JANUARY 2021 ECONOMIC FORECAST | EMERGING TRENDS IN SACRAMENTO'S ECONOMY

sacramento BUSINESS REVIEW

JANUARY 2021

Volume 13 Issue 1 » sacbusinessreview.com

A Post COVID World: Is Sacramento better than the Bay Area?

JANUARY 2021

sacramento BUSINESS REVIEW

MISSION

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

LABOR MARKETS & REGIONAL ECONOMY

SBR/SAFE CREDIT UNION CONSUMER SENTIMENT SURVEY

THE SMALL BUSINESS ECONOMY

REAL ESTATE

CAPITAL MARKETS & BANKING

HUMAN CAPITAL TRENDS

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MESSAGE FROM THE CHIEF ECONOMIST

Dear Friends,

2020 will be forever etched in history as the pandemic year of the century where the world did not come to an end, but rather a decade worth of futuristic technology has already accelerated change in just a few months – from dining, shopping, education, entertainment, food delivery, exercising, investing, travel, to work from home. As I predicted, the U.S. economy has shown resilience with a sharp V-shaped recovery in the second half. The stock market has already trounced previous highs, and continues to defy gravity. There are winners and losers, and among the wreckage there is still plenty of optimism. The vaccine is here! 2021 will return the world to a new normalcy that will still feel different. And oh! We also elected a new President amidst all the turmoil. As we predicted, election years are good for the stock market.

Sacramento has been a winner thus far, on the back of the housing market that is up 10.9% over last year due to Bay Area residents seeking more affordability and better quality of life in a pandemic world that encourages work from home. Our construction and financial sectors have been winners, and information technology the biggest loser. Our small businesses continue to struggle; consumer confidence lags the rest of the nation; artificial intelligence (the future of our new world) ranks at the bottom in our region; and policy makers continue to confound, driving businesses out of the state (HP, Oracle, Tesla all announced departures to Texas). We also predict dire state/county/city budgets in 2021/22. Can the Golden State keep its shine in Sacramento?

2021 will bring continued strong recovery and growth due to pent up demand from consumers that are still largely unaffected. While in many ways we will never feel normal again, the new normal will bring a sense of relief that the worst is behind us. With that, we will once again confront the old challenges of whether Sacramento can thrive just based on housing, government, and service sector jobs.

Warm regards,

Sanjay Varshney

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FEATURES

KEY POINTS

LABOR MARKETS & REGIONAL ECONOMY

- Over the last 10 years of economic growth following the Great Recession and prior to the pandemic, Construction was the biggest winner and the Information sector was the biggest loser in the local labor market.
- Finance and Construction sectors have bounced back the quickest since the pandemic.
- The Leisure & Hospitality industry will continue to struggle in 2021.
- Government may face a severe budget deficit in 2021.
- Overall, we expect the economy to get back to near normal in 2021.

SBR/SAFE CREDIT UNION CONSUMER SENTIMENT SURVEY

- Regional sentiment continued its downward trend since our mid-year update, but the rate of decline has tapered.
- National sentiment has rebounded slightly since our mid-year update and once again exceeds regional sentiment.
- Consumer sentiment continues to vary substantially by household income, with a notable boost in sentiment occurring among the highest income households since our mid-year 2020 release.
- Consumers indicate a slight uptick in credit acquisition plans.

SMALL BUSINESS ECONOMY

- Overall sentiment in the economic outlook has a lot of room to improve, but other areas such as credit access and the future revenue outlook seem to have recovered better at the Services Sector and are closely tracking or above their 18-month moving averages.
- Lending activity in El Dorado County and Sacramento County are on pace to finish at the highest level in the last 15 years, and Yolo County is having a strong year vs. 2019, finishing with the second highest reading in 15 years. However, the numbers paint a different story for Placer County, where lending activity is down -32% year-over-year, a level not seen since 2013.
- Business transactions in the region have recovered from their lows, however, still far off from their latest peak seen in Q4 2019. The number of open listings did not improve from mid-year data.

REAL ESTATE

- **Office Market:** Demand declined due to uncertainty regarding long-term office needs as a result of COVID-19. Long-term impact is still unclear as many occupiers may rely more heavily on a remote work model going forward.
- **Industrial Market:** Fundamentals remain strong. Vacancy has increased slightly but this is primarily due to increased construction completions. The market continues to garner demand from distribution users looking to capitalize on the market's comparatively cheap labor.
- **Retail:** Outlook remains in doubt given the substantial impact that COVID-19 has had on the retail landscape. Lack of consistency in pandemic restrictions only increases economic pressure on users' long-term viability.
- **Single Family:** Property value growth continued during the back half of the year. Consistent migration from the Bay Area has put significant upward pressure on sale prices, resulting in a 10.9% year-over-year increase.

CAPITAL MARKETS & BANKING FORECAST

- Stock and bond markets continue a relentless trek higher even though the U.S. economy endures the pandemic incited recession.
- The Fed has grown its balance sheet by over $3 trillion and Congress has passed over $3.5 trillion in fiscal stimulus to keep the economy from collapsing as lockdowns and business restrictions take their toll.
- Regional financial institutions have seen close to 20% asset growth as the "flight to safety" effect leads to more savings; asset quality has remained healthy, but can the positive credit quality trends persist into 2021 with vaccine distribution providing some light at the end of the tunnel?

HUMAN CAPITAL TRENDS

- Skills gap is at its widest margin since 2017; voluntary turnover expected to increase.
- Cost reduction, managing persistent talent shortage, and skills gap expected to have most significant impact on local organizations.
- Improving employee engagement, talent development, and succession planning are top priorities for area HR managers in 2020.
- Artificial Intelligence ranks toward the bottom in our region.

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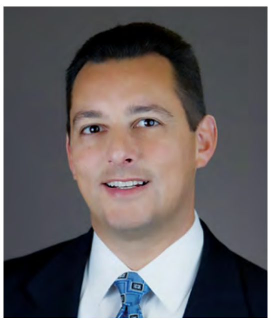

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Matt Cologna graduated with a degree in business from California State University, Sacramento, and has been active in commercial real estate in Sacramento for the past 21 years. His experience includes owner/user and investment sales, logistics, landlord 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 17 million square feet of deals with a value exceeding $620 million.

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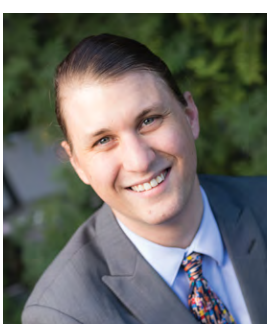
John Frisch has been active in commercial real estate brokerage in the Sacramento Region for 39 years. During his career, he has been involved in over 1,000 lease, sale, and build-to-suit transactions totaling over 10 million square feet. John is also an active volunteer with several non-profit organizations in the region, including the Salvation Army, the Los Rios Community College Foundation, the Sacramento Metro Chamber of Commerce, and the Rotary Club of Sacramento.



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Joe Niehaus is the Vice President of Finance for Golden 1 Credit Union, where he is responsible for managing the treasury, profitability, and financial analytics functions. Previously, Joe was the Treasurer for SAFE Credit Union, and he has also worked as a bank examiner for both the public and private sectors. Prior to his corporate experience, Joe served five years in the U.S. Navy as an Electronic Warfare Operator and attained the rank of Second Class Petty Officer. Joe earned an MBA from the University of Nebraska, Lincoln, and a BS in business administration from California State University, Sacramento. He holds the Chartered Financial Analyst designation and is Past President of the CFA Society Sacramento.

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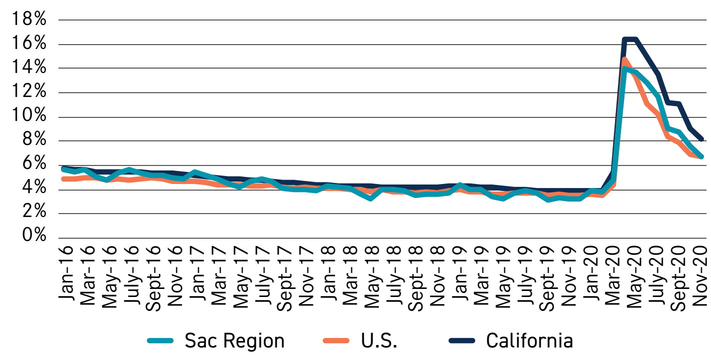
Labor Markets
& Regional Economy

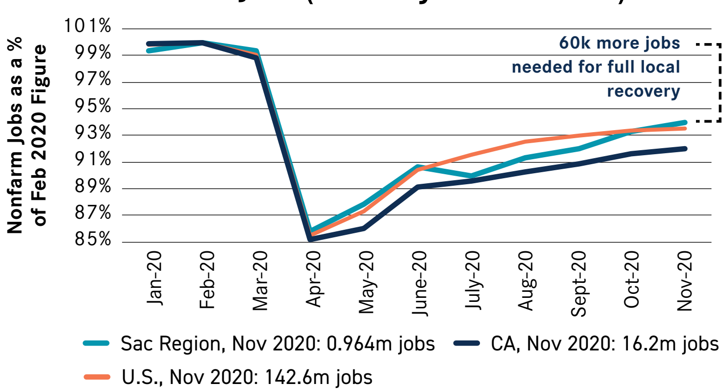
From February 2020 to April 2020, the nation, the State of California, and the Sacramento region all lost nearly 15% of their nonfarm jobs as COVID-19 entered the US. The local unemployment rate reached 14% in April, roughly in-line with the national figure. While the unemployment rates have appeared to recover relatively quickly since April 2020 (Figure 1), the Sacramento region still needs over 60,000 more nonfarm jobs to get back to the pre-pandemic level (Figure 2). The full economic recovery needs the State of California to regain 1.4 million more jobs in 2021; the U.S., 9.8 million more jobs. Overall, the Sacramento Region's job recovery is in-line with the nationwide average and better than the State of California as a whole. We expect economies to get back to near normal in 2021; locally in the Sacramento region, statewide and nationally. The presumption is that the distribution of the vaccines can effectively stop the spread of the virus and a second stimulus package has been passed to keep assisting the economic rebound.

Figure 1 • Unemployment Rates



Data Source: BLS & CA EDD

Figure 2 • 2020 National, State, and Local Nonfarm Jobs (February 2020 = 100%)



Data Source: BLS & CA EDD

Figure 3A • Sacramento 10-Year Job Growth by Sector (January 2010 = 100%)

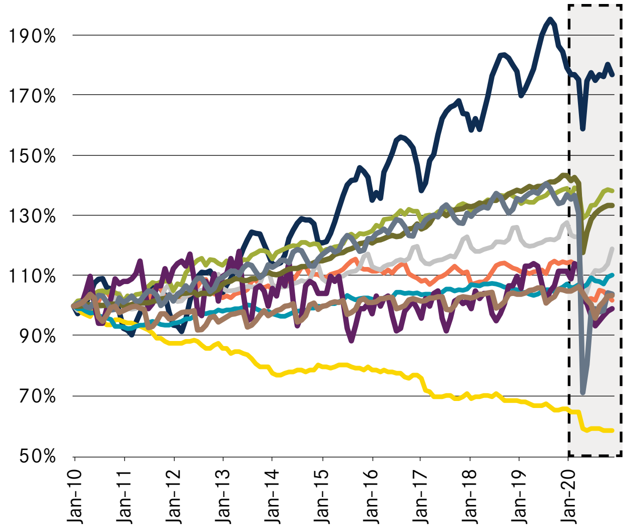
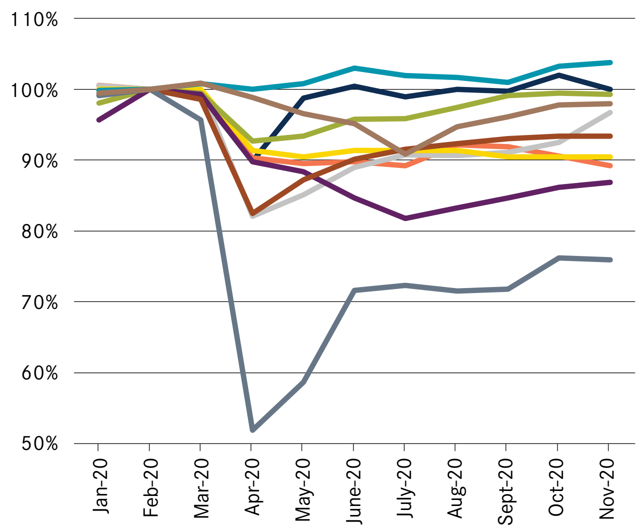


Figure 3B • Sacramento 2020 Job Change by Sector (February 2020 = 100%)

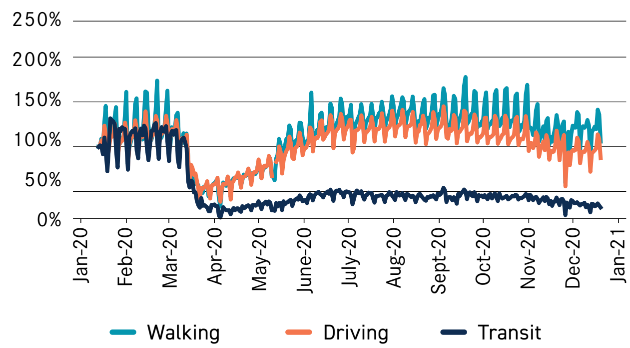


Data Source: CA EDD

During the economic growth since the Great Recession and prior to the pandemic, most economic sectors reported positive job growth in the Sacramento region with the exception of the Information industry (Figure 3A). While the Publishing Industries obviously lost market share to their internet and social media counterparts. Telecommunication also lost a significant number of jobs over the last 10 years. Construction was clearly the biggest winner, increasing over 80%, or nearly 30,000 jobs in 10 years. Health Care, Professional & Business Services and Leisure & Hospitality also increased approximately 40% over the 10 years of growth. These were followed by Trade, Transportation & Utilities, which grew over 20%, while the Manufacturing and Education sectors added about 10%.

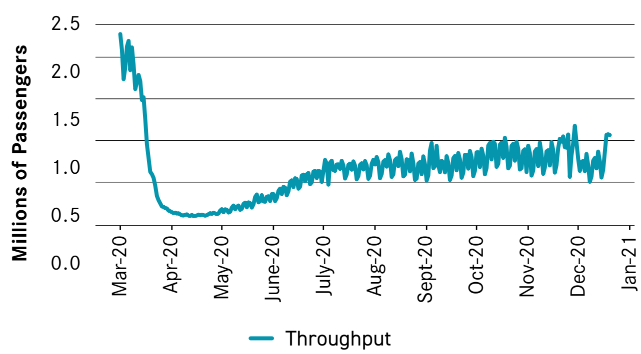
However, as the pandemic came in March 2020, state and the federal governments imposed shelter-in-place/stay-at-home orders. Nearly 150,000 jobs were immediately lost, and many small businesses that depended on daily earnings were sent into a state of shock and uncertainty. Leisure & Hospitality was hit the hardest with nearly 50% of its jobs lost (Figure 3B). By the end of 2020, about half of the lost jobs in this sector were recovered locally. We expect this industry to take another year to fully recover. Vaccinated people may still be capable of transmitting infection, and it takes time for COVID-19 vaccines to be distributed to every corner of the country. Social distancing and masks are still

Figure 4 • Sacramento Mobility Trends Since January 2020



Data Source: apple.com

Figure 5 • U.S. Airport TSA Throughput Data

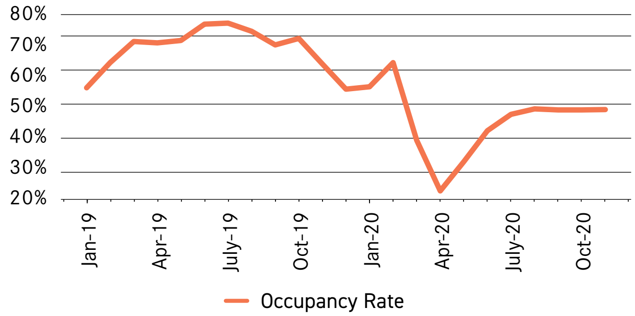


Data Source: TSA

Figure 6 • Restaurant Bookings in California

Data Source: OpenTable

Figure 7 • U.S. Monthly Hotel Occupancy Rate



Data Source: str

needed practices through the year 2021. While the Apple Maps mobility data has shown that people's driving behaviors have returned to normal, not many people are taking public transit since the pandemic. Meanwhile, TSA data show that people taking airplanes are still less than half of the normal level. Hotel occupancy and restaurant booking remain low (see Figures 4-7). The Leisure & Hospitality industry will continue to struggle.

Nonetheless, some sectors bounced back quickly or even thrived despite COVID-related economic restrictions. This was apparent in the Sacramento region where some labor market sectors have bounced back much faster than others. Finance and Construction have created more jobs than what they lost at the beginning of the pandemic. Jobs in Business & Professional Services, Government, Trade, Transportation & Utilities and Health Care are also getting close to the pre-pandemic level (Figure 3B). Overall, the goods producing economy lost 11,300 jobs but recovered 7,300, or 71% of the jobs lost, while the services sector lost 135,800 jobs and has recovered 78,300 jobs, or 58% of the jobs lost.

While one out of every four jobs in Sacramento is a government job, it is expected that the Government sector will face more severe fiscal deficits (as will most governments in the world) in 2021 when the 2020 tax revenue comes in. This may create turbulence in the local job market next year. Consumer sentiment is expected to remain low, especially among low-income families. Disrupted supply chains and trade tensions around the world will keep affecting the economy in the long run. COVID-19 cases are still surging (Figures 8A – 8C, with rough predictions), so in the short term we should keep practicing measures that reduce the risk of spreading the virus as the vaccines are expected to be produced and distributed throughout the first three quarters of 2021.

Figure 8A • U.S. Daily New COVID Cases

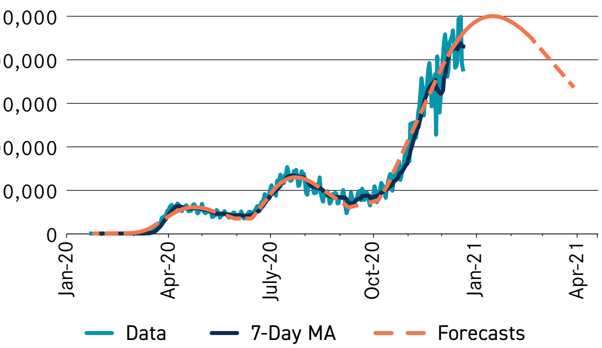


Figure 8B • California Daily New COVID Cases

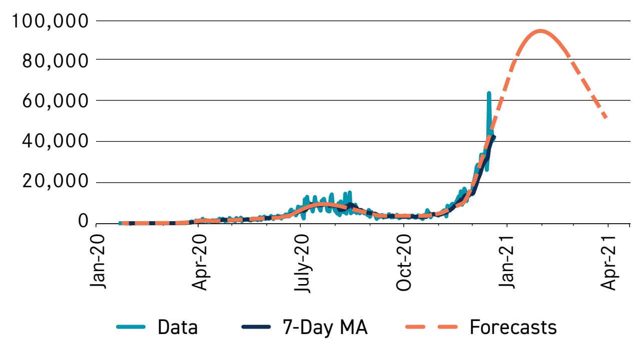
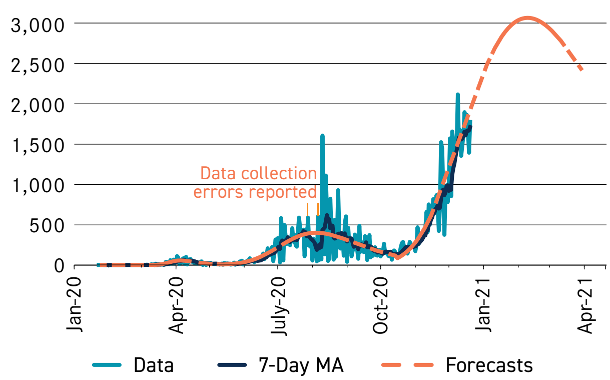


Figure 8C • 7-County Sacramento Region Daily New COVID Cases



Data Source (Figures 8A, 8B, & 8C): JHU CSSE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Consumer Sentiment *Survey*

For the 2021 annual release, the Sacramento Business Review (SBR), in partnership with SAFE Credit Union, conducted another round of our regional consumer sentiment survey. The survey included measures of personal and regional economic conditions along with purchasing and credit utilization.

Regional vs. National Sentiment

The SBR team once again compared regional sentiment to national sentiment measures with the results shown in Table 1. To measure sentiment, we utilized questions from the University of Michigan Consumer Sentiment© survey that were adapted to specifically address the Sacramento region. Per methods used by the University of Michigan survey, we calculated the following three indices for the region and compared them to the national data.

(1) **Index of Consumer Sentiment:** An overall measure of how consumers assess their own personal economic prospects and broader regional or national economic conditions.

(2) **Index of Current Economic Conditions:** A measure of how consumers assess their own personal economic prospects compared to a year ago along with perceptions about the current market for making major household purchases.

(3) **Index of Consumer Expectations:** A measure of what consumers expect to happen in the future for their own finances and the regional or national economy.

Regional consumer sentiment dropped since our mid-year update, although the decline was much less significant than what we observed during the first half of 2020. The largest decline regionally was in the index of current economic conditions, whereas the index of consumer expectations has held fairly steady since our mid-year 2020 update (see Table 1). In contrast, nationally, consumer sentiment rebounded slightly after dipping significantly during the first half of the year. National sentiment once again exceeds regional sentiment. However, national sentiment remains substantially lower than where it was a year ago (see Table 1 and Figure 1).

Regional Consumer Sentiment and Household Income

The data suggest that consumer sentiment continues to vary by household income level. As with our mid-year report in 2020, the data collected for our annual 2021 release show consumer sentiment is down across all income levels compared to where it was at the beginning of 2020. Also, the current data show that sentiment has remained flat or declined for all household income levels over the past 6 months, with the exception of the highest income category ($250,000 or higher), which is up

Table 1 · Regional vs. National

	Regional Index Score			National Index Score		
	Annual Release 2021	Change Since Mid-Year 2020	Change Since January 2020	Annual Release 2021	Change Since Mid-Year 2020	Change Since January 2020
Index of Consumer Sentiment	72.4	**-2.5**	**-21.8**	80.7	**+7.5**	**-18.6**
Index of Current Economic Conditions	72.8	**-5.7**	**-26.2**	90.0	**+5.8**	**-25.5**
Index of Consumer Expectations	72.1	**-0.4**	**-19.1**	74.6	**+8.4**	**-14.3**

Notes: National data obtained from the University of Michigan Consumer Sentiment Survey December 2020, available at: https://data.sca.isr.umich.edu/. Indices calculated using the methods specified at: https://data.sca.isr.umich.edu/fetchdoc.php?docid=24770.

> **THE ECONOMIC IMPACT OF CORONAVIRUS IS REFLECTED IN THE OVERALL DECLINE OF CONSUMER SENTIMENT**

Figure 1
Regional and National Consumer Sentiment

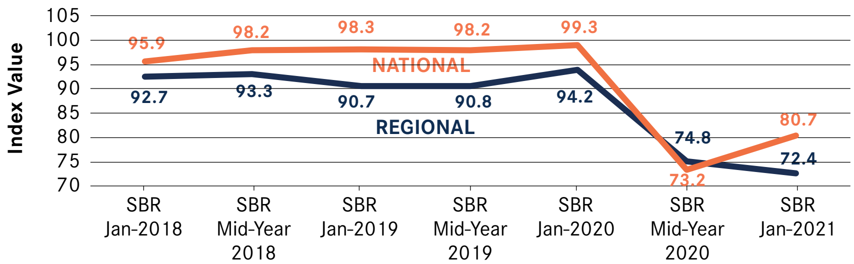

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Figure 2
Regional Consumer Sentiment By Household Income Level

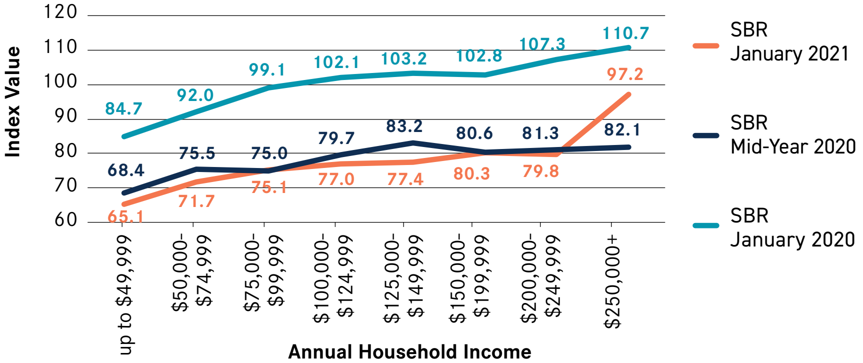
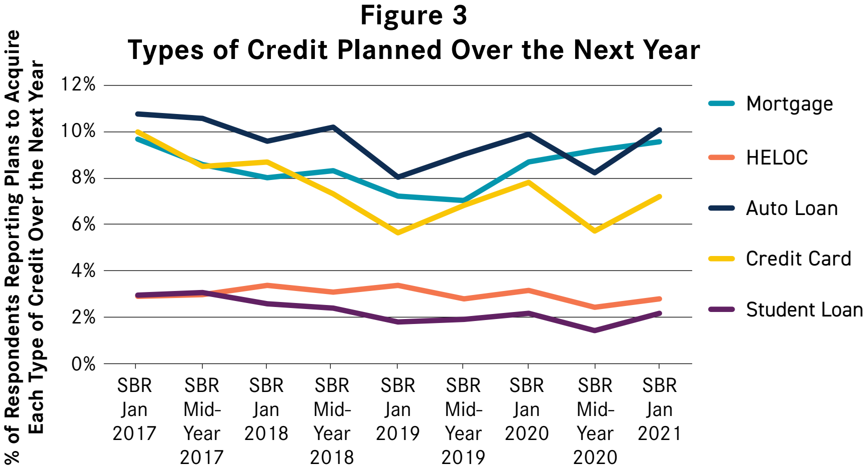


Figure 3
Types of Credit Planned Over the Next Year



considerably from where it was in mid-2020 (see Figure 2). The data reinforce the notion that the economic consequences of the pandemic are being felt unevenly across the population, with lower income households often being hit harder.

Purchasing and Credit

We again asked regional respondents about the types of credit they currently hold and their plans to acquire credit over the next year. While we didn't see a large change in patterns of credit held, plans for acquisition suggest a modest rebound in regional consumers' plans to acquire credit of all types compared to mid-year 2020 (see Figure 3).

Summary

The economic impact of coronavirus is reflected in the overall decline of consumer sentiment nationally and regionally since the beginning of 2020. National sentiment has started to recover in all categories compared to mid-year 2020. In contrast, compared to mid-year 2020, regional perceptions of current economic conditions continued downward slightly, whereas expectations for the future remained relatively flat.

The Small Business *Economy*

The *Sacramento Business Review* (SBR) team conducted its annual review of the Small Business Economy in the region. As usual, this includes a read on our proprietary Small Business Confidence Index (SBCI), a review on regional loan trends in El Dorado, Placer, Sacramento, and Yolo Counties, and a look at business transactions.

After analyzing the results of the (SBCI) survey, a slight rebound can be observed at the aggregate in the Economic Outlook as compared to the mid-year update. The positive increase from the mid-year reading is 17% higher. However, the reading is still low and the last time this was observed was in 2012. Further progress is needed, but other areas, such as credit access and the future revenue outlook paint a more positive story and seem to have recovered faster at the Services Sector and are closely tracking at or above their 18-month moving averages.

Lending activity data provided by the Small Business Administration shows that loan volumes are very different across counties. For example, lending activity in El Dorado County and in Sacramento County are at their highest levels in the last 15 years. Yolo County is having a strong year vs. 2019 and is on pace to finish with the second highest reading in the last 15 years. However, the story looks different for Placer County, where lending activity is down -32% year-over-year, a level not seen since 2013. Overall, lending activity volume on the Total MSA is on track to finish at the second highest reading in 15 years.

Figure 1 • Overall Sentiment

(January 2011 - January 2021)

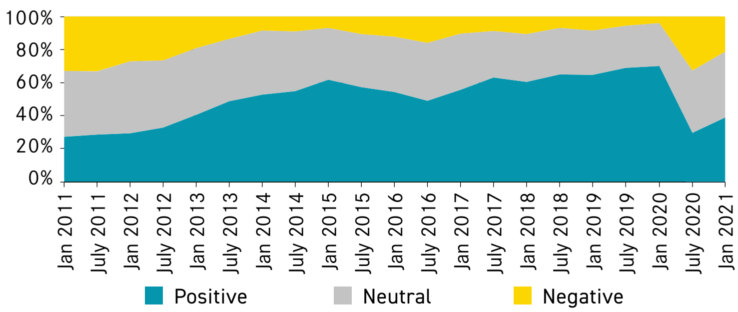


Figure 2 • SBCI Total: Economic Outlook

(18-month Moving Average)

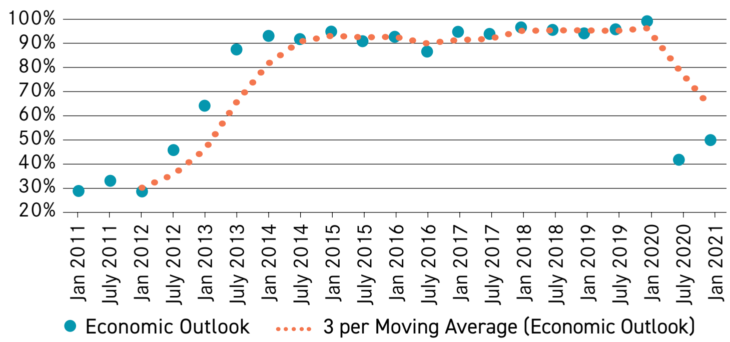


Figure 3 • SBCI Service: Credit Access

(18-month Moving Average)

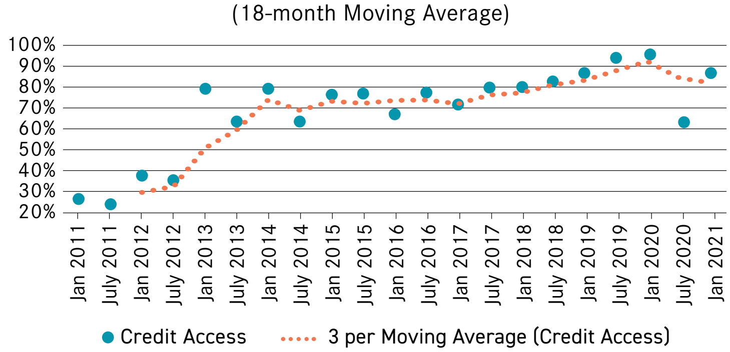
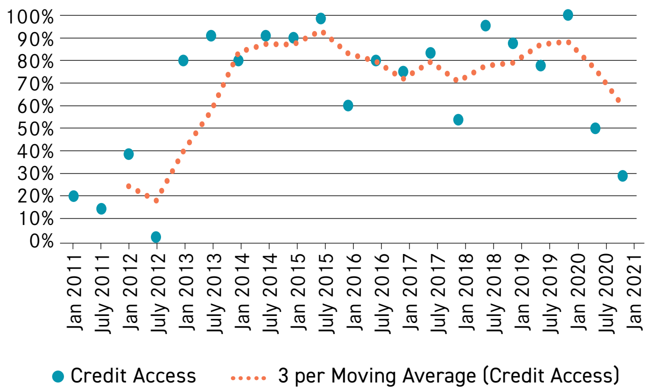


Figure 4 • SBCI Manufacturing: Credit Access

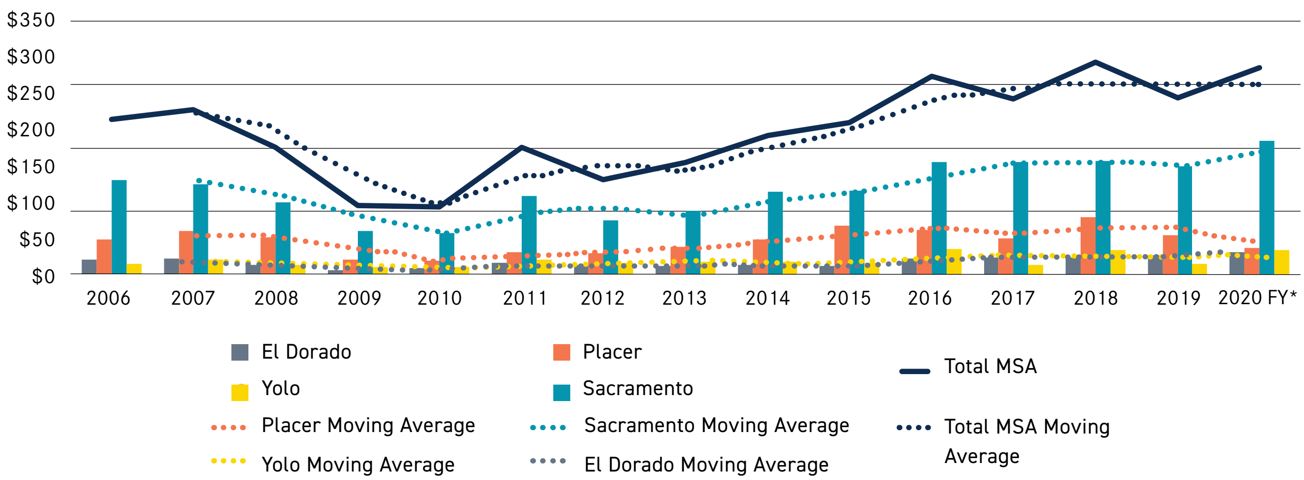
(18-month Moving Average)



Business transactions in the region have recovered from their lows, however, still far off from their latest peak seen in Q4 2019. The number of listings did not seem to improve from mid-year data. Revenue metrics for closed transactions recovered to 2019 levels, but the sales price of the transaction is below its one-year moving average. Finally, cash flow metrics improved slightly to Q1 2019 levels, but are still below the latest peak seen in Q4 of 2019. Due to the special economic circumstances this year, it may take longer than usual to resume back to normal activity.

Figure 5 • Total SBA Loan Approvals By County

(in millions, 2-Year Moving Average)



Moving Average is average of two previous data points. *FY: October 2019 through September 2020

Figure 6 • Number of Listings vs. Actual Sales (Quarterly)

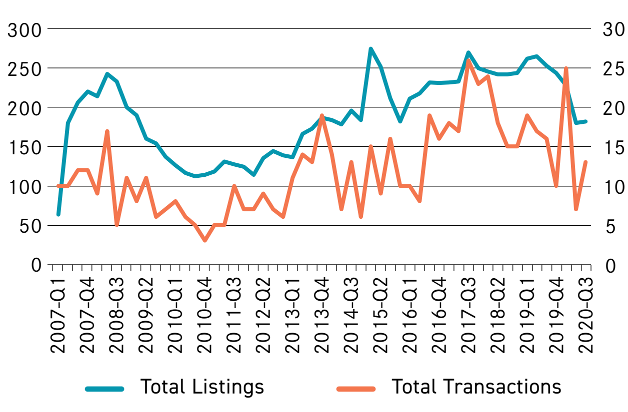
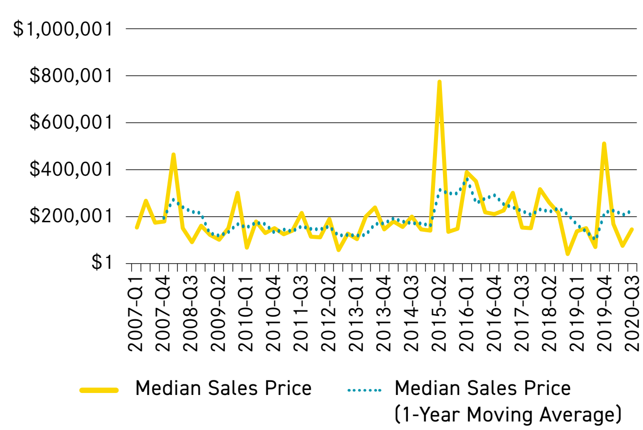


Figure 7 • Median Closed Sales Price (Quarterly)



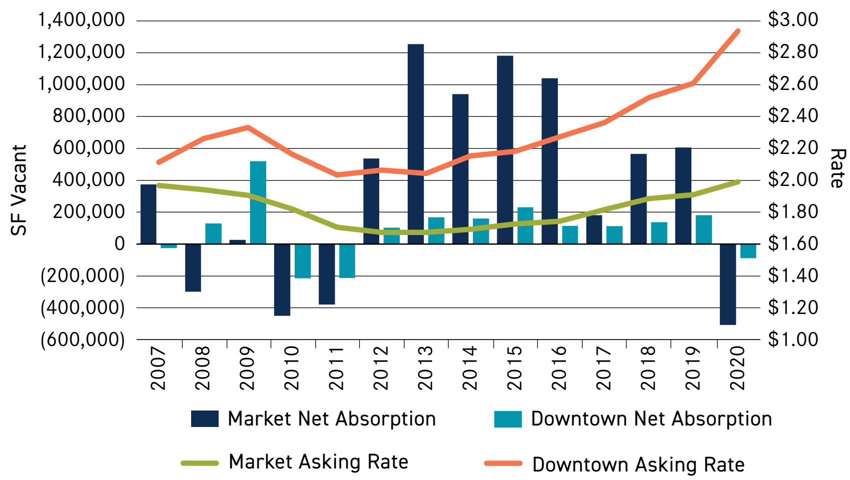
Real Estate

Office

The primary impact of the economic shutdown remains a decrease in occupier demand, throughout the third and fourth quarters of 2020. Market fundamentals bear this story out as annual net absorption totaled negative 506,000 square feet (sf), the overall vacancy rate ended the year at 11.7%, an increase of 130 basis points (bps), and the overall asking lease rate is beginning to plateau reaching $1.99, up only $0.02 since the third quarter of 2020.

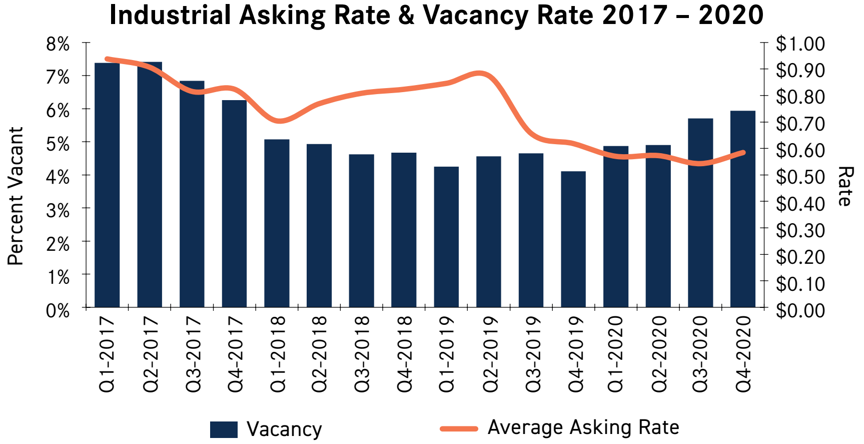
SACRAMENTO IS ONE OF THE ONLY LOW-RISK OFFICE MARKETS IN THE STATE.

Figure 1
Office Market Activity 2007 – YTD 2020



THE INDUSTRIAL MARKET IS THE BEST POSITIONED COMMERCIAL SECTOR TO WEATHER THE ECONOMIC CRISIS.

Figure 2
Industrial Asking Rate & Vacancy Rate 2017 – 2020



Looking long-term, the office market remains well-positioned to weather the impact of COVID-19. The lack of new, speculative construction during the prior economic cycle combined with an increasingly diversified tenant base, makes Sacramento one of the only low-risk office markets in the state.

Industrial

The industrial market is the best positioned commercial sector to weather to economic crisis. With consumer shopping increasingly shifting towards an online model, the need for large, high clear-height distribution buildings is increasing. Net absorption totaled negative 357,000 sf for the year, primarily due to single building vacancies. The vacancy rate ticked up, climbing 180 basis points (bps) year-over-year, but remains near full occupancy at only 5.9%. Construction remains a major market component, with 5.3 million sf under construction and 1.9 million sf completed during the year, led by the 1.1 million sf Wal-Mart distribution center at Metro Air Park in Natomas.

Despite the less than stellar annual figures, industrial product is the least affected commercial sector thus far. The large footprint of many users, particularly distribution users, combined with the scheduling flexibility that comes with shiftwork allows for greater distancing between workers.

Retail

The pandemic has had the largest effect on the retail sector. Repeated mandatory shutdowns of many retail establishments resulted in layoffs, economic hardship, and business closures. As a result, net absorption for the first half of 2020 totaled -99,000 sf. Vacancy was on the rise as well, increasing by 30 bps during the quarter. There is little relief on the horizon as a complete reopening is likely still months

Figure 3
Gross Absorption & Construction 2006 – YTD 2020

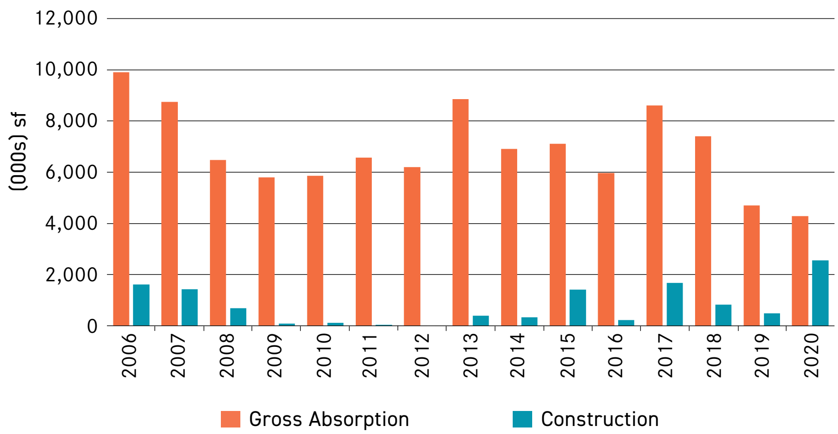
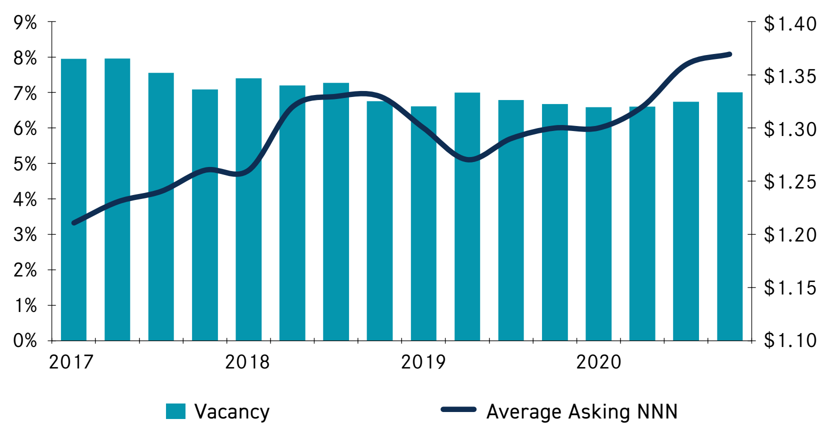


Figure 4
Retail Asking Rate & Vacancy Rate 2017 to YTD 2020



Repeated mandatory shutdowns of many retail establishments resulted in layoffs, economic hardship, and business closures.

Real Estate

PEOPLE FROM THE BAY AREA ARE NOW LOOKING TO RELOCATE TO THE SACRAMENTO REGION.

away and more time is needed before herd immunity through a vaccine can be achieved. In the meantime, retailers have growing competition from online shopping and struggle to find a short-term solution.

Single Family

The single-family housing market has enjoyed accelerated growth in the second half of the year. The median sale price reached $460,500 an increase of 10.9% year-over-year. With that said, the market transacts primarily at mid-range pricing, with 73.6% of all sales occurring between $200,000 and $600,000. Interestingly, the rapidly rising sale prices means that during 2020 Sacramento had more sales of $1 million or more than it did of less than $200,000.

The increase in demand is primarily coming from outside the market as people from the Bay Area are now looking to relocate to the region. In November, Redfin.com ranked Sacramento as the top destination in the country for people looking to leave their current metropolitan area, with most interested individuals coming from the Bay Area. As many top tech employers reevaluate their workplace strategy and shift towards a remote work model, more transplants could be coming in the near future.

Figure 5
Median Home Prices & Cost Per Square Foot 2015 - 2020

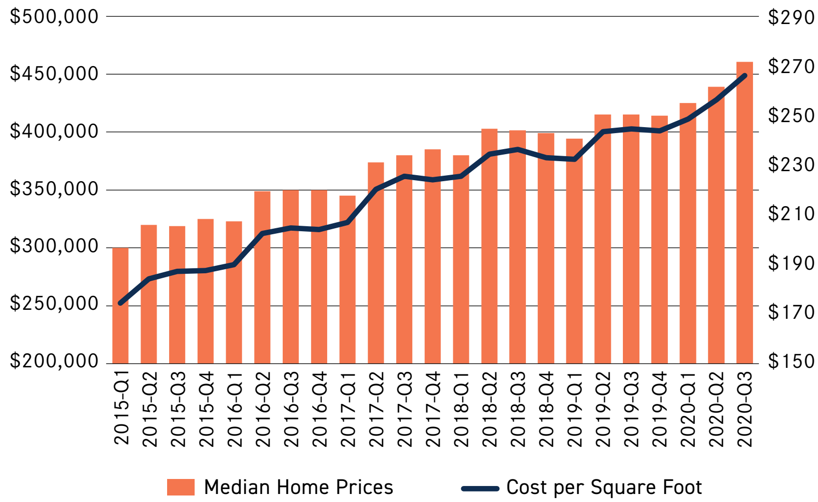
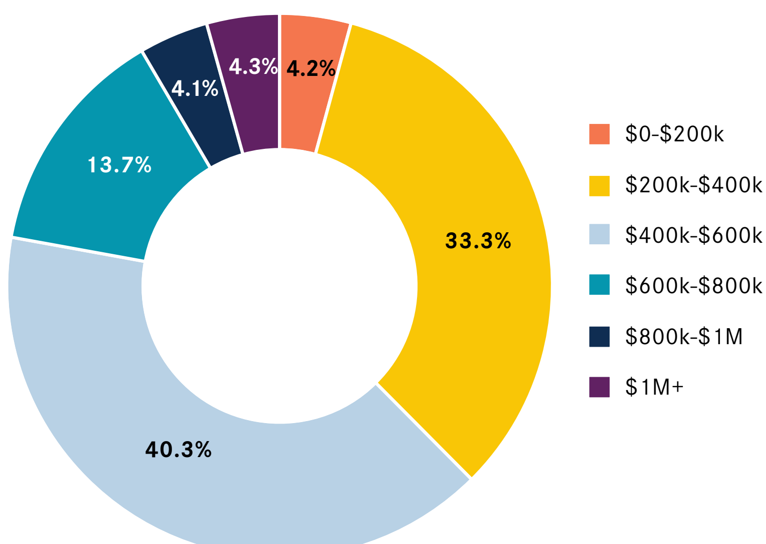


Figure 6
Home Sales by Price: YTD 2020



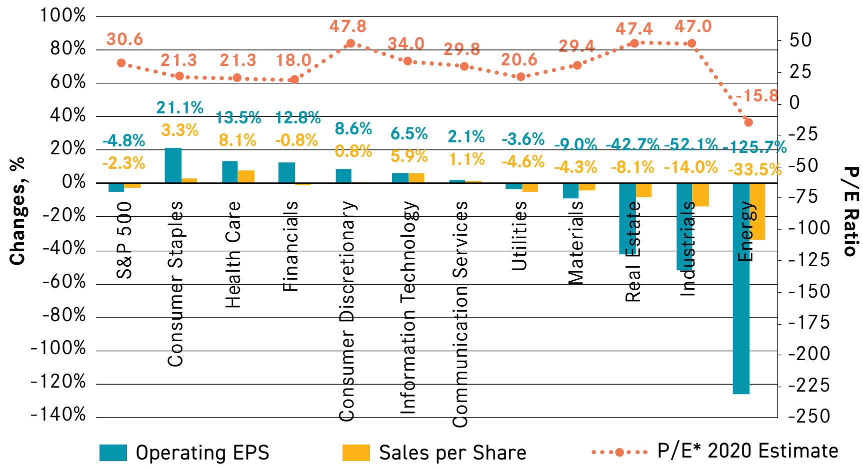
*2020 data includes January 1 through September 30

Capital Markets & Banking *Forecast*

THE S&P 500 ACHIEVED A RETURN OF ALMOST 15% IN 2020.

Given everything that has occurred over the past year, it is likely all will remember 2020 as "an odd one out" to say the least. Looking at the market and economic performance data, this is likely to be a year that marks the origins of several structural shifts for markets. Many would say that the U.S. economy is in a recession, but that does not seem to be much of a worry for equity investors with the S&P 500 achieving a return of almost 15% in 2020, largely fueled by the information technology sector (the NASDAQ is up by just over 42%). Technically, a recession did hit the U.S. earlier this year as states and local governments imposed lockdowns in the initial stages of the pandemic, but markets and consumers were quick to adjust through the summer months leading to a rather sharp rebound in economic activity.

Figure 1 • Sales, Earnings, and P/E by Sector



What Has Markets Reaching New Highs?

A number of indicators have been showing positive trends and helping to fuel optimistic sentiment for investors. GDP turned the corner in the third quarter of 2020 along with industrial production, and domestic unemployment figures, although elevated, have persisted downward. Additionally, hopes of a rapid deployment of COVID-19 vaccines have many thinking the world will be open for business sooner than once thought. We cannot forget the massive fiscal and monetary stimulus, of course, which played a major role, pushing markets to lofty highs at year-end. The Federal Reserve's balance sheet has ballooned by more than $3 trillion since the beginning of 2020, and Congress just passed a second relief package, bringing total 2020 fiscal stimulus to over $3.5 trillion. For perspective, recall that the Troubled Asset Relief Program (TARP), the bailout authorized by Congress in October of 2008 to stave off the Financial Crisis, amounted to "only" $700 billion.

Our Outlook

With the bulk of the recession hopefully behind us, the SBR team is cautiously optimistic with the outlook for the next year. We expect equity markets to achieve double digit returns in the 10% to 15% range, with growth dominated by the IT, Healthcare, and Consumer Discretionary sectors. Savings accumulated over the past year will start finding its way into discretionary products, travel, and entertainment spending, boosting these sectors' performance in 2021. Corporate earnings and sales have already shown healthy growth that is likely to continue. The Fed will most likely continue to keep rates low, providing additional support to increase economic activity. Inflation is one key risk over the next 12 to 24 months, which many acknowledge, but few spend much time worrying about. It seems impossible that the massive global stimulus injected into the financial system will not come back to haunt us in the form of rapid price increases, and the Fed has acknowledged that higher average inflation may be in our future.

Figure 2 • Real GDP, S&P 500, and Corporate Profits

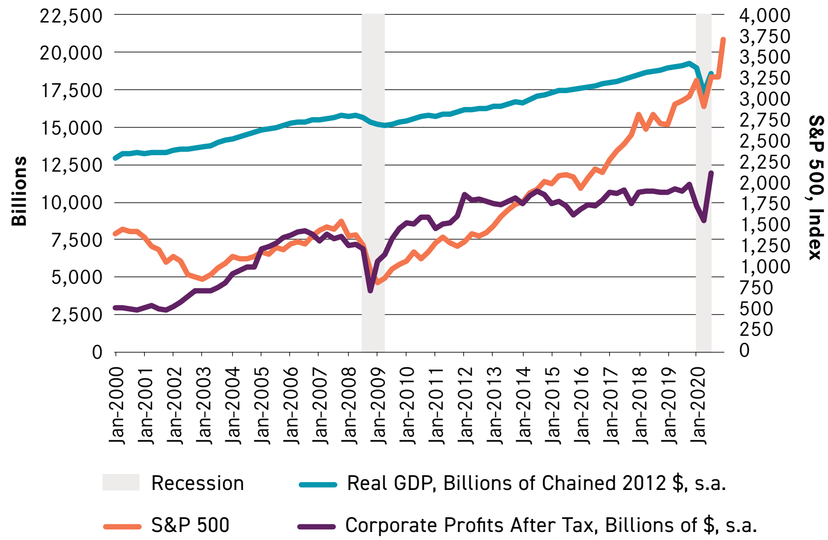
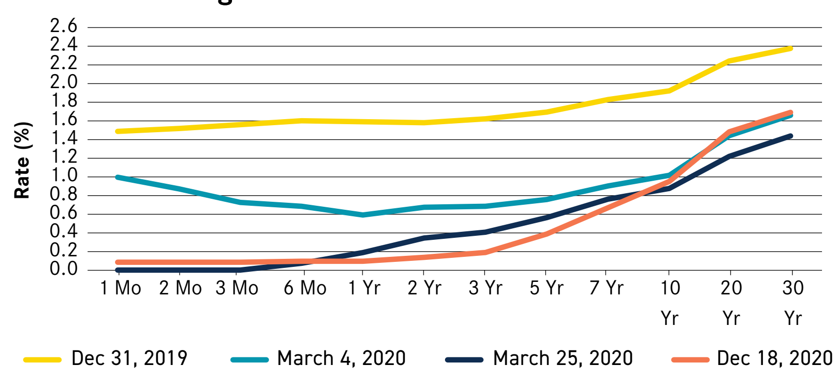


Figure 3 • Recent Yield Curves



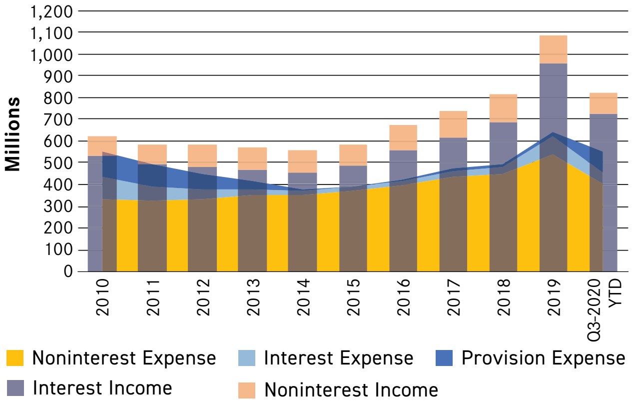
Regional Financial Institution Performance and a Look Ahead

Regional financial institutions (FIs) have seen some amazing asset growth this past year, approaching 20%, due to increased savings in the recessionary environment. However, the sharp increase in assets has come at a time of historically low interest rates, putting severe downward pressure on net interest margins. Also impacting the bottom lines of regional FIs were increased provision expenses, as institutions prepared to weather a sharp downturn in credit quality, incited by the pandemic influenced rise in unemployment and the reduced economic activity related to lockdowns and operating restrictions for local businesses.

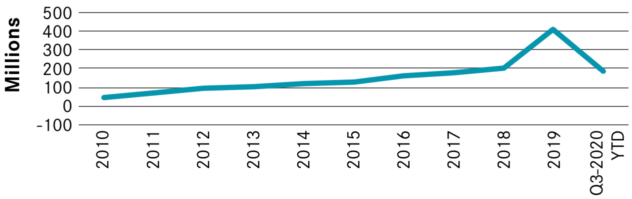
Regional FIs, mainly banks, will have another opportunity to facilitate loans through the Payment Protection Program (PPP) under the most recently approved fiscal stimulus package. With local FIs extending more than $1.5 billion of PPP loans in 2020, the Program has had — and will continue to have — an incremental, positive impact on net income. However, the PPP does come with significant logistical and servicing hurdles that FIs must account for when evaluating the Program's overall benefit.

In spite of the recession, loan quality has been surprisingly healthy, with the ratio of loans in a nonaccrual status to total loans persisting well below 1.0% for both the commercially focused banks and consumer focused credit unions.

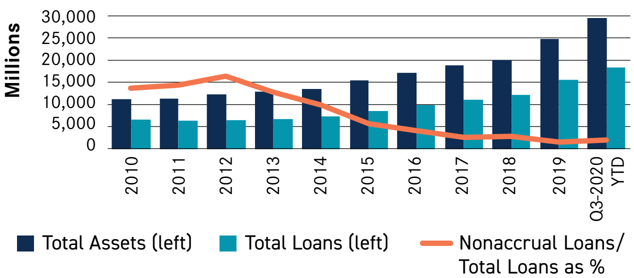
Figure 4 • Regional Banks – Key Income Statement Items



Net Income

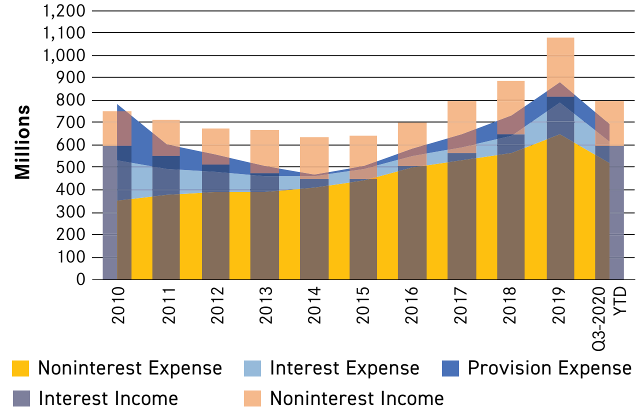


Regional Banks – Asset & Loan Performance

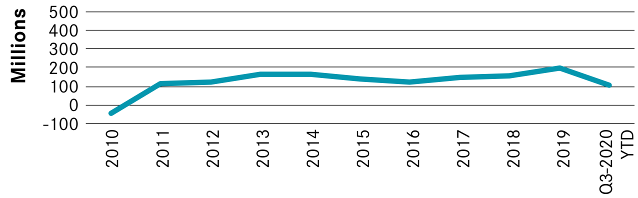


Source: FDIC

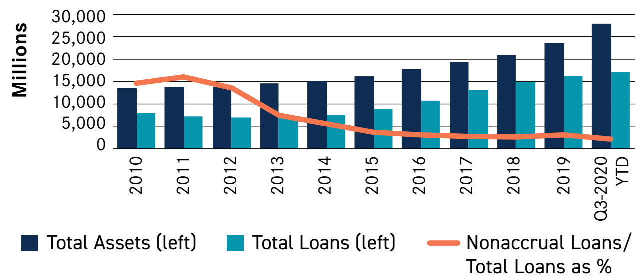
Figure 5 • Regional Credit Unions – Key Income Statement Items



Net Income



Regional Credit Unions – Asset & Loan Performance



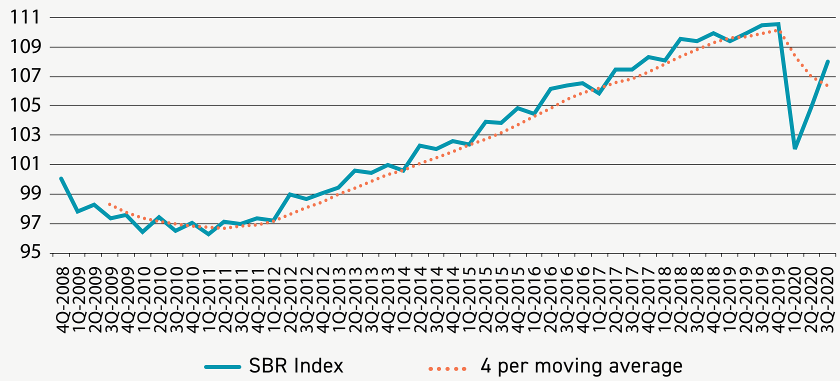
Source: NCUA

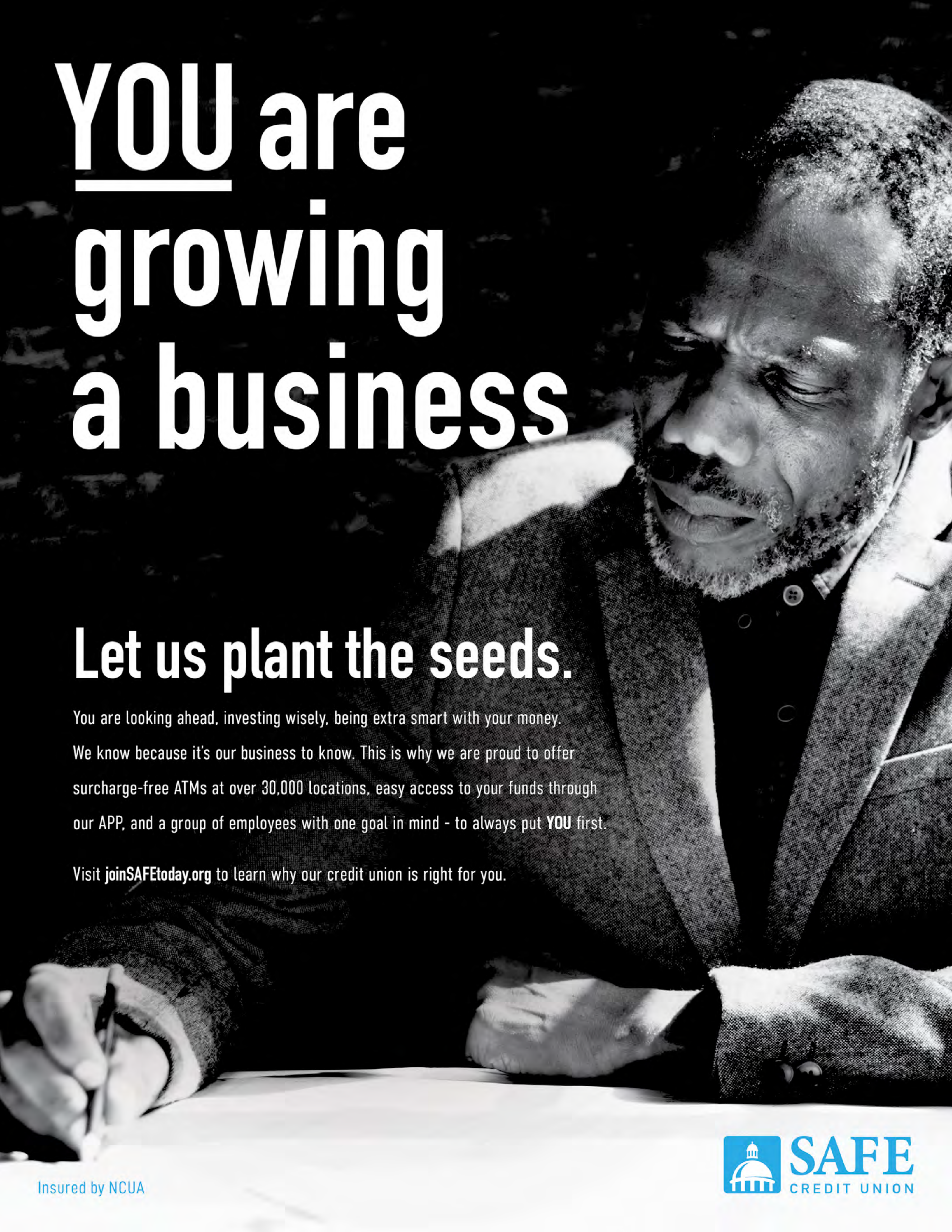
Our Outlook

The SBR team expects local area FIs to have difficulty growing their bottom line in 2021 with significant headwinds for net interest margin as well as credit losses that could begin to materialize in the first half of the year. Interest rates on the asset side of the balance sheet are likely to remain low, but rates paid on the liability side of the balance sheet may become more competitive if deposits begin to flow back out with the reopening of the economy.

Sacramento Business Review Financial Conditions Index

Our proprietary financial conditions index, which acts as a broad measure of economic health for the region, confirms that the Sacramento area followed broader economic trends with both a sharp decline and a sharp rebound in economic activity through the third quarter of 2020. We see regional economic growth remaining at or near current levels as we continue to face the pandemic situation well into 2021.




YOU are growing a business
Let us plant the seeds.
You are looking ahead, investing wisely, being extra smart with your money. We know because it's our business to know. This is why we are proud to offer surcharge-free ATMs at over 30,000 locations, easy access to your funds through our APP, and a group of employees with one goal in mind - to always put YOU first.
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Human Capital Trends

> *We are seeing organizations lean slightly toward actively laying off employees in our region; moving away from remaining at current talent levels and indicating little to no new recruitments.*

IN 2021, ORGANIZATIONS ARE PROJECTING A GREAT REDUCTION IN RESIGNATIONS.

Our human capital indexes are illustrated in figures 1-6 on the following page. Movements in the graphs may appear slight; however, since the responses are on a three-point scale, even small movements have real impact. In general, positive numbers indicate movement in the desired direction, and negative numbers indicate decline.

We are seeing that Sacramento employees are not expected to head out the door in 2021. For 2021, organizations are projecting a great reduction in anticipated resignations (Figure 1). Relatedly for headcount, we are seeing organizations lean slightly toward actively laying off employees in our region; moving away from remaining at current talent levels and indicating little to no new recruitments (Figure 2).

ORGANIZATIONS ARE EXPECTING TO MEET COMPENSATION GOALS THIS YEAR.

In the last couple of years, we have reported a heavy focus on training and development; however, this trend is slowing down slightly (larger numbers means that the organization is expecting to meet their goals for training and development). Current numbers indicate a small slowdown in need for training and development (Figure 3). Perhaps the focus on training and development over the last couple of years is starting to produce downstream effects.

Similarly, we previously reported stunted numbers regarding organizations' compensation goals (Figure 4). However, we see a boost for 2021, suggesting that organizations are expecting to meet these compensation goals this year. Forecasting 2021 on the optional benefits and perquisites side, numbers continue their uptick, showing that organizations are more stable than prior years and showing an even stronger intent to maintain current levels (Figure 5).

In spite of the increased awareness of racial justice and diversity efforts nationally, the upcoming year shows that local Sacramento organizations plan to maintain current levels of diversity and inclusion efforts compared to prior years (lower number indicates maintaining current levels as opposed to increasing efforts) (Figure 6).

Figure 1 • Resignations

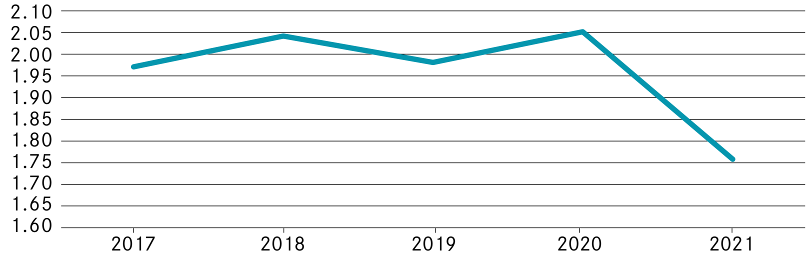


Figure 2 • Expected Layoffs

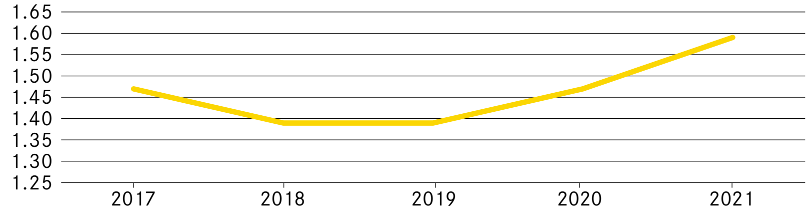


Figure 3 • Meeting Training/Development Goals

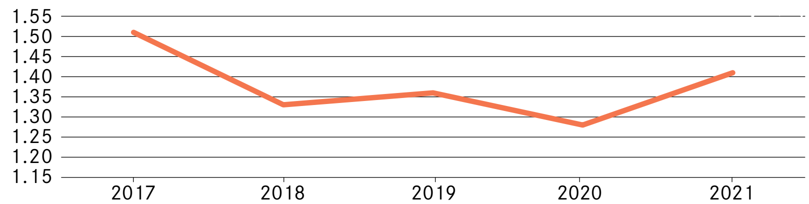


Figure 4 • Meeting Compensation Goals

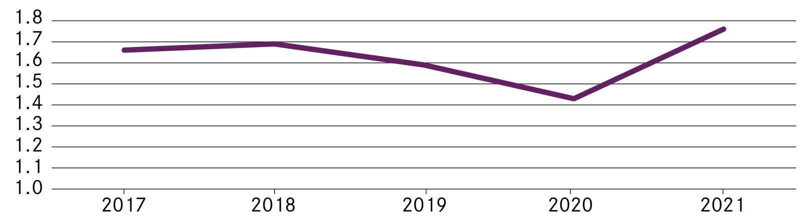


Figure 5 • Meeting Goals for Optional Benefits

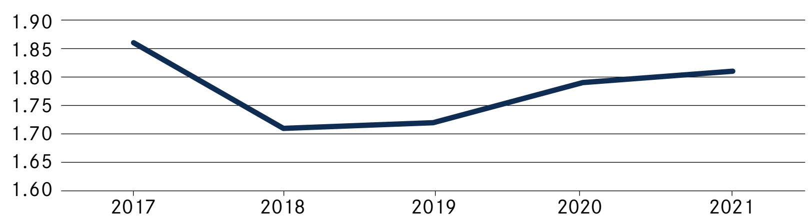
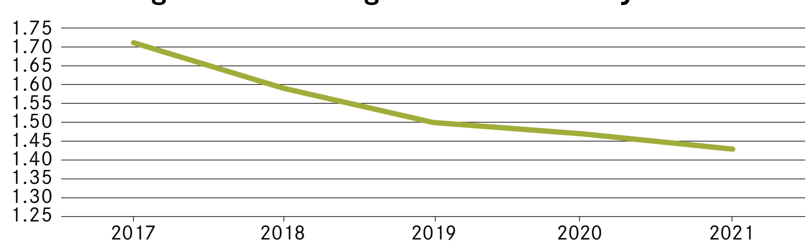


Figure 6 • Meeting Goals for Diversity



Factors Expected to Exert the Most Influence on Organizations in 2021

Among the factors expected to exert the greatest influence on local organizations (Table 1), pressure on cost reduction has retained its top ranking from 2019 and 2020. This year, its close cousin — challenging productivity and profit targets — comes in at second place (up from 5th). We have seen additional shifts in the most significant pressures, with the talent shortage and skills gap – which have dominated the top together with cost pressures – shifting downward (from 2nd to 9th, and from 3rd to 4th respectively). These numbers tell us that local organizations have more job candidates available than recent years; however, they still lack the skills and abilities needed. This is also reflected in organizational efforts to develop new competencies (3rd place, up from 4th).

Artificial Intelligence (machine learning and new technologies) is still not yet realizing a top spot locally, although it has moved from 9th to 7th in importance. Given the current ongoing pandemic, we are now seeing market volatility and fear of a recession moving up to 6th place from 9th. Pandemic recovery – a new entry in our survey – came in at number 8. Our country also witnessed racial unrest last year, which may not translate into local efforts; the new entry, racial justice, ranked in 13th place. Downsizing keeps the bottom rank and remains the lowest predicted probability event for 2021.

In the open-ended answers, several comments included the novel challenges with remote working and difficulty in the ability to train new hires in this new form. Strategic planning included closing regional offices as large parts of the workforce now work from home. Employers are reporting that employees are happier and more productive working from home; work from home is more effective than expected; and international teams proved to be more important to company success than realized prior. Another pandemic related problem has been recruiting into the healthcare field – one of the growing industries here locally in the past few years. Healthcare employers indicate it's more challenging to recruit, as fewer job candidates want to work in the medical field because of the current risks.

Diversity-related during the pandemic, as reported, is that parents seem to be affected most severely with childcare and schooling issues, and working mothers take on the majority of home school responsibilities. As the pandemic becomes more of a long-term issue, organizations may need to consider needs-based policies and benefits. Generational issues include older managers being less willing to accept the reality of employees working remotely, equating face time in the office to productivity. There is some unwillingness to be creative about letting work-from-home continue after COVID public safety issues are resolved, even in situations where employees thrive on the work from home environment. The assumption of "in-person is a must" is not true anymore. This offers an opportunity for organizations to train managers in effective remote management.

The pandemic has also highlighted the importance of timely communication, as well as transparency and openness. Overcommunicating is preferable to undercommunicating. Being clear and open with employees is essential. Communication is key, and there is never enough of it. Tight processes and policies are essential.

Finally, as organizations quickly had to adjust overall policies and procedures — or create and implement new ones — to accommodate the stay at home orders, they are now reevaluating these procedures in the first half of 2021. The pandemic has also highlighted the importance of preparation and having emergency and crisis management plans in place, and to communicate more effectively with employees when a crisis occurs.

The pandemic of last year is very much imprinting on HR and management practices of the upcoming year, showing us that local organizations are staying agile and finding opportunities to thrive in crisis.

Table 1

2021's Most Significant Pressures	Rank
Pressure on cost reduction	1
Challenging productivity and profit targets	2
Development and management of new competencies	3
Skills gap (job candidates available but don't have desired skills)	4
Change in company culture	5
Market volatility and fear of recession	6
AI (machine learning, new technologies)	7
Pandemic recovery	8
Talent shortage (job candidates not available)	9
Increased market competition	10
Expansion of operations in new markets	11
Organizational restructuring	12
Racial justice	13
Downsizing	14