

Fortune's Favorites

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To get a feel for the kind of money being thrown around Los Angeles these days, consider the recent sale of a home in Beverly Hills.

The North Alpine Drive estate had been pulled off the market last year after no one met the \$19 million asking price. But a few months ago, it was put back on the market, and this time a buyer grabbed the home for \$26 million.

"The high end has definitely come up exponentially," said broker Stephen Shapiro, chairman of Westside Estate Agency, a brokerage in Beverly Hills. "I've been in this business 32 years and the answer is, 'No, I've never seen anything like this.' In the old days it used to be people leveraging to get into houses, now it's everyone coming into houses with cash."

And so it is in Los Angeles of 2007, and elsewhere, as cheap capital, a resurgent tech sector and the opening of new global markets are creating wealth perhaps like never before.

It's also creating a new kind of wealth gap: between the rich and the even richer.

There's always been a gap between the wealthy and the excruciatingly rich, of course. The difference now is that there is rapid growth at the very top. And all the newly minted billionaires and centimillionaires (those with at least \$100 million) are snapping up rare wine and fine art, penthouse condos, ocean front property and other desirable luxuries. In the process, they often bid up prices beyond the reach of the merely wealthy, who could have afforded them just a few years ago. Ten years ago, a business owner who sold his mid-market business probably could afford a beachfront estate in Malibu. Today, that's less likely.

The phenomenon is particularly acute in Los Angeles. This year, the Business Journal's annual list of Wealthiest Angelenos now counts 41 billionaires, five more than last year and second only in the nation to New York City's 51. But it's also a worldwide trend. Forbes recently calculated there are 946 billionaires worldwide, including 195 newcomers, while only 32 billionaires from 2006 fell off the list.

Recent academic studies conducted by University of California, Berkeley economist Emmanuel Saez and a colleague found that besides the usual wealth gap between rich and poor, there is a surprisingly big gap between the top rungs of the wealth ladder.

Households in the top hundredth of the top 1 percent (incomes of roughly \$20 million per year) are seeing their wealth increase even faster than those in the top tenth of the top 1 percent (about \$4.4 million annual income.)

“We are seeing a separation of the classes like we haven’t seen since probably the Industrial Revolution,” is how Shapiro puts it, with his close-up view of wealth. “I think we are seeing an enormous accumulation of wealth.”

Obscene wealth?

Shapiro may be on to something. A recent estimate of Bill Gates’ wealth – put at \$82 billion – found that as measured as a percentage of gross domestic product it was in the range of Gilded Age luminaries Andrew Carnegie and Jay Gould.

And while Gates remains in a class by himself, his own increasing net worth reflects what is going on in the larger universe of the ultra wealthy amid big global trends.

Since the tech bust of 2000, there has been a boom of so-called Web 2.0 companies, led by Google Inc. and many smaller players. Those include L.A.’s own Cogent Inc., which has developed fingerprint recognition software and hardware that has catapulted its founder, Ming Hsieh, onto the Wealthiest Angelenos list with an estimated net worth of \$714 million.

At the same time, emerging economies in Russia, India and China (which joined the World Trade Organization) have minted their own new billionaires, all while offering new markets to U. S. and foreign corporations. That has boosted the public and private equity markets alike.

“It’s not just the U.S. – the world in general has moved toward increased free trade,” said Jerry Nickelsburg, an economist with the UCLA Anderson Forecast. “Increasing free trade is a very powerful stimulus for economic growth.”

The result? The Dow Jones industrial average is hitting new highs, bloating the market cap of public companies and fueling CEO paydays that are sometimes in the hundreds of millions of dollars. Investor Kirk Kerkorian had already seen his wealth rise about 50 percent to about \$14

billion over the past 12 months, when his play last week to increase his stake in MGM Mirage catapulted his wealth up to \$16.1 billion.

Other local billionaires whose wealth is based largely on stock holdings have also seen substantial growth in their net worth, from Eli Broad, to Charles Munger, to Robert Addison Day Jr.

And then there are executives such as Occidental Petroleum's Ray Irani, who took home a jaw dropping \$460 million last year, mostly from cashing out stock options. Other local chief executives whose pay has exceeded \$100 million include Countrywide Financial Corp.'s Angelo Mozilo and Bruce Karatz, the former chief executive of KB Home. None of these executives are on the list of wealthiest Angelenos.

Meanwhile, a recent study found that L.A. County was home to 268,000 millionaires, more than any other county in the United States. The study, which measured net worth excluding primary residences, also found that the number of millionaire households nationwide has risen to a record high of 9.3 million in 2006.

Business opportunity

The moves that big financial institutions are making to capture a piece of this growing wealth indicate its ascendancy.

In March, for example, City National Corp., the parent of City National Bank, which already has a reputation of catering to the wealthy, acquired Lydian Wealth Management. The East Coast firm caters to "ultra affluent" households with average assets of at least \$40 million.

Mellon Bank is another institution that has made a big local play to serve the growing sector. The company, which already had a wealth management operation in downtown L.A., opened a Century City office in December. About 20 people work in the downtown office and the company hired 10 more employees to help staff the new Westside office.

Los Angeles is the fastest growing market for the wealth management group, save for Boston, where the company is headquartered.

"Business is up across the board," said Clint Hodges, a senior Mellon director who runs the Century City office and is aiming to manage really big money – that of billionaires, and not necessarily those who call L.A. home. "We are more mobile with global wealth. It has created a

huge pool of liquidity worldwide. We find there are global investors that may have homes in L.A. or Miami and across the world.”

Seeking out ultra wealthy who may not call L.A. home but spend lots of time here is probably not a bad strategy, according to people who study wealth in Los Angeles and those on the ground who rub up against it.

Nickelsburg said that international ultra-rich individuals are attracted to the United States because of the country’s stable economy and relatively lenient taxes. “In Scandinavian countries, (for example), there is very heavy taxation for the wealthy, so there are incentives to leave,” he said.

Then, of course, there is L.A.’s traditional appeal of sun, surf and sand, especially to Northern Europeans and others who live in colder climates, such as Russia. “International wealth gravitates to Los Angeles because of the lifestyle,” said developer Rick Caruso, president of Caruso Affiliated Holdings, and a new entrant this year to the Business Journal’s list of 50 wealthiest.

Priced out

All this wealth means that limited luxury items have been bid up. The price rise is as prosaic as the cost of a nanny, some of whom these days command salaries of \$80,000 a year if they are educated and well qualified.

“It is hard to compete with movie stars who can afford to pay their nannies a lot of money,” said commercial real estate broker Laurie Lustig-Bower, who lives in Beverly Hills and is an executive vice president at CB Richard Ellis Group. “For other people with two working parents – maybe two doctors or lawyers – it’s still a nice lifestyle, but it’s very competitive when you are competing with this upper echelon of new wealth.”

Other luxury items that have seen sharp increases in price are artworks by famous painters, ranging from the masters to modern and contemporary artists. And rare wines have risen more than 50 percent in price over the past five years. For example, the highly sought-after 1945 Mouton Rothschild was selling at auction for less than \$4,000 in 2001. Last year, auction prices for the classic Bordeaux topped \$10,000.

Such prices hardly get the notice of today’s wealthy. Tim Bower, Lustig-Bower’s husband who is also a senior vice president at CB Richard Ellis, recalls a recent dinner in Beverly Hills during which one of the diners learned the host owned a collection of rare Bordeaux.

The fellow diner bought a bottle for \$10,000 as casually as if he'd asked for another glass of Merlot. "It's a significant number," said Bower. "I want to be there when they open it. It is very rare wine."

And, of course, real estate has bounced up sharply. It's reflected in the new spate of ultra high-end condominiums penthouses that are currently under construction in West L.A.

The current top of the condo market is less than \$10 million a unit along the Wilshire Corridor from Beverly Hills to Westwood. But the newest units will cost as much as \$25 million, and are largely marketed at international buyers, though L.A.'s growing class of the uber wealthy could well afford them too.

Then there's the traditional market of estate homes, whether they are cloistered in the canyons of Bel Air or hugging the beach in Malibu. Tom Cruise's new Beverly Hills hideaway cost him \$35 million. Larry Ellison, the Northern California chief of Oracle Corp. and one of the world's richest men, has famously bought up multiple beach front properties in Malibu, spending perhaps more than \$200 million.

Much of the new demand may be coming from outside the country. For example, one broker at Rodeo Realty, another high end local residential brokerage, specializes in procuring estates for rich Russian nationals.

Does it matter?

The question is whether a growing gap between the merely wealthy and those who have hundreds of millions of dollars really has any larger impact than raising the price of expensive art, bottles of wine and mansions.

Recently writers in the New York Times, Fortune magazine and other publications have wondered whether resentment about all this wealth could lead to a sort of class warfare among the rich, especially given that some of the new wealth is being generated when chief executives get golden parachutes worth \$100 million even when their stock is falling.

"Here's my outlandish theory: that economic resentment at the bottom of the top 1 percent of America's income distribution is the new wild card in public life," writes Fortune magazine columnist Matt Miller. "Ordinary workers won't rise up against ultras because they take it as given that 'the rich get richer.' But the hopes and dreams of today's educated class are based

on the idea that market capitalism is a meritocracy. The unreachable success of the super rich shreds those dreams.”

But others, such as Russell Roberts, an economics professor at George Mason University, contend that advances in technology, science and medicine – which have put huge plasma screens in middle class living rooms, tiny cell phones in just about everyone’s pocket and heart bypasses in the neighborhood hospital – mean the growing gap between the super wealthy and everyone else is virtually meaningless.

“I don’t think there is any time in history where the palpable difference between the uber-rich and the average American was so small. Almost everything glorious in life starts off as a luxury but as time passes and competition occurs the average person has access to those things and they become accessible to everyone,” he said.

Roberts, who’s also a research fellow at Stanford University’s Hoover Institution, suggests that for other things that are unaffordable, people should simply face the reality of life.

“There are certain things limited in supply, therefore only the richest of the rich get them – like an original Van Gogh, Bruce Springsteen performing at your birthday party or beach front property at Malibu,” he said. “That’s the way it is.”

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