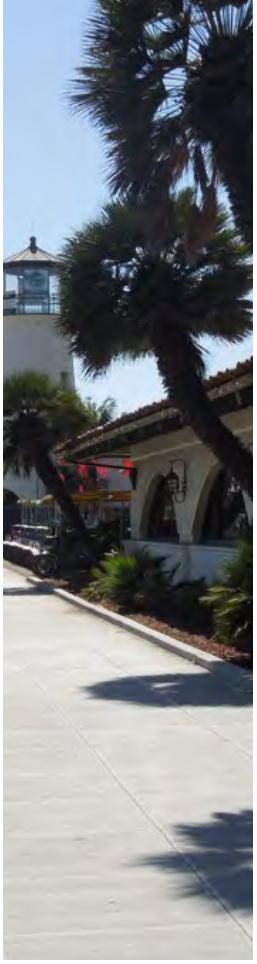

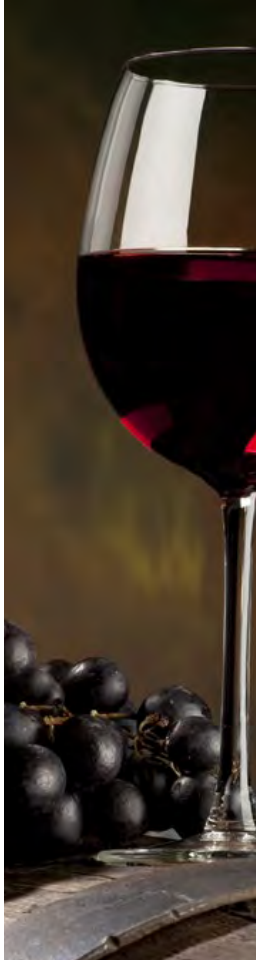

The Lee Central Coast Brief

04

2016

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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

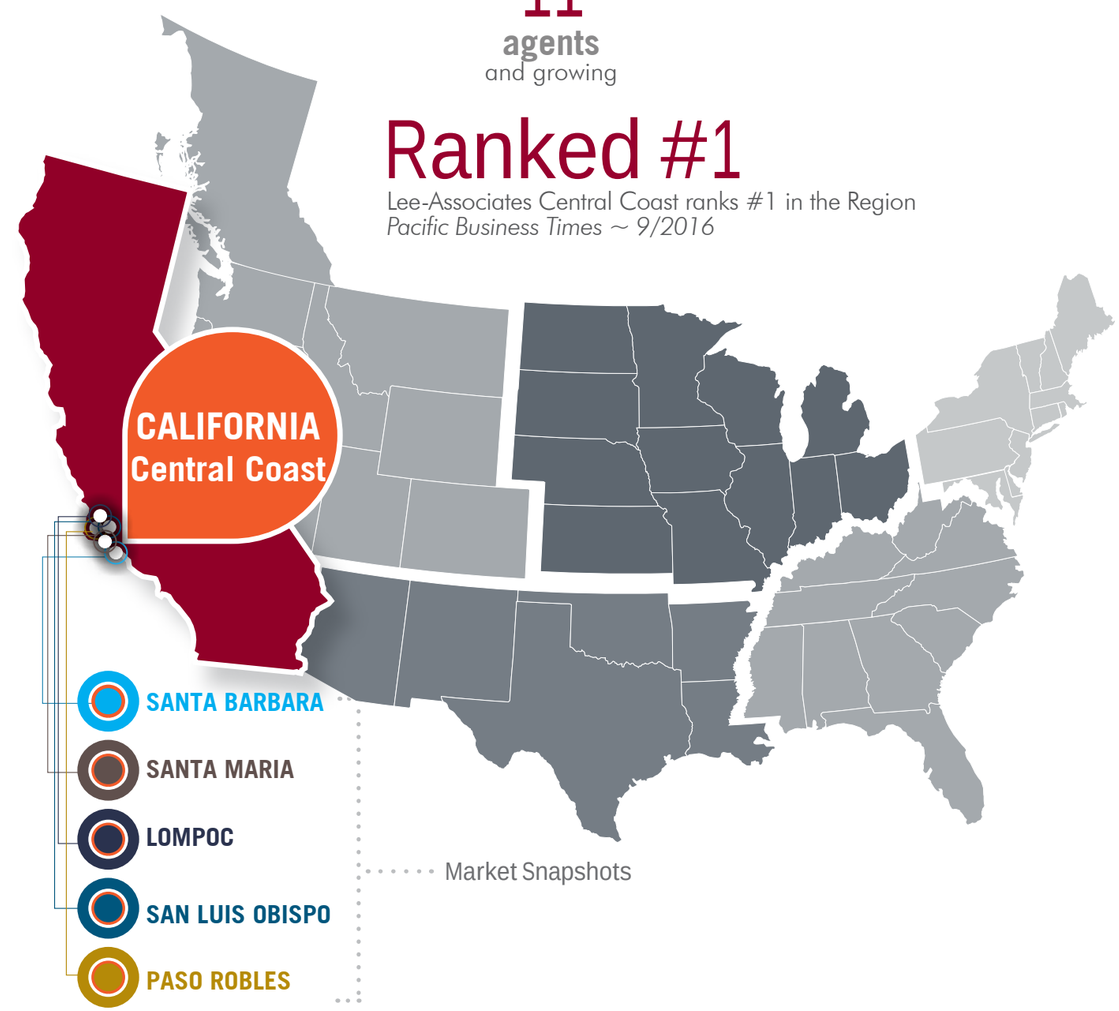
LEE & ASSOCIATES CENTRAL COAST

3
offices
within the tri-counties

11
agents
and growing

Ranked #1

Lee-Associates Central Coast ranks #1 in the Region
Pacific Business Times ~ 9/2016



Market Snapshots

GLOBAL ECONOMY

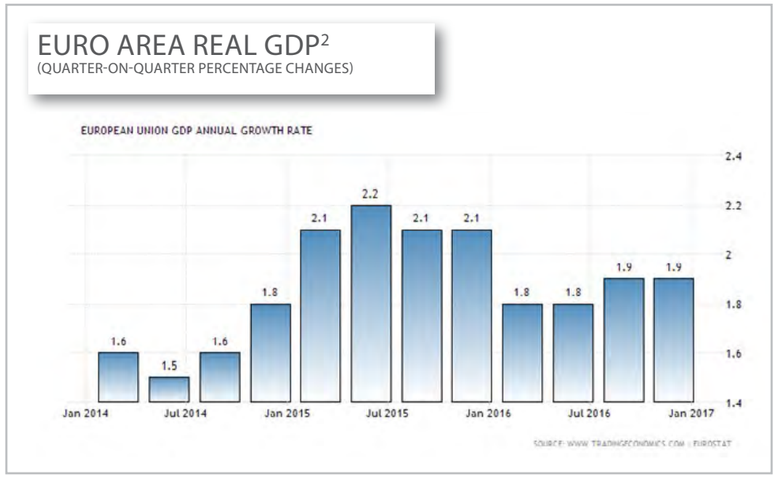
In the past two quarters we have been describing the global economic outlook as troublesome. We still do, but we can point to at least some improvement around the world. The panic over the Brexit vote was short-lived. It didn't take long for world markets to absorb the news. There's a long way to go, but the UK's exit from the EU is drawing much less attention now. The British Pound took a beating, but that may also be short-lived, once the actual process ramps up this spring.

When the UK made its surprise decision, the long term survival of the EU became a major topic. Europe's political union is still in crisis mode and without a governing body with the real authority to enforce anything, it will likely remain so. Sovereign debts keep rising, unemployment is persistently high and GDP growth in Europe is nearing recession territory, despite the aggressive monetary policy of the European Central Bank. Calls for fiscal austerity have been largely ignored, and the ongoing refugee crisis has whipped up nationalist fervor throughout Europe. The Euro and British Pound have taken a beating.

Energy exporting nations are still hurting due to the sharp decline in oil prices, but the recent OPEC agreement to cap production has sent the price of a barrel of oil back above $50. Though, oil is transacted in dollars and the dollar strengthened against other currencies. So, the effect of the price gain may be partially offset. Non-OPEC producers like Russia and Venezuela have also shown a willingness to cap production in order to bring supply and demand into better balance. At the same time, US production looks to be ramping back up, as evidenced by an increase in rig count over the past several months. As the price of a barrel of oil goes up, more wells can turn a profit. For now, supplies are still running ahead of demand and recent agreements essentially cap production at current levels in the hope that an increase in demand from economic expansion over time will eventually absorb excess supply.

Oil-rich Middle-Eastern countries, including Saudi Arabia, are burning through cash reserves to cover revenue shortfalls precipitated by the falling price of oil. China is issuing sovereign bonds to help it cope with its massive transition from total dependence on the exportation of manufactured goods.

None of this sounds like good news and that is undeniably correct. However, the US economy is in much better shape relatively speaking. Once again, the world views the US as the safe haven of choice. That keeps capital moving into the US and much of that finds its way to the commercial real estate market. In fact, foreign demand for US real estate assets continues to contribute to gains in asset prices, as it increases competition in all product types. Foreign investors are willing to pay a premium to assure the preservation of their capital.

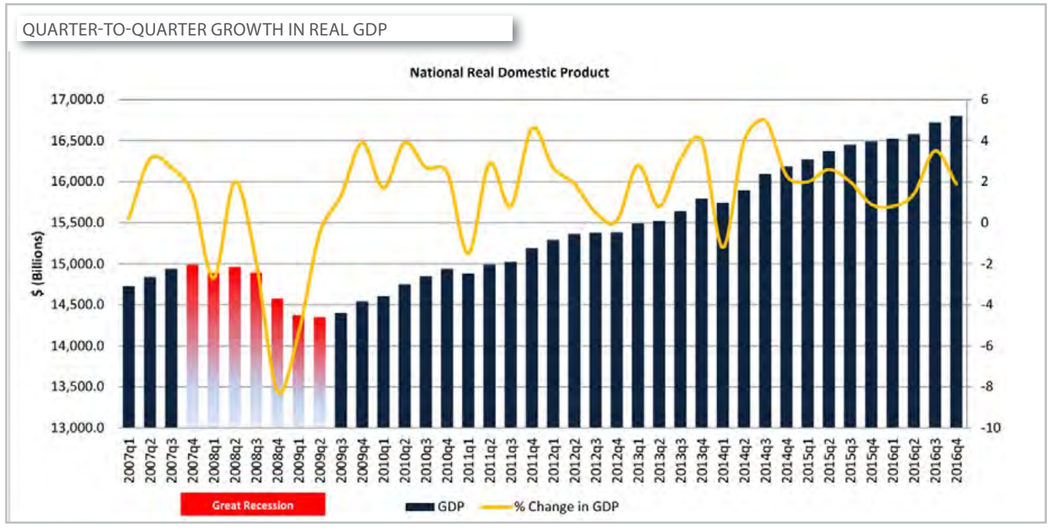


GDP GROWTH

US GDP, the primary metric for tracking the total output of US goods and services, is perhaps the most closely watched statistic in the world. Our economy is, by far, the largest on the planet and we also consume more foreign goods and services than any other nation. Whatever happens here at home, is felt and observed the world over.

Fortunately, US GDP growth picked up in Q3 after several dismal quarterly performances that had the domestic economy running just above stall speed. In Q1, the economy expanded by just .9%, followed by a disappointing 1.4% rate in Q2. The third and final estimate of Q3 growth came in at 3.2%, which had investors breathing a collective sigh of relief. However, a rather obscure but important fact is that the export of soy beans resulting from a poor harvest in South America accounted for more than a fourth of that number.

Unfortunately, the first estimate of Q4 growth came in at just 1.9%, which left 2016 with a growth rate of just 1.6%. That is good relative to the rest of the world. Europe and Japan are still in tough shape, despite drastic monetary and fiscal measures to keep their economies from sliding into recession.



GDPNow, the Atlanta Fed's weekly index measuring GDP, currently estimates 2.9% growth for Q4. If that proves true, the US economy will at least surpass 2% growth for the year, which is weak, but still on the right side of the line. In 2015, GDP grew at a 2.4% clip. Even with that decline, the US looks relatively good. Europe and Japan are still in tough shape, despite drastic monetary and fiscal measures to keep their economies from sliding into recession. The central banks in both regions continue their experiment in NIRP (Negative Interest Rate Policy) and they have ongoing and bond-buying programs to encourage businesses to borrow at low or negative rates. Even with all that meddling, GDP growth remains well under 2% in the Euro Area, and the unknown danger associated with unwinding the European Central Bank's monetary experiment is still looming. The Bank of Japan keeps printing money and buying bonds in such volume that it is running out of bonds to buy. So, it has resorted to buying equities to get the stimulus money placed.

There is no denying the reality of globalization and things are not going well outside our borders. Political turmoil, civil unrest and economic challenges around the world weigh heavy on the minds of domestic investors, and most definitely figure into the strategy of our central bankers. The question that remains is whether or not US companies and consumers will accept the slower growth model as the "new normal" and act in a way that promotes further growth.

GDP GROWTH

No discussion on economics can be had without considering the newest wild card in global economics: Donald Trump. The US President-Elect stunned the globe with a victory that odds-makers didn't see coming. Neither did Hillary Clinton and her followers, who woke up on November 9th in a world they least expected. Regardless of your political persuasion, there's no denying the immediate effects of the election. Equities markets soared on the expectation of lower corporate and personal income tax rates, reduced regulations and a huge infrastructure spending program. Of course, none of that has yet happened. Mr. Trump will have just taken the oath of office as this writing is released and he will only be beginning to navigate a political system designed to have big change occur over time. Checks and balances built into the US Constitution give the minority protection against being steamrolled. So, our new leader, who is used to calling all the shots when making business decisions, will need some time to acclimate to a different set of rules. But, the preliminary indication from the business world has been positive now that the reality of his victory is sinking in. What impact he can have on GDP in the short run is a complete unknown at this point, but the psychology of decision making going forward may be influenced by the prospects of a more business-friendly President.

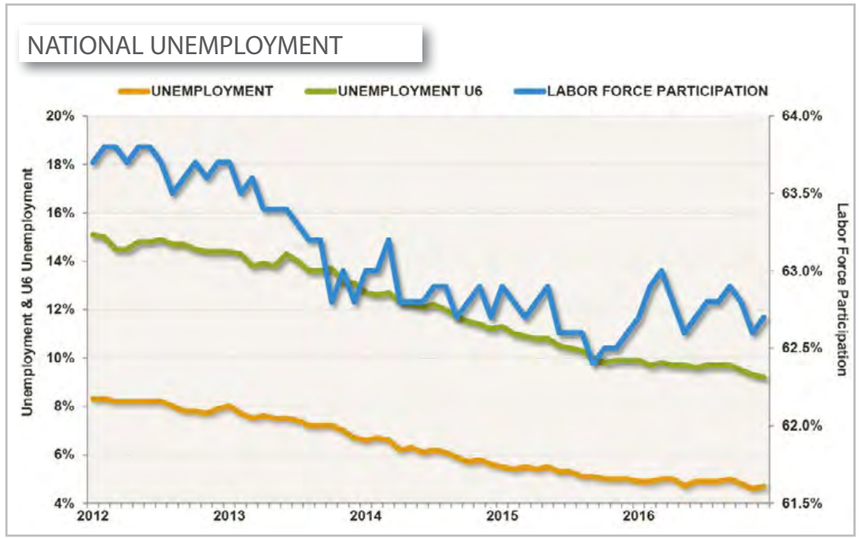
Volatility in equities has been on the rise in 2016, as US companies grapple with sluggish market conditions. Corporate earnings have declined repeatedly the last six quarters and companies have been resorting to cost-cutting and stock buyback programs to increase profits and earnings per share. Reducing operating costs means job cuts and that means reduced consumer spending, which accounts for roughly 70% of GDP. Though, it is important to note that the most recent earnings cycle did show signs of improvement.

As we have pointed out all year, US consumers have been riding the brakes on spending. Retail sales growth, a large component of consumer spending, has been a problem and wage growth has been lagging behind previous economic recoveries, though it did spike in December to 2.9% year-over-year. Auto sales set a record, but most of a December increase can attributed to incentives to move slow selling vehicles off the lots before the year ended. The bottom line on GDP is that it could go either way. If the Trump effect lasts for a while, business investment and consumer spending could build some momentum and those are the two main components of GDP. If that happens, however, the Fed will make more interest rate moves and that will strengthen the US Dollar and hurt exports, another key component of GDP.

EMPLOYMENT

Job growth is one the most perplexing of economic indicators, especially due to the fact that the U3 unemployment rate is the most widely quoted rate. The base for the U3 rate includes those who are employed and those who are unemployed but have actively sought employment in the last five weeks. We are not sure who made that one up, but we would sure like to know what the logic was. The U3 equation often produces counter-intuitive results. When job creation is good, those who have not been looking for work, re-engage in their search and are added to the total of those who are actively looking, increasing the number of unemployed workers and thereby raising the unemployment rate.

The U6 unemployment rate, presents a different story. It includes those working part time in their field of choice, who would prefer to be working full time, as unemployed. Many believe U6 metrics offer a more accurate employment picture. It does make clearer the frustration of many in the middle class who still feel like the recession never ended. They are technically employed, but don't feel the impact of higher income. This is the group that may have turned the election for Mr. Trump.



U6 unemployment is currently more than double that of U3, at 9.7%. Job creation has been slowing over the past year. The 12 month rolling average has fallen to 180,000 per month from 229,000; not an insignificant number and important to note that it includes part time jobs, most of which are at or near minimum wage. Q4 started strong with a total new job count of 161,000. November hit 178,000 and December came in under estimates at 156,000. The low point for 2016 came in May when only 11,000 new jobs were recorded. The best month of the year thus far came in June, when 271,000 new jobs were created. Wild swings in job growth affect current and future consumer spending, prompting CEOs to be more cautious and less inclined to implement aggressive growth strategies.

Despite erratic job growth numbers, the U3 unemployment rate for December came in at 4.7%, which is generally indicative of a fully employed economy. However, that number is deceiving because so many of the jobs being created are either part time or at the lower range of the wage scale.

EMPLOYMENT

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. The new administration has vowed to repeal and replace the landmark legislation, but that could take years to make happen, if it ever does. Too much water may have flowed under that bridge already.

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, also remains stagnant. Choppy job growth reports and the early exit of Baby Boomers, have combined to keep just 62.7% of potential workers in active production. It is important to note that Labor Participation has moved off a five decade low, but it may head down again in the next few years as the rate of early-retiring Baby Boomers increases.

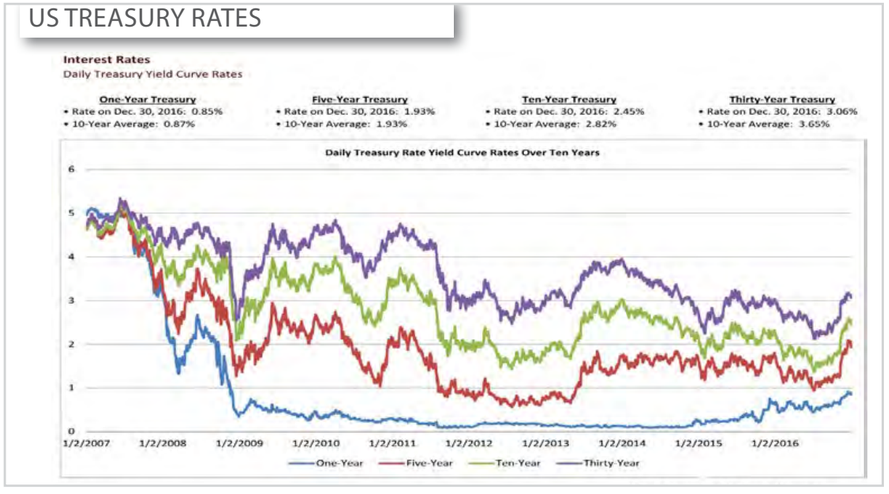
Lagging wage growth is another problem that has dogged the US economy in this recovery. Full-time, high-paying jobs are in short supply and wage growth overall is tracking at a rate that finally rose to 2.9% in December. If you are making a middle income wage, a 3% increase may not change your spending habits. Half of that increase will cover inflation, leaving the other half for discretionary spending. That kind of wage growth offers little relief to workers at or near the minimum wage level who are struggling to make ends meet. It's no wonder that so many middle class workers are disillusioned with a recovery that they feel has left them behind.

Layoffs in the energy sector have not helped the job picture, either. More than 700,000 full time positions have been eliminated since oil prices declined sharply back in 2014. Many of those jobs were high-paying technical positions that are not easily replaced in other business sectors like technology and business services that have contributed most to recent job gains.

MONETARY POLICY

After a year of sending cryptic mixed signals, the Fed finally stepped up in December and bumped up its benchmark Fed Funds Rate by another 25 basis points to .75%. By historical standards, that is still a very low number, and it will take a sustained series of quarter-point increases to reverse the activist stance of our central bank. Since the financial crisis that began at the tail end of 2007, the Fed has been heavily involved in manipulating the cost and flow of capital, more so than at any other time in its 100+ year history. Many have warned that the Fed has too much influence on the direction of the overall economy. Some believe our central bankers were caught off guard when their first move on rates roiled world markets and sent the US Dollar soaring back in January of 2016. A strong dollar makes US exports more expensive and raises US TREASURY RATES the cost of paying back dollar-denominated loans for borrowers around the world. Simply put, the world threw an economic fit and central bankers around the globe pleaded with the Fed to forestall further increases until the global economy improved. It took several months for things to settle down, but Ms. Yellen and her colleagues were spooked away from raising rates for the rest of the year. Yield-chasers poured money back into the equity markets and the January slide turned into a bull run that was turbocharged by Trump's surprise win in November.

Meanwhile, central bank policy around the world has been going the other way. The European Central Bank has taken its benchmark rate into negative territory, as has the Bank of Japan. That means that borrowers get paid for borrowing money, which is counter-intuitive at a minimum. Both those central banks are buying corporate bonds in addition to their own sovereign debt, raising further concerns over the long term consequences of actions that are based on unproven economic models. The Bank of Japan is even buying individual stocks, an action that would be against the law for our Fed. Critics of central bank policy are calling out individual central bankers for doubling down on failed policies to save their academic reputations. That argument may just have some merit.



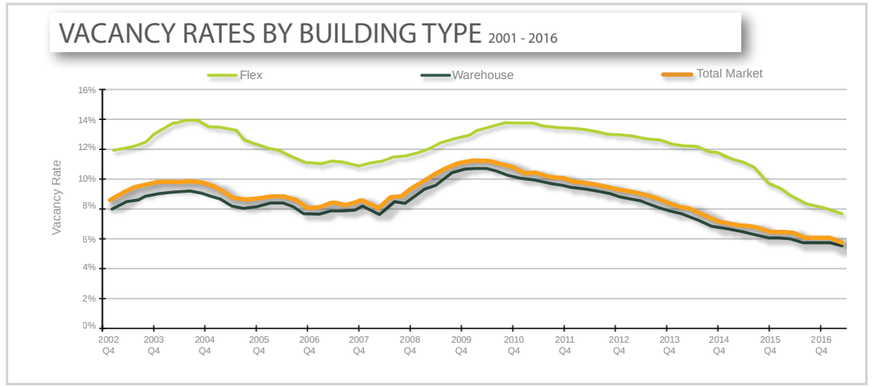
The good news about the most recent move by the Fed is that it gave itself a little room to work with if the economic recovery does stall. With GDP growth so weak in the first half of 2016, concern a possible recession was on the rise.

Fortunately, Q3 growth improved, but the first estimates for Q4 came in at a disappointing 1.9%. Hopefully, the Fed can follow through with further rate hikes in 2017 to move further out of the corner it painted itself in to over the past 10 years. If not, it could run out of ammunition to stimulate growth and be forced into the uncharted waters of negative interest rates. Trump's promise of a massive infrastructure investment has buoyed hopes that the Federal government will help out on the fiscal side of the equation, and not continue to leave all the heavy lifting up to the Fed. But, that means bigger federal deficits that are already on their way back to over $1 Trillion per year. Bottom line: the Fed still has itself in a pickle and is short on ideas to get the economy back on a track of healthy growth. The takeaway might be that the Fed has reached the limits of its effectiveness, and that might get investors more focused on markets themselves rather than what impact Fed action will have on those markets. We'll just have to see if we are really open to learning that lesson. Real estate borrowers are still the beneficiaries of the Fed's current monetary policy direction. Mortgage rates have remained at historic lows, but they have begun to move up. Most commercial property lenders use a spread over the yield on the 10 Year T-bill to set mortgage rates, and that yield has risen by over 50 basis points since the election. Long-term loans are still readily available, but underwriting is tightening up and interest rates have already moved higher. The Fed's willingness to make another move up in the short term will be a signal for long term lenders to get more aggressive with further rate hikes of their own. For the moment, it's still a good time to borrow money. Nothing against Ms. Yellen and her Board of Governors, but it would sure be nice if they were off the front page every day.

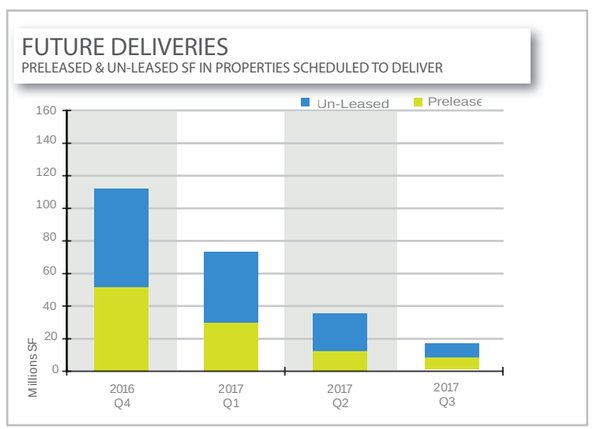
US INDUSTRIAL MARKET

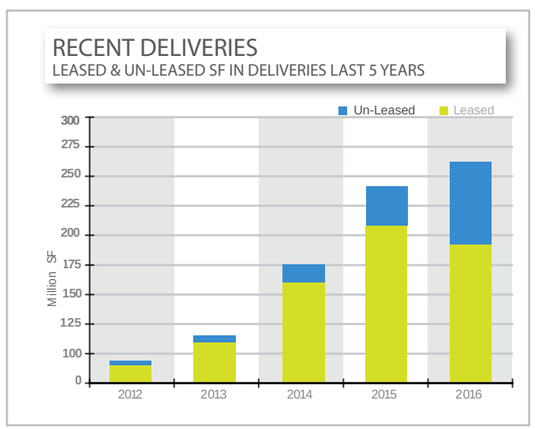
After a third quarter that was cause for celebration, the industrial market put in another strong performance to finish the year on a high note. Talk of the raging bull market running out of breath have been largely quieted and the post-election surge of optimism is helping the industrial market carry momentum into 2017.

That comes despite the Fed's action to raise the Fed Funds Rate in December. When the central bank made a similar move in December of 2015, it caused global economic upheaval that took months to calm. This time around, the Fed's move has been largely lauded as necessary and appropriate, and markets around the world took the change in stride. The biggest impact of the Fed's move has been a stronger US Dollar against most of the world' major currencies. Anticipation of the rate hike, along hike, along factors, has already pushed mortgage rates higher, but steeper borrowing costs have done little to dampen buyer enthusiasm to acquire properties that have reached record-high values. While it is true that lenders are toughening up on underwriting standards, they've made it clear they are ready to keep lending. They're just taking a harder look at each deal, which is probably a good thing anyway.



In Q4, net absorption and rent growth were strong, vacancy declined and new deliveries continued at a steady pace. Q3 GDP growth came in at a revised 3.2% annualized rate and preliminary estimates for Q4 growth are in the same range. That bodes well for a US economic recovery that has been showing signs of stalling out. Third quarter earnings season improved somewhat after slowing for six straight quarters. The global economic growth picture still isn't good, but there was some improvement during the second half of the year. However, central banks around the world are still printing money and experimenting with negative interest rates to prop up sluggish economic growth. Yet, despite that mixed bag of economic indicators, the US industrial market continues to outperform expectations. Vacancy continued its decline in almost every primary and secondary market. Quality space offered for lease got even tougher to find and





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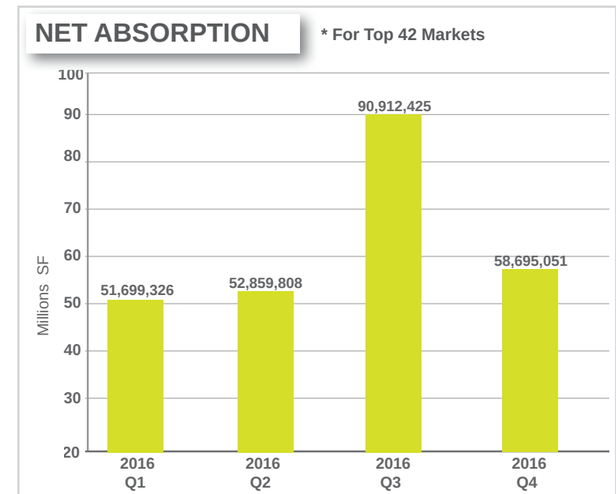
National Economic Overview

many tenants are force d to either renew in inefficient space or settle for relocating to space that doesn't optimize efficiency. For those tenants choosing first generation space, there's a price to pay, as landlords often have multiple interested parties lined up to lease their buildings. Rent growth is being driven by the increased efficiency offered in new projects where the latest in materials handling technology can help tenants think more three dimensionally. Owners of new space are demanding longer terms and stronger credit on top of higher rents. It truly is good to be an owner these days.

Owner/user buyers, anxious to take advantage of cheap money while they can, are lining up to pay record prices. Property values have been rising at a double-digit pace for several years in many markets, but even though owners can reap windfall profits from a sale, they are loathe to sell and face the massive tax hit. Exchanging doesn't help much, as trading up just means paying a premium for someone else's property who is trying to do the same thing. Still, buyers remain aggressive, especially user buyers who can take advantage of SBA financing at 90% of a property's value. That can keep occupancy costs flat for up to 25 years.

For investor buyers, the odds for successful acquisitions are just as long. Competition for industrial investment property remains a problem for buyers who have to bid prices up and cap rates down under 5% in primary markets. Increased activity in secondary markets has had the same effect, as investors looking for less competition have expanded their acquisition criteria. All industrial product types remain in high demand. The institutional players still prefer big bulk distribution deals, but they'll still compete against local and regional players for the multi-tenant NET ABSORPTION * For Top 42 Markets business parks. Developers unable to find land for ground-up development are playing the add-value game, and in many instances adding the most value comes from repurposing properties to multifamily and mixed-use retail/office projects in gentrifying areas. Land is getting more expensive to acquire, taking longer to get entitled and buildings are getting more expensive to construct, which is keeping significant amounts of spec building concentrated in major land-rich markets like Dallas/Fort Worth, Atlanta, Phoenix and the Inland Empire.



Net absorption took off in Q3 when over 118 million square feet of positive net gain in occupied space was recorded nationwide. In the final period of 2016, another 80 million square feet was absorbed, and property owners again have the e-commerce sector, big shippers and 3PL operators to thank for the new occupancy. Until recently, is was just the biggest distribution hubs getting most of the action, but the push for "Last Mile" locations to speed up shipping time is now making a difference in secondary and tertiary markets. Amazon.com continues its massive expansion by leasing multiple fulfillment centers each quarter, some over 1 million square feet. Walmart is expanding in a similar fashion as part of its long term strategy to take the battle to Amazon. Without the e-commerce boom, industrial market metrics would be profoundly different, but the e-commerce sector, despite its prolific growth is still a small fraction of overall retail sales. That means it probably has plenty of room for growth and that means the need for state-of-the-art distribution space will be ongoing for years to come, especially if economic growth accelerates.

New deliveries for both speculative and build-to-suit projects for Q4 reached 60.5 million square feet in 473 buildings. That brings total US industrial property inventory up to 21.94 billion square feet. As the quarter ended, another 256.4 million square feet was still in the construction pipeline, a substantial increase over Q3's total. Development activity is focused primarily in markets like Dallas,

US INDUSTRIAL MARKET

Chicago and Atlanta where land is still available at prices that allow projects to pencil at today's rents. That is not the case in mature markets like Los Angeles where what little land remains is too expensive for conventional industrial development. Infill markets like LA are in danger of losing industrial inventory to repurposing to other product types that make more economic sense.

As we reported last quarter, the balance between spec and build-to-suit construction has helped keep market metrics in balance and the risks of overbuilding at a minimum. New deliveries continue to run short of net absorption, which has maintained market equilibrium even in markets with substantial construction. Speculative buildings are leasing quickly to fast growing tenants who like not having to wait for build-to-suit space.

The national vacancy rate for warehouse and flex space continued to decline in Q4, shedding another 10 basis points to finish the period at 5.5%. In the past three quarters, the vacancy rate has fallen by 40 basis points, and several major market areas still have vacancy rates in the 2% range, including Central Los Angeles, Long Island, New York and California's Orange County.

Average asking lease rates across the country moved higher again in Q4, ending the period up $.07 to $6.05. Markets with the highest levels of construction are still seeing the most rent growth, as tenants remain willing to pay a premium for efficient, first generation space. Rising land and construction costs are becoming more of challenge, as some developers and lenders are getting more cautious about projecting rents for projects that might be years away from completion. Protracted and expensive entitlement processes have contributed to the problem.

LOOKING AHEAD

The US industrial market heads into 2017 firing on all cylinders. High demand, low supply, rising prices and declining vacancy are still driving market dynamics, just as they did as 2016 began. Stronger economic growth, more direction on monetary policy and minor economic improvement around the globe could give the US industrial market growth another boost this year. Our central bankers have given themselves some maneuvering room by raising the Fed Funds Rate in December. Many economists are relieved as a result and they remain hopeful the Fed will follow through with more rate hikes this year. However, that raises the risk that cap rates will decompress in response to higher yields in other asset classes. For example, the yield on 10-Year Treasuries, the so-called riskless investment, has risen over 100 basis points since March of 2016.

Internationally, the news is not as bad as it was three months ago. The global economy is still in tough shape, but the post-Brexit scare was short-lived the markets have gotten used to the idea of an EU without the United Kingdom. China and other emerging economies are still facing big challenges, but stock market volatility has subsided and the doomsayers have been largely silenced by those who see the global economy as showing signs of stability, albeit with the assistance of massive monetary intervention in Europe, Japan, China and other emerging markets.

The US economy is doing better, relatively speaking. GDP numbers are improving, job creation is trending down, but still in healthy territory and wage growth hit an annualized rate of 2.9% in December, highest in several years. Barring a "significant" economic event, the industrial property market should continue to expand. The US is still the preferred safe haven for foreign investment, as well, and owning US Dollar-denominated assets is a priority for foreign investors, big and small. So, capital will keep flowing into the US, which could serve to mitigate cap rate decompression by keeping demand for industrial running ahead of supply.

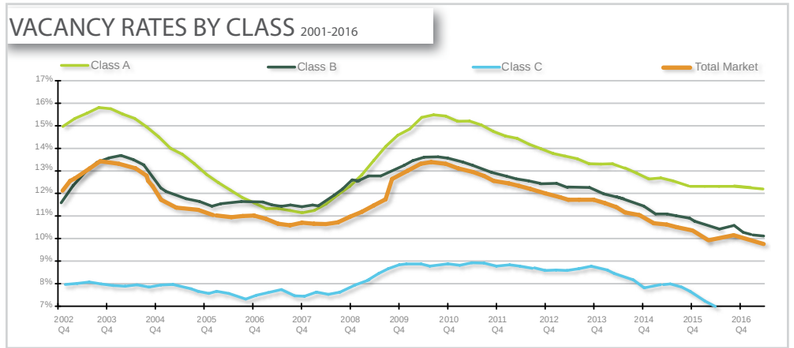
Vacancy will keep moving lower, as the bulk of new construction is concentrated in distribution hub markets with strong, ongoing positive net absorption. Net absorption should remain positive and healthy in 2017, but may moderate in markets that lack quality options for expanding tenants. More tenants in those areas will be forced to renew in place at higher lease rates, even for functionally obsolete space. Construction will remain at current levels in areas with ample supplies of land, but will decline further in markets with fewer available sites.

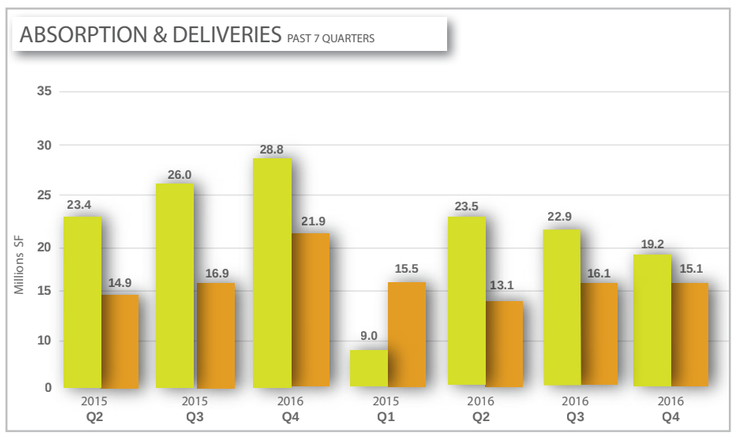
US OFFICE MARKET

After a sluggish start, the US office market picked up the pace in the middle quarters and finished the year with a solid and consistent performance across the board. In fact, the market has been remarkably steady since it began to recover in earnest back in 2011. Vacancy has declined back to levels not seen since 2007, rent growth has been steady and net absorption has remained well into positive territory. New deliveries are keeping pace with net absorption, limiting the chances of over-supply experienced in previous real estate All-in-all, the office market is generally healthy across the country in both primary and secondary markets and there are no clear signs of a disruption to current trend line. That doesn't mean the office sector is without its challenges. Older, less functional product, especially buildings not in proximity to public transportation, multifamily housing and other amenities preferred by a younger workforce, are faring poorly in many markets. Millennials are redefining the workforce by way of their strong lifestyle preferences, and landlords who don't or can't respond accordingly are being caught out.

Let's take a look at some numbers for the final quarter of 2016. Net absorption came in at 26.6 million square feet, a decline compared to a very strong gain in occupied space of 37 million square feet in each of the two previous quarters, but still solidly in positive territory. For the year, over 113 million square feet of net absorption was realized, which is further indication of the ongoing demand for office space nationwide.

All but a handful of US markets tracked by CoStar across the US posted positive net absorption in 2016. Only Houston and Chicago posted significant losses of 241,000 square feet and 979,000 square feet, respectively. Considering the massive impact of the energy market on Houston's local economy, it is easy to see how things there could be much worse.



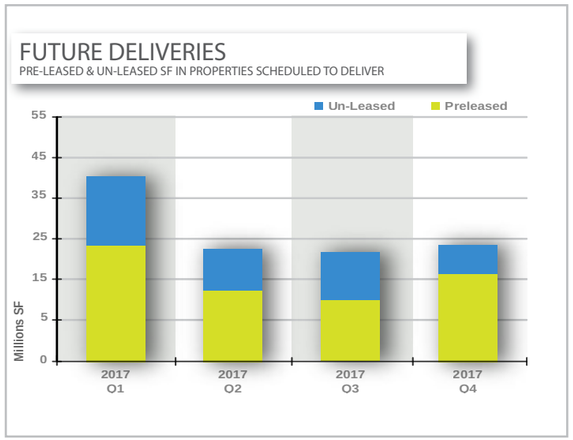


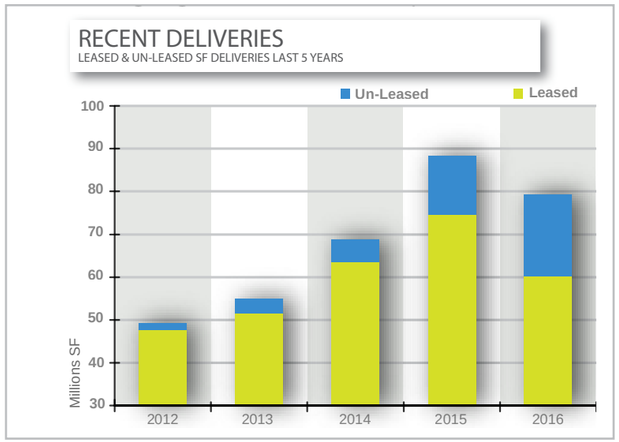
Market leaders in absorption include the usual suspects like Boston at 4.4 million square feet, Los Angeles and Philadelphia at 4.1 million square feet, Dallas/Fort Worth and Phoenix, both at 4 million square feet, while tech hot spot Seattle/Puget Sound had a gain of 3.5 million square feet. Surprise performers for the year included Detroit at 3.6 million square feet and Salt Lake City at 3.5 million square feet.

A major market posting a disappointing annual result was New York City, which had occupancy rise by just 201,000 square feet.

The level of new deliveries has been remarkably consistent throughout the year. In Q4, 18.5 million square feet of new office space was

US OFFICE MARKET





delivered, compared to 21.2 million square feet in Q3, 20.3 million square feet in Q2 and 20.7 million square feet in Q1. This has allowed the market to grow steadily with minimal risk of overbuilding. The quarter ended with another 152.3 million square feet of space in the construction queue, with most of that total concentrated in the nation's ten largest markets. New York City is at the top of that list with over 15.2 million square feet underway. Dallas/Fort Worth is not far behind at 11.8 million square feet, followed by Washington DC at 10 million square feet and South Bay/San Jose (Silicon Valley) at 9.9 million square feet. Another tech-heavy market, Seattle/Puget Sound, rounds out the top five at just under 8.7 million square feet. The largest project underway in Q4 was the 3 World Trade Center tower in Manhattan. That building is set for delivery in early 2018.

In order to make projects pencil, developers are focusing on mixed-use projects in urbanized, amenity-rich areas that will bring the highest rents. Rising land and construction prices are outpacing rent growth in many markets and that has kept speculative office development to a minimum in all but the hottest markets.

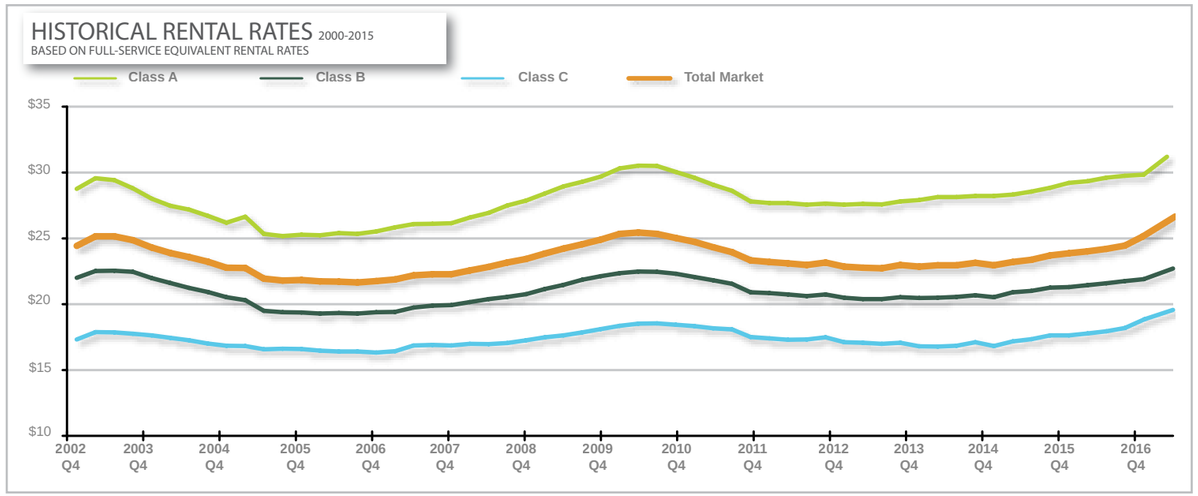
Institutions and private investors are still making aggressive plays to acquire good quality office buildings. Cap rates have compressed into 4% for trophy properties. In January of 2016, CalPERS, one of the nation's largest public employee pension funds, acquired the 1.7-million-square-foot Equitable building in Manhattan at a price reported to reflect a 4.13% cap rate.

However, there are concerns about cap rates heading north, as a tighter monetary policy by the Fed, should start driving yields in other asset classes higher. Since March of 2016, the yield on the "riskless" 10-year Treasury has risen approximately 100 basis points to the 2.4% range. If that trend continues, cap rates are likely to move higher. A 50 basis point rise in cap rate in a 5%-cap world is not insignificant and is a fact not lost on investors already wary of buying in at the top of a cycle. If rent growth slows as it has in some markets across the country, the loss in property values could be substantial. The fact that foreign buyers keep pouring capital into US assets has kept the lid on cap rate decompression by keeping demand well ahead of supply. They like the idea of having their capital invested in a safe place in dollar-denominated assets.

By building class, net absorption remains relatively well-balanced, as Class A, B product reported strong Q4 and full-year gains. In terms of Suburban versus CBD performance, over 82% of the Q4 net absorption was recorded in the suburbs, as many suburban submarkets are developing urbanized hubs that appeal to employers who are intent on satisfying the live, work and play lifestyle preferred by millennial generation workers. Average asking lease rates for the US moved up again in Q4, adding another $.32 to $24.30 per square foot. That is a 1.3% increase in just three months. Rents are moving up in most office markets around the country, but there are significant differences in the trajectory of rent growth within local markets as tenants move between building classes and submarkets to realize operational efficiencies.

2
National Economic Overview

Office Market Remains Solid in Q4



Office occupiers across all sectors are finding new ways to leverage advances in communication and computing technologies in order to use less space. Markets with more active tech and healthcare sectors tend to see bigger rent gains, but energy markets are seeing rent declines, mainly to due to large blocks of sublease space. Slack in space utilization will take some time to tighten up. So, even when oil prices rebound significantly, energy-heavy office markets will be playing catch up for a while.

LOOKING AHEAD

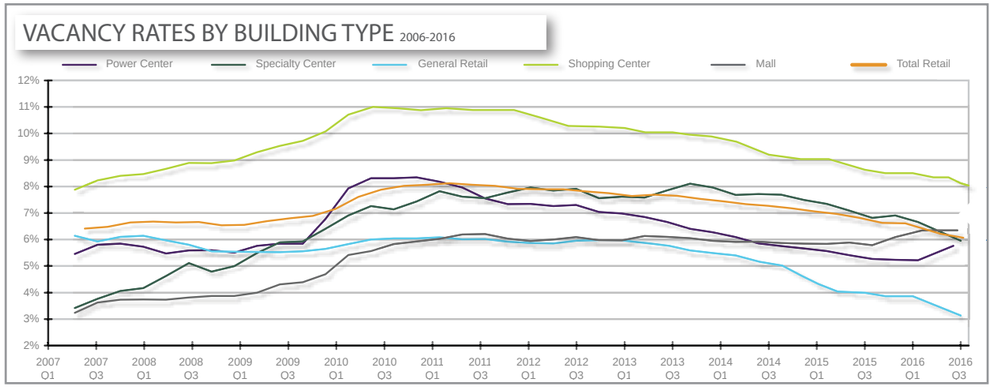
The US office market has good momentum heading into 2017, but concerns over a slowdown in US employment growth has more industry experts wondering if the market expansion is getting long in the tooth. Job growth in office-using sectors drive net absorption and the twelve month rolling average of jobs created each month has fallen from 229,000 to just 180,000 in the past year. Fortunately, office tenants are generating a good chunk of the new jobs, but other sectors that tend to hire more part time workers at the lower end of the pay scale are still accounting for too big a slice of the job creation pie. Wage growth has improved somewhat over the past few months, but an uptick in inflation is eating into those gains.

Rent growth will continue, especially in major markets where big employers continue their efforts to upgrade their workplace designs to attract and retain good workers who are, as a group, getting younger each day. Owners with older properties not in proximity to preferred amenities and public transportation will be under pressure to upgrade their buildings or be forced to lower rents and boost concessions. That will get expensive either way and those owners unable or unwilling to meet the demands of the market may become sellers at add-value pricing levels that reflect the additional risk.

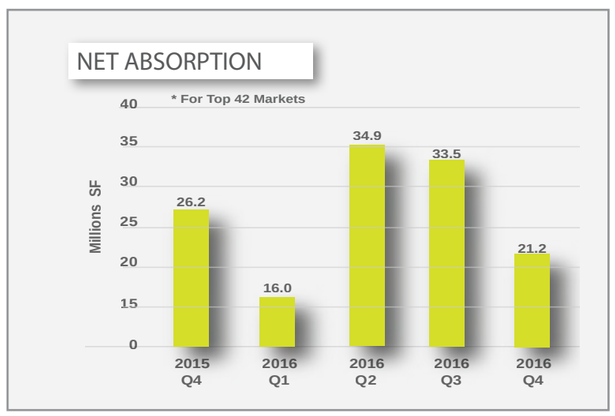
As we reported last quarter, there is little risk of a substantial increase in the pace of construction in 2017, so vacancy should continue to decline in 10-20 basis-point quarterly increments. Markets more dependent on the energy sector will see vacancy move in the other direction as sublease inventory swells further.

US RETAIL MARKET

The US retail property market kept pace in Q4. Vacancy and construction activity were relatively unchanged, rents rose modestly and net absorption remained solidly in positive territory. Even though the numbers point to market consistency, the retail industry continues to experience significant change as traditional department stores struggle to adjust to the massive challenge presented by growth in online sales and the demographic shift from baby boomers to millennials. Macy's announced that it will close 68 more stores in 2017, displacing thousands of workers, and the company will also be selling off valuable real estate assets.



Sears Holding Corporation plans to close another 150 Sears and K-Mart stores due to lagging sales and it recently announced the sale of its iconic Craftsman tool brand to Stanley Black & Decker. Walmart is making big moves to compete more effectively with e-commerce behemoth, Amazon, which continues to expand at amazing speed. In 2016, Walmart acquired Jet.com to enhance its online capabilities and it is leasing major distribution facilities around the country to increase "last mile" efficiency. In recent weeks, the world's largest retailer also announced further job cuts on the administrative side as part of its ongoing efforts to improve operating efficiency. Office Depot is also feeling the pinch from increased online competition. The office products giant decided in 2016 to consolidate operations by closing 300 more locations across the country. Other national retailers called it quits by the end of the year. Sporting goods operators Sport Chalet and Sport's Authority shuttered all their stores in 2016, as did women's apparel giant, The Limited, which will remain in business as an online-only retailer.

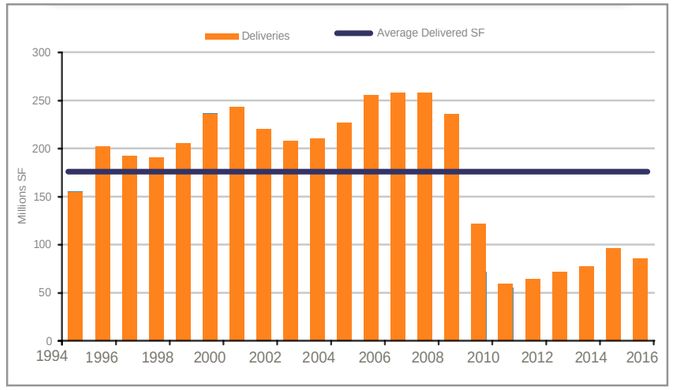


According to a recent report from the National Retail Federation, holiday retail sales numbers for November and December exceeded expectations with a 4% year-over-year increase to $658 Billion.

The increase came despite a 7% decline in department store sales, but better than expected e-commerce sales offset the falloff. US retail sales picked up late in the year. December's rise was .6%, bringing year-over-year growth to 4.1%. That, combined with stronger wage growth in the final quarter of the year, bodes well for overall retail sales in 2017. The vacancy rate was unchanged in Q4 at 4.9%, but it has fallen by 50 basis points since the end of Q1. As reported last quarter, vacancy is sharply higher in secondary submarkets. General retail (freestanding, general purpose properties) posted the lowest vacancy of all retail property types at 2.9%, down 10 basis points in the quarter, followed closely by Power Centers at 4.8%, up another 10 basis points in Q4, in part due to more store closures in the sporting goods category.

RETAIL SECTOR STAYS ON COURSE IN Q4

Shopping Center (neighborhood, community and strip centers combined) rates are still highest at 7.9% despite another 10 basis point decline in Q4. Excess supply in this category remains concentrated in traditional suburban submarkets that have more turnover due to a higher concentration of mom & pop tenants. Urban areas continue to account for a greater share of net absorption as retailers continue to shift their marketing focus onto millennial consumers. This group prefers multifamily housing near public transportation, hip restaurants, cool bars and entertainment venues over the sprawling "burbs" they were raised in. They are more inclined to rent than own their homes, prefer Uber to owning their own cars and like the idea of walking to work, restaurants and entertainment venues. As a result, mixed use projects near public transportation tend to have the lowest retail vacancy. Q4 net absorption totaled 26.9 million square feet in the final quarter of 2016, bringing the net gain in occupied space up to 137.2 million square feet. The General Retail category accounted for almost 78 million of that total, followed by 51 million square feet in the Shopping Center category and 5 million square feet in Malls. Power Centers posted a slight decline in occupied space of 110,000 square feet. These numbers clearly reflect the current trends in retailing: department stores closing, big-box retailers reducing store size and count and the shift to urbanized areas with the most millennial population growth. The overall average asking rate moved up another $.15 to $15.84 per square foot in Q4.

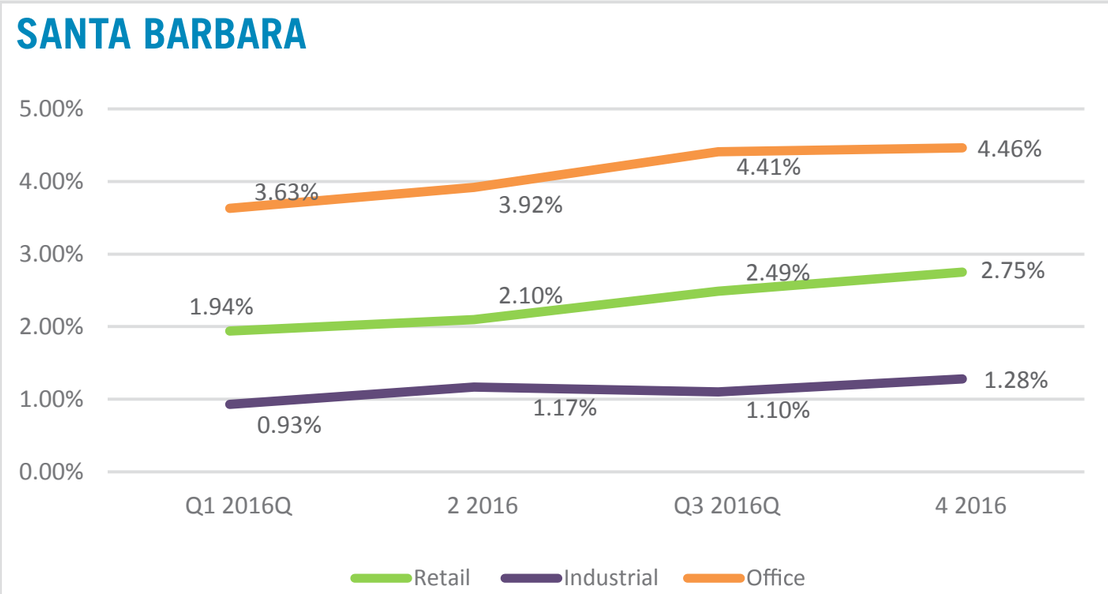


Over the past four quarters, retail rents across all product types and locations moved up by just over 3%, but rent gains are more robust in urban locales. Suburban retail centers continue to see weaker growth and higher vacancy. The rate of rent growth suffers as distance from an urbanized core increases, which reflects the ongoing shift in lifestyle priorities. New deliveries for the quarter totaled 20.8 million square feet, bringing the total of completed inventory in the past four quarters to 84.1 million square feet. The total of all retail space nationwide stands at 13.1 billion square feet, with another 80 million square feet currently under construction.

LOOKING AHEAD The US retail market will keep growing, but that growth will remain concentrated in more densely populated areas that have been or are undergoing the gentrification process. GDP and wage growth picked up late last year and that may give retail sales a welcome boost. But, consumer spending and retail sales growth have been uneven and the monthly rate of job creation has slowed from 229,000 a year ago, to just 180,000. If post-election optimism becomes reality in the form of stronger job growth, retail sales could gain momentum. Amazon recently announced that it would be adding another 100,000 full time employees to its ranks by 2018. Other large US corporations have also announced new investment in plant and equipment that will create more jobs.

Imported goods will remain cheap due to the strength of the US dollar, and that will keep the discounters busy expanding their footprints. Central banks around the world have resorted to negative interest rate policies to reduce the risk of a deflationary cycle, but Europe and Asia are showing signs of increasing stability. The US central bank made a move to raise rates In December, but the cost of capital is still relatively low. Further rate hikes are likely and they may impact business expansion later in 2017 and into 2018. Low oil prices, with us for more than two years now, did not produce the boost in retail sales that was hoped for, and oil prices rebounded somewhat in the last half of the year, which may help energy market economies in 2017. Job growth will need to pick back up again to expect further increases in retail sales. For the time being, vacancy, net absorption and rental rates trends are unlikely to change significantly. Demand for retail investment properties continues to run well ahead of demand. Cap rates are compressed to record lows, but there is a lot more talk about an investment market that is getting long in the tooth. Through the first nine months of 2016, cap rates for retail investment properties fell another 11 basis points to 7.06%. However, well-located, prime retail properties are trading at cap rates under 5%. Foreign investors will keep giving demand a boost, as they continue to move capital to US markets for safety.

SANTA BARBARA



SANTA BARBARA

SALES PRICE/SF - HIGH $1,866.00

SALES PRICE/SF - AVG
RETAIL $772.00
INDUSTRIAL $459.37
OFFICE $570.42

AVG ASKING RENTS (GROSS)
RETAIL $4.10
INDUSTRIAL $1.90
OFFICE $2.95

SALES PRICE/UNIT - AVG (MULTI-FAMILY) $311,521.64
LARGEST LEASE (AVAILABLE) 32,000 SF 600 Ward Dr.

LARGEST LEASE (LEASED) 27 E COTA ST. - 23,000 SF - OFFICE
ASKING RATE (HIGH)15.63 NNN 42 HELENA AVE. - 800 SF - RETAIL
ASKING RATE (LOW).95 MG 1 1W CANON PERDIDO - 7306 SF - RETAIL

Q4

RETAIL VACANCY RATE 2.75%

INDUSTRIAL VACANCY RATE 1.28%

OFFICE VACANCY RATE 4.46%

SANTA BARBARA MARKET HIGHLIGHTS

Investors of all types have been extremely active in the market. Total commercial sales volume, while not matching the incredible year we saw in 2015, reached almost $300 million in Santa Barbara proper.

Mixed-use development activity is on the rise, with several projects underway that include multi-family, office and retail components. The steady influx of new residents is fueling a housing shortage, which is boosting residential development throughout the region. The Kor Group has completed Phase I on the 89-unit luxury apartment complex, The MARC, located near La Cumbre Plaza. The project was designed under the City's Average Unit Density (AUD) program, which allowed the developer to add more units per acre with fewer parking spaces. This has given the Upper State Street area a boost, reinvigorating nearby shopping centers and attracting national credit tenants. Smart & Final Extra! leased the 35,000 square foot space in Five Points Shopping Center and Blaze Pizza moved into the centers retail pad.

Despite the positive signs, landlords are becoming more concerned with an increase in store closings and the depth of new prospects to backfill vacated space. Retail space in heavy tourist areas like the Funk Zone and Waterfront district are still in high demand, whereas the State Street corridor continues to see further vacancies. Vacancy in the downtown core seems to be an issue of changing consumer dynamics rather than the local economy, which continues to improve. While online retailers have weakened the success of brick-and-mortar stores, it has done little to hamper the areas growing success of hospitality, restaurants, and night life. This was visible in the City's reported transient occupancy tax which was up 4.6% YOY. Overall, retail vacancy increased 26 basis points in Q4 to 2.75%, after slight upticks throughout the year.

With industrial property vacancy rate running below 2% in recent quarters, the focus has turned to the redevelopment of the aging industrial stock. Any industrial space offered for sale is in high demand. Landlords who choose not to re-invest in their property have the option of selling to any number of eager owner/users. Much of the industrial inventory has been repurposed for creative office, retail, restaurant and other users.

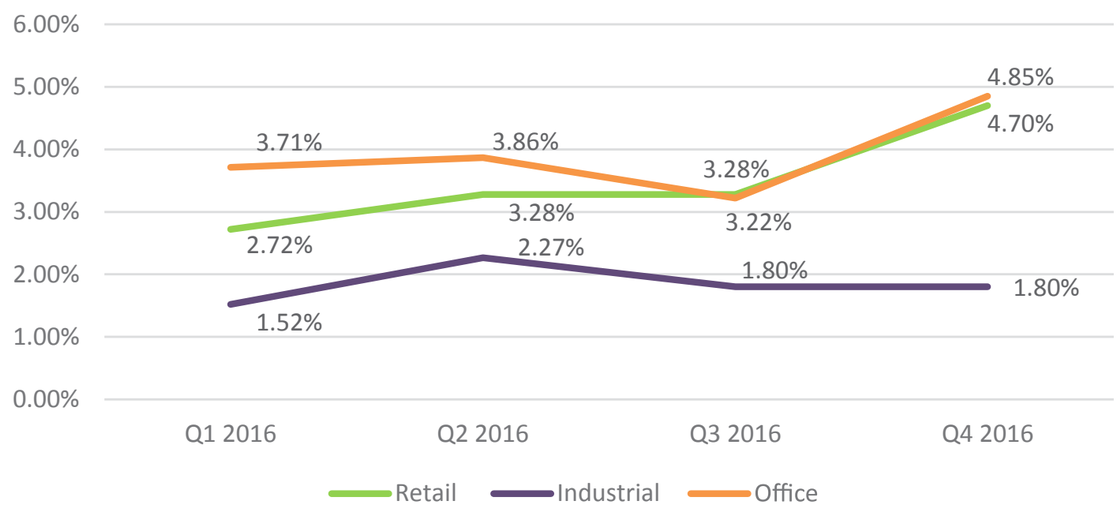
By the end of Q4, the overall office vacancy rate had risen by 5 basis points to 4.46%. Vacancy is up by 83 basis points in the past four quarters, but most of that increase came in Q3. Momentum in activity for large office requirements has slowed, fortunately, smaller users are remaining active. Collaborative work environments are choosing downtown sites to grow their operations. A prime example of this trend is the 11,196 square foot lease to Impact Hub located at 1117 State Street and the 3,240 square foot lease to The Sandbox at 414 Olive Street. Creative co-working sites are in expansion mode, meeting the demands for the smaller office user.

THE MARC. LOCATED NEAR LA CUMBRE PLAZA. THE KOR GROUP HAS COMPLETED PHASE I ON THE 89-UNIT LUXURY APARTMENT COMPLEX. RETAIL SPACE AVAILABLE AS OF 2/1/17.

3
Key Market Snapshots

SAN LUIS OBISPO

SAN LUIS OBISPO



SAN LUIS OBISPO

SALES PRICE/SF - HIGH **$907.00**

SALES PRICE/SF - AVG
RETAIL **$344.78**
INDUSTRIAL **$281.86**
OFFICE **$345.38**

AVG ASKING RENTS (GROSS)
RETAIL **$2.31**
INDUSTRIAL **$1.15**
OFFICE **$1.82**

SALES PRICE/UNIT - AVG (MULTI-FAMILY) $255,066.67
LARGEST LEASE (AVAILABLE) 108,000 SF
317 Madonna Rd. (SLO Promenade)

LARGEST LEASE (LEASED) 97,949 SF 125 VENTURE DR.
97,949 SF - INDUSTRIAL

ASKING RATE (HIGH) 4.50 MG 774 MARSH ST. - 375 SF - OFFICE
ASKING RATE (LOW) .70 NNN 733 MARSH ST. - 3557 SF - OFFICE

Q4

RETAIL VACANCY RATE 4.70%

INDUSTRIAL VACANCY RATE 1.80%

OFFICE VACANCY RATE 4.85%

SAN LUIS OBISPO MARKET HIGHLIGHTS

Area development is definitely focused on mixed-use projects, with a total of twelve projects underway, adding an estimated 290,000 square feet to the market. Mixed-use developments in the downtown core like Pacific Courtyards, a nine residential unit complex with 10,000 square feet of office space, alongside the Chinatown project on Monterey Street, owned by Atlanta-based real estate investment firm, Jamestown, all offer the live-work-play lifestyle that has become so popular with millennials.

The Industrial vacancy rate for warehouse and manufacturing space has been falling steadily, a trend that continued through Q4 to finish the year at 1.80%. Diminishing industrial inventory also has average asking lease rates moving higher.The 19.6 acre undeveloped land parcel on Tank Farm Road, sold for $6.4 million ($7.50 per square foot). The new owners intend to subdivide and sell the parcel into seven lots, capitalizing on a market that has historically been in short supply of development ready land.

Lockheed Martin renewed their 97,000 square foot R&D space located at 125 Venture Drive. The original tenant, Aeromech was purchased by Lockheed shortly after their occupancy. Since then, Lockheed utilizes the space for its Unmanned Aerial System technology.

Significant new deliveries for 2016 include the stand-alone industrial buildings on Buckley Road totaling 28,000 square feet delivered thus far. Construction has finalized on two of three buildings, alleviating some of the pent up demand. The office sector remains the most active, and that activity is focused on spaces larger than 10,000 square feet. Developers are responding to the shortage of functional space by ramping up construction. The East Airport district dominates growth, with several approved projects now under building review. Various projects on Aerovista Place will bring new deliveries totaling 80,000 square feet of office space to market. TAMI (technology, advertising, media and information) sector companies are among the most active office users, however this trend has meant that high-quality buildings suitable for mid-size companies are hard to come by.

The overall retail vacancy rate in Q4 rose 90 basis points, to 4.7%. The sharp increase is due to the 108,000 square foot vacancy in San Luis Obispo Promenade, the former site of Forever 21.

Landlords are becoming more concerned with an increase in store closings among chain retailers, and the depth of new prospects to backfill vacated space. The departure of Forever 21 and Sports Authority has heavily impacted the SLO Promenade, while Grocery stores and fitness centers remain in expansion mode. Smart & Final Extra! moved into the market in early Q1 adding two new locations, with Sprouts Market closing out the year by absorbing approximately 30,000 square foot of the former Forever 21 space.

In 2016, major area sales were marked by the 95,000 sq. ft. ($144 PSF) Forever 21 space sold at the beginning of the year for 13,650,000 and the $13.3 million sale for a 40,000 SF multi-tenant office building located at 100 Cross Street. The exchange sale for $13.3 million traded at an estimated 6% cap rate. Cap rates remain compressed and demand continues to run well ahead of supply. Cap rates on big box retail buildings may see an uptick as the retail sector adjusts to major shopping trend changes.

AN ARCHITECTURAL RENDERING SHOWING THE MONTEREY STREET PORTION OF COPELAND PROPERTIES' CHINATOWN PROJECT.

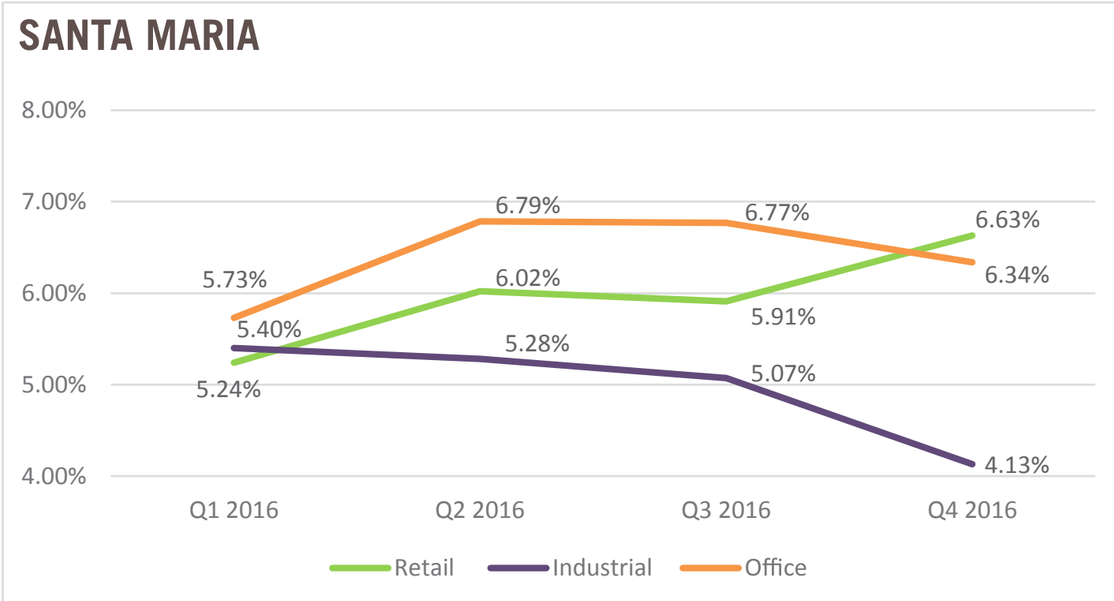
CHINATOWN - LIVE-WORK-PLAY MIXED-USE PROJECT.

19.6-ACRE LAND PARCEL LOCATED AT 265 MEISSNER LN. SOLD FOR $6.4M.

LOCKHEED MARTIN RENEWED THEIR 97,000 SF R&D SPACE LOCATED AT 125 VENTURE DRIVE.

3
Key Market Snapshots

SANTA MARIA



SANTA MARIA

SALES PRICE/SF - HIGH $468.00

SALES PRICE/SF - AVG
RETAIL $195.54
INDUSTRIAL $123.73
OFFICE $146.37

AVG ASKING RENTS (GROSS)
RETAIL $1.78
INDUSTRIAL $0.75
OFFICE $1.46

SALES PRICE/UNIT - AVG (MULTI-FAMILY) $163,064.90

LARGEST LEASE (AVAILABLE) 50,000 SF
1351-1447 Fairway Dr.

LARGEST LEASE (LEASED) 62,000 SF
2800 INDUSTRIAL PKWY - 62,000 SF - INDUSTRIAL

ASKING RATE (HIGH) 2.95 NNN 1839 N BROADWAY- 3500 SF - RETAIL
ASKING RATE (LOW) .37 MG 319 N DEPOT ST. - 5000 SF - INDUSTRIAL

Q4

RETAIL
VACANCY RATE
6.63%

INDUSTRIAL
VACANCY RATE
4.13%

OFFICE
VACANCY RATE
6.34%

SANTA MARIA MARKET HIGHLIGHTS

Santa Maria Investment activity remained strong across all sectors, driven by several large portfolio-level transactions. Real Estate Investment firm, Benedict Canyon Equities (BCE), acquired Country Oaks Apartments, a 208-unit multi-family complex, for $37 million or $177,884 per unit. This marks the company's second acquisition in the area after purchasing the Carmen Apartments, a 128-unit a complex purchased in 2015 for $15 million. Phillips Edison, a Grocery Center REIT, acquired Broadway Pavilion Shopping Center, 142,000 square foot grocery anchored center for $28 million ($128 PSF). Demand from investors for value add opportunities remain strong as Santa Maria continues to attract yield-seeking institutional investors who are looking to capitalize on the area's upside potential.

The Santa Maria retail market remains relatively positive. While the construction of major retail projects will continue to put upward pressure on vacancies, there is growing demand from retail users and investors alike. Rents have spiked in power centers anchored by the area's most popular discount retailers, while rates in traditional strip centers remain relatively flat.

The most significant new development, Santa Maria Ranch, a 500,000 square foot retail project located on a 48 acre site on Betteravia Road, is well underway. The project is under construction and is purportedly 80% preleased with anchor tenants including Costco, Lowes, Dicks Sporting Goods and Home Goods. The center is leading the way with asking rates, commanding premium rents some upwards of $4.00 PSF (NNN). Costco plans on relocating to their new site in early 2017, leaving a sizeable vacancy at their former location on Bradley Road. Power centers are still the focus of national retailers as they continue to expand into well-located developments.

Industrial leasing slowed slightly in Q4, but strong demand from tenants and low inventory has left vacancy rates compressed. The Santa Maria Valley has traditionally offered tenants competitively low lease rates compared to that of surrounding sub-markets attracting a host of industrial users, however vacancy declines have average asking rates moving higher. The vacancy rate for industrial space has been falling steadily, and that trend continued in Q4 with another 94 basis point drop to finish the year at 4.13%. The largest leases signed this year include a 50,000 square foot lease on Fairway Drive to Wine Direct, a Direct-To-Consumer wine fulfillment provider, and Cool-pak, a produce packaging supplier, renewing their 62,000 square foot lease at 2800 Industrial Parkway. Istorage PO purchased the 140,000 square foot Self-Storage development on 330 Roemer Way for $21 million, and Santa Maria based Healing Rooms purchased the 48,000 square foot property at 3010 Skyway Drive for $5.2 million or $109 PSF.

COOL-PAK RENEWING
THEIR 62,000 SQUARE FOOT LEASE
AT 2800 INDUSTRIAL PARKWAY.

Santa Maria Ranch - 500,000 SQUARE FOOT RETAIL PROJECT
LOCATED ON A 48 ACRE SITE ON BETTERAVIA RD.

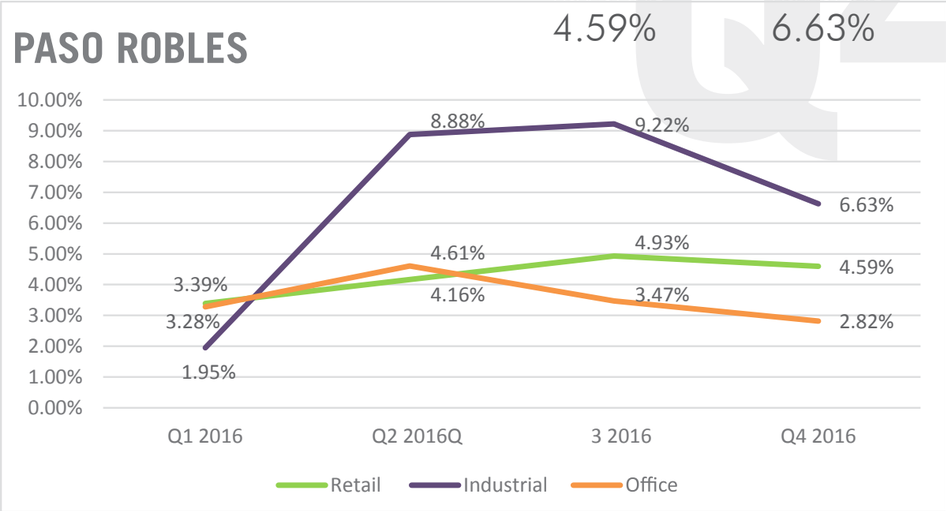
PASO ROBLES

Q4

RETAIL VACANCY RATE 4.59%

INDUSTRIAL VACANCY RATE 6.63%

OFFICE VACANCY RATE 2.82%



PASO ROBLES

SALES PRICE/SF - HIGH $903.00

SALES PRICE/SF - AVG

RETAIL	$336.35
INDUSTRIAL	$134.40
OFFICE	$192.67

AVG ASKING RENTS (GROSS)

RETAIL	$1.41
INDUSTRIAL	$0.75
OFFICE	$1.79

SALES PRICE/UNIT - AVG (MULTI-FAMILY) $155,035.71

LARGEST LEASE (AVAILABLE) 156,488 SF
1650 RAMADA DR.

LARGEST LEASE (LEASED) 1650 RAMADA DR. - 29,267 SF - INDUSTRIAL
ASKING RATE (HIGH) 4.63 GROSS 1244 PINE ST. - 97 SF - OFFICE
ASKING RATE (LOW) .46 NNN
2005-2305 THEATRE DR. - 12,000 SF - RETAIL

PASO ROBLES MARKET HIGHLIGHTS

Located halfway between San Francisco and Los Angeles, Paso Robles is one of California's fastest growing wine regions, encompassing more than 40,000 vineyard acres and over 200 wineries. The Paso Robles AVA and the greater San Luis Obispo County wine industry have an annual economic impact of $1.9 billion dollars to the regional economy.

The area continues to draw new residents, fueling a housing shortage, which is boosting development interest throughout the region. Irvine based developer, MBK Rental Living, purchased a fully entitled 12.5 acre parcel located adjacent to Highway 46, just east of the downtown area for $5.8 million. The 142-unit multi-family project known as Buena Vista Apartments will be the newest development in the area. With a multi-family vacancy rate hovering under 2%, the entitled project is expected to provide a nice boost to the existing housing stock as the market hasn't seen new multi-family development in over ten years.

Industrial vacancy rates spiked mid-year to 9.22% due to the considerable vacancy at 1650 Ramada Drive. The exit of Paris Precision, a Paso Robles based sheet metal fabricator which employed more than 100 workers, vacated their 220,000 square foot facility in Q2. Despite the mid-year increase, the industrial vacancy rate for warehouse and flex space saw a dramatic decline in Q4 to finish the year at 6.63%. The swift drop was due to Century Park LLC's acquisition of the 220,000 square facility for $15 million.

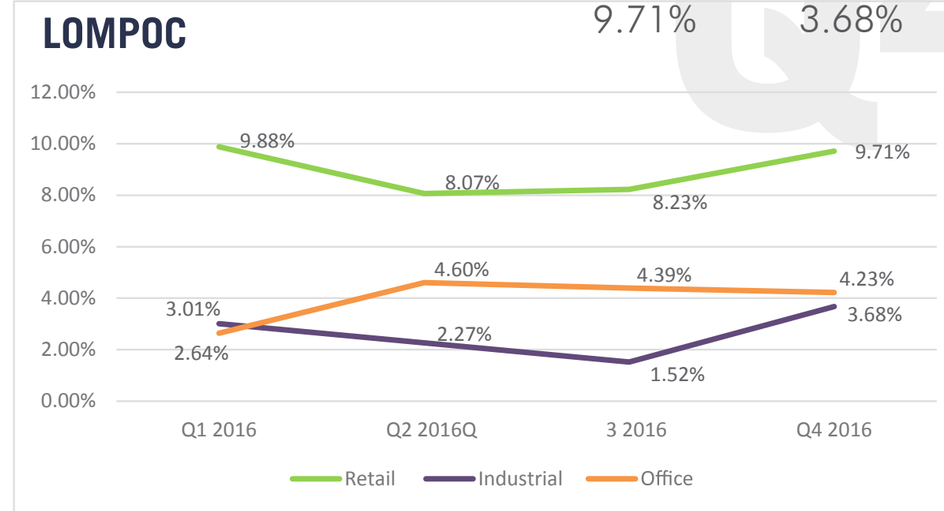
LOMPOC

Q4

RETAIL VACANCY RATE 9.71%

INDUSTRIAL VACANCY RATE 3.68%

OFFICE VACANCY RATE 4.23%



LOMPOC

SALES PRICE/SF - HIGH $243.00

SALES PRICE/SF - AVG

RETAIL	$130.2
INDUSTRIAL	$114.25
OFFICE	$124.25

AVG ASKING RENTS (GROSS)

RETAIL	$1.51
INDUSTRIAL	$1.00
OFFICE	$0.99

SALES PRICE/UNIT - AVG (MULTI-FAMILY) $147,081.05

LARGEST LEASE (AVAILABLE) 62,523 SF
1600 N H Street

LARGEST LEASE (LEASED) 700 N H ST. - 15,971 SF - RETAIL
ASKING RATE (HIGH) 3.00 NNN 1405 N H ST. - 1,900 SF - RETAIL
ASKING RATE (LOW) .65 NNN 1600 N H ST. - 62,523 SF - RETAIL

LOMPOC MARKET HIGHLIGHTS

Industrial vacancy rates actually rose over 200 basis points in Q4 to settle at 3.68%. The exit of Custom Cabinets, Etc., which occupied 20,000 square feet of industrial space, has vacated their west Central Avenue location. The general vacancy rate does not accurately reflect the degree of tightness in the market. Overall, demand for industrial space remains high. Areas like the Wine Ghetto, with its unique collection of wineries, tasting rooms, and production facilities, continues to be a prime target for the local wine industry, absorbing all available space almost immediately. Deliveries in Lompoc remain light, with just over 28,000 square feet of new product added this year.

Significant vacancies during the period include the former Fallas Discount Store, a 26,000 square foot space located in the Palm Plaza Shopping Center, and the stagnant 62,000 square foot vacancy at Mission Plaza. The overall retail vacancy rate in Q4 rose to 9.71%, but that is still 17 basis points lower than it was at the beginning of 2016. Lompoc's general retail category posted one of the highest vacancy rates in the County. The national discounters are still among the most active retailers in the Lompoc area. However, fast-food chains are stepping up activity. In 2016, new retail openings include the 1,900 square foot space to The Habit Burger alongside Chipotle Mexican Grill at 1413 N H Street, with Blaze Pizza joining the market at 1405 North H Street.

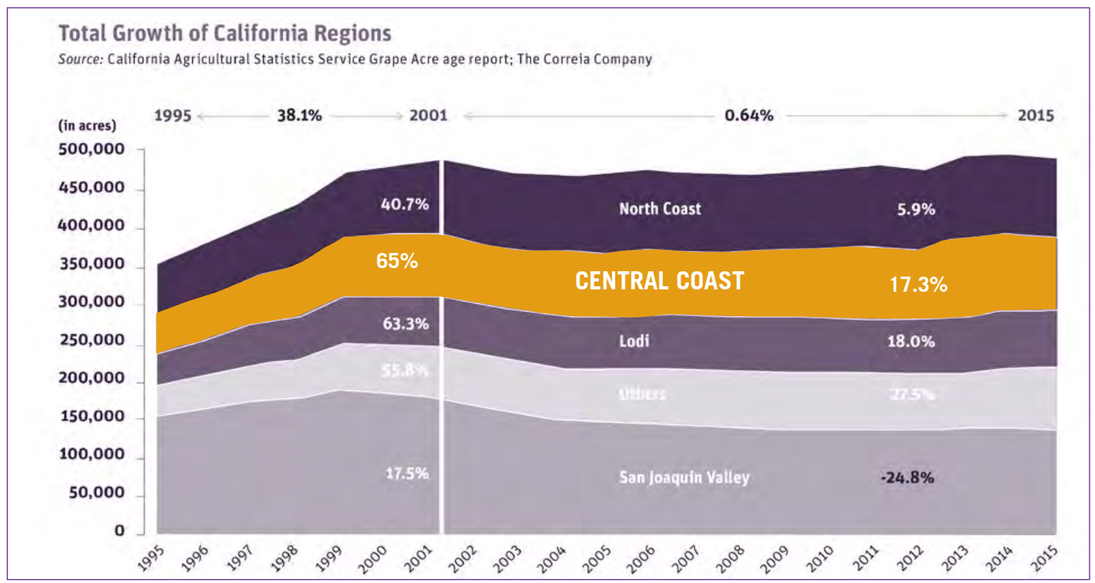
WINE COUNTRY

The wine industry showed improved growth in 2016, particularly in the premium wine market, dominating sales and accountable for nearly all the growth in the trade. Existing Wineries focused on brand expansion and acquisitions, as established wineries sought out land for vineyard development. Institutional players also expressed interest in vineyard holdings as a play to diversify their portfolio. As predicted, average land prices continued to see sustained growth as large to mid-sized wine companies focused on acquiring land that can produce premium quality wine. Mergers & Acquisitions (M&A) remained active throughout the year, with several notable sales seen along the Central Coast.

San Francisco based real estate investment firm, Jay Paul Company, purchased 1,134 acres located in the easternmost part of the Santa Ynez Valley for $26 million. In mid-August, Sea Smoke purchased the 201-acre State-of-the-Art, high density Rita's Crown Vineyard for $3,290,000. The cool-climate site located in the Santa Rita Hills AVA is best suited for its production of world-class Pinot Noir and Chardonnay. Following suit was the sale of Robert Hall Winery purchased by California bulk wine producer, O'Neill Vintners & Distillers. The $16 million sale included the 160-acre vineyard, hospitality center and existing inventory exceeding 60,000 cases per year.

Escalating municipal regulations continued to be controversial, particularly true in Santa Barbara County, where a proposed ordinance would further restrict the small wineries ability to sell direct. In late 2016, Santa Barbara County Supervisors rejected a proposed ordinance, which included updates to the county's permitting process for winery tasting rooms, the number of daily visitors allowed, and special events rules. The outcome was met with mixed emotions as Santa Barbara County continues to demonstrate a highly restrictive regulatory climate making it difficult for small wineries to operate.

Overall, California harvest came in at 3.9 million tons, slightly higher than the historical average. Area growers reported a slightly larger than normal yield with excellent harvest quality. As in previous years, 2012, 2013 and 2014, California's drought brought healthy growing conditions, producing quality crops. While the bottle pricing in the $11 to $14.99 sector reflects the greatest overall growth, it's the red blends in $8 to $10.99 bracket that are triggering a healthy appetite among the cost-conscious millennials**. Varietals topping the sales include Cabernet, red blends and Pinot Noir with Merlot, Syrah, Riesling and Zinfandel falling short.



Sources & Credits

*Predictions based on SVN State of the Wine Industry Report **Techonomic data suggest that growth in the lower price tier is driven by frugal-minded millennials.

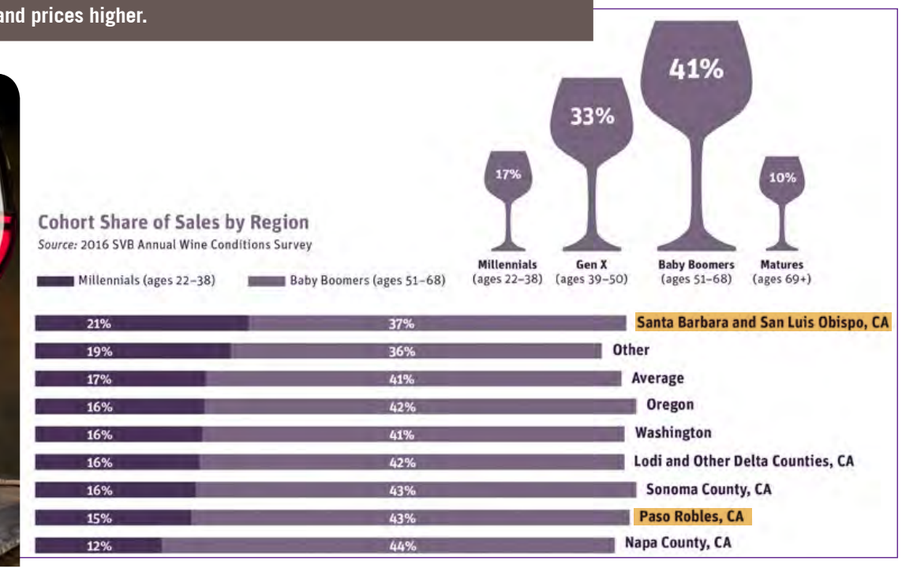
- SVN Wine Industry Report USDA National Agriculture Statistics Service

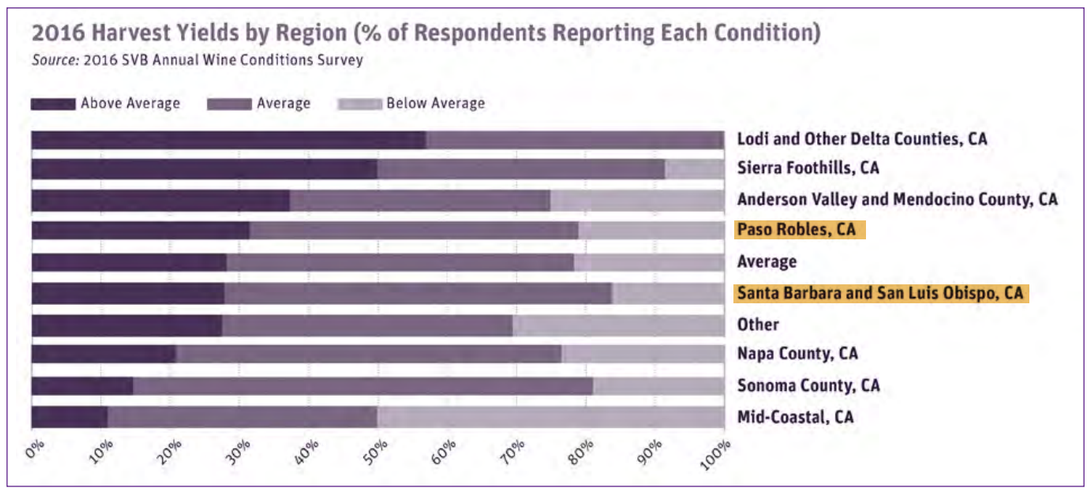
3
Key Market Snapshots

Looking ahead, the Central Coast region, including Santa Barbara and San Luis Obispo counties, will remain a primary target for vineyard development. With diminishing land suitable for premium wine production, land will be the principal demand causing upward pressure on values.

2017 OUTLOOK:

- **Sales growth range of 10 to 14 percent for premium wine, up from 9 to 13 percent in 2016.***
- **Federal, State and Local regulations will bring continued challenges to the trade.**
- **Demand for land will drive land prices higher.**





NOTABLE SALES Q4

ROEMER WAY
SANTA MARIA

Property: Industrial
Size: 140,000 SF
Sale Price: $21,240,000
Sale Price/SF: $151.71
Sale Date: 10/2016

1

2100 BROADWAY
SANTA MARIA

Property: Hospitality
Size: 191,644 SF
Sale Price: $19,232,000
Sale Price/SF: $97.13
Sale Date: 11/2016

2

1650 RAMADA DR.
PASO ROBLES

Property: Industrial
Size: 220,000 SF
Sale Price: $15,750,000
Sale Price/SF: $71.59
Sale Date: 12/2016

3

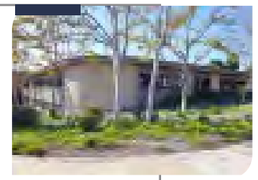
100 CROSS ST.
SAN LUIS OBISPO

Property: Office
Size: 156,590 SF
Sale Price: $13,300,000
Sale Price/SF: $327.70
Sale Date: 12/2016

4

NOTABLE LEASES Q4

6300 LINDMAR DR.
GOLETA



Tenant: Pacific Design Technologies
Property: Industrial
Size: 38,000 SF
Lease Date: 11/2016

1

325 MADONNA RD.
SAN LUIS OBISPO

Tenant: Sprouts Market
Property: Retail
Size: 30,816 SF
Lease Date: 11/2016

2

1650 RAMADA DR., STE 7
PASO ROBLES

Property: Industrial
Size: 29,267 SF
Lease Date: 12/2016

3

1650 RAMADA DR., STE 1
PASO ROBLES

Property: Industrial
Size: 26,827 SF
Lease Date: 12/2016

4

SANTA BARBARA	SAN LUIS OBISPO	LOMPOC
NUMBER OF SALES 92	**NUMBER OF SALES** 46	**NUMBER OF SALES** 23
SALES VOLUME ±$287M	**SALES VOLUME** ± $93	**SALES VOLUME** ±$27M

SANTA MARIA	PASO ROBLES
NUMBER OF SALES 47	**NUMBER OF SALES** 28
SALES VOLUME ±$176M	**SALES VOLUME** ±$71M

Q4

4
Significant Transactions

NOTABLE SALES 2016

1

Property: Retail

5182 HOLLISTER AVE.
GOLETA
Size: 116,000 SF
Sale Price: $39,200,000
Sale Price/SF: $337.93
Sale Date: 03/2016

1000 CASITAS PASS
CARPINTERIA
Size: 97,407 SF
Sale Price: $24,900,000
Sale Price/SF: $255.63
Sale Date: 03/2016

333 E. ENOS DR.
SANTA MARIA

Property: Multi-Family
Size: 156,590 SF
Sale Price: $37,000,000
Sale Price/SF: $236.29
Sale Date: 08/2016

2

2528-2530 S. BROADWAY
SANTA MARIA

Property: Retail
Size: 144,000 SF
Sale Price: $28,600,000
Sale Price/SF: $198.61
Sale Date: 08/2016

3

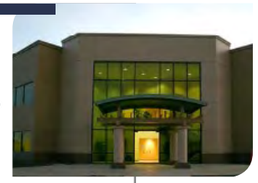
POSITANO APTS.
SANTA BARBARA

Property: Multi-Family
Units #: 118
Sale Price: $22,640,000
Price per Unit: $191,644
Sale Date: 10/2016

4

NOTABLE LEASES 2016

125 VENTURE DR.
SAN LUIS OBISPO



Tenant: Lockheed Martin Corp
Property: Industrial
Size: 97,949 SF
Lease Date: 03/2016

1

2800 INDUSTRIAL PKY.
SANTA MARIA

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

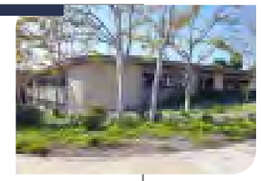
2

1351-1447 FAIRWAY DR.
SANTA MARIA

Tenant: WineDirect
Property: Industrial
Size: 50,000 SF
Lease Date: 09/2016

3

6300 LINDMAR DR.
GOLETA



Tenant:
Pacific Design Technologies
Property: Industrial
Size: 38,000 SF
Lease Date: 11/2016

4

SANTA BARBARA	SAN LUIS OBISPO	LOMPOC
NUMBER OF LEASES 188	**NUMBER OF LEASES** 97	**NUMBER OF LEASES** 9
SF LEASED 442,068	**SF LEASED** 381,515	**SF LEASED** 29,191

SANTA MARIA	PASO ROBLES
NUMBER OF LEASES 28	**NUMBER OF LEASES** 38
SF LEASED 263,555	**SF LEASED** 94,795

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The Lee Central Coast Brief

leecentralcoast.com

Q4

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Third-party data sources: CoStar Group, Inc., The Economist, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Congressional Budget Office, European Central Bank, GlobeSt.com, SVN State of the Wine Industry Report, California Agricultural Statistics Service Grape Acre age report; The Correia Company, CoStar Property and Lee Proprietary Data, Paso Robles City Alliance.

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