Mid-Year 2016

UPDATE

sacramento BUSINESS REVIEW

Emerging Trends in Sacramento's Economy

Volume 8 Issue 2 » sacbusinessreview.com

2016 Mid-Year Update

Your Best Guide to Sacramento's Economy

Labor Market Forecast » Real Estate » Banking Industry » Small Business » Capital Markets » NEW! Human Resources/Leadership

SAVE THE DATE

2017 Economic Forecast

January 17, 2017 **» 3:00 – 5:00 p.m.**

Sacramento State, University Union Ballroom

Hosted bar, refreshments, and networking from 5:00 – 7:00 p.m.

Keynote Speaker

John C. Williams,

President and CEO,

Federal Reserve Bank of San Francisco

Mid-Year 2016

Message from the Chief Economist

Dear Friends,

I am pleased to share the 16th edition of the *Sacramento Business Review* – the most comprehensive, precise, and intellectually sophisticated analysis of the regional economy. For eight years, our team has provided thoughtful predictions that have accurately forecast the economic and business climate. With 15 of Sacramento's very best financial analysts and researchers combining their skills and talent, the *Sacramento Business Review* (SBR) is now the most credible source of independent thinking, insights, and research on our economy in the region.

We are pleased to announce that **John Williams** (President of the Federal Reserve Bank of San Francisco) will be our keynote speaker when we release our 2017 market forecasts on January 17, 2017. At that event, we also plan to unveil our new **HR Barometer**, and our new **Consumer Confidence Index**.

While California led the entire nation as well as the Western region in job growth and outperformed most other states in the country, the greater Sacramento region has lagged both the nation and the state. As predicted, we are seeing a modest, yet lackluster, 2016 with stabilizing employment in the face of a deteriorating job mix. Some bright spots in the economy are the construction, health care, and professional services sectors. Our comprehensive **Financial Conditions Index** suggests continued improvements to our economic health, even though our region's economic success pales in comparison to what is happening in the Bay Area.

All real estate property types in commercial real estate have strengthened due to supply being limited, rents and demand rising, and vacancy rates dropping. Residential real estate similarly experienced appreciation in median valuation and improved sales, including new home sales. We predicted and continue to see more consolidation in the banking industry. Both loan growth and net interest margin have improved for local banks and credit unions. Small Business Administration lending in the region increased significantly. However, our **Small Business Confidence Index** declined significantly across the board due to increasing pessimism resulting from global headwinds, election-year anxiety, and a cloudy outlook for both the economic/political backdrop and regulatory climate.

I am both pleased and grateful for your overwhelmingly positive response to the publication, as you have embraced it and used it as your regional guide. Last year, we made countless presentations of our work to the community, and I received hundreds of emails and phone calls complimenting the work. I want you to know that our analysts do this work entirely as a public service to the region.

We are committed to delivering the very best economic and financial research to the region. I invite your feedback. Please do not hesitate to let me know how we may improve future issues or if you wish to be a supporting sponsor. To download your free copy, please visit ***sacbusinessreview.com***.

Warm regards,

Sanjay Varshney

Sanjay Varshney, PhD, CFA

Chief Economist, SBR » Professor of Finance, California State University, Sacramento »
Vice President/Investment Strategy Specialist for California/Nevada, Wells Fargo Private Bank – Wealth Management Group » **(916) 799-6527** » ***sbvarshney@yahoo.com*** » ***sacbusinessreview.com***

sacramento BUSINESS REVIEW

sacbusinessreview.com

MISSION

To educate consumers on the economic and financial health of the Sacramento region.

LABOR MARKET FORECAST

REAL ESTATE

BANKING INDUSTRY

SMALL BUSINESS

CAPITAL MARKETS

NEW! HUMAN RESOURCES/ LEADERSHIP

Follow us on twitter

https://twitter.com/SacReview

@SacReview

CONTACT

Sanjay Varshney, PhD, CFA, Chief Economist,
Sacramento Business Review

(916) 799-6527 » ***sbvarshney@yahoo.com***

sacbusinessreview.com

EDITORS

Jason Bell, CFA
Jonathan E. Lederer, CFA
Sanjay Varshney, PhD, CFA

GRAPHIC DESIGN

Carrie Dennis Design

PHOTOGRAPHY

Dee and Kris Photography
istockphoto.com
Sacramento Kings / Sara Molina

PROOFREADING

JMT Communications Management

Contents

- The Western U.S. region has outperformed the rest of the nation in the labor market recovery.
- California has led the Western region in job growth and reduction in the unemployment rate.
- Despite these recent gains, job and wage growth in the Sacramento region has lagged growth in most other California regions over the past three to five years due to industry mix.
- We expect the Sacramento region unemployment rate to stabilize in the 6% range, with primary sources of job growth coming from the construction, health care and professional services industries.

- Commercial real estate across all property types in Sacramento remains strong.
  - Vacancy continues to drop among all property types.
  - New construction generally remains limited except for build-to-suit projects and key retail and multifamily projects. Development fees remain an obstacle to making projects viable.
  - Generally there has been substantial rent growth across all property types in Class A product over the past two years, while the rental growth of class B and C properties has been more modest.
  - There are limited investment properties available in the marketplace.
  - Sacramento has the highest rate of multifamily rent growth in the country.
- The median house price in the Sacramento region rose 9% year-over-year to $320,000.
- Sales of all homes increased by only 5.4% in the first two quarters of 2016.
- New homes represented 12% of all home sales in 2016, up from 10.5% in the first two quarters of 2015.

- Through the first six months of 2016, loan volumes in the Sacramento region[1] have increased at a 15.3% annualized rate, exceeding the SBR banking team's 10-12% annual growth projection.
- Loans at the Sacramento Credit Unions[2] have risen 19.3% (annualized) through June 30. This strong performance has been "driven" by auto loans, which increased at a 25% annualized rate.
- Loan volumes at the Sacramento Region Banks[3] have been in line with the team's forecast, rising 11.3% (annualized) during the first half of the year. Solid commercial real estate and multifamily loan growth was dragged by the residential category, which was virtually unchanged.
- Net interest margins[4] are at risk of further compression given the sizable flattening of the yield curve[5] since January.
- The team's longtime merger-and-acquisition (M&A) prediction came to fruition yet again in April, when Sierra Vista Bank (Folsom) announced it would be acquired by Central Valley Community Bancorp (Fresno).

- Total SBA lending in the Sacramento MSA increased an impressive 35% to fuel more credit to the small business sector.
- Consistent with national trends, the Small Business Confidence Index declined significantly, indicating increasing pessimism regarding future revenues and local supportiveness with sluggish growth in the economy.
- Small business sales activities have significantly cooled off with declining listings, sales prices, and revenues for businesses sold. This is consistent with data from the National Federation of Independent Business, given the macro conditions and uncertainty in the economy and markets.
- A cloudy political outlook in an election year with major uncertainties surrounding the regulatory, tax, and health care environments will pressure the small business economy in the coming months.

- For the first time, the January 2016 Sacramento Business Review (SBR) reported on Sacramento's Human Resources practices.
- Next year's SBR report will include an HR index that can be tracked year-over-year for our region.
- The index will include assessment of numerous talent management factors, including compensation levels, recruitment, turnover, and diversity.

- Voter remorse seemed widespread on June 24th as financial markets exhibited some of the worst trading day returns for the year following the June 23 British referendum to leave or remain in the European Union. It is still too early to grasp the overall impact on world economies, but the vote did little to help promote confidence for a global economy struggling to promote growth and hold the line on disinflation.
- Although U.S. stock markets appear to be making new highs daily, mutual fund flows show investors continue to seek the safety of bonds even in the low rate environment.
- The SBR team believes the Fed is looking to hike its rate one time before year-end as long as the trend of strong job growth and steady wages continues for the remainder of 2016.
- Our proprietary financial conditions index suggests that the local economy continued to expand through the end of 2015 and into the beginning of 2016.

1 We have defined the Sacramento region as El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba counties.
2 The Sacramento Credit Unions are The Golden 1, SAFE Credit Union, Schools Financial Credit Union, Sierra Central Credit Union, Sacramento Credit Union, First U.S. Community Credit Union, and Heritage Community Foundation.
3 The Sacramento Region Banks are American River Bank, Community 1st Bank, Community Business Bank, El Dorado Savings Bank, Farmers & Merchants Bank, First Northern Bank, Five Star Bank, Folsom Lake Bank, Gold Country Bank, Merchants Bank of Sacramento, Redding Bank of Commerce, River City Bank, River Valley Community Bank, Sierra Vista Bank, and Tri Counties Bank.
4 The net interest margin is the difference between a bank's interest income and interest expense, measured as a percentage of its average earning assets.
5 The yield curve mentioned in this section refers to the chart of U.S. Treasury yields from the shortest-maturity issues to the longest-maturity ones.

Authors

Chase Armer, CFA

Chase Armer is a co-owner of Planned Solutions, Inc., a Sacramento-based financial planning and investment advisory firm, where he currently acts as a financial planner and is a member of the Planned Solutions Investment Management Committee. Chase holds several professional designations including Certified Financial Planner Practitioner, Chartered Financial Analyst, and Enrolled Agent. Chase has a degree in economics from California State University, Sacramento, a master's in taxation from William Howard Taft University, and a certificate in personal financial planning from UC Davis Extension. Chase is a past president of the Financial Planning Association of Northern California and currently teaches the Fundamentals of Personal Finance and Investments classes at UC Davis Extension.

Seung Bach, PhD

Seung Bach is Professor of Entrepreneurship and Strategic Management in the College of Business Administration, and he currently serves as the faculty director of the Center for Entrepreneurship at California State University, Sacramento. He earned his PhD in business administration at the University of Tennessee, Knoxville, and his MBA at the George Washington University, Washington, D.C. His expertise is in the areas of new venture creation, small business management, entrepreneurial transitions, innovation and corporate entrepreneurship, and global management and strategy.

Jessica Bagger, PhD

Jessica Bagger is a Management Professor at California State University, Sacramento, and Associated Faculty at the University of Gothenburg in Sweden. She received her PhD in management at the University of Arizona. Jessica's scientific research relates to factors impacting employee well-being and performance, including HR systems, leadership, and organizational culture.

Jason Bell, CFA

Jason Bell is a Senior Vice President and Senior Investment Strategist for Wells Fargo Private Bank, where he manages funds for a select group of clients. He is a member of Wells Fargo's Global Strategies team and previously led the bank's Domestic Equity Sector Strategy team. During the past several years, Jason has served as a senior volunteer leader and advisor to the Board at CFA Institute. He holds the Chartered Financial Analyst designation and a business degree from the University of the Pacific, as well as an MBA from the University of California, Davis.

Matt Cologna

Matt Cologna graduated with a degree in Business from California State University, Sacramento, and has been active in commercial real estate for the past 20 years in Sacramento. His experience includes owner/user and investment sales, logistics, landlord and tenant representation, land assemblage, build to suits, and developer relations. He has represented clients on a local, regional, and national basis. He is involved with the Cushman & Wakefield Global Supply Chain Solutions Group offering additional insight into current and future needs of occupiers in the market. Matt has completed over 12 million square feet of deals with a value exceeding $411 million.

Authors

Nuriddin Ikromov, PhD
Nuriddin Ikromov is an Associate Professor in the College of Business Administration at California State University, Sacramento. He received his PhD in real estate finance from the Pennsylvania State University. Nuriddin's research interests include real estate market efficiency, experimental economics, and valuation.

Jessica Kriegel, EdD
Jessica Kriegel works as an Organizational Development Consultant for Oracle Corporation, where she acts as an adviser and strategist in matters of organizational development, change management and talent development. She is also a Partner at OE Consulting Group an organization development consulting firm. In 2013 she completed her doctoral degree in Educational Leadership and Management with a specialization in Human Resources Development from Drexel University. Jessica also recently joined Fulcrum Property as its Chief Revenue Officer.

Jonathan E. Lederer, CFA
Jonathan Lederer is a Vice President and Senior Investment Strategist for Wells Fargo Private Bank. He graduated with his MBA from the University of Michigan's Ross School of Business and received his BA from the University of California, Berkeley. Jonathan has held the Chartered Financial Analyst designation since 2003 and is currently President of the CFA Society Sacramento.

Brian M. Leu, CFA, CAIA
Brian Leu is the Head of Trading in the Execution Services and Strategy (ESS) group at CalPERS, overseeing the trading activities of the internally managed equity and derivatives portfolio. Prior to joining CalPERS, he worked at DCA Capital Partners supporting the firm's private equity investments and investment banking business. Previously, Brian worked in the Equities division at Deutsche Bank Securities and at a long-short equity hedge fund in NYC. Brian earned his MBA from the New York University Stern School of Business and an economics degree from Duke University and also holds the Chartered Financial Analyst and the Chartered Alternative Investment Analyst designations. He is also a past president of the CFA Society Sacramento.

Hao Lin, PhD, CFA
Hao Lin is an Associate Professor of Finance in the College of Business Administration at California State University, Sacramento. He has a PhD in finance and MS in financial mathematics, both from the University of Warwick in England. His expertise is in the areas of financial markets and market microstructure. Hao holds the Chartered Financial Analyst designation and serves on the Board of Directors of the CFA Society Sacramento.

Authors

Lan Liu, PhD, CFA

Lan Liu is an Associate Professor of Finance in the College of Business Administration at California State University, Sacramento. She received both her PhD in finance and MSc in economics and finance from the University of Warwick in England. Her research focuses on portfolio risk management, forecasting, and performance measurement. Lan holds the Chartered Financial Analyst designation and is the Treasurer of the CFA Society Sacramento.

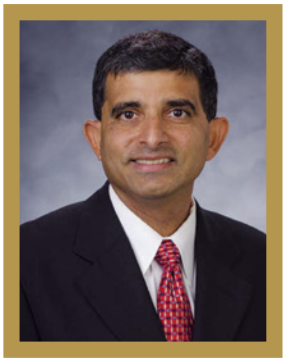
Joe Niehaus, CFA

Joe Niehaus is an Investment Manager for Golden 1 Credit Union. Joe has worked as a bank examiner for both the public and private sectors, and he also served five years as an Electronic Intelligence Analyst with the U.S. Navy. Joe holds a BS in business administration from California State University, Sacramento, and an MBA from the University of Nebraska, Lincoln. He also holds the Chartered Financial Analyst designation and serves on the Board of Directors of the CFA Society Sacramento.

Yang Sun, PhD

Yang Sun is an Associate Professor of Supply Chain Management and Quantitative Methods in the College of Business Administration at California State University, Sacramento. In addition to his PhD in industrial engineering from Arizona State University, he has a Six-Sigma Black Belt. He also received an engineering degree from Tsinghua University in Beijing, China. He has research and teaching interests in the areas of global supply chain management, operations strategy, Lean and Six Sigma, managerial economics, operations research, and big data, and is a recipient of the university's Outstanding Scholarly and Creative Activities Award as well as Outstanding Teaching Award.

Sanjay Varshney, PhD, CFA



Sanjay Varshney is Professor of Finance at California State University, Sacramento, and Vice President/Investment Strategy Specialist for California and Nevada at Wells Fargo Private Bank – Wealth Management Group. He recently served as the Vice President for Economic and Regional Partnerships and Dean of the College of Business Administration at California State University, Sacramento, for 10 years. He earned an undergraduate degree in accounting and financial management from Bombay University, a master's degree in economics from the University of Cincinnati, and a PhD in finance from Louisiana State University. He also holds the Chartered Financial Analyst designation. Dr. Varshney serves as the Chief Economist for the *Sacramento Business Review*.

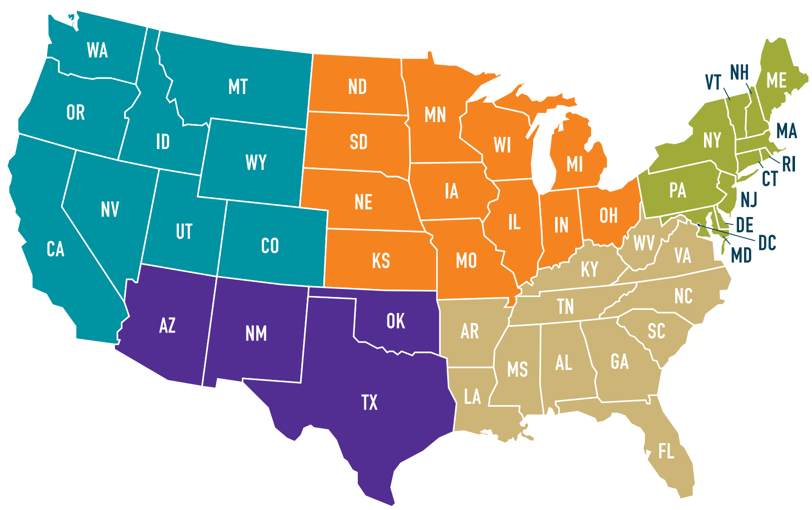
Anna V. Vygodina, PhD

Anna Vygodina is an Associate Professor of Finance in the College of Business Administration at California State University, Sacramento. She holds a PhD degree in finance from the University of Nebraska, Lincoln, and an MBA with economics minor from the University of Nebraska, Omaha. Anna's research interests are in exchange rates, speculative tensions, and heterogeneous expectations in the capital markets.

UPDATE

Sacramento's Labor Market & Regional Economy

2016 Mid-Year Update



U.S., Regional, and Local Labor Markets Show an Uneven Recovery

The aftermath of the Great Recession is now in its seventh year. However, this recovery has been uneven, with some counties, regions, and states coming out as winners while others have struggled to keep pace. Looking at the five major U.S. regions, it is clear that the Western region has benefited from the greatest growth in employment and the largest decrease in unemployment rates on a relative basis.

However, the recovery within the Western region has also been uneven. California, Idaho, Colorado, Utah, and Nevada have reported strong labor market results, while Washington, Oregon, Montana, and Hawaii have experienced more moderate job growth. The commodity-focused states of Wyoming and Alaska have reported further job declines over the same period.

Table 1
Change in Employment

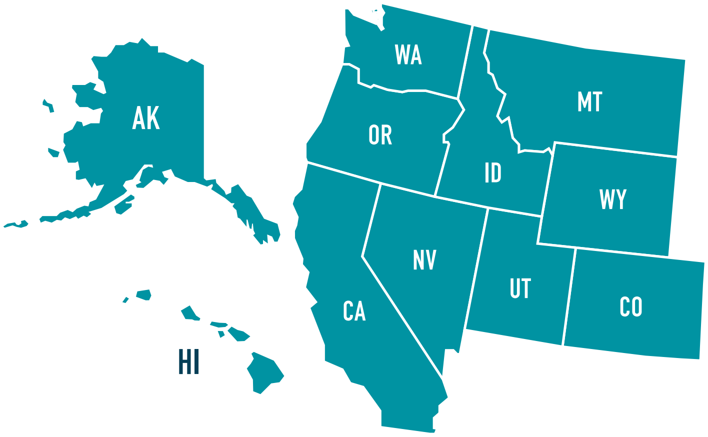
	Northeast	Southeast	Midwest	Southwest	West
1 Year	1.51%	2.27%	2.18%	2.22%	2.25%
3 Year	4.09%	4.95%	5.24%	5.78%	6.86%
5 Year	5.76%	7.61%	6.99%	10.07%	11.08%

Data Source: Economagic.com

Table 2
Change in Unemployment Rate

	Northeast	Southeast	Midwest	Southwest	West
1 Year	-0.49%	-0.59%	-0.06%	-0.07%	-0.82%
3 Year	-2.56%	-2.34%	-2.38%	-1.65%	-3.13%
5 Year	-3.28%	-4.34%	-3.64%	-3.18%	-5.53%

Data Source: Economagic.com



These trends, which favor the Western region in general and California in particular, should provide a tailwind to the Sacramento region.

Table 3
Change in Employment

	WA	OR	CA	ID	MT	WY	CO	UT	NV	AK	HI
1 Year	2.54%	6.05%	1.90%	2.32%	0.15%	-3.75%	3.38%	2.11%	1.67%	-1.46%	2.32%
3 Year	6.25%	11.42%	6.48%	7.97%	3.63%	-3.09%	8.43%	7.39%	7.90%	-1.25%	8.10%
5 Year	9.21%	8.30%	11.75%	11.69%	8.09%	-1.83%	12.43%	14.87%	13.33%	-0.61%	7.81%

Table 4
Change Unemployment Rate

	WA	OR	CA	ID	MT	WY	CO	UT	NV	AK	HI
1 Year	0.2%	-1.3%	-1.2%	-0.5%	0.1%	1.4%	-0.5%	0.2%	-0.7%	0.3%	-0.5%
3 Year	-1.2%	-3.5%	-3.8%	-2.6%	-1.2%	0.9%	-3.4%	-0.8%	-3.6%	-0.2%	-1.6%
5 Year	-3.5%	-4.9%	-6.5%	-4.8%	-2.9%	-0.2%	-4.9%	-3.1%	-7.1%	-0.9%	-3.5%

These trends, which favor the Western region in general and California in particular, should provide a tailwind to the Sacramento region. However, the Sacramento region continues to trail much of the rest of the state in job growth, even though it has reported better-than-average declines in unemployment.

Table 5
Change in Employment

Region	1 Year	3 Year	5 Year
SF Bay Area[4]	1.53%	7.79%	14.70%
Central Valley[6]	1.20%	5.22%	11.04%
So. CA & Inland Empire[8]	1.66%	6.51%	10.70%
Central Coast[5]	0.93%	5.30%	10.66%
Southern Border[9]	1.10%	4.73%	9.55%
Sacramento[1]	0.59%	4.62%	9.04%
North Central[3]	0.37%	3.74%	8.21%
Central Sierra[7]	0.91%	4.19%	3.59%
Northern[2]	-0.04%	2.55%	3.13%

Data Source (Tables 3, 4, and 5): Economagic.com

Table 6
Change in Unemployment Rate

Region	1 Year	3 Year	5 Year
North Central[3]	-0.62%	-4.26%	-7.89%
Central Sierra[7]	-0.85%	-4.03%	-7.00%
Central Valley[6]	-0.61%	-3.47%	-6.92%
Northern[2]	-0.71%	-3.76%	-6.85%
Sacramento[1]	-0.63%	-3.46%	-6.82%
So. CA & Inland Empire[8]	-1.42%	-3.97%	-6.53%
Southern Border[9]	-0.68%	-3.11%	-5.67%
SF Bay Area[4]	-0.46%	-2.73%	-5.61%
Central Coast[5]	-0.35%	-2.52%	-4.93%

1 Sacramento, Yolo, Sutter, Yoba, Placer, & El Dorado counties
2 Mendocino, Lake, Humboldt, Trinity, Del Norte, Siskiyou, Modoc, Lassen, Plumas, Sierra, and Nevada counties.
3 Shasta, Tehama, Glenn, Butte, and Colusa counties.
4 Sonoma, Napa, Solano, Marin, Contra Costa, Alameda, Santa Clara, San Benito, San Francisco, San Mateo, and Santa Cruz counties.
5 Monterrey, San Luis Obispo, and Santa Barbara counties.
6 San Joaquin, Stanislaus, Merced, Madera, Fresno, Kings, Tulare, and Kern counties.
7 Amador, Calaveras, Alpine, Tuolumne, Mariposa, Mono, and Inyo counties.
8 Ventura, Los Angeles, Orange, San Bernardino, and Riverside counties.
9 San Diego and Imperial counties.

Data Source (Tables 5 and 6): Economagic.com

Why is the Sacramento region lagging in employment growth? We believe it is due to the industry mix and their associated growth rates. Close to 80% of the local labor market is growing at a slower pace than the rest of the state or is entrenched in structurally low growth industries, while only 20% of the job market is growing faster than statewide averages. Lastly, sources of job growth in California, such as education and information services, have seen dramatic declines in the Sacramento region.

Wage growth in the region continues to lag in many of the industry groups as well, particularly in the higher wage sectors such as information, manufacturing, and professional services.

We expect the Sacramento Region's unemployment rate to continue to stabilize in the 5-6% range during the next six-month period. Our analyses suggest the forecasts for job growth in major local industry sectors shown in Table 9.

Table 7
Job Distribution and Growth Rates for California and the Sacramento Region

	Sacramento		California	
	% of Jobs	5yr Growth	% of Jobs	5yr Growth
Trade, Transportation & Utilities	15.63%	10.38%	18.05%	11.80%
Government	25.49%	3.53%	15.58%	3.68%
Professional & Business Services	12.93%	17.10%	15.57%	21.32%
Health Care	14.14%	20.70%	13.26%	17.87%
Leisure & Hospitality	10.29%	18.54%	11.56%	23.25%
Manufacturing	3.84%	8.81%	7.77%	2.23%
Finance	5.54%	10.49%	4.93%	6.65%
Construction	5.85%	50.55%	4.63%	37.21%
Other Services	3.44%	13.83%	3.39%	12.29%
Information Services	1.50%	-15.66%	3.01%	15.52%
Education	1.36%	-7.97%	2.27%	18.79%

Data Source: EDD

Table 8
Average Weekly Earnings and 5 Year Growth Rate for California and the Sacramento Region (Q3 2015)

	Sacramento		California	
	Earnings	5yr Growth	Earnings	5yr Growth
Information Services	$1,383	10.82%	$2,654	35.13%
Finance	$1,275	14.56%	$1,661	14.08%
Manufacturing	$1,218	-7.94%	$1,532	5.51%
Professional & Business Services	$1,157	0.69%	$1,474	13.04%
Government	$1,403	10.40%	$1,255	7.91%
Construction	$1,150	6.09%	$1,180	7.08%
Education & Health Care	$1,021	-9.96%	$913	-11.19%
Trade, Transportation & Utilities	$729	1.96%	$908	5.58%
Other Services	$783	38.83%	$695	33.40%
Leisure & Hospitality	$393	15.59%	$493	6.48%

Data Source: EDD

Table 9
Regional Industry Sectors Job Growth Outlook

Sector	% of Local Economy	Change over the Past 12 Months	Forecast for the Next 12 Months
Government	25.4%	+2.3%	Stable →
Health Care	13.9%	+3.7%	Moderate ↑
Professional & Business Services	13.0%	+3.3%	Moderate ↑
Retail	10.4%	+2.3%	Stable →
Leisure & Hospitality	10.4%	+2.2%	Stable →
Construction	5.9%	+11.2%	Moderate ↑
Financial Services	5.4%	+0.5%	Moderate ↓
Manufacturing	3.9%	+1.1%	Stable →
Education	1.3%	-0.8%	Stable →

Data Source: EDD

UPDATE

Real Estate Trends *in the* Sacramento Region

Golden 1 Center » Downtown Sacramento

photo credit: Sacramento Kings

Office

Office vacancies have tumbled 120 basis points since the second quarter of 2015, reaching 12.5%. Average asking rents across the Sacramento market have been rising as demand for office space continues to grow. Fueled by the low unemployment rate of 4.7% and lack of major new construction, overall net absorption reached 155,000 square feet. Class A office rents on average have climbed in the Central Business District, and the top "trophy" skyline buildings command rents from $2.25 to $3.50 per square foot, per month. With the new Golden 1 Center and Downtown Commons (DOCO) on track for a late 2016 debut, we can be expect a sharp increase in average asking rents among the top tier of Class A office buildings. Proximity to these new attractions, as well as proposed future revitalization projects in the Central Business District, will come at a premium but should prove to be worth it. Even with the positive absorption and reduced vacancy, office product is still lagging behind the recovery of other property types. Additionally, some of the larger blocks of space that remain in the market are older and do not meet all of the needs of today's office tenant. As such, the office marketplace has been seeing a good percentage of renewals.

Retail

Despite the news about Sports Authority and Sports Chalet filing for bankruptcy earlier this year, the overall net absorption across all shopping center types in the Sacramento market remains positive, although down 25% from this time last year. The vacancy rate dropped another 20 basis points, bringing our vacancy rate to 10.1% as of mid-year 2016. In newer Class A office product, the vacancy rate is closer to 5%. This paradigm has helped to drive Class A rents on newer centers to around $3.00 per square foot per month compared with the average rents across all retail properties of about $1.40 per square foot per month. While last year saw many new property deliveries, the lack of new buildings being delivered to the market this year is also helping to drive rents as vacancy continues to decrease. That said, look for several new projects to break ground or be delivered in the next year such as the long-awaited Delta Shores project in South Sacramento near the Pocket area. Activity in retail seems to transcend a variety of users looking in the market including discounters, fast casual restaurants, and fitness.

Industrial

For the Sacramento industrial market, the overall vacancy rate has dropped by 90 basis points since the second quarter of 2015, from 9.8% to 8.9%. The steadily declining vacancy paired with the low supply of quality larger spaces is aiding in the robust overall net absorption for the Sacramento market, which was almost 800,000 square feet in the second quarter of 2016. The past three quarters, in fact, have posted positive net absorption. The last notable deliveries in the Sacramento market were in the fourth quarter of 2015 and first quarter of 2016 at Southport Business Park (2951-2965 Thomas Place) in West Sacramento, with 328,740 square feet of Class A warehouse space completed. While no major new construction is currently underway, we will finally see construction in Metro Air Park in the Natomas area with the coming of a new Amazon fulfillment center. There are other projects also eying Metro Air Park, which will finally take flight after several decades of planning and false starts, including the flood moratorium. A continued decline in vacancy can be expected until developers can justify new speculative construction, which would require another 5-10% rent increase. Like other product types, the Class A product has seen larger rent increases while the older products have seen only more moderate increases to date.

Sales of all homes (condominiums, existing, and new homes) in the Sacramento MSA increased by only 5.4% in the first two quarters of 2016 compared with the same period in 2015. This compares unfavorably to the 15.6% increase from the second quarter of 2014 to the second quarter of 2015. Overall, 19,582 homes were sold in the first half of 2016, compared with 18,362 in the same period of 2015. Geographically, the largest increase in sales activity occurred in El Dorado County (13%), while the smallest increase was observed in Yolo County (2%).

Residential

The median sale price for all houses in the Sacramento region showed a moderate increase during the first half of 2016. The median sale price in June 2016 was $349,000, which is an approximately 7% increase from the fourth quarter of 2015 ($325,000) and 9% year-over-year ($320,000). This makes it the eighth consecutive quarter with single-digit year-over-year price increases, with an 8.4% average increase in the past two years. This is a far cry from the eight quarters of double-digit increases from the third quarter of 2012 to the second quarter of 2014, when house prices increased by an average of 24% year-over-year. However, four years of significant price appreciation has meant that the median house price is currently only 17% below its 2006 peak. The median price per square foot in the Sacramento metropolitan statistical area (MSA) for single-family residences increased by 10% year-over-year, to $202. Increases in price per square foot ranged from 11% in Sacramento County to 8% in Yolo County.

Lack of inventory, particularly of new homes, remains the primary reason for house price increases.

Lack of inventory, particularly of new homes, remains the primary reason for house price increases. Encouragingly, inventory of new homes and sales of new homes as a proportion of all sales continue to trend upward. Sales of new homes increased by 32% year-over-year, from 1,651 in the first half of 2015 to 2,185 in the same period this year. Further, new homes represented 12% of all sales in 2016, up from 10.5% in the first two quarters of 2015. However, it is worth noting that both new-home inventory and the proportion of new homes in sales both remain far below pre-housing crisis levels. For instance, almost 16,500 new homes were sold in 2005, which represented 28% of all home sales.

The modest rise in median house prices can be further explained by the continued decline in the distress sales and the slight increase in the proportion of higher-priced homes. The real estate owned by banks (REO) represented an average of 3.9% of all sales in the first two quarters of 2016, down from 5.8% in 2015, and 8.0% in 2014.

Figure 1
Office Lease Rates vs. Vacancy Rates | Sacramento MSA

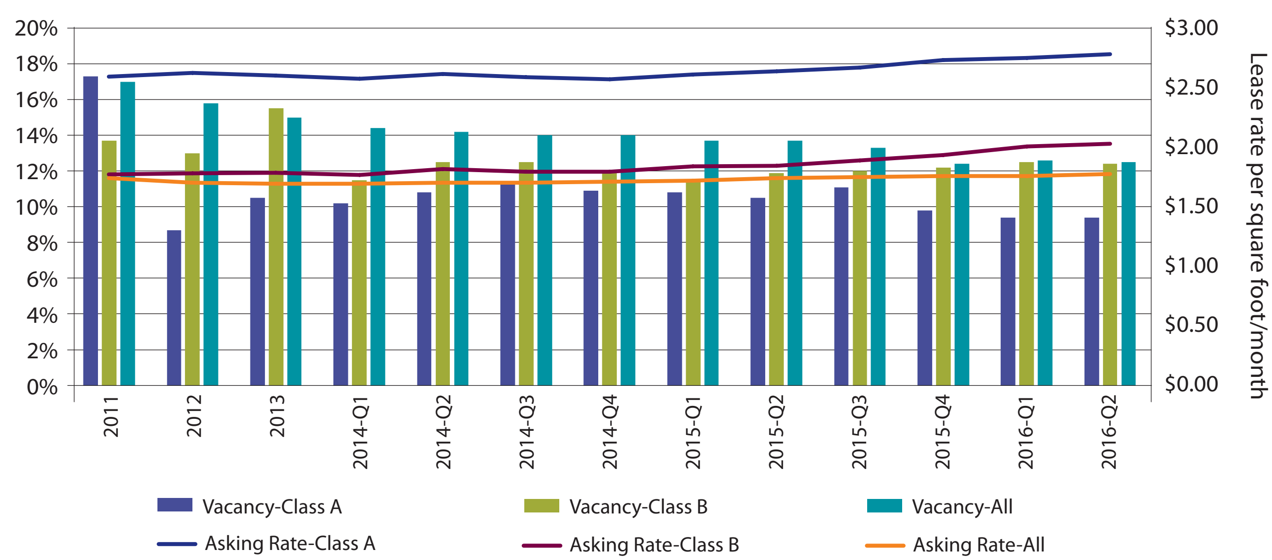


Figure 2
Retail Lease Rates vs. Vacancy Rates | Sacramento MSA

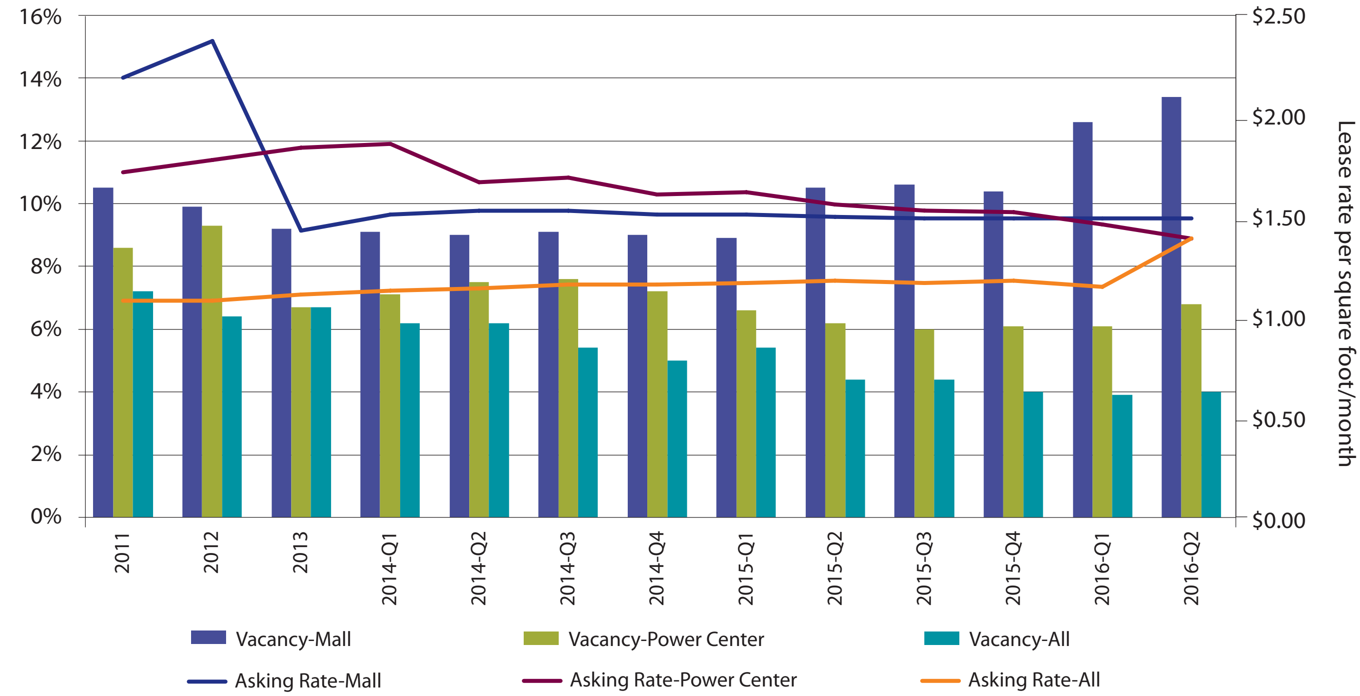


Figure 3
Industrial Lease Rates vs. Vacancy Rates | Sacramento MSA

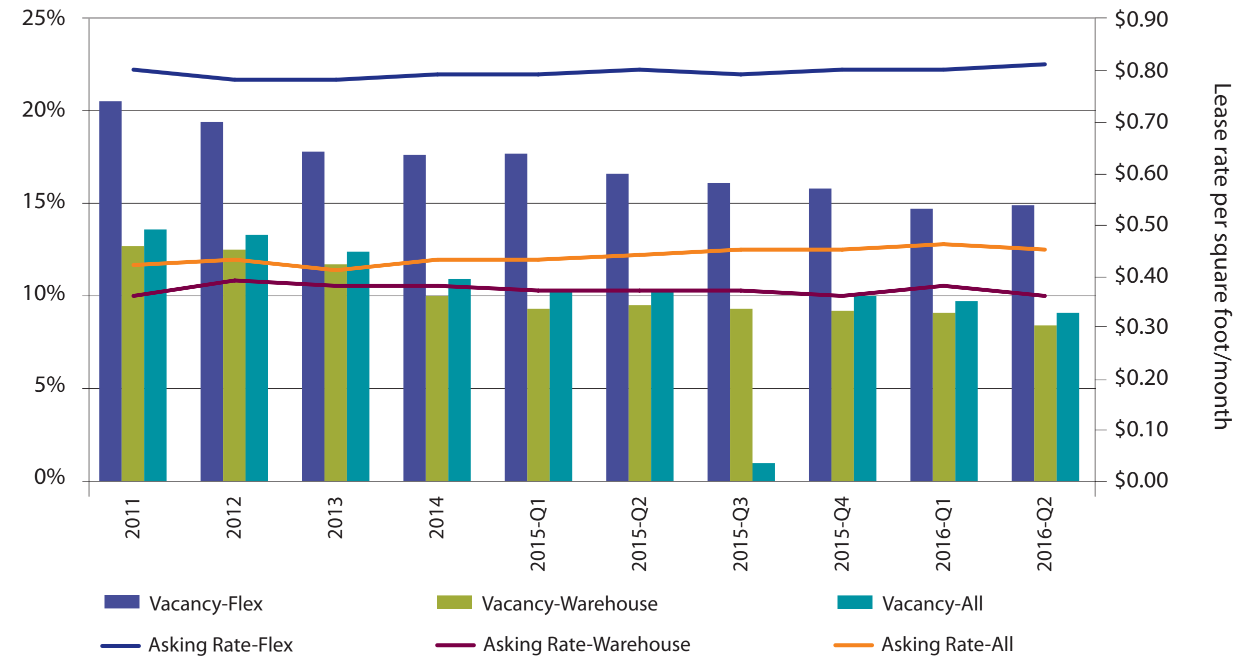


Figure 4
Median Sales Price (All Homes) vs. REO Share of Sales | Sacramento MSA

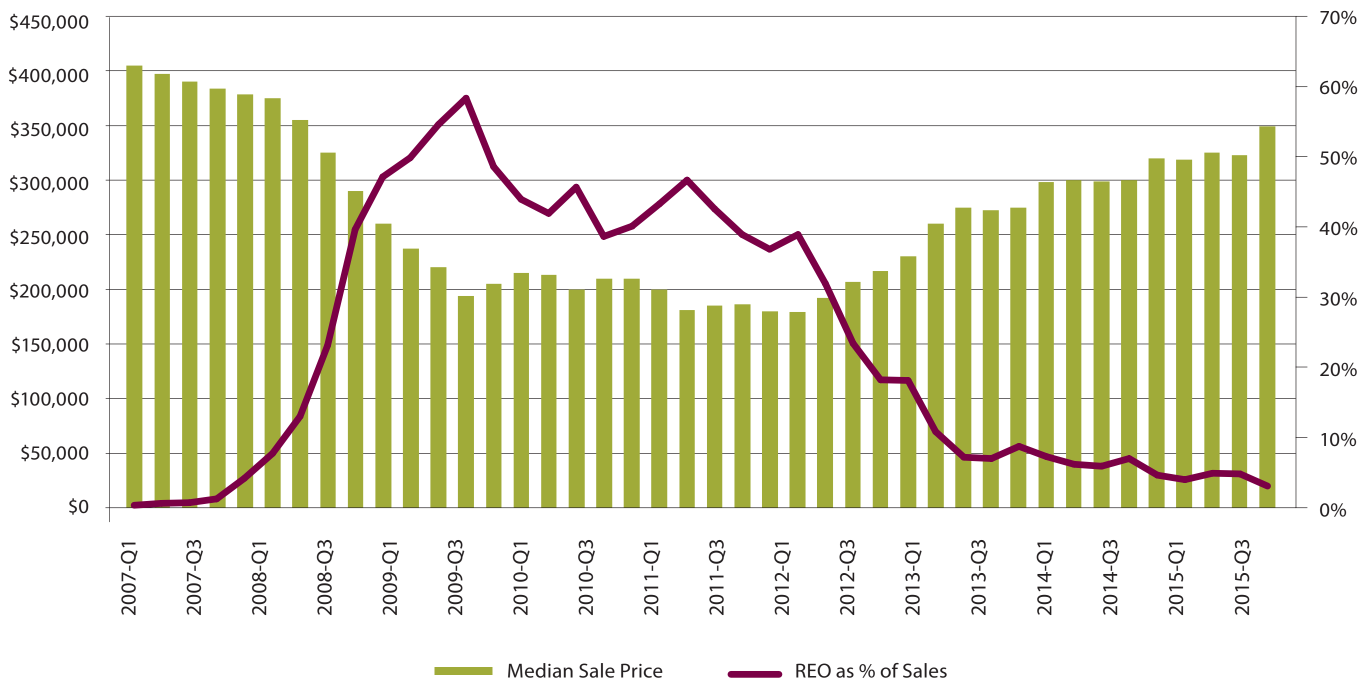
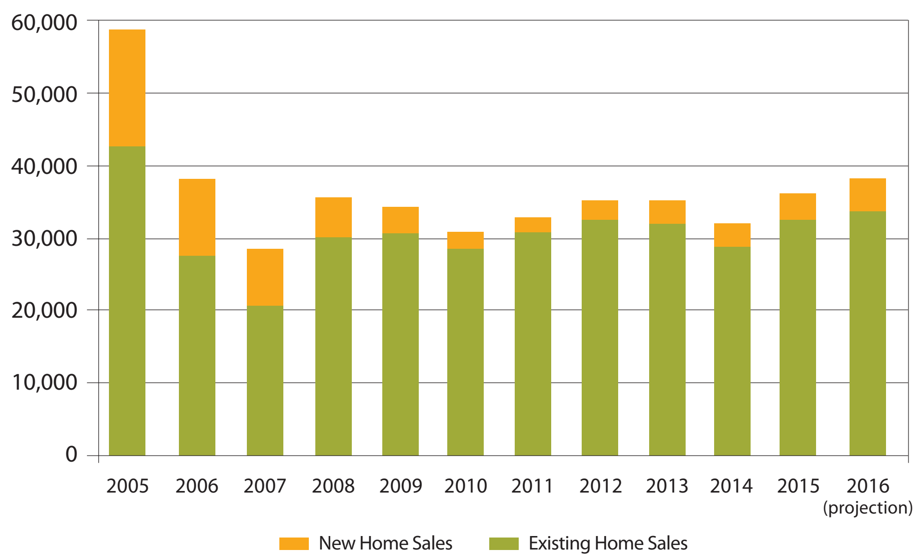


Figure 5
Residential New Home Sales vs. Existing Home Sales | Sacramento MSA



Data Sources (Figures 4 and 5): CoreLogic

UPDATE

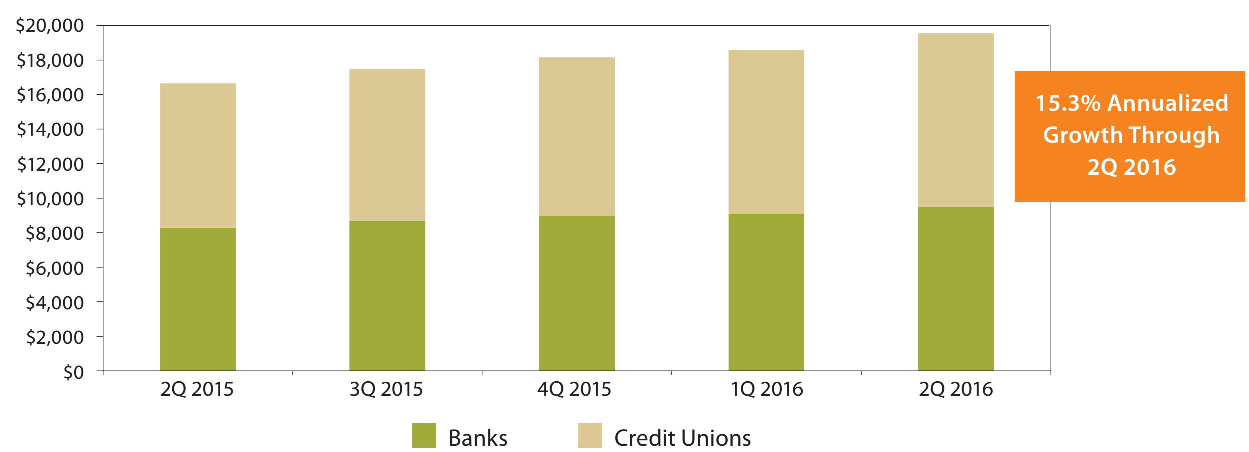
2016 Sacramento Banking Industry Forecast
Mid-Year Update

In January's annual forecast publication, the SBR banking industry analysts predicted that the Sacramento Region Banks and Sacramento Credit Unions, in aggregate, would achieve low-double-digit loan growth during 2016. On the heels of 2015's impressive 17% increase, the team thought the pace would fall modestly given the higher base figure.

Through the first six months of 2016, the pace of loan growth has indeed fallen, but just slightly. Analyzing the available loan data through June 30 (Figure 1), one can see how overall loan volumes increased at a 15.3% annualized rate.

The solid loan figures have been spearheaded by the local credit unions, which have increased their loan books by 19.3% (annualized) this year. Table 1 shows how auto loans continue to "drive" this substantial growth, rising at more than a 25% annualized rate through the first half of 2016. The January report highlighted how the Sacramento Credit Unions have nearly doubled their auto loan balances since the end of 2012, representing 27% growth per annum. This trend has remained intact so far this year.

Figure 1
Aggregate Loans | Sacramento Region Banks & Credit Unions | 2Q 2015- 2Q 2016



Data Sources: FDIC & NCUA

Analyzing the Sacramento Region Banks, one can see how year-to-date loan growth (11.3% annualized) has been in line with the SBR team's 10-12% forecast. Commercial real estate loans, which make up nearly 45% of loans at the local banks, increased at a solid 12.9% annualized rate. Multifamily residential and construction loans, though a smaller proportion of overall loan balances, rose at impressive 37.9% and 32.7% annualized rates, respectively.

Table 1
Loan Growth by Category | Sacramento Region Credit Unions
4Q 2015- 2Q 2016

% of Total	Category	% Change Since 12/31/15*
48.8%	Auto Loans	25.5%
40.2%	Residential / RE Lines of Credit	13.9%
8.9%	Credit Card / Unsecured	10.0%
2.1%	Other	23.3%
100.0%	**Total**	**19.3%**

** Figures showing the year-to-date changes are annualized.*

Data Source: FDIC

Table 2
Loan Growth by Category | Sacramento Region Banks
4Q 2015- 2Q 2016

% of Total	Category	% Change Since 6/30/15	% Change Since 12/31/15*
44.9%	Commercial Real Estate	16.8%	12.9%
20.3%	Residential	2.4%	0.0%
10.0%	Commercial & Industrial	9.8%	13.6%
5.5%	Multifamily Residential	36.0%	37.9%
5.2%	Construction Loans	47.0%	32.7%
14.1%	Other	12.3%	4.9%
100.0%	**Total**	**14.3%**	**11.2%**

** Figures showing the year-to-date changes are annualized.*

Data Source: FDIC

Interestingly, residential real estate loans at the local banks were virtually unchanged through the first six months of the year.

Interestingly, residential real estate loans at the local banks were virtually unchanged through the first six months of the year. This lack of growth was in stark contrast to the residential lending trend at the local credit unions, which increased mortgage and home equity lines of credit by nearly 14% (annualized) during the same time frame.

Net Interest Margin Compression

In January's report, the SBR banking analysts predicted that top-line net interest income would increase at a slower pace, relative to loan growth, given lower projected margins due to the flatter yield curve. This prediction has held true during the first half of 2016 (Table 3).

Table 3
Sacramento Region Banks and Credit Unions | Annualized Year-to-Date Loan and Net Interest Income Growth

Institutions	Loan Growth	Net Interest Income Growth
Sacramento Region Banks	11.2%	8.5%
Sacramento Credit Unions	19.3%	9.3%
Total	**15.3%**	**8.9%**

Data Source: FDIC

At the time, the banking team expected the yield curve compression would be caused by rising shorter-term interest rates, as the Federal Reserve had discussed a series of rate hikes throughout 2016. However, given several economic shocks overseas (Brexit, etc.), the Fed has held off on raising rates while longer-term rates have fallen substantially. Figure 2 shows this year's dramatic compression between the 7-year and 3-month U.S. Treasury rates. Though the lower interest rates at the long end of the curve should benefit the banks via continued borrowing, the same phenomenon of slower top-line growth due to lower spreads will likely persist through the remainder of the year.

More M&A Activity

The SBR banking team's longtime prediction for M&A activity amongst the smaller banks again proved prescient during the first half of the year. In April, Folsom's Sierra Vista Bank, one of the Sacramento Region Banks, announced that it would be acquired by Central Valley Community Bancorp (Fresno).

Figure 2
Differential Between 7-Year and 3-Month U.S. Treasury Rates | 2013 – Present

Data Source: FDIC

UPDATE

The Small Business Economy

Sacramento » 19th and L Streets

The small business sector in the Greater Sacramento Region continues to show increased caution as our most recent Small Business Confidence Index, SBA lending activity, and small business sales data are yielding increasingly pessimistic results. The good news is: SBA lending increased by an impressive 35%. The bad news is: The market for small business sales continues down the path of a major softening, and all of the components of our Small Business Confidence Index other than credit accessibility declined significantly from previous levels, and now sit at their lowest readings since January 2015.

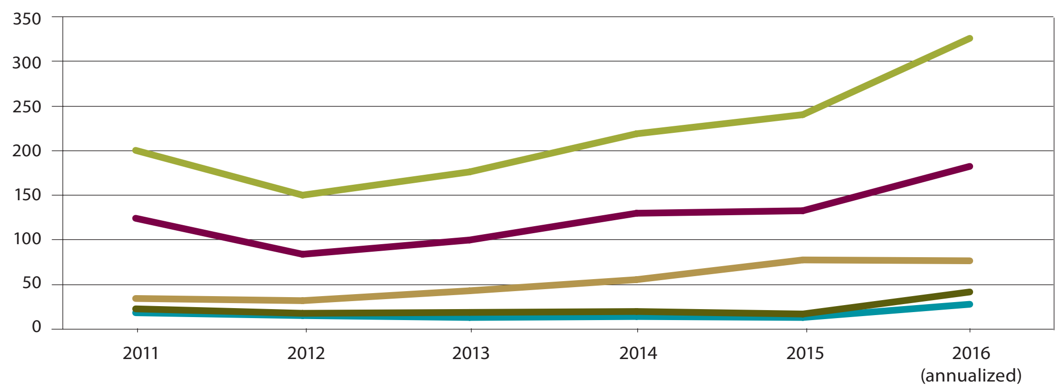
The total dollar volume of SBA loans in the Sacramento MSA increased by 35% to $325 million. This overall increase was driven primarily by significantly higher lending activities from Sacramento County (37%) that constitutes two-thirds of the MSA economy, although all four counties experienced a significant increase. An increase in SBA lending has also fueled continued optimism regarding access to credit, which we know was a major problem following the "Great Recession." This trend in improved credit is consistent with what we observe nationally.

Overall, our SBR Small Business Confidence Index declined noticeably compared with previous measures from earlier in the year across the board in the areas of economic outlook, local supportiveness, future revenues, and likelihood of new hires. In particular expectations regarding both future revenues and likelihood of new hires declined almost 10%. The only exception was credit accessibility, which actually improved slightly and is consistent with our finding of increased SBA lending.

Among the three sectors that we follow closely — manufacturing, service, and others — small businesses in the "service" and "others" sectors followed the overall trends. The "manufacturing" sector bucked the trend. All three measures of economic outlook, local supportiveness, and credit accessibility improved, but future revenues and likelihood of new hires declined 23% and 53% respectively. Manufacturing has made a comeback nationally as evidenced by the manufacturing purchasing managers' index. These trends spell lack of confidence in the coming months both for the economy and for the labor market.

The number of small businesses listed for sale in the Sacramento region in 2016 thus far increased noticeably from last year. The actual number of businesses sold in the first half of this year declined somewhat from last year's levels. The median closed sales price has jumped significantly, as did the median cash flow of closed sales from the end of last year. All of this suggests an active market for small business sales with valuations much improved.

Figure 1
Total Dollar Amount of SBA Loans Approved in the Sacramento MSA – July 2016 (in Millions)



Data Source: U.S. Small Business Administration

Figure 2
Small Business Confidence Index Trends: January 2015 – July 2016

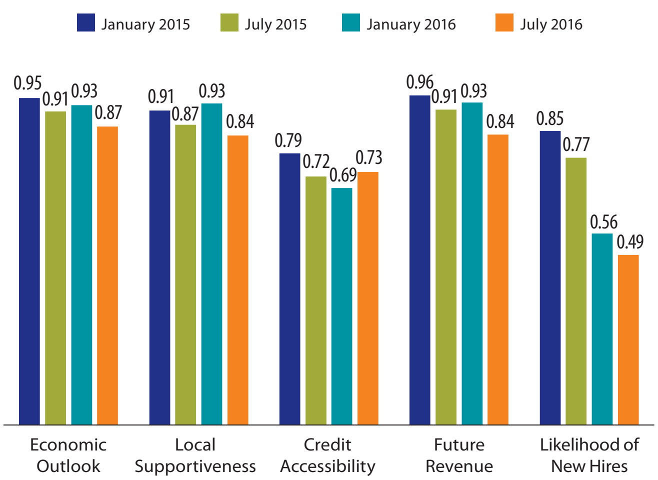


Figure 3
SBCI Trends in the Manufacturing Sector

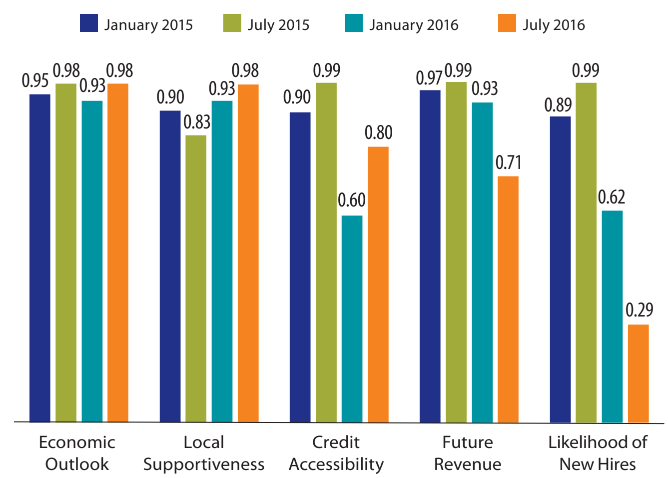


Figure 4
SBCI Trends in the Service Sector

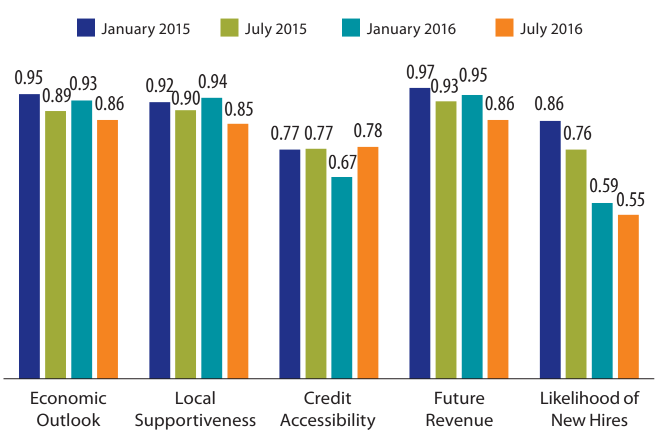
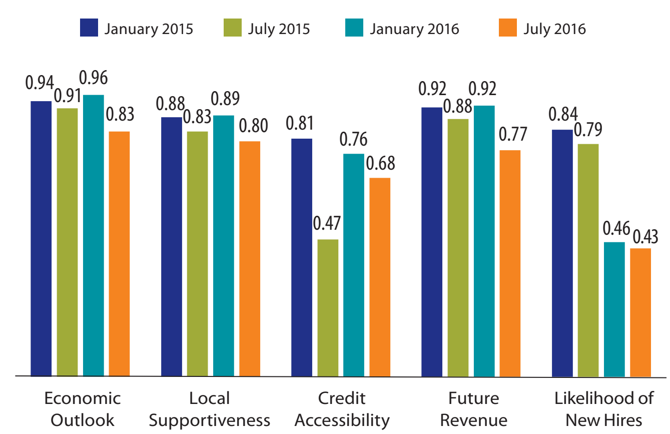


Figure 5
SBCI Trends in Others Sector



Data Source (Figures 2-5): U.S. Small Business Administration

Small Business Sales

Figure 6
Numbers of Listing vs. Actual Sales (Quarterly)

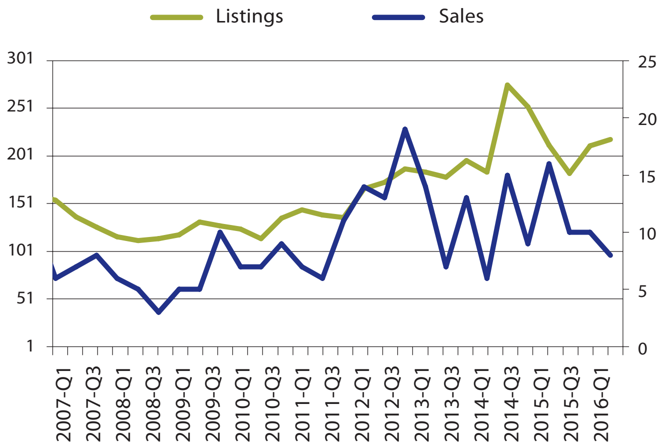


Figure 7
Median Closed Sales Price (Quarterly)

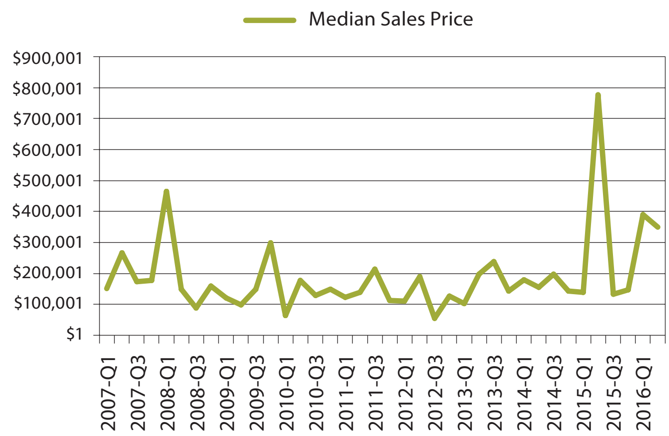


Figure 8
Median Revenue of Closed Sales (Quarterly)

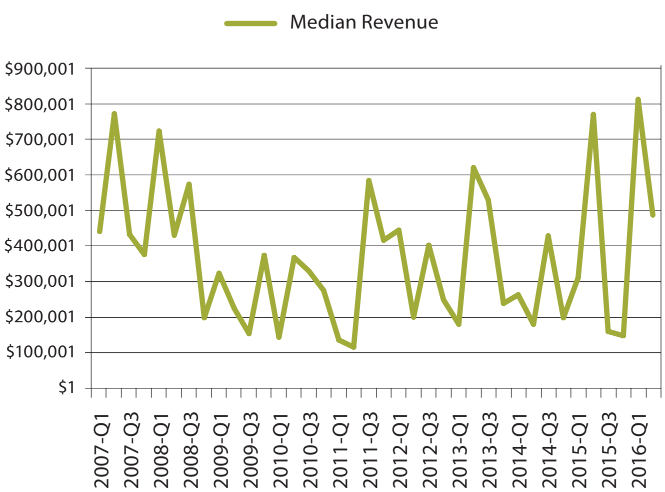
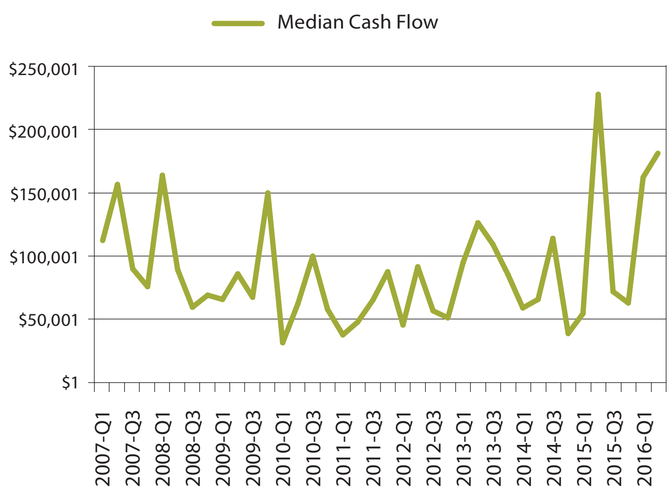
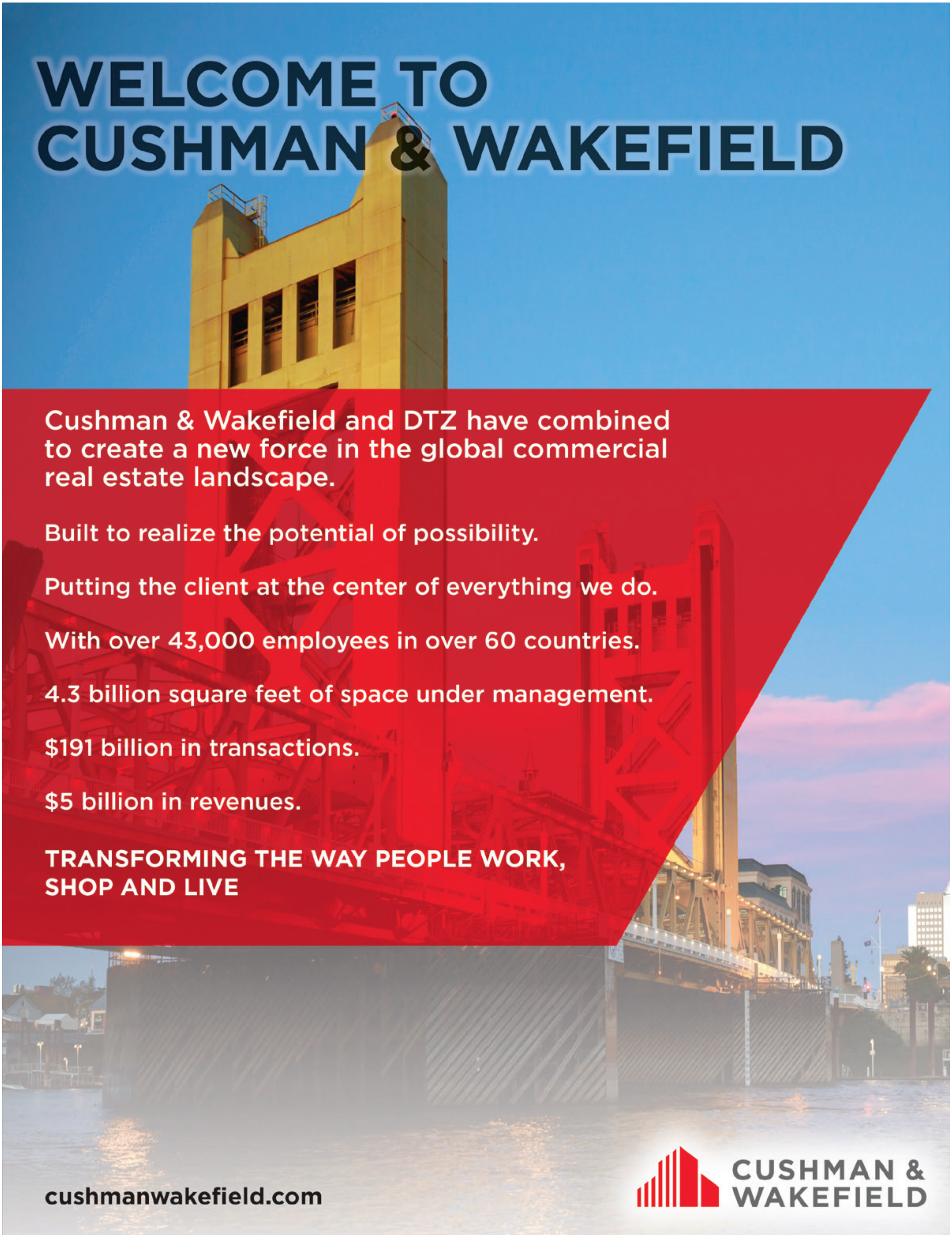


Figure 9
Median Cash Flow of Closed Sales (Quarterly)

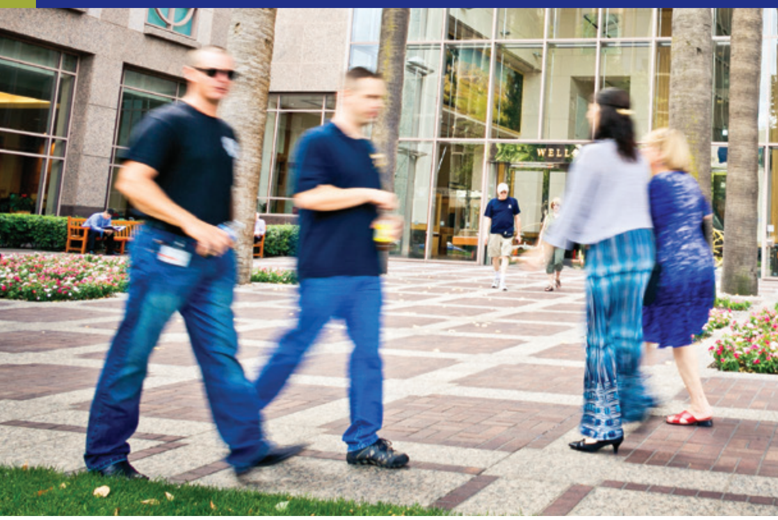


Data Source (Figures 6-9): BizBuySell


WELCOME TO CUSHMAN & WAKEFIELD
Cushman & Wakefield and DTZ have combined to create a new force in the global commercial real estate landscape.
Built to realize the potential of possibility.
Putting the client at the center of everything we do.
With over 43,000 employees in over 60 countries.
4.3 billion square feet of space under management.
$191 billion in transactions.
$5 billion in revenues.
TRANSFORMING THE WAY PEOPLE WORK, SHOP AND LIVE
cushmanwakefield.com
CUSHMAN & WAKEFIELD

UPDATE

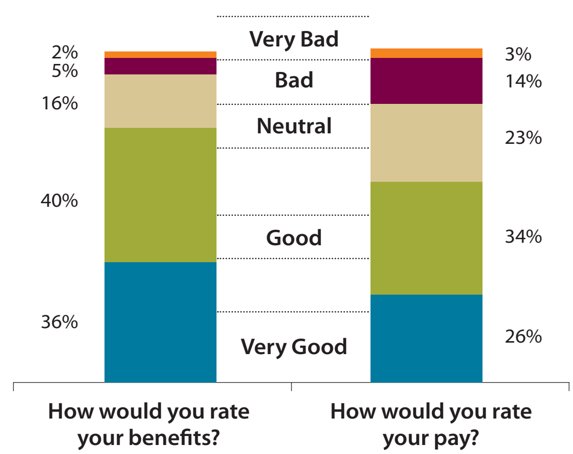
Sacramento Region
Human Resources Barometer



The 15th edition of the Sacramento Business Review, released in January 2016, reported for the first time on business insights gained from the Sacramento region's human resources practices. This first HR coverage was extremely well-received, fueling a desire to continually assess HR initiatives and challenges faced by our regional employers. Given this reception, we are thrilled to announce that this fall we will re-assess local HR practices. To that end, we are revamping the survey in order to obtain a baseline of the current state of HR efforts and to create an index – the HR Barometer – that can be tracked year-over-year for our region.

One of the cornerstones of the HR Barometer will be an assessment of compensation levels in the region. According to the U.S. Bureau of Labor Statistics (BLS), in the Pacific Region (Alaska, California, Hawaii, Oregon, Washington), private industry workers saw a total compensation of $35.07 per hour worked (BLS News Release June 10, 2016). This total compensation comprises wages and salaries ($24.55) and total benefits ($10.52). This can be compared with the lower national average where total compensation amounts to $32.06 of which $22.33 is wages and salaries and $9.73 is total benefits. Looking at changes in compensation levels, the Pacific Region has had a 3.1% increase in total compensation in the past year, with the past 6 months showing a 0.9% increase (BLS). The Pacific Region compensation can be compared with the lower national average, which shows a 1.8% increase in the past year, with a 0.7% increase in the past 6 months. This can be collated with the majority of survey respondents of the pilot Sacramento Business Review HR survey who indicated that they did not foresee a connection between their future level of performance and their future level of compensation. Asked about current compensation levels (Table 1), however, 60% of survey respondents agreed their compensation was satisfactory ("very good" or "good"). The view on benefits was more favorable, with 76% of respondents agreeing that their benefits were satisfactory.

Figure 1
How would you rate your pay and benefits?



Further, the HR Barometer will assess expected changes in headcount, to determine whether to anticipate overall unemployment or business growth among our employers. Current unemployment levels at 5.1% in Sacramento (down from 5.7% in April 2015) differ greatly depending on type of industry (BLS), with some industries reporting higher numbers while others report lower unemployment or even a demand for talent. Specifically, we see leisure/hospitality and construction sectors increasing unemployment numbers (5.3% and 9.9% respectively) while manufacturing and trade/transportation/utilities essentially showing no changes in headcount (0.6% and 0.1%) over the past year. Contrariwise, the information industry increased its demand for talent (-1.4%) (BLS, April 2016).

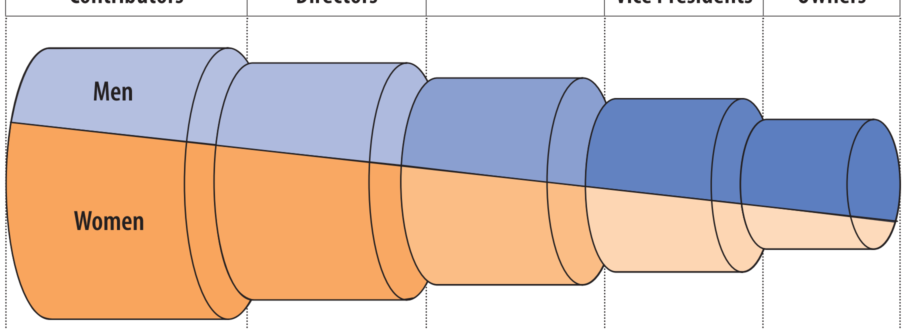
In addition to the fundamental HR areas of compensation, recruitment, and turnover, the HR Barometer will gauge talent management trends, including diversity issues. In the initial HR survey, we found that women were severely underrepresented at the top management level. Only 26% of respondents at the C-suite/ownership level were women, 29% of respondents at the Senior Vice President level were women, and 50% of Vice Presidents were women.

> ***In the initial HR Survey, we found that women were severely underrepresented at the top management level.***

National averages painted an even bleaker picture. A 2015 McKinsey study titled "Women in Leadership" revealed that only 17% of C-suite/owner-level workers at the national level were women. We also looked at role distribution through a racial lens. Unfortunately, minorities were underrepresented at every level. This was particularly troubling given that Sacramento is one of the country's most diverse cities (Welcome to America's Most Diverse City, *TIME* magazine, 2002, and American Community Survey, U.S. Census Bureau 2013). While 55% of our population is non-white, they represent no more than 25% of any level of the organization in our Barometer (US Census Bureau, 2014). Talent management will prove increasingly important as organizations try to ensure an effective workforce and a well-developed leadership and succession pipeline.

Other HR areas to be assessed in the upcoming survey including anticipated talent management initiatives, factors influencing HR efforts, and HR metrics. The SBR team is excited to present this new effort in the 17th edition of the *Sacramento Business Review*.

Figure 2
Gender Representation in the Workforce by Job Level



	Individual Contributors	Managers/ Directors	Vice Presidents	Senior Vice Presidents	C-suite & Owners
Men	30%	33%	50%	71%	74%
Women	70%	67%	50%	29%	26%

UPDATE

2016 Capital Markets *Outlook*

What's Next?

A little more than a month after our 2016 release event, the United Kingdom Prime Minister, David Cameron, called for a referendum to be held on June 23, to determine the proper course for the U.K. regarding whether it would remain in the European Union. It is apparent now that Cameron and many regretful U.K. citizens failed to grasp the impact that the vote to leave the U.K. would have on the U.K.'s economy and global financial markets. The Leave Campaign's triumph on June 23rd resulted in some of the largest one-day losses seen in years for markets around the world. The amount of sovereign debt trading at negative yields has far surpassed the $10 trillion mark, and the yield on the 10-year U.S. Treasury note reached an all-time low of 1.37% as investors ducked for cover. So, what's next? We will revisit some of our key points made in our initial 2016 release and attempt to chart a path for the rest of the year.

Weakness Abroad

For the first half of 2016, continued stimulus was on the minds of central bankers and investors alike in parts of the world, such as Europe and Asia, where the tepid growth we spoke of in January persistently weighed on those economies. Negative short-term lending rates targeted by central banks did not appear to be gaining traction, but rather diverted the flow of capital to U.S. markets where the yield curve continued to flatten due to the demand imposed by this foreign capital flow.

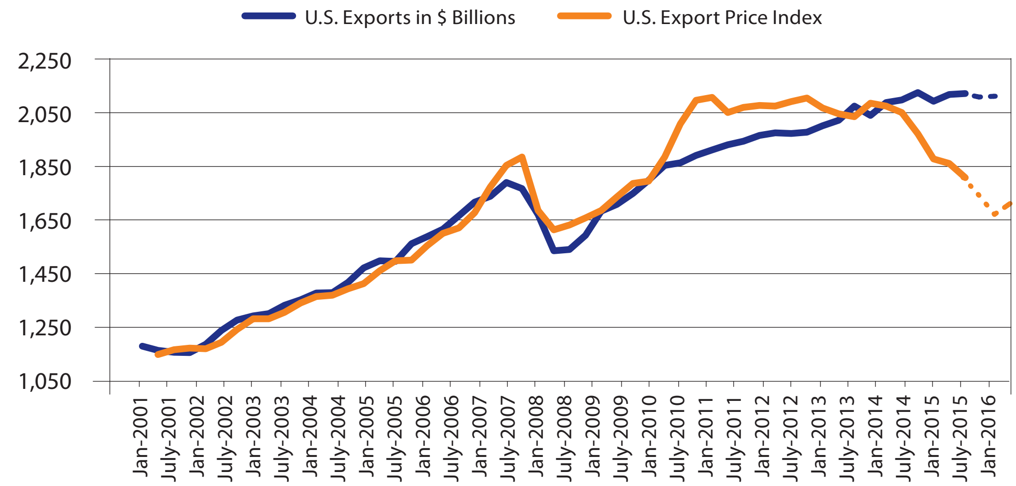
Figure 1 provides an update to the one we initially published in January, but with a few more data points added. We can see that export prices continued to decline and volumes leveled off as economies abroad struggled with the stronger dollar and U.S. companies struggled to increase output at the lower prices. The recent bump in export prices shown for the last data point will likely renew its downward trend following the Brexit (British exit) debacle as the dollar strengthens in light of all of the uncertainty.

We think much of this pressure from abroad will remain for the duration of the year and feel it necessary to revise our initial call of a quarter point increase on longer term Treasuries to that of a quarter- to half-point decrease on yields to end the year.

Investor Reactions

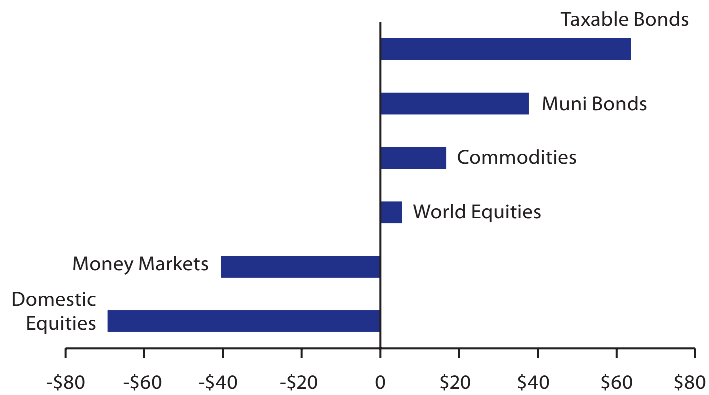
With everything going on in the world and here at home, where are investors putting their money? Figure 2 shows mutual fund and ETF fund flows for the first half of the year. We can see that even though the stock market has been able to reach new highs, mutual fund investors have not felt comfortable with the domestic equity outlook and have sought refuge in bonds. The S&P 500 Index is up approximately 5.9% since the beginning of the year, in line with our initial estimate of low- to mid-single-digit returns for 2016. Even with steady, consistent economic performance here in the U.S., the confusion and uncertainty of economic developments abroad is likely to sap any additional performance that would otherwise be expected for domestic equities.

Figure 1
U.S. Export Volume and Prices



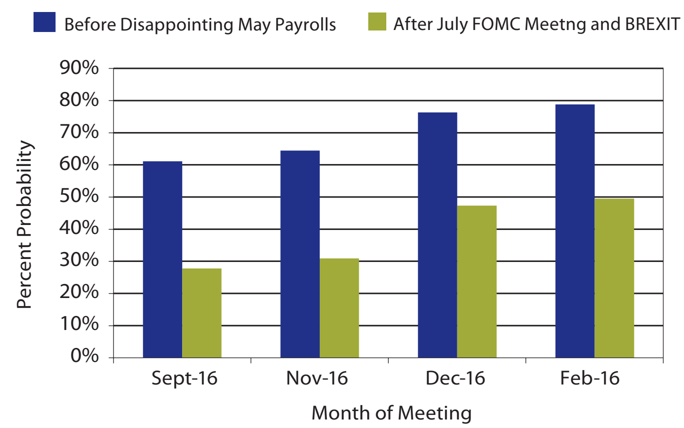
Data Sources: U.S. Bureaus of Economic Analysis and Labor Statistics data retrieved from FRED, Federal Reserve Bank of St. Louis

Figure 2
Mutual Fund and ETF Net Fund Flows: 1st Half 2016
($ in Billions)



Data Source: Investment Company Institute Estimated Fund Flows

Figure 3
Fed Rate Bets Based on Fed Fund Futures



Data Source: Bloomberg World Interest Rate Probability (WIRP)

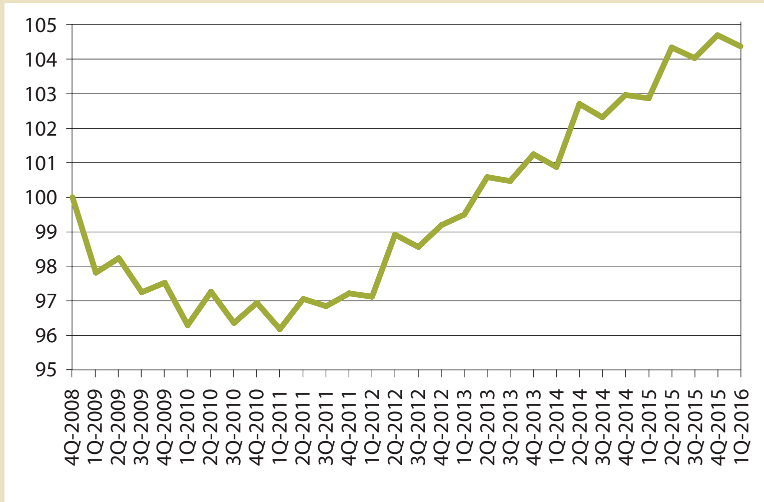
Just like last year, the Fed's initial rate hike expectations have been reduced to almost nothing.

Déjà Vu for the Federal Reserve

Just like last year, the Fed's initial rate hike expectations have been reduced to almost nothing. Our initial thought that the Fed was overly ambitious at the beginning of the year has been proven correct. The futures market has struggled to imply even a 50% probability of a hike before the end of the year; however, the SBR team thinks a one-quarter-point increase is likely before year-end, assuming we continue to see relatively good economic data for the U.S. We think the Fed wants to raise the rate to give it more room for decreases should the economy turn south, especially considering that we have been in the expansionary part of the business cycle for some time now. Our call for a quarter-point Fed rate increase before the end of the year along with our call for a quarter- to half-point decrease on longer-term Treasuries is consistent with our initial sentiment of a flattening yield curve for 2016.

Sacramento Business Review Financial Conditions Index

The latest reading of our proprietary SBR Financial Conditions Index shows strong government hiring and bank lending helped the SBR Financial Conditions Index remain at high levels through the first quarter of 2016.



650 Alumni since 2005

Average age 37

Global Mindset

MBA *for Executives*

Developing Exemplary Leaders

23 cohorts

Average work experience: 13 years

AACSB ACCREDITED

- building lifelong partnerships
- accelerating career advancement
- learning while working
- opportunities forged
- aspirations fulfilled
- unparalleled educational experience
- AACSB accreditation- only 5% of business schools globally have this accreditation
- Global Mindset- measure and cultivate your aptitude for global success
  (Thunderbird Graduate School of Global Management Strategic Partner)
- 15-month completion time
- Convenient weekend schedule-complimentary Friday night stay for qualifying candidates

Spring 2017 Classes to be held at Intel in Folsom

SACRAMENTO STATE
COLLEGE OF BUSINESS ADMINISTRATION

cba.csus.edu/emba

Publication Sponsors

at&t

CA Intern NETWORK

capital public radio
Licensed to SACRAMENTO STATE

CFA Society Sacramento

CUSHMAN & WAKEFIELD

FORUM MW

WELLS FARGO

SACRAMENTO BUSINESS JOURNAL

SACRAMENTO STATE

SMUD®

VSP Global™

WELLS FARGO The Private Bank

CFA Society Sacramento

Global Network • Local Presence

Founded in 1991, the CFA Society Sacramento operates as a member society of CFA Institute. Our membership consists of more than 180 regional investment professionals and academics who work in both the private and public sectors in a broad range of capacities. More information may be found at ***www.cfass.org***.

CFA Charter is The Gold Standard

First awarded in 1963, the Chartered Financial Analyst (CFA) charter has become known as the gold standard of professional credentials within the global investment community. Investors recognize the CFA designation as the definitive standard for measuring competence and integrity in the fields of portfolio management and investment analysis.

About CFA Institute

With more than 96,000 members in 133 countries and territories, CFA Institute is the global association for investment professionals. It administers the CFA curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

CFA Institute is a respected advocate worldwide for full and fair disclosure of financial information by public issuers to investors, ethical conduct by investment professionals that protects the clients' best interests, investment performance standards, and the highest level of investment knowledge and competence. More information may be found at ***www.cfainstitute.org***.

A Member Society of CFA Institute

Get connected.

As your community-owned, not-for-profit electric service, we're committed to powering local business—it's written into our mission, and we live it every day.

Give your business the competitive edge. Contact our Economic Development team and get connected to valuable SMUD resources.

smud.org/EconDev | EconDev@smud.org | 877-768-3674

Powering forward. Together.

SMUD®