

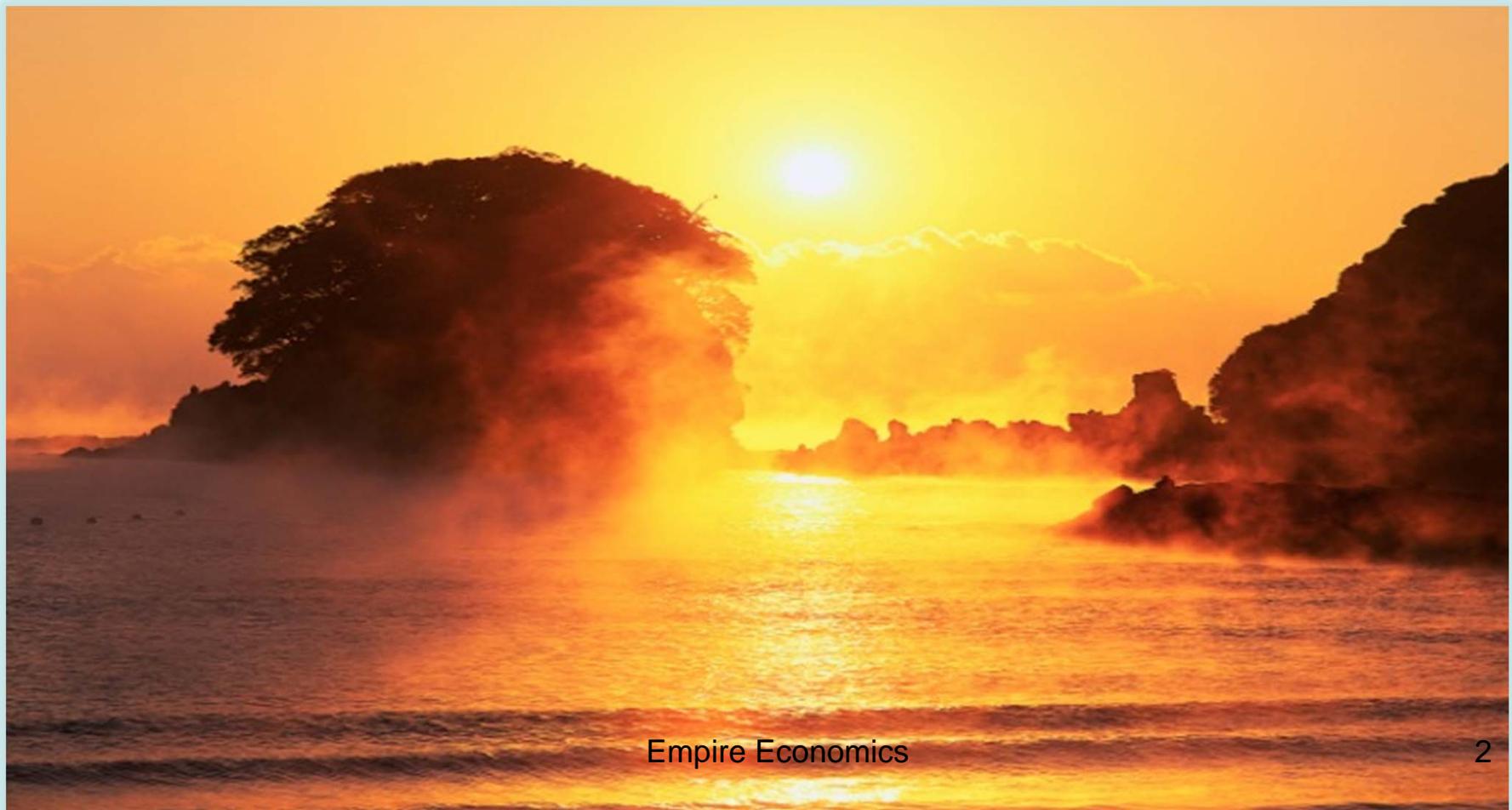
**CALIFORNIA DEBT AND ADVISORY COMMISSION
WEBINAR - JANUARY 11, 2012**

**RECENT AND EXPECTED ECONOMIC CONDITIONS UNDERLYING
LOCAL GOVERNMENT BOND ISSUES
(LAND SECURED AND GENERAL OBLIGATION BONDS)**

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WHAT ARE THE PROSPECTS FOR YOUR LOCAL ECONOMY: SUNNY, HAZY OR SHADOWY ???

- **WHAT IS AN OVERALL ECONOMIC FRAMEWORK FOR EVALUATING THE FORTHCOMING REAL ESTATE RECOVERY ?**
- **WHAT ECONOMIC METRIC REFLECTS THE RATE OF RECOVERY SPECIFICALLY FOR YOUR LOCAL ECONOMY ?**



OVERVIEW OF TOPICS

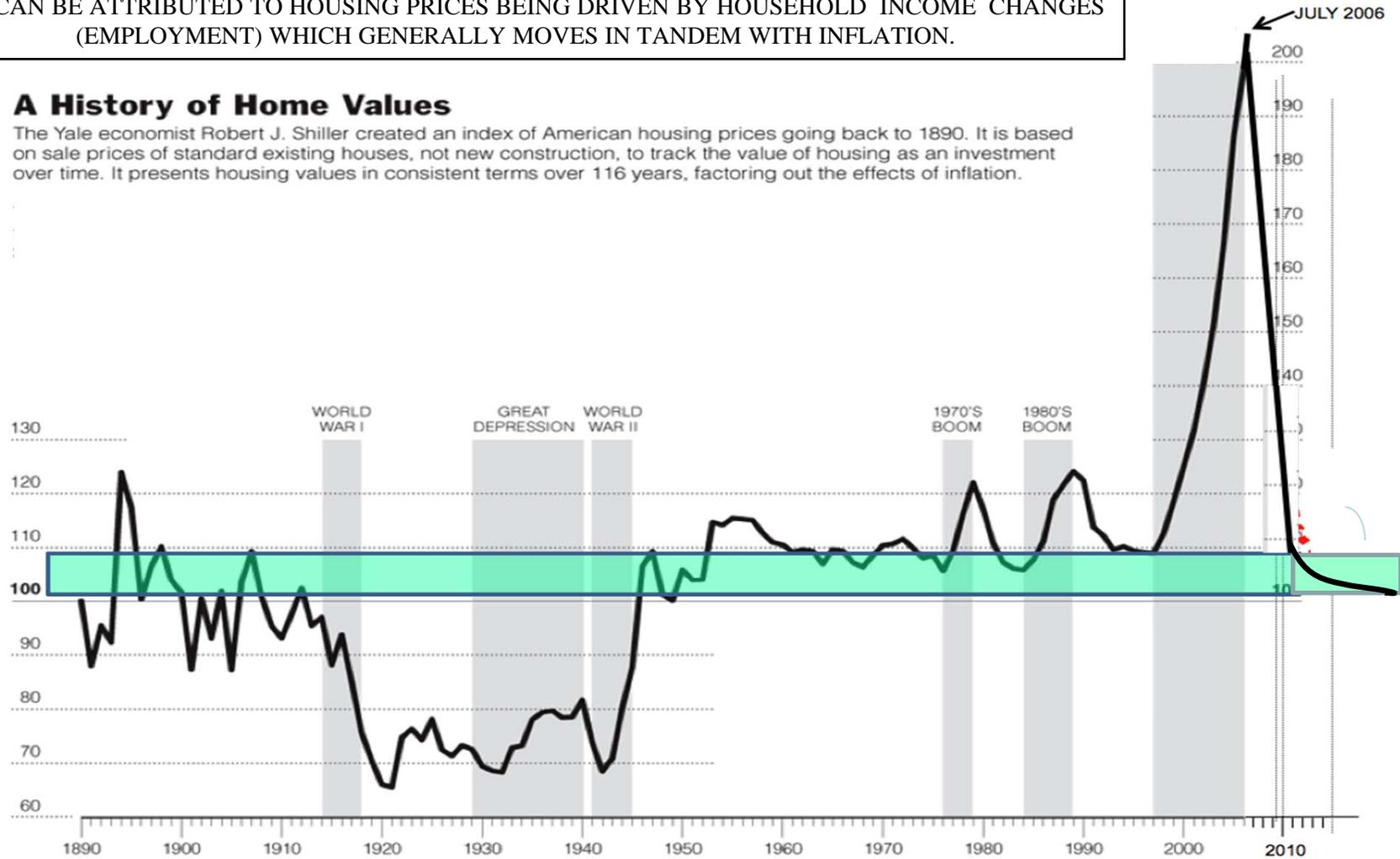
1. WHAT HAS BEEN THE PRIMARY ECONOMIC FACTOR UNDERLYING HOUSING PRICE CHANGES DURING THE PAST 120 YEARS ?
2. HOW WAS THE RECENT HOUSING MARKET BUBBLE, DRIVEN BY FINANCIAL FACTORS, AN ABERRATION FROM THE HISTORICAL NORMS, AND WHAT RE-ADJUSTMENTS ARE NOW REQUIRED ?
3. WHAT ARE THE NEAR-TERM PROSPECTS FOR A REAL ESTATE RECOVERY AND HOUSING PRICE APPRECIATION ?
4. HOW DOES THE TIMING OF RECOVERIES FOR LOCAL ECONOMIES VARY, AND WHAT ECONOMIC METRIC CAN YOU USE TO GAUGE THE SPECIFIC ECONOMIC CONDITIONS IN YOUR JURISDICTION ?
5. WHAT ARE THE PROSPECTS FOR LOCAL MUNICIPAL FINANCINGS FOR 2012, WITH A FOCUS ON LAND SECURED AND GENERAL OBLIGATION BONDS ?

1. WHAT HAS BEEN THE PRIMARY ECONOMIC FACTOR UNDERLYING HOUSING PRICE CHANGES DURING THE PAST 120 YEARS ?

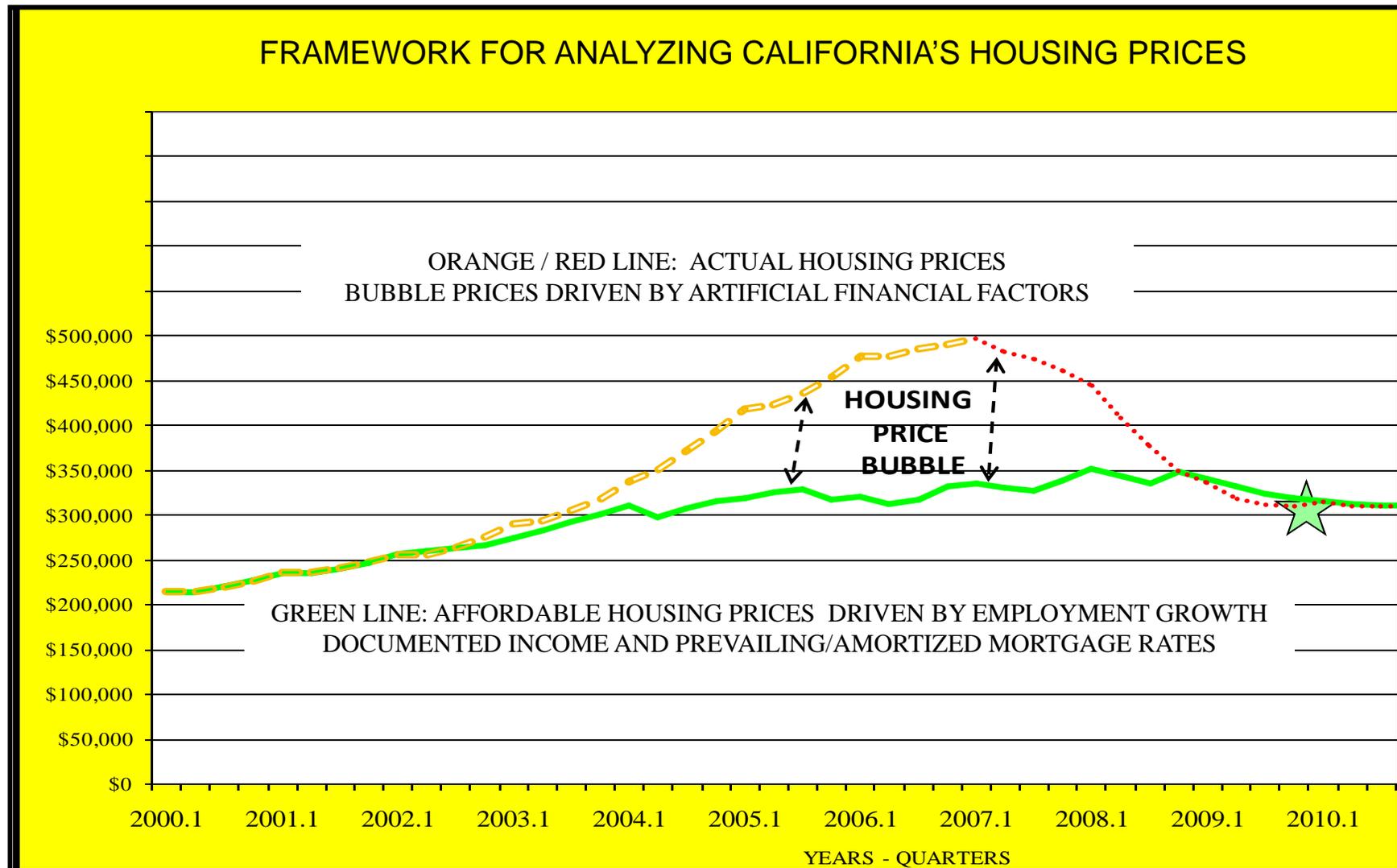
THIS GRAPH DEMONSTRATES THAT OVER TIME, REAL HOUSING PRICES, ADJUSTED FOR INFLATION, TEND TO REMAIN STABLE – THE GREEN BOX
THIS CAN BE ATTRIBUTED TO HOUSING PRICES BEING DRIVEN BY HOUSEHOLD INCOME CHANGES (EMPLOYMENT) WHICH GENERALLY MOVES IN TANDEM WITH INFLATION.

A History of Home Values

The Yale economist Robert J. Shiller created an index of American housing prices going back to 1890. It is based on sale prices of standard existing houses, not new construction, to track the value of housing as an investment over time. It presents housing values in consistent terms over 116 years, factoring out the effects of inflation.



2. HOW WAS THE RECENT HOUSING MARKET BUBBLE, DRIVEN BY FINANCIAL FACTORS, AN ABERRATION FROM THE HISTORICAL NORMS, AND WHAT RE-ADJUSTMENTS ARE NOW REQUIRED ?



RE-ADJUSTMENTS REQUIRED DUE TO THE IMPLOSION OF THE HOUSING PRICE BUBBLE

THE ENORMOUS SCOPE OF THE PRICE BUBBLE:

- PURCHASE OF A HOME: LARGEST EXPENDITURE FOR A HOUSEHOLD
 - USE 1/3 OF ANNUAL INCOME FOR MORTGAGE PAYMENTS
 - MAKE MORTGAGE PAYMENTS FOR 30 YEARS
- IMPACTED PURCHASES OF NEW AND EXISTING HOMES, PURCHASED AT ARTIFICIALLY HIGH PRICES
- ALSO IMPACTED HOMES THAT WERE NOT SOLD BUT WERE RE-FINANCED, SINCE HIGHER LOAN AMOUNTS WERE BASED UPON ARTIFICIAL EQUITY



THE MARKET HAS BEEN READJUSTING FROM ARTIFICIAL FINANCING TO EMPLOYMENT:

- HOMEOWNERS WITH NEGATIVE EQUITY – DELINQUENCIES AND FORECLOSURES

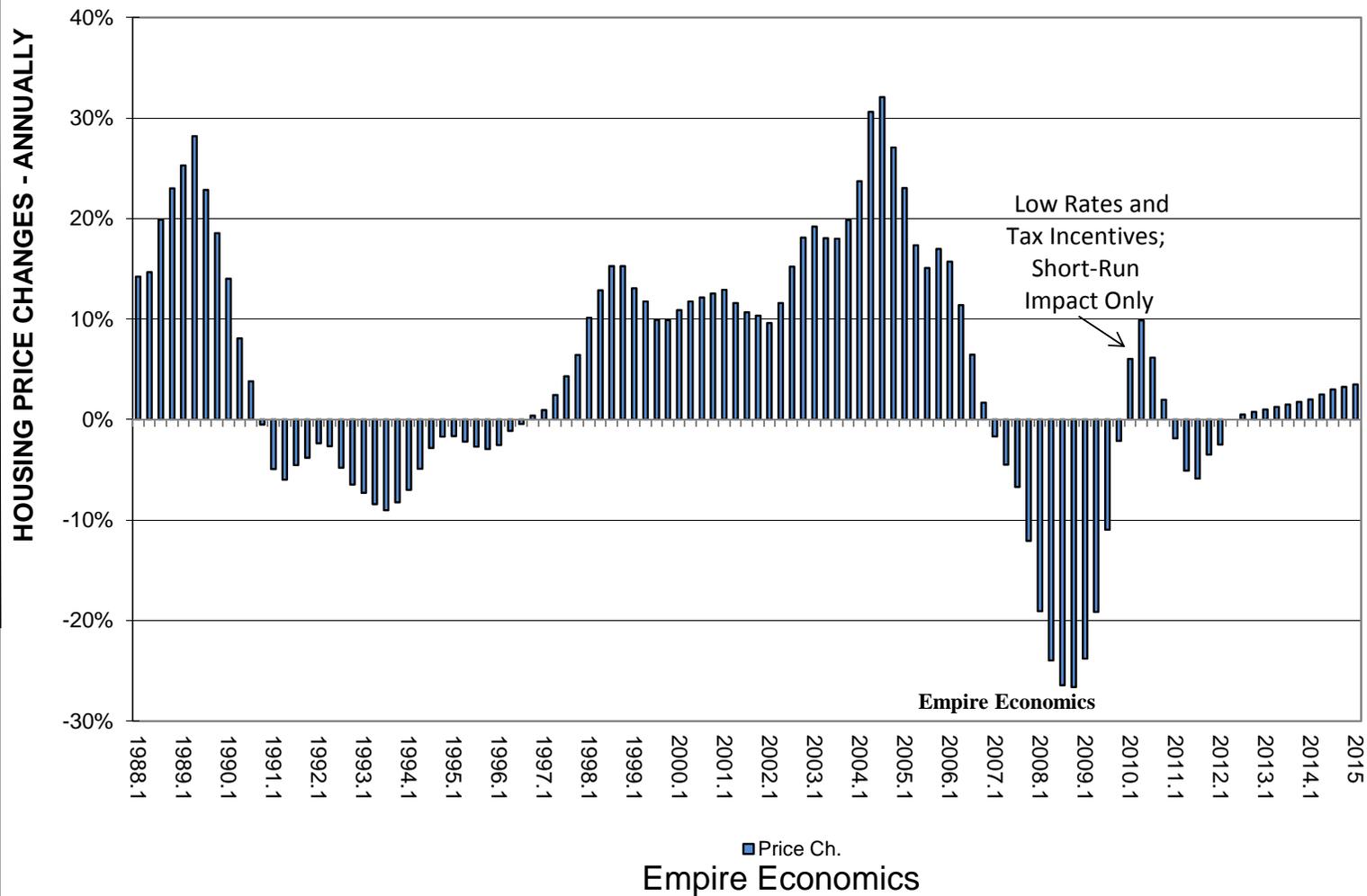
“MANY WILL LOSE THEIR HOMES TO”

HOMEOWNERS THAT ARE EMPLOYED AND HAVE SUFFICIENT INCOMES

EFFECTIVELY, MILLIONS OF DECISIONS BASED UPON “ARTIFICIAL FINANCIAL” FACTORS ARE NOW BEING RE-ALIGNED TO “EMPLOYMENT” FACTORS, THE HISTORICAL NORM.

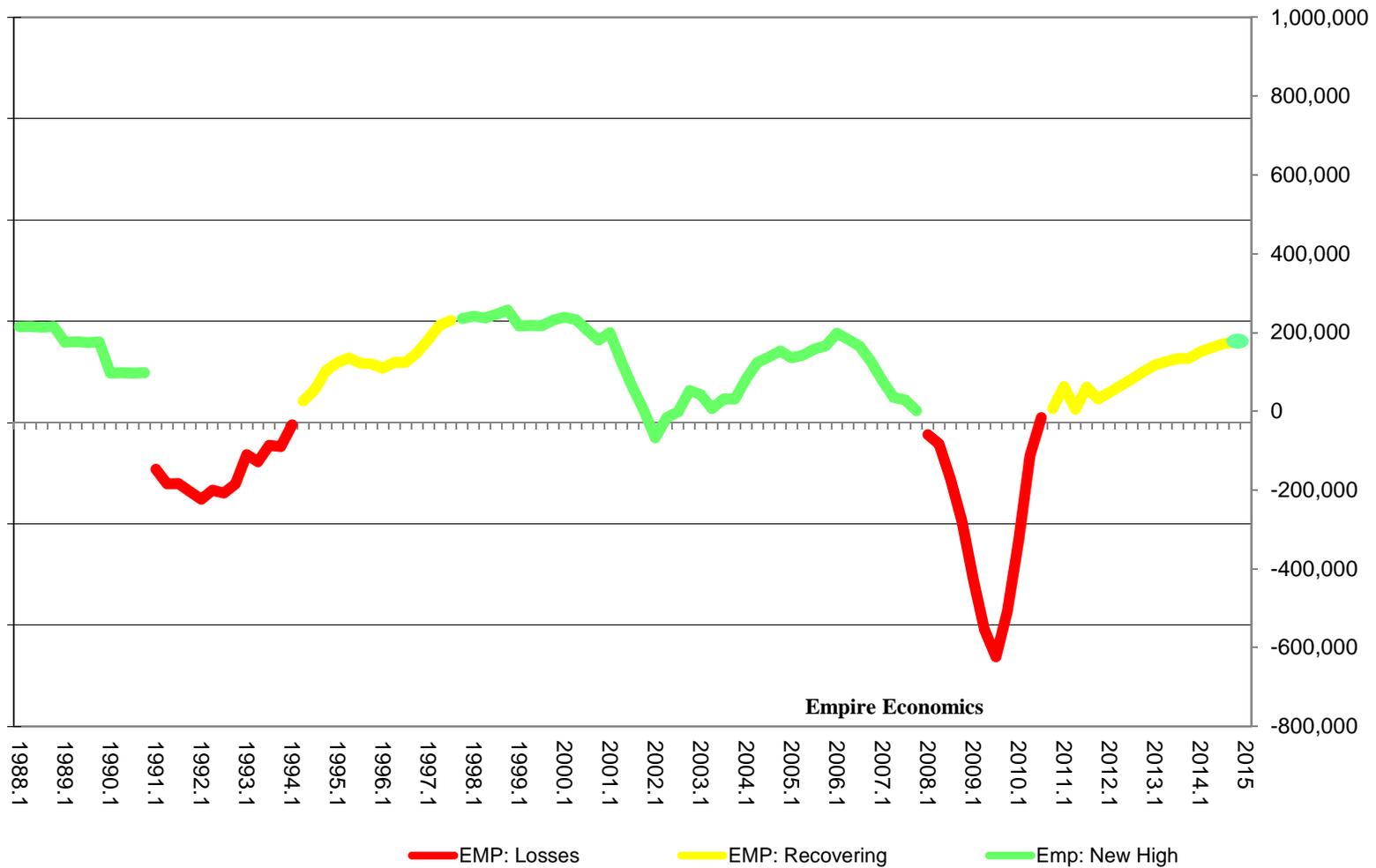
3. WHAT ARE THE NEAR-TERM PROSPECTS FOR A REAL ESTATE RECOVERY AND HOUSING PRICE APPRECIATION ?

SOUTHERN CALIFORNIA: EMPLOYMENT AS THE PRIMARY FORCE FOR PRICE CHANGES
 PART 1: CHANGES IN HOUSING PRICES



SOUTHERN CALIFORNIA: EMPLOYMENT AS THE PRIMARY FORCE FOR PRICE CHANGES

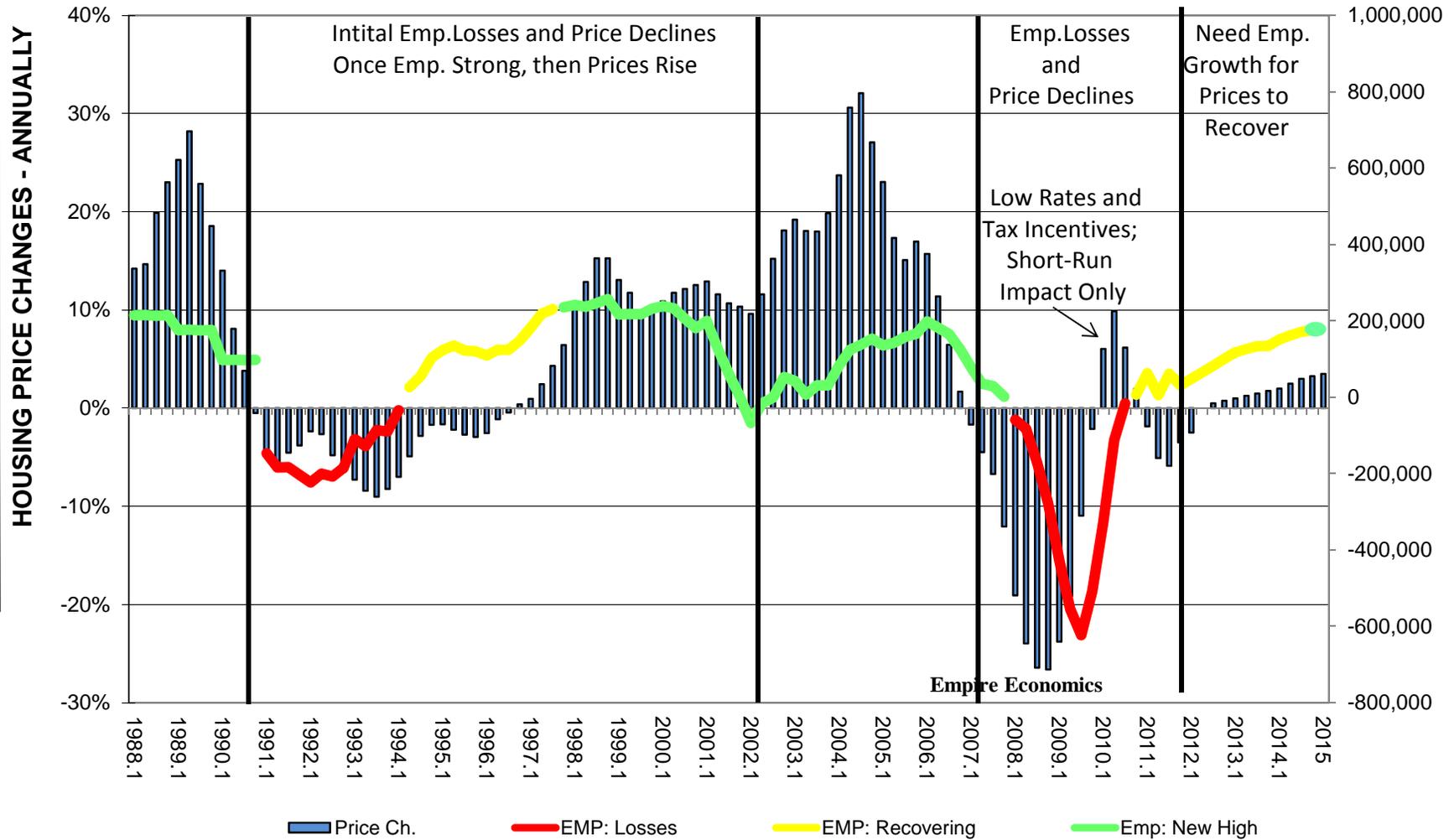
PART 11: CHANGES IN EMPLOYMENT



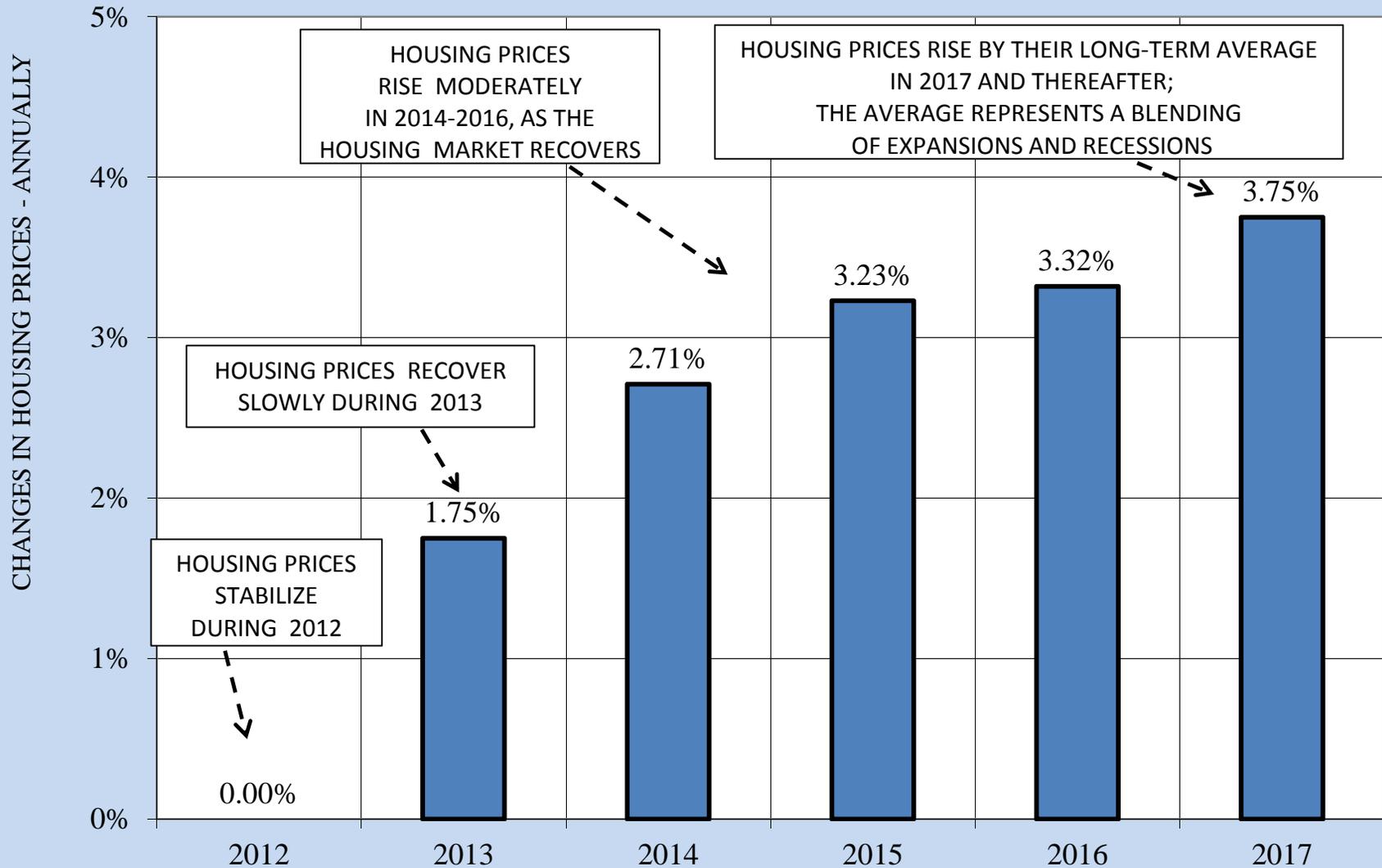
SOUTHERN CALIFORNIA: EMPLOYMENT AS THE PRIMARY FORCE FOR PRICE CHANGES

Strong Emp. Growth
Strong Appreciation
Despite High Rates, 10%

Housing Prices Rise,
Despite Slow Emp. Growth
Price Bubble



CONSENSUS FORECAST FOR UNITED STATES HOUSING PRICES DURING THE 2012-2017 TIME PERIOD



CONSENSUS FORECAST OF UNITED STATES HOUSING PRICES

SAMPLE OF PARTICIPANTS IN HOUSING PRICE SURVEY



HOME PRICE EXPECTATIONS SURVEY RESULTS: DECEMBER 2011

Panelist	Title	Affiliation	Cumulative					
			2011	2012	2013	2014	2015	2016
Esmael Adibi	Director	Chapman University	-1.90%	0.65%	4.98%	8.97%	12.56%	16.05%
Scott Anderson	Director and Senior Economist	Wells Fargo	-3.30%	-5.14%	-3.24%	-1.30%	1.16%	4.00%
Dean Baker	Co-Director	Center for Economic & Policy Research	-2.00%	-5.43%	-4.48%	-2.10%	0.35%	2.86%
Paul Ballew	Economist	Nationwide	-4.10%	-6.50%	-6.03%	-4.62%	-2.71%	-0.77%
Kevin Barry	Mortgage Trader	Caxton Associates	-0.70%	-4.67%	-2.77%	2.10%	8.22%	16.88%
Bob Baur	Chief Global Economist	Principal Global Investors	0.00%	1.00%	2.01%	4.05%	6.13%	8.25%
Nariman Behravesh	Chief Economist	IHS Global Insight	-0.60%	-5.09%	-2.15%	2.35%	6.96%	12.41%
David Berson	Chief Economist	PMI Group	0.70%	1.70%	4.75%	8.47%	12.43%	16.70%
Jay Brinkmann	Chief Economist	Mortgage Bankers Association						
Teunis Brosens	Economist	ING Financial Markets	-2.50%	-2.60%	-1.23%	0.54%	3.16%	6.25%
John Brynjolfsson	Chief Investment Officer	Armored Wolf, LLC	-4.00%	-13.60%	-17.92%	-17.92%	-16.28%	-12.09%
Michael Carey	Chief Economist, North America	Credit Agricole						
Michael Carliner	Housing Economist	Independent Consultant	-2.60%	-2.11%	-0.16%	3.34%	7.99%	10.69%
Maryann Carroll	Director, U.S. Macroanalysis	Wellington Management Company						
Joseph Carson	Chief Economist	Alliance Bernstein	-2.00%	-0.04%	2.96%	7.08%	11.36%	16.93%
Bill Cheney	Chief Economist	John Hancock Financial	0.00%	3.00%	8.15%	13.56%	16.96%	20.47%
Mike Cosgrove	Principal	The Economist	-1.00%	-1.50%	-0.51%	1.48%	4.02%	6.62%
Marsha Courchane	Director, Financial Economics	Charles River Associates	-1.10%	1.17%	4.21%	6.82%	8.95%	13.31%
Amy Crews Cutts	Chief Economist	IXI Corp.	-3.20%	-2.23%	0.70%	4.73%	9.97%	15.46%
David Crowe	Chief Economist	National Association of Home Builders	-3.00%	-2.03%	-0.56%	2.42%	6.01%	9.72%
Paul Dales	Economist	Capital Economics Ltd	-3.60%	-3.60%	-3.60%	-0.23%	3.76%	7.92%
Michael Darda	Chief Economist	MKM Partners						
Rajesh Dhawan	Director, Economic Forecasting Center	Georgia State University	-1.00%	1.48%	5.53%	10.28%	15.80%	22.75%
Robert DiClemente	Chief U.S. Economist	Citigroup						
John Dolan	President	Second Order Strategies, Inc.	-1.80%	-2.09%	-1.41%	-0.62%	2.46%	6.35%
Mark Dotzour	Chief Economist	Texas A&M University Real Estate Center	-0.40%	-0.90%	-0.40%	1.59%	3.62%	5.69%
David Downs	Real Estate Finance Professor	Virginia Commonwealth University	-0.70%	0.79%	3.31%	6.41%	9.60%	12.34%
Doug Duncan	Chief Economist	Fannie Mae						
Robert Dye	Chief Economist	Comerica Bank	-3.20%	-4.85%	-4.18%	-2.74%	0.18%	3.18%
Jerry Ehlinger	Co-Head of Real Estate Securities, Americas	RREEF						
Michael Englund	Chief Economist	Action Economics LLC	-3.20%	-3.30%	-1.65%	1.30%	5.35%	10.62%
Craig Evers	Economist	Brean Howard						
Maria Fiorini Ramirez	Chief Executive Officer	MFR, Inc.						
Larry Foley	Principal	Bronson Point Partners	-0.75%	-0.01%	1.74%	3.78%	7.41%	10.63%
Carlos Garriga	Senior Economist	Federal Reserve Bank of St. Louis	-0.50%	-0.75%	-0.50%	0.25%	1.25%	2.77%
Kevin Gillen	Vice President	Econsult LLC						
Dan Greenhaus	Chief Global Strategist	BTIG LLC	-4.00%	-5.92%	-4.98%	-3.08%	-0.17%	1.83%
Marc Halle	Managing Director, Portfolio Manager	Prudential Real Estate Investors	-3.00%	-2.03%	0.91%	4.44%	8.62%	12.96%

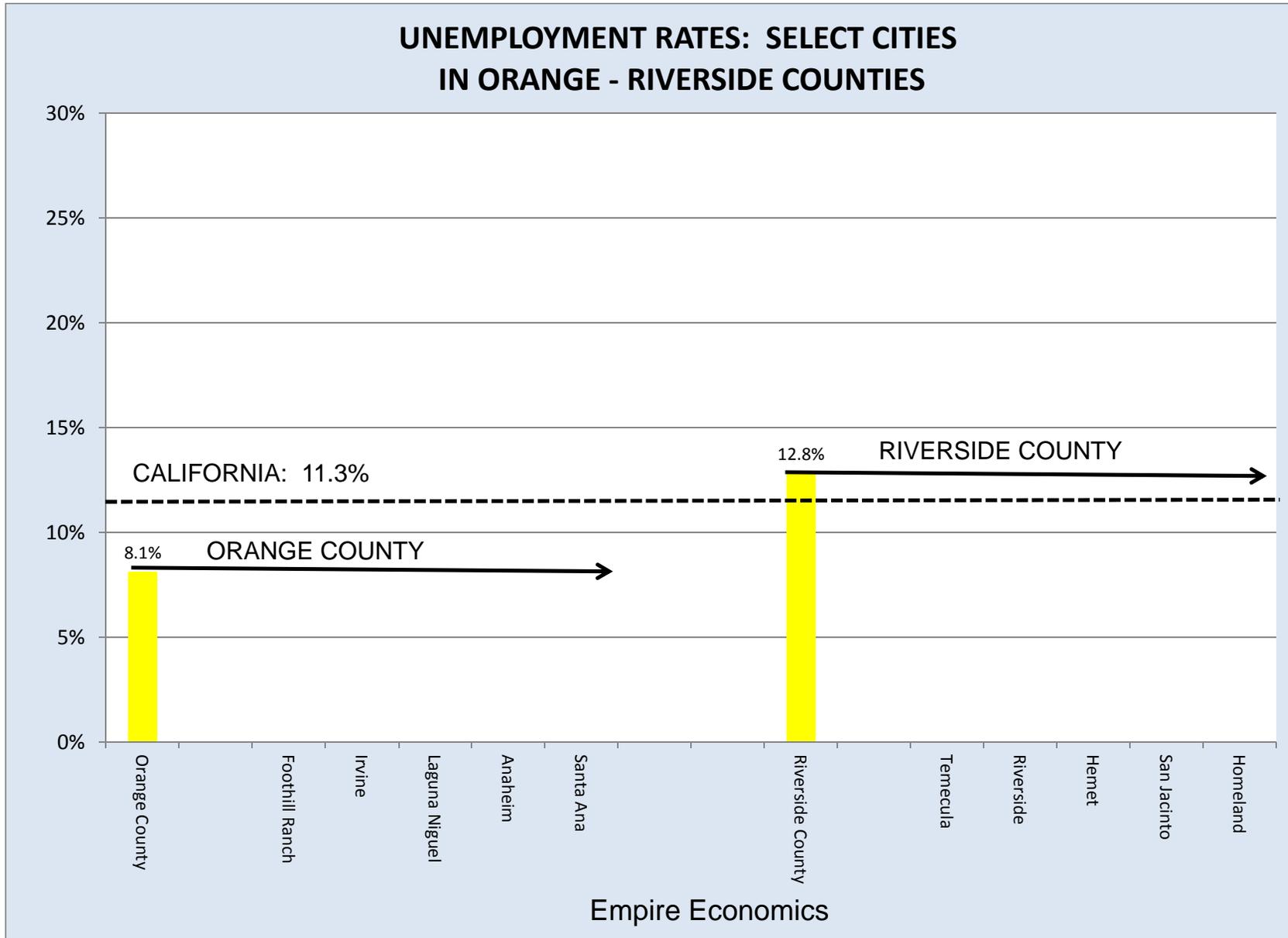
4. HOW DOES THE TIMING OF RECOVERIES FOR LOCAL ECONOMIES VARY, AND WHAT ECONOMIC METRIC CAN YOU USE TO GAUGE THE ECONOMIC CONDITIONS IN YOUR JURISDICTION ?

- **OBSERVATION: SINCE SUMMER 2009, THE CITY OF IRVINE IN ORANGE COUNTY HAS HAD 15 NEW RESIDENTIAL PROJECTS ENTER THE MARKETPLACE AND ACHIEVE SALES OF MORE THAN 1,800 NEW HOMES**

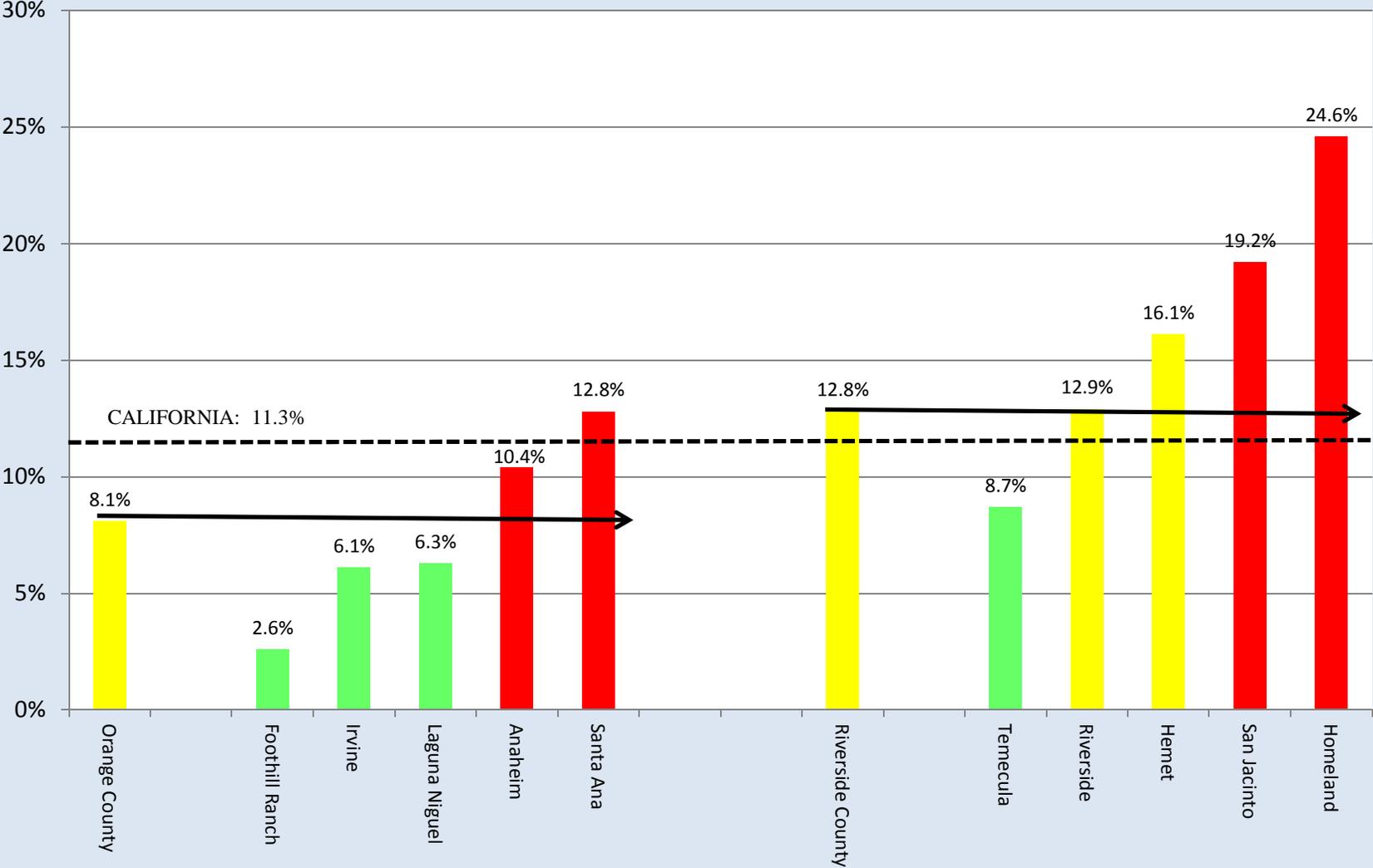
WHY IS THERE SUCH A STRONG LEVEL OF DEMAND FOR NEW HOMES ???

- **AFTER SIGNIFICANT RESEARCH ON NUMEROUS ECONOMIC STATISTICS, THE CONCLUSION WAS THAT A PRIMARY METRIC FOR GAUGING THE VITALITY OF A LOCAL ECONOMY IS THE CITY'S "UNEMPLOYMENT RATE"**
- **FOR A CITY WITH A RELATIVELY LOW UNEMPLOYMENT RATE, ITS FEATURES ARE:**
 - **A HIGH PROPORTION OF THE CITY'S POPULATION IS EMPLOYED**
 - **EMPLOYMENT SUPPORTS A STRONG LEVEL OF HOUSING DEMAND**
 - **MOST OF THE HOUSEHOLDS HAVE POSITIVE EQUITY LEVELS**
 - **THE VALUE OF RAW LAND BEING POSITIVE – BENEFICIAL TO NEW DEVELOPMENT**

KEY ECONOMIC METRIC – UNEMPLOYMENT RATE



UNEMPLOYMENT RATES: SELECT CITIES IN ORANGE - RIVERSIDE COUNTIES



FACTORS REFLECTING THE ECONOMIC CONDITIONS FOR LOCAL ECONOMIES

EMPIRE ECONOMICS HAS PROVIDED A FILE TO CDIAC WITH RECENT UNEMPLOYMENT RATES FOR ALL OF THE CITIES IN CALIFORNIA:

- LOOK UP THE UNEMPLOYMENT RATE FOR YOUR CITY
- COMPARE THIS TO CALIFORNIA'S UNEMPLOYMENT RATE OF 11.3%
- COMPARE THIS TO THAT OF THE COUNTY
- COMPARE THIS TO OTHER CITIES IN THE COUNTY

THE UNEMPLOYMENT RATE IS REGARDED AS BEING A PRIMARY METRIC THAT CAN BE USED TO GAUGE THE ECONOMIC CONDITIONS IN A CITY. HOWEVER, WHILE THIS METRIC IS USEFUL AS A GENERAL INDICATOR, CAUTION SHOULD BE EXERCISED IF THERE ARE OTHER SIGNIFICANT ECONOMIC OR POLITICAL FACTORS.

**5. WHAT ARE THE PROSPECTS FOR LOCAL MUNICIPAL FINANCINGS FOR 2012,
WITH A FOCUS ON LAND SECURED AND GENERAL OBLIGATION BONDS (GO) BONDS ?**

LAND SECURED BONDS: EMPLOYMENT A DRIVING FORCE, MORE DEMAND FOR HOMES:

OUTSTANDING BONDS: POTENTIAL FOR REFINANCINGS – BASED UPON CALL DATES

SALE OF NEW BONDS FOR EXISTING CFDS
PROJECTS WITH HOMES THAT HAVE BEEN BUILT/OCCUPIED

NEW CFD FORMATIONS: FORWARD PLANNING –FORMING NOW BUT SALES IN 2-4 YRS.
SOME IN COASTAL AREAS SUCH AS ORANGE COUNTY AND SAN FRANCISCO
EXPECT MORE IN AREAS WITH LOW UNEMPLOYMENT RATES

CFDS FOR SERVICES:

TYPICALLY, CFDS USED PRIMARILY FOR INFRASTRUCTURE

EMERGING TREND: CFDS PAY FOR SERVICES
FOR A PROJECT AREA
CITY-WIDE

GENERAL OBLIGATION BONDS – DEPEND UPON ASSESSED VALUE (AV)

THE DRIVING FORCES ARE PRICE APPRECIATION AND NEW DEVELOPMENTS

EXISTING PROPERTIES:

ANNUAL ESCALATOR, UP TO 2% PER YEAR

RESALES THAT HAVE A HIGHER AV

PRE-BUBBLE: NEW AV HAS A SIGNIFICANT INCREASE

BUBBLE: ALREADY AV ADJUSTED, MINIMAL CHANGE

PROPERTIES NOT RE-SOLD: PROP 8 UPWARD ADJUSTMENTS

NEW DEVELOPMENT: CREATES ADDITIONAL AV:

NEW INFRASTRUCTURE

NEW CONSTRUCTION ACTIVITY

CONCLUDING REMARKS

1. THE HOUSING MARKET IS NOW RE-ADJUSTING FROM THE PRICE BUBBLE WHICH WAS DRIVEN BY ARTIFICIAL FINANCING FACTORS TO EMPLOYMENT GROWTH AS THE PRIMARY FACTOR UNDERLYING HOUSING PRICE CHANGES.
2. FOR CALIFORNIA, AS A WHOLE, THE ADJUSTMENT PROCESS WILL TAKE SEVERAL YEARS, DUE TO THE ECONOMIC RECESSION ALONG WITH THE HIGH LEVELS OF SHADOW INVENTORY.
3. DURING THIS ADJUSTMENT PERIOD, PRICES WILL BE STABLE / SOFT, AND THE AMOUNT OF NEW DEVELOPMENT WILL BE RELATIVELY LOW.
4. THE “RATES” OF RECOVERY WILL VARY SUBSTANTIALLY BY CITIES, SINCE EACH HAS ITS OWN UNIQUE SET OF FACTORS:
COMPOSITION OF ITS ECONOMIC BASE: MANUFACTURING, SERVICES, ETC.
AMOUNT OF SHADOW INVENTORY FROM THE PRICE BUBBLE.
5. TO GAUGE THE RELATIVE RATE OF RECOVERY IN YOUR LOCAL ECONOMY, A USEFUL METRIC IS THE UNEMPLOYMENT RATE, SINCE THIS SYNTHESIZES THE SPECIFIC ECONOMIC CONDITIONS IN YOUR JURISDICTION.

PLEASE REFER TO THE EXCEL FILE FOR MORE INFORMATION ON THE RECENT UNEMPLOYMENT RATES FOR THE CITIES IN CALIFORNIA.

GREAT DEPRESSION VS. GREAT RECESSION - WHICH QUOTE FOR WHICH EVENT ???

1. "Waiting to be solved...lurks the great question of banking reform."

2. "I have great, great confidence in our capital markets and in our financial institutions. Our financial institution, banks, and investment banks, are strong."

3. "Financial or commercial crises seem to be mathematically impossible."

4. "The risk that the economy has entered a substantial downturn appears to have diminished over the past month or so."

5. "We will not have any more crashes in our time."

6. "The fundamentals of the American economy are strong."

Ben Bernanke, June 2008

John Maynard Keynes, 1927

Hank Paulson, March 2008

Woodrow Wilson, 1912

John McCain, September 2008

Comptroller of the Currency,
remarking on the creation of the
Federal Reserve System, 1914

Empire Economics

ANSWERS IN ORDER OF
QUOTES:

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