REGIONAL INTELLIGENCE REPORT

BEACON ECONOMICS

Prepared by Beacon Economics, LLC

CITY OF ONTARIO SOUTHERN CALIFORNIA

Sixeenth Edition

September 2016

The National Economy

U.S. economic output has slowed to a crawl over the last three quarters—averaging a 1% pace of growth compared to 3% in the previous 6 quarters. Despite these disappointing results, prognosticators of the economy have, for the most part, not reduced their growth outlook for the nation by much. Most are still looking for rates in the 2% to 2.5% range.

The reason for the relative optimism is that the headwinds that have slowed the U.S. economy in recent months have come largely from external sources—the global commodity glut, the slowing of the Chinese economy, political turmoil in the Middle East and Europe, and wild gyrations in equity markets driven by fears over all these issues. These problems have stalled U.S. exports and industrial production, and led to a decline in business investment—in particular a big runoff of business inventories.

Components of Gross Domestic Product

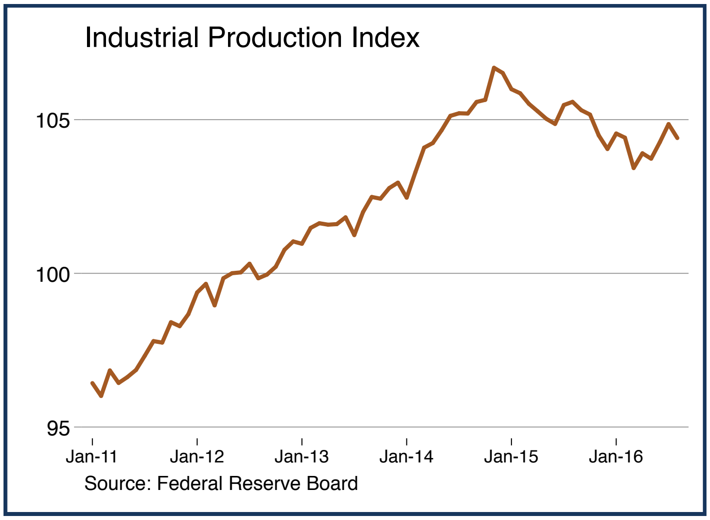
	2015 Avg.	Q1-16	Q2-16
Gross Domestic Product	1.88	0.8	1.2
Personal Consumption	1.73	1.11	2.83
Fixed Investment	0.55	-0.15	-0.52
Change in Inventories	-0.11	-0.41	-1.16
Net Exports	-0.68	0.01	0.23
Government	0.39	0.28	-0.16

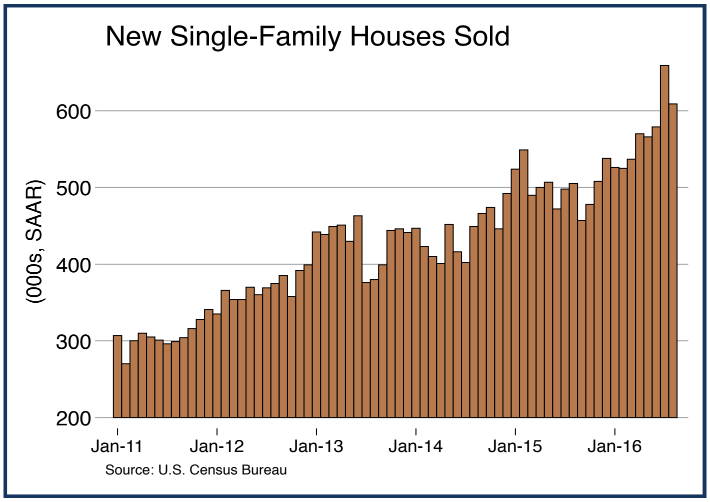
Source: Bureau of Economic Analysis

In contrast, domestic demand has remained quite strong. Consumer spending added almost 3% to growth in the 2nd quarter, more than enough to offset declines in business investment. Consumers are also increasing their spending for the right reason—they are earning more. The U.S. labor markets continue to expand, adding 275,000 jobs in July and 151,000 in August after a weak spring. The Construction, Healthcare, Professional Services, and Hospitality sectors have all been growing at a faster than average rate.

Also helping is weak inflation driven by low commodity prices and low unemployment rates that have finally shifted the economic balance towards labor to some small degree. Median real wages for a full time worker have grown 4% over the past two years, still modest but better than the previous 8 years when real earnings didn't grow at all.

More importantly, there are a number of indicators that suggest the business spending pullback is ending and that overall investment trends will begin to turn positive again soon. In April, the Institute for Supply Management PMI for Manufacturing climbed above 50, and in June the Industrial Production Index also started rising again with the best pace of growth since late 2014. Inventory to sales ratios are currently the lowest they have been since 2003—suggesting that businesses will need to start stocking up soon.





The housing market has also shown stronger signs of life recently. Sales of new and existing homes, while still far below long run sustainable levels, have hit post-Great Recession highs in recent months. While tight credit remains a major impediment to full recovery, the improved financial situation of the average American household combined with ongoing low interest rates will lead to a faster pace of construction in the second half of the year.

As positive as all these signs are, the United States is unlikely to return to an average pace of growth within the next year or more. While the nation has muscled through the turbulence so far, the global outlook remains poor. The Chinese economy is still weak despite various policy measures put into place over the last year. Europe is growing again, but they are dealing with issues surrounding deflation and the Brexit. And the commodity glut—while good for American consumers—continues to hurt growth prospects for many developing economies. As such, the overall outlook for U.S. growth remains much as it did last year at this time.

The only major change in expectations is in regard to interest rates and Federal Reserve policy. Given the recent weak U.S. growth data and the decline in interest rates driven by nervous investors seeking safety in U.S. markets following the Brexit, there is amounting realization that low interest rates are going to be with us for some time.

California Stays on Track

California has stayed on course with a solid economic performance through the first three quarters of 2016 despite slower growth nationally. The state outdistanced the U.S. in terms of economic growth and job creation, although the pace of growth in 2016 in both California and the U.S. has been somewhat slower than last year. Through the first seven months of this year, nonfarm jobs grew at 2.3%, compared to 1.8% nationally. The unemployment rate dropped below 6% late last year, moving sideways in the mid-5% range for most of the summer as sustained job growth and wage gains have drawn more people into the labor force.

Virtually every industry in the state continues to add jobs and the unemployment rate is lower than a year ago. Leisure and Hospitality and Health Care and Social Assistance led the way with the largest absolute job gains in the state, with significant contributions from Professional, Scientific, and Technical Services, Construction, and Retail Trade. Just two industries lost jobs, with combined losses of 9,000 (5,000 in manufacturing and 4,000 in natural resources and mining) on a job base of 16.5 million, illustrating the breadth of job gains throughout the private sector of the economy. Government also was also among those industries with the largest absolute gains, with most of the increase occurring in state and local government. Last but not least, California's farm employment is on track to hit its highest level in over a dozen years, despite the state's prolonged drought.

Job Gains Continue in California

Industry	Aug-16 (000s)	1-Yr. Chg. (000s)	1-Yr. Chg. (%)
Total Nonfarm	16,534.3	378.0	2.3
Education	371.2	20.3	5.8
Prof, Sci, & Tech	1,277.0	60.1	4.9
Leisure & Hospitality	1,896.7	62.3	3.4
NR/Construction	790.1	25.8	3.4
Health Care	2,192.2	63.3	3.0
Information	499.6	13.2	2.7
Admin Support	1,086.4	25.1	2.4
Wholesale Trade	738.4	14.9	2.1
Management	235.8	4.7	2.0
Government	2,525.7	45.2	1.8
Logistics	510.3	8.4	1.7
Retail Trade	1,696.6	25.3	1.5
Financial Activities	813.6	11.4	1.4
Other Services	553.2	5.6	1.0
Manufacturing	1,288.1	-8.6	-0.7

Source: California Employment Development Dept.

Continued increases in taxable sales are symptomatic of strength among businesses and households in the private sector, while also boding well for the state and local government sector. Meanwhile, economic growth continues to spread inland from coastal counties, with many parts of the state hitting new records for employment and unemployment rates that have declined to their lowest in several years. All in all, the statewide economy is poised for continued growth over the next several quarters, outpacing most other states around the U.S.

The picture for housing has been mixed since the recession, with prices advancing modestly despite many hurdles that have limited sales activity. Outside of the Bay Area, home prices have yet to surpass their pre-recession peaks. Demand for homes has been sustained by low interest rates, but has also been impeded by limited inventories, high underwriting standards, and large down payment requirements. On the supply side, existing homes for sale have been well below long run averages, while new home construction has struggled to advance since the recession. Meanwhile, with the homeownership rate at its lowest in over thirty years, rental units have been in high demand, driving rents up and vacancy rates down.

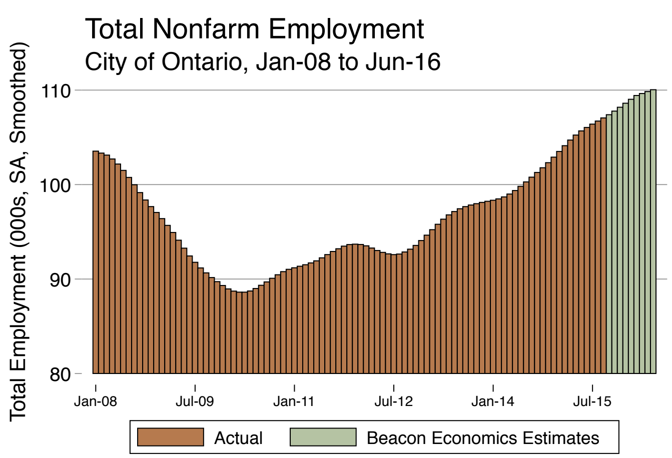
The state continues to face nagging policy problems, not the least of which is housing. Rising home prices and rents mean that the state is not producing enough housing. This is not a low-income problem, but one that extends to middle-income households as well. In many parts of the state, rent as a share of renter income exceeds the 30% threshold that is considered to be the norm. Meanwhile, in the market for owner-occupied homes, a household must earn at least $100,000 annually in order to afford the payment on a median priced home in California. This has ramifications for employers who increasingly find it difficult to hire and retain qualified employees. Solutions will be hard to come by, but must include reducing permitting and regulatory burdens associated with construction costs, and possibly, tax reform.

Looking through the rest of 2016 and into 2017, the state's economic engine will chug along. Businesses and households exercised greater caution in this expansion compared to previous cycles, but California's economy has consistently outperformed all but a few states around the nation. The Tech sector continues to impress, not just in the Silicon Valley/Bay Area but elsewhere in the state. Economic growth nationally will continue to drive the state's tourism and goods movement industries, while health care and retail activity will see further gains as households across the state benefit from job growth and wage gains.

Ontario Economy Continues to Grow

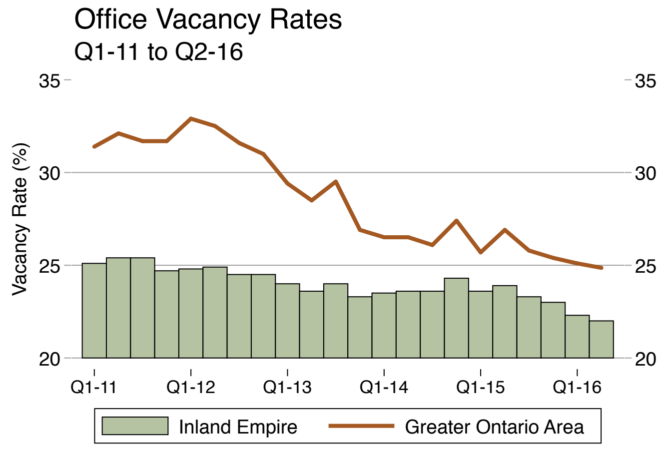
The City of Ontario's economy continued to gain ground in the first half of 2016, posting impressive numbers in job growth, spending, commercial vacancy rates, and rents. Business spending has been especially strong and has helped overcome reduced spending at fuel and services stations due to lower energy costs. Relatively affordable home prices have helped draw many young professionals into Ontario, which has supplied local businesses with the labor needed to expand their services.

Total nonfarm employment in the City of Ontario increased by 4.2% year-over-year to just over 110,000 workers in June 2016, based on data from the California Employment Development Department (EDD) and Beacon Economics' estimates. Job growth in the City continues to expand at a faster pace than the broader Inland Empire (3.3%), due largely to a few of Ontario's vibrant industries.



Source: California Employment Development Department

Job gains over the past year have been spread across most of the City's industries, but Logistics related industries have experienced the largest absolute job gains, followed by Professional, Scientific and Technical Services, and Education and Health. Additionally, with steady population and job growth, industries that serve the local area such as Retail Trade and Leisure and Hospitality have also experienced solid hiring.



Source: REIS

Recent global turmoil has helped strengthen the U.S. dollar, which deters export volumes and encourages imports. Many of Ontario's large distribution centers stand to benefit from incoming goods that require intermediary processing on their way to becoming final goods, or simply from goods movement that is re-routed from Ontario to the rest of the nation. The Transport, Warehouse, and Utilities industry provided the most net new jobs in the City over the year. That industry is expected to continue growing its local presence as several companies have moved, or are planning to move, to Ontario, including a large QVC distribution center.

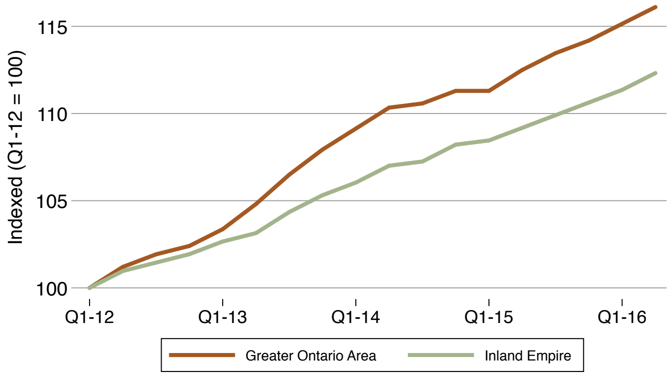
Employment by Industry in the City of Ontario

Industry	Jun-16	YOY Chg.	YOY (%)
Finance and Insurance	2,675	250	9.6
Prof Sci and Tech and Mgmt	6,975	575	9.1
Transport/Warehouse	16,000	1,200	8.0
Construction	4,700	300	7.1
Education/Health	8,900	575	7.0
Information	2,025	100	6.1
Wholesale Trade	11,300	625	5.9
Leisure and Hospitality	7,425	250	3.7
Real Estate	1,375	25	3.1
Manufacturing	13,050	300	2.2
Retail Trade	13,650	250	1.9
NR/Mining	775	25	1.6
Other Services	3,200	0	0.6
Government	5,725	25	0.4
Admin Support	12,575	-150	-1.1
Total All Industries	110,375	4,400	4.2

Source: EDD & Beacon Economics

Furthermore, increased demand for logistics centers has bolstered demand for warehouse and distribution centers in the area. Warehouse and distribution rents in the Greater Ontario Area grew by 3.2% year-over-year in the second quarter of 2016, compared to 2.9% growth in the Inland Empire as a whole.

Warehouse/Distribution Rental Rate Growth
Q1-12 to Q2-16



Source: REIS

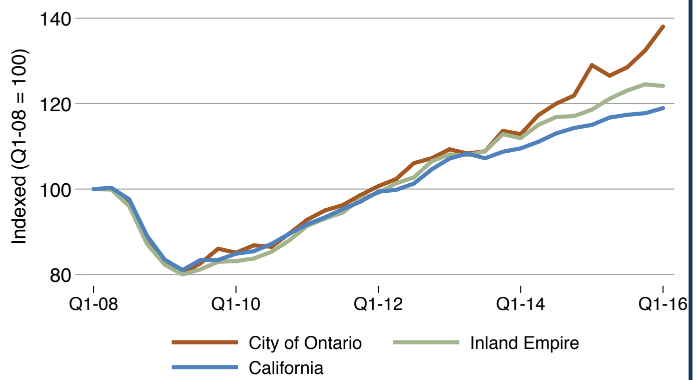
Finance and Insurance sector establishments in the City have also been on the rise, bucking a trend that is occurring in much of the nation. Finance and Insurance industry jobs in Ontario grew by 9.6% year-over-year in June 2016, while jobs in this industry contracted by 0.5% in the Inland Empire and grew by just 1.0% in California. Much of the job growth in Ontario's Finance and Insurance industry is due to new businesses moving into the City, offsetting trends that have been affecting the rest of the nation, such as the growing less-labor dependent FinTech industry and uncertainty over the effects of new financial regulations. Apart from supplying new jobs, local Finance and Insurance sector businesses have contributed to recent improvements in Ontario's office vacancy rate.

Other primarily office-occupying industries that have been adding jobs locally include Professional, Scientific, and Technical Services, Management Services, and Information. Generally high-paying, over the long run, jobs in these industries help increase consumer spending across categories.

Many local businesses are ramping up spending on capital investments and research and development, in addition to increasing payrolls. Yuneec International, a major manufacturer of drones with U.S. headquarters in Ontario, recently received $60 million in venture capital funding. Overall, Business and Industry spending in San Bernardino County grew by 29.9% from the first quarter of 2015 to the first quarter of 2016.

Job and wage growth has also led to a jump in consumer spending. Autos and Transportation spending in San Bernardino County grew by 8.8% in the first quarter of 2016 year-over-year. Construction of a new Audi dealership in Ontario is nearly complete and the facility is scheduled to open later this year, demonstrating an expectation that automobile spending in the region will continue to grow.[1]

Taxable Sales (Indexed)
Q1-08 to Q1-16



Source: California Board of Equalization

[1] Neil Nisperos, "Ontario Goes Upscale: Audi Dealership Coming to Town," Inland Valley Daily Bulletin, http://www.dailybulletin.com/government-and-politics/20160217/ontario-goes-upscale-audi-dealership-coming-to-town, February 17, 2016.

Sales Tax Receipts by Category in San Bernardino County

Category	Q1-2016 ($000s, SA)	YOY Chg. (%)	2 Yr Chg. (%)
Business and Industry	21,686	29.9	45.7
Autos and Transportation	15,539	8.8	22.5
Building and Construction	7,016	7.4	11.0
General Consumer Goods	18,468	6.9	10.3
Restaurants and Hotels	8,294	6.4	18.7
Food and Drugs	3,729	4.6	5.5
Fuel and Service Stations	8,209	-11.4	-25.3
Total	93,590	10.0	16.6

Source: HdL Companies

Based on data available, local taxable spending is trending strongly upwards, fueled by both business and consumer consumption. The CA Board of Equalization reports taxable sales at the local and state level, and indexed values indicate that Ontario sales growth has continued to outpace both the surrounding metro area and state, as of the most recent quarterly data. More granular data is compiled by HdL, which releases detailed tax receipts by type at the county level. Between the first quarter of 2015 and the first quarter of 2016, taxable receipts in San Bernardino County grew by 10%. The only category that contracted over this period - Fuel and Service Stations – saw lower receipts as the global oil glut depressed gasoline prices across the nation.

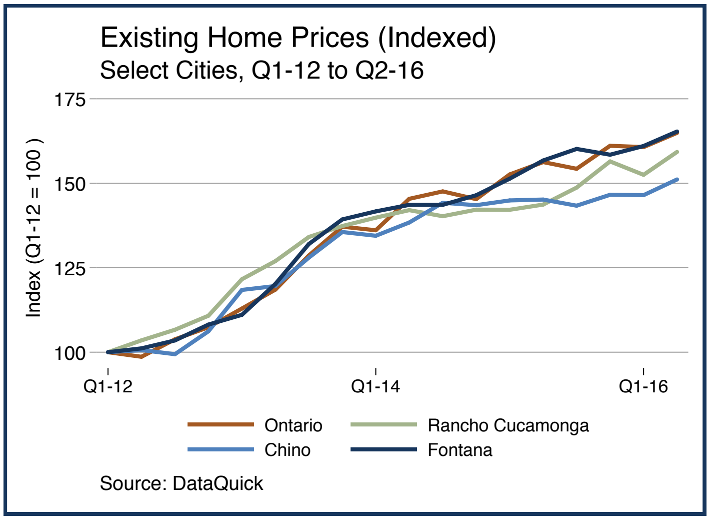
Consumer spending in other categories continues to expand as well, particularly in categories tied to the Leisure and Hospitality and Retail Trade industries. Much of the spending growth in these categories has been coming from local residents as demand from tourism, which has had three full years of robust growth, is starting to level off. Increased consumer spending by locals will help support the recent Fashion Alley expansion at Ontario Mills.

In terms of local tourism, hotel occupancy rates in the first quarter of 2016 were just 1.2 percentage points higher than they were one year earlier, albeit the average daily room rates grew by 7.8%. Meanwhile, passenger traffic in and out of Ontario International Airport grew by only 0.4% year-over-year in the first half of 2016. But despite recent mixed signals, tourism is expected to continue to play a major role in supporting local businesses. The widely publicized transfer of Ontario International Airport to local control is nearly complete and local authorities have their sights set on remodeling the Airport and redeveloping the land around it to attract more airlines and passengers. Citizens Business Bank Arena recently came under new management and the reported main focus will be attracting "big-name concerts."[2]

Income growth and improvements in Ontario's labor market have also helped the City's real estate market flourish. Home price appreciation in Ontario continues to rise, and has been outpacing neighboring Rancho Cucamonga and Fontana since the first quarter of 2012. The median price of a single-family home in Ontario grew by 5.5% from the second quarter of 2015 to the second quarter of 2016.

Still, Ontario's home prices remain affordable relative to coastal cities and locations closer to the metropolitan center of Los Angeles. The median price of a home in Ontario in the second quarter of 2016 was $362,900, compared to $539,500 in Los Angeles County. To put this in context, median household income in Los Angeles is only 6.7% higher than it is in Ontario, while median home prices differ by 48.7%.

[2]Neil Nisperos, "What's In Store for Ontario Arena (Hint: Bigger Name Concerts)", Inland Valley Daily Bulletin, http://www.dailybulletin.com/business/20160712/whats-in-store-for-ontario-arena-hint-bigger-name-concerts, July 12, 2016.



Existing Home Prices (Indexed)
Select Cities, Q1-12 to Q2-16

Source: DataQuick

While Southern California in general suffers from an ongoing housing shortage, the Inland Empire and the City of Ontario in particular are developing infrastructure to better accommodate higher rates of population growth. Ontario Ranch, formerly known as the New Model Colony, is already introducing new single-family and multifamily residences to the City, with thousands more planned over the next 30 years. Over the last twelve months, 328 single-family and 196 multifamily building permits were issued in Ontario, compared to 137 and 108 permits issued, respectively, per year in the previous nine years.

The rental landscape in Ontario appears to be less affordable than homeownership. The U.S. Census Bureau reports that 55.6% of renter households in Ontario used 35% or more of their household income on rent in 2014, up from 45.9% in 2010. Furthermore apartment rents are estimated to have grown by 3.2% year-over-year in the second quarter of 2016 after growing by 6.0% year-over-year in the second quarter of 2015. New apartments units added to the local housing stock, such as the recently completed Vistara project, will help alleviate affordability concerns, despite being developed as luxury units. Ultimately, all new housing units, both owner- and renter-purposed, will improve overall housing affordability in the coming years.

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