

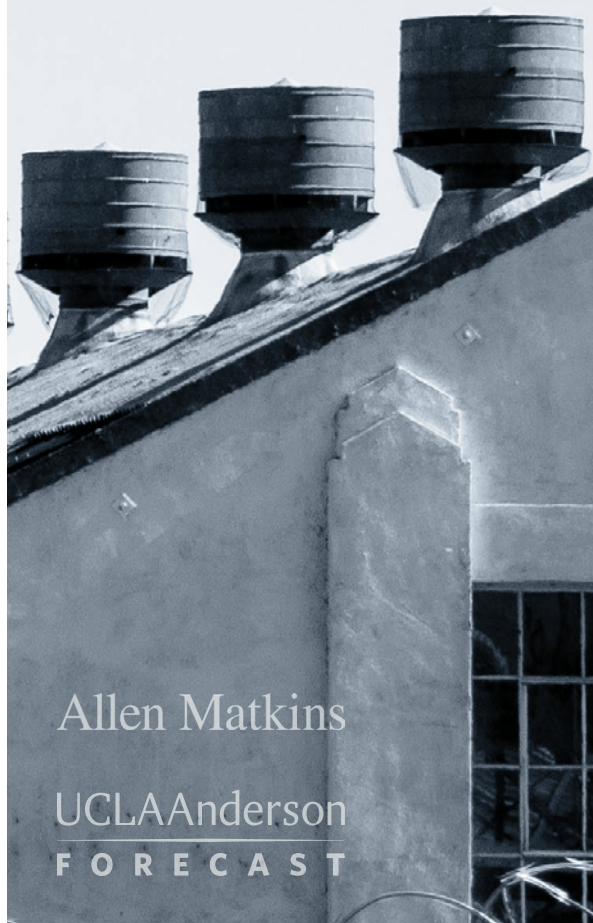
Allen Matkins | UCLA Anderson Forecast

COMMERCIAL REAL ESTATE SURVEY

Summer/Fall 2014
Issue No. 15

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 Increase
 - B Decrease
 - C Stay the same
 - D N/A
12. In the next 12 months, will the vacancy rate in Los Angeles County
- A Increase
 - B Decrease
 - C Stay the same
 - D N/A
13. In the next 12 months, will the vacancy rate in San Diego County
- A Increase
 - B Decrease
 - C Stay the same
 - D N/A
14. In the next 12 months, will the vacancy rate in Orange County
- 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

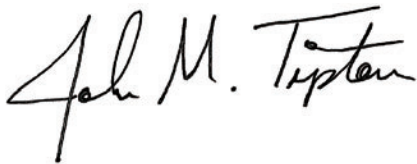
Allen Matkins and UCLA Anderson Forecast have partnered to create a Commercial Real Estate Survey and Index to better predict future California commercial rental and vacancy rates. This tool surveys supply-side participants – commercial developers and financiers of commercial development – for insights 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 and multi-family space in major California geographical markets. This fifteenth survey covers the major Southern California and Bay Area markets for office, industrial 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:

CALIFORNIA
BUILDING ONCE
AGAIN

OFFICE SPACE MARKET

In January 2014, we observed that there was renewed developer optimism with regard to vacancy and occupancy rates across most California commercial real estate markets, based on the results of the December 2013 Allen Matkins/UCLA Anderson Forecast Survey. Since then, continued economic growth including growth in office using employment and in goods movement through California's ports, has resulted in real estate developers continuing to be broadly optimistic on the outlook through 2017. The current Survey, conducted in May and June of 2014, now foretells an increase of construction of new commercial space through 2017. Indeed, across seven markets and three commercial real estate types there is renewed building activity. Based on our Survey Panels, that activity will have legs to carry it through this phase of the economic expansion.

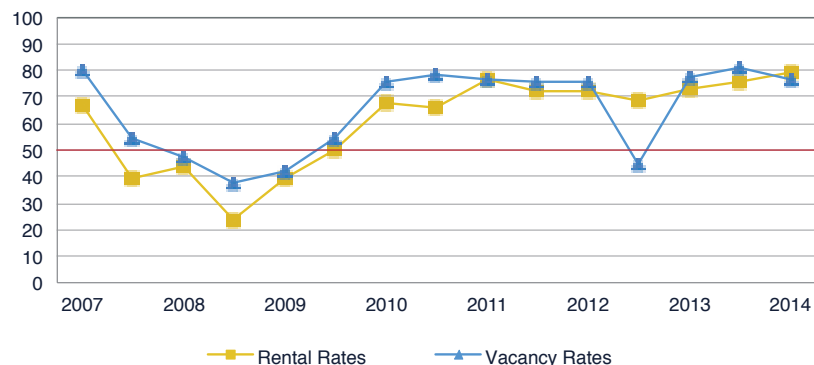
The Allen Matkins/UCLA Anderson Forecast Survey project compiles the views of commercial real estate developers with respect to markets three years hence. The three-year time horizon was chosen to approximate the average time a new commercial project requires for completion (though projects with significant environmental issues often take much longer). The Panel's view on occupancy 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 2017, then initial work for a new project with an expected ready for occupancy date of 2017--a business plan, preliminary architecture, and a search for financial backing-- would have to begin no later than 2014. Although optimism does not always translate into new construction projects, this sentiment is a prerequisite for it.

Office Space Markets: No Change In The Building Trend

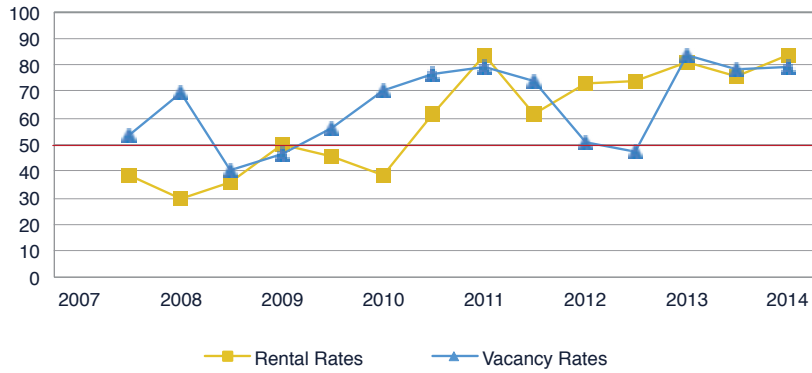
Though the Allen Matkins/UCLA Anderson Forecast Survey project is still in its infancy, its track record forecasting changes in commercial real estate markets has been quite good. In office markets, we have now completed fifteen surveys of developer sentiment in Los Angeles. The first important prediction came in an early Survey taken in November and December of 2007. The Survey analysis showed a dramatic drop in confidence with respect to office markets more than a month before the official start of the 2008 recession and ten months prior to the failure of Lehman Brothers.

Similarly, the recession ended in July of 2009 but employment in California continued its decline throughout the year. Nevertheless, the two surveys taken in late 2009 and early 2010 yielded indices indicating a resurgence of optimism within Los Angeles office markets. This optimism was not about current markets, but a forecast of office markets in 2013. This proved to be an accurate forecast of the 2013 market as well. Since that time, developer sentiment in Los Angeles has been quite high with the exception of the December 2012 Survey, a survey taken at the time of the impending fiscal cliff. However, the change in optimism in the face of the fiscal cliff was mixed and reflected some uncertainty, but not a definite prediction of a 2015 downturn. The Orange County and San Diego Sentiment shows a similar pattern.

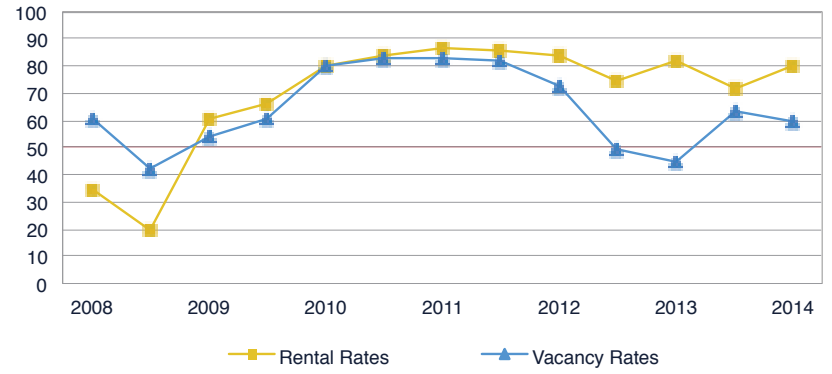
Los Angeles Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



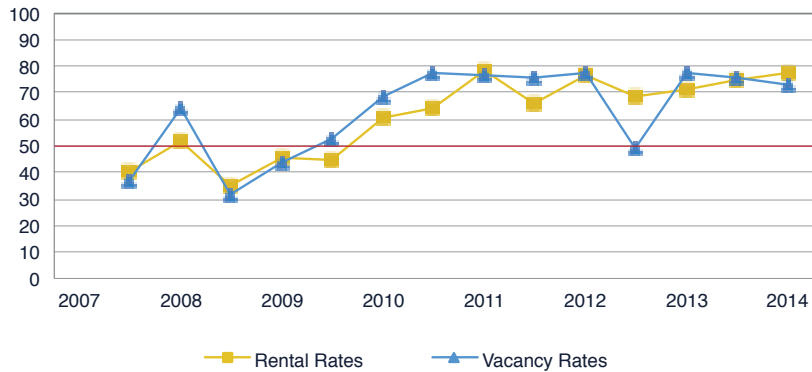
Orange County Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



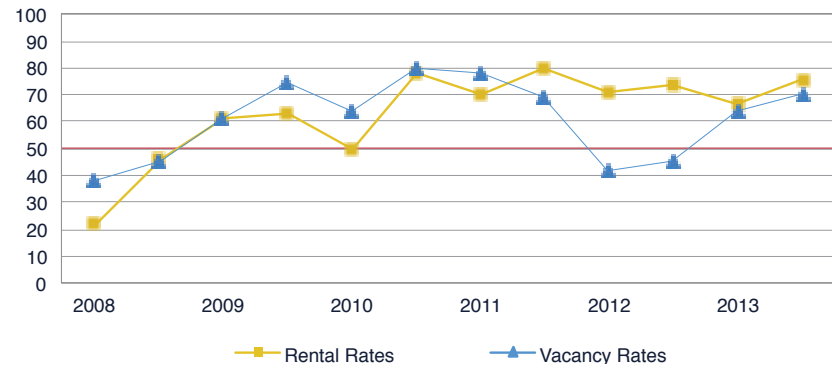
San Francisco Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



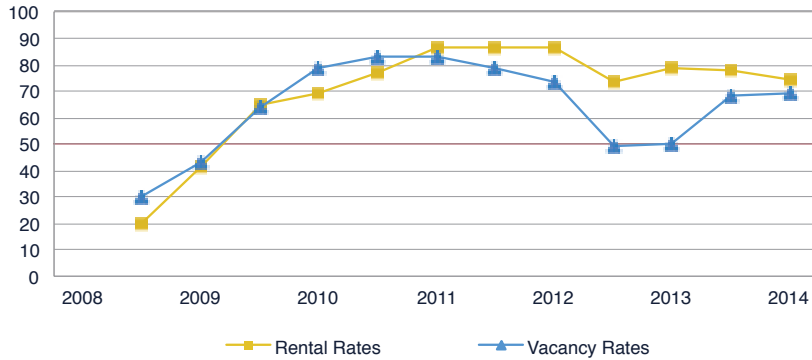
San Diego Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



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

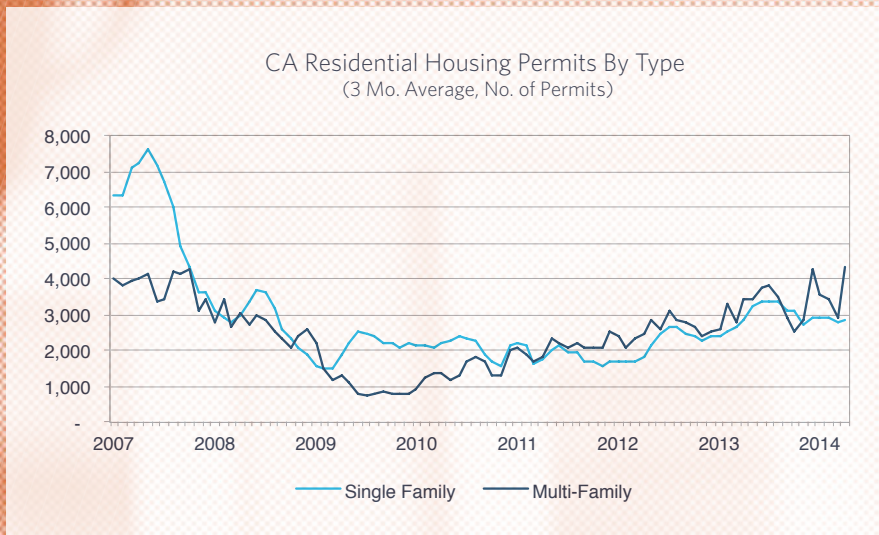


Silicon Valley Office Market
 Indexes of Survey: 3 year forecast
 (<50 market weakening, >50 market tightening)



In the latest office markets sentiment survey for Southern California, June 2014, the indices for each of the three markets, San Diego, Orange County and Los Angeles fall strongly in the optimistic range and are at approximately the same levels as seen over the previous eighteen months. In other words, developers are viewing 2016 and 2017 as years in which office markets in Southern California will be better than today in both rental and occupancy rates. Though optimistic, our panels for each of these three markets are demonstrating some caution in the creation of new office space. Of the panel members, just under 30% are beginning a new office development in the next 12 months, approximately the same percentage as began at least one new development in the previous 12 months.

The Bay Area office market developer panel's sentiment has a slightly different pattern. The vacancy rate index weakened in late 2012 and early 2013 before moving back into the improving vacancy rate region. In part, this prior pessimistic view of the vacancy rate was due to uncertainty about the fiscal cliff, but for the most part it was due to the view that new construction already in the pipeline was sufficient to meet forecast demand with a buffer for future demand growth. That more pessimistic view has changed with the faster than expected increase in office using employment the Bay Area has experienced over the last twelve months. From June 2013 to June 2014 the Bay Area grew at more than double U.S. rates. Consequently, the Bay Area Panels now forecast 2015 and 2016 to be years in which both vacancy and rental rates improve relative to 2014. Indeed, half the Panel surveyed said that they would be starting one or more new projects in the Bay Area over the coming 12 months.



“Developers are saying that as they look forward to 2016 and 2017, they see no let up in this demand, so they’re out looking at new projects to build even more multi-family housing in the county of Los Angeles.”

- Jerry Nickelsburg,
Senior Economist, UCLA Anderson Forecast

MULTI-FAMILY MARKET

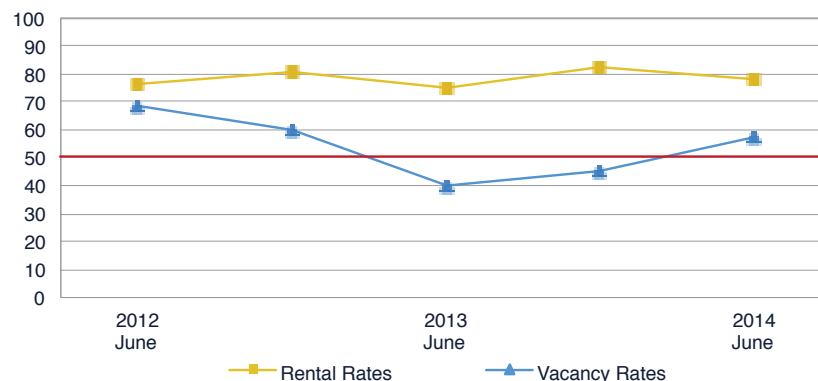
The Multi-Family Puzzle

At first blush, the multi-family surveys present a puzzle. The demand for multi-family housing stems from household formation. The rate of household formation in California was greatly suppressed by the recession of 2008/09. The recent growth of jobs in the State—employment is now above pre-recession levels—induces new household formation as the kids are able to move out of their parents homes, friends out of friends homes, and Mom and Dad out of their children’s homes into their own space. An increase in the rate of household formation increases the demand for rental housing, particularly multi-family housing, thereby driving up occupancy and rents. One would then expect the fastest growth job markets, Silicon Valley and San Francisco to be the ones where our survey panels would be the most optimistic and Los Angeles, a slower growth market, less so. Exactly the opposite is reflected in the survey indices.

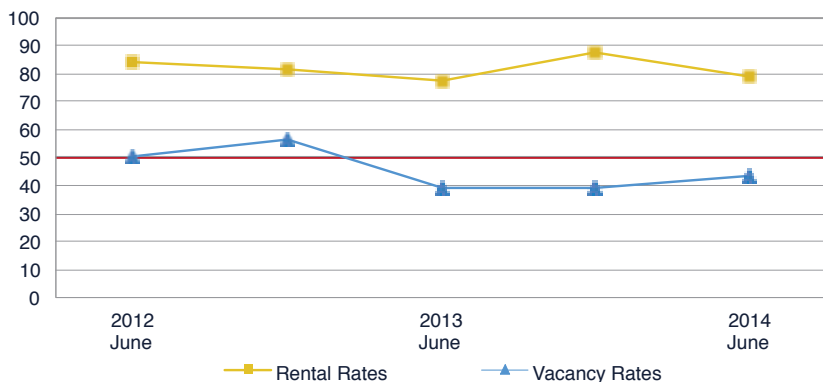
To understand this, we need to consider both sides of the market. In a market such as the previously discussed office market where little new supply has been added to the market, the above reasoning holds. In such a market, all of the action is on the demand side. In the case of multi-family housing, however, the supply has been adjusting along with the demand. The number of permits for new multi-family housing in the State have now returned to 2007 levels. In San Francisco and Silicon Valley, they are exceeding previous building permit levels. If the supply of multi-family housing is increasing concomitant with, or in anticipation of increased demand, then one would not expect the panel to think that vacancy rates would be lower than today. Indeed, a conservative view would yield a higher vacancy rate. This is exactly what we observe in the survey. In spite of the less optimistic view of 2016 and 2017 than the Los Angeles Panel, 44% of the Bay Area Panel will be starting one or more new multi-family projects in the coming year,

the same as started one or more in the previous year. The Survey indices are telling us that in these markets an equilibrium prevails, and in spite of rising rents, they are not overheated.

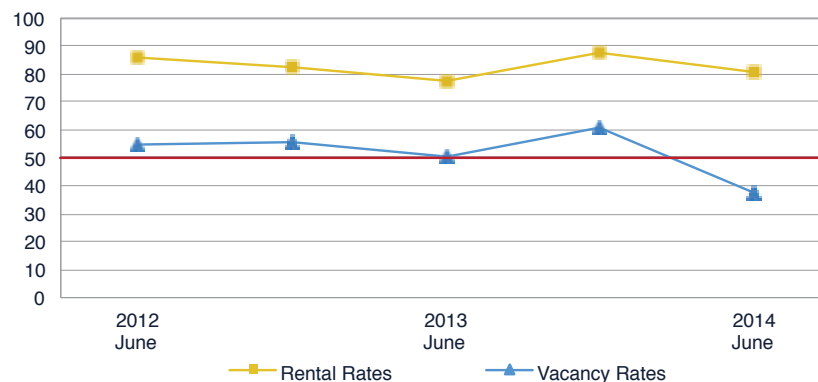
Los Angeles Multi-family Housing Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)




Silicon Valley Multi-family Housing Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)



San Francisco Multi-family Housing Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)





"The Inland Empire has been one of the hottest markets in Southern California, and that's really because of the fact that it has land and you can build the big buildings there."

- Barbara Emmons,
Vice Chairman at CBRE, Inc.

INDUSTRIAL MARKET

California Industrial Space Markets

Industrial Space is comprised of two distinct markets, manufacturing and warehousing, where the dominant one by floor space is warehousing. Although each geography is a mixture of both, San Francisco, Silicon Valley and Orange County can be broadly characterized as being more heavily manufacturing, the East Bay and Los Angeles a mix of the two, and the Inland Empire by warehousing. The basic underlying economic forces in industrial markets are California manufacturing, the export of goods to Asia and Mexico, and consumer goods from the manufacturing centers of Asia brought into the U.S. through the California ports.

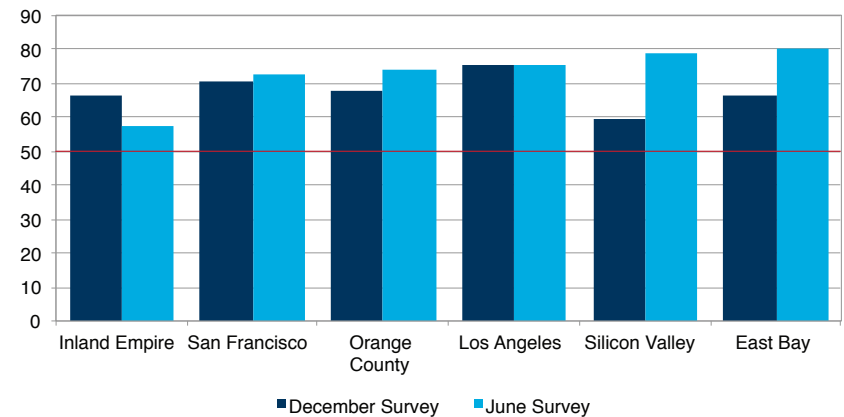
The current survey of industrial space developers indicates little change in sentiment from six months ago. There is a slight drop in the optimism of the panel for the Inland Empire, however this change is not significant. One half of the panel of developers began a project during the last twelve months and seventy percent will begin one or more industrial space projects in the coming twelve months. The largest change in industrial space sentiment is found in Silicon Valley where developers have become more bullish on 2017. As with office space, this can be traced to a renewed sense that the rapid pace of growth in coastal California and the steady increase in imported goods will continue to create more non-residential space requirements in the coming three years.

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 2017 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 two years and of opportunities for new investment in multi-family, office 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 to be a good run of California again building non-residential space, building which should continue through the next phase of the economic recovery.

Industrial Space Developer Sentiment Index For 2017
(>50 optimistic)



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