ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

Allen Matkins

Winter 2025
Issue No. 36

UCLA Anderson Forecast

Office | Multifamily | Industrial | Retail


Allen Matkins FORECAST
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
vacancy rate in Los Angeles will:
A. Increase
B. Decrease
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

As we begin 2025, I am excited and honored to lead my first publication of the Allen Matkins/UCLA Anderson Forecast Commercial Real Estate Survey and Index. After taking the reins from my partner John Tipton's capable hands, I present our Winter 2025 edition, which looks at future development in office, retail, industrial, and multifamily spaces and helps predict future California commercial rental and vacancy rates.

This survey is now in its 36th edition, and I look forward to continuing what has become a mainstay for California commercial real estate participants. But I also hope to hear your feedback. Are we asking the right questions? Are the insights helping you plan for the future? We hope to continue to innovate and fine-tune for many years to come. We sponsor this Survey to provide value to the industry and better understand our clients' markets.

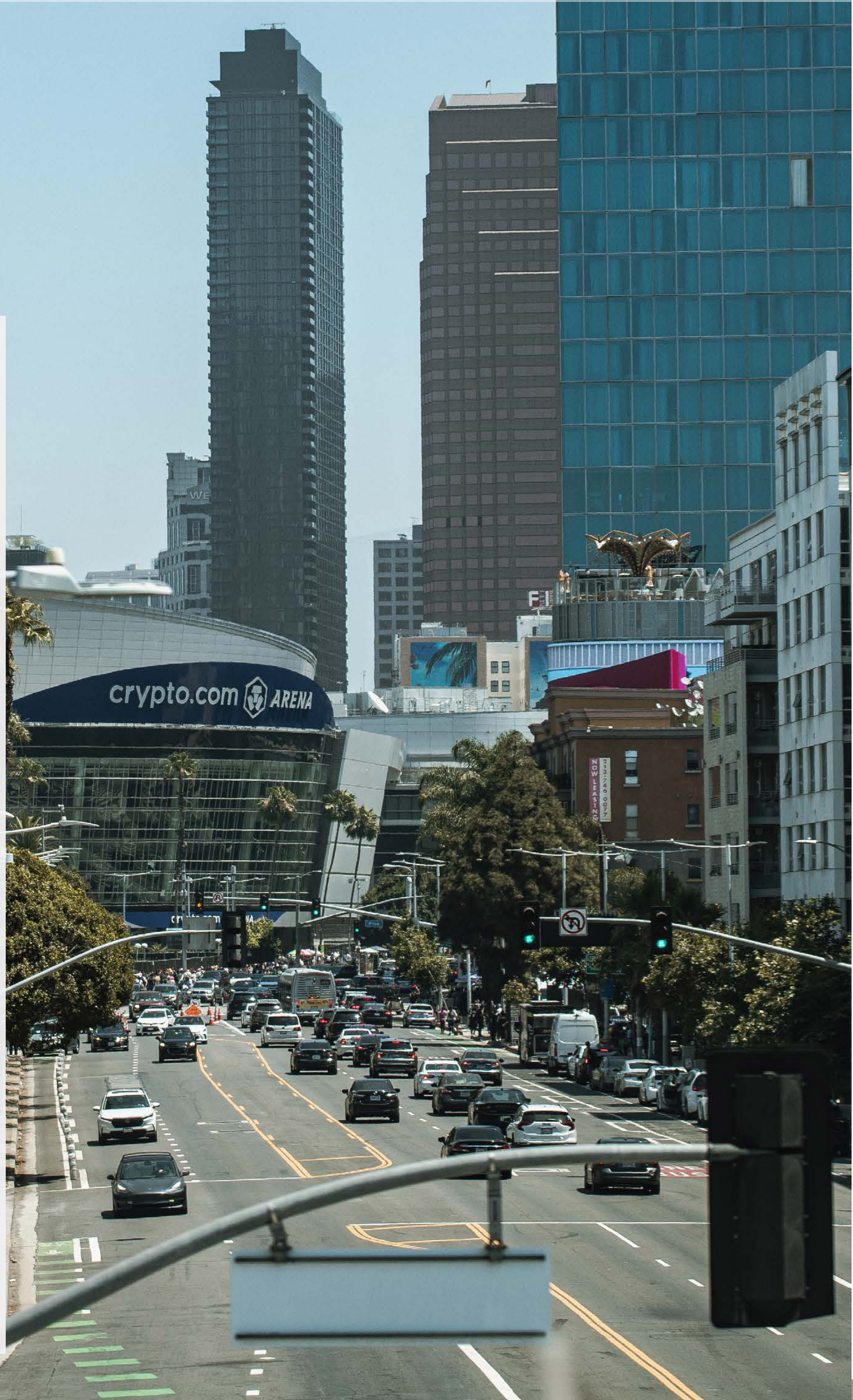
The Allen Matkins and UCLA Anderson Forecast partnership

If you don't know Allen Matkins, we are a premier real estate and business law firm consistently ranked among the leading firms in California. We have been fortunate to work with 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 have partnered with UCLA Anderson Forecast, the leading independent economic forecast of both the U.S. and California economies for over 70 years and have tapped the knowledge of the leading developers and financiers in California to provide what we believe is the best, clear-sighted forecast of the California commercial real estate industry.

We hope you find the Survey helpful and look forward to connecting with you.

Spencer B. Kallick
Partner, Real Estate Department
Allen Matkins

Cautious Upsurge Amidst Change



"Developers are looking to build out their shopping centers with a variety of service-oriented tenants that help support the community around them, which helps drive foot traffic into the center. They're looking for childcare centers and learning centers, for example, but they're also looking to grow the restaurant and food-service footprints because these uses also help to create heavier foot traffic for centers."

- Sandra A. Jacobson
Partner,
Allen Matkins

Results of the Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey for Winter 2025

S. Sayantani
Jerry Nickelsburg
UCLA Anderson Forecast

The Allen Matkins / UCLA Anderson California Commercial Real Estate Survey, taken after the November election, shows how developers and stakeholders of office, retail, industrial and multifamily spaces view the future and by implication, how they will invest. It also reflects how the nation, and by extension, California, has been anticipating potential changes in federal policies from the new presidential administration.

Amidst these changes, the Winter 2025 Allen Matkins / UCLA Anderson Forecast California Commercial Real Estate Survey suggests a positive uptake in new projects started last year and projects expected to be started this year. Sentiments about the next three years are much more positive in both commercial and multifamily markets, relative to the 2024 Summer Survey. Still, over the next few years, California's commercial real estate market is expected to see a mix of progress and challenges. The state, as a whole, has observed continued drops in construction sector employment and reduction in new housing units authorized by building permits between May and November of last year. Compared to the Summer 2024 Survey, optimism has grown in multifamily, industrial, and retail, while office markets still exhibit more cautious sentiment.

Across regions within California, changes in equity requirements, investment thresholds, and rental/vacancy rates indicate a nuanced landscape. Looking forward, the multiple wildfires that devasted areas in and around Los Angeles in January 2025 have brought forth questions about recovery in multifamily development and their spillover effects on other real estate indicators in the Southern California sub-region.

Statistical forecast analysis has as its basis the proposition that past statistical relationships hold into the future. A knowledge of those correlations, current data, and perhaps some assumptions about data not yet known lead to the forecast. In addition to the summary measures of developer sentiment reported here, the Survey has a rich set of questions such that, with past trends in the Survey's indexes, we can now infer nuanced developments in commercial real estate markets.

The Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey compiles the views of commercial real estate developers, owners, and investors 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 entitlement and/or environmental issues often take much longer). The panelists' 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 is a leading indicator of future commercial construction. For example, if a developer were optimistic about economic conditions in Silicon Valley's office market in 2027, then initial work for a new project with an expected ready-for-occupancy date of 2027 — a business plan, preliminary architecture, and a search for financial backing — would have to begin no later than the latter part of 2024. Although optimism does not always translate into new construction projects, this sentiment is usually a prerequisite for it.

The 2025 Winter Survey collected views from a total of 92 respondents, about 60% of whom characterized themselves as core or value investors, with the rest identifying as developers, builders, or brokers. Most of the respondents (about 88%) are associated with privately held firms. Corresponding to several sub-regions of Northern and Southern California, the following sections of this article provide a summary of the survey findings for each of the markets surveyed: retail space, office space, industrial space and multifamily residential housing.

RETAIL SPACE MARKETS

Relative to the Summer Survey, the number of panelists surveyed increased in Northen California (from 24 to 34 panelists), but fell in Southern California (from 64 to 51 panelists). In terms of retail vacancy rates, the three-year-forecast is mixed across regions. Survey respondents expect retail vacancy rates to rise in San Francisco and Sacramento/San Joaquin and reduce in Orange County and San Diego. In Northern California, Silicon Valley and East Bay panelists expect lower rates. In Southern California, retail panelist respondents from Los Angeles and the Inland Empire expect slight rises in vacancy rates over the next three years.

Rental rates are expected to increase in Orange County, San Diego, and most of Northern California, except for Sacramento where they are expected to continue at their previous rate. In most of the Bay Area sub-regions, rental rates are forecasted to be higher over the next few years, with Silicon Valley and the East Bay exhibiting optimistic expectations and San Francisco and Sacramento on the borderline between optimism and pessimism. Overall, Silicon Valley and the East Bay have optimistic sentiments toward rental rates. Among the Southern California sub-regions, Orange County, San Diego, Los Angeles, and the Inland Empire maintain a generally optimistic view of rental rates in retail space over the next three years (Chart 2).

In Northern California 55% of panelists reported that they have new projects planned for the next 12 months (up from the Summer Survey's 38%). About 55% of respondents also reported that they had projects ongoing in the past 12 months, up from the 37% who reported ongoing projects in the Summer Survey. Although Southern California panelists report similar encouraging numbers for the next 12 months, new projects started in the prior year are down from 44% in the Summer Survey to 35% in the current Survey. A potential cause for this downward shift might be a lack of equity capital for anything other than multifamily residential and industrial investment, as was observed by one of the respondents to the Survey.

In terms of investments, in the Bay area, there is no significant change in the share of respondents who expect their equity requirements to increase. On a positive note, the share of panelists who expect their un-leveraged investment return threshold to increase over the next 12 months is 56% according to this Survey, relative to the Summer Survey's 74%. This reduction implies some expectation of a looser financing requirement in Bay Area retail markets. There has also been an improvement in the expectations of panelists from Southern California about increases in IRR threshold requirements. Some 57% of respondents now expect the threshold to increase, down from the Summer Survey's 61%. However, in Southern California, relative to the Summer Survey, a higher share of respondents (58%) believe that they would need more equity in their projects. Rising interest rates and higher construction costs may have impacted these expectations. More than half the respondents cited high interest rates as a primary determinant. The expectation for building costs for Southern California is that they will rise faster than inflation.

To summarize, the Winter Survey shows optimism in Northern California's retail markets in Silicon Valley and the East Bay, but Sacramento faces challenges with higher vacancy rates. Among Southern California regions, Orange County and San Diego are optimistic, while Los Angeles and the Inland Empire expect rents to keep up with inflation but vacancies to rise. Overall, retail development sentiment has improved everywhere, with six out of the eight markets surveyed being optimistic. Relative to 2024, both Northern and Southern California have more new development planned in 2025.

Chart 1

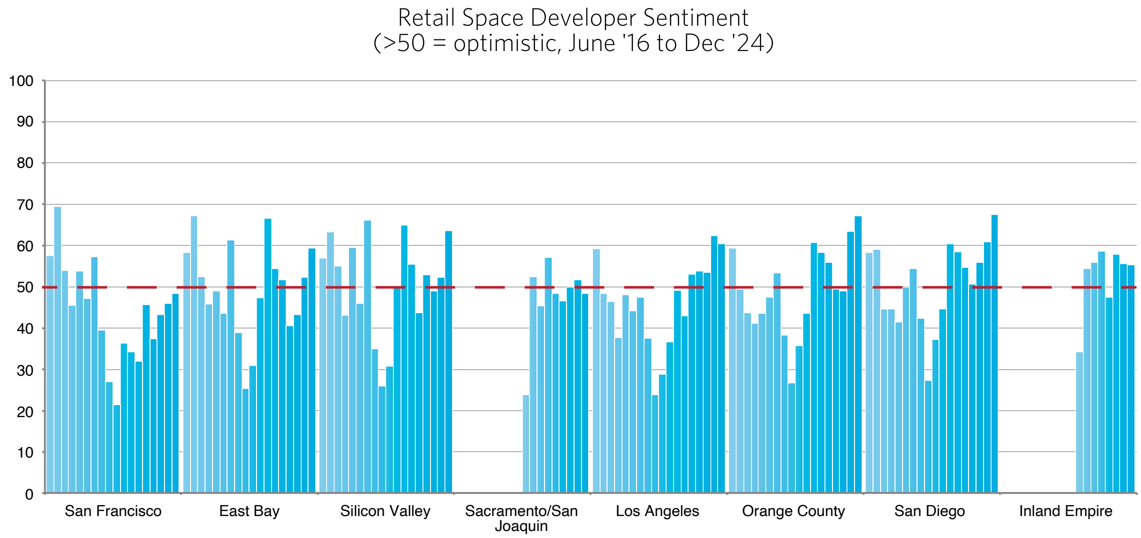
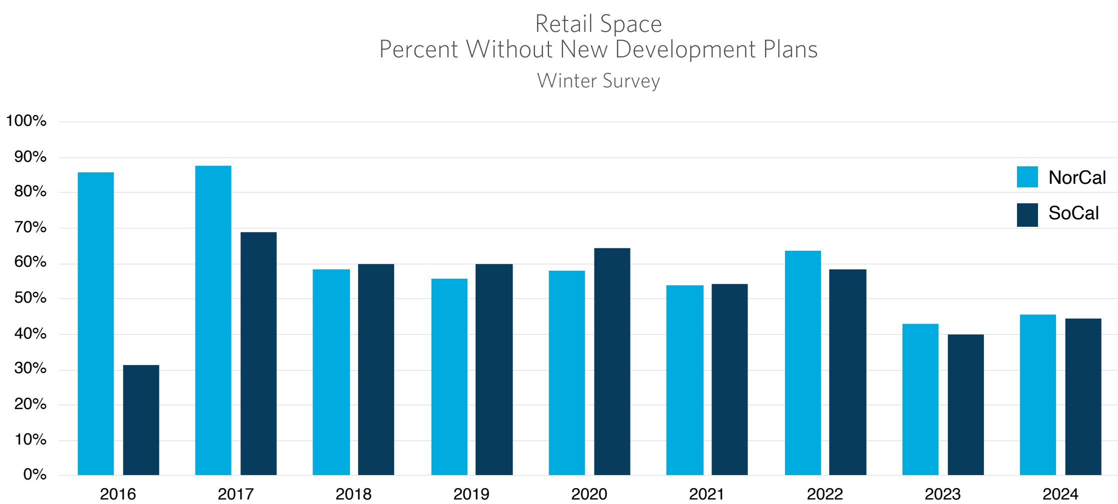
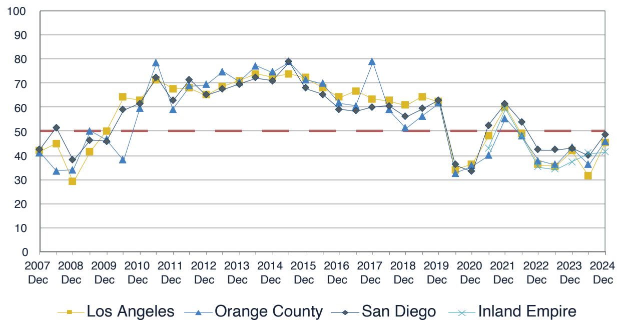


Chart 2



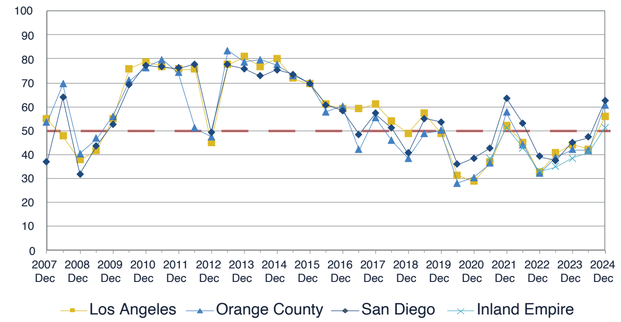
Southern California Office Rental Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



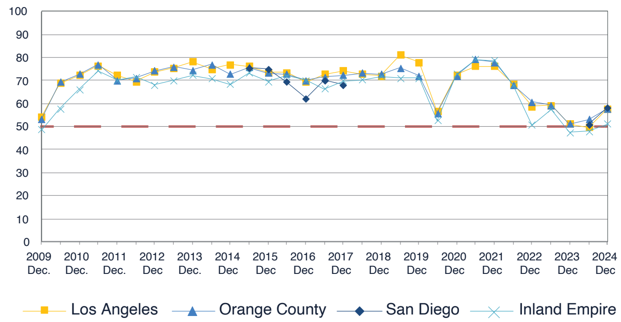
Southern California Office Vacancy Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



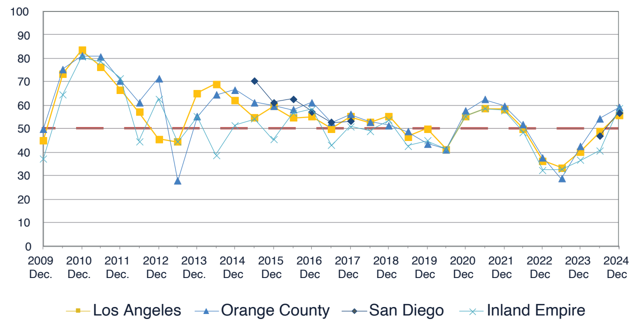
Southern California Industrial Rental Rates

Indexes of Survey Responses
(<50 market weakening, >50 market tightening)



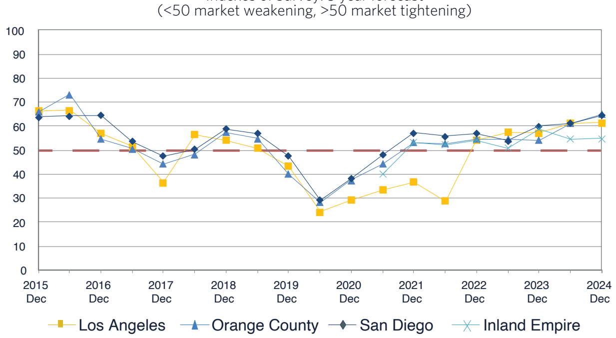
Southern California Industrial Vacancy Rates

Indexes of Survey Responses
(<50 market weakening, >50 market tightening)



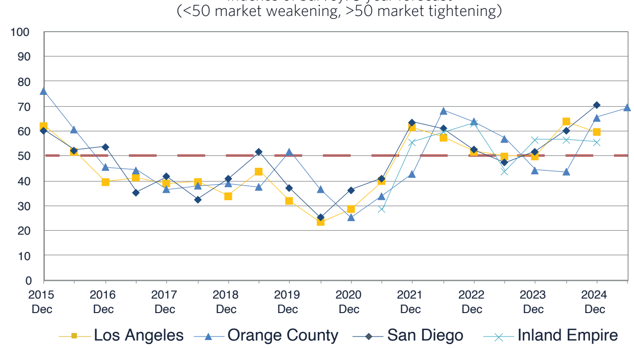
Southern California Retail Rental Rates

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



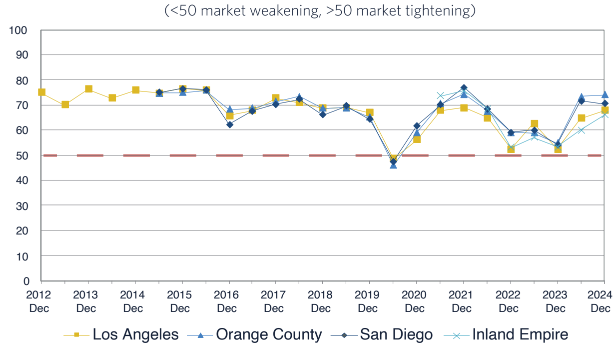
Southern California Retail Vacancy Rates

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



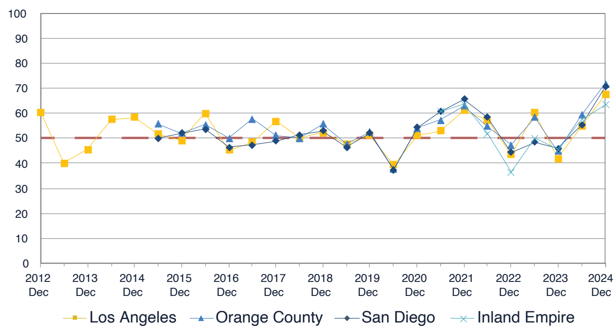
Southern California Multifamily Rental Rates

Indexes of Survey Responses
(<50 market weakening, >50 market tightening)



Southern California Multifamily Vacancy Rates

Indexes of Survey Responses
(<50 market weakening, >50 market tightening)



OFFICE SPACE MARKETS

Office space panelist sentiments with respect to 2027 are improving everywhere, though they are still in the pessimistic zone for three of the eight markets surveyed (Chart 3). The East Bay, Sacramento, and the Inland Empire panels continue to be pessimistic about office market and expectations by the Los Angeles panelists are now neutral, progressing from a long-standing pessimism that started back in 2022.

In Northern California, new office space development by the panelists has dropped slightly with 4% of developers beginning new office space development, relative to the previous Summer Survey's 5% (Chart 4). Southern California's new office space development has picked up slightly, with 14% of developers beginning new office space development, relative to the Summer Survey's 9%. Also relative to the Summer Survey, the share of developers with new projects started (in the previous year) is higher by five percentage points, and the share of developers with projects to be completed (over the next year) is lower by three percentage points. A substantial number of respondents cited remote and hybrid work-induced reduction in office demand as primary market trends that affected them, while some others cited return to work as a major source of their activities.

Some respondents also mentioned high building costs along with uncertainties about the use of office buildings as primary drivers of their business. An index estimating the evolution of non-labor building costs in Northern California has observed a slight drop of two index points between the Winter 2025 and the Summer 2024 surveys. This office-construction-specific index combines land and material cost expectations. Although the Winter Survey numbers show a slight drop in the Northern California index, the Southern California index has maintained an almost steady positive trend over the last few years. This difference across regions may be reflected, in part, by the fewer projects the Northern California panelists have lined up over the next 12 months.

In the Bay Area, three-year-forecasts of vacancy rates are lower than before. The rental rate forecast for San Francisco is now optimistic, with about 70% of the respondents expecting rental rates to grow and about 42% respondents expecting vacancy rates to grow. Three-year-forecasts for rental rates and vacancy rates are improving everywhere in Southern California.

In the Bay Area, relative to the Summer Survey, about 65% of respondents (up from 62%) believe that they would need more equity in their projects over the next three years, while about 60% (down from 63%) expect their investment IRR threshold to increase for the next three years. In Southern California, about 71% of respondents in the current Survey expect to be required to have more equity in their projects over the next three years, up from about 62% in the previous Survey, and the percentage of respondents who expect the investment IRR threshold to increase is steady at about 63%.

In summary, office market sentiments are improving. The East Bay, Sacramento, and the Inland Empire panels remain pessimistic, and the Los Angeles panel is nearing optimism. New office space development is slightly down in Northern California but has increased in Southern California, where market trends show higher demand despite remote work challenges. Northern California sees slower growth, reflected in fewer planned projects. Forecasts for rental rates and vacancy improvements are optimistic across Southern California.

Chart 3

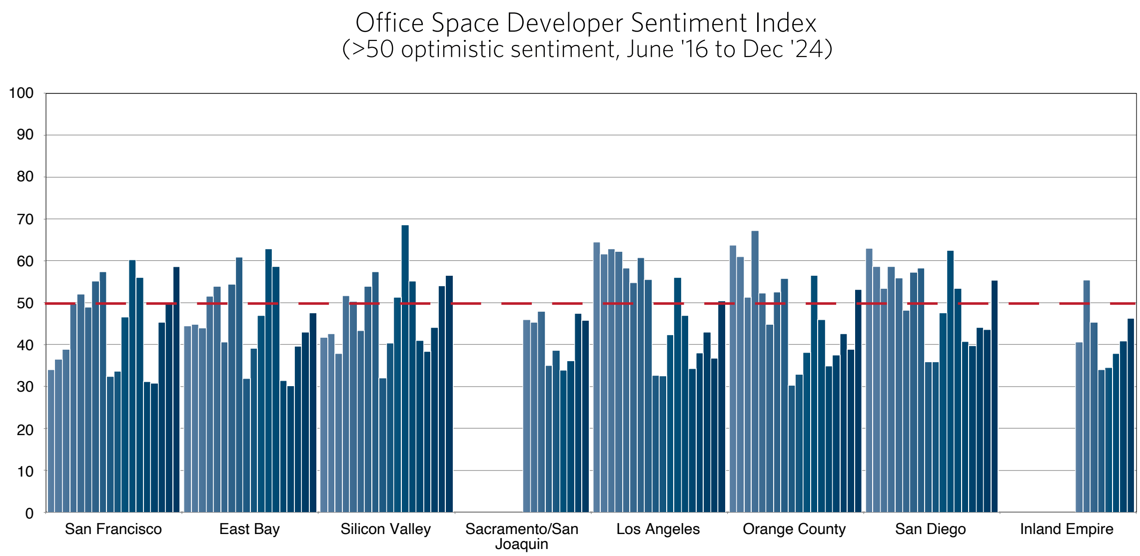
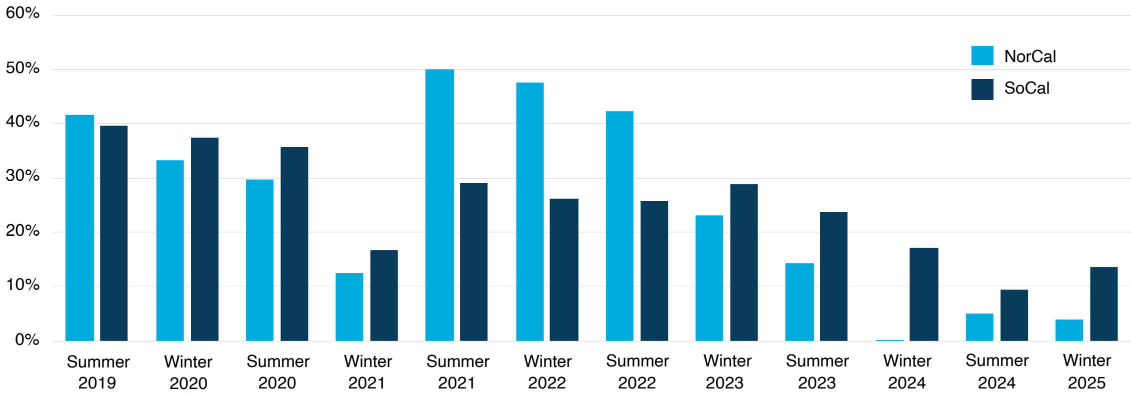
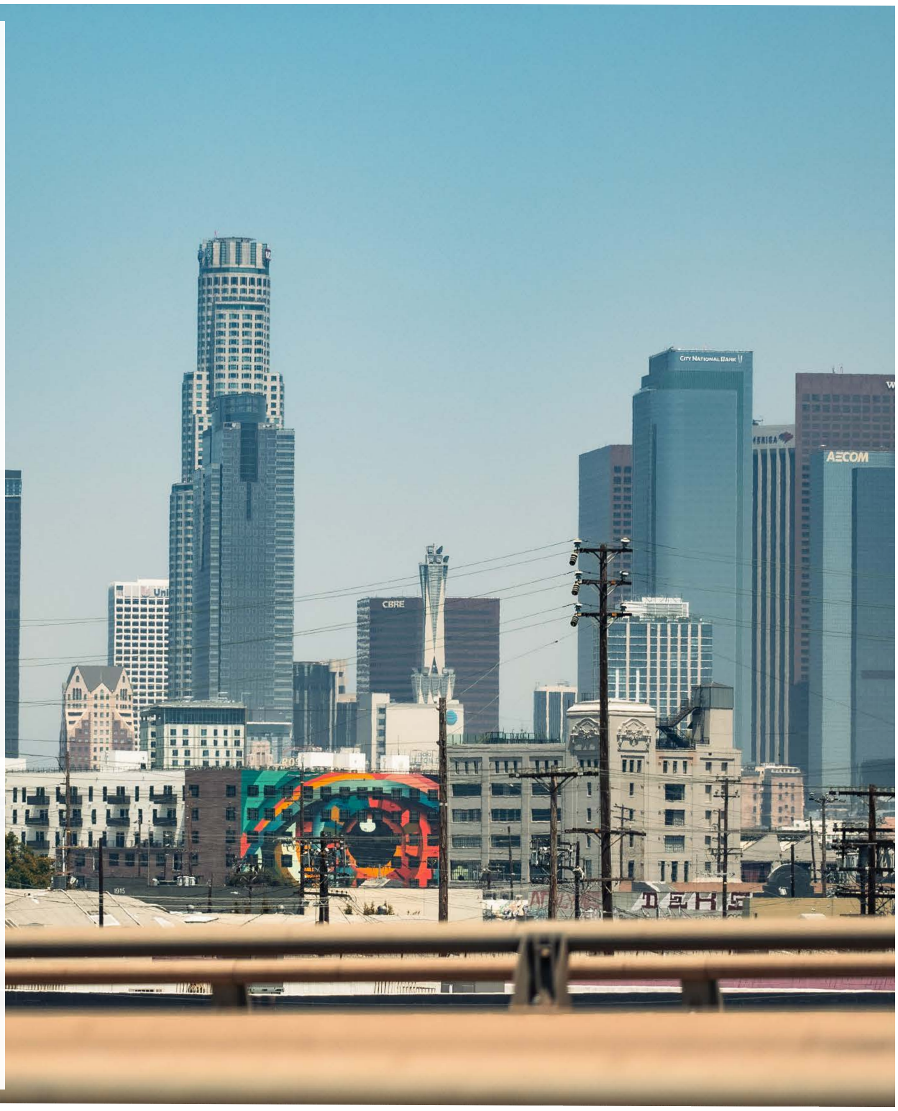


Chart 4

Percent of Panelists Planning New Office Development
(Next 12 Months, 8 Markets, Winter Survey)





"Tenants know that deals are coming in terms of cheaper rents. With many landlords still owning at an unrealistically high basis, there is an inability to meet the market on rent, creating a misalignment of interests between landlords and lenders. As lenders take things back or sell properties, a re-set basis will allow ownership to meet the market on rent. The exception to this is trophy product in premier markets – they have been able to consistently outperform."

- Dan Wagman
Partner,
Pendulum Property Partners

INDUSTRIAL SPACE MARKETS

The industrial space pessimism that persisted over the previous few surveys has improved according to the current Survey. Four out of the five markets surveyed: the East Bay, Los Angeles, the Inland Empire, and Orange County show a greater than 50 number in the Industrial Space Developer Sentiment Index, implying optimism (Chart 5). This improvement in sentiment has moved Los Angeles and the Inland Empire from being pessimistic previously to now being objectively optimistic. In Sacramento/San Joaquin Valley however, the Summer Survey's optimism has taken a hit. Among the five sub-regions surveyed, this sub-region alone is on the border of optimism and pessimism.

Among the Northern California industrial markets, relative to the Summer Survey, a marginally lower share of respondents from the East Bay and Sacramento are expecting to observe increasing rental rates in the next three years. An average of about 50% of respondents foresee a rise in rental rates. In terms of vacancy rates, relative to the Summer Survey, more respondents expect a fall in the East Bay and a rise in Sacramento over the next three years. While most of the respondents expect vacancy rates to fall over the next three years in all the markets in Southern California, responses regarding rental rates are mixed. While rental rates in San Diego and Orange County are expected to rise, they are expected to fall in Los Angeles and the Inland Empire.

In terms of new development in Northern California, new projects started over the last year and new projects to be started over the next year are higher than their Summer Survey counterparts. While 56% (up from 38%) of developers surveyed mentioned having started new projects over the last year, 69% (up from 31%) mentioned having

"Key trends we're seeing in the industrial sector relate to a reassessment of location and the types of users that are out there in the industrial marketplace. With a reassessment of location, we're seeing users look further away from the ports, even though it's more advantageous to be closer to the ports, because there's not a lot of product in the infill markets."

- Jonathan Shardlow
Partner,
Allen Matkins

plans to start new projects over the next year. Southern California too, has fared better relative to the Summer Survey in the share of developers that have plans for industrial development, with 61% of respondents having started projects over the last 12 months (up from 50% in the Summer Survey). However, in Southern California, the share of developers that have plans for new industrial development in the next 12 months fell from 44% (in the Summer Survey) to 38% in the current survey.

In the three-year-horizon, relative to the Summer Survey, the new survey demonstrates a growth in expectation of demand surpassing supply in Southern California. A slight dip was reported in the share of respondents believing demand will surpass supply in Northern California (Chart 6). In both Northern California and Southern California, about 63% of the respondents believe that demand will grow more than supply over the next three years.

In terms of financing requirements, in Northern California, compared with the Summer Survey, around the same share (68%) of respondents expect to require more equity for their projects. A full 54% of respondents (down from the Summer Survey's 63%) expect a higher investment IRR threshold over the next three years. In Southern California, about 62% of the respondents expect to require more equity, and 47% (down from the Summer Survey's 64%) expect a higher investment IRR threshold over the next three years.

In summary, industrial market sentiment has improved, with optimism in four of five markets (the East Bay, Los Angeles, Inland Empire, and Orange County), though Sacramento remains borderline. Northern and Southern California show rising industrial development, with higher project activity than the previous survey. Southern California on the other hand, anticipates slightly fewer new projects next year. Most respondents expect falling vacancy rates and mixed rental growth. Financing requirements show stable or lower equity and investment return thresholds across regions. It is important to note that these positive sentiments toward the returns to industrial space development were reported by the panelists post-election.

Chart 5

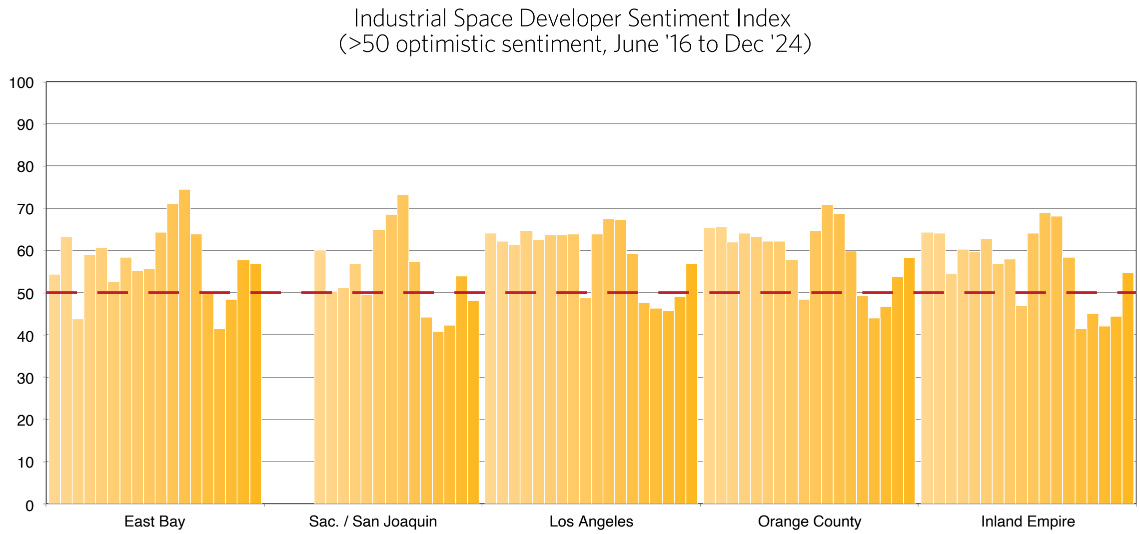
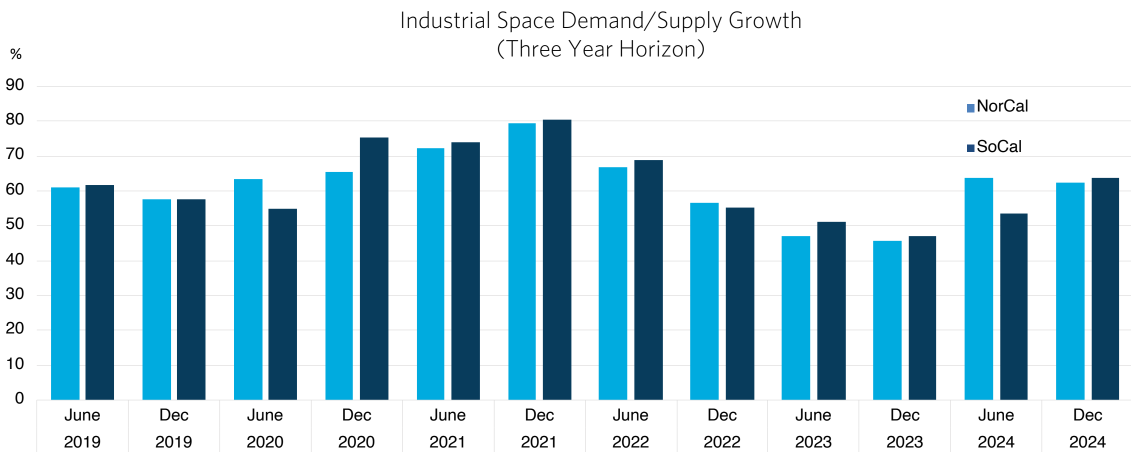


Chart 6



MULTIFAMILY HOUSING MARKETS

The multifamily outlook in California has been generally more promising and resilient than retail and office sectors, and the current survey continues to tell a similar story. Multifamily housing development sentiment is higher and optimistic in all the eight sub-regions studied by the survey: San Francisco, Silicon Valley, the East Bay, Los Angeles, Orange County, San Diego, Sacramento/San Joaquin and the Inland Empire (Chart 7). Among the regions listed, sentiments in the East Bay, Orange County, and Sacramento had marked increases relative to the Summer Survey findings, with Orange County and San Diego being most optimistic.

Housing demand is growing much faster than supply, and the state has responded by relaxing regulations that affect multifamily development. Consequently, the share of participants planning new multifamily development according to this Survey is higher than any of the development plans captured in winter surveys starting 2019. A large share of developers (74%) is planning to start new developments in the next 12 months, and 60% of the respondents expect to start more than one. (Chart 8).

Rental rates for multifamily buildings are expected to grow higher than the rate of inflation. However, the expectation of this growth is only slightly more (about three index points) relative to the growth expectations from the Summer Survey's findings. Vacancy rates are also forecasted to continue dropping in all the markets.

Approximately 61% of the current survey respondents expect to require more equity and about 51% expect to face a higher investment IRR threshold. This expectation of an increase in IRR threshold is now lower than the Summer Survey's 61%.

Overall, the share of developers who have new development slated to be started over the next year are higher in this survey at 74% (up from 53%). Regionally, a greater percentage of Bay Area panelists,40%, are planning new projects in the next 12 months, relative to the Summer Survey.

Overall, the multifamily housing market in California remains strong, with optimistic sentiment in all eight surveyed regions, especially in the East Bay, Orange County, and San Diego. About 74% of developers plan new projects in the next year, marking the highest activity since 2019. Rental rates are expected to rise moderately, vacancy rates to drop, and financing requirements show slight improvement compared to the previous Survey.

Chart 7

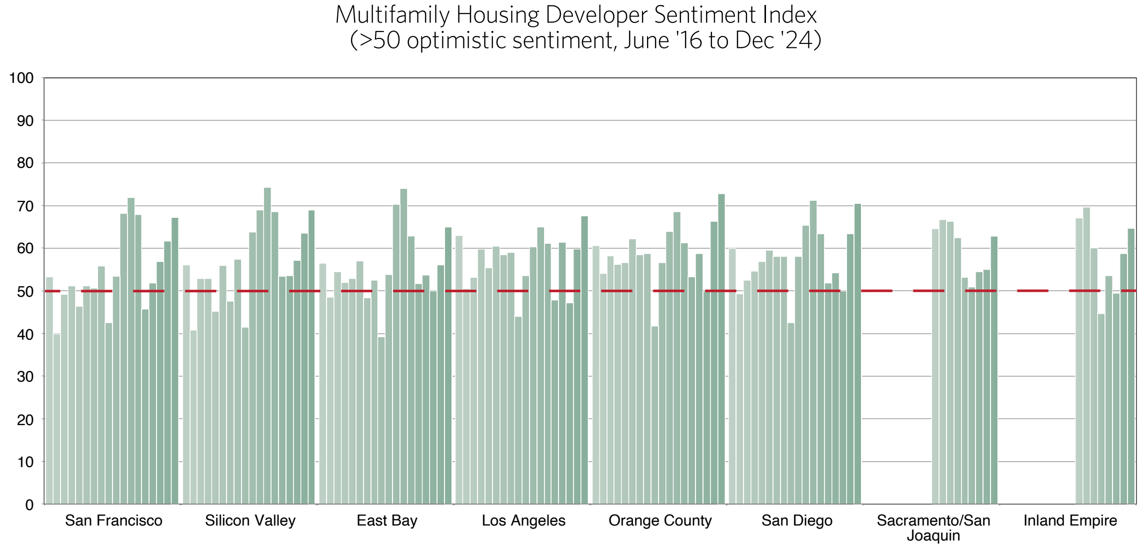
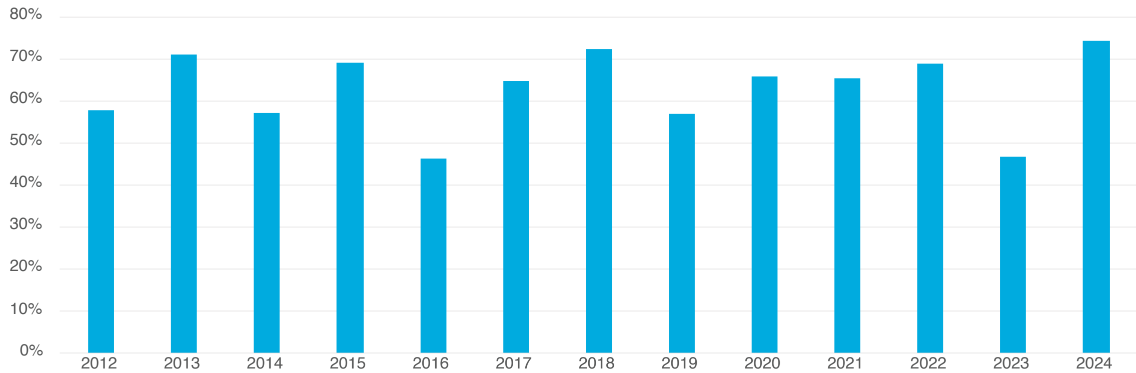
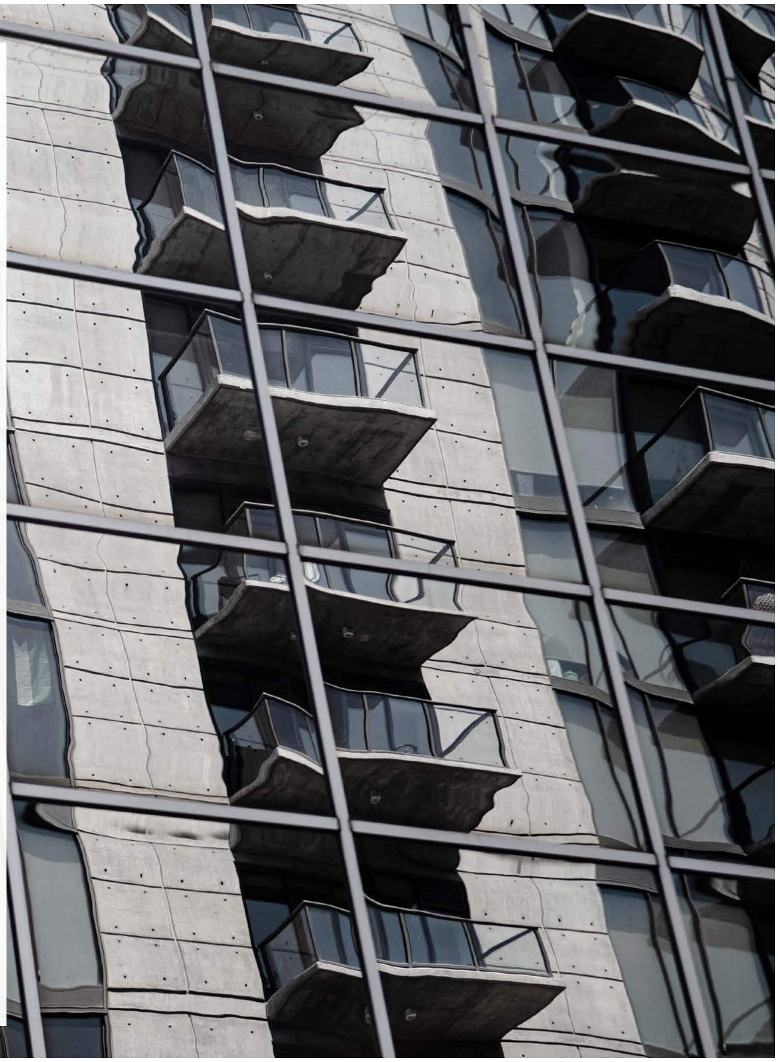


Chart 8

Percent of Panelists Planning New Multifamily Development
(Next 12 months, 8 markets, Winter Survey)



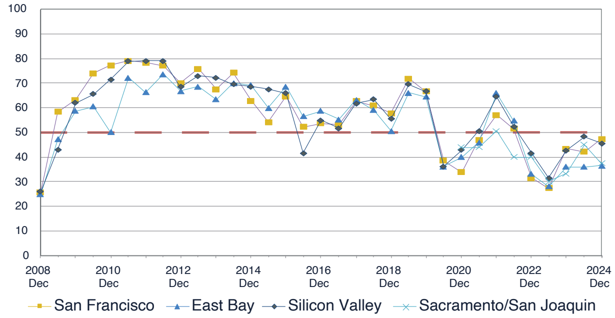


"In California, multifamily development is expected to increase this year. San Diego, the Inland Empire, and San Jose dominated California's multifamily development pipeline across 2024 in terms of percentage of inventory under construction."

- Jennifer Jeffers
Senior Counsel,
Allen Matkins

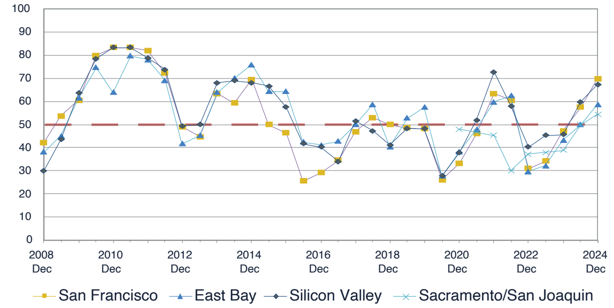
Bay Area Office Rental Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



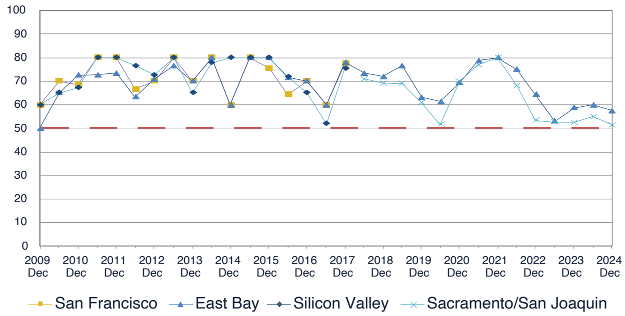
Bay Area Office Vacancy Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



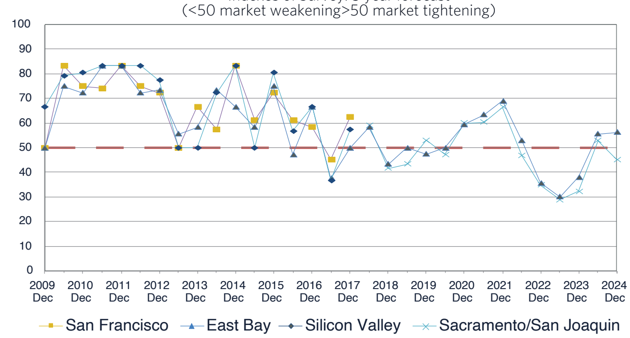
Bay Area Industrial Rental Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



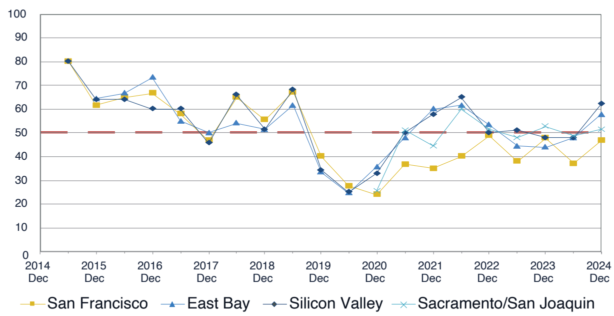
Bay Area Industrial Vacancy Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



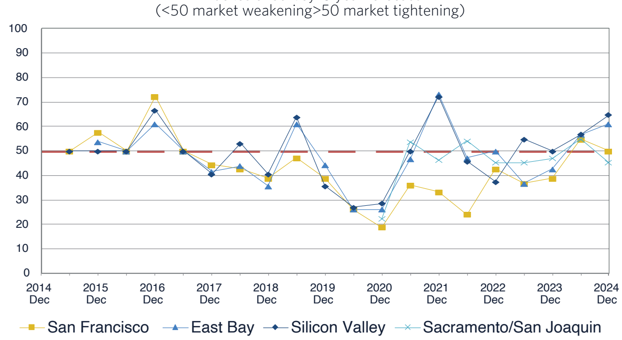
Bay Area Retail Rental Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



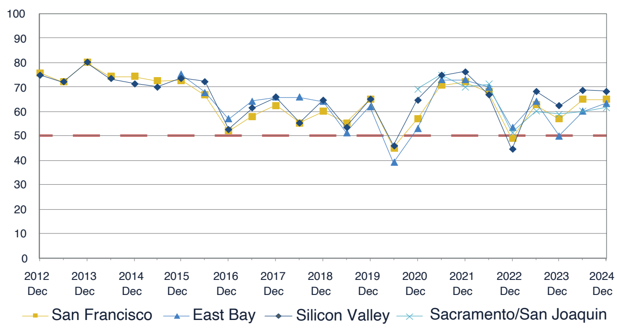
Bay Area Retail Vacancy Rates

Indexes of Survey: 3 year forecast
(<50 market weakening>50 market tightening)



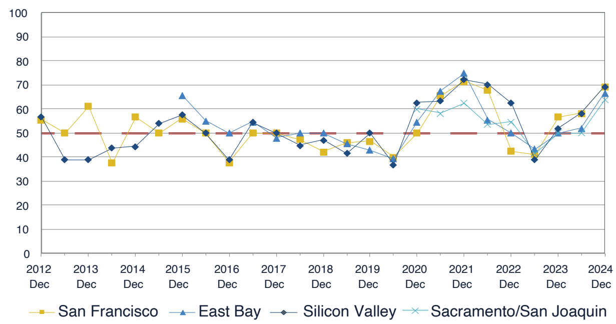
Bay Area Multifamily Rental Rates

Indexes of Survey Responses
(<50 market weakening, >50 market tightening)



Bay Area Multifamily Vacancy Rates

Indexes of Survey Responses
(<50 market weakening, >50 market tightening)



THE SURVEY IN PERSPECTIVE

The Winter 2025 Allen Matkins/UCLA Anderson Forecast California Commercial Real Estate Survey responses show an overall improvement in sentiments across several markets: retail, industrial, and multifamily. Higher numbers are noted in terms in commercial projects that have been developed in the last year, and even higher numbers are expected in the next year. Compared to the Summer 2024 Survey, expectations of financial requirements, and IRR thresholds are more relaxed, and expectations with respect to equity requirements are relatively mixed. The office sector is, as expected, still struggling.

"Key takeaways from the Winter 2025 survey show more investment into e-commerce and data center spaces, unstoppable momentum in the multifamily sector, and a positive outlook for retail."

- Spencer Kallick
Partner,
Allen Matkins

"Amidst the backdrop of a major political shift, policy changes and sustained drops in construction industry employment, the survey points to overall improvements and positive sentiments towards several commercial and multifamily markets over the next three years."

- Sayantani Sayantani
Economist,
UCLA Anderson Forecast and
UCLA Ziman Center for Real Estate

ALLEN MATKINS | UCLA ANDERSON FORECAST

COMMERCIAL REAL ESTATE SURVEY

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

Allen Matkins

1901 Avenue of the Stars
Suite 1800
Los Angeles, CA 90067
Phone: 310-788-2400
Fax: 310-788-2410

www.allenmatkins.com

UCLA Anderson Forecast

110 Westwood Plaza Gold Hall
Suite B305
Los Angeles, CA 90095
Phone: 310-825-1623
Fax: 310-206-9940

www.uclaforecast.com

For more information on this report, call 310-825-1623, email forecast@anderson.ucla.edu, or visit our website at www.uclaforecast.com.