East Bay

Los Angeles

Orange County

San Diego

San Francisco

Silicon Valley

Inland Empire

JANUARY 2010

ALLEN MATKINS/UCLA ANDERSON FORECAST

California Commercial Real Estate Survey

Allen Matkins

UCLA Anderson FORECAST

UCLA ANDERSON FORECAST STAFF

Edward E. Leamer
Director
UCLA Anderson Forecast

Jerry Nickelsburg
Senior Economist
UCLA Anderson Forecast

David Shulman
Senior Economist
UCLA Anderson Forecast

Sherif Hanna
Managing Director
UCLA Anderson Forecast

Patricia Nomura
Economic Research/Managing Editor
UCLA Anderson Forecast

George Lee
Publications and Marketing Manager
UCLA Anderson Forecast

Winnie Ocean
Member and Program Manager
UCLA Anderson Forecast

Kristen Schoeck
Marketing Coordinator
UCLA Anderson Forecast

Paul Feinberg
Editorial
UCLA Anderson Forecast

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 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 and industrial space in major California geographical markets. This sixth survey covers the major Southern California and Bay Area markets for office and industrial 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, 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

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

California Office and Industrial Markets: Return of the Optimist

Jerry Nickelsburg
Senior Economist

Despite the onset of winter, pessimism concerning commercial real estate has melted into optimism. Six months have passed since our last Allen Matkins / UCLA Anderson Forecast CRE Survey. At that time we reported[1] pervasive pessimism about the prospects for California's commercial real estate markets in 2012 by our panel of investors. Since last June the news from commercial real estate markets around the state has been fraught with stories of defaults, rising vacancy rates and falling rental rates[2]. Moreover there have been continual reports of commercial real estate finance being the next shoe to drop in the current economic crisis[3].

We have just completed the 2nd half 2009 Allen Matkins / UCLA Anderson Forecast Commercial Real Estate Survey and somewhat to our surprise have found that through the gloom of autumn, our panel sees rays of sunshine lifting their expectations. Though the near term news about commercial real estate markets has little to be cheery about, that on the overall economy does. As the recovery from this deep recession takes hold, investors in commercial real estate are increasingly of the view that 2012 is going to represent an improvement over today and will present new investment opportunities.

This is the sixth Allen Matkins / UCLA Survey Project report. The survey has expanded to include all of the major industrial and office markets in California, and polls a panel of investors in commercial real estate as to their views of how the market will be changing over the coming three years. Because of the nature of the survey, we are able to gain insight into the early stage investments in office and industrial space and infer changing market supply conditions from them. To be sure, the commercial real estate market has not turned, but optimism about the future, a precursor to a turn in the market, certainly has.

Southern California Office Markets

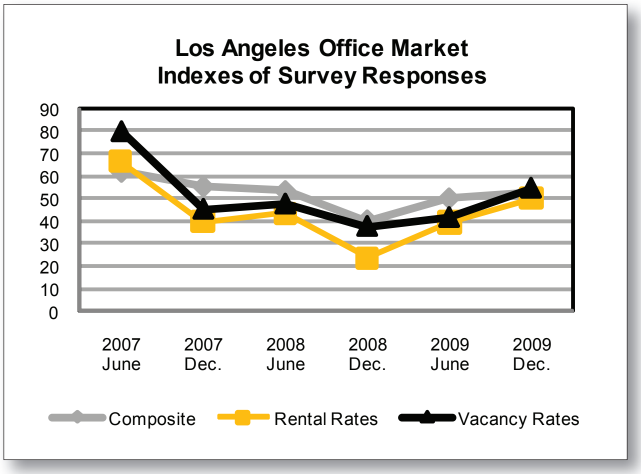
As office projects in Southern California were completed through the past year, the cranes, machinery and men building them went silent. Southern California's already swollen ranks of the unemployed grew further with little new commercial construction work available. In the 12 months since the end of 2008, there have been almost no new permits for office building construction issued in San Diego and Orange County and a small number issued in Los Angeles – all reminiscent of the building doldrums of the '90s. In Los Angeles there was an uptick towards the end of 2009, but this was due to a single project, a medical office building, being approved in October[4].

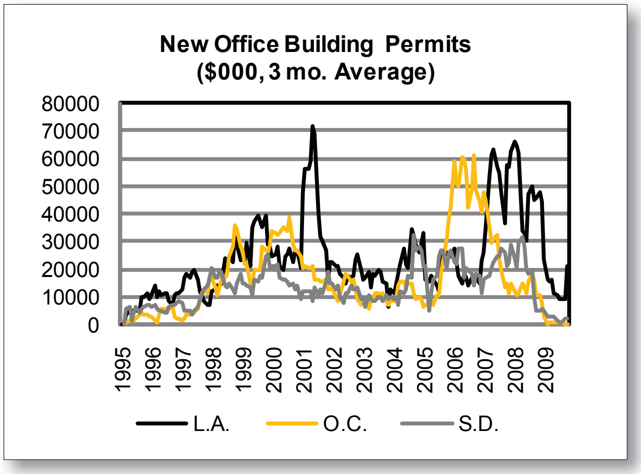
The combination of the supply of funds for new building drying up, and plummeting rents and occupancies cutting off the demand resulted in 2009 being a dismal year for new construction. With the exception of Orange County which lost an entire office-using industry with the collapse of sub-prime mortgage finance, the situation in Southern California is now quite different than the early 80s and the mid 90s. Specifically, the decreased occupancy is a demand cycle event and not a result of overbuilding as before.

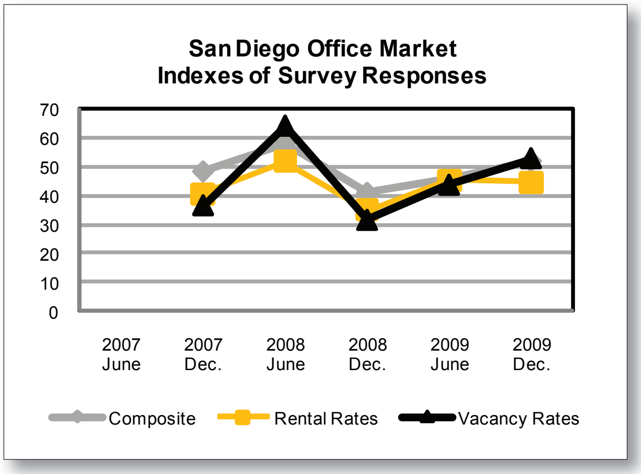
In the current L.A. market, rents are down about 8% from the average 2007 rate. After adjusting for inflation, rents have retreated to the levels experienced in 2004 and 2005. With occupancy at 85% and falling, rental rates should remain weak in the current year. But, as the L.A. economy rebounds it will be lead by professional and business services, health care, and education all heavy users of office space. What this means is increased demand, increased occupancy and rising rents. Our panel agrees and expects a turn-around in rental rates and a decline in vacancy rates by 2012. So, opportunities for new office space in the right markets will begin to appear over the next year or two and building projects begun in 2010 and 2011 will be come on line as markets begin to tighten.

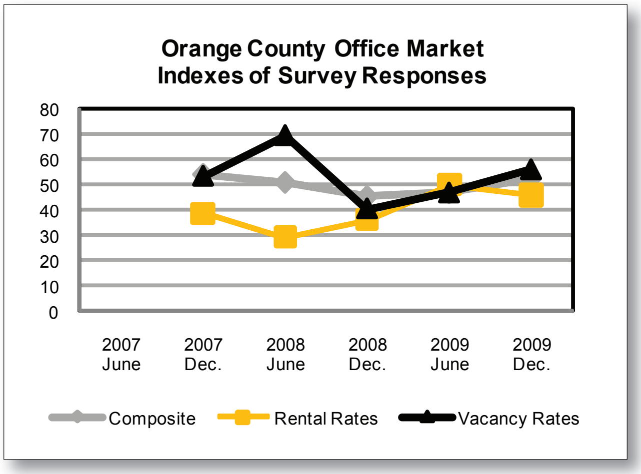
Though the fundamentals of demand for office space in San Diego during the recovery are similar to those in Los Angeles, the supply dynamics are a little different. Just prior to the recession new additions to the supply of office space amounted to approximately 10% of the existing stock. This space has been difficult to place and vacancy rates are currently over 20%. The new space is not overbuilding in the sense that it will take years to burn off, but the average occupancy rate in the county will remain higher than that of L.A. as the two counties grow out of the recession. Our panel is also optimistic about 2012 in San Diego, but unlike L.A. their optimism is based upon no new projects being scheduled for completion between now and then. Our panel's view is that rental rates will be at approximately today's levels but that vacancy rates will fall with the improved market conditions.

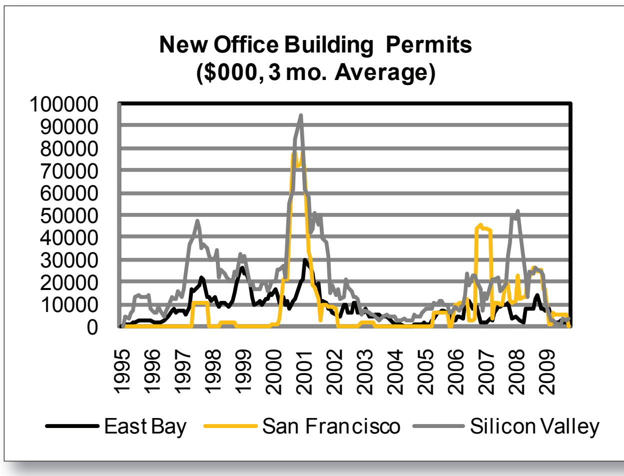
For some time we have been saying that the Orange County office market is a 2013 or 2014 recovery. The loss of finance and real estate jobs created a huge hole in demand which is not easily filled. Our panel is also more optimistic about Orange County than they were six months ago, but the optimism seems to be based more on the transfer of buildings to new owners at lower capital costs and on the decline of rents to levels which are sustainable in today's market[5]. In other words, the panel expects markets to equilibrate and market conditions to improve, but not to the extent of Los Angeles or San Diego. So, opportunities are going to exist in this very tough market, but not in the creation of new floor space for lease.

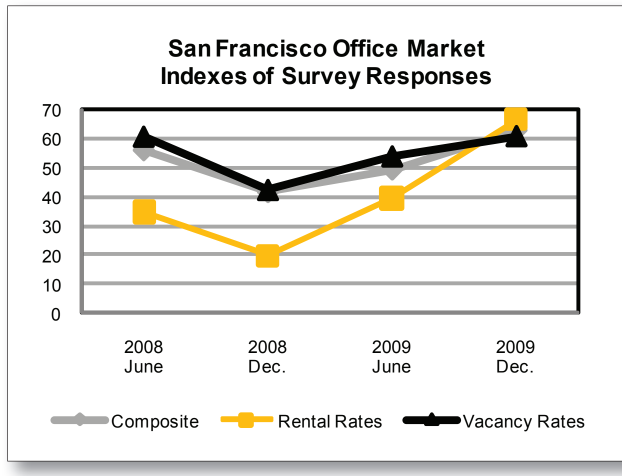


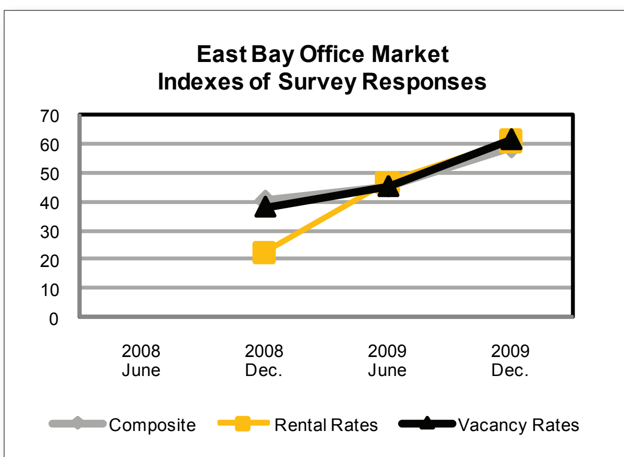


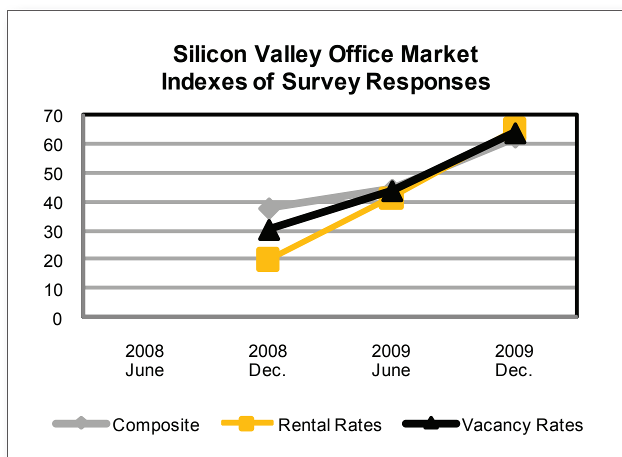





New Office Building Permits
($000, 3 mo. Average)
100000
90000
80000
70000
60000
50000
40000
30000
20000
10000
0
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
East Bay
San Francisco
Silicon Valley


San Francisco Office Market
Indexes of Survey Responses
70
60
50
40
30
20
10
0
2008 June
2008 Dec.
2009 June
2009 Dec.
Composite
Rental Rates
Vacancy Rates

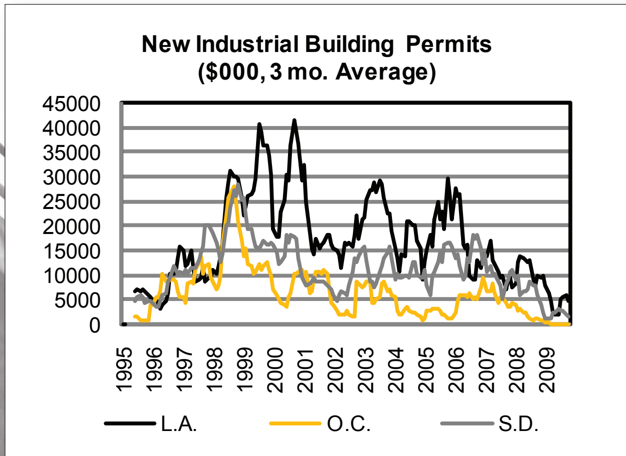

East Bay Office Market
Indexes of Survey Responses
70
60
50
40
30
20
10
0
2008 June
2008 Dec.
2009 June
2009 Dec.
Composite
Rental Rates
Vacancy Rates

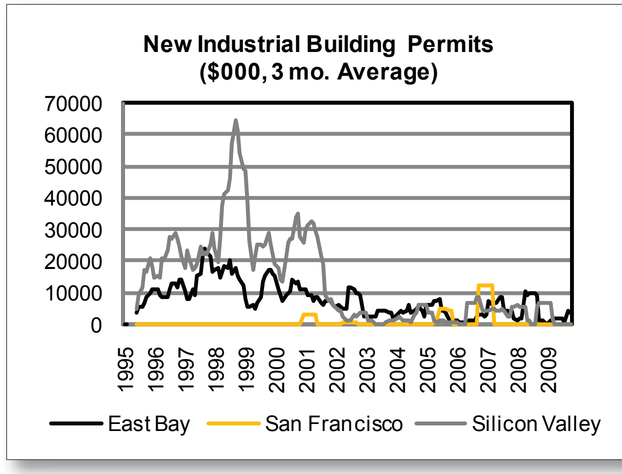

Silicon Valley Office Market
Indexes of Survey Responses
70
60
50
40
30
20
10
0
2008 June
2008 Dec.
2009 June
2009 Dec.
Composite
Rental Rates
Vacancy Rates

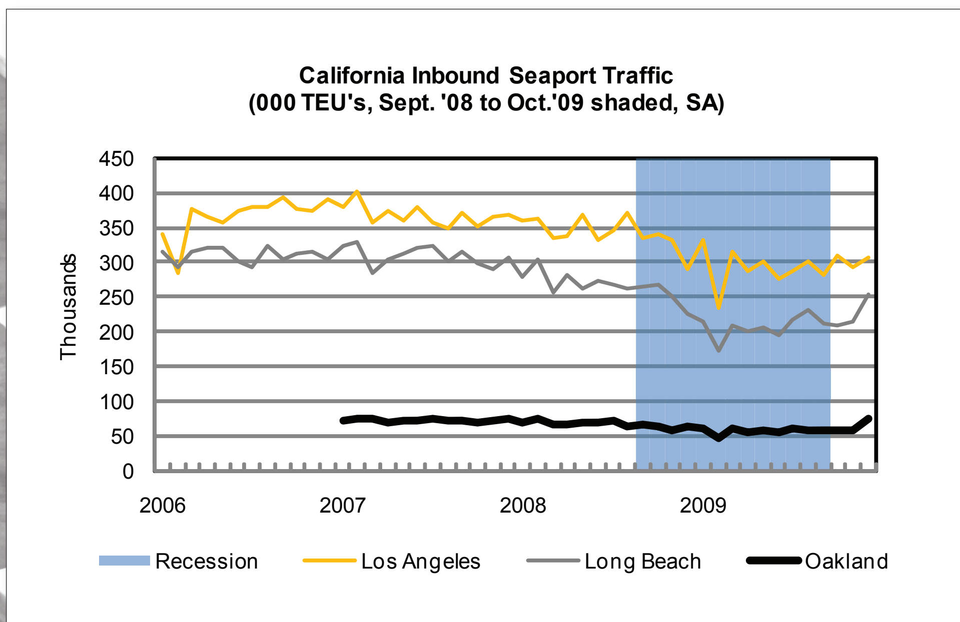
Bay Area Office Markets

Bay Area office markets have been hammered in the current recession. The overbuilding that accompanied the internet/dot-com boom of the late '90s did not fully shake out during the last decade. With easy money and a growing economy, speculative building occurred throughout the area and the subsequent bust, which hit all areas including the finance heavy San Francisco and the retail and service heavy East Bay has taken its toll. In the Silicon Valley, a mini-building boom has resulted in completions just at the time when absorption of new demand was going negative. All of this has resulted in the average occupancy rate in each of the three Bay Area sub-markets to drop below 80% and for new projects to be delayed or cancelled.

So why is our panel smiling on the Bay Area and predicting that 2012 will be substantially better than December 2009? Their view is that both rental rates will increase and vacancy rates will fall. This can only occur if the demand for office space increases substantially over the next few years and the UCLA Anderson Forecast for California agrees with this prediction. Growth out of the recession will be led by increases in the demand for California's professional and scientific services sectors, which are an important and integral part of the Bay Area economy. The Bay Area, along with L.A., will lead the state out of the recession and office demand will drive down the current high vacancy rates. The only caveat is that further consolidation of the finance industry, a reduction in state government demand for space, or a rapid restart of approved but delayed projects could well continue the current supply imbalances in San Francisco and the East Bay into 2012. So, these are markets to watch closely. There may be real opportunities here as our panel believes, but there are also a few potential land mines as well.


New Industrial Building Permits
($000, 3 mo. Average)
45000
40000
35000
30000
25000
20000
15000
10000
5000
0
1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
L.A.
O.C.
S.D.


New Industrial Building Permits
($000, 3 mo. Average)
70000
60000
50000
40000
30000
20000
10000
0
1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
East Bay
San Francisco
Silicon Valley


California Inbound Seaport Traffic
(000 TEU's, Sept. '08 to Oct.'09 shaded, SA)
Thousands
450
400
350
300
250
200
150
100
50
0
2006
2007
2008
2009
Recession
Los Angeles
Long Beach
Oakland

Industrial Markets

This survey expands our coverage of industrial markets to include the three Bay Area submarkets. As with office markets our panel is looking beyond the current market malaise to the impact of the recovery on industrial space markets in 2012 and they are uniformly optimistic with regard to improvement in rental and occupancy rates.

The industrial space market consists of factory and warehouse space. As consumer demand collapsed in the fall of 2008 the demand for both fell with it. Our first survey in June of 2009 concentrated on industrial space markets in Southern California at the depths of the recession. At that time the panel was decidedly pessimistic about the next few years. While there has been some increase in manufacturing activity in California, particularly with respect to exports, the amount of excess capacity generated by the recession remains large. The big user of warehouse space, imports and logistics, has been dead in the water. Imports through the three major ports of California, Los Angeles, Long Beach, and Oakland, have not grown since they bottomed out in the 1st quarter of 2009 and the need to warehouse inventories of consumer goods and of building supplies has diminished substantially. Vacancy rates are now in double digits for most of our markets and rental rates are falling.

So the only objective data that might explain our panel's new view of 2012 is the overall sense of optimism and opportunity associated with the recovery. Imports will grow once more as consumers begin to open up their wallets. Although national retail sales were nothing to write home about, imports edged up slightly in December. With virtually no new industrial permits being issued in California over the last year, the recovery will grow into the stock of warehouse and factory space and market conditions will improve. For industrial space markets there is no objective data for our panel's optimism, but this may be a case of it being so bad, that with an economic recovery beginning, it can only get better.

Finally, we initiated a new panel for the Bay Area Industrial markets this time. The survey results are a single snapshot, and therefore we are unable to do inference with them. In contrast to the lack of new building in the Bay Area and the depressed level of imports at the Port of Oakland, the panel reports the same optimism about 2012 that we see in Southern California.

Forecasting With The Survey

The Allen Matkins / UCLA Anderson Forecast survey was designed to improve forecasting the evolution of commercial real estate markets. Although the survey is 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. The optimism about 2012 in the survey, which cannot be found in the data on current market conditions, 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 office and industrial space. After eighteen months of pessimism about office and industrial markets we are now seeing indications that commercial real estate will turn in the early years of the recovery. ■

1. Jerry Nickelsburg, "California Industrial and Office Markets: Searching for Green Shoots," June 2009.
2. See for example, Dan Levy, "Silicon Valley Bloodbath Leaves Buildings Empty," Bloomberg, January 5, 2010.
3. See for example, Lingling Wei and Peter Grant, "Commercial Real Estate Looms as the Next Potential Mortgage Crisis," Wall Street Journal, August 31, 2009.
4. http://www.laedc.org/eedge/archive/2009/ee091130.html
5. As an example of this see, Mark Mueller, "Grubb & Ellis Takes Over Leasing for Maguire Properties," Orange County Business Journal, December 7, 2009.

Fred Allen
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP

Mike Matkins
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP

John Tipton
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP

William Devine
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP

Tony Natsis
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP

Adam L. Stock
Director of Marketing & Business Development
Allen Matkins Leck Gamble Mallory & Natsis LLP

Cary Lefton
CEO
Agora Realty and Management, Inc.

David Twist
VP Research
AMB Property Corporation

Greg Blomstrand
Principal - Managing Director
American Realty Advisors

Craig Pierson
VP, Asset Operations
Arden Realty, Inc.

Richard Johnson
Executive vice President-Finance
Barker Pacific Group, Inc.

McClure Kelly
Vice President
Beacon Capital Partners

Brandon Birtcher
President/CEO
Birtcher Development and Investments

Jeff Halbert
President
Blackpoint Group

Rod Diehl
Senior Vice President, Leasing
Boston Properties

Kimberly Stevens
Asset Manager
Brandywine Realty Trust

David Simon
Managing Director
Broadreach Capital Partners

John Cecconi
Principal
CAC Group

Turner Newton
President
Capital & Counties USA, Inc.

Tom Bracken
SVP
Capmark Finance Inc.

Robert Merkin
Senior Vice President
CB Richard Ellis

Steve Black
Principal
Cisterra Partners

Michael Monroe
SVP
Colliers International

William R. Karnick
Managing Director
Colony Realty Partners

Alex J. Rose
SVP, Development & Asset Management
Continental Development Corporation

Sean Cooley
Partner
Cooley Development Partners

William E. Purcell
Senior Vice President
Cornish & Carey Commercial Real Estate

Steve Kerhart CPA ASA MRICS CCIM MAI
Managing Partner
CRA

Mark McGranahan
EVP
Cushman & Wakefield

Jeff Weber
Senior Managing Director
Eastdil Secured

Kirk Cyper
CLO/COO
Equastone Real Estate Investment Advisors

John Moe
Market Managing Director
Equity Office Properties

Spencer Rose
Senior Associate
Equity Office Properties

Larry Jackel
Fenway Properties

Richard Ortwein
Partner
Focus Real Estate LP

Michael Steele
EVP/COO
Glenborough, LLC

Alan Chamorro
Senior Vice President, General Manager
Grosvenor

Jim McDonald, SIOR, BCCR
President
GROUP 100/JIM MCDONALD

Michael Neal
President/CEO
H.G. Fenton Company

Jonathan Epstein
President
Hackman Capital Partners

Gregg Foster
Principal
Halifax Group

Bill Rodewald
Sr. Vice President
Harsch Investment Properties

Brad Hilgren
Principal/CEO
High Rhodes Investment Group

Hugh Jackson
Highridge Partners

Doug Metzler
Project Manager
Hines

Paul Twardowski
Vice President / Partner
Hines

Alex Moradi
Managing Partner
ICD Development, LLC

David Mgrublian
CEO
IDS Real Estate Group

Tom Messmer
VP of Development
Industrial Realty Group

Richard Pink
Managing Director
ING Clarion

Doug Holte
President
Irvine Company Office Properties

Jason Hughes
President
Irving Hughes, Inc.

Daniel D Allen
Vice President
iStar Financial

James V. Camp
Managing Member
J. V. Camp & Associates

Todd Chapman
Managing Partner
JMA Ventures

John Monahan
Senior Managing Director
John Hancock Real Estate Finance

Bob Russell
Senior Vice President
Jones Lang LaSalle

Robert Stanbrook
Senior Analyst
Karlin Real Estate

Chuck Schneider
CEO
KBS Realty Advisors

Peter Bren
KBS Realty Advisors

Jeff Dritley
Managing Partner
Kearny Real Estate Company

Steve Scott
SVP
Kilroy Realty Corp

Ted Tapfer
Managing Director
Legacy Partners Commercial

Barry DiRaimondo
President
Legacy Partners Commercial LLC

David Binswanger
EVP
Lincoln Property Company

Eric Paulsen
Vice President
LNR Property Corp

Lang Cottrell
Regional President
LNR Property Corp - CPG

Christopher C. Rising
Senior Vice President
Maguire Properties

Joseph Mani
Partner
Mani Brothers Real Estate Group

Joe Haeussler
SVP
McMillin Commercial

Henry Bullock
Chairman & Founder
Menlo Equities LLC

Andrew Kawahara
Senior Vice President
Myers Development Company

Jack Myers
Chairman
Myers Development Company

Tony Perino
Executive Vice President
Nearon Enterprises

Steve Kirk
Vice President
New York Life

Chris Robbins
Principal
North Point Capital Partners

Timur Tecimer
President/CEO
Overton Moore Properties

Brigham Black
SVP
Pacific Office Properties

Russ Parker
Vice Chairman
Parker Properties

Lee Redmond
CEO
Parker Properties LLC

Pat Cavanagh
Senior VP
ProLogis

Mike Parker
Managing Partner
Quattro Realty Group

Jonathan A. Needell
Chief Financial Officer
Redwood Real Estate Partners, LLC

Michael Potter
Managing Director
Regis Capital Partners

Peter Kaye
Managing Director
Rockwood Capital

Rick Putnam
Managing Director
RREEF

Matthew Reid
Vice President Development
Ryan Companies US, Inc.

Rob Wagner
Partner
Sares Regis Group of Northern California

Andrew Friedman
MD
Shorenstein Properties LLC

Mike Souza
VP Development
Souza Realty & Development

Steve Meckfessel
President
SRM Associates

Julia Viskanta
Senior Asset Management Officer
State Teachers Retirement System of Ohio

Brian P. Ffrench
Senior Vice President
Studley

Curt Stephenson
President
Sunroad Ventures

Jed Tarr
President
Tarr Organization

Rhonda L. Bennon
Vice-President
The Empire Group

Scott Meserve
The Koll Company

Daniel Krausz
Chief Legal Officer and Director of Acquisitions
The Krausz Companies, Inc.

Kevin Staley
Principal
The Magellan Group

Jim Bannan
Director of Leasing
The Muller Company

Tim Steele
Senior Director of Real Estate Planning
The Sobrato Organization

Chantal Byrne
Assistant Vice President
The Swig Company, LLC

Tomas Schoenberg
Senior Vice President
The Swig Company, LLC

Mark Laderman
Managing Director
Tishman Speyer

David P Cropper
Managing Director
TMG Partners

MIchael Covarrubias
Chairman and CEO
TMG Partners

Thomas Irish
President
Transpacific Development Company

Mary Lyons
Senior Vice President
TRI Commercial

Steven Ames
Managing Director
USAA Real Estate Company

Kurt Stregmann
Managing Director
Voit Real Estate Services

Kirk Johnson
EVP
Watson Land Company

Terry Thompson
Vice President - Acquisitions
WCB Properties

Chris Mahon
Asset Management
WCB Properties

Chris Meany
Co-Manager, Member
Wilson Meany Sullivan

Ben Reiling
COB & CEO
Zelman Development Co.

UCLA Anderson
FORECAST

Founded in 1952, the UCLA Anderson Forecast is one of the most widely watched and often-cited economic outlooks for California and the nation. Award-winning for its accuracy, the UCLA Anderson Forecast has a long tradition of breaking with the consensus forecast to be among the first to spot turning points in the economy.

The forecasting team is credited as the first major U.S. economic forecasting group to predict the 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. In 2002, the UCLA Anderson Forecast was among the first to identify the growing imbalances in the housing sector and correctly predicted sharply declining sales volumes and weak prices when rates returned to normal.

UCLA Anderson Forecast
110 Westwood Plaza
Gold Hall, Suite B302
Los Angeles, CA 90095
Phone: 310.825.1623
Fax: 310.206.9940
www.uclaforecast.com

forecast@anderson.ucla.edu

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.

Allen Matkins Leck Gamble Mallory & Natsis LLP
515 South Figueroa Street, 7th Floor
Los Angeles, CA 90071-3398
Phone: (213) 622-5555
Fax: (213) 620-8816
www.allenmatkins.com

Marie Hsing
mhsing@allenmatkins.com

For more information on this report, call 310.825.1623, send an email to forecast@anderson.ucla.edu, or visit our website at www.uclaforecast.com.

auniqueapproach
criticalanswers

Accurate.