REGIONAL INTELLIGENCE REPORT™

BEACON ECONOMICS Prepared by Beacon Economics, LLC

CITY OF ONTARIO SOUTHERN CALIFORNIA

City of Ontario

Tenth Edition February 2015

U.S. Economic Outlook

The year 2014 came in like a lamb, but it is going out like a lion. After a year of decent growth in 2013, it was a bit of a shock to see the U.S. economy contract sharply in the first quarter of the year. But the forces that caused this slowdown were purely transitory and since then the nation has been growing at a 4% plus pace. Most impressive is that this growth is being driven almost exclusively by internal factors, given that the global economy continues to stumble along.

Consumers continue to ramp up their spending, and are starting to borrow more. And while Black Friday was a dud relative to last year—we don't hear retailers complaining. Indeed, this is a sign of growing strength in consumer spending—and the fact that many people don't feel the need to get up at 3:00 a.m. to wait in painfully long lines for discounted goods! Businesses are happy too. Profits continue to rise along with stock prices, they are investing more, and the pace of hiring is up. Public spending has finally stabilized after years of austerity. When all is said and done, expect 2014 to be a better year for growth than 2013 despite that first quarter glitch. Moreover, the really good news is that there is little reason to expect this pace of growth to slacken in 2015.

Beacon Economics expect this year to be modestly better than last year, with growth coming in a bit above 3%, largely driven by the ongoing growth trends in consumer spending and business investment, with an additional bump from better numbers from the housing market. The nation will finally begin to close some of the output gap, and labor markets will continue to advance. Here are the most important things that will occur next year, for better or for worse.

1. Incomes will finally start to rise: While corporate profits have been hitting regular record highs, this has come largely at the expense of worker wages, which have been mostly stagnant. But now that the labor markets have turned the corner there is enough compression in some markets to actually push some of the gains to labor. This will become more widespread in 2015—and keep consumer spending growth rolling. Rising incomes will also encourage people to re-enter the workforce and participation rates will start to rise slowly.

2. Real estate recovery, part 2: The housing market will begin to come back in 2015, this time driven by the retail buyer. Mortgage credit is becoming easier to get. The average Fico score for those receiving a Fannie Mae prime mortgage has fallen from a ridiculous 760 in 2013 to below 740. Add in all the new home equity created by rising prices—$6 trillion total since 2012—all this points to a second surge in the housing market. And this time it will come with more demand for new units—expect SF permits to break out of the 600K zone finally.

3. Inflation?: Price growth will remain stable, as money supply growth remains constrained. While the pace of bank lending is picking up speed, we don't see it growing rapidly enough to cause all that QE money that is tied up in excess reserves to come spilling out into the economy. The lack of inflation implies low interest rates and a strong stock market.

4. Low interest rates and a strong stock market: The global economy will continue to disappoint, but this will spur central banks to continue to loosen. Look for QE-type programs in Europe as well as Japan, and China will start working to stabilize growth there as well. Interest rates will remain quite low. Look for the $US to continue its slow pace of appreciation. The fact that the US will be the bright star on the international scene will continue to attract foreign investors—look for the stock market to continue its slow climb towards the sky.

All is not right in the United States. The nation continues to deal with ludicrous political gridlock in Washington DC that prevents reasonable conversations on needed policy changes in healthcare and the various public insurance programs that are unsustainable in their current form. Growing inequality is an issue that must be dealt with, and there is little movement to try and fix a broken revenue system. And of course there will be another recession—there is always another one somewhere in the future. But none of this worries us in the near term, so expect a prosperous 2015!

California Economy

Beacon Economics remains bullish on the California economy. That isn't to minimize the challenges that the state faces, which could propel the state even further ahead of the nation overall. But not reaching your full potential is a far cry from being an economic horror story. Realistically, California has outpaced the nation in several key areas despite its formidable issues. As such, the current 5-year forecast calls for ongoing improvement in virtually every aspect of the economy.

1. Jobs will continue to expand: California has already recovered more than the 1.3 million jobs lost during the downturn. Virtually every major industry in the state has returned to job growth. With tourism, business investment, housing, and consumers all moving forward at a respectable pace, Beacon Economics forecasts that the state's non-farm job base will continue to expand. Specifically, Beacon Economics is calling for employment growth to increase to 2.5% over the next year, with unemployment dipping to the low 6%-range by 2016.

2. Population forecast calls for ongoing growth: Although domestic migration has remained negative over the past few years, this has been more than offset by natural increases and net foreign immigration to the state. Given the weakness of the dollar and the rising number of high-net-worth individuals abroad, the California will continue to attract immigrants. Natural population increases are also expected to continue, which translates into overall population growth hovering in the 0.8%-1.0% per year range.

3. Housing and permits to remain a driver of growth: The State's residential market is expected to remain a driver of growth moving forward. Home prices are expected to taper down from double-digit annual increases to growth that is more in line with incomes over the next few years. And, with both housing vacancies and inventories remaining low, the upward trend in new residential construction is also expected to continue. However, these new units are not expected to be enough to stem the tide of under-supply, so price growth is expected to remain positive through the life of our forecast.

Despite our relatively optimistic forecast Beacon Economics is the first to acknowledge that California faces substantial, though not insurmountable challenges moving forward. The cost of housing is perhaps the single-most important policy challenge facing lawmakers in the state today. While the policy prescriptions are relatively easy—boost supply—the path to achieving this straight-forward objective is fraught with political difficulties. We are currently seeing a new wave of affordable housing measures pop up in municipalities across California, however, these local ordinances are attacking the symptom of a much broader cause, which is that we don't have enough housing in the state—affordable and otherwise. California desperately needs to expand its housing stock in order to manage the cost of housing in the state that makes it more difficult and costly for businesses to recruit and retain the talent they need to succeed in the Golden State.

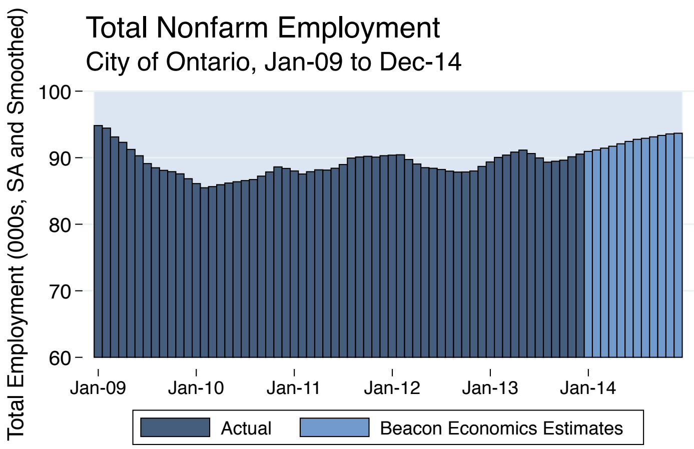
In addition its housing woes, infrastructure remains as focus for future growth. Here again, the cyclical effects of the Great Recession are waning, and yet how much of the uptick in government revenues will be allocated to improving California's infrastructure remains to be seen. What is clear is that the state has many unmet infrastructure needs that were canceled or delayed in response to belt-tightening associated with the Great Recession. California's Infrastructure Report Card got a C grade in 2013, and the American Society of Civil Engineers estimates that California needs to invest as much as $65 billion per year on our collective infrastructure needs.[1]

If we do not shift our focus to these longer-term challenges now that revenues are growing and the economy is healing, California will be even further behind the 8-ball when the inevitable next business cycle rears its ugly head. With the economy forecasted to continue to improve over the life of our forecast, now is the time to begin chipping away at these structural issues to ensure that California remains a driver of U.S. growth moving forward.

[1]American Society of Civil Engineers, "California's 2013 Infrastructure Report Card."

Employment

The City of Ontario's labor markets are showing sustained growth. From December 2013 to December 2014, Ontario grew its employment base by 3.2% to nearly 94,000. Strong hiring in the Wholesale Trade, Leisure and Hospitality, and Transportation/Warehousing sectors propelled the city's labor markets, outpacing the labor markets throughout the IE—where the employment base grew by only 1.9% over the last year. Overall, continued strength in the region's housing markets and increasing spending activity are certainly positive signs for employment, especially given Ontario's strong retail and logistics presence. Furthermore, while Ontario's total employment levels are not quite back to pre-recession levels, the continued growth in Ontario's employment base shows that the Great Recession continues to fade farther into the rear-view mirror.



Source: California Employment Development Department
Note: Estimates by Beacon Economics

Over the past year, Ontario's labor markets were primarily led by the Logistics and Wholesale Trade industries. Both sectors experienced substantial gains in hiring over the last year, with Wholesale Trade expanding by 7.5% and Transportation expanding by 5.1%. With lower gas prices spurring growth in consumer demand, the transportation and logistics industries in the region is experiencing a corresponding uptick with the rise of not just port-oriented logistics operations, but fulfillment centers for domestic consumption associated with rising e-commerce sales. In fact, to meet the growing demand, the city is currently in the midst of developing the Mission Grove Business Park, which will serve light manufacturing and warehousing that will accommodate the increased demand for in these sectors.[1] Indeed, Ontario should be poised for continued employment growth in this sector, which should entail further stimulus to the region.

Employment in the tourism sector also grew significantly over the last year. During this time period, Leisure and Hospitality increased its employment base by 6.9% to over 7,000 jobs in the city. According to PKF Consulting, Ontario's hotel occupancy rate increased by 8% through September 2014, compared to the same time the prior year. The increased demand for hotel accommodations in Ontario drove continued increases in room rates, which were up 2.9% year-to-date. The growth in the local hotel industry has certainly contributed to the industry's employment growth, and it provides a source of optimism for the future outlook of local tourism.

Employment by Sector
City of Ontario, December 2013 to December 2014 (SA)

Sector	Dec-13	Dec-14	Annual Chg.	Annual Chg. (%)
Wholesale Trade	10,025	10,775	750	7.5
Leisure and Hospitality	6,750	7,225	475	6.9
Transport/Warehouse	12,750	13,400	650	5.1
Education/Health	6,125	6,425	300	4.7
Admin. Support	10,525	10,925	400	3.9
Prof., Sci., and Tech. and Mgmt	4,500	4,625	125	3.0
Real Estate	1,025	1,025	0	1.9
Retail Trade	13,850	14,075	225	1.6
Manufacturing	11,050	11,175	125	1.2
NR/Mining	750	750	0	0.7
Information	1,525	1,525	0	0.4
Finance and Insurance	2,325	2,325	0	0.1
Government	3,925	3,925	0	-0.1
Construction	3,600	3,525	-75	-1.7
Other Services	2,125	2,075	-50	-2.2
Total All Industries	**90,875**	**93,800**	**2,925**	**3.2**

Source: California Employment Development Department
Note: Estimates by Beacon Economics

As the regional economy continues to expand its employment base and incomes improve, residents are beginning to feel less financially constrained. Residents are consuming goods and services that they may not have otherwise consumed during the Great Recession, when employment and incomes were significantly weaker. An increase in consumption in healthcare has helped lead to an increase in healthcare employment. With the implementation of the Affordable Care Act and with more Baby Boomers aging into retirement, increased demand for healthcare services across the nation has served as a catalyst for increased employment in the Education/Health sector. Over the last year, employment in this sector grew by 4.7% to 6,400 jobs in Ontario, mostly coming from the following: Offices of Physicians, Individual and Family Services, and Other Residential Care Facilities. Continued employment growth in this sector is consistent with the growing healthcare industry in the region, especially given

[1] Neil Nispersos, "Mission Grove Business Park in Ontario is creating jobs", Inland Valley Daily Bulletin, November 8, 2014.

that a West Coast University campus is situated in Ontario, training future healthcare professionals. In addition, this sector is usually comprises high-paying occupations.

Despite the negative employment growth in the Construction sector, Beacon Economics remains optimistic about residential construction picking up, most notably in multi-family housing. Indeed, the total year-to-date (to November 2014) residential permit values in Ontario increased 54.3% compared to the same time in 2013. Thus, we should expect construction employment to expand in 2015.

Spotlight on Ontario Manufacturing

Ontario has a heavy manufacturing presence. As of the fourth quarter of 2013, approximately 11,000 workers were employed at Ontario's manufacturing establishments. Given the significant improvement in the Inland Empire's economy since that time, we forecast that manufacturing employment in Ontario has improved, growing by 1.2% from December 2013 to December 2014. In addition, there are approximately 340 firms as of the fourth quarter of 2013. We expect that more firms have and will continue to enter the market, as consumer demand for manufactured goods has increased. For example, the new Mission Grove Business Park will accommodate light manufacturing and warehousing in response to growing demand for manufacturing-related facilities.

Top Manufacturing Sub Sectors by Employment
City of Ontario (As of Q4-2013)

Sector	# of Employees	Share of Total Employment
Plastics and Rubber Products Manufacturing	2,040	18.5%
Fabricated Metal Product Manufacturing	1,416	12.9%
Food Manufacturing	1,348	12.3%
Electrical Equipment and Appliance Mfg.	1,006	9.1%
Furniture and Related Product Manufacturing	807	7.3%
Transportation Equipment Manufacturing	663	6.0%
Miscellaneous Manufacturing	652	5.9%
Paper Manufacturing	578	5.3%
Primary Metal Manufacturing	412	3.7%
Machinery Manufacturing	355	3.2%
Other Sub Sectors	1,721	15.6%
Total	**10,998**	**100.0%**

Source: California EDD

Three manufacturing subsectors heavily concentrated in Ontario produce products or by-products that will generally be consumed by a typical consumer – Plastics and Rubber, Fabricated Metal Products, and Food.

Employment in the manufacturing of plastics and rubber stands at over 2,000 workers and spans over 30 different establishments. Overall, this subsector constitutes 18.5% of total manufacturing employment in Ontario, which is significant, when compared to this subsector only comprising 1.7% of manufacturing jobs throughout California. Our outlook for businesses in the manufacturing industries is positive because the price of inputs, oil in particular, is currently very low. Furthermore, many of these manufacturers produce household goods for families throughout the nation. Consumer spending throughout the nation has been growing robustly and again the low price of oil will help further drive demand for consumer-driven products such as those produced by these local manufacturers.

The City of Ontario is also home to 65 fabricated metal product manufacturing establishments, which have over 1,400 employees. This subsector constitutes nearly 13% of total manufacturing employment in the City, compared to only 5% throughout California. This subsector consists of manufacturing structural and architectural metal products, which are essential to construction projects. The continued improvement in the construction sector should spur increased production activity in this subsector. This subsector has also experienced a positive increase in average wages throughout the county, up by 3.7% over the last year.

There are also a significant number of workers employed in the food manufacturing subsector in Ontario. With 30 establishments operating in the city employing 1,350 workers, this subsector makes up 12.3% of total manufacturing employment, compared to only 6% of total manufacturing employment throughout California. Given that the demand for food consumption is driven almost entirely by population growth, the population growth underway throughout the state should lead to an increase in demand for food products, which should necessitate further expansion within this subsector locally.

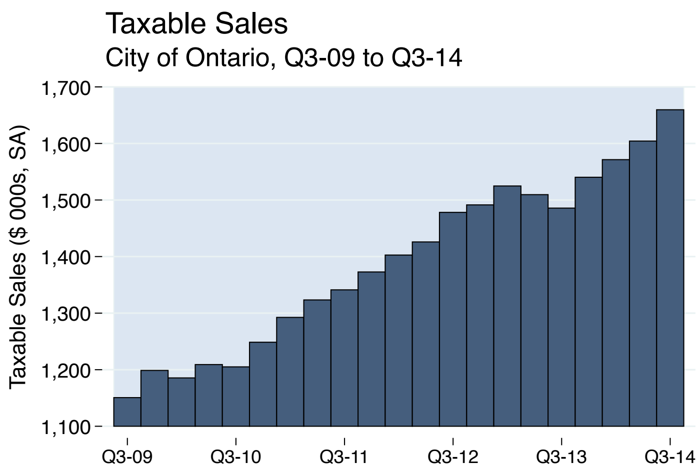
Top Manufacturing Sub Sectors by Establishments
City of Ontario (As of Q4-2013)

Sector	# of Establishments	Share of Est. Total
Fabricated Metal Product Manufacturing	65	19.1%
Plastics and Rubber Products Mfg.	36	10.6%
Machinery Manufacturing	32	9.4%
Food Manufacturing	30	8.8%
Transportation Equipment Mfg.	22	6.5%
Miscellaneous Manufacturing	22	6.5%
Furniture and Related Product Mfg.	20	5.9%
Chemical Manufacturing	17	5.0%
Printing and Related Support Activities	17	5.0%
Computer and Electronic Product Mfg.	14	4.1%
Other Sub Sectors	65	19.1%
Total	**340**	**100.0%**

Source: California EDD

Local Consumer and Business Spending

Led by strength in regional labor markets and growing consumer confidence amidst falling gas prices, consumer and business spending in the City of Ontario moves quickly upward. From the second quarter of 2014 to the third quarter of 2014, taxable sales in Ontario increased 3.5% to nearly $1.7 billion. On an annual basis, taxable sales in the city grew nearly 12%, compared to the entire Inland Empire, where taxable sales grew by 8% over the last year. The City of Ontario surpassed the state in terms of taxable sales growth by nearly six percentage points. Indeed, the construction activity has certainly contributed towards the increase in spending, by consumers and businesses alike, throughout Ontario.



Source: California State Board of Equalization

During the third quarter of 2014, the City of Ontario experienced some changes in the composition of taxable sales. Although Building and Construction spending grew the most, at 10.2% year over year, the Fuel and Service Station and Restaurants and Hotels sectors climbed towards the top, each growing by nearly 8%. The strength in Building and Construction spending can be explained by the development of a significant master-planned community in Ontario. This community—known as the New Model Colony—will be built out over the course of two decades and will comprise 50,000 new homes and nearly a dozen schools. This development project will benefit all those involved:

1. Construction employment will continue to grow in the area and the increased earnings generated by the long-term spending in the Building and Construction sector will facilitate spending in other sectors and continue to grow the local and regional economy;

2. Prospective homeowners, who are feeling priced-out of the Los Angeles and Orange counties, will find relief in the opportunity to purchase less expensive real estate in the Inland Empire, an area that has been historically less expensive than its coastal neighbors; and

3. The local and regional economy will benefit from the inflow of residents who will purchase a home in this development, bringing in much-needed sales tax revenue for the city and county.

Tax receipts on Fuel and Service Stations increased by 7.7% over the last year to $11.6 million. The third quarter usually consists of heavy driving activity, as the summer driving season is in full swing. Also, the City of Ontario is home to a considerable number of trucking companies, which can explain the increased level of spending on fuel. However, we should be wary about the continued sales tax receipts growth in this sector. As global oil prices continue to plummet, significantly lowering the price of gasoline, this will negatively affect the Fuel and Service Stations sector. However, that savings on fuel should help to bolster spending in other categories, offsetting most of decline in sales taxes associated with gasoline.

Sales Tax Receipts by Category
County of San Bernardino, Select Quarters (SA)

	Q3-2014 ($ Thousands)	Q3-2013 ($ Thousands)	Q3-2013 to Q3-2014 (% Change)
Building and Construction	6,512	5,912	10.2
Fuel and Service Stations	11,564	10,735	7.7
Restaurants and Hotels	7,278	6,761	7.6
Food and Drugs	3,586	3,337	7.5
Autos and Transportations	12,774	12,094	5.6
General Consumer Goods	17,583	16,697	5.3
Business and Industry	14,737	14,131	4.3
Total	**83,150**	**77,564**	**7.2**

Source: HdL Companies

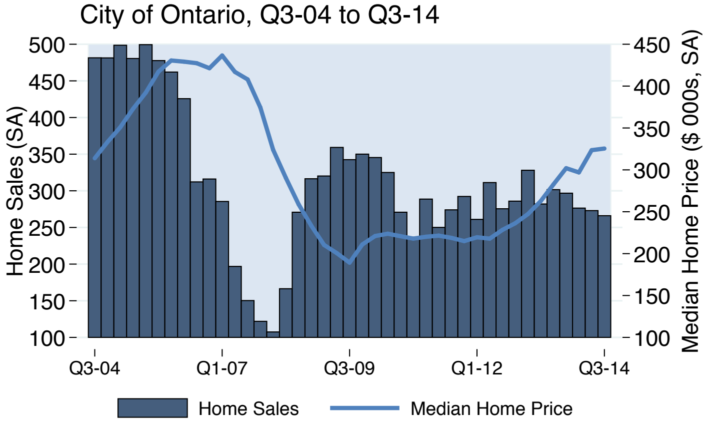
Spending on restaurants and hotels, as mentioned in the previous RIR installment, continues to grow at a steady rate. Over the last year, sales tax receipts from restaurants and hotels in San Bernardino County increased 7.6% to $7.3 million in the most recent data available. Given Ontario's heavy presence in this sector, much of the increased restaurant and hotel spending throughout the county can be attributed to the City of Ontario. With the local labor market continuing to expand and the consumer confidence among locals and visitors increasing, more consumers are willing to spend more of their take-home pay dining out. This is a big positive for Ontario, where the selection of restaurants and other fine eateries comprises of many locally-owned establishments. With residents spending more money on dining out, those impacted the most will be these locally/family-owned establishments, providing increased revenue potential for these businesses.

Overall, residents of the City of Ontario are spending more money across all major consumption categories, which should lend itself to a stronger local economy. In addition, Visit California reports that the year-to-date (up to August) total domestic airport visitor traffic in 2014 is up 2.1% compared to 2013. This should further bolster local spending, as inbound visitors will likely make expenditures within the city limits.

Residential Real Estate

Led by strength in the local and regional labor markets and a significant drop in distressed properties, Ontario's residential real estate market is growing. While the quarter-over-quarter growth in median home prices seemed to settle a bit (rising only 0.6% from the second quarter of 2014 to the third quarter of 2014), median prices for existing single-family homes increased 15.2% since the third quarter of 2013. What is more important is that since Ontario's residential real estate market bottomed out in the third quarter of 2009, median home prices have increased by 72%. While median home prices have yet to reach the $440,000 peak of 2007, we should not expect prices to reach this level anytime soon, as real estate prices in Ontario during that time were unsustainable given the level of personal income in the region. Despite significant home price appreciation over the past year, sales of homes were relatively steady in that time, averaging approximately 283 homes sold per quarter since the third quarter of 2013. Home prices in Ontario, as well as in the rest of the Inland Empire, are still quite reasonable when compared to Los Angeles and Orange Counties, where the increased cost of living continue to force many families farther inland.

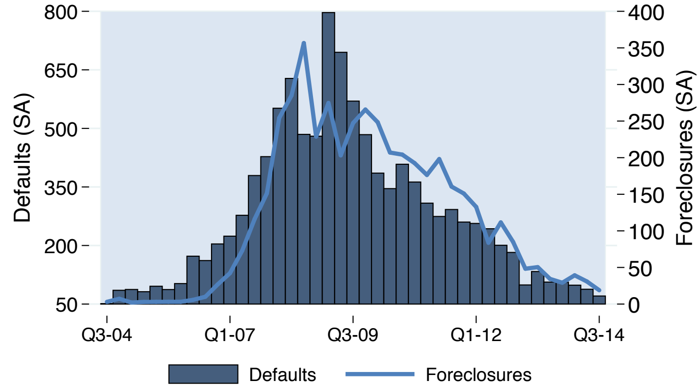
Existing Single-Family Home Prices & Sales
City of Ontario, Q3-04 to Q3-14



Source: DataQuick

Ontario's new master-planned community, The New Model Colony, should attract more homebuyers to the region. According to Ontario city planners, the housing community will eventually consist of nearly 50,000 homes, a 355-acre park, and 30 million square feet of industrial and commercial space. This housing development championed by the city provides further evidence of just how far the City of Ontario's housing market has come since the Great Recession, when it is now expanding and attracting more commercial activity to the area.

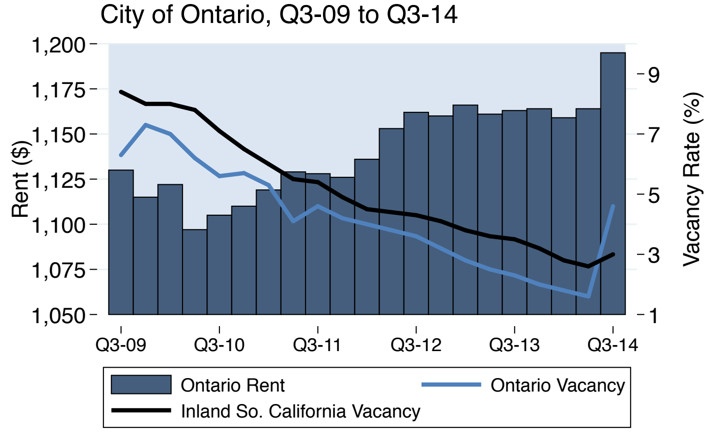
Defaults and Foreclosures
City of Ontario, Q3-04 to Q3-14



Source: DataQuick

Home sales continue to be limited due to low inventories, which have in turn been reduced due to the dramatic reductions in the number of distressed properties within the City. Over the last quarter, Ontario experienced a 20% drop in the number of defaulted properties and nearly a 40% drop in the number of foreclosures. Over the last year, the number of defaults and foreclosures fell by 34% and 45%, respectively. Many current homeowners who were once facing possible default or foreclosure have taken advantage of low interest rates to refinance their properties at much more reasonable terms, thus avoiding default. In addition, investors and prospective homeowners have already purchased many of the distressed properties that once plagued the market. The continued fall in the number of distressed properties in Ontario should help to

Apartment Vacancy Rates and Rent Prices
City of Ontario, Q3-09 to Q3-14

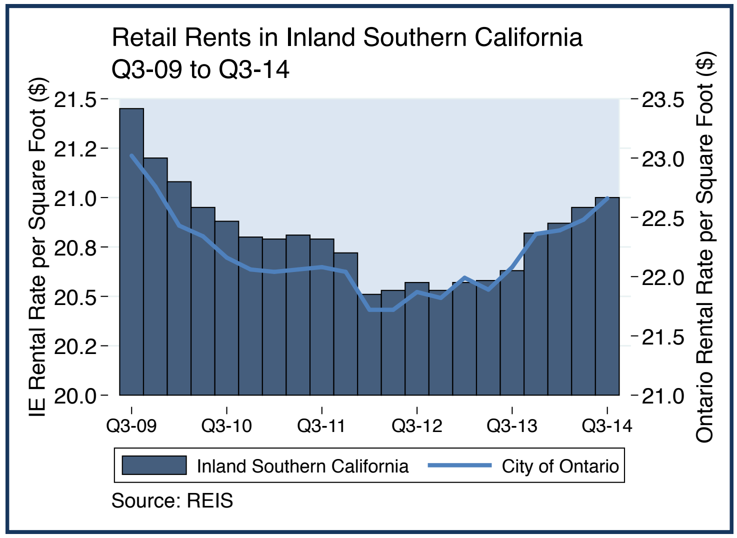


Source: REIS

bolster the local residential market over the long term, even as it limits housing supply on the market over the short run. Ontario's apartment market experienced mixed results. While rental rates throughout the city continue to increase at a steady pace (up about 3% to just under $1,200 per month from the third quarter of 2013 to the third quarter of 2014), vacancy rates in Ontario have doubled over the past year to 4.6%. At the same time, apartment vacancy rates in the Inland Empire have gone down 14.3% over the last year. However, there should be no cause for concern. According to CIRB construction data, the year-to-date value for multi-unit permits is $21.8 million. The significant spike in vacancy rates indicates new apartment units entering the market that have yet to be absorbed. However, these newly-constructed apartment units should be absorbed within a matter of months, especially as demand for housing in the region continues to rise and the overall vacancy rate that is still below 5% indicates that demand conditions within the City remain strong. Thus, the increase in the apartment vacancy rate in the third quarter actually reflects a positive force in the economy: more residential construction rather than a shift in the current market trend.

Commercial Real Estate

With a significant retail and industrial presence, Ontario's commercial real estate market appears to be holding steady. Rental rates for both retail space and industrial space experienced annual increases ranging from 2.6% (to $22.26 per square foot) for retail and 3.8% (to $4.60 per square foot) for industrial, in line with the growth rates for both sectors in the entire Inland Empire. However, we do notice the negative growth rates in the value of retail and industrial permitting in Ontario. CIRB construction data reports that the year-to-date (up to November 2014) value of retail and industrial permits is down 80% and 26%, respectively, when compared to 2013. However, this is after a very strong 2013, which makes the year-to-year comparisons seem more discouraging when nonresidential construction continues to move forward. And, increased consumer and business spending throughout the region coupled with strong employment growth should induce more retail-related spending and facilitate demand for retail space. The market for industrial space should remain strong going into 2015, especially as aggregate demand for various goods across the region will induce more warehouse and transportation activity.



The market for office space, however, continues to remain weak, with rental rates essentially flat since the third quarter of 2013 (only 0.2% growth). Since the market bottomed out in the third quarter of 2009, office rental rates actually dropped 8% to $22.29. Despite the growth in office-using employment in the professional sectors, this has yet to materialize into much new demand for office space due to the rise of telecommuting, hotel-style offices, and remote employees.

Overall, the commercial real estate market appears to be driven primarily by alterations. This can be seen through the 140% increase in the year-to-date value of permits pertaining to non-residential alterations. It would appear, for now at least, that rather than seek out newer/larger commercial space, firms are improving their existing commercial space. But, as the build-out of the New Model Colony and other infill residential projects—such as the 298-unit apartment complex at Haven Avenue and Fourth Street—continues, we should expect retail commercial activity to increase in order to accommodate the expected rise in the number of residents in the coming years.

BEACON ECONOMICS

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