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LOS ANGELES BUSINESS JOURNAL

ECONOMIC TRENDS 2023

A Look Into What to Expect for the Year Ahead

ECONOMIC TRENDS 2023

Los Angeles Business Journal Presents Economic Trends 2023

The Los Angeles Business Journal was excited to host the 2023 Economic Trends virtual discussion event on Wednesday afternoon, February 1st.

The event featured two lively virtual panel discussions featuring leading experts on the hottest topics on the minds of LA area business leaders at the start of this year. The panels offered an insightful look back on the unprecedented challenges and silver linings of the past couple of years while providing a deep dive into the economic trends we are facing moving forward into 2023.

Our outstanding group of panelists and moderators examined the issues as they shared their experiences and predictions for the year to come. The panels this year focused on the hot-button topics of "The Real Estate Question: What's Actually Happening?" and "Trends to Expect in 2023," with expert insights and analysis about the impact current trends are likely to have on the overall economic climate.

The Real Estate panel, moderated by Jim Kruse, the regional president, greater LA, for Kidder Matthews, featured a spirited discussion containing shared knowledge from Erica Finck of Cushman & Wakefield; Sean Fulp of Colliers; Martin Griffiths of KPMG; and Kofi Nartey of Globl Red.

Each of the experts weighed in on a variety of hot real estate issues and talking points, including:

- Office utilization and how safety and cleanliness impacts interest in coming to the office;
- The role of public transportation in Los Angeles;
- An analysis of the tax property basis for DTLA, the amount of TIER 1 and 2 buildings, and what happens to that tax base when the values reset to something much lower;
- An analysis of sales and hotel taxes which would be tied to retail sales and hotel occupancy;
- The likelihood of workouts or foreclosures over the next 12 months;
- What can be done to attract tenants and/or reduce vacancy rates;
- Forthcoming opportunities in the market;
- How buyers and sellers navigate through an uncertain economic environment;
- How developers, large and small, navigate through today's market; and
- The various impacts of Measure ULA.

Immediately following the eye-opening real estate conversation, the Los Angeles Business Journal audience was treated to an equally in-depth and timely group roundtable on what trends we can expect to see in the coming 12 months.

The Outlook panel, moderated by Elsa R. Burton, the Los Angeles regional manager of Fifth Third Bank, featured expert insights from Kevin Conner of Conner Advisory Group LLC; Larry Holt of the Los Angeles County Economic Development Corporation; and Brian Oard of Wilmington Trust.

Each of these professionals weighed in on a number of discussion topics, including:

- Whether the Fed will continue to increase rates and what affect it will have on inflation;
- The status of the consumer products market, including specialty retail – and the near-term outlook for commercial retail including a further push into on-line e-commerce;
- The federal tax landscape outlook for 2023 as we approach a presidential election in 2024;
- The continued impact the pandemic will have on the relationship between employees and their employers;
- How LA County ranks nationally for job growth;
- The pros and cons to doing business in LA County;
- Successful models of progressive economic development;
- The impact of labor regulations and cost of labor;
- How increased regulation, litigation from trial lawyers, cost of living, crime and traffic has impacted the ability for small businesses to compete in our state;
- …and much more!

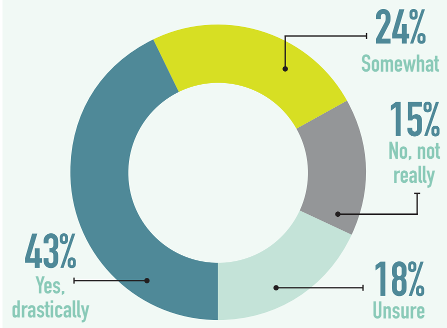
Many thanks to our excellent panelists, who took the time to share their insights on the biggest headlines and where the market is going in 2023.

A recap video of the discussion is available at labusinessjournal.com/events.

Has the tax regime influenced you to consider migrating out of California?

No, we have not considered migrating	43%
Yes, we will be migrating	27%
Doesn't apply to me	30%

Are the labor regulations and cost of labor impacting your business?



Do you expect transaction activity to increase in 2023?

No, it will be lower than 2022	55%
Yes, it will increase compared to 2022	22%
Unsure	23%

Results from a Los Angeles Business Journal poll taken during the event.

PANEL 1 THE REAL ESTATE QUESTION: WHAT'S ACTUALLY HAPPENING?

ERICA FINCK
Capital Markets
Cushman & Wakefield

SEAN FULP
Vice Chair & Head of Office Capital Markets, U.S. Southwest
Colliers

MARTIN GRIFFITHS
Partner
KPMG

JIM KRUSE
Regional President, Greater LA
Kidder Mathews

KOFI NARTEY
Chief Executive Officer
Globl Red

PANEL 2 TRENDS TO EXPECT IN 2023

ELSA R. BURTON
Los Angeles Regional Manager
Fifth Third Bank

KEVIN CONNER
Managing Director
Conner Advisory Group LLC

LARRY HOLT
Vice President – Economic & Workforce Development
Los Angeles County Economic Development Corporation

BRIAN OARD
President, Western Region
Wilmington Trust

View highlights from the panel discussion online:
labusinessjournal.com/events/economictrends2023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ECONOMIC TRENDS 2023

Office Utilization: An Issue the City Cannot Afford to Ignore

By SEAN FULP

There are many concerns surrounding the office market: office utilization, lender and investor appetite, construction and operating costs, functional obsolescence, and the list continues, but property taxes should top the list as most vexing in the City of Los Angeles.

A local government's property tax budget is generally the largest source of revenue, and nearly 22 percent of the city's 2022-2023 budgeted revenue will come from property taxes. Suppose office property values decline by 50 percent or more. In that case, the city will struggle to pay for necessary government services, putting additional downward pressure on property values and creating a circular pattern that becomes very difficult to break.

The city may not be able to control rising interest rates, but homelessness, crime, cleanliness, transportation, and affordable housing are within its control. These issues also significantly impact office utilization and could lead to significant property value decline in a rising interest rate environment.

> There is roughly 38 million square feet of office space in Downtown Los Angeles. At an average property value of $250 per square foot and an approximate tax rate of 1.25 percent, the city's roughly 27 percent share of the Downtown office property tax base would be approximately $32 million.

As just one example, there is roughly 38 million square feet of office space in Downtown Los Angeles. At an average property value of $250 per square foot and an approximate tax rate of 1.25 percent, the city's 27 percent share of the Downtown office property tax base would be approximately $32 million. If discounted property sales cut assessments in half, the city would lose $16 million of revenue from the Downtown office properties alone. The reality is office values could quickly decline by much more, and office utilization is down across all Los Angeles. Office utilization also directly impacts retail and multifamily performance and valuation.

The city should have the same goal as its property owners and do what it can to get people back into the office before declining property values and city services become a pattern that leads to permanence.

Humbly, this article does not attempt to devise a solution to these problems. Instead, the intent is to call attention to the need for a community of thought leaders to create safe and clean environments where people want to work and live. This article intends to highlight that office utilization is a problem the city cannot afford to ignore.

Sean Fulp is vice chair and head of office capital markets, U.S. southwest region for Colliers.

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Brian Oard
President, Western Region
310.300.3060
board@wilmingtontrust.com

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Study Details Commercial Real Estate's Impact on the Overall US Economy

The impact of new commercial real estate development in the US continues to grow, according to the annual "Economic Impacts of Commercial Real Estate" research study conducted by the NAIOP Research Foundation.

The combined economic contributions of new commercial building development and the operations of existing commercial buildings in 2022 resulted in direct expenditures of $826.9 billion and the following impacts on the U.S. economy:

- Contributed $2.3 trillion to U.S. gross domestic product (GDP).
- Generated $831.8 billion in personal earnings.
- Supported 15.1 million jobs.

Among other highlights:

- Significant (143.4%) increase in non-warehouse (manufacturing) industrial building construction in 2022, making it the largest segment of new CRE construction in 2022.
- The four property types covered in the report saw increased construction spending (hard costs) last year.
- With continued remote work, some firms are defensively putting space onto the sublease market, a trend exacerbated by true downsizing and layoffs, which has been especially concentrated in the tech sector.
- Notwithstanding the challenges of office-linked retail in urban-core markets, demand for traditional retail space has rebounded, and overall occupancy rates have recovered to pre-pandemic levels.

"The construction sector ended 2022 with positive momentum that we hope will continue into the new year," said Richard Branch, chief economist, Dodge Construction Network, provider of the commercial construction data cited in the report. "As we look ahead, growth in sectors such as life sciences, data centers and manufacturing will be important for seeing the potential amid the economic slowdown in 2023."

Altogether, commercial, residential, institutional and infrastructure development and operations of existing commercial buildings contributed $6.5 trillion to the US economy and supported 37.7 million jobs in 2022.

"The data in the report are strong economic indicators of commercial real estate development investment, job growth, and subsequential contributions to the US economy," said Marc Selvitelli, CAE, president and CEO of NAIOP. "Our success could be met with headwinds as inflation, workforce constraints and higher interest rates create uncertainty. Our Research Foundation, legislative team and education will keep our members and industry professionals informed on these issues and offer resources as the industry navigates potentially choppy waters."

> 'As we look ahead, growth in sectors such as life sciences, data centers and manufacturing will be important for seeing the potential amid the economic slowdown in 2023.'

The report notes that "slow growth in real (inflation-adjusted) GDP (0.2%) is expected, as well as in nonresidential fixed business investment (0.6%) – both evidence of potential declines in demand for construction and real estate. While expected slowdowns in economic growth in 2023 could dampen demand, the total value of construction is anticipated to increase modestly."

The "Economic Impacts of Commercial Real Estate" report is authored by Brian Lewandowski, Adam Illig, Michael P. Kercheval, Ph.D., and Richard Wobbekind, Ph.D., at the University of Colorado Boulder Leeds School of Business.

Since 2008, NAIOP has conducted this study for purposes of estimating the annual economic contribution of commercial real estate development to the U.S. economy. This study is used by real estate professionals and municipal, state, and federal officials and employees, to understand and quantify the key economic benefits of commercial real estate development. The full report is online at naiop.org/contributions23.

For more information, visit naiop.org.

A Global View: Slowdown to Hit Some Nations Hard

Global growth is slowing sharply in the face of elevated inflation, higher interest rates, reduced investment, and disruptions caused by Russia's invasion of Ukraine, according to the World Bank's latest Global Economic Prospects report.

Given fragile economic conditions, any new adverse development—such as higher-than-expected inflation, abrupt rises in interest rates to contain it, a resurgence of the COVID-19 pandemic, or escalating geopolitical tensions—could push the global economy into recession. This would mark the first time in more than 80 years that two global recessions have occurred within the same decade.

The global economy is projected to grow by 1.7% in 2023 and 2.7% in 2024. The sharp downturn in growth is expected to be widespread, with forecasts in 2023 revised down for 95% of advanced economies and nearly 70% of emerging market and developing economies.

Over the next two years, per-capita income growth in emerging market and developing economies is projected to average 2.8%—a full percentage point lower than the 2010-2019 average. In Sub-Saharan Africa—which accounts for about 60% of the world's extreme poor—growth in per capita income over 2023-24 is expected to average just 1.2%, a rate that could cause poverty rates to rise, not fall.

"The crisis facing development is intensifying as the global growth outlook deteriorates," said World Bank group president David Malpass. "Emerging and developing countries are facing a multi-year period of slow growth driven by heavy debt burdens and weak investment as global capital is absorbed by advanced economies faced with extremely high government debt levels and rising interest rates. Weakness in growth and business investment will compound the already-devastating reversals in education, health, poverty and infrastructure and the increasing demands from climate change."

Growth in advanced economies is projected to slow from 2.5% in 2022 to 0.5% in 2023. Over the past two decades, slowdowns of this scale have foreshadowed a global recession. In the United States, growth is forecast to fall to 0.5% in 2023—1.9 percentage points below previous forecasts and the weakest performance outside of official recessions since 1970. In 2023, euro-area growth is expected at zero percent—a downward revision of 1.9 percentage points. In China, growth is projected at 4.3% in 2023—0.9 percentage point below previous forecasts.

Excluding China, growth in emerging market and developing economies is expected to decelerate from 3.8% in 2022 to 2.7% in 2023, reflecting significantly weaker external demand compounded by high inflation, currency depreciation, tighter financing conditions, and other domestic headwinds.

By the end of 2024, GDP levels in emerging and developing economies will be roughly 6% below levels expected before the pandemic. Although global inflation is expected to moderate, it will remain above pre-pandemic levels.

The report offers the first comprehensive assessment of the medium-term outlook for investment growth in emerging market and developing economies. Over the 2022-2024 period, gross investment in these economies is likely to grow by about 3.5% on average—less than half the rate that prevailed in the previous two decades. The report lays out a menu of options for policy makers to accelerate investment growth.

"Subdued investment is a serious concern because it is associated with weak productivity and trade and dampens overall economic prospects. Without strong and sustained investment growth, it is simply impossible to make meaningful progress in achieving broader development and climate-related goals," said Ayhan Kose, director of the World Bank's Prospects Group. "National policies to boost investment growth need to be tailored to country circumstances but they always start with establishing sound fiscal and monetary policy frameworks and undertaking comprehensive reforms in the investment climate."

The report also sheds light on the dilemma of 37 small states—countries with a population of 1.5 million or less. These states suffered a sharper COVID-19 recession and a much weaker rebound than other economies, partly because of prolonged disruptions to tourism. In 2020, economic output in small states fell by more than 11%— seven times the decline in other emerging and developing economies. The report finds that small states often experience disaster-related losses that average roughly 5% of GDP per year. This creates severe obstacles to economic development.

Policymakers in small states can improve long-term growth prospects by bolstering resilience to climate change, fostering effective economic diversification, and improving government efficiency. The report calls upon the global community to assist small states by maintaining the flow of official assistance to support climate-change adaptation and help restore debt sustainability.

Learn more at WorldBank.org.

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Our office capital markets experts offer dynamic solutions for every market condition.

It’s no secret that office investors are feeling the pressure of declining property value and rising interest rates. As they navigate this challenging environment, investors turn to experts like Sean, leader of Colliers’ Southwest Investment Services Team. Providing disposition, acquisition, and debt placement expertise on assets across the entire risk spectrum, Sean and his team generate boundless opportunities and unparalleled visibility, no matter the market condition.

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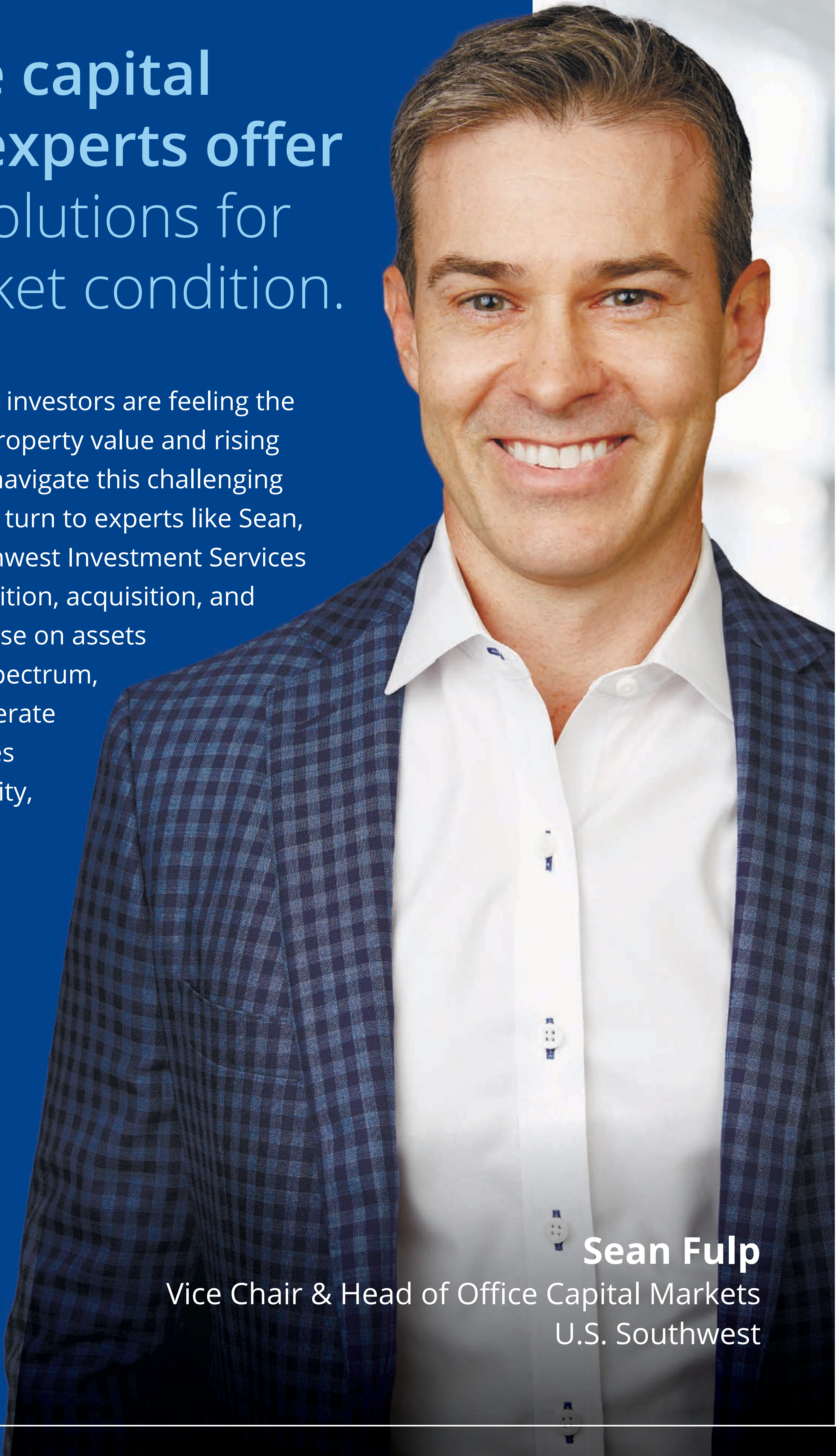

Sean Fulp
Vice Chair & Head of Office Capital Markets
U.S. Southwest

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