

# REGIONAL INTELLIGENCE REPORT



BEACONECONOMICS Prepared by Beacon Economics, LLC



## City of San Bernardino EDA

Ninth Edition

December 2011

## Things Are Looking Up—But Challenges Remain

On September 30th the Economic Cycle Research Institute (ECRI) announced that the U.S. economy had “officially” entered a new recession.<sup>1</sup> This call had two interesting features to it. First, the ECRI does not date recessions. Rather the National Bureau of Economic Research took that task upon itself decades ago. So for the ECRI to call it “official” seems presumptuous. Secondly, they are wrong, as the data simply does not support such a call.

Despite ECRI’s declaration, other negative reports, the grim prognoses of the TV pundits, and the stock market volatility, the U.S. economy is not, we repeat, not, falling back into another recession. Yes—the U.S. economy slowed sharply in the first half of the year, but slowing growth is not the same thing as a recessionary contraction. For the economy to shrink there needs to be a significant and sustained negative shock to the system. While there have been a number of mild ones—some of which have contributed significantly to the slowing of the economy in the first half of the year—these have all been reversed, and as such we expect growth to pick up in the second half of the year and into 2012.

There is plenty of data to support this view:

- Consumer spending was back in positive territory in July and August.
- Auto sales and overall levels of retail spending were very solid in September.
- Industrial production and durable goods orders have also showed signs of growth over the past few weeks.
- Private sector employment continues to expand as the nation adds jobs, albeit at a very weak pace (the U.S. added nearly 150,000 jobs in September, and the previous two months also saw upward revisions).
- Incomes are growing, despite all the turmoil in recent months, and the number of job openings continues its slow climb.

- Exports are growing as well, fueled by strong fundamentals in Asia, Canada, and Mexico.
- Housing prices have stabilized, and population growth will surely help to chip away at the problem of excess supply.

This is not to say that the markets will quickly regain lost ground. Much of the decline in equity values reflects the simple fact that the recovery of the financial market was far too aggressive given the slow pace of economic recovery.

While we are optimistic in the short term, we also acknowledge that there are substantial problems the nation will eventually have to address. As noted in the “Key Findings” section above, the U.S. economy is still far behind where it should be at this stage in the business cycle, explaining much of the weakness in the labor markets. Yet even as the economy starts to close the gap, there are issues that give us pause regarding how fast the recovery can occur.

Some of these issues are still left over from the massive imbalances that pushed the U.S. economy into the recession in the first place. But most stem directly from the massive government intervention in the economy that pulled us out of the downturn. In some cases, these policies prevented the U.S. economy from getting back on a normal footing—that is, they were good for supporting the economy in the short run, but they ultimately left some of the painful but necessary readjustments to be dealt with in the future. In other cases, the problems are the direct results of these programs—namely, the Federal budget deficit and loose money policies by the Federal Reserve.

We think that the U.S. economy will ultimately overcome these challenges and will make up some of the lost ground of the last few years. But clearly the road is going to be bumpy.

<sup>1</sup> “U.S. Cyclical Outlook: September 21, 2011,” Economic Cycle Research Institute. Note: this report was posted on the ECRI website. [www.businesscycle.com](http://www.businesscycle.com), on September 30, 2011.

## Skills Mismatch Affecting California's Jobs Recovery

Although we believe that fears of a double dip have been largely overblown in the media and that there are reasons to be cautiously optimistic about a sustained recovery, there are nonetheless several factors preventing California from experiencing faster growth. The most serious problem is the skills mismatch in the labor market. To be more specific, there is a real dichotomy between the skill sets of the workers in those sectors that were pummeled by the downturn and the skill sets required by the sectors that are leading California out of the recovery. On a proportional basis, construction, real estate, and retail trade were among the hardest-hit sectors in the region in terms of job losses. These sectors traditionally have low education requirements and pay relatively low wages, which are two of the predominant characteristics of our unemployed population.

The Annual Social and Economic Supplement to the Current Population Survey (CPS) allows us to examine the characteristics of the employed and unemployed populations in California. Given that the consumer-oriented and housing-oriented sectors suffered the most during the recession, it is no surprise to see that these sectors are exhibiting the highest unemployment rates in the state, while the sectors that have been performing relatively well have maintained much lower levels of unemployment. According to the 2010 statistics, the unemployment rates for construction, wholesale and retail trade, and the household sector (other services) are showing unemployment rates ranging from 14% to nearly 18%, which are much higher figures than the statewide average for all sectors. On the other hand, education, and professional and business services are far below the state average, with unemployment rates in the single digits. If we want to plan for future growth, it is important to realize that the sectors with high rates of unemployment account for more than one-third of all the unemployed workers in California. Getting these folks back to work is a big part of bringing down California's unemployment rate—though this is much easier said than done.

In addition to letting us pull out unemployment statistics by industry, the CPS also allows us to look at unemployment by education level, which highlights some important challenges that our state will face going forward. The most recent data for 2010 shows that Californians with the lowest levels of educational attainment are being disproportionately affected by the downturn, while the most highly educated residents are maintaining "normal" levels of unemployment. More than

17% of all adults over the age of 25 who have less than a high school diploma were unemployed last year, compared with roughly 5% of all Californians with a graduate or professional degree. Not only do the less educated suffer from higher rates of unemployment, but they are a much larger group than Californians with graduate degrees. Residents without a college degree constitute more than 75% of the unemployed.

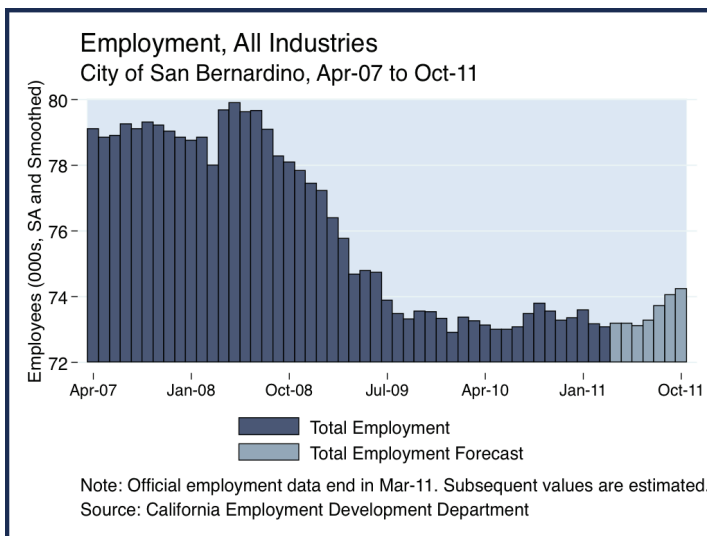
This represents a serious issue for both the short-term prospects and the long-run growth of California's economy. Earlier, we discussed some of the bright spots in the state's recovery, from trade in high-tech goods and intellectual property to new developments in biotechnology and software. California is indeed adding jobs: more than 225,000 since late 2010; but almost half of these jobs have been in the professional and business services or education and health industries. It is very difficult to take advantage of growth in these sectors without a college degree. It's true that some of the jobs in administrative support and in education and health care do provide some jobs for those on the lower end of the educational-attainment scale, but these industries are dominated by jobs that require some postsecondary training.

Of course, policymakers cannot wave a magic wand and grant every Californian a college degree. But that does not mean that we should ignore the skills mismatch that is currently bogging down the state's recovery and jeopardizing the long-run growth in sectors that, up to now, have been the centerpiece of California's "new economy." The current budget woes certainly do not make things any easier, but these simple statistics would suggest that we need more focus on education, not less.

This means requiring better quality results from our K-12 system, which will require investments at a time when K-12 spending is on the chopping block. California needs to expand enrollments and provide more assistance to lower-income students. Our community college system can play a critical role—especially over the short-run—in providing professional development opportunities in certificate or other training and retooling programs that would allow students to take advantage of the jobs that are in demand. Of course, this will require new resources to be effective, but the costs of failing to make higher education available for California residents will be even more expensive in the long run if the state doesn't take steps to address these challenges today.

## Labor Market Growth

Total employment continues to improve in the City of San Bernardino, though at a slow pace. The growth in employment that occurred at the end of 2010 took a slight dip in the beginning of 2011, but subsequently recovered, and we should see a slow upward trend through the rest of the year. Based on the total nonfarm employment growth we have seen in the Inland Empire as of October 2011, we predict that employment numbers for San Bernardino will steadily rise. As in the region and the state, one of the reasons that employment growth remains slow is that there continues to be a skill mismatch in the labor market.

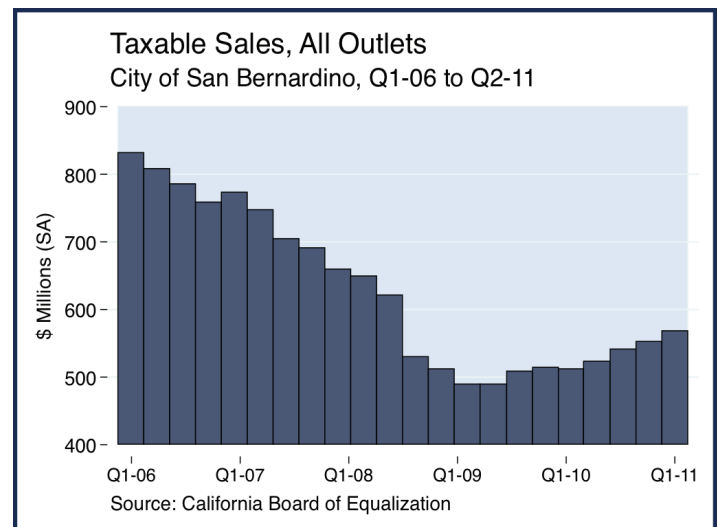


Given the current skills mismatch between job seekers and available employment, it is not surprising that educational attainment levels for the City of San Bernardino, as well as for Inland Southern California, have been low. With over 35% of the population over the age of 25 not having a high school diploma, job recovery will remain slow in San Bernardino. But there has been recent evidence of improvement in educating the area's residents. Technical Employment Training Inc., a nonprofit company started by the president of a local engineering firm, trains adults, many of whom are high school dropouts, parolees, and displaced workers, to be machinists. This program has found employment for 74% of its graduates. In addition, the Alliance for Education of San Bernardino County is working to increase education in mathematics and science in the county, aiming to get high school students more interested in science and technology.<sup>1</sup>

## Consumer Spending Rebound

Since reaching its lowest point in 2009, taxable sales have continued their general upward trend for the second quarter of 2011, up 3% from last quarter and up by over 16% since reaching the trough. Although the level of taxable sales per capita in the City of San Bernardino (\$2,429) was lower than in the region (\$2,797), in the second quarter of 2011 year-over-year growth for San Bernardino (10.4%) was among the highest in the Inland Empire.

Taxable sales have also been trending upward in the Inland Empire—sales reached their lowest levels back in 2009. With income levels rising and with strong population growth, taxable sales have continued to show positive growth in the region. Prior to the recession, the Inland Empire was one of the fastest-growing areas in California—the relative affordability of housing led to increased migration from the coastal regions of California. Since 2000, Riverside and San Bernardino counties have had the two highest population growth rates among California counties, averaging 3.4% and 1.7% a year, respectively. With the housing and labor markets starting to turn around, taxable sales have been buoyed by the naturally increasing population and the influx of those moving inland from the coast to seek cheaper housing.



cont'd, page 4

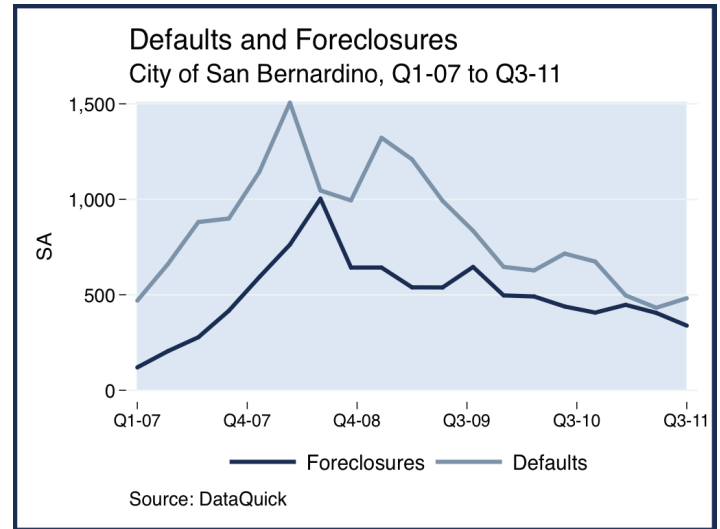
<sup>1</sup>Janet Zimmerman, "Battle on to Increase Graduation, College-Going Rates," The Press-Enterprise, October 30, 2011.

A new boost to the local business environment has come from the recent buyout of a fruit juice company. Evolution Fresh Inc. is a producer of premium fruit juices based in San Bernardino. In recent years, the firm secured several rounds of venture capital investment. Fireman Capital Partners, a consumer-focused buyout and growth equity firm, first invested in Evolution Fresh in May 2010.<sup>2</sup> Since then, Evolution Fresh was bought by Starbucks Corporation on November 10, 2011, for \$30 million.<sup>3</sup> Evolution Fresh Inc. has produced 100% natural juices that have been sold in grocery stores across the western United States. This injection of new investment and activity is certainly welcome news in a city and region that is still trying to get back on its feet in the wake of the Great Recession.

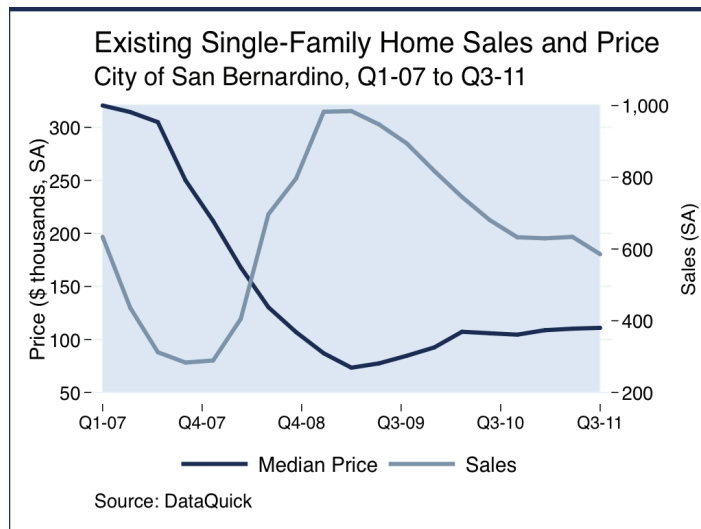
2010 due to government-injected programs. Though home sales are down, the affordability of the region relative to areas such as Los Angeles or Orange County has increased relative to the demand for homes in the region, which may place some upward pressure on prices moving forward.

## Housing Market

The latest quarter of data shows that while median prices for single-family homes have begun to stabilize over the past few quarters, with a slight increase in the third quarter of 2011, sales have decreased by 8% in the third quarter, the largest quarter-to-quarter decline in a year. This downward trend can be partially explained by the decrease in foreclosures. As the number of foreclosures has continued to fall, the number of sales has followed a similar trend, with fewer relatively inexpensive distressed properties available on the market. Sales have been generally declining since 2008, with the exception of a brief and slight shift upward in



As in the state, the metropolitan statistical area, and the county, defaults for the City of San Bernardino have risen slightly while foreclosures have fallen in the third quarter of 2011. The number of foreclosures has declined quarter-to-quarter for the previous three quarters, with the third quarter of 2011 showing 337 foreclosures, the fewest since 2007. Defaults have followed a downward trend since the third quarter of 2010. The year-to-date number of defaults for San Bernardino this year, at 1,411, is the fewest number of defaults in the City of San Bernardino since before the recession began in 2006. There is, however, a modest increase in defaults in the most recent data. This recent uptick in defaults may be attributed to the end of investigations of improper foreclosure procedures by certain banks. With the investigation into the “robo-signing” scandal complete, banks are now able to restart the foreclosure processes that were put on hold while the inquiry was being conducted. Although defaults rose slightly last quarter, Beacon Economics expects foreclosures will continue trending downward, though the city is by no means out of the woods. The general health of the housing market is improving, however, and a temporary increase in defaults or foreclosures during a single quarter is not indicative of another housing crisis.



<sup>2</sup> Lisa van der Pool, “Starbucks Buys Juice Co. Evolution Fresh from Fireman Capital,” Boston Business Journal, November 10, 2011.

<sup>3</sup> Julie Jargon, “Latest Starbucks Concoction: Juice,” The Wall Street Journal, November 11, 2011.

## Trends in Construction

Unlike the permit numbers for many other cities across the state, new single-family building permits in San Bernardino have risen from last year. The 19 single-family building permits that have been issued year-to-date in 2011 have already exceeded the number issued in all of 2009 and 2010 combined. Even though the levels are much lower than the peak levels reached in 2005, any new construction in the Inland Empire is a welcome change given the fact that a substantial portion of the region's unemployed hail from that sector. However, those peak levels reached before the housing bubble burst were unsustainable in the long run, and are not goals that San Bernardino should be aspiring to reach over the near term. Due to the heavy reliance on construction in the region, San Bernardino's economy took a big hit, and new building construction was relatively non-existent. The jump in single-family building permits is a good sign that the economy is beginning to turn around, but given the overall health of the economy and the inventory of foreclosed and distressed properties, we expect this trend to move slowly.

On the nonresidential side of construction, there has also been growth in total nonresidential permits in the city, as the year-to-date value for permits for 2011 has exceeded that of 2010 year-to-date, as well as exceeding the total value for all of 2009. The Inland Empire has experienced similar growth over the same time frame, while the county, after seeing permit values fall from 2009 to 2010, has seen the value rebound in 2011 to exceed the total value for all of 2010. Total nonresidential permit values for San Bernardino for 2011 thus far have climbed to \$33 million, while the 2010 year-to-date value was \$25 million, and the 2009 value was \$30 million.

City of San Bernardino Building Permits			
Type of Permit	2009	2010 YTD	2011 YTD
Single-Family	11	4	19
Multi-Family	165	0	0
Total Non-Residential (\$ mill.)	30.4	24.9	33

Source: Construction Industry Research Board

This growth in the total value of nonresidential permits was aided by the growth in nonresidential alterations. Alterations have contributed approximately \$30 million to the 2011 year-to-date total of all nonresidential permit values, which is the highest value for these types of permits we have seen on record for San Bernardino. As the economy begins to rebound from the recession, alterations and additions that were previously put off due to slowed business activity are now starting up again. With such a significant portion of the total value coming from alterations, it's clear that there is not much leftover to represent other types of nonresidential construction. Specifically, retail, office, and industrial permits have been at zero for the past three years. However, as the economy continues down the path of economic recovery, and as the labor markets continue to expand, Beacon Economics expects that construction of new nonresidential structures, including office and retail space, will start to pick up in 2012 and beyond.



**BEACON**ECONOMICS

## About Beacon Economics

Beacon Economics, LLC is an independent economic research and consulting firm located in Los Angeles. We deliver economic analysis that help our clients make informed, strategic decisions about investment, growth, revenue, policy, and other critical economic and financial issues. Our core areas of expertise include economic and revenue forecasting, market and industry analysis, economic impact studies, economic policy analysis, and international trade analysis.

For more information go to [www.BeaconEcon.com](http://www.BeaconEcon.com)

Office: 310-571-3399



**Economic Development Agency**

201 N. E Street, Suite 301 • San Bernardino, CA 92401 • USA • 909-663-1044 • Email: [info@sbrda.org](mailto:info@sbrda.org) • [www.sbrda.org](http://www.sbrda.org)

Analysis. Answers.