

Fall 2009 Market Update

Fall Edition

August 31, 2009

Market Overview

The Sacramento Metropolitan Area commercial real estate market has continued to see contraction in all sectors during 2009. These declines are linked to the sustained fall-out from the housing downturn and also the broader economic uncertainty that crippled the U.S. economy in the second half of 2008. Some of the conditions contributing to the current contracting market environment include declining home values, volatile oil and gas prices, lack of available credit, and rising unemployment. While recent data regarding consumer confidence and expectations regarding the economy/employment have been improving, continued declines are expected for the regional commercial real estate markets at least through the end of 2009. A brief overview of the retail, office and industrial sectors of the Sacramento Metropolitan Area is presented below.

Retail

The retail sector has experienced steep

declines in occupancy, rental rates and absorption over the past two-year period, as shown in the chart to the right. The housing downturn triggered the initial softening within the retail market and subsequent decreases

in consumer spending and tightening of credit have served to worsen the situation. This is exemplified by the recent closures of prominent retailers including, but not limited to, Circuit City, Gottschalks, Linens 'n Things and Mervyns. Vacancy rates are also among the highest figures observed in many years as a result of reduced demand and excess supply of newly constructed space. In this current market environment, landlords have become much more aggressive in courting prospective tenants. Specifically, based on conversations with area brokers, shorter term leases and increased



tenant incentives have become the standard. Typical rent concessions for new leases have generally consisted of one month of free rent per year of lease signed. However, there are some bright spots within the retail sector as fast food restaurants and discount stores have flourished under the current shift in consumption habits. Overall though, continued deterioration within the retail sector in the form of rising vacancy rates and declining rental rates is projected at least through the end of 2009 and into 2010. (continued on pg.4)

Auto Dealership News

Auto Industry in Trouble

The current recession and tight credit conditions have negatively impacted the auto industry in 2008 and 2009. The industry was already struggling with weak sales in early 2008 because of declining consumer spending and high gas prices. Since mid-2008, sales have slowed even more dramatically due to credit difficulties, rising unemployment and historically

low consumer confidence. In terms of new car sales, 2008 was the worst year for the auto industry since 1992. The California New Car Dealers Association projects that new vehicle sales for the year 2009 will be down nearly 50% from the peak in 2005 and 2006.

Dealerships Closing

With fewer cars being sold, many dealer-

ships are struggling, closing or consolidating. According to the National Automobile Dealers Association (NADA), approximately 900 dealerships closed and 200 opened in 2008, for a net loss of 700 dealerships nationwide. (continued on pg. 3)



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Central Valley Industrial Market



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Industrial

The primary industrial markets in the Central Valley are Fresno and San Joaquin Counties. These areas are geographically ideal for industrial distributors, as commercial trucks can serve most of California from these locations in one day's time. In addition, users have benefited from the fact that, historically, the cost of operations has been lower in these areas, compared to the densely populated San Francisco Bay Area and Los Angeles.

While over the long term these areas are expected to remain viable industrial market areas, the current economic recession has led to softening in the industrial sector. For Fresno County, unemployment jumped to 15.4% through the first half of 2009 despite performing below 10% last year. With increasing unemployment, industrial vacancy rates have correspondingly increased over this period in the Fresno market. As of the Second Quarter 2009, the industrial vacancy rate was at 8%, an increase of about 1% from the end of 2008 (Grubb & Ellis). CB Richard Ellis reported a Second Quarter 2009 vacancy rate slightly above 9%, a jump from 6.5% during the same quarter last year. Although the industrial market has been relatively healthy over the past several years (with generally stable vacancy rates, lease rates and sales prices) the industrial sector is anticipated to continue to slow through the balance of 2009. Average lease rates are expected to decline by 5 to 10% by the end of

the year, despite the fact they were relatively flat through the first half of the year. Landlords are now accepting shorter lease terms and the projection is for increased rental concessions into 2010. Considering the current market conditions, where there exists the potential for vacancy rates to increase in conjunction with declining lease rates, building and land values in the Fresno Region could decrease over the near term.

For the other major industrial market in the Central Valley, Stockton/San Joaquin County, industrial markets have been historically healthy, though this sector has been softening since the second half of 2008. Despite the fact that new construction starts and construction activity have been relatively stagnant over the first half of 2009 and supply has been somewhat fixed, vacancy rates have increased over the past two quarters from 12% during the Fourth Quarter 2008 to 16% during the Second Quarter 2009. While 1.9 million square feet was completed for build-to-suit users, including distribution centers for Home Depot and Crate and Barrel, most plans for speculative construction have been put on hold. While the slowing of new construction will help lead to market stabilization, the industrial vacancy rate is expected to increase over the remainder of the year. Until vacancy rates stabilize and absorption rates reach positive and sustainable levels, the point of recovery for the Stockton/San

Joaquin County industrial market will not be evident.

While industrial market conditions are not ideal right now, this real estate sector is expected to fare better than most other property types under the current economic recession. It is expected that any further contraction in the Central Valley industrial market will be mild compared to the retail and office markets. Over the long term, Fresno and San Joaquin County industrial markets will stabilize and continue to offer attractive opportunities to users and investors.

“While the slowing of new construction will help lead to market stabilization, the industrial vacancy rate is expected to increase over the remainder of the year.”

Auto Dealership News (continued)

For 2009, NADA forecasts a net loss of 900 additional dealerships. General Motors and Chrysler, as part of bankruptcy restructuring plans, are eliminating 1,100 and 789 U.S. dealerships, respectively. On the bright side locally, only 30 GM and 6 Chrysler facilities are located in the state of California.

Vacant Dealership Buildings

As dealerships are being closed or consolidated in most metropolitan areas, the inventory of vacant auto dealership facilities is rising. According to CoStar Property Professional, a leading commercial real estate data provider, 5.4% of auto dealership properties across the country were vacant as of April 2009, and another 3.7% were available for lease, bringing total availability to 9.1%, or 1,023 properties. Only 95 properties were sold during the first quarter. Additionally, CoStar data showed there were over 1,800 auto dealership properties actively listed for sale across the country. Considering the NADA's estimate that 900 dealerships could close in 2009, this translates into another 13 million to 16 million square feet of buildings becoming vacant. CoStar reports that over the last three years, the average sale price to asking price ratio has declined from 90% to 74%, and the average marketing time has increased from 230 days to 362 days.

As the auto industry continues to experience closings and consolidations, it is expected that some dealerships will continue to be in demand, while others will become obsolete. Dealerships most likely

Location	Sale Date	Building SF	Price/SF
<u>Before the Recession ...</u>			
Sacramento Co.	Nov-06	15,000 - 25,000	\$283.55
Placer Co.	Jan-06	15,000 - 25,000	\$327.78
Placer Co.	Jan-06	15,000 - 25,000	\$225.25
Sacramento Co.	Apr-05	15,000 - 25,000	\$415.21
Fresno Co.	Jan-05	15,000 - 25,000	\$234.35
Sacramento Co.	Mar-04	15,000 - 25,000	\$266.67
Placer Co.	Jan-04	15,000 - 25,000	\$196.99
Placer Co.	Jan-04	15,000 - 25,000	\$245.68
Placer Co.	Jan-04	25,000 - 40,000	\$262.74
Solano Co.	Aug-03	25,000 - 40,000	\$201.93
Solano Co.	Jul-02	15,000 - 25,000	\$236.84
<u>After the Recession ...</u>			
Alameda Co.	Dec-08	15,000 - 25,000	\$173.06
Alameda Co.	Listing	25,000 - 40,000	\$133.15
Sacramento Co.	Listing	Over 40,000	\$121.54
Sacramento Co.	Listing	15,000 - 25,000	\$211.40
Sacramento Co.	Listing	25,000 - 40,000	\$309.21
San Joaquin Co.	Listing	25,000 - 40,000	\$109.16
Solano Co.	Listing	25,000 - 40,000	\$105.45
Solano Co.	Listing	Over 40,000	\$161.76
Yolo Co.	Listing	25,000 - 40,000	\$158.58

to continue include newer modern facilities in good condition and those located within auto malls and densely populated areas with a limited amount of competition. There have been too many dealerships selling the same or similar products within too small of a geographic area, and we expect the number of dealerships will decline and stay at a lower level than in the past.

Dealership Price Trends

With supply climbing and demand falling, sale prices for owner-user auto dealership properties are declining for most locations and property types. The table to the upper-right of the page provides a comparison of new-car dealerships before and after the recession in northern and central California. The current listings and recent sale reflect declining market conditions.

Recovery Projections

The auto industry is expected to

be the most financially troubled industry in the United States in 2009, taking the top spot from the homebuilding group, according to a recent survey of restructuring and bankruptcy professionals. There have been few signs of any easing of the conditions that precipitated the downturn, although the U.S. government's "Cash for Clunkers" program has certainly created a temporary spike in new car sales this summer. Most industry groups are predicting worsening conditions in 2009 before stabilization in 2010 or 2011 at the earliest. A significant recovery may not be likely for at least two to three years. Under current market conditions, dealerships are continuing to close and consolidate, the inventory of vacant dealership buildings is growing, and there is very little demand for dealerships and land within auto malls.

“approximately 900 dealerships closed and 200 opened in 2008, for a net loss of 700 dealerships nationwide.”

Market Overview (continued)



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Appraiser

“there are some bright spots within the retail sector as fast food restaurants and discount stores have flourished under the current shift in consumption habits.”

Office

The office sector in the Sacramento Metropolitan Area continues to be adversely affected by rising

unemployment,

overall economic uncertainty and the introduction of significant amounts of speculative construction. These factors have resulted in the regional vacancy rate climbing above 20% in the Second Quarter 2009. Much of this vacancy is clustered in suburban submarkets like Roseville/Rocklin and Elk Grove, which saw excessive amounts of new construction in the recent expansionary period. Multiple new speculative office buildings have also been constructed in the Downtown and Natomas submarkets and these have served to further increase regional vacancy and decrease overall rental rates. Some recently constructed projects have even begun to market single offices or suites in an attempt to spur any type of absorption. The office sector’s backbone has traditionally been governmental agencies like the State of California, who typically have long term leases and are generally considered to be low-risk tenants overall. However, given the state budgetary crisis, the State of California has been seeking to reduce costs through re-negotiation of existing leases or exercising early termination clauses. Similar to other commercial sectors within the region,

leases have trended toward lower rental rates, shorter terms, and increased concessions in the form of higher tenant improvement allowances and free rent. Given the continued overall economic uncertainty and the significant inventories of surplus space, overall market conditions for the office sector are not expected to improve in the near term.

Industrial

Although the industrial sector has also experienced contraction over recent periods, it has weathered the economic storm better than the retail and office sectors. A primary reason for this is that industrial construction slowed prior to the sharp economic declines and, as a result, did not result in the unsustainable amounts of inventory exhibited by other sectors. The relative stability in the industrial market is highlighted by its manageable vacancy rate of approximately 11% to 12%, which is generally the range reported by several local brokerage houses. However, the industrial sector has not been completely immune to the overall contraction affecting the region as brokers have reported declining rental rates and increasing tenant concessions like

the retail and office sectors. New leases and renewals have been overwhelmingly short term in nature (one to three years) because tenants are hesitant to commit to longer terms given the uncertainty regarding the economy and rising unemployment levels. Additionally, although current asking rental rates are historically low for the region, the economic recession has prevented many users from taking advantage of these deals. The chart at the top of the page details some notable leases that have commenced in 2009. In summary, the industrial sector is expected to continue seeing slightly depressed rental rates and increases in vacancy over the near term. However, the magnitude of these declines is expected to be more moderate compared to the retail and office sectors.

NOTABLE INDUSTRIAL TRANSACTIONS - 2009

Address	Submarket	SF Leased	Tenant	Notes
2935 Ramco St.	West Sacramento	444,600	Safeway	Renewal
1685 E. Tide Ct.	Davis/Woodland	151,200	E&E Trading	Renewal
849 N. 10th St.	North Richards	113,000	Valet Indoor RV	8/1/2009 move-in
8670 Younger Creek Dr.	Power Inn	101,256	Continental Warehouse	Renewal
1660 Tide Ct.	Davis/Woodland	91,445	Amerimax Building Products	Renewal
1751 Aviation Blvd.	Roseville/Rocklin	77,165	X2 Motorsports	6/1/2009 move-in
3062 Prospect Park Dr.	Highway 50	44,740	EDS	Renewal
1341 N. Market Blvd.	Natomas/Northgate	36,000	Dayton Phoenix	6/1/2009 move-in
700 Santa Anita Dr.	Davis/Woodland	35,500	Continental Supply	Renewal
3200 Reed Avenue	West Sacramento	32,000	Valley Relocation & Storage	10/1/2009 move-in
1460 Tanforan Ave.	Davis/Woodland	32,000	Norcal Indoor Sports	7/1/2009 move-in
3885 Seaport Blvd.	West Sacramento	29,128	Mission Foods	1/1/2009 move-in

Source: Colliers Industrial Overview Sacramento 2nd Quarter 2009

Sacramento Apartment Market

In 2009, the Sacramento apartment market has begun to feel the effects of the housing downturn, with continued increases in vacancy and market rents slightly falling. The industry research group RealFacts reported an average vacancy rate of 8.4% in the second quarter of 2009, up from 7.8% during the first quarter. This chart shows the trend in average annual apartment vacancy rate in the Sacramento market.

Overall, empty apartments are starting to drive down rents as landlords try to keep apartment complexes at a stabilized occupancy level. A slight decline was recorded by RealFacts in the first quarter of 2009, when the average rent fell from \$966 to \$961 per month. In the second quarter of 2009, the average rent fell for a third straight quarter to \$949, the lowest rent in almost three years. Based on surveys of over 300 properties by RealFacts average rents have fallen over the past year in every city in the Sacramento region except Davis.

Additionally, the housing market

crisis is having a mixed effect on the apartment market. On the positive side, many people who no longer can afford their mortgages are returning to the market as renters. But on the negative side, many single-family homes are being offered for rent when they cannot be sold, creating a type of "shadow market". Thus, single-family homes that were once owner-occupied are now part of the supply competing with apartment complexes for renters, further driving down rental rates.

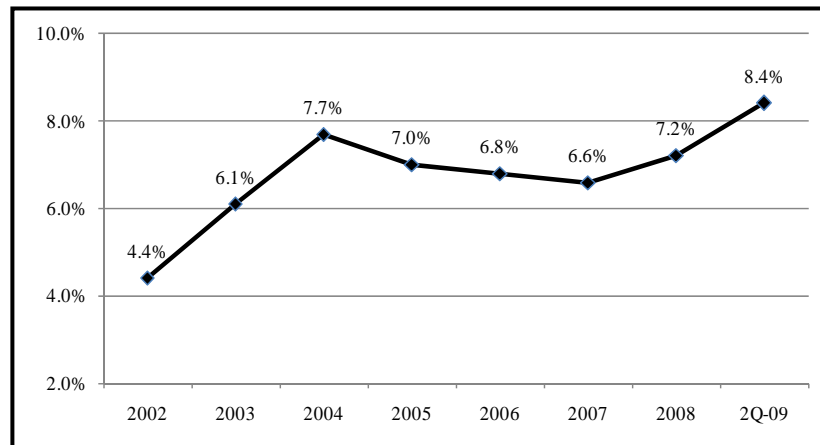
As with most other sectors in the Sacramento market, there have

been a limited number of transactions of apartment properties in 2009 thus far, as buyers continue to look for bargains. However, most market participants expect the Sacramento apartment market to remain relatively healthy in the coming year as demand continues and new construction is very limited.



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Average Vacancy Rate (Sacramento Area)



Source: RealFacts, published in *The Sacramento Bee*

About Seevers Jordan Ziegenmeyer

Seevers · Jordan · Ziegenmeyer (**SJZ**) is a commercial real estate appraisal and consulting firm with offices in Rocklin (headquarters) and Modesto. SJZ services California markets from Redding to Bakersfield, as well as Northern Nevada.

Management Profile

SJZ's senior partner, P. Richard Seevers, has over 28 years of real estate appraisal and consulting experience, and is a Member of the Appraisal Institute, holding both the MAI and SRA designations. Lance Jordan and Kevin Ziegenmeyer began working for Richard (Dick) in the early 1990s and the three formed a partnership in 1998. Eric Segal and Nelson Wong have since assumed executive positions within the firm. The company steadily expanded for several years, with a full-time staff of 18 today.

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Residential Land Update

Residential land values in select core urban areas have stabilized. Virtually all public builders that liquidated positions for tax motivations in 2007 and 2008 are now competitively looking for properties to buy, with their focus remaining on finished versus unimproved lots. In the Roseville area of the Sacramento region, two public builders closed escrow on finished lots in mid-2009 with the intent to build homes this year. Other public builders have submitted Letters-Of-Intent to purchase other properties. In early 2009, a local area newspaper reported that a bank-owned group of finished lots in W. Roseville attracted more than 40 offers. While public builders may be looking for new inventory, not all regional builders are buying; many regional builders lack the capital to acquire land at the present time. However, there have been numerous instances where a principal of a regional company has acquired lots for investment purposes, while continuing to manage debt losses at other projects. Many market participants cite a disconnect between current home and lot prices, indicating little or no profit on home construction, even at speculator lot pricing. Some sources say public builders may be willing to acquire land at such trim profit margins if it means keeping market share, covering overhead and positioning itself with a supply of buildable lots for market recovery and economic expansion.

Further, the demand for finished

lots in 2009 has exceeded the available supply, especially with builders no longer on the sidelines. All else being equal, builders are typically willing to pay more for lots than investors. The increased competition for finished lots has led many investors to look at unimproved lots in core urban areas. For properties in areas where development is not financially feasible, the price points are largely speculator-driven and tend to be at levels slightly more than agricultural value. In contrast, unimproved properties located in areas with higher household incomes--where there is adequate profit on construction--have sold at higher price points. Such properties are apt to be developed before finished lots in outlying, commuter-based market areas. Although land prices appear to have stabilized in core urban areas--moving forward--residential market recovery in 2010 will depend on the jobs, the supply of homes in the resale market, and the effect of commercial mortgage defaults on residential loan availability. Unemployment and prime loan defaults continue to rise. These trends are anticipated to reverse in late 2010. The status of the credit markets in the future remains unclear at this time. With these factors in mind, many real estate consultants forecast an extended period of marginal price and sales increases before typical residential expansion begins in 2013 or 2014.

Unlike the Sacramento and

Contra Costa County regions, land prices in many Central Valley cities--Merced, Modesto, Lathrop--continue to decline. Many 2008 investor purchases now appear as premature. Finished lots purchased for 30% of replacement costs with a three to five year development horizon at time of sale now have prices closer to 10% of replacement cost with a five to ten year development horizon. In some cases, investors that acquired lots in 2007 or 2008 have walked away from their purchases. Exceptions within the Central Valley include the Clovis and North Fresno submarkets, where the supply of finished lots remains relatively limited. These areas also have relatively higher household incomes. In 2010, we expect an acceleration in subdivision foreclosures and subdivision lot sales. Public builders will remain focused on finished lots in core urban areas and will avoid secondary market locations. Many deals will be structured with rolling take-downs to mitigate risks. Investors that once expected 30% to 50% returns with a three to five year hold will now accept 20% to 40% with a two to four year hold. In some instances, lot values will increase year-over-year as market unknowns reveal themselves and the point of recovery becomes clear.



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