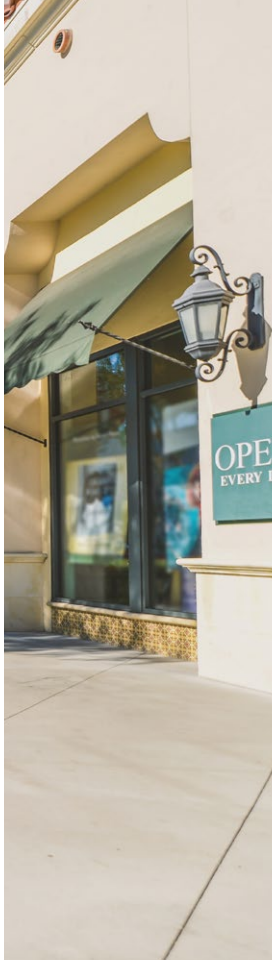
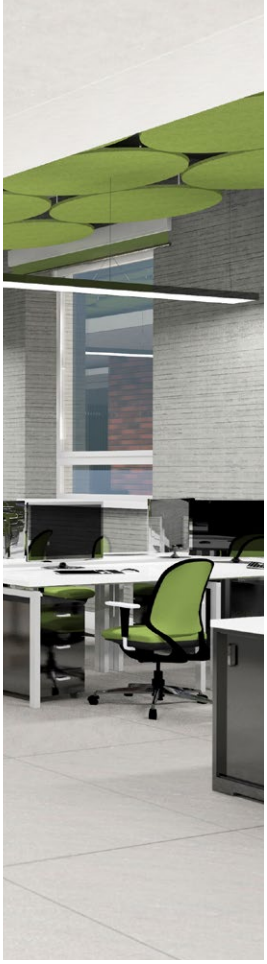
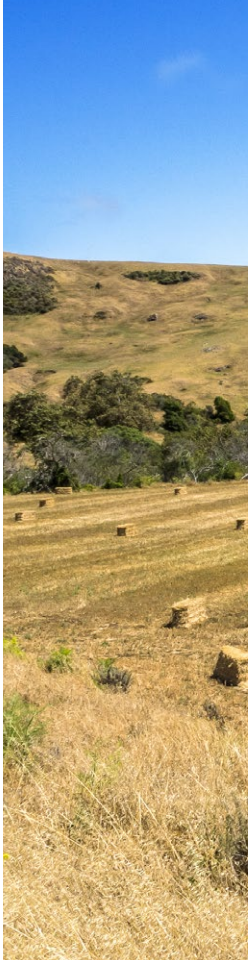






The Lee Central Coast Brief

Q2 2016

LEE & ASSOCIATES®
COMMERCIAL REAL ESTATE SERVICES

155%
increase
in transaction volume over 5 years

$12+ billion
transaction volume
2015

870
agents
and growing nationwide

Ranked 2nd
June 2016, Commercial Property Executive
(2016 Top Brokerage Firms)

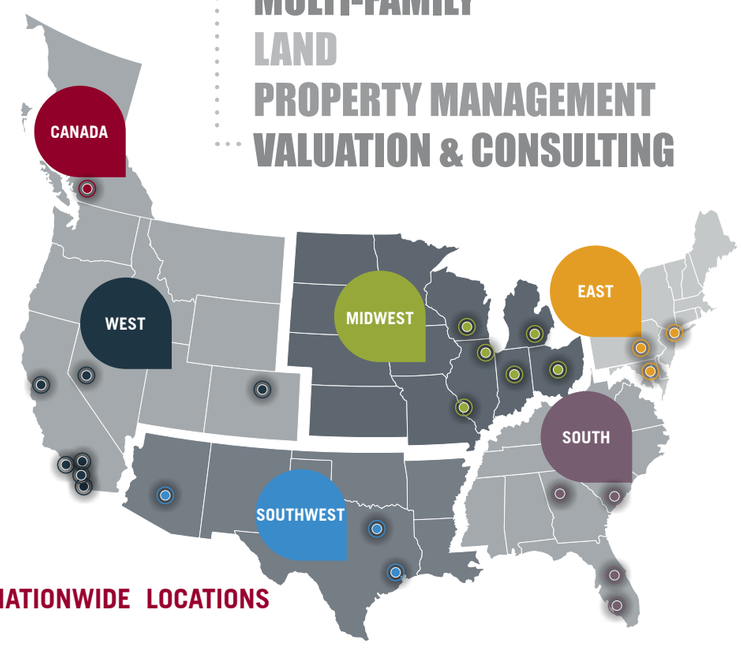
LOCAL EXPERTISE.
NATIONAL REACH.
WORLD CLASS.

- OFFICE
- INDUSTRIAL
- RETAIL
- INVESTMENT
- APPRAISAL
- MULTI-FAMILY
- LAND
- PROPERTY MANAGEMENT
- VALUATION & CONSULTING

At Lee & Associates® our reach is national but our expertise is local market implementation. This translates into seamless, consistent execution and value driven market-to-market services.

Our agents understand real estate and accountability. They provide an integrated approach to leasing, operational efficiencies, capital markets, property management, valuation, disposition, development, research and consulting.

We are creative strategists who provide value and custom solutions, enabling our clients to make profitable decisions.



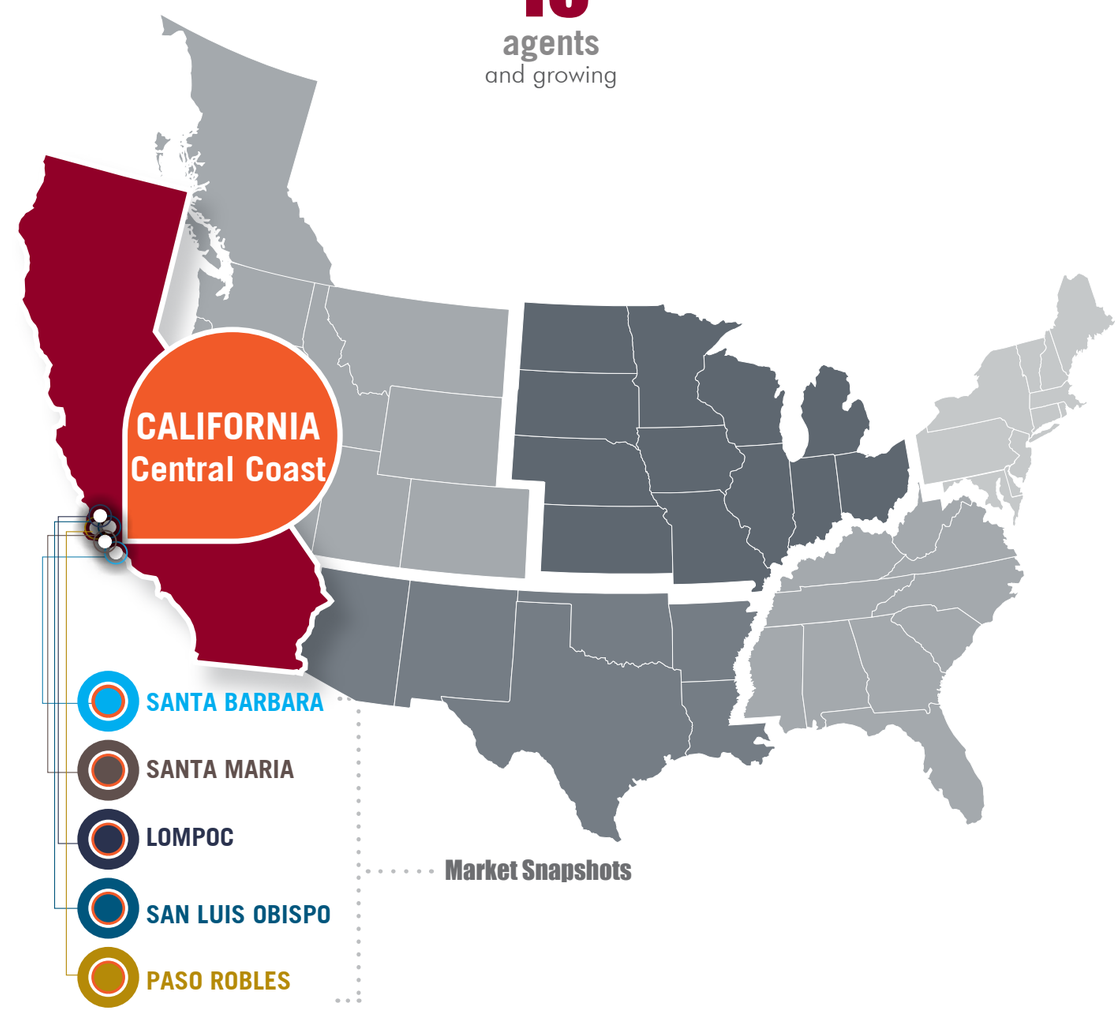
NATIONWIDE LOCATIONS

Columbus, OH · Houston, TX · Denver, CO · Cleveland, OH · Long Island-Queens, NY · Chesapeake Region , MD · Charleston, SC · Edison, NJ · Orlando, FL · Fort Myers, FL · Manhattan, NY · Greenville, SC · Atlanta, GA · Greenwood, IN · Indianapolis, IN · Long Beach, CA · Elmwood Park, NJ · Boise, ID · Palm Desert, CA · Santa Barbara, CA · Antelope Valley, CA · Dallas, TX · Madison, WI · Oakland, CA · Reno, NV · San Diego, CA · Ventura, CA · San Luis Obispo, CA · Southfield, MI · Los Olivos, CA · Calabasas, CA · St. Louis, MO · Chicago, IL · Victorville, CA · Temecula Valley, CA · Central LA, CA · Sherman Oaks, CA · West LA, CA · Pleasanton, CA · Stockton, CA · Las Vegas, NV · Phoenix, AZ · Carlsbad, CA · Industry, CA · Los Angeles, CA · Riverside, CA · Ontario, CA · Newport Beach, CA · Orange, CA · Irvine, CA, · Vancouver, CANADA

LEE & ASSOCIATES CENTRAL COAST

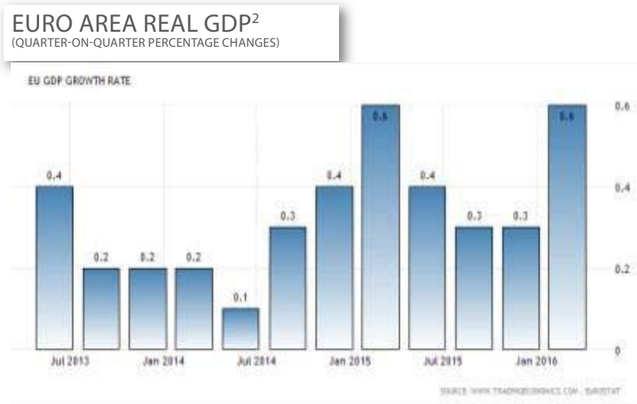
3
offices
within the tri-counties

10
agents
and growing



THE GLOBAL ECONOMY

Last quarter we described the global economic outlook as troublesome. As it turned out, we were wrong. It's worse than troublesome. It's downright scary and increasingly complex. The stakes are high and the outcome of the current global economic conundrum is anything but certain. Whether the topic is the European Union, emerging markets, energy-producing states or the manufacturers of the world's goods, the news is mostly bad. Global growth estimates keep moving down and several countries like Brazil and Venezuela that depend almost entirely on the export of raw materials and oil, are mired in recession with runaway inflation. Then came Brexit, the UK vote to leave the European Union. Few gave it a chance and the shock wave from the vote was instantaneous. Europe's political union in constant crisis mode these days and there is no governing body with the real authority to enforce anything. EU leaders and European Central Bank have been ineffective in terms of getting things on track. Sovereign debts are mounting, unemployment is persistently high dismal economic growth in Europe makes the US economic look positively dazzling. Concerns over deflation are driving the European Central Bank to send interest rates into negative territory. The bank is also buying up sovereign bonds and has even resorted to buying corporate bonds, an action that would be illegal in the US. Calls for austerity from nations swimming in debt been largely ignored, and the recent refugee crisis is exacerbating economic problems and reigniting nationalist fervor throughout Europe. Many credit concerns over immigration for the surprise passage of the Brexit referendum in the UK. If nothing else, that vote brought the differences between European nations back into the light. The fate of the European Union is uncertain at best, and that bodes well for the US commercial real estate market. For all our failings, the US is still considered the safest place to keep money in troublesome times. The flight to safety phenomenon has already driven US Treasury yields to all time lows.



Oil-rich Middle-Eastern countries, including Saudi Arabia, are issuing sovereign debt and burning through cash reserves to cover revenue shortfalls precipitated by the falling price of oil. Even China is issuing sovereign bonds to help it cope with its massive transition from total dependence on the exportation of manufactured goods to a more consumer-based economy that can be self- supporting. Gone are the days of double-digit economic growth in the world's most populous country.

Despite all these concerns, the US economy is still growing, but sluggishly so, a fact not lost on major corporations that are already facing a slowdown in profit growth. Many of the nation's biggest companies are boosting share prices by buying back their own stock and slashing operating costs, rather than by increasing revenues. Even commercial real estate markets continue to grow at a steady and healthy pace. Rents are rising, vacancy is declining and new buildings are being delivered at a pace that limits the potential of overbuilding. Employment is on the rise, but wage growth is weak. Inflation, once considered evil, is the hoped-for outcome of central bank policy. Yet, even with all the Fed's efforts to boost inflation, it is still running well below the desired level of 2%. Without rising prices, there is little incentive to increase production by hiring new workers. We don't see things changing much to the good as we look ahead. So, we expect 2016 to be another year of so-so economic growth and more of the same for commercial real estate. All things considered, there's no place like home.

GDP GROWTH

After a dismal showing in the first quarter of 2016, the first estimate of GDP growth for Q2 came in at just 1.2%, less than half of what was expected. Inventories, thought by most experts to be on the rise, declined substantially. However, a 4.2% increase in consumer spending kept economic growth from being even more of a disappointment. Adding to concerns over chronically sluggish GDP was the downward revision of Q1's growth rate to .8% from 1.1%. Anemic growth in Europe, Japan and most of the world's other economies isn't helping sentiments here at home, either. Despite massive central bank interventions to stave off a deflationary spiral, little progress has been realized.

Persistent concerns over political and economic issues around the world are keeping optimism here at home in check. The year started with a big selloff in US equities. Fortunately, those losses were recovered late in Q1, and the Dow Jones Industrials Average surged back up to 18,000. The problem is there was little to point to for that to be

the case other than fear. But, the "Brexit" vote in late June surprised just about everybody and the Dow took another dive on the news. Four days later, the Dow set a new record high on July 8th.

Volatility in equities has become commonplace and savvy chief executives are going take that into account as they make decisions for their companies that will show up in GDP numbers down the road. Now, volatility and uncertainty seems to be the rule of the day no matter what the topic may be.

Output of US goods and services are becoming more expensive around the world, and that fact will impact the net investment in business and the trade deficit, both major components of GDP. It now looks like US GDP growth will lag behind 2015's final tally of 2.4%. There just doesn't seem to be enough evidence to expect anything more, as nominal increases in consumer and government spending (the other components in the GDP equation) will not be

GDP GROWTH

enough to make up the difference. The fact is that our economic growth is anemic despite unprecedented action by our central bankers to give the economy a booster shot.

Consumer spending, which accounts for roughly 70% of GDP, and the numbers don't look good. As we pointed out last quarter, US consumers are keeping a firm grip on their wallets because they're pessimistic about what's to come economically. Retail sales, a large component of consumer spending, has made some modest gains of late, but it did nothing more than make up for declines earlier in the year. Wage growth, or lack thereof, has been a persistent problem throughout this marathon of a recovery, and it is central the issue impacting consumer spending. Income growth is running just above the rate of inflation, which is still under the Fed's target of 2%. So, workers are just don't feel like they are getting ahead, and that makes them more cautious about making the kind of purchases that will move the GDP needle in any significant way. Instead, they continue to pay down existing debt, which doesn't contribute a penny to current GDP.

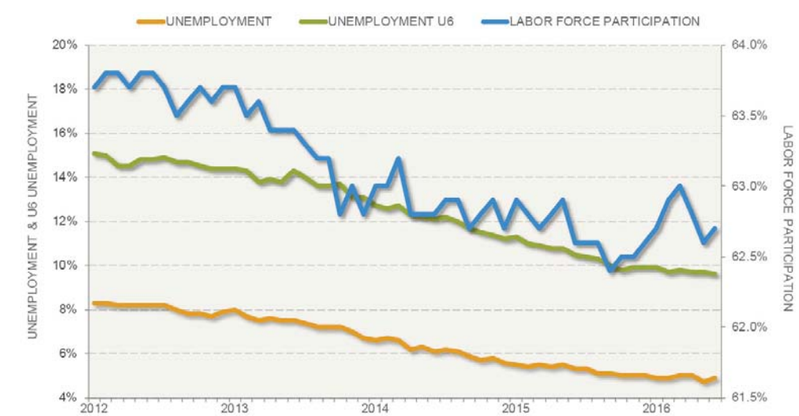
Net exports, another key component of the GDP equation, have been hurt by the US dollar's strength against other currencies. US goods and services have become more expensive abroad and the impact to US companies who sell products and services that are paid for in other currencies, has been substantial. Exchange rates fluctuate daily, but it's safe to say that the dollar will remain strong as long as the current level of economic uncertainty persists. If other countries voluntarily devalue their currencies to increase the competiveness of their exports, the US Dollar will soar and things could get worse for American companies that have substantial exposure to foreign markets.

EMPLOYMENT

Predicting job growth numbers is getting tougher each month. A year ago, the average monthly increase for non-farm employment over the previous 12 months was well over 200,000 new positions. That number has fallen substantially, and the monthly numbers are getting more erratic. Q2 is a good example. April's total was 144,000. The latest estimate for May came in at 11,000 and the first estimate for June was 287,000! How do people make big business decisions with numbers like that? The simple answer is: they get more careful about every decision they make. When they get more careful, they tend to spend less. When they spend less, they hire fewer people or lay more people off. Those people have less to spend. You get the picture.

The interesting thing here is that despite the erratic job growth number, the U3 unemployment rate (the index most widely used) is at a very low rate of 4.8%. Our Econ 101 professors taught us that an economy with 5% unemployment rate is fully employed. If it were only that simple. Tell that to the worker making close to minimum wage who doesn't have the skills for a better job, has a high level of skill for a job that doesn't exist or can only find part time work. The U6 unemployment rate, which accounts for part-time workers who would prefer to work full time in their field, is at 9.7%. This index tells a different and perhaps more telling story about the realities of the US economy; too many people working at jobs that don't pay the bills. For these folks, discretionary income is a concept not a reality.

NATIONAL UNEMPLOYMENT



Another way to get a clearer picture of the job numbers is to look at employment by business sector. Unfortunately, doing so makes things look even worse. For example, over 140,000 of the 287,000 created in June were in Leisure and Hospitality, Retail Trade and Healthcare and Social Assistance. These are generally lower-paying jobs that can disappear quickly as things change. By contrast, manufacturers hired 14,000 workers, and gains in construction jobs amounted to zero. Another 15,000 were hired on a temporary basis, and the total hours per worked on a weekly basis was unchanged from a year ago at just over 34 hours. The key manufacturing index compiled by the Institute of Supply Management (ISM) has spent most of the past year in negative territory.

Concerns over slowing domestic growth and the prospect of recessions abroad is prompting employers to hire more part time and temporary workers. The cost of health care pursuant to the Affordable Care Act (ACA) is also contributing to part time employment problem, as employers are inclined to hire workers just under the 30 hour per week threshold that would require them to provide health benefits.

EMPLOYMENT

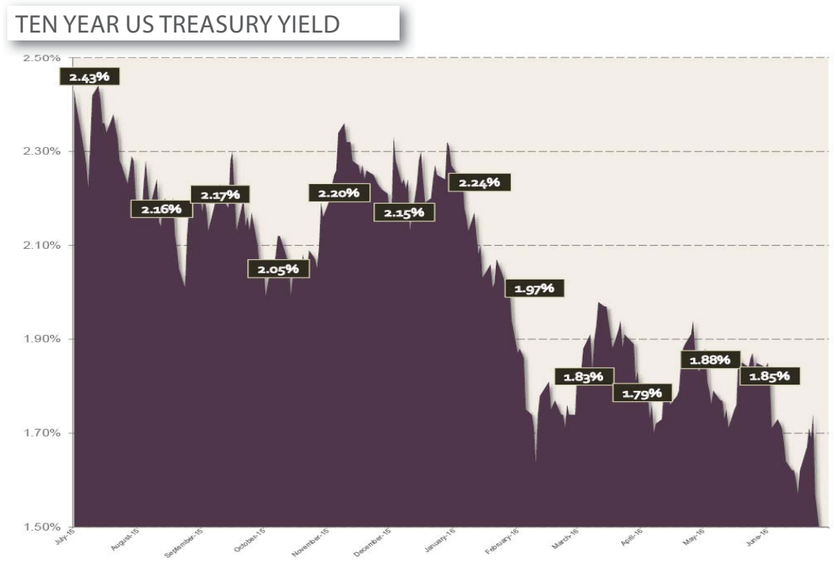
The Labor Participation Rate, the metric that measures the percentage of those eligible for employment between the ages of 16 and 64 who are currently working, is also stagnant. Sporadic job growth and the early exit of Baby Boomers, have combined to keep just 62.7% of potential workers in active production.

Wage growth is another problem that has dogged the US economy. While the general unemployment rate fell to 4.8% by the end of June, full-time, high-paying jobs are in short supply and wage growth overall is tracking at a rate of approximately 2.5%. For a worker making close to the minimum wage, that kind of growth is nothing to celebrate. This is one of the reasons why so many middle class workers feel left behind.

Ironically, many of the best-paying positions that are available go unfilled for lack of qualified candidates. Layoffs in the energy sector has not helped the job picture, either. Thousands of high wage positions are disappearing and it may be years before the energy sector recovers enough to see those jobs return. The jobs being lost are generally full-time, and that only makes things worse. The oil industry continued its belt tightening in Q2 idling more wells, laying off more workers and slashing capital budgets. So, further job losses in that sector can be expected.

MONETARY POLICY

In December of last year, the US Federal Reserve Bank's open market committee finally pulled the trigger and boosted the Fed Funds rate by 25 basis points to .5%. While it had little immediate effect here at home, the rest of the world reacted, stock markets slid and the dollar strengthened against most of the world's currency. At the same time the European Central Bank was sending interest rates into negative territory and was buying 60 billion Euros worth of bonds each month in its own version of QE. Not exactly a well-coordinated effort, but that wasn't Congress' idea when they created our central bank back in 2013. Needless to say, central bankers around the world expressed their displeasure with the move and have since been warning the Fed that further rate hikes in the short term will be harmful to the global economy. The Fed's action reduced uncertainty about the policy direction in the beginning, but now Ms. Yellen has backed off the clear talk and returned to more familiar cryptic language when discussing the Fed's future actions. Though, most experts now agree that circumstances are too shaky around the world for the Fed to raise rates anytime soon. That may be the main reason why the Dow Industrials Average hit a record high on July 8th.



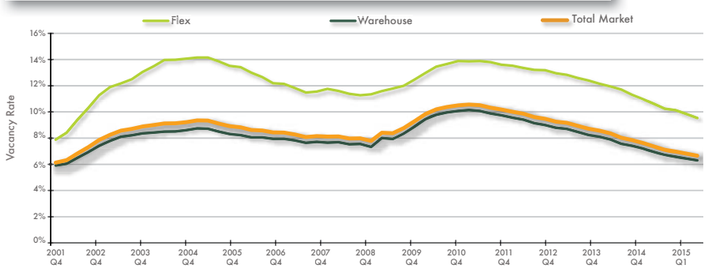
Real estate borrowers have been relieved to discover that the Fed's initial rate hike had little effect on mortgage interest rates, and they should be even happier now, as it appears that the days of cheap capital will be with us a while longer, and mortgage interest rates may even move lower in the coming months. The yield on the 10 Year US Treasury Bill has moved to a record low under 1.5% of late. It's that rate that is used as the index for most mortgage loans made on commercial real estate. It probably also means that the danger of cap rate decompression, a very real concern as it relates to real estate valuations, is abated at least for time being because borrowers will still have access to capital at a rate less than current cap rates. When the Fed finally follows through with more rate hikes, the possibility of higher cap rates will become very real indeed. Even a 50 basis point move up would have a massive impact on property values. Rents, even in the fastest growing markets are not climbing nearly fast enough to bridge that gap.

Keeping a close eye on what central bankers are up to around the world is a good idea. It seems that more drastic measures are being taken every day somewhere around the world, including the newest stimulative tool, negative interest rates. Imagine paying someone interest for the privilege of loaning them money. Sounds crazy, and it might be. But, it is also where over $10 Trillion has recently been "invested".

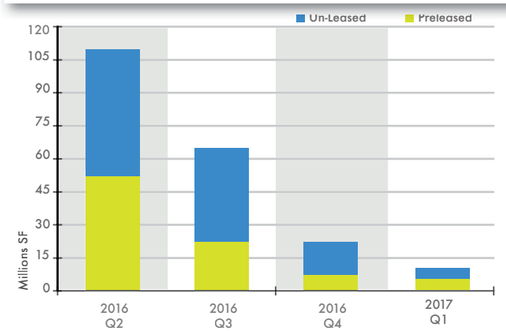
US INDUSTRIAL MARKET

The US industrial property market posted another slate of good numbers in Q2. Despite economic indicators that have been sporadic at best, the industrial property market has been consistently strong. Net absorption has been positive in every quarter dating back to 2010. New deliveries have been running very close to total net absorption, which has kept the risk of overbuilding very low and vacancy in steady decline. A substantial percentage of new construction has been in build-to-suit transactions, which has given builders the confidence to get more aggressive in terms of speculative development. Of the 97.4 million square feet currently under construction in the six most active markets, 41% of that space was preleased. That's good news for developers, but also good for occupiers, as that means there is also a steady supply of new spec space that allows expanding companies to be more nimble in executing plans for growth. In the country's hottest markets, large blocks of spec space are being leased during construction or within just a few months of completion. With net absorption as strong as it has been, the construction pipeline for distribution product should continue to flow at least at current levels for the next several quarters. New deliveries for both speculative and build-to-suit projects for Q2 hit 53.2 million square feet in 381 buildings. That followed a nearly 60.8-million-square foot gain in inventory in Q1. The US industrial property topped 21.73 billion square feet in Q2, and another 224.8 million square feet was still under construction by the end of the period. However, construction is concentrated in just a handful of major markets including Dallas, Houston, Atlanta Philadelphia, Chicago and Southern California's Inland Empire. Last quarter we reported that a disproportionate amount of market activity was concentrated in big deals by big tenants in big buildings. That hasn't changed. In fact, the warehouse sector accounted for just under 90% of the 74.4 million square feet of net absorption recorded in Q2. Most of that was in large distribution deals. The top three lease signings for the quarter were all over 1 million square feet each, and over 40% of the net absorption through the first half of the year was posted in just 10 markets.

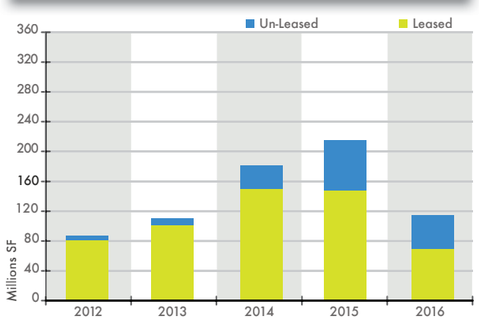
VACANCY RATES BY BUILDING TYPE 2001 - 2015



FUTURE DELIVERIES
PRELEASED & UN-LEASED SF IN PROPERTIES SCHEDULED TO DELIVER



RECENT DELIVERIES
LEASED & UN-LEASED SF IN DELIVERIES LAST 5 YEARS



2
National Economic Overview

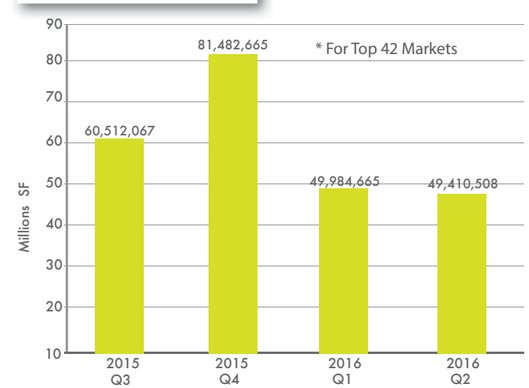
ANOTHER SOLID PERFORMANCE

It's not usual for the bigger distribution hubs to report multiple transactions over 1 million square feet in the same quarter. Large 3PL operators and online retailers like Amazon currently have the biggest appetite for space. Although, electric car manufacturer, Tesla Motors, also signed a lease in Q2 for over 1 million square feet in the Oakland/East Bay market.

The national vacancy rate for warehouse and flex space combined has been falling steadily, and that trend continued in Q2, as the amount of vacant space declined by another 10 basis points to finish the quarter at 5.9%. In the past four quarters, the vacancy rate has fallen by 50 basis points, but several major market areas have reached critically low levels, including Los Angeles and Long Island, New York, both of which are experiencing critically low vacancy and almost no new construction. Finding quality product there is problematic at best, as the aging inventory in those markets is becoming functionally obsolete. Relief is not in sight in those markets, either, as older industrial product is being repurposed for mixed use residential, retail and office projects, which means the base inventory of industrial product is shrinking despite rising demand.

Vacancy declines have average asking lease rates moving higher in the majority of US markets. The national average asking rate has moved up in every quarter dating back to 2011. In Q2, rents moved up another $.10 to $5.93 per square foot. Markets with the most construction are seeing more rapid rent growth as tenants continue to pay a premium for first generation space that offers higher ceiling clearance and state-of-the-art fire suppression capabilities.

NET ABSORPTION



The owner/user market remains seriously out of balance. Demand from users to buy their own facilities is running much higher than supply. Competitive bidding and price points that exceed asking prices are commonplace these days. In most markets, prices have risen to levels beyond the previous market peak. Business owners who've had it with paying higher and higher rents are opting to buy so they can control occupancy cost with fixed rate loans in the 4% range, some fully amortized over 25 years at up to 90% loan-to-value. We have our central bankers to thank for the opportunity. The Fed's low interest rate policy has kept the yield on 10 Year US Treasuries (the index used for setting rates for most commercial property loans) at record lows for the last six years. Without that stimulus, this niche market would not be getting near the attention that it is, and prices would be far below current levels. But, the Fed remains reluctant to move rates higher due to a long list of economic indicators that are still cause for concern. So, users can probably count on low rates to persist for the time being, and that means that prices are likely to keep moving higher, too. Even so, the temptation to lock in occupancy cost for decades is compelling.

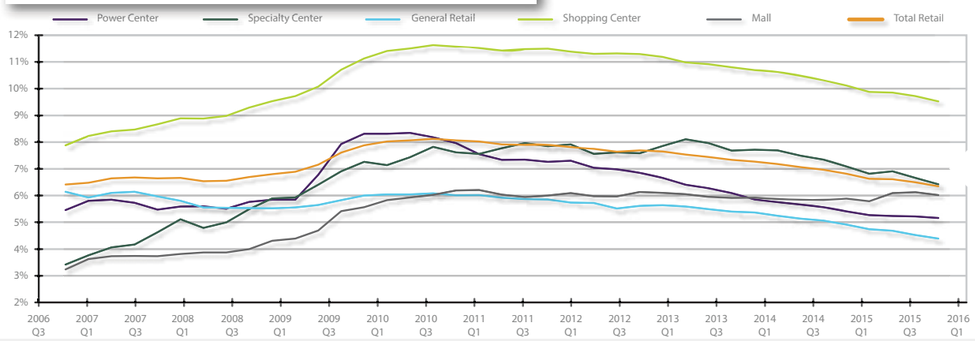
Investors, both institutional and private, have lots of money to spend, but too few places to put it. As we point out every quarter, cap rates are compressed and there is no clear indication of a change in that trend. Though, for those who follow markets closely, the chatter is sounding more cautious and experts in all real estate disciplines are more inclined to sound the alarm about a potential market correction. Lenders are tightening up on underwriting for riskier deals and institutions are closely scrutinizing tenant credit. Some experts think this market is getting long in the tooth, but that sentiment doesn't seem to have dampened demand to any significant degree.

PROPERTY MARKET TIGHTENS

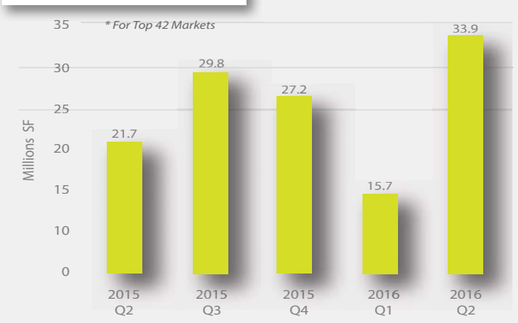
The US retail property market picked back up in Q2 after a disappointing first quarter. Net absorption more than doubled during the period, the vacancy rate resumed its decline and average asking rents moved up again. Construction activity was little changed.

US retail sales rose by 2.6% in Q2 as compared to the same period last years, nearly doubling the quarterly growth recorded in Q1. Of the 13 major retail categories, 11 posted gains, with non-store retailers leading the pack with 12.7% increase in year-over-year sales gains. Food services and drinking places, saw another bump of 5.4%. Health and personal care store sales rose 8.2% over the same period last year. Quarterly gasoline station sales slipped 9.3% year-over-year,

VACANCY RATES BY BUILDING TYPE 2006-2016



NET ABSORPTION



as worldwide surpluses erased price gains earned in Q1. Furniture and home furnishings stores sales grew by 2.1% year-over-year due to improving housing market conditions, while electronics and appliance stores declined by 3.4% for the same period.

The vacancy rate moved lower in Q2, shedding 20 basis points to settle at 5.2%. In the past year, a 40-basis point decline in the vacancy rate has been realized. As reported last quarter, vacancy is sharply higher in secondary locations and nearing 0% in prime submarkets. General retail (freestanding, general purpose properties) posted the lowest vacancy of all retail property types at 3.3%, down 40 basis points in the quarter, followed closely by Power Centers at 4.5%, unchanged in Q2. Shopping Center (neighborhood, community and strip centers combined) rates are still highest at 8.3% despite a 40 basis point decline in the period. Excess supply in this category is concentrated in suburban submarkets that have fallen out of favor with expanding retailers.

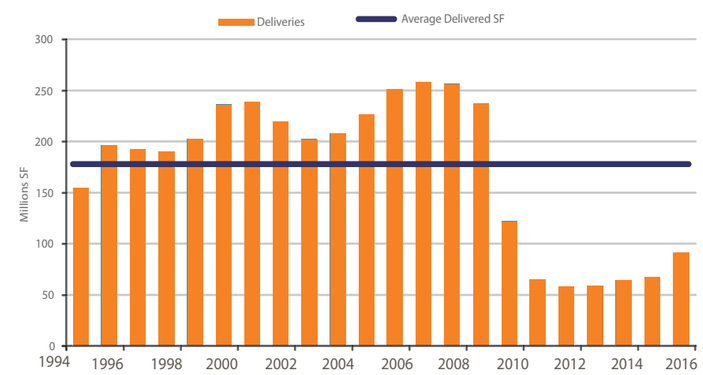
Urban areas continue to account for a greater share of net absorption performance as more retailers look to younger consumers for sales growth. These younger consumers, who seem to prefer multifamily housing near public transportation, hip restaurants, cool bars and entertainment venues, are attracted more to the amenities and less about owning single family homes that increase commute times.

RETAIL SECTOR PICKS UP THE PACE IN Q2

Q2 net absorption more than doubled Q1's total, finishing the period with a net gain of 43.4 million square feet. In the past four quarters, just over 136 million square feet of net absorption has been recorded, a very impressive number given the fact that overall retail sales and wage growth have both been disappointing throughout the economic recovery. The overall average asking rate moved up another $.14 to $15.46 per square foot in Q2. Over the past four quarters, retail rents across all product types and locations moved up by 2.1%, but rent growth was concentrated in urban locales. Suburban retail centers, especially mid-block strip centers that cater to mom and pop retailers, have seen weaker growth and more persistent vacancy. The rate of rent growth declines as distance from an urbanized core increases, a trend that has been ongoing for the past several years.

New deliveries for the quarter totaled 17 million square feet, bringing the total of completed inventory in the past four quarters to 84.6 million square feet. Another 74.4 million square feet is currently under construction. In keeping with retailer preferences and their willingness to pay more, urban locales are seeing the bulk of new construction.

HISTORICAL DELIVERIES 1994 - 2016



Traditional, brick and mortar and online retailers continue to move toward greater balance to boost sales. Online retailers are adding physical locations as more traditional retailers are boosting their online presence and closing down underperforming physical locations. Macy's, Walmart and Sears have all announced major store closings, while big sporting goods retailers Sport Chalet and Sports Authority decided to call it quits in the first half of the year. After a merger with Staples failed, Office Depot announced its decision to consolidate operations by closing 300 more locations across the country, further evidence of how the prolific growth in online sales continues to erode the market share of traditional retailers across the retail spectrum.

A LOOK AHEAD

The US retail market will keep growing, but further gains will be hard fought. Weak GDP and wage growth numbers will put downward pressure on retail sales volume. It remains to be seen if Q2 consumer spending will reinvigorate retail sales. Imported goods will remain cheap due to the strength of the US dollar, and that will keep the discount retailers busy expanding. Oil prices moved up in Q1, but reversed course by the end of the quarter. Central banks around the world have resorted to negative interest rate policies to reduce the risk of a deflationary cycle. Results of that effort have been disappointing. So, expect the price of imported goods to remain near current levels for the time being.

Low oil prices have been with us for two full years now, but the boost in domestic retail sales that was expected as a result of an increase in disposable income, has been disappointing at best. Job growth, while still positive, is decelerating in terms of the 12 month rolling average. Q2 earnings season was a mixed bag, with many major corporations resorting to cost-cutting and stock buy-backs to improve profitability and earnings-per-share performance. Without higher wages, retail sales growth, vacancy and net absorption will likely follow the current trend line for the balance of the year.

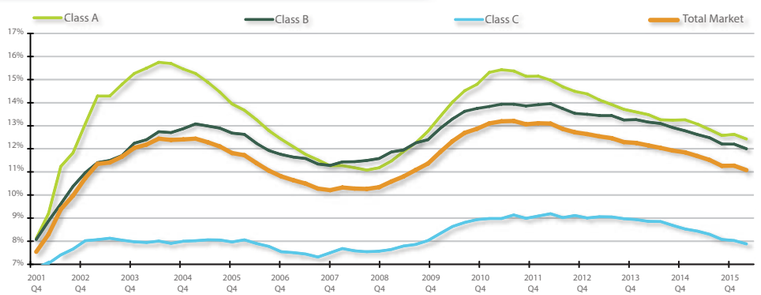
Oversupply of capital to invest will keep yields on retail investment properties compressed, expect lenders to tighten underwriting standards and demand and lower loan-to-value ratios. Foreign investor demand will keep the pressure on supply, as they look even more to US markets as a safe haven.

US OFFICE MARKET

After a lackluster first quarter performance, the US office market rebounded in Q2. Vacancy, which was unchanged in Q1 compared to Q4 of 2015, resumed its decline, falling 20 basis points to finish the period at 10.1%. Net absorption more than doubled and average asking rental rates moved up again to extend a more than five year run of quarterly increases.

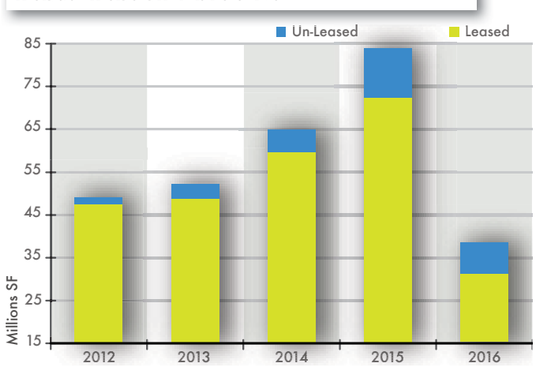
Office markets including New York City, Washington, DC, Chicago and Orange County, CA, all reported net gains in occupied space in Q2 after posting negative net absorption in Q1. That helped bring net absorption nationwide to a healthy 37.5 million square feet compared to just 15.2 million square feet in the first quarter. Talk of a slowdown in tech sector growth hasn't slowed down net absorption in the San Francisco and Silicon Valley markets, as those areas together reported over 1.7 million square feet of gains in occupied space.

VACANCY RATES BY CLASS 2001-2015

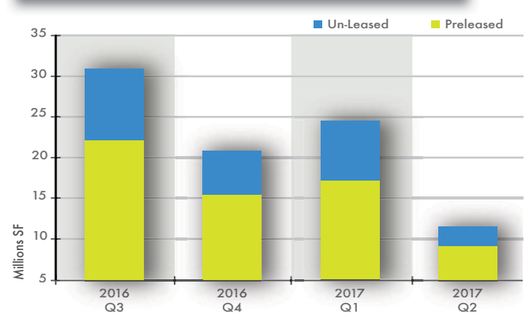


The Seattle/Puget Sound market, another tech hot spot added 921,000 square feet to the total of occupied space. Los Angeles also had a good quarter, as its occupied space total swelled by over 1.2 million square feet. Even Houston, despite challenges posed by the energy sector slowdown, managed to nearly break even for the period reporting negative absorption of just 61,000 square feet. Average asking lease rates for the US moved up $.12 in Q2 to $23.56 per square foot, which represents .5% increase for the period.

RECENT DELIVERIES
LEASED & UN-LEASED SF DELIVERIES LAST 5 YEARS



FUTURE DELIVERIES



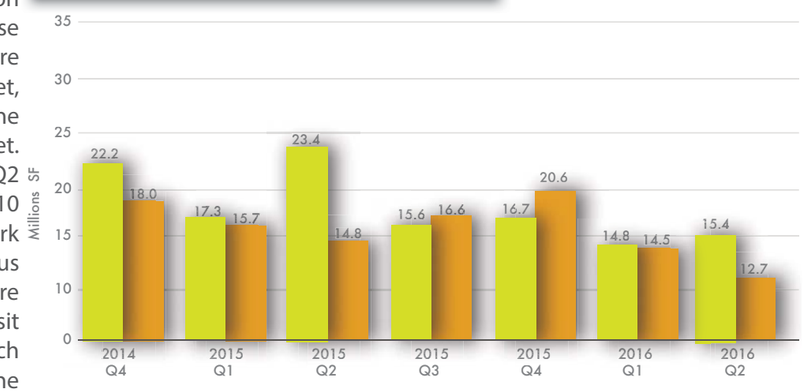
Rents are moving up in most office markets around the country, but markets with large TAMI and healthcare sectors tend to see bigger rent gains. Energy markets are beginning to see rental rates slide back. Houston, perhaps the biggest energy market in the country, saw a $.36 decrease in asking rents, ending the quarter at $27.70 for all building classes combined. The looming problem there is the large blocks of space that have been coming back on the market for sublease, which is putting downward pressure on rents. That pressure on rents and net absorption, as well, is likely to persist until the slack in demand caused by under-utilization tightens back up.

2
National Economic Overview

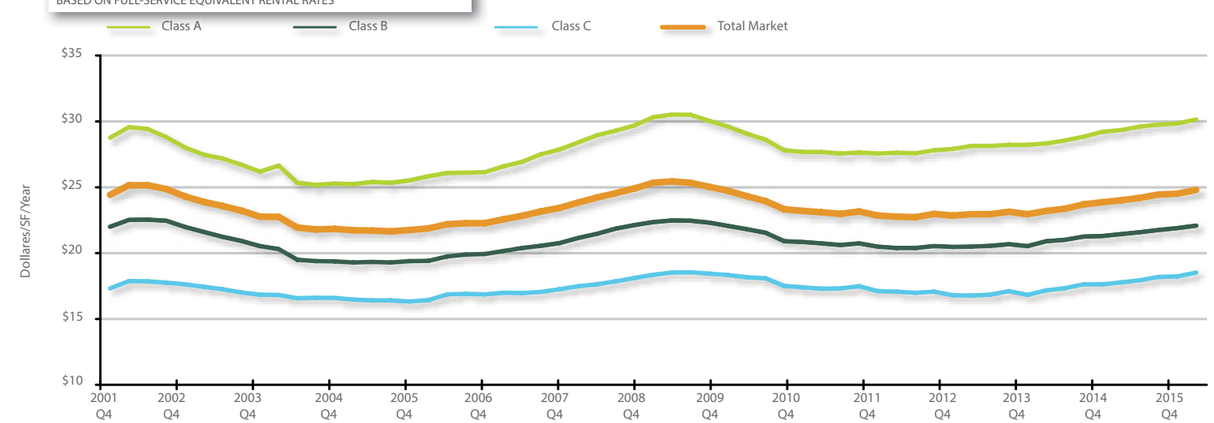
OFFICE MARKET BOUNCES BACK IN Q2

The level of new deliveries remained steady in Q2 at just over 19 million square feet in 313 new buildings. Another 142.6 million square feet is still being constructed, and 55% of that is concentrated in just 10 of the nation's largest markets. New York City is at the top of that list with nearly 13.3 million square feet underway. Dallas/Fort Worth is not far behind at 11.3 million square feet, followed by Washington, D.C. at 9.6 million square feet and South Bay/San Jose (Silicon Valley) at 9.2 million square feet. Another tech-heavy market, Seattle/Puget Sound, rounds out the top five at 7.8 million square feet. The largest project delivered in Q2 was the 1.7-million-square-foot 10 Hudson Yards building in New York City. Developers continue to focus on mixed-use projects in urban core areas that are near public transit and entertainment venues, which appear to be high priorities for the millennials.

ABSORPTION & DELIVERIES PAST 7 QUARTERS



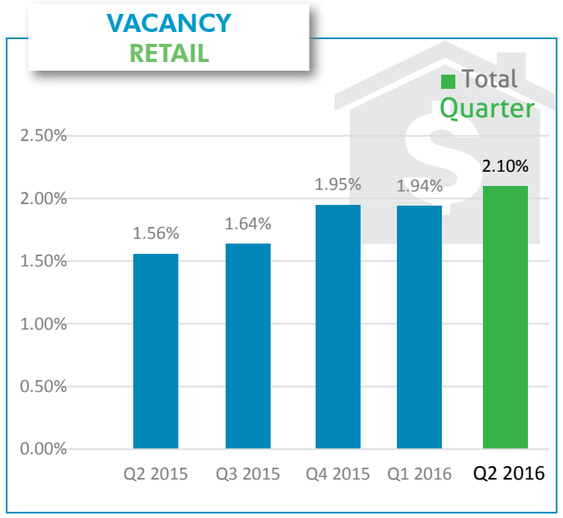
HISTORICAL RENTAL RATES 2001-2015
BASED ON FULL-SERVICE EQUIVALENT RENTAL RATES



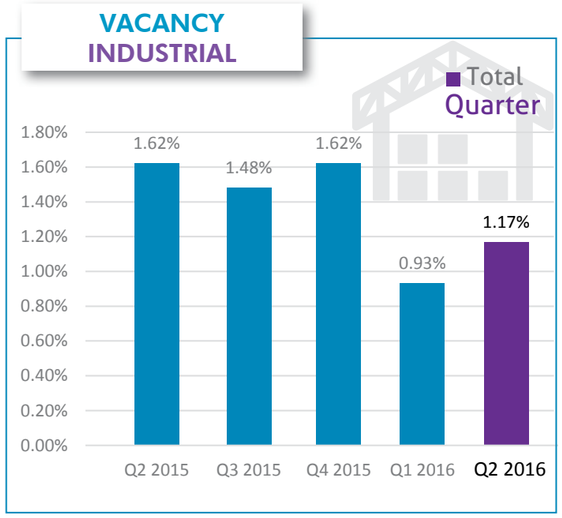
As we have been reporting for the past two years, institutions and private investors, both large and small, have been chasing short supply of office product for sale. Cap rates remain compressed to record lows and core assets are trading hands below 5%. Foreign buyers are still hungry for US assets, and that is likely to continue given increasing concerns over a weakening global economy and new concerns over the European Union occasioned by the recent Brexit vote. Investors everywhere still see the US as the safest of safe havens to stash capital when the going gets tough

SANTA BARBARA

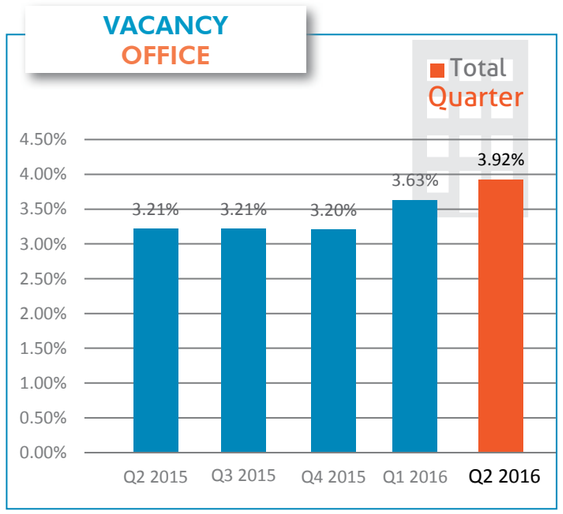
VACANCY RETAIL



VACANCY INDUSTRIAL



VACANCY OFFICE



MARKET HIGHLIGHTS

- Multi-Family developments are getting a fast pass in Santa Barbara, a notoriously difficult city for development. With high demand for both multifamily and single-family product, there are nearly 5,000 units (including Goleta & Santa Barbara) currently in the development cycle.
- Absorption of south county office product has been slow and steady with rental rates remaining stagnant.

RETAIL
VACANCY RATE
2.10%

OFFICE
VACANCY RATE
3.92%

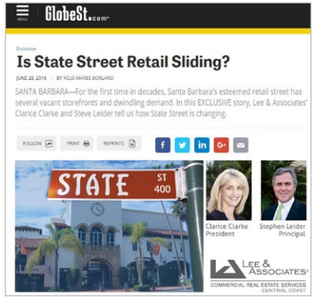
INDUSTRIAL
VACANCY RATE
1.17%

Lee in the News

STATE STREET RETAIL

"While foot traffic may have declined, tourism has not. **Santa Barbara** still receives 32 ocean liners per year and Leider says that 8 million tourists spend at least four hours traipsing through the submarket. Yet, some mom-and-pop retailers are either closing or choosing to move to other markets. Boutique clothing store K Frank, currently on **State Street**, is one example. The owners are moving the store to an upscale shopping area in Montecito, where it says a lot of its customers are now based. "Things are shifting around quite a bit, and a lot of the high-end retailers are relocating to Coast Village Road in Montecito or to the Funk Zone, which is the new hip area," Clarice Clarke a principal and the president Lee & Associates Central Coast, tells GlobeSt.com.

One issue is that the ownership is very fragmented, Clarke says that some families that have owned the individual storefronts for several generations. The market needs a catalyst to revive demand, and Clarke says that the Paseo Nuevo Mall might be just that. "Paseo Nuevo Mall has a new equity partner, and I think that will be the catalyst for change," she explains. "They are planning to do some very positive things that will reinvigorate the mall and bring in a new and very effective tenant mix. They are really open to bringing back some of the successful mom and pops and they are renovating the exterior facades and signage, and it really needs that. I think that may be the impetus to start drawing people back in, because that is really the prime Downtown area."



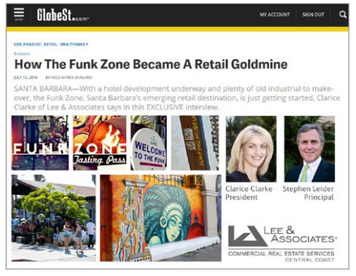
CLICK HERE TO READ MORE

FUNK ZONE

"Clarke and her partner Steve Leider, a principal in Lee & Associates Central Coast, are well aware of the zoning struggles in the market. The duo attempted to buy a building in the **Funk Zone** more than a decade ago. "We were going to put our office in the back and rent out the retail space, but when we went to the city, they said no office," says Leider.

While there is little office space in the market, interesting and boutique retail concepts have exploded. The Lark is perhaps the most noteworthy of a handful of high-volume restaurants flanked by wine tasting rooms. There are also two high-end condo developments under construction. Those units will carry price tags starting at $3 million once complete. "The biggest thing that you will see down there is the redevelopment of La Entrada, which encompasses three corners," says Clarke. "Michael Rosenfeld, the developer, is building a new hotel with retail across the street and a parking garage on the opposite corner."

Much of this development will come on line in the next few years, and will unveil the next evolution in the market; however, Clarke points to a number of untouched industrial facilities and lots that have yet to join the movement. Some owners are holding out for higher prices," she explains, adding that they will sell, eventually. With those lots, which are substantial in number, the Funk Zone has plenty of development runway left."



CLICK HERE TO READ MORE

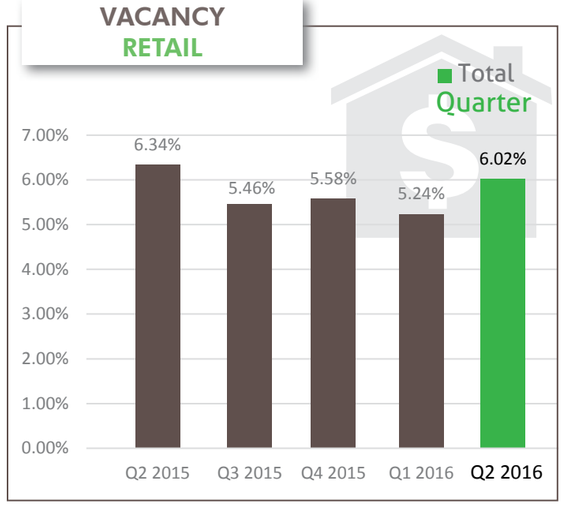
MULTI-FAMILY

"The lack of supply has helped to boost property values. Clarke says that the market is one of the most expensive in the state, with the average single-family house running $850,000. For multifamily product, institutional ownership is starting to pick up, although there is limited institutional product. **Isla Vista**, because of the student housing, has the highest concentration of institutional ownership in the market. "In Isla Vista there is a concentration of institutional ownership, and that is also evolving quite a bit," adds Clarke. "Individual investors are also buying up a lot of the product out there." Clarke and Leider expect the housing construction to continue, especially as the demand for housing continues to grow in the market."

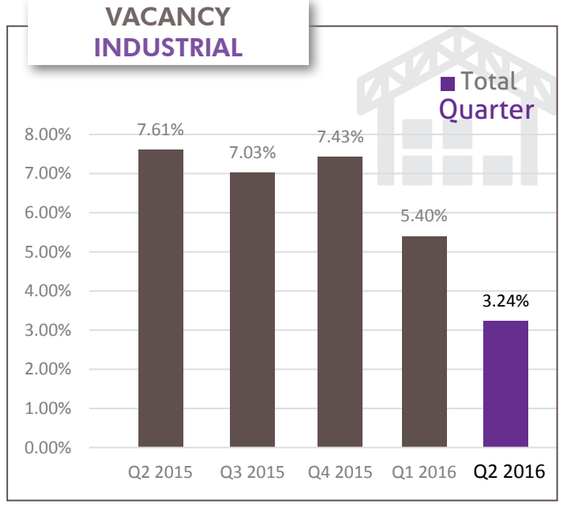
CLICK HERE TO READ MORE

SANTA MARIA

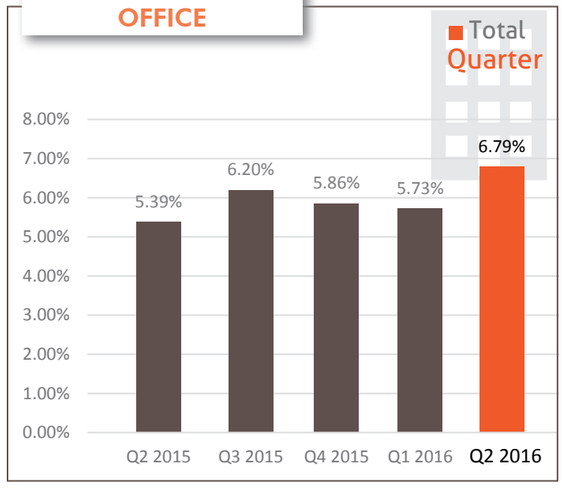
VACANCY RETAIL



VACANCY INDUSTRIAL



VACANCY OFFICE



MARKET HIGHLIGHTS

- Development of new inventory will remain flat creating high demand for larger industrial and office spaces driving vacancy rates down.
- Several significant leases were signed in Q2 that will help keep vacancy trending down, including the 50,000 square-foot industrial lease to Wine Direct at 1351 Fairway Drive.
- A wide range of pending residential and retail developments in the area will improve the retail landscape and attract strong tenants to the market.

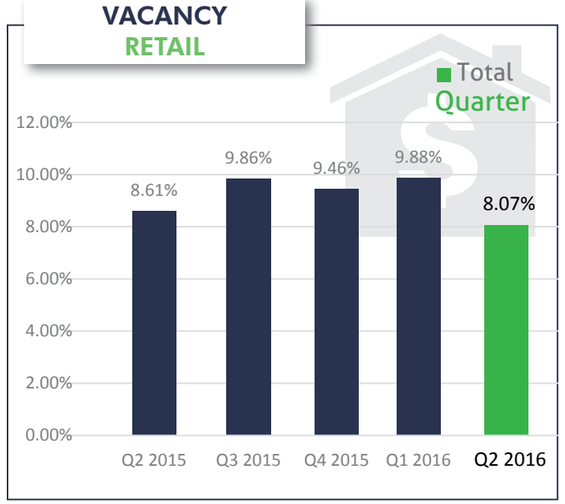
RETAIL
VACANCY RATE
6.02%

OFFICE
VACANCY RATE
6.79%

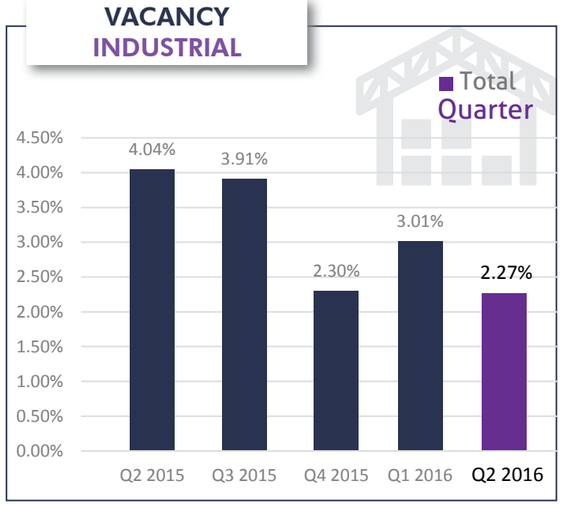
INDUSTRIAL
VACANCY RATE
3.24%

LOMPOC

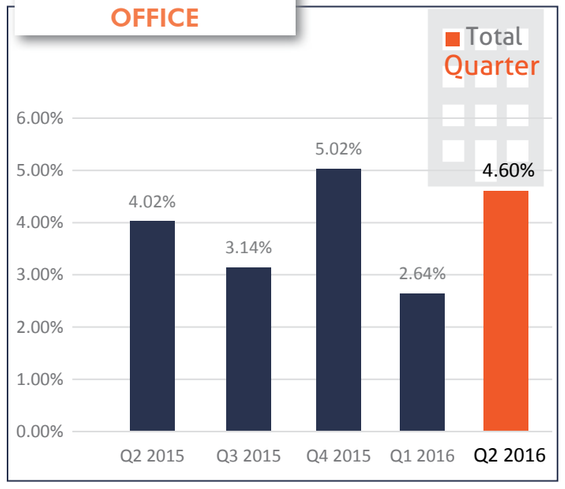
VACANCY RETAIL



VACANCY INDUSTRIAL



VACANCY OFFICE



MARKET HIGHLIGHTS

- Harbor Freight Tools has opened a location in the former Pier 1 space in the Lompoc Shopping Center.
- Retail development for tenants The Chiptole Mexican Grill and the Habit Burger will occupy newly construction on the 3,770 square-foot retail pad. The two restaurant chains will operate under the same roof located at the intersection of North H Street and Central Avenue.
- Hilton Garden Inn, a 156-Room hotel project is currently underway on North H Street. The 108,000 square-foot project is currently under construction, opening in the first quarter of 2017.

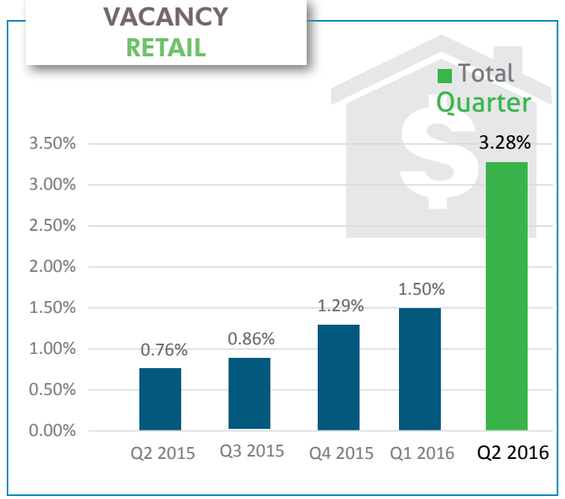
RETAIL
VACANCY RATE
8.07%

OFFICE
VACANCY RATE
4.60%

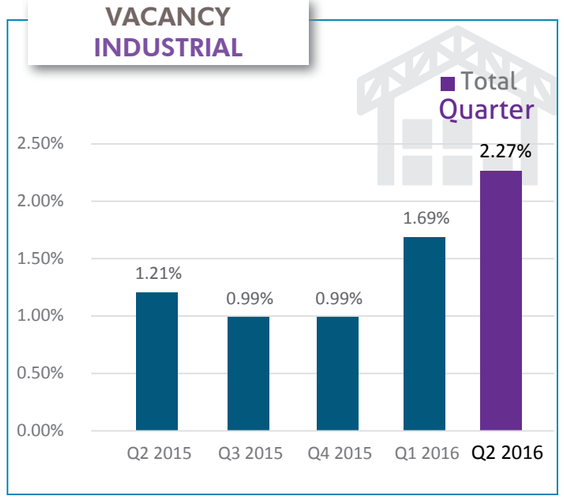
INDUSTRIAL
VACANCY RATE
2.27%

SAN LUIS OBISPO

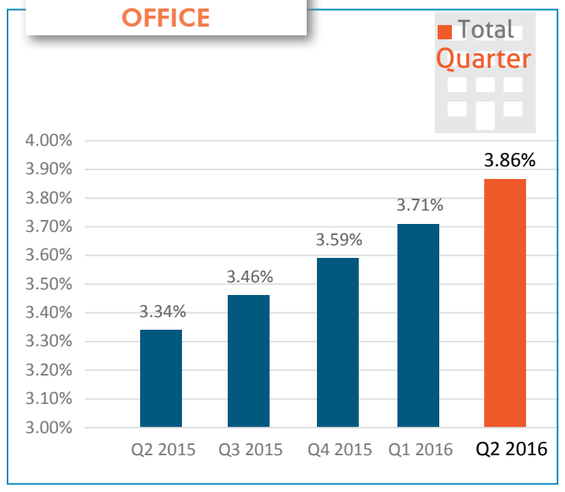
VACANCY RETAIL



VACANCY INDUSTRIAL



VACANCY OFFICE



MARKET HIGHLIGHTS

- Development activity in downtown San Luis Obispo is at record highs. In all, there is over $70MM currently underway or nearing completion.
- Industrial and Office vacancy rates have leveled off and average asking rental rates are being pushed upward.
- Highly competitive investment demand will keep cap rates compressed in the 6% range for quality commercial assets while cap rates for Multi-family and strong core assets to remain below 6%.

RETAIL
VACANCY RATE
3.28%

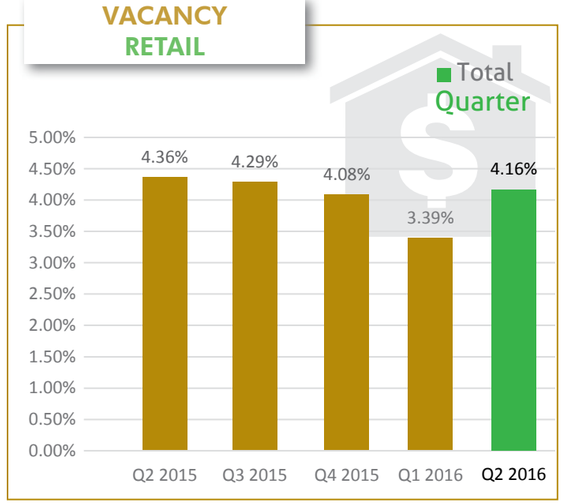
OFFICE
VACANCY RATE
3.86%

INDUSTRIAL
VACANCY RATE
2.27%

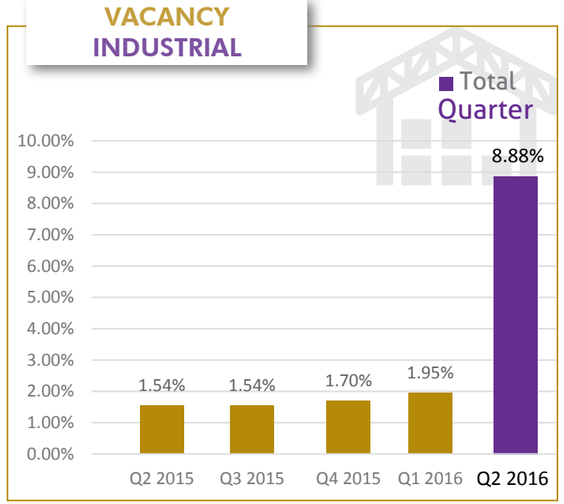
3
Key Market Snapshots

PASO ROBLES

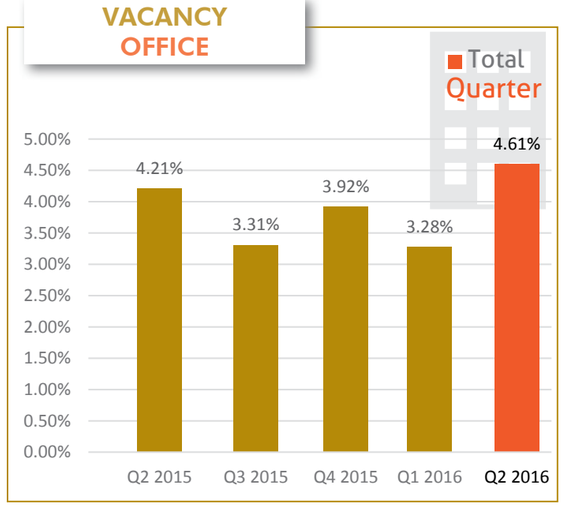
VACANCY RETAIL



VACANCY INDUSTRIAL



VACANCY OFFICE



MARKET HIGHLIGHTS

- Paso Robles Industrial market has seen a sharp increase in vacancy due to the complete closure of Paris Precision's 220,000 square-foot facility located at 1650 Ramada Drive. The Paso Robles sheet metal fabricator, closed its doors in May and terminated approximately 130 employees.
- The office and retail markets of Paso Robles remain healthy with sub-5% vacancy continuing in both sectors.

RETAIL
VACANCY RATE
4.16%

OFFICE
VACANCY RATE
4.61%

INDUSTRIAL
VACANCY RATE
8.88%

Wine Country

With Central Coast land acquisitions on the rise, the area is seeing new and sustained vineyard development occurring in the region. Central Coast, which includes six federally-sanctioned American Viticultural Areas (AVAs), is becoming a prized location for Vineyard expansion and is attracting Napa and Sonoma based operators anxious to tap into Santa Barbara County land values.

Some of the latest deals contributing to this growing trend include the long-term lease negotiated by Clos Pepe owners, Steve and Cathy Pepe. The vineyard was leased to the Napa-based Hall Family for their Walt wines program, who will continue farming the vineyard and providing fruit to the winemaking producers still under contract.

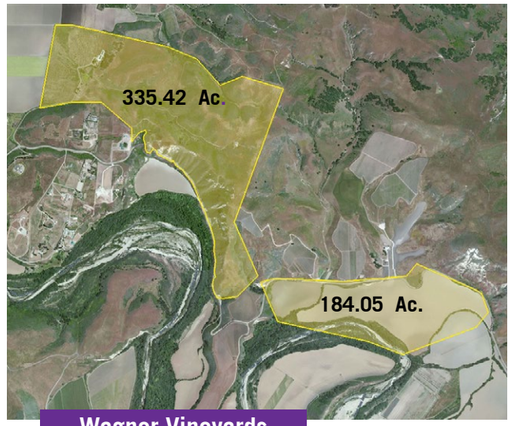
Meiomi founder and fifth generation Napa Valley winemaker, Joe Wagner, son of Chuck Wagner, founder of Caymus Vineyards, has recently purchased a $4.1 million land parcel located on Sweeney Road, Lompoc. The 184 acre parcel, located within the Santa Rita Hills AVA is planned for an approximately 120 acre vineyard, likely to expand his Napa based brand, Copper Cane Wine & Provisions.

Wagner continues to develop his operations with 9th generation Californian, James Ontiveros, whose family established the Santa Maria Valley based, Alta Maria vineyards. Wagner and Ontiveros recently formed a partnership, leasing an approximately 3,500-square-foot commercial space in Los Alamos, where they plan to display their wines.

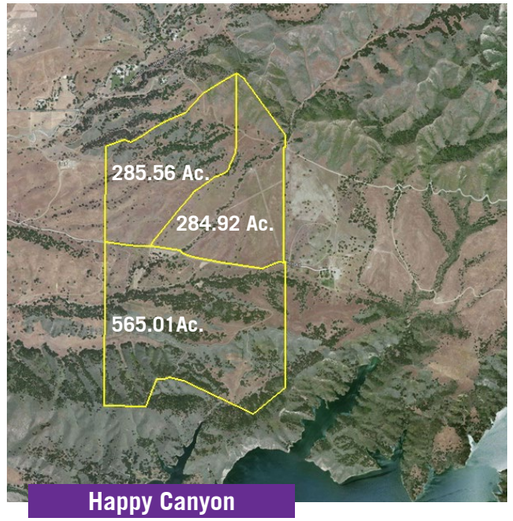
Dave Phinney founder of the Orin Swift and Prisoner labels from the Napa area has purchased a $3.5 million land parcel located on Sweeney Road, Lompoc. The 335 acre lot resides east of Highway 246 partially within the Santa Rita Hills AVA.

In June, San Francisco based real estate investment firm, Jay Paul Company, purchased a 1,134 acre site with plans of developing a several hundred acre vineyard. The $26 million purchase is comprised of three adjoining parcels located in the easternmost part of the Santa Ynez Valley, within Happy Canyon. The bucolic area is recognized for its unique micro-climate and its ability to produce top quality Bordeaux varietals.

With such activity and a growing interest by Napa and Sonoma vineyards in the Santa Barbara region, land prices will continue to be the primary lure, especially with Napa and Sonoma land values at multiples of those seen in our region. However, with ongoing expansion and limited availability, there will be upward pressure on land values.

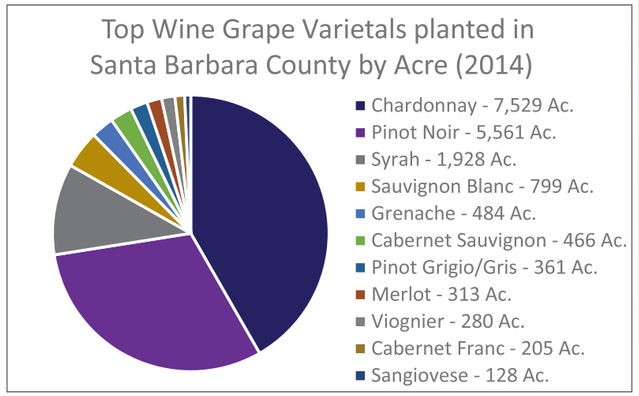


Wagner Vineyards



Happy Canyon

ORIN·SWIFT · Wagner Family of Wine · Clos Pepe Estate · The Prisoner · alta maria vineyards · Narrative · Caymus Vineyards · Meiomi Coastal California Wines · Copper Cane Wines & Provisions



LEE CENTRAL COAST PRESENTS:

CENT'ANNI WINEYARDS

Presented by:
Clarice Clarke CalBRE# 00943106
805-962-6700 x102
claricec@lee-associates.com

ROSS & BARTON CalBRE# 01167539
310-500-3983
rossandbarton@thepartnerstrust.com

Sale Price: **$5,490,000**
Location: 59 Industrial Way, Buellton, CA
Premium wines with consistent 90+ ratings
Over $1,600,000 current inventory (FOB Pricing)
$850,000 bottled value $800,000 barreled value
Italian varietals, including Sangiovese (4 clones), Montepulciano and the only Canialo and Colorino plantings in California. Vines established over the last 10 years.
AVA: Los Olivos District AVA, which encompasses the "historic" Santa Ynez Valley (Los Olivos, Ballard, Santa Ynez, and Solvang).
Approximately 5 Acres planted
Yield: 3.5-4+ tons/Acre, vine spacing is 6' x 3'
Farming Contractor: Coastal Vineyard Care
Miscellaneous farm equipment is included
Water: Well established in 2005; 75 gpm for irrigation
Domestic water - Municipal
Automatic water misting system throughout Vineyard for frost protection
Sustainable farming free of pesticides and chemicals

STA. RITA HILLS A.V.A.

Property Type: Land
Property Size: 18.72 ± Acres
Sale Price: **$850,000**
APN: 099-160-073
Zoning: 100-AG
Available Date: Immediately

Presented by:
Tom Davidson CalBRE# 00595846
805-588-7777
tdavidson@lee-associates.com

Highway 246 in the Santa Rita Hills A.V.A.
Santa Rita Hills area with recorded certificate of compliance.
May be combined with 3.25 ± acre parcel across Hwy 246, APN 099-160-075.

NOTABLE SALES **Q2** 2016

2528-2530 S. BROADWAY, SANTA MARIA

Property: Retail
Size: 144,000 SF
Sale Price: $28,600,000
Sale Price/SF: $198.61
Sale Date: 05/2016

1

775 N. OAK PARK BLVD., GROVER BEACH

Property: Retail
Size: 43,554 SF
Sale Price: $8,820,000
Sale Price/SF: $202.50
Sale Date: 05/2016

2

711 TANK FARM RD., SAN LUIS OBISPO

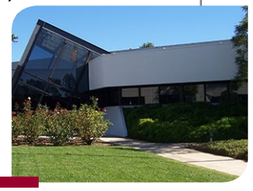
Property: Office
Size: 24,012 SF
Sale Price: $8,350,000
Sale Price/SF: $347.74
Sale Date: 04/2016

3

55 CASTILIAN DR., GOLETA

Property: Office
Size: 37,116 SF
Sale Price: $7,950,000
Sale Price/SF: $214.19
Sale Date: 04/2016

4



HOLLISTER AVE., GOLETA

Property: Land
Size: 162,043 SF
Sale Price: $7,255,500
Sale Price/SF: $44.78
Sale Date: 04/2016

5

309 CANON PERDIDO ST., SANTA BARBARA

Property: Multi-Family
Size: 15,494 SF
Sale Price: $5,400,000
Sale Price/SF: $348.52
Sale Date: 05/2016

6

11145 EL CAMINO REAL, ATASCADERO

Property: Multi-Family
Size: 52,942 SF
Sale Price: $5,223,000
Sale Price/SF: $98.65
Sale Date: 04/2016

7

114 E HIGHWAY 246, BUELLTON

Property: Hospitality
Size: 58,000 SF
Sale Price: $4,650,000
Sale Price/SF: $80.17
Sale Date: 04/2016

8

4
Significant Transactions

NOTABLE LEASES **Q2** 2016

2800 INDUSTRIAL PKY., SANTA MARIA

Tenant: Cool-Pak, LLC
Property: Industrial
Size: 62,000 SF
Lease Date: 06/2016

1

1351 FAIRWAY DR., SANTA MARIA

Tenant: WineDirect
Property: Industrial
Size: 50,000 SF
Lease Date: 05/2016

2

3042 INDUSTRIAL PKY., SANTA MARIA

Tenant: US Army Corps of Engineers
Property: Retail
Size: 23,777 SF
Lease Date: 06/2016

3

222 N. MILPAS STREET, SANTA BARBARA

Property: Grocery
Size: 22,000 SF
Lease Date: 06/2016

4

793 E. FOOTHILL BLVD., SAN LUIS OBISPO

Property: Retail
Size: 19,000 SF
Lease Date: 05/2016

5

700 N. H STREET, LOMPOC

Tenant: Harbor Freight Tools
Property: Retail
Size: 15,971 SF
Lease Date: 05/2016

6

2811 AIRPARK DR., SANTA MARIA

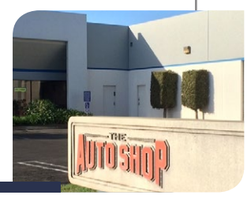
Tenant: Data Computer Corporation of America Inc.
Property: Office
Size: 12,585 SF
Lease Date: 06/2016

7

1160 W. BETTERAVIA RD., SANTA MARIA

Tenant: Idler's Home
Property: Industrial
Size: 11,994 SF
Lease Date: 04/2016

8



THE LEE & ASSOCIATES CENTRAL COAST TEAM

PRINCIPAL TEAM

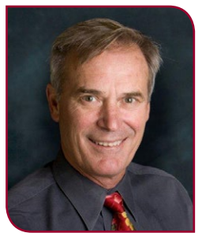

CLARICE CLARKE


STEVE LEIDER


MARTY INDVIK

BROKER TEAM


ALLEN SEGAL


TOM DAVIDSON


CHRISTI VIOR


JEFF ALLEN


ANTHONY KUHNS


ROB ADAMS


NATALIE V. WAGNER

OFFICE SUPPORT TEAM


SHARIF ELSEIFY
Research Assistant


KAREN HELTON
Administrative Director


ANA STORK
Marketing Manager


JODY WALTERS
Broker Assistant

Nationwide Lee Offices

Arizona
Fred Darche
602.956.7777
Phoenix, AZ 85018

California
Clarice Clarke
805.898.4362
Santa Barbara, CA 93101
(Central Coast)

Brian Ward
760.346.2521
Palm Desert, CA 92260
(Greater Palm Springs)

John Hall
949.727.1200
Irvine, CA 92618

Mike Tingus
818.223.4380
LA North/Ventura, CA 91302

Craig Phillips
323.720.8484
Commerce, CA 90040
(LA Central)

Robert Leveen
213.623.1305
Los Angeles, CA 90071
(LA ISG)

Greg Gill
562.354.2500
Long Beach, CA 90815
(Los Angeles)

Aleks Trifunovic
310.899.2700
Santa Monica, CA 90404
(LA West)

Steve Jehorek
949.724.1000
Newport Beach, CA 92660

Craig Phillips
562.699.7500
City Of Industry, CA 91746

Craig Hagglund
510.903.7611
Oakland, CA 94607

Don Kazanjian
909.989.7771
Ontario, CA 91764

Bob Sattler
714.564.7166
Orange, CA 92865

California (cont'd)
Craig Phillips
323.720.8484
Pasadena, CA 91101

Mike Furay
925.737.4140
Pleasanton, CA 94588

Dave Illsley
951.276.3626
Riverside, CA 92507

Dave Howard
760.929.9700
Carlsbad, CA 92008
(San Diego North)

Steve Malley
858.642.2354
San Diego, CA 92121
(San Diego UTC)

Tom Davis
209.983.1111
Stockton, CA 95206

Dave Illsley
951.276.3626
Murrieta, CA 92562
(Temecula Valley)

Don Brown
760.241.5211
Victorville, CA 92392

Denver
John Bitzer
303.296.8770
Denver, CO 80202

Florida
Jerry Messonnier
239.210.7610
Ft. Myers, FL 33966 (Naples)

Tom McFadden
321.281.8501
Orlando, FL 32839

Georgia
Dick Bryant
404.442.2810
Atlanta, GA 30326

Victor Segrest
404.781.2140
Atlanta, GA 30328 (Appraisal)

Idaho
Matt Mahoney
208.343.2300
Boise, ID 83703

Illinois
James Planey
773.355.3014
Rosemont, IL 60018 (Chicago)

Indiana
Scot Courtney
317.218.1038
Indianapolis, IN 46240

Maryland
J. Allan Riorda
443.741.4040
Columbia, MD 21046

Michigan
Jon Savoy
248.351.3500
Southfield, MI 48034

Minnesota
Chris Garcia
952.955.4400
Minneapolis, MN 55401

Missouri
Thomas Homco
314.400.4003
St. Louis, MO 63114

Nevada
Lyle Chamberlain
775.851.5300
Reno, NV 89501

New Jersey
Rick Marchiso
973.475.7055
Elmwood Park, NJ 07407

New York
Jim Wacht
212.776.1202
New York, NY 10022

Ohio
Brad Coven
216.282.0101
Pepper Pike, OH 44124
(Cleveland)

Tim Kelton
614.923.3300
Dublin, OH 43017
(Columbus)

Pennsylvania
John Van Buskirk
717.695.3840
Camp Hill, PA 17011

South Carolina
Bob Nuttall
843.747.1200
Charleston, SC 29492

Randall Bentley
864.704.1040
Greenville, SC 29601

Texas
Trey Fricke
972.934.4000
Addison, TX 75001
(Dallas/Fort Worth)

Chris Lewis
713.660.1160
Houston, TX 77027

Wisconsin
Todd Waller
608.327.4000
Madison, WI 53713

Canada
Chris Anderson
604.684.7117
Vancouver, British Columbia

Gerald Eve
James Southey
+44 (0) 20 7333 6226
www.geraldeve.com

*Please contact individual managers for information in specific markets.

The Lee Central Coast Brief

leecentralcoast.com

Q2

2016

LEE & ASSOCIATES®

COMMERCIAL REAL ESTATE SERVICES