KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Eric Fonstein, Jennifer Ott, and Lori Taylor
City of Alameda

From: Tim Kelly and Ernesto Vilchis

Date: August 30, 2012

Subject: Industry Feasibility Testing and Interviews: Task 5

This memorandum presents the findings by Keyser Marston Associates, Inc. (KMA) for Task 5 of the Economic Development Strategy for Alameda Point: Industry Feasibility Testing and Interviews.

In Task 1, the Market Study, KMA recommended that Alameda Point should be viewed as having four sub-areas for capturing development. KMA made the following preliminary recommendations for each of the following sub-areas:

1) Commercial: This sub-area should build on its existing market position and tenant base.
2) Campus: This sub-area has the potential to be marketed with its own unique identity and northern entrance. Opportunities may exist to be developed as a campus for an institution, such as an academic or a corporate user willing to invest in the renovation of the buildings. This sub-area could also function as a series of smaller office buildings.
3) South of Atlantic: This sub-area is quite large (over 150 acres). Given the large areas of underdeveloped land, this is the sub-area that offers the best opportunity for build to suit owners. The site could be developed by a large employer seeking a new campus, such as the LBNL Campus. Alternatively, the sub-area could be developed incrementally on individual parcels, such as 5 to 10 acre sites, for owners of new build to suit buildings.
4) North of Atlantic: This sub-area is assumed to remain primarily residential and was not analyzed further.

55 PACIFIC AVENUE MALL ➤ SAN FRANCISCO, CALIFORNIA 94111 ➤ PHONE 415 398 3050 ➤ FAX 415 397 5065

WWW.KEYSERMARSTON.COM

001-005; jf
10002.012

Attachment 1 provides further description of each of these sub-areas as well as a map delineating each sub-area.

In Task 2, Tenant Assessment and Forum, KMA identified Alameda Point's existing tenant base and identified areas that may be targeted for long-term leasing. KMA identified 14 industry clusters at the Point, which currently lease more than 1.8 million square feet of space and generate more than $6.6 million in annual rent revenues. KMA posited that retaining businesses currently in Alameda Point affords an excellent foundation for future growth. KMA also posited that offering longer term leases may provide incentive to grow the job base, increase investment in the buildings, and provide much needed revenues to fund critical investments. Attachment 2 highlights the sub-areas within Alameda Point which KMA identified as potentially suitable for long-term leases.

In Task 3, KMA identified a list of potential types of industries that present the greatest potential for relocating or expanding at Alameda Point. For this task, KMA identified growing industries that may be suitable for new light industrial, R&D, and business park/campus development in the South of Atlantic sub-area as well as the reuse of existing buildings primarily in the Campus and Commercial sub-areas. The industries with high potential identified in Task 3 included:

1) Specialty Manufacturing
    a. Specialty food production
    b. Specialty beverages (wine, beer, and sprits production)
    c. Artisan goods/small-scale urban manufacturing
2) Marine-related industries

KMA also identified 1) Arts, Entertainment and Recreation, and 2) Film/Event Production as industries that may have moderate to high potential for growth at Alameda Point. Other industries with moderate potential for growth at Alameda Point may include high tech manufacturing and the clean tech (biofuels, wind, hydro) industries.

In Task 4 of the Economic Development Strategy, KMA, Field Paoli, and CBG (Carlson, Barbee & Gibson) prepared conceptual drawings and financial analyses of five prototypical buildings in the Commercial and Campus sub-areas to market these buildings to potential users.

Task 5 builds on the work completed to date. This task consists of findings from interviews with a cross-section of relevant development, business, and industry professionals to review and "market test" proposed land use, adaptive reuse, and market and financial assumptions developed in Tasks 1-4. Attachment 3 presents a list of interviewees. The findings of Task 5 fall within two broad categories:

1. *Opportunities and challenges for reuse of existing buildings in the Commercial and Campus sub-areas.*
   - Condition of buildings and availability of competing space offered at relatively affordable rental rates will make leasing of existing buildings challenging. Competitive, affordable rent structure at Alameda Point is the main advantage for businesses selecting space within existing buildings.
   - Tenants who may find the existing space at Alameda Point suitable for their operations may not have resources to invest in buildings, at least not in the short- to mid-term.
   - Tenants that are able to invest in building improvements and infrastructure will require long term leases and rent abatement.
   - However, long term leases and rent abatement may not be sufficient to lease existing buildings that require major long term capital improvements to be funded by the lessees. City investment may be required to make long term capital improvements in the buildings to enhance their marketability.
   - Existing business community now at Alameda Point can help to promote Alameda Point as a place to do business (i.e., they can be an effective marketing tool.)
   - Need to streamline approval process for new leases.
   - Lack of amenities and public transportation impacts ability to lease existing buildings.

2. *Opportunities and challenges for new development in the South of Atlantic sub-area.*
   - Alameda Point presents an attractive opportunity with a world class waterfront setting for new development occupied by build-to-suit businesses, i.e., single businesses or end users.
   - Current market rents for office and R&D space do not support development of multi-tenant, speculative office space.
   - Possible high infrastructure costs and site development costs need to be addressed when attracting new development. Reducing uncertainty is a key for any new development.

- A development partner working with individual businesses in search of build-to-suit space may be needed to oversee new development, which is now the approach at Harbor Bay. Such an approach would require a master developer to work with businesses.

Each of these observations/comments by the interviews is explained in more detail below. Interviewees were also asked to identify industries and businesses with the highest potential for expansion or relocation to Alameda Point. Their input regarding this topic was presented in the report for Task 3.

1) Opportunities and challenges for reuse of existing buildings

The commercial sub-area has the potential to build on its existing market position and tenant base. The campus sub-area meanwhile may have the potential to be marketed with its own unique identity as a campus for an institution, such as an academic institution or a corporate user willing to invest in the renovation of the buildings. Alternatively, the campus sub-area could also function as a series of smaller office buildings leased to multiple tenants.

In Task 4, KMA, Field Paoli, and CBG examined potential reuse scenarios for five prototypical buildings within these two sub-areas.

Interviewees provided the following comments regarding the potential for reuse of these buildings:

- *Condition of buildings and availability of competing space will make leasing of existing buildings challenging*

  One of the challenges for Alameda Point is that it offers Class C space in need of significant investment in a market with plenty of Class A and B space ready for occupancy. For example, according to Grubb & Ellis, during the first quarter of 2012, Marina Village had a vacancy rate of 30 percent; more than 500,000 square feet of vacant office and R&D space. There are also more than 1.8 square feet of vacant Class A office space, nearly 2.2 million square feet of vacant Class B office space, and more than 9.8 million square feet of competitively priced vacant industrial/warehouse space in the I-80/I-880 Corridor.

- *Tenants who may find the existing space at Alameda Point suitable for their operations may not have resources to invest in buildings, at least not in the short- to mid-term.*

While Class B and C space users are most suitable for the existing buildings, these users typically do not have the ability to make significant investments in building improvements. Most businesses in this category would rather invest capital into the operations of their business to make them grow rather than into real estate. This is true for office users as well as for Industrial/R&D users.

According to brokers, few industrial users generally have interest in investing in the buildings particularly because there is a lot of available inventory in Hayward, San Leandro, and Oakland where owners can assist with tenant improvement costs. As long as vacancy remains higher than 10 percent, there will be very limited interest to invest in obsolete space requiring substantial capital costs.

On the flip side, companies that cannot afford to make improvements or to pay high rents may be more flexible when looking at space. Features they may need, such as docks, floor drains, etc. may not have to be in place. These companies will be creative and find ways to do without these features as long as the space is affordable. The tradeoff for companies is: they pay higher rents for something that is ready for production, or they pay less rent and make some of the improvements themselves. As these companies grow they may be able to make more significant investments in buildings.

- *Affordability is the main competitive advantage of existing buildings*

  In the current real estate market, affordable rent is the main competitive advantage of Alameda Point. Alameda Point may represent an attractive alternative to companies that are priced out markets such as San Francisco, Emeryville, or Berkeley.

- *Tenants that are able to invest in building improvements and infrastructure may require long term leases and rent abatement*

  The general sentiment among people interviewed is that if a potential tenant is going to spend $150 or more per square foot in basic improvements to a building, they will not want to pay any rent at all. Furthermore, such a business would seek a long term lease or ownership of the land and building.

  However rent abatement may not be enough to attract new tenants. For example, it is reported that one of the reasons for Marina Village's high vacancy rate is that the landlord does not offer sufficient tenant improvement allowances to potential tenants.

Also, tenants with the resources to finance the necessary improvements to make the buildings occupiable may also require 10-20 years on a lease. The most common lease term for industrial space is 5 years for a ready-for-move-in building. Leases can be shorter for office space. However, people interviewed indicated that 10-year lease terms may not sufficient to entice businesses to invest into the building. If there is a high level of capital improvements required, a lease term of at least 20 years may be needed, so the business owner can borrow the funds for the improvements.

Another potential challenge is that if a business is going to invest significant resources into a building, then it would probably choose to buy the building rather than leasing it.

- *Long term leases and rent abatement may not be sufficient to lease existing buildings. City investment may be required to make the buildings marketable*

  Existing buildings at Alameda Point are currently not tracked by real estate brokers as they are considered obsolete. To make these buildings marketable, the City may need to reinvest some of the rent revenue generated by existing leases to make basic improvements in vacant buildings.

  In Task 1, KMA estimated that over 100 businesses at Alameda Point lease over 1.8 million square feet of space and generate over $6.6 million in annual rent revenues. An interviewee commented that the City needs to directly reinvest some of the revenues generated into some of the buildings that need improvements to make them leasable so that they can in turn generate more rent that can be invested in infrastructure.

- *Need to streamline approval process for new leases*

  Most industrial/warehousing businesses have a short lead time for leasing a space. Potential industrial tenants cannot afford to spend time on protracted lease negotiations, especially given that there are so many alternatives in the market. For businesses looking to expand and potentially relocate, the relocation process is stressful enough. These businesses do not want to complicate the process further by having to spend significant resources negotiating leases or waiting for public hearings for lease approval. The process needs to be efficient. The space needs to be ready to be leased and occupied.

- *Existing business community at Alameda can help to promote Alameda Point as a place to do business (e.g. they can be an effective marketing tool.)*

  An interviewee, who is currently operating a specialty food company out of Oakland, mentioned that one of the advantages of being based in the Oakland waterfront is that there are other companies that provide services to food-production companies: welders, mechanics, packaging, etc.

  Alameda also has a vibrant community of skilled professional service providers and companies that could help to attract other businesses to the area. The City should promote the existing businesses to attract similar tenants or tenants that may benefit from the services provided by the existing tenants.

- *Lack of amenities and public transportation impacts leasing of existing buildings*

  A recurring theme among interviewees regarding the potential to attract new tenants to Alameda Point is the lack of amenities such as public transit, restaurants, and entertainment venues (e.g. bars, theater, music, etc.)

  The high tech-boom in San Francisco and the peninsula has created strong demand for creative, "funky" spaces, such as those found in the South of Market District (SOMA) or Potrero Hill in San Francisco. Some of the buildings in Alameda Point, such as the hangars or the control tower, may fit in the "creative space" category. However, the creative space in SOMA or Potrero offers a myriad of amenities within walking distance. High tech workers want to be close to amenities (especially transportation). It is for this reason that companies are willing to pay premium rents. Affordable rents in the East Bay are not sufficient to entice high tech companies to make the move. More attractive amenities are needed.

  Webster Street is limited in its ability to be considered part of the day-to-day amenities because of its distance and, according to real estate brokers and industry professionals, the available amenities are not attractive enough for young tech workers.

  Access to transportation is another challenge for Alameda Point. Shuttle systems may be necessary to attract major businesses and the employment talent they seek.

  It is not just high-tech companies that value transit and other amenities. When NUMI Tea was looking for a new location in the East Bay, it was particularly important for them to find a location close to BART for the convenience of their employees and customers. Public transit linkages were also important to LBNL as they considered their location for a second campus.

Lack of amenities could potentially be offset by affordable rents and suitable space, but the companies that are willing to forgo amenities for lower rents are less likely to have the funds to invest in significant upgrades.

2) Challenges/opportunities for new development South of Atlantic Avenue

In Task 1, KMA discussed that given the large areas of underdeveloped land in the sub-area South of Atlantic, this is the sub-area that offers the best opportunity to attract a large major employer to build a new campus. KMA discussed this concept with real estate brokers and real estate developers. Interviewees provided the following comments regarding the potential challenges and opportunities for this sub-area to attract new development:

- *Alameda Point presents an attractive opportunity for new development*

  The consensus among real estate developers and brokers interviewed is that Alameda Point offers a unique development opportunity in a world-class waterfront setting. Alameda Point is particularly attractive because there are few large development sites left for development in the land-constrained core of the Bay Area. The fact that it is under single ownership also makes it very attractive to a potential user looking for a large development site.

  Additionally, the City of Alameda is perceived as a safe, welcoming community with good schools and relatively affordable housing opportunities for potential employees.

  Alameda Point's location works both in its favor and against it. On the one hand its relative proximity to downtown Oakland and downtown San Francisco, as well as the Oakland Airport and UC Berkeley make the site attractive. However, its distance to I-880 and BART stations creates a perception of isolation.

- *Current market rents for office and R&D space do not support development of multi-tenant, speculative office space. Development by an end-user is more likely.*

  One of the major obstacles to commercial development at Alameda Point is that current market rents do not justify new, multi-tenant, speculative development. A large, special user such as Google, Lucas Skywalker, or Pixar may be better positioned to develop there, but the opportunities for this kind of development are limited. Demand from end-users in search of smaller development sites is more likely.

- *Possible high infrastructure costs get in the way of development*

  A recurring topic among some of the interviewees is that because of the potential need to replace aging infrastructure, it appears to be expensive to develop new commercial space at Alameda Point. It is very difficult for general businesses to finance the infrastructure that may be needed at Alameda Point and the types of business that may be able to afford such level of investment would prefer to be in the Peninsula or Silicon Valley.

  One of the interviewees recommended identifying sites where there is already some infrastructure in place or where the least amount of new infrastructure may be needed to accommodate new commercial development.

- *Reducing uncertainty is key to attracting new development*

  Several of the interviewees believe that opportunities to attract businesses looking for new commercial space to Alameda Point will present themselves in the future, but the key to attracting such new development to Alameda Point is to have 15-25 acre sites (200,000 sq. ft. of building) that can be marketed and ready to go. This is the development model that made Harbor Bay relatively successful (that along with having an experienced developer with whom to work).

  Having a site ready means identifying, and if possible addressing, the major potential barriers to development such as environmental cleanup, geotechnical issues, infrastructure, and entitlements. The process of building a new campus or a new facility is risky and complex. Uncertainty about the costs of development (due to infrastructure, environmental clean up, or relocation of existing businesses) introduces additional risks to an already complex process and reduces the pool of businesses willing to move forward with new development at Alameda Point.

- *A development partner is needed to oversee new development*

  The sub-area South of Atlantic could present a great opportunity for new development. However, because of the complexity of developing the site, interviewees recommended that the City engage a development partner. According to some brokers, part of the reason why Harbor Bay has been relatively successful at attracting end-users (such as VF Outdoor and Peet's Coffee & Tea) is because of the opportunity to partner with an experienced developer that can oversee the development from start to finish is very attractive to businesses looking to build new facilities.

- *Master developer vs. incremental approach*

  Some of the interviewees indicated that having a master developer for all of Alameda Point would be ideal. This approach is perceived to offer an option to coordinate infrastructure development.

  A second group of interviewees recommended an incremental approach for development of Alameda Point. Instead of working with a single master developer to oversee the development of the Point, they recommended working on 15 to 25 acres of new development at a time, and create competition among developers to optimize solutions for Alameda Point.

Attachment 1: Alameda Point Sub Areas

To facilitate the opportunities and timing for job growth, Alameda Point should be viewed as having four sub-areas for capturing development based on the existing inventory of buildings and underdeveloped land area (see map in Figure A1):

a. Commercial Reuse – This sub area should build on its existing market position and tenant base. Buildings in this sub-area consist mostly of large warehouse and manufacturing type spaces. There are few places available in the Inner Bay Area that offer the features of some of the largest spaces at Alameda Point, such as clear-span large floor plates with 40' ceiling heights, and door access with 27'x98' clearance. The business clusters most prevalent in this sub-area include Arts/Entertainment/Recreation, Specialty Beverage and Food, and Midsized Manufacturing and Repair (including artisans, specialty craftsmen, maritime businesses, etc.) These three clusters account for more than 50 percent of the approximately 890,000 square feet of leased space.

b. Campus – This area benefits from the historic military campus with its well constructed buildings, views, and open spaces. The location has the potential to be marketed with its own unique identity and northern entrance. Opportunities exist to be developed as an institutional campus, such as an academic institution or a corporate user willing to invest in the renovation of the buildings. The area could also function as a series of smaller office buildings that should be able to be competitively priced in a campus setting.

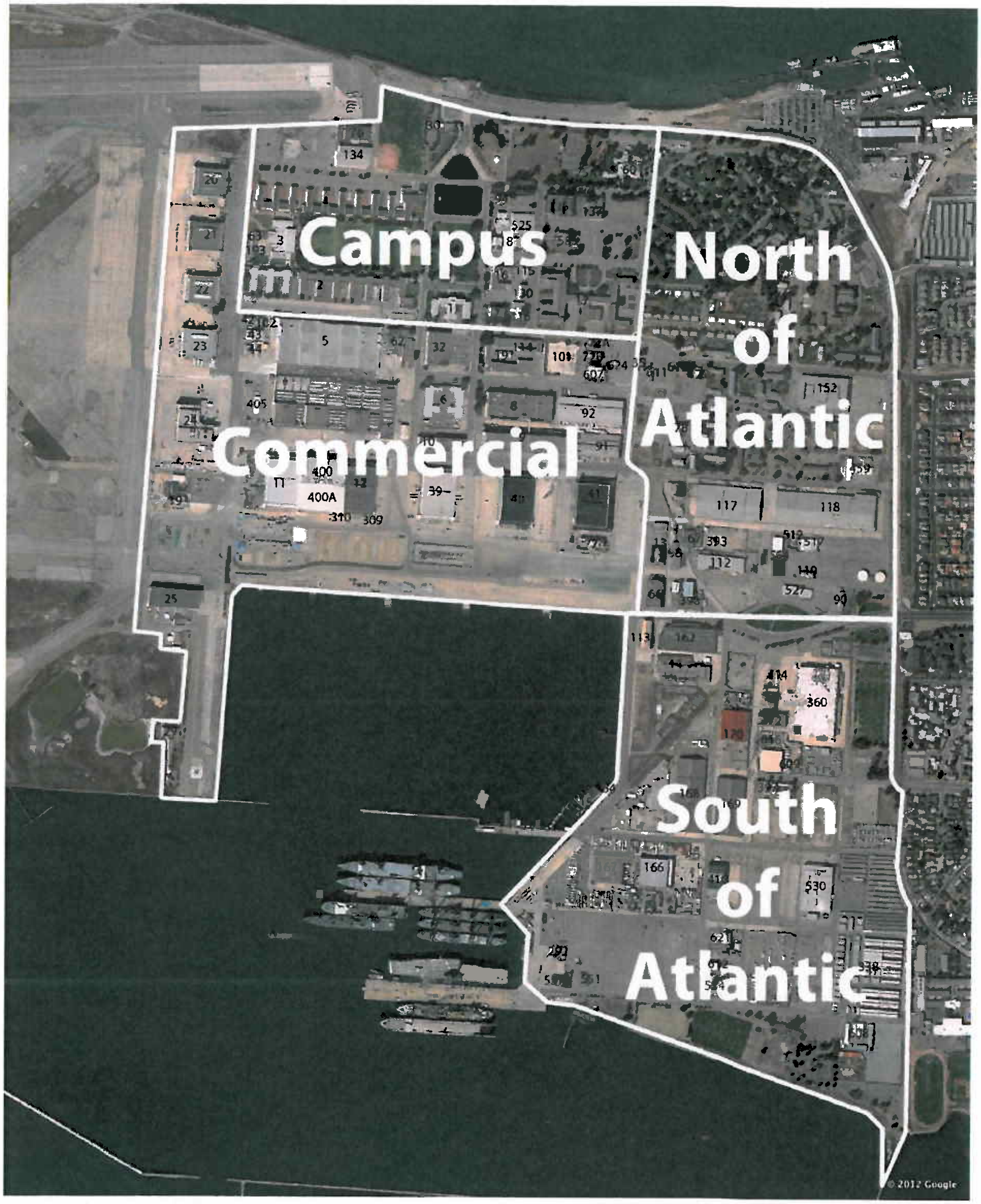
   This sub-area currently has the lowest occupancy rate. This is partially explained by the unique configurations of the buildings located there (former military dormitories). Also, the current conditions of the buildings do not allow for them to be occupied or marketed more aggressively. Uses currently consist mostly of limited office, civic and nonprofit businesses, and business related storage.

c. South of Atlantic – This sub-area is in excess of 150 acres. To place the size in context, it as large as the commercial/institutional portion Mission Bay in San Francisco. The sub-area contains both large underdeveloped land areas as well as approximately 1 million square feet of leasable building area with one of the highest occupancy rates in Alameda Point. Marine users and personal storage are the most prevalent uses in this area (45 percent and 20 percent of total space leased, respective).

   Given the large areas of underdeveloped land, this is the sub-area that offers the best opportunity to attract a large major employer to build a new campus and, in fact, was the proposed location for the LBNL Second Campus.

d. North of Atlantic – This sub-area consists mostly of residential uses (e.g., Alameda Point Collaborative and Big Whites). It is assumed that this sub-area will continue to have a primarily residential emphasis.

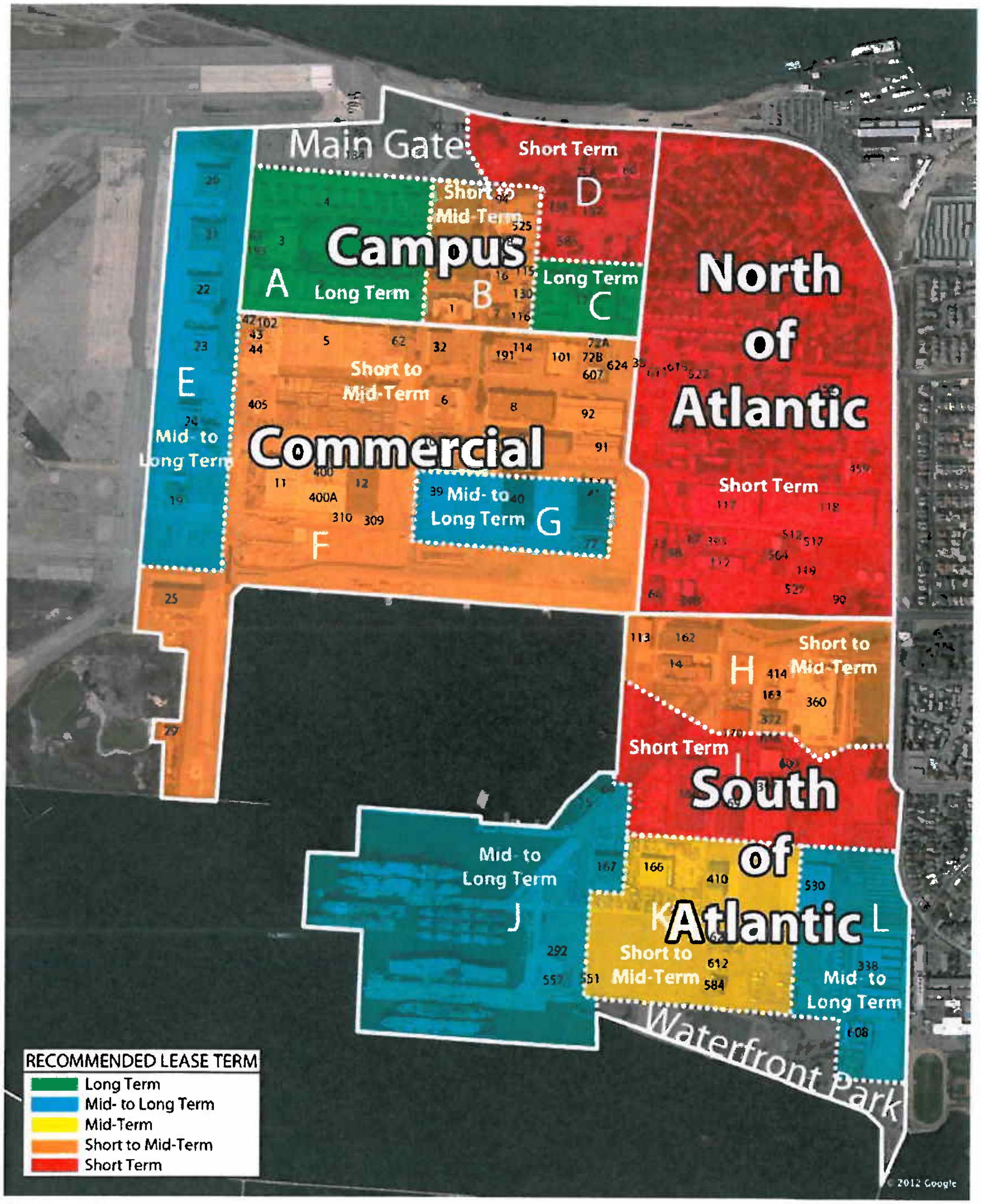
Figure 1 – Alameda Point Sub-Areas



Source: Google Maps, KMA.

Attachment 2: Potential Lease Term for Commercial Buildings

As part of Task 2 of the Economic Development Strategy, KMA identified areas within Alameda Point that could be targeted for long-term leasing. KMA assumes that leases are for buildings as opposed to land. The following map illustrates these sub-areas. Additional detail about this map can be found in the Memorandum dated April 19, 2012.



Source: KMA

Attachment 3: List of Interviewees

Contact		Title	Company	Industry
1	Tom Currier	Founder	Black Swan Solar/ Founder's Castle	High tech, Start-ups, Solar
2	Karen Engel	Executive Director	East Bay EDA	Regional Economic Promotion
3	Joe Ernst	Development Partner	SRM Associates	Real Estate Development
4	Ian Griffith/ Tony Lawson/Liz Taylor	Operations/Engineering Director/President	DOER Marine	Marine Services
5	Seth Hamalian	Principal	Mission Bay Development Group	Real Estate Development
6	Jon Haveman	Chief Economist	Bay Area Council	Economist
7	Duncan Logan	Founder/CEO	Rocketspace	High tech, Start-ups, Co-Working Space
8	John McManus	Broker	Cushman & Wakefield	Real Estate Brokerage
9	David Mik	Vice President	Power Engineering	Marine Engineering Services
10	Bill Nork	Senior Vice President	Cornish & Carey	Real Estate Brokerage
11	Kent Rosenblum	Founder	Rock Wall Company	Urban Wines
12	J.R. Eddie Orton III	President	Orton Development Inc.	Real Estate Development
13	John Scharffenberger	CEO	Hodo Soy	Specialty Food Production
14	Ahmed Rubin	Founder	NUMI Teas	Specialty Teas
15	Steve Shaffer	Founder	Urban Legend Cellars	Urban Wines
16	T. Jeff Sterkovich / Sam Higgins	Managing Partner / Vice President	BT Commercial	Real Estate Brokerage
17	Sam Swan / Jon Elder	Managing Director / Senior Associate	Jones Lang LaSalle	Real Estate Brokerage