THE ECONOMY

As 2012 draws to a close, the economic news for Los Angeles is just as much on the development front as the economic front. Big projects in both size and scope are getting off the ground. "The Cornfield" is a "660-acre area approximately two miles north of Downtown Los Angeles that abuts the communities of Chinatown, Solano Canyon, Lincoln Heights, and Cypress Park," according to the City Planning Commission. In an editorial that ran January 31st, *The Los Angeles Times* noted that, at long last, the city council's Planning Committee had passed an initial measure called the Cornfield Arroyo Seco Specific Plan. This plan will turn the "neglected neighborhoods and underused industrial properties next to the former Southern Pacific Railroad yard," the editorial states, "into a collection of new urban zones."

According to city planning documents, "the proposed project will guide the future development" by creating a series of "mixed-use zoning districts that allow private, public, and non-profit sector developers to combined retail, residential, commercial, civic and industrial uses" for a "human scale, engaging urban fabric." *The Los Angeles Times* editorial calls the move "a model for LA planning." The plan will be put before the entire city council for a regular vote in the near future.

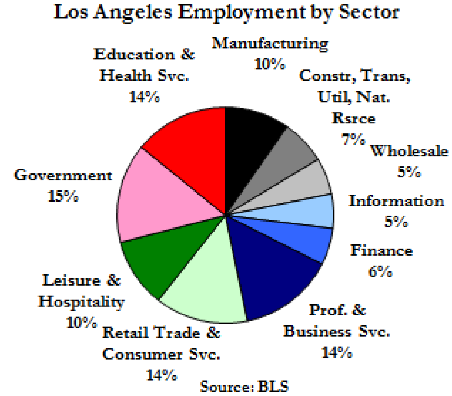
There is more on the development front, even to the extent of changing the Los Angeles skyline, or at least part of. On January 8th, city officials held a groundbreaking ceremony for the beginning of construction on the $1 billion Gerald Desmond Bridge Replacement Project. The Gerald Desmond Bridge connects Terminal Island to Downtown Long Beach and is the major bridge for the port of Long Beach. Originally built in 1968, the current structure is in poor repair and cannot handle its current traffic load, and will be replaced. The construction project will last about five years and will generate, on average, about 3,000 jobs per year, according to information posted on the project's website. The presence of the Ports of Long Beach and Los Angeles means a large Transportation and Warehousing sector, which employs about 139,000. However, this sector has posted an increase of only 400 jobs (0.3%) in the 12 months ending in November 2012, according to Current Employment survey data from the U.S. Bureau of Labor Statistics (BLS). Thus, the development of port facilities is a major issue for this metro.

Jobs are, of course, of prime concern as 2012 winds down and 2013 begins, and the employment news from the U.S. Department of Labor is

Employment:

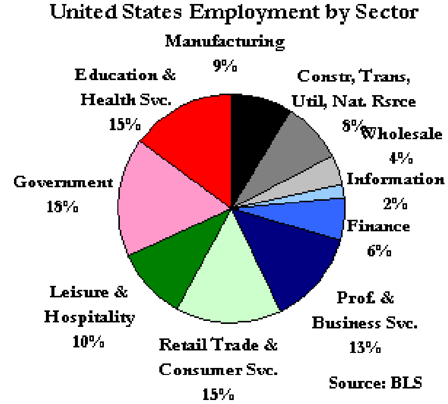
- *The BLS reports a seasonally unadjusted unemployment rate of 9.8% in November for the Los Angeles Metropolitan Division, down from 11.6% one year earlier.*
- *Total non-farm employment in Los Angeles was up 1.9% year-over-year in November, according the BLS.*
- *Moody's Economy.com reports a fourth quarter 2012 average household income of $133,474 for Los Angeles. Average household incomes of $125,057 and $127,162 are reported for the top metros in the nation and West region, respectively.*

Los Angeles Employment by Sector



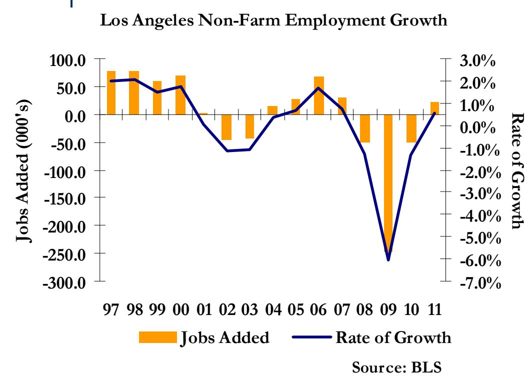
Source: BLS

United States Employment by Sector

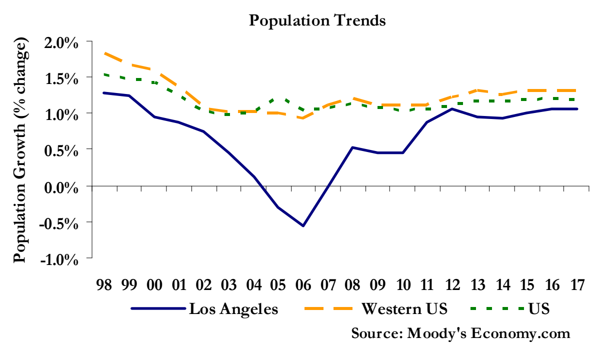


Source: BLS

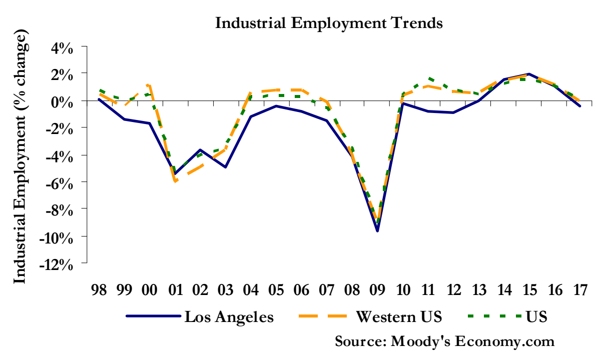
generally positive. For the 12 months ending in November 2012, total non-farm employment in the Los Angeles metropolitan division increased by 72,500 jobs (1.9%). This is not as large as the increase noted in the previous *Reis Observer*, but is an increase nonetheless. Construction increased by 2,100 jobs (2.0%), but Manufacturing continues to struggle here, losing 3,600 jobs (1.0%). Wholesale Trade, another employment sector keyed to port activity, was down 700 jobs (0.3%), while Retail Trade employment increased by 13,700 jobs (3.4%).



Yet again, Long Beach is in the news as the home of a developing street level retail renaissance. The *Los Angeles Business Journal* reported in late January that "a flood of development has poured into the city, much of it in response to an updated, more developer-friendly zoning plan adopted last January," this source reports. "Projects planned or under construction are expected to add up to 1,750 new residences, 533,000 square feet of office space, 400 hotel rooms and 53,200 square feet of retail space as well as a half-million square feet of civic space," according to the *Business Journal*.



As for Los Angeles itself, its employment mainstays were in good shape as the year ended. The ever-critical Motion Picture and Sound Recording Industries, for which Los Angeles is justly renowned, saw a substantial increase of 9,000 jobs (7.0%). Financial Activities, which employs over nearly 220,000, saw an increase of 9,300 jobs (4.4%). Professional and Business Services saw a strong increase of 18,900 jobs (3.5%) while Employment Services grew by 4,800 jobs (5.4%). The substantially government–funded Education and Health Services sector saw employment increase by 11,300 jobs (2.1%). The increase of 20,600 jobs in the Leisure and Hospitality sector indicates that tourism, once slow during the recession, could be making a comeback.



OUTLOOK

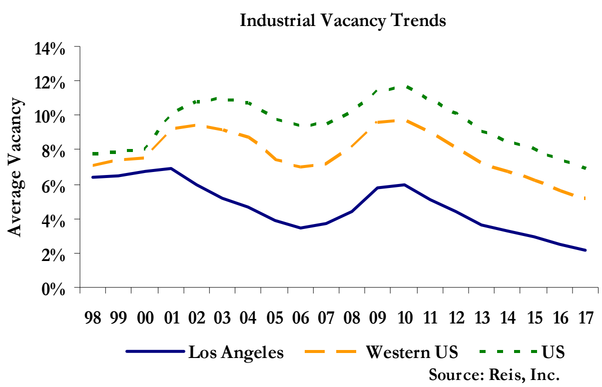
Moody's Economy.com reports that Total Employment in Los Angeles increased by 58,100 jobs (1.5%) in 2012 and is on tap to increase by 43,230 jobs (1.1%) in 2013. Office employment rose by 1.7% in 2012, and is estimated to rise by 12,200 jobs in 2013. These are not hefty gains but Los Angeles continues to gain in population (106,000 in 2012, 96,000 expected in 2013) so it is still a metro that attracts businesses and residents.

THE REAL ESTATE MARKET

In Los Angeles County, both Flex/R&D and warehouse/distribution space finished 2012 on solid ground. Rents increased, if modestly, and vacancy declined for both property types. Daum Commercial Real Estate services notes that vacancy decreased in the fourth quarter and rents gained year-over-year.

OCCUPANCY

Reis reports a fourth quarter 2012 vacancy rate of 7.9% for 444.6 million square feet of multi-tenant warehouse/distribution space in Los Angeles County, down 30 basis points from the prior quarter and 110 from the fourth quarter of 2011. The rate was 8.9% during the first quarter and worked its way downward. For 38.7 million square feet of multi-tenant Flex/R&D space, Reis reports a vacancy rate of 5.2%, down 40 basis points from the prior quarter and down 150 year-over-year. This rate has also worked it way down through the year, after ending first quarter at 6.6%. Both warehouse/distribution and Flex/R&D vacancies have improved considerably since 2010, which posted respective vacancy rates of 10.3% and 8.8%.



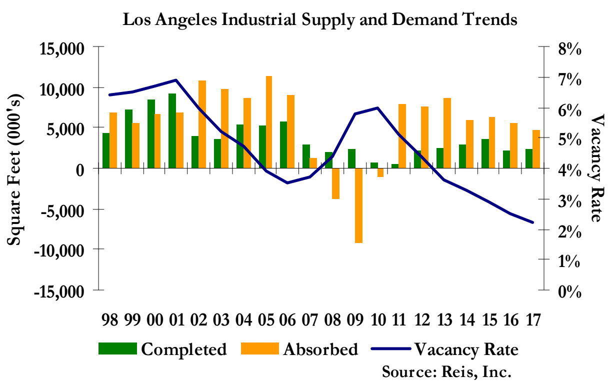
"Overall vacancy rates (including sublease space) decreased from 5.1% to 4.7% during the quarter," according to Daum. "Since the fourth quarter of 2011, overall vacancy rates have declined from 5.0% to 4.7%," according to this source. According to Newmark Grubb Knight Frank, "the year-end vacancy rate for the Los Angeles industrial market closed at 2.1% in the fourth quarter of 2012, remaining flat over the prior quarter and was 90 basis points below the 3.0% registered a year ago in the fourth quarter of 2011." Colliers reports a vacancy rate of 4.2% for Los Angeles County, down 20 basis points from the prior quarter, according to its fourth quarter Los Angeles Basin report. Reis forecast further declines in warehouse/distribution vacancy, to 7.4% in 2013, with Flex/R&D vacancy falling to 4.6%.

Special Real Estate Factors:

- *Politics is playing a part in the fortunes of a local bioresin company. The Los Angeles Business Journal reported in January that "struggling bioresin maker Cereplast Inc. is finally getting some new revenue, and it has government regulation in Italy to thank. The El Segundo Company, which supplies resin used to create environmentally friendly plastic packaging, has been waiting for the Italian government to tighten restrictions on the use of non-compostable resin. Now the government is moving forward on applying the regulations. Italy's parliament voted last month to confirm proposed sanctions on companies using traditional plastic bags and require a switch to bioplastic or other alternatives. Cereplast said last week it generated $500,000 in new business from clients in Italy in the previous six weeks in anticipation that the legislation will go into effect," the Business Journal reported.*

- *"The threat of another strike looms over the ports of Los Angeles and Long Beach. Members of International Longshore and Warehouse Union Local 63 Office Clerical Unit have voted to reject the tentative labor agreement that ended the eight-day strike that shut ten container terminals late last year," the Marine Log reported in February. "The LA Times reports that with the tentative agreement rejected, clerical employees will be working under the terms of their expired contract and says that*

SUPPLY AND DEMAND



Warehouse/distribution space posted 2 million square feet of positive net absorption in the fourth quarter, bringing the 2012 total to 6.3 million, slightly above the total recorded for 2011, and a vast improvement over the negative 1.8 million recorded for 2010. For Flex/R&D space, fourth quarter saw 171,000 square feet absorbed, bringing the year's total to 596,000 square feet. This is in fact a decline from the 813,000 recorded in 2011, but again, an improvement of the negative 394,000 recorded in 2001. The overall Los Angeles industrial market, like many others, took some time to come out of the economic downturn of 2008-2009, and it showed in the market's indices. The Flex/R&D demand total is of note in that it comes at a time of no new construction. According to Reis' latest construction data, there was no such space completed in 2011 or 2012. Warehouse/distribution construction, however, has been more active. Reis' latest construction data indicate 1.6 million square feet of such space completing in 2012.

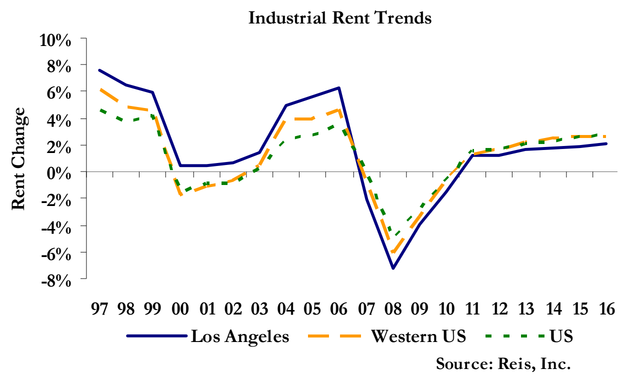
"During the quarter, gross absorption finished with 18.6 million square feet of activity, up 46% compared to the previous quarter, and higher by 63% compared to a year ago. Net absorption posted a gain of 4.5 million square feet of occupied space during the quarter, and finished with a gain of 5.5 million square feet for the year. In 2011, the market gained 2.8 million square feet, after losing 800,000 square feet during 2010," according to Daum. "Year-to-date net absorption for warehouse/distribution logistics represented over 4.5 million square feet of total net absorption in the market," according to Newmark Grubb Knight Frank. Colliers reports 8.4 million square feet of net absorption in 2012 including 2.2 million square feet during the fourth quarter. This source reports 1.6 million square feet under construction and 5 million more planned. Looking forward, Reis reports 1.4 million square feet of warehouse/distribution space under construction for completion in 2013, although no Flex/R&D space is on tap. All told, 782,000 square feet of Flex space is forecast to complete from 2013 to 2017, and 8.1 million of warehouse/distribution.

Special Real Estate Factors:
Continued

operations at the ports of Los Angeles and Long Beach are continuing as usual." "It's not clear today what will happen next," the newspaper quotes Steve Getzug, a spokesman for the Harbor Employers Association as saying.

- *Commercial real estate is improving. Take that from a December study by the USC's annual Casden office and property forecast, the Los Angeles Times reported. "The office and industrial real estate sectors continue to improve for Southern California landlords," according to the report, "but high office vacancy will remain common for the foreseeable future as businesses put more workers into less space. The regional economy has strengthened the past year and enabled some businesses to hire more workers" the Casden report stated. "That has resulted in higher occupancy and rising rent for industrial buildings, while office landlords are seeing rising occupancy and smaller declines in the amount of rent they can charge."*

RENTS



Warehouse/distribution rents posted modest but positive gains in 2012, Reis reports. Average asking and effective rents increased 0.3% and 0.4%, respectively, over the fourth quarter, to $6.06 psf and $5.59 psf. These rates are up 1.7% and 2.2%, respectively, year-over-year. For Flex/R&D space, the average asking and effective rents were both up 0.2% during the fourth quarter, to $11.03 psf and $9.90 psf. The year-over-year gains are 0.9% and 1.0%. For warehouse/distribution space, Reis predicts gains of 1.5% asking and 1.8% effective for all of 2013, with similarly modest gains to follow. Not until 2016 does Reis forecast increases of 2.0% for both rental categories. For Flex/R&D space, gains of 1.0% asking and 1.3% effective are forecast for 2013. Reis' forecast still calls for rent increases improve over the forecast period, but remain below 2.0% through 2016.

According to Daum, "standard industrial asking rental rates increased 3.7%, year-over-year, moving from $0.54 NNN to $0.56 NNN ($6.48 psf to $6.72 psf)." Daum reports that of the four major markets within Los Angeles County, the LA-North market ended the quarter with the highest standard industrial rental rate of $7.68 psf, followed by the LA-West/South market at $7.08 psf, the LA- Central/SE markets at $6.12 psf, and the San Gabriel Valley market at $6.00 psf. According to Newmark Grubb Knight Frank, "the average asking rent for warehouse/distribution space ended the quarter at $0.48/sf ($5.76 psf)." This is one cent above the year-end 2011 rate. Colliers reports an average asking rent of $6.24 psf for Los Angeles County. In 2013, according to this source, the market "should see higher rental rates and higher sales prices as the vacancy rate will continue to decline. In certain tighter industrial markets, tenants will have to get creative in order to find space that will meet their industrial demands, or they will have to move into neighboring and potentially less desirable markets in order to find their ideal space."

SUBMARKETS

The South Bay area is the home of the ports of Los Angeles and Long Beach, and the key to the region's economic prosperity, although distribution centers are located throughout the county and further inland, particularly in the Mid Cities submarket. The San Gabriel Valley contains more traditional manufacturing, along with high-tech and distribution space while the San Fernando Valley is more technology and local-market oriented. Labor-intensive light manufacturing, including apparel and toys, is clustered in the central areas.

San Fernando Valley

- Reis reports a vacancy rate of 18.1%, highest among eight submarkets, and an average asking rent of $8.65 psf, also the highest countywide, for 6.6 million square feet of warehouse/distribution space in the San Fernando Valley West submarket.

- The vacancy rate is down 520 basis points year-over-year including 60 in the fourth quarter. Rents were mostly flat this quarter, with the average asking rent unchanged for the quarter and the average effective rent up 0.1% $7.79 psf. The year-over-year increases are 2.1% and 3.0%, respectively.

- For 22.2 million square feet of warehouse/distribution space in the San Fernando Valley East submarket, Reis reports a vacancy rate of 7.3%, and an average asking rent of $7.26 psf.

- There, the vacancy rate is down 40 basis points from the prior quarter and 170 from a year earlier. The average asking rent is up 0.1% from the prior quarter and up 0.8% year-over-year, while the average effective rent is unchanged for the quarter and up 1.4% year-over-year to $6.71 psf.

- Reis reports a vacancy rate of 9.2% and an average asking rent of $12.30 psf for 3.1 million square feet of Flex/R&D space in the San Fernando Valley West submarket.

- The vacancy rate is up 120 basis points from the prior quarter, and up 60 year-over-year. The asking average decreased 0.3% during the fourth quarter, with the average effective rent down 0.4% to $11.07 psf. Rents increased 1.2% by both measures during 2012.

- The vacancy rate for 2.1 million square feet of Flex/R&D space in the San Fernando Valley East submarket is 5.6% according to Reis, while the average asking rent is $8.61 psf.

- Flex/R&D vacancy is down 320 basis points from a year earlier and down 140 from the prior quarter. The average asking rent is up 0.2% for the quarter and down 0.3% from a year earlier, while the average effective rent is up 0.4% during the quarter at $7.74 psf. It is up 0.9% year-over-year.

- For a 223 million-square-foot LA North submarket that also includes the Los Angeles County portion of the Inland Empire, Cushman & Wakefield reports an overall vacancy rate of 4.8%, down 20 basis points over the year, and a direct weighted average net rental rate of $7.08 psf for warehouse/distribution space and $9.84 psf for office service.

- "East San Fernando Valley accounted for 31.9% of the markets' leasing total with 2.1 msf (million square feet)," according to Cushman & Wakefield. The East valley was the healthiest submarket in terms of met demand, with the net absorption of 437,810 square feet, mostly due to the FedEx's occupancy of a 230,000-square-foot build-to-suit distribution center in Pacoima in the third quarter, this source reports.

San Gabriel Valley

- In the San Gabriel Valley, Reis reports a fourth quarter vacancy rate of 8.8% and an asking rent of $6.23 psf for 16.1 million square feet of multi-tenant warehouse/distribution space.

- The vacancy rate is down 70 basis points over three months and down 140 year-over-year. The average asking rent and the average effective rent were both up 0.2% over the quarter, the latter at $5.71 psf. Rents are up 0.6% and 1.1% from a year earlier.

- This is one of Los Angeles County's largest industrial markets according to other sources, but the Reis inventory is small. This implies that a large share of the space is single-tenant, owner-occupied or general industrial space.

- Moreover, Reis breaks out some of the more prominent industrial areas, such as City of Industry, in its separate and adjacent E. Los Angeles/Covina/Pomona Corridor submarket, which has 83.9 million square feet of warehouse/distribution space. Here Reis reports a vacancy rate of 7.5% and an average asking rent of $6.12 psf. The average effective rent is $5.59 psf. These rents are up 1.3% and 1.8% over 12 months.

- For 2.4 million square feet of Flex/R&D space in the San Gabriel Valley, Reis reports a vacancy rate of 6.2% and an average asking rent of $10.95 psf.

- The vacancy rate increased 40 basis points in the fourth quarter, and is down 20 from one year earlier. The average asking rent and the average effective rent both increased 0.2% in the fourth quarter, the latter to $9.86 psf. The year-over-year increases are 0.1% and 0.2%, respectively.

- Cushman & Wakefield reports an overall vacancy rate of 4.8% and a direct weighted average net rental rate of $5.64 psf for warehouse/distribution space and $9.72 psf for office/service in the San Gabriel Valley. This source gives an inventory of 191 million square feet.

- This source reports that San Gabriel Valley led the region in user sales with 2.8 million square feet of activity, 67.0% higher than last year. According to Cushman, "in terms of leasing demand, San Gabriel Valley improved the most in 2012 with a 33.9% increase in activity this year," a significant uptick in demand fueled by 19 new deals over 100,000 square feet.

South Bay

- The South Bay submarket is home to the Ports of Los Angeles and Long Beach. Reis reports a fourth quarter vacancy rate of 8.9%, and an asking rent of $6.49 psf for 101 million square feet of multi-tenant, warehouse/distribution space.

- This submarket posted 630,000 square feet of positive net absorption in the warehouse/distribution category in the fourth quarter, for an annual total of 2.1 million square feet. The vacancy rate is down 20 basis points for the quarter and down 130 year-over-year.

- The average asking rent rose 0.5% during the fourth quarter as did the average effective rent, to $6.01 psf. The asking average is up 2.5% year-over-year, and the effective average is up 3.4%.

- According to Reis' latest construction data, Buildings 1 through 4 of Pacific Pointe North in Long Beach, totaling 265,123 feet, completed in 2012. The Avalon Industrial Center and the Watson Corporate Center, at 230,000 square feet and 225,000 square feet, respectively, also completed in South Bay in 2012.

- Reis reports the Pacific Pointe Buildings 5, 6, and 7 are under construction for completion in 2013, totaling 413,152 square feet. Also under construction but with no completion date in the South Bay submarket is the Victoria Street office/warehouse project, at 17,865 square feet.

- The Xebec Commerce Center Buildings 1 and 2 are under construction in South Bay as well, at 173,000 and 263,000 square feet, respectively. Both have early 2013 completion dates.

- For 9.0 million square feet of Flex/R&D space in South Bay, the most among the submarkets, Reis reports a vacancy rate of 6.1% and an average asking rent of $10.47 psf.

- The vacancy rate decreased 40 basis points in the fourth quarter on 40,000 square feet of positive net absorption, and is down 140 from a year earlier. The average asking rent is up 0.2% for the quarter and up 1.4% from a year earlier. The average effective rent increased 0.1% for the quarter and 2.0% for the year to $9.50 psf.

- According to Cushman & Wakefield, the South Bay industrial market's occupancy gains of 353,500 square feet in the fourth quarter bought 2012's total overall net absorption to 1.5 million square feet, "more than double 2011's total of 656,115 sf." However, new construction added over 690,000 square feet in the quarter, causing South Bay's "overall vacancy" to increase slightly to 5.1%. This source reports a direct weighted rent of $6.84 psf for warehouse/distribution and $9.84 psf for office/service.

Central Los Angeles

- In Central Los Angeles, the older but intensely-used industrial submarket surrounding Downtown Los Angeles, Reis reports a vacancy rate of 6.8%, lowest among the submarkets, and an average asking rent of $5.94 psf, for 77.3 million square feet of multi-tenant warehouse/distribution space.

- The vacancy rate is down 40 basis points for the fourth quarter and 100 from one year earlier on 270,000 square feet of positive net absorption for the quarter, and a solid 777,000 for the year. The average asking rent is up 0.2% over three months and 2.4% over twelve months. The average effective rent is up 0.2% and 3.2%, respectively, to $5.52 psf.

- For 8.2 million square feet of multi-tenant Flex/R&D space, Reis reports a vacancy rate of 2.2%, and an average asking rent of $14.40 psf.

- The vacancy rate fell 110 basis points in the fourth quarter on 88,000 square feet of positive net absorption. The total for the year was 438,000 square feet. The average asking rent increased 0.3% for the quarter, with the average effective rent up 0.6% to $12.77 psf. The year-over-year gains are 2.1% and 2.8%, respectively.

- The Central Los Angeles market's "overall vacancy was unchanged at 3.9% at year-end and rental rates remained on the same course, with little change in the past 12 months," according to Cushman & Wakefield. This source notes that "in Commerce, KTR Capital Partners started construction on the largest speculative projects in the region since 2007," a 620,000-square-foot building on the 27.5-acre former ICI Glidden Site.

- This source reports an overall asking net rental rate of $5.52 psf, "only $0.01 psf/mo (per square foot per month) higher than this time last year, but 12.2% higher than the recent low in 2010."

OUTLOOK

Writing about Los Angeles County, Daum reports that "the overall market fundamentals continue to improve as net absorption nearly doubled from 2011 to 2012, while vacancy levels have reached their lowest level since 2009. Average asking rents are now trending higher and the time to lease space is moving lower." This source projects that they "expect to see market fundamentals strengthen further in 2013, with vacancy declining, while rents and sale prices continue to trend upward." Reis forecasts gradually declining vacancy rates for both warehouse/distribution and Flex/R&D space, although rent growth, while positive, will be modest the next few years.