Southern California

Industry Intelligence Report

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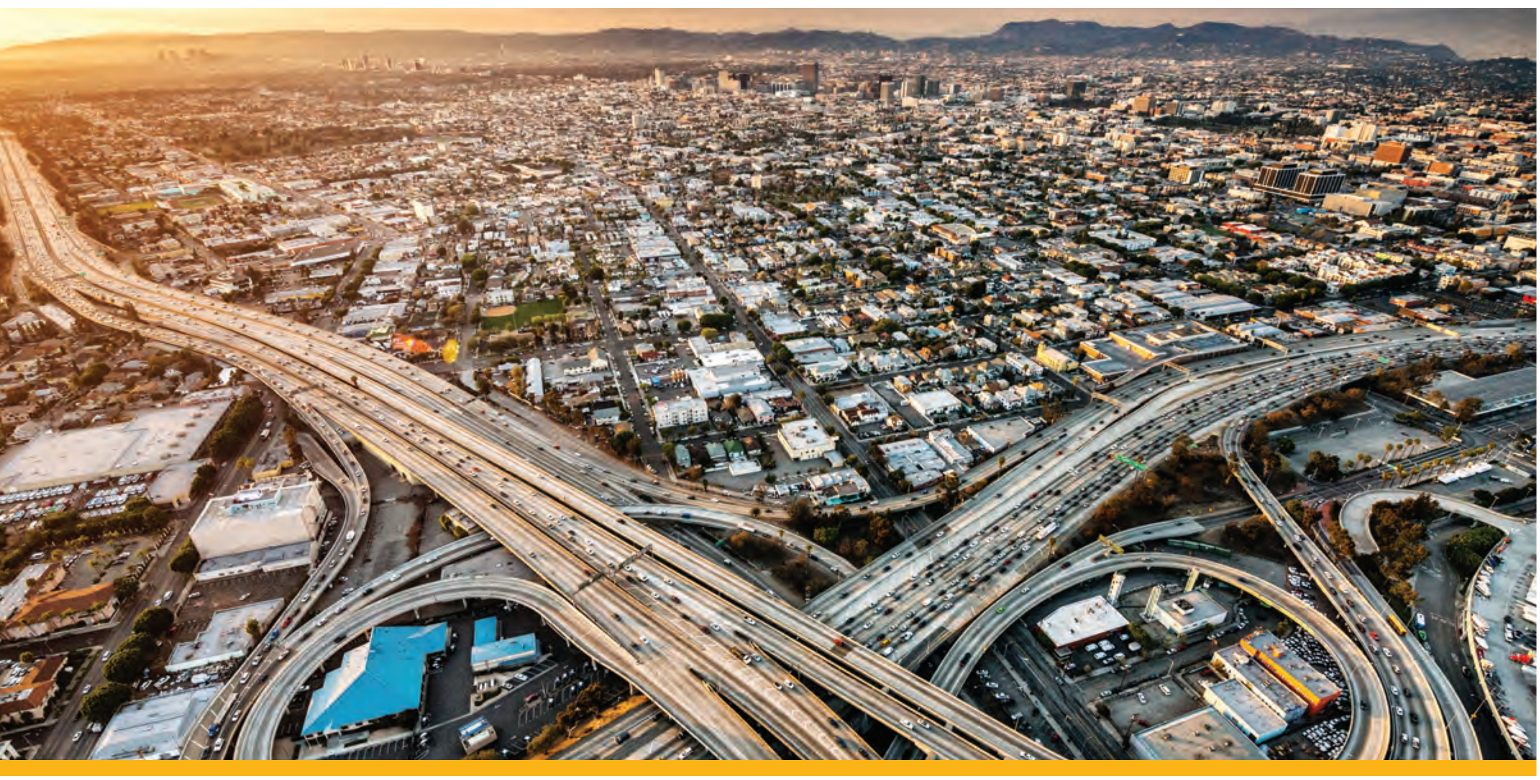

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The Economy

By | **Christopher Thornberg**, Economist
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LIMITS TO CALIFORNIA'S ECONOMIC GROWTH

For most of the post-recession era, the California economy has been among the fastest growing of the 50 states, both in terms of job gains and growth in economic activity. Credit for this growth trajectory has largely been attributed to high tech, which has experienced phenomenal growth since the recession. But it was also made possible by enormous slack in the labor market as the state recovered from the highest rates of unemployment seen in at least 40 years. For more than 60 months, from early 2012 through mid-2016, California added jobs at roughly twice the rate as the United States. Job gains were impressive, at times exceeding 3% year-over-year, and the state gradually chipped away at its double-digit unemployment rate, which fell from 12.2% in 2010 to 5.4% in 2016.

Yet, by the third quarter of 2016, that slack had been squeezed out: Instead of handily outpacing U.S. job gains, California's growth rate slipped to just above 1.5% putting it roughly on par with the nation. But by early 2017, slack in the labor force was wrung out as California saw its unemployment rate hit a 16-year low, effectively at full employment. Job gains continued in most industries, to be sure, but the pace of growth was much slower than in recent years. Entering the final quarter of 2017, some observers have worried that the slowdown in the labor market is a precursor to a stalling statewide economy.

NOT SO FAST!

Yes, California's pace of job growth has slowed considerably, but not because the expansion is stalling out. In fact, the state continued to add jobs through the first several months of this year, but at a slower rate. Wage and salary jobs rose by 1.5% year-over-year in October, adding 256,800 jobs year-to-year. In the private sector, the Health Care industry made the largest contribution, followed by Construction, and Accommodation and Food Services (by far the largest sector within Leisure and Hospitality). Professional Scientific, and Technical Services, the source of so much job growth in recent years, was essentially flat, as was Retail Trade. The Government sector saw a significant gain mostly due to hiring by local governments. Otherwise, job losses occurred only in Mining and Logging and in Non-Durable Goods. In all, growth across the state has driven the unemployment rate below 5% in recent months, to the lowest rate since 2000.

Despite the slowdown in job growth, California's gross state product continues to advance at a modest pace, increasing by 2.6% from the second quarter of 2016 to the second quarter of this year. However, taxable sales growth slowed in the first quarter of 2017, but increased by 4.2% year-to-year in the second quarter of 2017.

With the state at full employment, job growth and general economic gains will largely be constrained by the availability of workers. This is good for workers who might achieve pay increases in the coming months and quarters, but it poses a challenge for firms that want to grow but cannot because they are unable to hire the necessary workers. Data at the national level indicates that job openings in general have reached historic highs. This holds true for most industries, from professional and business services to manufacturing to food and beverage establishments. There are shortages of skilled workers in well-paying occupations, of unskilled workers in food services and similar industries, and even of skilled and semi-skilled occupations in manufacturing and construction.

What is holding back growth and can be anything done about it? There is an easy answer to the first question but the second is a different story.

BUILD IT… THEY'RE ALREADY HERE

For decades, California augmented its home-grown labor force with workers from elsewhere, drawing from both other states and other countries. Through much of the post-World War II era, the state was a magnet for workers from around the country and the world. There were opportunities for aerospace engineers, fruit pickers, and everything in between. In the 1970s and 1980s, California's labor force grew by an average of 3.1% per year, during which time net migration matched or exceeded California's internal population gains. But net migration turned negative with the 1990s recession, and in turn, growth in the labor force has slowed to just 0.9% annually since 1991. Significantly, in the last decade and a half, consistent state-to-state migration out of California has been offset only by international migration into the state.

It is no coincidence that slower labor force growth has occurred as the cost of living has soared in California. As recently as the mid-1970s, the median price of a California home was just a few thousand dollars higher than the national median. But since 1990, the California median has consistently exceeded the U.S. median by more than 50%, with the state median at least double the U.S. median in 10 of the last 27 years. Meanwhile, rents have reached such heights that rent burdens in many communities across the state are among the nation's highest.

Countless headlines in recent years have described California as facing a housing shortage and an affordability crisis as construction has lagged demand. This is not a new theme, just the latest chapter in California's housing story. One need only look back to the early 2000s to find the same storylines:

- the state's need for housing far outstrips the current pace of building
- the state needs more affordable and workforce housing
- even middle and upper middle income households face affordability challenges

Jobs by Major Industry
California

Industry	Oct-16	Oct-17	YTY	YTY %
Total Nonfarm	16,603.5	16,860.3	256,800	1.5
NR/Mining	23.3	22.7	-600	-2.6
Construction	784.1	828.5	44,400	5.7
Manufacturing	1,301.8	1,297.1	-4,700	-0.4
Durable Goods	816.3	820.4	4,100	0.5
Non-Durable Goods	485.5	476.7	-8,800	-1.8
Wholesale Trade	726.6	740.1	13,500	1.9
Retail Trade	1,690.6	1,694.0	3,400	0.2
Transport,Warehouse,Util.	588.3	600.4	12,100	2.1
Information	528.7	534.3	5,600	1.1
Finance and Insurance	548.5	551.3	2,800	0.5
Real Estate	283.1	284.9	1,800	0.6
Prof Sci and Tech	1,229.1	1,232.9	3,800	0.3
Management	226.3	230.8	4,465	2.0
Admin Support	1,085.7	1,088.7	3,000	0.3
Educational Services	356.4	372.2	15,800	4.4
Health Care	2,205.2	2,265.8	60,600	2.7
Leisure and Hospitality	1,918.2	1,955.7	37,500	2.0
Accommodation and Food	1,613.2	1,645.1	31,900	2.0
Other Services	563.3	581.3	18,000	3.2
Government	2,543.5	2,578.9	35,400	1.4

Source: EDD; Analysis by Beacon Economics

Without attempting to sound trite, it all boils down to supply and demand. On the demand side, the much-anticipated arrival of Millennials on the housing scene, coupled with recent job and income growth and low interest rates, are all driving demand for housing, both owner-occupied and rental. On the supply side, existing home sales have fallen below expectations, given the strength of the economy, while new single-family and multi-family construction has been relatively weak since the recession.

Demand-side solutions to the problem include easier underwriting standards (though not as slack as in the 2000s), reduced down payments, and special finance programs for would-be buyers, along with rent subsidies for qualified households. But in the absence of increased supply, these programs result in more would-be buyers/renters competing for scarce housing. No, the situation must ultimately be addressed by increasing supply, a tall order indeed. But until California does so, in earnest, growth of the statewide economy will be constrained.

That is not to say that California won't grow. It will. The state and its regions should experience continued growth in economic activity and jobs well into 2018. Most of the job gains will occur in Health Care, Leisure and Hospitality, and Construction. But California will fall short of its potential until it crafts long-term supply-oriented solutions to the chronic problem of high housing costs and low housing affordability.

The Industry:

Employment & Wages

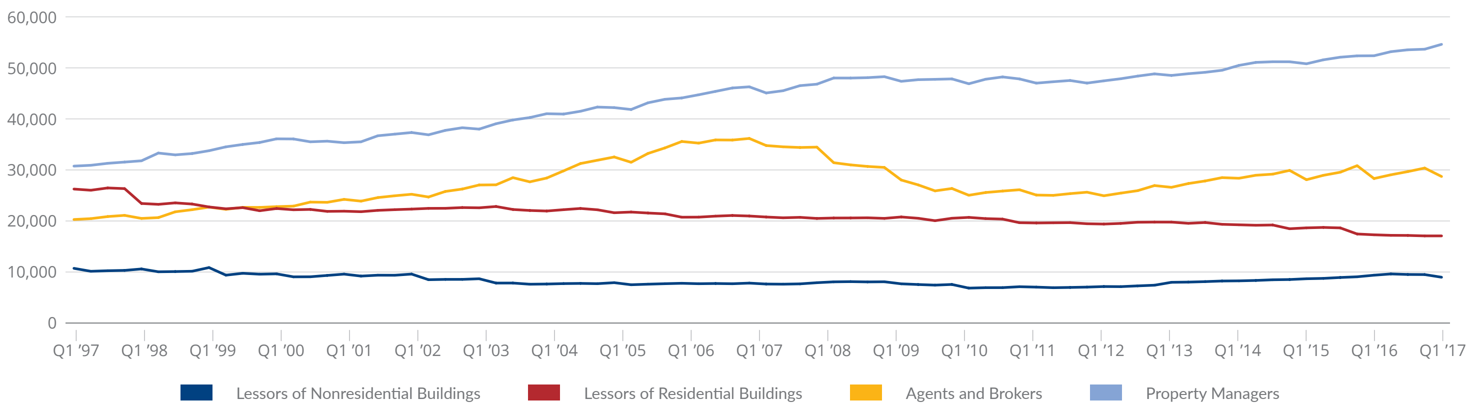
By **Christopher Thornberg**, Economist
Peter Breslin, Research Associate
Beacon Economics

There were 400 more real estate establishments in southern California in the first quarter of 2017 than there were in 2016. Employment decreased by approximately 450 during that time but was still 10.8% higher than in 2012. Companies have increased wages to keep employees and stay competitive; average annual wages increased by more than $1,500 from the first quarter of 2016 to the first quarter of 2017.

In the first quarter of 2017, 129,000 people were employed in the real estate industry in southern California, 0.3% fewer than in 2016 but more than 10% more than in 2012. The largest sub industry was Real Estate Property Manager, employing 54,880. From the first quarter of 2016 to the first quarter of 2017, employment in this category increased employment by 2.7%; the five-year increase was 13.7%. The second-largest subcategory is Real Estate Agents and Brokers, employing 28,700 people who sell, buy, or rent real estate for others. Lessors of Residential Buildings' is the third largest subcategory and employs 17,300 workers.

After the housing crisis and Great Recession, the California economy has rebounded, and employment has reached record highs, resulting in more demand for housing. As this demand continues to increase, prices will rise; and as higher prices lead to more opportunity to profit from sales, more workers will enter the real estate market.

Southern California Real Estate Employment
Largest Sub Industries



Source: BLS, QCEW; Analysis by Beacon Economics

The Legislative Housing Package

By | **Chris Chau**, Research Associate
Beacon Economics

The California Legislature passed a landmark series of 15 bills in 2017 designed to increase the supply of affordable housing. Measures include financing new affordable housing developments, streamlining local regulations, and committing local governments to building an equitable share of their region's new housing needs. Ambitious in scope, the housing package represents the first significant legislative action related to housing since the elimination of the redevelopment agencies in 2011. But after years of inaction on the crisis, these steps are only the beginning in reversing the state's affordable housing shortage. Highlights from the package:

Senate Bill 2, authored by Sen. Toni Atkins, creates a $75 fee on select real estate transactions. The projected $200 million to $300 million in revenues from this fee will go toward affordable housing development and services for homeless people.

Senate Bill 3, authored by Sen. Jim Beall, places a $4-billion bond proposal on the ballot for the 2018 state election. This bill would fund affordable housing programs in California that were previously supported by the state's redevelopment agencies, which were cut in 2011. Additionally, this bill includes $1 billion to extend the CalVet Home Loan Program.

Senate Bill 35, authored by Sen. Scott Wiener, requires local governments that have not met goals for housing development to follow a streamlined local review process that would fast-track development in areas lacking sufficient affordable housing and serve as an incentive for cities and counties to commit to state housing development goals.

Assembly Bill 1515, authored by Assemblyman Tom Daly, forces courts to give less deference to local governments in legal challenges to blocked housing developments. This legislation pushes back on obstacles to new housing proposals driven by so-called not-in-my-back-yard (NIMBY) motives.

Senate Bill 678, authored by Assemblyman Raul Bocanegra, D-San Fernando, and its companion bill, Senate Bill 167, authored by Sen. Nancy Skinner, also combat NIMBY movements that have used downsizing to challenge new development. It increases the burden of proof for local governments to reject or downsize developments that include affordable housing units.

Apartment Trends

By | **Adam J. Fowler**, Research Manager
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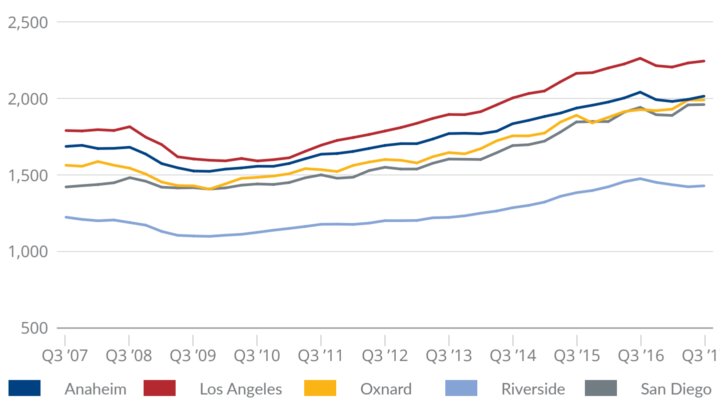
Asking rents have increased in every major Southern California county since the foreclosure crisis as the continued strength of the economy and labor markets have bolstered demand. Southern California as a whole has an averaging asking rent of $1,750 in the second quarter of 2017, and an average household size of 3 in 2016. In particular rents, net absorption, and vacancy rates show that housing in Los Angeles County is stretched exceptionally thin.

Los Angeles County and Orange County shared the highest average asking rent in 2016, $1,830 per month. Los Angeles County's asking rents increased by

Southern California Rents
Select MSAs



Source: Axiometrics; Analysis by Beacon Economics

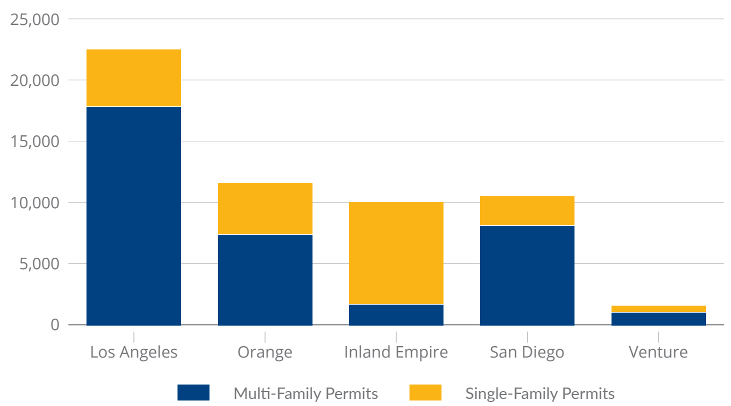
5.3% and Orange County's increased by 2.8% from 2015. Net absorption, an indicator of housing inventory, was the highest in Los Angeles in 2016 at 1,149. Net absorption is a measurement of the increase or decrease in occupied and vacated housing units. If more people are moving in than leaving, net absorption is positive. The vacancy rate in Los Angeles is 3.3%, which is very low and shows a high demand for housing despite rent increases.

The Inland Empire will see more people moving in because of its lower rents and wider choice of housing. The average asking rent in the Inland Empire was the lowest in Southern California at $1,290 in 2016. This was $540 less a month on average than in Los Angeles and Orange counties. The vacancy rate is currently very low in the Inland Empire, at 2.8%. Rents will increase dramatically with higher demand from those deciding to live outside of Los Angeles and Orange County. The Inland Empire has a large amount of land for new housing.

Reflecting its dense development, Los Angeles County issued 17,870 multi-family permits in 2016, the largest number in Southern California, and 4,670 single-family permits. San Diego, also densely populated, issued 8,180 multi-family permits in 2016 and 2,390 single-family permits.

Areas where space is not a problem, including the Inland Empire, issued almost eight times more single-family permits than multi-family permits; from 2015 to 2016, single-family permits increased by 20% and multi-family permits decreased by 23% there. The Inland Empire also has the highest percentage increase in alteration values; their value increased by 7.2% in 2016, when Southern California average rose 0.8%.

Residential Permits 2016
Southern California



Source: CIRB (Construction Industry Research Board); Analysis by Beacon Economics

Southern California Renters

By **Adam J. Fowler**, Research Manager
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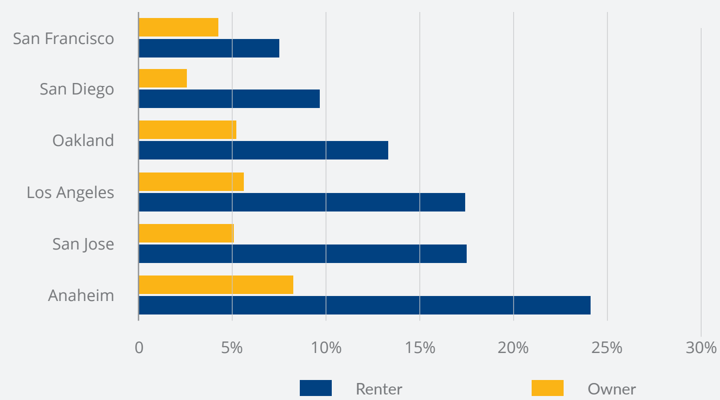
The average household in California remained steady in 2016 at 2.9 people, as it also did in Los Angeles and San Diego counties. The largest average household size is in the Inland Empire, at 3.3 people, 1.7% lower than in 2015.

More than 30% of Inland Empire residents make less than $25,000 a year, and more than 36% use more than 30% of their wages on rent.
In comparison, in Orange County, which has the highest average wages in Southern California, only 14.8% of residents earn less than $25,000. The median income is $81,840, and more than 42% of renters earn more than $75,000 a

Percent of Units
Having More Than 1.0 Occupants per Room



Source: American Community Survey, 1-year estimates; Analysis by Beacon Economics

30%

Of residents make less than $25,000 annually in the Inland Empire

OF THOSE

36%

Use more than 30% of their wages on rent.

year. San Diego is close behind with a median income of $70,820 and more than 37% of renters earning more than $75,000 a year.

Recent demand has created an influx of housing development in the Inland Empire. More than 80% of renters moved into their apartments after 2010, the highest percentage in any area in Southern California. Second is San Diego with 77.7%. Los Angeles County accounts for more than 50% of renter households in Southern California and 30.5% of California rentals. It also has the highest percentage of long-term renters, with 12% of renters having moved into their properties before 1999. Without rent control policies in much of Los Angeles County, these numbers would shift to newer dates and the 2010+ column would be even larger.

Most Southern California rental units were built between 1960 and 1999, and Los Angeles County has more than 45% of those built before 1959. The second largest percentage is in San Diego, with 18.9%. This fits the picture of both areas having high density and high demand, reducing the incentive for landlords to demolish and replace old buildings. In the Inland Empire, more than 23% of rental structures were built after 2000.

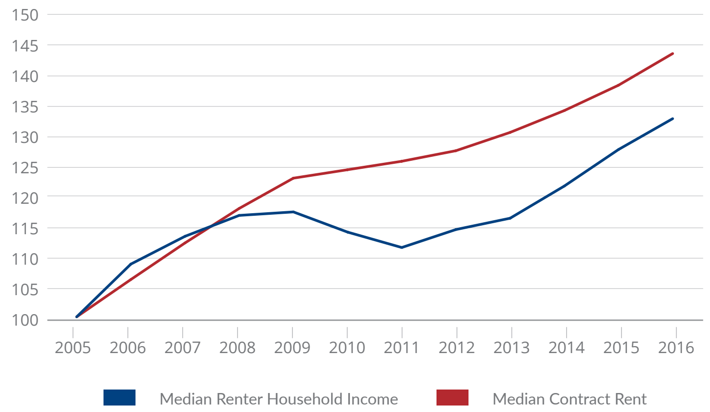
All areas in Southern California have very low vacancy rates for rental units, with the lowest, 2.8%, in the Inland Empire in the second quarter of 2017. The highest rate, 3.5%, is in Orange County; Los Angeles County's rate was 3.3%, and San Diego County's was 3.1%. With very low vacancy rates, rents will continue to rise until development adds options for renters. An issue with southern California is the space, especially around Los Angeles, San Diego, and Orange counties. The Inland Empire is best suited for large-scale developments.

Average Income Distribution
2016

Location	$5,000-24,999	$25,000-49,999	$50,000-74,999	$75,000-99,999	$100,000+
Los Angeles	29.10%	26.60%	17.50%	9.80%	17.00%
Orange	14.80%	21.00%	22.10%	17.20%	24.90%
Inland Empire	30.90%	31.10%	18.30%	10.90%	8.80%
San Diego	19.70%	24.30%	18.90%	13.10%	24.10%
Ventura	20.10%	29.60%	17.90%	14.70%	17.70%

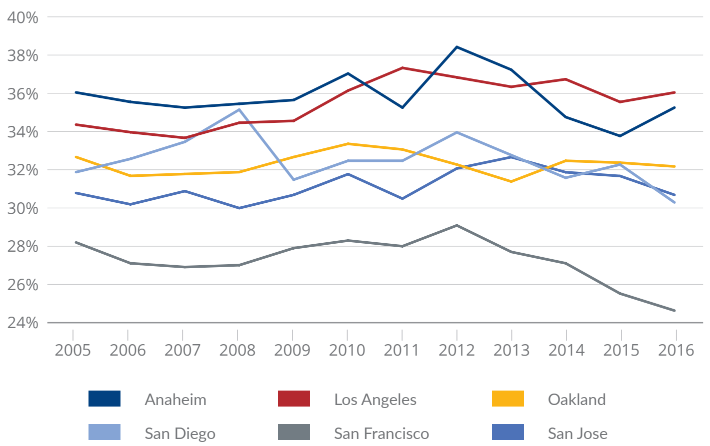
Source: Census 2016

Indexed Renter Income and Rents
Los Angeles County, 2005 to 2016



Source: American Community Survey, 1-year estimates; Analysis by Beacon Economics

Rent Burden
Select California Cities



Source: American Community Survey, 1-year estimates; Analysis by Beacon Economics

Region in Focus:

Los Angeles

By **Adam J. Fowler**, Research Manager
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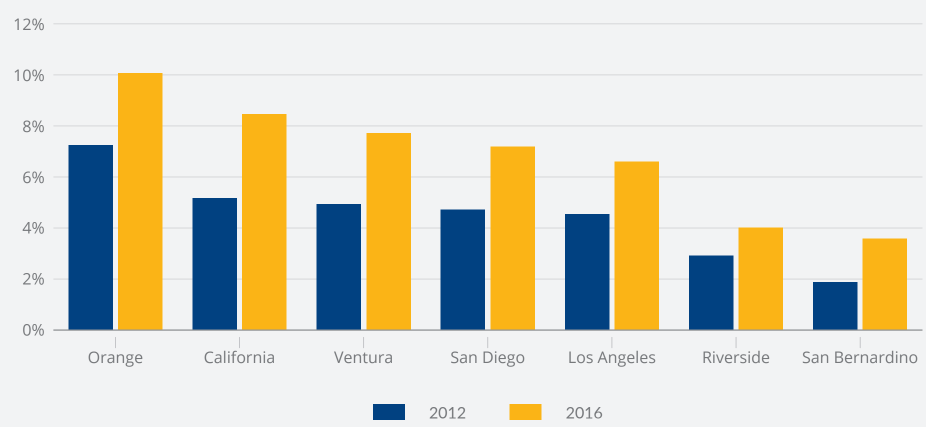
The Los Angeles-Long Beach-Glendale MSA is central to Southern California and a main driving factor in economic growth, ranking ninth in the nation in terms of new apartment units and second in the nation for apartment rent.[1] Santa Monica, Beverly Hills, and Brentwood have rents well above the average. The MSA also includes lower-income, low-rent areas, among them Palmdale/Lancaster, Mid-City, and North Hollywood, that have recently been experiencing rapid growth. Such growth seems more enticing to new residents looking for affordability and to real estate developers seeking higher potential for investment returns.

Percentage of Renters Earning $150,000 or More
Southern California Counties



Source: American Community Survey, 1-year estimates; Analysis by Beacon Economics

From August 2016 to August 2017, 37,200 jobs were added in the Los Angeles MSA, a 0.9% increase. In comparison, national employment increased by 1.5%. The Los Angeles MSA is projected to maintain employment growth with a 1.4% average annual increase into 2021.[2]

The increase in employment has been met with a 5.6% increase in residential permits issued from August 2016 to August 2017, an increase of 18,820 permits, primarily for single-family dwellings, which increased by 15.1% from August 2016 to August 2017 while multi-family permits increased by 0.5%. Even with single-family permits increasing at a much faster rate, there were 2.5 times more multi-family permits than single-family permits.

In the Los Angeles-Long Beach-Glendale MSA, Palmdale/Lancaster had the greatest annual rent growth in the third quarter of 2017, an increase of 12.4%. Eclipsing the MSA's average of 3.3%, Palmdale/Lancaster's average rent is now $1,219 a month. The most stagnant area is Central Los Angeles, which had an average annual rent decrease of 0.9%. Rent there ranks seventh in this MSA, averaging $2,610 a month, more than $350 higher than the MSA's average. Santa Monica, a city known for the beach, shopping, and tourism, has the highest average rent as of the third quarter of 2017. At $3,590, more than $1,330 higher than the MSA average, it is projected to increase well into 2020, when it is expected to reach $3,947 a month.[2]

High rents in Los Angeles County are forcing low-income residents to move out. Over 60% of outbound migration from 2014-2016 was from residents who earn less than $25,000 a year. More than 81% of all residents moving out of LA County earn below $50,000 a year. Average incomes and rent burdens do not tell the whole story when such a high proportion of lower income residents are leaving. As rents continue to increase, more and more lower waged workers will have to move and choose to either endure longer commutes or find work elsewhere.

1 Metropolitan Statistical Los Angeles-Long Beach-Glendale, CA. (Q3, 2017). Retrieved from https://axio.realpage.com/Publication

2 Metropolitan Statistical Los Angeles-Long Beach-Glendale, CA. (Q3, 2017). Retrieved from https://axio.realpage.com/Publication