East Bay

Los Angeles

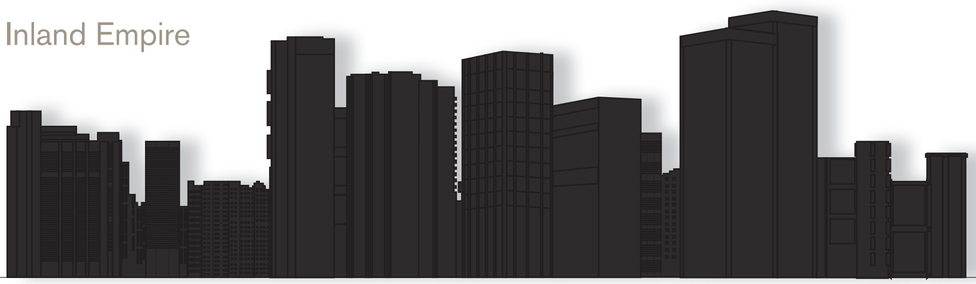
Orange County

San Diego

San Francisco

Silicon Valley

Inland Empire



JUNE 2009

ALLEN MATKINS/UCLA ANDERSON FORECAST
California Commercial Real Estate Survey

Allen Matkins

UCLA Anderson FORECAST

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More detail on the construction and methodology behind this survey can be found in the Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey Support Document available at www.uclaforecast.com.

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 rates 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, retail and industrial space in major California geographical markets. This fifth survey installment covers the Los Angeles, Orange County, San Diego and San Francisco area commercial office markets as well as the Los Angeles, Orange County and Inland Empire industrial markets.

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, 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 50 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.

John M. Tipton
Partner, Real Estate Department
Allen Matkins Leck Gamble Mallory & Natsis, LLP

California Office and Industrial Markets: Searching for Green Shoots

Last December, in our last Allen Matkins / UCLA Anderson Forecast Commercial Real Estate Survey, we reported pervasive pessimism in California's office space markets. Buffeted by costly or non-existent financing and an economy declining with no bottom in sight, investors and developers were sitting on the sidelines. What has changed since then is only the passage of time. Recessions run their course and this one is now showing signs of getting to the end. But there are no green shoots in the commercial real estate world. Our survey panels are not yet feeling exuberant about the future, but they do show some weak signs that the early freeze of autumn may thaw. Through their dour outlook and our economic models we see potential turning points in Los Angeles and San Francisco. Continued weakness in the balance of California's office markets and in Southern California industrial space markets, where fundamentals are anything but buoyant, is also evident in the survey results.

Each survey being reported here is conducted with a panel of investors and developers active in the region and type of commercial real estate being surveyed. The surveys compare the respective panel's forecast of the market three years hence with today's market. This captures existing market conditions, development projects in process, and developments whose fruition depends critically on near term market conditions. To the extent possible, panel members remain the same over time. The May surveys add panels for the Los Angeles, Orange County and Inland Empire industrial space markets. The Survey and Index Research Project will continue to expand coverage in Industrial Space markets and report a complete overview of California for these markets in December.

Los Angeles and San Francisco Office Markets: Signposts of a Future Turn in the Market.

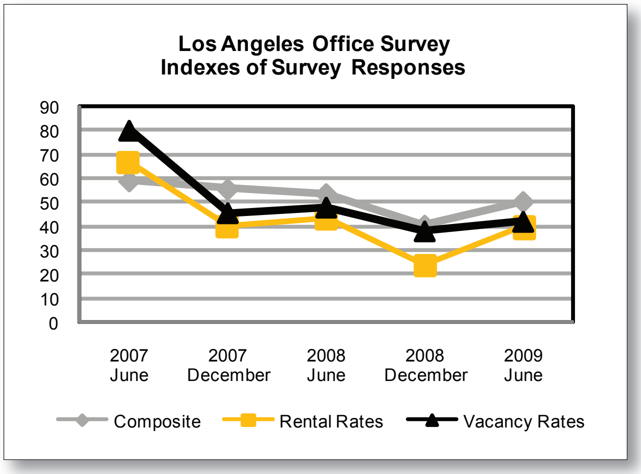
Los Angeles is the market we have been following the longest. Last time around we reported our panel as strikingly bearish. The composite index went below 50 for the first time and pessimism was pervasive. In the present survey, the panel shows a bit less pessimism. The composite index is at 50 indicating an overall sentiment of markets recovering at least to 2009 levels by 2012. Vacancy rate and rental rate indexes lag behind but they also show increased optimism on the part of some of the panel.

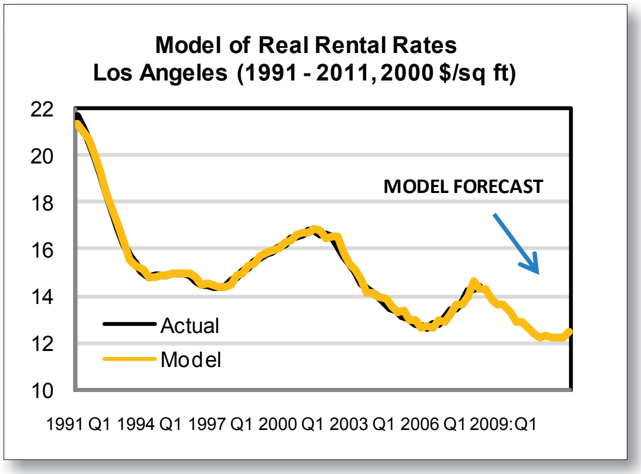
Jerry Nickelsburg
Senior Economist
UCLA Anderson Forecast

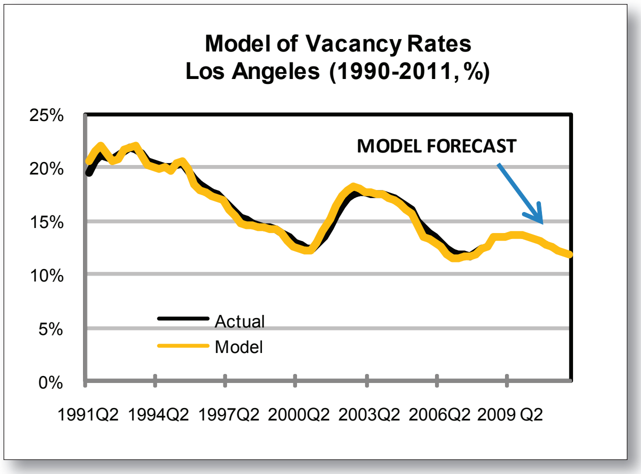
The San Francisco Office market shows the same pattern. The survey panel is less pessimistic than they were six months ago about the three year out market as represented by the composite, the rental rates and the vacancy rate indexes. On the near term supply side, there is very little in the pipeline after 2009. Building permits for new construction are down by 75% since last summer. The survey results are consistent with this and indicate that the amount of new additions to office space will only grow slowly over the next year.

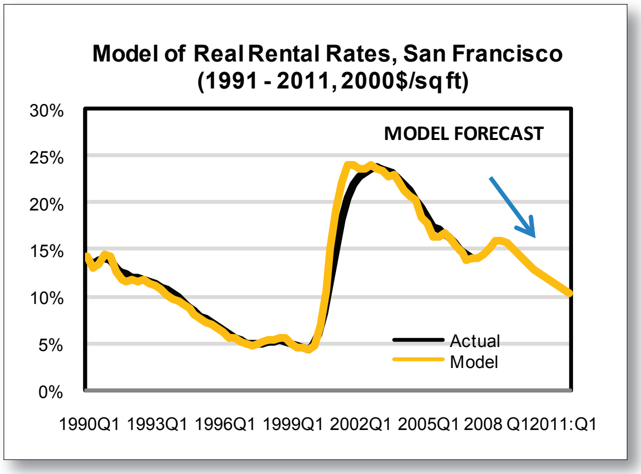
Our economic model of demand conditions for the two markets shows the decline in real rental rates abating and the occupancy rates rising in 2011. These are being driven by a recovery in office using demand as the San Francisco and Los Angeles economies grow out of the recession and in San Francisco, by a recovery in finance employment after the current shakeout is over.

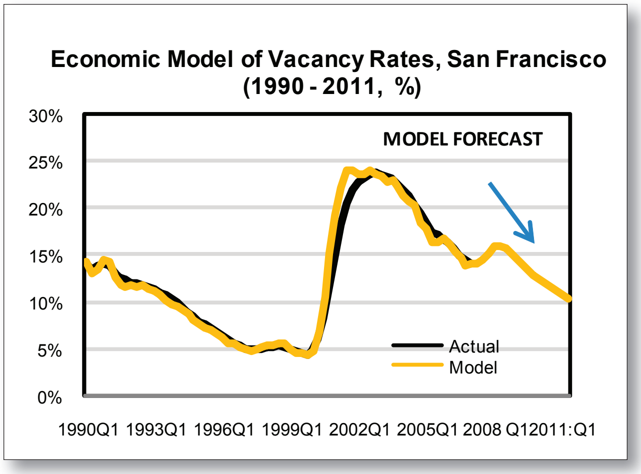
This diminished pessimism in Los Angeles and San Francisco makes sense. Even with rental and occupancy rates falling there is a realization that the previous building boom in these two markets was relatively small and therefore it will not take a huge rise in demand to force vacancy rates back below 12%. Although the index does not indicate a rush to build in neither the Los Angeles nor the San Francisco office markets, it does provide an indication



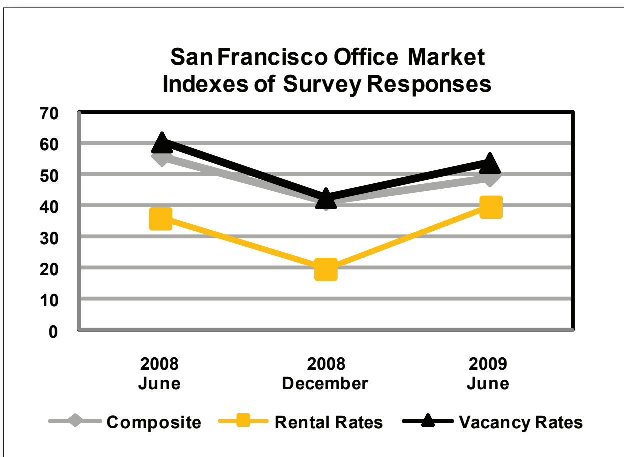








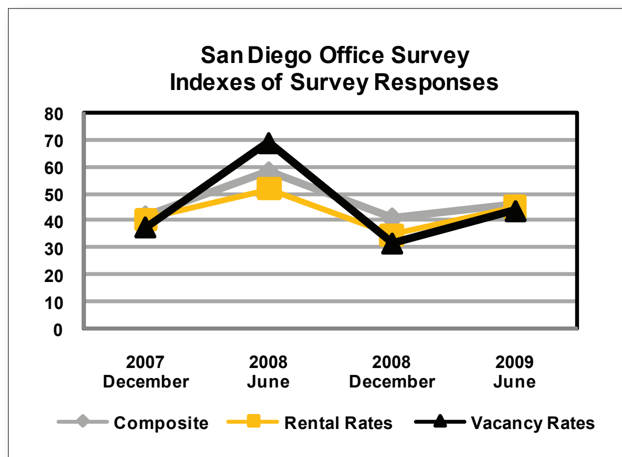
that developers are beginning to think about building once again. In the near term, demand conditions warrant the beginning of additions to stock. With difficult financing and an uncertain future, the additions should come later rather than sooner. As a consequence of this delay in pulling the trigger on new building, these two office space markets should begin to turn by the end of 2010 or the beginning of 2011.

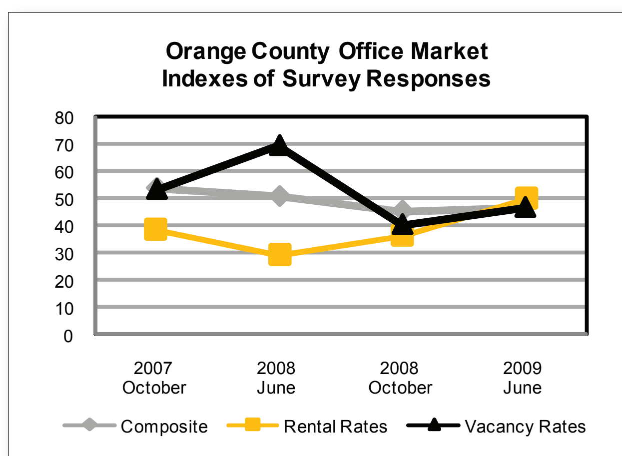


San Diego and Orange County: Still in the Doldrums

The latest surveys for San Diego and Orange County show the expected pattern of slightly less pessimism as we move the target one year out, but unlike the San Francisco and Los Angeles Surveys each of the indexes indicates worsening office market conditions between today and 2012. This is consistent with our economic models of demand. In the case of San Diego, our forecast is for office using demand to return to its 2009 level in 2012[1]. With an increase in the stock of office space from those projects already underway in 2006, 2007 and 2008, falling rental rates and occupancy rates follow.

For Orange County the hole in the office space demand created with the collapse of the home mortgage finance industry remains the cause of weak demand. Similar instances of regional economies with declines in a major industry of the size of the Orange County mortgage finance industry indicate that five or more years of expansion in other sectors is usually needed to fill in the hole[2]. 2008 and 2009 are not those years. Instead of other sectors growing to fill in the demand gap, other sectors have been contracting. We are now expecting office demand to reach its 2006 levels no early than 2014. The excess supply of office space will continue to put pressure on rental and occupancy rates and no early turn of the market is expected.



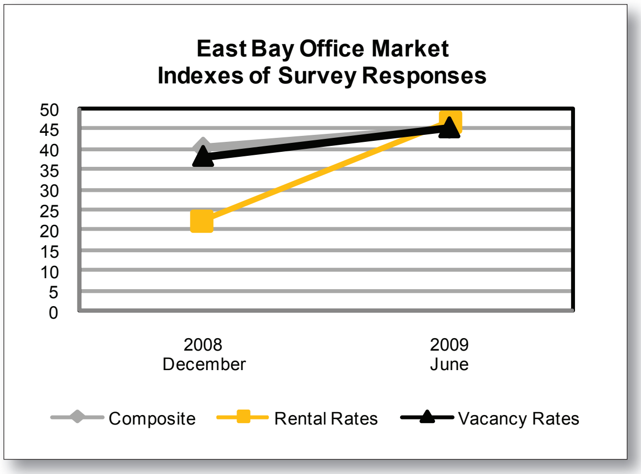


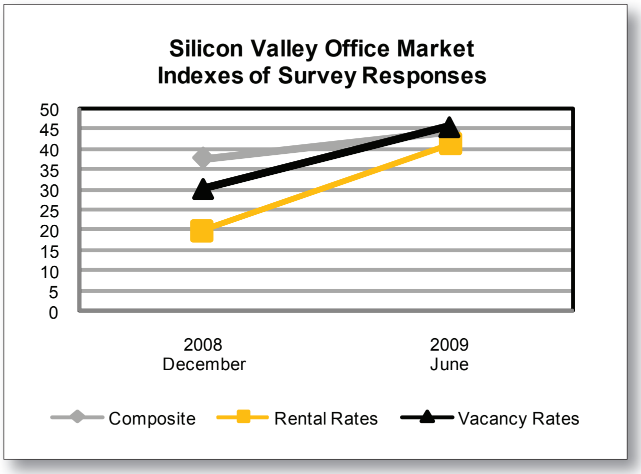
Silicon Valley and the East Bay

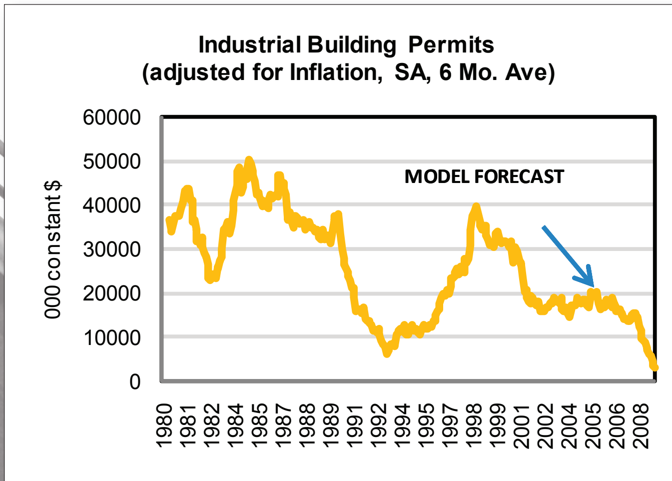
The May survey marks the second time we have taken a survey of office markets for the Silicon Valley and the East Bay. What is surprising in these markets is that the pessimism of December has not given way to at least a little less gloomy vision of the future in the June surveys, particularly since the December surveys were forecasts of the market in 2011 and the June surveys were forecasts for 2012. One reason for this could be the current supply conditions in these markets.

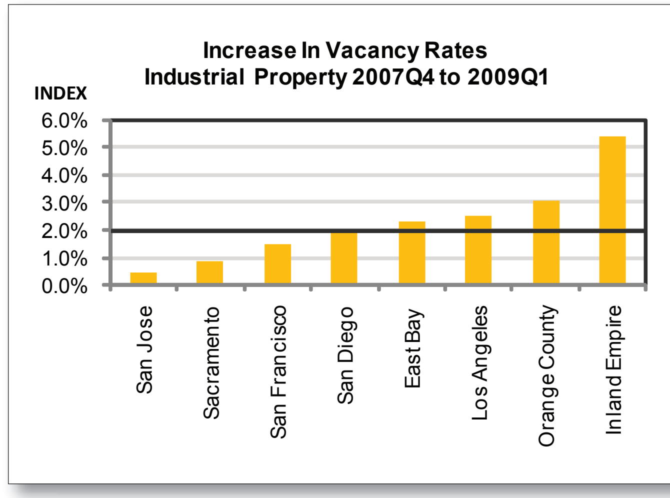
In the East Bay the lower rental rates, particularly in the inland communities such as Pleasanton, and the postponement of the next City Center Project are clear indicators of current over supply[3]. Though occupancy is only marginally lower, nominal rental rates have fallen by more than 5% over the past year. During the last expansion cycle, 2002-2007, occupancy rates stayed relatively low and new additions to supply just about matched increases in demand. The lack of new building is a reflection of a relatively low rate of return in general. The current declining market forces these returns even lower. The pessimism about the East Bay may be an echo from the last recession, or real concern that as office demand increases, it will do so very slowly and there exists sufficient idle capacity in the market to handle the increase without pressure on rental rates.

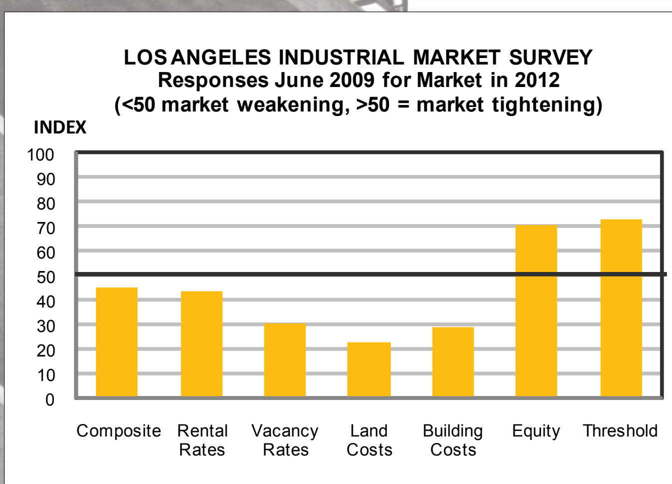
In the Silicon Valley there still is a large amount of square footage to hit the market. Even though demand conditions ought to pick up sharply in 2011, the survey panel does not think that this will be enough to relieve the pressure of the current and expected future excess supply of office space. This is an instance where the survey panel might be too pessimistic. California is expected to grow briskly after the problems in Sacramento are solved. The investment, spurred by California's energy policy and the energy initiatives of the Obama administration, will surely be felt in the Silicon Valley[4]. If the panel is too pessimistic and there are few additions to the supply of office space after next year, then the market should turn in late 2011 with rising rental and occupancy rates.

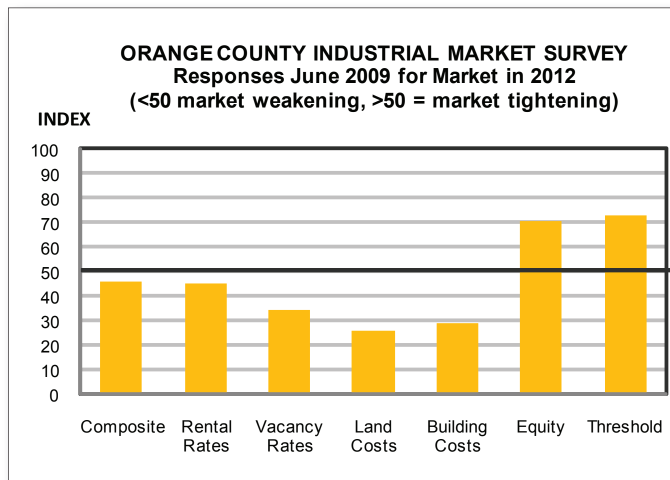





Industrial Building Permits
(adjusted for Inflation, SA, 6 Mo. Ave)
000 constant $
60000
50000
40000
30000
20000
10000
0
MODEL FORECAST
1980 1981 1982 1984 1985 1987 1988 1989 1991 1992 1994 1995 1997 1998 1999 2001 2002 2004 2005 2006 2008


Increase In Vacancy Rates
Industrial Property 2007Q4 to 2009Q1
INDEX
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
San Jose
Sacramento
San Francisco
San Diego
East Bay
Los Angeles
Orange County
Inland Empire


LOS ANGELES INDUSTRIAL MARKET SURVEY
Responses June 2009 for Market in 2012
(<50 market weakening, >50 = market tightening)
INDEX
100
90
80
70
60
50
40
30
20
10
0
Composite
Rental Rates
Vacancy Rates
Land Costs
Building Costs
Equity
Threshold


ORANGE COUNTY INDUSTRIAL MARKET SURVEY
Responses June 2009 for Market in 2012
(<50 market weakening, >50 = market tightening)
INDEX
100
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70
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50
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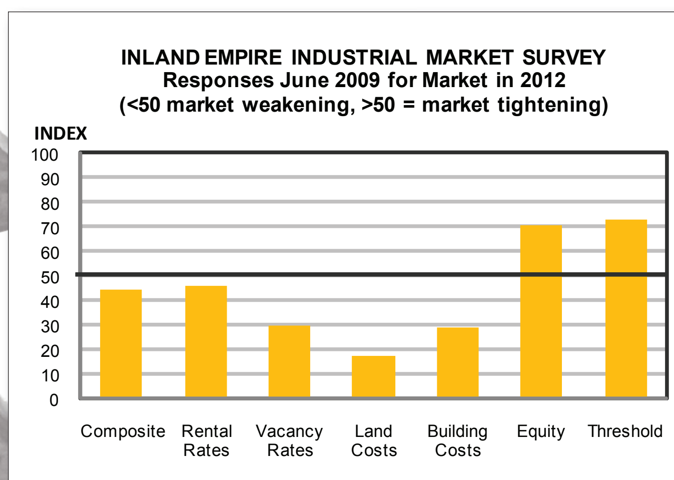
10
0
Composite
Rental Rates
Vacancy Rates
Land Costs
Building Costs
Equity
Threshold


INLAND EMPIRE INDUSTRIAL MARKET SURVEY
Responses June 2009 for Market in 2012
(<50 market weakening, >50 = market tightening)
INDEX
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0
Composite
Rental Rates
Vacancy Rates
Land Costs
Building Costs
Equity
Threshold

Industrial Markets in Southern California

This May represented our first foray into industrial markets. New permits for industrial markets have taken a nose dive in California since the fall of 2008. New industrial building permits in April were less than 30% of the value of permits in August 2008 and less than 20% of one year previous. Although consumption held up through the summer of 2008, the writing was clearly on the wall. During the 2nd and 3rd quarter of 2008 manufacturing was in a slow steady decline and there was evident weakness in retail and imports. After the collapse of consumption in September, manufacturing, retail, wholesale and imports all collapsed and the demand for new manufacturing and warehousing space dropped with it.

This was particularly true of the three markets surveyed in May. Los Angeles and the Inland Empire are not only distribution centers for their own population, they act as distribution centers for the imports of manufactured goods coming through the ports of Los Angeles and Long Beach for the rest of the country. April imports are down 29% at Long Beach and 15% at Los Angeles from the previous year[5]. Orange County warehouse space is oriented towards the regional retail and leisure sector and ought not to feel this decline in imports in the same way. However, as with office space the virtual elimination of the mortgage finance business in Orange County must be felt in the retail, and hence in warehousing and distribution as well. The other important component of industrial space is manufacturing. Los Angeles and Orange County are manufacturing centers having 10.8% and 11.2% percent of their non-farm payroll workforce engaged in goods production. The fall off in consumer demand was quickly felt in manufacturing with a decline in manufacturing employment in the two counties of -8.1% and -5.6% percent respectively[6].

All of these slack demand components translate into rising vacancy rates and the not surprising result that our panels were pessimistic about recovery in industrial markets in Southern California by 2012. The panels' view is that rental rates and occupancy rates in three years time will be lower than they are today in each of the three markets. The Orange County panel's view is that it will still be feeling the impact of the now absent mortgage finance industry. For Los Angeles and the Inland Empire the panels' view is consistent with the Anderson Forecast's projections for 2011, but it might be too pessimistic with regard to 2012. The Anderson Forecast, released in June 2009, includes imports rising by about 12% in the early part of the recovery after tumbling nearly 20% during the downturn. An increase in imports in 2012 along with continued, albeit slow, growth in consumption could close the gap. With respect to manufacturing, growth in California's technology sectors, well represented in Los Angeles and Orange County, should be robust by 2012. So the data are inconclusive, but the panel, representing investors and developers, are indicating that at least for the time being they will not be aggressive in putting up new industrial structures.

Final Comments

When these surveys were conducted we were hoping to see more optimism, more signs of the "green shoots" appearing elsewhere in the economy. This was not to be. As a snapshot of today's conditions, the current surveys are decidedly pessimistic. But, they also give important clues as to the longer term supply conditions. The dynamics in the Los Angeles and San Francisco markets indicate a turning point at the end of 2010 or early 2011. For the Silicon Valley the data are less clear, but may suggest later in 2011. For the balance of the markets, the surveys clearly indicate a longer term adjustment process. The near term outlook for new construction in industrial markets does not look encouraging, but could change rapidly if those "green shoots" elsewhere turn into enough new consumption growth.

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1 UCLA Anderson Forecast; San Diego Outlook, May 2009
2 Jerry Nickelsburg, "The California Report: Did It Really Stay In Housing?" UCLA Anderson Forecast, June 2008.
3 Studley Market Snapshot, East Bay, Oakland, 1Q 2009.
Property & Portfolio Research, 2009
4 Jerry Nickelsburg, "Are We There Yet? California Vistas From The Middle of The Recession," UCLA Anderson Forecast, June 2009
5 http://www.portoflosangeles.org/, http://www.polb.com/
6 http://www.labormarketinfo.edd.ca.gov/

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The forecasting team is credited as the first major U.S. economic forecasting group to predict the most recent recession in 2001. The team was also ahead of the pack in predicting both the seriousness of the early-1990s downturn in California, and the strength of the state's rebound since 1993.

Allen Matkins

Allen Matkins Leck Gamble Mallory & Natsis LLP, founded in 1977, is a California law firm with approximately 230 attorneys practicing out of seven offices in Los Angeles, Orange County, Century City, Del Mar Heights, San Diego, San Francisco, and Walnut Creek. The firm's broad based areas of focus include corporate, real estate, construction, real estate finance, business litigation, taxation, land use, environmental, bankruptcy and creditors' rights, and employment and labor law. The firm has also been ranked as the #1 real estate firm in California by Chambers & Partners for the last six years.

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