



Kosmont Companies
Real Estate and Economic Advisory

Renaissance Community Fund
Revitalization & Development Projects



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An aerial night photograph of a city, likely Kosmos, with a dense grid of lights. In the foreground, a large, dark sign with white letters is visible, though the letters are mostly obscured by shadows. The sky is a deep blue, and the city lights create a bright, glowing horizon.

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17th Annual Real Estate Forecast Breakfast

PRESENTING:
Corporate Recovery!
Consumer Caution!
Political Confusion!
Hold on to your seats! (and your money)

Premiering 1-20-11 and hosted by:

Larry J. Kosmont, CRE: Pres., Kosmont Companies

Research and Production: **Matt Goulet**



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UNDER 17 REQUIRES ACCOMPANYING
PARENT OR ADULT GUARDIAN

WARNING: THE FOLLOWING
PRESENTATION INCLUDES GRAPHIC
DEPICTIONS OF TAXES, POLITICAL
DYSFUNCTION, AND GRATUITOUS
IMAGES OF FISCAL UNCERTAINTY.

VIEWER DISCRETION ADVISED FOR
ANYONE WITH A WALLET

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The State of the State



A Critic's Review

California Before...



...and After



California Waking Up In Vegas...Broke

STATE FINANCIAL DISTRESS

- California has a **\$25.4 billion** budget deficit and \$89 billion in long-term bond debt. Debt service ratio is approx. 7.71% this year (<6% considered healthy)
- Economic distress hitting all tax categories; compounding structural problem
- A significant grab for additional taxes and fees impairs business investment.

LOCAL GOVERNMENT DISTRESS

- Three straight years of tax-base reductions
- Increased unfunded pension obligations pitting management vs. unions
- Few tools for local economic development yet State proposes RDA wipeout

ECONOMIC DISTRESS

- Unemployment --1.3M jobs lost with long recovery, and State budget is roughly 45% from income tax
- Housing – values have dropped over 40% in some areas presenting a major obstacle to local recovery

Governor Brown's Second Act

The Governor's Distress-Buster Budget:

- \$12 billion in cuts and about \$12.5 billion in revenue extensions
- To ask voters in June to decide on extending various taxes:
 - income tax rate increase by 0.25%
 - dependent credit reduction by 2/3
 - annual vehicle license fee doubling to 1.15% of car's value
 - state sales tax increase by 1%
- Realignment – Tinker with Prop 13 by modifying taxation powers and distribution of services between state and local governments.
- Eliminate Redevelopment Agencies & Enterprise Zones

"A Tough Budget for Tough Times" – Governor Brown

Redevelopment's

**BALLS OF
FURY**

ECONOMIC DEV. PROTECTED

Prop 98 (2008) Defeated

WOULD HAVE ELIMINATED TAKINGS
OF PRIVATE PROP FOR ECON
DEVELOPMENT

Prop 99 (2009) Passed

PROTECTED SINGLE-FAMILY HOMES
FROM TAKINGS WHILE
PRESERVING UTILITY OF
EMINENT DOMAIN

STATE TAKING RDA MONEY

ABX4-26 (2009)

Passed

ALLOWED STATE TO SEIZE \$2.05
B. OF LOCAL REDEVELOPMENT
FUNDS

LOCAL REVENUE PROTECTED

Prop 22 (2010)

Passed

PROHIBITED STATE FROM
TAKING LOCAL MONEY

ELIMINATE REDEVELOPMENT?

Redevelopment =
Economic Development !

Brown's Budget Proposal

Governor Brown's Second Act

Budget Proposal promises to eliminate all 397 Redevelopment Agencies by July 1 of this year:

1. Only existing projects and debt to be paid until retired
2. Diverting \$1.7 billion to the State's General Fund in 2011-12.
3. Distributing the remaining \$210 mil. and tax increment to schools, cities, and counties.
4. The housing set-aside funds will be shifted to local housing authorities.
5. Requiring 55% voter approval for economic development projects similar to those currently funded through redevelopment.

California's Triple Threat



CALIFORNIA REPUBLIC



UNEMPLOYMENT



HOUSING



GOVERNMENT

California Today



How did we get this far???


30 Years of Ballot Box Budgeting

California Budget – The Movie!



Starring... Ballot Box Budgeting, Tax Revolts, and Pension Obligations!!

30 Years of “Tax Revolts”

- **1978 – PROP 13** Limits prop tax valuations to 1% and escalation to 2%
 - **1986 – Prop 62**: Requires general tax approval by 2/3rd of the governing body and a **majority of the voters**.
 - **1996 – Prop 218**: Limits authority to impose property-related assessments, fees, and charges. Majority of voters approve increases in general taxes and 2/3rd must approve special tax.
- 
- **2010 - Prop 22**: Protect city, county and redevelopment funds from State re-appropriation
 - **2010 – Prop 26**: Many local fees now subject to 2/3rd public vote.

Pension Obligations are a Real Threat

- **California's public pension liabilities are underfunded** by nearly \$500 Billion according to a Stanford University study
- **Pension costs have increased over 2000%** while tax revenues increased only 24% over the past ten years.
- **Pension obligations cost each California resident \$3000 per year** according to a recent Milken Institute study.
- **Threatens solvency of cities** more than debt
- **Vallejo's 2007 bankruptcy a direct consequence of pension liabilities**

California Positioned to do Better in Rehab

The voters have made some significant changes –

- **Redistricting Process** has been overhauled- Prop 11 (2008) for Legislature; Prop 27 (2010) for Congress
- **Open Primary** Prop 14 (2010); Top two primary vote getters move to general election despite party affiliation.
- **Budget Threshold Reduced** Prop 25 (2010) – Budget now passed with 51% vote, no longer with a “super-majority” 2/3 vote, *but...*
- **Fees Now Subject to 2/3 Vote** (Prop 26 – 2010) – applies the 2/3 majority to fees and taxes in both elections and legislation. May protect business...but more difficult for local governments.

But Still Dysfunctional



- **Term Limits** – Back on the Ballot in Feb 2012.
- **Ballot-Box Budgeting (Propositions):**
 - There were 479 local ballot measures in 2010 alone.
 - 2010 also saw 90 proposed statewide ballot measures of which 14 went to a vote.

State Turning to Local Government for \$\$\$

The Hungry Legislature has dipped into local revenues:

- **Took \$2.05 B for schools from Redevelopment Agencies** (2009)
- **Sales Tax** : 6% of 8.25%* goes to State's General Fund

Despite voter protest:

- **Prop 1A (2004)**: Protects local prop & sales tax from state
- **Prop 1A (2006)**: Ensures that gas taxes can only be spent on transportation projects
- **Prop 22: (2010)**: Protects local government and redevelopment funds from appropriation by the State – Gov. Brown would seek to repeal this law in 2011.

Local Government Looking for Options

Ongoing march to tax business – over 85 sales tax increases in California in 2010 alone. 22 of 23 proposed increases in utility user taxes were approved.

Creative cost-recovery programs are flourishing - At least 50 cities in CA have adopted laws that seek reimbursement from insurance companies for the costs of sending public emergency crews to accident scenes.



Business takes the Heat



A Celebrity
State with
“Issues”

Business Picks up the Tab

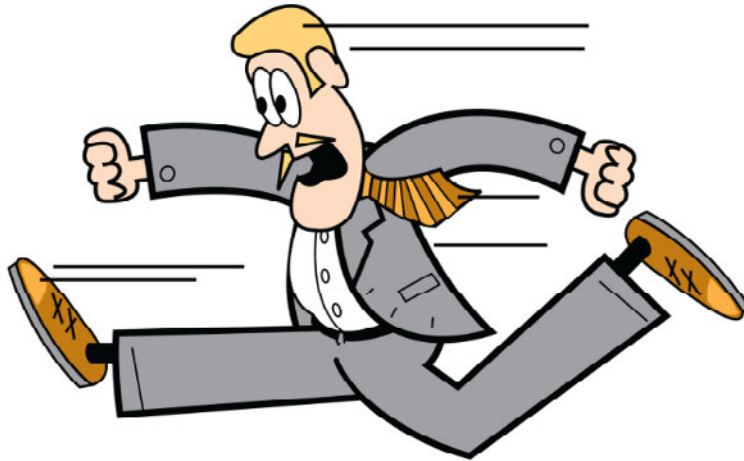
- **Businesses are more politically vulnerable than citizens.**
- **California continues to be a high cost state.**
 - Sales tax in California is 9.75% to 10% in most places and 10.5% in some cities such as South Gate and Pico Rivera.
 - As California raises its taxes, it continues to lose businesses to nearby Nevada, Arizona and Texas.
- **Sample of tax rates - California and a few competitors:**

	California	Nevada	Arizona	Texas
Income Tax	8.84%	0.00%	4.63%	0.00%
Sales Tax	8.25%	6.85%	5.60%	8.00%

Kosmont-Rose Institute 2010 Cost of Doing Business Survey

- **First published by Kosmont Companies in 1994.**
- **2010 edition of the Survey compares the cost of doing business in 413 cities across all 50 states.**
- **20 lowest cost cities are located west of the Mississippi River, none of which are in California.**
- **California has 13 of the 40 most expensive cities but only 4 of the 40 least expensive cities.**

...and Business Suffers



BUSINESS



THE GRUMPY STATE

**So where's the "stimulus" for
Business in Los Angeles?**

Opportunities for Business



Lights!

Camera!

Action!

Cities Are in the Real Estate Business

The primary tools for local government in California to generate revenue and gain jobs are **“THE FOUR R’s”**:

REAL ESTATE DEVELOPMENT – New Prop Tax Assessment or Tax Increment in Redevelopment

RETAIL – Sales Tax & Jobs (entry level)

RELOCATION -- Business Tax & Jobs (from Expansion)

ROOMS – Hotel transient occupancy tax (TOT)



Cities compete for Jobs, Taxes, Business, and Real Estate Projects



Opportunities for Business

- 1. Public-Private Partnerships**
- 2. Redevelopment**
- 3. Enterprise Zones**
- 4. EB 5 Visa Program**
- 5. Small Business Jobs Act**
- 6. Tax Relief Act of 2010**
- 7. Rail Transit Expansion**
- 8. Downtown LA Still Booming**

P3 Deal Structures

Ground Leases

- Sources for stable cash flow
- Financing for capital projects
- Ownership of property/development after lease term is over

Lease-Leaseback (financing public assets & revenue)

- Frees up equity from existing projects to fund new projects
- Allows continued use of assets
- Ownership of property/development after lease term is over
- Capitalizes public agency revenue streams

**P3's can be augmented by Revenue Bonds, CFD's
Redevelopment Bonds (gas tax, sales tax, tax increment)**

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

Redevelopment Agencies?

A Source of Funds that enables economic development:

- **Nearly 400 agencies operate in California**
- **Redevelopment Agencies (RDAs) typically invest in real estate, retail and infrastructure.**
- **RDA's are required to invest 20% of revenues on affordable housing.**
- **Most major infill or TOD projects have some RDA involvement.**

Governor Brown plans to eliminate Redevelopment Agencies.

Enterprise Zones?

Offers significant tax incentives:

- Hiring credit
- Sales or use tax credit for qualified machinery purchases
- Accelerated business expense deduction
- Net interest deduction
- 15-year net operating loss (NOL) carry-forward (suspended under the State's 2010-11 budget)

Governor Brown seeks to eliminate the EZ Program to recover revenues lost from tax credits

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 in a Regional Center or Targeted Employment Area
 - Investment must create full-time employment for ≥ 10 US workers
 - 10,000 EB5 visas available every year
- **California houses 25% of U.S. Regional Centers. (31 of 123)**
 - Eligible Categories – Hotels, Retail, Restaurants, Food, Apparel, Transportation, Warehousing, Furnishings, Printing & Paper, Health Care, and many others.
 - Can be used for real estate projects (new and existing)

Small Businesses Jobs Act

- \$12 B in Tax Relief to Small Business (effective Sept 27, 2010)
- Expansion and enhancement of SBA loan programs, including:
 - **More funds and expanded eligibility for businesses:** Jobs Act loans will support about 14 billion in small business lending
 - **Higher Loan Limits:** Permanently increases SBA 7(a) and 504 from \$2M to \$5M (up to \$5.5M for manufacturers in 504 program). “Microloans” for underserved communities increased \$35K to \$50K.
 - **Working Capital and Commercial Real Estate Refinancing:** Increases “SBA Express” loans from \$350K to \$1M through 9/17/11.
 - **Specific assistance for businesses that sell inventory with title** (cars, RVs, boats, etc.).

Tax Relief Act of 2010

- **Income Tax** - Current rates ordinary income retained for two years, including capital gains @ 15%
- **Bonus Depreciation** - 100% of investment in new equipment for 2011; 50% for 2012
- **Research and Development Tax Credits thru 2011**
- **Social Security Tax** - Employees & self-employed workers get a reduction of 2 percentage points in 2011
- **Estate Tax** - Reinstated with a top rate of 35% with lifetime exclusion to \$5M per person

Transportation - TOD

High-Speed Rail (HSR)

- Plan includes: 790 miles of track and 26 stations
- Funding: \$42 Bil approx = \$9 Bil (Prop 1A-2008) + \$5.5 Bil (Fed) + ???
- Projected completion 2020-2030, providing all funding is established
- Local governments and COG's working on TOD plans at HSR stations
- P3 Opportunities throughout the State



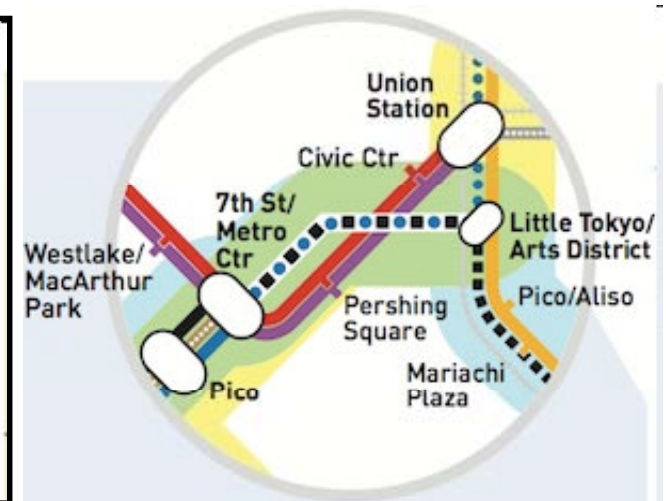
Transportation - TOD

AB 987 – “Transit Village Development Districts”

Expands the max. size of a transit village development district from ¼ mile to ½ mile radius of a transit station. More P3 opportunities!

Measure R and the 30/10 Plan

- Westside Subway extension (Purple Line) route approved by MTA Board on Oct 28, 2010 from Western Ave to VA Hospital. Construction could begin in 2013.
- Downtown regional connector also approved. Could boost ridership on existing lines by 5-18%.



Downtown LA Update

Transportation – Regional Connector will allow rail riders to cross the County while minimizing transfers.

Neighborhoods

Spring Street becoming a cohesive stretch of residential, retail and nightlife (4th to 7th St). New Spring Street Park expected.

Bringing Back Broadway – Now in 4th year of 10 yr plan to revive Broadway. New Street Car to break ground 2013 and open 2015.

Major Projects

Possible new Football Stadium, Convention, & Hotel facility by AEG

“The Broad” Art Museum to be finished by 2013

Electric car mfr BYD Headquarters set to open next month

Wilshire Grand’s Grand Plans – including city’s new tallest building





City of Los Angeles “Siren of the Southland”

- Lure of the City is strong, but business costs remain a dangerous harbor.
- Consistently a “highest cost” city in California for business (per Kosmont-Rose Cost of Doing Business Survey).
- Gross Receipts tax significantly higher than neighboring cities despite recent reductions and exemptions.
- Despite high taxes, budget deficit looms at \$350M+.

Forecast 2011



Will this Sequel
be better?

Commercial Real Estate

- **Trading at the top and bottom** – Pricing on trophy prices is strong. Interest in distressed properties is high. The middle is muddled. Lenders beginning to trade. CMBS is reviving.
- **Geography is Bifurcated** - Coastal, core markets are reviving. Inland markets still suffering from weaker fundamentals & investor interest.
- **CRE Recovery is Sensitive to Unemployment, Occupancy and Interest Rates** – Debt financing will remain challenging.
- **Ground-up private development is scarce** - Land prices favorable, but high vacancy rates and stringent construction lending are problematic. Public money available to induce.

Commercial Real Estate

Other Challenges to Commercial Recovery include:

- **Uneven housing recovery & high foreclosure levels**
- **Record US Public Debt; forthcoming spending cuts and higher taxes**
- **Local & State deficits; higher real estate taxes and fees**

Muni Bond Defaults Looming

Next crisis from the housing meltdown could be municipal defaults:

- Since Prop 13, government bonds have leveraged budgets where taxes couldn't be raised or capital accumulated
- Pension liabilities and severely reduced tax flow to strain governments ability to pay back debt on these muni bonds
- Reduced bond ratings prevalent and municipal market severely impaired
- Market continues to experience an increase in muni bond "redemptions" as bond holders opt for other investments
- Some experts predict 50+ cities may default on their debt in 2011.

CENTRAL VALLEY TOWN OF CHOWCHILLA DEFAULTED THIS MONTH

Forecast 2011

1. **CORPORATE SECTOR WILL STEP UP AS THE BEST CONSUMER OF THE YEAR. MAIN STREET WILL GRADUALLY FOLLOW.**
2. **A RETURN TO THE BASICS FOR REAL ESTATE – “Real estate is not the driver of real estate” in 2011. Business and jobs will influence RE more than speculation or capital markets.**
3. **SLOW BUT CONSISTENT RECOVERY FOR UNEMPLOYMENT.** The Golden State still harbors enough gold to stimulate our diversified and innovative industrial base.
4. **COMMERCIAL REAL ESTATE TRANSACTIONS TO START FLOWING IN 2011.** More CMBS financing and more investor equity available in 2011.
5. **PUBLIC-PRIVATE DEALS.** Public Facilities a major opportunity: transportation, infrastructure, schools, other public/private. City Hall open for business but not a very flush player right now.

6. **GOVERNMENT STILL TAKING THE BRUNT...BUT PRIVATE SECTOR IS WAKING UP** - Private equity is coming out of hiding since second half of 2010, looking for deal fundamentals based on reliable returns and very picky about value add strategies.
7. **AFFORDABLE HOUSING STEADY** - Affordable Housing will continue to be a dominant product type for new and rehab development in California, but redevelopment at risk may mean one less MAJOR financing source.
8. **STIMULUS STILL STIMULATING** - Money for Real Estate Investment is still available from Federal and Local Government sources (equity, debt, infrastructure and land)
 - Public Money may be a primary engine for deals in 2011
 - Leftover ARRA funds will drive projects in CA , but at a slow pace due to “red tape” in the award process

9. **REDEVELOPMENT AND ENTERPRISE ZONES.** Stiff opposition to Brown's plan will likely prevent the decimation of both programs, but expect both to be changed or curtailed.
10. **NO SACRED COWS.** Brown wants to tinker with Prop 13 and repeal Prop 22 (measure protecting local revenues). Labor and management will wrestle between pension benefits and salaries.
11. **MODERATES MEAN BUSINESS.** The redraw of Legislative Districts and 51% budget majority may reduce legislative partisanship, enabling more pro-business legislation. Don't expect sweeping change until 2020.
12. **FOR WHOM THE "BELL" TOLLS.** More small cities will be exposed for mismanagement and many public agency managers are moving quickly to retirement.

*"Fasten your seatbelt; it's going to be a rough ride."
– Governor Brown*

The End



An aerial night view of a city, likely Los Angeles, with the Hollywood sign visible in the foreground. The city lights are illuminated, and the sky is dark blue. The text "This presentation is available online" is overlaid in white.

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