

Public Release Draft Report
Submitted April 22, 2013

For the

CITY OF MERCED

Marketing Strategy & Feasibility Study for the SHAFFER BUILDING



**West Main and M Streets
Merced, California**

Prepared by



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Shaffer Building Marketing Strategy

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SECTION 1 Introduction and Study Objectives

As requested by the City of Merced, this marketing strategy is intended to assess the need for a mixed use facility in downtown Merced and identify potential tenants for each of the three floors of the building. The end result of the study will aid the owner and the City in the development of the property. Study results will provide a basis for tenant recruitment, identification of economically sustainable land uses, and estimate user square footage demand.

In order to accomplish these goals, the market trade zone of the subject property needs to be identified and the characteristics that lead to market demand analyzed: population growth trends, demographic characteristics of that population, employment growth and dynamics, housing demand trends, major development patterns and community facility locations, and specific land use patterns of the downtown Merced environs.

The start date of the project was January 22, 2013. A final report to the City Council is anticipated by August 2013.

Merced County is located in the heartland of California's Central Valley. Fresno, the State's fifth largest city is located approximately one hour south, connected by Highway 99, the major north south artery of the Central Valley. The demographics and real estate market of this area is driven by the agricultural character of the Valley and the hot seasonal climate that makes the area well located for row crops and ranching.

Merced is 110 miles south of Sacramento, 130 miles east of San Francisco, and 270 miles north of Los Angeles.



Merced's centrality is depicted in Figure 1, Regional Location Map.

Community Profile (Merced County and the City of Merced)

As of January 2013, the California State Department of Finance reports that the unincorporated areas around Merced account for 90,407 persons. The City of Merced is growing and has recently passed the 80,000 population threshold. Merced is by far the largest concentration of population in Merced County. Merced is the government and economic center in the County with a population base of approximately 260,000 people.

Merced was established in 1877 as a major rail head for the shipment of agricultural and ranch products. The City incorporated in 1889. Merced is a charter city under the Manager-Council form of local government. Agriculture still plays a vital role in the local economy. The town was named for the nearby Merced River, for the mercy received by thirsty Spanish explorers in early California history.

Food processing emerged in the early 20th century and is a major employment generating industry with over 10,000 jobs (2008 per City website). Other key sectors of the Merced economy include government with 15,700 employees, service sector with 11,000 jobs, and manufacturing with 9,000 jobs. Retail accounts for 7,900 jobs. The seasonal nature of the agricultural based local economy has created a higher unemployment rate with the civilian unemployment rate standing at 13.2% (2008).

Major facilities near Merced include the former Castle Air Force Base, Lake Merced, Merced Falls, the historic Mainzer Theatre, the County Courthouse Museum, the Merced Mall on Olive Avenue, and the newly establish University of California campus.

According to U.S. Census data and the City website, the top ten employers are the County of Merced, UC Merced, Mercy Medical Center, Merced City Schools, AT & T Telecommunications, Merced College, the City of Merced, Quad Graphics, and Wal Mart. This array shows the significant dependence the area has on public sector and nonprofit employment.

Table 1

Merced Major Employers 2010

Employer	No. of Employees
County of Merced	2,028
University of Calif. Merced	1,602
Mercy Medical Center	1,200
Merced School District	1,141
Merced Unified High School Dist.	949
AT and T Mobile	900
Merced Community College	900
City of Merced	584
Quad Graphics	564
Wal Mart	311

Proximity to Yosemite National Park

Merced is known as the “gateway” to Yosemite as it is less than 2 hours west of the national park. Merced is the central approach to Yosemite Valley via Route 140. According to the National Park Service, the El Portal gate sees approximately 400,000 visitors per year. Yosemite National Park is an international draw and approaches 2 Million annual visitors. This proximity to a major recreational and cultural attraction is a vital component of the economic resources of a downtown Merced location. Merced draws family and individual visitors from North and Southern California. This type of tourism makes the subject property and downtown Merced a potential hotel or motel location.

Context for Planning, 2008 Downtown Development Strategy

The last major planning effort occurred in 2006-07 under the supervision of the Merced Redevelopment Agency. A major strategy was prepared for the downtown core area in which the Shaffer building is a key location. The Merced Redevelopment Agency was

dissolved and the Successor Agency is the State of California. All of the background research for that study now reside in the hands of a State depository and are not accessible to the consulting team. Much of the data collected in that study has been redone by the consulting team.

The Downtown Strategy does provide an excellent historical basis for the current feasibility study. It captures the downtown at a time of reinvestments and revitalization, just prior to the financial crisis of 2008 which created the current world- wide recession.

The Strategy defined 8 neighborhood districts and makes recommendations for future development: Auto Center to the west, Uptown District to 22nd Street, the Expanded City Center anchored by the County facilities, the Midtown residential district, East Main/G Street Corridor, the City Center around M and Main, West Main to V Street, and the Gateway District along Highway 99 anchored by Costco and other big box development.

The Downtown Strategy area is also the Primary Trade Area for the Shaffer market strategy.

The context for planning derived from the Downtown Strategy is a follows:

- In 2006, the Merced local economy was on a major growth upturn with unemployment declining to the lowest rate in twenty years;
- In 2007, a land use survey of the downtown central district (street level) indicated a vacancy factor of only 3%, an indicator of a very strong local real estate market;
- Redevelopment Agency financed projects were eliminating the historical vacancy factor of 33% (2001), and several projects had been completed: the Mondo Building rehabilitation, Mainplace Merced, the Multi-Cultural Arts Center, the Merced Theatre restoration, and a mixed use housing/retail project, "The Lofts;"
- Class A commercial space had increased 500% and Class D (code violating) space had been reduced by 58%;
- First floor Retail and professional spaces were filling in rapidly,
- Demand for 300 housing units in mixed use projects in the core area;
- Several key vacant and historic buildings were identified for further revitalization including the Shaffer Building.

The conclusion of the Downtown Strategy was that the downtown core area was well positioned to become an entertainment, visitor, and cultural center for the community., that there was also strong demand to introduce housing in the vacant second and third floors of older buildings, and that parking was plentiful and could be developed into an effective off street public parking system. Entertainment, arts, and government work centers were to be a catalyst for this vision of mixed use and pedestrian friendly development.

The vision of the strategy should be the vision for the Shaffer Building—a mixed use development that is compatible with an Arts and Cultural District and provides affordable housing opportunities.

University of California, Merced

In 2005, Merced became the first expansion of the University of California system in 40 years. 2005 was the school's initial year of academic operation. It is the newest and tenth campus of the UC system. Current enrollment is 5,760 students and the forecast build out of the campus is for 25,000 students. UC Merced employs 1,216 workers.

The educational mission for the Merced campus is the development of innovative science and technology programs. A school of medicine is expected to be developed over the next decade. Biology is the largest undergraduate major with 22% of declared students. Psychology is the second largest major. Engineering is a significant and growing major at 7% of student body. The University has launched two major research institutes—the Merced Energy Research Institute and the Biomedical Sciences Research Institute.

The campus has grown steadily in student enrollment. Applications are increasing and the University now needs to expand facilities to accommodate current and projected growth. As part of the planning for facilities, the Chancellor's Office (Dorothy Leland) gathered the original Urban Land Institute (ULI) planning team to update and review the current master plan of the campus. The University commissioned the ULI to report back on any recommended adjustments to the campus Capital Facilities Program. In the early fall of 2012, the ULI team recommended several key amendments to the current facility expansion program:

- Recruit additional real estate advisory services to recalibrate the existing plan;
- Solve the physical infrastructure expansion problems that are limiting on campus development;
- Develop a Campus "Branding" Strategy for marketing the campus;
- Establish a high priority facility list to focus existing resources;
- Seek federal and State funding sources outside the University system;
- Identify cost effective building development, including rehabilitation and adaptive reuse;
- Build sustainability and energy efficiency into every project.

Due to recent budget constraints, the UC system recently decided to put large capital projects on hold. This has become a development barrier for UC Merced as the site is constrained by a canal system and wetlands. In order to develop horizontally, UC Merced need extensive new infrastructure to expand. The report identified the need to go off campus with clustered support facilities for administration and management functions. Downtown Merced was clearly stated to be the preferred alternative for off campus support buildings. The report suggests the consolidation of several small buildings into one combined location, preferably in downtown Merced.

The need to expand off campus creates increased demand for buildings such as the Shaffer. The caveat to develop older buildings is that they must meet the same high standards for energy and safety as the new on campus buildings. Therefore, the Shaffer building can compete for UC Merced office space if the contemplated rehabilitation is of a very high standard meeting all seismic safety, disabled access, energy efficiency, and utility standard of the UC inventory. Any project to accommodate UC offices would have to meet at least a silver LEED grade of “green” building standards.

High Speed Rail

One of the most recent major economic development influences for the downtown Merced area is the approval of plans for a station location for the new California High Speed Rail Project. This project would create a new train service with intrastate ground transportation at speeds competitive with modern jet air travel. A high speed rail based train can travel at speeds of 200-250 miles per hour. Maximum speeds of current Amtrak service are 60-70 mph. The system will be 800 miles long with 6 central valley stops from Los Angeles to Sacramento. Merced will be a key central location with a valuable connector to the Bay Area. The consequences of high speed rail for the downtown are many: park and ride facilities, staging for trips to Yosemite, key transfer of passengers between the Bay Area and the Central Valley, an affordable alternative to expensive air travel, and a more desirable method for businesses and students to reach UC Merced. The supportive services needed for the station are hotels, retail, restaurant, services, and parking.

There will be many economic multipliers received from the operation of the station in a downtown setting. The station location at N and 16th is very close (2-3 blocks) to the Shaffer Building and will help create demand for visitor services, retail, and office uses in the building.

Merced Enterprise Zone

Downtown Merced and the Shaffer building site are located in an Enterprise Zone. The State of California Enterprise Program provides for payroll tax incentives for companies locating inside the zone. The enterprise must be job producing to claim the available tax credits. A map of the Merced Regional Enterprise Zone is attached as Figure 2.

Table 2

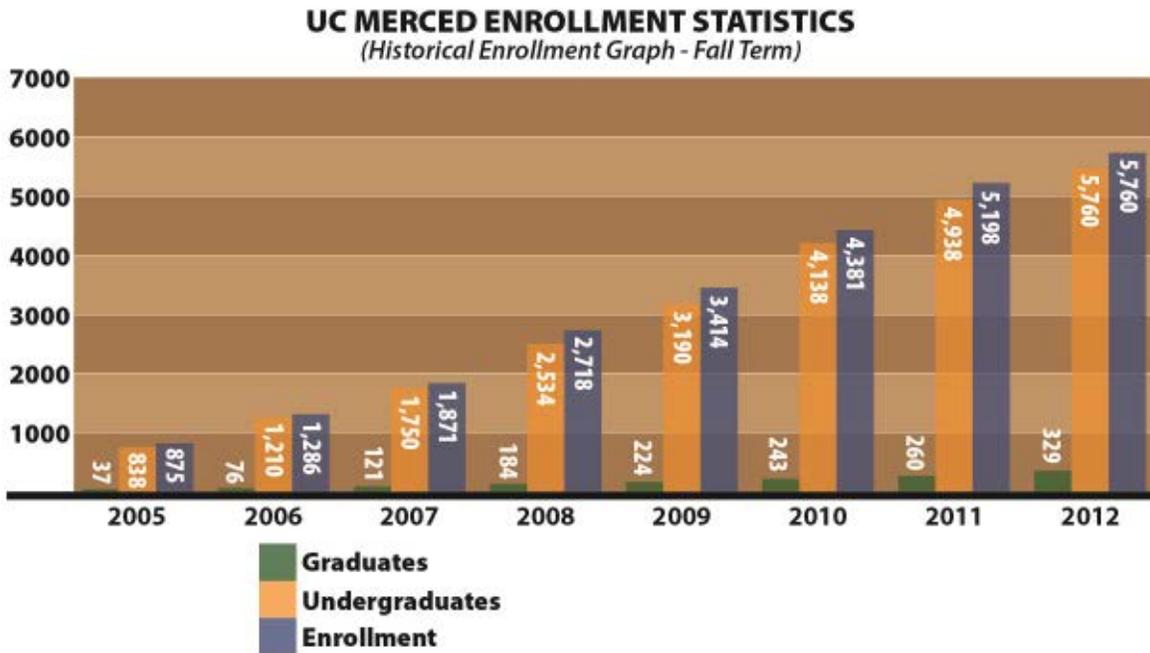


Table 3

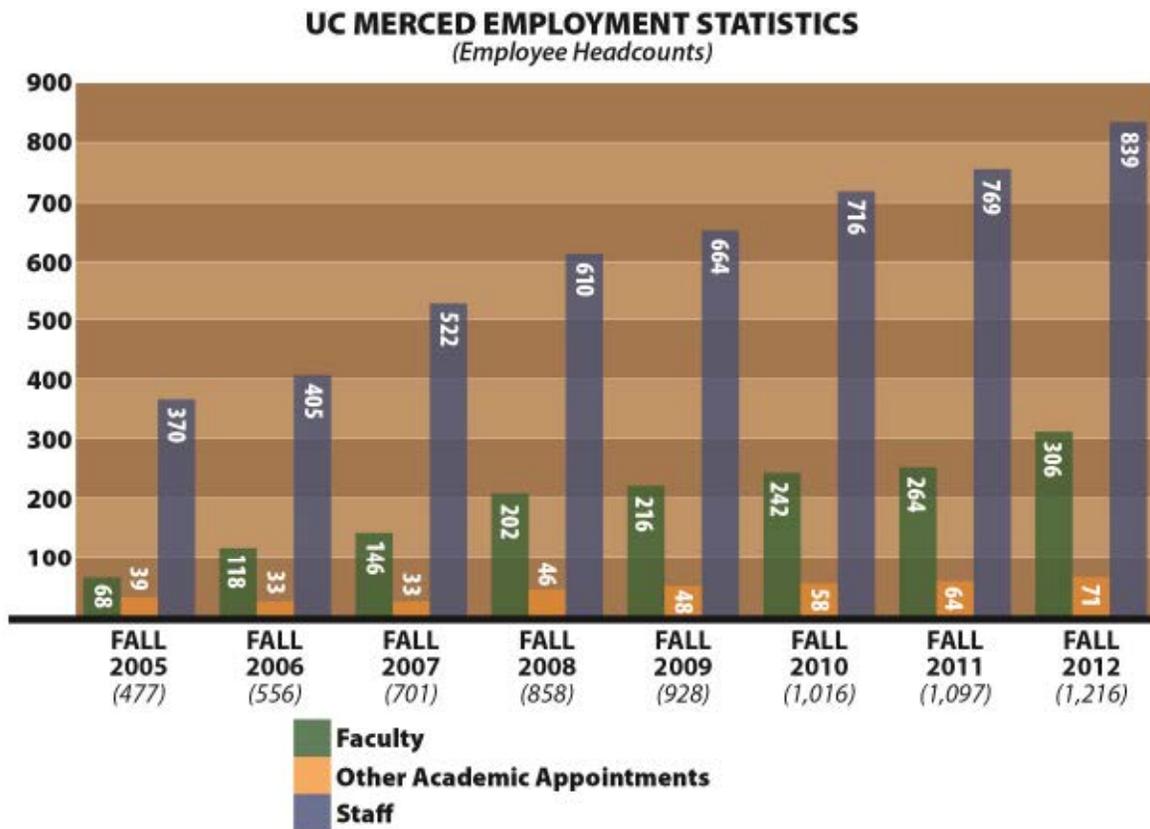


Figure 2

Merced Regional Enterprise Zone Map

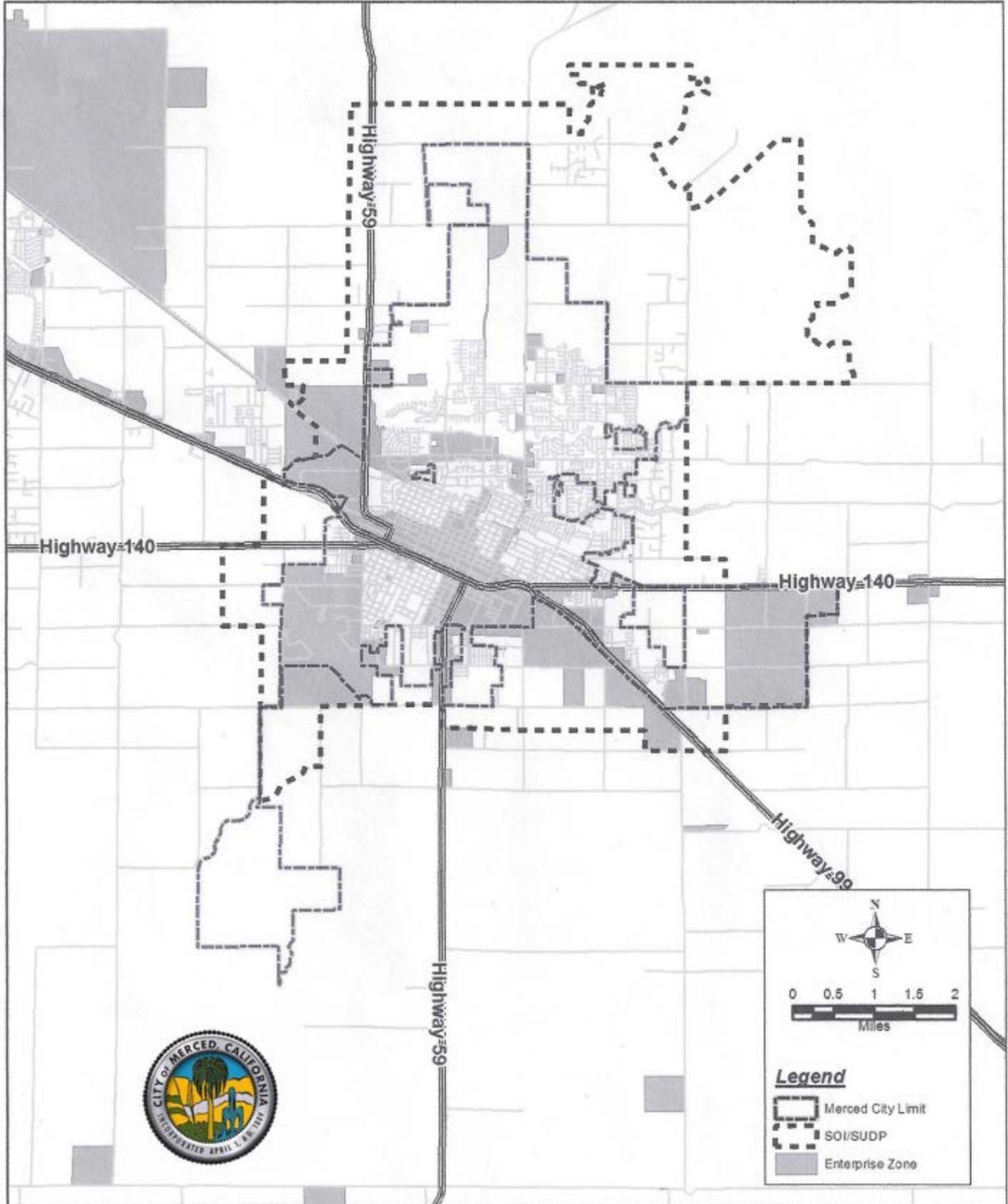


Figure 3

Merced City Limits Map

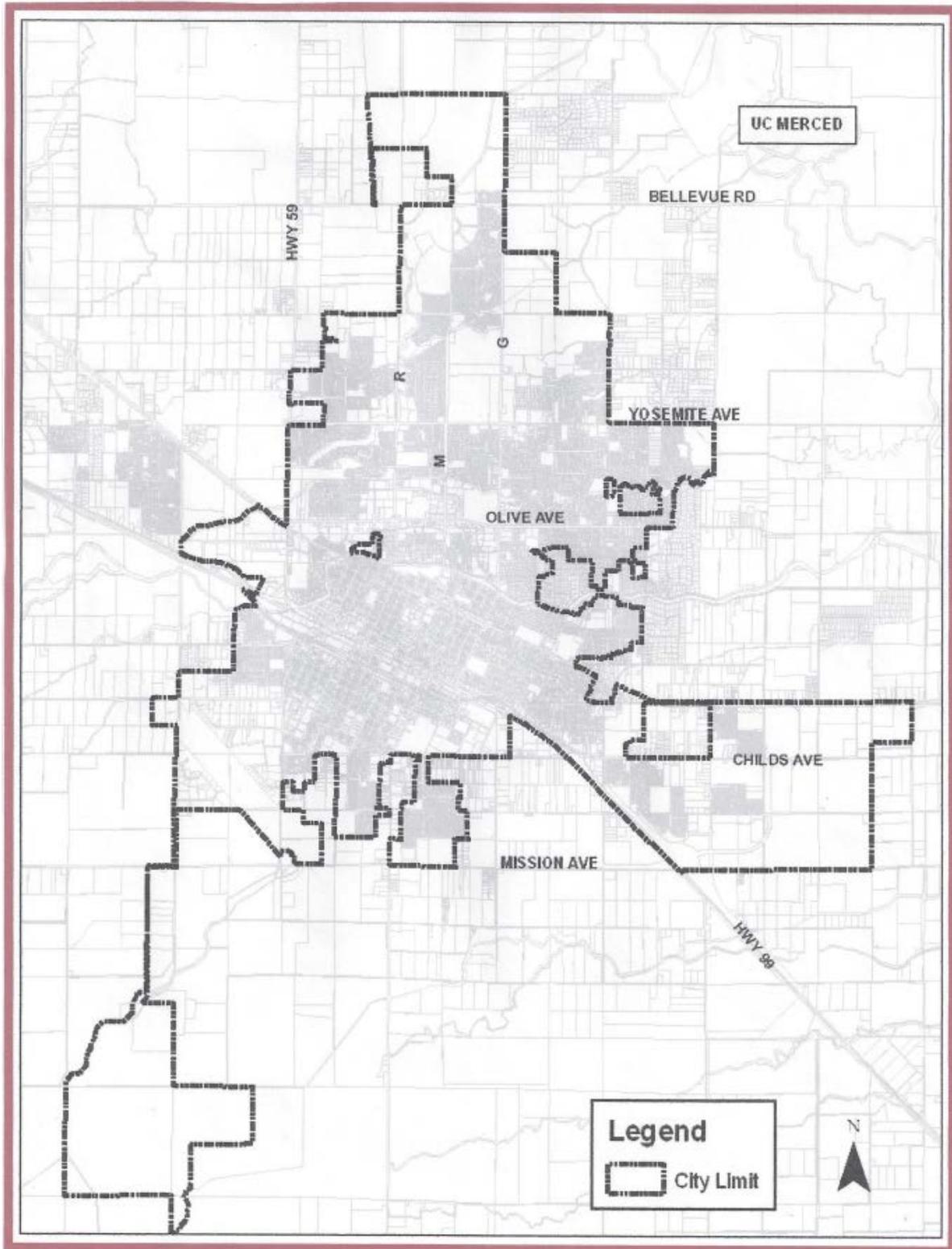
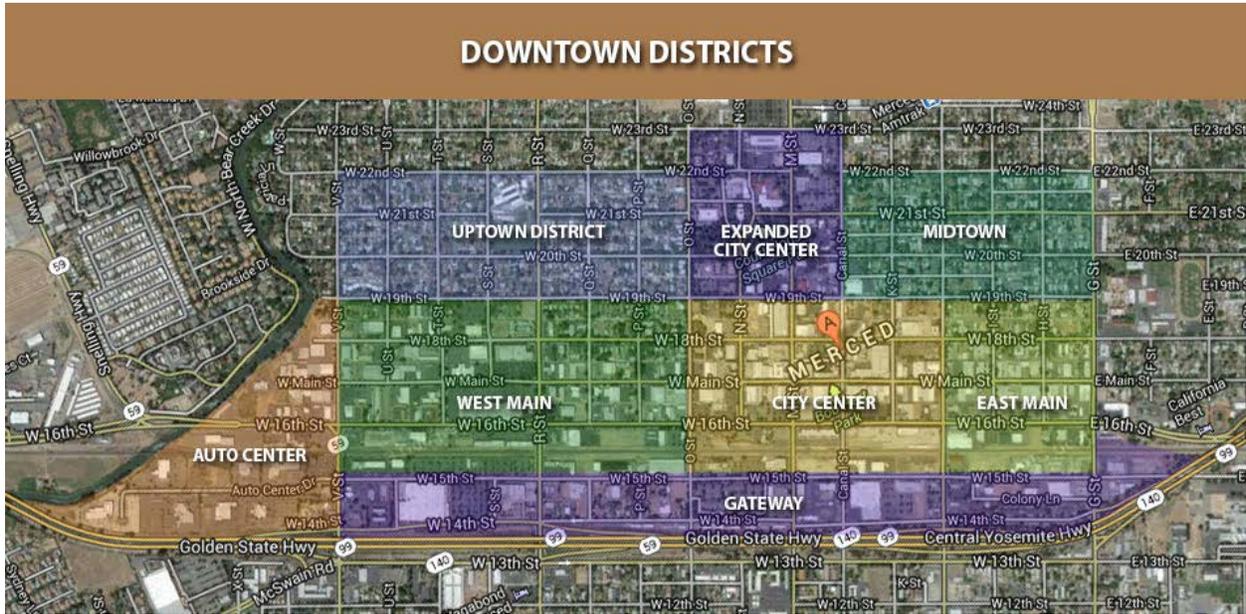


Figure 4

Downtown Districts per Downtown Strategic Plan



Downtown Merced is generally bounded by Highway 99 to the south, Burlington Northern Santa Fe line to the north, "G" Street to the east and "V" Street to the west.

Downtown contains eight distinct districts. These districts are unique in their design and economic function.

SECTION 2 Property Descriptions and Market Area Definition

The Shaffer Building

The subject property was built in 1912. There are two adjoining structures—a three story building on the northeast corner of M and West Main and a two story structure which fronts on West Main. Property records for title search purposes are found fewer than 541 and 557 West Main Street, Merced, and California. However, over time, several related addresses have been assigned to the building including 509 West Main. The Assessor Parcel No. for the property is 031-141-013-000. In 2000, the property was placed in the Razzari Family Trust, Timothy F. and Billie K. Razzari Revocable Trust. The Razzari Family has had ownership in the property since the 1980s.

The property is described as Lot 9 and 10, Block 163, Map of Town of Merced, original recordation March 4, 1889, in the City of Merced, County of Merced, State of California, as per plat recorded in Book 31 page 14 of records of said County.

The estimated gross square footage of all three floors is approximately 48,000 square feet. Net useable rental area after removal of common areas and utility rooms is 30,000 square feet. The assessed valuation on the title report is slightly above \$1,100,000.

At present the building is over 90% vacant and in disrepair. A small barber shop operates out of the easterly two story building. Former tenants include a bank, a medical office complex, a social services office, and retail.

There is a for lease sign on the building but no commercial broker listing. The building is in poor condition and most of the building is not in leasable condition. Major repairs will be needed to put the subject property into full service at market rents.

Public parking in City of Merced lots adjoins the building to the north. On street parking along West Main is also plentiful.

Surrounding land use includes a catering service and public parking to the north, a mixed use two story retail and office building to the east, the County District Attorney's office to the south, and across the street to the west, a two story retail and office building.

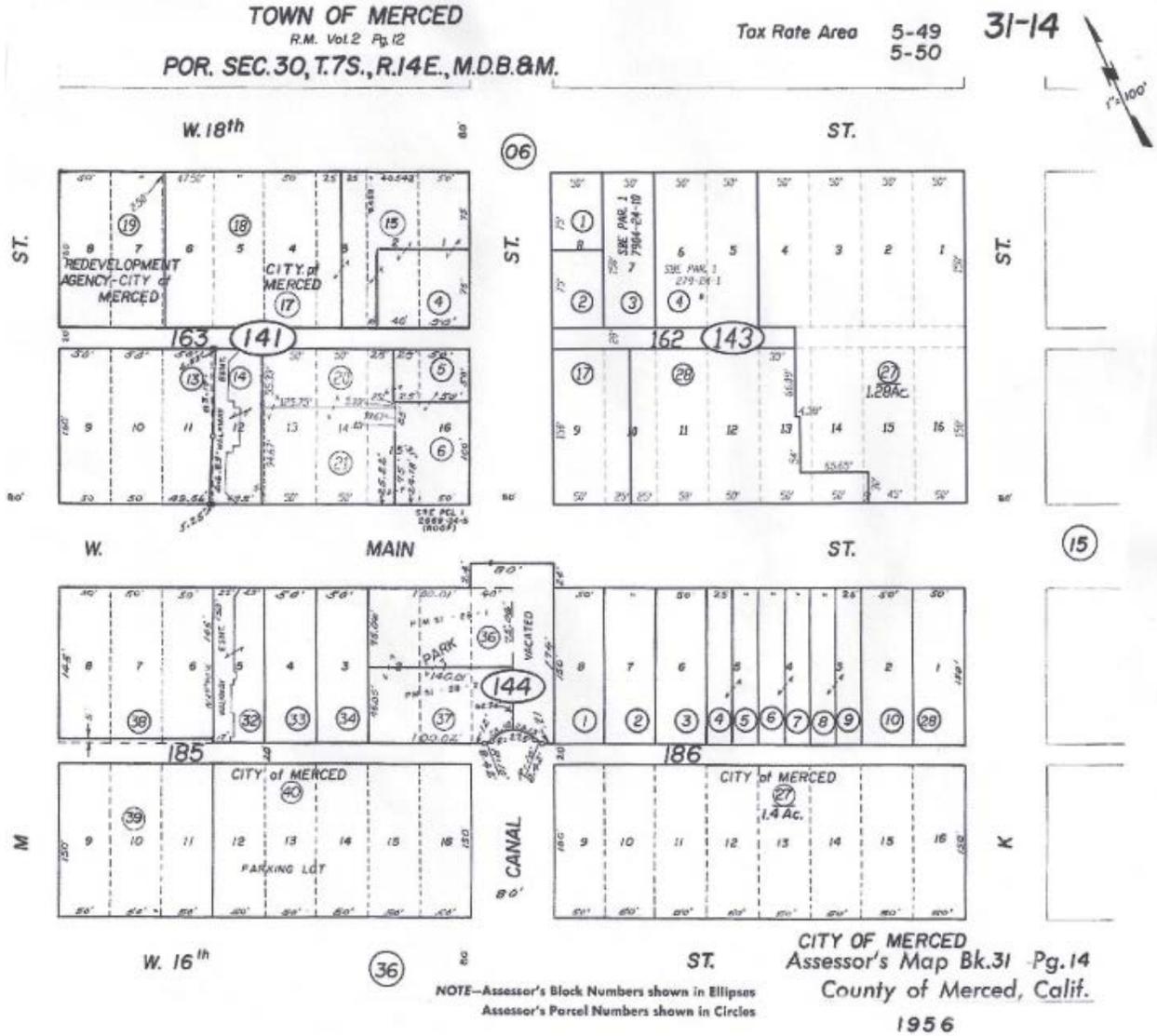
Table 4

Property Profile

Owner	Address	Parcel/Tax ID	
RAZZARI,TIMOTHY F & BILLIE K CO-TRUSTEES TR	541 W MAIN ST MERCED , CA 95340	031-141-013-000	
Property Profile			
Ownership Information			
Primary Owner	RAZZARI,TIMOTHY F & BILLIE K CO-TRUSTEES TR	Site Address	541 W MAIN ST
Secondary Owner		Site City, St Zip	MERCED, CA 95340
Ownership Description	Trustee	Mail Address	1234 AUTO CENTER DR
Telephone Number		Mail City, St Zip	MERCED, CA 95340
Lot	9	Census Tract	0013.02
Housing Tract / Subdivision Name	/ MERCED		
Legal Description	MERCED LOTS 9 & 10 ETC BLK 163		
Property Details			
Use Code	Commercial miscellaneous		
State	C A	County/Municipality	MERCED
RTSQ		Total Rooms	
Zoning		Bedrooms	
Number Of Units		Bathrooms	
Year Built		Basement Square Feet	
# Of Stories		Parking	
Lot Size		Parking Square Feet	
Usable Lot Size		View	
Lot Depth		Pool	
Lot Width		Fireplace	
Square Feet		HT/AC	
Square Ft 1st Flr		Cooling Detail	
Square Ft 2nd Flr		Heating Detail	
Square Ft 3rd Flr		Roof Type	
Additions - Square Feet		Construction Quality	
Building Shape	Other	Construction Type	Other
New Page Grid	794D6	Exterior	
Old Page Grid		Foundation	
Tax Information			
Assessor's Parcel Number/Tax ID	031-141-013-000	Assessor's Market Value	
Assessed Total	\$1,138,514	Tax Amount	\$12,713
Land Total	\$160,000	Status/Yr Delinquent	Current
Improvement	\$970,000	Tax Rate Area	5050
Percent Improvement	85.19%	HomeOwners Exemption	N
Sale Information			
Last Sale Date	Jan 01, 1985	1st Loan Amount	
Document Number	0000020809	2nd Loan Amount	
Sale Value		Last Transaction W/O \$	
Cost / Square feet		Last Transaction W/O \$ Doc	
Title Company			
Lender			

Figure 5

Assessors Map of Property Vicinity



In order to analyze market conditions, the geographic limits of the market area need to be delineated. In the case of the Shaffer Building or any commercial location, it is common to look at demographic demand characteristics of primary (neighborhood level), secondary (community level), and tertiary (regional) areas and examine how these characteristics translate into demand for the project location.

Generally, retail demand analysis involves simple rings or polygons. For purposes of this strategy, one mile, three mile, and twenty five mile rings will be utilized. Population and demographic statistics have been compiled and will be contrasted between these areas. The data set utilized is sourced from Dunn and Bradstreet's demographic service, Nielsen Solution Center.

The Appraisal Institute has set standard criteria for shopping center market definition:

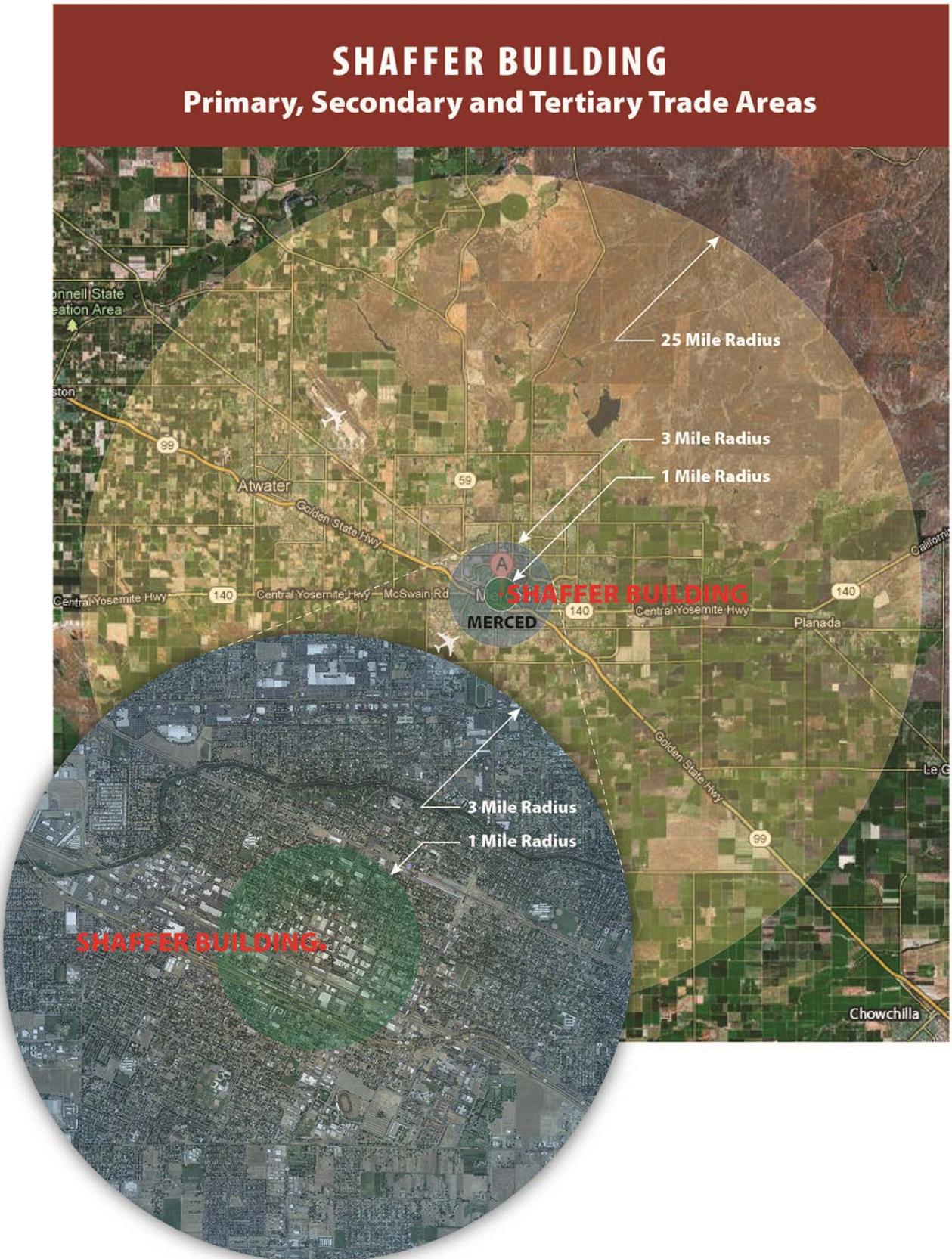
- Neighborhood Center-Supermarket or Drugstore anchor, 30,000-100,000 square feet in size, 4-10 acres, trade area of 5,000 to 40,000 population, 1 to 1.5 mile ring.
- Community Center-Junior Department Store, Super Drugstore, Home Improvements, or Clothing store anchor, 100,000-300,000 square feet in size, 10-30 acres, with a trade zone of 40,000 to 150,000 population, typical 3 mile ring.
- Regional Center-anchored by Department Stores, 300,000 to 1,000,000 square feet in size, 30 or more acres, with a trade zone of 150,000 to 500,000 in population, drive time radius of 30 minutes for its trade area draw, typical 25 mile ring.

The Central Core Area of downtown Merced, adjoining Main and 16th Street is similar to a Neighborhood Center, the Merced Mall is a Community Center, and all of the downtown area with the Auto Mall/Costco between Highway 99 and Bear Creek would qualify as a Regional Center.

The demographic profile generated by Nielsen's "Demographic Snapshot" data base will be presented in the next section of the report. The data has been compiled in 1, 3, and 25 mile rings.

Housing demand also follows demographic characteristics and Section 3 will also examine the population, income, and age characteristics that drive housing demand for Merced.

Figure 6



SECTION 3 Market Demand Analyses (Socio-Economic Trends)

In order to better understand the concentric market zones, we need to first look at community socio-economic information from the Merced General Plan/Housing Element and statistics from the State of California Department of Finance to establish trends for the entire community.

State of California Trends

According to the State of California, Department of Finance, the State of California grew by almost 250,000 new residents in 2011. Total State population is 37.7 Million people as of May 2012. The annual growth rate for California is 0.7%, much lower than the prerecession rate of 1.5% per year.

In terms of numbers of persons, the four growth communities were Los Angeles, San Jose, San Diego and Fresno. Measuring percentage growth, the fastest growing communities are California City in Kern County (3.7 %), Winters in Yolo County (3.5 %), Dinuba in Tulare County (3.4 %), and Eastvale in Riverside County (2.8 %).

The growth in Dinuba and Fresno has some influence on Merced County growth. Fresno is now the fifth largest city in California, 505,000 population, growing at 1.5% per year. Stockton is the third fastest growing community under 300,000. Its population was 295,707 in 2012. Merced finds itself midway between two major population and growth concentrations.

City of Merced Trends

As of 2013, the City of Merced population was approximately 80,599 persons. This represents 30% of the countywide population of 258,736. The current annual growth rate for the City is about 0.5% per year. Merced's overall population is growing slower than the State and much lower than the region. The average family size is 3.144. Median age is 27 years, substantially lower than the State average. The college age cluster of 20-25 years is the largest and represents 4.5 % of the population.

There are 27,412 housing units, of which 16,856 are single family homes, about 62%. About 4,691 of the units are multifamily housing, approximately 17%. About 60% of households rent, making the Merced housing market have a high rental demand.

Merced is a recipient of a substantial amount of emigrant demographics. About 22% of Merced residents are foreign born. Approximately 40% speak a language other than English, demonstrating the cultural vitality and diversity of Merced. Hispanic or Latino racial characteristics show a 41% level. The Asian population is at 13%.

There is also a high number of families below the poverty line, 22% in the 2000 census. In 2000, the median family income was \$30,000 per household.

Educational level data shows Merced college graduates at 15% of the population. This trend is expected to increase substantially with the presence of UC Merced.

Downtown Merced Trends (Highway 99 Gateway and Main Street Core)

The downtown core has experienced several cyclical changes over the past 30 years. The City of Merced has had an aggressive redevelopment program during this period and the recent termination of California redevelopment agencies and financing has been a major blow to downtown Merced. The 1991 Downtown Strategy sought to maintain the area as the primary governmental center and promoted the core as an office and education focus for the community. Regional development of freeway oriented development in retail land uses was introduced and has been very successful. The “Gateway District” along Highway 99 is vibrant and healthy.

In 1999, a revised strategy focused on small retail and boutique style projects along the Main Street corridor and introduction of an Entertainment District approach. The strategy also aggressively sought to develop a business class hotel and a youth center. Downtown streetscaping and aesthetic physical improvements were implemented.

In 2007, a final revised strategy was put in place making the downtown a diversified entertainment and arts center. Utilizing then available redevelopment funding, several older buildings were restored and occupancy levels increased to historic high levels. Downtown capitalized on the Central Valley building boom and new investment following the creation of the UC Merced campus.

Despite this progress, the downtown has continued to lose population and income levels to the northern suburban areas. New retail construction also boomed in the north, sending most corporate retail development to Olive and G Streets.

Downtown has continued to be a mecca for innovative startup businesses and unique small, independent retailers. Unique restaurants have also found a home in the downtown district. The resident population is changing with the introduction of loft style housing in the mixed use development along West Main. The student population has also been drawn to the downtown environment.

The current trend has been a mix of student and young professional oriented businesses and the growth of some educational and government oriented offices. The population base of the downtown continues to be younger and lower in income than the suburban north.

Table 5

California Dept. of Finance, City and County Population and Household Estimates, as of 1/1/2013

E-5 City/County Population and Housing Estimates, 1/1/2013

County / City	POPULATION			HOUSING UNITS							Vacancy Rate	Persons per Household	
	Total	Household	Group Quarters	Total	Single Detached	Single Attached	Two to Four	Five Plus	Mobile Homes	Occupied			
Merced County													
Atwater	28,931	28,829	102	9,858	6,302	607	1,627	582	740	8,917	9.5%	3.23	
Dos Palos	5,036	5,008	28	1,699	1,452	0	81	120	46	1,500	11.7%	3.34	
Gustine	5,626	5,626	0	2,089	1,721	48	85	84	151	1,881	10.0%	2.99	
Livingston	13,542	13,538	4	3,382	2,865	11	189	263	54	3,215	4.9%	4.21	
Los Banos	37,017	36,836	181	11,499	9,608	142	475	878	396	10,371	9.8%	3.55	
Merced	80,599	79,408	1,191	27,487	16,856	1,043	4,087	4,755	746	24,936	9.3%	3.18	
Balance Of County	91,727	87,555	4,172	28,108	22,297	674	1,007	738	3,392	25,208	10.3%	3.47	
Incorporated	170,751	169,245	1,506	56,014	38,804	1,851	6,544	6,682	2,133	50,820	9.3%	3.33	
County Total	262,478	256,800	5,678	84,122	61,101	2,525	7,551	7,420	5,525	76,028	9.6%	3.38	

Source: California Department of Finance, Demographic Research Unit (May 1, 2013)

Ring Data Comparisons/Primary, Secondary, and Tertiary Market Analysis

Touchstone Consultants purchased a current demographic ring study for the Shaffer site in February 2013. Data was compiled by Nielsen Demographics. The following area profiles were compiled: 1 mile, 3 mile, and 25 mile rings. (See Primary, Secondary, and Tertiary Trade Zone Map, Figure 6).

For the immediate one mile ring of the downtown core, there is a significant residential population of 17,171. Population has seen a 7% decline from 2000-2010. Hispanic population is high at 65% of the population base. The report shows a 12% unemployment rate with a substantial number of persons, 44% not participating in the labor force. The median age is 29 years. The largest age cohorts are from 25-34 years. The current 2013 average household income level is \$37,520. Most households rent with 72% of units renter occupied. The median home value is below area averages at \$113,405.

The secondary 3 mile ring has a contrasting profile. This ring encompasses all of the Merced citywide population and its fringe with a current population of 85,588. This area is expected to have growth of 5% over the next five years, reaching 89,946 in 2018. This area has a lower Hispanic and Asian population profile. The median age is similar to the downtown with a strong cluster in the 25-35 age range. College levels are much higher at 14% of the population. Incomes are substantially higher at an average household income of \$54,189. The median home value is \$132,142.

The largest or tertiary trade ring is 25 miles and reaches the County border to the north and extends down to Chowchilla and Madera County to the south. It falls short of Los Banos which is a separate market with its Bay Area Commuter profile. This larger area has a population base of 304,664 and is growing a little slower than the secondary ring at 4.8% over the next five years. The Hispanic and Asian populations are higher than the secondary ring but lower than the downtown ring. Age characteristics are much older than the downtown and Merced rings at 31.2. Educational levels are lower than the Merced area ring but higher than the downtown area. The income levels are the highest of all 3 rings at \$57,967 indicating the location of higher income households in rural and suburban areas. Household size is the largest at 3.26. Housing values are also higher at \$141,420. Homeownership is highest in this larger trade area at 54% owner occupied. Rental demand is lowest in this zone.

SECTION 4 Competition and Supply Analysis (Real Estate Survey)

Overall Real Estate Trends/Current Market Conditions

Over the past 4 years, beginning with the Great Recession of 2008-2011, the U.S. real estate market has been severely impacted with substantial loss of values and enormous increases in financial defaults and foreclosures. This economic collapse has been most dramatic in the housing market but has also impacted retail, office and hotel markets.

Merced and the Central Valley have experienced a deeper recession than the coastal area of California and other parts of the United States. Much of the growth in the Merced County Market was lost to the recession and the local market is resetting itself near base conditions from several years ago. The local real estate markets are finally in recovery and stabilization but there is still uncertainty about the strength of the recovery. New construction is still largely frozen but the rehabilitation and reuse of existing buildings is on the rise. Vacant inventory is being absorbed. Rents will eventually increase to a point where new construction demand will reengage. Commercial and residential mortgages continue to be suppressed and are expected to rise and the economy recovers. In the meantime, the financing costs of construction are extremely low.

In addition to the economic downturn, there are several technological, cultural, and demographic trends that are reshaping the real estate markets of the 21st century. The emergence of on line shopping is having a direct impact on the physical needs of retail space. Home based business and work trends are reducing the size and needs of office space planning. Residential home sizing is towards the smaller more energy efficient home and many retirees are looking to a downsized life style in multifamily housing. There is a return to urban inner city living by older adults and the reduction in family size, postponement of child bearing among the youth population is creating a steady increase in demand for a more urban and higher density residential pattern. All this speaks to increased demand for housing in revitalized buildings in downtown environments, similar to the Shaffer Building location.

Touchstone Consultants interviewed key local real estate experts in February and March of 2013 and also conducted extensive drive by surveys, collecting for lease contacts and compiling building vacancy square footages. This data has been compiled to estimate local market conditions in terms of rental demand, pricing, vacancy factors and the implications for use of the Shaffer Building. Since the Shaffer Building has a mixed use zoning potential, we have separately examined the housing, retail, office, and hotel markets for the downtown, the Merced community and the larger Merced County market areas. Touchstone Consultants also acquired detailed property rent and vacancy surveys from Reis Reports, Inc., a major real estate technical market data provider.

Touchstone Consultants wishes to thank the real estate market experts that have participated in our stakeholder interview process and acknowledge that much of the data in this report has come from the following people:

- Salvadori Property Management (Tammy)
- Loren Gonella, Coldwell Banker Gonella Realty
- Kathy Hoffman, Property Manager, Gonella Realty
- Robert Olzack, Commercial Division, Gonella Realty
- Dan Gallagher, Commercial Division, Gonella Realty
- Karen Baker, Development Services, City of Merced
- Frank Quintero, Economic Development, City of Merced
- M. Westerdoll, County of Merced
- Anika Khan, Senior Economist, Wells Fargo Securities
- Mark Vitner, Senior Economist, Wells Fargo Securities
- Ed Laplante, Associate Realtor, Tinetti Realty Group
- Steve Tinnetti, Owner Principal, Tinetti Realty Group
- Jacob Morgner, Associate Realtor, Tinetti Realty Group
- Tasha Bass, Property Manager, Tinetti Realty Group, Property Mgt.
- Travis Gutke, Harmon Management Group
- T. Soloman, Cosol Real Estate
- Tim Bettencourt, Cosol Real Estate
- Commercial Retail Associates (CRA)
- Shannon Ramer, Research Analyst, CBRE Fresno Commercial Office
- Abigail Christian, Research Manager, CBRE Fresno Commercial Office
- R. Cordes, Northwest Outlets Inc.
- Yasser Sadik, Private Property Owner

- Stephen Blank, Urban Land Institute, Researcher “Emerging Trends in Real Estate 2013”
- Dean Schwanke, Urban Land Institute, Researcher “Emerging Trends in Real Estate 2013”
- Carol Griggs, Manager of Best Western, Downtown Clovis, CA
- Modesto Visitors Bureau

In addition to real estate experts, Touchstone Consultants conducted stakeholder interviews with organization representatives on concerns and considerations for downtown development. The following citizens participated in the survey:

- Adam Miller, Managing Director, Merced Theatre Foundation
- Rich McMillan, Radio Merced
- Tom Price, Downtown Life Magazine
- John Cardenas, Director, Merced Multicultural Chamber of Commerce
- Steve Simmons, downtown business person, NLBDG Consulting
- John Franco, UC Merced graduate student

Interview questionnaires are available upon request.

The Housing Market

Home Ownership

After several years of declining values, Merced home prices are finally increasing. Average single family home prices have risen 24% from \$109,000 to \$135,000 as of December 2012 (Gonella Realty). Inventories are at historic lows with only two months of normal demand available. In Merced County, bank owned foreclosure sales have declined dramatically with standard sales now being over half the listings, short sales 33%, and bank owned distress sales only 10%. This shows that the single family residential market is healing and showing significant recovery. New construction is still almost non-existent, down from the 1400 units in 2005, at the height of the housing “boom.” What little new construction that has occurred is in suburban areas outside the City of Merced.

This trend is following the U.S. market dynamic. According to the National Association of Realtors, from January 2012 to August 2012, there were 4.82 million homes sold in the nation. This was an annual increase of 9.3%. Median sales prices for the U.S. were up 11.5% to \$180,800. Demand is fueled by increased consumer confidence, falling unemployment rates, and interest rates between 3.5-3.75%.

The news has been good for the State of California as well. Prices were up to \$343,000 as of August 2012, a 15.5% annual increase. Equity or standard sales make up most the transactions at 62%. Real Estate Owned (REOs) have fallen to 14% of transactions. According to the California Association of Realtors, inventories remain is short supply. In California, a substantial amount of the transactions have been investor driven with purchases for “flipping” or short term holds as rentals for future appreciation. The investor dynamic in California has limited the inventory available for first time homebuyers, causing an increased demand in multifamily rental housing.

The Central Valley has followed these national and statewide trends. Fresno County is up 7%, Kern County is up 16%, Sacramento County is up 20%, and Stanislaus County is up 5.2%.

Rental Housing

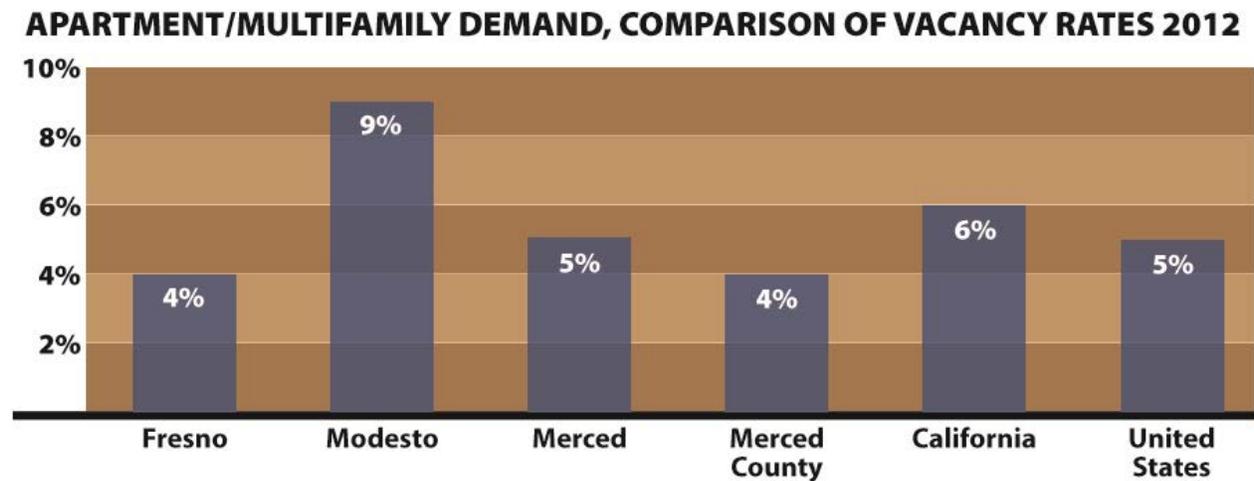
Conditions for the rental market are becoming more favorable. Demand for multifamily has been increasing in the national and California markets for over 2 years. Government financing and subsidies are still available for affordable housing and some of the last remaining redevelopment funding has been targeted to multifamily housing projects. Multifamily housing became of more interest in the wake of the foreclosure crisis. Many were forced towards rental housing; others felt it prudent to wait out the disruption of the ownership market and continue to rent. The result was increased multifamily and apartment demand. The increased interest in transit oriented development near transportation nodes has also spurred apartment demand. Lifestyle and economic necessity have combined to create a recession demand wave for multifamily rental housing. Nationally, the apartment vacancy rate fell to 4% in 2011. New construction has increased 27.3% over the past two years and this new supply is expected to cool the apartment market slightly in 2013 and 2014. Still rents are on the increase and projects continue to fill up.

As depicted in the following bar chart, Merced County apartment demand is solid with a 6% vacancy factor at the end of 2012. This rate is not as strong as Fresno demand but better than Modesto’s 9%. Apartment demand in the Central Valley is strong and mirrors statewide demand with a vacancy factor of 6%. The City of Merced has an even lower vacancy at 4%.

Average rents for Merced County apartments are around \$700 per unit. Rents are stable and only increasing at .5% per year. Statewide rental rates have been going up at 3% per year. City of Merced apartments average about \$650 per unit per month.

The sales price per unit for Merced apartments is also strong. Older complexes are selling in the \$17,000 per unit mark while new complexes command around \$45,000 per unit. A West 18th Street property, very close to the Shaffer location sold at \$40,000 per unit in 2009.

Figure 8



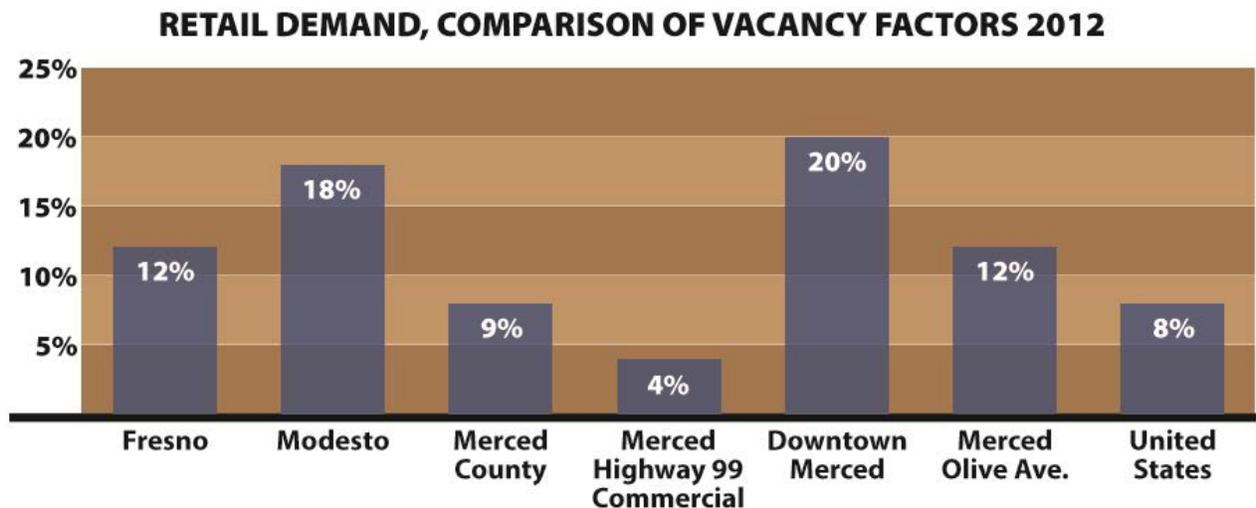
The Retail Market

In the U.S., the retail recovery is underway but the momentum is tenuous. A big factor in this market is the steady acceptance and use of E Commerce and less brick and mortar building development. Consumer confidence is steady and key products have cycled through to necessity purchases, especially in durable goods and automobiles. Real estate prices in retail have been flat but vacancies have been dropping. Cap rates on retail real estate are around 7%. Personal consumption of retail goods is moving up at a modest 2% per annum rate. US vacancy rates for retail average 8%, lower than California retail real estate.

Rents in Merced have been dropping and not keeping pace 1-2% increase in the U.S. and the Western United States. The Merced average mean rent per square foot per year has been running at \$15.28 triple net or about \$1.27 per SF per month. Rents in the downtown area are substantially lower, ranging from \$.50 per SF per month to \$1.10 per SF per month. The average rent in downtown Merced is around \$0.75 per SF per month. Rents on Olive Avenue are consistently over \$1.00 per SF per month with the Merced Mall holding steady at \$1.50 per month per SF for the satellite non anchor retailers.

Vacancies in Merced County average 9%, with highway commercial areas running 4% and downtown, central Merced reaching 20% vacant. Olive Avenue averages 12% vacancy, running very close to Fresno and Modesto vacancy rates.

Figure 9



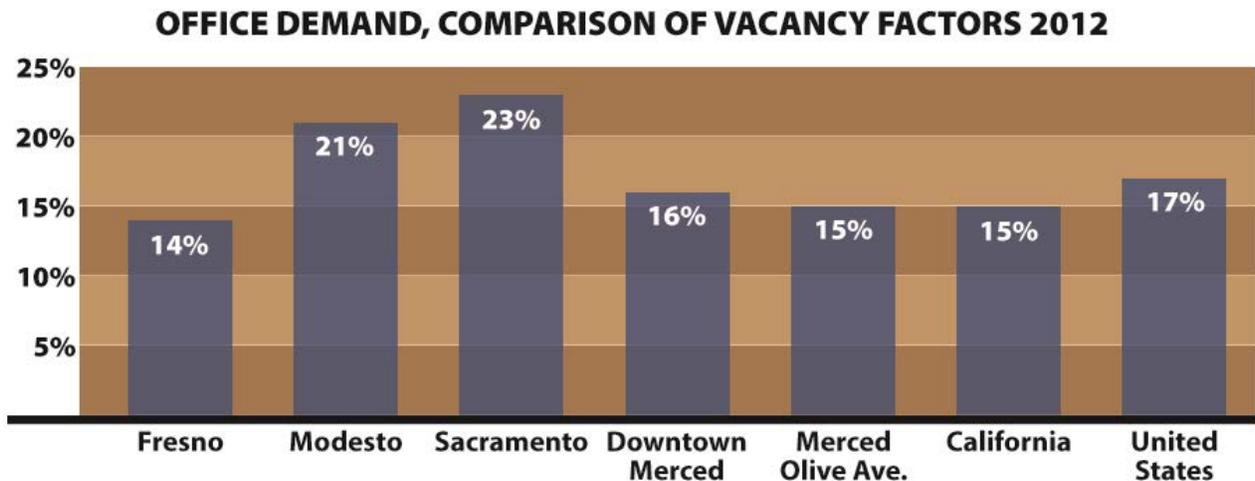
The Office Market

During the economic expansion of 2000-2007, a substantial amount of speculative office space was built throughout the United States. The office market has been especially soft in California but increased supplies during the real estate “boom” has caused this market to lag behind in the current mild recovery. Office space is driven by employment and business growth and a sluggish economy and high unemployment causes oversupply in the market. Until the large inventory of vacant space is absorbed, the demand for new office buildings will be very low.

In the United States, the office vacancy factor has stabilized around 17%. California is lower at 15%. In the Central Valley, Modesto and Sacramento are over supplied with 21 to 23% vacancy factor. Merced is 15-16% vacant and follows the State trend. There are several vacant office buildings in downtown Merced, with the Shaffer being a prime example.

Office rental rates are \$1.40 per square foot per month in Fresno. The high rents are in the North Herdon submarket and the rents in downtown Fresno are running \$1.15 per square foot per month. Downtown Merced office rents are at \$0.85 to \$1.00 per square foot per month.

Figure 10



The Hotel and Visitor Services Market

The final land use market for the Shaffer Building is the hotel market. Merced is a major gateway to Sierra recreational sites and Yosemite National Park. The high visitor traffic during summer months has fed a strong demand for affordable accommodations in Merced. There is a very large concentration of hotel units in the vicinity of the intersection of G Street and Highway 99 and at Yosemite Parkway and Highway 99. It is estimated that the motel district has approximately 800 units with an average property size of 52 units. Room rates vary with season and day of week. On average the room rates in Merced are \$80 to \$90 per room per day. These rates are very affordable and explain Merced's fairly high occupancy rate. Merced hotels and motels are family friendly and affordable. As a result, Merced runs a strong average occupancy rate of 67%. The U.S. average occupancy is 65% and the State averages 69%. Nearby communities are averaging 50-55% occupancy rate. Rates in Fresno and Stockton are higher, commanding over \$100 per night.

The amenities of Merced hotels and motels are on par with other Central Valley cities. The Merced hotels lack sizeable meeting rooms and spaces but so do almost all surrounding communities, with the exception of the Double Tree in Modesto, which is a significant participant in the convention trade. Merced does offer a small high end bed and breakfast which is very successful. The market data indicates support for a small high end business oriented facility.

Figure 11



SECTION 5 Highest and Best Uses of the Shaffer Building (Alternatives)

After compiling all demographic demand factors, current growth projections, and analyzing the existing real estate market for supply and use, Touchstone Consultants is recommending the following ranking of project tenant potential. The listing of rank order is not based on any individualized real estate proposal but on real estate demand factors and the level of completion for tenants.

The following potential uses are recommended for the Shaffer Building:

- Multifamily Housing on the Second and Third Floors
- First Floor Retail

Suggested High Demand Tenants are Pharmacy, Clothing Store, Sporting Goods Store, or Convenience Market

- Professional Offices for an Educational Organization or Private Non Profit Service Providers (UC Merced Administration would be the preferred tenant)
- Small Business Oriented Hotel (40-50 Room) with Meeting or Classroom spaces

Market demand is the strongest for the multifamily housing component of the project. The demographics of the downtown and the City of Merced support the need for the development of housing at the site. Feasibility issues on off street parking may prevent the optimum implementation of a housing project. These concerns will be addressed in the Architect's report for the building.

Consolidation of UC Merced's demand for office space would be the strongest anchor for the building. At this time, UC Merced has not committed to a location and is

exploring two other sites in the downtown, both of which would involve new construction. The Shaffer is the most feasible sized existing building available to consolidate the expansion needs of UC Merced. Without this specific demand for space, the overall market for downtown offices is very weak. There is a high office vacancy factor in the downtown and rents are suppressed. Therefore a speculative office development is not recommended.

First floor retail also has high vacancy factors in downtown Merced. The existence of chain corporate big box development along Highway 99 is a substantial competition factor for the Shaffer Building. Retail development for the building must be focused on a neighborhood serving target list of retailers. There is not a neighborhood pharmacy in the downtown. Large grocery stores are located a few blocks west of Main Street. Therefore a neighborhood convenience store with specialty food items would be the best fit on Main Street. A target list of retail contacts will be provided with the Implementation Program in Section 6.

In conclusion, market supply/demand factors point to retail on the first floor with housing development on the second and third floors. If a specific commitment with UC Merced can be formulated, the property could be developed with first floor retail and administrative offices on the second and third floors. This would be the most preferred alternative and an anchor such as the UC would draw private construction funding to the project.

SECTION 6

Potential Funding Programs/Lender Contact List

SECTION 6**Potential Funding Programs/Lender Contact List**

Company	Street	City	State	Zip
Ygreen	900 College Ave	Santa Rosa	CA	95404
Ecology Action	877 Cedar Street, Ste 240	Santa Cruz	CA	95060
PG&E	P.O Box 770000	San Francisco	CA	94177
Paramount Equity	8781 Sierra College Blvd	Roseville	CA	95661
River City Bank	2485 Natomas Park Dr.	Sacramento	CA	95833
SBDC	1 Harpst Street, House 71	Arcata	CA	95521
Umpqua Bank	One Capitol Mall, Suite 600	Sacramento	CA	95814
Wells Fargo	6047 Sunrise Blvd	Citrus Heights	CA	95610
Chase	1305 Stratford Ave	Dixon	CA	95620
First Northern Bank	195 N First St.	Dixon	CA	95620
Neighborhood Partners, LLC	2745 Portage Bay East	Davis	CA	95616
Mercy Housing	1500 S Grand Ave., Ste 100	Los Angeles	CA	90015
J.S. Kendall Construction Inc	1470 Maria Lane, Ste 101	Walnut Creek	CA	94596
Pacific West Communities	26302 Table Meadow Rd	Auburn	CA	95602
Mercy Housing	3120 Freeboard Dr, Ste 202	West Sacramento	CA	95691
John Stewart Company	1455 Response Rd, Ste 140	Sacramento	CA	95815
JA Collins	720 Howe Ave, Ste 103	Sacramento	CA	95825
CB Richard Ellis	555 Capitol Mall, Ste 100	Sacramento	CA	95814
Hickey & Associates, LLC	333 Washington Ave North, Ste 300	Minneapolis	MN	55401
Cassidy Turely BT Commercial	520 Capitol Mall, 5th Floor	Sacramento	CA	95814
Pulte Homes	4196 Douglas Blvd, Ste 100	Granite Bay	CA	95746
	6625 The Corners Parkway, Ste 200	Peachtree Corners	GA	30092
Site Selection Magazine				
I Bank	PO Box 2830	Sacramento	CA	95812
GoEd	1130 K St., Ste 101	Sacramento	CA	95814
State of California	1800 3rd St, MS 390-3	Sacramento	CA	95811
I Bank	PO Box 2830	Sacramento	CA	95812
SBA	6501 Sylvan Rd, Ste 100	Citrus Heights	CA	95610
STAN Alliance	1010 10th St, Ste 1400	Modesto	CA	95354
Friedmans	4055 Santa Rosa Ave	Santa Rosa	CA	95407
Ernst & Young	275 Shoreline Dr., Ste 600	Redwood City	CA	94065
Viva Supermarket	4211 Norwood Ave	Sacramento	CA	95838
Comfort Suites	155 Dorset Dr.	Dixon	CA	95620
U.S Hotel	2601 Sagebrush Dr., Ste 101	Flower Mound	TX	75028
City of Merced	678 W 18th St.	Merced	CA	95340
City of Merced	710 W 16th St	Merced	CA	95340
City of Merced	678 W 18th St.	Merced	CA	95340
Kibby Road LLC	2269 Chestnut St., Ste 242	San Francisco	CA	94123
UC Merced				
Downtown Life				
Gonella Realty	701 W Olive Ave	Merced	CA	95348
UC Merced	5200 N Lake Rd	Merced	CA	95343
Go 1 Card	2255 Morello Ave, Ste 150	Pleasant Hill	CA	94523
UC Merced	5200 N Lake Rd	Merced	CA	95343
Toni's Courtyard Café & Bakery	516 W 18th St	Merced	CA	95340
Modesto Convention & Visitors Bureau	1150 9th St, Ste C	Modesto	CA	95354
Ross Stores Inc	4440 Rosewood Dr	Pleasanton	CA	94588
Quiksilver Inc.	15202 Graham St	Huntington Beach	CA	92649
The Men's Wearhouse Inc	40650 Encyclopedia Cir	Fremont	CA	94538
Gap Inc	2 Folsom St	San Francisco	CA	94105

Company	Street	City	State	Zip
The Gymboree Corp.	500 Howard St	San Francisco	CA	94105
99 Cents Only Stores	4000 Union Pacific Ave	Los Angeles	CA	90023
Haller's Pharmacy & Medical Supply	37323 Fremont Blvd	Fremont	CA	94536
Johnny Quik Food Stores	96 Shaw Ave, Ste 240	Clovis	CA	93612
Sierra Minit Marts Inc.	101 W Morton Ave	Porterville	CA	93257
Cost Plus Inc.	200 4th St	Oakland	CA	94607
Pharmkee Inc.	5796 S Elm Ave	Fresno	CA	93706
Walgreens - Fresno Division	114 E Shaw Ave, Ste 100	Fresno	CA	93710
The Disney Store Franchise	443 S Raymond Ave	Pasadena	CA	91105
Friar Tux Shop Inc.	1711 S Claudina Way	Anaheim	CA	92805
The Clothing Broker	5327 Jacuzzi St, Ste 3C	Richmond	CA	94804
Dick Bruhn Inc.	300 Main St	Salinas	CA	93901
Bebe Stores	400 Valley Dr.	Brisbane	CA	94005
Bedrosians	4285 N Golden State Blvd	Fresno	CA	93722
Sun Queen Inc.	1124 E Valencia Dr.	Fullerton	CA	92831
Pacific Retail Group LLC	17352 Von Karman Ave	Irvine	CA	92614
Louis H. Nicolaus Opticians	3301 Arden Way	Sacramento	CA	95825
Mail Boxes Etc. Inc.	6060 Cornerstone Ct. W	San Diego	CA	92121
PostalAnnex	7580 Metropolitan Dr., Ste 200	San Diego	CA	92108
Patrick & Company	611 Mission St, Fl 2	San Francisco	CA	94105
Johnson Development Corp.	9100 Wilshire Blvd, Ste 710E	Beverly Hills	CA	90212
Mr. Chow Inc.	344 N Camden Dr.	Beverly Hills	CA	90210
Marie Callender Pie Shops	27081 Aliso Creek Rd, Ste 200	Aliso Viejo	CA	92656
Islands Restaurants LP	5750 Fleet St., Ste 120	Carlsbad	CA	92008
Specialty Restaurants Corp.	8191 E Kaiser Blvd	Anaheim	CA	92808
Wolfgang Puck Inc.	100 N Crescent Dr, Ste 100	Beverly Hills	CA	90210
Panda Restaurant	1683 Walnut Grove Ave	Rosemead	CA	91770
Peet's Coffee & Tea Inc	1400 Park Ave	Emeryville	CA	94608
Sega Entertainment U.S.A., Inc.	600 N Brand Blvd, FL 5	Glendale	CA	91203
Rubio's Restaurants Inc.	1902 Wright Pl, Ste 300	Carlsbad	CA	92008
Coco's Restaurants Inc.	5780 Fleet St, Ste 250	Carlsbad	CA	92008
The Johnny Rockets Group Inc	25550 Commercentre Dr, Ste 200	Lake Forest	CA	92630
Harman Management Corp	8334 Gerber Rd	Sacramento	CA	95828
IHOP Corp	450 N Brand Blvd, Fl 7	Glendale	CA	91203
The Cheesecake Factory Inc.	26901 Malibu Hills Rd	Calabasas Hills	CA	91301
Jimboy's Marketing Inc.	1830 Sierra Gardens Dr	Roseville	CA	95661
Davro Enterprises	5435 Madison Ave	Sacramento	CA	95841
FoodBrand LLC	340 N Westlake Blvd, Ste 115	Westlake Village	CA	91362
Strategic Restaurants Corp	3000 Executive Pkwy, Ste 515	San Ramon	CA	94583
Carl's Jr. Region 3	1430 Blue Oaks Blvd, Ste 130	Roseville	CA	95747
Wendy's International Inc.	2140 Professional Dr, Ste 130	Roseville	CA	95661
Big 5 Sporting Goods	2525 E El Segundo Blvd	El Segundo	CA	90245
The North Face Inc.	2013 Farallon Dr	San Leandro	CA	94577
University Art Inc.	267 Hamilton Ave	Palo Alto	CA	94301
Beverly Fabrics Inc.	100 Cotton Lane	Soquel	CA	95073
KinderSport Jr. Ski & Sports Outfitters Inc.	3566 Sacramento St	San Francisco	CA	94110
Fisherman's Warehouse	2201 E Yosemite Ave	Manteca	CA	95336
Fisherman's Warehouse	17821 S Ideal Pkwy	Manteca	CA	95336
Any Mountain Ltd.	71 Tamal Vista Blvd	Corte Madera	CA	94925