JANUARY 2023 ECONOMIC FORECAST | EMERGING TRENDS IN SACRAMENTO'S ECONOMY

sacramento BUSINESS REVIEW

JANUARY 2023

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The state budget shortfall is predicted to be $25 billion.

Is Sacramento Recession Ready in 2023?

Labor Market & Regional Economy
SBR/SAFE Credit Union Consumer Sentiment Survey
The Small Business Economy
Real Estate
Capital Markets & Banking Forecast
Human Capital Trends
Healthcare Industry Conditions
Tourism & Hospitality

JANUARY 2023

sacramento BUSINESS REVIEW

MISSION

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

LABOR MARKET & REGIONAL ECONOMY

SBR/SAFE CREDIT UNION CONSUMER SENTIMENT SURVEY

THE SMALL BUSINESS ECONOMY

REAL ESTATE

CAPITAL MARKETS & BANKING FORECAST

HUMAN CAPITAL TRENDS

HEALTHCARE INDUSTRY CONDITIONS

TOURISM & HOSPITALITY

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MESSAGE FROM THE CHIEF ECONOMIST

Dear Friends,

The year ended on a sour note, with the stock market performing the worst since 2008 and the bond market deeply negative. It's a rare coincidence for both markets to be down at the same time. The value destruction has been swift and traumatic: 8 popular quality stocks (Apple, Microsoft, Google, Tesla, Nvidia, Meta, Amazon, and Netflix) lost a combined $5 trillion in market value — approximately the size of the economy of Japan.

The year proved to be a memorable one for plenty of unpleasant reasons: Russia's shocking invasion of Ukraine; disruption in the energy market due to the war, resulting in record high oil prices; the highest inflation in 42 years; the fastest record rate increases (4.25%) by the Federal Reserve in a single year; the collapse of FTX and upheaval in the crypto market; and a vigorously contested mid-term election.

While the Fed is trying to squeeze trillions of dollars of COVID relief out of the economy, Congress is busy adding many more trillions through the Infrastructure Bill, Inflation Reduction Act, Chips Act, and the Spending Bill. Public debt now exceeds $31 trillion — but who is counting?

Both CPI and Personal Consumption Expenditure inflation numbers are dropping significantly; personal savings rates are down; credit card balances are rising; retail holiday sales were sluggish; oil and other commodity prices have rolled over; the money supply has dramatically declined; massive layoffs have begun, especially in the technology sector; labor is becoming nervous about job stability as employers are asking employees to reduce work from home; and business and consumer confidence have tanked. The Fed's efforts to slow down the economy are working. While a recession is widely feared, we might see a soft landing in 2023.

Sacramento is already experiencing additional challenges: housing unaffordability and slowdown; reduced access to credit and declining loan volume for small businesses; record low confidence among consumers and businesses; reduced demand for mortgages and auto loans; and a wide skills gap. The state budget deficit — projected at $25 billion — may further hurt Sacramento due to its over exposure to state jobs. While the worst may be behind us, 2023 may still bring more economic stress.

Warm regards,

Sanjay Varshney

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FEATURES

4 KEY POINTS

6 AUTHORS

10 PARTNERS AND SPONSORS

12 LABOR MARKETS & REGIONAL ECONOMY

16 SBR/SAFE CREDIT UNION CONSUMER SENTIMENT SURVEY

20 THE SMALL BUSINESS ECONOMY

24 REAL ESTATE

30 CAPITAL MARKETS & BANKING FORECAST

36 HUMAN CAPITAL TRENDS

40 HEALTHCARE INDUSTRY CONDITIONS

42 TOURISM & HOSPITALITY

KEY POINTS

LABOR MARKETS & REGIONAL ECONOMY

- We expect the region to maintain a relatively stable population and labor force, and an unemployment rate at about 4% in the year to come.
- We expect the post-pandemic rapid growth of construction jobs to slow in 2023. Meanwhile, we expect the region's healthcare jobs to continue to grow.
- The mismatch between supply and demand in the labor market will continue to hold back the economic development of the region.
- On a macro level, we expect the inflation to be under control in 2023. However, an aggressive Fed policy and a potential government budget deficit might bring headwinds to the economy.

SBR/SAFE CREDIT UNION CONSUMER SENTIMENT SURVEY

- Regional sentiment has rebounded slightly since our mid-year release; however, it still sits at the second lowest point since the inception of our survey.
- While both regional and national sentiment are pessimistic in absolute terms, regional sentiment exceeds national sentiment overall.
- Consumers continue to exhibit inflationary concerns, but less so than they did a year ago.
- Consumer plans to acquire mortgages and auto loans are at the lowest point since the inception of our survey.

SMALL BUSINESS ECONOMY

- The overall assessment of the Small Business Economy is weakening rapidly. The results, relative to the January 2022 update, reflect a cause for concern, with more negative sentiment, tighter financial conditions, and a slowdown of business transactions activity. The results in virtually every category point lower; however, some of them are still holding onto the progress made since bottoming in 2020.
- All 5 categories of the Small Business Confidence Index – Economic Outlook, Business Conditions, Credit Access, New Hires, and Future Revenue Outlook scored below their 18-month moving averages; however, New Hires was unchanged relative to the mid-year update. Responses to Credit Access and Economic Outlook were the weakest versus last year, dropping 26% and 24%, respectively. The silver lining; however, is that the overall health appears to be doing better versus the lows of the pandemic.
- Total loan volume activity has declined 20% relative to 2021. This is against a record-breaking year backdrop. Lending activity has slowed down and coincides with negative responses to Credit Access in the Small Business Confidence survey. Sacramento County's three-year average loan volume activity pre-pandemic was 60% of the volume, but this year it dropped to 55%. The difference was captured by a slight increase in loan volume from Placer County and the overall share increased from 19% to 25%. While the total loan volume declined meaningfully, the volume is 34% higher versus 2019.
- The number of business listings and transactions are higher compared to 2021, but the Median Closed Sales Price declined 3% versus last year. While business transactions data portrays a view of the past, the general takeaway is the data peaked at the end of 2021 and is slowly coming down.

REAL ESTATE

- **Residential Market:** Rising interest rates have already impacted the Sacramento housing market. Single family housing values are still up for the year but have started to come down after peaking in May. More of the same is expected as high cost of capital limits buying power for potential homeowners.
- **Office Market:** The office market is better insulated from large-scale occupancy swings than larger markets as Sacramento has a large number of small tenants, who are giving back less space in totality. However, rising interest rates and uncertainty surrounding how employees will return to the office permanently will likely erode substantial value from the sector over the next few years.
- **Industrial Market**: The industrial market is the best position to weather the upcoming economic storm. The risk of oversupply is limited as developers have been very deliberate in breaking ground on new projects. Additionally, proximity to a large population base both locally and in the Bay Area makes it a top consideration for companies looking to grow in Northern California.
- **Retail Market:** The retail market is in good standing considering the last few years but continues to face headwinds. Rising inflation and high interest rates could limit consumer spending making it difficult for tenants to stay afloat. Correspondingly, property values will likely erode as interest rate increases limit buyer interest in new retail investments.

CAPITAL MARKETS & BANKING FORECAST

- Despite two quarters of consecutive negative GDP growth in the first half of 2022, the Federal Reserve hiked rates on seven separate occasions in 2022 from a range of 0.00%-0.25% to 4.25%-4.50%.
- GDP growth has since stabilized, with third quarter GDP growth at 2.9% and a fourth quarter forecast by Atlanta Fed suggesting GDP growth of 3.7%.
- Persistent inflation, higher rates, and lower liquidity are likely to remain dominant themes in 2023. As a result, lower employment is likely to follow, which in turn could affect household purchasing power and drive consumption lower.
- The first half of 2023 will be choppy, followed with a stronger second-half, resulting in equity returns of around 10-15% for the full year.

- Financial institutions are seeing attractive yields earned on their excess liquidity for the first time in many years. As a result, we continue to believe that loan growth will improve. However, because of the expected loss of purchasing power and an increase in unemployment, institutions will likely start seeing stagnant deposit growth, which might impact liquidity issues for some financial institutions.

HUMAN CAPITAL TRENDS

- A majority of Sacramento employees would not recommend their employers.
- The region is expecting a 20% drop in headcount.
- While the skills abyss is ever-present, compensation levels are surfacing as a concern in these inflationary times.
- Racial equity and diversity have taken on importance for the first time, and are now included in Top 10 efforts.
- Focus in Q1 and Q2 will be on compensation and benefits, improving organizational effectiveness, leadership and employee development, closing the skills gap, and recruitment and retention.
- Internal communication ineffectiveness remains a key concern and surfaces as the #1 answer to the question "what can your employer do better?"

TOURISM & HOSPITALITY

- After slowing at the beginning of 2022, post-COVID recovery in the Sacramento hotel industry became more visible by the end of the year.
- Despite steady growth, hotel industry revenues still have not achieved their pre-COVID level, both in terms of total revenues and revenues per available room.
- Average daily rates substantially increased in 2022 compared to 2021 and are approximately at the same level as immediately before COVID.
- In 2022, Downtown demonstrated the most substantial growth in terms of occupancy rates, while Natomas experienced modest growth, and two other zones (Point West and Outlying) saw declining occupancy rates.

HEALTHCARE

- Healthcare sector will focus on continued financial recovery efforts, identification of cost-cutting opportunities, and reinforcement of the skilled workforce.
- Significant healthcare workforce upheaval and increased labor costs will remain intrinsically linked to industry recovery.
- Technology-enabled healthcare continues to present opportunity and differentiation.
- In the face of inflation and possible recession, the Sacramento market is predicted to bear increasing opportunities for innovation, expanded professional training, and healthcare jobs.

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Will Austin is the Director of Market Analytics at CoStar Group, specializing in Sacramento and the Central Valley. He analyzes market fundamentals for office, industrial, retail, and multifamily commercial real estate throughout Northern California for a variety of platforms. He holds bachelor's and master's degrees in sociology from Trinity College and California State University, Fullerton, respectively and an MBA from UC Davis.

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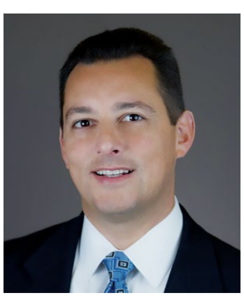

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Matt Cologna graduated with a degree in business from California State University, Sacramento, and has been active in commercial real estate in Sacramento for the past 21 years. His experience includes owner/user and investment sales, logistics, landlord and tenant representation, land assemblage, build to suits, and developer relations. He has represented clients on a local, regional, and national basis. He is involved with the Cushman & Wakefield Global Supply Chain Solutions Group, offering additional insight into current and future needs of occupiers in the market. Matt has completed over 17 million square feet of deals with a value exceeding $620 million.

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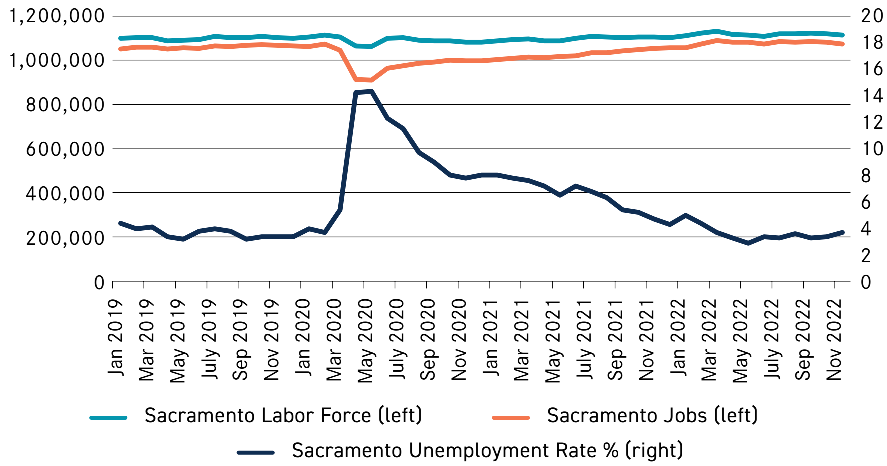
Labor Markets
& Regional Economy

At the beginning of the COVID-19 pandemic, the Sacramento Region lost approximately 4.5%, or 50,000 individuals, in its labor force. Meanwhile, the region lost 15% of its employment (over 160,000 lost jobs). While in the summer of 2020 the Sacramento region's labor force quickly recovered, partially due to a population influx, it took much longer for the region to regain the lost jobs. In the first quarter of 2022, the Sacramento Region's total employment had come back to the pre-pandemic level. In the second quarter of 2022, the region's unemployment rate reached 2.9%, the lowest over the last 30 years. However, labor force and employment growth seemed to have stopped since then. We expect the region

WE EXPECT THE REGION TO MAINTAIN AN UNEMPLOYMENT RATE OF ABOUT 4% IN THE YEAR TO COME.

Figure 1
Sacramento Labor Force and Unemployment Rate



to maintain a relatively stable population and labor force, and an unemployment rate of about 4% in the year to come.

The Sacramento region's service economy is very much population driven. At the beginning of the pandemic, the relative affordability has attracted people to move into the region from other areas including the Bay Area. However, the rising cost of living has slowed this trend. Construction has been the biggest post-pandemic winner in terms of job creation. Over the last 12 months, the region has obtained approximately 2,600 new jobs, or a 17.4% growth, for the construction of buildings. We expect the growth of construction jobs to slow in 2023.

In 2022, transportation and warehousing jobs experienced a 9.9% year-over-year growth, partially due to the revitalizing of supply chains. We expect this trend to continue in 2023. The leisure and hospitality sector has also regained most of the jobs it lost during the pandemic — a 7% growth over the last year. We expect this sector to maintain a relatively stable labor force in the next year.

The healthcare industry is a bright spot in the Sacramento region. It employs over 15% of the region's nonfarm jobs — the second largest behind the government sector among all service sectors. Healthcare obtained a 6.7% growth over the last year. We expect the region's healthcare jobs to continue to increase in 2023 — due to its continued growing trend as well as the need for fulfilling the employment gap caused by the pandemic.

Table 1 • Local Labor Market — 2022 Change and 2023 Forecast by Economic Sector

Labor Market Sector	y/y growth in 2022	2023 Forecast
All Nonfarm Jobs	3.3%	Stable
Goods Producing Jobs	1.3%	Slow down — mainly due to construction
Construction of Buildings	17.4%	Slow down
Manufacturing	2.4%	Stable
Service Jobs	3.5%	Stable
Trade, Transportation, and Utility	4.1%	Stable
Retail	-1.0%	Grow — revitalizing of supply chains
Transportation and Warehousing	9.9%	Grow — revitalizing of supply chains
Financial Services	1.7%	Slow down
Professional and Business Services	2.6%	Stable
Education	4.0%	Grow — to fill the gap in employment
Healthcare	6.7%	Grow — to fill the gap in employment
Leisure and Hospitality	7.0%	Stable
Government	1.9%	Slow down — due to potential fiscal deficit

Data Source: CA EDD

However, we have observed a mismatched supply and demand in the labor market, both statewide and locally. While we can have an inflow of labor from other states, fresh graduates from local postsecondary educational programs, including certificate and vocational programs, build the foundation of the labor supply in the economy. From the tables below, we can observe that the State of California heavily needs a larger workforce of software developers and computer professionals, truck drivers, teachers, and healthcare workers. In Sacramento, there is a large demand for truck drivers, accounting professionals, teachers, healthcare workers, and other service providers due to the region's population-based and government-centered service economy. These demands are not satisfied by the education system in the state. Such a mismatch between supply and demand in the labor market will continue to hold back the economic development of the region.

On a macro level, we expect the inflation to be under control in 2023. In addition to the actions of the Fed, global supply chains are functioning better. While the pandemic and zero-COVID policies in Asia had hurt global supply chains over the past three years, we have seen corporations rebuild more diversified, resilient supply chains. The most recent relaxation of COVID restrictions in China will also make a positive impact on the global economy. We have seen the supply catch up with the demand in this last holiday season. In addition, decreased fuel prices will help cut transportation costs. Overall, the supply-based inflation will be eased in 2023. On the other hand, an aggressive Fed policy and a potential government budget deficit might bring headwinds to the economy both statewide and locally by triggering a recession, increasing the unemployment rate, reducing job growth, and slowing down the construction of buildings.

. . . we have observed a mismatched supply and demand in the labor market, both statewide and locally.

Table 2
Statewide Top Educational Outputs and Occupational Demand

SUPPLY Top 20 CA Education Programs by Completers in 2021		**DEMAND** Top 20 CA Occupations by Job Openings in 2021	
Business Administration and Management, General	1,102,741	Software Developers and Software Quality Assurance Analysts and Testers	390,460
Psychology, General	177,840	General and Operations Manager	309,480
Computer Science	144,276	Project Management Specialists and Business Operations Specialists, All Other	286,290
Biology/Biological Sciences, General	111,872	Heavy and Tractor-Trailer Truck Drivers	280,150
Liberal Arts and Sciences/Liberal Studies	95,343	Bookkeeping, Accounting, and Auditing Clerks	214,660
Speech Communication and Rhetoric	65,100	Registered Nurses	211,970
Sociology, General	60,328	Accountants and Auditors	169,600
Biological and Physical Sciences	57,369	Market Research Analysts and Marketing Specialists	162,330
Social Sciences, General	46,390	Managements Analysts	145,060
Business/Commerce, General	43,442	Teaching Assistants, Except Postsecondary	144,090
Social Work	43,254	Medical Assistants	139,960
Mathematics, General	40,350	Nursing Assistants	137,770
Political Science and Government, General	39,375	Elementary School Teachers, Except Special Education	127,200
Economics, General	31,968	Teachers and Instructors, All Other, Except Substitute Teachers	119,800
Registered Nursing/Registered Nurse	31,944	Personal Service Managers; Entertainment & Recreation Managers, Other Managers	108,900
Electrical and Electronics Engineering	31,283	Financial Managers	107,580
Mechanical Engineering	30,300	Human Resources Specialists	106,190
Econometrics and Quantitative Economics	27,336	Computer Occupations, All Other	105,430
Sports, Kinesiology, and Physical Education/ Fitness, General	26,308	Computer and Information Systems Managers	99,920
Criminal Justice/Law Enforcement Administration	25,629	Sales Managers	95,480

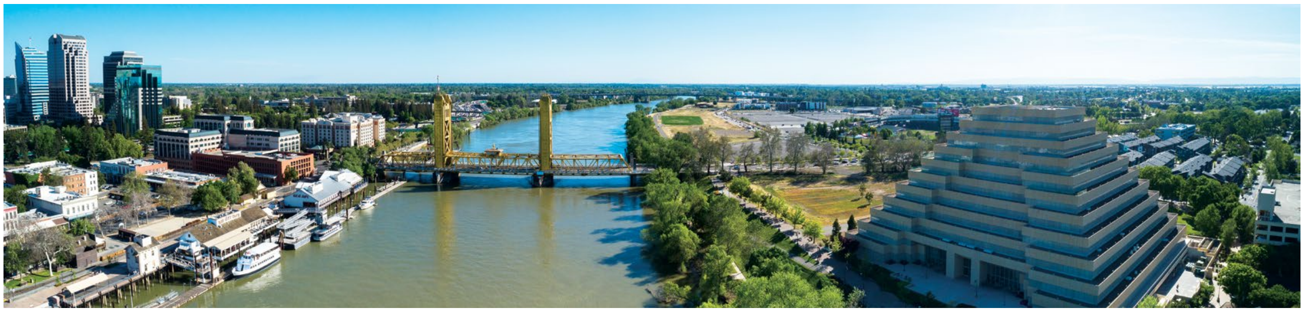
■ Undersupplied Areas ■ Oversupplied Areas

Data Source: EDD

Table 3 Regional Top Educational Outputs and Occupational Demand			
SUPPLY **Top 20 Sac Region Education (Coded by Occupations) by Completers in 2021**		**DEMAND** **Top 20 Sac Region Occupations by Job Openings in 2021**	
Personal Service Managers, Entertainment & Recreation Managers, Other Managers	11,390	Heavy and Tractor-Trailer Truck Drivers	13,614
Secondary School Teachers, Except Special and Career/Technical Education	8,373	Bookkeeping, Accounting, and Auditing Clerks	12,890
Social Science Research Assistants	6,257	Teaching Assistants, Except Postsecondary	12,283
Natural Sciences Managers	5,890	Medical Assistants	10,383
Postsecondary Teachers, All Other	4,653	Nursing Assistants	8,398
Cost Estimators	3,410	Hairdressers, Hairstylists, and Cosmetologists	7,280
Social and Community Service Managers	3,268	Automotive Service Technicians and Mechanics	5,030
Business Teachers, Postsecondary	3,106	Dental Assistants	4,757
General and Operations Managers	3,022	Preschool Teachers, Except Special Education	4,107
Chief Executives	3,021	Licensed Practical and Licensed Vocational Nurses	3,952
Management Analysts	2,998	Heating, Air Conditioning, and Refrigeration, Mechanics	3,899
Health Specialties Teachers, Postsecondary	2,934	Telecommunications Equipment Installers, and Repairers	3,036
Construction Managers	2,903	Computer User Support Specialists	2,833
Transportation, Storage, and Distribution Managers	2,882	Medical Records Specialists, Health Technologists, and Technicians	2,797
Project Management Specialists and Business Operations Specialists, All Other	2,875	Manicurists and Pedicurists	2,434
Administrative Services and Facilities Managers	2,861	Massage Therapists	2,362
Sales Managers	2,848	Paralegals and Legal Assistants	2,250
Industrial Production Managers	2,848	Electrical and Electronic Engineering Technologists and Technicians	1,567
Human Resources Managers	2,708	Firefighters	1,489
Training and Development Managers	2,708	Order Clerks	1,450

■ Undersupplied Areas   Supply includes those who completed post-secondary certificate programs

Data Source: EDD



LABOR MARKETS

Consumer Sentiment *Survey*

For the 2023 annual release, the Sacramento Business Review (SBR), in partnership with SAFE Credit Union, conducted another round of our regional consumer sentiment survey. The survey included measures of personal and regional economic conditions along with expectations regarding prices and income, as well as purchasing and credit utilization.

Regional vs. National Sentiment

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

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

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

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

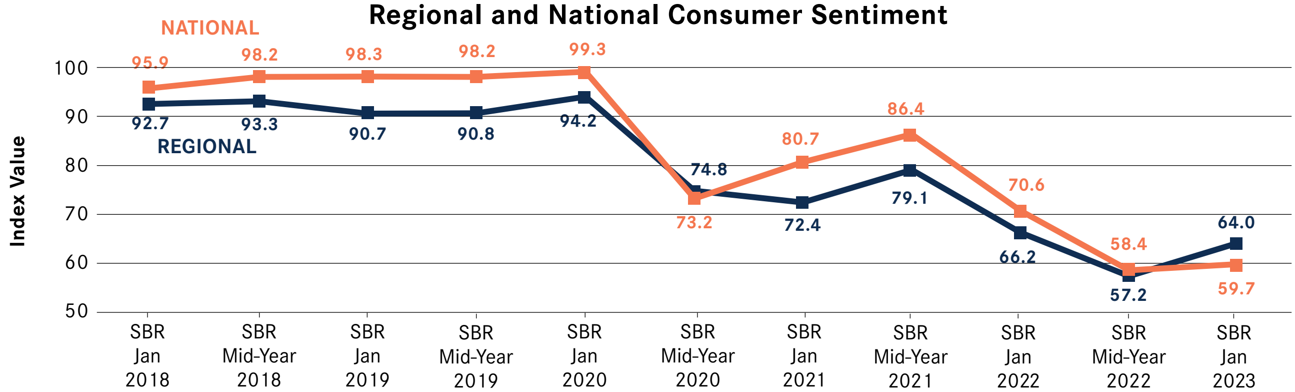
Overall, regional sentiment now sits slightly below where it was a year ago, having rebounded somewhat from a dip in our mid-year release. Notably, national sentiment has not seen as much of a rebound and now lags behind regional sentiment. This is only the second time regional sentiment has exceeded national sentiment since the inception of our survey. Still, in absolute terms, consumers have a rather pessimistic view at both the regional and national levels. In terms of the subcomponents, it appears that consumers in the region view the current economic conditions less favorably than consumers nationwide, yet regional consumers are substantially more optimistic about the future compared to the national data (see Table 1).

Table 1 · Regional vs. National

	Regional Index Score			National Index Score		
	Annual Release 2023	Change Since Mid-Year 2022	Change Since January 2022	Annual Release 2023	Change Since Mid-Year 2022	Change Since January 2022
Index of Consumer Sentiment	64.0	**+6.8**	**-2.1**	59.7	**+1.3**	**-10.9**
Index of Current Economic Conditions	56.2	**+3.9**	**-5.6**	59.4	**-3.9**	**-14.8**
Index of Consumer Expectations	69.1	**+8.7**	**+0.1**	59.9	**+4.7**	**-8.4**

Notes: National data obtained from the University of Michigan Consumer Sentiment Survey December 2022 Final Data, available at: https://data.sca.isr.umich.edu/. Indices calculated using the methods specified at: https://data.sca.isr.umich.edu/fetchdoc.php?docid=24770.

Figure 1
Regional and National Consumer Sentiment



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

Figure 2
Expectations for Prices (Inflation) Over the Next Year
(% of Responses)

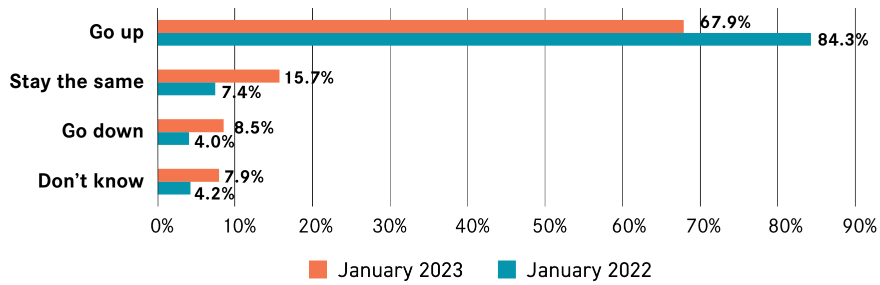
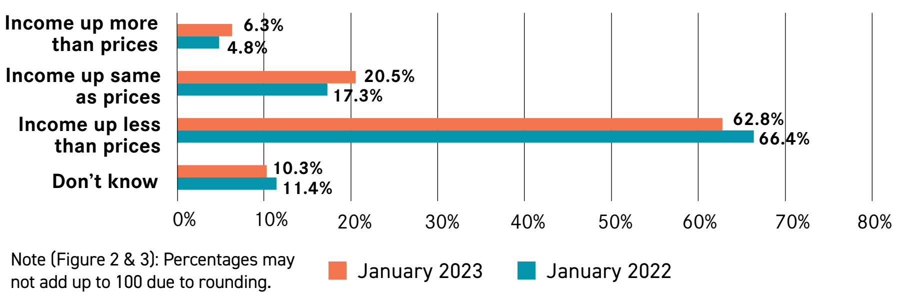


Figure 3
Expectations for Income Relative to Prices (Inflation) Next Year
(% of Responses)



Note (Figure 2 & 3): Percentages may not add up to 100 due to rounding.

Inflation and Income

Regional consumers remain concerned about inflation and the ability of their incomes to keep pace with rising prices. However, we see some attenuation of these concerns compared to last year. For example, 67.9% of regional respondents expect prices to go up over the next year compared to 84.3% of respondents expecting price increases a year ago (see Figure 2). Additionally, well over half of respondents do not expect their income to keep pace with rising prices over the next year. However, there does appear to be a slight uptick in the number of regional consumers who expect their income to keep pace with or exceed inflation compared to last year (see Figure 3). This pattern of results could imply that a growing portion of regional consumers believe the worst is over when it comes to inflationary headwinds.

Regional consumers remain concerned about inflationary issues but less so than a year ago.

WE CONTINUE TO SEE PESSIMISM IN SENTIMENT AT BOTH THE REGIONAL AND NATIONAL LEVELS.

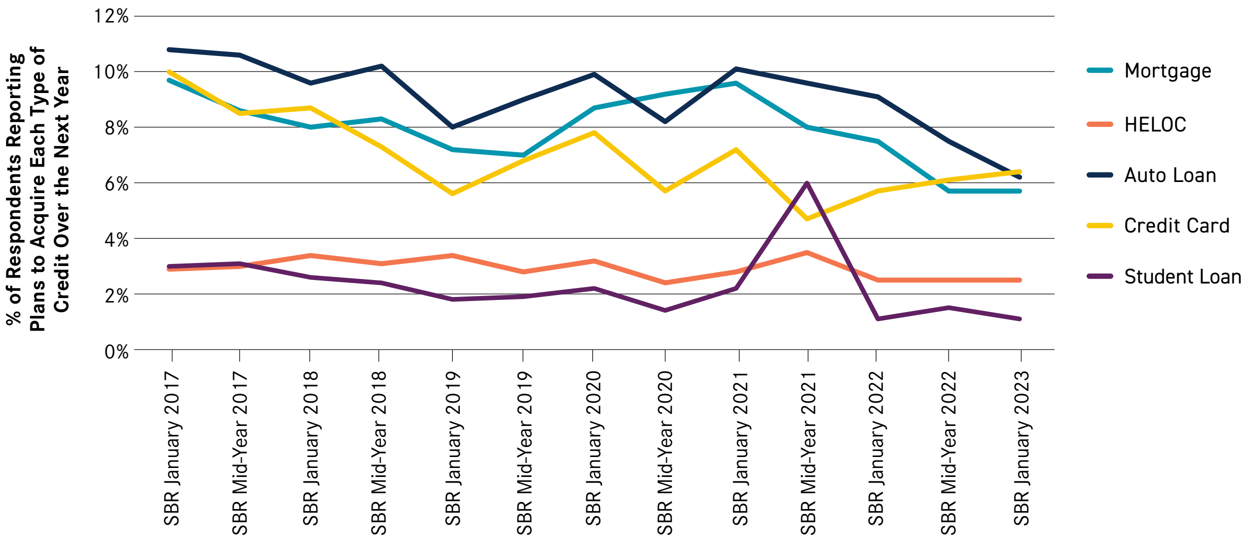
Purchasing and Credit

We again asked regional respondents about the types of credit they currently hold and their plans to acquire credit over the next year. Most notably, we see some declines in plans to acquire mortgages and auto loans, both of which are at their lowest point since the inception of our survey (see Figure 4). These results could be a signal of the consumer lending impact of increasing interest rates.

Summary

Overall, we continue to see pessimism in sentiment at both the regional and national levels. However, we see some modest signs of rebound and optimism for the future among regional respondents compared to the national data. Regional consumers remain concerned about inflationary issues but less so than a year ago. Consumers in the region also indicate potential belt-tightening when it comes to taking on mortgages and auto loans.

Figure 4
Types of Credit Planned Over the Next Year



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SCAN ME

The Small Business *Economy*

The health of the Small Business Economy is a crucial component to the success of a community. Each year, the *Sacramento Business Review* (SBR) team conducts an annual assessment of the Greater Sacramento area economy and interprets the current environment. To do so, the team examines the results of its proprietary Small Business Confidence Index (SBCI), analyzes loan trends in the region, and reviews business transactions results. The results, relative to the January 2022 update, reflect a cause for concern, with more negative sentiment, tighter financial conditions, and a slowdown of business transactions activity. The positive side; however, is that the overall health is holding up better than during the lows of the depths of the pandemic.

The responses in the Small Business Confidence Index display a material drop in Overall Sentiment across most categories. The two weakest components relative to last year are Credit Access and Economic Outlook, which dropped 26% and 24%, respectively. Related to credit, a recent national survey by the National Federation of Independent Business (NFIB), shows that the average rate paid on short maturity loans was 7.9%, the highest since March 2008. Respondents also indicated weaker readings on Local

Figure 1 • Overall Sentiment
(January 2011 - January 2023)

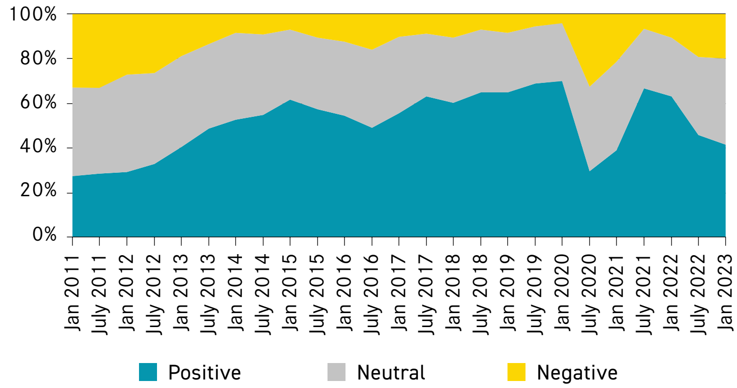
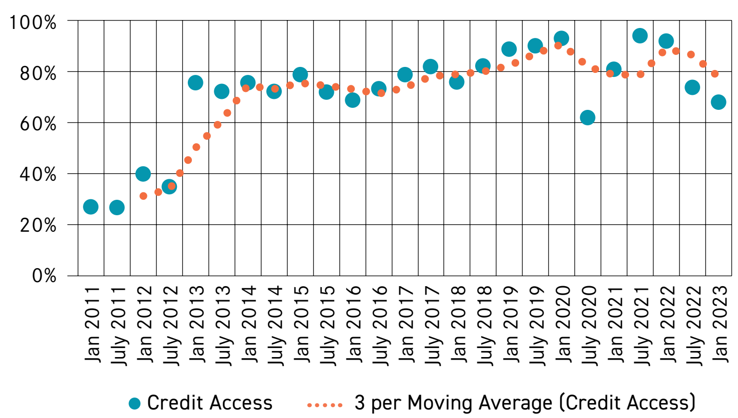
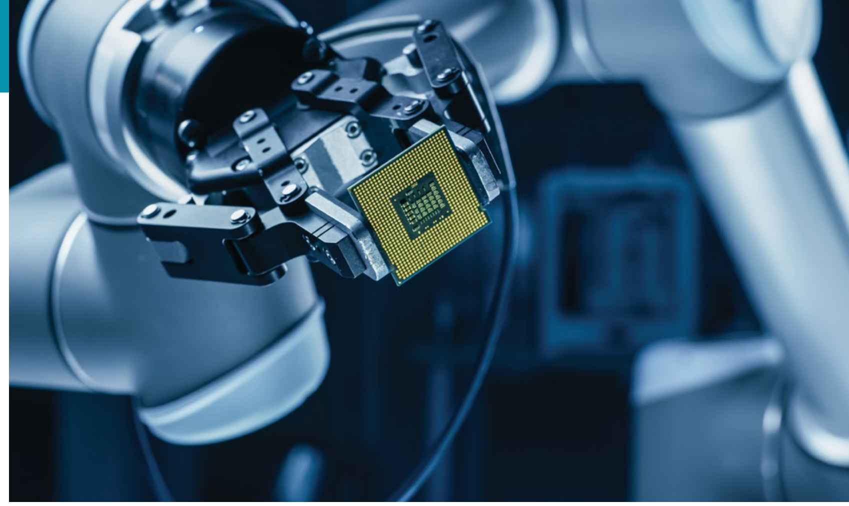
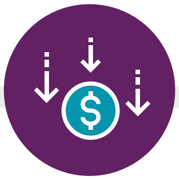


Figure 2 • SBCI Total: Credit Access
(18-month Moving Average)





CREDIT ACCESS SHOWED THE LARGEST DECLINE RELATIVE TO A YEAR AGO.



THE MANUFACTURING SECTOR OUTLOOK WAS SIGNIFICANTLY WEAKER, EVEN MORE SO THAN DURING THE PANDEMIC.

Supportiveness and Future Revenue, which dropped 21% and 22% versus last year. The better reading of the Index was Likelihood of Hiring, which dropped only 14% versus last year.

While all results have dropped double digits versus last year, all of them are still higher than the lows recorded during the pandemic. Credit Access is the only indicator that is not sharply higher (only 9% higher) versus the lows. This is not surprising considering the record pace of rate hikes by the Fed year-to-date. All 5 categories — Economic Outlook, Business Conditions, Credit Access, New Hires, and Future Revenue Outlook came in below their 18-month moving averages. The Manufacturing sector readings came in significantly weaker, down more than 65% on average.

While all results have dropped double digits versus last year, all of them are still higher than the lows recorded during the pandemic.

Figure 3 • SBCI Manufacturing: Economic Outlook
(18-month Moving Average)

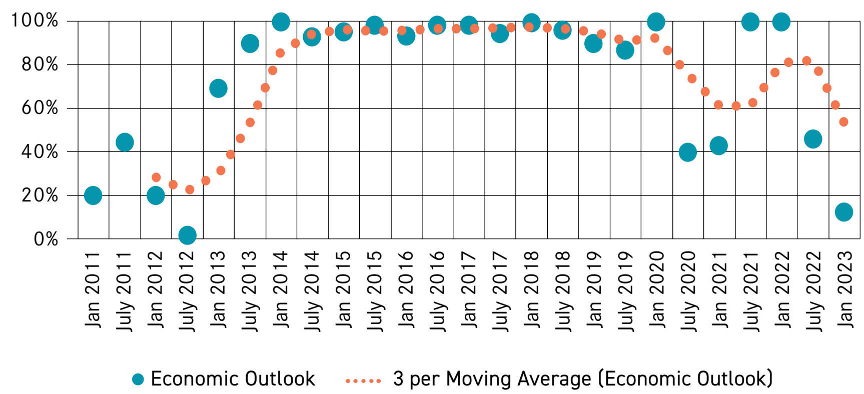
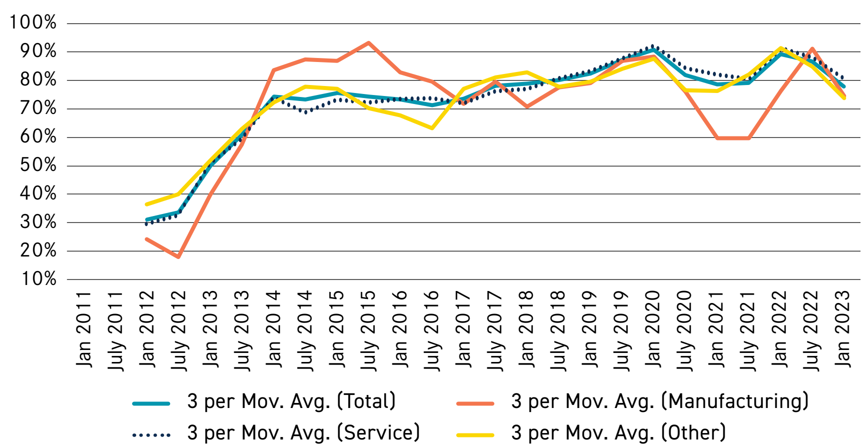


Figure 4 • SBCI Credit Access by Sector
(18-month Moving Average)



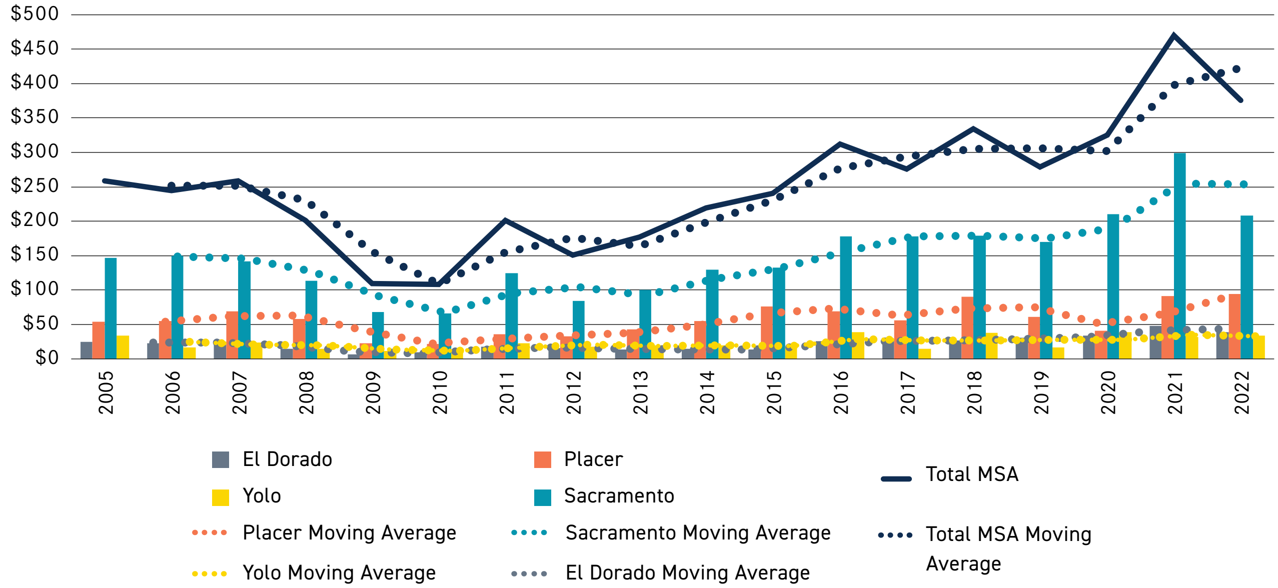
The Small Business *Economy*

The loan volume activity data in the mid-year update was on pace to come in 30% below last year's record total lending volume. While the numbers have slowed down meaningfully versus last year, the good news is the data is clocking in better than expected and still 30% higher than the 5-year pre-pandemic average of $288 million. Total volume of $375 million came in 20% below last year's record total volume of $469 million. Given Sacramento County comprises the largest share of the volume, it is expected that the largest decline will show up here. Indeed, the numbers for Sacramento County came in 30% lower versus last year. The second laggard was El Dorado County coming in 19% below last year's volume. However, both Yolo County and Placer County showed a slight improvement, increasing 8% and 3% versus last year. The loan volume share that Sacramento County makes up came in at 55% of the total, which is below the 3-year average of 63%. Placer County picked up the difference by increasing to 25% of the total loan volume versus 19% last year. Yolo County increased slightly from 7% to 9%. Finally, El Dorado County remained unchanged marking 10% of the total loan volume in the region. It is important to note that the comparisons are to the all-time high of 2021. Considering this data, along with the SBCI results, higher interest rates, and tighter financial conditions set by the Fed, credit access is certainly slowing and being impacted in the region.

The loan volume activity data in the mid-year update was on pace to come in 30% below last year's record total lending volume... but activity picked up slightly and ended 20% below last year's record volume.

Compared to 2021, there are 25% more business listings and 50% more transactions year-to-date. On a rolling year-over-year basis, the Median Closed Sales Price declined 3%. Data on reported sold businesses showed that the rolling year-over-year Median Revenue increased 15% and rolling year-over-year Median Cash Flow declined 1%. The premium in transactions over Median Sales Price was cut in half versus the last update and came in at 22% in the last twelve months. Business transactions tend to be a lagging indicator given various factors, such as the time it takes to close deals and historical past data in the reports; nonetheless, the data shows a decline versus the peaks of 2021.

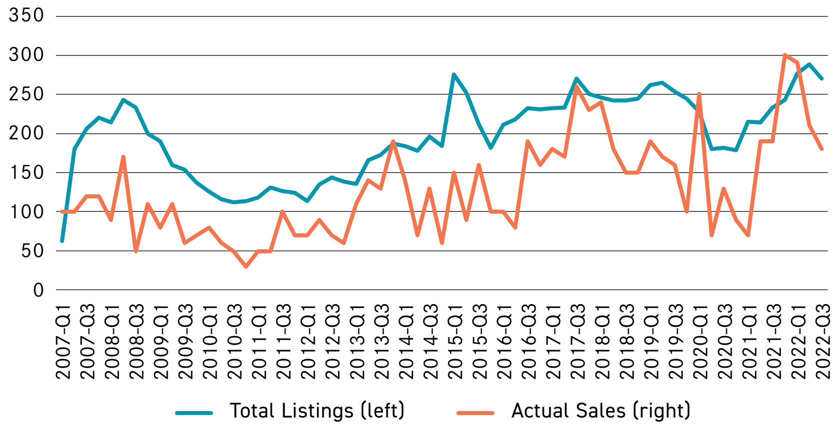
Figure 5 • Total SBA Loan Approvals By County
(in millions, 2-Year Moving Average)



Moving Average is average of two previous data points.

LISTINGS AND TRANSACTIONS DECLINED VERSUS THE MID-YEAR UPDATE.

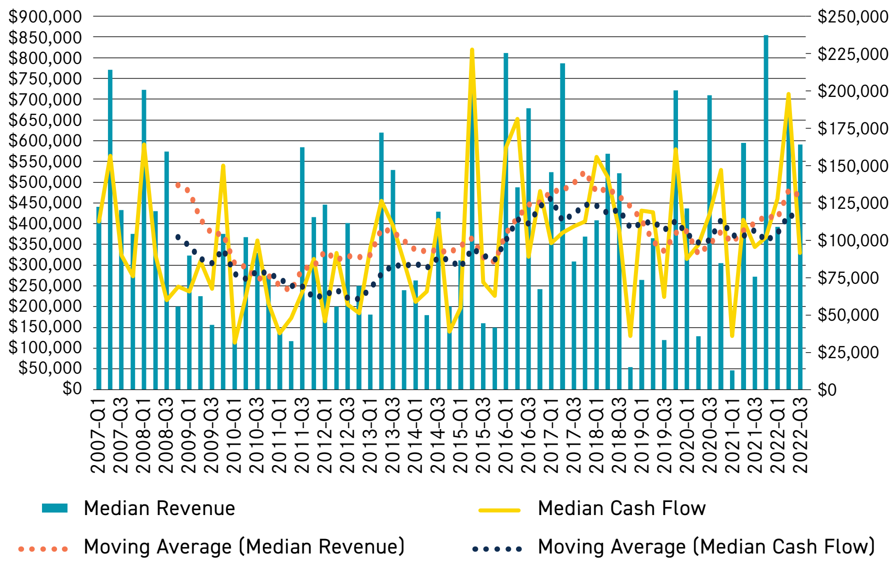
Figure 6 • Number of Listings vs. Actual Sales (Quarterly)



YEAR-OVER-YEAR ROLLING MEDIAN REVENUE INCREASED 15% AND MEDIAN CASH FLOW DECLINED 1% ON REPORTED TRANSACTIONS.

Figure 7 • Median Revenue & Cash Flow of Transactions

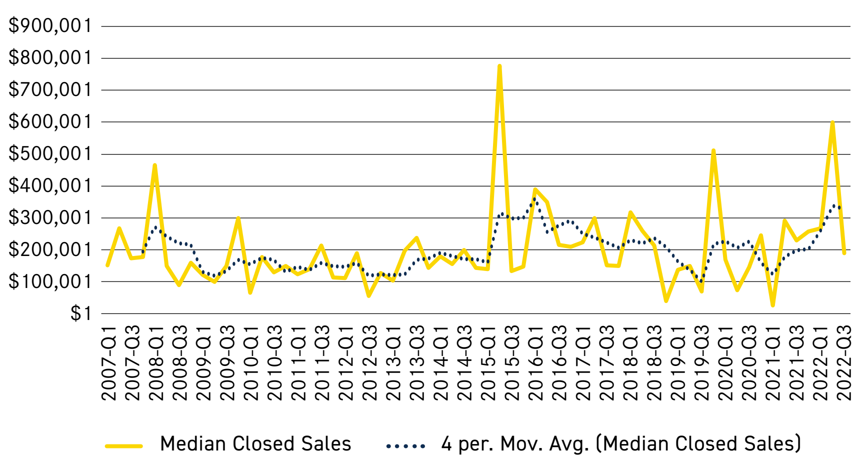
(2-year Moving Average)



MEDIAN CLOSED SALES PRICE DECLINED 3% COMPARED TO LAST YEAR.

Figure 8 • Median Closed Sales Price (Quarterly)

(1-year Moving Average)



Data Source (Figures 6-8): BizBuySell

SMALL BUSINESS

WHILE PRICING REMAINS UP OVER THE PAST YEAR HOME VALUES ARE STARTING TO COME DOWN.

Real Estate

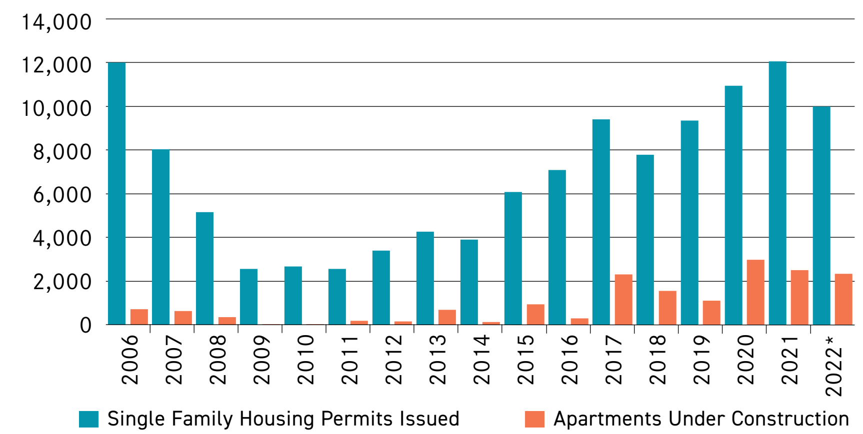
Residential

As demand for housing exploded in Sacramento, construction became a headline. Single family and multifamily developers flocked to the market to fill the need in the market and capitalize on the rapidly rising housing prices. This led to some of the highest levels of housing construction ever seen in Sacramento. The 12,100 single family permits pulled in 2021 surpassed the prior peak set back in 2006. Apartment construction peaked in 2020 with 3,000 units under development. One trend that shows up on both sides of the residential market is falling construction levels.

Declines in development closely followed reduced demand from buyers. Sales activity was quickly curtailed by rising interest rates. Prospective buyers could no longer afford the same prices that they could just months earlier. Meanwhile, current owners with low interest rates locked in have little incentive to sell. Despite the slowdown, prices still increased year-over-year, up by 3.3%. However, this is down significantly from the peak in May, which saw annual increases of more than 10%.

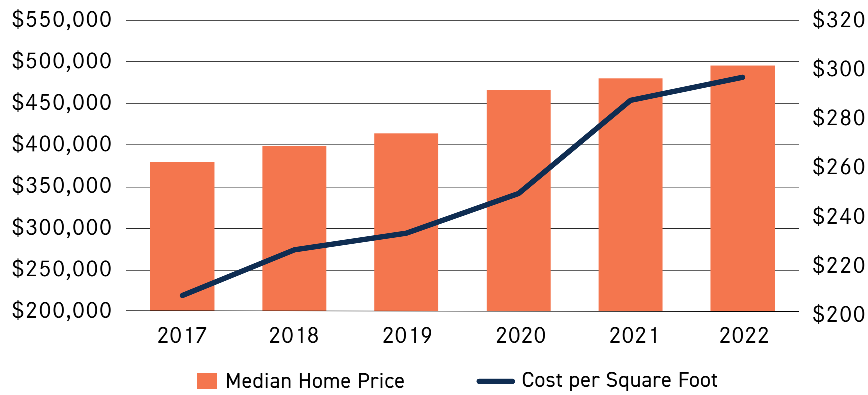
A similar story is happening in the rental market. Rent growth slowed to

Figure 1
Housing Permits Issued & Apartments Under Construction



Source: Federal Reserve & CoStar

Figure 2
Median Home Prices & Cost Per Square Foot • 2017 - 2022



Source: DQ News

1% at year end. This compared to the peak set in the third quarter of 2021 when rents were up 12.2% over the prior year. A number of the market's highest rent areas are starting to see rents fall, most notably Elk Grove, Roseville/Rocklin, and Downtown.

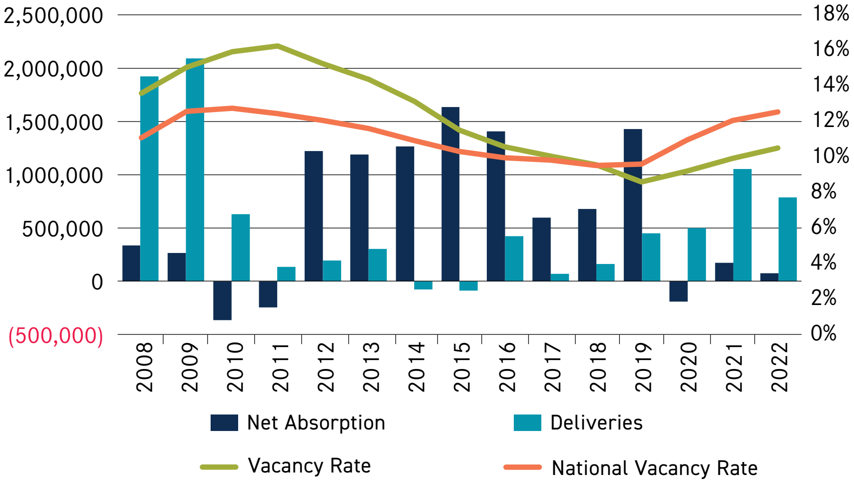
While pricing remains up over the past year, home values are starting to come down. More is expected next year as interest rates will continue to increase, but likely at a slower pace. A slowing economy will also affect new household formation. Currently, more than 50% of adults between age 18 and 29 are electing to live at home to avoid high real estate costs, thereby depressing demand for both single family and multifamily housing.

Office

When compared to the office market nationally, Sacramento is faring well. The capitol region holds a lower vacancy rate than the national average, which was not the case during the Great Recession. This led to a long, plodding recovery. However, the office sector is standing on an increasingly shaky foundation. Despite positive demand metrics in 2021 and 2022, the vacancy rate continues to rise. At the same time, more inventory is being added to the market in the form of new construction for numerous state agencies, and government employees continue to resist a return to the workplace, extending the recovery period.

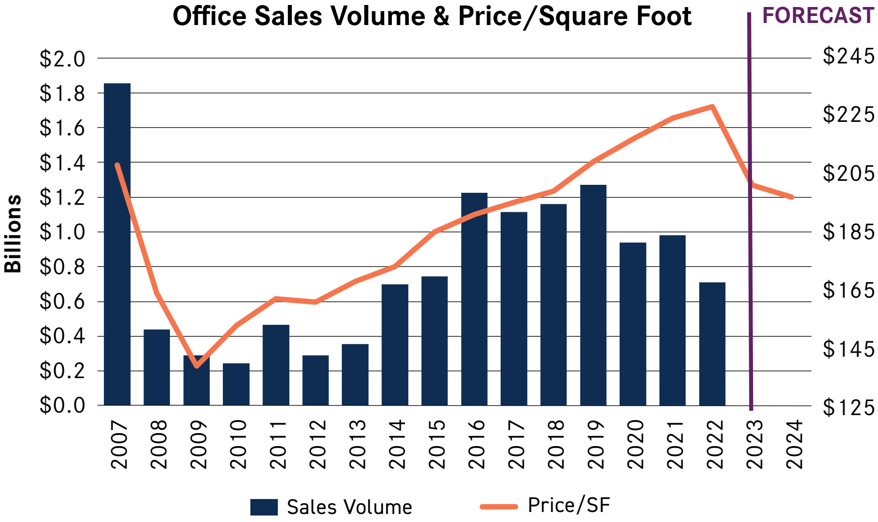
A primary factor in maintaining a comparatively tight market is a smaller average tenant size. There are several examples of large tenants giving back huge chunks of space, like Blue Shield in El Dorado Hills vacating nearly 100,000 square feet when they sold their El Dorado Hills campus, but by and large, that is not

Figure 3
Office Market Activity • 2008-2022



Source: CoStar

Figure 4
Office Sales Volume & Price/Square Foot



Source: CoStar

REAL ESTATE

the norm. Sacramento's smaller tenants equate to a reduced impact on market availability as they shrink their footprint and space is added to available office inventory. With that said, it is 12 to 24 months too early to realize the full impact of the pandemic on office leasing.

Historically, a weakening job market — one of the stated goals of increasing interest rates — would lead to further increases in office vacancy. However, the persistence of remote work-from-home policies for many office-based employers has weakened the correlation between white collar job growth and office occupancy levels. As layoffs begin to mount, the impact on the local office sector is expected to be muted compared to prior cycles.

With that said, increasing interest rates along with high tenant improvement construction costs, are expected to have a significant impact on property values. Continued increases are expected for the next few months, and current forecasts indicate as much as a 15% drop in pricing over the next few years. Sales volume has declined, and potential investors are waiting to see how far pricing will fall before investing in new office projects.

Despite all the headwinds facing the sector, the market is still much better positioned than it was in 2008. At that time, two office towers were completed downtown, and they pushed market vacancy rates above 16% — about 600 basis points higher than current levels. Substantial office developments being built and occupied by state government agencies have added to the challenges facing our region. As office market stability becomes increasingly reliant on the private sector for its success, the region needs to refocus its efforts on improving the quality of its office space to accommodate work environments to which employees want to return — prioritizing high quality, design forward, and flexible working environments.

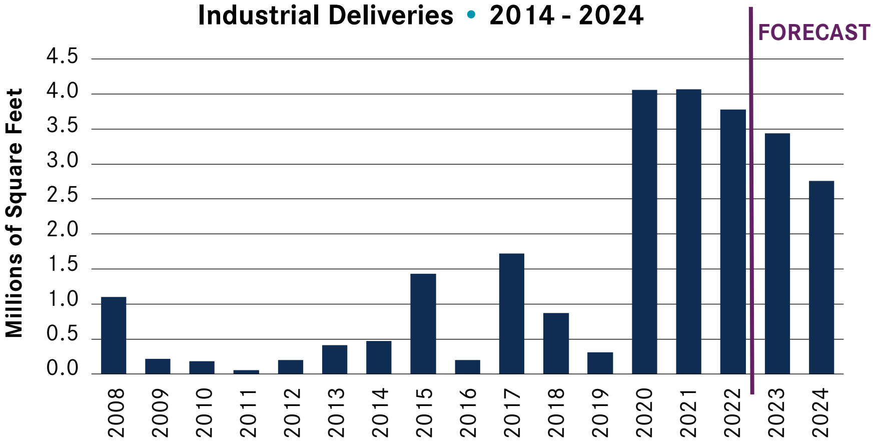
While the rest of the commercial sectors faced hardship in 2022, the industrial sector continued to perform well.

Industrial

While the rest of the commercial sectors faced hardship in 2022, the industrial sector continued to perform well. Demand has consistently increased to meet the waves of new supply entering the market, and new occupiers continue to look to the region for their distribution and manufacturing needs.

Looking nationally, the primary risk to the industrial sector comes from oversupply. Many markets set records for new deliveries in 2022 and expect even higher figures in 2023. In Sacramento, that is not the case. Deliveries peaked in 2021,

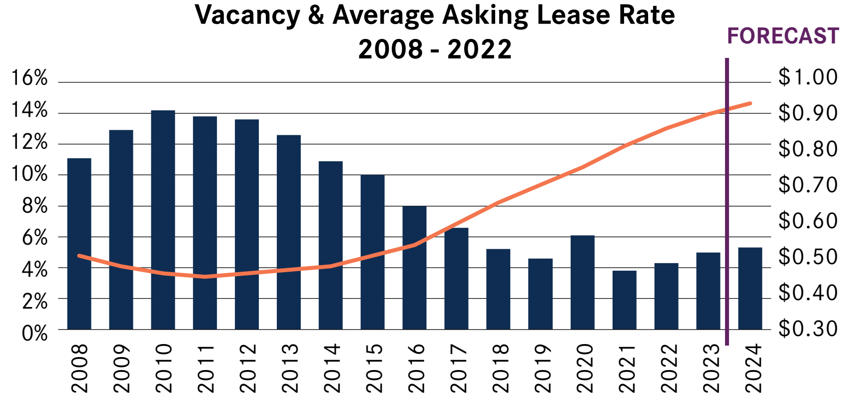
Figure 5
Industrial Deliveries • 2014 - 2024



Source: CoStar

THE INDUSTRIAL MARKET VACANCY RATE REMAINS BELOW 5%.

Figure 6
Vacancy & Average Asking Lease Rate
2008 - 2022



Source: CoStar

setting a new market record of 4.1 million square feet. Activity in 2022 was strong but fell from that pace, bringing 3.8 million square feet to the region. That figure is again expected to decline in 2023, with 3.4 million square feet added to inventory. This will add enough to the market to allow it to grow, but not at the frenetic pace seen in Midwest and Sunbelt markets.

It is likely that more projects will break ground in the new year. For example, while nothing has been announced and there are no timelines yet, Target's recent purchase of 75 acres at Metro Air Park points to a planned expansion in the area located close to both Amazon and Wal-Mart.

Even with 12 million square feet being added to the market over the past three years, the vacancy rate remains well below 5%. This compares to the Great Recession when vacancy reached above 14% — a level of over supply that is not plausible given current market conditions. If all of the expected deliveries in 2023 were to complete and remain vacant, availability would increase by less than 2%. Additionally, spaces of less than 10,000 square feet remain extremely difficult to find, giving another option for owners needing to reposition assets.

Strong industrial market conditions do not mean that there is no risk of a downturn. The leasing side of the market is expected to remain strong, but the investment side is likely to see value erosion over the next year. The increases in interest rates are not just making loans more expensive for borrowers, but also requiring more equity to fund the loan in the first place. This raises the risk profile of potential investments and makes it harder for sales to close. The likely effect is that fewer deals will enter the market for sale, and those that do will be at a discount compared to today's pricing. Generally speaking, market pricing will remain in flux for the first half of 2023, possibly longer.

Overall, the industrial market is unlikely to see a significant downside over the next year. Solid leasing activity in the market and high occupancy levels will keep property values from eroding to the same extent as other sectors. Additionally, the industrial market will be well-positioned to recover lost value quickly as strong underlying market fundamentals persist.

Retail

The retail sector is in a better position than was anticipated a year ago. Leasing activity returned quickly as pandemic restrictions lifted and retailers began to expand their footprint in the region. The vacancy rate is holding below pre-pandemic levels and has been for the past year.

Demand has come from a variety of sectors, with home improvement stores, gyms, and discount retailers accounting for a large proportion of market activity in 2022. This resulted in a significant uptick in tenant demand for large spaces during the year, with more than 40 leases of 10,000 square feet or more signing. The increased availability of second generation restaurant space has been sought after as well, with many of those spaces leasing to new concepts.

There is some concern about the retail sector going forward. An extended period of high inflation — combined with rapidly rising rents in the region — have made consumers increasingly price sensitive. This is reflected in discount retailers, like Marshalls, TJ Maxx, and Ross Dress For Less expanding their footprints in the region.

THE BIGGEST EFFECT OF AN ECONOMIC SLOWDOWN WILL BE IN THE CAPITAL MARKETS SECTOR.

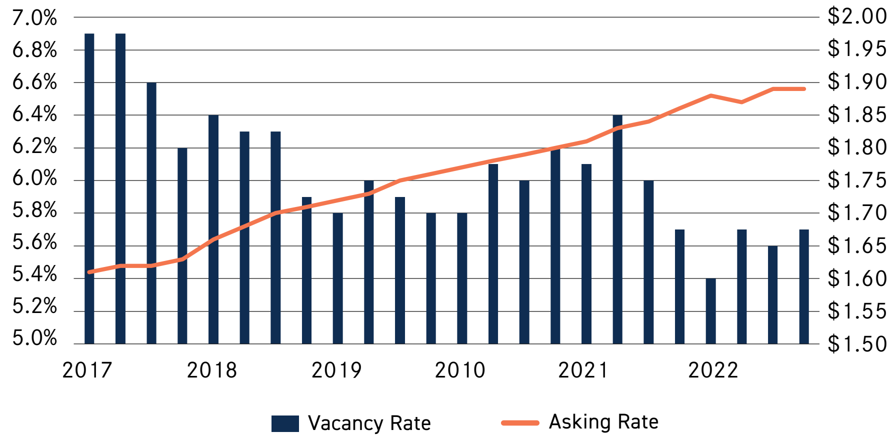
The upcoming recession is likely to be just less severe than 2008-2009.

Additionally, it is reported that consumer debt is at an all-time high. Heading into a recession, retailers could feel strain from pull backs in consumer spending.

The biggest effect of an economic slowdown will be in the capital markets sector. Some properties, like grocery anchored shopping centers will hold value well, but erosion is expected in the balance of the market. Cap rates have expanded by roughly 100 basis points over the past year, and while current pricing has baked in the most recent increases, further interest rate increases are expected, creating more upward pressure.

The upcoming recession is likely to be just less severe than 2008-2009. During that time, the market was over-retailed, resulting in excessive supply that took years to lease. Development has been more measured in recent years, and the pandemic has eliminated a number of marginal operators that could have more easily faltered during a recession.

Figure 7
Vacancy & Average Asking Lease Rate • 2017 - 2022



Capital Markets & Banking *Forecast*

PERSISTENT INFLATION, HIGHER RATES, AND LOWER LIQUIDITY ARE LIKELY TO REMAIN DOMINANT THEMES IN 2023.

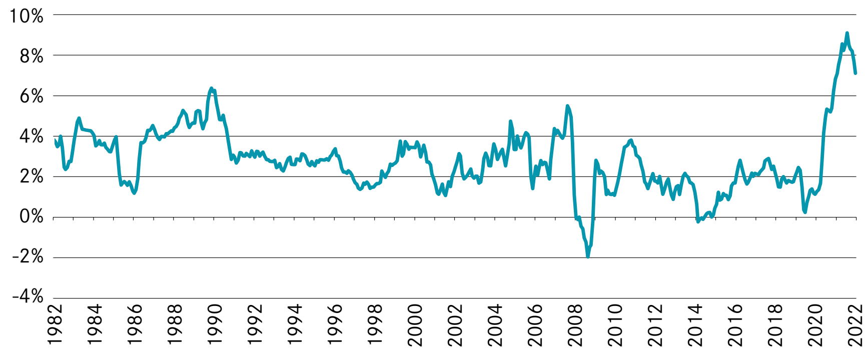
With 2023 upon us, it's helpful to look back and remember where we were just one year ago. January 2022 started with a backdrop of strong corporate earnings, low unemployment, and stable economic growth coming in the COVID recovery phase. Rates were low and quantitative easing was ongoing. While the dark clouds of inflation were on the horizon, all other indicators were positive and had pushed equity valuation to extreme levels.

As the year progressed, the inflation clouds quickly turned to a tempest. The Federal Open Market Committee (FOMC) was slow to raise rates and end quantitative easing, resulting in a dangerous game of catch up. During the first half of the year, the U.S. economy surprised market participants when it experienced two straight quarters of negative GDP growth, which is the conventional, but non-technical, definition of a recession. Paradoxically, unemployment remained extremely low by historical standards throughout this period, and consumer spending was consistently growing*. In conjunction with the recession-like environment, U.S. equity markets fell meaningfully, entering bear market territory (defined as falling by 20% or more) by mid-year.

Despite the negative economic growth and market sell off, inflation remained persistently high, encouraging the Fed to continue ratcheting rates.

*Note: It is the current prevailing view and that of the SBR, that although economic growth was negative for two consecutive quarters, the National Bureau of Economic Research (NBER) — which identifies economic recessions — is unlikely to define this period as such due to the positive data points in labor markets and consumer spending.

Figure 1 • Consumer Price Index (year-over-year change)



Source: U.S. Bureau of Labor Statistics. Consumer Price Index, year-over-year change, monthly from December 1982 to November 2022.

Despite the negative economic growth and market sell off, inflation remained persistently high, encouraging the Fed to continue ratcheting rates. Overall, the Fed boosted rates seven times in 2022, from a range of 0.00-0.25% to 4.25-4.50% over the course of the year — including four straight increases of 75 bps. Inflation has fallen slightly from its high but remains elevated. Capital markets have seen marked reductions in liquidity, stalling certain areas, and affecting rate-sensitive markets such as residential housing.

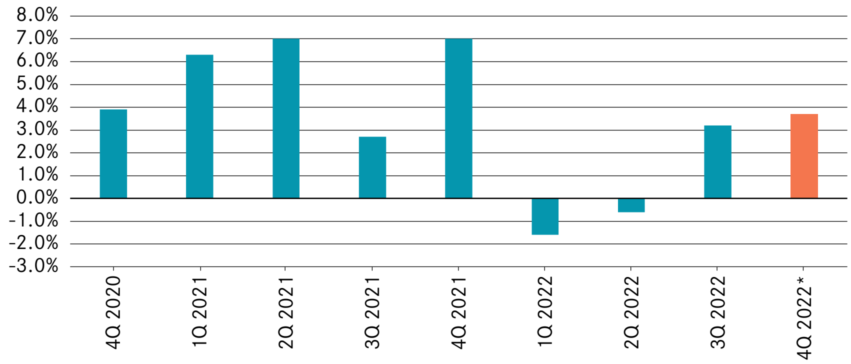
Moving to the second half of the year, third quarter GDP stabilized at 2.9% and the Atlanta Fed GDPNow™ forecast suggests 3.7% for the fourth quarter (as of December 23, 2022). In addition to the persistently strong labor market, consumer spending has remained remarkably stable. Wages have increased, but lagged overall inflation, implying a loss of purchasing power.

Outside the U.S., Central Banks around the world have begun coordinated rate tightening efforts to manage inflation, and currency volatility has increased as a result. In addition, the effects of inflation have driven up the cost of necessities, such as food and fuel, greatly affecting emerging markets and developing economies.

Another area of uncertainty includes Russia's invasion of Ukraine, which extended into its tenth month. While contributing to geopolitical volatility, the conflict also has pronounced impacts on commodities markets such as oil and wheat. Russia is the second largest exporter of crude oil and the largest exporter of wheat, whereas Ukraine is the fifth largest exporter of the latter.

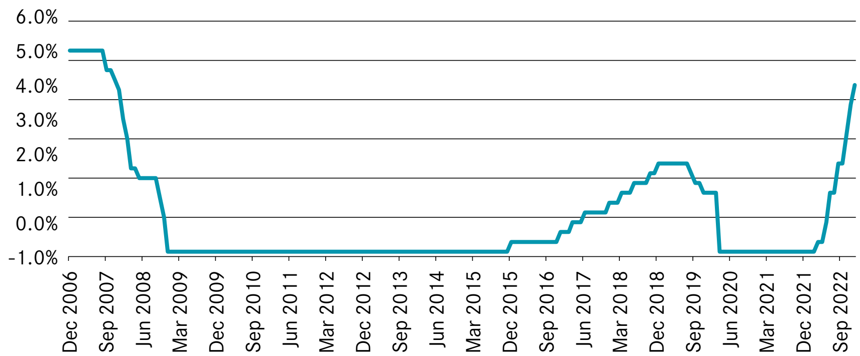
In December, China abruptly ended their "Zero Covid" policy. While this is a promising development for longer term

Figure 2 • Real GDP Growth (year-over-year, quarterly)



Source: Bureau of Economic Analysis. Real GDP Growth, year-over-year, quarterly.

Figure 3 • Federal Open Market Committee Rate Changes (2006 to 2022)



global growth, it may lead to greater volatility as the world's largest export economy navigates its reopening. Currently, COVID cases are increasing exponentially, and it is yet unknown whether this will be a footnote or another chapter in the COVID story.

Equity Market Outlook

As we move forward, the SBR Team believes inflation will remain persistently elevated, since it will take time for higher rates and lower liquidity to work through the system and impact the broader economy. Labor markets, while thus far exceptionally resilient, seem more likely to soften rather than remaining tight. As a result of higher rates and lower employment, it is likely household purchasing power will be impacted and consumption will fall. Market forecasters are currently projecting a recession at approximately a 50% probability. The SBR Team is in alignment with this estimate, but since markets anticipate economic data, it can often be challenging to distinguish the noise from the echo. For 2023, we see equity returns experiencing a bumpy first half, but normalizing to around 10-15% for the full year.

We have seen several years of macroeconomic factors driving markets — first COVID and now interest rates — where correlations increased with asset prices rising and falling together. Now, in addition to the prospect of a recovery rally, we anticipate that in 2023 the relative valuations of assets will move to the forefront. The cross-correlation of asset prices is likely to fall, providing opportunities for more discerning investors. While it is impossible to call the bottom, we believe we are closer to the end than the beginning or middle of this bear market. Markets tend to overshoot —

providing great opportunities for longer term investors. And though volatility is likely to remain elevated, investors establishing positions at these valuation levels will likely be rewarded over longer time horizons.

On the fixed income side, after years of extreme valuations, markets are beginning to offer attractive yields. Capital is moving into the space, mostly in high quality areas, but it will probably move down the credit stack as a recovery takes hold. We see the 10-year treasury yield moving up with rates in the first half of 2023 but likely stabilizing to around 4.50% by the end of the year.

General Macro Outlook for Financial Institutions

A lot has happened in the six months since the last issue. By the end of the first half of 2022, many market participants were waiting with bated breath to see the Fed let off the gas on this tightening cycle, but the opposite happened in the second half of 2022. Since July, we have seen the Federal Open Market Committee (FOMC) hike rates 275 basis points. In total, the Federal Reserve hiked rates on 7 different occasions throughout the year. Core CPI, which measures prices for items such as food and energy, advanced 6.0% year-over-year in November of 2022, slightly lower than the previous month at 6.3%. Despite this first glimmer of inflation turning in the other direction, we are not clear yet, and many business and economic risks remain on the table for 2023.

The Fed Fund futures signal that we still have more Fed tightening on the horizon — with another two to three 25-basis point rate hikes probable. This current Fed tightening cycle, which has been on a record pace, will likely continue through mid-2023.

Market and credit risks have not been a major theme in the economy thus far, but as we turn the page to 2023, we expect more of these risks to materialize and have noticeable impacts on bank earnings. Most of 2022 was accompanied by a somewhat "rosy" feeling that the economy was still chugging along and doing well, and with that came robust loan growth. There is a possibility that some regional institutions stretched themselves on credit, even prior to the rate hiking cycle in 2022. Low-yielding paper that many institutions still have on their balance sheets, along with deposits that are drying up, could pose a serious issue for financial institutions that have not adequately prepared for the turning of this business cycle.

We have reached the period in the economic cycle where every prominent money manager or CEO is "certain that a recession is coming." Yes, the chances of a recession have increased substantially over the past 12 months, but that is not to say that the degree and magnitude of this next recession is clear. And let's address the elephant in the room that is often forgotten about when fear and panic kicks in: Money and opportunity exist at a large scale during these periods of the business cycle. Recessions are painful, and the average recession lasts approximately ten months, with a -2.5% GDP growth rate. However, expansions are extremely powerful, and the average expansion lasts 69 months with a cumulative growth rate of 24.6%.

We are in the third most profound period of curve inversion (measured by the 2s10s spread) in over 30 years due to surging inflation that has just now started showing signs of slowing.

Table 1 • Bear Markets and Recessions

	Since 1929	Since 1945
Number of bear markets	27	15
Number of recessions	15	13
Fraction of bear markets w/recessions (percent)	38	57
Fraction of recessions w/bear markets (percent)	73	69
Average length of bear market with recession (months)	13	15
Average length of all bear markets (months)	10	11
Average loss of bear market with recession (percent)	-37.5	-34.5
Average loss of all bear markets (percent)	-35.6	-32.1
Average time to recover from bear markets (months)		23
Fraction of time in bear markets (percent)	23	18

Bear market and recession statistics (data from Seeking Alpha, The Balance, and the Washington Post)

Table 2 • Inverted Curve History

Dates	Days Inverted	Max Inversion
12/26/2000	227	-0.52%
3/20/2007	150	-0.19%
12/23/2022 (Current)	119	-0.84%
3/7/2006	25	-0.16%
7/9/1998	24	-0.07%
7/27/2006	19	-0.11%

233 MILLION NEW CREDIT CARD ACCOUNTS WERE OPENED IN Q2 OF 2022. THE MOST SINCE 2008.

Because of this, the SBR team is closely examining the pace of growth for both loans and deposits. Up to this point, the consumer has been bearing the brunt of inflation, evidenced from the savings rate plummeting from a multi-decade high (33.8% in 2020) to a 3.1% household savings rate as of November 2022.

Q2 2022 exhibited a period of record credit card account openings, with more than 233 million accounts opened, the most since 2008. Additionally, home affordability in California continues to draw down at a dramatic pace, with the average 30-year fixed mortgage at 6.32%.

Regional Financial Institution Outlook

The remarkable increase in the fed fund rates ushered in a new era, especially for regional financial institutions. We are now seeing attractive yields earned on excess liquidity that institutions had built up before the pandemic. The latest deposit financial data is as of Q3 2022, and is shown to drive an improvement in loans, deposits, and net income.

Figure 4 • Consumer Loans and Personal Savings Rate by Date

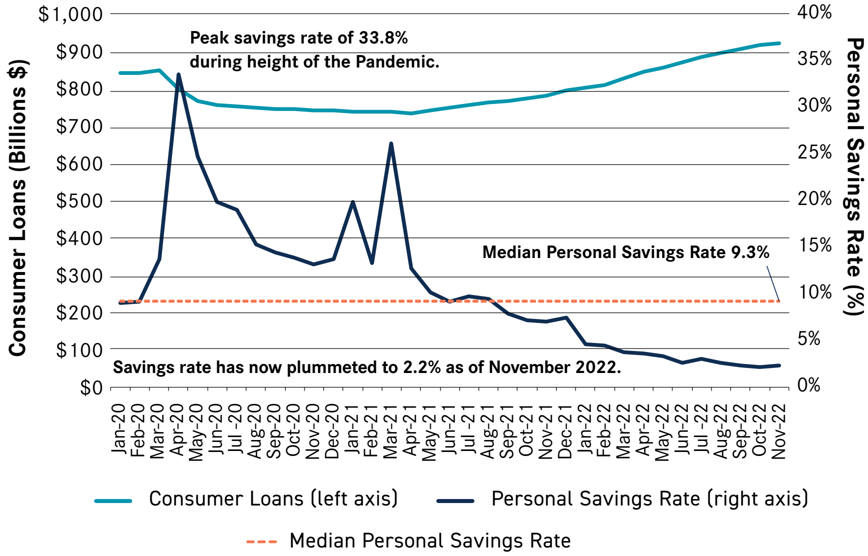


Figure 5 • Loan, Deposit, and Net Income Trends – Region Banks (Quarterly)

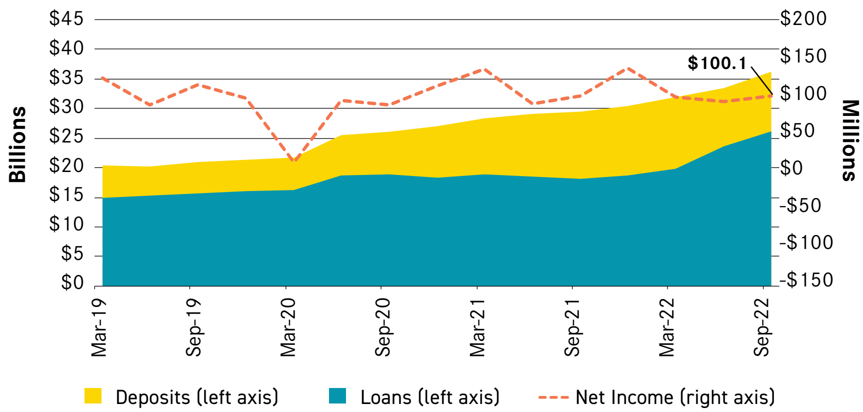
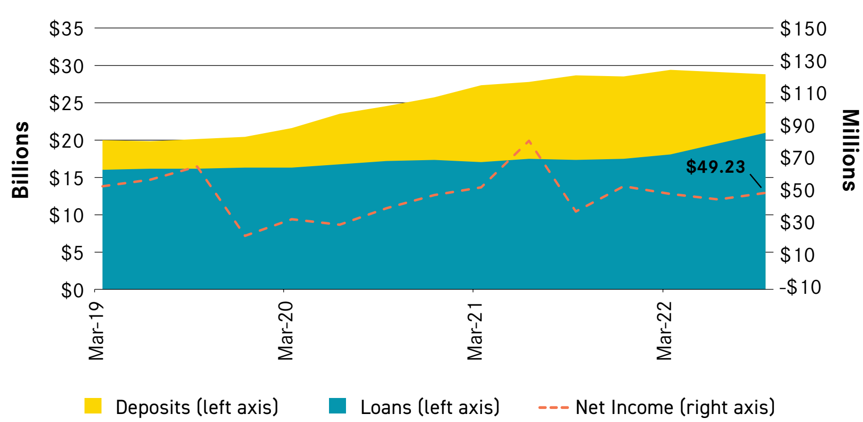


Figure 6 • Loan, Deposit, and Net Income Trends – Region Credit Unions (Quarterly)



CAPITAL MARKETS & BANKING

Capital Markets & Banking *Forecast*

One distinction is the impact on the net interest margin. Although financial institutions now benefit from the increased yield on their portfolio, the cost of funds has increased dramatically, especially with the curve being as inverted as it is. Because of that, the net interest margin of financial institutions has not improved as much as many would have expected.

The SBR team believes that the Fed intends to complete the path of rate hikes it has currently set out as consumers and businesses continue to face higher prices for goods and services. A considerable risk that both credit unions and banks face is "deposit flight." Even though financial institutions and their balance sheets generally strengthened over the past couple of years, we are seeing trends of declining deposits, especially for regional credit unions. This story seems to coincide with the liquidity stress that many regional financial institutions are facing. As consumers have continued to face rising rates and less affordable houses, they have subsequently been strapped for cash and naturally have been inclined to draw down their deposits.

The national picture is quite similar, with U.S. bank deposits falling 1.34% from June 22 to December 14, according to monthly Fed data (without the seasonal adjustment).

This could be a concern for those financial institutions that are experiencing strong funding needs from their loan portfolio but have smaller pools of deposits. With the continual pressure coming from the rate hiking cycle, the cost of these deposits could become quite a burden, especially for regional financial institutions. Due to heightened rate volatility, we are starting to observe increased rate sensitivity on bank deposits. This will likely curb any changes of robust industry-wide deposit growth in 2023 and might even drive

The SBR team believes that the Fed intends to complete the path of rate hikes it has currently set out as consumers and businesses continue to face higher prices for goods and services.

Figure 7 • QoQ Loan & Deposit Growth – Region Banks (Quarterly)

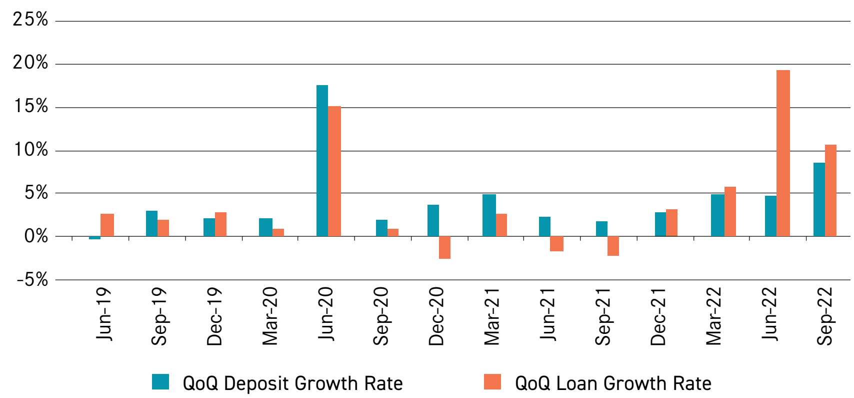
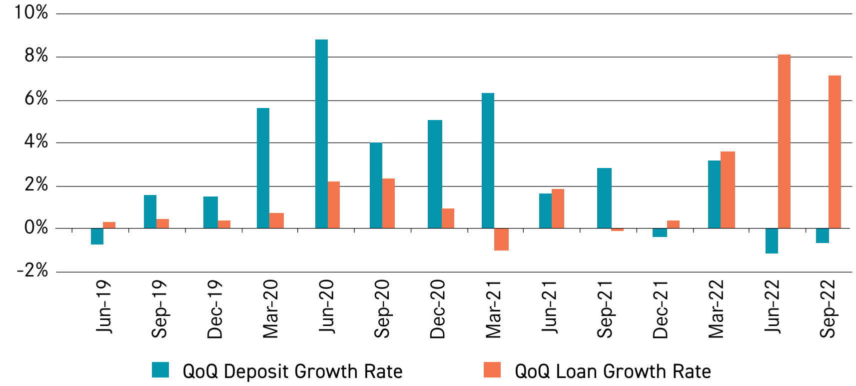


Figure 8 • QoQ Loan & Deposit Growth – Region Credit Unions (Quarterly)

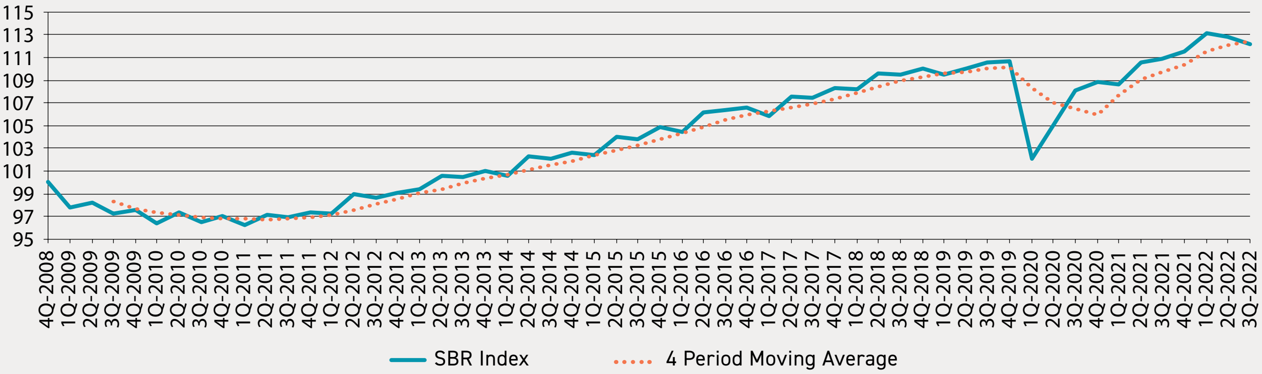


some financial institutions to experience negative deposit growth. As a result, it is likely that net interest margins for the vast majority of financial institutions have peaked, and we will likely see these turn in the other direction as we push on into 2023.

The new year could present an opportunity for consolidation within the banking industry, especially for regional banks and credit unions. With elevated financial risks going into 2023 due to the ongoing economic uncertainty, smaller financial institutions could be much more susceptible to default and liquidity problems.

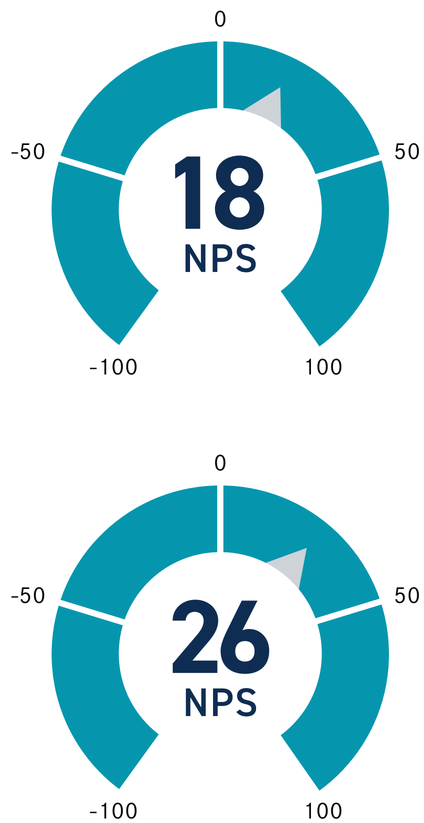
Sacramento Business Review Financial Conditions Index (with 2-year moving average)

Consistent with many of the views expressed by the SBR team for regional economic activity in 2023, our proprietary Financial Conditions Index for the region's economy shows growth slowing as we head into the new year. These slowing trends, particularly in housing, suggest that recessionary factors have already taken hold within the Sacramento region.



Human Capital Trends

Figure 1
HR MGMT's NPS (over) and Employees' NPS (under)



Would your HR team and your employees recommend you as an employer to others? The Employee Net Promoter Score (NPS) gives us an answer. On a scale of 0 to 10, we asked Sacramento's HR professionals/managers and employees, "How likely is it that you would recommend your employer to a friend?" The answers, as shown in Figure 1, might be considered underwhelming. In Figure 2, we see in the NPS' breakdown that HR management is highest in "Promoters" (47%), making it a slight majority who would not recommend their employers to others. Employees are highest in "Passives" (46.51%), meaning they do not recommend their employer to others. While "Passives" are generally content, they are still open to changing employers if they find better opportunities.

HR management reported the percentage of voluntary turnover at the end of 2022 to be 29.67%. They anticipate headcount to decrease at a slower rate in the first 6 months of 2023, with an anticipated decrease of 20%. Looking at the employee side of the equation, 18% of Sacramento employees sampled reported that they are about to quit their job. We also see 74% of employees reporting that they are currently pursuing more education, setting themselves up for more desirable future job opportunities (Figures 3 and 4).

Figure 2
Breakdown of HR MGMT's NPS (over) and Employees' NPS (under)

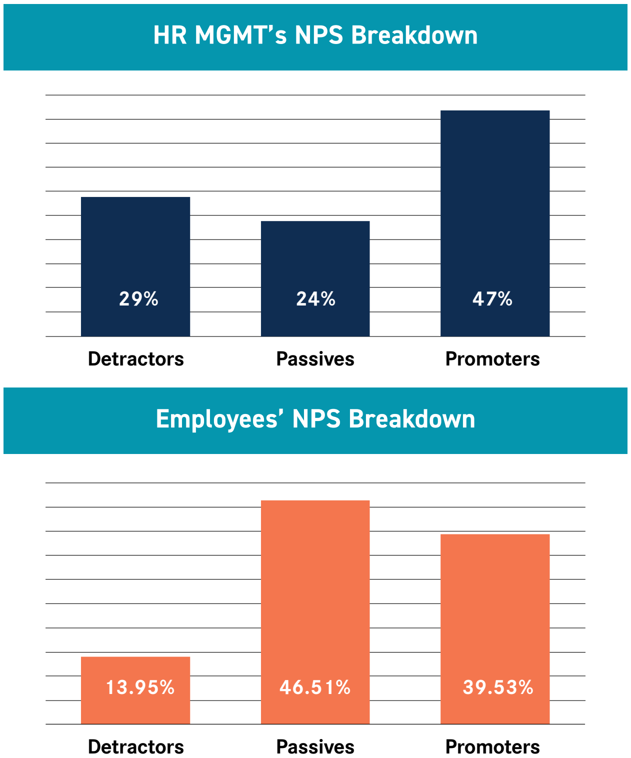


Figure 3
Are you about to quit your job?

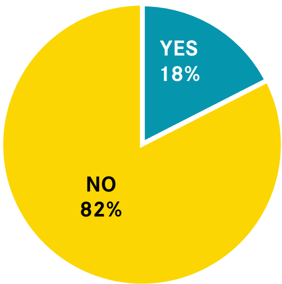


Figure 4
Are you pursuing more education?

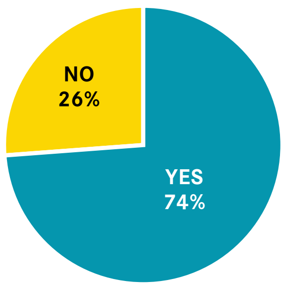


Figure 5
Q1 and Q2 Anticipated Resignations

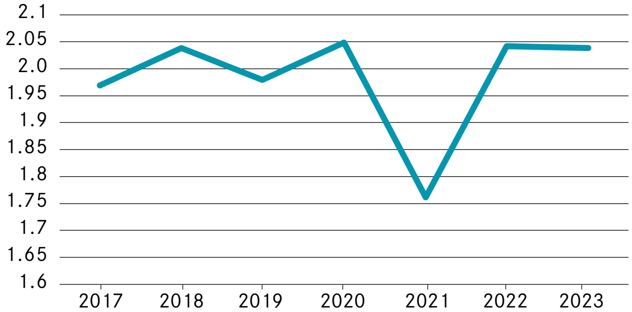


Figure 6
Q1 and Q2 Anticipated Headcount

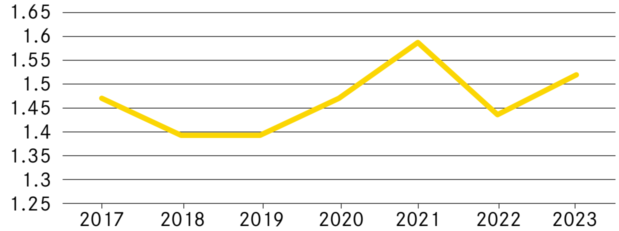


Figure 7
Q1 and Q2 Anticipated Meeting Needs for Training/Development

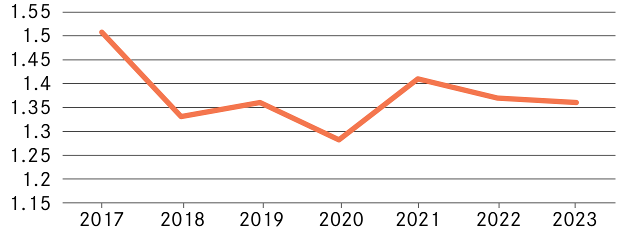


Figure 8
Q1 and Q2 Anticipated Meeting Compensation Goals

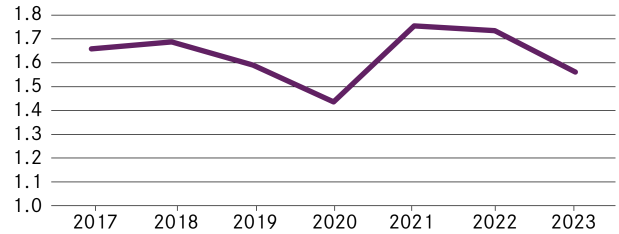


Figure 9
Q1 and Q2 Anticipated Meeting Goals for Optional Benefits

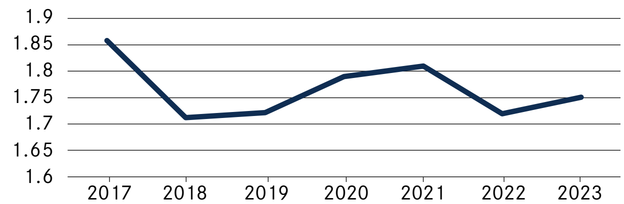
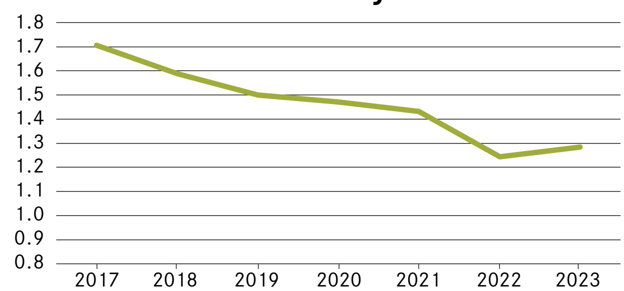


Figure 10
Q1 and Q2 Anticipated Meeting Goals for Diversity



Human Capital Trends

Our human capital indexes are illustrated in Figures 5-10. Movements may appear insignificant; however, given that data is shown on a three-point scale, even minor movements illustrate real impact. Upward movements are movements in the desired direction while downward movements are reductions.

Sacramento is projecting voluntary turnover at the same higher level as last year (Figure 5) prompting a spike in active recruitment (Figure 6). Current numbers on training and development tell the story that Sacramento employers are still not being effective in meeting the needs for skills remediation and development (Figure 7). We have dropped from a high in 2017, seeing a slight uptick in 2021, to again falling short of internal T&D goals. Compensation-wise, Sacramento's employers are reporting not being close to meeting compensation goals in the first half of 2023 (Figure 8), although it looks like organizations are focusing greater efforts in providing optional benefits and perquisites at appropriate levels (Figure 9). Racial justice and diversity efforts show renewed energy after a landslide downwards for the last few years (Figure 10), and a vast majority of our HR management respondents indicate they intend to increase diversity and inclusion efforts in the first half of 2023.

Goals and projected activities are worthwhile as planning efforts. How do our regional businesses follow up to ensure resources were well spent? Out of our HR management respondents, a third (33.34%) currently don't measure the impact of HR activities/projects. Some in this group reported that they are still looking for relevant quantitative measures, others reported that they would like to measure HRM but do not have the resources to do so, while the rest simply do not measure the impact of HR. Best practices tell us that without measurement, accountability is challenging. Another third (33.34%) utilize HR-specific indicators that have been decided jointly by HR and business operations. The final third use traditional HR metrics including days of training delivered, internal client (non-HR colleagues) satisfaction survey, talent attraction score/rate, as well as a balanced scorecard. It is challenging to ensure corporate strategy is being executed when appropriate measures are not in place. This may be increasing the challenges we are currently facing with our regional workforce.

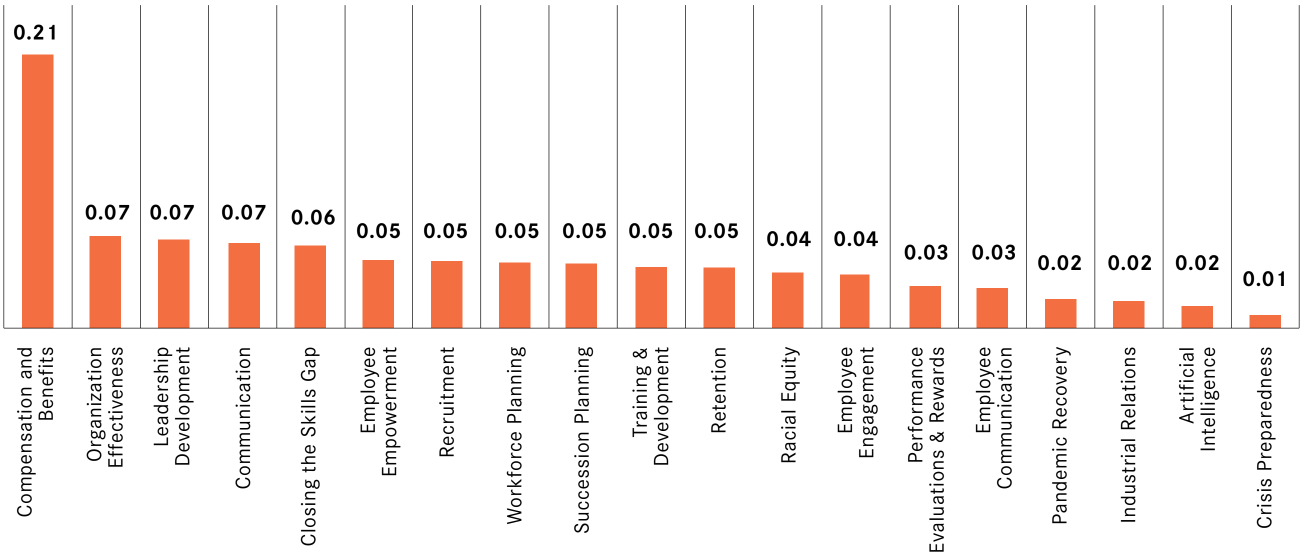
Table 1 depicts the most significant external pressures expected for Q1 and Q2. The Top 5 has had some internal shuffling over the last couple of years, but challenges with cost constraints and targets, as well as a workforce not fit for the job, have been a mainstay in the top. Some movement occurred for development and management of new competencies, which dropped two slots this year, and racial justice which made 10th place after not having made the Top 11 since being included in the survey 3 years ago. AI has occupied the same spot for 3 years in a row, since being included in the survey for the first time. Pandemic recovery started at number 8, climbed to 5th place last year, and this year is clocking in at the lowest place so far, ranking 13th in priority. Perhaps the pandemic-specific recovery has mutated into the general workforce challenges we are witnessing. In this tight labor market, downsizing fell off the radar, from 11 last year to last place this year.

Table 1
Most Significant External Pressures Expected for Q1 and Q2 2023

Factors	Rank
Pressure on cost reduction	1
Talent shortage (job candidates are not available)	2
Skills gap (job candidates available, but don't have desired skills)	3
Challenging productivity and profit targets	4
Change in organizational culture	5
Development and management of new competencies	6
Expansion of operations in new markets	7
AI (machine learning, new technologies)	8
Increased market competition	8
Racial justice	8
Market volatility and fear of recession	9
Downsizing	10
Organizational restructuring	11
Market volatility and fear of recession	12
Pandemic recovery	13
Inflation	14
Other	15
Downsizing	16

Some of the other external pressures reported include "expectation of a decrease in turnover rate due to our methods to ensure employee satisfaction," a "decision to continue to work remotely and [tactics for] how to incorporate unity amongst the team," a real concern that "profits may drop so the company may experience a layoff," and "turnover rate". An HR respondent put it this way: "one factor is people resigning and looking for better opportunities and diminishing the workforce." Several other comments surfaced similar sentiments around great levels of employee dissatisfaction, strategies for adopting flex work policies and remote work locations, and the perceived (incorrect) conflict between profits and desire to achieve "Great

Figure 11
HR Activities with Greatest Anticipated Impact on Business Performance in 2023



HUMAN CAPITAL TRENDS

SACRAMENTO EMPLOYERS' INEFFECTIVE COMMUNICATION REMAINS A CHALLENGE.

Sacramento's employers are facing severe challenges in their people and HR operations efforts going into 2023.

Place to Work" status. Comments are still being made around generational challenges. Now that millennials are aging and we are facing Gen Z in the workplace, there is a renewed concern regarding tensions and diversity challenges. Strong and humane leadership is necessary to solve these workforce challenges.

Top HR activities expected to have the greatest impact on business performance in Q1 and Q2 (Figure 11) paint a picture of serious workforce challenges, including compensation and benefits, ensuring an effective organization, preparing the workforce for tomorrow — both leadership and employees — and trying to stop the bleeding. The most important activities last year were recruitment/selection, retention, pandemic recovery, and improving communication with employees — showing us that the majority of focus has shifted, while effective communication is an ever-present roadblock.

Other HR/management challenges reported include: how to train new hires while working remotely, how to communicate with employees while working remotely, facing very low retention rates, low performance levels, transparency, cultivating future leaders, cultivating intrinsic motivation, systems thinking, cross functional/discipline experience, determining fair telecommuting policies, virtual management and leadership, onboarding and developing talent, and change management and ideological consistency. One respondent shared: "due to inconsistent directives, the team has developed unskilled agile traits," again pointing to the negative outcomes of ineffective communication.

In sum, Sacramento's employers are facing severe challenges in their people and HR operations efforts going into 2023. A renewed commitment to ensuring that HR policies and structures are in alignment with strategy and values — and focused on employee health and wellbeing — as well as being executed by competent servant leaders, is necessary for our region to be home to employers deemed attractive by the workforce.

Healthcare *Industry Conditions*

MOST NON-PROFIT HEALTH SYSTEMS ENDED THE YEAR WITH NEGATIVE MARGINS.

Economic Forecast in the Healthcare Industry

The post-acute pandemic healthcare landscape has left healthcare organizations, hospitals, and physician practices battered. Industry experts are labeling 2022 as among the worst financial years in healthcare. Most non-profit health systems ended the year with negative margins. The 2023 regional healthcare focus will encompass ongoing financial recovery efforts and identification of cost-cutting opportunities, while fortifying the specialized and equally battered professional healthcare workforce. Traditionally, inflation in healthcare lags behind that of the rest of the economy because prices are regulated in the industry and do not support rapid change. But the lag does not mean inflation has not hit the healthcare industry. Inflation is predicted to hit health systems hard because the increase in operating expenses is outpacing the rate of reimbursement (RSM, 2022). On the positive front, the Sacramento region's momentum towards highly anticipated expansion efforts may slow — but are unlikely to be scrapped as healthcare leaders seek differentiation in a highly competitive market.

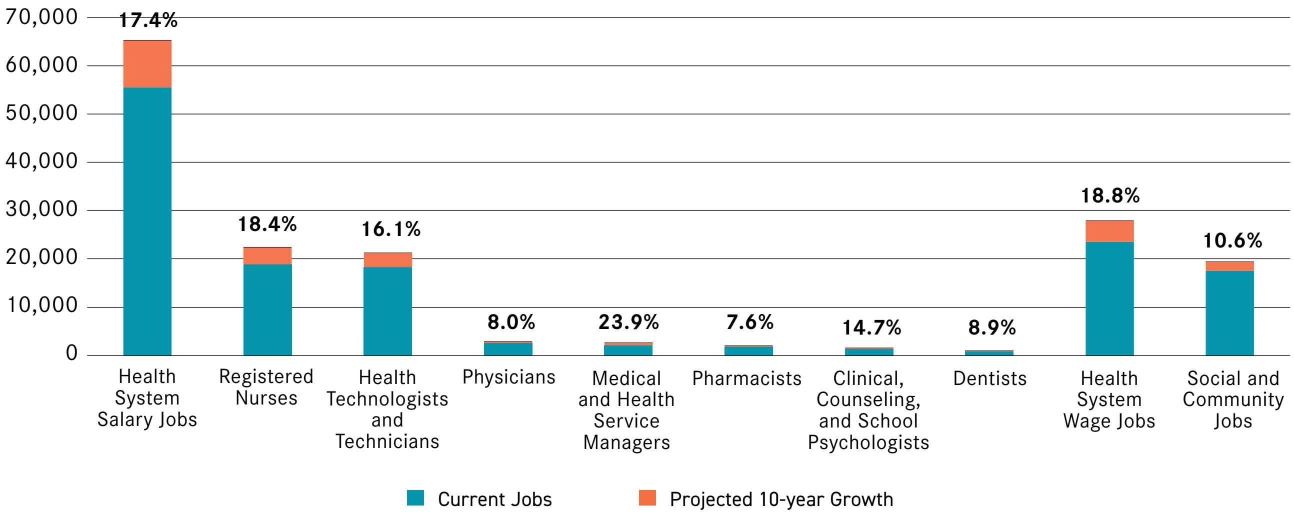
Labor Force

Healthcare workforce upheaval and labor costs are intrinsically linked to industry recovery. Clinical staff departures during and after the pandemic, along with a national nursing shortage, have significantly impacted operating expenses as well as professional morale throughout healthcare. An aging nursing workforce choosing retirement over risky working conditions and the high cost of travel nurses have converged on the margins of healthcare employers. Burnout in healthcare continues to plague the professional labor force. Years of clinical staff complaints regarding unnecessary administrative tasks, including laborious electronic health record (EHR) data entry have — until now — been given cursory attention by healthcare system administrators. This turmoil in clinical staffing has unveiled opportunities for real change and improvement in the industry. Industry recovery will be dependent upon healthcare leaders' ability to inspire and engage professional labor.

Data for local employment over the 10 year period 2018-2028 projects the Healthcare industry is one of the sectors with the most job openings and fastest growing occupations. For Bachelor's degree level applicants,14,480 new jobs are projected with the occupational title of Registered Nurse alone. For Master's degree level applicants, five of the top six fastest growing occupations in the region will be in healthcare: Physician Assistant, Nurse Practitioner, Speech-Language Pathologist, Mental Health and Substance Abuse Social Worker, and Healthcare Social Worker. In addition, the region expects to see a 24% increase in Medical and Health Services Manager jobs. That is, over 500 new managerial positions will be added in the local healthcare industry. (All data: CA EDD 2022)

Healthcare job opportunities will continue to expand and make Sacramento an increasingly renowned hub for healthcare jobs at all levels.

Figure 1
Sacramento Region Healthcare Job Growth Projection
(% Change 2018-2028, with Selected Subsectors)



Data Source: CA EDD; this chart represents projections based on pre-pandemic job opening data.

Healthcare Growth Opportunity

- Healthcare in Sacramento remains a generally stable industry through both inflationary periods and recession due to a predictably increasing population base.
- 2023 will see increasing opportunities for innovation, expanded professional training, and the addition of healthcare jobs to the region.
- In California, median RN salaries are the highest in the nation according to data compiled by the U.S. Bureau of Labor Statistics. Healthcare job opportunities will continue to expand and make Sacramento an increasingly renowned hub for healthcare jobs at all levels.
- The next decade will welcome expanded professional training and certification opportunities in the region. Notably, UC Davis Health and California Northstate University (CNU) are in early construction of "hospitals of the future." Sutter, Dignity, Kaiser and Davis all provide medical residency training in their hospital centers which are predicted to change in scope to emphasize public health. CNU will expand its footprint from professional training schools in medicine, pharmacy, dental medicine, psychology, and healthcare administration to welcome a school of nursing.
- Retail health clinics will continue to expand and offer improved patient access, becoming an increasingly competitive force for the traditional outpatient healthcare market.

Tourism & Hospitality

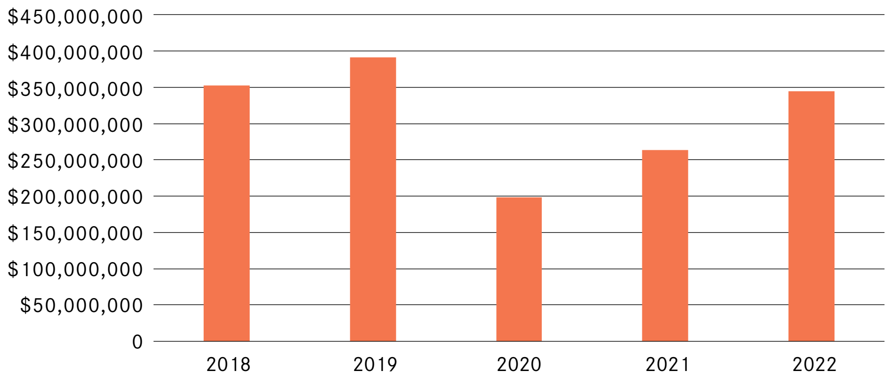
Sacramento Hotel Revenues

The estimates described below are based on the summary statistics for four zones provided by Sacramento Convention & Visitors Bureau (Downtown, Point West, Natomas, and Outlying hotels) as of the end of October 2022.

The decline of Sacramento hotel revenues in the first quarter of 2022 — after some post-COVID growth as reported in the previous SBR — was a relatively short-term trend. Overall, 2022 promises relatively substantial growth in Sacramento hotel revenues compared to both 2021 and 2020. Based on the first 10 months' statistics it is 30.9 percent and 74.2 percent, respectively.

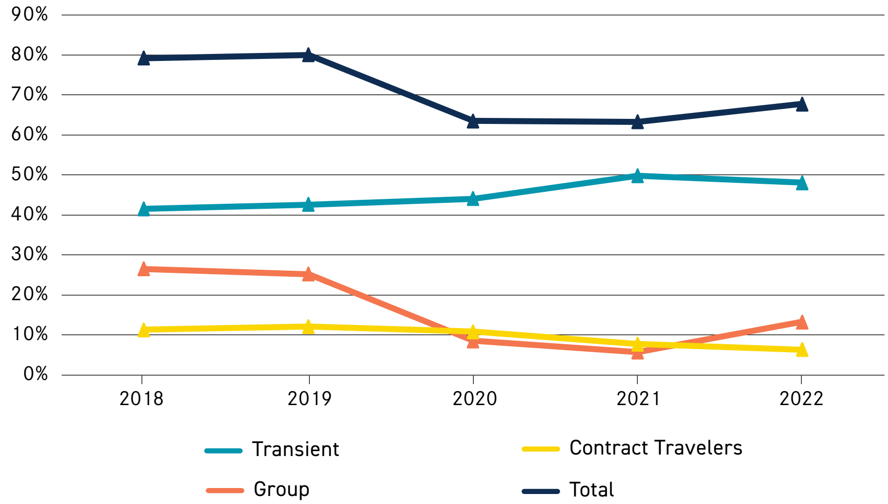
Combined with the first 10 months, the pre-COVID level of hotel revenues are still not reached in 2022. Instead, 2022 will be close to 2018 and somewhat lower than 2019 (a 2.3 and 13.5 percent decline, respectively).

Figure 1
Sacramento Hotel Revenues (first 10 months of the year)



Source: Visit Sacramento

Figure 2
Sacramento Hotel Occupancy (%)



Source: Visit Sacramento

Occupancy rates increased somewhat compared to COVID years, but are still far below the pre-COVID period.

The Demand/Supply Ratio and Occupancy Rates

The same observation about the dynamics of post-COVID recovery holds for the demand/supply ratio. In 2022, it was improved compared to the two COVID years (67.4 percent in 2022 compared to 63.9 percent and 51.6 percent in 2021 and 2020, respectively). However, it is still substantially lower than the pre-COVID years of 2019 and 2018 (78.9 and 78.7 percent, respectively).

Occupancy rates increased somewhat compared to COVID years, but are still far below the pre-COVID period. Rates declined from 79.2 and 80.0 percent in 2018 and 2019, respectively to 63.5 and 63.3 percent in 2020 and 2021, respectively. In contrast, in 2022, the Sacramento occupancy rate based on 10 months' statistics, increased only 67.7 percent.

Among three segments of hotel guests (transient, group, and contract travelers) only the group segment experienced a relatively substantial occupancy rate increase in 2022 compared to COVID years (13.3 percent in 2022 compared to 5.8 and 8.6 percent in 2021 and 2020, respectively). Transient travelers occupied 48.1 percent of Sacramento hotel spaces in the first 10 months of 2022 compared to 49.8 and 44.1 percent in 2021 and 2020, respectively. The contract segment demonstrated a declining trend (6.4 percent in 2022 compared to 7.7 and 10.8 percent in 2021 and 2020, respectively).

Pricing Trends

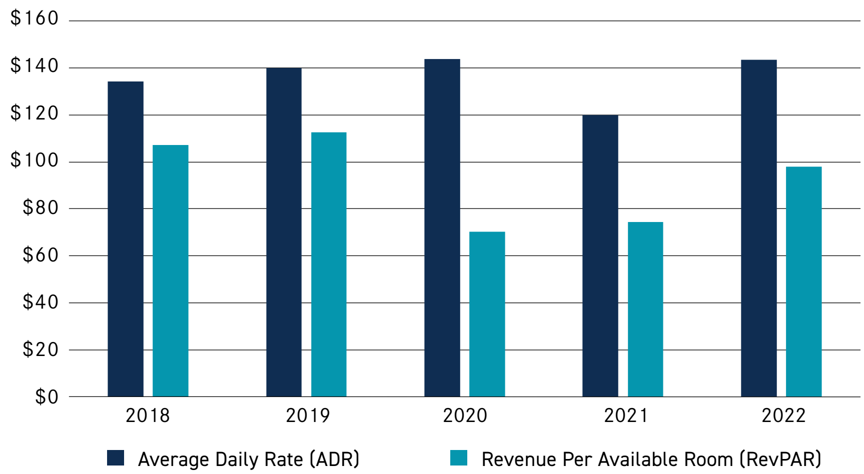
Average daily room rates charged by Sacramento hotels declined sharply during COVID, recovered nicely in 2021, but declined again in 2022 Q1. Downtown and Point West average daily rates 2022 Q1 remained even lower than in pre-COVID 2020 Q1 ($149.00 vs $150.20 and $116.85 vs $125.42 respectively), while Natomas and Outlying hotel rates were somewhat higher ($130.17 vs $124.29 and $103.75 vs $93.54 respectively).

Geographic Segmentation of Sacramento Hotels

The above mentioned trends worked differently for four geographic segments of the Sacramento market (Downtown, Point West, Natomas, and Outlying). In the first 10 months of 2022, Downtown (Zone 1, according to Sacramento Convention and Visitors Bureau) demonstrated substantial growth in all dimensions compared to the same period of 2021: occupancy rates (15.0 percent increase), ADR (25.2 percent increase), and RevPAR (44.0 percent increase). Another growing segment was Natomas (Zone 3): 1.6 percent growth in occupancy rates, 18.9 percent growth in ADR, and 20.9 percent growth in RevPAR.

Two other segments of the Sacramento market — Point West (Zone 2) and Outlying (Zone 4) — showed declining occupancy rates (4.8 and 11.1 percent decrease, respectively) compared to the same period of 2021. Due to the increased rates (15.9 and 16.9, respectively, growth of ADR), the average per room revenue in both cases also experienced some increase compared to 2021 (10.4 and 4.0 percent, respectively).

Figure 3
Sacramento Hotels Average Daily Rate and Revenue Per Available Room



Source: Visit Sacramento

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