

# REGIONAL INTELLIGENCE REPORT™



BEACON ECONOMICS Prepared by Beacon Economics, LLC



City of Ontario

Twelfth Edition

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## U.S. Economic Outlook

The U.S. financial markets began to swoon over the summer of 2015. They have since recovered much of their lost ground, but the damage is done. The dip has reaffirmed, to many, the ongoing fragility of the current economic expansion. Beacon Economics disagrees. While all eyes have been focused on global equity markets, a slew of new economic data has been coming out that point to a healthier U.S. economy:

- The U.S. Bureau of Economic Analysis recently revised 2nd quarter growth to 3.7%—substantially higher than their initial reading.
- Other data points to acceleration in the pace of construction, industrial production, and business investment.
- Consumer spending is up and job growth is on track to add 2.6 million jobs this year.
- Interest rates remain low and bank delinquency rates continue to fall.

Add it all up and the nation's economy could end up growing by 3% this year—the best showing since the start of the recovery. Not only does the U.S. economy not look fragile, it looks increasingly able to weather whatever storm is unleashed in Asia by a slowing Chinese economy.

Here are the big things that Beacon Economics is currently tracking:

- **Low commodity prices:** The collapse in oil prices last year caused a sharp pullback in oil exploration in the first half of 2015. The good news for the second half of the year is that spending on new wells has hit bottom and will no longer act as a drag on the economy.
- **A rebounding housing market:** The 2014 slow down in the U.S. housing market recovery is now officially history. Existing home sales in July hit their second highest level since the markets began their collapse in 2006. Home price appreciation is also starting to accelerate fairly uniformly across all major markets in the nation. And the market still has plenty of headroom due to low interest rates—affordability today is considerably better than it was in 2001 and 2002.

- **Europe:** The political drama that played out recently in Greece over the latest bailout has grabbed most headlines regarding the EU lately. That has unfortunately overshadowed the positive economic news coming from the old world. Industrial production is on the rise, and GDP and employment growth figures for the 2nd quarter looked promising for many countries including Spain, France, and Italy. Bank balance sheets are being repaired and credit seems to be flowing again, and worries about deflation are waning. The EU looks to be firmly in recovery mode.

Despite these relatively positive (or at least not so negative) trends, there are still some causes for concern regarding the nation's economic climate.

- **Rising inequality:** The recovery of the U.S. economy over the past few years has not lifted all boats equally. Big moves in the financial markets have primarily benefitted the wealthiest households in the nation. Average wages have been rising, but median wages have not—suggesting that income gains are happening mainly among skilled workers. The long-term trend of rising inequality is unfortunately at play again after a brief respite in the midst of the 'Great Recession'.
- **Mortgage Credit:** While there are some positive numbers coming out of the housing market, the pace of new home construction remains very depressed relative to long run trends. Holding back the potential of the market are new rules that have severely limited the ability of many borrowers to get credit – excepting those with relatively high credit scores.
- **The Markets:** Beacon Economics has written repeatedly in recent months that the markets have not gone into 'bubble' mode. Valuations appear to make sense given high corporate profits and low interest rates. So what of the recent swoon in prices? Not much there actually. And the rapid recovery in prices that has already occurred (as of this writing) back this up. But there is still cause for concern as the markets turned volatile for almost no reason and these episodes of volatility may become increasingly frequent.

## California Economy

Over the past year, the Golden State has been one of the brightest spots in the national economy. June 2015 marked the 40th consecutive month that California has outpaced the U.S. overall in terms of nonfarm job growth. Real state GDP increased by 2.8% over the last year compared with 2.4% growth in the nation overall. With a 3.1% expansion through the mid-point of 2015, California's labor market is growing half-again as fast as the nation's as a whole.

Over the past 12 months California has been the 5th fastest growing state in the nation and the single largest source of new U.S. jobs, with more than 461,000 positions created as of June 2015.

San Francisco and San Jose continue to lead the pack in terms of employment gains. Both have averaged growth in excess of 4% so far this year. However, growth has not been limited to tech-heavy areas of the state. The Inland Empire has climbed to the #3 spot for growth, expanding its employment base by 3.6% over the last 12 months. The state's Farm sector, which has been plagued by drought in recent years, is holding steady with no job losses as of July 2015 relative to the previous year.

Home sales are finally coming around as well. Through the first half of 2015, sales of existing single-family homes have climbed 9.8% more than at the same point in 2014. To date, nearly 170,000 homes have been sold in California.

Over the past five years California's economy has made great strides in recovering from the recession. The growth and improvement, however, has not been evenly distributed across all segments of the economy. While California has created a significant number of both high-wage and lower wage positions, middle-income industries either remain well below their pre-recession levels or have yet to exhibit any significant growth since the downturn ended.

Over the past three years wage growth has been robust in high-wage sectors, but has been below average in lower wage industries including Construction, Logistics, Tourism, and Retail. This suggests that income inequality in the state will continue to worsen, which may lead to further political polarization in Sacramento and hinder the state's ability to address long-term challenges.

Ongoing troubles abroad could also impact exports. Recent turmoil in Europe/Greece and the downgraded outlook for Chinese economic growth have reignited speculation about the likelihood of another recession in the near term. While Beacon Economics remains firmly in the "no recession on the horizon" camp, economic woes abroad could impact exports at California's air and seaports.

Through July 2015, loaded containers for export at the Ports of Los Angeles and Long Beach were down 12% over the same time last year. However, import traffic has held relatively steady, which will help to provide alternative demand for the state's Logistics industry. Many of the goods shipped through California ports are produced out of state and brought in by truck or rail to access overseas markets. It isn't clear whether slowing exports has broader implications for the state's Agriculture or Manufacturing sectors.

Home prices also continue to outstrip income growth, which is concerning from a long-term standpoint. The state's habitual under-building of new residential units has exacerbated the affordability problem over the past 30 years. Home building has simply not kept pace with population growth. Now that home prices are rising again, homes are affordable for a smaller and smaller share of Californians. But given the limited supply, this group still represents a large enough pool of buyers to maintain significant upward pressure on the state's housing market.

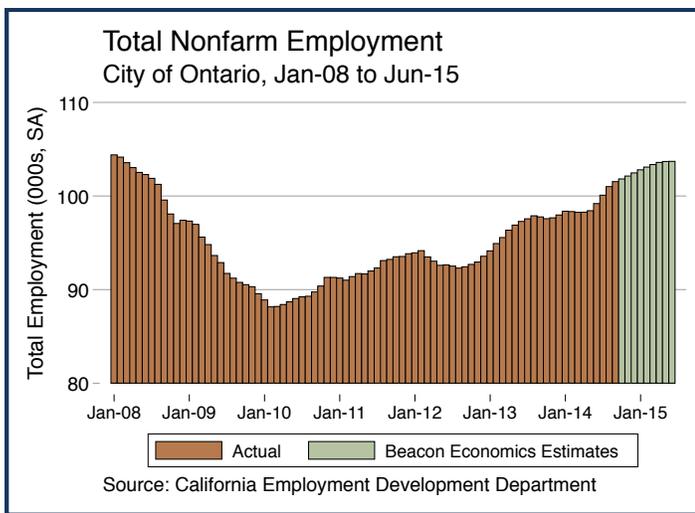
The good news is that home prices, although growing, have yet to reach a level that Beacon Economics would characterize as a bubble. In fact, when taking historically low interest rates into account, financing the monthly payment for a median-priced home in the state requires just 26% of the state's median income. At Beacon Economics, the running joke is that California is back down to historic levels of unaffordability.

In sum however, the good more than offsets the bad and California is expected to continue growing at a healthy pace into 2016 and beyond.

## Employment

Ontario's labor market continues to grow robustly. Total nonfarm employment grew by 4.4% to nearly 103,150 jobs from June 2014 to June 2015, according to the California Employment Development Department. Inland Southern California's employment, meanwhile, grew by 3.6% over the year. While the City has not fully recovered all its jobs lost due to the recession, Ontario has made significant progress by increasing its employment base by 17.2% since labor markets bottomed out in February 2010. Ontario is poised for future employment growth, as the City remains active in recruiting large-scale logistics operations to the City.

The Construction sector also experienced sizeable gains in payrolls that reflect the improvement in Inland Southern California's residential real estate market. Construction payrolls increased by roughly 300 jobs between June 2014 and June 2015, an increase of 7.9%. Construction sector hiring is also being supported by demand for larger logistics and warehouse facilities. One such facility, Majestic Chino Gateway, comprises 1.4 million square feet of logistics space.<sup>1</sup> Further demand for these types of warehouses will continue to induce more construction activity and employment growth in this sector.



As Ontario's labor markets continue to expand, so too have the wages of those employed in the City. Average wages, as measured during the period between October 2013 and September 2014, increased by 1.4% to \$43,100 compared to the previous twelve-month period. In comparison, the average wages throughout San Bernardino County grew by 0.3% during this time period. Since 2009, average wages have increased by nearly 10% in the City of Ontario compared to only 5% in San Bernardino County.

### Employment by Sector in the City of Ontario

Sector	Jun-15	Annual Chg.	Annual Chg. (%)
Prof., Sci., Tech., and Mgmt.	5,850	500	9.3
Construction	4,050	300	7.9
Transport/Warehouse	13,950	950	7.3
Wholesale Trade	10,725	650	6.4
Financial Activities	3,575	175	5.0
Education/Health	7,625	325	4.5
Admin Support	13,875	550	4.1
Leisure and Hospitality	7,125	225	3.3
Retail Trade	13,900	325	2.4
Other Services	2,350	50	2.3
Manufacturing	12,200	250	2.0
Information	1,825	25	1.7
Government	5,450	50	1.0
NR/Mining	700	0	0.7
<b>Total All Industries</b>	<b>103,150</b>	<b>4,375</b>	<b>4.4</b>

Source: California Employment Development Department

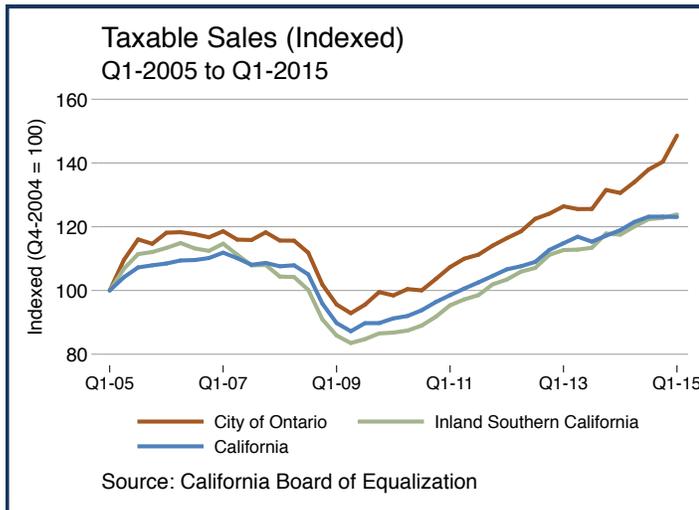
The City of Ontario experienced positive employment growth in nearly all sectors over the last year, with much of the employment growth originating from Professional Services and Construction. Ontario is no longer hindered by the lingering effects of the recession and is now in the midst of a labor market expansion.

Professional Services was the fastest growing sector in the City over the last year. Employment in this sector increased by 9.3% to 5,850 jobs from June 2014 to June 2015, similar to the rate of expansion in the sector throughout Inland Southern California. Job growth in this predominantly high-wage sector is an indicator of increased demand for services that accommodate the increased commercial and business activity throughout the region. Meanwhile, the Administrative Support sector expanded payrolls by 4.1%. Wages paid to employees in this sector are typically on the lower end of the spectrum, yet the jobs added also reflect a growing economy and increased business activity throughout the City.

<sup>1</sup>Debra Gruszecki, "Logistics: Amazon, FedEx arrival spur logistics-ready construction", The Press Enterprise, June 15, 2015.

## Business and Local Spending

Local businesses continue to thrive as economic growth approaches full force. Boosted by increased business and tourism activity, local spending continued to expand in the City of Ontario during the first quarter of 2015, growing by nearly 14% year-over-year. Local spending growth in the City outpaced growth in Inland Southern California (5.4%) and the State overall (3.5%) during this time period, a sign that things are really starting to pick up in Ontario.



The Autos and Transportations sector remains the fastest growing category of spending throughout the region— sales tax receipts in San Bernardino County grew by 12.6% over the last year. Much of this growth occurred in the City of Ontario, as it is home to a significant share of the automobile market in San Bernardino County. Spending in this sector also provides a good gauge for the overall health of an economy. Businesses and consumers are making these expenditures not out of necessity, but out of increased optimism for the economy.

Business and Industry spending also made significant strides over the past year. Sales tax receipts grew by 10.4% throughout San Bernardino County from the first quarter of 2014 to the first quarter of 2015. Fulfillment centers, heavy industrial, and food service equipment/supplies are the cause of such robust spending growth throughout the City and County. As a testament to such growth, QVC, a major online and television shopping company, is planning on housing its West Coast distribution center in the City of Ontario and is expected to create 1,000 new jobs in the region by 2020.<sup>2</sup>

### Sales Tax Receipts by Category

#### San Bernardino County, Seasonally Adjusted

	Q1-2015 (\$Thousands)	Annual Chg. %
Autos and Transportation	14,401	12.6
Business and Industry	16,182	10.4
Restaurants and Hotels	7,713	10
Building and Construction	6,715	5.8
General Consumer Goods	17,144	2.8
Food and Drugs	3,563	1.1
Fuel and Service Stations	9,007	-16.4
<b>Total</b>	<b>84,425</b>	<b>5.7</b>

Source: HdL Companies

Spending at Restaurants and Hotels throughout the County continued to grow at a rapid rate (10% over the last year). Airport traffic and hotel activity in Ontario have both experienced an uptick over the last year. In particular, the amount of airport traffic at Ontario International Airport (ONT) through May 2015 is up 2.2% compared to this time the previous year.<sup>3</sup> Meanwhile, the occupancy rate of hotels in Ontario increased 4.7% over the past year, even as the average daily rate grew 5.1% during this time period.<sup>4</sup>

Earlier in 2015, the city of Los Angeles tentatively agreed to hand over operations of ONT to the City of Ontario. The Ontario International Airport Strategic Business Plan from 2013 outlines the new goals of the Ontario International Airport Authority, including two key components:

- reducing airline costs to help lower prices and attract more passengers and
- economic development of airport related businesses, including air cargo.

<sup>2</sup>Grace Wong, "QVC to build first West Coast distribution center in Ontario", Daily Bulletin, July 14, 2015.

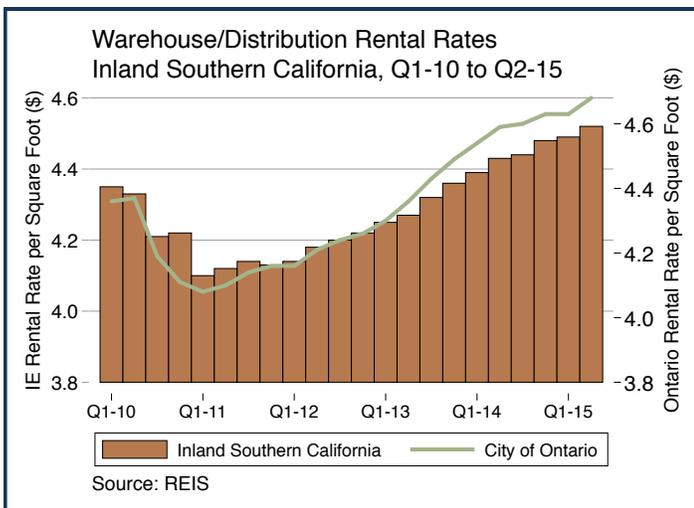
<sup>3</sup>Source: Los Angeles World Airports

<sup>4</sup>Robert Mandelbaum and Gary McDade, "Trends in the Hotel Industry: Inland Southern California", PKF Consulting, April 2015.

## Commercial Real Estate

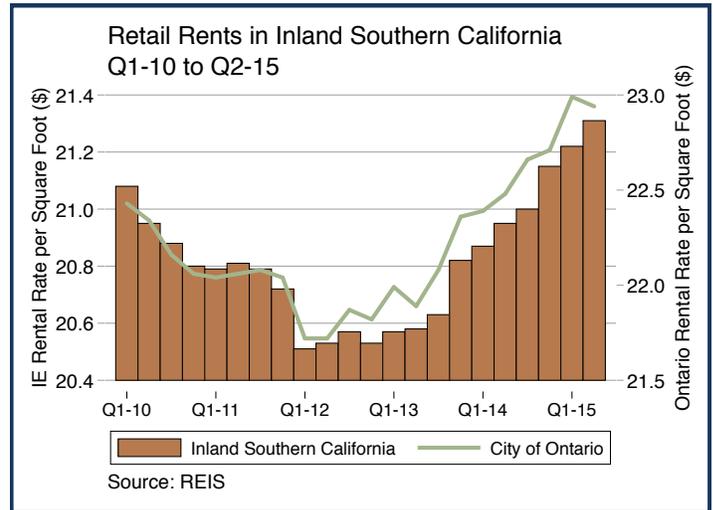
The City of Ontario's commercial real estate market continues to improve, as are commercial markets across Inland Southern California. Although the improvements in this market have been relatively broad-based, the gains seen in the retail and warehouse/distribution markets have really stood out over the past year.

Ontario's growing reputation as a world-class logistics hub has garnered much attention from big-name companies to establish distribution centers in Ontario. Rental rates have remained on par with Inland Southern California, increasing by 2% from the second quarter of 2014 to the second quarter of 2015. The pending arrival of QVC is a testament to such growth for Ontario's logistics sector. We expect even more demand for warehouse/distribution space throughout the region as trade activity in the Ports of Los Angeles and Long Beach starts to pick up once again.



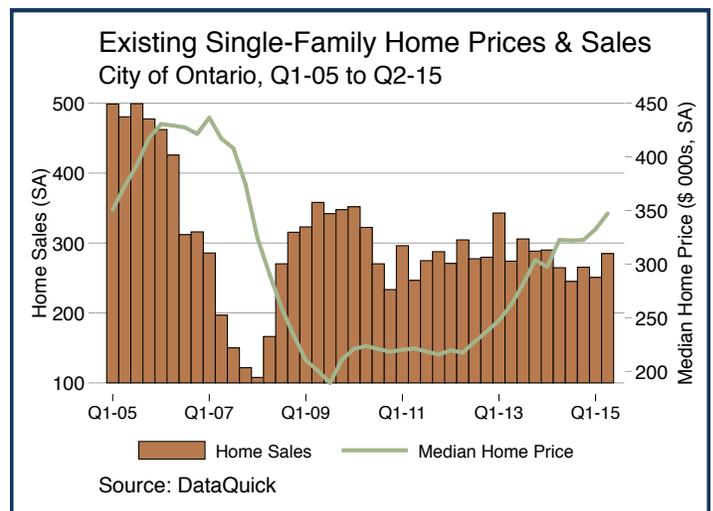
Strong demand continues to drive trends in the retail market. Throughout the region, retail outlet malls have been thriving more than any other type of retail property – Ontario Mills exemplifies this trend. Strong tourism growth in the region continues to bring additional customers to these retail centers and, here too, we expect that local control of the Ontario International Airport will help court inbound travelers to the City's retail shopping centers.

Vacancy rates are trending down even as the rental rates for retail space grew by 2.0% over the last year, surpassing the 1.7% year-over-year growth rate for all of Inland Southern California. The increased demand for retail space has resulted in an increased number of retail construction projects. Permit values for retail construction reached \$2.9 million through May 2015, compared to only \$1 million at this time last year.



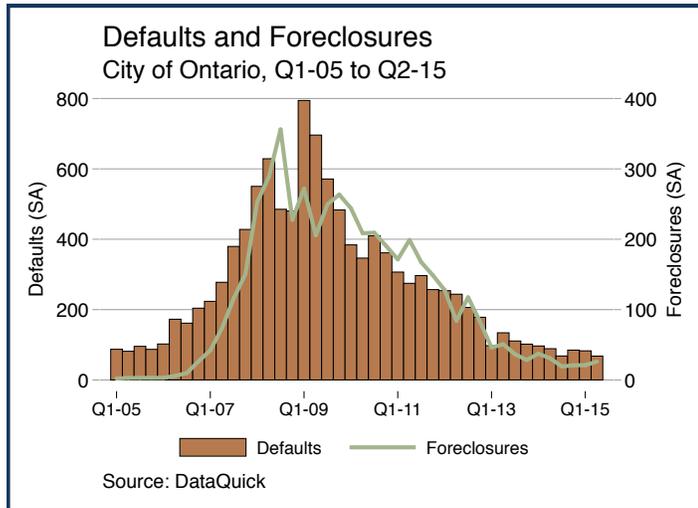
## Residential Real Estate

The City of Ontario's residential real estate market continues its upward trend. From the second quarter of 2014 to the second quarter of 2015, home prices grew almost 8%, well surpassing the 5.2% year-over-year growth rate statewide. The relative affordability, coupled with the ongoing labor market expansion is fueling demand for single-family homes in Ontario.



The number of existing single-family home sales in Ontario has increased nearly 8% over the last year. Despite the rising prices, Inland Southern California remains an attractive place to purchase a home. Also driving this trend are historically low mortgage rates, which make owning a home a very attractive proposition.

Even as conditions in the residential real estate market continue to improve, the combination of pent-up demand and the lack of supply of housing has been a growing concern in Ontario. Fortunately, developers have started to respond to market signals, with over three times as much construction activity through May 2015 compared to this time last year.



Construction of multifamily units has also been growing in the City. Through May 2015, construction permits for multifamily units were valued at a total of \$16.4 million. Construction activity has been even stronger when you include the luxury Vistara apartment complex that are already on the market. Indeed, these units have resulted in a moderate uptick in the vacancy rate and significant increase in apartment rent asking rents.

## Spotlight on Ontario’s Logistics Sector

The City of Ontario has long held its reputation as a world-class logistics hub. Over the years, the City has aggressively pursued many avenues to become a leader in transportation and logistics in the West Coast. Total logistics employment<sup>5</sup> stood at over 23,200 jobs as of the third quarter of 2014. Establishment growth has also been positive, with the total number of establishments increasing by 5% to over 2,300 from the third quarter of 2008 to the third quarter of 2014. Growing trade activity will facilitate further growth in Ontario’s logistics sector, especially among e-commerce companies, who are currently seeking out larger warehouse facilities to accommodate the growth in electronic transactions.

The largest Wholesale Trade sub-sector is Durable Goods, which comprises over 43% of total logistics employment in the City. This sub-sector, which ranges from motor vehicle parts to home furnishings, supplies a wide range of businesses and is an important component of Ontario’s thriving logistics sector.

### Top 5 Logistics Sub Sectors by Employment City of Ontario (As of Q3-2014)

Sub Sector	# of Employees	Share of Emp. Total
Merchant Wholesalers, Durable Goods	6,295	27.1%
Couriers and Messengers	5,541	23.8%
Warehousing and Storage	3,606	15.5%
Merchant Wholesalers, Non-Durable Goods	3,221	13.8%
Truck Transportation	1,955	8.4%
<b>Total All Sub Sectors</b>	<b>23,257</b>	<b>100.0%</b>

Source: California Employment Development Department

The increased demand for e-commerce transactions has helped the City recover many of the jobs lost during the recession and has also been beneficial to Ontario’s logistics sector. Growth in the Electronic Markets sub-sector, while negative over the past five years, has grown substantially over the last 12 months. Over the last year, employment in this sub-sector grew 20%, which is attributable to the returning presence of e-commerce businesses to Ontario and throughout Inland Southern California.

### Top 5 Logistics Sub Sectors by Establishment City of Ontario (As of Q3-2014)

Sub Sector	# of Establishments	Share of Est. Total
Merchant Wholesalers, Durable Goods	1,051	45.1%
Merchant Wholesalers, Non-Durable Goods	465	19.9%
Truck Transportation	294	12.6%
Warehousing and Storage	161	6.9%
Wholesale Electronic Markets and Agents and Brokers	150	6.4%
<b>Total All Sub Sectors</b>	<b>2,332</b>	<b>100.0%</b>

Source: California Employment Development Department

The Warehousing and Storage sub-sector comprises nearly 20% of Ontario logistics employment. While total employment is down over the last five years, total employment increased nearly 12% from the third quarter of 2013 to the third quarter of 2014, indicating a strong resurgence in this sector since the recession. The number of establishments in this sector has also made steady progress, up 1.3% over the last 12 months, yet still not quite back to pre-recession levels.

The Truck Transportation sub-sector has also seen a sizeable bump in employment over the last five years, increased 17.3%. While this is certainly not beneficial for commuters—who will face increased traffic congestion—the added number of trucking employees and firms is certainly a good sign for the City and the local economy. Nonetheless, it is clear that increased consumer demand is driving employment in this sector, a trend we fully expect to persist over the near-term.

Ontario’s logistics sector has become a key component of the region’s economic landscape. As consumer spending throughout the country ramps up, especially as the holiday season nears, expect Ontario’s logistics sector to further expand its influence in the region as a top logistics hub.

<sup>5</sup>The Logistics sector is defined as: Wholesale Trade, Transportation, and Warehousing and Storage.



## 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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