To: John Peterson
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Subject: East Pointe Business District Proposal
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EXECUTIVE SUMMARY

Upon review of the San Antonio market and pertinent submarkets paired with rigorous analysis of the past and present market conditions, our opinion is that the defined product in the Northeast submarket of San Antonio has great potential to be a successful venture. Below is the definition of our proposal along with data and analysis to support our argument.

PRODUCT LOCATION AND DESCRIPTION

Our proposed site is situated at the corner of I-35 and Tech Com Drive in Northeast San Antonio. The site is currently bare, being one of the few undeveloped tracts remaining within this development corridor. The lot is 14.364 acres and we plan on developing the Southwest corner, proposing a Class B office building consisting of 3 stories, each with 10,000 SF of office space, and 30,000 SF of parking. The lot could be further developed in phases as necessary.

SUPPORTING ANALYSIS

Property Productivity Analysis

1. Physical Attributes

The subject property is a rectangular 14.364 acre lot, directly adjacent to our proposed area is a larger vacant land parcel. An addition to this, across the street of Tech Com Drive lies a vacant property with a creek and retention pond. This pond could be used in the future as a retention pond for proposed East Pointe Business District. Currently, all utilities including sewer, electricity, and and water are already provided to this lot.

Major interstate, I-35, runs directly adjacent to our property, as well two additional side roads Crosswinds Way, and Tech Com Drive. To provide direct access to the site, vehicles would enter from the north via Crosswinds Way, or via Tech Com Drive from the west. Both roads are adequately sized and feed into the I-35 and Wurzbach Parkway/O’Connor Road. Traffic count on I-35 in this area is approximately 200,000 plus vehicles per day, and traffic congestion can be problematic on I-35. Contrast to I-35, Crosswinds Way and Tech Com Drive does not have heavy traffic. Nearby residences from the neighborhoods have access to the site without needing to use the interstate.

The abundance of roads which feed into the neighborhoods may be advantageous to nearby patrons. Roughly 260,000 residents live in nearby neighborhoods, utilizing the I-35 for short distances is typically time consuming, especially during peak hours. Residents can easily avoiding driving on the interstate by utilizing alternative routes, such as O'Connor Road to minimize time spent in vehicle.

The land lot sits approximately .9 miles away from the 100-year floodplain. The location, like much of North East San Antonio is within the 500-year flood plain.

2. Legal and Regulatory attributes

The parcel is currently zoned C-3, meaning our proposed Office Development should not have any regulatory constraints. All direct adjacent properties to our proposed development are also C-3. Tenant makeup will be mixed, with all offices being leased will be private. Tenants will have leased fee estate right to property.

3. Location Attributes

Adjacent property to proposed East Pointe Business District is the Alorica San Antonio Crosswinds office, built in 2015. This office provides a diverse small private call center business. Their location is isolated away from most other businesses. In addition to that, within a quarter mile of the development, there is a McDonald's, Sonic Drive-in, two hotels, Bingo Hall, Enterprise Car Rental, U.S. Post Office, Bank of America Calling Center, Walgreens, Shell Gas Stations, and a Lowe's.

The nearby location is ideal for employees within a 20 minute commute; approximately 260,000 residents live in this area, and a few million within an hour commute. In addition to the surrounding neighborhoods, the I-35 connection between San Antonio and Austin has the largest volume of goods transferred from Mexico into the United States. 80% of all Mexican imported truck goods come through the State of Texas, and 75% of those goods get transfered via I-35 from San Antonio to Austin.

With an increase demand and growth of imported goods from Mexico, cities like San Antonio whom lay in direct commercial path of trade see an increase in jobs and populations. The Austin-San Antonio 76 mile I-35 stretch has become one of the fastest growing areas in the United States. In addition, it has become desirable for both domestic and international immigration for numerous opportunities.

Some major opportunities in the Northeast San Antonio market is the ongoing leniency in property taxes for development, lower cost of living compared to the United States, and constant positive job growth. The two cities of Austin and San Antonio are continuing to grow at a fast pace, where eventually by 2030 it is projected the two cities will merge and be megapolitan region. In the Northeast area of San Antonio, there are underdeveloped land parcels along I-35. These plots in the future will increase in price with population and job growth.

Market Delineation

Within the market of San Antonio, the Northeast Submarket has a variety of important, unique characteristics that help delineate the market of our office proposal. The first source of unique characteristics are its demand sources. San Antonio itself is growing at an annual growth rate of 1.494%, and is currently sitting at a population of 1,512,000. 26.7% of the population, on average, are college graduates (minimum requirement of Bachelor's). With that educational standard in mind, there is 64.3% of that population that is currently participating in the workforce. That yield an average median income of $48,813. These figures are slightly less opportunistic than the Northeast submarket, as population growth in the sector has hovered at 1.5% annual growth, above the city wide rate. This growth has lead to a population of 250,626, with 28% of citizens attaining a college degree (minimum of a Bachelor's) and 67% of the same populus participating in the workforce. The increased attainment of education has yielded a median income of $56,605, almost $10,000 above the city wide average. These statistics are helpful for framing the economic prosperity that the Northeast corridor has faced as density increases and citizen's continue to benefit themselves.

This continuous prosperity has recruited multiple employers to the city, as tax abatements and economic benefits have found companies such as USAA, HEB, Frost Bank, CPS Energy, Toyota, Rackspace, Southwest Research Institute, and other major businesses. This recruitment has yielded an annual 9.6% annual growth rate in the number of San Antonio jobs, and the benefits have lead to many middle- and upper-middle class employees residing in the area. Continued residential and job growth has driven the San Antonio office market to a positive absorption of 12,522 in Q3 of 2018. That compares to a net positive 375,505 SF in Q2 of 2018, negative (134,596) SF in Q1 of 2018, and positive 572,595 absorption in Q4 of 2017.

Market area delineation concepts:

Tenants moving out of large blocks of space in 2018 include: Medtronic Inc moving out of 145,025 square feet at 18302 Talavera Rdg; Institute for Drug Development moving out of 67,586 square feet at 14960 Omicron Dr; and South Texas Regional Medical Center moving out of 48,556 square feet at 1901 Hwy 97 East. Tenants moving into large blocks of space in 2018 include Spectrum moving into 75,672 square feet at 12238 Silicon Dr; Capture Rx moving into 48,000 square feet at 420 Broadway St, The Light Building; and Allcat Claims Service moving into 45,763 square feet at 814 Arion Pky. The Class-B office market recorded net absorption of negative (98,838) square feet in the Q3 of 2018, compared to positive 92,682 square feet in Q2 of 2018, negative (33,471) in the Q1 of 2018, and positive 270,730 in Q4 of 2017. Net absorption for the suburban markets was positive 34,311 square feet in Q3 of 2018. That compares to positive 269,381 square feet in Q2 of 2018, negative (57,879) in the Q1 2018, and positive 522,213 in the Q4 of 2017. Between both the transient nature of businesses as they escalate their economic abilities through expansion, and the opportunistic absorption rates, lies an important niche for mid-tier class B office inventory expansion.

With the potential expansion of office space in San Antonio, comes the potential risk of high vacancy rates. The Q3 office vacancy rate in the San Antonio market area remained unchanged from the second quarter at 9.5%. The vacancy rate was 9.7% at the end of Q1 2018, and 9.4% at the end of the Q4 2017. Class-B projects reported a vacancy rate of 8.9% at the end of Q3 2018, 8.6% at the end of Q2 of 2018, 8.8% at the end of Q1 of 2018, and 8.5% at the end of Q4 of 2017. The vacancy rate in the suburban markets remained unchanged at 9.5% in the first three quarters of 2018. The vacancy rate was 9.3% at the end of the fourth quarter 2017. The amount of vacant sublease space in the San Antonio market increased to 152,193 square feet by the end of Q3 of 2018, from 134,899 square feet at the end of the second quarter 2018. There was 160,520 square feet vacant at the end of Q1 of 2018 and 149,148 square feet at the end of the fourth quarter 2017. Class-B projects reported vacant sublease space of 68,070 square feet at the end of Q3 of 2018, up from the 56,471 square feet reported at the end of the second quarter 2018. At the end of the first quarter 2018 there were 52,843 square feet, and at the end of the fourth quarter 2017 there were 58,264 square feet vacant.

The effect of absorption rates and vacancies in the San Antonio market have been relatively minimal, as rental rates have remained stable. The average quoted asking rental rate for available office space, all classes, was $21.62 per square foot per year at the end of Q3 2018 in the San Antonio market area. This represented a 1.1% increase in quoted rental rates from the end of the second quarter 2018, when rents were reported at $21.38 per square foot. These rates show an ability to be economically flexible, and along with the other growth trends, show that the market is able to remain stable even with an increase in the office inventory.

The majority of users for competitive properties are derived from middle- to upper-middle class professionals. These professionals are primarily focused in the financial services, information technology, cybersecurity, new energy, bioscience, healthcare, aerospace, defense, advanced manufacturing workforces. These workforces are specifically segmented into basic, regional employers (Lackland Air Force Base, Fort Sam Houston, HEB, USAA, Randolph Air Force Base, Methodist Healthcare System, City of San Antonio, Baptist Health System, Wells Fargo, Harland Clarke, JP Morgan Chase, Andeavor, Bill Miller BBQ, AT&T, Valero Energy Corp, Rackspace, CPS Energy, Six Flags Fiesta Texas, Toyota Motor Manufacturing, Citibank, Southwest Research Institute, Frost Bank) and Non-Basic corporations (HEB, USAA, Cullen/Frost Bank, Bill Miller BBQ, Rackspace, CPS Energy, Toyota Motor Manufacturing, Clear Channel Communications, Southwest Research Institute, Valero Energy, Harland Clarke, Tesoro, KCI, HVHC, Security Service Federal Credit Union, SWBC, NuStar Energy).

Demand Analysis

There are two different ways that demand for this area is analyzed: inferred demand forecast and fundamental demand forecast. Within the inferred demand forecast, absorption rate and the historical growth of the market area provide insight. The net absorption rate for the overall San Antonio market is a positive 12,522 square feet for the third quarter of 2018. More specifically, the Class B office space recorded a negative absorption of 93,838 square feet in the third quarter of 2018.

However, the absorption rate of the Class B office space has had a variety of growth and decline in the 2018 year alone. This trend of having a variety of negative and positive quarters with an overall positive trend is likely to continue into 2019. Even though the absorption rate for the Class B office space in the San Antonio market has varied through the years of 2017 and 2018, the Class B office space vacancy rate has remained the most stable in comparison to Class A and Class C office spaces. The whole San Antonio office market area remains with a positive and stable vacancy rate of 9.5%. More specifically, Class B projects have remained even lower at 8.9% at the end of the third quarter. In comparison to previous years, the vacancy rate for Class B has varied slightly reaching 9.4% at the end of the third quarter 2016 and as low as 8.5% at the end of the fourth quarter of 2016.

If this trend continues there will be a small variation in vacancy rates, but the overall trend will be slightly increasing. Considering the growth in the market as another factor of the inferred demand analysis, the amount of deliveries to the market is analyzed. In 2017, there were 14 buildings under 50,000 square feet delivered. In 2018, there were 38 buildings under 50,000 square feet delivered in the market. Specifically, the total RBA located in the Northeast corridor increased from 3,491,177 in 2017 to 3,714,670 in 2018. This steady increase in growth of the development in the area shows that there is a demand for these office buildings.

The rental rates have increased as well starting at around $15.00 per square foot in Class B office space in 2005 to around $20.00 per square foot in Class B space in 2018. More specifically, the quoted rates for Class-B buildings in the Northeast submarket increased from $19.71 in 2017 to $19.75 in 2018.

Through the coming years the trend is predicted to continually have a positive increase. This shows that the market is not oversaturated with supply and there is a demand for the product we have proposed.

The other type of demand analysis is fundamental demand analysis. There are many factors that were analyzed to create a fundamental demand analysis for the subject property. Most importantly, the increase in population and the increase in employment are major demand drivers. The San Antonio market has an annual population increase of 1.494% and the Northeast San Antonio submarket has an annual population increase of 1.5%. In addition, it has been proven within the market delineation that there is a significant increase in employment in the market area. The combination of the increase in population and employment will result in the need for more office space. This is because the growth or decline of employment is directly correlated with the with the amount of office users in the market. Concluding, due to the acknowledgement of the demand drivers in the market area of the subject property, the demand for office space is very evident.

Supply Analysis

Existing supply in the submarket:

A level A analysis was conducted on the Northeast submarket to identify characteristics of competitive properties. Using Business Analyst Online various existing office buildings in the Northeast area were mapped out. Existing offices of all three classes were analyzed on criterias like location, total Rentable Area (RBA), quoted rent, and so on.

The San Antonio office market is comprised of 78,587,913 square feet in 4,066 buildings as of the end of the third quarter of 2018. There were a total of 7 structures in terms of Class A offices in the area with the highest vacancy rate of 22.5% among all the three classes. The existing average rent was found to be $23.22/sq.ft. Class B displayed the lowest amount of vacancy rate of 6.4% and there are no ongoing constructions in the submarket for this type. The average rent for such properties was found to be $20.12/sq.ft. The Northeast area also has a lot of inventory in terms of Class C (241 buildings) and had a vacancy rate of 10.3%. The existing average rent for this type was found to be $16.48/sq.ft.

Properties under construction:

To understand the current trends in the market, properties that are under construction with similar attributes to our proposal were also taken into consideration. Properties that lay within the 5-10 mile radius from the proposed site were considered. Three properties were identified which lay in close proximity to the site and displayed similar characteristics. All three properties are located right next to the highway allowing easy access. (A - 1 Randolph Brooks Pkwy., B - 430 W Sunset Road, C - 111 Tower Road). The properties located on 111 Tower Road and Sunset Road have a closer proximity towards the San Antonio International Airport and the Downtown area while the Property B is located towards the Live Oak area and is much closer proximity to the proposed site. The properties B and C had predicted rents of about $27 and $19.7 respectively.

The properties A and C are Class A while Property B is Class C which clearly displays an existing demand for Class B offices. Property A rises up to 5 floors with a total RBA of 192,000 sq.ft and is 100% pre-leased. Property B rises upto 3 floors with a total RBA of 48,000 sq.ft and is about 48% pre-leased. Property C has only one floor with a total RBA of 75,090 sq.ft out of which 80% is pre-leased. Both the properties A and C are predicted to be completed by the second quarter of 2019 and Property B by the third quarter of 2019.

Market Condition Analysis

Looking into the conditions of the current market, we can understand that demand for the proposed building type in the selected market area is relatively high when compared to other project characteristics in differing locations. Through analysis of trends over the past few quarters, the absorption in San Antonio's CBD is decreasing whereas in the subject market of the Northeast San Antonio district has seen an increase in absorption over time. According to CoStar, the change is relatively low on average, however is highest for the proposed Class B office space in the area.

This trend is following the egress of population from the city's center to the suburban portions of the city directed along the I-35 corridor where population is forecasted to continue to grow. According to CoStar, the YTD absorption in the CBD was down by 61,292 square feet with only 93 buildings in existing inventory and no new deliveries for the year at the third quarter of 2018. In contrast, the suburban market as a whole has seen a YTD absorption of 21,665 square feet in the same timeframe, and has a relatively high amount of Class B office under construction. This trend has been relatively steady throughout the past three quarters with a decrease in absorption in the CBD and relatively steady vacancy, while the suburban market has seen a fairly dramatic increase in absorption with very steady vacancy rates throughout, which is a good indicator of high demand in these areas.

Through analysis of the trends of demand within our proposed submarket, we can infer that the demand for Class B office space in the area is relatively high given the increasing absorption and steady vacancy rate. However, the supply for this area is low when compared to the overall San Antonio market. According to CoStar, there has been a low amount of Class B office square footage delivered to the Northeast submarket over the past three quarters and with population and demand increasing in the area, the supply does not adequately satisfy the current market, showing a high residual demand. Given these circumstances, our proposed project would provide a portion of the necessary supply to satisfy the demand for Class B office space in the Northeast San Antonio submarket.

Subject Marketability Analysis

The focus of this section is to understand the future market demand for 11911 Crosswinds Way. We have looked at our parcel of land and analyzed its site, legal, and locational attributes to compare with other Class B office spaces in the area. There are three methods used to approach this data: inferred capture, fundamental capture, and reconcile subject capture.

The first of the inferred capture methods includes comparison of our subject property to general market indicators. We have narrowed our market down to the Northeast subject area, and are proceeding with a Class B office space with our parcel being in an opportunity zone. According to CoStar, Class B projects reported a vacancy rate of 8.9% at the end of the third quarter of 2018. Low vacancy rates indicate that there is a high demand and a need for more attractive inventory. Comparable property data is another inferred method. Some constant variables seen throughout this submarket are the *triple-net* service type, a Class B multi-tenant space, located in a suburban area. Finally, a common lease term within the area is 5-10 years. There is very little; if not, no, historical performance data to refer to because this is a vacant piece of land. By analyzing the local economic trends we can get a generalized understanding of the growth and demand for new office space. Between October of 2016 and 2017 there were over 26,000 new jobs added to the market. Major industry sectors include financial services, information technology, cybersecurity, new energy, bioscience, healthcare, aerospace, defense, and, advanced manufacturing.

To approach the fundamental capture methods, start by estimating the subject capture potential of fundamental demand forecast. To do this, use methods such as; share of the market, adjust by quantifiable rating techniques, and subject historical capture rate which includes no data due to the vacant status of the parcel.

Share of the market includes identifying the competition. We used Bexar Appraisal District's website as a strong source to identify competitive vacant tracts located in the same geographic area, with similar utilities and zoning. Rating the subject area in relation to other competitive areas is a quantifiable way to understand the market share. The first of two steps is to compare the subject parcel to others as better than, equal to, or worse than according to a specific rating factor. The next step is the calibration process. Position each pair so that all pairs are ranked in relation to one another. Higher scores are considered superior.

CONCLUSION

In conclusion, with an increasing amount of jobs in the San Antonio market, specifically the North East side coming from Military, HEB, USAA and other smaller industries, we believe that the I-35 is currently underdeveloped. Vacancy rates are 3.4% below the average of San Antonio's office market with specificity to our produce. This product type of Class B office is specifically historically the most stable property type in San Antonio's office market place, with the most static absorption rate and the lowest vacancy percentage per our submarket. This indicates that when compared with the submarket vacancy and absorption with the CBD, the submarket has an increase in absorption for the past two quarters and a steady vacancy.

Provided the current demand and supply for Class B office space in the market, the residual demand for this project relatively high. Given the direction of growth of the market for this type of property, the current supply is not too high that the proposed property would not be absorbed into the current office market in San Antonio. Currently, the cap rate is at 9.63% and looking ahead in the next 5-10 years, the growth for jobs is steadily increase in the area, population will also look to increase which will drive the demand for more office space. The I-35 is one of the main commercial transportation systems within North America, 80% of all goods from Mexico travel into Texas and 75% of those goods travel via I-35 from San Antonio to Austin. The increase of volume on the I-35 to Austin is becoming the fastest growing area within the US, maximizing the land use on the I-35 will yield financial return because of the expected growth in accordance to the financial data to support it.