



KEYSER MARSTON ASSOCIATES™
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

ADVISORS IN:
REAL ESTATE
AFFORDABLE HOUSING
ECONOMIC DEVELOPMENT

To: Gregory Mattson, Project Manager
Rick Engineering Company

SAN FRANCISCO
A. JERRY KEYSER
TIMOTHY C. KELLY
KATE EARLE FUNK
DEBBIE M. KERN
REED T. KAWAHARA
DAVID DOEZEMA

From: KEYSER MARSTON ASSOCIATES, INC.

Date: December 18, 2017

LOS ANGELES
KATHLEEN H. HEAD
JAMES A. RABE
GREGORY D. SOO-HOO
KEVIN E. ENGSTROM
JULIE L. ROMNEY

Subject: Limited Market Assessment of Industrial Uses
East Otay Mesa

I. BACKGROUND

SAN DIEGO
PAUL C. MARRA

Pursuant to our agreement dated March 6, 2017, Keyser Marston Associates, Inc. (KMA) has conducted a limited market assessment of industrial uses in East Otay Mesa. As background, in May 2017, KMA completed a peer review of the September 2014 Market Study prepared by Meyers Research for the County of San Diego (County) and Sunroad Enterprises (Developer) regarding opportunities to catalyze economic growth and stimulate high value jobs in East Otay Mesa and the County. The Developer owns an approximately 250-acre tract of land (Property) located northeasterly of the juncture of State Route 125 and Otay Mesa Road in East Otay Mesa. The Developer proposes to redesignate the Property from Business/Industrial Tech to mixed-use development, consisting of approximately 3,100 residential units and 760,000 square feet (SF) of employment and retail uses. The County has requested that KMA: (1) undertake a peer review of the Market Study and (2) conduct a limited assessment of the development potential for industrial uses in East Otay Mesa.

This memorandum presents KMA's limited market assessment of industrial uses in East Otay Mesa. The KMA assessment includes a review of demographic, economic, and market trends. In order to gain greater insight regarding the East Otay Mesa industrial market, KMA also conducted interviews with various stakeholders, including brokers, developers, planners, and business representatives. The objective of this assessment was to address the following five (5) specific questions identified by the County:

To: Gregory Mattson, Project Manager
Subject: Limited Market Assessment of Industrial Uses
East Otay Mesa

December 18, 2017

Page 2

1. Are the industrial trends identified by the Developer a reasonable explanation for why East Otay Mesa has not developed as expected?
2. How is the introduction of a mix of land uses, including residential, likely to contribute to the economic development goals of this industrially focused area? Is this mix of uses likely to have positive or negative effects on the short- and long-term viability of technology and industrial uses?
3. Are residential uses and residential neighborhoods likely to be viable and compatible in the overall setting and context of existing and planned uses in the area?
4. Can the introduction of a mix of uses act as a catalyst or contribute to the growth of higher value jobs in the area and stimulate new development?
5. Is the introduction of a mix of uses likely to lead to other changes to the current goals and intent set forth by the East Otay Mesa Specific Plan as amended in 2015?

II. SUMMARY OF KEY FINDINGS

Based on this limited market assessment, KMA concludes the following for the Otay Mesa industrial submarket:

- High tech development has flourished elsewhere in the County, while the Otay Mesa submarket is primarily oriented toward distribution and warehousing.
- Historical absorption of industrial land and buildings in Otay Mesa has been slow and the remaining available supply is substantial. KMA projections indicate that the Otay Mesa submarket will experience full absorption in 62 to 93 years.
- Development of new residential uses -- and associated public infrastructure improvements and amenities -- are likely to have positive effects on the viability of technology and industrial uses in the near- to mid-term. However, in the longer term, the introduction of residential uses may generate adverse impacts due to potential land use incompatibilities.
- Potential incompatibilities between residential uses and existing and planned industrial uses could potentially be mitigated through appropriate buffers and transition zoning.

III. KMA RESPONSES TO KEY QUESTIONS

Table III-1 below summarizes the KMA responses related to the five (5) questions identified by the County.

Table III-1: KMA Responses to Key Questions
1. Industrial Trends in East Otay Mesa
<i>Industrial trends identified by the Developer are a reasonable explanation, but not to the extent that the Developer asserts, for why East Otay Mesa has not developed as expected.</i>
<p><i>A peer review of the Meyers Research Market Study key findings indicate that East Otay Mesa has not developed due to a number of variables, including: (1) the high tech industry flourished in other areas of the County such as Palomar Airport, University Towne Centre, Miramar, and Sorrento Valley; (2) the Otay Mesa submarket is more distribution-oriented; (3) the industrial market in the County is over-supplied and experiencing high vacancy; and (4) the slow absorption pace projected for Otay Mesa, estimated at 143 years to absorb. Key objectives of the East Otay Mesa Specific Plan include facilitating the area as a major employment area in South County; encouraging and protecting the area for regional technology manufacturing; and providing adequate land area for warehousing, light industrial, and heavy industrial uses. East Otay Mesa is an area planned for various industrial uses. KMA completed an independent assessment of industrial trends identified by the Developer in order to understand why East Otay Mesa is not developing as expected. Based on an analysis of historical data and interviews with key stakeholders, KMA concurs that high tech has flourished elsewhere in the County and that Otay Mesa is primarily oriented toward distribution and warehousing. KMA also concurs that historical absorption of industrial land and buildings in Otay Mesa has been slow and the available supply is substantial. However, the Developer appears to overstate the length of time for the Otay Mesa submarket to fully absorb. According to the Meyers Research Market Study, it will take Otay Mesa 143 years to fully absorb future industrial space. KMA estimates that it will require between 69 and 103 years for Otay Mesa to absorb its future industrial space. Furthermore, the redesignation of the Property will cause this range to decline to between 62 and 93 years until full absorption. The Developer also indicates that industrial vacancy is highest in Otay Mesa, relative to other San Diego County submarkets. However, this factor has changed since the date of their initial market study (2014) -- Otay Mesa industrial vacancy has declined by nearly 50% since 2014.</i></p>

Table III-1: KMA Responses to Key Questions

2. Mix of Land Uses Contribution to Economic Development Goals

The introduction of a mix of land uses, including residential, can have a positive impact on the County's economic development goals of the industrial-focused East Otay Mesa area by supplying more quality of life amenities and work force housing to the area.

East Otay Mesa today lacks roads, basic infrastructure, public facilities, and amenities to serve workers and residents alike. Development of a new residential community within a portion of East Otay Mesa will likely introduce initial infrastructure and public facilities to the area. It will also likely attract retail, food service, and other amenities. The introduction of these new developments/amenities will depend on market demand factors and may not coincide with the onset of new residential development. These changes are likely to have positive effects on the viability of technology and industrial uses in the near- to mid-term due to accessibility and overall quality of life improvements. In the longer term, however, the introduction of residential uses has the potential to generate negative effects due to potential land use conflicts (e.g., noise, traffic, hazardous materials, pollution) that may arise between future residents and owners/operators of industrial/tech businesses and manufacturing facilities. Additionally, the placement of an essentially suburban residential community in close proximity to a major technology business park could negatively impact the marketing and branding identity of the business park.

3. Residential Compatibility with Existing and Planned Uses

The overall setting and context of existing and planned uses in the area will make it difficult to create a quality residential community in this location; however, buffers and transition zones may help to alleviate any incompatibility between these uses.

East Otay Mesa's mix of existing and planned uses will play a major factor in the potential viability of residential uses and neighborhoods in the area. Existing uses such as Correctional and Detention Facilities, Port of Entry (POE) Truck Routes, the Otay Mesa Landfill, and Brown Field Airport; as well as planned uses such as the expansion of the Brown Field Airport (i.e., increased employment and flight operations), and the increase in traffic that will be caused by the new POE in East Otay Mesa, may make it difficult to create a quality residential community on the Property. However, the Property's close proximity to State Route (SR) 125 and established residential communities such as Chula Vista's Otay Ranch make the area a more logical location for residential use than other areas within East Otay Mesa. Residential incompatibility with existing and planned uses can be somewhat mitigated through buffer and transition zoning in and around the Property.

Table III-1: KMA Responses to Key Questions

4. Catalytic Impacts for New Development

The introduction of a mix of uses may act as a catalyst and/or contribute to the growth of higher value jobs in the area; however, it is not the sole source for this growth.

Development of high quality employment uses, such as a technology business park, is dependent on a number of factors, including the presence of executive and/or high-end housing, high quality school districts, and leisure/lifestyle amenities. The area benefits from proximity to existing desirable amenities (i.e., beaches, San Diego Bay, Downtown San Diego), schools (Beyer Elementary School, San Ysidro Middle School, and San Ysidro High School), and freeway access. However, the area lacks the executive/high-end housing and higher-performing school districts which are more prevalent in North County. The introduction of a mix of uses to the area, primarily residential, may not serve as the sole source for attracting high quality jobs and catalyzing new development. For example, the addition of housing in the Otay Ranch community (adjacent to East Otay Mesa) has yet to stimulate meaningful industrial development activity for the Eastlake Business Center in the City of Chula Vista. Furthermore, the communities showcased in the Market Study (Kearny Mesa, Carlsbad, Miramar) as containing high quality employment offer many other important elements above and beyond housing, including a centralized location in the County and access to a broad variety of residential/quality of life amenities.

5. Potential Changes to Current Goals in the East Otay Mesa Specific Plan

The introduction of a mix of land uses is likely to lead to other changes to the current goals and intent set forth by the East Otay Mesa Specific Plan.

As noted above, the key objectives of the Specific Plan include facilitating the area as a major employment area in South County; encouraging and protecting the area for regional technology manufacturing; and providing adequate land use area for warehousing, light industrial, and heavy industrial uses. The introduction of neighborhood uses, through future residents, may potentially impact the type of employment uses that will be allowed in the Specific Plan. Future residents are likely to discourage the flow of truck traffic and restrict the type of industrial uses (i.e., those that use chemicals) that may be added in the future. Also, due to the lack of public infrastructure in the area and potential incompatibility of uses, new provisions may need to be added to the Specific Plan in order to encourage the healthy mix of uses (i.e., the creation of a buffer/transition zone separating residential from industrial).

IV. INDUSTRIAL MARKET TRENDS

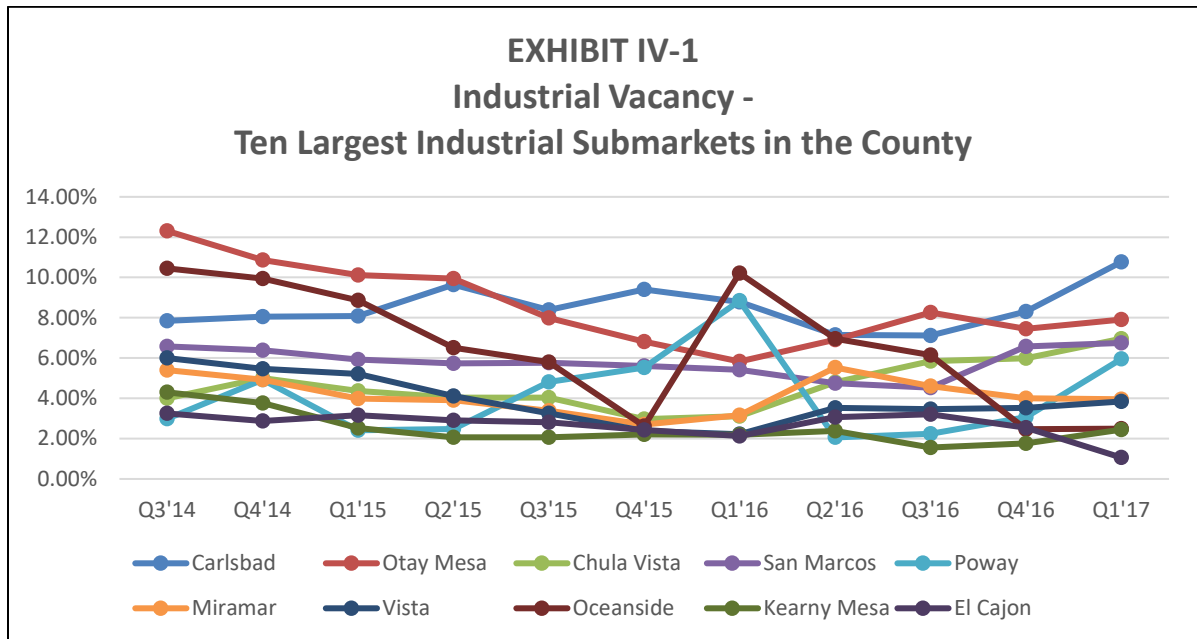
A. Industrial Supply

To evaluate current industrial supply, KMA obtained market data from Voit Real Estate Services for the largest industrial submarkets in the County. Table IV-1 presents the County’s top ten (10) largest industrial submarkets by net rentable SF. As shown, the Otay Mesa submarket (bounded by Main Street to the north, Interstate 805 to the west, Enrico Fermi Drive to the east, and the United States-Mexico border to the south) has the largest quantity of net rentable SF at approximately 10.8% of total County industrial inventory, followed by Miramar (9.3%), Vista (8.9%), Kearny Mesa (6.8%), and El Cajon (6.3%).

Table IV-1: Top Ten Largest Industrial Submarkets in the County ⁽¹⁾				
	Submarket	Net Rentable SF	% of Total SF	% of County
1	Otay Mesa	15,371,370	15.4%	10.8%
2	Miramar	13,262,689	13.3%	9.3%
3	Vista	12,644,505	12.7%	8.9%
4	Kearny Mesa	9,755,338	9.8%	6.8%
5	El Cajon	9,062,136	9.1%	6.3%
6	Oceanside	8,739,689	8.8%	6.1%
7	Chula Vista	8,677,732	8.7%	6.1%
8	Carlsbad	7,655,611	7.7%	5.4%
9	San Marcos	7,258,685	7.3%	5.1%
10	Poway	7,213,472	7.2%	5.1%
	Total, Submarkets	99,641,227	100.0%	69.8%
	Total, County	142,762,621	---	100.0%

(1) Source: Voit Real Estate Services, Q1, 2017.

Exhibit IV-1 indicates that, among the ten largest industrial submarkets, Otay Mesa is currently experiencing the second largest industrial vacancy at 7.9%, less than Carlsbad at 10.8%, and greater than Chula Vista (7.0%), San Marcos (6.8%), and Poway (6.0%).



B. Industrial Space Absorption

KMA surveyed historical annual absorption data from Voit Real Estate Services as presented in Table IV-2. Based on an analysis of annual net absorption from 2004 to 2016, it can be estimated that the average annual absorption for the Otay Mesa submarket is approximately 301,000 SF per year. Comparatively, the average annual absorption for the County is estimated at 1,090,000 SF per year.

	<i>Otay Mesa</i>	<i>San Diego County</i>	<i>Otay Mesa as % of County</i>
2004	217,727	2,256,803	10%
2005	374,794	1,998,586	19%
2006	1,081,429	2,673,429	40%
2007	384,565	1,367,759	28%
2008	(295,118)	(1,138,442)	26%
2009	(401,686)	(2,981,280)	13%
2010	527,417	944,625	56%
2011	157,274	829,459	19%
2012	681,061	1,386,252	49%

Table IV-2: Net Industrial Absorption (Building SF)			
	<i>Otay Mesa</i>	<i>San Diego County</i>	<i>Otay Mesa as % of County</i>
2013	(30,915)	1,236,148	n/a
2014	686,507	2,417,433	28%
2015	494,515	2,600,146	19%
2016	32,610	574,883	6%
Average Annual Absorption (SF/Year)	301,000	1,090,000	28%
(1) Source: Voit Real Estate Services.			

C. Median Household Income and Employment

To evaluate income and employment trends, KMA retrieved current data from Nielsen and historical data from the U.S. Census Bureau, Center for Economic Studies. Table IV-3 presents the estimated median household income for residents within each submarket. As presented below, Otay Mesa has the lowest median household income compared to two of the largest employment zone submarkets, Kearny Mesa and Miramar.

Table IV-3: Estimated Median Household Income, 2017 ⁽¹⁾	
Otay Mesa	\$66,000
Kearny Mesa	\$68,000
Miramar	\$96,127
(1) Source: Nielsen Population Facts Demographic Snapshot, 2017. Reflects median household income by zip code.	

KMA also compared Otay Mesa submarket employment (by place of work) with the same large employment zones, Kearny Mesa and Miramar. This comparison is presented in Table IV-4 below. As shown, Otay Mesa has historically accounted for only 8.0% to 9.0% of the total employment when compared with the larger submarkets. This is an indicator that employment in Otay Mesa is extremely limited when compared to these other high-quality employment submarkets in the County.

Table IV-4: Employment by Submarket (1)						
	2010	2011	2012	2013	2014	2014 % of Total
Otay Mesa	19,653	20,197	20,229	20,454	20,827	8%
Kearny Mesa	100,422	103,638	117,389	119,786	125,648	48%
Miramar	<u>96,762</u>	<u>109,746</u>	<u>108,993</u>	<u>114,065</u>	<u>114,155</u>	<u>44%</u>
Total	216,837	233,581	246,611	254,305	260,630	100%
<i>Otay Mesa as % of Total</i>	9%	9%	8%	8%	8%	

(1) Source: U.S. Census Bureau, Center for Economic Studies. Reflects employment by zip code.

V. OVERVIEW OF INDUSTRIAL MARKET ABSORPTION

A. Estimated Industrial Land Supply

KMA conducted an independent analysis of vacant developable land inventory from the San Diego Association of Governments (SANDAG) and estimated that the Otay Mesa Submarket contains approximately one-third, or 34%, of the County’s total industrial land inventory. As shown in Table V-1, there are approximately 2,106 developable acres of industrial land in Otay Mesa compared to a total of 6,242 acres Countywide. KMA translated these available land area figures to potential industrial building square footage using typical assumptions for developable-to-gross land area (ratio of 75%) and Floor Area Ratio (FAR of 0.45). Based on these factors, KMA estimates the remaining developable building area for Otay Mesa and the County as 31.0 million SF and 91.8 million SF, respectively.

Table V-1: Industrial Land and Building Supply (1)		
	Undeveloped Acres	Estimated Building SF (2)(3)
Otay Mesa Submarket	2,106 (4)	30,962,000 SF
County of San Diego (excl. Otay Mesa Submarket)	4,136	60,805,000 SF
Total - County of San Diego	6,242	91,767,000 SF

(1) Source: SANDAG Series 13 Growth Forecast.
 (2) Assumes a Floor Area Ratio (FAR) of 0.45.
 (3) Assumes a developable-to-gross land area of 75%.
 (4) Reflects KMA estimate based on discussions with SANDAG and City of San Diego for West Otay Mesa vacant developable acres. Note that SANDAG land inventory tabulations were prepared in 2012 and the Otay Mesa Community Plan was subsequently adopted in 2014. Therefore, KMA has estimated remaining industrial land inventory after designation of the Southwest and Central Villages for mixed-use and residential development in West Otay Mesa.

B. Assumptions for Future Industrial Absorption

KMA prepared absorption projections for industrial land/building area using market data from Voit Real Estate Services. The “low” scenario reflects the historical average annual absorption presented in Section III. In order to account for anticipated increases in industrial demand a “high” scenario was formulated at 50% higher absorption than the historical average. The high scenario accounts for factors that may increase industrial demand in the short- and long-term. These factors include new infrastructure such as the planned East Otay Mesa Port of Entry as well as the anticipated build-out of the County’s industrial submarket. Under the high scenario, absorption is estimated at 452,000 SF per year and 1,635,000 SF per year for Otay Mesa and the County, respectively.

Table V-2: Projected Annual Absorption of Industrial SF		
	Low Scenario ⁽¹⁾	High Scenario
Otay Mesa Submarket	301,000 SF	452,000 SF
County of San Diego (excl. Otay Mesa Submarket)	789,000 SF	1,184,000 SF
Total - County of San Diego	1,090,000 SF	1,635,000 SF
(1) Source: Voit Real Estate Services. Reflects average absorption for years 2004-2016.		
(2) Assumes a “high” scenario at 50.0% higher than historical average absorption.		

C. Absorption Projections

Using the low and high absorption scenarios above, KMA estimated the number of years until full absorption of the Otay Mesa submarket. As shown in Table V-3, the entire Otay Mesa submarket is estimated to be fully absorbed between 69 and 103 years. By comparison, the Meyers Research Market Study estimates that it would take 143 years for full absorption of the Otay Mesa submarket. Although KMA estimates a shorter timeframe than the Meyers Research Market Study, it is still projected that the Otay Mesa submarket will require many decades to fully absorb.

Table V-3: Estimated Number of Years to Absorb Vacant Industrial Land				
			Number of Years to Absorb	
	Undeveloped Acres	Estimated Building SF	Low Scenario	High Scenario
Total - Otay Mesa Submarket	2,106	30,962,000	103	69

D. Potential Loss in Business/Industrial Tech Land

Table V-4 presents the potential reduction of Business/Industrial Tech land in East Otay Mesa as a result of the redesignation of the Property. As shown, the East Otay Mesa Specific Plan would be rezoning approximately 198 acres, or 2.9 million SF, of high-quality employment land. The loss of this employment land is approximately 12.0% of the current inventory in East Otay Mesa. As a result in the loss of this inventory, it is estimated that the number of years for the entire Otay Mesa submarket to fully absorb will be reduced to a range of 62 to 93 years. In the short-term, this reduction appears to be beneficial, reducing the oversupplied industrial land in the Otay Mesa submarket. However, in the long-term, this redesignation of land would reduce the achievable number of high-quality jobs in the submarket and may discourage larger industrial users from locating in close proximity to the Property.

Table V-4: Potential Reduction in Business/Industrial Tech Land		
	Undeveloped Acres	Estimated Building SF ⁽¹⁾⁽²⁾
Existing Business/Industrial Tech	250	3,675,000 SF
(Less) Preserved Employment and Retail Uses	(52)	(760,000) SF
Potential Reduction in Business/Industrial Tech	198	2,915,000 SF
(1) Assumes a Floor Area Ratio (FAR) of 0.45.		
(2) Assumes a developable-to-gross land area of 75%.		

VI. LIMITING CONDITIONS

1. KMA has made extensive efforts to confirm the accuracy and timeliness of the information contained in this study. Such information was compiled from a variety of sources deemed to be reliable including state and local government, planning agencies, real estate brokers, and other third parties. Although KMA believes all information in this study is correct, it does not guarantee the accuracy of such and assumes no responsibility for inaccuracies in the information provided by third parties.
2. Market feasibility is not equivalent to financial feasibility; other factors apart from the level of demand for a land use are of crucial importance in determining feasibility. These factors include the cost of acquiring sites, relocation burdens, traffic impacts, remediation of toxics (if any), and mitigation measures required through the approval process.
3. The findings are based on economic rather than political considerations. Therefore, they should be construed neither as a representation nor opinion that government approvals for development can be secured.

To: Gregory Mattson, Project Manager
Subject: Limited Market Assessment of Industrial Uses
East Otay Mesa

December 18, 2017

Page 12

4. The analysis, opinions, recommendations, and conclusions of this study are KMA's informed judgment based on market and economic conditions as of the date of this report. Due to the volatility of market conditions and complex dynamics influencing the economic conditions of the building and development industry, conclusions and recommended actions contained herein should not be relied upon as sole input for final business decisions regarding current and future development and planning.

5. The analysis assumes that neither the local nor national economy will experience a major recession. If an unforeseen change occurs in the economy, the conclusions contained herein may no longer be valid.