REGIONAL AND AREA ECONOMIC OVERVIEW

The commercial real estate sector of the economy is influenced by factors that are global, national, and regional in nature. In order to understand the local conditions which affect the ever-changing value of individual assets, the larger economic forces which drive those conditions must be considered.

Developments in the Global and National Economy

The Global Economy

Risks to the global economy include a generalized slowdown in emerging market economies, China's rebalancing away from investment and manufacturing toward consumption and services, lower prices for energy and other commodities, and the gradual tightening in monetary policy in the United States. Manufacturing activity and trade remain weak globally, and the dramatic decline in imports in a number of emerging market and developing economies is also weighing heavily on global trade. Despite these challenges, the latest IMF World Economic Outlook update projects a 3.4% global growth rate in 2016 and a 3.6% rate in 2017. In advanced economies, a modest recovery is expected to continue. The projected pickup in growth in the next two years primarily reflects forecasts of a gradual improvement of growth rates in countries currently in economic distress, namely Brazil, Russia, and some countries in the Middle East.

Since the U.S. Federal Reserve lifted the federal funds rate from the zero lower bound in December 2015, monetary easing is proceeding broadly in the euro area and Japan. The oil price decline has had a notable impact on investment in oil and gas extraction, also subtracting from global aggregate demand. Higher growth is projected for the Middle East, but lower oil prices, and in some cases geopolitical tensions and domestic strife, continue to weigh on the outlook.[1]

The National Economy

According to the Los Angeles County Economic Development Corporation's 2016-2017 Economic Forecast & Industry Outlook report, the U.S. economy achieved a 2.4% GDP growth rate in 2015. The LAEDC expects a 2.5% GDP growth rate this year and next, partly because of the momentum in the consumer sector but also due to improving numbers in housing. Furthermore, the tightening labor market should prompt increases in the wages of many workers. Overall activity remains resilient in the United States, supported by relaxed financial conditions and strengthening housing and labor markets. However, dollar strength is weighing on manufacturing activity and lower oil prices are curtailing investment in mining structures and equipment.[2]

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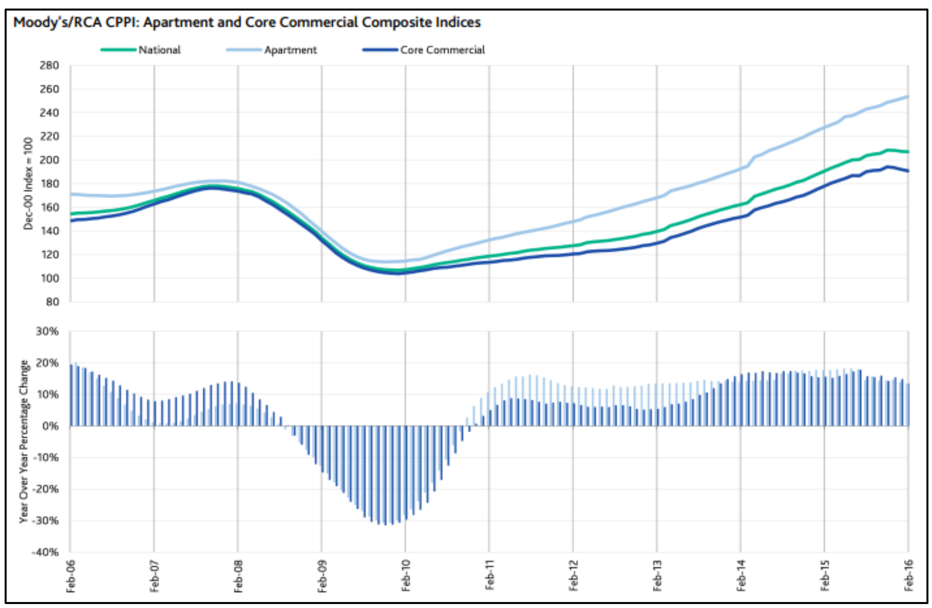
[1] http://www.imf.org/external/pubs/ft/weo/2016/update/01/pdf/0116.pdf
[2] http://laedc.org/wp-content/uploads/2016/02/LAEDC-2016-2017-February-Forecast.pdf

Commercial Real Estate Market

According to Deloitte's Commercial Real Estate Industry Outlook, commercial real estate usage will undergo a metamorphosis over the next decade. Technological advancements are increasingly automating brokerage and leasing tasks and activities, bringing down barriers between potential tenants and real estate owners. Developments in cloud computing combined with mobile and social media are resulting in cost-effective and real-time availability of property information and are enabling many leasing activities online.

Deloitte forecasts that evolution in the talent marketplace will have a significant impact on where commercial real estate is located and the way it is designed and used. Because of the demand for integrated urban-lifestyle centers that cater to the "live, work, play" mantra, mixed-use spaces that include office, residence, and recreation options will be favored over stand-alone properties. Furthermore, the increase in contract workers, or flexible work locations, will result in knowledge workers preferring to work from home, with many tenants demanding small offices in their apartments. Because a large part of experiential retailing is being driven by increased competition from the exponential growth in online retailing, neighborhood warehouses and distribution centers could eventually replace neighborhood retail.[3]



The Moody's/RCA commercial property price index is a periodic same-property round-trip investment price change index of the U.S. commercial investment property market, based on data from Real Capital Analytics. The index is designed to track same-property realized price changes based purely on the documented prices in completed, contemporary property transactions. The Moody's/RCA CPPI decreased by 0.2% in February. Core commercial prices declined by 0.6%, while prices in the apartment sector increased by 0.7%. The overall price decline was driven by office, down 1.1%, and by industrial, down 0.9%. Apartment prices continue to increase but at a decelerating pace, up by 0.7% over the month of March and 2.0% over the last few months (January-March 2016).[4]

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[3] http://www2.deloitte.com/us/en/pages/real-estate/articles/commercial-real-estate-redefined.html

[4] https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_1022232

Due to the increasing strength of the U.S. real estate market, the United States is seen as a safe investment haven, even though interest rates are set to rise and concerns still exist regarding macroeconomic conditions.

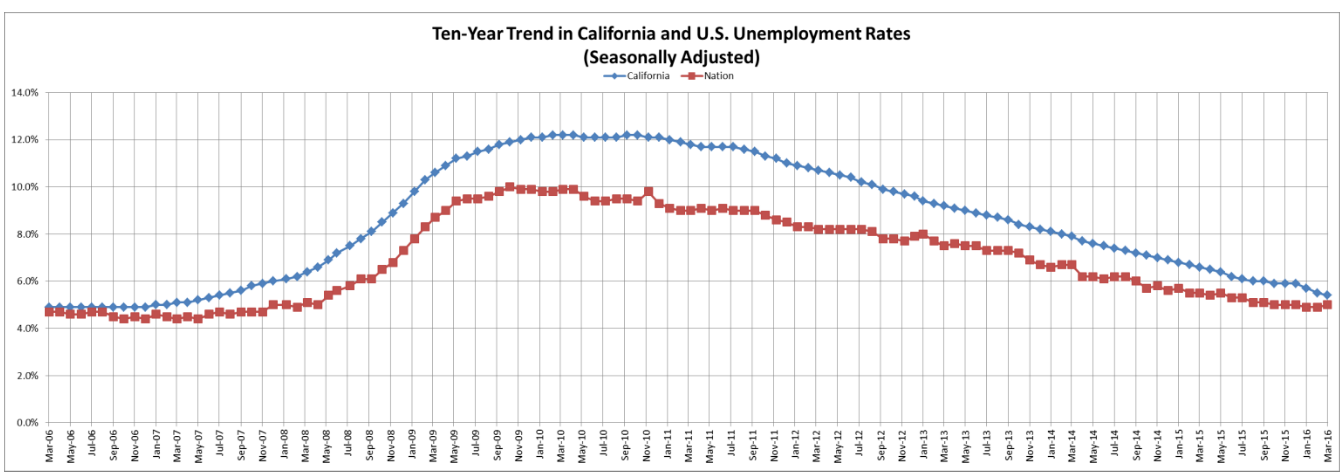
State of California

California is the most populous state in the nation, with roughly 39.1 million residents. The table below summarizes California's population and employment changes from 1990 through 2014 via data provided by the U.S. Census Bureau.

State of California - Population & Employment: 1990-2014														
			1990-2000 Growth				2001-2010 Growth						2010-2014 Growth	
	1990	2000	#	%	2001	2010	#	%	2011	2012	2013	2014	#	%
Population (000s)	29,757	33,872	4,115	13.8%	34,501	37,254	2,753	8.0%	37,692	38,041	37,966	38,803	1,549	4.6%
Employment (000s)	14,294	16,024	1,730	12.1%	16,220	15,878	-342	-2.1%	16,201	16,871	16,663	18,832	2,954	18.4%

Source: Census Department & The Employment Development Department (EDD)

Reviewing the Employment and Population information above, it is clear that population has steadily increased since 1990, while employment has fluctuated significantly due to the economic climate. From 2001 through 2010 there was an increase of 2.75 million persons, or 8.1%, but state employment numbers decreased by 342,000, or 2.1%. The U.S. Census Bureau reports that between the 2010 Census and July 1, 2014, California's population increased by 4.6%, which is attributable to net migration and natural increases in the population. Employment during that same period has increased dramatically at 18.4% in the wake of a constant recovery from the great recession.[5]



The chart above, created with data from the State of California Employment Development Department and the United States Bureau of Labor Statistics, provides a snapshot of ten-year trends in unemployment rates for California and the nation. This chart shows that California's unemployment rate has steadily declined over the past several years from a high of 12.2% in

[5] http://www.census.gov/quickfacts/table/AGE295214/0644000,06

September and October of 2010 to its most current rate of 5.4% in March 2016. This recent decline reflects a gradual recovery from the recession of 2008-2009 and does not suggest that the unemployment rate will continue to decrease as cyclical and unpredictable economic fluctuations are to be expected. Moreover, California's unemployment rates are still higher than the nation-wide rates.[6,7]

California Economic Indicators

A summary of the California's Economic Indicators are displayed below. Since 2004, the population has been on the rise with slight fluctuations in nonfarm employment. The unemployment rate after 2006 rose until it reached its peak at 12.2% in 2010, falling back down to approximately 5.5% for 2016 (projected). Total personal income in billions has risen since 2004 as well as per capita personal income.

Overall, growth appears to be very consistent with continued modest growth expected in 2016 and 2017.[8]

Year	Population on July 1 (Thousands)	Nonfarm Employment (Ave., thousands)	Unemployment Rate (Ave., %)	Total Personal Income ($Billions)	Per Capita Personal Income ($)	Total TaxableSales ($Billions)	Value of Two-way Trade ($Billions)	Housing Unit Permits Issued	Nonresidential Buidling Permits ($Millions)
2004	35,752.8	14,723.6	6.2	1,324.9	34,244	500.1	394.3	212,960	19,718
2005	35,985.6	15,012.9	5.4	1,399.0	39,046	536.9	433.1	208,972	21,469
2006	36,246.8	15,285.9	4.9	1,501.8	41,693	559.7	487.6	164,280	23,298
2007	36,552.5	15,413.5	5.4	1,565.3	43,182	561.1	512.9	113,034	23,733
2008	36,856.2	15,244.1	7.3	1,602.7	43,786	531.7	523.3	64,962	19,588
2009	37,077.2	14,375.8	11.2	1,537.1	41,588	456.5	413.3	36,421	10,866
2010	37,339.5	14,215.5	12.2	1,583.4	42,411	477.3	502.6	44,762	11,200
2011	37,676.0	14,364.1	11.7	1,691.0	44,852	520.6	558.5	47,090	12,991
2012	38,037.9	14,712.1	10.4	1,812.3	47,614	558.4	578.2	57,496	14,815
2013	38,366.5	15,183.3	8.9	1,849.5	48,125	586.8	596.4	82,283	21,792
2014	38,725.1	15,645.1	7.5	1,939.5	49,985	615.5	608.5	85,846	23,686
2015	39,071.3	16,114.0	6.2	2,060.3	52,700	636.2	581.0	96,451	24,700
2016f	39,423.0	16,516.9	5.5	2,153.6	54,600	671.0	579.0	110,000	27,000
2017f	39,777.8	16,781.1	5.3	2,271.5	57,100	718.1	632.1	128,800	29,100

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept of Commerce, Construction Industry Research Board; California Homebuilding Foundation; estimates and forecasts by the LAEDC

Nonfarm jobs are expected to increase by 2.5% in 2016, noting less growth than 2014 and 2015, which both saw a 3.0% increase. The unemployment rate fell from 7.5% in 2014 to 6.2% in 2015 and is expected to decline to 5.5% in 2016. With continued improvement in the labor market, personal income may increase by as much as 4.5%, and total taxable sales may increase by 5.5% this year.[8]

Forecasts for the 2016-2017 California Economy include:

- General Fund expected to end the current fiscal year with a cash surplus
- Construction employment expected to grow 4.7% this year and 5.5% in 2017
- All major tourism markets expected to see gains this year and next

[6] http://www.labormarketinfo.edd.ca.gov/cgi/dataanalysis/labForceReport.asp?menuchoice=LABFORCE
[7] http://data.bls.gov/timeseries/LNS14000000

- If more dry years follow El Niño storms, agricultural employment will suffer further declines along with a drop in production

Southern California

The Southern California region consists of a six-county area including Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura Counties. Combined, this region extends along 36,300 square miles, with San Bernardino accounting for 55% or 20,052 square miles, largely consisting of the desert. Southern California represents the nation's second most populous region after the New York metropolitan region, and is a key driver fueling the California economy. The Southern California regional economy is linked to the global economy through several channels. Those channels include foreign direct investment, tourism, international trade, education and film, television and digital entertainment content and delivery.[8]

<u>Population</u>

Southern California's population grew 1.8 million persons between 2000 and January 2010, according to Census data. During 1990-2000, Los Angeles County was last in terms of percentage population growth, but first in term of absolute population growth. During 2000-2015, Los Angeles remained last in percentage population growth, well behind Riverside County, which had the highest percentage change. Additionally, Los Angeles no longer came first in terms of absolute population growth, falling to second behind Riverside County and just ahead of San Bernardino and San Diego Counties.[9]

<u>Employment Trends</u>

Southern California has experienced four consecutive years (2012-2015) of solid employment gains. Every county in the region has seen consistent increases in nonfarm jobs, contributing to the decline in unemployment rates across the region. Although California's unemployment rate is still greater than the national rate, Los Angeles County has consistently outpaced the nation in job growth. With the economy back at full employment levels, wage gains are expected over the next year across many occupations. Households could experience gains in purchasing power this year as wage gains spread out more broadly than in recent years.[9]

<u>Real Estate Forecast</u>

Following the Federal Reserve's rate hike in December, mortgage interest rates are expected to rise moderately this year. In 2016, the Mortgage Bankers Association is projecting mortgage origination growth of 10% in the purchase market in spite of higher interest rates. With continuing job growth, increases in home sales and new home construction, home price

[8] http://laedc.org/wp-content/uploads/2016/02/LAEDC-2016-2017-February-Forecast.pdf
[9] http://laedc.org/wp-content/uploads/2016/02/LAEDC-2016-2017-February-Forecast.pdf

increases, and increases in the number of homeowners with positive equity, housing and new home construction have potential for stronger gains.

In Southern California, nonresidential real estate vacancy rates continue to decline, rental rates are up, and interest from foreign investors is on the rise. The fundamentals of commercial and industrial real estate are strong, supported by employment growth and stronger economic activity. Delinquency rates on commercial and industrial loans, and default rates on commercial mortgage-backed securities, are near all-time lows.

Los Angeles County is the nation's largest manufacturing center and is home to its biggest port complex. County office market rents are returning to pre-recession highs and the countywide vacancy rate is now below 15%. In 2016, with additional gains in office employment expected, vacancy rates should continue to trend lower. Industrial space vacancy rates continue to decline and average asking lease rates have steadily increased. Availability levels are at record lows, constricting activity in the face of rising demand. Lease rates are expected to continue to rise over the next 12 months as developers push to deliver new product to the market.[9]