

The Lake County Economy: Real Estate Markets and Outlook

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The Agenda

- The local economy
 - National and state situations affect our regional economy
 - Banking of key importance now in facilitating a turnaround
 - State budget failures the current, major uncertainty
 - Need to consider our entire region rather than specific counties
- Economic outlook
 - Recession continues: some signs of a turnaround
 - Long-term outlook still strong in North Bay
- Local real estate: regional connections
 - Regional economic development ultimately dictates housing

Where are we now?

- Financial Markets Stabilized
 - Nationalized banking system losses
 - Confirmed no companies are too big to fail
- Real economy has shown signs of hitting bottom
 - Unemployment may stay relatively high until inflation begins to show its face
- Reform needed, but lagging
 - Federal and state (banking and budget)
- Inflation unlikely before late 2010, but...
 - Oil prices are a precursor to another commodities market rally based on the dollar
- Decoupling not happening
 - Emerging markets still very much tied to US and Europe

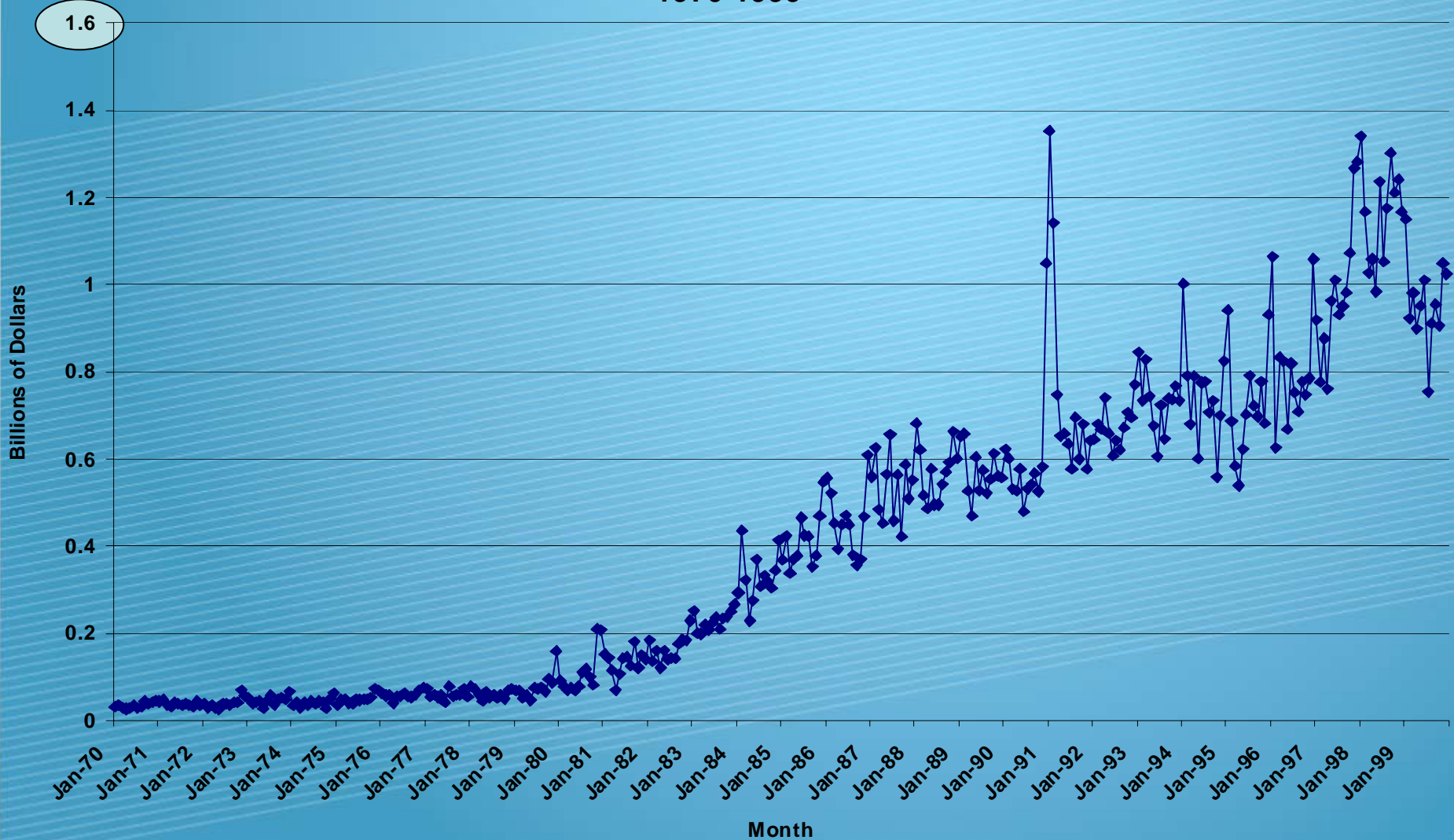
Domestic Macroeconomy

- Fiscal stimulus beginning its work
 - Already have had stimulus in place
 - This is more of a supply-side focus
 - Job creation the aim (including saving jobs)
 - Stimulating innovation not consumption
- Deflation: why we care
- Monetary policy at a natural endpoint
 - What else could possibly be done?
 - Why have banks not started lending again?
 - Expect regulation will encompass all lending and slow the speed of real estate transactions

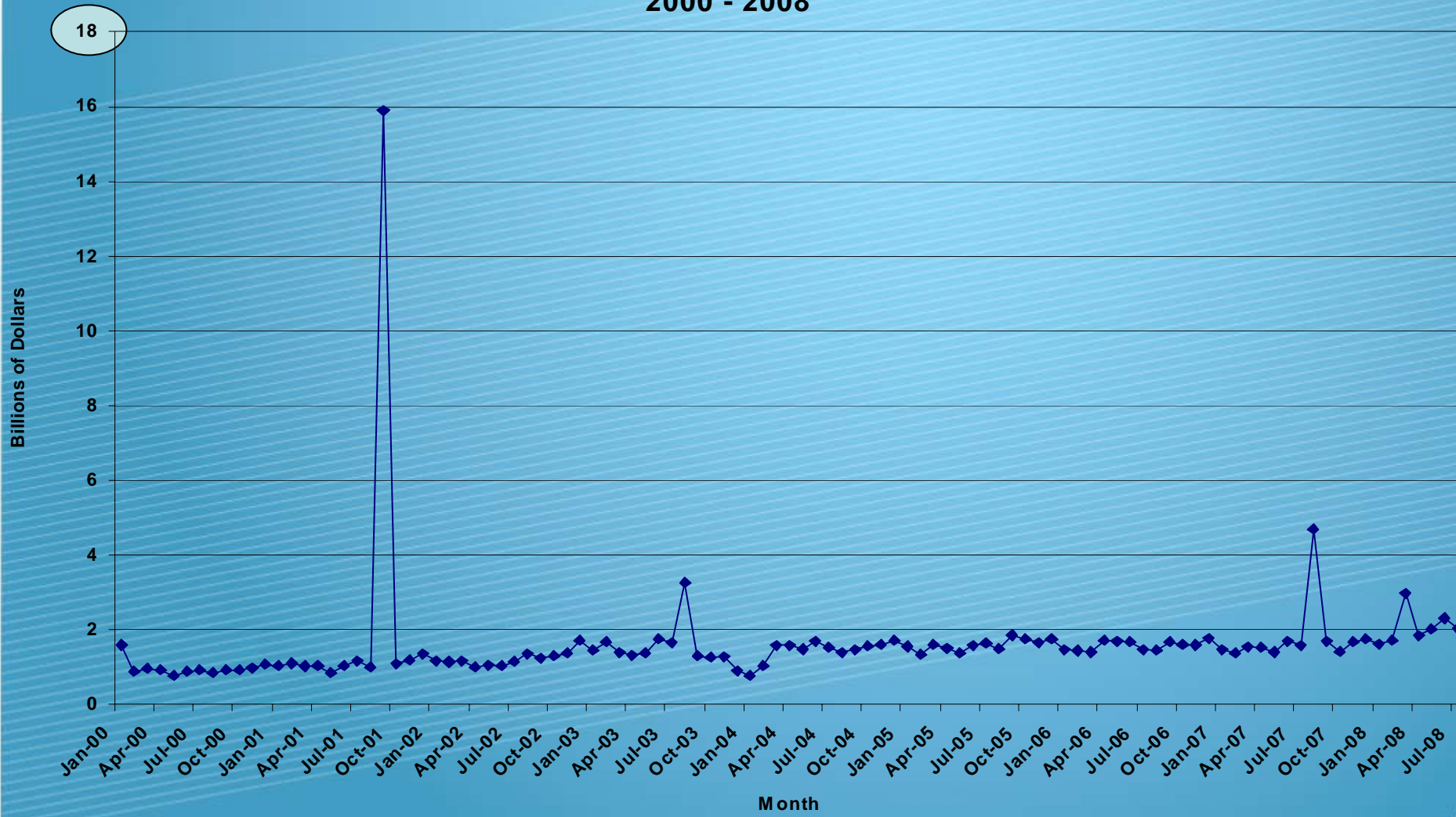
The Important Role of Banking

- Banking is both culprit and savior here
 - Riskiness drove current issues
 - Riskiness will help pull the economy out of recession
- Banking central in our classic models of growth
 - Investment from savings begets economic growth
 - Lending should be for investment, not consumption
- Banks still see too much risk generally
 - Following charts show banks remain nervous
- Local banks targets for consolidation, acquisition
 - Also a great place for a boom to start

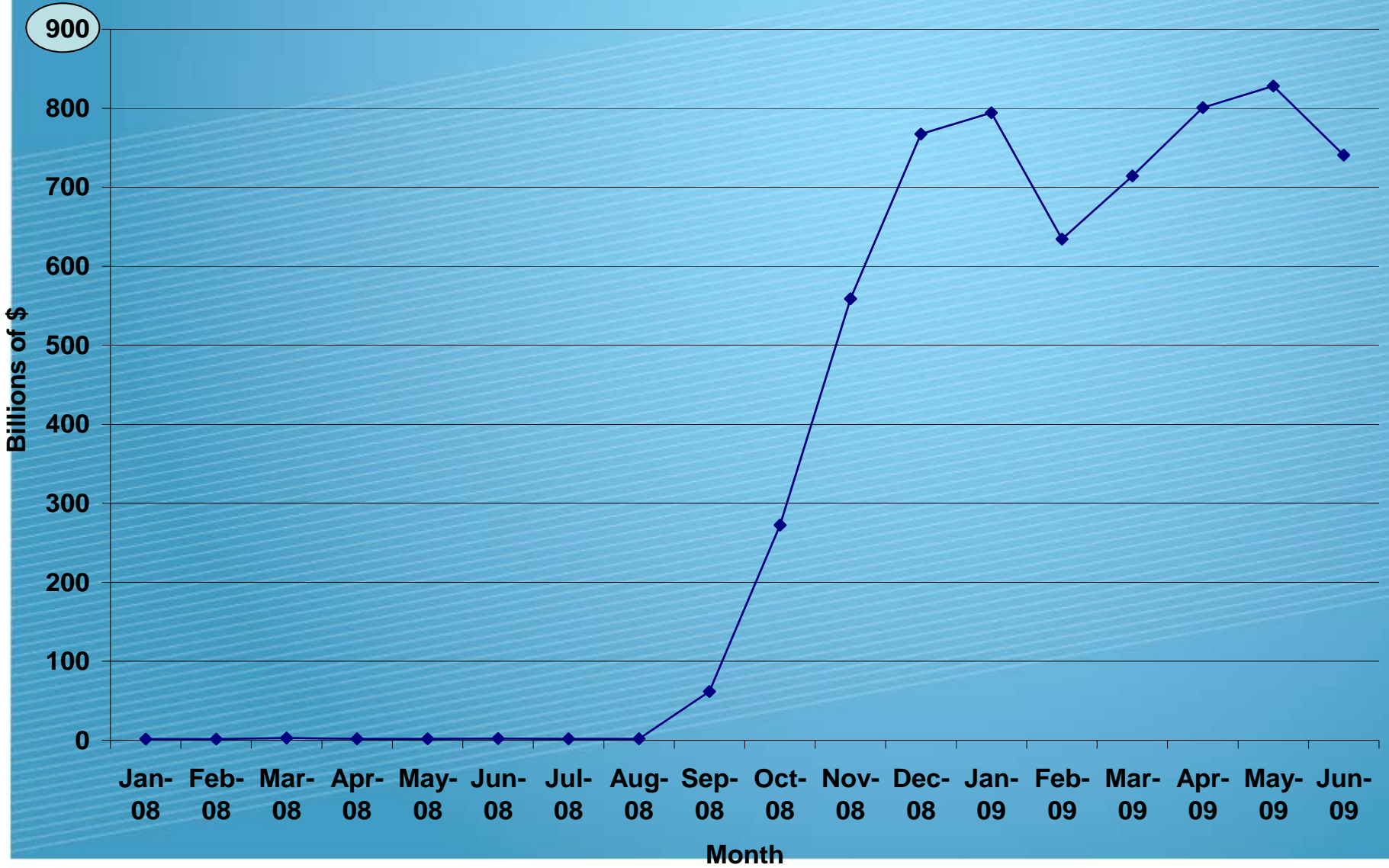
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ 1970-1999



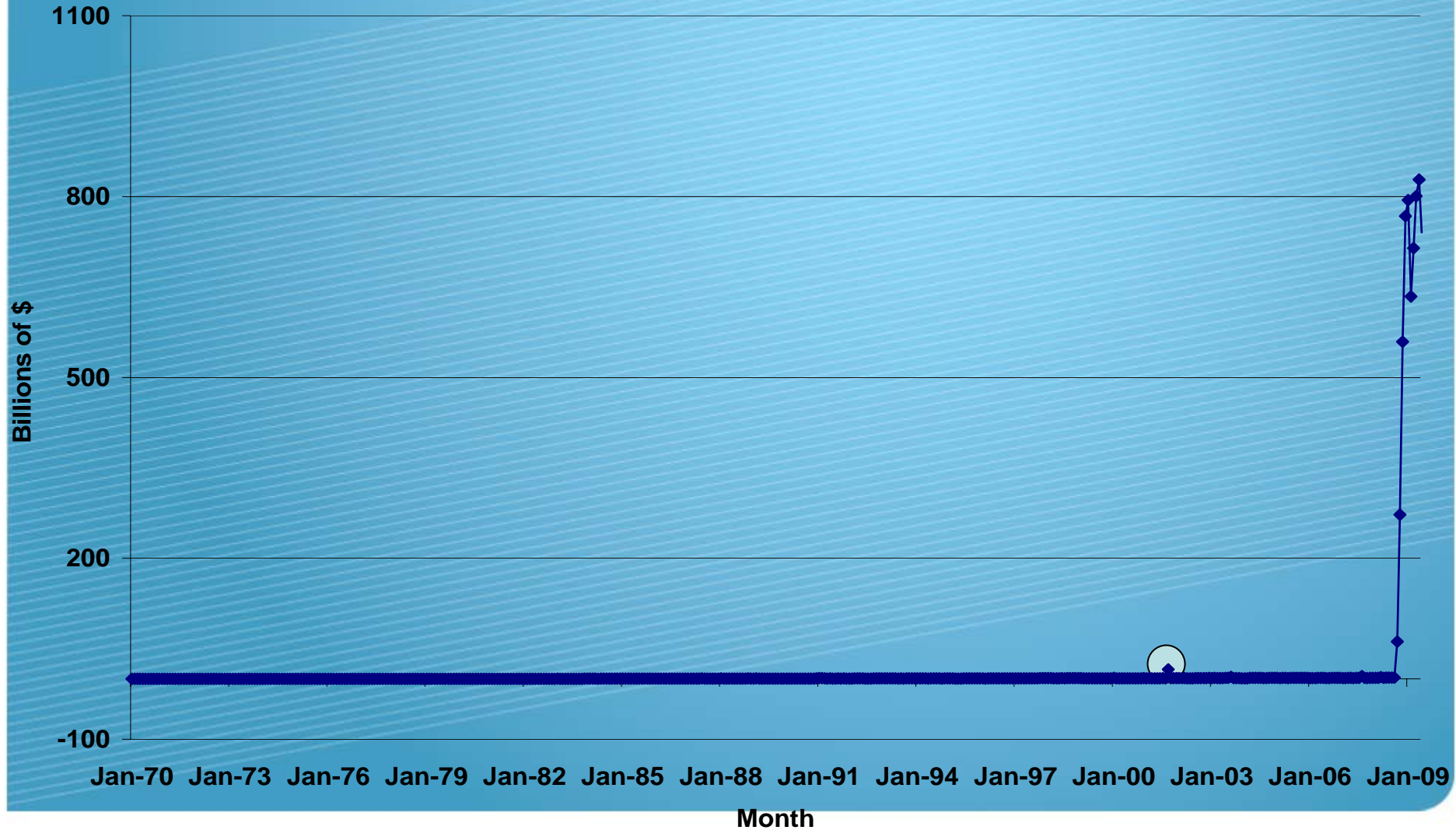
Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ 2000 - 2008



Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 2008 - June 2009



Excess Reserves at U.S. Banks (Loanable Funds Not Lent), 2008\$ Jan 1970 - June 2009



Long-Term Effects of Policies

- A decade of fiscal stimulus has already made national debt soar: now it is a lot more
- Current “monetary” package is fueled by a combination of debt and money printing
- Permanent cuts have larger short-term effects than temporary
 - Temporary cuts or spending provide better long-term signal of discipline
- Social security suffers during downturns due to reduced tax revenue and larger draw
- Inflation a no-brainer: speed and magnitude the questions
- Outlook for 2010 good if nothing unknown changes the economic outlook

California: into the unknown

- 2002 saw use of fiscal surplus from capital gains taxes spent on **permanent** spending
 - We are now paying for that in current deficit
 - Deficit rising every day: now \$50 billion by 2010??
 - Federal spending has filled void partially
 - \$5 billion of Federal Stimulus used already to plug the hole
 - Model of taxation in CA broken for long-term
 - Pension system to be stretched soon
 - School spending in CA now 50th in nation (\approx \$18K per pupil)
 - **Opportunity: public-private partnerships in education**

What is California Likely to Do

- Budget gap closed through borrowing
 - Borrow, if and when possible
 - May 19 showed CA voters do not want more taxes
 - Not going to have a choice at some point
 - Tax (and potentially political) reform is needed
 - Tax reform: What about Prop 13?
 - Budget reform: need a change to 2/3 vote and term limits?
- Effects on real estate
 - Higher tax rates slow down transactions
 - Commercial real estate threatened by changes in corporate and worker's compensation taxes just for starters
 - Glacial economic turnaround slows down progress also

Lake County: A Regional Conundrum

- Economic Development has three main foci:
 - Economic Growth
 - What businesses will drive Lake County's economy?
 - Social Equity stabilization
 - Can businesses and citizens help local services here?
 - Philanthropy, volunteerism, public-private partnerships
 - Environmental Protection
 - AB 32 and AB 811 working together
- Does Lake County want high tech?
- What about tourism long-term?
 - Regional competition for all these issues

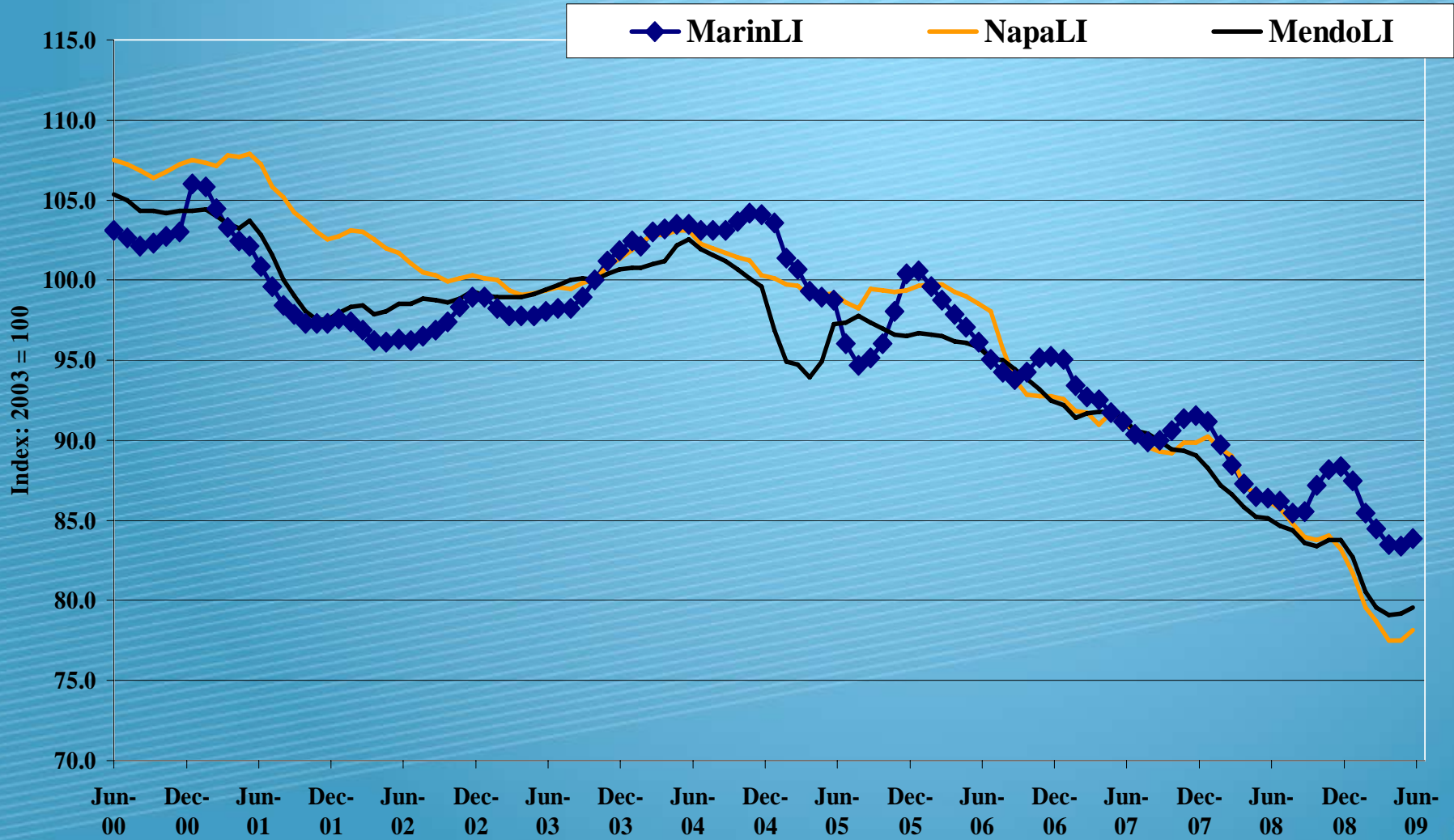
Toby Tyler North Bay Indicators

- Leading and Coincident Indicator for North Bay counties
 - The leading tells us where we are
 - The coincident tells us where we are going
 - The combination suggests a cyclic shape
- The indicators show recession has been here for some time

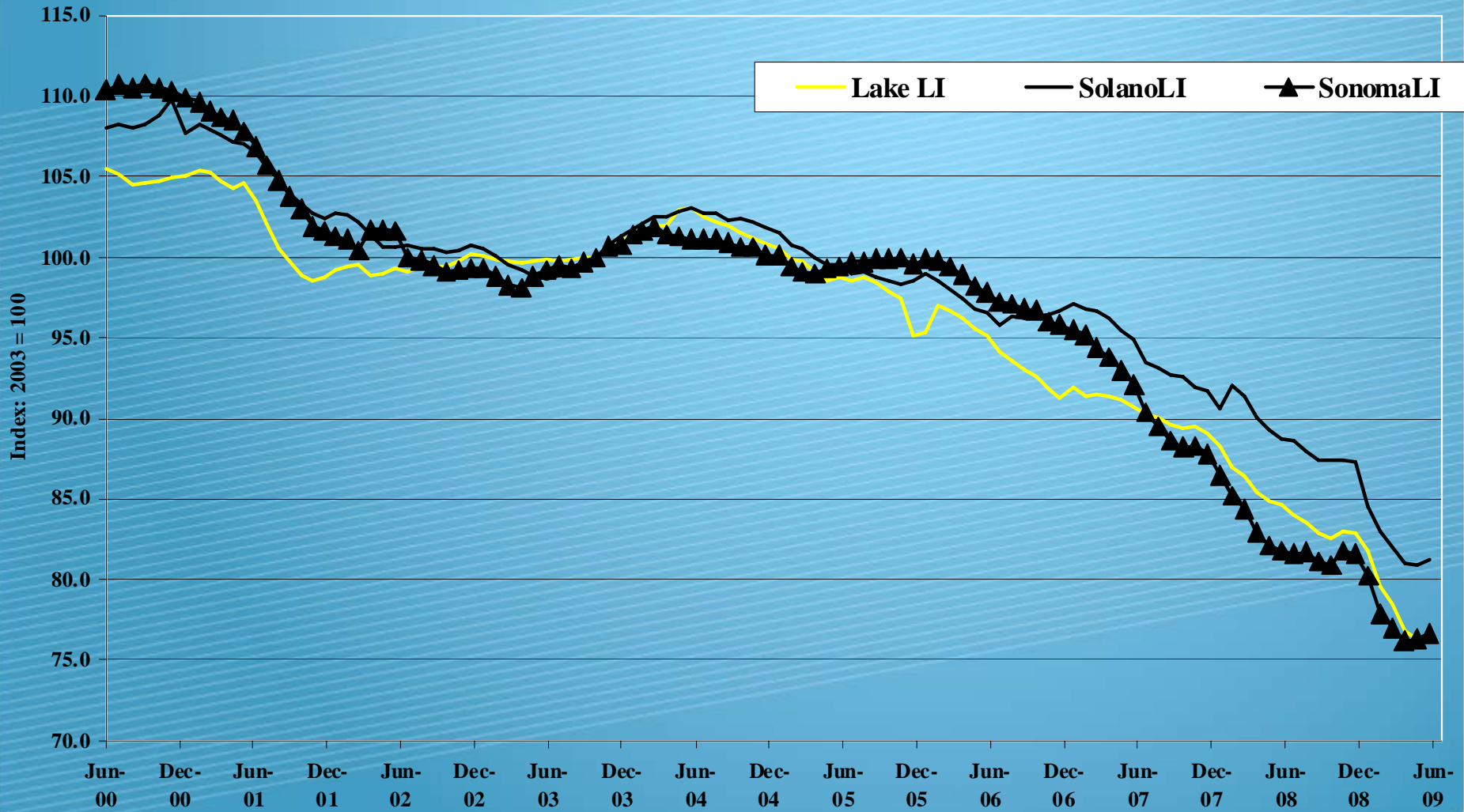
Leading Indicators

- Tyler Leading Indicators tell us where we are headed:
 - Default Notices (**Inverse**)
 - Building Permits (**Positive**)
 - New UI Claims (**Inverse**)
 - US Leading Index (**Positive**)
 - Help-Wanted Ads (**Positive**)
 - Ag Price Index (**Positive**)****
- As indicator increases, economy forecasted to move in **bolded** direction.

Tyler Leading Indicators: Marin, Napa, and Mendocino Counties



Tyler Leading Indicators: Lake, Solano and Sonoma Counties



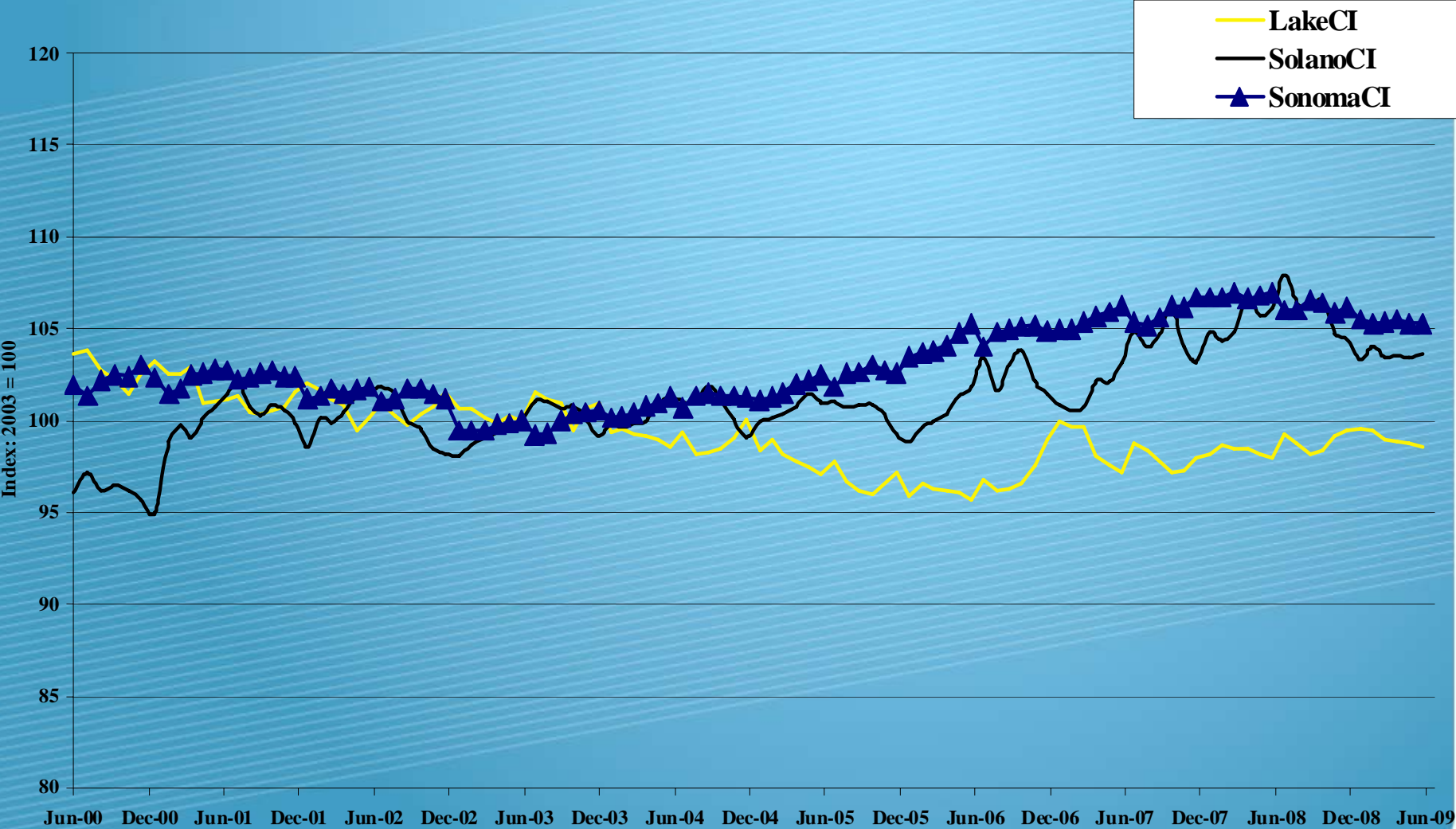
Coincident Indicators

- Tyler Coincident Indicators tell us where we are:
 - **Non-agricultural employment**
 - **Retail Sales**
 - **Personal Income**
- Coincident a mix of employer and residential spending

Tyler Coincident Indicators: Marin, Mendocino, and Napa Counties



Tyler Coincident Indicators: Lake, Solano, and Sonoma Counties

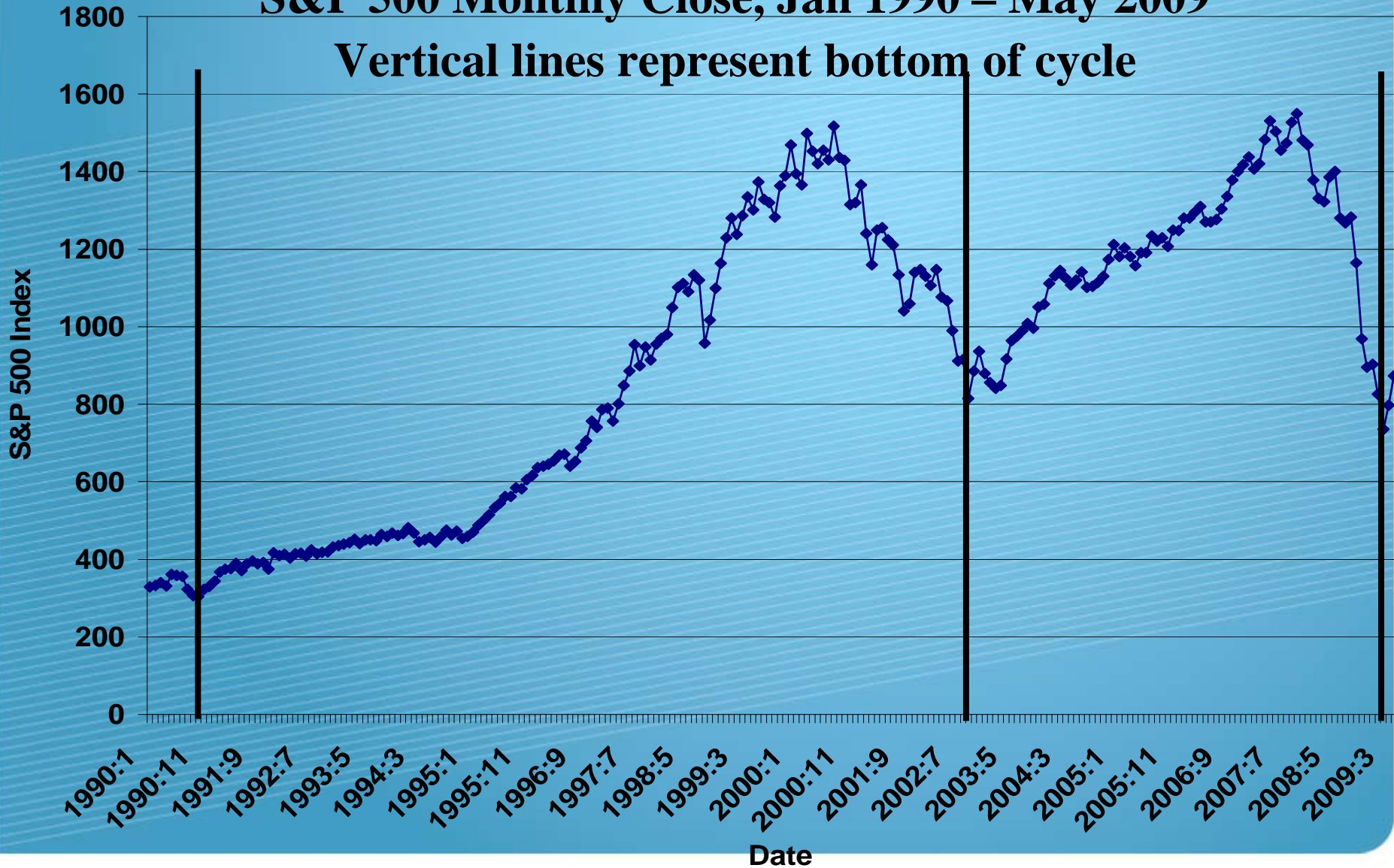


Signs of hope

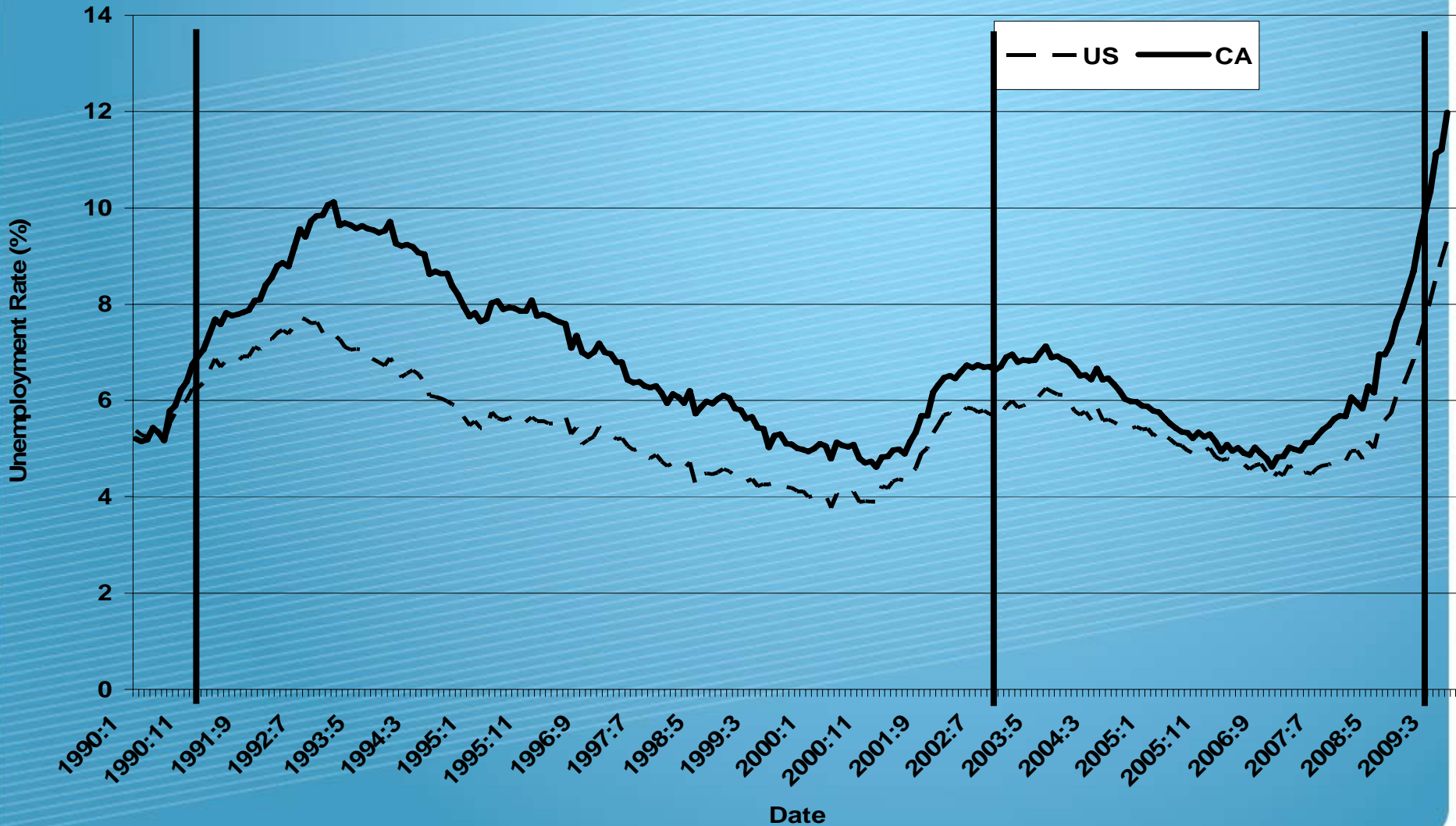
- Link between S&P 500 and labor markets
 - Historically, S&P 500 index and national unemployment linked
 - When S&P 500 hits bottom, 5 – 6 months later is when unemployment peaks on average since 1948
 - S&P 500 trough was on March 9, 2009: about 35% growth since this trough
 - Average return between troughs of S&P500 and labor market = 22% since 1948

S&P 500 Monthly Close, Jan 1990 – May 2009

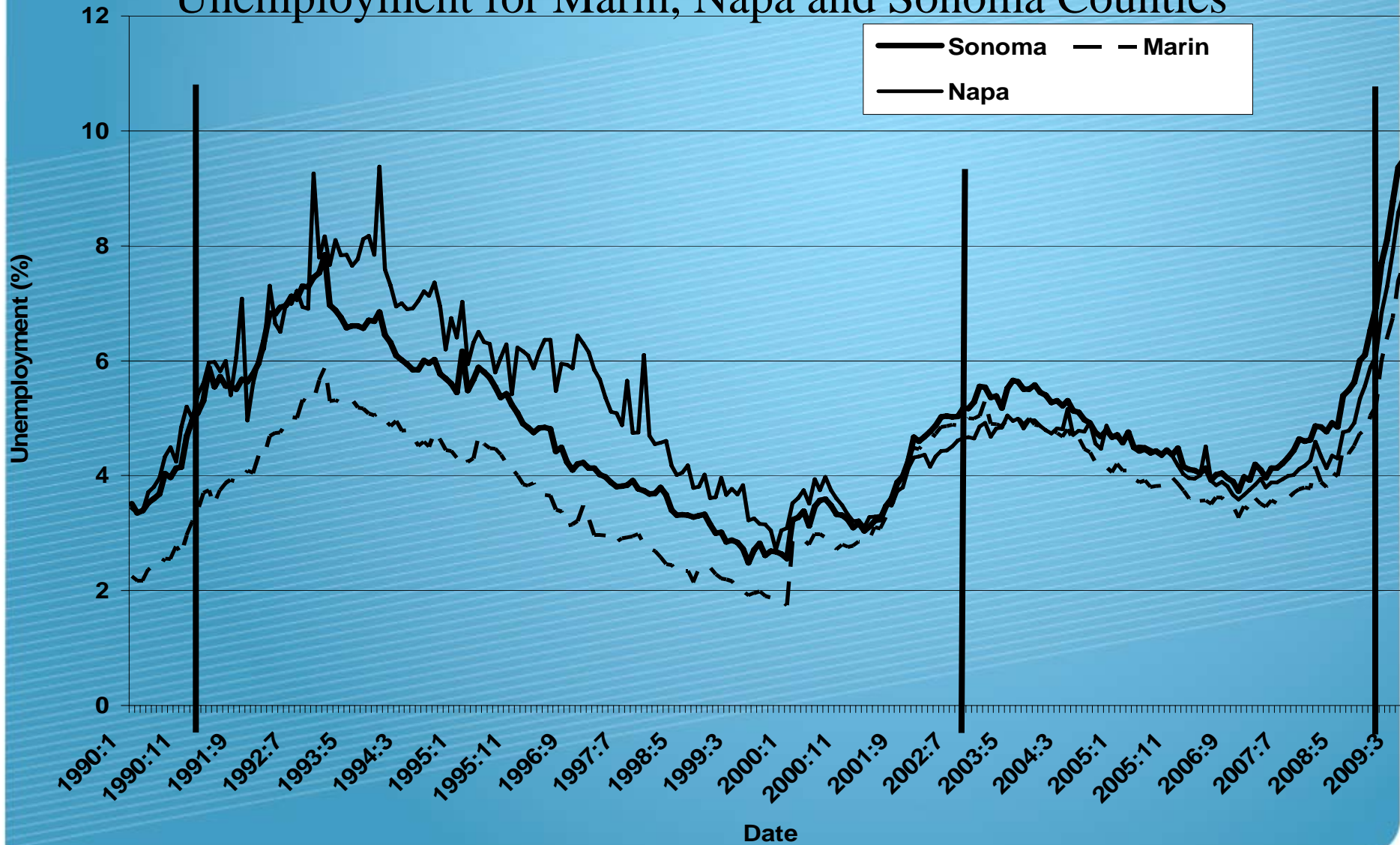
Vertical lines represent bottom of cycle



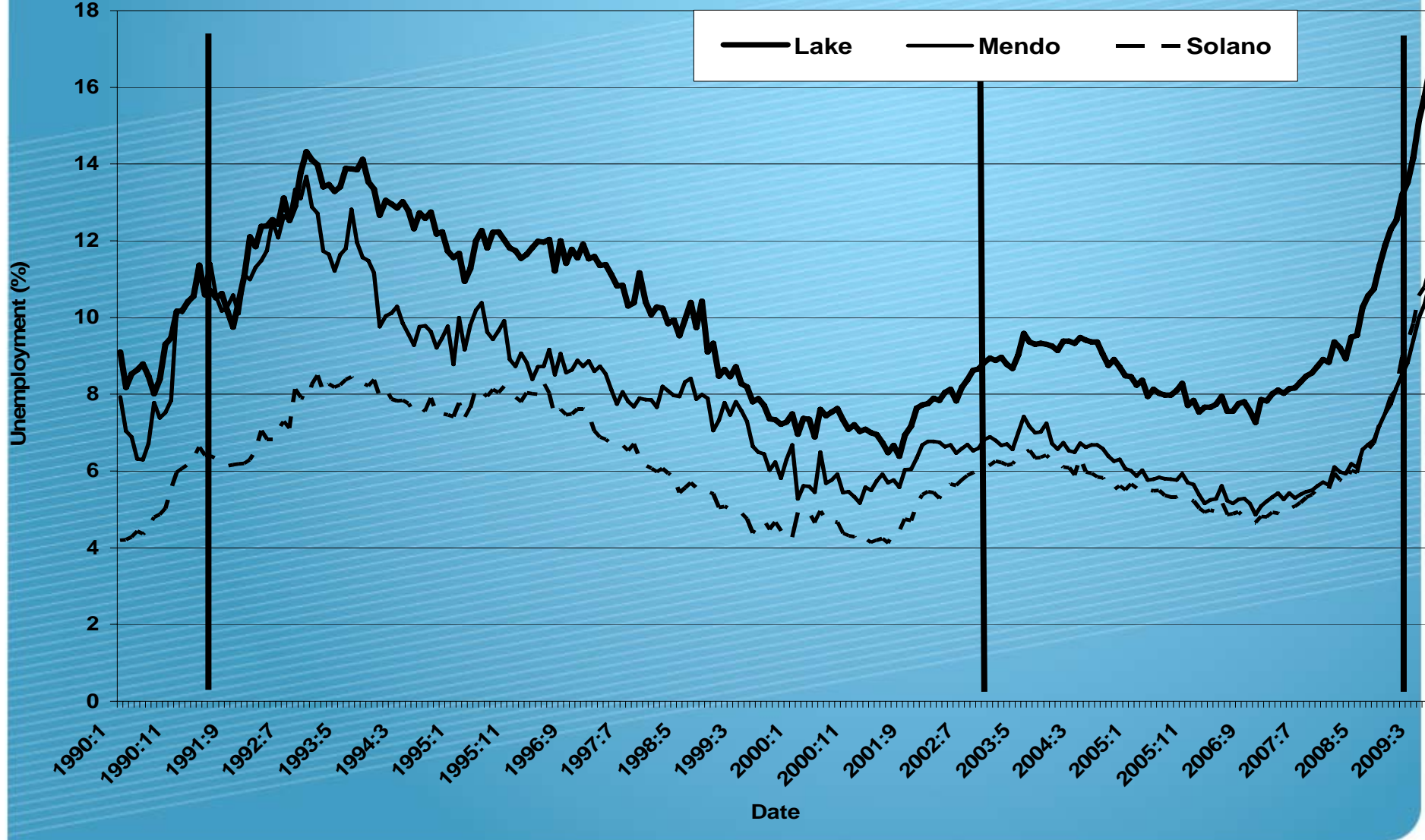
US and CA Monthly Unemployment, Jan 1990 – June 2009



Unemployment for Marin, Napa and Sonoma Counties



Unemployment for Lake, Mendocino and Solano Counties



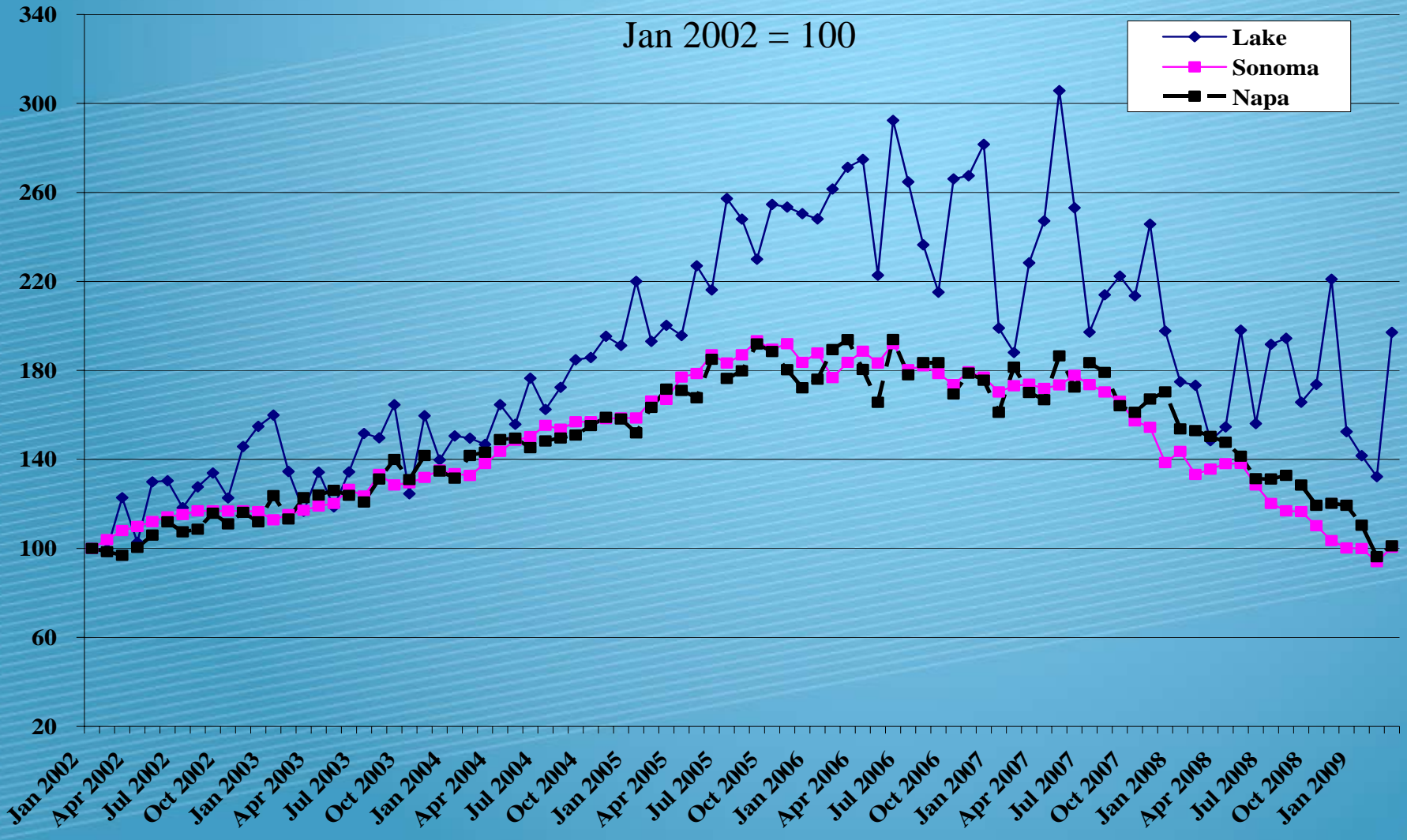
Residential Real Estate

- Unemployment puts both supply and demand pressures on market
 - Supply: as unemployment rises, number of units rise
 - Demand: as unemployment rises, fear over lost jobs reduces demand
- Interdependence: 96.6% correlation between Sonoma and Marin County median home price since 1995
 - Similar across North Bay: which county is the driver?
- Two big questions the market has yet to answer
 - Was the old pricing correct?
 - Is the current pricing correct?

Real Estate (cont.)

- Foundations
 - Is demand stable?
 - Tourism and retirement purchases, what %?
 - What are the supply conditions?
- Those that remain in their homes will reap long-term gains.
 - Lake and Mendocino Counties likely to be longer-term growth areas
- Commercial space
 - Demand should remain, worse case as a movement from Bay Area otherwise.
 - Supply naturally to contract, especially as a reaction to recession
- Financial literacy a big deal going forward in residential real estate
- Following graph compares counties and their growth of real estate prices since 2002.

Median Home Prices Indices, Lake, Napa, Sonoma counties, 2002 – June 2009



Lake County Economic Outlook

- Recession through 2009
 - Summer should begin the slow turnaround
 - State budget situation and its solutions may delay recovery
 - Short of a major technological innovation, slow recovery
 - Lake County may be more exposed than other local counties to contraction of state services
 - Rising again
 - What will drive Lake County's economy forward?
 - What role will real estate have?
 - What will guide it?
 - Think about regional economic development