoing investment or further improvements by classifying most of Southtown as nonconforming. Nonconforming properties are limited with regard to the ability to remodel, construct additions, or obtain refinancing. The effect of the proposed rezoning and code amendments would not be to encourage redevelopment, but rather it would reduce property values and prohibit further investment. With leases extending into the 2040s, the City's actions to implement the Plan would create the conditions that achieve the opposite of the intended vision.

Mr. Larry Lee
September 4, 2014
Page 4

3. The Penn American Plan Fails to Accommodate a Balance of Office and Retail Uses

The Plan envisions a surge of office development in the Penn American District to the extent of nearly a million square feet by 2050. At the same time, the Plan envisions a reduction of retail by 229,000 square feet. This will have a negative effect on Southtown, which has been successful due to its size and mix of retail stores. Any significant reductions in retail square footage will diminish Southtown's appeal, reducing its sales productivity and property values. The Plan's vision will also exacerbate already congested local roads and highways. The 494 corridor needs a balance of land uses, not an overconcentration of any one use.

4. Southtown is Not A Failing Development and Implementation of the Penn American Plan is Therefore Unlike Mixed-Use Redevelopment in the Twin Cities.

The Report provided case studies of several mixed-use developments in the Twin Cities. Notably absent were any comparable developments that were as successful, prior to redevelopment, such as Southtown. The case studies, which included Excelsior & Grand, West End, Brookdale, Silver Lake Village, Wayzata Bay, and the Genesee were all largely failing or closed commercial developments prior to redevelopment. Each of the case studies redevelopments required significant public sector investments, ranging from \$4.6 million to \$30.0 million. Southtown, however, is not failing; it is a successful and thriving development. The City's vision in seeking to compel redevelopment of the Penn American District by making continued operation more difficult is misguided and not an appropriate policy for a successful shopping center.

REGULATORY TAKINGS

If the City proceeds with the adoption of the rezoning to implement the Penn American Plan, the City will become a co-actor with Metro Transit in effecting a regulatory taking under Minnesota law. The Minnesota Supreme Court held in McShane v. City of Faribault that "where land use regulations . . . are designed to benefit a specific public or governmental enterprise, there must be compensation to landowners whose property has suffered a substantial and measurable decline in market value as a result of the regulations."¹ Minnesota courts have held that article I, section 13 of the Minnesota Constitution which states that, "[p]rivate property shall not be taken, destroyed or damaged for public use without just compensation," is broader than the takings clause in the United States Constitution. Thus, a substantial diminution in property value, as would result from the adoption of the rezoning actions proposed would effect a regulatory taking under McShane.

Here, the proposed land use regulations are designed to benefit the Metro Transit Orange line. The City engaged in the update to the Penn American District planning process concurrently with Metro Transit's Orange Line planning efforts, and the Penn American Plan was updated and adopted to compliment the Orange Line station planning. The language of the Plan itself includes so many references to the Orange Line that the Plan cannot be separated from the Orange Line station planning efforts. Many of the policies established in the Plan rely entirely on the assumption that

¹ McShane v. City of Faribault, 292 N.W.2d at 258-59.

Mr. Larry Lee
September 4, 2014
Page 5

the Orange Line will run through or adjacent to Southtown. The Plan discusses the alternative alignments for the Orange Line at length and the resulting policies that govern future road alignments, pedestrian and bicycle improvements, and zoning guidance are simultaneously dependent on the Orange Line and intended to compliment the Orange Line BRT station. As described above, the consequences of implementing the policies and proposed zoning amendments established in the Plan will include a substantial diminution of property values by making much of the Southtown development nonconforming. Thus, if the City proceeds with adopting the proposed zoning amendments contained in the Penn American Plan, the City will become a co-actor with Metro Transit in effecting a regulatory taking under Minnesota law due to the resulting substantial diminution in value to Southtown property values.

CONCLUSION

The McComb Report confirms what Kraus Anderson has consistently stated throughout the Penn American District planning process; that Southtown is a viable successful regional shopping center that creates a regional draw for the Penn American District. There are numerous constraints that would prevent the redevelopment of Southtown as contemplated in the Penn American Plan, and the long term leases of the Property indicate that Southtown will remain viable through the 2040s. If Southtown is rezoned as proposed, the impact will be to make most of the Southtown property nonconforming. The proposed changes would make future retail improvements or redevelopment impracticable or impossible and the property values of Southtown would be substantially diminished.

We conclude that the only alternative to the proposed rezoning that would mitigate the damage that would otherwise result from the City's actions is to allow the existing CR-1(PD) zoning to remain. If the proposed rezoning of the Southtown properties proceeds, it will substantially affect the value of Southtown and the City's role in effecting this diminution in value will create liability for a regulatory taking under Minnesota law.

If you would like to meet with representatives of Kraus Anderson, please contact me. Also, please include this letter and the materials to which it refers in the record of decision regarding the rezoning proposed for Southtown. Thank you.

Sincerely,



William C. Griffith, for
Larkin Hoffman Daly & Lindgren Ltd.

Direct Dial: (952) 896-3290
Direct Fax: (952) 842-1729
Email: wgriffith@larkinhoffman.com

Enclosures

Mr. Larry Lee
September 4, 2014
Page 6

cc: Dan Engelsma, Kraus-Anderson Realty (with enclosure)
Ken Vinje, Kraus-Anderson Realty (with enclosure)
Michael Korsh, Kraus-Anderson Realty (with enclosure)
Sandra Johnson, City of Bloomington (with enclosure)
Glenn Markegard, City of Bloomington (enclosure sent electronically)
Bloomington Planning Commission (enclosure sent electronically)