REGIONAL INTELLIGENCE REPORT

BEACON ECONOMICS

Prepared by Beacon Economics, LLC

CITY OF ONTARIO SOUTHERN CALIFORNIA

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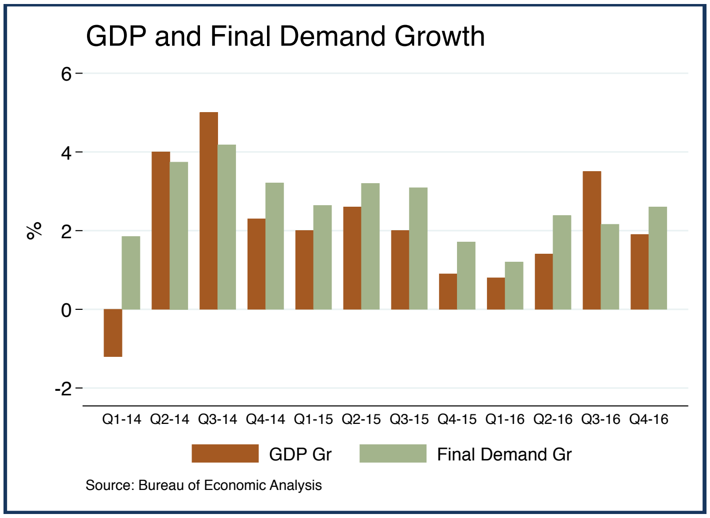
U.S. Economy: The Unknown Unknowns

The U.S. economy has started 2017 with two distinctly opposing trends forming in terms of the outlook for the year. The economy is clearly starting to pick up momentum after a slow year of growth in 2016, while policy uncertainties created by the election of Donald Trump to the presidency have continued as his administration moves into its third month.

President Trump's first major agenda items—travel bans and health insurance reform—have become mired in political and legal battles. The net result is that while Beacon Economics' point estimate for growth in 2017 has been increased slightly to less than 2.5% growth for the year, but the range of variance around this estimate is also widening. In other words, uncertainty is the biggest issue the nation is dealing with.

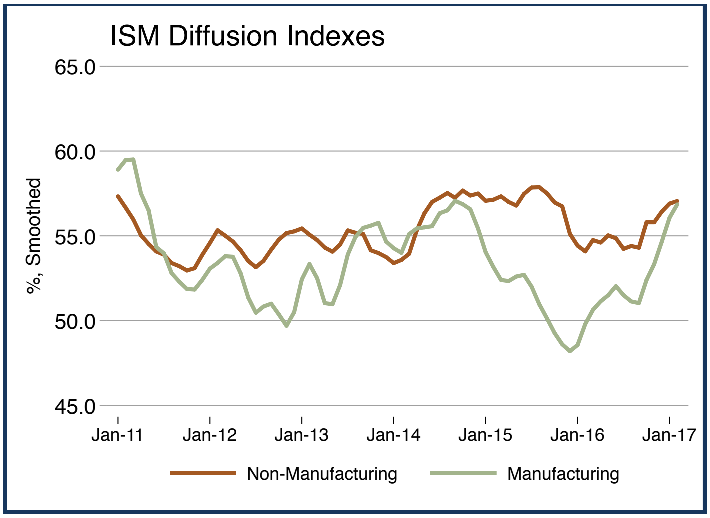


Start with current economic trends. Growth in the last quarter of 2016 came in at a weaker than expected 1.9% and may be even lower for the first quarter of this year—perhaps as low as 1% given the current reading. But these top line numbers belie growing momentum in the economy.

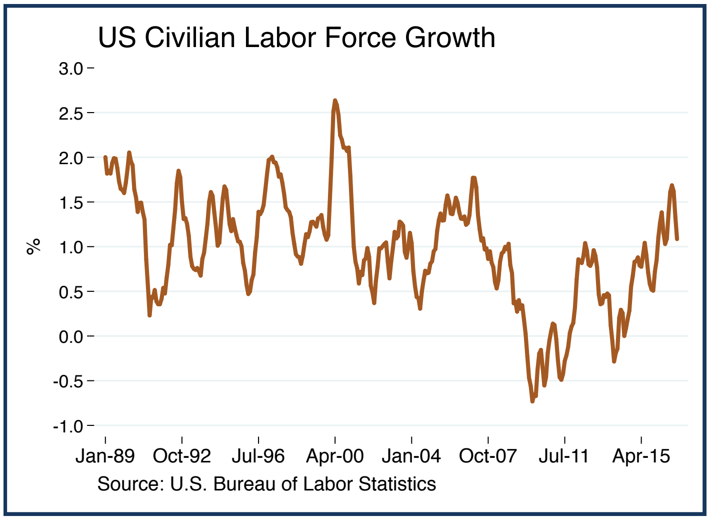
The fourth quarter growth rate was pushed down by a very large jump in the nation's trade deficit, yet in contrast domestic demand (driven by increases in consumer, business, and government spending) grew at a 2.6% pace of growth—the best since the third quarter of 2015.

As for the weak first quarter—this is a pattern in the data seen continuously since 2010, with first quarters averaging 1%, while the final three of the year averaging 2.5%. Why the seasonal adjustment process has not ironed out this persistent pattern is hard to say.

There are plenty of other indicators that the U.S. economy is gathering momentum. Industrial production estimates from the Federal Reserve have been rising since last fall, while the ISM indexes for both manufacturing and services continue to rise as well. These improved outcomes are being driven by a global economy that is back on a growth track with better than expected numbers coming out of many corners of the globe including Europe, China, and Japan, all beating expectations for growth. Exports have expanded accordingly, despite the rising value of the U.S. dollar. The oil slump is also reversing itself. New well construction is rising again, and oil production is back over 9 million barrels per day.



These gains are reflected in increased business investment and rising corporate profits. But it isn't just business experiencing better times. Also significant is the nation's increasingly tight labor market. The headline U.S. unemployment rate is well below 5%, even as job openings remain close to an all-time high level. Consumer spending and credit expansion continues to move forward at a sustainable pace, helping to smooth out some of the bumps created by a volatile global economy. The net result has been an increase in wages as well as a sharp acceleration in labor force growth Participation rates are starting to climb again as well.



The primary impacts from the Trump administration's proposed policy shifts will largely be confined to what economists refer to as the "law of unintended consequences." One example is the Federal budget. President Trump is proposing broad tax cuts for corporations and individuals, without any major cuts in expenditures. Implicit in this proposal is the idea that a surge in economic growth combined with a reduction in wasteful spending and some tax deductions will make these actions largely revenue neutral.

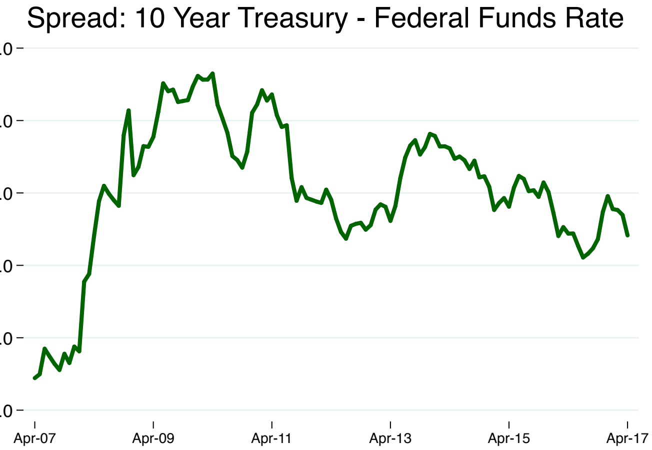
Of course, this entire conversation has aggressively steered clear of Federal entitlements, all of which are about to see a rapid acceleration in spending growth due to the Baby Boomer generation moving into retirement. By our internal calculations without any changes in tax policies Medicare by itself will rise from using 18% of current revenues to over 40% in 2035.

Realistically the outlook for the deficit is grim regardless of Trump budget changes unless the nation is willing to face these very real issues. This is highly unlikely in today's political environment, where even basic decision such as raising the debt ceiling have become hyper-partisan. Similar arguments can be made around other hot policy items on the Presidential agenda, including trade and immigration.

Uncertainty about the direction of the nation seems to fly in the face of the stock market's ongoing rally. The market's focus is exclusively on profits and the potential for corporate tax cuts. Wall Street may only start to worry if Trump's tax cut proposals look less likely to succeed, a valid concern given the ongoing failures of his administration.

Then there is the Federal Reserve. The Fed has now raised rates three times in the last 6 months—a very sharp pace. The justifications for the increases are typical—that a full labor market implies that they need to back off the stimulus before creating inflation. But such a concern is of limited value in today's economy. First, inflation is still low by historical standards and money supply growth is also constrained hard to see any nascent issues here.

Second, the Philips curve (the inverse relationship between inflation and unemployment) is hardly existent in a low inflation world. Lastly, the Fed typically chases a rise in the 10-year bond rate—responding to a steepening yield curve. The current move keeps the spread at well below 2 percentage points—very low from a long-term standpoint and even low relative to the spreads seen since the start of the Great Recession.



Source: Federal Reserve Bank of St. Louis

Trying to ascertain what is on the minds of the people at the Federal Reserve Banks is impossible at the best of times. Are they really concerned about inflation? Or are they more concerned about the potential for a new Trump driven bubble? Or is there some other motivation—such as heading off an effort by Congress to take control over the Federal Reserve after years of complaints about the Fed's loose monetary policy even though those complaints have no basis. Given we don't really know, it is hard to say just how far they will go in flattening the yield curve.

The mystery only adds to the overall confusion about where the economy is headed next. If there were a well-defined policy direction from the Trump administration or the Federal Reserve, even if the policies were unwise, it would allow for some clarity on the direction of the economy. But the uncertainty within this administration leaves us, as forecasters, with little idea as to what might actually occur. As we move through the year, beware the unknown unknowns.

California Economy: Slower Growth Ahead

California stands to be significantly impacted by shifts in the political environment that have characterized President Trump's first three months in office. With a large foreign-born population (foreign-born residents made up more than one-quarter of California's population in 2015, compared to 13% for the United States as a whole) and a significant amount of the nation's trade passing through its ports and over its borders, the state economy is hard-wired to the rest of the world. The Administration's desire to enact a travel ban along with its hardline positions on trade have significant implications for many parts of the California economy. California government officials and business leaders are challenging the Administration on these issues and other policy fronts such as environmental regulation and infrastructure investment. State leaders will need to ensure that decisions from Washington work for the California economy, as well as its businesses and residents.

The California economy generally tracked the national economy as it advanced throughout 2016. The state's unemployment rate fell to it lowest in 10 years at 5.1% in January 2017, marginally higher than the U.S. rate. California's real Gross Domestic Product in the third quarter of 2016 (latest available data) grew 3.3% over the prior quarter in annualized terms, approximately on par with the nation's 3.5% rate in that period. For all of 2016, the pace of economic growth in both California and the U.S. was slower than in 2015. Meanwhile, California continues to get significant contributions from the tech sector, which accounted for 30% of the state's economic growth in the third quarter. Two other sectors, Transportation and Logistics and Finance and Insurance each accounted for 14%, and Durable Goods Manufacturing accounted for 12%.

The state has continued to experience steady but somewhat slower job growth as it has entered 2017. Wage and salary jobs rose by 2.0% year-over-year in January 2017, considerably lower than the 3.2% growth rate a year earlier. In the private sector, Health Care made the largest contribution, followed by Leisure and Hospitality, Professional Services, and Information. The Government sector also saw a significant gain mostly due to hiring by local school districts. These five sectors accounted for two-thirds of the 330,500 jobs added during the period. Private Education, Information Health Care, and Logistics experienced the largest percentage gains, while job losses occurred in Manufacturing (4,800 jobs or 0.4%) and Administrative Support (400 jobs or less than 0.1%). Having finished out 2016 with the highest annual employment on record despite the drought and the strong dollar, Agriculture posted an impressive 2.4% yearly job gain in January 2017.

Table 1 - Industry Employment for California (jobs in thousands)

Industry	Jan-16	Jan-17	Yr-to-Yr	YTY % Change
NR/Construction	787.9	800.4	12.5	1.6%
Manufacturing	1,309.3	1,304.5	-4.8	-0.4%
Wholesale Trade	719.4	732.2	12.8	1.8%
Retail Trade	1,671.1	1,680.1	9.0	0.5%
Logistics	572.1	589.7	17.6	3.1%
Information	511.8	531.7	19.9	3.9%
Financial Activities	814.6	833.2	18.6	2.3%
Prof Sci Tech	1,206.2	1,239.0	32.8	2.7%
Management	224.9	227.2	2.3	1.0%
Admin Support	1,089.7	1,089.3	-0.4	0.0%
Education	350.0	364.1	14.1	4.0%
Health Care	2,147.7	2,226.2	78.5	3.7%
Leisure and Hospitality	1,874.6	1,917.9	43.3	2.3%
Other Services	550.4	564.9	14.5	2.6%
Government	2,486.8	2,546.5	59.7	2.4%
Total Nonfarm	16,317.1	16,647.6	330.5	2.0%

Source: EDD Compiled by Beacon Economics

Regionally, virtually all the metro areas of the state saw yearly job gains in January 2017. Among the MSAs with more than 100,000 jobs, the Modesto MSA led the way with a 3.6% increase from January 2016 to January 2017, followed by the Inland Empire, the Fresno MSA, and the Oakland MSA. As usual, Los Angeles County led in terms of absolute job gains adding 84,500 jobs.

Housing Outlook Mixed

The picture for California housing continues to be mixed. In general, prices have advanced modestly despite hurdles that have limited sales activity. Outside of the San Francisco 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 home sales have been well below their long run averages, while new home construction has been relatively weak since the recession. Meanwhile, with the homeownership rate at its lowest level in decades, high demand for rental units has driven rents up and rental vacancy rates down.

Location	Annual Wages ($)	Monthly Rents	Rent as % of Wage/Mo
Santa Cruz	49,364	1,954	47
Sonoma	51,878	1,598	37
San Joaquin	45,401	1,084	29
Orange	62,666	1,799	34
Monterey	47,141	1,418	36
Tulare	39,552	878	27
Santa Barbara	53,240	1,511	34
San Bernardino	46,874	1,262	32
Riverside	45,622	1,262	33
Contra Costa	67,516	2,112	38
San Diego	61,233	1,669	33
San Francisco	106,151	2,932	33
Alameda	73,889	2,112	34
Fresno	42,616	915	26
Kern	45,901	957	25
Sacramento	58,979	1,178	24
Santa Clara	120,947	2,468	24

Source: QCEW, REIS, Compiled by Beacon Economics

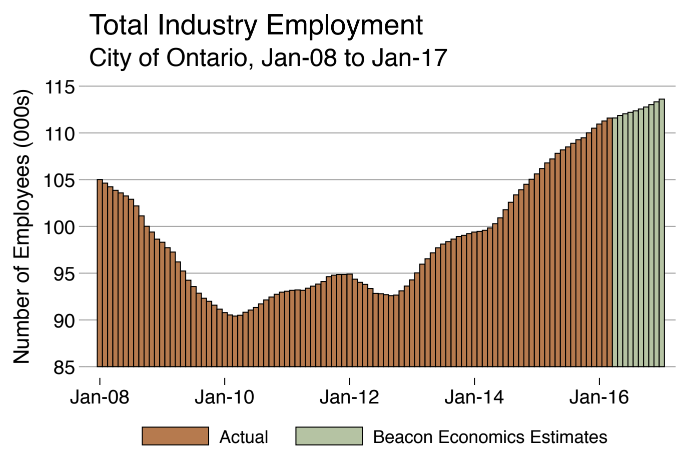
The outlook for housing in 2017 is mixed. With growing incomes, more households will seemingly be in a position to become homeowners. However, interest rates are expected to rise, as will prices, and it appears that lenders are ratcheting up their lending requirements.

A just released Federal Reserve Bank Senior Loan Officer Survey suggests that already tight consumer credit standards have become more stringent as the economy's expansion has lengthened and raised concern in the lending community about a forthcoming slowdown. Meanwhile, the rental market will offer little relief as renters face yet another year of rent hikes, prompting concern about affordability in many communities around the state.

Conclusion and Statewide Policy Issues

It will take time for policy changes in D.C. to work their way through the political process. As such, California and its regions should experience continued growth in economic activity and jobs throughout 2017, with the largest contributions to employment coming from Health Care, Leisure and Hospitality, and Professional Services. Meanwhile, California must deal with its own homegrown issues. In addition to housing affordability concerns, the state must face up to long-run water problems, even though the precipitation of recent months has alleviated severe drought conditions across most of the state. And as the situation at Lake Oroville has demonstrated, decades of neglected maintenance and repairs have contributed to a significant infrastructure investment deficit. The state and its regions must do more to ensure that the all-important statewide water system, which ties north to south and inland California to coastal California, will be up to the task in the future. More generally, California must find ways to address and finance its infrastructure needs in transportation and other systems to support a growing state economy in the decades ahead.

Ontario Economy Continues to Grow



Source: California Employment Development Department

The City of Ontario continued to be a model of growth in San Bernardino County, even as nonfarm employment gains decelerated over the last year. Based on Beacon Economics' estimates, local employers added 2,670 jobs between January 2016 and January 2017, a 2.4% gain. Although it was slower than overall growth in the Inland Empire (+2.8% year over year), this is a recent development; Ontario has generally outpaced the broader region during the current expansion. Despite modest slowdown in nonfarm employment growth, critical industries continued to perform. Transportation and Warehousing, the city's largest industry, accounted for 35.9% of net nonfarm job gains. Other major contributors to growth included Leisure and Hospitality (+4.9% year over year) and Retail Trade (+2.7% year over year). On the other hand, although Ontario continues to offer a disproportionate number of jobs in professional sectors, initial estimates indicate that Professional, Scientific, Technology, and Management (-0.6%) and Information (-3.4%) sectors could be losing steam following strong growth over the past couple of years. Estimated job losses in these sectors accounted for 107 layoffs on a citywide employment base of 113,600.

Leisure and Hospitality has been flourishing as the city's residents continue to dine and spend locally. Additionally, top executives at the Ontario International Airport Authority have made efforts to attract major Chinese courier companies to use the airport as a hub for United States and Latin American markets.

Although traffic volume at the airport has yet to recover to pre-recession levels, the addition of routes and the recent change of ownership may be a boon to the local tourist industry, as both business travelers and tourists seek direct routes into the Inland Empire. According to a local newspaper, the local authority saw almost a 10% increase in revenues in the first six months since the handover.[1] As of 2016, annual passenger volumes and freight tonnage passing through the airport remained below 2007 peak levels, at 58% and 96%, respectively. Freight volumes have been recovering at a faster rate thanks to the strength of the Logistics industry in the Inland Empire overall; in 2016, annual tonnage increased 12.5% from 2015. Although passenger volumes posted a more modest annual growth rate of 0.8%, the transfer of the airport to local authority appears to be boosting the business community, particularly in goods movement trades.

Flight statistics from the first three months of 2017 indicate a continuation of this trend, as both freight (+10.7% YTD) and passenger volumes (+6.8% YTD) rose well over volumes seen in the first three months of 2016. Rising passenger flights at the airport have led a number of airlines to add non-stop flights to Dallas and Chicago. Furthermore, the Mexican Airline Volaris has announced their intention to start nonstop flights to León (BJX).[2] This could boost international travel through ONT, which has seen flagging international passenger traffic in early 2017.

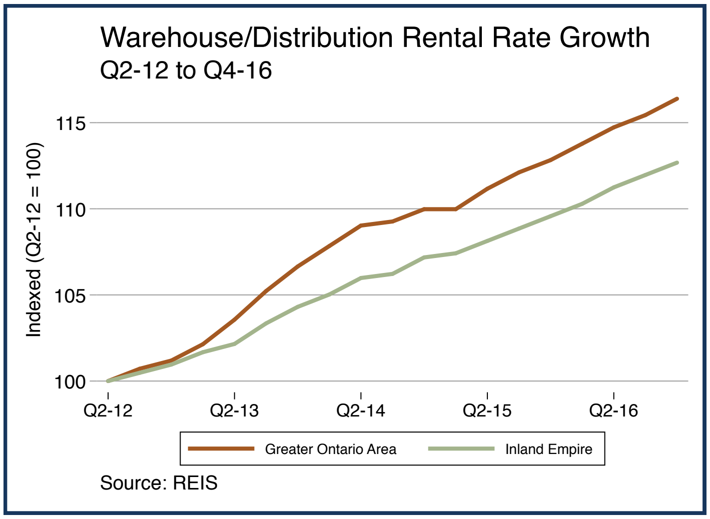
[1]http://www.sbsun.com/business/20170402/after-6-months-of-local-control-heres-how-ontario-airports-income-has-changed

[2]http://www.flyontario.com/corporate/news/volaris-schedules-nonstop-ontleonguanajuato-flights

Employment by Industry in the City of Ontario

Industry	17-Jan	1-Yr. Chg.	1-Yr. % Chg.
Finance & Insurance	2,878.9	211.6	7.9
Transport/Warehouse	16,625.3	957.2	6.1
NR/Construction	5,825.7	301.7	5.5
Leisure & Hospitality	7,987.0	372.3	4.9
Real Estate	1,525.2	69.4	4.8
Other Services	3,133.7	93.7	3.1
Retail Trade	13,788.5	362.2	2.7
Wholesale Trade	11,267.1	200.6	1.8
Manufacturing	14,126.6	248.5	1.8
Education/Health	8,663.8	126.8	1.5
Admin Support	13,677.1	35.6	0.3
Government	5,874.2	5.3	0.1
Prof Sci and Tech and Management	5,980.7	-38.4	-0.6
Information	1,960.4	-68.9	-3.4
Total All Industries	113,611.4	2,665.5	2.4

Source: EDD & Beacon Economics, LLC



Generally speaking, the local goods movement sector has continued to show strength alongside rising imports nationwide. The Inland Empire represents an entry point for inbound cargo destined for Northern California and the Midwest, and as consumer preferences have increasingly favored online shopping, the need to efficiently transport and store goods along logistical networks has led to an explosion of the local Transportation and Warehousing sector.

In Ontario, the Transportation and Warehousing sector has continued to see substantial growth over the last year, expanding by 6.1% between January 2016 and January 2017. Furthermore, commercial real estate indicators demonstrate that local warehouse/distribution properties are in high demand: Rents in the Greater Ontario Area grew 3.2%, while vacancy rates tightened further by 0.8 percentage-points. QVC, Inc. recently opened its first West Coast distribution center there, which is expected to lead to the addition of 1,000 jobs by 2020.[3] Joining QVC at the Meredith International Centre near the airport are Arvato, Metro Air Services, the Wheel Group, and Metropolitan Logistics Services.[4] Because of heightened demand for workers in the Logistics sector, the Manufacturing Skill Standards Council is offering a free 132-hour course in the Inland Empire for people seeking jobs in the Logistics and Distribution industries.[5]

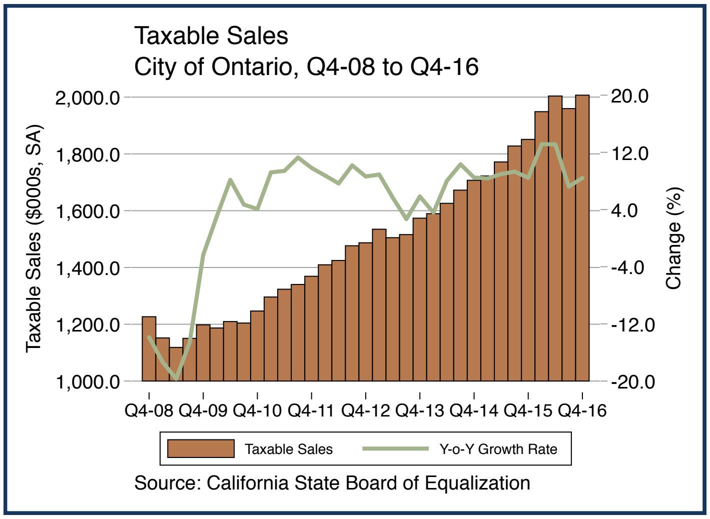
As employment gains have started to decelerate in the broader San Bernardino County, so has employer investment in office and industrial supplies. Taxable receipts in this category fell 7.7% from the fourth quarter of 2015 to the fourth quarter of 2016, while still remaining relatively high.

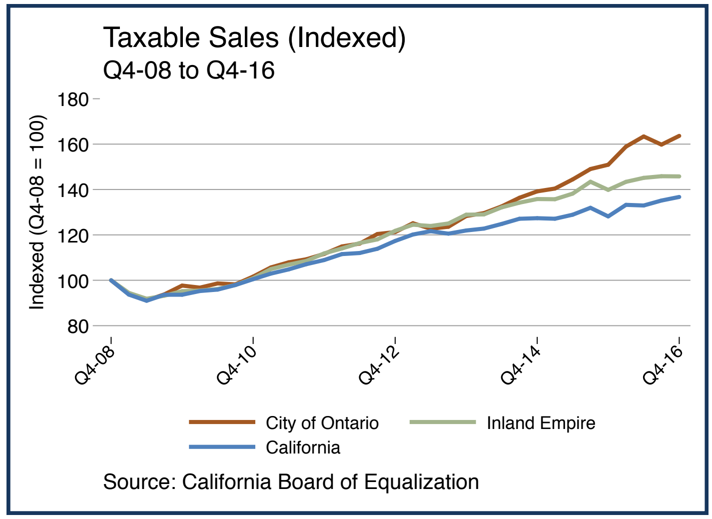
Tightening labor conditions are triggering wage gains in broader San Bernardino County, however, where annualized average wages grew 9.1% year to year in the third quarter of 2016 to an average of $44,696. Local job gains in Retail and in Leisure and Hospitality are clear manifestations of increasing consumer spending in the County. Spending in the Restaurants and Hotels (+5.1%) and General Consumer Goods (+3.7%) categories saw the highest year-over-year increases in the fourth quarter of 2016. Although restaurants tend to account for the largest share of spending in this category, the local hotel industry has been contributing as well. According to PKF Consulting, revenue per available room increased 6.4% in Ontario between December 2015 and December 2016.

[3] http://www.prnewswire.com/news-releases/qvc-distribution-center-expected-to-bring-approximately-1000-new-jobs-to-ontario-ca-300319058.html

[4] http://www.prnewswire.com/news-releases/saresregis-group-signs-long-term-leases-on-four-new-distribution-buildings-near-ontario-international-airport-300426342.html

[5] http://www.sbsun.com/social-affairs/20170321/free-hands-on-logistics-training-classes-are-being-held-in-the-inland-empire?source=most_viewed





Consumers in San Bernardino County continued to save at the pump as receipts at Fuel and Service Stations fell 1.4% year to year in the fourth quarter of 2016. OPEC may have arrested falling oil prices by agreeing to cut production, however. As of February 2017, oil prices are up 73.6% year over year. Receipts in this category can be expected to increase in the near term, perhaps along with prices of other consumer goods as transport costs rise. This may also slow the gains in new car purchases, although recent data from HdL Companies indicate that receipts in the Autos and Transportation category grew by the largest amount (+6.4% year over year).

Although HdL Companies does not provide city-level breakouts of taxable spending, the City of Ontario has been growing at a faster rate than the broader region in annual taxable sales growth since the recession. Over the last eight-year period, quarterly sales in the City of Ontario increased 63.6%, significantly outpacing both the state (+36.7%) and the Inland Empire (+45.8%). Recent sales activity has continued to trend upwards, and 2016 taxable sales amounted to $7.9 million, marking a 10.4% gain over 2015. As resident finances have continued to improve, the City has become an increasingly attractive market for high-value luxury goods. Retail options are already expanding rapidly in the region, including an Audi dealership that opened late last year.[6] Furthermore, millennials, young professionals, and move-down renters are increasingly demanding mixed-use districts that combine high-density residences with hip retail and night life options. Three developers are seeking a zoning change so they can build a grocery-anchored shopping center, new restaurants, brew pubs, a hotel, and hundreds of apartments north of the Citizen's Business Bank Arena. [7]

A number of high-profile residential projects are also underway. Residential permitting increased by 73% in 2016, fueled by strong gains in both multi-family and single-family markets. Permits for 723 housing units were issued during the year. Developers have been green-lighted to begin construction on an 800-unit apartment complex near the Meredith Industrial Centre,[8] and this project alone would account for more permits than the city has seen in any of the last ten years.

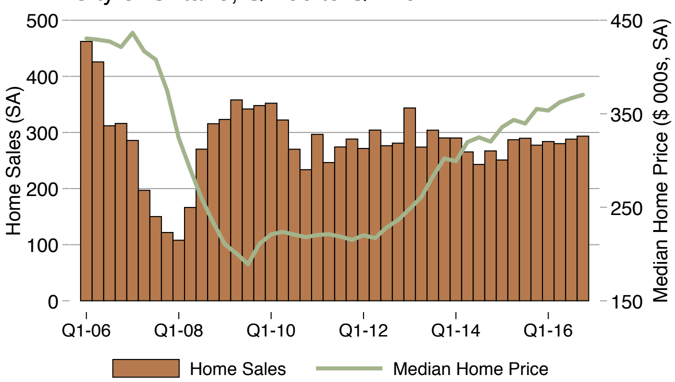
[6]http://www.dailybulletin.com/government-and-politics/20160217/ontario-goes-upscale-audi-dealership-coming-to-town

[7]http://www.dailybulletin.com/government-and-politics/20170324/projects-propose-restaurant-row-hip-urban-feel-for-land-near-ontario-arena

[8]http://www.pe.com/articles/units-812685-center-city.html

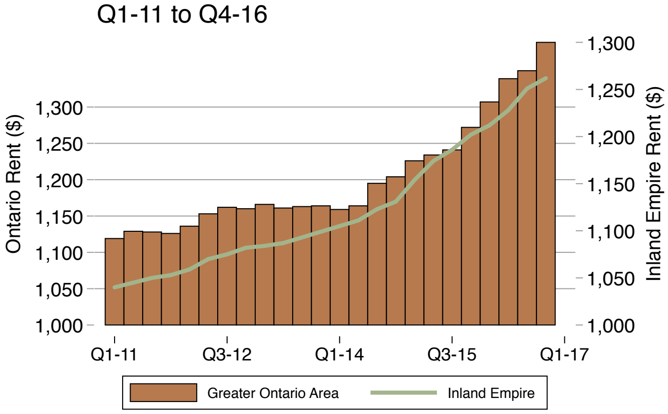
This signals a shift from recent trends, as the market has generally favored single-family housing development. Despite a 3.7% annual increase in single family-home sales, median home price gains showed signs of winding down in 2016. Between the fourth quarter of 2015 and the fourth quarter of 2016, the median home price in Ontario increased by 4.25%, less than year-over-year growth in nearby Fontana (+6.48%) and Chino (+4.72%) and the state overall (+5.8%). As of the fourth quarter of 2016, the median-priced home in the City was valued at approximately $370,260. This makes Ontario the second most affordable option among nearby cities, with only Fontana offering a modest advantage with a median home price of $350,000.

Existing Single-Family Home Prices & Sales
City of Ontario, Q1-06 to Q4-16



Source: DataQuick

Apartment Rent Prices
Q1-11 to Q4-16



Source: REIS

On the other hand, the multi-family market appears to be heating up. The Census Bureau's American Community Survey data demonstrate that renter households made substantially less than owner households in 2015 ($46,257 and $73,311, respectively) but also that renter households have seen incomes increase at a faster rate. Between 2014 and 2015, the median household income for renters increased by 4.8%, compared to 2.0% for owners. Therefore, it is unsurprising that rental costs are increasing substantially faster: The average rent in the Greater Ontario Area increased 9.2% year over year in the fourth quarter of 2016, reaching $1,389. This appears to be a prime motivator for the addition of luxury apartment units.

Renter rates have generally been increasing in Ontario for as long as the Census Bureau has been tracking those data. In 2015, 46.5% of city housing units were rented, up from 45.3% in 2014. Although some of these renters are priced out of the home-ownership market, affordability is clearly not the only force at work. Ontario, like the greater Inland Empire, has a relatively high proportion of youth. In 2015, 39% of Ontario's population was estimated to be younger than 25, slightly more than the county (37%) as a whole. Because millennials are more likely to prefer mixed-use, high-density areas and to delay home ownership, an increase in renting is not necessarily a function of lack of access. In fact, as Ontario becomes an increasingly attractive place for young people to remain, the demand for rentals is likely to grow.

About Beacon Economics

Beacon Economics, LLC is a leading provider of economic research, forecasting, industry analysis, and data services. By delivering independent, rigorous analysis we give our clients the knowledge they need to make the right strategic decisions about investment, growth, revenue, and policy.

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