# REGIONAL INTELLIGENCE REPORT

BEACON ECONOMICS

Prepared by Beacon Economics, LLC

CITY OF RIVERSIDE

City of Arts & Innovation

GREATER RIVERSIDE CHAMBERS OF COMMERCE

# City of Riverside

Sixteenth Edition

March 2017

## United States Outlook

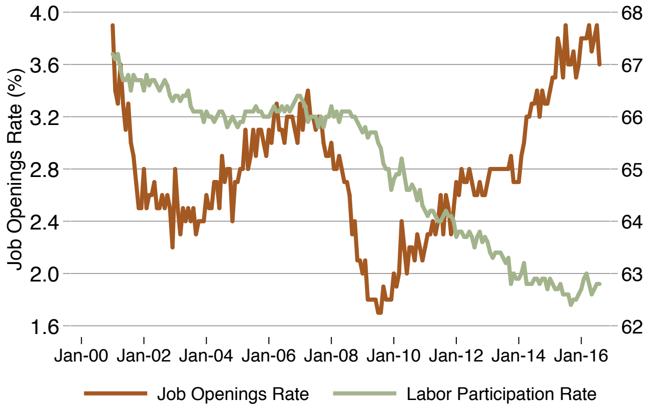
The election that puts Donald Trump in the White House in 2017 was a shock to the vast majority of pollsters who predicted a victory for Hillary Clinton. Our economic outlook over the last year implicitly (and incorrectly) assumed a Clinton win, a split Congress, and continued political gridlock in Washington DC. Instead, Republicans now control the Oval Office, the Senate, and the House. However, contending factions in the Republican Party may pose an impediment to President-elect Trump's stated economic policy priorities.

Donald Trump's victory stems from the frustration of many who see an economy in decline, driven by bad regulations, bad trade deals, and bad tax policies. Rhetoric aside, the U.S. economy is in the 7th year of economic expansion, albeit at a below average pace. Given current economic fundamentals, the economy should remain on track. Labor markets are at full employment, wages are starting to rise, and asset prices are at or near record high levels. Significantly, GDP growth in the 3rd quarter came in at a steady 3.2% after a weak first half of the year.

Consumer spending remains one of the bright spots and sources of momentum in the U.S. economy, responding to both job growth and ongoing wage gains. Meanwhile, the recent drag in business investment stems largely from the continued commodity glut and the resulting sharp declines in oil and natural gas exploration, which have shaved almost a full percentage point off overall GDP growth in the last two years. Even so, the oil and gas glut is still with us, as are low energy prices. Meanwhile, both new and existing home markets continue to be disappointing. This can be traced in part to a sharp reduction in credit accessibility in the wake of Dodd-Frank, which has served to hold back the pace of new building, homeownership, and house sales—a problem that explains the overall softness of the market.

There has been a modest slowing in job growth, but this is mainly because the tight labor market is making it more difficult for employers to find the right employee. Meanwhile, the labor force participation rate has edged up, despite the aging of the nation's workforce, which suggests it should continue to fall. People are being drawn back into the labor market in a significant way for the first time in a decade.

Job Openings and Labor Force Particpation




Source: U.S. Bureau of Labor Statistics

Despite these positive trends, throughout his campaign, President elect Donald Trump has talked about enacting changes in economic policy which could potentially disrupt the current trajectory of the slow, steady growth previously described. Recessions are caused by real shocks to the economy that have three characteristics—they have to be large, rapid, and sustained. Examples of possible changes in policy that meet these characteristics include:

•Slashing taxes, which may stimulate the economy in the short run but will also increase the Federal budget deficit and may lead to sharply rising interest rates and a weaker dollar.

•Efforts to back out of NAFTA or the WTO, and change trade relations with China, which could result in sharply falling imports AND exports, disruptions of supply chains, and a rise in consumer prices.

•Significant changes in immigration policy that would lead to the deportation of undocumented residents would disrupt the supply of labor to key industries such as agriculture and construction, and would also cause massive disruptions in supply chains and consumer spending.

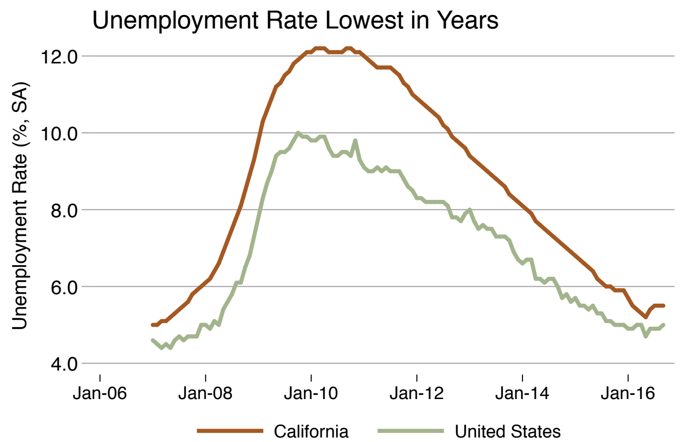
Any of these three policies, if pursued vigorously, has the potential to cause a recession and to do long term damage to the economy. Whether any of these comes to pass depends largely on how well the new Trump administration works with Congress.

## The California Outlook

California has stayed on course with a solid economic performance through the first three quarters of 2016, outpacing the nation in terms of economic growth and job creation, albeit at a slower rate than last year. Virtually every industry in the state continues to add jobs and the unemployment rate is lower than one year ago.

Through September of this year, nonfarm jobs in California grew at 2.6%, compared to 1.8% nationally. The state unemployment rate moved sideways in the mid-5% range in recent months as job growth and wage gains have drawn more people into the labor force. Health Care and Social Assistance has led the way with the largest absolute job gains in the state, followed by Leisure and Hospitality, Professional, Scientific, and Technical Services, and Construction. Only Manufacturing and Mining & Logging have lost jobs. Government also saw large gains, while California's farm employment is on track to hit its highest level in over a dozen years.

Regional economies across the state continue to grow. Many areas have hit new records for employment, and unemployment rates have declined to their lowest in several years. Smaller regions may lead the state in terms of percentage job gains, but Los Angeles County routinely adds by far the largest absolute number of jobs.



Source: California Employment Development Department

Statewide spending activity continues to rise, with taxable sales increasing by over 2% through the first half of 2016, and the busy holiday season is still ahead. Taxable receipts by consumers as well as businesses experienced modest increases through the first half of this year.

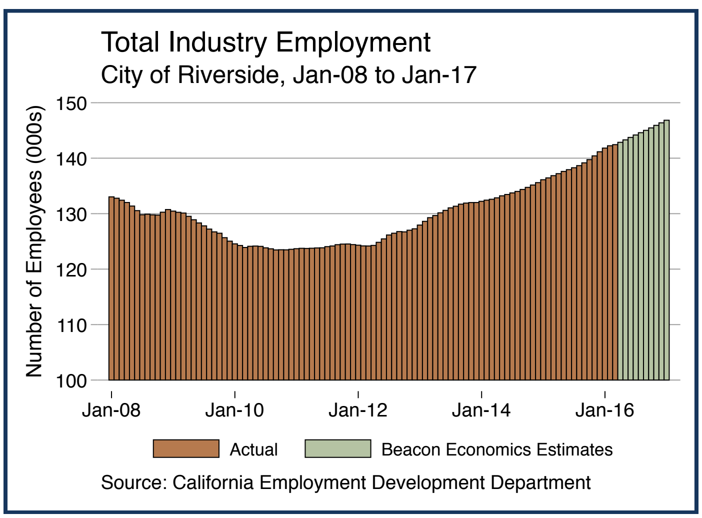
Meanwhile, the housing market has been mixed, with prices advancing modestly despite many hurdles that have limited sales activity. New home construction has struggled since the recession, with permit levels that remain well below the long-run average. On the rental side of the market, high demand for apartments has driven vacancy rates down and rents up.

All in all, California's economy is poised for continued growth over the next several quarters, outpacing most other states in the nation. Still, California continues to face nagging policy problems including a chronic housing shortage. Rising home prices and rents mean that the state is not producing enough housing.

This is not exclusively a low-income problem, but one that extends to middle-income households as well. In many parts of the state, rent as a share of income exceeds the 30% threshold that is considered to be the norm. This has ramifications for employers who find it increasingly difficult to hire and retain qualified employees. Solutions will be hard to come by, but must include reducing the permitting and regulatory burdens associated with construction costs, and possibly, tax reform.

## City of Riverside

The City of Riverside's economy gained ground in January 2017, outpacing both the Inland Empire and the State of California in nonfarm employment growth. For the City, Beacon Economics' estimates also reflect a healthy pace of wage growth, with a 4.2% increase in annual wages paid over the last year. As of January 2017, the average annual wage for nonfarm workers was estimated at $47,374. Given this growth, consumer spending has been trending upward as well, and finished out 2016 3.2% ahead of 2015 levels. Broader population gains and healthy wage growth have served as primary drivers of growth, supporting outsized gains in sectors that serve the local population, such as retail store and food and beverage-establishments.




As rising incomes and job counts expanded disposable incomes, consumers spent more on big-ticket items and leisure and entertainment activities. Overall expenditures in the Restaurants and Hotels category saw a year-to-year increase of 8.8% in the third quarter of 2016. This was nearly twice the 4.5% increase in overall taxable sales for the quarter. Autos and Transportation also outdistanced gains in other spending categories, and posted a 5.3% year-to-year growth rate. The taxable sales analysis also reflects optimism in the business sector. Taxable receipts in the Business and Industry category grew by 8.4%, as employers expanded business related expenditures.

**Sales Tax Receipts by Category in Riverside County**

| Category | Q1-2016 ($M, SA) | YOY Chg. (%) | 3 Yr Chg. (%) |
|---|---|---|---|
| Restaurants and Hotels | 10.3 | 8.8 | 30.8 |
| Business and Industry | 10.0 | 8.4 | 2.0 |
| Building and Construction | 9.5 | 7.6 | 31.5 |
| Autos and Transportation | 15.4 | 5.2 | 29.1 |
| General Consumer Goods | 19.9 | 1.1 | 11.0 |
| Food and Drugs | 4.6 | -0.1 | 12.3 |
| Fuel and Service Stations | 6.9 | -17.5 | -24.9 |
| Total | 87.1 | 4.3 | 15.1 |

Source: HdL Companies

Based on employment and wage data posted by the California Employment Development Department, the City of Riverside posted a stronger-than-expected performance through the first quarter of 2016. Therefore, Beacon Economics has revised its nonfarm employment estimates upward to 146,800 for January 2017. Annual job creation of 5,020 new positions reflects a 3.5% increase from January 2016 and a faster rate of growth than the Inland Empire (+3.2% year to year) as a whole. This marks a shift from historical norms, as the City of Riverside has lagged behind the broader metro area for much of the current expansion.

**Employment by Industry in the City of Riverside**

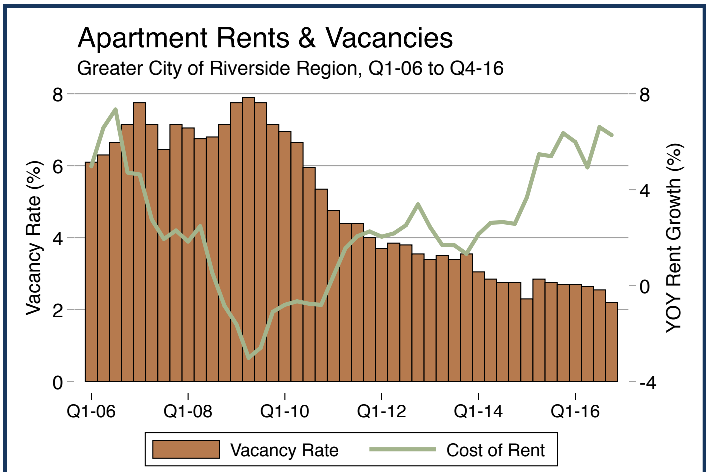
| Industry | Jan-17 | 1-Yr. Chg. | 1-Yr. (%) |
|---|---|---|---|
| NR/Construction | 13,134.4 | 1,331.9 | 11.3 |
| Leisure & Hospitality | 12,856.7 | 652.5 | 5.3 |
| Admin Support | 12,015.8 | 513.8 | 4.5 |
| Prof, Sci, Tech, & Mgmt | 6,164.1 | 191.5 | 3.2 |
| Retail Trade | 15,803.2 | 447.4 | 2.9 |
| Education/Health | 23,984.1 | 588.6 | 2.5 |
| Finance & Insurance | 3,541.8 | 54.7 | 1.6 |
| Other Services | 3,898.1 | 47.9 | 1.2 |
| Manufacturing | 5,418.0 | -44.8 | -0.8 |
| Transport/Warehouse | 4,300.0 | -40.7 | -0.9 |
| Real Estate | 1,973.6 | -20.2 | -1.0 |
| Wholesale Trade | 4,345.0 | -46.9 | -1.1 |
| Information | 1,608.7 | -22.3 | -1.4 |
| Total Private | 109,408.2 | 3,688.4 | 3.5 |
| Government | 37,429.7 | 1,331.3 | 3.7 |
| Total | 146,837.8 | 5,019.6 | 3.5 |

Source: EDD & Beacon Economics

Although employment growth has been robust, Beacon's estimates indicate that job gains have not been evenly distributed. Recent job creation has been disproportionately found in internally serving sectors, including Leisure and Hospitality (+5.3% year to year), Natural Resources & Construction (+11.3% year to year), and Government (+3.7% year to year). In particular, Government and Natural Resources & Construction sectors made up the largest component of net employment gains over the last year.

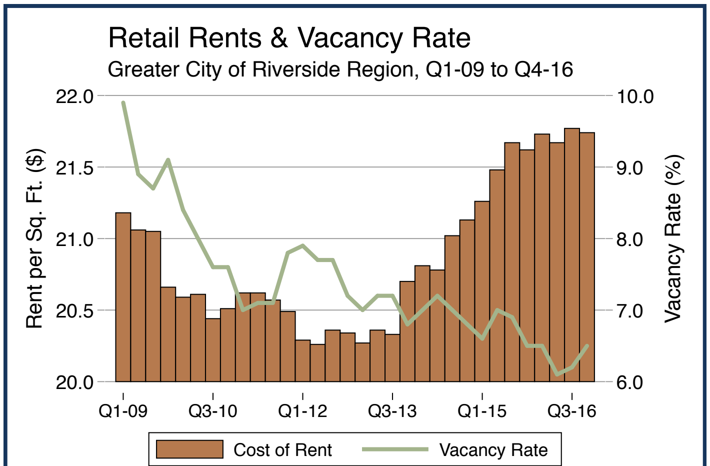
The local Government sector, which represents the largest sector in the city, added an estimated 1,300 jobs between January 2016 and January 2017, accounting for more than a quarter of overall job gains in the City. The University of California, Riverside, one of the City's largest public employers, reported hiring an additional 132 faculty in the fall of last year, as enrollment swelled to a record 22,921[1] students for the 2016-17 academic year. Additionally, public servants saw stronger wage gains than the nonfarm workforce as a whole, based on Beacon Economics' estimates. As of January, average annual wages increased 6.1% to $65,500. Because the city disproportionately houses public institutions that serve the County of Riverside, expansion in the government sector is a reflection of the strain placed on public services by ongoing population growth in the broader region.

Population gains also drove housing demand higher in 2016, with a 14% increase in the value of permitted residential projects compared to the year prior. Over the last two years, the composition of permitted residential development has favored multi-family units. Although 254 new units were added to the development pipeline last year, Reis, Inc. data reflect that no new apartment stock has been added to the greater City of Riverside rental market since early 2015. This has resulted in vacancy rates tightening to a historic low of 2.2%, driving rents up at rapid pace. As of the fourth quarter of 2016, average asking rents climbed 6.3% to $1,235. The single-family real estate market has also picked up modestly, with a 3.1% increase in annual sales. The median home price in the City rose to $358,600 in the final quarter of 2016, reflecting a growth rate of 9.1% year to year.



Source: Reis

On the nonresidential side of real estate, permitting activity rose 20.7% above 2015 levels. Although retail construction continued to comprise the largest component of planned new structures, total valuations of permitted retail projects fell 18% in 2016, as rental rate appreciation lost steam and vacancy rates remained more or less static compared to the year prior. Still, growing payrolls in storefront-facing industries, including Leisure and Hospitality (+5.3% year to year) and Retail (+2.9% year to year), demonstrate that employers have been benefitting from improving resident finances.

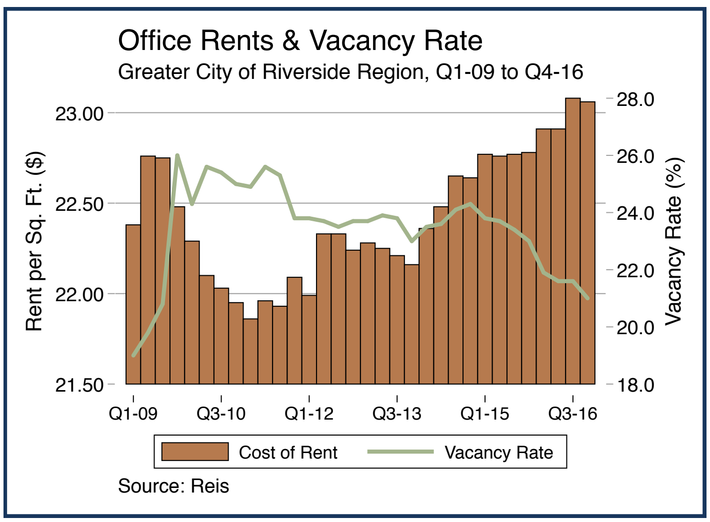


Source: Reis

1 https://ucrtoday.ucr.edu/42047

Furthermore, occupancy rates at hotels in the Riverside/Corona submarket increased to 76.64% in 2016, a 2.5 percentage point increase from a year prior. The increase in occupancy rates coupled with rising room rates in the region fueled a 7.5% increase in revenue per available room for local hotels. Increasing flight capacity at Ontario International Airport is probably helping to make the city a more attractive destination for both business travel and tourism. Passenger volumes began showing marked improvement in the second half of 2016, resulting in overall traffic growth of 0.9% between 2015 and 2016.

On the other hand, modest to robust employment gains in professional industries have been boosting demand for office-based properties. The local Administrative Support Sector demonstrated particularly strong gains of 4.5%, outpacing the City's rate of growth. Over the most recent yearlong period, office properties have continued to face relatively high but rapidly declining vacancy rates. Local vacancy rates decreased by 2 percentage points, falling to 21% in the fourth quarter of 2016. Rental rates have started to exhibit modest gains, with a 1.2% increase over the last year.




Elevated planned development for both residential and commercial properties is expected to fuel the ongoing construction boom in the city. The Natural Resources and Construction sector added an estimated 1,300 jobs over the last year, representing year-over-year gains of 11.3%, with most of those gains coming in Construction. Heated employment gains correspond to growing compensation, with annual compensation estimated to have grown 5.7% year to year.

Although overall employment gains have been impressive, some sectors have been lagging in job creation. Based on poorer-than-anticipated performance in the Logistics industry, Beacon Economics has revised employment estimates downward since the last edition of this report. The Transport/Warehousing sector posted modest employment losses, compared to the year prior. This is in marked contrast to the broader Inland Empire, where the sector posted 7.7% employment growth.

Beacon sees little reason to believe that employment losses in the local logistics sector will continue. However, it is worth mentioning that although the Transportation and Warehousing sector represents 7.2% of nonfarm employment for the metro, it comprises less than 3% of nonfarm jobs in the city, a share that has fallen since the recession. One reason for the contrast is that much of recent warehouse/distribution center development has been occurring in outlying parts of the Inland Empire, where large, industrially zoned land parcels are easier to come by.

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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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Real estate market analysis

Industry and market analysis

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