

METRO CENTER, PHASE I

SACRAMENTO, CALIFORNIA

Piedmont Realty Advisors
650 California Street, 22nd Floor
San Francisco, California 94108
(415) 433-4100
December 17, 1987



TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	THE PROPERTY	16
	A. INTRODUCTION	16
	B. LOCATION	16
	C. THE SITE	18
	D. THE IMPROVEMENTS	18
	E. PROJECT BUDGET	19
	F. CONCLUSIONS	19
III.	THE MARKET OVERVIEW	28
	A. INTRODUCTION	28
	B. THE SACRAMENTO OFFICE MARKET	28
	C. COMPETITIVE OFFICE MARKET	29
	D. CONCLUSION	30
IV.	BORROWER/DEVELOPER	39
	A. INTRODUCTION	39
	B. THE BORROWER	39
	C. BORROWER TRACK RECORD	40
	D. CONCLUSION	40
V.	RISK AND RETURN	42
	A. DEAL STRUCTURE	42
	B. VALUE ESTIMATE	43
	C. RETURN	44
	D. RISK	45
	E. CONCLUSIONS AND RECOMMENDATIONS	47

I. INTRODUCTION

PIEDMONT REALTY ADVISORS

650 CALIFORNIA STREET
TWENTY-SECOND FLOOR
SAN FRANCISCO, CALIFORNIA 94108
415-433-4100

December 17, 1987

Real Estate Investment Committee Members
United States Fidelity and Guaranty Company
100 Light Street
Baltimore, Maryland 21202

Re: **Metropolitan Center, Phase I**
Sacramento, California

Dear Committee Members:

Enclosed for your review is an Investment Report on the Metro Center, Phase I office complex. The proposed investment is an immediate funding, participating mortgage for Metro Center, a 258,304 net rentable square foot office complex developed by McCuen & Steele on 20.5-acres of land. A summary of the proposed investment is shown as Exhibit I-1.

The Property

Metro Center, Phase I is an existing office complex located at the southwest corner of the Interstate 80/Interstate 5 interchange in Sacramento, California. Specifically, the subject property is located in the South Natomas area, an office submarket that serves as a more affordable alternative to downtown Sacramento. The location provides unique access to Downtown Sacramento, just one-mile south via Interstate 5, and the Sacramento Metropolitan Airport six miles north on Interstate 5. The subject property is the first phase of Metropolitan Center, a 160-acre mixed-use project that will eventually offer over one million square feet of office space complimented by a hotel, multi-family residential and retail.

Metro Center, Phase I consists of four, two- and three-story office buildings totaling 258,304 square feet of net rentable area on approximately 20.5 acres of land. The buildings were completed in November, 1986 and are currently 42.1 percent leased with a 27,000 square foot GTE lease negotiated, but not approved by GTE's Real Estate Committee. The GTE lease would increase the total occupancy of the project to 52.5 percent.

All buildings are constructed of steel and concrete with attractive red brick exteriors. The floor plans are designed for multi-tenant use and can accommodate a tenant as small as 2,000 square feet. Metro Center, Phase I is

superior to all existing office developments in South Natomas in terms of freeway visibility and access, construction quality and site amenities.

The Market

Sacramento's economic outlook is outstanding. While the state and federal government sectors still represent Sacramento's largest employment category, their dominance has declined as the City has evolved into a regional business center. Chase Econometrics forecasts that the Sacramento metropolitan area's employment growth rate for the 1987 through 1990 time frame will be the highest in the nation for metropolitan areas with populations in excess of one million. Sacramento enjoys the stability of government employment and the growth of manufacturing and services in the private sector.

The Sacramento metropolitan office market contains over 23 million square feet and currently has a 20 percent vacancy rate. Most of this vacancy can be found in suburban markets which have exploded in response to employment growth in the private sector. Downtown office vacancy is substantially lower at 12 percent and still lower if only Class "A" space comparable to Metro Center, Phase I is considered. This fact is particularly important to the leasing of Metro Center, Phase I as the South Natomas market draws tenants from Downtown seeking rental savings, accessibility and a less congested office environment.

Based on Piedmont Realty Advisor's review of the market, Metro Center, Phase I has a unique opportunity to achieve 100 percent occupancy in the next 18 months due to lack of competitive space Downtown and in South Natomas. The subject property is expected to lease-up at \$18.00 per net rentable square foot which represents no increase from what has already been achieved. Leases will include a \$4.20 expense stop and free rent discounts are projected to average 10 percent of the lease value. Funds will be withheld from the initial funding that will provide a \$20.00 per rentable square foot tenant improvement allowance, a figure at least \$2.00 per square foot in excess of the current market. Piedmont Realty Advisors believes that Metro Center, Phase I will have little difficulty achieving the proforma rental assumptions over the next 12 to 18 months.

The Borrower

The borrowing entity is a general partnership of Peter McCuen, Christopher Steele, and Richard Nelson. McCuen & Steele is Sacramento's premier suburban developer having developed over 2.5 million square feet of office, high-tech and industrial space since 1980. An integral part of McCuen & Steele team is Richard Nelson who was the top producer in the entire Coldwell Banker system before joining the firm. His expertise in marketing will be a valuable asset in the leasing of Metro Center, Phase I. Based on Piedmont's interviews of the leasing and management team we conclude that McCuen &

Steele has assembled a group capable of successfully leasing and managing the project.

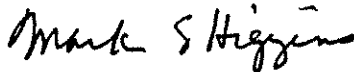
The Risk and Return

The proposed participating mortgage has been structured to adequately compensate USF&G for lease-up risk while providing economic incentives for McCuen & Steele to lease Metro Center, Phase I rapidly and in a manner that will maximize the property's long-term value. This is accomplished through the use of USF&G's standard economic holdback, McCuen & Steele's lease-up deficit guarantee and the additional feature of a developer's equity preference. Additionally, USF&G's participation in 50 percent of excess cash flow and 70 percent of residual assures attractive yields in the future. The projected yield is 12.4 percent with initial funding anticipated in March, 1988.

The successful leasing activity of Metro Center, Phase I is expected to accelerate as competitive space becomes scarce due to competitive developers' inability to deliver space for the next 18 months. The subject property fills the need for more affordable space than Downtown while providing accessibility, visibility, quality construction and a campus-like environment to prospective tenants.

Piedmont Realty Advisors therefore recommends that USF&G issue a commitment for a participating mortgage for \$34,000,000 for Metro Center, Phase I.

Sincerely,



Mark S. Higgins
Vice President

APPLICATION LETTER

PIEDMONT REALTY ADVISORS

650 CALIFORNIA STREET
TWENTY-SECOND FLOOR
SAN FRANCISCO, CALIFORNIA 94108
415-433-4100

December 4, 1987

Mr. George E. Kelts
General Manager
McCuen & Steele
10969 Trade Center Drive, Suite 100
Rancho Cordova, CA 95670

Re: Metro Center, Phase I
Sacramento, California

Dear George:

This letter summarizes the terms on which Piedmont Realty Advisors is prepared to recommend to its client's Investment Committee that it authorize the issuance of a Commitment for a participating first mortgage loan on the Property described below.

Property:	Metro Center Phase I
Location:	Sacramento, California
Real Property:	Approximately 20.5 acres located on the northwestern intersection of West El Camino and Interstate 5, and zoned OB-PUD office building.
Personal Property:	All personal property owned by Borrower and used in connection with the improvements.
Borrower:	A California partnership to be formed. General Partners - Richard D. Nelson, Christopher R. Steele and Peter McCuen.
Lender:	United States Fidelity and Guaranty Company.
Loan Amount:	\$34,000,000.

**Base Interest
Rate:**

The Base Interest Rate shall be 9.25% and shall be paid or accrued monthly and compounded quarterly as set forth below, on the Outstanding Loan Balance. The term "Outstanding Loan Balance" shall mean the amount Lender has disbursed and which remains outstanding, plus any accrued and unpaid interest. The Borrower shall make payments on the disbursed amount during years 1 and 2 of the loan, and beginning in year 3 shall make payments on the Outstanding Loan Balance at the beginning of the third loan year in accordance with the pay rate listed in the following table:

<u>Loan Years</u>	<u>Pay Rate</u>	<u>Base Interest Rate</u>
1-20	8.25%	9.25%

If the Property generates any Net Cash Flow (defined below), then such Net Cash Flow shall first be used to pay the interest which would otherwise accrue at the accrual rate plus any previously accrued and unpaid interest.

Amortization:

Not applicable, interest only.

Term:

20 Years

Call Option:

Lender may call the Loan anytime after the 5th anniversary of initial funding upon 12 month's written notice.

Prepayment:

- o No prepayment before the 5th anniversary of initial funding. If a prepayment occurs due to a default by Borrower, Borrower shall pay Lender a prepayment fee which will be the greater of (a) 10% of the Outstanding Loan Balance or (b) a yield maintenance fee based on the 9.25% interest rate.
- o Prepayment fee of actual costs incurred by Lender in the reconveyance of the Loan not to exceed \$100,000 after the 5th anniversary of initial funding.
- o No prepayment penalty if Lender exercises its option to call the Loan.

Recourse: With the exception of the Lease-up Guarantee, the Loan will be non-recourse to the Borrower and its Partners.

Additional Interest

A. Operations: Borrower shall pay Lender 50% of the annual Net Cash Flow from the Property. The term "Net Cash Flow" shall mean the excess of (a) collected gross revenue less (b) the sum of (i) approved capital expenses and actual operating expenses for the Property and (ii) interest on the Outstanding Loan Balance at the base interest rate including any previously accrued and unpaid interest.

**B. Sale,
Refinancing or
Maturity:**

If Borrower sells the Property in a bona fide sale, Borrower shall pay Lender 70% of the excess of (a) the net sales price for the Property (i.e. the gross sales price less sales expenses not to exceed 3% of the gross sales price) less (b) the sum of (i) the Outstanding Loan Balance plus (ii) the Equity Preference Amount described below. (Exhibit B of this letter provides a detailed summary of the Equity Preference Amount calculation.)

If Lender calls the Loan, Borrower refinances the Property, or the 20th anniversary of the initial funding occurs, Borrower shall pay Lender 70% of the excess of (a) the fair market value of the Property as determined by appraisal less (b) the sum of (i) the Outstanding Loan Balance plus (ii) the Equity Preference Amount described below. (Exhibit B of this letter provides a detailed summary of the Equity Preference Amount calculation.)

Commitment Fee: \$255,000 to be paid upon acceptance of the Commitment.

Initial Funding: \$28,500,000

Holdbacks

**A. Tenant
Improvements:**

\$2,950,000; disbursed for the lesser of (a) the actual costs of the tenant improvements or (b) \$19.70 per square foot of rentable area as space is leased and tenant improvements are completed. Any funds remaining under this holdback will be (a) adjusted to a reasonable amount to build out the remaining vacant space in the Property after 95% physical occupancy. This adjustment will be made on Lender's sole discretion. Or (b) disbursed to Borrower after the Property is 100% built-out.

**B. Leasing
Commissions:**

\$550,000; disbursed as Borrower pays commissions. Disbursements shall not exceed \$4.50 per square foot of rentable area leased. Any funds remaining under this holdback after the Property is 100% leased and occupied shall be disbursed to Borrower.

**C. Interest,
Real Estate
Taxes, Insurance
and Approved
Operating
Expenses:**

\$1,000,000; disbursed for payments of debt service, real estate taxes, property insurance, and actual operating expenses in excess of revenues collected from the Property. Any funds remaining under this holdback shall be disbursed to Borrower upon the earlier to occur of (a) three consecutive months of annualized gross income greater than \$4,000,000 or (b) 24 months after initial funding.

**D. Economic
Holdback:**

\$1,000,000; disbursed at a rate of \$0.50 per \$1.00 of annualized gross income collected in excess of \$2,400,000.

Borrower shall have 24-months after initial funding to obtain disbursement of the holdback. Disbursement of the economic holdback may occur after the 24-month earnout period if the leases upon which the disbursements are based were executed during the 24-month period. Lender shall have the right to review and approve all leases of the Property which differ from the leasing standards attached as Exhibit A of this letter.

Mr. George E. Kelts
December 4, 1987
Page 5

**Borrower's Equity
Preference:**

Anytime during the first 36 months of the loan, Borrower may exercise a one time option to calculate its Equity Preference Amount. The Equity Preference Amount is used to determine the amount of Lender's additional interest as referenced in Additional Interest B. Sale, Refinancing or Maturity.

Borrower shall give Lender 30 days written notice of its intent to exercise its option to calculate the Equity Preference Amount. The formulae used for the calculation of the Equity Preference Amount are as follows (Exhibit B of this letter provides a detailed explanation of the formulae):

(1) Net Operating Income

Annualized Gross Income
Less: Property Vacancy Factor
Less: Property Expenses
Equals: Net Operating Income

(2) Property Total

Net Operating Income
Divided by: 9.35%
Equals: Property Total

(3) Equity Preference Amount

Property Total
Less: \$36,000,000
Equals: Subtotal
Plus: \$500,000 (marginal value of Heffner
Lease)
Equals: Equity Preference Amount

Note: Equity Preference amount can not exceed \$3,000,000, if calculated Equity Preference Amount is less than \$0.00 or if Borrower fails to exercise its option then Equity Preference Amount will equal \$0.00.

**Economic Due
Diligence:**

The issuance of a Commitment by the Lender to enter into this transaction is contingent upon the satisfaction of Piedmont Realty Advisors with the results of its economic due diligence by December 23, 1987.

**Lender
Approval:**

This application and the transaction contemplated herein must be approved by Lender's Investment Committee by December 23, 1987.

Additional Loan Provisions

A. Leases:

Lender shall have the right to review all existing leases and approve all future leases of the Property which differ from leasing standards attached as Exhibit A to this letter. Lender agrees to review and approve the existing leases prior to the acceptance of the Commitment.

**B. Secondary
Financing:**

No secondary financing permitted.

**C. Right of
First Offer:**

If the Borrower desires to sell the Property, the Lender shall have the right of first offer to purchase the Property.

**D. Budget
Approval:**

During the term of the Loan, Borrower shall submit to Lender annual operating and capital budgets for the Property for Lender's review and approval.

**E. Lease-up
Guarantee:**

The borrower shall execute a guarantee of Cash Flow Deficits from the Property. The term "Cash Flow Deficits" shall mean the excess of (a) interest payments based on the pay rate on the Outstanding Loan Balance and approved capital and actual operating expenses for the Property over (b) revenues actually collected from the Property. The guarantee shall terminate upon the earlier to occur of (a) three consecutive months of annualized gross income greater than \$4,000,000 or (b) 24 months following initial funding.

**F. Due on
Sale:**

Neither the Property nor any interest in Borrower may be sold or otherwise transferred without Lender's prior written consent.

G. Management:

A management company satisfactory to Lender shall be designated by the Borrower as the Property Manager and shall be entitled to earn the management fees specified in the existing tenant leases and which in total shall not exceed 4% of the scheduled gross income.

H. Future Financing:

The Lender shall have the right of first offer to finance any future office building development in the Metropolitan Center project.

Contingencies

The Commitment shall have the following contingencies:

A. Engineering:

The Borrower will engage an engineer approved by Lender to review the plans and specifications for the Property and perform a complete mechanical, electrical, and structural components analysis of the Property. Lender reserves the right to review and approve the scope and substance of the engineering study. The cost of the engineering study will be paid for by the Borrower. Lender must be satisfied with the results of the engineering study.

B. Appraisal:

Receipt of an appraisal of the Property from an MAI appraiser approved by Lender stating that the market value of the Property assuming stabilized occupancy is at least \$37,000,000.

**C. Environmental
Report:**

Receipt of an environmental study of the Property by a reputable engineering or environmental firm acceptable to Lender which demonstrates to the Lender's reasonable satisfaction that there are no environmental hazards or hazardous or toxic materials existing upon or affecting the Property. The analysis will involve a physical inspection of the building and a historical review of the previous uses of the land. In the event that the historical review indicates that toxic materials may exist in the soil, soil borings will be conducted and the results will be analyzed by a laboratory. The cost of the environmental study will be paid for by the Borrower.

Mr. George E. Kelts
December 4, 1987
Page 8

- D. Partnership Documents: Approval by Lender of the Partnership Agreement of Borrower.
- E. Mortgage Broker: Lender and Borrower agree that First Interstate Mortgage Company is the sole mortgage broker in this transaction and the parties will mutually indemnify each other from any claims which result from any other brokerage commission claims arising from this transaction.
- F. Other Contingencies: Such other contingencies as Lender may reasonably require and which are consistent with prudent lending practices of institutional investors making participating loans.

If the terms outlined in this letter are acceptable, please sign below and return this letter together with an application fee in the amount of \$50,000. The application fee should be wired to a custodial account. Please call me for wiring instructions. The application fee shall be refundable only if the Lender does not issue a Commitment according to the terms set forth in this letter, in which event Lender shall return the application fee within 5 business days. If you accept the Commitment, the application fee will be applied to the cash portion of the Commitment Fee upon your acceptance of the Commitment. The terms set forth in this letter shall expire if you do not accept and return a signed copy of this letter and wire the application fee by December 9, 1987. You understand that this letter is only an outline of the general terms and conditions of a Commitment and it is not a binding contract for the parties to enter into a Commitment.

Sincerely,

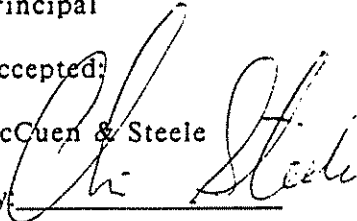


Stephen L. Grant
Principal

Accepted:

McCuen & Steele

By:



12-9-87
Date

General Partner
Title

EXHIBIT A
LEASING STANDARDS

All leases for space in the Property shall conform with the conditions set forth below (the "leasing standards") or upon such other terms as Lender may reasonably accept:

1. The primary term of any lease shall be for a term of not fewer than thirty-six (36) months nor more than one hundred twenty (120) months. In the case of a lease with a primary term in excess of sixty (60) months, there must be a rental increase not less than 25% of the base rent at the end of the fifth lease year.
2. The leases may include rights and options to renew the term thereof at the then prevailing market rental for a period not to exceed sixty (60) months.
3. During the twenty-four (24) months following the initial disbursement date (the "leaseup period"), the leases shall provide for an average annual base triple net (or calculated equivalent) rent at a rate not less than \$12.84 per square foot of net rentable area of office space. After the leaseup period, all leases must be at a rate not less than the then average annual base triple net (or calculated equivalent) rent per square foot for the entire building.
4. The standard form of lease, including those standard modifications previously approved by Lender (subsequent to approval by Lender), shall not be materially altered or amended without the prior written consent of Lender.
5. All leases shall be duly authorized and properly executed by Borrower pursuant to all necessary corporate or partnership action.
6. Amounts allocated for tenant finish work, as provided in a work letter from Borrower to each tenant, shall not be less than \$15.00 per square foot of net rentable area.
7. The term of any executed lease must commence within nine (9) months of the signing of such lease.
8. Free rent or early occupancy agreement may not exceed 10% of the primary lease term (e.g., 3.6 months on a 36 month lease).

Leases conforming to the above standards shall be deemed automatically approved. All other leases shall be subject to Lender's reasonable approval within 10 business days. These leasing standards shall apply from the date of this letter until the date 36 months after the date of initial disbursement. Thereafter the parties shall revise such standards annually by submission by Borrower to Lender during the 34th month following initial disbursement and each 12th month thereafter of proposed leasing standards with appropriate supporting data to show that such proposed standards conform to market standards at other buildings of equal or better architectural and construction quality, location, amenities and management in the Sacramento suburban area. The leasing standards shall be subject to Lender's approval, such approval not

EXHIBIT A
LEASING STANDARDS
(continued)

to be unreasonably withheld. Lender shall respond to annual initial submissions within 22 business days and within 10 business days to subsequent revised submissions.

EXHIBIT B

DEVELOPER'S EQUITY PREFERENCE DETAIL SUMMARY

Anytime during the first 36 months of the Loan the Borrower may exercise the one time option to calculate its Equity Preference Amount. The following methodology will be used in the calculation of the Equity Preference amount:

1. Borrower will give Lender 30 days written notice of its intent to exercise its option to calculate the Equity Preference Amount.
2. The Net Operating Income of the property will be estimated using the leasing in place during the month of the written notice (Notice Month).
3. The Annualized Gross Income will be estimated as follows:
 - (a) The annualized scheduled gross income for executed paying leases in place at during the notice month;
 - (b) All vacant space will be assigned on annualized gross income of \$0.00; and
 - (c) The annualized gross income for executed leases in free rent periods will be estimated by calculating an effective gross income for the lease. Exhibit C to this letter contains examples of effective rent calculations and the calculation of annualized effective gross income.
4. A Property Vacancy Factor will be applied to the Annualized Gross Income and will be the lesser of (i) 5% or (ii) a percentage factor determined as follows:
 - (a) 5% minus (the total amount of vacant net rentable square footage divided by 258,304 net rentable square feet.

Note: If the calculation results in a percentage factor less than 0%, then the Property Vacancy Factor will be 0%.
5. The Property Expenses of the property will be estimated by totalling the expense stops (includes previously calculated "Base Year" expenses stops) specified in each existing tenants leases.
 - (a) For tenants with unspecified "base year" stops, that tenant's pro rata share of that year's budgeted expenses will be used.
 - (b) For vacant space a \$0.00 expense stop will be assigned for the purposes of estimating total expenses.

II. THE PROPERTY

Exhibit C
EFFECTIVE RENT EXAMPLES

Free rent concessions which occur prior to the Notice Month will be excluded from the effective rent calculation. Effective rent is calculated for various types of leases as follows:

EXAMPLE ONE -- FLAT LEASE

Assumptions:

Contract Rent:	\$12.00 PSF/Year
Lease Term:	3 Years
Rent Concession:	.5 Year of Free Rent

Calculations:

	Rent Concession (.5 Yr. X \$12 PSF/Yr.	\$ 6.00
divided by:	Total Rental Payments w/o Concession	
	<u>3 Yrs. X \$12 PSF Yr.)</u>	<u>36.00</u>
equals:	Rent Concession Given	16.67%
less:	Free Rent Prior to Notice Month	<u>10.00%</u>
equals:	Reduction in Contract Rent	6.67%
so that,		
	Contract Rent	\$12.00/PSF/YR
less:	Reduction in Contract Rent	
	<u>(6.67% X \$12.00)</u>	<u>.80</u>
equals:	Effective Rental Rate	\$11.20/PSF/YR

EXAMPLE TWO -- STEP UP LEASE

Assumptions:

Contract Rental Rate	Year One	\$11.00 PSF
	Year Two	\$12.00 PSF
	Year Three	<u>\$13.00 PSF</u>
	Total Payments	\$36.00 PSF
Lease Term:	3 Years	
Rent Concession:	.5 Year of Free Rent	

Calculations:

	Rent Concession (.5 X \$11 PSF)	\$ 5.50
divided by:	Total Rental Payments w/o Concession	<u>36.00</u>
equals:	Rental Concession Given	15.28%
less:	Free Rent Prior to Notice Month	<u>10.00%</u>
equals:	Reduction in Contract Rent	5.28%
so that,		
	Average Contract Rent *(36/3 Yrs.)	\$12.00 PSF
less:	Reduction in Contract Rents (\$12 X 5.28%)	<u>.63</u>
equals:	Effective Rental Rate	\$11.37 PSF

* Average Contract Rent is based on fixed rent increases over a maximum period of five years.

II. THE PROPERTY

A. INTRODUCTION

Metro Center, Phase I is an existing office complex consisting of four, two- and three-story office buildings located at the northwest interchange of West El Camino Avenue and Interstate 5 in the South Natomas area of Sacramento, California (see Exhibit II-1). The complex totals 258,304 square feet of net rentable area on approximately 20.5 acres of land. The subject property is the first phase of a 160-acre mixed-use project that will eventually offer over 1 million square feet of office space complimented by a hotel, multi-family residential and retail. Metro Center is located in South Natomas, an emerging suburban office market just one mile north of Downtown Sacramento and six miles south of the Sacramento Metropolitan Airport via Interstate 5.

B. LOCATION

1. Neighborhood Demographics

The Sacramento metropolitan area has developed along the region's four major freeways. The US-50 corridor extends from Downtown Sacramento east to Folsom. The I-80 corridor is bounded by the subject property on the west and Rocklin on the east. The I-5/US-99 corridor is defined as that area to the south of the I-5/I-80 intersection (location of subject property) bounded by the Sacramento River on the west and US-99 on the east.

The South Natomas area is the location of the subject property and is an emerging mixed-use suburban market with existing office, retail, and residential improvements and a substantial amount of land available for future development (see Exhibit II-2). It is in the process of becoming a master-planned development area by the Sacramento City Planning Department in an effort to provide the region with a new, prestigious growth corridor at the City's northern "Gateway".

2. Accessibility

Metropolitan Center is located at the southwest corner of the Interstate 80/Interstate 5 interchange. Specifically, the subject property is located at the northwest corner of West El Camino Avenue and Interstate 5. Interstate 5 is the major north/south thoroughfare serving the Sacramento/San Joaquin Valley. Interstate 80 is the major thoroughfare from the San Francisco Bay Area east to Sacramento and on to the Sierra Nevada Mountain range and Reno, Nevada. Additionally, Highway 50 originates one mile west at Interstate 80 and intersects with Interstate 5 just one mile south of Metropolitan Center providing prospective office tenants with access to the "50 Corridor" and executive housing.

Access to the site from Interstate 5 northbound is via an off-ramp on West El Camino, and from Interstate 5 southbound via the Garden Highway exit 1/2 mile south of the site (see Exhibit II-3). The developer has requested approval

III. THE MARKET OVERVIEW

from the City for a new ramp from Interstate 5 southbound to West El Camino. Money has been budgeted for this request and the Metro Center site plans accommodate the ramp, but State approval has not been given. This off ramp would improve I-5 access by allowing direct entrance to the site from southbound Interstate 5 at West El Camino. Eastbound and westbound traffic on Interstate 80 has access to the site via its intersection with West El Camino, 1/2 mile west of the site.

3. Adjacent Land Uses

Within the immediate vicinity of the site there are two major office developments that will compliment and compete with Metropolitan Center Office Park: Gateway Centre Business Park and Natomas Corporate Center (see Exhibit II-4).

Gateway Centre, a 57-acre project being developed by Lee Sammis, is located directly across West El Camino from the subject property. Approximately 850,000 square feet of office and 35,000 square feet of retail will eventually be developed in several phases. The California State Compensation Insurance Fund has completed a 78,000 square foot regional operations center there and the Christopher Company completed and substantially leased a 55,000 square foot office building. The Christopher Company is currently building an 83,000 square foot office building that will be completed in the second quarter of 1988. Christopher's office building is 25 percent preleased to Home Savings.

Natomas Corporate Center, a 65-acre park being developed by KCS Development Company, has plans for 800,000 square feet of office space in thirteen buildings. The project is located south of West El Camino across Interstate 5 from the subject property. Currently, a three-story building containing 97,000 square feet and a four-story office building containing 82,000 square feet are complete and fully occupied. Both buildings were completed in 1986.

South Natomas is also witnessing significant growth in the residential sector. Opposite Interstate 5 from the subject is a middle income residential project developed by Lincoln Property Company called Discovery Park. It consists of 800 units renting from \$330 to \$440 per month. Adjacent to Discovery Park are neighborhoods with homes ranging from \$70,000 to over \$100,000. Additionally, the Grupe Company completed 100 upper-end units and Institutional Property Investors recently completed over 400 units south of Metro Center, Phase I on Gateway Oaks Drive.

South Natomas is currently served by three retail centers. A new neighborhood center is located on the southeast corner of West El Camino and Truxel Road, 1/2 mile east of Metropolitan Center and a community center anchored by a Lucky's market is located further east on West El Camino Avenue at Northgate Boulevard. Specialty retail, including a marina and two restaurants, can be found 1/2 mile south of the subject on Garden Highway. Additionally, the land directly across West El Camino from the subject is zoned commercial and a Los Angeles retail developer has recently purchased the site and plans to build a specialty retail center.

C. THE SITE

Metro Center, Phase I is built on 20.5-acres of fully improved land (see Exhibit II-5). Most of South Natomas was formerly used for agriculture and as a result the topography is generally level with good drainage. The subject property is also level at the surrounding street grade. The site offers a parcourse fitness center and bike path around its perimeter and includes a heavily landscaped courtyard with extensive water features. The property is zoned for commercial office development with a floor area ratio (FAR) of .3. However, the extensive use of landscaping in the parking lots along with freeway set backs has resulted in an actual FAR of .28.

Metro Center, Phase I is the first phase of a 160-acre multi-use development. A pending lawsuit currently restricts the site to 570,000 square feet of office space in addition to Phase I. In 1986 Pacific Gas & Electric constructed a 70,000 square foot, three-story owner-user facility immediately north of the subject property. McCuen & Steele intends to continue to sell office land to users and to develop approximately 150,000 square feet of speculative office space sometime in the 1989 time frame.

D. THE IMPROVEMENTS

Metro Center, Phase I consists of one, two-story building and three, three-story buildings, of which two are connected with a second- and third-story walkway (see Exhibit II-6). The following is a summary of the buildings' characteristics:

<u>Building</u>	<u>Height (Stories)</u>	<u>Size</u>	<u>% Leased</u>
A (North)	3	56,106	65.7%
A (South)	3	56,106	36.0%
B	3	55,559	92.9%
C	2	<u>90,533</u>	<u>29.8%</u>
TOTAL		258,304	52.2%

Total gross square footage is 267,231 and rentable area is 258,304 square feet (96.7% efficiency). Each building is served by three elevators. All elevators are hydraulic and slow relative to downtown high-rises, but compare favorably with the competitive buildings in South Natomas. Parking for Phase I is provided for 1084 automobiles using standard stall striping (4.2 spaces per 1,000 square feet of net rentable area).

Metro Center, Phase I utilizes a structural steel frame clad in reinforced red face brick and tinted single pane windows. The buildings are functional and well-designed. The buildings offer floor areas ranging from 18,520 rentable square feet to 45,450 square feet and can accommodate a tenant as small as 2,000 square feet (see Exhibit II-7 and Appendix A). Each building features locker and shower facilities within the ground floor restrooms. This is an important amenity for tenant's relocating from Downtown Sacramento.

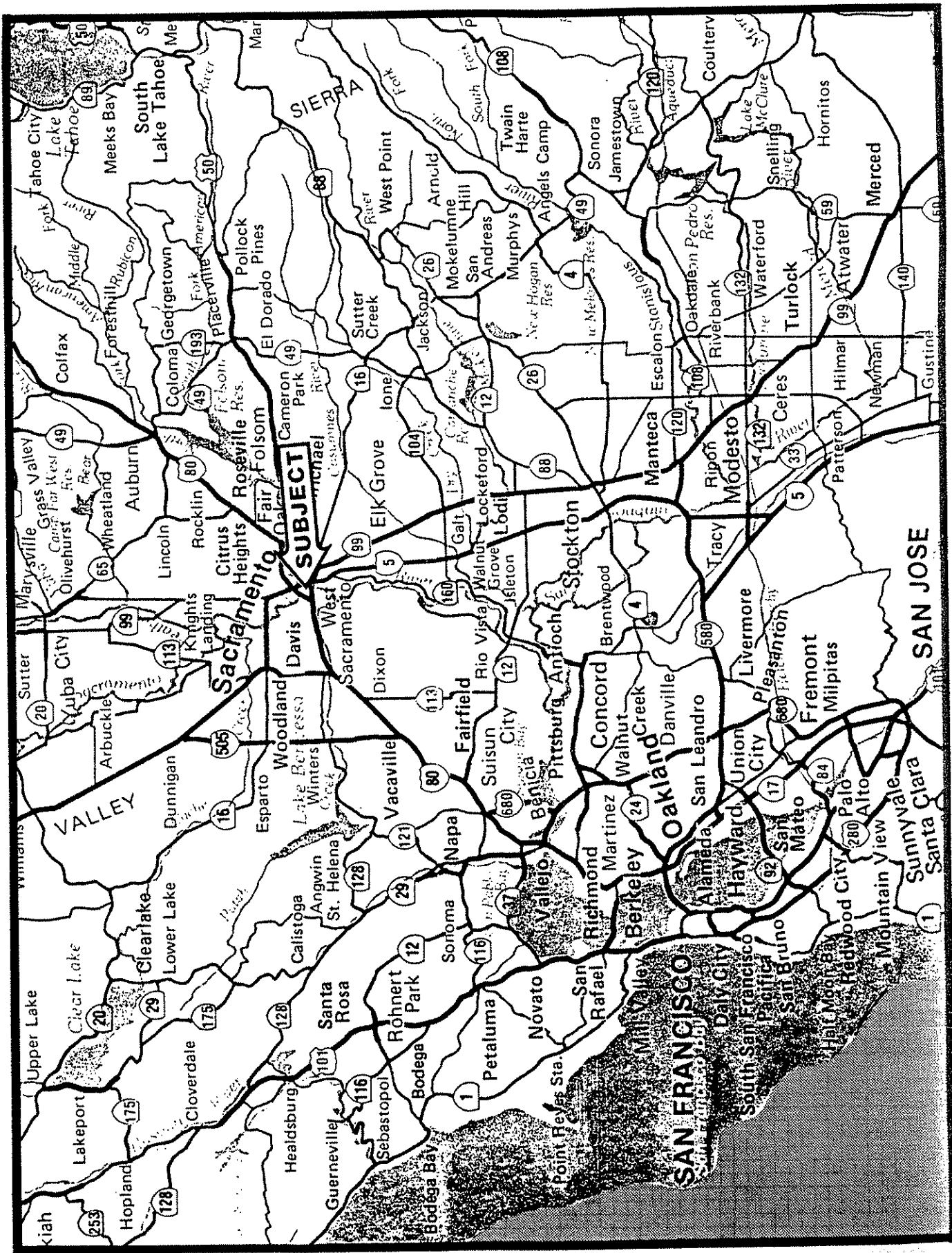
E. PROJECT BUDGET

The project budget for Metro Center, Phase I is presented in Exhibit II-8. The estimated construction budget, as of March 1, 1988, is \$26,800,000. McCuen & Steele has contributed approximately \$2,200,000 due to cost overruns and the gross value of lease assumptions associated with the project's lease up. The total development basis of \$29,000,000 slightly exceeds USF&G's initial funding of \$28,500,000. After accounting for loan fees and closing costs McCuen & Steele should have approximately \$1,200,000 in net equity invested in this transaction at loan closing. USF&G's loan commitment is \$34,000,000 or \$131.62 per square foot of net rentable area. This cost basis is average for multi-story office buildings in the Sacramento metropolitan area.

F. CONCLUSIONS

The Metropolitan Center is the 100 percent location in the South Natomas area of Sacramento, California. Specifically the subject property is located at the intersection of Interstate 5 and Interstate 80 in South Natomas, an emerging suburban office market with excellent access to Downtown Sacramento and the Metropolitan Airport. Metro Center, Phase I is the highest quality office complex in its market offering space comparable to the CBD at more affordable rents. The subject property's access, visibility and quality construction assure its continued leasing activity and long-term viability.

Exhibit I
REGIONAL LOCATION MAP
METROPOLITAN CENTER



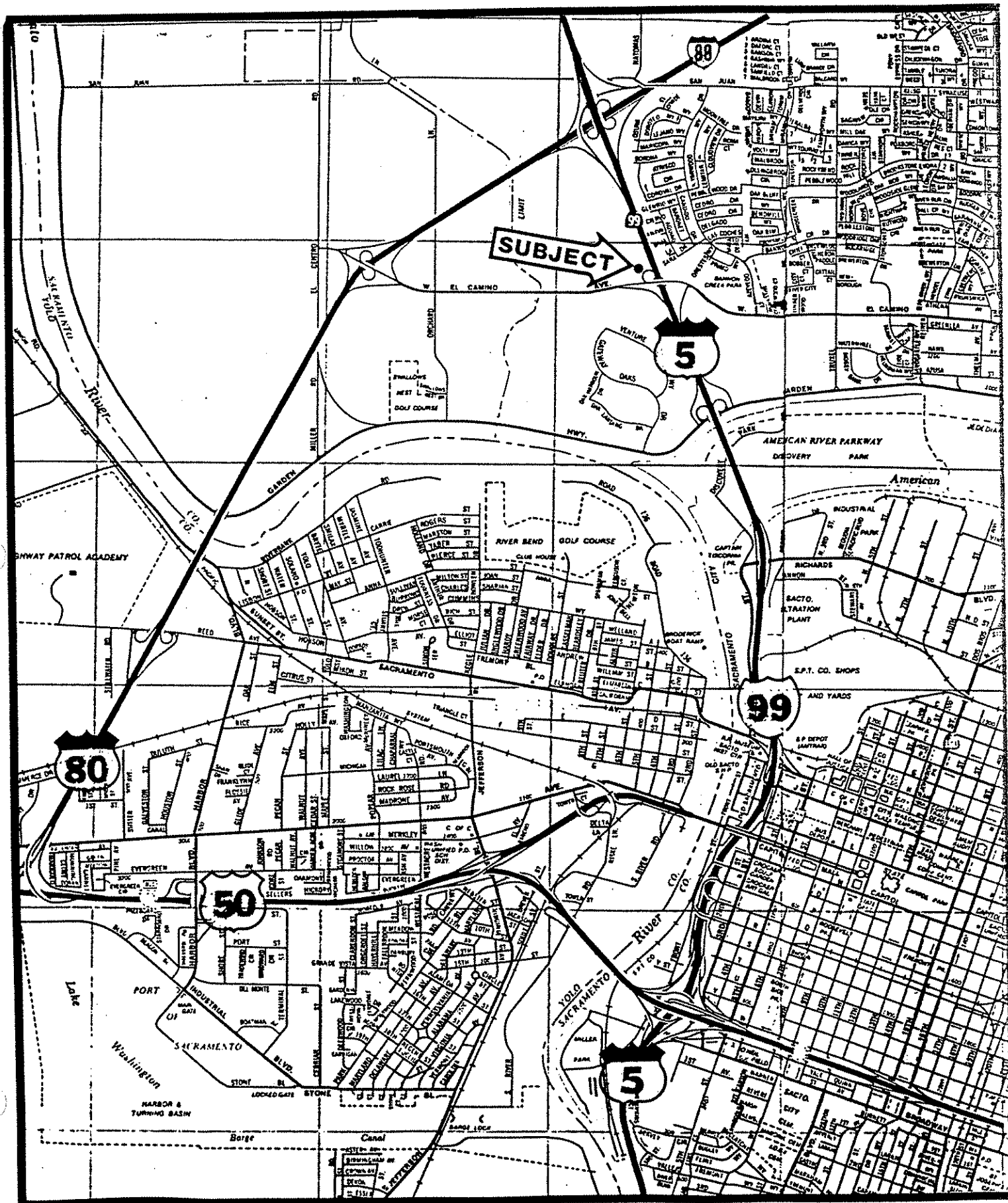
SITE VICINITY MAP
METROPOLITAN CENTER I

Exhibit II-3
SITE ACCESS MAP
METRO CENTER, PHASE I

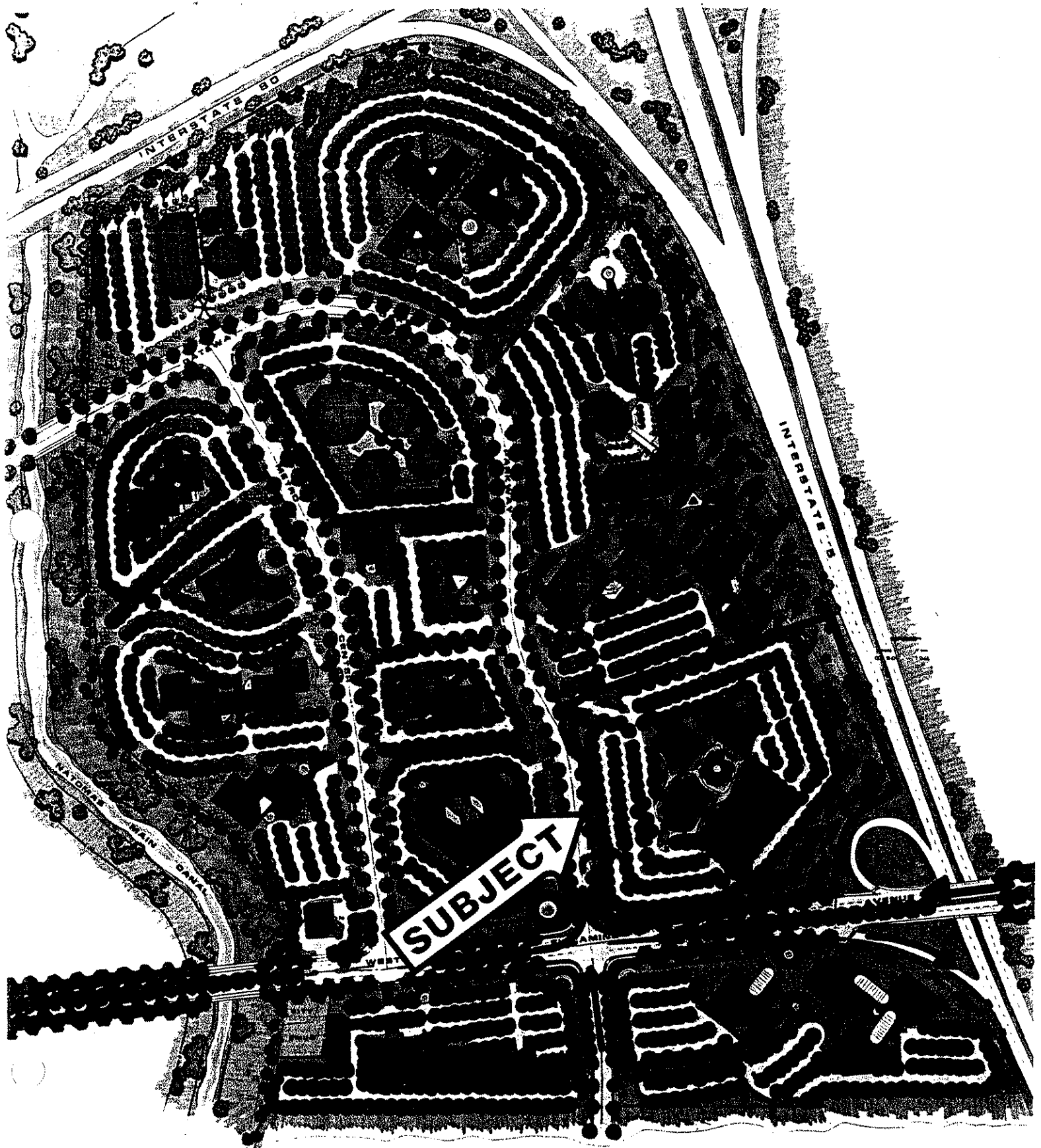


EXHIBIT 11-4

AERIAL PHOTOGRAPH

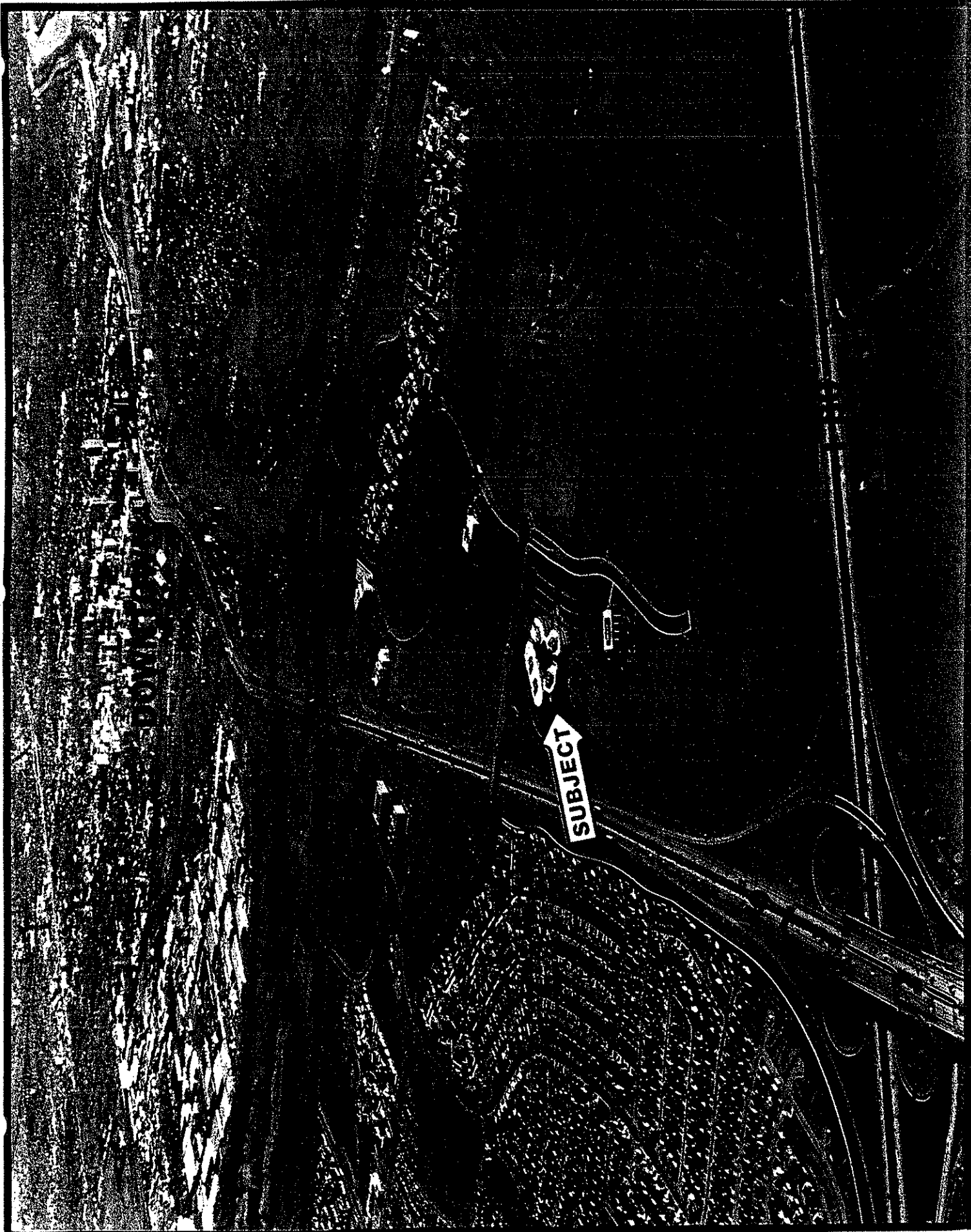


Exhibit II-5
SITE PLAN
METRO CENTER, PHASE I

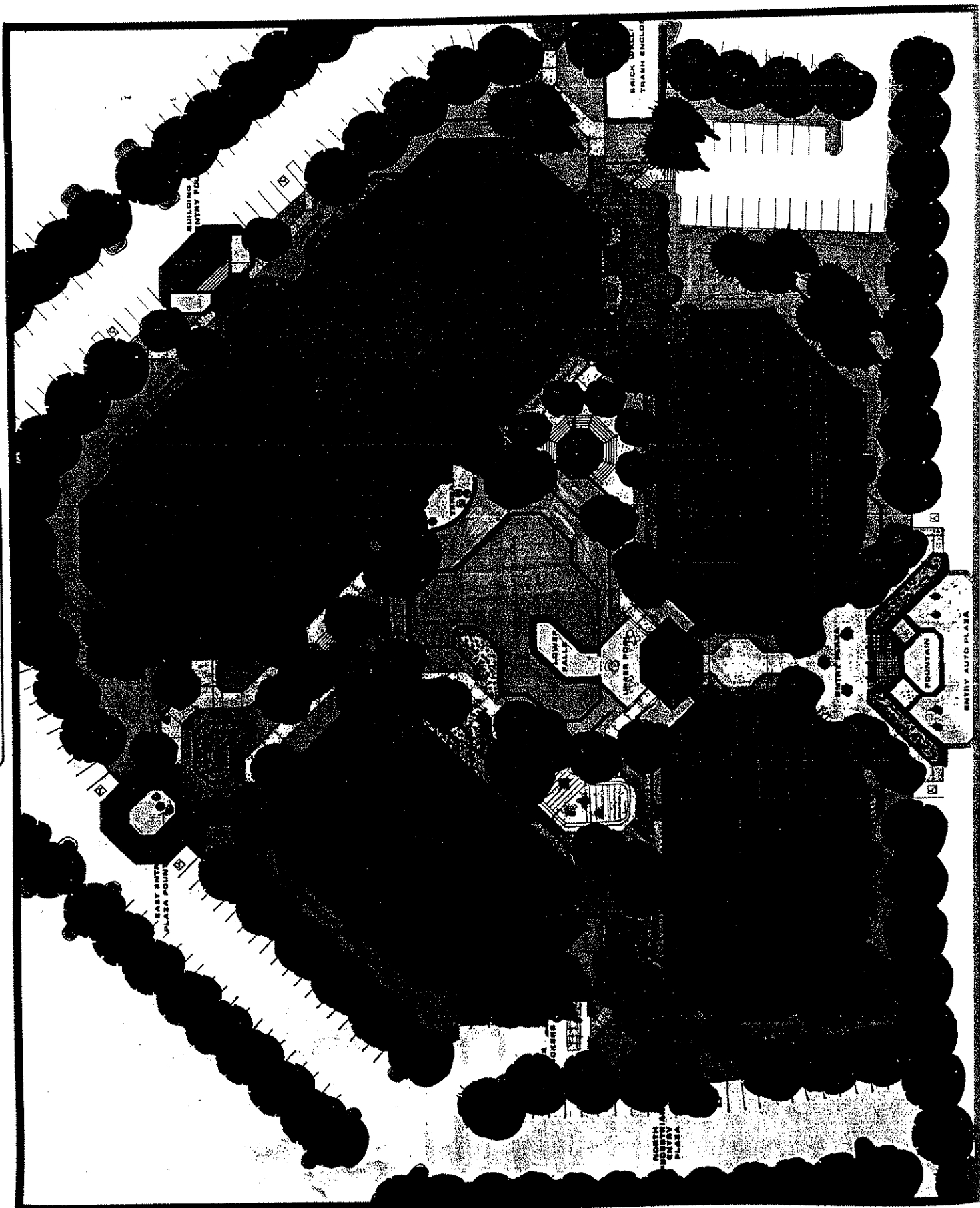


Exhibit II-6
ARCHITECT'S RENDERING
METRO CENTER, PHASE I

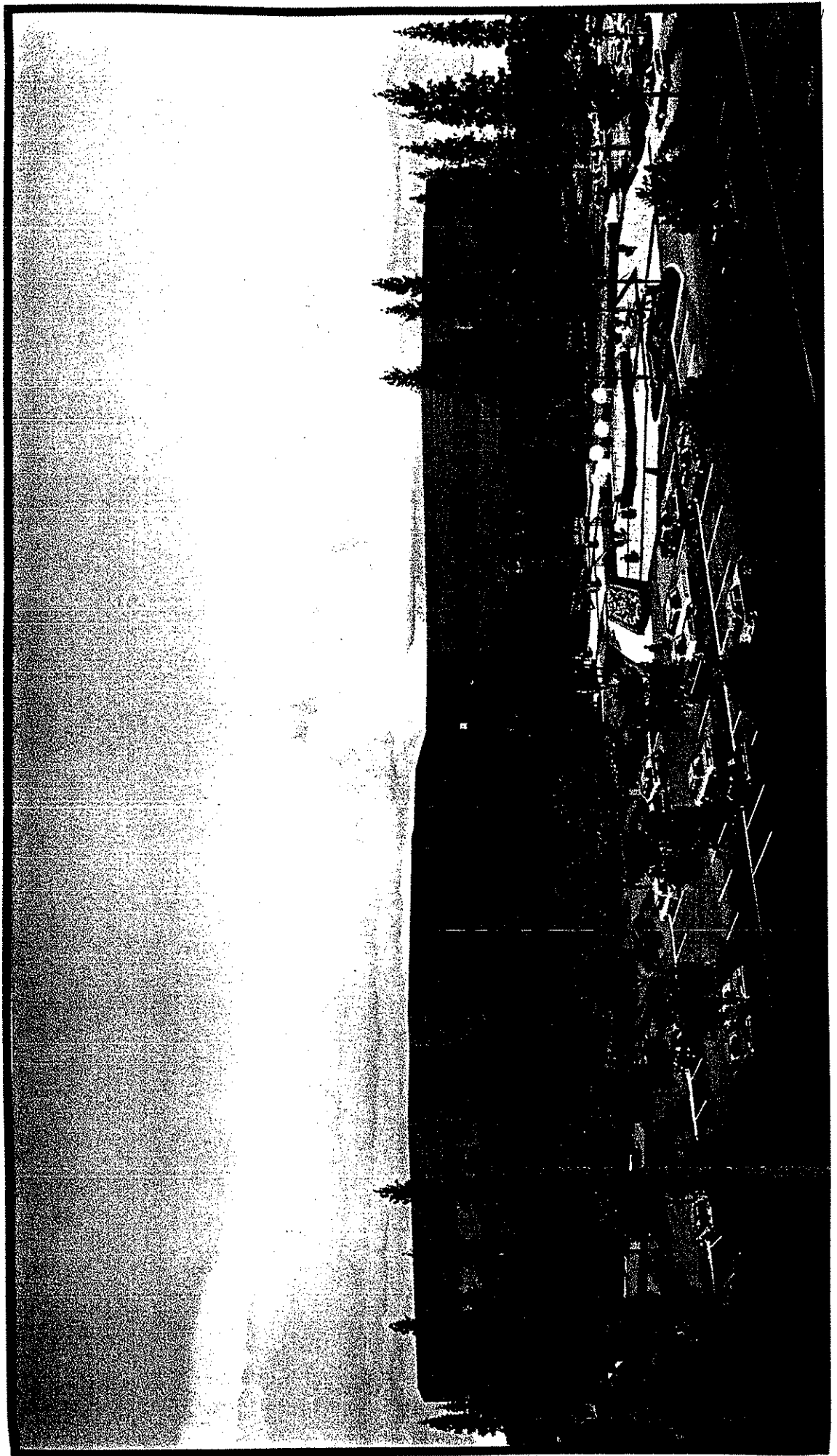


Exhibit II
TYPICAL FLOOR PLAN
BUILDING A - NORTH
FIRST FLOOR

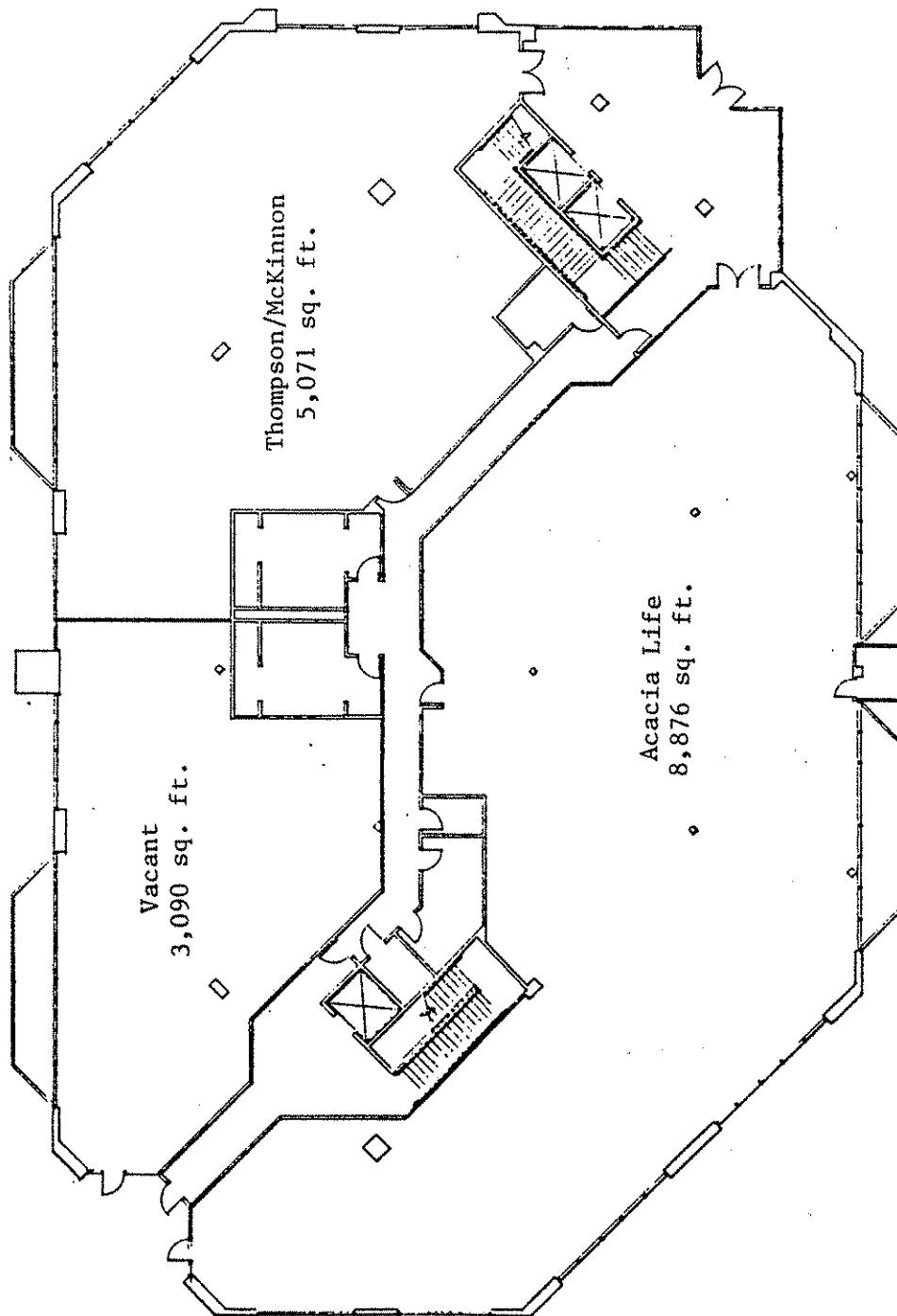


Exhibit II-8

PROJECT BUDGET

Source of Funds

Total Loan Commitment	\$34,000,000
Deficit Holdback	1,000,000
Economic Holdback	1,000,000
T.I. Holdback	2,950,000
Leasing Commission Holdback	<u>550,000</u>

Initial Disbursement \$28,500,000

F.I.B. Fee	340,000
USF&G Fee	255,000
Appraisal	8,500
Environmental (Inspection)	3,000
Environmental (Borings Optional)	7,000
Engineering	15,000
ALTA Survey	7,000
Title/Closing	5,000
Legal	40,000
Miscellaneous	<u>5,000</u>

Net to McCuen & Steele \$27,814,500

Use of Funds

Repay F.I.B. Construction Loan	\$26,800,000
Repay McCuen & Steele Equity (\$2,200,000)	<u>1,014,500</u>

Total \$27,814,500

Sources: McCuen & Steele;
First Interstate Bank (F.I.B.);
Piedmont Realty Advisors.

III. THE MARKET OVERVIEW

A. INTRODUCTION

The City of Sacramento was initially developed in the Gold Rush days of 1849 and 1850 on the original site of Sutter's Fort. Four years after statehood was achieved in 1850, Sacramento was selected as the state capitol of California. This remains one of the City's primary distinguishing features today and consequently government (both state and federal) is the largest employer representing 30.5 percent of the jobs in Sacramento. This provides Sacramento's economy with both stability and growth as the State of California, with a GNP that ranks seventh in the world against all countries, continues to grow.

The overall economic outlook for Sacramento is very bright. In 1986 Chase Econometrics forecasted that Sacramento's growth rate in employment over the next three years will be at least fifteen percent. This projection places Sacramento atop the nation's list of the 50 largest metropolitan areas. This growth can be explained by a number of factors. As the population passed the one million mark (currently 1.4 million) the area made the transformation from local branch office to a regional business center. Over the past decade Sacramento's population grew at an annual rate of 2.7 percent and is forecasted to grow at an annual rate of 3.0 percent this year. This growth rate is nearly twice as fast as the State and almost three times as fast as the rest of the nation. Inexpensive housing, lower commercial rents and affordable development land have also contributed to the rapid growth. Additionally, state government, three federal military installations, an agricultural base, a transportation hub and proximity to outstanding recreation areas all come together in Sacramento.

B. SACRAMENTO OFFICE MARKET

The Sacramento office market currently contains over 23 million square feet in seven submarkets (see Exhibit III-1 and III-2), more than double its 1983 size of ten million square feet. Distribution of employment has changed and continues to evolve as the population and economy grow. Since 1980 government employment, as a percentage of the employment base, has decreased from 35.4 percent to 30.5 percent currently, while service employment increased from 18.4 percent to 21.2 percent during the same time period. Not surprisingly, developers responded to this growth with unprecedented levels of construction. In spite of high levels of absorption, office vacancy was measured at 26 percent at the end of 1985.

In the last two years construction has slowed and gross absorption has continued to increase. Gross absorption in 1985 was 2.0 million square feet and increased to 2.3 million square feet in 1986. 1987 is expected to be at another record level with absorption in excess of 2.6 million square feet. Overall vacancy has declined to 20 percent currently, and in Downtown Sacramento the vacancy has fallen to 12 percent from levels well in excess of

20 percent in the early 1980's (see Exhibit III-3). Downtown Class "A" vacancy is even lower than the total submarket figures at 9 percent.

Downtown's low vacancy rate is of particular importance to South Natomas as more than 50 percent of tenants moving to South Natomas come from Downtown. These tenants, primarily law firms and other service companies, seek refuge from the congestion and high rental rates of Downtown, while maintaining convenient access to the CBD (one mile south). The low vacancy rate of Downtown has driven rents up to between \$22.00 and \$26.00 per square foot full service and parking costs have increased to \$75 per space per month. Concessions Downtown are generally 10 percent of lease value, however, Downtown landlords are becoming more reluctant to give into tenant's demands as the market has firmed.

A closer look at the Downtown office market reveals that there is a very short supply of space that directly competes with Metro Center, Phase I. Only two buildings currently offer 10,000 or more square feet of contiguous space with quality similar to the subject - Capitol Bank of Commerce, a 400,000 square foot building; and Capitol Place, a 260,000 square foot building. Capitol Bank of Commerce can only offer the space through a sublease and Capitol Place is 60 percent leased to the state government, a fact that makes the building considerably less desirable to most private sector tenants. Additionally, while several buildings are planned for Downtown, only one building recently started construction and will not be able to offer space for 18 months. It is this "leasing window" which is the key to the Metro Center, Phase I investment.

C. COMPETITIVE OFFICE MARKET

South Natomas currently has an office space inventory of 1.1 million square feet with 210,680 square feet available. Another 200,000 square feet is under construction with delivery expected in the first half of 1988. Vacancy currently stands at 17.2 percent, but rises to 23.7 percent if construction is included. However, in an emerging market supply and demand figures can be misleading. For example, absorption in South Natomas was 280,000 square feet in 1986 and is expected to be 520,000 square feet in 1987. These figures could lead to the conclusion that there is anywhere from 9 to 18 months supply of space. The South Natomas office market is dependent on tenant immigration from outside the Sacramento region and tenant migration from Downtown Sacramento. The firming of the Downtown office market should lead to a steady flow of tenants to South Natomas, but the amount of absorption for 1988 can not be predicted as accurately as a market with a substantial existing tenant base.

If the upper end of the South Natomas market is focused upon, the competitive market tightens considerably. Much of the existing vacancy within the South Natomas office market is located in single story tilt up buildings being offered at rents of \$12.50 to \$15.00 per square foot fully serviced. Only one existing building, Christopher Oaks I, can offer comparable space to the subject property and it only has 14,000 square feet out of a total of 55,000 available. Christopher Oaks II, an 81,000 square foot building is under construction, but

it will not be able to offer its 61,000 square feet of available space until mid-1988. The remaining top quality space in South Natomas can only be found in Metro Center, Phase I. While more space will undoubtedly be delivered, it isn't possible for this space to be available for at least 18 months.

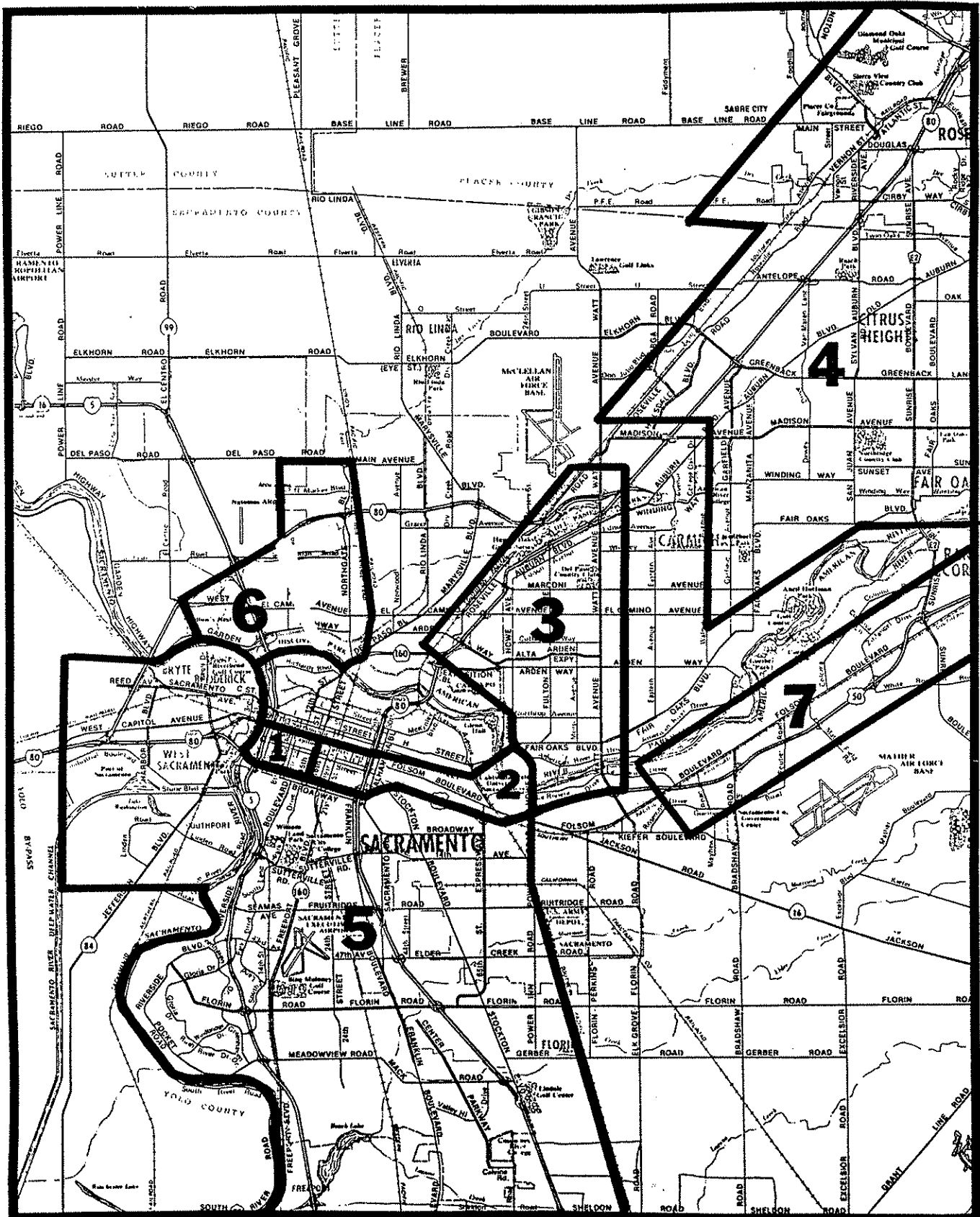
Rents in South Natomas for Class "A" space are currently \$18.00 to \$19.50 per rentable square foot full service with a \$4.20 expense stop. Concessions generally average 10 percent of lease value in the form of free rent and/or excess tenant improvements and parking is free. These rent levels make South Natomas the least expensive quality suburban office market in the Sacramento region with at least a \$2.00 per square foot rental savings when compared with other Sacramento suburban office markets. South Natomas also has superior access to the Downtown market and the Sacramento Airport.

D. CONCLUSION

Metro Center, Phase I has a unique opportunity to achieve full occupancy in the next 18 months. Downtown Sacramento is currently firm overall and space comparable to the subject is particularly difficult to find. The quality, ease of access and visibility of the subject property is reflected by its current leasing activity and this pace should quicken as comparable space becomes even more scarce. The subject property is the highest quality office product in South Natomas offering the Downtown Sacramento office tenant more affordable space in a campus-like setting with free and abundant parking.

Metro Center, Phase I is expected to be fully occupied within 18 months at rental rates ranging from \$18.00 to \$19.50 per square foot full service. Piedmont Realty Advisors underwrote the lease up period with \$18.00 rents, \$4.20 expense stops and \$20.00 tenant improvement budgets. This conservative underwriting approach reflects the uncertainty relating to absorption projections which are inherent in suburban growth markets in general and in South Natomas in particular. There is a high probability that the actual performance of Metro Center, Phase I will exceed Piedmont's expectations.

Exhibit III-1
OFFICE SUBMARKET
LOCATION MAP



1-7 Correspond to Exhibit III-2

Exhibit III-2

SACRAMENTO OFFICE MARKET CHARACTERISTICS
FOURTH QUARTER 1987

<u>Map No.</u>	<u>Submarket</u>	<u>Rentable (Sq. Ft.)</u>	<u>Vacant (Sq. Ft.)</u>	<u>Percent Vacant</u>
1	Downtown	6,030,472	758,742	12.6%
2	Midtown/Campus Commons	2,996,766	473,028	15.8
3	Point West	4,683,692	773,936	16.5
4	I-80 Corridor	2,967,511	850,681	28.7
5	Southwest Sacramento	1,421,102	316,450	22.3
6	Natomas (1)	1,562,725	376,486	24.1
7	I-50 Corridor	<u>4,172,770</u>	<u>1,253,669</u>	<u>30.0</u>
	TOTAL METROPOLITAN	<u>23,835,038</u>	<u>4,802,992</u>	<u>20.2%</u>

(1) Includes both North and South Natomas office markets.

Sources: Coldwell Banker;
Piedmont Realty Advisors.

Exhibit III-3
SACRAMENTO METRO AREA
OFFICE VACANCY

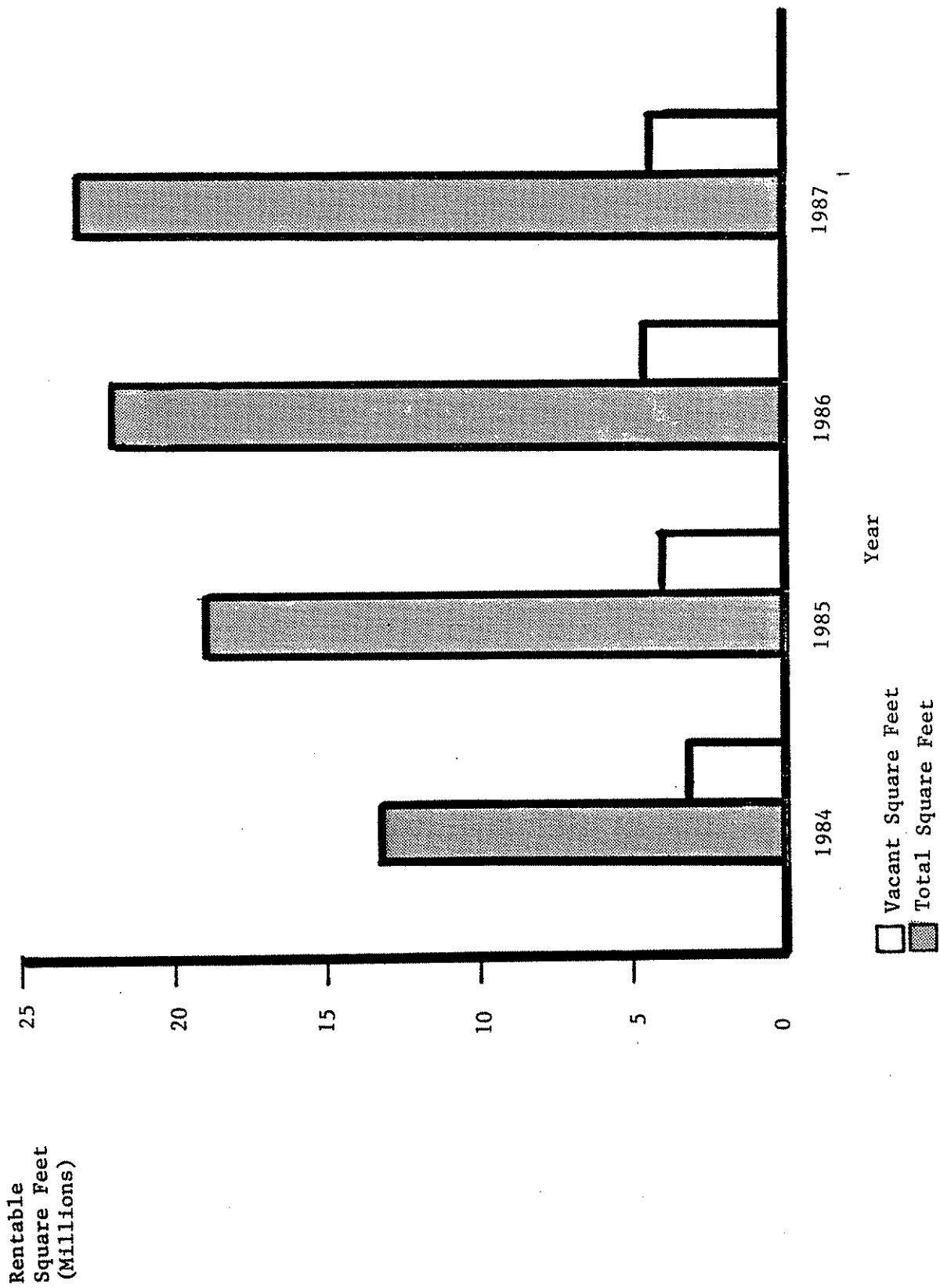


Exhibit III-3A
DOWNTOWN SACRAMENTO
OFFICE VACANCY

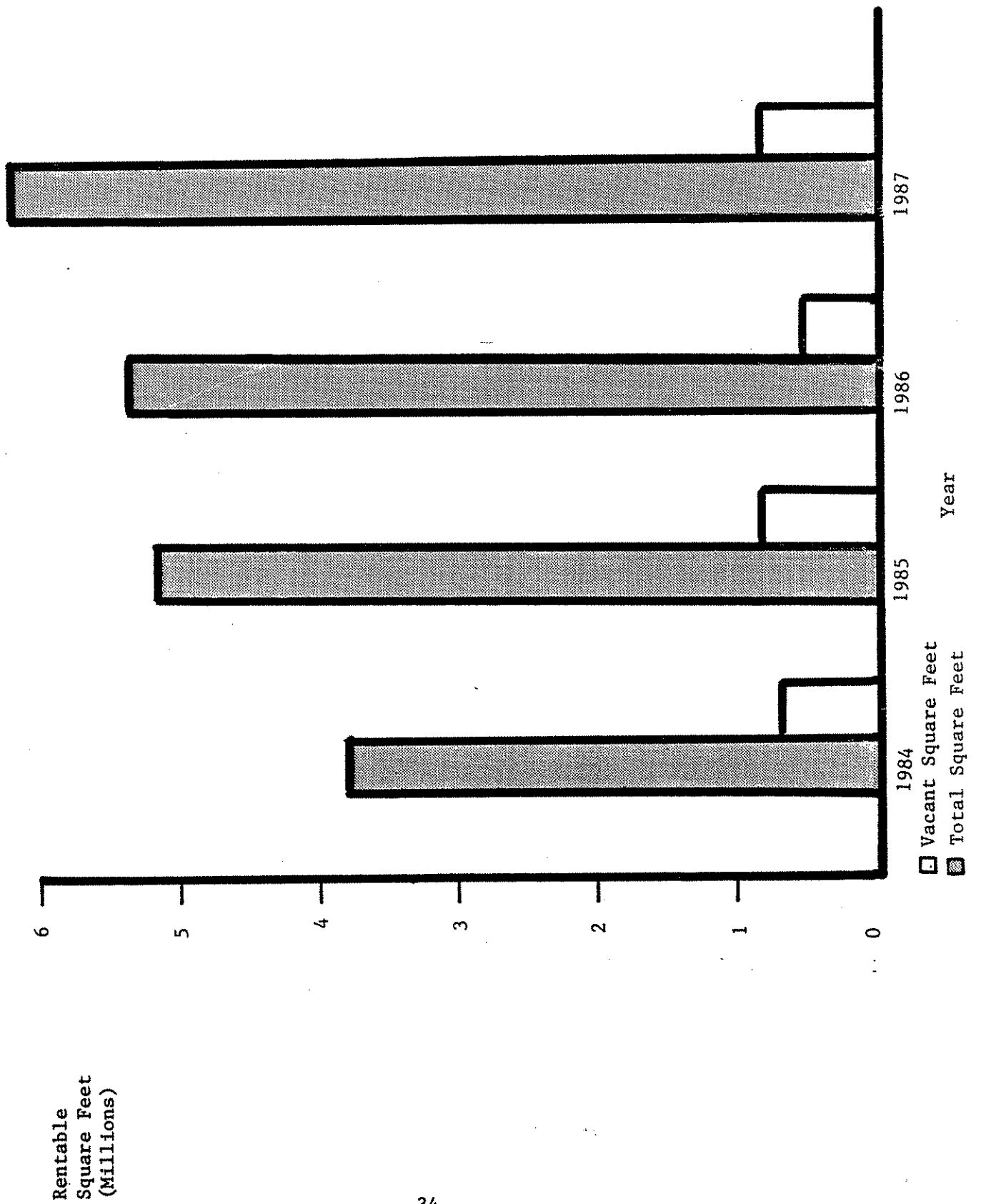


Exhibit III-3B

SACRAMENTO OFFICE ABSORPTION
TOTAL METRO vs. DOWNTOWN

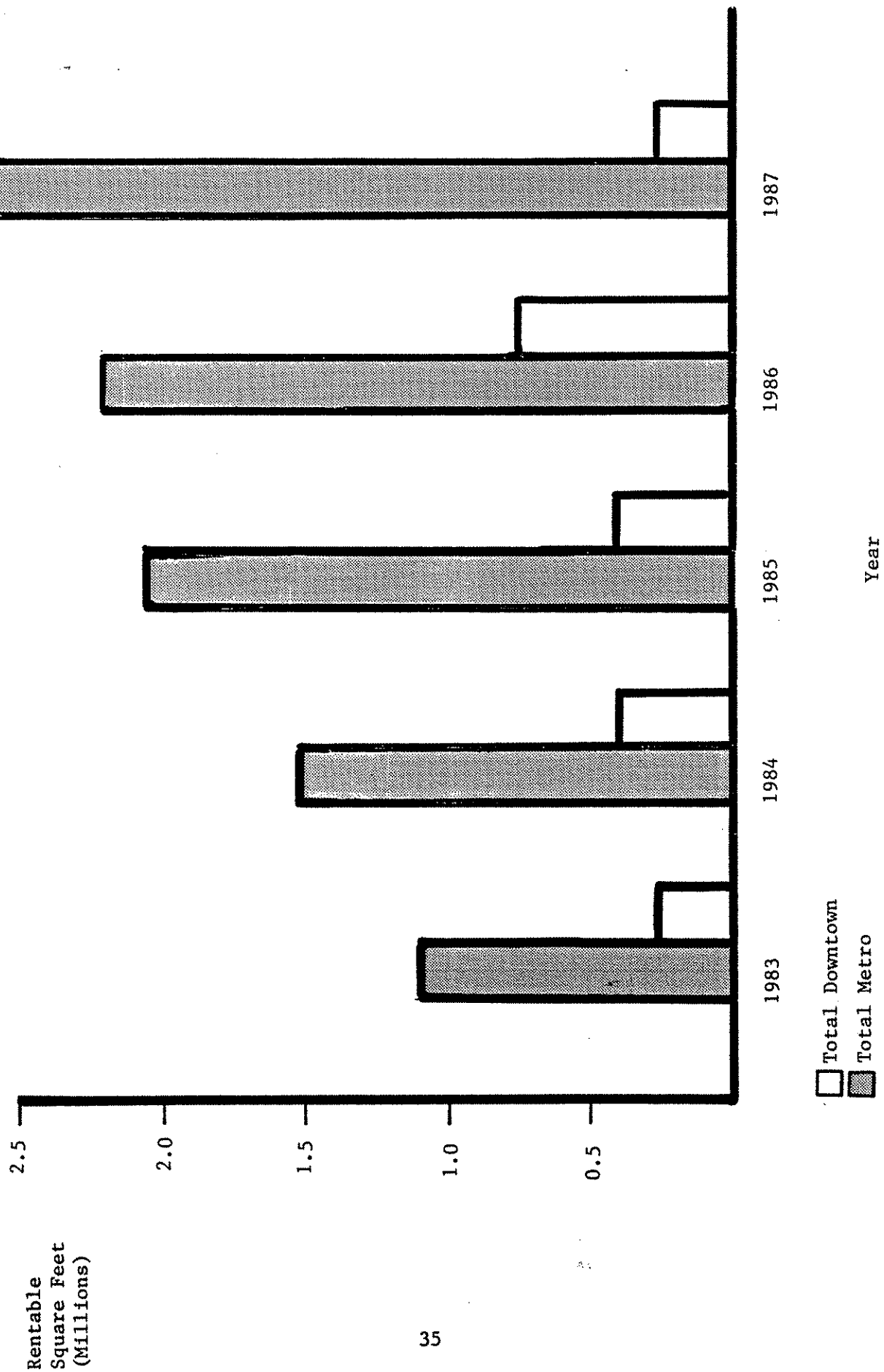


Exhibit III-4

COMPETITIVE OFFICE SURVEY
SOUTH NATOMAS

Map No.	Building Name	Rentable Sq. Ft.	Available Sq. Ft.	Lease Rent*	Tenant Improvement Allowance	Free Rent Months
1	Natomas Corporate Center	91,658	-0-	---	---	---
2	Natomas Corporate Center	81,150	-0-	---	---	---
3	State Compensation Insurance Fund Building	71,673	-0-	---	---	---
4	Christopher Oaks I	55,079	16,100	\$19.25	\$15.00	2-4
5	The Spink Building	40,592	-0-	---	---	---
6	Sutter Business Park	66,000	-0-	---	---	---
7	Sutter Business Park	47,198	-0-	---	---	---
8	Sutter Business Park	66,000	-0-	---	---	---
9	Sutter Business Park	47,198	10,000	\$14.50	\$16.00	3-4
10	Sutter Business Park	66,000	30,000	\$14.50	\$16.00	3-4
11	Honeywell Building	25,600	3,400	\$15.00	\$16.00	1-3
12	Golden Gate University Building	14,000	1,400	\$15.00	\$16.00	1-3
13	Discovery Park	44,045	6,180	\$12.60	\$10.00	3-4
14	American River Commons	92,000	3,700	\$12.60	\$10.00	3-4
15	River Park Business Center	74,879	3,200	\$14.50	\$12.00	3-4
	SUBJECT	258,304	122,678(1)	\$18.75	\$18.00	1-3
		<u>1,141,376</u>	<u>196,658</u>	<u>(17.2%)</u>		

* Lease rents are on a gross basis with expense stops averaging \$4.20 per rentable square foot.

(1) Excludes GTE lease.

Sources: Coldwell Banker;
Piedmont Realty Advisors.

Exhibit III-4A
COMPETITIVE OFFICE BUILDINGS
SOUTH NATOMAS

UNDER CONSTRUCTION

<u>Map Key</u>	<u>Developer</u>	<u>Square Footage</u>	<u>Available</u>	<u>Lease Rent*</u>	<u>Completion</u>
A	Christopher Company	80,670	61,424	\$20.50	2nd Quarter 1988
B	McCuen & Steele	<u>70,000</u>	<u>48,000</u>	\$14.00	1st Quarter 1988
		150,670	109,424		

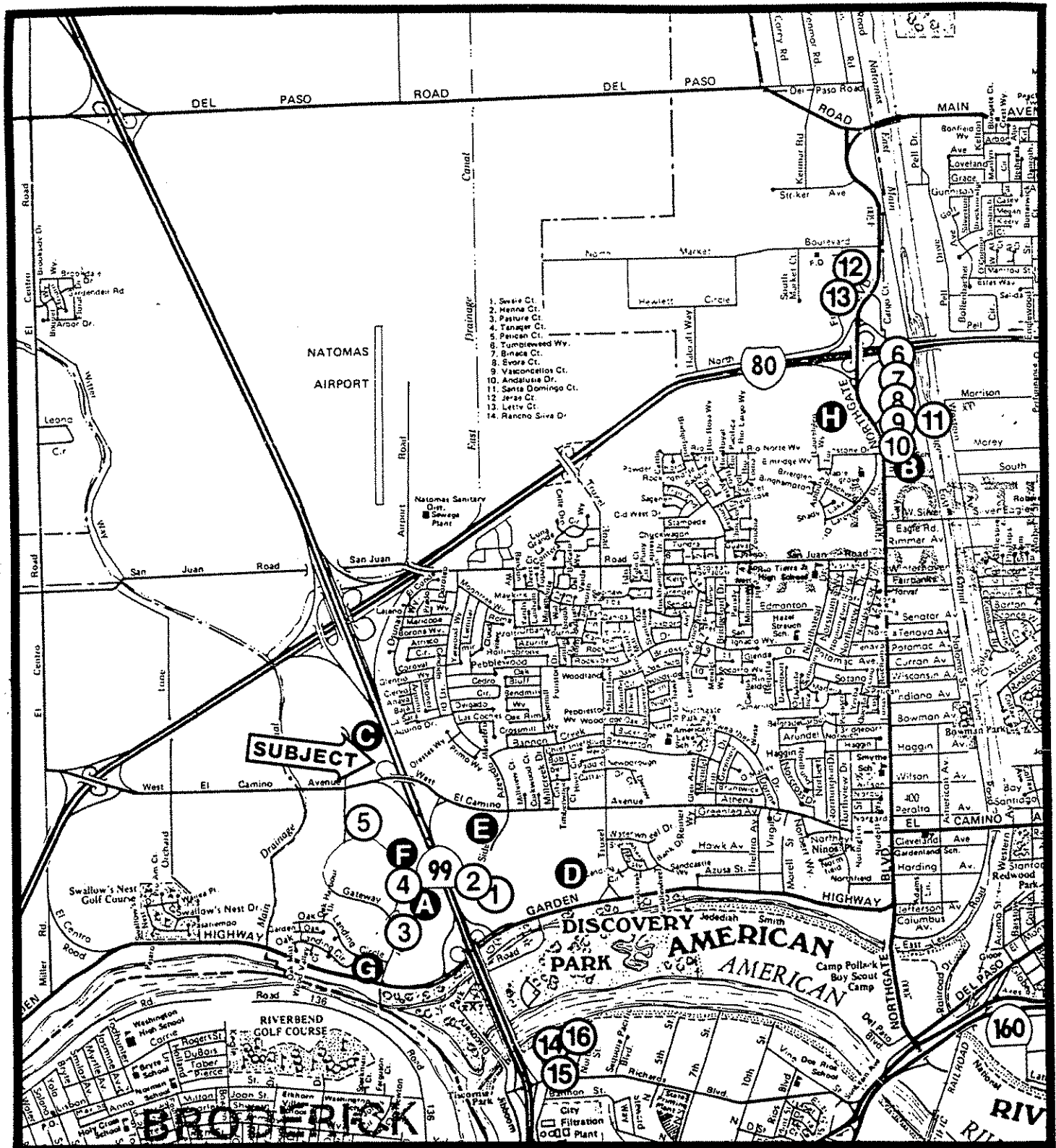
PLANNED

<u>Map Key</u>	<u>Developer</u>	<u>Square Footage</u>	<u>Lease Rent*</u>	<u>Start</u>
C	McCuen & Steele	100,000 (5-stories) 40,000 (2-stories)	\$19.25	1st Quarter 1988
D	KCS Development	291,720 (6-two-story buildings)	\$18.50	2nd Quarter 1988
E	KCS Development	60,000 (2-stories)	\$17.00	1st Quarter 1988
F	Christopher Company	100,000 (5-stories)	\$20.00	3rd Quarter 1988
G	River West	374,000 (10-stories)	Undetermined	Undetermined
H	McCuen & Steele	<u>75,000</u>	\$15.00	Undetermined
		1,040,720		

* Lease rents are on a gross basis with expense stops averaging \$4.20 per rentable square foot.

Sources: Coldwell Banker;
Piedmont Realty Advisors.

Exhibit III-5
COMPETITIVE PROPERTY
LOCATION MAP



A-H Correspond to Exhibit III-4A

1-16 Correspond to Exhibit III-4

IV. THE BORROWER/DEVELOPER

IV. BORROWER/DEVELOPER

A. INTRODUCTION

The Borrower for Metro Center, Phase I will be an entity formed by McCuen & Steele (M&S). M&S will be responsible for managing the property and leasing the remaining vacant space in the buildings. As part of those functions M&S will be responsible for managing the construction of all tenant improvements. Furthermore M&S will be responsible for providing all the necessary operating reports and accounting statements in a manner and format that is approved by USF&G. This section will provide specific information regarding M&S, particularly focusing on its organization, development history, operating responsibility and motivations to achieve success for this property.

B. THE BORROWER

1. Organization

McCuen & Steele is one of Sacramento's strongest developers. They are structured with key employees staffing development and construction, community relations, finance and leasing positions (see Exhibit IV-1).

The organization is oriented toward the development of large parcels of land which they acquired in joint venture with Peery & Arrilluga in 1980 and 1982. Peery & Arrilluga are the largest and best land speculators in Northern California. They acquired four key Sacramento parcels with McCuen & Steele at prices which are now (with accrued interest) 25 percent to 50 percent below market value. Because they are oriented toward the development of similarly designed product, the McCuen & Steele organization is not burdened by several layers of project management employees.

2. Key People

The borrowing entity will be SIC II/N, a general partnership. The general partners will be Richard D. Nelson (20 percent) and Sacramento Investment Company II, Ltd., a California limited partnership (80 percent). Peter A. McCuen and Christopher R. Steele are each 20 percent general partners in Sacramento Investment Company II, Ltd.

- (a) Peter A. McCuen - is in charge of finance and community relations for McCuen & Steele. He is the founder of the Acurex and Verbatim Corporations. He sold Acurex in 1974 and Verbatim in 1980 and joined Christopher Steele to develop property in Sacramento in 1980. He has been instrumental in McCuen & Steele's dominance in Sacramento's high technology development sector.
- (b) Christopher R. Steele - is in charge of development and construction. Chris Steele introduced both the business park concept and flex-space building design to the Sacramento market in 1978 and 1979. He is in charge of developing the remaining land at Metro Center.

- (c) Richard D. Nelson - is in charge of marketing and leasing. Dick Nelson was formerly with the Sacramento office of Coldwell Banker. Mr. Nelson was company rookie of the year in 1977, number one broker in Sacramento 1983 through 1985 and number one broker in the entire Coldwell Banker system in 1985. He joined McCuen & Steele in 1986 as partner and has since been responsible for over 600,000 square feet of leasing.

C. BORROWER TRACK RECORD

McCuen & Steele have developed over 2.5 million square feet of office, high-tech and industrial space in the Sacramento area since 1980. Their existing portfolio is currently 87 percent leased and occupied (including the subject property) and is summarized as follows:

- o Prospect Park (US-50) - 30 buildings containing 1.7 million square feet of multi-story office buildings have been completed with an aggregate occupancy of 96%.
- o Sutter Business Park (I-80) - 350,000 square feet in 6 buildings have been completed. This park is located one mile northeast of the subject property and consists of one-story tilt up buildings oriented toward back office and government tenancy. There is one, two-story building in this park which has been designed as flex space and is not comparable to Metro Center, Phase I.
- o Laguna Business Park (US-99) - Construction of the first 150,000 square foot, one-story complex will begin in January 1988 as the first phase of an 800-acre business park.
- o Metro Center (I-5/I-80) - The subject property is the first phase of a 110-acre (out of a 160-acre multi-use parcel) office park located at the intersection of I-5 and I-80.

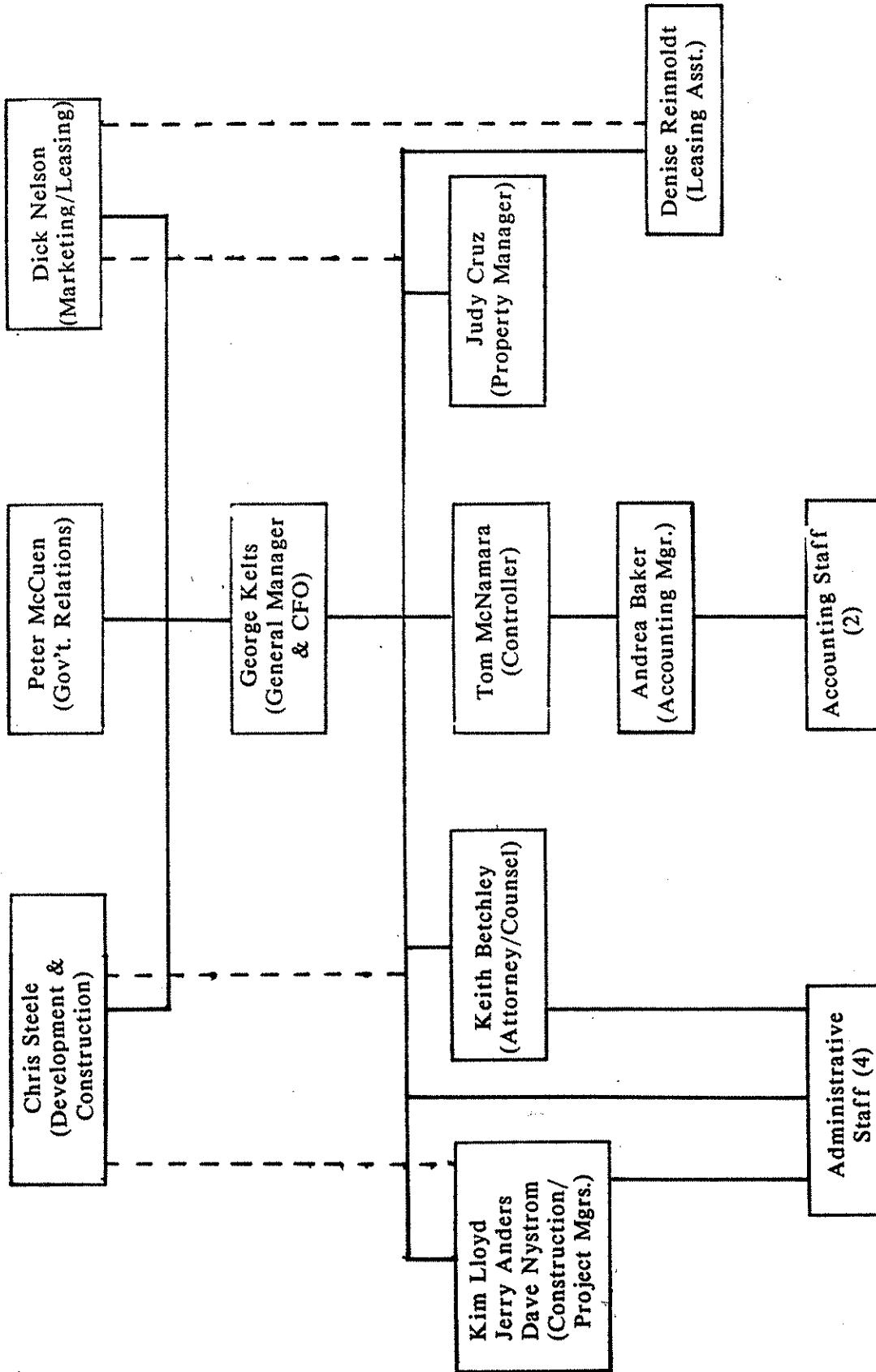
D. CONCLUSION

McCuen & Steele is Sacramento's premier suburban developer. It introduced the business/office park concept to Sacramento in 1980 and is currently in an excellent position to benefit from the region's economic growth. McCuen & Steele has an excellent reputation with the brokerage community due to its (1) high quality product line (2) excellent locations in each major suburban submarket (3) responsiveness (4) timely payment of brokerage commissions and (5) good property management.

Metro Center, Phase I is well positioned in the South Natomas office market as the best quality project with a flexible tenant orientation due to the various building designs. Dick Nelson continues to generate a consistent flow of tenants in the 7,000 to 15,000 square foot range and there is no indication that this flow will slow down in the immediate future. McCuen & Steele has put together a team for Metro Center which is capable of meeting and maintaining Piedmont's economic expectations for the subject property.

Exhibit IV

ORGANIZATION CHART
MCCUEN & STEELE



V. RISK AND RETURN

V. RISK AND RETURN

A. DEAL STRUCTURE

1. Introduction

As a form of investment, the participating mortgage has some of the advantages of an equity investment as well as the guaranteed return and security position of traditional mortgage debt. The participating mortgage for Metro Center, Phase I will be fully collateralized by a first lien on an existing property which is currently 42.1 percent leased (52.5 percent with GTE). As additional security the general partners of the borrowing entity will guarantee the cash flow deficits of the project for 24-months or breakeven occupancy whichever occurs first. The guarantee will be sufficient to cover operating expenses and debt service.

2. Special Deal Features

The proposed participating mortgage has been structured to allow USF&G to enter the project slightly below McCuen & Steele's construction basis. McCuen & Steele will not receive a "developer's profit" based on the existing leasing of the subject property at initial funding. Instead, any potential profit must be earned by McCuen & Steele's success in leasing the remaining vacant space in the building. This incentive has been structured as (1) USF&G's standard economic holdback and (2) as an Equity Preference.

The deal structure allows the borrower to "earn" up to \$3,000,000 in Equity Preference during the first 36-months of the loan based on the capitalized net operating income of the property. This Equity Preference will assume the form of a priority distribution of capital proceeds upon sale or refinancing after USF&G receives its loan balance, but before the 70 percent (USF&G) and 30 percent (M&S) split of net capital proceeds. For example, in the event that the property achieves the stabilized proforma net operating income estimate of \$3,511,449, the borrower would earn an Equity Preference of \$2,055,000. This \$2,055,000 accounts for 8.6 percent of the residual proceeds based on the proforma cash flow. This feature is advantageous to USF&G because the Equity Preference amount is based on the actual leasing in place and not on imputed equity at initial funding. It is common for a developer to demand imputed equity for an immediate fund participating mortgage on an existing and leased property. The proposed structure allows USF&G to fix its commitment amount at a reasonable loan to value ratio by allowing the developer to earn its Equity Preference which is contingent upon actual leasing and paid only after a capital event. This method allows USF&G to avoid the placement of the \$3,000,000 in the economic holdback which would result in substantial loan to value risk.

The proposed mortgage also maintains a fixed spread between the pay rate and the accrual rate. Any available cash flow is first used to pay (1) the accrual rate of 9.25%, (2) then to pay any previously accrued interest and (3) then split 50/50. This structure has significant benefits to McCuen & Steele during the lease-up phase of the transaction because they can be very competitive (relative to other South Natomas office buildings) for prospective tenants due to lower carrying costs based on the loan pay rate. The structure also has benefits USF&G by reducing the default risk during the tenant rollover phase of the transaction by minimizing the debt burden when net income is decreasing and capital costs are increasing.

B. VALUE ESTIMATE

1. Introduction

The initial funding of the proposed transaction is \$28,500,000 of which \$685,500 are fees and closing costs associated with the USF&G participating loan. The net proceeds to McCuen & Steele of \$27,814,500 are approximately \$1,000,000 greater than the estimated March 1, 1988 construction loan balance of \$26,800,000. However, McCuen & Steele currently have invested approximately \$2,200,000 in equity in the project since ground breaking. Therefore, USF&G's initial loan basis should be slightly less than Metro Center, Phase I's construction basis.

2. Existing Rent Roll

Ten tenants occupy a total of 108,626 square feet in Metro Center, Phase I or 42.1 percent of the project's total net rentable area. A 27,000 square foot lease with GTE has been negotiated and is scheduled for GTE approval during the last week of December, 1987. If the GTE lease is approved it will increase the project's occupancy rate to 52.5 percent.

The existing rent roll is a good mix of prestigious Downtown tenants-Heffner, Stark/Memering, Varanini; strong local companies - Mercy Health Care; and national credit - Ford Motor Credit/URS/IDS (see Exhibit V-1). Future leasing in the project should have a higher proportion of Downtown firms due to the strengthening Downtown office market. Future leases will probably be similar in form to the existing leases with "stepped up" rental payments during the term, similar free rent and less lease assumption activity.

3. Proforma Income and Expenses

Proforma income and expenses for Metro Center, Phase I are based on the rent roll presented in Exhibit V-1. The proforma was estimated as of the end of the second loan year using the following assumptions (see Exhibit V-2):

- (a) The existing lease schedules for tenants that will be in occupancy as of the closing were incorporated.

- (b) The vacant office space was leased based on:
- (1) Annual contract rent of \$18.00 full service with a \$4.20 expense stop.
 - (2) Rental concession of 6-months for a five year lease term resulting in a 10 percent discount.
 - (3) The lease-up of the vacant space is projected to occur at a rate of approximately 6,814 net rentable square feet per month (18 months to 100 percent occupancy).
- (c) All rental rates during the lease term were increased 12.5 percent effective the 31st lease month.

4. Preliminary Valuation Estimate

Piedmont Realty Advisors estimated the preliminary value of the property by comparing the subject property to recent building sales in the Sacramento metropolitan area. The value estimate in Exhibit V-3 indicates a value range of \$37,500,000 to \$39,000,000 for Metro Center, Phase I. The proposed loan amount of \$34,000,000 is 87.2 percent to 90.7 percent of the value estimate.

C. RETURN

1. Cash Flows

Piedmont Realty Advisors estimated the property's income and expenses to calculate the cash flow to USF&G during an investment holding period of 10 years. Income figures were based on the actual terms of existing leases and the assumptions outlined in Exhibit V-4 for vacant space. It is estimated that USF&G will have an average annual loan balance of \$30,300,000 during the first loan year and will receive debt service based on the pay rate of 8.25% (see Exhibit V-5). By the third loan year there is sufficient cash flow to cover the 9.25% accrual and offset previously accrued and unpaid interest. The cash flow from the property declines in years five and six due to tenant rollovers, but increases to a level sufficient to pay the 9.25% interest rate on the loan in year seven and thereafter.

2. Returns at Sale

The net residual value of the property was calculated by capitalizing the 11th year's net operating income at nine percent and deducting three percent selling expenses. The gross estimated selling price of \$59.5 million is approximately \$230 per square foot and represents a 4.4 to 4.7 percent average annual increase over Piedmont's preliminary value estimate.

Piedmont Realty Advisors estimates that all previously accrued interest will be repaid before the point of sale and that after deducting the \$34,000,000 loan balance and McCuen & Steele's estimated Equity Preference of \$2,055,000, distributable proceeds of \$21,722,339 will remain. USF&G will receive 70 percent of these proceeds or \$15,205,637.

3. Yield Analysis

USF&G's internal rate of return for the proposed investment based on the proforma is 12.4%. This yield is based on a proposed ten-year holding period which corresponds to the seven- to ten-year development time frame of the South Natomas area. USF&G's internal rate of return varies from 11.2% to 13.1% depending on the capitalization rate and market rental rate assumptions (see Exhibit V-6).

D. RISK

The risks involved with this project are outlined below:

<u>Risks</u>	<u>Mitigating Factors</u>
Project Risks:	
(a) Subject property is Phase I of a multi-phase park. Conflict of Interest potential.	South Natomas market is currently in a "lease-up" window with Downtown. The subject property is 52% leased (including GTE). McCuen & Steele will not be able to introduce a new building within the next 14 to 18 months which is the approximate length of the existing leasing window. Therefore, there is a low probability for conflict of interest.
(b) Elevators and Lobbies. Elevators are slow, and dark. Lobbies are small and dark.	May negatively impact certain tenants, but both features compare well with competition.

Risks

Mitigating Factors

Market Risks:

- (a) Land supply can support extensive office development.

Subject property is the best site in the market. Two large build-to-suits have absorbed large parcels in Natomas during 1987-First Nationwide Savings and State Compensation Fund. This trend should continue.

- (b) The vacancy rate in South Natomas has historically exceeded 20%.

Tenant activity remains good and subject has been capturing greater than its fair share of demand. Concessions are only 10% despite 17% vacancy rate.

Deal Structure:

- (a) USF&G is participating in 70% of the residual. This may present a motivational issue.

The equity preference feature should either (i) solve the problem if it produces a reasonable level of imputed equity or (ii) exacerbate the problem of motivation which may result in an early sale of the property.

- (b) Loan to value. The preliminary value estimate is \$37.5 to \$39.0 million indicating a potential for a 90%+ loan to value ratio.

This is an existing property with proven market acceptance - tenant improvement cost overruns and property carry have increased the cost of the project. There is adequate indicated equity for the identified risks.

E. CONCLUSIONS AND RECOMMENDATIONS

Metro Center, Phase I is a well located, well designed office project and has demonstrated office market acceptance as evidenced by its 42.1 percent occupancy. The timing of the investment is excellent for USF&G due to a firming of the South Natomas and Downtown Sacramento office markets which has resulted in a "lease-up" window for the subject property during the next 14 to 18 months.

The base case internal rate of return of 12.4% is very high relative to the identified risks. Furthermore, there is relatively small variation of the internal rate of return when market rental rate and capitalization rate assumptions are changed. This is due to the nature of the existing leasing in the property which is relatively long-term with fixed rental rate increases.

We therefore recommend that the Real Estate Investment Committee of the United States Fidelity and Guaranty Company approve the issuance of the commitment for a first mortgage of \$34,000,000 for Metro Center, Phase I.

Exhibit V-1
RENT ROLL

<u>TENANT</u>	<u>BUILDING</u>	<u>COMMENCEMENT DATE</u>	<u>TERM/ EXPIRATION</u>	<u>S.F.</u>	<u>LEASE TYPE/ EXPENSE STOP</u>	<u>RENT PSF</u>	<u>RENTS ADJUSTMENTS</u>	<u>FREE RENT 1/</u>	<u>TENANT IMPROVEMENTS</u>	<u>OPTION TO RENEW</u>	<u>COMMENTS</u>
Mercy Health Care	A-North	1/01/87	60 Months 12/31/91	22,915	Gross/ \$3.60 psf	\$ 7.56	Mo. 1-12 \$16.56 Mo. 13-24 \$20.16 Mo. 25-36 \$21.60 Mo. 37-48 \$23.16 Mo. 49-60	None	\$30.00 psf 2/ \$4 TIs	2, 5 yr @ TBA	None
Thompson-McKinnon	A-North	8/15/87	120 Months/ 8/14/97	5,071	Gross/ \$3.60 psf	\$18.84	Mo. 1-30 \$20.04 Mo. 31-60 \$22.44 Mo. 61-90 \$23.64 Mo. 91-120	3 Months	\$21.00 psf	None	Early occupancy began 5/15/87 @ \$0.30 psf/mo for 3 mos. \$9.00 TI paid in cash by tenant
Acacia Mutual Life	A-North	2/01/88	60 Months/ 1/31/93	8,876	Gross/ \$3.60 psf	\$20.40	Mo. 1-60	6 Months	\$24.00 psf 2/	1, 5 yr @ market	Early occupancy began 8/1/87 @ \$0.30 psf/mo for 6 mos.
Heffner, Stark	A-South	8/01/87	120 Months/ 7/31/97	20,192	Gross/ \$4.20 psf	\$13.92	Mo. 1-30 \$16.32 Mo. 31-60 \$18.72 Mo. 61-90 \$20.52 Mo. 91-120	3 Months	\$20.00 psf	2, 10 yr @ market	Early occupancy began 5/1/87. Equity interest: prorata of 2.5% of sales price.
Ford Motor Credit	B	2/01/87	63 Months/ 4/30/92	10,051	Gross/ \$3.60 psf	\$21.00	Mo. 1-36 \$22.20 Mo. 37-63	None	\$30.00 psf 2/	1, 5 yr @ market	None
Hayne R. Moyer	B	3/01/88	60 Months/ 2/28/93	5,048	Gross/ \$3.96 psf	\$17.64	Mo. 1-30 \$18.60 Mo. 31-60	4 Months	\$20.00 psf	1, 5 yr @ market	Early occupancy began @ \$0.33 psf/mo for 4 mos.
Memering, Varanini	B	9/01/87	60 Months/ 8/31/92	9,118	Gross/ \$4.20 psf	\$16.80	Mo. 1-24 \$17.40 Mo. 25-36 \$18.00 Mo. 37-60	6 Months	\$25.50 psf 2/	2, 5 yr @ market	Early occupancy began 3/1/87 @ \$0.35 psf/mo for 6 mos. \$3.50 T.I. paid in cash by tenant.
URS Corporation	B	1/01/87	72 Months/ 12/31/92	10,579	Gross/ \$3.96 psf	\$19.20	Mo. 1-12 \$19.80 Mo. 13-24 \$20.40 Mo. 25-36 \$21.00 Mo. 37-48 \$21.60 Mo. 49-60 \$22.20 Mo. 61-72	None	\$27.00 psf 2/	1, 5 yr @ market	Right to terminate after 36 mos. Full recapture of unamor- tized tenant costs in favor of landlord

Exhibit V-1
RENT ROLL
(Cont'd)

<u>TENANT</u>	<u>BUILDING</u>	<u>COMMENCEMENT DATE</u>	<u>TERM/ EXPIRATION</u>	<u>S.F.</u>	<u>LEASE TYPE/ EXPENSE STOP</u>	<u>RENT PSF</u>	<u>RENTS ADJUSTMENTS</u>	<u>FREE RENT 1/</u>	<u>TENANT IMPROVEMENTS</u>	<u>OPTION TO RENEW</u>	<u>COMMENTS</u>
IDS Financial	B	5/01/88	96 Months/ 4/30/96	14,476	Gross/ \$4.20 psf	\$18.60 \$19.80	Mo. 1-60 Mo. 61-96	6 months	\$30.00 psf 2/	1, 5 yr @ 95%	Early occupancy prior to 5/1/88 @ \$0.35 psf/mo market for 6 mos. Full recapture of unamortized tenant costs in favor of landlord. Right to terminate after 62 mos.
Cafe M	B	11/01/87	120 Months/ 10/31/97	2,300	Gross/ \$4.08 psf	\$ 0.00 \$ 4.80	Mo. 1-3 Mo. 4-6	None	\$19.00 psf	1, 5 yr @ market	Right to terminate after 36 mos. Full recapture of unamortized tenant costs in favor of landlord. Moving allowance: \$0.50 psf.
GTE Data Services	C	4/01/88	60 Months/ 3/31/93	27,000	Gross/ \$3.96 psf	\$18.36 \$19.08 \$19.92	Mo. 1-36 Mo. 37-48 Mo. 49-60	None	\$14.00 psf	1, 6 mos. mo. to mo.	Right to terminate prior to 1/15/88.
TOTAL SQUARE FOOTAGE LEASED				<u>135,626</u>							

1/ FREE RENT equals EARLY OCCUPANCY: Early occupancy are periods prior to the commencement of the actual lease term whereby the tenant is normally required to pay expenses only. All Metro Center rent concessions are in the form of early occupancy.

2/ Excess tenant improvements over \$18.00 psf are amortized in rental rate.

Sources: McQueen & Steele;
First Interstate Mortgage;
Piedmont Realty Advisors.

Exhibit V-2

PROFORMA INCOME AND EXPENSES

Gross Income

Leased Space (1)	\$2,094,252
GTE (2)	495,720
Vacant Space (3)	<u>2,207,574</u>

Gross Potential Income \$4,797,546

Less: Vacancy 5% 239,877

Effective Gross Income \$4,557,669

Less: Existing Stops (1)	424,200
Less: GTE Stop (2)	106,920
Less: Future Stops (4)	<u>515,100</u>

Net Operating Income \$3,511,449

NOTE: Income at stabilized occupancy 24 months after initial funding.

- (1) Actual scheduled.
- (2) Lease to go to GTE committee by the end of December, 1987.
- (3) 122,643 vacant square feet @ \$18.00 gross.
- (4) 122,643 vacant square feet @ \$4.20 psf.

Sources: McCuen & Steele;
Piedmont Realty Advisors.

Exhibit V-3

VALUE ESTIMATE

Piedmont Realty Advisors reviewed 16 office building sales which occurred in Sacramento since 1982. Six comparable sales were chosen based on construction quality and location within each comparable sale's respective submarket (see Exhibit V-3A and V-3B). All six sales were adjusted by the actual change in the CPI to calculate a December, 1987 time adjustment. The sales comparables were then ranked in order of comparability and the following value range for Metro Center, Phase I was estimated:

\$37,500,000 - \$39,000,000

Exhibit V-3A

COMPARABLE SALE RANKING

<u>Map No.</u>	<u>Building Name</u>	<u>Year Completed</u>	<u>Square Feet</u>	<u>Occupancy At Sale</u>	<u>Date of Sale</u>	<u>Price/ S.F. (1)</u>	<u>Cap Rate</u>
1	University Park	1982	120,050	81.4%	12/83	\$142.10	9.20%
2	California Center	1982	180,000	48.9%	12/82	\$150.93	8.00%
	SUBJECT PROPERTY	1986	258,304	52.1%	12/87	\$145-\$150	9.00-9.25%
3	Point West Commerce	1984	110,000	55.0%	5/86	\$153.63	9.00%(3)
4	Christopher Center	1984	72,888	100.0%	6/85	\$165.16(2)	N/A(2)
5	One City Center	1985	168,000	94.2%	12/86	\$210.00	8.00%
6	Capital Bank	1984	371,000	87.5%	12/86	\$215.60	8.10%

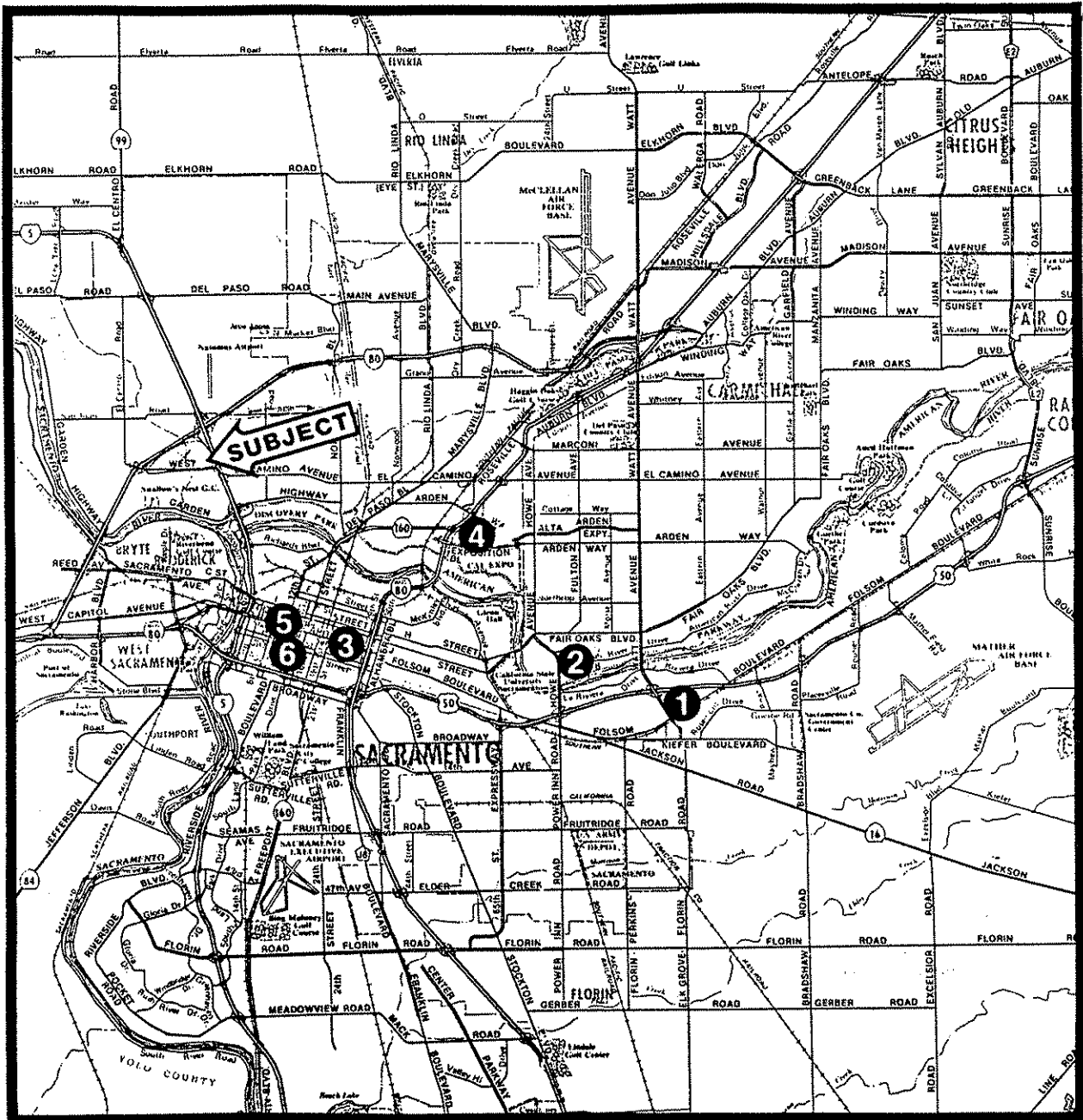
NOTE: The sales are ranked based on comparability. Sale number one is the most inferior comparable. Sale number six is the most superior comparable.

- (1) All sale prices were adjusted for time by applying the actual charge in the CPI to the actual sales price.
- (2) 40 percent of the tenants in this building received equity as part of the leasing concession package. Therefore, it is difficult to calculate an effective cap rate for this transaction. The profit from the transaction is estimated at \$33.00 per square foot. Piedmont adjusted the price for the equity participation in the leases (\$33 X .4).
- (3) Sale included a two-year master lease at 9.00%.

Source: Coldwell Banker;
First Interstate;
Piedmont Realty Advisors.

Exhibit V-3B

COMPARABLE SALE
LOCATION MAP



①-⑥ Correspond to Exhibit V-3A

Exhibit V-4

CASH FLOW ASSUMPTIONS

Initial Lease-Up		Operating	
Market Contract (PSF)	\$18.00 - \$19.50	% Market Growth	5%
Market Effective (PSF)	15.50	CPI in Lease	5%
Free Rent (% of term)	10%	Building Rental Growth	5%
Other Concessions	T.I.'s (10%)	Vacancy Rate	5%
Building Contract (PSF)	18.00	Sales Growth Rate (Retail)	N/A
Building Effective (PSF)	16.00	Vacancy at Release (mos)	3 mos.
Time to Lease-Up (mos.)	8 mos.	Tenant Refits (PSF)	
Contract Lease-Up Increase	0%	2nd Generation	\$5
		3rd Generation	\$10
Effective Lease-Up Increase	0%	Leasing Commissions (PSF)	3.75%
		Expenses (PSF)	4.20
Sale			
Value Assumptions	9% caps.	Selling Expenses	3%
Loan Information			
Investment Amount	\$34,000,000	Holdbacks	
Interest Rate (%)	9.25%	T.I.	\$2.95M
Pay Rate (%)	8.25%	Leasing Commission	\$0.55M
		Economic	\$1.00M
		Interest	\$1.00M
Cash Flow Offsets	yes	Lender % of NOI	
		Operations Cash Flow	50%
Amortization Schedule	N/A	Lender % of Sale	70% after Developer Equity
Term	10 yrs.	Total Investment (Debt and Equity)	N/A
Appraised Value and Year	9% yr. 11		

Exhibit V-5 CASH FLOW ANALYSIS

NET30 CENTER - SACRAMENTO, CALIFORNIA

OPERATING YEAR	1	2	3	4	5	6	7	8	9	10	
PAY RATE	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	
AVE PRINCIPAL BALANCE	30,312,500	33,062,500	34,415,054	34,142,490	34,000,000	34,233,312	34,597,987	34,453,759	34,000,000	34,000,000	
NET OPERATING INCOME	1,358,958	2,975,380	3,495,701	3,587,956	3,565,091	3,445,411	3,975,122	4,469,934	4,825,232	4,982,666	5,360,784
DEBT SERVICE	2,500,781	2,727,656	2,839,242	2,816,755	2,805,000	2,824,248	2,854,334	2,842,435	2,805,000	2,805,000	CRP # 9.00%
PLUNGED DEFICIT HOLDBACK	1,000,000										
CASH FLOW GUARANTEE	163,873										59,564,267
LEASING COMMISSIONS	0	0	0	0	277,631	407,510	225,462	0	0	51,436	SALES COM# 3.00%
TENANT IMPROVEMENTS	0	0	0	0	378,772	623,965	347,855	0	0	252,085	
OPERATING CASH FLOW	0	247,724	656,459	771,201	106,688	(410,252)	547,471	1,627,499	2,020,232	1,874,145	REPAY DEBT 34,000,000
											23,777,339
											0
DEBT SERVICE # 9.250%	2,802,906	3,058,281	3,183,392	3,158,180	3,145,000	3,166,591	3,200,314	3,186,973	3,145,000	3,145,000	REPAY ACCRUAL
PREP YEAR ACCRUAL BALANCE		303,125	415,054	142,490	0	233,312	597,987	453,759	142,490	0	23,777,339
QTYLY COMPOUNDING # 9.576%		29,027	39,746	13,645	0	22,342	57,263	43,452	13,645	0	McCUEY PREF 2,053,000
DEBT SERVICE PAID	2,500,781	2,727,656	2,839,242	2,816,755	2,805,000	2,824,248	2,854,334	2,842,435	2,805,000	2,805,000	
OFFSETTING CASH FLOW	0	247,724	656,459	497,560	106,688	0	547,471	841,749	496,135	340,000	21,722,339
											USF&S RESIDUAL 15,205,637
EDP ACCRUAL BALANCE	303,125	415,054	142,490	0	233,312	597,987	453,759	(0)	0	0	McCUEY RESIDOL 8,571,702
CASH FLOW TO USF&S	(28,500,000)										
IMPROVEMENTS	(2,250,000)	(750,000)									
LEASING COMMISSIONS	(375,000)	(125,000)									
DEFICITS	(1,000,000)										
ECONOMIC HOLDBACK		(1,000,000)									
DEBT SERVICE--SCHEDULED	2,500,781	2,727,656	2,839,242	2,816,755	2,805,000	2,824,248	2,854,334	2,842,435	2,805,000	2,805,000	
DEBT SERVICE--OFFSET	0	247,724	656,459	497,560	106,688	0	547,471	841,749	496,135	340,000	
PART OPERATIONS # 50.000%	0	0	0	136,820	0	0	0	392,875	762,048	767,073	
REPAYMENT OF PRINCIPAL										34,000,000	
PAYMENT OF ACCRUAL										0	
RESIDUAL # 70.000%										15,205,637	
	(28,500,000)	(1,124,219)	1,100,380	3,495,701	3,451,136	2,911,688	2,824,248	3,401,805	4,077,059	4,063,184	53,117,710
TOTAL INVESTED	34,000,000										
CASH ON CASH RETURN	8.25%	9.00%	10.28%	10.15%	8.56%	8.31%	10.01%	11.99%	11.95%		
IRR	12.4										

Sources: Piedmont Realty Advisors

Exhibit V-6
YIELD MATRIX

<u>Rental Rate (1)</u>	<u>Capitalization Rate</u>		
	<u>8.5%</u>	<u>9.0%</u>	<u>9.5%</u>
\$16.80	11.8	11.5	11.2
\$18.00	12.8	12.4	12.1
\$19.20	13.1	12.7	12.4

NOTE: Internal rate of return calculated using actual loan terms and anticipated disbursement schedule based on the cash flow assumptions in Exhibit V-4.

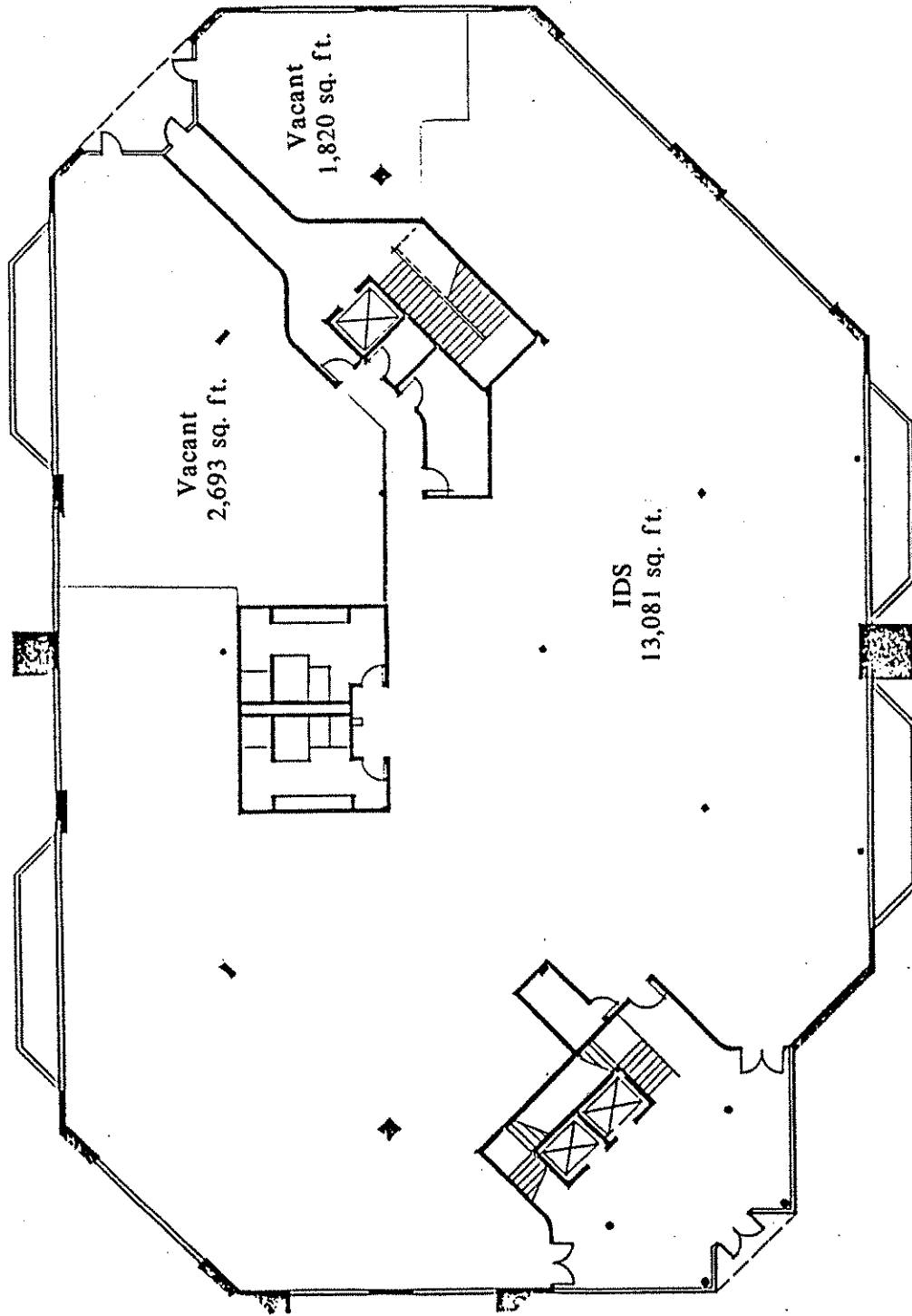
(1) Rental rate applies to all existing vacant space and market rent for tenant rollovers.

Source: Piedmont Realty Advisors.

APPENDIX A

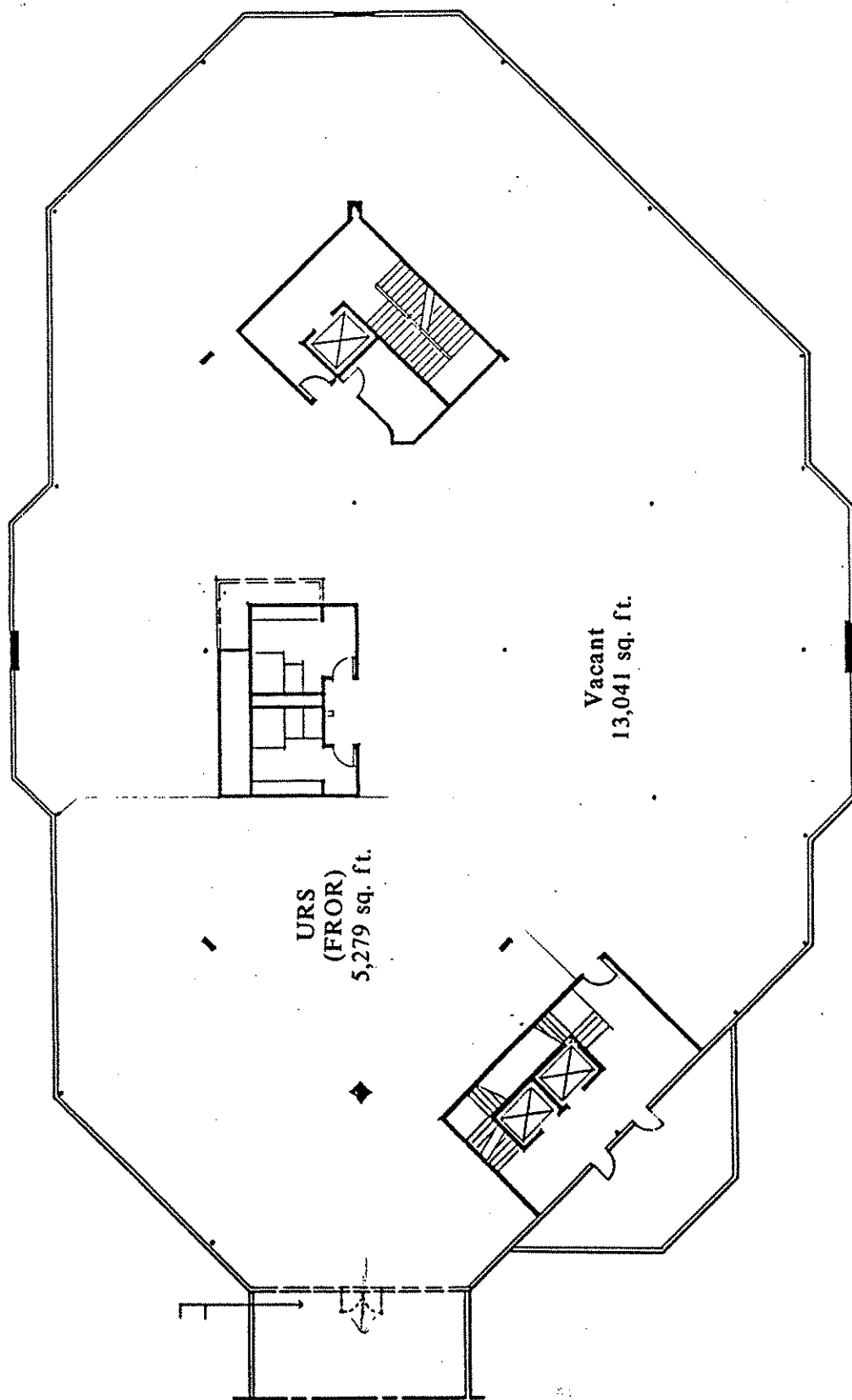
Appendix

BUILDING A - SOUTH
FIRST FLOOR

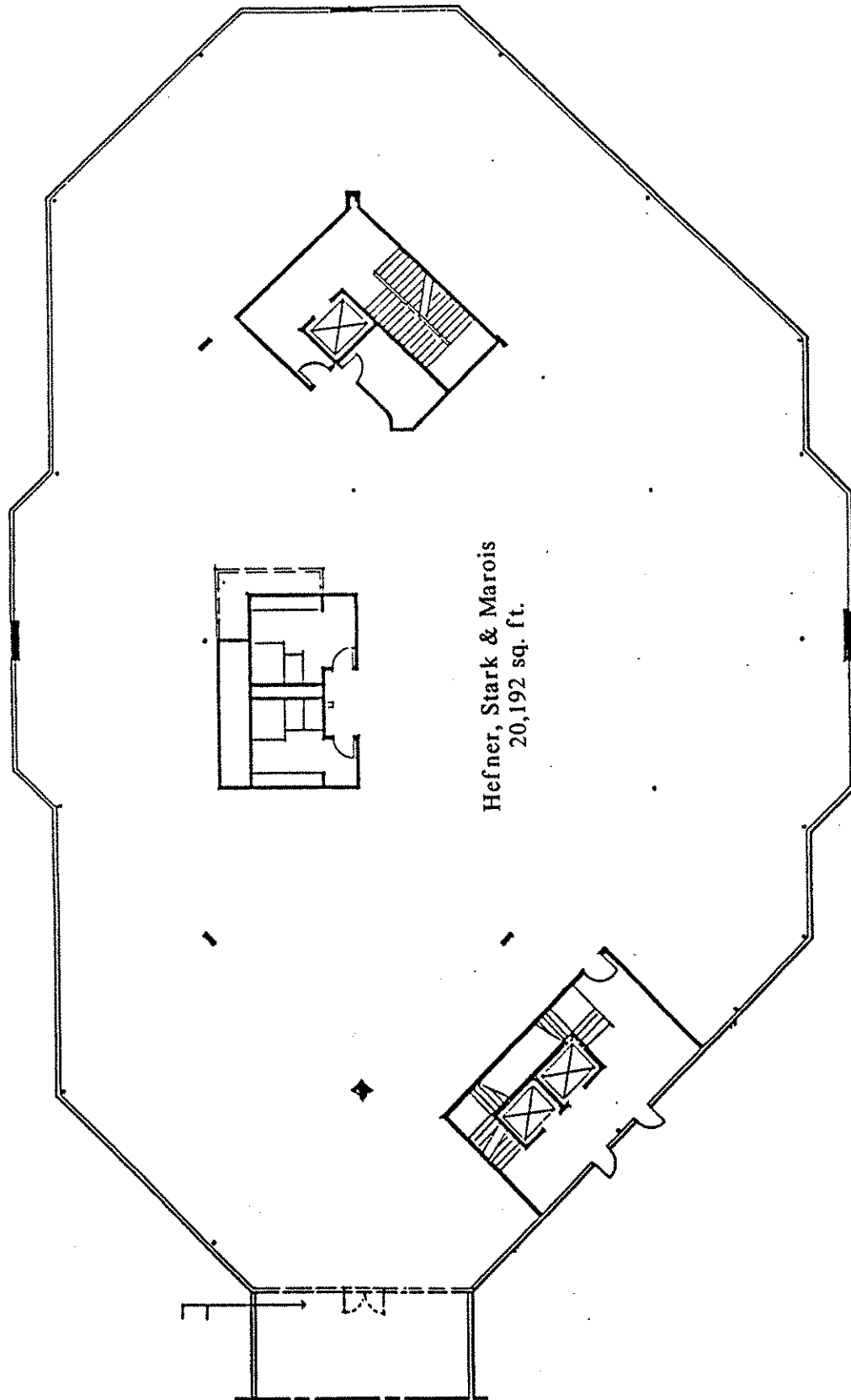


Appendix A

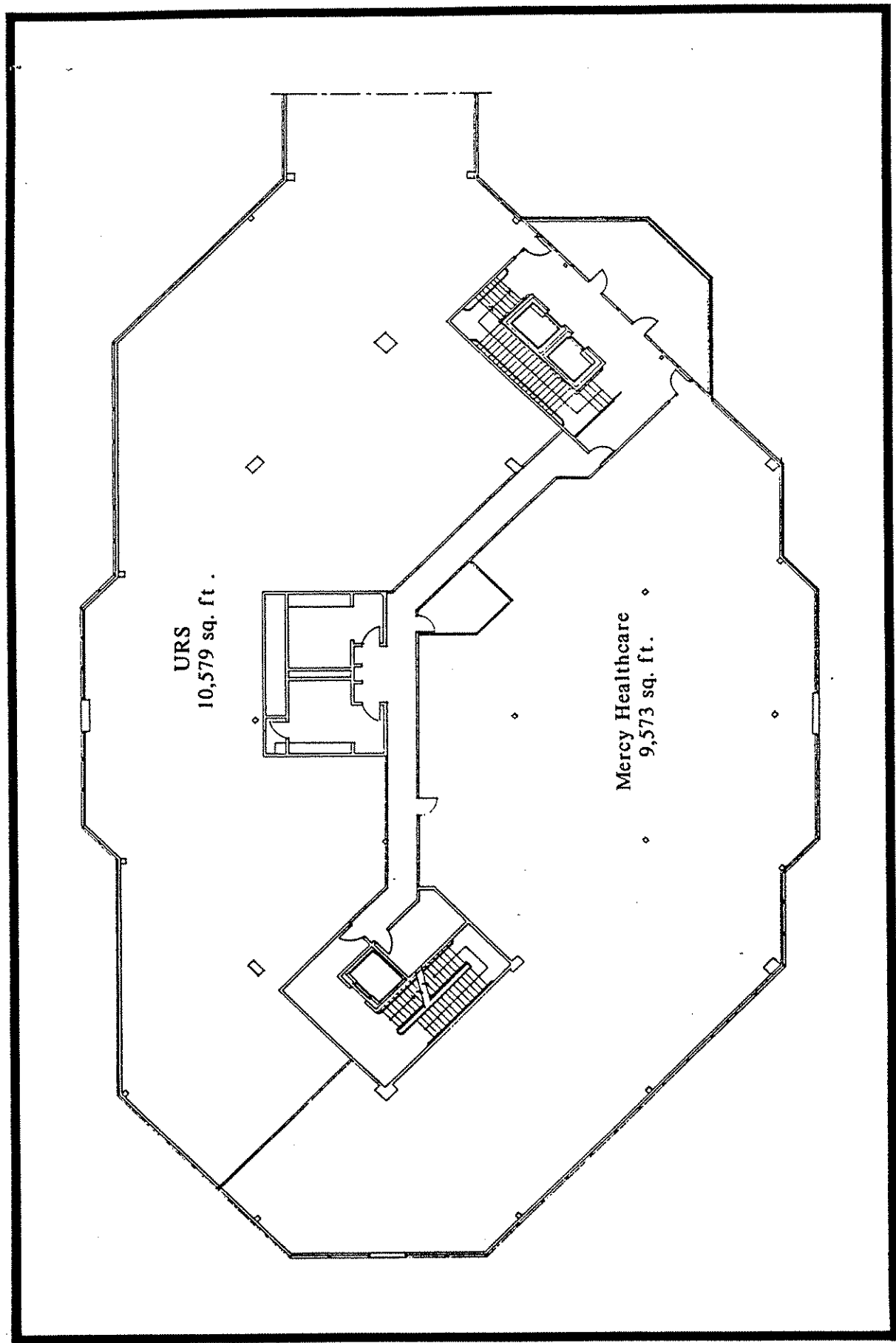
BUILDING A - SOUTH
SECOND FLOOR



Appendix A
BUILDING A - SOUTH
THIRD FLOOR

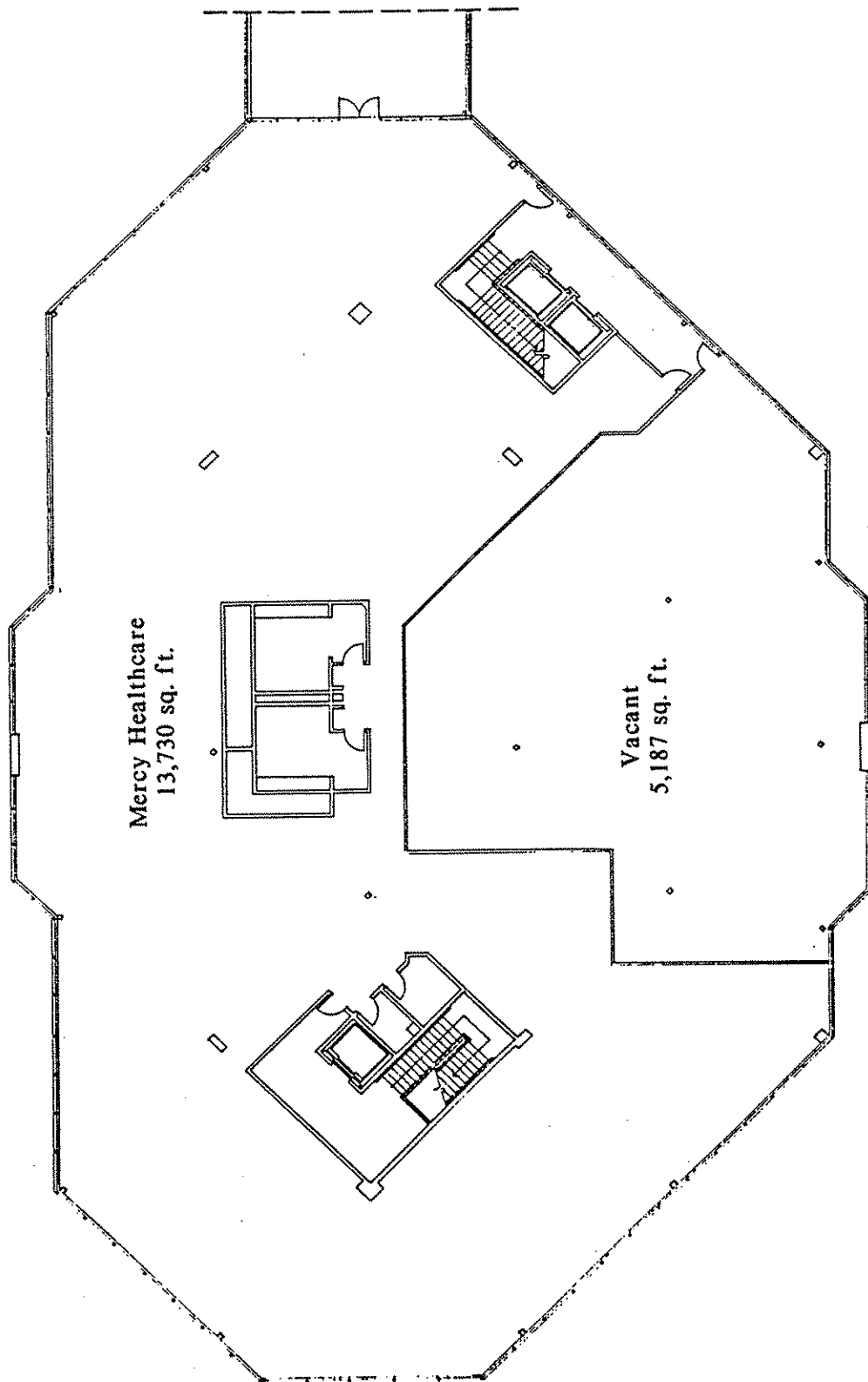


Appendix A
BUILDING A - NORTH
SECOND FLOOR

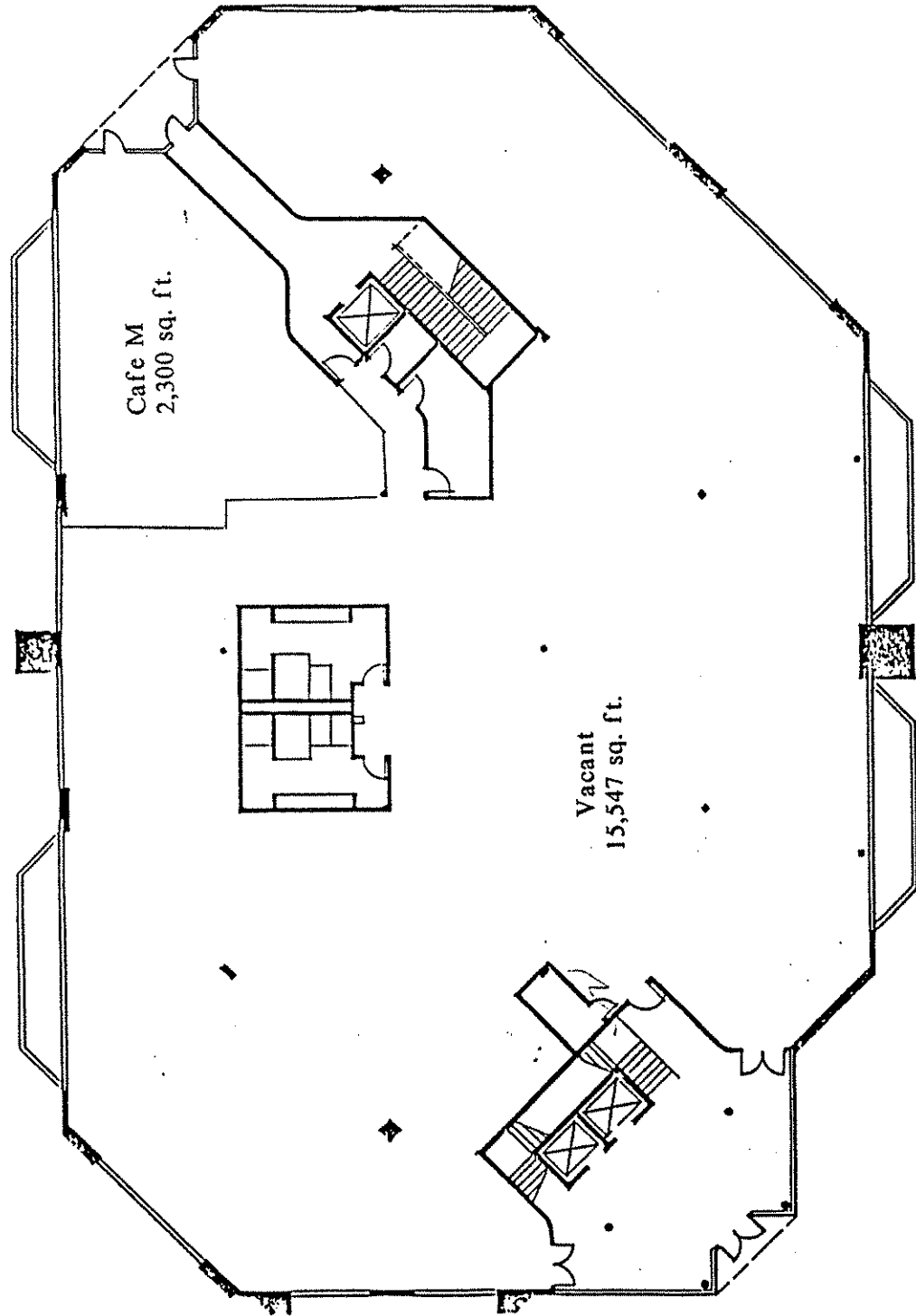


Appendix A

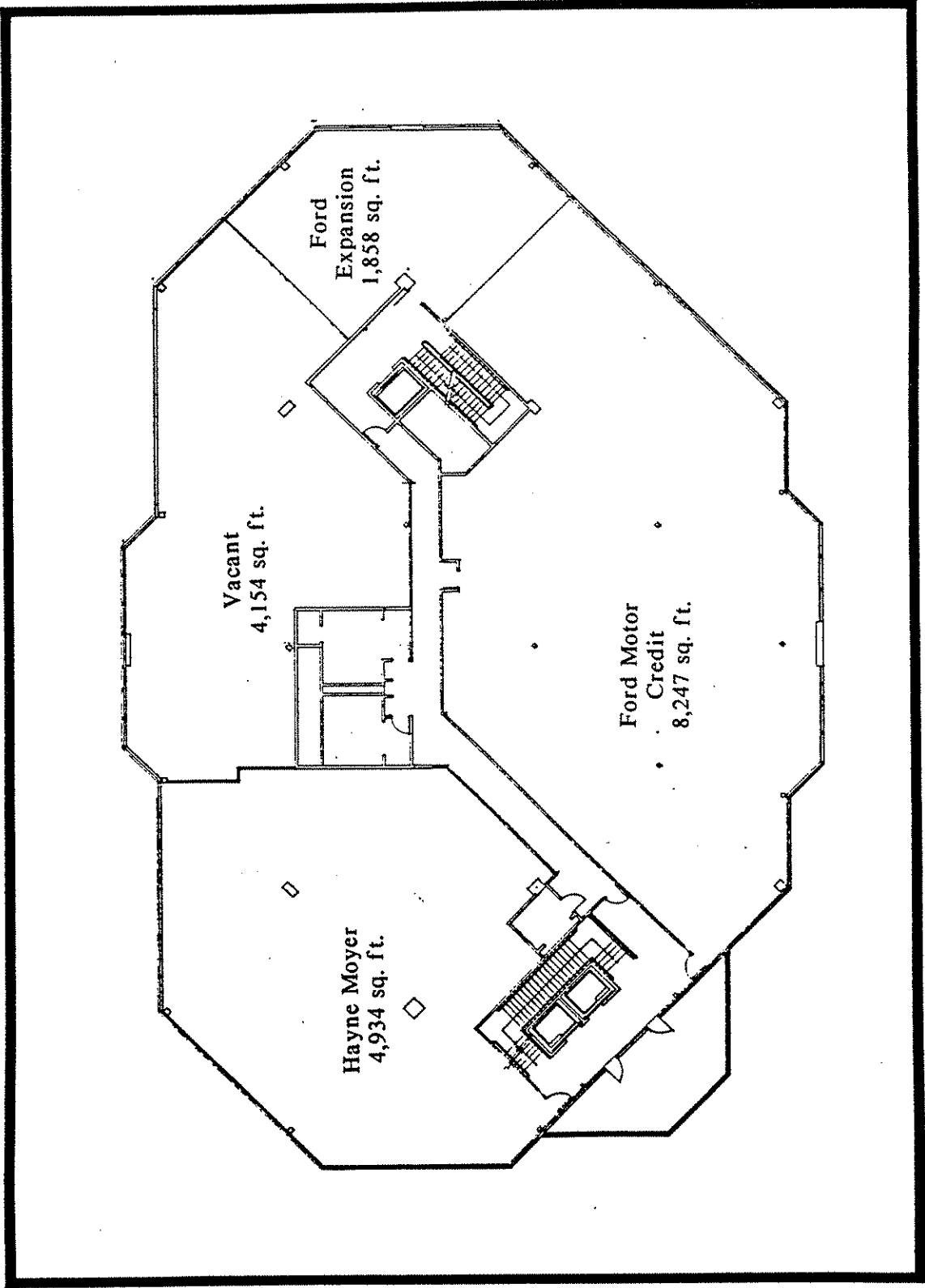
BUILDING A - NORTH
THIRD FLOOR



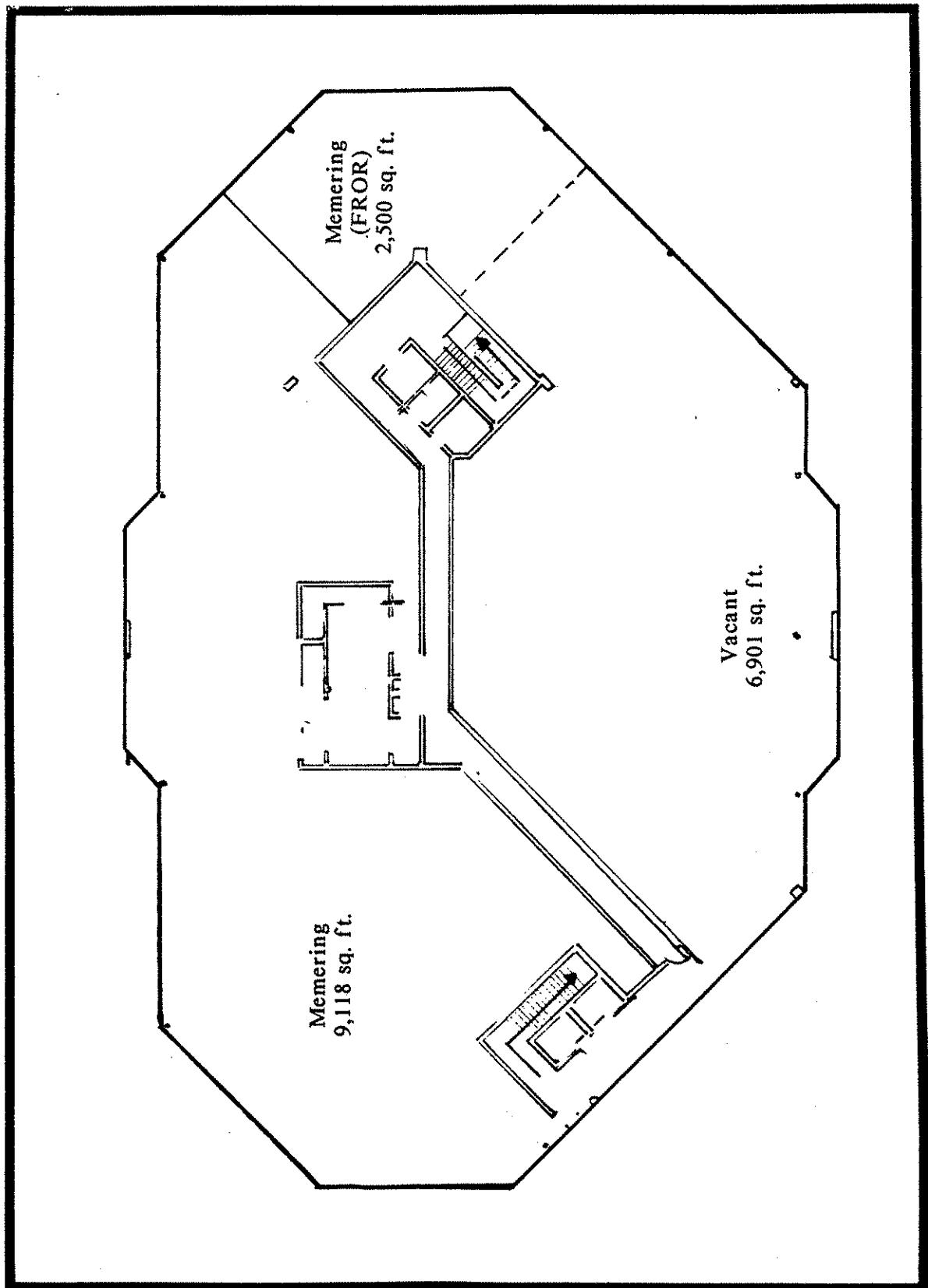
Appendix A
BUILDING B
FIRST FLOOR



Appendix A
BUILDING B
SECOND FLOOR

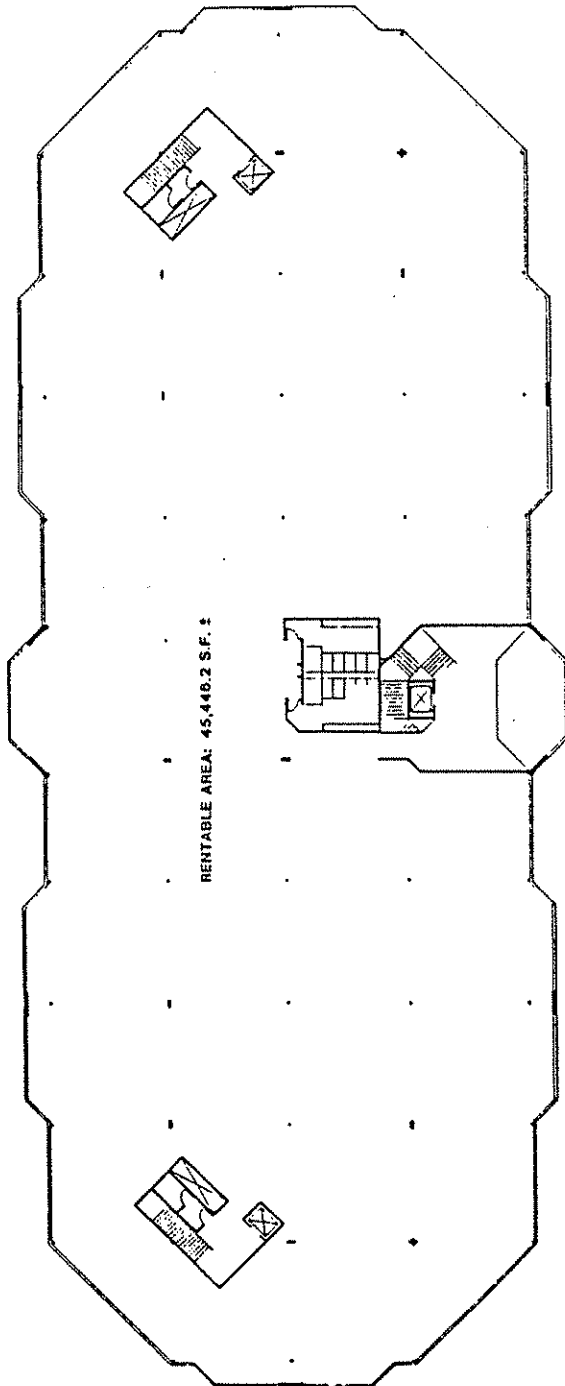


Appendix A
BUILDING B
THIRD FLOOR

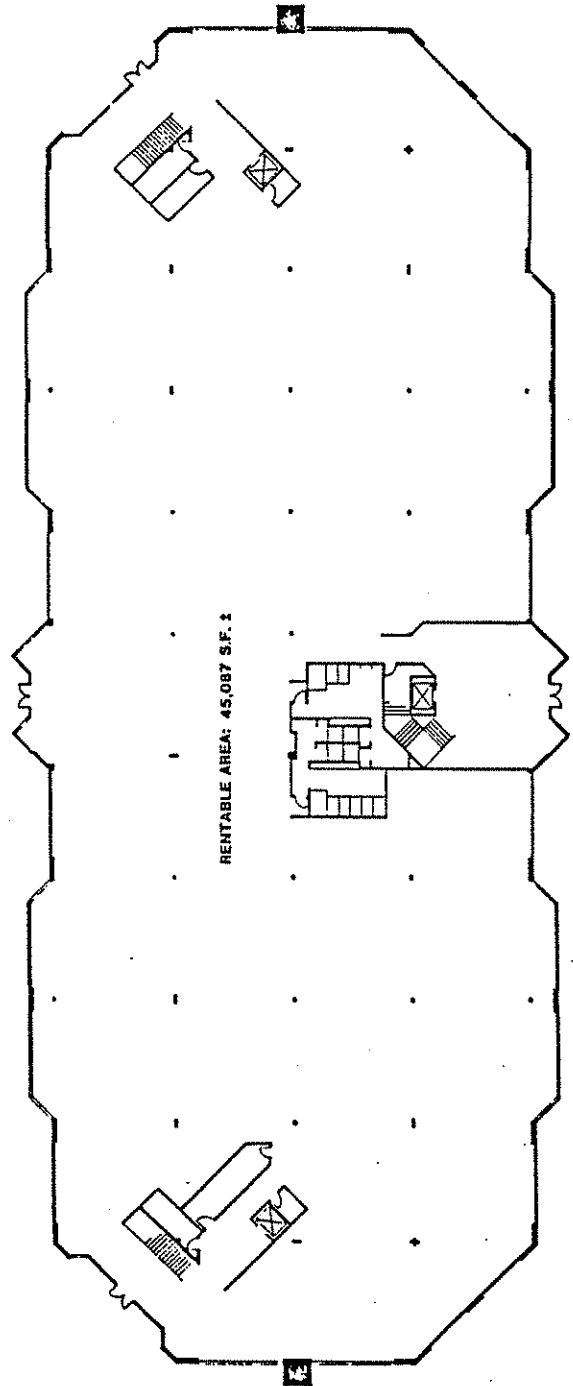


Appendix A

BUILDING C



SECOND FLOOR PLAN TOTAL AREA: 48,455.5 S.F. ±



FIRST FLOOR PLAN TOTAL AREA: 45,336.8 S.F. ±