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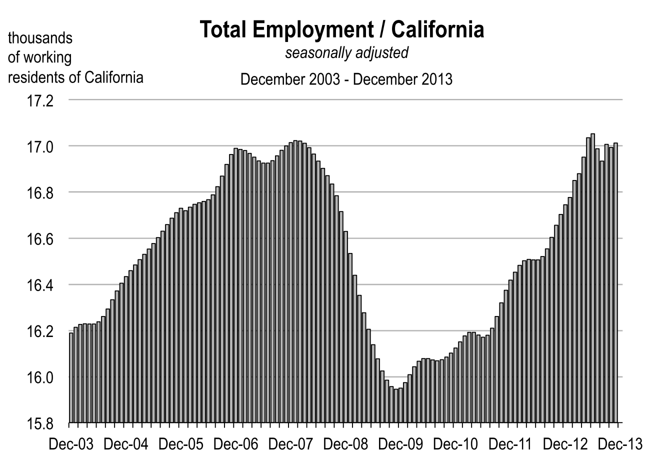
The California Economy

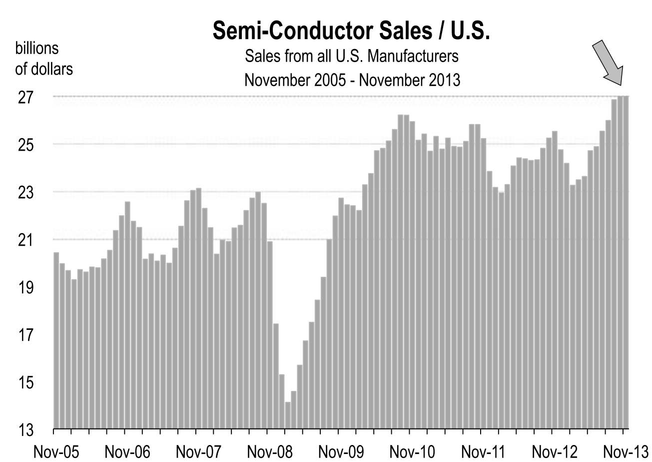
The U.S. economy has grown slowly and California has followed suit. As we assess the recent evidence of the state's economy at the beginning of 2014, the business environment has generally returned to a state of normalcy; all sectors appear to be growing again and there is little chance of recession this year. Real estate and labor markets have dramatically improved over the last 15 months. And the number of residents that are now working has finally reached the previous peak attained before the Great Recession.

The best news for California is the outlook for the world economies in 2014. Growth returns to Europe and Japan, and accelerates in China and India. The Latin American countries appear to be doing well, except for Brazil. Consequently, the export sector is revived in 2014 and general business investment will grow faster this year, especially in the technology industries.

If there is a negative side, it's that the housing market, while improving, has not taken off as rapidly as was originally forecast a year ago, and there remains some concern that housing may stumble in 2014. That risk, however, is low.

The outlook for the first half of 2014 shows home sales improving slightly over 2013. More Californians are working and the formation of new households is rising again. While employment growth will be slightly slower in 2014 than expected, this is due to more rapid employment growth in 2013 and a slower ramp up in new residential construction over the next 6 months.





The production of housing has been very slow to improve but a significant increase is forecast in 2014 and 2015. Nevertheless, new housing will be limited in the coastal areas by the lack of available land, and the difficulty associated with the state's permitting process. More of the housing in future years will be attached product and apartments. This is especially true currently, due to the record volume of the apartment age population in California.

Total employment growth in California during 2013 was 2.4 percent. The UCLA forecast calls for total employment (payroll, farm and self employed) to grow 1.5 and 2.0 percent in 2014 and 2015 respectively. Total payroll employment without the volatile farm sector grows 1.8 and 2.2 percent for the next two years.

Real personal income growth is forecast to be 0.6 percent in 2013 followed by 3.2 and 3.1 percent in 2014 and 2015.

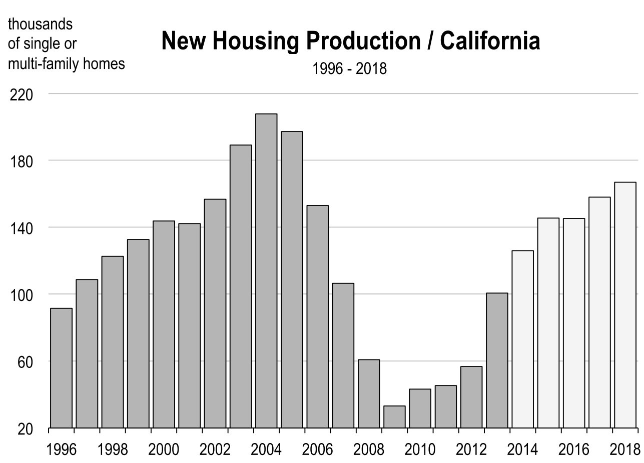
Unemployment fell throughout 2013, averaging 8.9 percent for the year. In 2014 the unemployment rate is expected to drop to 8.2 percent on average, one percentage point higher than the forecast for the nation, and 7.3 percent in 2015.

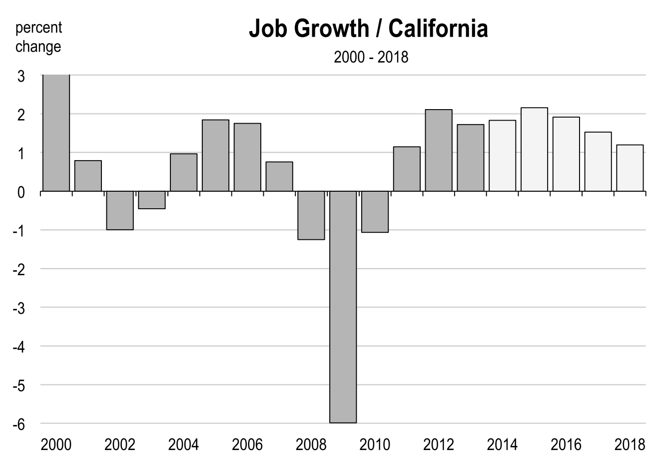
Santa Clarita Valley Forecast Summary

The Santa Clarita Valley's labor market has rebounded sharply since 2011, creating 5,500 new jobs over the last two years; the unemployment rate has continued to contract, to 6.0 percent.

The job base throughout Los Angeles County is clearly expanding. During 2013, employment increased 1.6 percent, producing 62,000 jobs. The rate of increase in the Santa Clarita Valley was 2.8 percent.

The creation of jobs will continue to accelerate this year, with the unemployment rate falling to 5.4 percent. However, the rate of unemployment in both the Santa Clarita and San Fernando Valleys will remain higher in 2014 and 2015 than





normal for this stage in the economic cycle. In 2014, the rate of job growth is expected to accelerate to 4.0 percent, with all sectors of the labor market expanding. However, look for the principal sectors of growth to be in the professional services, tourism, and construction sectors.

- With an expansion of employment, the utilization of commercial real estate has accelerated. The expectation is for the office market to tighten over the next two years, and for more industrial space to break ground.

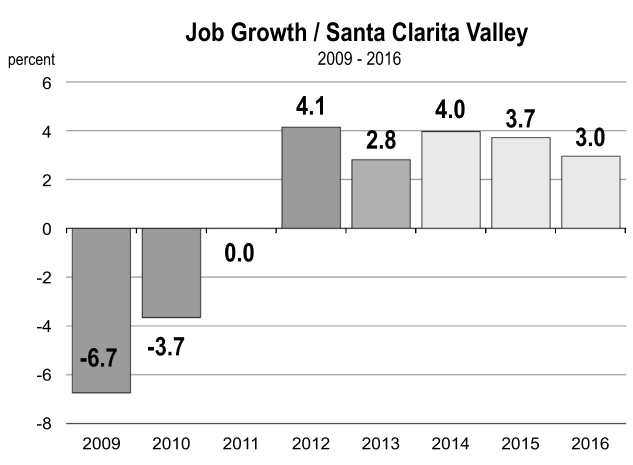
- Homeowner distress is clearly abating and no longer weighing in on the housing market. Consequently, home prices are rising sharply, reflecting the absence of distressed properties from the transactions record of existing home sales.

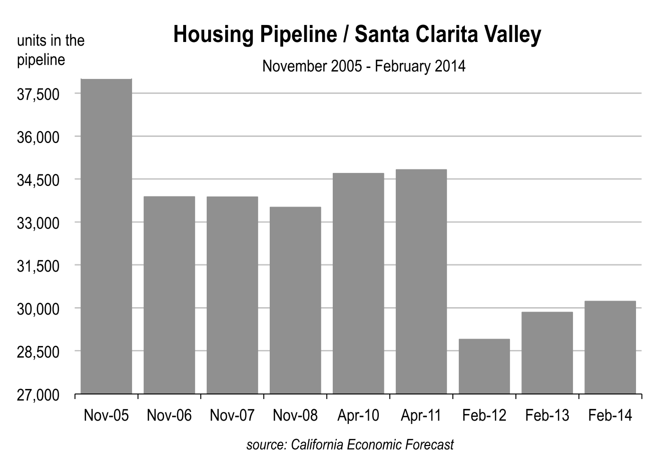
- Existing home sales were higher in 2012 and 2013, and the momentum will carry into 2014, especially as more employment opportunities increase. Currently the market has slowed, and the risk facing the housing market is the lack of inventory and higher interest rates this year.

- The visitor industry has rebounded and job creation in leisure and recreation services is rising sharply. Average occupancy rates for the region's hotels and motels are now back to pre-recession levels.

- The forecast has been upgraded from last year to show more growth in 2013 with the recovery transitioning into an expansion later this year.

- There will be more new homes under production in the Valley this year. Last year, more homes were started than in any year since 2004. The rate of new housing will continue to increase this decade, especially with the onset of Newhall Ranch which is scheduled to produce the first homes by 2017.





The 2014 Forecast

What We Forecast in 2013 and What Actually Occured

The 2013 forecast was produced a year ago in early February of 2013 for the Santa Clarita Valley. The December 2012 forecast of the nation and California by the UCLA Anderson School was used in the determination of the regional forecast. Clearly, a year ago, the economy was growing and general indications pointed to broader based growth of housing, the labor markets, and the retail sector in the Santa Clarita Valley.

Today, we have most of the information for 2013 now completed. Consequently, a comparison between our 2013 forecast and the 2013 actual can be presented.

Forecast Comparison	Santa Clarita Valley 2013		
Economic Indicator	2013 Forecast[1]	2013 Actual	% Error
	-- percent change --		
Non-farm Job Growth	4.4	4.1	-6.8
Unemployment Rate	6.1	6.0	-1.6
Personal Income Growth	4.9	4.8	-2.4
Real Pers. Income Growth	3.4	3.7	+8.8
Inflation	1.7	1.1	-35
Population growth	1.6	1.2	-25
Retail Sales growth	4.4	4.4	0.0
	---- number ----		
Non-farm Jobs Created	3,300	2,263	-31.4
Number of New Res Units	1,046	985	-5.8

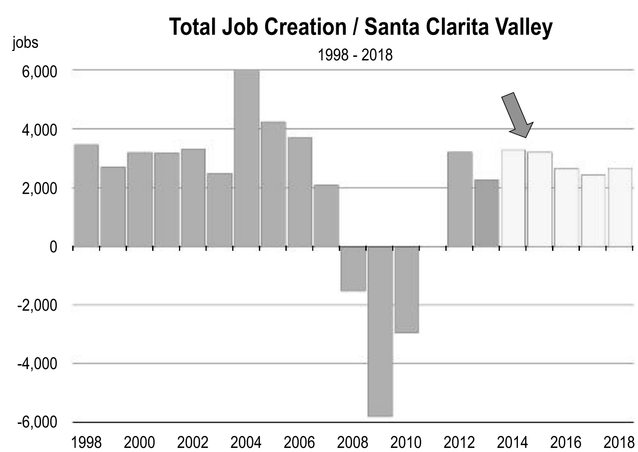
Source: California Economic Forecast

[1] 2013 Economic and Real Estate Outlook, pages 36-37, 58-59.

- Labor markets in Los Angeles County and the Santa Clarita Valley produced jobs a bit less than our expectations in 2013. This was also true for population growth. Nevertheless, the expected 2013 outlook for other indicators was generally very close to the actual outcome.

Looking back, 2013 was clearly a break-out year with 12 of 13 private labor market sectors creating new jobs, the residential and commercial real estate sectors building momentum, and incomes rising for workers and families.

The forecast for 2013 was for the creation of 3,500 jobs in the Santa Clarita Valley. The actual number of jobs was 2,263. Consequently, we expect an acceleration of job growth in 2014.



Nearly all sectors of the labor market added jobs last year in the Santa Clarita Valley. The only exception was the federal government sector. This year, 3,300 new jobs are forecast for the Valley's economy.

- The unemployment rate was forecast to descend as labor markets produced more consistent job growth. The rate was expected to average about 6.0 percent in 2013. The actual rate came in at our forecast.

Expected Time Line for the Local Economy in 2014

The local economy has improved over the last 30 months, in tandem with the U.S. and statewide economies. Consumer and business confidence are more rapidly recovering. The job market at the national, state, and regional levels is methodically restoring the severe job loss that prevailed in 2008-2010. For 2014 and 2015, the economy will evolve as follows.

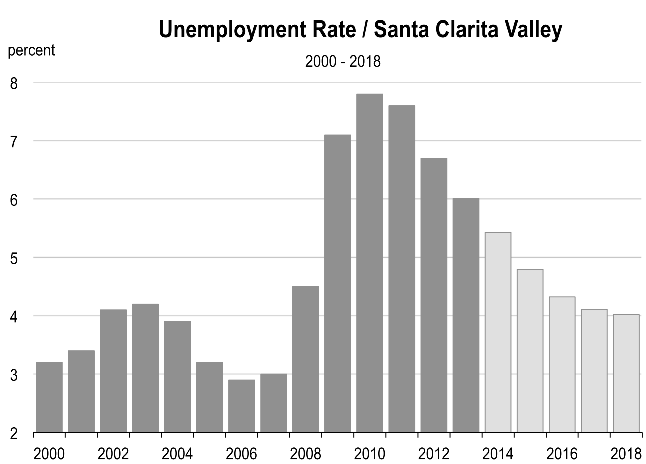
- The labor market recovery accelerates in 2014 with all sectors adding new jobs.

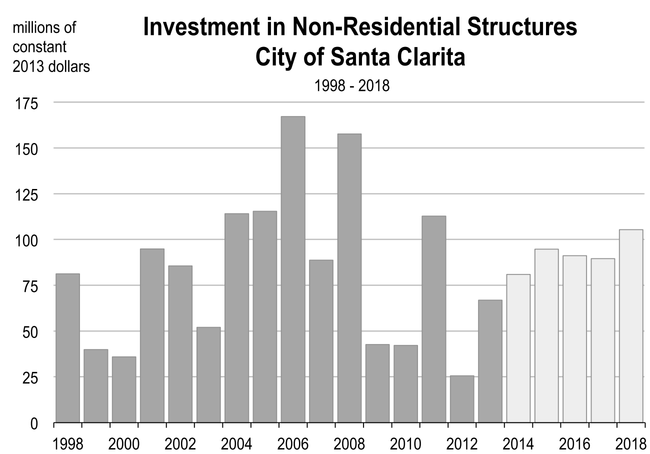
- The unemployment rate continues to contract, but remains high for the next 2 years, consistent with higher overall rates of unemployment in the U.S. and California. The labor force has increased faster than employment growth due largely to demographics and technology.

- Utilization of the office market has rapidly improved, and vacancy rates will continue to contract in 2014 as more office-using jobs are created.

- More industrial building will start in 2014, namely, with the first structures at Gateway V near the Valencia Commerce Center, and with land development for the Sterling Gateway project just west of the Commerce Center.

- Selling values for housing rose 14 percent in 2013. Prices are forecast to rise again this year by a similar appreciation level. The reason is the lack of inventory, from both the existing and new home market, and the evaporation of distressed properties from the existing home landscape.





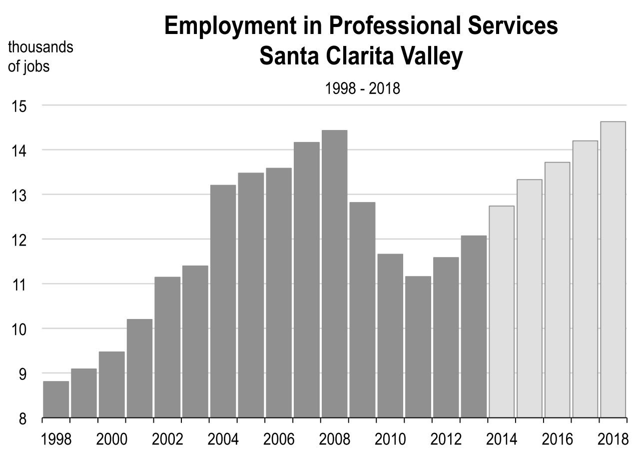
2014 Forecast Highlights

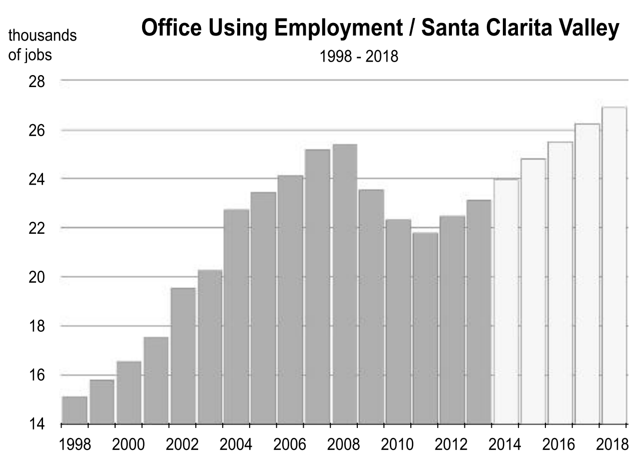
- The principal job creation in the Santa Clarita Valley will occur in construction, professional services, finance, leisure services, and wholesale/retail trade. In the government sector, no further downsizing is expected this year.

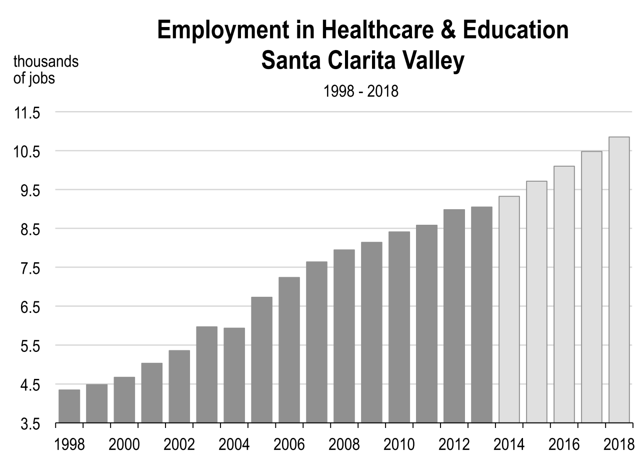
- The current 15 percent office vacancy rate in the Santa Clarita Valley, though tightening rapidly, is still high. The office real estate market will continue to strengthen this year. With office-using jobs now forecast to rise sharply this year (including jobs in professional services, leisure and hospitality, healthcare, and financial activities), vacancy rates are expected to decline further. Employment in professional services will produce meaningful office-using demand through 2016.

- Existing company expansion in the Santa Clarita Valley will ultimately require more office and industrial space and more projects will be completed longer term. Consequently, with the upturn in job growth, the rate of investment in non-residential structures will ramp up gradually over the next three years.

- Traffic continues to increase on Interstate 5 through the Santa Clarita Valley. This occurs because the workforce (and population) increases locally, in Kern County and in the rest of Los Angeles County. Vehicle registration growth rises 2.2 percent in 2014 after growing 1.8 percent in 2013. Expect crowded freeway conditions though at a diminishing rate of increase.





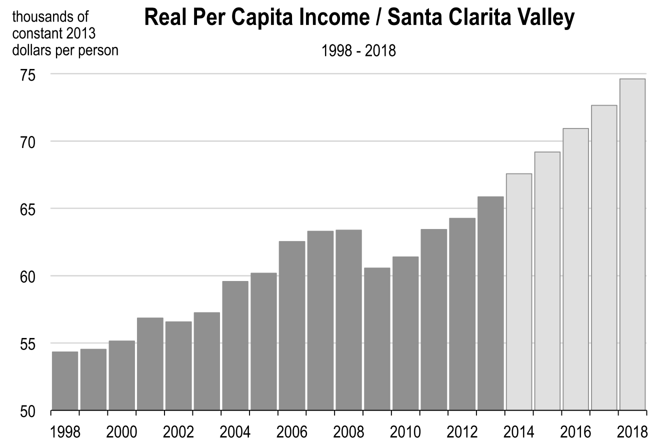


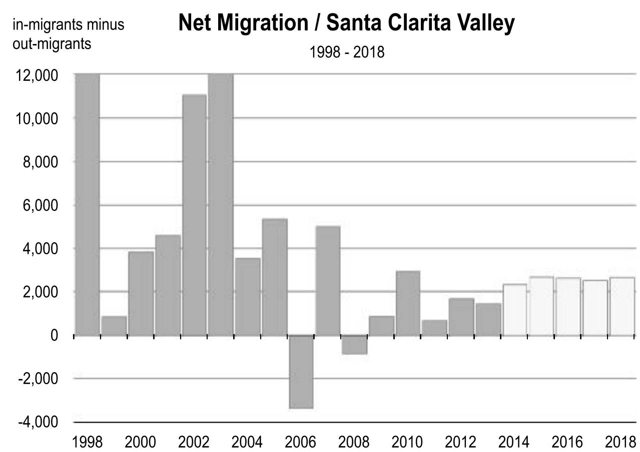
- Household incomes in California, Los Angeles County, and the Santa Clarita Valley will continue to strengthen further in 2014. Inflation adjusted per capita income rises 2.6 percent in 2014 and 2.4 percent in 2015.

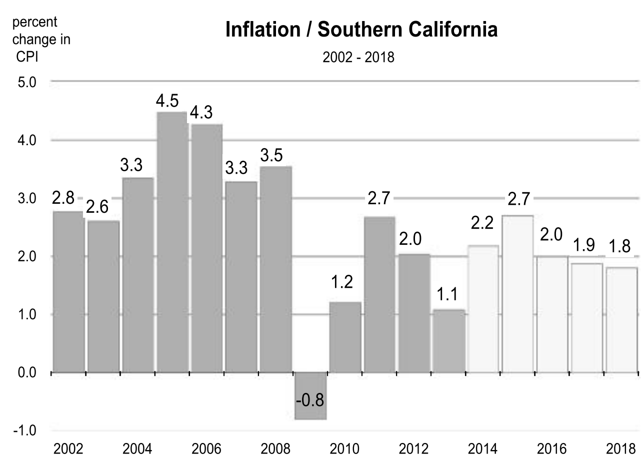
- The lack of new home construction together with a weak job market slowed population growth over the last 5 years. The rate of net in-migration slowed substantially. Net in-migrating population turns up over the next few years as more employment opportunities require more people in the Santa Clarita Valley.

- Inflation in Southern California finished 2013 with an average rate of only 1.1 percent. It will increase in 2014 and 2015 as the economic expansion reaches maturity. Interest rates rise as well, with the 10 year U.S. Treasury Bond Yield eclipsing 4 percent in 2015.

Despite all the Government stimulus in recent years, inflation is not forecast to rise beyond 2.7 percent for the foreseeable future. Any spikes in inflation will be due to rising gasoline and food prices, which are not anticipated. The increases that are forecast are the consequence of rising home prices, apartment rents, and healthcare costs. Continued slack in the labor markets will alleviate some of the pressure on the general price level, both regionally and nationwide for the next several years.







Population and Housing

Demographics

In the Santa Clarita Valley, population growth accelerates to 1.5 percent in 2014. The increase is largely due to higher in-migration. The natural increase also remains positive. New migrants are generally workforce age adults and their families.

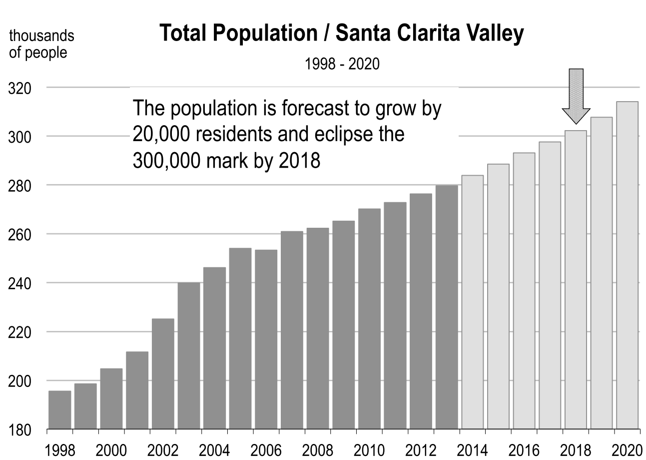
Population growth rises over the next several years. The rate is 1.6 percent in both 2015 and 2016, rising to 2.0 percent by 2020. More new housing in the Valley will support the expansion of the population. This is also true of all the commercial and industrial development that is planned over the next 6 years.

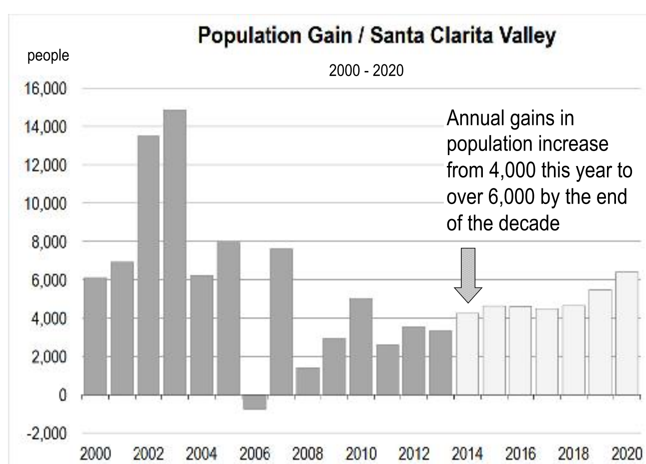
More affordable housing and new job creation in the Santa Clarita Valley will continue to attract more people into the region. The greater Valley area is forecast to have 300,000 residents by 2018. This population growth will surge thereafter when thousands of homes are built in Newhall Ranch, Legacy Village, and Entrada.

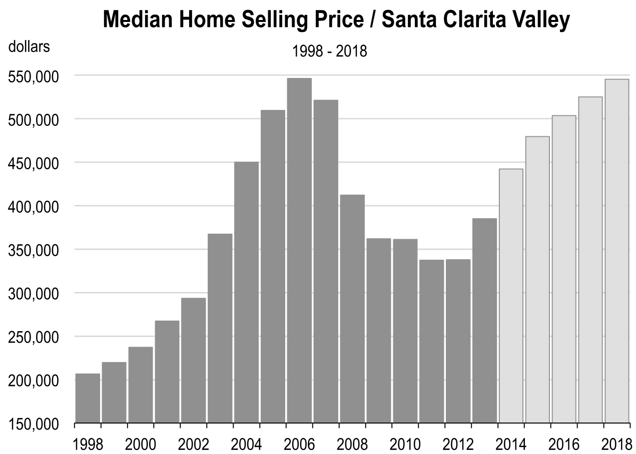
The Outlook for Housing

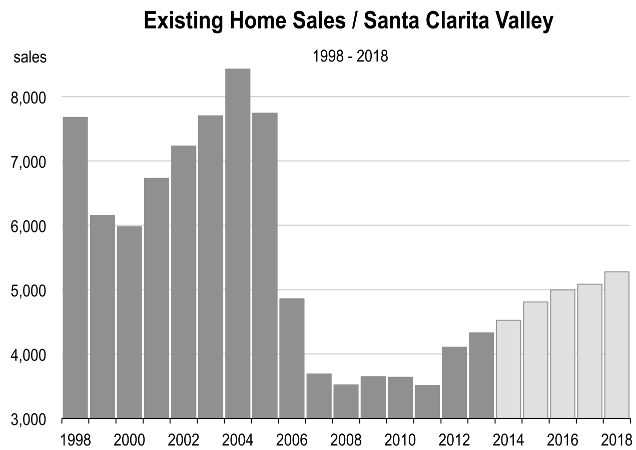
The environment for homeowner defaults and foreclosures has dramatically changed, and this is having a significant impact on for-sale inventory and home selling values. Inventory is currently at 10 year lows and selling value appreciation soared in 2013.

Recently, there has been concern expressed in the media about the sustainability of the housing recovery in 2014. To date, the momentum for existing home sales remains in place through December 2013, and selling values continue to move higher. The major concern is the lack of inventory which is due for a boost from the new home market over the next 2 years.









The outlook for both sales and selling values does not break with the current upward trend that began in the Summer of 2012. More job creation and the rapid decline of distressed properties remains a big positive for existing home market. The new home market will add the necessary inventory.

Home sales rise 5 percent in 2014, limited by the amount of resale inventory in the market. Median selling values in 2014 will continue to rise though not as sharply as in 2013, reflecting (1) the low inventory, (2) more conventional home sales, and (3) rising interest rates. There is still pent-up demand for housing, especially among trade-up buyers. The meaningful recovery in housing that we forecast will help to create more jobs and income in the Valley economy in 2014.

The forecast for home price appreciation is 15 percent in 2014—about half the rate recorded for all California housing in 2013. Most of this increase occurs because distressed housing transactions no longer weigh in on the overall record for selling values. Rising home prices will ultimately induce more inventory, including new home production.

New Residential Development

With the resale home market now rallying, and because the inventory of distressed housing is rapidly being depleted, a recovery in new housing production is on the horizon. While the general economy will continue to improve in 2014 due to the rebound in job creation followed by resale housing, more time for the upturn in new housing has been needed. Finally, a more convincing recovery in new housing production occurs in 2014.

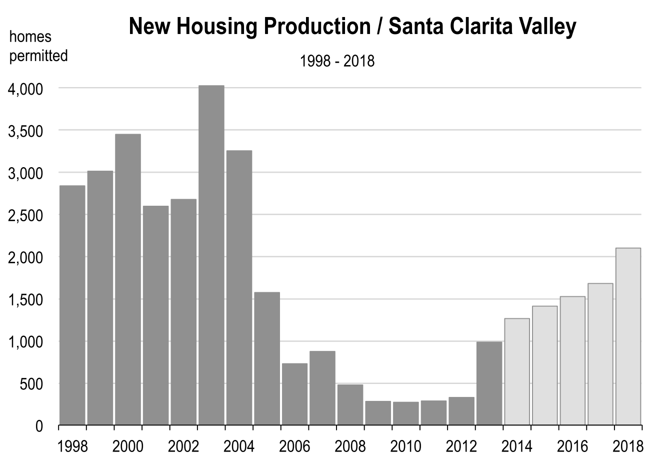
There are already signs of improvement in the new housing market of Southern California but these signs are limited. They include a gradually returning interest in new housing developments by cautious home buyers.

The forecast of housing supply over the next five years is influenced by a number of factors, especially the inventory of pipeline projects in the Santa Clarita Valley. This would include both approved and planned projects. Total presumed build-out of zoned residential land has been evaluated with assumptions made about actual production of housing units over time to develop the forecast.

The profile of new home production per year is impossible to predict. Over a five year period, total units can be forecast based on in-migrating populations, rising housing densities, and interest rate movements. Consequently, the forecasts of new housing units per year are a plausible though imprecise estimate based on prevailing economic conditions and housing demand, with the total over five years representing the amount of housing needed to accommodate a growing population.

The acceleration in the forecast rate of new housing starts compared to the annual levels of 2005-2012 represent a material increase in new housing production in the Santa Clarita Valley.

The forecast calls for about 1,000 new housing units to be started in the Santa Clarita Valley this year and 1,500 in 2015. Between 2014 and 2018, a total of 9,900 homes are started. While this is our base forecast, it is conservative since production levels of less than 10,000 units over the next 6 years will likely result in rising average household sizes, an indicator for the crowding of other public and private resources like libraries, parks, and schools.



State and National Influences

Because the economic climate of the State of California is the dominant influence on the Northern Los Angeles economy, the future direction of the state has obvious implications for the direction of the region. For that reason, the December 2013 UCLA Anderson Forecast of the state and national economies is an integral part of the forecast model used to develop projections of economic indicators and activity in the Santa Clarita Valley.

The models used to develop the forecasts predict economic activity to the year 2019. The demographic models extend the forecast to 2020. The model for the labor markets and general economy is based on annual data.

The U.S. and World Outlook in 2014-2015

GDP growth across the principal developed nations of the world is projected to accelerate from the 2013 rate of 1.2 percent to a 2.3 percent rate in 2014 and a 2.7% rate in 2015, according to the Outlook by the OECD.[2]

In contrast, the world economy will grow at a 2.7 percent rate this year, before accelerating to a 3.6 percent rate in 2014 and 3.9 percent in 2015. The pace of the global recovery is weaker than forecast last May, largely as a result of the worsened outlook for some emerging economies.

Growth in the United States is projected at 2.7 to 3.1 percent in 2014, and a 3.0 to 3.2 percent rate in 2015. In Japan, GDP is expected to drop to a 1.5 percent growth rate in 2014 and a 1 percent rate in 2015. The Eurozone is expected to experience a gradual recovery, with growth of 1% in 2014 and 1.6% in 2015. This reverses negative growth that prevailed in 2013.

[2] http://www.oecd.org, November 2013

Growth has begun picking up in China but will remain weaker than previously projected in most other major emerging market economies. A group of emerging OECD member countries – Chile, Turkey, Mexico, Korea and Israel – will continue out-pacing growth in other advanced economies.

Source: UCLA Anderson Forecast, December 2013

Santa Clarita Valley Economic Forecast Summary 2005 - 2013 History, 2014 - 2018 Forecast

Year	Population (people)	Population (growth rate)	New Homes Net Migration (people)	Households (thousands)	New Homes Permtted (homes)	Retail Sales (billions)
2005	254,012	3.2	5,327	84.2	1,574	$2.3
2006	253,265	-0.3	-3,367	84.6	730	$2.4
2007	260,862	3.0	4,982	87.5	876	$2.4
2008	262,255	0.5	-866	88.4	478	$2.2
2009	265,167	1.1	859	89.5	281	$1.9
2010	270,190	1.9	2,933	91.2	272	$2.0
2011	272,795	1.0	669	91.9	287	$2.2
2012	276,341	1.3	1,660	92.9	330	$2.3
2013	279,657	1.2	1,439	94.8	985	$2.4
2014	283,897	1.5	2,312	95.9	1,265	$2.6
2015	288,526	1.6	2,679	97.2	1,412	$2.8
2016	293,125	1.6	2,637	98.6	1,526	$3.0
2017	297,615	1.5	2,528	100.2	1,681	$3.2
2018	302,256	1.6	2,670	101.9	2,102	$3.4

– employment (thousands of jobs) –

Year	Non-Farm Wage & Salary	Non-Farm Job Growth (% change)	Construction	Manufacturing	Transportation Utilities	Wholesale & Retail Trade
2005	81.7	5.5	7.5	10.9	1.5	14.1
2006	85.4	4.5	8.0	11.3	1.6	15.2
2007	87.4	2.4	7.6	11.4	1.6	15.9
2008	86.0	-1.7	6.7	10.5	1.6	15.3
2009	80.1	-6.8	5.1	9.9	1.5	14.3
2010	77.2	-3.6	4.8	9.3	1.1	14.2
2011	77.2	0.0	4.7	9.5	1.1	14.5
2012	80.4	4.1	4.9	10.1	1.2	15.0
2013	82.6	2.8	5.5	10.4	1.1	15.3
2014	85.9	4.0	6.1	10.6	1.2	16.0
2015	89.1	3.7	6.8	10.5	1.2	16.6
2016	91.8	3.0	7.1	10.5	1.3	17.2
2017	94.2	2.6	7.3	10.4	1.4	17.8
2018	96.8	2.8	7.8	10.3	1.4	18.5

Source: California Economic Forecast, March 2014

Santa Clarita Valley Economic Forecast Summary **2005 - 2013 History, 2014 - 2018 Forecast**

Personal Income (billions)	Real per capita income (dollars)	Median Home Selling Price (dollars)	Existing Home Sales	Inflation Rate (Percent change in local CPI)	Unemployment Rate (percent)
$12.9	$60,197	$510,000	7,744	4.5	3.2
$13.9	$62,543	$546,840	4,862	4.3	2.9
$15.0	$63,312	$521,744	3,690	3.3	3.0
$15.6	$63,396	$412,434	3,521	3.5	4.5
$15.0	$60,577	$362,082	3,649	-0.8	7.1
$15.7	$61,410	$361,524	3,638	1.2	7.8
$16.8	$63,443	$337,626	3,511	2.7	7.6
$17.6	$64,275	$337,964	4,105	2.0	6.7
$18.4	$65,872	$385,279	4,331	1.1	6.0
$19.6	$67,589	$442,495	4,525	2.2	5.4
$21.0	$69,203	$479,879	4,811	2.7	4.8
$22.3	$70,953	$504,012	4,998	2.0	4.3
$23.6	$72,673	$525,500	5,086	1.9	4.1
$25.0	$74,640	$550,276	5,279	1.8	4.0

– employment (thousands of jobs) –

Financial Activities	Professional Services	Information	Health & Education	Leisure	Government
3.3	13.5	1.2	6.7	11.0	9.6
3.6	13.6	1.2	7.2	11.5	9.6
3.8	14.2	1.3	7.6	11.6	9.9
3.8	14.4	1.3	7.9	11.7	10.2
3.7	12.8	1.3	8.1	11.3	9.9
3.7	11.7	1.2	8.4	11.2	9.5
3.6	11.2	1.2	8.6	11.4	9.2
3.6	11.6	1.2	9.0	12.0	9.4
3.7	12.1	1.2	9.1	12.4	9.4
3.7	12.7	1.2	9.3	12.9	9.6
3.7	13.3	1.2	9.7	13.5	9.7
3.8	13.7	1.2	10.1	14.2	9.8
3.8	14.2	1.2	10.5	14.8	9.9
3.9	14.6	1.3	10.9	15.1	10.0

Source: California Economic Forecast, March 2014

The data source for this chapter is principally our forecast models for the Santa Clarita Valley. Economy.com is the source of the Semi-Conductor Sales for the U.S.; historical jobs numbers are from the Labor Market Information Division; housing starts and commercial and industrial investment is from the Construction Industry Research Board; demographic data is from Claritas; price level data is from the Bureau of Labor Statistics; income data is from the U.S. Department of Commerce; and home sales and selling price information is from DataQuick.