REGIONAL INTELLIGENCE REPORT™

BEACON ECONOMICS

Prepared by Beacon Economics, LLC

CITY OF ONTARIO
SOUTHERN CALIFORNIA

City of Ontario

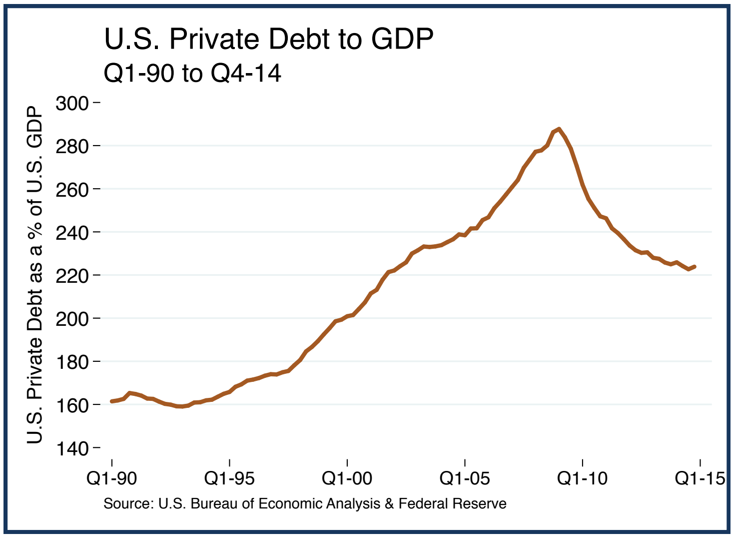
Eleventh Edition

May 2015

U.S. Economic Outlook

It's happened again. The United States economy rallied for a strong few quarters of growth, only to see the apple cart upset again by a number of worrisome trends. Growth at the start of 2015 came in at a measly 0.2% after booming for the last three quarters of 2014—and that number will surely be revised downward before all is said and done. The widening trade deficit, slowing consumer spending, and sagging industrial production drove the downshift as employment growth decelerated.

As always—the question is how serious is the current lull? Is it enough to keep the nation on the same 2% to 2.5% growth rate as in 2014? Could it be even slower? Or will the U.S. be able to shake off the sluggishness and accelerate past last year's measure? Beacon Economics' forecast still points to the latter —albeit we have reduced our U.S. GDP growth outlook for 2015 to just below 3%. Ultimately Beacon Economics doesn't see any near term risk of a recession in the data, despite the choppiness in growth. With that in mind, the focus is on the medium- and long-term challenges in the nation



Top 3 Positive Trends

U.S. GDP – GDP growth came in at a measly 0.2% in the first quarter of 2015. While the nation will likely shake off this level of sluggishness and ultimately accelerate past last year's measure, Beacon Economics has reduced its growth outlook for 2015 to just below 3%.

Cheap Oil – Relatively cheap oil is likely to be here for some time. In 2015, the average U.S. family will earn $700 in savings due to lower oil prices, according to the forecast. Companies that use a lot of petroleum are already beginning to see the profit effect and will turn those profits into investment. Although the oil industry has shed thousands of jobs since last year, on net, the drop in oil prices will be a big boost for the nation, even if not yet apparent.

Financial Markets – While there are clearly signs of 'froth' in some asset markets, there is currently little indication of any dangerous accumulation of debt. Reasonable asset prices today could turn into bubble pricing in the next few years – but this will be largely determined by the amount of leverage that is allowed to build up.

Top 3 Negative Trends

Education Debt – Consumer debt delinquencies are falling across all loan types except student loans. This is not a function of the market, however, but is related to multiple federal funding programs that have been misused by some for-profit educational institutions, leaving students in significant debt.

Infrastructure – Public investment in the nation's roads, bridges, rail lines, and other infrastructure has declined by $80 billion over the last 5 years and is 25% lower today than it was at the beginning of the recession. Infrastructure spending is between a federal rock and a local hard place with local officials deferring expenses in the face of slowly recovering budgets and policy makers at the federal level moving to cut infrastructure subsidies for state and local government.

Wealth Inequality – While comfortable with the increase in asset prices, the forecast is not comfortable with the fact that these gains are accruing heavily to a very small group of people. Many Americans continue to have zero investment in any sort of asset and wages for lower skilled workers continue to sag.

Overview Forecast/Outlook

California's economy continues the robust expansion it began more than 5 years ago and is showing its strength relative to the rest of the nation. While Texas, which is regularly paraded as a point of comparison to California, has stumbled recently amidst a changing energy landscape, the economic environment in the Golden State is in solid growth mode. And this is despite the West Coast Ports shutdown in February and the ongoing drought.

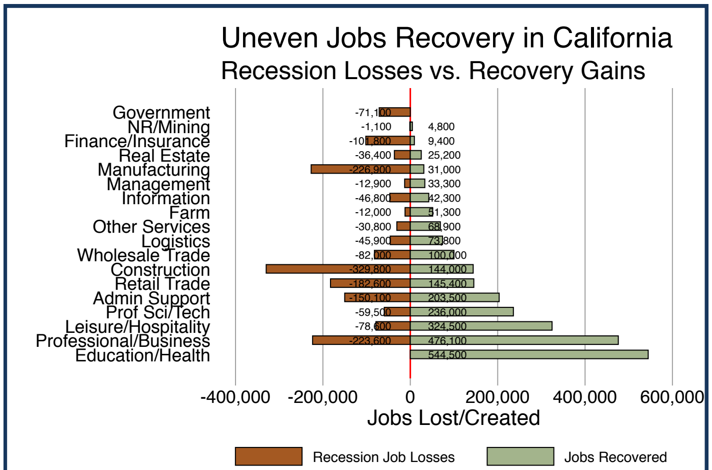
Overall, current statistics paint a picture of a state performing particularly well:

- California's nonfarm employment base has reached nearly 16 million—an all-time high
- Unemployment is now 6.5%, just 1 percentage point above the national average
- Every region in California is on the rise, with each metro area adding jobs over the past year
- Median home prices continue to increase at a 6% pace after several years of double-digit growth
- The first quarter of 2015 saw the largest number of new residential building permits since 2007
- New residential construction in 2015 is growing at nearly 4 times the national pace
- Venture capitalists invested nearly $28 billion in California firms last year, 62% more than the pre-recession peak
- Income growth in California has outperformed the nation overall for 12 consecutive quarters

California has seen a net out-migration of residents in recent years. However, this out-migration has been more than offset by natural increases in population (new births minus deaths) and an influx of international immigrants. As a result, population growth in the state has hovered in the 1% range. This has exacerbated California's under-supplied housing market and put even greater strain on public infrastructure. Investments in infrastructure have been badly neglected due to budget issues associated with the recession as well as competing priorities from other long-term obligations such as retiree healthcare and public pensions. These critical long-term issues will need to be addressed with deliberate action over a sustained period of time but do not represent immediate risks to the economic expansion running strong in California right now.

Over the short term, Beacon Economics is optimistic about the current trajectory of the state economy. Over the next 5 years, the forecast has employment growth remaining in excess of 2% per year, home sales gaining momentum, and growth occurring in both the lower-skilled tourism sector as well as in higher-skilled sectors such as professional services, information technology, biotech, and scientific research and development. Unemployment in the state, which has already fallen substantially, will continue to slide, dropping to the mid-single digits by late 2017. While the pace of home price growth will moderate, it will remain positive and in line with historical norms through the life of the forecast.

Over the longer term, California will need to address its structural issues in order to retain its position as one of the fastest growing economies in the nation. In addition to underfunded infrastructure needs and retiree pension/healthcare reform, education, housing, and allocation of the state's water remain critical areas of focus for policymakers in Sacramento.



Source: California Employment Development Department

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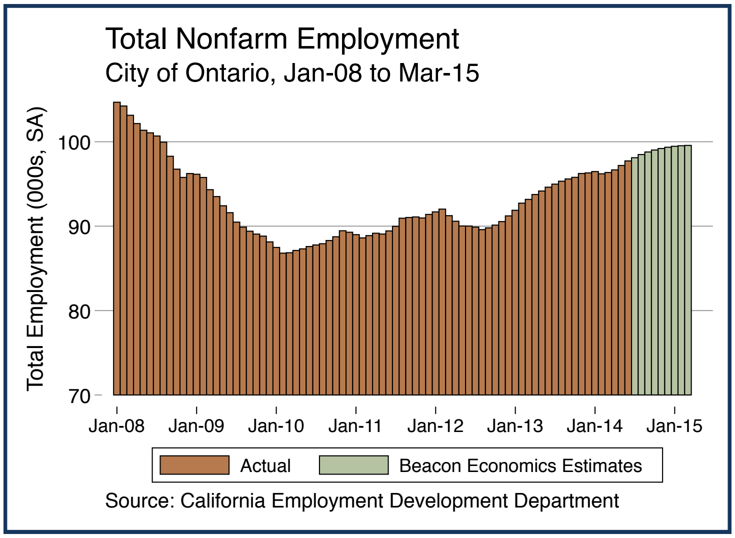
Employment

The labor market in the City of Ontario is recovering admirably, much like the labor market throughout the Inland Empire. Over the last year, total employment in the city increased by 3.6% to 99,575 jobs in March 2015, according to the data provided by the California Employment Development Department and estimates by Beacon Economics. Job growth over the past year is below the rest of the Inland Empire (4.4%) and remains 5% (5,100 jobs) below its pre-recession peak in early 2008 whereas the region as a whole has recovered all of the jobs lost during the downturn.



The Wholesale Trade and Transportation/Warehouse sectors have led job growth in the City of Ontario. Together, these sectors account for 44% of jobs added from March 2014 to March 2015 within the city, or 1,500 jobs. Domestic demand for consumer goods continues to grow, which has resulted in increased demand for services from local wholesale trade and logistics companies. International trade flows have grown steadily in recent years; yet, due largely to recent labor disputes at west coast maritime ports, container counts are arriving at a slower rate in recent months. Container counts at the Ports of Los Angeles and Long Beach combined are 0.7% lower in the current fiscal year to date (July 2014 through March 2015) than the same period a year before. Some freight forwarders pursuing an alternative means to transport goods have been utilizing Ontario International Airport (ONT) more heavily, where cargo shipments (measured in tons) entering or exiting out the airport have grown by 4.0% in the current fiscal year (July 2014 through March 2015) compared to the same period a year ago.

Employment by Sector
City of Ontario, March 2014 to March 2015 (SA)

Sector	Mar-14	Mar-15	Annual Chg.	Annual Chg. (%)
Wholesale Trade	9,975	10,650	675	6.9
Transport/Warehouse	14,100	14,925	825	5.9
Education/Health	6,500	6,875	375	5.8
Construction	3,550	3,725	175	5.4
Admin. Support	11,250	11,750	500	4.4
Financial Activities	3,300	3,450	150	4.2
Leisure and Hospitality	6,875	7,150	275	4.1
Retail Trade	13,425	13,750	325	2.4
Information	1,750	1,775	25	1.7
Other Services	2,300	2,325	25	1.1
Government	5,125	5,150	25	0.8
Manufacturing	11,825	11,875	50	0.4
Prof., Sci., and Tech. and Mgmt	5,500	5,500	0	0
NR/Mining	700	650	-50	-5.7
Total All Industries	**96,150**	**99,575**	**3,425**	**3.6**

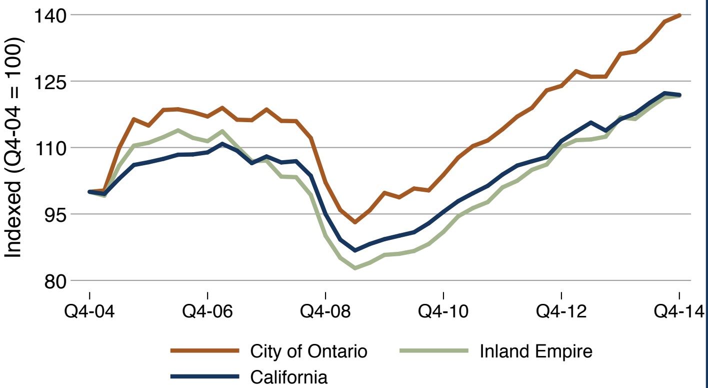
Source: California Employment Development Department
Note: Estimates by Beacon Economics

Robust job growth has also been evident in virtually every other sector throughout the City of Ontario. The Education and Health Care sector grew by 5.8% from March 2014 to March 2015, while the Construction sector grew by 5.4%. Construction establishments have seen a boost in demand as rising home prices and commercial rents alongside falling vacancies have incentivized investors to develop more residential and commercial structures. Jobs in Administrative Support Services (4.4%), Financial Activities (4.2%), and Leisure and Hospitality (4.1%) establishments are all growing at an elevated pace – showing that job growth has been widespread across both industries and across wage categories. The few select sectors not experiencing the same positive trends in job creation are Natural Resources and Mining (which is very small locally), and Professional, Scientific, Technology, and Management.

Overall, the local labor market appears poised for continued growth, with a lower proportion of the workforce unemployed, and more seeking better positions through career advancement. Ontario's workforce continues to become more educated and skilled, which will attract new businesses in numerous sectors. These trends will bode well for other parts of the economy, including consumer and business spending, real estate, and, ultimately, lead to a better quality of life.

Local Spending

Fueled by continued improvement in the local labor market and rising consumer confidence throughout the region, consumer and business spending within the City of Ontario continues to rise. From the third quarter of 2014 to the fourth quarter of 2014, Ontario experienced taxable sales growth by 1% to nearly $1.7 billion, far outpacing the Inland Empire (0.3%) and California (-0.3%). Over the last year, taxable sales throughout the City of Ontario grew by 6.7%, surpassing both the Inland Empire (4.2%) and California (4.7%). Indeed, it is readily apparent that the City of Ontario is well behind the effects of the recession, with taxable sales increasing by over 50% since bottoming out in the second quarter of 2009. The continued rise in automobile sales and the thriving hospitality industry in Ontario were the most significant components to spending growth and should continue to be a significant source of business activity throughout the remainder of 2015.



Source: California Board of Equalization

With the region well past any lingering effects of the recession, rising consumer confidence has led residents in not only Ontario but throughout San Bernardino County to make higher-level purchases. Throughout the region, the Autos and Transportation sector experienced a 12% year-over-year increase in sales tax receipts. This shows that consumers are feeling more optimistic about the economy and are willing to take on bigger and longer-term financial obligations, especially as the region is experiencing an improved employment landscape. Christopher Leggio, co-owner of Mark Christopher Auto Center in Ontario indicated that: "In past years, people were holding onto their cars longer, waiting through this tough economic time. But with the current environment, what just took place in November (2014), there's a lot of confidence in the market place right now."”[1]

Sales Tax Receipts by Category
City of Ontario, Select Quarters (SA)

	Q4-2014 ($ Thousands)	Q4-2013 ($ Thousands)	Q4-2013 to Q4-2014 (% Change)
Autos and Transportations	14,267	12,741	12.0
Restaurants and Hotels	7,741	7,043	9.9
Food and Drugs	3,674	3,455	6.3
Building and Construction	6,314	6,054	4.3
General Consumer Goods	17,227	17,003	1.3
Business and Industry	15,508	15,333	1.1
Fuel and Service Stations	10,541	10,745	-1.9
Total	**83,635**	**80,204**	**4.3**

Source: HdL Companies

Another significant component driving Ontario's strong spending growth is the Restaurants and Hotels sector due to business and visitor travel to the region. Over the past year, this sector exhibited nearly 10% in sales tax receipt growth, increasing tax receipts to over $7.7 million. Ontario's hotel market in particular has remained robust over the last year. According to PKF consulting, the occupancy rate throughout Ontario-area hotels increased by 4.4 % to 72.5% from February 2014 to February 2015. This increase in hotel room demand was met with a 5.9% increase in the average daily rate to over $96 over the same time period.[2] Recognizing strong travel and tourism growth in Ontario, the State of California recently awarded the Greater Ontario Convention & Visitors Bureau a contract to build, own, and operate a California Welcome Center to support the growing local industry in the area.[3] The expansion of Ontario's tourism sector will bring about increased economic activity, as visitor spending by hotel guests—among others—will provide added stimulus to the city.

The Building and Construction sector continues to be a key component in spending growth throughout Ontario. Over the past year, sales tax receipts in this sector grew by over 4% to $6.3 million. Much of this construction spending growth is concentrated in residential real estate. One major project currently underway is Vistara, a $67 million, 298-unit complex. This project represents one of the first post-recession construction projects in Ontario, and is just the first phase of a planned urban district called the Ontario Airport Metro Center, which will comprise offices, restaurants, shops, and housing.[4] This project, which will likely span several years, is a good sign for the city, as increased levels of construction activity will generate multiplier effects in the local economy through new employment and spending.

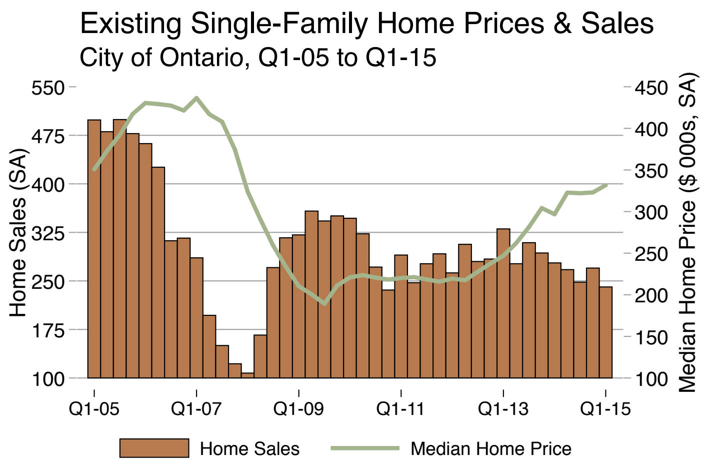
Overall, consumer and business spending continue to remain robust in Ontario. With employment continuing to grow and residential real estate flourishing, we should expect spending growth to further its gains throughout 2015.

[1]Neil Nisperos, "Car sales in Inland Empire, California are up 77 percent in 5 years", Inland Valley Daily Bulletin, November 29, 2014.
[2]Robert Mandelbaum and Gary McDade, "Trends in the Hotel Industry", PKF Consulting, USA, January 2015.
[3]http://www.prweb.com/releases/2015/05/prweb12696526.htm
[4]Neil Nisperos, "Luxury apartments going up in Ontario", Inland Valley Daily Bulletin, February 27, 2015.

Residential Real Estate

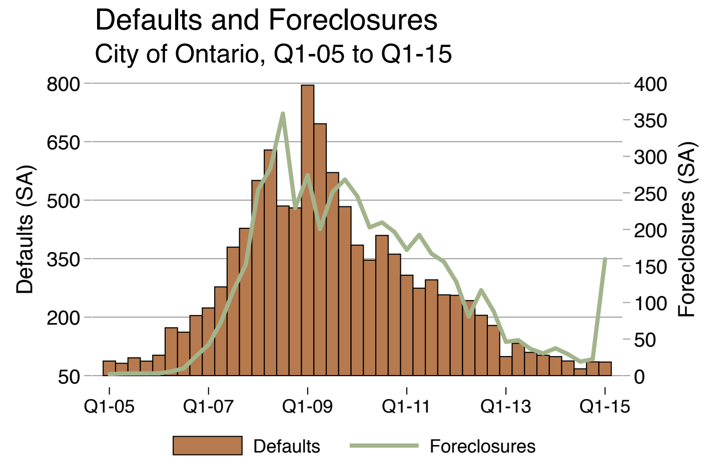
With employment throughout the entire Inland Empire continuing to improve significantly, and as more residents from the coastal cities migrating inland to take advantage of more affordable home prices, Ontario's residential real estate market continues to remain a bright spot in the local economy.

From the fourth quarter of 2014 to the first quarter of 2015, the median home price for existing single-family homes increased 2.7% to over $331,000. Over the past year, home prices are up by nearly 12%–surpassing neighboring Chino, Fontana, and the State overall. While the number of home sales did decrease by approximately 11% over the last quarter, and over 13% over the last year, the demand for single-family housing in Ontario should remain strong throughout the year: lackluster home sales are largely a function of low inventories rather than a lack of demand.



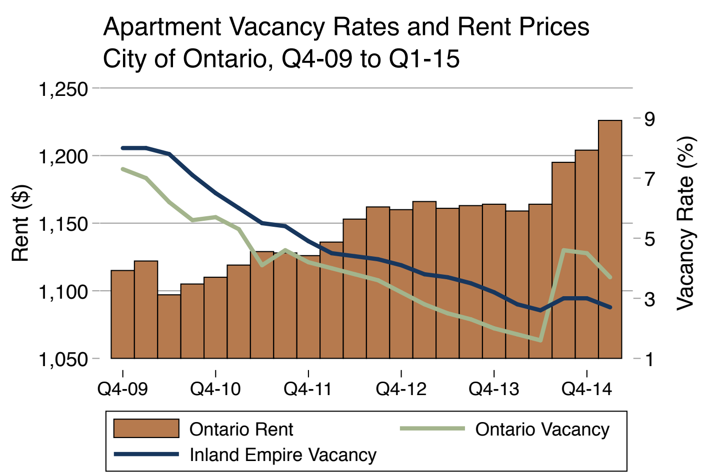
Source: DataQuick

While home price appreciation in Ontario did continue to improve, the number of foreclosures in the City increased substantially over the last quarter. According to DataQuick, foreclosures increased from 23 during the fourth quarter of 2014 to 159 in the first quarter of 2015. However, this staggering 607.2% increase in the number of foreclosure filings over the last quarter was due to a single condominium complex—which has 139 condo units (each unit has a different parcel number)—being foreclosed upon and each unit was counted as an individual foreclosure. Thus, this gives Beacon Economics no real cause for concern, since absent that one property, foreclosures would have fallen from 23 units at the end of 2014 to 20 units during the first quarter of this year. Builders in the area seem to agree. Residential construction permit data reported by CIRB indicates that the year-to-date (to March) value of residential permits is 150% higher in 2015 over 2014.



Source: DataQuick

As is the case in the single-family home market, Ontario's apartment market remains robust. After experiencing a spike in vacancy rates in the third quarter of 2014 (due to new stock coming online), apartment vacancy rates are trending downward again to 3.7% by the first quarter of 2015. The increased demand for apartment rentals over the last year was met by a 5.8% increase in apartment rental rates in Ontario, which are now $1,226/month on average compared to $1,159 a year ago. As noted, construction on a 298-unit luxury apartment complex is currently underway and should provide some relief to what appears to be a tight apartment market in Ontario.

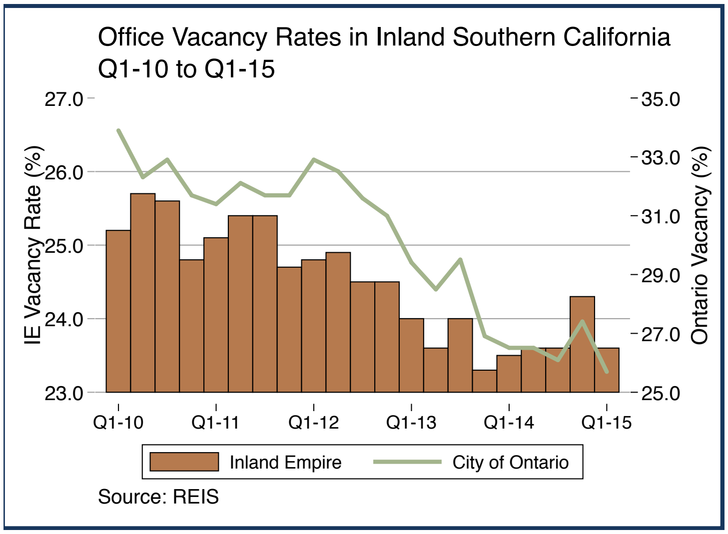


Source: REIS

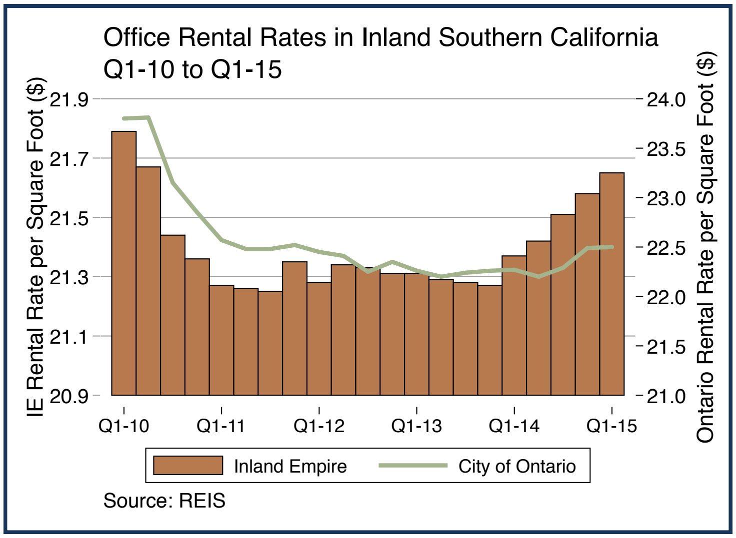
Clearly, the City of Ontario is making strides to accommodate the increased demand for housing (both at the single-family and multi-family level) through a series of construction projects (both under construction and planned), which should bolster economic growth, attract future residents to the City, and alleviate some of the strain of low inventory levels and overall housing supply.

Commercial Real Estate

Ontario's commercial real estate market showed varied results. Consistent with the flat year-over-year employment growth in the Professional Services sector, the market for office space in Ontario experienced tepid growth, and maintained relatively high levels of vacancy. Office vacancies did fall from the fourth quarter of 2014 to the first quarter of 2015 to 25.7%, rental rates remained flat at $22.50 per square foot. Today, rents are 5.5% less (on average) than they were five years ago. Over the last year, rental rates have increased by 1%, but still trail the entire Inland Empire. In addition, CIRB construction data has not reported any office construction activity since July 2013.



On the opposite end of the spectrum, the market for industrial space in Ontario provides a sense of optimism. From the first quarter of 2014 to the first quarter of 2015, both industrial vacancy rates and rental rates edged up by 1.8% and 2.0%, respectively. Rental rates now currently stand at $4.63, while vacancy rates are at 11.2%.

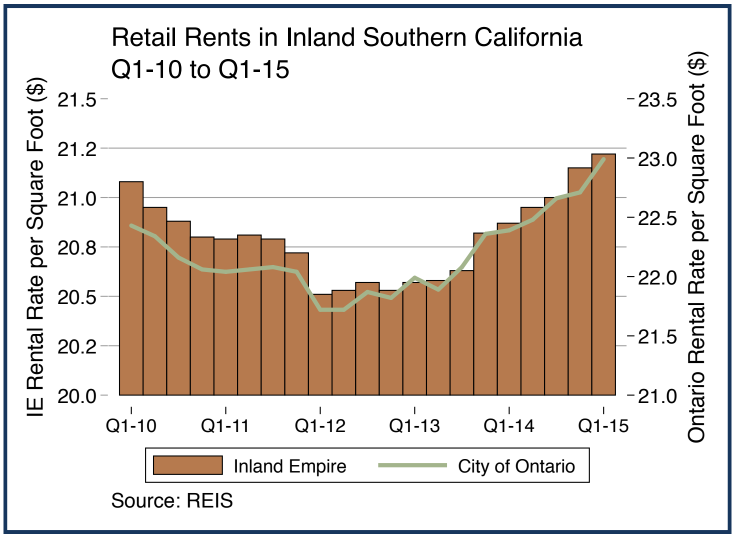


There are two key components driving the positive rental metrics for industrial space. The first is the continued growth in port activity in Los Angeles and Long Beach barring the shutdown due to labor strikes in February. Increased levels of imports, which is attributable to a stronger dollar, have made the trucking and transportation industry a vital component to the logistics industry. The increased demand for imported goods has made logistics hubs in Ontario and elsewhere in the Inland Empire important parts of the domestic supply chain. Goods come in through the region's ports and airports and flow through logistics facilities in Ontario and throughout the Inland Empire before being transported to consumers or to retailers and wholesalers across the nation. The second component driving this growth is more local in nature. In Ontario and throughout the region, distribution centers that serve as fulfillment centers that help to move goods associated with e-commerce deliveries, have seen tremendous growth as consumers become more comfortable doing more of their shopping online.

In response, and wisely so, the City of Ontario is planning a large-scale development comprising 3 million square feet of industrial space located north of the 10 Freeway, near Vineyard Avenue. If approved and completed, the project is expected to generate over 5,000 jobs and about $85 million in revenue to the City of Ontario over 20 years.5 The continued strength of the local logistics industry has enabled Ontario to seek out further opportunities and position itself as a key player in this ever-expanding industry.

[5]Neil Nisperos, "Potential industrial project aims to bring 5,000 jobs to Ontario", Inland Valley Daily Bulletin, March 5, 2015.

Improved employment growth in the Retail Trade industry, coupled by increased consumer and business spending, has contributed towards the sustained improvement in the market for retail space throughout Ontario. Over the last quarter, rental rates increased by 1.2% to $23 per square foot, while vacancy rates remained below 10%. Over the last year, rents have increased by 3%, while vacancy rates decreased by 1%. Continued spending and employment growth in retail should allow employers more flexibility to either renovate/expand their existing space or seek out larger retail space.



Challenges and Opportunities

One of the main topics at the 2015 State of the City was to encourage resident pride throughout the City of Ontario. Pride among residents, which can also be viewed as a quality of life indicator, is also beneficial to the local economy, as residents who take pride in their city are more likely to invest locally, buy locally, and support local organizations.

City officials and stakeholders have used beautification to accomplish this goal through numerous efforts. For example, the city council and Greater Ontario Convention and Visitors Bureau recently launched a strategic planning initiative to bring new arts and culture programs to the Downtown District.[6] The city is attracting new businesses with similar intentions, such as the business that will reside in the old Sunkist factory that will retain the iconic water tower.[7] Homeowners too are encouraged to beautify the city through a city ordinance called CARES that provides grants to homeowners who make exterior home improvements.[8] The CARES grant is available to low-income households living in a Focus Area, thus helping revitalize neighborhoods in less-affluent neighborhoods.

Beautification efforts can bring numerous benefits to the local economy, such as bringing in more tourism from outside of the city, which in turn leads to higher job growth. Yet, like past efforts, future beautification efforts will come with their challenges. For example, the recent state water-restriction mandates may affect the Euclid Median, a 5.3-mile by 60 feet grassy median on one of the city's primary roads.[9] The cuts are expected to affect the median because it uses drinking water for its irrigation. Still, the City of Ontario appears well poised to continue to beautify its streets, parks, residential neighborhoods, and commercial districts for the years to come.

[6]See www.ontarioarts.org for more information.
[7]David Allen, "Sunkist Tower All That's Left of Ontario Factory," Inland Valley Daily Bulletin, June 27, 2014.
[8]CARES stands for Code Enforcement, Arterial Street Improvement, RE-Leaf Program, Sidewalk Program – Safe Route to School.
[9]David Allen, "Drought Could Mow Down Ontario's Euclid Avenue Turf," Inland Valley Daily Bulletin, May 5, 2015.

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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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