

# **California Contract Cities Association**

## **31<sup>st</sup> Annual Fall Conference**



# **Weathering the Financial Storm**

Presented on 10-15-11 by:

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**CEO & President, Kosmont Companies**

# Today's Forecast

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- **State of the State**
- **Case Study: Montebello's Road to Recovery**
  - **Downward Spiral**
  - **Financial Recovery Plan**
- **Tools for Success**
  - **Private/Public Partnerships**
  - **Lease-Leaseback**
  - **EB-5 Funding**



# State of the State



# California New Years Eve...2006



# And In 2011....





# California's Triple Threat



**CALIFORNIA REPUBLIC**



**UNEMPLOYMENT**



**HOUSING**



**GOVERNMENT**



# Long Hangover- Downward Spiral Continues

## LABOR MARKETS CONTINUE TO LANGUISH

- In June, Los Angeles County lost 18,000 Jobs
  - Government had largest cutbacks YOY = 18,700 job losses
- In May, CA lost 29,200 Jobs
  - Professional & business services = 16,300 job losses
  - Government jobs fell by 87,300 statewide YOY



## REAL ESTATE MARKETS SHOW LITTLE SIGN OF RECOVERY

- SFH sales down 5.6% in May from previous month; 15% from previous year
- Median home prices down 11% from previous year
- SFH building permits down 11% from previous year



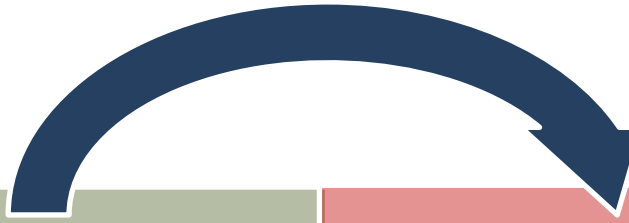
# To Make Matters Worse: Redevelopment at Risk



**PAY UP**

**OR**

**CLOSE  
DOWN!**



## CEASE OPERATIONS

Under AB1x26 Redevelopment Agencies ordered to wind down activities by October 1, 2011

*Agencies are prohibited from taking any actions until adopt  
**PAY-TO PLAY***

## PAY TO PLAY

Under AB1x27 Local RDAs have “voluntary option” to pay the State annual “Net Tax Increment”

Total Payments = \$1.7B in 2011-12  
\$400M ongoing  
**MUST ENACT BY 11/1/11**



# **Case Study: Montebello's Road to Recovery**



# Montebello....a Tough Time to be in a Tough Spot

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- **When the music stopped, Montebello was caught without a safe harbor:**
  - Most severe recession in modern history
  - Spent its reserves (no rainy day account)
  - Inadequate and outdated accounting systems and records
  - Council recalls and Administrator vacancies/turnover
  - Hostile credit environment due to financial markets dysfunction
  - Media attention negative due to “looking for the next Bell” mentality
- **These circumstances (among others) made Council action on the Financial Turnaround imperative**
- **Turnaround plan began May 12 when Kosmont Companies installed as City Administrator/Turnaround Specialist and FirstSouthwest as Fin. Advisor**

# The Beginning of Financial Distress

sgvtribune.com  
SAN GABRIEL VALLEY

Whittier Daily News  
WHITTIER, CALIFORNIA

## Los Angeles Times

Date	Headline
Feb 19:	Fiscal Mess Fuels Crisis in Montebello
Feb 22:	D.A.'s Office opens inquiry into off-the-books bank accounts in Montebello
Feb 24:	Montebello Seeks Missing Bank Accounts
Mar 10:	Solution nears in mystery of off-the-books \$1 million account in Montebello
Mar 31:	Montebello May Have Trouble Making Payroll, Paying Bills
Apr 22:	California Orders Audit of Montebello Finances
Apr 22:	Montebello officials consult bankruptcy attorneys
Apr 23:	Montebello May Face Insolvency if it Doesn't Close Budget Deficit
Apr 28:	Federal housing department freezes Montebello funds
Apr 28:	Montebello to subpoena suspect bank records; HUD suspends funding to city because of violations
Apr 29:	Public corruption prosecutors launch criminal investigation of Montebello bank accounts
May 5:	Troubled Montebello's Bonds Downgraded to Junk Status
May 14:	Special Report: Montebello uses financial maneuver to help repay \$17M loan from its redevelopment agency
Jun 19:	HUD auditing Montebello over use of federal dollars
Jun 30:	FBI is Investigating Montebello's Finances



# Montebello's Road to Financial Recovery: City Council Financial Recovery Plan

<u>Week of</u>	<u>Activities</u>
May 4	Moody's Credit Rating Assigned to Series 2000 COPs – Downgraded two notches to Ba1 (negative outlook)
May 4	City hires FirstSouthwest as financial advisors <b>(Approved 3-1; Cortez – NO)</b>
May 11	City hires Kosmont Companies as Interim City Administrator/ Financial Turnaround Specialist <b>(Approved 4-1; Cortez – NO)</b>
May/June	Kosmont Pursues Reconstruction of City budget and finances/initiates FRP
June 1	Introduction of Financial Recovery Plan Components & Preliminary Schedule
June 8	Community Primer – Detailed Introduction on the Budget Process & the FRP/Financial guidelines – Received and filed by City Council <b>(Approved 4-1; Cortez – NO)</b>
June 15	Council and Community briefing of 2011/12 Budget & FRP discussion; Adoption of final 2010/2011 City and RDA Budget <b>(Approved 4-1; Cortez – NO)</b>
June 22	Adoption of final 2011/2012 Budget, Financial Guidelines, Fee resolutions; FRP authorization <b>(Approved 4-1; Cortez – NO)</b>
July 13	City retains Investment Banking firm De La Rosa & Co. <b>(Approved 4-1; Cortez – NO)</b>
August 24	<i>City Council review of short term TRAN Financing Package (Approval is Anticipated)</i>



# Financial Recovery Plan

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## Short Term

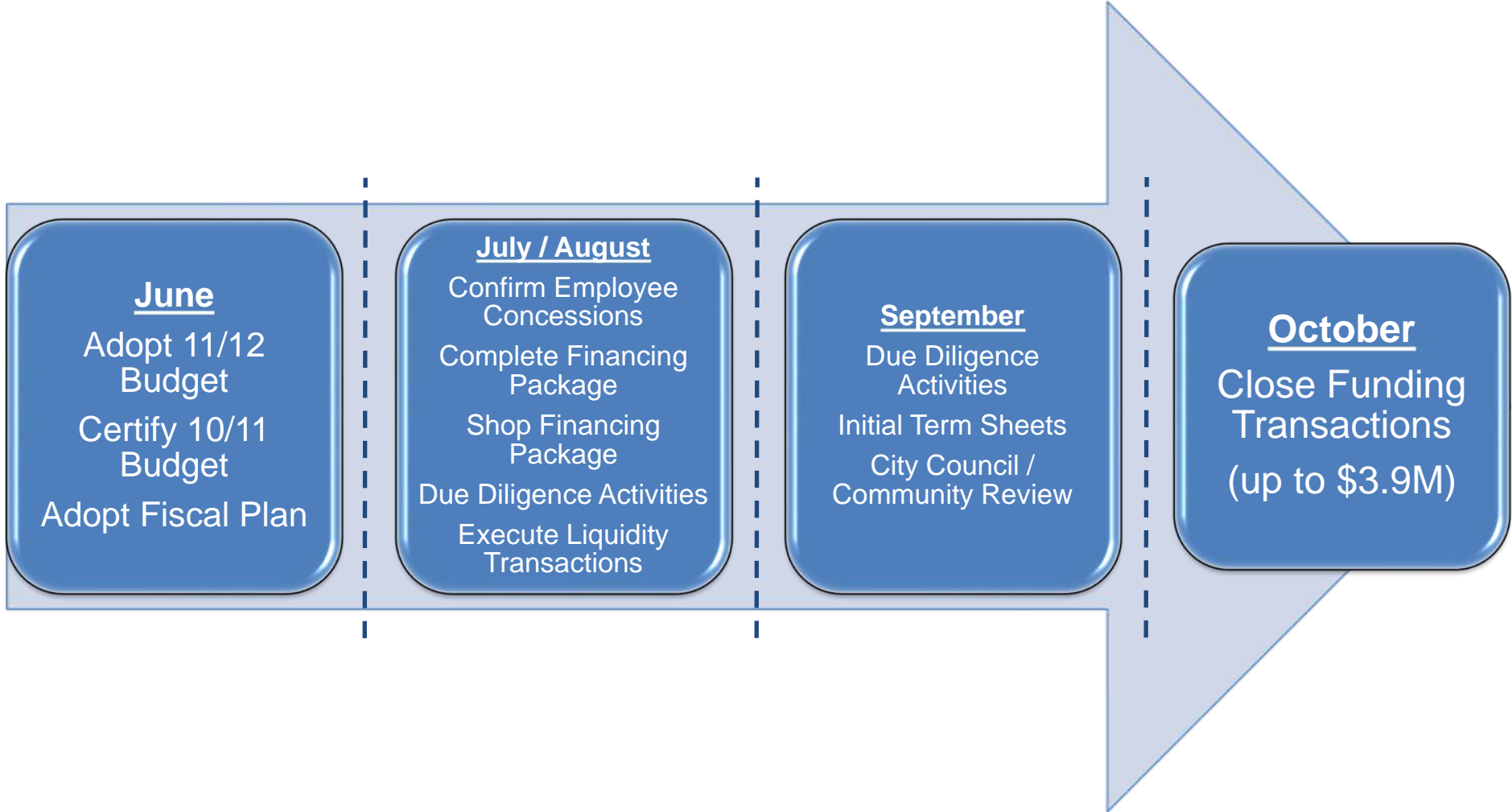
- Adopt Balanced Budget w/ Reserve
- Adopt Financial Recovery Plan
- Complete Short Term Financing

## Long Term

- Upgrade Financial Processes
- Restore Financial Reserves
- Restore Level of Services

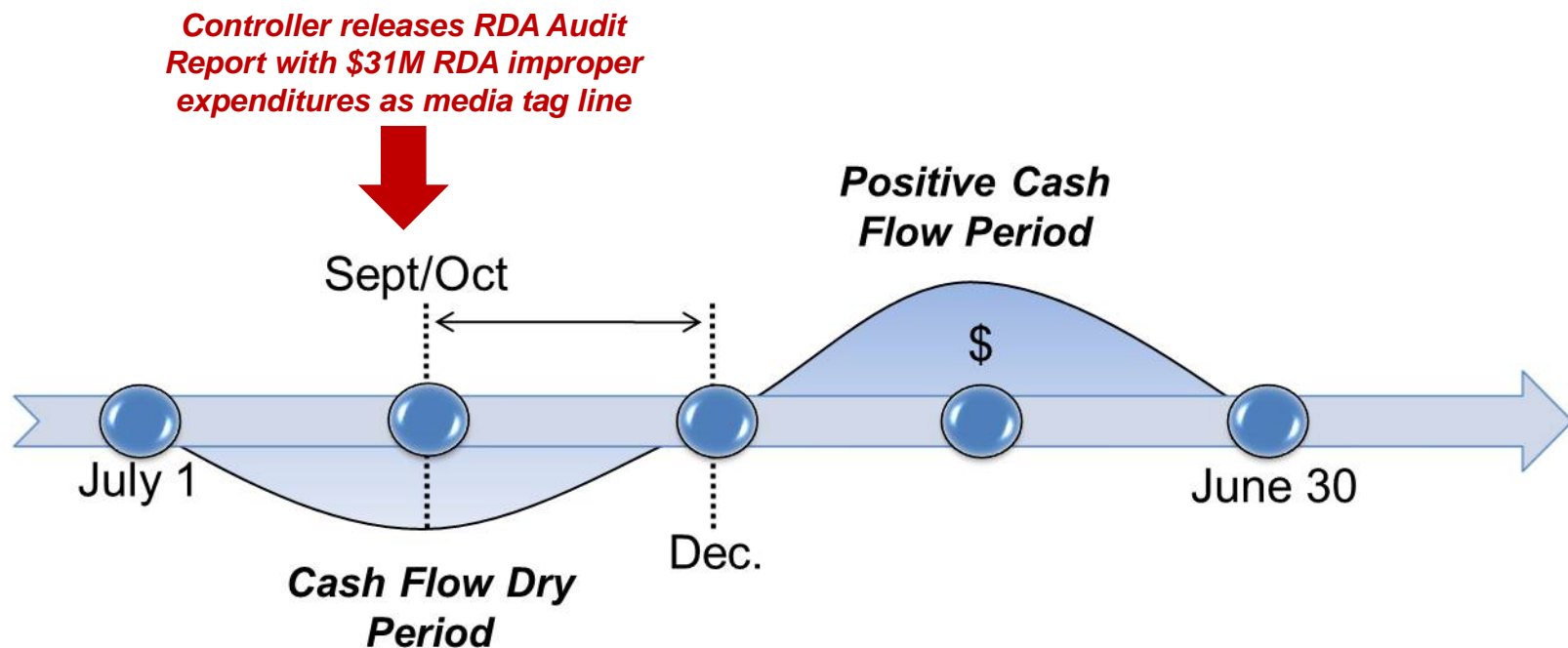


# Capital Markets Schedule



# Timing of Cash Flows: TRAN Issuance & Repayment

- Based on FY 2012 projected cash flows, the estimated size of the TRAN borrowing is approximately \$3.8 million, to be sold in Sept./Oct. 2011
- Review of The Plan and 2011/12 Budget by February 2012 required



# The City's Options after the SCO media bomb

<b>Plan A</b>	<b>City Directly Places TRAN/Secures Commercial Bank Line of Credit</b> <ul style="list-style-type: none"><li>• City has begun direct dialogue with interested parties; credit approval, not yield, expected to be the issue</li><li>• FirstSouthwest and City management continue discussions with commercial banks regarding banking services</li></ul>
<b>Plan B</b>	<b>Pursue Transaction Credit Rating Then Market TRANs Selectively to Investors and Financial Institutions</b> <ul style="list-style-type: none"><li>• Seek credit rating, since City financial condition is actually improving</li><li>• A rating of Moody's MIG 2 or S&amp;P SP-2 (or better)</li></ul>
<b>Plan C</b>	<b>Cash Flow Management- No External Borrowing</b>



# What Montebello wants vs. What the Market Needs to Believe

- Cash flow loan for FY 2011/12 is preferred to provide sufficient GF liquidity:
  - To maintain City services; and
  - Promptly implement 5 yr Financial Recovery Plan
- Financial market needs to conclude:
  - 2011-12 adopted budget is reasonable and austere
  - Guiding Financial Principles and FRP are adopted and put into service
  - Potential success with Buckets of Opportunity & City's capacity to minimize/resolve primary Buckets of Peril
  - ***That Media coverage is not totally consistent with reality (e.g. no bankruptcy, no apparent corruption)***
  - ***Maintaining balanced media image is an essential component***

# What Holds Montebello Back

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- We are living in a post “Bell” world and suspicion is pervasive
- Montebello’s media coverage has been mostly negative, and financial community remains nervous
- Council political shifts and City Administrator turnover have resulted in bad decisions and deficient administrative processes
- Financial markets do not comprehend lack of political unanimity on financial turnaround (efforts to secure cost effective credit impacted)
- Claims and stories re: bankruptcy, “off the books bank accounts with double payments” are not true or accurate, yet damage is done
- **Release of next Controller Audit Report will generate more negative stories while Montebello seeks its TRAN financing**





# What Keeps Montebello's Hopes Alive

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- **Montebello is not Bell (no deliberate and consistent march to corruption)**
  - **Deficient processes and aging accounting/reporting systems – YES**
  - **Administrative mishaps and sloppy records - YES**
  - **Can these be fixed? – YES (in process...takes time & leadership)**
- **Fierce loyalty to City and proud heritage (employees and constituents) – there is a sense that the “jewel” can restore its luster**
- **Good economic development “bones” based on superior in-fill location with strong retail and residential demand**
- **Comprehensive services and public amenities in a small town atmosphere can be restored to higher quality levels with Financial Recovery Plan**
- **City Council is determined to move the City in the right direction**
- **Current Priority - economic development to generate improved revenue**



# Tools for Success



# Economic Development Priorities

## ECONOMIC DEVELOPMENT TARGETS

- **Real Estate Development** – new property taxes or tax increment from “RDA”
- **Retail** – sales tax & jobs (entry level)
- **Relocation/Expansion** – business tax & commercial jobs
- **Rooms** – hotel transient occupancy tax (TOT)



***Cities have used Redevelopment as primary tool to grow new jobs and taxes***

***Cities must expand other Economic Development programs and strategies***

# Public-Private Transactions

*Making it Work...*



# Primary Sources of Public Funds for Subsidies

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- **Sales Tax Reimbursement Pledges (City vs. RDA)**
- **Property Tax Reimbursement Pledges (City vs. RDA)**
- **Development Fee Credits/Waivers/Deferrals**
- **City purchase/improvement of open/public space or other amenities (roadway, parking structure)**
- **Gas Tax**
- **Federal & State Grants (transportation, energy, others)**
- **Affordable Housing Funds (State, Local)**

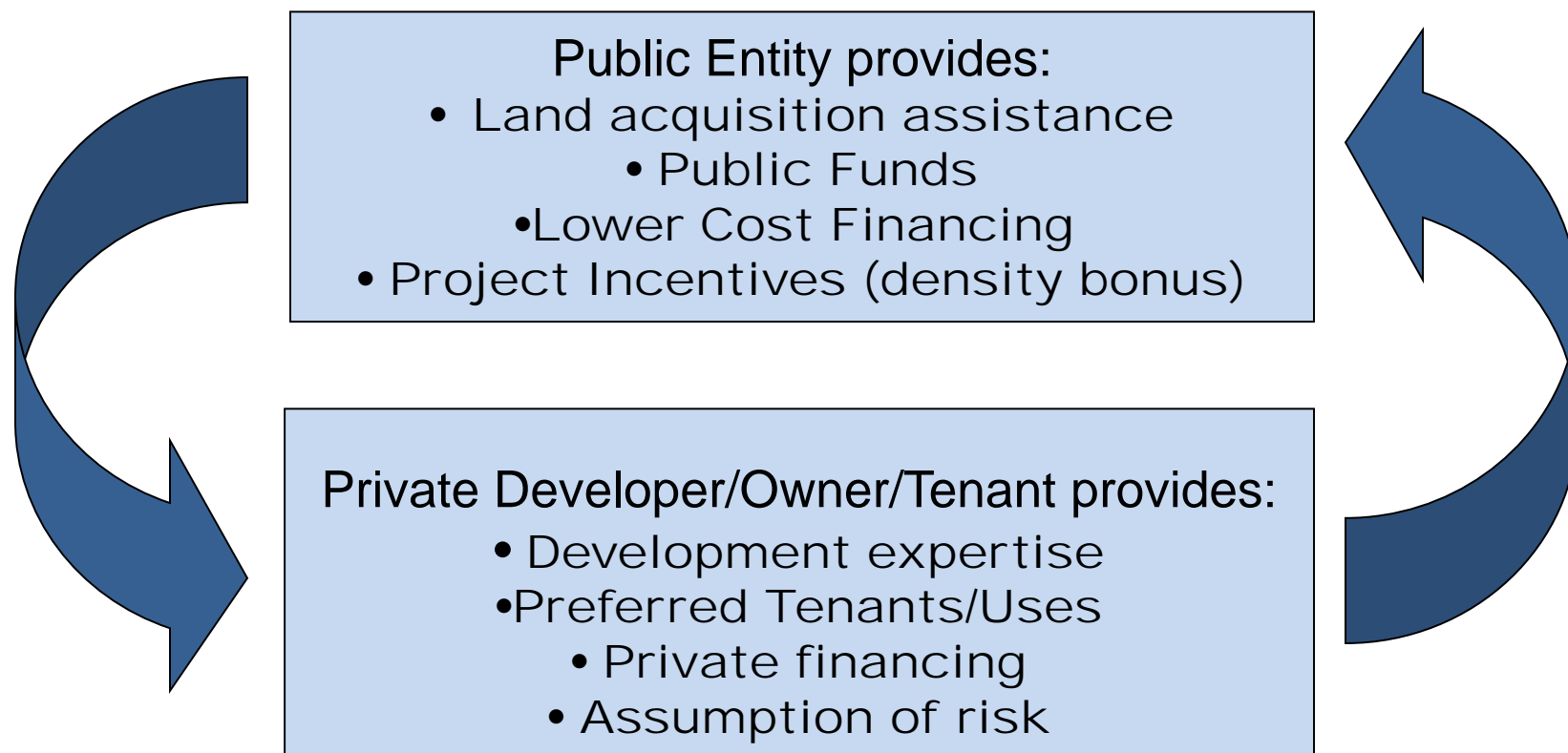
*All sources will likely trigger prevailing wage requirements*





# Public-Private Transaction - Basic Roles

## Putting private capital into public/private transactions



# Incentives that Cities Can Offer

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## Reduce Project Cost

- Cash subsidies
- Cost effective standards

## Increase Project Revenue

- Pledge of sales tax
- Property tax pledge

## Increase Project Value

- Adding density
- Allowing more valuable mix of uses
- Low cost land

## Finance Portion of Project

- less expensive financing
- e.g. Tax-exempt financing for public improvements

# Making a Project Economically Feasible

## Step 1

### Determine Economic Feasibility Gap

- Gap exists when the project costs are not supported by project revenues
- This gap is defined as return on cost

## Step 2

### Evaluate Available Resources to Fill Gap

#### Reduce Project Costs

Include up-front subsidies such as:

- land write down
- fee waivers
- Pay for infrastructure
- tax-exempt financing

#### Increase Project Revenues

pledge of tax revenues

## Step 3

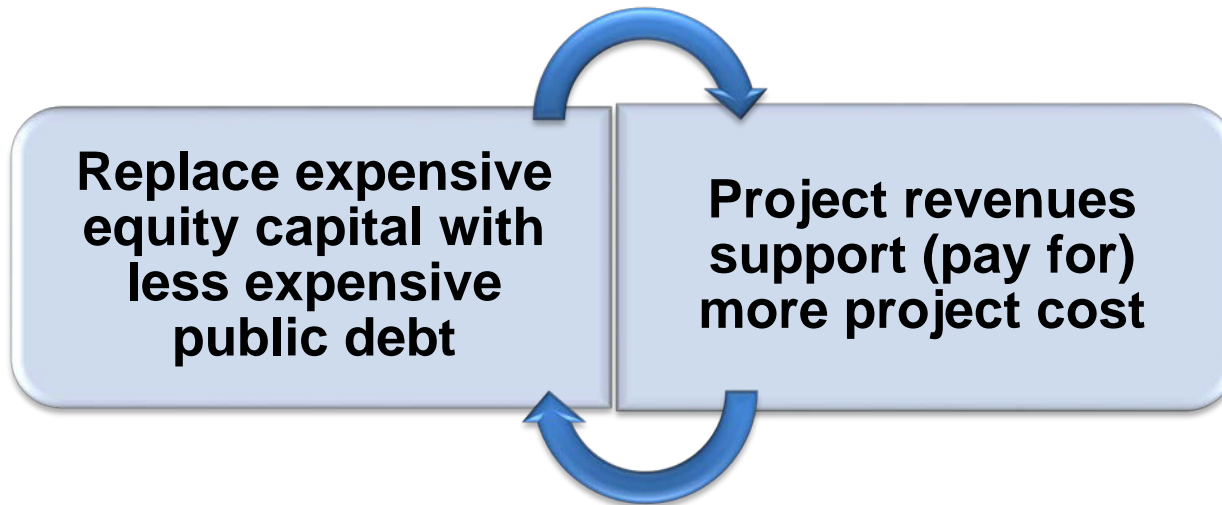
### Evaluate the Project before approvals

- public agency investment must generate policy goals
- Evaluate a projects' entire fiscal and economic impact
- Negotiate for returns within a specific and acceptable time frame (e.g. 10 years or less)

# Minimizing Public Agency Contributions

Project costs typically funded by using combination of conventional debt & developer equity

- Conventional debt is inexpensive
- Developer's equity capital is very expensive



Any savings realized can be converted toward a reduction of Public Subsidies



# Toolbox of Financing Solutions for Projects

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May not be able to rely on redevelopment funds.

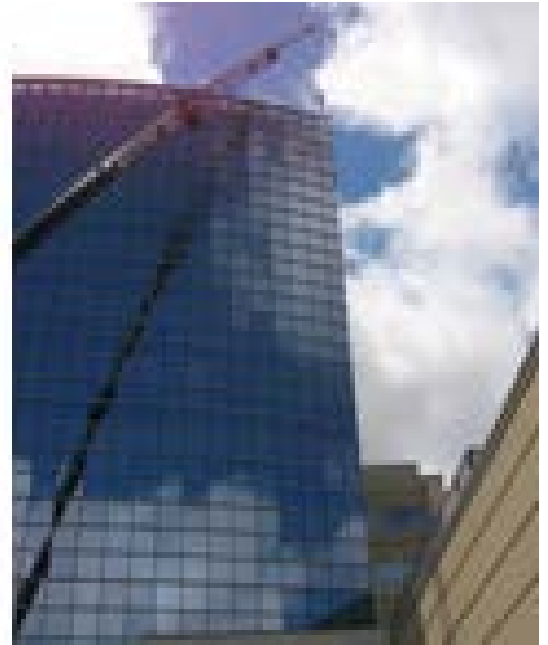
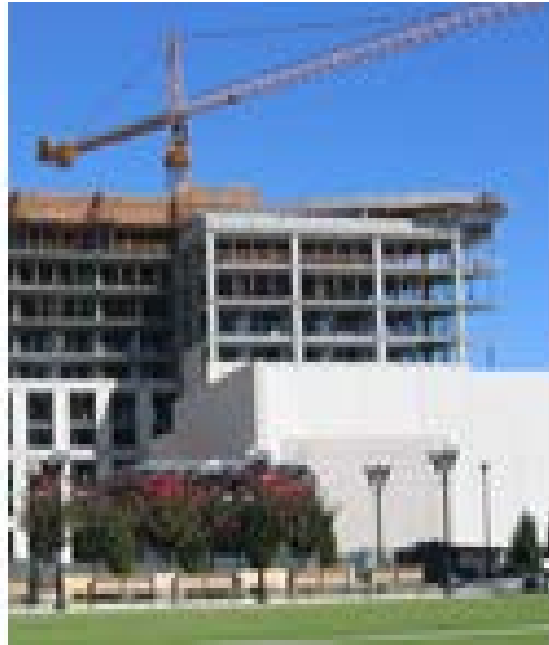
Other alternatives now available:

- **Lease/Leaseback Financing**
- **EB-5 Investment**
- **Public/Private Transactions (P3)**
- **Infrastructure Financing Districts**
- **Special Tax Districts (CFD)**



# Lease-Leaseback

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# Overview of Lease-Leaseback Program

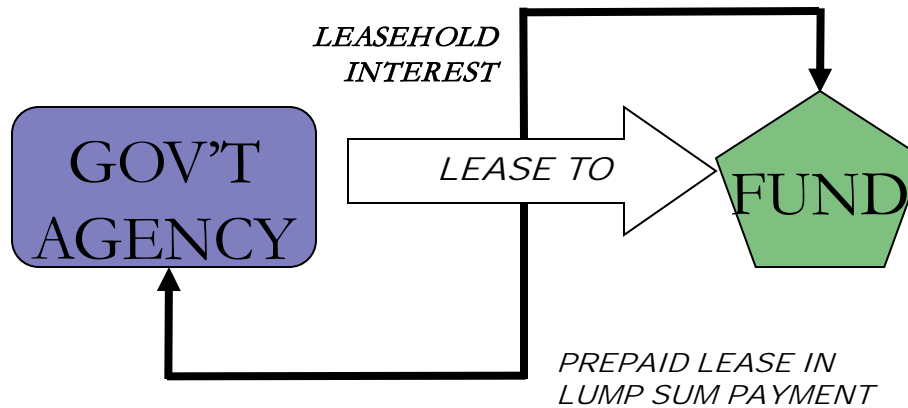
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- **Finance vehicle that uses private debt to finance :**
  - **Stalled real estate projects**
  - **Parking facilities –build & operate**
  - **Redevelop land and aging public assets**
  - **City owned facilities & real estate – free “trapped equity”**
- **Sample Transaction Types:**
  - **Hotel and Retail Center transactions**
  - **Parking Facilities & Multi-Modal Transportation Facilities**
  - **Public Safety Buildings, Courthouses & Correctional Facilities**
  - **Tourism & Convention Facilities/Sporting Venues & Stadiums**
  - **Airports, Seaports, Utility Infrastructure & Energy Related Developments**

# How it the Program Works

## Step 1

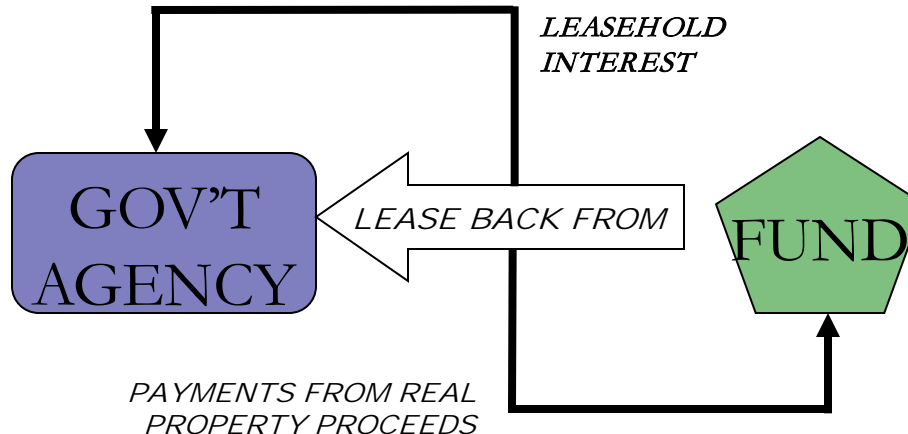
“LEASE”



TRANSACTIONS OCCUR SIMULTANEOUSLY

## Step 2

“LEASEBACK”



## Gov't Benefits

- UP-FRONT PAYMENT FOR VALUE OF ASSET
  - RETAINS OWNERSHIP & OPERATIONAL CONTROL
  - MAY REINVEST FUNDS IN DEVELOPMENT AND/OR OTHER PRIORITIES
- 
- RETAINS OWNERSHIP AND CONTROL
  - PREDICTABLE DEBT PAYMENTS AT COMPETITIVE INTEREST RATES
  - RETAINS EXCESS PROCEEDS AFTER DEBT SERVICE



AT END OF LEASE TERM, LEASE CAN BE RENEWED OR PROPERTY REVERTS BACK TO AGENCY

# LLB - Viable Alternative to Bonds

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- **Competitive cost of capital**
- **Little or no up-front cost to local governments**
- **Capital available faster - typically within 60 days**
- **Documentation simpler than Bonds**
- **Streamlined Disclosure and Public Hearing process**
- **Long term periods available (20 to 60+ years)**
- **Private sector can share financial risk for payments**
- **Certain lease structures can be booked "off balance sheet"**



# EB-5 Financing Overview

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**An EB-5 Regional Center is a legal entity that has been authorized and approved by the U.S. Citizenship and Immigration Services (USCIS)**

- EB-5 Financing can provide alternative **equity and debt financing** for public and private projects
- An EB-5 Regional Center operates in a defined geographic area
- Equity and debt investments can focus on all types of job producing businesses and real estate projects and uses such as Hotel, Retail, Restaurant, Medical, Hospital, Manufacturing, Office, Infrastructure, Port and Transit Orientated Development

**Congress created the EB-5 Program in 1990 as an immigration program to allow foreign citizens to obtain U.S. Residency through investment**

Regulatory Investment Requirements:

- A minimum investment of **either \$1,000,000 or \$500,000** for projects located in a designated high unemployment area (Targeted Employment Area / TEA)
- Creation of **10 permanent jobs** in the economy per investment
- Funds typically invested for five years

**The EB-5 Regional Center aggregates pools of foreign investors and deploys funds into a qualified project**

- An EB-5 regional center manages the investment and delivers funding to the project
- An EB-5 regional center is approved for specific geographic areas and industries



# Benefits of EB-5 Financing

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EB-5 Financing is a low cost source of financing for public and private projects which can easily be combined with other forms of project financing

- Funding ranges from **\$5 Million to \$100 Million** per project; can be phased and financed with **no minimum LTV**
- **Flexible and can subordinate** to other equity and debt
- Compatible with City and other governmental goals and objectives to **promote economic development, job growth, and direct investment**
- Short-term; typically structured as a 5 year repayment program
- **Streamlined** source of front-end money that is not burdened by the complexities of governmental programs involving tax exempt “public purpose” regulations and costs
- If a City or Redevelopment Agency is involved, then typically **no general fund guarantees**; instead, pledge tax increment or site specific tax revenue to secure investor interest





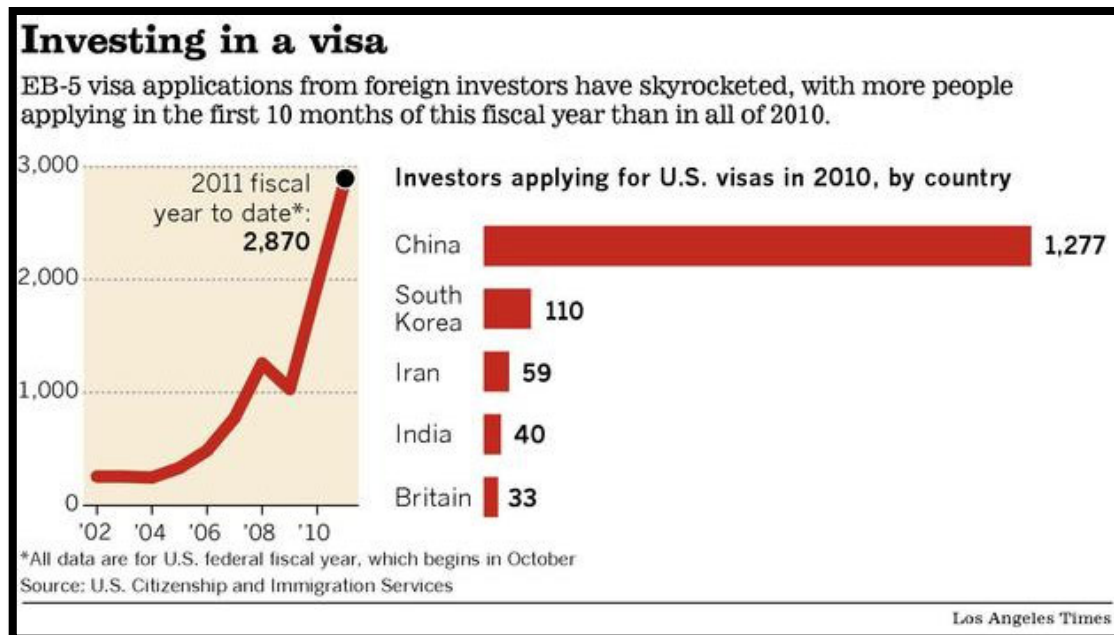


# Immigrant Investor Profile

*EB-5 Immigrant Investors come from all over the world.*

## Typical EB-5 Immigrant Investor:

- Looking to invest in U.S.
- Desires to educate children in the U.S.
- Seeks citizenship for immediate family
- Usually high net worth
- Must have a “clean” source of funds, because program is monitored by U.S. Dept. of Homeland Security



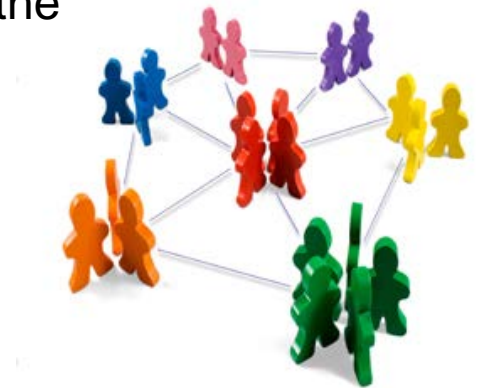
Source: USCIS via Los Angeles Times





# EB-5 - Who are the Key Players?

1. **U.S. Congress**; bi-partisan support for investment and responsible immigration
2. **U.S. Citizenship and Immigration Services (USCIS)**, a Federal Agency
3. **Approved USCIS Regional Center** who provides the investment and coordinates all activities
4. **Immigrant Investors** seeking U.S. citizenship via investment in a U.S. Project
5. **Network of foreign investors**
6. **Developers and operators** seeking competitively priced capital for various projects
7. **Cities and Redevelopment Agencies** desiring to promote local economic development and job growth through public and private projects without general fund exposure



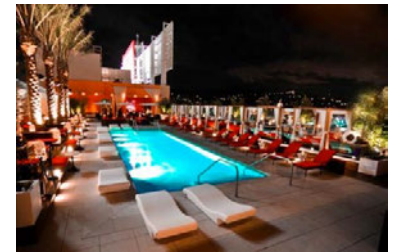
# Hypothetical Investment Through an EB-5 Regional Center

*Regional center's aggregates Immigrant Investors and disperses funding to a qualified project, such as a Retail Center, located in a TEA.*



# W Hollywood Hotel –CGF Funded Project Case Study

<b><u>Funding Target:</u></b>	\$200M total project capitalization <b><i>\$17.5M funding gap – funded by EB-5</i></b>
<b><u>Investment Level:</u></b>	\$500,000 per Investor plus processing costs
<b><u>Investment Placement:</u></b>	Drai’s Restaurant and Nightclub Delphine Restaurant
<b><u>Job Creation Required:</u></b>	Minimum 10 jobs per \$500,000 (established and validated by economic study)
<b><u>Repayment Period:</u></b>	Five years
<b><u>Status:</u></b>	35 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.



# California Golden Fund Regional Center

## CGF Geographic Area (expansion in progress)



Across six counties in Southern California with statewide expansion in progress. CGF was formed to fund a broad range of economic development, public/private, and private sector projects including:

- Hotel
- Retail
- Restaurant
- Medical/Hospital
- Manufacturing
- Office
- Infrastructure
- Port
- Transit-Oriented Development

For More Information, Contact:

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# The Future Is Here...and there is hope

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- This economy is going through structural change, will be a tough time for California cities for many years. Montebello is classic example.
- State approved “balanced” 2012/2012 budget diminishes the primary tool for economic development (RDA)
- Cities need private investment for new local jobs and taxes, yet capital markets are very constrained and business is stymied
- Private/Public partnerships are the key format for inducing economic development.
- Cities must look beyond redevelopment for successful economic development.
- There are alternative financing solutions available for cities that want to maintain a competitive edge

- *If you are relying on Sacramento, I have used car I want to sell you☺*





*THE END*