

# REGIONAL INTELLIGENCE REPORT™



Prepared by Beacon Economics, LLC



Twenty-Second Edition

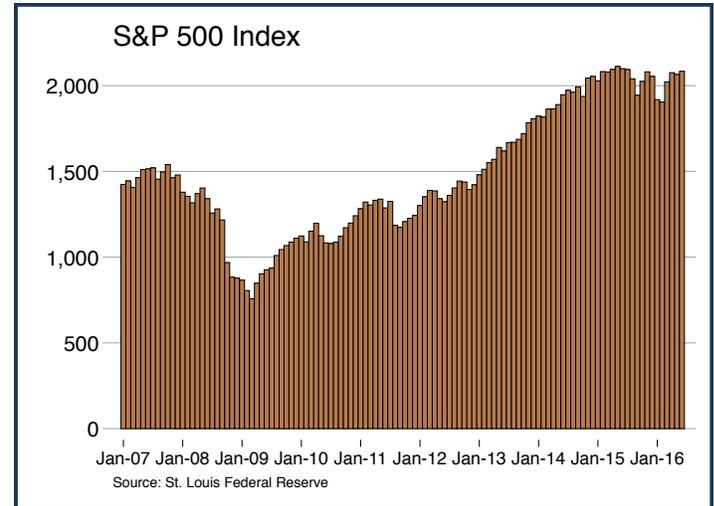
July 2016

## U.S. Expansion to Continue Despite Market Chaos

The U.S. stock markets are yet again in the midst of a major selloff. As the great Yogi Berra once said, “it’s like déjà vu all over again.” This will be the third major sell-off in the past year, the first two being the turmoil in August of 2015 and then again at the start of 2016. As with the last two rounds, the market’s reaction to global events is, to put it politely, completely hyperbolic. Beacon Economics does not see any significant chance of the nation’s current economic expansion ending in the next two years, although we do see growth slowing modestly as a direct result of an over-reaction by traders, not global events.

This isn’t to say that issues in the global economy—namely a wobbly Chinese economy and the Brexit—aren’t serious. They are. But these are serious issues that will play out over many years, not within a few months. This is a critical distinction. Sharp sell-offs such as the ones we have observed in the market over the past year are reasonable reactions to the potential onset of a U.S. recession where corporate profits fall sharply and the chance of a major corporate bankruptcy is heightened. But we see no chance that current global issues will cause a national downturn, and as such, the market gyrations are largely inappropriate.

Beacon Economics’ optimism stems from a couple of factors. First, any negative shock that could cause the U.S. economy to fall into a recession has to have three distinct features—the shock must be large, rapid, and sustained. If any of these features are missing, it will not set off the negative feedback loop of reduced demand, idling factors of production, and so on. Instead, the economy may slow a bit but will otherwise simply adjust around the problem.



United States

Current global events fail to meet two of these conditions—rapid and large.

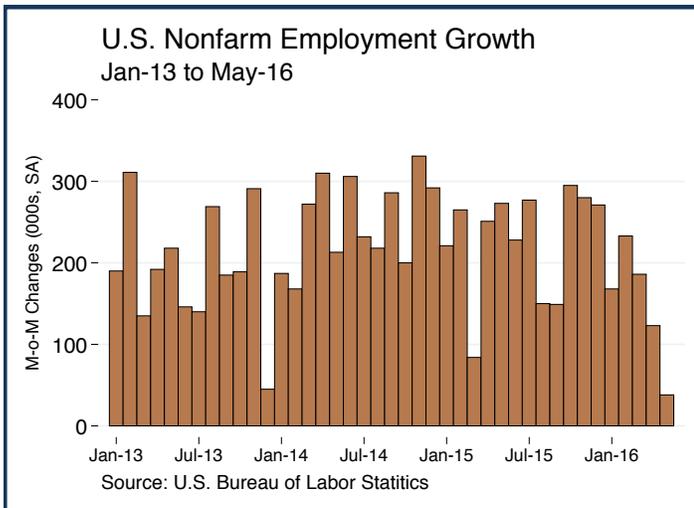
- The issues in the UK and China will not occur rapidly but will play out over a number of years. Britain, for example, will be in the EU for a full two years while a new arrangement is negotiated. And while China clearly has enormous issues with bad debt and excess capacity, these problems exist largely in the realm of state owned banks and companies. The Chinese government has over \$3 trillion in excess reserves—real money that can be used to paper over these problems for many years. Both economies may slow in the short term but there is little imminent danger of either tipping into a major recession right now.

- Even if we are wrong and one economy or the other does enter a recession, what difference does it really make for the relatively insulated U.S. economy? Exports are a relatively small share of our economy—and two of our three largest trading partners are Mexico and Canada. In 2015, 7.3% of U.S. exports went to China, while 5.4% went to the UK. The only major risk is from falling foreign earnings among U.S. corporations. But such losses will be met by the paring back of foreign operations—not domestic ones.

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Second, it is worth noting that in modern history the U.S. economy has never suffered a recession driven by shocks emanating from outside the country. And the domestic economy seems to be moving forward at a steady, sustainable pace. Consumer spending is up nicely, driven by better earnings and a solid job market. Real estate markets are still in recovery mode, and state and local sectors are finally able to begin investing more in local infrastructure and exports—despite slowing global growth and a strong dollar. Even the oil market seems to have hit bottom and is steadying. And remember that the overall economy is benefitting from low interest rates and cheap commodity prices, which are a direct result of the global slowdown.

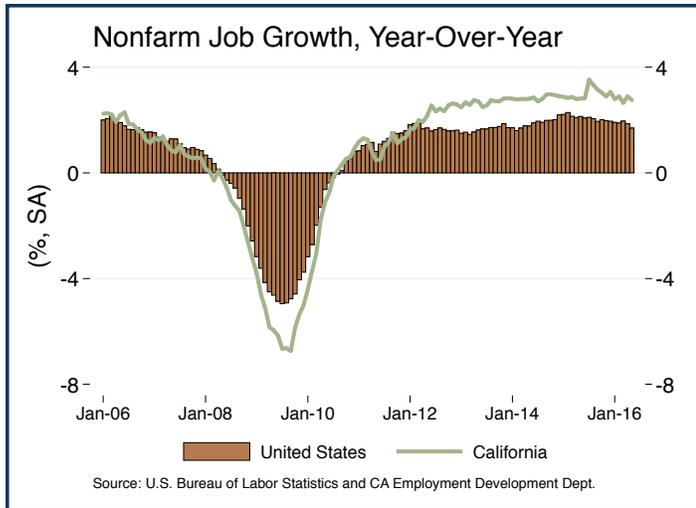
Beacon Economics' assessment is not Pollyannaish; we have significant concerns. Rather than confronting its true structural problems, China instead seems to be reverting to a more centrist hardline regime. The Brexit vote is another example of the rise of populist/xenophobic political movements occurring in many countries, including our own. But these are worries that will play out over the next decade, not the next year. So for now, ignore the market theatrics. Over the next 24 months, the U.S. economy will do just fine.



The one place where we do see some slowing in the U.S. economy is in the pace of business investment. However, this is not being caused by China or the UK but by the markets themselves. Such market volatility is truly unprecedented during a period of time when indicators of the real economy continue to show ongoing expansion at a steady, if modest, pace. Such wild gyrations will naturally and reasonably cause investors to become more risk averse. With less capital, businesses will have to reduce new investments—something that occurred in the first quarter of this year. Presumably, once the markets calm, as they have after the last two false alarms, the situation will improve.

## California Stays on Track

As first half of 2016 drew to a close, the California economy maintained a steady course and is on track for a fifth consecutive year of economic growth, job creation, and lower unemployment. Nearly every major industry added jobs in the first several months of this year, while business activity increased and wages advanced modestly.



California ranked first among the 50 states in economic growth last year with a 4.1% gain. Gross state product grew at an estimated 2.0% rate in the first quarter of 2016, more than double the U.S. growth rate of 0.8%. The state also outpaced the nation in terms of job gains, with a 2.8% yearly increase in May compared to the nation's 1.7% rate. With continued job gains, California's unemployment rate fell to 5.2% in May, the lowest in nine years. Meanwhile, statewide taxable sales climbed by an estimated 3.4% in the first quarter of this year compared with the same period in 2015.

With few exceptions, California's major industries added jobs in yearly terms. Education led the state in percentage terms with a 6.0% increase (20,500 jobs) year-to-year in May, followed by Construction (5.5%), Professional, Scientific, and Technical Services (4.5%) and Health Care and Social Assistance (3.9%). In absolute terms, Health Care added the largest number of jobs (81,500) by far, with Government, Professional, Scientific, and Technical Services, and Construction also making significant contributions to job gains. Only Manufacturing and Mining and Logging lost jobs, representing 0.1% of all wage and salary jobs in the state.

## Employment by Industry California, May 2016

Industry	May-16 (000s)	YOY (000s)	YOY (%)
<b>Total Nonfarm</b>	<b>16,407.1</b>	<b>440.3</b>	<b>2.8</b>
NR/Construction	786.0	35.8	4.8
Prof Sci and Tech	1,255.2	53.8	4.5
Health Care	2,176.2	81.5	3.9
Leisure and Hospitality	1,882.4	64.4	3.5
Transport, Warehouse, Util	566.2	17.3	3.2
Wholesale Trade	738.7	20.9	2.9
Information	495.7	13.0	2.7
Admin Support	1,074.8	28.1	2.7
Government	2,501.7	58.4	2.4
Financial Activities	810.8	15.0	1.9
Management	234.3	4.3	1.9
Other Services	553.2	9.9	1.8
Retail Trade	1,688.5	30.0	1.8
Manufacturing	1,280.1	-12.1	-0.9

Source: Bureau of Labor Statistics & CA EDD

Throughout much of the current expansion, San Francisco and San Jose were at or near the top among California's metropolitan areas in terms of percentage job gains, and the first part of the year was no exception. Among the larger metropolitan areas, Stockton actually saw the fastest rate of growth at 4.4% from May to May, San Jose was right behind at 4.0%, while Anaheim (3.5%) edged out San Francisco (3.4%). Los Angeles County grew by just over 2% but its absolute gain of 96,100 jobs was well ahead of second-place Anaheim (53,500) and the Inland Empire (45,000). Every metropolitan area of the state added jobs in year-to-year terms during May of this year.

## Employment by Metro Area California, May 2016

Region	May-16 (000s)	YOY (000s)	YOY (%)
<b>California</b>	<b>16,407.1</b>	<b>440.3</b>	<b>2.8</b>
San Jose	1,076.5	41.2	4.0
Orange County (MD)	1,584.9	53.5	3.5
San Francisco (MD)	1,079.0	35.1	3.4
Inland Empire	1,383.6	45.0	3.4
South Central Valley	1,028.9	31.0	3.1
Other Bay Area	523.9	14.4	2.8
Central Coast	537.7	14.3	2.7
Oakland (MD)	1,116.8	26.8	2.5
San Diego	1,414.6	33.8	2.4
North Central Valley	1,340.1	30.6	2.3
Los Angeles (MD)	4,354.5	96.1	2.3
Other Southern California	351.8	5.7	1.6

Source: Bureau of Labor Statistics & CA EDD

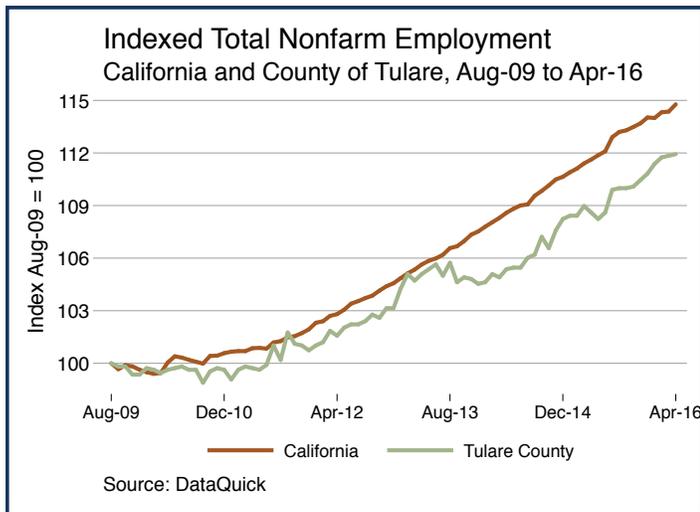
The California housing market continues to move forward although it is hardly back to full health. The median price of a home rose 5.3% from the first quarter of 2015 to the first quarter of 2016 on a 3.5% increase in sales, and low mortgage rates are constraining increases in monthly payments. However, lending standards are still very tight, and would-be buyers in many parts of the state face the challenge of coming up with a down payment that may be anywhere between \$30,000 and \$100,000. On the supply side, the supply of existing homes is lean, while new home construction has proceeded at a cautious pace through this expansion, although the pace of single-family construction accelerated in early 2016 even as multi-family construction trailed off. The effect of a less-than-healthy owner-occupied housing market has been a falling homeownership rate and higher rents. While the former may finally turn around this year, rents will continue to increase in markets where supply is constrained.

Just as the nation is poised to grow through the balance of this year, California's economy is fully expected to outpace the nation, both in terms output growth and job growth. Job and wage gains in communities around the state will trigger increases in local expenditures, which mean continued improvement in local government revenues.

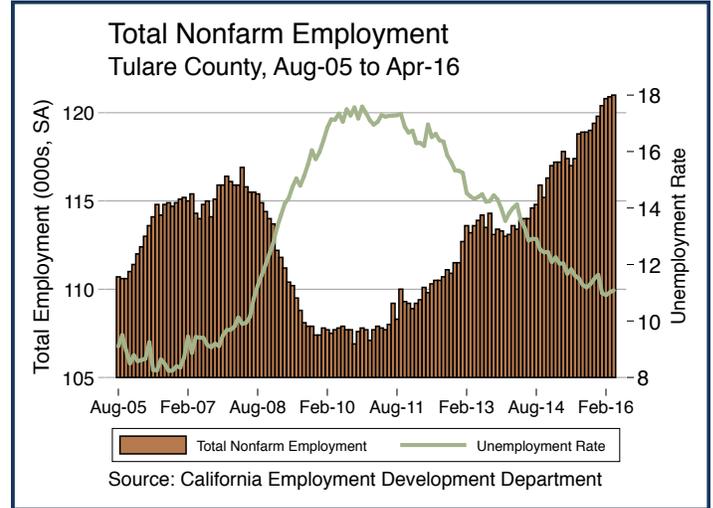
## Tulare County Employment

Slowly but surely, the Tulare County economy is gaining ground. Notwithstanding the infamous drought and a second-rate El Nino, employment levels in the County expanded with essentially unchanged levels of farm employment. From April 2015 to April 2016, total nonfarm employment in Tulare County increased 3.6%, outpacing the state overall where nonfarm payrolls grew by 2.8% over the same period. Farm employment, the County's largest employment sector, shed a mere 20 jobs, leaving overall levels of farm employment effectively unchanged in April 2016.

With recent gains in payrolls, unemployment in Tulare County continues to fall. Although, the County has a higher unemployment rate (11.1%) than the state (5.3%), the gap between the two is closing. And the important point is not that Tulare County's unemployment rate is higher relative to the state, but that the County's unemployment rate has been falling for the last six years. Overall, Tulare County's higher unemployment rate has much to do with local demographics, the composition of the labor force, and the strong agricultural presence in the area.



Tulare County's employment by sector has been mixed over the past year. Job growth has been concentrated in Trade, Transportation, and Utilities; Government; Education and Health; and Manufacturing. Leading the pack was the Trade, Transportation, and Utilities sector, which expanded by 1,200 jobs over the past year. Within the trade sector, Retail Trade increased 3.3% and Wholesale Trade increased 2.9%.



Over the last three years, one of the fastest growing job sectors was the Natural Resources and Construction sector, which increased payrolls 22.8% from April 2013 to April 2016. Over the last year however, the sector grew by only 0.1%. Recently, the Tulare County Board of Supervisors awarded a \$52.4 million contract to build a 510-bed Detention Facility in Porterville<sup>1</sup>, something that should boost Construction employment. Construction on the new facility is set to begin this summer and will take two years to complete. It has been reported that the new facility could also impact County expenditures. Because inmates are currently transported between Tulare County's two courthouses, the new detention facility could help drive down transportation costs.

### Employment by Sector in Tulare County

Sector	Apr-16	YoY Chg.	YoY (%)	3 Yr. (%)
Trade,Transport,Util.	29,000	1,210	1.2	8.8
Education/Health	14,000	540	0.5	6.2
Government	31,000	1,090	1.1	2.0
Manufacturing	12,500	440	0.4	6.8
Other Services	3,400	110	0.1	10.0
NR/Construction	5,000	120	0.1	22.8
Professional/Business	9,900	40	0.0	0.3
Information	1,000	0	0.0	11.2
Financial Activities	4,100	10	0.0	5.2
Leisure and Hospitality	11,000	30	0.0	12.9
<b>Total Nonfarm</b>	<b>121,000</b>	<b>3,600</b>	<b>3.6</b>	<b>6.5</b>
<b>Farm</b>	<b>39,100</b>	<b>-20</b>	<b>0.0</b>	<b>7.8</b>

Source: California Employment Development Department

<sup>1</sup> "Tulare County to Break Ground on New Detention Facility." CorrectionalNEWS. May 10, 2016.

Not far behind the leading private sector industries was the Government sector, which added nearly 1,100 jobs (1.1% growth) from April 2015 to April 2016. Government is now Tulare County's second largest nonfarm sector by employment, constituting 25.6% of all non-farm jobs in the area. Should this be considered either positive or negative for Tulare County? Government jobs offer both advantages and disadvantages over private sector employment. Although there are a myriad of different types of government jobs, overall, employment in Government tends to be more stable compared to the private sector. In addition, Government benefits typically exceed private sector benefit packages.

## Wages

Another sign of an improving economy in Tulare County is wage growth. According to the latest data available from the U.S. Bureau of Labor Statistics' Quarterly Census of Employment and Wages (QCEW), wage growth in the County grew by leaps and bounds in the third quarter of 2015, and occurred across all major industries.

### Wages by Sector: Tulare County

Industry	Q3-15 Ann. Avg. Wage (\$)	YoY Chg. (%)
Financial Activities	50,310	11.1
Admin Support	27,720	8.6
Leisure & Hospitality	15,520	7.6
Information	71,380	7.1
Government	49,140	5.3
Manufacturing	49,650	4.8
Trade, Transport, Util.	34,940	4.1
Education/Health	34,950	4.1
Prof, Sci, Tech & Mgmt	52,850	3.4
NR/Construction	43,800	2.4
Other Services	29,740	1.4
<b>Total Nonfarm</b>	<b>36,060</b>	<b>4.0</b>
<b>Farm</b>	<b>25,710</b>	<b>3.1</b>

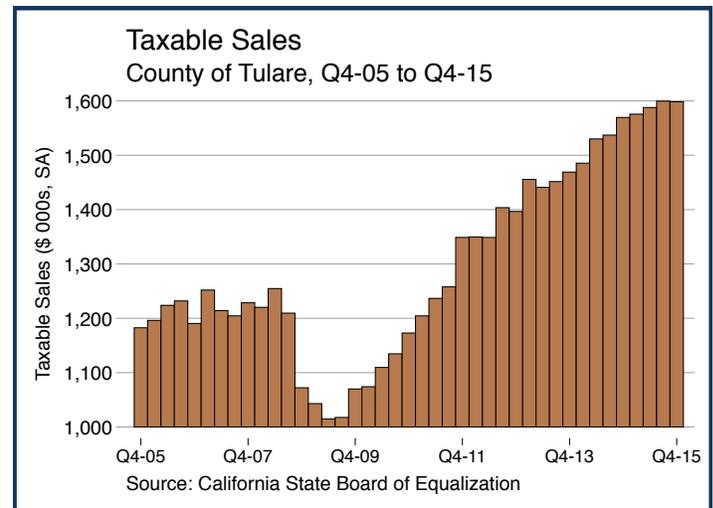
Source: Bureau of Labor Statistics

Significantly, wage growth was distributed across industries that employ workers in a range of occupations from high to lower skilled. For example, the high-wage Financial Activities sector saw significant increases in average annual wages, up 11.1%. At the same time, the relatively lower-wage Administrative Support sector saw a substantial 8.6% wage increase. Overall, wages in Agriculture increased 3.1% and 4.0% in non-farm industries.

Wage growth across industry sectors bodes well for Tulare County's economic outlook. Rising wages – from both pay hikes and increases in the number of hours worked – support increases in spending and economic activity in the region. What's more, because of today's low inflation environment, real wage growth has been even more impressive. Expanding industry and commerce beyond agriculture will bode well for Tulare County's economy in the long term.

## Local Spending

Consumer and business spending in Tulare County came in moderately soft at the close of 2015. From the fourth quarter of 2014 to the fourth quarter of 2015, taxable sales in Tulare County increased 1.8%. That puts Tulare County ahead of Kern County, where taxable sales declined 9.0%, but behind both Fresno (5.8%) and Kings (24.0%) Counties.



Overall, with the exception of a few quarters, there has been an upward trend in taxable sales since the onset of the economic recovery and expansion. Spending in Tulare County over the last three quarters was at its highest level on record. Given recent improvements in the labor market and wage gains, higher spending is likely to be maintained.

Total taxable receipts show a modest contraction in spending in Tulare County in 2015, according to HdL Companies. This was mainly due to declines in two categories that together accounted for one-third of the County's taxable receipts in the fourth quarter of 2015: Fuel and Service Stations and Business and Industry spending.

**Sales Tax Receipts by Category, Tulare County**

Category	Q4-2015 (\$000s)	YoY (%)	3 Yr. (%)
Building and Construction	1,050	9.5	16.6
Autos and Transportation	2,100	8.6	24.4
Restaurants and Hotels	1,290	6.5	22.9
Food and Drugs	760	4.4	-14.4
General Consumer Goods	3,250	3.9	12.1
Business and Industry	3,650	-9.8	33.9
Fuel and Service Stations	1,610	-20.1	-22.9
<b>Total</b>	<b>15,800</b>	<b>-0.6</b>	<b>12.6</b>

Source: HdL Companies

While Business and Industry spending dropped considerably over the last year, looking further back, it has been one of the fastest growing categories. Over a three-year period, from the fourth quarter of 2012 to the fourth quarter of 2015, Business and Industry spending increased 33.9%, followed by Autos and Transportation spending, which grew 24.4% over the same three years. Thus, while spending dropped off at the close of 2015, over the long run, the trend in Business and Industry spending has been positive and significant. The decline was less of a drop-off, and more of a slowdown relative to higher levels observed last year from a winding down of energy projects that had been underway.

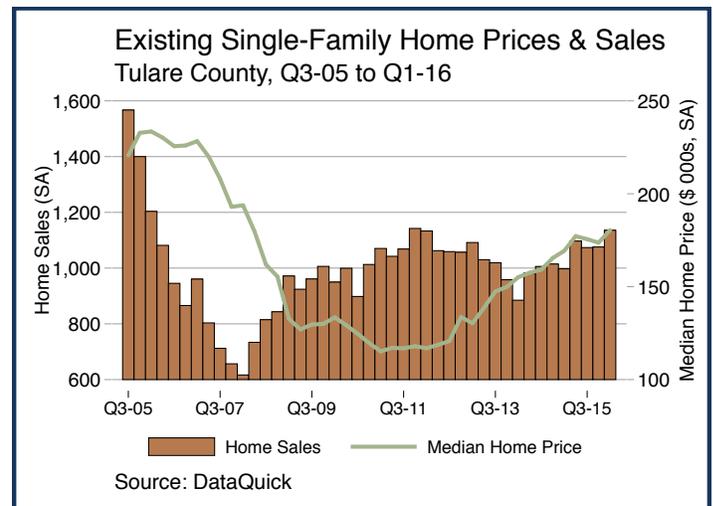
However, it appears that more solar projects are underway in Tulare County. There are six solar projects underway in the county at the moment. The current projects will provide a healthy source of revenue once they are completed and also a substantial amount of revenue for the county while construction commences.<sup>2</sup>

<sup>2</sup> "Ducor solar projects under construction." The Porterville Recorder. May 30, 2016.

In Tulare County, as in the rest of the state, low gas prices led to a significant drop-off in Fuel and Service Stations spending. From the fourth quarter of 2014 to the fourth quarter of 2015, taxable receipts in that category fell 20.1%. While low gasoline prices can negatively impact Fuel and Service Stations spending, the savings to consumers helps drive spending in other categories, offsetting the decline in taxable receipts associated with gasoline. Is the consumer better off as a result of lower gas prices? From the fourth quarter of 2014 to the fourth quarter of 2015, consumer consumption expenditures were up, with nice spending gains in Autos and Transportation (8.6%), Restaurants and Hotels (6.5%), Food and Drugs (4.4%), and General Consumer Goods (3.9%). The combination of lower fuel prices, low interest rates, improved labor market conditions, and rising wages all helped drive consumption in Tulare County.

**Residential Real Estate**

Home prices across California continue to rise, and Tulare County is no exception. From the first quarter of 2015 to the first quarter of 2016, the median price for an existing single-family home in the County increased 6.6%; sales have continued to pick up as well. Home prices still remain far below their pre-recession levels, however. The median price for a single-family home was more than \$233,000 ten years ago and is just above \$180,000 today. But with the level of defaults and foreclosures stabilizing, the health of the County's housing market is improving. Recently, after three years of planning, the Tulare County Association of Realtors and the Orange Belt Board of Realtors, both based in Tulare County, are merging. This will allow realtors to better serve clients in the area



The rental market in Tulare County has gained momentum in the last couple of quarters. From the first quarter of 2015 to the first quarter of 2016, the average apartment rent increased 3.9%, the largest increase observed in years. While higher rents indicate a growing market, they also producer a higher burden on future and existing occupants. The City of Exeter is currently developing a parcel of land that will be the site of 25 low-income apartments. The resulting increase in supply will partially offset demand-based growth in rents, while the construction activity will help bring much needed building activity to the small town.

## Commercial Real Estate

Tulare County's commercial real estate sector appears to be a mixed bag heading into the second half of 2016. There are a number of business closures scheduled to happen in the future, however, there are also a number of projects in the works. Moreover, for the last two years retail rents in Tulare County have continued to climb higher, and more and more tenants continue to occupy the County's vacant real estate.

### *The Good News:*

- GreenPower Motor Company finalized its purchase of 9.3 acres of land near the Porterville Airport. The company is building its first United States assembly plant and will employ approximately 400 workers, but that number could grow.<sup>3</sup> Construction of the plant is expected to take four to five months, with the first electric-powered bus rolling off the assembly line early next year.

- The City of Visalia a competing finalist to attract a big prize: a Nordstrom distribution center.<sup>4</sup> The distribution center will generate as many as 1,875 jobs over the long run and give the city and surrounding region an economic boost. Locating out of state was a potential option. However, the California Competes Tax Credit Committee approved an \$11 million dollar tax credit to Nordstrom if the company decides to locate its new distribution center in California. Nordstrom officials have yet to announce an official decision.

<sup>3</sup>. "GreenPower Finalizes Local Land Purchase." The Porterville Recorder. May 28, 2016.

<sup>4</sup>. "Nordstrom Close to Decision." Valley Voice. April 16, 2016.

- The California Employment Development Department recently awarded Tulare County a \$950,000 grant to retain 474 laid-off employees, including 164 workers who lost their jobs at Odwalla Inc.<sup>5</sup> These funds will prepare jobs seekers for work by providing them with on-the-job and vocational training.

- There are a number of potential retail shops that could open up new development in Tulare County including Valero (3,000 square feet), Bueno Beverage (22,000 square feet), Azkara Clothing (2,741 square feet), and a Dollar General Store (9,100 square feet).<sup>6</sup>

### *The Bad News:*

- Kmart has announced plans to close 68 stores this summer, including stores in Tulare and Dinuba.<sup>7</sup>

- The Odwalla juice plant in Dinuba plans to lay off a total of 164 employees by this summer. The layoffs include a broad mix of different job types – from blend masters and machine operators to warehouse shipping clerks and forklift operators.<sup>8</sup>

- American Medical Response, the largest ambulance company in the country, is ending its operations in Tulare County in August. The company currently employs 71 people in the area.<sup>9</sup>

How will commercial real estate in Tulare County fare for the rest of 2016? A number of factors determine how things will play out. For now, the County's commercial markets appear to be moving along smoothly with some minor bumps in the road. Businesses come and go, but what is important is replacing vacancies. As unemployment falls and consumers continue to spend, businesses will find increasing value in Tulare County's retail landscape.

<sup>5</sup>. "Retraining funds to help laid-off Odwalla workers." The Fresno Bee. May 26, 2016.

<sup>6</sup>. "Forever 21 closes, Tulare gets new seafood restaurant. Visalia Times-Delta. March 10, 2016.

<sup>7</sup>. "Tulare, Dinuba Kmart's closing." Visalia Times-Delta. April 21, 2016.

<sup>8</sup>. "164 workers to be laid off as Odwalla closes Dinuba plant." The Fresno Bee. February 16, 2016.

<sup>9</sup>. "Tulare County losing ambulance company." Visalia Times-Delta. May 21, 2016.

## 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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