Los Angeles | Orange County | San Diego | San Francisco | East Bay | Silicon Valley | Inland Empire

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ALLEN MATKINS / UCLA ANDERSON FORECAST

CALIFORNIA COMMERCIAL REAL ESTATE SURVEY

Allen Matkins

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

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California Commercial Real Estate: Evidence of the Recovery

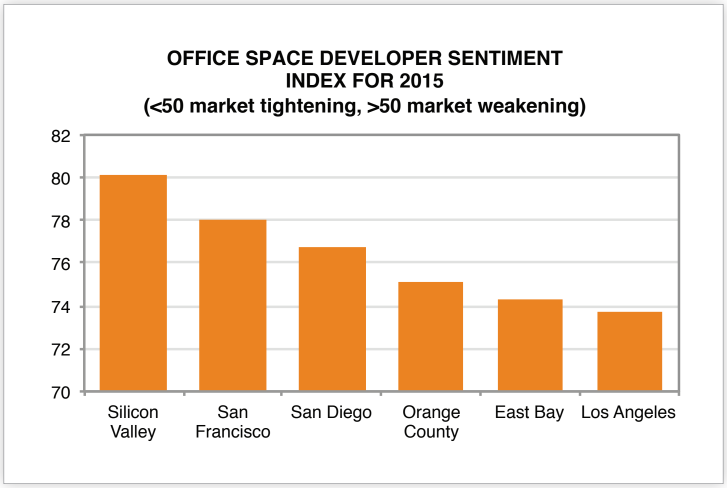
Jerry Nickelsburg
Senior Economist

The Allen Matkins / UCLA Anderson Forecast Commercial Real Estate Survey was initiated just before the 2008 recession. The downturn in developer sentiment, as measured by the individual Survey Indexes, was coincident with a precipitous drop in commercial building. Not so the up-turn. Developer sentiment turned from pessimism to optimism between two and three years ago yet significant new building has yet to be seen in major California markets. The current survey, taken in May/June 2012, shows continued optimistic developer sentiment and the continued solid indications of incipient new commercial construction in each of the seven markets surveyed. The Allen Matkins UCLA Anderson Forecast Survey project expands with the H2 2012 Survey to include multi-family developer sentiment in San Francisco, Silicon Valley and Los Angeles.

The original concept of the Survey and the Index produced from survey results was to capture sentiment with respect to markets three years out. This horizon was set to be, on average, the time a builder required to complete a development life cycle. For example, if a developer were optimistic about the office market in Silicon Valley in 2015, then the initial work for a new project with an expected occupancy date of 2015--a business plan, preliminary architecture, and a search for financial backing-- would have to begin no later than 2012. However the converse is not true. A developer could be optimistic about 2015 and still not find the case compelling enough to begin a new development. Since the end of the recession we have seen developer optimism spread to all of the markets and types of commercial space we survey, yet the new building potentially implied by that optimism has not yet come to fruition. The current survey, completed in June 2012, shows

a consistent pattern coming out of this recession of 2 ½ years between a change in sentiment, and a willingness to go forward with new development. We expect the length of the time lag to be variable and to depend on economic conditions, but the 2 ½ years identified here provides a baseline for our future forecasts and the analysis of future CRE cycles.

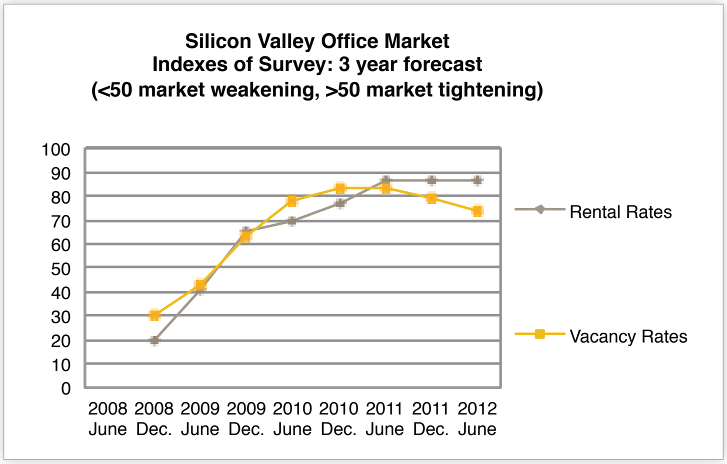
The Allen Matkins UCLA Anderson Forecast Survey and Index project compiles the views of commercial real estate developers with respect to markets three years hence. The three-year time horizon was chosen to approximate the average time a new commercial project requires for completion (though projects with significant environmental issues often take much longer). The panel's view on occupancy and rental rates are key ingredients to their own business plans for new projects, and as such, the survey provides insight to new, not yet on the radar, building projects and is a leading indicator of future commercial construction.

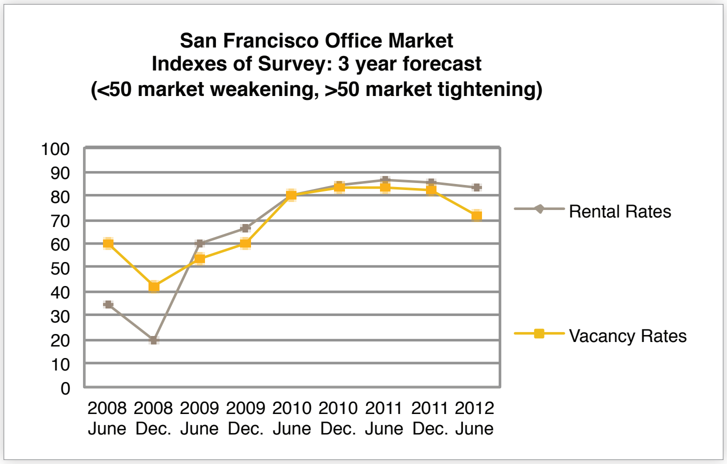


California Office Space Markets

The Survey covers six office space markets in California. The highest sentiment Indexes are in San Francisco, Silicon Valley and San Diego. This is followed by Orange County, The East Bay and Los Angeles. Not surprisingly, this correlates with job growth in office using employment over the past three years.[1] However, the differences in sentiment are small. In both Southern California and the Bay Area 16% of the panel expressed that they would begin or had an associate who would begin one new project and 9% that they would begin more than one project in the coming 12 months.

The Bay Area Index fell from last December, albeit by a small 2.3 points. This was driven by an optimistic, but slightly less optimistic view of vacancy rates. For yields to hold up and vacancy rates to be slightly less robust is consistent with the view that the supply in the pipeline, including those projects reported in December, is seen as taking some of the demand pressure off and perhaps moderating the pace of additional building development.




San Francisco Office Market
Indexes of Survey: 3 year forecast
(<50 market weakening, >50 market tightening)
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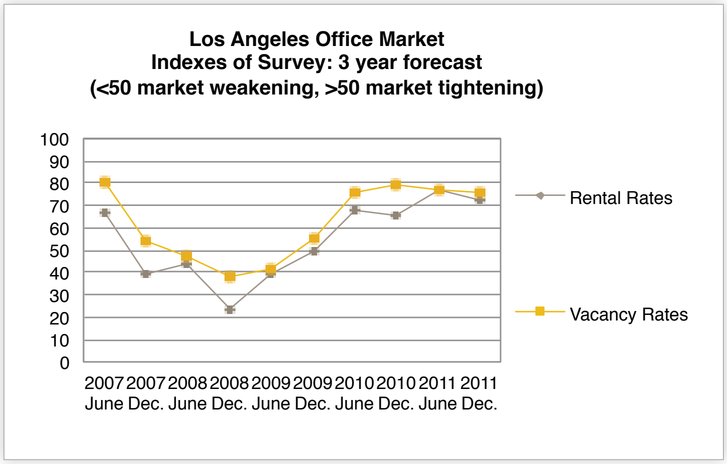
Rental Rates
Vacancy Rates


Los Angeles Office Market
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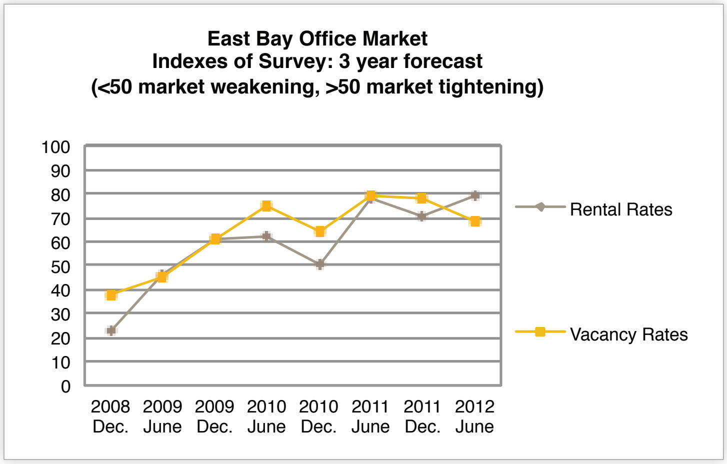
Vacancy Rates


East Bay Office Market
Indexes of Survey: 3 year forecast
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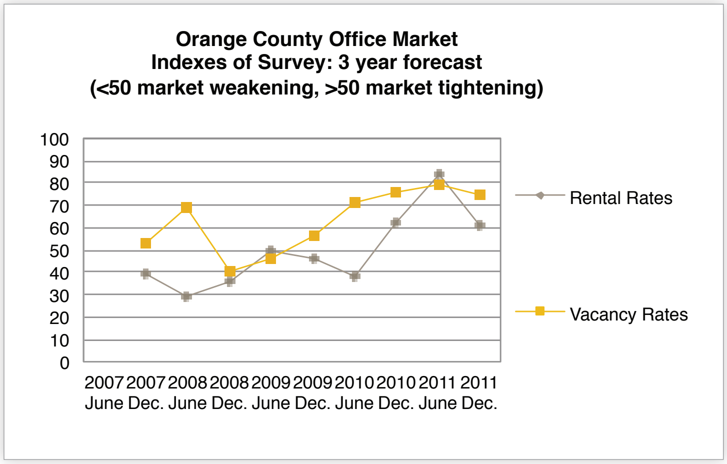
Rental Rates
Vacancy Rates


Orange County Office Market
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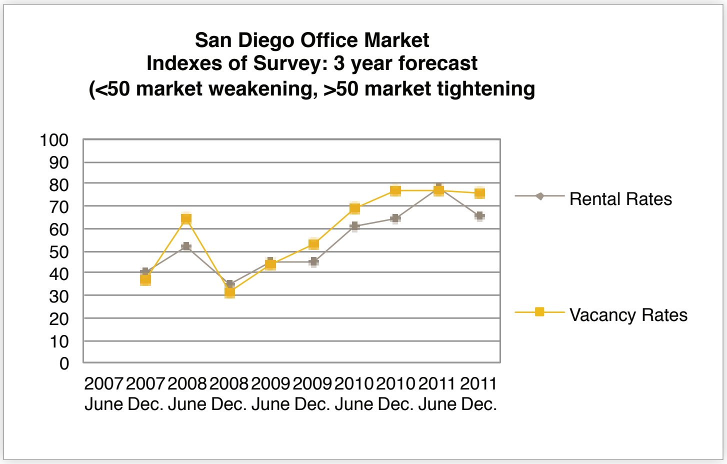
Rental Rates
Vacancy Rates


San Diego Office Market
Indexes of Survey: 3 year forecast
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2011 June
2011 Dec.
Rental Rates
Vacancy Rates

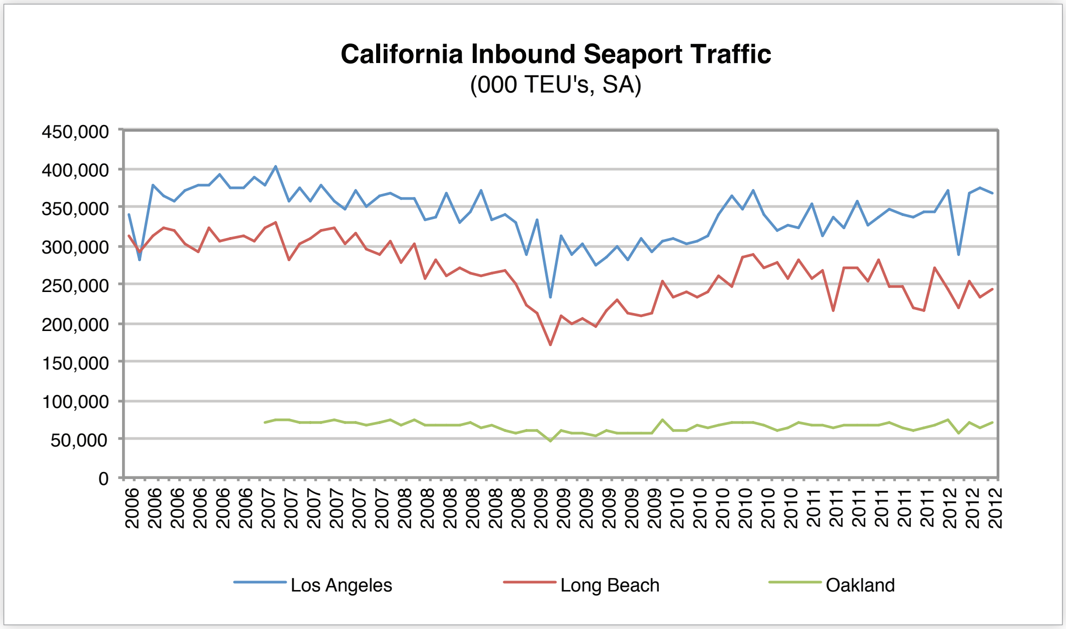
The June 2012 Survey of Developer Sentiment for California Office Markets highlights are:

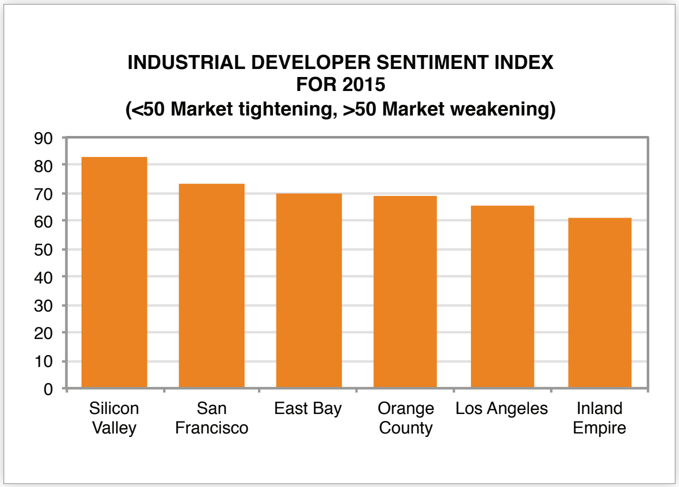
1. The San Francisco and Silicon Valley Market sentiment is unchanged for rental rates and slightly lower for vacancy rates since the last survey reflecting a slight weakening of demand pressures.
2. San Diego and Orange County sentiment is improved for rental rates and approximately the same for vacancy rates reflecting a strengthening of demand relative to supply.
3. The Los Angeles market sentiment remains unchanged.
4. The East Bay market sentiment is stronger with respect to rental rates and weaker with respect to vacancy rates.
5. The market sentiment has been optimistic for almost three years and in each of the markets we expect new office space construction to begin in the coming 12 to 18 months.
6. The survey results are consistent with the growth of office using employment and the UCLA Anderson Forecast employment growth for California even taking into account the move towards conservation of space by office using business.

California Industrial Space Markets

Industrial Space is comprised of two distinct markets, manufacturing and warehousing. Although each geography is a mixture of both, San Francisco, Silicon Valley and Orange County can be broadly characterized as being more heavily manufacturing, the East Bay, and Los Angeles a mix of the two, and the Inland Empire by warehousing. The basic underlying economic forces in industrial markets are a growth in California manufacturing, a growth in exports and slow-to-no-growth in consumer goods imports through the California's ports.

In all of the markets surveyed, developer sentiment, though still very positive, is weaker than six months ago. This is consistent with the nervousness over Europe and the potential impact that could have on manufacturing exports. As well, the uncertainty with respect to the fiscal stance of the U.S. in 2013 has led to importers being much more cautious. Imports through California seaports have grown at only a moderate rate in 2012 reflecting the slow growth in consumption of consumer goods from the manufacturing centers of Asia.





Even though sentiment is not as high as six months ago, it has been sufficiently optimistic for long enough to generate new building activity. In most California markets, occupancy rates are rising. This is particularly true in Los Angeles and Orange County where occupancy rates have hit 96%. As a consequence 45% of the Southern California panel and 28% of the Bay Area panel are expecting to begin a new industrial space development in the next 12 months.

Highlights of the June 2012 Industrial Space Survey are:

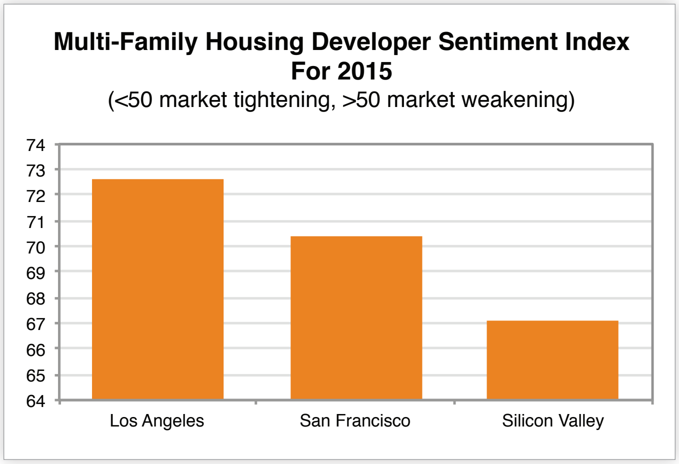
1. The San Francisco, East Bay, and Los Angeles panels are optimistic, but slightly less so than six months ago.
2. Silicon Valley is less optimistic with respect to rental rates, but as optimistic as December with respect to occupancy suggesting that there is a slightly increased expectation of more competition from new construction over the next three years.
3. Orange County and the Inland Empire are more optimistic about rental rates and less optimistic about occupancy suggesting lessors are achieving more pricing power due to the already low vacancy rates.
4. Nearly half of the Southern California Panel reports they or their associates are in the process of putting together new industrial space projects, while 28% of the Bay Area Panel are associated with incipient projects.

California Multi-Family Housing Space Markets

The most encouraging news we find in the June Survey comes from the first Allen Matkins UCLA Anderson Forecast survey of multi-family housing developers. While there are no historical data to form a basis for analytical comparison, the results are quite striking. In each of the three markets surveyed, Los Angeles, San Francisco, and Silicon Valley, the panel was optimistic about the prospects for returns on multi-family housing in the coming three years. The survey indicates that the market outlook is sufficiently bright for 70% of our panel or their associates to begin new multi-family projects in the coming 12 months.

The booming San Francisco market, for example, has seen rents increase at double-digit rates and vacancies fall to under 4%. This has given rise to a number of new building projects including the massive Park Merced, Treasure Island and Hunter's Point developments. Similarly there are a number of new developments around Silicon Valley expected to begin in the coming year.[2]

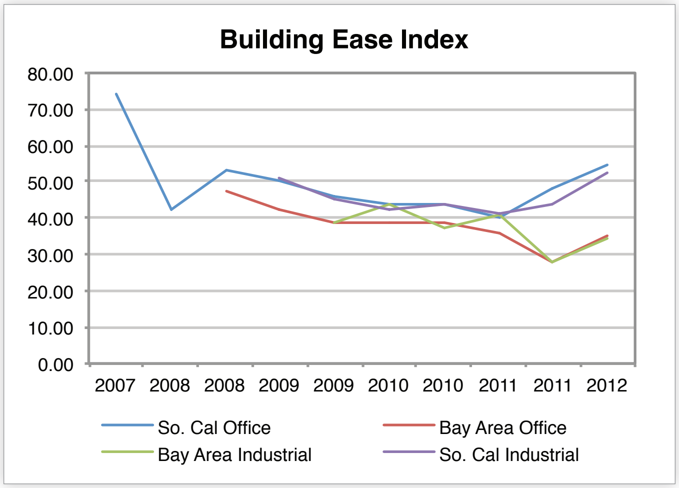
Los Angeles, with the most optimistic panel, has seen similar movement in new housing including Playa Vista II, a restart of downtown multi-family construction, and new developments in Hollywood, Santa Monica and along the recently opened Expo-Line rail from downtown to Culver City. While average rental rates for the County have not risen at the same rate as San Francisco, vacancies in specific markets are now under 2% and rental rates have been pushed up sufficiently to induce a rebirth of the apartment construction market.[3]



Building Cost and Financing Indexes

Survey Project also generates building cost and financing indexes. These measure the expected improvement or deterioration in the cost of building and as a companion to market sentiment. The index measures changes to the physical and financial costs of building over the coming three years as opposed to the Sentiment Index that measures the end of the three year horizon.

In all four of our markets the BCF Index declined from 2009 to 2011. This reflected a perception on the part of developers that land costs will be increasing faster than the rate of inflation over the next three years and financing would be at least as difficult as today. In the second half of 2011 the BCF Index increased for all of our markets, primarily due to a perception of an improvement in the availability of funds for new development projects. A higher BCF coupled with 2 ½ years of optimism about the market are good indicators of new development and sentiment turning to activity in investment in commercial real estate.



Summary

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 2015 in the Survey 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. The eighteen months of pessimism during the recession has now been followed by two and a half to three years of increasing optimism among the Survey panels. This is qualitatively consistent with the historical pattern of commercial real estate cycles. Moreover, the data thus far indicate that two years of optimism is approximately what is required for new building to be initiated. We have reached that point in Office, Industrial and Multi-Family markets and now expect to see projects turn to development and construction in 2013.

■

1. http://www.edd.ca.gov.
2. See for example, Jordan Moss, "Rocking the Bay Area," Apartment Finance Today, March/April 2012. And David Goll, "Milpitas Multifamily Projects Ramp Up," Silicon Valley/San Jose Business Journal, October 21, 2011.
3. See for example, Roger Vincent, "Santa Monica project to break ground," Los Angeles Times, February 16, 2012. And Alejandro Lazo, "Southern California rental market getting more expensive," Los Angeles Times, April 12, 2012.

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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.

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Allen Matkins

Allen Matkins, founded in 1977, is a California-based law firm with approximately 220 attorneys in four major metropolitan areas of California: Los Angeles, Orange County, San Francisco and San Diego. The firm's core specialties include real estate, real estate and commercial finance, bankruptcy and creditors' rights, construction, land use, natural resources, environmental, corporate and securities, intellectual property, joint ventures, taxation, employment and labor law, and dispute resolution and litigation in all these matters. For more than 30 years, Allen Matkins has helped clients turn opportunity and challenge into success by providing practical advice, innovative solutions and valuable business opportunities. When clients' challenges require experienced trial counsel, Allen Matkins has a proven track record of successful litigation before juries, judges and arbitrators. Allen Matkins is located on the Web at www.allenmatkins.com.

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