## Attachment A Summary of Recommendations

## Attachment A Summary of Recommendations

For convenience, this section repeats the recommendations contained in the main report. There is no new information in Attachment A.

***Recommendation 1:*** *That the Board of Supervisors approve a policy position to designate toward general fund capital projects all revenue distributed to the county resulting from liquidation of the assets of former redevelopment agencies.*

***Recommendation 2:*** *That the Board of Supervisors 1) approve and direct the Auditor-Controller to make adjustments to estimated revenue in the amount of $1,216,548 and appropriations totaling $858,858 pertaining to the Solar Power Plant Program; and 2) to approve commitment of the remaining unappropriated solar program revenue in the amount of $357,690, as follows:*

| | | |
|---|---|---|
| Increase estimated revenue: | | |
| 10000-1102900000-725020 | Franchises | $1,216,548 |
| | | |
| Increase appropriations: | | |
| 10000-1102900000-525200 | Legal services | 297,920 |
| 10000-1102900000-525500 | Salary & benefit reimbursement | 123,755 |
| 10000-1102900000-551100 | Contribution to other funds | 437,183 |
| | Total | 858,858 |
| | | |
| Commitment of fund balance: | | |
| 10000-1102900000-330100 | Committed fund balance | 357,690 |
| | | |
| Increase appropriations: | | |
| 10000-1100100000-573400 | Intrafund – Salary & benefit reimbursement | (42,760) |
| | | |
| Anticipated increase in available fund balance: | | |
| 10000-1100100000-370100 | Unassigned fund balance | 42,760 |
| | | |
| Increase appropriations: | | |
| 10000-3120100000-573400 | Intrafund – Salary & benefit reimbursement | (80,995) |
| | | |
| Anticipated increase in available fund balance: | | |
| 10000-3120100000-370100 | Unassigned fund balance | 80,995 |
| | | |
| Increase estimated revenue: | | |
| 20200-3100200000-790600 | Contribution from other county funds | 437,183 |
| | | |
| Increase appropriations: | | |
| 20200-3100200000-525020 | Legal services | 50,000 |
| 20200-3100200000-525440 | Professional services | 19,316 |
| 20200-3100200000-529040 | Private mileage | 133 |

| | | |
|---|---|---|
| 20200-3100200000-537020 | Interfund Expense – legal services | 320,829 |
| | Total | 390,278 |

Anticipated increase in available fund balance:

| | | |
|---|---|---|
| 20200-3100200000-350100 | Assigned fund balance for program money | 46,905 |

***Recommendation 3:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations in the amount of $591,100 for Human Resource's Delta Dental fund, as follows:*

Increase appropriations:

| | | |
|---|---|---|
| 45860-1130600000-523350 | Administrative expense | $ 91,100 |
| 45860-1130600000-534240 | Dental claims | 500,000 |
| | | 591,100 |

Anticipated use of unrestricted net assets:

| | | |
|---|---|---|
| 45860-1130600000-380100 | Unrestricted net assets | 591,100 |

***Recommendation 4:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue in the amount of $720,000 for the Temporary Assistance Pool, as follows:*

Increase estimated revenue:

| | | |
|---|---|---|
| 47000-1131800000-777540 | Reimbursement of salaries | $225,000 |

Increase appropriations:

| | | |
|---|---|---|
| 47000-1131800000-510040 | Regular salaries | 150,000 |
| 47000-1131800000-510200 | Payoff permanent-seasonal | 75,000 |
| 47000-1131800000-510240 | Per diem salaries | 25,000 |
| 47000-1131800000-510280 | Other pay - non-specified | 225,000 |
| 47000-1131800000-518180 | Budgeted benefits | 95,000 |
| 47000-1131800000-510320 | Temporary salaries | 150,000 |
| | | 720,000 |

Anticipated use of unrestricted net assets:

| | | |
|---|---|---|
| 47000-1131800000-380100 | Unrestricted net assets | 495,000 |

***Recommendation 5:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue in the amount of $214,014 for the Desert Expo, as follows:*

Increase appropriations:

| | | |
|---|---|---|
| 22200-1920100000-525320 | Security guard services | $ 18,000 |
| 22200-1920100000-526530 | Rent-lease equipment | 40,000 |
| 22200-1920100000-529540 | Utilities | 34,267 |
| 22200-1920100000-537020 | Interfund exp-legal services | 6,617 |

| | | |
|---|---|---|
| 22200-1920100000-537180 | Interfund exp-salary reimbursement | 115,220 |
| | Total appropriations | 214,104 |

Increase estimated revenue:

| | | |
|---|---|---|
| 22200-1920100000-741020 | Admissions | 87,387 |
| 22200-1920100000-741060 | Carnival | 33,073 |
| 22200-1920100000-741230 | Fair time alcohol sales | 14,095 |
| 22200-1920100000-741380 | Parking | 42,403 |
| 22200-1920100000-781120 | Rebates and refunds | 37,146 |
| | Total estimated revenue | 214,104 |

***Recommendation 6:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue in the amount of $1.3 million for the Fire Department, as follows:*

Decrease appropriations:

| | | |
|---|---|---|
| 10000-1109000000-581000 | Appropriations for contingency | $1,000,000 |

Increase appropriations:

| | | |
|---|---|---|
| 10000-2700200000-525440 | Professional services | 1,000,000 |
| 10000-2700200000-546160 | Equipment other | 300,000 |
| | Total | 1,300,000 |

Increase estimated revenue:

| | | |
|---|---|---|
| 10000-2700200000-767220 | Fed-Other operating grants | 300,000 |

***Recommendation 7:*** *That the Board of Supervisors approve amending Ordinance 440 to add one IT supervising user support technician and one secretary II position and to delete one IT user technician III and one office assistant III.*

***Recommendation 8:*** *That the Board of Supervisors 1) authorize the county purchasing agent to purchase 13 vehicles and six computer servers; and, 2) approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue for a net total of $755,960 for Probation, as follows:*

Increase estimated revenue:

| | | |
|---|---|---|
| 10000-2600200000-755900 | CA-AB118 Local revenue | $755,960 |

Decrease appropriations:

| | | |
|---|---|---|
| 10000-2600200000-510040 | Regular salaries | 290,000 |

Increase appropriations:

| | | |
|---|---|---|
| 10000-2600200000-536240 | Other contract agencies | 755,960 |
| 10000-2600200000-546080 | Equipment - computer | 40,000 |
| 10000-2600200000-546320 | Vehicles - cars/light trucks | 250,000 |
| | | 1,045,960 |

***Recommendation 9:*** *That the Board approve and direct the Auditor-Controller to make budget adjustments to appropriations and estimated revenue for the Agricultural Commissioner, as follows:*

| | | |
|---|---|---|
| Increase estimated revenue: | | |
| 10000-2800100000-752060 | Unclaimed gas tax | $20,000 |
| | | |
| Decrease appropriations: | | |
| 10000-2800100000-510040 | Regular salaries | 26,000 |
| 10000-2800100000-518100 | Budgeted benefits | 24,000 |
| | Total | 50,000 |
| | | |
| Increase appropriations: | | |
| 10000-2800100000-520800 | Household expense | 20,000 |
| 10000-2800100000-522310 | Maintenance – building and improvement | 10,000 |
| 10000-2800100000-523640 | Computer equipment – non-fixed asset | 30,000 |
| 10000-2800100000-526960 | Small tools and instruments | 10,000 |
| | Total | 70,000 |

***Recommendation 10:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue totaling $1,359,184 for Public Health, as follows:*

| | | |
|---|---|---|
| Increase estimated revenue: | | |
| 10000-4200200000-751210 | CA Medi-Cal | $ 693,184 |
| 10000-4200200000-751500 | CA-realignment | 462,123 |
| 10000-4200200000-751680 | CA-grant revenue | 203,877 |
| | Total | 1,359,184 |
| | | |
| Increase appropriations: | | |
| 10000-4200200000-530220 | Support and care of persons | 1,359,184 |

***Recommendation 11:*** *That the Board of Supervisors authorize the Department of Mental Health to purchase one (1) dishwasher and two (2) freezers for the Oasis Psychiatric Health Treatment facility.*

***Recommendation 12:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue totaling a net decrease of $4.3 million for DPSS, as follows:*

| | | |
|---|---|---|
| Decrease estimated revenue: | | |
| 10000-5100100000-760000 | Fed-Public assistance admin | $4,500,000 |
| 10000-5100100000-750300 | CA-Public assistance admin | 500,000 |
| | Total | 5,000,000 |

Increase estimated revenue:

| | | |
|---|---|---|
| 10000-5100100000-767220 | Fed-other operating grants | 700,000 |

Increase appropriations:

| | | |
|---|---|---|
| 10000-5100100000-525440 | Professional Services | 700,000 |

Decrease appropriations:

| | | |
|---|---|---|
| 10000-5100100000-530420 | Child Care Services | 5,000,000 |

***Recommendation 13:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations by $200,000 for the Community Action Partnership, as follows:*

Decrease appropriations:

| | | |
|---|---|---|
| 21050-5200200000-510040 | Regular Salaries | $200,000 |

Increase appropriations:

| | | |
|---|---|---|
| 21050-5200300000-510040 | Regular salaries | 130,000 |
| 21050-5200300000-527780 | Special program expense | 50,000 |
| 21050-5200300000-526700 | Rent-lease buildings | 20,000 |
| | Total | 200,000 |

***Recommendation 14:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenues in the amount of $982,000 for Fleet Services, as follows:*

Increase appropriations:

| | | |
|---|---|---|
| 45300 7300500000 527106 | Fuel-bulk unleaded | $982,000 |

Increase estimated revenue:

| | | |
|---|---|---|
| 45300 7300500000 777070 | Fuel sales | 982,000 |

***Recommendation 15:*** *That the Board of Supervisors approve and direct the Auditor Controller to make budget adjustments increasing appropriations by $420,000 and release committed fund balance in the amount of $150,000 for Flood Control, as follows:*

Increase appropriations:

| | | |
|---|---|---|
| 15000-947180-510040 | Regular salaries | $155,000 |
| 15000-947180-518100 | Budgeted benefits | 115,000 |
| | Total | 270,000 |

Anticipated use of unassigned fund balance:

| | | |
|---|---|---|
| 15000-947180-370100 | Unassigned fund balance – Flood | 270,000 |

Increase appropriations:

| | | |
|---|---|---|
| 25190-947560-510040 | Regular salaries | 90,000 |
| 25190-947560-518100 | Budgeted benefits | 60,000 |
| | Total | 150,000 |

Release committed fund balance:

| | | |
|---|---|---|
| 25190-947560-330100 | Committed fund balance | 150,000 |

***Recommendation 16:*** *That the Board of Supervisors approve and direct the Auditor-Controller to make adjustments to appropriations and estimated revenue in the amount of $45,000 for CSA 51, as follows:*

Increase appropriations:

| | | |
|---|---|---|
| 23525-905102-537180 | Interfund exp-salary reimbursement | $45,000 |

Increase estimated revenue:

| | | |
|---|---|---|
| 23525-905102-777300 | Irrigation water service | 45,000 |

## Attachment B Resolution No. 440-8885 Amending Ordinance No. 440

### Resolution No. 440-8885

BE IT RESOLVED by the Board of Supervisors of the County of Riverside, State of California, in regular session assembled on May 1, 2012, that pursuant to Section 4(a)(ii) of Ordinance No. 440, the Executive Office is authorized to make the following listed change(s), operative on the date of approval, as follows:

| Job code | +/- | Department ID | Class Title | Type |
|---|---|---|---|---|
| 86187 | +1 | 2600700000 | IT Supervising User Support Technician | Regular |
| 13924 | +1 | 2600700000 | Secretary II | Regular |
| 86185 | -1 | 2600700000 | IT User Support Technician III | Regular |
| 13866 | -1 | 2600700000 | Office Assistant III | Regular |

## Attachment C Sales and Use Tax Update

Q4 2011

# Riverside County Sales Tax *Update*

*First Quarter Receipts for Fourth Quarter Sales (October - December 2011)*

## Riverside County In Brief

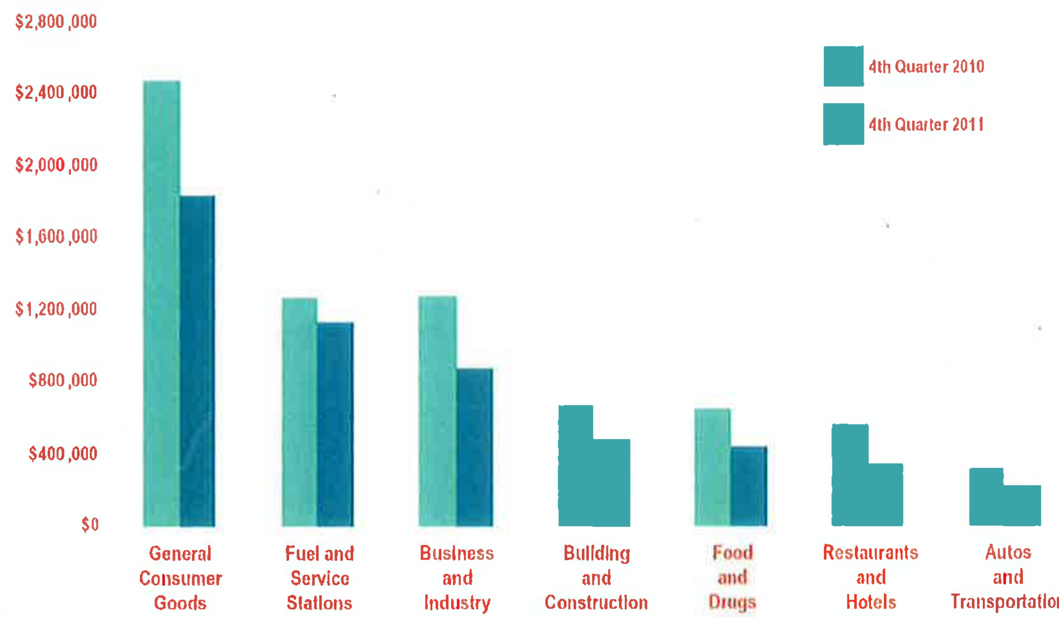
Receipts for the unincorporated area's October through December sales were 23.9% lower than the same quarter one year ago. Actual sales activity was down 22.4% when reporting aberrations were factored out.

The decline in all business groups reflects the shift of sales tax from the county to the newly incorporated cities of Eastvale and Jurupa Valley. Eastvale incorporated a year ago, however, this is the first quarter that shifts sales tax receipts to Jurupa Valley.

Same store sales in general consumer goods for this holiday season showed gains with new stores adding to the increase. An additional station partially offset the shift in service stations. Onetime use tax, several retroactive adjustments, a couple of new enterprises and a rise in agricultural equipment/products helped soften the decline in business and industry.

Adjusted for aberrations, taxable sales for all of Riverside County increased 10.1% over the comparable time period, while the Southern California region as a whole was up 7.6%.

## Sales Tax by Major Business Group




## Top 25 Producers

In Alphabetical Order

| | |
|---|---|
| Albertsons | Gucci America |
| Arco Travel Zone Center | Mecca Travel Center Subway |
| Blackgold Operations | Morongo Shell |
| Burberry | Nike |
| California Trusframe | Pilot Travel Centers |
| Calvin Klein | Ralph Lauren |
| Chevron | RDO Equipment |
| Circle K | Space Prada Miu Miu |
| Coach | Stater Bros |
| Dos Lagos Arco | Vestas American Wind Technology |
| French Valley Shell | Volvo Construction Equipment |
| G & M Oil | Vons |
| General Electric | |

## Revenue Comparison

Three Quarters – Fiscal Year To Date

| | 2010-11 | 2011-12 |
|---|---|---|
| Point-of-Sale | $19,750,365 | $18,363,430 |
| County Pool | 1,978,793 | 2,107,696 |
| State Pool | 9,819 | 2,149 |
| Gross Receipts | $21,738,977 | $20,473,274 |
| Cty/Cnty Share | 9,988 | 0 |
| Net Receipts | $21,748,965 | $20,473,274 |
| Less Triple Flip* | $(5,437,241) | $(5,118,319) |

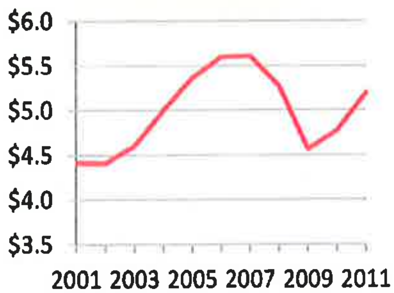
**Reimbursed from county compensation fund*

Published by HdL Companies in Spring 2012
www.hdlcompanies.com | 888.861.0220

## California Overall

Retail sales in the final quarter of 2011, excluding onetime reporting aberrations, were up 7.8% compared to the same period in 2010. Strong 4th quarter sales brought statewide calendar year 2011 within 7.25% of the pre-recession peak reached in 2006. At their 2009 low point, retail sales were 18.6% below their 2006 highs.

**CA Local Sales Tax Receipts in $Billions**




To close the remaining gap, annual retail sales need to grow by $40.5 billion, a daunting task with high unemployment and weak housing markets still hindering growth. Retail sales have risen on strong demand for new autos, increased consumer spending, significant use tax receipts from alternative energy projects and federal stimulus funded infrastructure projects. However, rising fuel costs and continued economic uncertainties are expected to slow the rate of growth in the second half of this year.

### Retailers downsizing ... creating new opportunities and challenges

A recent survey concluded that 53% of the U.S. population has made an online purchase and that 7% of all retail sales are now done over the Internet. With mobile and tablet shopping capabilities making online purchases ever easier, Internet market share is expected to hit 9% by 2016.

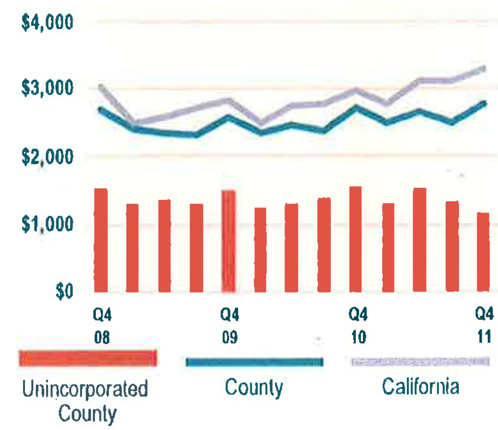
The ease of online research has sharpened price competition and brick and mortar retailers are racing to accommodate the new consumer patterns by focusing on enhancing the shopping experience. This includes the development of more intimate shopping environments, use of social media to reach buyers, higher levels of customer service, specialized merchandise that cannot be purchased elsewhere and expanding the selection of goods offered with in-store kiosks supplemented with timely deliveries.

To cut overhead and compete on price, more retailers are going to the "endless aisle" concept of selling items not actually in the store. This allows the retailer to increase product variety in a smaller space.

Almost every major retailer has plans for either downsizing the footprint of new stores or subleasing space in existing stores.

On the plus side, this trend allows entrance into retail markets too small for large format stores to be feasible. Less populous communities could find their retail bases growing with new compact stores offering the same or more merchandise as their larger counterparts. Communities with substantial existing retail could see new challenges in filling vacated space while also keeping up with the need for more inviting shopping environments.

## Sales Per Capita




## Riverside County Top 15 Business Types

| Business Type | Unincorporated County Q4 '11* | Unincorporated County Change | County Change | HdL State Change |
|---|---|---|---|---|
| Contractors | 330.6 | -12.1% | 3.3% | 17.9% |
| Energy/Utilities | 176.4 | na | 519.5% | -13.6% |
| Family Apparel | 792.0 | 3.6% | 9.1% | 10.6% |
| Garden/Agricultural Supplies | 93.9 | 68.6% | 10.3% | 9.6% |
| Grocery Stores Beer/Wine | 132.8 | -29.8% | 14.1% | 4.6% |
| Grocery Stores Liquor | 179.1 | -43.4% | -7.1% | -1.2% |
| Lumber/Building Materials | 81.9 | -59.9% | 9.8% | 8.2% |
| Restaurants No Alcohol | 216.2 | -41.2% | 9.7% | 7.3% |
| Service Stations | 1,103.4 | -12.2% | 13.9% | 14.7% |
| Shoe Stores | 149.7 | 1.0% | 4.6% | 6.7% |
| Specialty Stores | 167.3 | -4.2% | 34.6% | 2.1% |
| Trailers/RVs | 77.3 | -18.9% | 10.0% | 9.8% |
| Warehse/Farm/Const. Equip. | 107.7 | 5.5% | 16.6% | 22.9% |
| Wineries | 175.6 | 9.8% | 14.3% | 11.9% |
| Women's Apparel | 431.3 | 25.1% | 13.9% | 6.8% |
| **Total All Accounts** | **$5,339.3** | **-26.2%** | **5.9%** | **7.8%** |
| **County & State Pool Allocation** | **738.1** | **-0.1%** | | |
| **Gross Receipts** | **$6,077.5** | **-23.8%** | | |
| **City/County Share** | **0.0** | **-100.0%** | | |
| **Net Receipts** | **$6,077.5** | **-23.9%** | | |

*In thousands

# California Forecast: Sales Tax Trends and Economic Drivers

April 2012

HdL provides relevant information and analyses on the economic forces affecting California's local government agencies. In addition, HdL's Revenue Enhancement Services and software help clients to maximize revenues.

HdL serves over 350 cities, counties and special districts in California and across the nation.

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HdL Consensus Forecast – April 2012

# STATEWIDE SALES TAX TRENDS

| | 2011-12 | 2012-13 |
|---|---|---|
| **Autos/Transportation** | 10.1% | 6.5% |

The need to replace aging fleets and personal vehicles along with improved availability of new models following months of limited production in Asia have contributed to significant sales gains in recent quarters. Easing credit restrictions and consumer demand for better fuel efficiency is adding to auto manufacturers' confidence of a steady recovery although the pace of the recovery is expected to be slightly slower in 2012-2013 as economic uncertainty continues and the most critical pent-up demand is satisfied.

| | | |
|---|---|---|
| **Building/Construction** | 7.3% | 6.5% |

Resurgence in home remodeling is helping sustain home improvement chain store sales. Federal stimulus funded infrastructure and energy projects are finally underway and showing up in the sales tax data. Some regions of the state are also reporting significant upticks in permitting activity particularly for office/industrial space and multiple family housing.

| | | |
|---|---|---|
| **Business/Industry** | 4.7% | 4.0% |

Companies are continuing to invest in new technology and equipment but economic slowdowns in Europe and Asia and political discord at home will keep expenditures cautious and gains moderate. Much of the projected state-wide increase in this segment will be from onetime use tax related to the construction and equipping of new energy generation projects.

| | | |
|---|---|---|
| **Food/Drugs** | 4.5% | 3.0% |

Chains continue to combat inroads by warehouse retailers, dollar stores and new specialty concepts with new merchandise and prepared food offerings. However, most of the projected gain for this segment will come from higher prices on fuel sold by convenience stores and some grocery chains and from the inflationary impact of rising transportation costs on taxable merchandise.

| | | |
|---|---|---|
| **Fuel/Service Stations** | 20.7% | 6.0% |

Gasoline prices are becoming more reflective of international rather than declining local demand and the U.S. has recently become a net exporter of fuel products. The recent closure of several unprofitable U.S. refineries and unrest in the Middle East boosted speculation that supplies would become tighter which resulted in the recent jump in crude oil futures. Prices are expected to level off but not retreat significantly from current highs.

| | | |
|---|---|---|
| **General Consumer Goods** | 4.7% | 3.5% |

Improved employment confidence, credit availability and pent up demand has resulted in better than anticipated sales in recent quarters. Even so, consumers remain cautious and primarily oriented toward discounts and value. Most of the recent gains have been in the luxury and low cost segments while those marketing to the shrinking middle class continue to struggle. The competition to reposition and accommodate the growing trend toward online shopping is expected to increase the numbers of retail winners and losers in the coming year.

| | | |
|---|---|---|
| **Restaurants/Hotels** | 6.5% | 4.0% |

Increased business travel, growing employment confidence, austerity fatigue and the popularity of new fast-casual dining concepts are helping produce gains in some restaurant segments.

| | | |
|---|---|---|
| **State and County Pools** | 8.2% | 4.7% |

Private vehicle transactions have been on the rise as have equipment leases and out-of-state purchases of business equipment and supplies. The gains are expected to level slightly in 2012-13. The impact of State and Federal proposals to more effectively collect taxes on out-of state purchases remains unclear.

| | | |
|---|---|---|
| **TOTAL** | 8.0% | 4.7% |

The **Propostion 172** growth factor is **7.6%** for Fiscal Year 2011-12. This factor varies from HdL's Bradley Burns growth rates due to differing collection periods and comparisons to prior year data that include onetime payment aberrations.

BEACON ECONOMICS

National and Statewide
# ECONOMIC DRIVERS

April 2012

| | 2011-12 | 2012-13 |
|---|---|---|
| **U.S. Real GDP Growth** | 2.6% | 3.1% |

U.S. real gross domestic product picked up at the end of 2011. The current estimate from the Bureau of Economic Analysis is 3% for the fourth quarter. Business investments in equipment and software, as well as inventory building, and consumer spending all contributed positively to real GDP last quarter. Even the residential component has started to add to growth. Beacon Economics is forecasting that the fiscal year will end with 2.6% growth continuing into 2012-13 at a 3.1% rate, though still well below post-recession norms.

| | | |
|---|---|---|
| **U.S. CPI Inflation** | 3.0% | 2.5% |

Overall CPI growth picked up in the second half of 2011. However, this could be due to rising oil and commodity prices rather than the aftereffects of the Federal Reserve's quantitative easing program, which is still lingering on bank balance sheets in the form of excess reserves and therefore has yet to exert much upward pressure on prices. With modest growth in the economy, we expect inflation to remain below 3% through mid 2013.

| | | |
|---|---|---|
| **California Population** | 37,764,678 | 38,125,560 |

The 2010 Census brought downward revisions to California's population base by a relatively large amount. Still, net migration, though still negative in 2011, was the least amount of out-migration that California has seen since 2004, and it is trending back toward positive territory. In addition, natural population increase continues to contribute to overall population growth. Population is expected to experience modest growth of 0.7% in 2011-12 and rising to 1% in 2012-13 as migration levels off.

| | | |
|---|---|---|
| **California Total Nonfarm Employment Growth** | 1.1% | 2.4% |

When the Employment Development Department released its benchmark revision in early March, there were some interesting changes. Our leading sectors in professional and finance categories look better than previously reported, while government and the other services sectors saw sharp downward revisions. Overall, the growth picture is slightly less positive over the past six months than previously reported, though the story continues to be one of improvement in California's labor markets. Expect nonfarm employment growth to increase by 1.1% this year and pick up momentum in 2012-13

| | | |
|---|---|---|
| **California Unemployment Rate** | 11.1% | 9.8% |

The state's unemployment rate dipped below 11% for the first time since April 2009. These are solid gains driven by genuine expansion in California's labor markets. The unemployment rate is expected to continue its gradual decline-averaging 11.1% this fiscal year and falling below 10% in 2012-13.

| | | |
|---|---|---|
| **California Existing Home Sales** | 324,724 | 343,048 |

The gradual healing of California's economy coupled with affordable home prices and low interest rates have helped to spur home sales in the Golden State. Through February, home sales had increased for almost 7 months consecutively. As the labor markets improve and prices and interest rates remain low, home sales are expected to continue to grow—totaling almost 325,000 in 2011-12, and surpassing 340,000 in 2012-13.

| | | |
|---|---|---|
| **California Median Existing Home Prices** | $ 239,300 | $ 242,500 |

The increase in demand has started to give way to some very modest price appreciation. As sales increase and the share of distressed properties in the sales mix declines, home prices are expected to begin growing at a very tepid pace—though one that is more in line with income growth in the state and thus more sustainable.

| | | |
|---|---|---|
| **California Multi-Family Building Permits** | 26,600 | 39,600 |

Although single-family construction has been bouncing around the bottom, multi-family building permits have been on a consistent upward trend since early 2010. This is especially true along the state's coastal regions in the Bay Area and Southern California. This trend is expected to continue as space constraints and preferences shift a larger portion of the state's residential construction toward multi-family housing.

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California's allocation data trails actual sales activity by three to six months. HdL compensates for the lack of current information by reviewing the latest reports, statistics and perspectives from fifty or more economists, analysts and trade associations to reach a consensus on probable trends for coming quarters. The forecast is used to help project revenues based on statewide formulas and for reference in tailoring sales tax estimates appropriate to each client's specific demographics, tax base and regional trends.

"Good information leads to good decisions."

BEACON ECONOMICS

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## Attachment D Economic Report from California State University, Fullerton

CALIFORNIA STATE UNIVERSITY FULLERTON

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# COUNTY OF RIVERSIDE
# FORECASTS AND ECONOMIC OUTLOOK

for

COUNTY OF RIVERSIDE

16 April 2012
Revised 20 April 2012

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# A. RIVERSIDE BUDGETARY VARIABLES

## A1. Property Tax Revenue

The County of Riverside provided the Institute for Environmental and Economic Studies (*IEES*) with *secured property tax* data on 903,611 property parcels for FY 2011-2012. This secured property tax data differs from the Riverside County Assessor's records which has a total of 940,618 parcels. In contrast to the Riverside County Assessor's office, the data provided to us excludes a number of items such as tax exemptions, fixtures, trees & vines, unsecured property, personal property and a few other data which are subject to time-recording and other accounting issues. Despite these differences, the data provided by the county and analyzed by the IEES is fairly inclusive and represents 94.5% of the county's assessed valuation.

### Property Tax Projections

The outlook for the county's assessment roll though improved compared to the height of the recession, remains exceptionally cautious especially in the near term. Housing prices are expected to decline slightly from their current levels and stabilize in late 2012 early 2013. Foreclosures are expected to pick up in 2012 compared to last year after the settlement between the state attorneys general and five major mortgage companies which means that prices will come under further pressure. The reassessment of commercial appeals will also take a while to be completed thus placing additional strains on assessment rolls. **More troubling, the assessment roll appears to have suffered a permanent decline since the crisis as increases in**

**foreclosures and distress sales have prompted the reevaluation of over 200,000 of the county's properties** (23% of total) to a lower base.

Our projections for Riverside County property values are based on econometric models that use a number of variables for forecasting purposes including data by type of property, failure to pay property tax installments, Proposition 8, Proposition 13, and property tax data from neighboring counties.

The forecasts are provided in Table 1. **The growth rates are representative of the projected growth of the County's property tax revenue.** Note that the data supplied to us by the County and displayed in Table 2 differ from the Assessor's Office data which shows commercial property values declining by -1.9% and non-commercial declining by -0.9% in FY 2011-2012. We project an overall decline of -2.1% in 2012-2013. This decline is due to Prop 8 re-assessments for commercial properties in the appeals process as well as Prop 8 reassessment decreases for residential properties reflecting lower housing prices earlier in the year. Property values are expected to remain roughly flat (increase only by 0.5%) in FY 2013-2014 as housing prices stabilize while commercial properties continued to be reassessed. In the long term, property values are expected to grow as housing prices rise, triggering a reversal of Prop. 8 and the commercial real estate market recovers.

**Table 1**
**Ad Valorem Property Taxes**
**Based on 94.5% of the Secured Property Tax Roll[a,b]**

| Fiscal Year | Commercial | Growth | Non-Commercial | Growth | Total | Growth |
|---|---|---|---|---|---|---|
| 10-11 | 497,585,858 | n/a | 1,470,577,991 | n/a | 1,968,163,849 | n/a |
| 11-12 | 486,808,992 | -2.2% | 1,453,140,307 | -1.2% | 1,939,949,299 | -1.4% |
| **Forecast** | | | | | | |
| 12-13 | 474,151,958 | -2.6% | 1,425,530,641 | -1.9% | 1,899,682,599 | -2.1% |
| 13-14 | 467,039,679 | -1.5% | 1,442,637,009 | 1.2% | 1,909,676,688 | 0.5% |
| 14-15 | 465,171,520 | -0.4% | 1,483,030,845 | 2.8% | 1,948,202,365 | 2.0% |
| 15-16 | 482,382,866 | 3.7% | 1,549,767,233 | 4.5% | 2,032,150,099 | 4.3% |
| 16-17 | 502,642,947 | 4.2% | 1,641,203,500 | 5.9% | 2,143,846,446 | 5.5% |

[a] Data provided by the County of Riverside representing 94.5% of assessed valuation.
[b] The growth rates are representative of the projected growth of the County's property tax revenue.

The property tax projections in Table 1 represent a baseline forecast. However, if downside risks intensify such that the labor market fails to heal as projected, mortgage delinquency rates and foreclosures rise more than the forecast, conditions in residential and commercial real estate take another setback, and the overall recovery in the county turns out to be much weaker than expected, another likely scenario shows a larger reduction in property taxes. Under this "increased-risk-scenario", our forecasts are as follows: FY 2012-13 (-2.8%), FY 2013-14 (-0.4%), FY 2014-15 (1.5%), FY 2015-16 (4.6%) and FY 2016-17 (5.8%).

In FY 2011-2012 the ad valorem secured property tax revenue (excluding tax exemptions, fixtures, trees & vines, unsecured property, personal property, as well as data subject to recording and other accounting issues) for the 903,611 parcels was $1,939,949,299 (see Table 2). This is lower than the revenue from the complete county property tax roll which amounted to $2,051,876,922 and also less than the secured county tax roll which was $1,973,857,128. Despite these discrepancies, the vast majority of property tax revenue is from secured property (land and structures) ad valorem taxes (1% of total assessed valuation) which account for 94.5% ($1,939,949,299 of $2,051,876,922) of the property tax revenue generated from the Riverside County Assessor's total property tax roll.

The parcels were classified into the following seven categories: Residential, Time Shares, Manufactured Homes, Vacant, Commercial, Agricultural and Unassigned Code (see Table 2 for more details). Note that for FY 2011-2012, there are 2,054 more parcels than in the data provided by the County for FY 2010-2011 when there were 901,557 parcels. Consequently, the historical data for the ad valorem taxes will differ relative to those reported in our previous study in April 2011. The analysis below is based on the latest secured property tax data provided to us by the County.

During the FY 2011-2012, the secured ad-valorem tax revenue from residential parcels (single and multifamily) totaled $1,297,382,404, which accounts for 66.88% of all property taxes (Table 2). The next largest share in the amount of $486,808,992 comes from commercial parcels, which account for 25.09% of property taxes. The remaining categories total $155,757,903 or 8.03% of property taxes in Riverside County.

**Table 2**
**Ad Valorem Property Taxes[a]**
**Fiscal Year 2011-2012**

| Type of Parcel | Dollars | Share of Property Taxes |
|---|---|---|
| **Residential[b]** | 1,297,382,404 | 66.88% |
| **Time Shares[c]** | 6,362,634 | 0.33% |
| **Manufactured Homes[d]** | 41,608,490 | 2.14% |
| **Vacant[e]** | 59,466,720 | 3.07% |
| **Commercial[f]** | 486,808,992 | 25.09% |
| **Agricultural[g]** | 48,085,356 | 2.48% |
| **Unassigned Code[h]** | 234,703 | 0.01% |
| **Total** | 1,939,949,299 | 100.00% |

[a] Data provided by the County of Riverside for 903,611 parcels.
[b] Single and multifamily
[c] Timeshare estates in a timeshare project pursuant to Section 2188.9 of the Revenue and Taxation Code.
[d] Factory built manufactured homes
[e] Vacant according to residential parcel codes
[f] Apartment buildings, commercial building on leased land, vacant commercial, special use and all other types of commercial property.
[g] Parcels under and not under an agricultural preserve act
[h] Unassigned code are parcels that were not assigned to residential, commercial or agricultural

The real estate crisis, deep recession and the subsequent exceptionally weak recovery has had a profoundly negative impact on the county's assessment roll. As reported by the county's Assessor Office, assessed valuations fell by an additional -1.45% in FY 2011-2012 after declining by -4.25% in FY 2010-2011 and by an unprecedented -10.51% in FY 2009-2010. Translated into dollar amounts, the assessment roll has shrunk by a total of $37 billion over the past three years, falling by an astounding $25 billion in FY 2009-2010 (the largest county decline in the state of California), an additional $9 billion in FY 2010-2011, and by an additional $3 billion in FY 2011-2012. All told, the county's assessment roll has plummeted by a total of -15.6% since it peak in FY 2008-2009.

The decrease in assessment roll was largely caused by a continued downward revision of assessment values in the county as housing and commercial real estate markets continue to experience strains. This is in line with Proposition 8, which requires the Assessor to apply the lower value of either the property's Factored-Base-Year Value (established under Proposition 13 -- with an increase of no more than 2%) or its market value as of the lien date (January 1). For FY 2011-2012, the Assessor's office reviewed over 500,000 properties of which 414,528 received a reduction. The average decrease was $133,881 for residential properties (compared to the base year) and $1,098,553 for commercial property. The total decrease in assessed valuation as per Proposition 8 for FY 2011-2012 was $44.3 billion, which is roughly the same as the decrease applied in the previous year.

The remainder of the nearly 1 million properties which were not subject to the Prop 8 assessment reduction experienced a 0.75% increase in FY 2010-2011 in assessed valuation -- in line with California inflation rate which rose by 0.75% from October 2009-October 2010. Though this was an improvement over the -0.237% negative inflation factor experienced from October 2008-October 2009, it is still below the 2% CPI maximum and was another contributing factor to the further weakening of assessment rolls during FY 2011-2012.

In order to get a better sense of the challenges facing property owners in the county, we also analyzed property tax delinquencies based on the data provided by the county. There were 61,716 (6.83%) property owners delinquent on paying their property taxes (at least one installment) for FY 2010-2011 (the most recent data available). The number of property owners who paid one installment but were delinquent on the other installment was 12,818 (1.42%) and the number of owners delinquent on both was 48,898 (5.41%). The number of delinquencies has improved slightly compared to a year ago when 71,550 (7.94%) of property owners were delinquent on their taxes.

Lower delinquency rates likely reflect the transfer of foreclosed and distressed sales to banks or property owners that are more able to pay property taxes rather than by healthy improvements in the fundamentals of residents and businesses of the county. Nonetheless, quite a lot of progress has been made compared to two years ago when 89,112 property owners (10% of total) were delinquent on paying their property taxes. Though at a snail-pace, property tax delinquencies should continue to decline further over the forecast horizon partly due to the transference of distressed property to banks and new households who are less likely to be delinquent on property tax payments. In addition, improvements in labor markets, stabilization of home values and a general more upbeat overall tone to local macroeconomic data should contribute further to a reduction in property tax delinquencies. The progress ahead, however, will be slow and high property tax delinquencies will continue to remain a concern for the county for quite a while -- at least until the real estate market normalizes.

**Non-Commercial Property**

Home prices in Riverside County trended lower for the most part of 2011, ending the year around -0.8% below their December 2010 values. Nonetheless, the market seems to have stabilized in 2011 with the single-family median home price oscillating around the $200,000 mark throughout last year, according to the California Association of Realtors. Home prices are up by around 14% from their April 2009 crisis-low values, though they have partially erased the 25% gain that occurred between the May 2009 - June 2010 period which was largely boosted by the temporary tax credits. Even with the current level of $200,000, home prices are still more than 53% below the peak of $431,713 recorded in June 2006.

The number of foreclosures, still very high, continued to trend lower in 2011 compared to the previous year, likely reflecting the efforts of the federal government and lenders to prevent foreclosures and the recent legal issues surrounding the foreclosure process. The County still has the highest foreclosure rate in Southern California, and the second highest in the state of California. A total of 41,319 mortgage default notices, auction sale notices and bank repossessions were recorded in the county in 2011 -- 1 in 19 households, which represents roughly 5.3% of the county's total residential properties. This likely underestimates the real number of properties that would have been foreclosed had the process not been interrupted by a number of concerns regarding the documentation and legal issues plaguing the foreclosure industry.

Further strains continue to weigh on the housing market in the Inland Empire region with around 43.7% owing more in their mortgages than the market value of their homes. While this is a considerable improvement over the 54.9% underwater mortgages recorded at the height of the crisis, there is little doubt that a large number of homes will end up in foreclosure at some point down the line or continue to remain distressed in 2012 and beyond.

Fundamental market forces have improved noticeably compared to the depth of the recession: job growth has finally resumed in the region and housing affordability has reached an all-time high with 69% of families able to afford the median home price. Nonetheless, a pick-up in demand for homes will take a while to materialize, given the still slow-pace of recovery in the region and low rates of household formation. Moreover, the shadow inventory of homes should restrain any meaningful appreciation in home prices until it is finally exhausted --- most likely in mid-to-late late 2015.

Housing market strains have negatively impacted the county's assessment roll. According to the Riverside County Assessor, in FY 2011-2012, 242,789 residential properties received a Proposition 8 reassessment, reducing the assessment roll by $32.5 billion. In comparison, in FY 2010-2011, 258,521 residential properties received a Proposition 8 reassessment and the assessment roll declined by $34.7 billion. Assessed values were also reduced for condominiums ($3.5 billion), vacant land ($2.1 billion) and other property ($2.7 billion). Because the California Consumer Price Index rose by 0.753% (from October 2009-October 2010), the maximum possible increase (as mandated by Proposition 13) in assessed value for existing property owners, was limited to 0.753% and most likely was only applied to houses purchased prior to 1999. The slight increase in factor-base was more than offset by Prop 8 reductions resulting in an overall decline in secured property values in 2011-2012.

Property tax delinquency rates for non-commercial property has improved relative to last year, though still remains high. We analyzed delinquencies on 861,889 parcels for non-commercial property provided by the county, which include residential, agricultural and unassigned parcels. The largest share of delinquencies came from owners of residential parcels who failed to make either one or both property tax installments. Single-family and multi-family delinquencies accounted for $42,339,600 (56.7%) of total delinquent non-commercial property taxes. Delinquencies for vacant land (residential, mountain, desert and manufacture homes) was $12,919,429 (17.3%) of total delinquencies. Delinquencies for agricultural property were $7,248,706 (13.3%) and for Condominiums or Planned Unit Developments were $3,753,051 (5.0%).

The contribution of non-commercial property to the assessment roll in FY 2012-2013 largely depends on two factors: 1) housing values in the first three months of 2012, and 2) the Prop 13 factor. Due to a high number of distressed sales, home prices trended lower at the end of 2011 and early in 2012. This means that properties under Prop 8 (which make up roughly half of the assessment roll) will likely receive a small reduction in their assessed valuation. The other (roughly) half of the roll -- mostly those properties purchased before 1999 -- are subject to a maximum 2% increase due to the fact that the

California CPI-inflation factor rose by 2.9% from October 2010-October 2011. Overall, non-commercial properties are likely to have a modest negative impact on assessment values for FY 2012-2013 compared to the previous fiscal year. Beyond this horizon, housing prices are projected to slowly increase which will raise assessed valuations and also begin the reversal of the Prop 8 temporary reductions.

**Commercial Property**

Parts of the commercial real estate market in the county experienced improvements in fundamentals in 2011 which indicate that this market is likely to begin to recover in 2012 and beyond. Nonetheless, the recovery seems to be two-tiered with industrial and multi-family sectors expanding while retail and office properties continuing to drag. The industrial sector has posted the strongest gain with manufacturing and logistics picking up steam as world trade volumes soared after the global recession. The market has experienced strong demand which has decreased its vacancy rate down to a pre-recession low of 6.3% (in Q4 2011). This trend is expected to continue and the vacancy rate for industrial properties should fall further in 2012. In fact, as of Q4 2011, the Inland Empire recorded the highest level of gross industrial space in the nation, which at 19.8 million square feet was just a notch below the 20 million recorded in boom periods. Similarly, rents for Class A&B Apartments have improved due to an increased demand for rental property (relative to homeownership)and are now only -6.4% below their all-time highs recorded in Q1 2008.

In contrast, office and retail markets continue to remain weak. Office vacancy rates remain high at 23.4% in Q4 2011 as professional and business job growth continues to remain exceptionally weak. This trend is expected to continue over the next few years partly due to a slow recovery in the housing market and partly due to the (still) high office vacancy rates in the neighboring counties. While 2011 proved also quite challenging for the retail market given modest consumption spending, the outlook for this sector is more upbeat due to the existence of a number of low-cost expansion opportunities for a number of retailers.

While activity has picked up and parts of the commercial real estate sector are showing some vitality, commercial values have yet to stage a meaningful recovery. This is due to the fact that the market has an abundant excess supply and the renewed demand has not yet pushed against capacity which is needed for a price pick-up. Overall, commercial property values should continue to experience re-assessment reduction over the next few years, reflecting in part some weakness in pricing until demand increases robustly. However, the main reason for continued assessment reduction is largely due to the complex and protracted assessment process involving commercial properties, which unlike the residential market, requires a thorough study of the fundamentals of each property. This process takes a long time, so we expect reassessment appeals regarding commercial properties to continue over the next two years. The lagged effect of this complex reassessment process will likely weigh on the County's Assessment roll even if commercial real estate prices begin to firm up slowly in the meantime. It should be noted that we do not foresee a notable price pick-up in the commercial real estate market over the next few years, which means that assessed valuations for commercial properties will remain depressed.

For FY 2011-2012, 2,535 commercial properties received a Proposition 8 reduction in assessed valuation for a total amount of $2.8 billion which is considerably higher than FY 2010-2011. During FY 2010-2011, 1,526 commercial properties had a Proposition 8 reduction in assessed valuation for a total amount of $1.8 billion. The sharp increase in commercial properties receiving a Proposition 8 reduction is largely due to the efforts by the Assessor's Office to revalue commercial property in an expedient manner. In addition, the commercial real estate market followed the collapse in housing prices with a lag of around 18 months, which means that their reassessment has also lagged the residential market.

We analyzed 41,722 commercial parcels provided by the County for FY 2011-2012. These consist of apartment buildings, commercial building on leased land, vacant commercial, special use, and other types. While a relatively large the number of property owners defaulted on property taxes in FY 2010-2011, much like the non-commercial market, the number of delinquencies is lower than in FY 2009-2010. Failure to pay property taxes on vacant commercial properties in FY 2010-2011 (latest available data) was $6,606,052 (27.7%) of all delinquent commercial properties. A further $2,744,061 (11.5%) of all delinquent commercial property taxes was on special use parcels. Apartment buildings accounted for 1,614,316 (6.76%) of all commercial delinquent taxes. Delinquencies on commercial properties are expected to edge down over the next two years as fundamentals continue to improve, but they will remain elevated relative to their historical values.

As previously mentioned, commercial properties will continue to place a downward pressure on assessment rolls over the next two years largely reflecting assessment appeals that will have to be resolved over this period. Assessed valuations for commercial property are expected to continue to decrease in FY 2012-2013 and FY 2013-2014 reflecting the protracted assessment process and price weakness. Given the complex process of reassessing commercial property, assessed values for commercial property are likely to also decrease slightly in FY 2013-2014. Beyond this horizon, assessed valuation for commercial properties is expected to stabilize and increase at a modest rate.

### A2. Motor Vehicle Licensing Fee (in Lieu)

Motor Vehicle Licensing Fee (MVLF) revenue is based on assessed property values (Table 3). In FY 2005-06, the state converted MVLF revenue into property taxes in lieu of MVLF. This source of revenue is linked to assessed valuation. Nonetheless, there are significant deviations from the assessed valuation trend. For example, during FY 2005-06, there was an underestimate of MVLF for Riverside County. To correct for the underpayment, an additional payment was made in FY 2006-07, causing the MVLF revenue in FY 2006-07 to be higher than what the actual payment should have been. Thus while this source of revenue tends to grow and fall at a similar rate to assessed property taxes, the state adjustments for underpayments or overpayments distorts the underlying trend for MVLF revenue. There was a -4.4% decline in MVLF revenue during FY 2010-2011. In tandem with assessed valuation, we project a decrease in this source of revenue in FY 2011-2012 and in FY 2012-2013. In the long term, as the real estate market recovers, MVLF revenue will increase as assessed values rebound from depressed levels.

**Table 3[a]**

| Fiscal Year | Motor Vehicle Licensing Fees Dollars | Growth |
|---|---|---|
| | Historical | |
| 08-09 | 221,661,746 | 1.4% |
| 09-10 | 197,932,854 | -10.7% |
| 10-11 | 189,210,416 | -4.4% |
| | Forecast | |
| 11-12 | 185,615,418 | -1.9% |
| 12-13 | 183,573,648 | -1.1% |
| 13-14 | 184,858,664 | 0.7% |
| 14-15 | 188,186,120 | 1.8% |
| 15-16 | 195,713,565 | 4.0% |
| 16-17 | 206,086,384 | 5.3% |

[a] Data provided by the County of Riverside

### A3. Taxable Sales Riverside County

The taxable sales data are from the County of Riverside which reports tax revenue derived from sales within the unincorporated areas. In addition to the deep recession and slow recovery -- which have had an adverse impact on the county's taxable sales, the incorporation of two areas Jurupa Valley and Eastvale have taken a significant chunk out of this source of revenue for the county. Since the incorporation of these two areas reflects a structural shift, the permanent loss of this revenue source will further depress taxable sales for the county at least in the near-term. More importantly, the sizable drop in taxable sales due to this incorporation tends to distort the real trend in sales, which move in tandem with the performance for the local economy. There is also some timing uncertainty between when incorporation occurs and when its effect on taxable sales for the county is fully exhausted from an accounting perspective.

For our projections, taxable sales from Eastvale are excluded from FY 2010-11 and in subsequent years. A portion of Jurupa Valley taxable sales is allocated to the County in FY 2011-12. In FY 2012-13 and beyond, taxable sales from Jurupa are excluded which assumes that all accounting procedures are implemented in FY 2012-13. Consequently taxable sales to Riverside County are projected to decline significantly in FY 12-13 by -21.9%. Taxable sales are expected to increase by 1.3% in FY 2013-2014 reflecting the sluggish recovery momentum in the county. In the long-term, taxable sales are projected to increase with growth rates exceeding 7% as the recovery in the county gains strength.

**Table 4**[a]

| Fiscal Year | Taxable Sales (dollars) | Growth |
|---|---|---|
| | Historical | |
| 08-09 | 34,181,132 | -16.6% |
| 09-10 | 25,761,880 | -24.6% |
| 10-11[b] | 25,317,375 | -1.7% |
| | Forecast | |
| 11-12 | 26,102,282 | 3.1% |
| 12-13 | 20,388,704 | -21.9% |
| 13-14 | 20,643,562 | 3.7% |
| 14-15 | 21,510,592 | 6.5% |
| 15-16 | 22,672,164 | 7.1% |
| 16-17 | 23,987,150 | 7.5% |

[a] Data provided by the HDL.
[b] Data for FY 10-11 include a projection for the last quarter as data are not available. Taxable sales from Eastvale are removed.
[c] Projections in FY 11-12 include a portion of taxable sales from Jurupa Valley.
[d] Projections in FY 12-13 exclude taxable sales from Jurupa Valley and thus assume that Jurupa Valley will be allocated their tax revenue in FY 12-13.

## A4. Proposition 172 Public Safety Sales Tax Projections

Proposition 172, the "Local Public Safety Protection and Improvement Act of 1993," was enacted in November 1993 and allocates a half-cent sales tax to public safety in cities and counties. The total sales tax revenue is distributed to cities in Riverside County as well as to the County. The state distribution of Proposition 172 revenue to Riverside County depends on the amount of taxable sales in Riverside County and on the Riverside County's share of total tax revenue. Forecasts for the Public Safety Sales Tax are determined using the state formula and regression techniques and estimates are in Table 5. For Riverside County, the public safety sales tax projections are forecasted to increase modestly in FY 2011-2012. In the longer term, as the state and county economies recover, there should be growth in this revenue for the County.

**Table 5**[a]

| Fiscal Year | Proposition 172 Public Safety Sales Tax (in thousands) | Growth |
|---|---|---|
| | Historical | |
| 08-09 | 120,458,414 | -16.7% |
| 09-10 | 110,158,678 | -8.6% |
| 10-11 | 110,585,796 | 0.4% |
| | Forecast | |
| 11-12 | 117,331,530 | 6.1% |
| 12-13 | 123,784,764 | 5.5% |
| 13-14 | 130,840,495 | 5.7% |
| 14-15 | 139,868,490 | 6.9% |
| 15-16 | 150,078,889 | 7.3% |
| 16-17 | 161,935,122 | 7.9% |

[a] Data are from the Riverside County

## A5. Documentary Transfer Tax

Documentary transfer tax is typically from a transfer of the ownership of real property and historical and projected values are in Table 6. The tax rate for the City of Riverside is $1.10 for every $500 of net consideration or value conveyed; the tax rate for all other cities and the unincorporated areas of the County of Riverside is $.55 for every $500 of net consideration or value conveyed. Documentary transfer tax is highly correlated with house sales, building permits, changes in interest rates which can trigger refinancing, changes in property values, changes in payroll employment, foreclosure rates, and other factors that cause a change in ownership. With persistent weaknesses in residential and commercial real estate, a slowdown in the foreclosure process, and a slow pick up in construction activity, documentary transfer tax is projected to increase by 9.6% in 2011-2012. This source of revenue should pick up more robustly in 2012-2013 as foreclosures pick up and distressed sales continue to dominate the county's housing market. In the long term, document transfer tax revenue is expected to grow more robustly reflecting genuinely improved real estate fundamentals.

**Table 6**

| Fiscal Year | Documentary Transfer Tax Dollars | Growth |
|---|---|---|
| | Historical | |
| 08-09 | 10,624,354 | -21.2% |
| 09-10 | 10,677,818 | 0.5% |
| 10-11 | 9,958,654 | -6.7% |
| | Forecast | |
| 11-12 | 10,914,685 | 9.6% |
| 12-13 | 12,399,082 | 13.6% |
| 13-14 | 14,159,751 | 14.2% |
| 14-15 | 16,807,625 | 18.7% |
| 15-16 | 20,101,919 | 19.6% |
| 16-17 | 24,202,711 | 20.4% |
| [a] Data are from the Riverside County | | |

## B. RIVERSIDE COUNTY OVERVIEW FORECAST AND REPORT

The economic outlook for Riverside County has improved considerably compared to a year ago but the region still has a way to go as the recovery remains sluggish with below-trend growth, high unemployment rates and a real estate market that will weigh on growth and county's finances for the foreseeable future. The good news for the county is that the worst is behind it and its economy is no longer mired in the doldrums of the recession: labor markets have shown signs of life, housing affordability is at a record-high, activity has sprung up in some segments of commercial real estate market, and the post-recession surge in international trade volumes has supported local growth. Nonetheless, the economic recovery in Riverside County continues to lag behind the Southern California region and the national recovery. The main challenge for a sustained recovery in the county continues to be the residential real estate market and segments of commercial real estate (office, retail) which are fundamentally weak and highly dependent on a broader recovery of the regional real estate market.

Going forward, we expect the Riverside economy to continue to heal, but at an exceptionally sluggish pace even when compared to the moderate growth of the national and Southern California economies. Labor markets will continue to improve and the local economy will add jobs, but the pace of job formation is expected to remain sluggish in the near-term given the deep recession experienced by the county. The unemployment rate is projected to decline slowly over the forecast horizon reflecting broader improvement of the labor market. Moreover, the pace of job growth will still remain too sluggish to provide a meaningful and sustained increase in discretionary income which means that retail sales are unlikely to surge over the next two years. International trade volumes will continue to help the economy, but the imminent global slowdown will likely translate in lower container traffic which means that growth in trade and logistics sectors will continue at a more moderate pace than in recent past. The housing market will bounce along after bottoming-out in 2012, but any meaningful recovery in this sector will be severely restrained by the large number of foreclosures that loom over the county. Housing affordability is one of the bright spots, but it is likely to become a factor in the long-term rather than in the immediate future given that affordability has also improved in the neighboring coastal counties. State and (particularly) local finances will continue to weigh on the county's economy. Local budgets will continue to experience stress particularly since reassessed residential properties (valued at a significantly lower value per Prop 8) are unlikely to see a significant upward revision given strained conditions in the housing market. Moreover, the lagged effects of reassessed commercial properties are expected to negatively impact county's finances for a couple more years.

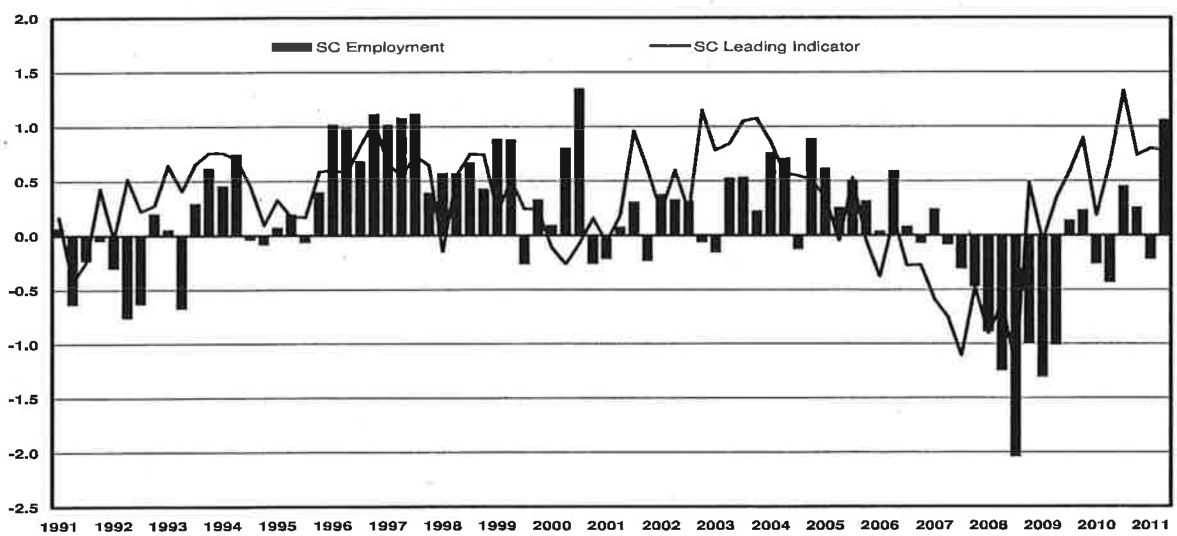
To analyze short-term economic conditions, the *Institute for Economic and Environmental Studies* (*IEES*) at California State University Fullerton has developed a leading economic indicator which has proven to be a reliable predictor of economic activity for the region over the near-term. Additionally, at the County level, employment and housing data provide an important indicator of overall regional economic conditions. The near-term and long-term economic outlook for Riverside County is discussed below using these measures, econometric models, and other data.

### B1. NEAR TERM OUTLOOK AND FORECAST

Regional economic activity is interdependent in the Southern California region which includes Los Angeles County, Orange County, San Bernardino County, Riverside County, Ventura County and Imperial County. To gauge the short-term overall economic activity in Southern California region, the IEES has developed the *IEES Southern California*

*Leading Economic Indicator.* The *S.C. Leading Indicator* uses a combination of national and regional data to project economic activity in the region. At the national level, macroeconomic indicators used in the index include the money supply adjusted for inflation, the interest rate spread and the Standard & Poor's S&P500 stock index. Regional variables include nonfarm employment changes, the unemployment rate, building permits and the Pacific Region consumer confidence index. An increase (decrease) in the SC Leading Indicator implies an increase (decrease) in economic activity in the Southern California region in the next 3 to 6 months. The indicator has been found to accurately predict turning points in economic activity for Southern California (Figure 1).

**Figure 1**
**Southern California Leading Economic Indicator and SC Employment**




***Source: California State University Fullerton.***

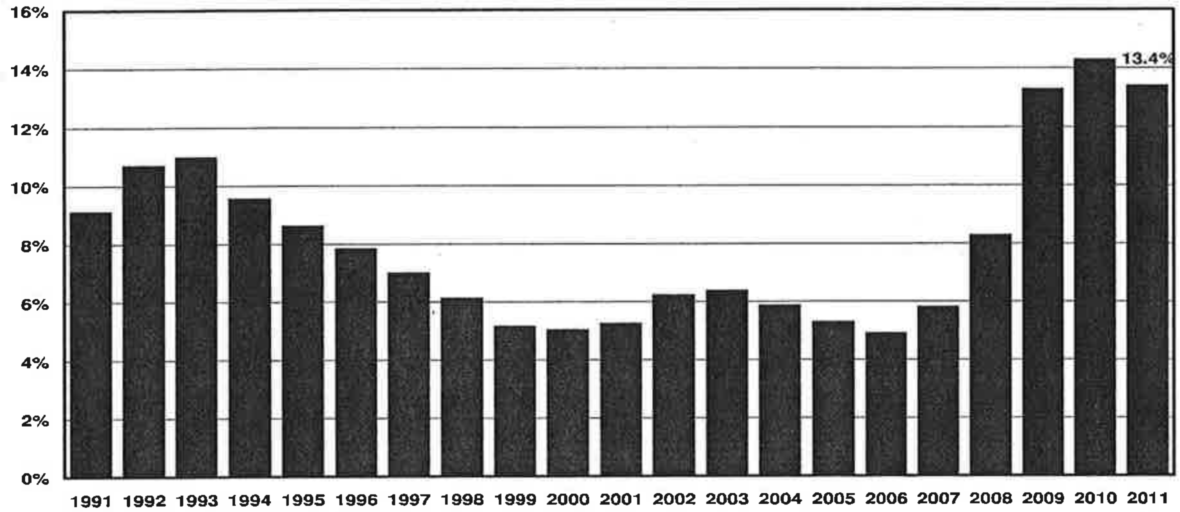
The current 0.78% increase in the *S.C. Leading Indicator* suggests an improvement in economic activity in the Southern California region over the next 3 to 6 month horizon. The *Indicator* has now increased for nine consecutive quarters since its last decline in the third quarter of 2009. This suggests that economic activity in the Southern California region will continue to expand in 2012, though at a moderate pace. The economic recovery in Riverside County will also strengthen this year and the next, while still lagging behind most counties in Southern California.

**Unemployment**

One of the best news for the county over the past few months has been a steady decline in the unemployment rate which indicates that the region's labor market is finally on the mend. The unemployment rate has been on a downtrend declining from 14.3% in July 2011 down to 12.5% in February 2012. Measured from the cycle highs of the Great Recession, the unemployment rate has declined by 2.5% from a record 15.1% in July 2010 down to the current level.

In fact, at the current 12.5% level of February 2012, the unemployment rate for the Inland Empire is at its lowest point in the past three years. This is a very welcome sign particularly since the area's unemployment rate rose sharply during the recession averaging 8.3% in 2008, 13.3% in 2009, and 14.5% in 2010 before declining to 13.4% in 2011 (Figure 2).

Figure 2
Civilian Unemployment Rate
Riverside-San Bernardino




*Source: Employment Development Department*

Despite these encouraging improvements, it should be noted that the unemployment rate is still well above historical norms, which should continue to place additional strains on consumer finances and hamper the region's recovery. The pace of improvement in unemployment rate numbers is considerably below the vast majority of other regions where the recovery -- though slow -- has far surpassed that of the Inland Empire. For example, Inland Empire's unemployment rate is higher than that of surrounding counties with the Orange County unemployment rate having edged down to 7.8% and Los Angeles County down to 12.1%. Compared to other Metropolitan Statistical Area's (MSA), the latest December 2011 labor employment report ranks the Riverside-San Bernardino MSA in the top 6.5% highest unemployment rate out of the nation's 372 MSAs. For large MSAs with populations of 1 million and above, the Riverside-San Bernardino MSA has the second highest unemployment rate in the nation behind Las Vegas-Paradise MSA.

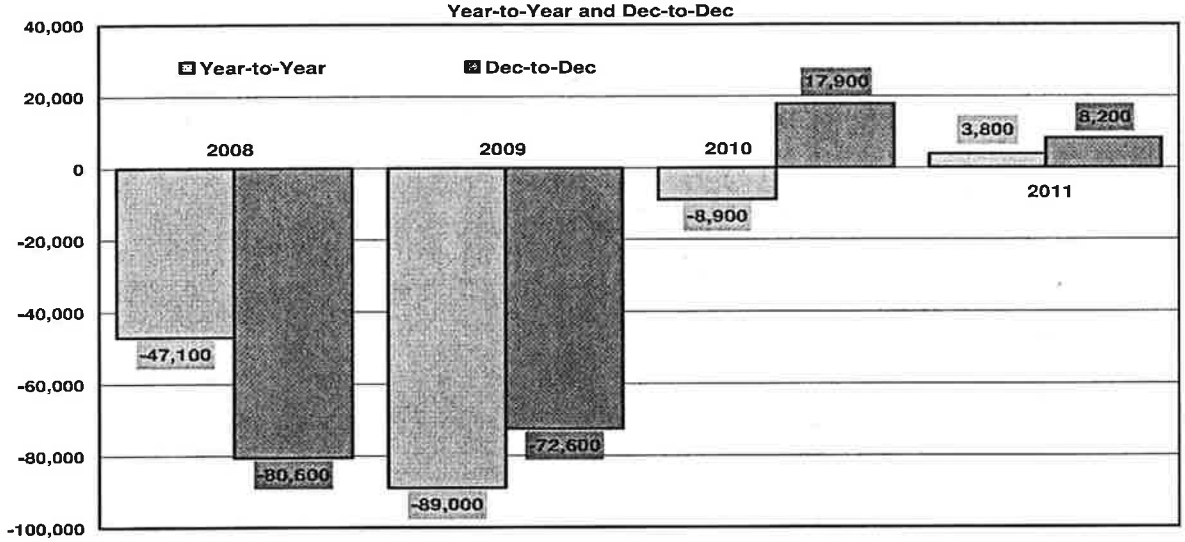
In addition, when considering a broader measure of unemployment which includes underemployed and "discouraged workers," the unemployment rate for the county is closer to 17%.

The outlook for the labor market is considerably brighter than one year ago. The labor market should continue to improve over the next few years, though the gains will be painfully slow given the depth of the abyss the recession left behind. The unemployment rate should drift down slowly over the next few years as the labor market continues to recover particularly in response to relatively stronger employment gains in the surrounding counties. The slow pace of the labor market recovery will likely keep the unemployment rate in double digits through the end of 2013.

**Payroll Employment**

After staggering job losses during the recession, the labor market for the Riverside-San Bernardino MSA has finally turned the corner and started adding jobs. This can be seen from Figure 3 below which shows changes in nonfarm payrolls using both annualized average data (year-over-year changes) and December-to-December changes. We display both measures because annual year-over-year changes based on annual average data tend to distort recent trends. For example, comparing the annual average data for year 2011 to year 2010 shows a gain of only 3,800 jobs. An alternative measure that gives a more accurate depiction of the current labor market is to compare nonfarm payrolls over a 12 month period using the December-to-December change. With this measure, from December 2010 to December 2011, 8,200 jobs were added which is considerably higher than the annual average. The difference is even more pronounced when comparing nonfarm changes in year 2010. The December 2010 to December 2009 had a gain of 17,900 while the annual average year-to-year changes show a decrease of -8,900 jobs.

**Figure 3**
**Nonfarm Payroll Employment**
**Year-to-Year and Dec-to-Dec**




*Source: Employment Development Department*

The good news for the County is that, regardless of how the data is measured, the county added jobs in 2011. It is also important to note that in March 2012, the Employment Development Department revised the nonfarm payroll data considerably having previously reported that the region lost -23,600 in 2010 compared to 2009 whereas the most recent data only shows a decline of -8,900.

These job gains represent a welcome boost to the region given the massive job losses that occurred in 2009. Nonfarm employment has now increased for 8 months on a year-on-year basis since July 2011. The region has added an additional 13,500 jobs since July 2011. For 2011, job gains were widespread through a number of sectors: the Service Providing sector gained a total of 8,800 jobs; 2,300 jobs were in Trade Transportation & Utilities, 3,000 in Educational & Health Services; and 2,500 in Professional and Business services. The construction sector continues to decline shedding an additional -1,600 jobs. While construction fell in 2011, job losses in this sector are considerably less than the sharp declines experienced over the previous five years. As of February 2012, the construction sector has lost a staggering -76,500 of jobs since the peak in June 2006. More encouragingly, employment in the manufacturing sector, has now increased for two consecutive years after four years of layoffs. Local governments slashed employment levels by -1,500 as property values plunged and tax revenues collapsed. Employment by the federal government declined by -500 jobs in 2011.

International trade increased just shy of 16% in 2011 compared to 2010. The recovery in international trade has a positive impact on the county's economy due to its geographic location since Riverside county serves as the main distribution center for roughly 75-80% of goods for the region's two ports (the Los Angeles Port and Long Beach Port). The increased demand from emerging markets and other global regions caused a sharp increase in international trade. While higher oil prices are expected to dampen trade in the first half of 2012, this is likely to be a temporary setback. Trade should continue to support the local economy in 2012 but at a more moderate pace compared to last year given the current slowdown in the emerging markets and weakness in the Eurozone.

The main force behind the strong economic growth in the Inland Empire prior to the Great Recession was from hiring in construction, manufacturing and the housing-related retail sector. In fact, from 2000-2007, Inland Empire added a total of 282,500 jobs -- or nearly 42% of California's 685,300 jobs. However, most of these jobs were wiped out during the recession. Though job growth has resumed recently in the region, employment rolls are currently around the same level as in 2003 despite the fact that during that time the county's population has risen by 23%. This means that going forward the challenges for the county's labor market remain formidable given the sizable drop in employment during the recession.

The labor market has improved considerably and is expected to continue to gradually improve over the forecast horizon. A host of sectors should continue to expand employment over the next few years, though at a slow pace in the short-term. Most jobs are likely to be created in Professional and Business Services; Health and Education; and Trade, Transportation and Utilities with the pace of job growth in this sectors still below the pre-recession years. We expect a modest pick-up in manufacturing jobs in the county given recent positive trends in this sector. The main sectors that will continue to experience setbacks are Construction and housing-related which will continue to lag the overall recovery. A recovery in these sectors is years away when the real estate sector stabilizes and foreclosures are no longer a major concern.

**The Housing Sector**

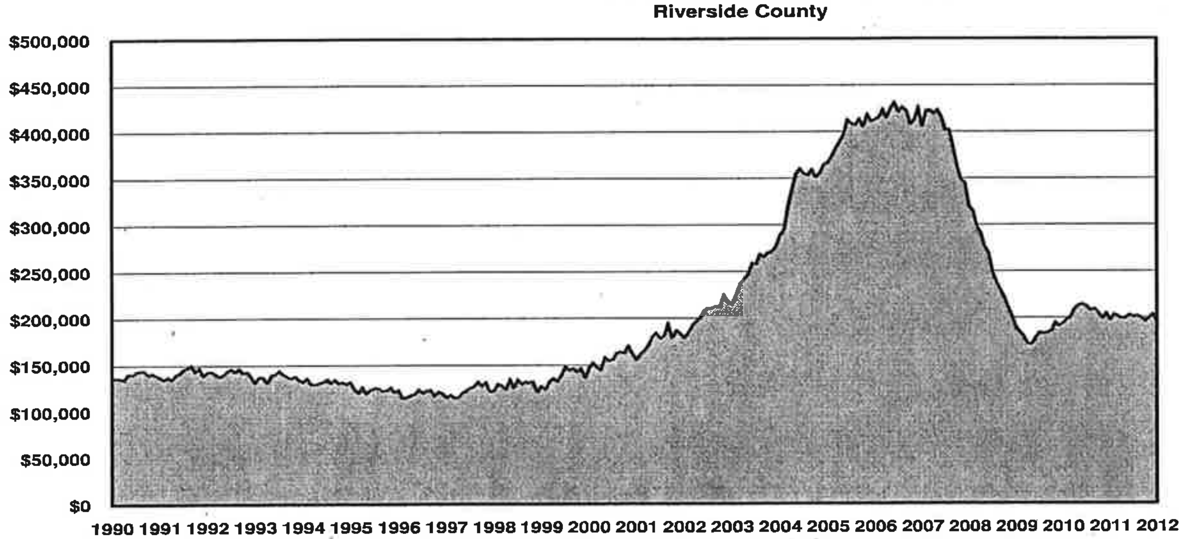
The housing market in Riverside County posted modest price declines in 2011, though at much more measured pace. In fact, according to the data from the California Association of Realtors (CAR), median home prices for single-family homes market appears to have stabilized around $200,000 -- a notch below the 2002 prices. This suggests that the recent housing crisis has wiped out a decade's worth of gains for the county's residents.

Home prices for the County experienced a setback in mid-2010 as government's tax credit -- which temporarily boosted demand -- expired and the market experienced renewed weakness. Based on the recently revised data by CAR, which now includes a larger sample of transactions, single family median house prices rose from a cycle low of $171,480 in April 2009 to $214,335 in June 2010 -- a 25% increase. These gains were partially reversed in the following months of 2010 and in 2011. As of the latest data (February 2012), single family median house price is at $203,640, up by 18.8% from its recession lows.

The apparent stabilization of home prices around $200,000 is at far lower levels relative to the housing boom period which generated much of the County's economic growth. Single family median house prices increased from $136,832 in January 1990 to a record high of $431,713 in June 2006. At their peak, housing prices and income at the county level were grossly misaligned with only 32% of the borrowers able to afford the median home price.

The next three years witnessed a dramatic and relentless fall in housing prices which led to the most devastating loss in real estate value in the history of the County. The decline which began in June 2007 continued for 22 consecutive months (Figure 4). On a year-over-year basis, the free-fall lasted a total of 31 months. By the end of April 2009, home prices had declined by 60% relative to their peak values (June 2006). The sharp fall in housing prices devastated the county's economy, shrinking homeowner equity and shriveling property tax revenues. It continues to remain a major impediment in the county's recovery.

**Figure 4**
**Median Price of Existing Detached Homes**
**Riverside County**




*Source: California Association of Realtors*

Prices for new homes also remain depressed given low demand and sluggish job growth. The median price in the fourth quarter of 2011 for new attached homes was $293,000 while for new unattached homes was

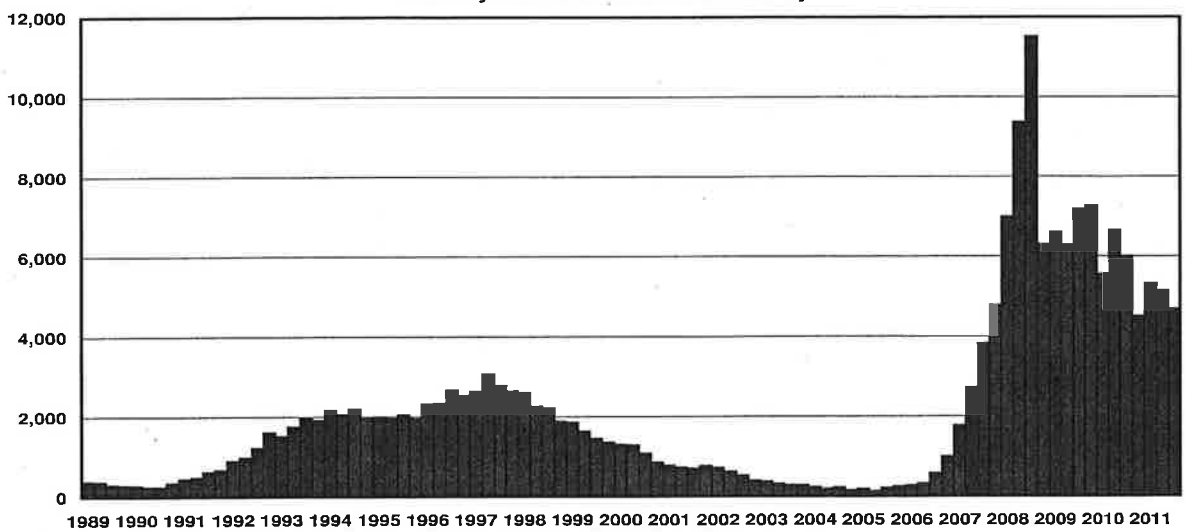
$221,250. Prices for these types of housing are more in line with those recorded during the 2002-2003 period.

One positive development from the sustained drop in home prices is that housing affordability in the county has improved significantly over the past two years. It stood at 69% in the fourth quarter of 2011, which means that 69% of residents are able to afford the median priced home. At the current level, housing affordability is at the highest level in over twenty years and should help the region's economy in the long-term.

The large number of distress properties in the county is expected to weigh heavily on home prices over the next two years restraining demand even as the economic recovery continues to move forward and expand. We expect home prices to weaken slightly (-1% to -2%) from their current levels in 2012, stabilize at low levels in 2013 and post modest increases until mid-to-end 2015 when the excess inventory is expected to have normalized somewhat from its current historic-high level.

Foreclosure rates remain a major concern for the region with the county still experiencing the second-highest foreclosure rate in the state of California in 2011. While the number of foreclosure filings have declined, largely due to the moratorium related to legal issues, they remain at elevated levels. During the fourth quarter of 2011, there were 4,689 foreclosure filings in the county, which represents a decrease of 59.3% from a record-high of 11,523 in the fourth quarter of 2008 (Figure 5). Much of this decline is due to the moratorium on foreclosures which was put in place in response to illegal filings and other irregularities in the foreclosure process.

**Figure 5**
**Quarterly Foreclosures Riverside County**



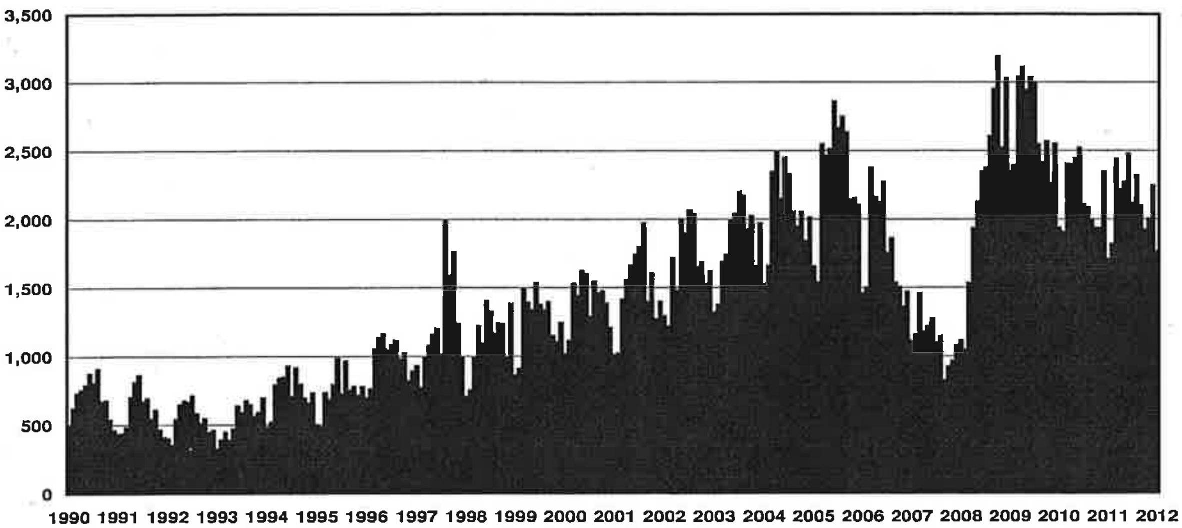

*Source: Real Estate Research Council*

The number of foreclosures is expected to increase in 2012 as the foreclosure process resumes its normal course after the settlement of the state attorneys' general with major servicers. In addition, though signs of economic pickup have recently spurred job growth in the county, much of the fundamentals needed for a meaningful housing recovery are simply not there yet. The unemployment rate remains high, the county has a significant amount of mortgages underwater (43.7%), and income growth has been minimal due to weak job creation. Nonetheless, while foreclosures in 2012 will exceed their 2011 level, they will be below the peak levels recorded during the crisis.

Sales activity has largely reflected distress sales in the region. In fact, 68% of sales in the county are distressed sales while

29% are short sales. This makes it difficult to assess real non-distressed activity since distressed sales account for such a large portion of transactions. According to California Association of Realtors, single family sales in the county fell by -2.7% in 2011 compared to 2010, but this likely reflects the interruption of the foreclosures process (Figure 6).

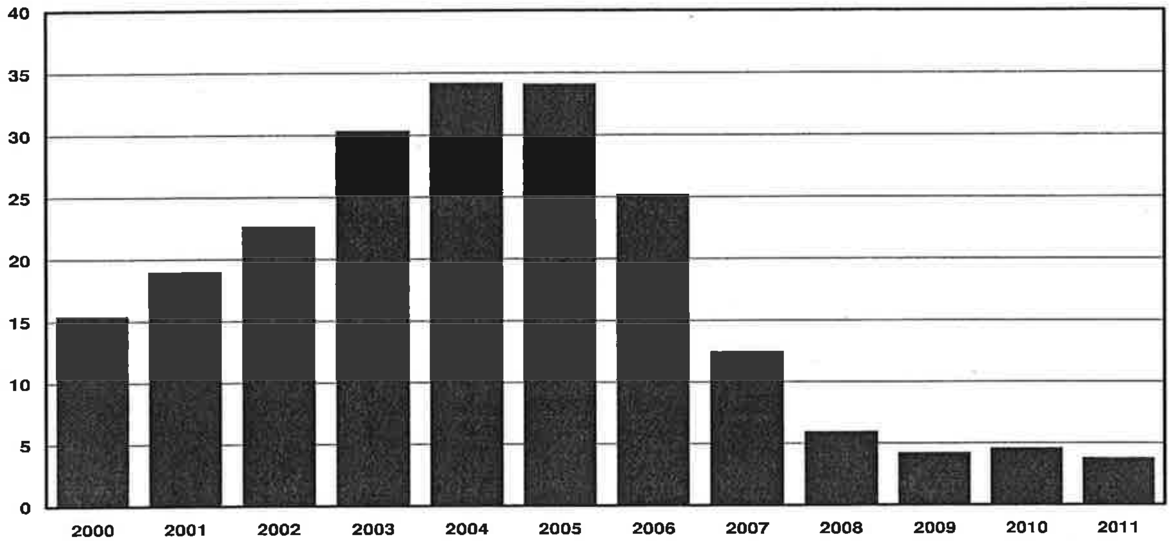
**Figure 6**
**Single Family Sales (monthly units)**
**Riverside County**




***Source: California Association of Realtors***

Given the large overhang of housing inventory, it is no surprise that construction activity remained at very low levels in 2011 -- resembling a mere shadow of its former self (see Figure 7). Annual new housing permits (single and multi-family) declined by -17.7% to 3,751 from the already depressed permit levels issued in 2010. In contrast, during the peak of the housing cycle in 2004-2006, building permits averaged over 31,100 units per year. Residential building permits are expected to remain at low levels over the next few years as weakness in the housing market limits new construction in the area.

Figure 7
Residential Building Permits Riverside County (1,000s)



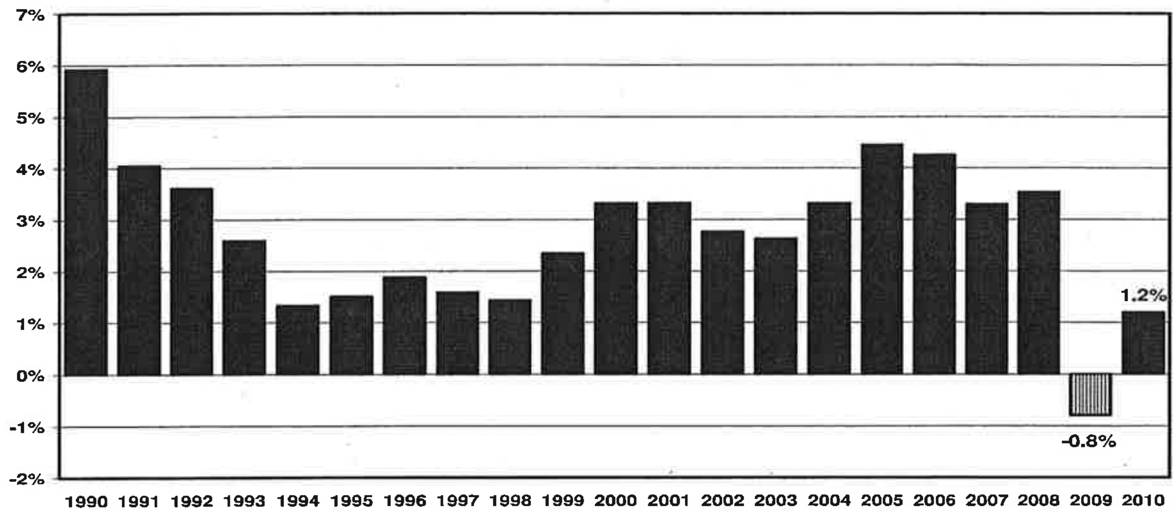

*Source: Construction Industry Research* Board

## Inflation

Riverside County headline inflation (which includes food and energy prices) as measured by the consumer price index for the Los Angeles-Riverside-Orange Counties, increased by 2.7% in 2011 (Figure 8). This follows a 1.2% increase in 2010 and a -0.8% decrease in 2009. The current higher inflation rate is still within the 2000-2008 levels when inflation rose steadily averaging between 2.6% and 4.5% per year. The concern with higher inflation is mostly related to the recent escalation in oil prices which take a sizable chunk out of the county's residential income particularly since a good portion of its labor force commutes to the coastal counties for work.

Inflation is expected to edge up further in 2012 given higher oil prices and further improvements in economic activity. Nonetheless, some of this pressure will be partially offset by weak wage and income growth as labor market continues to heal very slowly from the depth of the recession. While we project a steady increase in inflation over the forecast horizon, we expect inflation expectations to remain well-

**Figure 8**
**Los Angeles-Riverside-Orange County**
**Consumer Price Index**




*Source: Bureau of Labor Statistics*

anchored in the long-run.

## Summary

In summary, the Riverside County economy will continue to heal over the next few years, but the healing process will be slow and take longer than the usual post-recession recovery. The labor market will continue to improve and the unemployment rate should decline steadily, but the pace of improvement should be below trend and certainly below the boom years in the middle of the past decade. The near-term future outlook for the county will be characterized by modest job gains, high but falling unemployment rates, a sluggish residential housing market and concerns about segments of the commercial real estate. The speed of the economic recovery in the county is still heavily dependant on the real estate market which shows little signs of staging even a moderate recovery. Going into 2012, the lingering negative effects in the real estate market will most likely cause a decrease in assessment rolls in FY 2012-2013. The continued deep cuts in public sector spending from state and local government will further restrain economic growth. Inflation will increase in 2012, but should remain contained in the near term given the wide margin of slack in economic activity in the county.

**B2. LONG TERM OUTLOOK AND FORECAST**

The long term economic outlook for Riverside County is much more upbeat than the near-term path. While the county will likely struggle until the middle of this decade (largely due to its collapse of the housing market and weak employment growth), its long term prospects (beyond 2020) are bright. So while the short- and medium-term outlook for the county is for moderate growth, the long-term is decidedly more prosperous with growth rates settling somewhat below the stellar performance of pre-recession years, but far above the current sluggish pace.

As argued above, Riverside County continues to face some tough challenges in the near-term given the decline in property values, continual Proposition 8 reassessment of residential and commercial property values by the County Assessor's Office, and pending foreclosures. During the next few years, the County's economy should trail behind the southern California region and its performance will depend heavily on the neighboring counties. In addition, the housing crisis will have a lasting impact on the county's economy as sharp declines in construction activity will contribute to a structurally higher unemployment rate for the foreseeable future and lower standards of living. While the local economy will continue to slowly recover from the recession, it will not resemble that of the pre-crisis. Some construction and manufacturing jobs may not return in the medium term and economic growth will trail significantly below the boom years.

Most of these issues are likely to be resolved by the end of the decade as the county's economy heals and as the distance from the Great Recession widens. As such, the long-run outlook for Riverside County remains positive given its fundamentals. Riverside County should outperform the coastal counties in the long-run given its large size and the availability of relatively affordable land. Other major advantages for the County are its location near the major ports, large swathes of undeveloped land, large storage facilities, affordable housing and relatively low rental rates. In addition, with many workers well trained in and specialized in areas such as logistics, construction and manufacturing, the county is poised to experience significant growth once these sectors recover.

Affordable housing in the county should attract many of the projected 78 million "baby boomers" who will retire over the next two decades. Given that much of the coastal communities are well developed, stronger growth in Southern California should attract more migration into the county in the long-term and boost the demand for housing and goods and services. Stronger growth should support net migration into the county in the long-term which should boost demand for housing, retail and sales. The County's population is projected to grow by more than 2% from 2015-2030, which is far above the expected levels for the surrounding areas. This indicates that, in the long-run, comparative advantage will be restored and the County's economy will be driven once again by affordable housing, cheap and abundant land, and population growth.

The County will remain heavily involved in logistics because of its central location, proximity to the ports of Long Beach and Los Angeles, and its pivotal role in transportation and distribution of goods. This remains an important driving force for the local economy given an increasingly competitive global market and expanding trade volumes. As the Southern California region grows, Riverside County will be able to attract new business because of the relatively low cost of office, industrial, retail real estate and logistics. In addition, affordable housing will ensure that a skilled work force will be available to meet an increased demand for labor. Thus there are strong fundamental forces that will support the County's growth in the long-run.

## B3. PROJECTIONS OF RIVERSIDE COUNTY MAIN ECONOMIC VARIABLES

**Table 7 (continued on next page)**
**Riverside County Forecasts[1]**

**Historical**

| Year | Payroll Employment[1] | Unemployment[1] | Single Family Median House Prices[2] |
|---|---|---|---|
| 2009 | -7.3% | 13.3% | $182,603 |
| 2010 | -0.8% | 14.5% | $206,179 |
| 2011 | 0.3% | 13.4% | $200,550 |
| **Forecast** | | | |
| 2012 | 1.5% | 12.3% | $198,946 |
| 2013 | 1.7% | 11.4% | $203,720 |
| 2014 | 2.1% | 10.2% | $211,054 |
| 2015 | 2.5% | 9.3% | $222,451 |
| 2016 | 3.1% | 7.8% | $237,133 |
| 2017 | 3.6% | 7.0% | $255,629 |

1. *Source: Employment Development Department*
2. *Source: California Association of Realtors.* The data includes the 2011 revisions from the increased sample of transactions.

**Table 7 (continued)**

| Year | California Consumer Price Index[1] | Consumer Price Index Los Angeles-Riverside-Orange Counties[2] | Building Permits (in 1,000s)[3] |
|---|---|---|---|
| Historical | | | |
| 2009 | -0.3% | -0.8% | 4.2 |
| 2010 | 1.3% | 1.2% | 4.6 |
| 2011 | 2.6% | 2.7% | 3.8 |
| Forecast | | | |
| 2012 | 2.4% | 2.2% | 4.1 |
| 2013 | 2.3% | 2.1% | 4.7 |
| 2014 | 2.9% | 2.7% | 5.5 |
| 2015 | 3.0% | 3.1% | 6.7 |
| 2016 | 2.9% | 2.8% | 8.7 |
| 2017 | 2.8% | 2.7% | 11.0 |

1. All items with base period 1982-84=100,
*Source: California Department of Finance*
2. All items with base period 1982-84=100.
*Source: Bureau of Labor Statistics*
3. *Source: Construction Industry Research Board*

## C. U.S. MACROECONOMIC OVERVIEW FORECAST AND REPORT

"If you want the rainbow, you have got to put up with the rain" -- Dolly Parton once famously remarked. True enough, after a grueling wait of two and a half years fraught with near-recession risks, gloomy prognosis, and quasi-catastrophe scenarios, the U.S. economy has gathered strength and the recovery has picked up momentum. This positive trend, which began in the last three months of 2011, has continued in the current year. Improvements are broad-based: labor markets have strengthened, retail sales continue to tick higher, real activity has grown at a solid pace, business investments continue to expand, consumption spending has remained steady, credit markets have normalized, and corporate profits are at an all-time high. Add these up and the case for modest optimism is a solid one. The recovery is now more broad-based than at any point in time since the Great Recession, showing both signs of depth and resiliency.

Despite these encouraging developments, we expect the recovery to proceed at a moderate pace -- a notch below the U.S. long-run potential growth and well below the historical rates of previous post-war recoveries. Our "no boom, but less gloom" outlook is shaped by our belief that while the U.S. is finally experiencing a real cyclical recovery, structural challenges and external shocks -- while unable to choke-off the upturn in economic activity -- will nonetheless considerably restrain the strength and the pace of the expansion. While healing, the U.S. economy will continue to edge forward in moderate steps rather than by leaps and bounds, but the progress ahead will persist and become more robust with the growing distance from the

Great Recession. In sum, while the recovery is neither spectacular nor dramatic, it is nonetheless real.

Though 2011 proved to be a near-utter disappointment, it served an important purpose in establishing the resiliency of the current recovery. High oil prices early in the year took a sizable chunk out of discretionary spending, and Japan's tsunami and earthquake severely disrupted supply chains around the world. Midsummer blues brought forth renewed concerns from the Eurozone sovereign debt crisis, political brinkmanship over the debt ceiling eroded confidence, the U.S. credit downgrade further depressed sentiment, and revisions of real GDP figures revealed that the recession was much deeper than previously thought and the subsequent recovery significantly shallower. As of mid-September 2011, everything that could go wrong had gone wrong: the labor markets seemed frozen, financial markets were operating in panic-mode, housing showed no sign of life, consumers appeared shell-shocked, and businesses seemed paralyzed. Calls for an imminent double-dip grew deafeningly loud as the U.S. economy inched dangerously close to the cusp of another recession.

As we had anticipated, these fears were overstated and the U.S. economy proved more resilient than most anticipated. Q4 2011 recorded solid growth, marked improvement in labor markets, robust consumer spending, and export strength. We expect this trend to continue with the recovery becoming more mature, broader-based, and more self-sustained during the current year. A few positive factors should support growth going forward: labor markets are expected to improve further, income should grow reflecting higher employment levels, business investments should remain robust, and production should expand further. There isn't one main driver supporting the moderate rebound ahead - just incremental improvements across a number of sectors.

Nonetheless, this cyclical recovery will remain moderate in the face of a number of structural challenges and external shocks. To start, this rebound is inherently more anemic than the garden-variety kind having followed in the footsteps of a severe housing crisis and a global financial near-collapse. The housing market, while stabilizing, is a long way off from a complete recovery given the looming supply of foreclosed homes, tighter lending standards and hesitant demand. Improvements in the labor market have been disappointingly slow when compared to the draconian job cuts during the recession and come amidst an alarming decline in labor force participation and a growing skills mismatch. Government spending is projected to become a drag on economic growth over the next two years as fiscal austerity measures (through automatic stabilizers) are set to kick in as the economy recovers. To make matters worse, fiscal austerity measures are expected to take effect in the short term -- when the economy is still fragile -- but fail to address long-term deficit reduction issues through entitlements and tax reforms.

There are three main risks to our baseline scenario of moderate and sustained growth. First, the Eurozone area, while no longer on the brink of a Lehman-like calamity, is nonetheless in the middle of a mild recession. Though its sovereign debt crisis has abated somewhat after the Greek debt restructuring, the fear still remains that pressure may build on other vulnerable economies (such as Italy or Spain). Second, oil prices have risen steadily during this year, posing a significant risk to the world economy. Increased tension with Iran and escalating conflicts in the Middle East may place further upward pressure on oil prices with negative consequences for growth. Third, growth in emerging markets (notably China and Brazil) has slowed down markedly in the past few months reflecting a deceleration of internal demand and policy tightening aimed at containing inflationary pressures. Though we don't expect these economies to experience a "hard-landing", this downshift should negatively impact U.S. exports in the near-term. In addition, the U.S. presidential election is expected to fuel partisanship rancor, which means that there will be more uncertainty and less agreement on policy issues (taxes, entitlements) until after the election.

Below we provide an analysis of the U.S. economy and discuss our outlook and forecasts as they relate to some of the main components of the economy: (A) real economic activity, (B) inflation, (C) financial and government sectors, and (D) global environment. Section (E) details our projections of key national economic variables.

### C1. Real Economic Activity

Real economic activity, as measured by real gross domestic product (RGDP), expanded by a solid 3.0% in 2010 after declining by -0.3% in 2008 and by an additional -3.5% in 2009. After the initial boost of 2010, the following year proved to be an utter disappointment: growth averaged a mere 0.75% in the first half of 2011 and a slightly more upbeat yet still anemic 1.8% in Q3 2011. Economic activity all but stalled in mid-year when it seemed that the U.S. economy was inching dangerously close to recession territory. Part of this was due to the dampening effect of higher energy prices and supply chain disruptions from Japan's earthquake and tsunami.

Mid-year panics related to RGDP numbers are now the norm rather than the exception. In what has become a depressing routine, U.S. RGDP numbers were revised downward yet again in late July revealing a disheartening story: real economic activity fell by an astounding -5.1% during the recession -- a much deeper collapse than the revised -4.1% (from an original -3.8%) reported a year earlier (Figure 1). At some point in Q4 2008, the economy was contracting at a shocking rate of -8.9%, the largest drop in five decades. The subsequent recovery turned out to be much flatter than previously thought having recovered from its pre-recession peak (recorded in Q4 2007) only in Q3 2011 -- more than four years after the initial decline -- even though the U.S. population grew by close to 10 million during this time.