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Economists Expect Second Half Of 2011 To Be Much Better

Experts Say Headwinds Only Temporary, Growth To Prevail By Year's End; Jobs, Consumer Confidence Remain Keys



The Downtown Long Beach skyline, as seen in late March in a photograph by the Business Journal's Thomas McConville. Many of the office, residential and retail buildings and projects pictured here came about with the assistance of the Long Beach Redevelopment Agency. Under the new state budget signed last week by Gov. Jerry Brown, RDAs cease to exist unless a city makes an annual payment to the state, which some city and statewide officials refer to as a "ransom payment." In Long Beach, City Manager Pat West says the payment to continue with redevelopment would be \$34 million in the first year, with annual payments thereafter in excess of \$8 million. "This payment would come on the heels of a \$6 million payment last year and \$29 million the year before to the State that we are still trying to pay off," he wrote last week in a letter to city councilmembers. "Even if the agency could somehow afford this payment (which remains to be seen if it is even affordable and that analysis is ongoing), redevelopment as we know it would be eviscerated." Approximately 400 California cities have redevelopment agencies.

■ By **SEAN BELK**
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Despite signs of the nation's economy feeling the effects of recent turmoil caused by higher gas prices and natural disasters, local economists say the negative vibes are only momentary and recovery should pick back up again later this year.

Positive strides in economic activity during last year's holiday season carried over into the early part of 2011, but recent reports have shown that consumer spending, job growth and international trade activity slowed further than expected during the second quarter. Still, economists said that the underlying factors are only temporary setbacks.

Long-term growth in various industries in California and the United States should, according to economists, prevail in the sec-

ond half of the year and more so by 2012 as the recovery regains traction. But, they agreed, the nation isn't out of the woods yet, as high unemployment, distressed properties and government cutbacks continue to weigh on the country's frail economy.

"The headwinds that have slowed down Long Beach, the Greater Los Angeles area, Southern California and the United States, we still feel are temporary and are not really permanent," said Eduardo Martinez, senior economist for Moody's Analytics. "We're not seeing companies that are going to start laying people off again . . . [but] the economy has not completely recovered."

A large portion of the nation's gross domestic product (GDP) growth was the result of increased consumer spending last year that brought more revenue into state and city coffers. Business spending

also increased for equipment purchases as did the hiring of temporary workers. However, the headway also relied heavily on federal government stimulus dollars, which have slowed.

Nancy Sidhu, chief economist of the Kyser Center for Economic Research for the Los Angeles Economic Development Corporation, said consumer spending is expected to lead the recovery for the remainder of this year. At the same time, there's less of a need for retailers and wholesale distributors to replenish inventories after a majority of restocking took place last year.

After the ports experienced double-digit increases in cargo volumes in 2010, consumer-related businesses reduced their orders this year, resulting in projected gains of only 5 or 6 percent for 2011, she said.

"Extracting from the [recent] pause,

what's going to contribute to growth in the latter part of 2011 and 2012 will be mostly consumer spending," Sidhu said. "Business inventories are back pretty close to where they should be, so you don't get that extra push. Business equipment spending will stay strong. But because consumers are so important, they will again take the lead going forward."

Sidhu noted that a drop in gas prices should bring relief to consumers and help the overall economy, as most people will spend the extra cash on immediate purchases rather than saving it. Impacts from Japan's earthquake, tsunami and nuclear disaster – which devastated that country's automobile export capabilities – should also be short-lived, Sidhu added, as Toyota has already announced adding vehicles to fill a backlog of orders.

Christopher Thornberg, a Los Angeles economist and founding principal of Beacon Economics, agreed that issues surrounding the recent slowdown in recovery are mostly "transitory." External accounts and consumer spending should continue to improve this year, he said.

"The economy's moving forward again," he said. "We've actually upped our forecast for the second half of the year, in part because we think the second quarter [data, when it's released] is going to be weak, pushing growth around, but not changing the growth path."

Thornberg added that many analysts were too optimistic on earlier projections for the year, but are now too pessimistic. According to findings from Beacon's "2011 Los Angeles Economic Forecast Book," the "disconnect" between Main Street and Wall Street showed a disparaging contrast in views of the nation's recovery.

Home Prices To Remain Flat Into 2012

On a national scale, single-family home prices hit a new low, as recent reports confirmed a "double dip" – due mainly to lenders unloading more foreclosed properties, thus putting downward pressure on prices. Home sales also dropped because of the expiration last year of federal tax incentives. However, Moody's Martinez predicted home prices in California and the Los Angeles County to remain relatively flat into 2012.

While credit standards remain tight for potential borrowers looking to acquire loans, a "retrenchment in value assets" should be healthy for financial markets, which, according to Thornberg, have somewhat gotten ahead of the recovery. The main drag on real estate markets is the cur-

rent low equity in homes, which makes it hard for would-be buyers to purchase new homes, he explained.

Thornberg noted that while California may have a "bigger hole to dig out of" in terms of real estate, exports through the ports should prove to be a positive trend for the local economy. He also added, "When oil prices stop going up, so too does the negative impact on people's incomes." Expect "substantial" gains in the third quarter, he said.

However, Sidhu said, with relatively flat personal income, a continued drop in home prices and overall uncertainty – plus the financial troubles in Europe – consumers and businesses need to remain cautious. "There's also this general angst," she added. "The anxiety, in a sense, itself is feeding because I think we're seeing it in consumer spending, which is not as strong as it could be, and also seeing it in what small- and medium-size businesses are doing."

Employment Growth To Slowly Improve

A longstanding concern is California's lofty unemployment rate, which, as of May, remained the second highest in the nation at 11.7 percent. Long Beach's rate was even higher at around 13 percent. Still, job growth gradually increased over the last few months.

The United States Department of Labor announced recently its allocation of \$48.7 million in funding to 37 states and the District of Columbia to implement "re-employment and eligibility assessments for beneficiaries of unemployment insurance." California was expected to receive a \$2.14 million grant.

According to a forecast by Moody's and the U.S. Bureau of Labor Statistics, state and Los Angeles County unemployment rates should stay relatively flat for the rest of the year, however, they are expected to drop below 10 percent by the end of 2012. Also, the country's unemployment rate, which hovered at 9 percent in May, should drop a percentage point by next year. "There has been a recovery in jobs," Martinez said. "It's slower than what we would like it, but it has increased."

John Challenger, CEO of global outplacement consultancy firm Challenger, Gray and Christmas, said the United States economy added 800,000 jobs to the market over the last year, and the first four months of the year showed consecutive job growth for the first time since the recession officially ended in 2009.

Although the federal government released May figures showing a slight drop

in employment gains, Challenger doesn't believe the drop off represented a long-term slowdown. "We had very strong job creation in the last three months, and that's what everybody's been waiting for. But in the month of May, it dropped to just 54,000 jobs created and that has caused a lot of concerns," he said

According to economists, growing industries across the Southland include: technology; international trade; tourism and hospitality, entertainment (commercials and motion pictures); and health and human services. Sidhu added that positive growth in these industries have already begun to trickle down to suppliers such as professional and business services and temporary work agencies, and the recovery should eventually become more widespread.

"When business firms in those industries do more business, then more contracts have to be written, more accounting has to take place, and more payroll has to be taken care of, and we see an increase in business services and more supplier industries," Sidhu said. "That's how the recovery spreads."

Cutbacks in the government sector have, however, kept unemployment rates high. The sector lost a total of 446,000 jobs nationwide since its peak in 2008, Challenger said. "It's not been a strong recovery, so from a job standpoint, even though the private sector has come out of a recession, the government is in a recession and jobs are disappearing from government every month."

Martinez added that reductions in state and local government positions are expected to primarily affect K-12 schools and California State University and University of California systems. The Legislature passed the budget on June 28 and Governor Jerry Brown signed it into law, along with a plan to eliminate the state's redevelopment agencies (RDA). Money from the latter, according to the governor, is an effort to help prevent further reductions in education funding.

Another factor dragging on the recovery is the general decline in construction jobs caused by the stagnant real estate markets. The steady decline in construction has been a "long slog" since peaking in 2005, Sidhu said. Recent infrastructure projects and an increase in investment for multi-family development may help the market improve, but construction overall should continue to lag, she said.

Manufacturing remains a vital industry to the Los Angeles County region, but many jobs have fallen victim to automation, machines and outsourcing, Martinez said. He added that production tied to large

federal defense budgets, primarily in aerospace, such as Boeing's C-17 production line, are expected to be hurt by federal cuts, while more international orders have helped salvage what industry remains.

City Officials Remain Cautious

In looking at the economic situation in Long Beach, City Manager Pat West said sales and property tax revenues have come in a "little bit low," and the city is adjusting revenue figures that have been "unrealistic" in some departments, such as parking citations and alarm fees that continued to decline. "Some revenue targets aren't being met and we need to structurally adjust that," he said.

However, oil revenue did come in above projections, allowing the city to balance the current year budget by offsetting an expected \$5.1 million deficit in the general fund. But city officials remained cautious for the remainder of the year, projecting a per barrel price increase to only \$55 from the previous \$45. This approach, they said, is due to the high volatility of the commodity.

City Treasurer David Nakamoto said financial management asked city departments to take on their "proportional share" of any budget adjustments for next fiscal year, which begins October 1. "We did ask departments to reduce their expenditure budgets [in fiscal year 2012]," he said. "Really, we left those options up to the departments individually. They know their business better than anybody else."

Nakamoto added, "We're not expecting a really robust economy in 2012, but we're certainly hopeful the economy continues to recover and the city will get that share of that benefit."

The city's fiscal year 2012 budget was expected to be presented to Mayor Bob Foster on July 1. He has until August 2 to review it and make his recommendations before it is presented to the city council, which will hold public hearings. However, that preliminary budget will need to be adjusted if the governor's elimination of redevelopment agencies – or a payment in lieu of elimination – withstands an expected court challenge.

The City of Signal Hill, which passed a nearly \$17 million budget in June, was projecting a surplus of about \$41,000, according to Charlie Honeycutt, deputy city manager. He said revenues are expected to be up 9 percent this year over last year. "We're starting to see a little bit of an uptick in the economy," he said. "We're hoping that we've seen the worst and have sort of hit the bottom and now starting to climb out of the hole."

About three years ago, the city began implementing fiscal strategies, which included: putting together an "economic uncertainty fund;" imposing a hiring freeze on all positions except police officers; and reducing costs by 2 percent per year, which has saved the city roughly \$1.2 million. The strategy has enabled the city to "stabilize" its general fund, Honeycutt said.

However, the city is still challenged in paying for employee pension costs. Honeycutt noted that the city has required all employees from all city unions to pay more toward their CalPERS pension funds, but the city is still projecting its unfunded liability to increase by \$530,000 over the next three years.

The other big issue is the impact on the city caused by the elimination of its redevelopment agency. In smaller cities such as Signal Hill, city employees often wear city and RDA hats, with salaries and other costs drawn from both budgets.

Carson Mayor Jim Dear said he remained "cautiously optimistic" in moving forward. Overall, the general fund budget "looks promising," he said, with sales tax, property tax and franchise fee revenue already increasing month-to-month. The city is reducing overall spending, he added, but hasn't had to implement employee furloughs this year, as it did last year to fix budget shortfalls.

Cities Ban Together To Save RDAs

City officials, including those in Long Beach, Signal Hill and Carson, have joined other local government representatives in a fight to save redevelopment agencies.

The California League of Cities has vowed to take the fight directly to the California Supreme Court, claiming the governor and the state violated the constitution and acted against the will of taxpayers.

Mayor Foster called the state's initial proposal "an illegal and indefensible shakedown of our cities," expressing frustration over the Legislature's refusal to compromise on salvaging what he calls the city's only economic development tool.

"Rather than create sensible, long-term solutions for California's dismal financial problems, they sought to recklessly raid local tax dollars and kill redevelopment – our strongest local tool to revitalize the economy and create jobs now," Foster said in a prepared statement.

Mayor Dear agreed, saying, "We're very concerned about the State of California eliminating the redevelopment agencies. Eliminating redevelopment

agencies is a big mistake."

With so many unknowns for cities regarding the impact of the governor's action on redevelopment agencies, one Long Beach official described it as being in a "holding pattern."

Business Journal Publisher George Economides added that the impact is far greater than most people realize, pointing out that it's not just direct jobs that will be lost within cities, but also jobs from contracts that would have been issued for design, construction, equipment purchases, etc. "It's a downward spiral with lots of tentacles. Many areas of the private sector will be negatively impacted and some firms who rely heavily on redevelopment projects will be out of business," he claimed.

New housing projects – especially affordable housing – will also be impacted heavily, he said, since developers will be unwilling, due to cost and other factors, to purchase several adjoining properties in order to assemble enough acreage to build a condo project or retail center. "Blighted areas will remain blighted until city coffers are healthy again, and that may be a decade or more," he stated.

"I'm disappointed in our state elected officials who voted for this – specifically former city councilmembers Alan Lowenthal in the Senate and Bonnie Lowenthal in the Assembly. They know redevelopment has played a huge role in helping Long Beach move forward. Their argument that the elimination of RDAs helps education is bogus. They haven't done their homework. They also forgot they were elected to represent the wishes of their district, not what their beloved teacher unions want. It's all politics – as usual." ■