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2017
Central Coast
Economic
Forecast

Presented by Beacon Economics

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U.S. Forecast

by Christopher Thornberg

Beacon Economics

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The National Outlook: Cruising Through Rough Waters

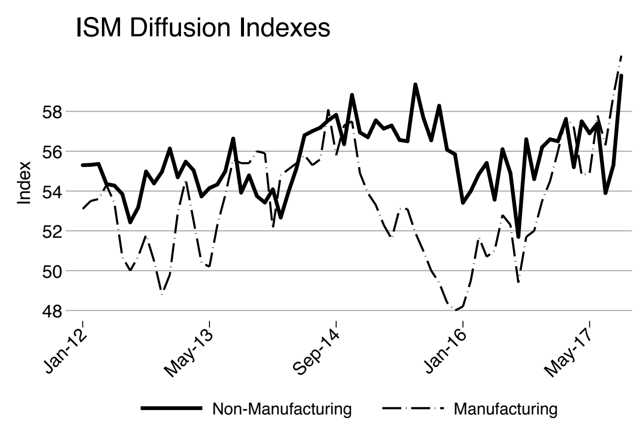
It may be tempting to interpret the hurricanes pounding the Southeast, major earthquakes in Mexico, bigger bombs going off in North Korea, and President Trump making a budget deal with the Democrats as the four horsemen of the economic apocalypse. Yet, despite all the scary headlines, under the surface the U.S. economy is ticking along at a steady if unexciting pace. Growth came in at 3% for the second quarter of the year (the best since the first quarter of 2015), making up for a relatively weak first quarter, and the outlook for the rest of the year remains in the 2.5% range. Overall, Beacon Economics expects the U.S. economy to grow faster in 2017 than during the last two. And the outlook for 2018 looks remarkably similar, short of some major change in government policy.

Here are some of the key economic trends we expect to see over the coming months.

Businesses are investing: One of the best signs for 2017 is the solid recovery in non-residential investment. Oil prices have stabilized and production and exploration are yet again on the rise. Globally, the European Union is seeing solid growth, China has stabilized, and commodity economies have started to bounce back, fueling U.S. export growth. The ISM Manufacturing Index for August had the highest reading in 6 years. The European Central Bank just announced the end of their quantitative easing program and the USD is beginning to depreciate from recent high levels, which should help maintain these trends in the second half of the year.

Source: Federal Reserve Bank of St. Louis

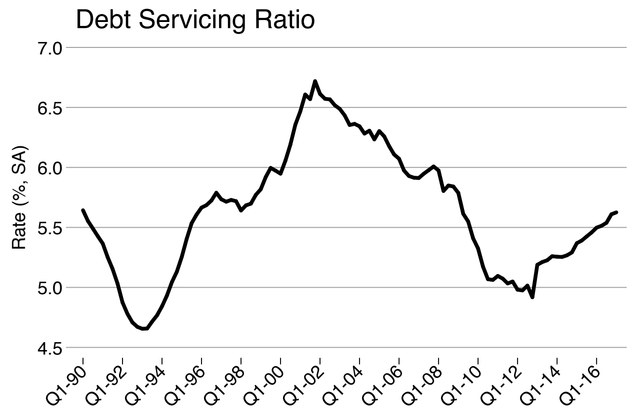
Disaster Economics: Only halfway through hurricane season, Houston is still in the midst of a major clean up after Hurricane Harvey inflicted unprecedented damage on this enormous metropolis, and the damage Hurricane Irma wreaked on Florida is still being assessed. The human tragedy of these storms is clear, but it is a mistaken to think they will have a negative impact on economic growth. In contrast, the rebuilding that occurs will actually stimulate economic growth in the short term, particularly in the residential sector as billions of dollars will be poured into fixing or replacing damaged homes. This certainly does not imply that natural disasters should be welcomed as a tool for economic stimulus – the surge in activity is driven by the need to replace destroyed capital (not to mention shattered lives). On net, we are worse off.



Source: Institute of Supply Management

Consumers to Rebalance: While business spending is heating up, we expect consumer spending to disappoint in the second half of the year. Solid growth in consumer spending kept the economy humming through the commodity bust—but spending got ahead of incomes by a good margin. The consumer savings rate has dropped below 4% of disposable income for the first time since before the Great Recession—a very worrisome trend since overspending today can lead to future problems. Beacon Economics believes consumers are starting to rebalance their spending, as least as indicated by recent softness seen in auto and retail sales. The expectation is that savings rates will begin to drift back up throughout the rest of 2017. Even better news is that this rebalancing will occur without many ‘side effects’ because consumer debt burdens are still near an all-time low level and the tightness of the labor markets is driving solid wage gains.

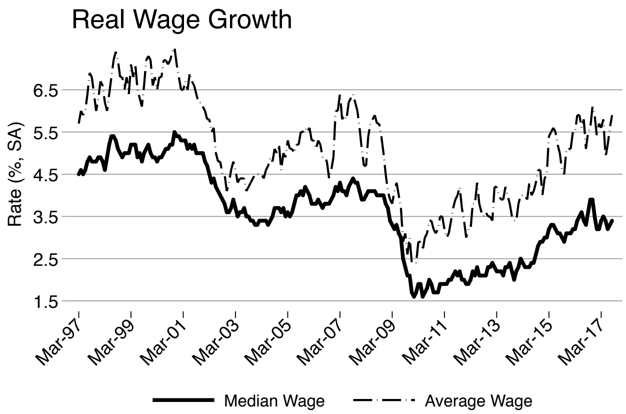
Source: Federal Reserve Bank of St. Louis



Source: Federal Reserve Bank of St. Louis

Beware the Labor Shortage: One of the key messages of Donald Trump’s presidential campaign last year focused on the lack of job opportunities for Americans—driven, he claimed, by bad taxes, bad regulations, and the huge number of undocumented workers in the nation. As much as that message resonated with part of the American public, it simply isn’t true. The United States was close to full employment during the campaign and now is not only at full employment but will start feeling the pinch of a labor shortages this year particularly in relation to the recovery and clean up efforts that will begin in the Southeastern areas of the nation affected by the recent hurricanes. The country’s headline unemployment rate is now at 4.4%—the lowest since the 1960s with the brief exception of the tech-bubble-fueled-economy of the late 1990s.

There are a number of benefits to a tight labor market—not the least of which is rising wages for workers. This might seem like a contradiction to the vast majority of press coverage of monthly jobs data, which almost always laments the lack of income growth. But the popular press is failing to account for low inflation and certain issues with the labor survey. Once we account for these issues in the data, the picture reveals that, on average, U.S. worker wages are rising at almost the fastest rate they have in 25 years.



Source: Federal Reserve Bank of Atlanta

Rising wages are pulling people back into the workforce and labor force growth is as strong as it has been in over a decade. This is a positive for discouraged workers who may have formerly dropped out of the labor force as they will be given opportunities to receive training and experience. But the pool of 'discouraged' workers is small—2 to 3 million at most. Soon, even that reserve of workers will be gone, and in addition, the baby boomers are beginning to retire in force. The solution to this problem is the expansion of immigration, an entirely opposite stance from the one the current presidential administration is pursuing. As always, our generals continue to fight the last war—not the next one.

The Trump Effect: This brings us to Federal policy, or perhaps the lack thereof. When President Trump entered office he promised radical shifts in government policy. Some of those policies could have been modestly stimulating to economic growth, while others could have put the nation on a path straight into recession. This uncertainty has been a concern for Beacon Economics—if not the stock markets, which have continued their climb into the stratosphere. But despite our unease, nothing has happened at the Federal level except the most basic functions of state. In many ways, the stasis currently gripping Washington DC looks to be a lot like what occurred under the Obama administration, with the exception that it is incompetence rather than partisanship that is now freezing the wheels of government. At this point, Beacon Economics believes the chance of a major change in policy (positive or negative) occurring is small but real. In the meantime, we're sitting back and taking in this year's must-watch TV—Survivor: White House.

Janet's Choice: And what about equities? Banks have been slowing their lending, commercial real estate markets seem to be plateauing, there are a variety of political and global worries, and rising wages are putting pressure on profits. But despite all this, equity markets continue to break records month after month. In Beacon Economics' view the market has become frothy—and apparently this is the view held by the Fed as well. They have continued to tighten despite the fact that bond rates have barely budged and inflation is already slowing from the very brief surge seen at the start of the year. The Fed is in a tough spot. They need to figure out how to slow equities before they end up popping on their own with potentially dangerous consequences. Yet, to date, raising the Federal Funds rate and starting to sell off their balance sheet, clearly isn't doing the job. Confounding the issue further is the question of leadership at the Fed in 2018 when Janet Yellen's term comes to an end. The prediction as to what the Fed does next boils down to a coin toss.

California Forecast

by Robert Kleinhenz

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The California Outlook **6**

The California Outlook

Limits to California's Economic Growth

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

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

Not So fast!

Yes, California's pace of job growth has slowed considerably, but not because the expansion is stalling out. In fact, the state continued to add jobs through the first several months of this year, but at a slower rate. Wage and salary jobs rose by 1.7% year-over-year in July, adding 276,300 jobs year-to-year, second only to Texas. In the private sector, the Health Care industry made the largest contribution, followed by Construction, and Accommodation and Food Services (by far the largest sector within Leisure and Hospitality). Professional Scientific, and Technical Services, the source of so much job growth in recent years, was essentially flat, as was Retail Trade. The Government sector saw a significant gain mostly due to hiring by local governments. Otherwise, job losses occurred only in Mining and Logging and in Durable Goods. In all, growth across the state has driven the unemployment rate below 5% in recent months, to the lowest rate since 2000.

Industry Job Gains Continue

Location/Industry	Jul-16 (000s)	Jul-17 (000s)	Change (000s)	Change (%)
Total Nonfarm	16,508	16,784	276.3	1.7
NR/Mining	24	23	-1.4	-5.7
Construction	776	827	51	6.6
Manufacturing	1,308	1,294	-14.1	-1.1
Durable Goods	819	819	0	0.0
Non-Durable Goods	489	475	-14.1	-2.9
Wholesale Trade	723	736	13.4	1.9
Retail Trade	1,684	1,684	-0.2	0.0
Transport,Warehouse,Util.	588	596	7.6	1.3
Information	524	529	5.2	1.0
Finance and Insurance	546	549	3.1	0.6
Real Estate	278	282	4.3	1.5
Prof Sci and Tech	1,229	1,229	-0.1	0.0
Management	226	231	4.5	2.0
Admin Support	1,089	1,100	10.4	1.0
Educational Services	354	368	13.4	3.8
Health Care	2,189	2,249	59.5	2.7
Leisure and Hospitality	1,897	1,949	52.6	2.8
Accommodation and Food	1,597	1,642	45.2	2.8
Other Services	559	577	17.9	3.2
Government	2,514	2,563	48.9	1.9

Source: California Employment Development Department

Despite the slowdown in job growth there California's gross state product continues to advance nicely, increasing by 3.1% from the first quarter of 2016 to the first quarter of this year. However, taxable sales growth slowed considerably, advancing by just 2.7% year-to-year in the first quarter of 2017 compared to a 6.7% increase in the final quarter of 2016.

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

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

Build It... They're Already Here

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

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

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

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

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

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

That is not to say that California won't grow. It will. The state and its regions should experience continued growth in economic activity and jobs throughout 2017 and into 2018. Most of the job gains will occur in Health Care, Leisure and Hospitality, and Construction. But California will fall short of its potential until it crafts long-term supply-oriented solutions to the chronic problem of high housing costs and low housing affordability.

San Luis Obispo County Forecast

by Justin Niakamal

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Key Chapter Findings

- Beacon Economics expects San Luis Obispo County to stay on course through 2017 and into the next couple of years. Employment levels continue to rise, the unemployment rate continues to inch lower, and home prices continue to appreciate above historic average rates.
- As of the second quarter of 2017, the County's median-priced single-family residence was 5.3% below its prerecession peak. Beacon Economics expects home prices in the County to surpass their prerecession peak in mid- to early 2018.
- Although it's anticipated that the local economy will continue to expand, the region faces some impediments to growth. A thin supply of housing coupled with a slowdown in labor force expansion is a recipe for slower growth on the horizon, but slow growth is better than no growth.

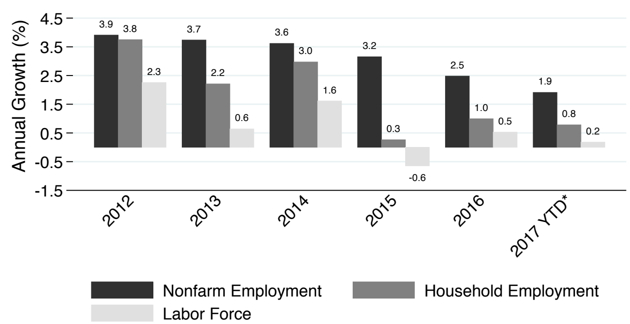
Overview

Growing, but slowing...

San Luis Obispo County's economy grew through the second half of 2017, although, as in the State as a whole, the pace of growth is somewhat sluggish compared with the last five years'. County nonfarm employment has grown, and the average unemployment rate now stands at 3.8%, the lowest level since 1999, which averaged 3.2%. Economic activity advanced relatively slowly in terms of total output, but local spending remains a bright spot, as marked by the growth in taxable sales, notably for business and industry spending. The County continues to play to its key strengths, including a strong tourism sector and an agricultural sector that is gaining steam now that the drought is over.

Job growth has outpaced the County's labor force growth every year since 2011. But by this year, so much slack had been eliminated from the labor market that job growth going forward will be bound by the supply of labor.

The County's economic slowdown is readily apparent in labor market statistics. Job growth exceeded 3% in the early years of the expansion and posted a 2.5% annual increase in 2016, but will be hard-pressed to hit 2% in 2017. For the first nine months of 2017, total nonfarm employment in San Luis Obispo County was 1.9% higher than the same period in 2016, but the latest figures for September 2017 indicate that jobs were up just 1.0% year to year.



*Year to date through Sep-17
Source: California Employment Development Dept.

Why are things slowing? A primary driver is the lack of labor supply. In 2016, for example, the labor force in San Luis Obispo County grew 0.5% from 2015. With slack in the labor force, nonfarm employment grew 2.5% over the period. In fact, job growth has outpaced the County's labor force growth every year since 2011. But by this year, so much slack had been eliminated from the labor market that job growth going forward will be bound by the supply of labor. Further reasons for the slowdown will be explored in the Outlook section of this chapter, but it appears that a shortage of new housing is also limiting growth, as elsewhere in the state.

Local Economic Performance

At the industry level, local gains have been concentrated in selected industries. Leading the way in job gains was the Leisure and Hospitality sector, which grew 3.6% over the year ending in September 2017, beating the State's 2.0% gain. Construction also posted solid gains over the past year, with employment growing 8.2%. Growth in the Construction sector is generally a good sign because it tends to be a leading indicator for economic activity. Closely behind the Construction sector was Manufacturing, which increased 5.8% year over year, largely because of a sizable gain in Non-Durable goods employment (10.3%).

Although there were gains across a few export-oriented and locally serving industries, there were also a few losers over the yearlong period. Among the major industries with job losses were Government and Professional and Business. The drop in Government was attributable to declines in Local Government payrolls, while the Professional and Business sector's decline was largely the result of a contract in the Management of Companies and Enterprises sector.

In addition to job gains, the County's local spending has increased, a result of recent years of job growth and more recently, income growth. Employment gains in the consumer-facing Leisure and Hospitality industry have been a boon to Restaurants and Hotels, with taxable receipts up 5.4% over the last year. Additionally, the employment gains in Construction have translated to meaningful increases in real output. Notably, output in the County's Construction sector grew 8.8% in 2016 (the latest data available).

The County's farm industry also posted positive gains as measured by output and employment growth. In April, Gov. Jerry Brown officially declared the drought over, with the exception of a few areas, none of which are in the County. Although the industry survived the lack of storms, the end to the drought should lead to more prosperous yields in the next year. Current data on the County's Agricultural sector show that total commodity values increased 10% in 2017 year to date, one of the best periods on record.

A long-run issue is the closure of the Diablo Canyon nuclear power plant. It has long been a part of the local economy but is scheduled to close in 2025 when its operating license expires. Although the plant is one of the largest contributors to the local economy, the utility has promised a number of settlements to help cushion the blow once operations cease. Pacific Gas and Electric Co., which owns and operates the plant, has committed millions of dollars to retrain employees for decommissioning and has agreed to pay the county $85 million to offset declining property taxes.[1] PG&E recently proposed a $352 million employee retention and severance program that could keep millions of dollars in the County as the plant is decommissioned.

Additionally, the Cal Poly San Luis Obispo Center for Innovation and Entrepreneurship received $500,000 to fund startup development in the county as part of an effort to mitigate job losses from the pending closure of Diablo Canyon.[2] Local government agencies, communities and businesses also stand to lose a large source of property taxes, spending power, the utility's charitable support and other benefits from the plant and its workers. As the situation develops, Beacon Economics will be keeping a close eye on the closure and

[1] *Santa Maria Times*. (2017, Sept. 10). Retrieved Oct. 20, 2017, from `http://santamariatimes.com/news/local/two-diablo-canyon-hearings-planned-public-urged-to-speak/article_81f9c86e-71f7-5053-94f0-47b6c260f105.html`

[2] *Pacific Coast Business Times*. (2017, Sept. 25). Retrieved Oct. 20, 2017, from `https://www.pacbiztimes.com/2017/09/25/cal-poly-slo-gets-500000-grant-to-fund-startup-development/`

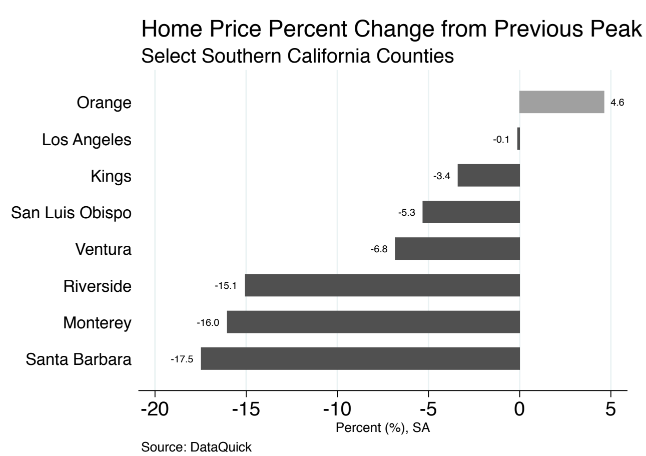
will continue to assess how it will affect the local economy.

The Outlook

Why is growth slowing?

Absent any efforts to change policies, housing costs will remain an impediment to growth in the longer term.

An increasingly tight labor market is affecting growth nationwide. At the State and local level, a shortfall of housing has amplified this slowdown. State impediments to housing development include Proposition 13 and the California Environmental Quality Act (CEQA). Locally, increases in the stock of housing have been dictated in part by the availability of water. There has been little talk of serious reform to either Proposition 13 or CEQA among state lawmakers, meaning that housing shortfalls will be a continuing problem. Absent any efforts to change policies, housing costs will remain an impediment to growth in the longer term.



At the County level, new housing has been constrained by the limited supply of water. As in much of the State, the region became keenly aware of water supply during the drought. Moving forward, it must reconcile growth in the local economy and the related need for new housing with the limits that water supplies place on that growth.

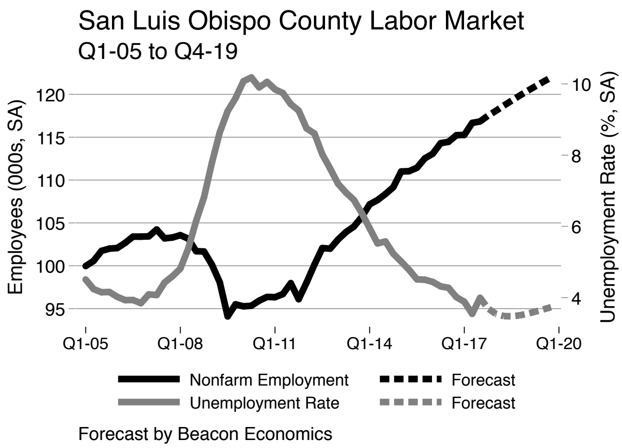
As of the second quarter of 2017, the County's median-priced single-family residence was 5.3% below its prerecession peak. Beacon Economics expects home prices in the County to surpass their prerecession peak in mid- to early 2018.

The large number of vacation units exacerbate the County's supply shortage. At first glance, the County appears to have a higher housing vacancy rate (13.7%) than that of the State and the nation overall. But when vacation units are removed from the picture, the housing vacancy rate falls to 4.3%. In fact, in 2005, 4.4% of all vacant units in the County were categorized as vacation homes, but by 2016 the amount nearly doubled to 8.1%. As of the second quarter of 2017, the County's median-priced single-family residence was 5.3% below its prerecession peak. Beacon Economics expects home prices in the County to surpass their prerecession peak in mid- to early 2018.

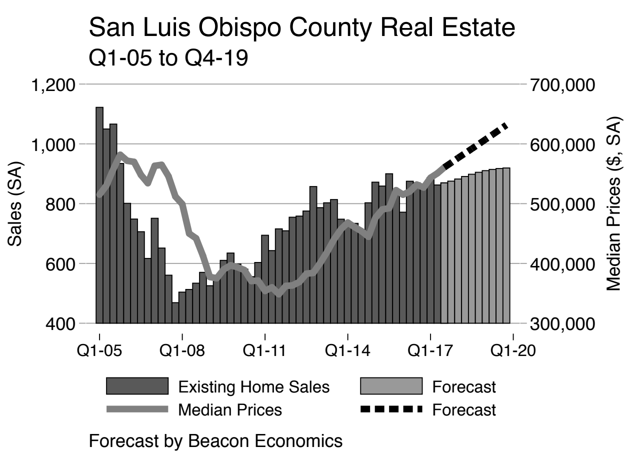
Where do we go from here?

With economic indicators generally trending in the right direction, Beacon Economics expects San Luis Obispo County to stay on course through 2017 and into the next couple of years. Employment levels continue to rise, the unemployment rate continues to inch lower, and home prices continue to appreciate above historic average rates.

Despite the fact that growth has slowed considerably over the last few years, the County continues to see a steady trajectory of employment gains, setting record highs virtually every month. Beacon Economics' current forecast calls for 1.5% to2.3% job growth over the next few years. Although the rate of growth is slower than what is forecast for the State overall, keep in mind that the County has recovered all lost ground from the Great Recession.



Although it's anticipated that the local economy will continue to expand, the region faces some impediments to growth. The lack of housing has compounded the region's affordability crisis, resulting in a larger commuter base because workers in many industries have trouble acclimating to the region's high housing costs and are forced to live outside the County. A thin supply of housing coupled with a slowdown in labor force expansion is a recipe for slower growth on the horizon, but slow growth is better than no growth.



The supply of housing has failed to keep up with demand for several years running, and although construction has been picking up after a slump in 2016, home construction in the County has remained well below the prerecession average. The continuous gap between housing demand and supply has driven forward-looking concerns about a shortage of housing in the region. In the context of this supply shortage, Beacon expects that home prices in the County will continue to appreciate at a solid clip. Mortgage rates remain near record lows and are not expected to increase much over the near term. The current forecast calls for existing home prices to continue to grow around 5% to 6% for much of the next five years.

By all accounts, the prospects for the economy of San Luis Obispo County are good. The major indicators are trending in the right direction, and Beacon Economics' outlook for the region remains positive. Business activity, employment and home prices have grown over the last five years and are headed in the right direction. Agriculture and Leisure and Hospitality appear to be in good shape and will help drive the local economy forward as outside dollars enter and circulate. Total nonfarm employment peaked in mid-2007, as it did in the rest of California and the nation. By February 2013, San Luis Obispo County recovered all of the jobs lost in the Great Recession and veered from recovery to expansion, and Beacon expects a continuing of this trend. Taken altogether, the County's outlook remains positive.

Employment

by Brian Vanderplas

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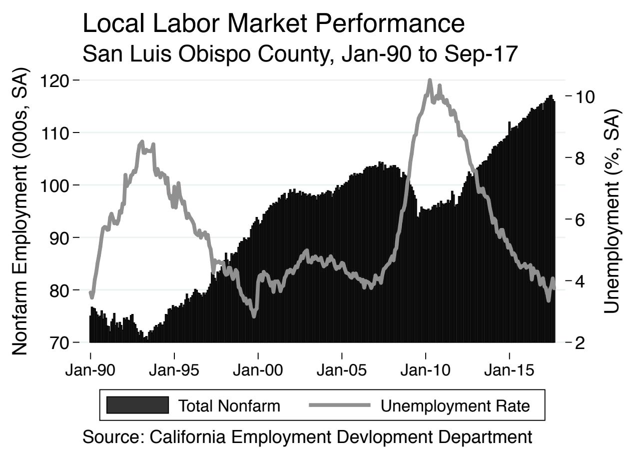
Key Chapter Findings

- Private-sector payrolls in San Luis Obispo County expanded 2.0% over the period, eclipsing the statewide pace of 1.6%.
- The Leisure and Hospitality sector was responsible for the most new jobs in the region over the last year, increasing payrolls 3.6% (700 jobs)
- From 2015 to 2016, wages in San Luis Obispo County grew an average of 2.8%, beating the 2.0% growth in the State overall.

Overview

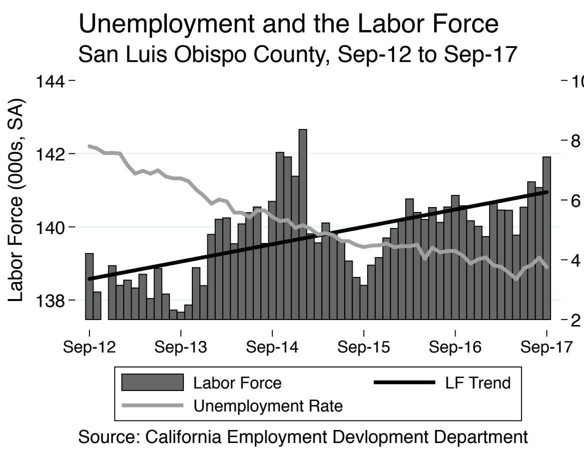
Although San Luis Obispo County's labor market grew at a modest pace compared with recent years, its expansion this year was respectable. County payroll employment grew 1.0% (1,100 jobs) from September 2016 to September 2017, based on data from California's Employment Development Department. Private-sector payrolls expanded 2.0% over the period, eclipsing the statewide pace of 1.6%. This puts the County in line with private-sector job growth in Santa Barbara County (1.9%) but behind Monterey County (2.5%) and Ventura County (3.5%), with respect to private sector job growth..

The modest gains in payroll jobs have also helped drive the unemployment rate down to 3.8% — well below the 5.1% mark in the State overall. The low unemployment rate in the region reflects the tight labor market: Although private payrolls expanded 2.0% over the last year, the labor force grew just 0.7%. With the labor force growing at such a modest pace, it will be difficult for the County to grow at the pace it has over the last five years. In this regard, San Luis Obispo is much like the state as a whole, which has effectively reach full employment and where job growth over the coming year will be constrained by labor force growth that is expected to be modest.



Although we expect that the labor market in San Luis Obispo County will continue to grow, the region does face challenges going forward. Affordability of workforce housing remains an ever-present issue, with builders often facing onerous barriers to development. Local companies are also finding it difficult to offer wages comparable to those in the Bay Area and Southern California. As a result, San Luis Obispo County struggles to attract high-skilled talent as well as keeping newly minted graduates for Cal Poly San Luis Obispo. These factors are making it difficult for firms to get both the high- and low-skilled workers they need.

In the coming years, the region will face another significant challenge: the closing of the Diablo Canyon nuclear power plant. Although the facility will not officially close until 2025, the shutdown will bring sweeping changes to San Luis Obispo County's economy. The plant employs nearly 1,500 workers with an average annual salary of over $150,000, according to 2014 figures. Additionally, in property taxes alone, schools and other agencies will lose about $26.8 million in annual revenue once the plant closes.[3] Recently Pacific Gas & Electric Co. agreed to offset some of the revenue loss by paying $85 million, up from the $49.5 million it originally proposed, to seven local cities, the San Luis Obispo Unified School District and San Luis Obispo County to support those agencies after Diablo Canyon closes. [4] It's also important to note that these jobs will not be lost immediately. The plant will employ a significant contingent of engineers and other workers during the plant's decommissioning phase. But it will ultimately take a strong collaboration between the private and public sectors to mitigate these significant losses in tax revenue.



San Luis Obispo Employment Growth

Industry	Sept-17 (000s)	Change (000s)	Change (%)
Total Nonfarm	115.9	1.1	1.0
Farm	5.1	-0.0	-0.1
Government	23.2	-0.7	-2.9
Leisure and Hospitality	19.2	0.7	3.6
Education/Health	15.6	0.5	3.3
Retail Trade	14.3	0.1	0.7
Professional/Business	9.9	-0.5	-4.9
NR/Construction	7.9	0.6	8.2
Manufacturing	7.2	0.4	5.8
Other Services	6.1	0.0	0.2
Transport,Warehouse,Util.	4.0	0.0	0.0
Wholesale Trade	2.9	-0.0	-0.1
Finance and Insurance	2.2	-0.0	-0.1
Real Estate	1.9	0.0	0.4
Information	1.4	0.0	0.3

Source: California Employment Development Dept.

Employment by Industry

Although the labor market expansion has slowed, the current growth spans a variety of sectors in San Luis Obispo County. The Leisure and Hospitality sector was responsible for the most new jobs in the region over the last year, increasing payrolls 3.6% (700 jobs) from September 2016 to September 2017. This should not come as a surprise given the region's growing status as a tourist destination.

The Natural Resource and Construction sector also had a strong year, building on its gains from 2016. From September 2016 to September 2017, the sector expanded 8.2% (600 jobs). The continued inflow of commercial and residential projects is helping fuel this growth. There were 802 residential units permitted in the County in the first eight months of 2017, a 37.8% increase over the same period in 2016. Many of these units were on the multifamily side of the market (347 units), and though these will help with affordability issues in the region, more building is necessary to keep up with population growth.

[3] Finucane, S., Leslie, K., & Sneed, D. (2016, June 21). What Diablo Canyon's closure will mean for SLO County's economy. Retrieved October 27, 2017, from http://www.sanluisobispo.com/news/local/article85204657.html

[4] Leslie, K. (2016, November 28). PG&E to pay $85 million to cities, SLO County, school district for Diablo Canyon closure. Retrieved October 27, 2017, from http://www.sanluisobispo.com/news/local/article117604388.html

The County's Education and Health Care sector is also continuing to expand at a robust pace. From September 2016 to September 2017, the sector increased payrolls 3.3% (500 jobs). A significant portion of the growth in this industry can be attributed to San Luis Obispo County's aging population which has relatively more health care needs: 19.1% of the County's population is over age 65, compared with 13.6% of the State population. Additionally, this number increased 3.3 percentage points from 15.8% in 2011. Perhaps more important, as the County's population continues to age, the Health Care sector should enjoy continued strong demand. The employment opportunities will target a variety of skill sets and may help attract new residents to the area.

Manufacturing also continues to be a strong source of new jobs in San Luis Obispo County; payrolls expanded 5.8% (400 jobs) over the last year. In contrast, Manufacturing sector payroll levels fell 0.2% in the State overall. A look at the types of new jobs shows how closely the Manufacturing sector is linked to the region's farms and vineyards. According to the Quarterly Census of Employment and Wages from the Bureau of Labor Statistics, beverage manufacturing (which includes wineries) is the largest Manufacturing subsector in San Luis Obispo County, accounting for nearly one in four positions. Employment levels at beverage firms were also up significantly, increasing 11.5% (208 jobs) from the first quarter of 2016 to the first quarter of 2017.

Although payrolls in most San Luis Obispo County industries expanded over the year, jobs declined in some sectors. Government led job losses last year, decreasing payrolls 2.9% (700 jobs). Government, which decreased payroll 5.4% (700 jobs), was responsible for this decline. The only private sector posting declines for the year was Professional and Business Services (-4.9%). The driving force behind this decline was a significant drop payrolls in employment services.

San Luis Obispo Employment Growth

City	Q4-16 (#)	Change (%)	Change (#)
Unincorporated	17,703	2.0	345
Pismo Beach	4,135	4.8	190
Atascadero	9,231	1.7	150
Morro Bay	3,718	3.5	125
Grover Beach	3,462	3.8	125
Arroyo Grande	9,034	1.4	120
Paso Robles	17,696	0.4	65
San Luis Obispo	50,288	-2.6	-1,315

Source: California Employment Development Dept.

City Labor Markets

At the city level, San Luis Obispo County enjoyed widespread growth. From the fourth quarter of 2015 to the fourth quarter of 2016, the unincorporated parts of the County gained the highest number of jobs, increasing payrolls 2.0% (345 jobs). In percentage terms, Pismo Beach led the way, increasing payrolls 4.8% (190 jobs). Other coastal communities also had a strong year, with payrolls increasing 1.4% in Arroyo Grande (120 jobs), 3.5% in Morro Bay (125 jobs) and 2.7% in Grover beach (125 jobs). The more inland regions of the County also posted gains, with payrolls increasing 1.7% in Atascadero (150 jobs) and 0.4% in Paso Robles (65 jobs). The City of San Luis Obispo (-2.7%) was the only city whose payrolls levels didn't increase.[5]

From 2011 to 2015, the unemployment rate in San Luis Obispo County averaged 6.6%, according to the American Community Survey from the U.S. Census Bureau, though this rate varied across the County.[6] Atascadero (4.7%), Arroyo Grande (5.5%) and Pismo Beach (4.7%) had average unemployment rates well

[5]City-level employment data are based upon the latest available period, the fourth quarter of 2016.

[6]City-level unemployment rate data are based upon the latest available period, the period from 2011 to 2015.

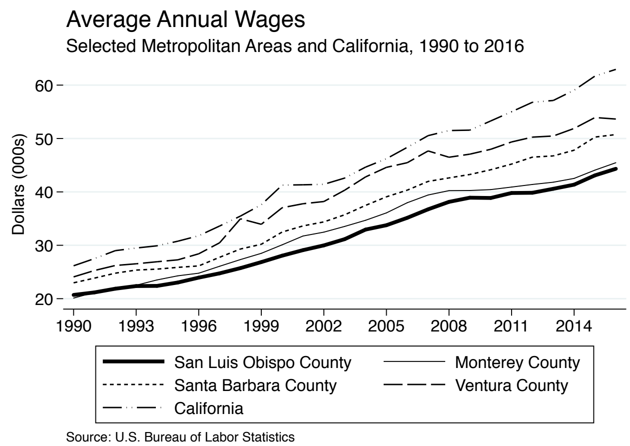
below the County average, but Grover Beach (7.8%) and Paso Robles (7.7%) sustained higher unemployment. Still, the unemployment rates across San Luis Obispo's cities were lower than the statewide rate of 9.9% over the five-year period.

Business Formation and Size

With more modest gains in the region's labor markets, business formation in San Luis Obispo County was also more modest in 2016. Still, the number of establishments grew across a broad range of sectors. According to the Quarterly Census of Employment and Wages, the number of establishments expanded by more than 216 in 2016, representing an annual 2.2% increase from 2015. This trails the State overall, where establishments increased 4.8% over the period.

At the industry level, the Health Care sector posted the largest gains in 2016, adding 92 firms. Other sectors posting sizable gains for the year included Accommodation & Food (35 firms), Construction (34) and Manufacturing (6). In addition, Unclassified Firms[7] accounted for 107 of the new companies in the region in 2016. These new firms will be classified in the coming quarters, providing a clearer picture of business formation. In percentage terms, State Government (+7.8%), Accommodations & Food (4.1%) and Construction (3.7%) led the way. These figures should not come as a surprise given the continued growth in Construction and Leisure and Hospitality over the past year.

Wages



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[7] Firms awaiting a NAICS industry classification from the U.S. Bureau of Labor Statistics

Business Activity

by Brian Vanderplas

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Key Chapter Findings

- Consumer and business spending in San Luis Obispo County increased a healthy 13.5% from the second quarter of 2016 to the second quarter of 2017.
- Economic growth slowed in San Luis Obispo County in 2016, increasing just 0.6% in real terms from 2015, well behind the 2.9% growth in the state overall over the period.
- 2017 has been a strong year for the airport, with passenger traffic through August 2017 increasing 21.2% compared with the same period a year earlier.

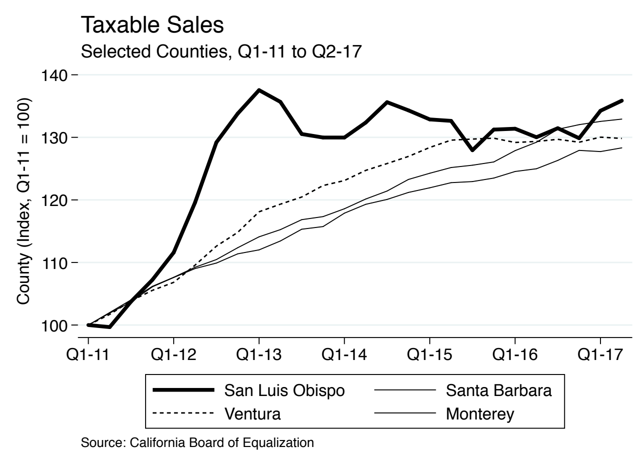
Business Activity Overview

Top-level indictors of business activity in San Luis Obispo County suggest that 2016 and 2017 were a mixed bag. Local spending was up in all categories, notably in Business and Industry. The bulk of the spending that helps drive new jobs and economic activity was also still rising, notably in Building and Construction and in Restaurants and Hotels.

On the other hand, economic growth slowed in San Luis Obispo County in 2016, increasing just 0.6% in real terms from 2015, well behind the 2.9% growth in the state overall over the period. A few sectors did have strong years, however. Notably, output in the County's Construction sector and Agriculture sector grew 8.8% and 5.7% respectively over the last year.

Although we expect that business activity will continue to grow, the region does face headwinds. First, a lack of affordable housing will limit growth. While construction activity has picked up recently, the housing stock has still not grown enough to meet the long-run needs of the County's growing population and employment base. Second, the pending closure of the Diablo Canyon nuclear power plant will be a challenge to the region. Indeed, because the plant generates over $1 billion of estimated economic activity each year, the County will need to put measures in place to help mitigate the impact of its closure on the local economy.[8] Third, local companies are finding it difficult to attract high-skilled talent with wages comparable to those in the Bay Area.

Local Spending



Consumer and business spending in San Luis Obispo County increased a healthy 13.5% from the second quarter of 2016 to the second quarter of 2017. This pace of growth puts it above the other Central Coast areas (Monterey, Santa Barbara and Ventura counties) and ahead of the 4.2% statewide pace. But consumer and business spending has been volatile in recent years. Although the county saw a faster pace of

[8] Finucane, S., Leslie, K., & Sneeds, D. (2016, June 21). What Diablo Canyon's closure will mean for SLO County's economy. Retrieved October 27, 2017, from http://www.sanluisobispo.com/news/local/article85204657.html

growth than the state so far this year, county taxable sales grew by an average of 9.1% over the last three years, somewhat below the state's 10.9% mark over the same period.

The main force behind the increase in consumer and business spending was a resurgence in business-to-business activity, with consumer-driven sectors also rising steadily. Business and Industry spending grew 55.2% from the second quarter of 2016 to the second quarter of 2017, but much of this growth is explained by an abnormally low level in the second quarter of 2016. The uptick in business activity also spilled into the construction sector, with taxable receipts for Building and Construction growing 10.9% over the last year, well ahead of the statewide pace of 0.8%.

Taxable Receipts by Category
Selected Counties and California, Q2-2017

Category	Q2-2017 ($ 000s)	1-Yr Chg (%)
Business and Industry	2,702	55.2
Building and Construction	1,348	10.9
Fuel and Service Stations	1,342	8.3
Autos and Transportation	1,994	7.8
Restaurants and Hotels	1,990	5.4
Food and Drugs	773	4.4
General Consumer Goods	2,487	2.1
San Luis Obispo County Total	14,134	12.3
Santa Barbara County Total	17,732	1.9
Ventura County Total	35,101	1.0
Monterey County Total	17,372	0.9
California Total	1,692,147	3.2

Source: HdL Companies

Consumer-driven sectors also performed well. With gas prices beginning to stabilize, taxable receipts at Fuel and Services Stations rose 8.3% from the second quarter of 2016 to the second quarter of 2017, regaining the ground it lost from 2015 to 2016 amid declining oil prices. Consumer spending on Autos and Transportation also rose steadily in the first half of 2017, with taxable receipts growing 7.8% over the previous year. The hospitality sector also fueled growth in the County's tax base, with taxable receipts at Restaurants and Hotels increasing 5.4%.

Taxable Sales by City
San Luis Obispo County, Q2-2017

City	Q2-2017 ($ 000s)	1-Yr Chg (%)	2-Yr Chg (%)
Paso Robles	231,861	10.9	15.3
Arroyo Grande	86,008	9.2	9.5
Atascadero	86,551	8.0	7.1
San Luis Obispo	377,878	4.4	6.1
Pismo Beach	65,298	3.0	6.0
Morro Bay	37,813	4.7	4.9
Grover Beach	29,833	-2.0	0.6

Source: California Board of Equalization

Taxable sales in some of the County's largest cities, San Luis Obispo and Paso Robles, grew at a solid pace in 2017, expanding 4.4% and 10.9% respectively from the second quarter of 2016 to the second quarter of 2017. The County's smaller cities — Arroyo Grande (9.2% increase), Atascadero (8.0%), Morro Bay (4.7%) and Pismo Beach (3.05%) — all grew at a healthy pace. The only city whose tax base failed to grow was Grover Beach, where taxable sales fell 2.0% over the period.

Although we expect taxable sales to continue to grow, lower birth rates and scarce housing will cause population growth to lag other parts of the state, and thus, consumer spending will not rise as rapidly.

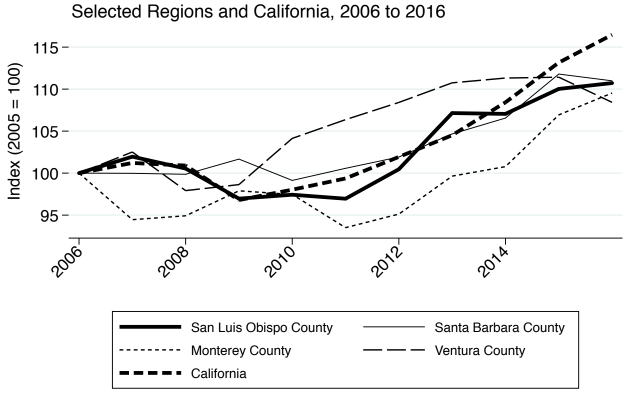
GDP Growth by Sector
San Luis Obispo County, 2014 to 2015

Industry	2016 $ 000s	2015 to 2016 Change (%)	2015 to 2016 Contributions to Growth (%)	2013 to 2016 Change (%)	2013 to 2016 Contributions to Growth (%)
Accommodation/Food	667	3.89	0.20	6.58	0.30
Government	1,869	2.75	0.40	1.98	0.29
Private goods-producing industries	2,129	5.92	0.96	1.69	0.29
Construction	808	8.75	0.53	3.92	0.24
Prof. Bus. Services.	967	-5.66	-0.47	3.13	0.23
Retail Trade	1,124	-1.06	-0.10	2.25	0.20
Health Care	961	3.00	0.23	2.02	0.15
Manufacturing	990	4.76	0.36	0.90	0.07
Wholesale Trade	395	0.25	0.01	1.59	0.05
Agriculture	354	5.67	0.15	1.47	0.04
Arts/Ent./Recreation	77	-18.95	-0.15	1.35	0.01
Trans./Warehousing/Utilities	1,249	1.13	0.11	-0.45	-0.05
Finance/Insurance	277	-4.48	-0.11	-2.24	-0.06
Durable goods manufacturing	331	-5.97	-0.17	-4.14	-0.13
Administrative and waste management services	238	-28.10	-0.75	-6.44	-0.16
All Industry Total	12,437	0.63	0.63	1.11	1.11

Source: U.S. Bureau of Economic Analysis

Production

Real GDP Growth
Selected Regions and California, 2006 to 2016



Source: U.S. Bureau of Economic Analysis

Economic activity in San Luis Obispo County grew 0.6% from 2015 to 2016, compared with 2.4% in Monterey County, -0.7% in Santa Barbara County and -2.7% in Ventura County. California's Central Coast trailed the state overall, where economic activity grew 2.9% over the period. Moreover, since 2006, economic activity in San Luis Obispo County has expanded just 10.7% in real terms, compared with 16.5% in California overall.

At the industry level growth continues to be volatile, with a handful of sectors boosting production levels sizably while others suffered declines. The Construction sector posted the largest gains in percentage terms in recent years, with output levels growing 8.8% from 2015 to 2016. 2017 is also shaping up to be another bright year for the sector, with employment levels growing 8.2 % from September 2016 to September 2017. Construction activity, and more specifically workforce housing, will be necessary to help drive long-run growth in the region.

San Luis Obispo County's wine industry also contributed to the region's production growth in 2016. Indeed, the County's Agriculture sector expanded 5.7% from 2015 to 2016. In addition, the sectors interconnected to the region's wine industry also had a strong year in 2016. For example, the Manufacturing sector expanded 4.8% from 2015 to 2016. The driving force was a 9.9% increase in Non-Durable Goods Manufacturing production. Durable Goods Manufacturing fell 6.0%.

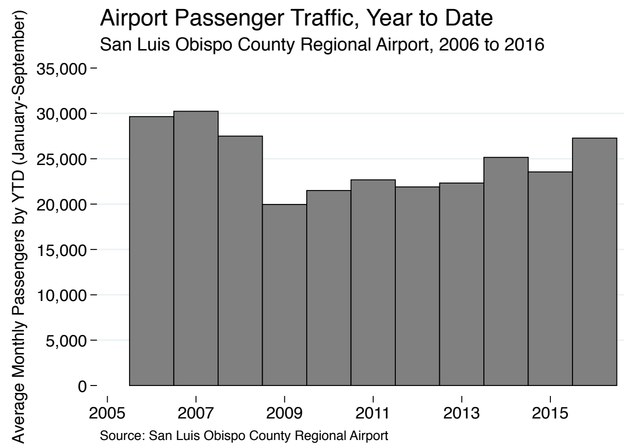
Other sectors posting sizable 2016 gains in output were Professional, Scientific and Technical Services (4.8%), Other Services (3.3%) and Health Care and Educational Services (3.0%). More important, these high-skilled sectors will be pivotal to the County's growth pattern, and continued growth will be necessary to attract talent from the Bay Area and Southern California. But as mentioned, local companies are finding it difficult to offer wages comparable to those in the Bay Area.

A few sectors did see a pullback in production in 2016. Declines were most pronounced in the Administrative Support sector, which fell 28.1%. Finance and Insurance (-4.5%), Real Estate (-3.5%) and Information (-2.9%) all declined. Although the region face headwinds from housing, we expect the region will continue to grow at stable pace over the next year.

Hospitality and Tourism

As the region draws more visitors each year, hospitality and tourism are becoming a bigger part of the County economy. Some indicators for the sector pulled back from last year's numbers, but the reach of San Luis Obispo County's tourism industry should continue to grow. Indeed, with the new terminal at San Luis Obispo County Regional Airport, the number of domestic and international visitors should increase in the years to come.[9] The county is an easy-to-reach destination for visitors coming from the dense population centers in the Bay Area and in Southern California just a few hours away. Moreover, the variety of amenities and activities the region has to offer ensures that many tourists will visit the region time and again.

Through August 2017, average daily room rates in San Luis Obispo County were 0.6% higher than during the same period in 2016. Room rates rose most steeply in Paso Robles and Pismo Beach, rising 2.5% and 1.8% respectively. In contrast, rates in the northern coast and in the City of San Luis Obispo fell 2.1% and 0.2%.



Occupancy rates were also a mixed bag in 2017. Occupancy in the City of San Luis Obispo rose significantly through August 2017, increasing 1.4 percentage points relative to the same period in 2016. But occupancy rates in the northern coast fell sharply, decreasing 7.2 percentage points relative to a year earlier.

With average daily rates growing slowly and occupancy rates falling, revenue per available room fell 0.4%. Much of this was confined to the northern coast (-12.4%). Paso Robles (3.15) and San Luis Obispo (1.6%) continued to post steady gains in revenue per available room, and Pismo Beach (-0.1%) posed only a modest decline.

Perhaps more important, when more leisure travelers are drawn to the region, they spend money at local attractions, restaurants and stores. This is evident in the 3.6% increase in Leisure and Hospitality employment from September 2016 to September 2017 and the 5.4%

[9] County of San Luis Obispo, SLO County Regional Airport. (2017, August 30). New Airport Terminal to Open in November [Press release]. Retrieved October 27, 2017, from http://www.slocounty.ca.gov/Departments/Airports/Department-News/New-Airport-Terminal-to-Open-in-November.aspx

increase in taxable receipts at Restaurants and Hotels from the second quarter of 2016 to the second quarter of 2017.

2017 has also been a strong year for the airport, with passenger traffic through August 2017 increasing 21.2% compared with the same period a year earlier. As mentioned, 2018 should be an even stronger year because of the new terminal.

Agriculture

by Jordan Giali

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Key Chapter Findings

- In 2016, commodity values experienced major growth over 2015 thanks to improved (although lingering) drought conditions and better yields and prices.
- Driving this growth was the Fruit and Nut category, with especially strong performances from wine grapes, strawberries and avocados.
- Real industry output reached a high during 2016, reflecting the robustness of the County's agriculture sector.
- Farm employment fell slightly as drought conditions led growers to reduce their planting of certain crops.
- Although the drought is officially over, farmers and households need to keep water conservation a priority.

Overview

By most measures, the San Luis Obispo County agriculture sector posted solid growth in 2016. Thanks to favorable weather conditions and good prices, the Fruit and Nut category carried commodity values to one of its best years ever. This is especially impressive considering that other categories experienced significant declines in value. For example, the Animal category continued its downward trend, as the number of cattle head sold reached its lowest point in almost a century, according to the San Luis Obispo County Annual Crop Report.[10]

Farm employment fell slightly from 2015 as lingering drought conditions reduced the need for workers. Growers cut back on certain types of crops, adding to the decline in the Vegetable and Nursery categories.

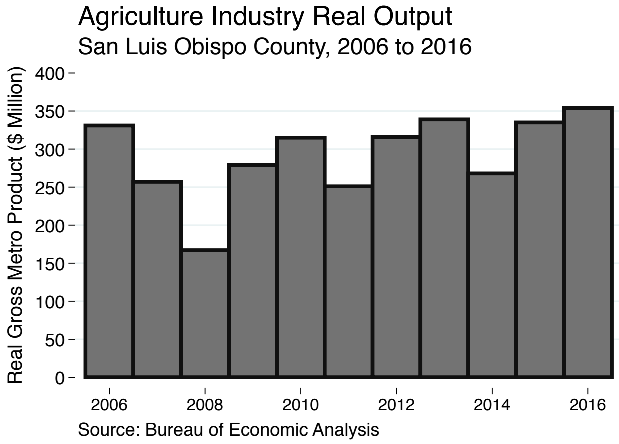
Although Governor Brown officially ended the statewide drought emergency (except for a few counties) in April 2017, growers and residents have continued to make water conservation a priority. Indeed, a variety of Groundwater Sustainability Agencies will be formed in the County to comply with the Sustainable Groundwater Management Act. [11]

2016 Industry Performance

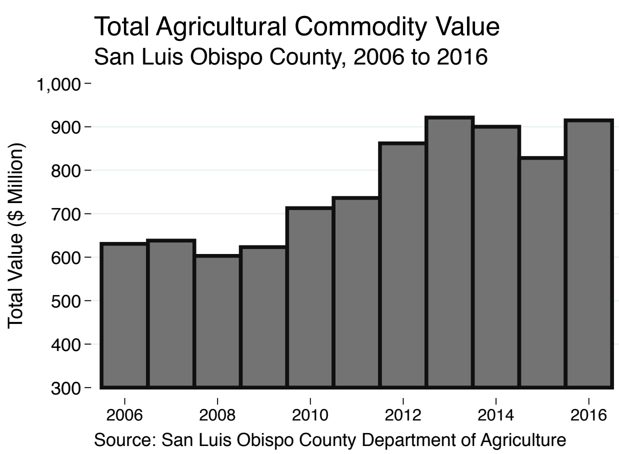
The performance of the San Luis Obispo County agriculture sector was very strong in 2016 despite some remaining drought complications. Real output for the County reached a record $354 million, a 5.7% increase from 2015. This was slightly below the performance of the statewide agriculture sector, which grew 7.5%. County agriculture production retained its share of State output, accounting for 1.2% of California agricultural product in 2016, the same as the previous year.

[10] *2016 Annual Crop Report for San Luis Obispo County.* San Luis Obispo County Department of Agriculture/Weights and Measures. Retrieved on October 19, 2017, from http://www.slocounty.ca.gov/getattachment/c4ee944c-b14f-4a1e-acf3-f8560ff59cac/2016-Annual-Crop-Report.aspx

[11] *Sustainable Groundwater Management.* California Department of Water Resources. Retrieved October 20, 2017, from http://www.water.ca.gov/groundwater/sgm/



Reflecting this growth was a 10.5% increase in commodity values from 2015 to 2016, totaling $914.7 million. This put the total value of commodities just shy of its record-breaking 2013 peak of $921 million, making it the second-best year for total values. Moreover, this marked the first year of growth after decreasing the previous two years primarily because of weak prices and yields.



Commodity values were largely driven by the Fruit and Nut category, which grew a whopping 33% from 2015 to 2016, reaching $568.1 million. Most of this can be ascribed to the wine grape crop, whose yields rose 58% amid better prices and weather conditions compared with 2015. Indeed, wine grape values set a record in 2016 at $242.9 million —a 66% annual increase. The value of wine grapes represented 27% of total commodity values in the County in 2016, as opposed to 18% a year earlier.

San Luis Obispo County Agricultural Product Values

Category	2015 ($ Million)	2016 ($ Million)	Annual Growth (%)
Total Value	828.2	914.7	10.5
Fruit & Nut	428.3	568.1	32.6
Vegetable	214.1	197.5	-7.7
Nursery	99.5	86.9	-12.6
Animal	70.7	45.4	-35.8
Field	15.6	16.8	7.6

Source: San Luis Obispo Department of Agriculture

San Luis Obispo County Wine Grapes Production, 2016

Grape Variety	Production		Prices	
	Tons	Annual Growth (%)	Price Per Ton ($)	Annual Growth (%)
White Grapes				
Chardonnay	15,835	26.5	1,472.0	5.4
Sauvignon Blanc	5,831	56.8	1,345.0	3.5
White Wine (Other)	6,357	30.0	1,457.0	4.2
Red Grapes				
Cabernet Sauvignon	64,585	110.7	1,586.0	2.7
Merlot	20,268	15.4	1,103.0	4.7
Pinot Noir	5,888	48.1	3,014.0	0.8
Syrah	10,270	56.8	1,506.0	6.6
Zinfandel	7,300	13.5	1,478.0	-0.1
Red Wine (Other)	19,751	58.3	1,706.0	2.5

Source: San Luis Obispo Department of Agriculture

Every variety of wine grape grew significantly in both production and price (except for Zinfandel, whose price dropped slightly while yields increased). As usual, the most output came from the Cabernet Sauvignon variety, whose yields grew a massive 111% from 2015 to 2016, along with a 2.7% increase in price. Significant growth also came from Other Red Wine, Syrah and Sauvignon Blanc, which all grew well over 50%. The variety with the most price gain was Syrah, which reached $1,506 per ton, a 6.6% increase. Pinot Noir had the smallest percentage price increase, 0.8%, but fetched the highest price per ton —$3,014.

Although they did not have as large an annual increase as wine grapes, strawberries proved to be equally important in driving commodity values. Like wine grapes, strawberries represented over a quarter of all commodity values during 2016, totaling $241.3 million. Benefiting from improved water conditions, both fresh and processed strawberries' acreage increased significantly. Altogether, strawberry yields grew by nearly 22,000 tons, or 15.5%, from 2015 to 2016.

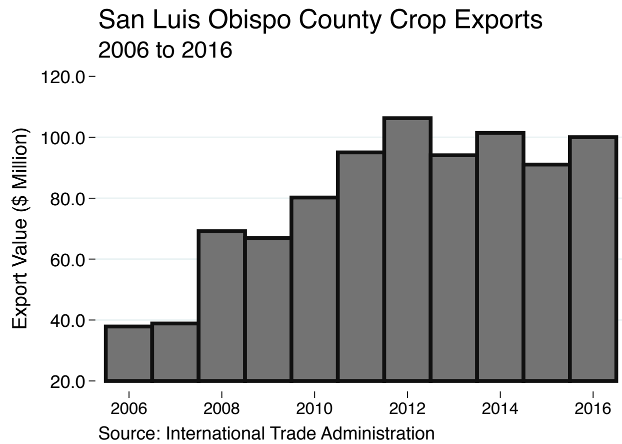
San Luis Obispo County Top Agricultural Commodities

Commodity	2015 ($ Million)	2016 ($ Million)	Annual Growth (%)	Share of All Crops (%)
Wine Grapes	146.4	242.9	65.9	26.6
Strawberries	222.6	241.3	8.4	26.4
Avocados	16.6	44.6	168.6	4.9
Broccoli	47.8	43.9	-8.1	4.8
Cattle and Calves	66.0	40.0	-39.4	4.4

Source: San Luis Obispo Department of Agriculture

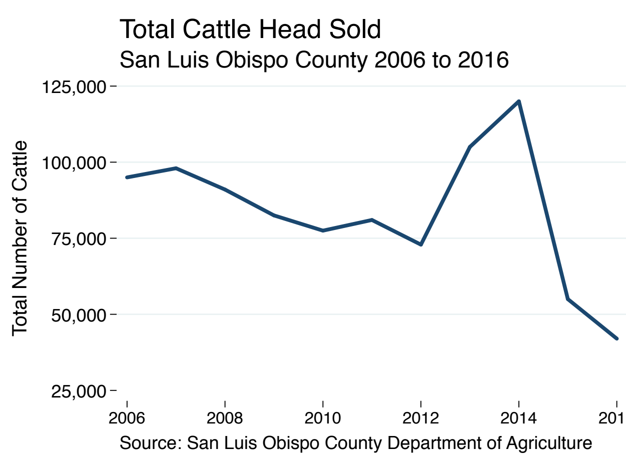
At 169%, avocados' increase in value was higher than any other fruit's, grossing $44.6 million in 2016. Like strawberries, avocados greatly benefited from better water conditions and less imported fruit during 2016, which increased demand and thus prices (which rose 23% over 2015). Altogether, avocado yields grew 119% even as acreage decreased 0.3%.

Although they are among the top commodities in the County, broccoli and cattle and calves posted declines again in 2016 as lingering drought conditions hampered their improvement. Both commodities' prices and production fell significantly. Broccoli prices, for instance, fell from $1,261 to $906 per ton (a 28% decrease), while cattle fell from $150 to $112 per hundredweight, about a 25% drop. Reduced land for raising herds along with lower demand



for beef added to this drought-battered commodity's downfall. As mentioned, the number of cattle head sold fell to its lowest point since 1928.

Agricultural exports rose 9.9% from 2015 to 2016, totaling $100 million, according to data from the International Trade Administration. County growers benefited from strong demand for their high yields of good-quality fruit in 2016. This bucked the statewide trend; California's agricultural exports sustained a second year of decline in 2016, falling 4.2% from 2015 on top of a 4.6% decline from the year before that.

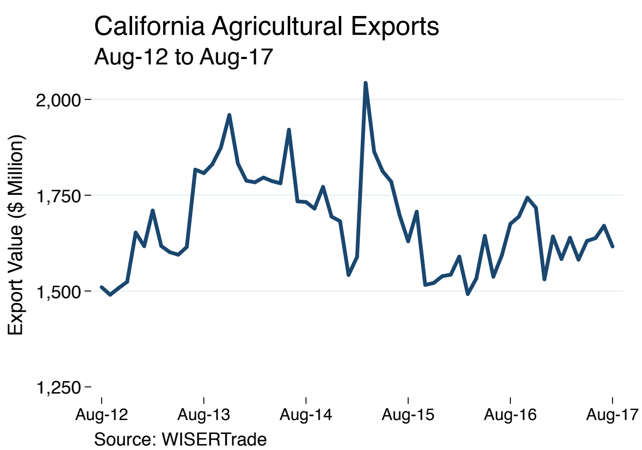


2017 Industry Outlook

Year to date through August 2017 (the latest available data), California agricultural exports are up

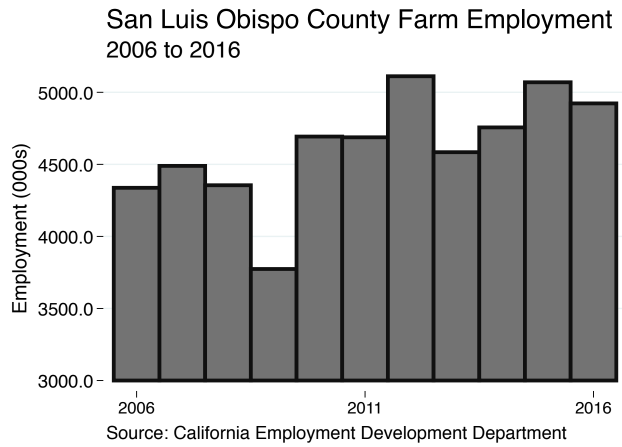
3.6% and totaling $12.3 billion. This growth mainly comes from improved water conditions and commodity prices—especially milk, which is a major export for the state. In general, California's agricultural exports reflect the overall strength of the state's economy.

Major trading partners continue to be Mexico and Canada, highlighting the importance of NAFTA for the U.S. in general and California in particular. And although San Luis Obispo County may not rely as heavily on agricultural exports as other parts of the State, trade plays a significant role in the regional economy. Any new legislation from Washington in regard to international trade is sure to have an effect on the County. Whether these potential changes



will be positive or negative is yet to be determined.

County farm employment, down 2.9% from 2015, averaged about 4,920 workers in 2016. Growers cut back on certain types of crops in response to water cutbacks, decreasing the demand for labor. Additionally, more tasks have become automated in recent times in response to labor shortages. This is not unique to San Luis Obispo County; many parts of the State have opted to make use of technology to fill the farm labor gap. This trend would most likely accelerate if the Trump administration drastically cuts immigration, as it plans to.[12] Many



immigrants fill roles that are crucial to farm operations. A reduction in this labor supply would diminish output in the short run and increase demand for automation technology. More can be said on this front if legislation is passed.

The number of vineyards in San Luis Obispo County fell from 50 to 48 from 2015 to 2016, a 4% decrease, according to the Bureau of Labor Statistics. This marks the third straight year of decline for County vineyards, following a statewide trend (California vineyards decreased 5.5% across the period). A decade ago, when water conditions were much better, the number of vineyards in San Luis Obispo County stood at 60—representing a 20% decrease today. But statewide, vineyards decreased 32% over the decade.

In contrast, the number of County winery establishments has increased over the years. In 2016, there were 124 wineries —two more than a year earlier and 46 more than a decade ago (a 59% increase). On this front, California wineries outperformed the County, growing 2.8% from 2015 to 2016, and 72% from a decade ago.

The Drought Situation

[12] Baker, P. (2017, Aug. 02). Trump Supports Plan to Cut Legal Immigration by Half. Retrieved Oct. 24, 2017, from https://www.nytimes.com/2017/08/02/us/politics/trump-immigration.html

Thanks to heavy precipitation and snowpack in 2016, Governor Brown officially declared the end of the drought emergency in April of this year.[13] Likewise, the City of San Luis Obispo lifted its drought status this year as reservoir levels reached capacity.[14] Despite this positive news, California and San Luis Obispo County must continue to make water conservation a long-term goal. Another drought is sure to occur at some point, increasing the urgency for growers and residents to find solutions to their water allocation needs in dry times.

With more water in the region, crop yields will increase over the next year. Traditional crops face a new challenge, however, from the recently legalized recreational marijuana industry. Indeed, San Luis Obispo County has a burgeoning cannabis growing industry that is increasing the demand for water. The Tribune reported that as of July 2017, 17 water wells had been drilled in California Valley to meet the demand for groundwater, putting the region on track to surpass the 20 wells drilled in 2016.[15] Only two wells were drilled in 2015, and just one in 2014. Indeed, the county is considering banning cannabis farming in the Valley out of fears of draining the water supply. Cannabis has potential to be a major cash crop for the region, but for it to be sustainable, serious water management efforts must be undertaken.

[13] U.S. Geological Survey California Water Science Center. (n.d.). California Drought. Retrieved Oct. 24, 2017, from https://ca.water.usgs.gov/data/drought/

[14] Wilson, N. (2017, June 30). Drought is officially over in SLO as city lifts water restrictions. Retrieved Oct. 24, 2017, from https://www.sanluisobispo.com/news/local/article159196119.html

[15] Vaughan, M. (2017, July 22). Marijuana farms tap into Carrizo Plain's scarce water —and SLO County is worried. Retrieved Oct. 24, 2017, from http://www.sanluisobispo.com/news/local/article163119508.html

Residential Real Estate

by Hoyu Chong

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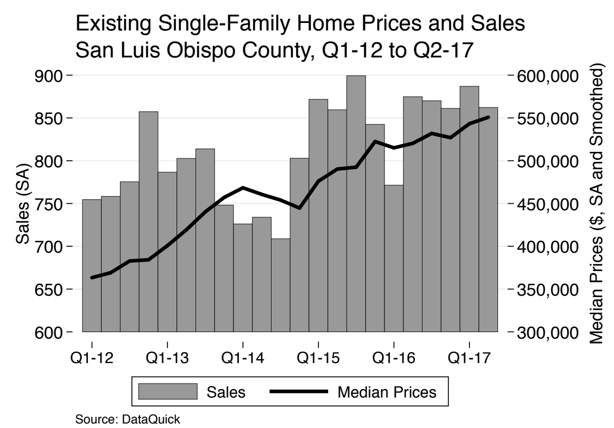
Key Chapter Findings

- While County home price appreciation is decelerating, and the median home value is currently nearer prerecession highs than the median home in the State.
- Relative to median household income, single family homes in San Luis Obispo County are still amongst the most affordable in the Central Coast. Halfway through 2017, 26% of households were able to afford the median home in the County — compared with 21% and 16% in Monterey and Santa Barbara counties.
- Rising incomes have meant that despite the fact that apartment rents are still rising at a robust pace, the share of rent burdened households fell from 52.5% of renter households in 2015 to 45.3% of renter households in 2016.
- So far into 2017, residential building activity rose by 47%, with a large share of planned projects concentrated in Pismo Beach and Paso Robles.

Trends Analysis

San Luis Obispo County finished the peak home selling season[16] with a 6.3% increase in sales, representing a larger increase than the State (2.1%) for the period. Price appreciation has been cooling in the County, as the median home value moves closer to historical highs. After sales fell in the fourth quarter of 2015 and the first quarter of 2016, they stabilized near the postrecession high in the second quarter of 2016. Meanwhile, sustained high sales volumes have pushed housing inventories down to 3.9 months' supply at the current rate of sales, as of August — a 14% decline over the past year. Although planned construction has been picking up, tightening inventories reflect the fact that home sales have been outpacing housing additions.



There are early indications that the single-family real estate market is losing steam. For one, the pace of appreciation has slowed after increasing significantly in 2015. The median price of existing single-family homes increased 5.9% from the second quarter of 2016 to the second quarter of 2017. By comparison, home price growth statewide (7.7%) picked up momentum and exceeded the County average. But County real estate was less severely affected than the State by the recession, based on peak-to-trough depreciation, and it's currently nearer prerecession highs than the median home in the State. As of the second quarter of 2017, the median County home was at 94.6% of peak historical value, whereas that figure was 85.8% for the

[16]Home sales historically peak in the first two quarters of the year.

Existing Single-Family Home Prices (SA)
By Region, Q2-17

Location	Median Price Q2-17 ($)	1-Year Chg (%)
Central California		
San Luis Obispo	551,000	5.9
Santa Barbara	537,000	12.6
Monterey	549,000	7.4
Southern California		
Los Angeles*	573,000	6.4
Orange County*	735,000	5.7
San Diego*	576,000	8.7
Inland Empire*	324,000	8.3
Ventura*	607,000	5.6
Northern California		
San Francisco*	1,206,000	6.7
East Bay*	655,000	9.1
San Jose*	1,008,000	11.0
Sacramento*	317,000	6.6
Other Northern California*	465,000	7.8
State of California	446,000	7.7

Source: DataQuick
*Average Regional Price

San Luis Obispo County Residential Real Estate, by City (SA)

Existing Single-Family Home Median Prices*			
Location	Q2-16 ($)	Q2-17 ($)	Change (%)
Arroyo Grande	625,000	755,000	20.8
Atascadero	466,000	473,000	1.7
Grover Beach	456,000	526,000	15.3
Paso Robles	425,000	470,000	10.5
San Luis Obispo	706,000	747,000	5.7
San Luis Obispo County	520,000	551,000	5.9
Residential Sales			
Location	2016 YTD	2017 YTD	Change (%)
Arroyo Grande	181	169	-6.8
Atascadero	179	228	27.7
Grover Beach	71	89	26.1
Paso Robles	381	425	11.6
San Luis Obispo	187	198	6.0
San Luis Obispo County	1,646	1,749	6.3

Source: DataQuick
*Prices have been rounded to the nearest thousand

State.[17] Furthermore, the California Association of Realtors reported that California home sales at the high end of the market gained steam in the third quarter of 2017, while it is likely that the opposite is true in the County, given more granular trends.

Price appreciation in San Luis Obispo County lagged Monterey County (7.4%) and Santa Barbara County (12.6%). This has further exacerbated differences in affordability between the rest of the Central Coast and San Luis Obispo County, where a higher percentage of residents can afford the median-priced home. According to the CAR, this figure was 26% of households in the second quarter of 2017 — compared with 21% and 16% in Monterey and Santa Barbara counties, both of whose affordability fell three or more percentage points over the last year. Still, uneven growth in the disparate cities in San Luis Obispo County continues. The communities of Arroyo Grande, Grover Beach and Paso Robles showed the strongest price and sales growth. This is in contrast to the previous year, when Atascadero and San Luis Obispo were the hottest real estate markets in the County.

[17] Comparisons in nominal terms.

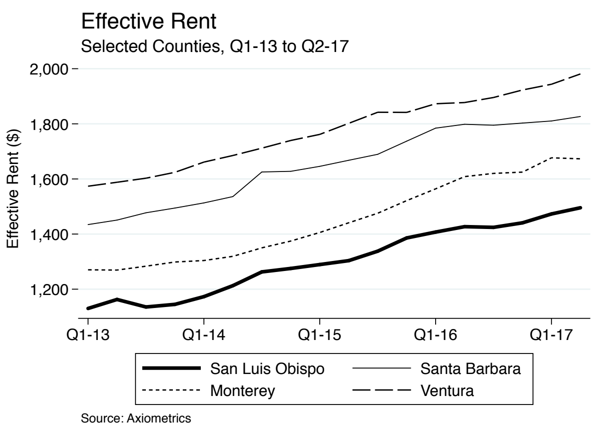
Multifamily Housing

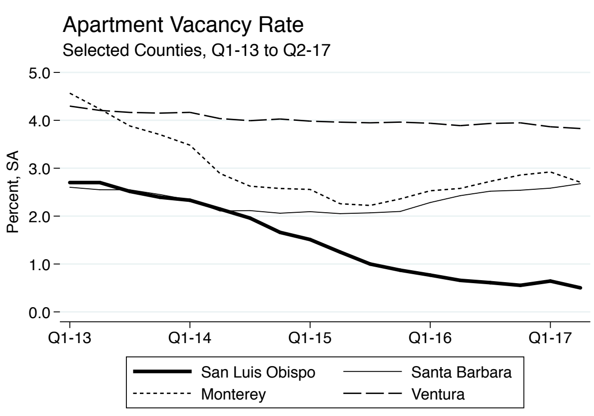
Similar to the single-family home market, sales of existing condominiums have topped out. Price appreciation of condominiums trailed that of existing single-family homes. After a surge in 2016, during which sales increased 18% over 2015, sales in the second quarter of 2017 fell 2.1% over the second quarter of 2016. But year-to-date sales are up 3.6% in 2017. The median price of condominiums in the County appreciated 4.2% from the second quarter of 2016 to the second quarter of 2017, ahead of Santa Barbara County (-0.4%) but behind Monterey County (7.2%).

Rent Burdened Households
By County

Year	San Luis Obispo	Monterey	Santa Barbara	California
Percent of Renters Paying at Least 30% of Income				
2014	52.9	54.7	55.2	53.8
2015	52.5	50.8	51.3	52.9
2016	45.3	52.7	57	52.6
Percent of Renters Paying at Least 50% of Income				
2014	29.5	25.4	29.7	28
2015	26.5	22.2	28	27.3
2016	24.3	21.3	28.4	27.1

Source: American Community Survey.

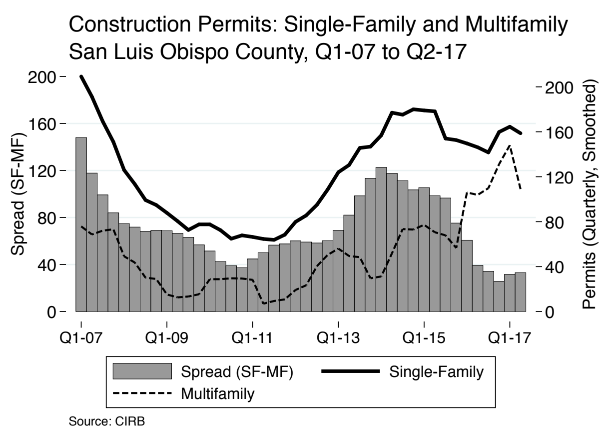




Effective rent averaged $1,495 in the second quarter of 2017 in the County, up 4.8% compared with the second quarter of 2016 and outpacing rent appreciation in Monterey County (4.0%) and Santa Barbara County (1.6%). Rents have increased modestly so far in 2017 compared with 2015 and 2016, which averaged 7% to 8% growth per year. Rental units in San Luis Obispo County have remained relatively affordable compared with other Central Coast counties, though the gap has shrunk slightly. In the second quarter of 2017, the average effective rent in San Luis Obispo County was 18.1% lower than in Santa Barbara County and 10.6% lower than in Monterey County. In 2016, 45.3% of renter households in the County spent 30% or more of their income on rent, a sharp decline from 2015 (52.5%). This was lower than in Monterey County (52.7%) and Santa Barbara County (57.0%). Furthermore, this was markedly lower than the statewide percentage of 52.6%.

Persistently low vacancy rates reflect the particularly strong demand for rental housing in San Luis Obispo County. Vacancy rates averaged just 0.83% in the second quarter of 2017, which actually represents an increase over the 0.35% vacancy rate in the second quarter of 2016. Nevertheless, this is significantly lower than the vacancy rates in Monterey (2.7%), Santa Barbara (3.0%) and Ventura (4.0%) counties.

Construction Activity



The steady-to-strong price appreciation and sales activity in major cities indicate growing demand in both single- and multifamily markets. As available rental units and housing supply has dwindled, and the consequential increase in developer profitability has been stimulating greater building activity, notably in Pismo Beach and Paso Robles. Overall, year-to-date residential permitting rose 47%. Year-to-date construction permits for single-family houses (January through August) increased 8.4% in 2017 compared with 2016, but there are still signs of weakness regarding housing supply. Multifamily construction activity in 2017 (January through July) maintained about the same pace as year-to-date 2016, with 304 units permitted, up 2.4%. But the 51 units permitted in the City of San Luis Obispo, home to Cal Poly San Luis Obispo, may do little to alleviate the local housing crunch. Cal Poly enrollment increased to an unexpected all-time level, partly because of the removal of the "early decision" option for Cal Poly applicants, which may have a long-term effect on increased student enrollment.[18] The City rental market will remain extremely tight, and the new dormitories under construction, which will serve 1,450 students, will not come online until fall 2018.

Single-Family Construction Permits in San Luis Obispo County Year-to-date 2014, 2015, and 2016

Location	Permits			Average Permit Value ($ thousands)		
	2014	2015	2016	2014	2015	2016
Arroyo Grande	10	15	41	315.1	201.2	173.7
Atascadero	35	30	30	154.5	203.4	210.2
Grover Beach	21	22	7	220.5	201.3	230.4
Morro Bay	11	12	9	262.8	327.4	281.3
Paso Robles	20	21	10	304.9	439.0	319.2
Pismo Beach	33	37	24	347.7	382.0	362.8
San Luis Obispo	74	34	24	252.7	276.3	328.5
County Unincorporated Area	179	161	215	427.7	433.7	378.4
San Luis Obispo County	383	332	360	336.6	361.6	329.7

Source: CIRB
* Prices have been rounded to the nearest thousand
** Year-to-date through second quarter.

[18] Johnson, P. (2017, Sept. 14). "Packed in: Housing at Cal Poly is getting pretty tight." New Times San Luis Obispo. Retrieved on Oct. 12, 2017. Available at https://www.newtimesslo.com/sanluisobispo/packed-in-housing-at-cal-poly-is-getting-pretty-tight/Content?oid=3409023

Multifamily Construction Permits in San Luis Obispo County Year to Date 2014, 2015, and 2016

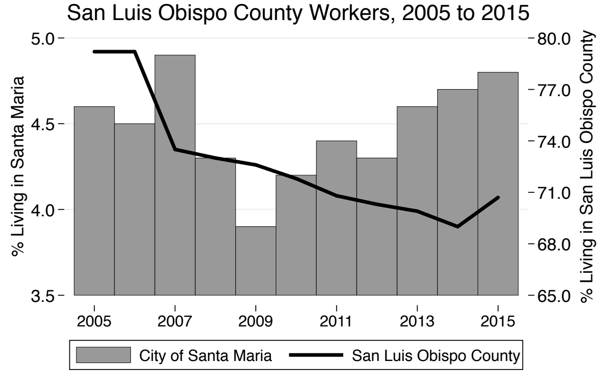
Location	Permits			Average Permit Value ($ thousands)		
	2014	2015	2016	2014	2015	2016
Paso Robles	59	0	125	151.0	0.0	131.1
Pismo Beach	12	104	128	140.3	147.7	149.8
San Luis Obispo	49	18	51	223.1	722.2	159.8
San Luis Obispo County	150	297	304	177.6	166.5	143.8

Source: CIRB
Note: Year-to-date through July.

Impediments to Growth

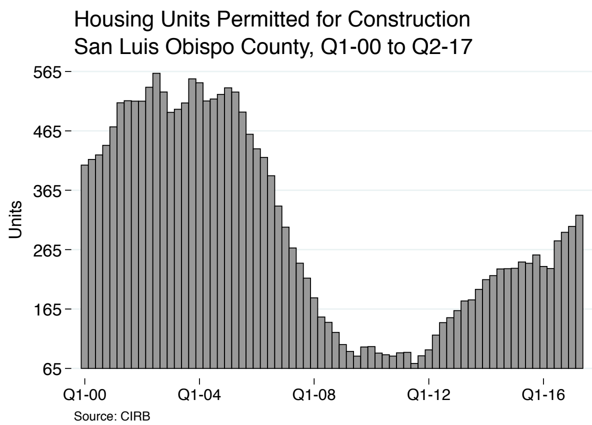
While the County remains affordable in relative terms, the vast majority of households in San Luis Obispo would not be able to qualify for a mortgage the median single family home. In addition to turning to the rental market, many households have moved to areas with lower home prices, which is reflected in the declining share of County workers who live in the County, based on data from the Longitudinal Employer-Household Dynamics. San Luis Obispo County's workforce has also been moving to cheaper parts of the County, and in 2015 (the latest year for which data are available), 4.8% of San Luis Obispo County's payroll workforce lived in Santa Maria in Santa Barbara County, where the median single-family home price is significantly less than the major cities in San Luis Obispo County.

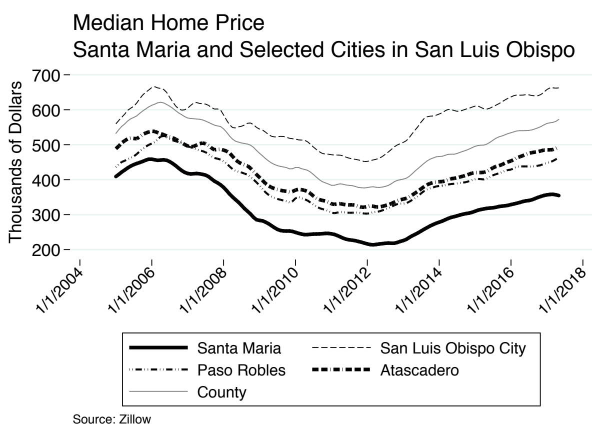
Place of Residence
San Luis Obispo County Workers, 2005 to 2015



Source: Longitudinal Employer-Household Dynamics

Housing supply has failed to keep up with housing demand for several years running. Although it has been picking up after a slump in 2016, home construction in the County has remained well below the prerecession average. In recent years, the statewide drought led to concerns that development of new housing would strain the region's limited water supply.[19] Although the drought officially ended in April 2017, it will take years to revise housing growth policies that are tied to water.





[19] McGuinness, C. (2016). "Wet work: Are building moratoriums the answer for SLO's drought-parched South County?" New Times SLO. https://www.newtimesslo.com/sanluisobispo/wet-work-are-building-moratoriums-the-answer-for-slos-drought-parched-south-county/Content?oid=2973655

Commercial Real Estate

by Steve McCarty and Steve Davis

Stafford McCarty Commercial Real Estate

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Key Chapter Findings

- Visible construction throughout the City of San Luis Obispo
- Buyer confidence in commercial real estate
- Sub market trends —banking, hotels, and cannabis

The following is a break out of the local market sectors and regions.

The Residential Market—A Brief Overview

Within the communities of San Luis Obispo County there is an effort to address workforce and affordable housing issues through higher densities in the urbanized areas as well as construction of new single family homes.

San Luis Obispo

The City of San Luis Obispo is recognizing the need to produce more housing and is supporting projects and density increases in the urban core. This has resulted in a wide range of product in both size and purchase price. Presently, the median price for a single family residence is approximately $700,000 which translates to an average 1,700 sq. ft. home selling for slightly over $410 per sq. ft.

North County

In the North County the market volume has remained steady over the last several years with approximately1,000 single family units selling in the same year-over-year period. An average 1,700 sq. ft. home in the North County would currently sell for approximately $285 per sq. ft., which is up from 2016's $250 per sq. ft.

Housing Related Projects in San Luis Obispo

In the City of San Luis Obispo and the immediate surrounding area, an impressive list of projects are in various stages of the planning pipeline.

Noted projects at, or near completion include:

- The Avivo Townhome project is in its final phase west of Sacramento Street.
- Sierra Meadows and Toscano, off Prado Road, are actively moving through their phases of single family detached homes
- Pacific Courtyards is near construction completion
- Chinatown is partially completed
- Garden Street Terraces is moving toward completion.

Upcoming projects include:

- Avila Ranch, on Buckley, south of the County Airport, has been approved for 720 units
- San Luis Ranch, the former Dalidio project, has been approved for 580 homes plus hotel and commercial space
- Wingate Homes, Righetti Ranch, the Jones Property, and West Creek —all located in the Orcutt Area

Specific Plan —are proceeding with construction or planning

- HASLO is under construction on its affordable units on Broad Street

Following is a summary of housing unit sales from 2008 through 2017 in San Luis Obispo and the North County.

Commercial Markets

Buyer confidence in commercial real estate continues and is illustrated in the following sections broken out by regions and market segments.

Commercial Markets in San Luis Obispo

As you drive through San Luis Obispo you see construction throughout the community, including Downtown, Broad and Higuera Streets, and the Airport Area. We are starting to see speculative industrial building but the most noticeable activity is office construction around the airport. The Airport Business Center is constructing another approximately 26,000 sq. ft. of office space after recently completing about 14,000 sq. ft. in two buildings. Ready for final inspection is the approximately 36,000 sq. ft. of office space at 892 Aerovista. These projects have targeted the back logged demand for office space, helping to address the lack of construction during the recession. The East Airport area has seen growth in both office and industrial product.

Retail

Breaking up Forever 21 and Sears

Retail vacancy is extremely small in San Luis Obispo if you exclude the large box footprint of Forever 21. Even with that space included, the vacancy rate is 4.02%, otherwise it is under 2%. With Tractor Supply adding over 19,000 sq. ft. in this last reporting period, the present retail inventory base is approximately 4,118,434 sq. ft. It has just been made public that the existing Sears building will be demolished and three smaller retail buildings will take its place, with two of those spaces being pre-leased. Smaller retail/restaurant buildings are selling for over $500 per sq. ft.

Office

Office vacancy has ticked up slightly from the 3.82% in 2016 to 5.38% this year. The largest space on the market, 45,350 sq. ft., is the vacancy that was left behind when CalTrans relocated from Atoll Business Center to South Higuera Street. Base inventory is approximately 2,933,380 sq. ft.

The nationally recognized start up, MindBody—as noted in earlier reports—still occupies the largest commercial office space in the market and continues to absorb tech hires. Cal Poly's incubator Hothouse is outgrowing its downtown location of approximately 15,500 sq. ft.

Any new office buildings coming on to the market will be $2.00+ per sq. ft., NNN.

A few noted sales of other, more typical, office product:

- 2625 Santa Rosa 2643 sq. ft. $ 1,025,000 $390 sq. ft.
- 412 Marsh Street 3112 sq. ft. $ 1,100,000 $353 sq. ft.

Industrial

The Industrial base of standing inventory is now just under 4,000,000 sq. ft. and has an incredibly low vacancy rate of 1.35%, which is down from the already low 1.6% in 2016. There is approximately 53,626 sq. ft. available on the market in a mixture of sizes. Rents are staying about the same as last year with quoted industrial rents in the $.90—$1.25 per sq. ft. NNN range.

Residential Unit Sales, 3rd Quarter Annual Data

Variable	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
San Luis Obispo										
# Units Sold	159	163	191	215	273	282	259	283	337	275
Median Price ($)	635,000	569,000	550,000	535,000	535,000	618,500	654,500	667,000	661,000	700,000
North County										
# Units Sold	638	702	698	892	991	1,045	1,032	1,138	923	976
Median Price ($)	390,000	340,000	296,000	270,000	305,000	355,000	375,500	404,500	422,421	483,000

Note: Comparative data is for the first three quarters of each year
Source: Central Coast Regional Multiple Listing Service;
Compilation by Stafford McCarty Commercial Real Estate*

Commercial Vacancy Rates (%), San Luis Obispo City Metropolitan Area, 2017

Property	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Industrial / Warehouse	2.8	3.8	6.4	4.0	4.3	2.3	5.4	6.1	9.1	8.7	4.5	1.9	3.1	2.3	1.6	1.4
Retail Functioning	1.9	2.4	2.2	1.7	1.8	1.4	3.0	5.6	5.1	3.4	3.7	1.8	2.7	1.3	5.6	4.0
Office Functioning	9.9	8.4	5.4	3.2	4.7	3.5	6.1	9.7	12.6	11.6	8.6	6.5	7.5	5.3	3.8	5.4

Source: Stafford McCarty Commercial Real Estate

East Airport parcel sales demonstrate increased values. A recent transaction had 2.5 acres selling for $2,500,000 or approximately $23 per sq. ft.

The following industrial transactions were on assets targeted for higher and better uses:

- San Luis Obispo Tribune 44,038 sq. ft. $9,000,000 $204 sq. ft. 5.37 acres
- 2146 Parker Street 13,227 sq. ft. $2,600,000 $197 sq. ft. 1.38 acres

Commercial Markets in Paso Robles and North County

After years of limited sales, all market segments have demonstrated transactions. Properties that have been on the market, some for over 12 months and in and out of escrow, have finally found buyers and closed the transactions. Additionally, investment properties with tenants and sustainable income have moved quickly. On the planning books are mixed use projects, mostly retail below with residential above.

Retail

Retail in Paso Robles has performed very well year-over-year and now again in 2017. It currently has a base of approximately 4,650,000 sq. ft. The vacancy rate was already low (2.1% in 2016) and has dropped to 1.14% in 2017. The approximate 53,000 sq. ft. of vacancy is comprised mostly of small spaces. Little inventory has been added for the last three years.

The Pine Street Promenade project on the former Hayward Lumber site near downtown (approx. 2.4 acres), has been rolled back from approximately 189,000 sq. ft. to 105,195 sq. ft. and will still include a 151 room hotel.

A few noted sales:

- 1315-1317 Park (1,575 sq. ft.)—$550,000 ($349/sq. ft.)
- 1436 Spring (3,700 sq. ft.)—$200,000 ($ 54/sq. ft.)
- 2111 Golden Hill (4,000 sq. ft.)—$965,000 ($241/sq. ft.)
- 1240 Spring Street (7,643 sq. ft.)—$2,050,000 ($268/sq. ft.)

Commercial Vacancy Rates (%), Paso Robles Metropolitan Area, 2017

Property	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Industrial / Warehouse (%)	9.4	10.7	3.5	5.0	2.8	7.5	13.2	8.0	7.7	6.5	5.7	3.6	1.1	9.3	5.8
Retail Functioning (%)	1.9	< 1.0	< 1.0	< 1.0	< 1.0	2.2	4.1	4.5	3.5	4.8	3.3	2.6	2.8	2.1	1.1
Office Functioning (%)	1.2	1.8	1.2	5.2	5.6	7.7	24.1	17.5	18.4	18.3	6.6	14.3	7.5	9.2	7.8

Source: Stafford McCarty Commercial Real Estate

- 2727 Buena Vista (19,499 sq. ft.)—$3,750,000 ($166/sq. ft.)

Office

Vacancy for the office sector has improved slightly over last year in the North County. Present vacancy is approximately 7.8%, down from 9.2% in 2016. This equates to approximately 34,400 sq. ft. of standing inventory on the market, on a base totaling 440,000 sq. ft. Once again, there has been minimal office inventory added this last year.

Manufacturing

Paso Robles is demonstrating a 5.8% vacancy rate with approximately 201,242 sq. ft. available. Base inventory has grown slightly and is approximately 3,467,000*** sq. ft. for 2017. The new inventory added was split between the "Tin City" submarket in neighboring Templeton and along Hwy 46 in east Paso Robles.

The 220,424 sq. ft. Paris Precision facility, which came on the market at the end of 2016, was purchased and has been repurposed to house multiple tenants. This product—broken up into smaller sections (ranging in size from 11,000 sq. ft. to 47,000 sq. ft.)—holds the bulk of the vacant market inventory. This large facility was purchased for $15,7500,000, approximately $71 per sq. ft. By comparison, a smaller facility sale was 2921 Union Road, which is approximately 20,000 sq.ft. and sold for $2,300,000, or $115 per sq. ft. These sales evince purchase prices under reproduction values.

Multiple small finished parcel land sales in east Paso Robles are demonstrating land values in the $5.00 to $10.00/sq. ft. range.

- 3522 Combine St. 17,284 sq.ft. $185,000 $10.70 per sq. ft.
- 3523 Combine St. 25,265 sq.ft. $229,500 $9.08 per sq. ft.
- Danley Ct. 78,408 sq.ft. $425,000 $5.42 per sq. ft.

Commercial Investments

Capitalization rates, or "Cap Rates," have been holding steady but are starting to creep lower. Many investors complain that San Luis Obispo County investment properties are difficult to find given the investment returns they are seeking—forcing them to look out-side the Central Coast market and the state. Yet, there are still enough investors willing to accept lower cap rates and exchange transactions have been an active part of the market.

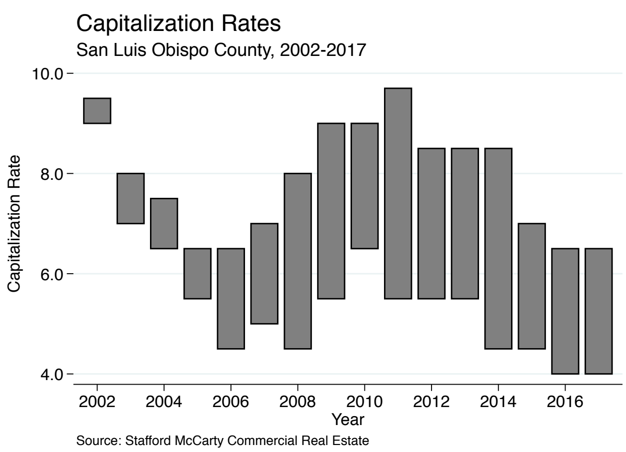
Some examples:

- Marigold Center 217,000 sq. ft. $43,550,000 $200 per sq. ft. approx. 6-7 cap
- Fiero Commerce Park 57,878 sq. ft. $11,250,000 $194 per sq. ft. approx. 5.9 cap
- 100 Cross Street 40,568 sq. ft. $13,300,000 $327 per sq. ft. approx. 6.03 cap
- Grand Ave 6,500 sq. ft. $1,250,000 $201 per sq. ft. approx. 4.8 cap
- Farrol Road 16,000 sq. ft. $1,800,000 $ 91 per sq. ft. approx. 4.5 cap

Similar to last year, local lenders are seeing imputed capitalization rates in their appraisals in the 5's while other regions in major markets are seeing lower caps, some even in the 3's.

Apartments are a different ball game as they will demonstrate cap rates in the 3's to 4's, and there seem to more buyers than sellers for this product submarket. Hospitality assets are presently 6 to 9 caps.

Following are capitalization rate ranges evinced over the last fifteen years for our market area:



Data Points in the Region and Data Bumps in the Submarkets

The Doors Close on Community Banks

With the recent sale of Founders Bank, San Luis Obispo County has run out of community banks. The industry prediction of larger banks absorbing smaller ones has finally played out in our community.

Hotels in San Luis Obispo and North County

Hospitality entitlements continue to be processed and will become a significant sector in permit and building activity over the next several years for both urban hotels and those located on the periphery.

There were a number of significant transactions in hospitality sector:

- Springhill Suites, at 130 rooms, sold for $24,937,000 or $191,823 per door.
- The Morgan in San Simeon, with 56 rooms, sold for $8,222,310, or $146,826 per door
- Azsa Hospitality purchased approximately 4.21 acres of land on 4th Street in Paso Robles for approximately $22.50 per sq. ft.

There is tremendous hospitality interest in the region, as it has become an increasingly popular tourist destination. The nightly "rack rates" are significantly below rates in neighboring Monterey and Santa Barbara, destinations that partly drive the area's appeal and investor interest for the opportunity to raise rates.

Values in San Luis Obispo County Agriculture Still Hold

Values are still holding in the $45,000 to $55,000 per acre range for strawberry and berry ground. North County planted values remain the same as last year: for smaller vineyards (20-80 acres), plantable east side acreage is generally $18,000 to $20,000 per acre versus $35,000 to $50,000 per acre on the west side. Planted acreage on the east side is $30,000 to $35,000 per acre and $50,000 to $65,000 per acre on the west side for the smaller vineyards. There were two west side vineyard sales in the mid $2,000,000 range supporting these planted values this past year.

Trends continue with buildings additions to support viticulture. The past significant growth we have seen in the addition of new wineries (10,000 sq. ft. and larger) has taken a breather, but modest expansion of existing facilities has continued throughout the County. Not enough time has passed to assess how the recent Northern California fires will impact land values in our region. The 100,000 sq. ft. Fetzer winery on 46 acres with some plantings, sold to Sutter Home at the end of last year for $14,750,000.

The Cannabis Factor in San Luis Obispo County

As of this date, only the City of Grover Beach has elected to allow cannabis activity in their industrial area, including two dispensaries. This has triggered some sales and caused values to skyrocket in the designated areas. Per square foot values for industrial buildings, which may have been around $100 per sq. ft., have jumped to $500-$600 per sq.ft. for smaller buildings.

The County's proposed cannabis regulations are under review and seem to be ever changing, causing great uncertainty for regulators, citizens, and especially those in the cannabis industry seeking to establish locations.

Conclusion

Like last year, 2017 has proved to be a solid year for commercial real estate. Buyer confidence is high, lenders are seeking opportunities to finance, and properties are getting more expensive. Tax deferred exchanges, as anticipated, have been a key part of market vitality. The link between our regional agriculture and tourism is becoming more defined. The nexus at which 'agritourism' and economic development meet is a topic of great interest to the region as well.

* Data from the San Luis Obispo Multiple Listing Service.

** 2017 data variations due to MLS service provider and reporting changes

*** Data correction for 2017.

Demographics

by Hoyu Chong

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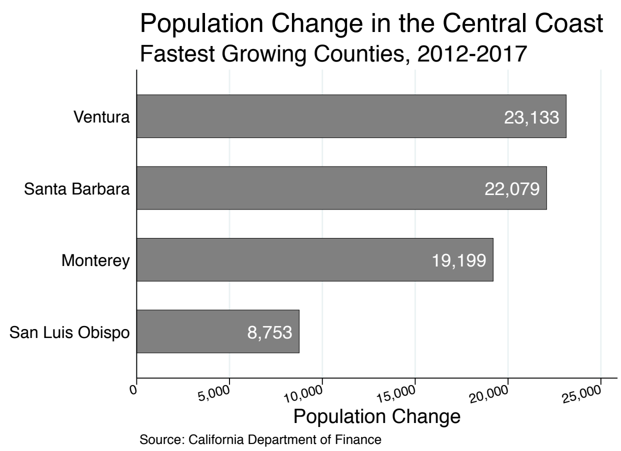
Key Chapter Findings

- Population gains continued to be restricted by a low rate of natural increase, but migration to the county gained steam between 2015 and 2016.
- Both property and violent crime rates per 100,000 residents decreased slightly from 2015 to 2016 in San Luis Obispo County, even as they increased slightly for California.
- Although San Luis Obispo County is still more ethnically homogeneous than other Central Coast counties and the State, the local demographic has been becoming more diverse. As of 2016, San Luis Obispo County's main minority groups —Asian, Black and Hispanic —have all increased from 10 years earlier.

Population



Population is growing in San Luis Obispo County, albeit more slowly than in the broader Central Coast and the State. Data from Department of Finance indicate that the population grew by just 1,621, or 0.6%, from 2015 to 2016, lower than the statewide growth of 0.9%. Still, over the most recent five year period, the county added roughly the population of the City of Pismo Beach. The County's population growth also trails that of Santa Barbara County (0.8%) and Monterey County (1.0%) but is ahead of Ventura County (0.4%). At the city level, larger cities have had higher population growth in percentage terms, with Paso Robles leading with 1.2% growth from 2016 to 2017, followed by the City of San Luis Obispo (0.9%). The smaller cities Grover Beach and Morro Bay each had only a 0.4% population increase. Overall, the unincorporated County area (0.3%) lagged incorporated areas (0.8%).

Population Growth in San Luis Obispo County 2017

Location	2017	1-Yr. Chg.	1-Yr. Chg. (%)
County Total	280,101	1,621	.58
Incorporated	159,552	1,241	.78
Unincorporated	120,549	380	.32
San Luis Obispo	46,724	426	.92
Paso Robles	31,745	367	1.2
Atascadero	30,900	267	.87
Arroyo Grande	17,736	16	.09
Grover Beach	13,438	47	.35
Morro Bay	10,762	48	.45
Pismo Beach	8,247	70	.86

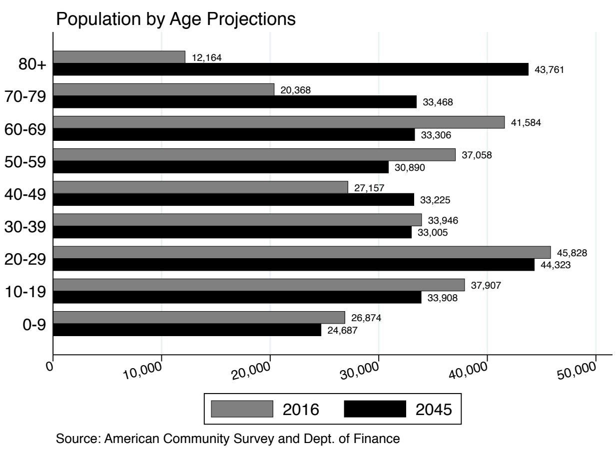
Source: CA Dept. of Finance

Migration Trends

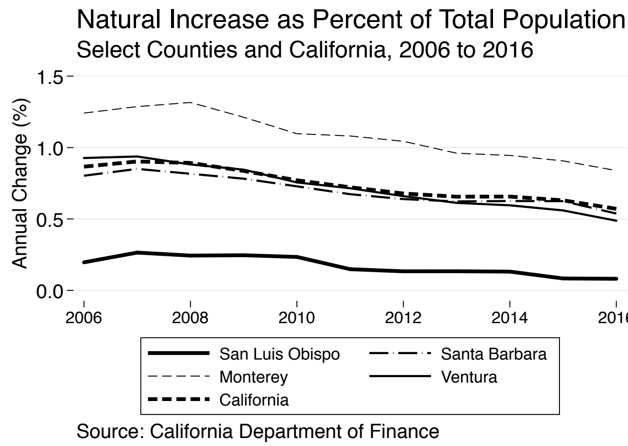
One trend limiting population growth in the County has been a low fertility rate. Natural increase in the population (births less deaths) has been much lower in San Luis Obispo County than statewide and other Central Coast counties.[20] In recent years, net migration accounted for most population growth. In fact, the natural rate of increase was just 0.08% in 2016, a low compared with the few previous years, which hovered around 0.13%. Nevertheless, population aging is

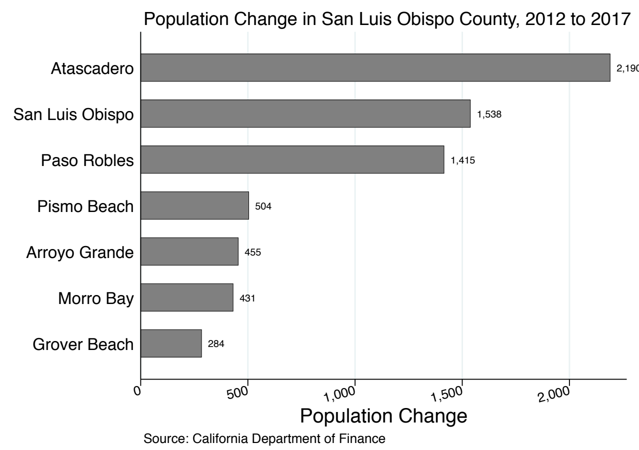
[20] On the other hand, net migration has been very cyclical in all Central Coast counties.

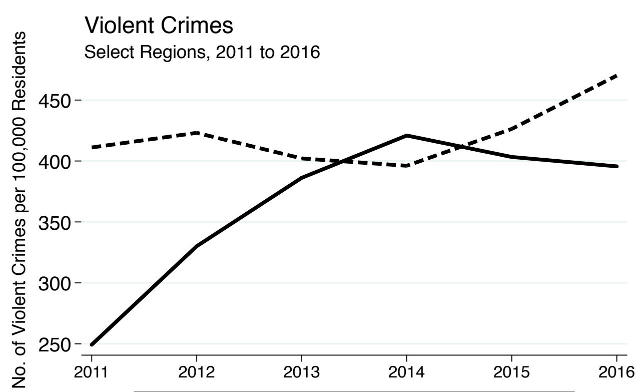
not a problem unique to San Luis Obispo County; natural increase as percent of total population has been falling in other Central Coast counties and statewide. The chronically low natural increase as a percentage of total population means that not only has population growth lagged the State average, but the gap is also growing. Further, despite the fact that San Luis Obispo County has a higher net migration rate than other Central Coast counties, migrants in older age cohorts are over-represented in comparison with the State. For instance, American Community Survey data demonstrate that 15.8% of migrants in 2015 were 56 or older —compared with a 14.1% representation in State migrants.



Those 25 years and younger are still the largest group of migrants, however, and the 11,800 who entered the County in 2015 represented 48% of all inbound migration. The migration dynamics of the County are highly influenced by post-secondary enrollment trends, and in 2017, the 22,500 students at Cal Poly San Luis Obispo accounted for close to 10% of the estimated population. The American Community Survey estimates that the cohort from 20 to 29 years old is the largest population group by age (16.2%), followed by those from 60 to 69 (14.7%). But by 2045, although the 20- to 29-year-old cohort will still be the largest group (14.3% of total projected population), seniors 80 and above will become the second-largest group (14.1% of total projected population).



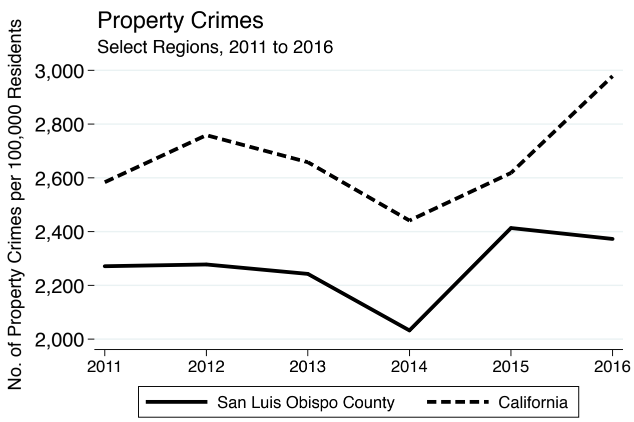




Central Coast and Age (Population Shares (%)), 2016

Age	San Luis Obispo	Monterey	Santa Barbara	Ventura	California	United States
Less than 5	4.6	7.5	6.5	6.1	6.3	6.1
5 to 19 y.o.	18.3	21.8	20.5	20.1	19.5	19.4
20 to 34 y.o.	21.9	21.8	24.4	20.2	22.2	20.6
35 to 49 y.o.	15.9	18.9	16.9	19.1	19.9	19.1
50 to 64 y.o.	20.2	17.1	17.1	20	18.5	19.6
65 and older	19.1	12.6	14.6	14.6	13.5	15.2
Median Age	38.8	34	33.8	37.7	36.4	37.9

Source: American Community Survey

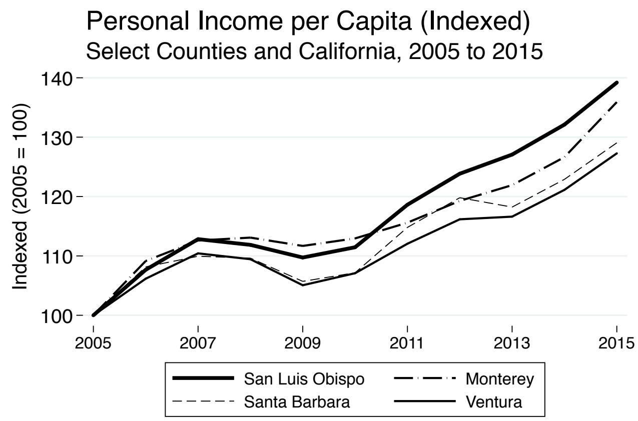


Source: Federal Bureau of Investigation

A number of factors have contributed to the high rates of inbound migration to the County, including the performance of the local economy, affordability and quality of life. Historically, crime rates have been relatively low in the Central Coast,[21] and San Luis Obispo County is no exception. Both property and violent crime rates per 100,000 residents decreased slightly from 2015 to 2016 in San Luis Obispo County, even as they increased slightly for California. The incidence of violent crimes has been falling since peaking in 2014, and reached 395.6 incidents per 100,000 residents in 2016. On the other hand, property crimes tend to be substantially more likely to occur. In 2016, there were 2,373 property crimes per 100,000 residents, which was significantly lower than the statewide average of 2,978 per 100,000 residents.

[21]Violent and property crimes rates per 100,000 population in 2016 in other Central Coast counties: Monterey County (419.3 and 2,392.6), Ventura County (257.9 and 1,931.5) and Santa Barbara (342.4 and 2,193.1).

Income



Source: Bureau of Economic Analysis

San Luis Obispo County has also done quite well in terms of income and income growth. In 2015, its per capita personal income was $49,873, slightly ahead of Monterey County's $49,835 but behind Santa Barbara County's $54,428. Over the last 10 years, San Luis Obispo County had the highest increase in personal income, 39.2% over 2005. In contrast, personal income in Monterey (35.9%), Santa Barbara (29.0%) and Ventura (27.3%) counties was significantly lower.

The impressive growth in personal income per capita can be mainly attributed to the high growth rates in investment income (73.2%)[22] and personal current transfers (48.3%).[23] On the other hand, although

[22]Investment incomes refer to dividends, interests and rent.

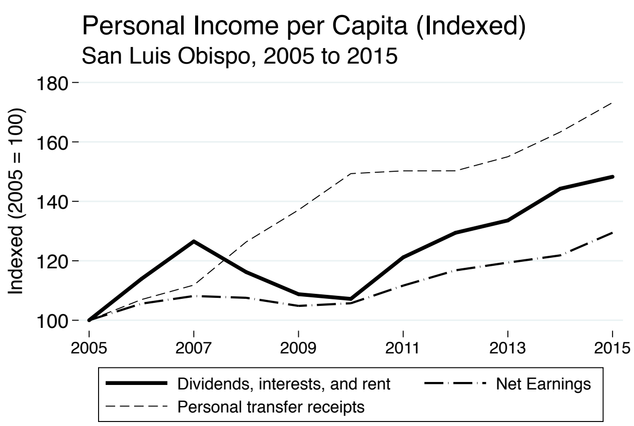
[23]The BEA defines personal current transfer receipts as benefits received by persons from federal, state and local governments and from businesses for which no current services are performed. Given that San Luis Obispo County has a high share of senior citizens, it is plausible that retirement and disability insurance bene-

Median Household Income, Selected Counties

Location	2016	1-Yr. Chg. (%)	5-Yr. Chg. (%)	10-Yr. Chg. (%)
Monterey	63,876	14.6	16.7	13.8
San Luis Obispo	70,564	23.5	23.2	28.8
Santa Barbara	67,436	15.8	10.3	20.7
Ventura	80,135	10.3	6.9	10.0
California	67,739	14.8	15.4	16.4

Source: American Community Survey

net earnings by place of residence[24] are still the biggest component of personal income, the growth (29.4%) has severely lagged other forms of income. Altogether, San Luis Obispo County has also led the Central Coast in terms of household income gains —on one-year, five-year and 10-year bases. In 2016, median household income in San Luis Obispo was $70,564, which was higher than that of Monterey County ($63,876) and Santa Barbara County ($67,436). Furthermore, median household income rose 12.6% between 2015 and 2016 in San Luis Obispo County, more than double the percentage increases in Monterey (5.6%), Santa Barbara (6.0%) and Ventura (0.1%) counties.



Source: Bureau of Economic Analysis

fits as well as Medicare make up a relatively high share of all personal transfer receipts compared with nearby counties.

[24]The BEA defines net earnings by place of residence as earnings by place of work less contributions for government social insurance plus adjustment to convert earnings by place of work to a place of residence basis.

High School Graduation and College Eligibility

Location	2015-16	2010-11	Change (%)
High School Graduation Rate			
San Luis Obispo	92.3	87.3	5.0
Monterey	85.5	75.3	10.2
Santa Barbara	88.6	82.8	5.8
Ventura	86.2	81.5	4.7
California	83.8	77.1	6.7
Share who Completed UC/CSU Entrance Requirements			
San Luis Obispo	37.4	37.7	-0.3
Monterey	36.1	25.2	10.9
Santa Barbara	34.9	33.9	1.0
Ventura	34.2	34.3	-0.1
California	45.4	36.9	8.5

Source: CA Dept. of Education

Population Share by Race, 2016

Race	California	Monterey	San Luis Obispo	Santa Barbara	Ventura
Asian	14.1	5.6	3.7	5.5	7.0
Black	5.5	2.5	1.7	1.8	1.7
Hispanic (all races)	38.9	58.3	22.3	45.1	42.5
White	37.5	30.0	69.2	44.9	45.7
Other	1.0	0.7	0.6	0.3	0.6
Two or more	3.0	2.8	2.5	2.4	2.5
Total Population	100.0	100.0	100.0	100.0	100.0

Source: American Community Survey

Education

Income has risen for workers of all educational attainment levels in San Luis Obispo County. Workers with only a high school diploma or some college/associate's degree made the greatest strides. San Luis Obispo is the only Central Coast county where income also rose nicely for its highly educated residents in 2016 —Monterey, Santa Barbara and Ventura counties all saw a decline in incomes for residents with a bachelor's degree or a graduate/professional degree. Although residents with a graduate or professional degree still command the highest median salary, $66,297 in 2016, they earn 18.5% and 5.5% less than their counterparts in Monterey and Santa Barbara counties, respectively. On the other hand, San Luis Obispo County residents with a high school diploma or less had the highest median income among Central Coast counties. Residents with less than a high school education earned 18.1% and 26.5% more than their counterparts in Santa Barbara and Monterey counties, respectively.

Educational Attainment and Income, 2011-2016

Attainment	San Luis Obispo		Monterey		Santa Barbara		Ventura	
	2016 ($)	5-Yr. Grt. (%)	2016 ($)	5-Yr. Grt. (%)	2016 ($)	5-Yr. Grt. (%)	2016 ($)	5-Yr. Grt. (%)
Less than High School	26,153	17.2	20,670	30.8	22,139	16.7	21,712	24.1
High School Diploma	34,726	39.4	28,410	20.4	30,478	10.4	31,386	15.4
Some College or Associate's Degree	40,829	26.6	35,854	1.1	35,929	6.5	40,963	7.1
Graduate/Professional Degree	66,297	8.2	81,386	22.3	70,151	1.1	80,333	-1.0
Bachelor's Degree	52,777	13.4	50,909	-0.4	52,487	-3.5	61,877	2.0

Source: American Community Survey

The quality of educational opportunities in San Luis Obispo County is another attractive feature for people thinking of moving to (and starting families in) the region. Education levels in San Luis Obispo County are significantly higher than elsewhere in the Central Coast. Of the population aged 25 and over, 36.2% had earned at least a bachelor's degree in 2016, which compares favorably against the counties of Monterey (24.8%), Santa Barbara (32.4%) Ventura (33.6%) and the State (32.9%). Public primary and secondary schools are also high performers in the region. San Luis Obispo County had a higher high school graduation rate than other counties in the Central Coast. For the class of 2016, San Luis Obispo County had an overall graduation rate of 92.3%. Even the school district with the lowest graduation rate (Paso Robles Joint Unified, at 89.6%) was higher than other Central Coast counties', which hovered in the mid-80% range. On the other hand, although the percentage of graduating seniors who completed the minimum UC/CSU entrance requirements (37.4%) was slightly higher than elsewhere in the Central Coast, the percentage was well below the statewide average (45.4%).

Racial Profile

Decreasing fertility rates, alongside strengthening migration, have been reshaping the racial profile of the region. Although San Luis Obispo County is still more ethnically homogeneous than other Central Coast counties and the State, the local demographic has been becoming more diverse. As of 2016, San Luis Obispo County's main minority groups —Asian, Black and Hispanic —have all increased from 10 years earlier. Of those, Hispanics had the largest gain, 4 percentage points. In contrast, Monterey County's Asian and Black populations as shares of total population both decreased from 2006 to 2016. San Luis Obispo County has by far the largest non-Hispanic white population and is the only Central Coast county whose share is greater than 50%.

Data Sources

The creation of this report would not have been possible without numerous public and private sources of data. We would like to acknowledge those sources here.

Bureau of Transportation Statistics

California Air Resources Board

California Association of Realtors

California Board of Equalization

California Dept. of Education

California Dept. of Finance

California Dept. of Justice

California Employment Development Dept.

California New Car Dealers Association

California State Controller

California State Franchise Tax Board

California State Legislative Analyst's Office

CB Richard Ellis

Central Coast Major Listing Service

Construction Industry Research Board

CoStarr/The London Group

DataQuick/CoreLogic

Federal Reserve Economic Data (FRED)

Fiserv Lending Solutions

Grubb & Ellis

Hanley Wood Market Intelligence

HousingTracker.net

Marcus & Millichap

Mortgage Bankers Association

National Science Foundation

NOAA National Weather Service

Property & Portfolio Research

RealFacts

Research and Development (RAND)

S&P Case Shiller

Texas Transportation Institute

U.S. Census Bureau, American Community Survey

U.S. Census Bureau, Longitudinal Employment - Housing Dynamics

U.S. Dept. of Commerce, Bureau of Economic Analysis

U.S. Dept. of Labor, Bureau of Labor Statistics

U.S. Dept. of Transp., Research and Innovative Technology Administration

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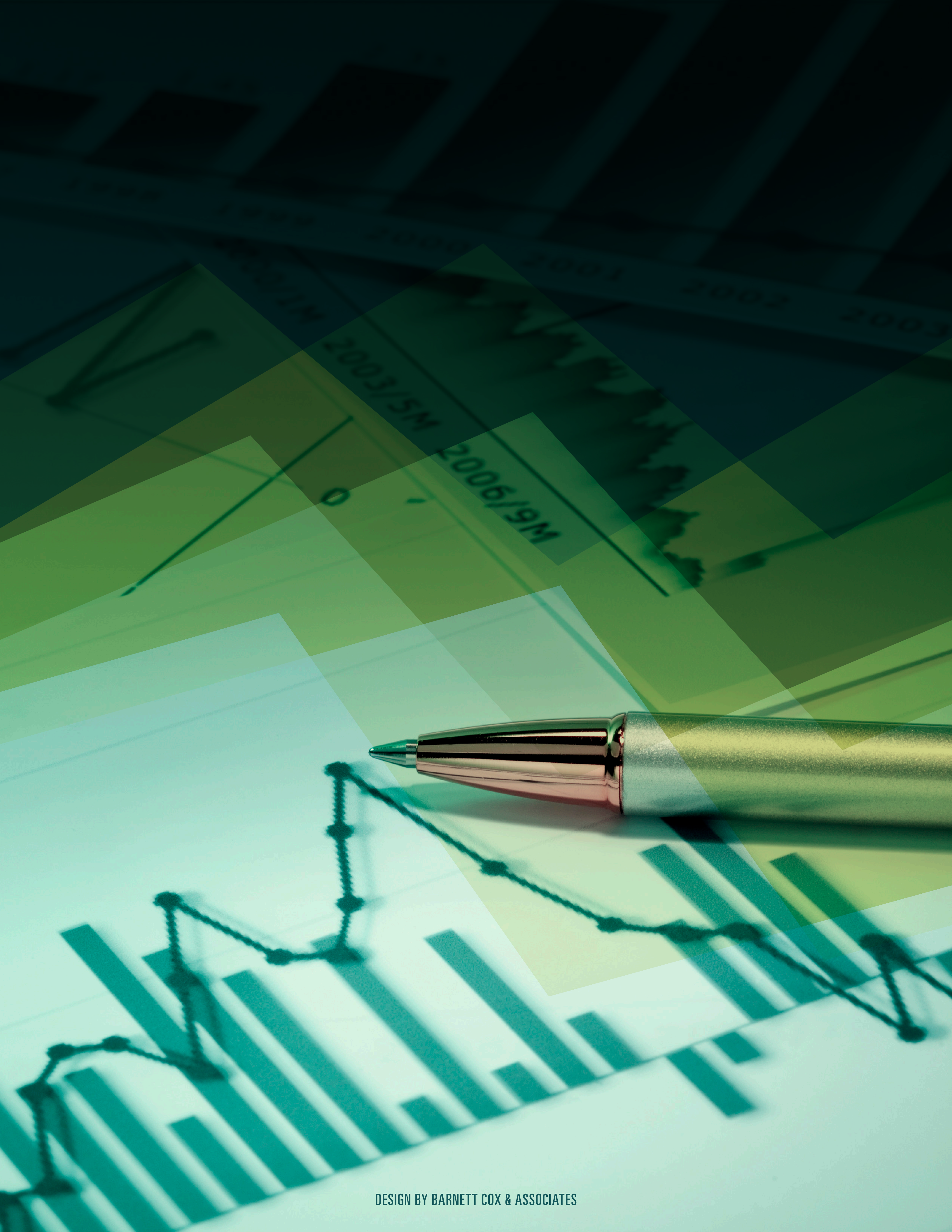
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