Economic Forecast

Introduction - General Economy

A report released by Chapman University economists in late November 2012 predicts that U.S. economic growth will be tempered by the threat of year-end tax increases and spending cuts that are looming if Congress does not act. This situation is being referred to as a "fiscal cliff." Should the tax increases and spending cuts go into effect, short-term impacts could include scant growth for the U.S. Gross Domestic Product (GDP). The report also indicates that the U.S. economy remains susceptible to impacts from a sluggish global economy as the Eurozone wends its way through its debt crisis and China's economy slackens.

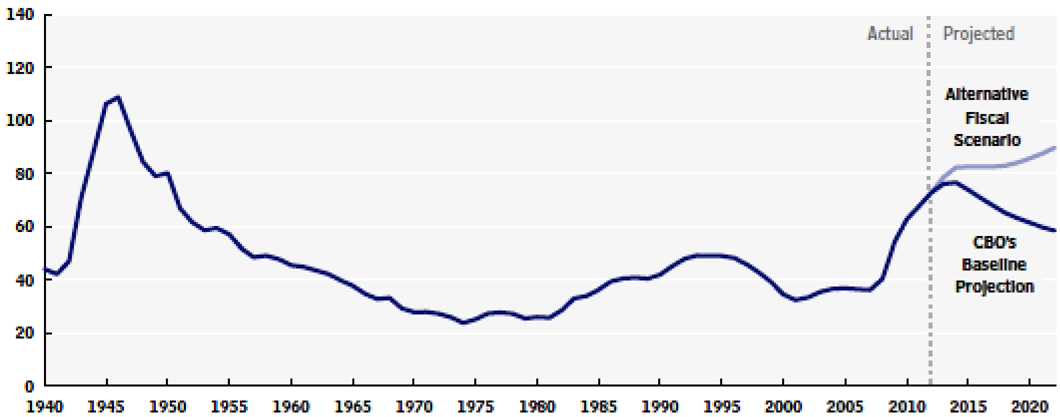
Trends in key economic indicators reflect a modest growth, including trends in housing prices and sales, employment and payrolls, consumer and business confidence levels, capital investment, etc. Consumer sentiment is at the highest level since third quarter of 2007, primarily attributed to an improving labor market and the recovering housing market. The Conference Board's *Consumer Confidence Index* rose 0.6 points in November 2012, rising to the highest level in four and a half years. Overall, recovery continues to be modest and economists project sluggish and minimal growth through 2012 with slightly higher growth expected in 2013.

National Economy 

The federal budget deficit continues to exceed $1 trillion and is projected at a total of $1.1 trillion in fiscal year 2012. At that level, the deficit would be 7.3% of GDP but only about three-quarters the size of the deficit three years ago relative to the size of the economy. The Congressional Budget Office (CBO) projects that budget deficits will begin to decline, falling from 7.3% of GDP to 4.0% of GDP in 2013, 2.4% of GDP in 2014 and then 1.0% of GDP from 2015 to 2022. The CBO projections are based upon the assumption that Congress will take no action to avoid the tax increases and automatic spending cuts that go into effect in 2013. The following schedules prepared by the CBO illustrate the level of national debt over time and the allocation of deficits.

Federal Debt Held by the Public, Historically and As Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of gross domestic product)

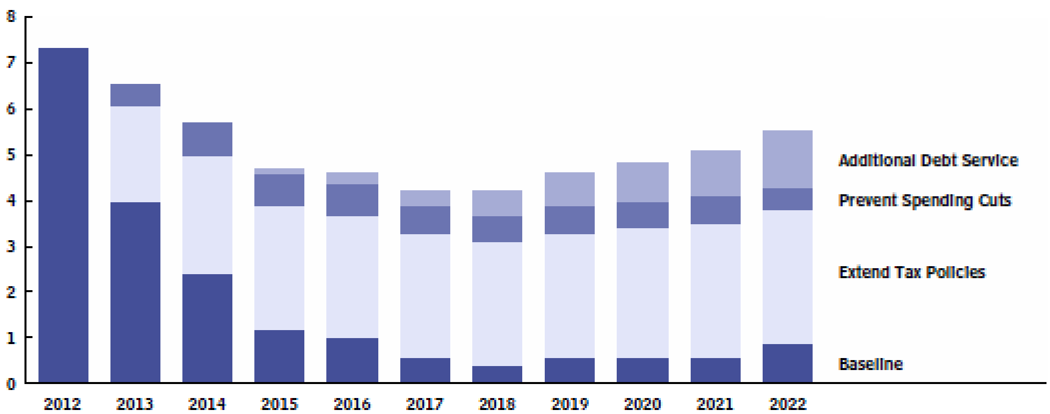


Source: Congressional Budget Office.

Note: The alternative fiscal scenario incorporates the assumptions that all expiring tax provisions (other than the payroll tax reduction), including those that expired at the end of December 2011, are instead extended; that the alternative minimum tax is indexed for inflation after 2011 (starting at the 2011 exemption amount); that Medicare's payment rates for physicians' services are held constant at their current level; and that the automatic enforcement procedures specified by the Budget Control Act of 2011 do not take effect. The budgetary effects under the alternative fiscal scenario also include the incremental interest costs associated with projected additional borrowing.

Deficits Projected in CBO's Baseline and Under an Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Note: "Additional Debt Service" is the amount of interest payments on the additional debt issued to the public that would result from the policies in the alternative fiscal scenario. "Prevent Spending Cuts" involves holding Medicare's payment rates for physicians' services at their current level (rather than permitting them to drop, as scheduled under current law) and preventing the cuts to federal spending that will occur under the automatic enforcement procedures of the Budget Control Act of 2011 from taking effect (but leaving in place the original caps on discretionary appropriations in that legislation). "Extend Tax Policies" reflects the assumptions that expiring tax provisions (other than the payroll tax reduction) are instead extended and that the alternative minimum tax is indexed for inflation.

Due to the continued weak economy, business owners, consumers and investors are cautiously optimistic. CBO forecasts of percentage change for key National indices are presented below:

Indices		Forecast		Projected Annual Average	
		2012	2013**	2014-2017	2018-2022
Real GDP	1	2.1%	-0.5%	4.3%	2.4%
CPI	1	1.3%	1.6%	2.1%	2.3%
Unemployment	2	8.2%	9.1%	5.7%	5.3%
3-Mo. T-Bill	3	0.1%	0.1%	1.3%	3.7%
10-Yr. Treasury Note	3	1.8%	1.8%	3.4%	5.0%
Fed. Deficit % to GDP	4	7.3%	4.0%	N/A	N/A

Notes:
1 – Fourth Quarter to Fourth Quarter, Percentage Change
2 – Fourth-Quarter Level, Percent (Annual averages reported reflect value for last year in the range)
3 – Calendar Year Average, Percent
4 – Year-over-Year Change, as a percentage of Gross Domestic Product
**Decrease in Real GDP and increase in unemployment assume that Congress takes no action and tax increases and spending cuts take effect in 2013

California Economy

After a number of years of state budget challenges, California now appears to be facing a much smaller budget problem. A combination of factors is responsible for the improved outlook including: the state's economic recovery, budget reductions, and temporary taxes provided by the voters' approval of Proposition 30. The California Legislative Analyst's Office (LAO), in a report released in mid-November 2012, cautions that although the outlook for the State Budget is positive, the forecast depends on certain economic, policy, and budget assumptions. For example, the forecast assumes that federal officials will take actions to avoid economic problems associated with the federal "fiscal cliff." Any changes to the assumptions could lower or eliminate projected operating surpluses.

The California Legislative Analyst (LAO) forecasts a $943 million FY 2012-13 state deficit and a projected FY 2013-14 $1.9 billion operating shortfall. The forecasted shortfall is due to a net of $625 million lower revenues for FY 2011-12 and 2012-13 combined; $2.7 billion in higher expenditures (including lower-than-budgeted savings from the dissolution of redevelopment agencies); and an assumed $1.4 billion positive adjustment to the FY 2010-11 ending budgeted fund balance.

The LAO projects continued high unemployment and weakness in job growth; however forecasts stronger growth in personal income in 2013. The LAO's economic forecast for California indices is presented below:

LAO Economic Forecast Summary

California	2010	2011	2012	2013	2014	2015	2016	2017	2018
Unemployment rate	12.3%	11.8%	10.6%	9.6%	8.7%	7.8%	7.1%	6.7%	6.7%
Percent change in:									
Personal income	3.1%	5.2%	4.1%	4.7%	5.5%	5.8%	5.4%	4.9%	4.7%
Wage and salary employment	-1.1	0.9	1.7	2.3	2.5	2.6	2.1	1.7	1.1
Consumer Price Index	1.3	2.6	2.2	1.3	1.7	1.7	1.9	1.9	2.0
Housing permits (thousands)	45	47	63	83	113	139	155	168	164
Percent change from prior year	23.0%	5.9%	32.6%	32.6%	35.8%	22.4%	11.6%	8.4%	-1.9%

Local economists, including forecasts by Chapman University and UCLA, predict that a slow recovery will continue through 2013 (only slightly outpacing 2012 growth). Per Chapman University, the California and Orange County economies will be facing higher sales, income, and payroll taxes which would impact the recovery. Positive signs are the increase in consumer confidence, and a rebound in construction spending.

UCLA, in its September 2012 report, agrees that the economy continues to recover slowly and is "muddling through" at the lower end of a 1% to 3% growth pace. And, although unemployment rates continue to improve, the rate remains higher than the national average, and no significant drop in the unemployment rate is anticipated until 2014.

Forecasts by local economists of average, nominal percentage change for key state indices are presented as follows:

Indices	Chapman		UCLA		
	2012	2013	2012	2013	2014
CPI	2.7%	3.0%	2.1%	1.8%	2.2%
Taxable Sales	5.6%	5.4%	6.3%	3.6%	4.2%
Personal Income	4.7%	5.4%	3.0%	4.1%	5.2%
Payroll Employment	1.3%	1.7%	1.8%	1.6%	2.4%
Unemployment Rate (not %change)	N/A	N/A	10.7%	9.8%	8.5%

Orange County Economy 

In Orange County, economic recovery continues to outperform national and state economic growth in many areas. Orange County recovery trends are also positive when compared to peer counties.

In 2012, the County's rate of unemployment dropped and there was growth in jobs and earnings. Consumers, who have tended to save more over the last two years, increased spending on consumer goods in the last quarter of 2011.

The County's two primary funding sources are property taxes and sales taxes which track in correlation with changes in the housing sector and taxable sales activity. By 2011 there were increases in both housing and sales. Trends in 2011 and 2012 have been generally positive.

Overall, Orange County economic recovery is positive and rates of growth anticipated in the 2011 SFP have been equal to, or slightly better than, projected. Growth has been steady and is likely to remain positive. Key growth trends are highlighted in the chart below and additional discussion of key indicators follows.

(Year-to-Year Percentage Changes)

Indices	2008	2009	2010	2011	2012 Forecast	2013 Projected	Trend
Payroll Employment	-2.2	-7.4	-1.3	1.2	1.8	2.0	⬆
Total Personal Income	1.6	-6.3	3.0	5.6	6.0	6.3	⬆
Taxable Sales	-6.4	-14.7	4.3	6.9	6.0	6.2	⬆
Permits – Dwelling Units	-55.3	-30.4	40.5	55.5	27.3	15.1	⬇
Consumer Price Index	3.5	-0.8	1.2	2.7	2.8	3.2	⬆
Homes Index, Resale Single Units (1990 = 100)	-24.4	-7.7	7.6	-5.7	2.0	7.1	⬌

Source: Chapman University, *Economic and Business Review*, June 2012

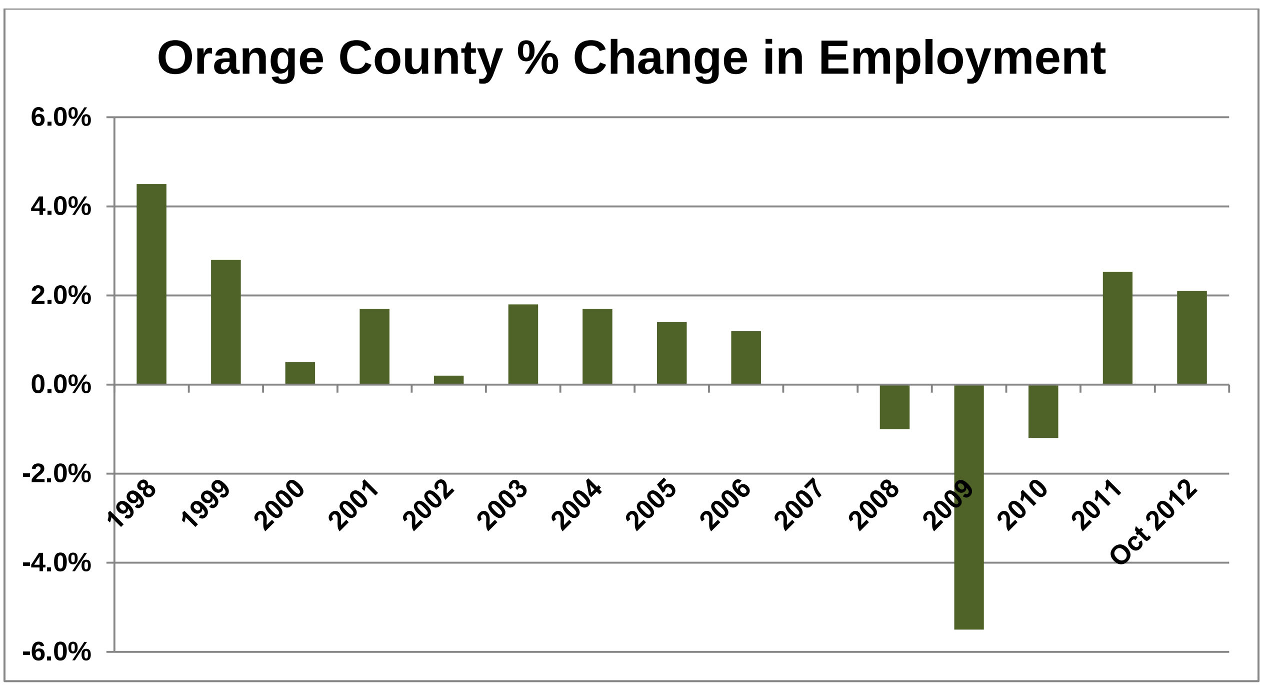
Employment – According to Chapman University and data released by the California Employment Development Department, payroll employment in many metro areas are still below peak levels. The good news is that there was job growth during the first three quarters of 2012. Orange County has experienced job growth in all sectors with the exception of *State & Local Government* and *Manufacturing* with both of those sectors experiencing continued job loss (*State and Local Government* job loss is a national trend). From January through October 2012, job growth increased by 8.4% in Construction, 5.9% in Leisure & Hospitality, 3.2% in Education & Health Services, 8.3% in Financial Activities, and 4.6% in Professional & Business Services. Orange County's rate of unemployment has declined to 7.2% and remains below the national rate of 7.9%.

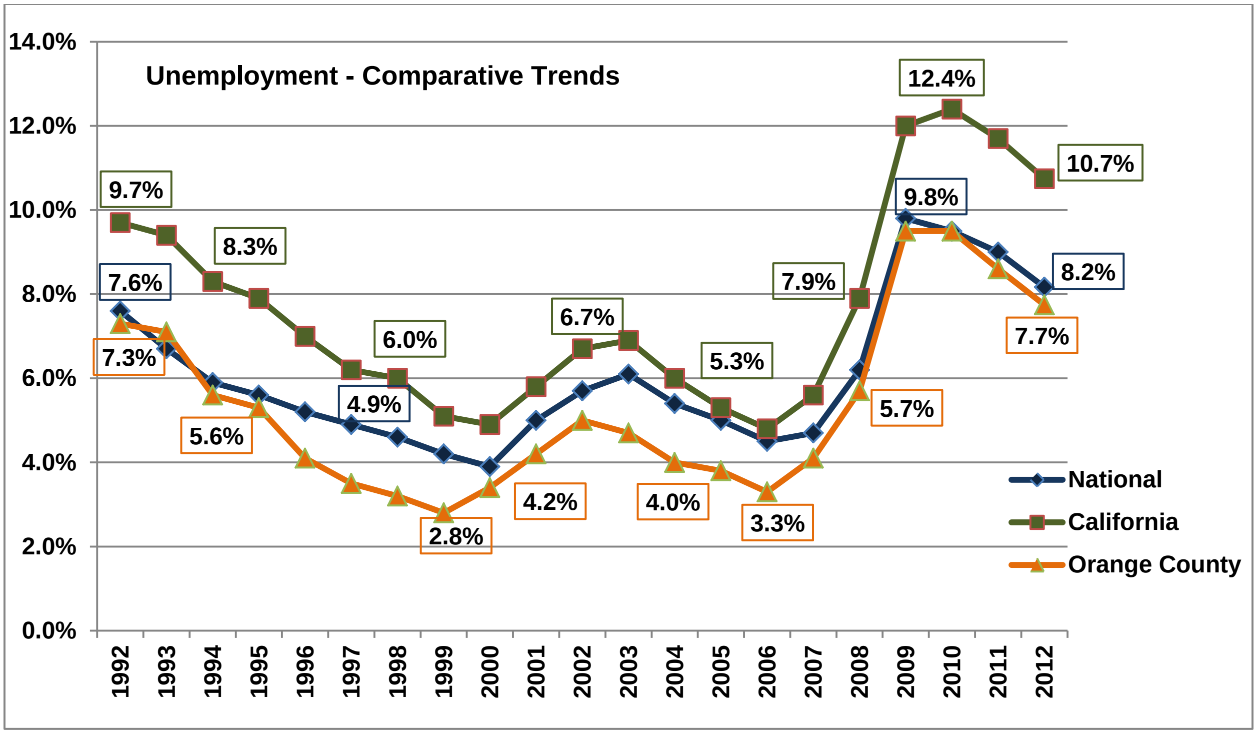
Key employment indices and analysis for Orange County follow:

COMPARATIVE EMPLOYMENT STATISTICS (October 2012 preliminary)			
	Total Labor Force	No. of Employed	% Unemployment
Los Angeles County	4,840,100	4,339,200	10.3%
Orange County	**1,623,200**	**1,506,800**	**7.2%**
Riverside County	937,300	824,500	12.0%
San Bernardino County	856,300	760,000	11.2%
San Diego County	1,601,700	1,464,800	8.6%

Sources: U.S. Bureau of Labor Statistics, U.S. Census Bureau and CA Employment Development Dept.

The Orange County Workforce Investment Board reported that in October 2012, Orange County industry employment was showing decreases in half of the top ten industries, and increases in the other half of the top ten industries. They also reported that overall growth remains slower than projected growth from 2008 to 2018, likely due to the extensive impacts associated with the Great Recession. The Chapman University California Employment Indicator Index reflected growth with a change from 105.1 in 4th quarter 2011 to 110.7 in 3rd quarter 2012 (an Index > 100 suggests job creation and growth).





Housing – The Southern California and Orange County housing market has picked up momentum in 2012, as evidenced by increases in sales and median prices and a drop in foreclosures. Year-over-year median prices have increased and the number of units in foreclosure is down significantly from the prior year. It is anticipated that housing will continue a lukewarm recovery during 2013 and significant growth will not be realized until 2014 or beyond.

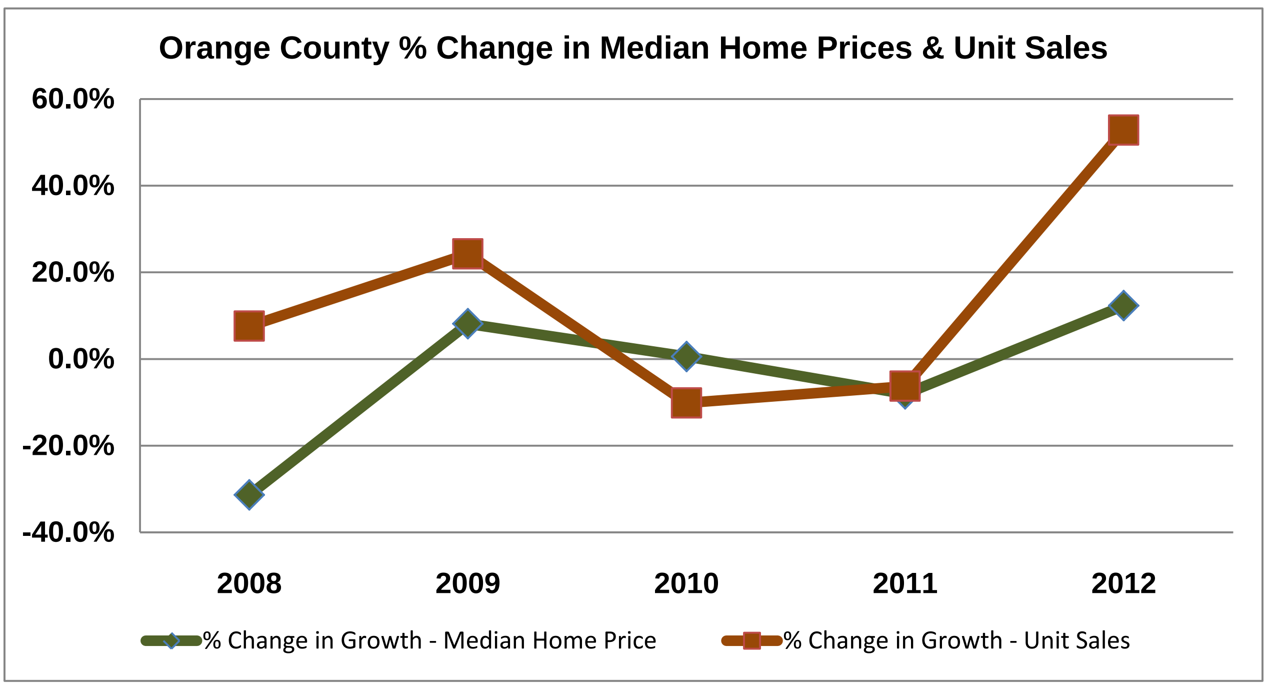
In Orange County, 2012 housing trends, overall, have been on the rise, with a 7.1% increase in median sales price reported by DataQuick in September 2012. Total Orange County sales of residences in September 2012 were up 18.9% from a year prior. Increases in year-over-year sales gains occurred in 65% of the Orange County market. Foreclosures, although down, were still high when compared to base years.

Key housing indices and analysis for Orange County are as follows:

Peer Counties - Comparative Housing Analysis							
County	**Median Home Price**			**Unit Sales**			**Median Family Income**
(as of Oct. 31)	**2011**	**2012**	**% Change**	**2011**	**2012**	**% Change**	**2012**
Los Angeles	$300,000	$341,000	13.70%	5,830	7,268	24.70%	$55,476
Orange County	**$405,000**	**$455,000**	**12.30%**	**2,241**	**3,148**	**40.50%**	**$74,344**
Riverside	$187,000	$220,000	17.60%	3,026	3,407	12.60%	$57,768
San Bernardino	$150,000	$170,000	13.30%	2,300	2,722	18.30%	$55,845
San Diego	$315,000	$350,000	11.10%	2,759	3,622	31.30%	$63,069
Ventura	$335,000	$360,000	7.50%	673	908	34.90%	$75,348
So. California	$270,000	$315,000	16.70%	16,829	21,075	25.20%	N/A

Data Sources: DataQuick (Housing) and U.S. Census Bureau (Income); Median Family Income is as of September 18, 2012

The chart below, based upon data published by DataQuick, summarizes trends in year-over-year growth as of October 31st for Orange County Median Home Prices and Unit Sales.



Foreclosure rates are calculated by dividing total County housing units per the U.S. Census Bureau by the total number of properties that received notices of default (new filings, foreclosure in process, not yet recorded) within the month. The lower the second number is in the ratio, the higher the foreclosure rate (e.g. 1 in 100 is higher than 1 in

1,000). RealtyTrac, Inc. forecasts that 1 in 513 OC homes received a foreclosure filing in November 2012. Among peer counties, Orange County had the lowest foreclosure rate in November (see table below). For the first ten months of 2012, there were 11,791 notices of default issued and trustee's deeds filed (recorded completed and recorded) of 4,243. In calendar year 2011, there were a total of 17,712 notices of default and 9,416 trustee deeds issued. RealtyTrac reports that to date, the average foreclosure sales price was $449,007.

Foreclosure Statistics

	Foreclosures
Los Angeles County	1 in 479
Orange County	**1 in 513**
Riverside County	1 in 205
San Bernardino County	1 in 219
San Diego County	1 in 453

Source: RealtyTrac, Inc.

Taxable Sales – Taxable sales represent consumer spending transactions that are subject to sales and use taxes. The California Board of Equalization (BOE) reports sales on a quarterly basis, generally two quarters in arrears (the Department of Finance provides monthly projections two months in arrears). Taxable sales provide an indication of economic activity and drive County funding sources such as General Purpose Revenue sales taxes and General Fund department sources such as Public Safety Sales Tax and a portion of Realignment Revenue.

After steep drops in years 2007 through 2009, there has been growth in taxable sales in years 2010 and 2011 and modest rates of growth are projected for 2012 and 2013. At September 30, 2012, General Purpose Revenue sales tax receipts were approximately 7.7% higher than the same period in the prior year. General Fund sales tax receipts typically trend with taxable sales. Orange County historical taxable sales are summarized in the following table:

Orange County Trends – Taxable Sales in the 3rd Quarter		
For the 3rd Quarter / Calendar Year	**Taxable Sales (Billions)**	**Percent Change**
2013 (f)	$14.47	6.1%
2012 (f)	$13.64	5.4%
2011	$12.94	6.9%
2010	$12.10	4.6%
2009	$11.57	-15.2%
2008	$13.64	-4.3%
2007	$14.26	-2.1%
2006	$14.57	2.8%
2005	$14.17	9.2%
2004	$12.98	5.7%
2003	$12.28	8.1%
2002	$11.36	3.5%

Source - State Board of Equalization through 2010
Chapman University June 2012 – for 2011 and Forecast (f) for 2012 & 2013

Taxable sales tend to increase when personal income increases. Based on Chapman University's June 2012 Economic & Business Review report, total personal income is projected to increase by 6% to 6.3% in the next two years which supports the forecasts for future taxable sales increases.

Other Economic Data – There are other positive indications that Orange County recovery is gaining speed.

- In October of 2012, the Orange County Automobile Dealers Association reported that registrations of new cars and light trucks increased by 23.2% from 2011 to 2012 and forecasted growth in 2013 of 9.2%. During the nine months ended September 30, 2012, new retail registrations had increased by 35.4% over the same period in 2011.
- Bankruptcies in the County decreased 27% in September from a year earlier. It was the 13th consecutive monthly decline year-over-year. This provides another sign that the local economy is recovering, although the number of monthly filings is still about three times what is was before the start of the recession.

Summary

The economy appears to be “muddling along,” but it is anticipated that the momentum will be modest over the next year. After the crash of 1929, it took nearly 25 years for the housing market to recover and for economic balance to be restored. During that time, the economy reinvented itself with new labor policies, changes in manufacturing technologies, unionization, etc. Quoting from the December 2011 UCLA Anderson Forecast, “The end of a recession does not mean “recovered from a recession.” It only means that contraction has ended. The pain remains real and persistent until solid and sustained gains occur.”

As the County works through this current period of recovery, it needs to be prepared for an extended period of recovery. Recovery levels that impact County funding sources suggest that continued focus on re-benchmarking and/or re-tooling already established programs and services is necessary. Key questions that continue to need answers include:

- How can costs be reduced without sacrificing quality?
- What impact will long-term investing in technology and human capital contribute to productivity?
- What are the best ways to identify critical needs and measure performance success?

Beginning in 2007, Orange County made adjustments to smooth out the impacts of the Great Recession. Through the diligent efforts of Departments and thoughtful and timely action by the Board of Supervisors, the County has been able to maintain key services with fewer resources. The County has also taken slow and deliberate action to ensure that actions taken now do not create long-term, unintended consequences. It’s often said, “Hope for the best - Prepare for the worst.” Orange County continues to take the necessary steps to avoid the worst in order to ensure that stakeholders continue to receive the best.

An economist is an expert who will know tomorrow why the things he predicted yesterday didn't happen today. ~ Laurence J. Peter, US educator & writer