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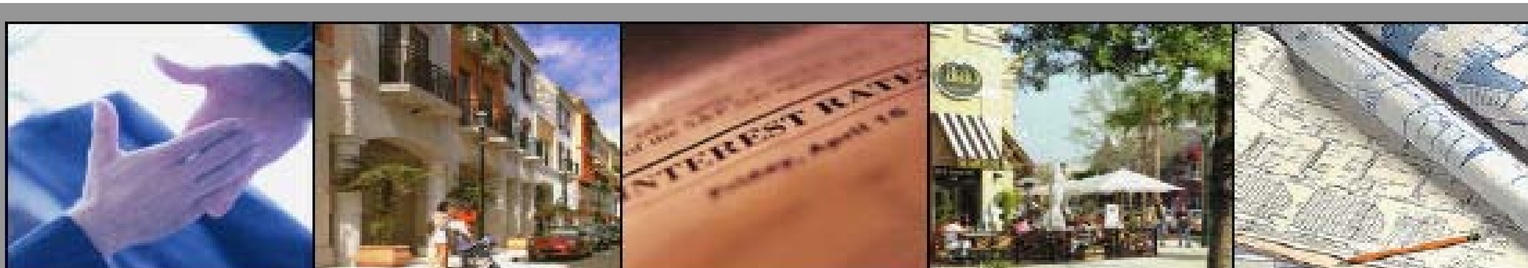
Real Estate and Economic Advisory

Kosmont Realty Corporation

Funding Solutions for Public-Private Deals



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CCA | Central City Association of LOS ANGELES

PRESENTS:

2012 Economic Forecast

Base Hit, Ball or Strike?

Presented by:

Larry J. Kosmont, CRE
President & CEO, Kosmont Companies

Research and Production: **Matt Goulet, Kosmont Companies**

Season Preview

- **The State of the State**

  Bases loaded, Bottom of the 9th…

- **Cities & Business Play Hardball**

  A Curve Ball from the State

- **What's Hot & What's Not in Los Angeles**

  MVP's and Rookies

- **Downtown LA**

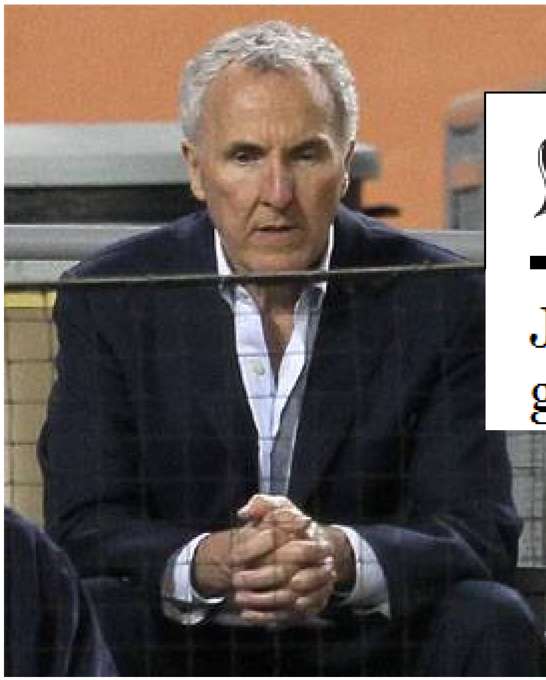
  Back in the Major Leagues

- **Outlook 2012**

  Bringing it Home

The State of the State

California Housing Crisis

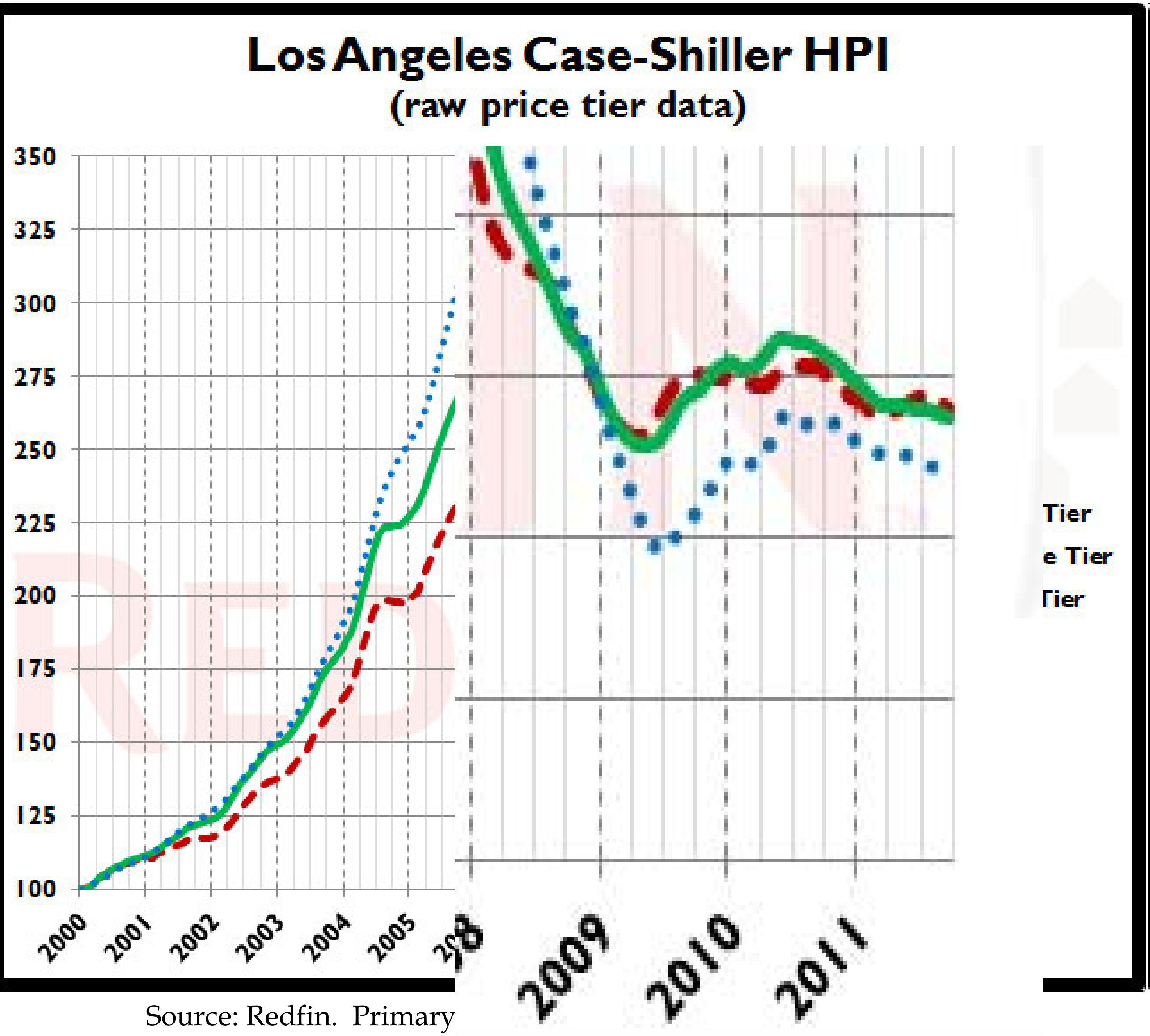


Los Angeles Times | SPORTS

Jamie McCourt gets four homes, Frank McCourt gets two

Home Prices

HOME PRICES – A Statistical "Grounder"



Source: Redfin. Primary

PRICES/SALES STABILIZING WITH POSSIBLE MODEST GROWTH

But…

<u>HURDLES REMAIN:</u>

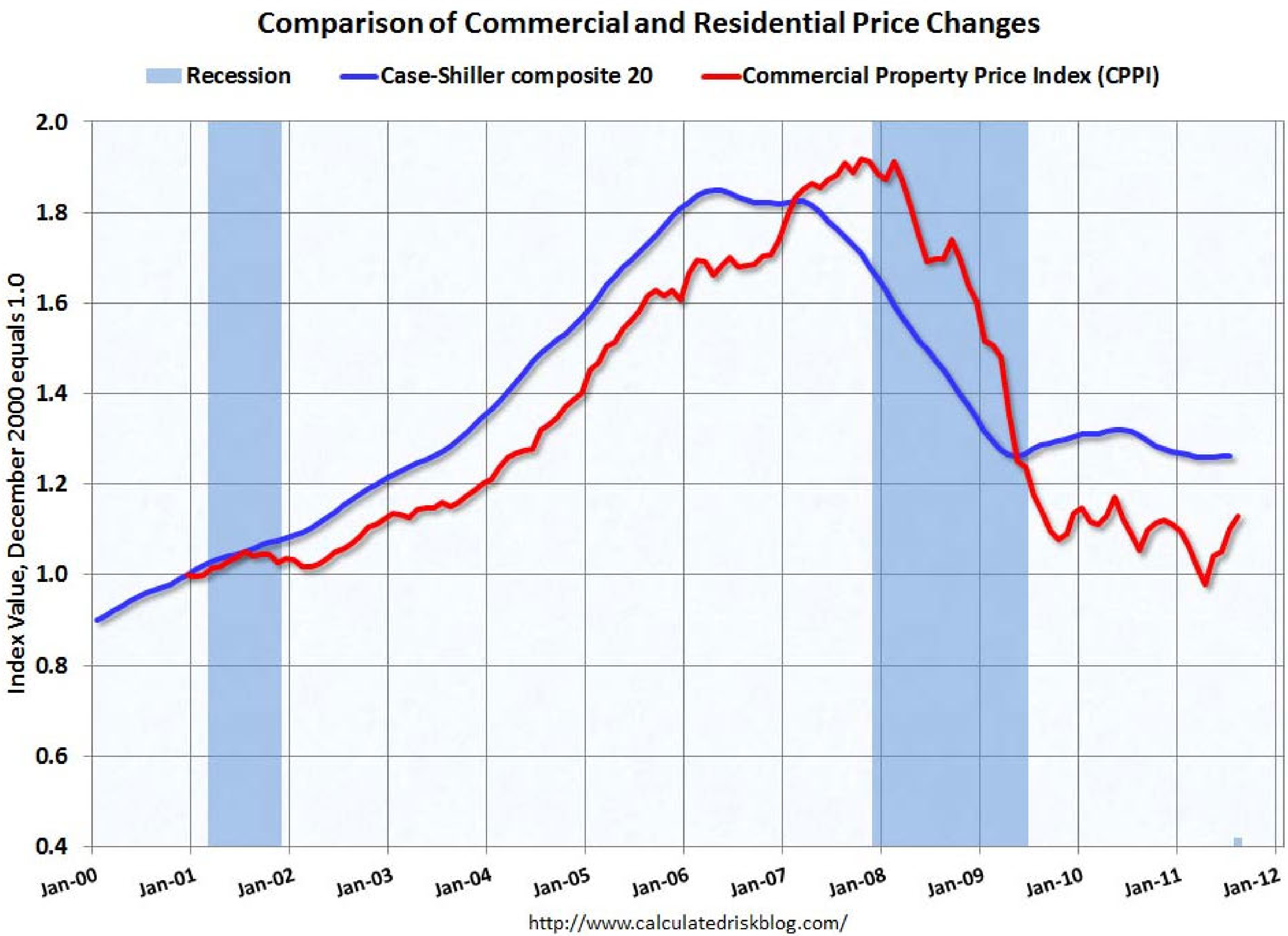
- UNEMPLOYMENT

- VACANCIES

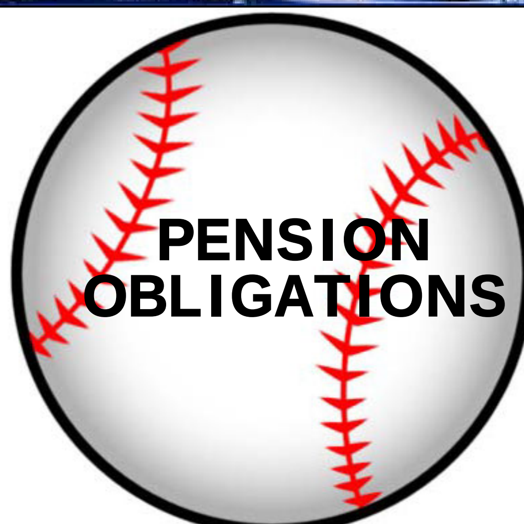
- FORECLOSURES INCREASING THE SUPPLY

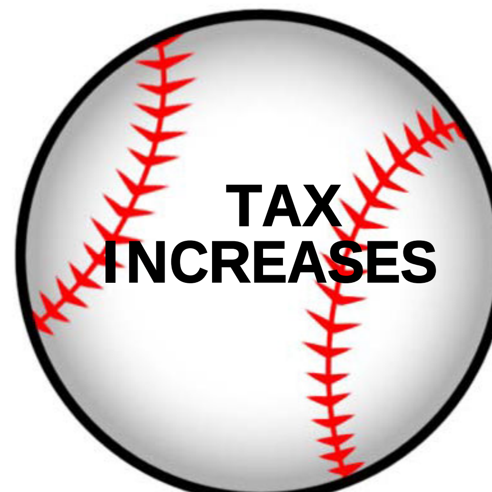
-MORTGAGE AVAILABILITY

Commercial Real Estate

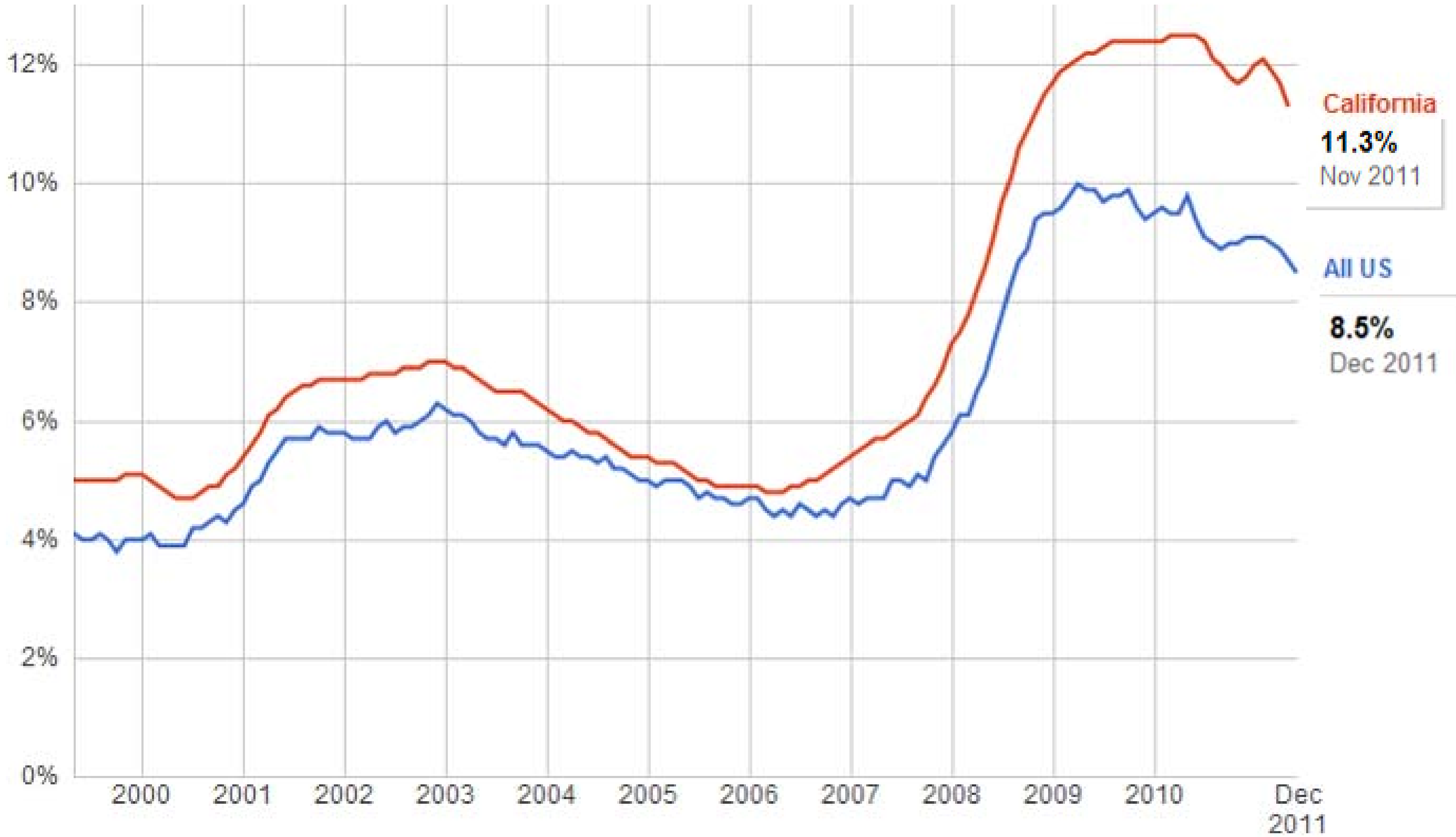


California's Starting Lineup



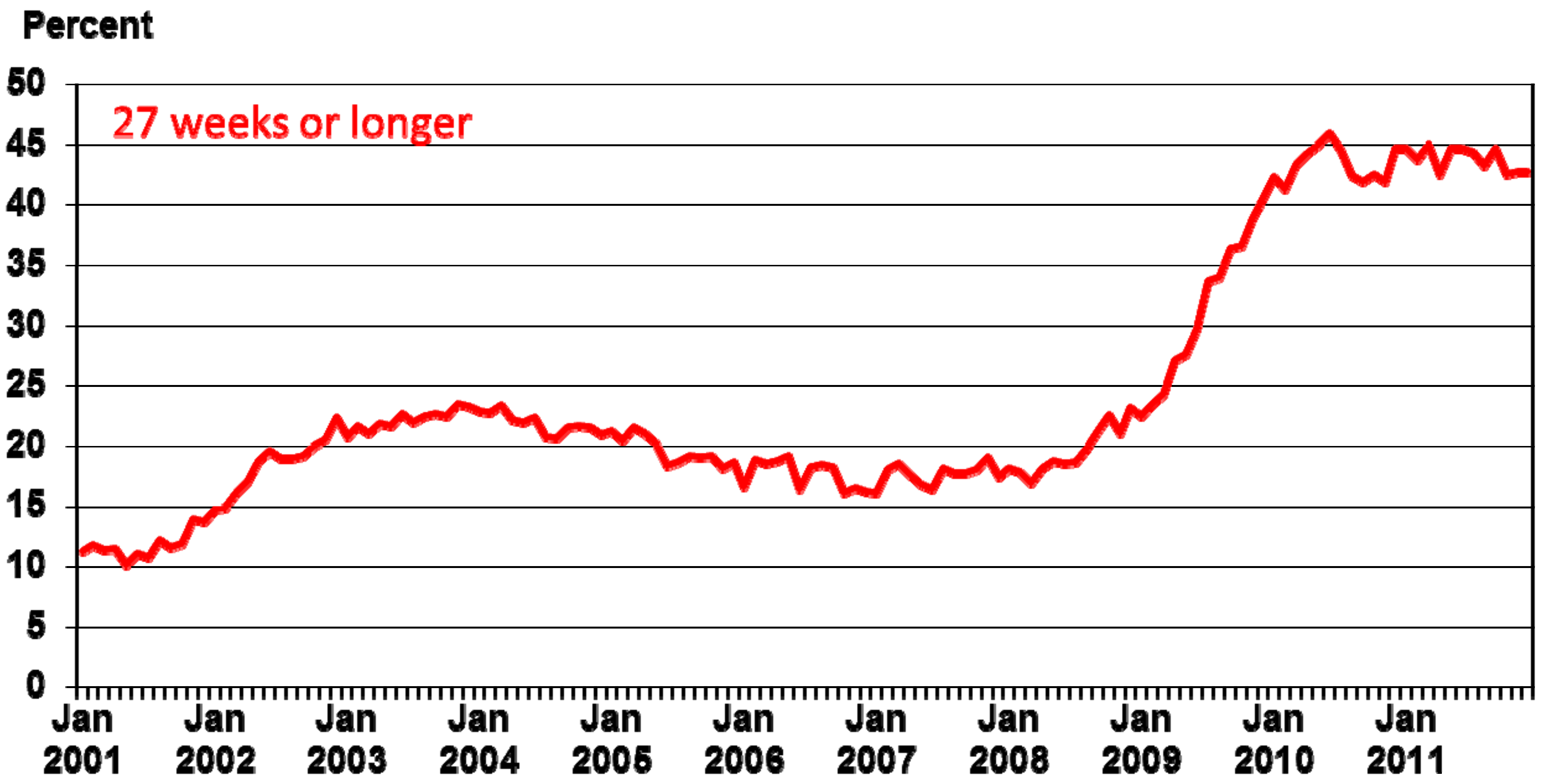


Unemployment Rate Down



Source: U.S. Bureau of Labor Statistics

But...Long term # unemployed not budging



Source: BLS, City National Bank

Pension Obligations – An Ongoing Threat

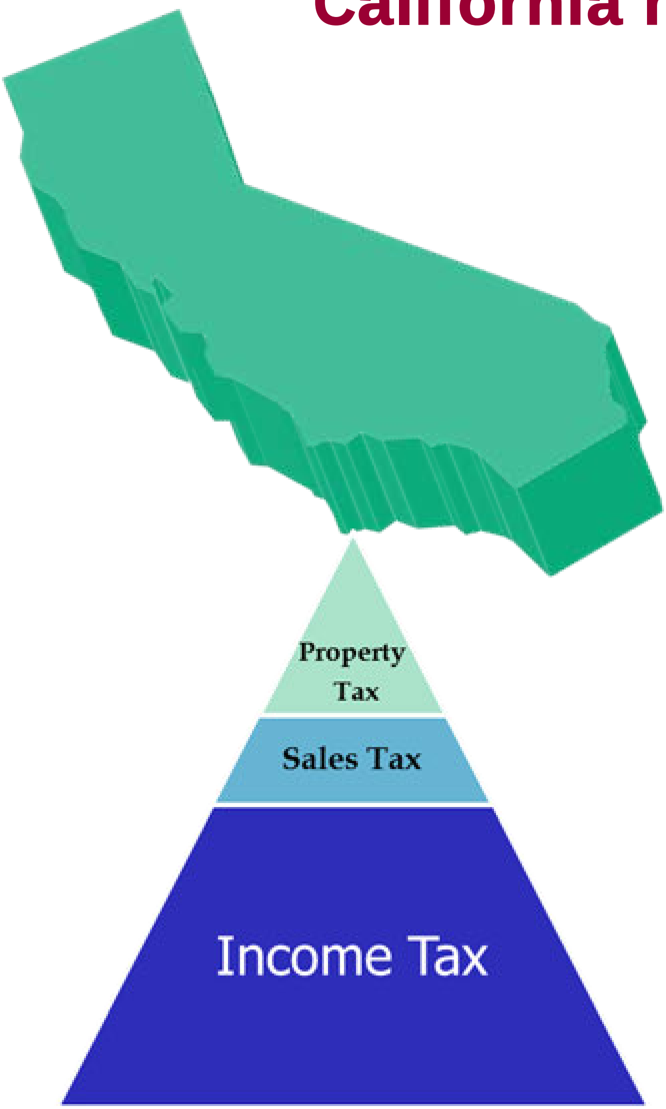
- **Stanford Univ. estimates unfunded deficit *EXCEED* $500B dollars over next 16 years**
- **Over 15,000 retired public workers with pensions *> $100,000 annually***
- **Today most public employees can retire in 50's with pensions at 90% of salary**
- **Santa Ana, arguably Orange County's most labor friendly city, is pressing labor unions to share pension benefit costs**
- **Last Nov. voters approved modest pension reforms in San Fran, San Jose, Vallejo, Palo Alto, Modesto & San Luis Obispo**

GOV. BROWN PROPOSING INCREMENTAL REFORM IN 2012

Source: California Foundation for Fiscal Responsibility; Ballotpedia

California Three Main Tax Sources

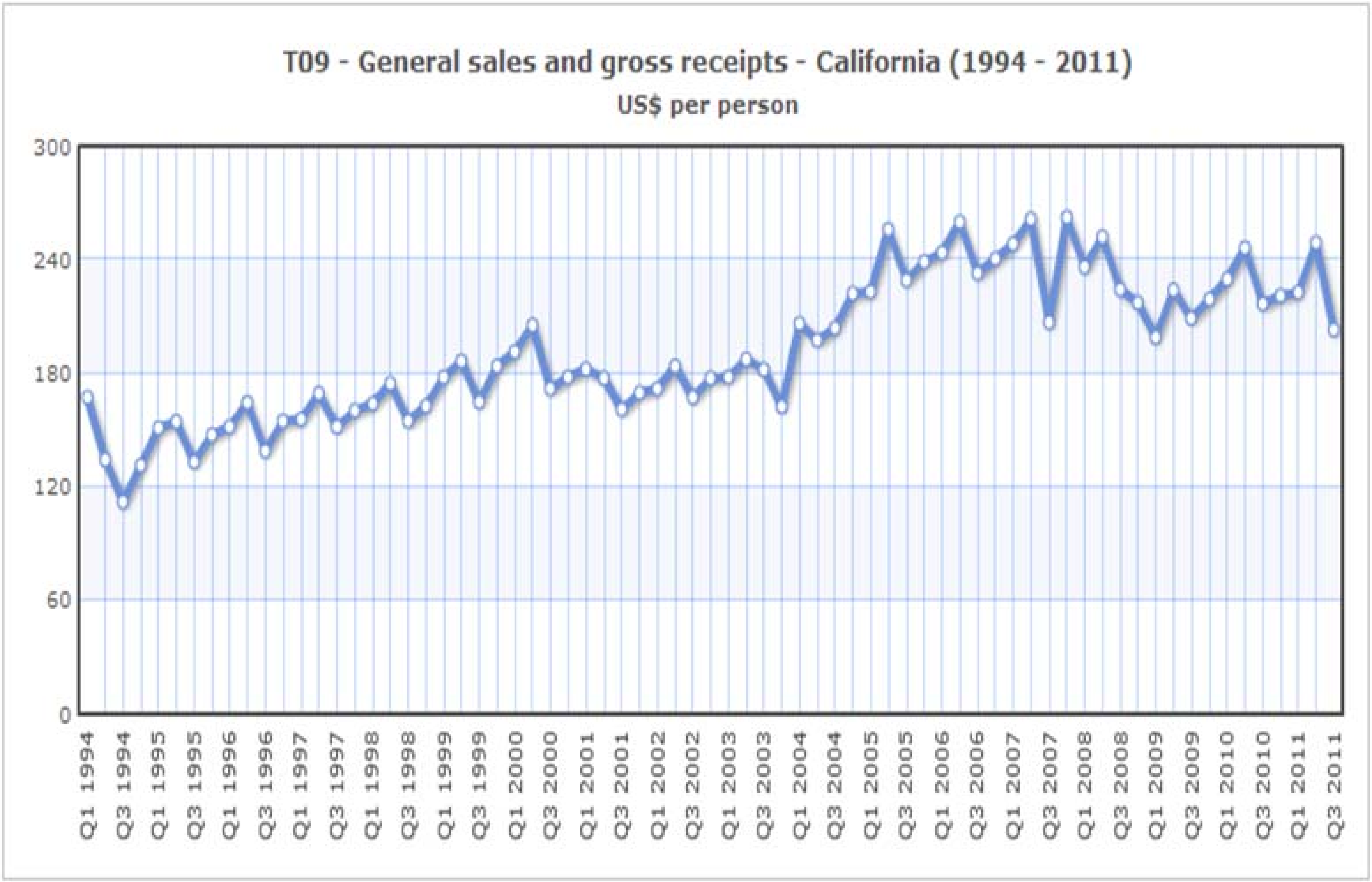
California has three main sources of revenue: income, sales, and property tax



- Income tax is CA's ***largest*** revenue source
- Top income earners sway the state budget
  - Personal Income Tax = 51% CA's total revenue in 2010
  - Those making over $200K comprise 50% of all income tax
- Sales Tax is prone to dramatic shifts in customer spending

Source: California Legislative Analyst; CA Dept of Finance

Sales Tax per Capita



Source: U.S. Census Bureau; IndexMundi.com

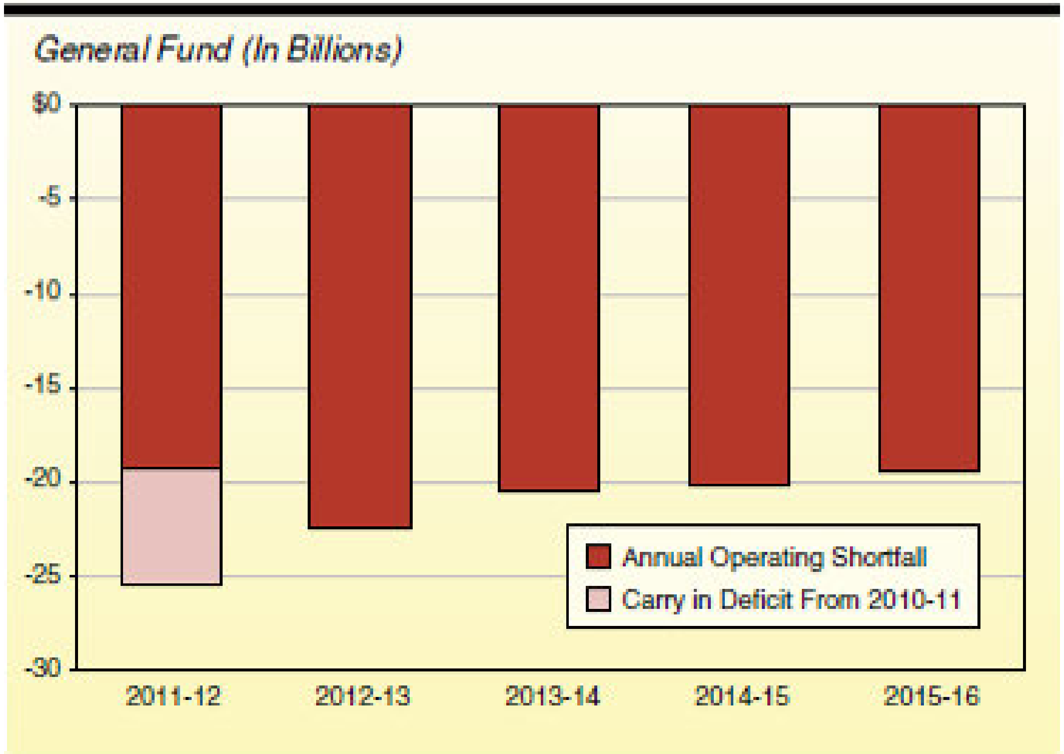
From Losing Streak to Comeback Kid?

- California still facing a **$9.2 billion** deficit this year. Structural deficit remains yet reduced. Budget up to $92.5B, $7B more than 2011-12.
- Economic distress hitting all tax categories for 5th year in a row (sales, property, income, hotel, etc.).
- Pension Fund obligations are severely underfunded and increasing.
- Redevelopment extinct – casualties include 1000's of jobs and 100's of projects.
- AARP rated California as the second worst (after Illinois) state to retire due to high cost of living and fiscal mess. ***BUT in 2011:***

  CA HITS A SINGLE! **– after years of losing population, California regained its status as an "net inbound" state in 2011, attracting more arriving than departing families.**

Source: Office of the Governor; AARP

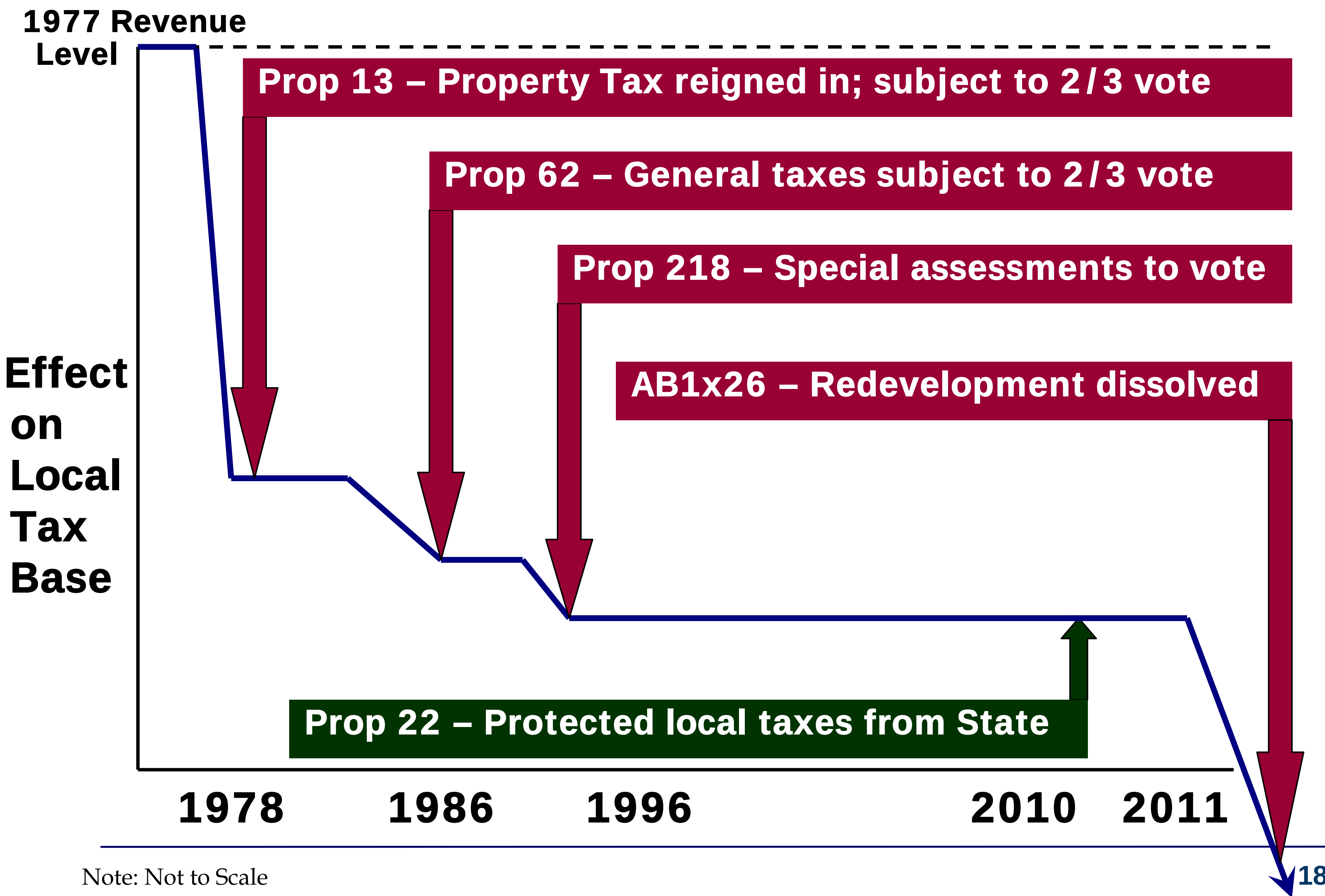
Budget Crisis



Source: Chief Legislative Office, State of California, 2011.

What the Heck Happened?

33 Years of "Tax Strikes"



Note: Not to Scale

Redevelopment – Shut Out

All RDA's officially closed on Feb 1st.

48 states have Tax-Increment Financing (TIF).
California does not.

Redevelopment - Shut Out

Some Local Governments in critical condition

- **Immediate unemployment of thousands from layoffs in over 400 redevelopment agencies**
- **CRA/LA alone has 74,000 construction jobs and 40,000 permanent jobs at risk**
- **Loss of jobs funded by RDA $$'s *including police and fire in some cities***
- **Private sector job losses from derailed projects**
- **Litigation expected, due to AB1x26's chaotic and unclear dissolution process**

Private sector expecting opportunities to buy real estate at a discount - but expect delays.

Source: California Redevelopment Association; CRA/LA

Successor Entity Process

State Department of Finance ("DOF")

State Controller's Office ("SCO")

All Oversight Board decisions subject to DOF & SCO approval

Oversight Board
(Schools/Counties/Cities/Districts)

All Successor Entity actions require Oversight Board approval

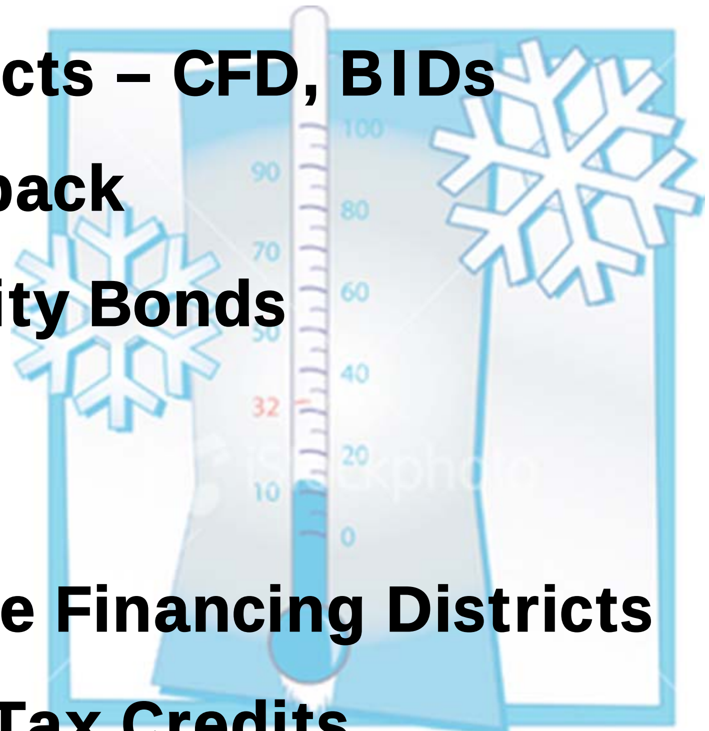
Successor Entity
(City / County / State)

Performs enforceable obligations
Terminate/default on contracts
Dispose assets of former Agency

[Former] Redevelopment Agency

Terminated as of February 1, 2012

What’s Left after Redevelopment?



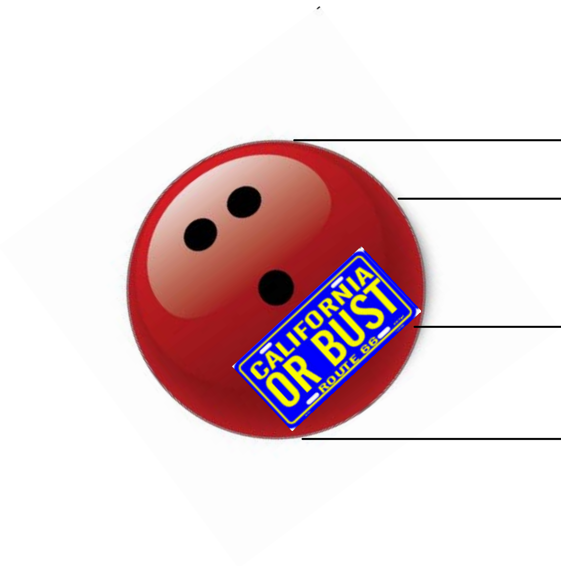
Existing Economic Development Tools

- **Special Districts – CFD, BIDs**
- **Lease-Leaseback**
- **Private Activity Bonds**

New Tools

- **Infrastructure Financing Districts**
- **New Market Tax Credits**
- **CA Infrastructure Development Bank**
- **EB-5: Immigrant Investor Program**

Cities and Business Play Hardball



Kosmont-Rose Institute
2011 Cost of Doing Business Survey

- First published by Kosmont Companies in 1994; gifted to Rose Institute in 2004
- 2011 edition of the Survey: 417 cities across all 50 states
- Classifies cities into five "Cost Ratings" in terms of their relative cost of doing business:

($) Very Low Cost

($$) Low Cost

($$$) Average Cost

($$$$) High Cost

($$$$$) Very High Cost

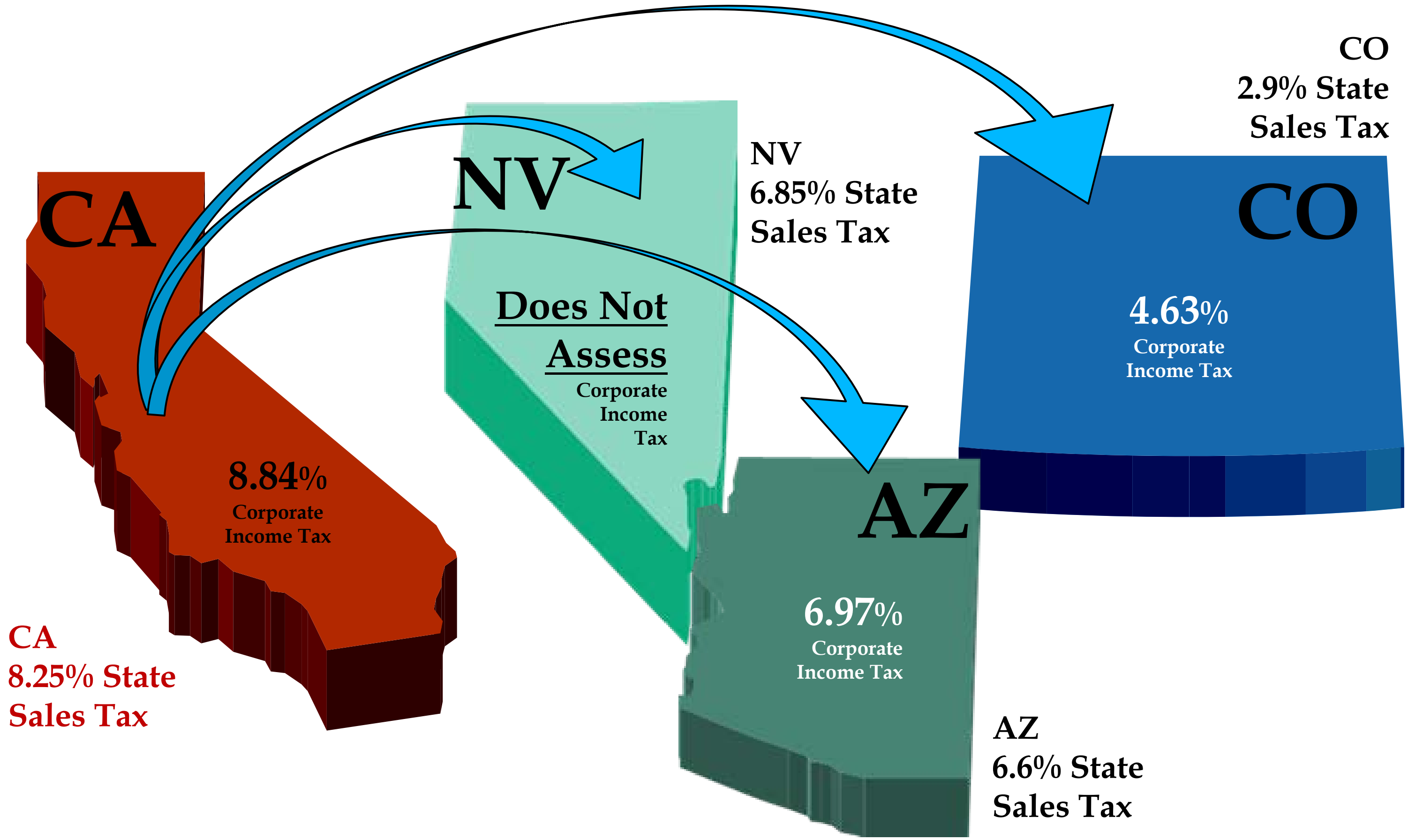
All 20 lowest cost cities are located west of the Mississippi River, but none are in California

California has 16 of the 50 most expensive cities but only 9 of the 50 least expensive cities

Source: Kosmont-Rose Cost of Doing Business, 2011

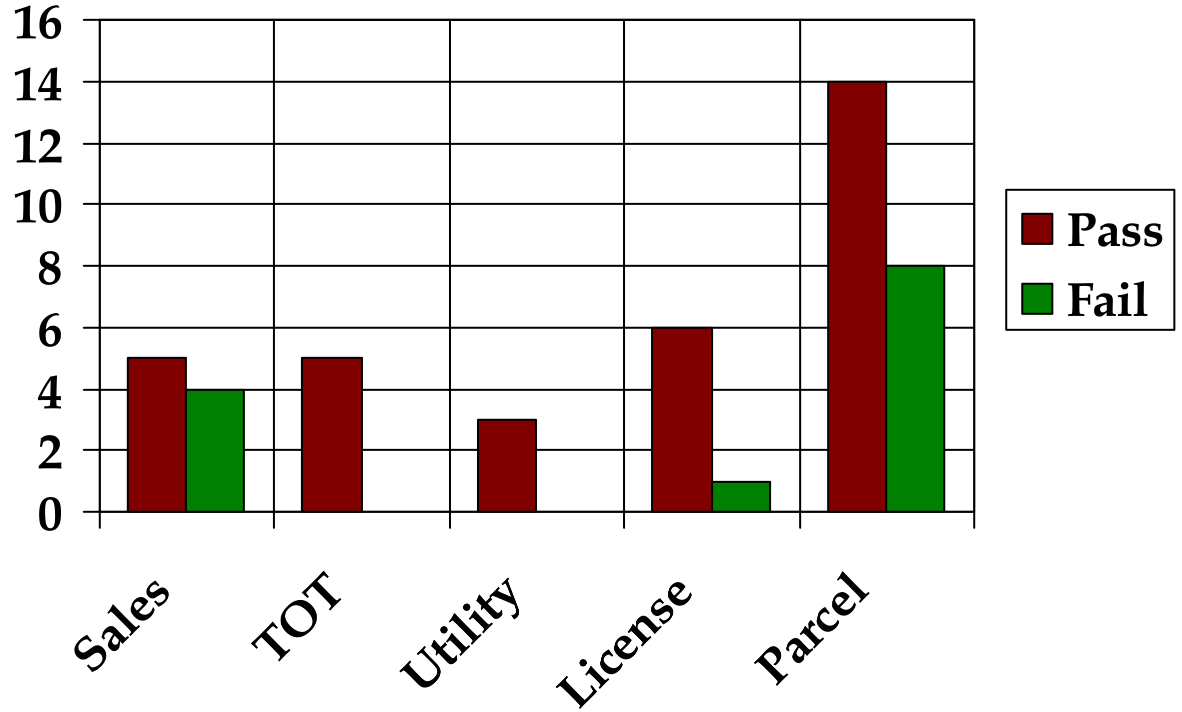
California Cities Play to Win

As California *raises its taxes*, it continues to *lose businesses* to Arizona, Colorado & Nevada



Local Government Swinging Two Bats

Ongoing march to raise taxes – Of 46 local initiatives on the Nov 2011 ballot designed to hike taxes in California, 33 passed.



- **LA reducing business tax in attempt to woo auto dealers & others**
- **Vallejo overwhelmingly voted to tax marijuana dispensaries**
- **Hermosa Beach overwhelmingly voted to NOT tax bars**

Source: California Secretary of State; Ballotpedia; CaliforniaCityFinance.com

Cities in the Real Estate Business

Cities targeted real estate for economic development

- **Retail** – sales tax & jobs (entry level)
- **Relocation/Expansion** – business tax & jobs
- **Rooms** – hotel transient occupancy tax (TOT)
- **Real Estate** ... ew property taxes or tax increment from “R

Redevelopment WAS the primary tool used to generate new jobs and taxes…

What’s *Hot*? What’s *Not*?

HOT – Infill Projects & Investment

- **Apartments** (rehab and Ground-up) - Vacancy rate at lowest level since 2001 (5.2%). Rent increases minimal but up in most markets. Employment lag is resistance point. Own vs. rent could get attractive.

- **Affordable Housing –** always in high demand but with Redevelopment out of the picture, there is less funding for projects

- **Most core office markets**, including Downtown, are sideways with rents stable. Secondary markets cooling. Some tech-based heating up.

- **Infrastructure Projects** (LAWA, POLA, LADWP, etc.) – Airport improvements, Harbor, upgrades by “proprietary” departments that are less dependent upon distressed general funds and redevelopment.

Suburban Single Family Sales & Development staying cool

HOT Retail

- **“Discount”: Dollar-type stores taking over** - Four biggest national dollar chains operate more locations than three biggest national drugstore chains.

- **Outlet Format (e.g. Nordstrom Rack)** – Most major retailers either have or are opening an outlet version.

  “Made For Factory” (MFF) goods – new retail segment

- **Luxury** - The “1%” is back.

- **Internet Sales** – 10% YoY growth. Some retailers succeeding at integrating on-line and store points of sale.

Source: International Council of Shopping Centers

COLD Retail

- **Department Store Downsizing or Closing** – Borders (all). 38 K-Mart & 41 Sears closing...more to follow

- **Formats have shrunk -** but buildings remain, spurring partitioning and subleasing to other tenants

  Example: Best Buy – was 45ksf, then down to 30ksf & now looking at even smaller formats

- **Currently ~50+ big box vacancies just in Orange Co.**

- **Malls & Power Centers seeking to diversify uses**
  - **Medical offices**
  - **Family entertainment**
  - **Trade / vocational schools**
  - **Rock climbing**
  - **Indoor soccer**
  - **Restaurants**

Source: International Council of Shopping Centers; GlobeSt.com; Grubb & Ellis

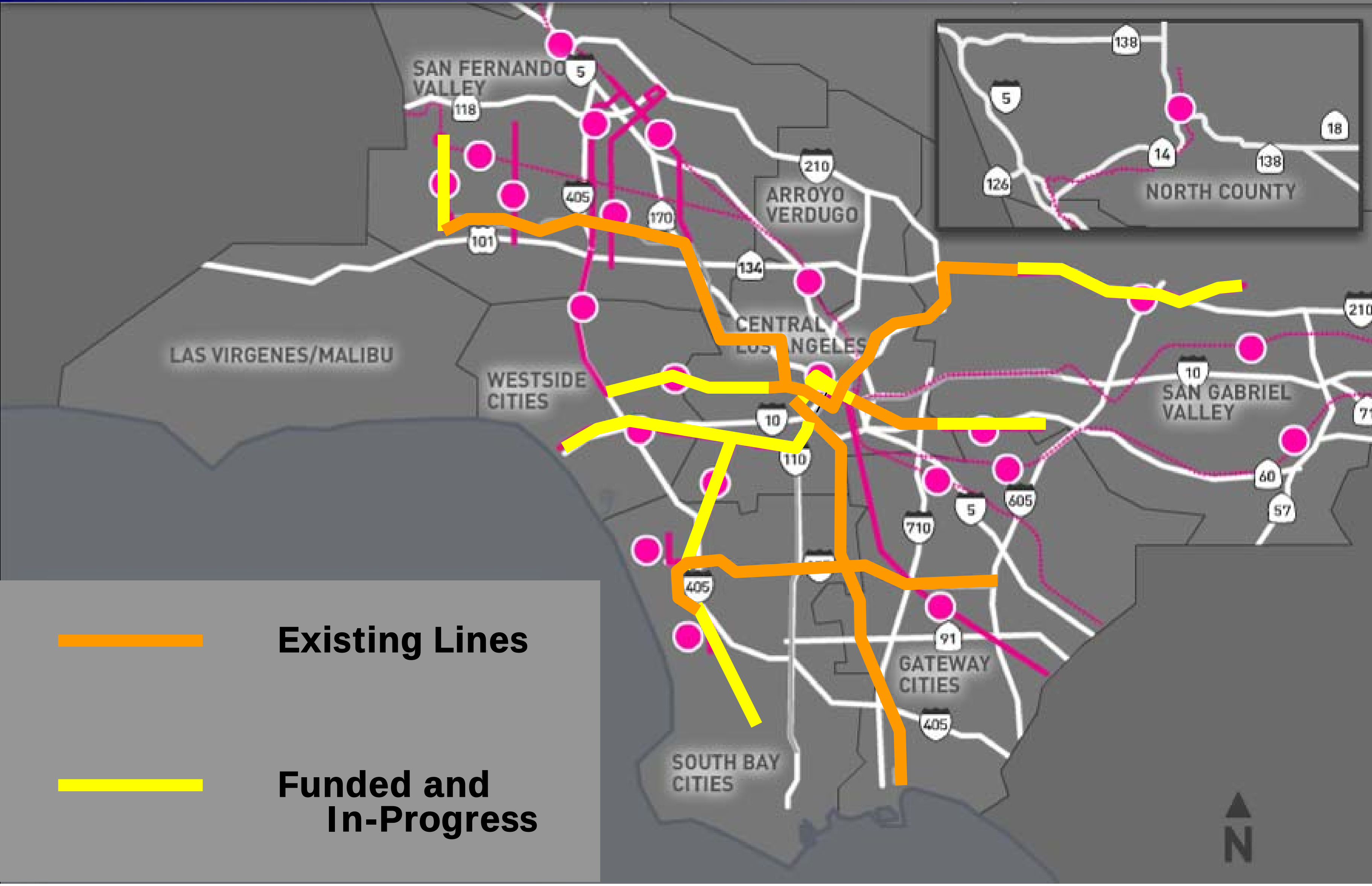
HOT – Public Transit

Projects will be developed by transit agencies representing billions in public investment. (e.g. OCTA, OLDA, Union Station)

More opportunities coming:

- **Federal Money – ~$56 Billion Transportation Bill.** Infrastructure and jobs act supported by both parties
- **LA County - Measure R extension of ½ cents sales tax for 10 years**
  - **Existing Measure R is 30 years (expires 2039)**
  - **Extension adds approximately $10 billion and another 10 years.**
  - **Metro to build projects sooner- less reliance on Fed/State $$**

HOT – Public Transit

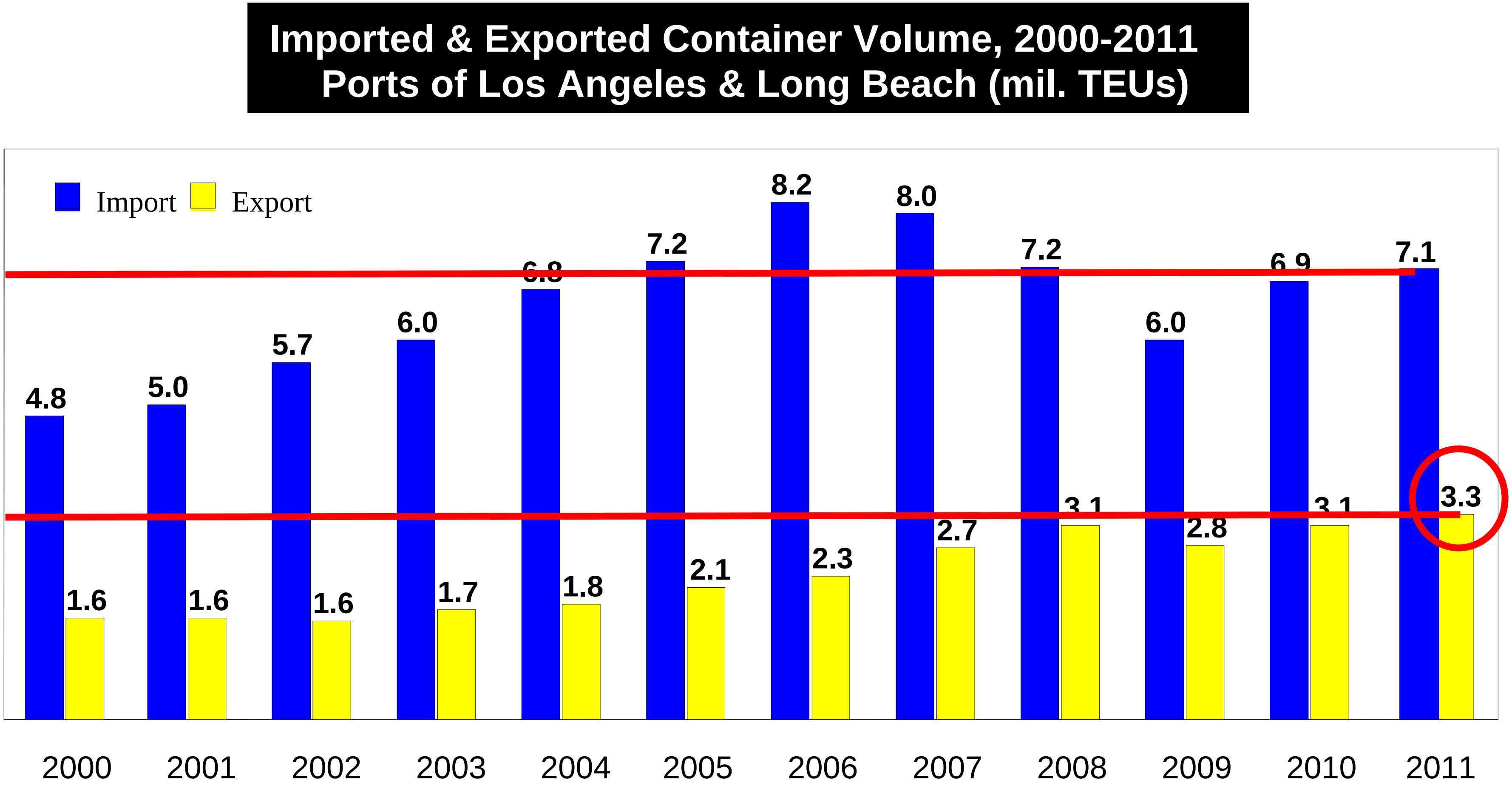


Source: LA County MTA

High Speed Rail (HSR) - COOLING

- **State Panel determined that the $98.5 Billion HSR is not feasible. Ridership forecasts questioned.**
- **But it should be HOT – studies claim econ. dev. benefits would exceed costs…system could fuel growth in underserved corridors.**

The Ports' Exports **- HOT**



- **2011 Exported figure is the *<u>highest in history for any US port complex</u>***
- ***Off ALL 50 States and Puerto Rico, LA Ports carry 40% of ALL import containers; 28% of ALL export containers***

Source: Economics & Politics, Inc.; Port Import Export Reporting Service (PIERS), collected from Vessel

HOT – Economic Development

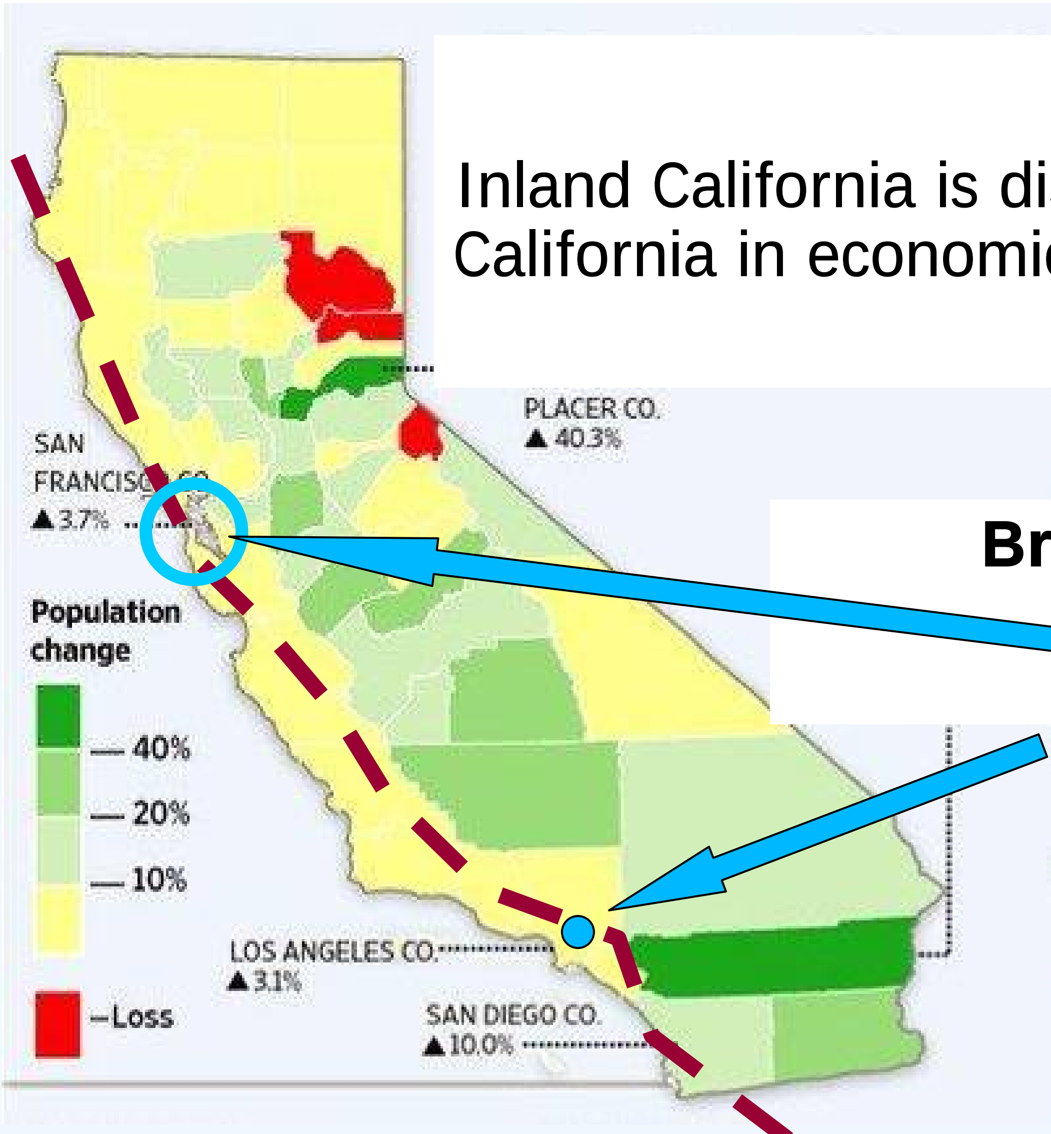
Two hot approaches (post-Redevelopment):

1. **Public-Private Partnerships & Deal Structures**
   - Lease-leasebacks with general fund guarantees
   - Site specific tax revenue pledges for hotels and retail
2. **EB-5 Immigrant Investor Program—create new U.S. jobs through foreign investment**
   - For real estate projects, new and existing
   - W Hotel Funded with $16.5 million of EB-5 investment
   - Downtown Marriott in process (Courtyard + Residence Inn)

Source: California Golden Fund (CGF)

Dissecting California

Inland California is distinct from Coastal California in economics & demographics.



Bright Spots:

Bay Area

Downtown LA

Sources: Wall Street Journal, 2011; US Census Bureau, 2010 (primary)

Downtown LA

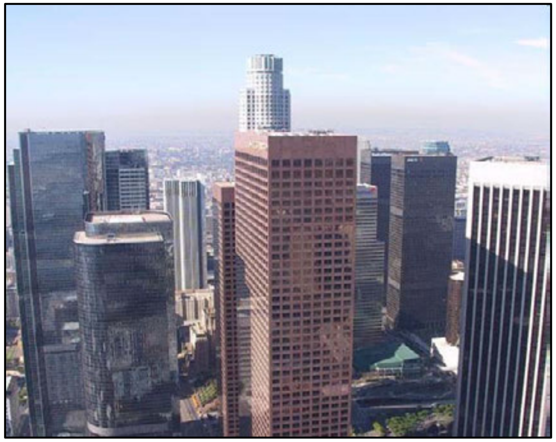
Downtown - Shaped by the CRA

Bunker Hill

Bunker Hill Towers Condos (1968)

High Rises (1968-1992)

Cathedral of our Lady of the Angels (2002)



South Park

Grand Hope Park (1993)

Affordable units – Hope Village, Villa Flores, Telacu Plaza, Parkside, Young Apts

Staples Center (1999)

South Village – Ralphs (2007)

Source: Downtown News archives

Downtown - On Its Own

Adaptive Reuse Ordinance – "ARO" (1999)

- **In 1999: 11,626 units in DT with 18,000 residents**
- **In 2011: 29,429 units in DT with 46,400 residents**
- **Adaptive Reuse enabled ~10,000 of the 17,803 new units**

Disney Concert Hall (2003)

- **Development funded mostly through private money**
- **Land and subterranean parking provided by the County**

Art Walk (2004)

- **Grew from 75 to as many as 40,000 visitors per event**

LA Live (2007-Nokia, 2008-Nightlife, 2010-Hotels)

Source: NavigateLA; Downtown Center Business Improvement District; Downtown News archives; LA Art Walk

Downtown Community Development

Nightlife. 21 new restaurants in 2011, many in the Historic Core

(vs. only 18 in Hollywood; 5 in Santa Monica)

Street life. Spring St. between 5th and 7th is new 24-hr hub of activity

Parks & "Complete Streets".

- **"Parklets" coming to Spring Street**
- **Civic Center Park (June 2012)**
- **Spring Street Park (late 2012)**

Connectivity.

- **Expo line linking Expo Park / USC with rest of Downtown (2012)**
- **Bike lanes down Spring Street**

Corner of 6th & Spring, Downtown (photo: Brigham Yen)

Parklet concept for Spring Street, (source: DLANC)

Source: LA Weekly; BrighamYen.com; Downtown News archives; LA City Bureau of Engineering

Warming Up In the Bullpen

- **FIGat7th Retail Center** (October 2012)
  - "City Target" - 100k sf, 2 levels, urban oriented with grocery
  - Function as anchor to 7th Street retail/restaurant corridor
  - Return of high-end apparel retail; Chef-driven restaurants

- **Wilshire Grand Office & Hotel Towers** (break ground in 2012)
  - 45 & 65 story towers (latter to be tallest bldg west of Chicago)
  - First office tower in Downtown in 23 years
  - Hotel + 100 Residential Units
  - $14 M in improvements to 7th Street on both sides of 110 freeway
  - Innovative signage on building skin

Source: BrighamYen.com; Downtown News archives

Warming Up in the Bullpen

- **Revised Adaptive Reuse Ordinance**
  - **To resolve conflicts with citywide live-work & artist-in-residence ordinances and with building code**
  - **Original ARO picked "low-hanging fruit". New ARO may be more flexible to tackle more difficult & costly conversions**
- **Bringing Back Broadway (ongoing incremental projects)**
- **LA Streetcar (2015 projected opening)**
- **"The Broad" Museum ($100 M; under construction; open late 2013)**
- **Marriott Courtyard/Residence Inn Hotel (303 rooms; EB-5 funds; nearing end of funding effort)**
- **Farmer's Field & Convention Space ($1.5 B, 1-2 NFL teams??)**

Source: BrighamYen.com; Downtown News archives

Downtown Transformation

Downtown LA exceeds expectations after 50 years of false starts and failed attempts to revive the core:

“[This is my] note on Downtown… because that is all Downtown Los Angeles deserves.”

- Reyner Banham (a long-time admirer of Los Angeles), 1971

“New York-like in its density and mishmash, the long-blighted center has become an accessible, pedestrian-friendly destination in recent years.”

– NY Times, February 20, 2011 article on Downtown Los Angeles

Source: Los Angeles – The Architecture of Four Ecologies by Reyner Banham; NY Times

Outlook 2012

Brown's Grand Slam Budget

Cuts - $4.2 Billion:

- **$2.04 Billion from Health & Human Services**
- **$1.32 Billion from Education**
- **$840 Million from other Sources**

Taxes - $7.0 Billion in revenue increases, including:

- **nearly $5.0 Billion in temporary tax increases for FY2012**
  - **Half cent sales tax hike**
  - **Income Tax hike to the wealthiest ($250K/yr and up)**
  - **OR suffer "trigger cuts" in education, firefighting, wildlife protection, lifeguards (Brown's "No Gain Then Pain" Plan)**
  - **Ballot in Nov 2012-more support than 2011's failed attempt**

BUT **– Taxing the wealthy makes the State's budget more unstable**

Sales tax already highest in the USA

Source: Office of the Governor

2012 – “The Year of the Tax”

In addition to Gov. Brown’s proposed ballot measures:

- **Labor-led “Millionaires Tax” gathering signatures and a broad-based tax hike earmarked for K-12 schools**
- **Multiple and competing tax ballot measures may doom all measures.**

ANTI-Business Tax Measures that could go to CA voters:

- **“Split-Roll” property tax to eliminate Prop-13 protection for commercial real estate**
- **Extend sales tax to service firms (law firms, accounting, real estate)**
- **1% increase in personal income taxes - adverse effect on small business (sole proprietorships, LLC’s)**

Source: Ballotpedia, 2012

Aiming Toward "Center" Field

Possible move to the center due to political changes. Once-safe incumbents to fight for their seats.

1. Redistricting of Legislative seats (Prop 11 - 2008) & Congress seats (Prop 20 - 2010) by Independent Commission:

- **California to experience biggest political turnover in 20 years.**
- **California loses Congressional clout as novices replace veterans.**

2. Open Primary (Prop 14, 2010) constitutional amendment:

- **Requires all candidates to compete in one primary election.**
- **Top two finalists face-off in November, despite party affiliation.**

Source: Ballotpedia, 2012

Kosmont's Draft Picks for 2012

1. ***IT'S ALL ABOUT THE MONEY***

   CUTS ALONE CAN'T CURE CALIFORNIA

2. ***2012 WILL BE THE "YEAR OF THE TAX"***

   STATE & LOCAL GOV'T TARGETING BUSINESS & THE WEALTHY

3. ***DEATH OF REDEVELOPMENT = LOSS OF JOBS AND PROJECTS***

   WILL SPUR NEW ECONOMIC DEVELOPMENT TOOLS & PROJECTS *BUT* LAG TIME EXPECTED DUE TO LEGISLATIVE GRIDLOCK.

4. ***NEXT GENERATION REDEVELOPMENT WILL BE MORE FOCUSED***

   URBAN INFILL, TRANSIT-ORIENTED DEVELOPMENT, AFFORDABLE HOUSING, SUSTAINABILITY, & INFRASTRUCTURE

Kosmont's Draft Picks for 2012

5. ***PENSION FUND REFORM IS UNDERWAY BUT SLOW***

BROWN'S PROPOSAL IS A GOOD START; PUBLIC UNIONS ARE POWERFUL

6. ***URBAN CENTERS INCREASINGLY ATTRACTIVE***

CENTRAL LOCATION, JOBS, TRANSIT, CULTURE, SOCIAL CONNECTIONS -- POPULAR WITH YOUNG, RETIRED AND OTHER URBAN DWELLERS.

7. ***DOWNTOWN IS A SURE THING***

DISTRICT HAS MOMENTUM AND CRITICAL MASS TO CONTINUE SELF-SUSTAINING GROWTH – BUT NEW POLICY TOOLS MUST HELP SHAPE THAT GROWTH.

8. ***CALIFORNIA – WHERE'S THE TROPHY?***

NOT THE PROMISED LAND IT ONCE WAS

...BUT IT CAN BE RESCUED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www.kosmont.com