



ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

Allen Matkins

UCLAAnderson
FORECAST

Allen Markins **FORECAST**

- A Increase faster than the rate of inflation
- B Increase slower than or at the rate of inflation
- C Stay the same
- D Decrease
- E N/A

9. If you invest in office space in Los Angeles, do you forecast that between 2014 and 2015, the vacancy rate in Los Angeles will:

- A Increase
- B Decrease
- C Stay the same
- D N/A

10. If you invest in office space in San Diego, do you forecast that between 2014 and 2015, the vacancy rate in San Diego will:

- A Increase
- B Decrease
- C Stay the same
- D N/A

11. If you invest in office space in Orange County, do you forecast that between 2014 and 2015, the vacancy rate in Orange County will:

- A Increase
- B Decrease
- C Stay the same
- D N/A

12. If you invest in office space in San Jose, do you forecast that between 2014 and 2015, the vacancy rate in San Jose will:

- A Increase
- B Decrease
- C Stay the same
- D N/A

13. If you invest in office space in San Francisco, do you forecast that between 2014 and 2015, the vacancy rate in San Francisco will:

- A Increase
- B Decrease
- C Stay the same
- D N/A

Welcome to the latest edition of the Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey and Index.

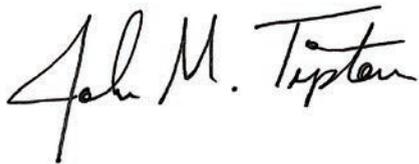
Allen Matkins and UCLA Anderson Forecast have partnered to create a Commercial Real Estate Survey and Index to better predict future California commercial rental and vacancy rates. This tool surveys supply-side participants – commercial developers and financiers of commercial development – for insights into their markets. The Survey and the resulting Index provide a measure of the commercial real estate supply-side participants' view of current and future conditions. Since participants make investment actions based upon these views, it provides a leading indicator of changing supply conditions.

Through an analysis of the Index and the incorporation of the Index into other economic forecasting models, the Survey is designed to provide more accurate information on future office, industrial, retail and multi-family space in major California geographical markets. This twenty-first survey covers the major Southern California and Bay Area markets for office, industrial, retail and multi-family space.

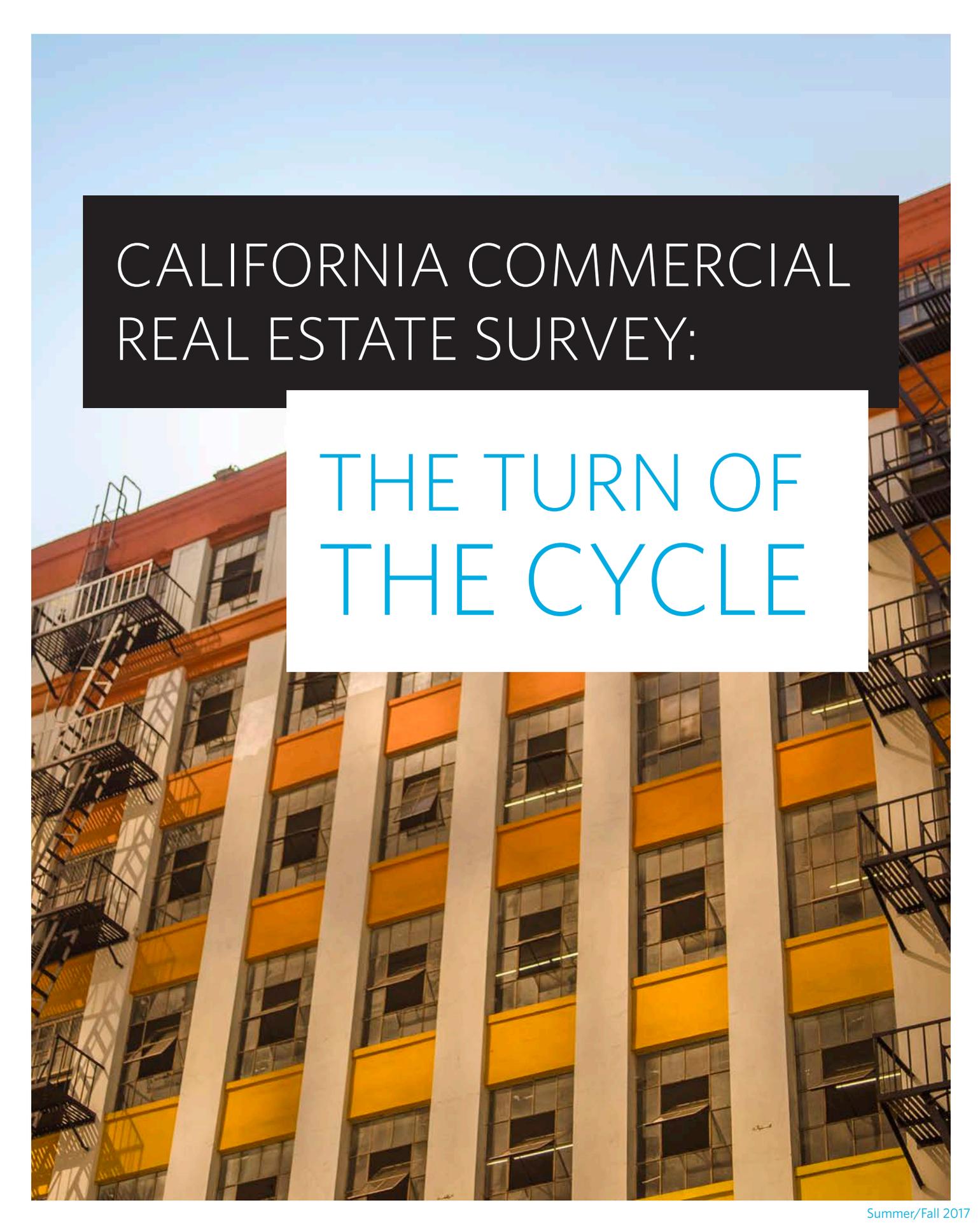
The Allen Matkins and UCLA Anderson Forecast partnership:

At Allen Matkins, a top-ranked California-based law firm servicing the real estate industry according to *Chambers USA*, we have been fortunate to work with and assist leading institutions, developers and lenders in the real estate industry. We have prospered, along with our clients, in this vital sector of the California economy. We sponsor this Survey to provide value to the industry. We have partnered with UCLA Anderson Forecast, the leading independent economic forecast of both the U.S. and California economies for over 65 years, and have tapped the knowledge of the leading developers and financiers of real estate development in California to provide what we believe is the best, clear-sighted forecast of the California commercial real estate industry.

We hope you will find this Survey and Index to be helpful.

A handwritten signature in black ink that reads "John M. Tipton". The signature is written in a cursive, flowing style.

John M. Tipton
Partner, Real Estate Department
Allen Matkins



CALIFORNIA COMMERCIAL REAL ESTATE SURVEY:

THE TURN OF THE CYCLE

The economic data of late has been reasonably good. The unemployment rate has fallen to 4.4%, more people are working, income and spending are increasing, and consumer sentiment is good. So one would expect the Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey to be a bouquet of roses. But it is not. The unique aspect of the survey reported herein is that it looks further forward than the current data to ascertain when developers will be cutting back on their plans as an indicator of future market conditions.

What are they, the developers, looking at that is not quite as fragrant? GDP growth in the first quarter was under 2%, employment growth rates have slowed and durable goods orders have been flat. The promised 4%-5% economic growth seems as elusive as ever. Although the economic data do not foreshadow a near term recession, the indicators from the CRE Survey clearly point to softening in broad segments of commercial real estate.

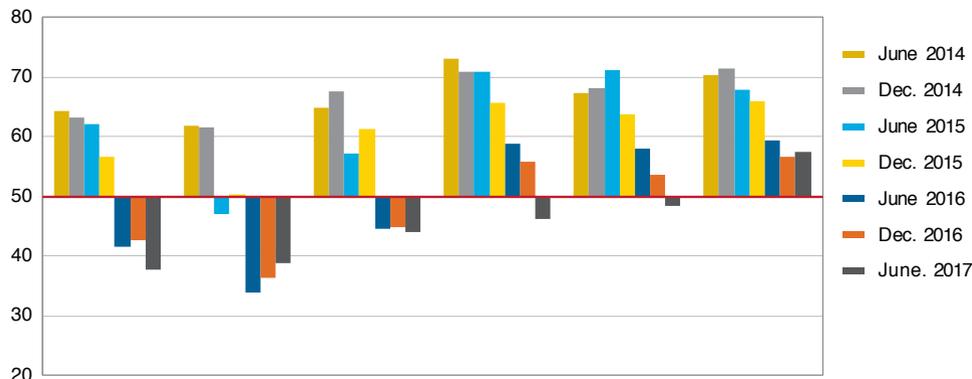
How can this be consistent with reasonable economic data? The answer lies in the fact that there are significant headwinds in retail and office space. This is due to an automation of many office functions and the transformation of retail to online shopping. There is also a bit less optimism about industrial markets. However, this result is more of an easing back of a red-hot market that previously brought millions of new square feet of warehouses into existence rather than a serious softening.

The Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey compiles the views of commercial real estate developers with respect to markets three years hence. The three-year time horizon was chosen to approximate the average time a new commercial project requires for completion (though projects with significant environmental issues often take much longer). The panelists' views on vacancy and rental rates are key ingredients to their own business plans for new projects, and as such, the Survey provides insights into new, not yet on the radar, building projects and is a leading indicator of future commercial construction. For example, if a developer were optimistic about economic conditions in the industrial market of Silicon Valley in 2020, then initial work for a new project with an expected ready for occupancy date of 2020--a business plan, preliminary architecture, and a search for financial backing-- would have to begin no later than 2017. Although optimism does not always translate into new construction projects, this sentiment is a prerequisite for it.

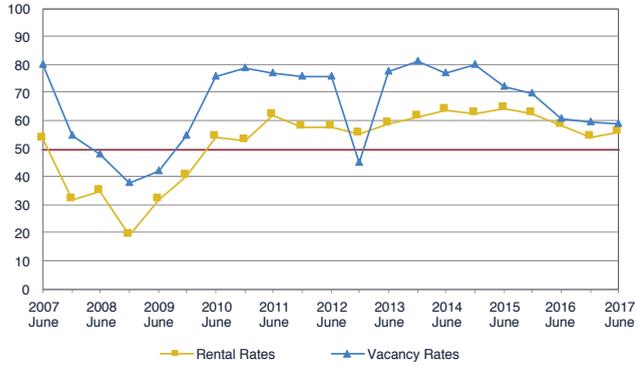
OFFICE SPACE MARKETS

The office market sentiment of Bay Area office developers has been trending down for some time. The index went below 50 for San Francisco two years ago and below 50 for Silicon Valley and the East Bay in June 2016. The current index is decidedly in the negative zone. Our panelists are negative

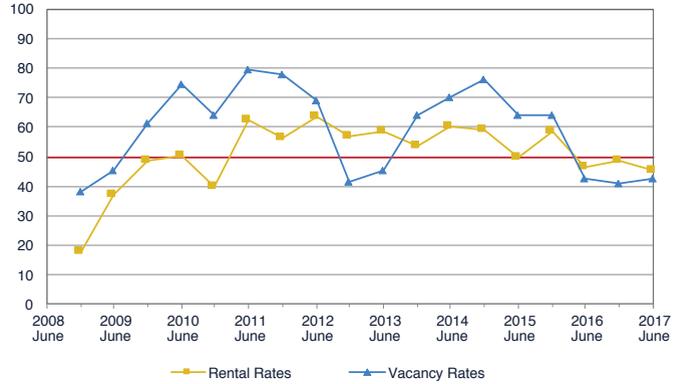
Office Space Developer Sentiment for 2020
(>50 optimistic sentiment)



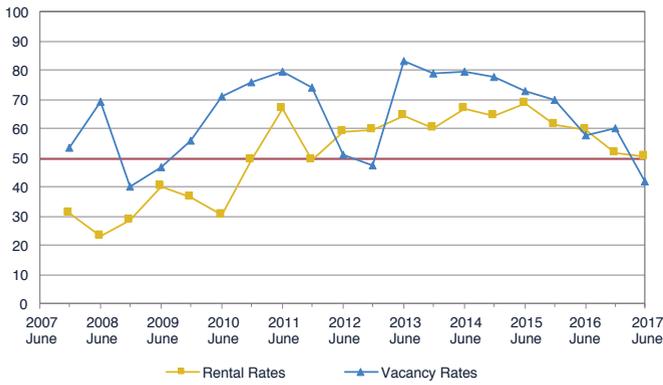
Los Angeles Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



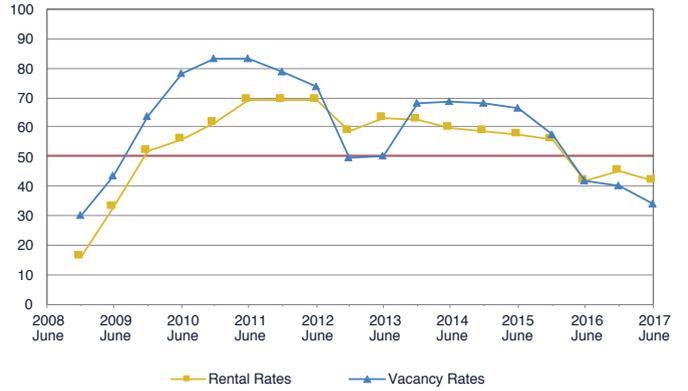
East Bay Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



Orange County Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



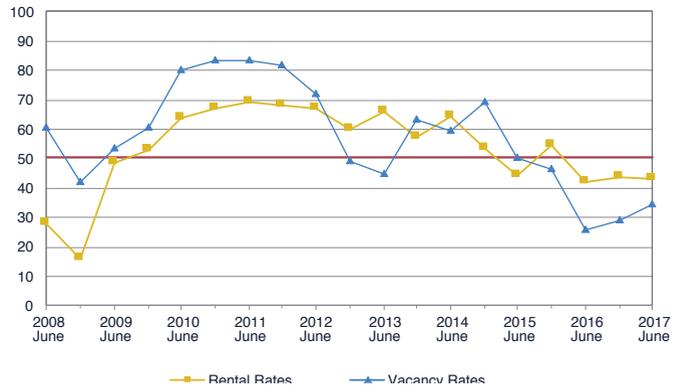
Silicon Valley Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



San Diego Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



San Francisco Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



about the ability of rents to keep up with inflation and of occupancy to remain at its current high level. Moreover, the panelists expect inflation adjusted land prices to abate by 2020.

Nevertheless, slightly more projects were started in the last 12 months than the panel anticipated last June. Going forward only 38% are looking at starting new projects in the next year. Part of the reason is the warning sign of sustained increases in subleases, and part is due to the slow-down in tech hiring in the Bay Area. The index is clearly indicating that the market has topped out throughout the Bay Area and the level of new construction is expected to turn down over the forecast horizon.

San Diego and Orange County are following a similar trend to the Bay Area. The index for these two markets went into the contraction zone with the current survey. In Orange County, the expectation is for rental rates to hold their inflation adjusted values, while occupancy rates fall. To keep occupancy rates up, landlords would need to push down rental rates fur-

ther. In San Diego, the expectation is for both to fall along with inflation adjusted land prices. Thus, as with the Bay Area, the index predicts a downturn in office construction over the forecast horizon.

With respect to Los Angeles, building continues apace and downtown remains “crane city.” Although the sentiment of the panel is less optimistic than two years ago, it remains decidedly optimistic. Indeed, the panelists are slightly more optimistic with respect to vacancy rates in 2020 relative to today’s market than they were six months ago. The difference between L.A. and the other California cities is Hollywood and Silicon Beach. The entertainment and tech industries continue to grow in the Los Angeles region in response to robust demand for gaming, streamed content, and television programming, and critical mass being achieved in Silicon Beach. The L.A. panel does not view the office products in the pipeline as sufficient to meet all of this demand. Consequently, their expectation is for rents and occupancy to increase through 2020.



COMMERCIAL MARKETS DEVELOPER SENTIMENT

>50 INDICATES POSITIVE OUTLOOK

Arrow denotes change from last survey



Office



Multi-Family



Industrial



Retail

Los Angeles



East Bay



Inland Empire



San Francisco



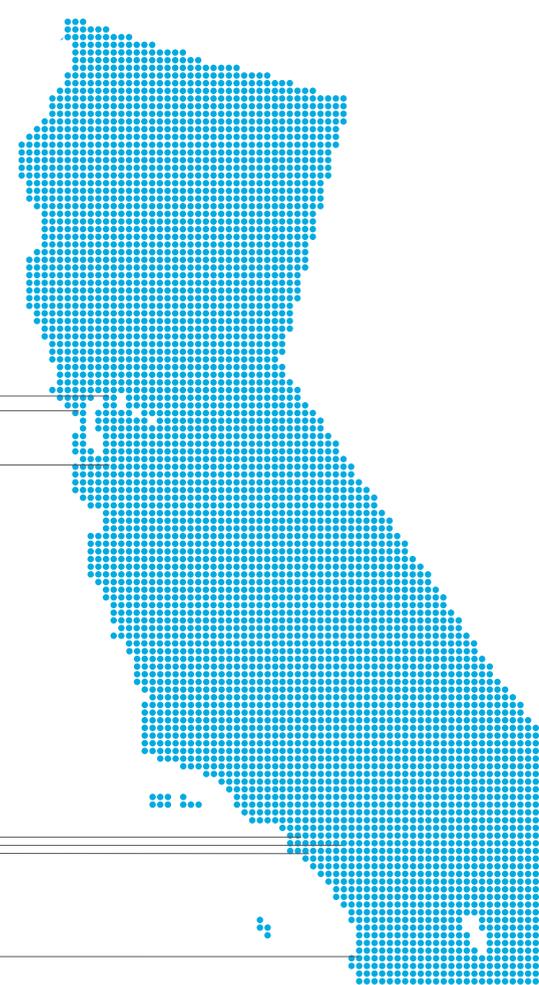
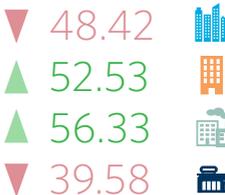
Orange County



Silicon Valley



San Diego



* Index weights have been updated

“We’re now seeing the turning points in most aspects of commercial real estate in California.”

- Jerry Nickelsburg,
Director,
UCLA Anderson Forecast

“The bright spot in this survey from an office perspective is Los Angeles.”

- John Tipton,
Real Estate Partner,
Allen Matkins

“Over the next few years, we’re forecasting 50-60 million square feet of new warehouse demand.”

- Rebecca Perlmutter Finkel,
Vice President,
CBRE

“Retail development is far from dead, it’s just different.”

- Rhonda Diaz Caldewey,
Managing Director,
Cushman & Wakefield



“We’re seeing good conditions
in the office market – it’s,
potentially, going to be the
longest recovery in history.”

- Kevin Shannon,
President,
West Coast Capital Markets,
Newmark Grubb Knight Frank

INDUSTRIAL SPACE MARKETS

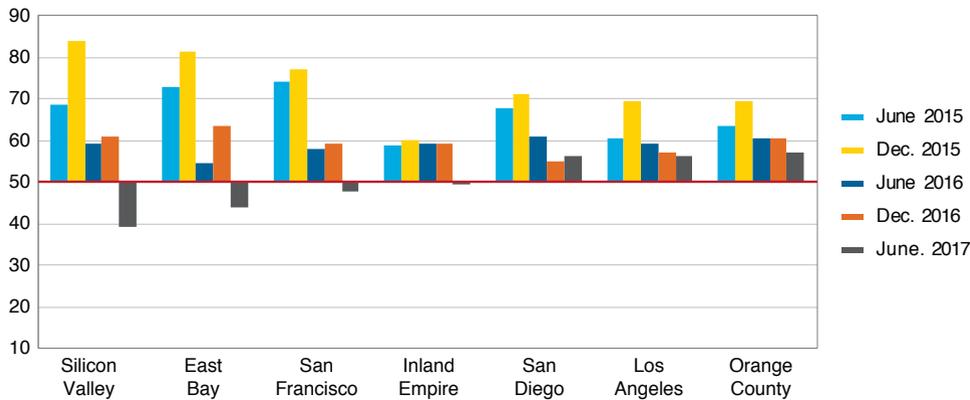
Bay Area industrial sentiment for markets in 2020 as compared to today turned negative in the current survey. The component of the sentiment index most responsible for this downturn was industrial space vacancy rates. However today's vacancies are extremely low and since 87% of the panel started new projects last year and all of the panel will again this year, the negative sentiment is a white hot market retreating to red hot.

In Southern California, the long run of optimism remains. In spite of talk in Washington D.C. about trade restrictions, double digit growth in online sales during the holiday season

coupled with increasing imports from Asia are generating an ever increasing demand for warehouse space. Our Southern California panelists expect continued tight industrial space markets over the next three years.

So, yes, sentiment about the next three years in industrial markets has abated somewhat, but only because this has been the hottest market and building-gone-wild has been seen throughout the state. E-commerce will continue to drive a hot market for warehouse space, just not quite as searing hot as before.

Industrial Space Developer Sentiment for 2020
(>50 optimistic sentiment)



"Mixed-use projects
continue to be important.
People are looking for
something more than just
shopping."

- Drew Emmel,
Real Estate Partner,
Allen Matkins



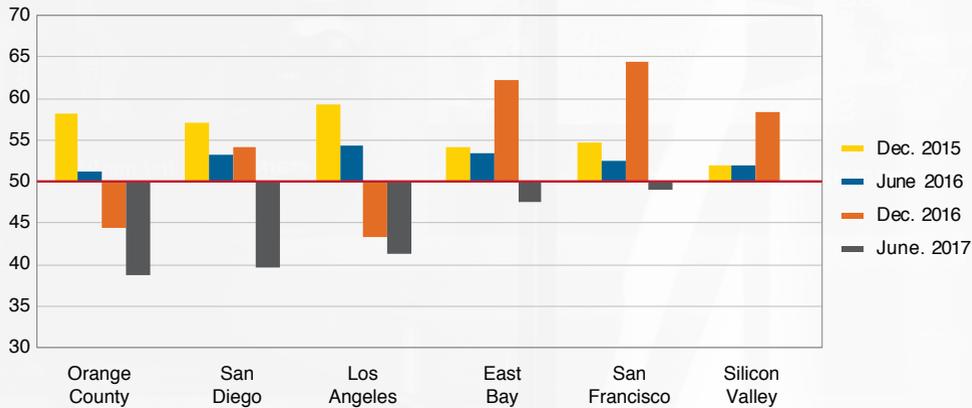
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RETAIL SPACE MARKET

Industrial's gain is retail's bane. In virtually every market in California, panelists see 2020 as worse than today, and this comes on top of the recent increase in vacancies. In the Bay Area, a little over one-third of panelists did some retail last year and just over one-half are planning on some this year. In Southern California, 40% of retail developers will stay on the sidelines and not start a new project in the coming 12 months. Although there will be new retail development as owners of existing space try to upgrade to experiential retail space and new office, multi-family housing and mixed-use development requires new retail, development is expected to abate over the forecast horizon.

Retail Space Developer Sentiment for 2020
(>50 optimistic sentiment)



“We have the four lowest cap rates in the country here – San Francisco, Orange County, Los Angeles and San Jose – people are buying and building in the multi-family space.”

- Kitty Wallace,
Executive Vice President,
Colliers International



MULTI-FAMILY HOUSING

Six months ago it looked as if multi-family housing had reached a peak. The explanation seemed to be that multi-family development at the mid- to high-end had indeed reached a peak and that land and building prices precluded more development at the lower end. This still seems to be the case, at least for more modestly priced apartments, but sentiment reversed itself in the current survey.

What caused this reversal? First, California continues to be a leader in job and income gains. Thus, there has been enough of an increase in rents for multi-family developers to see opportunities in new projects for the coming three years. In every market, developers are optimistic about the course of rental and occupancy rates for the next three years.

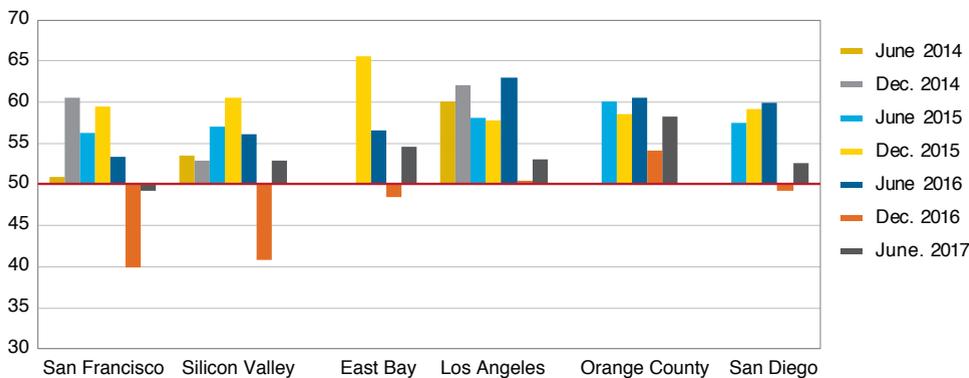
As a consequence, three-quarters of the panelists will start a new project in the coming year with over one-half of them starting more than one project. In addition, the panelists predicted that the price of land will increase and rental prices will more than keep up with inflation. The survey results are consistent with the June 2017 UCLA Anderson Forecast economic outlook for continued building of multi-family homes throughout the state through 2019.

THE TURN OF THE CYCLE

The lack of optimism about 2020 in the Surveys with respect to office and retail space, broad-based across all markets, is an important indicator of both the probability of new additions to stock being started over the next three years and of opportunities for new investment. Though both job and income growth ought to support a continuation of the good markets currently being experienced, the slowdown in growth combined with adequate capacity coming onto the market signal a similar slowdown in development.

It is still the case that the industrial and multi-family markets are not signaling a turn in the cycle, though the ebbing of optimism about 2020 in these markets suggests the possibility that it might follow soon. The UCLA Anderson Forecast's latest outlook is consistent with the survey results presented herein. Specifically, office and retail commercial real estate construction is expected to slow, while industrial and multi-family will continue growth, albeit at a slower rate than in recent years.

Multi-Family Housing Developer Sentiment Index For 2020
(>50 optimistic sentiment)



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