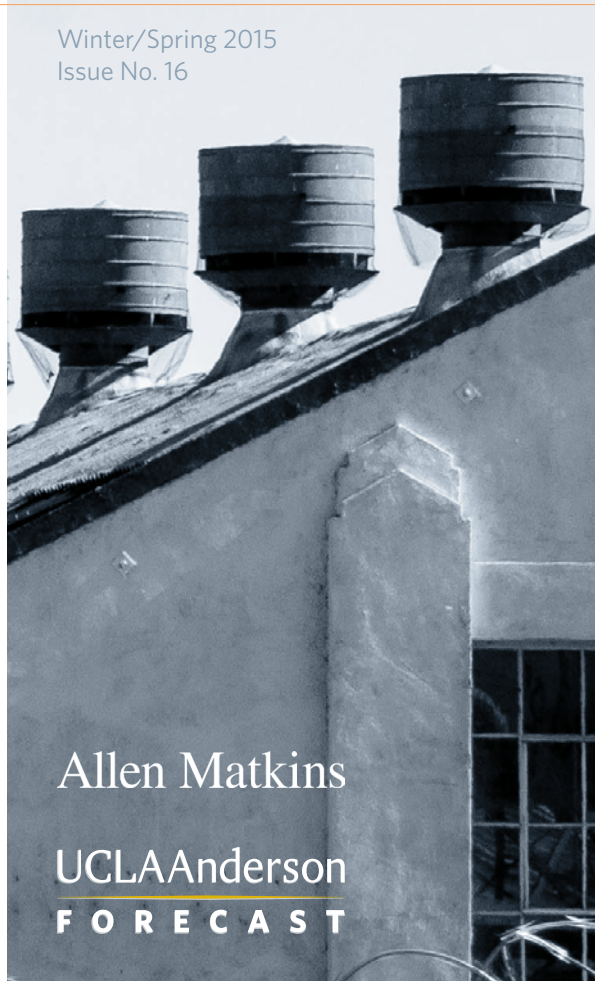


ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

Winter/Spring 2015
Issue No. 16



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

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

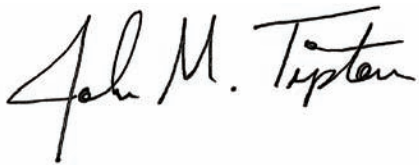
Allen Matkins and UCLA Anderson Forecast have partnered to create a Commercial Real Estate Survey and Index to better predict future California commercial rental and vacancy rates. This tool surveys supply-side participants – commercial developers and financiers of commercial development – for insights 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 sixteenth 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

A black and white photograph of several skyscrapers, viewed from a low angle looking up. The buildings are modern with many windows. Two large black rectangular boxes with white text are overlaid on the image. The top box contains the text 'CALIFORNIA COMMERCIAL REAL ESTATE SURVEY:' and the bottom box contains 'REACHING NEW HEIGHTS AND BEYOND'.

CALIFORNIA
COMMERCIAL REAL
ESTATE SURVEY:

**REACHING NEW
HEIGHTS AND
BEYOND**

OFFICE SPACE MARKET

California commercial real estate is booming once again. During the past six months the average value of newly issued permits for non-residential construction after adjusting for inflation was the highest it had been since the middle of 2001. And more projects are getting ready to start, from sports venues in Sacramento and the Bay Area to multi-use buildings in South Park Los Angeles and the East Bay, to new tech complexes in Silicon Valley and Silicon Beach, the Golden State's commercial construction has returned. But for how long will this spurt in a highly cyclical industry last? Apparently for some time is the view of the survey panels of experts and developers who participate in the Allen Matkins UCLA Anderson Forecast bi-annual survey of developer sentiment.

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 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.

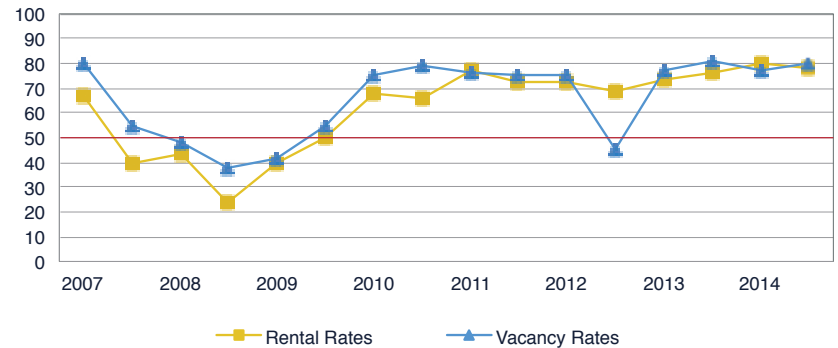
Office Space Markets

Office market sentiment throughout the six regions we survey remained strong in the December Survey. For Southern California the optimism about the next three years has been consistently positive at about the same levels for the past two years. The continued growth in office using employment, falling vacancy rates in specific sub-markets and overall positive outlook for the economy (The Anderson Forecast projects increased growth through 2016), all contribute to the consensus for improved returns to office space as the State's economic expansion unfolds.

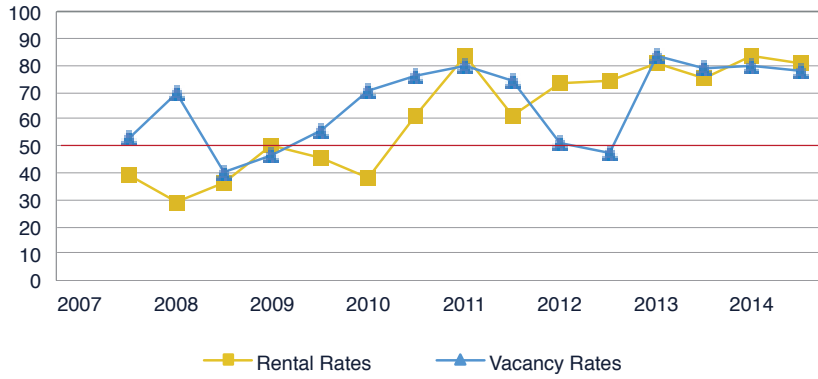
In each of the three Southern California markets surveyed, Los Angeles, Orange County and San Diego, the survey panelists were mostly very optimistic about rental rates with a minority expecting rates to increase at about the same rate of inflation. None of the panelists expect future rental or occupancy rate weakness through 2017.

Further evidence is found in the panelist's answer to a survey question on their actions since the previous May Survey. At that time 36% stated that they planned one or more new office project starts in the coming 12 months. In fact 47% began new projects over the last 12 months. Looking forward 51% now state that they would begin new office space development projects over the next year with 35% (up from 9%) planning more than one new development.

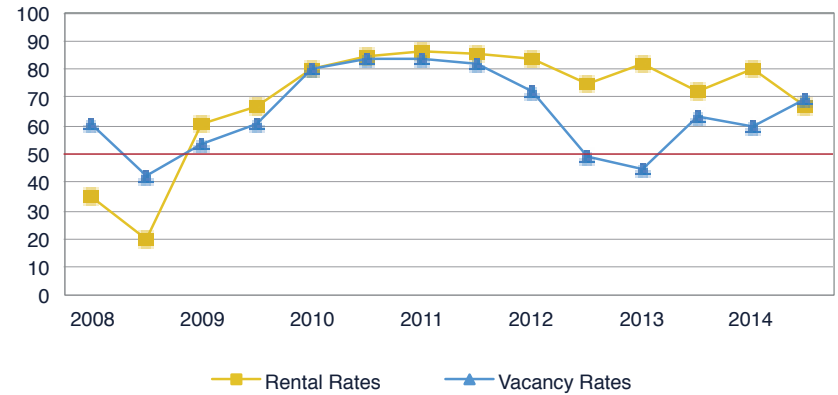
Los Angeles Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



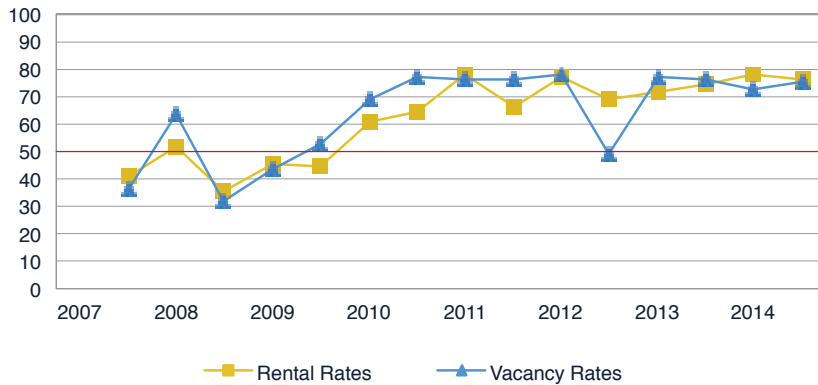
Orange County Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



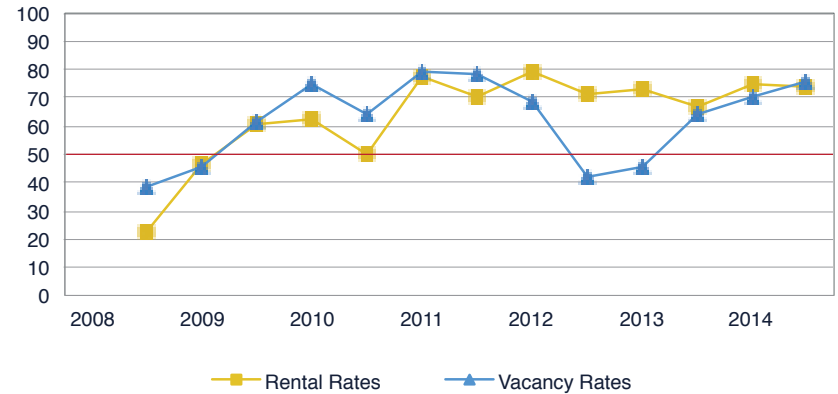
San Francisco Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



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)

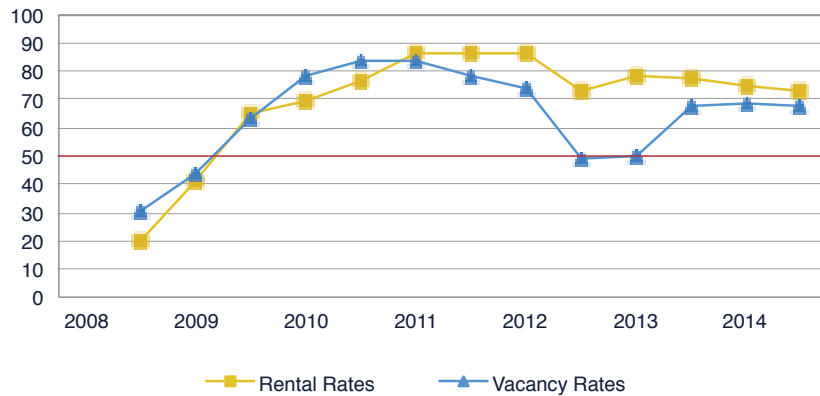


Table 1
Office Using Employment Relative to 2007
(November 2014)²

	Finance, Insurance, Legal & Accounting	Finance & Insurance	All Other
San Diego	90%	87%	110%
Orange County	90%	82%	105%
Los Angeles	87%	83%	105%
San Francisco	88%	82%	129%
East Bay	n/a	79%	116%
Silicon Valley	n/a	100%	115%

The Bay Area panels are very optimistic as well, but the Survey is beginning to pick up some developer concerns. The San Francisco panel is slightly less optimistic about rental rate growth but more optimistic with regard to vacancy rates. This is symptomatic of the view that while the market is not over-built, some easing of pressure on rental rates is expected in the next few years. The East Bay continues an upward trend towards more optimism as the West Bay economy remains white-hot and rental rates push more office space users across the reconstructed Bay Bridge. Silicon Valley developer sentiment remains highly optimistic and has been for the past eighteen months. What is different about the San Francisco and Silicon Valley markets is a wider spread of opinion with regard to 2017. For some of the panelists, though far from a majority of them, current new construction is sufficient to meet what they perceive to be future demand. Therefore, they do not expect further improvements in rental rates or vacancy rates in these markets.

The view that office space demand, though growing at significant rates, is no longer outpacing office space construction is reflected in the Bay Area panelists' actions as well. In December, 39% of the panel reported plans to embark on new development over the next 12 months. This is a drop from 50% reported in the previous Survey. But plans do not always come to fruition and only 15% stated in the current Survey that they had begun at least one project during the past year. These data do not portend a downturn, but do provide an indication that for now there may be a maturation in the current build cycle.

The principal driver of these strongly optimistic views for our six survey markets is continued growth in office-using employment. However, in this cycle employment growth is skewed away from some traditional users of office space, finance, insurance, and legal services, and towards other business services, software design, and medical offices (Table 1)¹. Aside from Silicon Valley, jobs in finance and insurance remain 13% to 21% lower than in 2007. When legal and accounting services are added back in the picture improves somewhat, but not by much. This shift in the types of work requires differently configured spaces, often in different locations than those that are being vacated. Consequently the outlook, while being positive for new construction of office space, is mixed in some sub-markets as owners and developers grapple with a changing environment for their products.

¹ The NAICS definition of financial activities include real estate and leasing. The sub-sectors of finance and insurance are those referred to herein.

² Finance and Insurance does not include real estate and leasing activities.

COMMERCIAL MARKETS DEVELOPER SENTIMENT



Office



Multi-Family



Industrial

>50 INDICATES POSITIVE OUTLOOK

Arrow is change from last survey

▲ 79.17 

▲ 70.31 

▼ 72.75 

Los Angeles

▲ 62.18 

Inland Empire

▼ 79.09 

▼ 72.54 

Orange County

▲ 75.79 

San Diego

▲ 74.89 

▼ 64.58 

East Bay

▼ 68.20 

▲ 68.51 

▲ 72.92 

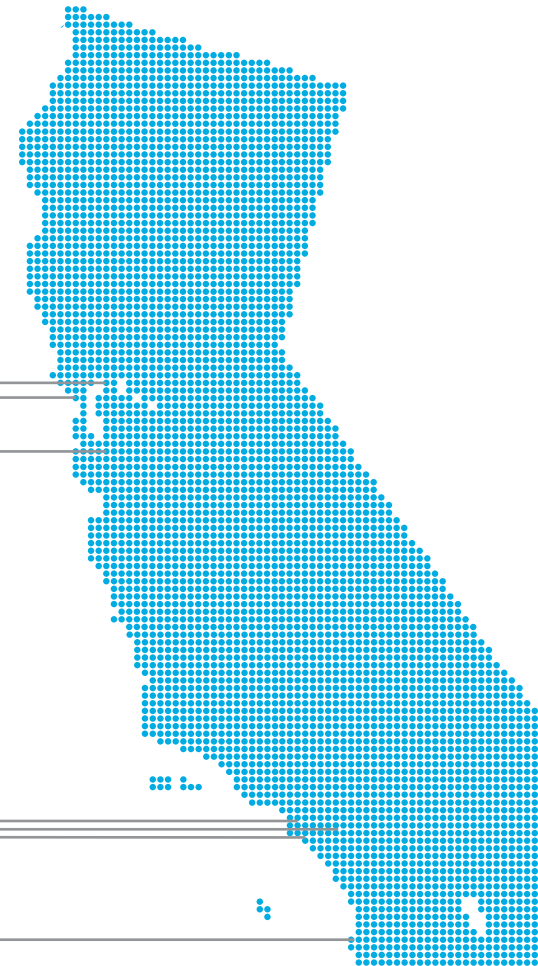
San Francisco


▼ 70.58 

▼ 60.62 

▲ 85.42 

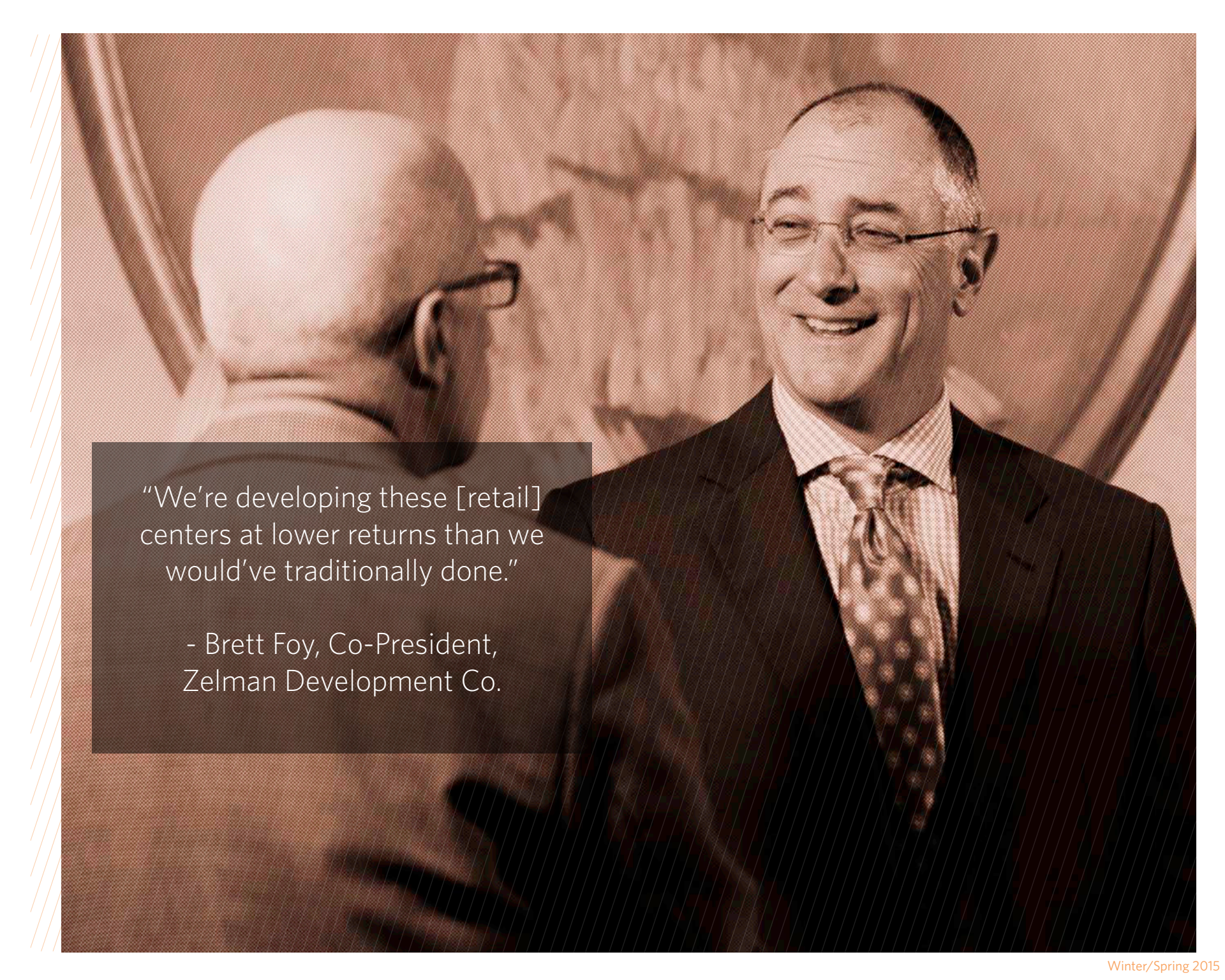
Silicon Valley



A man with glasses, wearing a dark suit, white shirt, and dark tie, is speaking into a microphone. The microphone has the letters 'AM' on it. The background is a blurred office setting. The image has a halftone or dot-matrix texture.

“Investors are taking more risk
as they’re going after more
transitional assets.”

- Scott Shepherd, EVP, Co-head
of Commercial Real Estate Group,
OneWest Bank



"We're developing these [retail] centers at lower returns than we would've traditionally done."

- Brett Foy, Co-President,
Zelman Development Co.

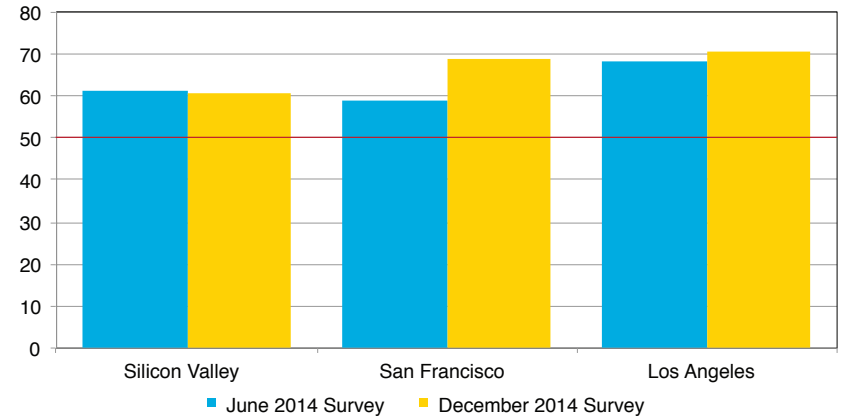
MULTI-FAMILY MARKET

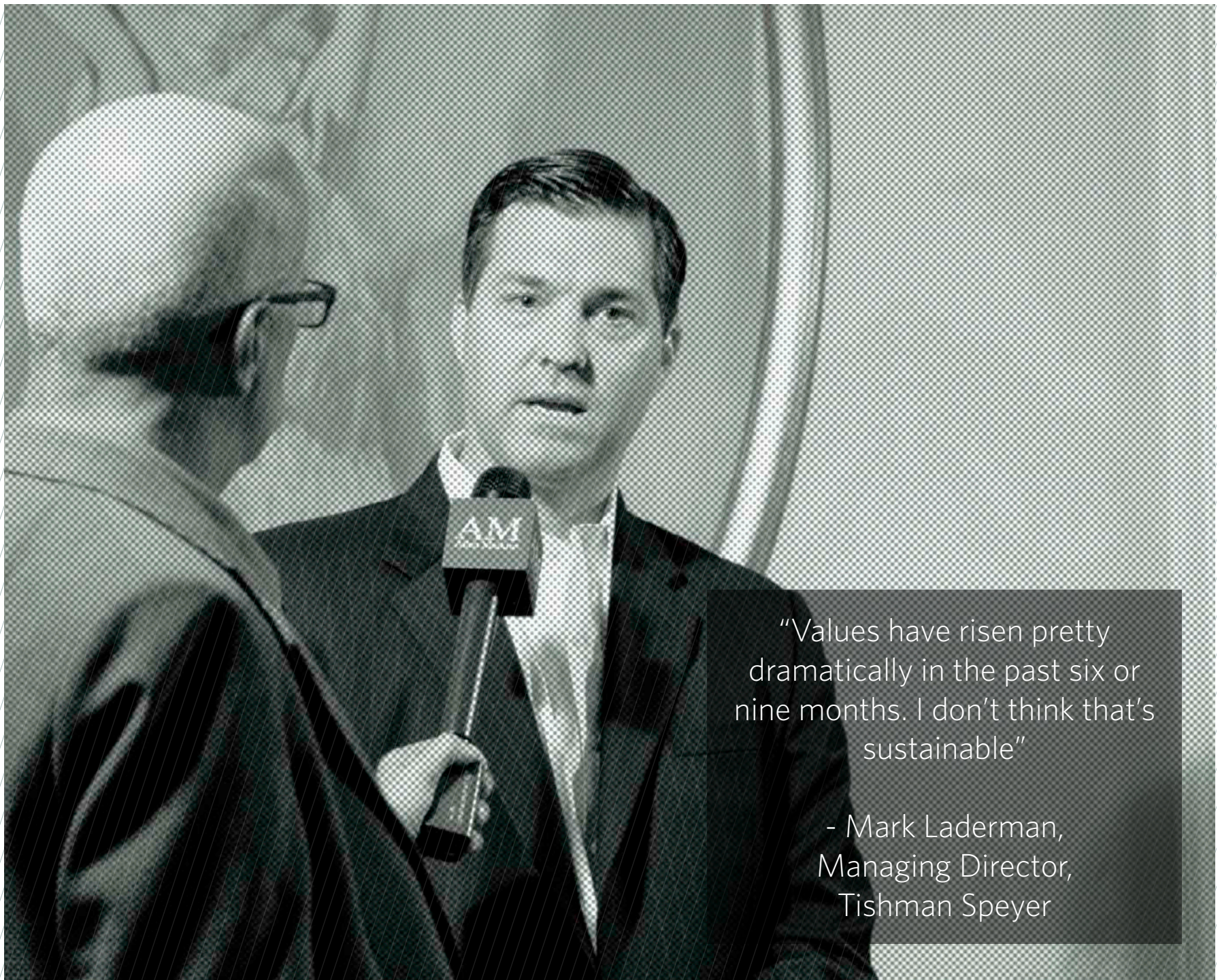
Multi-Family Residential Markets

Multi-Family developer sentiment has remained very optimistic over the past six months. Among our three regions, the San Francisco Panel was decidedly more optimistic about vacancy rates than six months ago and therefore about the market in general, while the other two markets surveyed, Los Angeles and Silicon Valley, were both optimistic about market conditions continuing to strengthen over the next three years. This positive view of the future of multi-family housing is expected to continue as job growth in California, forecast at a 2.2% rate over the next two years, will continue to be skewed towards these three coastal cities. Increased employment translates directly into new household formation and additional demands for housing. All three markets are at a state where in-fill and more density are the obvious answers to this increased demand.

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. Our forecast, consistent with the sentiment expressed by our three panels, is for the current mix of single and multi family units to persist. Higher rents and higher occupancy means higher returns, thereby will stimulating more building of multi-family units. Thus far, the number of multi-family permits issued in the state per month has risen to and plateaued at 70% of its house-bubble peak. Our panel of developers is not currently contemplating an increased number of projects in the next 12 months. However, the progressively higher rents and occupancy rates will induce an increase in multi-family construction in 2016 and 2017.

Multi-Family Housing Developer Sentiment Index For 2017
(>50 optimistic sentiment)





“Values have risen pretty dramatically in the past six or nine months. I don’t think that’s sustainable”

- Mark Laderman,
Managing Director,
Tishman Speyer

INDUSTRIAL MARKET

California Industrial Space Markets

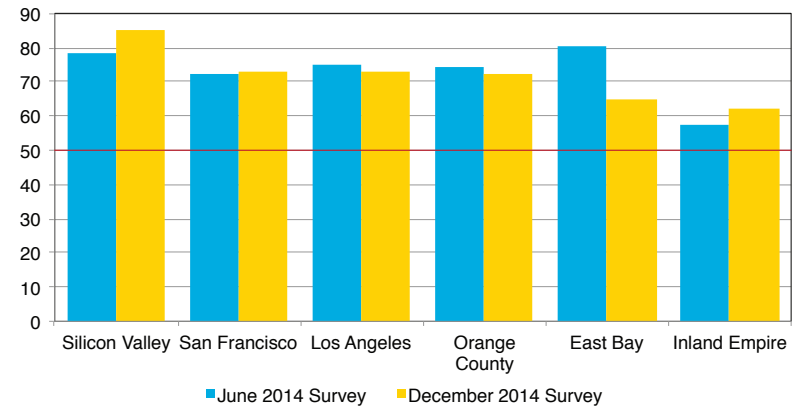
Industrial Space is comprised of two distinct markets, manufacturing and warehousing. Although each geography surveyed has a mixture of both, Orange County can be broadly characterized as being more heavily manufacturing, Los Angeles a mix of the two, and the Inland Empire by warehousing. The basic underlying economic forces driving the demand for industrial space in California are manufacturing and the export of goods to Asia and Mexico, and U.S. importation of consumer goods from the manufacturing centers of Asia transiting through the California's ports.

The current Survey of industrial space developers indicates little change in sentiment from six months ago. For Southern California 70% of the Panel intend on beginning new development projects in the next 12 months, the same as six months ago, however there has been a shift of eight percentage points from the proportion of the Panel intending only one project to those intending to begin more than one. Looking backwards, the number of projects begun during the previous 12 months was at about the same rate as planned last May. So while the sentiment is unchanged at strongly optimistic, there is clearly a strengthening of the Southern California industrial space market. This is due in part with the increased imports through the San Pedro Ports and more generally with the increased consumer confidence in the U.S. economy.

The shift in demand composition being reported by developers is from those sub-markets which are more predominately factory space using such as the San Fernando Valley and Downtown Los Angeles towards those serving as distribution centers, the South Bay, Wilmington, Long Beach and the Gateway Cities and the Inland Empire. The reduction in space used by manufacturing is a continuing trend with its origins in the cost of land and labor in Southern California. For example, alternative uses for land in Downtown Los Angeles, (e.g. apartment, mixed-use retail and creative office space) bids up the price of land and induces factories to relocate to more cost effective venues. On the other hand, the advent of EEE class ships plying the Pacific and carrying significantly more cargo from Asia, a continued shift to e-commerce distribution of retail goods and the up-tick in consumer demand leaves the region short of warehouse space. The expectation of the panel is for Southern California industrial space markets to remain hot for at least the next three years which will induce both speculative and build-to-suit construction.

Industrial Space Developer Sentiment Index For 2017

(>50 optimistic)



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 three 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, a continuation the fifteen-year highs in the value of non-residential construction projects permitted.

Allen Matkins FORECAST

FROM
CAST

12. In the last 12 months national building costs have increased by 4.3%. Do you forecast that between 2016 and 2017 Southern California building costs will:
- A. Increase faster than the rate of inflation
 - B. Increase slower than or at the rate of inflation
 - C. Stay the same
 - D. Decrease
13. If you invest in Los Angeles, do you forecast that the cost of land for building office space in Los Angeles will:
- 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
14. If you invest in San Diego, do you forecast that the cost of land for building office space in San Diego will:
- 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
15. If you invest in Orange County, do you forecast that the cost of land for building office space in Orange County will:
- 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
16. Planning for your office space projects over the next 24 months, will the percentage of your firm's office space projects:
- A. Increase
 - B. Stay the same
 - C. Decrease
17. Will your firm's targeted investment return threshold over the next 12 months:
- A. Increase
 - B. Stay the same
 - C. Decrease
18. Will your firm be investigating new office space in the next 12 months:
- A. Increase
 - B. Stay the same
 - C. Decrease

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