2014 Central Coast Economic Forecast

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BEACON ECONOMICS

2014 Central Coast Economic Forecast

Presented by Beacon Economics

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by Christopher Thornberg

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Zero To Hero

In 2008 the U.S. economy sunk into the deepest downturn since the Great Depression. By the end of that year most of the globe had followed the United States into recession and in 2009 global output shrank by over 2%, the first time that has happened since World War II ended. The United States was not the only country with a large housing bubble, nor were U.S. banks the only to indulge in over-leveraging even as they invested in highly risky assets. Nevertheless, it was clear that the United States was at the heart of the problem.

Today, the global economy is weak again. Europe has yet to fully pull out of the recession, led by sovereign debt crisis, that it experienced last year. The BRICS (an acronym for an association of five major emerging national economies: Brazil, Russia, India, China, and South Africa) are also showing signs of trouble. China, while still growing, has slowed and its real estate markets are showing signs of distress. Brazil has slipped into a mild recession due to sagging commodity prices. Sanctions on Russia are clearly having an impact on that nation and India has also slowed sharply. The World Bank and the IMF have both had to scale back their growth outlook numerous times in the last few months.

But this time the United States is no longer at the core of the problem; quite the opposite, the U.S. economy will be an important source of strength globally as these nations work to reverse course and get back onto a growth trajectory. Nearly every part of the U.S. economy is showing real signs of slow but steady improvement, from housing to public spending to credit. The only portion of the economy that is acting as a drain on the nation is the export sector—for all the aforementioned global reasons. That said, the U.S. economy will keep growing this year, but at slightly below 3%, a bit slower than last year. Next year, expect the U.S. economy to grow at a pace modestly over 3%, with the following year improving even more—the growing momentum will be driven by improving fundamentals.

As for major risks, they remain largely external – although there is nothing on the international front that could seriously derail the nation's economy. The global economy remains the swing item. If there is a better recovery than expected, then next year will be better than Beacon Economics' current forecast. If it is significantly worse, then growth will likely dip into the low 2% range. Regardless, the U.S. economy will continue to expand for the foreseeable future.

Curb Your Enthusiasm

The U.S. economy's 4.6% growth rate in the second quarter of 2014 came as a relief to many policymakers after the -2% hit taken during the first quarter of the year. Data from the third quarter have simply confirmed Beacon Economics' interpretation of the first quarter as a blip. Beacon's monthly GDP estimate suggests that growth in the third quarter will come in at 3.6%. Combine this with better labor market numbers—on average 220,000 jobs were added per month over the last year and the official unemployment rate has dropped to below 6% for the first time since 2007—and suddenly the economy looks like a talking point for the Democrats rather the Republicans. Although this does not seem to be having any impact on the outlook for the midterm elections.

Still, while there is little doubt the mid-year numbers look good, these big numbers are really just a bounce from the weak first quarter – a quarter that was largely an artifact of the extreme weather experienced in many parts of the nation and of a big run off in inventories (likely also related to weather). The second and third quarters were largely mirror images of the first, as growing inventories and a bounce in consumer spending made up for ground lost earlier in the year. Average the three quarters out and growth is running at about 2%.

One small part of the slowing is in the estimates of consumer health care expenditures. This seems odd, given that other numbers on consumer spending, including retail sales, auto sales, and other more easily measured forms of spending, are rising. Additionally, by all accounts, approximately 7 to 8 million more Americans have health insurance today compared to one or two years ago. If anything, health care expenditures would be expected to increase. And healthcare employment continues to grow at a steady 2% annual pace. Add it up and it seems this is more likely a glitch in the U.S. Bureau of Economic Analysis' (BEA) estimates rather than a real phenomena.

The real reason for the deceleration is the nation's external accounts, with a sudden widening of the trade deficit. Beacon Economics' initial outlook for GDP growth in the 3% range in 2014 was based largely on the assumption that the trade deficit would continue to close. But this didn't happen. Instead, a weak global economy slowed export growth sharply, even as stronger demand in the United States caused import growth to accelerate.

Contributions to Real GDP Growth

Component	Q1-14	Q2-14	Q3-14	Avg. Diff.
Real GDP	-2.1	4.60	3.60	−1.09
Consumption	0.83	1.75	1.50	−0.54
Durable goods	0.23	0.99	0.79	0.24
Nondurable goods	0.00	0.34	0.26	−0.19
Services	0.60	0.42	0.46	−0.59
Private Domestic Inv.	-1.13	2.87	1.21	−0.33
Structures	0.08	0.35	0.17	0.08
Equipment	-0.06	0.63	0.51	0.01
IP products	0.18	0.21	0.26	0.11
Residential	-0.17	0.27	0.27	−0.08
Change in Inventories	-1.16	1.42	0.00	−0.45
Net Exports	-1.66	-0.34	0.78	−0.67
Exports	-1.30	1.43	0.89	−0.33
Imports	-0.36	-1.77	-0.11	−0.34
Government	-0.15	0.31	0.13	0.44
Federal	-0.01	-0.06	0.06	0.48
State/Local	-0.14	0.38	0.07	−0.03

Source: U.S. Bureau of Economic Analysis

Right now the United States still doesn't have the 'umph' to close the output gap that opened during the course of the downturn. And while the labor markets are modestly stronger, the operative word is 'modest'. Participation rates are still under 63%, far below the 66% level prior to the recession. Wage growth remains tepid—even if other sorts of income are doing better. And none of this suggests that there will be a dramatic shift in Federal Reserve policy any time in the near future.

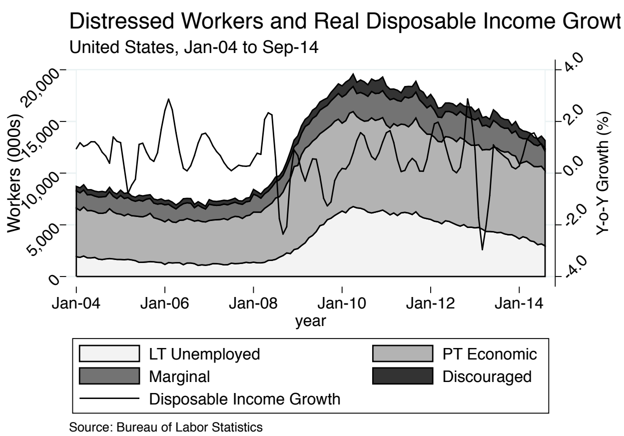
The Bounce In Our Step

The current trends do seem to be a frustrating repeat of the last few years—three steps ahead, two steps back. But in reality there are plenty of indications that the United States is shifting towards being in a higher growth regime, with many economic indicators picking up steam on many fronts. Indeed there is enough momentum in the nation's economy to push us past the problems in the broader global economy. Following is an overview of some of the brighter spots in the U.S. economy—consumer spending, construction and business investment—followed by a look at trade and public spending, two areas that are preventing even better growth rates.

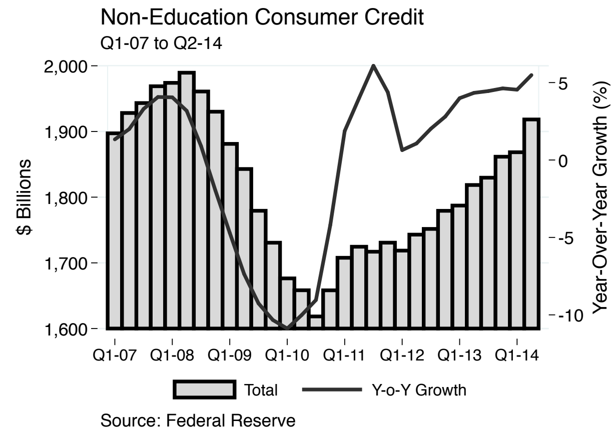
Consumer Spending

Consumer spending, outside of healthcare, has been growing at a steady pace since the start of 2014. Auto sales have hit a 17 million annual pace in recent months—the best showing since before the recession. Retail sales have been growing at a nominal 4.5% annualized pace in recent months. And there are plenty of indications that the pace of growth will at least be maintained over the next year.

The labor market is showing some of the strongest growth since the end of the recession, expanding at a pace of 200,000 plus jobs per month over the last year. Moreover, the nation's headline unemployment has dropped below 6%. And while there are still a higher than normal number of distressed workers (long term unemployed, discouraged, or under employed) the trend in unemployment is clearly on a downward trajectory. The labor markets may start to look 'normal' again within two years. Also encouraging, personal income growth has been expanding at a better pace. Real aggregate disposable personal income is growing at a 2.7% pace, after running flat for most of 2013.



Another bit of good news comes from consumer credit. Outside of student debt, consumer credit growth has been very subdued in recent years. But in 2014 things have started to shift. Consumers have become more comfortable with borrowing as their financial confidence and net worth has expanded, and the banking system has been more willing to add loans to their balance sheets. The pace of expansion is now over 6% per year. And with the savings rate remaining at a sufficient level, there is little sign of Americans over-extending themselves like they did in the middle of last decade.



Construction

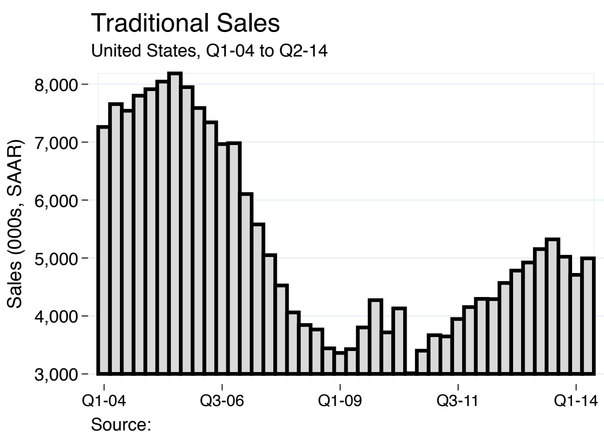
Construction is one of the big shortfalls in the U.S. economy (as noted in past years' reports). Prior to the downturn, close to 8% of U.S. GDP went to residential and nonresidential investments. Today, that figure is 6%, and with multiplier effects, explains close to half the output gap in the U.S. economy. Housing permits remain stuck at one million units, with disappointing sales of new homes constraining construction of new single-family structures. Existing home sales have also softened this year, leading some to predict another slump in the market. There are, however, other signals that housing is not in a slump—but rather at the front end of a solid expansion.

While sales of existing homes have slowed, this appears to be largely due to a decline in the number of foreclosures rather than a pull back in what might best be termed 'retail' demand—move-up owner-occupants shifting to new properties. Indeed, other indicators continue to suggest the market is not 'soft' by any traditional measure. Inventories of units for sale remain tight and prices are still rising, albeit at a slower rate than earlier in the year. Rather, the pull back by investors has not yet been made up for by better retail buyer demand.

But that increased retail demand looks to be on the horizon. The recent growth in home prices has added substantially to home equity—which is now close to

$14 trillion, up from $8 trillion at the bottom of the slump. Credit has also been a problem, but again, conditions are easing. Recent Fannie Mae data shows a decline in the average FICO score for new borrowers. Data from the Federal Reserve's Senior Loan Officer Survey indicates that banks are starting to ease credit conditions for prime mortgage loans. And data on outstanding mortgage debt held directly by the banking system is beginning to grow slowly for the first time in years. The coming increase in retail demand implies more need for new product—which should give new home construction a nice lift in 2015.

Beacon Economics expects the second half of 2014 to show distinct improvement in terms of sales and building permits over the first half. Preliminary statistics for the first two months of the third quarter appear to back this up—existing home sales have started to increase again, and new home sales have also jumped somewhat.

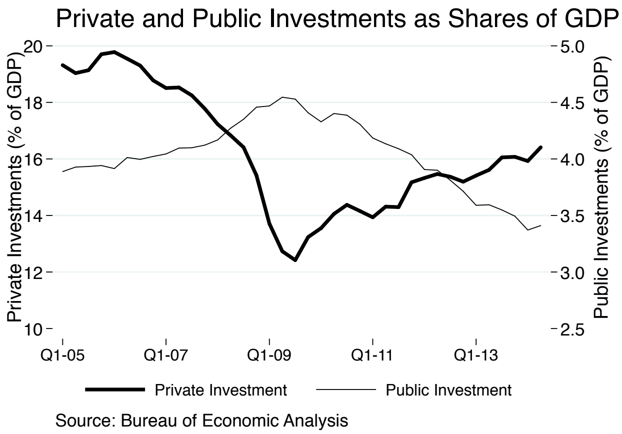


Non-residential spending has also started to ramp up in recent months. Much of the growth continues to be in 'alternative' projects such as private infrastructure and manufacturing. But traditional commercial projects—retail, office, hotel, and industrial space—are also starting to expand rapidly, despite the relatively high vacancy rate in these markets. Although overall vacancy rates are higher, there are pockets of high-demand and specialty type products that are in short supply. Demand in these areas has pushed rent prices towards pre-recession levels and the net result has been a new wave of construction—either of new structures or to repurpose existing ones into more high-demand products. With business activity continuing to grow, this trend will very likely continue for the next few years.

Business Investment

Corporate profits and proprietor incomes have bounced back faster than almost any other part of the economy since the recession came to an end. They are now 35% higher than before the downturn began. Low interest rates, benign wage growth, and a weak dollar have all contributed. Still, recent reports have suggested that businesses have not used the positive environment to expand real investment. Rather, the story goes, they are only interested in various financial maneuvers, from buying back stock to purchasing other firms to finding interesting ways to avoid paying taxes.

Actually the idea of declining investment by business isn't true—it is an illusion caused by the declining cost of various sorts of investment, particularly information technology. Real (price adjusted) investments in equipment or intellectual property as a share of U.S. GDP are currently at record high levels. And there is plenty of reason to believe the level of investment will continue to grow. In the short term, orders and shipments of durable capital goods have risen sharply and the third quarter will likely show solid growth driven by spending. Capacity utilization has continued to rise, a good leading indicator of more business investment for the near term. And the ISM indexes for manufacturing and non-manufacturing activity are also strongly in the black.



Ultimately, business spending is driven by health in other parts of the economy. As consumer spending expands along with construction, it will continue to bolster the need for business investment.

Still, although consumer spending, business investment, and construction are clearing heating up, other weaknesses in the economy will keep the United States from growing at an even faster pace.

Public Spending

Government plays two roles in our economy. The first is as the primary investor in many public infrastructure projects—from roads to schools to security. This part of public spending is down—way down. Public direct spending today is 13% of the economy, down from 15.5% in 2000. Public spending is another of the three imbalances in the current U.S. economy, and while things are looking better, the improvement has only been marginal. Although deficits have closed, demands from transfer programs (social security, public health care, subsidies, pensions, and other programs) have largely absorbed new revenues leaving direct spending constrained.

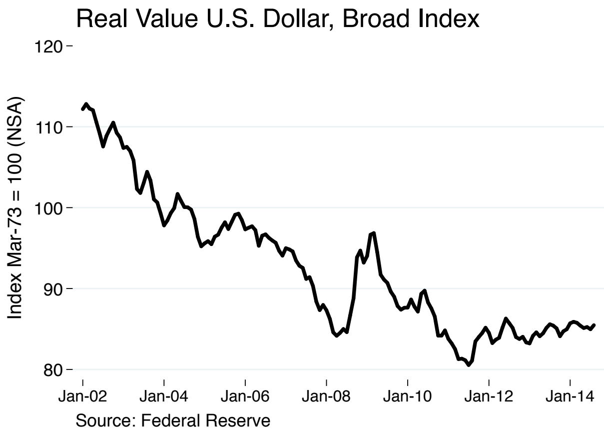
With faster growth in the economy and the end of various fiscal stimulus programs, the budget deficit at the Federal level has closed sharply. It is currently 60% less than it was at its peak back in 2010. As a result, the issue has completely fallen out of political debates leading up to the midterm elections. This is almost amazing considering that partisan debates over the issue were so vitriolic in the past few years they spooked the financial markets on more than one occasion and directly led to the downgrading of Federal debt by two rating agencies. But despite the smaller deficit, the outlook for spending remains constrained. There is little desire in Congress to increase spending, particularly given that the budget will be hit again by expanding military operations in the Middle East.

State and local governments continue to struggle to increase their spending as pension problems and debt left over from the recession limit their ability to invest in their communities. There have been some gains. In California, the passage of Proposition 30, which raises income and sales taxes, has created a modest budget surplus. But losses in funding from the Federal government, driven by austerity policies, are in part offsetting those modest gains.

Still, non-Federal spending added one-third of 1% to growth in the second quarter—the best number since before the recession. And both state and local governments are adding jobs again although overall levels of employment remain far below where they were in 2007. If nothing else, state and local governments may no longer be the same drag they have been over the last few years.

Trade

The trade gap has come a long way from the peak it hit in 2006, but is still too large to be sustainable in the long run. And with the U.S. dollar well below where it was in 2001—save for the weakness in global growth—there is no reason that demand for U.S. products shouldn't be growing faster than demand for imports except for the weakness in the global economy.

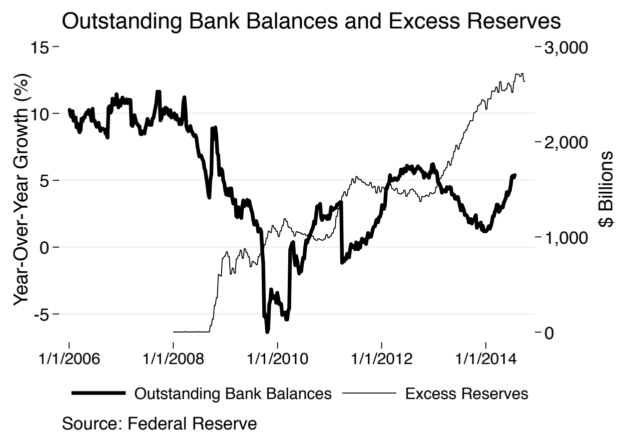


While the global economy will hopefully start to stabilize, the asymmetric nature of the recovery is leading to another short-term problem. Better U.S. numbers suggest the Federal Reserve will start backtracking on interest rate policies faster than other central banks across the globe. This speculation has put some upward pressure on the U.S. dollar. It is now 5% higher than last year. This will put some dampening pressure on exports. Still, the good news is that ongoing growth in U.S. energy production should continue to reduce demand for imported energy products.

On Policy and Prices...

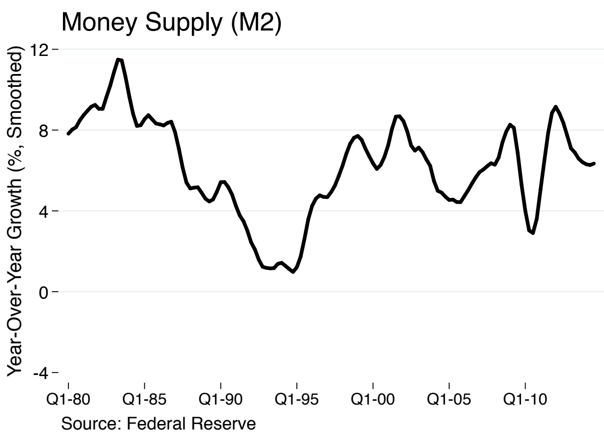
And what of the market's fear of changes in Federal Reserve policy? What about inflation? Beacon Economics sees little that will change the current path of policy or price growth. The first half of 2014 looks weaker than 2013, and that suggests a more, rather than less, dovish Fed for the balance of the year. Quantitative easing is largely finished, but the Fed will be happy to sit on their current balance sheet for a while. The only major lever to pull will be the inevitable increase in the Fed Fund rate—something that is likely to happen late this year or in early 2015—but in a gradual manner. Beacon Economics sees the Fed's rate up to possibly 2% by the end of 2015. Long-term rates will respond, but only modestly.

Beacon Economics is relatively benign on rates even though Fed recession policies are ending because the impact of these policies on interest rates has likely been overestimated by quite a bit—and anticipation of the negative effect of their withdrawal is largely overblown. The vast majority, 86% to be exact, of money placed 'into' the economy through Quantitative Easing 1, 2, and 3 still sits in the vaults of banks as excess reserves—and is not 'in' the economy in any real way. Consequently, this is not having any substantial impact on interest rates or inflation. And growth rates in lending aren't high enough to threaten the situation anytime soon.



The only major issues with the potential to upset the apple cart are a bout of inflation or the Fed trying to head off a perceived bubble in the market. Recent reports show inflation to be slightly faster than earlier in the year, yet still only about 2% year-over-year, a fairly modest pace. Some commentators have been fretting that wage growth in a tighter labor market will push up inflation. The evidence for such 'wage-led inflation' is, at best, thin in the literature and data. Why this is considered to be a major concern is not clear. In any case, real per capita disposable incomes are only growing at 1.5% year over, and unlike corporate profits, have yet to see any substantial recovery.

Realistically, there simply isn't enough excess cash in the system to create a sustained surge. Money growth remains at a modest level because of all the cash sitting in excess reserves. And the Federal Reserve can see the situation forming long before it becomes a problem. Beacon Economics doesn't see inflation as a problem.



The only real fear is that the Federal Reserve start pushing rates up sharply in response to a perceived financial bubble—the way it did between 2004 and 2006—with little impact on the bubble it should be noted. Beacon Economics doesn't believe the markets are too high at this point, so it is too early to make such a forecast. But, one bit of irony is that Wall Street's own irrational fear of the Federal Reserve may well be the thing that prevents the Fed from having to act.

U.S. Historical Table

United States	Q1-2012	Q2-2012	Q3-2012	Q4-2012	Q1-2013	Q2-2013	Q3-2013	Q4-2013	Q1-2014	Q2-2014
National Real GDP ($ Bill.,SAAR)	15,293.40	15,356.40	15,449.50	15,449.10	15,555.30	15,626.30	15,801.40	15,936.60	15,853.80	16,036.50
Growth (%,SAAR)	2.30	1.60	2.50	0.10	2.70	1.80	4.50	3.50	-2.10	4.60
Real Personal Consumption ($ Bill.,SAAR)	10,387.60	10,420.20	10,470.40	10,520.60	10,613.70	10,660.40	10,713.30	10,811.40	10,844.30	10,912.60
Real Investment ($ Bill.,SAAR)	2,413.70	2,448.00	2,457.70	2,424.30	2,469.00	2,510.70	2,610.30	2,634.70	2,588.20	2,703.70
Real Government Expend. ($ Bill.,SAAR)	2,957.80	2,954.90	2,974.40	2,928.70	2,899.80	2,901.20	2,902.40	2,874.50	2,868.50	2,880.60
Real Net Exports ($ Bill.,SAAR)	-465.70	-466.70	-453.00	-424.50	-427.20	-446.00	-424.60	-384.00	-447.20	-460.40
Total Nonfarm Empl. (Mill, SA)	133.42	133.86	134.26	134.85	135.49	136.08	136.62	137.25	137.75	138.51
Growth (%,SAAR)	2.36	1.31	1.23	1.77	1.91	1.75	1.59	1.84	1.49	2.21
Unemployment Rate (%,SA)	8.23	8.20	8.03	7.83	7.70	7.50	7.23	6.97	6.67	6.23
Personal Income ($ Trill.)	13.65	13.78	13.83	14.30	13.98	14.13	14.25	14.31	14.48	14.71
Growth (%,SAAR)	9.46	3.73	1.54	14.18	-8.60	4.48	3.33	1.82	4.92	6.30
Savings Rate (%)	6.01	6.26	5.79	7.70	4.15	4.58	4.58	3.86	4.32	4.73
Tax Rate (%)	10.73	10.74	10.88	10.95	11.71	11.75	11.66	11.80	11.82	11.71

U.S. Forecast Table

United States	Q3-2014	Q4-2014	Q1-2015	Q2-2015	Q3-2015	Q4-2015	Q1-2016	Q2-2016	Q3-2016	Q4-2016
National Real GDP ($ Bill.,SAAR)	16,178.92	16,311.41	16,446.93	16,577.58	16,703.77	16,838.15	16,982.23	17,132.82	17,275.92	17,423.18
Growth (%,SAAR)	3.60	3.32	3.37	3.22	3.08	3.26	3.47	3.59	3.38	3.45
Real Personal Consumption ($ Bill.,SAAR)	10,995.38	11,022.66	11,104.48	11,200.16	11,270.82	11,340.62	11,445.88	11,557.55	11,652.95	11,758.89
Real Investment ($ Bill.,SAAR)	2,729.23	2,812.40	2,861.46	2,898.32	2,952.76	3,002.76	3,037.83	3,078.51	3,123.03	3,161.33
Real Government Expend. ($ Bill.,SAAR)	2,884.79	2,899.99	2,909.86	2,925.00	2,941.84	2,960.27	2,975.61	2,990.74	3,001.82	3,010.73
Real Net Exports ($ Bill.,SAAR)	-429.50	-423.64	-428.86	-445.90	-461.65	-465.50	-477.09	-493.98	-501.87	-507.77
Total Nonfarm Empl. (Mill, SA)	139.21	139.90	140.70	141.58	142.51	143.46	144.46	145.48	146.51	147.53
Growth (%,SAAR)	2.04	2.00	2.30	2.53	2.64	2.70	2.81	2.87	2.85	2.83
Unemployment Rate (%,SA)	6.07	5.94	5.84	5.76	5.69	5.62	5.56	5.50	5.44	5.38
Personal Income ($ Trill.)	14.87	14.99	15.19	15.37	15.57	15.70	15.91	16.12	16.33	16.55
Growth (%,SAAR)	4.42	3.47	5.31	4.81	5.33	3.46	5.32	5.38	5.40	5.42
Savings Rate (%)	4.71	4.95	5.05	5.04	5.31	5.31	5.30	5.30	5.39	5.39
Tax Rate (%)	11.70	11.69	11.71	11.70	11.69	11.66	11.65	11.65	11.65	11.65

Forecasts by Beacon Economics

California Forecast

by Jordan G. Levine

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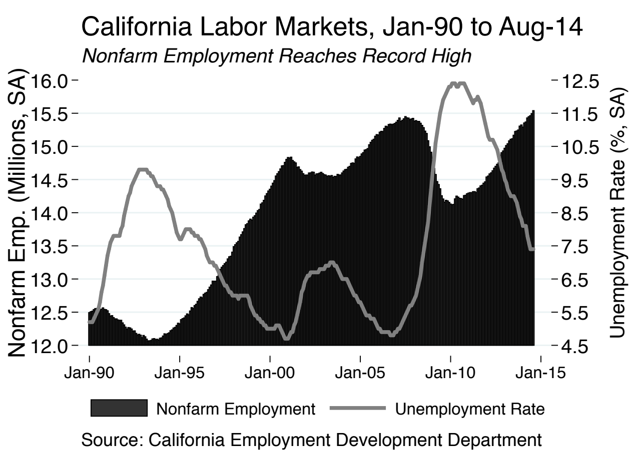
California Overview

With the Great Recession firmly in the rear-view mirror, and California's economy well into its recovery, it's a good time to assess both what is working in the state, and the greatest challenges that still lay ahead. The following forecast focuses on what's right in today's California, which areas need improvement, and where the state's economy is headed over the next five years.

What's Right Cyclically?

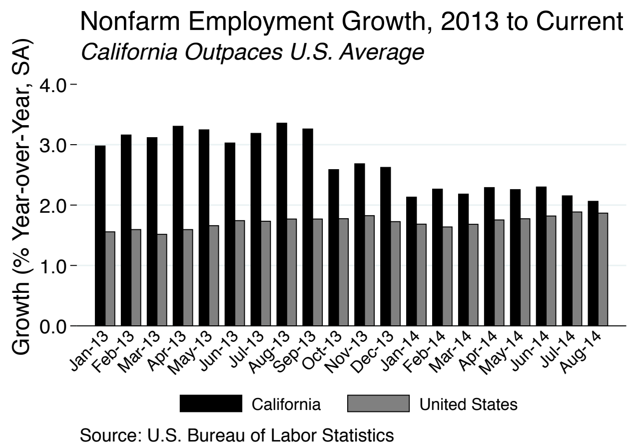
From a cyclical standpoint, many things are going well in California's economy.

Labor Markets: Employment in the state is growing consistently. In June 2014, California finally surpassed its pre-recession employment peak, recovering all of the 1.35 million jobs lost during the downturn and reaching the state's highest level of nonfarm jobs on record. Through August 2014, California added an additional 75,700 jobs and now has nearly 90,000 more jobs than it did at the height of the previous bubble.



Every major metropolitan area in California has experienced a return to job growth, although some regions continue to do better than others. Similarly, every job sector, with the exception of Government and Finance, has seen an uptick over the past four years, since the recession ended.

Moreover, as of August 2014, California had outpaced job growth in the nation overall for 30 consecutive months. In August, California dipped from the 9th fastest growing state in the nation (June 2014) to the 13th fastest. However, the number of jobs created was second only to Texas (314,000 vs. 395,000). In fact, one out of every eight jobs created nationwide over the last 12 months was created in California.



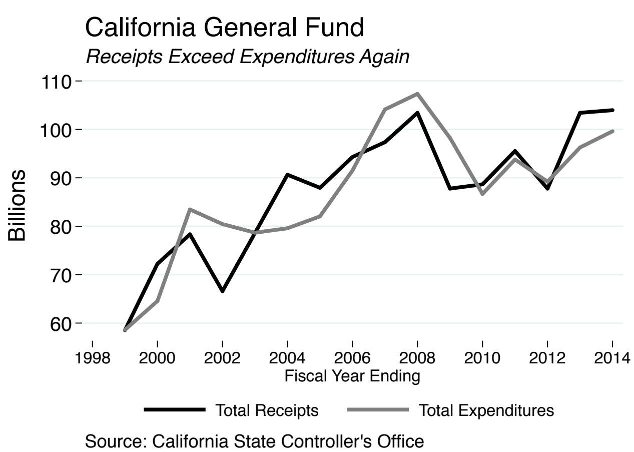
Broader Economic Conditions: Virtually every key economic indicator in California is moving in the right direction: GDP is expanding in real terms, incomes are rising in the aggregate, consumer and business spending is approaching its fifth year of consecutive growth, and the state's unemployment rate has fallen from a peak of 12.4%, to 7.4% (August 2014) despite the fact that the labor force has expanded since the end of the downturn.

California Economic Indicators

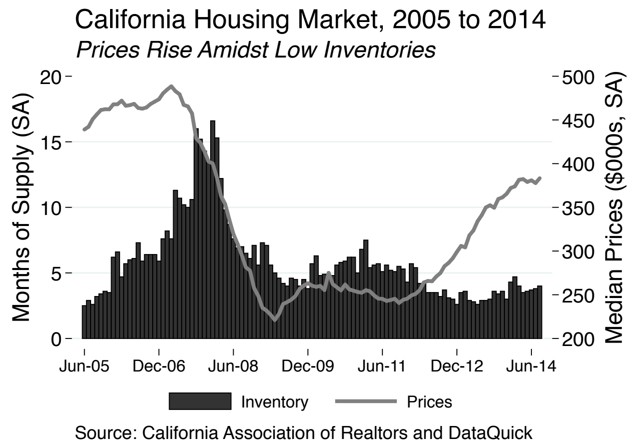
Indicator	2012	2013
Real GSP Growth (%)	2.7	2.0
Personal Income Growth (%)	5.0	2.8
Taxable Sales Growth (%)	7.3	6.8
Unemployment Rate (%)	10.4	8.9
Labor Force (Millions)	18.52	18.60

Source: Various

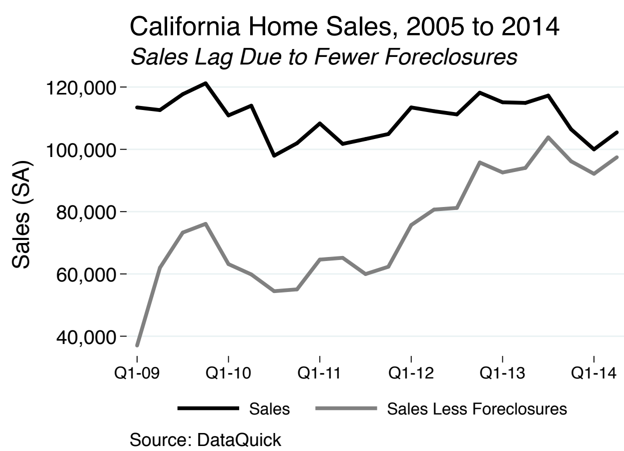
Fiscal Situation: California's budget continues to heal with Governor Jerry Brown earning some national praise for balancing the books.[1] Although the budget situation is more nuanced than the headlines suggest, revenues have improved tremendously. With the passage of Proposition 30, which raised income and sales taxes, General Fund receipts are up by more than 18% since hitting bottom in 2011-2012 when the previous temporary sales tax increase expired. And, for the past two years, receipts have actually outstripped expenditures, resulting in a $1.9 billion positive balance in the state's General Fund as of the end of fiscal year 2013-2014. This improvement is being felt at the local level as both sales taxes and property taxes rise across California.



Residential Real Estate: After precipitating many of the issues that drove the state and nation into recession in the first place, California's real estate markets are also on a robust growth path. The median price of an existing single-family home has been growing by double-digit percentages all across the state since June 2012. The growth is due in part to limited inventory, which the California Association of Realtors estimate was at just 4.0 months of supply in August 2014. The numbers of distressed units coming onto the market has also fallen as defaults and foreclosures have plummeted in the wake of the recovery.



Home sales in California have been lackluster and largely viewed as a disappointment by the markets and in the media. Sales have indeed been weak on the surface. However, the reason for the lackluster total sales figures is due to the reduction in new foreclosures across California. When foreclosures are omitted from the equation, California home sales have been on the uptick in 2014. Although the headline figures have disappointed some, they are the result of very positive trends.



Residential Permits: New construction activity continues to grow as builders are enticed by rising prices and limited inventories. Multi-family properties make up the majority of new residential units being built in the state, driven by demand, as the renter population has increased significantly since the foreclosure

[1] Thomas Del Beccaro, "Jerry Brown Stands Atop California's Collapsing House Of Cards", Forbes.com, July 8, 2014.

crisis. And unlike many other states, the vacancy rate for both ownership (1.2%) and rental properties (5.2%) is very low, which should continue to drive new construction permits for both single- and multi-family properties into the future.

California Residential Permitting

Indicator	Aug-13 YTD	Aug-14 YTD	Change (%)
California			
Multi-Family	27,179	26,730	-1.7
Single-Family	24,867	25,768	3.6
52,046	52,498	0.9	
United States			
Multi-Family	219,274	256,523	17.0
Single-Family	428,989	426,681	-0.5
Total	648,263	683,204	5.4

Source: U.S. Census Bureau

<u>Commercial Real Estate:</u> The commercial side of the real estate market was much slower out of the 're-covery' gate than were residential properties. However, California's nonresidential market is experiencing progress. Vacancies for office space in particular, while remaining high, have begun to decline. Industrial properties in California stand out as the healthiest part of the commercial market with vacancy rates now in the low single-digits in most major metropolitan areas.

<u>Nonresidential Permits:</u> Improvements in the commercial real estate market have spawned new commercial development projects. Through August 2014, nonresidential permit values were up 17.7%, with gains spread between the development of new office, hotel, and retail space, and alterations/additions to existing structures. The increased activity, coupled with improving residential market conditions, should help drive additional job growth in Construction over the next few years.

California Nonresidential Permitting

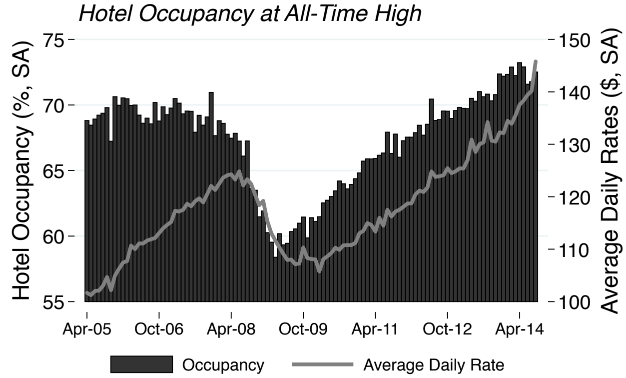
Indicator	Aug-14 YTD ($Mill.)	Change (%)
New Commercial	4,632	49.9
Office	1,183	48.4
Retail	1,835	29.2
Hotel	548	204.4
Industrial	522	-16.2
Other Nonres.	2,386	-18.4
Nonres. Alts./Adds.	7,940	21.9
Total Nonres.	15,479	17.7

Source: California Homebuilding Foundation

<u>Tourism:</u> External forces are also propelling California's economy ahead.

California Hotel Market, 2005 to 2014

Hotel Occupancy at All-Time High



Source: VisitCalifornia

Hotel occupancy in the state was up 1.7 percentage points in August 2014 from one year prior. That puts hotel occupancy at nearly 73% statewide—almost 8 percentage points higher than the national average. At the same time, average daily room rates have climbed by more than 8% over the past year to $145.80. And at California's airports, international passenger traffic was up more sharply than domestic passenger traffic indicating that the state remains a top tourist destination for foreign visitors.

What's Wrong Cyclically?

Although the cyclical effects of the recent recession continue to fade, that progress has not been spread evenly across the population base. Some Californians are doing much better in the current economic environment than others.

Workers Left Behind: California recently returned to its pre-recession peak employment level. However, the sectors that experienced the most growth during the recovery are not the same sectors that lost the most jobs during the recession, and many workers continue to face difficulty finding work. For example, the Healthcare, Professional/Scientific/Technical sector has at least 100,000 more jobs now than at the peak of the bubble.

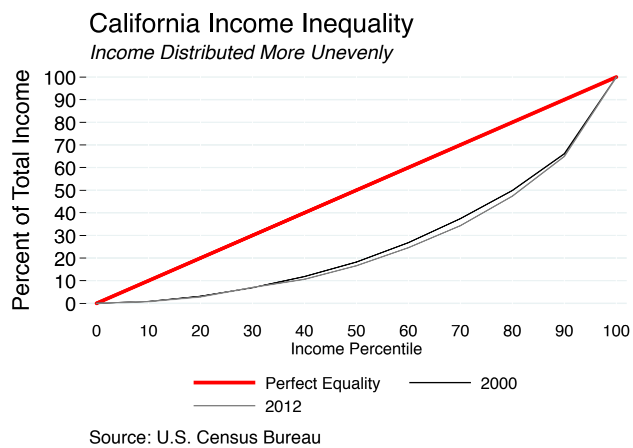
California Employment Levels

Industry	Jul-07 Peak	Aug-14 (Current)	Diff. (000s)
Education/Health	1,919.6	2,405.3	485.7
Leisure/Hospitality	1,562.6	1,721.7	159.1
Prof/Sci/Tech	1,062.9	1,190.6	127.7
Admin Support	999.7	1,025.9	26.2
Management	207.2	226.0	18.9
Other Services	514.2	524.6	10.4
NR/Mining	26.7	31.5	4.8
Logistics	511.7	512.1	0.4
Information	471.4	471.7	0.3
Wholesale Trade	717.3	709.0	-8.3
Real Estate	284.2	264.2	-20.0
Retail Trade	1,691.6	1,626.9	-64.7
Finance/Insurance	614.2	514.3	-99.9
Government	2,498.0	2,389.3	-108.7
Manufacturing	1,468.8	1,250.6	-218.2
Construction	899.4	676.4	-223.0
Total Private	12,951.8	13,150.3	198.5
Total Nonfarm	15,449.8	15,539.6	89.8

Source: California EDD

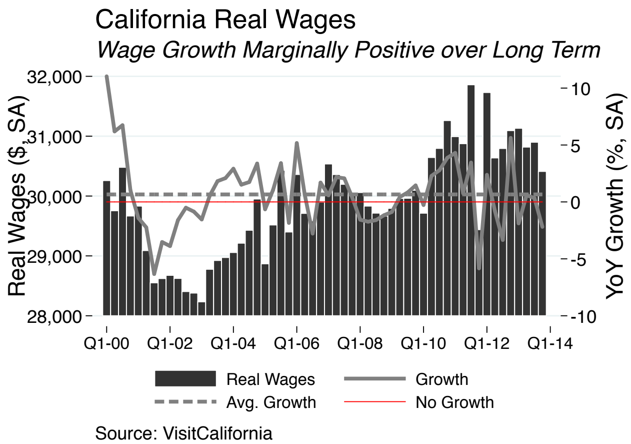
On the other hand, collectively, there are still 500,000 fewer jobs in the Retail, Construction, and Manufacturing sectors. Many former Retail and Construction workers are not in a position in terms of skill sets to tap into the faster growing and higher wage Professional job sector. As such, at least 25% of the state's unemployed workers have been unemployed for over six months—a point at which their skill levels and employability begin to erode.

Rising Inequality: Given the uneven growth across higher and lower wage job sectors, income inequality in California has increased in the wake of the recession.



In 2012, the top 20% of income earners in the state accounted for 52.6% of all income earned. In 2000, the top 20% of income earners accounted for just 50.1% of all income earned. Income has become increasingly concentrated and inequality has risen over the past decade as high-income earners have done better and middle-income earners have been more prone to migrate out of California in search of more affordable housing.

Lackluster Wage Growth: Although nominal wages have been rising over the past 15 years, so too has the cost of housing, goods, and services. Adjusting annual average wages into real terms with the Consumer Price Index for the western region, and wage growth has been lackluster at best.



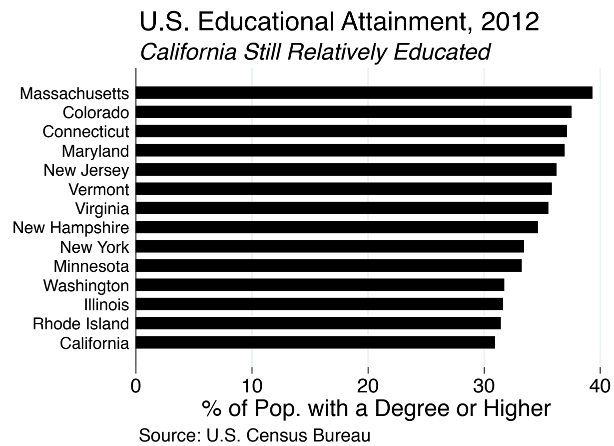
In fact, wage growth has only been slightly more positive on a year-over-year basis than it has been negative with growth dropping below zero in 23 of the past 56 quarters. On average, real wages in California have grown by 0.66% since 2000, and at the end of 2013, real wages are almost identical to what they were at the turn of the century, meaning that the quality of life for the average Californian has not improved much.

What's Right Structurally?

In addition to its more recent recovery from the recession, California's many structural assets and advantages will also help stimulate economic growth over the next five years.

Strategic Infrastructure: California is home to infrastructure that will help generate jobs and economic activity as the state moves ahead. When combined, the Ports of Los Angeles and Long Beach are the second largest exporting ports in the nation, behind only Houston. Add exports from Los Angeles International Airport and more goods are shipped through the Southern California economy than from any other port in the nation. While there have been concerns over the competitive threats associated with the expansion of the Panama Canal, those fears are largely overblown. Although some firms may find it advantageous to circumvent West Coast ports in favor of ports along the Gulf of Mexico, California will still remain competitive for time-sensitive deliveries as well as for the next generation of super-ships that will be too large for even the widened Panama Canal to accommodate.

Educated Workers: California has long been home to a highly educated workforce.



According to data from the U.S. Census Bureau, over 30% of California residents hold at least a bachelor's degree. That ranks 15th nationwide, and represents a solid contingent of skilled workers who feed the high-tech industries synonymous with the state. Indeed, California has been ranked amongst the most innovative states in the entire union.[2]

Venture Capital: Perhaps as a result of the skill and educational levels of California residents, the state continues to be a center for technology-based growth and new inventions. Venture capital funding has seen strong, though bumpy, growth since hitting bottom in 2009. Total venture capital funding in California exceeded its pre-recession peak during the first quarter of 2014—nearly doubling over the first quarter of 2013. Indeed, in 2013 California received more than half of all venture capital investment in several high-tech categories including Semiconductors, Computers

[2] CNN Money, "10 most inventive states", October 24, 2012, http://money.cnn.com/gallery/smallbusiness/2012/10/24/states-patent-invention/.

and Peripherals, Telecommunications, Media and Entertainment, Software, and IT Services.[3]

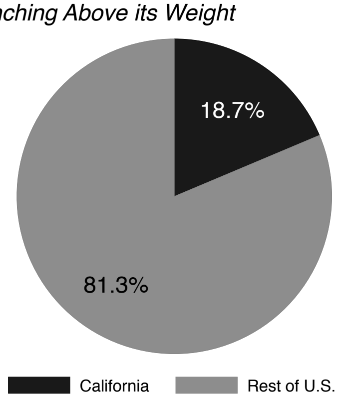
Venture Capital Investment in 2013

Industry	California	United States	California Share (%)
Semiconductors	395	601	65.7
Computers/Periphs.	327	517	63.2
Telecomms.	390	644	60.7
Media/Entertain.	1,753	2,963	59.2
Software	6,206	11,074	56.0
IT Services	1,017	1,965	51.8
Retailing/Distribution	122	237	51.5
Medical Devices/Equip.	980	2,102	46.6
Healthcare Services	81	193	41.9
Bus. Products/Svcs.	91	218	41.8
Biotechnology	1,919	4,655	41.2
Industrial Energy	601	1,491	40.3
Consumer Prods./Svcs.	423	1,259	33.6
Networking/Equipment	212	672	31.6
Electronics Instrs.	95	326	29.1
Financial Services	160	566	28.2
Other	23	98	24.0
Total	14,793	29,580	50.0

Source: PWC MoneyTree

Innovation: California is also responsible for a significant portion of all U.S. patent activity.

U.S. Patent Activity, 1963-2013
California Punching Above its Weight



Source: U.S. Patent and Trademark Office

[3] PWC MoneyTree

According to the U.S. Patent and Trademark Office, over 27% of all utility patents issued to domestic firms and individuals were granted in California last year. Since this patent data first started to be collected in 1963, California has been home to more than 18% of all domestic patents issued. That is roughly six percentage points higher than the state's share of the U.S. economy overall, demonstrating that California has historically contributed more than its proportional share of technological advances in the nation.

What's Wrong Structurally?

Not only have Californians benefitted unevenly from the economic recovery, there are also a number of long-term structural issues that persist in the state and pose a threat to future economic growth. Fortunately, as the recession fades, the opportunity to focus on these critical issues grows.

Hyper-cyclical Budgeting: Cyclically, the passage of Proposition 30 has helped raise needed public revenues as the economy gradually heals and home prices and incomes rise. However, the law has also made the state's General Fund more dependent on an even narrower segment of California's tax base by raising the top marginal income tax rates. While in an expansionary mode, with the stock market yielding solid returns, revenues are expected to over-perform. However, when the next eventual downturn hits the economy, it will yield even greater fiscal woes as incomes and financial markets inevitably contract. California's leaders have not displayed a serious commitment to reforming the state's tax structure in order to insulate against the business cycle. This includes revisiting Proposition 13, taxing the consumption of services and not just goods, and a host of other options that would enable California to lower marginal income and sales tax rates across the board.

Failure to Address Entitlements: California has yet to tackle its substantial long-term pension obligations at the state and local level. Together, CalPERS and CalSTRS represent nearly $140 billion in unfunded liabilities—even after accounting for the recent stock market surge—and are still 24% and 33% unfunded, respectively. Some form of compromise between retirees and state and local governments is badly needed as these unfunded obligations represent more than one full year of General Fund receipts.

CEQA and Housing Costs: One of California's biggest challenges is the state's high cost of housing. The abuse of the well-intentioned California Environmental Quality Act (CEQA) plays a large role in driving up building costs by limiting and delaying construction projects. And with the recent surge in the real estate market, California has grown even more expensive relative to other states. California's most inexpensive metro areas are on par with the most expensive metro areas in places like Texas, while California's most expensive markets are quickly approaching median prices of $1 million. That is well beyond the reach of the average Californian, and as a result, the state has experienced more out-migration among lower- and mid-income workers than among high-income workers. This worrisome trend deprives businesses of a strong mid-skilled workforce and makes it difficult to recruit talent because businesses can't afford to pay wages that would offer a desired quality of life (such as the ability to buy a home). Containing the excessive cost of housing should be a top policy goal, and reforming CEQA should be at the heart of that process.

Education Gap Closing: California has historically been a "barbell" state with many high- and low-skilled workers, and a shrinking population of mid-skilled workers. It has always, however, had a strong contingent of residents on the highly educated end of the scale. And while California remains a state with a relatively educated population base, over the past decade or so, that education gap has slowly been closing as other states raise their levels of educational attainment more and faster. Striving to build and retain the most skilled workforce is critical to California maintaining its advantage in the high-tech sectors that drive so much of the state's economic growth.

Educational Attainment Levels
Population with a Bachelor's or Higher

Location	2000	2012	Diff. (%)
California	26.6	30.9	4.3
Rest of US	24.1	28.9	4.8
Education Gap (%)	2.5	2.0	-0.5

Source: U.S. Census Bureau

Effects of Technological Change: Gauging and responding to technological change will remain a long-term challenge for California and for all states. Commercial real estate provides a strong example. With the ubiquitous nature of the Internet, wireless technology, laptops, smartphones, and tablets in today's world, traditional relationships between employment and commercial absorption are breaking down as more workers telecommute, work remotely, or work on-site for their clients. As such, the job growth that used to propel new commercial construction activities, is expected to have a smaller and smaller effect on commercial markets in California in the future.

The Forecast

Beacon Economics is forecasting ongoing improvement in California's economy through the life of the forecast in 2019.

- Employment growth will settle in at 2.5% by 2016 and the unemployment rate is expected to dip below 6% by mid-2017.
- Home prices will continue to grow over the next two years, although growth will cool to a 4% to 6% pace that is more consistent with income growth.

- As home equity rises and bank lending increases, home sales are also expected to turn around in 2015, rising by double-digit percentages next year.
- As the economy continues to heal, new construction activity will be stimulated in the residential market (190,000 new units forecast over the next two years) and the nonresidential market (4% growth forecast this year).
- Consumer spending is also forecasted to continue its upward trajectory, growing by roughly 4% over the next two years.

Cyclically, things are improving. Whether focusing on employment, incomes, GDP, home prices, building permits, or taxable sales (among many other indicators), California's economy is in growth mode. In fact, despite the state's many challenges, California continues to lead the nation in many key ways.

California also faces critical challenges including education, infrastructure, housing costs, and the need to invigorate manufacturing. Tackled appropriately, California could climb even higher in the state rankings and become an even greater economic success.

State Historical Table

California	Q1-2012	Q2-2012	Q3-2012	Q4-2012	Q1-2013	Q2-2013	Q3-2013	Q4-2013	Q1-2014	Q2-2014
Total Nonfarm Empl. (Mill, SA)	14.56	14.64	14.73	14.90	15.01	15.10	15.21	15.29	15.34	15.45
Growth (%,SAAR)	3.35	2.10	2.55	4.77	2.94	2.53	2.85	2.21	1.19	2.89
Unemployment Rate (%,SA)	10.83	10.67	10.37	9.83	9.37	9.03	8.90	8.43	8.10	7.60
Personal Income ($ Bill)	1,760.98	1,780.94	1,795.42	1,883.43	1,816.45	1,848.27	1,871.83	1,889.91	1,909.09	1,937.41
Growth (%,SAAR)	15.68	4.61	3.29	21.10	-13.49	7.19	5.20	3.92	4.12	6.07
Taxable Sales ($ Bill, SA)	136.50	137.55	139.69	143.93	147.04	149.36	148.88	151.51	152.31	155.27
Growth (%,SAAR)	9.02	3.09	6.39	12.70	8.93	6.46	-1.29	7.27	2.14	7.99
Single-Family Home Prices ($ 000s, SA)	251.18	263.10	274.87	296.50	308.59	336.76	350.23	361.20	368.06	373.57
Growth (%,SAAR)	18.42	20.38	19.13	35.40	17.34	41.82	16.99	13.13	7.81	6.13
Single-Family Home Sales (000s, SA)	87.79	86.64	85.43	89.89	86.75	86.96	87.45	79.04	73.58	78.65
Growth (%,SAAR)	32.62	-5.15	-5.43	22.55	-13.25	0.95	2.27	-33.26	-24.91	30.60
Single-Family Permits (000s, SA)	6.21	6.76	7.26	7.76	8.28	8.68	8.98	9.15	9.12	9.24
Growth (%,SAAR)	25.61	39.69	33.12	30.65	29.77	20.94	14.23	8.19	-1.51	5.43
Multi-Family Permits (000s, SA)	7.48	8.30	8.98	9.40	10.14	10.46	11.00	11.48	11.32	11.31
Growth (%,SAAR)	24.63	51.83	37.03	20.06	35.51	13.15	22.36	18.67	-5.59	-0.05
Nonresidential Permits ($ Bill, SA)	3.42	3.77	3.89	4.10	4.48	4.73	5.10	5.32	5.25	5.51
Growth (%,SAAR)	14.51	47.66	13.32	22.96	42.48	24.33	35.63	18.38	-5.08	20.78
Population (Mill)	37.79	37.87	37.95	38.04	38.12	38.20	38.29	38.38	38.47	38.56
Growth (%,SAAR)	0.82	0.84	0.86	0.87	0.89	0.90	0.91	0.92	0.94	0.96
Net Migration (000s)	11.07	13.14	14.86	16.24	17.26	17.93	19.14	19.79	21.42	22.76
Natural Increase (000s)	65.72	65.70	65.84	66.15	66.62	67.26	67.72	68.28	68.82	69.58

State Forecast Table

California	Q3-2014	Q4-2014	Q1-2015	Q2-2015	Q3-2015	Q4-2015	Q1-2016	Q2-2016	Q3-2016	Q4-2016
Total Nonfarm Empl. (Mill, SA)	15.52	15.60	15.70	15.79	15.88	15.98	16.08	16.18	16.28	16.39
Growth (%,SAAR)	1.83	2.24	2.37	2.42	2.44	2.45	2.51	2.52	2.53	2.56
Unemployment Rate (%,SA)	7.40	7.26	7.10	6.96	6.82	6.69	6.55	6.42	6.30	6.18
Personal Income ($ Bill)	1,947.71	1,973.43	1,997.80	2,021.99	2,047.54	2,070.85	2,098.08	2,124.32	2,152.03	2,180.80
Growth (%,SAAR)	2.14	5.39	5.03	4.93	5.15	4.63	5.36	5.10	5.32	5.46
Taxable Sales ($ Bill, SA)	156.99	157.14	158.70	160.74	162.09	163.12	165.62	168.06	170.14	172.59
Growth (%,SAAR)	4.51	0.39	4.04	5.23	3.41	2.57	6.28	6.01	5.04	5.89
Single-Family Home Prices ($ 000s, SA)	378.31	383.44	388.75	394.15	399.67	405.08	410.62	416.17	421.77	427.46
Growth (%,SAAR)	5.17	5.53	5.66	5.67	5.72	5.52	5.59	5.51	5.50	5.51
Single-Family Home Sales (000s, SA)	82.35	85.08	87.11	88.84	90.41	91.82	93.10	94.23	95.25	96.19
Growth (%,SAAR)	20.19	13.93	9.87	8.19	7.27	6.37	5.69	4.95	4.42	4.00
Single-Family Permits (000s, SA)	9.86	10.55	11.24	12.17	13.15	14.14	15.14	16.11	17.08	18.01
Growth (%,SAAR)	29.64	31.02	28.62	37.49	36.32	34.00	31.40	27.99	26.36	23.80
Multi-Family Permits (000s, SA)	11.48	11.85	12.50	13.44	14.61	15.93	17.34	18.72	20.00	21.16
Growth (%,SAAR)	6.05	13.62	23.50	33.81	39.74	41.37	40.11	35.87	30.47	25.13
Nonresidential Permits ($ Bill, SA)	5.66	5.77	5.91	6.03	6.16	6.29	6.40	6.52	6.64	6.75
Growth (%,SAAR)	11.28	8.17	9.83	8.82	8.60	8.46	7.76	7.50	7.26	6.93
Population (Mill)	38.66	38.75	38.85	38.95	39.05	39.15	39.26	39.36	39.46	39.57
Growth (%,SAAR)	0.99	1.00	1.02	1.03	1.04	1.04	1.05	1.06	1.06	1.06
Net Migration (000s)	24.76	25.95	26.92	27.61	28.13	28.49	28.73	28.91	29.02	29.06
Natural Increase (000s)	70.29	70.73	71.27	71.69	72.31	72.96	73.60	74.23	74.85	75.45

Forecasts by Beacon Economics

San Luis Obispo Forecast

by Rafael De Anda
Beacon Economics

Contents

Key Chapter Findings

- San Luis Obispo County's economy continues to improve, despite the effects of the ongoing drought. In 2013, economic output in the county increased by 3.8%, and current economic indicators suggest that the economy will continue to grow at a robust rate in the coming years.
- Consumer spending in the local economy over the last year surpassed our most recent expectations. Much of that growth is attributable to the local wine industry.
- The composition of employment by industry has changed drastically since the start of the recession. Several export-serving industries have more prominent roles in the local labor market, while a few local-serving industries have diminished roles. Nonetheless, these local-serving industries are adding workers and showing signs of recovery.
- Home prices have continued to grow over the last year, but at a slower rate than prices in the rest of the state. Prices in many parts of the state are surging because these regions have just recently begun to recover from the housing crash. While our outlook for San Luis Obispo County remains positive, our projections for home prices have been tempered due to recent subpar population growth.

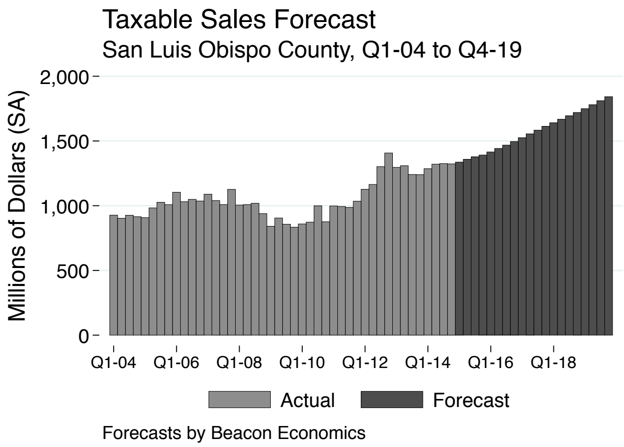
Overview

San Luis Obispo County's economy continued to expand over the last year. Job growth has been widespread among industries and has benefited residents in different parts of the county. Increased demand for wine throughout the world has not only boosted the county's agriculture sector but has also has spurred an influx of enotourism. New hotels are being constructed to accommodate more visitors. In addition, many tech-related businesses, such as software development and e-commerce companies, are moving into downtown San Luis Obispo and other parts of the county.

The future looks promising for San Luis Obispo's economy—economic output has been growing faster in SLO than in the rest of the state and the nation. The ongoing drought in California remains a wildcard, however. Although the county's infrastructure is better prepared for a water shortage than infrastructure in other parts of the state, the severity of the drought is unprecedented; how it affects the rest of the state can impact the local economy. A longer-term concern to economic growth in the region is the lack of affordable housing, which is discouraging migration into the county and hence reducing the benefits that are associated with increased population growth.

Business Activity Forecast

Consumer and business spending throughout San Luis Obispo County performed adequately in the second half of 2013 and the first half of 2014, despite the anticipated wind down of several major solar projects that contributed significantly to the county's business spending over the last two years. Taxable sales grew by 0.9% from the second quarter of 2013 to the second quarter of 2014. Consumers are in a much better place than they were a year ago, and consumer spending has thus played a bigger role in helping the region's economy grow. Taxable receipts from consumer categories grew by 5.4% during this time, while taxable receipts from businesses declined by 12.6%.



A significant portion of the growth in consumer spending is tied to local wine production. As a byproduct of the increased demand for local wine over the last five years, many local businesses in the industry have prospered, including wine grape growers, wineries, bottlers, and businesses that benefit from wine tasting and winery tours. Although wine prices throughout the nation have been relatively flat over the last year, the growth in demand for higher-end wines has exceeded the growth in demand for lower-priced wines, which has been especially beneficial for San Luis Obispo County winemakers. For example, the price of Cabernet Sauvignon grapes, the number one grape variety in San Luis Obispo County in terms of production value, grew by 6.3% from 2012 to 2013 (based on the average price per ton produced in the county), while production of these grapes grew by 5.5%.

A substantial reliance on one particular industry exposes the local economy to concentrated risk. Demand for the region's wine has paid off recently, but the ongoing drought may pose a risk in the coming years as recent statewide legislation regarding groundwater management can especially affect some San Luis Obispo County businesses.

Fortunately the county has other assets that have helped drive recent growth in consumer spending, such as tourism (which is not entirely dependent on the wine industry). The cities of Grover Beach and Arroyo Grande experienced robust growth in taxable sales over the last year, and both have strong ties to tourism. The Grover Beach Amtrak station boarded 19,169 passengers in FY2013, compared to 18,005 in FY2012.[4]

We project that taxable sales will grow by 2.6% from the second quarter of 2014 to the second quarter of 2015.

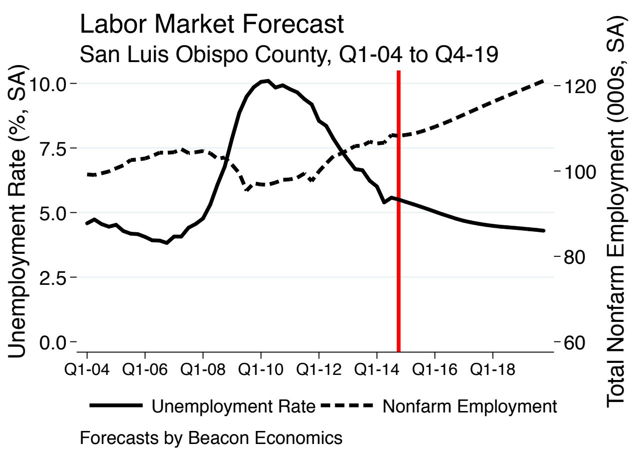
Beacon Economics remains optimistic about economic growth and consumer and business spending in the long run. A year ago, we projected that the county would experience a short-term dip in taxable sales (a 3.2% decline from the second quarter of 2013 to the second quarter of 2014) due to the winding down of major solar projects, only to return with robust growth the following year (a 6.0% increase by the second quarter of 2015). Because the dip was not as dire as we expected (0.9% growth rather than a slight decline), we project that taxable sales will grow by 2.6% from the second quarter of 2014 to the second quarter of 2015. Afterward, we project that taxable sales will grow by an average annual rate of 6% from 2015 to 2019.

Employment Forecast

Businesses in San Luis Obispo County began bringing employment back up to peak levels much earlier in the economic recovery than businesses elsewhere in the state. But with job counts now above their pre-recession peak, it's important to note that the composition of employment by industry does not resemble the industry composition in the late 2000s, which may be a good sign for future employment growth.

[4] See Amtrak.com.

Several predominantly local-serving industries, such as Retail Trade and Construction, have fewer employees now than they did before the recession, but these industries have added plenty of new jobs over the last year. Since these industries serve the local population, their employment levels are expected to return to levels near their pre-recession peak, given that production methods and customer bases have not changed drastically in the last few years. For example, retail stores need about the same number of workers to serve the 276,000 person population base, and construction businesses need about the same number of workers to serve the 100,000 households.



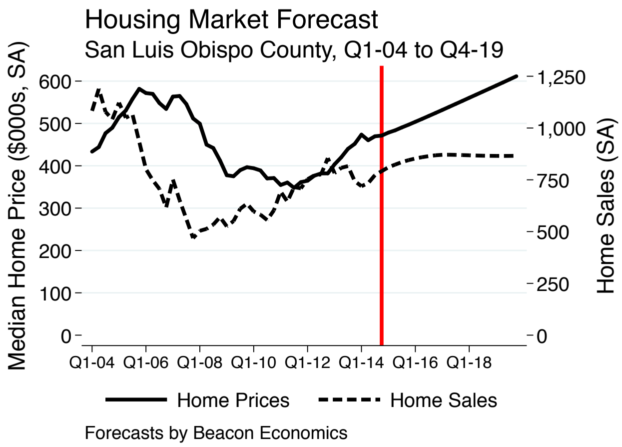
Several industries that have also served economies outside of the region (that is, export-serving industries) recovered from the recession much earlier and have been expanding over the last year. The local Professional and Business Services industry is perhaps the best example. Since June 2007, employment at Professional and Business Services establishments grew by 37.8%, while total nonfarm employment grew by 14.2%. Manufacturing employment, meanwhile, grew by 20.2%, even though manufacturing employment across the state declined by 14.9% over the same period. Wineries were key contributors to the upward trend in manufacturing employment, as employment at local wineries grew from about 1,300 workers in 2007 to about 1,600 workers in 2013.[5] Unlike local-serving industries, export-serving industries can continue to expand even as the local population base remains the same because the demand for their goods and services extends to customers beyond the county's borders.

Last year, we projected that total nonfarm employment would grow to 106,500 jobs by the second quarter of 2014, taking into consideration the high likelihood of a steep upward revision during the annual March benchmark conducted by the California Employment Development Department. With recent job growth being broad-based across industries, Beacon Economics remains confident that employment growth will remain strong in the coming year. From the second quarter of 2014 to the second quarter of 2015, we project total nonfarm employment to grow by 2.0%, followed by 2.1% the following year. Likewise, we project that per capita personal income, which grew by 2.7% from the second quarter of 2013 to the second quarter of 2014, will grow by an additional 3.2% over the next year as more residents find jobs.

Housing and Construction Forecast

Home prices in San Luis Obispo County, as measured by the median price of existing single-family homes sold, grew by 9.6% from the second quarter of 2013 to the second quarter of 2014—slower than our 16.2% growth projection from a year ago. Home prices in nearby Santa Barbara County grew by 2.1%, while home prices in Monterey County grew by 27.5%.

[5] These numbers are based on data imputed from the QCEW surveys, as data is not available for some quarters and years.



A key difference in the current local housing market versus the market a year ago is that homebuyers are feeling less pressure to compete for housing, even though the supply of homes on the market remains the same. According to the California Association of Realtors (CAR), there are still enough homes on the market to accommodate homebuyers for the next 5.1 months based on the number of recent monthly home sales, but the median time a home is on the market has grown from 29.0 days in September 2013 to 46.7 days in September 2014. Meanwhile, the supply of homes for sale in Santa Barbara County (4.3 months) and Monterey County (4.6 months) remains a bit tighter than the supply of homes for sale in San Luis Obispo County, but supplies in those counties have been easing over the last year.

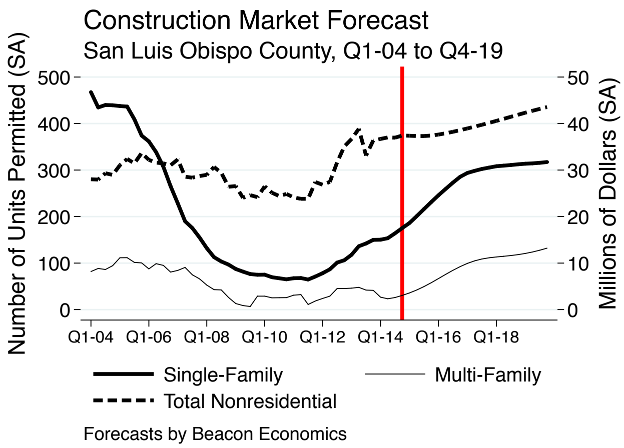
The lack of affordable housing is deterring migration into the county, which is in turn placing downward pressure on the county's population growth.

The lack of affordable housing is the primary long-term concern for local economic growth. Although home prices remain affordable relative to historical levels, and although they are also affordable relative to the household incomes of the county's current residents, they are not within reach for many first-time buyers, nor are they sufficiently affordable to draw new residents to the county. We believe that the lack of affordable housing is deterring migration into the county, which is in turn placing downward pressure on the county's population growth.

Because population growth in the county has been essentially flat, Beacon Economics' forecast for home prices has been tapered to a 5.1% rate of growth from the second quarter of 2014 to the second quarter of 2015, from the previously expected 7.6% rate of growth over the same period. In the second quarter of 2015, we expect that the median single-family home will sell for $483,800, about $20,000 more than the current median price.

Construction of new single-family homes over the last year is helping to alleviate the shortage of homes on the market. The number of single-family home permits grew by 29.1% over the year, based on permits filed in the last four quarters (from the third quarter of 2013 to the second quarter of 2014) compared with the previous four quarters (from the third quarter of 2012 to the second quarter of 2013). Our projection for single-family permits has also been tapered as a result of slower population growth. We expect that the number of single-family permits over the next four quarters will grow by 22%, to 7,250 units.

On the other hand, multifamily construction activity has struggled over the last year, owing in part to the difficulties in obtaining permits and to environmental concerns, which add to building costs. Only 1,333 units were permitted over the last four quarters (from the third quarter of 2013 to the second quarter of 2014), compared with 1,814 units four quarters ago (from the third quarter of 2012 to the second quarter of 2013). But demand for apartments and condominiums may also not be as strong as it was a year ago. The vacancy rate at apartments in the second quarter of 2014 was estimated at 2.8%, 1.4 percentage points higher than it was in the second quarter of 2013. We project another 1,350 multifamily units to be permitted over the next four quarters, so construction activity in this category will largely resemble construction activity over the last year.



Population Forecast

One of the underlying factors in our long-term economic growth projections is the expected rate of growth in the region's population base. New residents inherently raise the demand for goods and services, housing, and jobs—so a faster rate of population growth generally leads to a faster rate of economic growth. For San Luis Obispo County, our projected population growth has been revised downward due to a lower than expected population estimate for 2014.

The California Department of Finance (DOF) estimates that the county's population declined by 0.04% in 2014. Previous DOF estimates have been low, however, when compared with estimates provided by the U.S. Census Bureau's American Community Survey on an annual basis since the last decennial census in 2010, which gives us reason to believe that the true rate of population growth was probably not negative. Still, population growth likely underperformed our projected growth of 0.86% from a year ago.

As of the writing of this report, the components of population change for San Luis Obispo County in 2014

Population growth will depend on a consistent flow of migrants into the county.

had not been released. But based on the tepid growth from both natural population increase (births minus deaths) and net migration in 2013, the lackluster population growth in 2014 is likely owing to both factors equally. The county's population base includes a low share of residents between the ages of 25 and 40, when people are more likely to reproduce, and that share has been declining precipitously. Therefore, population growth will depend on a consistent flow of migrants into the county, which will in turn depend on the number of affordable housing units built in the near future. We project that San Luis Obispo County's population will grow by 0.7% in 2015 and between 0.8% and 1% per year through 2019.

Summary

Numerous economic indicators paint a rosy picture of economic growth throughout San Luis Obispo County in the coming years. Business activity, employment, and home prices have continued to grow since late 2010, when the economic recovery began in the county. Many other regions, particularly those that are inland, faced longer periods of economic hardship while struggling to cope with the fallout from the recession. By now, however, most regions are experiencing economic growth. The regions that just recently began to recover are likely to post robust growth in taxable sales, employment, and home prices, while San Luis Obispo continues on its steady pace.

Employment

by Brian Vanderplas

Contents

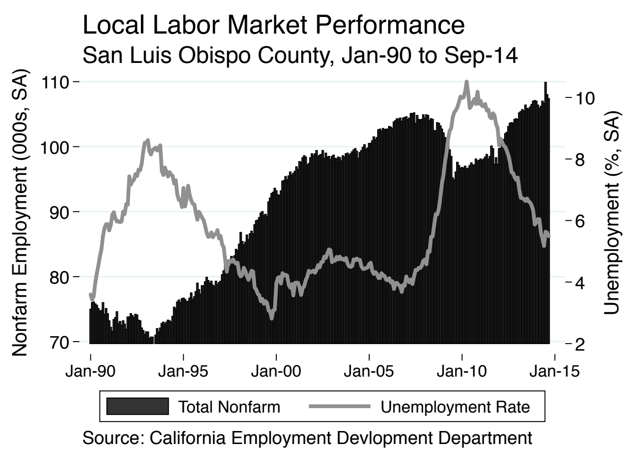
Key Chapter Findings

- Since hitting bottom in August 2009, the labor market in San Luis Obispo County has seen nonfarm payrolls expand by 12,500 positions.
- San Luis Obispo County's unemployment rate of 5.5% in September 2014 remains well below the statewide rate and continues to improve.
- Recent employment growth has been broad based across various industries, including both high-wage and low-wage sectors.
- Wages in the county have been rising faster than the rest of the state. In 2013, the average wage increased by 1.8%, while the state's average wage increased by 0.6%.

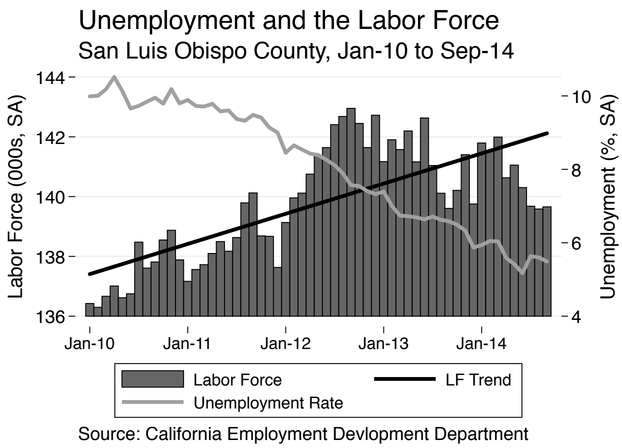
Labor Market Overview

San Luis Obispo County has continued to enjoy steady gains in employment over the past year. From September 2013 to September 2014, total nonfarm employment in San Luis increased by 1.2%. This is a slowdown from recent years, however this was to be expected given the robust growth the region enjoyed during the post-recession recovery. Indeed, since hitting bottom in August 2009, nonfarm payrolls in San Luis Obispo County have expanded by 12,500 positions – 2,200 more jobs than were lost during the downturn. The growth also marks a 13.2% increase from the trough through September 2014, making the region the third fastest growing region in the state over the period, placing the region just behind the economic powerhouses of San Francisco and San Jose.

In relative terms, San Luis Obispo County is the shining star along California's Central Coast. Indeed, employment levels are just 1.1% above peak in Santa Barbara County, and Monterey and Ventura Counties remain 1.2% and 2.5% below peak, respectively. Nonfarm payrolls grew by just 1.9% in Monterey County and 1.6% in Santa Barbara County from September 2013 to September 2014.



The improving labor market has also pushed the unemployment rate down to just 5.5% in September 2014, a 1.1 percentage point drop from the same month a year ago, which puts the unemployment rate in San Luis Obispo County well below the California average of 7.3%. The primary driver of the drop in the unemployment rate in San Luis Obispo County was a 1.0% increase in household employment over the year. However, another factor was a 0.1% decline in the labor force over last year. Despite the decline in the labor force, the majority of the drop in the unemployment rate was a result of more area residents finding jobs. More importantly, San Luis Obispo County is enjoying the lowest unemployment rate among Central Coast counties, with Monterey (8.4%), Santa Barbara (5.7%), and Ventura (6.3%) Counties all having a higher unemployment rate in September 2014.



Employment by Industry

Fortunately, the job recovery in San Luis Obispo County has been relatively broad-based over the past year, and to a greater extent since the bottom of the recession. Indeed, with the exception of Retail Trade, Transportation and Warehousing, and Finance and Insurance, every sector in San Luis Obispo County has added jobs from a year ago. While some sectors have added more jobs over the last year than others, the entre labor market in San Luis Obispo County has continued to move forward.

Leading the way has been Education and Health Care; from September 2013 to September 2014 the sector has added roughly 600 new positions. Importantly, jobs in this sector tend to be relatively high paying. As a result, job growth in the Education and Health Care industry not only helps increase local employment levels, but also generates additional activity in the region as these workers spend their income at local restaurants and retail establishments. Another surging industry over the past year has been the Professional and Business Services sector. From August 2013 to August 2014, the Professional and Business Service sector increased payrolls by roughly 6.2%, which is the equivalent of roughly 700 new positions. More importantly, according to the Bureau of Labor Statistics' Quarterly Census of Employment and Wage (QCEW), the majority of these new positions were at Professional, Scientific, and Technical Services and Management firms, which increased payroll by 8.8% and 12.1%, respectively, from the first quarter of 2013 to the first quarter of 2014. In contrast, employment levels in the Administrative Support sector, the other subsector in the larger Professional and Business Services super-sector, were basically unchanged over the same period.

Manufacturing employment also picked up over the last year, with payrolls rising by roughly 2.9%. However, if we drill down into the types of manufacturing jobs that were created, we can see just how linked the manufacturing sector is with the region's farms and vineyards. Indeed, according to the QCEW the Beverage Manufacturing is the single largest subsector for manufacturing in San Luis Obispo, accounting for nearly one in four Manufacturing positions. More importantly, employment levels at Beverage Manufacturing firms are 4.8% higher than they were a year ago and establishment counts are over 11% higher than they were a year ago.

San Luis Obispo's prominent Tourism industry also continued to make contributions to local employment growth, in line with growth at local wineries. In fact, the Leisure and Hospitality sector increased payrolls by 3.9% from a year ago, outpacing this sector's growth in the state overall (2.8%). What's more, the Ayres Resort and Spa in Paso Robles is slated to be completed by the end of 2014, once completed the resort is projected to support close to 40 permanent jobs. Marriot International is also working on getting the go ahead for a new extended stay hotel just off Los Osos Valley Road and Highway 101, which would feature between 105 and 115 rooms.

Government payrolls also turned the corner this year, with all of the growth being driven by State Govern-

San Luis Obispo Employment Growth

Industry	Sept-13 (000s)	Sept-14 (000s)	Change (000s)	Change (%)
Leisure and Hospitality	16,248	16,890	642	3.9
Education/Health	13,346	13,928	582	4.4
Government	21,236	21,712	476	2.2
Other Services	4,586	5,021	435	9.5
Manufacturing	6,479	6,666	188	2.9
NR/Construction	6,157	6,333	176	2.9
Professional/Business	11,851	12,001	150	1.3
Real Estate	1,861	1,954	93	5.0
Farm	3,688	3,696	8	0.2
Wholesale Trade	2,581	2,581	0	0.0
Information	1,430	1,427	-3	-0.2
Finance and Insurance	2,284	2,181	-104	-4.5
Transport,Warehouse,Util.	4,173	3,867	-306	-7.3
Retail Trade	13,868	12,838	-1,030	-7.4
Total Private	84,864	85,688	824	1.0
Total Nonfarm	106,100	107,400	1,300	1.2

Source: California Employment Development Dept.

ment positions. From September 2013 to September 2014 the Government increased their payrolls by 500 new positions. Most of these gains were concentrated in State government, as payrolls for Local Governments contracted over the same period while Federal Government payrolls were unchanged. Still, the improvement in the underlying tax base for local municipalities should begin to arrest some the declines in Governments that have been offsetting the private-sector growth that started much earlier in the region.

The strong growth in high-wage sectors like Professional, Scientific, and Technical Services, Management, and Education and Health Care, along with growth in low-wage sectors like Leisure and Hospitality, emphasizes how job growth is occurring over a broad range of sectors. This is important given the unemployment rate varies significantly across education levels. According the US Census Bureau's American Community Survey (ACS), the unemployment rate for San Luis Obispo County resident with a high school degree or less was nearly 8.0% in 2013, in contrast the unemployment rate for residents with a Bachelor's degree or higher was just 4.0%. With these varying unemployment rates, it is important the region creates jobs on both ends of the wage spectrum, in addition to helping advance educational attainment levels for area residents in order to help insure a rising tide lifts all boats.

The Changing Composition of the Labor Market

While San Luis Obispo County has added back all the jobs it lost between 2007 and 2009, the jobs that have gained over the past five years have not replaced the exact jobs lost during the downturn. More specifically, only five sectors in San Luis Obispo County have increased their payrolls since nonfarm employment peaked in June 2007, despite overall employment levels sitting 2.1% above this peak. The Professional and Business Services sector posted the largest uptick in employment levels since nonfarm employment peaked in June 2007, having added another 2,650 positions since. Not far behind is Education and Health, which added another 2,640 positions over the same period. Moreover, jobs in these sectors tend to be relatively high paying. As a result, many of the jobs added in the post-recession recovery have helped stimulate additional jobs in the region, as these workers will spend their earnings in the local economy.

In contrast to the overall growth in the County's employment levels, the Construction sector remains 1,430 below June 2007 levels and the Retail Trade sector is still 1,070 below peak levels. Indeed, these sectors were some of the hardest-hit, and individuals in these sectors are still having difficulty finding employment, despite the resurgence in the broader labor market. Even so, since the trough in August 2009 employment levels have risen by 25.9% in Construction and Retail Trade Employment levels have increased by 4.4%.

The varying growth, or lack thereof, between sectors in San Luis Obispo County has resulted in shifts in the composition of industries in the area. For example, the

San Luis Obispo Employment Concentrations
Percent of Total Employment by Industry

Industry	2007	2014	California	Difference
Government	21.4	20.4	15.4	5.0
Leisure and Hospitality	15.0	15.4	11.1	4.3
NR/Construction	7.3	5.8	2.3	3.5
Retail Trade	13.5	12.4	10.5	1.9
Other Services	4.3	4.5	3.4	1.2
Transport,Warehouse,Util.	3.9	3.7	3.3	0.3
Real Estate	2.0	1.8	1.7	0.1
Finance and Insurance	2.4	2.1	3.3	-1.3
Information	1.4	1.3	3.0	-1.7
Manufacturing	5.8	6.1	8.1	-1.9
Wholesale Trade	2.6	2.5	4.6	-2.1
Education/Health	11.0	12.7	15.4	-2.7
Professional/Business	9.4	11.3	15.7	-4.4
Total Private	78.6	79.6	84.6	-5.0
Total Nonfarm	100.0	100.0	100.0	0.0

Source: California Employment Development Dept.

Professional and Business Services sector went from making up 9.4% of nonfarm positions in 2007 to 11.3% of nonfarm positions in 2014. Similarly, the Education and Health Care sector went from making up 11.0% of nonfarm jobs in 2007 to 12.7% 2014.

On the opposite side of the coin, some of the most heavily affected sectors have had the largest declines in their shares of total employments. For example, Construction used to represent nearly 7.5% of all nonfarm jobs in San Luis Obispo County at the height of the housing boom, it has since fallen to just 5.8% of total employment despite the recent resurgence. Retail Trade's share of the county's jobs also declined over the past year. However, with increases in spending from tourists, businesses, and consumers in the region, the sector should start to get some of its lost market share back, though they are not expected to hit the highs reached at the peak of the bubble for several years.

Perhaps more importantly, the private sector now accounts for a larger share of the County's job than it has in years past. Indeed, constrained government budgets have pushed Government's share of nonfarm employment to 20.4%, down a full percentage point from just before the Great Recession. With these shifting employment concentrations in San Luis Obispo County the region is beginning to look more like California as a whole in terms of concentrations, which has a significantly lower concentration of Government employees. What's more, with the uptick in private enterprises share of the employment the region should be more insulated from future cyclical downturns that negatively impact government balance sheets.

City Labor Markets

From 2008 to 2012 the unemployment rate in San Luis Obispo County averaged 8.7% according to the ACS, though this rate varied across the County. Cities like Morro Bay (6.7%) and Pismo Beach (5.7%) averaged unemployment rates well below the county as whole.

However, city like Grover Beach (10.7%) and Paso Robles (9.0%) averaged rates above the county as a whole. Still, even the local cities with relatively high unemployment rates compared to the county average came in lower than the state (11.0%) overall over the five-year period.

One of the driving forces behind the varying unemployment rate in San Luis Obispo County is the industries residents of each city work in, which often varies from city to city. Indeed, many of the industries that were hardest hit by the downturn in the economy were more concentrated in the areas with a higher unemployment rate, and these cities were less concentrated in the ones the expanded the most. For example, over the five-year period Paso Robles had 10.2% of its labor force employed in Public Administration, compared to 6.2% in the county overall. As noted earlier, Government employment still has not returned to peak levels, as a result area residents who lost their jobs in this industry have had a harder time finding new positions as readily as in other industries. What's more, Paso Robles has a lower concentration of education and health care workers, 16.1% in Paso Robles to the counties 22.7%. Since the Education and Health Care industry was one of the fastest expanding over the period it is not too surprising that Paso Robles is lagging the broader region, given its lower concentration in this booming industry.

Wage and Business Formation

Along with the rising employment levels, wages have also risen in San Luis Obispo County. From 2012 to 2013, the average wage across all industries ticked up 1.8% in San Luis Obispo. This puts San Luis Obispo well ahead of the state, where wages expand by just 0.6% over the period. What's more, San Luis Obispo was the leader along California's Central Coast, with Monterey (1.2%), Santa Barbara (0.5%), and Ventura (0.5%) Counties posting lower wage growth than San Luis Obispo County from 2012 to 2013.

From an industry perspective, average annual wages increased across the majority of industries in San Luis Obispo. Leading the way was agriculture, where wages grew by roughly 20 % from 2012 to 2013. Not far behind was the Mining and Natural Resource sector where wages jumped 15.1% over the same period. Perhaps more importantly, wages grew by 2.2% in the regions Accommodation and Food sector -- boosting the incomes of a large portion of area residents who generally earn less than the County average.

New establishment are continuing to spring up in San Luis Obispo County as well. From the first quarter of 2013 to the first quarter of 2014, the number of establishments in the San Luis Obispo County increased by 400 – representing an 4.5% jump in the County's establishment count. This pace a growth far outpaces the state overall where establishment counts increased by just 0.3% over the same period. At the industry level, more than 50 new establishments were added in the Financial Activates sector and the Professional and Business Services sector's establishment counts increased 50, together these industries accounted for more than a quarter of the new businesses in the county over the period.

Overall, while not growing as rapidly as it was during much of the recovery, San Luis Obispo's labor continues to grow steadily. More importantly, employment levels are at record highs, growth has occurred over a broad base of industries, and average annual wages are at the highest they have ever been. Although some workers are still feeling the effects of the Great Recession, the San Luis Obispo labor market as a whole is doing well. Moreover, the key industries that have propelled growth over the last year are poised for future success, which will help San Luis Obispo maintain healthy rates of job growth moving forward.

Business Activity

by Maximilian Saia

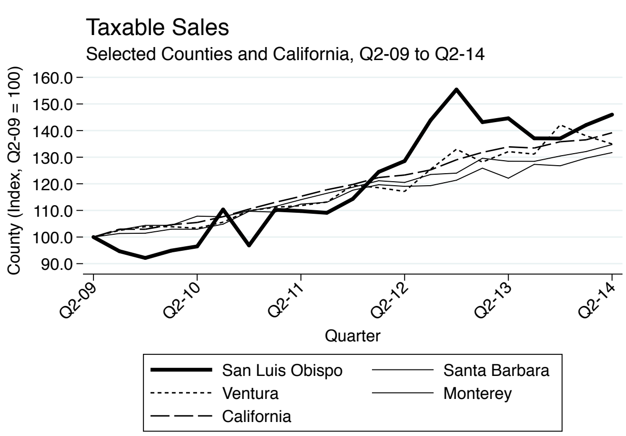
Contents

Key Chapter Findings

- Agro-tourism is continuing to play a central role in Central Coast business activity, with wineries drawing in tourists and boosting the region's agricultural sector as well as local restaurants and hotels.
- Strong consumer spending is expected to drive taxable sales growth moving forward. Last year, construction on several large-scale solar projects stimulated growth in business spending, but construction on these projects has begun to wind down.
- Growth in economic activity is widespread, with some key sectors—including Agriculture and Information—experiencing double-digit growth.

Consumer Spending Continues to Expand—Arroyo Grande and Grover Beach Experience Double-Digit Growth

The San Luis Obispo County economy continues to improve on multiple fronts. Although it is true that consumer spending increased by less than 1% from the second quarter of 2013 to the second quarter of 2014, a much slower rate of growth than we reported in our last forecast, the slowdown can be attributed to a decrease in spending from the second quarter of 2013 to the third quarter of 2013.



Source: California Board of Equalization

Taxable sales growth from the third quarter of 2013 to the second quarter of 2014 grew 6.5% on a seasonally adjusted basis, to $1.32 billion overall. Thus, the reduction in spending was transitory and largely attributable to the completion of several large-scale solar projects, which had been driving growth in 2012 and 2013.

If we look at taxable sales for the last three quarters, factoring out the slowdown from the second quarter of 2013 to the third quarter of 2013, we can see that taxable sales growth in San Luis Obispo County is in line with growth in the rest of the Central Coast. Taxable sales for all of California increased by an estimated 4.0% year over year—3 percentage points higher than the estimated increase in San Luis Obispo County.

Taxable Sales by City
San Luis Obispo County, Q2-2012 to Q2-2014

City	Q2-2012 ($ 000s)	Q2-2013 ($ 000s)	Q2-2014 ($ 000s)	2-Yr Chg (%)	1-Yr Chg (%)
San Luis Obispo	318,917	336,971	350,913	10.0	4.1
Paso Robles	175,952	179,948	191,827	9.0	6.6
Arroyo Grande	69,501	72,341	80,355	15.6	11.1
Atascadero	70,844	77,432	77,767	9.8	0.4
Pismo Beach	55,307	57,654	59,773	8.1	3.7
Morro Bay	34,284	34,648	36,296	5.9	4.8
Grover Beach	24,584	24,125	26,947	9.6	11.7

Source: California Board of Equalization

Encouragingly, consumer spending has grown substantially in most of the region's major cities, with the momentum from last year continuing. The City of San Luis Obispo, which contributed 26.6% of the county's taxable sales revenues, experienced an increase of 4.1% in taxable sales from the second quarter of 2013 to the second quarter of 2014. Despite slowing to mid-single-digit growth over the past year, the city's taxable sales have grown 10% over the past two years. Arroyo Grande, which has the third-highest total dollar value of taxable sales among cities in San Luis Obispo County, experienced double-digit growth (11.1%) over the past year. This increase for Arroyo Grande comes on the back of a strong year in 2013. As a result, taxable sales in Arroyo Grande have grown the fastest (15.6%) of any city in the County of San Luis Obispo over the past two years.

This year, Grover Beach surprised us, leading the way in consumer spending growth: taxable sales in Grover Beach increased by 11.7% from the second quarter of 2013 to the second quarter of 2014. As shown below, tourism continues to be a boon for San Luis Obispo County. This largely explains why Arroyo Grande and Grover Beach, two neighboring cities with economies oriented heavily around tourism, are seeing a significant bump in local economic activity.

Additionally, the City of San Luis Obispo continues to make a wide variety of "best place" lists, which, according to Molly Cano, the city's tourism manager, has been a big positive for tax revenue. According to Cano, the Transient Occupancy Tax (TOT) is "one of the top three producers" into the general fund. She notes that these tax dollars help pave the streets and support public safety officers. [6]

The increase in economic activity in San Luis Obispo County can be attributed solely to growth in consumer-to-business spending, as business-to-business spending decreased over the past year due to the imminent completion of several large solar projects. According to HdL Companies, taxable receipts in San Luis Obispo County increased by 1.1% from the second quarter of 2013 to the second quarter of 2014. Business taxable receipts decreased by 12.6%, while consumer taxable receipts (such as general retail sales or gasoline sales) increased by 5.6%.

Taxable Receipts by Category
Selected Counties and California, Q2-2013 to Q2-2014

County	Category	Q2-2013 ($ 000s)	Q2-2014 ($ 000s)	Change (%)
San Luis Obispo	Business	3,183	2,781	-12.6
San Luis Obispo	Consumer	9,806	10,352	5.6
San Luis Obispo	Total	12,989	13,133	1.1
Santa Barbara	Business	1,340	1,358	1.4
Santa Barbara	Consumer	8,232	8,781	6.7
Santa Barbara	Total	9,572	10,139	5.9
Ventura	Business	4,725	4,856	2.8
Ventura	Consumer	27,344	28,535	4.4
Ventura	Total	32,069	33,391	4.1
California	Business	218,580	226,765	3.7
California	Consumer	1,235,839	1,305,280	5.6
California	Total	1,454,419	1,532,045	5.3

Source: HdL Companies

San Luis Obispo County is being outpaced by Santa Barbara County, Ventura County, and the state overall in both business and consumer taxable receipts growth from the second quarter of 2013 to the second quarter of 2014. Again, the sharp drop in business taxable receipts for San Luis Obispo County is merely a reflection of the large solar projects, such as the Topaz Solar Farm, coming to an end and should be heavily discounted when constructing a picture of the overall health of business spending in the economy. Indeed, the county has posted quarterly increases through the first half of 2014, suggesting that the slowdown was only a temporary adjustment.

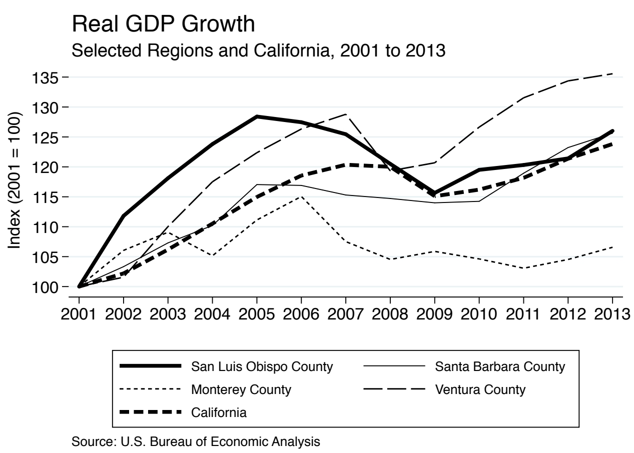
Taxable receipts in Ventura County grew by 4.1% from the second quarter of 2013 to the second quarter of 2014. Taxable receipts in Santa Barbara County (5.9%) grew more quickly, as did taxable receipts in the state overall (5.3%). Altogether, the rise in consumer spending shows that the economy of San Luis Obispo County is continuing to grow stronger, despite not showing as much year-over-year improvement as it has in the past. Now that San Luis Obispo County has caught up and regained all of the ground lost during the reces-

[6] Randol White, "San Luis Obispo Continues to Ride Wave of 'Best Places' Lists," KCBX, Central Coast Public Radio, July 22, 2014.

sion and then some, growth going forward will remain moderate, but sustainable.

Economic Output Recovers from a Slow 2011, but Important Sectors Have Struggled

Overall economic activity in San Luis Obispo County, as measured by gross domestic product (GDP), is experiencing a broad-based rise. Over the longer term, GDP growth in San Luis Obispo County has been outpacing GDP growth in California since 2001. Indeed, from 2001 to 2013, GDP in the county grew by 26.0%—slightly slower than the 25.6% in Santa Barbara County or the 35.6% in Ventura County, but well ahead of the 6.6% growth in Monterey County and the 23.8% growth in the state overall.



More recently, San Luis Obispo County has outpaced other Central Coast counties and the state overall. From 2012 to 2013, GDP in San Luis Obispo County grew 3.79%, compared with 1.95% in Monterey, 1.94% in Santa Barbara, 0.89% in Ventura, and 2.03% in California over the same time period.

From 2012 to 2013, GDP growth in San Luis Obispo County was both helped and hindered by differing economic activity in some of the county's largest sectors. Real Estate, the largest sector in the economy, contracted by 0.4%, while Transportation and Warehousing, the third-largest sector, grew by 8.9%. Manufacturing and Construction, two sectors that struggled greatly throughout the recession but experienced a big increase from 2011 to 2012, continued the strong growth in economic activity last year, expanding by 6.8% and 5.2%, respectively. The strong growth in Construction was once again aided by the continued construction of solar farms. Increased Tourism in the area has led to a rise in new hotel projects, as well as renovations of existing hotels. Indeed, even with the large solar projects such as the Topaz Solar Farm and California Valley Solar Ranch coming to an end, projects such as Solarize SLO have continued to aid growth in construction.[7]

In addition, as discussed below, many new hotel projects are either under construction or in the pipeline. For example, two hotels are in the planning stages for Pismo Beach and Avila Beach. The 50-room hotel near Avila Beach would be built on a 23-acre ocean-view piece of property. Land adjacent to the Pismo Pier is the site of the other $40 million, 108-room hotel with a possible construction start of early 2015. [8]

GDP in the Government sector, which has remained sluggish since the onset of the recession, fell by roughly 0.3% from 2012 to 2013. Overall, it is a pattern that largely mimics that seen in the State of California: solid growth in residential and commercial construction that supplements related economic sectors (such as manufacturing), even as the public sector struggles.

During this same time last year, our forecast emphasized that weakness in some key sectors was a concern going forward. Those concerns can now be tempered, as we have seen these key sectors returning to growth. The Professional, Scientific, and Technical Services sector, which contracted from 2011 to 2012,

[7] Randol White, "Central Coast Jobs, Solar Expansion, Business Investment," KCBX, Central Coast Public Radio, June 26, 2014.

[8] Randol White, "Proposed Hotels on the Way for Pismo, Avila Beaches," KCBX, Central Coast Public Radio, June 12, 2014.

GDP Growth by Sector
San Luis Obispo County, 2012 to 2013

Industry	2012 ($ 000s)	2013 ($ 000s)	Change (%)	Contributions to GDP Growth (%)
Real Estate	1,994	1,986	-0.4	17.3
Government	1,805	1,800	-0.3	15.7
Trans./Warehousing	1,277	1,391	8.9	12.1
Prof. Bus. Services.	889	926	4.2	8.1
Retail Trade	897	907	1.1	7.9
Manufacturing	764	838	9.7	7.3
Health Care	794	805	1.4	7.0
Construction	643	650	1.1	5.7
Accommodation/Food	511	526	2.9	4.6
Wholesale Trade	373	378	1.3	3.3
Other Services	292	317	8.6	2.8
Information	237	309	30.4	2.7
Natural resources and mining	261	297	13.8	2.6
Finance/Insurance	285	297	4.2	2.6
Agriculture	217	254	17.1	2.2
Arts/Ent./Recreation	71	67	-5.6	0.6
Educational Services	27	30	11.1	0.3
Private goods-producing industries	1,632	1,758	7.7	15.3
Private services-providing industries	7,646	7,936	3.8	69.1
Private Industries	9,259	9,682	4.6	84.3
All Industry Total	11063	11482	3.8	100.0

Source: U.S. Bureau of Economic Analysis

resumed modest economic growth from 2012 to 2013, expanding by 1%. One of the biggest surprises over the past year came from the Information sector, which surged by 30.4% from 2012 to 2013. Amazon's expansion into the City of San Luis Obispo supported growth in Information, drawing a large number of software developers to the region.[9] The Arts, Entertainment, and Recreation sector went through the biggest contraction from 2012 to 2013, with output declining by 5.6%. While this fact in and of itself is concerning, Private Services-Providing Industries actually had a good year overall, growing 3.8% from 2012 to 2013.

The Agriculture sector had a big year, expanding 17.1% from 2012 to 2013. Much of the growth was driven by increased wine grape production, as grapes dethroned strawberries to become the number one crop, as measured by gross earnings in San Luis Obispo County.[10]

Overall, economic growth was widespread in the County of San Luis Obispo from 2012 to 2013. Now that San Luis Obispo County has made up the ground lost during the recession, we aren't expecting jaw-dropping growth in the future. Nonetheless, there are plenty of reasons to remain optimistic about the future of economic and business growth in the region. The county has worked hard to grow future prospects outside of tourism and hospitality, encouraging the private-public partnership of the San Luis Obispo Economic Vitality Corporation, fostering renewable energy development through various programs, and creating business incubators like the SLO HotHouse for start-up companies.

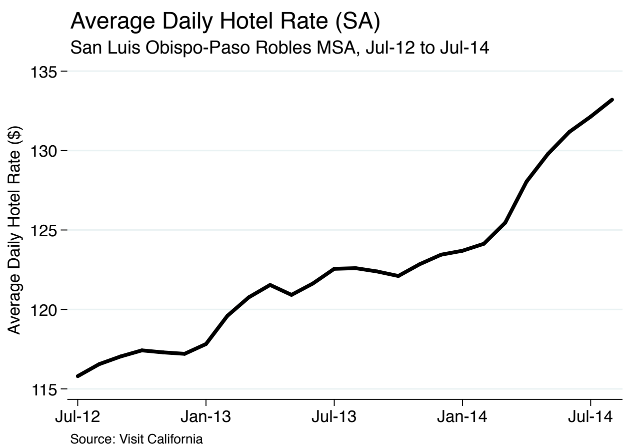
[9] Julie Lynem, "Amazon Is Hiring for Its Downtown SLO Office," *San Luis Obispo Tribune,* July 25, 2014.

[10] *2013 Crop Report,* Department of Agriculture, County of San Luis Obispo.

Tourism and Hospitality: Still a Source of Strength in San Luis Obispo County

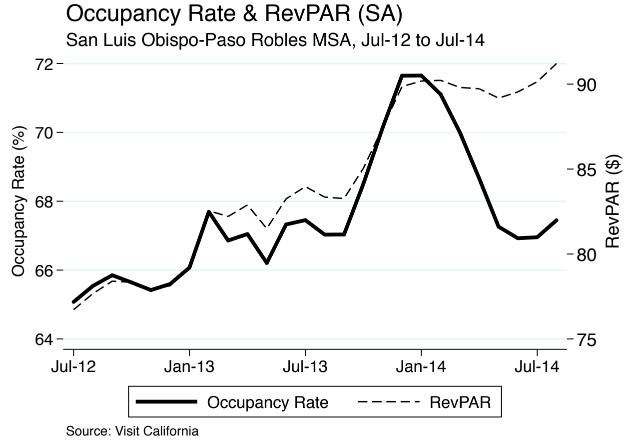
Tourism is continuing to show solid growth in San Luis Obispo County. According to Visit California, the average daily rate for hotel rooms in San Luis Obispo County increased by 8.5% from August 2013 to August 2014, to $134.68. By comparison, the average daily room rate increased by 8.4% in Santa Barbara County (to $174.50) and by 5.9% in Monterey County (to $181.84). Despite this stronger growth, room rates remain relatively competitive with the average rates directly to the north and south, which should also help tourism in the region.

Hotel occupancy has been more of a mixed bag as of late. The hotel occupancy rate in San Luis Obispo County edged up 0.49 percentage points from August 2013 to August 2014, but is down 4.27 percentage points from its two-year high in December of 2013, when the occupancy rate reached 71.79%. This is compared to a 1.88 percentage point increase in occupancy rate in Santa Barbara County and a 1.72 percentage point increase in Monterey County.



Hotel revenue per available room (revPAR), a combination of the two measurements above, shows that San Luis Obispo County is experiencing revPAR growth in line with its neighbor to the south, Santa Barbara, and slightly ahead of Monterey in the north.

From August 2013 to August 2014, revPAR increased in San Luis Obispo County by 9.4%, to $91.21. By comparison, revPAR increased by 9.4%, to $122.44, in Santa Barbara County and by 6.9%, to $121.22, in Monterey County.



Overall, the signs are continuing to point to strength across the Central Coast, but where are the *biggest* gains in San Luis Obispo County tourism coming from? Once again, Pismo Beach is leading the way. According to PKF Consulting, revPAR in Pismo Beach increased by 11.1% from January–August 2013 to January–August 2014, due in equal parts to average daily room rates increasing 5.5%, to $154.45, and occupancy rates increasing 5.4%. Both the average daily rates and occupancy rates in Pismo Beach are high water marks for cities in San Luis Obispo County. However, other areas are also showing strong performance. The North Coastal area, which includes cities such as Cambria, saw occupancy rates increase by 4.9% from January–August 2013 to January–August 2014, 0.9 percentage points above the regional average increase of 4.0%. North Coastal revPAR grew by 8.3% from January–August 2013 to January–August 2014. Altogether, the regional average revPAR grew by 9.1% from January–August 2013 to January–August 2014. Tourism continues to serve as an important driver of economic growth in San Luis Obispo County, and the strength of the region's tourism bodes well for the strength of its economy going forward.

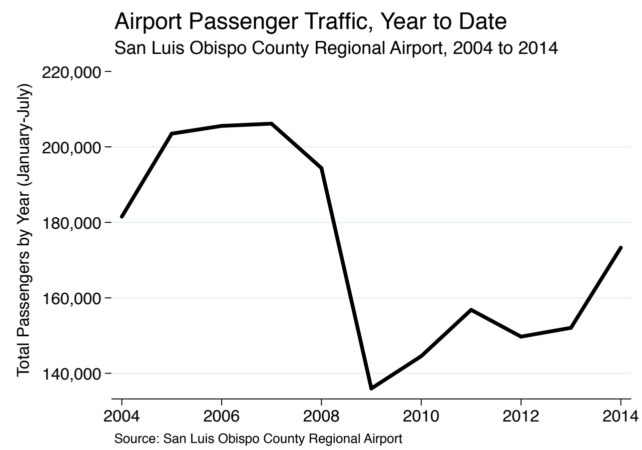
Hotel Statistics by City
San Luis Obispo & Other Coastal Cities, Jan-July 2013 to Jan-July 2014

Location	2013 Average Daily Rate ($)	2014 Average Daily Rate ($)	1-Year Change (%)	2013 Occ Rate (%)	2014 Occ Rate (%)	1-Year Change (%)	2013 RevPAR ($)	2014 RevPAR ($)	1-Year Change (%)
Pismo Beach	146.45	154.45	5.5	71.8	75.64	5.4	105.14	116.83	11.1
San Luis Obispo	123.69	129.11	4.4	72.47	74.52	2.8	89.64	96.21	7.3
Paso Robles	108.67	114.13	5.0	65.04	66.63	2.4	70.68	76.04	7.6
North Coastal	130.85	135.09	3.2	61.6	64.61	4.9	80.60	87.28	8.3
Regional Average	130.85	137.26	4.9	69.42	72.18	4.0	90.83	99.08	9.1

Source: PKF Consulting

The sustained uptick in tourism in San Luis Obispo County (as well as in the broader Central Coast region) is finally being accompanied by increased airport passenger traffic. After slower increases in traffic for the past couple of years, passenger traffic out of San Luis Obispo County Regional Airport has begun to edge up at an increasing rate. From January–July 2013 to January–July 2014, the total number of passengers at the airport increased by 14.0%, a noticeable improvement over the 1.6% increase from January–July 2012 to January–July 2013. The economic recession led to a steep drop in passenger traffic at the airport, and it has yet to fully recover. In the first seven months of 2007, the busiest year in the past decade, 206,000 passengers traveled through the airport. The recent growth in traffic has brought the number of passengers during the first seven months of 2014 to 173,000. So the lost ground is being recouped, but there is still a ways to go—current passenger levels remain 16% below the 2007 peak. Continued promotion of San Luis Obispo County's tourist attractions will help nudge up passenger traffic, but tourism promotion is not a one-stop solution.

Lost ground is being recouped, but there is still a ways to go.



Regional airports tend to have a difficult time setting up and maintaining direct service to major hubs in California and beyond. This is an issue that has affected not just the San Luis Obispo County Airport, but also regional airports in Santa Barbara, Bakersfield, and Monterey. According to commentary from San Luis Obispo's own Economic Vitality Corporation, available direct flights into and out of a small city have a direct impact on the area's business climate. San Luis Obispo appears to have taken notice, as the airport is working to add direct service to both Denver and Seattle.[11] In addition, recent increases in passenger traffic have San Luis Obispo Airport General Manager Kevin Bumen bullish about future prospects. Bumen is seeking permission from the County Board of Supervisors

[11] Randol White, "Regional Airports Struggle to Maintain Direct Service to Major Hubs," KCBX, Central Coast Public Radio, September 25, 2014.

to move forward with a federal grant proposal. If approved by the Federal Aviation Administration (FAA), the $20 million expansion grant would be used in large part to *quadruple* the airport's current terminal space. Bumen states that the San Luis Obispo County Airport is in a more fortunate position than airports in surrounding areas in that people are traveling to the county for both business and leisure.[12]

Agriculture and Wine Tourism Are Continuing to Boost Regional Business Activity

The growth of the region's wine industry is already playing a central role in the region's Tourism sector. For instance, Paso Robles winegrowers just earned new recognition from the federal government, with the designation of several new American Viticultural Areas in the region.[13] Growth in the Paso Robles wine industry has contributed to Tourism, as the City of Paso Robles is in the midst of a hotel boom. According to Susan DiCarli, the city's planning manager, "We're receiving more applications and more inquiries than ever before" with "seven or eight hotels in process right now." DiCarli added that the majority of the planned projects have 100 rooms or more.[14]

As revPAR has risen and as the hotel industry has become more profitable, the improvements have stimulated a variety of additional hotel projects, including a newly approved 127-room Oxford Suites in South Paso Robles, a 228-room hotel across from Hunter Ranch, and a 291-room hotel also in South Paso Robles that is still in litigation. All totaled, there's more than 1,500 rooms planned within a 6-mile radius in Paso Robles. [15]

Agritourism in San Luis Obispo County extends beyond its wineries. The increasing popularity and demand for farm-fresh regional foods was showcased this September at the California Grown Pavilion during the Savor the Central Coast food and wine festival. Attendees at these events are part of a growing number of consumers who are looking to bridge the gap between farmer and consumer via educating consumers about where our food comes from, how it is produced, and who is producing it. The event was attended by California Department of Food and Agriculture Secretary Karen Ross who, when asked about California Grown, commented, "California Grown is a marketing agreement with a number of commodities that are signatories and it's all about really capitalizing on our unique and highly desirable California brand."[16]

On top of events like these, the strength of wine production in the area will help to drive both agritourists and a large influx of wine consumers to San Luis Obispo wineries. As mentioned in the previous chapter, wine exporting is rising in San Luis Obispo County each year. According to WISERTrade, the county's total dollar value of exports for wine increased by 13.0% from January–June 2013 to January–June 2014 to $467 million overall. This is an increase of 48.8% from export values for January–June 2010.

The City of Paso Robles is in the midst of a hotel boom.

[12] Randol White, "San Luis Obispo's Airport Pushing for $20 Million Expansion Grant," KCBX, Central Coast Public Radio, October 9, 2014.

[13] Randol White, "Paso Robles Wine-Growing Region Has New Recognition for Its Diversity," KCBX, Central Coast Public Radio, October 9, 2014.

[14] Randol white, "Record Number of Hotel Properties Proposed for Paso Robles Wine Region," KCBX, Central Coast Public Radio, April 29, 2014.

[15] Interview with Dick Willhoit, September 23, 2014.

[16] Hayley Hooson, "CDFA Secretary Ross Visiting Central Coast for Savor Event," KCBX, Central Coast Public Radio, September 19, 2014.

Wine Export Values
San Luis Obispo County, 2011 to 2013

Product	2011 ($ Mil)	2012 ($ Mil)	2013 ($ Mil)	1-Yr Chg (%)
Wine Grapes (All)	129.7	197.9	220.4	11.4
Cabernet Sauvignon	40.3	64.9	72.8	12.2
Merlot	22	26.5	28.7	8.3
Red Wine (Other)	16.6	26.2	29.4	12.2
Chardonnay	14.3	22.2	25.4	14.4
Pinot Noir	7.8	14.1	17.5	24.1
Zinfandel	9.8	14.1	13.4	-5.0
White Wine (Other)	5.7	9	10	11.1
Sauvignon Blanc	4	6.1	7.2	18.0

Source: WISERTrade

Although data is currently unavailable for 2014 exports by types of wine, data for 2013 show that wine export values were up double-digits almost across the board. For example, from 2012 to 2013, Cabernet Sauvignon export values increased by 12.2%, to $72.8 million. Total Cabernet Sauvignon production increased by 5.5%, to roughly 52,800 tons, a much smaller increase than the 39.8% increase in production from 2011 to 2012. Merlot export values increased by 8.3%, to $28.7 million, as total Merlot production increased by 13.0%, to 27,600 tons, after falling by 2.3% from 2011 to 2012.

Because wine is not necessarily fermented or bottled in San Luis Obispo County for distribution, the data above could reflect only an increase in economic activity for vintners, rather than crop growers. However, from 2012 to 2013, total export values for all wine grapes increased by 11.4%, to $220.4 million. Total production of all wine grapes increased by 10.0%, to 165,000 tons. San Luis Obispo County is clearly continuing to make a mark as a leader in California wine growing.

Agriculture

by Eric Meux

Contents

Key Chapter Findings

- The local Agriculture industry had a great year in 2013. Total economic output from the industry hit a post-recession high, and the total value of agricultural commodities produced in the County hit an all time high for the fourth consecutive year.
- State exports of agricultural commodities increased at a slightly lower rate during the first eight months of the year compared to last year, 7.5% versus 11.8%, but nevertheless represents positive growth at a time when water is becoming increasingly scarce.
- The number of vineyards and winery establishments in the county has increased over the last year, further illustrating the local industry's resiliency in the face of the current dry spell.
- The San Luis Obispo Board of Supervisors is considering a plan to set up a locally controlled water district to manage the Paso Robles groundwater basin. While not all in the county support the creation of this district, it would prevent the state from stepping in and taking control of the local groundwater sources.

Introduction

San Luis Obispo County's Agriculture industry has continued to thrive over the last year, despite the continued dry spell in the state. Virtually all of the major indicators for the industry have maintained upward momentum in 2013 and have reached post-recession or all-time highs. Whether measured by economic output or crop production, the Agriculture industry in San Luis Obispo County remains strong.

Over the last several years we have seen some contraction in the local Agriculture industry, however, in terms of the number of farms and the amount of land. The latest figures from the U.S. Department of Agriculture's Census of Agriculture, conducted every five years, shows the number of farms in the county has declined by 4.2% from 2007 to 2012. San Luis Obispo County is not alone in this trend, however. The state overall also saw a decline in the total number of farms. Over the five-year period, the number of farms across California decreased by 3.9%.

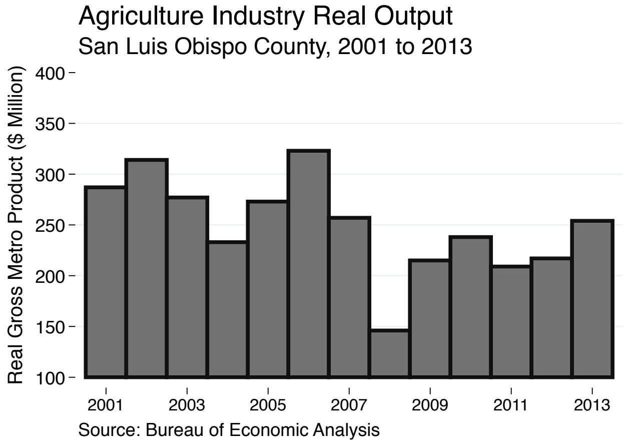
The number of farms in the county may have declined over the last several years, but you wouldn't know it by looking at the latest annual statistics. The county's Agriculture industry had a great year in 2013. Gross metropolitan product (GMP) for the local Agriculture industry is at a post-recession high, and the total value of agricultural commodities in the county reached an all-time record high for a fourth consecutive year. Wine grapes were the single largest driver of growth, but several crop categories reached record high values in 2013.

Census of Agriculture Statistics

	2007	2008	% Change
California			
Number of Farms	81,033	77,857	-3.9
Land in Farms (000 Acres)	25,365	25,569	0.8
Total Cropland (000 Acres)	9,465	9,592	1.3
San Luis Obispo County			
Number of Farms	2,784	2,666	-4.2
Land in Farms (000 Acres)	1,370	1,339	-2.2
Total Cropland (000 Acres)	300	255	-14.8

Source: United States Department of Agriculture

State exports of strawberries, San Luis Obispo County's number two crop by value, were up nearly 10% YTD, an acceleration over the 5% annual increase in 2013. Additionally, farm employment levels were virtually unchanged during the first eight months of the year compared with last year, indicating the state's current dry spell is not significantly impacting the county's Agriculture industry.



Thus far, 2014 is also shaping up to be a great year for SLO wine. The harvest started about a month ahead of schedule due to warmer temperatures. Yields are a bit lower, but quality is high and price increases could help make up for any declines in production.

Looking forward, the water situation in the county, and indeed in the state overall, will become an increasingly important topic for local authorities. Already the county has had to take measures in the face of declining water tables in the Paso Robles groundwater basin. In August 2013, the Board of Supervisors established a moratorium on expansions of irrigated cropland or any developments that are dependent on a well.

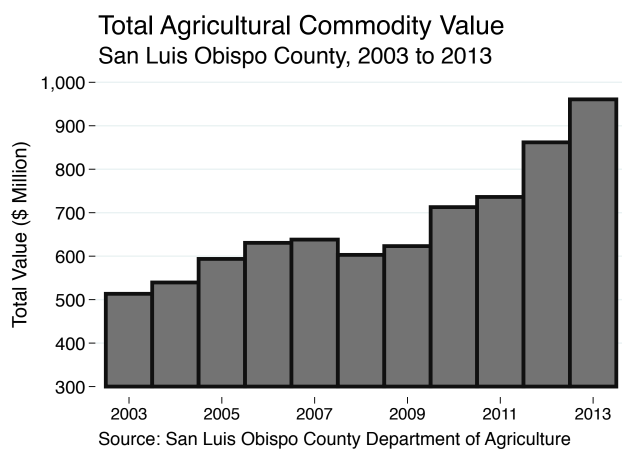
More recently, there has been new legislation coming out of Sacramento that has put into place new laws for groundwater management, which will impact San Luis Obispo County in particular given the region's relatively large reliance on groundwater sources compared with other regions in the state. Talks are well underway for the establishment of a local water district that would handle compliance and management of water resources locally, rather than receiving direction from Sacramento.

The current dry spell won't be the last, and ultimately strategies and infrastructure must be developed to manage resources more effectively to preserve long-term growth potential for the county's Agriculture industry.

2013 Agriculture Industry Performance

The Agriculture industry in San Luis Obispo County had an excellent year in 2013. Real economic output (that is, economic output adjusted for inflation) totaled $254 million, a 17.1% increase over 2012 output levels. This was a sharp increase over the 3.8% growth from 2011 to 2012, and it also outpaced annual growth in the overall state industry. From 2012 to 2013, California's overall agricultural output grew by 15.2%.

The total value of crop and animal products in San Luis Obispo County reached an all-time high in 2013 for a fourth consecutive year. According to the latest report from the San Luis Obispo County Department of Agriculture, the total value of all agricultural commodities in the county was $960.7 million, an 11.5% increase over the prior year. This comes on top of the 17.1% increase from 2011 to 2012 and marks the second consecutive year of double-digit annual growth.



Virtually all of the county's major product categories posted positive growth from 2012 to 2013, and more than half of those saw year-over-year increases in the double digits. The fruit and nut, vegetable, and animal product categories each made significant contributions to the annual gains, and the total dollar value of these categories each reached record highs of their own.

San Luis Obispo Agricultural Categories

Category	2012 ($ Million)	2013 ($ Million)	Annual Growth (%)
Total Value	861.8	960.7	11.5
Fruit and Nut	463.3	507.9	9.6
Vegetable	204.9	237.9	16.1
Animal	73.9	100.9	36.6
Nursery	95.2	97.7	2.6
Field	24.6	16.4	-33.5

Source: San Luis Obispo Department of Agriculture

The fruit and nut category, the largest category by dollar value, made the largest contribution to overall growth. The value of these products increased by 9.6% from 2012 to 2013 and contributed 5.2 percentage points to the 11.5% growth in the total value of all commodities. Not to be outdone, the total dollar value of the vegetable and animal product categories, the second and third largest categories, grew by 16.1% and 36.6%, respectively. Vegetable products made the second largest contribution to overall growth, 3.8 percentage points, and animal products came in third, with a contribution of 3.2 percentage points to the 11.5% overall growth.

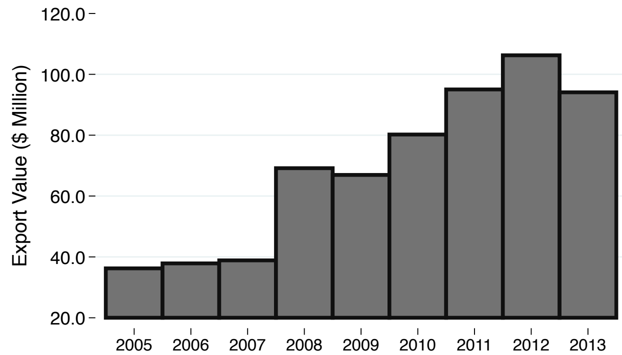
San Luis Obispo Agricultural Commodities

Commodity	2012 ($ Million)	2013 ($ Million)	Annual Growth (%)
Wine Grapes	198.0	220.4	11.3
Strawberries	205.0	210.6	2.7
Cattle and Calves	69.5	96.4	38.7
Broccoli	51.2	64.1	25.3
Avocados	18.4	44.3	140.5

Source: San Luis Obispo Department of Agriculture

In terms of top ranking commodities for the county, wine grapes once again took over the number one spot in 2013, up from number two in 2012. The total value of all of the county's top commodities increased in 2013. The total value of wine grapes came in at $220 million for the year, up 11.3% from the year prior. Strawberries slipped down to the number two spot in 2013 but nonetheless still saw positive growth in total crop value and increased by 2.7% over 2012 values. Cattle and calves, broccoli, and avocados rounded out the top five commodities, and the value of these products each increased sharply from 2012 to 2013.

San Luis Obispo County Crop Exports
2005 to 2013



Source: International Trade Administration

The bulk of the increase for the total value of wine grapes in the county came from increased production and prices for Cabernet Sauvignon grapes, the number one grape variety in the county in terms of production volume. Total production of Cabernet Sauvignon grapes reached 52,837 tons in 2013, a 5.5% increase over 2012 levels. Additionally, the price per ton for these grapes increased by 6.3% (to $1,378) in 2013. These trends led to a 12.2% increase in the total value of Cabernet Sauvignon production in 2013 and represented over one-third of the net increase in value of total wine grape production. Pinot Noir grapes, one of the smallest in terms of production volume, also made a significant contribution to growth in total wine grape value as production increased by 23.2%, and prices increased by 0.6% from 2012 to 2013.

In addition to being the number one agricultural commodity for the county, wine grapes, and the wineries and tasting rooms associated with the wine industry, are an important component of the local economy. In-

San Luis Obispo Wine Grape Crop Production

Grape Variety	Production 2013 Ton	Production Annual Growth (%)	Prices 2013 $ Per Ton	Prices Annual Growth (%)
White Grapes				
Chardonnay	20,385	19.5	1,247.0	-4.3
Sauvignon Blanc	6,278	13.1	1,148.0	4.3
White Wine (Other)	8,274	16.7	1,207.0	-4.8
Red Grapes				
Cabernet Sauvignon	52,837	5.5	1,378.0	6.3
Merlot	27,610	13.0	1,041.0	-4.1
Pinot Noir	6,761	23.2	2,594.0	0.6
Syrah	12,244	7.8	1,291.0	-0.5
Zinfandel	10,593	0.8	1,266.0	-5.7
Red Wine (Other)	19,820	9.1	1,485.0	2.9

Source: San Luis Obispo Department of Agriculture

creased activity in the wine industry helps support job growth in industries downstream, such as Wholesale Trade, Transportation and Warehousing, and Retail Trade. Additionally, tourists coming to the county for wine tasting support the local Leisure and Hospitality industry and increase overall spending levels, which benefits local government coffers through sales taxes.

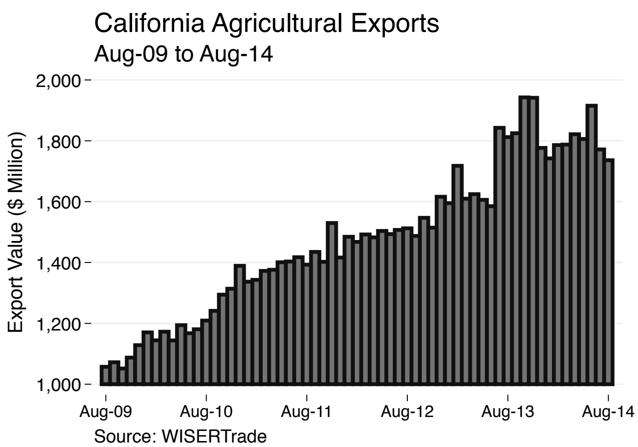
Exports of the county's crops bucked the trend of other indicators for the local Agriculture industry and declined from 2012 to 2013. The total value of crop exports attributed to the San Luis Obispo metropolitan area was $94.1 million in 2013, down 11.5% from a record high of $106.3 million in 2012. These exports, however, are not necessarily indicative of the overall industry's performance, which can readily be seen by looking at the other records set for economic output and commodity value. It is important to remember that California is not only the biggest producer of agricultural commodities in the country, but is also the biggest consumer since it has the largest population in the country. A large proportion of San Luis Obispo County crops is no doubt consumed right here in California or in other parts of the United States—the local industry does not need to rely on exports to drive growth. Additionally, other international factors, such as slow global economic growth and demand for wine in Europe and Asia, impact export performance and do not necessarily reflect how well the local industry is doing.

2014 Agricultural Exports and Industry Employment

As the state overall becomes increasingly parched due to the lack of rainfall and snowpack, it is a relief to see that the latest statistics for the state and local Agriculture industry show that the industry has not taken a substantial hit so far this year. The total value of agricultural exports for the state overall increased by 7.5% for the first eight months of the year, compared with the same year-to-date period last year. This may be lower than the 11.8% growth from 2012 YTD to 2013 YTD, but nevertheless represents positive growth at a time when water is becoming increasingly scarce.

As the state overall becomes increasingly parched due to the lack of rainfall and snowpack, it is a relief to see that the latest statistics for the state and local Agriculture industry show that the industry has not taken a substantial hit so far this year.

State exports of San Luis Obispo County's top commodities have been mixed this year. The year-to-date value of California's exports of strawberries, as well as cauliflower and broccoli, were up by 13.1% and 5.4%, respectively; however, exports of wine, beef, and avocados were down by 4.5%, 8.9%, and 22.5%, respectively. As previously mentioned, San Luis Obispo County does not need to rely on exports for growth in the local industry, but these latest statistics show that there has been some softening of international demand for certain products in 2014.



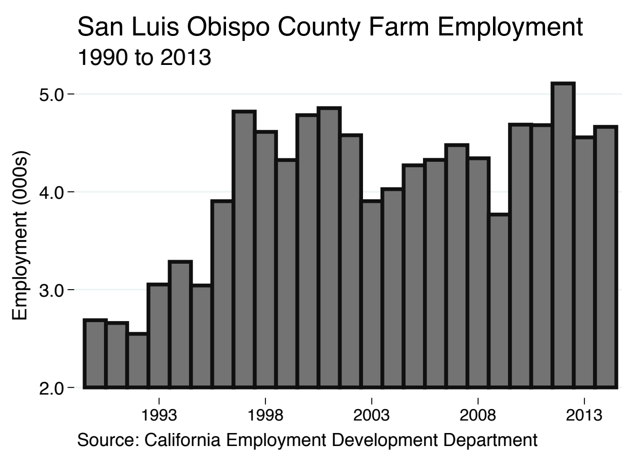
Overall farm employment in San Luis Obispo County has trended sideways in 2014 for the most part, suggesting that the local industry has not experienced any major contractions. As of September 2014, the total number of farm employees on company payrolls was estimated to be 3,700 on a seasonally adjusted basis, unchanged from September 2013. Caution should be used when looking at farm payroll statistics, however, given that many farm workers are not on official company payrolls. Nevertheless, the trends we are seeing in this series are reassuring given the current state of the water supply in California.

California Agricultural Exports Through August 2013

Commodity	2013 YTD ($ Million)	YTD Growth (%)
Total Agricultural Exports	13,564.8	7.5
Wine	883.5	-4.5
Strawberries	274.9	13.1
Beef	223.0	-8.9
Cauliflower and Broccoli	71.7	5.4
Avocados	40.9	-22.5

Source: WISERTrade

The most recent data from the Quarterly Census of Employment and Wages (QCEW) show that the number of vineyards and winery establishments in the county has increased over the last year, further illustrating the local industry's resiliency in the face of the current dry spell. The QCEW includes a quarterly count of employment and wages reported by employers and covers 98% of U.S. jobs. An establishment in the QCEW data is defined as a single economic unit, such as a farm, a mine, a factory, or a store, that produces goods or services. A company could be made up of one or more establishments.



According to the QCEW, the number of grape vineyard establishments in San Luis Obispo County increased from 45 in the first quarter of 2013 to 50 in the first quarter of 2014, an 11.1% increase. The number of winery establishments in the county saw a similar increase. From the first quarter of 2013 to the first quarter of 2014, winery establishments grew by 10.5%.

San Luis Obispo County Wine Industry

Establishment Type	Number of Establishments Q1-13	Number of Establishments Q1-14	YoY Growth (%)
Grape Vineyards	45	50	11.1
Wineries	105	116	10.5

Source: Bureau of Labor Statistics

The Water Situation in the State and County

The state's dry spell has impacted the county's Agriculture industry and has hampered short-term growth as water becomes an increasingly scarce resource. Last year the San Luis Obispo County Board of Supervisors enacted an urgency ordinance, which established a moratorium on new or expanded irrigated crop production, conversion of dry farm or grazing land to new or expanded irrigated crop production, and new development dependent on a well in the Paso Robles groundwater basin.

New irrigated cropland or developments are allowed, however, if the additional water use is offset elsewhere. This ordinance came as wells began running dry in the Paso Robles basin last year and as well owners were faced with the choice of trucking in water or drilling deeper wells. The current moratorium is set to stay in effect until August 2015.

More recently, the state has taken steps of its own. On September 16th, Governor Jerry Brown signed into law new legislation that will require groundwater sources to be managed in order to prevent aquifer water levels from dropping and wells from running dry. This is considered a historic change in groundwater management and could lead to restrictions on pumping. The new laws put local agencies in charge of management but also give the state authority to step in if water tables are declining. Until now, California had been the only western state where groundwater pumping was unregulated.

The new legislation will take years before it begins to make an impact. Local authorities have two years to identify or create a groundwater sustainability agency. Thereafter, local agencies will then have several years to develop plans to manage groundwater sources.

In San Luis Obispo County, there has been discussion among the county's Board of Supervisors to set up a locally controlled water district to manage the Paso Robles groundwater basin. This proposed water district has been called a "hybrid" water district because some of the directors would be elected by registered voters and others by landowners. While not all in the county support the creation of this district, it would prevent the state from stepping in and taking control of the local groundwater sources.

Setting up this district in San Luis Obispo County will not happen overnight. First the county Board of Supervisors will need to decide if they want the Public Works Department to petition the Local Agency Formation Commission (LAFCO) to form a Paso Robles water district. This petition would be no small task, and some have estimated it would cost the county $350,000, the bulk of which would go toward an election if the proposal goes to a vote among landowners.[17]

The state of the Paso Robles water basin is not as dire as problems in other parts of the state, such as in the Central Valley, as the groundwater reserves are not as depleted. However, water remains a key concern for the county given the large presence of the Agriculture industry and the importance of wine in particular. Going forward, conservation, innovations, and effective management will be paramount.

[17] David Sneed, "Supervisors to Discuss Water District, Drought's Effects," *San Luis Obispo Tribune*, October 13, 2014, available at `http://www.sanluisobispo.com/2012/10/13/3294443_supervisors=paso-robles-water.html?rh=1`.

Residential Real Estate

by Alan Hooper

Contents

Key Chapter Findings

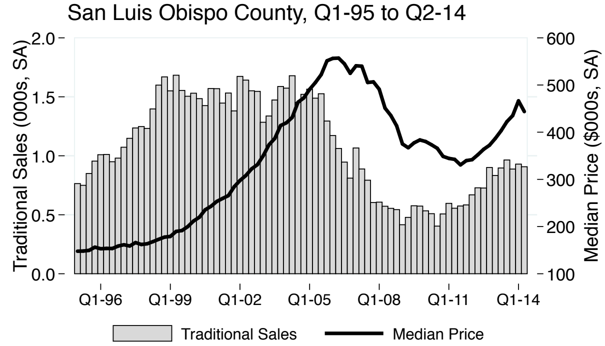
- The housing market in San Luis Obispo County began to normalize over the last year—home prices grew at a relatively moderate pace (10.1%) from the second quarter of 2013 to the second quarter of 2014, while traditional sales were up 6.2% year-to-date.
- The supply of housing in San Luis Obispo County has improved at a faster rate than in any other county in the Central Coast, although the supply of existing single-family homes remains tight.
- In a sign that developers are responding to the persistent rise in home prices, permit activity is picking up in San Luis Obispo County. The number of permits issued for construction of single-family homes increased by 20.8% year-to-date.
- Rents continued to march steadily upwards, increasing by 2.6% from the second quarter of 2013 to the second quarter of 2014. At the same time, the 1.4 percentage point increase in the vacancy rate in the county indicates that a number of the construction projects permitted in 2012 and 2013 have been completed and added to the stock of available units.

Housing Market Overview

The housing market in San Luis Obispo County started to normalize over the past year. Home prices grew 10.1% from the second quarter of 2013 to the second quarter of 2014, a rate that is relatively moderate compared with the 14.4% growth during the previous year. At the same time, the number of traditional housing sales in the county (which are estimated by subtracting foreclosures from total sales) continues to grow—traditional sales are up 6.2% year-to-date. Although this figure reflects a relatively slower pace of growth compared with the increase observed over the past year, it indicates that the housing market in the county is slowly, but surely, moving toward a more sustainable pattern of growth.

Data for the most recent quarter show a break in the trend of rising home prices, but Beacon Economics strongly believes that this result is driven entirely by the mix of houses sold during the first quarter of this year—current market conditions do not indicate that prices will decrease going forward. This belief is driven by our positive outlook for housing demand in San Luis Obispo County, demand which has been boosted by the continued relaxation of lending standards and historically low interest rates. For example, the average FICO score accepted for FHA home purchase loans fell 1.9%, from 699 in February 2013 to 686 in February 2014, while the current 30-year fixed-rate mortgage fell 0.3 percentage points, to 4.2% in September 2014. Taken together, a greater number of prospective homebuyers will have access to the affordable credit needed to complete housing purchases.

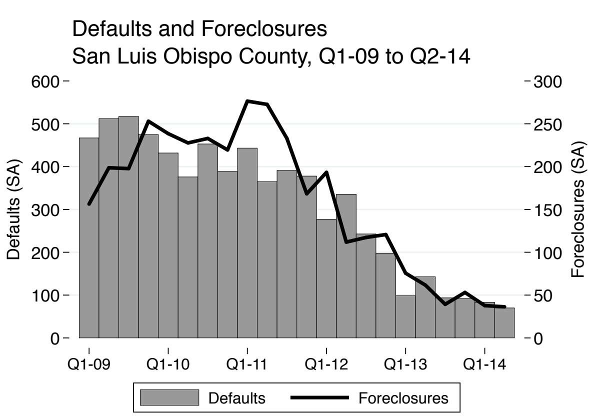
Res. Real Estate Prices and Traditional Sales
San Luis Obispo County, Q1-95 to Q2-14



Note: Traditional Sales are estimated by subtracting foreclosures from total sales.
Source: DataQuick

Additionally, affordability remains low by historical standards. At the median sales price for an existing single-family home, a homebuyer in San Luis Obispo County today would face a monthly mortgage payment of $1,777. In comparison, a homebuyer in the county during the peak of the housing bubble would pay $2,166 per month for a mortgage. Overall, a homebuyer in the county can expect 45.8% of his or her household income to go toward housing costs, down from 57% at the peak of the bubble. As such, the relative affordability of housing in San Luis Obispo County should continue to boost demand.

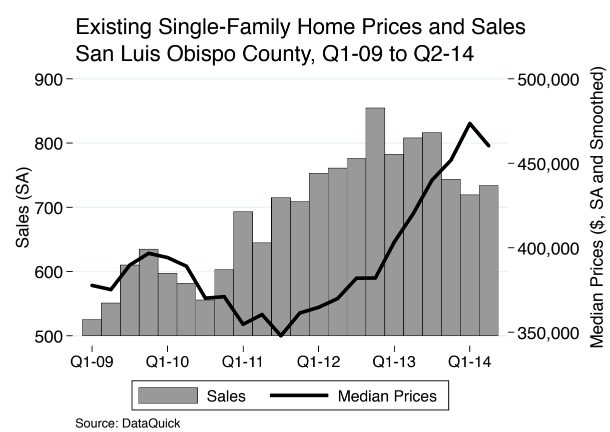
Further bolstering our position on the housing market in San Luis Obispo County is the rate at which the supply of housing has recovered. Although inventories of 6 to 8 months typically characterize a healthy housing market, the 5 months' supply of housing in San Luis Obispo County during August 2014 is the highest seen in the coastal counties in the state. The closest county, Santa Barbara, has a 4.7 months' supply, while the statewide average is currently only 4 months. Clearly, the housing supply in San Luis Obispo County has started to overcome the sharp decline in the number of distressed properties entering the market. Foreclosures are down 41% year-over-year, while defaults declined 51% during this time period. This indicates that the housing market in the county is much closer to normal than any other comparable market.



Nonetheless, supply concerns will continue to dictate the pace of the housing market's recovery in San Luis Obispo County. Inventories may be trending in the right direction, but they are a cyclical measure. Overall housing vacancy, which is a longer-term issue, indicates that there are not enough homes to meet growing demand. For instance, only 4,000, or 3.4%, of the roughly 118,000 housing units in the county were reported as vacant in the 2013 American Community Survey. This is a sign that there is a shortage of all types of housing in San Luis Obispo County. Lingering supply issues will continue to impact the county's housing market until new housing is constructed to bridge the gap between supply and demand.

Single-Family Housing Market

Prices and Sales



The median sales price for existing single-family homes increased by 9.6%, to $460,400, in San Luis Obispo County from the second quarter of 2013 to the second quarter of this year. The rate of growth in San Luis Obispo County pales in comparison to that of Monterey County (14.2%), although it is much faster than the rate of growth observed in Santa Barbara County, where prices declined by 5.3% during this period.

Existing Single-Family Home Prices (SA)
By Region, Q2-14

Location	Median Price Q2-14 ($)	1-Year Chg (%)
Central California		
San Luis Obispo	460,000	9.6
Santa Barbara	393,000	-5.3
Monterey	415,000	14.2
Southern California		
Los Angeles*	469,000	10.4
Orange County*	631,000	7.7
San Diego*	470,000	6.8
Inland Empire*	264,000	16.5
Ventura*	510,000	9.4
Northern California		
San Francisco*	902,000	7.0
Oakland*	528,000	14.7
San Jose*	769,000	10.6
Sacramento*	255,000	15.9
Other Northern California*	370,000	13.3
State of California	374,000	10.9

Source: DataQuick
*Average Regional Price

San Luis Obispo County Residential Real Estate, by City (SA)

Existing Single-Family Home Median Prices*			
Location	Q2-13 ($)	Q2-14 ($)	Change (%)
Arroyo Grande	479,000	584,000	21.9
Atascadero	366,000	412,000	12.6
Grover Beach	337,000	377,000	11.9
Paso Robles	350,000	373,000	6.5
San Luis Obispo	576,000	663,000	15.1
San Luis Obispo County	420,000	460,000	9.6
Residential Sales			
Location	2013 YTD	2014 YTD	Change (%)
Arroyo Grande	158	147	-6.7
Atascadero	205	186	-9.4
Grover Beach	77	55	-28.4
Paso Robles	324	273	-15.9
San Luis Obispo	179	179	0.0
San Luis Obispo County	1,590	1,453	-8.6

Source: DataQuick
*Prices have been rounded to the nearest thousand

The particularly heated housing markets in the middle of the county have heavily influenced the overall rate of price appreciation. For instance, median prices increased 23% (to $584,000) in Arroyo Grande from the second quarter of 2013 to the second quarter of 2014, while they increased by 18.8% (to $412,000) further north in Atascadero. Growth was much more reasonable in other cities in San Luis Obispo County—prices grew by 9% in Paso Robles during this time, while they were relatively flat in Grover Beach (0.4% year-over-year). Ultimately, this indicates that some parts of the county have returned to normal faster than others.

While the supply shortage throughout the county will spur rapid price appreciation in the short run, the additional construction induced by the rising prices will hasten the normalization of the market.

Despite the fact that overall traditional housing sales in San Luis Obispo County increased over the past year, total sales of existing single-family homes in the county dipped in recent quarters. Sales are down 8.6% year-to-date after increasing 5.1% at this time last year. Undoubtedly, the market for existing single-family homes is impacted by the decline of distressed properties on the market, which explains the recent downward trend in sales. A tight supply of housing caused by a shortage of distressed properties is ultimately good news for the Central Coast, despite the fact that this trend has weighed down the headline sales statistics, as it indicates that fewer households are struggling with troubled mortgages.

The decline in sales is spread throughout the county, although Paso Robles (down 15.9% year-to-date) and Atascadero (down 9.4% year-to-date) account for the bulk of this decrease. The City of San Luis Obispo demonstrated the most stability, with the number of sales unchanged when compared with sales at this time last year, even after defaults and foreclosure fell within the city. While the supply shortage throughout the county will spur rapid price appreciation in the short run, the additional construction induced by the rising prices will hasten the normalization of the market.

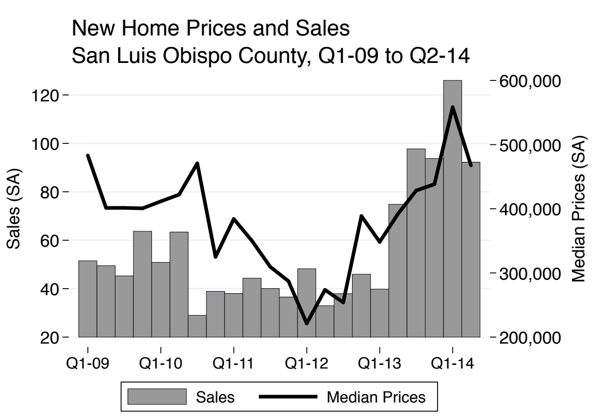
New Homes and Construction

Indeed, developers have already responded to the price appreciation in San Luis Obispo County: 307 permits have been issued for the construction of single-family homes in the county through August 2014, up 20.8% from this time last year. In particular, 120 permits have been issued for single-family construction year-to-date in Atascadero, up from 69 permits issued at this point last year. Meanwhile, the City of San Luis Obispo has had a decent amount of permit activity (48 permits issued) thus far in 2014. These two cities will be at the forefront of the San Luis Obispo County housing market in the year ahead. When these new homes enter the market, the aforementioned supply constraints should loosen up, thus causing price appreciation to moderate.

Single-Family Construction Permits in San Luis Obispo County
Year-to-date 2012, 2013, and 2014

Location	Permits			Average Permit Value ($ thousands)		
	2012	2013	2014	2012	2013	2014
Arroyo Grande	18	9	9	233.0	226.7	324.4
Atascadero	24	69	120	154.0	174.1	212.8
Grover Beach	1	1	5	240.0	340.3	208.4
Morro Bay	8	17	5	209.0	186.3	232.3
Paso Robles	42	38	20	277.7	298.0	294.6
Pismo Beach	14	8	35	400.7	401.7	336.4
San Luis Obispo	31	41	48	306.2	261.4	252.8
County Unincorporated Area	205	180	204	381.7	360.9	389.0

Source: CIRB
Note: Year-to-date through June.



Source: DataQuick

With construction activity continuing to grow in San Luis Obispo County, the jump in new home sales since the third quarter of last year comes as little surprise. There have been 218 new home sales in the county, year-to-date, which is a 90.4% increase from the previous year. At the same time, the median sales price for new homes has grown 38.6%, to $467,700, which is only $7,000 more than the current median for existing single-family homes.

Multifamily Housing Market

Existing Condominiums

Although the multifamily market represents a relatively small fraction of the overall housing market in San Luis Obispo County, multifamily housing in the county is among the most affordable in the Central Coast. The median sales price for existing condominiums in the county is $335,700, up 9.4% since the second quarter of 2014. Despite the healthy appreciation of prices in this market, the median sales price for existing condominiums in San Luis Obispo County is more affordable than the median price in Monterey and Santa Barbara Counties, and only 2.6% more expensive than the median price in Ventura County.

With construction activity continuing to grow in San Luis Obispo County, the jump in new home sales since the third quarter of last year comes as little surprise.

Existing condominium sales, which are down 2.0% year-to-date, have been relatively flat so far this year, at least compared to sales for existing single-family homes. The decline in sales has been more pronounced elsewhere in the Central Coast—sales are down 20.2% year-to-date in Monterey County, 7.8% in Santa Barbara County, and 6.3% in Ventura County. Ultimately, the affordability of existing condominiums, coupled with the relative stability of sales in San Luis Obispo County, paints a picture of a burgeoning multifamily housing market.

Multifamily Construction Permits in San Luis Obispo County
Year to Date 2012, 2013, and 2014

Location	Permits			Average Permit Value ($ thousands)		
	2012	2013	2014	2012	2013	2014
Arroyo Grande	0	36	28	0.0	120.5	72.9
Atascadero	66	48	20	135.2	121.2	97.8
Pismo Beach	0	5	8	0.0	248.5	290.6
San Luis Obispo	27	15	14	99.0	129.2	187.4
County Unincorporated Area	0	2	7	0.0	253.8	88.9

Source: CIRB
Note: Year-to-date through June.

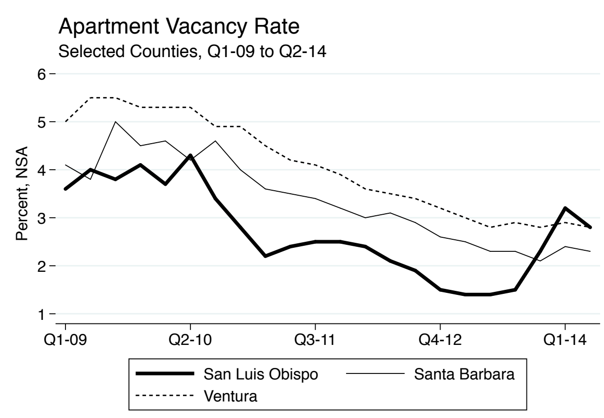
Construction activity in the multifamily sector also suggests a healthy outlook, even though 69 fewer permits have been issued year-to-date than had been issued at this point last year. Despite this decrease, the multifamily housing market will be boosted by the strong construction activity that occurred in the county throughout 2013. During 2013, developers picked up a number of projects that had been abandoned during the downturn. For instance, Coastal Community Builders has several mixed-use projects near downtown Pismo Beach, including the construction of 52 multifamily units. [18] This bodes well for the multifamily housing market in the near-term. As these projects are completed and brought onto the market, price appreciation will slow down and sales will grow. As such, the multifamily housing market is primed to take over a larger share of the overall market in San Luis Obispo County over the next year.

Rental Market

The rental market in the county continues to grow at a solid pace. The average cost of rent grew by 2.6%, to $984/month, from the second quarter of 2013 to the second quarter of 2014. By comparison, the average cost of rent grew by 3.1% year-over-year, to $1,506/month in Ventura County, and by 2.7%, to $1,317/month, in Santa Barbara County. Clearly, rental units in San Luis Obispo County remain considerably more affordable than elsewhere in the Central Coast.

The fundamentals of the rental market remain strong—demand will continue to grow and the recent multifamily construction activity should add to the existing stock of rental units.

After reaching a low of 1.4% during the second quarter of last year, vacancy rates in the county climbed to 2.8% in the second quarter of 2014. The fact that the cost of rent and vacancy rates grew at the same time indicates a surge in demand for rentals and an increase in the stock of available units. In particular, it appears a number of the aforementioned construction projects entered the market during the fourth quarter of 2013 and the first quarter of 2014, when the vacancy rate reached 3.2%. Meanwhile, the strong demand for rentals in San Luis Obispo County during 2013 has carried into 2014. The decline in homeownership among millennials, and the corresponding increase in renting, has been the primary driver of demand growth for rental units during this time period.[19]



[18] Julie Lynem, "New Homes, Restaurants, Hotel Underway in Pismo Beach," *San Luis Obispo Tribune,* May 27, 2014.

[19] Hadley Malcom, "Millennials Are Not Big Homebuyers Near Term," *USA Today,* September 16, 2013.

Overall, the outlook for the rental market in the county is positive. The fundamentals of the rental market remain strong—demand will continue to grow and the recent multifamily construction activity should add to the existing stock of rental units. We expect that the cost of rent will continue to grow at a reasonable rate, while vacancies will remain low.

2014 Commercial Real Estate

by Steve McCarty and Steve Davis
Stafford McCarty Commercial Real Estate

Contents

Key Chapter Findings

- Transitioning from a period of inventory surplus to scarcity.
- New commercial construction underway.
- Strong interest in hospitality.
- Larger projects coming back on line.

A Brief Note on Residential Market—How Deep is the Market?

San Luis Obispo

The housing market in San Luis Obispo has seen paced growth this past year. Total single family unit sales were slightly less than in 2013, but the median price, which topped $375 per square foot, increased over the previous year and has exceeded the pre-recession 2008 high water mark. Other areas of the Central Coast have yet to experience the same percentage increase in price per square foot. Mixed use projects (residential over commercial spaces) are getting a lot of attention in the downtown core.

North County

The North County shows increasing price trends, but is not on the same trajectory as San Luis Obispo. Unit sale volume is down slightly from 2013 but median prices have increased. In the North County, the median price per square foot is $233, compared to San Luis Obispo's $375 median price (noted above).

Housing Related Projects

Growth in the new construction housing market is continuing to gain momentum.

- Sierra Meadows on Prado Road is actively selling single-family detached homes.
- The first downtown mixed use project at the corner of Marsh and Nipomo has sold all of its residential (and commercial) units.
- ROEM Development, out of San Jose, has closed on the McCarthy Steel property on South Street for a housing project in conjunction with the Housing Authority.

Many other projects are once again working their way through the planning/entitlement pipeline. Projects with housing components that have been on hold for some time are now being actively processed, including:

- Pacific Courtyards
- Chinatown
- Bridge Street
- Monterey Place
- The reworking of the Dalidio project to provide more housing and less commercial space

Other new projects include:

- Wingate Homes, Righetti Ranch, the Jones Property, and West Creek—all in the Orcutt Area Specific Plan
- Avila Ranch South of the SLO County Airport
- Brownstones on Marsh

Residential Unit Sales, 3rd Quarter Annual Data

Variable	2008	2009	2010	2011	2012	2013	2014
			San Luis Obispo				
# Units Sold	159	163	191	215	273	282	259
Median Price ($)	635,000	569,000	550,000	535,000	535,000	618,500	654,500
			North County				
# Units Sold	638	702	698	892	991	1,045	1,032
Median Price ($)	390,000	340,000	296,000	270,000	305,000	355,000	375,500

Note: Comparative data is for the first three quarters of each year
Source: Central Coast Regional Multiple Listing Service;
Compilation by Stafford McCarty Commercial Real Estate

Following is a summary of unit sales from 2008 through 2014 in San Luis Obispo and North County.

Clearly the market is supporting new construction and inviting builders to return. The remaining question is how much new housing, and at what price, will the market absorb in the post recovery.

Commercial Markets

Overall there is new vitality and a sense of excitement in Central Coast commercial real estate. The market is finally showing sales activity across all sectors, including medical, retail, office, R and D, industrial, and land.

Both the industrial and office categories are seeing new construction completed, adding to the existing inventory. We have also seen a slight rise in the vacancy rates in these categories. As companies such as Rosetta and Family Care Networks have moved into their new facilities, the vacancies left behind have not been completely backfilled as of this writing.

The market is finally showing sales activity across all sectors, including medical, retail, office, R and D, industrial, and land.

Commercial land has even "flipped"—bought for one price and resold at a higher price —in a relatively short time. An example is 791 Orcutt Road, an entitled multifamily project of approximately 80 units, which sold in 2012 for approximately $2,300,000 and resold 2 years later for $3,600,000.

Regarding rent recovery, the market is just starting to revive after the 25% to 30% rental rate decrease that occurred during the economic downturn. New construction, or first generation space, have higher rents that are more closely tied to the costs of construction.

Lenders have been the focus of conversation, but now OREO's (bank owned properties) have virtually been cleared up and lenders are targeting new loans. Equity requirements for conventional loans are still problematic for many borrowers. Small Business Administration (SBA) loans and owner financing are the most common commercial loan vehicles.

Commercial Markets in San Luis Obispo

The market is continuing to grow in confidence with commercial sales returning after years of scant activity. Big projects are back as well. One of the most noted has been the San Luis Ranch Project (formerly the "Dalido Ranch" annexation), which has occupied more newspaper space over the years than any other

Commercial Vacancy Rates (%), San Luis Obispo City Metropolitan Area, 2014

Property	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Industrial/Warehouse	2.8	3.8	6.4	4.0	4.3	2.3	5.4	6.1	9.1	8.7	4.5	1.9	3.1
Retail Functioning	1.9	2.4	2.2	1.7	1.8	1.4	3.0	5.6	5.1	3.4	3.7	1.8	2.7
Office Functioning	9.9	8.4	5.4	3.2	4.7	3.5	6.1	9.7	12.6	11.6	8.6	6.5	7.5

Source: Stafford McCarty Commercial Real Estate

development we can remember. Coastal Community Builders is making progress on reworking the 131-acre 101 freeway frontage entitlements. The project is dependent upon the current draft Land Use Circulation Element (LUCE) being approved, but the LUCE is in conflict with current airport safety zones. The coordination of these agencies is critical to the growth of San Luis Obispo and the outcome is yet to be determined.

The downtown core of San Luis Obispo continues to be active with low vacancy and infill projects in various stages of planning and completion. Restaurants are predominating the downtown experience and as suspected not all of them are making a go of it. However, the ones that do not endure are soon replaced and vacancy remains tight. The former Daylight Gardens location has been reworked into a project called Heritage Plaza and has signed leases for most of the renovated space.

Tech sector expansion continues to be robust, with many "home-grown" companies sustaining growth. The Hothouse partnership between Cal Poly, the City, and local businesses is fostering new company formation and a cross pollination of ideas. Mind Body continues its staggering growth and has plans to occupy 180,000 square feet (Mind Body is an anomaly for our market with most companies being significantly smaller).

Manufacturing is seeing growth in our area as well. Cloud completed 26,000 square feet of construction, SRAM is in the process of completing its 20,000 square foot new location, and AccuAir continues its growth and need for square footage. Other smaller manufacturers are moving up and into larger facilities as well.

Aside from downtown, the other area seeing a lot of activity is on South Broad Street. In addition to the new construction across from the airport, SESLOC is settling into their new 40,000 square foot headquarters and Mind Body (noted above) is deep into the construction of their new corporate headquarters (both are within the City limits).

In other parts of town, owner and users projects are still moving forward including: Digital West, McCarthy Steel, Tractor Supply, and University Square, to name a few.

Retail

Retail vacancy stands higher than last year at 2.7%, with approximately 112,505 square feet vacant in a market with a base inventory of 4,163,270 square feet. Only 3,987 square feet of new construction was added to the retail sector base inventory this past year. Retail has the lowest vacancy of any market sector and has been a strong performer in the post recession years.

Confidence from investors is noted here as well. At 1119 Chorro Street, 3,500 square feet sold for $1,500,000, ($429 per square foot) vacant, and listed at 5 cap on proforma rents (capitalization rates discussed in later section).

Kreuzberg Cafe at 685 Higuera (5,500 square feet) sold for $2,215,000, or $386 per square foot, to a quasi related owner/user demonstrating substantial value as an improved property sale downtown.

Office

The office inventory base is approximately 2,842,000 square feet. Vacancy is up slightly to 7.45% from 6.47% last year. Total available office inventory in San Luis Obispo is approximately 212,000 square feet. New or "newer" space has been able to command the upper rental range of approximately $2.00 NNN per square foot.

The office market is growing as seen by the initiation of some speculative building projects. San Luis Obispo Airport Business Park is about ready to break ground on building 7,300 square feet of office/retail space. This is a significant turning point with the return of spec product.

Within the office market, the submarket of medical offices has seen robust sales and leasing activity. Pacific Eye has leased approximately 9,000 square feet at the new SESLOC Campus, and groundbreaking has commenced on the new medical education center at the French Hospital Campus for approximately 18,000 square feet.

Several medical office sales demonstrate the range of sale prices per square foot:

- 1531 Higuera Street (6,000 sq. ft.)—Newer Product—$900,000 ($435 per sq. ft.)
- 1304 Ella Street #A (3,072 sq. ft.)—$875,000 ($285 per sq. ft.)
- 1250 Peach #A (2,760 sq. ft.)—$712,500 ($258 per sq. ft.)

Industrial

Although the vacancy rate for industrial product has increased up to 3.14% (1.9% in 2013), functional industrial space has all but disappeared. Available manufacturing inventory is approximately 121,200 square feet with a total base of industrial inventory at approximately 3,854,600 square feet.

There is still unmet demand across the board for industrial spaces of up to 25,000 square feet and larger. No significant buildings have been added to the manufacturing inventory. Approximately 49,000 square feet has been added in the last four years and 40,000 square feet of that was in 2013. This segment of the market is seeing rental rates start to climb with the dearth of inventory. Quoted industrial rents have risen from $0.65 to $0.85 per square foot NNN.

The following noted sales show a range of pricing for industrial type product:

- 785 Buckley Road (10,000 sq. ft. with surplus land)—$2,800,000 ($280 per sq. ft.)
- 805 Aerovista #104 (9,593 sq. ft.)—$1,600,000 ($167 per sq. ft.)
- 4120 Horizon (8,600 sq. ft.)—$825,000 ($99 per sq. ft.)

In other industrial activity, Specialty Construction has started moving earth on their approximately 6.16 acre site on Buckley Road for a multi building project.

Industrial and CS zoned land is approximately $10 to $15 per square foot on offerings, and appraisal discussions and can be higher if the parcels have a retail presence.

Downtown San Luis Obispo

Scaffolding and blocked sidewalks are recent signs of construction starts and building renovations which have come to life again.

Developers are looking for projects in the downtown area as the City is supporting residential in that area. Mixed use (typically retail or office below and residential above) has drawn attention. PB Group has the Foster's Freeze corner under contract and has closed escrow on adjoining properties for development. The remodeling is underway at 650 Higuera (formerly Central Coast Surfboards) for the new home of SLO Brew.

Following are recent land sales on the edges of the downtown core:

- 7,841 square feet of downtown property was purchased on the corner of Marsh and Broad for approximately $800,000, or $102 per square foot.
- 581 Higuera: the 26,000 square foot lot was purchased for $1,555,000 (former Heritage Oaks Bank Branch), or $73 per square foot of land area.

Commercial Markets in Paso Robles and North County

Issues surrounding water rights and control of the over-drafted basin have escalated to new levels and will be key to future development and the expansion of the viticulture industries.

Excluding the office market sector, Paso Robles vacancies have decreased again over the previous year.

The Firestone Walker Brewery, and noted 805 brand, has absorbed the vacant industrial parcels at Vendels Circle and continues its expansion and popularity at the southern gateway to the City.

A prominent property of approximately 2.5 acres, entitled for mixed used at 4th and Spring Streets, has changed hands. This highly visible gateway property sold for approximately $18.65 per square foot.

Retail

All in all, retail in Paso Robles has done very well in the post recession. The retail base inventory for the market remains at approximately 4,646,000 square feet. Retail vacancies have again decreased slightly from 3.3% last year to 2.61% this year. There is approximately 121,000 square feet of retail space on the market at this time.

Spaces have been slow to fill with some well located properties still having vacancy in spite of tight inventory. Real estate can be quirky this way sometimes.

Office

Office remains a weak spot in the Paso Robles market. After year-over-year improvement for the last several years, vacancy has nearly doubled, climbing from 6.58% in 2013 to 14.25% in 2014. The sizes vary from small units up to the largest vacancy of approximately 10,000 square feet. There is approximately 61,500 square feet vacant at this time.

Rent recovery for second generation office will be on hold in this market sector until absorption improves. Targeted asking rents are centered around $1.50 per square foot gross for better finished units. Older units will compete for rents at lower levels.

Technology companies such as IQMS, Santa Cruz Biotech, Applied Technologies, and Silicone Fabricators are settling into their recently added expansions. North County is steadily growing its tech base.

Manufacturing

The manufacturing sector has performed well and inventory has become increasingly snug. Overall absorption has been lackluster but the owner/user expansion has continued with companies noted above. The industrial sector added approximately 119,000 square feet,with vacancy now standing at a modest 3.62%. Paso Robles' industrial base is presently approximately 3,287,650 square feet.

Please note our comments in the Agricultural section as the viticulture industry has filled many manufacturing vacancies in the City as well as the surrounding county areas.

Recent industrial parcel sales indicate values at about $3.00 per square foot for two to three acres.

Commercial Vacancy Rates (%), Paso Robles Metropolitan Area, 2014

Property	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Industrial/Warehouse	9.4	10.7	3.5	5.0	2.8	7.5	13.2	8.0	7.7	6.5	5.7	3.6
Retail Functioning	1.9	< 1.0	< 1.0	< 1.0	< 1.0	2.2	4.1	4.5	3.5	4.8	3.3	2.6
Office Functioning	1.2	1.8	1.2	5.2	5.6	7.7	24.1	17.5	18.4	18.3	6.6	14.3

Source: Stafford McCarty Commercial Real Estate

Hotels in North County

Hospitality interest in the Paso Robles area is extremely high. Aside from the Ayers project of 225 rooms and the La Qunita 37 room expansion now under construction, there are an additional 535 rooms by multiple hospitality operators approved by the City. Neighboring Atascadero has a Marriott project being completed. There are even more hospitality projects in planning stages. Given the size of the market, rack rate, and occupancy, there is tremendous confidence in the market. Whether or not they will be built immediately is yet to be seen.

Agricultural Impact: Wine Industry Facilities Continue to Expand.

Our viticulture industry is pushing roots further into the economic base. Buildings and facility additions specific to the industry continue in a significant way. After adding approximately 122,000 square feet last year and 150,000 square feet the year prior, the Paso Robles and San Luis Obispo areas combined added an additional 92,000 square feet this year. Again, most of this inventory is in North County outside of city limits.

Our viticulture industry is pushing roots further into the economic base.

Notable vineyard transactions include Global Ag Properties' purchase of the Sunbelt Vineyard for $15.25M or $45K/planted acre. Estrella River Vineyard sold for $14.6M or about $55K/planted acre, and the price was $18Kk/acre for the open ground by Sunshine Agriculture. These have set the bar higher for valuations of larger plantings.

A lender driven sale of the winery and the hospitality/tasting room (approximately 13,000 square feet and 7,900 square feet, respectively) on 25 (11 planted) acres at Anderson/46 West sold for $4,800,000. Another smaller winery (5,000 cases) on 20 acres with about 9 acres of planting sold for $2,279,000. All are signs of active markets.

Commercial Investments

The investment market sector has been elusive in regards to establishing/determining a capitalization rate (cap rate). The most notable change is that the delta between higher and lower cap rates has become wider. Arriving at a generic capitalization rate has become more of an art than a science.

As we anticipated, with interest rates remaining low, there were increased sales transactions in 2014. Entry-level investors have decided to come off the side lines, moving from purchasing residential units as investments into the commercial arena. Product under one million dollars is difficult to find.

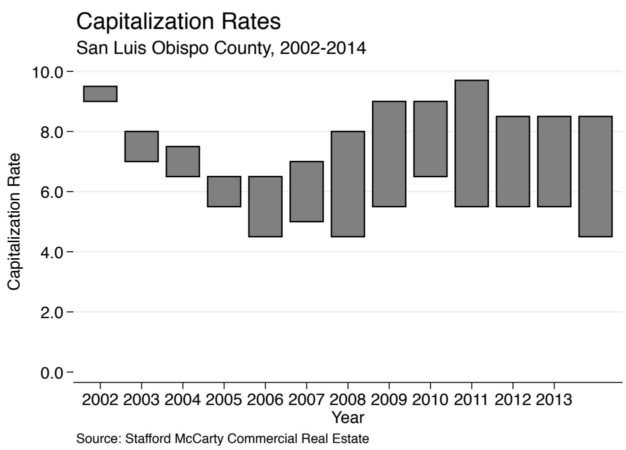
Multi-family investments, (apartments) have been active and producing capitalization rates mostly in the sub five cap rate range.

The investment sales selected below demonstrate the range in the present market on the Central Coast:

- 110 Mary Ave. (37,939 sq. ft.)—$12,000,000 ($280 per sq. ft.; Cap 7.7)
- 3701 S. Higuera (18,620 sq. ft.)—$4,150,000 ($223 per sq. ft.; Cap 8.4)
- 1255 Grand Ave. (4,017 sq. ft.)—$1,060,000 ($263 per sq. ft.; Cap 5.55)

Investment sales with credit tenants are offered in the mid 5's. The higher cap rates in the examples above indicate investments with more associated risk, lease terms which were short, or impending lender issues. If lenders and appraisers were forced to pick a rate we would see them start with a 7.

Following are capitalization rate ranges evinced over the last eleven years for our market area:



To illustrate the capitalization influence on valuation, let us assume a commercial building produces a net income to the investor of $100,000 per year. The declining market cap rates would correlate to the approximate purchase prices according to the following years:

Cap Rates and Implied Value

Year	Cap Rate Range Low	Cap Rate Range High	Implied Asset Value ($)
2002	9	9.5	1,100,000
2003	7	8	1,428,000
2004	6.5	7.5	1,538,000
2005	5.5	6.5	1,818,000
2006	4.5	6.5	2,222,000
2007	5	7	2,000,000
2008	4.5	8	2,000,000
2009	5.5	9	1,818,000
2010	6.5	9	1,538,000
2011	5.5	9.7	1,818,000
2012	5.5	8.5	1,818,000
2013	5.5	8.5	1,818,000
2014	4.5	8.5	1,818,000

Source: Stafford McCarty Commercial Real Estate. Note: Value based upon $100,000 in annual net income

Conclusions

Given the dour nature of commercial real estate in recent years there is excitement at this time. The question is how long will it last and will the general business owner benefit, as opposed to the well-heeled plucking of the best deals. Commercial properties are selling faster and there is interest in new development. Overall, there is strong market activity and pent up demand. How the current and planned projects develop will shape the Central Coast for the foreseeable future.

Demographics and Quality of Life

by Christian Cruz

Contents

Key Chapter Findings

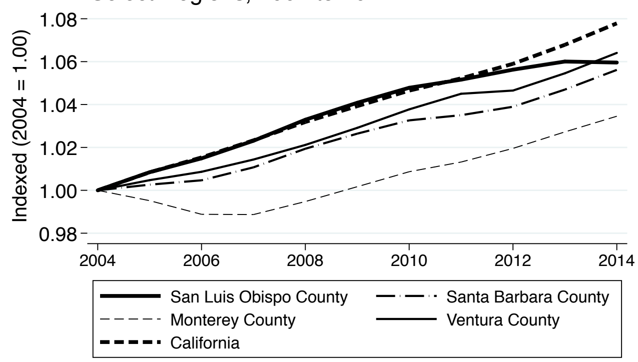
- Population growth in San Luis Obispo County slowed down in 2013, dipping slightly by 0.04% from January 2013 to January 2014.
- Personal income in the county grew by 4.4% in 2012 and by 51.8% over the last 10 years.
- The share of the population with a bachelor's degree decreased from 21.7% in 2012 to 20.7% in 2013. The trend is more positive over the long term—the share of the population with a bachelor's degree is 5.6% higher than it was in 2008.
- Applications for CalFresh assistance remained relatively flat in San Luis Obispo over the past year, while the number of applications soared throughout the Central Coast and the state.

Population

The Central Coast as a whole experienced positive population growth over the last year, but the population in San Luis Obispo County slowed down during this time period. From January 2013 to January 2014, the population in the county dipped by 0.04%, to 272,357.

However, the Census Bureau's American Community Survey has noted faster population growth than the California Department of Finance (DOF) estimates over the past few years, suggesting that the slowdown in population growth is not indicative of a shrinking population base. Indeed, over the last 10 years, the total population in San Luis Obispo County grew by 6.0%, placing it among the fastest-growing counties along the Central Coast over the last decade, second only to Ventura County, whose population grew by 6.4%. During the last decade, population growth in San Luis Obispo County—and in the rest of the Central Coast—lagged behind population growth in the state overall (7.8%).

Population (Indexed)
Select Regions, 2004 to 2014

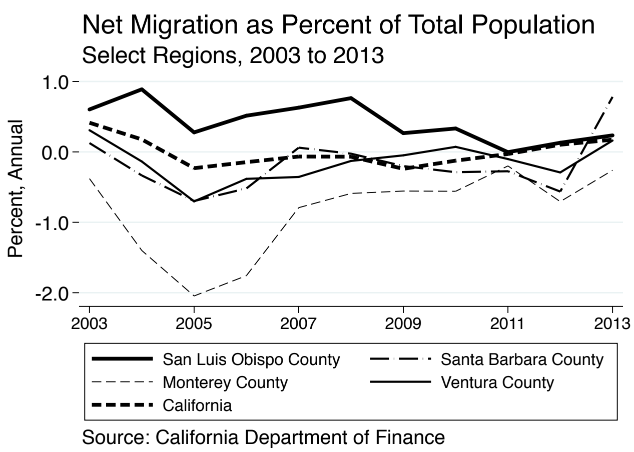


Source: CA Department of Finance

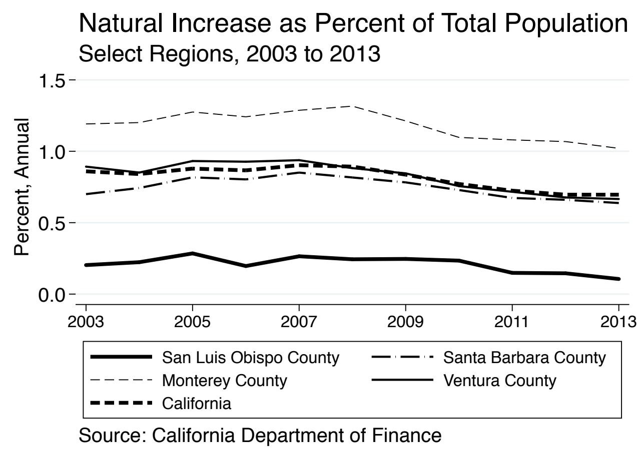
Positive net migration continues to be a significant contributor toward San Luis Obispo County's population growth. In 2013, San Luis Obispo County added 638 residents due to migration. While this is a relatively small number when compared with the net gains in migration in Santa Barbara (3,377) and Ventura Counties (1,360), San Luis Obispo County is the only county in the Central Coast, and one of the few counties in the state, to experience positive net migration over the last 10 years. During this time, San Luis Obispo County added 12,193 new residents as a result of positive net migration, while the remaining Central Coast counties experienced net out-migration during the same time period.

San Luis Obispo County is the only county in the Central Coast to experience positive net migration over the last 10 years.

In fact, migration accounted for 66.8% of San Luis Obispo's population growth over the last 10 years, while net out-migration diminished population growth in Monterey County, Santa Barbara County, and Ventura County. The fact that San Luis Obispo has experienced positive net migration over the last 10 years is a sign of the many economic opportunities present in the county, none more prevalent than the local wine industry. Paso Robles, for instance, was the 2013 wine region of the year and has attracted many foreign investors, especially from China, the largest wine market in the world.[20] Thus, as San Luis Obispo continues to draw interest from foreign investors, population growth in the county should persist and possibly outpace growth in the state in the coming years, as people move to the county to take advantage of the burgeoning wine and tourism industries.



Of the seven major cities in the county, San Luis Obispo continues to be the largest (45,473 residents, as of January 2014), followed by Paso Robles (30,469). When combined, the cities of San Luis Obispo and Paso Robles constitute nearly 28% of the total county population, and thus contribute a significant amount of the economic and commercial activity. With continued growth in the local wine industry, and with increases in beverage manufacturing, it is no surprise that the City of Paso Robles is the fastest-growing city in the county and the third fastest-growing city in the Central Coast. From 2004 to 2014, Paso Robles grew by an impressive 12.3%; the city is responsible for 24% of total countywide population growth during this decade. With the wine industry and tourism both flourishing, we expect the City of Paso Robles to continue to provide many economic opportunities for county residents.



The data also show that San Luis Obispo County is a popular area for retirees and individuals near retirement age. According to 2013 data from the U.S. Census Bureau, 31.2% of residents are 55 years of age or older, whereas five years ago that share was only 26%. At the same time, the proportion of those of prime working age (20 to 54 years old) decreased from 50.5% to 46.0%.

Central Coast Population by Age, 2013 (%)

County	< 5	5-19	20-34	35-54	55-64	65+
San Luis Obispo	4.8	17.9	22.6	23.4	14.2	17.0
Monterey	7.7	21.9	22.8	25.2	10.7	11.7
Santa Barbara	6.5	20.9	24.3	23.4	11.2	13.7
Ventura	6.4	21.0	20.2	27.1	12.3	13.0
California	6.5	20.2	22.2	27.1	11.5	12.5

Source: U.S. Census, 2013 American Community Survey

[20] Heather Young, "Foreign Investors Show Interest in Paso Robles Wine Industry," *Paso Robles Daily News,* July 30, 2014.

Fastest Growing Cities in the Central Coast

City	2004	2014	Change (%)
Greenfield	12,583	16,919	34.5
Santa Maria	87,732	101,103	15.2
Paso Robles	**27,139**	**30,469**	**12.3**
King City	11,804	13,211	11.9
Sand City	310	343	10.6
Oxnard	184,572	203,645	10.3
Buellton	4,459	4,893	9.7
Guadalupe	6,517	7,144	9.6
Camarillo	61,033	66,752	9.4
Simi Valley	117,311	126,305	7.7

Source: California Department of Finance

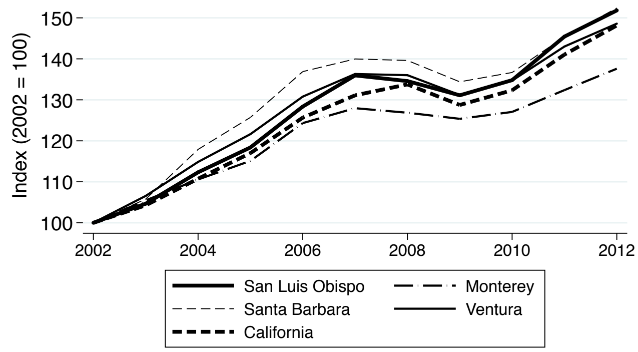
As the county's population of 55- to 64-year-olds moves toward retirement, it is important to have a large and well-trained pool of young people residing in the region in order to maintain continued economic growth. As discussed below, focusing on both primary and post-secondary education will help to prepare the labor supply and support a growing economy in the form of increased earnings, economic output, and taxes paid to the local government. San Luis Obispo County will feel the effects of the baby boomers entering retirement more acutely than other parts of California. Indeed, the county had a larger positive change in the proportion of its elderly population than seen in the rest of the Central Coast and in the state overall.

Personal and Household Income

The ongoing economic recovery has contributed to improvements in the quality of life locally. From 2011 to 2012, San Luis Obispo County experienced continued growth in total personal income (4.4%) and was surpassed only by Santa Barbara (4.8%). While San Luis Obispo County's year-over-year growth in personal income fell short of the 5.0% personal income growth for the entire state, the 10-year growth rate for personal income in the county (51.8%) surpassed the 10-year growth rate for the state (48.2%). The strong employment gains in high-wage sectors like Management and Professional, Scientific, and Technical Services certainly contributed to the increase in personal income.

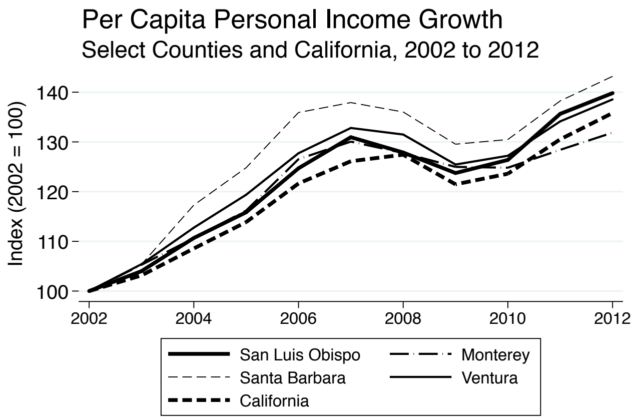
Personal Income Growth

Select Counties and California, 2002 to 2012



Source: U.S. Bureau of Economic Analysis

With population growth being relatively flat over the last year, the growth in total personal income can likely be explained by the health of the local labor market and the growth in the Tourism industry, which has provided job opportunities for many previously unemployed residents. Indeed, the local Hospitality sector continues to attract outside interest due to the region's increased reputation as one of the best destinations for wine tourism in the world. Thus, as the local wine industry continues to grow in popularity, and as more tourists seek to enjoy the local wine scene, San Luis Obispo can expect steady and consistent growth in personal income in the coming years.



Source: U.S. Bureau of Economic Analysis

Central Coast Household Income, 2012 & 2013

County	Yearly HH Income ($)		
	2013	2012	Chg (%)
San Luis Obispo	58,158	60,264	-3.5
Monterey	57,052	58,109	-1.8
Santa Barbara	62,421	61,890	0.9
Ventura	77,363	71,517	8.2
California	60,190	58,328	3.2

Source: U.S. Census, 2012/2013 Amer. Com'ty Survey

Even after accounting for the lost income during the economic downturn, personal income in San Luis Obispo County has grown by an average of 5.2% over the past 10 years, on par with Santa Barbara County for the highest 10-year annual average growth in personal income, and surpassing the 10-year annual average growth for the state.

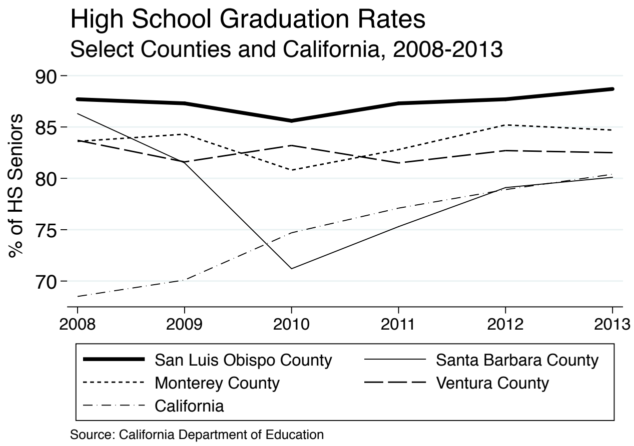
Median household in 2013 income overall is 7.7% higher than in 2010.

While total personal income and per capita personal income in San Luis Obispo County continue to grow, these are not the most accurate measures of economic progress. A more salient measure of economic improvement in an economy is actual per capita personal income. At $43,698, per capita personal income in San Luis Obispo County continues to rank near the bottom as of 2012.

Regarding household income, San Luis Obispo County experienced a 3.5% drop in median household income from 2012 to 2013, and a 3.9% drop since 2008, the largest drop in the Central Coast for both time periods. The most likely explanation for the decrease in median household income during this time is the fact that San Luis Obispo County was hit hard during the Great Recession, with low-wage sectors, such as Construction and Retail Trade, adversely affected. We should note, however, that whereas median household income in San Luis Obispo County experienced a decrease in the last year, median household income overall is still 7.7% higher than in 2010—the year San Luis Obispo County experienced the lowest median household income. Thus, when examined over a longer time frame, San Luis Obispo County is showing signs of improvement in median household income since the recession. In addition, current median household income in San Luis Obispo County is consistent with incomes in the rest of the Central Coast—with the exception of Ventura County—and the state. Indeed, San Luis Obispo County should be well positioned next year for an increase in household income, especially as the local Tourism industry continues to thrive.

Education

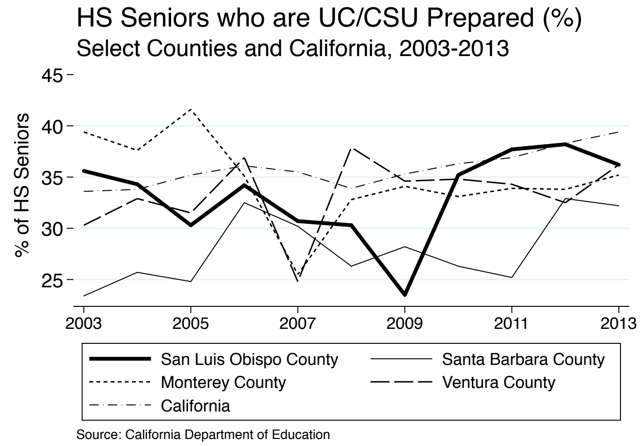
As labor markets become more technically oriented, lower levels of educational attainment will no longer be sufficient for workers to obtain higher-earning jobs. In order to be a desirable candidate for these higher-wage positions, it is essential to pursue, at the very least, some form of higher education, either through a four-year college, an apprenticeship program, regional occupational programs, or vocational school. While high school graduation rates have been relatively steady since 2008—San Luis Obispo has the highest high school graduation rate in the Central Coast, and its rate even surpasses that of the state—a stronger determinant of the future educational outlook for San Luis Obispo County high school graduates is the percentage of 12th graders who have completed courses required for UC and/or CSU entrance. This is a more accurate metric for determining how many students are adequately prepared for the rigors of college-level coursework and hence have the potential to earn bachelor's degrees and enter higher-wage occupations.



According to statistics from the California Department of Education, as of 2013 approximately 36.2% of high school 12th graders in San Luis Obispo County have met the necessary requirements for UC and Cal-State University admittance, which is consistent with the share in the rest of the Central Coast. However, the share in San Luis Obispo County still lags the state average (39.4%). Thus, preparation for higher education should remain a top priority for San Luis Obispo County moving forward.

Cal Poly San Luis Obispo is ranked among the best colleges by Money Magazine.

Encouragingly, many forms of post-secondary training are available to area residents. Cuesta College—which is now free of all accreditation sanctions—is taking measures to improve its infrastructure and to facilitate enrollment for students with financial hardships and students who are not yet ready to attend a four-year university.



The Paso Robles City Council recently endorsed a $275 million countywide bond measure to improve the current facilities of Cuesta College. The funds will be used for the construction of campus centers for student services, early childhood education, and job and career development.[21] This measure is clearly a step in the right direction.

In addition, with the help of the Cuesta College Promise scholarship program, it is now possible for San Luis Obispo County students planning to enroll at the community college to attend their first year for free. Originally, this scholarship program was meant to pay for classes and fees for only the first semester. But with increased earnings on the scholarship endowment's investments, it is now possible for students to have their tuition paid for the entire year.[22] This should aid high school graduates who want to pursue higher education but who come from financially struggling families. This scholarship program should prompt more local high school students to, at the least, consider higher education, since the first year of tuition at the local community college is free.

[21] Tonya Strickland, "Cuesta College Bond Measure Endorsed by Paso Robles City Council," *San Luis Obispo Tribune,* October 9, 2014.

[22] Annmarie Cornejo, "Cuesta College Now Offers Free Year of Classes to Local Students," *San Luis Obispo Tribune,* October 1, 2014.

Central Coast Population by Educational Attainment, 2013 (%)

Educational Attainment	San Luis Obispo County	Monterey County	Sta. Barbara County	Ventura County	California
Less than HS Diploma	10.9	26.6	21.7	16.6	18.3
HS Diploma or GED	19.1	23.1	15.8	20.1	20.8
Some College or Assoc. Degree	38.7	28.1	30.3	32.0	29.9
Bachelor's Degree	20.7	13.2	19.2	19.0	19.5
Graduate or Professional Degree	10.8	9.0	13.0	12.2	11.5

Source: U.S. Census, 2013 American Community Survey

Overall, educational attainment in San Luis Obispo County has improved significantly over the last five years. In response to labor market pressures for an increasingly skilled workforce, the share of the county's population with some college or an associate's degree, and the share of those with a bachelor's degree, is up 6.3% and 5.6%, respectively. The attention that Cal Poly San Luis Obispo is receiving for being ranked among the best colleges by *Money Magazine* is certainly contributing to the growing educational prestige of the region and is prompting many locals to apply and enroll.

The preceding measures taken by local government leaders and educational institutions indicate that the county is serious about improving its current educational infrastructure to prepare its students for academic success beyond the high school level and into four-year institutions. However, it remains to be seen if a significant portion of those who graduate college will elect to stay in the county. Encouraging recent college graduates to stay in San Luis Obispo County could provide a strong boost to the region, stimulating economic activity and growing the local stock of human capital.

Poverty & Social Assistance

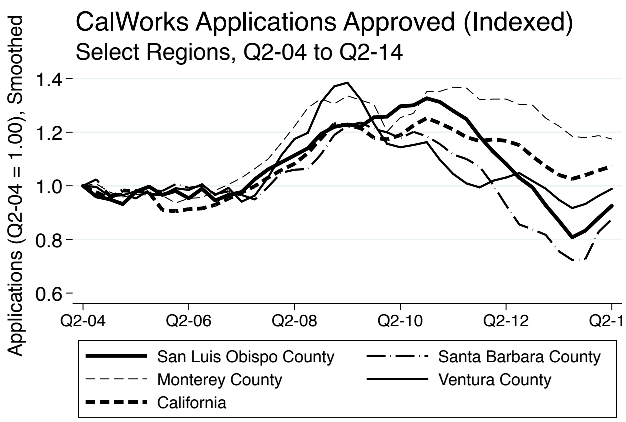
Although personal income levels have improved, and the labor market shows signs of health, the poverty rate in San Luis Obispo County unexpectedly increased. During 2013, San Luis Obispo's poverty rate reached 15.3%, compared with only 13.7% in 2012. In contrast, Monterey County experienced a decline in the county's poverty rate over the last year, and Santa Barbara's poverty rate remained the same. Ventura County did experience a slight increase in its poverty rate (3.5%), while the poverty rate in the state decreased from 17.0% in 2012 to 16.8% in 2013. The increase in the poverty rate in San Luis Obispo County indicates that even though the economy continues to improve, the progress has not necessarily been evenly spread across all industries. As noted in the employment chapter, several of the higher-skilled industries are already above their pre-recession peak, whereas other lower-paying sectors are still making up lost ground.

The increased poverty rate in the county over the last year coincided with a 6.5% increase in the number of applicants for CalWORKS benefits, a cash assistance program for needy families. San Luis Obispo County was not the only county in the Central Coast, however, to experience an increase in CalWORKS applicants. With the exception of Monterey County, the remaining Central Coast counties, as well as the state as a whole, also experienced an uptick in applicants. Thus, it appears that the increased number of CalWORKS applicants is a statewide issue. Still, this recent increase masks the underlying progress that has been made during the recovery, as the number of CalWorks applicants in San Luis Obispo County is nearly 25% below the pre-recession level.

Proportion of Population in Poverty (%)

County	2013	2012	Change (%)
San Luis Obispo	15.3	13.7	11.7
Monterey	17.9	18.4	-2.7
Santa Barbara	16.3	16.3	0.0
Ventura	11.9	11.5	3.5
California	16.8	17.0	-1.2

Source: U.S Census, 2012/2013 Amer. Com'ty Survey

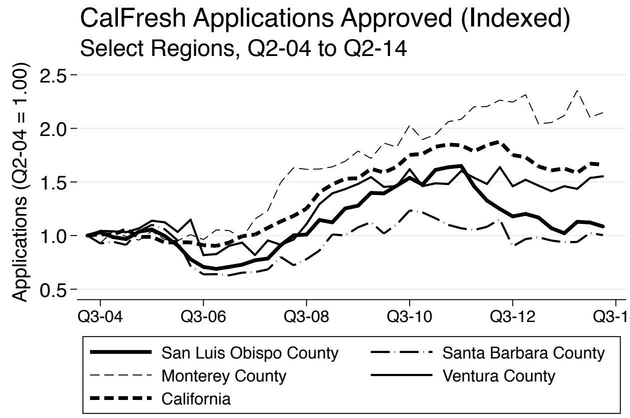


Source: CA Department of Social Services

San Luis Obispo County experienced a 13.4% drop in the number of CalFresh applications over the last five years.

Regarding the number of CalFresh applications, the year-long trend in San Luis Obispo County has been relatively flat, with applications growing in number by only 1.4%, while the rest of the Central Coast experienced increases ranging from 4.5% (in Monterey County) to 9.8% (in Ventura County). The state likewise experienced growth (8.6%) in CalFresh applications. When we look at applications over a broader time period, we see that San Luis Obispo County experienced a 13.4% drop in the number of applications over the last five years, while the remaining Central Coast counties and the state experienced increases over this time period.

Poverty and unemployment are inversely related to the level of educational attainment. Thus, it is important for the county to continue its efforts to improve the educational landscape of San Luis Obispo County so as to foster greater academic achievement. Boosting college enrollment rates will help mitigate poverty and improve employment.



Source: CA Department of Social Services

Summary

Population growth in San Luis Obispo County slowed down in 2013, contracting by approximately 0.04%. Despite the slower than expected population growth rate over the last year, however, San Luis Obispo County remains an attractive place for domestic migrants. Notably, the San Luis Obispo area was one of the few counties in California to see positive domestic migration over the last decade. One of the most significant differences between the San Luis Obispo area and nearby counties is the age structure of the population, with the median age of the population in San Luis Obispo County at 40.1 years, compared with 35.7 years in California, 33.4 years in Monterey, 33.6 years in Santa Barbara, and 37.2 years in Ventura. The County of San Luis Obispo's statistics suggest that some of the County's older population has moved beyond childbearing years.

The premiums for living in the Bay Area and Southern California have continued to increase over the last year. The rapid rise of Real Estate prices in these markets over the last year is driving up the premiums paid for living in these areas. With relatively affordable housing prices and an improving employment landscape, San Luis Obispo County could see a continued increase in future net domestic migration.

The quality of education in San Luis Obispo County is another draw for residents thinking of moving into the region. High school graduation rates in the County remain well above the state average and continue to outpace nearby counties, with a graduation rate of 88.7% of San Luis Obispo County high school students.

Data Sources

The creation of this report would not have been possible without numerous public and private sources of data. We would like to acknowledge those sources here.

Bureau of Transportation Statistics

California Air Resources Board

California Association of Realtors

California Board of Equalization

California Dept. of Education

California Dept. of Finance

California Dept. of Justice

California Employment Development Dept.

California New Car Dealers Association

California State Controller

California State Franchise Tax Board

California State Legislative Analyst's Office

CB Richard Ellis

Central Coast Major Listing Service

Construction Industry Research Board

CoStarr/The London Group

DataQuick Information Systems

Federal Reserve Economic Data (FRED)

Fiserv Lending Solutions

Grubb & Ellis

Hanley Wood Market Intelligence

HousingTracker.net

Marcus & Millichap

Mortgage Bankers Association

National Science Foundation

NOAA National Weather Service

Property & Portfolio Research

RealFacts

Research and Development (RAND)

S&P Case Shiller

Texas Transportation Institute

U.S. Census Bureau, American Community Survey

U.S. Census Bureau, Longitudinal Employment - Housing Dynamics

U.S. Dept. of Commerce, Bureau of Economic Analysis

U.S. Dept. of Labor, Bureau of Labor Statistics

U.S. Dept. of Transp., Research and Innovative Technology Administration

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