revenues for the Economic Development Agency/Facilities Management by $215,771, as follows:

Increase estimated revenues:		
10000-7200100000-777500	Reimbursement of special purchase	$215,771
Increase appropriations:		
10000-7200100000-528020	Inventory stores	72,500
10000-7200100000-536920	Interfund expense – general office expense	287,040
10000-7200100000-574000	Intrafund expense – indirect costs	(143,769)
	Total	215,771

Recommendation 23: *That the Board 1) authorize replacement of two (2) vehicles for Treasurer-Tax Collector; and, 2) approve and authorize the Auditor-Controller to make budget adjustments to appropriations, estimated revenue and net assets for Fleet Services totaling $62,000, as follows:*

Increase appropriations:		
45300-7300500000-535562	Depreciation – vehicle	$ 2,000
45300-7300500000-546320	Vehicles – cars/light trucks	60,000
	Total	62,000
Increase estimated revenue:		
45300-7300500000-777620	Vehicle cost recovery	60,000
Decrease unrestricted net assets:		
45300-7300500000-380100	Unrestricted net assets	2,000

Recommendation 24: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenue for Supply Services in the amount of $1,651,219, as follows:*

Increase Appropriations:		
45700 7300400000 527560	Direct materials	$ 641,354
45700 7300400000 527600	Indirect materials	1,009,865
	Total	1,651,219
Increase Estimated Revenue:		
45700 7300400000 777760	Stores – county	641,354
45700 7300400000 781600	Systems furniture	1,009,865
	Total	1,651,219

Recommendation 25: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenue for Central Mail by $230,710, as follows:*

Increase Appropriations:		
45620-7300600000-523760	Postage/mailing	$230,710

Increase Estimated Revenue:

45620-7300600000-781340	Postage	230,710

Recommendation 26: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments to appropriations, estimated revenue, and use of unrestricted net assets for Malpractice Insurance by $1,950,000, as follows:*

Increase estimated revenues:

46000-1130900000-777010	Stop loss reimbursement	$1,550,000

Increase appropriations:

46000-1130900000-534340	Malpractice – liability	1,950,000

Use unrestricted net assets:

46000-1130900000-380100	Unrestricted net assets	400,000

Recommendation 27: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenue for Workers Compensation by $115,594, as follows:*

Increase estimated revenue:

46100-1130800000-777010	Stop loss reimbursement	$115,594

Increase appropriations:

46100-1130800000-521640	Maintenance – software	115,594

Recommendation 28: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenue for Safety Loss Control by $8,991, as follows:*

Increase estimated revenues:

46040-1131300000-755180	CA – from other state government agencies	$8,991

Increase appropriations:

46040-1131300000-520350	IT core services	8,991

Recommendation 29: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenue for Occupational Health and Wellness by $170,000, as follows:*

Increase estimated revenues:

46120-1132900000-774500	Health services	$ 85,000
46120-1132900000-775010	Wellness incentive	85,000
	Total	170,000

Increase appropriations:

46120-1132900000-520350	IT core services	85,000

46120-1132900000-527780	Special program expense	85,000
	Total	170,000

Recommendation 30: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments to appropriations, estimated revenue, unrestricted net assets for Delta Dental PPO by $550,000, as follows:*

Increase estimated revenue:		
45860-1130600000-781320	Insurance proceeds	$250,000
Increase appropriations:		
45860-1130600000-534240	Dental claims	550,000
Use unrestricted net assets:		
45860-1130600000-380100	Unrestricted net assets	300,000

Recommendation 31: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments to appropriations, estimated revenue, and use of unrestricted net assets for Exclusive Provider Option by a net total of $1,950,000, as follows:*

Increase estimated revenue:		
45800-1132000000-781320	Insurance proceeds	$6,775,000
45800-1132000000-774980	EPO select retiree	775,000
	Total	7,550,000
Decrease estimated revenue:		
45800-1132000000-774970	IHSS insurance premiums	4,100,000
Increase appropriations:		
45800-1132000000-534500	Hospital care services claims	5,450,000
Use unrestricted net assets:		
45800-1132000000-380100	Unrestricted net assets	2,000,000

Recommendation 32: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and estimated revenue for Employee Assistance Services by $77,500, as follows:*

Increase estimated revenues:		
46100-1132200000-777030	Personnel services	$77,500
Increase appropriations:		
46100-1132200000-510040	Regular salaries	17,170
46100-1132200000-520350	IT core services	60,330
	Total	77,500

Recommendation 33: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and use of fund balance for the Perris Valley Cemetery by $10,000, as follows:*

Increase appropriations:		
22900-980501-537180	Interfund expense – salary reimbursement	$10,000
Use of fund balance:		
22900-980501-321101	Restricted program money	10,000

Recommendation 34: *That the Board of Supervisors approve and direct the Auditor Controller to make budget adjustments increasing appropriations and estimated revenue for the Regional Park and Open Space District by $525,000, as follows:*

Increase appropriations:		
25400-931104-518100	Budgeted benefits	$525,000
Increase estimated revenues:		
25400-931104-777480	Reimbursement of cost – administrative overhead	100,000
25400-931104-781000	Contractual revenue	425,000
	Total	525,000

Recommendation 35: *That the Board of Supervisors approve and direct the Auditor Controller to make budget adjustments increasing appropriations and estimated revenue for the Regional Park and Open Space District by $203,500, as follows:*

Increase appropriations:		
25420-931180-518100	Budgeted benefits	$145,000
25420-931180-525060	Medical examinations – physicals	16,000
25420-931180-525440	Professional services	26,000
25420-931180-536760	Interfund expense - audit & accounting fee	6,500
25420-931180-541060	Equipment – other	10,000
	Total	203,500
Increase estimated revenues:		
25420-931180-741000	Rents	136,900
25420-931180-741080	Exhibits	1,600
25420-931180-741360	Concessions	35,000
25420-931180-778010	Interfund – CDBG	30,000
	Total	203,500

Recommendation 36: *That the Board of Supervisors approve and direct the Auditor Controller to make budget adjustments increasing appropriations and use of unassigned fund balance for the Park District by $50,000, as follows:*

Increase appropriations:		
25520-931107-518100	Budgeted benefits	$ 7,000
25520-931107-527940	Weed abatement	43,000
	Total	50,000

Use of fund balance:		
25520-931107-321101	Restricted program money	50,000

Recommendation 37: *That the Board of Supervisors approve and direct the Auditor-Controller to make budget adjustments increasing appropriations and use of fund balances for the county service areas, as follows:*

Increase appropriations:		
23010-915202-510040	Regular salaries	$115,000
Use restricted fund balance:		
23010-915202-321101	Restricted program money	115,000
Increase appropriations:		
23775-908001-529530	Street lights	5,000
Use restricted fund balance:		
23775-908001-321101	Restricted program money	5,000
Increase appropriations:		
40400-912211-529540	Utilities	25,000
Use unrestricted net assets:		
40400-912211-380100	Unrestricted net assets	25,000
Increase appropriations:		
24300-912501-529530	Street lights	5,000
Use restricted fund balance:		
24300-912501-321101	Restricted program money	5,000
Increase appropriations:		
24450-913401-510040	Regular salaries	60,000
24450-913401-522320	Maintenance – grounds	15,000
	Total	75,000
Use restricted fund balance:		
24450-913401-321101	Restricted program money	75,000
Increase appropriations:		
24875-915201-537280	Interfund expense – miscellaneous project expense	78,323
Use restricted fund balance:		
24875-915201-321101	Restricted program money	78,323
Increase appropriations:		
33200-915201-537180	Interfund expense – salary reimbursement	12,000
Use restricted fund balance:		
33200-915201-321101	Restricted program money	12,000

Attachment B Sales and Use Tax Update

Q4 2013

Riverside Co. Uninc Sales Tax *Update*

First Quarter Receipts for Fourth Quarter Sales (October - December 2013)

Riverside County In Brief

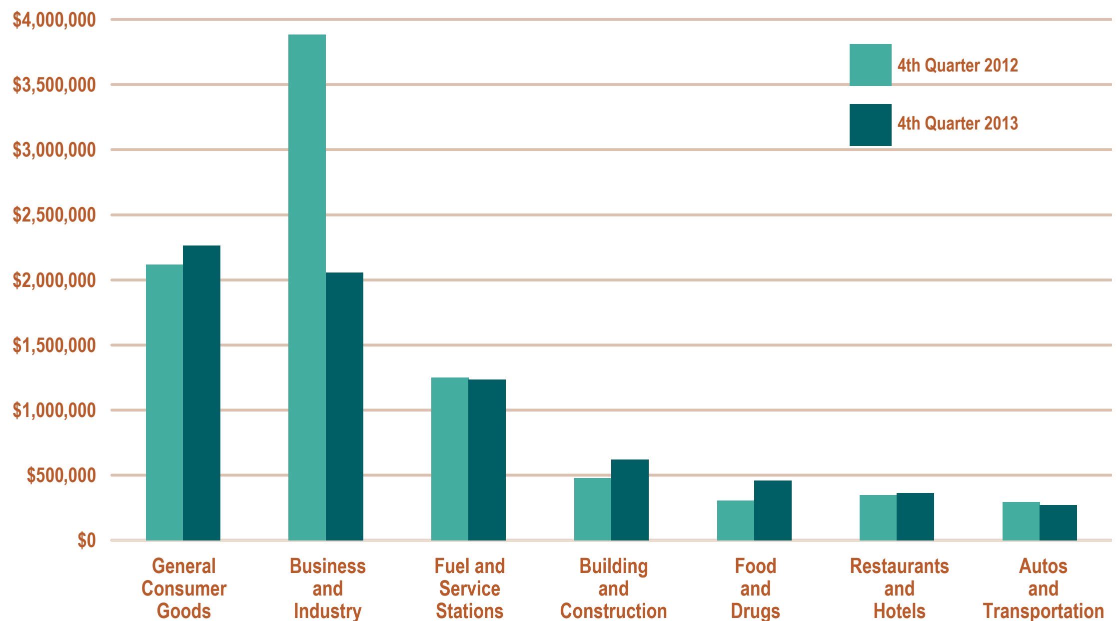
Receipts for the unincorporated area's October through December sales were 16.9% below the like quarter one year ago. Excluding temporary payment aberrations, actual sales dropped 12.7%.

Business and industry results were affected by reporting errors that that inflated year-ago receipts in the warehouse/farm/construction and electrical equipment categories and by actual decreases in a variety of other groups. A onetime use tax payment in the comparison quarter caused the decline in the autos and transportation group. Easing prices at the pump cut fuel and service station receipts.

Multiple business classifications in the building and construction group were up for the third consecutive quarter. General consumer sales benefited from the expansion at Desert Hills Premium Outlets. Most restaurant groups were also up. Onetime payment adjustments exaggerated food and drug gains.

Adjusted for aberrations, taxable sales for all of Riverside County increased 5.2% over the comparable time period, while the Southern California region as a whole was up 2.7%.

Sales Tax by Major Business Group



Top 25 Producers

In Alphabetical Order

7 Eleven	Mecca Travel Center/Subway
Arco Travel Zone Center	Morongo Shell
Burberry	Nike
California Trusframe	Pilot Travel Center
Calvin Klein	Prada
Circle K	Ralph Lauren
Coach	RDO Equipment
Desert Sunlight	Russell Sigler
Dos Lagos Arco	Spates Fabricators
Fresh & Easy	Stater Bros
Gucci	Sysco
Liz Claiborne	Vons Fuel
McMahons RV	

Revenue Comparison

Three Quarters – Fiscal Year To Date

	2012-13	2013-14
Point-of-Sale	$21,637,649	$22,337,235
County Pool	2,490,442	2,407,085
State Pool	9,731	13,074
Gross Receipts	$24,137,822	$24,757,394
Less Triple Flip*	$(6,034,456)	$(6,189,348)

**Reimbursed from county compensation fund*

Published by HdL Companies in Spring 2014
www.hdlcompanies.com | 888.861.0220
HdL COMPANIES

NOTES

Statewide Results

Excluding accounting anomalies, the local share of sales and use tax receipts from California's 2013 holiday spending rose 3.4% over the fourth quarter of 2012.

Auto sales and leases and all categories of building and construction materials were substantially up over the previous year while tourism and convenience-driven consumer demand continued to produce healthy gains in restaurant related revenues.

Sales of luxury goods and portable electronics did particularly well while cut backs in food stamp programs and unemployment benefits reduced spending at discount department stores and many value oriented retailers. Generally, the gains in sales from online purchases were higher than for brick and mortar stores.

Rising fuel efficiency resulted in lower receipts from service stations and petroleum supply companies while a slowing pace in solar and alternate energy development reduced use tax receipts from the business/industrial segment.

Spending patterns were fairly consistent throughout most regions.

E-Commerce Spending Up

Tax receipts from holiday spending on general consumer goods at brick and mortar stores grew by 2.3% over last year's comparable quarter while local tax revenues from online purchases increased 16% and accounted for 10.3% of total general consumer goods sales and use tax receipts.

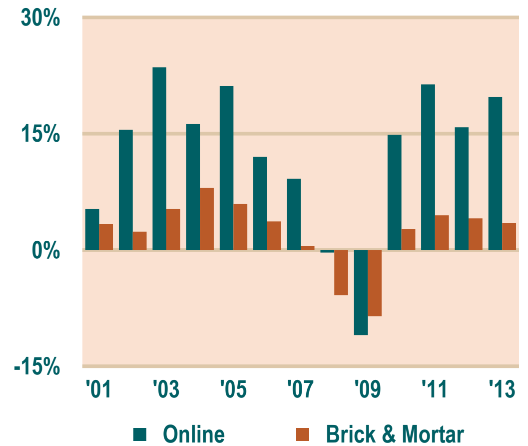
The rise in online retail shopping accelerates trends that began 20 years ago by sellers of materials and equipment to business and industrial users. Suppliers were able to take advantage of business preferences for the ease of online ordering by consolidating sales offices and inventories into just a few locations.

However, it was not until social networking and growth in the use of mobile devices that the general public became fully comfortable with online purchasing. Retail analysts expect the trend to expand and every major retailer is testing new concepts to reduce store size and overhead costs by driving more of their sales to centralized web-based order desks.

New technology, recent court decisions and legislative exemptions are constantly reducing what is taxable and has substantially altered the base on which the tax was created in 1933. The concentration of business supplies and now consumer goods into fewer and larger "points of sale" has accelerated competition for what is becoming a diminishing resource. Local governments are now bidding rebates up to 85% of the local tax collected in exchange for location of order desks.

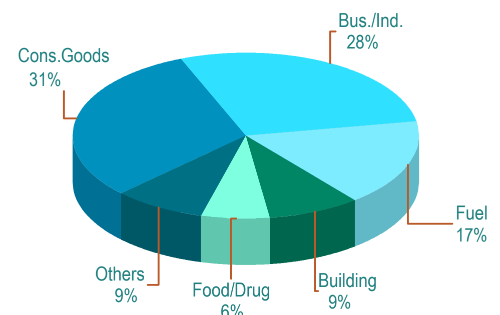
Online vs. Brick & Mortar

Year-Over-Year Percent Growth



Revenue by Business Group

Riverside County This Quarter



Riverside County Top 15 Business Types

**In thousands*	Unincorporated County		County	HdL State
Business Type	Q4 '13*	Change	Change	Change
Contractors	431.5	24.5%	21.2%	15.4%
Energy/Utilities	— CONFIDENTIAL —		-46.6%	-40.2%
Family Apparel	881.8	1.3%	5.0%	6.8%
Food Service Equip./Supplies	114.0	135.4%	73.9%	19.5%
Garden/Agricultural Supplies	116.9	-6.4%	26.5%	9.2%
Grocery Stores Beer/Wine	139.9	155.1%	16.0%	1.8%
Grocery Stores Liquor	196.3	40.6%	61.8%	38.3%
Quick-Service Restaurants	200.6	-0.4%	6.4%	7.8%
Service Stations	1,213.4	-1.8%	3.4%	-2.7%
Shoe Stores	232.6	6.7%	8.8%	5.8%
Specialty Stores	237.7	34.9%	9.6%	7.7%
Trailers/RVs	125.2	18.2%	8.4%	28.8%
Warehse/Farm/Const. Equip.	124.7	-15.1%	-5.3%	11.5%
Wineries	206.9	36.5%	12.9%	11.4%
Women's Apparel	530.3	5.3%	4.2%	2.7%
Total All Accounts	**$7,268.8**	**-16.2%**	**11.0%**	**8.7%**
County & State Pool Allocation	**$815.7**	**-22.2%**	**3.1%**	**9.4%**
Gross Receipts	**$8,084.5**	**-16.9%**	**10.1%**	**8.8%**

April 2014

California Forecast:

Sales Tax Trends and Economic Drivers

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 380 cities, counties and special districts in California and across the nation.

HdL COMPANIES

HdL Consensus Forecast – April 2014

STATEWIDE SALES TAX TRENDS

	2013-14	2014-15
Autos/Transportation	9.7%	5.0%

The rebound in construction activity is boosting pickup and truck sales. However, new car inventories have reached their highest levels since 2009 and manufacturers are beginning to offer discounts and other incentives to entice customers onto dealer lots. Pent-up demand remains but the rate of sales growth is expected to be more moderate in 2014-15.

	2013-14	2014-15
Building/Construction	10.2%	7.5%

California's construction sector continues to gain momentum, with demand for multi-family units particularly robust. The supply of new apartments hasn't kept pace with new household formations, especially in the state's urban centers. Accelerating employment, modest improvement in mortgage availability and historically low interest rates are expected to lead to higher housing demand over the next two years. Investment in transportation infrastructure, water projects and commercial building related to the tech boom are also on the rise.

	2013-14	2014-15
Business/Industry	0.6%	2.0%

An alternative energy project building "boom" that peaked a year ago has skewed growth comparisons for this group. A drop in federal subsidies available for these projects and fewer power purchasing agreements signed by major utilities will slow the pace of future energy development. However, net of the energy segment, business and industry sales should experience a 4.0% statewide gain in 2014-15.

	2013-14	2014-15
Food/Drugs	2.1%	2.0%

Traditional supermarket chains continue to be the location of choice for most grocery purchases but consumers face an ever-growing number of shopping choices from high-end and specialty grocers to drug stores, warehouse clubs and dollar stores. Despite the expansion of options, growth in this segment will remain slow and steady.

	2013-14	2014-15
Fuel/Service Stations	-3.4%	1.0%

Even with declining domestic fuel consumption, increased global demand for oil is putting upward pressure on gasoline prices. With the expectation of $4.00 per gallon prices through the busy summer season, a moderate uptick in receipts is anticipated for 2014-15.

	2013-14	2014-15
General Consumer Goods	2.9%	2.0%

The demand for luxury goods appears to be peaking while the expiration of long-term unemployment benefits and cuts to food stamp programs have reduced lower income and unemployed consumer's purchases of discount and value priced goods. The trend toward online shopping is shifting tax revenues from brick and mortar stores to either countywide pools or centralized fulfillment distribution warehouses.

	2013-14	2014-15
Restaurants/Hotels	5.9%	5.0%

The health and wellness trend is shifting sales at traditional quick service restaurants to fast casual operations with healthier alternatives which are also stealing sales from full service dining chains. The lower prices and convenience of the fast casual boom and increased domestic and international air travel and tourism have all contributed to ongoing gains in this group.

	2013-14	2014-15
State and County Pools	10.3%	7.0%

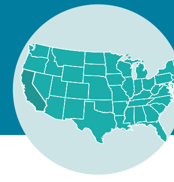
County pool allocations are increasing due to the shift in consumer habits of buying more goods online. However, future receipts are uncertain as more in-state distribution facilities qualify for point of sale status in lieu of pool allocations. Rising private automobile transactions, equipment leases and out-of-state purchases of business equipment and supplies are adding to the gains.

	2013-14	2014-15
TOTAL	4.4%	3.7%

The Proposition 172 growth projection is 2.6% for Fiscal Year 2013-14. This factor varies from HdL's Bradley-Burns growth forecast due to differing collection periods and comparisons to prior year data that include onetime payment aberrations.

BEACON ECONOMICS

National and Statewide
ECONOMIC DRIVERS



April 2014

	2013-14	2014-15
U.S. Real GDP Growth	3.3%	3.8%

The U.S. economy enters 2014 poised for improved economic growth. Posting a solid 2.6% increase in Real GDP during the fourth quarter of 2013, the U.S. economy has seen steady gains in consumer and business spending, residential investment is rising, and there has been some modest resolutions to the federal headwinds in Washington D.C. Beacon Economics expects the economy to grow during the remainder of fiscal 2013-14 and is expected to accelerate in the first half of fiscal 2014-15 as the recovery gains momentum.

	2013-14	2014-15
U.S. Unemployment Rate	6.8%	6.3%

The employment recovery continues to progress through the first quarter of 2014 with nonfarm employment growth averaging 178,000 jobs in the first three months of the year. Through March, the U.S. had added back over 8.3 million of the roughly 8.6 million jobs lost during the Great Recession. The unemployment rate reached 6.7% in March, and the coming fiscal year will see the unemployment rate dip below 6.5% for the first time since 2008.

	2013-14	2014-15
California Total Nonfarm Employment Growth	2.5%	2.1%

Jobs growth in California progressed during the first quarter of 2014, adding nearly 26,800 new nonfarm positions in January and February. More revealing was the EDD's annual benchmark revisions which showed that nonfarm employment had been undercounted by 158,600 jobs throughout the state, not counting private household jobs that were simply reclassified into the health care sector. California continues to be a leader in the nation's employment recovery because businesses are expanding their operations. Through February, California had added back more than 1.2 million jobs since hitting bottom in February 2010. This rebound has been broad based across both regions as well as industries. Tourism, real estate and professional services are expected to continue driving solid job growth.

	2013-14	2014-15
California Unemployment Rate	8.3%	7.5%

At 8.0%, California's unemployment rate is improving more quickly than the nation's rate - reducing the spread between the two rates from over 3 percentage points in 2011 to 1.3 percentage points currently. And while the improvement over the last year came as the labor force did not expand, the number of unemployed persons looking for work shrank by 14.1%. Beacon Economics expects the unemployment rate to continue to fall, dipping below 7% by the end of 2015.

	2013-14	2014-15
California Population Growth	0.9%	1.0%

The California Department of Finance recently reported that population growth in California increased to 0.9% in 2013. Despite the fact that more than 100,000 former Californians left the state (net of new residents from other states), almost 170,000 new residents immigrated to California from other countries last year. Combined with more than 265,000 in natural population increases, the state's population expanded by more than 332,000 last year to 38.2 million. Still, given the high cost of living and lower fertility rates amongst many segments of the population, 1% population growth is forecast to remain in place for some time.

	2013-14	2014-15
California Median Existing Home Prices	$ 364,800	$ 396,100

The median sales price of a home in California was 22.8% higher in February 2014 than it was a year earlier, although prices have remained level on a month-to-month basis since the latter half of 2013. Housing inventories have risen, but remain below five months of supply. Meanwhile, interest rates have remained fairly stable since June 2013 and are very low by historical standards, which will help encourage first-time and move-up buyers that have been on the sidelines of the recent surge. Home prices are expected to continue to rise, but growth will return toward historical norms of 5% annually over the next two years.

	2013-14	2014-15
California Residential Building Permits	85,500	109,100

From February 2013 to February 2014, there were more than 80,100 new residential units permitted across California. That represents a 20% increase over permits filed in the same period a year before, primarily because home prices rose rapidly and the number of homes on the market remains limited. Multifamily construction continues to form a larger portion of new developments than the single-family market due to the increasing number of renters statewide. Given that California remains undersupplied on housing, with one of the lowest residential vacancy rates in the nation, Beacon Economics is forecasting that residential permit growth will be robust over the next two years.

HdL Companies
1340 Valley Vista Drive, Suite 200
Diamond Bar, California 91765
Telephone: 909.861.4335 • 888.861.0220
Fax: 909.861.7726

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."

SOUTHERN CALIFORNIA OFFICE
5777 West Century Boulevard, Suite 895
Los Angeles, California 90045
Telephone: 310.571.3399
Fax: 424.646.4660
E-Fax: 888.821.4647

Beacon Economics, LLC has proven to be one of the most thorough and accurate, economic research/analytical forecasters in the country. Their evaluation of the key drivers impacting local economies and tax revenues provides additional perspective to HdL's quarterly consensus updates. The collaboration and sharing of informatiion between Beacon Economics and HdL helps both companies enhance the accuracy of the work that they perform for their respective clients.

Attachment C Quarterly Fleet Vehicle Report

Units Sold by Departments for Periods1/1/2014 to *3/31/2014	
Name	**Total**
AGRICULTURAL COMMISSIONER	4
BUILDING AND SAFETY	2
CABAZON DISPATCH	1
DISTRICT ATTORNEY	1
DPSS	9
EDA-ADMINISTRATION	1
INDIO DISPATCH	1
MORENO VALLEY DISPATCH	2
RIDESHARE VEHICLES	1
SHERIFF	27
Grand Total	**49**
Units Pending Sale by Departments for Periods 1/1/2014 to 3/31/2014	
Name	**Total**
AGRICULTURAL COMMISSIONER	1
ASSESSOR	1
BUILDING AND SAFETY	1
COMMUNITY HEALTH AGENCY	1
COUNTY FARM DISPATCH	3
CSA EDA	1
DISTRICT ATTORNEY	7
DPSS	7
ECONOMIC DEVELOPMENT AGENCY	1
EDA-ADMINISTRATION	4
INDIO DISPATCH	1
MENTAL HEALTH	1
PROBATION	1
RIVERSIDE DISPATCH	1
RUBIDOUX DISPATCH	1
SHERIFF	33
Grand Total	**65**
*March 2014 units sold have yet to be received	

Attachment D Beacon Economics Economic Forecast

A Revenue Forecast

COUNTY OF RIVERSIDE, APRIL 2014

This publication was prepared by:

Beacon Economics, LLC

Christopher Thornberg, Ph.D.
Founding Partner
310.571.3399
Chris@BeaconEcon.com

Jordan G. Levine
Economist & Director of Economic Research
424.646.4652
Jordan@BeaconEcon.com

For further information about Beacon Economics, please contact:

Victoria Pike Bond
Director of Communications
415.457.6030
Victoria@BeaconEcon.com

Or visit our website at www.BeaconEcon.com.

Reproduction of this document or any portion therein is prohibited without the expressed written permission of Beacon Economics. Copyright ©2014 by Beacon Economics LLC.

Contents

Introduction	1
An Overview on Assessed Valuation	2
Factors Directly Affecting AV	2
Other Factors Indirectly Affecting AV	7
Taxable Sales, Sales/Use Tax, and Prop. 172 Revenues	8
Transfer Tax Revenues	10
Summary	10

Introduction

Beacon Economics, LLC has undertaken a forecast of the assessed valuation and property tax, sales and use taxes, Proposition 172 revenues, and real property transfer tax revenues in the County of Riverside over the next five years.

As in previous editions, the forecast presented here uses standard time-series econometric techniques based on historical correlations and future trends. Beacon Economics' approach to forecasting follows a layered approach. National policy changes and external shocks are built into a U.S. model with a variety of indicators, including GDP, production, demographics, interest rates, government spending, taxes, savings, income growth, and real estate. A California model is then developed that incorporates macro trends at the national level with trends in the local labor market, including demographics, real estate, and business activity indicators.

Taking into account these state and national forecasts, a regional model is set up for the Inland Empire, and wherever possible for Riverside County specifically, that uses the macro trends along with a variety of specific regional data to create a Riverside County forecast. This local forecast provides a broad outlook for the region's employment by industry along with the unemployment rate, consumer spending and income trends, population and components of change, residential real estate and construction, and nonresidential real estate and construction. Each of these factors is specific to either Riverside County in particular, or, in the case of employment, for the broader Inland Empire region (which are the most detailed employment data available for the area that includes Riverside County and pertain to the Riverside-San Bernardino-Ontario MSA and/or Riverside and San Bernardino Counties collectively). Thus, in our regional assessment, we draw on detailed forecasts of the nation and state, as well as how Riverside County has performed relative to these broader geographies over time to provide a forecast of the economic activity and thus, the revenues that the County of Riverside can expect out to 2018–19.

In this edition, Beacon Economics' forecast incorporates updated figures on assessed valuation (AV) in Riverside County for 2013-14 as disclosed by the County Assessor's Office. As in previous versions of this report, Beacon Economics has also performed a forecast of the sales tax revenues or property transfer tax revenues. However, Beacon Economics has been instructed to focus primarily on AV and corresponding property tax revenues. That forecast and the drivers behind that forecast are presented in detail in the remainder of the report, while the remaining items are addressed briefly per the County's guidance.

Over the short run, this forecast is more optimistic than our previous forecast, and it confirms our earlier prediction that the worst is behind the County of Riverside. Indeed, depending on the performance of the County over the next six months, Beacon Economics may further increase our forecast for local AV.

County of Riverside Revenue Forecast

Variable	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Assessed Valuation	204,888.5	212,975.5	228,975.1	244,781.4	260,380.0	276,459.1	292,220.4
Growth	-0.1%	3.9%	7.5%	6.9%	6.4%	6.2%	5.7%
Property Tax Revenues	479.5	505.2	543.2	580.6	619.8	659.3	700.0
Transfer Tax Revenues	11.1	12.9	14.7	16.5	17.6	18.9	20.2
Growth	18.8%	15.6%	14.0%	12.9%	6.6%	6.9%	7.0%
Sales & Use Tax Revenues	29.8	31.8	34.2	36.7	39.7	42.8	45.8
Growth	11.7%	6.9%	7.5%	7.4%	8.2%	7.7%	7.0%
Proposition 172 Revenues	133.0	146.7	156.9	168.6	181.0	195.8	211.0
Growth	11.7%	10.3%	6.9%	7.5%	7.4%	8.2%	7.7%

Source: Forecasts by Beacon Economics. Dollar values in $Millions.

An Overview on Assessed Valuation

Assessed Valuation (AV) in the County of Riverside is driven by a variety of factors. As noted in our previous report, the Riverside County Assessor's Office has already announced that the AV roll for the 2013–14 fiscal year increased by 3.95%. This was stronger than what was expected—owing in large part to significant improvements on the residential side of the property market and increases in the stock of both residential and nonresidential property throughout the region. In addition, although CPI growth for the 2014-15 fiscal year was below 2%, which will limit AV increases on Prop. 13-protected properties, other aspects of the local property market support ongoing improvements in the AV base. Furthermore, several key economic indicators that affect property values indirectly, by boosting demand for residential and nonresidential structures, have also exceeded expectations since we last reported on the Riverside County economy.

For simplicity's sake, there are four major areas of the economy that have a direct impact on the local AV base in Riverside County:

1. Proposition 13, governing increases in AV for properties that do not change hands throughout the fiscal year;
2. Recapturing AV that was reduced during the Great Recession under the auspices of Proposition 8;
3. Reassessments to properties that change hands during the fiscal year; and
4. New additions to the stock of both residential and nonresidential properties in Riverside County.

In addition to the factors that directly impact local AV in Riverside County, there are also a variety of factors that can impact AV indirectly. These factors include:

1. The expansion/recovery of the local labor market, which can boost demand for housing;
2. Relative housing affordability, local population growth, and demographic shifts;
3. Home ownership, interest rates, and overall housing vacancy.

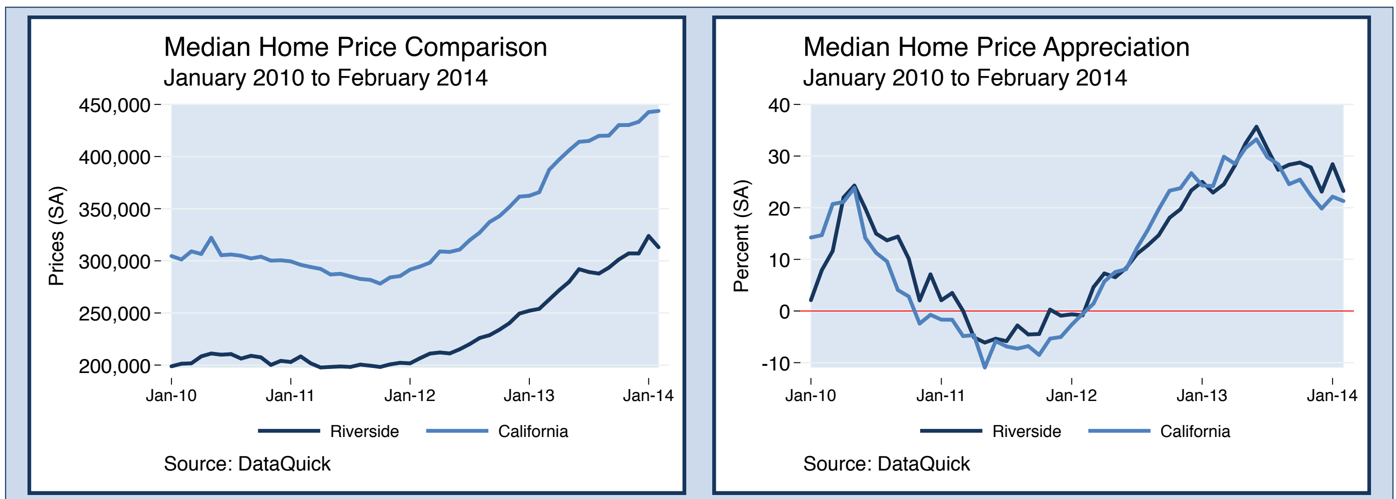
The remainder of this section will detail the direct and indirect drivers of our forecast for AV in Riverside County between 2014-15 and 2018-19. Overall, Beacon Economics expects solid growth in Riverside County's AV base during 2014-15 before the AV base gradually begins to trend back toward more "normal" levels of growth in the 5.5% range by the end of our forecast.

Factors Directly Affecting AV

Local Residential Real Estate Continues to Improve

One of the primary drivers of our forecast for AV in Riverside County is the genuine improvement in the local residential and nonresidential property markets. For example, the median sales price of an existing home in Riverside County was up by nearly 28% on average during 2013. This progress comes after a relatively solid year of growth in 2012 as well. Overall, since hitting bottom, median home prices, which stood at almost $315,000 in February 2014, have rebounded by more than 84% from their trough of just under $170,000 in May 2009. In fact, Riverside County

has started to gain some real momentum—outpacing the state overall on home price growth in nine out of the last 10 months.

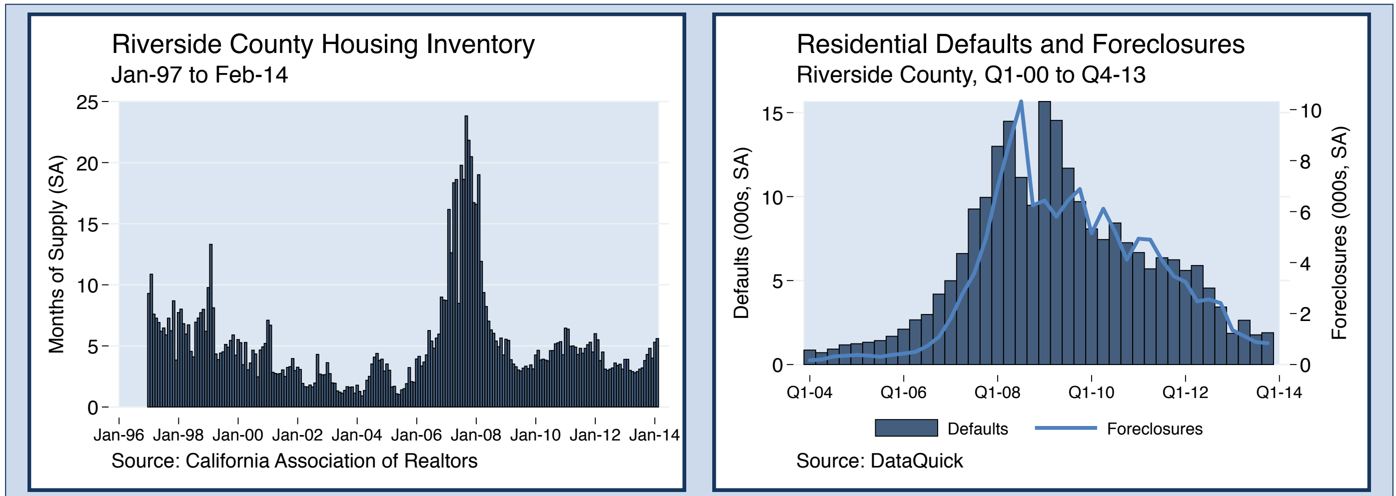


That is not to say that the area is completely recovered. Home prices still remain roughly 27% below their pre-recession peak. However, home prices have been trending upward consistently over the past three years, demonstrating that the worst is certainly behind us and the region is poised for ongoing improvement. From an AV perspective, it is not only the increase in the value of home prices that matters, as homes that do not change hands are largely protected from excessive increases to their AV by Prop. 13. AV is also partially determined by how many homes are sold at these higher prices—thereby triggering reassessments to their sales prices. Fortunately, the signs there are also encouraging: more than 110,000 existing homes and condos have been sold in the past three years. That represents more than 15% of the occupied housing units within the County that have been sold in an environment of rising prices. These sales should help to bolster AV in the coming year and beyond as these properties are reassessed at higher sales prices.

What's more, the outlook is even brighter for future home sales. Indeed, one reason that there has not been a bigger increase in home sales is due to the limited supply of inventory on the market. For example, housing supply is currently hovering at 5.6 months, meaning that the current supply of homes will be exhausted in less than 6 months at the current pace of home sales.

In addition, though still relatively low by historical standards, this represents a modest increase from the average of just 3.5 months of supply in Riverside County throughout 2013. As home prices have started to rise and more residents of the county have gotten back to work, prospective home buyers have sought to take advantage of historically low interest rates and home prices that are back to a semblance of affordability relative to their incomes. This has created very strong demand for a relatively limited amount of supply, which has helped to fuel further price appreciation.

The good news is that many homeowners are returning to positive equity, which should help to facilitate additional listings in 2014 and beyond. Indeed, according to real estate research firm CoreLogic, only 19.2% of homes in the Inland Empire were in negative equity during the final quarter of 2013 compared to more than 40% at the depths of the recession. As these homeowners return to positive equity, they will once again have the option to move up to other homes, which will free up more entry level homes for first-time home buyers. Each of these will help to improve local assessed values as more homes change hands at higher prices.



Another factor contributing to the increase in residential property values across the county is the precipitous drop in defaults and foreclosures across Riverside County. Specifically, both defaults and foreclosures were down by between 55% and 60% all across the county. In total, there were just under 4,200 foreclosures in the county last year, which is a significant decrease from the 25,000+ foreclosures in the county during the worst of the housing crisis in 2008. Not only has this reduction in distressed properties helped local property values by removing large volumes of discounted units from the sales mix, but they have also contributed to the aforementioned reduction in homes available for sale in Riverside County, which has helped to fuel additional price appreciation as prospective buyers bid over an ever-dwindling stock of distressed homes.

A recent report by RealtyTrac showed an increase in foreclosures during the first calendar quarter of 2014. However, this is largely, if not entirely, a jump for administrative rather than economic reasons. Last year, banks were paused from processing foreclosures due to the implementation of the California Homeowners Bill of Rights (CHBR) and that process is now resuming. In effect, these foreclosures that we are seeing now are actually foreclosures that should have been processed some time during the past 12-18 months, but were not able to.

Other indicators on the health of the mortgage market, demonstrate that things continue to improve. There has not been a new wave of mortgage delinquencies—the delinquency rates for mortgage loans from both the FDIC data and the Mortgage Banker's Association data show the California mortgage market continuing to heal. Indeed, as noted, the number of households in the Inland Empire that have moved from negative equity to positive equity over the course of the last few years has been considerable. This is the largest indicator of whether future homeowners will foreclose, and given that prices are forecasted to continue to increase, more households should see their equity improve as well.

As home prices rise and more homes are sold, AV growth is expected to be solid during the 2014-15 fiscal year and beyond. Specifically, Beacon Economics is forecasting that home prices will post another double-digit year in 2014, before trending back down.

Local Commercial Markets Slower Out of Gate, but Improving Nonetheless

The stock of existing commercial and industrial space in the local region is also showing signs of life—though progress has been slower than on the residential side of the market. According to REIS, vacancy rates for both offices and re-

tail space declined last year. Retail stores, where vacancy dipped into the single-digits at the end of last year, are in relatively better shape than the office market, which still suffers from over 23% vacancy.

As vacancy rates fall, capitalization rates improve, thereby increasing the implicit value of an existing structure. That said, commercial properties change ownership much less frequently than residential properties. Thus, the increases in implied values do not always translate into actual AV growth at the same pace. However, the improvement in commercial real estate fundamentals does impact the local AV base in Riverside County by stimulating new construction.

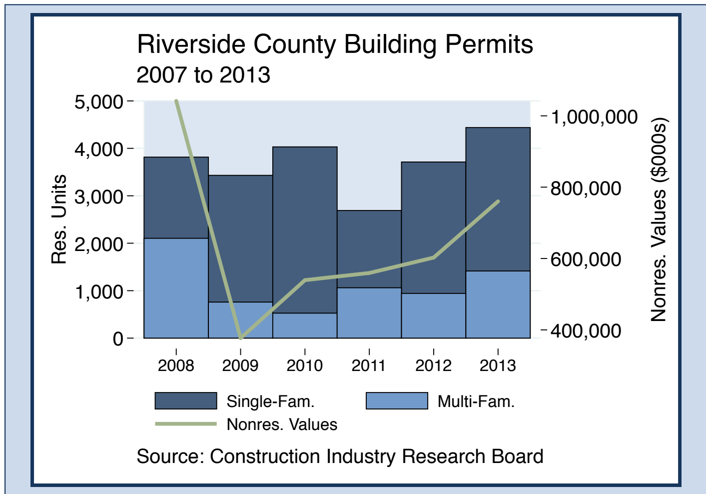
For example, at 9.7%, retail space in the Inland Empire has already dipped below the threshold of 10% vacancy that is typically associated with an uptick in new construction activity. Thus, as the commercial market heals, Riverside County will see an uptick in nonresidential building permits that will expand the stock of nonresidential properties—thereby exerting upward pressure on the local AV base.

Cyclical and Structural Factors Precipitate New Construction

From a structural standpoint, California has not built enough housing over the past few decades to keep up with population growth. In fact, despite all of the construction that took place during the housing bubble, California still maintained the 8th lowest housing vacancy rate in the nation at 5.0% at the end of 2013. This is also true in Riverside County, which, after removing seasonal/recreational properties, had just a 6.9% housing vacancy rate in 2012.

This under-supply of housing in the local economy combined with a gradually healing residential property market and economy in general has already started to motivate new construction activity throughout Riverside County. These new structures add to the existing stock of properties in the local AV base, which can have a significant impact on the local roll—particularly when transforming previously undeveloped land. Fortunately, Riverside County has seen an increase in the number of new residential permits issued by nearly 25% in both 2012 and 2013.

Similar trends are emerging in nonresidential construction activity within the county. In fact, 2013 marked the fourth consecutive year of rising nonresidential permit values. Overall, the total value of all nonresidential permits issued in Riverside County last year increased by more than 26%. Roughly half of this increase came from alterations and additions to existing structures. This is positive from an AV perspective as it increases the value of these particular structures. However, it is also an important bellwether for future *new* construction activity, which typically follows alterations/additions. Indeed, we are already seeing some of this activity getting started in Riverside County, as both new hotel and new industrial permits more than doubled during 2013 compared to the previous year.



As they come online, these new structures will help to bolster the overall AV in Riverside. Not only are prices for existing structures rising, but these structures are being improved, and we're creating new structures altogether. These are all positive indicators for growth in Riverside County's AV in 2014-15 and beyond.

Propositions 13 and 8

Since the 1970s, changes in California's AV base have been governed by Proposition 13, which limits the growth in the value of an individual property to either 2% or consumer price index (CPI) inflation as measured by the population-weighted average CPI of Los Angeles and San Francisco between Octobers. Thus, in times of low inflation, such as the current environment, property owners will see their AV rise by less than 2%, while in times of high inflation, property values will only increase by a maximum of 2% as long as there are no significant improvements made to the property or the property does not change ownership. Recently published guidance from California's State Board of Equalization show that the change in California's CPI between October 2012 and October 2013 was less than 0.5%. Therefore, properties that do not change hands this year will see their AV base rise by a 0.45% factor.

On its surface, this would seem contrary to the relatively optimistic forecast for AV growth in the coming year. However, there are several reasons why Beacon Economics has forecasted solid growth in AV over the next two years in particular, despite the relatively lackluster increase in CPI inflation.

First, many homeowners received Proposition 8 reductions during the downturn. According to the State Board of Equalization:

> In 1978, California voters passed Proposition 8, a constitutional amendment to Article XIII A that allows a temporary reduction in assessed value when real property suffers a decline in value. A decline in value occurs when the current market value of real property is less than the current assessed (taxable) factored base year value as of the lien date, January 1.[1]

Unfortunately, during the housing collapse of last decade, home prices in California generally, and the Inland Empire region specifically, were among the hardest hit in the entire nation. As noted earlier, home prices in Riverside County collapsed by more than 60% from their peak to their trough. As a result, the Riverside County Assessor's Office reduced the AV of a large quantity of property throughout the county. This was relatively painful for the county during the downturn, as many residences and businesses saw a reduction in their AV base. Indeed, according to the 2013-14 Annual Report published by the County Assessor's Office, these Prop. 8 reductions totaled more than $40 billion each in 2009, 2010, 2011, and 2012.

However, as painful as these reductions in value were to AV, and thus to property tax revenues for Riverside County, these properties will not fall back under the protection of Prop. 13 until they get back to their previous (Prop. 13) value. In other words, these properties are not limited to the 0.45% increase during the 2014-15 fiscal year, because Prop. 8 allows for the recapture of these temporary reductions as market values increase—even if there is no change in ownership that would trigger a reassessment. Given that median home prices have increased by more than 20% for two years running, Beacon Economics is forecasting that these Prop. 8 recaptures will help to offset the lackluster grow coming from Prop. 13-protected properties.

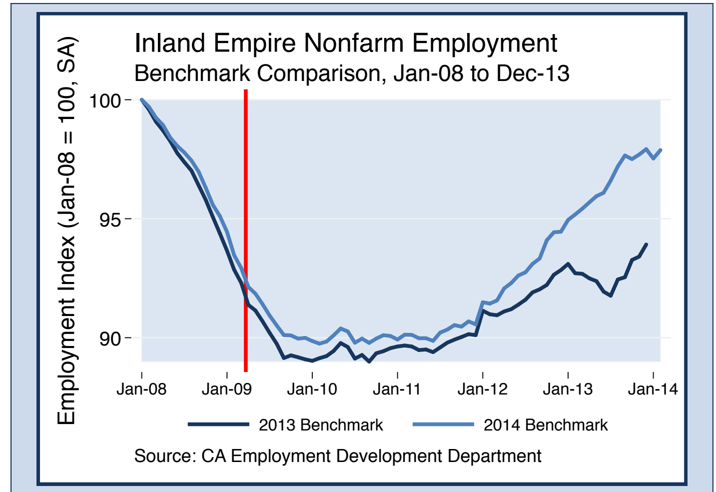
Combine these Prop. 8 recaptures with the reassessments stemming from homes being sold at higher prices, improvements to existing commercial and industrial properties, and new residential and nonresidential structures coming online, and AV growth is expected to be robust, despite the fact that CPI inflation was weak last October.[2]

[1] `http://www.boe.ca.gov/proptaxes/faqs/prop8.htm#1`

[2] It is also worth noting the CPI inflation is also expected to pick up in the coming year. Although Oct-12 to Oct-13 showed only 0.45% growth in California's CPI, the year-over-year growth of the surrounding months was more than double what we saw in October. As such, CPI inflation is expected to begin increasing this year, and will reach the 2% cap in the next few years.

Other Factors Indirectly Affecting AV

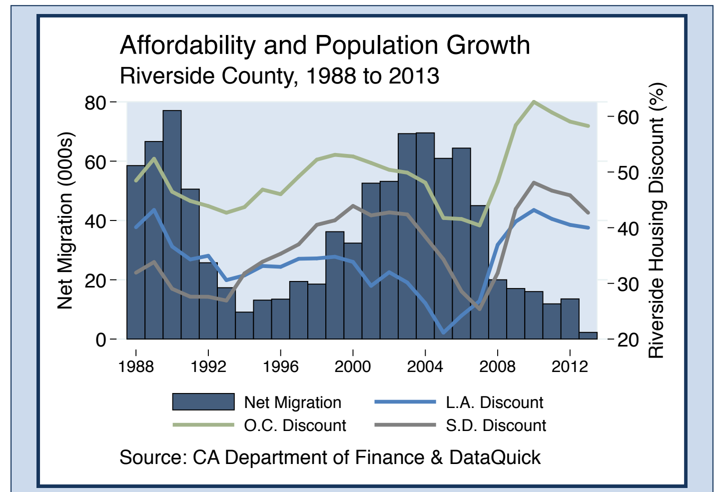
In addition to the factors that directly impact the local AV base in Riverside County, there are also several indirect factors that leave Beacon Economics optimistic about the direction of future property values and thus future property taxes.



The first is that the local economic recovery has been much more robust than originally reported. Newly revised benchmark estimates of employment in California paint a completely different picture of the state's economic recovery than has previously been reported—one that shows California has not been trailing the nation in job growth, but has been leading it. In sum, California was home to 150,000 more jobs in 2013 than was reported by the California Employment Development Department (EDD) last year.

This very positive news for the state's economy is even more significant for the Inland Empire because it changes the story of the local economic recovery completely. Indeed, through December 2013, the EDD data was showing comparatively lackluster labor market growth, with the Inland Empire expanding nonfarm payrolls by just 1.2%.

Fast-forward to March 7, 2014, and that narrative has been tipped on its head. Instead of falling behind the statewide average, the Inland Empire not only outpaced the state overall, but the region was one of the top performing economies last year—ending 2013 above all other major Southern California metros on a proportional basis, including Los Angeles, Orange County, and San Diego. These revisions have rewritten the script of the Inland Empire region being a drag on the state's overall job creation to being a driver of California employment growth.



Secondly, there are several structural features of the current economy in Riverside County that leave Beacon Economics optimistic about future housing demand, and thus AV. This is largely a function of relative affordability. Given that home prices fell so much faster in the local economy, Riverside County has actually seen a dramatic increase in affordability relative to these other Southern California employment centers.

For example, a prospective buyer in Orange County looking to purchase the median-priced home currently stands to save nearly 60% on the cost of that home by considering the median-priced home in Riverside County. Given that these individuals would still maintain convenient access to their place of work with the

existing transportation infrastructure (SR-91, SR-60, SR-74, and MetroLink, among others), this provides a strong financial incentive for all Southern California residents to consider a longer commute. We see similar resurgences in relative affordability when comparing prices in Riverside County to those in San Diego and Los Angeles.

Indeed, the County is already beginning to reap the benefits of this relative affordability. For example, despite the fact that there was very little migration during 2013, Riverside County was one of only 13 counties in California to see more residents move into the area than leave it during 2012. As the local economy continues to build steam, Beacon Economics expects an increasing number of coastal residents who want to maximize their residential investment dollar to continue to look to Riverside County as a way to get a larger home or a bigger lot at a relatively affordable price without cutting ties to their current employment center.

This influx of new residents will create additional demand for housing in an area that is already short on supply. This will have two impacts: first, it will bolster the price of the homes that do sell; second, it will increase new construction activity and expand the stock of existing properties. Each of these effects will help to indirectly bolster assessed valuations throughout the county.

Fortunately, these outbound commuters tend toward the higher end of the education, skills, and income spectrums. Thus, not only will they increase demand for housing, they will help to provide demand in the middle and upper tiers, which carry larger sales, and therefore assessment values.

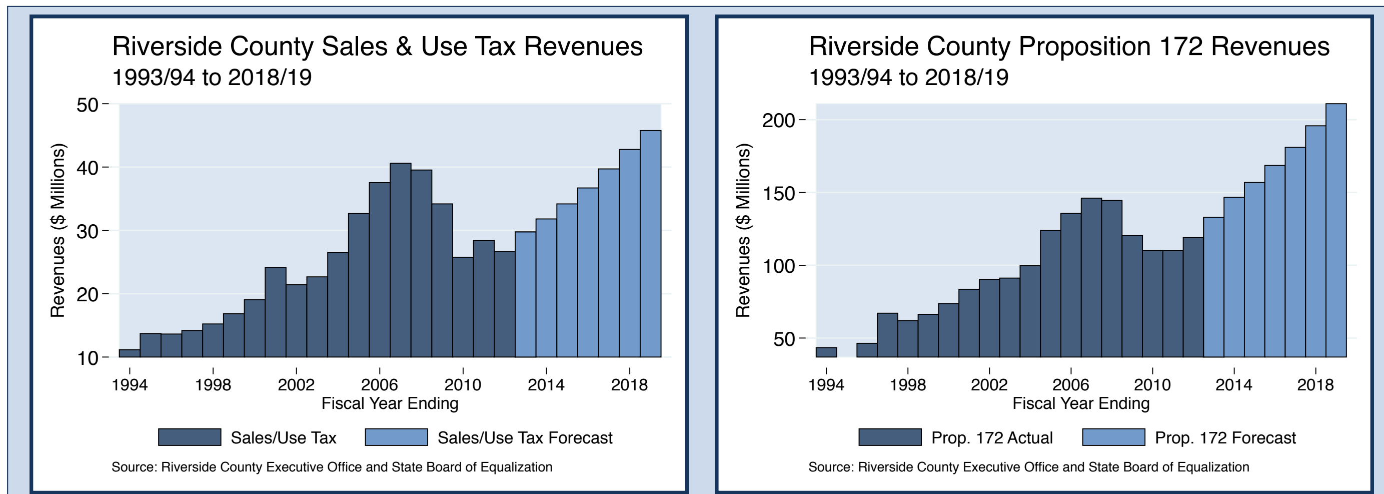
Overall, the outlook for AV in the County of Riverside remains quite positive. In fact, Beacon Economics has revised up its forecast for AV growth in Riverside County for 2014-15 and 2015-16. In addition, depending on how the next six months play out, Beacon Economics may make further upward revisions to this forecast in the fall. Not only is the current stock of residential and nonresidential properties seeing improvement in prices and underlying fundamentals, but this improvement has catalyzed new construction activity. Together with a gradually healing economy and several advantageous structural assets like affordability and access to larger employment centers, Beacon Economics expects growth to exceed 7% in the coming fiscal year before trending back toward 5.5% annual growth by 2018-19.

Taxable Sales, Sales/Use Tax, and Prop. 172 Revenues

As noted herein, Beacon Economics was asked to focus primarily on the outlook for AV. Thus, the remaining sections of this report provide a synopsis of our forecast for taxable sales, sales tax revenues, and the Prop. 172 Public Safety Sales Tax.

These other major revenue streams for Riverside County are driven primarily by trends in local spending and the health of the economy overall. Sales and use tax benefits directly from increased spending in the County. The County's public safety and realignment revenues, which benefit from higher local and statewide spending, will continue to increase as the local and state economy moves forward. Beacon Economics is currently forecasting positive growth across each of these revenue streams over the next five fiscal years.

Our taxable sales forecast has been downgraded very slightly since our previous report due to weaker than expected spending in the first half of fiscal 2013-14. Beacon Economics is currently projecting taxable sales in the unincorporated portion of the County to increase by 6.9% in fiscal 2013-14, then grow in the 7% to 8% range for the life of the forecast. Our forecasts for public safety sales tax revenues remain largely unchanged from our previous estimates.



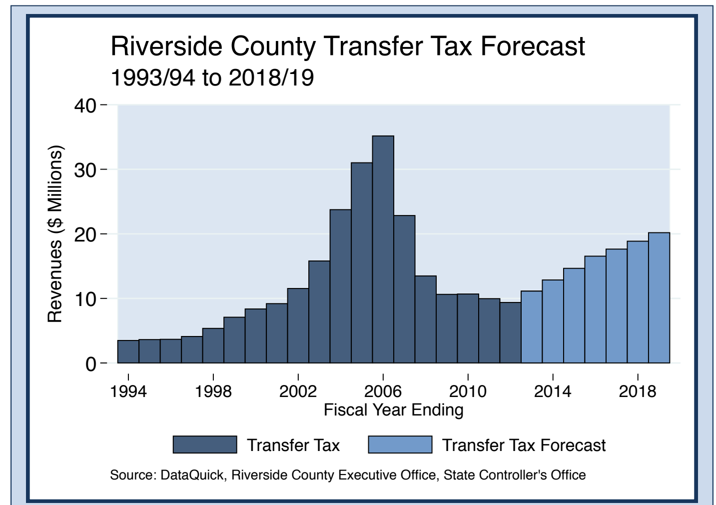
Unincorporated Spending Shines in the First Half of 2013-14

- According to taxable receipts data from the HdL companies, spending in the unincorporated portion of Riverside County was up by roughly 20% for the first six months of fiscal 2013-14. This indicates that spending growth in the overall region is still trending up.
- Taxable receipts from Building and Construction Materials made up the bulk of the gains for the first half of fiscal 2013-14 and were up nearly 32% from the first half of fiscal 2012-13.
- Autos and Transportation spending was up by roughly 19% through the first half of the fiscal year. This is not only a positive for current sales tax receipts, but is also an important bellwether for future spending, as spending on these types of long-term durable goods is typically postponed during times of economic uncertainty. The fact that these sales in particular have continued to move forward suggests that local consumers are feeling more confident about the direction of the economy in Riverside County.
- Fuel and Service Stations sales were down slightly, as were Business and Industry sales, but all other categories saw positive growth.
- Statewide spending trended higher in 2013. Taxable sales in California increased 7% over 2012 levels. As spending increases throughout the state, this will help boost public safety revenues by enlarging the state pool from which these revenues are distributed.

Tourist, consumer, and business spending in Riverside County continues its upward trend that began in mid-2009. Overall, spending has been driven by improved economic conditions in the County and, more specifically, by the housing market recovery and positive employment trends. In addition, as noted, the region has experienced an increase in tourist spending, which is critical for sales tax hubs like Cabazon.

Transfer Tax Revenues

As noted, there have been a significant number of home sales over the past three years. And, while home sales did not increase in 2013, they were relatively flat at much higher prices. This ultimately results in positive growth in transfer tax revenues. In addition, we expect sales to pick up in 2014 due to the improving economic conditions already discussed. Continued positive net migration, as we forecast, will also increase demand for housing. In fact, one of the reasons for positive net migration is the affordability of the local housing market relative to the neighboring coastal counties. Residents from Los Angeles County, San Diego County and Orange County have traditionally opted for Inland Southern California when prices in the region create a discount-incentive relative to neighboring markets. As noted, this affordability is at a very high level by historical standards because prices in Riverside County fell faster than they did along the coast.



Also, although interest rates have increased modestly over the past six months, mortgage debt remains very affordable relative to historical norms. As the economy continues to heal, the property market remains strong, and homeowners begin to see positive home equity again, Beacon Economics expects that local home sales will continue to rise, generating further growth in local transfer tax revenues.

As a result, Beacon Economics estimates that transfer tax revenues will increase by more than 10% in the next two fiscal years, due to both rising sales and higher transaction values. Our forecast for 2014-15 and 2015-16 calls for double-digit gains in transfer tax revenues. Thereafter, we expect the revenues to slow to a more sustainable single-digit growth rate as the pace of home price appreciation and transaction volumes moderate toward historical norms.

Summary

Our view that Riverside County had turned the corner toward recovery in the wake of the Great Recession has been confirmed with recent data and is reflected in the current forecast. The region continues to expand employment levels and in fact has done much better over the past few years than was initially reported by the EDD.

Residential real estate has posted some impressive gains over the past year and continues to lead the recovery. Commercial real estate is also on the mend, though some sectors are doing much better than others. Beacon Economics expects the AV to improve on its 3.95% increase of 2013-14 in 2014-15 and beyond. In addition, we expect the AV to reach pre-recession levels in fiscal year 2015-16.

The County of Riverside still has a long way to go to get back to where we were before the Great Recession, but the economy is clearly moving in the right direction.

About Beacon Economics

Beacon Economics, LLC is a leading provider of economic research, forecasting, industry analysis, and data services. By delivering independent, rigorous analysis we give our clients the knowledge they need to make the right strategic decisions about investment, growth, revenue, and policy. Learn more at www.BeaconEcon.com.

Services

- Economic, Revenue, & Occupational Forecasting
- Economic Impact Analysis
- Regional Economic Analysis
- Economic Policy Analysis
- Real Estate Market Analysis
- Industry and Market Analysis
- EB-5 Economic Analysis
- Public Speaking
- Expert Testimony

Contacts

- **Sherif Hanna**
  Managing Partner
  (424) 646-4656
  Sherif@BeaconEcon.com
- **Victoria Pike Bond**
  Director of Communications
  (415) 457-6030
  Victoria@BeaconEcon.com

Attachment E California State Fullerton Economic and Revenue Forecast

CALIFORNIA STATE UNIVERSITY FULLERTON

CENTER FOR ECONOMIC ANALYSIS AND FORECASTING

Dr. Mira Farka

Dr. Adrian R. Fleissig

COUNTY OF RIVERSIDE: ECONOMIC FORECASTS AND ANALYSIS

for

COUNTY OF RIVERSIDE

April 2014

TABLE OF CONTENTS

Section	Topic	Page
	EXECUTIVE SUMMARY	**2**
A	**NATIONAL ECONOMY**	
A1	Overview and Economic Outlook	**3**
A2	Projections of Key National Economic Indicators	**11**
B	**RIVERSIDE COUNTY ECONOMY**	
B1	Overview	**12**
B2	Labor Market Outlook	**13**
B3	Real Estate Market	**16**
B4	Inflation Outlook: California and the Region	**19**
B5	Projections of Riverside County Main Economic Variables	**21**
C	**RIVERSIDE COUNTY BUDGETARY VARIABLES**	
C1	Overview of Assessed Property Values	**22**
C2	Secured Assessed Valuations and Projections	**23**
C3	Detailed Analysis on Parcel Data	**24**
C4	Motor Vehicle Licensing Fee (in Lieu)	**26**
C5	Documentary Transfer Tax	**27**

EXECUTIVE SUMMARY

US Economy

- U.S. Economy will expand more robustly over the forecast horizon with growth rates closer to historical underlying trend rates though still below the historical average post-recession rates.
- Four main reasons for optimism: business sector finances are in great shape, construction will expand (particularly in residential market), fiscal policy is no longer a drag on growth and global and policy risks have receded from year-ago levels.
- As it heals the economy faces a number of challenges: the labor market faces issues on both demand (automation, globalization) and supply side (reduction in labor force participation); consumption spending will be somewhat restrained from lack of income growth; behavioral changes in household preferences may have led to a permanent increase in rental versus homeownership.
- A number of short-term risks weigh on the forecasts: persistent low inflation, the timing of interest rate hikes, financial market froth and volatility, emerging market instability and increased geo-political risks.

Riverside County Economy

- The economic outlook for Riverside County continued to improve over the past year.
- Hiring has increased primarily in low-paying sectors with growth in higher paying jobs continuing to languish below their pre-recession peaks.
- The construction sector is roughly half the size of pre-recession while manufacturing employment has leveled off.
- Home values posted astounding home gains over the past year spurred primarily by investor demand with commercial activity (especially in the industrial market) rebounding dramatically from cycle-lows.
- We expect the recovery to continue over the next few years at a slightly faster clip than normal.
- A main challenge is the lack of progress in education and human development required for future jobs.
- The county is well positioned for growth in the long-term with its central location, proximity to the ports of Long Beach and Los Angeles, and relatively affordable land and large storage facilities.

Riverside County Secured Assessed Valuation

- The long-awaited recovery in Riverside County's assessment rolls commenced at last in FY 2013-2014. Secured valuations grew by 4.2% after four consecutive years of decline.
- Secured assessed valuation are projected to increase by a further 5.1% in FY 2014-2015 and 5.0% in FY 2015-2016 as real estate values continue to increase albeit at a slower rate compared to 2013.
- For the remainder of the forecast horizon, property values are expected to pick up more robustly as the economy heals and demand for housing increases.

Riverside County Budgetary Variables

- During FY 2014-2015, MVLF revenue is projected to increase by 4.3% to $202,348,828 and by 5.2% to $212,870,967 in FY 2015-2016.
- MVLF revenue is projected to increase at a modest pace in the long term as the real estate market recovers with assessed values rebounding from depressed levels.
- Documentary Transfer Tax revenue is projected to increase by 11.4% (to $12,391,374) in FY 2013-2014 and by an additional 9.2% (to $13,531,381) in FY 2014-2015.
- In the long term, document transfer tax revenue is expected to continue to grow as the recovery in the real estate market continues to expand.

A. NATIONAL ECONOMY

A1. Overview and Economic Outlook

Overview

The outlook for the US economy has evolved broadly in line with our expectations: the recovery has continued to expand, though the pace of growth has been generally below what is expected at this stage of the business cycle. Our view is that the economy will expand more robustly gaining strength and pace over the forecast horizon. In fact, the next three years will likely be the strongest consecutive years of growth over this decade, as growth comes in closer to the historical underlying trend rates, though still below the historical average post-recession rates.

There are four main reasons for this optimism. First, it appears that fiscal policy may no longer act as the growth-deterrent factor it has been over the past few years given the year-end budget deal and the early-year increase in the debt ceiling -- both of which proceeded without the usual drama. Second, the private sector has rarely been in better shape: profit margins are high, business debt levels are quite manageable, corporate coffers are flush with cash, and low US energy prices have dramatically improved the global competitiveness of US businesses. Third, the housing sector -- an emerging bright spot in 2013 -- will continue to contribute importantly to growth even though the pace of improvement may be a bit more restrained due to higher mortgage rates and a waning of investor interest. Fourth, global and policy risks have receded quite markedly since our last report: issues related to the Eurozone debt crisis while not fully resolved no longer present the imminent threat they once did to the global outlook, the Chinese economy appears to have averted a "hard-landing", and the much-awaited "tapering" from the Federal Reserve has finally begun with minimal adverse impact (so far) on growth or financial stability.

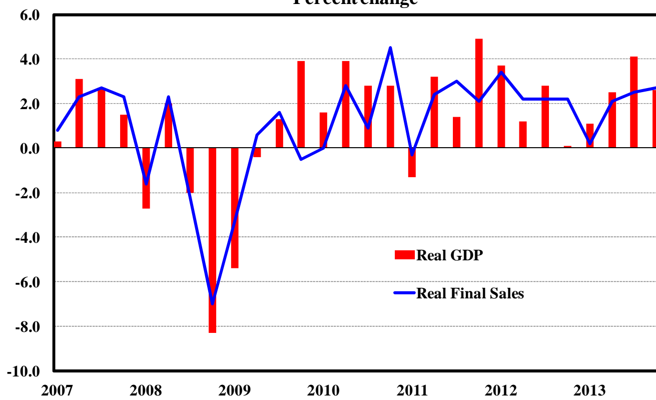
Though these factors make a solid case for optimism in the years ahead, our overall assessment of the national economic outlook remains guardedly upbeat and still slightly below the consensus. While growth will continue to edge up from the current anemic 2% pace towards trend-rates, it will still remain below average recovery levels (4%-5%). Consumer spending, while supportive of growth, will continue to expand by only marginally higher rates than over the past two years partially because credit availability is still tight and partially because income growth has been particularly lackluster. Labor markets will continue to improve, but challenges remain both on the demand and supply side. Manufacturing production should also contribute to growth though at a moderate pace since it is partially restrained by the current inventory built-up.

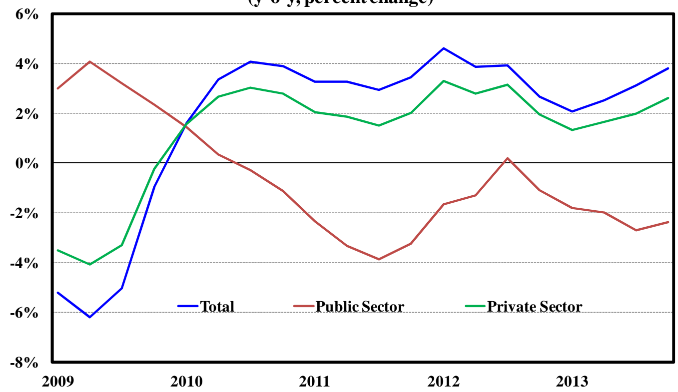
A number of short- and long-term risks also weigh on the forecasts. The risk of persistently low inflation both in the US and in the Eurozone remains a cause for worry. The ability of the Fed to correctly manage expectations with regards to the future path of monetary policy presents another important risk factor for the outlook. Financial markets, which have had a spectacular run over the past five years, may display more volatility as a result of a re-calibration of monetary policy. Likewise, emerging markets have experienced large capital outflows, increased financial volatility and sizable currency depreciations since tapering began. Finally, geopolitical risks are on the rise: further escalations in the Ukrainian/Russian conflict may have global spillover effects, particularly in Eurozone, which is heavily dependent on Russia for its energy supply and on Ukraine for its pipeline delivery.

Economic Activity: Shaking Off the Winter Chills

Real GDP grew by 1.9% in 2013, almost a full percentage point below the 2.8% rate of 2012 and broadly in line with the 1.8% growth recorded in 2011. The second half of the year proved a lot more encouraging as real GDP grew by 4.1% in the third quarter and by 2.6% in the fourth -- above the full-year rate of 1.9%. This buoyed expectations that the recovery had finally turned the corner: many analysts were quick to declare that 2014 would be the "break-out" year for the economy.

Our outlook is a bit less sanguine. While we expect real GDP to expand at a faster clip over the next two years than it has in recent past, we believe that the pace of improvement will be a steady slow march rather than a gallop. Part of the reason is because the momentum from the second half of 2013 is not as strong as initially envisioned: Q4 GDP, for example, was revised down sharply from a high of 3.2% to a current 2.6%. In addition, much of the strength in numbers came from an inventory build-up which is expected to reverse course and restrain growth in the first half of 2014 -- real final sales grew only by 2.5% in the third quarter of 2014, even though real GDP growth came at a solid 4.1% (Figure A1).





Weather effects are also expected to take a heavy toll on economic activity in the first quarter of 2014: unusually cold temperatures in the MidWest and NorthEast have adversely impacted consumer spending, home sales, construction and production while a severe drought in the West has reduced agricultural production and bolstered prices of crops. When coupled with the slower rate of inventory accumulation, real GDP growth in the first quarter appears to be hovering around 1.1-1.2%.

The outlook for growth is more bullish in the second half of the year: weather setbacks and the inventory cycle are simply temporary factors: by mid-2014 and beyond, the strength of the private sector, the waning impact of the fiscal withdrawal and robust housing construction should bolster growth. We expect real GDP to grow by 2.6% in 2014 and a more robust 3.1% in 2015.

Reasons for Optimism

The Private Sector is doing Fine...Business Outlook

One of the main reasons for a more upbeat outlook over the next few years comes from the strength in the private sector: real output from this sector grew by 2.5% in 2011 (relative to an overall 1.8% growth in real GDP), by 3.0% in 2012 (compared to an RGDP growth of 2.8%) and 2.3% in 2013 (relative to a 1.9% RGDP growth) (Figure A2). The business sector is in the best shape it has been in years: profit margins are at record-highs, balance sheets are healthy, and corporations have accumulated roughly 2 trillion dollars in cash with an additional 1.95 trillion from multinational companies remaining outside the US.

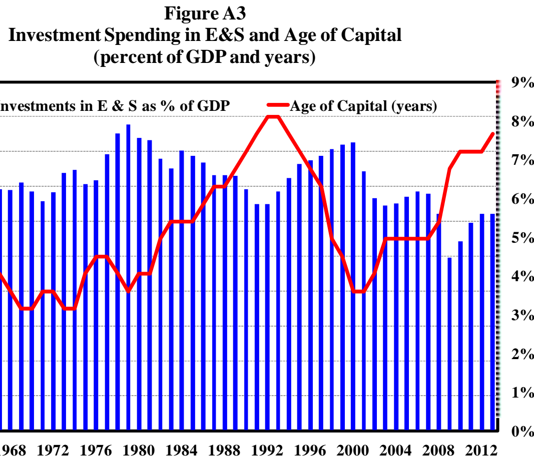
Despite these continued improvements, companies have been reluctant to expand, embark on large-scale capital investments or go on a hiring binge. Our outlook is that this reluctance will dissipate somewhat over the course of this year and in the following two years. Apart from concerns about sales and policy uncertainty, one reason that appears to have held back hiring during the recovery is a relatively high level of real wages: real wages have increased roughly by 2% since the end of the recession largely due to a low-inflation environment. With inflation rates firming up over the forecast horizon, we expect real wages to edge down, which should prove as an impetus to hiring. Besides, productivity growth has edged down substantially since the height of the crisis which means that if firms are planning to expand output they would need to hire more labor.

In addition, US businesses have a significant competitive edge globally: unit labor costs (the ratio of productivity to hourly wages) -- arguably the single-best measure of competitiveness -- has declined recently for US firms and it's among one of the lowest in the advanced world. Energy costs have further contributed to the competitiveness of US firms: the unconventional oil and gas revolution that has occurred in the U.S. over the past few year's means that US businesses pay one third of energy-related costs paid by European businesses and one-fifth of costs paid in Japan and in the rest of Asia.

A number of factors bode well for business investments going forward. Real Investment in Equipment and Software (E&S) as a share of real GDP are just barely at the same level as in December 2007 despite growing at a galloping pace early in the recovery. Likewise, investment in structures is well below historical levels. We expect both these components to contribute more to growth going forward when compared to the past two years, though the pace would be rather moderate. First, in nominal terms

Investments in E&S continue to remain below historical levels suggesting there is room for spending. Second the average age of capital stock is the highest it has been for decades, which means that some replacement, especially in equipment, is warranted to replace old and worn-out capital (Figure A3).

Figure A3
Investment Spending in E&S and Age of Capital
(percent of GDP and years)



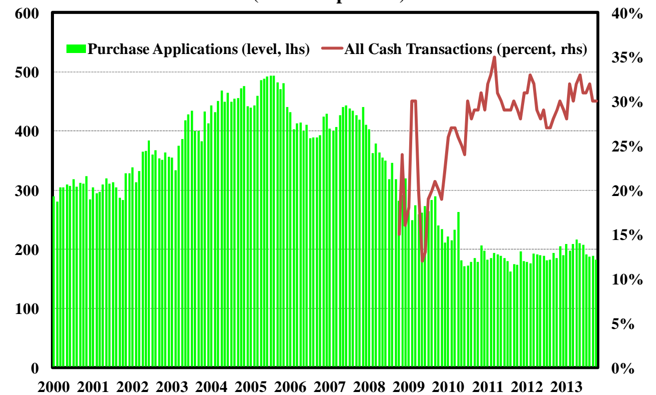
US Bureau of Economic Analysis and CEAF

Housing Rebound to Continue

The housing market has made a spectacular comeback since mid-2012. Compared to their cycle-lows, home sales are currently up 33%, home prices by 23% (according to Case-Shiller Price Index), and the share of homeowners with negative equity has dropped from 25% to a current 13%. More encouragingly, construction has picked up dramatically: real spending on residential investments is up 33% from its trough at the height of the crises and housing starts have almost doubled from a historical low of 478,000 to a current 907,000. This momentum ebbed to a certain extent over the past few months as unusually cold winter, higher mortgage rates and a pullback from investors slowed sales, prices, and construction.

A reversal of the slowdown from the winter chills is certainly expected: we anticipate that housing market will continue to add significantly to economic growth over the forecast horizon though the pace of improvement -- particularly in home prices -- will likely be a notch below the break-neck rate of the past year. The early housing market rebound was largely due to investor demand: "all-cash" transactions (which usually represent investor demand) jumped to a high of 30% since 2009 while mortgage purchase applications for home purchase (which represent traditional home-buyers) are hovering at 15-year lows (Figure A4). Anecdotal evidence suggests that investor demand has begun to wane now that home prices have firmed up and the bargain-deals are no longer available, which may have led to a softening in the housing data as of late. The transitional phase from investors to traditional home buyers will continue during this year and, as we cautioned in the past, may prove more uneven than some initial analysts have predicted.

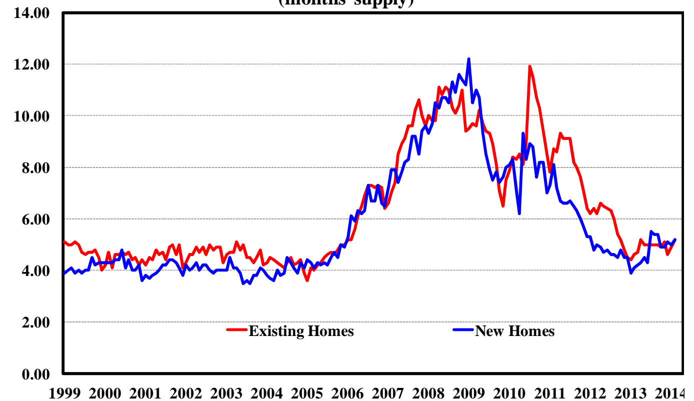
Figure A4
Mortgage Application and All-Cash Transactions
(level and percent)



Mortgage Bankers Association, National Association of Realtors and CEAF

There is strong evidence to support the eventual re-entrance of the traditional home-buyers. On the demand side, though mortgage rates are now around 70 basis points higher than a year earlier, they are still at historical-low levels. Housing affordability -- though below its year-ago levels is still at historical highs, household formation has picked up and the slide in homeownership rates has stabilized at around 65% over the past few months --down from a high of 69%. On the supply side, home inventories (both existing homes and new homes) are at record-lows and the months' supply of homes is largely in line with the historical average of around 5 months (Figure A5).

Figure A5
Housing Inventory
(months' supply)



US Census Bureau and CEAF

Though fundamentals for a continued pickup in the housing market are in place, our view is that this will happen more gradually than what we have seen in recent past. Household formation, though up from recession-trough levels, are still running below historical rates reflecting weak income and job growth as well as secular demographic trends with

young adults postponing life-cycle decisions due to higher student debt, longer schooling years and a behavioral shift towards renting (at least for now).

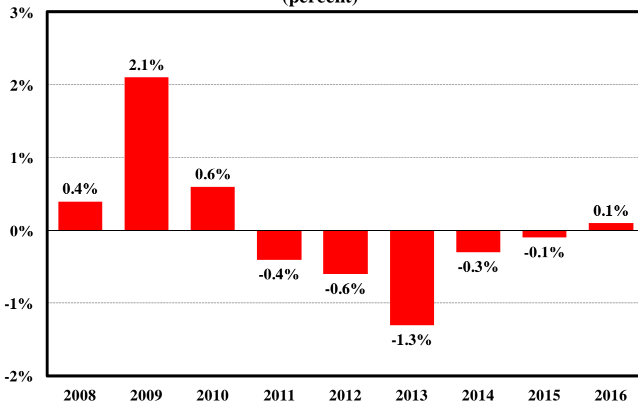
Going forward, we expect housing starts to average around 1.1 million this year and 1.3 million in 2015. Home price appreciation will continue albeit at a lower clip than in 2013, posting 7%-9% gains this year and 5-7% in 2015.

Smaller Drag from Fiscal Policy

For the first time in years it appears that fiscal policy will not be the growth-restraining factor it has become as of late. The bipartisan budget deal of December which laid the groundwork for funding the government for two years and the early-year debt-ceiling agreement to raise the debt ceiling until March 2015, provide a much-needed reprieve from the policy uncertainty that has clouded the outlook and threatened the fragile recovery over the past few years. The budget framework provides some relief from the sequester, avoids further defense cuts, and restores some funding for non-defense discretionary programs. More importantly, the agreement covers fiscal years 2013-2014 and 2014-2015, thus providing some predictability about the path of fiscal policy, at least in the near term.

While these moves hardly constitute responsible policy, they are a welcome change from the countless cliffhangers and last-minute deals of the last few years. Though federal fiscal policy won't contribute to real GDP growth, the drag it will impose over the forecast horizon is minimal. Fiscal austerity weighed significantly on growth in 2013 when the expiration of the payroll tax cut, an increase in the marginal tax rate of high-income households and the mandatory across-the-board sequester cuts collectively combined for a -1.3% drag on real GDP growth (Figure A6). The drag will

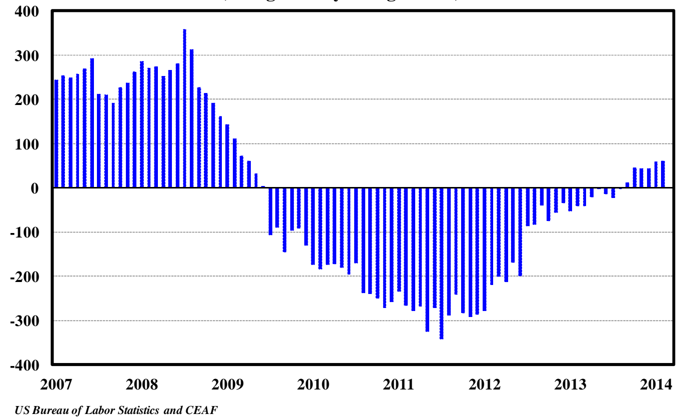
Figure A6
Fiscal Policy Impact on GDP Growth
(percent)



be significantly less in 2014; federal fiscal policy is expected to chip away around -0.3% from real GDP growth, a large part of which is due to the expiration of emergency unemployment benefits for 1.3 million long-term unemployed (amounting to around 25 billion dollars).

State and local governments are also faring better compared to the height of the recession. Real consumption from state and local governments rose for the first time last year since 2009 and real investments have declined at significantly lower rates than in the past suggesting that a modest pick-up is just around the corner. In fact, public construction spending is up 2.5% this year compared to year-ago levels, spurred primarily by state and local projects on Highway and Street Work and other Transportation related projects. Employment in this sector has also begun to heal slowly: after shedding a total of 750,000 jobs since the start of the recession, state and local government have added a total of 77,000 jobs to their roll -- far below the pre-recession level, but an improvement nonetheless (Figure A7).

Figure A7
State and Local Payroll Employment
(change from year-ago levels)

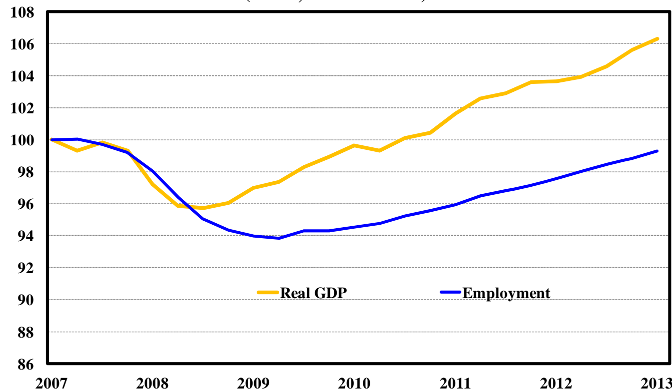


Challenging Spots

Labor Market Pathologies

Perhaps the most defining characteristic of this recovery has been the unmistakable gulf that separates the output and labor markets: though sluggish, output growth seems vigorous when compared to the snail-paced recovery in employment (Figure A8). Of course, quite a lot of progress has been made: the economy has recovered nearly all of the 8.7 million jobs lost during the recession, job growth has continued for an uninterrupted three and a half years, and the unemployment rate has dropped from a cycle high of 10% to a current 6.7%.

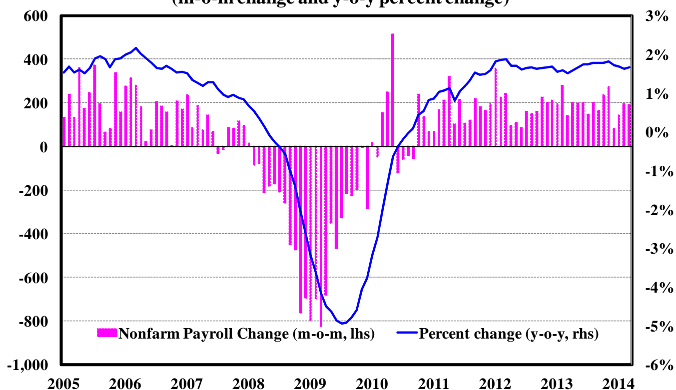
Figure A8
Real GDP and Labor Market
(Index, Dec 2007=100)



US Bureau of Economic Analysis; US Bureau of Labor Statistics and CEAF

The pace of job formation has improved from 1 million in 2010, to 2.2 million in 2011, 2.2 million in 2012 and 2.3 million in 2013. In fact, the recent pace of job creation is roughly the same as in the 2004-2007 period -- which means that the labor market is improving at what might have become the "normal" pace (Figure A9). This would not be cause for concern in an ordinary period, but it is quite worrisome after the dramatic job losses wreaked by the recession. A slowly recovering labor market, though better than intermittent growth or no growth, does pose new challenges as the long-term unemployed become less employable with the passage of time and discouraged workers remain out of the labor force.

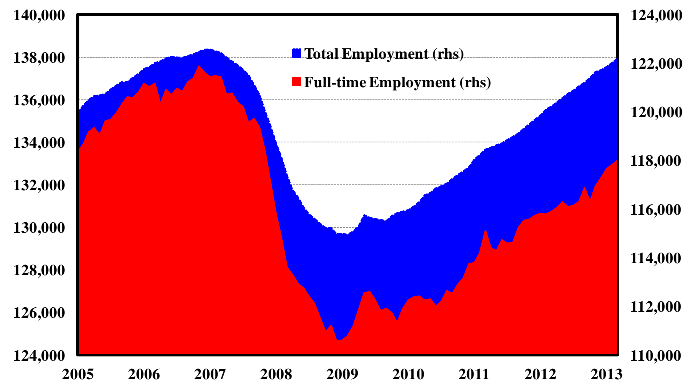
Figure A9
Total Nonfarm Payroll Employment
(m-o-m change and y-o-y percent change)



US Bureau of Labor Statistics and CEAF

A number of other abnormalities appear to be plaguing the recovery in the labor market. Though the overall employment is just shy of its all-time high of December 2007, full-time employment is still a staggering 3.8 million below its pre-recession peak, suggesting that a large number of newly created jobs are part-time (Figure A10). Moreover, temp employment has risen by 62% since the end of the recession, surpassing by far the 5.7% total growth posted by the non-temp sector over the same period. Though temp work is usually one of the first sectors to pick up during the early stages of the recovery, 56 months into the recovery hardly qualifies as the "early stage."

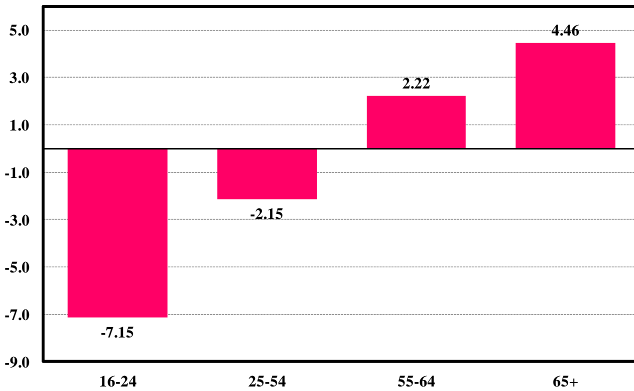
Figure A10
Total Employment and Full-time Employment
(level, thousand of employees)

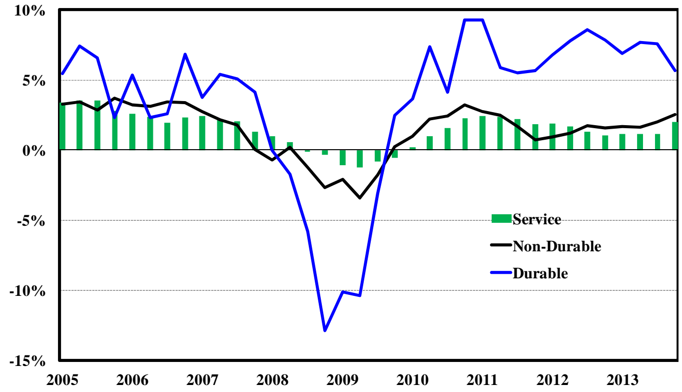


US Bureau of Labor Statistics and CEAF

Labor market woes are be both demand and supply-driven. On the demand side, there appears to be a shift on the part of employers in reorganization of production towards more capital-intensive technologies and away from labor. This has allowed firms to save on wages and benefits while retaining the flexibility that comes with temp employment which has now become increasingly long-term. Productivity also rose substantially after the end of the recession, which allowed businesses to maintain production levels without having to substantially expand their labor force.

On the supply side, the precipitous decline in labor force participation rates is the most worrisome development. Participation rate fell nearly 3% since the start of the recession, which means that the labor force today is roughly around 7 million smaller than what it would be had participation rates remained the same. Labor force participation rates have declined the most among young adults (down by 7% since the start of the recession), but have increased markedly for the older cohorts: participation rates for 55-64 year-olds is up by 2.2% since the start of the recession, while that of 65+ year-olds is up by 4.5% (Figure A11). The more worrisome aspect is the decline in participation rates amongst the 25-54 year old cohorts, which make up the bulk of the labor force. These trends are also reflected in employment levels: compared to the pre-recession, employment has risen by 4 million for the 55-64 age cohort and by 2.3 million for the 65+ age cohort. In contrast, employment levels among 16-24 years olds have declined by 1.5 million and for the prime-work demographic of 25-54 they are down by a staggering 5 million.





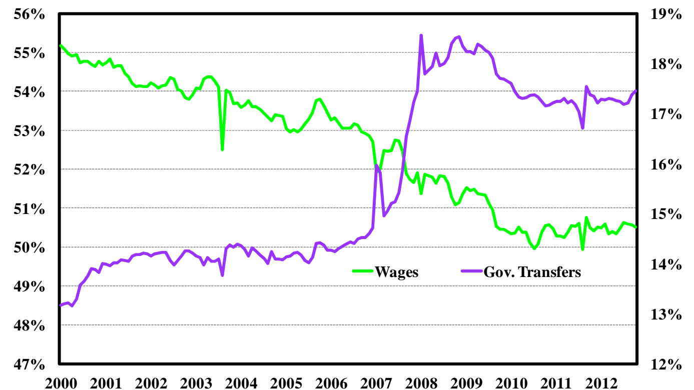
Going forward, we expect the labor market to continue to improve, albeit at a similar pace as it has over the past few years. Nonfarm payrolls should increase by an average of around 200,000 jobs per month over the next couple of years. The unemployment rate is expected to average 6.5% in 2014 and 6.1% in 2015.

The Household Sector

Consumer spending picked up steam in the second half of 2013 after an expected slowdown in the first half due to marginal tax rate hikes in the upper-income households and the expiration of the payroll tax cuts. Real spending on durable goods rose by a healthy 6.9% (on a year-over-year-basis) buoyed primarily by spending in motor vehicles (due to pent-up demand during the lean post-recession years) and by expenditures on furnishing and household appliances spurred by continued improvements in the housing market (Figure A12). Spending on services (which makes up roughly around 44% of US real GDP) has improved at a more tepid pace, growing by an average of 1.6% over the past four years -- roughly half of the historical average rate of 3%.

We expect consumer spending to contribute to growth over the forecast horizon. There seems to be still quite a lot of pent-up demand for motor-vehicles, auto loans are growing and interest rates for new auto loans continue to remain at historical low levels. Overall, there appears to be a desire from the part of households to increase spending: personal savings rate has fallen over the past few months while consumer credit continues to expand at a healthy 5% pace. Household balance sheets are in the best shape compared to any point during the recovery: the household debt-to-GDP ratio is at historical low levels and household delinquencies have declined across the board.

While we expect consumer spending to support growth, we don't envision it to be the main driver in the road ahead. Thanks to labor market woes, wage and income growth has been significantly restrained during the recovery: wage growth has averaged around 2% per year since the start of the recovery -- far below the historical average of 4.6%. More worryingly, wages as a share of income have been on a steady downtrend since the beginning of the millennium declining from around 55% to a current 50%. In contrast, government transfers as a share of disposable income have grown from 13% in 2001 to 17.4% as of the latest reading, a phenomenon that is partly due to demographic trends (the retirement of baby-boomers) and partly to the expansion of safety nets (unemployment benefits, disability rolls) (Figure A13). Our baseline forecast calls for growth in real consumption spending of 2.4% this year and 2.7% in 2015.



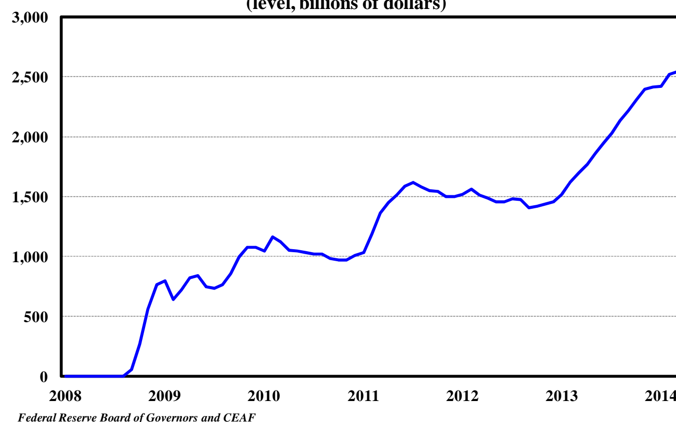
Risks

Monetary Policy

While dangers from fiscal policymaking appear on the wane over the next couple of years, uncertainty about monetary policy has increased considerably. Earlier concerns -- which appeared in mid-2013 -- were largely spurred by uncertainty about the timing and pace of "tapering" of asset purchases. After a number of confusing signals beginning last summer, the Fed finally began to reduce the pace of its asset purchases in December 2013. As of this writing, the Fed is buying $55 billion securities per month -- down from the $85 billion pace of the past eighteen months ($30 billion in Treasuries and $25 billion in MBS). With the current course, the tapering is expected to end sometime in the fall by which time the Fed's balance sheet would have swollen to $4.4 trillion dollars with the Fed owning around 40% of all MBS securities and about 25% of the US Treasuries.

Going forward, the biggest source of risk concerning monetary policy is the timing and pace of interest rate hikes. The forward guidance policy -- the message that the Fed has used since the end of the recession to anchor expectations about the future path of policy has become more opaque especially since the current unemployment rate is only a hair above the Fed's stated 6.5% threshold. Faced with this new reality, the Fed qualified that interest rates would stay low even beyond the 6.5% level at which point the threshold ceases to have any meaningful value. Indeed, in the latest meeting, the Fed dropped the 6.5% threshold altogether announcing that it would use a tapestry of indicators --"a wide range of information" to guide its decision-making. Just what those factors are remains a mystery: we know that they are loosely connected to the labor markets, inflation and financial developments. Beyond that, the broader message from the Fed appears to be "we'll see..."

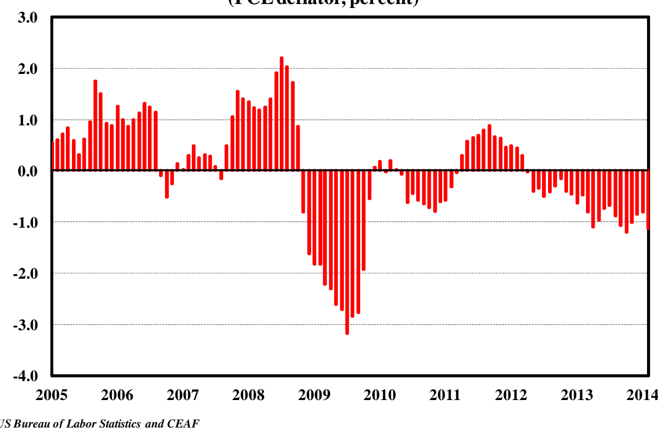
The deeper concern is that monetary policy may be powerless in nudging the economy further. If labor supply issues and lower potential GDP are indeed at the core of the sluggish recovery (which is largely our view), there is little the Fed can do to boost growth and spur activity. The "slack" in the economy may in fact be of a lesser magnitude than what the Fed (and most analysts) have assumed all along which means that boosting aggregate demand is equivalent to pushing on a string. No one can argue that there is not enough liquidity to support an expanding economy: bank excess reserves have risen from $40 billion prior to the recession to a current $2.5 trillion (Figure A14). Labor market concerns appear to be paramount in guiding monetary policy, but the issues there appear more supply-driven (low employment-to-population ratio) rather than demand-driven (job openings).



Our view is that interest rates will continue to remain at the zero-bound for quite some time with the first rate hike occurring by end-2015/early 2016. This is a bit longer than the consensus view, but it is grounded on the view that a slowly recovering labor market will also be accompanied with below-target inflation rates. The Fed will be hard-pressed to justify rate hikes in the face of low inflation and a still-unhealthy labor market, at which point the liftoff may be pushed out beyond the current consensus horizon.

The Dangers of Lower Inflation

Inflation is another short-term risk factor in our outlook, or rather the lack of inflation is. Inflation in the US has been low and falling for over two years: the current reading of the PCE deflator shows a measly 0.9% increase (on a year-over-year basis), CPI inflation is running and 1.1%, while core inflation (which excludes volatile food and energy prices) is at 1.5%. By all measures, inflation is well below the Fed's target rate of 2%, having undershot that target for the last 23 consecutive months (Figure A15).



A disinflationary environment is disconcerting for many reasons: it leads to wage stagnation because if prices don't increase neither do wages. It also impedes hiring because it results in higher real wages for employers, a fact that may have held back employment, as discussed previously. Another risk is that low inflation may lead to deflation -- an outright fall in wages and prices -- which is deeply damaging and hard to escape when economies are weak and debt burdens are high (witness Japan). Once expectations of lower prices set in, less spending and investment occur as people delay purchases anticipating lower future prices. Deflation also increases real debt burdens since debt contracts are fixed in nominal terms and falling prices effectively raise the real cost of that debt.

Though low inflation is certainly a concern, we do not expect the US economy to experience deflation. In fact, our forecasts are consistent with below-trend but increasing inflation over the next two years as economic activity continues to expand and labor markets heal. In fact, the PCE deflator (the Fed's inflation gauge) should end up closer to the 2% target range by this time next year.

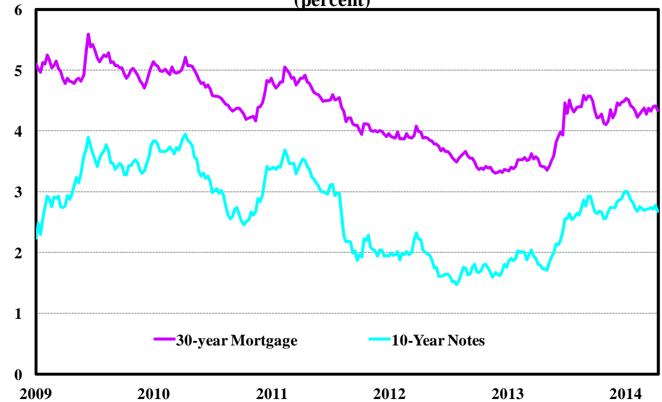
Financial Markets: Unsettling Times Ahead

Equity markets had another spectacular run in 2013 -- in fact, the best since the end of the recession when measured from year-end to year-end. In all, the market rose by nearly 30%, buoyed in large part by the accommodative stance of monetary policy and an improving outlook for the US economy.

By far, the largest impact of Fed tapering has been on the bond market. Yields on 10-year Treasury note surged by more 125 basis points from mid-May to early September (as the Fed pondered the beginning of taper), while 30-year conventional mortgage rates rose from 3.3% to 4.6% over the same period (Figure A16). Some of this increase was partially reversed in the fall in response to the postponement of the taper and again early this year due to the "flight-to-safety" phenomenon spurred by the turmoil in emerging markets. The 10-year yields have hovered around a tight range of 2.6%-2.8% so far this year, though continued improvement in the outlook and the eventual end of the QE program should push the yield above 3% towards the end of the year.

It is not a surprise (though unfortunate) that developments in the financial sector are driven more by whispers about monetary policy than actual economic fundamentals. The ultra-low interest rate environment engineered by the Fed has allowed businesses to radically and significantly improve their financial position. The result is a market rally that has almost tripled the S&P500 Index since it hit cycle lows in March 2009.

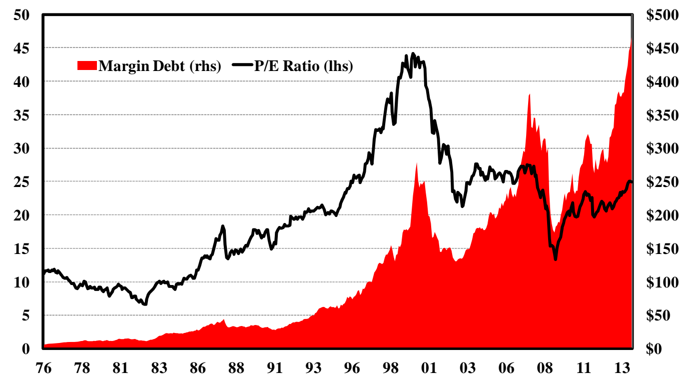
Figure A16
Interest Rates
(percent)



Federal Reserve Bank Board of Governors and CEAF

These developments are encouraging but they also raise concerns about market froth. Indeed the market does appear to be somewhat bubbly from a variety of metrics. The inflation-adjusted PE ratio (price-to-earnings) is around 26 -- far above its historical average (of around 16) and dangerously close to correction levels (the measure hit 30 on Black Tuesday in 1929 and an all-time high of 44 before the dot-com collapse of late 1999). Margin debt has set historical highs suggesting highly leveraged positions on the part of the investors (Figure A17). The market capitalization as percentage of nominal GDP is at 125% -- below the record-highs set in the late 1990s but well above its historical value. Junk bond yields are also nearing record lows and investors' stock allocations are near their highest levels since 2007.

Figure A17
P/E Ratio (Inflation-Adjusted) and Margin Debt
(P/E Index; Margin Debt level, billions of dollars)



NYSE and CEAF

Though we do not anticipate a dramatic market reversal in 2014, we remain watchful of valuations. Markets may experience more volatility ahead especially as the Fed re-calibrates its forward-looking guidance and winds down its QE program.

A2. Projections of Key National Economic Variables

Table A1
National Economy: Macroeconomic Variables
(percent)

Year	RGDP	Consumption	Fixed Investment	Residential Construction	Unemployment	Payroll Employment	Headline Inflation	PCE Inflation
				Historical				
2011	1.8	2.5	7.6	0.5	8.9	1.2	3.1	2.4
2012	2.8	2.2	7.3	12.9	8.1	1.7	2.1	1.8
2013	1.9	2.0	2.7	12.2	7.4	1.7	1.5	1.1
				Forecast				
2014	2.6	2.4	5.5	8.3	6.5	1.9	1.8	1.4
2015	3.1	2.7	6.8	13.5	6.1	2.0	2.1	1.8
2016	3.0	2.8	5.3	10.2	5.8	2.1	2.2	1.9
2017	2.8	2.4	5.2	8.3	5.7	2.0	2.3	2.0
2018	2.6	2.5	5.1	7.4	5.6	2.0	2.3	2.2

Table A2
Financial Variables
(percent)

Year	Federal Funds Rate	3-month Tbill Rate	10-year yield	30-year Mortgage Rate	US Dollar Index (percent change)
			Historical		
2011	0.10	0.05	2.79	4.46	-4.53
2012	0.14	0.09	2.80	3.66	2.70
2013	0.11	0.06	2.35	3.98	2.51
			Forecast		
2014	0.10	0.18	2.77	4.55	2.73
2015	0.20	0.36	3.39	5.14	1.90
2016	1.86	1.68	3.92	5.57	1.33
2017	2.87	2.92	4.65	6.24	-2.04
2018	3.78	3.65	5.52	6.65	-1.68

B. RIVERSIDE COUNTY ECONOMY

B1. Overview

The economic outlook for Riverside County continued to improve over the past year, though much like the national picture, the pace of the recovery has been distinctly uneven and broadly lukewarm. On the plus side, the recovery has continued to expand, labor markets have broadened their gains, housing values have risen at a staggering rate, and commercial activity (especially in the industrial market) has rebounded dramatically from cycle-lows. The county's population rose throughout the crisis and the tepid recovery, though at a lower clip than during pre-recession years. The unemployment rate has fallen precipitously, though it continues to remain well above normal and higher than the neighboring counties (including San Bernardino). Nationally, the county ranks in the top third of all counties in the U.S. with highest unemployment rates, which is not entirely surprising given that the region was hit particularly hard during the recession.

One challenging aspect of the recovery is that employment growth has occurred primarily in low-paying sectors: Leisure & Hospitality, Trade & Transportation, and Health & Social Assistance. Though this trend is also reflected nationally, Riverside County has lagged the nation and the region in the creation of higher paying jobs: Professional and Business Services, Financial Activities, and Information sectors continue to languish and are well below their pre-recession peaks. The construction has shrunk dramatically and employment in Manufacturing has leveled-off to a rather low base. This has shaped up the post-recession labor market to look radically different from the norm with Construction employment shrinking from 11% of the total labor force to 6.1% and Manufacturing labor shares dropping from 9.1% to 7.1%.

Home values posted astounding gains over the past year spurred primarily by a surge in investor demand: private equity and real estate investment firms have snapped up a large amount of distressed properties in the area. The sharp appreciation in home prices has boosted homeowner equity but at the same time it has led to a dramatic erosion in housing affordability. An organic, self-sustained recovery in the housing market will occur when traditional home buyers re-enter the market; our view is that the fundamentals for this transition over the next few years are in place due to a faster clip of household formation (largely restrained during the recession and the sluggish recovery) and the return of the county to its traditional role as an affordable alternative relative to the pricey coastal areas.

We expect the recovery in the county to continue to expand over the next few years at a slightly faster clip than what has been the norm thus far though still not fast enough to quickly erase the devastating impact of the Great Recession. Job growth is projected to proceed at more robust rates with continued gains in Government, Education and Health Services. Employment in the Construction sector is also expected to grow, though it will still remain well below its pre-recession highs. As investor interest in residential real estate begins to wane, home prices are projected to grow at a more moderate rate compared to the last eighteen months. Construction is expected to pick up in both the residential and commercial sectors spurred by low housing inventory and increased demand for industrial space.

The County is also beginning to overcome some of the tough near-term challenges especially as property values increase and labor markets heal. With higher property values, the County Assessor's Office will continue to reverse the Proposition 8 reduction in assessment of residential and commercial property values. This will increase the county's assessment rolls and its property tax revenues, which were hit particularly hard during the crisis.

Longer-term the county faces a number of challenges and growth opportunities. Perhaps the most worrisome factor is the lack of continued progress in education and human development which would allow yesterday's workforce to acquire the skill-set suitable for the jobs of the future. Low levels of educational attainment have consigned broad swaths of the county's demographics to contend with high rates of unemployment and dim job prospects as the construction and manufacturing sectors are no longer the same engines of growth they were a few years ago. This has further contributed to high poverty rates and stagnant income growth in the county. The manufacturing sector presents an opportunity for growth, though the lack of a post-recession revival indicates that so far this has been a missed opportunity for the county.

Despite these challenges, the county is well positioned for growth in the long-term. The demographics are in its favor, with projected population growth in the county outpacing the neighboring counties. The county's central location, proximity to the ports of Long Beach and Los Angeles, and relatively affordable land and large storage facilities, mean that the county will remain an ideal region for transportation and distribution of goods. As the economic recovery drives up the value of real estate in the coastal areas, the county will once again become a designated destination in the Southern California region to absorb a growing population in search for affordable housing.

Southern California Leading Indicator

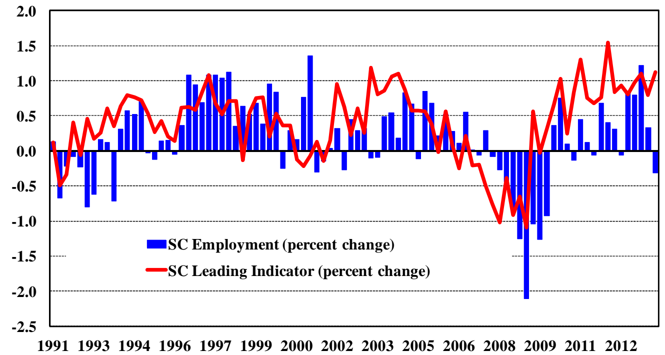
The economy of Riverside County is heavily dependent on the broader Southern California region which includes Los Angeles County, Orange County, Riverside County, San Bernardino County, Ventura County, and Imperial County. The region is home to over 18 million people and represents a sizable economic geographic region. It generates a significant amount of goods and services and serves as an important hub for product transportation across the country and internationally.

Economic development in the broader region tends to filter through to individual counties due to the deep economic integration within the region. A large number of residents live in one county (Riverside County, for example) but work in another county (OC or LA). And though the coastal areas have tended to lead during the recovery, while the inland regions have lagged, developments tend to be cross-shared over time given the degree of integration within the region.

To measure the short-term economic outlook for the Southern California region, CSUF has developed the Southern California Leading Economic Indicator (S.C. Leading Indicator). The S.C. Leading Indicator uses a combination of national and regional data to project economic activity in the broader region. At the national level, macroeconomic indicators used in the index include the interest rate spread, Standard & Poor's S&P500 stock index and money supply adjusted for inflation. Regional variables include nonfarm employment, the unemployment rate, building permits and the Pacific Region consumer confidence index. An increase (decrease) in the S.C. 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 B1).

The latest reading shows an increase of 1.12% in the index, suggesting a continued improvement in economic activity in the Southern California region over the next 3 to 6 months. The Indicator has increased for seventeen 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, albeit at a moderate pace in the first half of 2014.

Figure B1
Southern California Leading Economic Indicator
and SC Employment



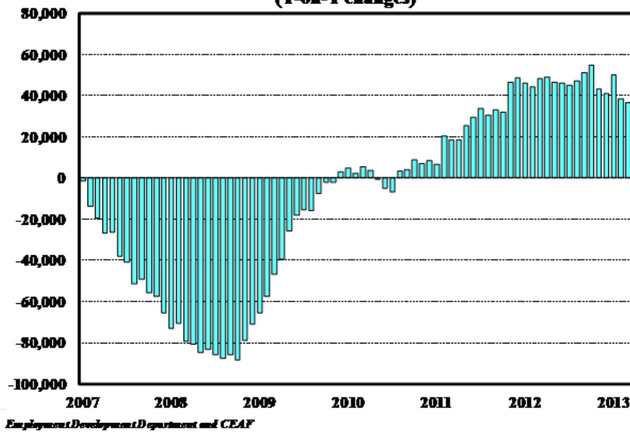
Source: California State University Fullerton. CEAF

B2. Labor Market Outlook

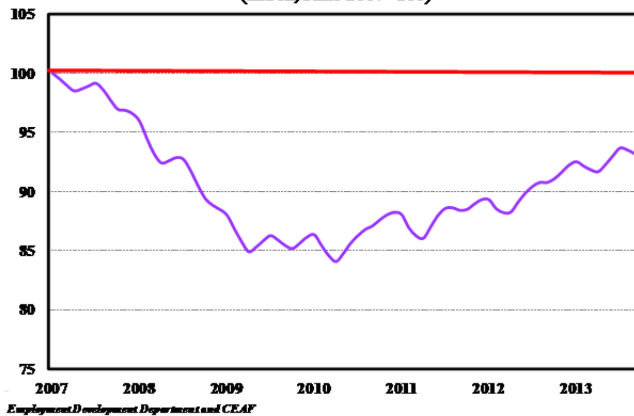
Payroll Employment: A Detailed Analysis

Labor market developments in Riverside county can be summed up in a short sentence: brighter but not bright enough. The county's labor market has continued to improve over the past two years, though much like the national economy, gains have been unevenly spread across sectors. More importantly, the labor market turnaround for the county lagged the improvement in the national and regional markets by nearly one year: the county's employment rolls declined by an additional -29,000 jobs from January 2010 to July 2010 during which time the national and other regional economies were well on their way to recovery.

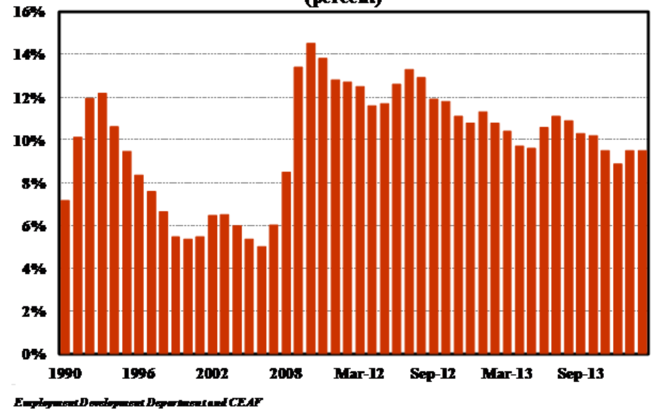
Labor market woes were dramatically sharper for the county in the most recent recession compared to previous downturns: from the start of the recession until mid-2010, payroll employment shrank by an unprecedented 96,800 jobs (Figure B2). Since then, the Riverside county labor market has begun to heal slowly, adding 19,000 payroll jobs in the second half of 2010 and roughly 13,000 jobs in 2011 and 2012 (December-to-December; latest available data). All told, as of December 2012 (latest available data), the county had recovered a total of 45,000 jobs -- or roughly 50% of jobs lost during the recession. Because data at the county level are not available for 2013, we project that payroll employment for the county increased by an additional 17,000 jobs in 2013.



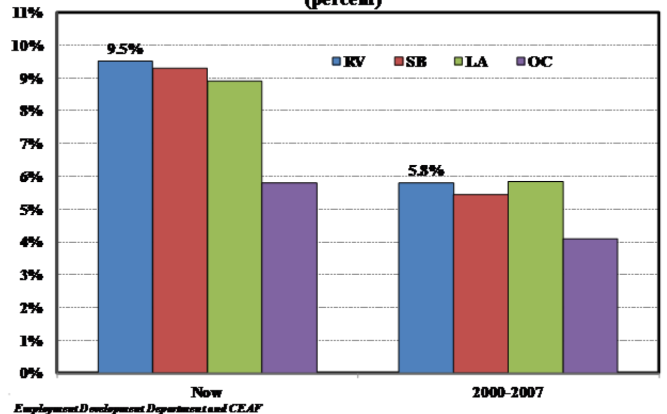
The momentum ebbed a bit early in 2014 as payroll numbers are estimated to have grown by around 11,400 in January 2014 compared to January 2013 and by an additional 12,313 in February 2014 compared to February 2013. On a year-over-year basis (which takes away the seasonal variation in the data) the county's employment rolls have increased for 40 consecutive months since the end of 2010. These much-welcomed improvements notwithstanding, the employment levels in the county are currently 7% below pre-recession levels, which means that the process of healing still has quite a ways to go (Figure B3).



As expected, the unemployment rate in the county has also edged down dramatically since the height of the recession, though it still remains elevated compared to historical norms. As of February 2014 (latest available data) the unemployment rate for the county stood at 9.5% -- a vast improvement over the 15.2% rate reported in the summer of 2010. The unemployment rate has fallen for three consecutive years though the rate of decline appears to have slowed somewhat in recent months, likely reflecting an increase in the labor force due to the re-entrance of previously discouraged workers now that job prospects appear less dim than a few years ago (Figure B4).



In comparative terms, the county's employment picture is still below pre-recession levels. Though vastly improved compared to the height of the crisis, the unemployment rate for the county is far above the 5.7% rate recorded during the 2000-2007 period. In fact, the county's jobless rate has remained higher than that of neighboring counties including San Bernardino County whose unemployment rate -- at 9.3% -- is a hair below Riverside's (Figure B5).



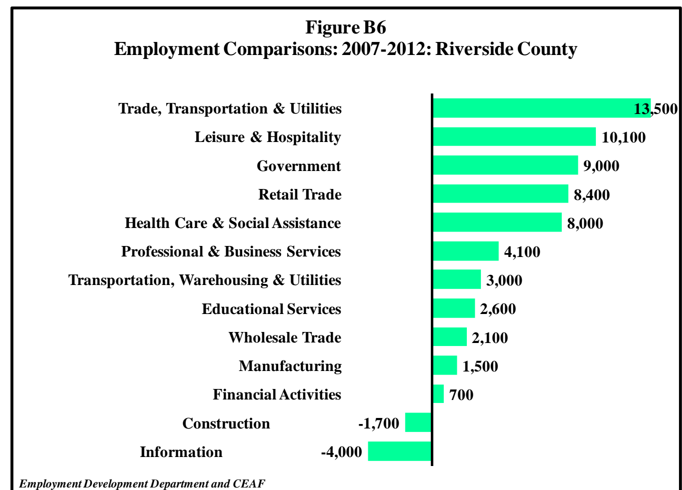
Nationally, the county has one of the highest unemployment rates in the nation, coming up in the top third of all counties in the U.S. when ranked from highest-to-lowest in terms of unemployment rates. This should not come as a surprise given how hard hit the area was during the recession. The broader MSA area, which includes parts of San Bernardino county fared a bit better in 2013 compared to the previous two years: with a combined

unemployment rate of 9.4%, the two-county region no longer ranks in the top 10% of MSAs for highest unemployment rate though it still hovers dangerously close to the top decile. The comparisons are even more grim when focusing on the largest MSAs (those with population greater than 1 million), where the two county region has the second highest unemployment rates out of the largest 50 Metropolitan Areas. Nonetheless, what truly matters for the outlook is not the level but rather the rate of change: the MSA ranks 8th among the largest 50 metropolitan areas when comparing the year-over-year declines in unemployment rates, which is certainly one of the most encouraging signs for the outlook of the labor market.

Job Growth by Sector: Where are the bright spots?

One consistent element of the labor market recovery at both the national and regional level, is that job growth has been uneven across sectors. The biggest gains have occurred largely in the low-paying sectors: Leisure & Hospitality, Trade & Transportation, and Health & Social Assistance. This has certainly restrained income and wage growth -- a defining characteristic of this recovery both at the national and local level.

Since summer 2010 when the labor market began to recover until December 2012 (latest available data), employment in Riverside County grew by 10,100 jobs in the Leisure & Hospitality sector, by 8,400 in Retail Trade, and by an additional 8,000 jobs in Health & Social Assistance. Middle-income sector employment also grew: the government sector added 9,000 jobs during this period with an additional 2,600 jobs in Educational Services. Growth in higher-paying industries was harder to come by: Professional & Business Services added a total of 4,100 jobs since the trough of the recession, while Financial Activities grew by a pitiful 700 during this period (Figure B6).



The post-recession labor market is proving to be radically different from its historical trends and is slowly revealing sea-changes in the composition of its labor force: long-standing sectors that tended to match the country's demographics (like construction and manufacturing) are no longer the main drivers of the labor market. In terms of labor shares, the construction sector has shrunk from a pre-recession average of 11% to 6.1% as of December 2012 while manufacturing labor shares dropped from 9.1% to 7.1%. Meanwhile labor shares grew for other sectors: Retail Trade employment made up 15.4% of total nonfarm payroll for the county in December 2012 (up from 14.2% before the onset of the recession), employment in Leisure & Hospitality constitutes 13.6% of total employment (up from 12.2%), Health & Social Assistance commands 10.8% of total employment (up from 8.3% before the recession), and the share of employment in the Government sector grew from 17.9% to nearly 20% (Figure B7).

Figure B7
Share of Employment, RV County

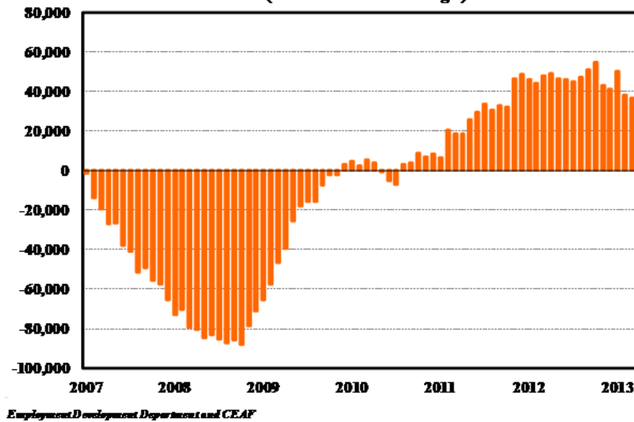
Sector	2012	2007
Government	19.9%	17.9%
Retail Trade	15.4%	14.2%
Leisure & Hospitality	13.6%	12.2%
Health Care & Social Assistance	10.8%	8.3%
Professional & Business Services	9.7%	10.4%
Manufacturing	7.1%	9.1%
Construction	6.1%	11.6%
Transportation, Warehousing & Utilities	4.0%	3.5%
Wholesale Trade	3.8%	3.5%
Financial Activities	3.6%	3.8%
Educational Services	1.3%	1.0%
Information	1.1%	1.2%

Source: Employment Development Department

Since sector-specific data at the county level are available only up to December 2012, we analyzed the sectoral outlook for the Riverside-San Bernardino MSA for recent trends in the data. The broader Inland Empire region displays a labor market profile that tends to closely match the county's labor force characteristics and demographics. As such, the MSA labor outlook should serve as a good indicator for future employment trends and sectoral growth in Riverside County.

The broader Riverside-San Bernardino MSA has continued to post solid job growth over the past two years, adding a total of 46,000 jobs in 2012 and an additional 50,200 in 2013 (measured as December-to-December changes) (Figure B8). Much like the county picture, the strongest employment gains for the Inland Empire were also in the Leisure & Hospitality sector, which grew by a total of 10,500 jobs in 2013. Education & Health Services provided an additional 8,700 jobs and trade (both retail and wholesale) generated another 7,200 jobs. Logistics

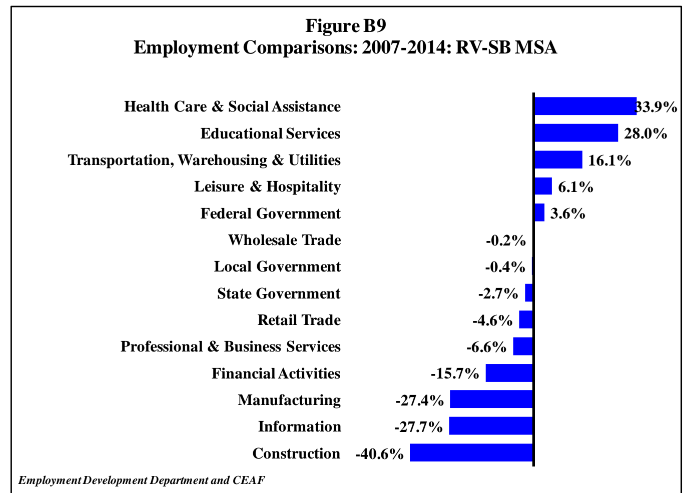
remained an important employment sector, adding an additional 4,300 jobs in Transportation, Warehousing, and Utilities.



Encouragingly, 2013 also registered an increase in construction jobs of 6,300 in line with increased construction activity in the region. This is important for the region since construction employment declined dramatically during the recession, falling from a high of over 130,000 to a low of 57,000 in 2010. Though the county's labor market will no longer rely so heavily on the construction sector, the recent pick-up in building activity bodes well for the region's employment and income outlook especially since demographic shifts and re-training take an enormous amount of time (after all construction workers cannot be turned into nurses overnight!).

One disappointing development is the lack of meaningful job growth in the manufacturing sector. Though manufacturing employment has been on a consistent down-trend both nationally and locally (largely due to globalization and technological improvements), there has been a partial reversal at least at the national level since the end of the recession. The U.S. manufacturing sector has added a total of 626,000 jobs since the depth of the recession, while Inland Empire's manufacturing base has only grown by a mere 1,300 jobs over the comparable period.

So what does the labor market for Inland Empire look like after the Great Recession? Which sectors have recovered their pre-recession employment levels? Which are still languishing? As seen in Figure B8, the recession and the subsequent weak recovery brought forth dramatic changes in the labor market profile: some sectors have gained tremendous ground -- Health and Social Assistance is up 33% from its pre-recession level, employment in Education has grown by 28% and Trade & Transportation by 16%. Others have shrunk noticeably particularly in construction (-40%), manufacturing (-27%) and Information (-27%) (Figure B9).



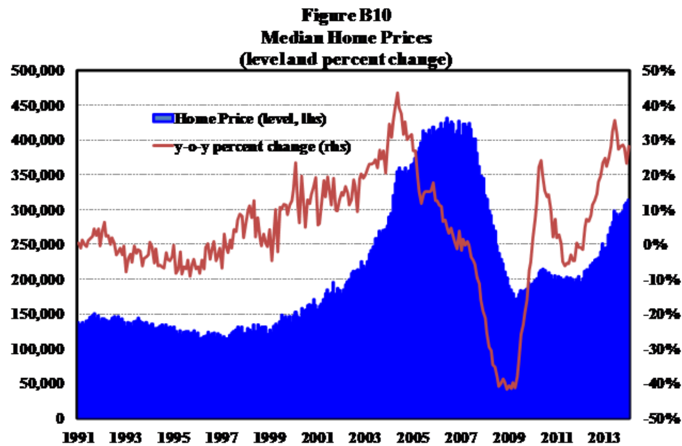
Going forward, the outlook for Riverside County's labor market is for continued steady improvement. The weaker early-year momentum will likely give way to stronger, more robust growth in the second half of the year and beyond. However, the job destruction wreaked by the Great Recession was so deep, it will require years for the county's labor market to "normalize." The gains in employment over the next few years are expected to be broad-based though some sectors (Retail Trade, Transportation, Health and Social Assistance and Education) should be at the forefront of growth. We also anticipate a pick-up in State and Local Government employment after the dramatic cuts witnessed over the past few years. There should be a slight recovery in manufacturing jobs given recent trends as well as moderate gains in the construction sector, as construction picks up from a significantly lower base. With projected moderate gains in employment, the county unemployment rate will likely decrease to below 9% by the end of 2014 and to 8.5% by end-2015.

B3. Real Estate Market

Housing Market: in Transition

Perhaps the most noteworthy event over the past year in the housing sector was the dramatic increase in home prices in Riverside County. According to the data provided by California Association of Realtors (CAR), median home prices of existing single-family homes soared by 25% from December 2012 to December 2013. End-year results mask to a certain extent the truly astounding turnaround: housing prices in the county rose by an average annualized rate of 28% -- a pace that was last seen in the county in late 2003-2004 (Figure B10). Existing home prices for single family

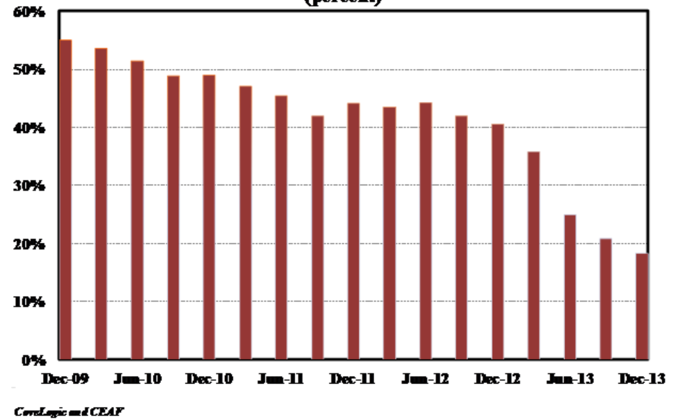
homes have risen for 23 consecutive months (on a year-over-year basis), exceeding double digits since July 2012.



California Association of Realtors and CEAF

As a result, the median price of existing single-family homes has risen from a low of roughly $171,000 in April 2009, to $314,000 in January 2014 -- a remarkable increase of 83%. The median price now stands at roughly the same level as in February 2008 and around -27% below the $431,713 record-high of June 2006. Prices have also increased for new homes, though the pace has been rather muted when compared to existing homes: in 2013, prices of new detached homes grew by an average of 4.5% (annualized) while prices for new attached homes by 4.7%. Prices of new detached homes have risen from $273,000 in the third quarter of 2009 to a current 345,000 (a 26% increase), while attached homes have gone from $205,000 to $245,000 (a 20% increase).

Housing appreciation has a dual positive impact for the county. First, it increases household net worth and repairs balance sheets which were badly damaged due to a steep decline in home valuation (more than 60%) as a result of the housing market collapse. At the height of the crisis more than half (55%) of residential mortgages in the area were underwater; by the end of 2013, that number had been reduced to below 20% -- an important improvement for the county's households (Figure B11). Home price appreciation will also help repair the county's fiscal position as large increases in house prices reverse the temporary Proposition 8 property tax reductions more rapidly and thus add to the secured assessment roll.

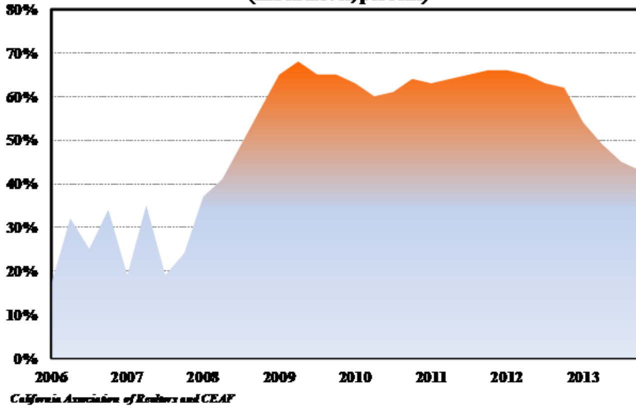


CoreLogic and CEAF

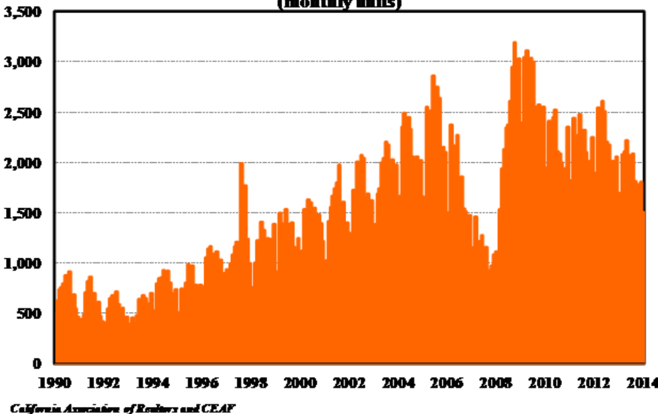
Despite these positive developments, we caution against overstated optimism. Improvements in home prices have generally not materialized because traditional homebuyers have shown an increased interest in purchasing homes in the county. The surge in demand is coming from private equity firms and real estate investment trusts which have snapped up much of the distressed properties in the area and in other distressed regions in the country. Colony Capital -- a real estate equity company -- sunk more than $150 million per month in 2013 in purchasing distressed homes from across the country with the intent of turning them into rental units. The Blackstone group purchased more than 40,000 single family homes worth around $3 billion that were previously foreclosed and are now also being turned into rental homes. For Riverside County roughly 30-40% of housing market transactions in 2013 were by private equity and real estate investment firms. Some estimates place the amount that institutional investors have amassed for single family rentals to as high as $8-$10 billion since the bottom of the housing market in 2012. This activity has given rise to a new asset class: the securitization of rental property income. Because of limited data due to their recent debut, it is hard to assess the risk of these products although vulnerabilities certainly exist related to the management of properties from distant owners such as repairs, maintenance expenses, etc.

The second source for concern is related to housing affordability in the county: sharp home price appreciation over the past eighteen months has significantly reduced affordability in the area. By the end of 2013, the housing affordability index for the county stood at 43 which means that 43% of residents were able to afford the median priced home. Just a year ago the housing affordability index was near record levels at 62% (Figure B12). The reduction in affordability will likely restrain the pace of healing in the

next leg of the recovery as investors retreat and traditional homebuyers step up.



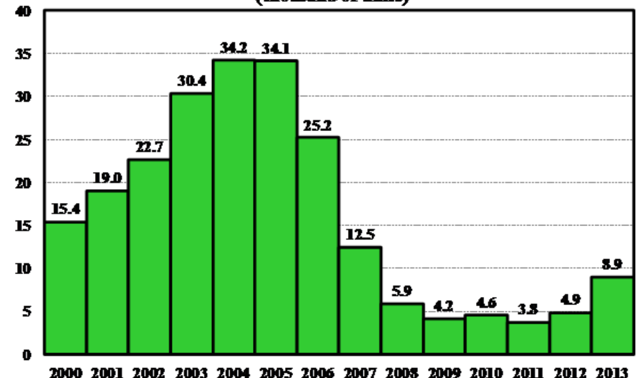
Another indicator that the county's housing market revival is driven by non-traditional buyers is home sales. Sales volume for existing detached homes declined from 25,860 in 2012 to 22,924 -- a staggering -11.4% decrease. The trend has continued into this year, with the January volume posting an additional -11% decline compared to year-ago levels (Figure B13). On a year-over-year basis, sales of existing homes have declined over the past fifteen months reflecting weak demand on the part of traditional buyers and a sharp decrease in affordability. On the plus side, some revival can be seen in new homes sales: Riverside County's sales volume in the fourth quarter of 2013 was 1,268 up 5.3% from the 1,204 sales recorded in Q4 2012. In addition, the volume of distressed sales seems to have ebbed considerably over the past year: distressed sales accounted for only 18% of total volume in February 2014 -- roughly half of the 39% recorded in February 2013.



We expect the housing market in Riverside County to continue to improve over the forecast horizon. Investor demand is expected to abate over the next few years as bargain deals are harder to come by thanks to the rapid home price appreciation in the area. For the rebound to be self-sustaining, traditional buyers will have to step in. We believe the county's fundamentals are in place for this to happen though the pace of improvement will be restrained by below-trend job and income growth. The County's population grew by an estimated 237,000 since 2007, which ultimately should lead to increased demand for homes. Despite decreases in affordability, homes in the county are now significantly more affordable than at the peak of housing market. We expect home prices to continue to rise over the next few years, though the pace of increase should be markedly below the breakneck rate of the past few quarters.

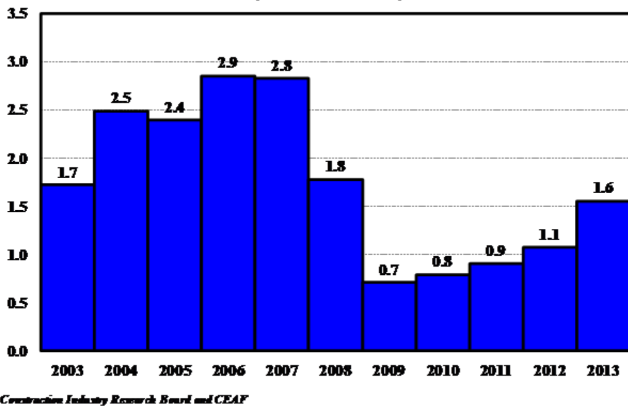
Construction Activity: on the Rebound

Residential construction was one of the hardest hit sectors in the county over the past six years. The drawdown in inventories due to investor activity and the persistent under-investment due to the housing crisis, have placed significant strains on housing supply for the county. As expected, building activity has picked up though the pace of improvement so far has been rather tentative even though the pick-up is starting from a severely depressed base. Annual new housing permits (single- and multi-family) for the Inland Empire increased to 9,000 in 2013 compared to the roughly 5,000 permits in 2012 (Figure B14). In valuation terms, total building permits for the two-region county has risen from $2.1 billion in 2011 to $3.6 billion in 2013 -- of which $2 billion are estimated to come from single-family units. This is a far from the 30,000+ units and $12.5 billion recorded in the middle of the last decade, but it's an improvement nonetheless.



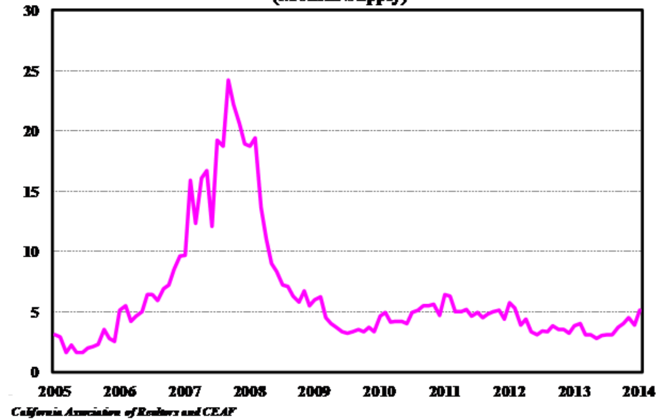
Non-residential construction declined significantly during the recession and ensuing slow recovery, but the pain was not as pronounced as in the residential market. Non-residential building permits fell from an annual pace of 2,800 prior to the recession to 710 in 2009 at the height of the crisis. Last year, permits more than doubled from their cycle lows coming in at 1,555 with an estimated valuation of $1.5 billion (Figure B15). Industrial construction has led the way with over 15.4 million square feet under construction in Q4 2013, with the vast majority being constructed for mega-developments at over 500,000 square feet. Construction activity in retail and office space has languished due to the sluggish growth in these sectors, but recent trends are encouraging and are pointing to an improvement in the coming years.

Figure B15
Inland Empire Non-Residential Building Permits
(thousand of units)



We expect housing construction to pick-up pace over the forecast horizon spurred both by demand and supply factors. On the supply side, the unsold inventory index for the county -- which represents the amount of months it would take to deplete the remaining inventory -- stood at its historical average level of 5.1 months in January 2014 (Figure B16). Likewise, the median time in the market for Single Family Homes is 37 days -- roughly in line with its historical average. On the demand side, home affordability in Riverside County-- though down from cycle-peaks -- is still far above coastal areas. Importantly, the first-time buyer affordability index continues to remain high: at a current reading of 66 it means that 66% of first-time home-buyers can afford the median home price in the county.

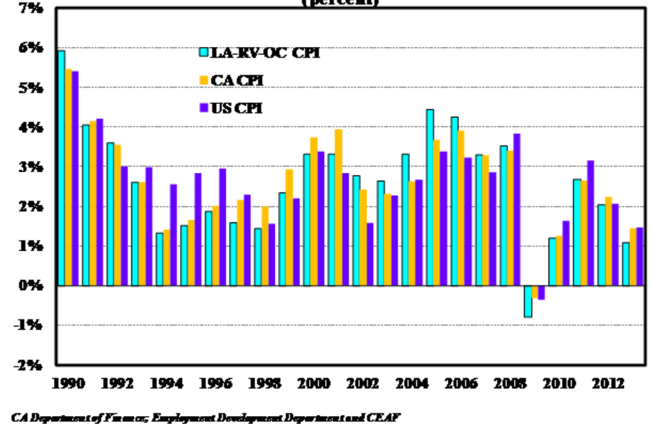
Figure B16
Unsold Inventory Index
(Months Supply)



B4. Inflation Outlook: California and the Region

Regional inflation remains relatively low largely due to the slow pace of the economic recovery in southern California. The Los Angeles-Riverside-Orange County headline inflation (which includes food and energy prices) increased by a tepid 1.1% in 2013 -- below the 1.5% rate recorded for the state of California and the U.S. (Figure B17). More concerning is the fact that the latest data points to a downtrend -- on a year-over-year basis, the region's inflation rate averaged 1.1% over the past four months down from an average of 2% in the previous four months. Low inflation is problematic because it leads to wage stagnation and an increase in real debt burdens on the part of leveraged household.

Figure B17
Inflation Rates: LA-RV-OC, CA and US
(percent)



California CPI projections are an important factor for the County's Assessed Valuations: based on Proposition 13, the maximum amount by which a property's assessed valuation for a given year can be increased is 2%, as long as California CPI rises by at least 2% based on October-to-October changes. If California CPI increases by less than 2% (as it is the case from October 2012-October 2013 when it rose by 0.454%), then the maximum increase for an assessed valuation on a property under Prop 13 (but not under Prop 8) would have to also be by a maximum of 0.454%.

Our projections include both the California inflation rate (October-to-October) given its importance when forecasting assessed valuations and the LA-RV-OC inflation rate (annual average). We opt to provide forecasts for the LA-RV-OC MSA as a gauge of real wages and income in the region and in order to get a better handle on consumer real purchasing power.

We forecast that California CPI will increase at below-trend rates especially over the near-term, rising by 1.5% from October 2013-October 2014 and by 2.0% from October 2014-October 2015. This means that Prop 13 assessed property values are likely to experience another below-2% increase in the next fiscal year. Beyond that, as the recovery continues to expand, inflation rates are expected to firm up (though remain contained) which means that this factor is not expected to weigh on assessment rolls.

Our projections for LA-RV-OC inflation rate is also more muted in the near-term: we forecast an average annual inflation rate for the region of 1.5% in 2014 and 1.8% in 2015. As regional economic activity continues to increase, we expect inflation in the region to edge up gradually towards 2%. Labor market slack in the region is expected to restrain wage growth particularly in the inland areas, which means that wage inflation is likely to exhort limited pressure on the overall inflation rate.

B5. Projections of Riverside County Main Economic Variables

Table B1
Riverside County Macroeconomic Forecasts

Year	Payroll Employment (y-o-y percent change)	Unemployment (percent)	Single Family Median House Prices (level)
		Historical	
2011	2.4	13.8	$200,600
2012	1.8	12.1	$221,451
2013	3.1	10.3	$283,386
		Forecast	
2014	2.8	9.3	$309,457
2015	3.0	8.4	$333,595
2016	2.9	7.3	$356,613
2017	2.6	6.7	$380,506
2018	2.5	6.2	$401,434

Table B2
Riverside County Macroeconomic Forecasts

Year	California CPI (October-to-October)	LA-RV-OC CPI (y-o-y percent change)	Residential Building Permits RV-SB (thousands of units)
		Historical	
2011	2.9	2.7	3.8
2012	3.1	2.0	4.9
2013	0.5	1.1	9.0
		Forecast	
2014	1.5	1.5	12.1
2015	2.0	1.8	15.4
2016	2.3	2.0	16.9
2017	2.5	2.1	14.6
2018	2.4	2.2	13.1

C. RIVERSIDE COUNTY BUDGETARY VARIABLES

C1. Overview of Assessed Property Values

The long-awaited recovery in Riverside County's assessment rolls commenced at last in FY 2013-2014. Secured valuations grew by 4.2% after four consecutive years of decline, a welcome reversal even if the turnaround is rather moderate. The boost in assessment rolls was due to a number of factors: a notable increase in home prices, the application of the full 2% inflation factor, and continued improvement in commercial properties particularly in the apartment and industrial sectors.

Not surprisingly, 2013-2014 marked the first year since the crisis when many property owners received an increase in their property taxes thanks to a surge in home valuation. Prop 8 reductions were also applied to fewer properties than in recent past: roughly 395,000 properties received Prop 8 reduction in FY 2013-2014 with the average reduction around $98,600. This represents quite an improvement over the FY 2012-2013 when roughly 450,000 properties received Prop 8 reduction with the average reduction coming at around $100,000.

It is important to note that even with recent positive developments (reversal of Prop 8 values, increased property valuations, the improvement in real estate market, etc.) the county's assessment roll has undergone a structural shift since the crisis as increases in foreclosures and distressed sales have prompted the reevaluation of over 200,000 of the county's properties (23% of total) to a lower base. For a robust increase in assessed valuation, the county will need to see a significant pick-up in new construction and a continued improvement in property values. While the county's secured assessment roll is projected to exceed its pre-recession peak in the not too distant future as the property market continues to recover, it is unlikely to reach the same trajectory it was heading towards before the housing crisis.

C2. Secured Assessed Valuation and Projections

The Center for Economic Analysis and Forecasting at California State University Fullerton, analyzed secured property tax data provided by the County of Riverside on 904,077 property parcels for FY 2013-2014. This excludes a number of items such as tax exemptions, fixtures, trees & vines, unsecured property, personal property as well as other data which are subject to time-recording and other accounting issues and differ to some extent from the data used by the Riverside County Assessor's office. Despite these differences, the data analyzed by CSUF are broadly inclusive and represent quite well the overall assessment rolls for the county. For example, in FY 2013-2014 the data captured 96.4% ($205,288,091,104/$212,975,540,874 = 96.4%) of the total assessed roll. This means that our projections provide a close representation of the entire assessed roll (secured plus unsecured).

Our projections for secured assessed valuations are based on econometric models that integrate a number of variables at the national and regional level. The nation model is used to project national variables such as real Consumption Spending, real Business Fixed Investments (residential and non-residential), real Government Spending (federal, state and local), and real Net Exports to capture economic activity at the national level. Financial variable forecasts, particularly interest rates (mortgage rates) are also produced given their close relationship to the real estate market.

These projections filter through in our regional model which is used to forecast trends at the county level for employment, unemployment, foreclosures, housing prices, construction activity, building permits, and earnings. These forecasts are then used in our econometric model for parcel data which provides a very detailed picture of the property market in the county for all parcel types. The information processed includes micro-level data on assessed valuation and property tax delinquencies. More importantly, our database has grown over the years that we have collaborated with the county on this project, so now we are able to incorporate a time-series dimension to our analysis which further enhances the accuracy of the forecasts. Our model also incorporates policy aspects related to assessed valuations such as: Proposition 13, Proposition 8, and changes in monetary and fiscal policy with direct effects to the real estate market (interest rates or changes in tax laws, for example).

We forecast an overall increase of 5.1% in 2014-2015 in the county’s secured assessed valuation. This is largely due to the recent sharp increases in home prices (over 20%+) thanks to unprecedented investor demand in the county. Increases in property values will induce continued and sizable reversals of the temporary Proposition 8 reductions on many residential properties and some commercial properties. However, properties that fall under Proposition 13 (generally those with base-year pre-1999) will only receive a maximum increase in assessed valuation of 0.454% rather than the 2% ceiling mandated by the law. This is because the California CPI inflation rate fell far short of the 2% rate: from October 2012-October 2013 inflation in the state grew by a meager 0.454% thus limiting the overall increase that can be applied to assessed values.

We expect the surge in property prices to continue to trigger reversals of the Proposition 8 temporary reductions on a large number of properties. Prop 8 reversals can unwind quickly in the face of sharp price appreciation since Prop 8 valuations move with the market and are unconstrained on the down or upside (in contrast to Prop 13 values which are limited to 2% growth). Nonetheless, the county's housing values are still a ways off from their cycle peaks which means that a full Prop 8 reversal will likely stretch out over the next few years.

Secured assessed valuation are projected to increase by a further 5.1% in FY 2014-2015 and an additional 5.0% in FY 2015-2016 as real estate values continue to increase albeit at a slower rate compared to 2013 (Table C1 and Figure C1). For the remainder of the forecast horizon, property values are expected to pick up more robustly as the economy heals and demand for housing increases.

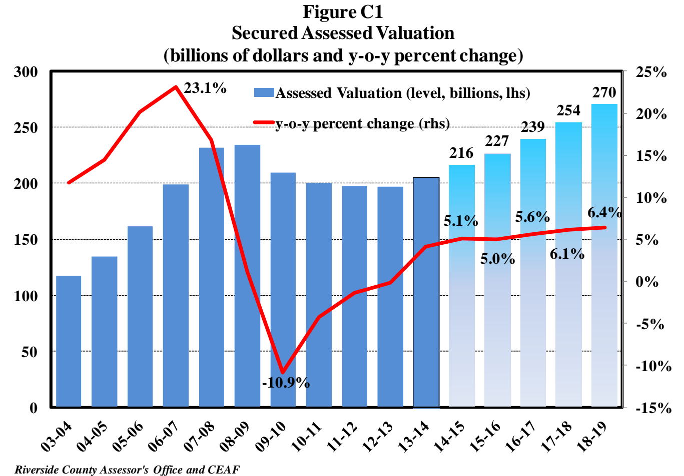


Table C1
Secured Assessed Valuation

Fiscal Year	Commercial Assessed Valuation	Growth	Non-Commercial Assessed Valuation	Growth	Total Assessed Valuation	Growth
Historical						
13-14	41,735,886,320	1.3%	163,552,204,784	4.9%	205,288,091,104	4.2%
Forecast						
14-15	42,737,547,592	2.4%	173,038,232,661	5.8%	215,775,780,253	5.1%
15-16	44,276,099,305	3.6%	182,382,297,225	5.4%	226,658,396,530	5.0%
16-17	46,534,180,370	5.1%	192,778,088,167	5.7%	239,312,268,537	5.6%
17-18	49,419,299,552	6.2%	204,537,551,545	6.1%	253,956,851,098	6.1%
18-19	52,285,618,926	5.8%	217,832,492,396	6.5%	270,118,111,322	6.4%

C3. Detailed Analysis on Parcel Data and Property Tax Delinquencies

In FY 2013-2014, secured assessed valuation for the 904,077 parcels provided to us by the County amounted to a total of $200,420,106,168. This is lower than the complete assessed value reported by the Assessor's Office ($212,975,540,87) which includes unsecured property and is also below the secured county tax roll of $205,288,091,104. Some discrepancies between our data and secured rolls include timing discrepancies between recording and reporting. In addition, there is a non-negligible time-lag between the date of this report and the cut-off date of parcel data provided by the county: in general, the data provides a snapshot of assessed valuations as of October/November 2013, roughly around 6 months prior to this report. One main reason for this time lag is related to property tax delinquencies: in order to receive a complete picture of tax delinquencies, assessed values from the Assessor's Office are merged with the property tax payment data from the Treasurer's Office with a cut-off date around October/November 2013.

Despite these timing issues, our data is fairly comprehensive: the majority of the total secured assessed property valuation for the county comes from secured property (land and structures). In addition, our models overlay the micro-level parcel data as of 6 months ago, with the most recent trends in macro-level assessed rolls provided by the Assessor's Office. In fact, a new feature of our models (implemented in this report) is that they combine parcel data with aggregate trends in assessed valuations provided to us by the Assessor's Office on a ***weekly*** basis: our very latest updates on the macro (aggregate) AV roll was as of 4/21/2014.

The parcels were classified into the following seven categories: Residential, Time Shares, Manufactured Homes, Vacant, Commercial, Agricultural and Unassigned Code. Based on parcel data, secured assessed property values for FY 2013-2014 from residential parcels (single and multifamily including condominiums but excluding apartments) totaled $138,240,729,377 which accounts for 68.8% of all assessed valuation. Commercial parcels accounted for the second largest share (over 20%) of secured assessed valuation totaling $41,631,784,048. The remaining categories totaled $21,022,176,129 or 10.5% of assessed valuations in Riverside County.

To gain further insights in gauging risks and pressure points in the current real estate market, we also analyzed property tax delinquencies based on the parcel data provided by the county. There were 49,333 (5.46% of total) property owners delinquent on paying their property taxes (at least one installment) in FY 2011-2012 (the most recent data available). The number of property owners who paid one installment but were delinquent on the other installment was 9,011 (1.00%) and the number of owners delinquent on both was 40,322 (4.46%). Even though the number of parcels in FY 2012-2013 provided by the County differs somewhat from the previous fiscal year (which limits a direct comparison), it appears as though the number of delinquencies has decreased compared to a year ago when total delinquencies were 55,561 (6.15% of total) and the number of owners delinquent on both payment was 44,443 (4.92%).

The decrease in property tax delinquencies bodes well for the county's real estate market since it is yet another indicator confirming positive trends and an improving economic picture. Property tax delinquencies are used in our model as a warning signal for the overall health of the local economy. With the labor market turning a corner, earnings in the county should receive a boost. Both of these factors should further reduce property tax delinquencies indicating less strain on the county's residents. With a stronger regional economy, property tax delinquencies are expected to continue to decline over the forecast horizon.

Riverside County Non-Commercial Properties

In the data provided by the county, non-commercial properties account for 868,585 parcels and include all categories with the exception of Commercial properties (see next section for a complete definition of Commercial properties). Though non-commercial properties (primarily residential properties) posted substantial gains in property values in FY 2013-2014, a large number of them (391,442) still received a temporary Proposition 8 reduction in assessed valuation. This reduced the secured assessment roll by $35.4 billion (a -15.9% decline) which is less than the $42.1 billion decline recorded the previous year.

A total of 217,859 residential properties received a Prop 8 reduction in the previous fiscal year, accounting for over 55.7% of all non-commercial properties with such a reduction. This amounted to a total of $26.2 billion, which constitutes the lion's share of the overall Prop 8 reductions in the county. The average Proposition 8 reduction for residential property was $120,406. This compares favorably with the previous year (FY 2012-2013) when 261,709 residential parcels received an average $122,532 reduction. Time shares accounted for 93,585 or 23.9% of non-commercial properties receiving a temporary Proposition 8 reduction in FY 2013-2014 with an average reduction of $7,759. The number is roughly the same as in the previous fiscal year when 93,963 timeshares received

an average reduction of $7,280. While there were only 700 apartments in FY 2013-2014 with a Prop 8 reduction, the average amount was relatively high at $857,076. The comparable values for apartments were generally unchanged from the previous fiscal year when 796 apartments received an average reduction of $859,669. There were also reductions in assessed values for condominiums ($3.2 billion), vacant land ($2.4 billion) and other property ($2.3 billion).

Property tax delinquencies for non-commercial property continue to decline as the overall local economy continues to heal. Owners of residential parcels account for the largest amount of delinquencies. Single-family and multi-family delinquencies amounted to $29,187,370 (or 46.1% of total delinquent non-commercial property taxes). Delinquencies for vacant land (residential, mountain, desert) and manufactured homes was $7,713,592 (12.2% of total delinquencies). Delinquencies for agricultural property were $6,063,542 (9.6% of the total), for apartments were $1,013,507 (1.6% of the total) and for Condominiums or Planned Unit Developments were $571,556 (0.9% of the total).

Riverside County Commercial Properties

The County provided parcel data for 35,492 commercial parcels for FY 2013-2014. These consist of commercial building on leased land, vacant commercial, special use, and other types. Overall, there is marked improvement in the commercial real estate in the county, though the recovery continues to remain uneven with different segments of the market healing at a different pace. While the industrial and apartment market have improved dramatically compared to their recession-levels, retail and office markets continue to languish though some improvements in these areas are also evident over the past few quarters. A large amount of activity in the commercial market involves revamping distressed properties.

The industrial market of Inland Empire has been one of the best performing sectors in the commercial market over the past few years. Vacancy rates continue to decline to around 5% in 2014 from the already low levels of 5.16% in 2013Q4 and are much improved compared to year-ago levels (industrial vacancy rates stood at 6.73% in 2012Q4). Not surprisingly, average lease rates in the industrial market have increased to $0.41 in Q1 2014 from $0.39 in 2013Q4. Construction activity has firmed up appreciably with over 9.8 million square feet of new deliveries completed in 2013. The region has quite a large number of planned development projects in industrial markets (one of the strongest in the country), so we expect this segment of the market to continue to perform well over the forecast horizon. Given that the county is heavily involved in logistics, the demand for industrial property should continue to increase particularly for mega-warehouses.

The strong recovery in the apartment market continues as asking rents for Class A&B Apartments in the last quarter of 2013 increased by 3.7% to $1,142 on a year-over-year basis. This is largely due to an increased demand for rental properties as a large number of residents either lost their homes during the housing crisis or did not qualify for home mortgages due to a tightening of loan standards. The surge in rental property prices have propelled rental prices close to their all-time high value of $1,165 recorded in Q1 2008. The rate of increase has been more moderate in 2013 relative to 2012, which is positive for those households that rent: with a surge in rental prices, over 72,000 of the county's households spent more than 50% in rental income in 2012 which places a significant strain in these households disposable income.

The recovery in the retail market has been rather sluggish for the Inland Empire, though even here there are unmistakable signs of improvement. Average asking lease rates have crept upwards to $1.39 in 2014 from around $1.35 during 2012 and 2013. Over 183,000 square feet of positive net absorption was added to the area in the first quarter of 2014, bringing the total net absorption just shy of 2 million over the past two years. While this by no means qualifies as a robust recovery, it certainly signals a positive trend and marks a continued (albeit sluggish) recovery in the sector. We expect the retail market to continue to stage a modest recovery in the years to come -- partially hindered by slower population and income growth (compared to the boom years of the previous decade). The overbuilding of the previous boom will also take a bit longer to correct which means that vacancy rates and rent prices will recover relatively slowly over the forecast horizon.

The office market is the weakest segment of the commercial real estate sector in the Inland Empire. Vacancy rates have decreased to 13.81% in 2014 but this is still considerably higher than the 8% rate recorded just prior to the recession. In addition, much of the activity is still focused on distressed buildings. The outlook for the office market depends largely on developments in the neighboring counties as the region serves as a low-cost alternative to the pricier coastal areas. As office rents continue to climb up in Orange County, we expect demand for office space to also firm up in Riverside County over the next few years. Construction additions however, should be limited given the still-large overhang of existing supply.

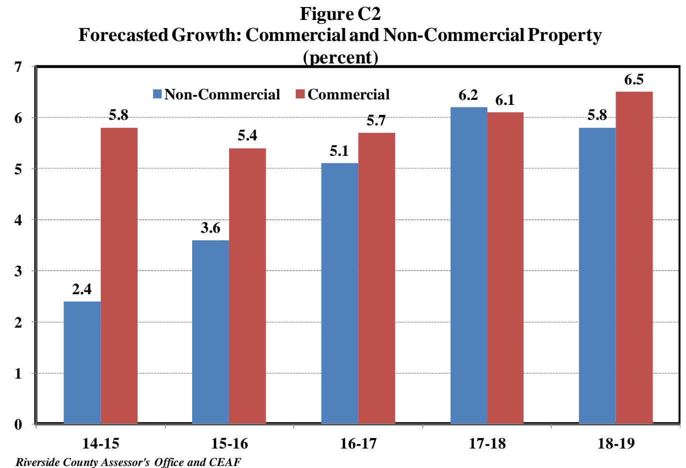
In terms of assessed valuations, there were a total of 3,775 commercial properties in FY 2013-2014 that received a Prop 8 reduction, with the average reduction coming at $953,788. The total decrease in Proposition 8 commercial assessed valuation was $3.6 billion. For FY 2012-2013, 3,190 commercial properties experienced an average reduction of $980,748 in assessed valuations. Thus the number of commercial properties receiving a Proposition 8 reduction increased by 18.3% in the most recent year compared to the previous fiscal year, while the average reduction fell by around -2.5%. In contrast, for non-commercial property, there was a reduction in both the number of properties receiving a Prop 8 reduction as well as in the average amount of the reduction.

Part of the reason for these discrepancies in Prop 8 valuations between commercial and non-commercial properties has to do with the fact that the reassessment of commercial properties is complex and time consuming because, in contrast to the residential market, it requires a thorough study of the fundamentals of each property. The lagged effect of this complex reassessment process will restrain to some extent the County's Assessment roll in the near term even as commercial real estate values continue to appreciate from current values. We project that reassessment appeals of commercial properties will continue over this next fiscal year, but the worst should be behind the county and Prop 8 reassessments will no longer be the growth-restraining factor for commercial properties they have been over the past few fiscal years.

Based on our analysis of parcel data, we found that the number of commercial property owners that defaulted on property tax payments in FY 2012-2013 declined compared to the previous fiscal year. Property tax delinquencies on commercial properties in FY 2012-2013 (latest available data) amounted to $15,129,115 which constitute 23.9% of the total of delinquencies. Delinquencies on commercial properties are expected to decrease over the next few years as the recovery continues to take hold in the commercial sector as well.

Commercial properties are expected to add more robustly to the county's assessment rolls over the forecast horizon compared to past trends. Though growth in commercial property values will likely be lower than that in the residential market over the next few years, it is expected to pick up towards the later part of the decade (Figure C2). Much of the growth in the commercial market is likely to come from the industrial, apartment and -- to a certain extent -- from the retail market.

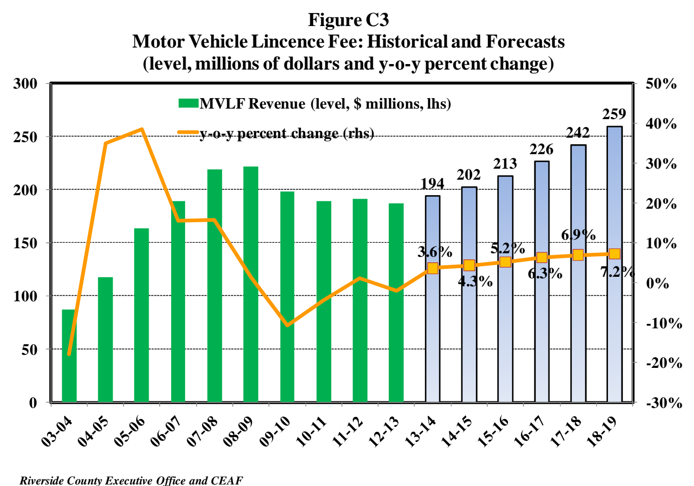
Figure C2
Forecasted Growth: Commercial and Non-Commercial Property
(percent)



C4. Motor Vehicle Licensing Fee (in Lieu)

Motor Vehicle Licensing Fee (MVLF) revenue is based on assessed property values. 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 on a historical basis. 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 frequently distorts the underlying trend for MVLF revenue, sometimes by a large margin (Figure C3).

Figure C3
Motor Vehicle Lincence Fee: Historical and Forecasts
(level, millions of dollars and y-o-y percent change)



To project MVLF revenue, we use our projected assessed valuations, regional variables and the underlying trend for MVLF. Since assessed valuations include the impact of foreclosures, property tax delinquencies, other housing related variables, labor market indicators, and earnings, the MVLF projections are largely driven by the Riverside real estate market and the local economy. However, because of state adjustments, we also use the underlying historical trend in MVLF revenue to augment the core projections. Thus our forecasts for this variable include a historical component which is driven by the over/under-compensation of revenues by the state. As such, the underlying trend in MVLF (past historical lags) which include the adjustments by the state do play a role in our projected values (shown in table C2). Having said that, assessed valuations are the main driving force behind the MVLF revenue projections with past state adjustments having a smaller impact over the forecast horizon.

MVLF revenue for the county rose by 1.13% in FY 2011-2012 but fell by -2.13% in the following fiscal year (FY 2012-2013). MVLF revenue is projected to increase by 3.6% to $194,006,547 in FY 2013-2014, by 4.3% to $202,348,828 in FY 2014-2015 and by 5.2% to $212,870,967 in FY 2015-2016. MVLF revenue is projected to increase more robustly in the long term as the real estate market recovers with assessed values rebounding from depressed levels.

C5. Documentary Transfer Tax

Documentary transfer tax is typically from a transfer of ownership of real property. Historical and projected values for this source of revenue for the county are provided in Table C3. 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 home 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 the relatively low interest rates, increased private investments in the real estate market, and a recent rise in construction activity, documentary transfer revenue received a strong boost in FY 2012-2013, growing by 18.77% to $11,123,316. The strong activity (mostly investor-driven) in the real estate market caused an increase in Documentary Transfer Tax revenue. Nonetheless, this source of revenue is still below the $13,477,571 level that was recorded in FY 2007-2008. Documentary transfer tax revenue is projected to increase by 11.4% (to $12,391,374) in FY 2013-2014 and by an additional 9.2% (to $13,531,381) in FY 2014-2015. In the long term, documentary transfer tax revenue is expected to continue to grow as the recovery in the real estate market continues to expand.

Table C2
Motor Vehicle Licensing Fees Dollars

Fiscal Year	Dollars	Growth
	Historical	
10-11	189,210,416	-4.41%
11-12	191,348,791	1.13%
12-13	187,265,007	-2.13%
	Forecast	
13-14	194,006,547	3.6%
14-15	202,348,828	4.3%
15-16	212,870,967	5.2%
16-17	226,281,838	6.3%
17-18	241,895,285	6.9%
18-19	259,311,746	7.2%

Table C3
Documentary Transfer Tax Dollars

Fiscal Year	Dollars	Growth
	Historical	
10-11	9,958,654	-6.74%
11-12	9,365,385	-5.96%
12-13	11,123,316	18.77%
	Forecast	
13-14	12,391,374	11.4%
14-15	13,531,381	9.2%
15-16	15,534,025	14.8%
16-17	18,143,741	16.8%
17-18	20,774,584	14.5%
18-19	23,392,181	12.6%