Good evening. Thank you very much for the opportunity to speak with you tonight on the outlook for southern New Jersey. South Jersey has had a very tough recovery from the Great Recession. As you’ll see, I believe that we have opportunities for improvement, but each of us will have to play an active role working to make things better. We have to work together to make the most of what we have.

**Safety**

First, though, I work for a utility – I’m responsible for forecasting for Atlantic City Electric – and we like to begin every presentation with a brief safety message. Safety is our first and most important corporate value, and we work hard to include it in everything we do. This safety message is also especially appropriate to our subject this evening.

At this point, Hurricane Sandy is a fading memory. It’s often referred to as “a perfect storm,” or Superstorm Sandy, and most people look back at it as a confidence builder. Since we endured Sandy as well as we did, we must be prepared for whatever Mother Nature may bring.

I grew up with hurricanes in Florida, and I’ve helped assess the aftermath of hurricanes in the south, here in the Mid-Atlantic and in Micronesia. I think we should be very concerned.

Believe it or not, Sandy was not a terribly bad storm. Sandy was classed as a Category 1 storm after it passed us. When I was in college down in
Florida, a storm like this would prompt us to buy beer and invite people over. When the storm passed, we would block traffic and use sandwiches to lure our alligator back across the road and into his home in our pond. It was no big deal. Here in the Northeast we’re not used to storms, and Sandy became a catastrophe.

When the eye crossed Egg Harbor Township, wind speed was reported at 70 mph. There were other weather factors that made things more complicated, but 70 mph is just a tropical storm. Atlantic City Electric had just completed a two-year, $200 million reliability improvement and storm hardening program, including a lot of tree trimming. South Jersey survived fairly well.

In North Jersey and NYC the impact was severe. They were relatively less well prepared, and they are much more congested. North Jersey and NYC had not been as focused on preparation. They had not had a storm in some time, so there was plenty of debris to blow around. Finally, they were much more vulnerable than the experts believed.

We should be very worried about hurricanes, and not believe that we can take all nature has to give. A big hurricane, like the 1938 Long Island Express or 1954’s Edna, with sustained winds of 120 mph or more, would do more than destroy beach homes and flood low lying areas. We should be prepared for damage even more severe than was seen up north, with hotels losing their windows and flooding, the flooding of areas that we do not usually think of as lowlands, loss of life, and much more time required to restore public services.

Right now we’re over confident and at risk. Each one of us needs to think it through, and make sure that we keep our families safe. It’s not enough to be prepared for the worst storm you remember – we need to prepare for a once in 20 year event. Each of us needs to take personal responsibility for the safety of our home and our family.
South Jersey is not all the same. I’d like to divide my remaining time into two parts, and begin by discussing South Jersey generally before going on to discuss our Shore economy around Atlantic City.

**South Jersey**

When you start trying to understand any local economy, the best data we have is employment. Everything else, such as income or Gross Product, is substantially less reliable. My opinion is these other local data are measured so imprecisely that they are not very helpful to us in forecasting. Understanding a small geographic area like South Jersey requires that the economist spend the time talking to local business people like you, lots of field work and good judgment.

I’m responsible for tracking our three economies of our three Mid Atlantic brand names very carefully, in order to understand the areas that we serve, PEPCO – Washington DC and its Maryland suburbs; Delmarva Power – most of Delaware and the Maryland Eastern Shore; and ACE – New Jersey’s eight southern-most counties. In Slide 1 I have rebased employment so that its 2008 average is equal to 100%; in other words, employment is re-expressed as an index that had a 2008 average value of 100. The dotted lines show our expectations just one year ago. The solid lines show our expectations today – we have really lowered our expectations. The black lines represent the national economy. They reflect the conventional point of view, the point of view you would gain from reading or listening to the news.
These forecasts are the IHS-Economics outlook for the Mid Atlantic. The other major vendor of regional economic forecasts is Moodys Analytics. Moodys is actually slightly more pessimistic than IHS. It’s widely believed that the Mid-Atlantic will continue to underperform the national economy because our capital stock is obsolescent. For example, late last year we lost the Anchor Glass works here in South Jersey – Anchor chose to close this 100 year old plant and consolidate manufacturing in their Ohio facility.

Of the three areas we serve, PEPCO was almost untouched by the recession and it continues to out-perform the national economy. Employment returned to pre-recession levels by mid-2010, while the national economy didn’t get there until 2014. I call that the Big Washington Shock Absorber. The local presence of federal spending
insures that our PEPCO jurisdiction is almost immune from downturns. To be fair, Northern Virginia is sensitive to downturns – for example, Virginia was hit hard by sequestration. But you can see from the chart that in DC and its Maryland suburbs it’s almost like sequestration never happened. Notice that over the past year, the outlook for PEPCO employment has been lowered. As this recovery has matured, it’s turning out to be much weaker than we expected (the spread between the solid and dotted lines) – we’ve gone from expecting 3% trend growth to about 2% trend growth. That is caused by falling productivity that will only be addressed over the longer term with better education and training for younger workers.

The second area we serve is Delmarva Power, which is most of the State of Delaware and the Maryland Eastern Shore. Employment in our Delmarva jurisdictions returned to pre-recession levels late last year. Like PEPCO, it’s expected to grow very slowly for the foreseeable future.

Finally, here in South Jersey – ACE – the consensus is that employment is not coming back. Two years ago it was expected that we would return to pre-recession levels by 2022. Early last year the expectation was 2019. Since the closure of the casino-hotels, that expectation has been revised to “not in my lifetime.” That’s what I mean when I say that I am more optimistic – my opinion is that the consensus could not be more incorrect. It’s wrong-headed, but it’s pervasive. It’s urgent that we correct that misperception.

The first thing we need to understand is that most of South Jersey (Slide 2) – Camden, Gloucester, Cumberland and Cape May counties – is relatively stable, with employment only about 5% below 2008 levels. Atlantic City has been hammered, but even their situation is not completely hopeless, as we’ll see in a few minutes. Slide 2 shows how each of the urban areas that make up South Jersey have fared during the recovery – even within South Jersey we have had big winners and losers.
Over the last few months there has been a big run up in employment in Ocean City – followed by an equally big run down – that has resulted from Superstorm Sandy Cycle One funding. It’s unfortunate that the people who filled those jobs were unemployed before the funding arrived and are probably unemployed again now that it is spent. We’re waiting on Cycle Two funding, and those jobs will also go away when the money is spent. I guess we’re fortunate to have them. The question we’re left with is “When will local businesses begin creating permanent jobs?” We need permanent, full-time jobs.

Fortunately for us, we have an important asset that helps us to answer that question. The Philadelphia Federal Reserve Bank – the Philly Fed – conducts the South Jersey Business Survey. Each quarter they ask the
membership of the South Jersey Chamber of Commerce – the independent businessmen that drive the South Jersey economy – 16 questions about their views on current business conditions and their expectations for their business over the upcoming six months. It’s a valuable tool, it’s free on their web site, and I recommend it to you.

The question from the Survey that we want to focus on is whether the businessperson will increase or decrease employment at their company over the upcoming six months. In Slide 3 the blue line shows the responses to the question. The responses are expressed as a diffusion index, which is the percent of respondents saying they expect to increase employment less the percent saying they expect to decrease employment.

Notice that in December 2008 we were at the bottom of the recession, and the number of respondents saying they expected to reduce employment outnumbered those who expected to increase employment by 20 percentage points (blue line). Over the next six months, January 2009 through June 2009, 6,000 jobs were created (red line) in South Jersey.

More recently, in December 2014, the situation was reversed, with those planning to hire outnumbering those who planned to reduce employment by 12.5 percentage points. We don’t yet have actual employment data for the upcoming six months (January through June), but if the relationship illustrated in this chart continues to hold we should expect modest hiring.

Right now, we’re hurting. As you can see in the chart (back to the red line), we just lost 6,000 jobs resulting from the direct and indirect effects of the four casino closings. It’s going to take time to make that up, and we are not going to make it up in the next six months, but we have started gaining jobs again. Beyond that, my calculation is that if we can achieve +0.5% annual growth, it will take us five years – until 2021 – to get back to where we were before the closings. It’s going to be a long, hard slog.
So that's the employment picture. When we look at Atlantic City we'll talk about the casino-hotels. Looking to the western side of South Jersey near the Delaware River south of the Walt Whitman Bridge, the market for commercial real estate is definitely improving. Over here we need to be concerned with commercial real estate, like warehousing, manufacturing space and space used for supporting office services.

Cushman and Wakefield publishes a quarterly survey of sales and leasing activity that I find very useful. A feature of this information is that it includes Camden County, so a little interpretation is required, like always.
Since the bottom of the recession, the inventory of commercial space has grown by a little more than 5 million sf. That works out to an increase of almost 7%, or about 1.1% annually. Rents have been weak, as you would expect, with rents for manufacturing space falling 30%, and rents for Office service or warehouse space down 10%.

The vacancy rate peaked at almost 10%, but it is now down to only 4.9%, very low, low enough that you would expect to see new construction. Even though the lower rents offer less profitability, we now have almost 2 million sf of space under construction, with almost all of it south of the Walt Whitman. Half of this new space is being built for two tenants – the Haines Industrial Center is being built as warehousing for Burlington Coat Factory and Destination Maternity Corp. for completion this quarter. Burlington Coat Factory is especially important – they’ve decided that they can relocate their Philadelphia County facility and cut their total warehousing costs.

The rest of this new space is being built on spec – it’s not yet leased and is scheduled for the third quarter. Once it’s on the market, we could see the vacancy rate go back up as high as 6.9%. That’s probably enough of an increase to keep rents where they are for the next year or two.
So, what is to be done? We could sure use some help getting growth started again – maybe some economic development. Many experts are quick to blame our persistent slow growth on infrastructure bottlenecks that limit our access to markets. That observation is always followed by a long list of our disadvantages.

Let’s cut through all of those objections with a simple observation – if we are not seeing the economic growth that we believe is necessary or desired, the simple policy solution is to put in place stronger incentives for economic development.

My team looked at the awards of tax incentives that have been made by the State in the last several years, and they tend to be in North Jersey. In fact, the only significant award that we could find in South Jersey (as we’re defining it) was to Liscio’s Italian Bakery. It has paid off well. Liscio’s bought the old ADM cocoa processing plant in Glassboro. This will be an excellent repurposing of that site. My understanding is that it is allowing Liscio’s to expand their business, hire more people and begin shipping their products to an even larger geography.

That’s a terrific outcome, and we need more. My opinion is that the only way we can get more is by expanding the incentives available to those who might consider relocating to our area. The only way we can do that is by asking the state to create more economic development zones in our area, including the types of zones that are awarded the larger incentives. If we want more economic development, the solution is not to discuss our disadvantages – the solution is to strengthen the existing incentives so that they achieve their objective.

AC

With that setting for South Jersey, let’s look at the Shore. Atlantic City is an island surrounded by endangered wetlands. In a situation like this, there is always a delicate balance between the need for growth
infrastructure and protecting the environment. It will be extremely difficult and time-consuming to get another expressway or another rail line or even another power transmission line. The environmental conditions make it very difficult to get new corridors approved. Just like everywhere else, as Atlantic City recovers and grows it will have to live within the current constraints.

The environmental constraints limit where new properties can be built, but they also limit how many properties can be built in total. There are really only a few candidate properties. Some are pretty inconvenient, like Bader Field, and are obviously among the last choices a developer might choose. Another group, like The Sands brownfield site, is convenient to the Boardwalk, but is unattractive to developers because they object to what they call urban blight. There has been a lot of discussion about how to clean up Atlantic City, and some small steps will be taken. That’s more of a negotiating point than a real objection. Take a trip to Las Vegas and wander away from the Strip. I dare you. It’s easy to find places that will make you very uncomfortable.

The third group is the properties still undeveloped on the inner harbor. That neighborhood has no urban blight. You drive over the Walt Whitman and enter the Atlantic City Expressway kind of like going into an Alice In Wonderland rabbit hole. There’s really nothing at all to look at, good or bad, until you come out the other end in the Water Club parking garage. Urban blight is absolutely not an issue – you don’t even need to slow down.

At the peak of the last building cycle there was a short list of less than a dozen usable parcels that could be developed. When the market comes back, no matter how long it takes, that list of the best ideas for development will still be the best ideas available. Nothing about the list will have changed. That’s true in every industry in every business cycle.

At this point, you’re shaking your head. Most people haven’t thought about it; we just assume the era of casino development is over. The world
has not come to an end. The sun will come up tomorrow and the time will come when the next casino-hotel to be built and we’ll figure out when that is likely to be. As always, it will be built for the top of the market. It’s the same whether you’re building office buildings, power plants or casino-hotels. If you want to build an office building you want to build for the top of the market – Class A space with a façade so impressive that the most successful law firms will feel they must have that prestige address. Those anchor tenants secure your financing. If you want to build a casino-hotel, you still want to build for the top of the market. While the last construction cycle was under way, one Vice President of Development in Atlantic City told me that their next project would be “more like the Bellagio and less like the Borgata” – that’s the top of the market.

That’s part of the competition for market share. It’s important to understand that has always been the case. When the casinos first opened, the gaming areas produced an inflation adjusted (real) average gaming revenue of $9,900/sf (2014 $). After 30 years of casino development, that metric has fallen to $2,149/sf in 2013, rebounding slightly to $2,455/sf in 2014 (Slide 5).

That’s not a bad story. It’s true that they are becoming less profitable on average, but let’s compare to some other benchmarks. First, the Las Vegas casinos were producing $2,518/sf in 1984, and that has now fallen to $1,225/sf in 2013. We have nothing to be shy about in Atlantic City. Second, an Apple Store, a good example of high end retail, brings in about $1,200/sf. Normal retail averages around $300/sf to $400/sf or even less. Gaming in Atlantic City is still a very profitable activity.
Of course, not every casino is earning $2,455/sf. That’s just the average. One of the things I’ve found is that in every industry there are operators who just manage to survive, and then there are truly genius process operators who set the benchmarks that everyone else aspires to reach. The Atlantic City casinos are no different. Since it opened, The Borgata has set the bar, earning $4,704/sf in 2014 – almost twice the average. At the low end, Trump Tower made $855/sf in 2013 – we shouldn’t be surprised they closed when times got tough. Of the survivors, the Taj Mahal brought in $1,349/sf in 2014, less than a third of The Borgata. When that next casino is built – someday – the developer will intend to be even more productive than the Borgata, and it will take market share from the least productive casinos. Unless something changes, that will be the Taj, Resorts and Ballys.
Slide 6

Atlantic City Real Gaming Revenues/ $sf
(2014 $)

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014 (Est.)</th>
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</thead>
<tbody>
<tr>
<td>The Atlantic Club Casino Hotel</td>
<td>$1,896.54</td>
<td></td>
</tr>
<tr>
<td>Bally’s Atlantic City</td>
<td>$2,345.68</td>
<td>$1,882.24</td>
</tr>
<tr>
<td>Borgata Hotel Casino &amp; SPA</td>
<td>$4,578.45</td>
<td>$4,704.66</td>
</tr>
<tr>
<td>Caesars (Boardwalk Regency Corporation)</td>
<td>$3,045.31</td>
<td>$2,869.67</td>
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<tr>
<td>Golden Nugget Atlantic City, LLC</td>
<td>$1,752.15</td>
<td>$2,419.10</td>
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<tr>
<td>Harrah’s Resort, Atlantic City</td>
<td>$2,317.56</td>
<td>$2,360.27</td>
</tr>
<tr>
<td>Resorts (DGMB Casino, LLC)</td>
<td>$1,616.87</td>
<td>$1,712.80</td>
</tr>
<tr>
<td>Revel Entertainment Group, LLC</td>
<td>$1,224.61</td>
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</tr>
<tr>
<td>Atlantic City Showboat, INC</td>
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</tr>
<tr>
<td>Tropicana Casino and Resort</td>
<td>$1,844.23</td>
<td>$2,200.70</td>
</tr>
<tr>
<td>Trump Plaza Associates, LLC</td>
<td>$855.27</td>
<td></td>
</tr>
<tr>
<td>Trump Taj Mahal Associates, LLC</td>
<td>$1,632.84</td>
<td>$1,349.22</td>
</tr>
<tr>
<td><strong>TOTAL INDUSTRY</strong></td>
<td><strong>$2,149.06</strong></td>
<td><strong>$2,455.58</strong></td>
</tr>
</tbody>
</table>

This brings us to everyone’s bottom line question – how meaningful is this? Will another casino-hotel ever be built? Will it be in our lifetimes?

The first thing we need to realize is that the casinos that recently closed are very unlikely to reopen as casino hotels. The HVAC system in the Trump Tower has been turned off; signaling that the owners do believe it only has value as another brownfield development site. The Showboat is being repurposed as a dormitory – now it will host some really wild parties. The Atlantic Club is being repurposed as a combined hotel with condominiums, and there is a stipulation that it is not allowed to host a casino.

That leaves the Revel. The Revel is a little harder to read. It is an incredibly beautiful façade. There are plans to reopen it with a hotel and condominiums. Many people believe The Revel had a design flaw, with the
casino located on the third floor. The bidders have discussed moving the casino to Boardwalk level at an estimated cost of $150 million. My own studies of construction projects cause me to believe this is a lowball estimate. The true cost is likely to be twice or even three times the initial construction cost estimate. Wild plans are being floated for water taxi service to Manhattan and a huge non gambling facility with attractions like a giant water park. The big plans will require big money, at a time when Atlantic City is not being viewed as an opportunity. The longer the project drags on, the less likely it is that The Revel can be rehabilitated to serve the top of the market. Personally, I think it is most likely to survive primarily as a condominium, and some of the early units may go for pretty attractive prices. Watch this space.

So, when might we see new casino-hotel development? I maintain an index (as opposed to an exact count) of visitation to AC based on traffic on the AC Expressway, arrivals at the AC Airport, chartered bus arrivals and NJ Transit rail arrivals. In 2002 slightly more than 10% of visitors came by bus, but by 2014 bus arrivals had fallen to 3%. The number of bus arrivals is important in determining how the casinos are configured. Visitors who arrive by bus are thought to spend more time at the slots instead of table games. Table games earn higher margins, but the slots do more volume.

Visitation peaked at 77.8 million visitor-days in 2008, immediately prior to the Great Recession, and decreased by one-third to 50.2 million days in 2014, or about 4.9% annually. Between September and December it has declined (-10.8%) from the prior year.
We know that the casinos get some business from locals and some from as far away as Baltimore or Washington, but the statistical studies that I have done show that most visitation comes from Philadelphia and New York. Even with the competition from new casinos in those cities, my studies show that for every 1,000 new jobs created in Philly and New York we see about 2,375 additional visitor-days each year to Atlantic City. When we combine these calculations with the forecasts of employment growth for Philadelphia and New York City, we come up with the result that the next casino-hotel will be built in Atlantic City in about a decade. A return to growth in our casino-hotels isn't hopeless; it's just well off in the future.

And this really tells the tale. For the past 35 years, we always referred to the casino-hotel industry as the engine of growth in South Jersey. That engine has seized. It no longer drives us forward, and it may not start up again for a long, long time. Cape May, Cumberland and Gloucester counties are doing reasonably well with stable and reliable growth. The area along the Delaware River has opportunities for growth that are promising, but they will also be slow to pay off. Our prospects for growth are really tied to economic development, and successful economic
development will require that each of us take on an advocacy role, and that we work together to create economic development tools that work for South Jersey.