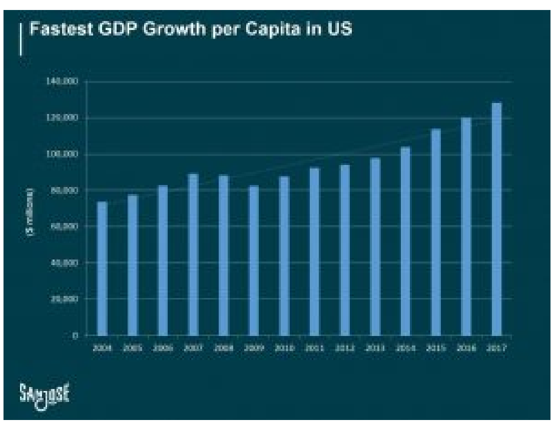
BLOG

OED presents 2019-2020 economic outlook at City Council budget session

/ May 28, 2019 by Elisabeth Handler

Chris Burton, Deputy Director of Economic Development, provided a close look at a wide range of economic indicators that will affect the City's economic future, as part of the City Council's budget deliberations for fiscal year 2019-20, which begins July 1, 2019. Chris noted that in previous years the forecasting had been referred to as "A Tale of Two Cities" but this year, the report was framed as a Story of Three Economies – the Regional Economy, the City Economy and the Other Economy – the interplay of jobs, workforce, housing and affordability which can expand or restrict opportunities for the city's residents.



Regionally, the City is affected by the country as a whole being in the longest economic cycle since World War II. There are indications that it will continue for a while, but the City must be prepared for a cooling off of national, regional and inevitably local economic growth.

San Jose saw its labor force grow after the end of the recession, but Chris pointed out that the rate of increase in employed residents is faster than the rate of jobs being added in the city, which means that we are still behind the economic curve, especially compared to other cities in Northern California.

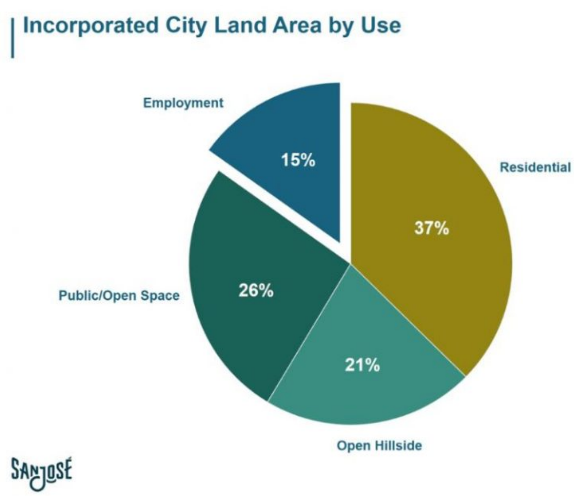
In terms of GDP per capita, San Jose is ranked the fastest growing and second highest in the US. Value is continuing to be created out of our regional economy, solidly dependent on the "information" portion of the tech sector, with strength continuing in manufacturing and professional services.

The commercial real estate picture in San Jose continued to be dominated by R&D, which accounts for fully one third of San Jose's job-creating real estate acreage. In the office-space market, San Jose still offers slightly lower rents than the rest of the region, so vacancies are low. A third of the office space is in downtown and another third in North San Jose. Downtown is poised for large changes as CityView Plaza, Museum Place and of course, the Diridon Station area projects move forward.

In San Jose, the housing situation is very much top of mind, but at an average 3,800 units per year, we are behind in production. Chris noted active residential construction projects and plans in the pipeline, and will be providing a more detailed analysis to the City Council in the fall. He explained that for already-constructed sites, San Jose's relatively lower rents are an attractive feature, but when it comes to penciling out the returns on new construction, the lower rents are a disincentive.

Sales taxes continue to play a key role in the City's economic health. Although there was an uptick in sales tax revenues in 2016 following the ballot measure's passage, the ongoing pattern has been rising more slowly. Per capita, San Jose has lower sales tax revenues than other Bay Area cities. For the next two quarters, OED will be watching the impact of changes in the income tax laws, where increased refunds may boost consumer spending.

Property tax contributions to the general fund vary with the national and regional economy. Leading up to the recession between 2004 and 2008, as real estate prices climbed, San Jose saw a spike in home sales, and the taxes on those newly assessed properties were realized. In addition, residential development in the city was brisk, generating new property tax revenues. For instance, between 2013 and 2015, 8,000 residential units came on line in North San Jose. Right now, home sales are slowing as values rise, and the best return to the City is from new construction, especially commercial/industrial and office R&D developments.



Chris and Kim Walesh emphasized that land use underlies all the possible value propositions for San Jose's economy, and that the decisions on land use rest with the Council. Only 15 percent of San Jose's incorporated area is employment land – land that supports development of commercial, office and industrial facilities and thus grows jobs and creates revenues from sales and business taxes. This is important because providing services to the large proportion of our area that is residential costs the City much more than residential taxes cover. The City's strategy must continue to be maximizing retail development, office R&D projects, and retaining and maximizing industrially zoned land, while still ensuring our share of new, densified residential development.

In looking at our "third city" – Opportunity – Chris explained that critically important middle-income jobs constitute a significant proportion of local jobs, but are losing ground. From 2006 to 2019, high-skill, high-wage jobs increased in San Jose from 32 to 37%, and low-skill, low-wage jobs increased from 27 to 28%. However, mid-skill, mid-wage jobs in San Jose actually declined from 41 to 35%.

In San Jose, only 40% of our workforce have four-year college degrees, a lower rate than other Bay Area cities. For the 34% of our workforce with only high school degrees, we have to be concerned about what job pipeline will be available.

Cost of living is a severe issue in San Jose. Chris presented an analysis of the relationship between average effective rents and San Jose wages, based on a one-bedroom apartment, assuming 40% of income will be spent on rent. This showed that to rent even a Class C apartment in San Jose, a worker needs to earn $25.88 per hour. Our low-skill, low-wage jobs currently pay about $13.33 per hour.

What's the outlook?

Chris didn't provide a forecast, rather shared the trends we are sensing – for instance, companies are reacting to uncertainties in trade policies and tariffs by showing increased interest in participating in San Jose's Foreign Trade Zone. http://sjeconomy.com/programs/foreign-trade-zone/

Unemployment in San Jose is at about 3%, and not likely to go lower. Consumer spending is a key indicator, as just the anticipation of a recession can slow purchasing and investment. We are also closely watching inflation, interest rates and bond yields.

Anecdotally, we are hearing the larger tech companies are expanding and pushing out established smaller companies, and we hear rumors about out-migration. The words “retail apocalypse” have been used, but what we see are consumers wanting to have experiences beyond online purchasing, and that retail is starting to rethink its brick-and-mortar options for more entertaining experiential offerings. Chris noted that the Wall Street Journal recently polled economists on whether they expected an economic reset by 2020. The results were split 50/50.

Chris ended by noting that within each of the three possible futures – reset, stagnation or growth – there were challenges. A reset would bring lower rents and more available space, but low- and middle-range jobs would be vulnerable to cost-cutting. Stagnation would mean that San Jose could lose ground to cities with a deeper labor pool. And growth would mean declining availability of commercial space, rising rents, and continued increases in construction costs.

To see the whole presentation on video, download the transcript and hear responses to Council’s questions, please visit the City’s **Civic Center News site (http://sanjose.granicus.com/MediaPlayer.php?view_id=51&clip_id=11057&meta_id=926802)**.

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