



ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

Allen Matkins

UCLA

Anderson
Forecast

Spring/Summer 2019
Issue No. 25

Office | Multi-Family | Industrial | Retail

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. In the last 12 months, have you received any offers to purchase office space in the Los Angeles area?

- A Yes
- B No

13. If you received any offers to purchase office space in the Los Angeles area, how many offers did you receive?

- A 1
- B 2
- C 3
- D 4
- E 5
- F 6
- G 7
- H 8
- I 9
- J 10
- K 11
- L 12
- M 13
- N 14
- O 15
- P 16
- Q 17
- R 18
- S 19
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- V 22
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- X 24
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- AH 34
- AI 35
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- AL 38
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- AO 41
- AP 42
- AQ 43
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- AU 47
- AV 48
- AW 49
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- BM 65
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- BO 67
- BP 68
- BQ 69
- BR 70
- BS 71
- BT 72
- BU 73
- BV 74
- BW 75
- BX 76
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- BZ 78
- CA 79
- CB 80
- CC 81
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- CE 83
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- CG 85
- CH 86
- CI 87
- CJ 88
- CK 89
- CL 90
- CM 91
- CN 92
- CO 93
- CP 94
- CQ 95
- CR 96
- CS 97
- CT 98
- CU 99
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- CY 103
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- JZ 286
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- MZ 364
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- NH 372
- NI 373
- NJ 374
- NK 375
- NL 376
- NO 377
- NP 378
- NQ 379
- NR 380
- NS 381
- NT 382
- NU 383
- NV 384
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- NY 387
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- OR 406
- OS 407
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- RY 491
- RZ 492
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- SC 495
- SD 496
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- ZY 698
- ZZ 699



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 25th 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 California-based top-ranked law firm 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



AN UPTURN IN CRE DEVELOPMENT FORETOLD



The Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey for 2019-2022

Good news about future commercial real estate (CRE) development has arrived with the first of two 2019 surveys of developers throughout the major population centers of California. The Survey, conducted in May 2019 with questions that look forward to 2022, reveals a more optimistic outlook, particularly in some spaces, than has been observed the last couple of years. This is in large part because of the design of the survey. By gauging the sentiment of developers that goes into their business plans for new projects due to come online in 2022 and beyond, the survey jumps over what the UCLA Anderson Forecast predicts will be a very weak economy through 2020. Thus, as CRE construction slows down these next 18 months, developers are already looking at getting in on the ground floor of the next CRE expansionary cycle. In this Spring/Summer Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey report, we examine these trends for four spaces — office, industrial, retail, and multi-family.

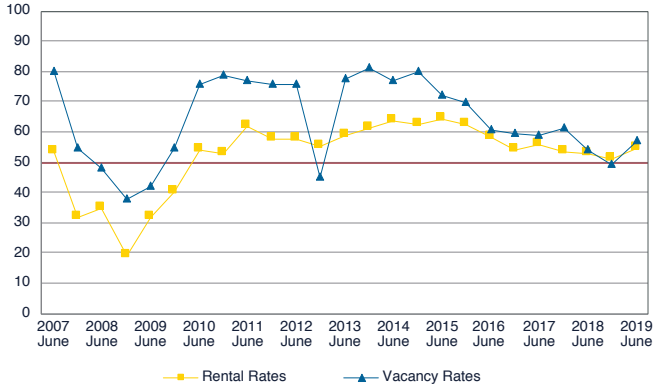
A recent study of the indexes created from survey responses demonstrated two aspects of the data.¹ First, the prediction that optimism or pessimism as recorded by the survey indexes would correspond to higher or lower levels of development of new properties three years into the future proved to be empirically accurate. Second, trends in the survey data, to the

limited extent the data can tell us at this point, indicate early warnings of directional shifts in the CRE building cycle. An application of these results to the current survey now indicates a directional shift in two types of CRE — office and retail.

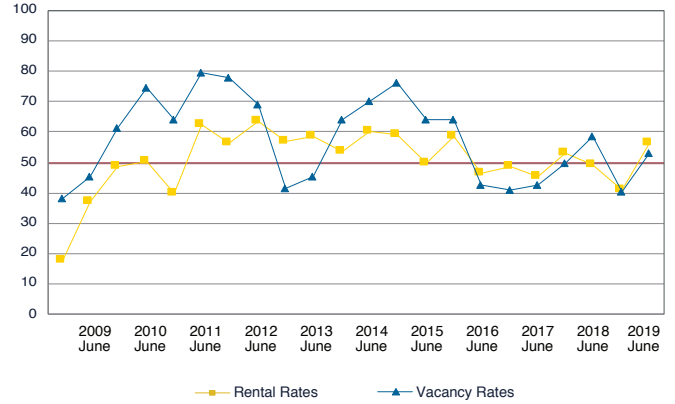
The Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey compiles the views of commercial real estate developers with respect to markets three years hence. The three-year time horizon was chosen to approximate the average time a new commercial project requires for completion (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 2022, then initial work for a new project with an expected ready-for-occupancy date of 2022 — a business plan, preliminary architecture, and a search for financial backing — would have to begin no later than the latter part of 2019. Although optimism does not always translate into new construction projects, this sentiment is a prerequisite for it.

1. Jerry Nickelsburg, "Predicting Commercial Real Estate Supply: An Analysis of The Allen Matkins/UCLA Anderson Forecast CRE Indexes" 2018.

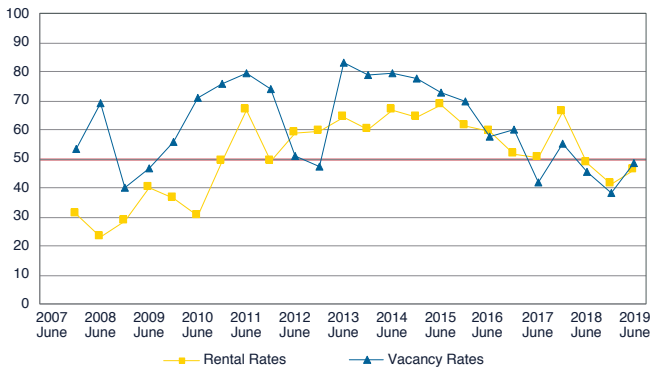
Los Angeles Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



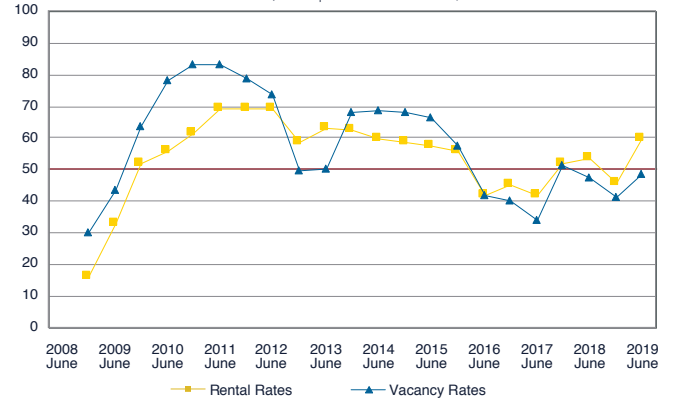
East Bay Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



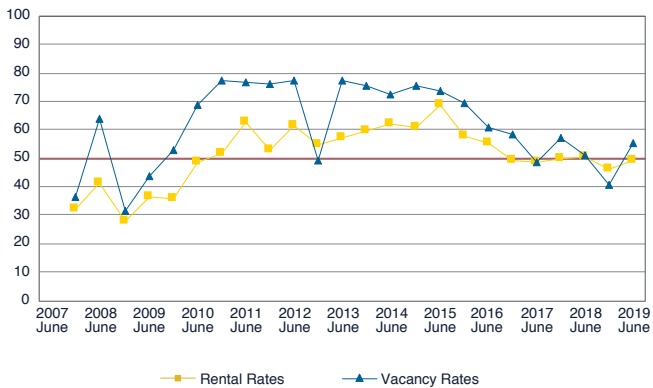
Orange County Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



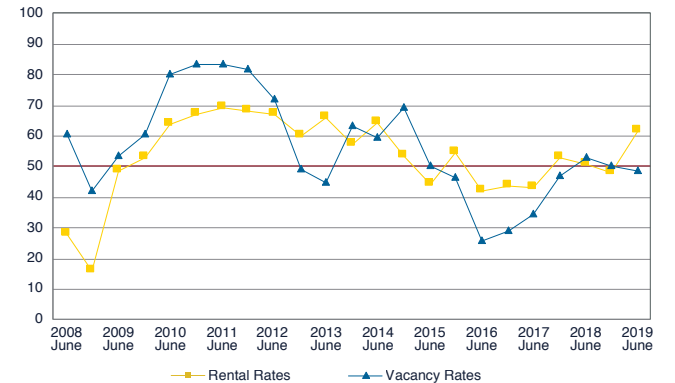
Silicon Valley Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



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)



OFFICE SPACE MARKETS

In our previous analysis of office markets, we deduced from the Survey that the peak of the market had been reached. For each of the markets surveyed over the last two years, with the exception of Los Angeles, the sentiment index fluctuated about the 50 level; the value dividing an optimistic or pessimistic sentiment response from the survey panelists. This indicated an expectation that in 2020 and 2021 office markets would be softer than they were in 2017 and 2018, respectively. Because of the variation in the Survey results, it did not indicate a downturn in development, but rather a pause.

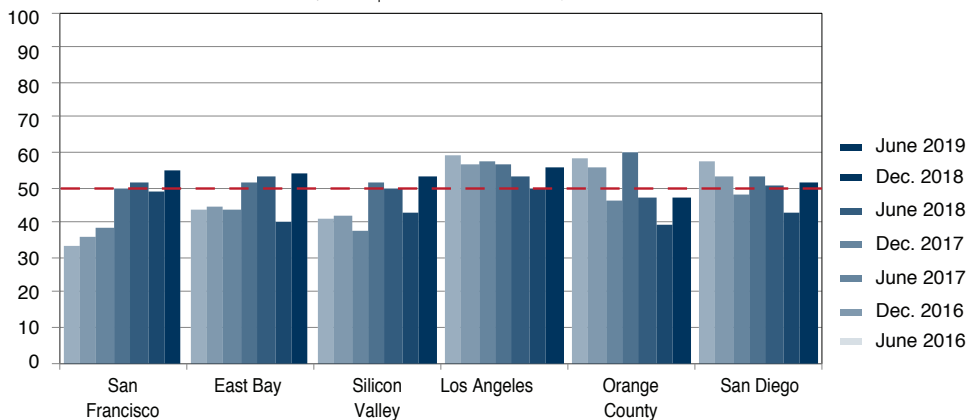
In the latest Survey, there is a return to confidence, however for one year later, 2022. If, as most economists predict, the economy returns to faster growth in 2021, the panelists' views on 2022 are consistent with that perspective. That is, a two percent national economy in 2021 and 2022 will generate office-using jobs, particularly in tech-heavy California. Since building has been at a moderate pace with 60 percent of our Bay Area panelists and 45 percent of our Southern California panelists on the sidelines during this time, there is not a large overhang of space waiting for this growth.

Recently, growth in the amount of new development has been flat, even though there has been some increase in office-using employment. The Survey tells us that office space developers see a post-near-recession demand surge that will improve rental and occupancy rates. Since the development in process is for a market that is currently subdued, the developer panelists view rental rates as going up more rapidly than inflation though they are a bit mixed on improvements in occupancy rates.

In San Francisco, Silicon Valley, and the East Bay, the overall view of the market looking three years into the future is better than it has been in the last three years. In particular, there is the expectation that rental rates adjusted for inflation will improve significantly. The view with respect to occupancy and non-labor development costs is more neutral. The combination of these is sufficient to induce increased development by 2022. The Survey is, therefore, predicting a pause in the increase in building the next couple of years followed by growth thereafter.

In two of the three Southern California markets surveyed, the message is also clear. For the last three years, the survey participants have been signaling that markets today (measured by occupancy and rental rates) are only going to improve, though somewhat marginally over the subsequent three years. The latest survey continues that trend, with Orange County being the exception as it is still struggling with an overhang of space and tepid job creation. The cost of housing and the cost of commuting from the Inland Empire coupled with a 2.6 percent unemployment rate are dampening factors on office using employment growth.

Office Space Developer Sentiment Index
(>50 optimistic sentiment)



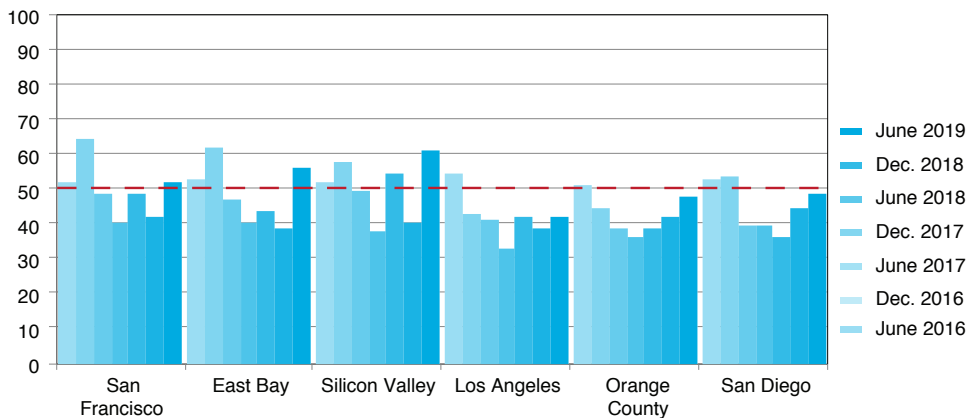
RETAIL SPACE MARKETS

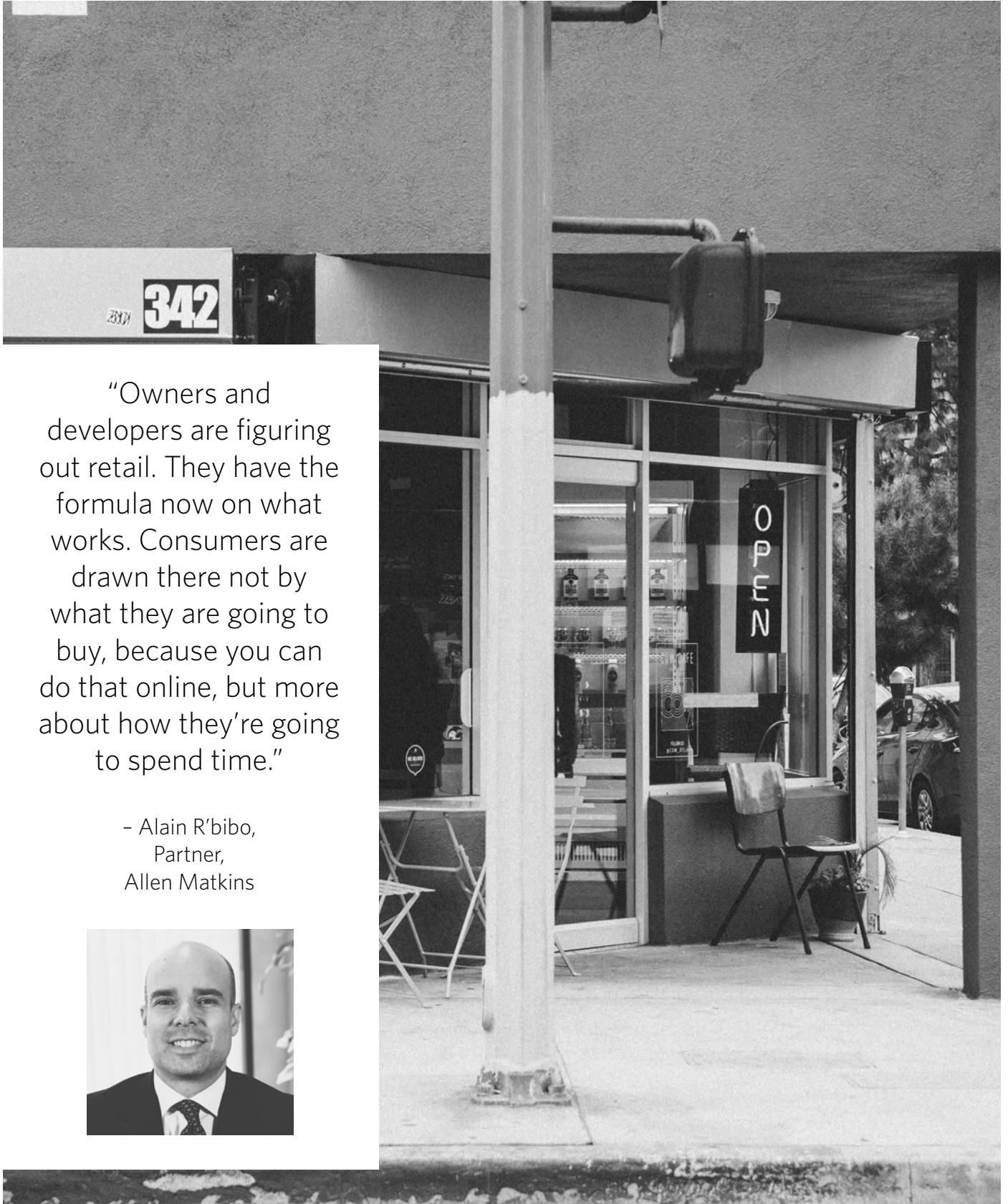
While retail continues to be the weakest space in commercial real estate, the latest Survey shows some surprising results. In the Bay Area, after two years of pessimism, the panel reports that they are optimistic when looking at 2022. In Southern California, there remains pessimism, but it is not as uniform across panel members as in previous surveys.

The explanation has to do with the fact that brick-and-mortar retail demand has been shrinking of late due to the strong move to online shopping. Thus, major new development has not been occurring, with the exception of some repurposing of older malls, and additions to multi-use developments. In fact, some retail space, the Westside Pavilion Mall in Los Angeles for example, is being repurposed as office, mixed-use, or residential space.

With very little building of new space and an economy forecast to grow at normal rates in the early part of the coming decade, there are going to be opportunities for retail to support new housing as well as upgrades associated with gentrification and densification. This is the improvement anticipated by our survey panel. But there is a caveat to the optimism seen in the survey results. The forecast that retail markets are going to be better than today does not mean they are going to be firing on all cylinders. Rather, from their depressed state, they will see some improvement, and there will be more opportunities than at present.

Retail Developer Sentiment Index
(>50 optimistic sentiment)





“Owners and developers are figuring out retail. They have the formula now on what works. Consumers are drawn there not by what they are going to buy, because you can do that online, but more about how they’re going to spend time.”

- Alain R'bibo,
Partner,
Allen Matkins



After a pause in 2021, our panelists see the office market picking back up in 2022.

- John Tipton,
Partner,
Allen Matkins

“You better have some entertainment value or experiential idea in your retail space that makes it more interesting to visit. People really want to have an experience.”

- Lew Horne,
Division President, Pacific Southwest,
CBRE

“In Carson, South Bay, City of Industry, Commerce, etc., the only way you can get more square footage, is by doing denser industrial product.”

- John Condas,
Partner,
Allen Matkins

“Our panelists seem to be relatively pessimistic about the future of multi-family housing in the Bay Area because the sense is that there will be rent control.”

- Jerry Nickelsburg,
Director & Senior Economist,
UCLA Anderson Forecast

INDUSTRIAL SPACE MARKETS

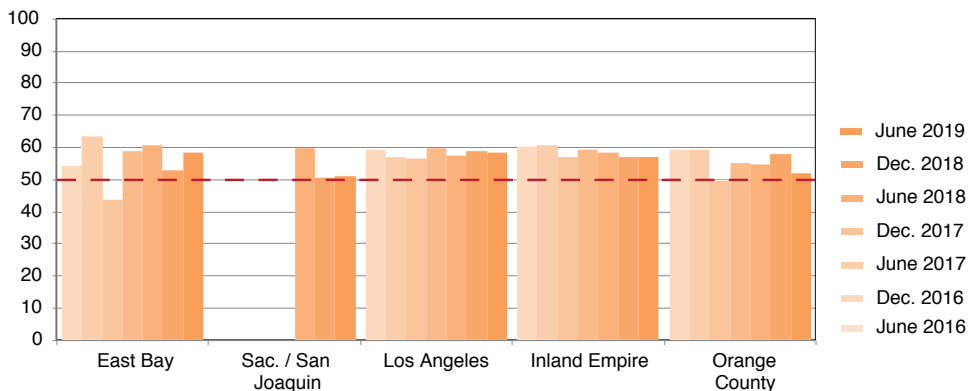
Industrial markets continue to be where the action is in non-residential commercial real estate development. Since California began transforming from a factory economy to an information economy, the space has shifted to being dominated by warehouses. In spite of the impact of the trade dispute with China, the panels for the East Bay, Los Angeles, and Orange County are looking at very good markets becoming even more lucrative by 2022.

That is not so for the Inland Empire and Inland Northern California. These have been the hottest markets for industrial space in recent years. The Survey, which asks for a comparison of the market in 2022 to today, is designed to ascertain market trends. The developers' responses were that it will be about the same as today – neither optimism about improvement nor

pessimism about deteriorating economics. What this means is that the red-hot markets in San Joaquin County and the Inland Empire are going to continue to be red-hot. Thus, there is really no change there.

However, closer to the ports and the population centers we find a move towards a densification of warehouses—multi-story edifices with productivity enhanced by robotics. Even though there is still technology development in process for multi-floor industrial, this appears to be what is driving values and optimism in the coastal areas. The timing of the introduction of requisite new technology is a risk to the timing of the development. In addition, the trade disputes with China and potential disruption of supply chains, neither of which seem to have influenced current developer sentiment, is a risk as well.

Industrial Space Developer Sentiment Index
(>50 optimistic sentiment)



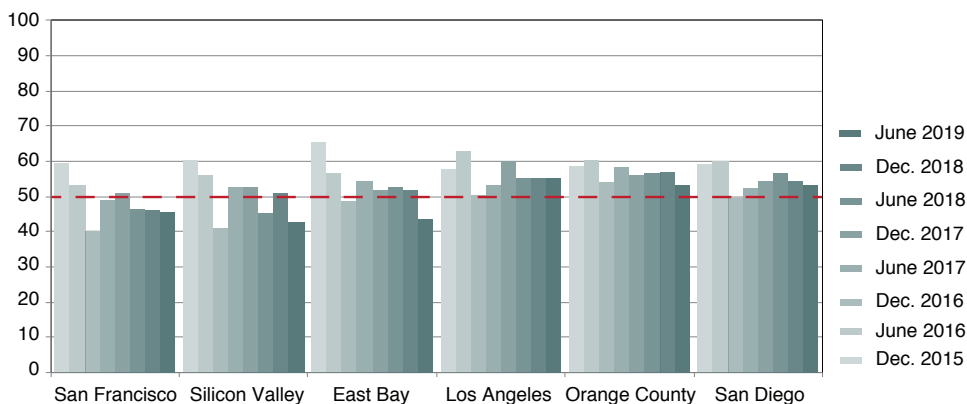
MULTI-FAMILY HOUSING MARKETS

The multi-family market has been tight since early in this economic expansion. Job growth, the precursor to household formation, has remained robust and the 2017 tax overhaul makes rental housing relatively more attractive. Once again, there were no big swings in multi-family developer expectations for the next three years for Los Angeles, Orange County, and San Diego. In the Bay Area, however, the expectation of the panel has changed. For all three markets — San Francisco, Silicon Valley, and the East Bay, developers think that 2022 will have worse economics than 2019.

In the last six months, Bay Area developers have pulled back on new development, and half of the panelists stated that they

were not planning to start a new development in the next 12 months. We have two possible explanations for these data points. First, home prices are falling in the Bay Area and the inventory of homes listed for sale has grown. Second, as the most expensive rental market in California, it is the most likely to be impacted by the growing movement towards rent control. These sources of uncertainty may well be the cause of pessimism among multi-family developers in the Bay Area in spite of the robust demand today. We will have to wait until the December survey to see if there is a trend developing here. Nevertheless, if this uncertainty is causing the building of multi-family projects to wane in the Bay Area, it will only exacerbate the housing shortage there.

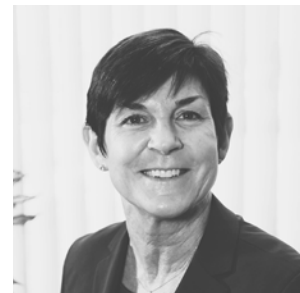
Multi-Family Housing Developer Sentiment Index
(>50 optimistic sentiment)





“We’re seeing a lot of enthusiasm in the multi-family market. Our vacancy is under 5 percent.”

- Kitty Wallace,
Executive Vice President,
Colliers International

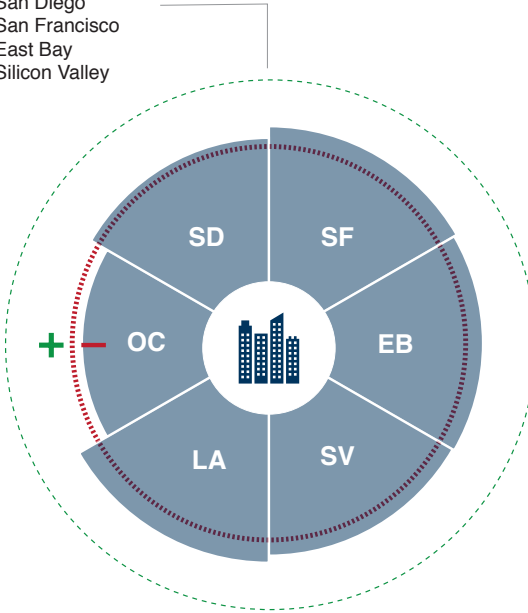


COMMERCIAL MARKETS DEVELOPER SENTIMENT

>50 INDICATES POSITIVE OUTLOOK
 Arrow denotes change from last survey

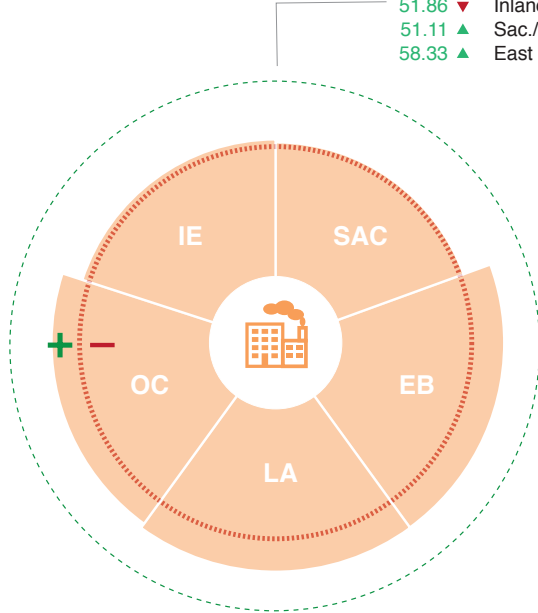
- 55.77 ▲ Los Angeles
- 47.53 ▲ Orange County
- 52.22 ▲ San Diego
- 55.18 ▲ San Francisco
- 54.43 ▲ East Bay
- 53.97 ▲ Silicon Valley

OFFICE

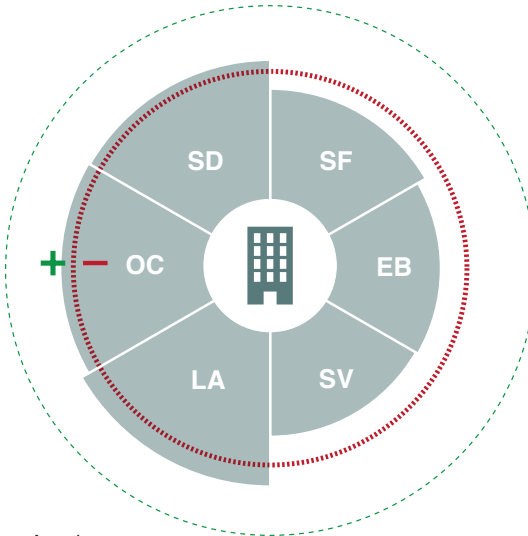


- 58.45 ▼ Los Angeles
- 57.16 ▲ Orange County
- 51.86 ▼ Inland Empire
- 51.11 ▲ Sac./San Joaquin
- 58.33 ▲ East Bay

INDUSTRIAL

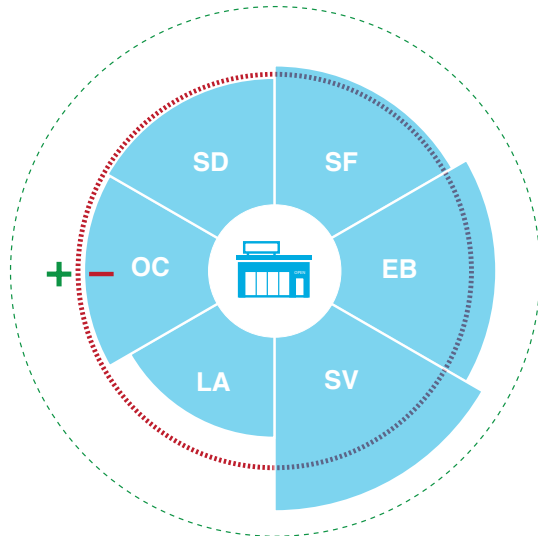


MULTI-FAMILY



- 55.48 - Los Angeles
- 53.41 ▼ Orange County
- 53.03 ▼ San Diego
- 45.69 ▼ San Francisco
- 43.40 ▼ East Bay
- 42.83 ▼ Silicon Valley

RETAIL



- 42.42 ▲ Los Angeles
- 48.43 ▲ Orange County
- 49.08 ▲ San Diego
- 52.25 ▲ San Francisco
- 56.39 ▲ East Bay
- 61.11 ▲ Silicon Valley

THE SURVEY IN PERSPECTIVE

“My clients are getting requests for tenants to use space in a different way. Tenants are looking to provide amenities for employees – cafeterias, bars in their space, allowing dogs, gyms, fitness centers, sometimes daycares.”

- Erin Murphy,
Partner,
Allen Matkins



The fiscal stimulus stemming from a tax overhaul and spending bill in Washington, D.C., at the beginning of 2018 has now run its course. The Allen Matkins/UCLA Anderson Forecast California CRE Survey did not pick up any potential impact on commercial real estate development in California, and subsequent development activity has confirmed that prediction. That is not to say there was not significant activity. Office market development continued apace, and both industrial development and multi-family development increased. With the slowing of economic growth in 2019, we are seeing some abatement of development, however the expectation of solid economic growth in 2021 and 2022 — the time when many projects begun today will receive their certificates of occupancy — has kept our panel optimistic about the status of these markets in the early part of the 2020s.

Clearly, underlying fundamentals in the eight California markets surveyed are dominating investment decisions, and these create something of a “tailwind” without regard to the declining federal fiscal stimulus. Consequently, the survey prediction is the not-very-exciting “more of the same”, at least in the near term. Since multi-family and industrial markets have been doing quite well, this is good news. For office markets, it is not bad news as the level of development is neither growing nor declining. And for retail space markets, it is the expected continued realignment of brick and mortar capital to meet 21st Century needs.

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COMMERCIAL REAL ESTATE SURVEY

Los Angeles
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Inland Empire
San Diego
Sacramento
San Joaquin County
San Francisco
East Bay
Silicon Valley

Allen Matkins

865 South Figueroa Street
Suite 2800
Los Angeles, CA 90017
Phone: 213.622.5555
Fax: 213.620.8816

www.allenmatkins.com

UCLA Anderson Forecast

110 Westwood Plaza Gold Hall
Suite B305
Los Angeles, CA 90095
Phone: 310.825.1623
Fax: 310.206.9940

www.uclaforecast.com