



Making ~~Lemonade~~ Lemons out of Lemons

By:
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CEO, Elliott D. Pollack & Company



Rating Decline



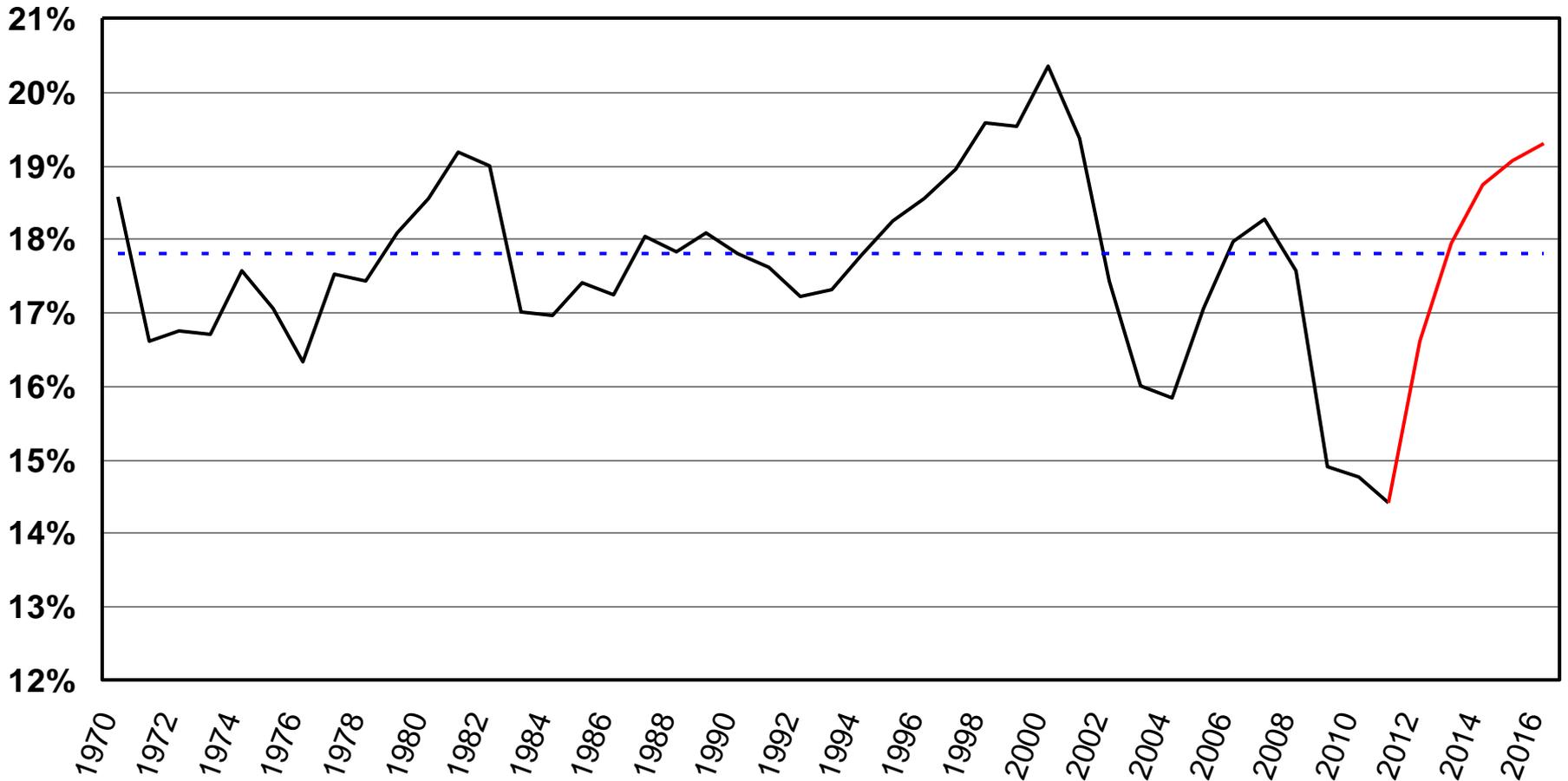
“The Emperor Has No Clothes”

–S&P and the Financial Markets.



Federal Receipts as a Percent of GDP

Source: FY 2012 Budget of the United States Government



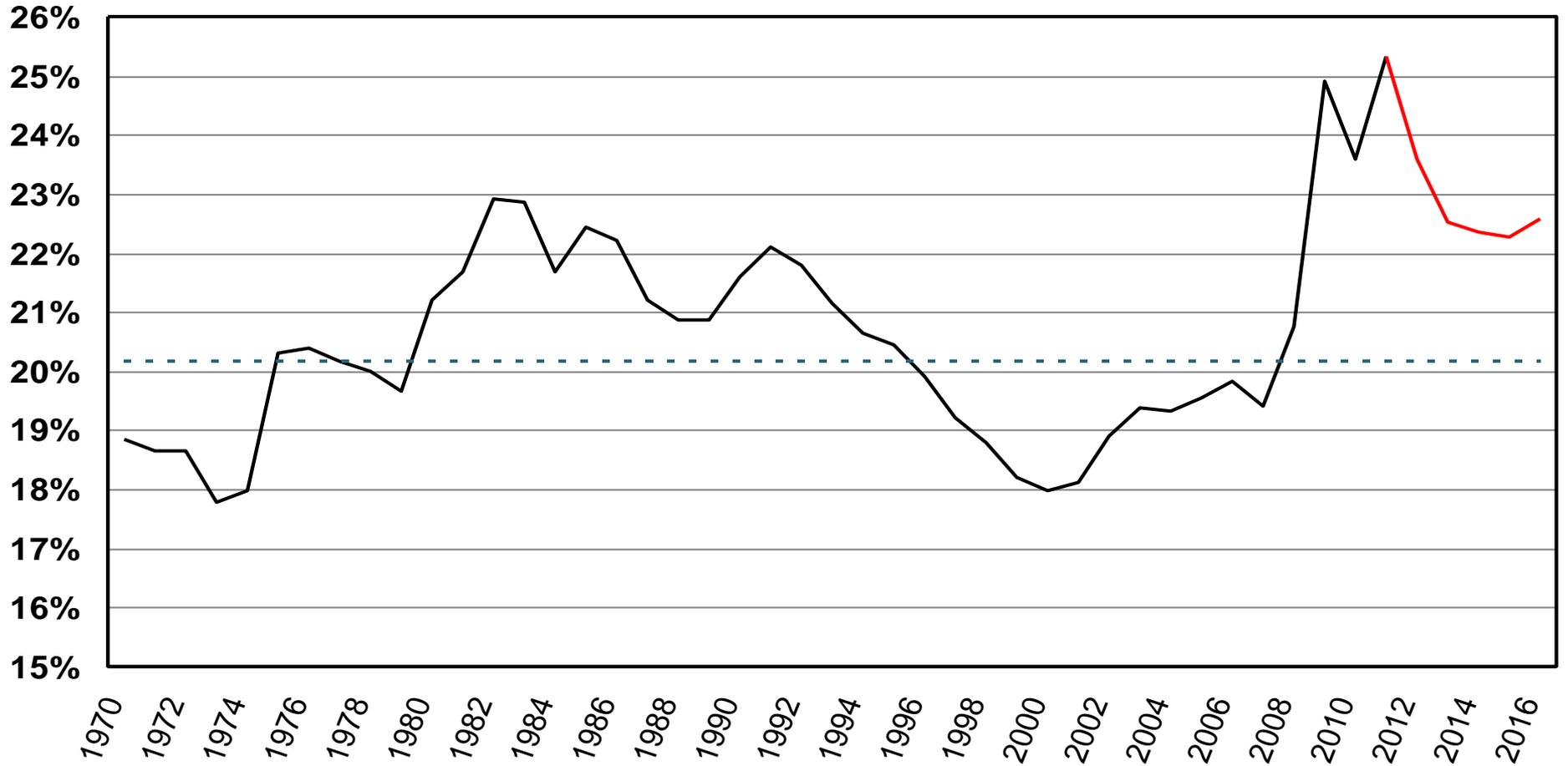
--- 1970 – 2007 average

--- Obama Administration proposed budget



Federal Outlays as a Percent of GDP

Source: FY 2012 Budget of the United States Government

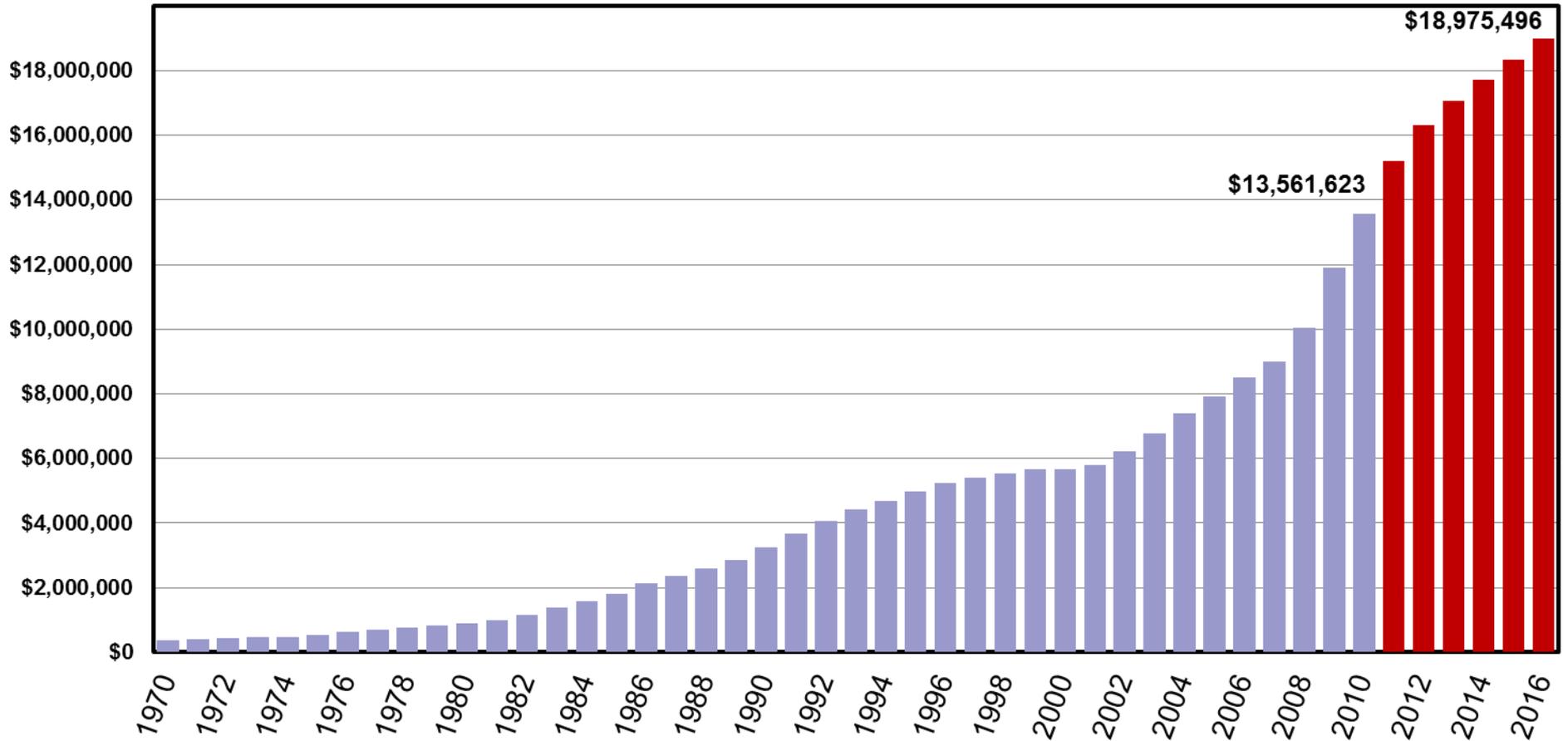


--- 1970 – 2007 average
--- Obama Administration proposed budget



U.S. National Debt (\$mil)

Source: U.S. Treasury; FY 2012 U.S. Budget



The Real Numbers

- Federal spending over the next 10 years is estimated at \$46 trillion.
- That is an increase of about \$9.1 trillion (before the cuts).
- After cuts, the increase is expected to be \$7.4 trillion.

****In other words, there are no cuts planned, just a reduction in the rate of increase.**



For Perspective

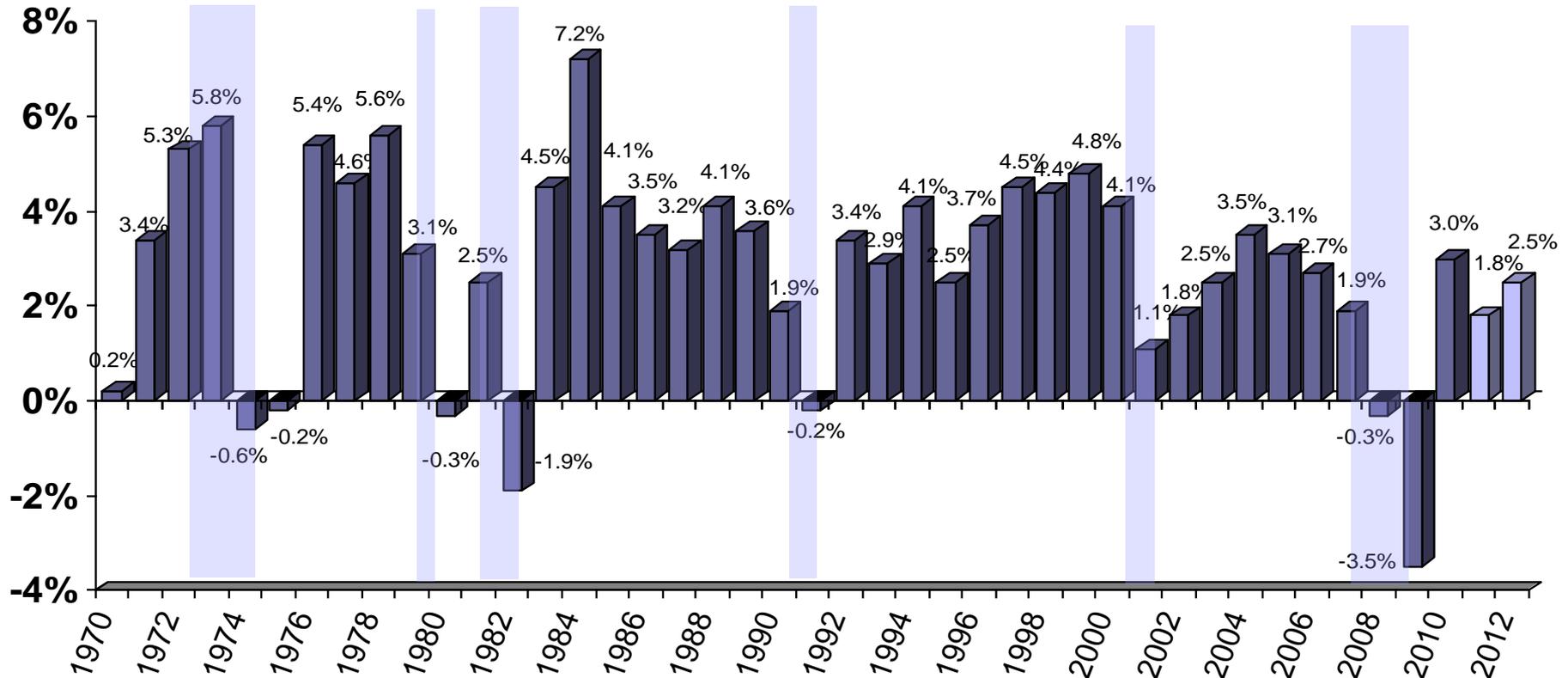
- Ma & Pa Kettle spend \$38,200 per year
- But their income is \$21,700.
- They have to put \$16,500 on credit card each year.

After the long, hard talk... they cut \$190 in year one and \$385 in year two.



United States Real Gross Domestic Product* Annual Growth 1970 - 2012**

Source: U.S. Bureau of Economic Analysis & *Blue Chip Economic Indicators*



* Based on chained 2005 dollars.

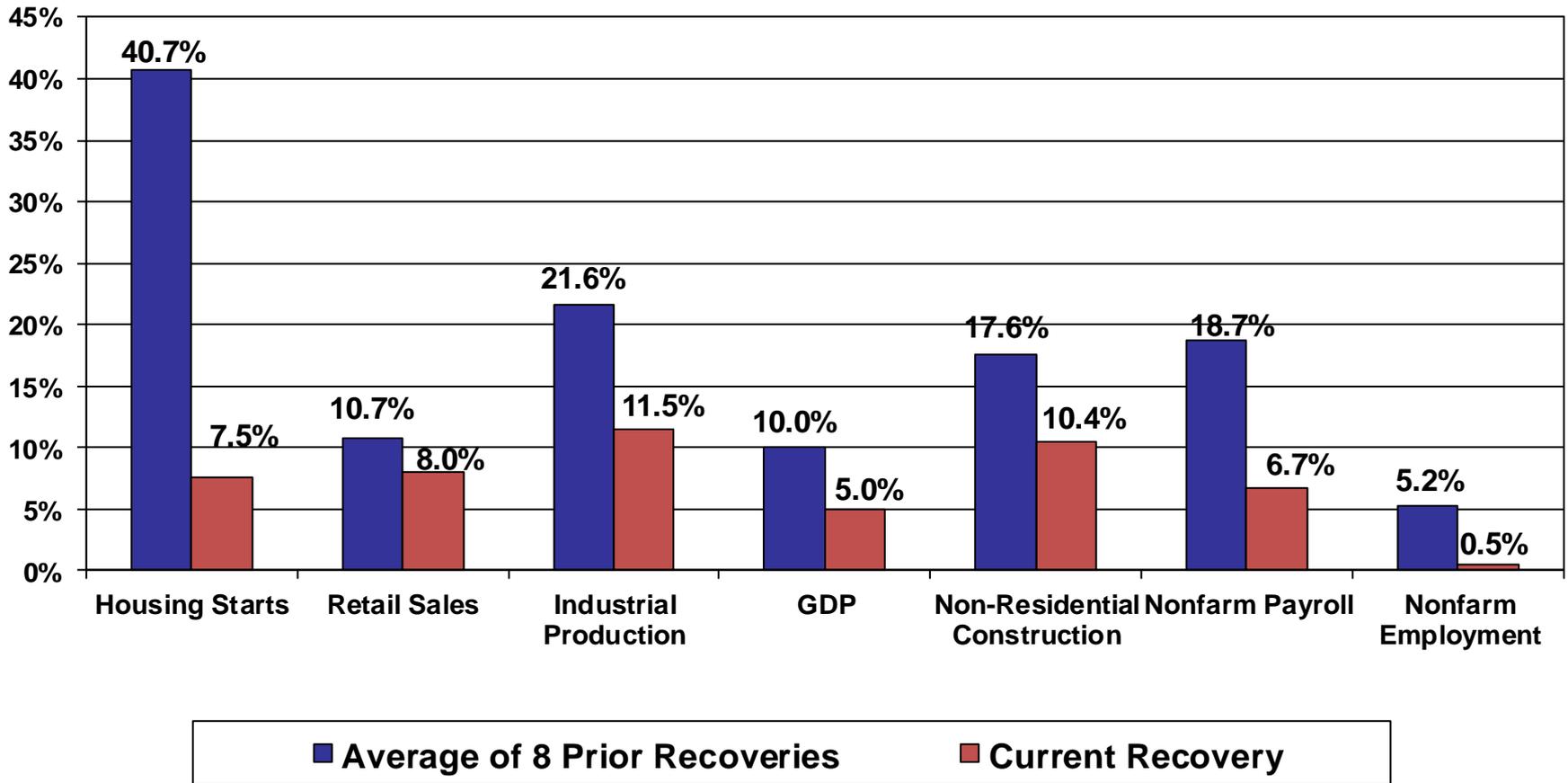
** 2011 - 2012 are forecasts from the Blue Chip Economic Indicators, August 2011

 **Recession Periods**



Recession End v. 8 Quarters Later

Sources: NAHB; Census, BEA, BLS



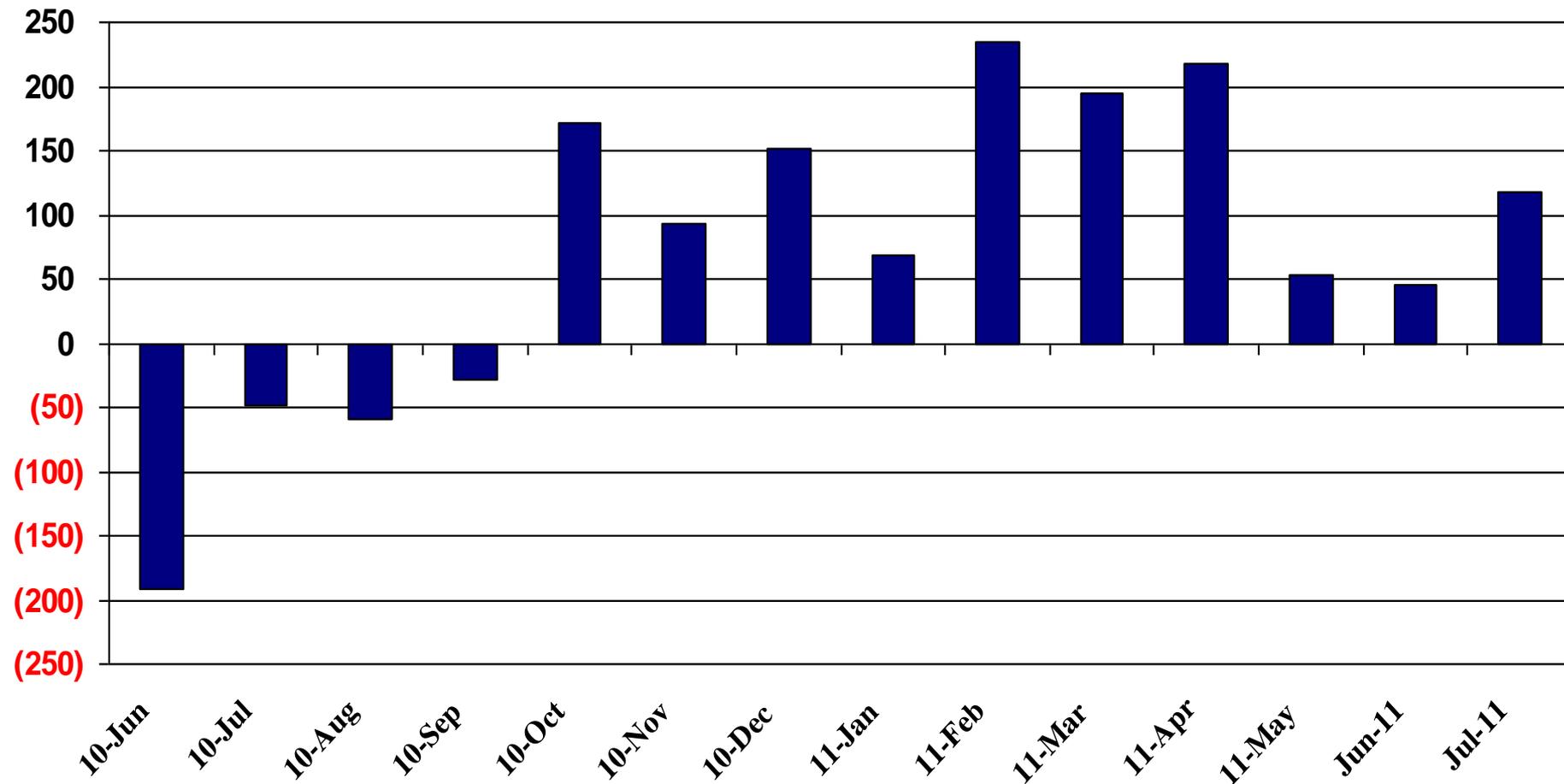
US New Job Data

Change from Prior Month (S/A)

June 2010 - July 2011

Source: Bureau Labor of Statistics

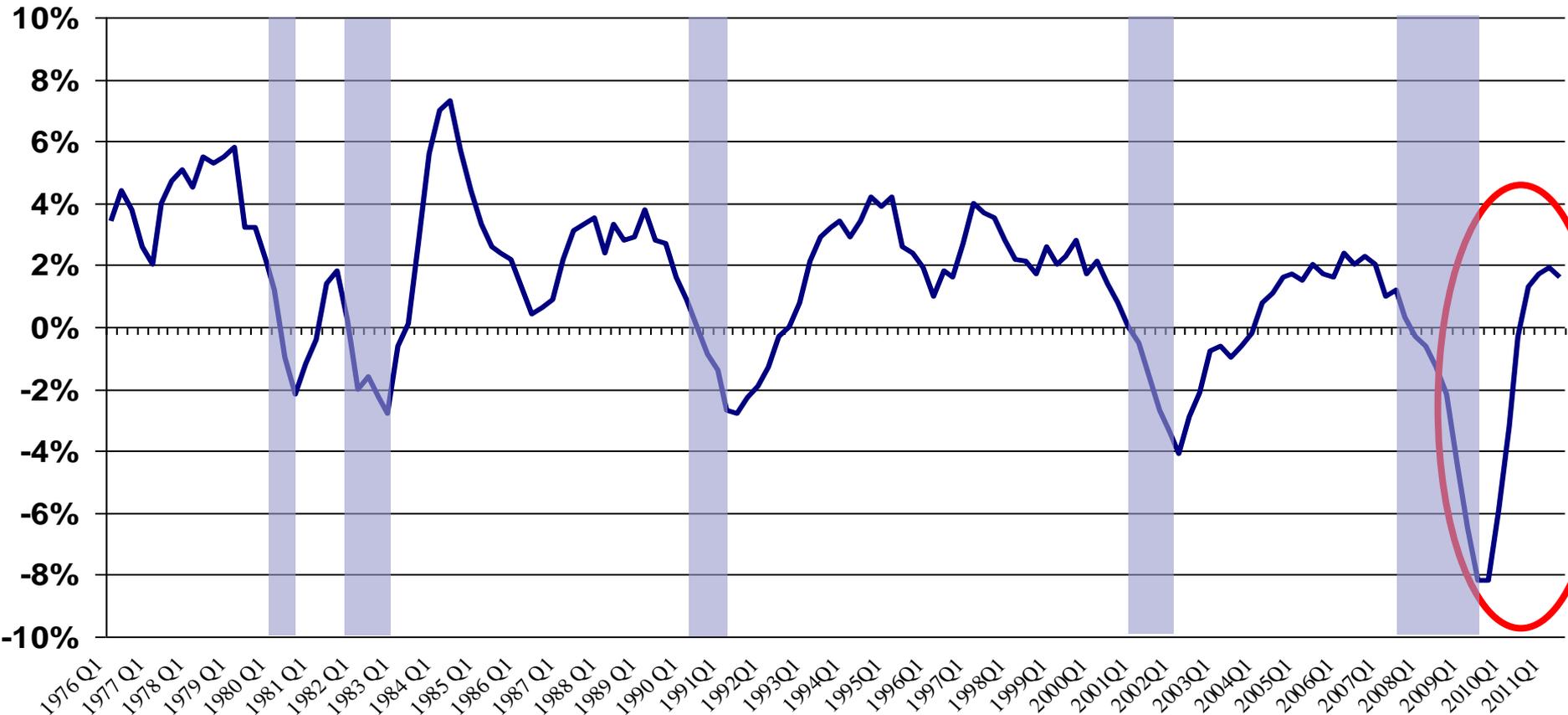
(000's)



Hours Worked Percent Change from Year Ago 1976 – 2011*

Source: Bureau of Labor Statistics

Recession Periods



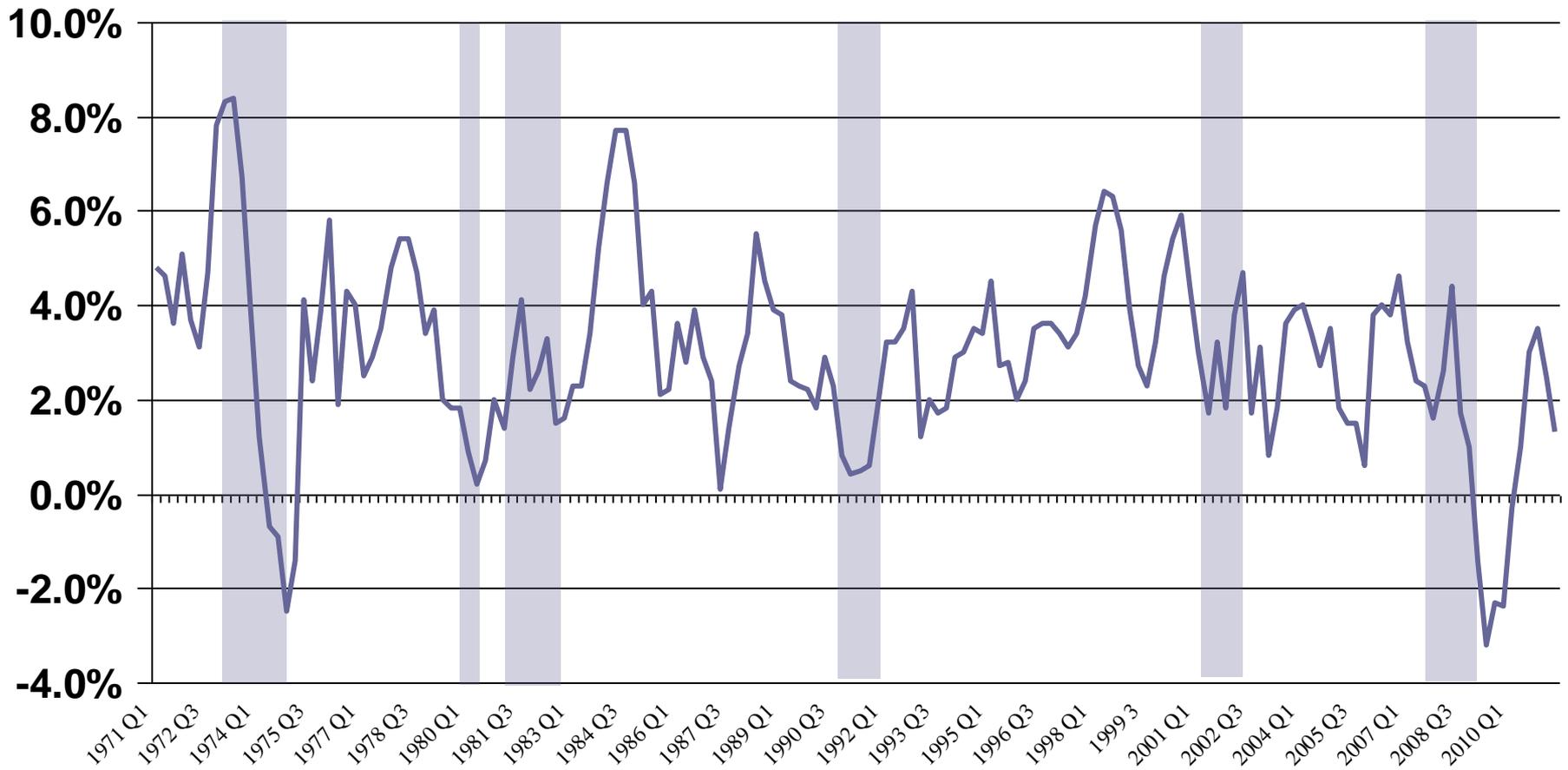
*Data through second quarter 2011



Real Disposable Personal Income Percent Change Year Ago 1971 – 2011*

Source: Bureau of Economic Analysis

Recession Periods



* Data through second quarter 2011

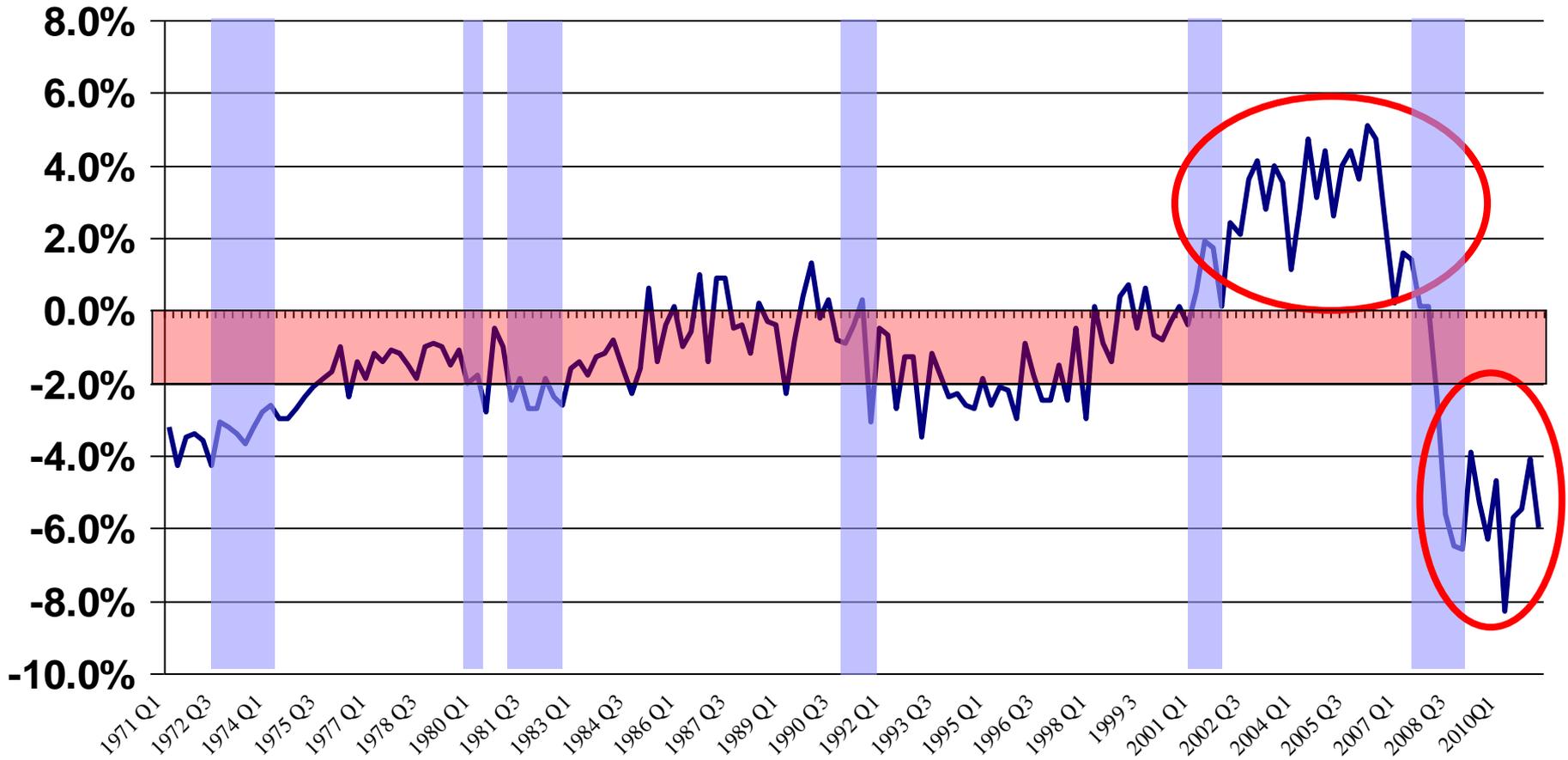


Mortgage Equity Withdrawal as a share of Disposable Income

U.S.: 1971 – 2011*

Source: Bureau of Economic Analysis

Recession Periods



* Data through first quarter 2011

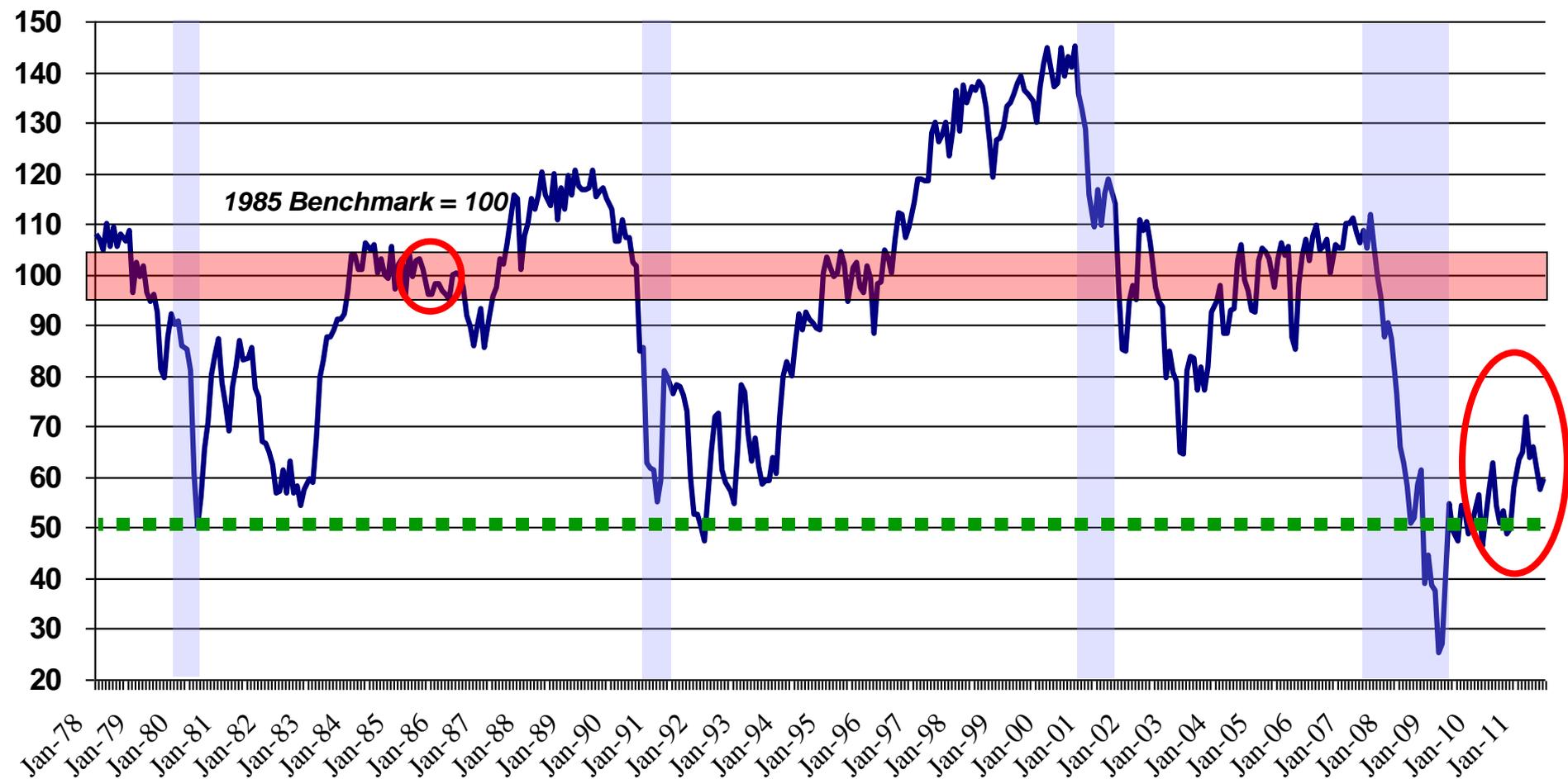


Consumer Confidence

1978 – 2011*

Source: The Dismal Scientist

Recession Periods

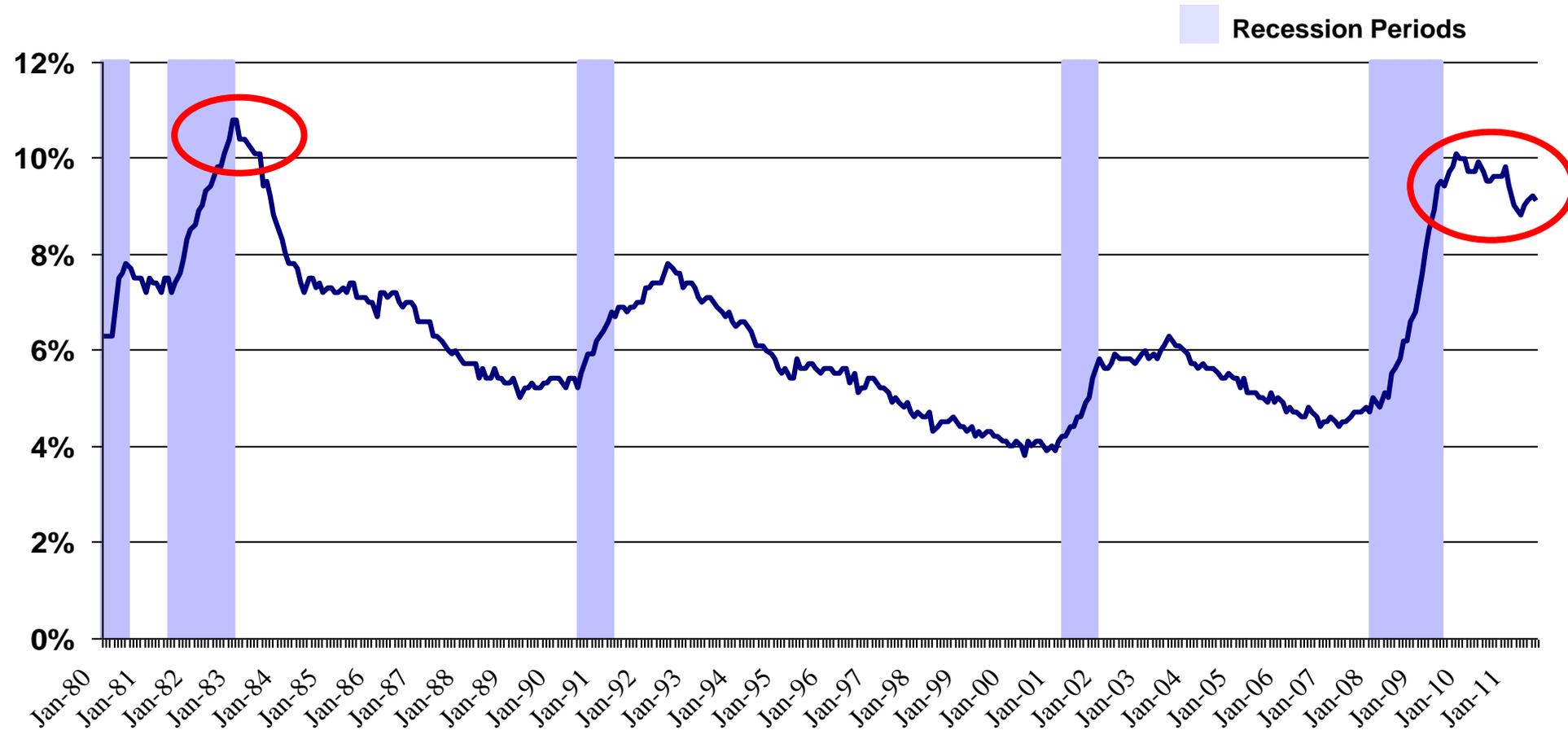


*Data through July 2011



U.S. Unemployment Rate 1980 – 2011*

Source: Bureau of Labor Statistics

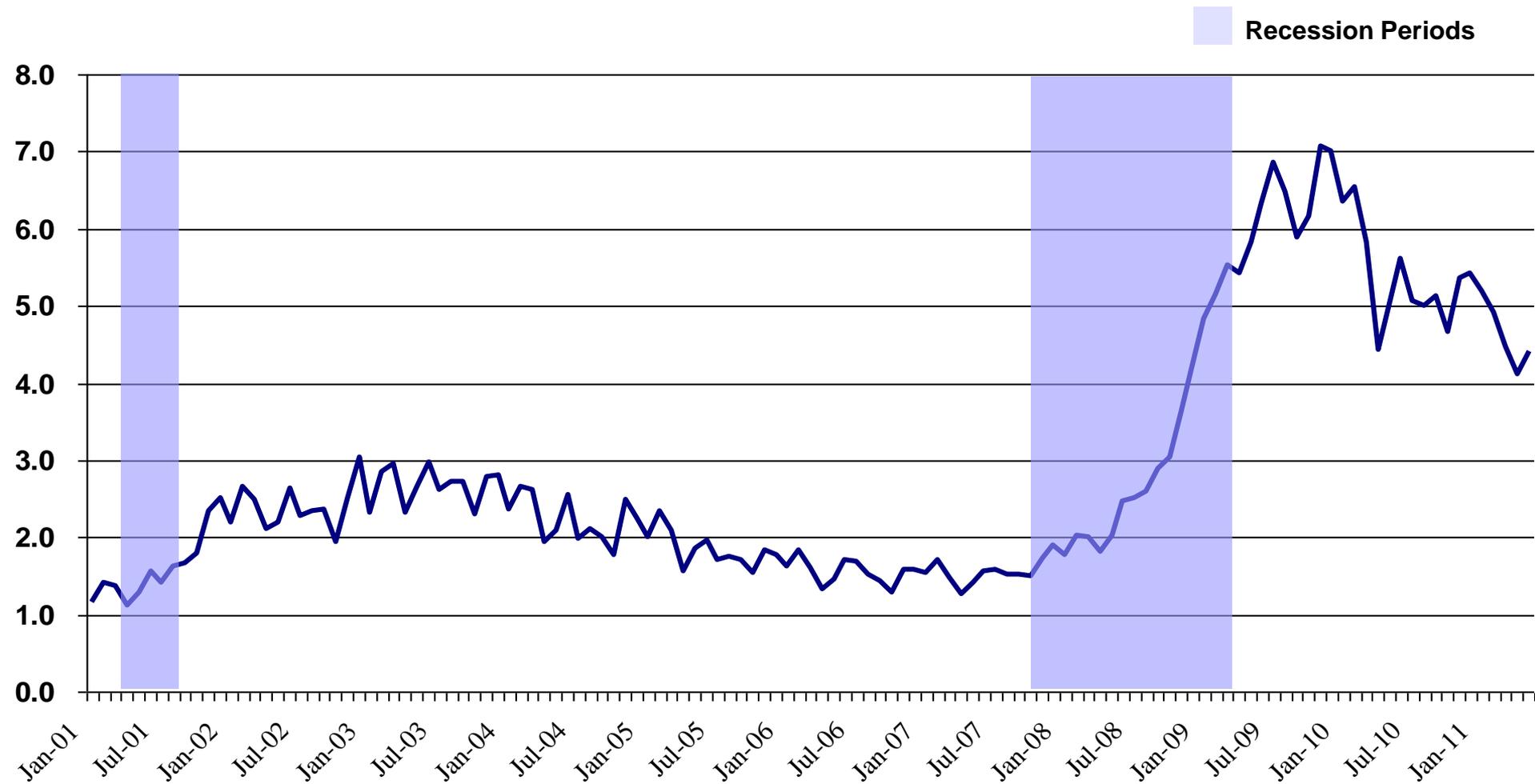


*Data through July 2011



Ratio of Unemployed People to Job Openings 2001-2011*

Source: BLS

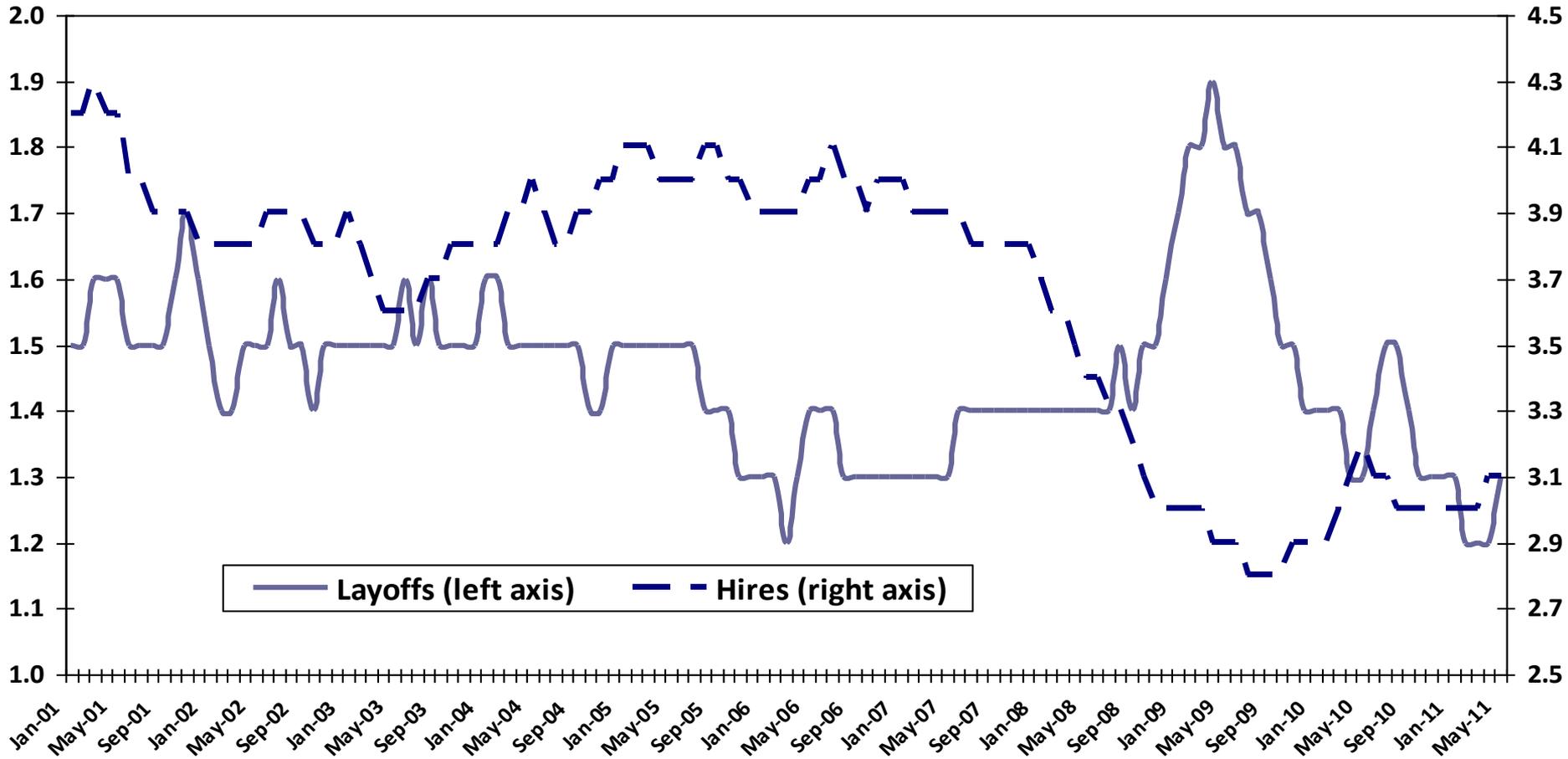


*Data through May 2011



Layoffs versus Hiring Rates 2001-2011

Source: BLS, Seasonally Adjusted, 3-month moving average



*Data through May 2011



Wealth Effect



What Will Happen to HH Net Worth?

In the 90s

Housing prices increased moderately,
but stock market boomed.

First half of 2000's

Stock market was doing poorly,
but housing prices boomed.

Now

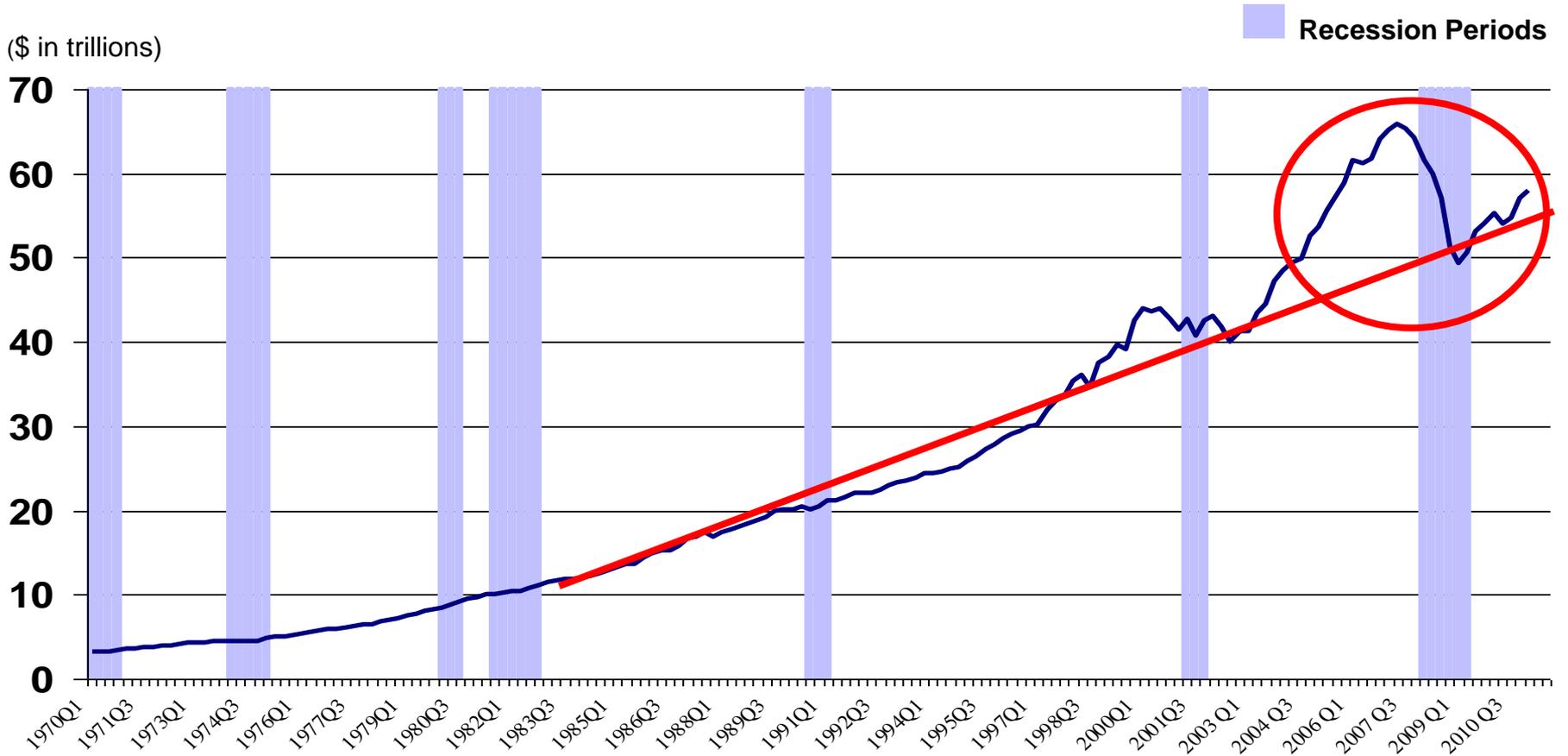
Housing prices AND stock market
down from the peak.



Household Net Worth (\$\$\$)

1970 – 2011*

Source: Federal Reserve



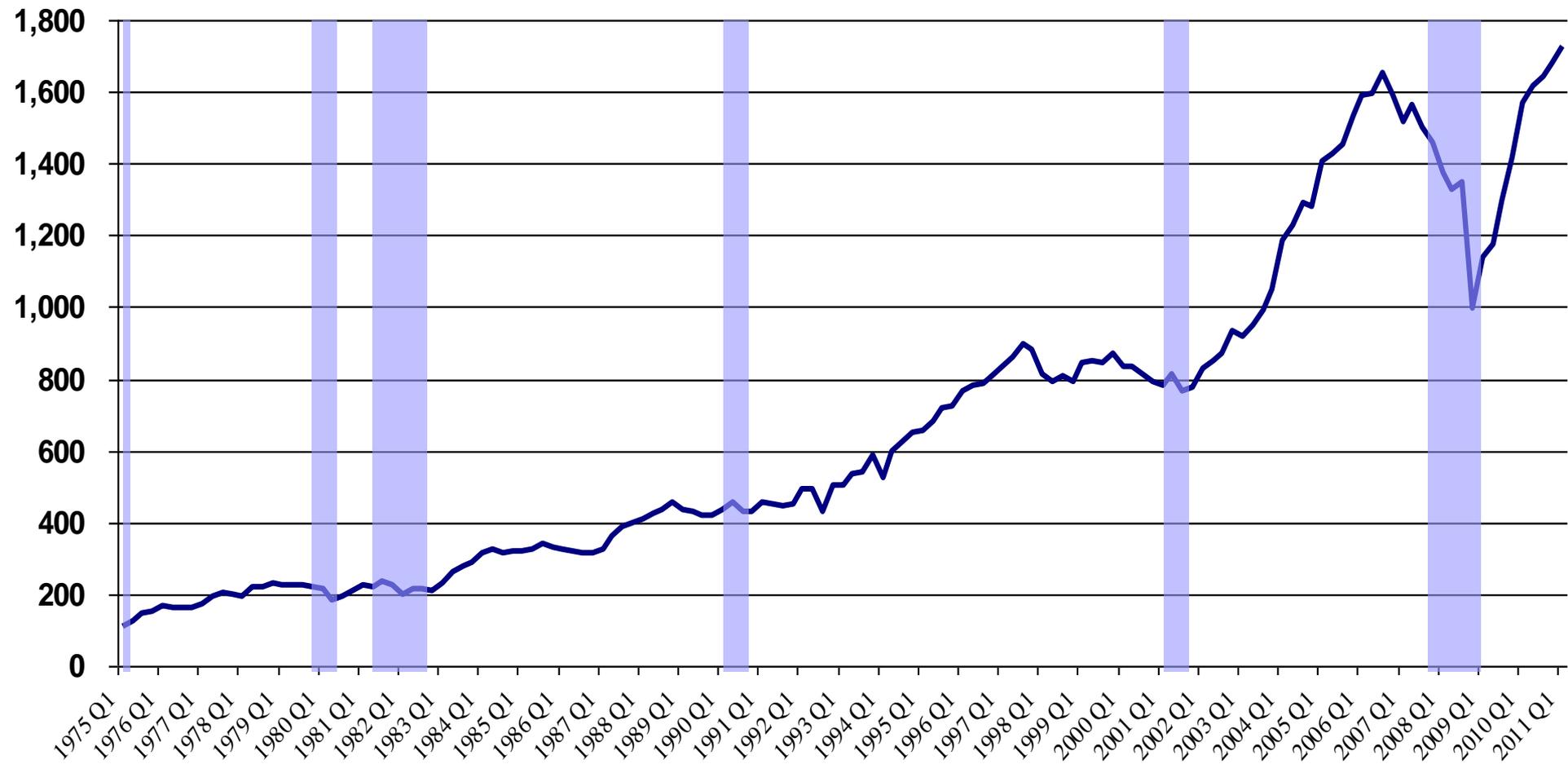
*Data through first quarter 2011.



Corporate Profit (Billions of Dollars, SA) 1975-2011*

Source: BEA

Recession Periods



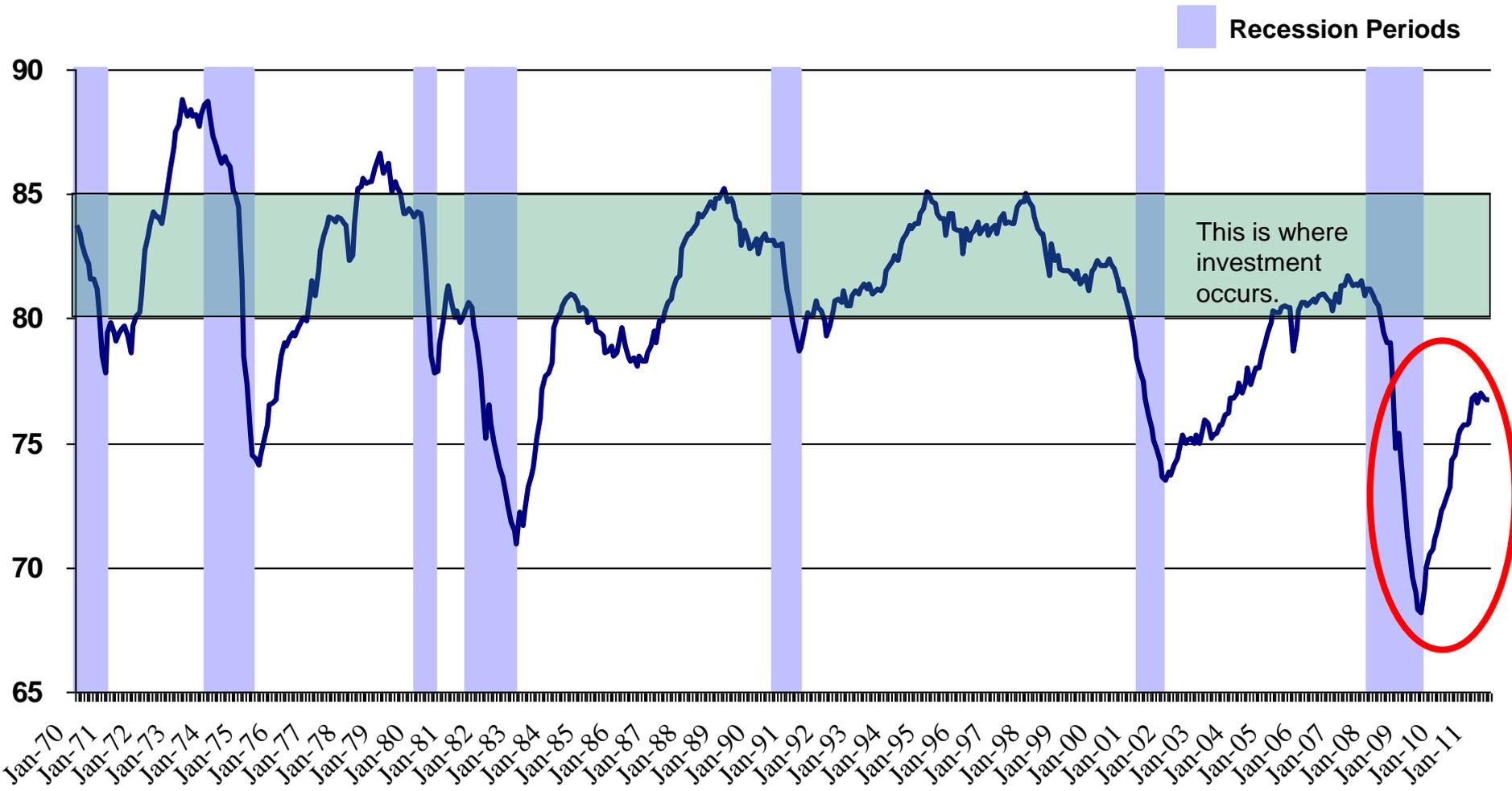
*Data through first quarter 2011



Capacity Utilization Rate

1970 – 2011*

Source: The Conference Board



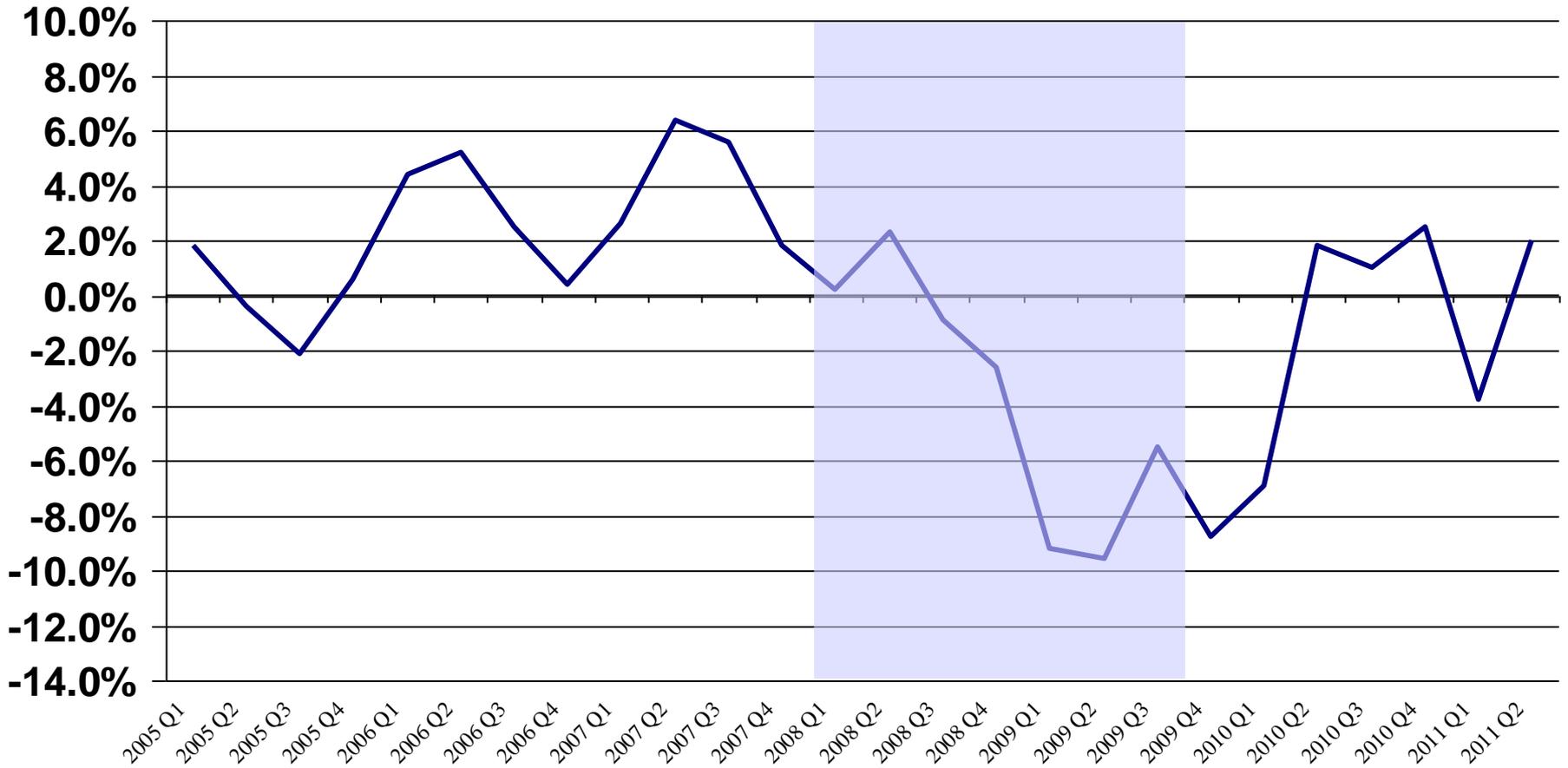
*Data through June 2011



Business Spending on Plant Percent Change from Prior Quarter 2005 – 2011*

Source: Bureau of Economic Analysis

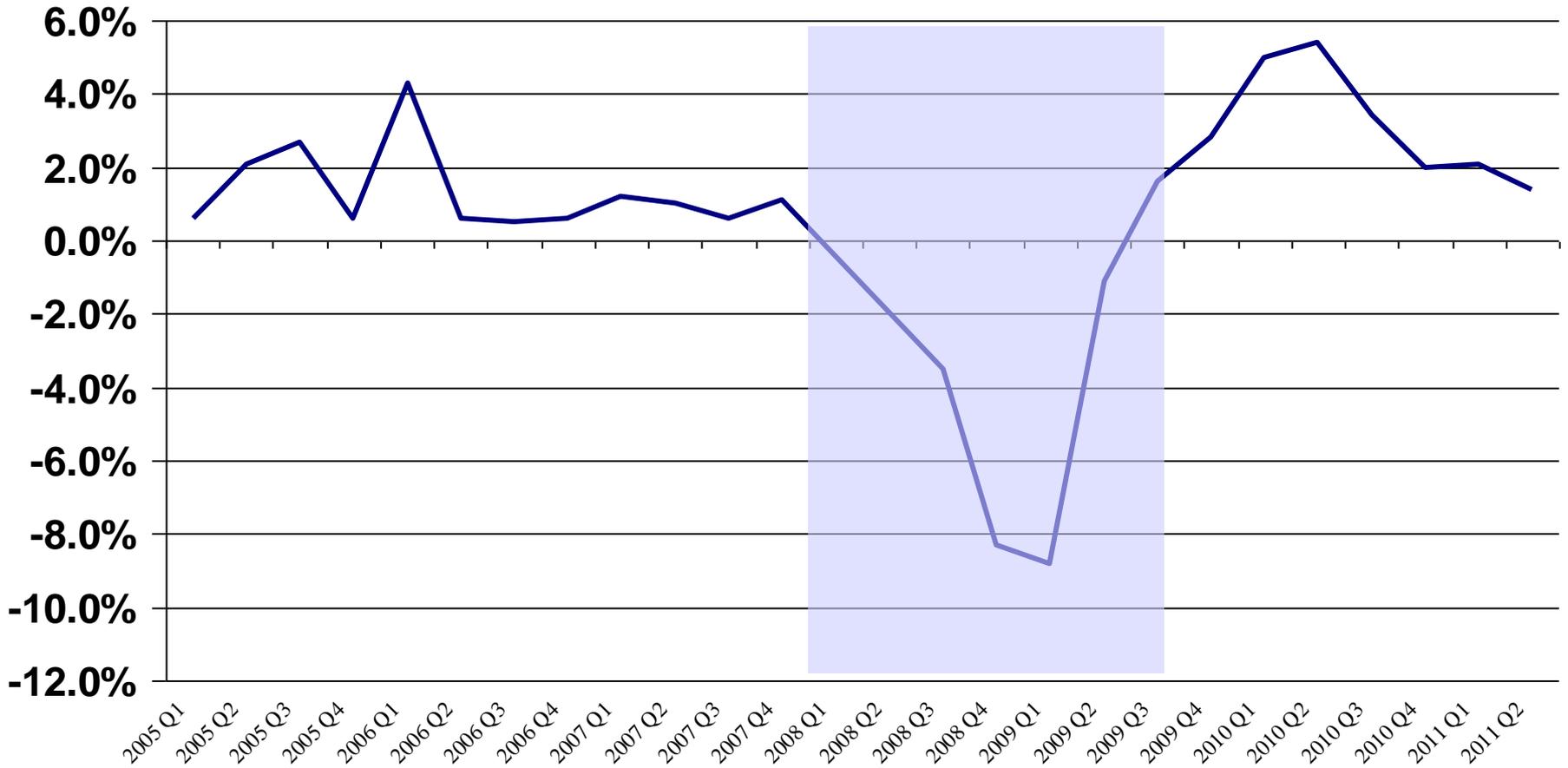
Recession Periods



Business Spending on Equipment Percent Change from Prior Quarter 2005 – 2011*

Source: Bureau of Economic Analysis

Recession Periods



*Data through second quarter 2011





U.S. Summary:

Recovering but not recovered.

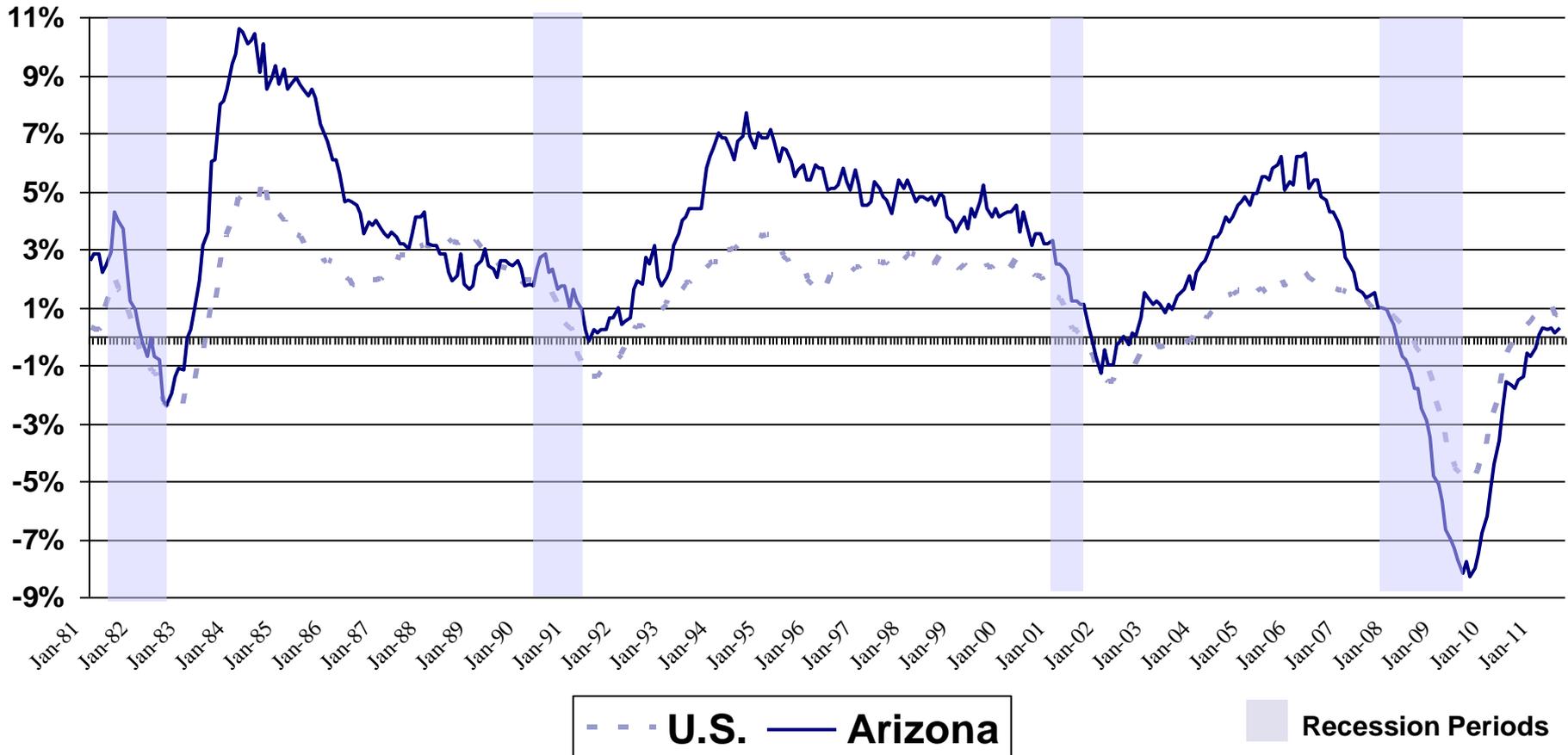


ARIZONA



Arizona & US Move Together

(Nonfarm Employment Percent Change 1980 – June 2011)



The WHY...

- **It took a number of unusual circumstances all occurring simultaneously,**
- **Virtually all are temporary events or conditions,**
- **This is still a basic “cyclical” problem.**



The WHO...

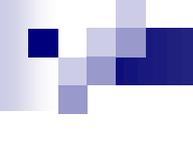
- **Tourism and Retirement were significantly impacted (two of our base sectors),**
- **“Growth” also acts like a base sector in many western states; this was similarly impacted (both residential and commercial) when population growth went from 3.0% to virtually 0%. We needed fewer doctors, car dealers, chiropractors, etc.**
- **Eventually the recession spread across all sectors.**



The WHEN...

- Home prices will stabilize across the US as will wealth levels.
- Those that postponed retirement will indeed retire and absorb AZ product.
- Those that postponed moving here will do so as job creation continues and home prices stabilize and grow.
- Now through about 2015 will still be slower than normal; but 2015 through 2025 should be strong.





**The problem with base
sectors is just cyclical;**

**the difference this time has
to do with our dependence
on growth and people's
ability to move.**



Arizona Economic Drivers (Base Industries):

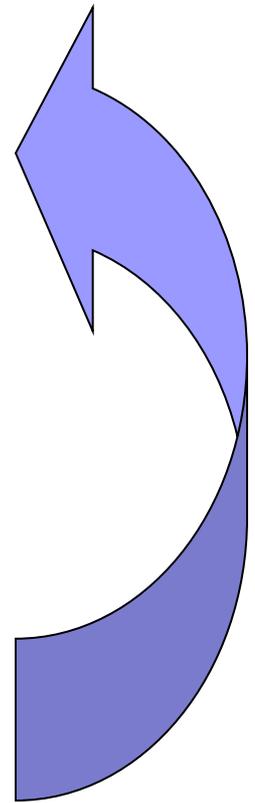
(where to focus?)

- **Manufacturing (focus)**
- **Tourism**
- **Advanced business services (focus)**
- **Federal government**
- **Retirement & second homes**
- **Others** (look to where money is being imported).



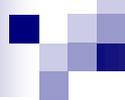
The Effect of Base Industries on the Local Economy

- Goods or services are sold outside the local economy;
- Money is imported into the region;
- These monies circulate;
- Leakage eventually occurs...



**All of these problems
are cyclical and
transitory.**





**The difference this
time is the population
slowdown.**



SRP Residential Utility Hookup Percentage Growth Greater Phoenix 2003 – 2011*

Source: SRP

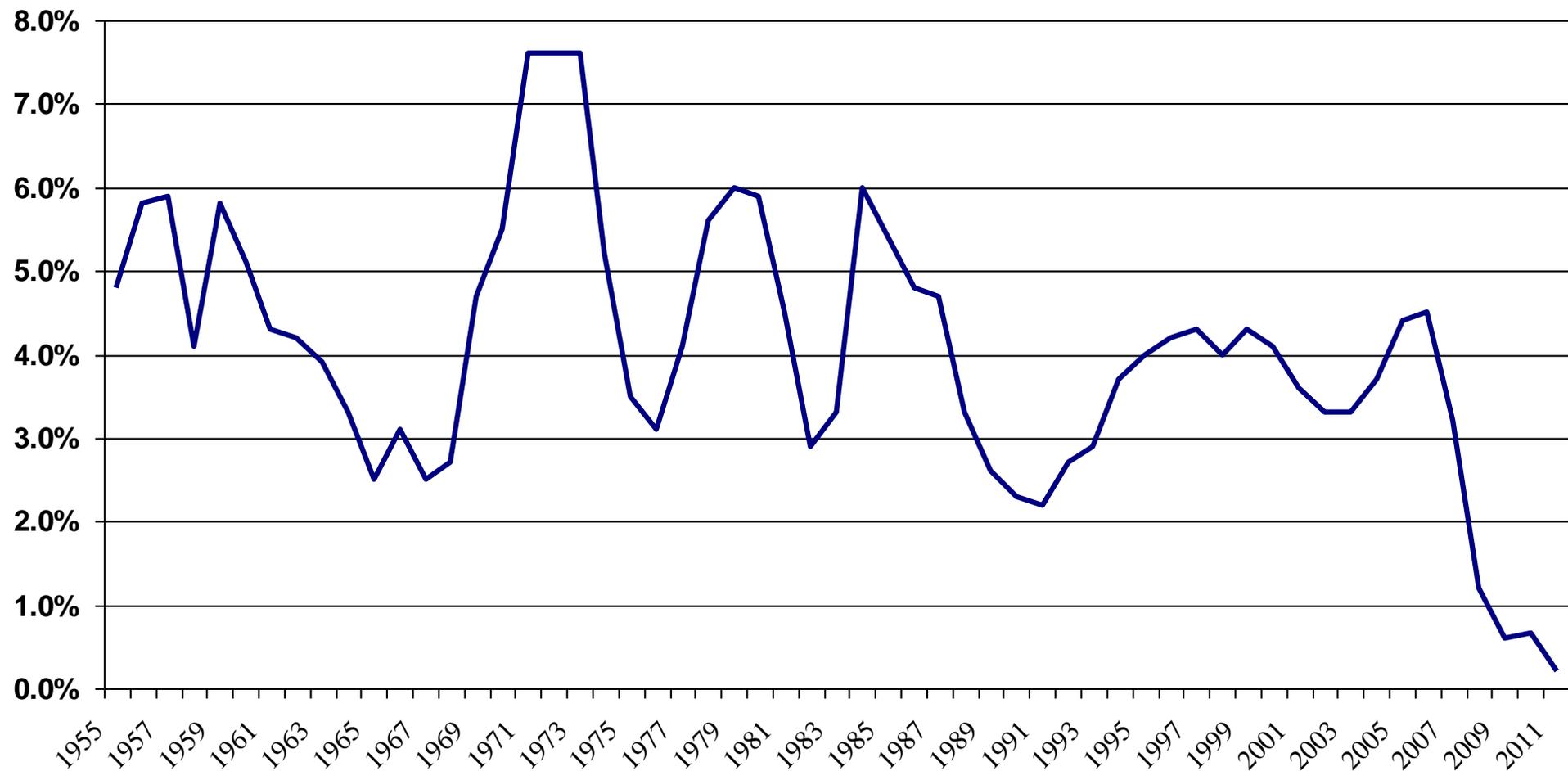


*Data through June 2011.



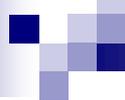
APS Residential Utility Hookup Percentage Growth Greater Phoenix 1955 – 2011*

Source: APS



*Data through Quarter 2 2011.





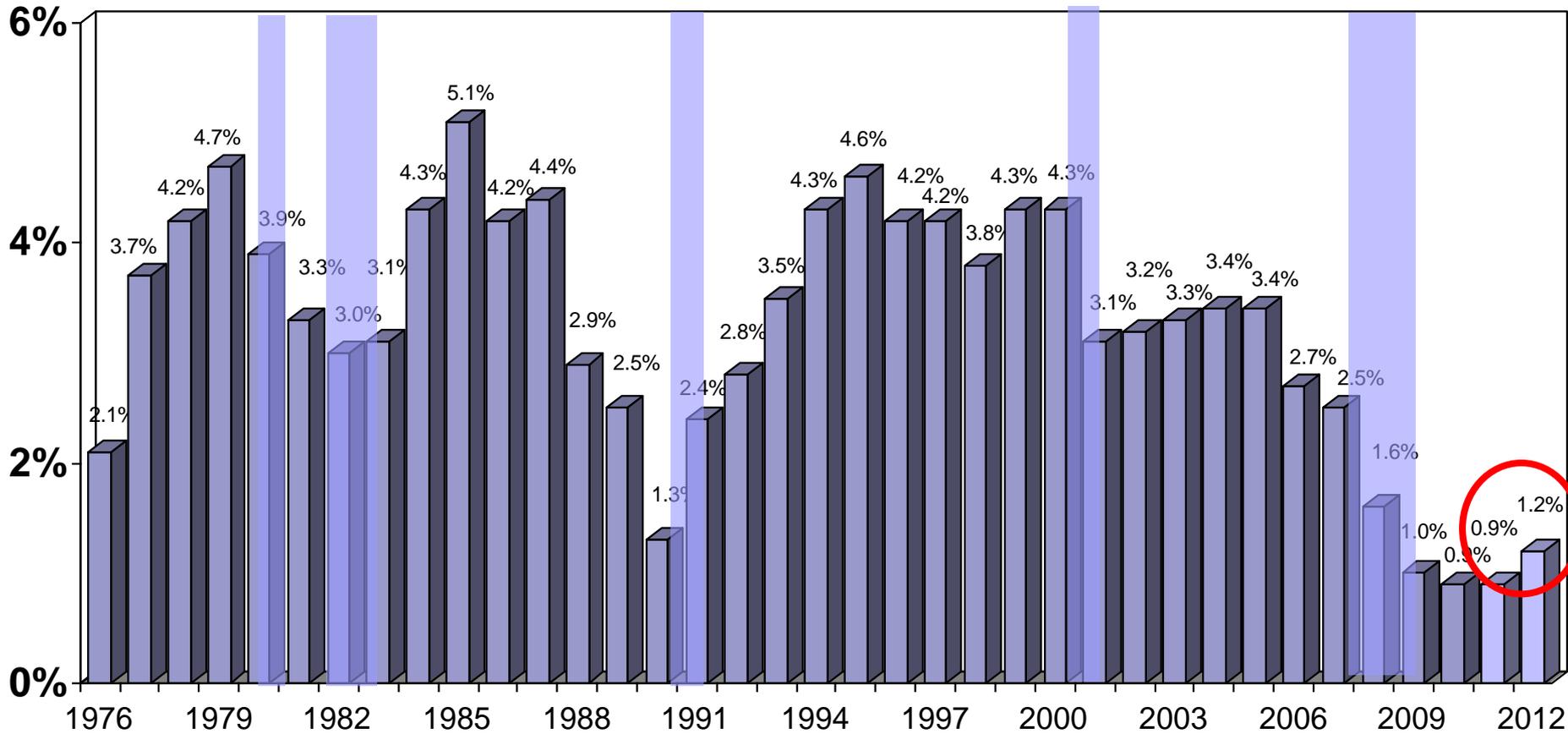
**Yet we are optimistic about the
long term and cautious about the
short term.**

**It's all about the basics: jobs and
population growth.**



Greater Phoenix Population Annual Percent Change 1976–2012*

Source: Arizona State University & Department of Commerce, Research Administration



2000-2010 estimates based on 2010 Census release.

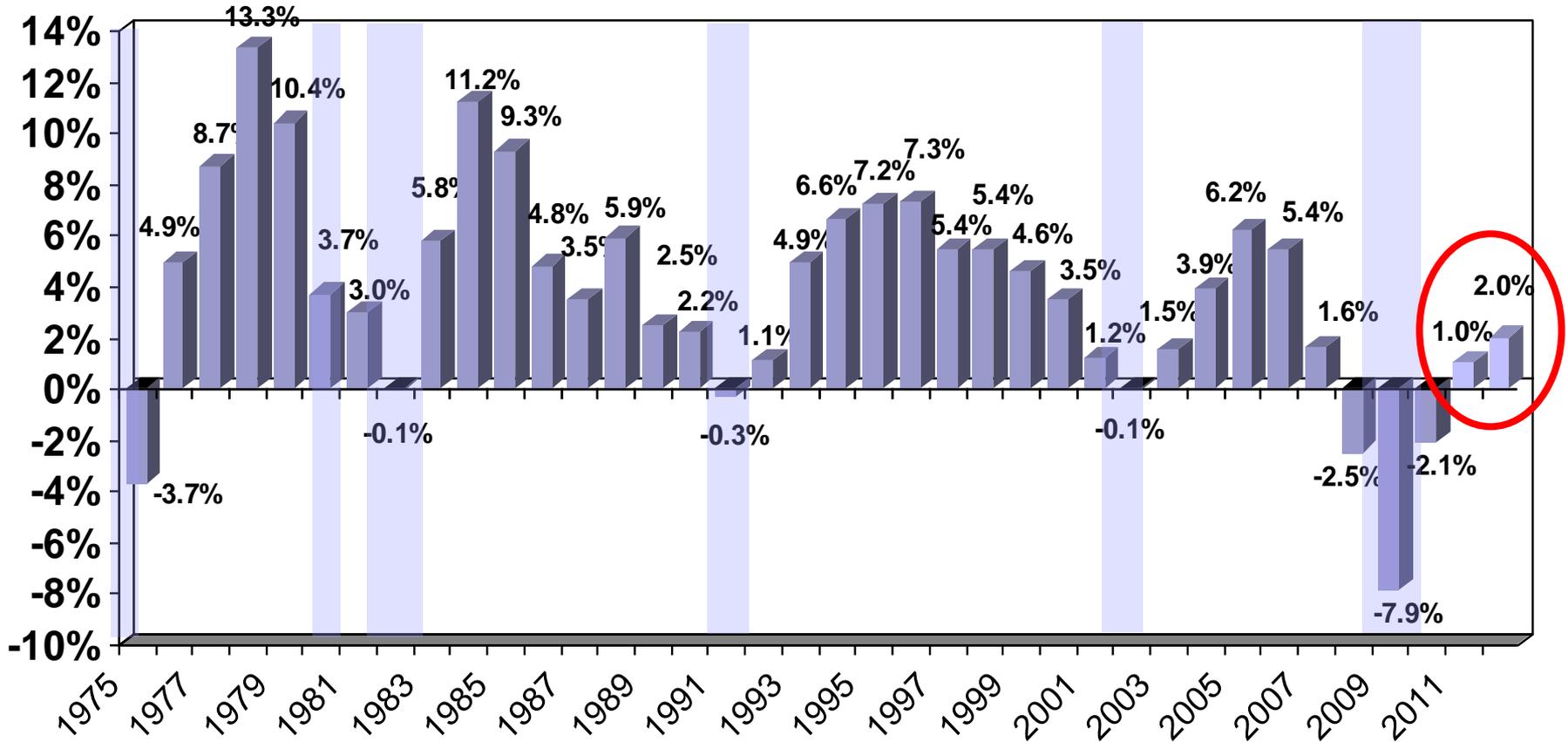
* 2011 & 2012 forecast is from *Elliott D. Pollack & Co.*

 **Recession Periods**



Greater Phoenix Employment* Annual Percent Change 1975–2012**

Source: Department of Commerce, Research Administration



*Non-agricultural wage & salary employment. Changed from SIC to NAICS reporting in 1990.

** 2011 & 2012 forecast is from *Elliott D. Pollack & Co.*

Recession Periods



Pre 2007

Arizona was one of the only two states to be in the top 5 growth states in terms of population, employment and personal income every decade since WWII.



Post 2007

Below average performance in many economic categories, but this is a temporary condition and is already improving...



How Arizona Ranks Among the States in Percentage Growth

Source: U.S. Bureau of Census; Bureau of Labor Statistics; Bureau of Economic Analysis

<u>DECADE</u>	<u>POPULATION</u>	<u>EMPLOYMENT</u>	<u>PERSONAL INCOME</u>
1950 - 1960	4 TH	3 RD	4 TH
1960 - 1970	3 RD	3 RD	4 TH
1970 - 1980	2 ND	3 RD	3 RD
1980 - 1990	3 RD	3 RD	5 TH
1990 - 2000	2 ND	2 ND	3 RD
2000 – 2006	3 RD	2 ND	3 RD
2007—2010	44 TH	49 TH	46 TH





**The recovery
has already started.**



Signs of Recovery

- Jobs
- Retail Sales
- Jobs rebound in other cities
- Fewer excess homes
- Fewer excess lots
- Population growth



Greater Phoenix - Jobs Finally in the Black

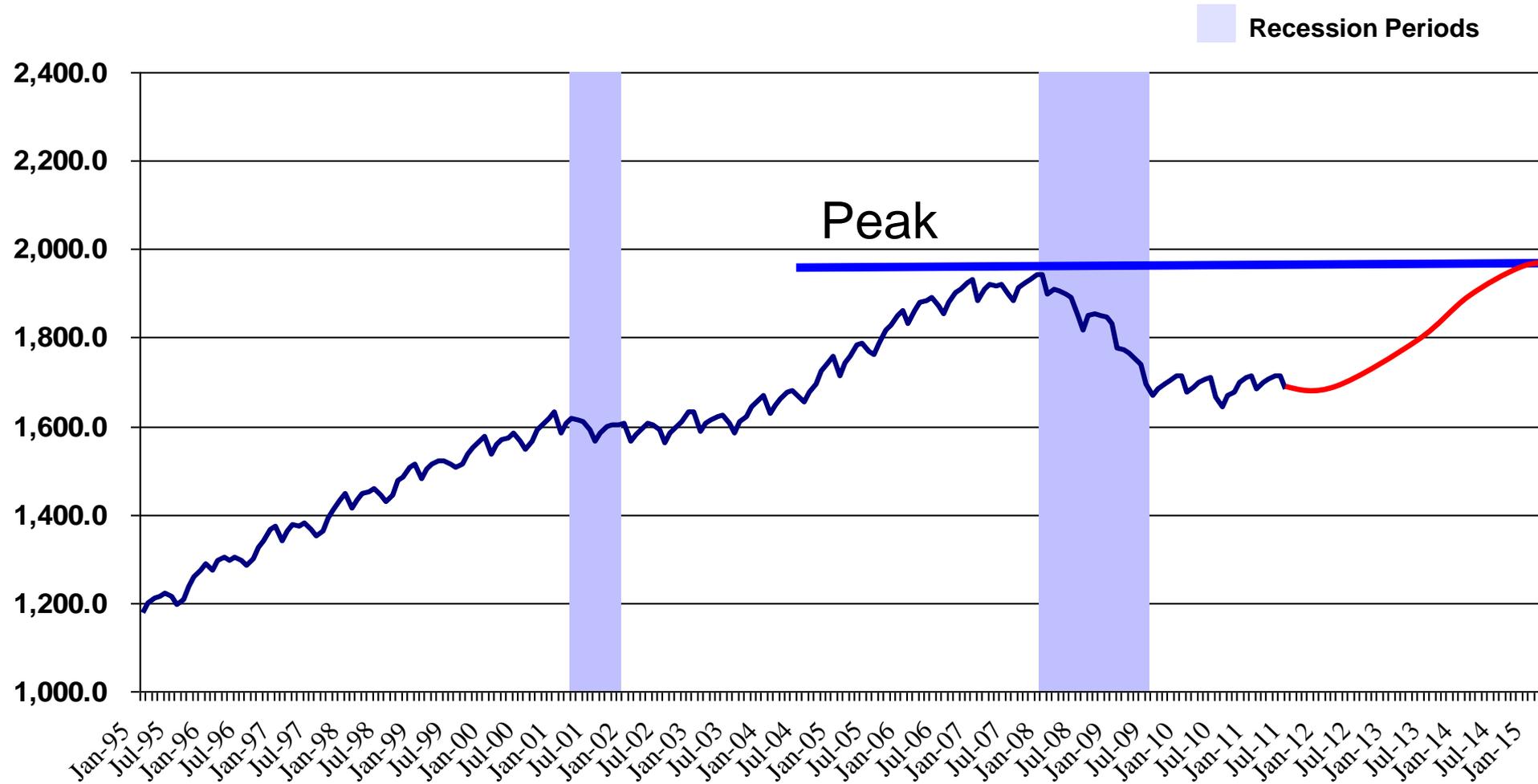
Over last 12 months:	17,900
12 months before that:	(29,100)
12 months before that:	(161,400)

* As of June 2011



Employment Levels: Greater Phoenix back to Peak in 2015?

Source: ADOC



Phoenix-Mesa Employment Growth

(Ranking among all metro areas greater than 1,000,000; 2011 June/June)

Source: Arizona State University, U.S. Bureau of Labor Statistics

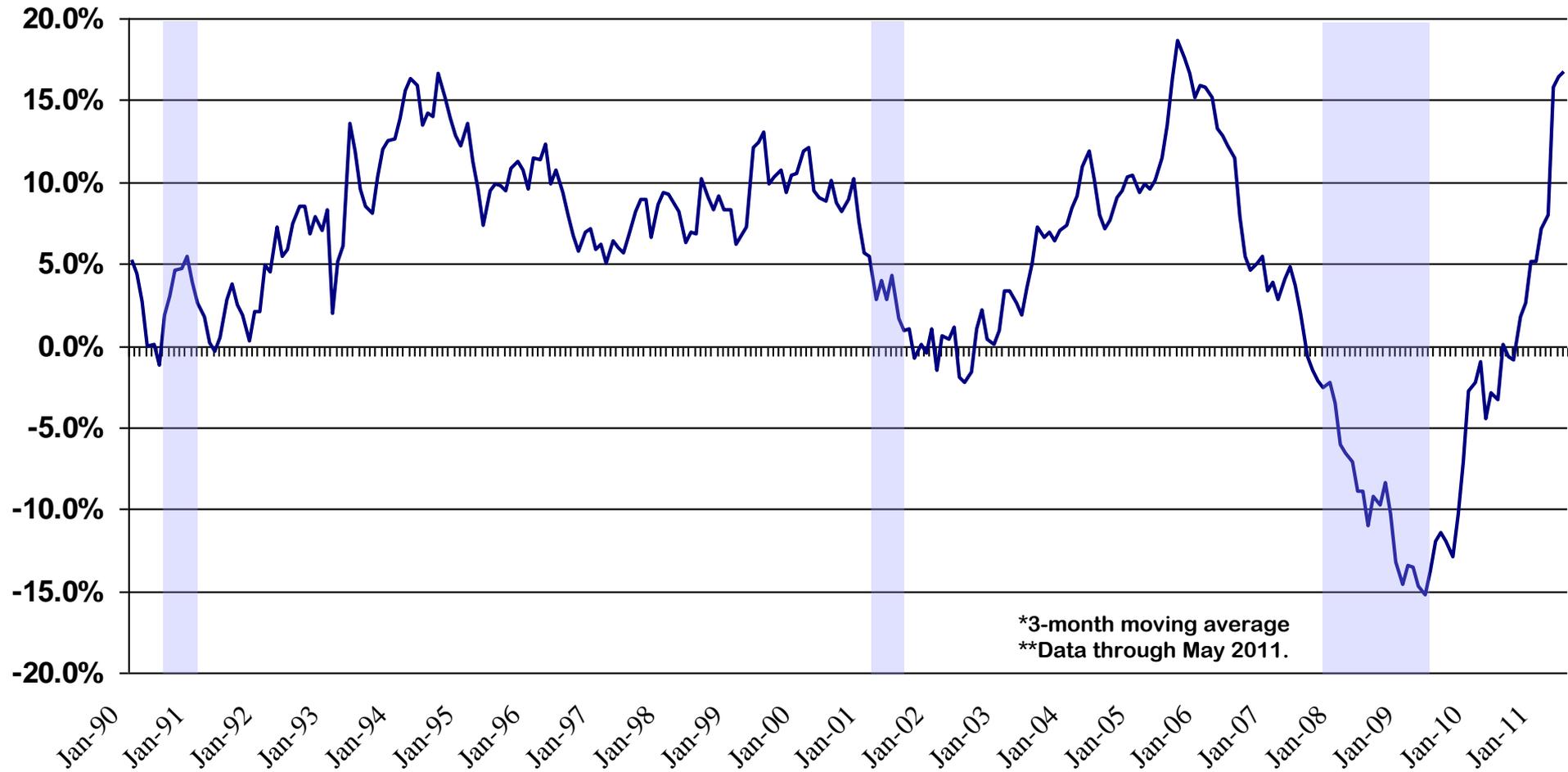
<u>YEAR</u>	<u>RANK</u>	<u># of MSAs</u>
1991	4	20
1992	5	20
1993	2	20
1994	1	20
1995	1	21
1996	1	23
1997	2	23
1998	1	24
1999	3	26
2000	8	26
2001	6	28
2002	5	28
2003	3	29
2004	4	29
2005	1	30
2006	1	31
2007	10	32
2008	29	32
2009	31	32
2010	31	32
2011	10	32



Maricopa County Retail Sales* Percent Change Year Ago 1990 to 2011**

Source: Arizona Department of Revenue

Recession Periods



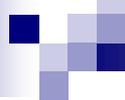
*3-month moving average
**Data through May 2011.



Single Family Housing

**“No significant recovery
without a recovery in
housing”**





For Housing -

**This is NOT a multi decade
recovery...**

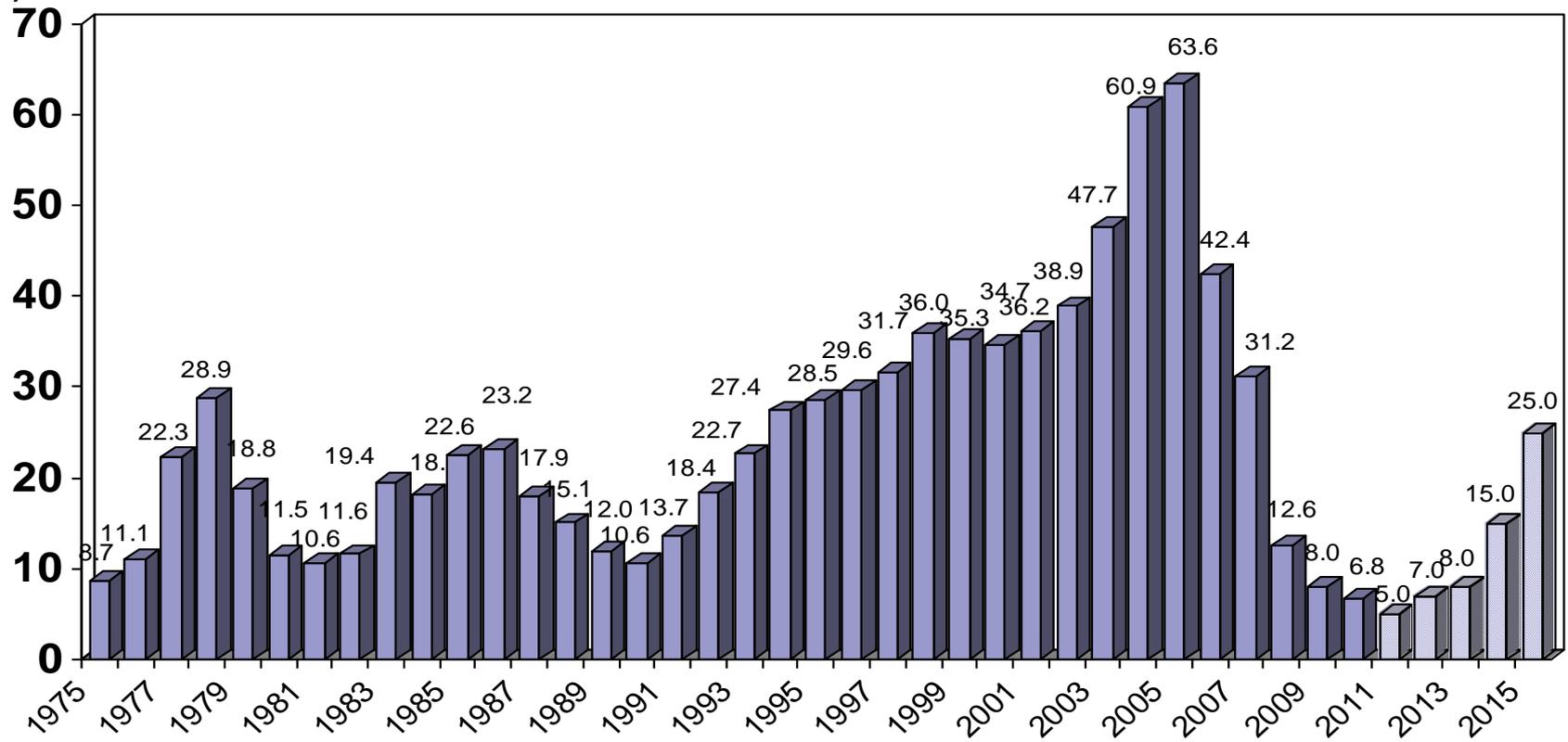
**Think 2015 – 2016 for full
recovery, but growth
before then.**



Single Family Permits (Forecast) Greater Phoenix 1975–2015*

Source: RL BROWN

Permits
(000)



* 2011 - 2015 forecast is from *Elliott D. Pollack & Co.*





**Across the US, little new
building has been
occurring.**

**This helps reduce the
oversupply.**





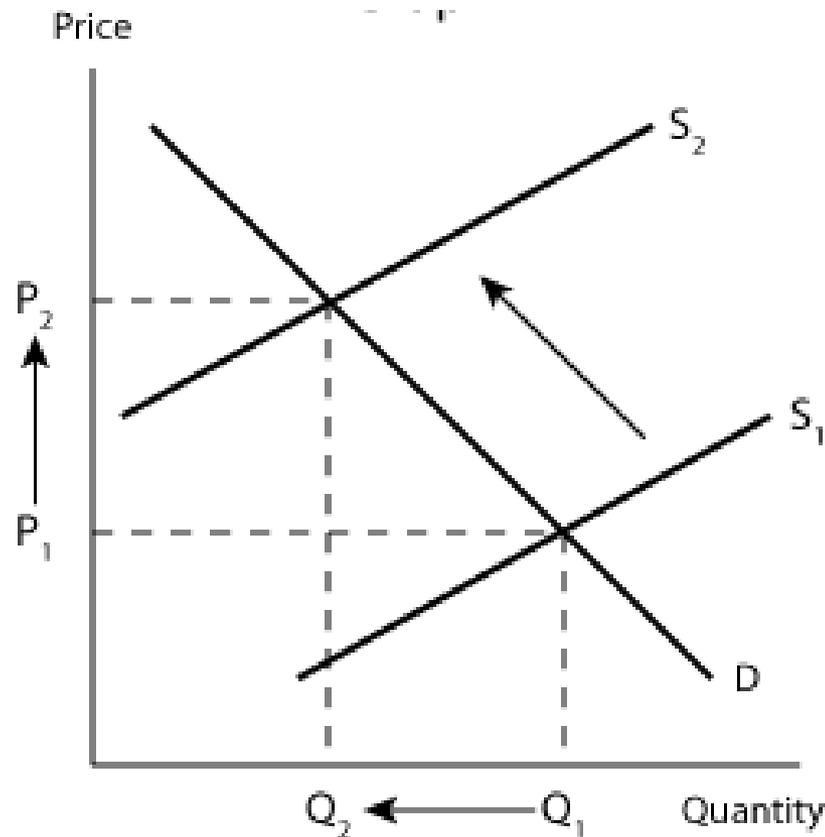
**Excess supply
in Greater
Phoenix is
about
55-60k units as
of today, down
from about 80k
units.**

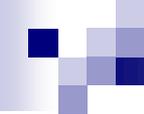


Think of what the housing market is going through as the same as any manufacturer that finds themselves with excess inventory. Prices are cut until the excess is sold. Then prices rise.



As excess is absorbed, prices will increase. This is Economics 101



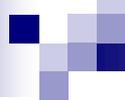


Historically, there is a one-to-one relationship between population growth and household growth

(meaning a 1% increase in population growth leads to a 1% increase in household growth).

Source: Linneman Letter





When unemployment **exceeds 7%, a 1% increase in population leads to a 0.3% increase in households.**

When unemployment **falls below 7%, each 1% increase in population leads to a 1.9% increase in households.**

Source: Linneman Letter



**Thus, in a weak economy,
population growth fails to
translate into household growth,
but when the economy begins to
strengthen, there is pent-up
demand for housing.**

Source: Linneman Letter



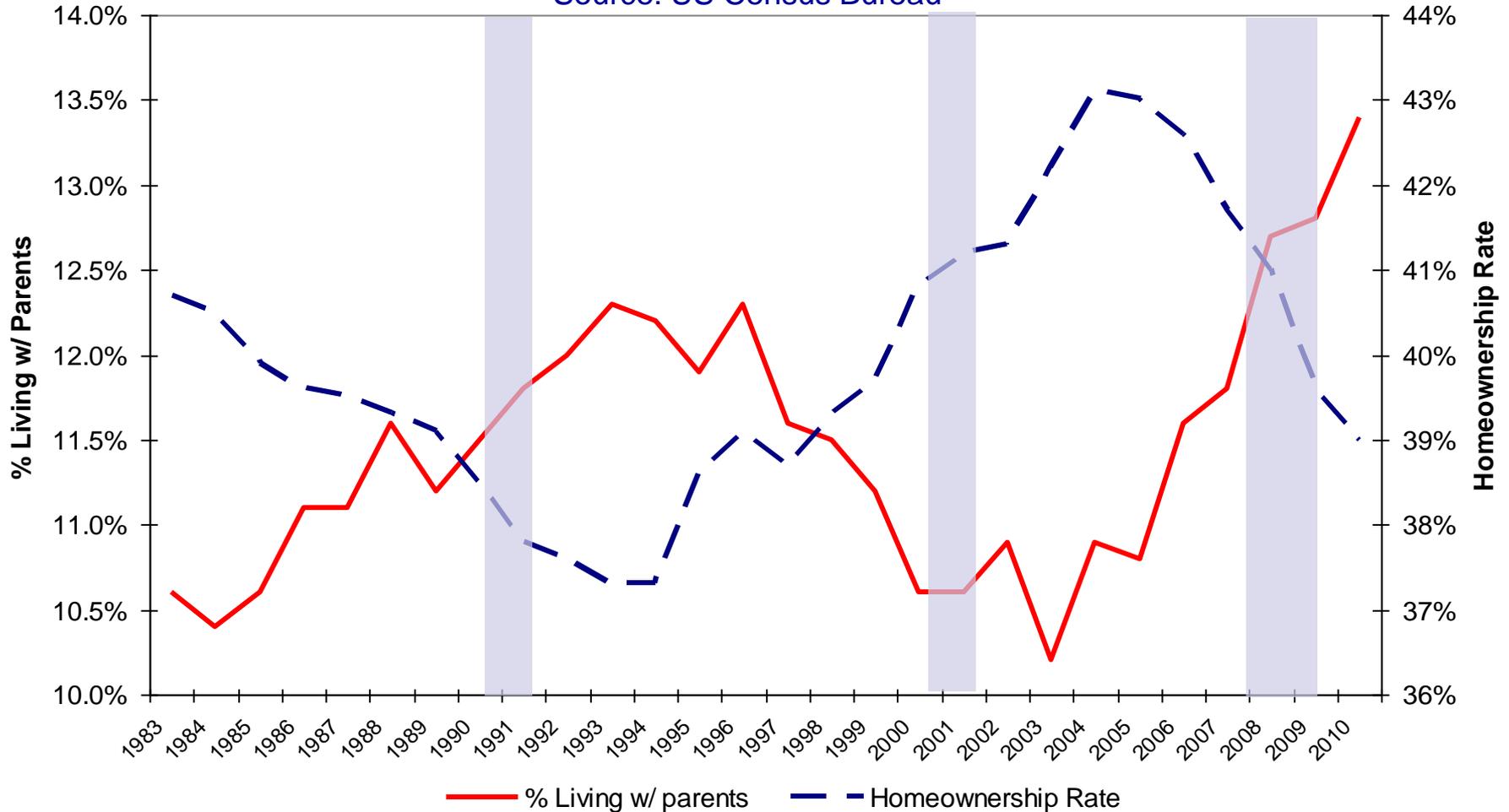
In Arizona, the same basic trend has occurred.



Percent of 25-34 Year Olds Living With Parents vs. Homeownership Rate, Under 35 Years Old

U.S.: 1983 – 2010

Source: US Census Bureau



Why are households not forming?

- 1. Lack of jobs,**
- 2. Inability to sell home elsewhere and
move to Greater Phoenix,**
- 3. Lack of jobs,**
- 4. Lack of jobs,**
- 5. Lack of jobs.**



The Real Problem:

- **Too many vacant homes
(but amount of excess is declining).**
- **Not enough new households
(but this will change as jobs increase).**



Commercial Markets...



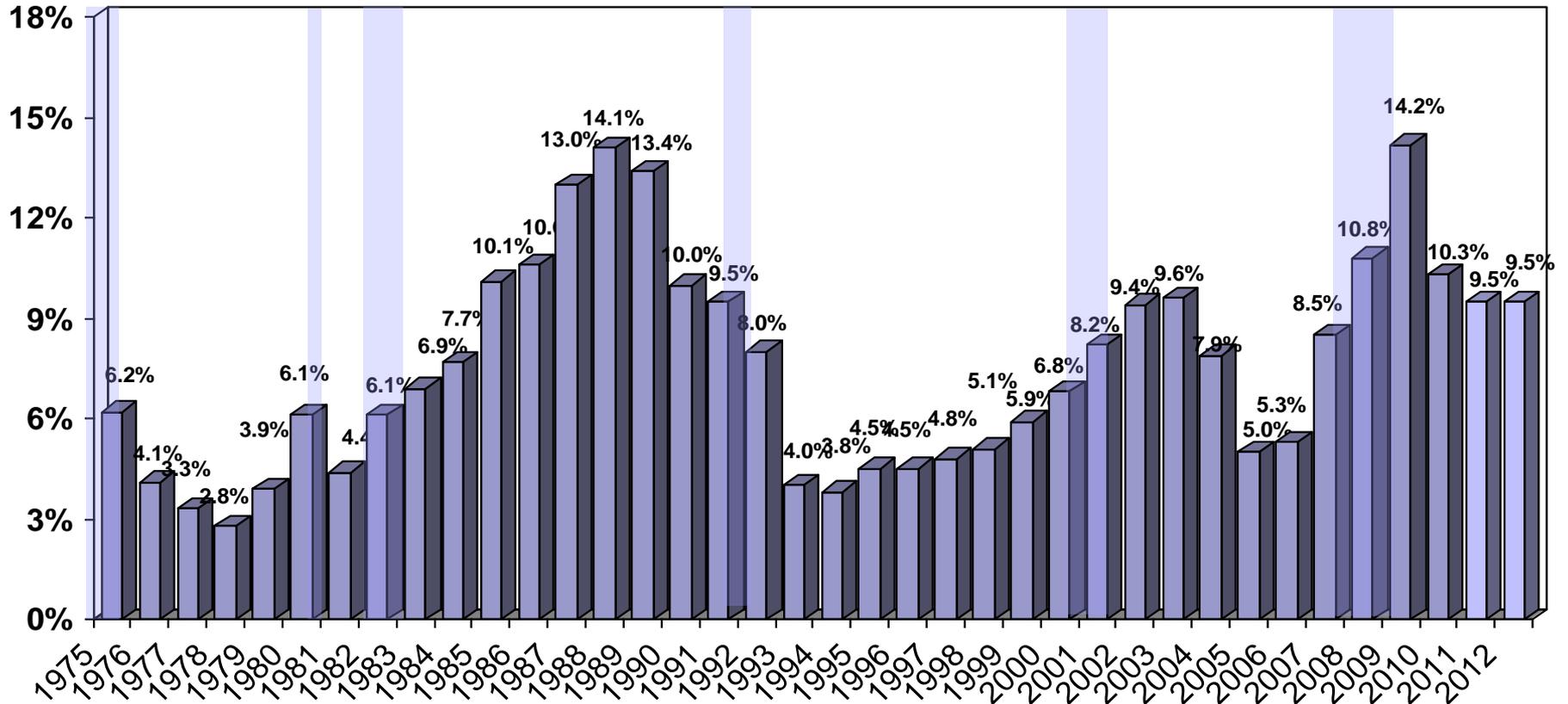
APARTMENTS



Multi-Family Year-End Vacancy Rates Maricopa County 1986–2012*

Source: ASU Realty Studies

Recession Periods



*2011 -2012 are forecasts from the Greater Phoenix Blue Chip



Multi-Family Construction Activity

Source: PMHS

	<u>Absorption</u>	<u>Chg in Inventory*</u>
2006	(4,653)	(3,828)
2007	(5,846)	4,979
2008	(4,466)	3,234
2009	(5,319)	6,831
2010	20,743	8,493
2011q2	(1,737)	463

*There were 19,949 condo conversion in the Greater Phoenix area from q1 2005 through q4 2009.



**There are currently
191 multi-family units under
construction (Q2 11).**





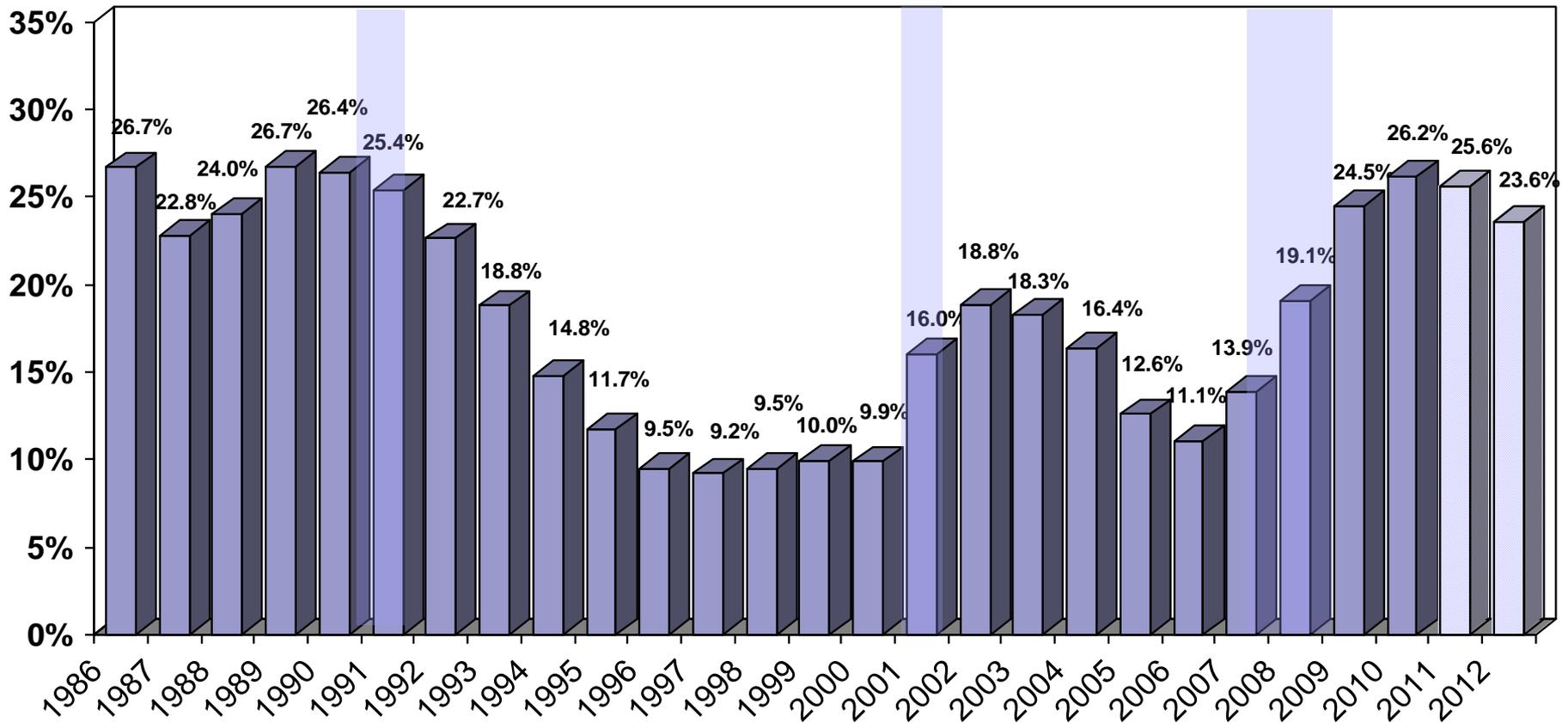
OFFICE



Office Space Year-End Vacancy Rates Maricopa County 1986–2012*

Source: CB Richard Ellis

Recession Periods



Greater Phoenix Office Market Construction Activity

Source: CB Richard Ellis

Year	Absorption (sf)	Chg in Inventory (sf)
2005	3,119,293	7,987
2006	3,245,888	**2,320,302
2007	1,500,704	4,905,374
2008	(603,112)	3,402,646
2009	(677,329)	1,798,415
2010	233,670	2,011,404
2011q2	960,477	***2,408,630

*Only includes multi-tenant space greater than 10,000 SF

** A number of buildings in downtown and mid-town are being converted to office condos.

***The 2.4 million square feet in 2011 are build-to-suit FBI building and Univ. of Phoenix building



**There is currently
NO multi-tenant office space under
construction (q2 11).**



**No significant office
building in Greater
Phoenix for next
3-5 years.**



INDUSTRIAL



Greater Phoenix Industrial Market Construction Activity

Source: CB Richard Ellis

Year	Absorption (sf)	Chg in Inventory (sf)
2005	12,339,591	7,072,477
2006	6,032,175	7,829,959
2007	8,359,835	13,914,181
2008	629,838	13,467,215
2009	(4,649,352)	4,753,218
2010	4,455,097	2,451,202
2011q2	2,931,634	580,554



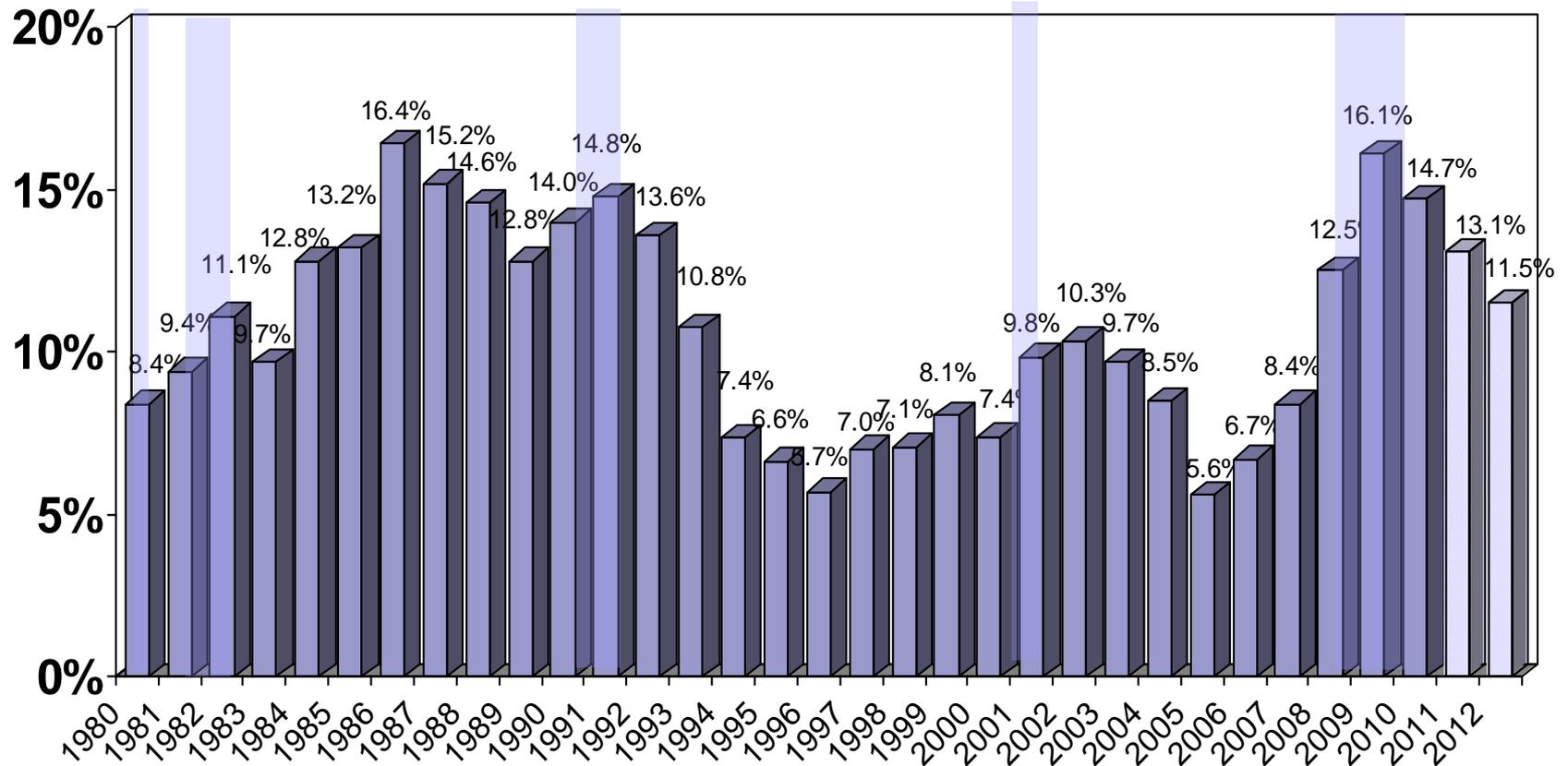
**There are currently
3.9 million square feet of
industrial space
under construction (q2 11).**



Industrial Space Vacancy Rates Maricopa County 1980 – 2012*

Source: CB Richard Ellis

Recession Periods



* 2011 - 2012 are forecasts from CB Richard Ellis



RETAIL



Greater Phoenix Retail Market Construction Activity

Source: CB Richard Ellis

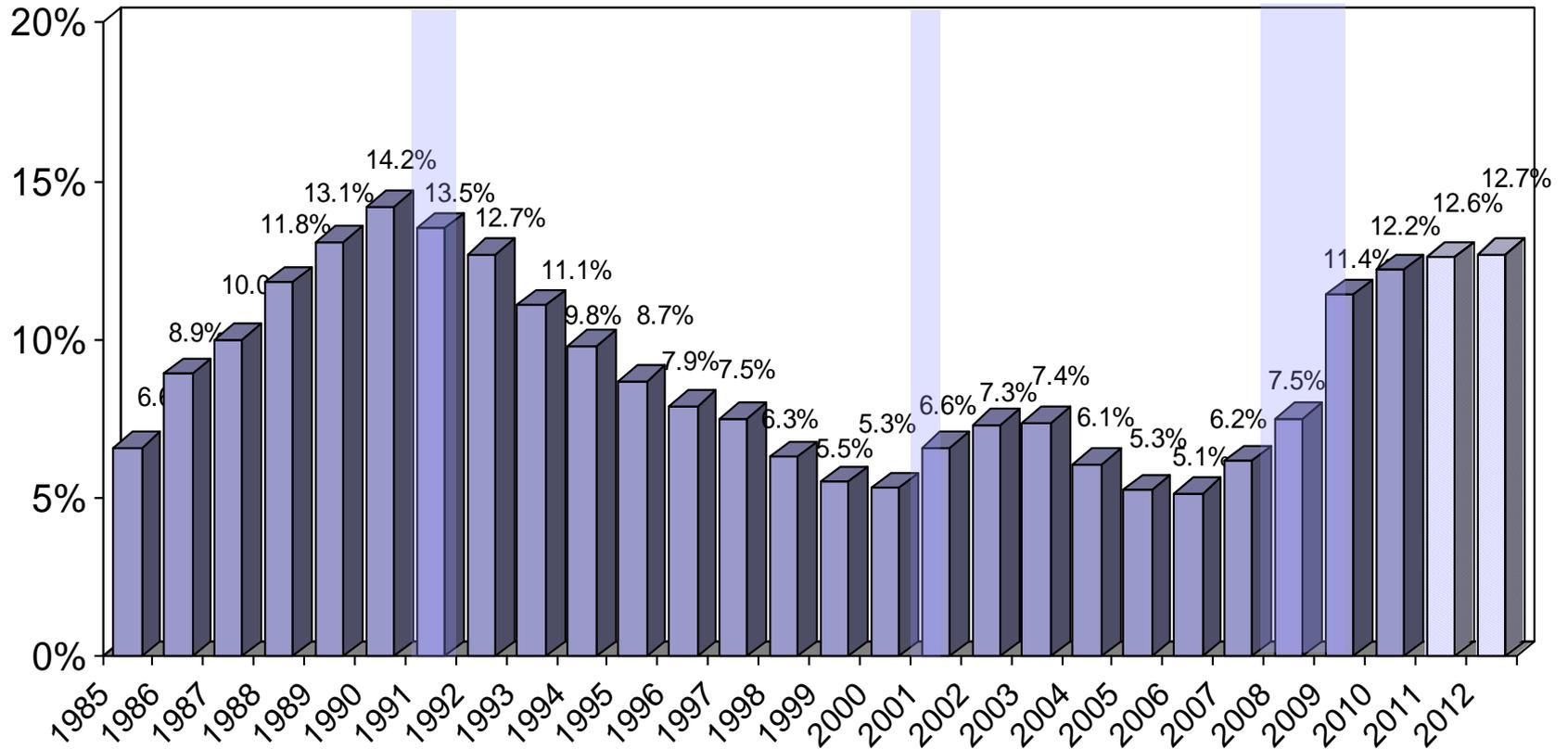
Year	Absorption (sf)	Chg in Inventory (sf)
2005	6,708,155	6,248,789
2006	5,244,597	4,582,618
2007	9,424,362	11,104,865
2008	3,395,986	6,229,205
2009	(1,117,100)	4,405,985
2010	(75,352)	902,380
2011q2	(648,697)	(181,048)



Retail Space Vacancy Rates Maricopa County 1985–2012*

Source: CB Richard Ellis**

Recession Periods



* 2011-2012 are forecasts from CB Richard Ellis

** Data prior to 1992 is from Grubb & Ellis



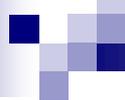
Back to Normal Vacancy?

- **Office = 2014 – 2015**
- **Industrial = 2013 – 2015**
- **Retail = 2014 – 2015**



**No new commercial
construction is needed
for years.**





**The long term economic
fundamentals have not really
changed.**

**The long term economic outlook
remains favorable.**

**AZ will be a national growth leader
by mid decade.**



**There is a BOOM for Arizona
out there somewhere.**



**But not in
2011, 2012 or 2013.**





What does this all mean for REVENUES?



Revenue Summary

- Despite the fact that the “recovery” has reached about two years in duration, rates of growth are still not that impressive.
- SALES TAX: For FY 2012 the pessimistic sales tax forecast has been revised slightly upward. While this forecast is building off of a weak base (an argument for higher rates of growth all else being equal) the additional uncertainty in the economy dictates a more conservative approach to forecasting and budgeting until a longer term trend develops.
- VLT: The FY 2012 pessimistic forecast remains at -1.0% to reflect weak population growth and car sales as well as the impact from higher gasoline prices. Since all of these things will be changing at different rates during the next year, this forecast has an additional level of uncertainty.
- PROPERTY TAX: Overall, housing prices in the County region should stay relatively flat for the next few months, as will commercial values.
- Net Assessed Values are not expected to start growing again until tax year 2013 (Fiscal year 2013-14). **UNKNOWN: PROPOSITION 13**



WHAT IS PROPOSITION 13?

- It is a property tax initiative planned for the November 2012 ballot that rolls back property values to 2003 values (until property sells).
- Similar to Prop 13 in California.



Prop 13 Impact

- Impacts overall revenue streams the most when property values start to go back up.
- UNKNOWN: how each of the taxing jurisdictions (including the County) would receive portions of total tax revenue.
- ALSO caps the total property tax to be only 0.5% of the value of the residential property (1.0% of commercial and other property). This alone would impact assessed values by a drop of more than 50%.





ELLIOTT D. POLLACK ***& Company***

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- **Revenue Forecasting**
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