



Kosmont Companies
Real Estate and Economic Advisory

Kosmont Realty Corporation
Funding Solutions for Public-Private Deals



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P R E S E N T S :

2012 Economic Forecast

Base Hit, Ball or Strike?

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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**

Bringing it Home

The State of the State



California Housing Crisis



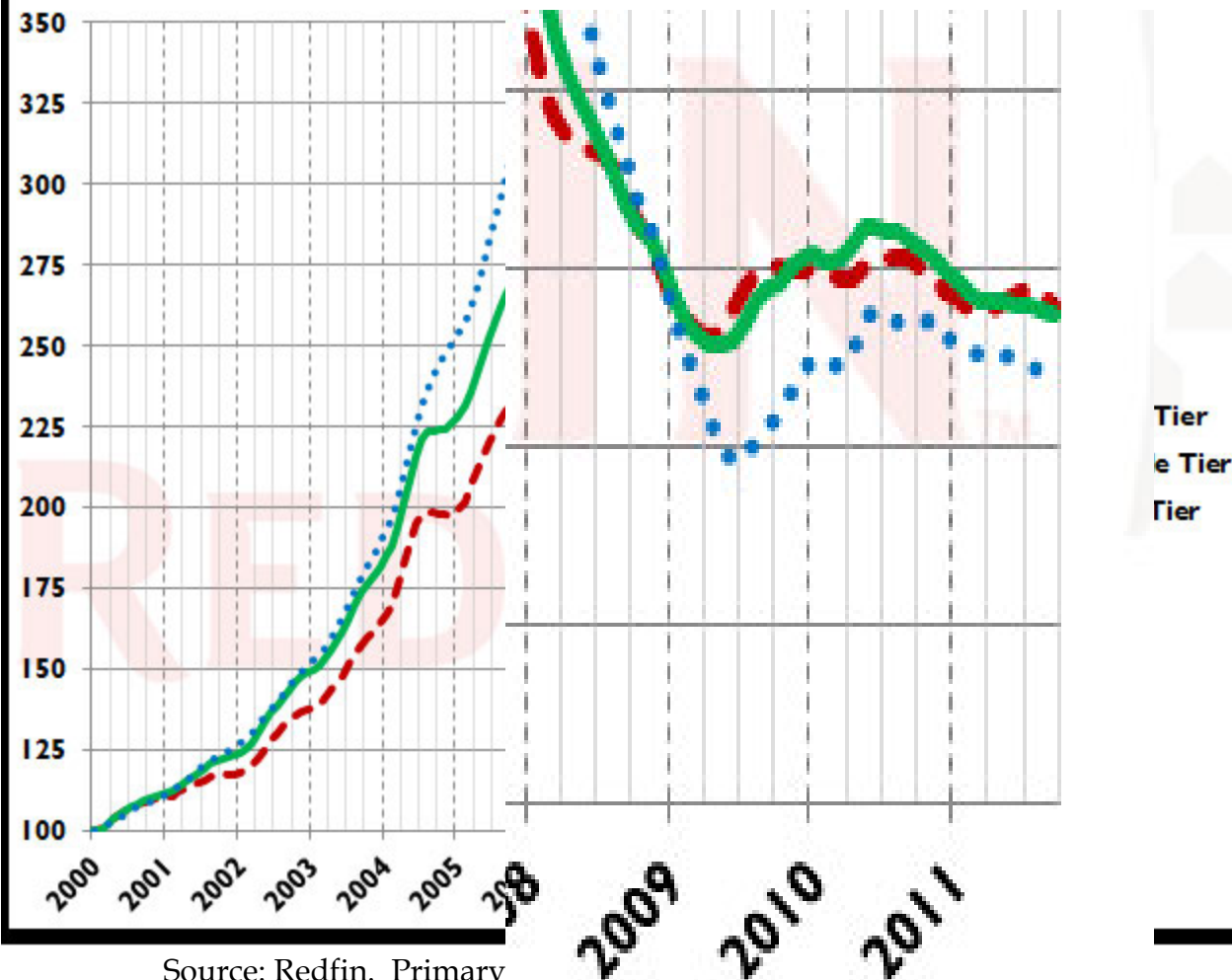
Los Angeles Times | SPORTS

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

Residential Sales Activity

Year-to-Year Percent Change

(Pending Sales vs. Closed Sales)

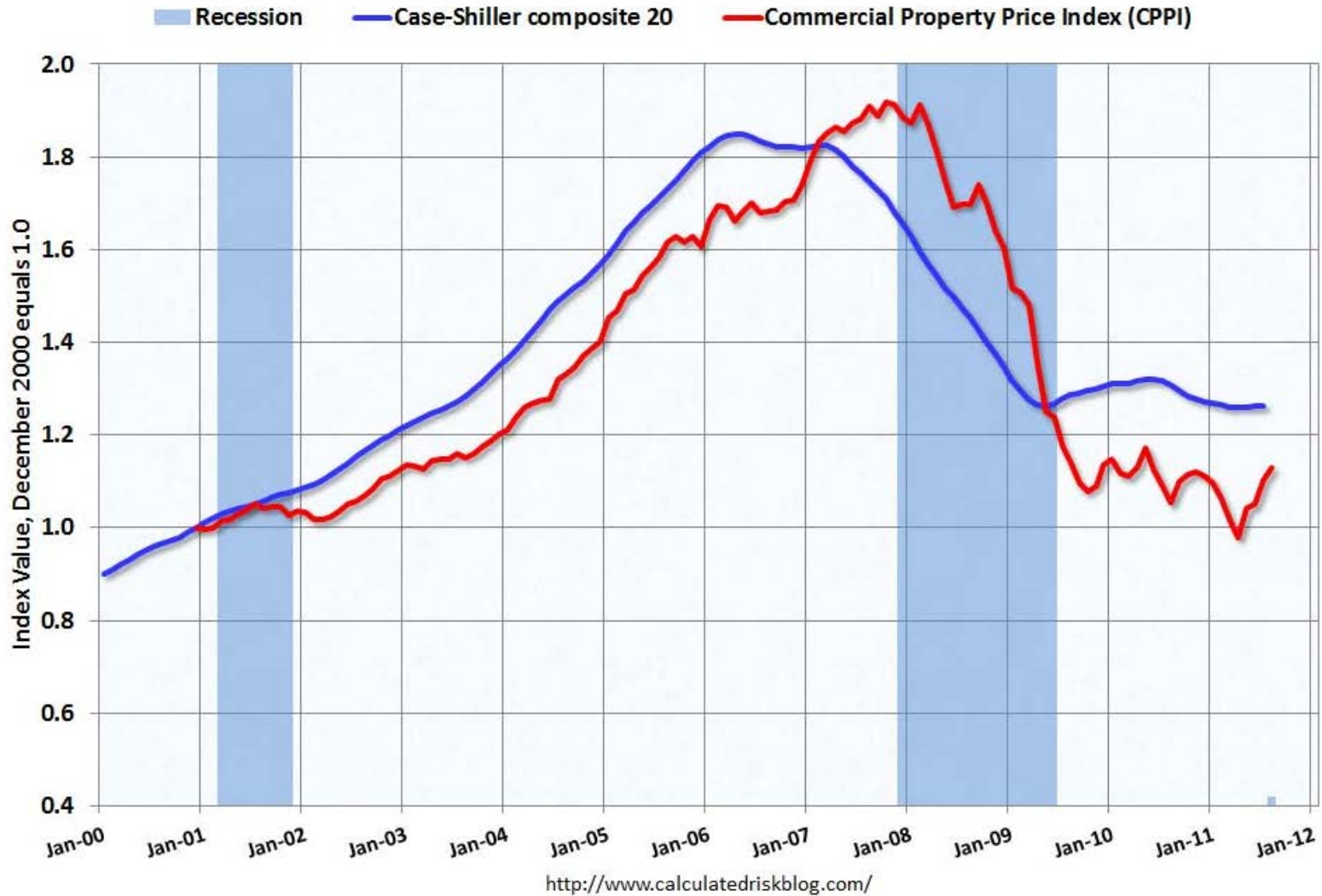


SOURCE: California Association of REALTORS®

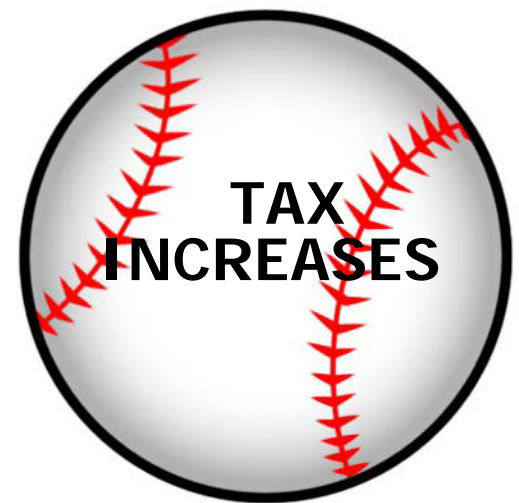


Commercial Real Estate

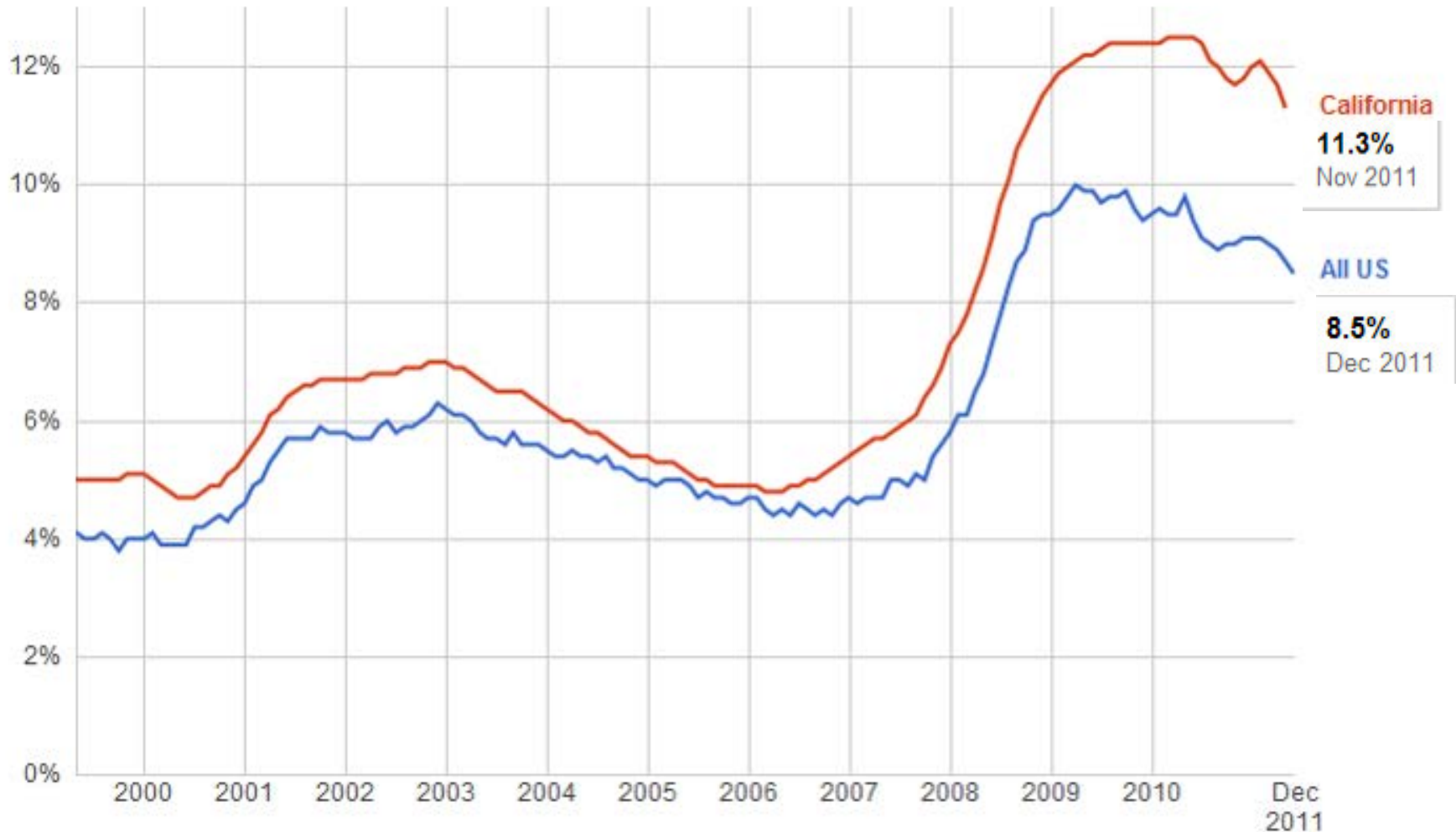
Comparison of Commercial and Residential Price Changes



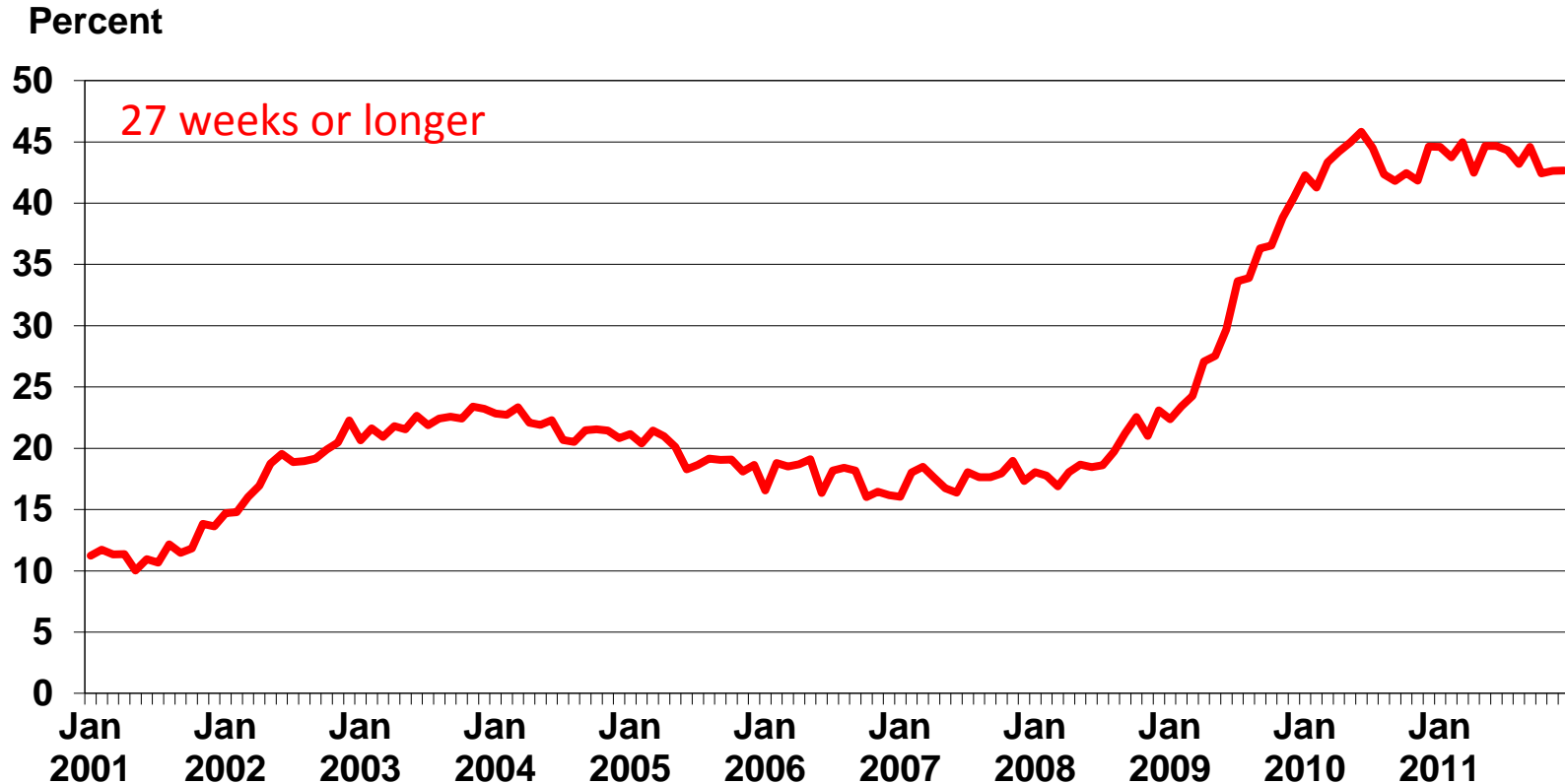
California's Starting Lineup



Unemployment Rate Down



But...Long term # unemployed not budging



Pension Obligations – An Ongoing Threat

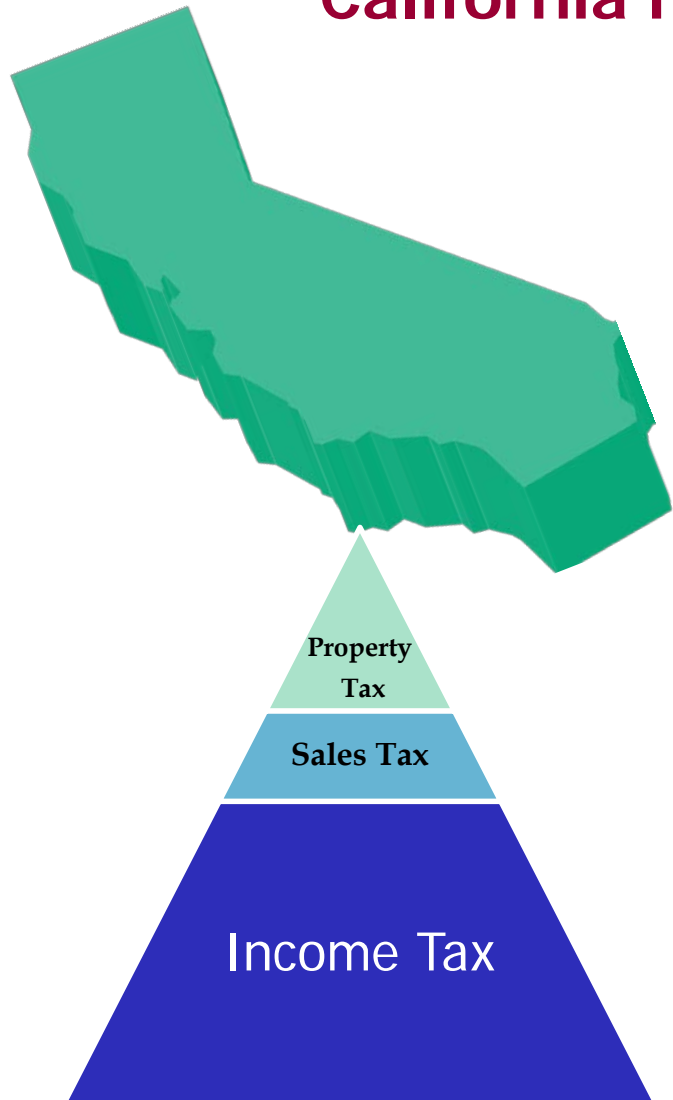
- **Stanford Univ. estimates unfunded deficit *EXCEED* \$500B dollars over next 16 years**
- **Over 15,000 retired public workers with pensions > \$100,000 annually**
- **Today most public employees can retire in 50's with pensions at 90% of salary**
- **Santa Ana, arguably Orange County's most labor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

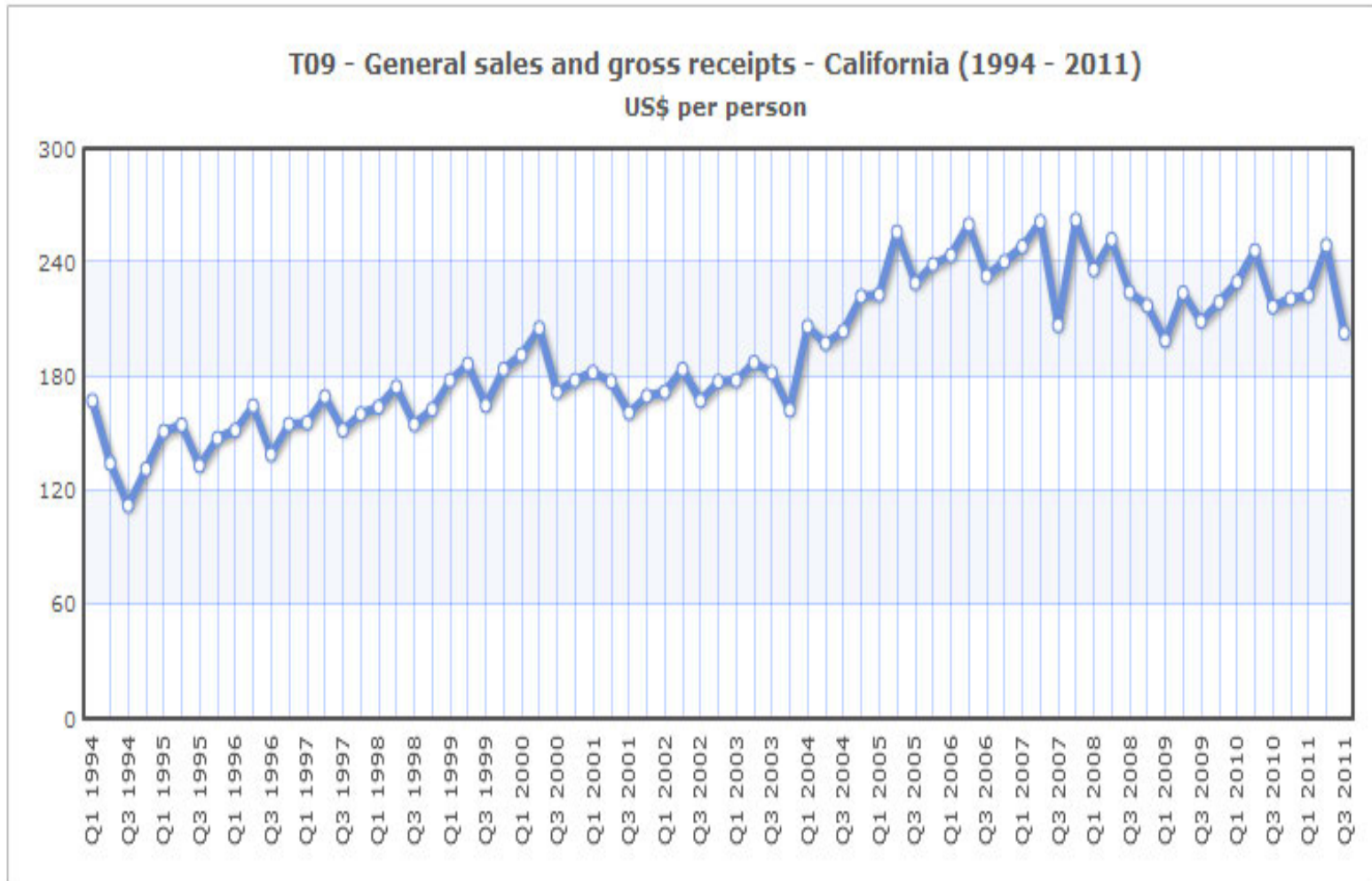
California Three Main Tax Sources

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



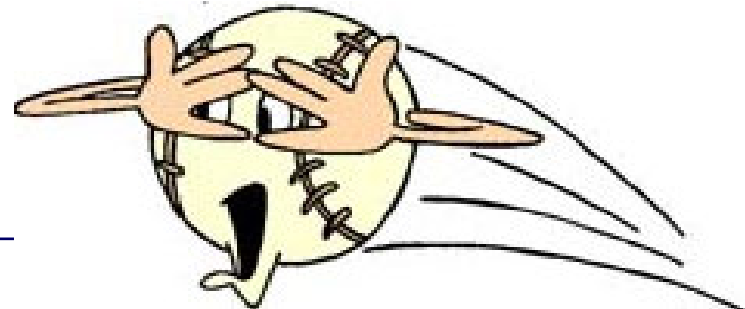
Sales Tax per Capita



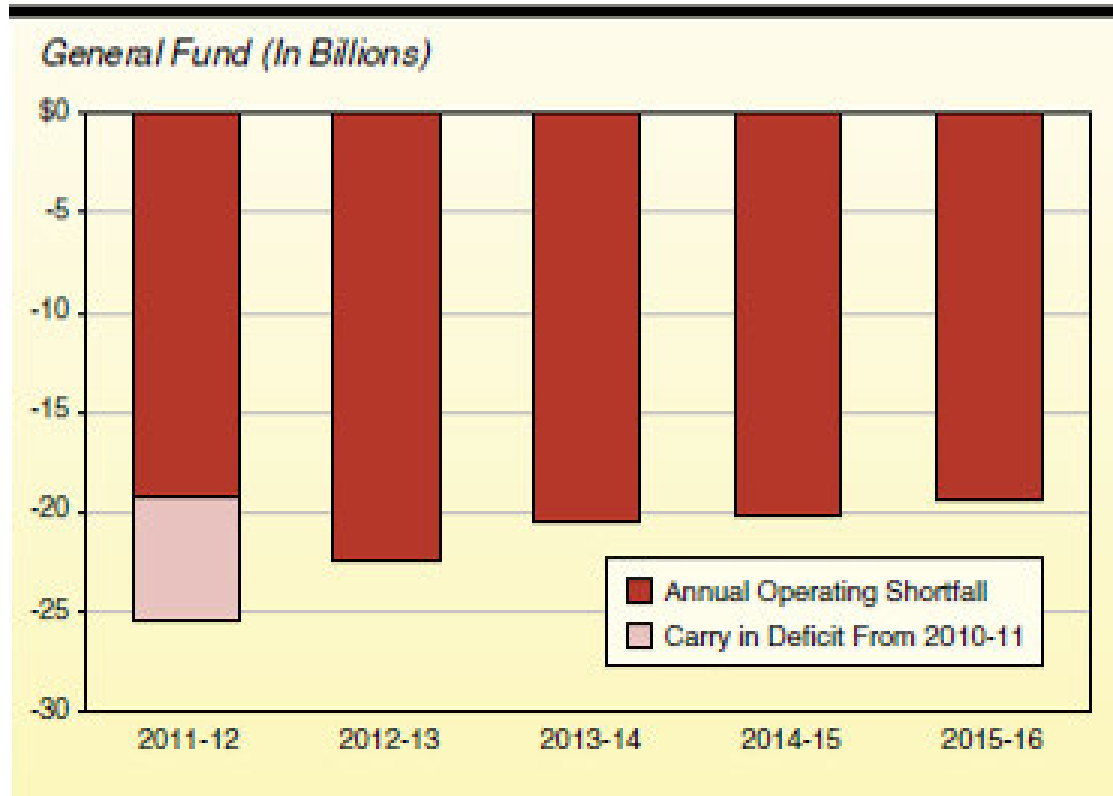
From Losing Streak to Comeback Kid?

- 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 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 HOME RUN – after years of losing population, California regained its status as an “net inbound” state in 2011, attracting more arriving than departing families.



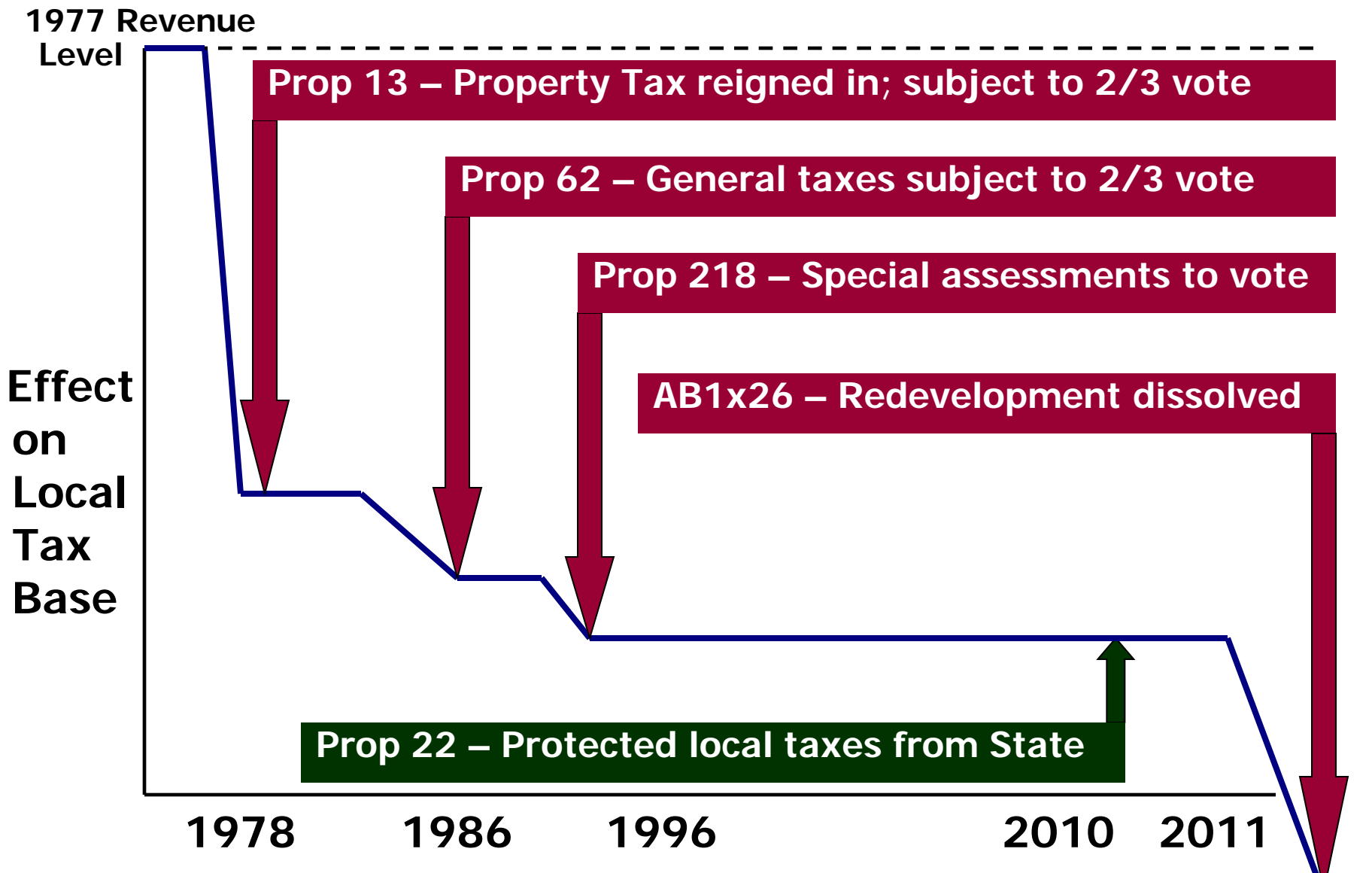
Budget Crisis



What the Heck Happened?



33 Years of "Tax Strikes"



Note: Not to Scale

Redevelopment – Shut Out

All RDA's officially closed on Feb 1st.

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



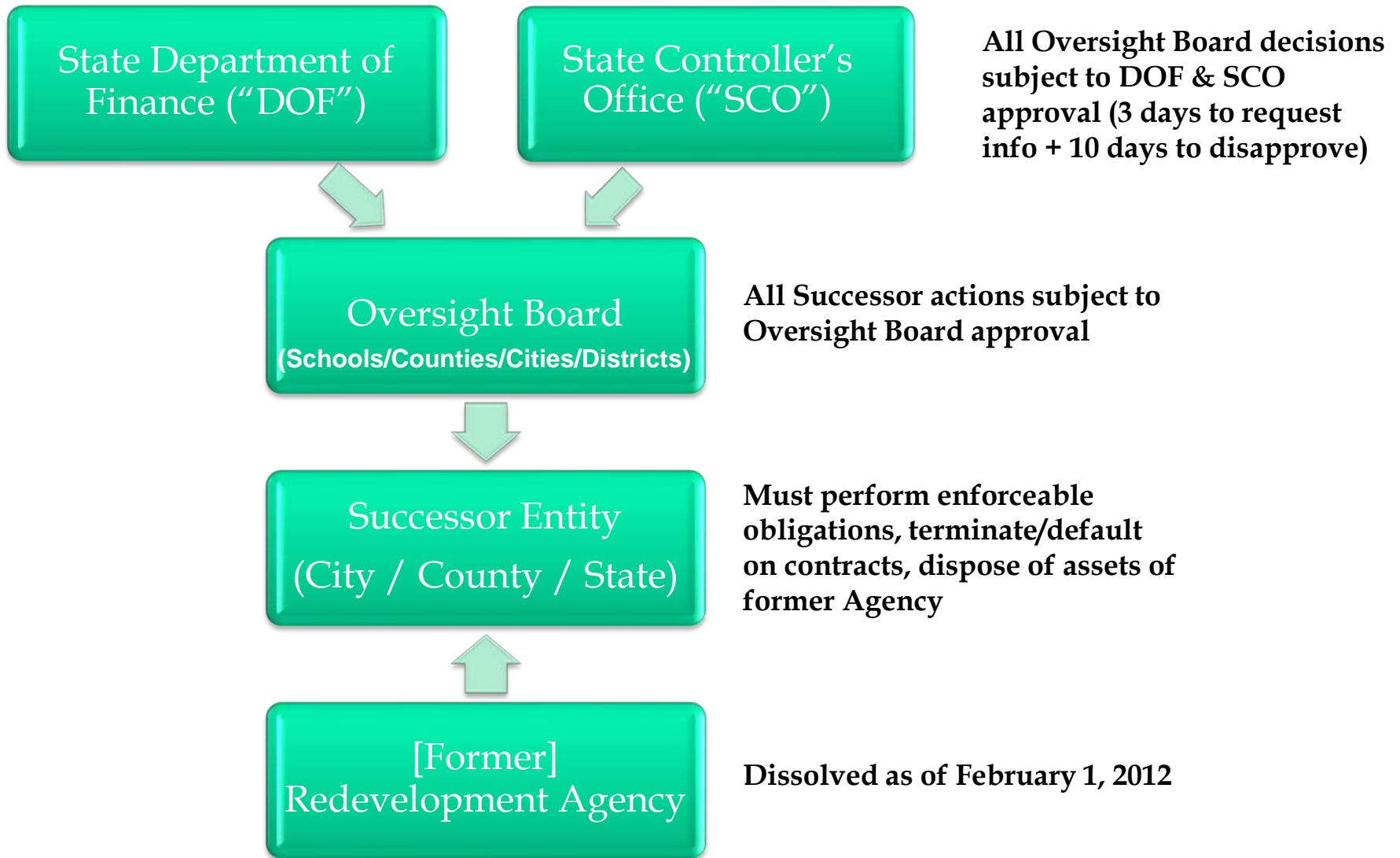
Redevelopment - Shut Out

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 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

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

Successor Entity Process



What's Left after Redevelopment?

Existing Economic Development Tools

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

New Tools, Re-tooled?

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



Cities and Business Play Hardball

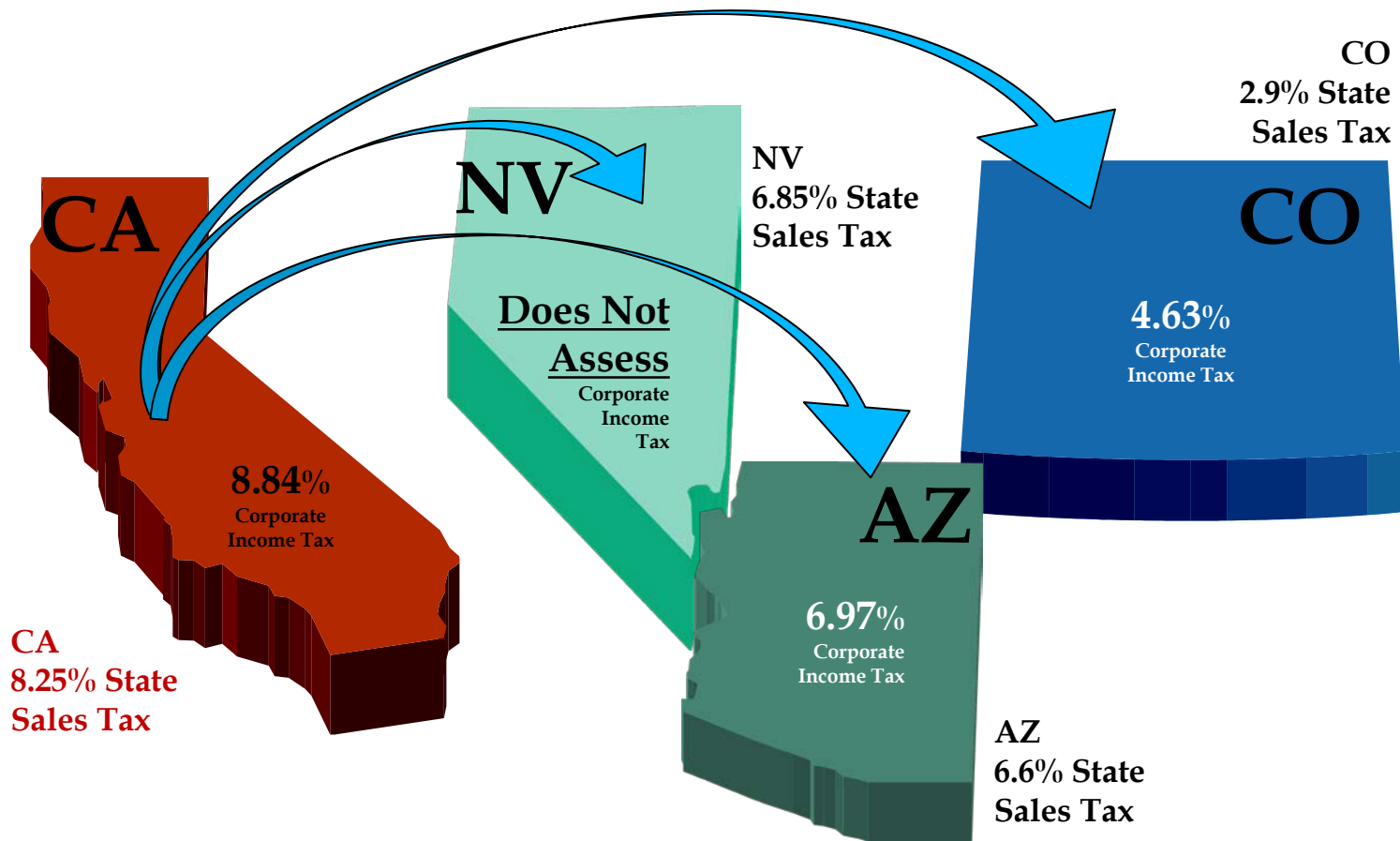


Kosmont-Rose Institute 2011 Cost of Doing Business Survey

- 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

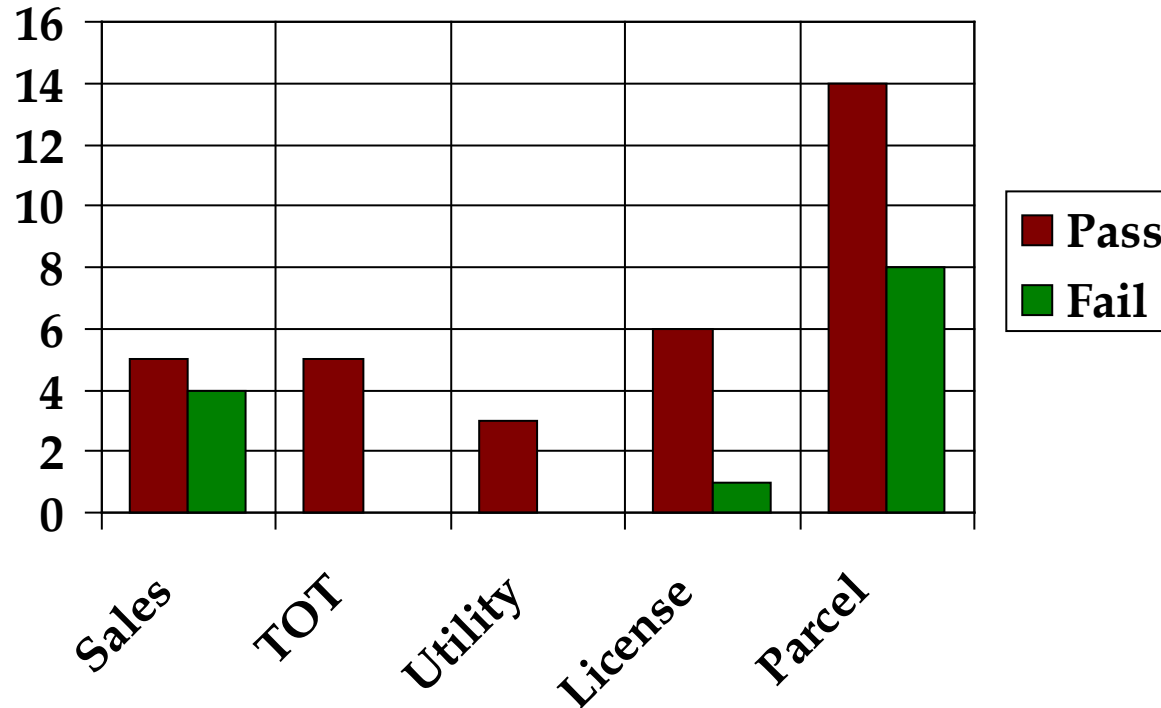
California Cities Play to Win

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

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"



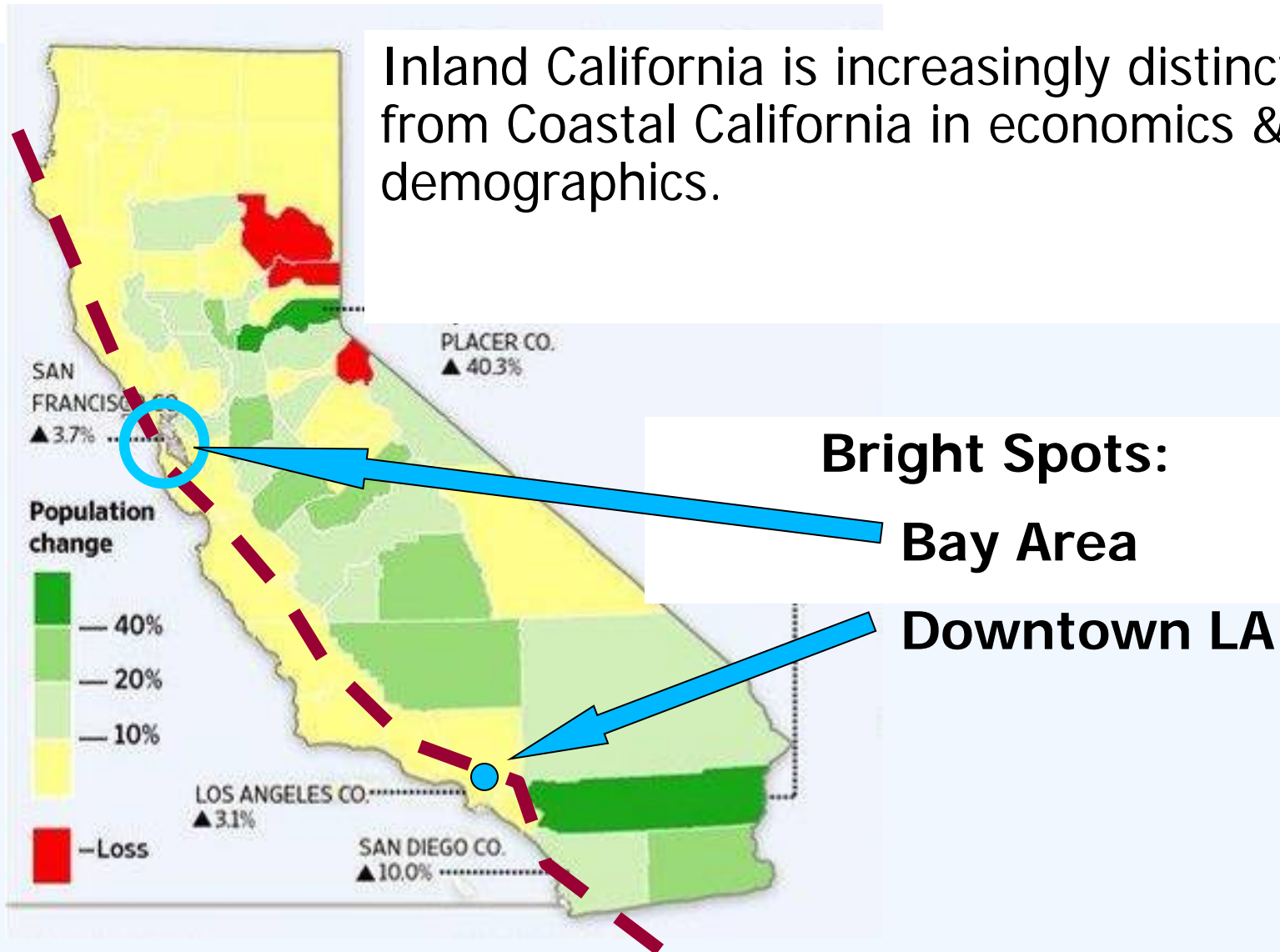
Redevelopment WAS the primary tool used to generate new jobs and taxes...

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



Dissecting California

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



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.



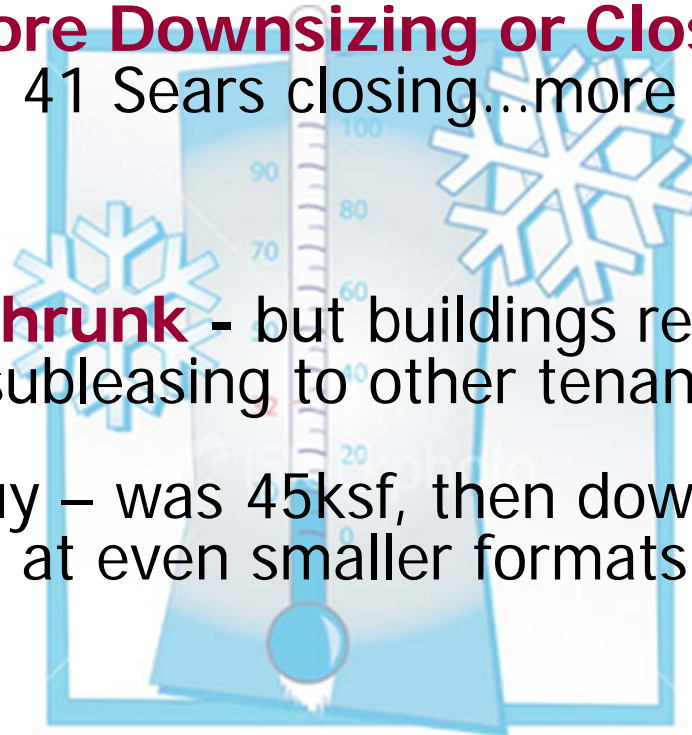
Suburban Single Family Sales & Development staying cool

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.



- **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.**



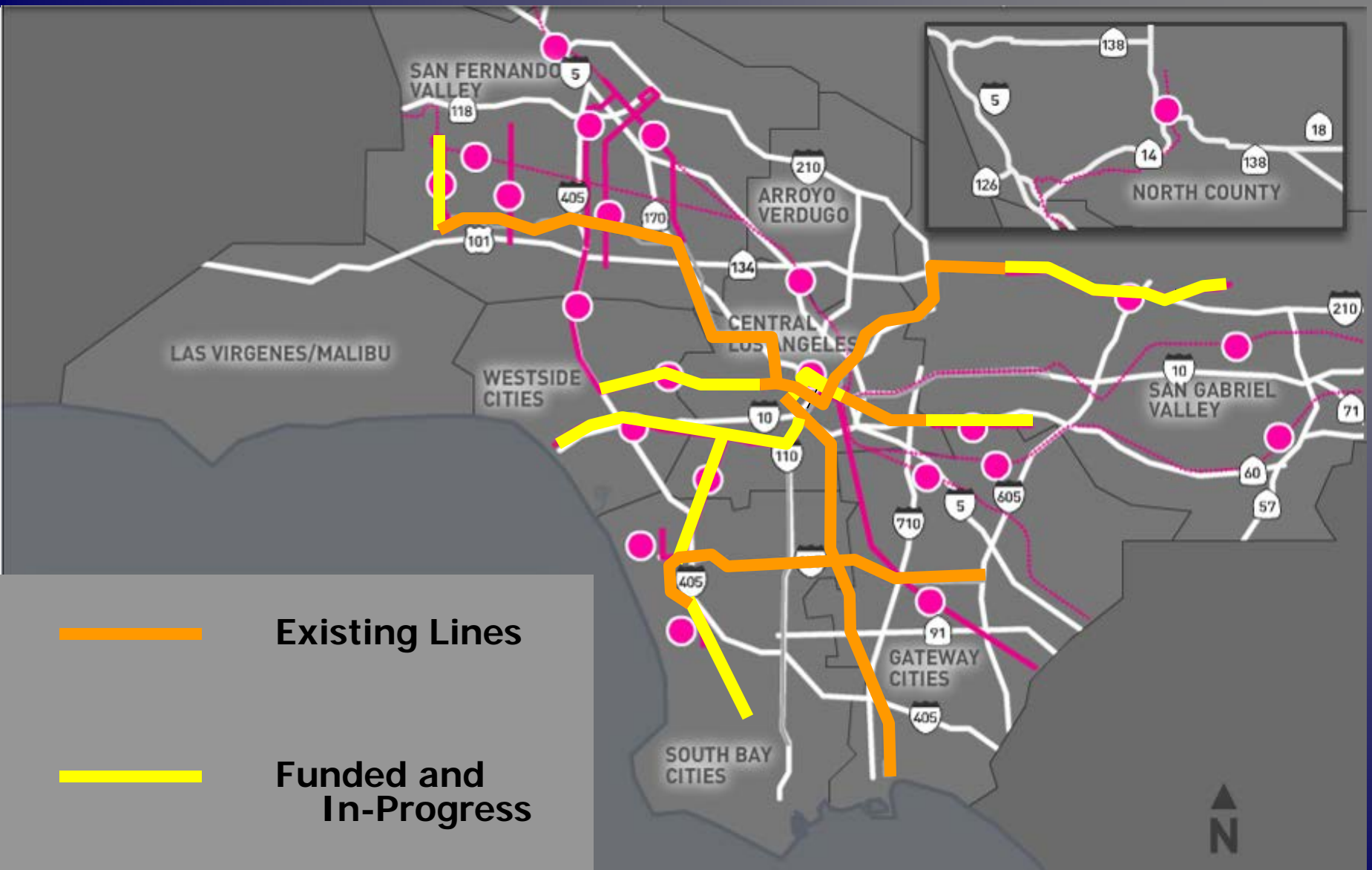
HOT – Public Transit

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

More opportunities coming:

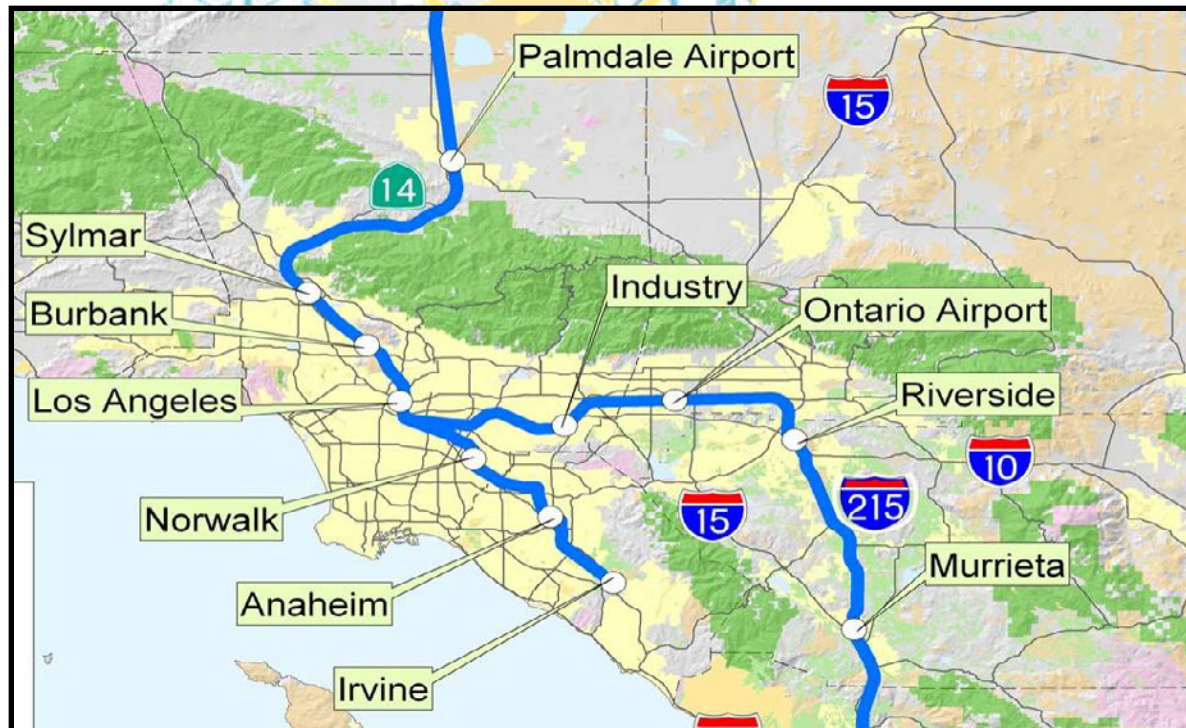
- **Federal Money – ~\$56 Billion Transportation Bill.** Infrastructure and jobs act supported by both parties
- **LA County - Measure R extension of ½ cents sales tax for 10 years**
 - Existing Measure R is 30 years (expires 2039)
 - Extension adds approximately \$10 billion and another 10 years. Enables Metro to build projects sooner without relying on Federal or State dollars.

HOT – Public Transit



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** – Some studies claim economic development benefits would exceed costs. System could fuel growth in underserved corridors.



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)

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

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 may lose considerable clout as novices replace veterans.

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

- Requires all candidates to compete in one primary election.
- The top two finalists face-off in November, regardless of 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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