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*P R E S E N T S :*

# **2012 Economic Forecast**

***Base Hit, Ball or Strike?***

Presented by:

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

# Season Preview

- **The State of the State**

*Bases loaded, Bottom of the 9<sup>th</sup>...*

- **Tools Available for Economic Development**

*A Return to Spring Training*

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

*MVP's and Rookies*

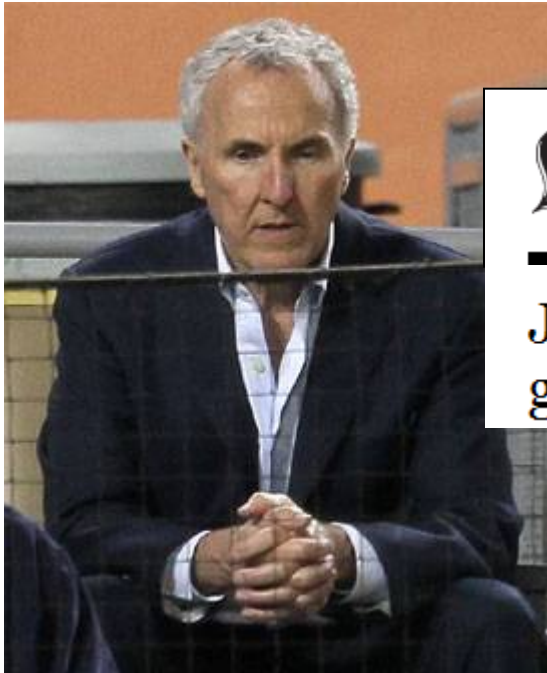
- **Outlook 2012**

*Bringing it Home*

# *The State of the State*



# California Housing Crisis



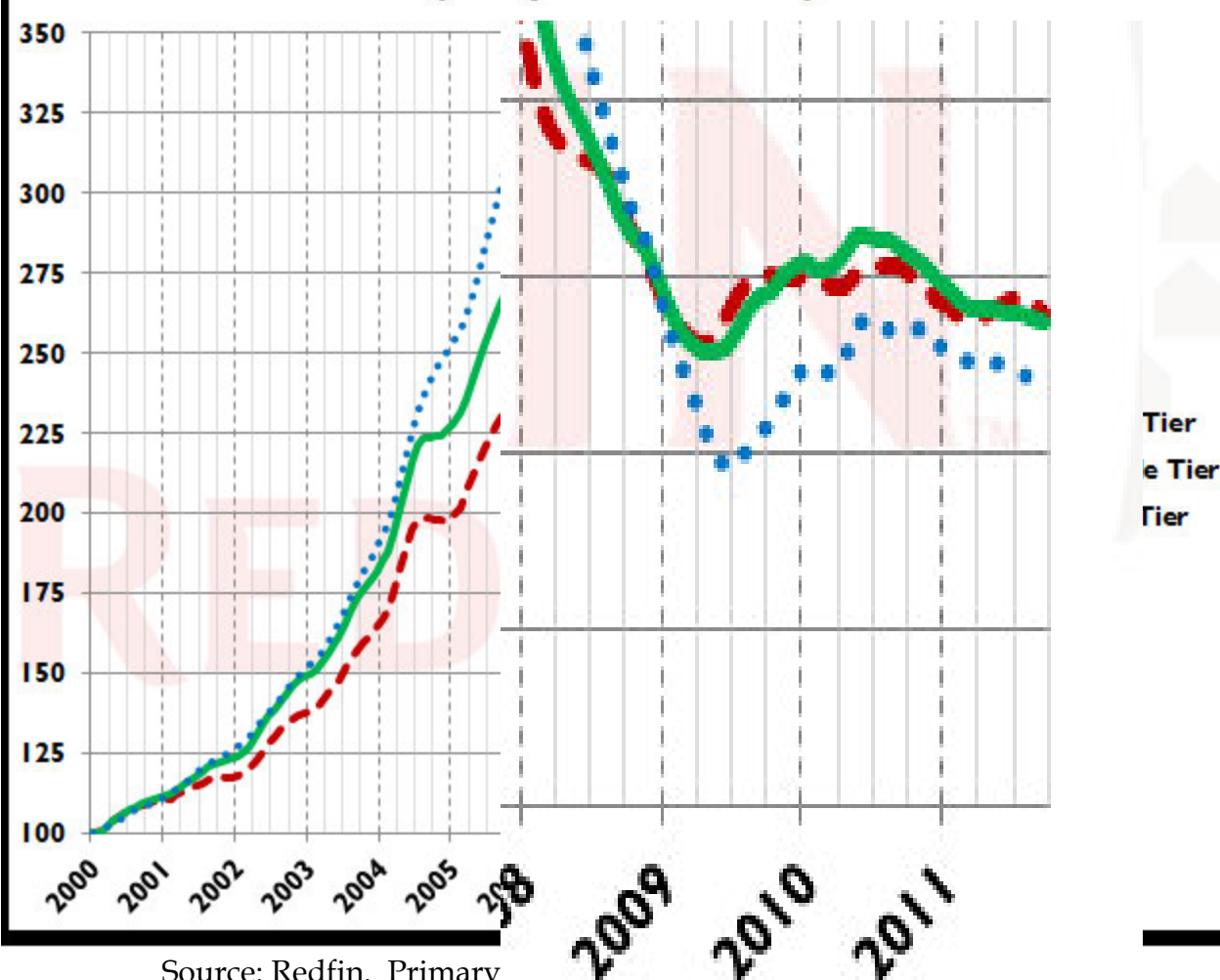
**Los Angeles Times** | SPORTS

Jamie McCourt gets four homes, Frank McCourt gets two

# Home Prices

## HOME PRICES – A Statistical "Grounder"

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



Source: Redfin. Primary

PRICES/SALES  
STABILIZING WITH  
POSSIBLE MODEST  
GROWTH

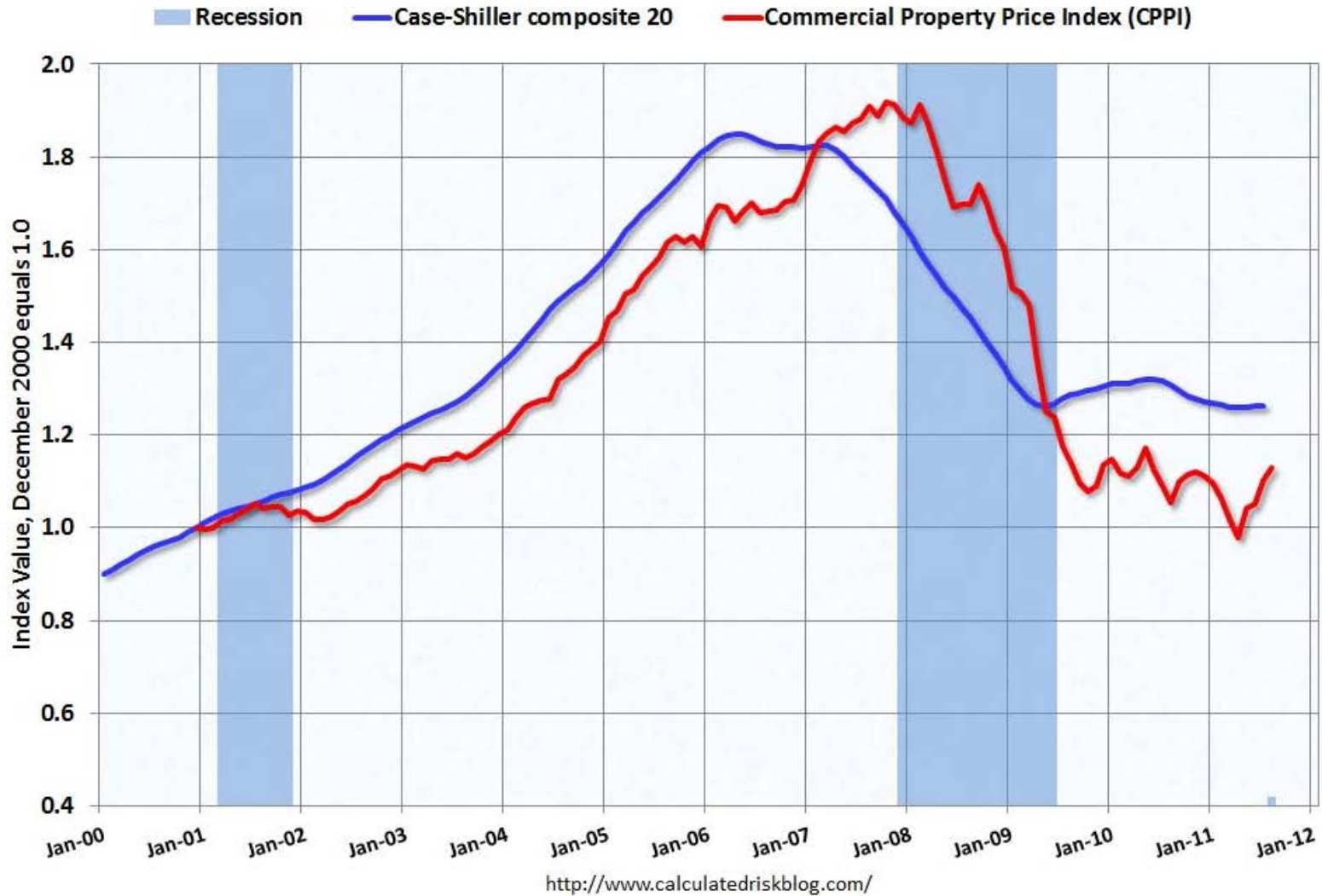
*But...*

HURDLES REMAIN:

- UNEMPLOYMENT
- VACANCIES
- FORECLOSURES  
INCREASING  
THE SUPPLY
- MORTGAGE  
AVAILABILITY

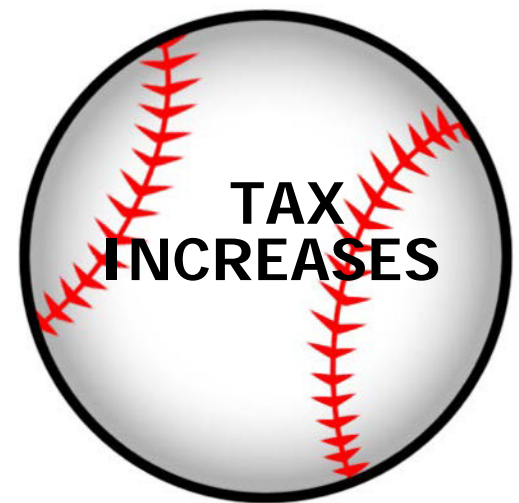
# Commercial Real Estate

## Comparison of Commercial and Residential Price Changes

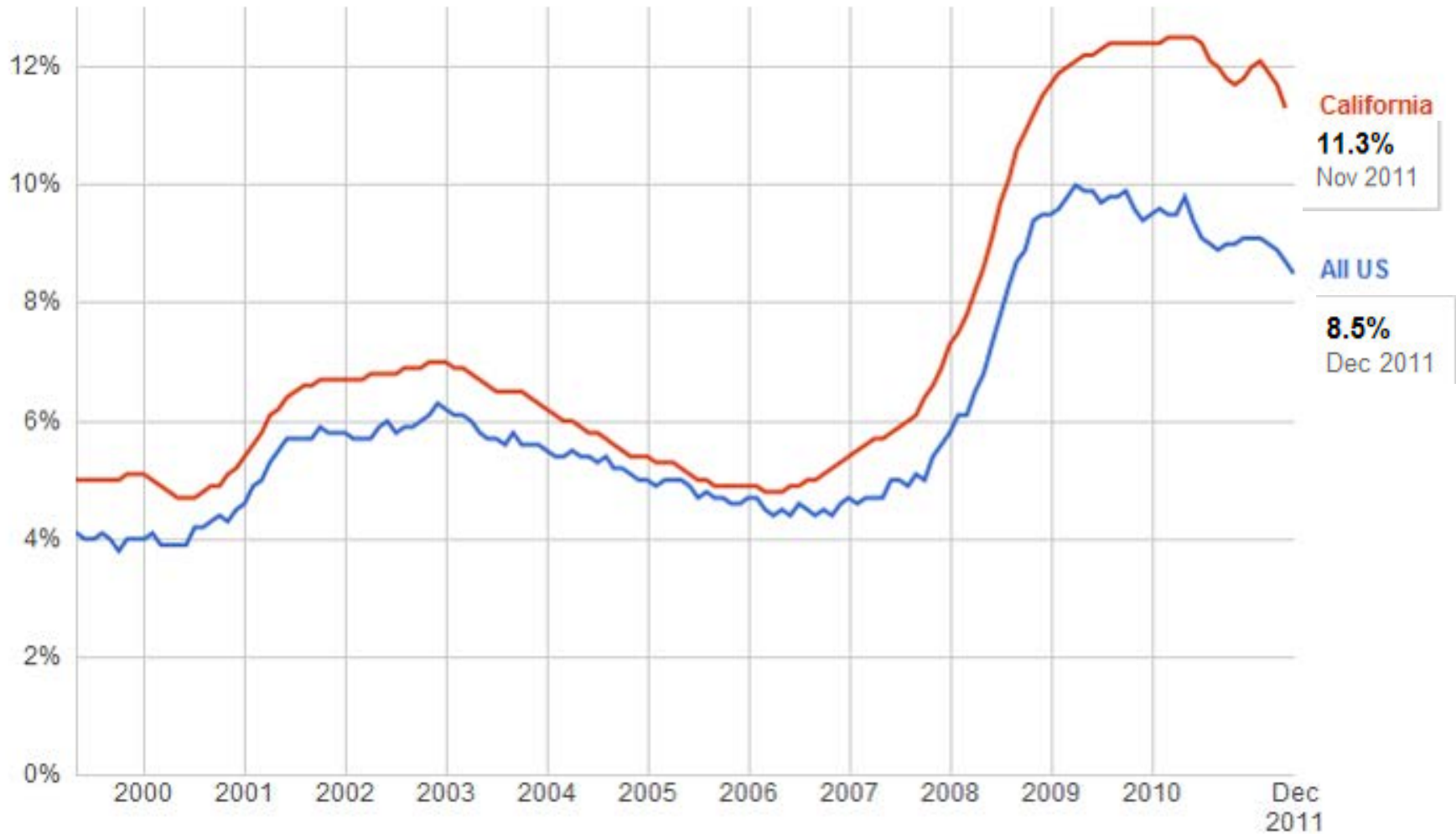




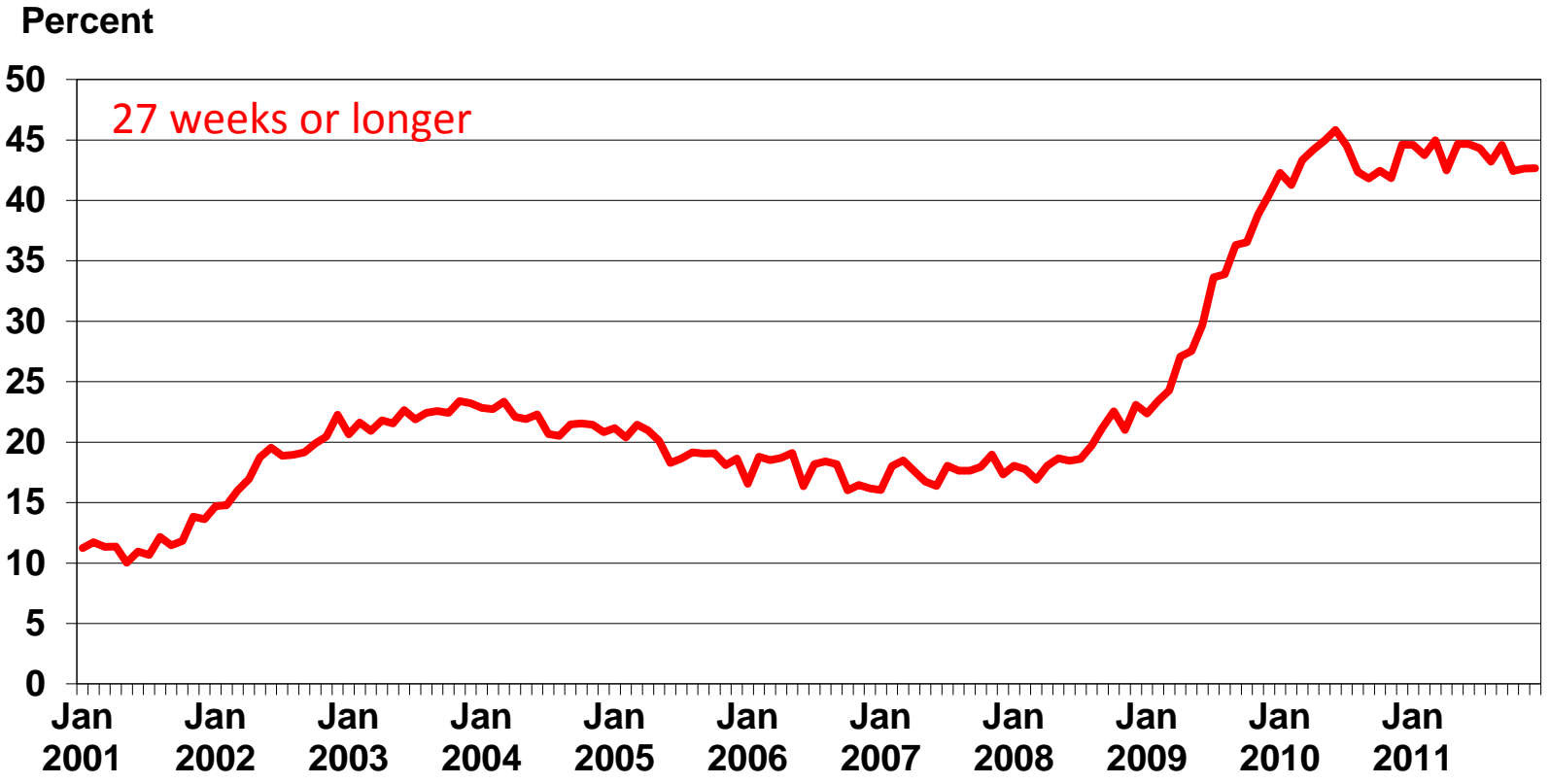
# California's Starting Lineup



# Unemployment Rate Down



# But...Long term # unemployed not budging



# 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***



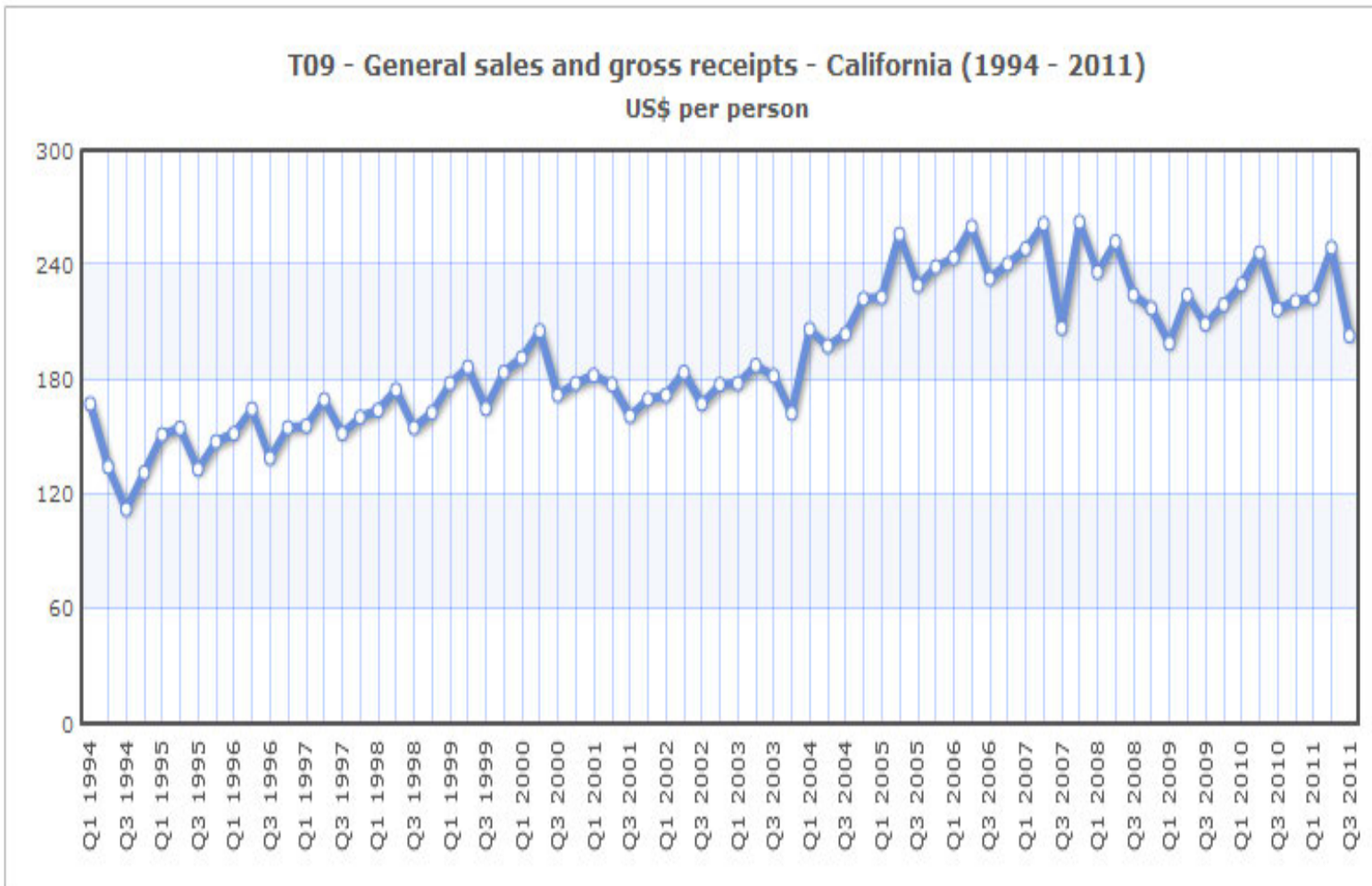
# California Three Main Tax Sources

**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



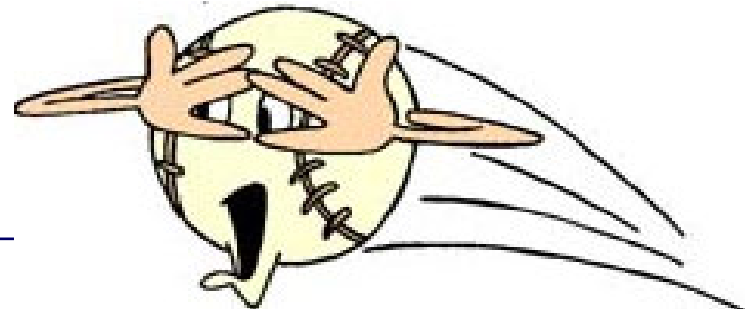
# Sales Tax per Capita



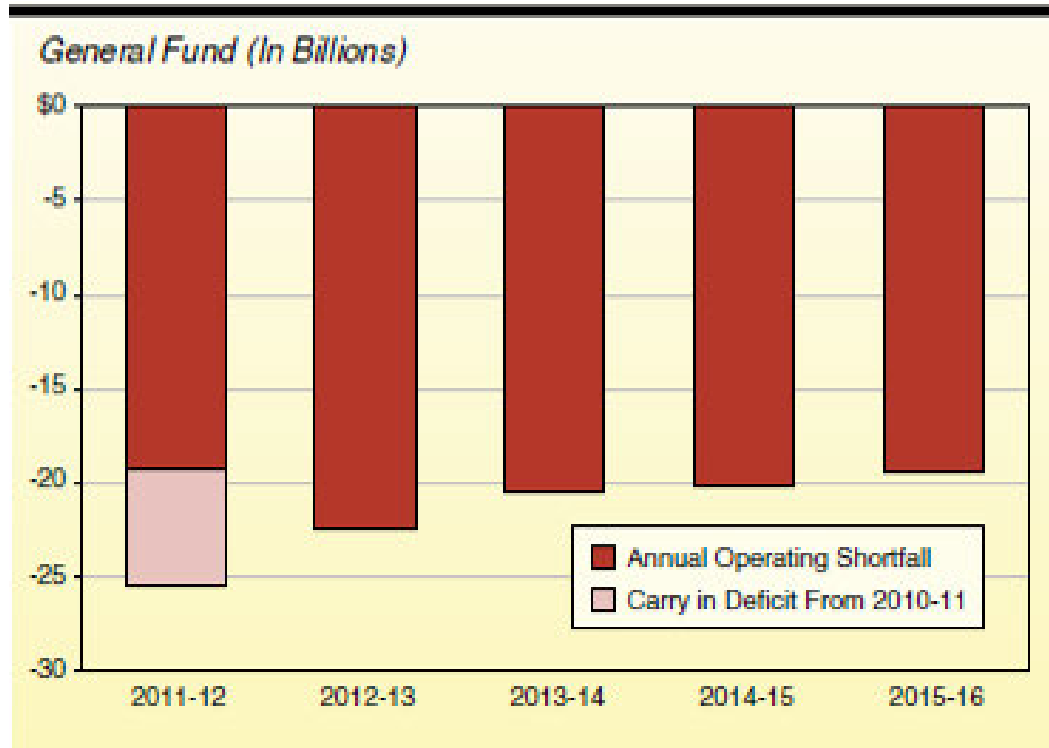
# From Losing Streak to Comeback Kid?

- 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 5<sup>th</sup> 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.



# Budget Crisis

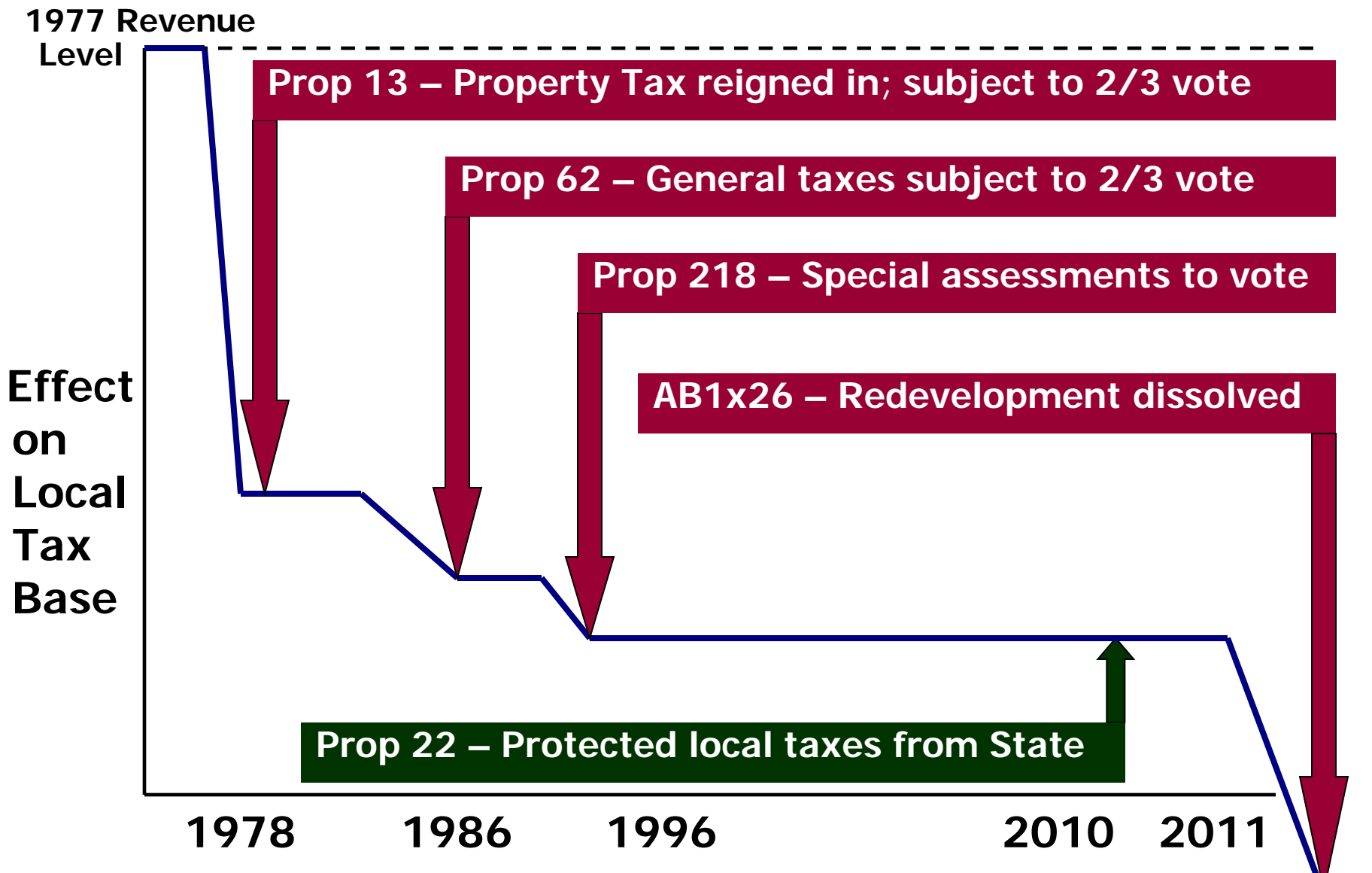




# *What the Heck Happened?*



# 33 Years of "Tax Strikes"



Note: Not to Scale

# Redevelopment – Shut Out

**All RDA's officially closed on Feb 1<sup>st</sup>.**

**48 states have Tax-Increment Financing (TIF).**

***California does not.***

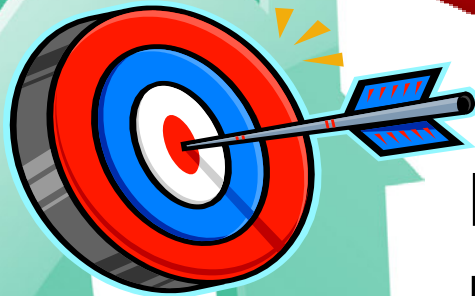


**Private sector expecting opportunities to buy real estate at a discount - but expect delays.**

# 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 “R”

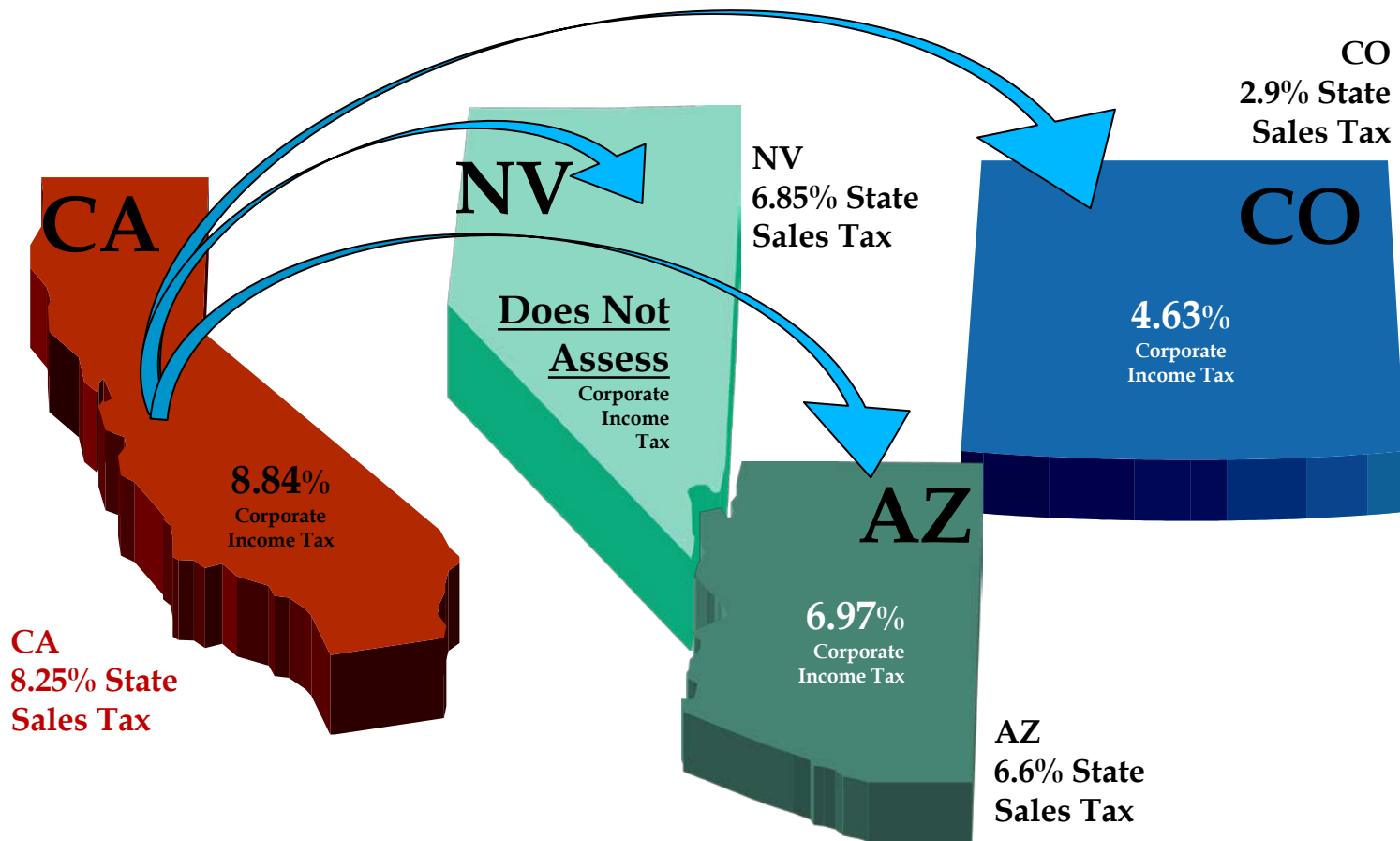


Redevelopment WAS the primary tool used to generate new jobs and taxes...



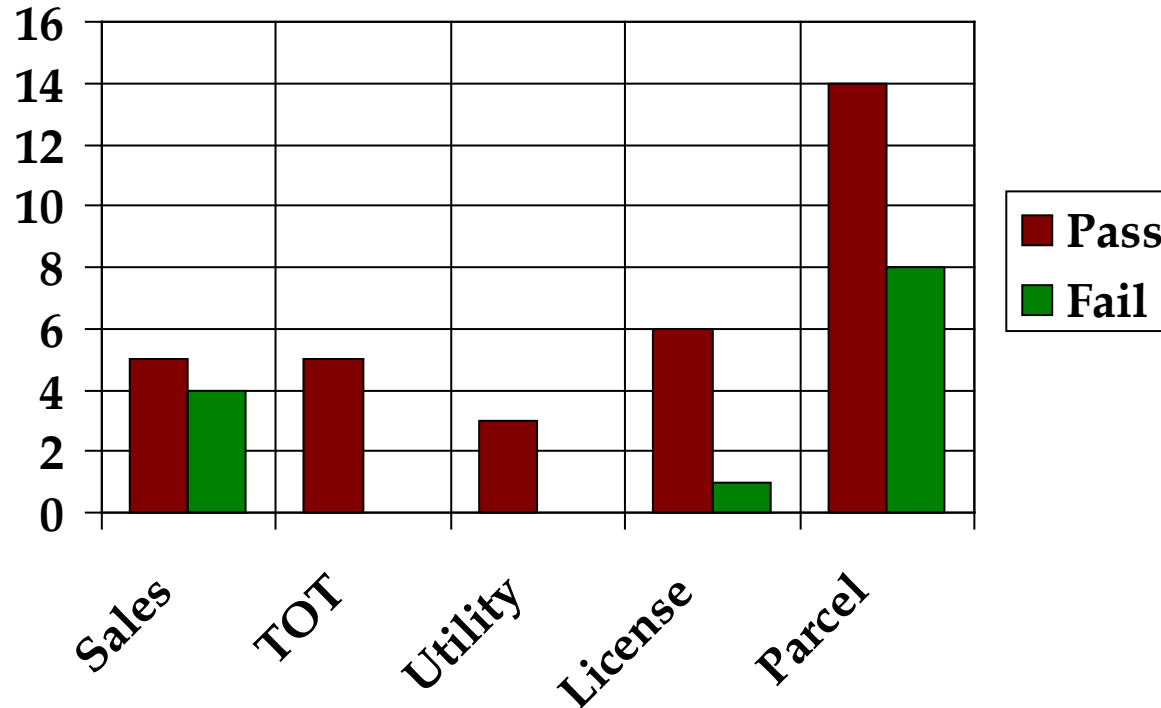
# California Cities Play to Win

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

# *Tools Available for Economic Development*



# What's Left after Redevelopment?

## Existing Economic Development Tools

- Lease-Leaseback
- Special Districts – CFD, BIDs
- New Market Tax Credits
- Private Activity Bonds
- CA Infrastructure Development Bank



## Newer Tools

- Infrastructure Financing Districts
- Site-Specific Tax Revenue Pledges
- EB-5: Immigrant Investor Program





# 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.**

- \$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  $\geq 10$  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)
- 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

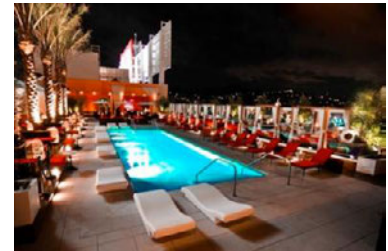
**Investment Placement:** Drai's Restaurant and Nightclub  
Delphine Restaurant

**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

- **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**

# 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.
- **PAB's won't heat up unless** small firms can gain sales and production volume.

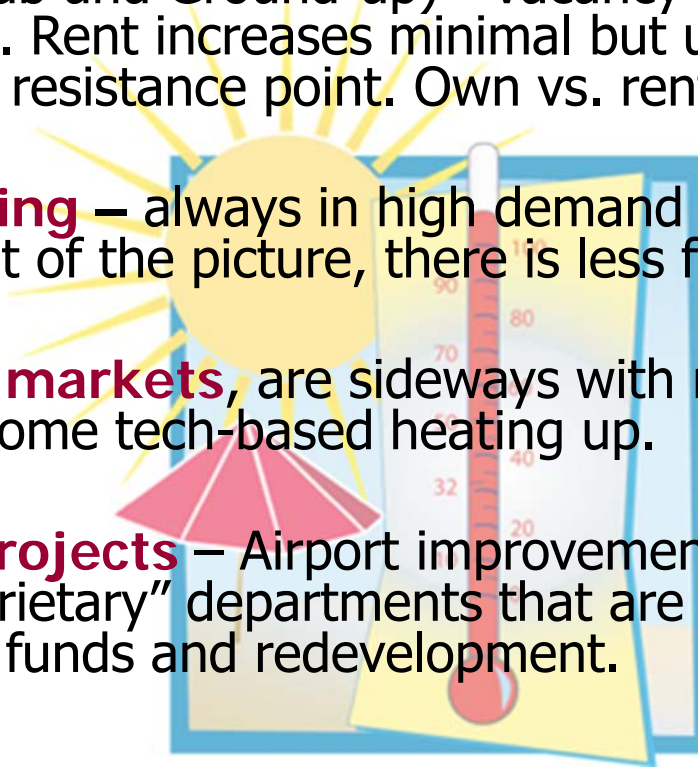
So where is the action for  
Economic Development?

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**, are sideways with rents stable. Secondary markets cooling. Some tech-based heating up.
- **Infrastructure Projects** – Airport improvements, Harbors, Utilities, upgrades by “proprietary” departments that are less dependent upon distressed general funds and redevelopment.



**Suburban Single Family Sales & Development staying cool**



- **“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.



- **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

# HOT – Public Transit

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

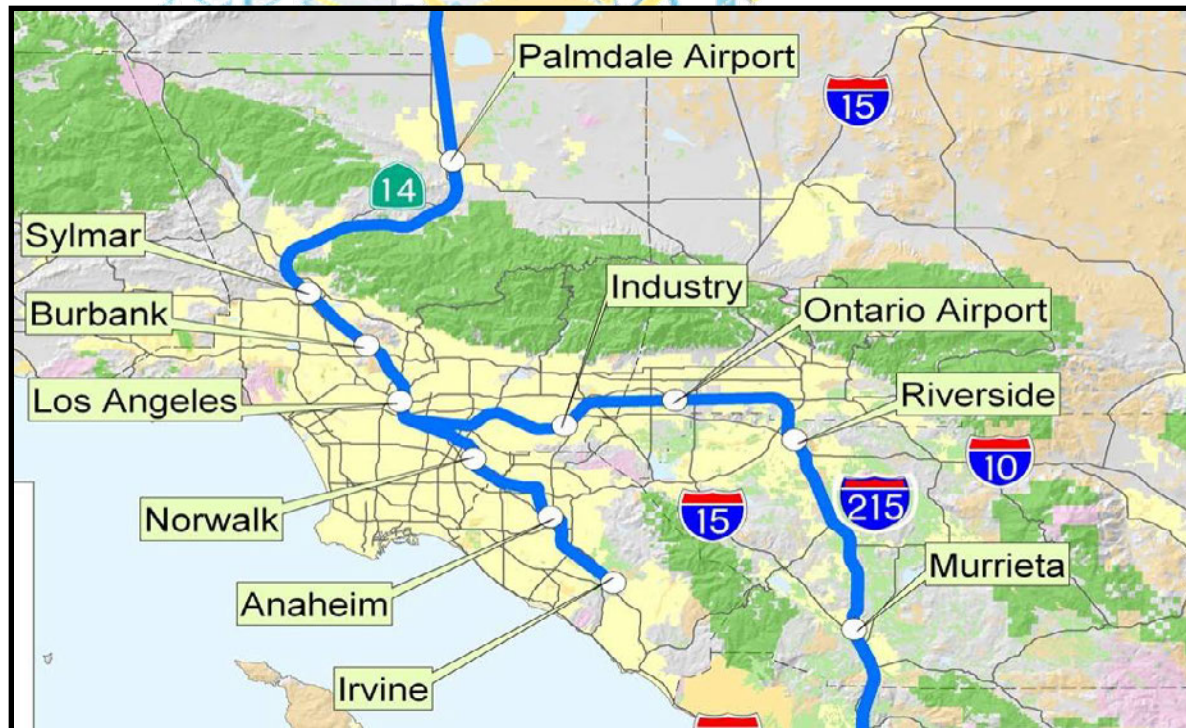
**More opportunities coming:**

- **Federal Money – ~\$56 Billion Transportation Bill.** Infrastructure and jobs act supported by both parties
- **Action to the North: LA County's Measure R** extension of ½ cents sales tax for 10 years



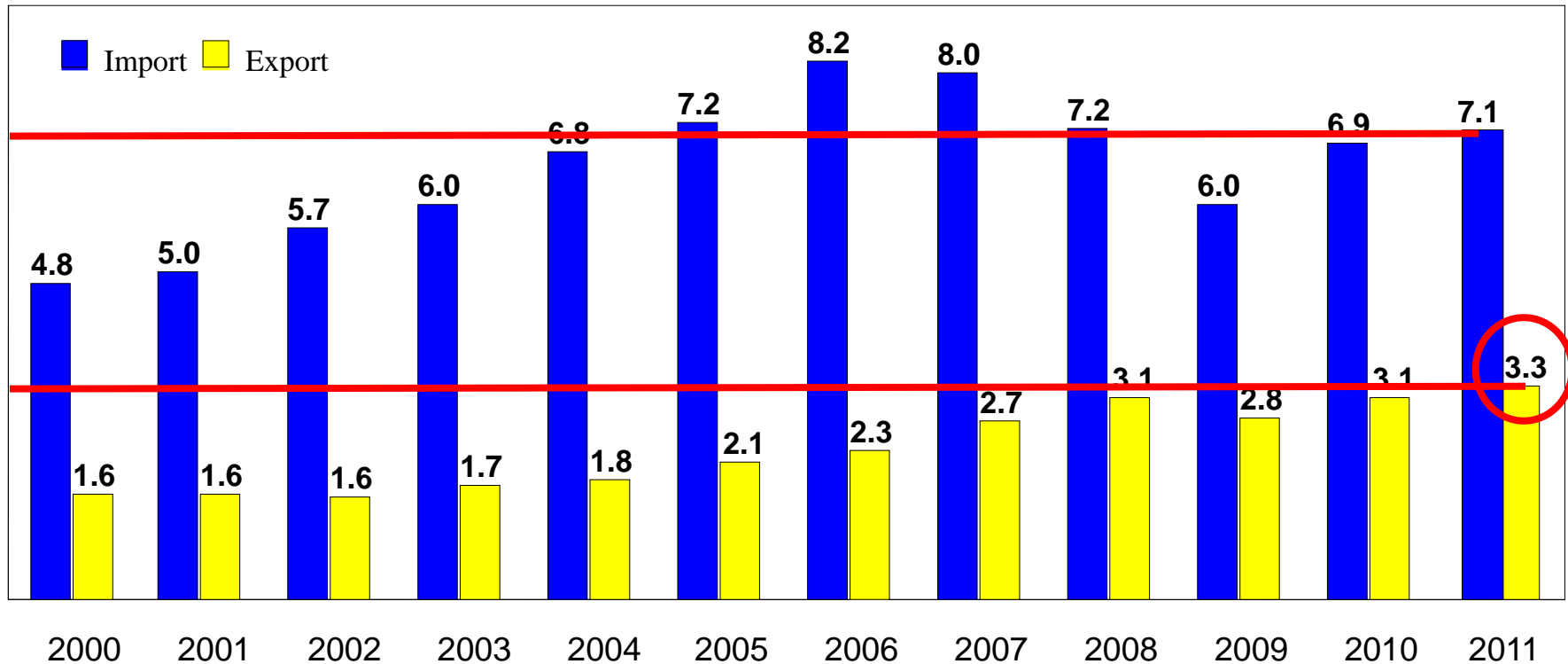
# High Speed Rail (HSR) - COOLING

- 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

## Imported & Exported Container Volume, 2000-2011 Ports of Los Angeles & Long Beach (mil. TEUs)



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

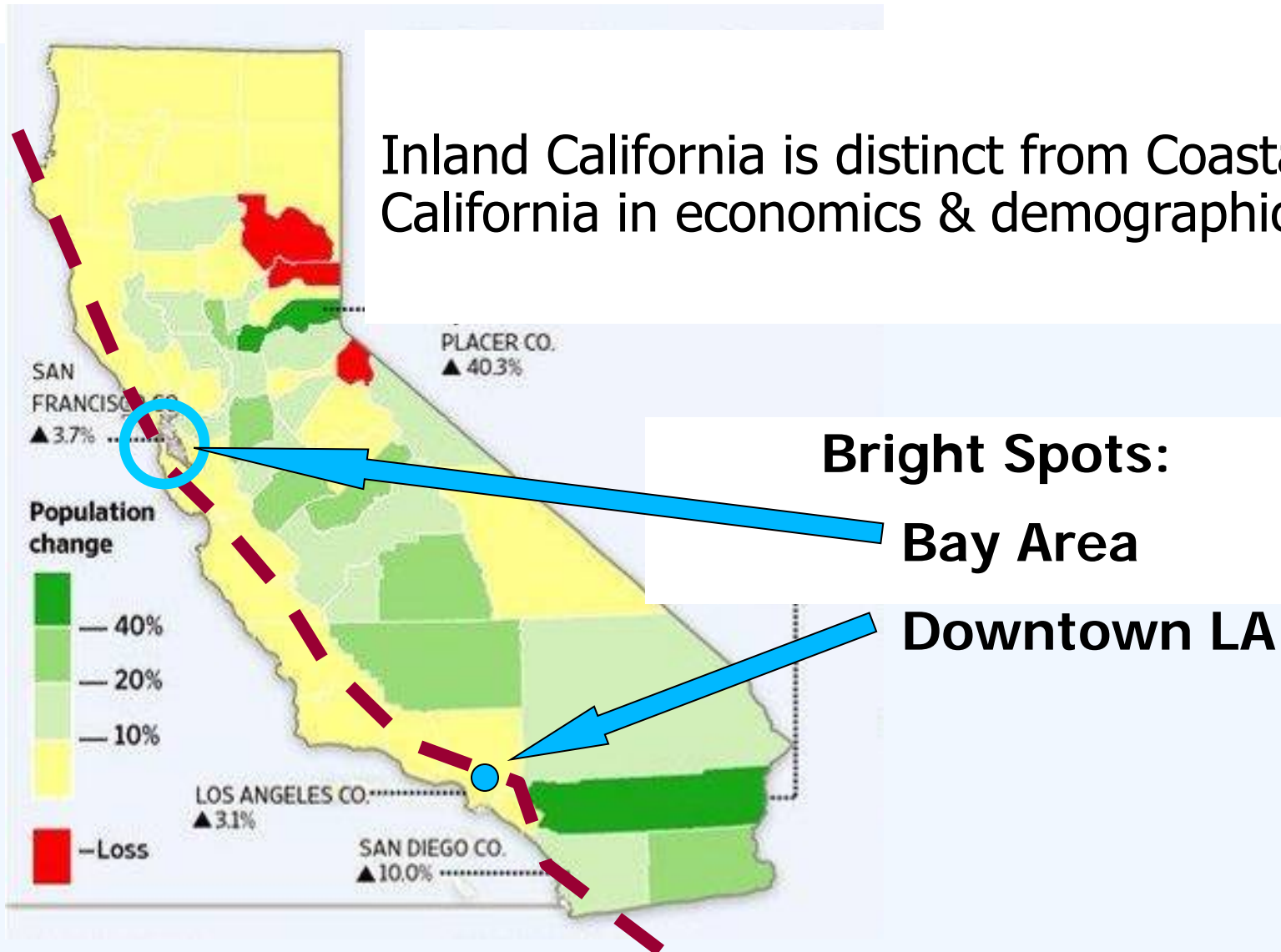


# *Outlook 2012*



# Dissecting California

Inland California is distinct from Coastal California in economics & 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 – “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)**

# 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.

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

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



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