Northern California/Nevada Economic Trends and Commercial Real Estate Investment Analysis 2009 - 2010

Prepared for

SVN NorCal/Reno Business Owners Conference

Prepared by

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- ***Professor – Real Estate/Finance***
  Golden Gate University

Fri 03/13/09

Johnson Souza Group, Inc

- Over 20 years of real estate economic and financial research, and institutional due diligence underwriting. Specializes in apartment and commercial market research, valuation and brokerage services.

- Offering tax deferred vehicles: 1031 Exchanges, Tenants in Common (TIC), Deferred Sales Trusts (DST), etc.; and real estate related investments: partnerships, funds, REITs, etc.

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Cell Direct: (415) 713-0213 Fax: (415) 826-2216

Introduction

- Introduction
- Business/Commercial Real Estate Cycles
- Commercial Market Fundamentals
- Employment
- Technology/Venture Capital Trends
- Interest Rates and Inflation
- Residential Market
- Conclusions: Advantages and Risks

Introduction


Chronicle / Michael Macor

SF Bay Area
Business-Market Cycle Overview

- Economy in decline/trough phase, employment contraction accelerating: 36-to-60 month trough.
- Economic contraction to bottom 2Q/3Q 2009.
- Commercial construction cycle peak 2002, trough in 2004-2005, growth phase from 2006 through 2007: low no new construction.
- Next business cycle peak 2015 - 2020, next technology-employment cycle peak 2016 – 2018, potential rent spikes.
- Target markets for commercial investment 2009-2010:

Downtown San Francisco/San Jose; I-680/880 Corridors-Walnut Creek/San Ramon/Pleasanton/Fremont; SF Peninsula-Redwood City/Palo Alto; Marin/Santa Cruz Counties

Institutional Foundations for Efficient Capital Markets

"Efficient real estate and securities capital markets require strong public and private sector cooperation, disclosure of government and corporate financial conditions, and institutional and individual investor confidence in financial and political institutions."

Lawrence Souza

Real Estate in a Social, Cultural and Economic Context

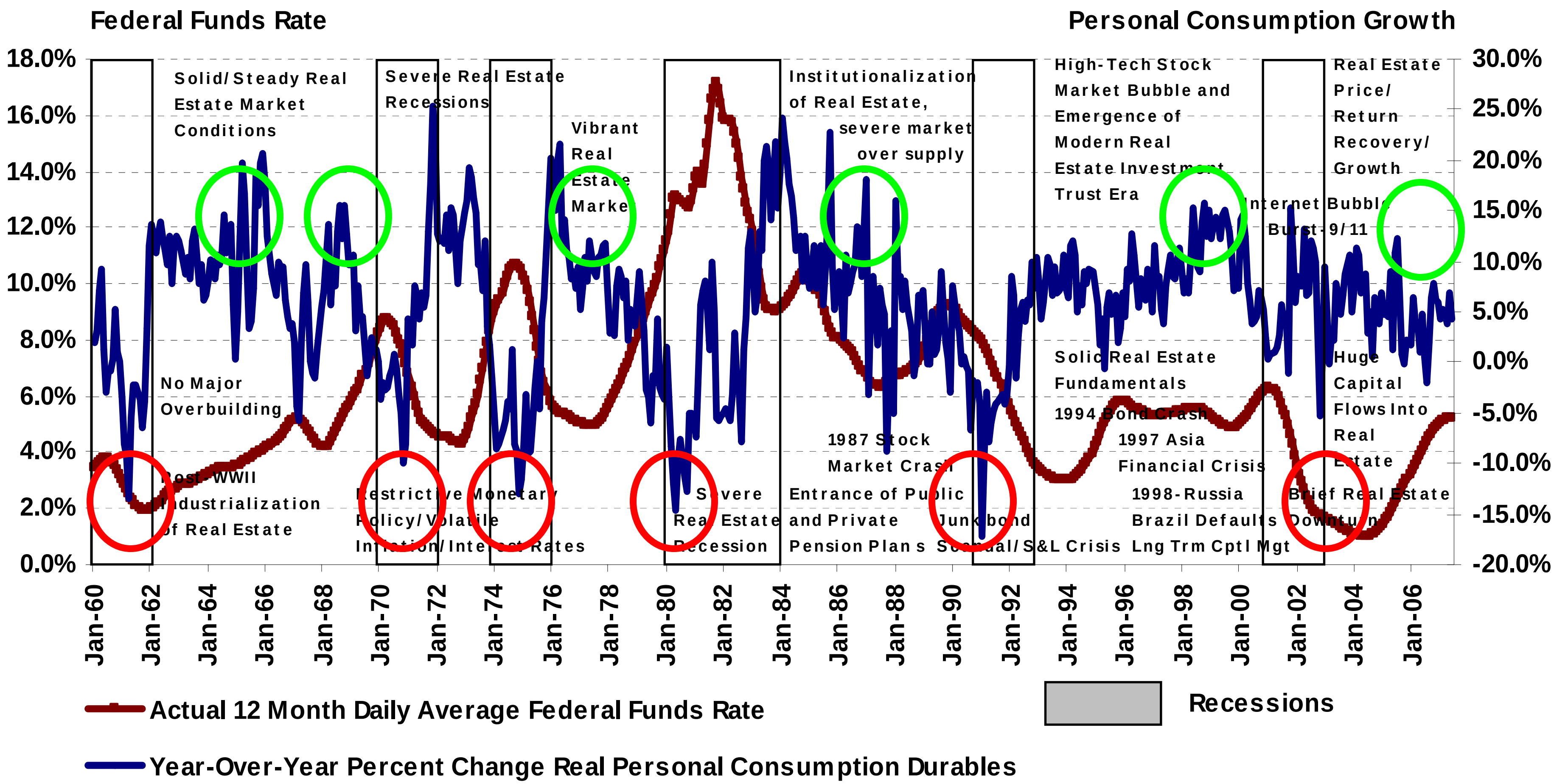
Interdisciplinary/Cross-Sectional Approach to Real Estate Market Analysis:

- Biological/Physiological/Psychological
- Philosophical Systems
- Legal Systems
- Political Systems
- Economic Systems
- Financial Systems

Business and Commercial Real Estate Cycles

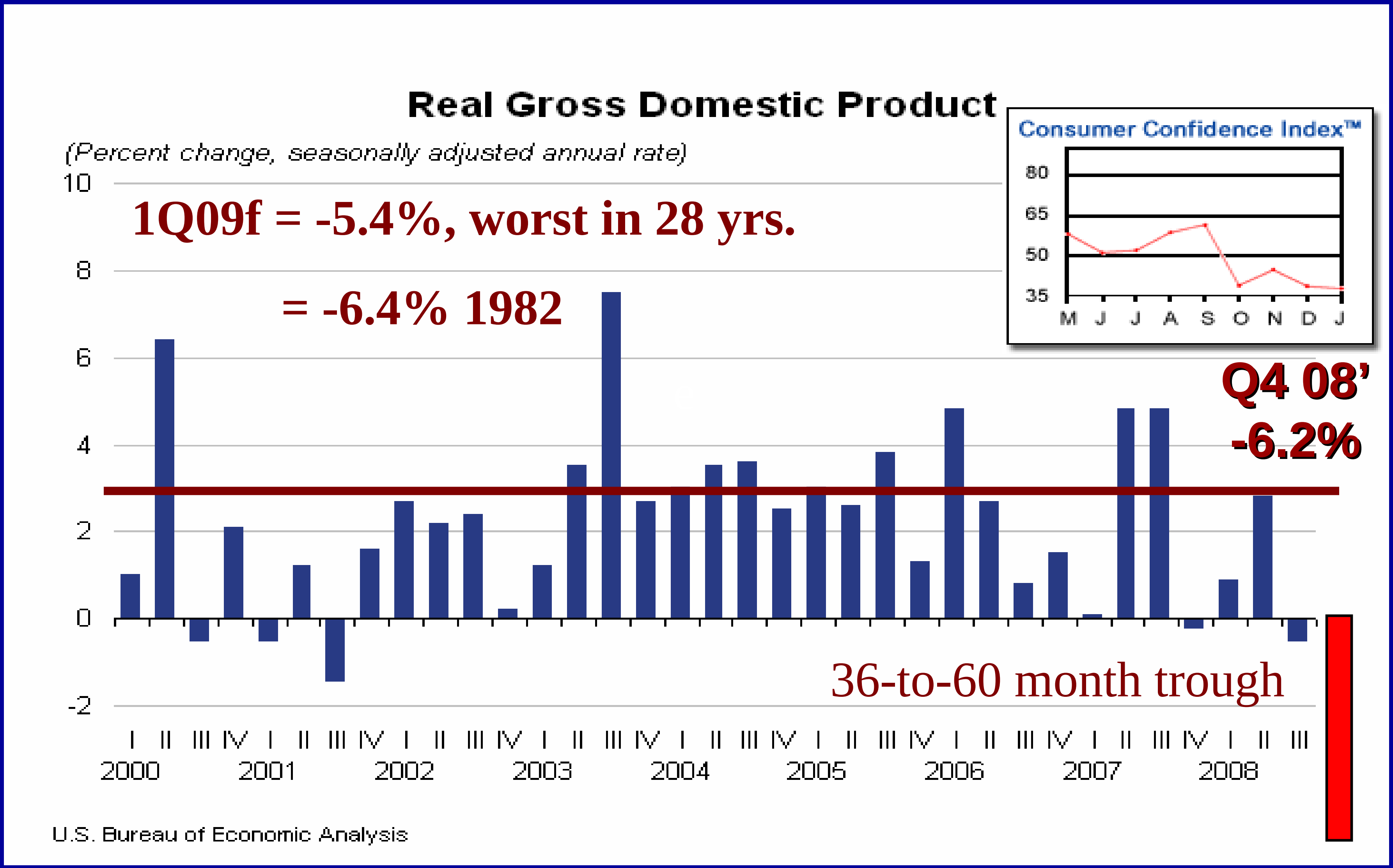
Business Cycle Theory

CONSUMPTION VS. INTEREST RATE CYCLES



Sources: Board of Governors of the Federal Reserve System and U.S. Department of Commerce: Bureau of Economic Analysis.

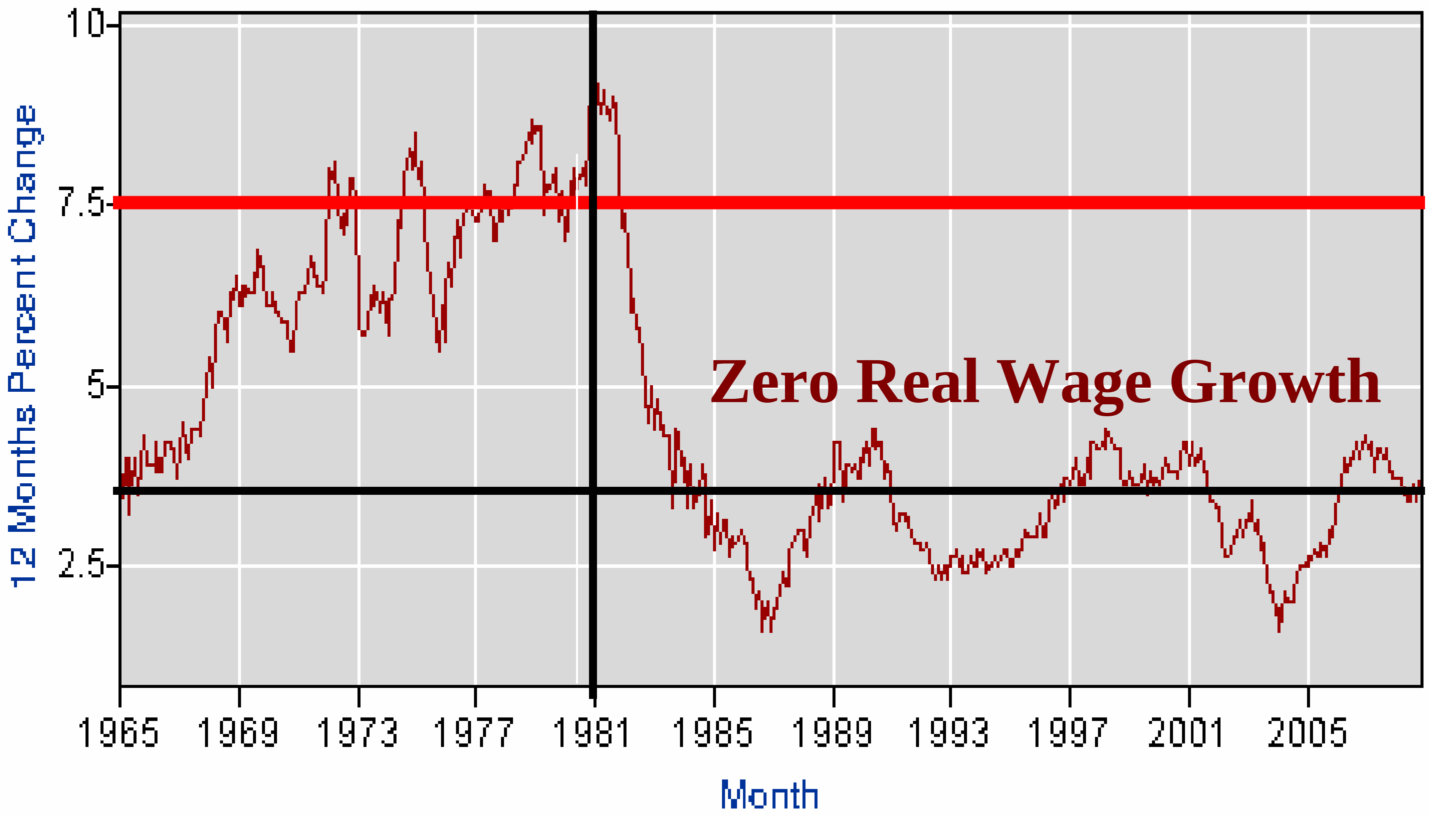
Gross National Product (GDP)



http://www.bea.doc.gov/bea/newsrel/gdp_glance.htm. http://www.conference-board.org/economics/ConsumerConfidence.cfm

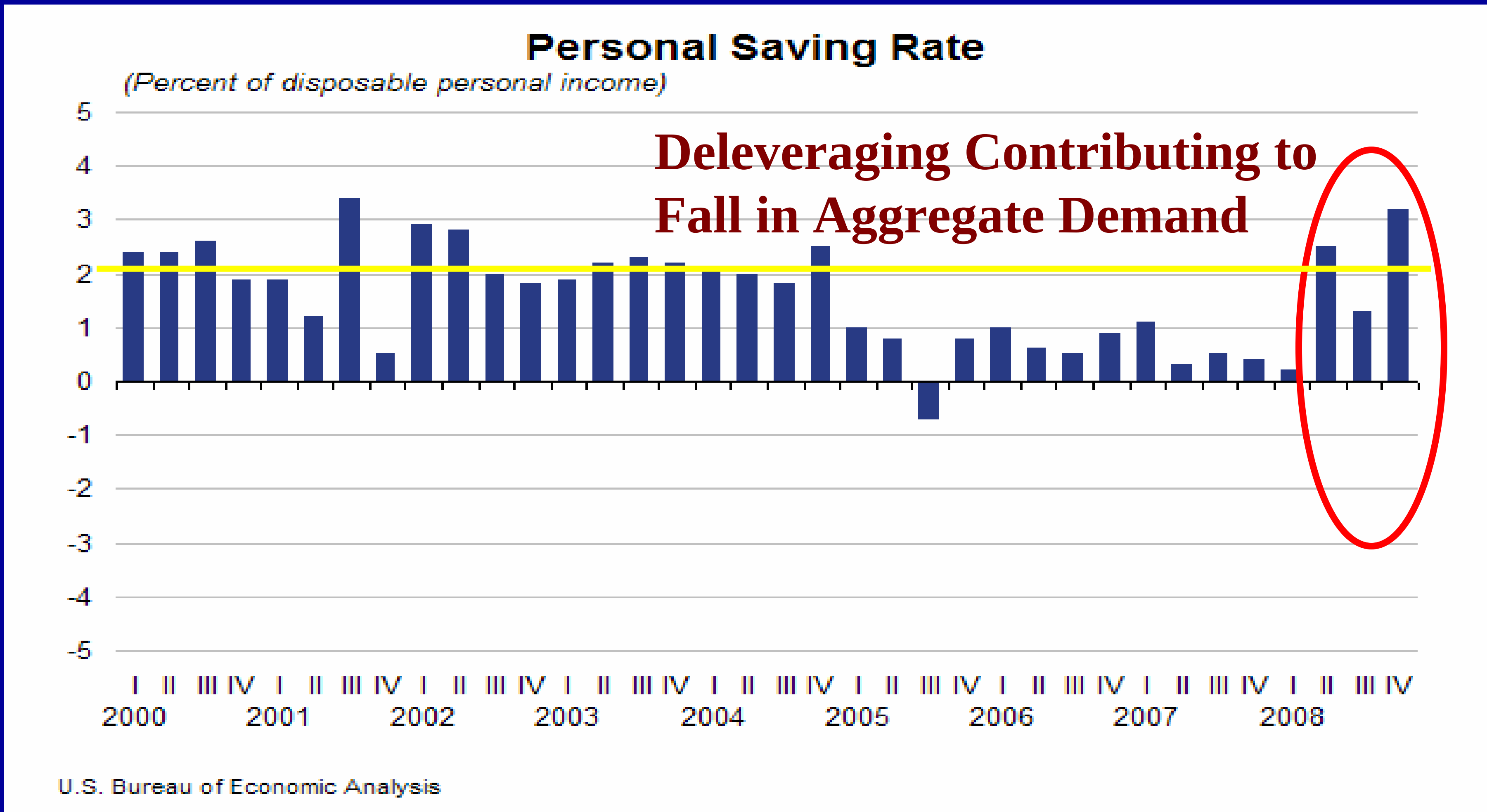
Income and Wages

Average Hourly Earnings of Production Workers



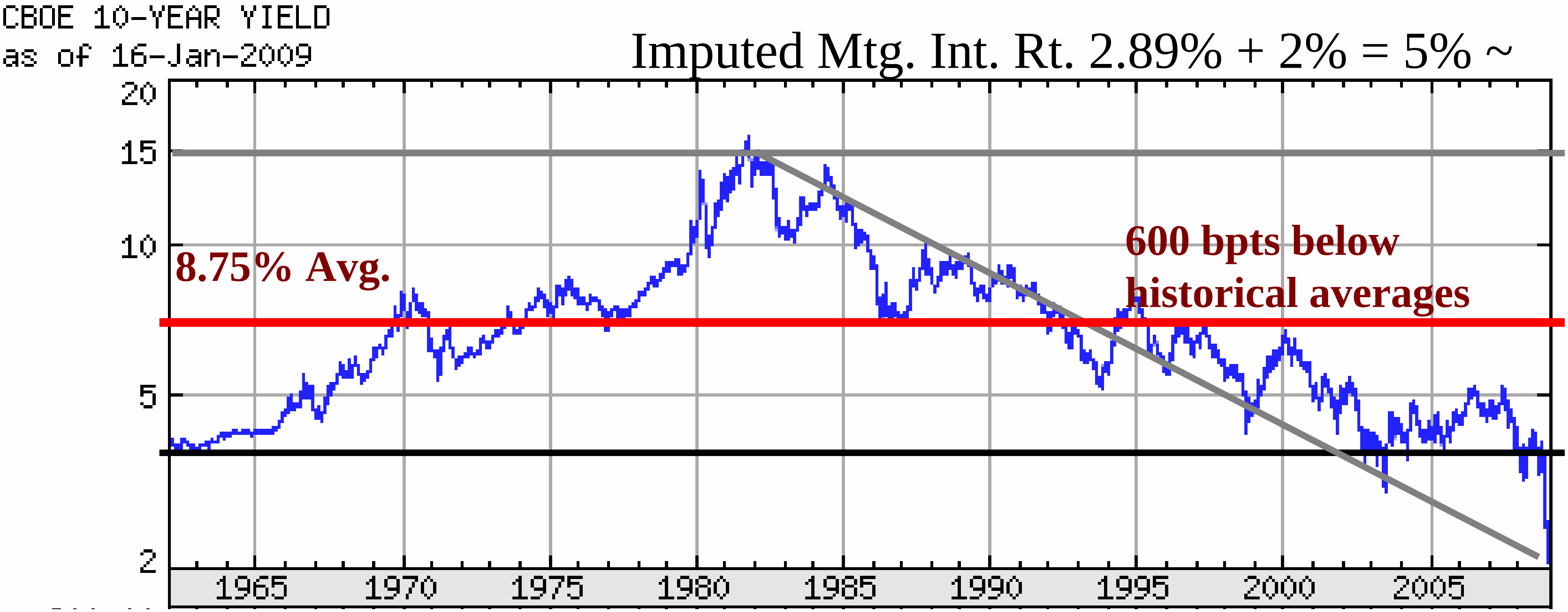
Source: Bureau of Labor Statistics. http://www.bls.gov

Personal Savings Rate



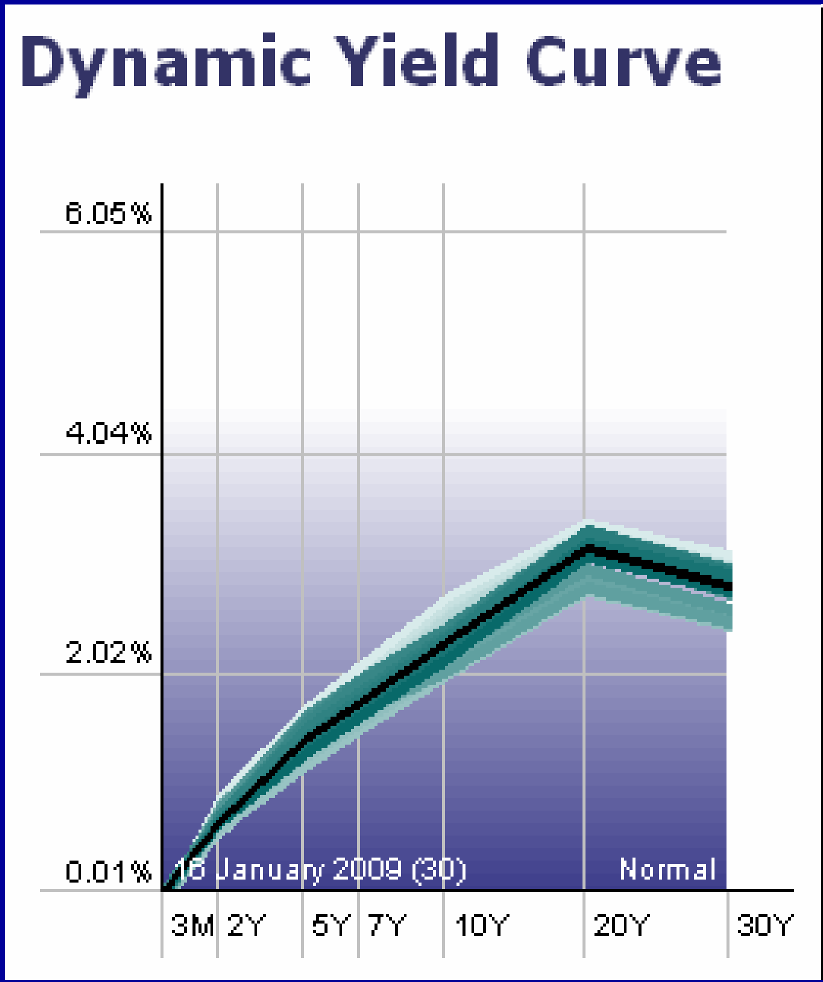
Source: Bureau of Economic Analysis. http://www.bea.gov/briefrm/saving.htm

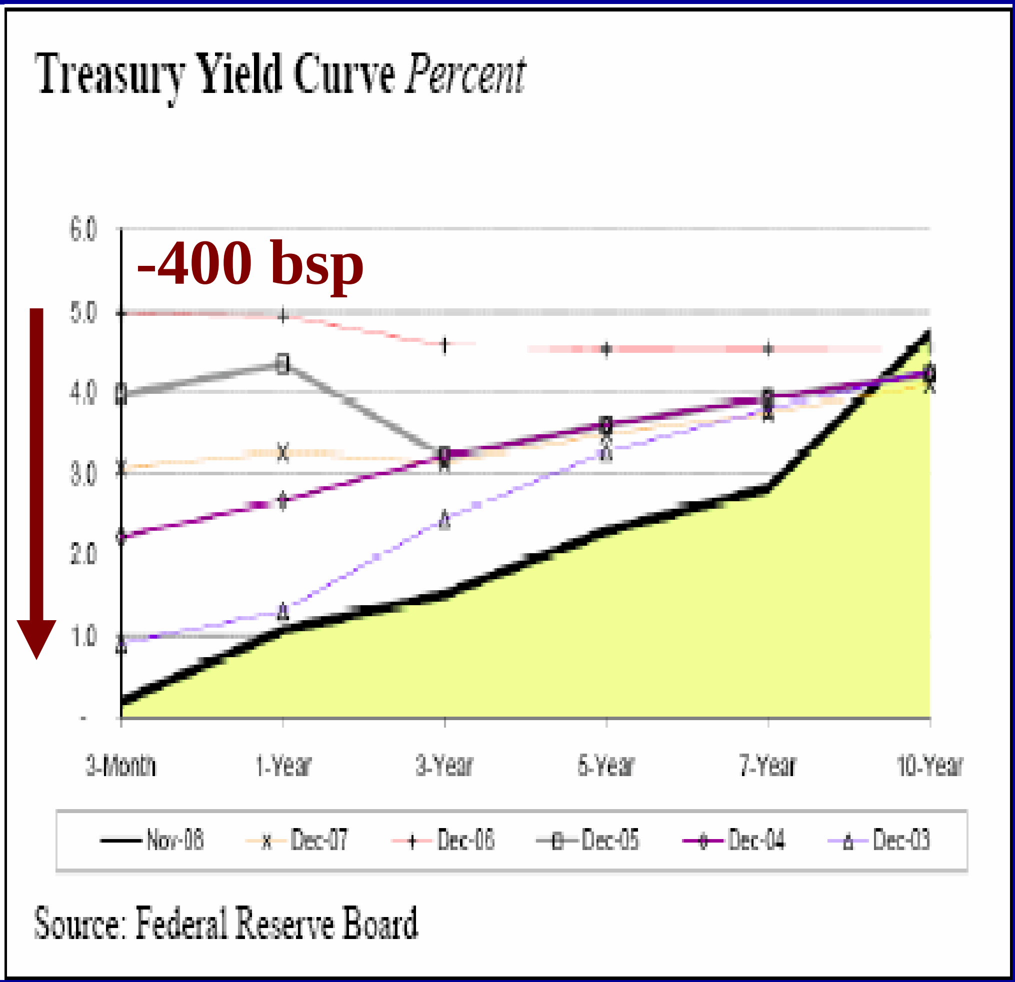
Yield 10-Year Treasury



http://finance.yahoo.com

Yield Curve

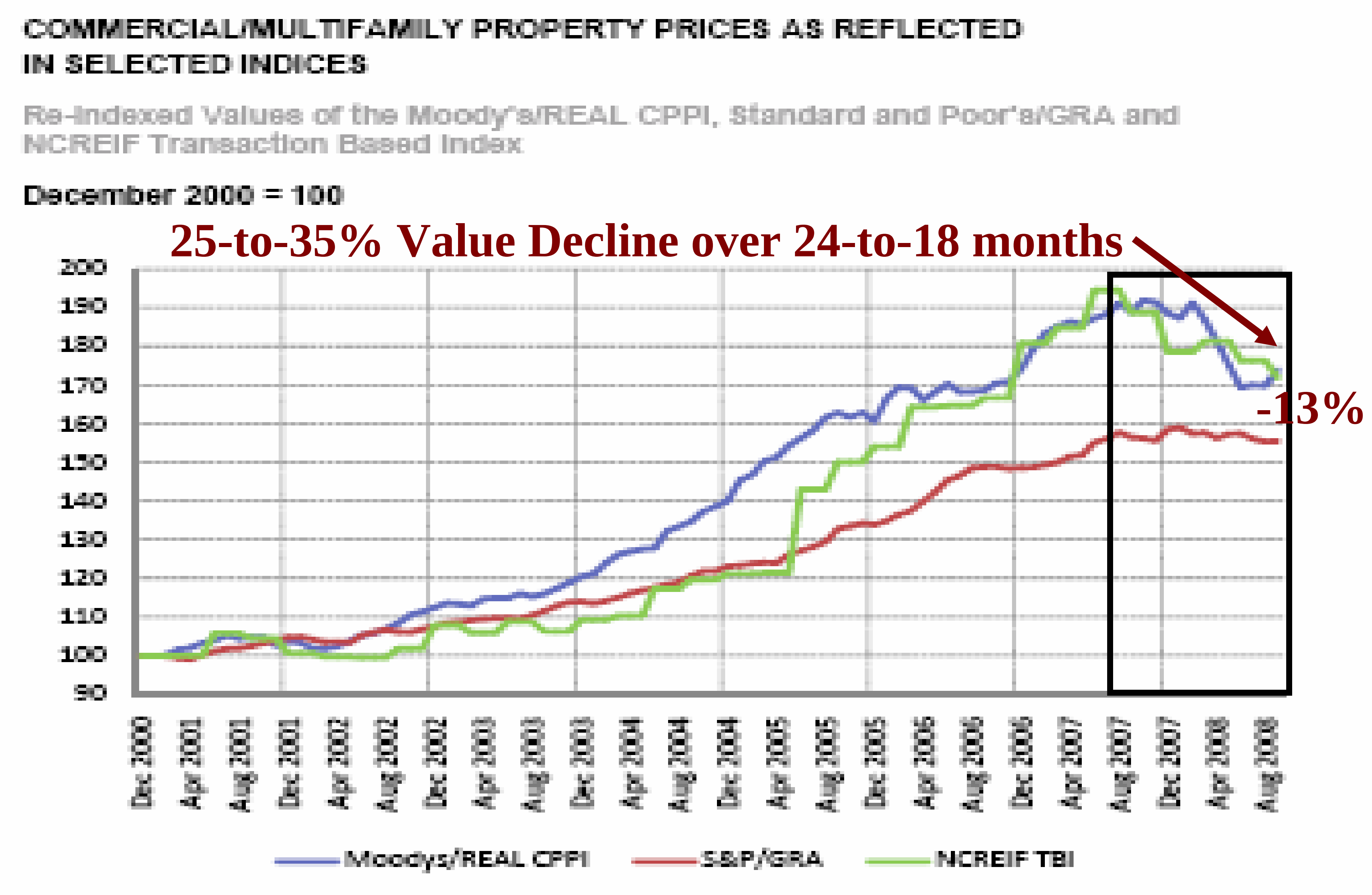




http://stockcharts.com/charts/YieldCurve.html

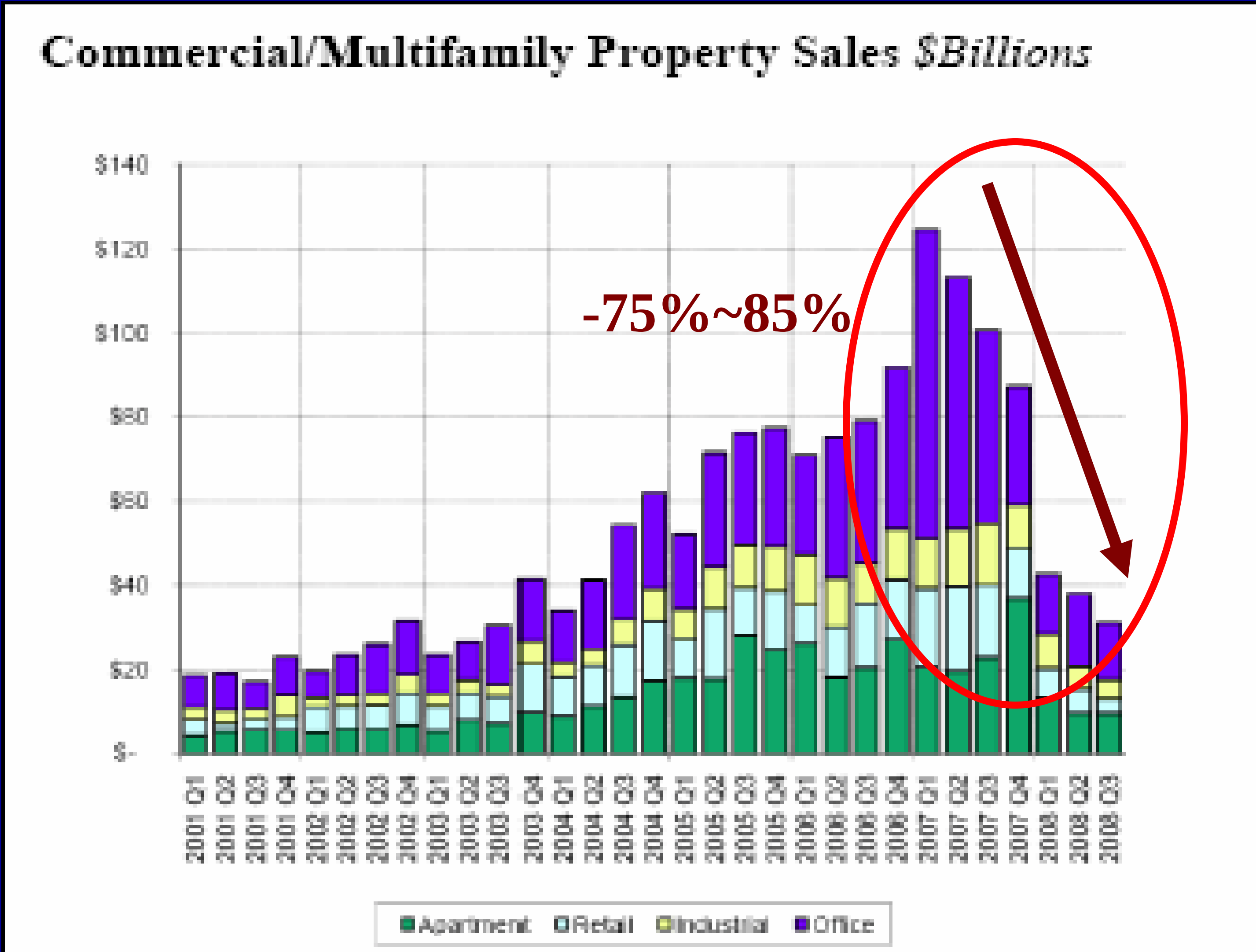
Commercial Real Estate
Space Market Fundamentals

Commercial Property Value Indices (From 2000 to 2008)



http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

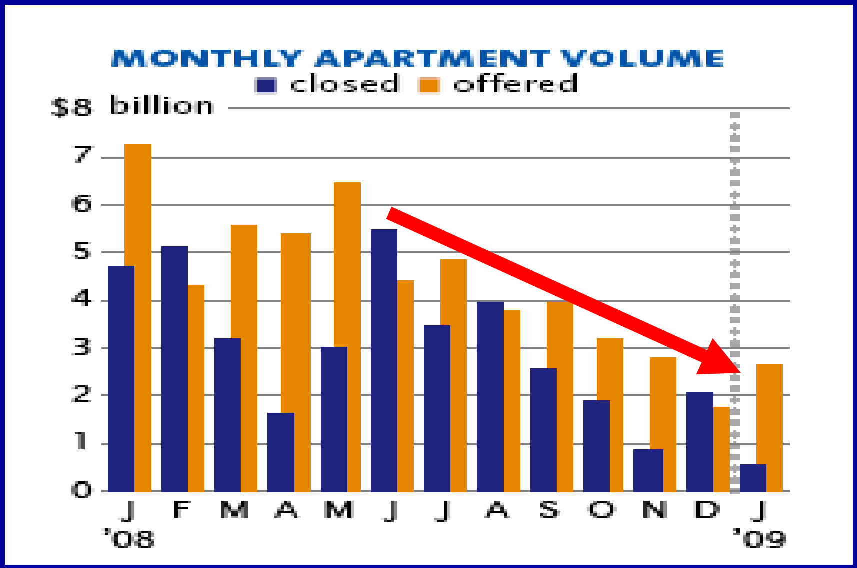
Commercial Property Sales Volume (From 2001 to 2008)

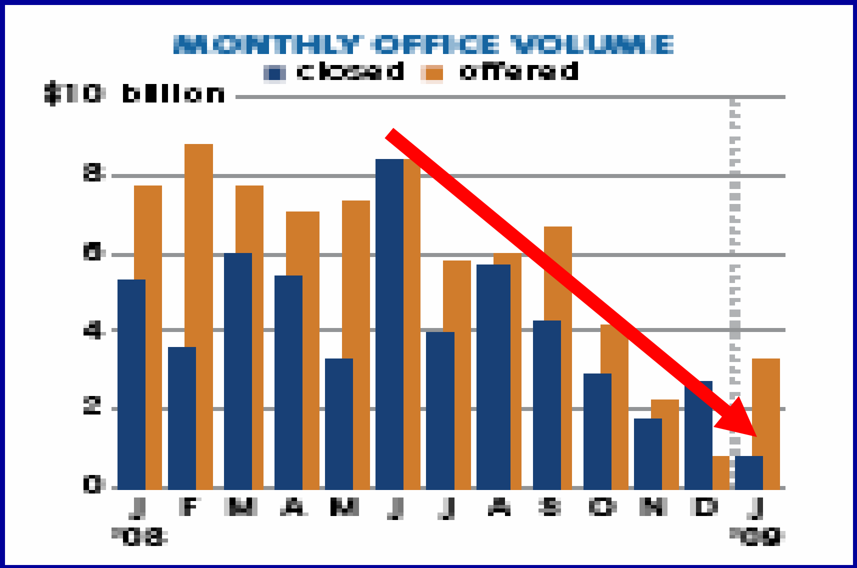


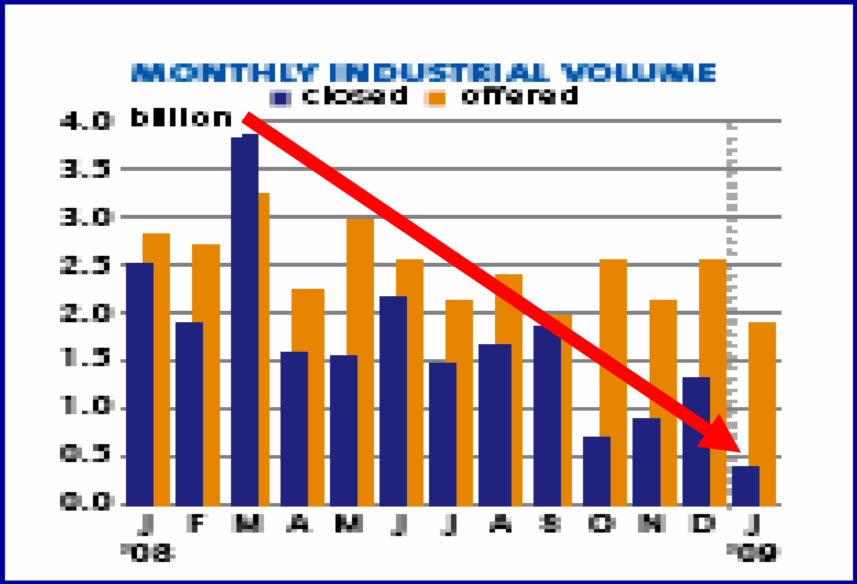
Source: Real Capital Analytics

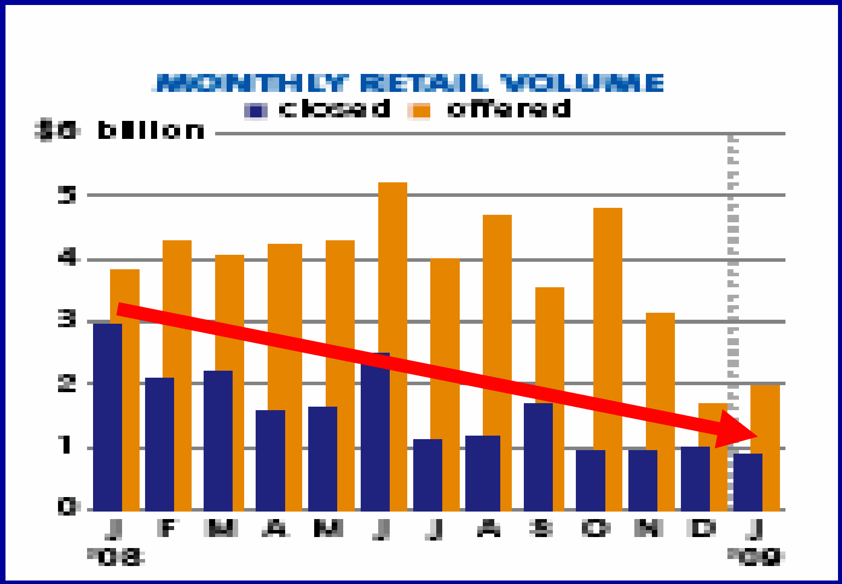
http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

Commercial Property Sales Volume (From 2001 to 2008)





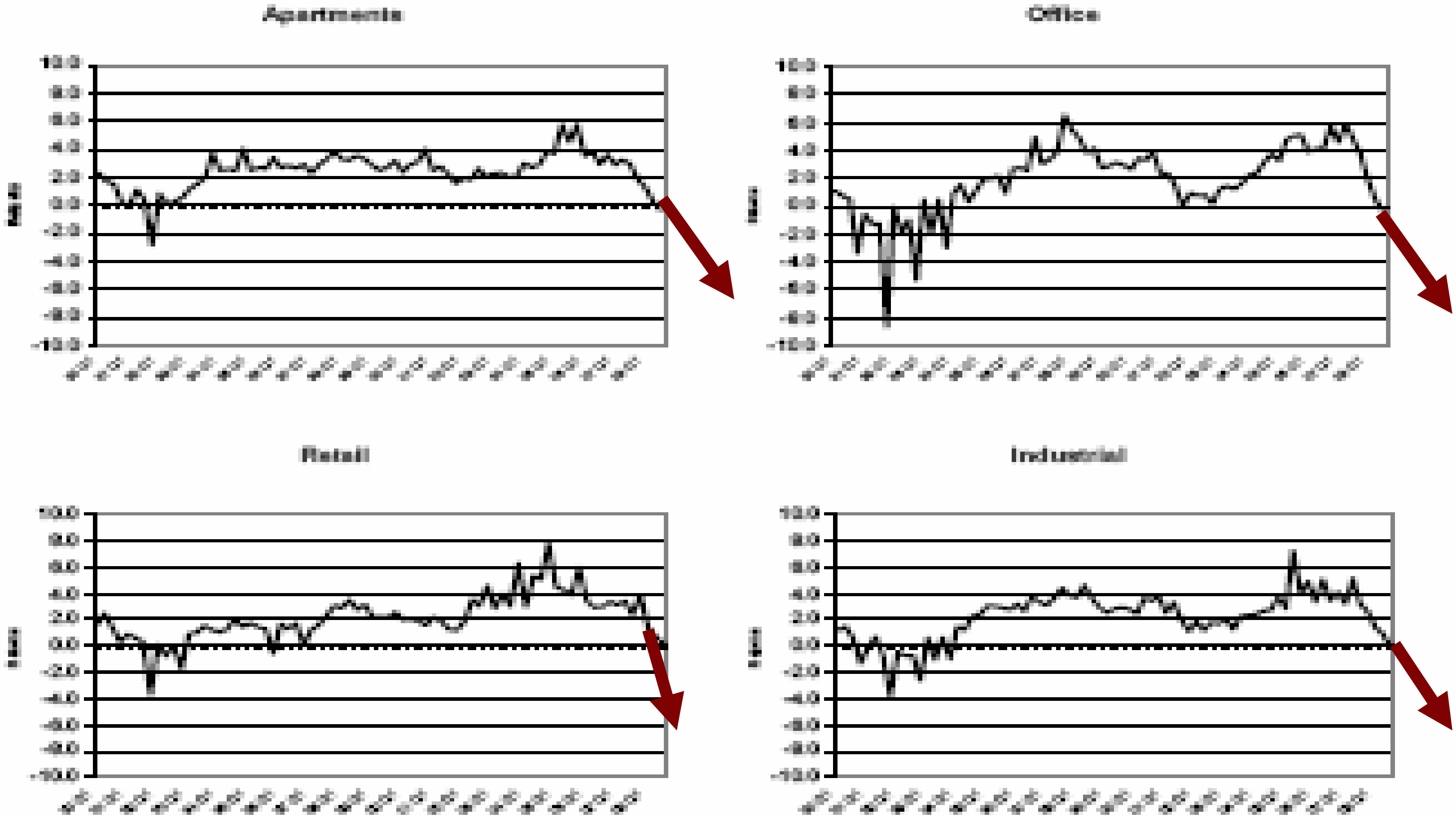




http://www.rcanalytics.com

Commercial Property Returns – NCREIF Index

US Quarterly Returns - By Property Type



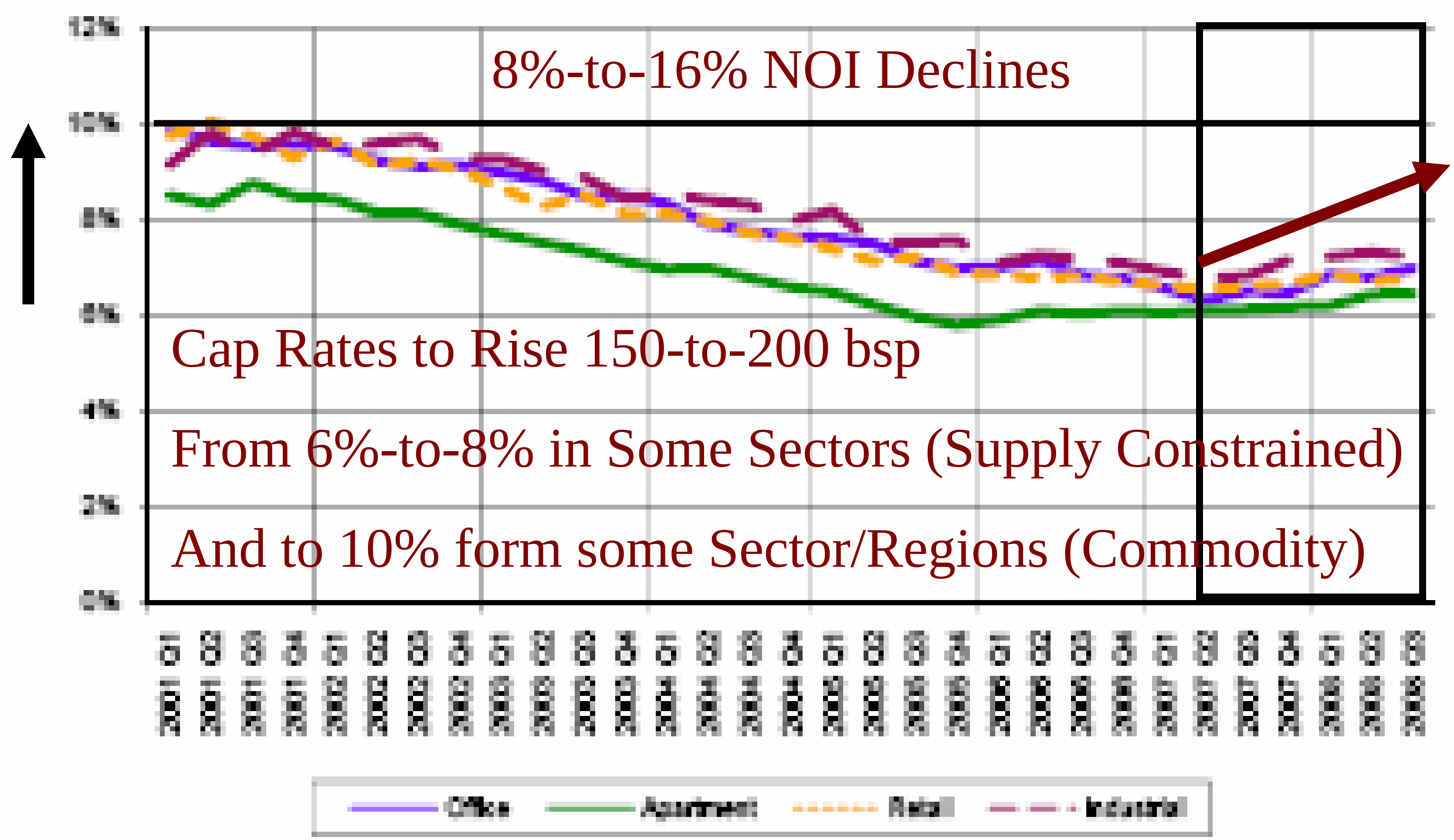
Source: National Council of Real Estate Investment Fiduciaries.

http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

Commercial Property – Capitalization Rates (2001-2008)

Capitalization rate

Potential Intrinsic Devaluation = 30%-to-50%*

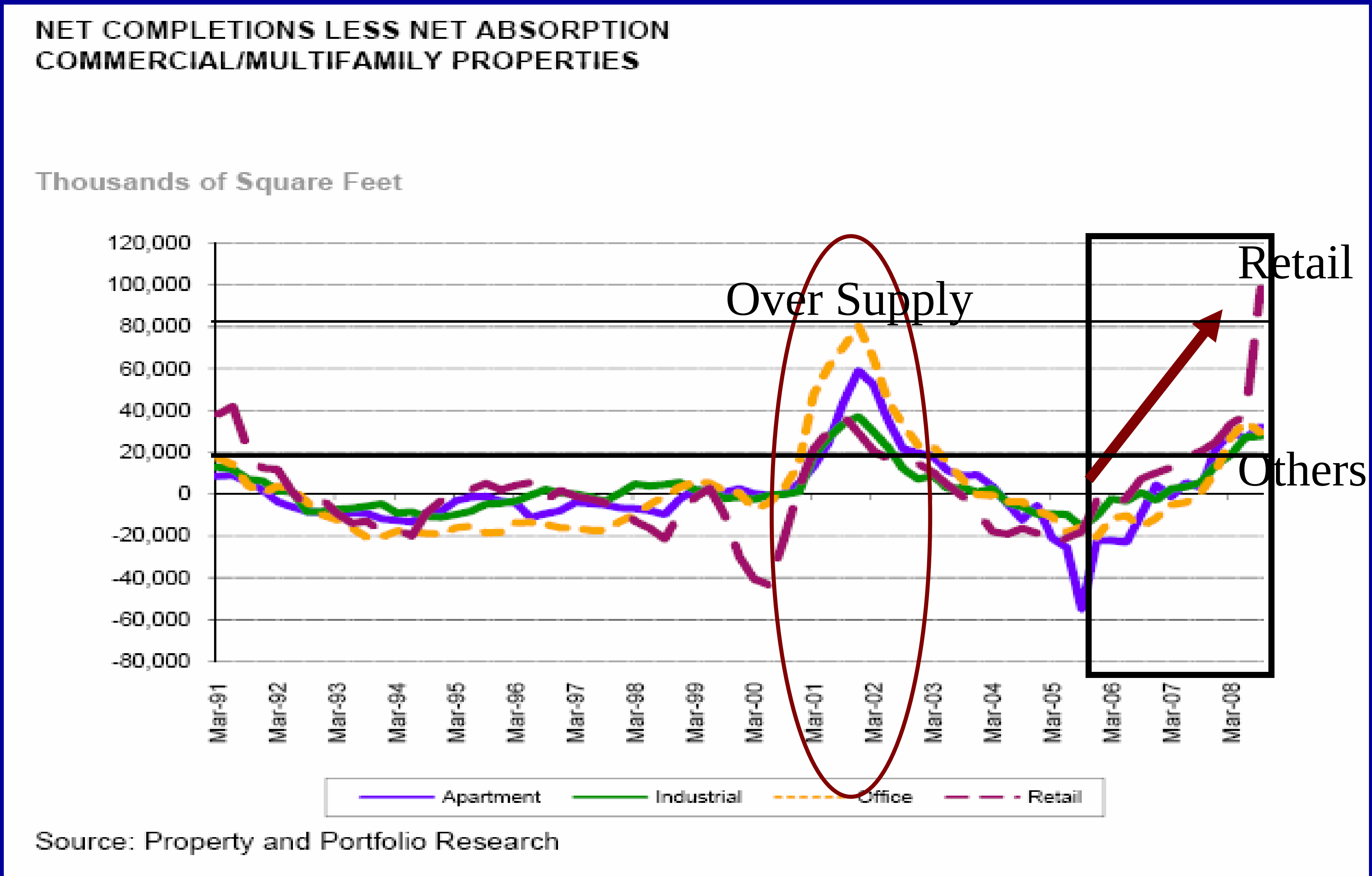


Source: Real Capital Analytics.

* Assumes 16% drop NOI, Cap rates to 10%

http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

Commercial Completions – Net Absorption (1991-2008)



http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

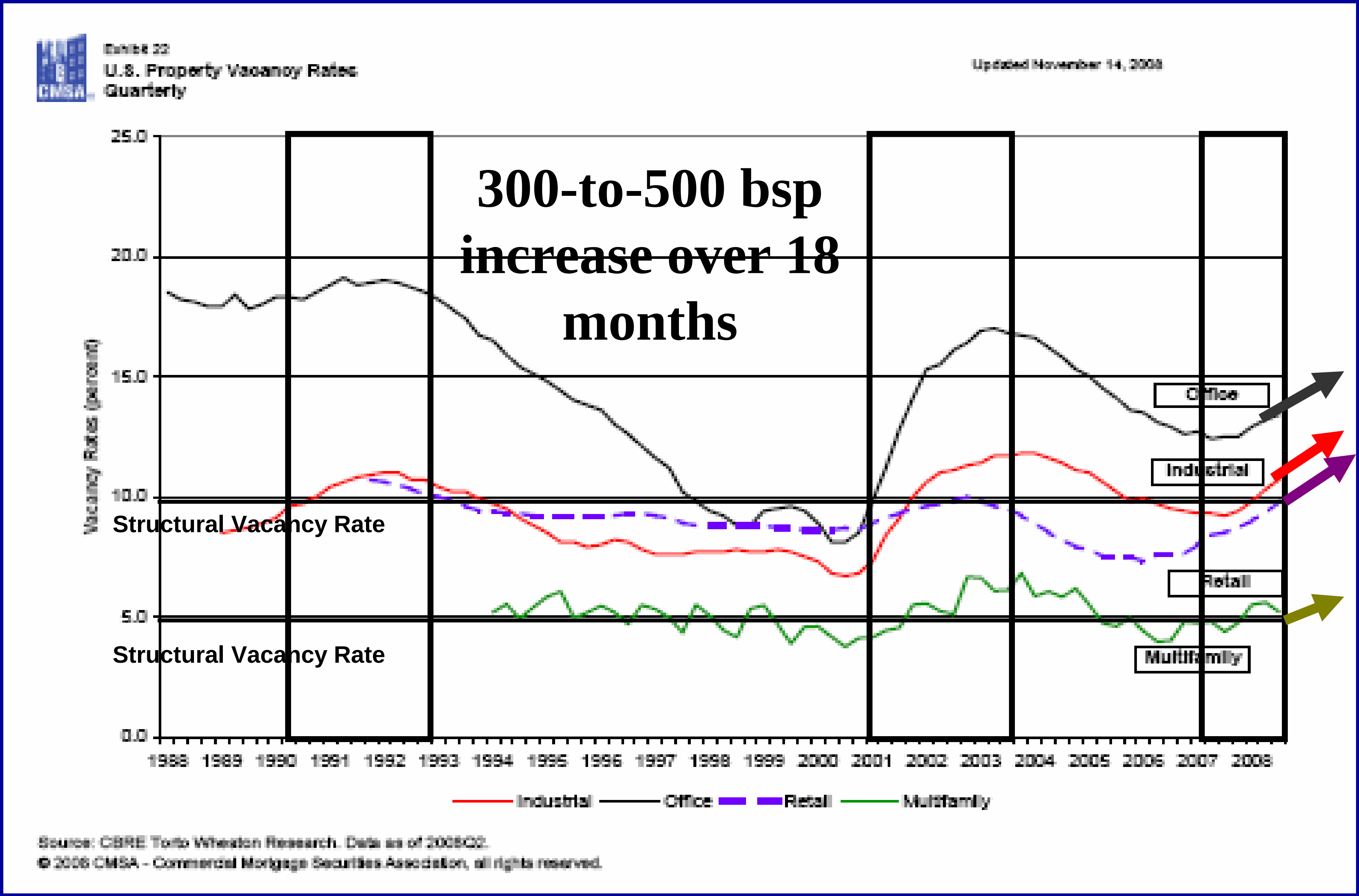
Non-Residential Commercial Construction Spending Forecast – Decrease by 11% in 2009

Commercial / industrial	2009	2010
• Hotels	20.2%	-12.2%
• Retail	-19.2%	-6.6%
• Office buildings	-17.5%	-11.1%
• Industrial facilities	-11.2%	-8.4%

Institutional	2009	2010
• Religious	-9.4%	1.4%
• Education	-7.4%	-1.9%
• Amusement / recreation	-5.9%	1.0%
• Health care facilities	-3.6%	-1.9%
• Public safety	-3.5%	-1.9%

http://www.aia.org/aiarchitect/thisweek09/0116/0116n_consensus.cfm

Commercial Vacancy Rates (From 1988 to 2008)

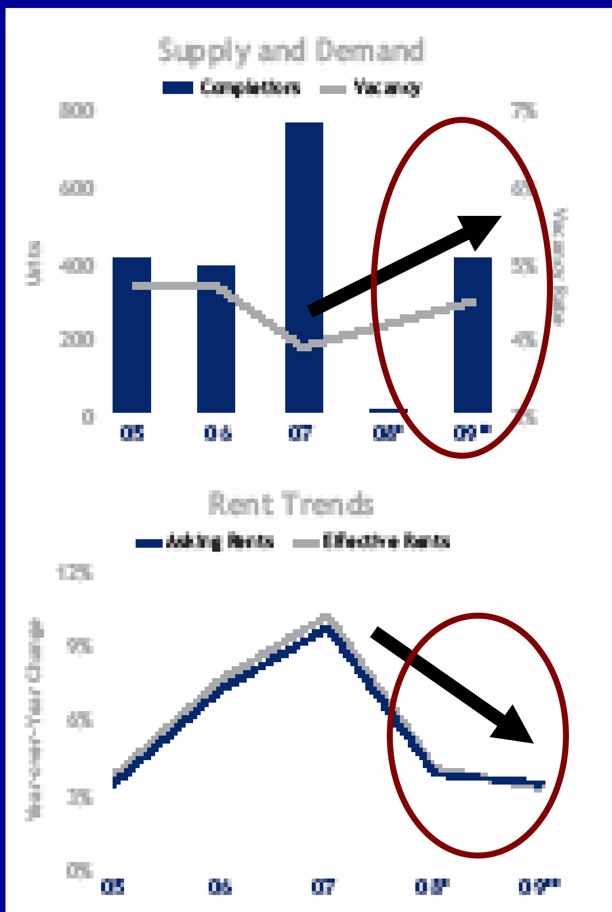


http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

San Francisco Apt

Vacancy Rates
5%-to-6%

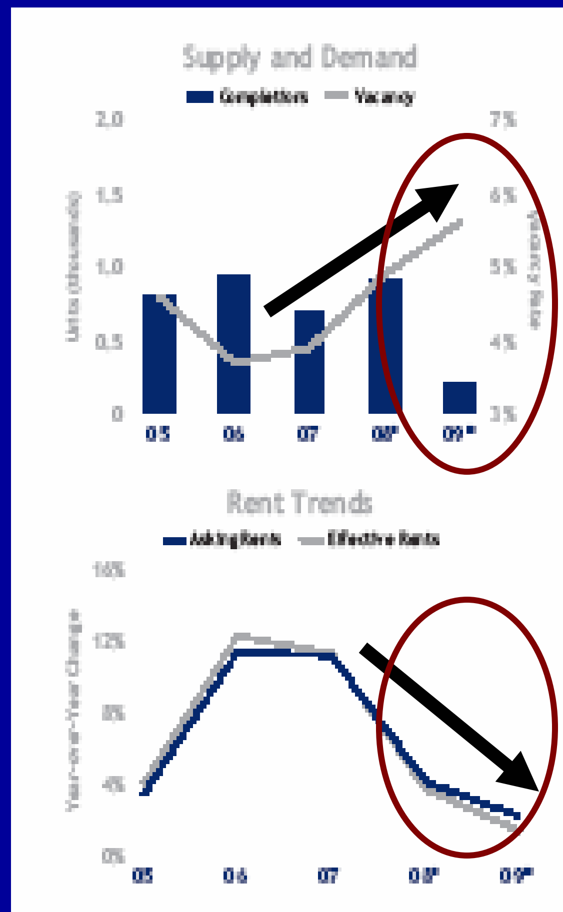
Effective Lease Rates
Up 2%-to-0%



Silicon Valley Apt

Vacancy Rates
6%-to-7%

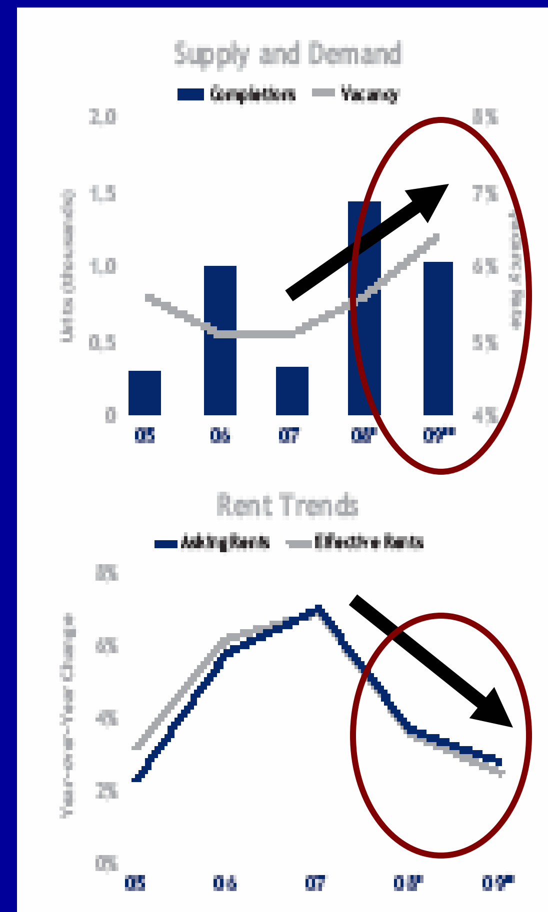
Effective Lease Rates
Down 0%-to-2%



Oakland Apt

Vacancy Rates
7%-to-8%

Effective Lease Rates
Down 2%-to-4%



Source: Marcus & Millichap National Apartment Report 2009

Office Vacancy Rates

Lowest Vacancy Rates

Rank	Metro Market	4Q
1	**New York**	**7.0%**
2	**Washington, D.C.**	**8.3%**
3	Birmingham, Ala.	10.2%
4	Nashville, Tenn.	10.5%
5	**Seattle**	**10.5%**
6	**Los Angeles**	**10.9%**
7	**San Francisco**	**11.1%**
8	Long Island, N.Y.	11.4%
9	Little Rock, Ark.	11.5%
10	Miami	11.5%

Highest Vacancy Rates

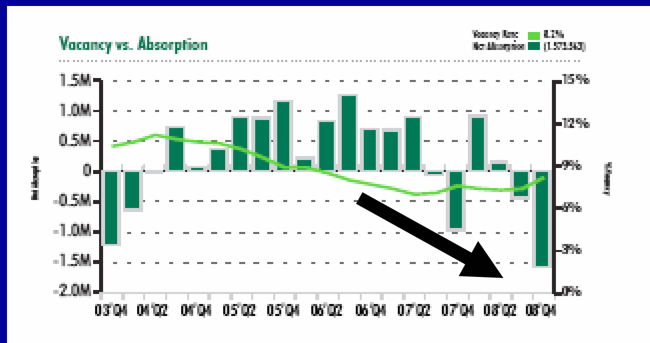
Rank	Metro Market	4Q
1	Detroit	24.6%
2	Dallas	22.6%
3	Dayton, Ohio	21.8%
4	Greensboro/Winston-Salem, N.C.	21.1%
5	**San Bernardino/ Riverside, Calif.**	**20.7%**
6	Hartford, Conn.	20.7%
7	Cincinnati	19.7%
8	**Phoenix**	**19.1%**
9	**Las Vegas**	**19.1%**
10	Greenville, S.C.	19.1%

Source: Reis, Inc.

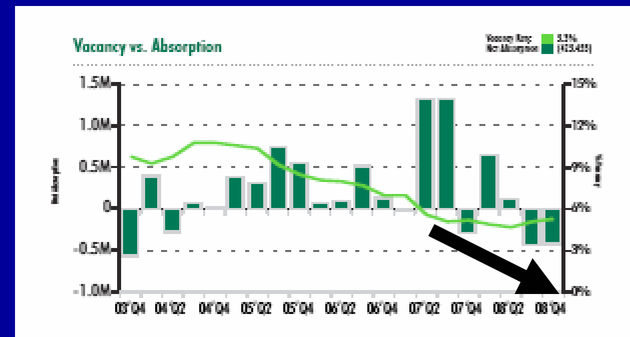
Note: Annual Rental Run Rates Dropping 8%-to-10%

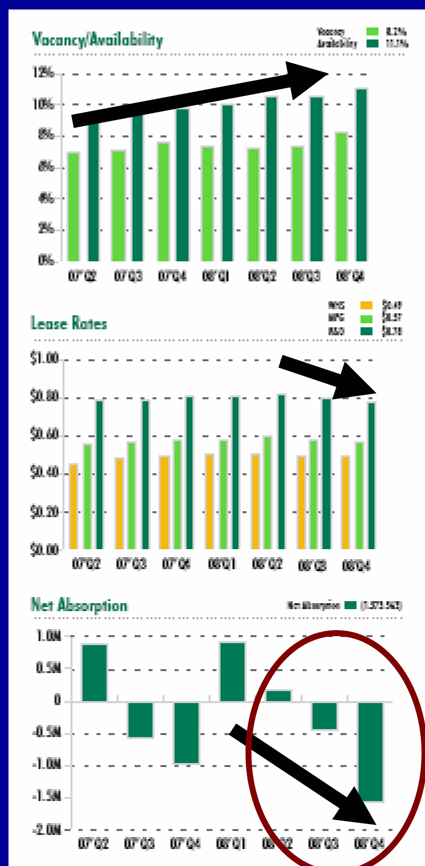
http://online.wsj.com/article/SB123119037906355027.html

Oakland Industrial



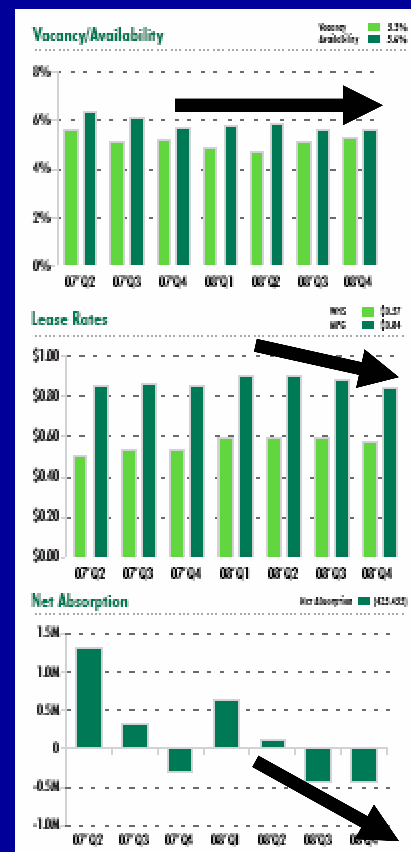
Silicon Valley Industrial





Vacancy
Rates
14%-to-16%

Lease
Rates
Down
8%-to-10%

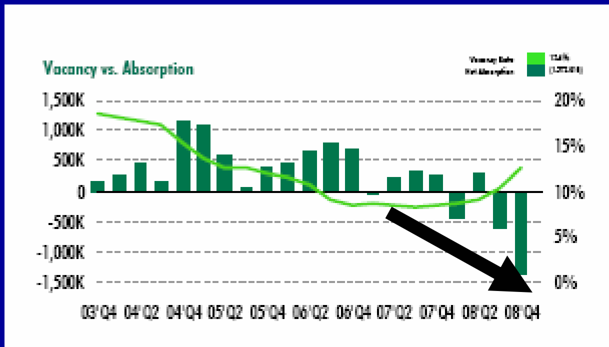


Vacancy
Rates
12%-to-14%

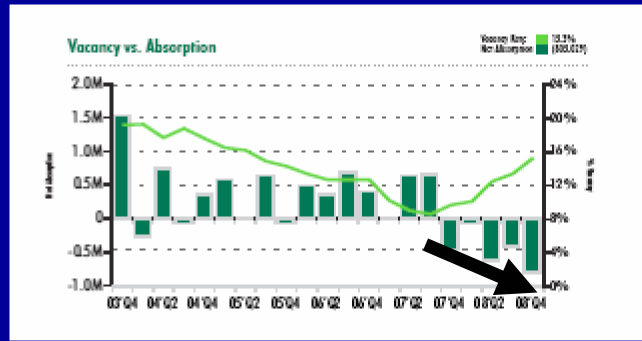
Lease
Rates
Down
6%-to-8%

Source: CBRE Market Research Reports.

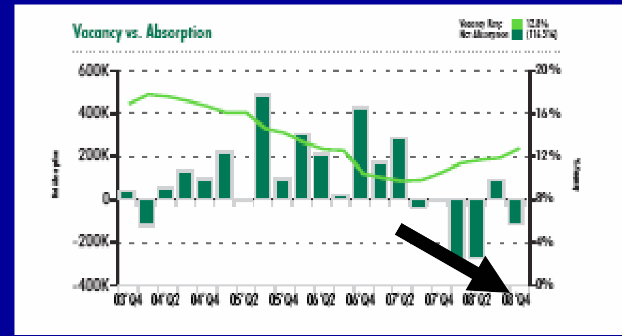
San Francisco Office

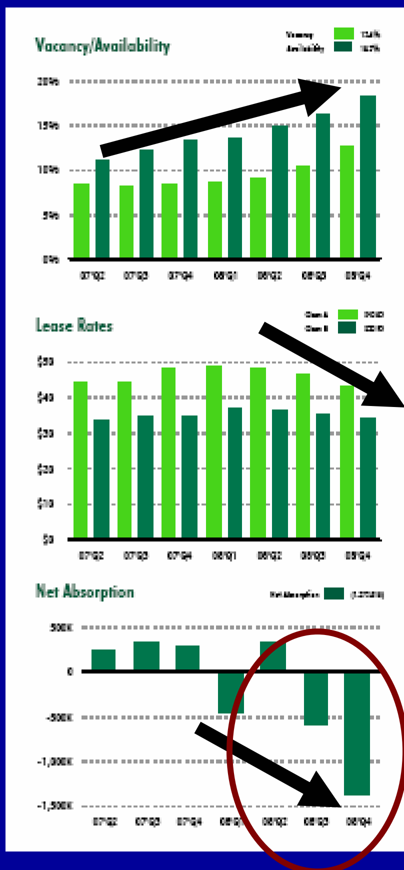


Silicon Valley Office



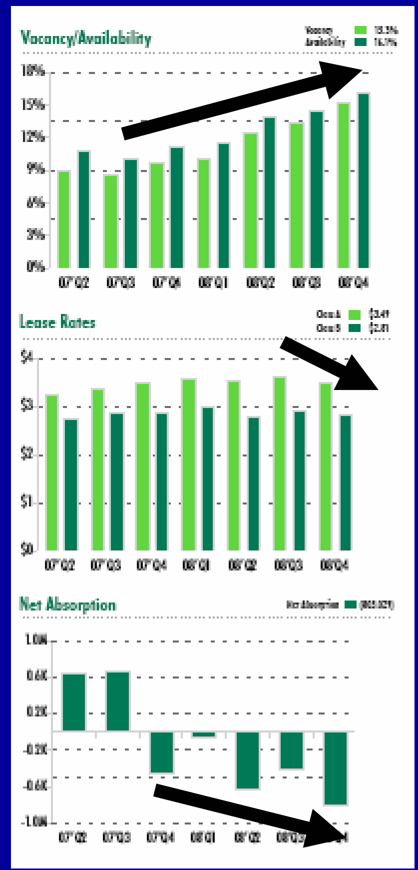
Oakland Office





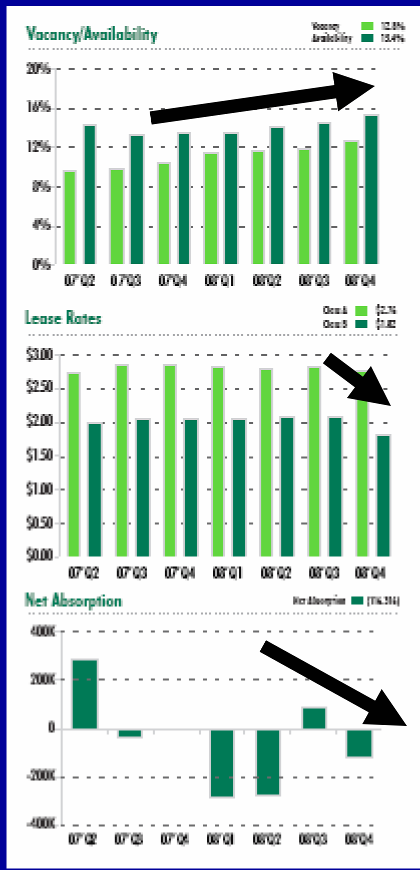
Vacancy Rates 15%-to-17%

Lease Rates Down 20%-to-25%



Vacancy Rates 15%-to-17%

Lease Rates Down 12%-to-15%

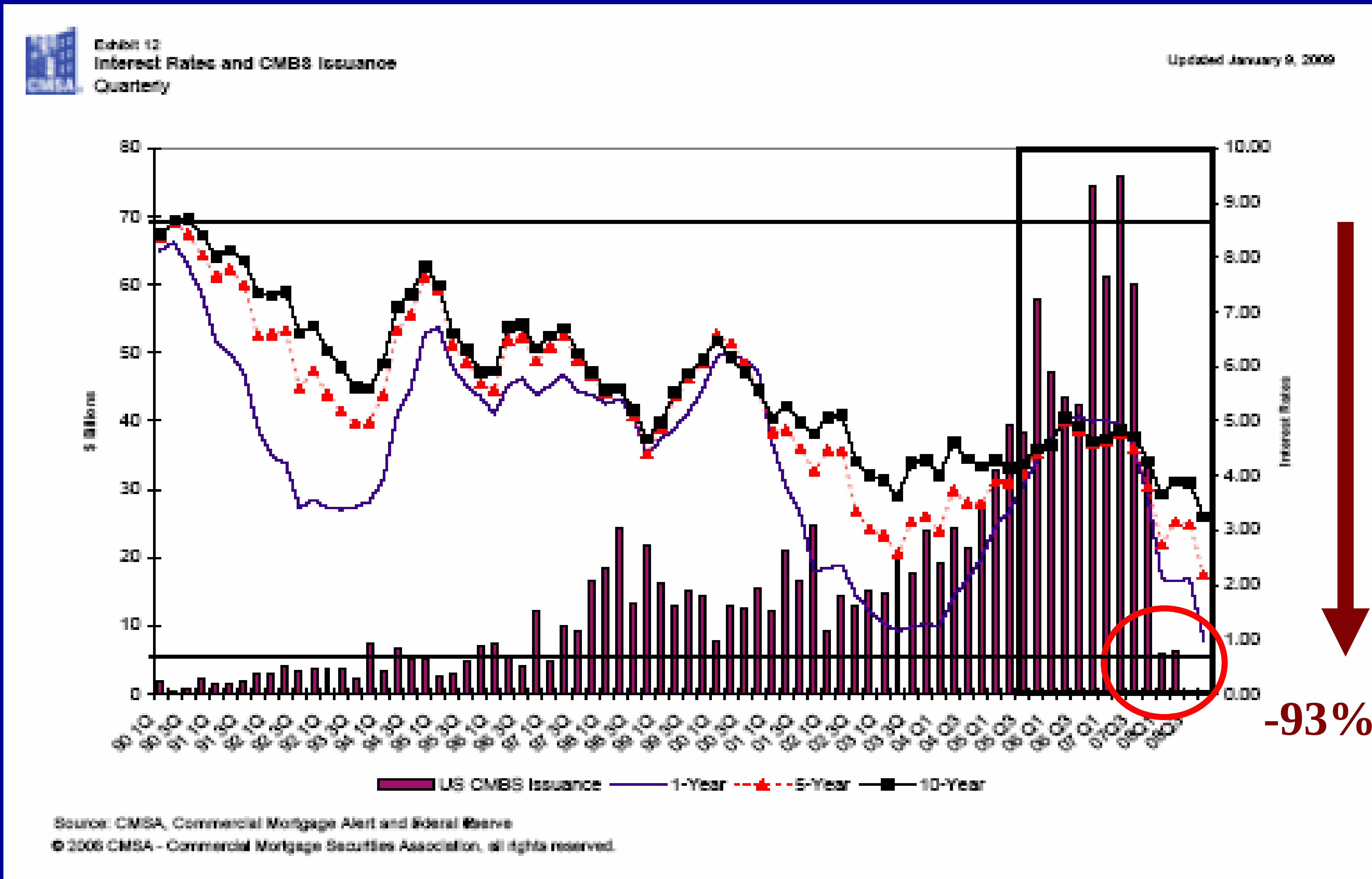


Source: CBRE Market Research Reports.

Commercial Real Estate
Capital Market Fundamentals

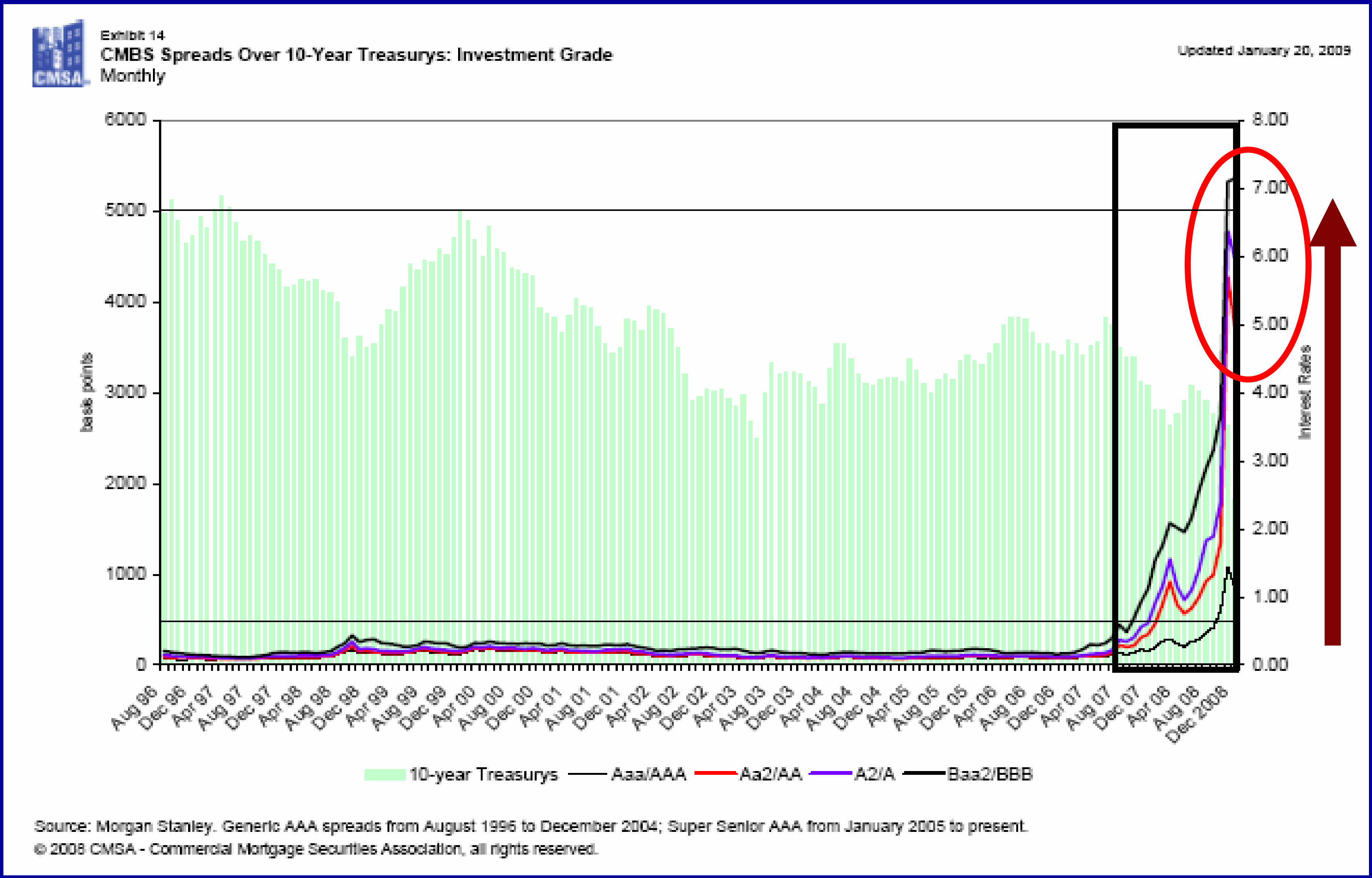
Commercial Mortgage-Backed Securities (CMBS)

Commercial Mortgage Back Securities (CMBS) Issuance



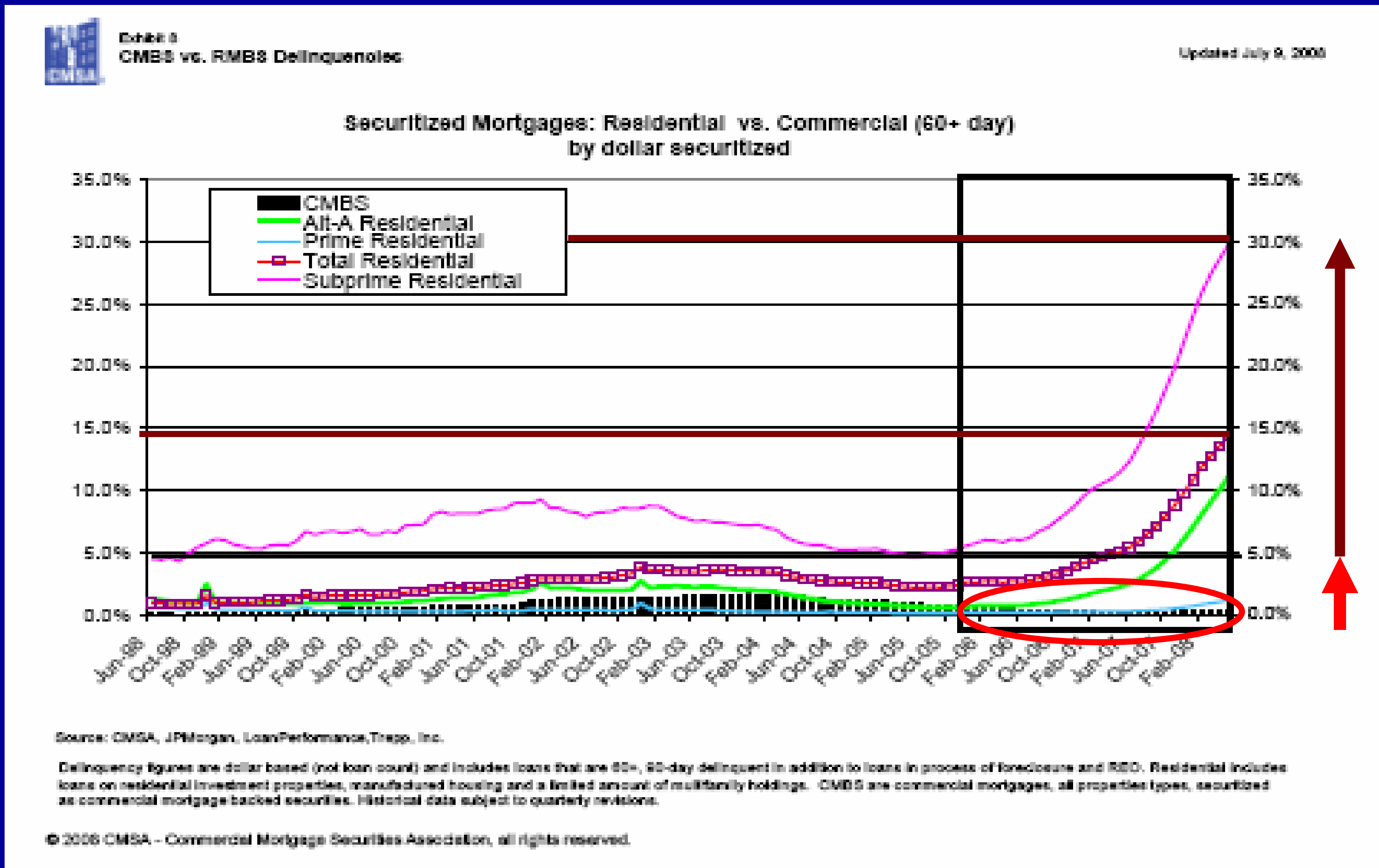
http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

CMBS Spreads – Investment Grade vs. 10 Yr. Treasury



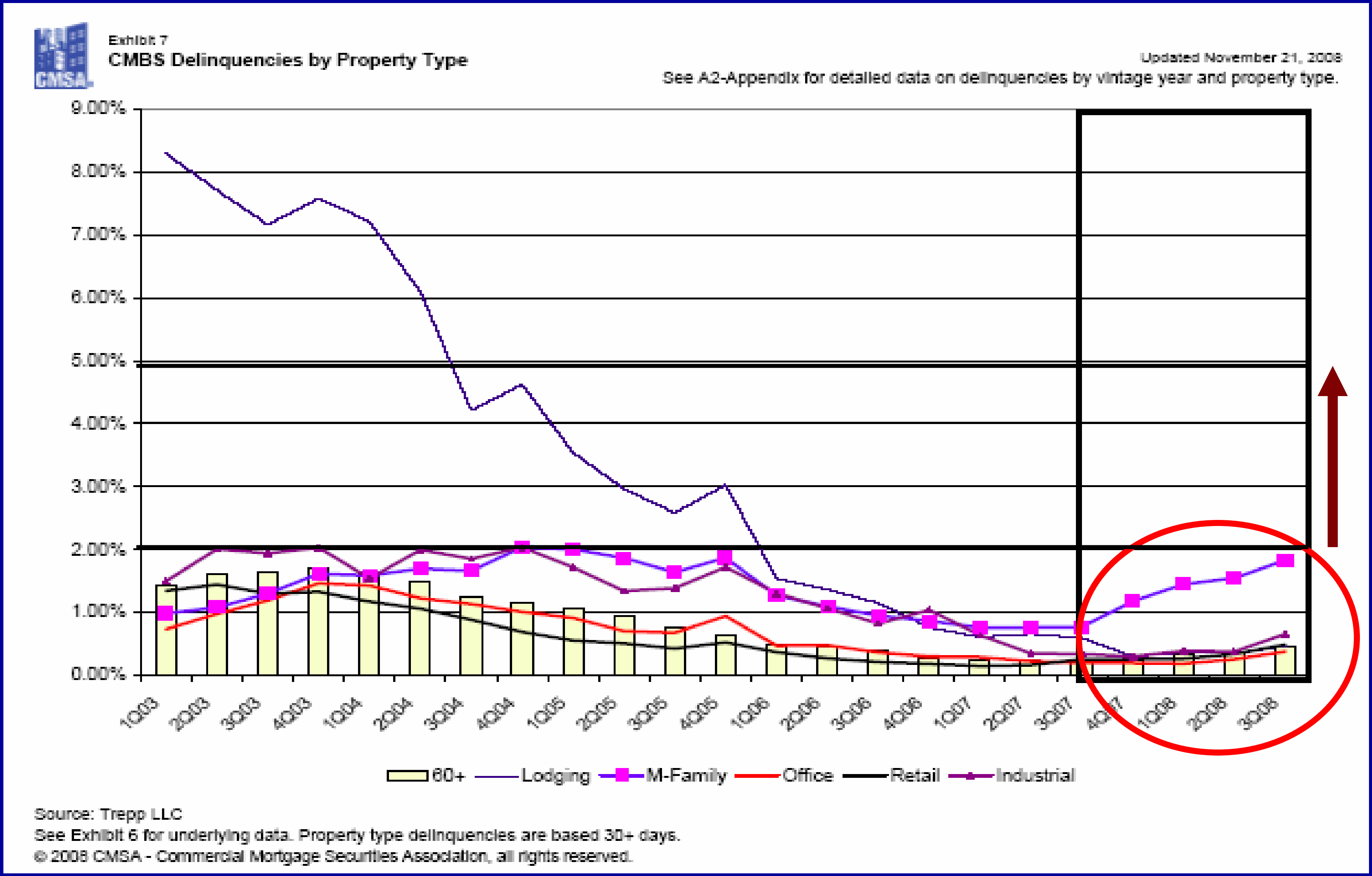
http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

Commercial Mortgage Back Securities (CMBS) Delinquency



http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

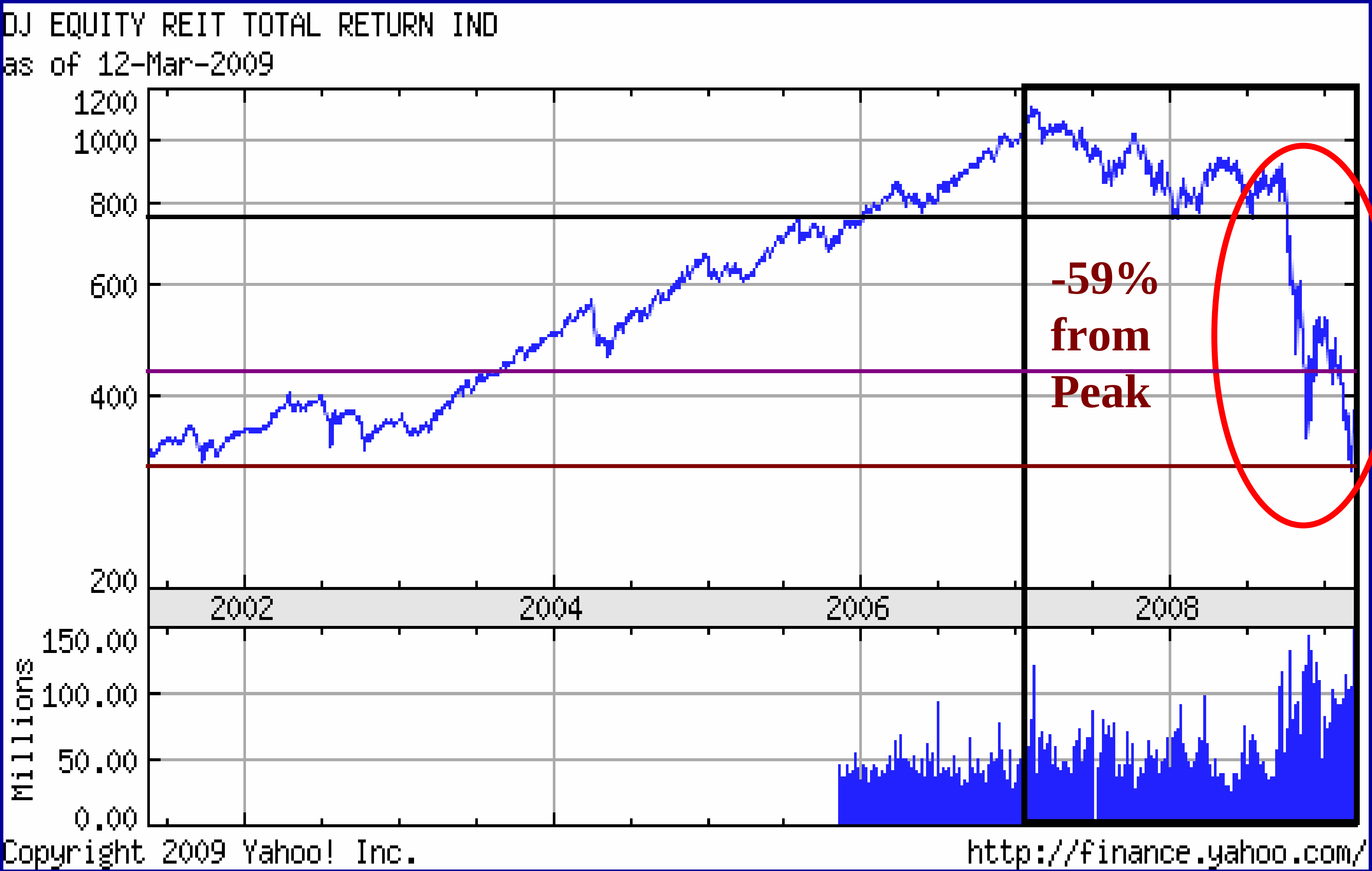
CMBS Delinquency Rates by Type (From 2003 to 2008)



http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

Real Estate Investment Trusts (REITs)

REIT Equity Stock Index Performance – Dow Jones



http://finance.yahoo.com/q/bc?s=REIT&t=my

REIT Equity Stock Index Performance – Redwood Trust

http://finance.yahoo.com/q/bc?s=RWT&t=my&l=on&z=m&q=l&c=

REIT Equity Stock Index Performance – AMB

http://finance.yahoo.com/q/bc?s=AMB&t=my&l=on&z=m&q=l&c=

REIT Equity Stock Index Performance – BRE

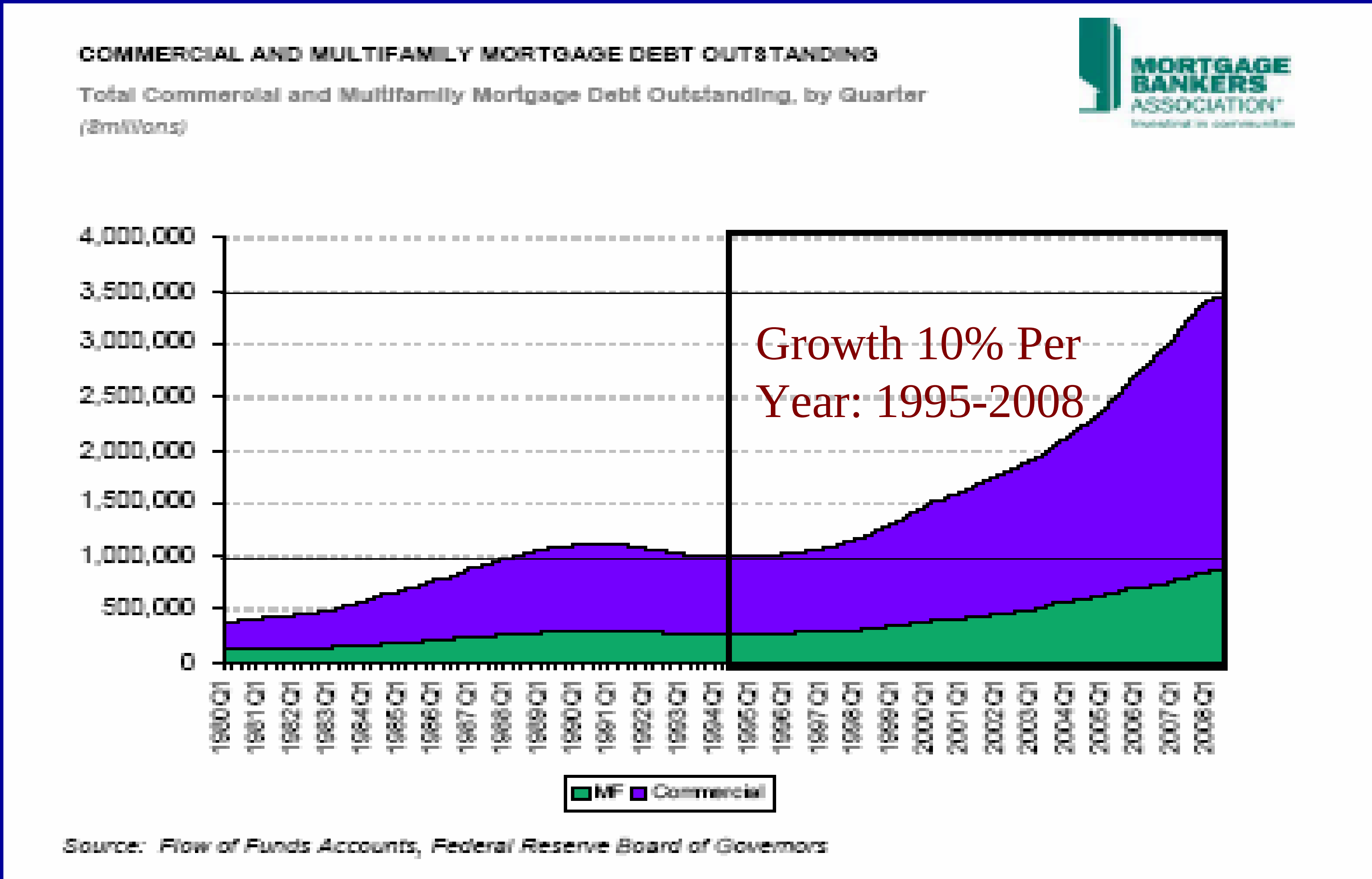
http://finance.yahoo.com/q/bc?s=BRE&t=my&l=on&z=m&q=l&c=

REIT Equity Stock Index Performance – Digital Realty Trust

http://finance.yahoo.com/q/bc?s=DLR&t=5y

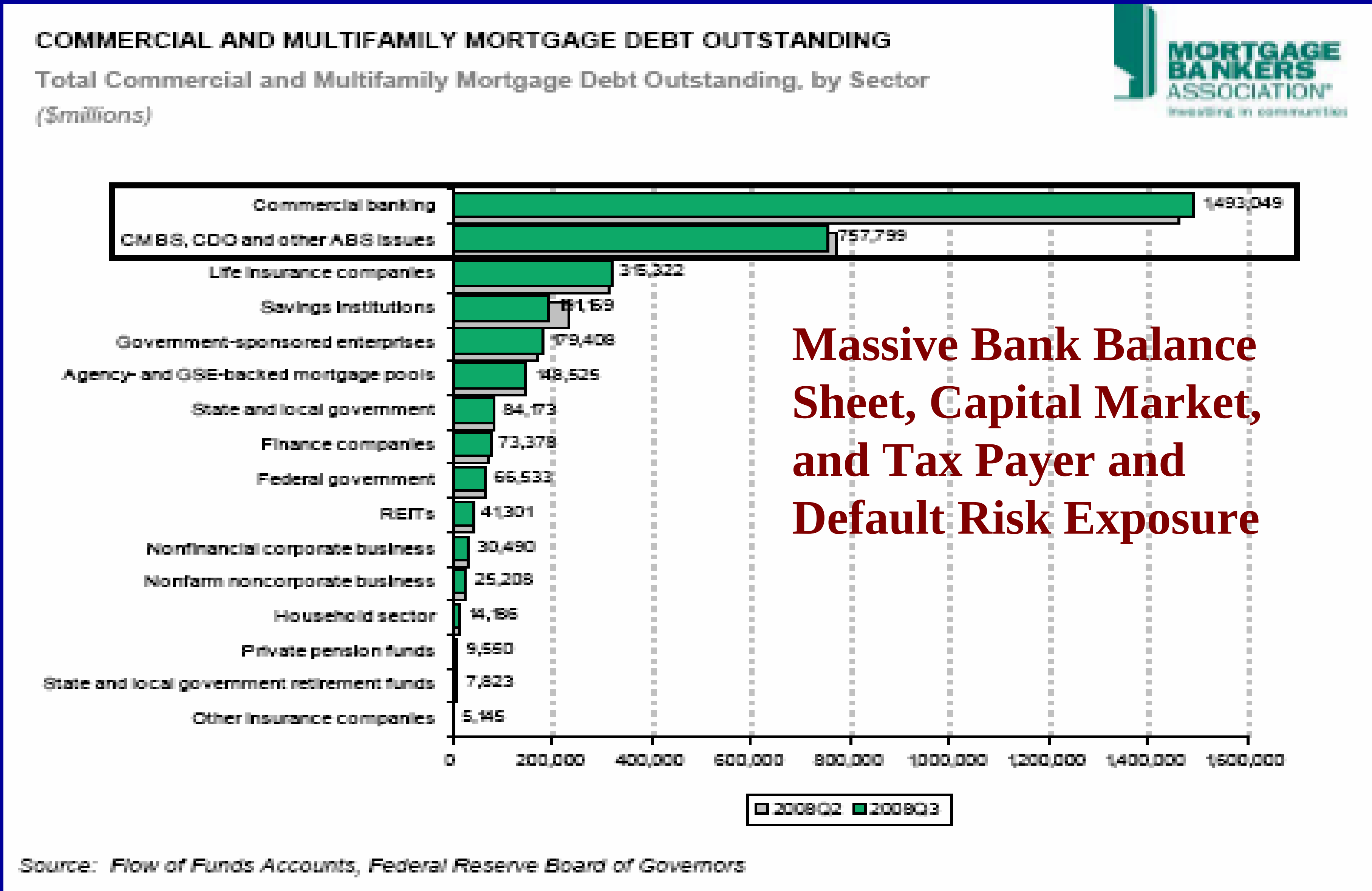
Commercial Mortgage Lending

Commercial Mortgage Debt Outstanding – (From 1980 to 2008)



http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

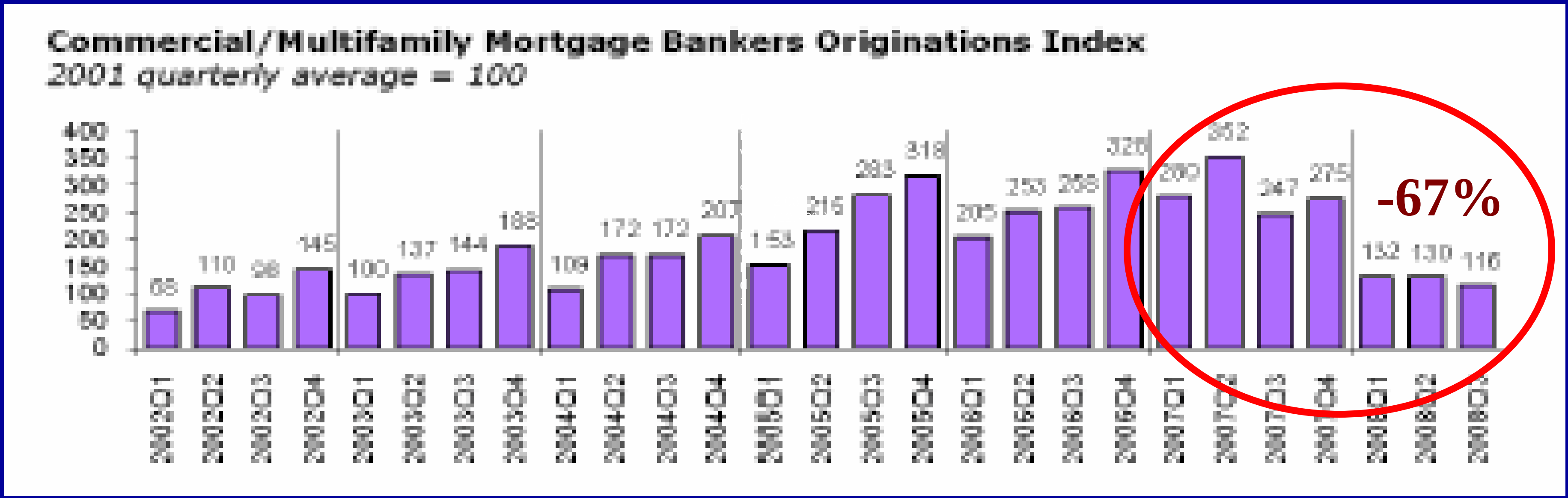
Commercial Mortgage Debt Exposure



Massive Bank Balance Sheet, Capital Market, and Tax Payer and Default Risk Exposure

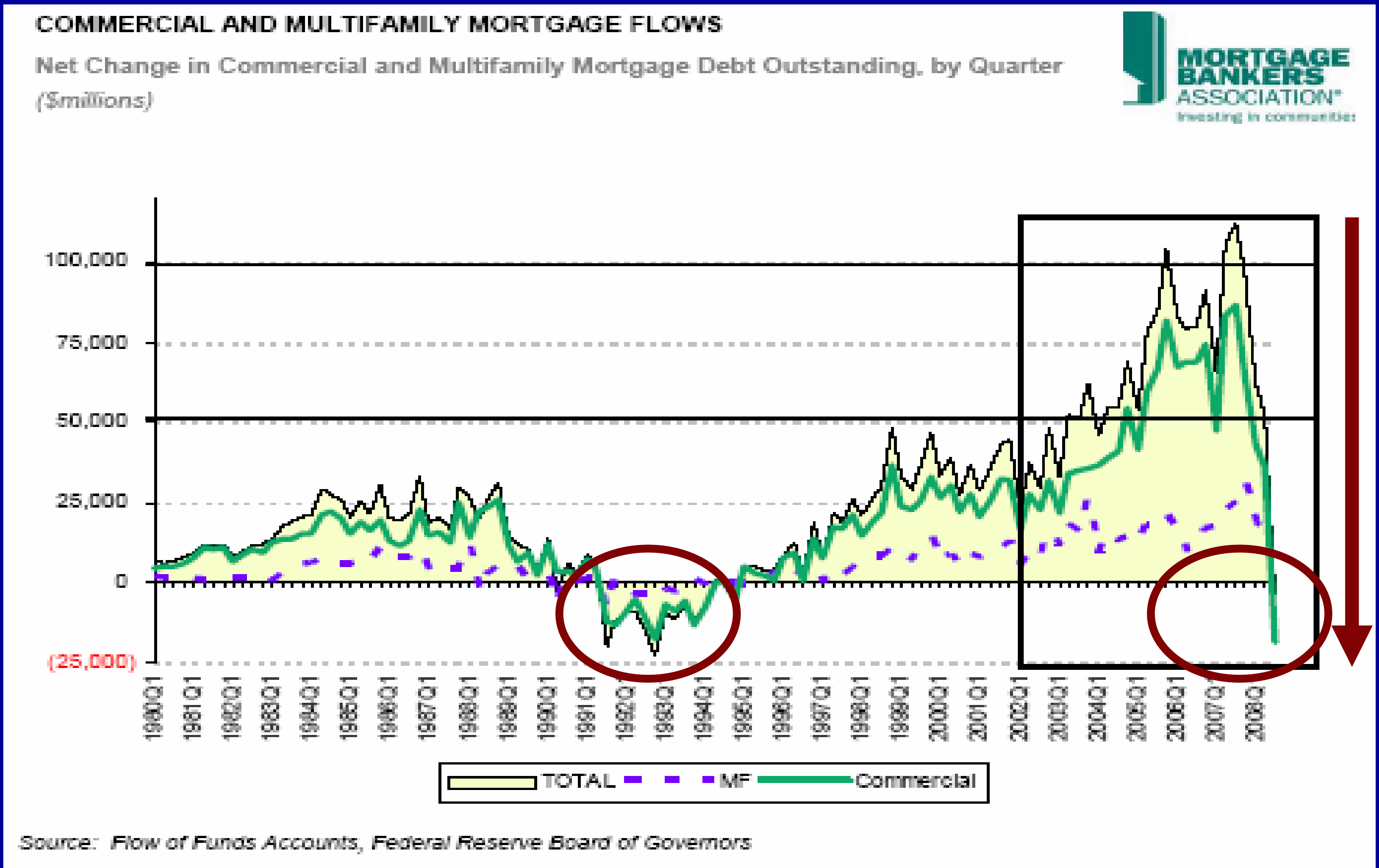
http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

Commercial Mortgage Origination Index – (From 2002 to 2008)



http://www.mortgagebankers.org/files/Research/CommercialOriginations/3Q08CMFOriginationsSurvey.pdf

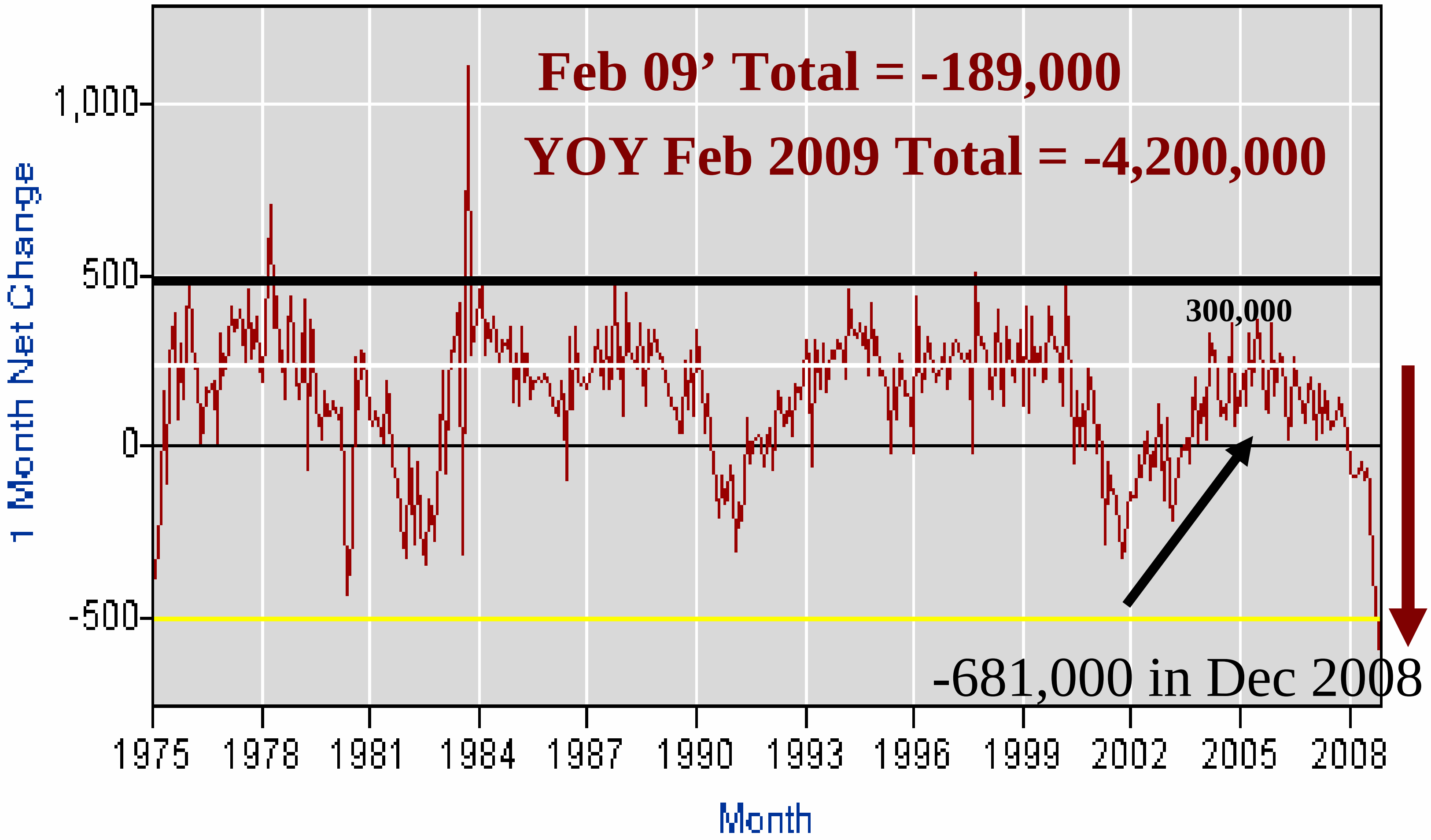
Net Change Commercial Mortgage Debt (1980-2008)



http://www.mbaa.org/files/Research/DataBooks/3Q08QuarterlyDataBook.pdf

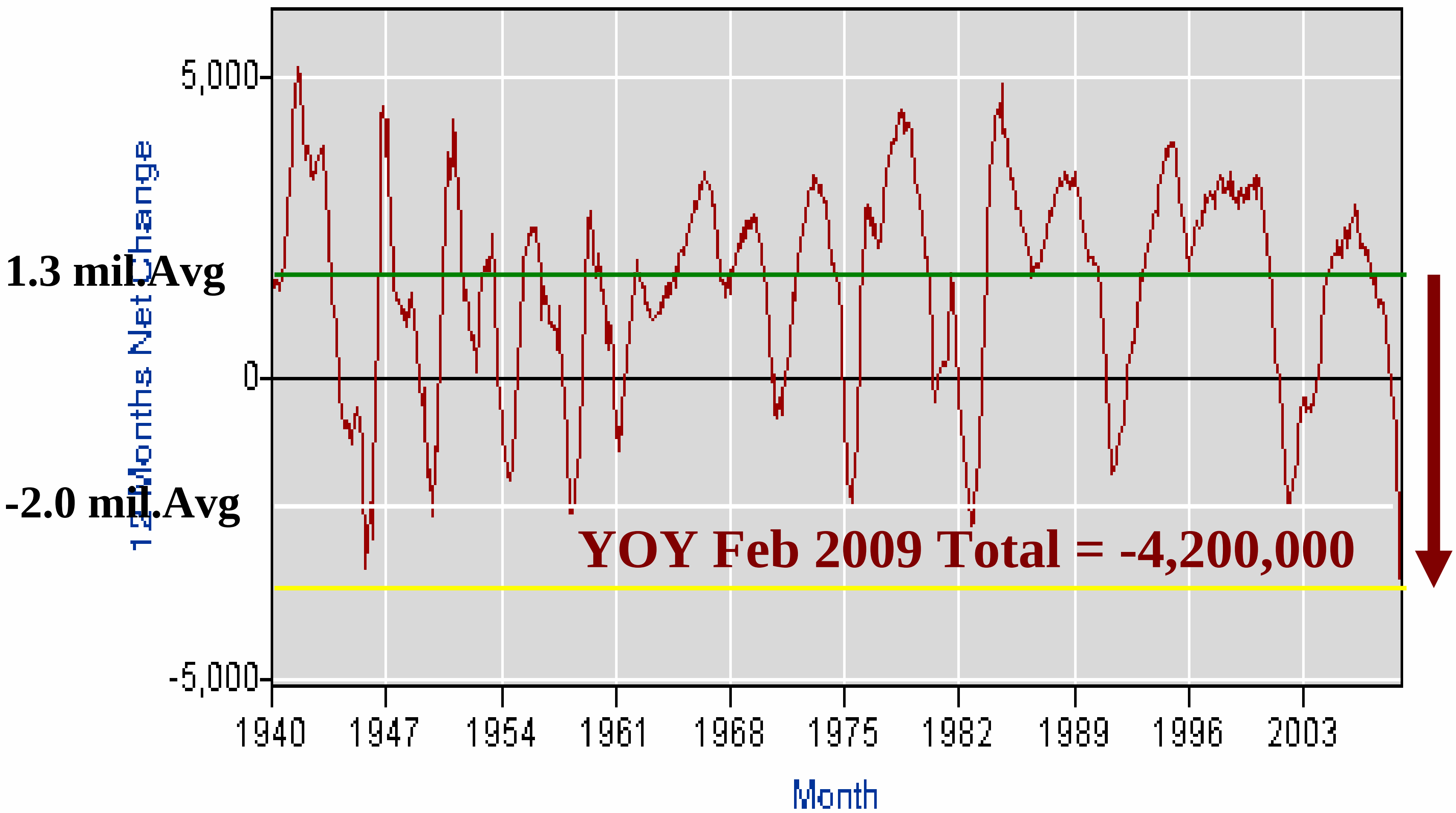
Production and Employment

Non-Farm Payroll Employment



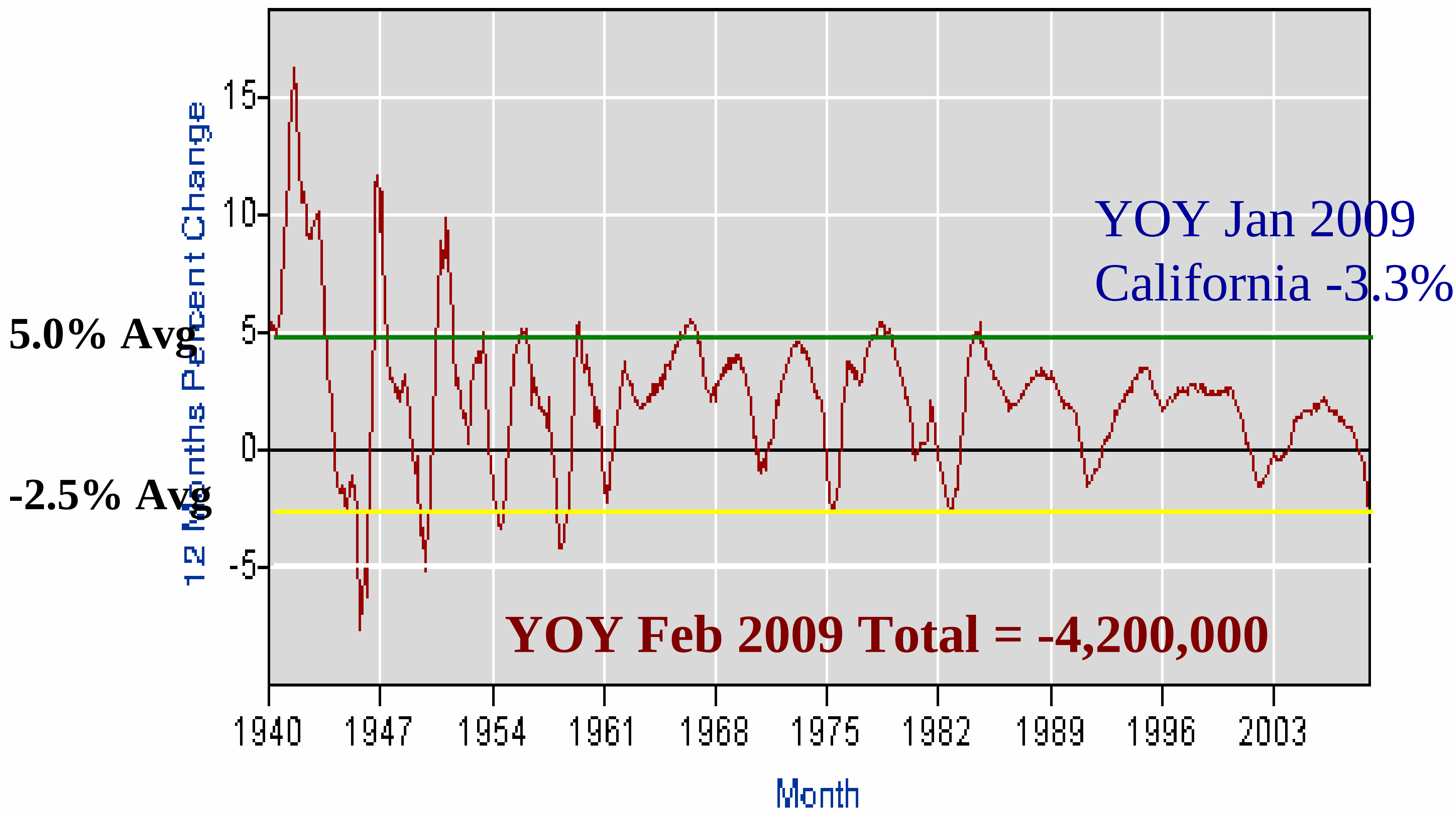
Source: Bureau of Labor Statistics.
http://www.bls.gov

Non-Farm Payroll Employment



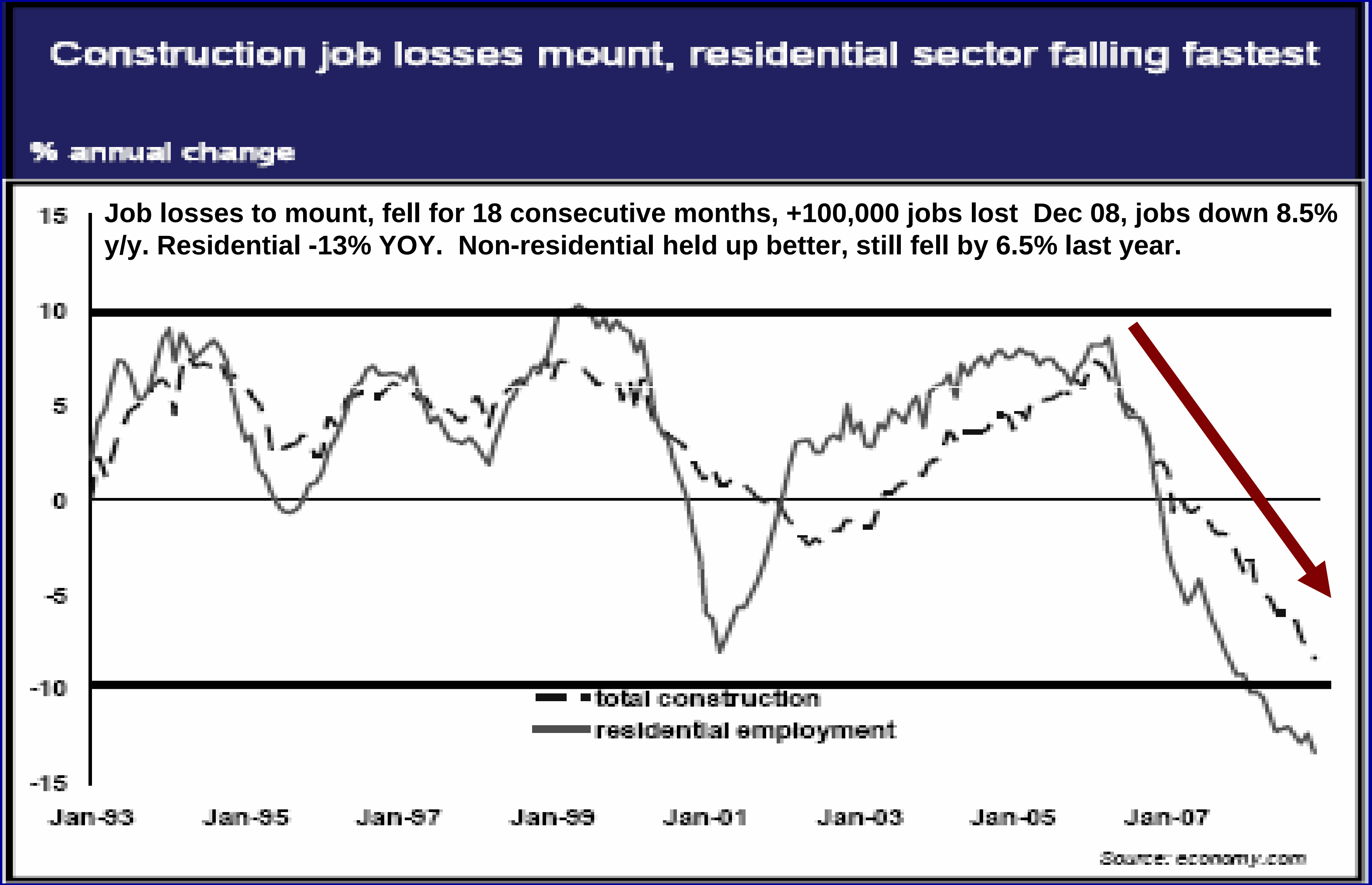
Source: Bureau of Labor Statistics.
http://www.bls.gov

Non-Farm Payroll Employment



Source: Bureau of Labor Statistics.
http://www.bls.gov

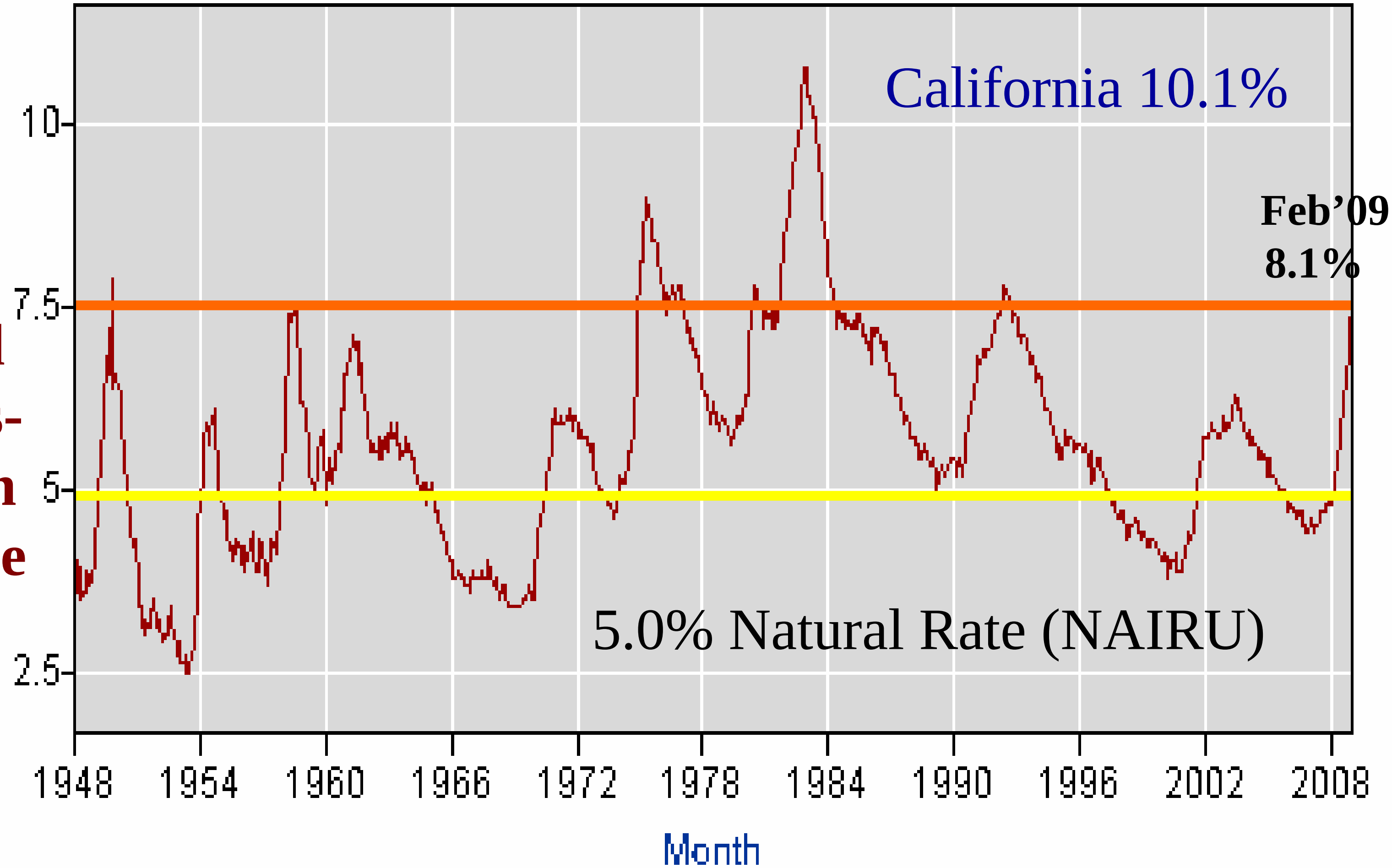
Construction Employment



http://www.ricsamericas.org/uploads/files/RICSGlobalRealEstateWeeklyJan30th.pdf

U.S. Unemployment Rate

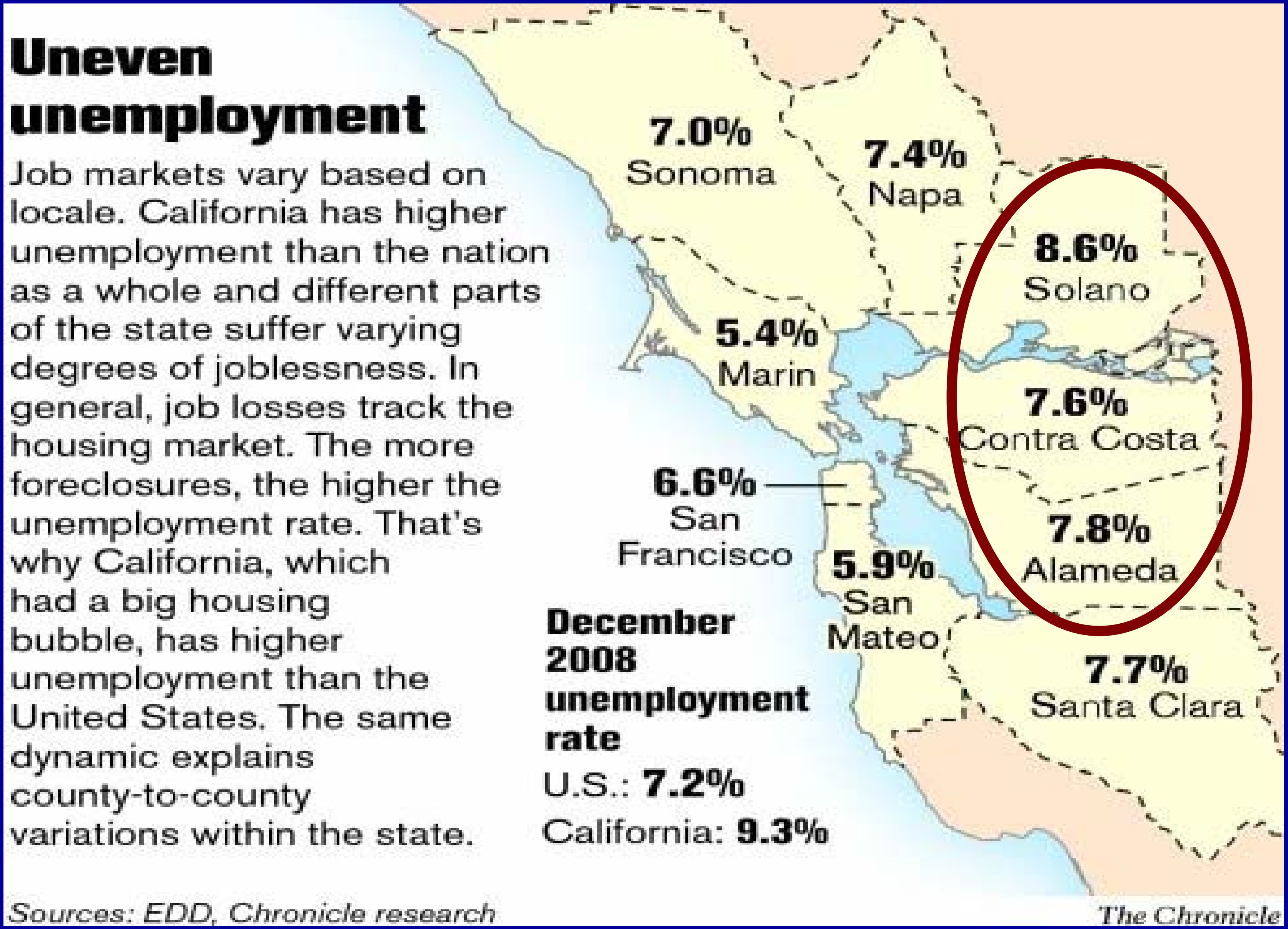
Well Above Natural rate, Dis-Inflation Exposure



Source: Bureau of Labor Statistics.

http://data.bls.gov/PDQ/servlet/SurveyOutputServlet

Local Unemployment Rates - 15 Yr. High

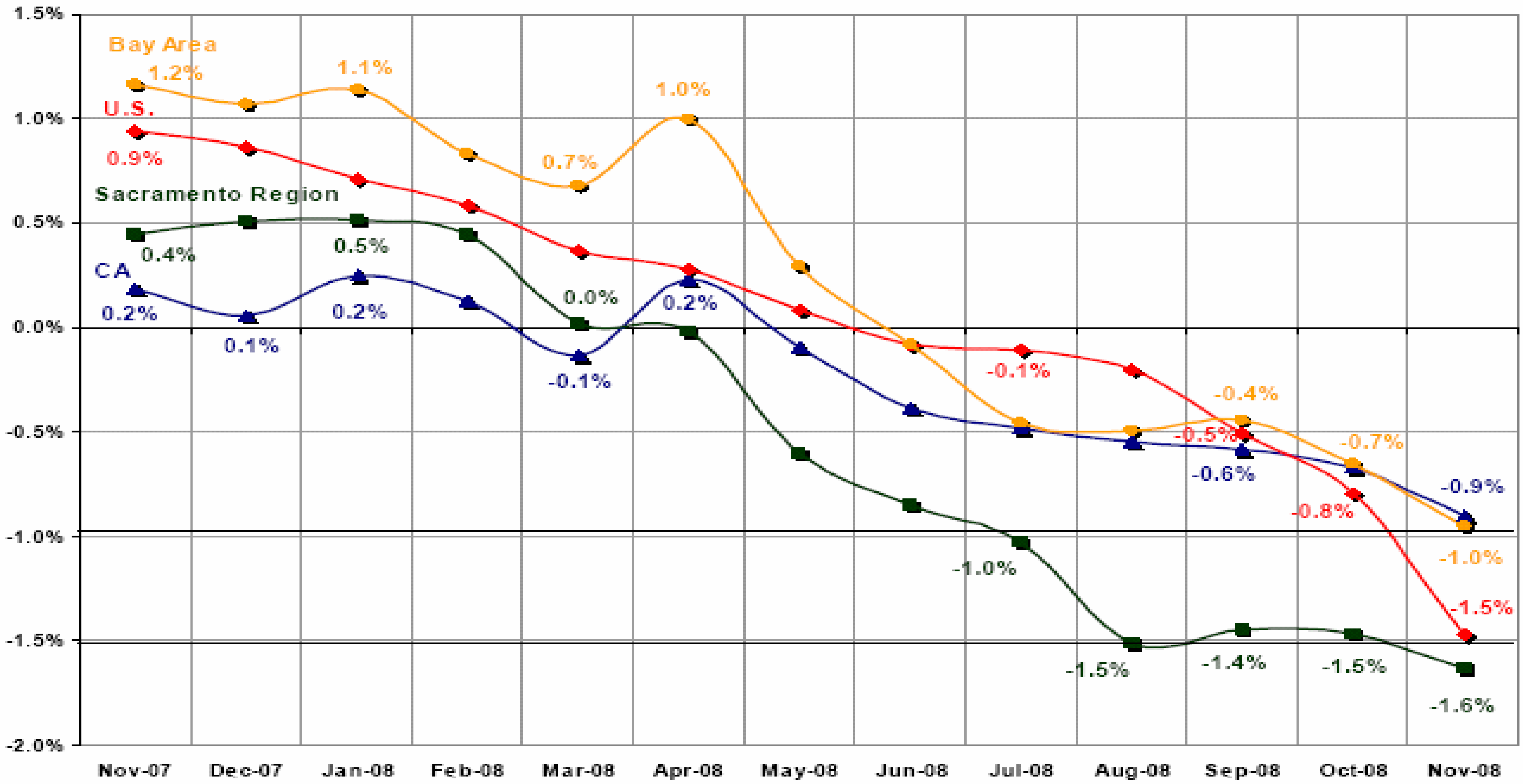


http://www.sfgate.com/cgi-bin/object/article?f=/c/a/2009/01/24/MNEU15FUSA.DTL&o=2

Local Employment

Job Losses Across California (2007-2008)

Monthly % Year-Over-Year Non-Farm Employment Growth Rates

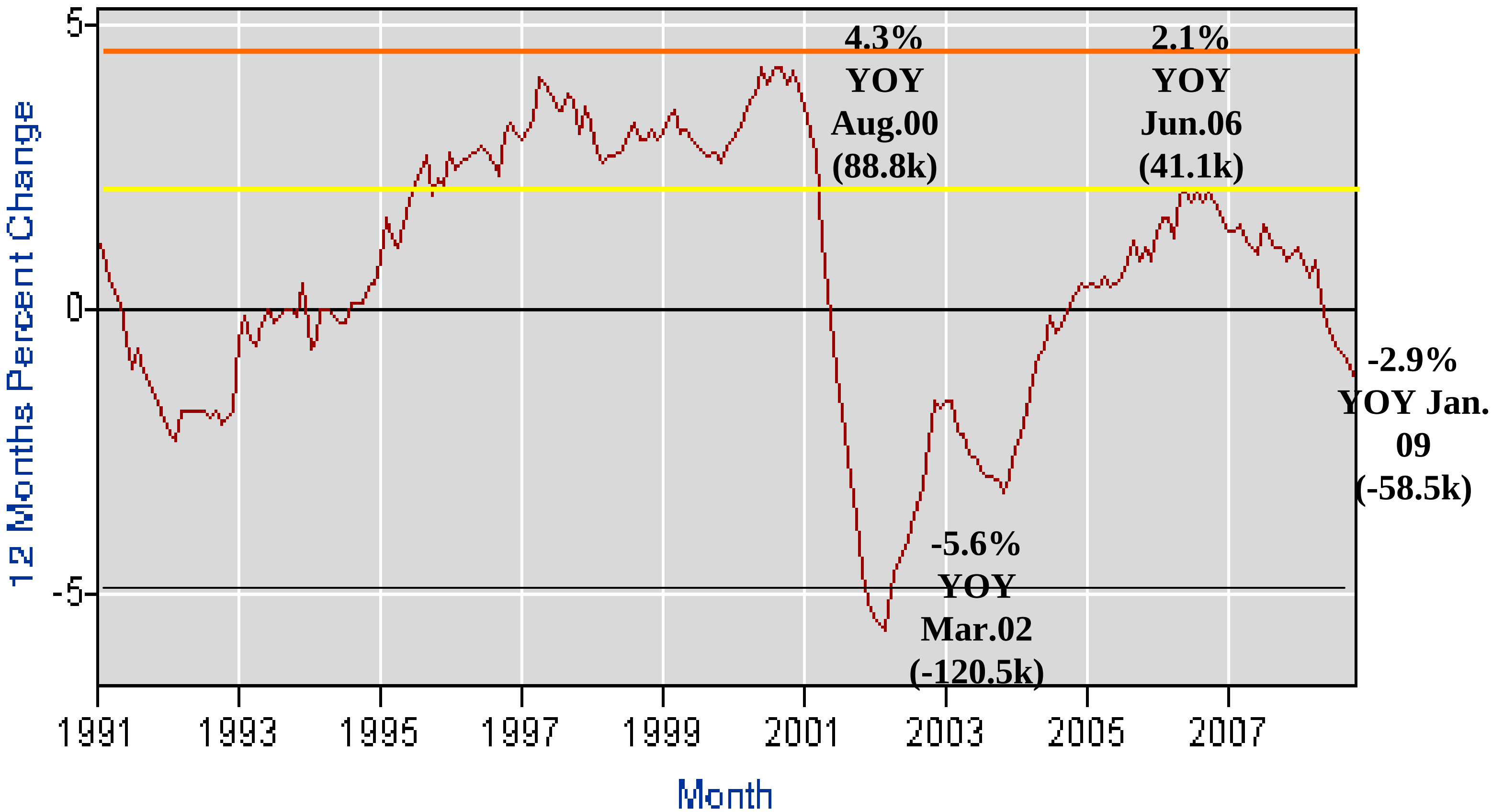


Sacramento Regional Research Institute, December 2008
Data Sources: Employment Development Department and Bureau of Labor Statistics
Notes: Sacramento Region includes Sacramento-Arden Arcade-Roseville and Yuba City MSAs.
Bay Area includes the Oakland-Fremont-Hayward MD, San Francisco-San Mateo-Redwood City MD, and San Jose-Sunnyvale-Santa Clara MSA.
Job growth reflects year-over-year Nonfarm employment growth rates.

Suzanne O'Keefe, Associate Professor, California State University, Sacramento, January 16, 2009.

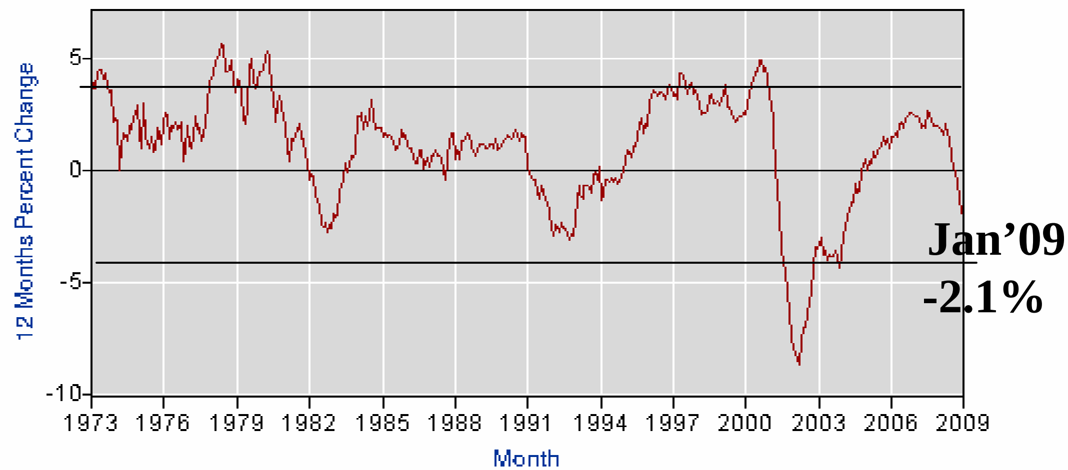
San Francisco-Oakland-Fremont, CA

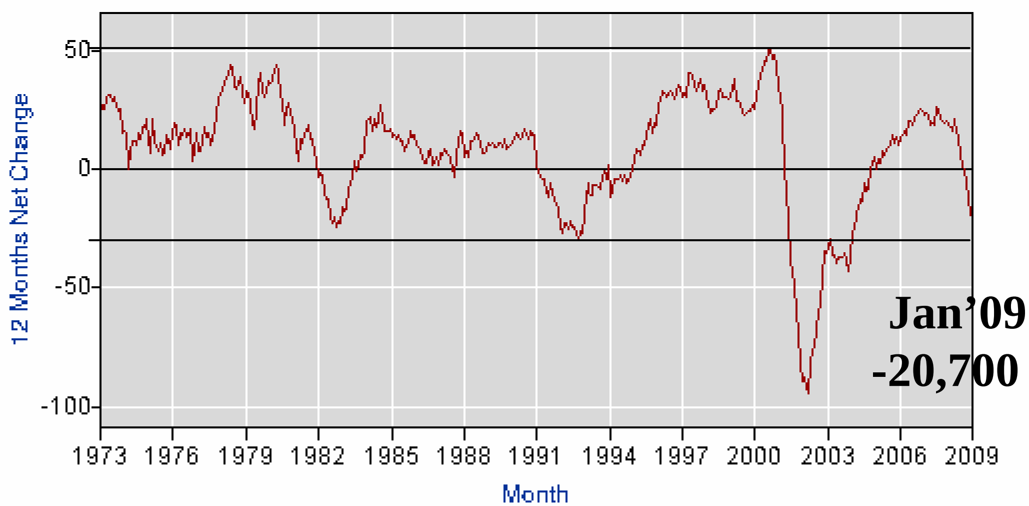
Monthly % Year-Over-Year Non-Farm Employment Growth Rates



Source: Bureau of Labor Statistics.
http://data.bls.gov/PDQ/servlet/SurveyOutputServlet

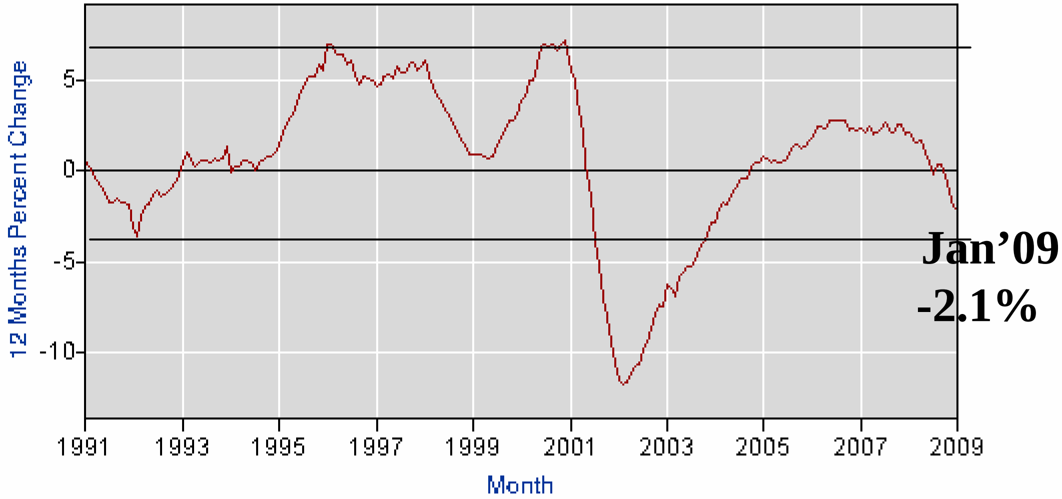
San Francisco PMSA Non-Farm Employment Growth (YOY)

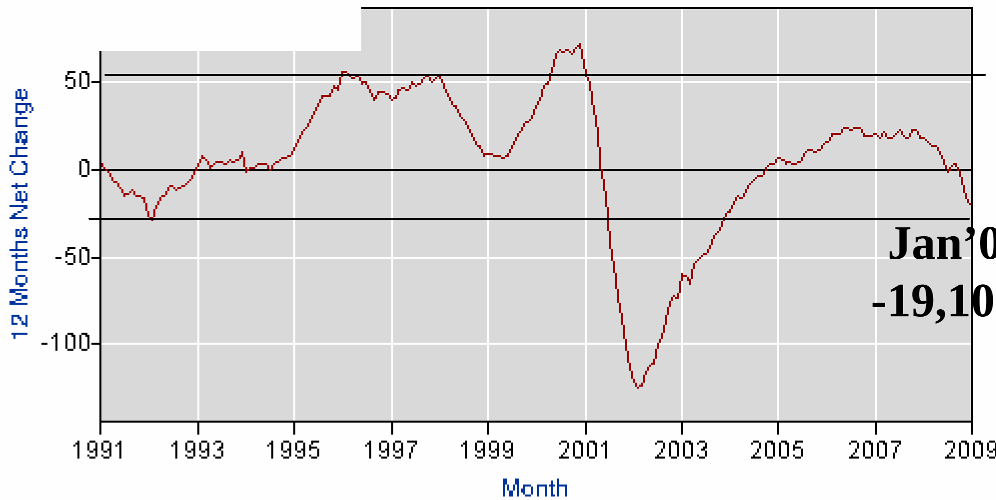




Source: Department of Labor Statistics.

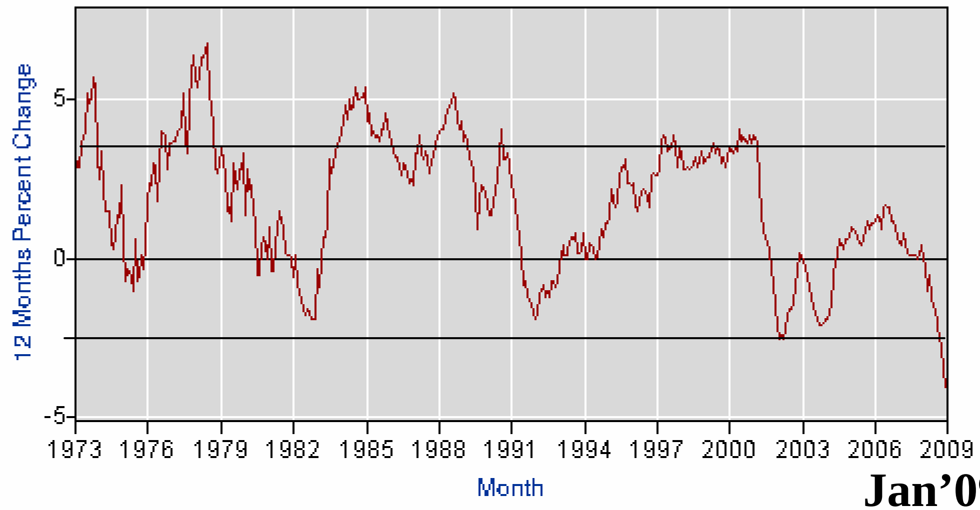
San Jose PMSA Non-Farm Employment Growth (YOY)



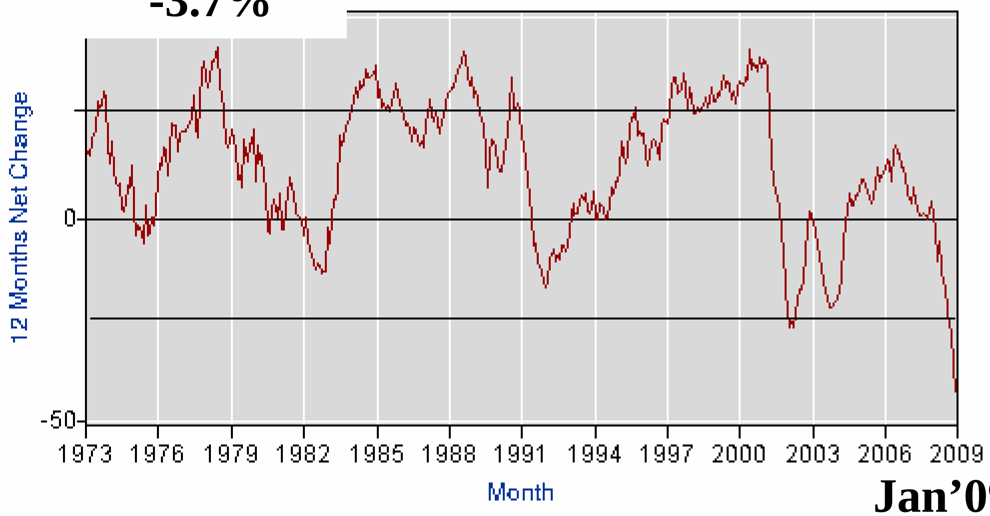


Source: Department of Labor Statistics.

Oakland PMSA Non-Farm Employment Growth (YOY)



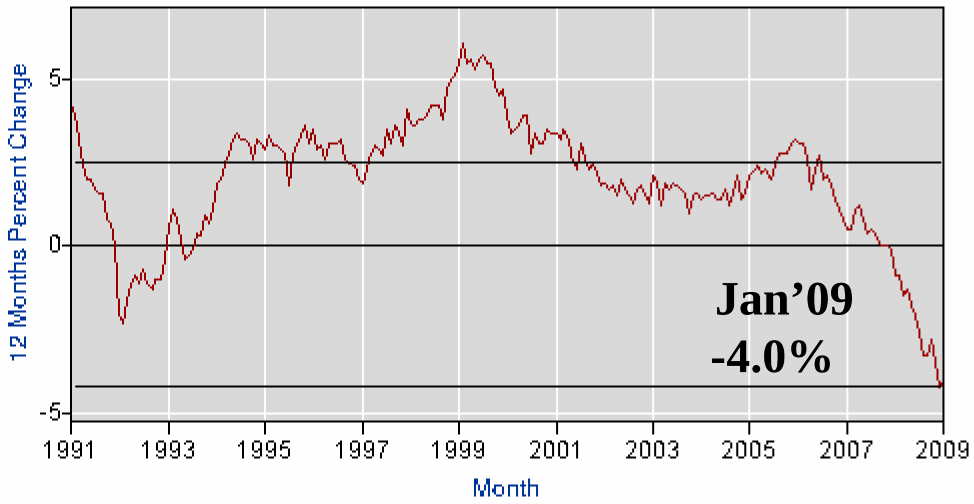
Jan'09
-3.7%

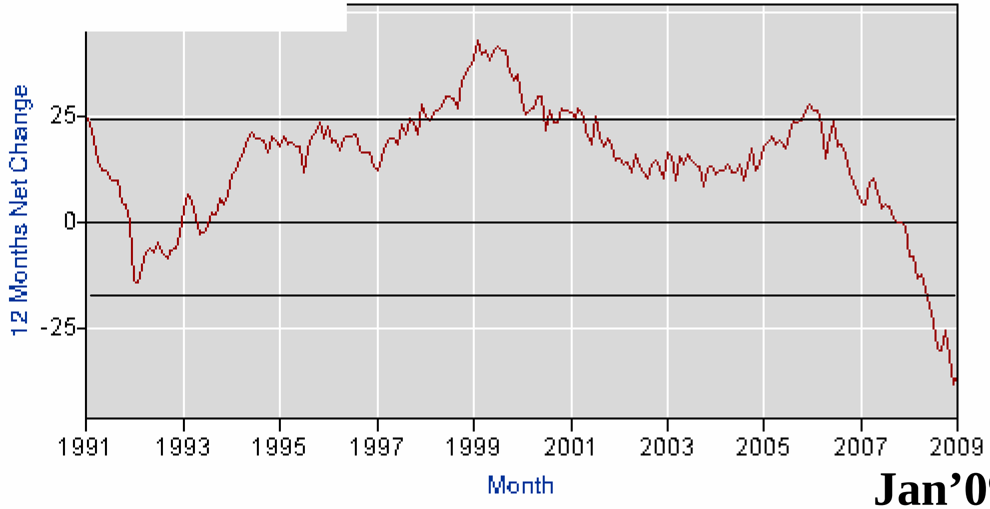


Jan'09
-37,800

Source: Department of Labor Statistics.

Sacramento PMSA Non-Farm Employment Growth (YOY)

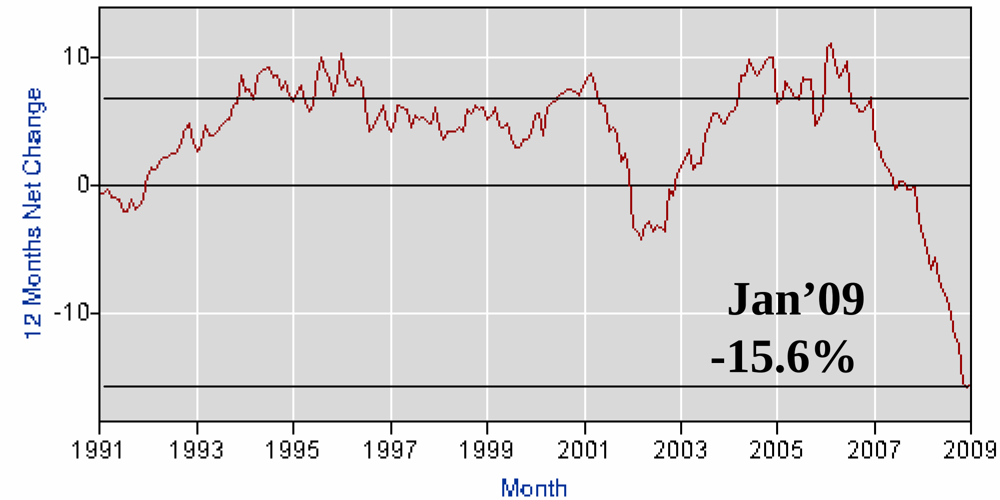


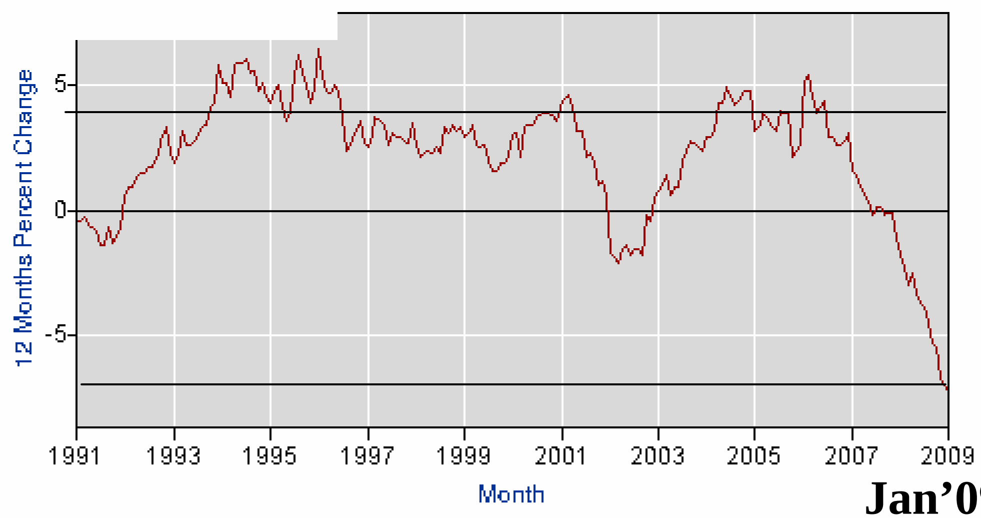


Jan'09
-35,800

Source: Department of Labor Statistics.

Reno PMSA Non-Farm Employment Growth (YOY)

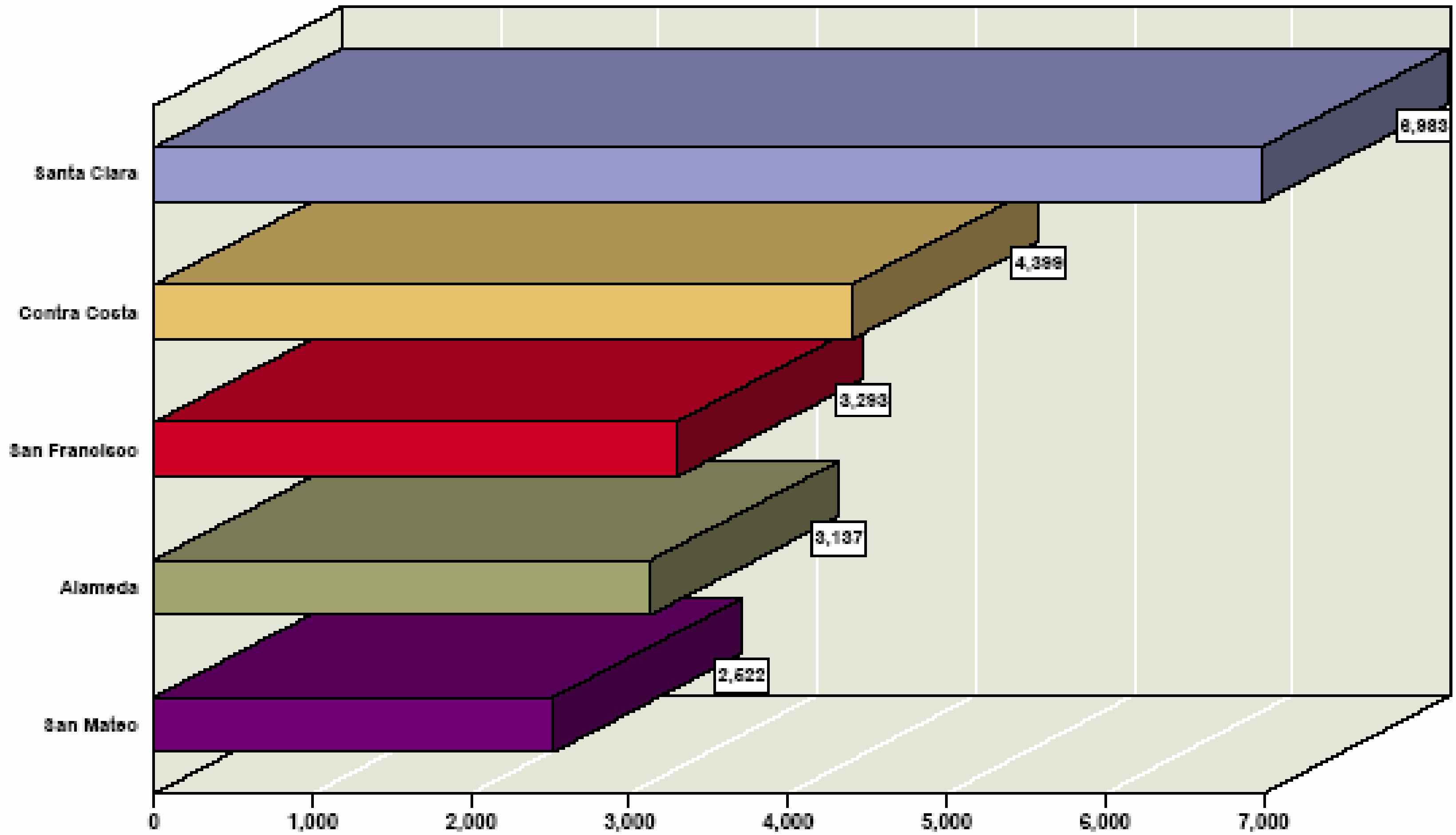




Jan'09
-7,300

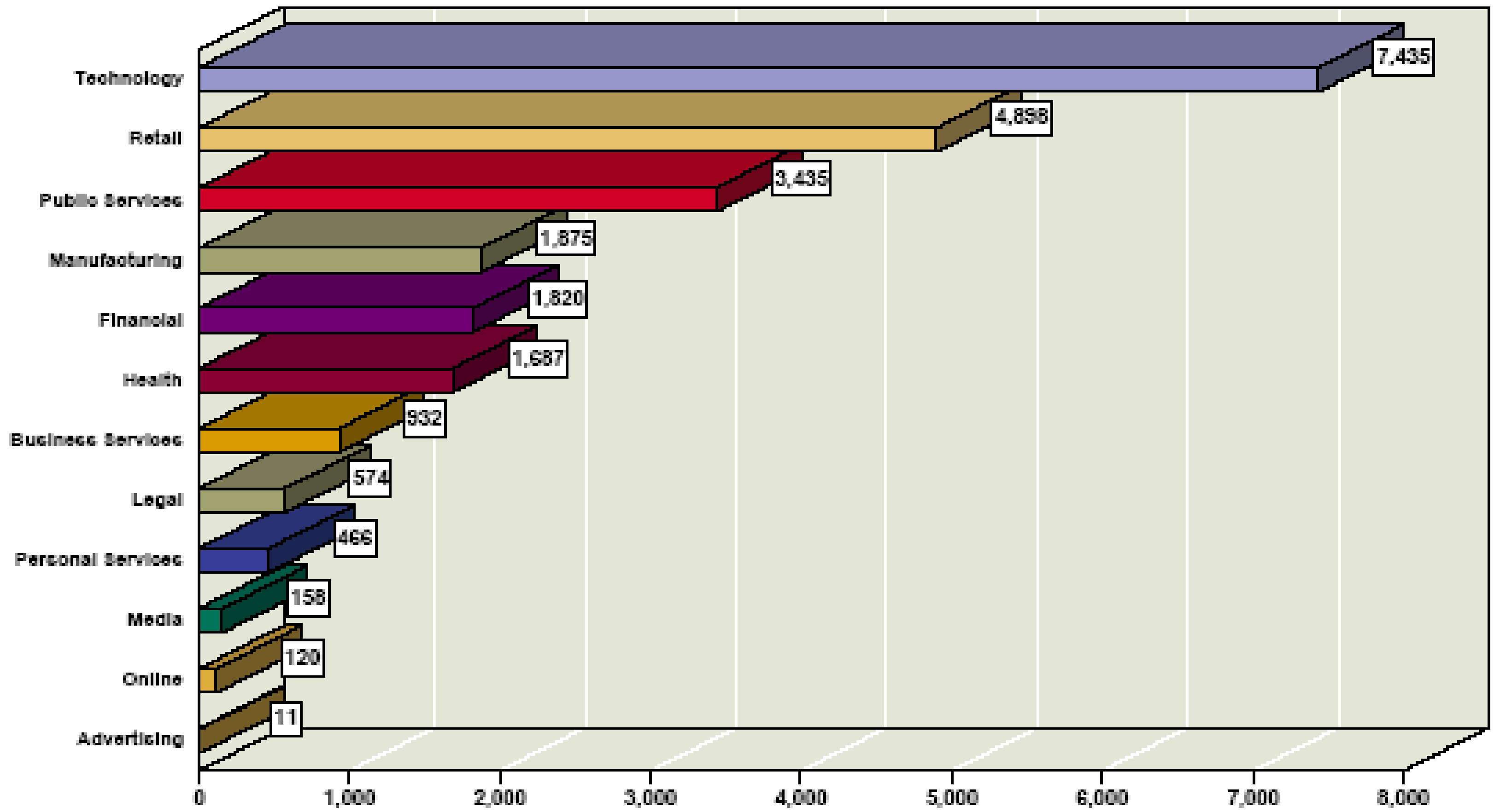
Source: Department of Labor Statistics.

of Employee Layoffs by County - Bay Area 2008



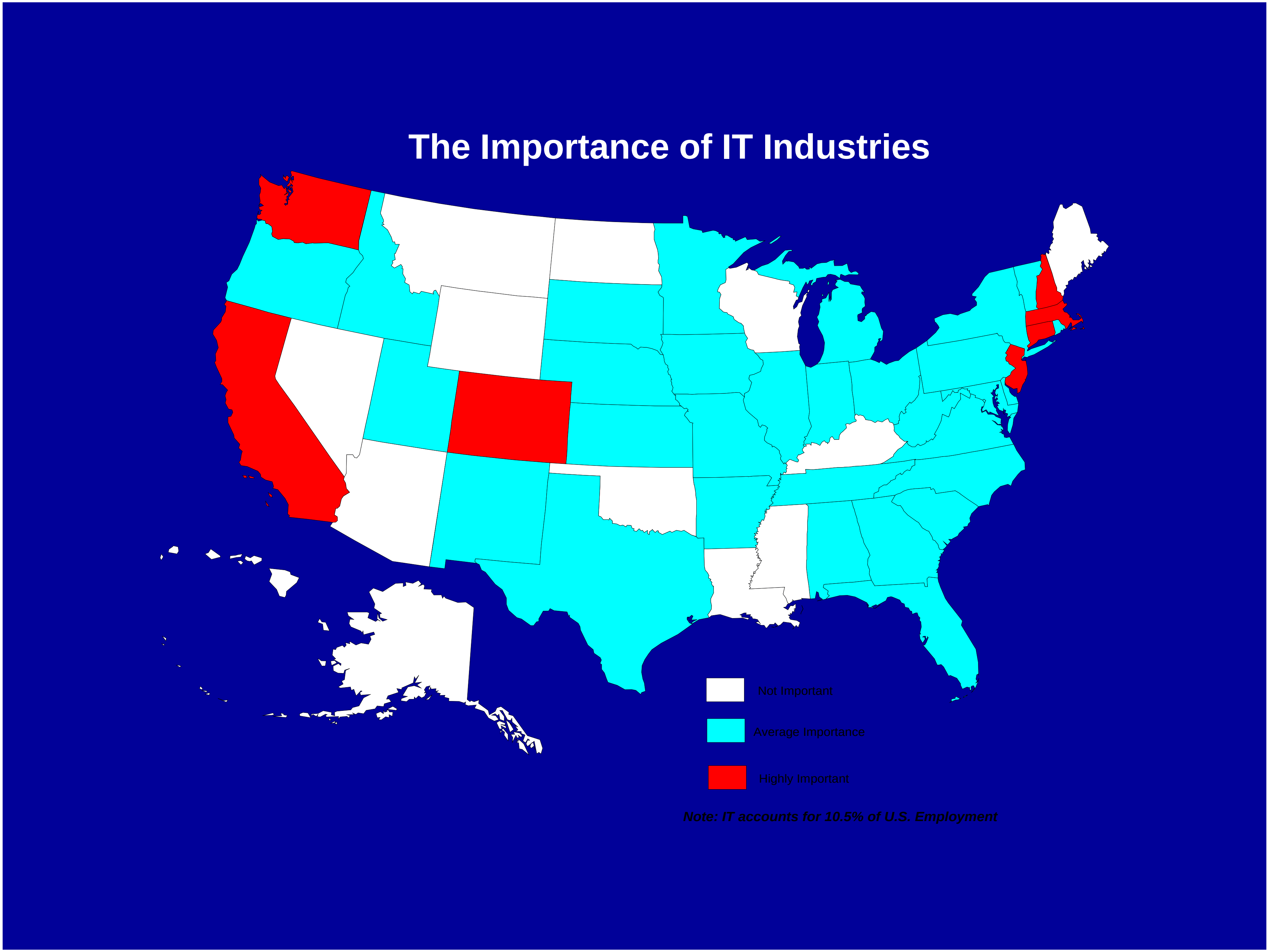
Source: EDD - Worker Adjustment and Retraining Notification (WARN)

of Employee Layoffs by Industry - Bay Area 2008



Source: EDD - Worker Adjustment and Retraining Notification (WARN)

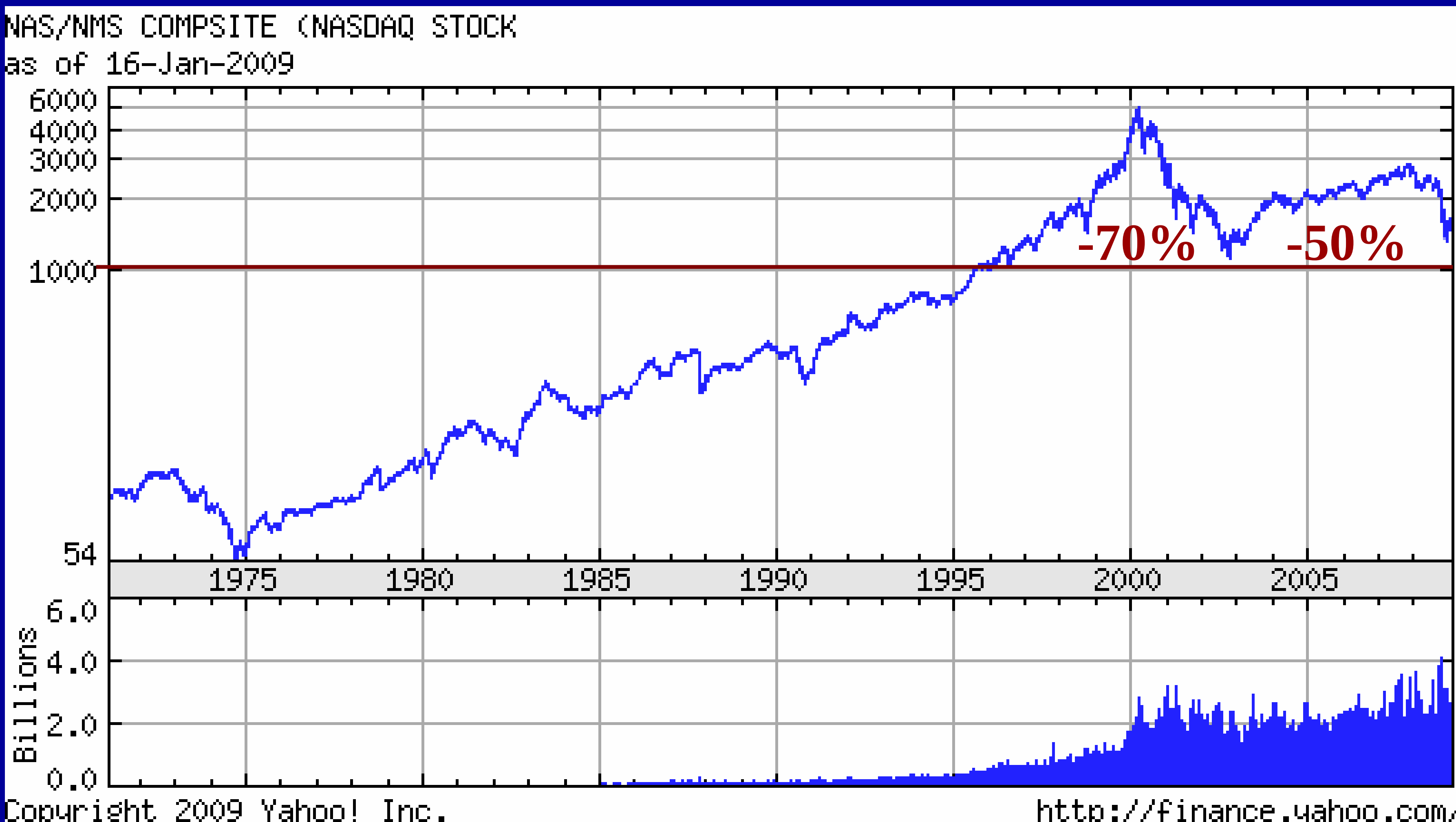
Technology/Venture Capital Trends



The Importance of IT Industries
Not Important
Average Importance
Highly Important
Note: IT accounts for 10.5% of U.S. Employment

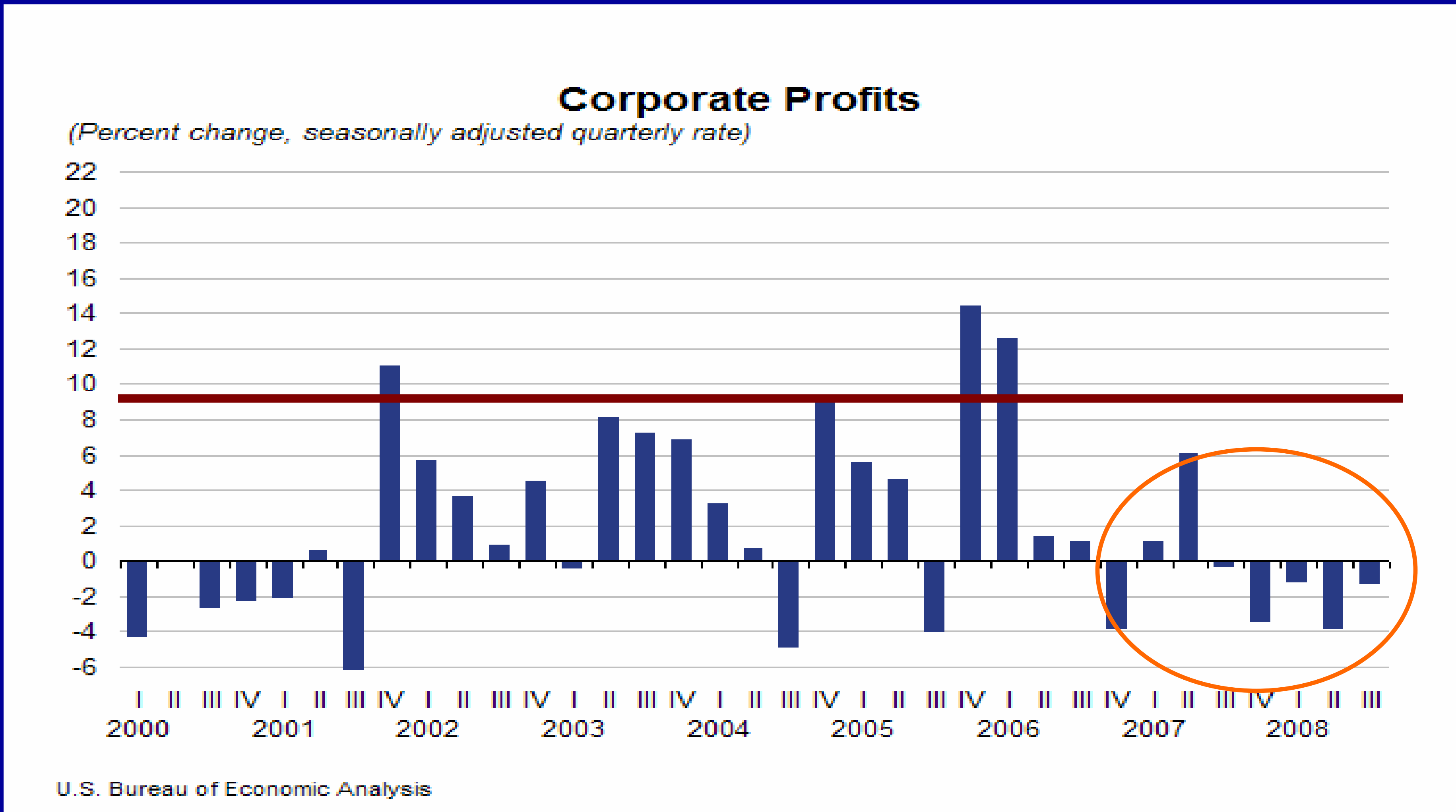
Silicon Valley Geography

Technology



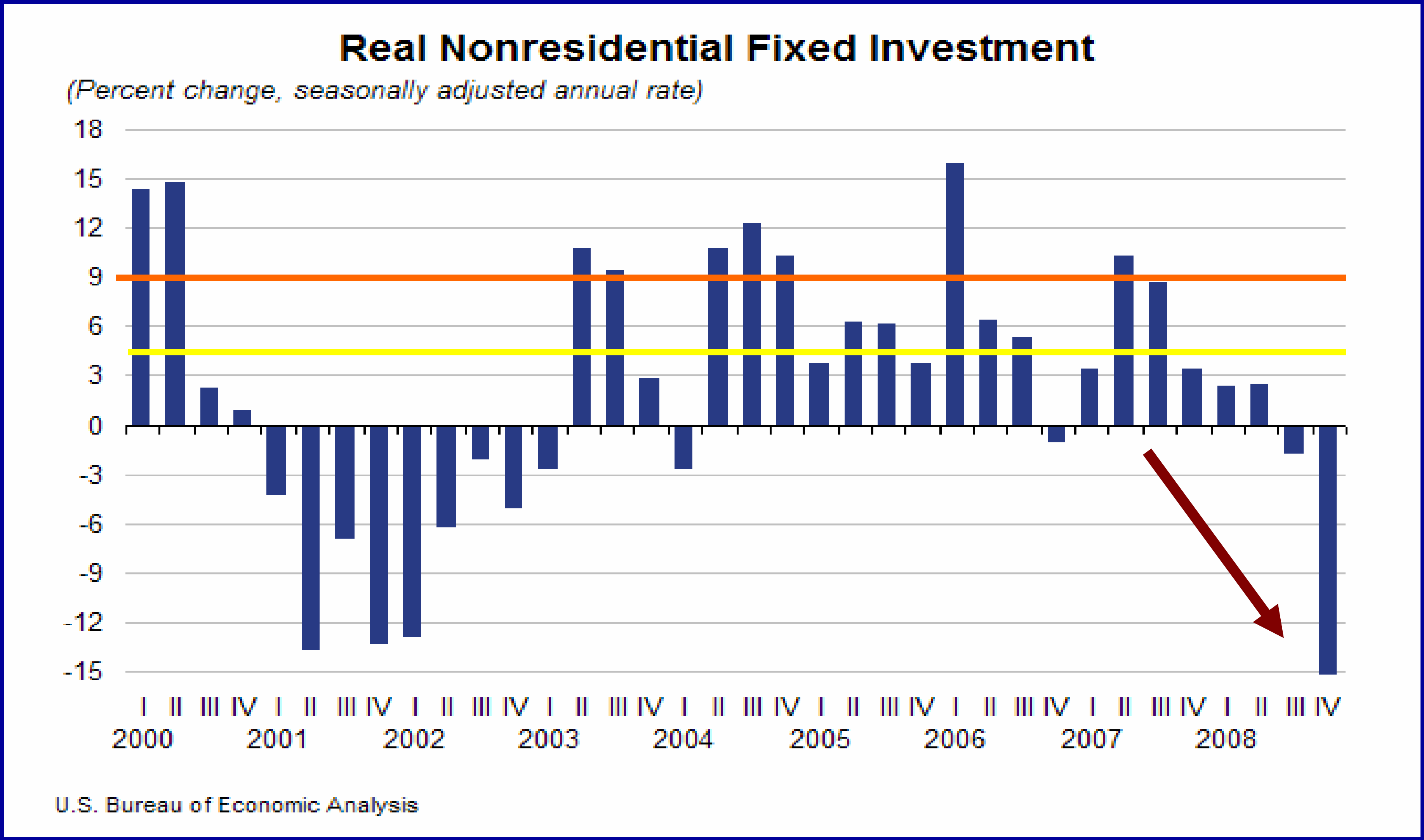
NAS/NMS COMPSITE (NASDAQ STOCK
as of 16-Jan-2009
6000
4000
3000
2000
1000
54
-70%
-50%
1975
1980
1985
1990
1995
2000
2005
6.0
4.0
2.0
0.0
Billions
Copyright 2009 Yahoo! Inc.
http://finance.yahoo.com/

Corporate Profits



http://www.bea.gov/briefrm/corpprof.htm

Non-Residential Fixed Investment



Source: Bureau of Economic Analysis. http://www.bea.gov/briefrm/nonresfi.htm

Source: Venture Economics. http://www.ventureeconomics.com/vec/us.html.
https://www.pwcmoneytree.com/MTPublic/ns/index.jsp

Venture Capital Flows

Investments by Region / Q3 2008

Regions Defined	Total $ Invested	Average $ Per Deal	Deals
All	$7,131,302,400	$7,862,516	907

Region	Amount	% of Total	Deals
Silicon Valley	$2773M	38.89%	292
New England	$834M	11.70%	117
LA/Orange County	$573M	8.03%	54
NY Metro	$546M	7.66%	71
Midwest	$395M	5.54%	60
Northwest	$295M	4.14%	44
Texas	$275M	3.86%	38
Philadelphia Metro	$268M	3.76%	36
Southeast	$250M	3.51%	51
North Central	$235M	3.30%	19
Colorado	$196M	2.75%	21
DC/Metroplex	$181M	2.53%	44
San Diego	$178M	2.50%	22
SouthWest	$59M	0.83%	17
Upstate NY	$32M	0.45%	5
Sacramento/N.Cal	$21M	0.29%	6
AK/HI/PR	$12M	0.17%	1
South Central	$7M	0.10%	9

Fundraising by U.S. **venture** firms plummeted last quarter.

	2008	2007	Change
Year	$28.0 billion	$35.5 billion	-21%
Quarter	3.4 billion	11.7 billion	-71

Source: National **Venture Capital** Association, Thomson Reuters

Venture Capital Flows

Investments by Industry / Q3 2008

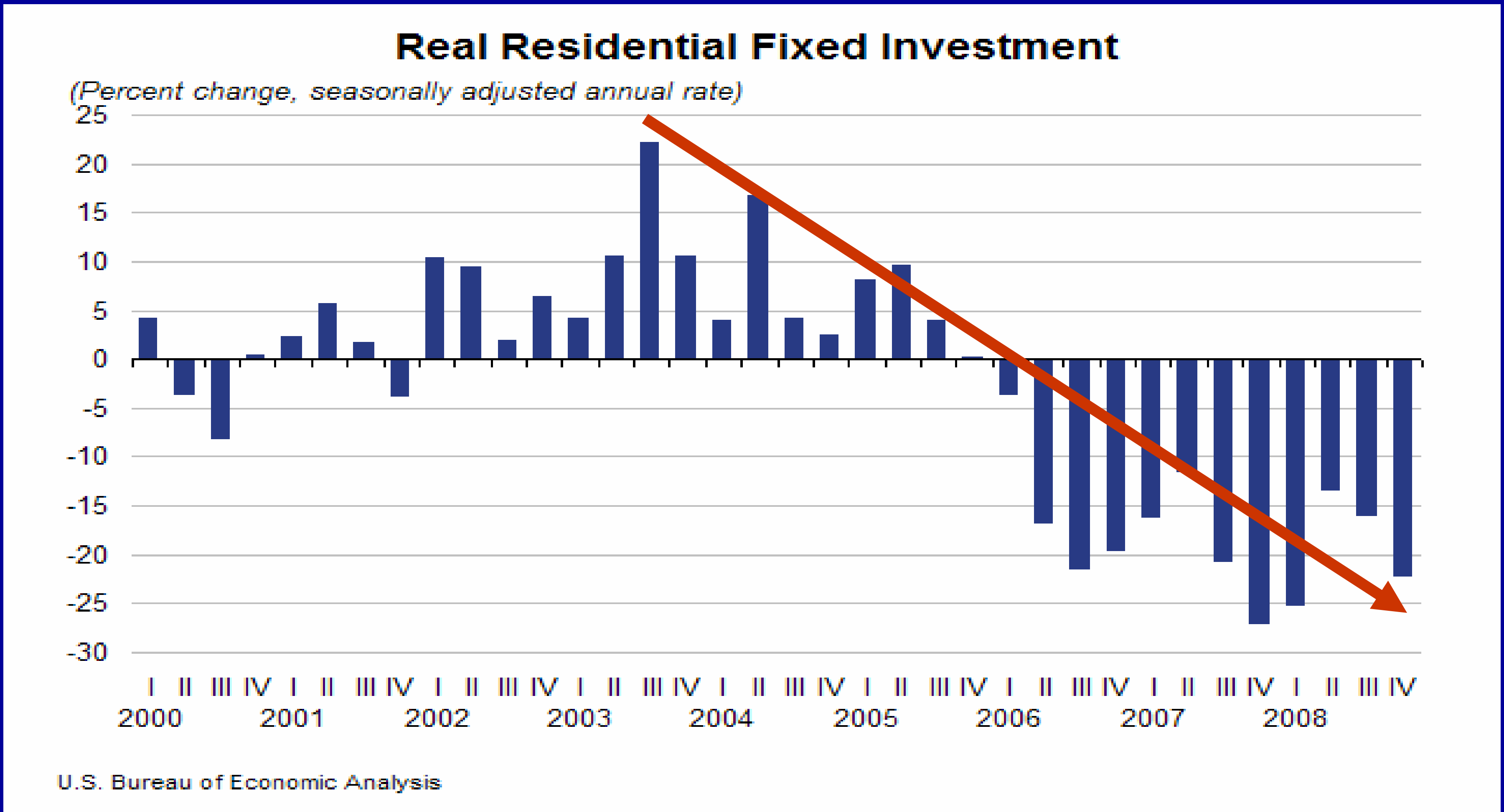
Industries Defined	Total $ Invested	Average $ Per Deal	Deals
All	$7,131,302,400	$7,862,516	907

	Amount	% of Total	Deals
Biotechnology	$1350M	18.93%	114
Software	$1343M	18.83%	214
Industrial/Energy	$1191M	16.71%	96
Medical Devices and Equipment	$896M	12.57%	93
Media and Entertainment	$409M	5.74%	92
IT Services	$403M	5.65%	62
Semiconductors	$396M	5.55%	50
Telecommunications	$323M	4.53%	45
Networking and Equipment	$178M	2.50%	21
Financial Services	$142M	1.99%	18
Electronics/Instrumentation	$120M	1.68%	18
Business Products and Services	$94M	1.32%	29
Consumer Products and Services	$92M	1.28%	18
Computers and Peripherals	$73M	1.03%	14
Healthcare Services	$56M	0.78%	13
Retailing/Distribution	$49M	0.69%	6
Other	$16M	0.23%	4

Source: Venture Economics. http://www.ventureeconomics.com/vec/us.html.
https://www.pwcmoneytree.com/MTPublic/ns/index.jsp

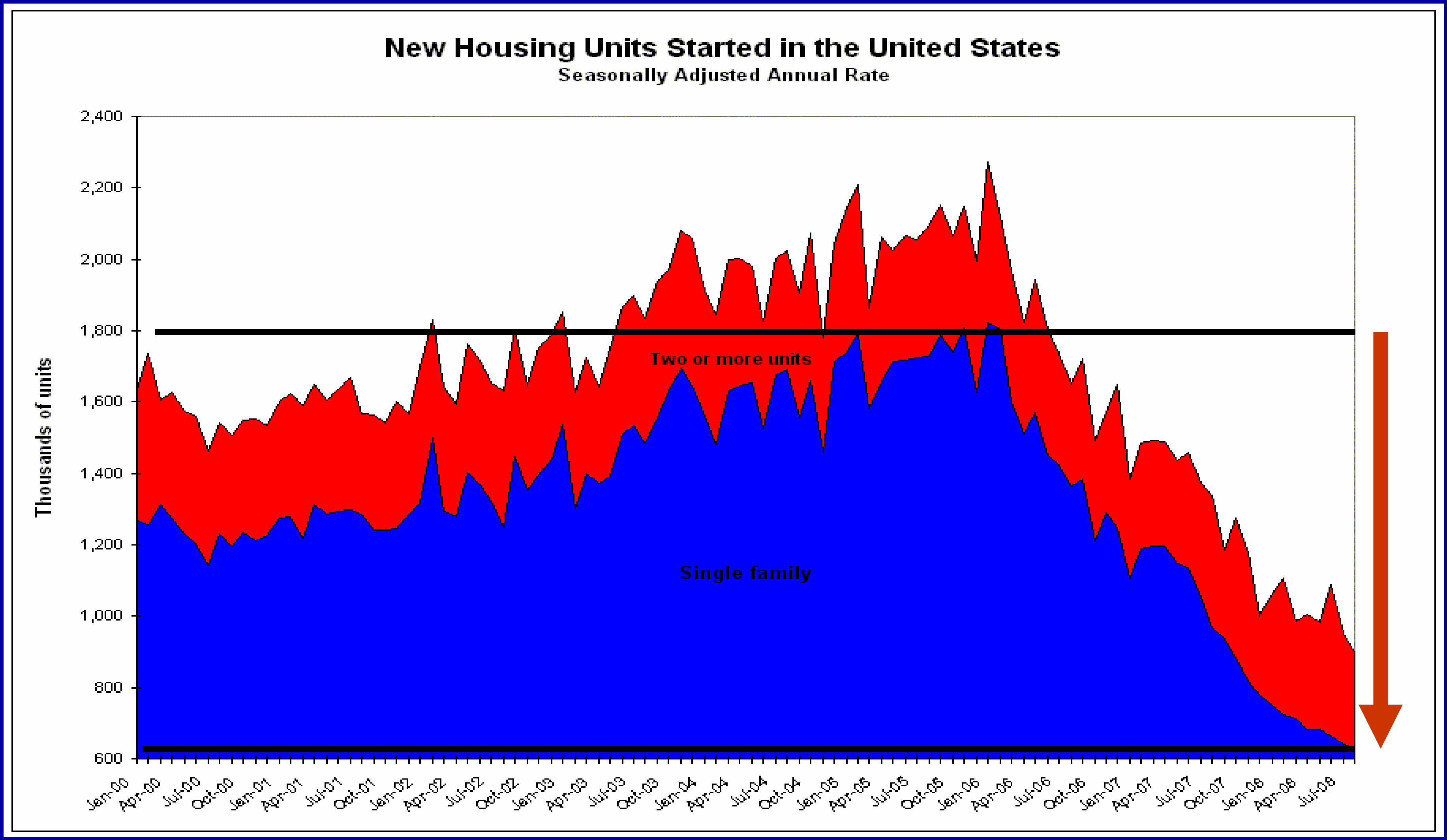
Home Prices and Affordability Rates

Real Residential Fixed Investment



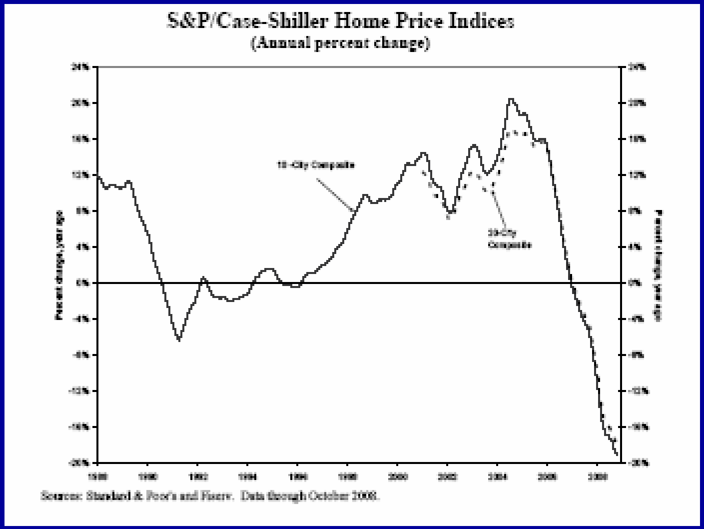
http://www.bea.gov/briefrm/resfi.htm

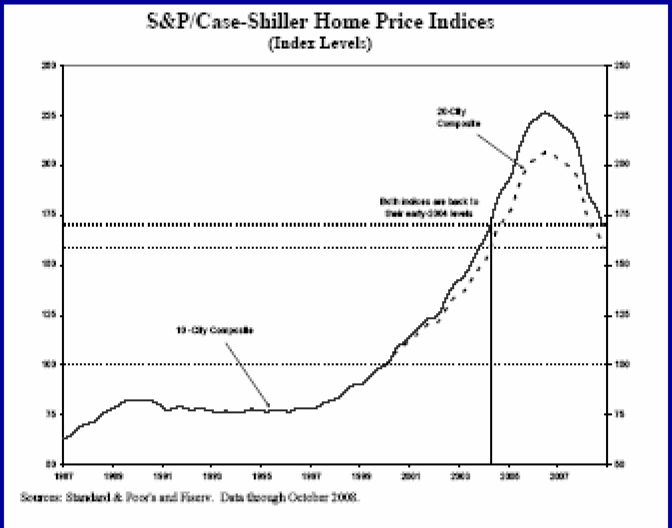
New Housing Starts

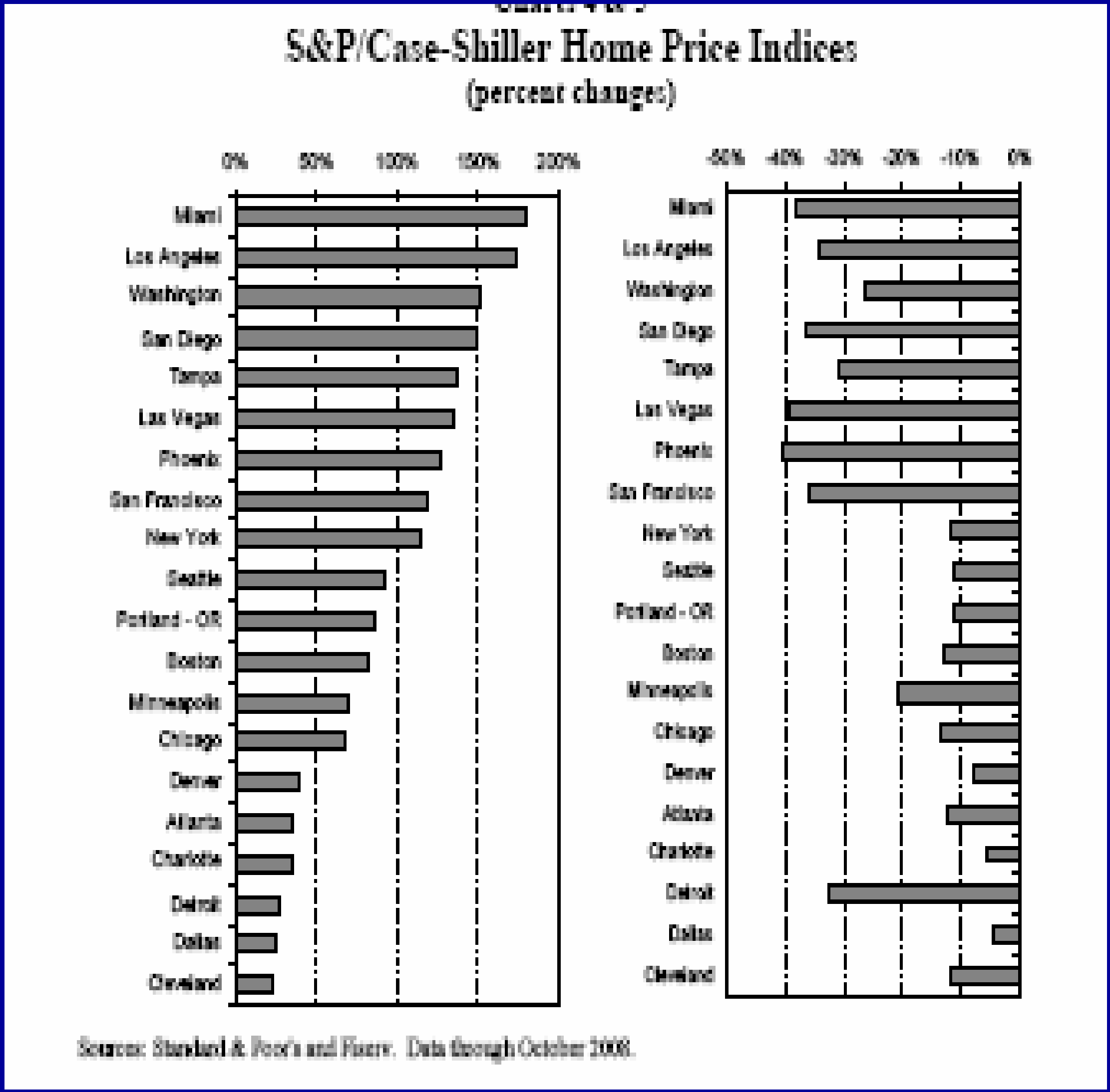


Source. United States Census Bureau. http://www.census.gov/briefrm/esbr/www/esbr020.html

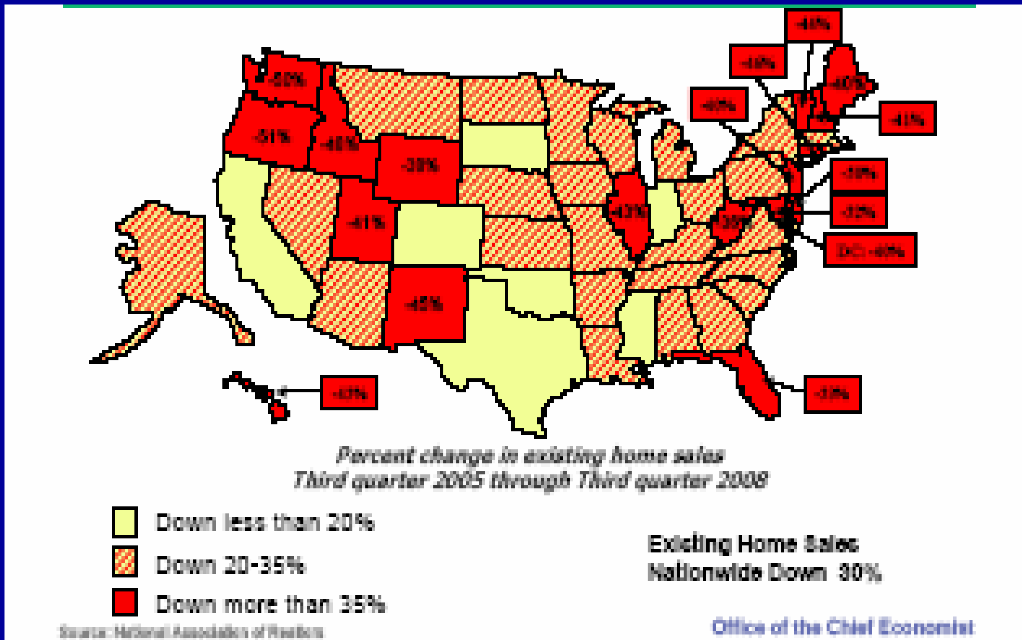
Housing Market – Price Declines

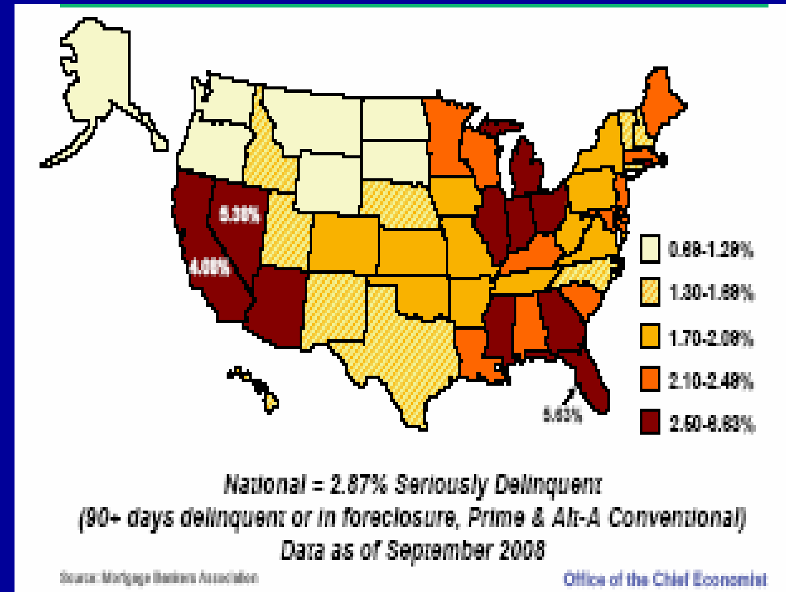


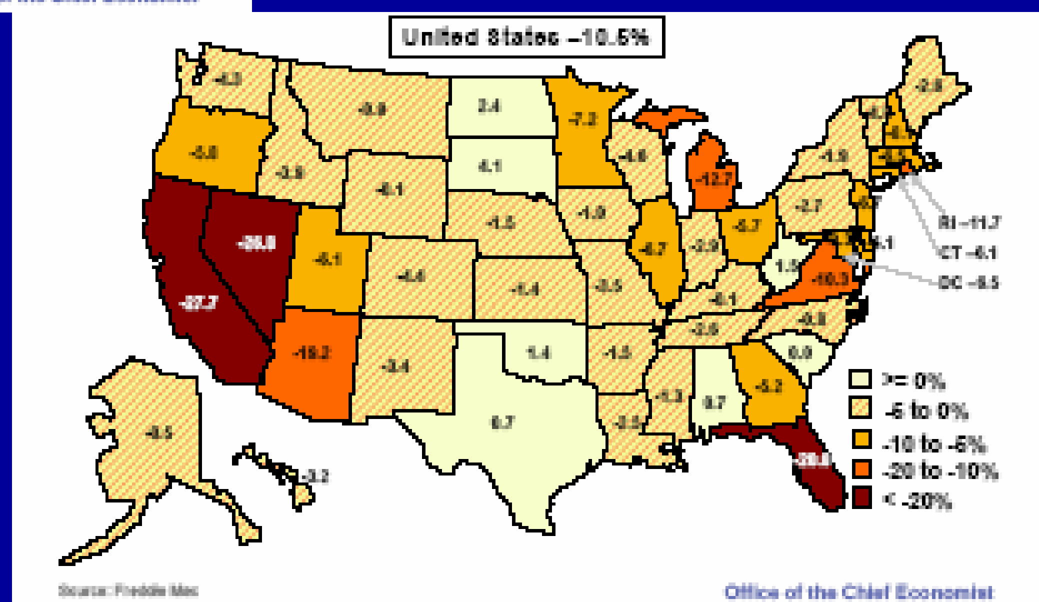




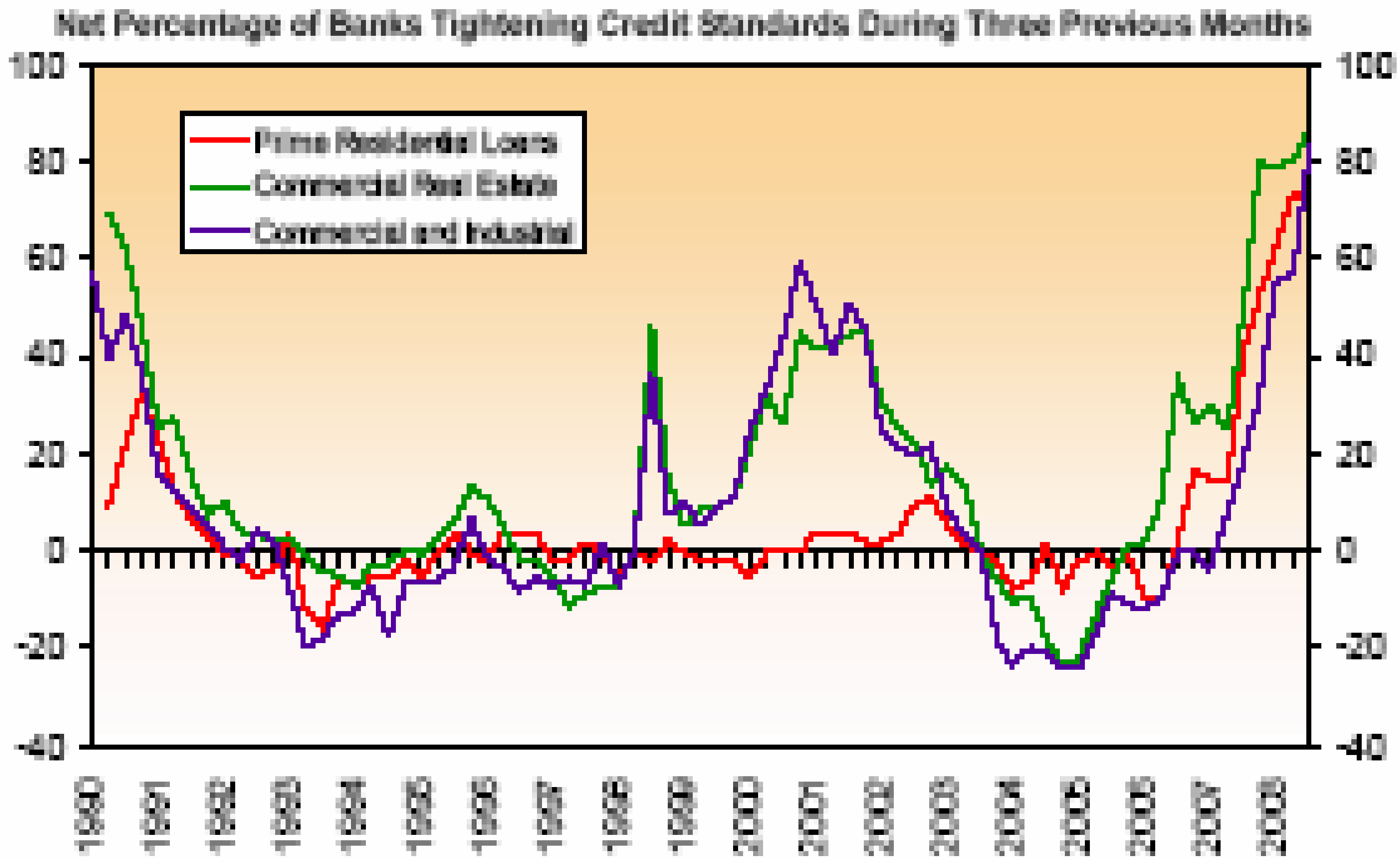
Housing Market – Price Declines







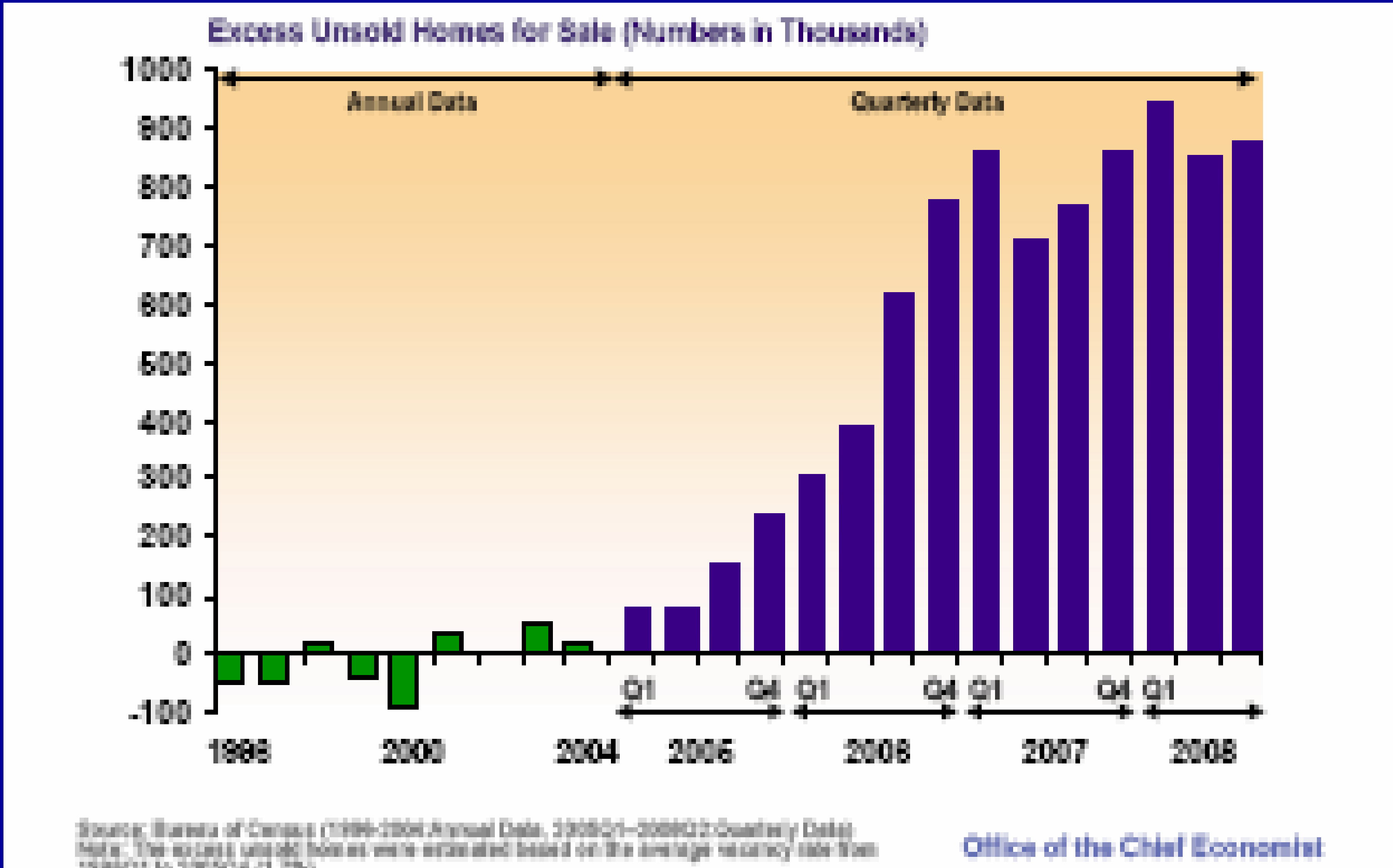
Housing Market – Tight Credit Standards



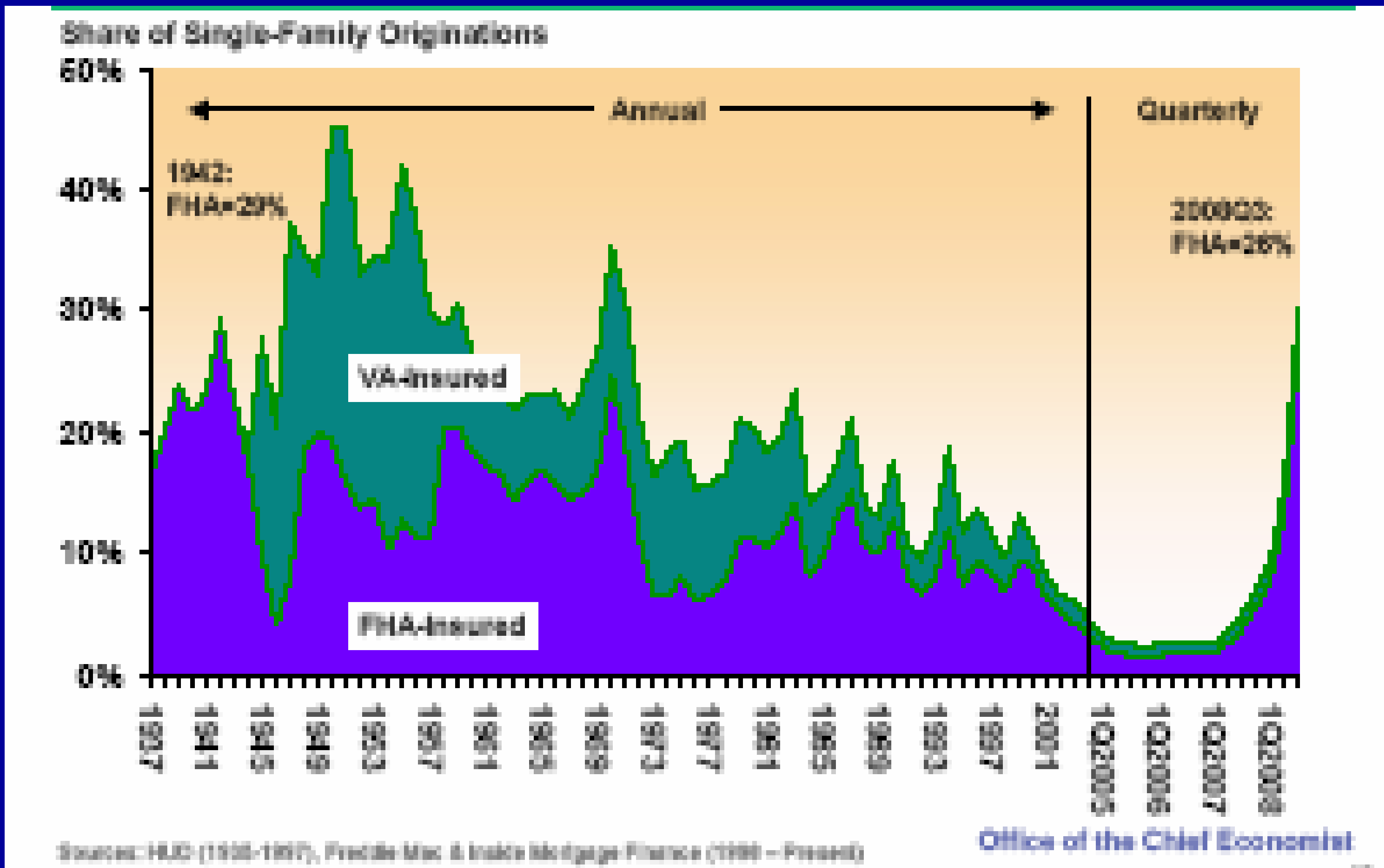
Source: Federal Reserve Board's Senior Loan Officer Survey (all residential loans through 2007Q1, prime residential starting 2007Q2; C&I loans to large and middle-market firms)
Last update: November 3, 2008

Office of the Chief Economist

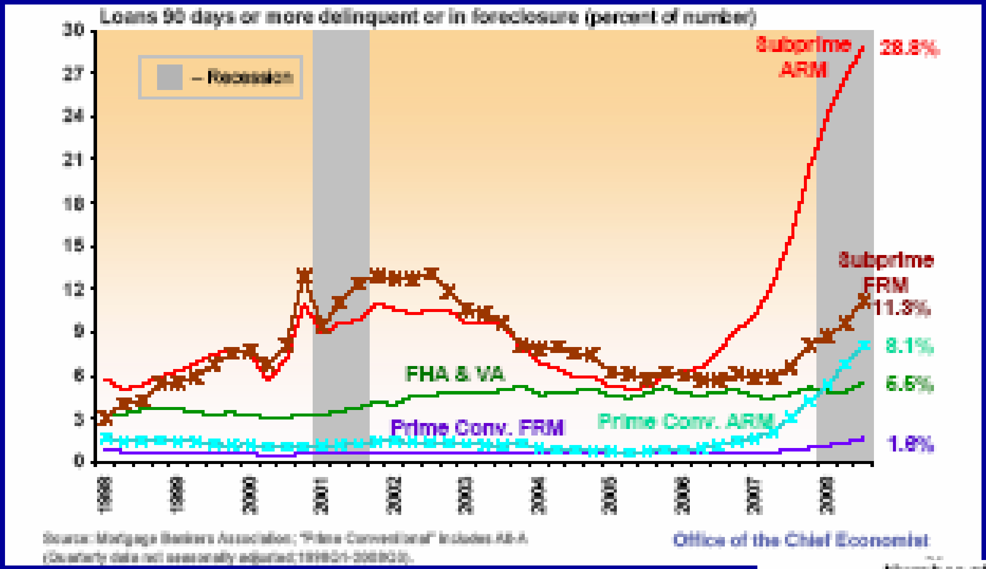
Housing Market - Excess Inventory

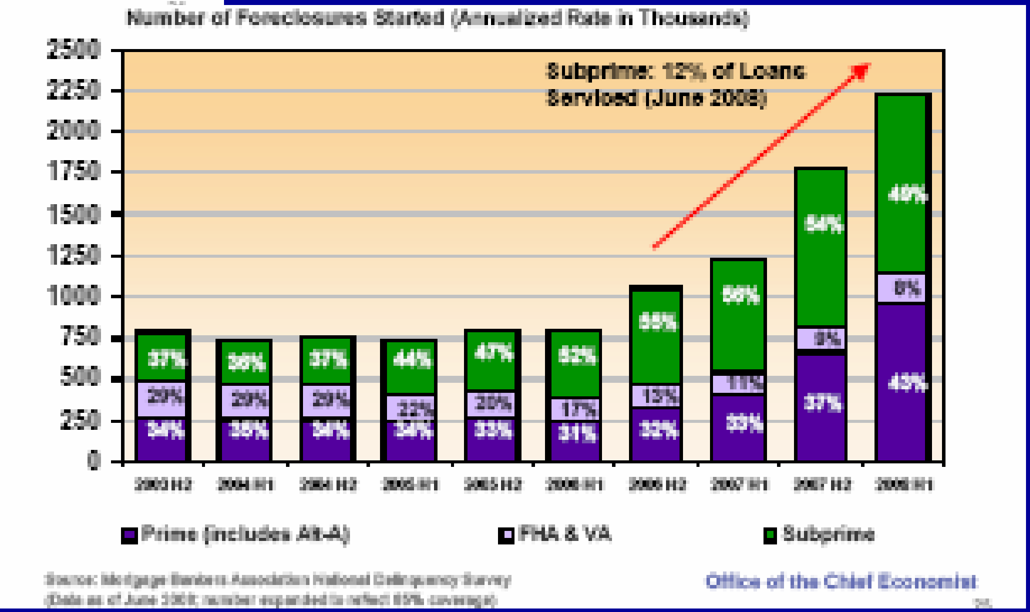


Housing Market – FHA Originations

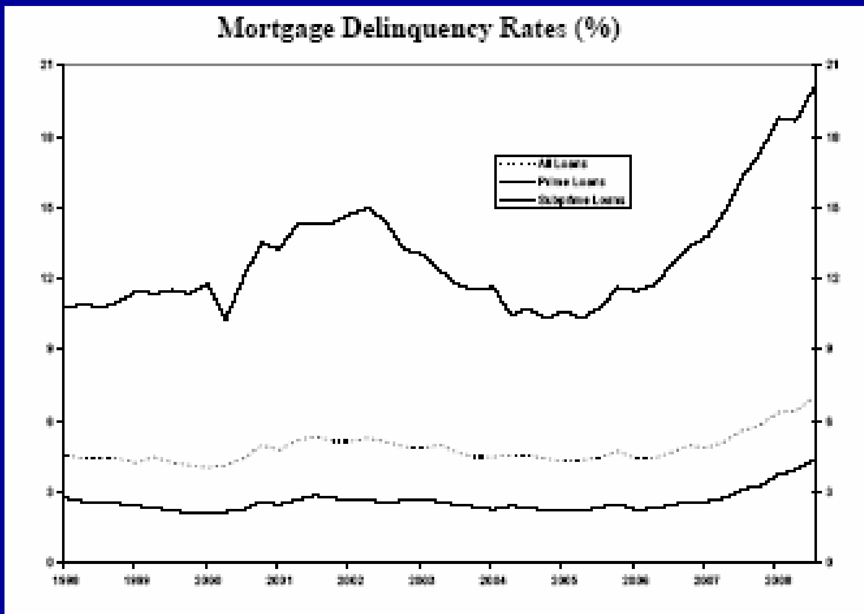


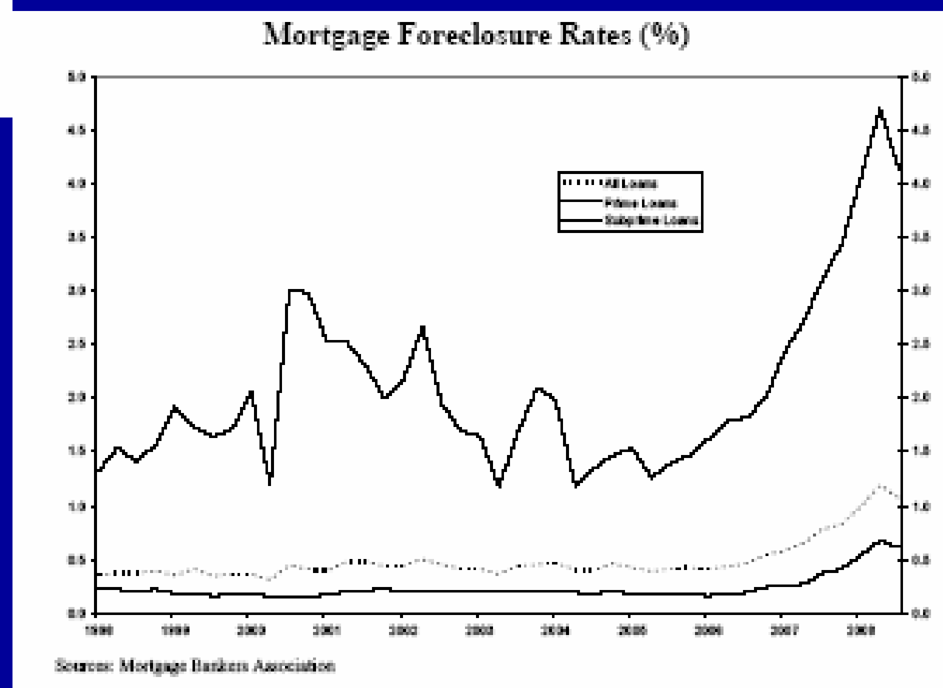
Housing Market – Default Rates



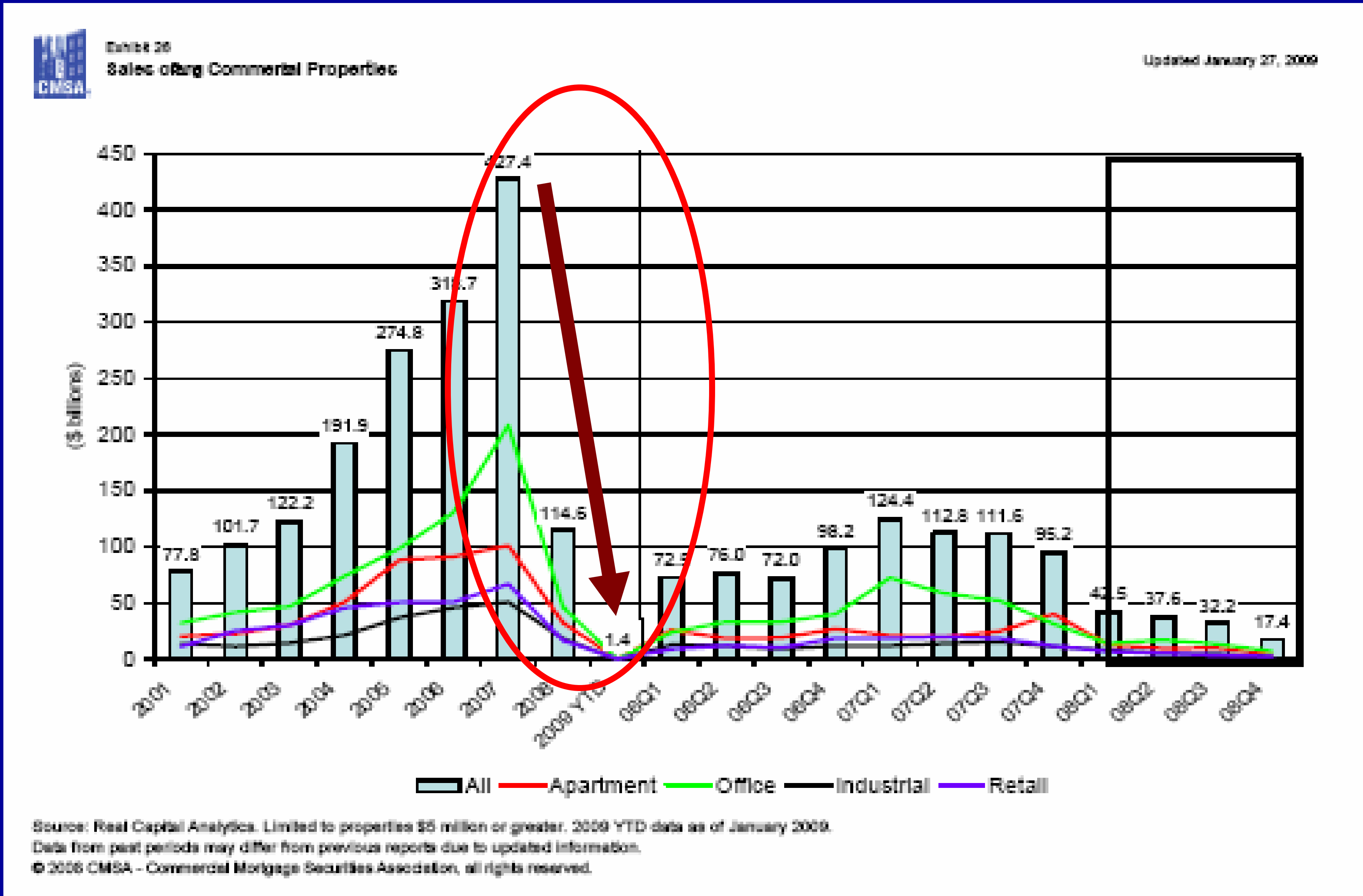


Housing Market – Delinquency/Foreclosure Rates





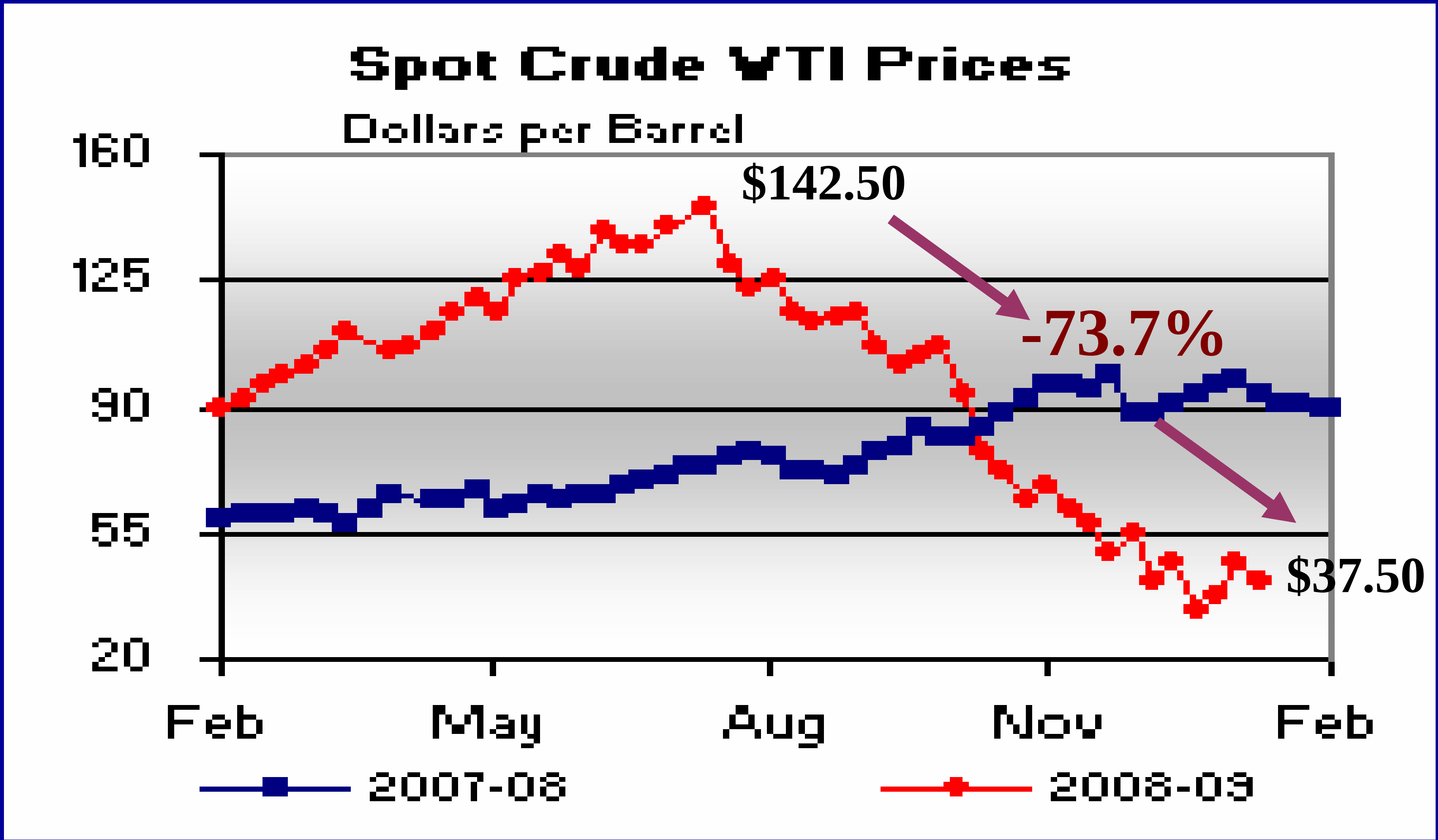
Commercial Property Sales



http://www.cmsaglobal.org/uploadedFiles/CMSA_Site_Home/Industry_Resources/Research/Industry_Statistics/CMSA_Compendium.pdf

Inflation

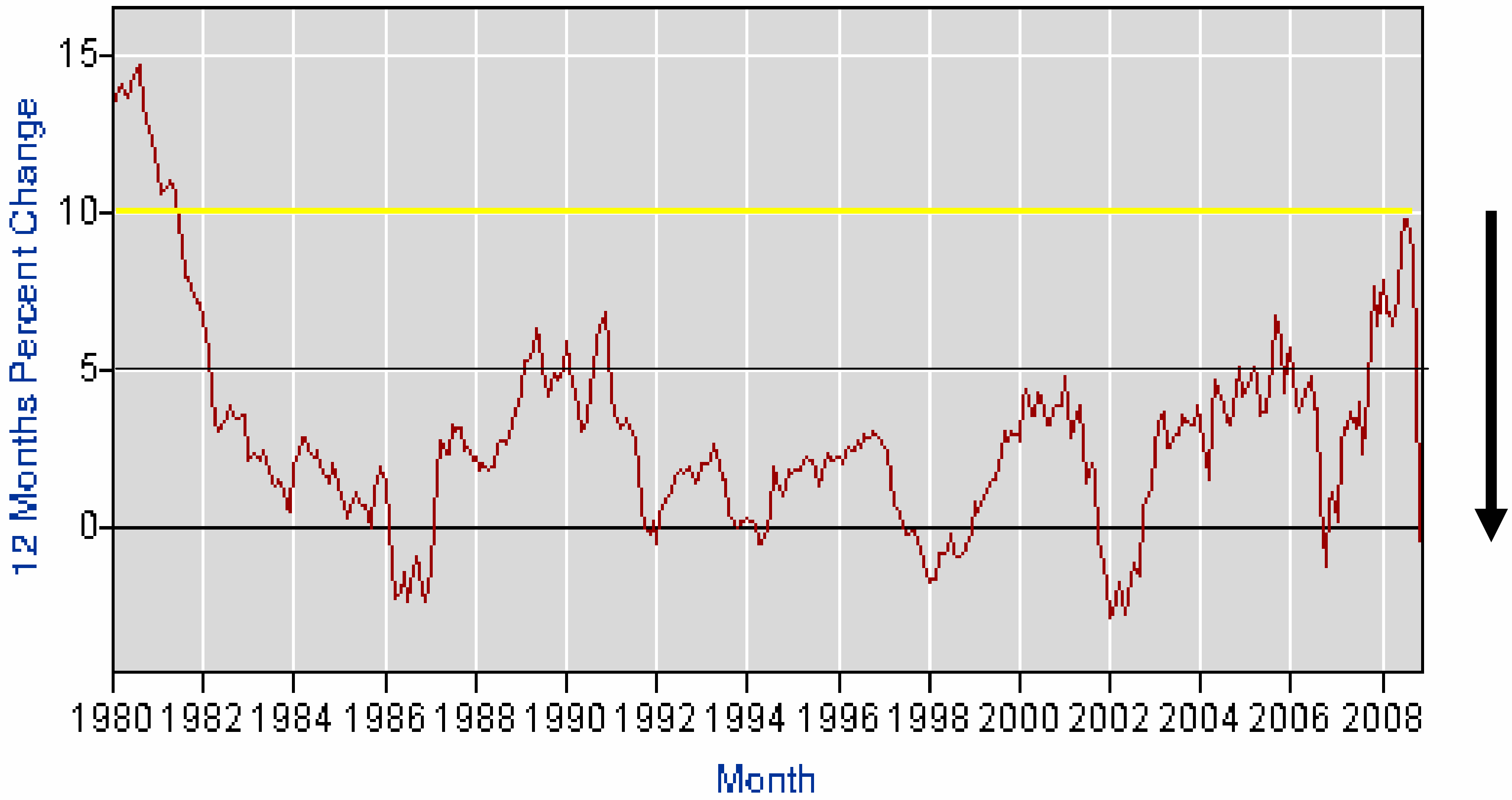
Inflation Expectations



Source: Energy Information Administration (http://eia.doe.gov/)

Inflation Expectations

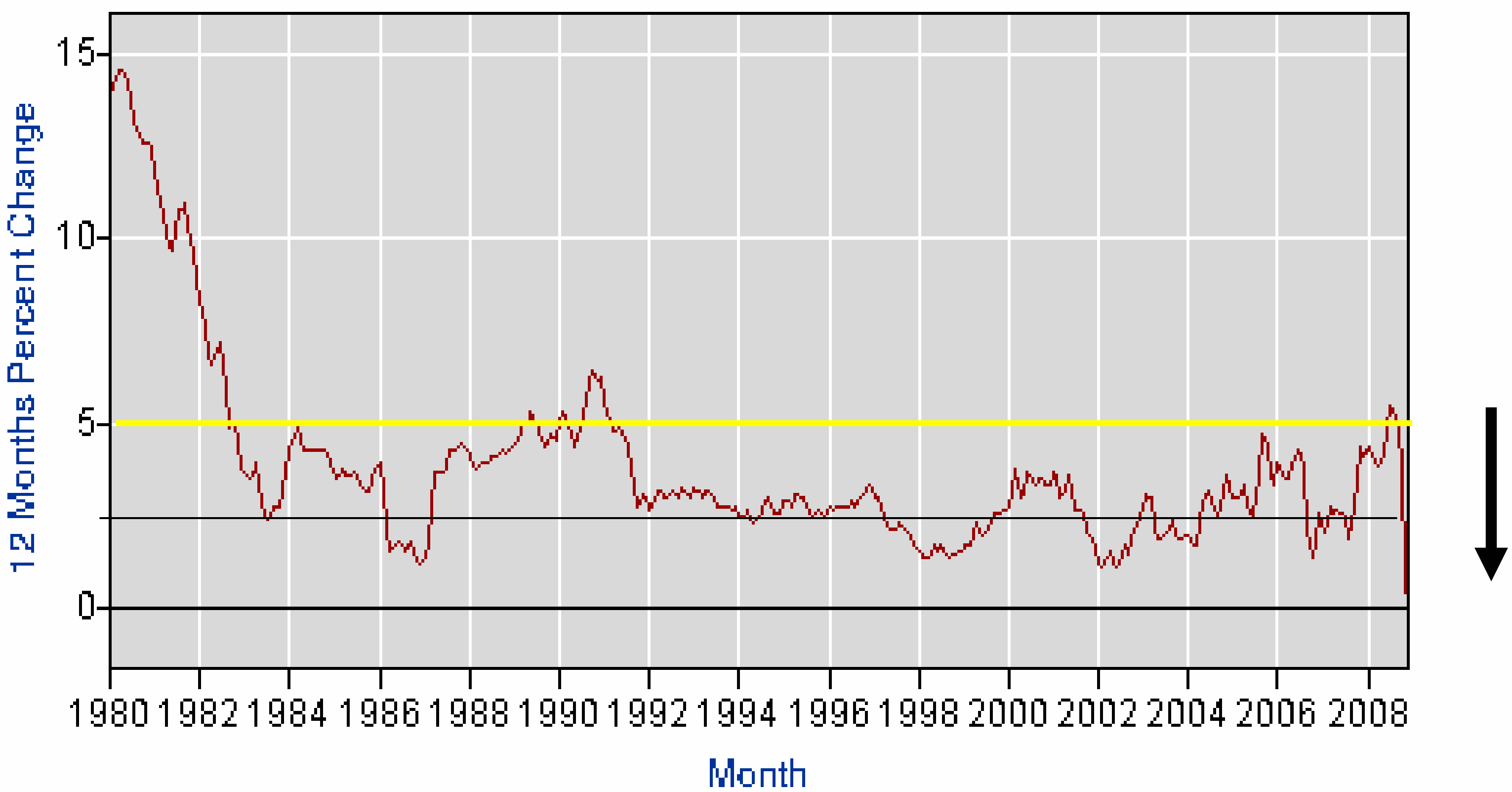
U.S. Producer Price Index (PPI) – Finished Goods



http://www.bls.gov/home.htm

Inflation Expectations

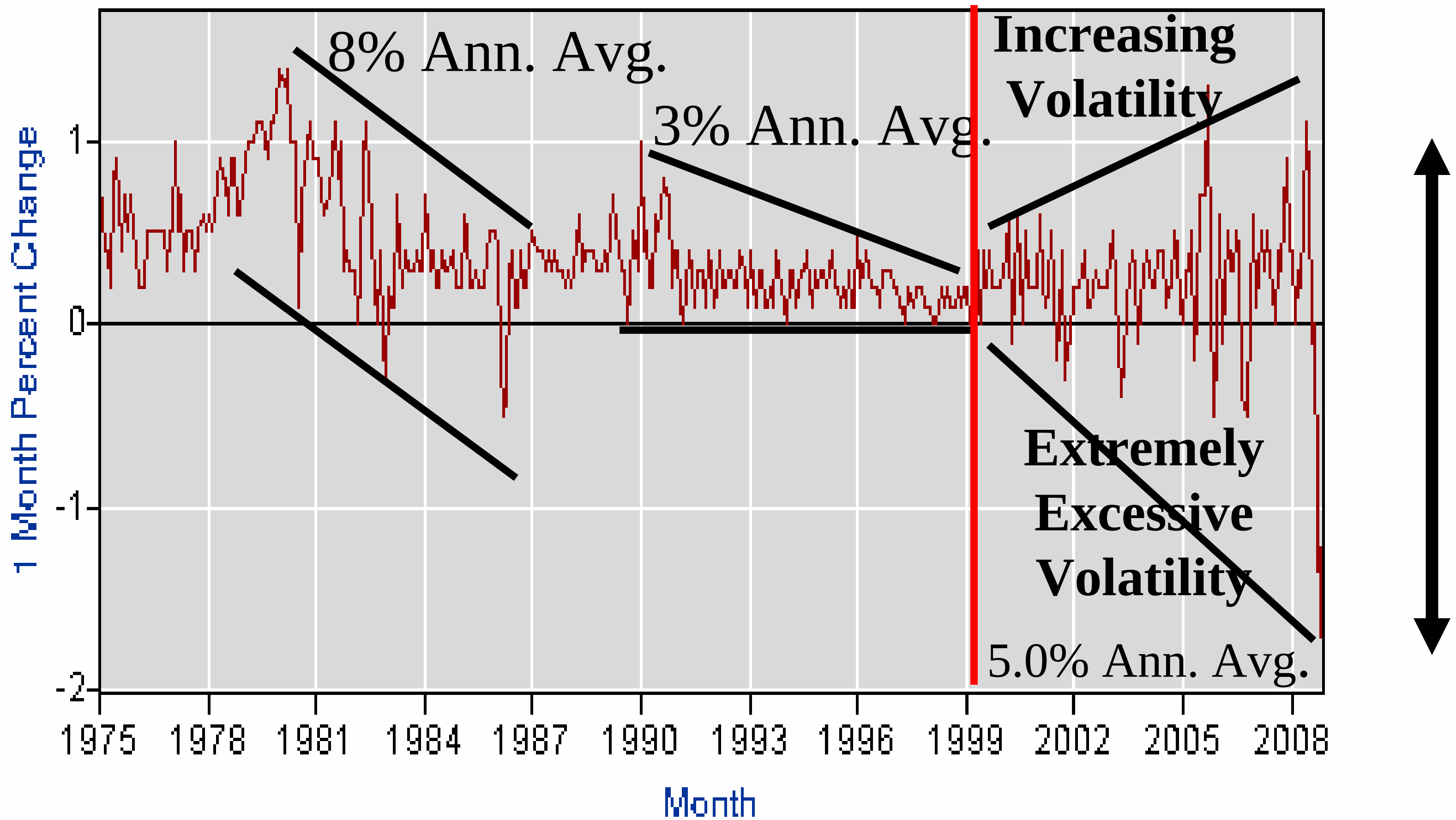
U.S. Consumer Price Index (CPI)



http://www.bls.gov/home.htm

Inflation Expectations - Volatility

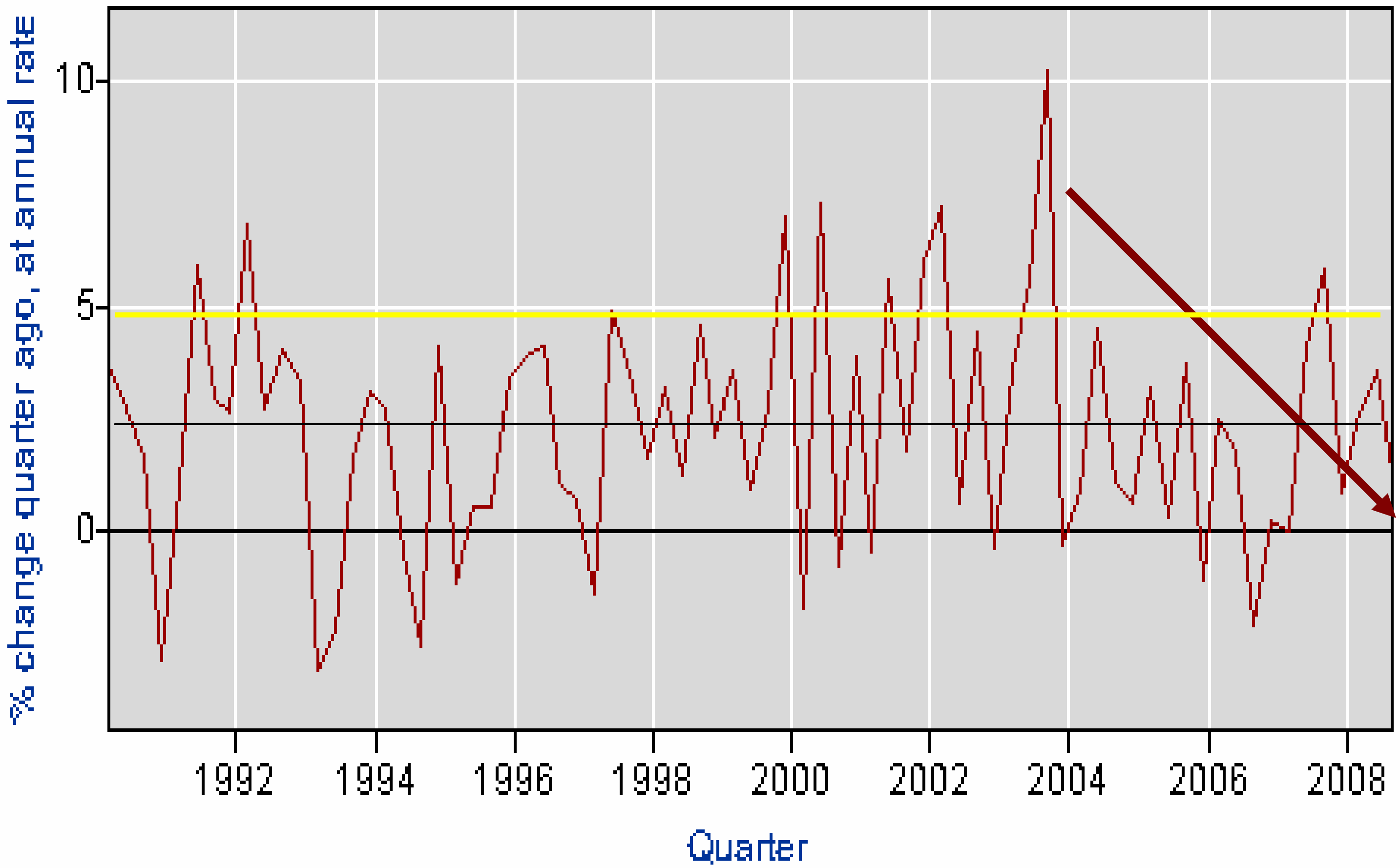
U.S. Consumer Price Index – All Items (U.S. City Average)



Source: Bureau of Labor Statistics.

http://www.bls.gov/home.htm

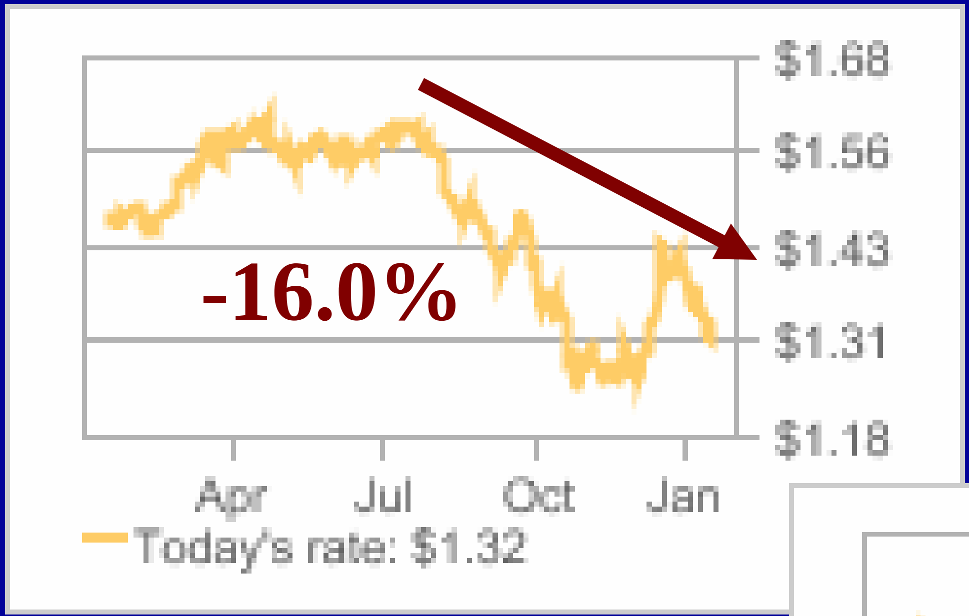
Non-Farm Productivity (Output Per Hour)

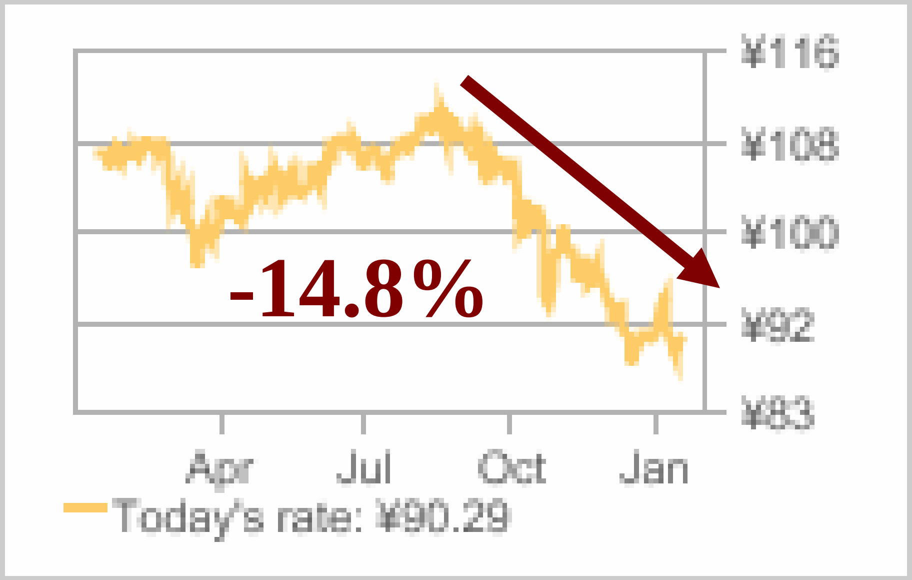


Source: Bureau of Labor Statistics.

http://www.bls.gov

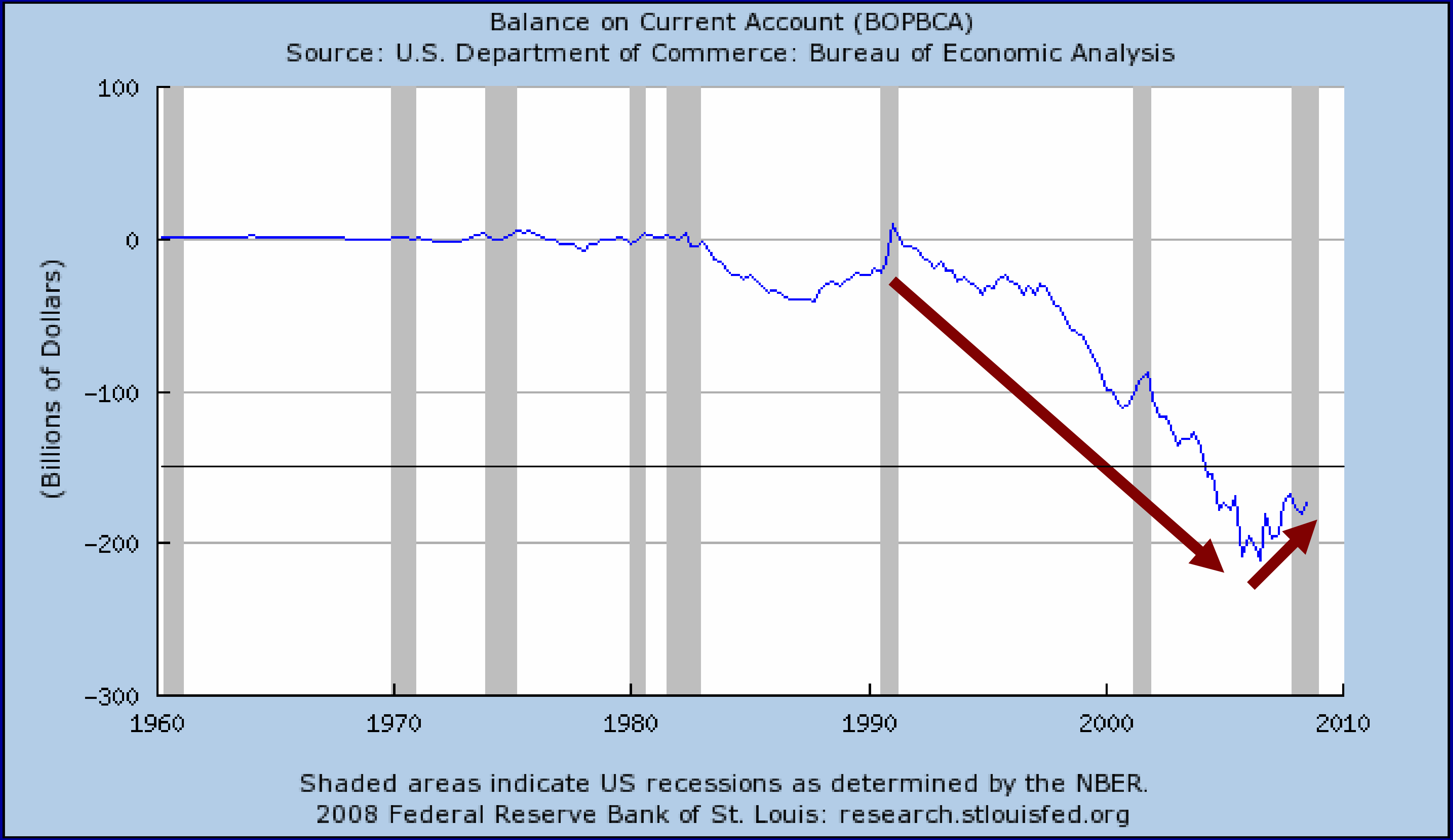
Euro/Yen Exchange Rates 2008-2009





Source: New York Federal Reserve Bank. http://www.ny.frb.org/markets/foreignex.html

Balance of Trade



Sources: U.S. Department of Commerce: Bureau of Economic Analysis
http://research.stlouisfed.org/fred2/series/BOPBCA/13

Conclusions

Geographic Comparative Advantages

Long run commercial market fundamentals:

- Low commercial market affordability (high costs)
- Scarcity of developable land (supply constraints)
- High concentrations of wealth/education
- High quality of life amenities
- Strong demographic trends:
  - Growing population of Empty-Nesters and Echo-Boomers, positive migration trends

Commercial Demand

Future job growth-housing demand:

- High-tech and Bio-tech Manufacturing
- Alternative and Clean Energy Technologies
- Healthcare-Information Systems Services
- Financial Services and Venture Capital
- Telecommunications/Networking
- Multimedia and Entertainment
- Internet and Software Programming
- International Trade and Tourism
- Construction and Engineering Services
- Education and Government Services
- Defense

Economic Risks

Market-Economic Risks:

- High costs of living and doing business
- State-Local regulations, taxes, workers comp, deficits
- Lack of affordable/developable land and housing
- Traffic congestion and infrastructure constraints
- Out sourcing and migration
- Cut-backs in education and social services
- Mergers-consolidation industrial, technology, telecommunications and financial institutions

Macro-Economic Risks

- Middle East (Oil Price Spikes)
- Current Account and Budget Deficits (Interest Rates)
- Rising Inflation Expectations (Health Care/Food Costs)
- High-Rising Credit-Equity Risk Premiums (Spreads)
- Consumer-Business Confidence Investment
- Slow Global Growth and Protectionist Trade Policy
- Rising Loan (Credit) Defaults and (Mtg) Foreclosures
- Labor Strikes, Low Wage Growth, Underemployment
- Stock Option Back-Dating, Other Accounting Announcements Irregularities, Investor Confidence

Lawrence Souza (**lsouza@Johnson/SouzaGroup.com**) brings to Johnson Souza Group, Inc. (**Direct: (415-713-0213**) over 20 years of experience in real estate economic and financial research. As Managing Director-Index Services, Charles Schwab Investment Management (CSIM); Chief Real Estate Economist and Director of Index Services, Global Real Analytics (GRA); Director of Research for BRE Properties, Inc. (REIT) in San Francisco and holding Senior Market/Research Analyst positions at Metric Institutional Realty Advisors and Mellon-McMahan/MacFarlane Realty Advisors, and market research positions at Norris, Beggs and Simpson and Grubb & Ellis commercial brokerage. Mr. Souza combines traditional fundamental real estate economic and market research with fundamental and technical financial and capital market research. This combined approach allows for the tracking and forecasting of economic, real estate and financial cycles and efficient portfolio construction, optimization and risk management.

Mr. Souza is also a licensed California Real Estate Broker (Realtor), specializing in urban-infill residential, commercial property transactions, and 1031 Exchanges in the San Francisco Bay Area and Western Region.

Mr. Souza has undergraduate degrees in Economics (BA) and Business Administration (BS) with concentrations in Accounting, Finance, Banking and Real Estate; and holds master's degrees in Applied Economics (MA), Finance/Investments (MS), Public Administration (MPA), and Information Systems (MSIS). Mr. Souza has been teaching Modern Real Estate Principles and Finance since 1996 with an emphasis on real estate in a modern portfolio and capital markets context; and the institutionalization, securitization, internationalization and technologization of real estate markets and products.

Appendix

Institutional Deconstruction

- **Loss of Civil Liberties and Personal/Individual Rights**
- **Lack of Governmental Transparency and Accountability**
- **Dismantling of Social Welfare State and Safety Net**
- **Direct Input into Policy Development by Special Interests**
- **Redistribution and Concentration of Wealth (Privatization)**
- **Lack of Access to Democratic Institutions and Legal System**
- **Freedom of Speech and Press Limitations (Censorship)**
- **Unification of Church and State, attack on science**

"Institutional deconstruction is the dismantling of pluralistic and democratic institutions by powerful interests within society. The goal is to "deconstruct" these institutions, and replace them with new authoritarian institutions that enforce and redistribute private property rights to privileged interests, at any cost."

Jacques Derrida, Martin Heidegger, Friedreich Nietzsche, Et.Al.

Greenspan Critique: Labor vs. Capital

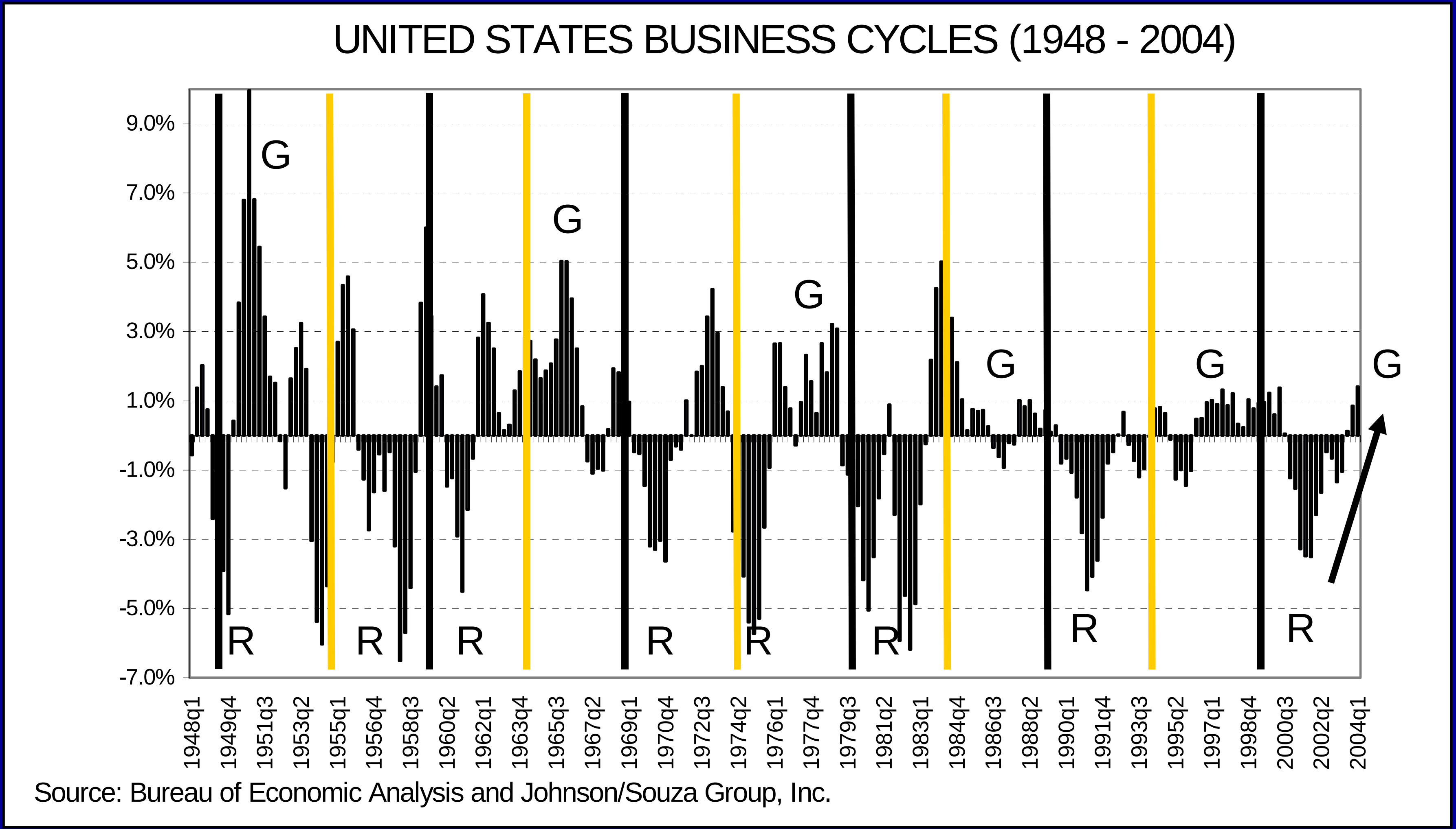
- Greenspan developed a New Business Cycle that privileges financial-capital markets over labor markets.
- Major shift to ***preemptive monetary policy strikes*** toward ***inflation targeting***, and away from ***full employment-real wage growth targeting*** (Paul Volcker -> Ben Bernanke).
- Foundation of monetary policy was deregulation, a financial boom in the stock and real estate markets and free trade, driving up consumer consumption and debt levels.
- **Results:** Cycle marked by deindustrialization, growing trade deficits, financial-asset market price bubbles, dollar overvaluation, L-T decline real wage growth, growing household debt levels, under investment by business in capital stock
- **Risks:** Fragile economy-recovery, high debt levels, under performing labor markets, exposure to financial market corrections, moral hazard – Fed intervention to rescue markets

Thomas Palley, Challenge, Nov.-Dec. 2005.

US Budget Deficits

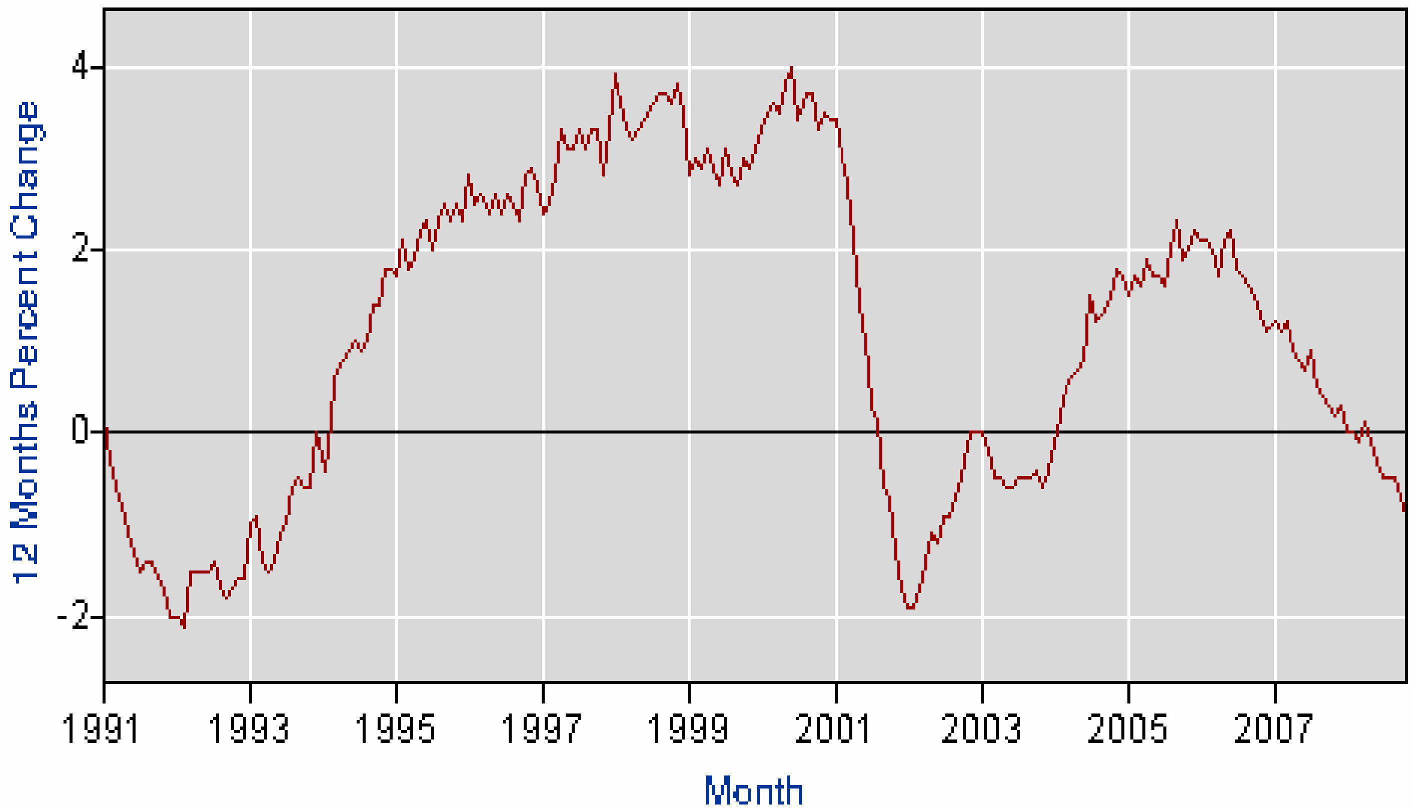
- **$11 trillion public debt outstanding, $55 billion in interest; Total Debt-to-GDP to reach ~100% by 2015.**
  - $1.2 trillion annual budget deficit, not including $600 billion for Iraq War 2004 – 2009; defense budget up 41% since 2001
  - Administration to cut deficit in half by 2009, over optimistic assumptions for rising tax revenue, excluding cost of Iraq/Afghanistan wars ($100 + billion in 2008)
  - After 2005, will have to pay $1.5 trillion for permanent tax cuts and $700 billion for Medicare prescription drug program
  - Budget deficits to total $10 trillion over next 10 years
  - Foreigners currently own 47% of U.S. government debt (China/Japan)

United States Business Cycles



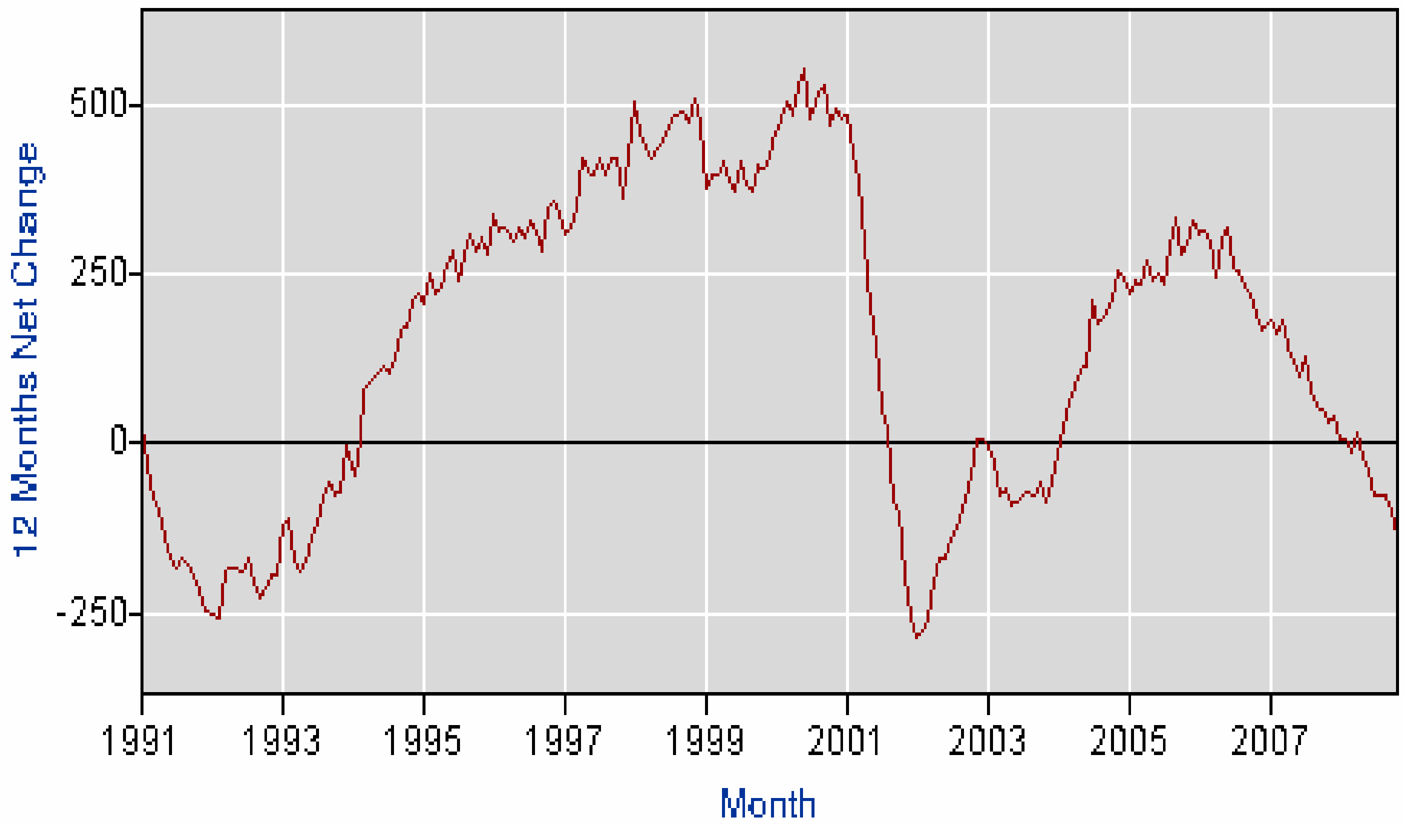
http://www.bea.doc.gov/bea/dn/home/gdp.htm

California
Employment Growth (% YOY)



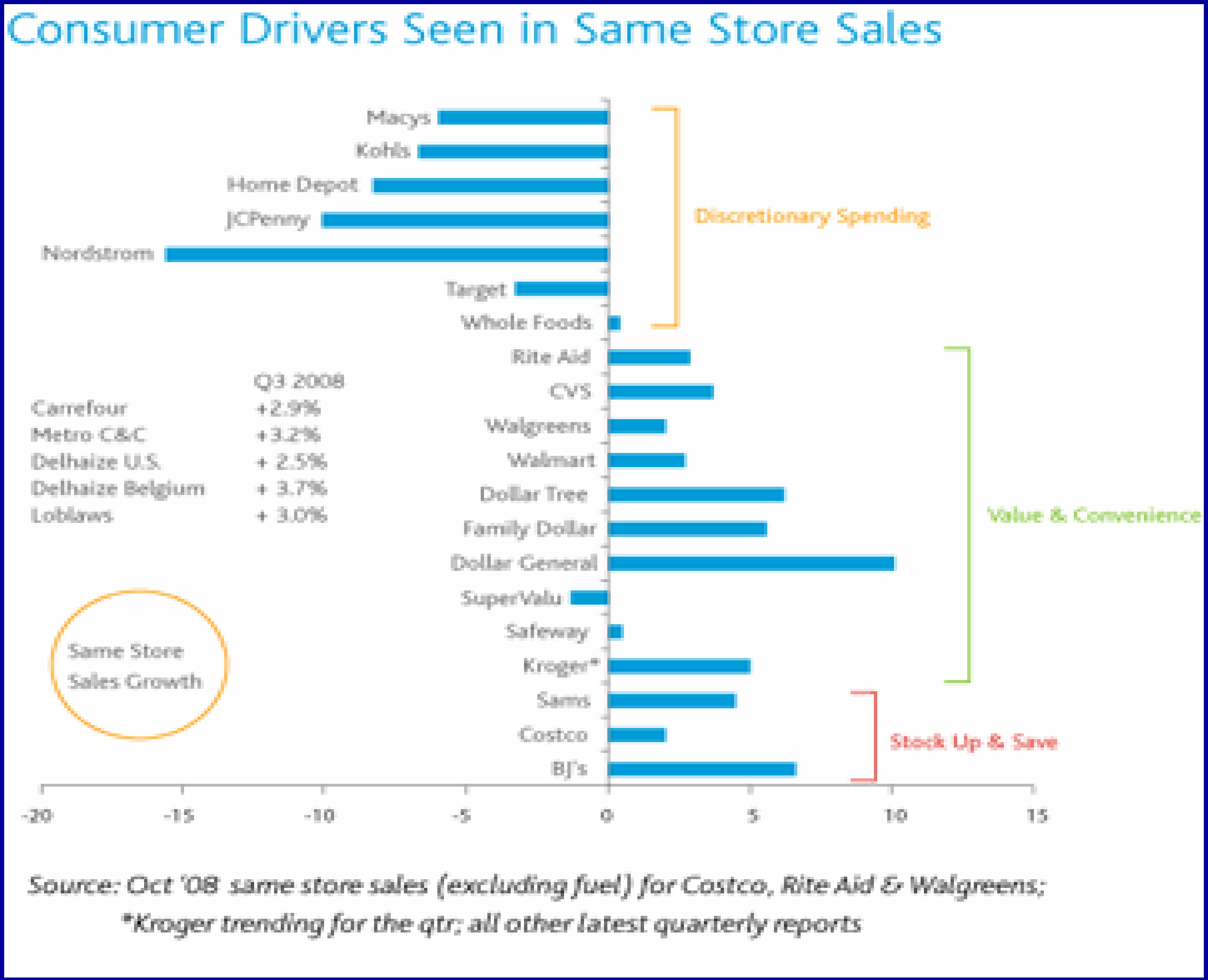
Source: Bureau of Labor Statistics.

California
Employment Growth (#YOY)



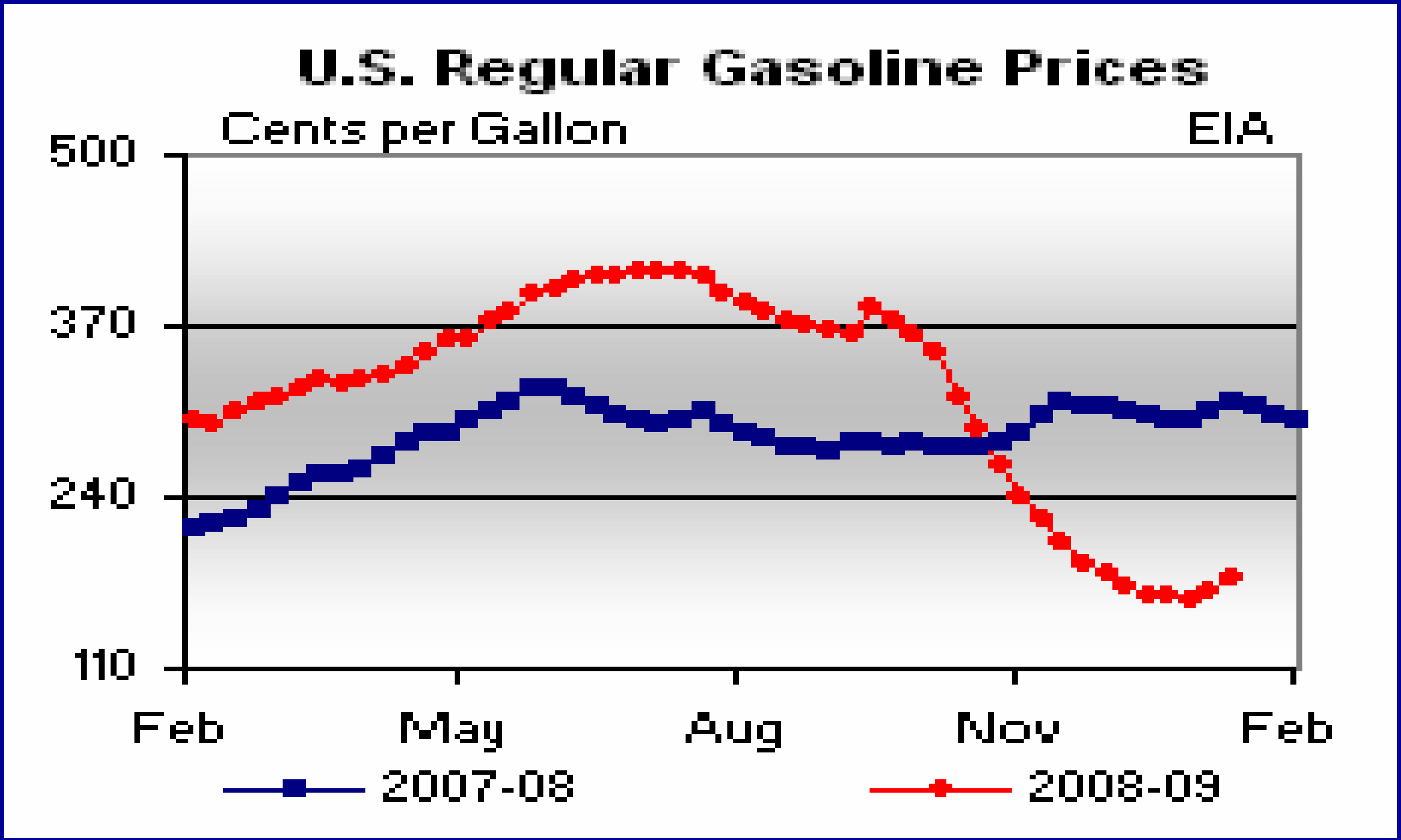
Source: Bureau of Labor Statistics.

Retail Sales



http://www.cre.org/publications/33_2.pdf

Inflation Expectations
Gas Prices



Source: U.S. Department of Energy, Energy Information Administration, Weekly Retail Gasoline Prices, available at http://eia.doe.gov/, as of November 16, 2005. http://www.bts.gov/publications/white_house_economic_statistics_briefing_room/october_2005/html/highway_retail_gasoline_prices.html