

ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

Winter/Spring 2016
Issue No. 18



Allen Matkins

UCLAAnderson
FORECAST





Allen Matkins **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 2004 and 2005 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 2004 and 2005 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 2004 and 2005 the vacancy rate in Orange County will
- A Decrease
 - B Increase
 - 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

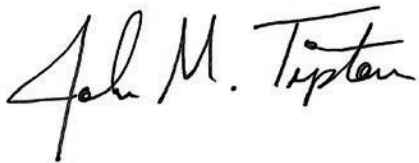
Allen Matkins and UCLA Anderson Forecast have partnered to create a Commercial Real Estate Survey and Index to better predict future California commercial rental and vacancy rates. This tool surveys supply-side participants – commercial developers and financiers of commercial development – for insights 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 eighteenth 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, the top-ranked California-based law firm servicing the real estate industry according to *Chambers & Partners 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 60 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 Leck Gamble Mallory & Natsis, LLP



CALIFORNIA COMMERCIAL REAL ESTATE SURVEY:

LITTLE IMPACT
FROM HIGHER
INTEREST RATES
AND SLOWER
ECONOMIC
GROWTH

California commercial real estate is booming once again and optimism about the future has not been dampened by the Fed's interest rate policy. As California's employment picture improves to a full-employment environment¹ the lack of supply in housing, warehouses, and offices portends continued rental and occupancy rate increases. All of this is good news, but it must be tempered by the fact that commercial real estate is a highly cyclical industry. The Allen Matkins UCLA Anderson Forecast Survey was designed not only to take the pulse of the market, but also to anticipate the peak. The December 2015 survey, reported here, indicates continued optimism with only a smattering of caution with respect to the continuation of the current run.

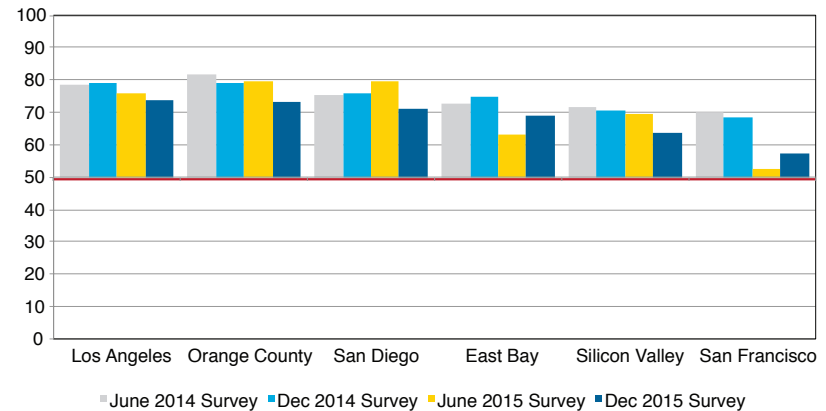
The Allen Matkins UCLA Anderson Forecast Survey project compiles the views of commercial real estate developers with respect to markets three years hence. The three-year time horizon was chosen to approximate the average time a new commercial project requires for completion (though projects with significant environmental issues often take much longer). The Panels' 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 it 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 2018, then initial work for a new project with an expected ready for occupancy date of 2018--a business plan, preliminary architecture, and a search for financial backing-- would have to begin no later than 2015. Although optimism does not always translate into new construction projects, this sentiment is a prerequisite for it.

OFFICE SPACE MARKETS

Office market developer sentiment abated slightly though remained very positive in December for four of the six regions we survey and improved in the San Francisco and East Bay markets. Although sentiment has remained quite optimistic for the 10 surveys covering the last five years, in the most recent survey the index is slightly below 2014. There

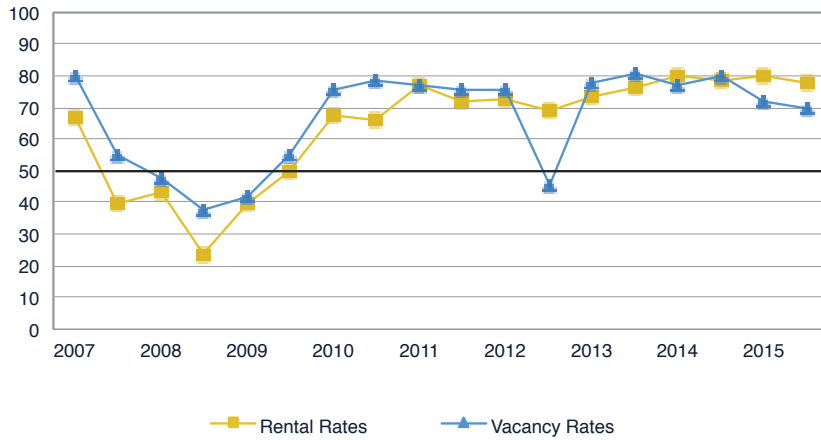
are a number of reasons for the tempering of developer sentiment, not the least of which is the general mood of investors that although the U.S. economy continues to grow, slower growth outside the U.S. and somewhat more volatile world financial markets dictate a bit of prudent caution. Nevertheless, the continued positive outlook for the economy in general and office using employment in particular (The Anderson Forecast projects increased growth rates through 2017), all contribute to the consensus for improved returns to office space as the economic expansion matures. As discussed in previous survey reports, the uneven growth in employment across different office using sectors has resulted in more differentiated submarkets of the six markets surveyed here.

Office Space Developer Sentiment
(>50 optimistic sentiment)

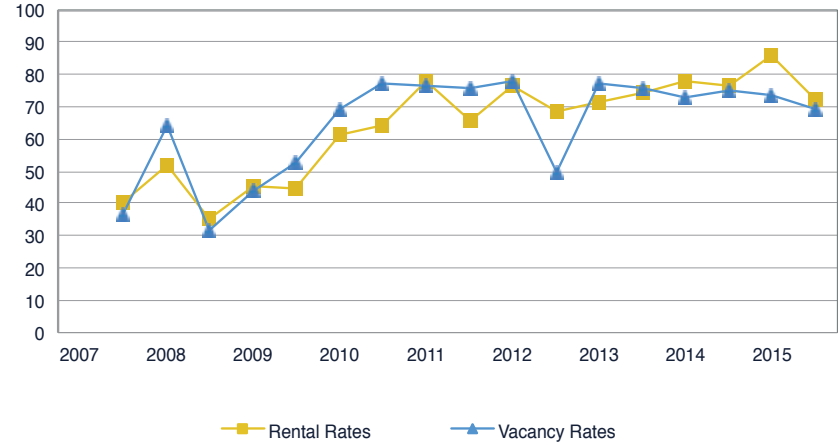


1. Jerry Nickelsburg, "Will California's Economy Stall As It Zeros in On Full Employment," UCLA Anderson Forecast, December 2015.

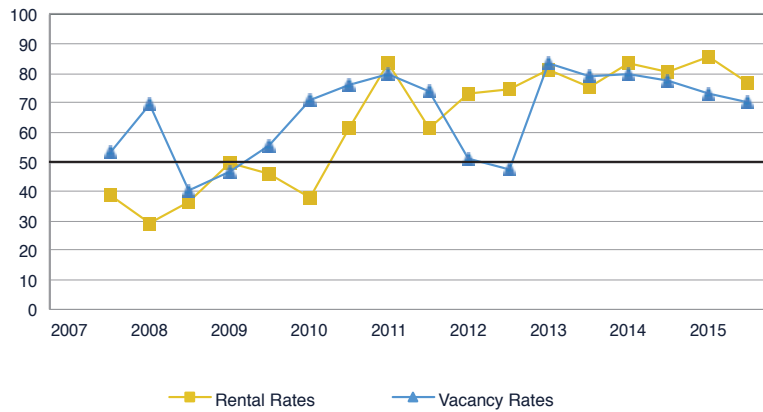
Los Angeles Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



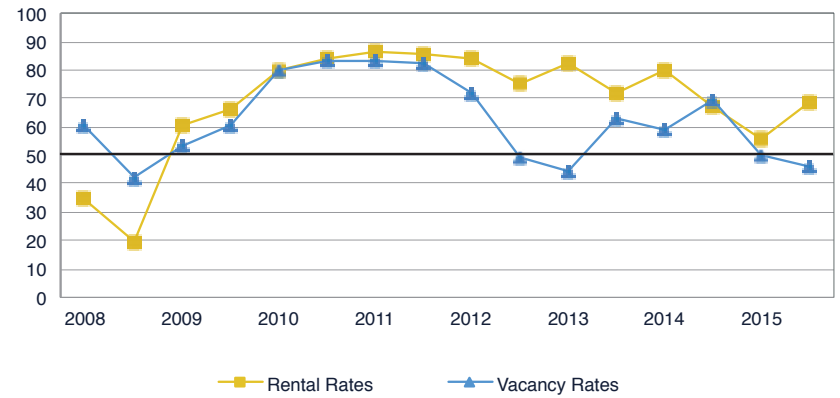
San Diego Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



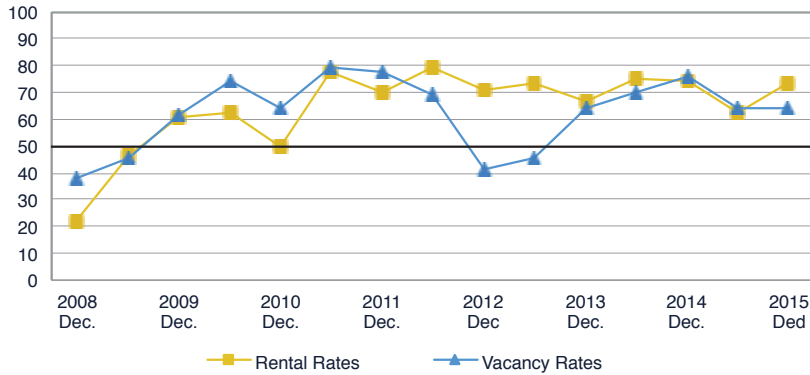
Orange County Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



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



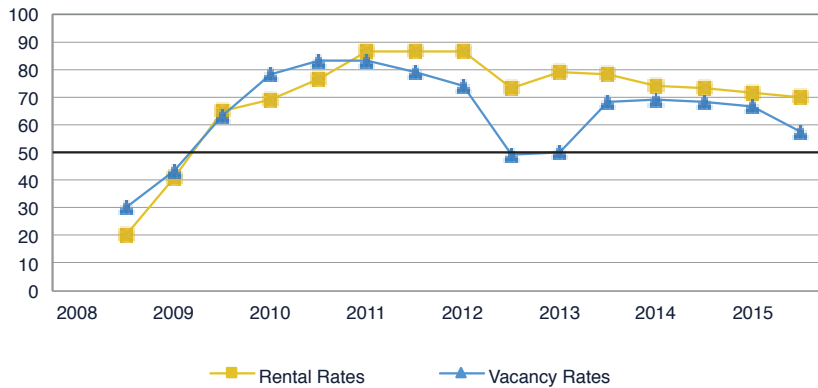
East Bay Office Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)



In each of the three Southern California markets surveyed, Los Angeles, Orange and San Diego Counties, the survey panelists were very optimistic about rental rates and even though there was a softening of the sentiment with respect to vacancy rates in 2018, it remained relatively strong. None of the panelists are expecting the market to weaken between now and 2018 and most expect it to tighten. In Los Angeles and Orange County, though not San Diego, office-using employment is still growing at rates at or below the overall rate of job growth for the regions. However tech related employment is growing faster and areas that are favored by these companies are experiencing robust markets.

Over the next 12 months 42% of the Southern California Panelists stated that they expect to begin at least one new project, the same as six months ago, and down slightly from a year ago. Of the Southern California panelists 34% began a new project during the previous twelve months, up significantly from the 23% in the June survey. Solid office-using job growth, a positive economic outlook and developers moving on new projects all confirm the survey responses forecasting a 2018 office market with better vacancy and rental rates than 2015.

Silicon Valley Office Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)



The Bay Area panels are optimistic as well, but not as much as in Southern California. The San Francisco and Silicon Valley panels, while optimistic in general, now forecast increasing vacancy rates for San Francisco and a moderation of the tightening for Silicon Valley. Nevertheless, the panels do not forecast an easing of rental pressure over the next three years. With current building and renovation, and a view that the current 5% rate of growth of office-using employment in San Francisco and 7% in Silicon Valley is not sustainable, developers are not expecting a dramatic improvement in an already very good market during the coming 3 years.

Sentiment among East Bay developers has remained highly optimistic and in the same range for the past 2 ½ years. If one were to look only at the rate of growth in office-using employment in the East Bay, 1.1% in 2015, this would be surprising, however the hot markets of San Francisco and Silicon Valley make East Bay properties attractive going forward.

Bay Area office space demand growth is reflected in the panelists' actions as well. In December 46% of the panel reported plans to embark on at least one new development over the next 12 months up from 33% in the previous survey.

COMMERCIAL MARKETS DEVELOPER SENTIMENT



Office



Multi-Family



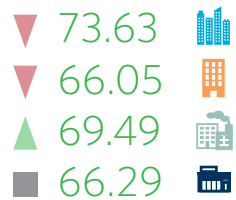
Industrial



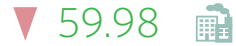
Retail

>50 INDICATES POSITIVE OUTLOOK

Arrow is change from last survey



Los Angeles



Inland Empire



Orange County



San Diego



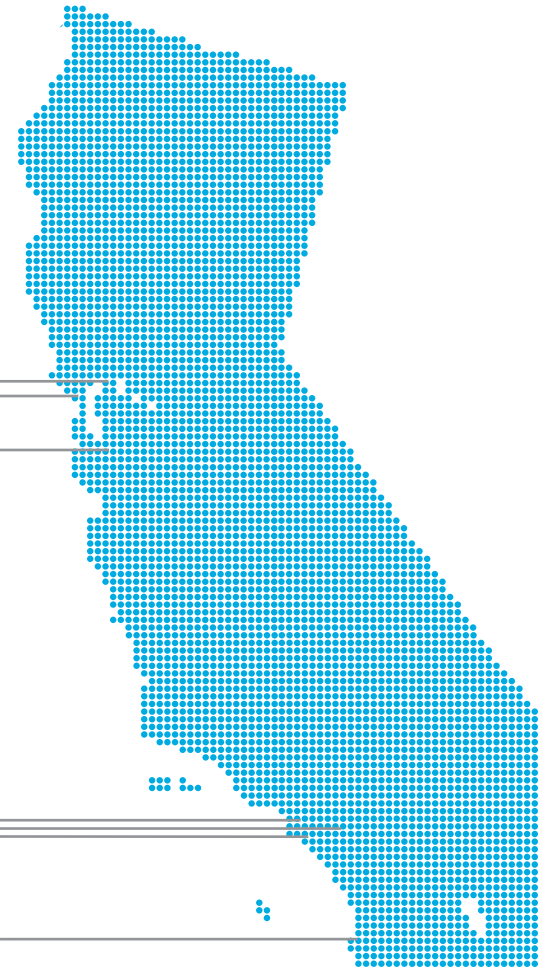
East Bay



San Francisco



Silicon Valley



"[We] are in this part of the cycle where the main players are focusing on ground up development."

- Tony Natsis,
Attorney,
Allen Matkins

"If you are not getting into too high risk and large condo projects, I think you're safe four years out."

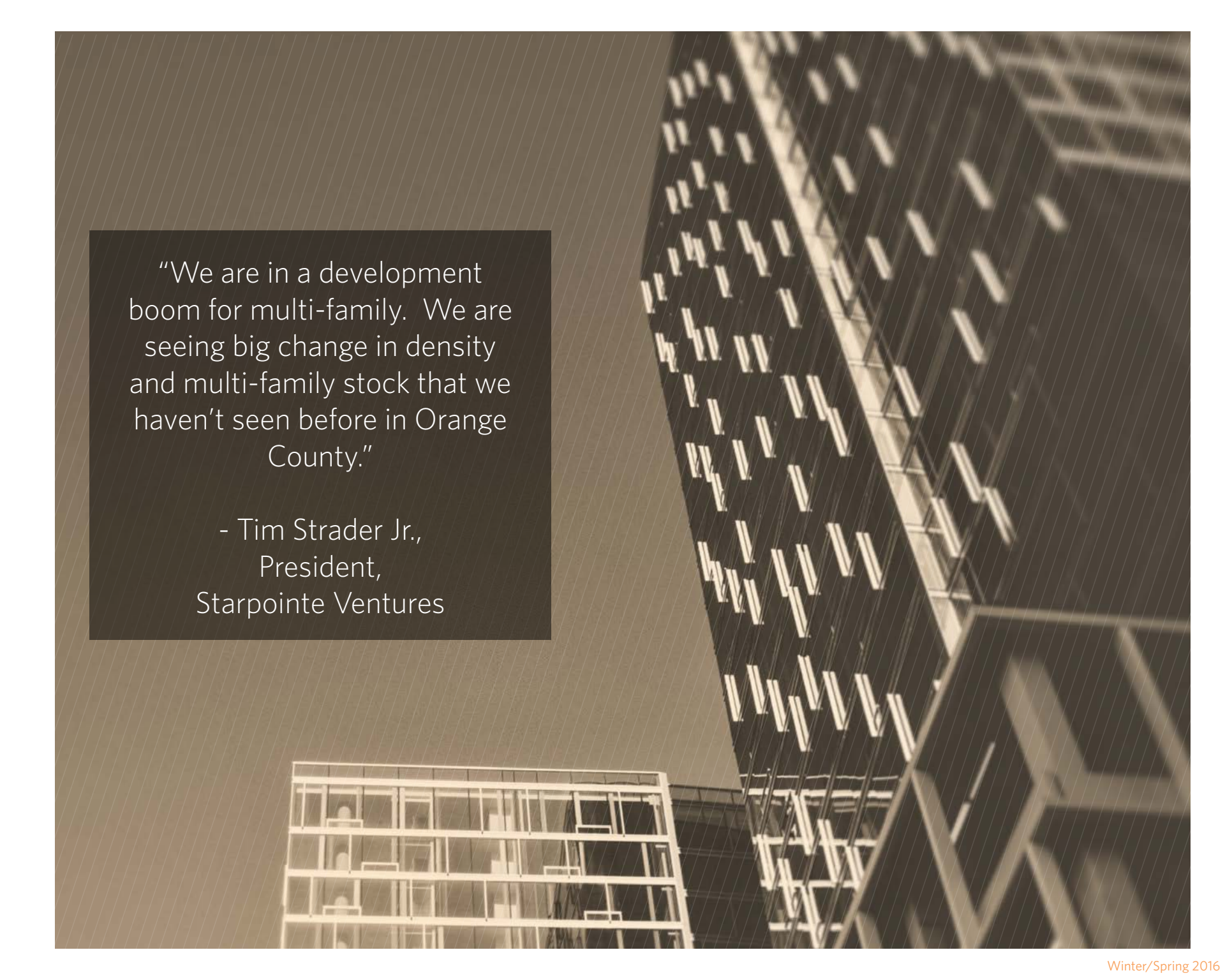
- Michael Marini,
CEO & Founder,
Planet Home Living

"We are seeing some interesting trends coming in from China and Korea with the size of the units, the pricing of the units, and the services that are available."

- Lewis Horne,
President, Greater Los Angeles
& Orange County,
CBRE

"We are very bullish. We look at Orange County as a bit of a sleeper relative to San Francisco and Seattle."

- Tom Bak,
Senior Managing Director,
Trammell Crow Company



“We are in a development boom for multi-family. We are seeing big change in density and multi-family stock that we haven’t seen before in Orange County.”

- Tim Strader Jr.,
President,
Starpointe Ventures

MULTI-FAMILY MARKET

Multi-Family Residential Markets

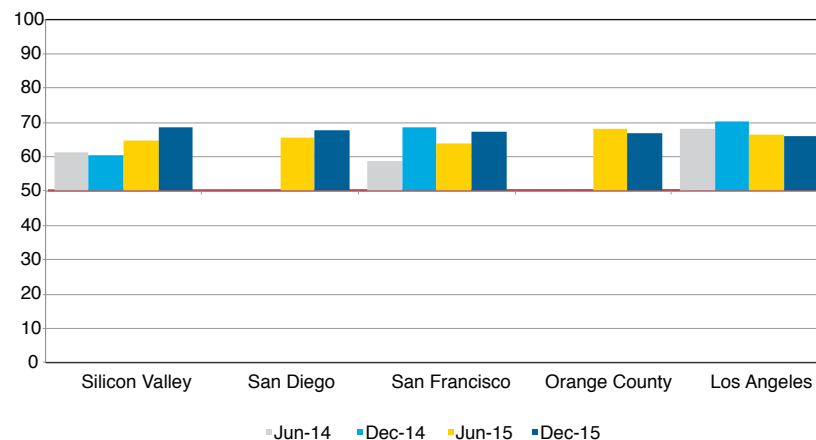
Multi-Family developer optimism has remained strong and consistent over the two years the survey has been conducted. The demand for multi-family housing tends to follow job growth in the more densely populated regions of California. Hence, one would expect the Silicon Valley, San Diego and San Francisco markets to tighten over the coming three years more than Los Angeles and Orange County. One market that is different is Los Angeles. Our Los Angeles panel expects the vacancy rate to increase over the next three years even as rental rates continue to rise. The building of new apartments in Los Angeles is therefore expected to ease some of the shortfall in housing units, even while higher rental rates permit lessors to tolerate somewhat higher vacancies.

The East Bay market was added to the survey coverage in December. The composite index for this market is surprisingly strong given the weaker job growth in the East Bay. However, job growth in San Francisco and Silicon Valley, growth that is outstripping available housing, drives East Bay housing demand as well.

The panels continue to echo an observation made recently by the Legislative Analysts Office² that California housing is seriously underbuilt and that household formation is happening faster than new building. This positive view of the future of multi-family housing market fundamentals for investors is expected to continue as employment in California is forecast to grow at a 2.0% rate over the next two years. Such growth will be skewed towards the six major coastal communities. Increased employment translates directly into new household formation and additional demands for housing.

The story of the current economic expansion has been a shift in tastes from single-family housing with concomitant commuting into the employment centers to a balanced mix between single-family and multi-family housing. Though overall residential construction has remained at depressed levels in the State, multi-family construction has rebounded sharply. This past year the number of multi-family permits issued in the state per month rose to pre-recession levels. The forecast for higher rents and continued low vacancy rates should induce a further increase in multi-family construction. Consistent with this, the Anderson Forecast for multi-family construction is for a 25-year high to be reached during the next three years.

Multi-Family Housing Developer Sentiment Index For 2018
(>50 optimistic sentiment)



2. "California's High Housing Costs: Causes and Consequences," March 2015. <http://lao.ca.gov>

"It's an exciting time in industrial. Everything is firing on all cylinders."

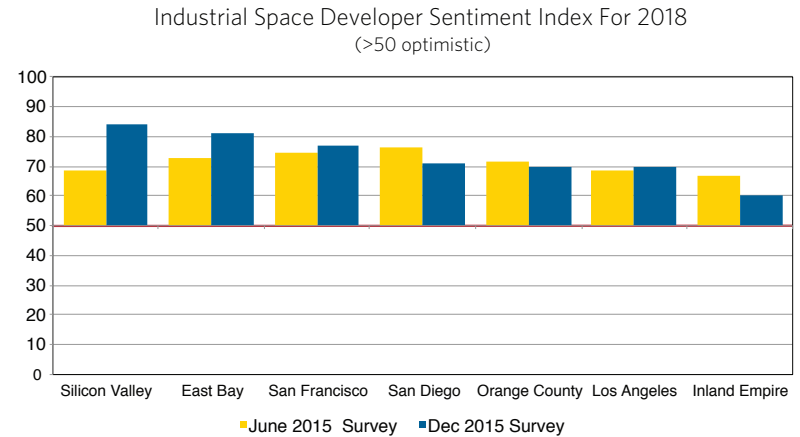
- Barbara Emmons,
Vice Chairman,
CBRE

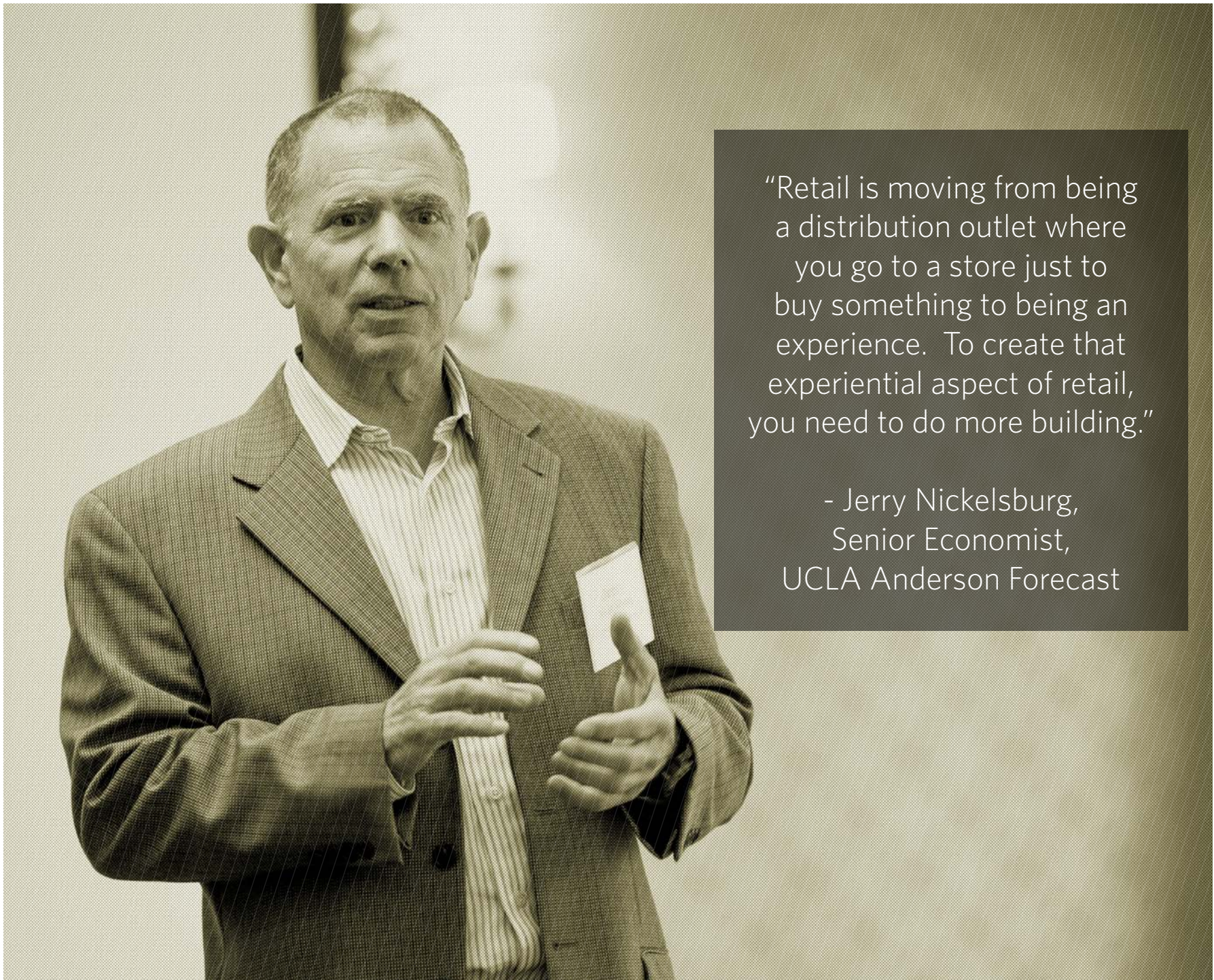


INDUSTRIAL MARKET

Industrial Space is comprised of two distinct markets, manufacturing and warehousing. Although each geography surveyed has a mixture of both, Silicon Valley, Orange County and San Diego County can be broadly characterized as being more heavily manufacturing, Los Angeles and The East Bay a mix of the two, and San Francisco and The Inland Empire by warehousing. The basic underlying economic forces driving the demand for industrial space in California are manufacturing, the export of goods to Asia and Mexico, and U.S. importation of consumer goods from the manufacturing centers of Asia transiting through California's ports. In recent years the rise of online shopping and warehouse distribution centers have boosted the demand for industrial space.

The current Survey of industrial space developers indicates little change in sentiment compared to last year. The optimism expressed continues to be manifested in new building, though in the Inland Empire a rush to build new space has now given rise to a view that vacancy rates will increase over the next three years. As vacancy rates are extremely low at present, this view is not indicative of a significantly weaker industrial market. Looking forward, 75% of both the Southern California and the Bay Area panels are planning one or more new projects in 2016. This comes on the heels of 66% having begun at least one new development during the past 12 months. So both reported sentiment and actions indicate a continued strengthening in California industrial space markets.





“Retail is moving from being a distribution outlet where you go to a store just to buy something to being an experience. To create that experiential aspect of retail, you need to do more building.”

- Jerry Nickelsburg,
Senior Economist,
UCLA Anderson Forecast

RETAIL SPACE MARKETS

The December Survey increased the scope of the Retail Market Developer Sentiment Survey to include three Bay Area markets. Although there are few observations some reflections on the data can be made. Part of the difficulty associated with inferences in the retail sector is the fact that retail is undergoing a profound change from distribution conduits to experience-shopping venues.

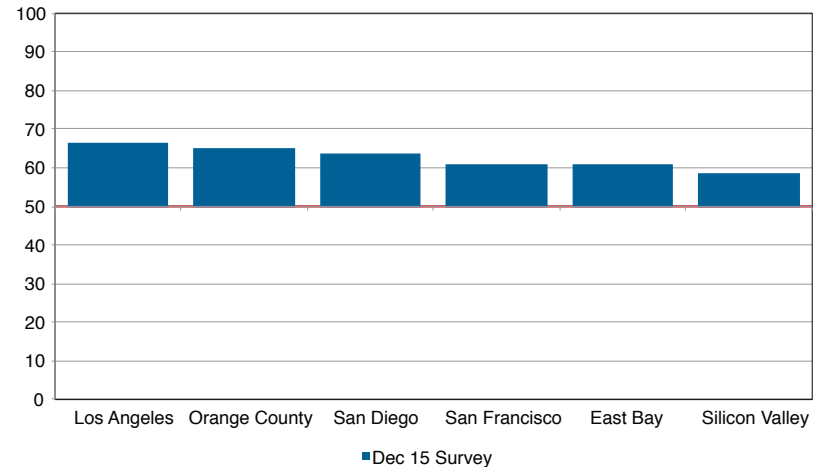
Though there are no reference points from which to judge these first survey results, in each of the six markets polled sentiment with respect to retail space was strongly positive. This may well be a function of the growth in consumption on a relatively weak retail market. However nearly two-thirds of the panelists stated that they were planning new retail construction in the coming 12 months and half stated that they had begun at least one new project in 2015. This suggests although the retail space maybe struggling in general there remain significant opportunities. Robust growth in sub-markets, the increased placement of retail in new mixed-use multi-family housing projects and the conversion of existing brick-and-mortar stores to experience venues provide an explanation for the difference between sentiment and the observation of ample available retail space.

A Broad Based Recovery

The Allen Matkins UCLA Anderson Forecast Survey was designed in 2006 as a vehicle for improving forecasts of the evolution of commercial real estate markets. Although the Survey remains quite new and there is as yet not enough data for rigorous statistical analysis, interpretation of the snapshots provided by each Survey provides insight into our statistically based forecasts. Importantly, the Survey indices are providing an early warning of significant changes in non-residential construction activity.

The optimism about 2018 in the Surveys, 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 in multi-family, office, retail and industrial space. This optimism, supported by job and income growth on the demand side and a lack of sufficient building on the supply side reflects what we expect, a continuation of the growth of non-residential construction at or above previous peak levels. The risks to this rather optimistic outlook are contagion in financial from the nascent re-valuation of tech start-up companies and a downturn in consumer attitudes engendered by an increasingly volatile world. Nevertheless the Anderson Forecast sees the most likely outlook for the economy, and therefore for commercial real estate to be consistent with the developer sentiment reported herein.

Retail Space Developer Sentiment for 2018
(>50 = optimistic)



COMMERCIAL REAL ESTATE SURVEY

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