



Kosmont Companies
Real Estate and Economic Advisory

Kosmont Realty Corporation
Funding Solutions for Public-Private Deals



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An aerial night photograph of a city, likely Kosmos, showing a dense grid of lights and a large, dark silhouette of a building in the foreground. The sky is a deep blue, and the city lights create a bright, glowing effect against the dark background.

This presentation is available online

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22st ANNUAL ECONOMIC FORECAST

PRESENTS:

CALIFORNIA 2012

WHO'S ON 1ST?

WHAT'S ON 2ND?

I DON'T KNOW'S ON 3RD!

Game day is 1-10-12 with expert commentary by:

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

Research and Production: Matt Goulet

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!**

MVP's and Rookies

- **Outlook 2012 and Kosmont's Draft Picks**

Placing Bets on the New Teams

The State of the State



California's Unemployment Crisis



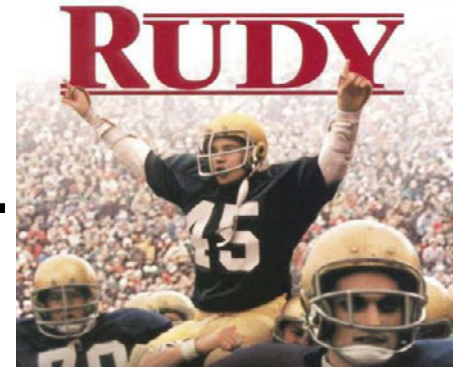
KTLA.COM
LOS ANGELES

Bell City Leaders Agree to 90% Pay Cut

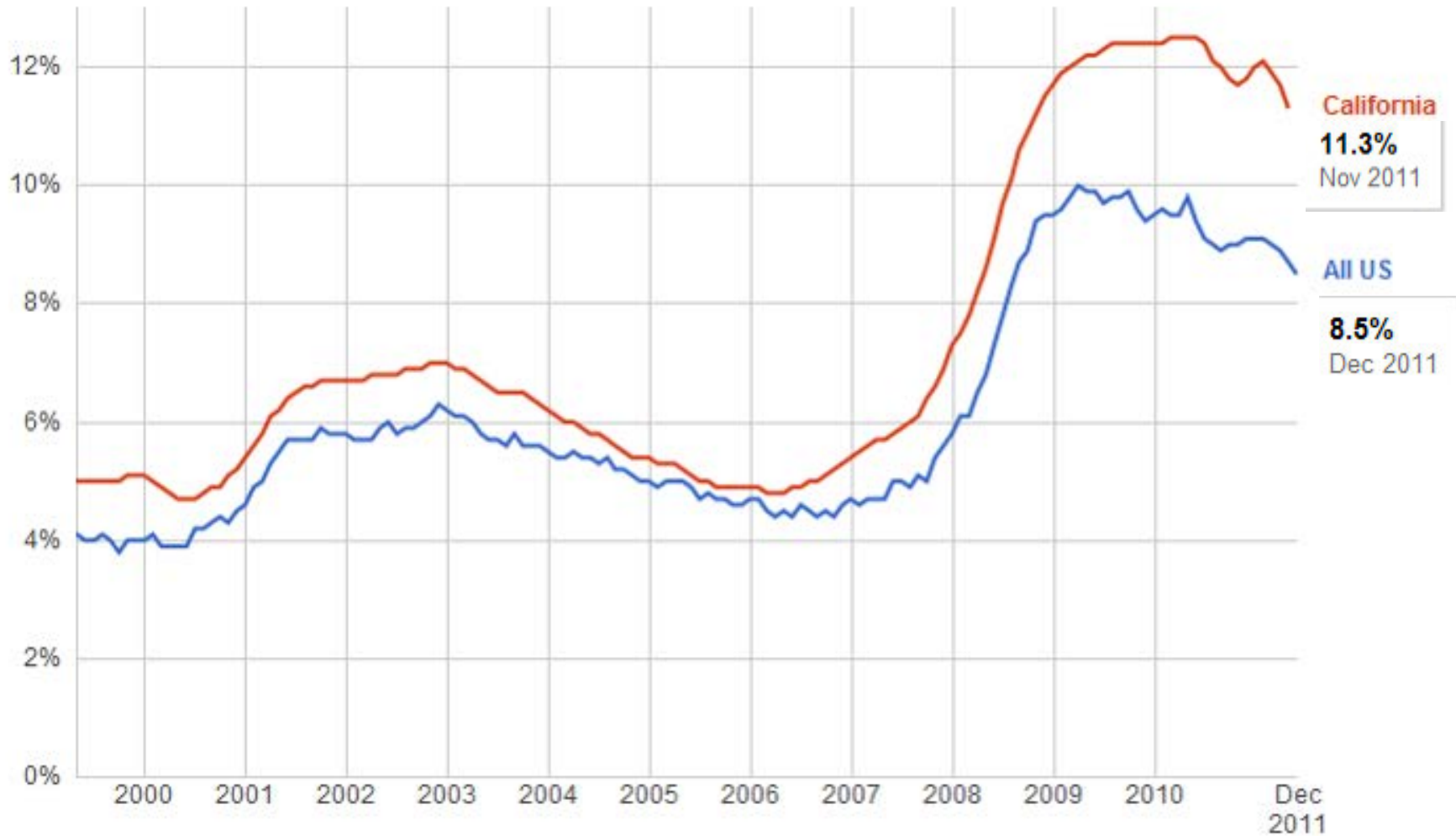
Attorney General Jerry Brown has subpoenaed hundreds of city records.

Los Angeles Times | LOCAL

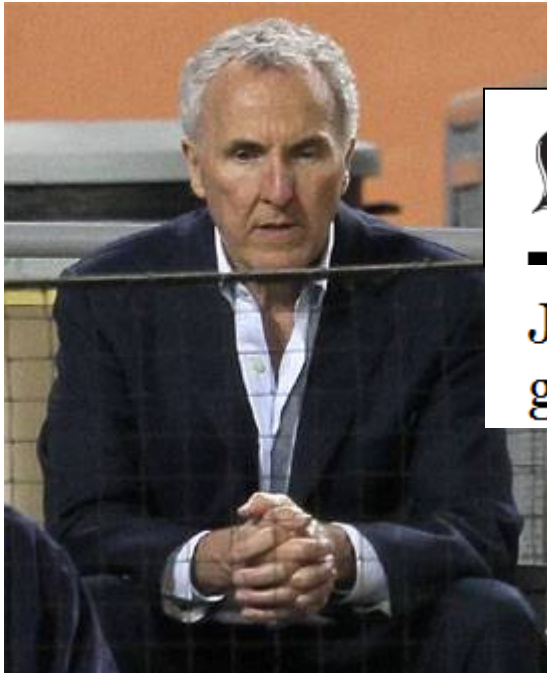
Ousted L.A. Housing Authority chief leaves with \$1.2 million



California's Unemployment Crisis



California Housing Crisis



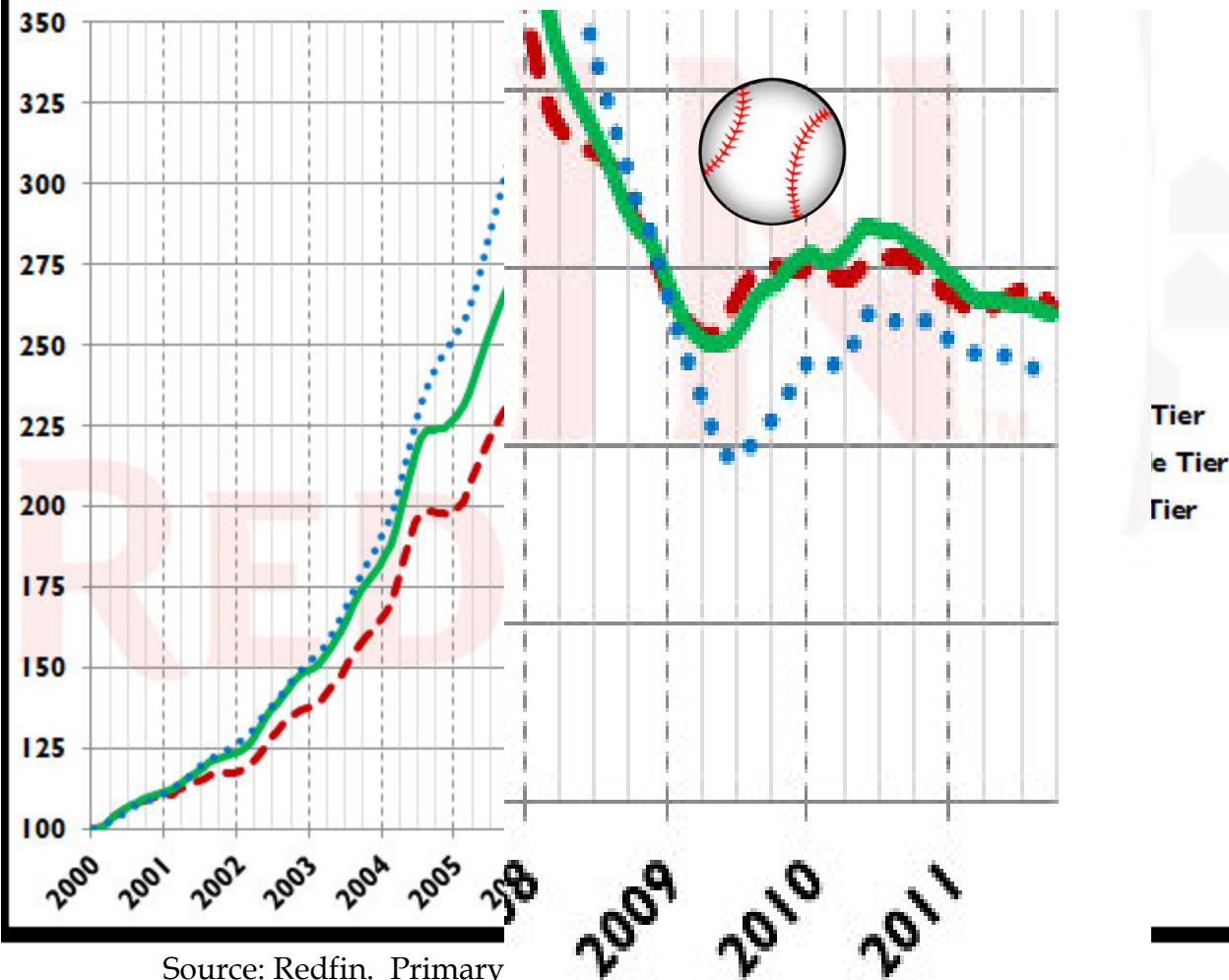
Los Angeles Times | SPORTS

Jamie McCourt gets four homes, Frank McCourt gets two

Southern California Housing

HOME PRICES – A Statistical "Grounder"

Los Angeles Case-Shiller HPI
(raw price tier data)



**PRICES/SALES
STABILIZING WITH
POSSIBLE MODEST
GROWTH**

But...

HURDLES REMAIN:

- UNEMPLOYMENT
- VACANCIES
- DISTRESSED SALES
- MORTGAGE AVAILABILITY

A Losing Streak

- 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.).
- Local governments can expect to be a drag on economy for next couple of years due to lag in the cycle of revenues.
- Pension Fund obligations are severely underfunded and increasing.
- Redevelopment extinct – 1000's of jobs and 100's of projects at risk.
- AARP rated California as the second worst (after Illinois) state to retire due to high cost of living and fiscal mess.



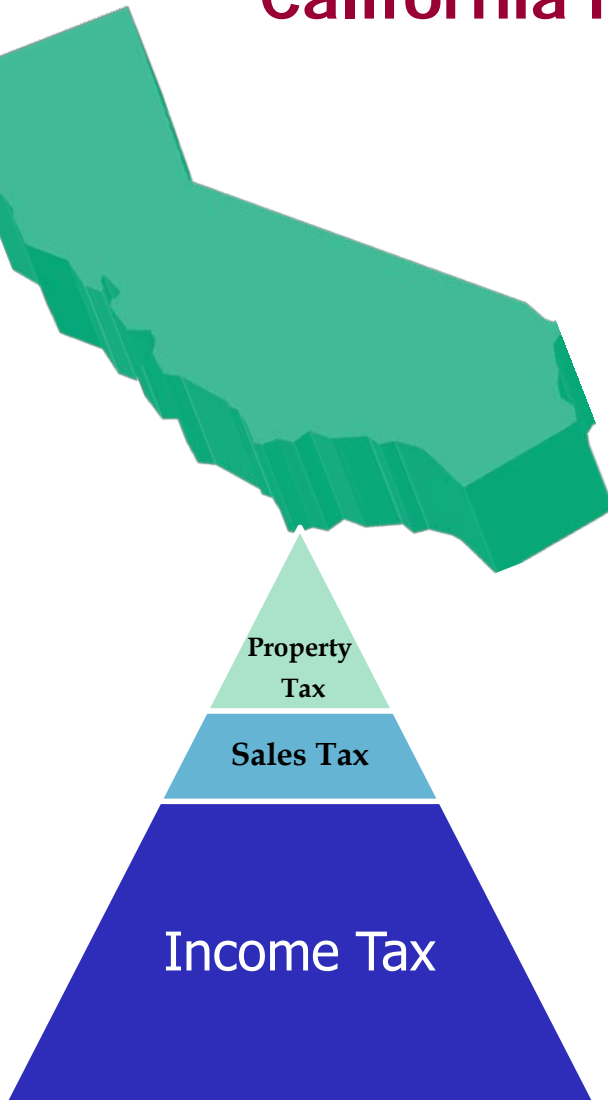
What the Heck Happened?



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



33 Years of “Tax Strikes”



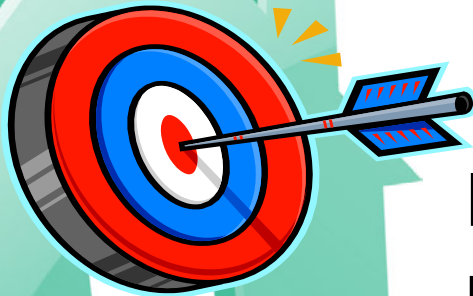
Ballot Box Tax Measures Rule California's Fiscal Policy

- **1978 – PROP 13:** Constrained prop tax valuations and escalations; new prop tax levies subject to 2/3 public vote.
- **1986 – Prop 62:** Required all local general tax subject to 2/3 public vote.
- **1996 – Prop 218:** Special property assessments must go to a public vote.
- **2010 - Prop 22:** Protect local taxes from the State (but ironically helped to sink Redevelopment Agencies)
- **2010 – Prop 25:** Budget now subject to 50% vote instead of 66% (2/3)

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 Development – new property taxes or tax increment from “RDA”



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

Redevelopment – Shut Out

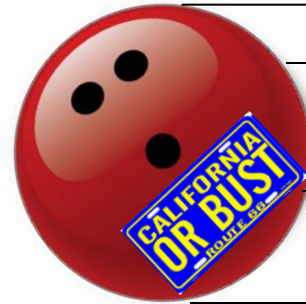
- **California Supreme Court upheld ABx1-26, forcing all Redevelopment Agencies to close and dealing a deadly blow to California’s primary local economic development engine.**
- **The ABx1-27 “Pay to Play” option invalidated, so no recourse for Redevelopment. Dismantling begins Feb 1 unless extended.**



Pension Obligations – An Ongoing Threat

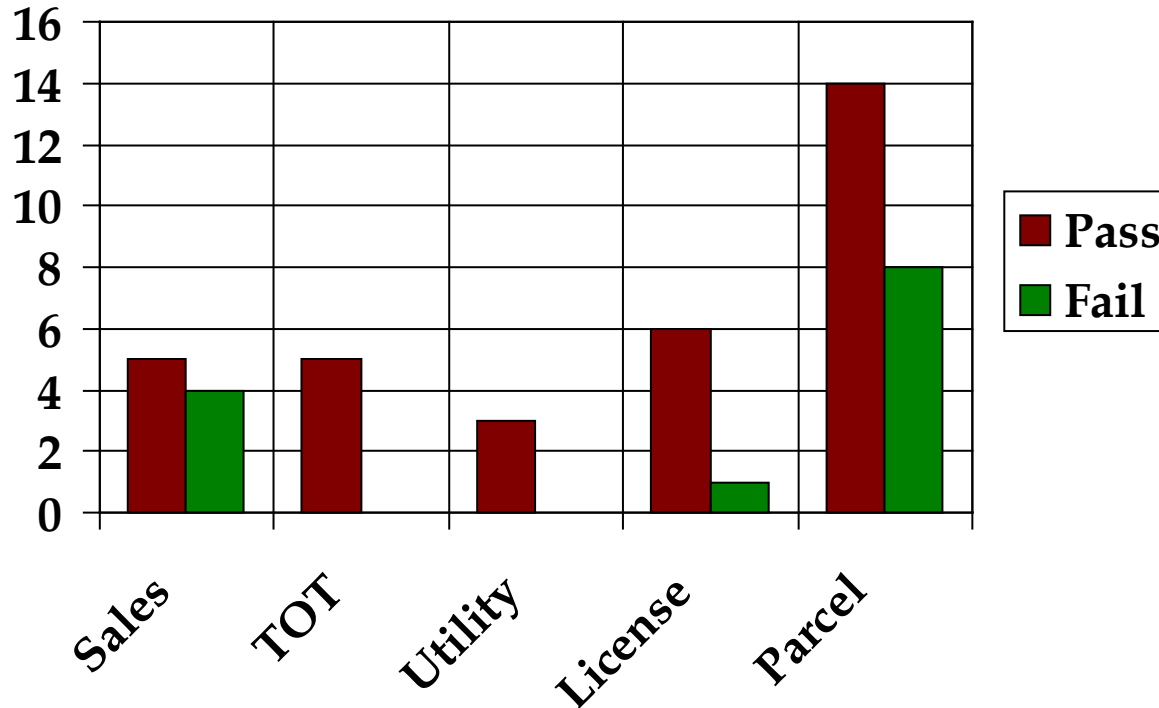
- **Stanford Univ. estimates unfunded deficit *EXCEED* \$500B dollars over next 16 years**
- **Over 15,000 retired public workers with pensions > \$100,000 annually**
- **Today most public employees can retire in 50's with pensions at 90% of salary**
- **Santa Ana, arguably Orange County's most labor 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**

Cities and Business Play Hardball



Local Government Swinging Two Bats

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



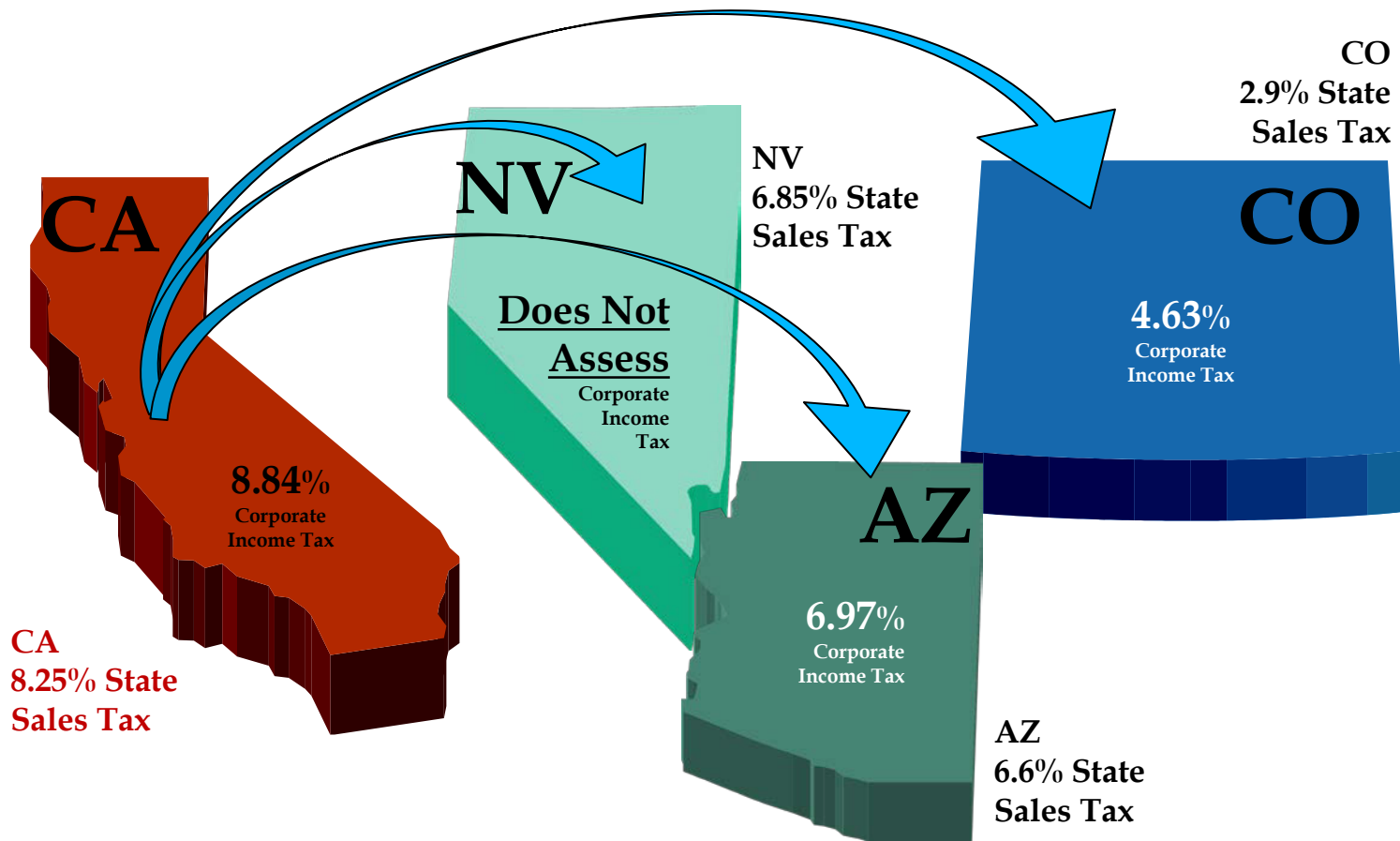
- LA reducing business tax in attempt to woo auto dealers & others
- Vallejo overwhelmingly voted to tax marijuana dispensaries;
Hermosa Beach overwhelmingly voted to NOT tax bars

Kosmont-Rose Institute 2011 Cost of Doing Business Survey

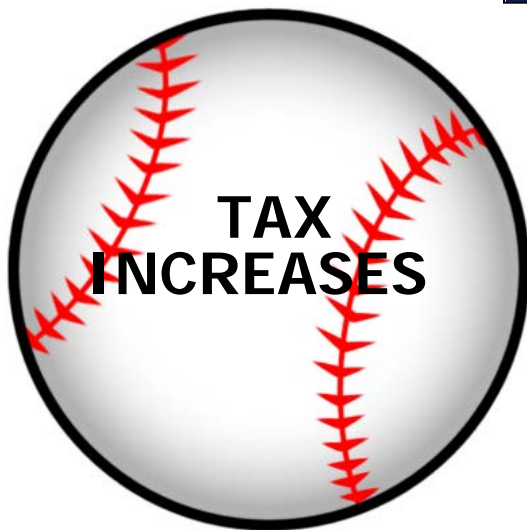
- First published by Kosmont Companies in 1994; gifted to Rose Institute in 2004
- 2011 edition of the Survey: 417 cities across all 50 states
- Classifies cities into five “Cost Ratings” in terms of their relative cost of doing business:
 - (\$) **Very Low Cost**
 - (\$\$) **Low Cost**
 - (\$\$\$) **Average 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

California Is Losing Its Trophies

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



California's Starting Lineup



What's *Hot*? What's *Not*?



HOT – Infill Projects & Investment

- **Affordable Housing** – still leads for residential development; however, with Redevelopment out of the picture, competition will be higher than ever for remaining sources of funding.
- **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.
- **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.

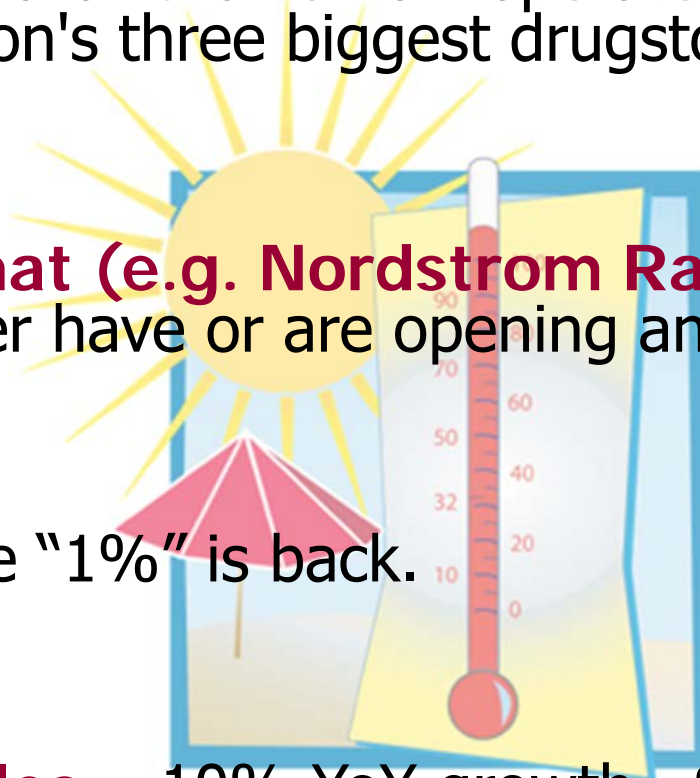
Suburban Single Family Sales and Development staying cool:

“Backlog” of foreclosures and high unemployment keeping prices low on existing stock.

Low household formation and competition from existing stock keeping construction even lower.

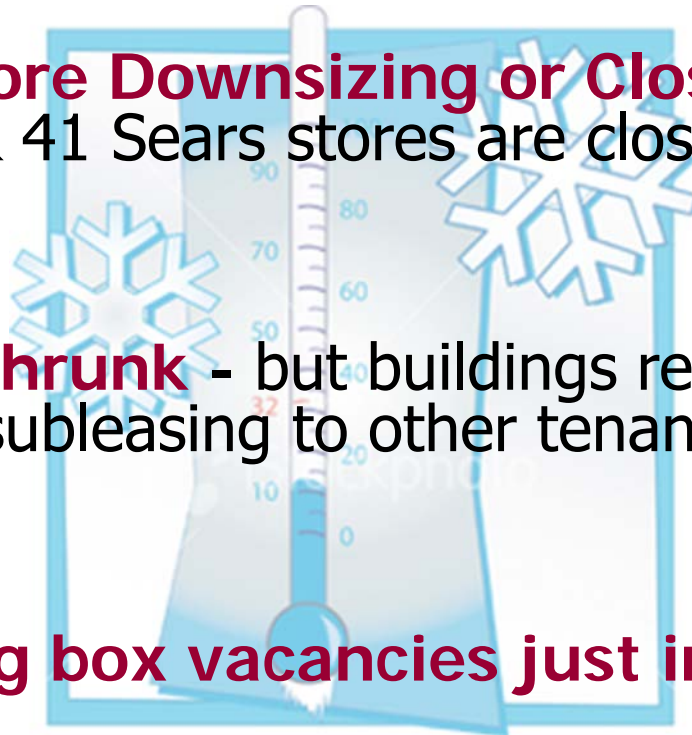
HOT - RETAIL

- **“Discount”**: **Dollar stores are taking over** - The four big national dollar chains now operate more locations than the nation's three biggest drugstore chains.
- **Outlet Format (e.g. Nordstrom Rack)** - All major retailers either have or are opening an outlet version.
- **Luxury** - The “1%” is back.
- **Internet Sales** – 10% YoY growth. Some retailers succeeding at integrating on-line and store points of sale.

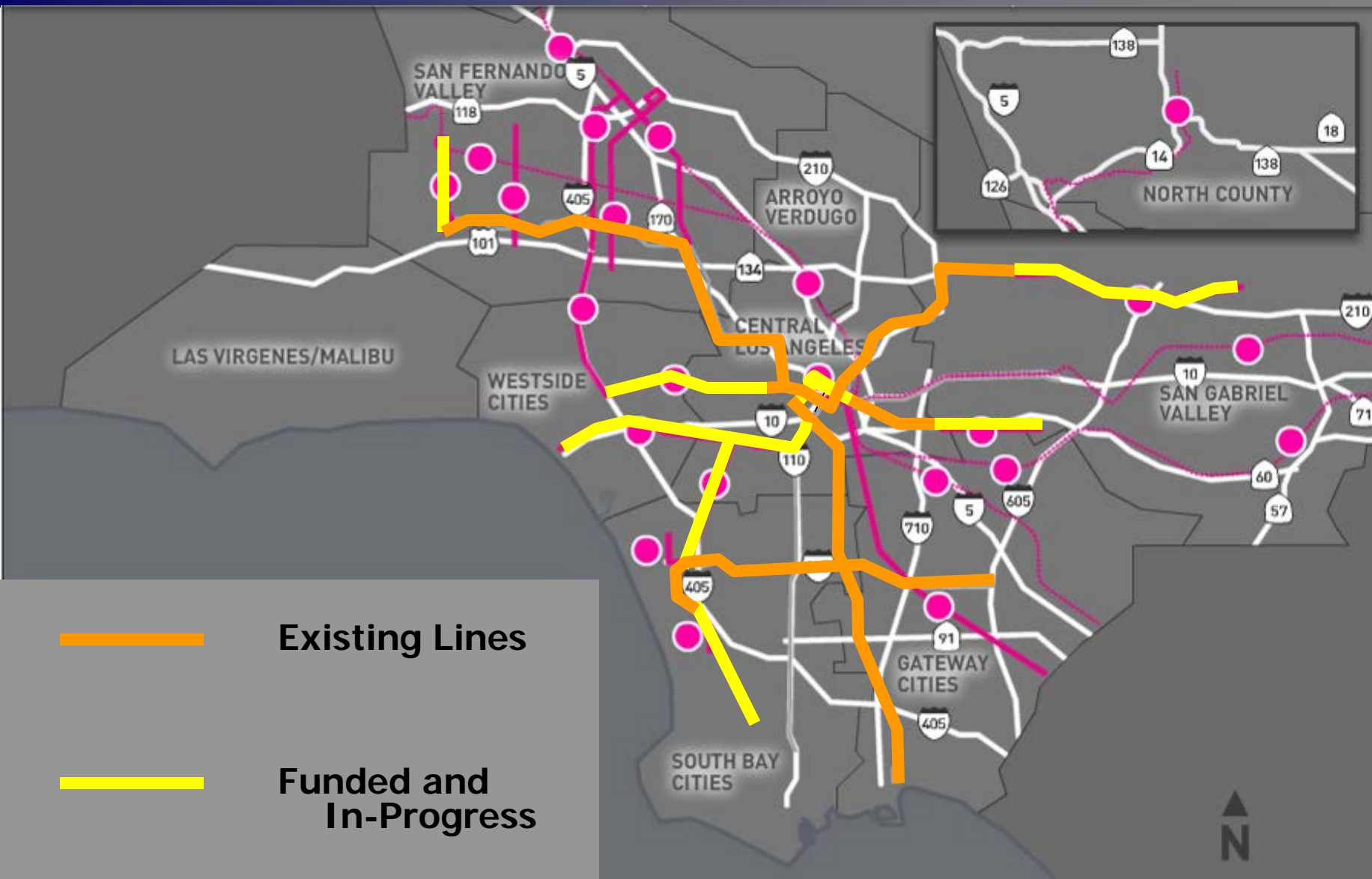


Big Box Retail - **COLD**

- **Department Store Downsizing or Closing** – Borders (all). 38 K-Mart & 41 Sears stores are closing, more to follow.
- **Formats have shrunk** - but buildings remain, spurring partitioning and subleasing to other tenants
- **Currently 59 big box vacancies just in Orange County**



HOT – Urban Rail & Mass Transit

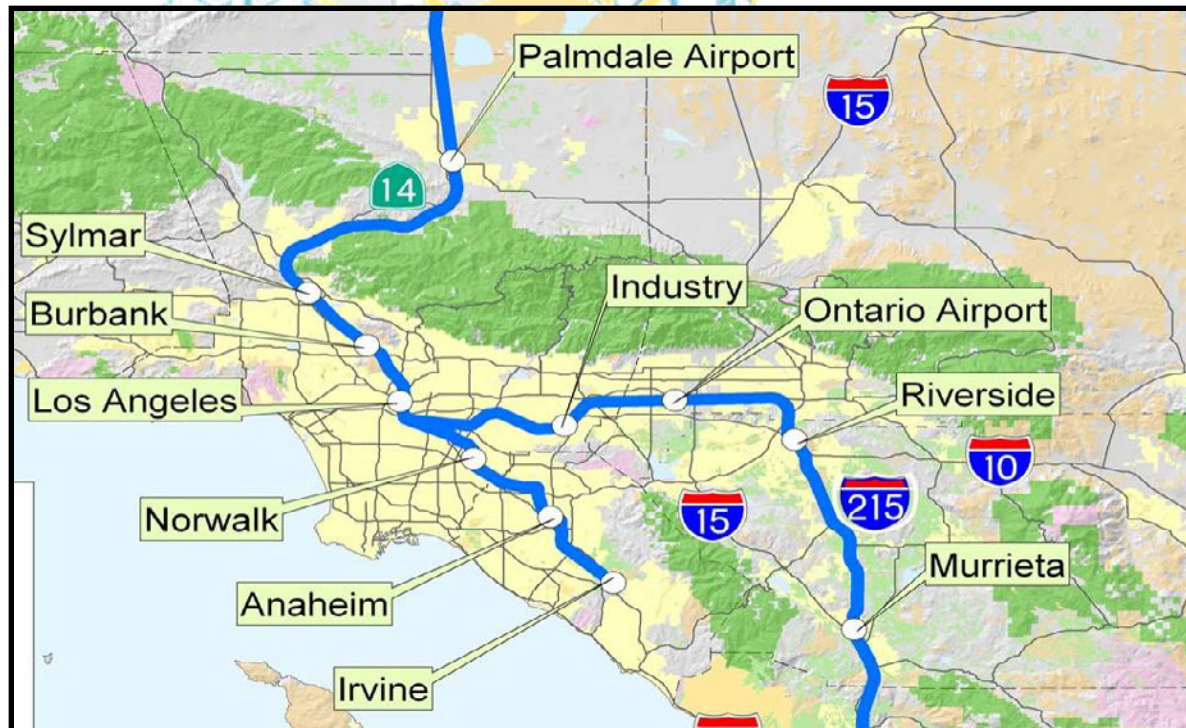


- **TOD projects being pursued by multiple agencies** (OCTA, OLDA, Union Station, SCAG – Compass) representing billions of public investment
- Multiple RFPs out for service providers and developers
- **More opportunities coming:**
 - **Federal Money – Approx. \$56 Billion Transportation Bill** seen as a jobs bill supported by both sides of Congress
 - **Measure R extension for 10 years- ½ cents sales tax**



High Speed Rail - COOLING

- An independent State panel determined that the \$98.5 Billion HSR will not be feasible.
- But it should be **HOT** – Some studies forecast economic development would far exceed cost. System could fuel growth in underserved corridors.



Redevelopment – COLD AS ICE

Redevelopment ended on December 29, 2011

- Cities that had RDA's must declare to become a "successor agency" responsible for liquidating RDA property beginning Feb 1, 2012.
- "Oversight Boards" composed of mixed gov't officials have control over the process.. But!
- State Finance Dept and Controller have 100% veto power over actions by Oversight Boards!
- Cal Red Association and League of Cal Cities seeking legislation to delay Feb 1 liquidation by several months.
- Instant Replay?

Nine cities jointly filed a motion for a stay on AB1x26 on grounds that it violates State and Federal law. Hearing is January 27th.

Redevelopment – COLD AS ICE

Some Local Governments will be 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 city jobs funded by RDA \$\$'s *including police and fire*
- Private sector job losses from derailed projects
- Litigation expected, due to AB1x26's chaotic and unclear dissolution process

HOT – Economic Development

Loss of Redevelopment makes economic development activity more crucial in 2012.

Two hot approaches:

- **Public-Private Partnerships ("P3's") & Deal Structures**
 - **Lease-leasebacks with general fund guarantees**
 - **Site specific tax revenue pledges for hotels and retail**
- **EB-5 Immigrant Investor Program—create new U.S. jobs through foreign investment**



P3 Deal Structures

Ground Leases

- Retain ownership of property/development after lease term is over
- Enables public agencies to achieve long-term cash flow
- Reduces developers financing cost

Lease-Leaseback Arrangements (financing public assets)

- Frees up equity from existing assets to fund new projects
- Ownership of property/development after lease term is over

Project Delivery Methods: CM At-Risk & Design-Build coupled with public financing

Tax-Exempt Revenue Bonds – gas tax, sales tax, utility tax & others; mostly for infrastructure & public facilities

Community Facilities District (Mello-Roos & other Special Districts)

Private sector can leverage property tax payments for infrastructure

New Market Tax Credits - Increased allocation from Feds will provide additional equity funding for eligible urban projects.

EB5 Program

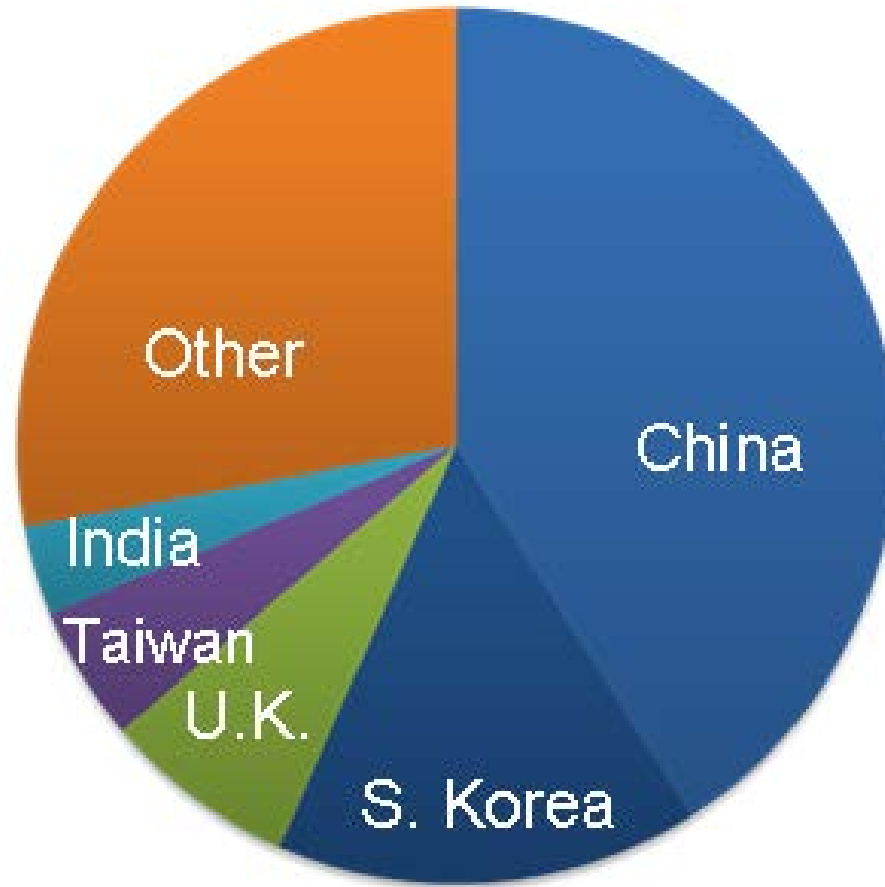
EB-5 Immigrant investor visa category created in 1990 to attract foreign capital and create jobs for American workers. Investments placed through “Regional Centers”

- \$1 million investment in a new or existing business
- \$500,000 if project is in a Targeted Employment Area - TEA)
- Investment must create full-time employment for ≥ 10 US workers
- 10,000 EB5 visas available every year (approx \$5 Billion investment)
- Estimated 3,000 visas approved in FY 2011 (approx \$1.5 Billion - \$2 Billion raised)

California houses 25% of U.S. Regional Centers. (31 of 123)

- Can be used for real estate projects (new and existing)
- Eligible Categories – Hotels, Retail, Restaurants, Food, Apparel, Transportation, Warehousing, Household Furnishings, Printing & Paper, Health Care, and many others.

Immigrant Investor Origins



Investment Through Regional Centers

Regional Centers are organizations that aggregate Immigrant Investors and disperse funding to qualified projects.



California Golden Fund – W Hotel Deal

Funding Target: \$200M total project capitalization

\$15.5M funded by EB-5

Investment Level: \$500,000 per Investor
plus processing costs

Investment Placement: Drai's Restaurant and Nightclub

Delphine Restaurant

Job Creation Required: Minimum 10 jobs per \$500,000
(established and validated by
economic study)

Repayment Period: Five years

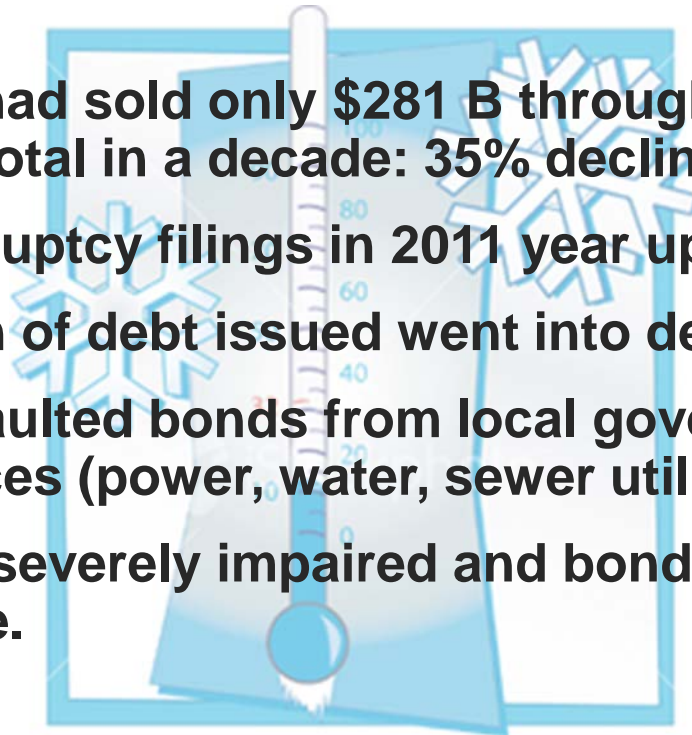
Status: 33 investors with EB-5 I-526 visa application in
process.
Restaurant loans to be funded in mid-2011.

Permanent jobs created by end of 2011/early 2012.



Municipal Bonds - **COLD**

- With yields in the first half of the year rising, issuance was scaled back.
- Municipalities had sold only \$281 B through December - lowest annual total in a decade: 35% decline from 2010.
- Ten muni bankruptcy filings in 2011 year up from 2010.
- About \$6 billion of debt issued went into default this year.
- Only 1% of defaulted bonds from local governments tied to essential services (power, water, sewer utilities, etc).
- City hall credit severely impaired and bond insurance no longer available.



BUT...

Defaults did not rise on the scale anticipated

WARMING UP – Private Activity Bonds

- **Private Activity Bonds** are issued by local or state gov't for purpose of financing a private user project.
- **Projects** apply to manufacturing processes and designs, priv. companies, hospitals, non-profit facilities, charter schools.
- **State and local governments will be able to issue a total of \$32 billion** (\$380 million more than in 2011).
- **California's cap increases to \$3.58 billion** from 2011-2012.
- **PAB's won't heat up unless** small firms can gain sales and production volume.



WARMING UP - Entitlements

- **Development is edging up.** This is prime time to secure entitlements which may take up to 2 years, but often last 2 years or more and may be renewed in many cases.

- **Entitlements are a fairly low-cost component of a project - can reduce risk and improve market timing.**

- **Use Predevelopment Meetings** as a streamlining tool – early in the process.

- **Use Case Management** where available to ensure projects are carried through and given attention



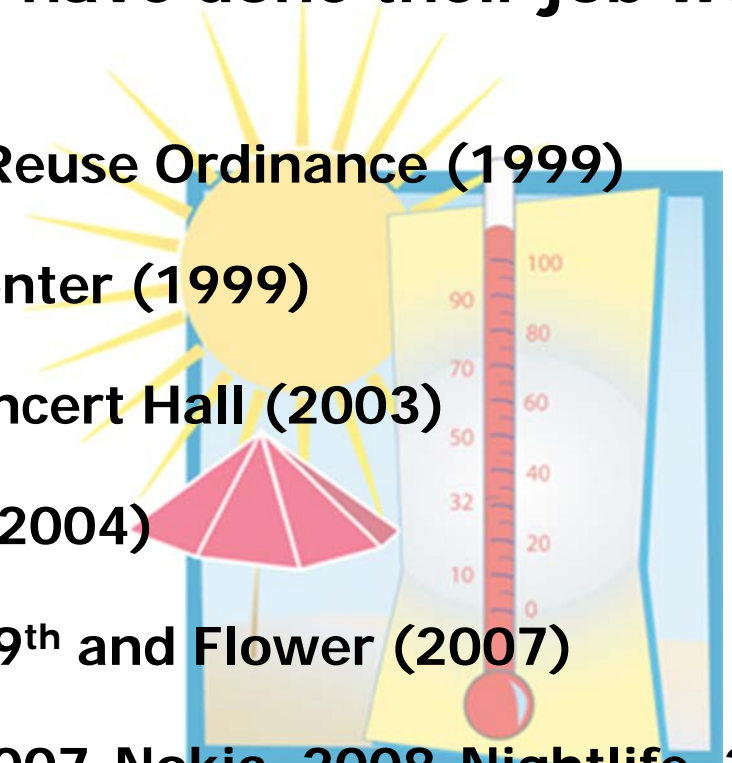
HOT – Downtown Districts

- **Educated '20' and '30' something's are moving downtown** (where they can walk and use public transit) in the USA's largest cities — even to urban centers losing population.
- **Detroit's population shrank by 25% since 2000; its downtown added 2,000 (59% more) young and educated residents.**
- **In two-thirds of the nation's 51 largest cities, the young, college-educated population grew twice as fast within 3 miles of the urban center as in the rest of the metropolitan area**
- **In 2000, young adults with a four-year degree were about 61% more likely to live in close-in urban neighborhoods than less-educated counterparts. Now, about 94% more likely.**



HOT – Downtown LA

The catalysts have done their job well:

- **Adaptive Reuse Ordinance (1999)**
 - **Staples Center (1999)**
 - **Disney Concert Hall (2003)**
 - **Art Walk (2004)**
 - **Ralphs at 9th and Flower (2007)**
 - **LA Live (2007-Nokia, 2008-Nightlife, 2010-Hotels)**
- 

HOT – Downtown LA

Restaurant & Nightlife Boom

- 21 new restaurants in 2011, many in the Historic Core (18 in Hollywood; 5 in Santa Monica)
- Spring St. between 5th and 7th is the new 24-hr hub of activity

The next catalysts?

- “City Target” (October 2012)
- Wilshire Grand Office & Hotel Towers (break ground in 2012)
- Bringing Back Broadway (ongoing)
- LA Streetcar (2015?)



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

Outlook 2012



Development Processing in 2012

- **Redevelopment cutbacks will reduce city staff available for processing; outsourcing of planning will be common**
- **Reimbursement Agreements for project services will be the norm—start this discussion early**
- **Cities are looking at flexible zoning formats to be more compatible with changing demographics.**

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

2012 - Year of the Tax

In addition to Gov. Brown's proposed ballot measures,

ANTI-Business Tax Measures that may go to CA voters in Nov:

- **The so-called "Split-Roll"**, which would exempt commercial properties from the shelter offered under Prop 13
- **Extending sales tax to some services**
- **A 1% increase in most personal income taxes** which would adversely affect some small business (sole proprietorships, LLC's)

Kosmont's Draft Picks for 2012

IT'S ALL ABOUT THE MONEY

CUTS ALONE CAN'T CURE CALIFORNIA

2012 IS THE "YEAR OF THE TAX"

STATE/LOCAL GOV'T TARGETING BUSINESS & THE WEALTHY

RDA LOSS WILL CREATE JOB AND PROJECT LOSSES

**ULTIMATELY WILL SPUR INNOVATIVE ECONOMIC
DEVELOPMENT TOOLS**

NEXT GENERATION REDEVELOPMENT LIKELY TO BE FOCUSED

**URBAN INFILL, TOD, AFFORDABLE HOUSING, SUSTAINABILITY,
& INFRASTRUCTURE**

Kosmont's Draft Picks for 2012

PENSION FUND REFORM IS UNDERWAY BUT SLOW

BROWN'S PROPOSAL IS A START, BUT PUBLIC UNIONS ARE POWERFUL

URBAN MIGRATION CONTINUES

DOWNTOWNS, DENSITY, TODs, MIXED USE POPULAR WITH GEN-Y'S

CALIFORNIA

**NOT THE PROMISED LAND IT ONCE WAS
...BUT IT CAN BE RESCUED**



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