

ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

Summer/Fall 2015
Issue No. 17



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

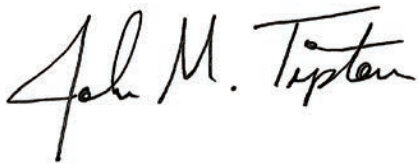
Allen Matkins and UCLA Anderson Forecast have partnered to create a Commercial Real Estate Survey and Index to better predict future California commercial rental and vacancy rates. This tool surveys supply-side participants – commercial developers and financiers of commercial development – for insights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

**TAMI AND
WAREHOUSE
DEMAND FUEL
CONSTRUCTION
BOOM**

California commercial real estate is booming once again. With availability of finance at near record levels and low cap rates easing the way, the demand from technology, advertising, media and information (TAMI) as well as distribution center warehousing and a shortage of multi-family housing has propelled the industry boom. In contrast, traditional office space tenant demand from the finance and legal sectors remain tepid. Nevertheless the TAMI tide is lifting all boats and commercial construction has risen to its highest level since 2001. 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 June 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.

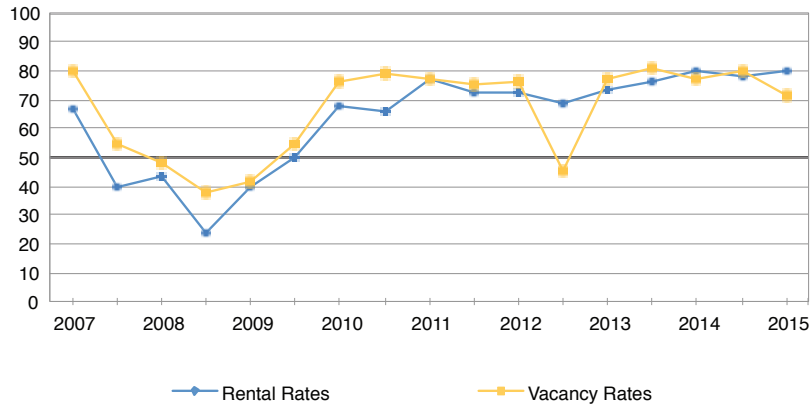
OFFICE SPACE MARKETS

Office market sentiment throughout the six regions we surveyed remained strong in the June Survey. During the last three years optimism has been consistently positive in California. The continued growth in office using employment, falling vacancy rates and an overall positive outlook for the economy (The Anderson Forecast projects increased growth through 2017), all contribute to the consensus for improved returns to office space as the State's economic expansion unfolds.

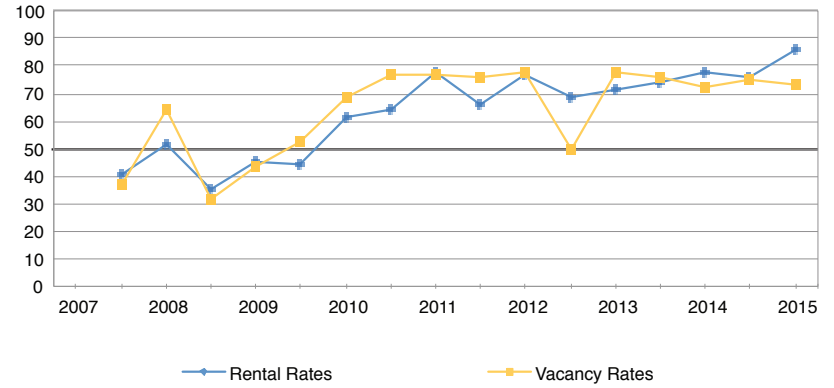
In each of the three Southern California markets surveyed, Los Angeles, Orange and San Diego Counties, the survey panelists were very optimistic for the most part about rental rates with a minority expecting rates to increase at about or slightly slower than the rate of inflation. None of the panelists are expecting the market to weaken between now and 2018. Nevertheless, the survey responses were slightly less optimistic than in the previous survey. This could be because office-using employment in finance, insurance, legal and accounting services has far from recovered since 2007 and in some markets it has shrunk further this past year. While that has perhaps created some caution on the part of the panelists, the growth in TAMI and other office using employment drove overall positive sentiment with regard to the next three years.

Over the next 12 months 40% of the Southern California Panelists stated that they expected to begin at least one new project. This compares to 23% that began one or more new developments over the past 12 months (the same percentage as predicted one year ago).

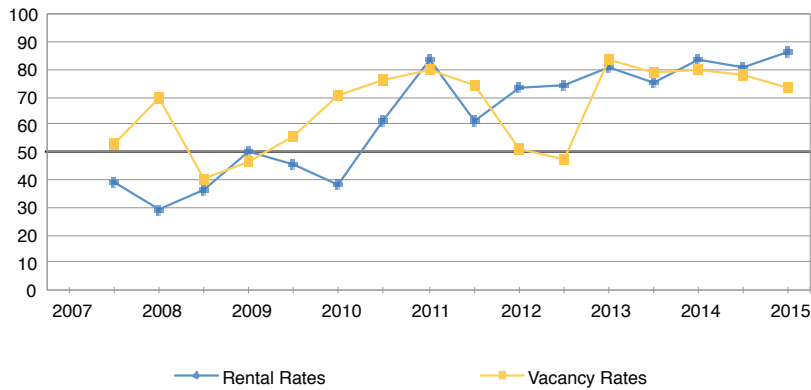
Los Angeles Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



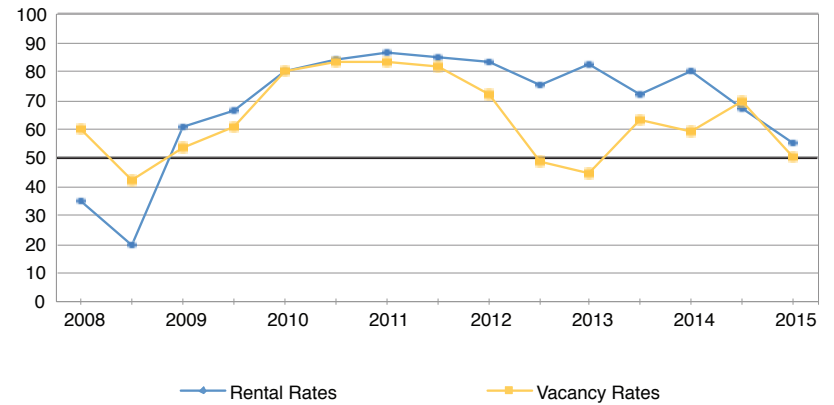
San Diego Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



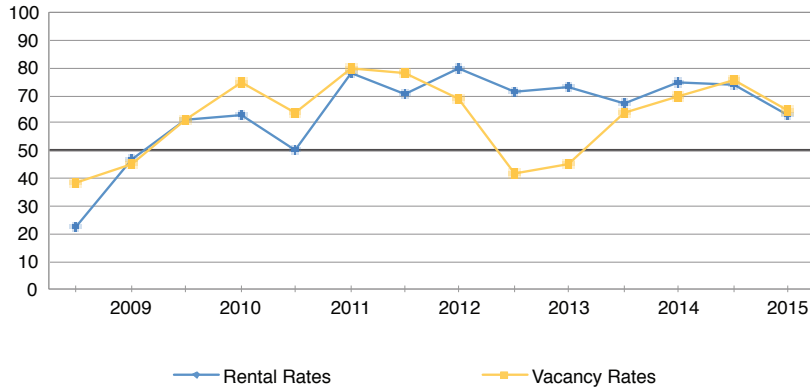
Orange County Office Market
Indexes of Survey: 3 year forecast
(>50 optimistic sentiment)



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

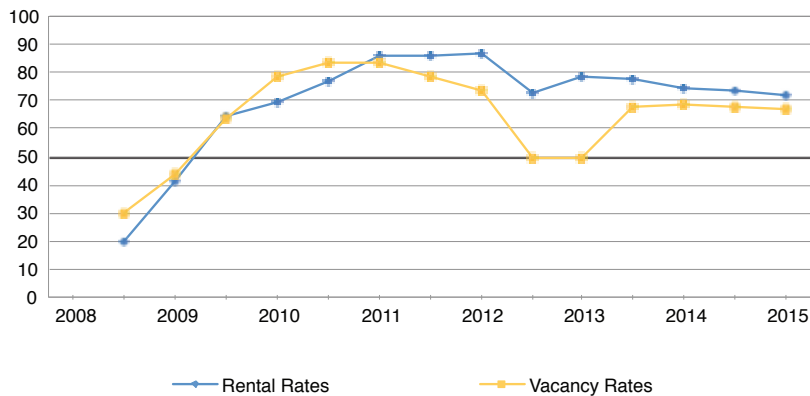


East Bay Office Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)



The Bay Area panels are optimistic as well, but the Survey continues to pick up some developer concerns. The San Francisco panel is slightly less optimistic about rental rate growth and about vacancy rates. This is symptomatic of the view that while the market may not be over-built, some easing of pressure on rental and vacancy rates is expected in the next few years. The East Bay sentiment ended an upward trend even as the West Bay economy remained white-hot and rental rates push more office space demand across the reconstructed Bay Bridge. In part, this is due to East Bay employment growth lagging behind the rest of the region. Silicon Valley developer sentiment remains highly optimistic. As in our previous survey the San Francisco and Silicon Valley panelists' responses were not uniform with regard to 2018. 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 future rental rates or vacancy rates in these markets to be better than today. Though these trends are worth keeping an eye on, they are variations between very optimistic and optimistic and are not cause for concern with respect to new office construction in the Bay Area.

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



Bay Area office space demand growth is reflected in the panelists' actions as well. In December 39% of the panel reported plans to embark on new development over the next 12 months. In fact 63% did begin one or more new projects. In the current survey one-third stated they would start one or more new projects in the coming year.

COMMERCIAL MARKETS DEVELOPER SENTIMENT



Office



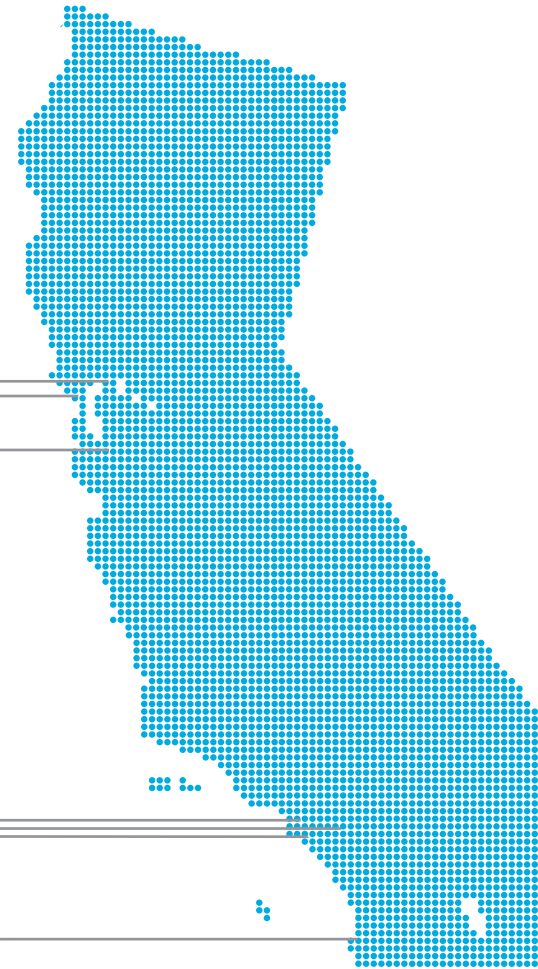
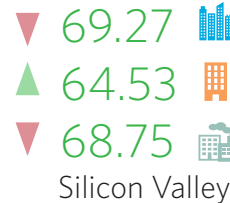
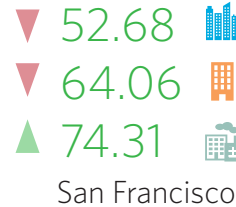
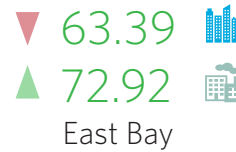
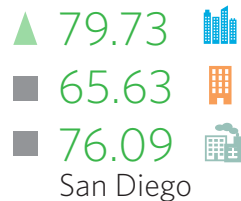
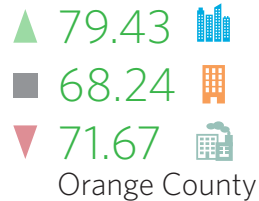
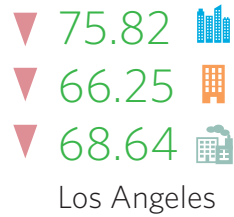
Multi-Family




Industrial

>50 INDICATES POSITIVE OUTLOOK


Arrow is change from last survey



A black and white portrait of Richard Hayes, a middle-aged man with short, dark hair, wearing a dark suit jacket over a light-colored collared shirt. He is looking slightly to the right of the camera with a neutral expression. The background is blurred, showing what appears to be a decorative object on a wall.

"I've never felt as bullish on being able to push rental rates as I have - as I do now."

- Richard Hayes,
VP of Leasing,
McCarthy Cook & Co.



"The residential segment is particularly attractive because I think that there's a real lack of supply for the demand coming up in the next few years."

- Paul Paradis,
Senior Managing Director,
Hines

MULTI-FAMILY MARKET

Multi-Family Residential Markets

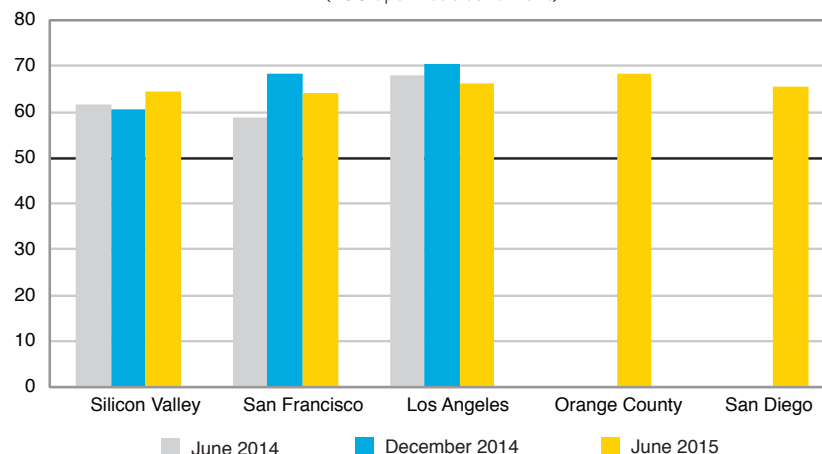
Multi-Family developer optimism has not abated over the past six months. This sentiment is reflected by the fact that over the last 12 months 74% of the panel participants began a new development and 79% are planning to begin new projects in the coming six months. For each of the five regions surveyed the sentiment index was above 64 with 50 and above indicating a belief that these markets, already quite tight, will tighten more in the next three years.

The Orange County and San Diego markets were added to the survey coverage in June. The composite index for these markets is similar to the previously surveyed markets; Los Angeles, San Francisco and Silicon Valley. In each a decrease in vacancy rates was not thought to be in the offing over the next three years. This is not surprising as they are currently quite low. Moreover, the rush to build new multi-family projects will add some supply to meet the growth in demand.

The panels are echoing an observation made recently by the Legislative Analysts Office¹ 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 is expected to continue as employment in California is forecast to grow at a 2.1% rate over the next two years, and such growth will continue to be skewed towards these five coastal communities. Increased employment translates directly into new household formation and additional demands for housing. All three markets are relatively mature and therefore, increased density will be the response of builders to this increased demand 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 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)



¹ "California's High Housing Costs: Causes and Consequences," March 2015. <http://lao.ca.gov>

"There is nothing in what is happening in the evolution of this recovery that suggests that we're going to have a downturn this year or next year or even into 2017."

- Jerry Nickelsburg,
Senior Economist,
UCLA Anderson Forecast



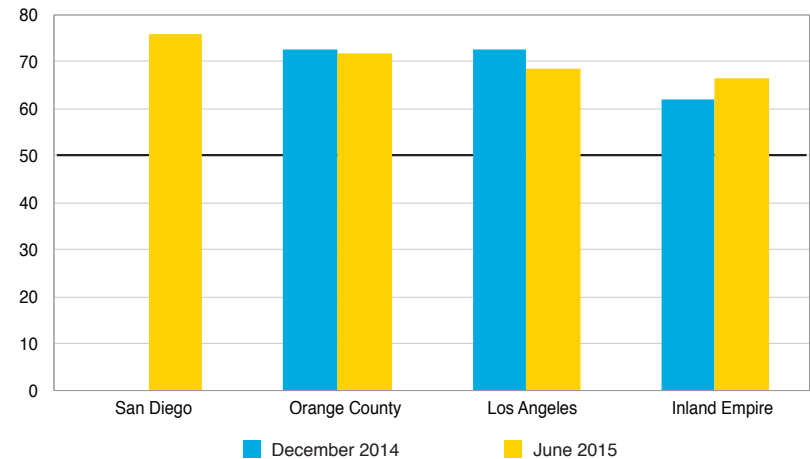
INDUSTRIAL MARKET


Industrial Space is comprised of two distinct markets, manufacturing and warehousing. Although each geography surveyed has a mixture of both, Orange County and San Diego 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, 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.

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, particularly in the Inland Empire. In the current survey 68% of the panel is planning one or more new industrial projects in Southern California between June 2015 and June 2016. This comes on the heels of 51% beginning new development during the past 12 months. So while the sentiment is unchanged at strongly optimistic, there is clearly a continued strengthening in the Southern California industrial space market.

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 locales. On the other hand, the advent of EEE class ships plying the Pacific with significantly more cargo per ship than before, 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. Thus, the forecast is for an increase in speculative as well as build-to-suit construction in each of the four Southern California markets.

Industrial Space Developer Sentiment Index For 2018
(>50 optimistic)





"We're seeing the transit oriented trends. People are really attracted to the subway stop areas."

- Kadie Wilson,
Senior Sales Director, CBRE

RETAIL SPACE MARKETS

The June Survey launched the Retail Market Developer Sentiment Survey. This addition to the coverage of the Allen Matkins UCLA Anderson Forecast CRE Survey included three markets in Southern California; Los Angeles, Orange County and San Diego. Extending the retail market survey to the Bay Area is planned for December 2015.

Though there are no reference points from which to judge the first survey results, in each of the three markets surveyed 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 two-thirds of the panelists stated that they were planning new retail construction in the coming twelve months. This suggests sub-markets doing very well, what one would expect from the robust growth in specific regions from the TAMI boom. More generally, The Anderson Forecast expects consumption to grow by 2% to 3% over the next three years and this ought to engender more widespread growth in retail tenant demand.

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. In proximate surveys it is expected that Bay Area industrial and retail markets will be added to the survey.

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 the fifteen-year highs in the value of non-residential construction projects permitted.

Allen Matkins | UCLA Anderson Forecast

COMMERCIAL REAL ESTATE SURVEY

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THINK IN THE NEXT