



BEACON ECONOMICS

California Battling Back: An Outlook for Local Revenues

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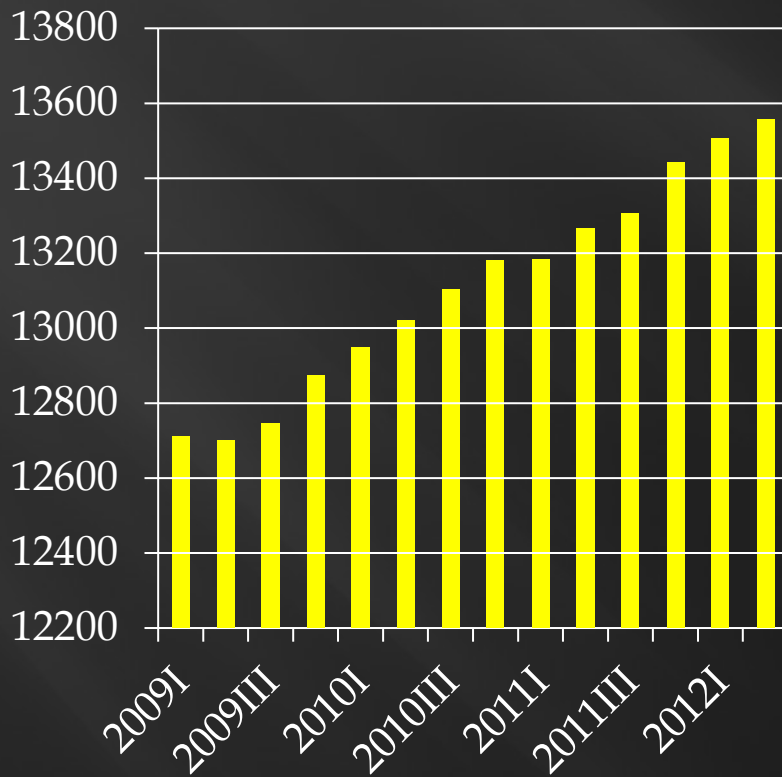
Overview

- ▣ US economic concerns are overblown
- ▣ California remains in the midst of a recovery
- ▣ Most indicators point to more improvement
- ▣ Revenue prospects are looking up
- ▣ Risk factors still require consideration
 - Cause for concern, not panic
- ▣ Chance to address structural issues
- ▣ California forecast: improve in 2013/beyond

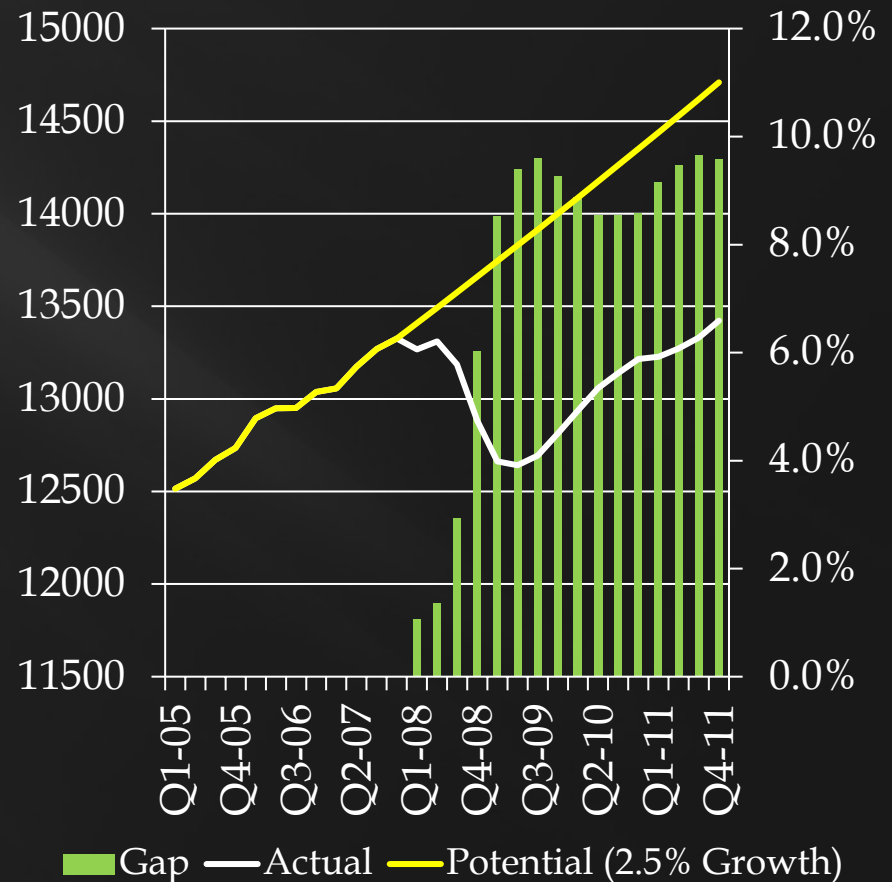


The Disappointing Recovery

Gross domestic product
Up 6.8% from Trough

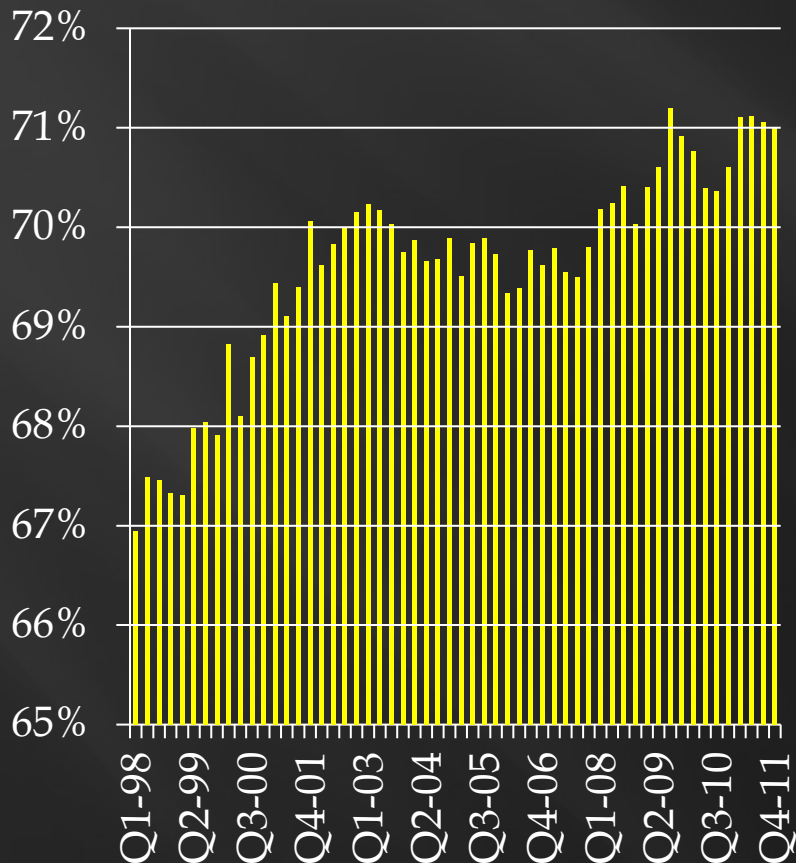


Potential v Actual GDP

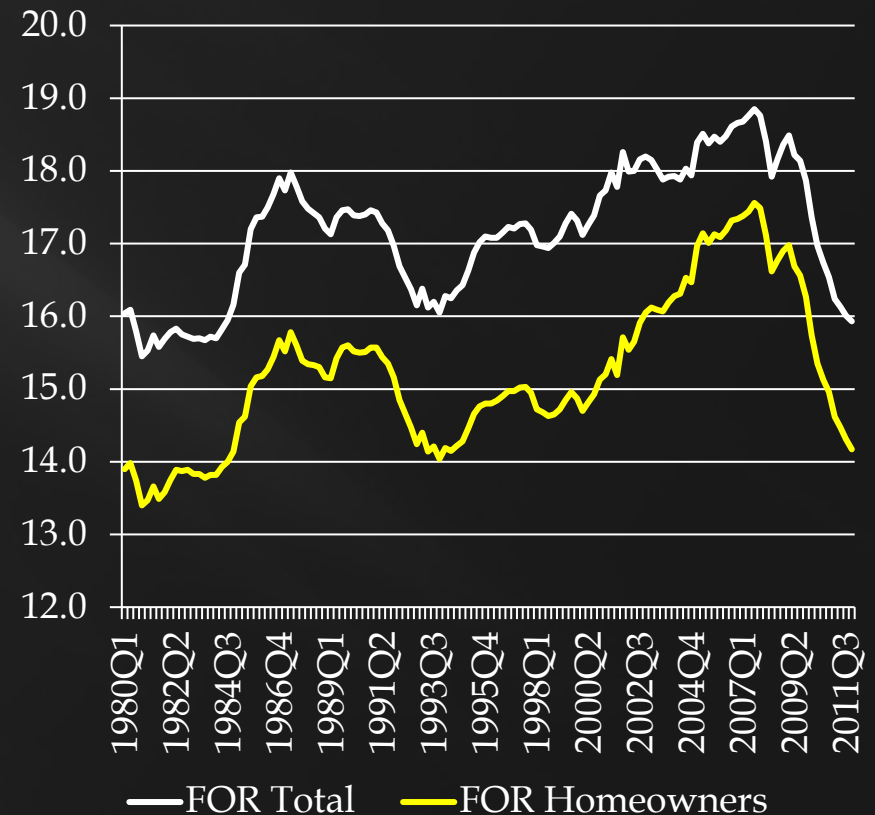


It's not the consumer...

Consumer Spending
as % GDP

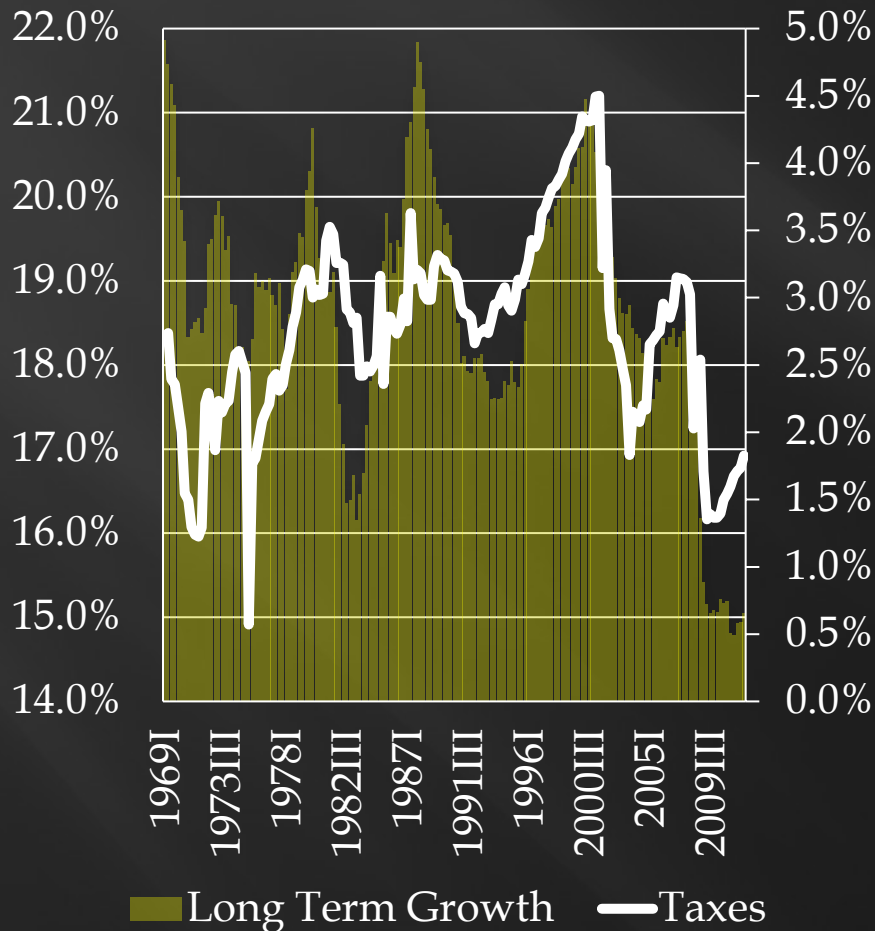


Financial Obligations Ratio (%
DPI)

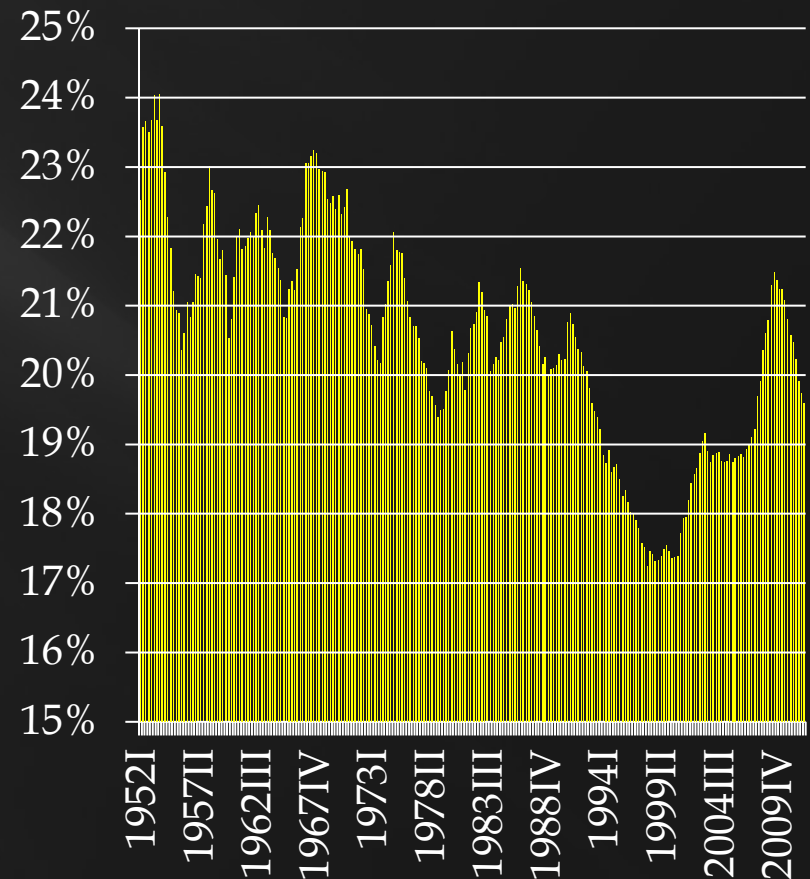


It's not taxes or government...

Taxes and Long Term Growth

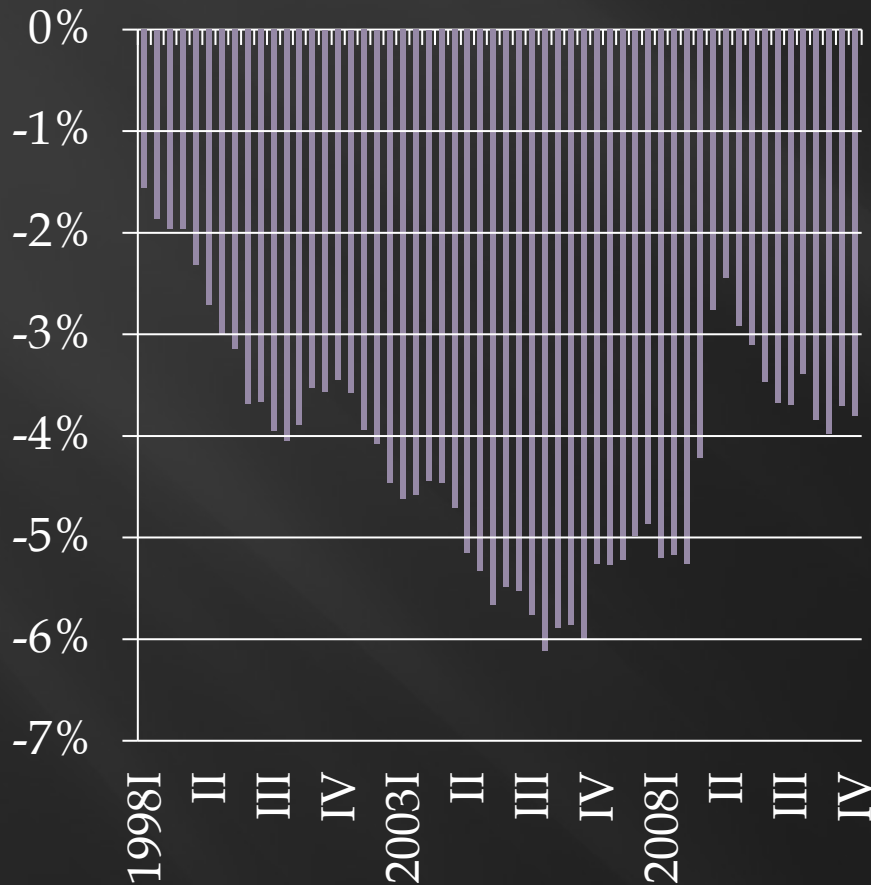


Government Direct Spending % GDP

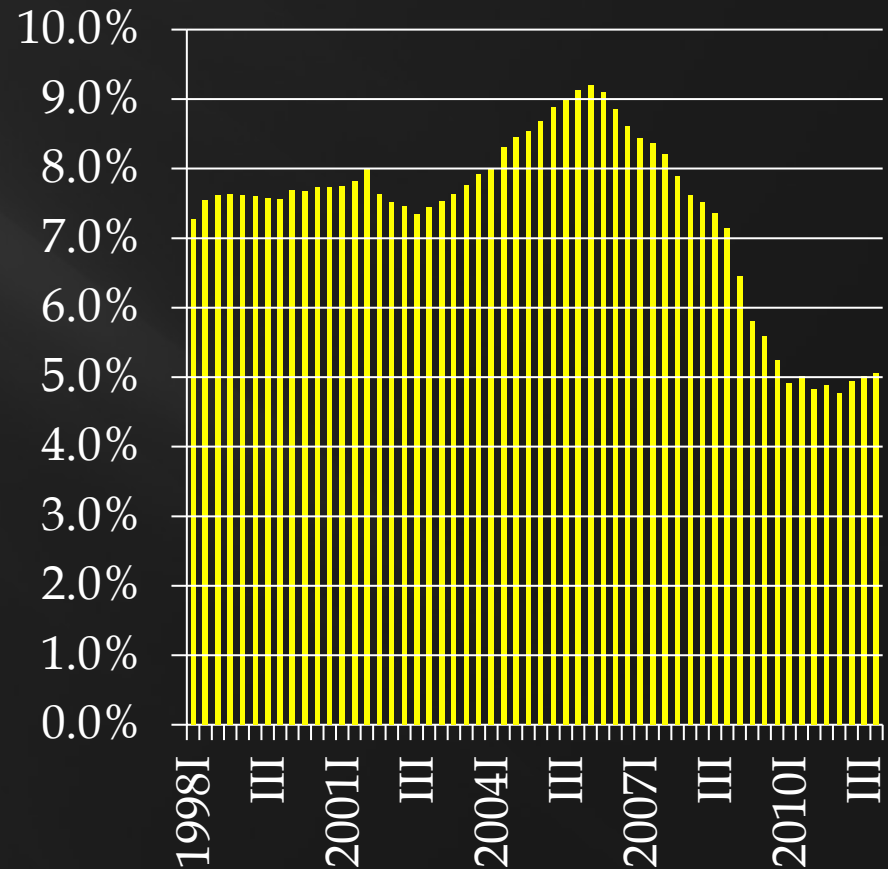


It's Trade and Construction

Trade Deficit as % GDP



Construction as % GDP



High Hurdles

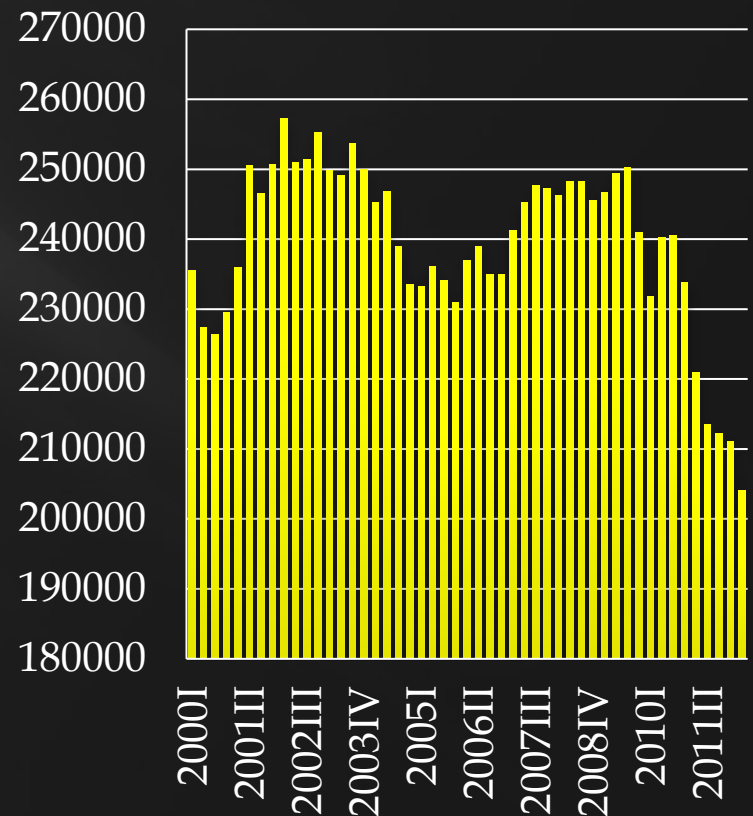
▣ Construction

- Tyranny of inventory – this portion of the economy will not improve until the economy grows to the point that excess space starts to be absorbed in a real way

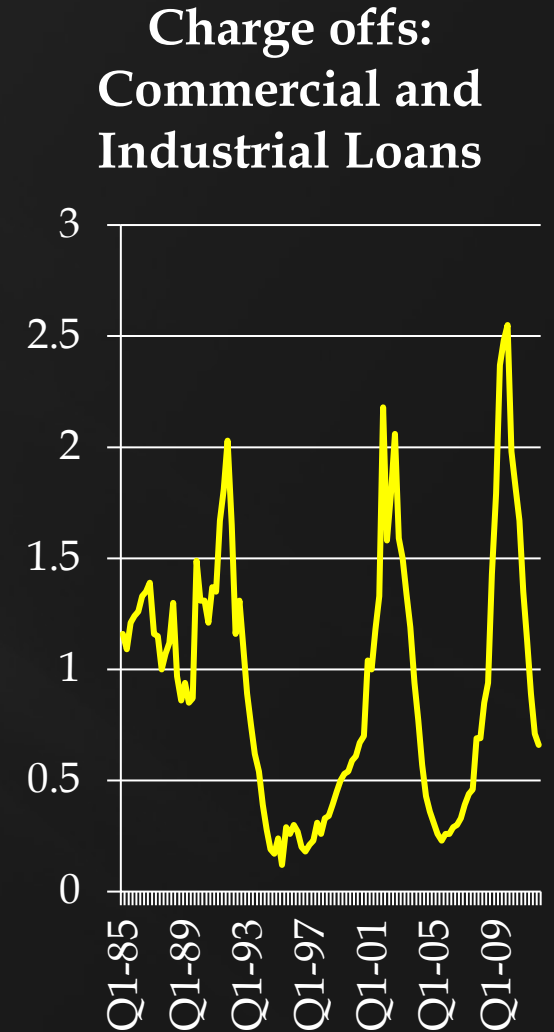
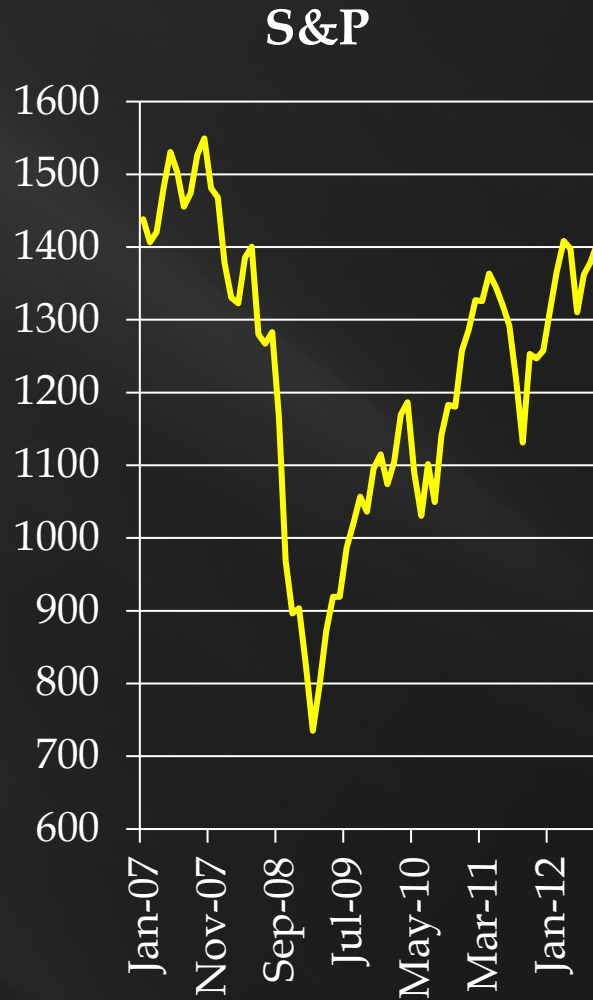
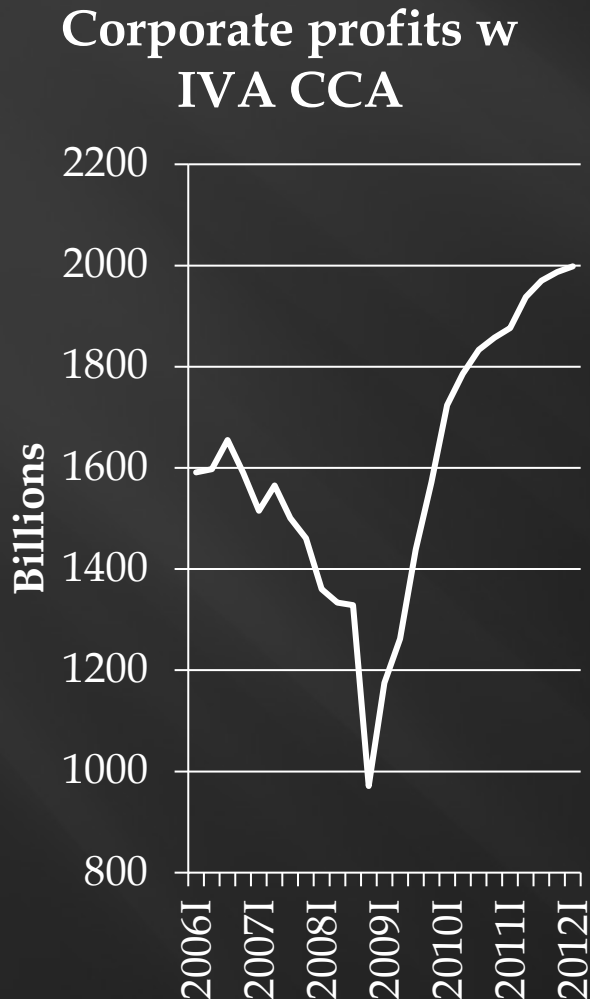
▣ Trade

- Internal – Massive fiscal deficits for tax cuts
- External – Inability for the world economy to be weaned off the US consumer
- Safe havens – Financial worries push investors to the \$US, sending it up and hurting exports

Real Public Spending on Construction



Corporations: Healthy



How About California: Fact Versus Fiction

The Hype

- ▣ “Flatten California! A proposal to fix the state’s business-killing tax regime” – Art Laffer in the City Journal
- ▣ "California, a bad bet for business: Why would new enterprises come to a state like this?" – Bradley Schiller in The Los Angeles Times
- ▣ “There is denial – California is in a Depression”
CAPoliticalNews.com

The Reality

- ▣ Cyclical issues are waning
- ▣ Bright spots – they’re out there
- ▣ Even major drivers of local tax revenues coming back



Real Economic Growth

Rank	State	2011 RGDP Growth (%)
1	North Dakota	8.68
2	West Virginia	5.67
3	Oregon	5.47
4	Texas	3.79
5	Michigan	3.00
6	Alaska	2.98
7	Washington	2.45
8	California	2.29
N/A	United States	1.76

- ▣ 8th Fastest Economy
- ▣ Most others bolstered by extraction
- ▣ Mining/NR less concentrated in CA

State	Mining Share of GDP (%)	Mining Cont. to Growth (%)
California	1.2	0.1
North Dakota	8.4	2.7
Texas	10.9	0.7
West Virginia	12.7	3.0
United States	2.2	0.1

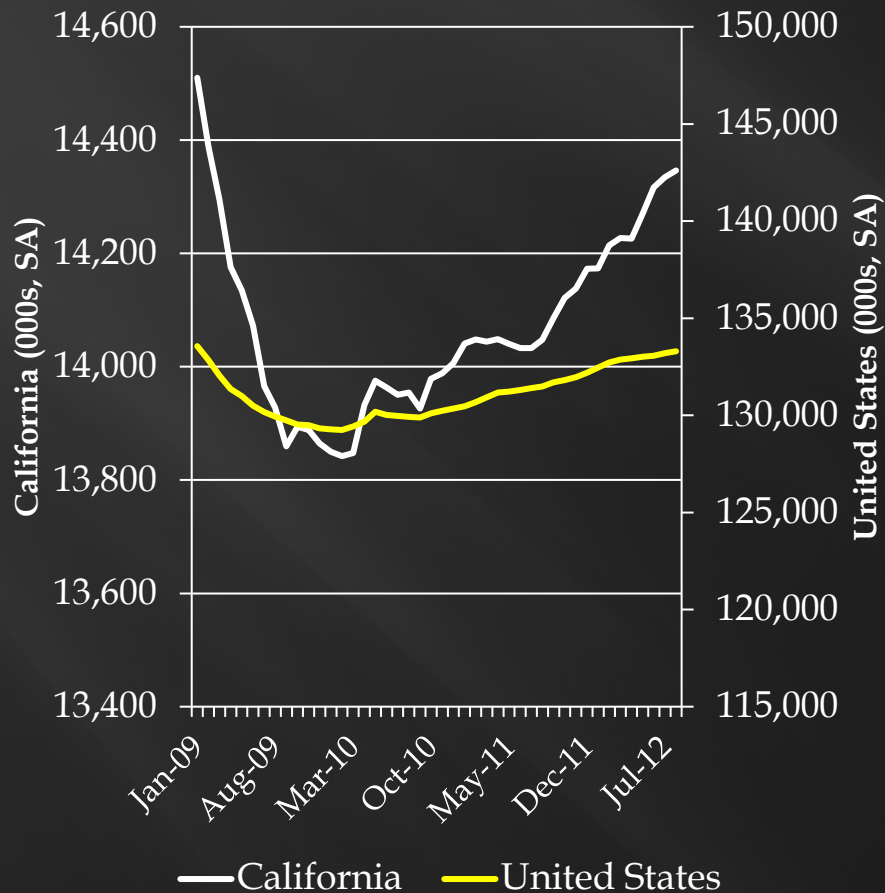
Leading in Some Key Areas

Contributions to Real GDP Growth by Industry, 2010-2011

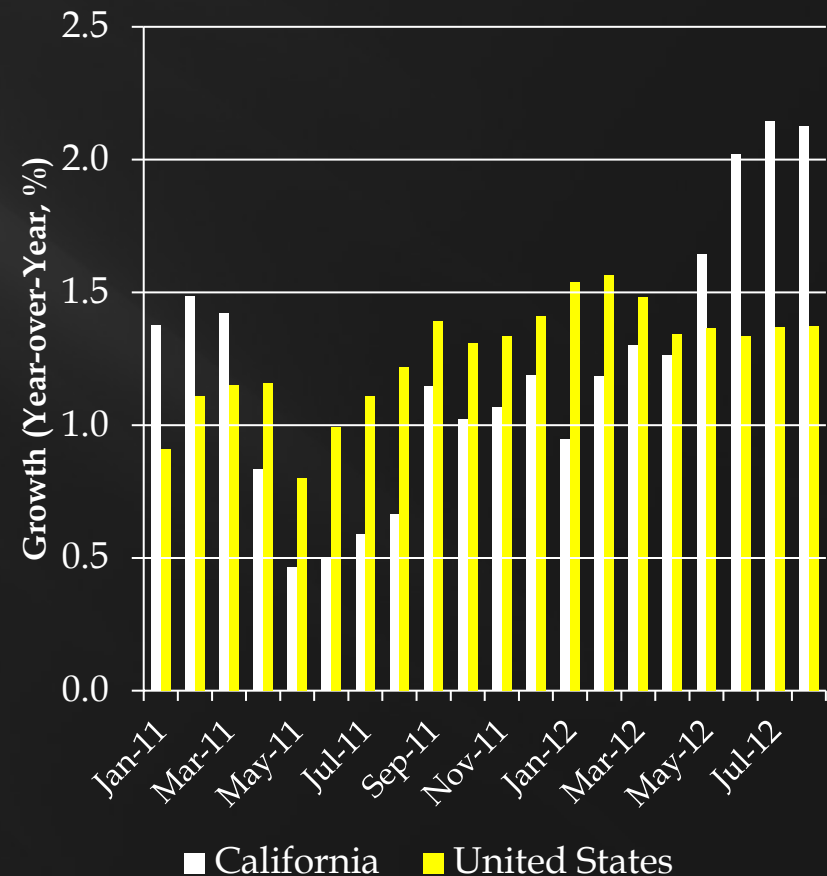
Industry	North				United
	Dakota	Oregon	Texas	California	States
Manufacturing	0.29	5.48	0.63	0.49	0.53
Professional/Business	0.53	0.37	0.64	0.70	0.51
Trade/Transportation	2.44	0.26	0.70	0.36	0.32
Information	0.12	0.20	0.19	0.56	0.25
Education/Health	0.54	0.33	0.25	0.22	0.18
Mining	2.75	0.00	0.72	0.12	0.12
Leisure/Hospitality	0.18	0.06	0.14	0.18	0.12
Other Services	0.06	-0.01	0.05	-0.03	0.00
Construction	0.69	0.11	0.07	0.02	-0.01
Government	0.12	-0.07	-0.04	-0.05	-0.06
Utilities	-0.11	-0.08	-0.11	0.00	-0.10
Agriculture	-1.74	-0.17	-0.17	-0.21	-0.13
Financial Activities	2.05	-0.25	0.36	-0.26	-0.17
All industry total	7.63	4.74	3.31	1.97	1.47

No Signs of Recent Slowdown

Total Nonfarm Employment



Employment Growth



California Shining in 2012

Location	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12
Job Growth (000s, Seasonally Adjusted)							
United States	259	143	68	87	45	141	96
Share of U.S. Job Growth (%)							
Texas	7.7	8.1	21.8	15.6	34.2	15.2	39.6
Florida	7.8	7.1	-15.1	5.3	27.6	-6.8	24.2
Missouri	0.3	4.8	3.7	-16.0	-8.0	-5.1	18.6
California	15.9	8.9	-1.2	51.1	101.1	12.7	12.5
Oklahoma	2.1	2.9	6.5	-0.6	1.1	1.1	10.8
Illinois	3.5	6.9	-4.1	-2.2	0.0	-3.6	10.0
Oregon	-1.2	0.8	4.6	8.7	2.0	0.9	9.2
New York	9.5	14.8	-5.6	-4.3	28.9	-4.4	8.4
Wisconsin	3.9	2.0	-6.2	2.8	-28.2	-4.7	8.1
New Jersey	2.7	-2.6	4.7	16.6	16.2	-5.2	5.5



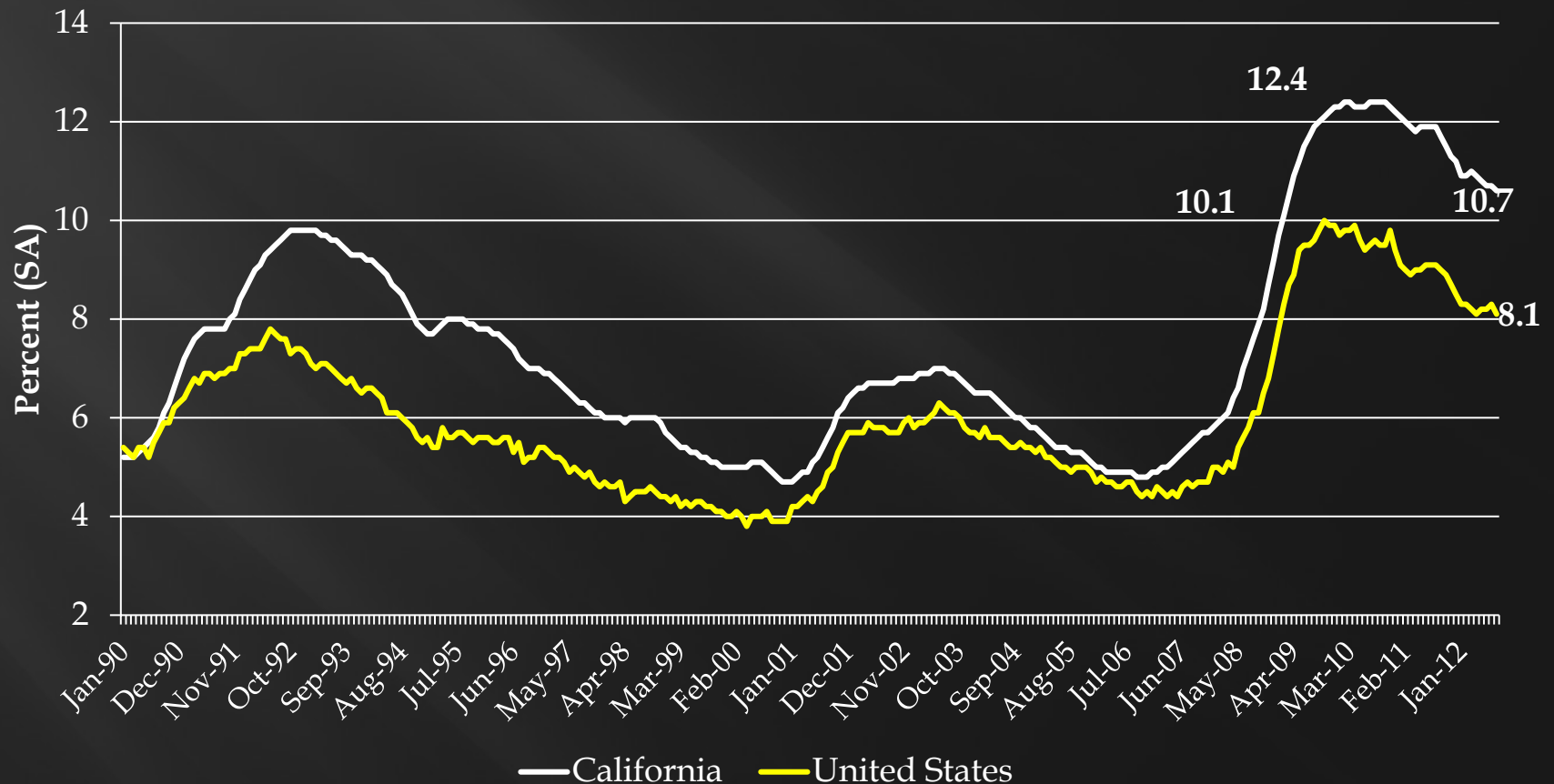
So Where's the Job Growth

Industry	Aug-11	Aug-12	Change (000s)	Change (%)
Construction	547.8	580.8	33.0	6.0
Admin Support	873.4	925.0	51.6	5.9
Information	432.7	452.6	19.9	4.6
Professional	1,057.5	1,105.8	48.3	4.6
Real Estate	244.7	254.4	9.7	4.0
Leisure/Hospitality	1,531.5	1,587.9	56.4	3.7
Education/Health	1,839.7	1,897.2	57.5	3.1
Finance/Insurance	515.0	526.9	11.9	2.3
Wholesale Trade	663.9	676.3	12.4	1.9
Management	199.2	202.6	3.4	1.7
Retail Trade	1,532.2	1,553.6	21.4	1.4
NR/Mining	28.6	28.9	0.3	1.0
Transport/Warehouse	470.8	473.6	2.8	0.6
Other Services	484.7	485.3	0.6	0.1
Manufacturing	1,250.9	1,243.9	-7.0	-0.6
Government	2,374.9	2,351.5	-23.4	-1.0
Farm	387.4	382.8	-4.6	-1.2
Total Private	11,672.7	11,994.8	322.1	2.8
Total Nonfarm	14,047.6	14,346.3	298.7	2.1



Even Unemployment is Falling

Unemployment Rate



Everything is Peachy?

- ▣ Still causes for concern, but not panic:
 - Fiscal hill – particularly for San Diego
 - European woes – disaster likely averted
 - Manufacturing slow - business climate issues?
- ▣ Lots of bright spots – especially local revenues
 - Consumer spending
 - Income growth
 - Venture Capital
 - Real estate no longer a drag
 - Government budgets improving



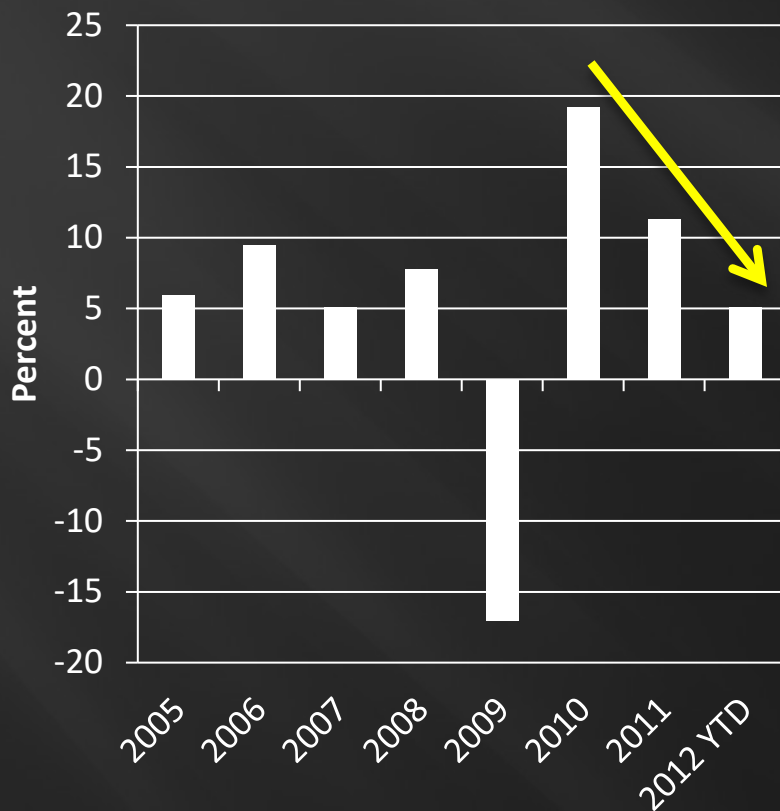
Fiscal Hill and CA

- ▣ Fiscal hill could have implications:
 - Higher income tax rates – consumption effect
 - Sequestration cuts – defense spending
 - ▣ Also important for defense contractors/manufacturers
 - ▣ BAE Systems, Lockheed Martin, Northrop Grumman
- ▣ Wouldn't impact state immediately
 - Defense contracts already locked in
 - Employment responds with a lag
 - Ultimately compromise will be reached



Trade Already Slowing

California Export Growth



Effects of Europe

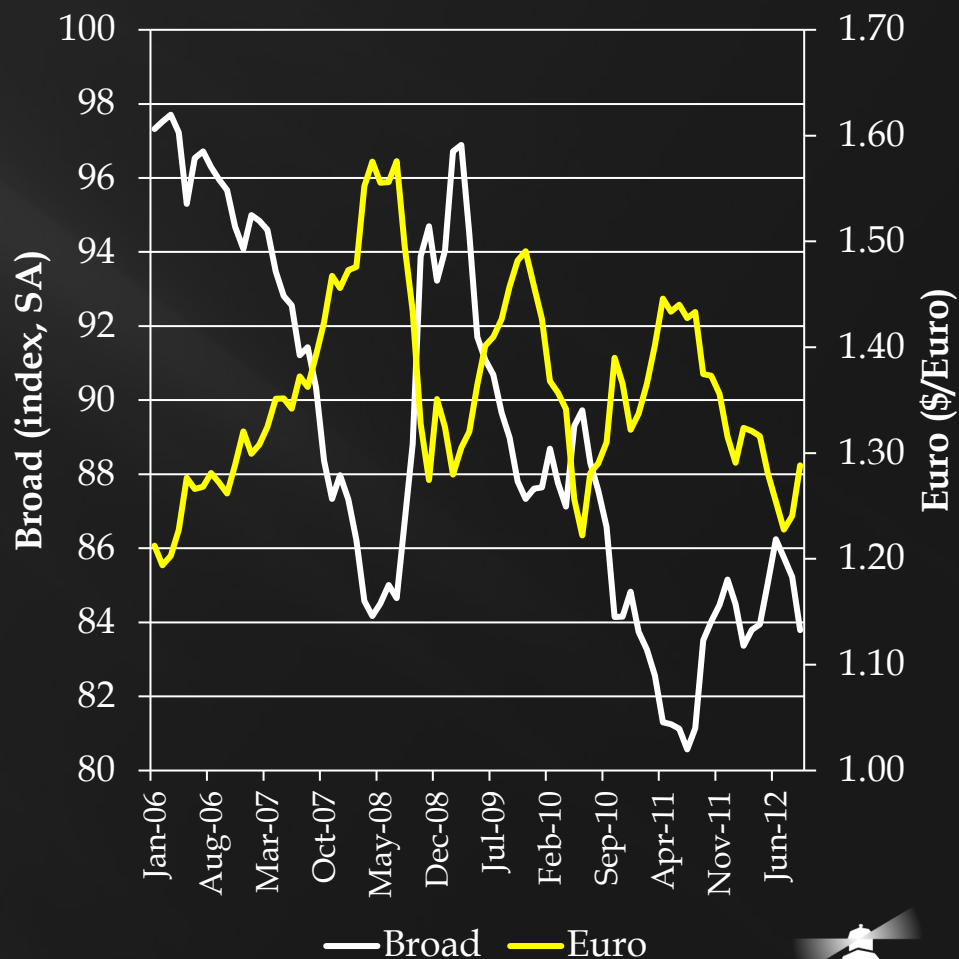
- Direct effects (exports)
- Indirect effects (currency)

Country/Region	2011 Exports	Share of Total
NAFTA	43.2	27.13
Euro Countries	19.6	12.27
China	14.2	8.91
Japan	13.1	8.22
Republic of Korea	8.4	5.27
Hong Kong	7.7	4.82
Taiwan	6.3	3.92
United Kingdom	4.2	2.61
Singapore	4.1	2.59
India	3.8	2.38
Other Countries	34.9	21.87
Total	159.4	100.00

Remember, Concern not Panic

Description	Percentage Change		
	2009 2010	2010 2011	2011 2012YTD
Industrial Machinery/Computers	32.26	10.79	8.19
Electric Machinery/Sound Equip/TV Equip	19.74	2.33	2.53
Optic/Photo/Medic/Surgical Instruments	18.78	4.7	7.36
Edible Fruit & Nuts; Citrus Fruit Or Melon Peel	21.05	14.2	16.21
Vehicles and Parts	13.24	21.38	9.79
Aircraft, Spacecraft, and Parts	-10.49	11.6	11.52
Mineral Fuel, Oil, Bitumin Subst, Mineral Wax	63.29	22.4	0.51
Nat Resources, Pearls, Stones, Pr Met, Coin	23.03	48.78	20.53
Plastics and Articles Thereof	16.98	10.45	1.27
Pharmaceutical Products	13.59	10.24	4.66
Total All Commodities	19.25	11.12	5.11

U.S. Exchange Rates

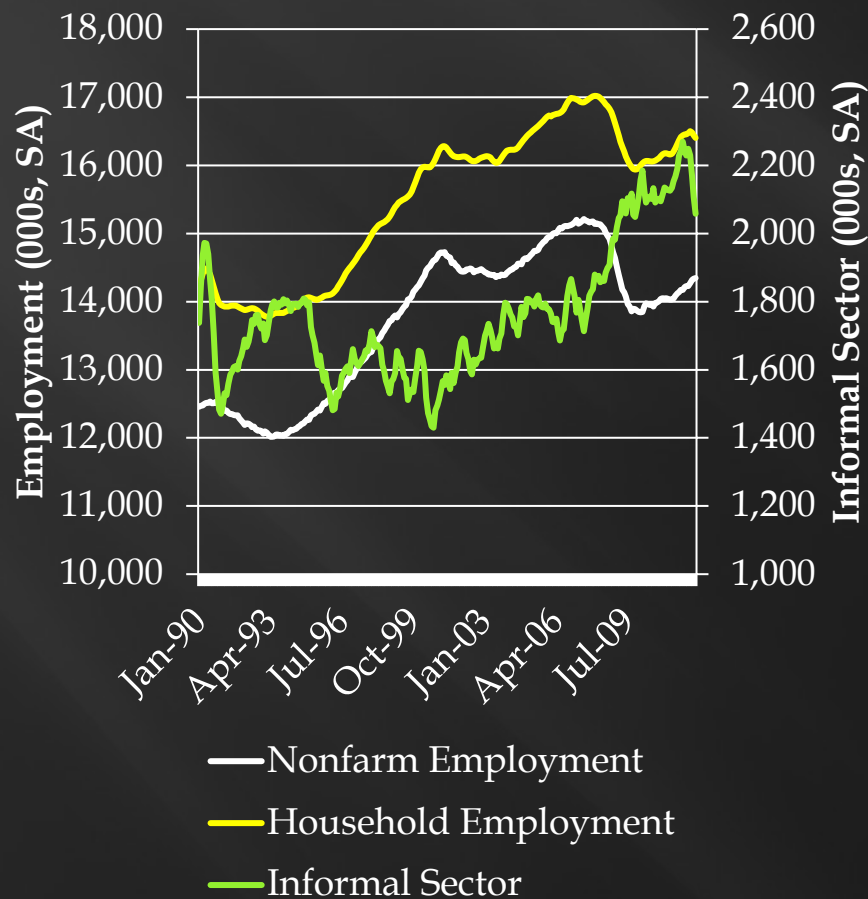


Recovery Still Moving Forward



Household Survey – Two Tales

Payroll vs. Household Employment



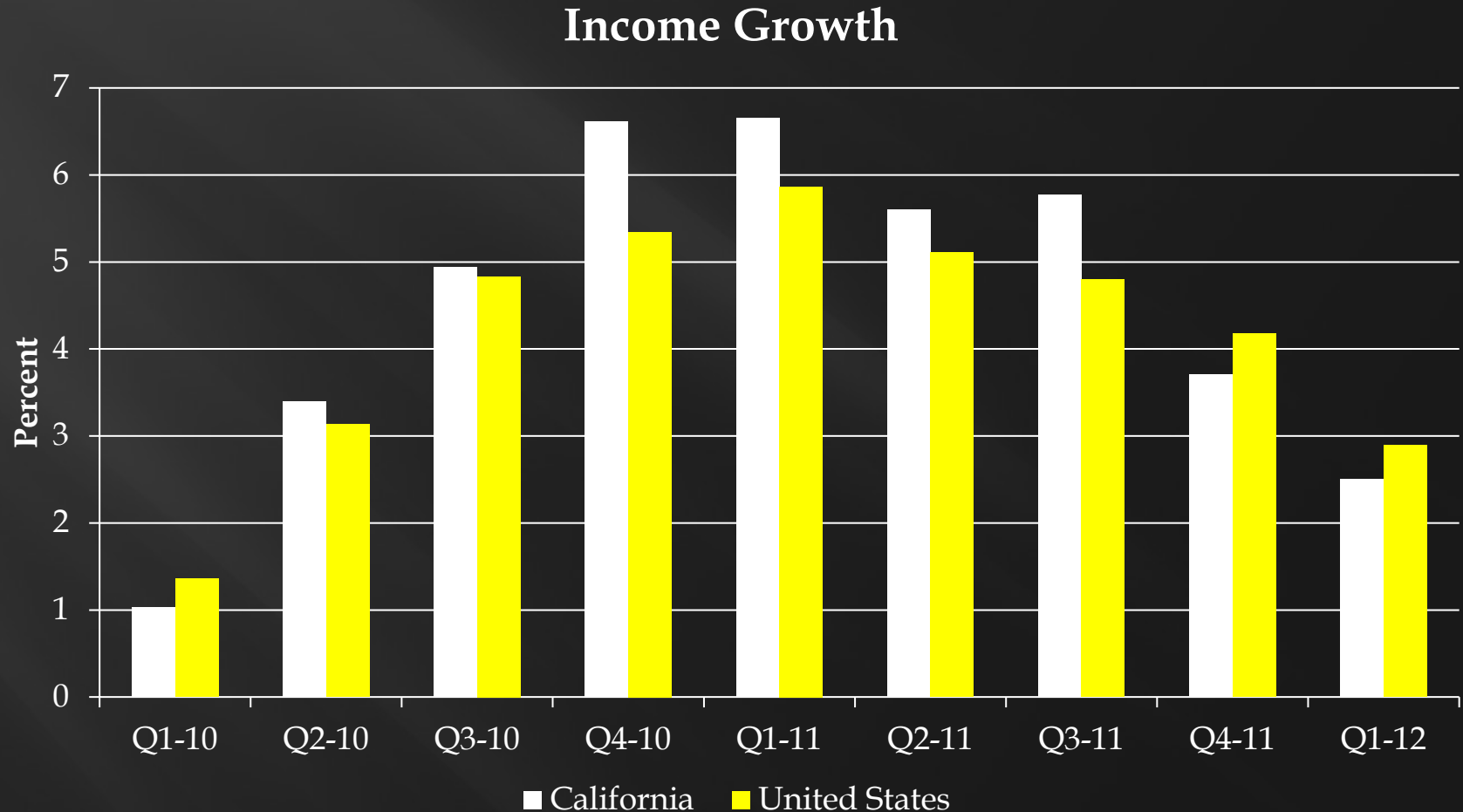
Indicator	Nonfarm Empl't	Household Empl't
Peak Month	Jul-07	Jan-08
Peak Employment	15,212.2	17,020.3
Trough Month	Feb-10	Nov-09
Trough Employment	13,842.3	15,936.8
Peak to Trough	-1,369.9	-1,083.5
Peak to Trough (%)	-9.0	-6.4
Current Month	Aug-12	Aug-12
Current Employment	14,346.3	16,404.0
Trough to Current	504.0	467.2
Trough to Current (%)	3.6	2.9
Remaining to Peak	-865.9	-616.3
Remaining to Peak (%)	-5.7	-3.6

Not Just Labor Markets

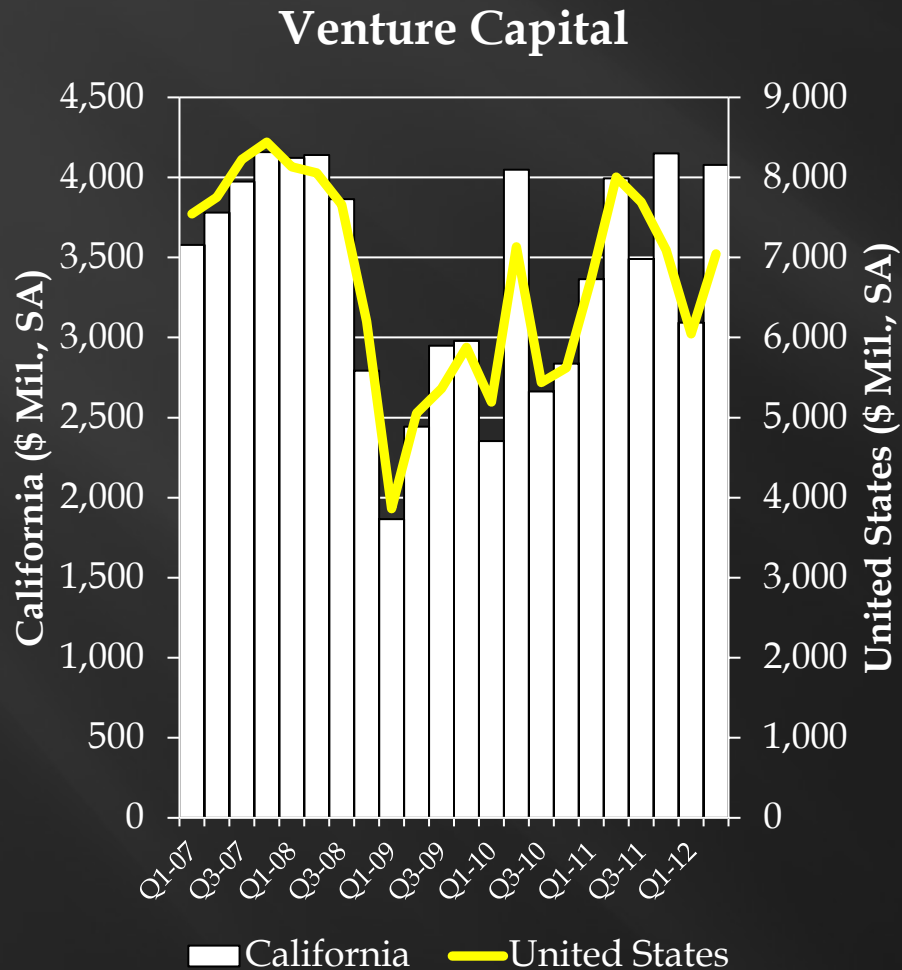
- ▣ Personal income is up
- ▣ Venture capital
- ▣ Consumer spending
- ▣ Hotels and tourism
- ▣ Housing/residential
- ▣ Commercial real estate



Leading on Income Growth



Venture Capital on the Rise



Industry	2011	2012	Diff.
Software	1,524.6	2,102.2	37.9
Industrial Energy	824.9	1,165.0	41.2
Media/Ent.	563.6	683.5	21.3
Biotechnology	948.9	681.7	-28.2
Medical Devices	826.1	678.5	-17.9
IT Services	746.4	512.0	-31.4
Consumer Prods	185.7	450.0	142.3
Semiconductors	678.1	355.3	-47.6
Telecomms	177.7	259.4	46.0
Network./Equip.	101.1	94.5	-6.5
Retailing/Distrib.	106.8	47.0	-56.0
Financial Services	99.9	45.7	-54.3
Electronics Instr.	366.2	30.8	-91.6
Business Products	77.3	23.2	-70.1
Computers	86.6	17.9	-79.4
Other	8.5	13.8	61.6
Healthcare	35.7	11.8	-67.1
Total	7,358.4	7,172.0	-2.5

Recovery Translating Into Revenue

- ▣ Better jobs and incomes
 - Rising consumer spending and sales tax
 - Durable goods purchases and tourism spending
 - Hotels on the rise – TOT revenues coming back

- ▣ Housing and Commercial RE
 - More transactions – transfer tax revenues
 - Rising property values – assessed valuation
 - Permits increasing – rising permit fees



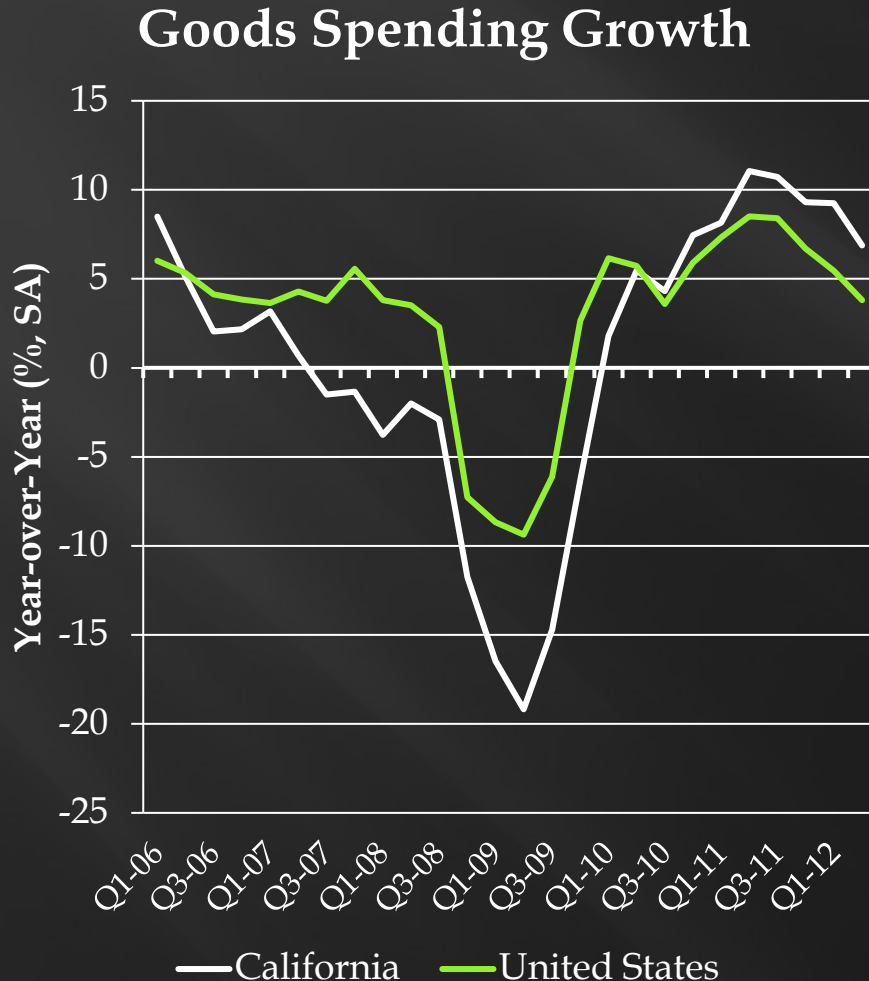
Consumers Opening Their Wallet



Tightness gives way to
increased optimism ➡



California Spending Leads



- CA and LA lead US
- Trough to Current:
 - CA – 25.2%
 - US – 19.7%
- Growing faster, but bigger hill to climb
- Slowdown at US level not seen in H1 in CA
- Slowdown may not be as acute here

What Types of Spending?

Business Group	Q2 2011	Q2 2012	% Change
Autos/Transportation	163,444,998	192,200,334	17.6
Restaurants/Hotels	151,228,515	164,198,611	8.6
Business/Industry	192,151,471	205,810,591	7.1
Food/Drugs	75,489,682	79,814,683	5.7
Building/Construction	90,996,216	95,375,916	4.8
General Consumer Goods	296,625,852	308,371,276	4.0
Fuel/Service Stations	177,933,975	181,642,235	2.1
Total	1,287,132,467	1,381,602,021	7.3

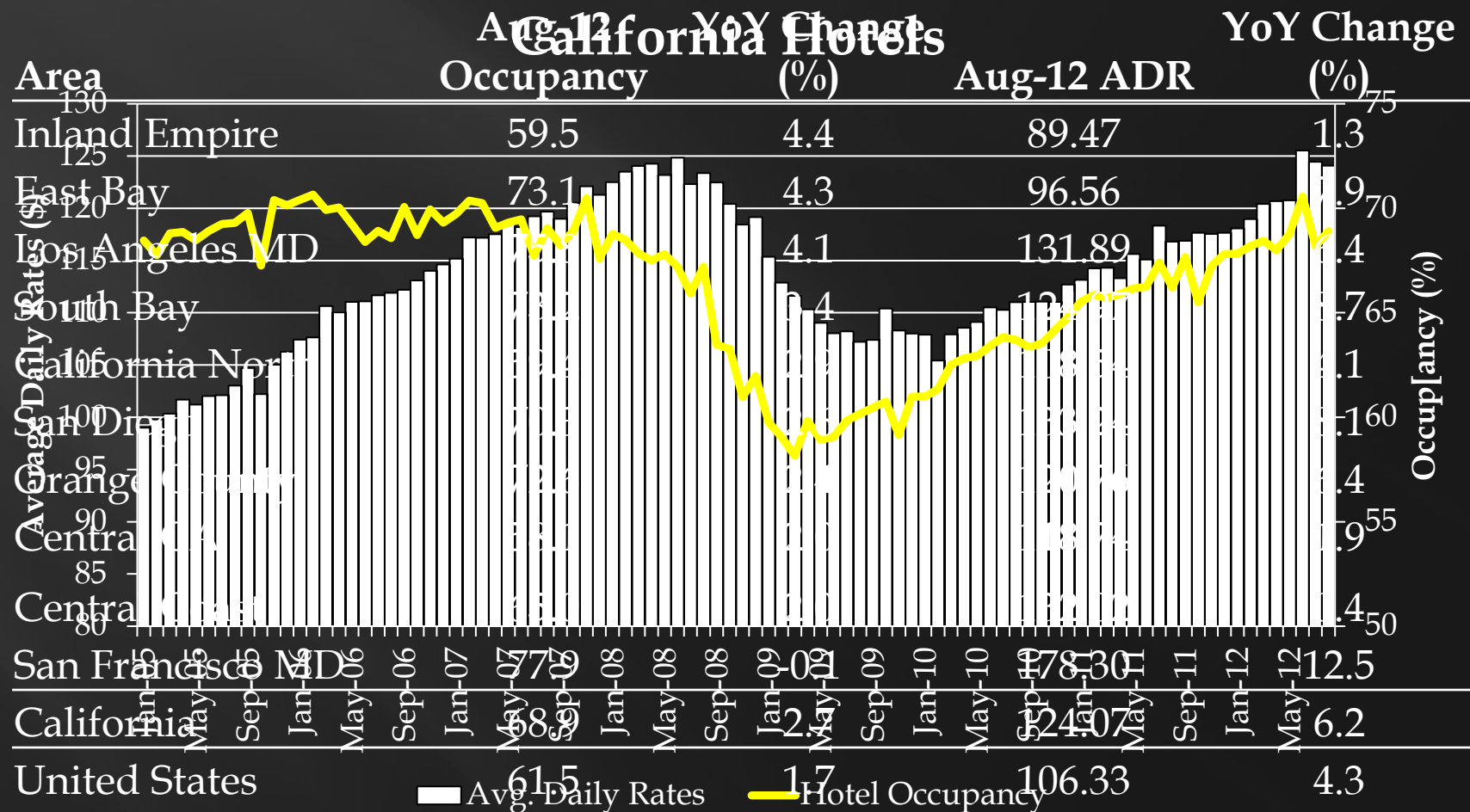
Source: HdL Companies

Airports Up Too: Mostly Domestic Travelers

Airport	Domestic		Total	
	2012	Change (%)	2012	Change (%)
San Francisco - SFO	14,500,000	13.3	18,400,000	11.5
Long Beach - LGB	1,383,300	12.0	1,383,300	12.0
Oakland - OAK	4,144,767	8.2	4,144,767	8.2
Los Angeles - LAX	19,500,000	4.3	26,600,000	3.9
San Diego - SAN	6,978,200	2.1	7,204,653	3.7
Sacramento - SMF	3,613,974	0.4	3,651,131	1.0
Orange County - SNA	3,599,499	-0.1	3,599,499	-0.1
San Jose - SJC	3,290,964	-2.4	3,362,236	-2.5
Burbank - Bob Hope	1,729,895	-3.8	1,729,895	-3.8
Ontario - ONT	1,800,019	-6.7	1,823,224	-6.7
California Totals	60,400,000	4.9	71,800,000	5.0



CA Remains Top Tourist Dest.

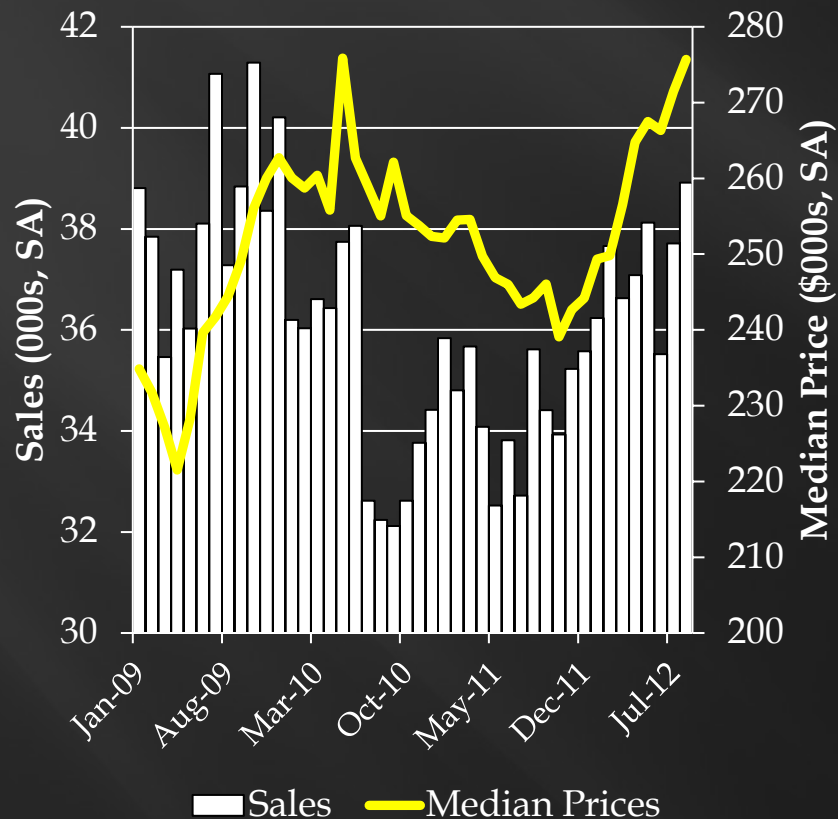


How About Housing

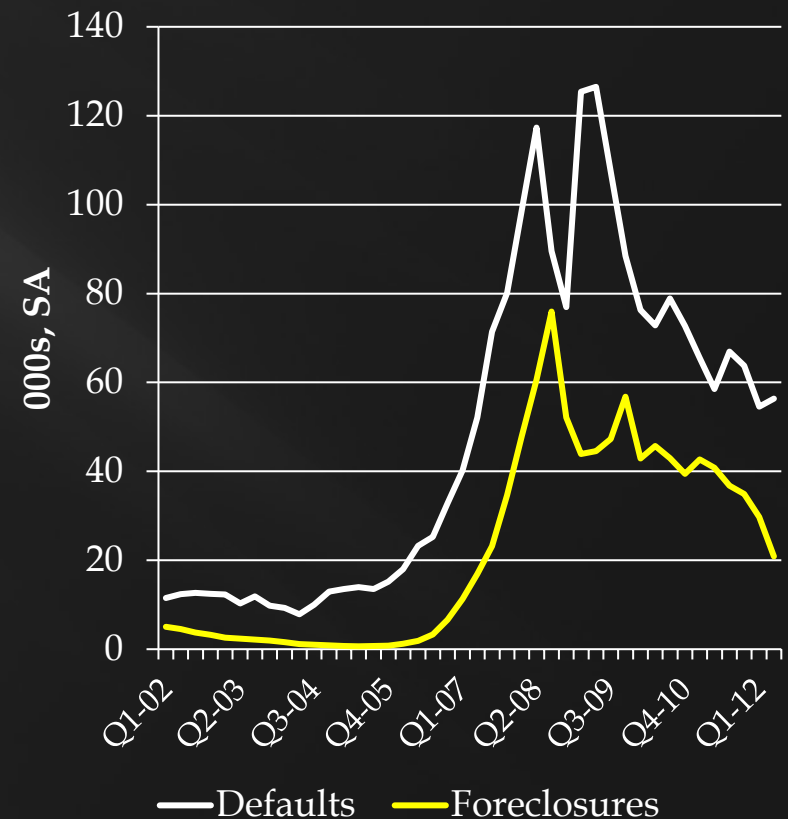


Residential Market Finally Turns

Residential Real Estate

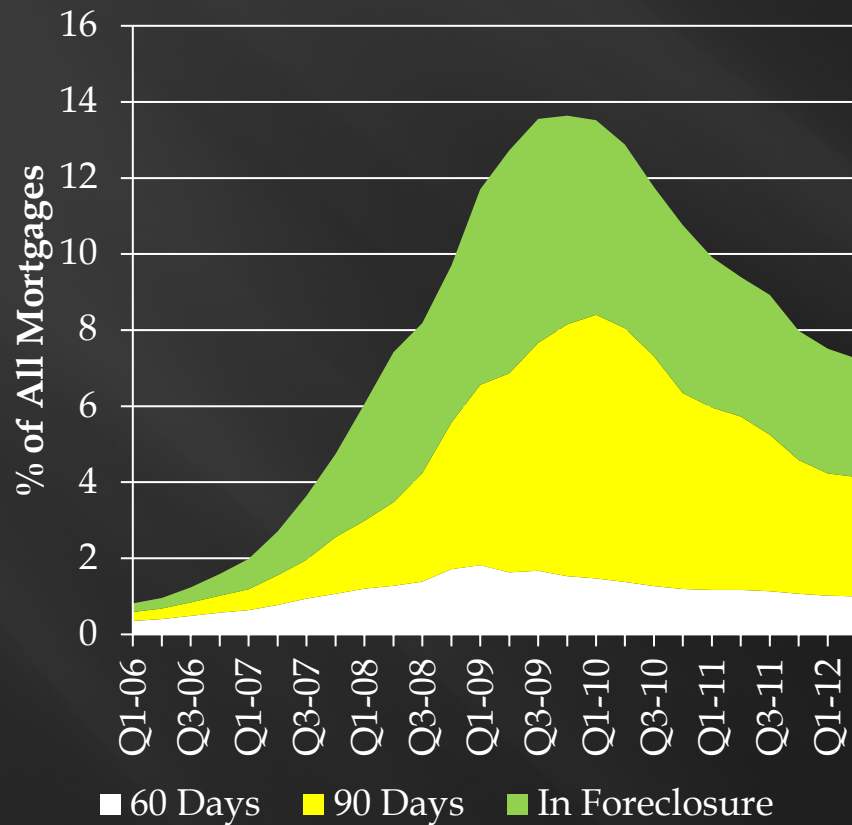


Defaults and Foreclosures

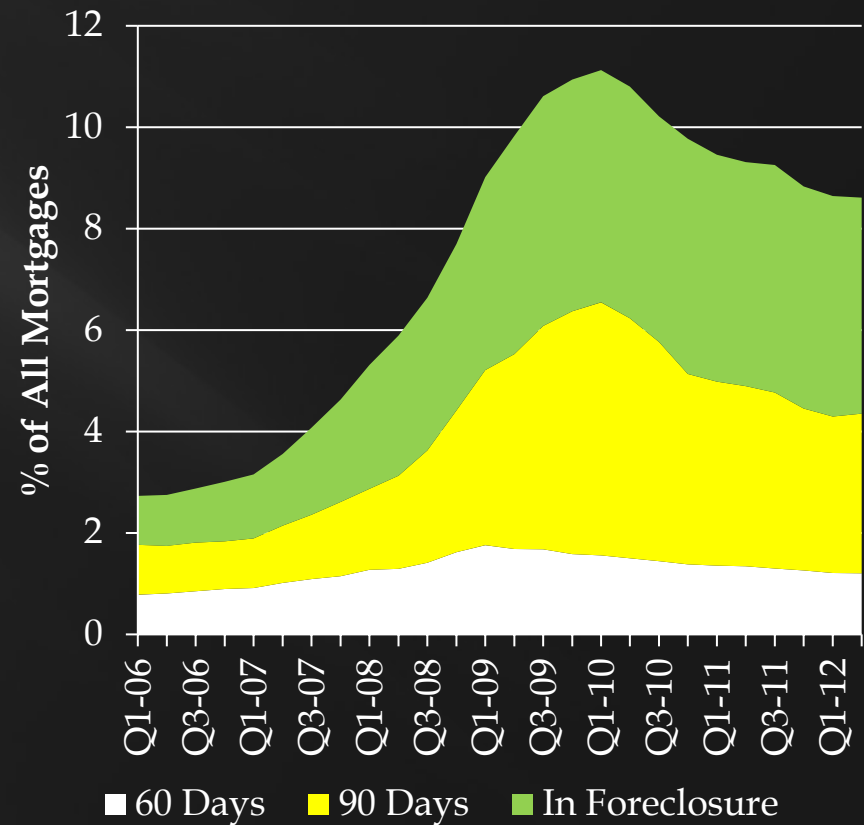


Foreclosures Dwindling

California



United States



Broad-Based Geographically

Metro Home Sales	2011 YTD	2012 YTD	Change (%)
San Diego	11,034	12,690	15.0
Orange	9,571	10,977	14.7
San Francisco MD	5,393	6,132	13.7
San Jose MSA	6,864	7,544	9.9
Los Angeles	26,916	29,224	8.6
Oakland MD	12,343	13,317	7.9
Inland Empire MSA	29,648	29,979	1.1

County Home Prices	Aug-11	Aug-12	Change (%)
Contra Costa	253,655	292,511	15.3
San Francisco	618,470	701,442	13.4
San Bernardino	148,064	165,635	11.9
Riverside	190,154	210,399	10.6
Santa Clara	481,366	531,555	10.4
Alameda	342,643	373,058	8.9
San Diego	312,179	336,953	7.9
Los Angeles	309,246	328,981	6.4
Orange	415,427	440,501	6.0
Marin	614,723	627,964	2.2



Permitting Activity Picking Up

Variable	2011 YTD	2012 YTD	Change (%)
California			
Single-Family	15,236	17,786	16.7
Multi-Family	14,214	19,546	37.5
Total Res.	29,450	37,332	26.8
United States			
Single-Family	283,351	344,458	21.6
Multi-Family	124,289	182,631	46.9
Total Res.	407,640	527,089	29.3

Commercial Markets Also Turn

Location	Cost of Rent			Vacancy Rate		
	Industrial	Office	Retail	Industrial	Office	Retail
Bakersfield	2.2	-0.2	2.6	-0.2	-1.2	0.8
Fresno	1.6	-4.3	-0.5	-1.2	0.2	1.0
Inland Empire (MSA)	6.0	-6.8	-4.2	-2.5	-1.6	-0.6
Lancaster	0.2	-10.4	-5.8	0.2	0.3	-0.7
Los Angeles (MD)	2.2	0.6	-3.5	-0.6	-0.2	-0.3
Napa	0.4	2.9	11.0	1.3	-1.1	-0.1
Oakland (MD)	1.5	-0.2	1.4	-1.2	-0.9	-0.4
Orange County (MD)	4.4	-3.4	1.4	-0.7	-0.8	0.3
Oxnard	-3.7	-2.0	-12.3	0.1	-0.5	-0.3
Sacramento	-4.2	-5.1	-8.0	-0.5	-0.3	-0.6
Salinas	8.1	0.7	-5.5	0.6	-0.5	-0.3
San Diego (MSA)	0.5	-1.3	-2.3	-0.5	-0.4	-0.6
San Francisco (MD)	11.3	19.1	-4.5	-1.2	-2.6	-0.3
San Jose (MSA)	1.5	6.7	2.1	-1.0	-2.8	-0.7
San Luis Obispo	3.9	-0.5	8.8	0.7	-1.1	-0.4
Santa Barbara	-4.6	0.8	-1.2	-2.5	0.1	0.2
Santa Cruz	1.3	4.8	-3.7	-0.3	-1.1	-0.6
Santa Rosa	-2.0	0.5	1.0	-1.2	0.8	-0.9
Stockton	2.1	-4.8	3.6	-5.0	0.6	-0.8
Vallejo-Fairfield	-2.7	-5.7	4.0	-1.0	-1.1	-0.6
Visalia	2.7	1.7	2.0	1.1	0.6	-0.6



Shifting from Alts to New

Nonresidential Permit Values by Type (\$ Millions)

Permit Type	2010	2011	2011 YTD	2012 YTD	Change (%)
New Commercial	1,990	2,213	895	1,224	36.8
Office	627	672	300	474	57.7
Retail	896	956	342	571	67.1
Hotel	97	164	67	43	-35.7
Industrial	358	479	274	302	9.9
Other Nonres.	1,937	2,225	1,047	1,077	2.8
Nonres. Alts./ Adds.	6,914	8,145	3,944	3,452	-12.5
Total Nonres.	11,200	13,061	6,161	6,054	-1.7



Opportunity Knocks: Addressing Persistent Structural Issues



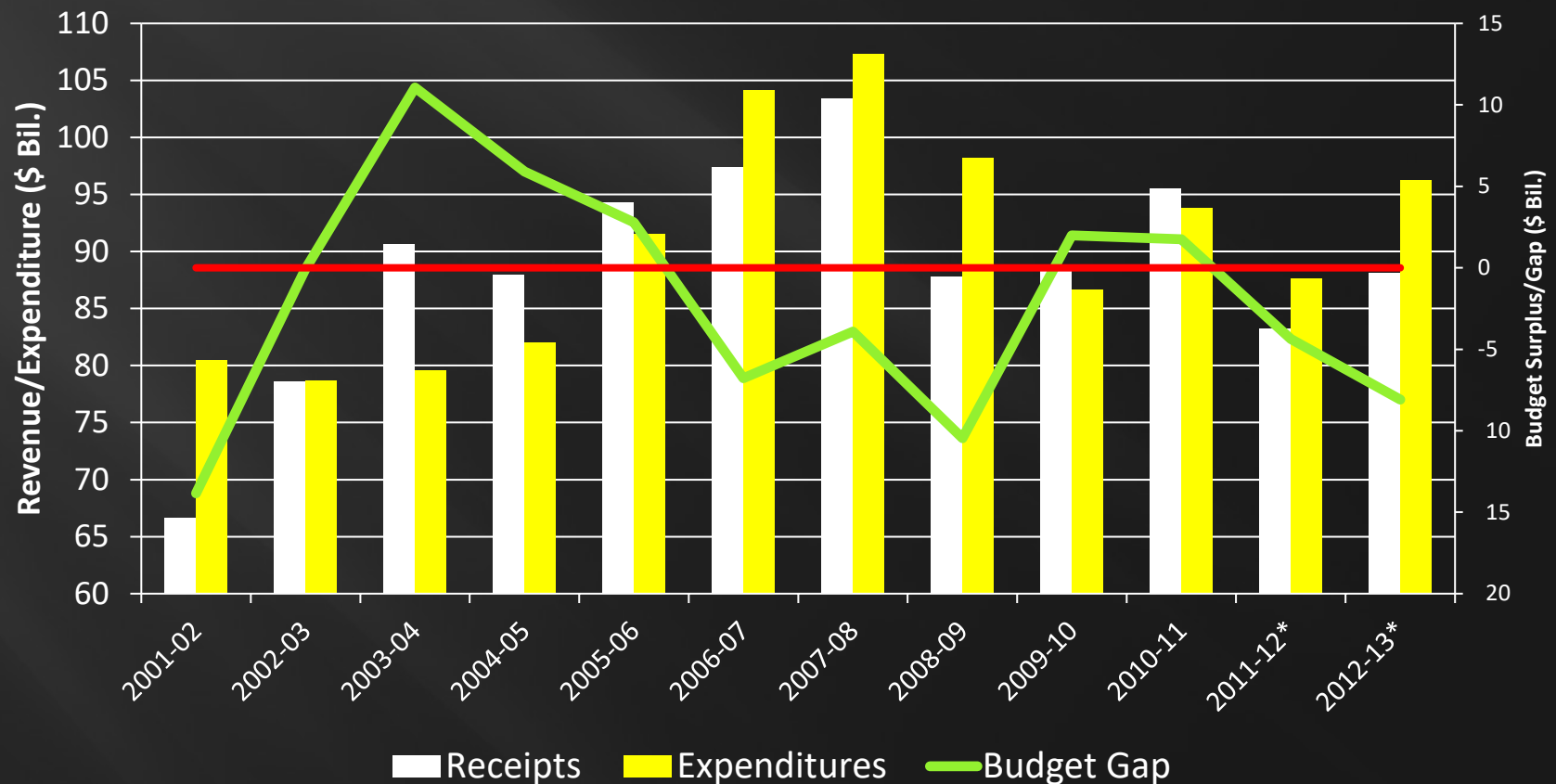
Fiscal Deficits, Housing Costs, and Educational Attainment

California's Chronic Deficit

	2011-12	2012-13
Prior Year Balance	-2,508	-6,879
Revenues/Transfers	83,238	88,137
Total Resources	80,730	81,258
Non-Prop. 98 Expenditures	54,195	59,074
Prop. 98 Expenditures	33,414	37,157
Total Expenditures	87,609	96,231
Fund Balance	-6,879	-14,973
Reserve for Liquidation of Encumbrances	719	719
Special Fund for Economic Uncertainties	-7,598	-15,692
Total Available Reserve	-7,598	-15,692

What Went Wrong

General Fund Receipts/Expenditures



Cyclical Revenues & Tough Cuts

	2007-08	2011-12	Diff. (%)	
Personal Income	54,849	55,495	1.2	
Sales Tax	26,837	19,997	-25.5	
Corporate Tax	10,124	8,488	-16.2	
Other Revenues	5	4,156	N/A	
Total Revenues	96,379	88,136	-8.6	

	2007-08	2011-12	Diff.	Diff. (%)
Health Human Services	28,688	26,772	-1,916	-6.7
K-12 Education	35,595	34,038	-1,557	-4.4
Corrections/Rehabilitation	9,489	8,082	-1,407	-14.8
Higher Education	10,624	9,770	-854	-8.0
General Government	2,616	1,767	-849	-32.5
EPA	74	51	-23	-30.9
State & Consumer Services	558	619	61	11.0
Legislative/Judicial/Executive	1,575	2,541	966	61.3

Budget Prescription: Permanent Solutions

- ▣ Temporary solutions only help temporarily
 - Governor wants temp. hike to sales/income taxes
 - Kicking the can down the road until they expire
- ▣ Cuts to education and healthcare do save
 - Effects enjoyed over the short run
 - Makes it hard to achieve long-term goals or maintain competitiveness with other states
- ▣ Look at reforming how we raise and spend
 - Taxing services, Prop. 13, mandatory spending, pension reform, etc., etc. – everything's an option



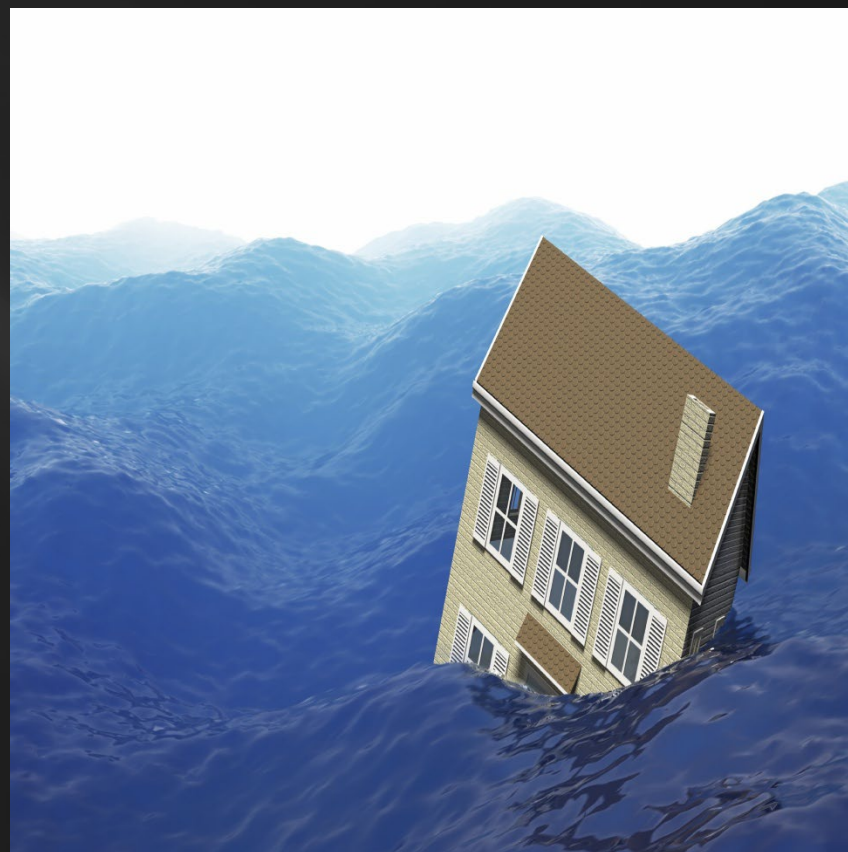
Education Costs, But It Pays Too

	Unemp. Rate (%)	Median Income (\$)
Less than HS	16.1	17,937
High School	14.0	27,122
Some College/ Associate's	11.4	35,735
Bachelor's/Higher	6.7	63,336

- ▣ Education critical to remain competitive
- ▣ 2020 job growth:
 - Post-secondary – 17.4%
 - High School/Less – 12.9%
- ▣ Professional/Business & Advanced Manufacturing Forecast to do well
 - Requires skilled workers

The Real Culprit: Housing Costs

- ▣ Fundamental Issue:
 - Not “Business Friendliness” per se, though we can learn from other states
 - Housing Costs key
- ▣ Long-Run Supply/ Demand – Not Enough Housing
- ▣ Has effects on the cost of doing business



Where Do We Stack Up?

MSA	Median Home Price
San Jose	535,500
Los Angeles	328,150
Inland Empire	174,300
Austin	193,200

State	Rental Vacancy	Rental Vacancy Rank	Owner Vacancy	Owner Vacancy (Rank)
Vermont	3.32	1	2.24	31
Washington	4.98	2	2.25	32
Wyoming	5.03	3	1.00	1
Wisconsin	5.07	4	1.87	18
California	5.21	5	1.98	21
Oregon	5.24	6	2.03	25
Montana	5.48	7	1.17	3
North Dakota	5.86	8	1.33	6
Colorado	5.97	9	2.13	27
Utah	6.03	10	1.70	13



Implications of Undersupply

	California	Texas
Owner-occupied housing units:	6,903,175	5,555,903
Paying 30% of Income or More	2,899,692	1,411,953
Paying 30% or More (%)	42.00%	25.40%
Renter-Occupied Housing Units	5,503,300	3,182,761
Paying 30% of Income or More	2,994,035	1,473,788
Paying 30% or More (%)	54.40%	46.30%
Total Occupied Housing Units	12,406,475	8,738,664
Paying 30% of Income or More	5,893,727	2,885,741
Paying 30% or More (%)	47.50%	33.00%

The Forecast

- ▣ Calling for continued slow growth in 2012
- ▣ Housing markets finally turning:
 - Expect moderate growth in sales and prices
- ▣ Permitting expected to resume upward trend
 - Residential shifting toward multi-family
- ▣ Consumer spending forecast to continue uptick
 - Coastal regions leads on that front
 - Bolstered by a strong tourism market



California Forecast Highlights

Indicator	2011	2012	2013	2014
Total Population	37,615,412	37,932,730	38,331,743	38,802,915
Growth (%)	0.7	0.8	1.1	1.2
Unemployment Rate (%)	11.8	10.7	10.1	9.3
Change (%)	-0.6	-1.0	-0.6	-0.8
Total Nonfarm Employment (000s)	14,071.2	14,305.4	14,574.7	14,890.3
Growth (%)	1.0	1.7	1.9	2.2
Median Home Price	245,053	264,041	276,883	286,495
Growth (%)	-4.3	7.7	4.9	3.5
Existing Home Sales	324,957	351,214	354,412	367,972
Growth (%)	0.0	8.1	0.9	3.8
Nonresidential Permit Values (\$000s)	13,051,217	15,124,296	16,437,667	17,217,609
Growth (%)	16.6	15.9	8.7	4.7
Single-Family Building Permits (000s)	21.6	26.6	37.7	51.4
Multi-Family Building Permits (000s)	25.5	34.7	48.0	64.0
Taxable Sales (\$ Millions)	524,548	566,178	595,283	629,138
Growth (%)	9.8	7.9	5.1	5.7

Wrap-Up: Denialist vs. Declinist

- ▣ California is not in or headed for a Great Depression
- ▣ California is actually outpacing the U.S. in key areas
- ▣ Housing starting to turn the corner
- ▣ Trade slowing—part Europe, part catch-up
- ▣ Labor markets continue to increase
- ▣ Forecast calls for continued improvement in 2012 and beyond—though the pace of growth will leave something to be desired





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