SPECIAL REPORT

Proposition ULA — City of Los Angeles

IPA INSTITUTIONAL PROPERTY ADVISORS

Fourth Quarter 2022

Investors Face New Tax on all Real Estate Transfers Priced Above $5 Million; Both Transaction and Development Landscape Negatively Affected

Measure ULA imposes new tax on real estate transactions. The city of Los Angeles' new Homelessness and Housing Solutions Tax establishes a 4 percent to 5.5 percent fee on all real property sales priced over $5 million, starting April 1, 2023. Dubbed a mansion tax, this voter-approved measure will significantly impact not only the single-family housing market, but also commercial and multifamily properties. Property owners will need to adjust near-term hold strategies, and investor demand for citywide listings could decrease or shift to other options in the metro area. Recent sales activity solidifies the significance of the measure's reach. Spanning the past 12 months ending June, nearly 760 apartment, retail, office and industrial listings each sold for more than $5 million, representing 44 percent of the metro's trade volume. Furthermore, based on current property assessments, roughly 18,100 citywide buildings could be potentially impacted. The threshold for taxation will be adjusted annually based on a chained Consumer Price Index, suggesting properties in the $5 million to $10 million tranche won't eventually be subject to the 5.5 percent tax rate because of inflation alone.

Owners face short interval to sidestep local taxation. Investors mulling a potential property sale as the year closes out have a roughly five-month window in which to execute a trade without being subject to the new tax. A boost in citywide listings volume may occur during this interval as a result, providing additional opportunities for active investors seeking longer-term holds in the city of Los Angeles. Still, buyers will weigh the taxation that awaits at the end of a potential hold when contemplating a near-term purchase. This may further alter buyer and seller pricing expectations during a span of rising interest rates and more stringent lending practices.

Projects may not pencil. Tax implementation will represent another hurdle for developers with proposed projects, specifically merchant builders that sell following stabilization. A 5.5 percent tax at the back end of a development's timeline — combined with volatile building costs and a more stringent lending environment — will tighten developers' margins, likely translating to some proposals being nixed in the near term and potentially exacerbating the city's housing shortage. Multifamily projects with a mix of market rate and affordable units may carry forward. As of mid-November, more than 40 percent of the apartments underway citywide were part of projects with some income restrictions. That share could rise in the future, as tax revenue will go toward the funding of income-restricted housing owned by non-profits, government agencies, and certain partnered organizations. Exemptions yet to be defined by the LA Housing Department could ultimately apply to other projects with a mix of market and non-market rate units.

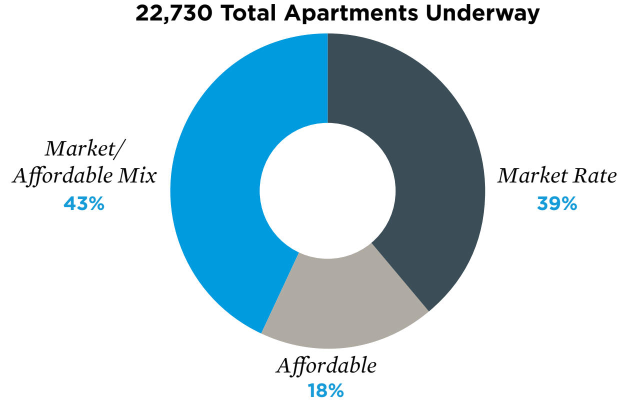
Key Takeaways

- New tax imposes minimum financial impacts of $200,000 on transfer of property priced over $5 million and $550,000 on property priced above $10 million.
- Cost of taxation could be recaptured through price appreciation — historical data implies average of three or more years, depending on property type.
- Investors may look elsewhere in the Los Angeles metro or to other markets to avoid additional tax burden.

Property performance remains an attractant. Adoption of the new tax will alter sales activity in the city of Los Angeles; however, most property types remain in heavy demand by residents and tenants, performance that should attract active investors. Class C apartment vacancy is extremely tight throughout most Los Angeles proper neighborhoods. Meanwhile, industrial vacancy in the county is anticipated to rank third-lowest among major U.S. markets at the end of this year, with warehouses in the city of Los Angeles expected to remain in high demand among users amid a lack of developable land and proximity to both ports. Elsewhere, forecasts call for the metro's retail sector to record a third consecutive year of vacancy compression during 2023, aided by an improvement in CBD midweek foot traffic. While availability in the office segment will enter next year at an all-time high, tenants absorbed nearly 1.5 million square feet of space during the 18-month stretch ending in September.

City of Los Angeles Active Pipeline*

22,730 Total Apartments Underway



*As of Nov. 18

Measure Applies to Tens of Thousands of Properties Across City of Los Angeles

City of Los Angeles	Apartments	Office	Retail	Industrial
Property Stock ($5M+)*	8,200	2,500	3,700	3,700
Property Stock ($10M+)*	3,300	1,600	1,500	1,600
Transactions ($5M+)**	350	90	150	170
Dollar Volume ($5M+)**	$6.3B	$2.8B	$2.0B	$3.6B
Transactions ($10M+)**	140	50	60	70
Dollar Volume (10M+)**	$4.8B	$2.5B	$1.4B	$2.9B
Average Pricing*	$320,700/unit	$600/sq. ft.	$700/sq.ft.	$420/sq.ft.

Proposition ULA Highlights

- Implements a tax on the sale or transfer of real property in the city of Los Angeles:
  - 4 percent tax on $5 million to $10 million sales and 5.5 percent tax on sales over $10 million.
- Measures becomes law on Jan. 1, 2023, but does not impact transactions until April 1, 2023. Taxation based on close of escrow date.
- Tax adds to an existing 0.56 percent combined city and county tax rate on property sales and transfers.
- Qualified affordable housing and government entities are exempt from the tax.
- Property value threshold subject to the tax will be adjusted annually based on the Chained Consumer Price Index at the discretion of the city's director of finance.
- Tax is estimated to generate $600 million to $1.1 billion annually. At least 92 percent of the proceeds will fund affordable housing and tenant assistance programs.
- Establishes the House LA Fund within the city treasury to collect additional tax revenue and fund affordable housing.
- The Los Angeles Housing Department has the authority to approve funding of up to $50 million per project without City Council review and approval.

**As of 3Q 2022*

***Trailing 12-months through 2Q 2022*

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Sources: IPA Research Services; CoStar Group, Inc.; Real Capital Analytics; RentCafe