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23<sup>rd</sup> ANNUAL ECONOMIC FORECAST

2013: 

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<b>Br</b>	+1
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2-8-18-7	

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137.33	+2
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d

...or 

79.904	-1
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35	+5
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ood?

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

Production: Matt Goulet, MBA, VP, Kosmont Companies

# Season Preview

## 1. The State of the State

*Recap from Last Season's Cliffhanger*

## 2. State & Local Gov't: A Look Behind the Scenes

*How it's Made – The California Sausage*

## 3. What's **Hot!** What's **Not!**

*Winners and Turkeys*

## 4. Kosmont's Must See TV in 2013

*Road to the Emmys of Real Estate*

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# The State of the State



*Is it too late to ask for directions?*

# 2012 – Critic's Review

## *"Breaking Better" – Housing, Jobs, State Budget:*

- Six straight months of home price increases
- Development of apartments kicks up
- CA Unemployment Rate dropped in 2012: 11.3% to 9.8%  
- *but more than 1.8 million out of work*
- Budget deficit reduced from \$13 B to \$1.9 B



## *Still, Breaking Bad for Cities:*

- Redevelopment “offed” after 62 seasons
- California remains high cost & unfriendly to business
- Pension obligations
- Sting of recession lingers with reduced tax revenue & tepid job growth



# 2012 – Critic's Review

## *Uncertainty Remains – “Fiscal Cliff-Hanger”*

### Deal Struck with hours to go – “American Taxpayer Relief Act”

- Allows tax cuts to expire only for individuals making over \$400K and couples making over 450K
- Renews tax credits for low income households and college students
- Extends unemployment benefits
- Raises Alternative Min. Tax (AMT) threshold; Raises estate tax rate
- Business tax credits extended for research & renewable energy

### Fiscal Cliff – The Sequel:

- The real fight lies ahead; markets and private sector will remain nervous until fight over raising debt ceiling is settled
- At stake? Cuts in defense & gov't programs for 2 more months; additional limitations on business deductions & increased taxes

**On November 6, 2012 California  
had an election.**

**Did we break bad or good?**

# Election 2012 – “Tuesday Night Live”

## THE WEST WING

- President Obama reelected. Assures continued implementation of Affordable Care Act (“Obamacare”).
- Employers will pay additional \$63 per insured by 2013
- Additional fees from State expected

***Impact: Obamacare is uncertain but costly for business***

## DYNASTY IN SACRAMENTO

- Democrats now hold more than 2/3 seats in Legislature
- Sacramento’s legislative engine now has free reign to
  - ***Raise more taxes***
  - ***Override a Governor veto***
- ***But many Dems elected in swing districts & may vote more as moderates***



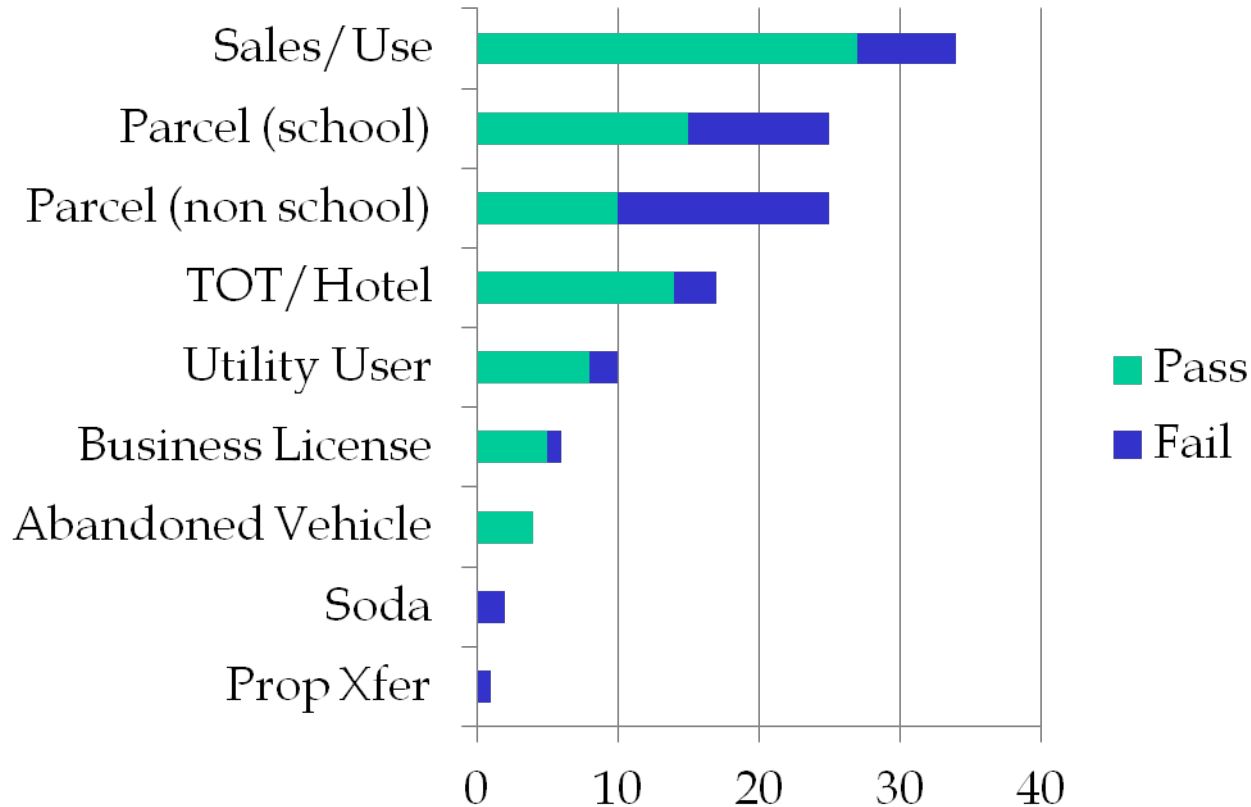
# State Ballot Channel – 30 Rock(ed) the Vote

PROP #	SYNOPSIS	PASS / FAIL
30	Gov. Brown's Tax Increase for education & General Fund	PASS
39	Income Tax Increase for Multi-State Business	PASS
31	Two-Year Budget Cycle	FAIL
32	Ban on union contributions to fund candidates	FAIL
33	"Persistency discounts" for car insurance rates	FAIL
37	Mandatory labeling of genetically-engineered food	FAIL
38	State tax increase for education	FAIL

***Prop 30 helps reduce state budget gap, but impacts small business by raising income tax rates.***

# 2012 was the “Year of the Tax”

**124 initiatives were on the Nov ballot to increase or expand local taxes**



**82 Passed. 42 Failed.**

**Only 1 initiative to repeal: Huntington Beach Retirement Fund  
Property Tax Levy repealed by Measure Z – *Failed!***

# Other Local Elections

## A *"Jerry Springer"* Year of Taxation and Regulation:



- Soda Tax: **2 – both failed**



- Marijuana (Tax/Regs): **1 pass / 7 fail**



- Corporations are NOT people: **All 4 passed**



- Condoms required on adult film sets in LA County: **Passed**

# Other Local Elections

You can't fool the voters in Santa Barbara County

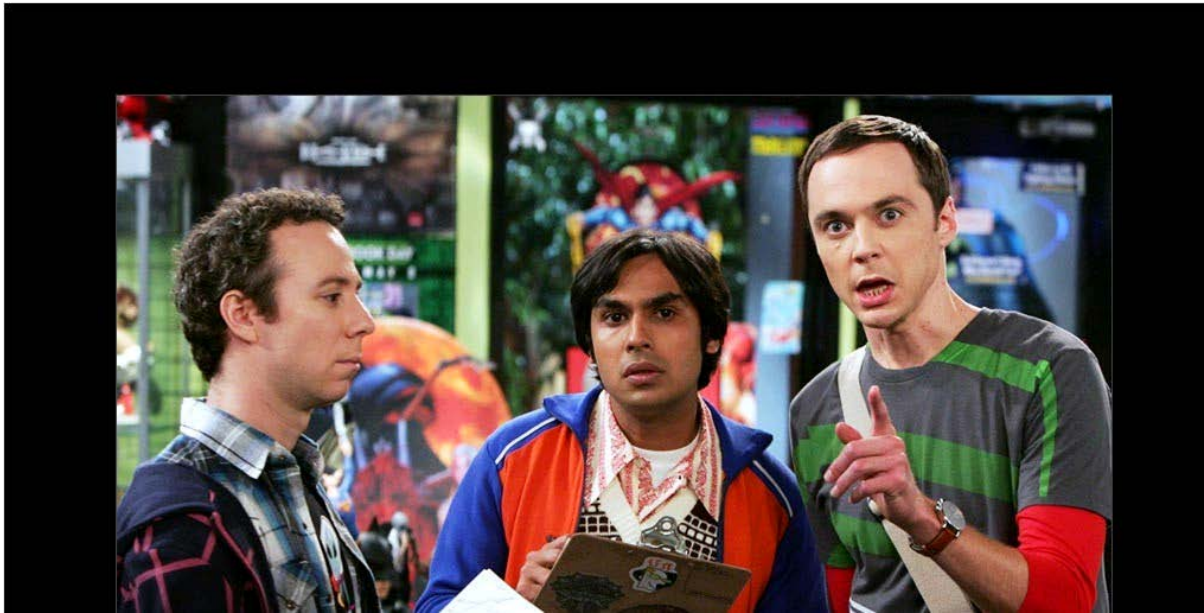
Measure J – Asked voters to rename land-locked City of Guadalupe  
to City of *GUADALUPE BEACH* **DEFEATED**



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# State and Local Gov't

A Look Behind the Scenes  
& what it means for the Private Sector



  
the **BiG**  
**BANG**  
**THEORY**

## Budget too dependent on “highly variable” sources

### **CALIFORNIA BUDGET REVENUE**

**Income Tax: ~55% of General Fund**

**Sales Tax: ~30%**

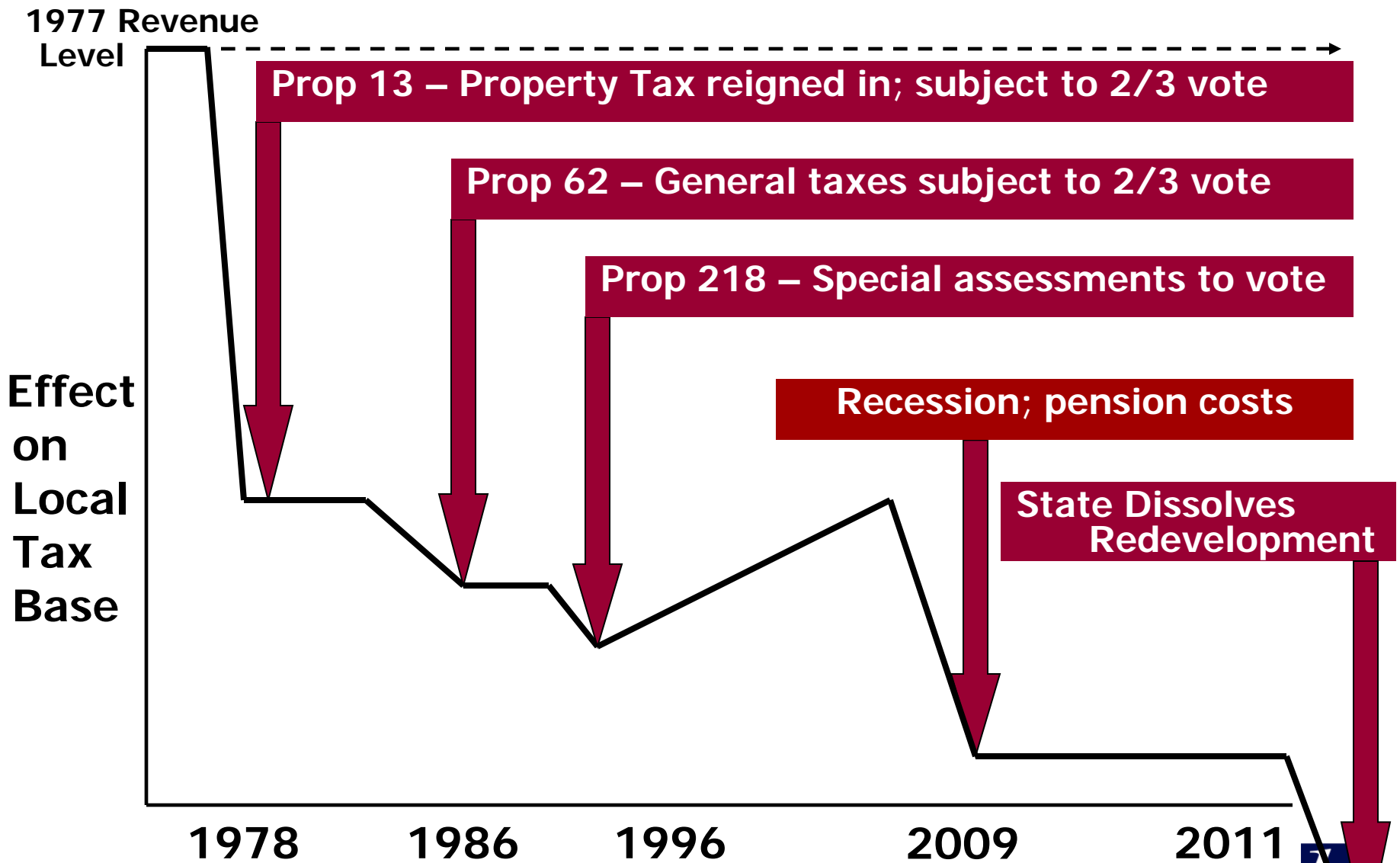
**Property Tax: <13%**

- Top 1% earners provide 40.9% of income tax \$\$
- Sales tax prone to dramatic shifts in customer spending
- Property Tax, the most stable source, is distant third

## State's financial health lags in the long-run

- Deficit improved in 2012, but still ~\$1.9 B. in 2013
- Fitch GO bond rating lowest in USA (A-)

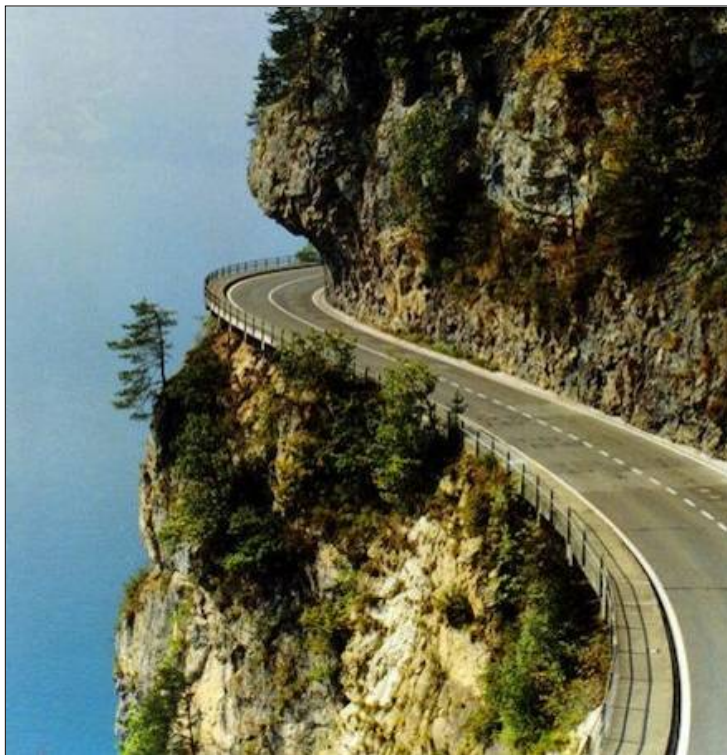
# After 34 Years – No More Free Cable



Note: Not to Scale

# Now The Cities Have the Bill

*Choose Your Stunt on*

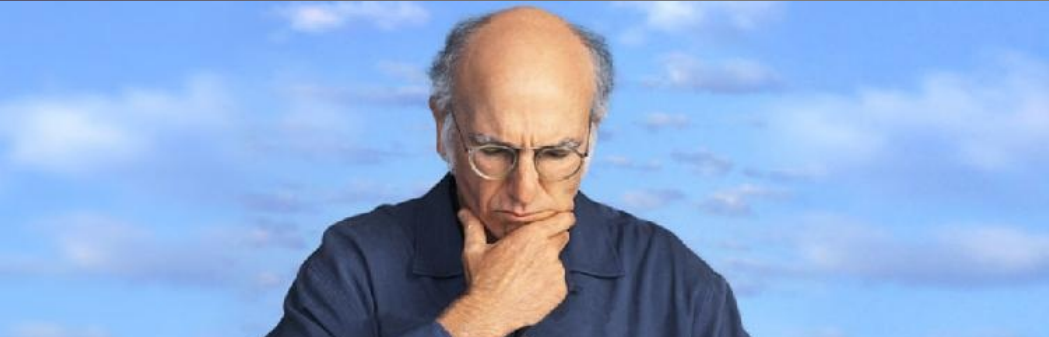


**Continue Raising Taxes?**



**Find Way to Economic Development  
without a Map?**





## Historic Trend of California Tax Requests Hits Business Hard – (sales, utility user, business license taxes)

<u>Nov (1<sup>st</sup> Tues)</u>	<u>On the ballot</u>	<u>Passed</u>	<u>Failed</u>	<u>Pass Rate</u>
2012:	124	82	42	66%
2011	47	33	14	70%
2010	122	63	59	51%
2009	52	26	26	50%
2008	122	79	43	65%
2007	2	1	1	*
2006	9	3	6	33%
2005	0	0	0	n/a
2004	1	1	0	*

Source: Ballotpedia.org

\* Sample size too small to provide meaningful pass rate

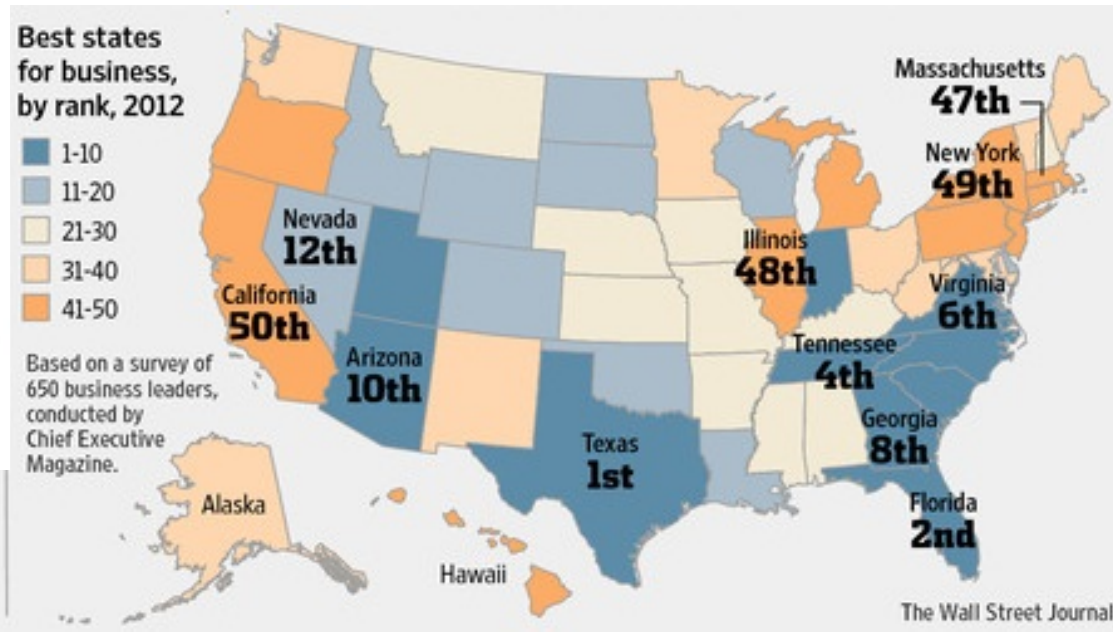
# Business Lemon Award: California 50<sup>th</sup> Place

Based on a Survey of 650 CEOs and other top execs conducted by Chief Executive Magazine:

California 50<sup>th</sup>. Texas 1<sup>st</sup>.



Source: California  
Manufacturers and  
Technology Association





# Survey Says: Economic Development

- **Economic Development is better solution than taxes:**
  - *Cities help themselves by helping the private sector invest locally to create jobs and taxes*
  - *Local Economic Development typically comes from Real Estate Projects and Business Expansion*
- **The average small CA business pays \$47 per hour, or close to \$2,000 per week, in regulatory/paperwork reporting**
- **New taxes increase fixed costs that all business must control to compete favorably**
- **Cities need to induce private investment to compensate for California's high costs**

# Cities are in the Real Estate Business

## Cities have few sources left to raise revenue:

- **Retail** – sales tax & jobs (entry level)
- **Relocation/Expansion** – business tax & jobs
- **Rooms** – hotel transient occupancy tax (TOT)
- **Real Estate Development** – property taxes & jobs



**"Cities need private partners for projects that generate taxes & jobs"**

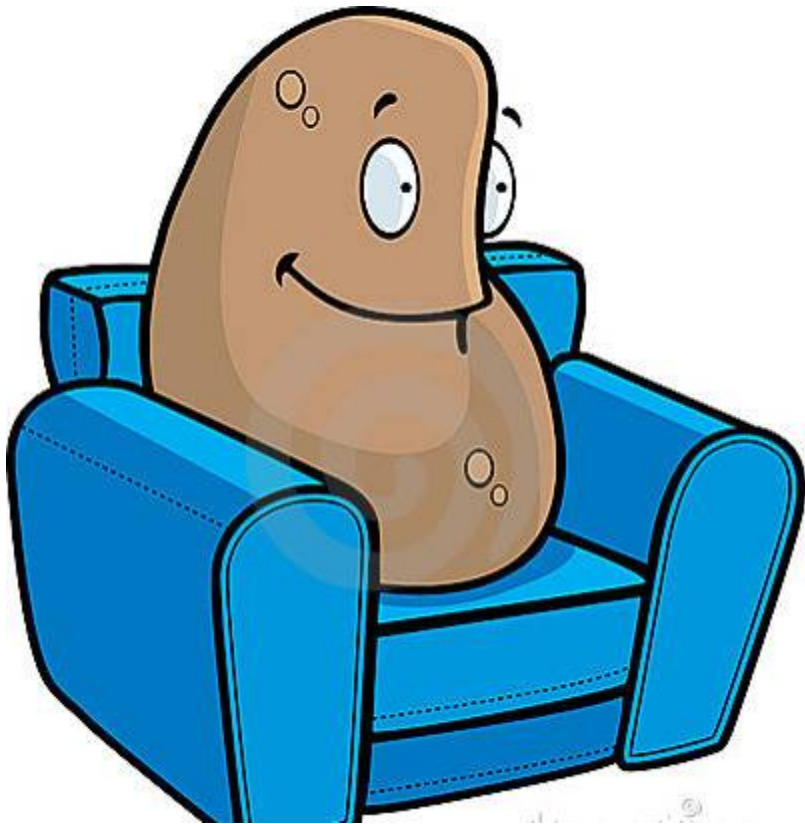
# Pension Obligations “Jump the Shark”

- **CalPERS and CalSTRS combined: unfunded by \$150 billion**
- **Annual payment toward pension obligations rose from \$300 million in 1999 to \$3.7 billion in the current fiscal year**
- **Governor signed reform of public pension benefits in 2012, but will take a decade or more for most savings to be realized**
- **Last year, voters overwhelmingly approved local pension reforms in San Diego and San Jose...**

***Don't touch that dial – there's more to come...***



# What's on TV in California



**TAX  
INCREASES**

**RISING  
PENSION  
OBLIGATIONS**

**ECONOMIC  
DEVELOPMENT  
LIMPING**

# What's *Hot*?      What's *Not*?

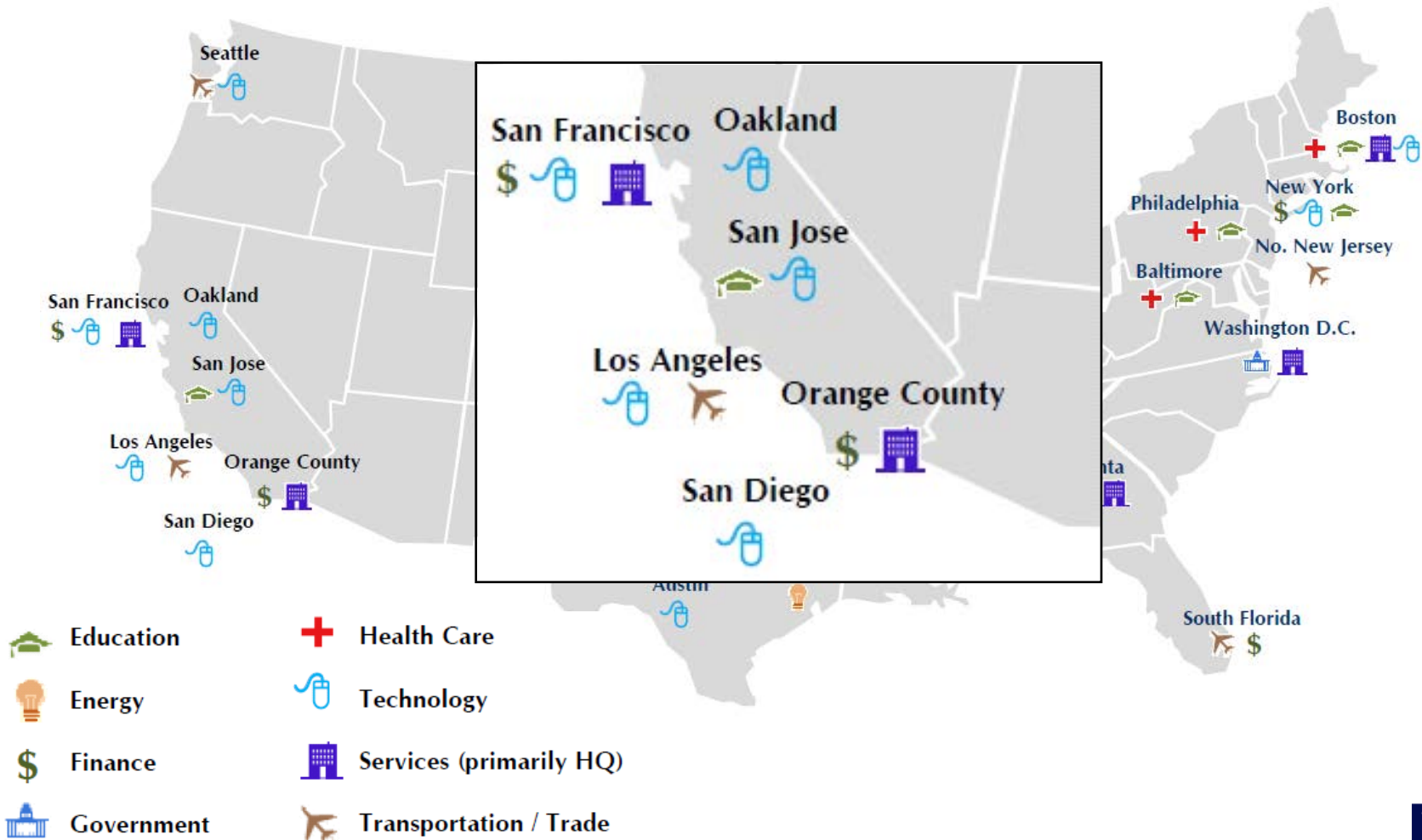
SILICON BEACH



# What's Hot?

# What's Not?

## What are the Opportunities for Business & Real Estate in California & Los Angeles?





# SIZZLING – Silicon Beach

- West LA region – new hub for tech & media companies
- Hot spot for tech, mobile device & entertainment content
- Benefits from proximity to entertainment industry
- Google/YouTube leading the way
- Hercules Campus at Playa Vista is southern anchor
- Demand for creative office space has spread down coast from Santa Monica to Venice to Playa Vista



***El Segundo next stop...but keep your eye on DTLA***

# HOT – Port Projects

## San Pedro Bay Ports (LA & Long Beach)

- Handles 44% of all US ship cargo
- Supports 1 out of every 22 jobs in Southern California

## Projects in the Works

- Port of LA spending \$1.2 billion over the next 5 years
- BNSF's proposed new rail yard
  - Goods loaded onto trains near docks instead of 24 miles to Downtown Los Angeles
  - Creating 22,000 indirect jobs over the long term
- Channel Deepening Project – Final Phase of 15-year project to complete in early 2013

## Competition Coming: *Widening of Panama Canal*

- Third lane opening in 2014 to accommodate mega-ships
- May make eastern U.S. ports more attractive to ships from Asia

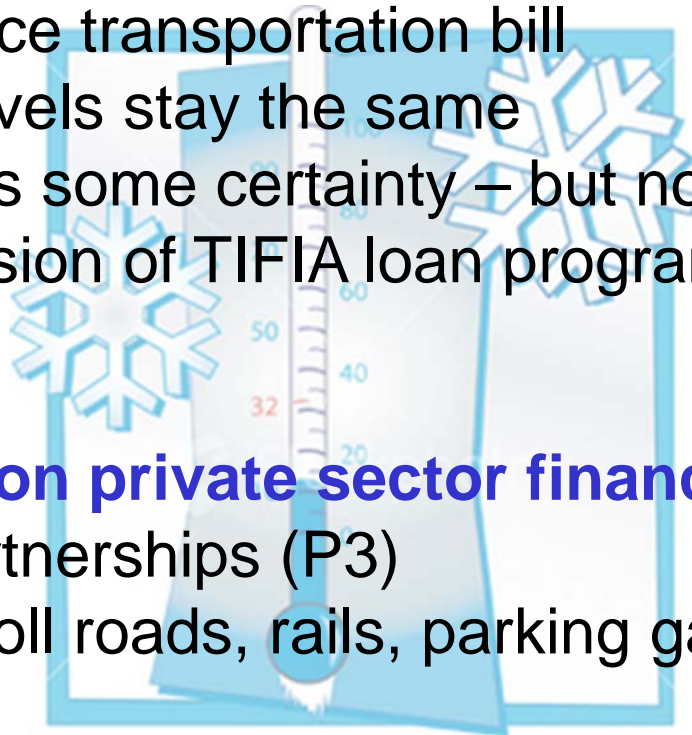
# **HOT** – Federal Trans. Funds

## **MAP-21 (\$105 Billion):**

- New federal surface transportation bill
- Overall funding levels stay the same
- 2 year period adds some certainty – but not a lot
- \$17 Billion Expansion of TIFIA loan program could help LA

## **Policy shift - rely on private sector finance infrastructure:**

- Public Private Partnerships (P3)
- Private control – toll roads, rails, parking garages



# REHEATING – High Speed Rail

## California High Speed Rail (CAHSR)

- State approved funding last year
- Federal approval granted for first phase from Merced to Fresno
- Construction begins this year

## Desert Express

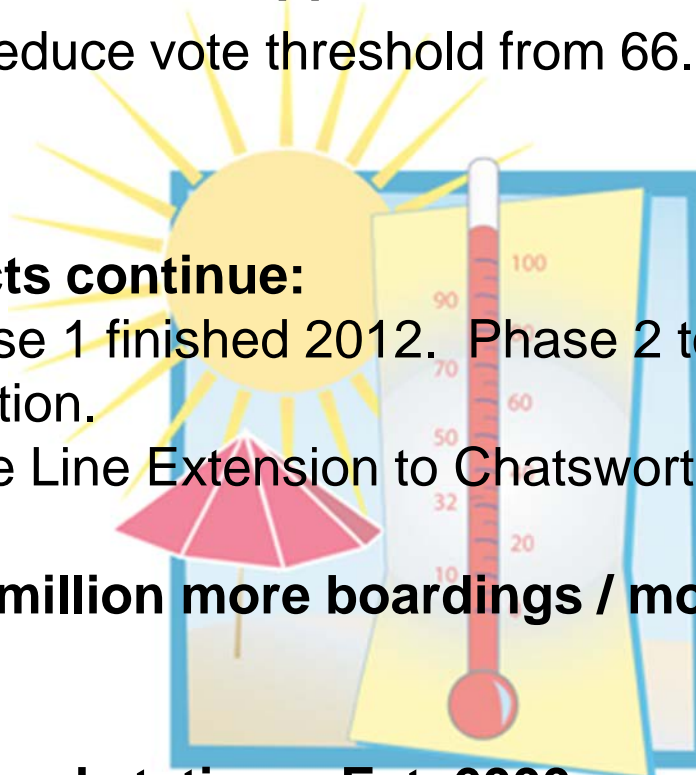
- Between Las Vegas and Victorville (ultimately to Palmdale)
- Cost: \$6 billion
- Awaiting Federal loan request

## High Speed Rail: Success or failure?

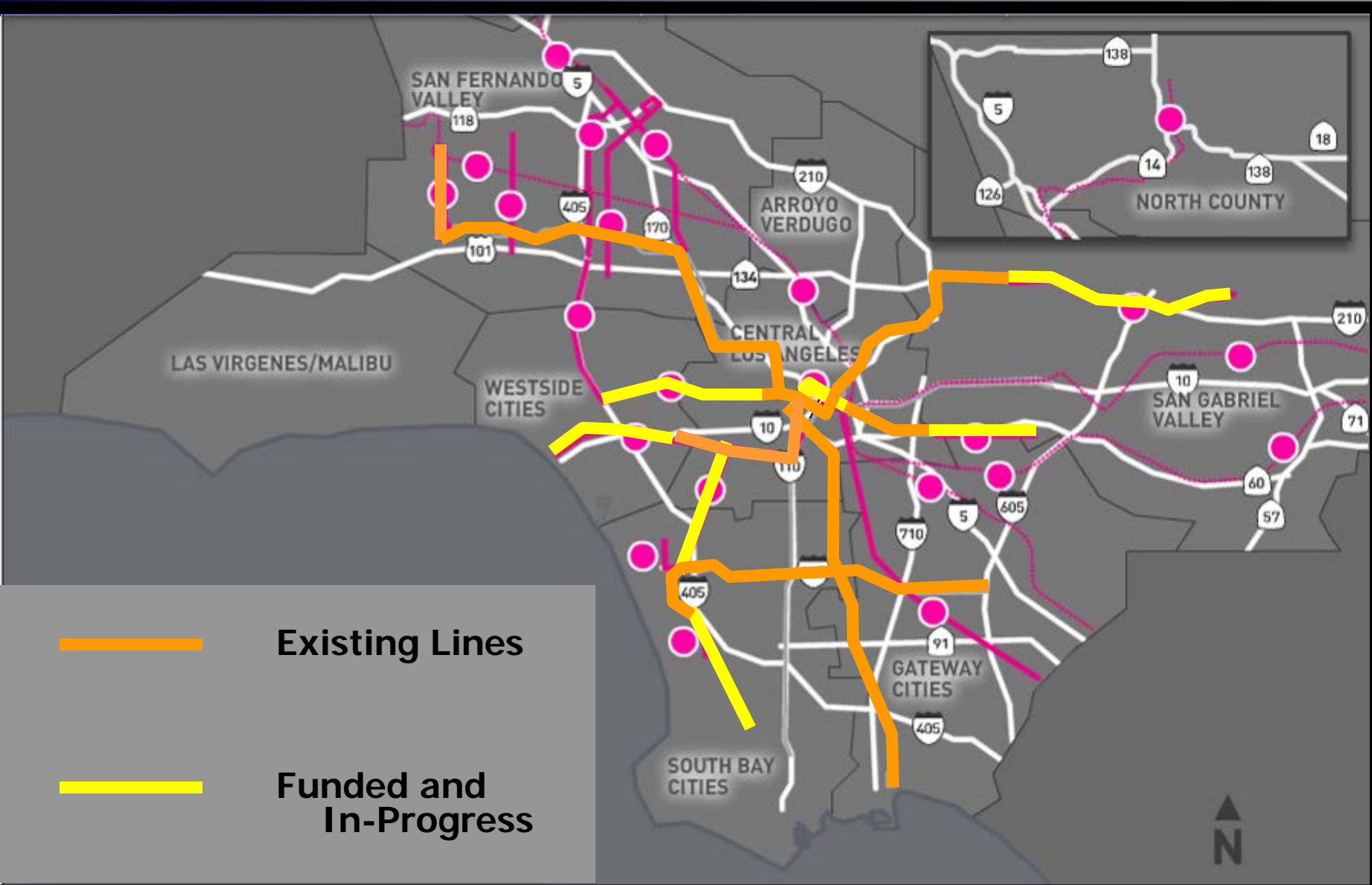
- High gas prices work in favor
- Alternative to regional jet service, reducing airspace congestion
- Regional airport expansion limited and typically controversial

# STILL HOT – Local Transit

- **Measure J Fails with 66% support**
  - (legislation to reduce vote threshold from 66.6% to 55% under consideration)
- **Measure R projects continue:**
  - Expo Line Phase 1 finished 2012. Phase 2 to Santa Monica under construction.
  - Valley's Orange Line Extension to Chatsworth finished
- **Rail Ridership: 1 million more boardings / month in 2012 vs. 2010**
- **TOD projects around stations: Est. 6000 new housing units along Expo Line by 2030.**



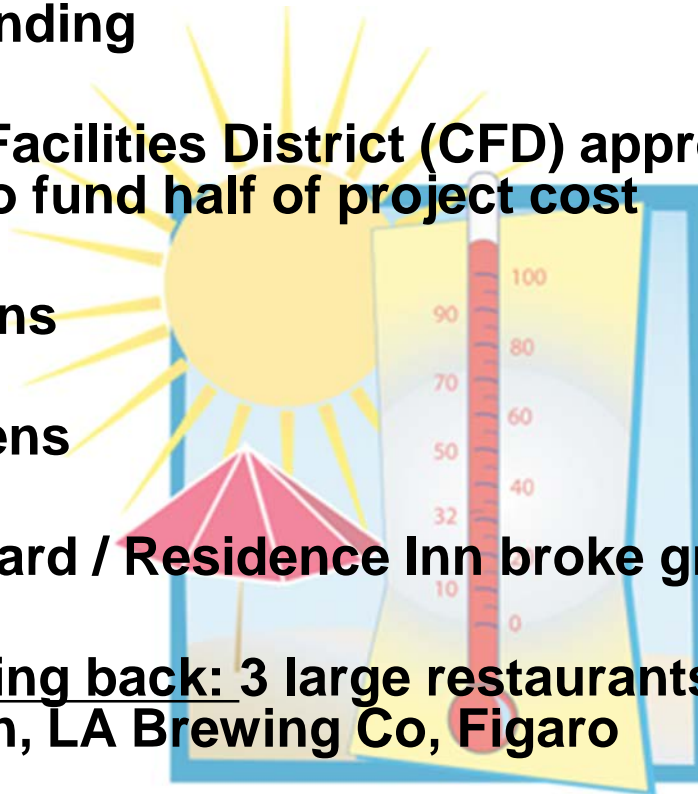
# HOT – Urban Rail & Mass Transit



# HOT – Downtown LA

## Big Happenings in 2012

- LA Streetcar funding
  - Community Facilities District (CFD) approved by residents – to fund half of project cost
- City Target opens
- Grand Park opens
- Marriott Courtyard / Residence Inn broke ground
- Broadway coming back: 3 large restaurants – Umamicatessen, LA Brewing Co, Figaro
- Historic Core getting “credit” retail with its first Starbucks at 6<sup>th</sup> & Spring



# HOT – Downtown LA

## TRENDS

- **Downtown maturing into a “core” real estate market**
  - “PHASE 1” – Smaller pioneers, mostly families
    - Shomof family; Delijani family; Barry Shy
  - “PHASE 2” – Established developers with institutional money
    - Rising Realty Partners (Nelson Rising and co.)
    - Ratkovich Co. (Wayne Ratkovich)
  - “PHASE 3” – Institutional owners / developers
    - Equity Residential
    - Essex Property Trust
- **Downtown poised to be a hub for creative offices**
  - Pacific Center, 523 West 6<sup>th</sup> (Rising Realty)
  - Corporation Building, 724 S. Spring (Izek Shomof)
  - Expect large technology tenant announcements in 2013





## TRENDS (continued)

- **Companies relocating main offices & regional HQ's to DTLA**
  - Gensler
  - Haight Brown Bonesteel
  - Chinatrust Bank
- **Broadway Renaissance Continues in 2013**
  - Clifton's Cafeteria – major renovation/preservation effort
  - ACE boutique hotel (former United Artists theater) under construction
  - Councilmember Huizar working on a commercial adaptive reuse ordinance to fill 1 million sq. ft. of upper-floor space
- **Apartment Development: ~2400 units under construction**
- **Retail Revolution**
  - MACY's Plaza revitalization (Ratkovich)
  - Grand Central Market renovation announced



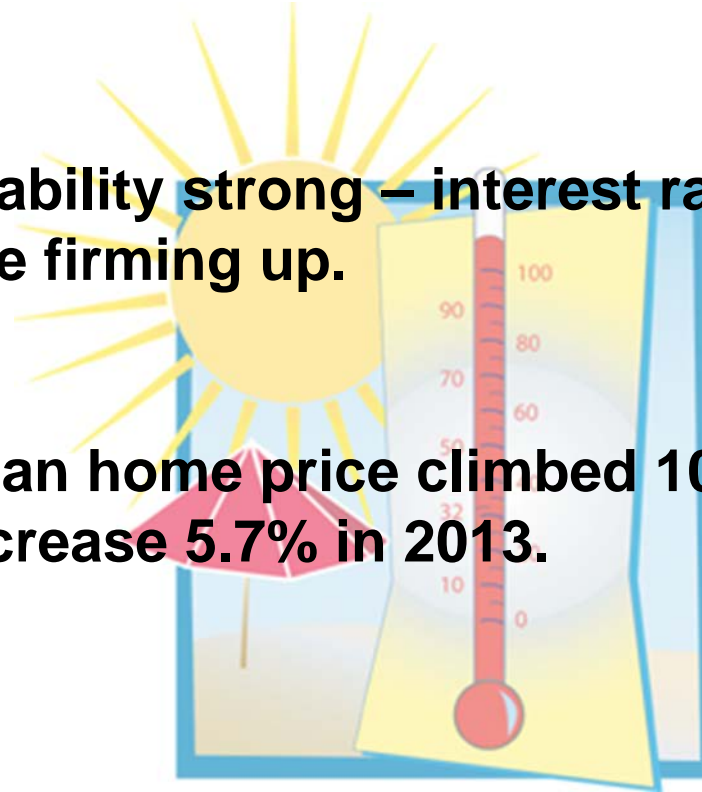
# HOT – Health Care Industry



- “Obamacare” here to stay – many unknowns
- In 2012 healthcare costs rose 2 times faster than inflation
- **BUT** - Industry poised for tremendous growth
  - “Individual Mandate” kicks in January 1, 2014
  - Aging Population
- Health care related construction up 5% from 2011

# WARMING – Residential

- C.A.R. forecasts sales to increase 1.3% in 2013.
- Housing affordability strong – interest rates remain low and home prices are firming up.
- California median home price climbed 10.9% in 2012 – projected to increase 5.7% in 2013.



# Retail – COOL IN SPOTS

- **Large Scale ground up development sparse**
- **300+ years of retailing at a fork in the road**  
JC Penney, Sears, and Radio Shack suffering identity crisis
- **Big Box Retailers with small formats to penetrate urban markets**  
City Target; Wal-Mart Neighborhood Market; Best Buy Mobile



# Retail – **HOT IN OTHER SPOTS**

- **Brick and Mortar will continue to be in demand in underserved and urban markets and in more urban formats**
- **“Discount” & Dollar stores are taking over** – 4 biggest dollar chains operate more locations than 3 biggest drugstore chains.
- **Outlet Format (Nordstrom Rack)** - All major retailers will get one
- **Non-Retail Reuse:** Gyms & medical offices in vacated big boxes
- **Coffee Wars – Starbucks in expansion mode (+1000 in 5 years).**  
McDonalds & Dunkin’ Donuts remain chief national foes



# WARMING – Commercial RE

- **Investor sentiment at its highest level since 2004 (Marcus & Millichap Investor Sentiment Survey)**
- **Acquisitions accelerated in second half of 2012; activity dependent on location & pricing mostly under replacement cost**
- **Foreign buyers have targeted American cities:  
*The Top 4: NY, Houston, DC, San Francisco***
- **Employers still on fence for hiring...economic uncertainty making businesses cautious, impacting occupancy & rents**
- **Lots of investment capital still on the sidelines, may loosen second half of 2013**

# WARMING – RDA Properties for Sale

## Redevelopment Agency (RDA) Dissolution:

- **Largest Public Sale of Real Estate Assets in California History begins 2nd half of 2013**
- **442 Former RDAs owned thousands of properties**
- **Some former RDA assets may be kept/used but vast majority to be liquidated via Property Management Plans (“PMP”) in 2013. The three fates are:**
  - *Real Estate transferred to Cities for governmental use*
  - *RE transferred to Cities for future development*
  - *Most properties liquidated via PMPs*



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# Must See TV





# Kosmont's Must See TV in 2013

## FISCAL CLIFF – STILL THE BIGGEST SHOW

### Raising Taxes/ Reducing Deductions?

- Impacts small business owners (taxed at personal income rates)
- Federal Tax increases on the wealthiest through elimination of deductions ironically hit Blue States the hardest
  - In 2010, five liberal (“blue”) states (CA, NY, NJ, MD and MA) used 1/2 of the nation’s \$250 B in income tax deductions
  - Results in “red” states subsidizing blue states

### Increasing Debt Limit /Cutting Programs?

- Issue badly split along party lines; not easy to resolve
- Defense cuts impact California’s global economies (e.g. South Bay, San Diego)
- Credit rating of US is at stake in this “World Series of Poker”

## BUSINESS INVESTMENT AND JOBS HANG IN THE BALANCE

# Kosmont's Must-See TV in 2013

## *POLICY-RELATED OPPORTUNITIES & ISSUES*

- 1. GOV BROWN PROPOSING RADICAL FUNDING REFORM FOR SCHOOLS  
MAY SHIFT FUNDING FROM WEALTHY TO POOR DISTRICTS**
- 2. CEQA REFORMS A HIGH PRIORITY FOR SOME LEGISLATORS  
EXPECT CHANGE TO BE INCREMENTAL; MUCH OPPOSITION**
- 3. NATION'S 1<sup>st</sup> CARBON CAP AND TRADE SYSTEM STARTS 2013  
CAPS EMISSIONS BUT CREATES EMISSION CREDIT MARKET**
- 4. CUTS TO STATE COURT SYSTEM INCREASING WAIT TIMES  
WAIT TIMES OF 3-5 YEARS DETERS SOME INVESTORS WHO NEED  
TIMELY RESOLUTION OF DISPUTES**

# Kosmont's Must-See TV in 2013

## PRIMARY REAL ESTATE OPPORTUNITIES

1. **"BAYWATCH" – SANTA MONICA to PLAYA VISTA...& SOUTHWARD**  
**SURGE OF INVESTMENT IN "SILICON BEACH"**
2. **DOWNTOWN'S "WONDER YEARS"**  
**APARTMENT DEVELOPMENT PICKING UP; RETAIL SWELLING;**  
**MORE INSTITUTIONAL PLAYERS BUT NICHE BUYS REMAIN**
3. **"COMMUNITY" BUILDING AROUND NEW LIGHT RAIL STATIONS**  
**DTLA CONNECTOR, GOLD LINE-FOOTHILL, EXPO, PURPLE, ETC.**
4. **"HOME IMPROVEMENT"; COMMERCIAL TRADING MORE**  
**SALES ACTIVITY IS ENCOURAGING; JOBS REMAIN WILDCARD**

# Kosmont's Must-See TV in 2013

## PRIMARY REAL ESTATE OPPORTUNITIES

### 5. RETAIL ADAPTING TO SMALLER, VIRTUAL & DISCOUNT FORMATS

**"BRICKS" AND "CLICKS" MUST LEARN TO COEXIST**

### 6. HOSPITALS AND EDUCATION

**INCREASES IN ARCHITECTURAL / ENGINEERING BILLINGS**

### 7. CITIES MAY LOOK AT FLEXIBLE ZONING FORMATS

**TRADING INCREASED DENSITY FOR PRIVATE INVESTMENT**

### 8. 2013 IS THE YEAR OF THE "PMP"

**RDA DISSOLUTION = REAL ESTATE ACQUISITION OPPORTUNITY**

# Kosmont's Must See TV in 2013

THERE IS STILL HOPE TO BREAK GOOD...

**CALIFORNIA WILL BE PICKED UP  
FOR YET ANOTHER SEASON**



Happy New Year, 2013

**Cheers**



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