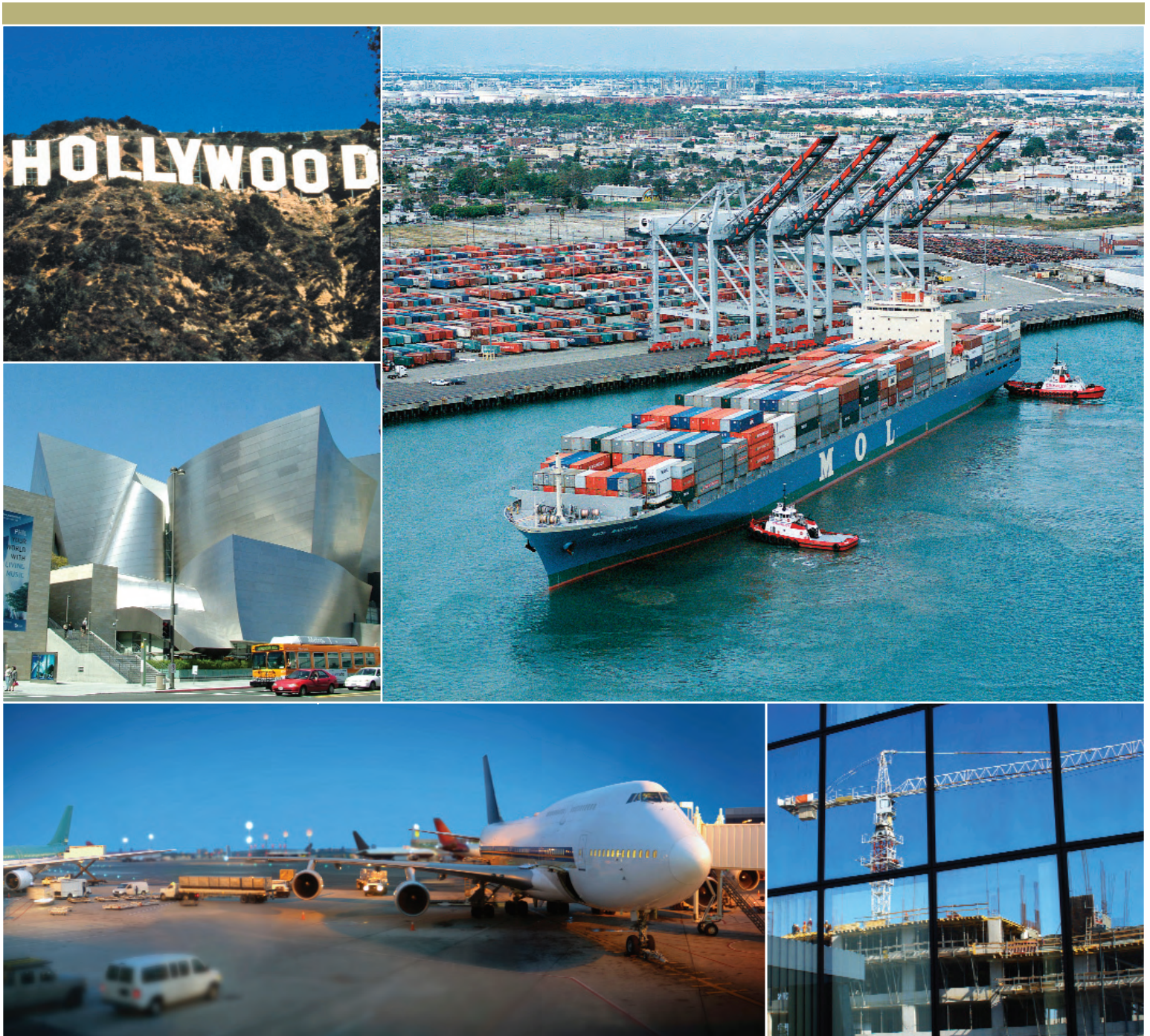


# 2010-2011 MID-YEAR UPDATE **ECONOMIC FORECAST** AND INDUSTRY OUTLOOK

JULY 2010



The LAEDC thanks the following Business Leaders for their generous support:



For information about LAEDC membership, contact Justin Goodkind (213) 236-4813.

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# **2010-2011 Economic Forecast and Industry Outlook: Mid-Year Update**

California & Southern California  
Including the National & International Setting

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July 2010



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The LAEDC, the region's premier business leadership organization, is a private, non-profit 501(c)3 organization established in 1981.

**As Southern California's premier business leadership organization, the mission of the LAEDC is to attract, retain, and grow businesses and jobs for the regions of Los Angeles County.**

Since 1996, the LAEDC has helped retain or attract more than 161,900 jobs, providing \$8.0 billion in direct economic impact from salaries and more than \$130 million in tax revenue benefit to local governments and education in Los Angeles County.

### **Regional Leadership**

The members of the LAEDC are civic leaders and ranking executives of the region's leading public and private organizations. Through financial support and direct participation in the mission, programs, and public policy initiatives of the LAEDC, the members are committed to playing a decisive role in shaping the region's economic future.

### **Business Services**

The LAEDC's Business Development and Assistance Program provides essential services to L.A. County businesses at no cost, including coordinating site searches, securing incentives and permits, and identifying traditional and nontraditional financing including industrial development bonds. The LAEDC also works with workforce training, transportation, and utility providers.

### **Economic Information**

Through our public information and for-fee research, the LAEDC provides critical economic analysis to business decision makers, education, media, and government. We publish a wide variety of industry focused and regional analysis, and our Economic Forecast report, produced by the **Kyser Center for Economic Research**, has been ranked #1 by the Wall Street Journal.

### **Economic Consulting**

The LAEDC consulting practice offers thoughtful, highly regarded economic and policy expertise to private- and public-sector clients. The LAEDC takes a flexible approach to problem solving, supplementing its in-house staff when needed with outside firms and consultants. Depending on our clients' needs, the LAEDC will assemble and lead teams for complex, long-term projects; contribute to other teams as a subcontractor; or act as sole consultant.

### **Leveraging our Leadership**

The LAEDC operates several subsidiary enterprises, including the World Trade Center Association Los Angeles-Long Beach (WTCA LA-LB), which facilitates trade expansion and foreign investment, the California Transportation and Logistics Institute, which enhances the quantity and quality of workforce training for the logistics industry, and L.A. PLAN, which assists major public land owners in developing real estate through the LAEDC network. In addition, the LAEDC's Center for Economic Development partners with the Southern California Leadership Council to help enable public sector officials, policy makers, and other civic leaders to address and solve public policy issues critical to the region's economic vitality and quality of life.

### **Global Connections**

The World Trade Center Association Los Angeles-Long Beach works to support the development of international trade and business opportunities for Southern California companies as the leading international trade association, trade service organization and trade resource in Los Angeles County. It also promotes the Los Angeles region as a destination for foreign investment. The WTCA LA-LB is a subsidiary of the Los Angeles County Economic Development Corporation. For more information, please visit [www.wtca-lalb.org](http://www.wtca-lalb.org)

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LOS ANGELES COUNTY ECONOMIC DEVELOPMENT CORPORATION

July 21, 2010

Good morning, Ladies and Gentlemen, and welcome to the LAEDC's *2010-2011 Mid-year Economic Forecast Update* event.

The LAEDC releases an economic forecast each year in February followed by an updated forecast report in July. Each forecast release is accompanied by a major public event featuring the insights of influential economists and public or private sector leaders. The forecast publications and events are highly regarded locally, nationally and internationally. The forecast report is produced by the **Kyser Center for Economic Research** at the LAEDC under the leadership of our Chief Economist, Dr. Nancy Sidhu. LAEDC's economic research reports are used by the media, government, and private industry organizations, and have been ranked #1 by the Wall Street Journal.

Today's event is presented by City National Bank, Los Angeles County Metropolitan Transportation Authority (Metro), Manpower, NBC Universal, Port of Long Beach, Port of Los Angeles and Woodbury University. The Mid-year Forecast features an expert panel of economists who will give presentations about our local housing industry, as well as the outlook for the Los Angeles five-county area and the national economic picture. Our infrastructure panel features leaders from some of the region's most critical infrastructure agencies, including Los Angeles World Airports, the Ports of Los Angeles and Long Beach, and Metro, who will discuss important issues pertaining to the more than \$50 billion in public dollars planned for upgrading our region's infrastructure.

We are also delighted to inform you that the first-ever consensus Los Angeles County Strategic Plan for Economic Development, which was unanimously adopted by the Los Angeles County Board of Supervisors on December 22<sup>nd</sup>, is continuing to generate progressively more interest and wide-ranging support locally and up-and-down the state. We continue to leverage and broaden the consensus developed during the plan's formation in order to ensure that the plan has maximum impact as we all come together to implement its strategies and objectives. In doing so, we have recently secured the unanimous endorsements of the Gateway Cities, San Gabriel Valley, South Bay Cities and Westside Cities Councils of Governments, representing 79 of L.A. County's 88 cities and, just last week, the Los Angeles City Council unanimously voted (14-0) to support the plan as well.

If your organization has not already done so, we ask that your organization consider expressing its formal endorsement for the plan by completing the endorsement form that is included in today's program, which also be downloaded from our website at [LACountyStrategicPlan.com](http://LACountyStrategicPlan.com). Your organization will be joining a growing number of entities that are joining the movement to take responsibility for the health and vibrancy of our communities.

We thank you for your support of the *2010-2011 Mid-year Economic Forecast Update* and for your continued support of the LAEDC and our mission to attract, retain and grow jobs for Los Angeles County.

Sincerely,

Bill Allen, President and CEO

## I. OVERVIEW OF THE LAEDC 2010-2011 ECONOMIC FORECAST

### The U.S. Economy

		<u>2010</u>	<u>2011</u>
<b>Real GDP</b>	A measured recovery	+3.1%	+2.9%
<b>Inflation</b>	Not a problem	+1.6%	+1.8%
<b>Fed Funds Rate</b>	Very low now, rising later	0.8%	2.8%
<b>Leading Sectors</b>	Consumer spending, business equipment investment		
<b>Laggards</b>	Nonresidential construction, state/local government spending		

### The California Economy

	<u>2010</u>	<u>2011</u>
<b>Nonfarm Employment</b>	-1.3%	+1.3%
<b>Industry Leaders</b>	Private education Administrative & support services Information	Leisure & hospitality Retail trade Administrative & support services
<b>Industry Laggards</b>	Construction Manufacturing Retail	Manufacturing Government

### Job Growth among Southern California Counties

	<u>2010</u>	<u>2011</u>
<b>Leaders</b>	<b>Jobs</b>	<b>Jobs</b>
Orange County	-0.5%	San Diego County +1.4%
San Diego County	-0.7%	Orange County +1.3%
<b>Laggards</b>		
Riverside-San Bernardino	-2.1%	Ventura County +1.1%
Ventura County	-1.5%	Riverside-San Bernardino +1.2%
Los Angeles County	-1.2%	Los Angeles County +1.2%

### Job Growth among Los Angeles County Sub-Regions

	<u>2010</u>
<b>Leaders</b>	<b>Jobs</b>
Central/Downtown LA	0.0%
Crenshaw/Mid-cities/Hollywood	0.0%
San Fernando Valley	-0.1%
<b>Laggards</b>	
Santa Clarita/Valencia	-2.4%
San Gabriel Valley	-2.3%
North Gateway	-1.5%

## II. OUTLOOK FOR THE U.S. ECONOMY

### Overview: Recovery is Underway

The U.S. economy was hammered by a deep recession combined with a severe financial crisis in 2008 and early 2009. Employment plunged throughout this period and jobless rates soared across the nation and across the industry spectrum. The economy reached bottom in June 2009 (by our estimates) and turned up in the second half of the year. Job losses continued a while longer but have been replaced by job gains beginning in 2010. Still, the damage was done: by year-end 2009, some 8.4 million jobs had disappeared, and one in ten workers was unemployed and looking for work.

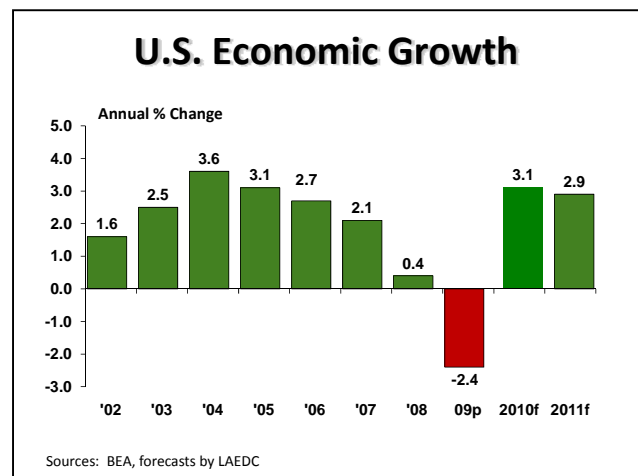
The signs of an economic recovery continue to spread. The stock market turned up in spring 2009 (it almost always leads an economic upturn), though it has suffered a case of the jitters in recent months. Retail sales have been moving up since September. Exports are growing, reflecting economic recovery elsewhere in the world, especially China. Even business investment in equipment and software turned up strongly around year end 2009.

A few sectors remain weak. State and local government spending continues to be constrained by reduced tax revenues despite the economic recovery. And commercial real estate and nonresidential building activity are withering due to lack of financing.

Housing remains a question mark. Home sales are up from the bottom in most locations, and new construction has stabilized, though at a pitifully low level. However, housing recent activity has been boosted by considerable government support, which has just recently been removed. We are optimistic for the medium term but cautious about 2010.

For the rest of 2010 and 2011, the key forecasting issues involve the shape and speed of the recovery. This forecast takes as given that the economic recovery is “for real.” That is, it will proceed

upwards and not relapse, though activity may grow in fits and starts. Because the recession was so deep, much damage remains to be re-dressed. Still, progress has been made. As more time passes, the economy will gather strength and upward momentum will spread. For now, we continue to be conservative in our forecasting posture.



Overall, the LAEDC projects the U.S. economy will grow by +3.1% in 2010 and by +2.9% in 2011 after plunging by -2.4% during 2009. Inflation is unlikely to be a problem in the near term, though the potential for higher energy prices is always cause for concern. Monetary policymakers acknowledge the inflation risk they are creating by their actions, but continue to be focused on restoring the health of the nation's economy and the financial sector. Thus, short-term rates are likely to remain at current extremely low levels for a while longer. The outlook for long-term rates is a bit more uncertain. Given the Fed's current activist policy stance, rates are unlikely to rise much until 2011. Below we review the outlook for the key sectors in more detail.



## Household Spending On the Rise Again

**Consumer spending** is the largest sector of the U.S. economy and holds one of the keys to the economic outlook. U.S. households came under considerable stress during the recession, as employment declined sharply and joblessness increased. The nation's unemployment rate, currently 9.5%, will remain elevated through the rest of 2010 and then decline slowly, reaching the 9% range by the end of 2011.

In contrast to 2009, most types of household incomes have been edging up in recent months. Wages and salaries were up by +0.3% in the March-April-May 2010 period compared with the year-ago period. Most other sources of income were up as well. Interest income rose by +0.4% despite low interest rates. Profits of independent, unincorporated businesses were up by +4.7% over the year. However, dividend income fell by -3.6% due to reduced corporate dividend payments. The government helped out too: personal transfer payments (mostly Social Security, welfare and unemployment benefits) were up by +6.4%. Bottom line: disposable personal income (net of personal taxes) grew by a moderate +2.4% over the year to March-May 2010. That increase was just barely enough to outweigh consumer inflation. After inflation and taxes, real disposable income grew by a very modest +0.5%.

While incomes have begun to turn around, household balance sheets are exhibiting the mixed after-effects engendered by the housing and financial crises. On the one hand, a recovery is under way in financial markets. In March 2010, total household financial assets had grown by +13.8% (or by +\$5.5 trillion) compared with a year earlier (latest data available). Also, the value of household real estate assets was up by +5.2% in a more tentative recovery. Home mortgage debt (including home equity loans and lines of credit) edged down by -2.4% over the year. Thus, homeowners' equity increased by +20.8% over the year to March 2010.

Meanwhile, total household liabilities slipped by -\$177 billion in the year to March. The bottom line: U.S. households' net worth (total assets minus total liabilities) increased by +13.0% (or +\$6.3 trillion) over the year to March 2010.

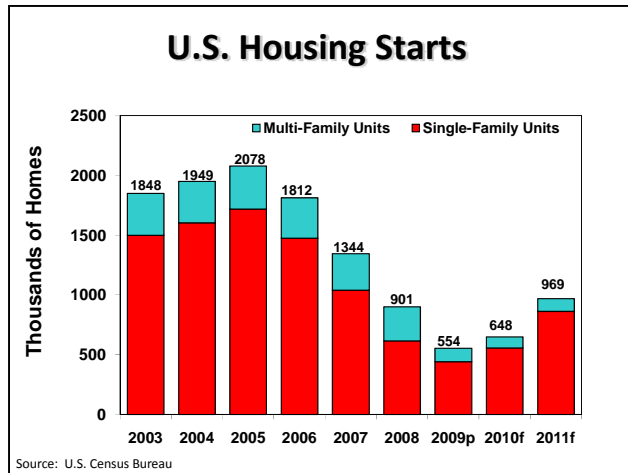
With incomes and household wealth growing and employment finally starting to rise, consumer confidence has improved somewhat. Consumer spending increased in the 2<sup>nd</sup> half of 2009 and early 2010 at respectable rates. Government appliance purchase incentives boosted spending during March and April, but other types of retail spending have improved this year without much in the way of incentives, an encouraging sign.

In particular, automotive sales have been rising at a moderate pace. Demand for cars and light trucks plunged from 16+ million vehicles (annual rate) at the peak to just 9.5 million units at the bottom in the 1<sup>st</sup> half of 2009. Since then, sales have moved irregularly north of 11 million vehicles (annual rate) by 2<sup>nd</sup> quarter 2010. This too was encouraging, though domestic makers' results were boosted by sales to fleet (non-retail business) buyers. The LAEDC assumes sales will stabilize for the rest of 2010, finishing the year at about 11.5 million vehicles. As the economic recovery gains steam, and more people find new jobs, sales are expected to increase to 13.3 million vehicles in 2011.

Overall consumer spending (inflation adjusted) is forecast to grow by +2.5% in 2010 and by +3.1% in 2011 after falling by -0.6% in 2009.

**The housing sector** was on a steep downtrend for more than four years but appears to have stabilized. New housing starts peaked in 2005 at 2.1 million units, the highest level since 1972. However, home construction activity declined to 554,000 units in 2009, the lowest level since before 1959 (when records began). Actually, housing starts hit bottom in the 1<sup>st</sup> quarter of 2009 and have trended modestly upward since then, averaging 620,000 units (annual rate) in the

first five months of 2010. All of the recent improvement came in single-family starts activity. Multi-family construction has continued to weaken, pressured by rising apartment vacancies and high inventories of unsold condominiums on the one hand and the lack of ready bank financing on the other.



Mortgage credit is still difficult to obtain for all but “prime” homebuyers (those with jobs and strong, well-documented credit and income histories). While loan modification programs are available for distressed homeowners, lending terms for would-be borrowers remain strict. Still, mortgage rates are relatively low, which helps borrowers who can get them. As of June 2010, mortgage commitment rates ranged from 3.86% for the average one-year adjustable rate mortgage to 4.74% for a 30-year fixed rate. Six months earlier, these rates were quoted at 4.31% and 4.93%, respectively.

Fixed mortgage rates are expected to hover between 4.5% and 5.5% over the rest of 2010, at least for prime borrowers. And lenders’ terms for non-prime borrowers are likely to remain strict, despite the availability of various mortgage workout programs. However, prices of new and existing homes have dropped markedly, increasing affordability. Buyers who can qualify for mortgage loans will find they can choose among more homes in 2010-2011 than in earlier years. And as future employment rolls grow, more families will gain the confidence to make

the plunge. Assuming the mortgage credit crunch begins to ease, LAEDC expects total housing starts to rise from just 554,000 units in 2009 to 650,000 units in 2010 and just under one million units in 2011.

## Business Investment Spending Mixed

**Business profits** and cash flows deteriorated in many industries during the recession and are only now beginning to improve. Adjusted total pre-tax corporate profits during first quarter 2010 (latest data available) were up by +34% compared to first-quarter 2009. Profits-by-sector data reflected the spreading economic recovery. Domestic industry profits were up by +46% over the year, with the financial industries recording a huge increase of +79% and non-financial industries up by a very-respectable +31%. Higher profits were reported for manufacturing (with automotive returning to the black), transportation & warehousing, information, and retail trade among others. Net profits earned from the rest of the world grew by +5.5%. Adjusted total corporate cash flow increased by +8.3% over the year-earlier period, its third consecutive annual increase.

Businesses typically invest their cash in new equipment and software. Indeed, equipment spending has been rising at double-digit rates since 4<sup>th</sup> quarter 2009. However, there's still a long way to go: spending in 1<sup>st</sup> quarter 2010 was still down by -15% from the pre-recession peak (in 4<sup>th</sup> quarter 2007).

Business purchases of high technology equipment and software declined the least over the six-quarter recession period--by -9% in inflation adjusted terms—but have been rising briskly, reaching a new high by 1<sup>st</sup> quarter 2010.

At the other end of the spectrum, purchases of transportation equipment plunged by a whopping -65% during the six-quarter downturn. By 1<sup>st</sup> quarter 2010 such purchases were up by +37% from the bottom, though they remained -52%

below the pre-recession peak. Much of the recent improvement reflects the resumption of business automotive purchases this year compared with near-industry shutdown conditions in early 2009. Such “fleet” purchases of new vehicles especially benefit domestic producers. Similarly, we expect demand for commercial aircraft to increase, as airlines return to profitability during the recovery. Demand for heavy trucks and railroad equipment will recover more slowly as goods movement activity has just begun to accelerate.

Business investment in nonresidential structures is still falling at midyear 2010 after peaking in mid 2008. Structures spending had dropped by a total of -30% by the 1<sup>st</sup> quarter of 2010. Declines were especially steep in lodging, retail, restaurant and office projects. The nonresidential construction industry has been hard hit by the credit crunch and, with vacancy rates rising, would-be developers of new commercial projects are simply unable to obtain adequate financing. With few new projects being initiated, nonresidential building activity is shrinking as projects that are currently under way get completed.

The economic recovery suggests a mixed outlook on business spending. Pre-tax adjusted profits are expected to turn up strongly in 2010, by as much as +30%, as the recovery gathers strength. Real business spending for equipment and software is forecast to grow by +10.9% in 2010 and by +9.0% in 2011. Meanwhile, spending for nonresidential structures will decline by -13.4% in 2010 and flatten out in 2011.

## Government Spending Soars

The current forecast anticipates continued growth in federal purchases of goods and services during 2010 and 2011. The conflicts in Iraq, Afghanistan, and Pakistan currently cost about \$160 billion annually. Aside from defense, spending is growing rapidly in most spending categories, especially unemployment compensation and Medicaid. Inflation adjusted, federal purchases of goods and services

(excluding loan programs) are expected to increase by +2.6% in 2010 and by +2.0% in 2011 after rising by +5.2% in 2009.

State and local government purchases of goods and services are another matter. Almost all states are experiencing weak or declining revenue growth. Many are cutting spending and/or increasing taxes. Despite the federal stimulus plan, revenue growth constraints mean that state/local spending—even for infrastructure—will be flat *at best* in the near future. The LAEDC forecast anticipates that state/local purchases (inflation adjusted) will decrease by -1.6% in calendar year 2010 and rise by only +0.4% in 2011.

## Net Exports to Deteriorate

Exports (foreign purchases of U.S. goods and services) plunged by -15% (inflation adjusted) between the 2<sup>nd</sup> quarter 2008 peak and 2<sup>nd</sup> quarter 2009 but turned up briskly in the second half of 2009. By the 1st quarter 2010, total exports of goods and services had made up 70% of the shortfall created during the downturn, as the economies of major U.S. trading partners, especially in Asia, turned up strongly. Exports of automotive products, which plunged in 2008-2009, turned up most strongly in 2010, followed by capital goods, industrial supplies and foodstuffs.

The value of the U.S. dollar drifted downward in the second half of 2009 and reversed direction in the first half of 2010, especially in the second quarter when Europe’s financial risks burst onto the stage. As long as Europe’s challenges appear to be contained, the dollar seems unlikely to change much in value during the rest of 2010 and 2011. In that case, the international macroeconomic fundamentals, which incorporate the economic recovery spreading around the globe by the end of 2011—should drive the export forecast. Exports will increase by +10.6% in 2010 and by +4.4% in 2011.

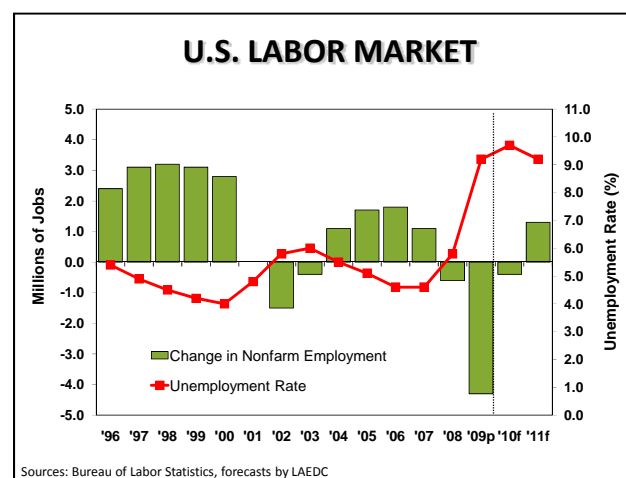
U.S. purchases abroad peaked during the 3rd quarter 2007 and declined by -20.8% through the 2nd quarter of 2009 before turning around. As of 1<sup>st</sup> quarter 2010, growth in total imports of goods and services had made up 48% of the decline, a somewhat smaller relative improvement than seen in exports. As with exports, imports of motor vehicles and parts, capital goods and non-oil industrial supplies recorded the largest increases in 2010. Overall U.S. purchases of foreign-made goods and services are forecast to increase by +10.5% in 2010 and by +6.1% in 2011.

For the U.S. economy, net exports (equals gross exports minus gross imports) are what matters most. Net exports contributed +1.2 percentage points to the U.S. economic growth rate during 2008 and +1.0 percentage point in 2009. However, the positive contributions will turn negative in 2010 and 2011, because imports will grow faster than exports. The net export balance (in constant dollars) reached a low point in 2006, at -\$729 billion, and then improved to -\$356 billion in 2009. LAEDC forecasts the deficit will retreat to -\$391 billion in 2010, followed by further deterioration--to -\$444 billion--in 2011.

## Labor Market Conditions

Labor market conditions deteriorated as economic activity declined in 2008 and 2009. By December 2009, total nonfarm employment payrolls shrank by -8.4 million jobs from the peak in December 2007. Losses were heaviest in manufacturing and construction but also afflicted business & professional services, retail and wholesale trade, tourism, finance and transportation. The decline in nonfarm employment apparently ended in December 2009, as nonfarm payrolls actually grew by +882,000 jobs in the first six months of 2010. Job growth is expected to continue--at a moderate pace in 2010 but gradually increasing through 2011. Nonetheless, average employment will decline a bit in 2010--by -0.4% or so--before turning up by +1.3% in 2011.

Unemployment is proving more difficult to turn around. Joblessness in the U.S. worsened from mid 2007 until December 2009, when the unemployment rate peaked at 10.0%. Joblessness has drifted down in the first half of 2010, but only reached 9.5% by June. The nation's unemployment rate will continue unacceptably high through most of the forecast period. This recession has been very severe, and many business firms expect to delay hiring until they are quite certain the currently-visible improvement in their business will persist. Even then, they will likely bring their laid off and part-time workers back to full-time status before any new workers are hired. In the meantime, current workers are being asked to work longer hours and more temporary employees are being hired. We expect the nation's jobless rate to average 9.6% in 4q2010. Unemployment won't break through the 9.0% mark until the end of 2011.



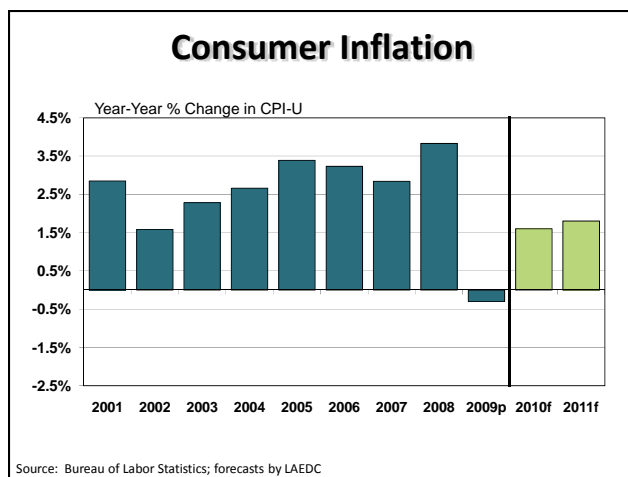
Total employee compensation increased by 1.7% in the year ended March 2010. Wages and salaries increased by 1.5% during that period, while benefit costs grew at a 2.2% rate. These figures are well below the 3% range of pre-recession years. Many businesses have reduced labor costs to offset declining sales. On the benefits side, employers have shifted an ever larger proportion of health insurance burdens onto their workers in order to contain rising costs. This strategy has met with some success and is likely to continue (at least until health care reform kicks in). Thus, we expect overall

employee compensation costs to continue escalating at a rather modest pace during the forecast period—rising by about 1.8% during 2010 and perhaps 2.0% in 2011.

## Inflation

Measured by the Consumer Price Index, annual consumer inflation decelerated from 2.8% in December 2009 to 2.0% in May 2010. Energy prices dropped during this period, accounting for some of the decline, but food prices turned up. Excluding these two categories, prices of all other consumer goods and services increased by +1.0% in the year to May, below the previous year's pace.

Going forward, we assume that gasoline and food prices will remain moderate during the rest of 2010 and 2011. If that happens, and prices of other goods and services follow current trends, then total CPI ("headline inflation" in the U.S.) is expected to increase by an average rate of +1.6% in 2010 and by +1.8% in 2011.



Crude oil prices certainly have been volatile in recent years. Using the West Texas Intermediate spot price, (WTI), oil prices peaked in June 2008 at nearly \$134 per barrel and then plunged to \$39 per barrel in February 2009. By April 2010, the price was back above \$84 per barrel. The main factors propelling crude oil prices downward were global economic weakness and rising inventories in the OECD nations. With the global economic recovery under way, crude oil consumption is turning up in 2010 and will rise

again in 2011. On the supply side, OPEC production of crude oil will take up most of the increase in demand. Even so, substantial excess production capacity will continue to exist in the OPEC nations, especially Saudi Arabia. Industry observers expect oil prices to remain near current levels, averaging between \$75/barrel and \$80/barrel in 2010 and drifting north to perhaps \$80/barrel to \$85/barrel in 2011.

Natural gas prices peaked in June 2008 at \$12.70/thousand cubic feet (using the Henry Hub spot price). Prices reached bottom in September 2009, averaging just \$3.00/thousand cubic feet. The spot price was back up to \$5.80/thousand cubic feet in January 2010 and then eased back into the \$4.00-\$4.80 range through June. Going forward, and assuming weather patterns across the nation remain "normal," industry observers expect electric power and industrial usage of natural gas to rise as the economic recovery gathers strength. Natural gas prices (delivered to Henry Hub, LA) will average about \$4.75/mcf in 2010 and \$5.25/mcf in 2011.

## Monetary Policy and Interest Rates

When will the Federal Reserve raise short term interest rates? That's a big question. Let's back up for a moment to late 2008. In response to the escalating financial crisis, the Federal Reserve reduced its target federal funds rate (the rate banks charge each other for overnight loans) to nearly zero. However, this was not enough to persuade financial institutions to return to the capital markets. As the crisis intensified and the number of loan defaults escalated, financial institutions reacted by shoring up their own cash reserves (i.e. they stopped making loans, even to each other), which further exacerbated the spreading credit crunch.

The Fed's next course of action was to devise a number of new "facilities" that channeled necessary liquidity directly to borrowers and investors in key credit markets. At its maximum (in December 2008), the Fed's balance sheet swelled by more than \$1.5 trillion – an



extraordinary number when one considers the output of the entire U.S. economy is \$14 trillion. The capital markets gradually became unstuck, and by the first quarter of 2010, almost all of the crisis-driven facilities were allowed to lapse because they were no longer needed.

In addition, to support the ailing housing market and mortgage lending, the Fed began buying mortgage backed securities (MBS) from Fannie Mae, Freddie Mac and Ginnie Mae. This effort was designed to increase mortgage credit availability and keep mortgage interest rates low. The Fed completed its purchase of MBS during the first quarter of 2010 and is currently holding \$1.3 trillion of MBS.

In May, the Federal Reserve also re-established U.S. dollar liquidity swaps with foreign central banks to address the re-emergence of strains in the global U.S. dollar short term funding market, especially in Europe.

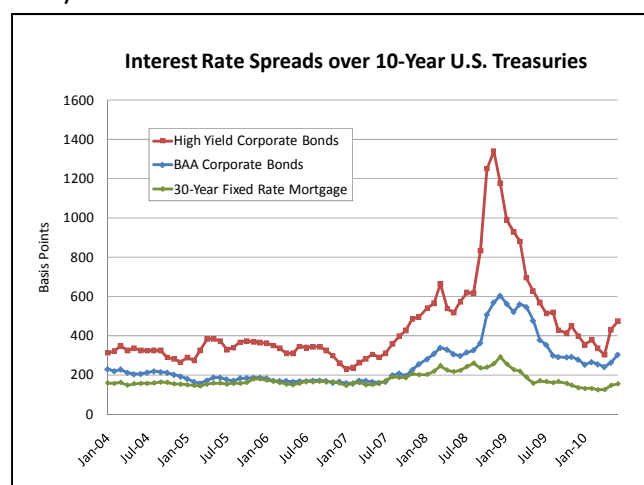
Much of the money created by the expansion of the Fed's balance sheet resides in commercial bank reserve accounts at the Federal Reserve. Banks' excess reserves (\$1.0 trillion as of June 30) earn 0.25% per year. Most banks do not need those reserves at the moment because demand for bank loans is still relatively weak and more stringent underwriting requirements mean fewer buyers would qualify anyway. A trillion dollars of excess reserves would pose an inflationary risk if banks suddenly decided to drain their reserve accounts and increase lending to businesses and households. However, this is an unlikely possibility, at least in the near term.

In the longer term, the Fed will have to tighten monetary policy to neutralize this risk. Fed officials are considering several new tools to accomplish this task, including raising the interest rate paid on excess bank reserves. Other options include selling off agency debt and MBS outright or simply letting these securities run off as they mature.

With few inflation concerns on the near horizon, the Fed is not expected to tighten soon so it can

keep rates low until the economy is on a more solid footing. If the recovery continues at its current moderate pace, short-term interest rates could remain at current levels until at least the first quarter of 2011, perhaps later. After that, the Fed will want to return rates to more normal levels as soon as possible for two reasons. First, the Fed needs to signal its intent to keep a lid on inflation. Second, with the federal funds rate already at zero, the Fed cannot use its most effective monetary policy tool should the economy slip back into recession.

Long-term interest rates traced different paths between the 4<sup>th</sup> quarter of 2008 and early 2010 as the financial markets first seized up and then gradually eased. The 10-year Treasury note yield stood at 3.25% late in 2008, dropped below 3% early in 2009 and then rose to 3.5% in the second



### Interest Rate Spreads

Another way of looking at interest rates is to compare them in terms of interest rate "spreads". The spread between two interest rates is measured in basis points and is a good indicator of the relative risk between different financial instruments. The chart above shows the spreads between investment grade corporate bonds, 30-year fixed rate mortgages and high yield (junk) bonds over the 10-year U.S. Treasury note. In 2008, when the financial crisis worsened, spreads widened considerably as investors fled from riskier assets to the safety of U.S. treasuries. Then the economy stabilized and investor confidence returned so spreads narrowed. More recently, periodic jitters in the financial markets have caused spreads to widen again.

quarter of 2010. During the same period, the 30-year fixed mortgage rate averaged 5.9%, drifted down to the 5% range and was fairly stable over the course of 2009. During the first two quarters of 2010, however, mortgage interest rates fell again and are now just below 5%.

Just as interesting, corporate bond yields which soared in late 2008 as investors fled risk, gradually drifted back down in 2009 and the first half of 2010. Corporate bond issuance, which collapsed during the financial crisis, has increased markedly this year as investors' appetite for risk and higher yields has returned.

Currently, the Fed is in a wait-and-see mode. Market jitters are creating a lot of noise which obscures the outlook for long-term rates. Still, some clues exist. By itself, the economic recovery will put some upward pressure on rates. Further pressure will come when the Federal Reserve starts to boost short-term rates. Assuming inflation behaves, market expectations of such a move could put the 10-year note yield at about 3.5% toward the end of 2010, and keep it near there or a little higher (perhaps 3.8%) by year end 2011. Meanwhile, the 30-year fixed rate mortgage should remain in the 5.0% range until the end of 2010 and then start edging up to 5.3% during 2011.

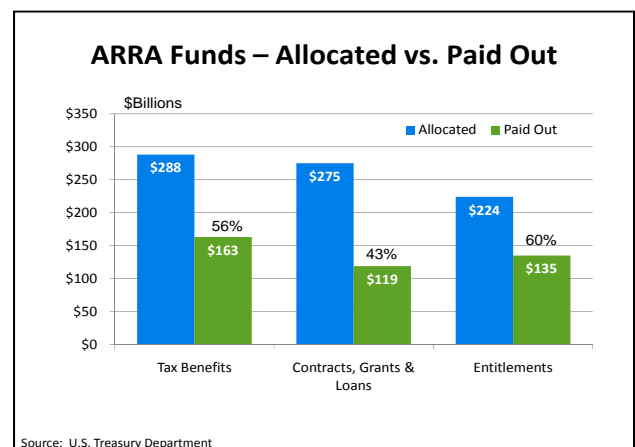
## Fiscal Policy

The U.S. government relied heavily on fiscal policy throughout the recession. During the second quarter of 2008, the first stimulus plan (Economic Stabilization Act of 2008) put tax rebate checks in the hands of consumers, helping to offset the loss of purchasing power that resulted from soaring gasoline prices. Later in 2008, the Bush Administration and Congress enacted the Troubled Asset Relief Plan (TARP). Under this program, up to \$700 billion was allocated to support commercial banks' balance sheets and to provide special assistance to the U.S. auto industry. In all, 707 U.S. banks received a total of \$205 billion in 2008 and 2009 with an additional \$331 billion used to bail out the auto industry and to expand the rescues of Citigroup Inc., Bank of America Corp. and AIG.

As the capital markets began to recover in 2009, a number of banks felt strong enough to raise new capital and return the TARP money they had received. As of May 2010, 71 banks have repaid \$194 billion in TARP funds along with \$23 billion in dividends, interest and other income. The funds that have been returned can be re-used for other purposes. The U.S. Treasury Department anticipates additional TARP expenditures will be made for housing initiatives, and for programs to assist smaller banks and the securitization markets.

In 2009, Congress and the Obama Administration enacted a huge stimulus bill, the American Recovery and Reinvestment Act (ARRA), authorizing \$787 billion in personal and corporate tax cuts plus increased federal aid to state and local governments and direct federal spending. As of June 2010, a total of \$417 billion has been distributed in tax benefits (\$163 billion), contracts, grants and loans (\$119 billion) and entitlements (\$135 billion).

The Congressional Budget Office estimates that the effects of ARRA on output and employment are expected to increase through 2010 and then begin to wind down in 2011, fading away entirely by 2012.



President Obama's FY 2011 budget proposed extending several ARRA programs that are scheduled to expire soon. Many members of Congress also have new stimulus proposals for the FY 2010 and FY 2011 years. Recently, the HIRE Act was passed which provides tax

incentives for businesses to hire and retain unemployed workers. The Administration has also proposed a \$30 billion small business lending program that would provide capital to small community banks, which play a niche role in business lending.

Additional fiscal stimulus is being considered for the states as well (funds provided by the ARRA's State Fiscal Stabilization Fund are set to expire at the end of the fiscal year). Collectively, state governments are facing a \$300 billion budgetary shortfall over the next two fiscal years. The death of a \$100 billion jobs bill to extend unemployment benefits could further strain state and local budgets.

Through the first nine months of the current fiscal year 2010, the U.S. Treasury Department recorded a deficit of \$1.0 trillion which was \$82 billion less than the same period last year. Receipts were higher compared to the same period in FY 2009 due to an increase in corporate income tax receipts and income the Federal Reserve earned on its asset holdings. Receipts from individual income taxes and social security were down, however, reflecting weakness in the labor market.

Outlays through June were lower compared to a year ago primarily due to a reduction in TARP spending and payments to support Fannie Mae and Freddie Mac. However, spending for unemployment benefits increased by almost 45%.

As a result, the federal budget deficit has surged to previously unheard of levels, reaching \$1.4 trillion in fiscal year 2009. With revenues still weak, the FY 2011 deficit is currently estimated at about \$1.5 trillion. Tax revenues should be rising again by FY 2011, reflecting growth in business profits, rising employment, incomes and possibly higher taxes (as Bush era and ARRA tax cuts are allowed to expire). Thus, the federal deficit should decline next year, depending on how much federal spending increases.

The ARRA stimulus package, financial bailout costs and the recession have taken their toll on the federal budget. In spite of growing concern regarding the sustainability of the federal debt

(estimated to reach 62% of GDP by the end of this year), immediate fiscal contraction might have the effect of nipping the recovery in the bud. Looking beyond the recession, Congress and the Administration will face difficult choices about spending priorities. Developing a credible, comprehensive plan for deficit reduction would go a long way toward creating a favorable climate for investment to ensure the future health of the economy.

### **Risks to the Forecast**

The baseline forecast calls for the U.S. economy to continue on a moderate recovery path through 2011. Consumer spending seems likely to follow this pattern. Automotive and housing related purchases will turn up in the recovery, but both will remain at historically low levels. Business investment in equipment will accelerate as the level of economic activity improves. However, nonresidential construction will lag. Foreign trade volumes will grow. Boosted by the various stimulus plans, federal government purchases will grow at a modest pace, helping to offset some of the expected weakness in state/local spending but not all. Labor markets will lag the economy throughout the forecast period. Employment will be growing by year end 2010 but sluggishly. Unemployment will remain high in both 2010 and 2011. Inflation looks like it will not be a problem during the forecast period.

A number of uncertainties make forecasting the U.S. economy especially difficult. We have made several assumptions in the LAEDC forecast that might turn out worse than expected—or better. The most important of these include the following:

**Financial fragility.** In 2010, capital market strictures have eased and stock prices have advanced. Still, the financial system undeniably carries risks. Consumer and business loan delinquencies continue high, dampening the profitability and capital adequacy of the banks involved and increasing their reluctance to lend. Large commercial banks appear to be healing, especially those with capital markets divisions,

though the recovery process will be slow. However, many small community banks are in weaker positions because they have high exposure to ailing commercial real estate ventures in their local areas.

Despite the revival, considerable risk remains in global capital markets, as evidenced by periodic cases of the jitters when unexpected news or data are released. In particular, the largest European banks hold unknown amounts of debt exposure to banks and governments in the weak economies (examples: Greece, Portugal, Ireland, Italy and Spain). A pronounced slowdown in European growth would reduce demand for U.S. exports and possibly boost demand for the U.S. dollar.

**Credit crunch.** Commercial banks and thrift institutions operate a key gateway between the financial sector and the rest of the economy. As loan losses worsened during the recession, banks raised credit standards, required more documentation, and boosted fees for all types of borrowers. Most of these restraints are still in operation.

For the forecast, the issue is how much longer it will be before bankers begin to loosen up. A growing economy requires more credit to finance business and household spending for big-ticket purchases. Recent surveys suggest that big banks have stopped tightening but are not yet making it easier for their customers to borrow. Only time will resolve this question.

**Can the housing sector fly solo?** Through April, the nation's housing and real estate industries were being supported by a number of federal government programs. Homebuyers were eligible for federal tax credits on homes they

purchased. The Federal Reserve purchased nearly \$1.25 trillion of mortgage backed securities to keep mortgage rates low. Indeed, the issuers of those securities, FNMA and Freddie Mac, are now owned by the government, to prevent their collapse during the financial crisis. But the Fed's buying program largely ended in March, 2010 and the tax credits expired after April. Sales of new and existing home sales have slumped—we assume temporarily. In fact, we simply don't know how long the housing downturn will last and if the industry will be strong enough to weather an extended downturn.

**"Optimism."** There is an upside risk to the LAEDC forecast. Americans--consumers and businesses alike—have been inundated with media reports of the economy's troubles and policymakers arguing about solutions and who's to blame. No wonder confidence seems so volatile.

And yet the economy *is* undeniably stirring. Retail sales have improved, and so have exports. Industrial production and imports have turned up, as businesses discovered they'd reduced their inventories too much and needed more to support the (currently slight) increase in their sales. Business attitudes are improving along with revenues, as shown by increased equipment purchases.

Economic recoveries often begin just this way. Sometimes the initial burst of growth is followed by a slower period. The LAEDC forecast includes such a slowdown but not a reversal. But sometimes the economy runs faster than we economists project. The LAEDC has been deliberately conservative in compiling this forecast. We'd be delighted to discover we were wrong!

**Table 1:****U.S. Economic Indicators**

(Annual % change except where noted)	2004	2005	2006	2007	2008	2009	2010f	2011f
Real GDP	3.6	3.1	2.7	2.1	0.4	-2.4	3.1	2.9
Nonfarm Employment	1.1	1.7	1.8	1.1	-0.6	-4.3	-0.4	1.3
Unemployment Rate (%)	5.5	5.1	4.6	4.6	5.8	9.2	9.7	9.2
Consumer Price Index	2.7	3.4	3.2	2.9	3.8	-0.3	1.6	1.8
Federal Budget Balance (FY, \$billions)	-\$413	-\$318	-\$248	-\$162	-\$455	-\$1,416	-\$1,500	-\$1,300

Sources: BEA, BLS and OMB; forecasts by LAEDC

**Table 2:****U.S. Interest Rates**

(4th quarter averages, %)	2004	2005	2006	2007	2008	2009	2010f	2011f
Fed Funds Rate	2.0	4.0	5.3	4.5	1.1	0.2	0.8	2.8
Bank Prime Rate	4.9	7.0	8.3	7.5	4.1	3.3	3.8	5.8
10-Yr Treasury Note	4.2	4.5	4.6	4.3	3.3	3.3	4.0	4.5
30-Year Fixed Mortgage	5.7	6.2	6.3	6.2	5.9	5.0	5.5	6.0

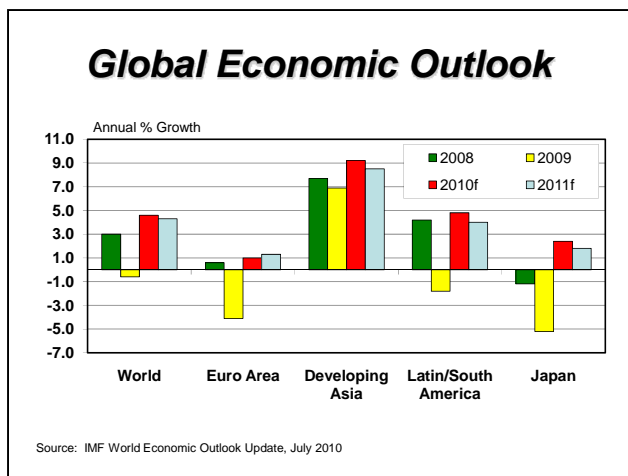
Sources: Federal Reserve Board; forecasts by LAEDC



### III. MAJOR DEVELOPMENTS IN THE INTERNATIONAL ECONOMY

#### Global Economy

The global economy has experienced some momentous events in recent months starting with the debt crisis in Europe and followed by the decision by the People's Bank of China to reintroduce some flexibility in the Yuan/Renminbi. Both of these developments will impact the upcoming global economic recovery. The big question is whether or not the European austerity measures (and the possibility of a government default or restructuring) will substantially slow down the overall recovery.



Overall, the pace of the global recovery picked up over the first half of 2010 with the Asian developing nations leading the way. The expectations for the rest of the year are for China and India to once again be the strongest performers with Brazil, Taiwan and South Korea right behind and then Canada and Mexico also performing relatively well. Asia and the Americas region will help the global recovery along while Europe will be the worst performer in 2010. Led by the emerging and developing economies, the global economy will grow along the lines of +4.0 to +4.5%.

The big issue for the rest of 2010 and 2011 will be how well the developed economies can perform as fiscal stimulus policies begin to come to an

end. The major concern going forward is related to the private sector, as high unemployment and weak bank lending will make it very difficult for the recovery to strengthen much. A related concern: when will these nations begin to tighten monetary policy? The world economy has entered into a new phase as countries have now become focused on cutting deficits and debts rather than promoting stimulus spending to ensure a global recovery. Advanced economies have declared that they would attempt to trim government deficits by half over the next three years and stabilize debt ratios by 2016. However, some countries including the U.S. continued to stress the overall importance of not moving too fast to reduce stimulus spending as the world economy was still very fragile and that avoiding a double-dip recession should be the number one priority.

For the rest of 2010 and 2011, the emerging and developing economies will experience very robust growth rates especially China, India and Brazil. These three nations will lead the global recovery.

Most of the Los Angeles Customs District's top trading partners (with the exception of Japan) should witness robust economic growth in the forecast period. All of these nations beginning with China have experienced strong growth in early 2010, although some have begun to soften slightly.

***The following section provides an overview of the major regions of the international economy and also includes details on the top five trading partners of the Los Angeles Customs District (LACD) – China, Japan, South Korea, Taiwan and Thailand – as well as the top five sources of foreign direct investment in Los Angeles County – Japan, the United Kingdom, France, Germany and Canada.***

## Major Regions

### Asia

**Overview:** Emerging Asia has been leading the global recovery and will continue to do so albeit at a slightly slower pace for the rest of the year and into 2011. China and India will continue to lead the way in 2010 and 2011, while Japan will be the laggard. South Korea and Taiwan will also experience very strong economic growth for the remainder of the year and beyond. Asia was the first region to tighten monetary policies as inflation has superseded economic growth as the top concern. To date, a resurgence in domestic demand and exports have been the keys to success.

**Japan (#1 source of FDI in LA County and #2 LACD Trading Partner):** Despite multiple stimulus packages along with near zero interest rates for most of 2009, Japan experienced a very modest recovery in the second half of 2009. However, strong demand from the emerging Asian countries has helped revive exports and further expanded the small domestic recovery during the first half of 2010. Japan's economy grew by +5.0% on an annualized basis in the first quarter 2010. Exports have risen strongly growing by 43.5% in March and by over 40% in April compared to a year earlier. The majority of this demand has come from China (Japan's largest market) and the rest of Asia.

A new Prime Minister was recently elected. Naoto Kan replaced Yukio Hatoyama as the leader of the Democratic Party of Japan (DPJ), which came into power just last year. Mr. Kan, the former finance minister is expected to place a greater emphasis on reducing Japan's soaring national debt. As a result, the island nation can expect political gridlock and economic instability. However, most recently, the DPJ lost its majority in the upper house coalition which will only make any reforms even more difficult to achieve.

Many key obstacles still lie ahead for Japan for the remainder of 2010 and in 2011. The economy faces big question marks related to its public indebtedness, deflation and a rising currency. Expansionary fiscal policy will be constrained by the already high budget deficits and will become less of a growth factor in the second half of 2010 and be absent altogether in 2011. Monetary policy is expected to remain loose in order to stimulate the weak recovery and to counter the deflationary environment. Many observers believe that the Japanese economic recovery could be particularly unstable as the nation attempts to address its structural economic problems. The recovery in the second half of 2010 and into 2011 will be highly dependent upon the strength of external demand on the one hand and on consumer spending and business investment on the other. The Japanese economy is projected to grow at a very moderate rate of around +2.0% in 2010 and in 2011.

**China (#1 LACD Trading Partner):** The Chinese economy performed exceptionally well in early 2010, as GDP climbed by +11.9% in the first quarter. A revival of external demand along with healthy domestic demand and strong real estate investment led to a surge in economic growth that has propelled the entire global economic recovery. Some indications of a slowdown have appeared recently, as government-led investment has weakened along with bank lending and industrial production. The manufacturing sector has experienced a slowdown for each month since February. However, recent export figures have been extremely strong, as exports in June were up by +44% after increasing by nearly +50% in May.

The People's Bank of China recently announced that they would allow the country's currency the Yuan or Renminbi to fluctuate again as it did from 2005 until the beginning of the crisis in 2008. For the government to make this move at this time suggests that they feel that the Chinese economy is on solid footing and there are more pressing

concerns to focus on, such as inflation. In fact, inflation exceeded the 3% government target in May, which makes it easier to explain why the government has decided to let the Yuan fluctuate albeit at a very gradual rate.

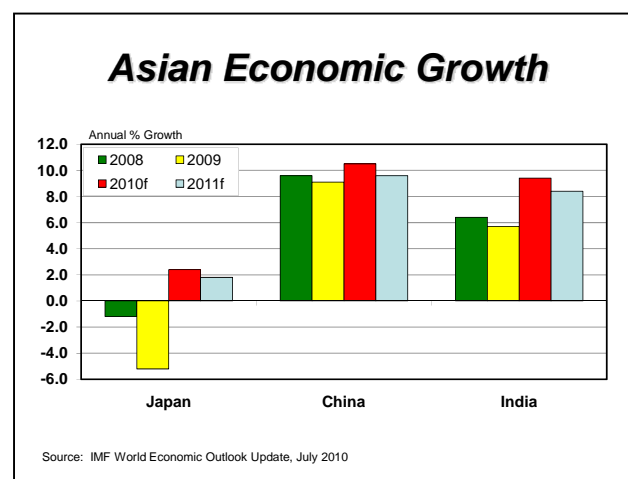
The global recovery has definitely helped Chinese exports, but the biggest story so far this year has been the consistency of Chinese domestic demand. Retail sales have seen double digit growth rates along with a surge in imports. During the first half of 2010, the government directed banks to slow down the pace of credit creation, with the majority of those new loans seen in construction and real estate. As a result, the make-up of Chinese economic growth has become more broad-based with consumption leading the way. In particular, strong sales of cars and housing have led the way. The most significant concerns for the rest of the year and in 2011 are related to the negative impact the declining Euro could have on Chinese exports to Europe and whether or not asset bubbles have emerged within the real estate and equity markets.

The outlook for 2010 remains very bright for China as exports, especially to other developing Asian nations, and domestic demand are expected to grow fast for the remainder of the year and into 2011. The Chinese economy is projected to expand by +10.0% in 2010 and by +9.5% in 2011.

**India:** China and India are leading the global economic recovery as both nations have been able to recover sooner than the advanced economies. The Indian economy has been the second best performer over the first half of 2010, with domestic demand and manufacturing leading the way. India's GDP expanded by +8.6% in the first quarter 2010, the second largest gain among the major economies. Industrial production was very strong in the first quarter, growing by over +15%. This strength continued

into the second quarter. In fact, industrial production climbed by nearly +18% in April, the highest in 16 years. In addition, retail sales and both exports & imports have registered very large gains over the first half of the year. Indian exports surged over the past few months, growing by over +50% compared to a year earlier.

After utilizing both fiscal and monetary policy to stimulate the economy last year and early this year, the Reserve Bank of India (RBI), the central bank, began to tighten monetary policy in March as economic growth became less of a concern and inflation fears rose. Going forward, the RBI is expected to continue increasing rates, as they were at historical lows and inflation continues to remain a real concern. Last summer in 2009 the country suffered a very abnormal monsoon season which heavily impacted agricultural output. The agricultural industry makes up about 18% of GDP and roughly 60% of employment. The hope is for agriculture to come back to normalcy, which would only add to the overall strength of the Indian economy.



Domestic consumption should be a key growth driver in 2010 as well as spending on public infrastructure. The outlook for the rest of the year and 2011 remains encouraging as exports and foreign direct investment strengthen, private demand grows, and agriculture improves.

There are some key downside risks. Another disappointing monsoon season and efforts to curtail high budget deficits could lead to lower than expected growth rates. Inflationary risks should lead the Reserve Bank of India to raise interest rates further in the second half of 2010 and 2011. The Indian currency, the rupee, should gain strength due to the rise in interest rates, stronger economic growth and an influx of capital inflows. The Indian economy is forecasted to grow by roughly +8.5% to 9.0% over the next two years.

**South Korea (#3 LACD Trading Partner):** South Korea's economy (Asia's fourth largest) has been another bright spot among the Asian economies. The nation has been one of the leaders of the global recovery and a main beneficiary of China's performance. Although not as robust as the Chinese or Indian economies, the South Korean economy has performed very well over the past year. South Korea's GDP in the first quarter of 2010 expanded by a very strong +7.8% on a yearly basis, with exports and industrial production continuing their strong renewal. Exports have surged over recent months rising by +31.5% in April and +41.9% in May on a year-to-year basis. The key has been the consistent strength of demand from Korea's Asian neighbors. In particular, demand from China, which comprises roughly 33% of South Korean exports, has been instrumental in propelling this growth. Electronics, autos and shipbuilding have been the most heavily demanded products.

The second half of 2010 and 2011 should see the rebound in growth continue, as both consumption and exports comeback strongly. Private demand and a comeback in exports over the remainder of the year will lead to a strong GDP growth rate. Improving labor market conditions should also lead to an increase in consumer spending. Unemployment hit a 19-month low in May, dropping to 3.2%. The very strong recovery in the Asian economies bodes well for South Korean exports. All of this equates

to an attractive environment for investment for the remainder of 2010 and beyond. The Bank of Korea is expected to tighten monetary policy in the second half of this year and follow the lead of Malaysia, India and Taiwan as inflation becomes a bigger concern. As a result, the South Korean currency, the Won, is expected to appreciate in the second half of 2010. The South Korean economy is projected to grow by roughly over +5.5% in 2010 and +5.0% in 2011.

**Taiwan (#4 LACD Trading Partner):** The Taiwanese economy relies very heavily on trade, as merchandise imports and exports combined almost equal 100% of total GDP. As a result, any economic expansion is contingent upon a rebound in exports. Taiwanese exports have surged since the beginning of the year. Exports increased by nearly 53% on a year-to-year basis over the first quarter of 2010 which led to Taiwan's GDP increasing by +13.3% in the first quarter. The expansion has continued over the past few months. In April and May, export orders climbed by 40% and 34%, respectively. The key to the growth in exports has been the strong recovery in China and other areas throughout Asia. Nearly 80% of all Taiwanese exports go to Asia, with over 40% sent to China and Hong Kong. In addition, industrial production and public infrastructure spending have also added to the economic recovery in Taiwan over the first half of 2010.

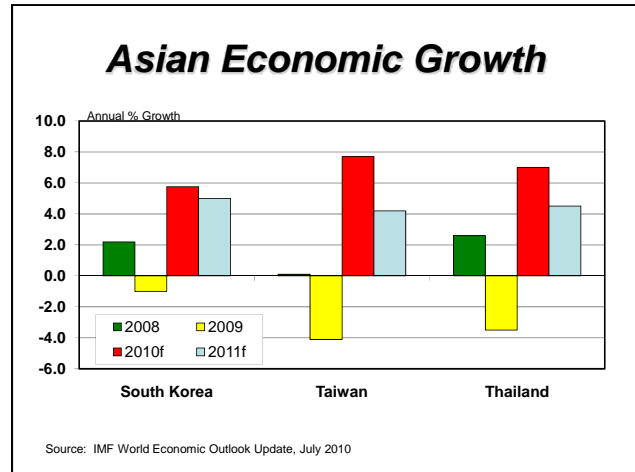
The good news is that the economic recovery in Taiwan is expected to continue in the second half of 2010, as exports and even domestic consumption are making a formidable return. Exports are continued to grow for the remainder of the year (albeit at a slower pace than in the first half of 2010) as demand from China and other emerging economies should remain strong. In addition, the economic recovery in the U.S. and Japan, albeit modest, will support additional foreign demand. The other positive factor should be the stabilization of domestic consumption as the employment situation and overall household

wealth improves. Other factors that will positively contribute to economic growth in Taiwan are reconstruction efforts for areas hit by Typhoon Morakot and very robust growth in fixed capital investment stemming from the upswing in merchandise exports. The overall outlook for 2010 calls for GDP to expand by +7.0% and +5.0 to +6.0% in 2011. Economic growth could end up being even stronger as Taiwan and China have signed a breakthrough trade deal known as the Economic Cooperation Framework Agreement (ECFA) which will begin to reduce tariffs in early 2011.

**Thailand (#5 LACD Trading Partner):** The political unrest that began in March finally ended in May, but it eroded consumer confidence and negatively impacted the tourism industry. However, the Thai economy proved to be resilient even in light of the political upheaval as exports rebounded strongly over the first half of 2010. Exports account for roughly 70% of Thai GDP and have performed exceptionally well in 2010, growing by nearly +35% over the first five months of the year. As a result, Thailand's GDP surged by +12% in the first quarter compared to a year earlier, the largest expansion in 15 years. Still the recent political tensions have had a negative impact on tourism and other key industries, and this will be seen in the second quarter results.

Exports are one key to overall growth in the Thai economy for the rest of the year. How well Thailand can attract foreign direct investment is another. Naturally, the global recovery, particularly in Asia will go a long way in determining how strong exports will be in the second half of the year and into 2011. Export growth will ultimately boost manufacturing production, employment and investment. In addition, political stability will be absolutely critical in order for Thailand to regain consumer confidence and tourism dollars. Oil prices are another concern as the country is Asia's largest net importer of petroleum relative to GDP.

Thailand's GDP is projected to increase by roughly +6.0% in 2010 depending upon the political situation and strength of external demand from Asia. In 2011, the Thai economy is forecasted to grow by +5.0% as exports and investment accelerate.



## Europe

**Overview:** The debt crisis has evolved into the number one concern for the European economy. As a result, the overall economic recovery in Europe will be anemic. In fact, it actually might lead to a double-dip recession in some areas – meaning Greece, Portugal, Spain and possibly Italy and the UK. Also, it led to a sharp depreciation of the Euro (by roughly -15%) since the beginning of the year. However, most recently the Euro has begun to stabilize. In addition, the crisis has led to a complete reversal of fiscal policies across the continent as Greece, Portugal, Spain, Italy, the UK and Germany have adopted fiscal austerity plans with France moving towards that direction. Germany has benefitted from the decline of the Euro as German exports have become more competitive and this will help the Germany economy grow this year.

**Germany (#4 source of FDI in LA County):** The German economy had to overcome many obstacles in 2009 and that was the case again in the first half of this year. Particularly, a harsh



winter, the worst in 14 years, suppressed economic activity and then the European debt crisis caused even more havoc for the fragile economy. However, the German economy actually grew by +1.6% in the first quarter as exports and capital investment rebounded. Similar to the Japanese and Taiwanese economies, the German economy is heavily reliant on exports, albeit different types of products. In recent months the German economy has actually received one benefit from the European debt crisis as the Euro has depreciated by -15% making German exports cheaper in foreign markets. In 2010, exports have been rising on a monthly basis and in April exports were up by over +19% compared to a year earlier. This bodes well for second quarter GDP growth. In the second half of 2010 German exports will continue to grow as Asian demand increases and the Euro remains weaker vis-à-vis the Yen, Dollar and Yuan.

The key to the strength of the German recovery will undoubtedly be the strength of its world trade volumes in the second half of 2010 and 2011. Another key factor will be how strong of a comeback the labor market can make in the second half of 2010 in order to revive private consumption. This will be necessary to offset the decline coming in public expenditures. Germany's economy should also be aided by low interest rates.

The Germany economy is forecasted to expand by +1.5% to +2.0% this year depending upon global demand and what transpires with the European government debt crisis. In 2011, German GDP growth (projected to be +1.0% to +1.5%) will depend upon the global economic recovery and how strongly private consumption rebounds.

**France (#3 source of FDI in LA County):** As was the case in Germany, exports led the economic recovery in France in the first half of 2010. The drop in the Euro has benefitted French exports

even more as they are more price sensitive than German exports. France's GDP grew by +1.2% in the first quarter on a year-to-year basis mainly on the strength of exports, which expanded by over +4%. Neither private nor public consumption grew in the first quarter, and total investment actually declined. The French economy has now grown for four straight quarters. Unemployment has stabilized, which should lead to an improvement in consumer spending in the second half of 2010. The hope is for export growth to lead to a climb in domestic demand and for investment to make a comeback in the second half of the year and into 2011.

The employment situation, industrial production and exports will go a long way in determining how strong the French recovery will be in the rest of 2010 and 2011. Unemployment will remain a big issue for the remainder of this year and in 2011. The consensus forecasts call for France to grow by +1.0% to +1.5% in 2010 and by +1.5% to +2.0% in 2011.

**United Kingdom (UK) (#2 source of FDI in LA County):** Of all the European countries, the UK economy suffered the worst contraction as a direct result of the financial and economic crisis. The economy actually declined for six consecutive quarters. The good news is that the UK economy returned to growth over the past two quarters. However, the recovery has been extremely slow, growing by just +0.7% over the past two quarters. Both consumer and capital spending have remained weak since the beginning of the year. The increase in the British valued added tax (VAT) that took place on January 1 has only exacerbated the situation. Similarly to the U.S., high unemployment has plagued the British economy in the first half of 2010, making it difficult for weak consumer spending to reverse its course. High unemployment will continue to be big issue in the second half of 2010 and in 2011. Consumer spending accounts for the largest percentage of economic output in the UK.

In June, the British government announced its emergency budget for 2010 thru 2011, which includes draconian spending cuts across the board. The UK is the latest European nation to announce a fiscal austerity plan as Europe begins to address its debt crisis. The big concern going forward will be how these drastic measures impact the economic recovery in the short term as the UK struggles to produce any substantial growth. On the other hand, the goal is to renew confidence in the capital markets, keep interest rates low and revive private investment in order to restore real economic growth.

The UK economy will face an uphill battle for the remainder of 2010 and into 2011, as it will have to overcome continuing high unemployment, lower incomes, cuts in public spending and a constrained supply of credit. Overall, the UK economy is forecasted to grow by roughly +1% in 2010, while expanding by nearly +2% in 2011. However, there are risks, particularly in financial markets, that could weaken any type of recovery.

**Italy:** The Italian economy has gradually come out of recession. In the first quarter the turnaround in the inventory cycle helped GDP expand by +0.5% mainly due to exports. Italian exports rose by +17% in the first quarter. Major concerns linger in the Italian economy as domestic demand and private investment remain fragile. More recently, the Italian economy has performed better as industrial production has grown considerably due to a spike in exports. Exports increased by over +15% in April as the Euro has significantly depreciated. Overall economic output expanded by nearly +8% in April compared to a year earlier. In addition, business confidence rose to its highest level in over two years. All of this implies second quarter results will be encouraging.

Italy's recession lasted into the second half of 2009 mainly because the Italian government lacked the fiscal capacity to implement any type

of stimulus program. Italy's fiscal house has been in great disorder for many years and the Greek debt crisis has finally brought Italy's real fiscal situation into the limelight. As a result, the Italian government has announced fierce budget cuts in order to begin to address its fiscal problems. The hope is that the Italian government will finally get serious about facing the problem instead of attempting to portray a completely different picture.

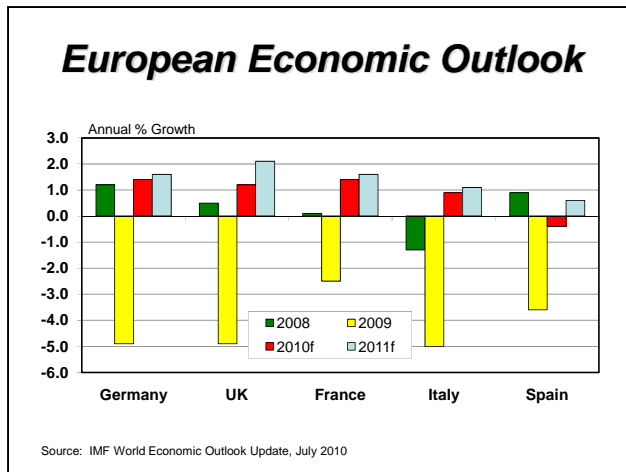
The Italian economy faces a long road ahead as a rigid labor market; weak consumer spending and private investment remain big problems. The potential bright spot for the Italian economy could be exports. The drop in the Euro should make Italian goods more competitive in world markets. Italian competitiveness has long been a major concern.

For the remainder of 2010 and 2011 the outlook is muted, as the existing weaknesses are likely to hamper the recovery, suggesting growth +1.0% to +1.5% driven by rising exports.

**Spain:** The first quarter of the year saw Spain edge out of recession based on a quarter-to-quarter basis. Spain's economy has significant problems and the situation is a concern for all of Europe. Spain has the Euro Zone's highest unemployment rate at 20% and has had the most difficult time of any European country of reversing its economic decline since the 2008 financial crisis. The nation's housing industry debacle has led to Spain having an extremely high level per capita of unsold properties. As a result, Spanish banks still face a very long road ahead. In May, the government passed the deepest budget cuts in 30 years in order to address its own fiscal crisis. Spain's budget deficit last year was a staggering 11.2% of GDP. The IMF seems to be confident in the steps taken thus far by the Spanish government. However, many concerns remain, as the budget needs to be approved and the current government has a very weak coalition

that could lead to elections in 2011. Fitch and S&P both downgraded Spain's credit rating in June which increases the cost of financing its overall debt.

Unemployment and the continued severe downturn in the housing and construction sectors suggest stagnant growth in the second half of 2010. Spain will most likely be the only major Euro area nation not to experience a recovery in 2010. The only positive for the Spanish economy for the rest of the year and in 2011 is an increase in exports, as the Euro has weakened. In addition, Spain's recent World Cup championship could provide some boost to consumer spending. Spain's GDP is forecasted to contract by -0.5% to -1.0% in 2010. The Spanish economy can only hope that at least by 2011 the situation will have improved enough to provide some sort of recovery, no matter how small. The big question mark going forward for Spain will be whether or not the country faces its own Greek tragedy. The consequences of a Spanish debt crisis would be more damaging, as the Spanish economy is more than four times the size of the Greek economy.



## The Americas

**Overview:** South America has followed Emerging Asia's direction in the global economic recovery process. Brazil has been the stellar performer so far and will continue to be this year and next.

Canada's economy has been impressive as the labor market has rebounded strongly while exports have also led the way. Mexico's economy has also performed well over the first half of this year and is projected to do well over the second half and into 2011.

### Canada (#5 source of FDI in Los Angeles County):

Of all the advanced economies, Canada has had the strongest economic recovery over the past year. The Canadian economy expanded by +2.2% in the first quarter compared to year earlier. All contributors to GDP performed well in the first quarter as exports, consumer spending, inventories, capital investment and government spending all increased. The key to the Canadian turnaround has been the revival of the domestic labor market and exports. The U.S. recovery has had a big impact on exports, as 80% of Canadian exports go to the U.S. Nearly all of the 417,000 jobs lost during the recession have been restored during the recovery. Most recently, employment surged in June, lowering the unemployment rate to 7.9%.

One of the main reasons the economy has been able to recover faster and stronger is that the banking sector in Canada was very healthy before the economic and financial crisis and came through the crisis unscathed. Due to tight regulation banks were not able to take on the risks that were accumulated on the balance sheets of the advanced economies. Due to the pace of its economic recovery, Canada became the first G-8 nation to raise interest rates in June.

The outlook for the second half of 2010 depends upon how well the U.S. economy performs. Still, the overall outlook for Canada is positive as consumer spending and capital investment should remain strong. Because Canada produces many commodity products, commodity prices (oil, natural gas, etc.) will impact the recovery in 2010. The Canadian economy is expected to expand by +3.5% in 2010 and +3.0% in 2011.

**Mexico:** The Mexican economy has recovered well in the first half of 2010 after experiencing a severe recession in 2009. Latin America's second largest economy suffered its worst economic environment in 2009 since 1932. Mexico's GDP grew by +4.3% on year-to-year basis in the first quarter, the first time the economy expanded in more than a year. The stark improvement was a direct result of the turnaround in the U.S. economy, as a strong rebound in American manufacturing increased demand for Mexican exports. U.S. demand is absolutely critical to the Mexican economy as the U.S. receives over 80% of Mexico's manufactured exports.

The drug war in Mexico has had a negative impact on economic growth in the first half of the year. Experts estimate that drug violence subtracts at least 1 percentage point from the nation's economic growth. The drug war depletes multiple resources and diverts crucial expenditures from the federal and local budgets. In addition, inbound foreign direct investment would be higher in the absence of violence. Even with that established, the government expects \$20 billion in foreign direct investment this year. Meanwhile, tourism has been impacted, but not too drastically, by the drug violence which is a huge relief. Tourism is Mexico's third largest source of dollar inflows after oil and remittances.

Relatively strong oil prices during the first half of 2010 have increased revenues for the Mexican government. Manufacturing grew by nearly 10% in the first quarter compared to a year earlier, and industrial production increased by the highest rate in nearly four years in March. The second half of the year should see a slowdown in growth in Mexico as the U.S. economy cools down. Mexico's enduring unemployment problem will hamper consumer spending, especially after the fiscal stimulus spending comes to an end.

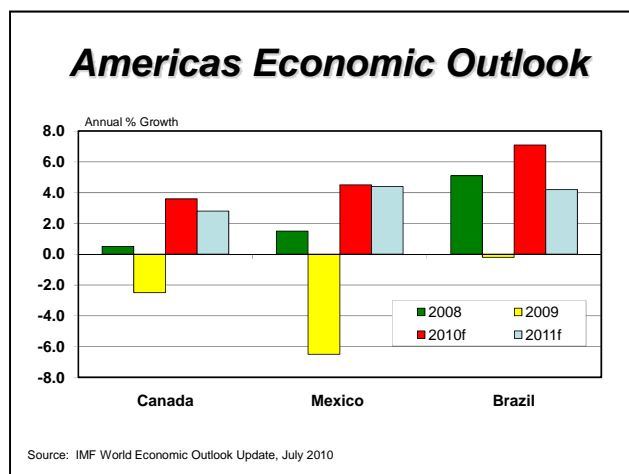
The Mexican economy is forecasted to recover by +4.5% in both 2010 and 2011, with improvements in tourism, remittances and oil revenues. If the U.S. economy performs better than expected, the Mexican economy will no doubt reap the benefits. On the other hand any significant slowdown in the U.S. economy would surely reduce growth. Note that a fiscal crisis in Spain, if it occurs, could negatively affect the banking sector. Many Mexican banks are exposed to Spain and Spanish foreign direct investment likely would be reduced.

**Brazil:** The Brazilian economy has experienced a "V" shaped recovery over the first half of 2010. Brazil trailed only China for the strongest economic growth over the first quarter of this year, as Brazil's GDP expanded by + 9.0% compared to a year earlier. Brazil was one of the last countries to go into the global crisis, and it has been one of the first to come out. The reforms put in place over the past ten years have truly made a great difference as the country used to be significantly impacted by financial crises and now is a model for Latin American and other nations.

Domestic demand has been the key economic driver in the first half of 2010. As a result, imports have surged. In addition, industrial production and the manufacturing sector have both experienced robust expansions this year. In the first quarter industrial production rose by nearly +15%, while manufacturing climbed by over +17% compared to a year earlier. The economic recovery has been so strong that the Brazilian central bank has had to raise interest rates over the past two meetings, and it might have to do so again in the coming months. Higher investment spending and productivity also have led the resurgence in economic growth.

The remainder of the year should see a slower pace of economic growth. The world economic recovery seems to be cooling down, which will

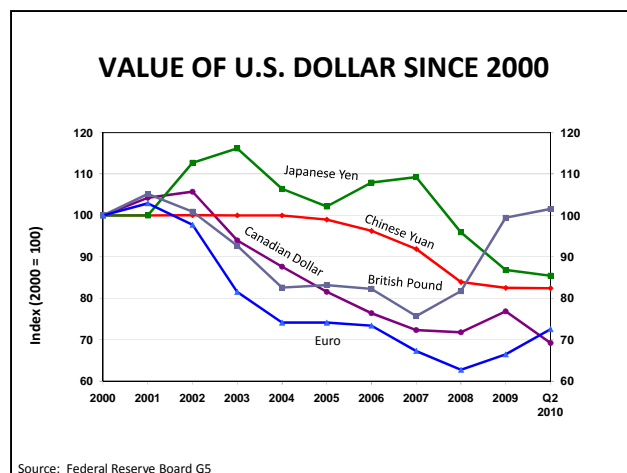
negatively impact Brazilian exports. However, consumer spending accounts for 60% of Brazilian GDP, so the economy should still perform well. With that established, domestic demand will slow down somewhat as fiscal stimulus begins to dwindle down and tax reductions along with subsidies will start to dissipate. Also, look for fiscal policy to be influenced by the upcoming presidential election in October. Strong capital investment along with adequate foreign direct investment over the next few years will continue to create significant growth in Brazil. On the downside, a legitimate concern for the near future will be how the European fiscal crisis plays out, particularly in Spain and Portugal. The Brazilian banking sector is heavily exposed to both these nations. The outlook for the Brazilian economy is very bright over the next few years as the emerging middle class propels domestic demand. A strong currency will also go a long way in supporting the growth in imports and alleviating inflationary concerns. The Brazilian economy is forecasted to expand by +7.0% this year and +6.5% in 2011.



## Foreign Exchange Rates

### Major World Currencies vis-à-vis the U.S. Dollar

The big foreign exchange in early 2010 has been the European debt crisis and its impact on the Euro vis-à-vis the U.S. Dollar. The other



interesting development has been the global economic recovery and its effect on international capital flows. The beginning of 2010 saw global investors becoming less risk averse as the global economy continued its rebound. As a result, the U.S. Dollar depreciated vis-à-vis most other currencies. In particular, the U.S. Dollar lost value versus the emerging market currencies that were leading the global recovery. Also, with interest rates at rock bottom levels, the U.S. Dollar was increasingly used as a carry-trade-funding currency. [Investors borrowed in U.S. Dollars and then bought higher yielding assets in other currencies, adding to the weakness of the U.S. Dollar.]

The U.S. Dollar appreciated vis-à-vis the Euro and other European currencies over the first half of 2010 as the U.S. economic recovery was stronger than in Europe. However, the U.S. Dollar has significantly appreciated versus the Euro since May, as the Greek fiscal crisis unfolded. In addition, the slow recovery in the UK also led to the U.S. Dollar strengthening versus the British Pound.

In recent months, concerns have spread from the European debt crisis to a possible slowdown in Asian growth, particularly in China, and to slower growth in the U.S. for the remainder of the year. Collectively, these issues have altered the risk

environment and world investors have become more risk averse. This should translate into investors seeking safety in U.S. Treasury securities and the U.S. Dollar strengthening vis-à-vis most major currencies over the short term.

If the global economic recovery continues to subside and the European debt situation worsens, the U.S. Dollar would likely be projected to gain strength vis-à-vis some currencies in the coming months. On the other hand, the U.S. Dollar would feel downward pressure if the Fed delays tightening monetary policy too long. In addition, the U.S. Dollar could weaken vis-à-vis emerging economies if they continue to dominate the global recovery.

#### ***Currencies of Los Angeles Customs District's Top Five Trading Partners***

**Chinese Renminbi/Yuan:** The Yuan remained pegged at or very near 6.85 Renminbi/Yuan per U.S. Dollar over most of the first half of 2010, as the Chinese government attempted to ensure that the Chinese economy was recovering strongly. As the year progressed, the Chinese government became more concerned about inflation, the economy overheating and creating more domestic demand to address global imbalances. As a result, the Chinese central bank announced in late June that it would allow the currency to fluctuate as it did from 2005 to 2008.

**Japanese Yen:** The Yen strengthened versus the U.S. Dollar over the first half of this year as the Japanese economy improved and the European debt crisis drew investors to the Japanese currency as a safe haven. Over the first half of 2010, the Yen appreciated by over +4%. However, the Yen is expected to lose some strength over the second half of the year as the Japanese economy struggles to expand.

**South Korean Won:** Similarly to the Yen, the Won strengthened in the first quarter of 2010 as the economy grew strongly and capital moved into

South Korea. However, since May the Won has depreciated vis-à-vis the U.S. Dollar as the Euro crisis unfolded and investors became increasingly concerned. Overall, the Won has depreciated by -4% versus the U.S. dollar thus far in 2010.

**Taiwanese Dollar and Thai Baht:** The Taiwanese Dollar strengthened slightly versus the U.S. dollar until the Euro crisis in May. Since then, the Taiwanese Dollar lost those gains and has returned to where it was to start the year. The Taiwanese Dollar remains at about 32 Taiwanese Dollars per U.S. Dollar. The Thai Baht has strengthened vis-à-vis the U.S. Dollar since the beginning of the year even with the political turmoil of April and May. The Baht has appreciated by nearly +3% in the first half of this year to 32.57 Thai Baht per U.S. Dollar.

#### ***Other Key Currencies***

**Canadian Dollar:** The Canadian Dollar has taken the same course as most other major currencies so far this year. The year began with the Canadian Dollar gaining strength versus the U.S. Dollar. Then in May, the Canadian Dollar gave back all of its strength to the U.S. Dollar as the two currencies moved away from parity. The Canadian Dollar has remained at around the same level over the first half of 2010.

**Mexican Peso:** The Peso performed well in the first quarter and in the beginning of the second quarter of this year versus the U.S. dollar until the European debt crisis came into play. The Peso weakened vis-à-vis the U.S. Dollar in May. Overall, the Mexican Peso has gained about +1% so far this year.

**Euro:** The European debt crisis triggered by the Greek fiscal situation led to a dramatic decline in the Euro in May. The Euro had already been weakening vis-à-vis the U.S. Dollar at the end of 2009 as the U.S. economic recovery overshadowed the European performance. Since January, the Euro deteriorated by nearly -15%



versus the U.S. Dollar. More recently, the Euro has stabilized as many Euro zone countries made significant movements towards fiscal austerity while the European Central Bank and IMF have implemented huge measures to revive confidence in the currency. However, the outlook is for the continued weakening of the Euro in the short-to-medium-term, as some European economies face potential double dips and anemic growth.

**British Pound:** The Pound witnessed a similar trajectory over the first half of this year. The Pound weakened alongside the Euro. Recently, the new British coalition government announced its own draconian cuts as it looks to place its fiscal house in order. The British Pound lost nearly -7% of its value over the first half of this year.

**Table 3:**  
**Foreign Exchange Rates of Major U.S. Trading Partners**

Country (Currency)*	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 1H	2010
Broad Currency Basket (index)	119.45	125.93	126.66	119.09	113.63	110.71	108.52	103.40	99.83	105.87	102.98
Canada (US\$/C\$)	1.486	1.549	1.570	1.401	1.302	1.212	1.134	1.073	1.066	1.141	1.034
China (US\$/yuan)	8.28	8.28	8.28	8.28	8.28	8.19	7.97	7.61	6.95	6.83	6.83
Euro Zone (US\$/€)**	0.923	0.895	0.945	1.132	1.244	1.245	1.256	1.371	1.473	1.393	1.329
Japan (US\$/¥)	107.8	121.6	125.2	115.9	108.2	110.1	116.3	117.8	103.7	93.7	91.45
Mexico (US\$/peso)	9.46	9.34	9.66	10.79	11.29	10.89	10.91	10.93	11.14	13.50	12.69
South Korea (US\$/₩)	1131	1292	1250	1192	1145	1024	954	929	1099	1275	1159
United Kingdom (US\$/£)**	1.516	1.440	1.503	1.635	1.833	1.820	1.843	2.002	1.855	1.566	1.526

Percent Change***	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 1H	2010
Broad currency basket (index)	6.3%	5.4%	0.6%	-6.0%	-4.6%	-2.6%	-2.0%	-4.7%	-3.5%	6.1%	-2.7%
Canada (C\$)	3.7%	4.3%	1.4%	-10.8%	-7.1%	-6.9%	-6.4%	-5.3%	-0.7%	7.0%	-9.4%
China (yuan)	0.0%	0.0%	0.0%	0.0%	0.0%	-1.0%	-2.7%	-4.6%	-8.7%	-1.7%	0.0%
Euro Zone (€)	6.8%	3.0%	-5.6%	-19.7%	-9.9%	-0.1%	-0.9%	-9.1%	-7.4%	5.4%	4.6%
Japan (¥)	10.7%	12.8%	3.0%	-7.4%	-6.7%	1.8%	5.6%	1.2%	-11.9%	-9.6%	-2.4%
Mexico (peso)	1.4%	-1.3%	3.5%	11.7%	4.6%	-3.5%	0.1%	0.2%	2.0%	21.2%	-6.0%
South Korea (₩)	10.3%	14.2%	-3.2%	-4.7%	-3.9%	-10.6%	-6.8%	-2.7%	18.3%	16.0%	-9.1%
United Kingdom (£)	7.4%	5.0%	-4.4%	-8.8%	-12.1%	0.7%	-1.3%	-8.6%	7.4%	15.6%	2.6%

Source: Federal Reserve Statistical Release G.5A; Annual Averages and Average of First Half of 2010

**Notes:**

\*Foreign currency units per U.S. dollar

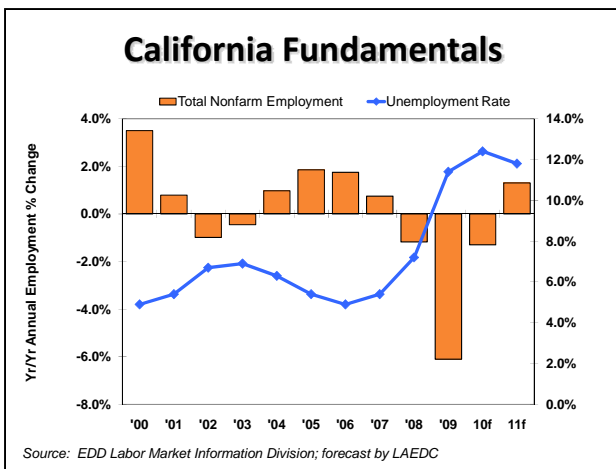
\*\*The value in U.S. dollars versus the foreign currency

\*\*\*Performance of U.S. dollar versus the foreign currency

## IV. OUTLOOK FOR THE CALIFORNIA ECONOMY

The California economy weakened in 2009 but is slowly beginning to turn around. However, few industries will come out of the recession unscathed. Retail sales deteriorated sharply, and tourism was down across the board. The manufacturing and transportation sectors were hard hit. Nonresidential and public works construction also declined, despite increased federal funding. State and local government revenues fell in line with declining incomes, sales, and property values, placing government spending plans—and jobs—at risk.

At mid 2010, California's economy appears to be moving up from the depths of the recession. While unemployment is still extremely high, employment seems to have stabilized. Only a few industries are growing at present, but more than were growing six months ago. The economic news in California will get better during 2010 but slowly. More improvement is expected in 2011.



### There are worries in addition to the recession

- The state budget situation continues to be a major concern. During fiscal year 2010 (FY 2010, ended June 30, 2010) revenues edged up by +1.0%, primarily due to higher sales tax and personal income tax revenues (corporate profits tax receipts declined over the prior year). Meanwhile, General Fund expenditures dropped by -11.8% (with some

of the decline backstopped by federal stimulus funds). Net-net, the state ran a surplus of \$2.0 billion in FY 2010. However, the state had previously incurred a deficit of -\$11.9 billion in FY 2009. This left an “operating cash deficit” of -\$9.9 billion as of June 30, 2010. This magical feat was accomplished by borrowing from non-General Fund accounts and by (involuntary) transfers of revenues from various local jurisdictions.

- Going forward, the state legislature and the Governor must agree not only on how to deal with the existing shortfall in the budget for FY 2011 (which began July 1, 2010), they must also figure out how to pay for the functions and personnel that were federally funded in FY 2010. No wonder the budget is late—again. Wrestling with the current problems—estimated at \$19 billion—reveals one salient fact: whatever the solutions turn out to be, they will weaken the state's economic recovery. One option is to reduce government spending and public employment at all levels in 2010-2011. Any tax or fee increases will simply shift the spending and employment shrinkage to the private sector.
- Water is another worry. California's water supply continues in very short supply, though last winter's precipitation was pretty good overall. Northern reservoirs were higher this year than last. However, many areas in the state are facing restrictions on water use, because water levels in the state's reservoirs fell so far in earlier years. Complicating matters further, environmental rulings have the potential to place at risk the state's premier agriculture industry and all urban areas that rely on water traversing the Sacramento-Bay Delta.

### Still a measured economic outlook

Nonfarm employment fell by -6.0% in California during 2009, or by -902,100 jobs. The unemployment rate surged into double digits,

averaging a painful 11.4%. As the recovery finally gets going, growth will be moderate at best in 2010. Business firms will be reluctant to hire until they are certain that better times will be long-lasting. As a result, the state's labor markets will continue to be weak in 2010, with nonfarm employment declining by -1.3% or by -185,800 jobs. Unemployment will remain stubbornly high, averaging 12.4% this year. Economic conditions will improve more noticeably in 2011. Employment will grow by +1.3%, and the jobless rate will come down to 11.8%.

### A Few More Positive Forces Through 2011

**Temporary Help Services:** While most businesses are still unwilling to risk hiring full-time employees, many have more orders than the current, depleted workforce can handle. This industry supplies a low-risk solution: hire temporary workers to fill the current orders and wait to see if the growth in sales is sustained going forward. Many firms have adopted this strategy: payrolls in the employment services industry have been rising since last summer.

**Private education:** This industry runs the gamut from private universities to private K-12 schools to technical and career training schools. Demand is driven by the need for more education, training and re-training to make headway in today's rapidly changing economy.

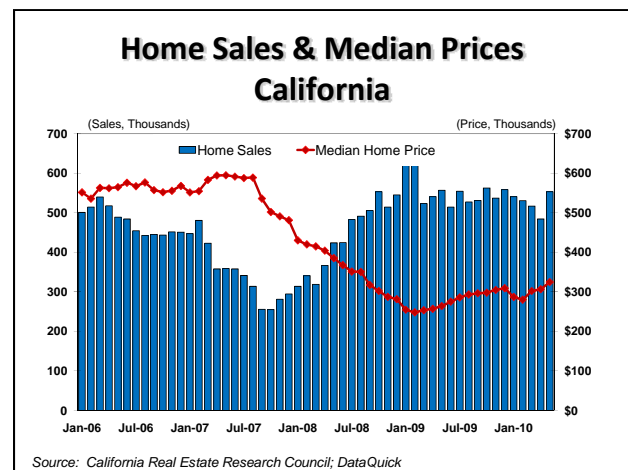
**Entertainment:** Activity in this industry began to turn up in late 2009 and continued to grow in the first half of 2010.

**Tourism:** The tourism indicators for California are improving and expected to gain strength throughout the forecast period.

**Health care:** This industry seems to grow no matter what the economic weather. Demand is driven by the state's ever-increasing population, especially those over 60 years of age, who use medical services intensively.

### Some Negative Forces

**Housing and related activities:** New home construction continues in a depressed state right now. Though activity picked up briefly this past winter, new home construction relapsed after federal tax credits expired. The market for existing homes looks somewhat better, as unit sales have returned to reasonably healthy levels and prices have stabilized in many locations. Still, the timing and strength of any upturn is uncertain. The main risk continues to be a large round of sudden foreclosures that subsequently come onto the market in a short period of time.



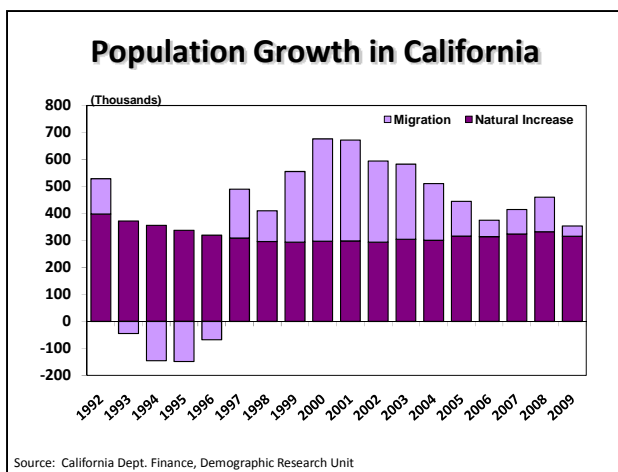
**Retail and autos:** With job counts falling across the state, spending by consumers has dropped sharply in 2009. Retail sales fell by -7.7% in 2008 and by an estimated -14.4% in 2009. However, retail sales hit bottom last year and are turning up in 2010. Many of the state's automotive dealers, who were hard hit during the downturn, also are experienced moderately better sales, including those selling products made by the "Detroit 3."

**Environmental regulations:** The recession and its aftereffects fill the headlines. Less noticed are efforts to "green" the state and its ports, as well as the looming implementation of AB 32 (the greenhouse gas legislation). A large number of new requirements for state businesses are in the regulatory hoppers, with final rules due before 2012. At minimum, this process raises uncertainty in today's adverse business climate.

California residents and many businesses will face higher energy costs in the future. Paying for the required investments in new vehicles, equipment and buildings also could be an issue.

### Demographic Trends

The California economy does have one big thing going for it: a large and growing population. The state's populace numbered 38.65 million persons as of January 1, 2010. That total is expected to swell by more than 375,000 persons annually. By mid 2011, the state will have 39.2 million residents.



Population growth has slowed since the early 2000s, primarily because the state has experienced negative net domestic migration; i.e., the number of Californians moving out-of-state is greater than the number of out-of-state residents moving here. Most of the state's population growth comes from natural increase (i.e., births minus deaths), with the remainder from international immigration.

A growing population benefits the California economy. For starters, growth ensures a firm, underlying demand for housing, furniture and appliances (at least during non-recessionary periods). This demand is not being met now but will boost residential construction and the associated retail sales whenever credit conditions loosen and the economic picture brightens.

Furthermore, growth in the population supports growth in the state's health care and education

sectors. Finally, the enormous size of the consumer market in California represents a huge opportunity for retailers and other consumer-serving industries, who find the market simply too big—and attractive—to ignore.

### Trends in Major Industries

**Agriculture:** All in all, 2009 was not an easy year for many of the state's farms, with revenues reduced by lower prices and reduced exports of California-grown products. In addition, water supply became an extremely serious concern, and many California farmers were forced to cut production to survive.

The situation looks a little better as of mid 2010. Some prices are rising, and water supplies have increased in the northern part of the state. Still, uncertainties remain, particularly for farmers south of the Bay Delta.

Farm statistics are released with a long lag, but here's the information currently available.

- Total gross farm receipts in California declined by -9.6% in 2009, primarily due to plunging prices of dairy products and livestock. However, gross receipts were up by +5.4% in 1<sup>st</sup> quarter 2010, partly due to higher livestock prices.
- Exports of California-grown and -bottled products decreased by -4.8% during 2009. However, the value of agricultural exports was up by +18.8% during the 1<sup>st</sup> five months of 2010.
- Also during the first five months of 2010, an average 337,400 workers were employed by California's farms and nurseries, about even with the same period in 2009.

2010 should be less challenging for California's farmers than 2009. Product prices look better, especially for meat products. And exports of most California farm and food products are rising strongly this year, due to higher demand from key Asian nations recovering early from the global recession.

**International trade:** Imports and exports through California's three customs districts

plunged through much of 2009, with the rate of decline easing at year end, as the economic recovery took hold in key Asian markets. For 2009 as a whole, the value of imports through the state's ports dropped by -21.7%, while exports decreased by -19.4%.



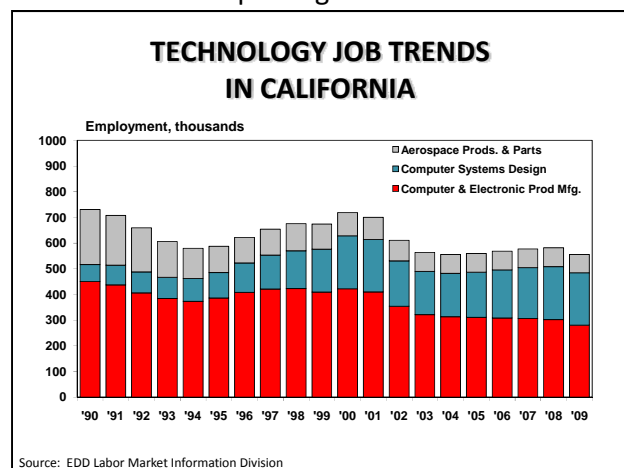
Both import and export flows are turning up in 2010, with imports expected to rise by +12% and exports by +16%. Exports started to improve late in 2009, boosted by demand from Asian emerging nations led by China. Imports recently have started to grow as well, as rising U.S. retail sales force retailers to increase orders from their foreign suppliers. Trade flows through California will increase further in 2011.

**Technology (including aerospace):** The various components of California's tech sector have disparate outlooks. Business demand for technology products was very weak during 2009, when businesses were reducing costs drastically in order to survive the recession. However, demand picked up noticeably during the 4<sup>th</sup> quarter and has continued to rise at a healthy pace in 2010. Sales of technology products did even better on the consumer side. Purchases of consumer products like computers, flat televisions, and cell phones, increased in 2009 despite the recession and have continued to grow nicely in 2010. There's always demand for well-designed personal gadgets like iPods, iPads and smart cell phones. California's high tech manufacturers—especially makers of semiconductors and other electronic

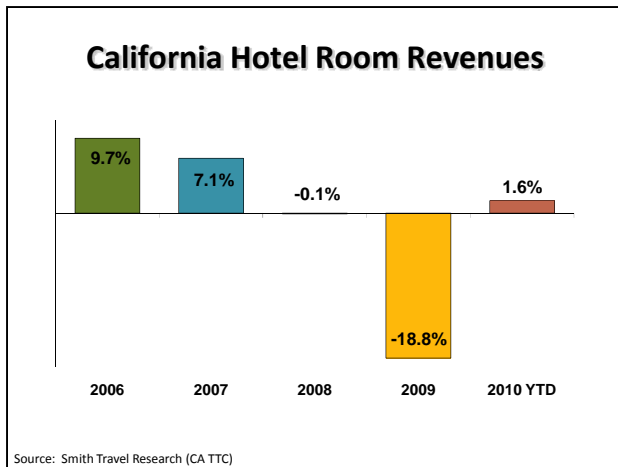
components—have remarked on the strong upturn in sales. However, it's not yet clear how fast their production in California will ramp up nor how fast they will boost in-state job counts.

In the aerospace sector, a number of major government-sponsored defense projects are underway in California, including satellites and unmanned aerial vehicles. Significant sub-contracting also takes place on Air Force fighter planes. The administration has again proposed key defense cutbacks that could hurt the state, on net, beginning in 2011. Also, the Defense Department is changing its defense posture from being able to handle two wars simultaneously to being able to deal with a number of presumably smaller conflicts. The change in priorities emphasizes flexibility. Beyond that, it's unclear how the state will make out.

Commercial aerospace also presents an uncertain picture. After shrinking production schedules in 2009, Airbus and Boeing are now adjusting their production schedules upward to accommodate their suddenly busier airline customers. However, delays in bringing new aircraft to the market (Boeing's 787 Dreamliner in particular) may be coming to a close; Boeing is racing to complete testing of the plane and hopes 787 deliveries might begin late in 2010. Both manufacturers have hefty backlogs and are beginning to ramp up production rates of more popular models. California's aerospace sub-contractors are expecting new orders.



**Tourism:** 2009 was a very difficult year for California's tourism industry. According to Smith Travel Research, the state's hotels reported declines in occupancy rates last year (averaging -8.8%) along with lower room rates (down by -10.9% on average). This combination caused total hotel room revenues to shrink by an unwelcome -18.8%. Conditions look somewhat better in 2010. Through April, average occupancy rates were up by +4.8% statewide. However, travelers were still bargain conscious: average room rates were down by -4.6%. Allowing for an increase in hotel room capacity, room revenues increased by +1.7% in the 1<sup>st</sup> four months of 2010 compared with early 2009.



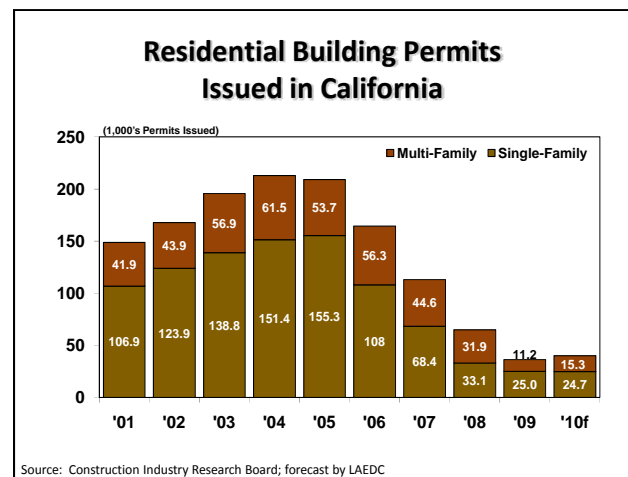
All major markets reported double-digit declines in 2009 room revenues, but several recorded single-digit increases early in 2010, a welcome upturn. San Jose/Santa Cruz reported a +8.6% increase in room revenues for the 1<sup>st</sup> four months of 2010, driven entirely by higher occupancy. Los Angeles ranked #2, with +5.5% growth in year-to-date room revenues (higher occupancies plus new capacity), followed by San Francisco/San Mateo, up by +2.3%. Year-to-date declines in room revenues of other major locations were relatively small, ranging from -0.8% in Orange County to -2.4% in Sacramento.

Going forward, tourism industry revenues should turn up in 2010. The pace of business travel is quickening, and leisure travel to California destinations likely will increase. Intra-state

travel also is likely to show steady improvement. While the pace of activity will rise, travelers of every type will continue to choose the lowest-cost options, whether airfares, rental cars, or hotel rooms.

**Construction:** And then there is the state's troubled construction industry. New home construction struggled in 2009, with just 36,421 units permitted, down by -43% from 2008 and a huge -83% plunge from the 2004 peak year (when 212,960 units were permitted). Nonresidential construction also is depressed, with the value of new permits in 2009 dropping by -43% to \$10.9 billion. Residential permits are expected to grow by +10% in 2010. Much of the increase will come in the single-family sector, as financing for new condominiums and apartment projects is difficult to obtain. Nonresidential construction activity is projected to decline by -5.2% in 2010.

What about public works? Severe revenue constraints caused most local governments and school districts to prune spending last year, especially for buildings, where new projects decreased by about -39%. Federal stimulus funds kept the decline in heavy construction—particularly roadwork—to -14%. While the impact of the stimulus program was relatively small in 2009, public works construction activity should increase in 2010 and 2011 as work on more contracts gets under way.

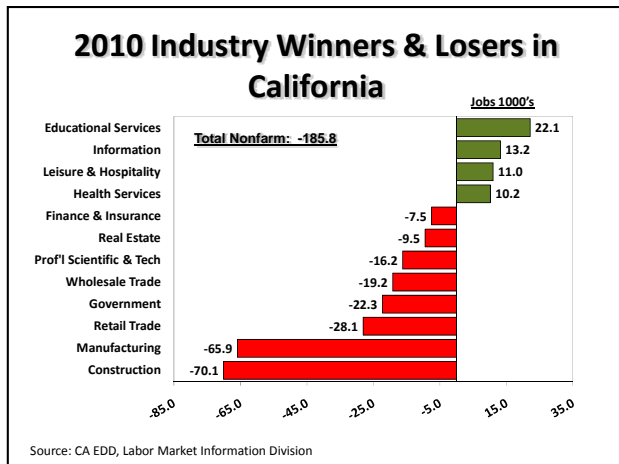




## Trends around the State

California is just beginning to emerge from a serious recession, and all thirteen large metropolitan areas saw significant employment declines during 2009. Three metro areas in the San Joaquin Valley are in the “less worse” category, including Modesto (with a nonfarm employment loss of -0.9% over the year to May 2010), Bakersfield (at -1.0%), and Stockton (-1.4% over the year). Still, a central location did not guarantee success; the Fresno area recorded a year-over employment decline of -2.6% while the Sacramento area a dropped by -2.7%.

Southern California’s metro areas were spread across the rankings. The area in the worst shape was Riverside-San Bernardino (down by -3.1% over the year to May 2010). Meanwhile, Ventura County (-1.9%) and Los Angeles (-1.8%) ranked near the middle of the list (# 6 and #7 respectively), while Orange County (at -1.1%) and San Diego (-1.0% over the year) placed fourth and second from the top.



The three major Bay Area metros also were spread out. Oakland had the worst results, with May 2010 employment down by -2.9% compared with a year earlier. San Francisco turned in a -2.7% performance, while the San Jose area recorded a year-over decline of -1.3%.

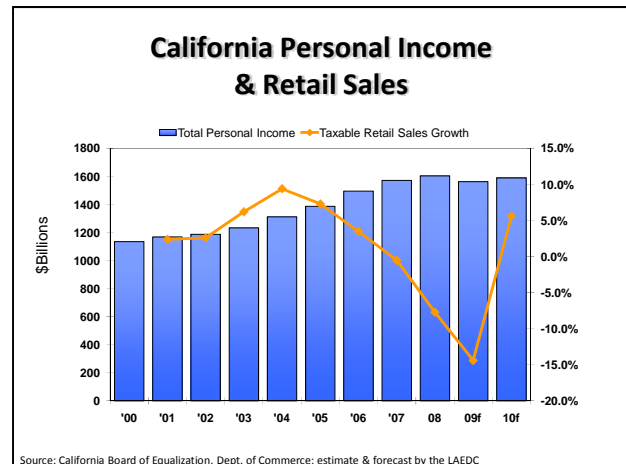
## Net Results

Recessionary employment losses in California started in housing and finance in 2008 but spread across the industry spectrum to manufacturing,

retail trade, business services, and goods movement in 2009.

Job losses will gradually diminish in 2010, as firms gain more confidence that the business recovery is sustainable. The largest losses this year are expected to occur in construction (-70,100 jobs), manufacturing (-65,900 jobs), retail trade (-28,100 jobs), and wholesale trade (-19,200 jobs). Five industry sectors will add employees in 2010: private education services (+22,100 jobs), administrative & support services (+19,200 jobs), information (+13,200 jobs), leisure & hospitality (+11,000 jobs), and health services (+10,200 jobs).

The state’s unemployment rate has moved well into double-digit territory, and will remain there during 2010-2011, averaging 12.4% in 2010 and 11.8% in 2011.



Total personal income dropped by -2.5% in 2009 to \$1.56 billion, the first annual decline since 1938. And 2009 meant rough times for California’s retailers, who saw a -14.4% decline in 2009 taxable retail sales.

In 2010, personal income will grow by +1.7%, while taxable retail sales will register a gain of +5.6%.

## Bottom Line

The near-term outlook for the California economy is better but still not especially pretty. Because the recession was so deep, 2010 won’t *feel* very good despite improvements in some industries. However, the state’s economy *is* moving in the right direction. The economic environment will seem more like a true recovery-expansion by 2011.

## Gross Product

People always ask how the state's gross domestic product (GDP) ranks among the nations of the world. They also ask about where the Los Angeles five-county area and LA County would rank if they were a sovereign countries. When they read or hear this information, they can get confused, often attributing the state's ranking to the five-county area. Or they will attribute an earlier (and higher) ranking to the area several years later.

To help keep things straight (at least for 2009), call it the "rule of 8...16...19." In 2009, the state ranked 8<sup>th</sup>, the five-county area placed 16<sup>th</sup>, while Los Angeles County on its own ranked 19<sup>th</sup> (based on what can be measured) among the nations of the world.

In 2009, California's 8<sup>th</sup> place ranking (behind Italy and now ahead of Brazil instead of Russia) was unchanged from 2008. Also, the ranking for the five-county area moved up from 17<sup>th</sup> to 16<sup>th</sup>. The Los Angeles County ranking remained at 19<sup>th</sup>, although it is now behind Indonesia instead of Poland (the Polish economy contracted substantially in 2009 falling from 18<sup>th</sup> to 21<sup>st</sup>).

The 2009 results demonstrated that the most substantial declines in GDP were in countries that were most heavily reliant upon exports and oil revenues, as both collapsed in 2009. California, the five-county area and Los Angeles County also experienced contractions in 2009 as the housing crash, high unemployment and lower consumer spending were very problematic. However, the state and Southern California did not perform as poorly as some other economies.

In nominal (not adjusted for inflation) GDP growth terms, the overall declines in 2009 were less severe in the United States, California, Los Angeles five-county area, and Los Angeles County than in most other nations on the list. There were only three nations that actually experienced economic growth in both nominal and real (adjusted for inflation) terms in 2009 and they included China, India and Indonesia.

When compared in real GDP terms, the major foreign countries also posted larger declines than the local Southern California economies. Oil producing nations experienced the largest GDP drops as oil prices plummeted after reaching all-time highs in mid-2008. This was clearly demonstrated for Russia, Saudi Arabia and Mexico, which witnessed the most significant deteriorations in overall nominal GDP. The UK, Poland, Turkey, Sweden and Ireland also had dismal economic environments in 2009.

In July 2011, we will publish the 2010 results. Most likely we will see the largest 2010 GDP increases amongst the Asian nations (excluding Japan) and the weakest performances in Europe. The key question will be how well the California and the local economies recover in 2010.

**Table 4: Gross Product Comparisons, 2009**

(In billions of US\$)

Rank	Country/Economy	2009	Nominal GDP	Real GDP
			'08-'09 % Chg	'08-'09 % Chg
1	United States	\$14,256.28	-1.3%	-2.4%
2	Japan	5,068.06	3.6%	-5.2%
3	China	4,908.98	7.9%	8.7%
4	Germany	3,352.74	-9.6%	-4.9%
5	France	2,675.92	-7.1%	-2.2%
6	United Kingdom	2,183.61	-22.9%	-4.9%
7	Italy	2,118.26	-8.9%	-5.0%
	<b>California</b>	<b>1,812.40</b>	<b>-1.9%</b>	<b>-3.0%</b>
8	Brazil	1,574.04	-3.9%	-0.2%
9	Spain	1,464.04	-9.4%	-3.6%
10	Canada	1,336.43	-12.2%	-2.6%
11	India	1,235.98	2.4%	5.7%
12	Russia	1,229.23	-35.0%	-7.9%
13	Australia	997.20	-6.2%	1.3%
14	Mexico	874.90	-24.6%	-6.5%
15	South Korea	832.51	-11.9%	0.2%
	<b>Los Angeles 5-co. area</b>	<b>823.50</b>	<b>-3.4%</b>	<b>-0.3%</b>
16	Netherlands	794.78	-10.3%	-3.9%
17	Turkey	615.33	-18.7%	-4.7%
18	Indonesia	539.38	5.2%	4.5%
	<b>Los Angeles County</b>	<b>499.80</b>	<b>-3.8%</b>	<b>-0.7%</b>
19	Switzerland	494.62	-1.1%	-1.4%
20	Belgium	470.40	-7.6%	-3.0%

Note: Nominal GDP figures are not adjusted for inflation.

Sources: IMF World Economic Outlook, April '10; LAEDC estimates

**Table 5:**  
**California Economic Indicators**

	Population on July 1 of (000s)	Nonfarm Employment (avg., 000s)	Unemp. Rate (avg., %)	Total Personal Income (\$ billions)	Per Capita Personal Income (\$)	Taxable Retail Sales (\$ billions)	Value of Two-way Trade (\$ billions)	Housing Unit Permits Issued	Nonresidential Building Permits (\$ millions)
2000	34,095.2	14,488.2	4.9	1,135.3	33,299	287.1	392.0	148,540	18,625
2001	34,766.7	14,602.0	5.4	1,168.7	33,616	294.0	340.7	148,757	16,753
2002	35,361.2	14,457.8	6.7	1,187.4	33,578	301.6	328.1	167,761	14,529
2003	35,944.2	14,392.8	6.8	1,233.0	34,303	320.2	348.0	195,682	13,915
2004	36,454.5	14,532.6	6.2	1,312.2	35,997	350.2	394.8	212,960	15,689
2005	36,899.4	14,801.3	5.4	1,387.7	37,607	375.8	433.8	208,972	18,266
2006	37,274.6	15,060.3	4.9	1,495.6	40,123	389.1	488.0	164,280	21,109
2007	37,674.4	15,173.5	5.2	1,572.3	41,733	387.0	513.4	113,034	22,542
2008	38,134.5	14,981.4	7.2	1,604.1	42,065	357.3	523.3	64,962	19,212
2009	38,487.9	14,079.3	11.4	1,563.4	40,620	306.0	413.5	36,421	10,866
2010f	38,841.3	13,893.5	12.4	1,590.0	40,936	323.0	425.7	40,000	10,300
2011f	39,229.7	14,079.2	11.8	1,660.0	42,315	341.0	444.4	55,000	10,850

**% Change**

'01/'00	2.0%	0.8%		2.9%	1.0%	2.4%	-13.1%	0.1%	-10.1%
'02/'01	1.7%	-1.0%		1.6%	-0.1%	2.6%	-3.7%	12.8%	-13.3%
'03/'02	1.6%	-0.4%		3.8%	2.2%	6.2%	6.1%	16.6%	-4.2%
'04/'03	1.4%	1.0%		6.4%	4.9%	9.4%	13.4%	8.8%	12.7%
'05/'04	1.2%	1.8%		5.7%	4.5%	7.3%	9.9%	-1.9%	16.4%
'06/'05	1.0%	1.7%		7.8%	6.7%	3.5%	12.5%	-21.4%	15.6%
'07/'06	1.1%	0.8%		5.1%	4.0%	-0.5%	5.2%	-31.2%	6.8%
'08/'07	1.2%	-1.3%		2.0%	0.8%	-7.7%	1.9%	-42.5%	-14.8%
'09/'08	0.9%	-6.0%		-2.5%	-3.4%	-14.4%	-21.0%	-43.9%	-43.4%
'10/'09	0.9%	-1.3%		1.7%	0.8%	5.6%	3.0%	9.8%	-5.2%
11/'10	1.0%	1.3%		4.4%	3.4%	5.6%	4.4%	37.5%	5.3%

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept. of Commerce Construction Industry Research Board; estimates and forecasts by the LAEDC

**Table 6:**  
**California Nonfarm Employment**

(Annual averages, in thousands, 2009 benchmark)

	Total Nonfarm Payroll	Natural Resources	Construction	Manufacturing	Mfg. -- <i>Durable</i>	Mfg. -- <i>Nondurable</i>	Wholesale Trade	Retail Trade	Transport. & Utilities	Information
2000	14,487.8	26.5	733.4	1,864.1	1,217.2	646.9	646.2	1,563.2	518.3	576.7
2001	14,602.6	25.6	780.4	1,791.3	1,173.9	617.4	658.9	1,576.1	514.1	551.9
2002	14,457.9	23.1	774.4	1,644.5	1,059.6	584.9	652.1	1,582.1	491.0	497.3
2003	14,393.1	22.2	796.8	1,542.5	976.4	566.1	649.5	1,588.3	480.6	476.1
2004	14,532.1	22.8	850.4	1,523.4	966.0	557.4	653.0	1,617.6	482.7	482.4
2005	14,800.7	23.6	905.3	1,504.7	959.0	545.7	673.6	1,659.3	487.1	473.6
2006	15,059.8	25.1	933.7	1,490.2	947.6	542.6	700.2	1,680.1	496.1	466.0
2007	15,173.5	26.7	892.6	1,464.3	927.9	536.4	715.3	1,689.9	507.6	470.8
2008	14,981.4	28.7	787.7	1,425.4	899.8	525.6	703.5	1,640.9	504.6	475.5
2009	14,079.3	25.7	620.1	1,280.9	798.2	482.7	644.2	1,518.1	474.1	446.8
2010f	13,893.5	24.0	550.0	1,215.0	755.0	460.0	625.0	1,490.0	460.0	460.0
2011f	14,079.2	26.0	575.0	1,210.0	765.0	445.0	640.0	1,520.0	475.0	465.0

	Finance & Insurance	Rental & Leasing	Prof, Sci & Tech Svcs	Mgmt. of Enterprises	Admin. & Support Svcs	Educational Services	Health Care & Social Asst	Leisure & Hospitality	Other Services	Government
2000	544.3	262.6	922.7	294.0	997.2	229.7	1,171.3	1,335.5	487.7	2,318.0
2001	568.9	267.2	936.9	283.6	657.6	237.1	1,210.6	1,365.1	499.2	2,382.1
2002	584.8	268.2	905.0	265.9	939.5	245.4	1,253.3	1,382.3	505.7	2,447.0
2003	613.4	272.3	906.6	246.8	931.2	258.2	1,278.1	1,400.1	504.3	2,426.0
2004	625.8	276.4	918.9	230.3	947.8	262.9	1,297.1	1,439.4	503.8	2,397.7
2005	643.6	283.6	970.2	221.2	968.3	272.2	1,314.3	1,475.2	505.5	2,420.2
2006	646.7	288.5	1,026.5	211.6	1003.3	277.6	1,336.4	1,519.0	207.1	2,452.3
2007	621.1	283.5	1,060.4	206.1	997.9	289.3	1,381.0	1,560.4	512.2	2,494.6
2008	574.5	275.9	1,079.6	206.0	951.6	300.6	1,424.1	1,572.6	511.3	2,518.9
2009	542.5	254.5	1,016.2	194.6	840.8	302.9	1,437.3	1,499.0	484.3	2,497.3
2010f	535.0	245.0	1,000.0	187.0	860.0	325.0	1,447.5	1,510.0	485.0	2,475.0
2011f	535.0	248.0	1,020.0	185.0	885.0	330.0	1,462.5	1,540.0	495.0	2,467.7

Sources: California Employment Development Department, LMID; estimates and forecasts by LAEDC

**Table 7:**  
**California Regional Nonfarm Employment**

(Annual averages for major metropolitan areas; March 2009 benchmark)

\MSA Year \	State of California*	Northern California			Central California					Southern California				
		Oakland	San Francisco	San Jose	Bakersfield	Fresno	Modesto	Sacramento	Stockton	Los Angeles	Orange	Riv- San Bern	San Diego	Ventura
1990	12,499.8	879.2	947.3	824.2	170.7	224.5	117.5	618.5	152.7	4,135.7	1,172.4	712.6	966.6	230.3
1991	12,358.9	879.7	939.5	815.4	177.3	227.3	117.8	630.9	155.2	3,982.7	1,143.7	718.9	962.6	230.4
1992	12,153.5	870.2	914.4	801.7	173.3	230.2	120.0	623.2	154.8	3,804.5	1,126.0	729.6	947.7	226.6
1993	12,045.4	873.5	908.3	806.7	169.9	233.6	121.6	626.0	156.2	3,707.6	1,115.4	733.9	947.0	227.0
1994	12,159.5	877.4	903.6	810.3	170.8	237.2	122.2	643.8	157.3	3,701.9	1,126.8	751.3	955.3	233.3
1995	12,422.0	897.5	916.5	842.8	172.8	243.5	124.0	662.8	160.3	3,746.6	1,151.7	779.9	978.5	237.3
1996	12,743.4	916.4	948.2	891.9	174.9	246.8	127.8	681.5	163.5	3,788.5	1,184.3	803.5	1,006.2	237.9
1997	13,129.7	947.8	983.5	939.7	179.2	249.8	131.7	702.0	167.4	3,865.0	1,233.8	841.5	1,054.3	242.7
1998	13,596.1	976.2	1,012.2	969.7	184.3	253.5	137.2	731.4	171.5	3,943.5	1,299.1	882.2	1,105.5	252.3
1999	13,991.8	1,008.0	1,040.0	985.1	188.8	262.0	141.7	770.5	178.7	4,002.9	1,345.2	939.0	1,152.9	263.6
2000	14,488.2	1,044.6	1,082.1	1,044.3	194.1	270.6	144.2	797.1	185.8	4,072.1	1,388.9	988.4	1,193.8	275.0
2001	14,602.0	1,054.8	1,053.9	1,017.9	202.2	275.9	149.7	818.9	191.1	4,073.6	1,413.7	1,029.7	1,218.4	279.9
2002	14,457.8	1,039.8	987.1	917.2	205.1	282.0	150.7	832.2	194.0	4,026.8	1,403.7	1,064.5	1,230.7	281.8
2003	14,392.8	1,025.6	950.7	870.3	207.1	282.7	152.3	846.0	197.3	3,982.9	1,429.0	1,099.2	1,240.1	284.2
2004	14,532.6	1,023.7	939.3	862.0	211.8	286.9	154.6	859.1	200.7	3,996.5	1,456.7	1,160.0	1,260.3	286.2
2005	14,801.3	1,032.2	945.8	869.9	222.1	294.3	159.1	880.9	205.8	4,024.2	1,491.0	1,222.0	1,282.1	291.2
2006	15,060.3	1,045.4	964.4	891.2	233.3	302.6	159.8	899.0	209.1	4,092.5	1,518.9	1,267.7	1,301.6	297.7
2007	15,173.5	1,048.2	989.1	911.2	238.7	306.4	160.1	903.0	211.5	4,122.1	1,515.5	1,270.9	1,308.8	296.8
2008	14,981.4	1,030.4	996.7	914.9	238.0	303.0	156.4	882.1	205.7	4,070.7	1,481.6	1,223.8	1,298.7	291.3
2009	14,079.3	966.4	942.3	855.6	227.9	286.6	146.8	833.4	193.6	3,829.4	1,371.4	1,131.9	1,229.6	275.0

\*Based on Current Employment Series

Sources: California Employment Development Department, Labor Market Division; forecasts by LAEDC

**Table 8:**  
**Total Nonfarm Employment in Southern California**

**Actual Data & Forecasts** (Annual averages in thousands)

	Los Angeles	Orange	Riv.-S'Bdo.	Ventura	LA 5-Co.	San Diego	California
2000	4,072.1	1,388.9	988.4	275.0	6,724.4	1,193.8	14,487.8
2001	4,073.6	1,413.7	1,029.7	280.0	6,797.0	1,218.4	14,602.6
2002	4,026.8	1,403.7	1,064.5	281.8	6,776.8	1,230.7	14,457.9
2003	3,982.9	1,429.0	1,099.2	284.2	6,795.3	1,240.1	14,393.1
2004	3,996.5	1,456.7	1,160.0	286.2	6,899.4	1,260.3	14,532.1
2005	4,024.2	1,491.0	1,222.0	291.2	7,028.4	1,282.1	14,800.7
2006	4,092.5	1,518.9	1,267.7	297.7	7,176.8	1,301.6	15,059.8
2007	4,122.1	1,515.5	1,270.9	296.8	7,205.3	1,308.8	15,173.5
2008	4,070.7	1,481.6	1,222.5	291.3	7,066.1	1,298.7	14,994.1
2009	3,829.4	1,371.4	1,131.9	275.0	6,607.7	1,229.6	14,325.3
2010f	3,784.5	1,364.1	1,108.0	271.0	6,527.6	1,220.9	14,205.0
2011f	3,831.3	1,382.5	1,120.8	274.0	6,608.6	1,237.9	14,350.0

**Numerical Change from Prior Year** (in thousands)

	Los Angeles	Orange	Riv.-S'Bdo.	Ventura	LA 5-Co.	San Diego	California
2000	69.2	43.7	49.4	11.4	173.7	40.9	496.0
2001	1.5	24.8	41.3	5.0	72.6	24.6	114.8
2002	-46.8	-10.0	34.8	1.8	-20.2	12.3	-144.7
2003	-43.9	25.3	34.7	2.4	18.5	9.4	-64.8
2004	13.6	27.7	60.8	2.0	104.1	20.2	139.0
2005	27.7	34.3	62.0	5.0	129.0	21.8	268.6
2006	68.3	27.9	45.7	6.5	148.4	19.5	259.1
2007	29.6	-3.4	3.2	-0.9	28.5	7.2	113.7
2008	-51.4	-33.9	-48.4	-5.5	-139.2	-10.1	-179.4
2009	-241.3	-110.2	-90.6	-16.3	-458.4	-69.1	-668.8
2010f	-44.9	-7.3	-23.9	-4.0	-80.1	-8.7	-120.3
2011f	46.8	18.4	12.8	3.0	81.0	17.0	145.0

**% Change from Prior Year**

	Los Angeles	Orange	Riv.-S'Bdo.	Ventura	LA 5-Co.	San Diego	California
1991	-3.7%	-2.4%	0.9%	0.0%	-2.8%	-0.4%	-1.1%
2000	1.7%	3.2%	5.3%	4.3%	2.7%	3.5%	3.5%
2001	0.0%	1.8%	4.2%	1.8%	1.1%	2.1%	0.8%
2002	-1.1%	-0.7%	3.4%	0.6%	-0.3%	1.0%	-1.0%
2003	-1.1%	1.8%	3.3%	0.9%	0.3%	0.8%	-0.4%
2004	0.3%	1.9%	5.5%	0.7%	1.5%	1.6%	1.0%
2005	0.7%	2.4%	5.3%	1.7%	1.9%	1.7%	1.8%
2006	1.7%	1.9%	3.7%	2.2%	2.1%	1.5%	1.8%
2007	0.7%	-0.2%	0.3%	-0.3%	0.4%	0.6%	0.8%
2008	-1.2%	-2.2%	-3.8%	-1.9%	-1.9%	-0.8%	-1.2%
2009	-5.9%	-7.4%	-7.4%	-5.6%	-6.5%	-5.3%	-4.5%
2010f	-1.2%	-0.5%	-2.1%	-1.5%	-1.2%	-0.7%	-0.8%
2011f	1.2%	1.3%	1.2%	1.1%	1.2%	1.4%	1.0%

Sources: EDD, Labor Market Information Division; all estimates & forecasts by LAEDC



**Table 9:****California Motion Picture/TV Production Employment**

(In thousands, 2009 benchmark, based on NAICS)

	Motion Picture & Related Industries	Motion Picture & Video Industries	Sound Recording Industries	Broadcasting (Radio, TV & Cable)	Magnetic Media Manufacturing & Reproduction	Independent Artists, Writers, & Performers
2000	247.1	160.2	10.1	46.4	16.0	14.4
2001	227.9	145.5	8.5	45.9	13.9	14.1
2002	218.2	139.0	6.8	45.0	12.0	15.4
2003	214.8	139.2	5.7	45.2	8.8	15.9
2004	229.8	152.5	4.9	46.8	10.8	14.8
2005	223.3	146.7	4.9	47.3	8.7	15.7
2006	220.9	143.4	4.6	47.7	8.0	17.2
2007	224.1	146.0	5.1	48.5	7.4	17.1
2008	226.4	150.1	3.9	48.6	6.9	16.9
2009	212.5	141.3	3.6	46.1	6.1	15.4

Sources: California Employment Development Department, Labor Market Information Division;  
all estimates and forecasts by LAEDC

**Table 10:****California Technology Employment**

(In thousands, 2009 benchmark, based on NAICS)

	Total Technology Employment	Computer & Electronic Product Manufacturing	Manufacturing Aerospace Product & Parts Manufacturing	Pharmaceutical & Medicine Manufacturing	Software Publishers	ISPs, Web Portals, Data Processing	Services Computer Systems Design & Rel. Services	Management, Scientific, & Technical Consulting	Scientific R&D Services
2000	1,027.7	421.8	90.7	38.0	48.2	32.1	206.6	95.1	95.2
2001	1,019.2	409.7	86.3	39.2	50.7	28.8	204.4	99.1	99.1
2002	922.0	353.7	79.6	39.5	48.8	20.7	177.1	102.1	100.5
2003	876.7	320.9	73.6	39.1	44.7	18.7	168.8	109.7	101.2
2004	877.1	313.4	73.7	40.6	42.6	18.5	168.5	119.0	100.8
2005	902.6	310.8	73.4	42.0	41.6	19.6	175.6	135.4	104.2
2006	932.2	308.2	73.0	44.0	41.3	20.9	187.3	151.3	106.2
2007	950.6	304.1	72.8	44.2	43.0	20.7	199.2	159.0	107.6
2008	971.3	300.0	73.7	43.6	44.9	20.4	205.8	166.8	116.1
2009	923.5	278.1	71.2	43.7	44.4	19.3	195.6	159.0	112.2

Sources: California Employment Development Department, Labor Market Information Division; all estimates and forecasts by LAEDC

**Table 11:****Population Trends in California and the Los Angeles Five-County Area**

Population estimates as of 7/1/09, in thousands

	Los Angeles County		Orange County		Riverside & San Bern. Area		Ventura County		Total of L.A. 5-Co. Area		State of California	
	Data	% Δ	Data	% Δ	Data	% Δ	Data	% Δ	Data	% Δ	Data	% Δ
1980	7,500 \		1,945 \		1,572 \		532 \		11,549 \		23,782 \	
		18.1%		24.0%		66.7%		25.8%		26.1%		25.4%
1990	8,860 /		2,412 /		2,620 /		669 /		14,561 /		29,828 /	
1991	8,955	1.1%	2,459	1.9%	2,751	5.0%	677	1.2%	14,842	1.9%	30,458	2.1%
1992	9,060	1.2%	2,512	2.2%	2,833	3.0%	686	1.3%	15,091	1.7%	30,987	1.7%
1993	9,084	0.3%	2,550	1.5%	2,885	1.8%	694	1.2%	15,213	0.8%	31,314	1.1%
1994	9,107	0.3%	2,576	1.0%	2,920	1.2%	701	1.0%	15,304	0.6%	31,524	0.7%
1995	9,101	-0.1%	2,605	1.1%	2,959	1.3%	705	0.6%	15,370	0.4%	31,712	0.6%
1996	9,108	0.1%	2,646	1.6%	3,006	1.6%	710	0.7%	15,470	0.7%	31,963	0.8%
1997	9,186	0.9%	2,700	2.0%	3,062	1.9%	722	1.7%	15,670	1.3%	32,453	1.5%
1998	9,266	0.9%	2,750	1.9%	3,117	1.8%	729	1.0%	15,862	1.2%	32,863	1.3%
1999	9,394	1.4%	2,803	1.9%	3,198	2.6%	743	1.9%	16,138	1.7%	33,419	1.7%
2000	9,576	1.9%	2,864	2.2%	3,281	2.6%	759	2.2%	16,480	2.1%	34,095	2.0%
2001	9,736	1.7%	2,917	1.9%	3,393	3.4%	773	1.8%	16,819	2.1%	34,767	2.0%
2002	9,893	1.6%	2,960	1.5%	3,499	3.1%	787	1.8%	17,139	1.9%	35,361	1.7%
2003	10,022	1.3%	3,000	1.4%	3,632	3.8%	798	1.4%	17,452	1.8%	35,944	1.6%
2004	10,120	1.0%	3,032	1.1%	3,765	3.7%	806	1.0%	17,723	1.6%	36,454	1.4%
2005	10,186	0.7%	3,056	0.8%	3,896	3.5%	812	0.7%	17,950	1.3%	36,899	1.2%
2006	10,217	0.3%	3,067	0.4%	4,010	2.9%	818	0.7%	18,112	0.9%	37,275	1.0%
2007	10,252	0.3%	3,090	0.7%	4,097	2.2%	824	0.7%	18,263	0.8%	37,674	1.1%
2008	10,341	0.9%	3,124	1.1%	4,152	1.3%	832	1.0%	18,449	1.0%	38,134	1.2%
2009	10,409	0.7%	3,155	1.0%	4,192	1.0%	841	1.1%	18,597	0.8%	38,488	0.9%

Source: California Dept. of Finance, Demographic Research Unit

**Table 12:**
**Components of Population Change – California & So. California Counties**

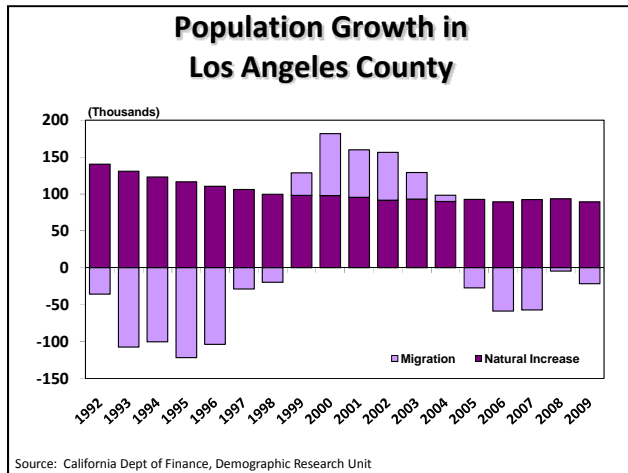
Figures in thousands, July 1 data compared with July 1 data the previous year

<b>Los Angeles County</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	98.5	151.3	61.2	90.1	8.4	65.2	-56.8
2005	65.4	151.4	58.6	92.8	-27.3	56.8	-84.1
2006	30.9	150.1	60.6	89.5	-58.6	62.4	-121.0
2007	35.5	151.4	58.7	92.7	-57.1	71.3	-128.4
2008	89.2	151.9	58.4	83.6	-104.4	81.4	-185.8
2009	67.6	147.3	58.0	89.4	-21.8	59.4	-81.2
<b>Orange County</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	31.5	45.0	17.5	27.5	4.0	17.2	-13.2
2005	23.9	44.7	16.5	28.2	-4.3	14.3	-18.6
2006	11.7	44.1	17.1	27.0	-15.2	16.3	-31.5
2007	22.4	43.8	16.9	26.9	-4.5	18.9	-23.4
2008	34.4	44.2	16.8	27.4	7.1	23.5	-16.4
2009	31.2	41.7	16.7	25.0	6.2	16.4	-10.3
<b>Riverside County</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	79.5	28.5	13.6	14.9	64.6	6.6	58.0
2005	79.6	30.4	13.5	16.9	62.7	6.2	56.5
2006	77.7	32.4	14.2	18.2	59.5	7.5	52.0
2007	58.9	34.2	13.9	20.3	38.6	9.1	29.5
2008	37.2	34.4	13.8	20.5	16.7	11.4	5.3
2009	30.2	32.9	13.8	19.1	11.1	7.9	3.2
<b>San Bernardino County</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	53.5	31.1	12.3	18.8	34.7	6.2	28.5
2005	51.3	32.4	11.8	20.6	30.7	5.3	25.4
2006	36.9	33.8	12.6	21.2	15.7	6.6	9.1
2007	27.6	35.2	12.3	22.8	4.7	7.6	-2.9
2008	18.1	34.8	12.2	22.6	-4.5	9.6	-14.1
2009	10.0	33.6	12.2	21.5	-11.5	6.6	-18.1
<b>San Diego County</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	31.2	45.2	20.4	24.7	6.5	14.0	-7.6
2005	27.6	46.0	19.0	27.0	0.6	12.4	-11.8
2006	24.2	46.2	19.8	26.3	-2.1	12.1	-14.2
2007	40.6	47.2	19.3	27.9	12.7	16.5	-3.8
2008	51.5	47.5	19.1	28.4	23.1	21.6	1.5
2009	39.0	46.4	19.0	27.3	11.6	14.9	-3.3
<b>Ventura County</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	8.0	11.9	5.2	6.8	1.2	3.9	-2.7
2005	5.5	12.0	4.6	7.4	-1.9	3.0	-4.9
2006	5.9	12.4	4.9	7.4	-1.5	3.3	-4.8
2007	5.8	12.4	4.8	7.6	-1.8	4.1	-5.8
2008	8.8	12.2	4.8	7.4	1.4	4.8	-3.5
2009	8.7	12.0	4.7	7.2	1.5	3.4	-1.9
<b>State of California</b>					Net Total Migration	Net Int'l Migration	Net Domestic Migration
Year	Pop. Chg.	Births	Deaths	Natural Incr. (Birth-Death)			
2004	510.3	539.9	239.3	300.5	209.7	194.1	15.60
2005	444.9	547.1	231.1	316.1	128.8	171.7	-42.9
2006	375.2	553.0	239.0	314.0	61.2	185.8	-124.6
2007	399.8	564.6	234.7	330.0	69.9	215.9	-146.0
2008	460.1	565.7	233.1	332.0	127.4	256.8	-129.4
2009	353.4	547.3	231.2	315.8	37.6	179.5	-141.9

Source: California Department of Finance, Demographic Research Unit

## V. OUTLOOK FOR LOS ANGELES COUNTY

While 2009 was a difficult year for Los Angeles County's economy, a gradual economic improvement is expected for 2010 and 2011. Even so, a number of the County's major industries will continue to be challenged.



### Positive Forces through 2010 and 2011

The Los Angeles economy appears to be past the bottom of the recession, though activity is still at relatively low levels in a number of industries. However, there are quite a few positives to report for the County's economy in the coming year and a half.

- The **entertainment industry** experienced a rebound in activity during the first half of 2010, with more motion pictures, television pilots and commercials being filmed. Industry employment has increased as well.
- **International trade** activity has turned up strongly after a sharp decline last year. A healthy increase in activity is expected in 2010 with more coming in 2011. Job counts will rise accordingly.
- **Tourism** also is turning up in 2010 after sliding in 2009. New hotels downtown and in Hollywood are drawing more business visitors as well as leisure travelers to the county. The improvement will continue in 2011.

- The **healthcare services** sector should continue to hold its own. The new 600-bed L.A. County-USC hospital is finally open for patients. Other area hospitals are engaged in building programs to meet stricter earthquake standards and to accommodate new patient handling techniques. Good hospitals attract excellent physicians, and L.A. County has some of the best. Though healthcare reform could be an issue in the future, right now this industry reliably generates jobs year in and year out.
- **Private education** is another sector that grows even in difficult economic times. Led by the county's topnotch universities, this sector also includes private K-12 schools and job training institutions that attract workers and the unemployed seeking training for better jobs.
- **Major construction projects** will provide more support this year, with a funding boost coming from the federal government's infrastructure program. The two ports, LAX and Metro all have significant construction programs underway.
- **Retail sales** were hit hard by the 2008-2009 recession, but are turning up in the recovery. Businesses and residents of Los Angeles County should feel more confident about their prospects later in 2010, which would have a positive impact on retail sales.

### Negative Forces through 2010 and 2011

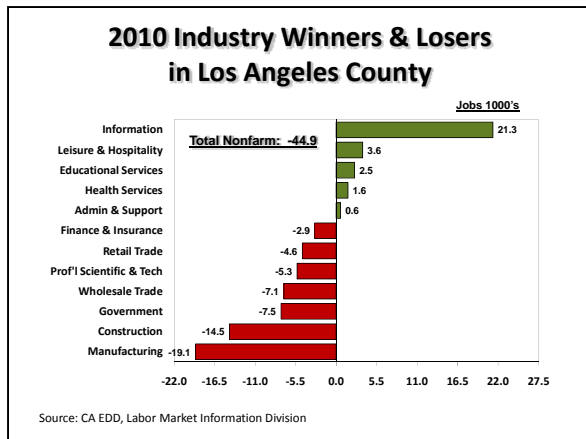
- The **nonresidential real estate sector** will continue to struggle with high vacancies, declining lease rates and falling property values in 2010. With little new project finance available, nonresidential construction activity will fall to minimal levels. More commercial properties could go into foreclosure or otherwise change ownership.
- **Local government finance** will be a continuing concern, as the decline in home

values, the slump in retail sales, and the state's budget problems all have hurt municipal and county budgets. More staff layoffs and service cuts are coming.

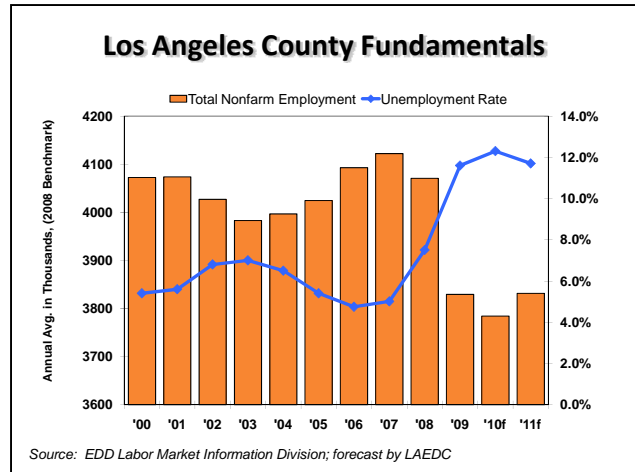
- Construction of **apartments and condominiums** will continue weak in 2010, reflecting higher rental vacancies and a scarcity of traditional funding.
- **Manufacturing** employment will continue to decline, mostly reflecting the problems in construction and housing.

### Net Results

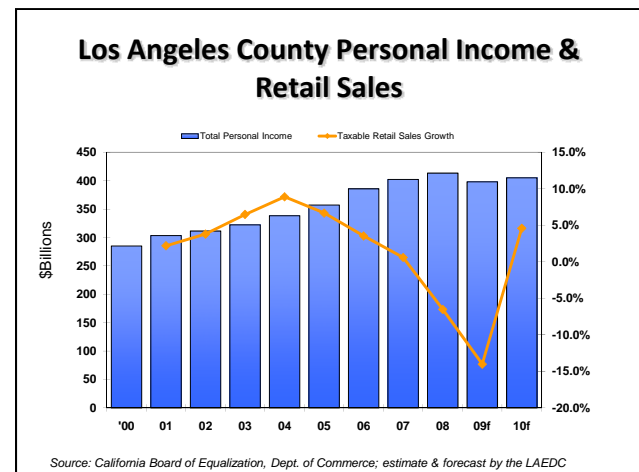
Total nonfarm employment in the County should fall by -1.2% or -44,900 jobs in 2010, after a drop of -5.9% or -241,300 jobs in 2009. Numerically, the largest employment losses during 2010 will come in: manufacturing (-19,100 jobs); construction (-14,500 jobs); government (-7,500 jobs); and wholesale trade (-7,100 jobs). The information sector (which includes the movie industry), will add +21,300 jobs. In addition, employment will increase by smaller amounts in leisure & hospitality (+3,600 jobs); (private) education (+2,500 jobs); health services (+1,600 jobs); and administration & support services (+600 jobs). Growing budget problems will force local government entities to shed jobs during 2010, though the federal employment rolls swelled temporarily with Census workers. Net-net, we expect government job counts to decline by -7,500 jobs this year. In 2011, total nonfarm



employment in the County is expected to increase by +1.2% or by +46,800 jobs as the economic recovery takes hold.



Unemployment rates will continue at painfully high levels during the forecast period, though they will gradually decline. Business firms initially will be cautious in rehiring until they believe the recovery in their own sales and profits is well established. The County's unemployment rate averaged 11.6% during 2009. In 2010, the jobless rate is expected to peak at 12.3%. By 2011, the unemployment rate should edge down to 11.7%.

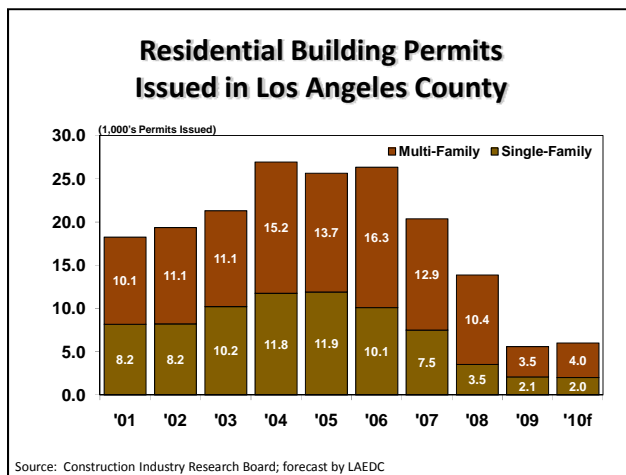


Total personal income in the county declined by an estimated -3.7% in 2009, but is expected to regain a little momentum in 2010 (+1.8%) and 2011 (+4.4%). Per capita personal income should

average \$38,635 in 2010, up by +1.0% over last year.

Taxable retail sales dropped at an estimated -14.0% rate in 2009, on the heels of a -6.5% decline in 2008. Retail sales are expected to increase in 2010-2011, but they will not return to pre-recession levels during the forecast period. This weakness is bad news for retail store owners, their landlords and local governments. Recycling vacant retail space will be a real challenge.

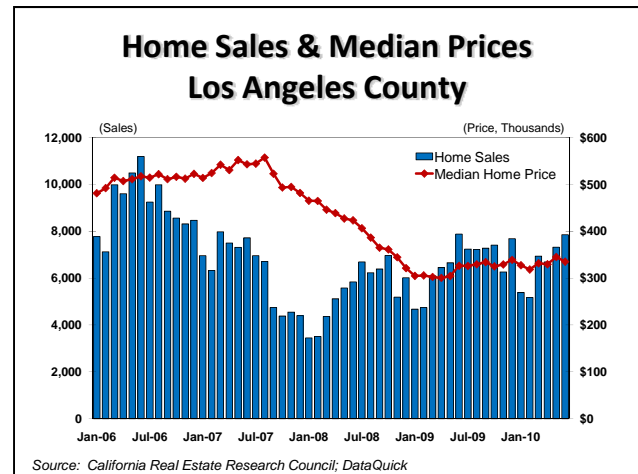
While Los Angeles County did not experience the huge boom in new home construction seen in other areas of Southern California, the drop in new permits issued was still rather dramatic. Only 5,610 new units got started in 2009, a -79% decline from the 2006 peak of 26,348 units.



The County has a large oversupply of apartments and condos to deal with before any significant recovery in homebuilding can get started. We expect only 6,000 units in total will be permitted during 2010, rising to 7,500 units in 2011.

The value of nonresidential building permits issued in the County plunged by -40.5% during 2009 to \$2.67 billion. The problem sectors were—and continue to be—office and retail. The County's office vacancy rate was 16.6% in June 2010, though it may have peaked. Comprehensive retail vacancy rates for the County are lacking, but the problems are quite visible in many shopping malls and in local strip

retail. Nonresidential building activity should hit bottom during 2010, with permit values falling by -3.6% to \$2.63 billion.



After solid performances in 2007-2008, the number of overnight visitors to Los Angeles eased down to 24.9 million in 2009. The year 2010 should see an uptick in the visitor count to perhaps 25.1 million visitors. This increase reflects the opening of the convention center hotel in downtown Los Angeles and the W Hotel in Hollywood, which will attract more business visitors, as well as some new attractions at local theme parks.

The value of international trade at the Los Angeles Customs District declined by -20.5% in 2009. A sparkling increase of +14.0% is forecast for 2010.

### Hot Spots

This section highlights areas with significant development activity. In fact, several major projects are under construction or just completed that will have a huge impact on their locations as economic activity begins to grow again.

- One such project is "LA Live" in Downtown Los Angeles. The convention center hotel's opening in early 2010 has given a significant boost to the convention center's efforts to attract more business shows and to the local travel industry.



- At the other end of Downtown, construction of the new Civic Park (running between the government buildings facing Temple and First streets from the Music Center to City Hall) and the upcoming Broad Art Museum (just south of Disney Concert Hall) will contribute to north Grand Avenue's status as the cultural focus of Downtown.
- The new W Hotel and condominium development at the intersection of Hollywood and Vine, which opened in January, provide an anchor for the eastern end of Hollywood Blvd. More development—think restaurants and clubs—is on the way in the Hollywood area.

### **Risks**

While the full impact would probably not be felt until 2012-2013, the biggest single risk for the County is the Defense Department's threatened stoppage of Boeing's C-17 program. Some 5,000 employees assemble or support this plane in Long Beach. In turn, they are supported by thousands more workers among the County's subcontractor base.

**Table 13:**  
**Los Angeles County Economic Indicators**

	Population on July 1 of (000s)	Nonfarm Employment (avg., 000s)	Unemp. Rate (avg., %)	Total Personal Income (\$ billions)	Per Capita Personal Income (\$)	Taxable Retail Sales (\$ billions)	Value of Two-way Trade (\$ billions)	Total Overnight Visitors (millions)	Housing Unit Permits Issued	Nonresidential Building Permits (\$ millions)	Chg. in CPI (%)
2000	9,576.1	4,072.1	5.4	284.985	29,760	70.321	230.0	24.2	17,071	3,296	3.3
2001	9,735.9	4,073.6	5.6	303.445	31,168	71.835	212.2	22.8	18,253	3,539	3.3
2002	9,892.5	4,026.8	6.8	311.367	31,475	74.548	212.8	22.1	19,364	2,920	2.8
2003	10,021.8	3,982.9	7.0	322.272	32,157	79.427	232.9	23.3	21,313	2,932	2.6
2004	10,120.3	3,996.5	6.5	338.210	33,419	86.497	261.7	24.3	26,935	3,174	3.3
2005	10,185.8	4,024.2	5.4	357.194	35,068	92.271	291.6	25.0	25,647	3,824	4.5
2006	10,216.7	4,092.5	4.8	385.733	37,755	95.544	326.4	25.4	26,348	3,896	4.3
2007	10,252.2	4,122.1	5.1	402.108	39,221	96.096	347.3	25.8	20,363	4,739	3.3
2008	10,341.4	4,070.7	7.5	413.317	39,967	89.810	355.8	25.6	13,704	4,491	3.5
2009	10,409.0	3,829.4	11.6	398.000	38,236	77.250	283.0	24.9	5,610	2,670	-0.8
2010f	10,482.8	3,784.5	12.3	405.000	38,635	80.800	290.4	25.1	6,000	2,630	1.5
2011f	10,566.7	3,831.3	11.7	423.000	40,031	85.300	302.9	25.5	7,500	2,655	2.0

**% Change**

'01/'00	1.7%	0.0%	6.5%	4.7%	2.2%	-7.8%	-5.8%	6.9%	7.4%
'02/'01	1.6%	-1.1%	2.6%	1.0%	3.8%	0.3%	-3.1%	6.1%	-17.5%
'03/'02	1.3%	-1.1%	3.5%	2.2%	6.5%	9.5%	5.4%	10.1%	0.4%
'04/'03	1.0%	0.3%	4.9%	3.9%	8.9%	12.4%	4.3%	26.4%	8.3%
'05/'04	0.6%	0.7%	5.6%	4.9%	6.7%	11.4%	2.9%	-4.8%	20.5%
'06/'05	0.3%	1.7%	8.0%	7.7%	3.5%	11.9%	1.6%	2.7%	1.9%
'07/'06	0.3%	0.7%	4.2%	3.9%	0.6%	6.4%	1.6%	-22.7%	21.6%
'08/'07	0.9%	-1.2%	2.8%	1.9%	-6.5%	2.5%	-0.8%	-32.7%	-5.2%
'09/'08	0.7%	-5.9%	-3.7%	-4.3%	-14.0%	-20.5%	-2.7%	-59.1%	-40.5%
'10/'09	0.7%	-1.2%	1.8%	1.0%	4.6%	2.6%	0.8%	7.0%	-1.5%
11/'10	0.8%	1.2%	4.4%	3.6%	5.6%	4.3%	1.6%	25.0%	1.0%

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept of Commerce Construction Industry Research Board; estimates and forecasts by the LAEDC

**Table 14:**  
**Los Angeles County Nonfarm Employment**

(Annual averages, in thousands, March 2009 benchmark)

	Total Nonfarm Payroll	Natural Resources	Construction	Manufacturing	Mfg. -- Durable	Mfg. -- Nondurable	Wholesale Trade	Retail Trade	Transport. & Utilities	Information
2000	4,072.1	3.4	131.7	612.2	342.3	269.9	219.4	392.0	174.6	243.7
2001	4,073.6	3.8	136.8	577.9	325.4	252.5	219.4	394.8	175.6	226.3
2002	4,026.8	3.7	134.5	534.8	299.3	235.5	217.3	398.2	167.2	207.3
2003	3,982.9	3.8	134.6	500.0	276.2	223.8	214.1	399.3	161.5	202.3
2004	3,996.5	3.8	140.2	483.6	267.8	215.8	215.1	405.4	161.1	211.9
2005	4,024.2	3.7	148.7	471.7	263.4	208.3	219.3	414.4	161.7	207.6
2006	4,092.5	4.0	157.5	461.7	257.3	204.4	225.7	423.3	165.2	205.6
2007	4,122.1	4.4	157.6	449.7	250.9	198.8	227.0	426.0	165.6	209.8
2008	4,070.7	4.4	145.2	434.4	243.2	191.2	223.7	416.5	163.1	210.3
2009	3,829.4	4.1	116.5	389.1	217.1	172.0	204.1	386.6	151.7	193.7
2010f	3,784.5	4.0	102.0	370.0	208.0	162.0	197.0	382.0	148.0	215.0
2011f	3,831.3	4.0	110.0	367.0	207.0	160.0	203.0	386.0	151.0	219.0

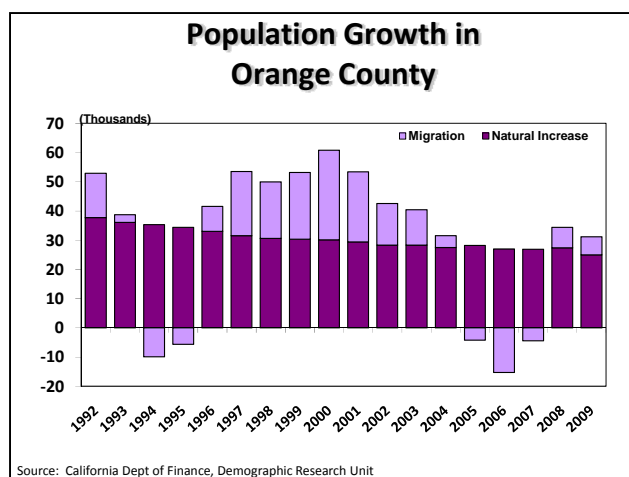
  

	Finance & Insurance	Rental & Leasing	Prof, Sci & Tech Svcs	Mgmt. of Enterprises	Admin. & Support Svcs	Educational Services	Health Care & Social Asst	Leisure & Hospitality	Other Services	Government
2000	150.8	73.8	227.7	85.6	274.6	86.2	330.7	344.7	140.0	581.3
2001	156.2	72.7	233.6	84.4	270.0	88.6	343.6	348.5	143.2	598.3
2002	159.8	72.8	231.6	82.5	261.0	93.0	357.4	354.2	145.6	606.1
2003	165.0	74.8	233.5	77.4	249.1	94.8	365.6	362.6	145.5	599.3
2004	165.0	76.7	237.7	71.2	253.6	95.4	371.6	372.8	144.7	587.1
2005	166.2	77.8	250.9	67.6	257.7	97.4	373.9	377.8	144.3	583.7
2006	169.0	79.8	264.0	63.0	271.9	99.4	379.3	388.6	145.2	589.4
2007	165.8	80.3	273.9	58.8	272.7	102.9	387.5	397.9	147.1	595.7
2008	156.3	79.4	269.6	56.7	256.4	105.1	398.3	401.6	146.1	603.7
2009	145.9	74.3	250.3	52.4	225.4	111.5	402.4	383.9	137.9	599.5
2010f	143.0	73.0	245.0	47.0	226.0	114.0	404.0	387.5	135.0	592.0
2011f	141.0	74.0	252.0	46.0	233.0	117.0	412.0	393.3	138.0	585.0

Sources: California Employment Development Department, LMID; estimates and forecasts by LAEDC.

## VI. OUTLOOK FOR ORANGE COUNTY

Orange County has absorbed some tremendous hits during the recession. In the run up to the financial crisis, the County's economic fortunes were closely tied to the two sectors that lay at the heart of the economic downturn: the financial services industry and construction. On the other hand, the County's unemployment rate (9.2% as of May) remains the lowest in Southern California.



The progress of the county's economic recovery will be measured by gains in employment. Job growth likely will be uneven and slow, continuing to decline in 2010, especially in several troubled sectors, before starting to improving in 2011.

Apart from financial services and construction, other components of the county's pre-recession success (demographics, universities, location, and high tech industries) remain mostly intact.

### Positive Forces

- The County will benefit from federal government stimulus funds earmarked for **infrastructure projects**. For some local developers, the government is the only source of sustained revenue these days. Coming down the pipeline are projects to widen the 91 freeway and to expand capacity at the John Wayne Airport. The Orange County Transportation Authority is also upgrading Metrolink rail commuter services. A series of construction projects to expand

service are slated to begin this summer and continue through 2011.

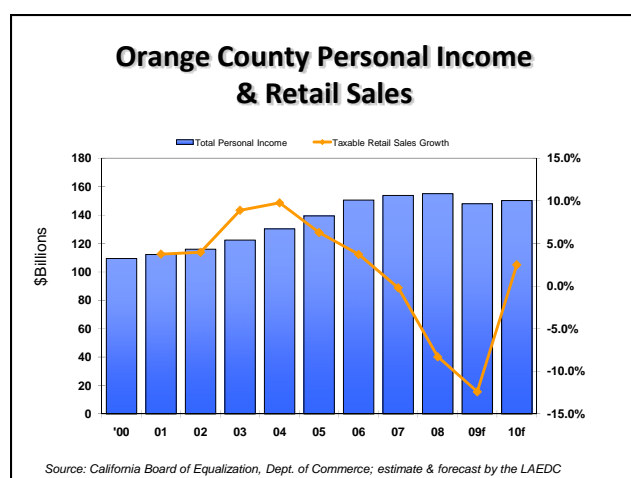
- The **Health Services** industry is one of the few that will be adding jobs this year and next. Hoag Memorial Hospital plans to open its newly renovated facility (\$85 million) in Irvine this summer, and Kaiser Permanente will continue working on its new \$850 million healthcare complex in Anaheim. This is the largest building project currently underway in Orange County. Set to be completed in 2013, the complex will include a hospital, two medical office buildings, a central utility plant and a parking structure.
- The County's **life science and medical instrument makers** are, for the most part holding up well.
- The **High Tech** industry is also doing relatively well. Both consumer electronics and business spending on technology products are expected to grow moderately this year. New products like electronic book readers and net books are expected to drive consumer growth. Lower prices on flat TVs and Blu-ray DVDs should also spur growth in Orange County. On the business side, corporate spending for new computers, networks and internet related equipment and software will increase
- Disney** will be continuing their major \$1.1 billion makeover of the California Adventure theme park.

### Negative forces

- Job losses in the **financial services** industry will finally bottom in 2010 – shedding a little over 4% of its remaining workforce before edging up in 2011. Local banks are bracing for a new round of problem commercial real estate loans. Declining rental incomes and

depressed property values are making it hard to renew expiring loans. Many lenders are attempting to forestall a crisis by adapting a strategy of “extend and pretend,” but this can only go on for so long. The fall-out from commercial real estate loan defaults could be substantial in Orange County.

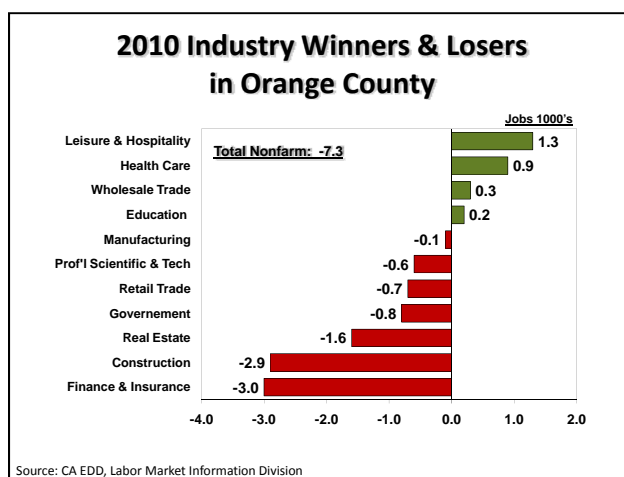
- **Retail** has also been a drain on the region’s economy. Vacancy rates are on the rise as stores close due to bankruptcies or simply scale back operations in response to weak customer demand.



- **Tourism** activity will be mostly flat but should begin to improve by the end of the year. The area around Disneyland will be one of the primary beneficiaries. Convention bookings are up from 2009 and the region is also expecting a boost from hosting Major League Baseball’s 2010 All-Star Game in July
- **Manufacturing** employment will continue to slide this year (the County ranks eighth in the nation in the number of factory jobs), but could see some growth in 2011. Expansion will come from export demand in Asia, as those economies continue to improve, plus increased domestic demand. Additionally, a shift in Pentagon spending from big ticket goods (fighter planes) to computers and unmanned aircraft, could provide some lift for local manufacturers.

## Net Results

Nonfarm employment in the County is expected to decline by -0.5% or -7,300 jobs during 2010. This follows a -7.4% job loss in 2009 and a -2.2% decline in 2008. Several industries will continue to struggle, with the largest employment losses in: finance & insurance (-3,000) jobs); construction (-2,900 jobs); real estate (-1,600 jobs); government (-800 jobs); and retail trade (-700 jobs). In 2011, employment in the County should turn up by +1.3%, posting a moderate increase of +18,400 jobs.



Orange County’s unemployment rate averaged 9.0% in 2009. In 2010 the rate could move up to 9.8% before recessionary forces finally begin to ease their grip. This would be the highest rate for the County in the current data series which starts in 1990. Mild relief will come in 2011, when the unemployment rate is expected to inch down to 9.4%.

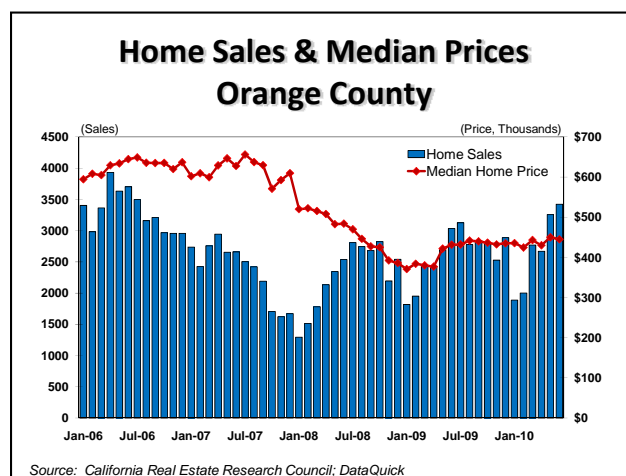
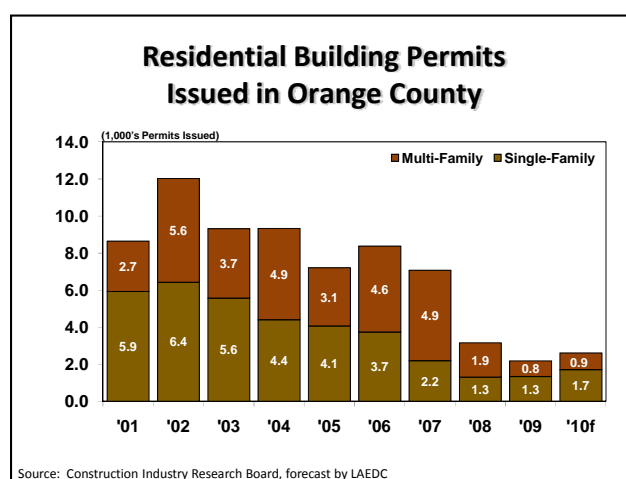
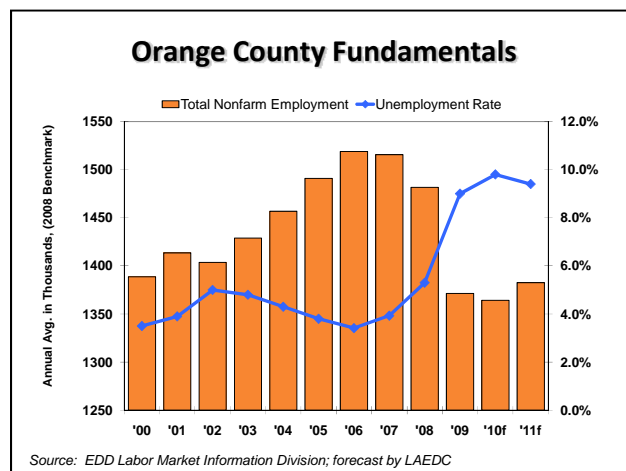
Total personal income in the County should edge up by +1.1% in 2010, with stronger growth coming in 2011 (+3.4%). Per capita personal income should average \$47,435 during 2010, up by +1.1% from the previous year. Retailing in Orange County has taken a beating, with a decline in taxable sales of -8.3% in 2008, followed by an estimated drop of -12.4% in 2009. For 2010 a moderate turn-around is expected (+2.5%) with a stronger rebound 2011 (5.7%).

New homebuilding in Orange County appears to have bottomed out in 2009 and will improve this year with the forecast for 2010 calling for 2,600 units to be permitted. Nonresidential permit values plummeted by -33.9% in 2009, are expected to improve by +9.4% 2010. At the end of the second quarter of 2011, the County's office vacancy rate was 21.0% and is expected to continue climbing until employment reverses its downward trajectory. The industrial vacancy rate was a more manageable 6.9% but is also trending higher.

The number of overnight tourists to the County should improve a bit this year, edging up by +0.7% to 43.0 million in 2010. In 2011, the number of overnight visitors is expected to increase by +0.9% to 43.4 million visitors. The tourist infrastructure surrounding Disneyland will begin to recover first. Upscale resorts and hotels will feel the pain longer as economically battered travelers trade down to less expensive hotels and corporate travel planners seek concessions or shun "resorts" altogether to avoid the "AIG Effect".

## Risks

The major risks to Orange County's outlook will come from the financial services sector, if and as commercial real estate problems arise. Retail sales will continue at low levels - though they should improve - putting local government tax revenues at risk. There is also uncertainty surrounding the State's budget crisis and how it will affect the County's economy.





**Table 15:**
**Orange County Economic Indicators**

	Population on July 1 of (000s)	Nonfarm Employment (avg., 000s)	Unemp. Rate (avg., %)	Total Personal Income (\$ billions)	Per Capita Personal Income (\$)	Taxable Retail Sales (\$ billions)	Total Overnight Visitors (millions)	Housing Unit Permits Issued	Nonresidential Building Permits (\$ millions)
2000	2,863.6	1,388.9	3.5	109.490	38,235	27.485	40.2	12,367	1,762
2001	2,917.0	1,413.7	3.9	112.245	38,479	28.519	40.9	8,646	1,350
2002	2,959.7	1,403.7	5.0	116.003	39,194	29.647	41.7	12,020	1,209
2003	3,000.1	1,429.0	4.8	122.426	40,807	32.288	42.7	9,311	1,006
2004	3,031.6	1,456.7	4.3	130.320	42,988	35.442	43.5	9,322	1,133
2005	3,055.5	1,491.0	3.8	139.408	45,625	37.673	44.7	7,206	1,495
2006	3,067.3	1,518.9	3.4	150.598	49,098	39.074	44.9	8,371	2,401
2007	3,089.8	1,515.5	3.9	153.839	49,790	38.988	44.4	7,072	2,005
2008	3,124.2	1,481.6	5.3	155.118	49,650	35.769	43.1	3,159	1,439
2009	3,155.4	1,371.4	9.0	147.982	46,898	31.350	42.7	2,177	951
2010f	3,166.5	1,364.1	9.8	150.200	47,435	32.134	43.0	2,600	1,040
2011f	3,191.8	1,382.5	9.4	156.543	49,045	33.965	43.4	3,920	1,145
<b>% Change</b>									
'01/'00	1.9%	1.8%		2.5%	0.6%	3.8%	1.7%	-30.1%	-23.4%
'02/'01	1.5%	-0.7%		3.3%	1.9%	4.0%	2.0%	39.0%	-10.4%
'03/'02	1.4%	1.8%		5.5%	4.1%	8.9%	2.4%	-22.5%	-16.8%
'04/'03	1.0%	1.9%		6.4%	5.3%	9.8%	1.9%	0.1%	12.6%
'05/'04	0.8%	2.4%		7.0%	6.1%	6.3%	2.8%	-22.7%	32.0%
'06/'05	0.4%	1.9%		8.0%	7.6%	3.7%	0.4%	16.2%	60.6%
'07/'06	0.7%	-0.2%		2.2%	1.4%	-0.2%	-1.1%	-15.5%	-16.5%
'08/'07	1.1%	-2.2%		0.8%	-0.3%	-8.3%	-2.9%	-55.3%	-28.2%
'09/'08	1.0%	-7.4%		-4.6%	-5.5%	-12.4%	-0.9%	-31.1%	-33.9%
'10/'09	0.4%	-0.5%		1.5%	1.1%	2.5%	0.7%	19.4%	9.3%
'10/'11	0.8%	1.3%		4.2%	3.4%	5.7%	0.9%	50.8%	10.1%

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept of Commerce Construction Industry Research Board; estimates and forecasts by the LAEDC

**Table 16:**  
**Orange County Nonfarm Employment**

(Annual averages, in thousands, March 2009 benchmark)

	Total Nonfarm Payroll	Natural Resources	Construction	Manufacturing	Mfg. -- Durable	Mfg. -- Nondurable	Wholesale Trade	Retail Trade	Transport. & Utilities	Information
2000	1,388.9	0.6	76.6	215.5	152.5	63.0	80.8	147.0	30.3	41.2
2001	1,413.7	0.6	80.7	208.5	147.8	60.7	83.9	150.1	30.4	40.2
2002	1,403.7	0.6	79.2	190.8	133.6	57.2	82.4	151.4	28.7	36.8
2003	1,429.0	0.5	83.7	183.9	127.2	56.7	83.2	152.8	29.0	35.2
2004	1,456.7	0.6	92.2	183.5	127.1	56.4	82.4	153.2	29.2	33.8
2005	1,491.0	0.7	99.9	182.9	128.3	54.6	83.0	158.1	28.7	32.8
2006	1,518.9	0.6	106.6	182.7	128.0	54.7	83.7	160.8	28.2	31.9
2007	1,515.5	0.6	103.1	180.4	126.2	54.2	86.9	161.2	28.9	31.2
2008	1,481.6	0.6	91.2	174.0	122.5	51.5	86.7	155.6	29.3	30.1
2009	1,371.4	0.5	73.6	154.5	108.9	45.6	80.1	141.9	27.9	27.4
2010f	1,364.1	0.5	70.7	154.4	109.3	45.1	80.4	141.2	28.0	27.8
2011f	1,382.5	0.5	73.6	156.3	110.8	45.5	81.7	143.0	28.1	28.5

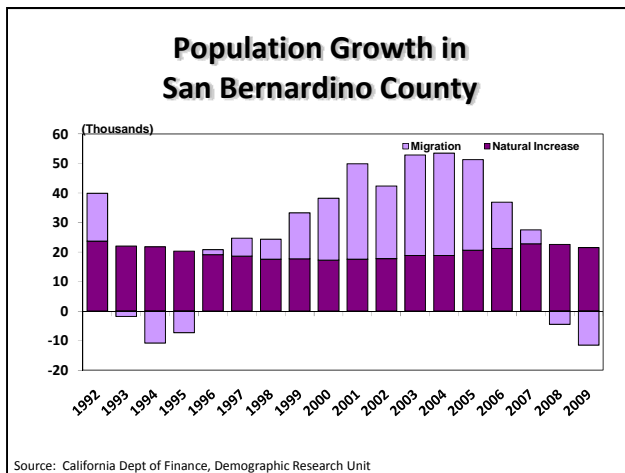
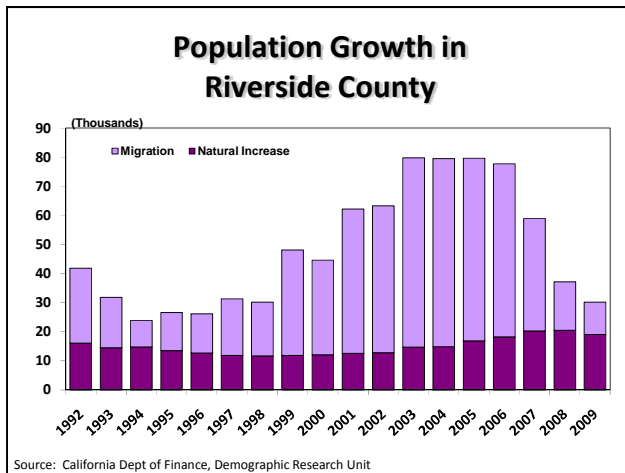
  

	Finance & Insurance	Real Estate, Rental & Leasing	Prof, Sci & Tech Svcs	Mgmt. of Enterprises	Admin. & Support Svcs	Educational Services	Health Care & Social Asst	Leisure & Hospitality	Other Services	Government
2000	70.0	30.9	91.2	38.6	117.7	17.7	94.4	145.9	43.9	146.6
2001	73.8	32.1	94.3	39.7	114.5	16.0	98.6	154.3	45.2	150.9
2002	77.4	32.7	95.1	35.8	118.0	15.9	102.5	155.4	45.9	155.1
2003	88.0	34.2	96.4	32.9	123.3	18.9	107.5	158.6	46.7	154.2
2004	96.0	36.3	97.6	30.6	126.7	19.2	111.8	162.9	47.4	153.4
2005	100.9	37.5	103.2	30.0	131.1	19.8	113.7	165.0	48.4	155.3
2006	99.0	39.1	109.3	28.9	136.4	20.8	117.0	169.6	47.7	156.7
2007	89.1	38.6	113.5	27.9	132.0	21.6	121.1	172.9	47.4	159.4
2008	76.1	37.0	116.1	26.1	124.5	23.6	127.1	176.4	46.5	160.8
2009	71.6	34.1	108.2	24.2	106.6	23.6	127.5	169.7	42.8	157.3
2010f	68.6	32.5	107.6	24.1	106.1	23.8	128.4	171.0	42.5	156.5
2011f	69.6	33.0	110.1	24.4	107.9	24.0	130.5	171.2	43.5	156.1

Sources: California Employment Development Department, LMD; estimates and forecasts by LAEDC

## VII. OUTLOOK FOR THE RIVERSIDE-SAN BERNARDINO AREA

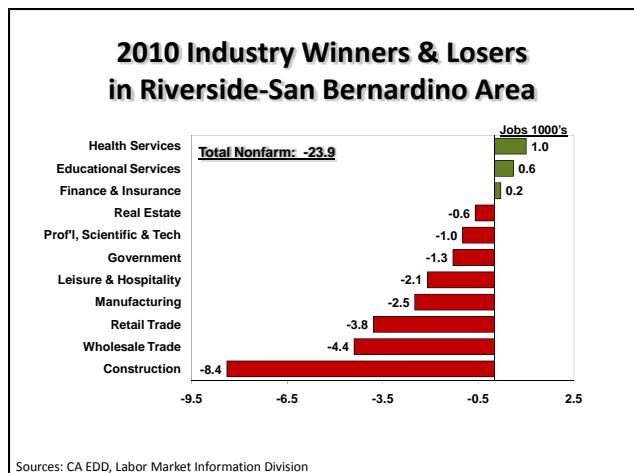
The outlook for the Riverside-San Bernardino (Inland Empire) area remains partly cloudy over the remainder of 2010 and into 2011, particularly with regards to the housing and labor markets. The Inland Empire has experienced a long and deep recession. A surge in the number of foreclosures along with plummeting home values a collapse in construction and soaring joblessness resulted in the worst ever economic crisis for the Inland Empire.



However, the region has begun to recover along with the rest of Southern California. The recovery will be slower for the Inland Empire as it has more ground to make-up due to its exposure to both the housing collapse and the dramatic decline in foreign trade volumes. The construction, manufacturing and trade related sectors are the key drivers of the Inland Empire economy. The good news is that they all have begun to pick up since the beginning of the year.

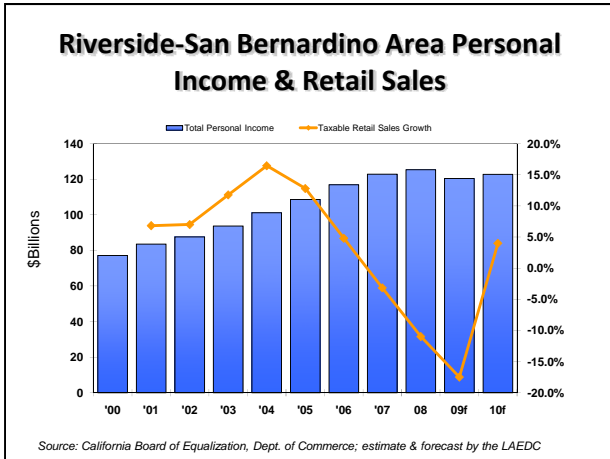
The recovery will not progress strongly until the housing market recovers and that is not expected for at least a year or two. The Inland Empire registered more defaults and foreclosures per capita during the economic downturn than any other area of Southern California. The good news is that housing prices have appreciated by +21% when compared to the lows of last year. However, housing prices are projected to stabilize at best for the remainder of 2010 and could drop off in some areas if demand fundamentals remain a real problem. Note that the median price of a home is still significantly below where it was before the crisis.

The region's construction industry has been hit hard by this recession, and the results show in the employment figures. Construction employment in May 2010 dropped by -16.8% from May 2009, and was -50% below the levels of May 2007. Industrial construction permits have declined by nearly -50% since last year and no hotel permits have been issued so far this year. In addition, retail permits are completely stagnant. It is safe to say that commercial construction will not experience any recovery in the short term.



Total nonfarm employment is expected to drop by -23,900 jobs in 2010. After construction, the sectors in the Inland Empire most affected by the recession are leisure & hospitality, manufacturing, retail trade, transportation and wholesale trade. All have been directly impacted by the severe decline in employment, consumer spending, and the housing market and trade volumes through the local ports. The

unemployment rate in the Inland Empire is forecasted to reach 14.6% in 2010 and then to drop to 14.2% in 2011. Persistently high unemployment has been really difficult for the Inland Empire to overcome and the results can be clearly seen as retail sales have fallen by nearly -27% in 2008 & 2009. However, in 2010 and 2011, retail sales are expected to increase.



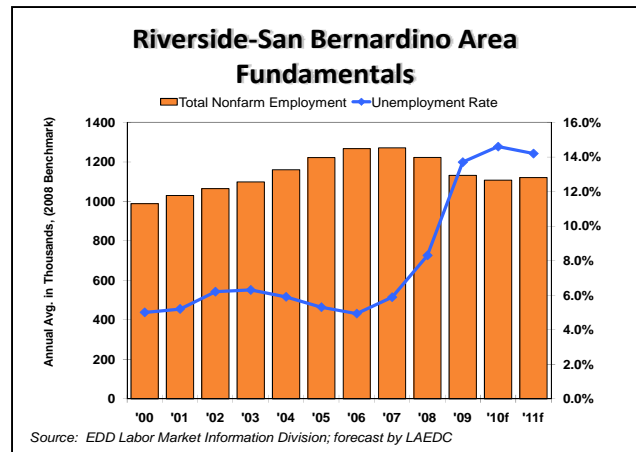
However, it is important to point out that the recovery has begun in the Inland Empire and has ended the dramatic declines that were experienced last year. Employment is expected to decline by just -1.1% in 2010 and increase by +1.2% in 2011.

The strong recovery underway at the twin ports will have positive results for the transportation and wholesale trade sectors in the coming months. The Inland Empire plays a pivotal role as a distribution center for many of the goods flowing through the ports of Long Beach and Los Angeles. World trade volumes are forecasted to grow by roughly +10 this year and by +5% to +6% in 2011 which will help the transportation and logistics sector.

The overall collapse of the Inland Empire economy brought migration into the area to a halt. Again, what was a part of the Inland Empire's competitive advantage has become a detriment to recovery. The population growth that took place particularly over the past ten years was the one of the key economic drivers for the area. However, economic recovery will end the slowdown in migration, allowing demand for housing, retail and services to grow again. Over time

the region's competitive advantage will lead to a resurgence in economic activity. The availability of abundant undeveloped land had been the major economic driver propelling the area's economic growth. The recession reversed that advantage as the downturn negatively impacted the industries that rely on cheap land the most. However, the Inland Empire will recover when home construction, manufacturing, industrial development and logistics make a comeback. However, the only sector that should potentially witness any real improvement over the short term is in logistics and warehousing.

Note that the Inland Empire economy in the long run will ultimately perform well due to its location as the central hub for logistics related to international trade and as the area where the most significant population growth is expected. Then, the key advantages for the Inland Empire will once again be the affordability of housing, population growth and available low-cost land for additional warehouse construction.



### Positive Forces through 2010 and into 2011

**Housing affordability:** Although home prices have rebounded in the first half of this year, housing affordability is much greater than before the recession. Prices are expected to stabilize over the remainder of the year. Going forward we expect housing to remain extremely affordable relative to where it was in earlier years.

**Goods Movement:** Trade volumes at local ports have experienced a very strong recovery so far this year and this trend is expected to continue for the remainder of the year and into 2011. The projected levels will still not be near the records set in 2006 and 2007. However, the increase in activity will positively impact the Inland Empire warehouse and distribution system network.

**Transportation projects:** Federal stimulus funds will boost infrastructure construction in the area and help create new jobs in the region's long suffering construction industry.

**Healthcare and education sectors:** These were the only two areas that grew throughout the economic recession. Expectations are for this trend to continue for the rest of the year and into 2011.

#### Negative Forces through 2010 and into 2011

**Housing:** High rates of defaults and foreclosures will pressure home values this year and into 2011 though the pace should gradually abate. Local governments continue to face significant financial issues over the next few years as property and sales taxes decline. However, the housing recovery is expected to continue in 2010 and 2011 albeit at a very slow pace.

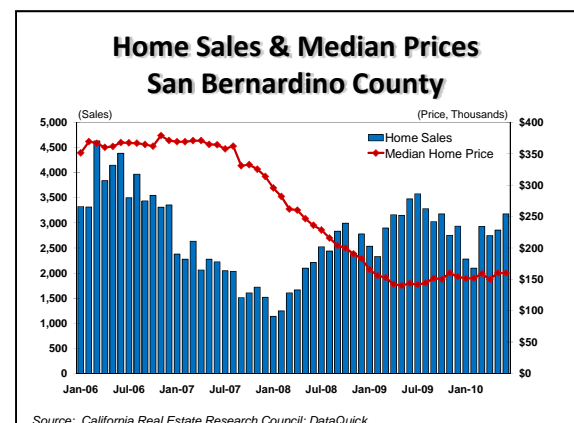
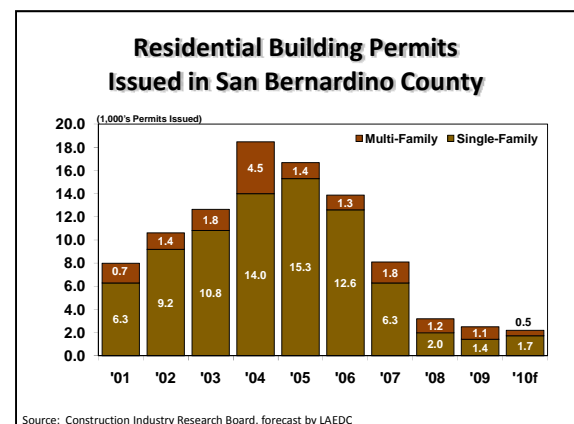
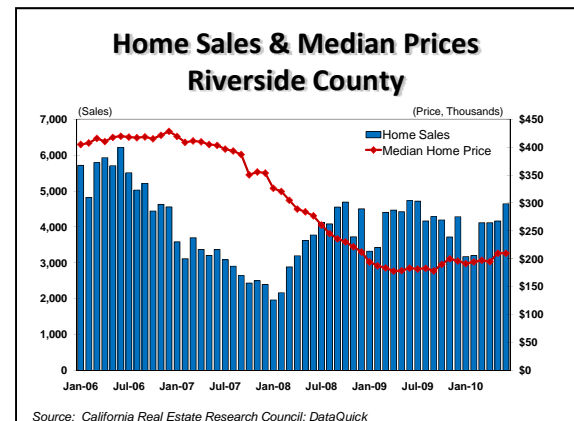
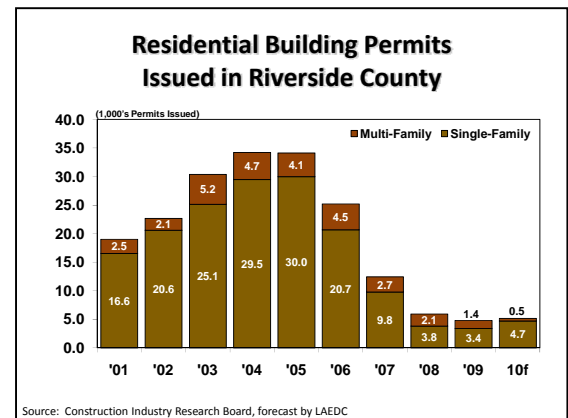
**Unemployment:** The Inland Empire still has one of the nation's highest unemployment rates among urban areas. Joblessness is forecasted to escalate this year before improving somewhat in 2011.

**State and Local Government sector:** State and local government employment should decline this year and next due to revenue constraints.

**Problems in commercial real estate:** Industrial and office vacancy rates are still very high and will continue to be a concern for the remainder of the year and into 2011.

**Weakness in tourism:** Travel to the Inland Empire has fallen off significantly. The leisure and hospitality sector is projected to lose over -2,000 jobs this year and then by 900 in 2011.

**Water supply:** This remains a very critical long-term issue for the area.



**Table 17:**  
**Riverside-San Bernardino Area Economic Indicators**

	Population on July 1 of (000s)	Nonfarm Employment (avg., 000s)	Unemp. Rate (avg., %)	Total Personal Income (\$ billions)	Per Capita Personal Income (\$)	Taxable Retail Sales (\$ billions)	Housing Unit Permits Issued	Nonresidential Building Permits (\$ millions)
2000	3,281.5	988.4	5.0	77.108	23,498	24.992	21,990	1,536
2001	3,392.6	1,029.7	5.2	83.538	24,624	26.699	27,541	1,423
2002	3,498.0	1,064.5	6.2	87.560	25,031	28.570	33,280	1,473
2003	3,631.0	1,099.2	6.3	93.702	25,806	31.936	43,001	1,720
2004	3,764.5	1,160.0	5.9	101.117	26,860	37.194	52,696	2,485
2005	3,895.3	1,222.0	5.3	108.599	27,880	41.960	50,818	2,394
2006	4,011.4	1,267.7	4.9	116.926	29,148	43.973	39,083	2,852
2007	4,100.5	1,270.9	5.9	122.811	29,950	42.578	20,457	2,824
2008	4,167.1	1,222.5	8.3	125.379	30,088	37.755	9,104	1,781
2009	4,191.9	1,131.9	13.7	120.364	29,177	31.150	6,681	709
2010f	4,250.6	1,108.0	14.6	122.771	28,117	32.395	7,350	560
2011f	4,318.6	1,120.8	14.2	128.296	28,713	34.015	9,920	670

% Change

'01/'00	3.4%	4.2%		8.3%	4.8%	6.8%	25.2%	-7.4%
'02/'01	3.1%	3.4%		4.8%	1.7%	7.0%	20.8%	3.5%
'03/'02	3.8%	3.3%		7.0%	3.1%	11.8%	29.2%	16.8%
'04/'03	3.7%	5.5%		7.9%	4.1%	16.5%	22.5%	44.5%
'05/'04	3.5%	5.3%		7.4%	3.8%	12.8%	-3.6%	-3.7%
'06/'05	3.0%	3.7%		7.7%	4.5%	4.8%	-23.1%	19.1%
'07/'06	2.2%	0.3%		5.0%	2.8%	-3.2%	-47.7%	-1.0%
'08/'07	1.6%	-3.8%		2.1%	0.5%	-11.3%	-55.5%	-37.0%
'09/'08	0.6%	-7.4%		-1.6%	-3.0%	-17.5%	-26.6%	-60.2%
'10/'09	1.4%	-2.1%		2.0%	-3.6%	4.0%	10.0%	-21.0%
'10/'11	1.6%	1.2%		4.5%	2.1%	5.0%	35.0%	19.6%

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept of Commerce Construction Industry Research Board; estimates and forecasts by the LAEDC

**Table 18:**  
**Riverside-San Bernardino Area Nonfarm Employment**

(Annual averages, in thousands, March 2009 benchmark)

	Total Nonfarm Payroll	Natural Resources	Construction	Manufacturing	Mfg. -- Durable	Mfg. -- Nondurable	Wholesale Trade	Retail Trade	Transport. & Utilities	Information
2000	988.4	1.3	79.9	119.7	85.3	34.4	38.2	127.0	46.3	14.3
2001	1,029.7	1.2	88.5	118.6	84.2	34.4	41.6	132.5	45.7	14.6
2002	1,064.5	1.2	90.9	115.4	82.0	33.4	41.9	137.5	46.8	14.1
2003	1,099.2	1.2	99.0	116.1	82.4	33.7	43.5	142.7	50.1	13.9
2004	1,160.0	1.2	111.8	120.1	85.5	34.6	45.6	153.8	55.5	14.0
2005	1,222.0	1.4	123.3	121.1	86.1	35.0	49.9	165.7	60.2	14.5
2006	1,267.7	1.4	127.5	123.4	86.9	36.5	54.2	173.2	63.8	15.3
2007	1,270.9	1.3	112.5	118.6	82.1	36.5	56.8	175.6	69.5	15.4
2008	1,222.5	1.2	90.5	107.0	72.6	34.4	55.1	168.0	70.2	14.8
2009	1,131.9	1.1	67.4	88.5	58.1	30.4	51.9	154.8	66.6	13.5
2010f	1,108.0	1.1	59.0	86.0	57.0	29.0	47.5	151.0	65.4	14.6
2011f	1,120.8	1.1	62.0	88.0	59.0	29.0	50.0	152.0	67.0	14.5

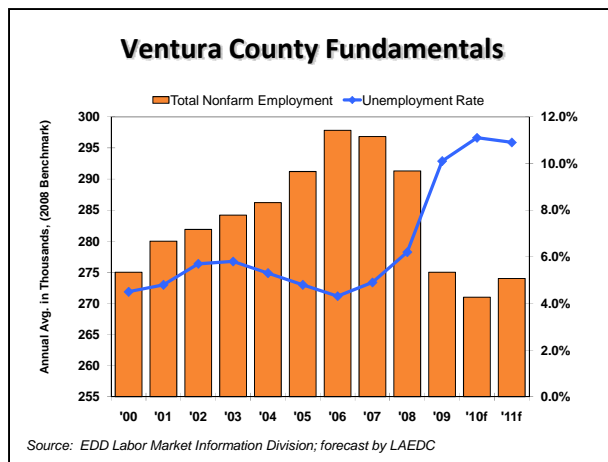
	Finance & Insurance	Rental & Leasing	Prof, Sci & Tech Srvs	Mgmt. of Enterprises	Admin. & Support Srvs	Educational Services	Health Care & Social Asst	Leisure & Hospitality	Other Services	Government
2000	21.5	14.2	22.1	10.3	64.4	11.1	90.7	100.6	34.8	192.1
2001	22.0	15.3	24.6	10.6	66.6	11.8	94.3	104.5	37.1	200.2
2002	23.5	15.9	27.1	11.3	68.4	12.6	99.8	107.2	38.1	212.7
2003	25.7	16.9	28.7	11.0	75.7	13.2	102.7	109.0	38.4	211.6
2004	28.0	17.7	31.0	11.6	82.9	13.4	104.9	116.7	39.3	212.5
2005	30.1	18.9	35.0	12.0	86.2	13.6	106.3	122.6	40.8	220.4
2006	31.7	19.9	39.9	10.8	91.7	14.1	108.0	128.1	42.5	222.5
2007	30.7	19.5	40.5	9.8	94.7	15.0	112.1	132.6	41.2	225.3
2008	27.8	18.5	40.1	9.9	86.7	15.8	115.9	130.1	40.9	230.0
2009p	27.0	16.5	38.2	8.8	77.7	16.4	116.2	123.0	36.6	227.3
2010f	27.2	15.9	37.2	8.6	76.9	17.0	117.2	120.9	36.5	226.0
2011f	27.1	15.9	38.0	8.9	78.2	19.0	118.0	120.0	36.6	224.5

Sources: California Employment Development Department, LMID; estimates and forecasts by LAEDC



## VIII. OUTLOOK FOR VENTURA COUNTY

Ventura County's economy has been in a rough patch since 2007, with year-to-year job losses that will carry through 2010. A variety of forces were at work, including: downsizings in the bio-medical industry, the fallout from financial industry mergers, a slowdown in activity at Port Hueneme, and very difficult times in construction and real estate. By the end of 2010, however, most of these clouds will have lifted, and positive growth is expected in 2011.



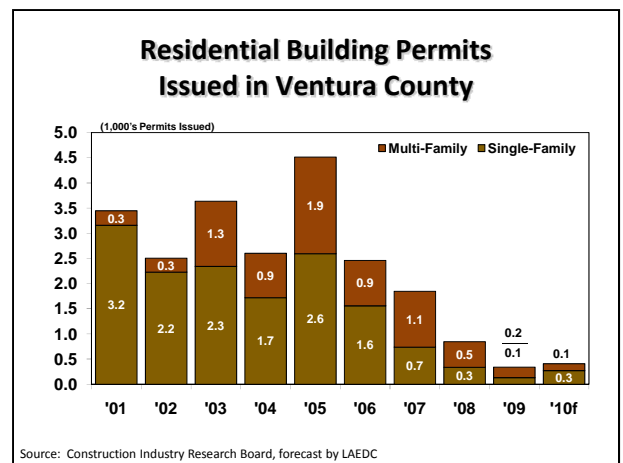
### Positive forces through 2010 into 2011

- While there were problems in the bio-medical industry, overall employment in health care and social services continued to grow.
- The County's agriculture industry should continue to record good results, although there is concern that changes in pesticide regulation could hurt the key strawberry crop.
- There is the military presence at Port Hueneme, which includes a Navy Seabee operation, and the Point Mugu Naval Air Station. The latter is part of Southern California's large network of military testing ranges which are being used intensively.

- There will be improved trends at the Port of Hueneme, due to strong sales of Hyundai and Kia vehicles. Both brands are imported through the facility.

### Negative forces through 2010 into 2011

- New homebuilding fell to stunningly low levels, with just 341 units permitted in 2009. The recent peak was 4,516 units authorized in 2005; so the pain for business in this sector is quite real.
- Commercial real estate markets in the County have also been hammered, with the office vacancy rate in early 2010 at 16.0%. This rate has been over 10% (considered a "balanced market") since the 4<sup>th</sup> quarter of 2007. These high vacancy rates primarily reflect the merger of Countrywide Finance into Bank of America. Industrial vacancy rates were also at high levels, 9.4% in the first quarter of 2010.

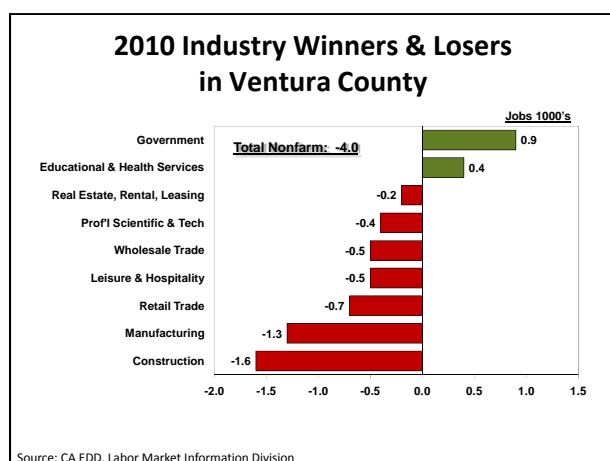


### Net results

Nonfarm employment in the County should decline by -1.5% or by -4,000 jobs in 2010. This will be the fourth annual decline in a row in this important indicator. As usual, the health care and social services sector should see an increase of +300 jobs. Also adding a few jobs during the

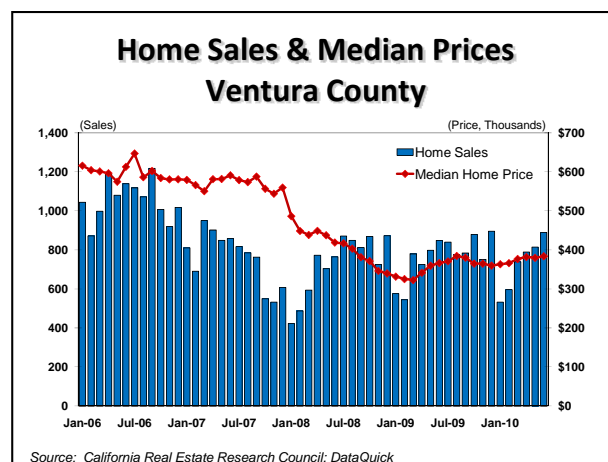
year will be finance and insurance, administrative and support services, and education. The largest employment losses during 2010 will come in construction (-1,600 jobs), and manufacturing (-1,300 jobs).

Nonfarm employment in the County will move back into a growth mode in 2011, up by +1.1% or by +3,000 jobs. However, government and management of enterprises will remain in the negative column, with losses of -300 jobs and -100 jobs, respectively. The largest increases during the year will come in retail trade (+700 jobs) and leisure & hospitality services (+500 jobs).



The county's unemployment rate has been running at distressingly high levels, with an average of 10.1% in 2009. For 2010, the rate will move up to an average of 11.1% (which would be the highest level in the last decade), before easing down to an average of 10.9% in 2011.

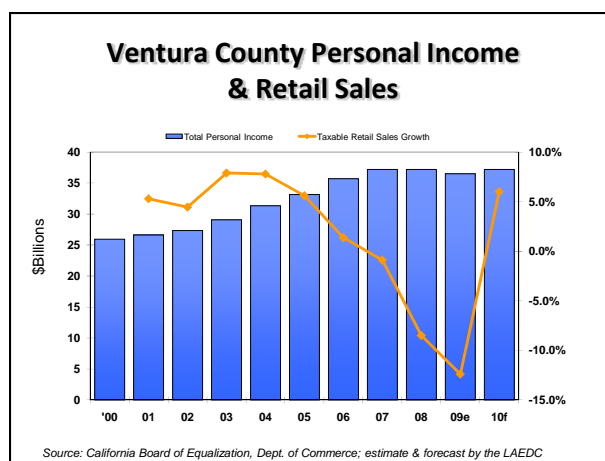
Ventura County's total personal income was unchanged in 2008, then declined by -1.8% in 2009. Growth will resume in 2011, with an increase of 4.3%. Per capita personal income declined in both 2008 and 2009, but will increase by +0.9% in 2010 to \$43,798. Retailing in the County had three difficult years starting in 2007, capped off by a -12.4% decline in 2009. Times will be better in 2010 with a forecast increase of +6.0%.



New homebuilding in the County will start to recover in 2010, with an increase in the number of units permitted of +20.2%. While this might sound good, the reality is that a still low total of 410 units will get their permits. In 2011 there will be continued growth, but only to 595 units; so times will remain difficult for construction related activities.

Nonresidential building permit values declined in 2008 and 2009 (the latter year saw a horrific -56.6% decline). In 2010 there will be continued slippage (-9.8%) reflecting those lofty office and industrial vacancy rate levels.

Like the rest of Southern California, Ventura County is moving into a slow and challenging economic recovery. The finances of government agencies will remain under pressure for the next few years, yet another concern.



**Table 19:****Ventura County Economic Indicators**

	Population on July 1 of (000s)	Nonfarm Employment (avg., 000s)	Unemp. Rate (avg., %)	Total Personal Income (\$ billions)	Per Capita Personal Income (\$)	Taxable Retail Sales (\$ billions)	Housing Unit Permits Issued	Nonresidential Building Permits (\$ millions)
2000	758.7	275.0	4.5	25.945	34,196	6.504	3,971	282
2001	772.4	280.0	4.8	26.624	34,470	6.848	3,446	309
2002	787.0	281.8	5.7	27.345	34,745	7.153	2,507	289
2003	798.4	284.2	5.8	29.068	36,408	7.717	3,635	379
2004	806.4	286.2	5.4	31.334	38,858	8.317	2,603	353
2005	811.9	291.2	4.8	33.151	40,833	8.782	4,516	372
2006	817.8	297.7	4.3	35.706	43,662	8.902	2,461	326
2007	823.5	296.8	4.9	37.192	43,943	8.823	1,847	346
2008	832.3	291.3	6.2	37.185	44,678	8.076	842	345
2009	841.0	275.0	10.1	36.500	43,401	7.075	341	150
2010f	849.4	271.0	11.1	37.200	43,796	7.500	410	135
2010f	858.7	274.0	10.9	38.800	45,185	7.950	595	150

**% Change**

'01/'00	1.8%	1.8%		2.6%	0.8%	5.3%	-13.2%	9.6%
'02/'01	1.9%	0.7%		2.7%	0.8%	4.5%	-27.2%	-6.5%
'03/'02	1.4%	0.9%		6.3%	4.8%	7.9%	45.0%	31.1%
'04/'03	1.0%	0.7%		7.8%	6.7%	7.8%	-28.4%	-6.9%
'05/'04	0.7%	1.7%		5.8%	5.1%	5.6%	73.5%	5.4%
'06/'05	0.7%	2.3%		7.7%	6.9%	1.4%	-45.5%	-12.4%
'07/'06	0.7%	-0.3%		4.2%	0.6%	-0.9%	-24.9%	6.1%
'08/'07	1.1%	-1.9%		0.0%	1.7%	-8.5%	-54.4%	-0.3%
'09/'08	1.0%	-5.6%		-1.8%	-2.9%	-12.4%	-59.5%	-56.5%
'10/'09	1.0%	-1.5%		1.9%	0.9%	6.0%	20.2%	-10.0%
'10/'11	1.1%	1.1%		4.3%	3.2%	6.0%	45.1%	11.1%

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept of Commerce Construction Industry Research Board; estimates and forecasts by the LAEDC

**Table 20:**
**Ventura County Nonfarm Employment**

(Annual averages, in thousands, March 2009 benchmark)

	Nonfarm Employment	Natural Resources	Construction	Manufacturing	Mfg. -- Durable	Mfg. -- Nondurable	Wholesale Trade	Retail Trade	Transport. & Utilities	Information
2000	275.0	0.7	15.4	41.1	27.7	13.4	10.3	33.6	5.6	7.9
2001	280.0	0.6	16.1	40.5	26.6	13.9	11.0	34.0	5.9	8.4
2002	281.8	0.7	15.7	38.0	24.9	13.1	11.7	34.2	5.8	8.1
2003	284.2	0.6	16.6	37.0	24.0	13.0	11.8	34.5	5.6	7.2
2004	286.2	0.7	16.9	38.3	24.2	14.1	12.2	35.3	5.7	6.8
2005	291.2	0.8	18.8	37.8	23.9	13.9	12.5	36.5	5.8	6.2
2006	297.7	1.1	20.5	38.4	24.1	14.3	12.6	37.6	6.1	6.0
2007	296.8	1.1	18.8	38.0	23.9	14.1	13.0	37.6	6.1	5.8
2008	291.3	1.2	16.7	35.9	23.2	12.7	12.8	37.3	6.0	5.6
2009	275.0	1.2	13.3	32.6	20.5	12.2	12.1	34.7	5.3	5.2
2010f	271.0	1.2	11.7	31.3	19.5	11.8	11.6	34.0	5.3	5.0
2011f	274.0	1.2	12.0	31.3	19.5	11.8	11.8	34.7	5.6	5.0

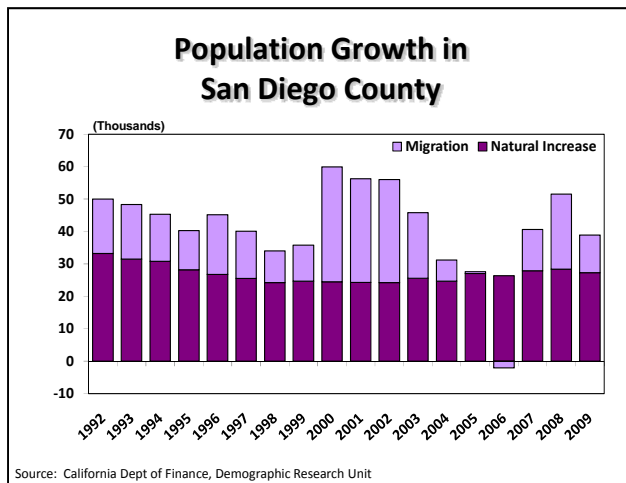
  

	Finance & Insurance	Real Estate, Rental&Leasing	Prof., Sci. & Tech. Svc.	Mgmt. of Enterprises	Admin. & Support Svc.	Educational Services	Health Care & Soc. Asst.	Leisure & Hospitality	Other Services	Government
2000	13.8	4.0	13.2	3.7	22.6	6.4	17.7	25.1	9.7	44.3
2001	15.5	4.2	13.8	3.4	20.0	7.1	18.2	26.6	9.6	45.1
2002	17.7	4.6	13.7	3.3	19.6	7.5	18.8	27.2	10.2	45.3
2003	19.2	4.3	13.6	3.9	19.4	7.8	19.8	27.6	10.4	44.8
2004	19.8	4.4	14.2	3.6	19.5	7.8	19.7	28.5	10.3	42.5
2005	20.0	4.4	15.1	3.5	19.8	7.9	20.4	29.2	10.4	42.2
2006	19.6	4.5	16.0	3.3	20.1	7.9	21.0	30.5	10.2	42.5
2007	17.9	4.8	16.2	3.2	18.9	8.9	21.6	32.0	9.9	43.0
2008	16.4	4.7	16.7	3.1	18.6	9.3	22.5	31.5	10.0	43.1
2009	16.1	4.3	16.2	2.9	17.0	9.1	23.1	29.5	9.4	42.9
2010f	16.2	4.1	15.8	2.7	17.1	9.2	23.4	29.0	9.6	43.8
2011f	16.3	4.2	16.0	2.6	17.5	9.3	23.7	29.5	9.8	43.5

Sources: California Employment Development Department, LMD; estimates and forecasts by LAEDC

## IX. OUTLOOK FOR SAN DIEGO COUNTY

San Diego County certainly shared the pain with the rest of Southern California in 2009. Construction, real estate, manufacturing and retail trade all suffered large employment declines. Still, the County's core strengths – its diverse economy, desirable location and demographic profile – place San Diego County on solid footing to retake the ground it lost during the recession.



### Positive Forces

- While there have been some layoffs in the **Defense and Aerospace Industry**, employment has been fairly stable. Congress finalized the Pentagon's spending plan earlier this year. Billions of dollars are expected to flow into the San Diego region. General Dynamics NASSCO (the County's major shipyard) will get funding to produce the final two USN cargo vessels out of a total order of 14 (total construction value estimated at \$5.2 billion). The new spending plan also will restore funding for five Global Hawk aircraft (robotic spy planes) built by Northrop Grumman, thereby saving 500-600 jobs in Rancho Bernardo. Another drone plane (BAMS) also built by Northrop will get \$441.8 million, employing 172 people in their San Diego R&D facility. Various other defense programs are also on the slate for the County's defense and aerospace industry.

- The military is also embarking on a number of sizable **construction** projects. The USMC Air Station at Miramar has awarded a \$19.5 million contract to a local builder to modify an existing hanger to accommodate new types of aircraft. On a larger scale, the Navy expects to oversee \$2.3 billion in expenditures for capital improvement in Southern California – much of it going to San Diego. Camp Pendleton is planning to build a \$563 million hospital (contract to be awarded September 2010) with another \$1.41 billion allocated for other improvements to the base. These projects will provide employment for about 3,200 construction workers. Military initiatives have been instrumental in slowing the decline in construction jobs.

- Private nonresidential construction** has declined precipitously, but there are still some significant projects in the works. The \$600 million Palomar Pomerado Health PMC West (hospital) project is scheduled for completion in 2011. Scripps Memorial Hospital in Encinitas is working on a \$350 million expansion project, while a new \$430 million cardiovascular institute (scheduled for completion in 2015) is part of a \$700 million renovation of the Scripps La Jolla campus. Poseidon Resources has been approved to start construction of a \$300 million desalination plant in Carlsbad.

The Port of San Diego has embarked on a \$28 million project to add a second cruise ship pier and to renovate the existing terminal. Work on the project is expected to be completed by October 2010.

### Negative Forces

- Tourism** has long been a positive mainstay of San Diego County's economy. The industry was hit hard in 2009, but is expected to turn up in 2010. Hotel occupancy rates are on the upswing and the region will benefit from the

- “drive” trade (nearby visitors coming from Los Angeles or Arizona) and by local companies booking meetings, especially firms in the bio-medical, high tech and healthcare industries.
- **Retail Trade:** The area economy will get a modest boost from consumer spending this year. Demand is restrained due to uncertainty in the job market. People are also saving more of their disposable income.
- Delays at the **San Ysidro border crossing** are a given, but recent enhanced efforts by the US and Mexico to check the flow of illegal drugs, guns, cash and stolen cars into Mexico have increased congestion. This could have a negative effect on San Diego businesses as longer transit times increase costs.

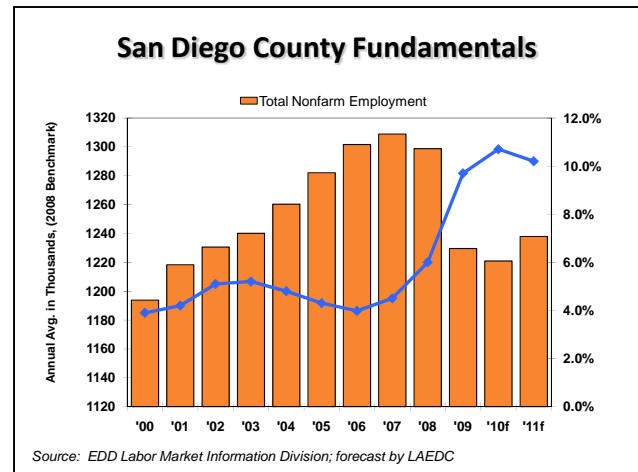
### Net Results

San Diego, along with the rest of Southern California will continue to lose jobs this year. Nonfarm employment in San Diego County is likely to fall by -0.7% or -8,700 jobs in 2010, after a -5.3% drop in 2009. In 2011, the employment situation will begin to improve, thought at a fairly moderate pace, with job counts increasing by +1.4%. The biggest employment losses in 2010 will come from government (-2,700 jobs) and retail (-2,400 jobs). Small employment gains should be recorded in health care (+600 jobs) and construction (+100 jobs).

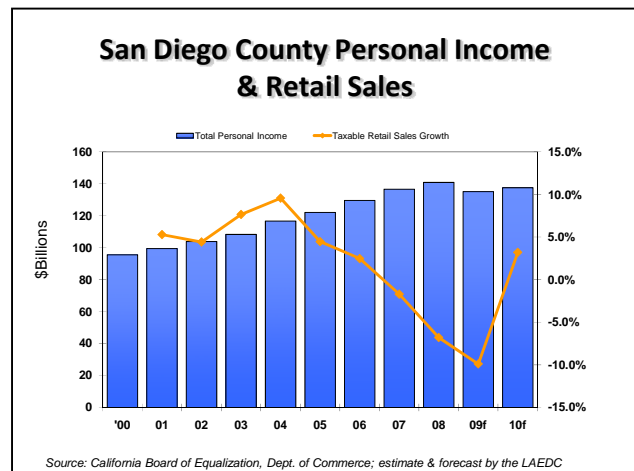


The County's unemployment rate should average 10.7% in 2010 compared with the 2009 average

of 9.7%. In 2011, the unemployment rate is expected to average 10.2%.

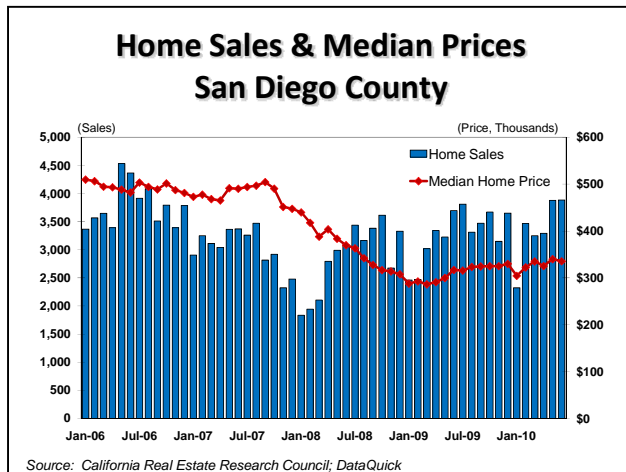
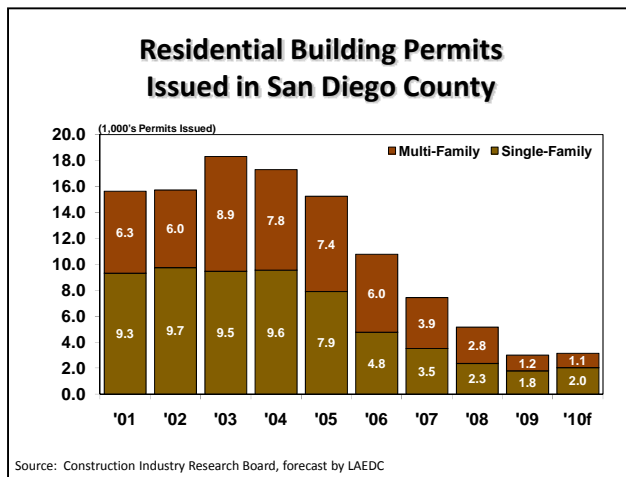


Personal income in San Diego County will increase by +1.8% in 2010. Per capita personal income should average \$42,651, up by +1.3% from 2009. The retail situation has been dismal, with taxable retail sales dropping by an estimated -9.9% in 2009. In 2010, retail will reverse course and increase by +3.2% and in 2011 post a stronger gain of +5.2%.



San Diego County's housing market has been subjected to intense scrutiny, as problems in the housing industry showed up here first (the downtown condo development surge and bust). The number of housing units permitted peaked back in 2003 at 18,314 units. In 2009, just 2,989 units were permitted. In 2010, residential

construction should see an improvement with 3,135 permits issued.



Nonresidential construction, however, will continue to decline, dropping by -9.2% in 2010 (after falling by -45% in 2009). Although office tenants are renewing leases, they are looking for ways to reduce their space requirements. In the near term, there may be some growth in government tenants, but office vacancy rates in the County shot up to 20.4% during the first quarter of 2010, with 292,807 square feet of new space still under construction (down from 700,000 square feet at the end of 2008). Tight credit conditions also continue to be a problem. San Diego's lack of a major commercial port or a gateway airport has impaired the market for office (and retail) space. Industrial space was less

affected but the vacancy rate in the first quarter of 2010 was still quite high at 12.5%.

The number of overnight visitors to the County will increase just a bit in 2010 - by +3.5% to 14.9 million visitors. This compares with a recent high of 15.8 million in 2006. Fewer visitors equates to declining hotel rates, which in turn are exerting downward pressure on hotel values. In 2009, San Diego County had a disproportionately high number of hotel properties in foreclosure compared with the rest of the state. This has been a little unnerving for the travel and tourism industry (one of San Diego's top job creators), after a string of years with 15 million or more overnight visitors. On the other hand, 2010 already has a steady flow of meetings and conventions booked, which are estimated to support 12,500 jobs county-wide and to generate \$542 million in spending and \$18.7 million in tax revenue

Two-way trade through the San Diego Customs District will improve in 2010, rising by +7.8% to \$47.4 billion.

### Hot Spots

This list is still pretty sparse, but increased military spending, and some large construction projects (hospitals, highways, military facilities) provide a bit of optimism. San Diego is also home to 850 communications companies. Local technology companies employ more than 300,000 people and benefit from the proximity of Department of Defense laboratories. The convergence of San Diego's vibrant information, energy and biotech sectors will be important growth drivers for the economy.

### Risks

Continued uncertainty about the local economy and high rates of unemployment through 2010 and 2011 will result in sluggish personal income growth and restrained consumer demand and business investment. Water shortages are an ongoing problem, especially for the County's agricultural sector. Lower properties values will hurt local government revenues, resulting in budget and spending constraints.



**Table 21:****San Diego County Economic Indicators**

	Population on July 1 of (000s)	Nonfarm Employment (avg., 000s)	Unemp. Rate (avg., %)	Total Personal Income (\$ billions)	Per Capita Personal Income (\$)	Taxable Retail Sales (\$ billions)	Value of Two-way Trade (\$ billions)	Total Overnight Visitors (millions)	Housing Unit Permits Issued	Nonresidential Building Permits (\$ millions)	Chg. in CPI (%)
2000	2836.3	1193.8	3.9	95.507	33,673	24.953	35.0	15.2	15,927	1,391	5.8
2001	2892.5	1218.4	4.2	99.445	34,380	26.263	33.6	14.8	15,638	1,194	4.6
2002	2948.5	1230.7	5.1	103.817	35,210	27.422	35.7	15.0	15,738	1,169	3.5
2003	2994.3	1240.1	5.2	108.298	36,168	29.521	35.6	15.4	18,314	1,169	3.7
2004	3025.5	1260.3	4.8	116.646	38,554	32.345	39.4	15.7	17,306	1,288	3.7
2005	3053.1	1282.1	4.3	122.033	39,970	33.785	43.2	15.7	15,258	1,382	3.7
2006	3077.3	1301.6	4.0	129.585	42,110	34.619	50.5	15.8	10,777	1,622	3.4
2007	3117.9	1308.8	4.5	136.616	43,816	34.039	53.9	15.4	7,445	1,417	2.3
2008	3169.5	1298.7	6.0	140.847	44,438	31.716	53.4	15.2	5,154	1,062	3.9
2009	3208.5	1229.6	9.7	135.058	42,094	28.588	44.0	14.4	2,989	584	0.0
2010f	3224.4	1220.9	10.7	137.525	42,651	29.500	47.4	14.9	3,135	530	2.0
2011f	3247.0	1237.9	10.2	144.264	44,430	31.025	49.8	15.3	4,235	580	2.0

**% Change**

'01/'00	2.0%	2.1%		4.1%	2.1%	5.3%	-4.0%	-2.6%	-1.8%	-14.2%
'02/'01	1.9%	1.0%		4.4%	2.4%	4.4%	6.3%	1.4%	0.6%	-2.1%
'03/'02	1.6%	0.8%		4.3%	2.7%	7.7%	-0.5%	2.7%	16.4%	0.0%
'04/'03	1.0%	1.6%		7.7%	6.6%	9.6%	10.7%	1.9%	-5.5%	10.2%
'05/'04	0.9%	1.7%		4.6%	3.7%	4.4%	9.6%	0.0%	-11.8%	7.3%
'06/'05	0.8%	1.5%		6.2%	5.4%	2.5%	17.0%	0.6%	-29.4%	17.4%
'07/'06	1.3%	0.6%		5.4%	4.1%	-1.7%	6.7%	-2.5%	-30.9%	-12.6%
'08/'07	1.7%	-0.8%		3.1%	1.4%	-6.8%	-0.8%	-1.3%	-30.8%	-25.1%
'09/'08	1.2%	-5.3%		-4.1%	-5.3%	-9.9%	-17.7%	-5.3%	-42.0%	-45.0%
'10/'09	0.5%	-0.7%		1.8%	1.3%	3.2%	7.8%	3.5%	4.9%	-9.2%
11/'10	0.7%	1.4%		4.9%	4.2%	5.2%	5.1%	2.7%	35.1%	9.4%

Sources: State of California: Dept. of Finance, Employment Development Department, Board of Equalization; U.S. Dept of Commerce Construction Industry Research Board, Tourism Economics; estimates and forecasts by the LAEDC

**Table 22:**  
**San Diego County Nonfarm Employment**

(Annual averages, in thousands, March 2009 benchmark)

	Total Nonfarm Payroll	Natural Resources	Construction	Manufacturing	Mfg. -- Durable	Mfg. -- Nondurable	Wholesale Trade	Retail Trade	Transport. & Utilities	Information
2000	1,193.8	0.3	69.7	122.6	92.2	30.4	39.1	133.8	29.8	39.2
2001	1,218.4	0.3	75.1	119.1	89.3	29.8	41.5	135.6	32.0	38.8
2002	1,230.7	0.3	76.4	112.4	84.7	27.7	41.3	138.0	29.3	37.7
2003	1,240.1	0.3	80.2	105.3	78.8	26.5	41.6	140.8	27.3	36.9
2004	1,260.3	0.4	87.7	104.3	78.1	26.2	41.9	144.9	28.4	36.6
2005	1,282.1	0.4	90.8	104.5	79.1	25.4	43.6	147.4	28.4	37.4
2006	1,301.6	0.5	92.7	103.9	78.4	25.5	45.1	148.3	28.7	37.3
2007	1,308.8	0.4	87.0	102.5	77.3	25.2	45.5	148.1	28.8	37.6
2008	1,298.7	0.4	76.1	102.8	78.1	24.7	44.9	142.0	29.0	38.5
2009	1,229.6	0.4	61.1	95.4	73.2	22.2	40.7	130.5	27.1	37.0
2010f	1,220.9	0.4	61.2	95.0	72.7	22.3	40.3	128.1	27.0	36.5
2011f	1,237.9	0.4	62.0	94.1	73.1	21.0	40.9	131.3	27.4	37.9

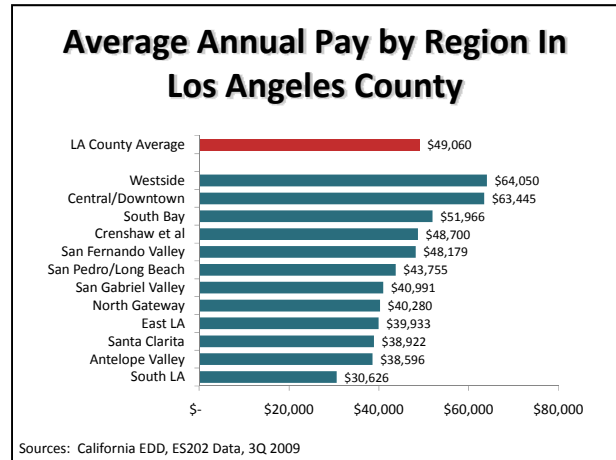
	Finance & Insurance	Real Estate, Rental & Leasing	Prof, Sci & Tech Svs	Mgmt. of Enterprises	Admin. & Support Svs	Educational Services	Health Care & Social Asst	Leisure & Hospitality	Other Services	Government
2000	44.0	27.2	92.3	18.7	84.2	18.2	97.2	129.0	42.2	206.6
2001	44.9	27.2	98.3	18.6	81.3	17.2	98.8	131.4	44.9	213.8
2002	47.3	27.7	100.8	19.9	81.0	17.2	102.5	133.8	45.6	219.7
2003	51.2	28.8	101.6	19.1	80.5	18.8	103.0	140.7	46.8	217.3
2004	52.8	29.1	99.8	18.2	86.6	20.1	101.6	145.7	47.9	214.3
2005	53.5	29.7	105.9	17.4	87.2	21.1	101.4	149.6	48.8	215.1
2006	53.2	30.5	109.7	16.9	87.1	21.3	103.8	156.5	48.4	217.9
2007	50.2	30.1	112.3	16.1	88.4	22.0	107.6	161.8	48.3	222.4
2008	46.1	29.2	113.3	15.9	85.9	24.4	112.9	164.0	48.4	225.1
2009	43.8	26.5	108.1	15.3	74.0	26.1	116.9	155.2	47.0	224.7
2010f	43.5	26.3	108.1	15.1	73.5	25.8	117.5	154.1	46.5	222.0
2011f	43.9	26.7	109.7	15.3	74.5	26.4	119.9	156.3	47.3	226.1

Sources: California Employment Development Department, LMID; estimates and forecasts by LAEDC

## X. OUTLOOK FOR LOS ANGELES SUB-COUNTY ECONOMIC AREAS

The LAEDC frequently receives requests for information about sub-regions in Los Angeles County. A special feature of the Mid-Year Forecast is a review of trends in 12 areas of Los Angeles County. These are natural market areas, defined by city limits, freeways and geographic features. As such there is quite a disparity in size among them. They are reported in alphabetical order.

The main indicator for all of these regions is employment. Data have been obtained from the California Employment Development Department's ES 202 files.



**Antelope Valley:** The region's housing market remains in the doldrums, while nonresidential construction is running at low levels. However, there is evidently a lot of work on advanced aerospace projects, including production of the unmanned Global Hawk. Boeing, Lockheed Martin and Northrop Grumman all have major research facilities in the Valley. The largest employment sectors are government, professional business services, and education and health.

After reaching a recent high of 77,800 jobs in 2008, employment in the Valley declined by -3.9% or by -3,000 jobs to an average of 74,800 jobs in 2009. Another decline, albeit more modest, is on tap for 2010, of -1.1%. The employment sectors in the region feeling the most pain have been retailing and professional and business services. Manufacturing, however, saw only modest losses. Note that a significant number of the Valley's residents commute into the San Fernando Valley and other areas of Los Angeles County for work.

**Crenshaw/Mid-cities/Hollywood:** There were problems for residential in the Korea Town area, and little new development can be expected in

the near term. There was also a lot of retail/entertainment development in this area, and some of these projects have also run in to problems. In Hollywood, the opening of the W Hotel has added capacity to this popular market, and the area is awaiting the opening of the Cirque de Soleil at the Kodak Theater. The rebound in motion picture/TV production has also given a boost to the employment situation. On the southern edge of the region, construction of the Exposition Blvd. light rail is moving along. The largest employment sectors are education and health (Kaiser Permanente and Children's Hospital), professional and business services, and leisure.

Total employment in the region declined by -5.6% or by -11,400 jobs in 2009 to an annual average of 235,900 jobs. Significant losses were recorded in professional and business services, and information (which includes motion picture production). For 2010, a very modest decline of -0.1% is expected despite the recovery in the entertainment industry.

**Central/Downtown:** The condo/residential market has been struggling, with little relief (and little new construction) expected in the near term. However, the hotels at LA Live have

opened, and the operators have been very aggressive in booking events. Moreover, the hotels arrival has enabled the Convention Center to book more business shows. Construction continues on the Exposition Blvd. light rail line, and on the LA Trade Technical College campus. The development process on the Wilshire/Grand project (a new hotel) is moving along, and ground has been broken on a new Civic Park, a \$56 million project. A decision will be made soon on construction of the Broad Art Museum on Grand Ave. The County's apparel industry is centered in the area, and this sector has been struggling. Employment numbers in the region are impacted by the huge government presence. The other major employment sectors are professional and business services, and education and health.

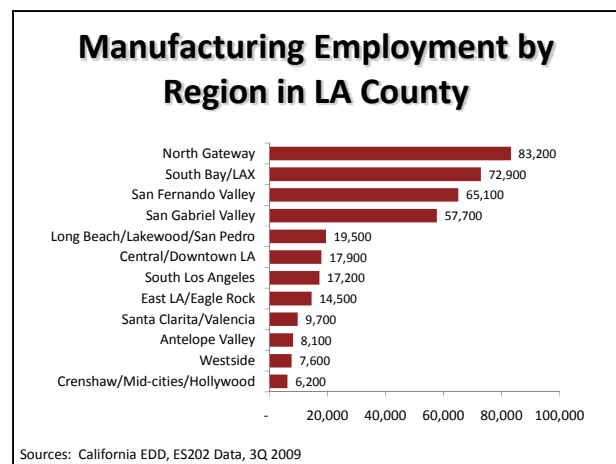
In 2009, total employment fell by -2.6% or by -12,300 jobs to an annual average of 453,100 jobs. In 2010, there should be little change. The biggest losses have been in business and professional services, and apparel manufacturing. Prospects for the former are improving.

#### **East Los Angeles/Eagle Rock:**

The unincorporated area of the County is again exploring the possibility of becoming an incorporated city (it would be the County's 89<sup>th</sup>). In the meantime, some floors in the "old" County-USC building are being developed as an incubator for bio-medical firms. There is also significant new construction on the USC Health Sciences Campus. The top employment sectors are government, manufacturing, and education and health.

Total employment in the region declined by -3.4% or by -3,400 jobs in 2009 to an annual average of 95,300 jobs. A -1.0% decline is forecast for 2010. A problem for the region is its exposure to the manufacturing sector, which has been under pressure.

**North Gateway:** The southeastern area of Los Angeles County struggled in 2008 and 2009. The region's exposure to both manufacturing (it has the largest number of factory jobs of any area in the County) and to international trade was a one/two punch. Some smaller cities in the northern part of the region are under financial pressures. The rebound in international trade will help, but the manufacturing sector will remain under strain into 2011. Another indicator of the pain is the jump in the region's industrial vacancy rate to 5.1% in early 2010 from just 1.8% a year earlier.



In 2009, total employment in the region declined by -6.1% or by -29,500 jobs to an annual average of 451,500 jobs. Manufacturing and wholesaling accounted for the lion's share of the losses. There will be further, but more moderate job losses in 2011 of -1.5%.

**San Fernando Valley:** Things are looking up for the Valley. The shakeout in the financial services sector has come to an end. Times were also difficult for the motion picture/TV production industry which is centered in the Valley's southeast quadrant. However, the rebound in filming activity at year-end 2009 should carry over into 2010. Work continues on the Orange Line busway extension from Woodland Hills to Chatsworth, and on the performing arts center at Cal State Northridge. Another plus for 2010 is the opening of the King Kong in 3-D attraction at Universal Studios Hollywood.

In 2009, total employment declined by -4.5% or by 33,900 jobs to an annual average of 716,400 jobs. The largest loss was in information, but professional and business services, construction and manufacturing all took hits. The good news is that only a -0.1% decline in employment is forecast for 2010. Hooray for North Hollywood and Studio City!

**San Gabriel Valley:** While the region's largest employment sectors are education and health, professional and business services, retail trade and government, the area also took a beating from the decline in international trade and manufacturing. Construction should get a boost from the extension of the Gold Line light rail from east Pasadena to Azusa. Despite the turmoil in manufacturing and wholesaling, the Valley's industrial vacancy rate has held at fairly low levels, 4.1% in early 2010.

In 2009, total employment fell by -5.1% or by -33,000 jobs to an annual average of 616,600 jobs. Another decrease is expected in 2010, of -2.3%. Helping will be the recovery in international trade activity, but manufacturing will remain under pressure.

**San Pedro/Long Beach/Lakewood:** The top employment sectors in this region are government, professional and business services, and leisure and hospitality. The area was obviously hurt by the slump in international trade, so this sector's recovery is very welcome news. More good news comes from progress on the construction of new container terminals at the ports of Long Beach and Los Angeles. Also, work is at last moving ahead on terminal improvements at the Long Beach Airport. Prospects for tourism are also improving. There is drama involving the fate of the C-17 military airlifter. There is no money in the 2011 DoD budget, with the threat of a presidential veto if Congress inserts funds as they have in the past. There are some foreign orders, and right now production of the plane could go into 2013.

Total employment fell by -3.2% or by -7,400 jobs in 2009 to an annual average of 225,500 jobs. For 2010 a more modest -0.8% decline is being forecast.

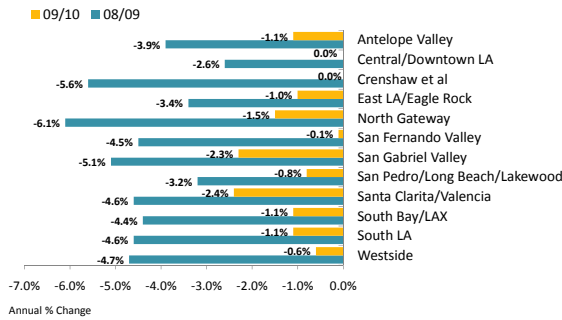
**Santa Clarita/Valencia:** The top employment sectors are professional and business services, government, retail, and leisure and hospitality services. The area also has exposure to the motion picture/TV production industry, thanks to some rental sound stages. The latter was a bad news/now good news situation, with the good news being the rebound in film production. In the future is construction of new production facilities for the Walt Disney Company. The region is also struggling with an overhang of office space, with a 25.9% vacancy rate at the start of 2010. The recovery in tourism to Southern California is good news, with Six Flags Magic Mountain developing a "family friendly" roller coaster.

In 2009, total employment in the region fell by -4.6% or by 3,900 jobs to an annual average of 80,300 jobs. Professional and business services was hit extremely hard. For 2010, employment should fall by -2.4%.

**South Bay/LAX:** The recovery in international trade is good news for the region, as is the work at LAX, including the renovation and expansion of the Tom Bradley International Terminal. On the business front, passenger traffic at LAX is increasing, while the aerospace sector in El Segundo/Redondo Beach has gotten some new contracts. Despite the recession, the industrial vacancy rate in the region has been holding at rather low levels, 2.7% in early 2010.

Total employment in the region declined by -4.4% or by -20,700 jobs in 2009 to a total of 448,700 jobs. Manufacturing (the region has the second largest number of factory jobs in the County) and professional and business services were hit the hardest. In 2010, a further decline of -1.1% is projected.

### Change in Employment by Region in Los Angeles County



**South Los Angeles:** The largest employment sectors in the region are manufacturing, private education and health, so the difficult times in the former took a toll on the region. Work on the Exposition Blvd. light rail line is a plus (it runs along the northern edge of the region), while there is serious discussion of a light rail line down Crenshaw Blvd. An ongoing problem for the region is a shortage of larger blocks of developable land.

In 2009, total employment fell by -4.6% or by -4,500 jobs to a total of 94,300 jobs. In 2010 a further decline of -1.1% is being forecast.

**Westside:** The region's largest employment sectors are professional and business services, leisure and hospitality, and government. There is also a significant exposure to the motion picture industry, which was stressed in 2008 and most of 2009. Worse, there is exposure to financial services, which was hard hit in the downturn. Another problem for the area is fairly high office vacancy rates, with a significant amount of new space still under construction. Lots of public works construction is under way in the region, including the expansion/improvement of the 405 Freeway (from the San Fernando Valley into the Westside), and the first stage of the Exposition Blvd. light rail line which will go as far west as Culver City. The ultimate plan here is to take the line into Santa Monica, but there is some local opposition. The revitalized Santa Monica Place shopping center will open in the second half of 2010, and should give a boost to the retail scene with both a Bloomingdale's and a Nordstrom.

Total employment in the region fell by -4.7% or by -21,100 jobs in 2009 to an average of 425,600 jobs. The largest losses came in professional and business services and retail (there still were/are a lot of vacancies in high-end retail districts). In 2010, a more modest drop in employment of -0.6% is projected.

## XI. MAJOR ECONOMIC DRIVERS OF THE SOUTHERN CALIFORNIA ECONOMY

The concept of an “economic driver” is that the industry or sector sells a significant portion of its goods or services outside the region, thus bringing new money into the Southern California economy. The region has a diverse array of drivers, but most were impacted by the great recession. Moreover, the pace of recovery among them will be quite uneven.

In each Forecast, performance ratings of the region’s largest drivers are presented using a scale ranging from “A” to “D.” This scale is based on overall industry prospects, and is not based on job growth or profitability.

**Table 23:**  
***Performance Ratings of Major Industries***

Industry	Grade	Comments
Aerospace: defense	C	Refocusing of Department of Defense with effort to cut "waste"; some key regional programs (C-17 & F-35 under scrutiny)
Aerospace: commercial	B-	Airlines have made it through the recession and there is a modest uptick in orders. Airbus & Boeing are stepping up production rates
Apparel design & manufacturing	C-	Consumers shopping a little more, but still focused on value. Stores still cautious in ordering and also interested in value.
Business & professional mgmt. services	B/C-	Best prospects for engineering and R&D. A rapid rebound in advertising. New federal regulations bode well for advisory work by accounting and law.
Financial services	C/B	Bank lending is weak at best. There are still problems in commercial real estate and land development. Smaller banks still at risk; investment banking in better shape.
Health care services	C/C-	Hospitals and providers still under financial stress. Impacts of health care reform still to be sorted out.
Health services: bio-medical	C+	Funding still a little tight, but possible benefits from federal health care reform. Some expansions in Orange County.
International Trade/Goods movement	B	Rebound in international trade, both exports and imports. New terminal projects underway at both ports.
Motion picture/TV production	B	Business model is still in flux, but there has been a rebound in TV production. State film incentives helping; run-away production still a concern.
Technology	C+	Lots of new consumer products and business spending on technology is picking up.
Tourism & travel	B	New attractions at local theme parks. Downtown Los Angeles Convention Center hotel attracting more business show. Pleasure travel is picking up.



## Aerospace

The uncertainty in some key segments of this industry remains in place. There is a shift in defense spending resulting from the recent Quadrennial Defense Review. The focus of the DoD will shift from fighting two major wars at once to fighting a wide array of contingencies. This will impact the type of equipment procured by the DoD. There is also an effort to wring “waste” out of the defense budget, which could put pressure on contractor profits. There will be very modest growth in DoD spending in the near term, and several defense agencies are facing major funding shortfalls through 2017. However, there is still talk of buying a new bomber, although its parameters have not been set.

Of interest to Southern California is the fate of the C-17 military air lifter built by Boeing in Long Beach. No money is in the 2011 DoD budget for it, with the threat of a presidential veto if Congress puts some in (as they have done in the last few years). With existing Air Force orders and foreign orders, production of the plane could run to September 2013. A recently completed Mobility Requirements Study says that the Air Force needs a little over 300 strategic air lifters, which includes both C-17s and the aging C-5.

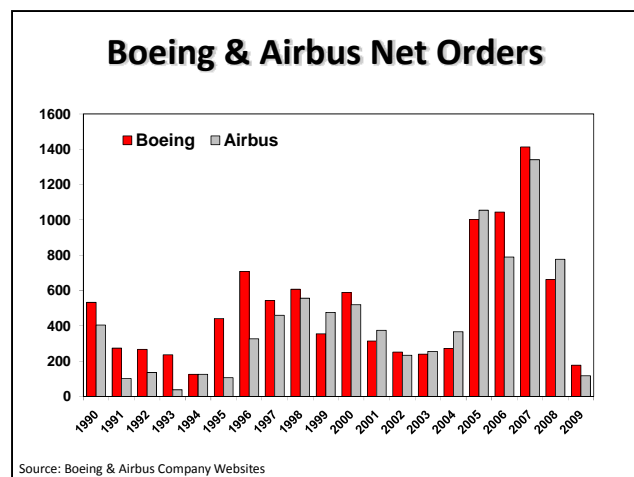
The F-35 fighter has encountered significant budget over-runs, and there is a push back on both program cost as well as the number of planes to be ordered. A large amount of subcontracting on the F-35 is done in Southern California.

An on-going drama for the military is the tanker replacement, and this program is still up in the air. Also, there is continuing development and production work being done in Southern California on unmanned aerial vehicles, much of it in the Antelope Valley.

On the commercial aircraft front, both Airbus and Boeing are increasing their production rates, as new orders are up. The airlines seem to have weathered the recession storm. Both makers are

NASA also faces a lot of uncertainty and controversy over the Obama administration’s decision to scrap the Constellation program (the replacement for the Space Shuttle, which will be retired at the end of 2010). There has been considerable push-back from Congress, especially from members in Florida, Texas and Alabama who stand to lose a lot of jobs from this action (California did not have a major stake in this program). No real decisions can be expected until after the November 2010 elections. However, this dispute is getting bitter. One aspect of President Obama’s proposal is to use commercially built space equipment. Locally based SpaceX has successfully tested a launch rocket that could take crew and cargo to the International Space Station. Moreover, advanced R & D is still being conducted with the best example being the X-37, a pilotless space plane developed by Boeing at their Orange County facilities.

There is also a new policy proposal from the Obama administration regarding the nation’s overall approach to space. However, it could also be controversial.



looking at updating their narrow-body offerings, as they are facing more competition at the lower end of this market, from companies in Canada, China and Brazil.

Finally, the organizational framework for planning and launching U.S. cyber attacks and defending military networks is in place. This could benefit firms in Southern California as they have major expertise in advanced communications.

Employment in aerospace in Southern California will continue to decline in both 2010 and 2011, as both contractors and their subs try to become more efficient in light of the new DoD environment.

**Table 24:**

***Aerospace Employment***

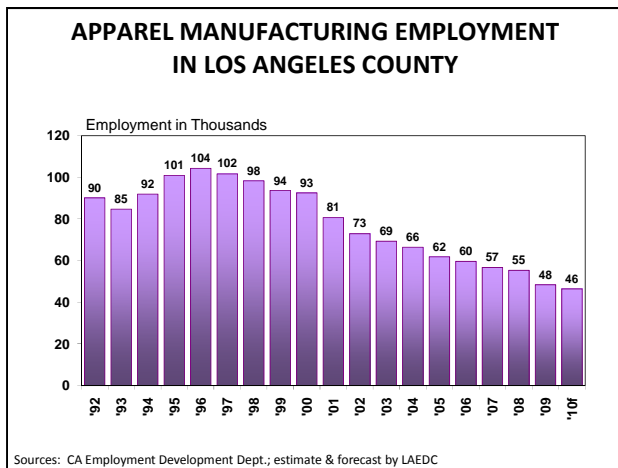
	2007	2008	2009	2010e	2011f	%chg. '07/'06	%chg. '08/'07	%chg. '09/'08	%chg. '10/'09	%chg. '11/'10
Los Angeles County	38,100	38,300	37,400	35,000	33,000	-1.6%	0.5%	-2.3%	-6.4%	-5.7%
Orange County	10,900	11,400	10,600	9,900	9,400	-3.5%	4.6%	-7.0%	-6.6%	-5.1%
San Diego County	6,300	6,400	5,900	5,900	5,800	6.8%	1.6%	-7.8%	0.0%	-1.7%

Sources: California Employment Development Department, estimates & forecasts by LAEDC

## Apparel Design & Manufacturing

The situation remains difficult for this industry. Retailers are seeing uneven growth in sales, both in year-to-year gains and by store type. Retailers are also continuing to focus on the cost of a garment, as consumers remain price sensitive. And major chains are still closing unprofitable store locations. Observers will be watching how the important “back to school” selling season unfolds

China is becoming more competitive in apparel production. It’s not just low-cost production of garments. They are developing a base of good designers and offering a broader array of textiles, which could be a challenge to the local industry.



There are more specific headaches for the local apparel industry, which is mainly small-to-medium sized firms. There is the issue of undocumented workers. Many of these people have good eye/hand coordination, which makes them very productive. These skills are very hard to find in the general populace. However, the immigration service has been checking on the immigration status of the workforce of larger apparel manufacturers in the region. Another headache is that the U.S. Customs Service is looking at the classification of imported textiles more closely. This is resulting in some

unexpected costs and delays in shipments. Apparel firms also have to be continually offering new lines – just turning out the same items each selling season doesn’t work any more. Finally, there are looming changes in labor regulation that could cause headaches for the local garment industry.

Despite this, some new apparel firms are still being started. The costs of entry in this sector are low, and there is a huge pool of design talent. Opportunity also remains for local apparel producers in providing quick turns on garments for retailers, who don’t want to wait for items to come in from overseas. While new construction has simmered down in the Fashion District, another building is being converted to showrooms, the fifth in the area.

Employment in the three major segments of this industry in Los Angeles County will continue to decline in both 2010 and 2011. There is a sizable apparel manufacturing sector in Orange County, but the state Employment Development Department no longer issues monthly reports.

**Table 25:****Apparel & Textiles Employment**

	2007	2008	2009	2010e	2011f	%chg. 07/06	%chg. 08/07	%chg. 09/08	%chg. 10/09	%chg. 11/10
Los Angeles County	86,100	85,400	76,000	72,500	70,700	-3.3%	-0.8%	-11.0%	-4.6%	-2.5%
Textiles mills	9,600	9,100	7,700	6,900	6,200	-6.8%	-5.2%	-15.4%	-10.4%	-10.1%
Apparel manufacturing	56,700	55,300	48,400	46,400	45,400	-4.9%	-2.5%	-12.5%	-4.1%	-2.2%
Apparel & piece goods wholesaling	19,800	21,000	19,900	19,200	19,100	3.7%	6.1%	-5.2%	-3.5%	-0.5%

Sources: California Employment Development Department, estimates & forecasts by LAEDC

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**Business & Professional Management Services**

The outlook for this diverse sector remains very uneven.

**Accounting:** Prospects for this sector are improving. Merger & acquisition activity is picking up just a tad, while new business will be generated by helping firms sort out what health care reform and looming new financial regulations mean to them. These regulations will be a burden for employers if compliance is not correctly done. Workouts in commercial real estate should also provide some opportunities.

**Advertising:** What a difference a few months make. Advertising spending is picking up (SNL Kagan is forecasting a +14% increase in U.S. TV ad revenue in 2010), especially by the auto industry. More TV commercials are being produced, good news for the local film production industry. There continues to be a steady stream of new product introductions in the consumer electronics sector. The November elections in California could generate another tidal wave of advertising by both candidates and supporters/opponents of propositions (currently there are nine). Finally, advertising agencies are moving more deeply into the social media.

**Architecture & engineering:** Business will continue to be sparse for the architecture

industry, especially on the nonresidential side. However, there could be some opportunities in remodeling/re-use of existing structures. For the engineering sector, business should continue to pick up, as there will be a growing focus on infrastructure projects. In Los Angeles County, for example, there is the “30/10” initiative to speed up construction of rail mass transit projects (this is over and above the boost provided by Measure R in Los Angeles County). Better yet, four airports in the region are doing expansions/renovations, while work should start soon on terminals at the ports of Long Beach and Los Angeles. Another boost should come from California’s “Green Building Code” which goes into effect January 1, 2011 and will affect all new commercial construction.

**Law:** Things seem to have stabilized in the region’s legal industry. The Federal financial regulation pending should generate new business as the financial industry and users of financial services (issuers of credit cards, for example) try to sort out all the implications. Bankruptcy business should also continue to run at high levels.

**Scientific research & development:** Money should continue to flow into the region for medical R & D. There is also lots of work being

done on “green” with electric vehicles being the focus of the moment.

Employment in these sectors will decline on an annual basis in 2010 (Orange County’s legal sector should see job gains in 2010), but turn up

in 2011 except in the architecture and engineering services sector. The latter will have to anxiously await a recovery in commercial real estate. In San Diego County, architecture and engineering will get a boost from high levels of military related construction.

**Table 26:**  
**Business & Professional Management Services Employment**

	2007	2008	2009	2010e	2011f	%chg. 07/06	%chg. 08/08	%chg. 09/10	%chg. 10/09	%chg. 11/10
<u>Los Angeles County</u>	163,400	157,500	145,400	140,500	139,800	4.5%	-3.6%	-7.7%	-3.4%	-0.5%
Legal services	49,400	49,100	46,800	46,300	47,000	0.4%	-0.6%	-4.7%	-1.1%	1.5%
Accounting services	49,600	41,500	38,400	37,800	38,100	6.9%	-16.3%	-7.5%	-1.6%	0.8%
Architecture & engineering	39,900	41,500	37,000	33,500	31,500	8.4%	4.0%	-10.8%	-9.5%	-6.0%
Advertising	24,500	25,400	23,200	22,900	23,200	2.1%	3.7%	-8.7%	-1.3%	1.3%
<u>Orange County</u>	51,200	51,500	48,100	46,000	46,100	3.0%	0.6%	-6.6%	-4.4%	0.2%
Legal services	14,400	14,300	15,100	15,300	15,600	0.7%	-0.7%	5.6%	1.3%	2.0%
Accounting services	12,600	13,200	12,500	12,100	12,400	4.1%	4.8%	-5.3%	-3.2%	2.5%
Architecture & engineering	24,200	24,000	20,500	18,600	18,100	3.9%	-0.8%	-14.6%	-9.3%	-2.7%
<u>San Diego County</u>	36,800	36,600	34,000	33,500	33,800	2.8%	-0.5%	-7.1%	-1.5%	0.9%
Legal services	12,700	12,500	12,200	12,100	12,300	2.4%	-1.6%	-2.4%	-0.8%	1.7%
Architecture & engineering	24,100	24,100	21,800	21,400	21,500	3.0%	0.0%	-9.5%	-1.8%	0.5%

Note: Includes computer software development

Sources: California Employment Development Department, estimates and forecasts by LAEDC

## Financial Services

2010 is turning out to be a thrill-packed year for the financial services industry. Federal regulation of the industry is working its way through Washington DC. Smaller banks continue to fall victim to bad commercial and real estate development loans in their portfolios, and are being taken over by larger institutions. The recovery in banking will lag the overall economic recovery.

In the meantime, the debt problems of Greece, Spain and Portugal have made the international financial markets quite volatile. This in combination with the halting nature of the U.S. economic recovery has made the stock markets very nervous.

Banks are building reserves and improving credit quality, so they are still cautious about lending (they continue to fret about the credit quality of would-be borrowers). However, some smaller banks in Southern California are stepping up their commercial lending, good news for the region’s small-to-medium sized business base. Despite the turmoil in financial services, a few banks are expanding in Southern California, and there is a quest to find sites for branches.

Credit unions have come through the financial turmoil in fairly good shape (though there have been some takeovers by regulators), and have been picking up members (and deposits).

Venture capital firms are focusing on their existing investments and are not very interested in start-ups, due to problems in exiting those existing investments. In addition, investors remain cautious about putting money into VCs. Angel investors continue to be very selective about where they put their money. However,

everyone is watching the small up tick in IPO's and mergers with great interest.

Employment in credit intermediation in Southern California will continue to decline in 2010 (although the Riverside-San Bernardino area did see a small increase). In 2011 employment will start to rebound.

**Table 27:**

***Financial Services Employment -- Credit Intermediation & Related Services***

	2007	2008	2009	2010e	2011f	%chg. 07/06	%chg. 08/07	%chg. 09/08	%chg. 10/09	%chg. 11/10
Los Angeles County	82,200	74,200	69,100	68,100	68,300	-3.2%	-9.7%	-6.9%	-1.4%	0.3%
Orange County	44,900	34,000	32,300	32,100	32,200	-13.7%	-24.3%	-5.0%	-0.6%	0.3%
Riverside-San Bernardino Area	18,100	16,400	15,500	15,700	15,800	-4.7%	-9.4%	-5.5%	1.3%	0.6%
San Diego County	24,600	20,700	19,500	18,700	18,800	-7.5%	-15.9%	-5.8%	-4.1%	0.5%
Ventura County	9,800	8,600	8,400	8,200	8,300	-11.7%	-12.2%	-2.3%	-2.4%	1.2%

Sources: California Employment Development Department, estimates and forecasts by LAEDC

## Health Services/Bio-medical

Health care was the only major local industry sector to add jobs through the great recession, and should continue to enjoy steady growth in the months ahead. However, some smaller hospitals continue to experience financial distress, partly brought on by the need to do seismic upgrading. How much health care reform will help these institutions is yet to be determined.

There are some large hospital construction projects underway in the region, part of it due to those seismic rules, and a lot of it due to expansions, as the population of Southern California continues to grow.

Other health care providers are also sorting through the health care reform bill, trying to determine what it will mean to them. Firms with over 50 employees will be required to provide health care coverage to their workers,

so there will be some new business for providers. Most analysts, however, don't expect much impact from the legislation until 2011.

On the bio-medical front, firms are focusing on drugs and vaccines to combat staph infections. The health care reform bill had a provision that would offer smaller bio-med firms the opportunity to offset R & D costs. Some major firms are doing expansions in Orange County to take advantage of the local talent pool as well as to have quick access to LAX. An on-going challenge for Southern California's bio-med industry is that many of the smaller innovative start-ups get taken over by large pharma and operations are then relocated.

All the major sectors of health care should continue to add jobs in 2010 and 2011, though the gains for nursing care facilities will be rather muted.

**Table 28:**  
**Health Services Employment**

	2007	2008	2009	2010e	2011f	%chg. 07/06	%chg. 08/07	%chg. 09/08	%chg. 10/09	%chg. 11/10
<b>Los Angeles County</b>	336,700	346,700	350,100	352,700	355,300	3.7%	3.0%	1.0%	0.7%	0.7%
Ambulatory health care services	160,400	165,800	166,100	168,000	170,100	2.6%	3.4%	0.2%	1.1%	1.3%
Hospitals	107,200	110,100	112,600	113,100	113,300	0.3%	2.7%	2.3%	0.4%	0.2%
Nursing care facilities	63,200	64,500	65,000	65,000	65,100	2.6%	2.1%	0.8%	0.0%	0.2%
Pharmaceutical & medicine mfg.	5,900	6,300	6,400	6,600	6,800	---	6.8%	1.6%	3.1%	3.0%
<b>Orange County</b>	107,700	112,600	113,100	113,700	114,300	3.6%	4.5%	0.4%	0.5%	0.5%
Ambulatory health care services	57,700	60,500	61,400	61,700	62,000	2.9%	4.9%	1.5%	0.5%	0.5%
Hospitals	31,200	31,800	30,700	30,800	30,900	5.8%	1.9%	-3.5%	0.3%	0.3%
Nursing care facilities	18,800	20,300	21,000	21,200	21,400	2.2%	8.0%	3.4%	1.0%	0.9%
<b>Riverside-San Bernardino Area</b>	97,800	101,400	102,000	103,000	104,000	3.3%	3.7%	0.6%	1.0%	1.0%
Ambulatory health care services	47,100	49,000	49,500	49,900	50,400	1.5%	4.0%	1.0%	0.8%	1.0%
Hospitals	30,200	31,800	32,300	32,700	33,000	5.2%	5.3%	1.6%	1.2%	0.9%
Nursing care facilities	20,500	20,600	20,200	20,400	20,600	4.6%	0.5%	-1.9%	1.0%	1.0%
<b>San Diego County</b>	90,000	95,000	98,200	100,700	103,000	3.8%	5.6%	3.4%	2.5%	2.3%
Ambulatory health care services	46,200	48,200	48,900	50,500	52,000	3.1%	4.3%	1.5%	3.3%	3.0%
Hospitals	24,500	25,400	26,300	26,700	27,100	2.1%	3.7%	3.5%	1.5%	1.5%
Nursing care facilities	19,300	21,400	23,000	23,500	23,900	7.8%	10.9%	7.5%	2.2%	1.7%

Sources: California Employment Development Department, estimates and forecasts by LAEDC



## International Trade/Goods Movement

International trade is a key driver of goods movement in Southern California. Because it plays such a vital role in the Southern California economy, the LAEDC has established goods movement as a separate cluster within the economic base of Southern California. The main components of this industry cluster include general freight trucking, marine cargo handling, air freight shipping agents and logistics firms.

The 2010 year-to-date trade figures have been very encouraging at the Port of Los Angeles (POLA) and the Port of Long Beach (POLB) for both imports and exports. As expected, rising U.S. imports have contributed to the recovery in trade as manufacturers and retailers restocked inventories over the past six months, which required a renewal of Asian exports. Through June 2010, the two ports have seen total containers climb by +17.0%, moving from 5.5 million containers in 2009 to over 6.4 million containers this year. At the Port of Long

million containers. The Los Angeles Customs District (LACD) maintained its number one position in the U.S. in 2009 with a two-way trade value of \$283.0 billion. The POLA remained the top port in the nation in 2009 with regards to total two-way trade (at \$197.3 billion), while the POLB maintained its #9 ranking with a value of \$68.6 billion.

The key reason why trade volumes rebounded so strongly this year was that the Asian economies were growing rapidly, leading the global recovery, as well as the turnaround in demand from the U.S. Over 40% of the nation's products imported in containers come through the ports of Los Angeles and Long Beach. The outlook for the rest of 2010 is positive as the global economy continues its recovery albeit at a slower pace. The Asian economies are expected to grow strongly, which bodes well for trade volumes at the local ports. The LACD's top five trading partners are all projected to post growth rates higher than +5% with the exception of Japan.

There are some concerns going forward that might produce a slowdown in trade volumes. First, trade flows could recede if the LACD's key trading partners decide to promote protectionist policies in an attempt to revive domestic demand. Second, trans-Pacific trade could soften if China begins to cool-off more than expected in the second half. The consensus of expert opinion points to a deceleration in trade growth (particularly regarding U.S. imports) in the second half of 2010 as manufacturing and distribution inventory pipelines are refilled.

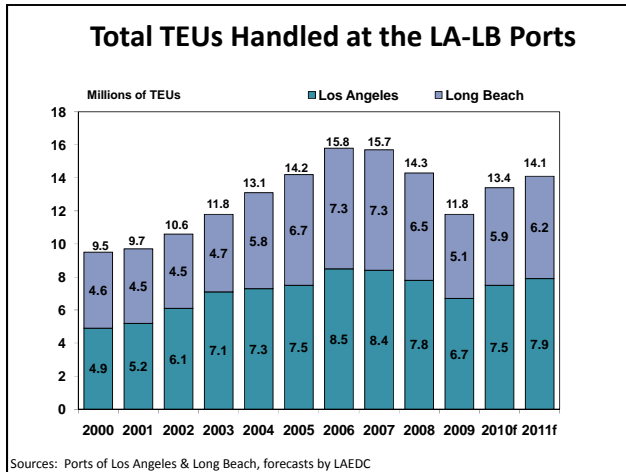


Beach, import container volume (excluding empties) increased by +21.7%, while export volume (excluding empties) climbed by +16.2%. At the Port of Los Angeles, the figures were also impressive as imports (including empties) grew by +13.0% and exports (including empties) by +17.2%.

The POLA and POLB maintained their top two rankings in the U.S. measured by the number of containers handled during 2009 with a total of 11.8 bringing total TEUs to 14.1 million. The expected improvement in trade will positively impact both ports as well as all the other industry players, from

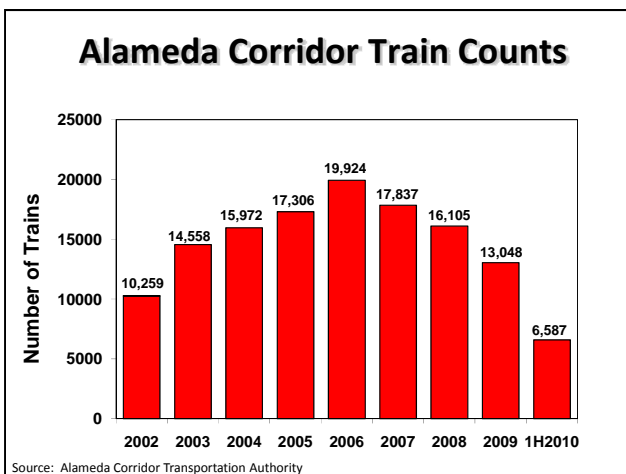
Total container traffic at the Port of Los Angeles and the Port of Long Beach is projected to expand in 2010 to 13.4 million TEUs, a rise of +14.0%. Both imports and exports should improve substantially this year with imports outperforming exports. The forecast for 2011 calls for a more moderate increase in total trade volumes for both local ports. Total traffic is projected to rise by +5% in 2011,

the longshoremen's union to the independent truck drivers to the railroads.



### Alameda Corridor

In recent years, the 20-mile rail cargo line that connects both ports to the main railroad yards near downtown Los Angeles experienced a downward trend in the number of trains running. The number of trains running on the Alameda Corridor has plunged by -34.5% between 2006 and 2009. In the first six months of 2010, the number of trains has increased by roughly +23%. However, that figure will rise over the remainder of 2010 and 2011.



### Positive Forces for 2010 and into 2011

- Both ports are actively pursuing expansion projects. The Port of Los Angeles signed a memorandum of understanding in mid-2009 to deepen its main channel to 53 feet so the port can accommodate the larger container ships coming into the global shipping fleet. The project will create thousands of construction jobs in the near-term and more port jobs when the new ships start using the port.
- The Middle Harbor at the Port of Long Beach: This 10-year project will upgrade terminals, more than double cargo capacity; add 14,000 new jobs and nearly 1,000 construction jobs annually. The project is also expected to cut air pollution by 50%.
- A \$1.1 billion Gerald Desmond Bridge replacement project is under consideration and is expected to take five years to complete.
- The Port of Long Beach and the U.S. Army Corps of Engineers have begun to work on a \$40 million project to deepen the Main Channel to allow for safer transit for the largest ships.
- At the Port of Los Angeles, work on the TransPacific (TRAPAC) is expected to be completed in the coming months.
- Federal economic stimulus funding for Southern California ports, highways and bridges is still working its way into the system and will further help alleviate capacity constraints.
- The local ports have become more competitive by launching new intermodal discounts and rail cargo incentive programs.
- Both ports have passed fiscal year 2011 budgets that continue to invest in environmental and capital improvement projects while keeping operating costs low.
- The ports of LA and LB are still the two most highly rated ports in the U.S. – the ports continue to have strong financial situations and

- competitive market positions relative to other key ports in the U.S.
- The Port of Long Beach was named North America's best seaport at the 2010 Asia Freight and Supply Chain Awards in Hong Kong. This was the 14<sup>th</sup> win in 15 years for the port.
- The Port of Los Angeles is proposing the creation of a Zero-Emission Vehicle Tariff Measure making it the world's first port to offer a reduced tariff for zero-emission vehicles imported into the U.S. through the port.

### Negative Forces for 2010 and into 2011

- The LA and LB ports might lose market share due to aggressive competition from Gulf and East Coast ports along with some from the Northwest ports (Seattle, Prince Rupert, British Columbia and Vancouver). West Coast ports had begun to lose some market share to the Gulf and East Coast ports before the economic crisis.
- The Clean Truck programs at the local ports have increased costs for shippers.
- Western railroads are still charging high intermodal rates, although they are becoming more competitive.
- International Longshore and Warehouse Union (ILWU) pension costs are rising rapidly.
- The global recession weakened the financial positions of many steamship companies. However, the global trade recovery in 2010 has boosted activity and revenues.
- The Maritime clerical workers negotiations could cause problems. This dispute has the potential to shut down much of the nation's busiest seaport complex.

## The Big Questions

For the goods movement sector, the three main questions going forward are: how strong will the economic recovery be in the second half of this year and into 2011? Will the clerical workers strike shut down the ports? When will we see the peak trade volume years of 2006-2007 return?

The general consensus seems to be that the global economic recovery will slow down in the second half of this year. In addition, the recovery will continue to reflect two different economic stories. The developing economies (especially in Emerging Asia) will lead the overall recovery, while the advanced economies will see modest improvements in GDP growth. The growth in Emerging Asia bodes well for trade volumes at the local ports (meaning U.S. exports). Overall, the results for 2010 should be very strong when compared to the depressing container figures of 2009.

With regards to the second pressing question, the outcome of the negotiations is difficult to foresee. We'll just have to wait and find out.

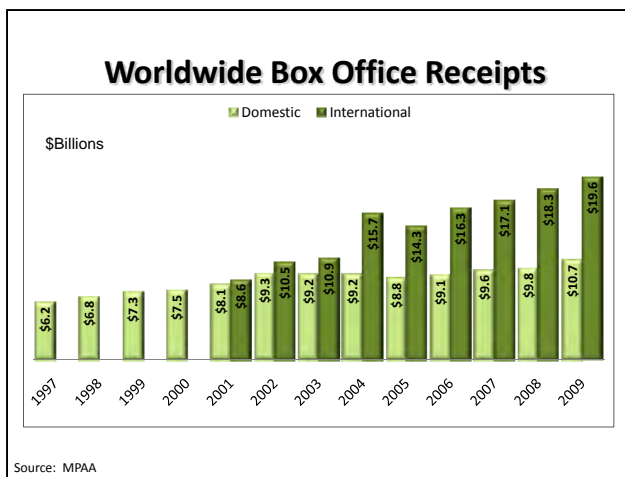
The answer to the final question that everyone wants answered, remains discouraging. However, we have seen a sharp improvement in trade volumes over the first half of this year, which is a very encouraging development and might translate into a better than expected result for the next couple of years. Meanwhile, most trade experts agree that trade volume levels are not projected to return to the glory days of 2006 & 2007 for a few years at a minimum.

Based on the most recent available data, goods movement employment in the Los Angeles 5-County area during 2008 totaled nearly 200,000 workers. San Diego County added about 83,000 more, bringing the grand total for Southern California to nearly 285,000 in the year 2008. A significant loss in goods movement employment occurred last year, though we lack the data to be more precise. However, the 2010 upturn in activity should be accompanied by employment upticks in the goods movement sector.

## Motion Picture/TV Production

The year 2010 got off to a good start for this industry. Domestic box office receipts were up strongly over the year, the state film production incentive plan was well received and being used, and television networks, both broadcast and cable, went on a pilot and series ordering spree. Even better, international box office has recorded strong growth, with many films now routinely generating more money overseas than domestically.

However, there were concerns, including the rapid run-up in ticket prices for 3-D films. Worse, at the start of the important summer exhibition season, some major films under performed at the U.S. box office.



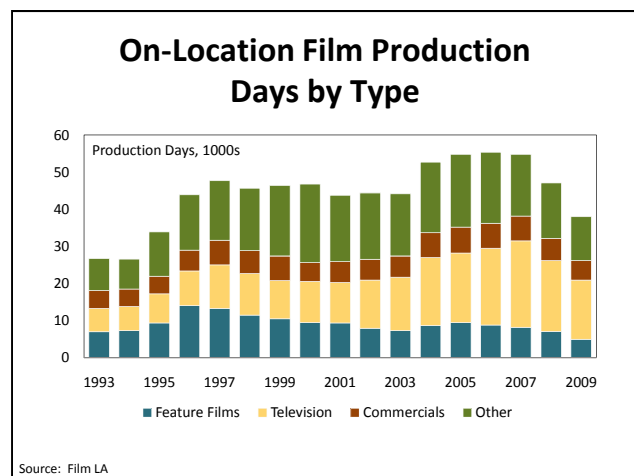
The entertainment industry also continued to see DVD sales decline. This is a major concern, as they were huge cash cows. Many new ways of delivering content are emerging (technology here is changing at warp speed), but there is the issue about how much money they might generate. One result is that the major studios are continuing to be cost conscious, for production of both feature films and TV series, so film incentives are quite attractive. Mid-budget films are becoming hard to get into production. A

current buzz word is “franchise,” or a film that generates multiple sequels.

In the category of some things never change, piracy is still a major issue. For example, pirated DVDs of “Iron Man 2” were being sold on one local light rail line a week before the film opened in theaters.

On the business front, the fate of MGM is still up in the air. Some smaller production companies are looking at mergers. The big event is the looming merger of Comcast and NBC/Universal.

In the meantime, the major guilds (unions) have started to prepare for the expiration of contracts in mid-2011. There is more moderate leadership



in place at the Screen Actors Guild, while many members of the Writers Guild are still smarting from the fall-out of the 2007-2008 strike.

Employment in the industry started to rebound at the end of 2009, and for 2010 an increase of 16,900 jobs is estimated in the motion picture and sound recording sector in Los Angeles County. Another gain is being forecast for 2011, but remember that all the major contracts expire at mid-year.

**Table 29:****Motion Picture/TV Production Employment in Los Angeles County**

	2007	2008	2009	2010e	2011f	%chg. 07/06	%chg. 08/07	%chg. 09/08	%chg. 10/09	%chg. 11/10
<u>Los Angeles County</u>	148,700	149,400	138,800	155,300	170,400	2.5%	0.5%	-7.1%	11.9%	9.7%
Motion picture & sound industries	129,200	130,000	120,500	137,400	152,400	2.5%	0.6%	-7.3%	14.0%	10.9%
Broadcasting (radio, TV & cable)	19,500	19,400	18,300	17,900	18,000	2.1%	-0.5%	-5.7%	-2.2%	0.6%

Sources: California Employment Development Department, estimates and forecasts by LAEDC

**Technology**

Business and consumer markets are coming back strongly. There continues to be a parade of new consumer product introductions – tablet computers, e-books, 3-D TV and advanced cell phones. Software development activity is picking up, and business is focusing on system and network upgrades. Data storage also has good prospects. The memory chip business has stabilized, while an emerging market for chip makers is utility “smart” meters (both gas and electric). The e-book or e-reader market has

gotten very competitive, with new or up-graded products being rapidly introduced.

Times are still tough for video game makers, but producers of game consoles are looking at their expanding use in viewing other content, with 3-D capability being introduced.

There is defense and space work in this sector, and the outlook here is mixed. The best prospects are for advanced communications. Job trends will generally be mixed in 2010.

**Table 30:****Technology Employment**

	2007	2008	2009	2010e	2011f	%chg. 07/06	%chg. 08/07	%chg. 09/08	%chg. 10/09	%chg. 11/10
<u>Los Angeles County</u>	146,400	147,100	138,900	135,500	135,800	-1.2%	0.5%	-5.6%	-2.4%	0.2%
Computer & electronic products mfg.	55,700	54,400	51,200	50,000	50,200	-6.2%	-2.3%	-5.9%	-2.3%	0.4%
Internet & data processing services	5,600	5,700	5,200	5,300	5,400	0.0%	1.8%	-8.8%	1.9%	1.9%
Computer systems design & services	27,800	28,600	26,800	26,800	27,000	5.7%	2.9%	-6.3%	0.0%	0.7%
Mgmt., scientific, & technical consulting	40,200	40,800	37,900	35,600	35,000	3.1%	1.5%	-7.1%	-6.1%	-1.7%
Scientific R&D services	17,100	17,600	17,800	17,800	18,200	-4.5%	2.9%	1.1%	0.0%	2.2%
<u>Orange County</u>	79,000	76,700	70,600	68,600	67,900	1.0%	-2.9%	-8.0%	-2.8%	-1.0%
Computer & electronic products mfg.	40,600	37,400	33,700	32,100	31,100	-3.6%	-7.9%	-9.9%	-4.7%	-3.1%
Computer systems design & services	18,000	18,500	17,500	17,500	17,600	6.5%	2.8%	-5.4%	0.0%	0.6%
Mgmt., scientific, & technical consulting	20,400	20,800	19,400	19,000	19,200	6.3%	2.0%	-6.7%	-2.1%	1.1%
<u>San Diego County</u>	50,500	51,400	49,500	48,900	49,500	-0.4%	1.8%	-3.7%	-1.2%	1.2%
Computer & electronic products mfg.	26,000	26,800	26,200	25,200	25,500	-2.6%	3.1%	-2.2%	-3.8%	1.2%
Scientific R&D services	24,500	24,600	23,300	23,700	24,000	2.1%	0.4%	-5.3%	1.7%	1.3%

Sources: California Employment Development Department, estimates and forecasts by LAEDC

## Travel & Tourism

The outlook for the region's large tourist industry is improving slowly, but there are still concerns. One is the economic problems in Europe, with the Euro having declined sharply in value against the U.S. dollar. This could hurt travel to Southern California from such key markets as Germany, the UK and France. Another concern is that hotels are still struggling financially, with more properties at risk despite growth in the number of visitors. Travelers are still focused on "deals," and continue to demand lower room rates, which is not good news for higher end properties.

And there is heated competition for the local tourism business, from Canada, Hawaii and Las Vegas among others. They are all running lots of radio and TV ads on local stations. Further in the future is another potential challenge from Las Vegas as they attempt to attract more nonstop international air service.

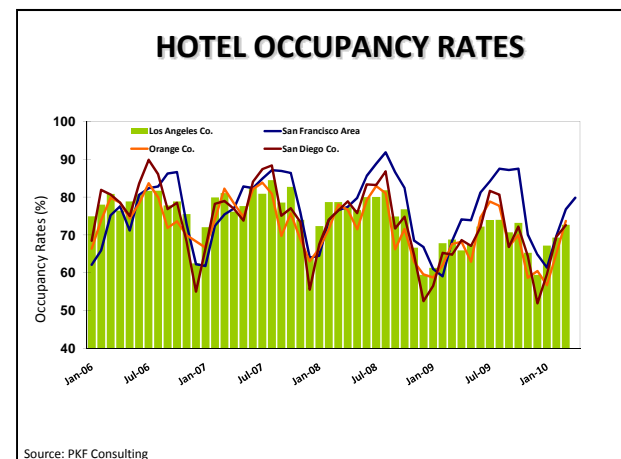
However, there is much more positive news to discuss. There is the U.S. "Travel Promotions Act," which should help attract more international visitors, as it makes the U.S. more travel friendly. It will advise potential foreign travelers on visa requirements and security procedures. Moreover, local attractions report that they are seeing more out-of-area travelers, as opposed to last year's "drive market" business.

The Tom Bradley International Terminal at LAX has gotten a major face lift, that will make it more attractive and user-friendly for travelers.

In the meantime, most local theme parks have new attractions opening up this year. The list includes: "The World of Color" at Disney's California Adventure; King Kong in 3-D at Universal Studios Hollywood; a water park at Lego Land in San Diego; a new light show at Knott's Berry Farm; and a new family style roller coaster at Six Flags Magic Mountain. Coming in the near future is the Cirque de Soleil show at the Kodak Theater at

Hollywood & Highland (it will go on hiatus when it's time for the Academy Awards). Disney is also doing a major renovation of the Disneyland Hotel.

With the opening of the new hotels at LA Live, the city of Los Angeles has been able to book some major business shows. So far in 2010, there has been some improvement in trends for the region's hotels. In Los Angeles County, the hotel occupancy rate is running at 69.7% compared with 65.5% in 2009. Average daily room rates are down by -4.8%, which has yielded a modest (+1.3%) increase in revenue per available room. The situation was not nearly as favorable in Orange County. To date in 2010, the occupancy rate has been averaging 67.4% compared with 64.2% in 2009. However, the average daily room rate was down by -6.7%, yielding a -2.1% decline in revenue per available room. In San Diego County, the hotel occupancy rate so far in 2010 was averaging 68.2% compared with 63.9% in 2009. The average daily room rate has fallen by -7.2%, yielding a -1.1% decline in the revenue per available room.



Despite signs of improvement, hotel employment in Southern California will decline again in 2010, though Orange County will manage a modest increase. In 2011, the overall employment outlook should perk up.

**Table 31:*****Tourism-centric Industries Employment***

	2007	2008	2009	2010e	2011f	%chg. 07/'06	%chg. 08/'09	%chg. 09/'10	%chg. 10/'09	%chg. 11/'10
<u>Los Angeles County</u>	52,300	52,600	48,000	47,500	48,200	0	0.6%	-8.7%	-1.0%	1.5%
Accommodation	40,300	41,200	38,600	38,500	39,000	3.1%	2.2%	-6.3%	-0.3%	1.3%
Travel arrangement & reservations	12,000	11,400	9,400	9,000	9,200	4.3%	-5.0%	-17.5%	-4.3%	2.2%
<u>Orange County</u>										
Accommodation	23,100	23,700	22,900	24,200	25,200	3.1%	2.6%	-3.4%	5.7%	4.1%
<u>Riverside-San Bernardino Area</u>										
Accommodation	17,400	16,400	14,700	13,700	13,800	-2.2%	-5.7%	-10.4%	-6.8%	0.7%
<u>San Diego County</u>										
Accommodation	31,900	32,700	30,300	30,100	30,400	4.6%	2.5%	-7.3%	-0.7%	1.0%
<u>Ventura County</u>										
Accommodation	2,900	2,900	2,400	2,000	1,900	7.4%	0.0%	-17.2%	-16.7%	-5.0%

Sources: California Employment Development Department, estimates and forecasts by LAEDC

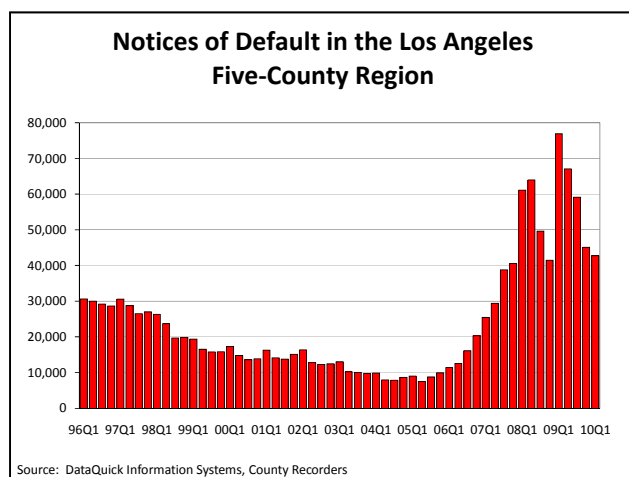


## XII. OUTLOOK FOR CONSTRUCTION & RETAILING

### Residential Real Estate

#### New Home Building

In 2009, the story of Southern California's housing market was one of continuing deterioration while the rest of the nation limped toward a modest recovery in the second half of the year. During the opening months of 2010, after a long spell of unmitigated bad news, it looked as if the nation and Southern California were finally on the verge of shrugging off the housing crisis. Builders' unsold inventories were falling, and home price deflation showed signs of leveling off. Most industry watchers agreed a bottom had been reached. However, the question, "How long will it take to climb back out?" remained anyone's guess. The market has been bumping along in a very deep hole since last year and hopes for a big turn-around in 2010 are fading.



The industry continues to face significant challenges on the demand side: a weak labor market, tighter bank lending standards and expired government incentives. Foreclosure activity remains a dominant feature in many local real estate markets. Builders have a hard time competing against low-priced foreclosed homes. While the number of foreclosed home sales in Southern California is falling, more are probably on the way.

California has the second highest foreclosure rate (behind Nevada) in the nation. During the first quarter of this year, foreclosures accounted for 51% of home sales, up from 50% in the fourth quarter of 2009.<sup>1</sup> While fewer people appear to be entering foreclosure, banks are stepping up home repossessions. The increase can be attributed in part to the expiration of government moratoria on foreclosures and the low success rate of permanent mortgage modification programs. At the same time, lenders will have to carefully manage their inventories of foreclosed homes to keep from flooding the market with too much supply and driving down prices.

Home sales received a significant boost from the first-time homebuyers' tax credit. Sales of new homes surged in late 2009 and then again in March-April of 2010 when the credit was extended. Existing home sales also received a lift, but it was less pronounced. However, the drop-off in sales activity during May-June following the expiration of the tax credit, indicated the primary effect of the incentive was to pull sales forward without laying the foundation for a consistent and sustained recovery. Home prices rose as buyers rushed to take advantage of the tax incentive, but as sales fall back to depressed levels, prices could well decline again.

Continuing high rates of unemployment in Southern California are also contributing to the general malaise in the housing market. Job growth is key to reducing foreclosures and delinquencies which, in turn, will be key to improving sales and price performance – a necessary condition to lure discretionary buyers back to the market.

<sup>1</sup> RealtyTrac

Total home building permits in the Los Angeles five-county region have been declining since 2004 (when 91,556 total units were permitted). During 2009, a total of 14,809 new residential construction permits were issued, a decline of -45% compared with 2008 and -84% from 2004. During the first five months of 2010, total new residential construction in the five-county area was up by nearly 8% from the same period in 2009 with 6,568 total permits issued for new single and multi-family units.

**Table 32:**  
**Total Housing Permits**

	L.A.	Orange	Riv-SB	Ventura	LA-5
1990	25,045	11,979	28,840	2,612	68,476
1991	16,195	6,569	16,191	2,194	41,149
1992	11,907	5,943	15,444	1,720	35,014
1993	<b>7,259</b>	6,410	13,151	1,372	<b>28,192</b>
1994	7,621	12,544	13,016	2,464	35,645
1995	8,405	8,300	10,899	2,166	29,770
1996	8,607	10,207	12,513	2,353	33,680
1997	10,424	12,251	15,377	2,316	40,368
1998	11,692	10,101	18,606	3,182	43,581
1999	14,383	12,348	21,651	4,442	52,824
2000	17,071	12,367	21,990	3,971	55,399
2001	18,253	8,646	27,541	3,446	57,886
2002	19,364	12,020	33,280	2,507	67,171
2003	21,313	9,311	43,001	3,635	77,260
2004	26,935	9,322	52,696	2,603	91,556
2005	25,647	7,206	50,818	4,516	88,187
2006	26,348	8,371	39,083	2,461	76,263
2007	20,363	7,072	20,457	1,847	49,739
2008	13,704	3,159	9,101	842	26,806
2009	5,610	2,177	6,681	341	14,809
2010f	6,000	2,600	7,350	410	16,360
2011f	7,500	3,920	9,920	595	21,935

Sources: Construction Industry Research Board, forecasts by LAEDC

Los Angeles County and the Inland Empire accounted for most of the permits issued in 2009 (about 83% combined). The difference between the two counties was that most of the permits Compared with the rest of the region, less construction occurs in Ventura County. The lengthy permitting process and constraints on land available for residential development act as barriers to new construction. A total of 341

issued in Los Angeles County (63%) were for multi-family units (there is less open land available for housing development in Los Angeles County except in the Antelope and Santa Clarita valleys). The Inland Empire market is just the opposite, as most of the new homes permitted were for single-family units (72%).

In Los Angeles County, total residential construction dropped to 5,610 units in 2009, a decline of -59.1% from the prior year and down by -79% from 2004. During the first five months of 2010, the number of permits issued for new homes was up by +7% compared with the same period in 2009.

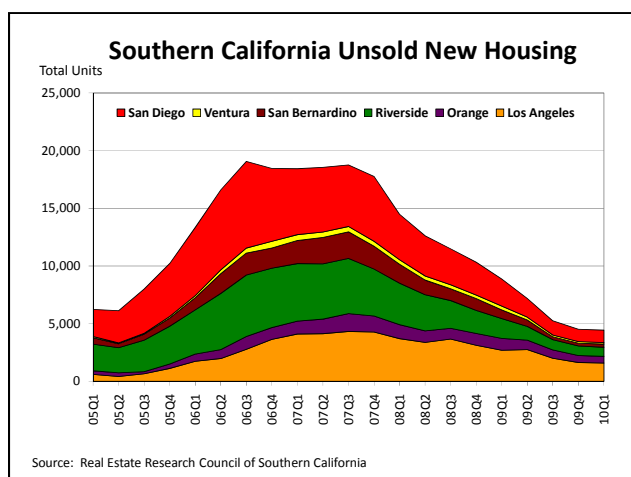
Total residential construction in the Inland Empire was down by -27% in 2009 to 6,681 units and by a shocking -87% from the region's new home building peak in 2004. The first half of 2010 showed some improvement: new permits inched up to 2,559 units from 2,445 issued during the first five months of 2009 (+5%).

In Orange County, a total of 2,177 residential permits was issued in 2009, a decline of -31% compared with the 2008 level. Since peaking in 2000 at 12,367 units, residential permits were down by -82%. Land availability is relatively low in Orange County and since 2004, multi-family units have accounted for the majority of residential construction permits issued in the County. Up to that point, Orange County had been considered a stronghold of single-family development. However, the trend toward more multi-family residences reversed last year. Multi-family permits plunged by -55% to 842 units (39% of total housing units) while single-family permits rose by +3% to 1,335 units. [Only five of California's 28 metropolitan areas posted an increase in single-family permits in 2009.]

residential permits were issued during 2009, a decline of -60% from the previous year. So far in 2010, residential construction activity has increased by +17% over the same period in 2008.

Of the housing permits issued this year through May, 67% were for multi-family residences.

On the upside, builders' levels of unsold new housing have fallen significantly over the past year in all five counties. Inventories in the first quarter of 2010 fell by -41.3% in Los Angeles County over the year, -43.4% in Orange County, -54.4% in Riverside County, -62.8% in San Bernardino County and by -60.5% in Ventura County. Even more telling is to compare recent unsold new home inventories with their peak levels: Los Angeles County -63.5% (3q07), Orange County -62.6% (3q07), Riverside County -83.5% (3q06), San Bernardino County -87.9% (3q07) and Ventura County -71.8% (4q06).



### Resale Housing

Unsold inventories of resale homes have also fallen dramatically over the year but have leveled off recently. According to the California Association of Realtors, the unsold inventory in California represented a 4.6 month supply at May's sales rates, unchanged from the previous year. Existing home sales in California increased by +1.2% in May over a year ago while the median price rose by +23.3% over the same

period. May represented the fifth consecutive month of double digit increases in the median price. Strong buyer demand relative to inventory helped drive prices up.

While the supply of distressed properties has been falling, sales of foreclosed homes continue to make up a large percentage of home sales, especially in Southern California's more affordable inland areas. As a percentage of total sales, the share fell in May to 34%, a considerable improvement over the peak of 56.7% reached in February 2009. Nonetheless, foreclosure activity remains at historically high levels and is largely responsible (along with the lack of financing for higher priced homes) for concentrating sales at the low end of the market. Still, sales of homes priced \$500,000 and above are starting to inch up. In May, sales of higher end homes made up 21.6% of the total number of transactions for the month. The housing market will need to return to a more normal distribution of sales across all price points to restore it a balanced condition.

In spite of rising prices, the resale housing market in Southern California is still a buyers' market (assuming buyers are able to qualify for a loan under the tighter lending standards imposed by less free-wheeling financial institutions). A comparison of median existing single-family home prices for May 2010 with the same period in 2009 by the California Association of Realtors revealed that the median home price in Los Angeles County was \$346,350, up by +10.6% over the year. In Orange County, the median home price rose by +6.7% to \$505,750. Ventura County had a median price of \$440,370 in May, an increase of +6.0% from a year ago. The Riverside-San Bernardino market posted the strongest gain with the median price rising by +21.2% to \$194,960.

More foreclosures are expected to hit the region's housing market over the second half of 2010, but it is the expiration of the tax credit incentive that likely will have the biggest impact on home sales and prices. The tax credit appears to have simply pulled demand forward without creating a foundation for a consistent and sustainable recovery. The question now is whether near-historic-low mortgage interest rates and affordable prices will be enough to entice buyers back into the market.

**Table 33:**

**Median Existing Single-Family Home Prices**

	LA	Orange	Riv-SB	Ventura
1996	\$172,886	\$213,370	\$115,240	\$205,720
1997	176,517	229,840	114,340	219,300
1998	191,700	261,700	121,500	233,770
1999	198,980	280,900	128,670	254,950
2000	215,900	316,240	138,560	295,080
2001	241,370	355,620	156,690	322,560
2002	290,030	412,650	176,460	372,400
2003	355,340	487,020	220,940	462,520
2004	446,380	627,270	296,350	599,280
2005	529,010	691,940	365,395	668,140
2006	584,820	709,000	400,660	685,960
2007	589,150	699,590	381,390	673,940
2008	402,110	533,200	234,220	463,560
2009	333,920	477,240	169,880	416,770

**Annual % Change**

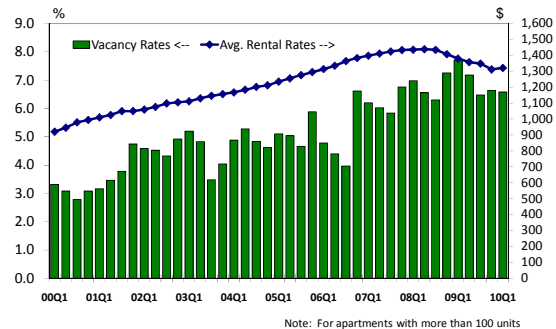
	LA	Orange	Riv-SB	Ventura
1997	2.1%	7.7%	-0.8%	6.6%
1998	8.6%	13.9%	6.3%	6.6%
1999	3.8%	7.3%	5.9%	9.1%
2000	8.5%	12.6%	7.7%	15.7%
2001	11.8%	12.5%	13.1%	9.3%
2002	20.2%	16.0%	12.6%	15.5%
2003	22.5%	18.0%	25.2%	24.2%
2004	25.6%	28.8%	34.1%	29.6%
2005	18.5%	10.3%	23.3%	11.5%
2006	10.5%	2.5%	9.7%	2.7%
2007	0.7%	-1.3%	-4.8%	-1.8%
2008	-31.7%	-23.8%	-38.6%	-31.2%
2009	-17.0%	-10.5%	-27.5%	-10.1%

Source: California Association of Realtors

**Apartments**

The apartment market made modest headway in 2009 in terms of lower vacancy rates. Rental rates continued to fall over the year, but the

**Los Angeles Five-County Apartment Vacancy Rates and Average Rental Rates**



Source: Real Facts/California Real Estate Research Council

decline slowed considerably during the first quarter of 2010.

The apartment vacancy rate in Los Angeles County was 6.4% compared to 6.7% a year ago. Apartment vacancy rates in Orange County averaged 5.7% (down from 7.7%). Riverside County also experienced a decline in vacancy rates over the year, from 8.7% to 8.0%. In San Bernardino, the rate declined to 6.4% (from 8.2%) and in Ventura County it dropped to 6.4% (from 7.2%)

Over the first three months of this year, rents in the Los Angeles five-county region fell by -4.3%. Rents in Los Angeles and Orange counties decreased by -3.9% and -4.6% respectively. Over the year, rents also fell in Riverside County (-4.8%), San Bernardino County (-5.6%) and Ventura County (-2.9%).

Apartment fundamentals remained relatively healthy during the recession compared to the detached for-sale housing market. However, the apartment market is now facing competition from single-family homes. A number of lenders, unable to sell foreclosed homes are renting them instead, sometimes to the former owners. Demand for apartment units has also been affected by the affordability of detached housing. Apartment owners are offering incentives to fill vacant units, creating still more competition and placing additional pressure on rents. The high

level of unemployment has also had an impact on apartment demand, as tenants are choosing to double up to save money. Still, very few new apartment buildings are going up; so when the labor market turns around, the apartment owners who managed to hang on through the recession will be in a good position. Future demand is also driven by population growth and the next five years will see a large cohort of 25-30 year olds (typically renters) establishing new households.

### **Housing Forecast**

In 2009, home affordability (the ratio of income to home prices) fell back in line with historic averages seen prior to the run up and collapse of the housing bubble. Sales of existing homes were brisk as buyers benefited from an advantageous confluence of favorable prices, historically low mortgage interest rates and various buyer tax credits. The sales gains realized over the past year have diminished however, as the supply of bargain-priced homes at the low to mid-end of the market dried up, and with the expiration of the first time buyers' tax incentive this past April.

In California, the median home price hovered around \$250,000 for the first half of 2009 and then began to rise steadily. By May 2010, the median price reached \$278,000. Normally, this would be an indication that prices were stabilizing but the tax credit probably pulled too many sales forward. The resulting bump up in prices may fade once home sales start to fall back to levels consistent with economic fundamentals. Foreclosures continue to be a major driver of sales in Southern California's distressed areas, and until that process plays out, the market outlook will remain uncertain.

The LAEDC forecasts that a total of 16,360 new housing units will be permitted during 2010 in the five-county region, an increase of 10.5% from 2009 but still down by -82% from the 2004 level of 91,556 units. As the number of unemployed workers begins to stabilize and then decline, foreclosure rates should drop off and allow home

prices to appreciate. An additional risk to recovery lurks in the "shadow" market. The shadow inventory includes homes in foreclosure that have not been put up for sale in the open market by banks or other lenders. This market is difficult to quantify and is also affected by state and federal programs designed to reduce the number/rate of foreclosures. To the extent that lenders dole out properties slowly to obtain the best possible price, it could prolong recovery of the housing market.

Although credit conditions remain tight, mortgage interest rates are extremely low and existing home inventories are tight. Federal government home buyer tax incentives helped sales and pushed up prices, but that support is now gone and the market will have to stand on its own.

In any event, recovery will require a renewed willingness on the part of mortgage lenders to make loans to qualified buyers, especially at the high end of the market, and on substantial improvement in the jobs outlook.

Housing activity will continue at low levels for the rest of 2010 with progress coming in fits and starts. Homes sales are important because they say a lot about the state of the economic recovery, and reflect the health of the job market with its implications for consumer spending. The on-the-on-again off-again recovery in the housing market will not gain any real traction until well into 2011 when jobs are expected to return and with those jobs, the confidence builders, lenders and consumers need to get housing moving again.

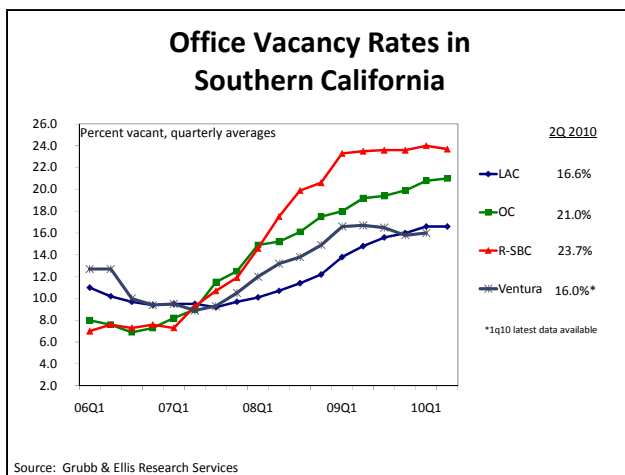
## Nonresidential Real Estate

### Office Space

Southern California's job growth came to a grinding halt in 2008, and as 2009 unfolded, the monthly litany of job losses became the yardstick by which the severity of the recession was measured. As the calendar rolled over to 2010, the declines in employment finally began to abate. Employment levels appear to have stabilized in recent months, but the unemployment rate remains very high.

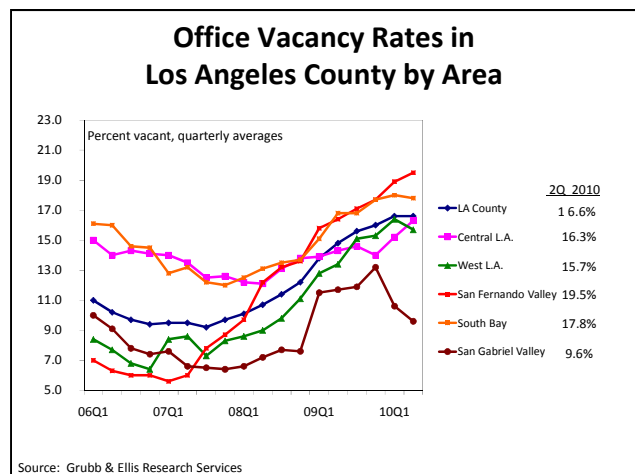
Office vacancy rates throughout the region increased as companies closed or downsized. Some areas within the region have fared better or worse than others depending on their exposure to problem industries and the volume of new construction, but none remained unaffected.

Now, after three quarters of economic growth but no improvement in employment, Southern California's office market may be at or near bottom. Los Angeles County's average office vacancy rate was 16.6% in the second quarter of 2010 compared with 14.8% during the same time last year. Compared to first quarter 2010, however, the vacancy rate remained unchanged. Still, 16.6% was the highest office vacancy rate Los Angeles County has experienced since late 2002.



The San Gabriel Valley and the Westside sub-markets had the lowest office vacancy rates at

the end of the second quarter, 9.6% (versus 10.6% in 1q10) and 15.7% (versus 16.4% in 1q10) respectively. The highest office vacancy rate occurred in the San Fernando Valley, which saw an increase to 19.5% in the second quarter from 18.9% in the first quarter. The South Bay office vacancy rate edged down to 17.8% (2q10) from 18.0% (1q10). The Central LA sub-region fared less well as the average office vacancy rate increased to 16.3% (from 15.2% in 1q10). While these quarter-to-quarter comparisons offer some encouragement, office vacancy rates in Los Angeles County remain elevated compared to where they were a year ago. The lone exception was the San Gabriel Valley, which actually saw office vacancy rates decline over the year.



Across the county, the after effects of the sub-prime fiasco and financial crisis linger, as tenant losses were heavily weighted toward the financial services industry. AIG, Countrywide Financial, IndyMac and Washington Mutual dumped millions of square feet of office space onto the market. Media and advertising companies also fared badly during the recession and gave up significant amounts of space.

During the first half 2010, Los Angeles County had 1.1 million square feet of negative net absorption (the net change in physically occupied space).

The County's office market has now experienced eleven consecutive quarters in which more office space was given up than was newly leased. The good news is that the rate of decline slowed considerably in the second quarter. The volume of new space under construction was 819,000 square feet mainly in West LA.

On average, the county's soft market for office space pushed Class A asking rents down to \$3.01/sf in the second quarter (a year-over decline of -5.0%). Some tenants took advantage of lower rental rates to upgrade to better space. Many more, however, sought concessions from landlords who were generally willing to go to great lengths to retain a tenant. As a result, effective rents were considerably lower than the published asking rates.

Increasing vacancy rates have not uniformly affected the rents among Los Angeles County's various communities. Westside Class A asking rents dropped to \$3.64 /sf in the second quarter, declining by -9.2% from a year ago, while South Bay rents rose to \$2.26/sf from \$2.18/sf (+3.7% over the year). The Westside tenant base, with its heavy concentration of financial services firms, was among the hardest hit in the county by the recession. Commercial real estate in the South Bay is heavily dependent on port related activity and has benefited from the recent uptick in port activity.

San Gabriel Valley asking rents declined by -6.2% year-over to \$2.41/sf in the second quarter. The San Fernando Valley also ended the quarter on a down note – average asking rent fell to \$2.44/sf (-5.1%). Downtown rates fell to \$3.14/sf from \$3.33/sf (-5.7% over the year). The downtown area with its diversified tenant base had been holding up fairly well, but the prolonged effects of the recession have taken a toll even there.

In Orange County, the average office vacancy rate edged up for the fifteenth consecutive quarter, increasing to 21.0% in the second quarter of 2010 from 19.2% a year earlier. Orange County has not

fared as well as its neighboring counties in terms of job losses; the unemployment rate is still high and not likely to improve appreciably through the remainder of this year. Trouble in the banking sector looms - a substantial number of commercial real estate loans are coming due this year. Additionally, the county's mortgage industry is constrained by tight credit and a moribund housing market.

New office construction in Orange County came to a complete standstill over the course of 2009, and no new construction has gotten underway so far in 2010. Even so, with almost 1.1 million square feet of negative new absorption year-to-date, supply greatly exceeded demand and is exerting downward pressure on rental rates. Despite an increase in recent leasing activity, demand is weak and activity is comprised mainly of renewals, many of which are short term (one to two years). Additionally, there is a large supply of "shadow space" i.e. space that is technically leased but actually empty and will return to the market when the lease term expires. On average, Class A asking rents have fallen by -12.5% over the year to \$2.30/sf, a six year low.

Helped by a slowdown in the loss of white collar jobs and no new construction, during the second quarter, the average office vacancy rate held fairly steady in the Inland Empire – edging up to 23.7% from 23.5% one year earlier. Even with no new construction in the pipeline, market saturation from speculative projects in progress prior to the real estate bust meant supply still exceeded demand. Rental rates fell by -5.9% (to \$2.07/sf in the second quarter of 2010 compared to \$2.20/sf during the same period in 2009). From January to May this year, total net absorption was negative 18,270 square feet.

Across Southern California, high levels of unemployment from businesses scaling back or closing have forced a shift of emphasis from new development to filling existing office space. Even so, leasing activity is expected to remaining rather flat and rents soft through the remainder



of 2010. Recovery in the office market will depend on a sustained upswing in the economy to convince firms to start hiring again. Right now most of the leasing activity is coming from sectors linked to population growth - law, medical, private education and engineering boosted by federal stimulus project funding.

Until the employment situation turns around, it will remain a tenant's market – high rates of space availability will encourage renters to trade up or to demand greater concessions from landlords in the form of higher improvement allowances, free rents and reduced parking fees.

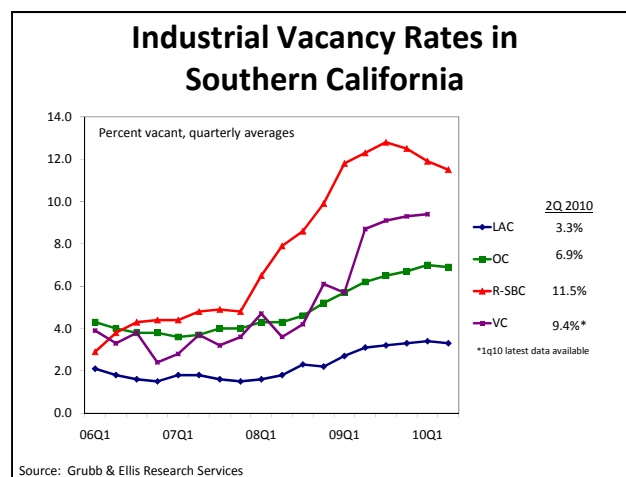
During 2009, office building permits valued at \$233 million were issued in the five-county region. The value of office permits plummeted by -68% compared with 2008. During the first five months of 2010, the value of new office permits issued was just \$60 million, a decline of -16.2% compared with the same period in 2009. Los Angeles County accounted for 30% by valuation of office building permits issued in the five-county area so far this year, compared with a 78% during the same period in 2009. The Inland Empire accounted for a 42% share (January to May), up from 17% during 2009. Ventura and Orange counties both held a 7% share.

### Industrial Space

Southern California is a major center for manufacturing, international trade and logistics and entertainment (sound stages are industrial space). Los Angeles County remains the nation's largest manufacturing center and is home to its biggest port complex. The worldwide economic downturn led to a decline in global demand for U.S. exports and a steep drop in domestic demand for imported goods. Trade activity at the ports plummeted through much of 2009.

The area's manufacturing and logistics industries, both of which are major users of industrial space, suffered as a result. Early in 2010, however, last year's slowdown in international trade was reversed by a surge in exports, especially to

China. More recently, imports have picked up as well, drawn in by the improving U.S. sales picture.



All things considered, the market for industrial property in Los Angeles has held up remarkably well. In the second quarter of 2010, the Los Angeles County average industrial vacancy rate was 3.3%; up from 3.1% a year ago, but down from 3.4% in the first quarter of this year. At 3.3%, Los Angeles County had the lowest industrial vacancy rate in the nation.

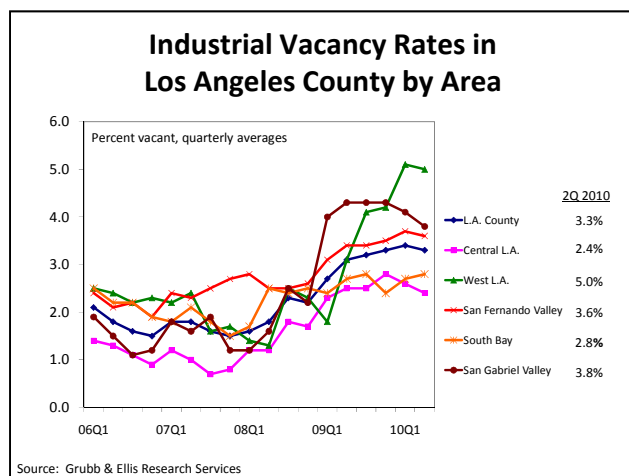
Although depressed trade volumes at the port and weak consumer demand inflicted a measure of discomfort on the Los Angeles County industrial real estate market during the recession, the county was able to meet the challenge from a position of relative strength. Due to a shortage of land available for development, Los Angeles did not go through the cycle of overbuilding that occurred in neighboring counties. Demand for space increased during the second quarter of 2010, and for the first time in over a year, quarterly net absorption was positive. Trade activity at the ports was up for the through June, which translated into demand for industrial space.

Increased leasing activity has helped stabilize vacancy rates, but there is still downward pressure on asking rents. Prospective tenants have become more aggressive in their lease negotiations, and leases are taking longer to

close. Landlords have been forced to concentrate on maintaining occupancy rates as opposed to holding out for higher rents. Over the year, the average asking rent for industrial space in Los Angeles County fell by -16.4% to \$0.51/sf.

Industrial vacancies ended 2009 at relatively low levels, but the extent and depth of the recession hurt commercial real estate markets badly. There is a sense that things are improving, however. Long one of the tightest submarkets in the region, Central LA experienced a slight decline in its average industrial vacancy rate at the end of the second quarter of 2010. It fell to 2.4% compared to 2.5% a year ago and 2.6% at the end of the first quarter 2010. Industrial markets elsewhere in the county also remained tight: Mid-cities (5.5%), San Fernando Valley (3.6%), the San Gabriel Valley (3.8%) and South Bay (2.8%).

While vacancy rates were elevated compared to a year ago, every sub-market in Los Angeles County saw a decline between the first and second quarters of this year. The exception was South Bay where the vacancy rate remained essentially flat.



Orange County's industrial real estate market fared less well, ending the first half of the year with a 6.9% vacancy rate, up from 6.2% a year ago. No new space was built in 2009 and very little is currently under construction. Weak consumer demand and sluggish business

investment reduced the demand for industrial space. With supply far in excess of demand, asking rents have declined accordingly. Businesses are taking a "wait and see" attitude about expanding or relocating to the area. Recovery in Orange County, as elsewhere, will depend on an improvement in the local economy (particularly in its technology and bio-medical sectors) and a revitalization of consumer demand.

As industrial space dwindled in Los Angeles and Orange Counties in the first half of the decade, an increasing number of companies searching for abundant land, lower costs and proximity to the San Pedro Bay ports, migrated east to the Inland Empire. Up until 2007, the large influx of distribution businesses into the Inland Empire competed for space with rapidly spreading low-cost housing developments, creating a tight regional industrial real estate market. Conditions deteriorated markedly during the recession as the housing crisis unfolded, unemployment soared and trade related activity declined. The market was flooded with new space built by speculators just as businesses were downsizing or closing up altogether.

Recent numbers show things may be turning around. The second quarter vacancy rate was 11.5%, high compared to pre-recession levels, but down from 12.8% during the same period last year. Vacancy rates shot up at warehouse and distribution centers for retail chains in 2009; casualties of the demise of several big retailers and plummeting imports of consumer goods, but the largest losses appear to be behind us. Retail sales have been on the upswing for several months, and retailers have been busy restocking their inventories.

The industrial property sector resisted recessionary pressures longer than office or retail and appears to be coming back faster. In the Inland Empire, several established businesses reacted quickly to the downturn. Seeking cost savings, there was a push to relocate along the I-215 corridor. This has caused localized variation

in vacancy rates and asking rents, but allowed the industrial real estate sector to start 2010 on firmer ground.

Tenant and landlord rental rate expectations are in better alignment and transaction volume has picked up in the Inland Empire. There were 161 transactions during the second quarter for 8.1 million square feet. That was nearly double the amount leased during the same period last year. Quarterly net absorption was positive 2.9 million square feet – quite a turn-around from the second quarter of 2009 which posted a negative figure of 2.2 million square feet. Asking rent for warehouse space was \$0.31/sf down by -11.4% from a year ago.

During 2009, industrial building permits valued at just \$102 million were issued in the five-county region. The value of industrial permits tumbled by -69% compared with 2008 (which was not exactly a banner year either). During the first five months of 2010, permits valued at \$52 million were issued versus \$64 million during a year ago. The Inland Empire accounted for 30% of 2010 permits by valuation; Los Angeles accounted for a 26% share; Orange County held a 30% share; while Ventura County recorded no industrial permit activity so far this year.

## **Forecast for Private Nonresidential Construction**

Total private nonresidential construction in the five-county region declined to \$4.5 billion in 2009 – just over half of the \$8.1 billion recorded in 2008. Activity will fall again in 2010, with a forecast total permit value of only \$4.3 billion for the region, a -4% drop. Contributing to expected declines in 2010 are stubbornly high unemployment rates and a lack of confidence on the part of consumers and financing for firms exhausted by the recession. The disappearance of businesses and employees over the past two years has slashed demand for office, industrial and retail space.

Businesses are reluctant to commit to new construction while the economic outlook remains uncertain. Real estate lenders and investors are just as leery. Thus, credit markets remain tight and it is not yet clear when they will begin to function normally again. Many projects have been delayed or cancelled outright. With vacancy rates rising and property prices falling across Southern California, and given the slow (and uncertain) rate of economic recovery, some developers could face difficulties rolling over their loans. Large regional and small community banks alike have built up large concentrations of commercial real estate (CRE) loans, and delinquencies are rising. An outgrowth of this trend is builders looking to private equity to finance new projects.

Private nonresidential building permit values in Los Angeles County declined by -41% in 2009 and will drop again in 2010 but at a much slower rate (-0.8%). Orange County's total construction activity value dropped by about -34% in 2009 but will pick up by +9% in 2010. The Riverside-San Bernardino area's total nonresidential building permit values plunged by -60% in 2009 and will decline again in 2010 by -21%. Ventura County's total nonresidential construction permit values contracted by -56.5% in 2009.

For the most part, office space development will be restrained in all five counties of the Southern California region. Many companies have ceased shedding employees but they are still in a wait-and-see stance regarding new hires due to the uncertain business outlook. Office vacancy rates around the region should be stable in 2010 (or may even decline in some areas) as the employment situation improves. Average rents will continue to soften with a still strong demand for concessions, especially in Orange County and the Inland Empire. The few companies considering expansion will look at several different markets to obtain more competitive lease rates.

The outlook for industrial space development, especially in the tight markets of Los Angeles and Orange counties, while not bright, is at least looking more stable. International trade continues to lead the region's economic recovery and will eventually require more distribution and warehouse space as the nation and its major

trading partners recover. When the construction recovery finally comes, the Inland Empire will again see most of the new industrial construction activity, but land is getting scarce in the western end of the region. Development activity will spread east along I-10 or go north over the Cajon Pass to the High Desert.

**Table 34:**  
**Office Building Permits Issued**

(In millions of dollars)

	LA	O	R	SB	V
1990	623	236	68	67	31
1991	386	118	50	34	33
1992	121	27	34	22	28
1993	144	51	41	17	6
1994	108	41	12	22	4
1995	88	29	10	32	9
1996	133	45	22	9	4
1997	161	129	22	12	6
1998	284	270	9	22	25
1999	393	289	24	16	13
2000	268	354	31	15	32
2001	547	174	43	20	30
2002	209	150	36	30	5
2003	182	118	85	61	40
2004	307	133	127	84	18
2005	233	313	148	85	23
2006	241	578	192	115	52
2007	716	282	224	118	55
2008	446	114	118	33	26
2009	187	5	27	8	6

**Table 36:**  
**Industrial Building Permits Issued**

(In millions of dollars)

	LA	O	R	SB	V
1990	309	59	120	182	43
1991	141	39	38	117	35
1992	92	22	21	38	37
1993	55	18	13	59	23
1994	71	11	14	76	32
1995	74	34	32	69	20
1996	124	84	51	87	64
1997	109	123	98	189	56
1998	308	234	118	209	82
1999	361	123	112	331	58
2000	359	87	99	405	42
2001	202	90	75	331	76
2002	225	62	81	243	31
2003	276	68	113	245	47
2004	178	26	203	436	45
2005	277	27	120	322	23
2006	182	91	288	373	21
2007	109	52	185	351	29
2008	135	14	70	92	16
2009	40	0	12	33	17

Source: Construction Industry Resource Board

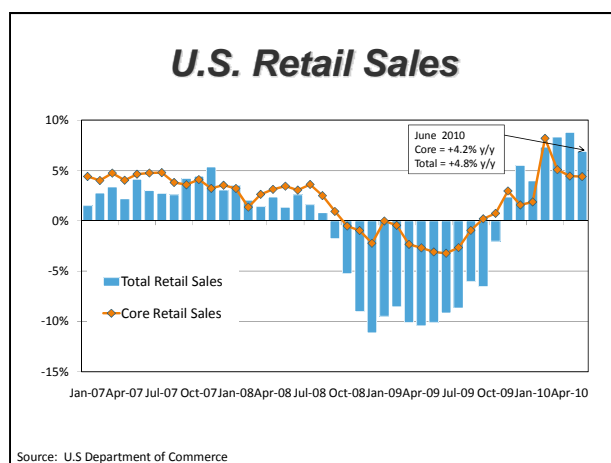
**Table 35:**  
**Retail Building Permits Issued**

(In millions of dollars)

	LA	O	R	SB	V
1990	509	222	174	201	46
1991	351	110	172	147	16
1992	244	91	216	87	7
1993	249	73	87	71	52
1994	265	144	77	97	16
1995	209	101	113	149	57
1996	322	136	101	100	43
1997	272	210	203	109	31
1998	368	155	175	158	49
1999	408	217	170	181	101
2000	447	223	316	132	23
2001	434	207	191	178	48
2002	459	194	231	163	81
2003	356	78	231	225	55
2004	484	118	406	176	90
2005	552	133	345	232	69
2006	482	178	372	294	54
2007	493	319	388	351	50
2008	469	132	317	243	63
2009	222	65	56	34	15

## Retailing

U.S. retail sales volumes began to slow towards the end 2007 and by late 2008, began a precipitous decline that lasted 14 months. Retail sales reached their nadir in December 2008, plummeting by -11.2% from their peak in November 2007. The industry limped along through April 2009. As the economy returned to growth in the second half of 2009, recession-weary consumers ventured back to the malls. Since then, and through the first two quarters of 2010, retail sales have rebounded, but are still below the levels seen in the months leading up to the financial crisis.



In recessions past, consumer spending has been a key component of recovery, but the financial crisis resulted in a severe contraction of credit availability. Outstanding consumer credit plunged by -\$93.9 billion during the past twelve months and by a total of -\$166.3 billion since its peak in July 2008. Not only were financial institutions less willing to make loans, but debt burdened consumers set to work repairing household balance sheets.

Total personal income fell by -1.8% in 2009 but began to grow again late in the year. During the first quarter of 2010 personal income increased by nearly +2.0% compared with the first quarter of 2009. What's missing is the return of consumer confidence.

The high rate of unemployment still has many people feeling insecure. Constrained by high debt burdens, depleted wealth and tight credit, individuals are adding more to personal savings. Personal savings as a percentage of disposable personal income increased to 3.5% (a high rate by recent historical standards) during the first quarter of 2010 compared with 1.2% during the same period in 2008.

While sales have increased, the business climate for most retailers remains difficult. The pace of store closings has slowed, but many retail organizations are barely hanging on. Additionally, retailers are resorting to discounting to entice cautious consumers to open their wallets. This puts the squeeze on profits and hurts share prices.

As retailers downsize or close their doors, retail space vacancy rates have increased dramatically. The retail vacancy rate for the Los Angeles metro area was 2.8% in 2007 and is forecast to rise to 7.1%<sup>2</sup> in 2010. The numbers are similar in Orange County (rising from 2.7% in 2007 to 7.0% in 2010). In the Riverside-San Bernardino area, retail vacancy rates climbed from 6.7% in 2007 to 12.7% in 2010. Asking rents and completions have declined accordingly. The good news is that while conditions are still getting worse for retail real estate, they are declining at a slower pace – an indication that the bottom may be near. On the flip side, stronger retailers have been able to upgrade to better locations and wrangle concessions out of struggling landlords.

As a result of high vacancy rates and declining property income, retail real estate has been rocked by a string of foreclosures involving major shopping centers with problems ranging from unfinished properties stopped short by the

<sup>2</sup> Marcus & Millichap

credit crunch to distressed properties with lots of vacancies.

Shopping centers account for about 47% of the nation's retail space. Across the U.S. there are approximately 104,990 shopping centers with 7.2 billion square feet of leasable space<sup>3</sup>. Many of the loans used to finance the recent construction of retail space will be coming due this year and next. Facing huge declines in property values and revenues, foreclosures may increase even as lenders and borrowers struggle to find ways to extend these loans.

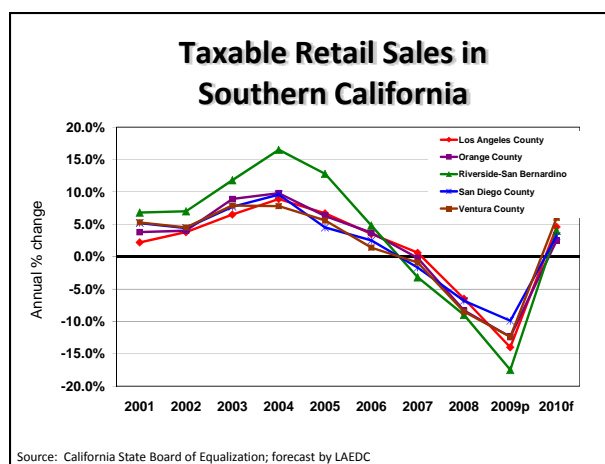
There is also the issue of what to do with empty big box locations. Many malls have large spaces vacated by former anchors that are not easy to fill. However, after standing empty for a year or two, stronger mid-sized retail operations are starting to take advantage of these empty spaces, many of which occupy prime locations. Retail chains like Kohl's, Forever 21 and TJ Maxx that appeal to bargain conscious shoppers are starting to take over those empty stores. Some building owners are reconfiguring cavernous spaces to attract smaller tenants, and businesses other than retailers are coming up with fairly creative solutions that include churches, gyms, office space and even community pools. While big box stores are not going to disappear altogether, there is a growing trend toward "right sizing" - even Target and Wal-Mart are testing smaller floor plans.

Newly cost-conscious consumers have created opportunities for discount retailers, many of which have not only weathered the downturn, but are thriving. Even department stores and teen chains, two retail sectors that were among the hardest hit during the recession, are starting to show strong gains. Surviving retailers that reacted quickly, tightening operations and trimming costs, will benefit from increased market share in a recovery environment stripped of weaker competitors.

<sup>3</sup> International Council of Shopping Centers

## Sales Trends

Southern California retail sales have seen steady growth during 2010. While high unemployment is weighing heavily on consumer confidence, jobs are beginning to return, albeit at a slow pace. Retail sales in most areas bottomed out in the spring or summer of 2009 and have been rising moderately in 2010. As the unemployment rate begins to fall later this year and through 2011, and consumer confidence gains traction, momentum will pick up for the retail industry.



The local retail scene demonstrated its expectations for a rosier future over the past year. The 25 largest shopping centers in Los Angeles County alone house a total of 4,000 stores and 29 million square feet of leasable space. Several of the region's large shopping centers embarked on a series of renovations to lure shoppers back in greater numbers. Los Cerritos Center just opened a larger Nordstrom's store and 36,400 square feet of new stores. In January, the mall opened an 86,000 square foot Forever 21 that took over a former Mervyn's spot. The Culver City Mall got a \$180 million renovation. In 2008, work started on Santa Monica Place. The mall is being converted from an enclosed structure to an open shopping center. The total cost of the project is estimated to be \$265 million and is scheduled for completion this summer. Local retail development reflects a growing trend

toward renovation and redevelopment as opposed to new building.

The LAEDC is forecasting moderate increases in taxable retail sales that will range from +6.0% in Ventura County to 2.5% in Orange County. Los

Angeles County is expected to see an increase of +4.6% in retail sales while sales in the Inland Empire and San Diego County are expected to rise by +4.0% and +3.2% respectively.

### *Top Ten Shopping Centers in Los Angeles County*

Rank	Retail Center	Size (leasable area)	Number of Stores	Average Household Income (5 mile radius)
1	Del Amo Fashion Center	2,381,000	212	\$95,973
2	Lakewood Center Mall	2,090,975	270	\$67,641
3	Westfield Topanga	1,634,634	277	\$90,360
4	Northridge Fashion Center	1,440,000	170	\$80,201
5	Glendale Galleria	1,320,000	250	\$68,965
6	Westfield Santa Anita	1,294,741	238	\$82,653
7	Burbank Town Center	1,240,000	140	\$74,989
8	Puente Hills Mall	1,183,303	102	\$82,891
9	Los Cerritos Center	1,143,613	208	\$74,129
10	Westfield West Covina	1,079,967	196	\$68,953

Source: Los Angeles Business Journal; June 21, 2010



### XIII. A Wrap Up

The 2008-2009 recession has ended, and good riddance! It was extremely painful for business, governments and consumers. A recovery is now underway both nationally and locally.

The recovery period will be challenging, especially for state and local governments. Their financial recovery always lags the overall economy, and this recovery will be impeded by the sharp drop in both residential and commercial property values. Many businesses haven't seen any upturn yet, but it will come to them eventually.

A significant challenge will be getting the long term unemployed back to work. Many of their old jobs have disappeared for good. Job training will be necessary to learn new skills. The hurdle here is making sure that there are real employment opportunities for training program graduates.

What should we expect for the Southern California economy in the months ahead?

- 1.) The economic news will gradually turn to "mixed" and then "better."
- 2.) However, there will more unpleasant headlines, especially about unemployment rates. This will be a given, and we will have to look beyond these numbers for proper perspective.
- 3.) We have to "like" ourselves. We have been so busy coping with the economic challenges that we have forgotten about the region's many assets.
- 4.) These assets are truly impressive, and we need to build on them. A few examples: three major research universities, the largest port complex in the U.S., the center for U.S.

entertainment, a major manufacturing center, and a rapidly developing rail transit network (who would have thought it possible?).

What are some of the challenges in the months ahead, and what can we do about them?

- 1.) Business recruiters from other states and areas are very active and quite sophisticated in their approach. We need to recognize what they do. It's time to fight back!
- 2.) One way to fight back is to improve the business environment. This is extremely important as our business base is small-to-medium sized firms. They have struggled over the past few years. Some have had to shut down. Several cities in Southern California have been very successful in being business friendly and attracting new businesses. They are good role models for the rest of us.
- 3.) We must recognize that economic development is more than attracting a new retail development for the sales tax revenue. Manufacturing and wholesale trade/logistics generate lots of sales tax revenue as well as creating good jobs.
- 4.) All local cities and counties need to work together more effectively to grow the region's economic base. Los Angeles County already has developed an economic growth strategy, and it can be a template for other counties in the region.

Our forecast: the future for Southern California remains sunny and bright, but we need to be more strategic and work together!



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