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24<sup>th</sup> ANNUAL ECONOMIC FORECAST

*PRESENTS:*  
**THE AVENGERS**  
*VS.*  
**THE EXPENDABLES!**

STARRING LARRY J. KOSMONT, CRE

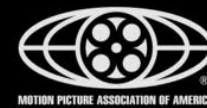
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## 1. The State of the State

*Recap of Last Year's Hits*

## 2. State & Local Gov't: A VIP Tour of the Set

*Jerry Brown and the California Sausage Factory*

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

*Oscars and Razzies*

## 4. Kosmont's Countdown to the Oscars

*Road to the Real Estate Academy Awards*

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# The State of the State



# California in 2013 – Critic's Review

## *The Avengers – The Heroes California Wanted*

- **Much like Miley Cyrus's tongue, CA legislature is left-leaning, but passed some business / real estate-friendly laws in 2013**
- **Home prices had double digit growth statewide**
  - **New single family home development and sales likely to increase based on continued increase in jobs.**
- **Development of apartments kicked up in 2012-2013**
- **Property and sales tax revenues coming back**
- **CA Unemployment Rate dropped in 2012:**
  - **9.8% to 8.7%**

# California in 2013 – Critic's Review

## *The Expendables – The “Heroes” CA Didn't Need*

- **Unemployment still 5<sup>th</sup> highest in U.S. with 1.6 mil out of work**
- **State unemployment very uneven: 5% in Marin Co; 26% Imperial**
- **Close to 25% of Californians live below the poverty line**
- **Cities distracted by RDA dissolution activity**
- **Enterprise Zones terminated, replaced by AB93**
- **California remains high cost & unfriendly to business**
- **State gas tax increased to 39.5 cents per gallon (highest in US)**
- **Pensions remain underfunded with no practical solution in sight**

# On the Set of The Brown Budget: Good for Now; Not Built to Last

- **State expects surplus 1<sup>st</sup> time in decade**
  - \$2.4 billion by June 2014
  - \$5.6 B in 2015, \$9.6B in 2018 (when Prop 30 expires)
- **S & P raised CA's credit rating to 'A'**
- **Temporarily balanced from income & sales taxes**
  - (Prop 30 – expires in '18)
- **Cities still in trouble: Stockton, Mammoth Lakes, San Bernardino filed for BK in 2012-13**
  - BK looming for Desert Hot Springs, Compton and others
  - Multiple School Districts facing serious cash flow issues & possible BK
- **Brown's 2014-15 proposed budget of \$155-billion includes general fund spending hike by 8%; repay \$11B in debt, and \$1.6B in a reserve fund**



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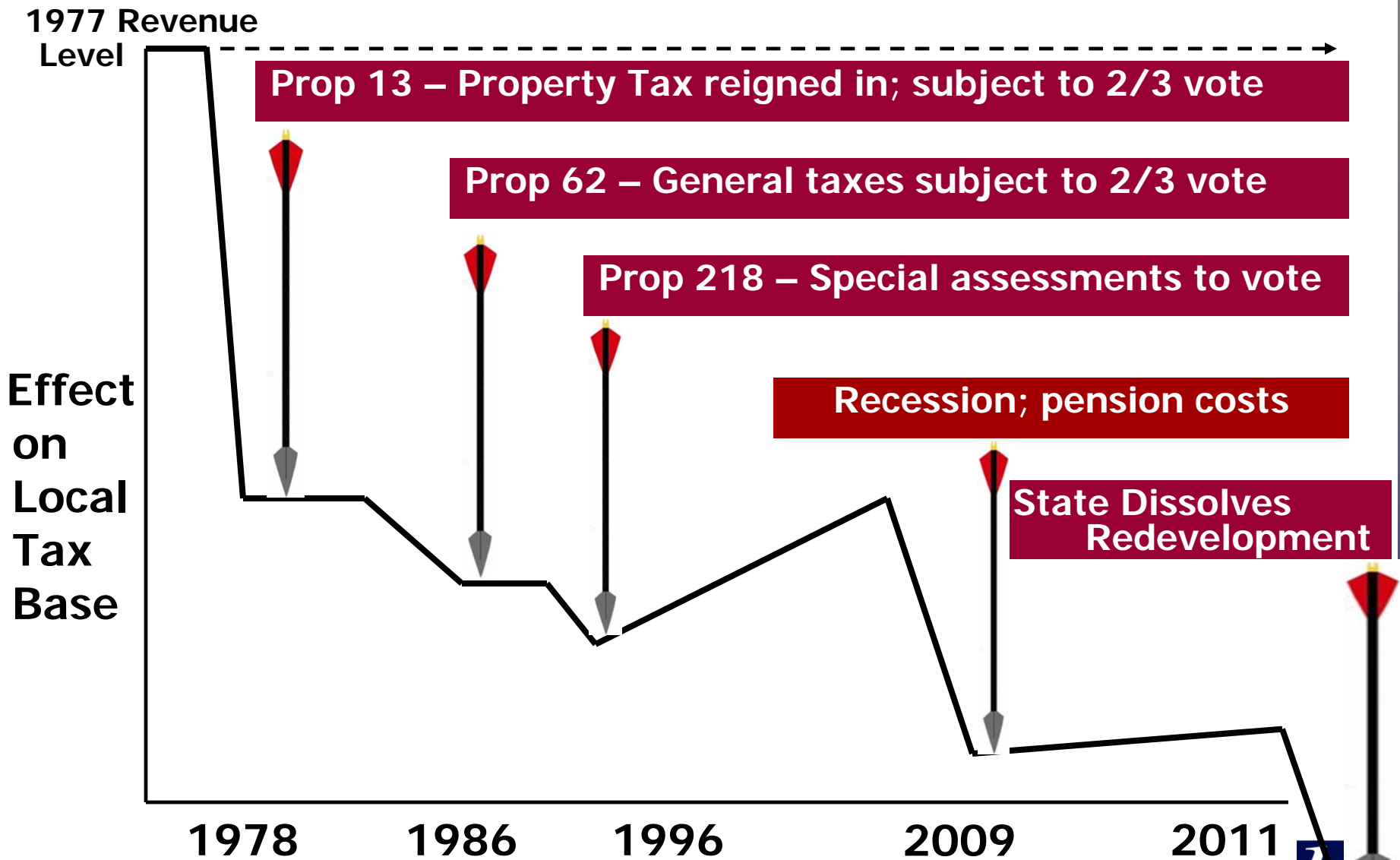
# State and Local Gov't

## A VIP Tour of Public-Private Real Estate





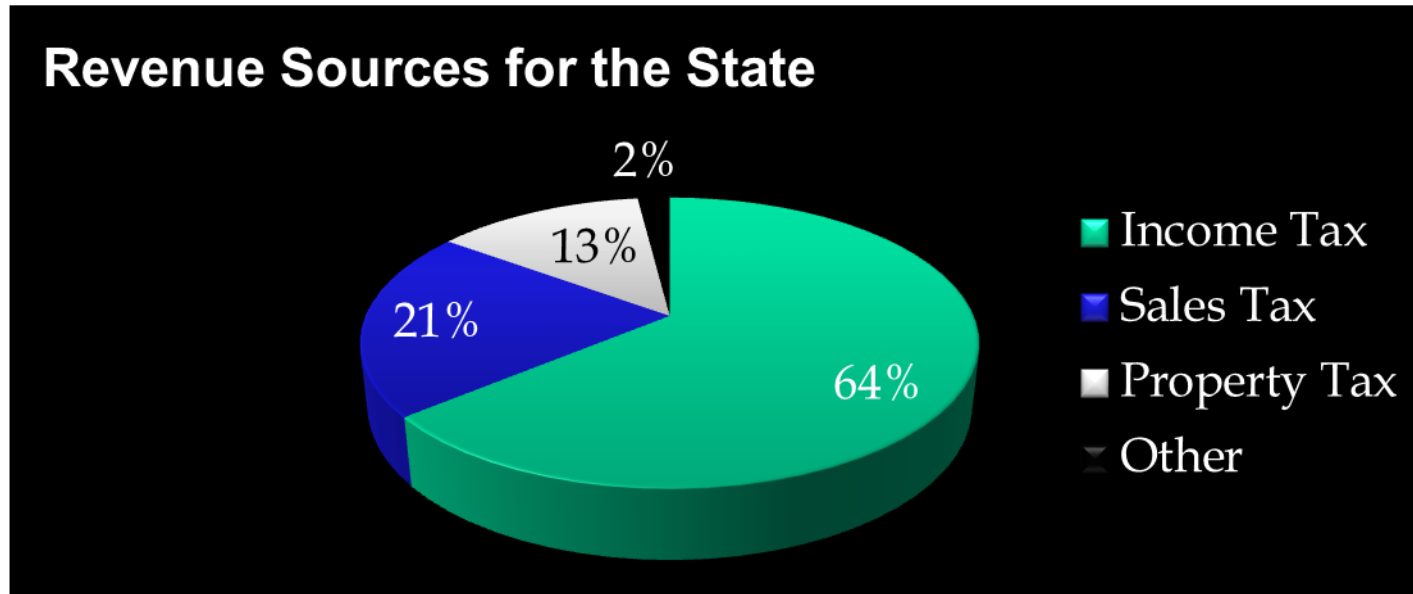
# Econ Dev. Needed after 34 yrs of Hunger Games



Note: Not to Scale

# SACRAMENTO UNCHAINED

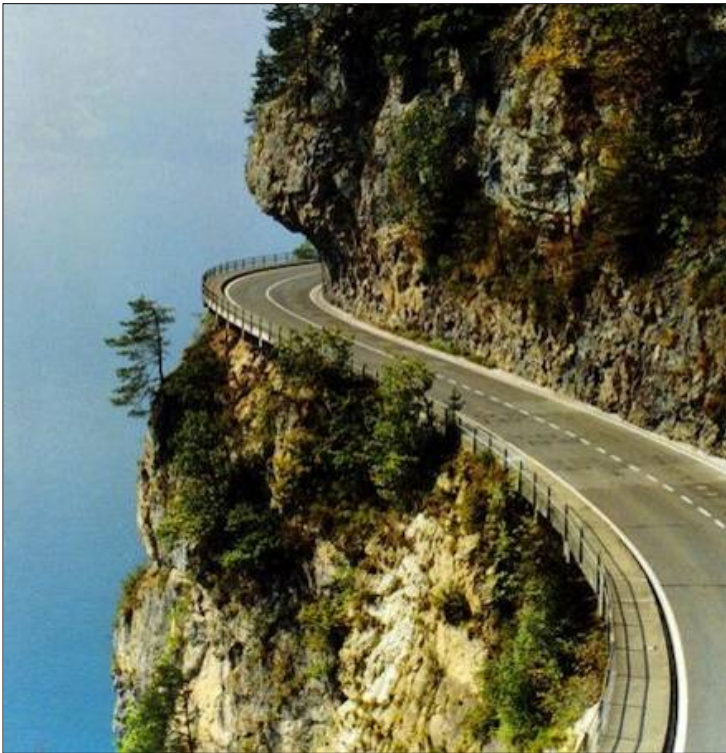
Budget too dependent on top 2 (highly unstable) sources



- **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**

# Now The Cities Have the Bill

## *Choose Your Stunt...*



**Continue Raising Taxes?**



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

# Taxes vs. Economic Development

- **INSIDIOUS SEQUELS OF TAXES: Higher taxes are part of the “fixed cost” equation that business must control to compete favorably**
  - California consistently rated least biz friendly by the CEO Roundtable
  - Without incentives, growth companies may look elsewhere
  - Over 175 cities & 32 counties at >9% unemployment, so we need jobs
  - Over 350 communities have raised taxes in last 2 elections
- **SILVER LININGS PLAYBOOK of ED: Economic Development is a better solution for California than taxes:**
  - Cities help themselves & State by helping companies to invest
  - Private investment = growth in real estate values and economic activity (local business spending, new wages, retail sales)
  - ED funding sources are very limited in California

# Cities still in the Real Estate Business

Cities are left with the “Four R’s” 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 sector partners that generate taxes & jobs*



What's *Hot*?

What's *Not*?

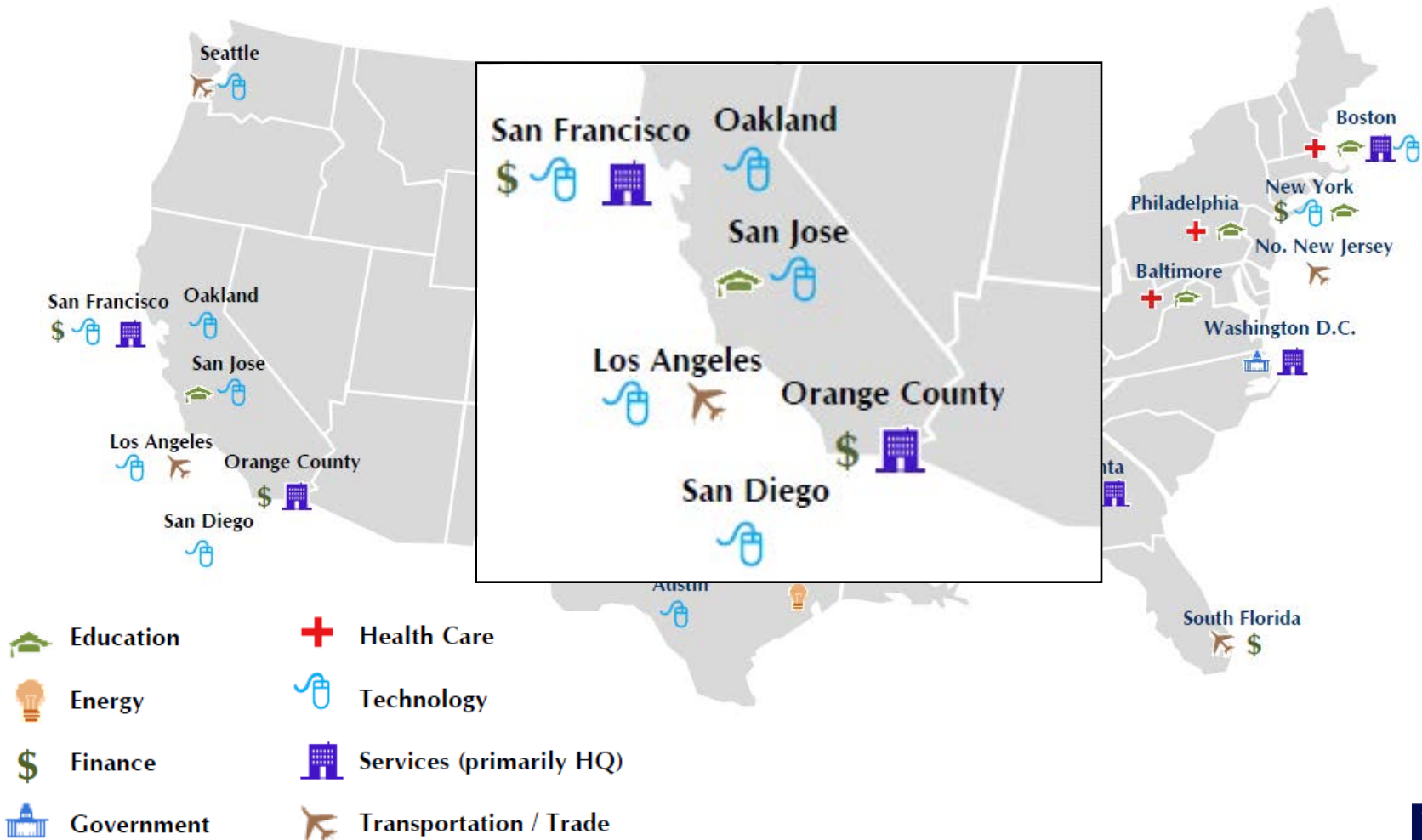


*STAY CLASSY SAN DIEGO*

# What's Hot?

# What's Not?

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



# TIF – “FROZEN” Stiff

**Tax Increment Financing is the “Gold Standard” public financing tool for real estate projects and economic development nationwide**

- **TIF allowed RDAs access to significant & long-term source of funds**
- **Typically uses property tax, a stable funding source**
- **TIF grows for decades over a base year, providing leverage over time**
- **RDA Projects created millions of dollars & thousands of new jobs; benefits were not well promoted & RDAs had many detractors**

**When the State tossed Redevelopment it also discarded TIF**

- **California is now one of only 3 states without this vital tool**
- ***Without TIF, CA does not compete effectively for business and jobs, AND cannot enter into productive Public Private Real Estate Projects.***
- **Gov’s ‘14-’15 Budget proposes minimal TIF reform with less restriction on Infrastructure Financing Districts; not likely to be effective**



# Former RDA Properties – **HOT**

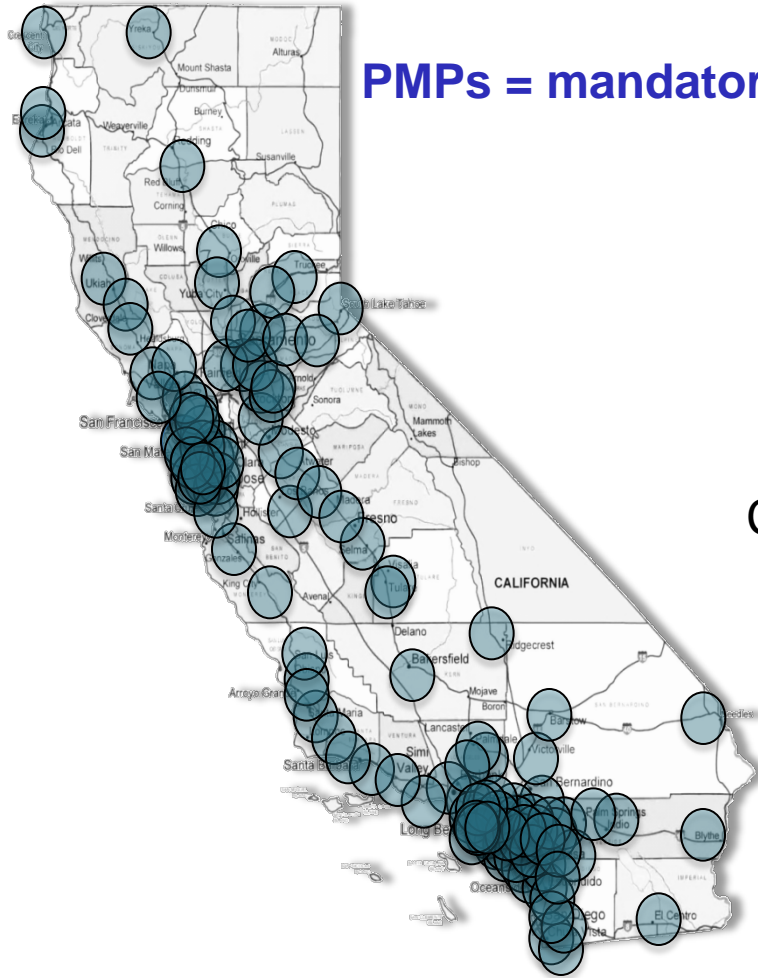
**427** former Agencies must complete Property Management Plans (PMPs) before January 1, 2015

**PMPs = mandatory liquidation** of RDA owned property (AB1484)

**~Over 3,000** RDA properties must be disposed of starting in Q2 2014

**Thousands of sizable properties** located in California's **primary urban & suburban** markets

*The Private Sector (investors, developers) positioning to take advantage of these properties*



# Public Private Projects – **HOT**

**Cities need new jobs and taxes more than ever:**

## **Public Entity provides:**

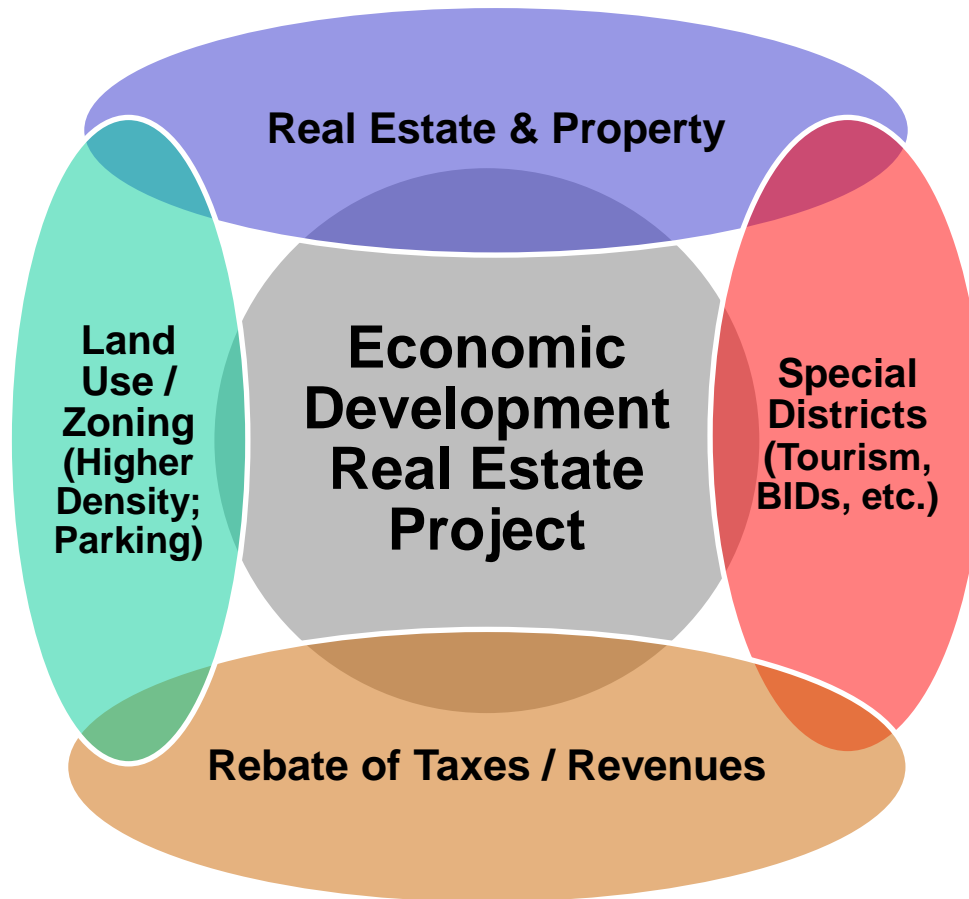
- Land
- Public Funds
- Lower Cost Financing
- Project Incentives (density bonus)

## **Private Developer/Owner/Tenant provides:**

- Development expertise
- Preferred Tenants/Uses
- Private financing
- Risk Assumption/Management

# Post-RDA Financing Tools – **HOT**

**Cities have 4 BASIC TOOLS for Public Private Projects**



***Theses tools often work best when used together***

# New Econ. Dev. Legislation – **HOT**

- **AB 440 (Gatto): “Hazardous Materials: Local Cleanup”**
  - RDAs used Polanco to clean-up / develop sites that suffered from environmental contamination; used to revitalize “blighted” areas
  - Renews Polanco Act – transfers power to cities and counties
  - Encourages infill development and cleanup of brownfields
- **SB 470 (Wright): “Community Development: Economic Opportunity”**
  - Allows City or County to sell real / RDA property for economic development purposes & defines “economic opportunity”
  - Property may be sold at “fair reuse value” rather than market value
  - Authorizes a loan program and allows land write-downs

# Gov's Incentives Review



- **Sales Tax Exemption**

- Existing sales tax credit for businesses in Enterprise Zones expanded to *statewide* sales tax exemption on purchase of manufacturing or R&D equipment
- Business allowed to exclude the first \$200 million equipment purchases from state share of sales tax (4.19%) from 7/1/14 through 6/30/22



- **Investment Incentive (attraction/retention credit)**

- Businesses compete for tax credits based on # of jobs to be created or retained
- Approval of any incentive by a five member committee composed Treasurer's office, Department of Finance, GO-Biz, the CA Senate and CA Assembly
- Approved credits may be recaptured if a business fails to fulfill contract

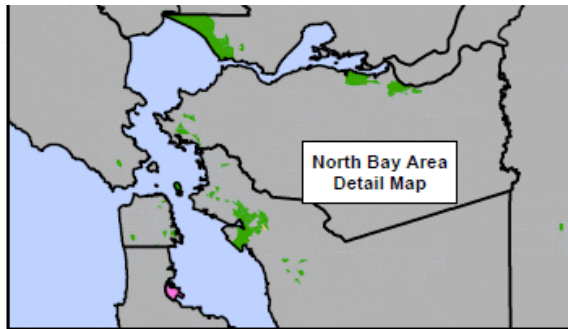
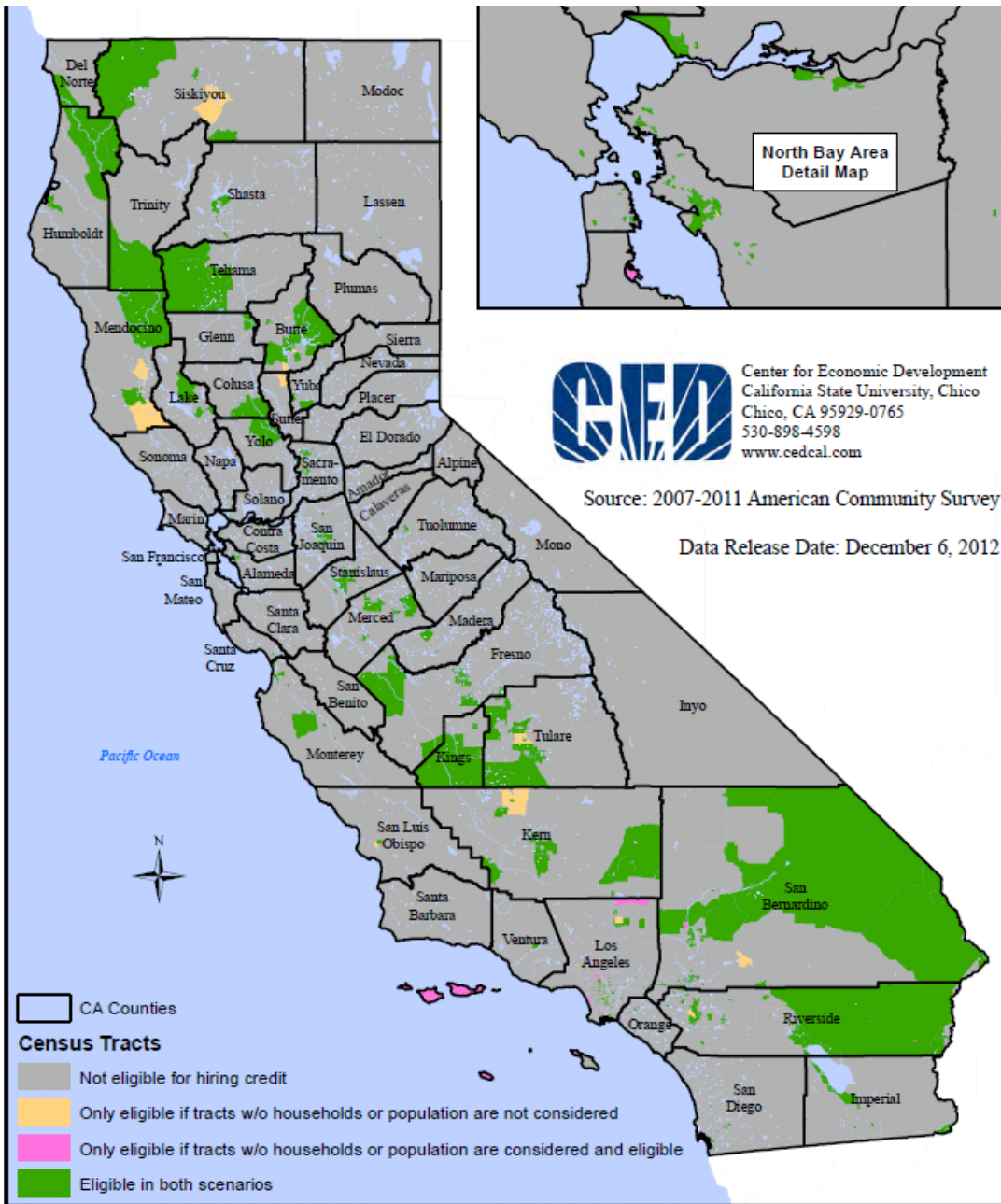


- **Hiring Credit**

- For businesses in census tracts with top 25% in unemployment & poverty
- Credit available for those who show a net increase in jobs
- Equals 35 percent of wages between 1.5 -3.5 times minimum wage (5 years)
- Five pilot areas picked by GO-Biz, credit calculated on wages  $\geq$  \$10/hour



# Census Tracts Where Businesses Would be Eligible for the Proposed Hiring Credit



Center for Economic Development  
California State University, Chico  
Chico, CA 95929-0765  
530-898-4598  
www.cedcal.com

Source: 2007-2011 American Community Survey

Data Release Date: December 6, 2012



# CEQA Reform – CHANGING CLIMATE

- **SB 743 (Steinberg): “CEQA Reform Bill”**
  - Reduced CEQA analysis for Urban Infill projects
  - Originally designed to speed up development of new Sacramento arena
  - Protects urban projects from challenges based on aesthetics & parking
  - New guidelines to be developed for measuring traffic impacts in transit priority areas using trips & vehicle miles traveled vs. Level of Service
  - Many developers in urban areas could avoid mitigation to counter parking impacts by developing an “infill site” as defined under SB 743

***“These key reforms move CEQA modernization forward to loosen the red tape on the kind of development we want to see in CA: clean, green projects that limit urban sprawl and reduce amount of time people spend in traffic” - Steinberg***



# Surplus School Property– **WARMING**

- **Despite passage of Prop 30, school districts face financial hurdles to undo impact of 5+ years of budget cuts from recession**
- **School districts have opportunity to dispose of surplus property using sale, lease, exchange, or P3**

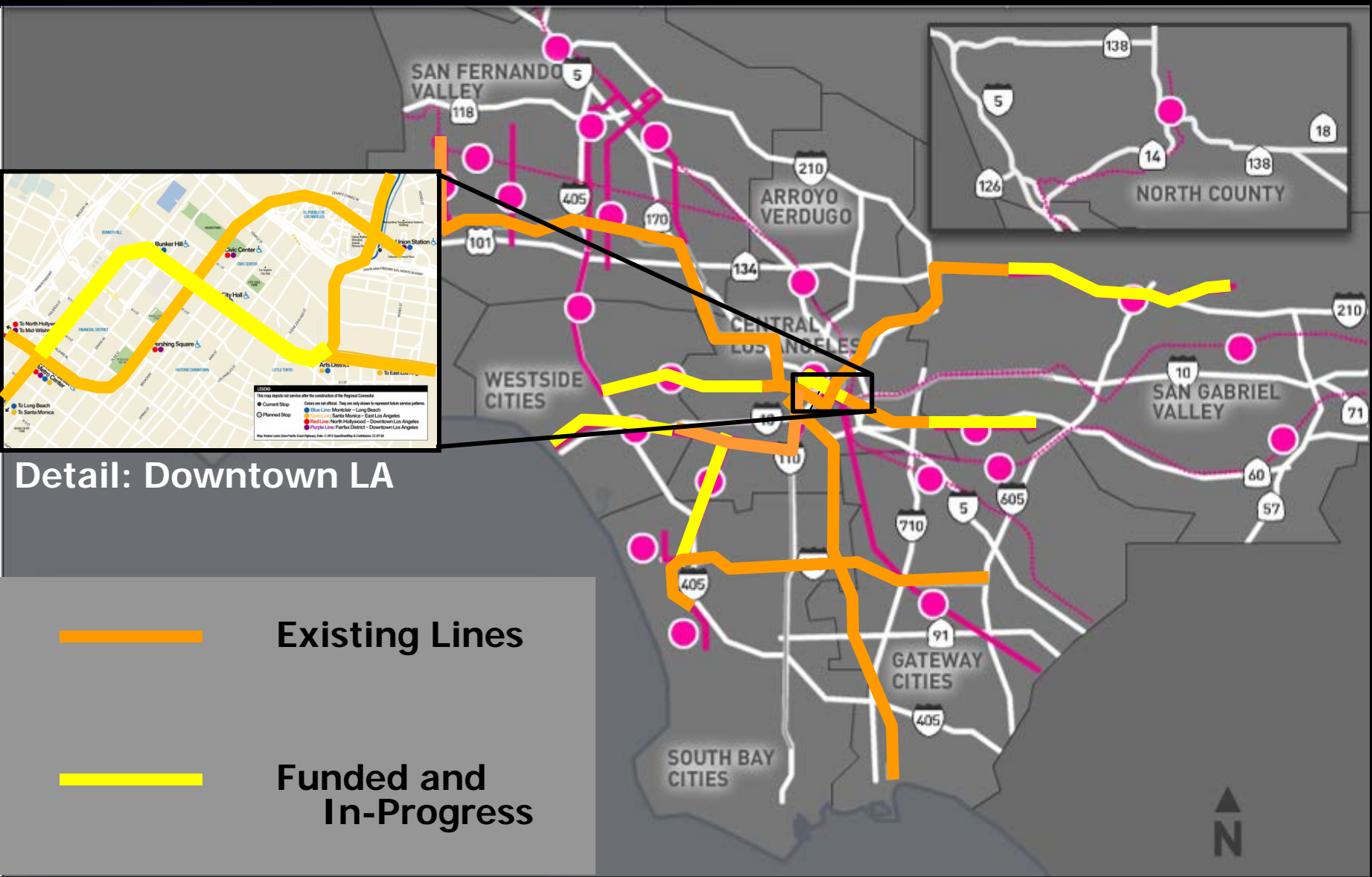




# Retail – **HOT SPOTS**

- **2013 Holiday sales indicated that internet was the driver of changes in shopper patterns and increase in sales volume**
- **But Brick and Mortar will continue to be in demand** in underserved and urban markets and in more urban formats
- **Internet + Brick & Mortar blending**, “staying together for the kids”
- **Tech Manufacturers creating Hip Lounge-type retail experiences for shoppers** – so called “emporiums of cool”
- **Competition for tenants is increasing** given loss of tenants and surviving tenants that are downsizing formats
- **Outlet Format (Nordstrom Rack)** - Most major retailers will get one
- **Coffee Wars – Starbucks in expansion mode (+1000 in 5 years).**  
McDonalds & Dunkin’ Donuts remain chief national foes

# HOT – Urban Rail & Mass Transit



# THERMAL FATIGUE – 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
- Estimated Distance: 800-miles
- Estimated Cost: \$68 billion

## High Speed Rail: Success or Failure?

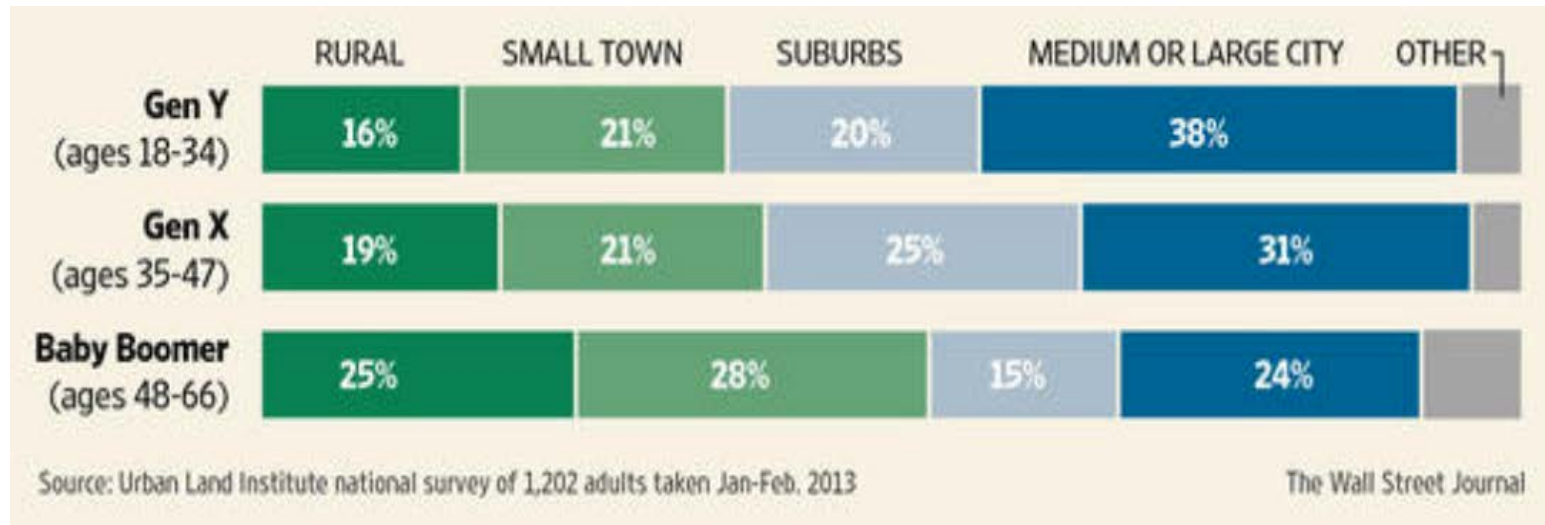
- High gas prices work in favor
- Alternative to regional jet survive congestion
- Regional airport expansion limited and typically controversial
- Skyrocketing costs – can California keep Federal funding?
- Difficult to “Buy American”; few domestic train equip. suppliers
- Governor Brown’s Legacy Bet – *Gov plans to use 1/3 of cap and trade proceeds (~\$280 million) for HSR as “sustainable transit”*

# HEATING UP – Offices with Walkability

## Companies following Millennials back into the City

“White Flight” → “Diverse Downtowns”

“Extreme Commuting” → “Corporate Urbanism”



- Silicon Valley shifting from Santa Clara to San Francisco
- DTLA’s walkable Financial District now favored over Bunker Hill

# ROASTING – DTLA Ground Floors

## Retail & Restaurants Maturing into Latest Phase

1. **Neighborhood Bars arrive (Golden Gopher, 2004-)**
2. **Mid-Priced (upscale casual) Restaurants (Daily Grill, 2004-)**
3. **Credit Pharmacies in Historic Core (Rite Aid, 2007-)**
4. **Supermarket (Ralphs, 2007)**
5. **Chef-Driven Restaurants (The Gorbals, Rivera, 2008)**
6. **Discount Chains arrive (Ross, 2012)**
7. **Urban Formats of Target, Wal-Mart, Smart n Final (2012-2013)**
8. **National Credit Boutiques arrive (Zara, H&M , 2013)**
9. ***High End Grocery (Whole Foods at 8<sup>th</sup> & Grand, 2015)***



# HOT – Downtown LA

## TRENDS - MULTIFAMILY & MIXED-USE DEVELOPMENT

- **Downtown maturing into a “core” real estate market**
  - “PHASE 1” – Pioneers and family & private developers
    - 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; NEW owners
    - Equity Residential
    - Essex Property Trust
- **Apartment Development: ~11,300 units in the works**
- **Properties have changed hands since the recession**
- **Many of the Developers are new to Downtown**  
(e.g. Wood Partners-GA, Carmel Partners-SF)

# HOT – Downtown LA

## TRENDS – HOTELS & TOURISM

- **Boutique Hotels coming to DTLA – many are adaptive reuse**
  - Boutique “ACE Hotel” opened January 6 on Broadway (**180 rooms**)
  - Historic Case Hotel at 11<sup>th</sup> & Broadway to be revived (TBD)
  - Ground-up SLS Hotel near Disney Concert Hall (TBD)
- **Convention Center –serving Hotel Development**
  - Courtyard Marriott/Residence Inn (2014 – **393 rooms**)
  - Renaissance Hotel just north of JW Marriott – (2016 - **450 rooms**)
  - Wilshire Grand Hotel (2017 – ~**960 rooms**)



## TRENDS – NEIGHBORHOOD REVITALIZATION

- **Parking into Parks**
  - Spring St. Park opened in 2013; former parking lot in residential area
  - Parklets on Spring Street turn parking spaces into “park” space
  - Southern Arts District to get its park on a lot next to Urth Caffe
- **Neighborhoods connecting by new development**
  - South Park, Historic Core and Fashion District starting to fuse
  - Block 8 connecting Old Bank District with Little Tokyo
- **Broadway is Back in 2014**
  - Yellin Company reviving Grand Central Market with new eateries
  - Improved streetscape, street lighting, neon and blade signs
  - Credit Tenant Retailers, High End Boutiques & Boutique Hotels



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# Kosmont's Countdown to the Oscars



AFTER EARTH

# Kosmont's Top 5 Oscar Picks

## 1. "PACIFIC RIM ECONOMIC DEVELOPMENT" – LEGISLATION HAS BIG IMPLICATIONS FOR REAL ESTATE

**AB440 & SB470 OFFER OPPORTUNITIES FOR P3'S**

## 2. "BRIGHT LIGHTS, BIG DEALS" – DOWNTOWN LA MATURING

**APARTMENT DEVELOPMENT PICKING UP; RETAIL SWELLING; MORE INSTITUTIONAL PLAYERS BUT NICHE BUYS REMAIN**

## 3. "RETAIL ADAPTATION" - SMALLER, VIRTUAL & DISCOUNT FORMATS

**"BRICKS" AND "CLICKS" MUST LEARN TO CO-EXIST**

## 4. "CITY OF ANGELS" - CITY HALL IS OPEN FOR BUSINESS

**CITIES HAVE THE FOUR "POST-RDA TOOLS" FOR PUBLIC-PRIVATE DEALS - REAL ESTATE, TAXES, ZONING AND SPECIAL DISTRICTS**

## 5. "THE P.M.P.s" – PROPERTY MGMT PLANS MEAN REAL ESTATE DEALS

**OVER 3000 FORMER RDA PROPERTIES TO GO ON MARKET IN 2Q14**

# In Development for 2014

- **Pension Reform Initiative led by Mayor of San Jose**
- **Jobs & Education District Initiative (JEDI)- TIF**
- **Additional Economic Development Props may surface**
- **Expect CEQA Reform & the return of AB731 (Steinberg)**
- **November Elections: more Republican seats up for grabs**

## ***Not to be out done:***

**Attorney John Cox proposes shrinking size of State Legislature Districts; increasing the number of legislators from 120...**

# In Development for 2014

*... to 12,000 State Legislators*



**"We're here to help"**





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