January 26, 2017

TO: Honorable Mayor and City Council

FROM: Edward C. Starr, City Manager

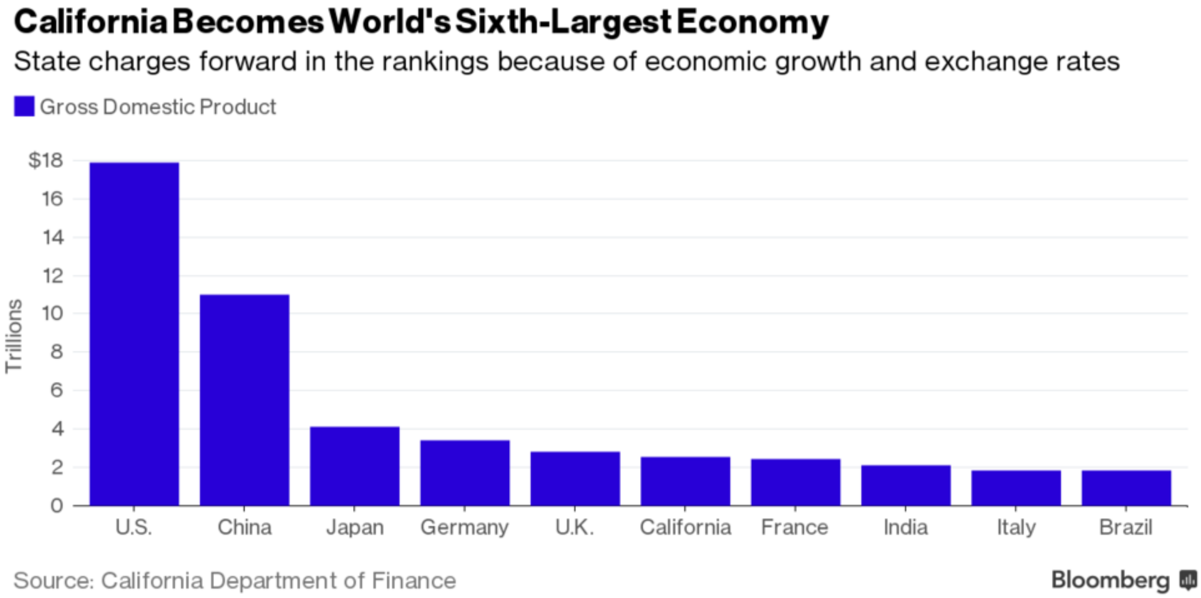
SUBJECT: CITY MANAGER'S WEEKLY REPORT: January 20-26, 2017

CITY MANAGER/ADMINISTRATIVE SERVICES DEPARTMENTS

- Earlier this month, Governor Brown, in releasing his state budget proposal for 2017-18, projected a $1.6 billion revenue shortfall. The Governor's projection is based, in large part, on declining income for top wage earners—an indication that California may be nearing the top end of a business cycle.

  For many observers, the Governor's projected revenue shortfall appears to run counter to stable growth in the state and nation's economies. By all measures, the U.S. economy has been expanding since 2010—the third-longest period of economic expansion in modern American history, with California leading the way and taking the position as the world's sixth most powerful economy.

  Data from the International Monetary Fund shows California's gross domestic product (GDP) at more than $2.4 trillion in 2015 with only the United States, China, Japan, Germany, and the United Kingdom ahead in ranking. In 2017, California may move ahead of the U.K. as the effects of Brexit take hold on the British economy.



In comparison to the nation as a whole, California's economy was particularly strong in 2016, growing by 4.1 percent year-to-year compared with a 2.4 percent increase for the U.S. as a whole. Last year, California created the most jobs of any state, and more than Texas and Florida combined. Statewide, the unemployment rate is 5 percent compared to approximately 4.7 percent nationwide. Several of the world's 50 largest companies are based in California, including Alphabet Inc. (Google), Apple Inc., Chevron, McKesson Pharmaceuticals, and Facebook.

Despite a generally rosy assessment of California and other state economies, data supports the conclusion that, in contrast, many state and local governments are experiencing revenue decline. According to an annual state spending survey conducted by the National Association of State Budget Officers' (NASBO), half of all states are seeing revenues come in lower than budgeted for the current fiscal year, and twenty-four states are seeing those weak revenue conditions carry into the next fiscal year—the highest number of states falling short on revenue earnings since thirty-six state budgets missed their mark in 2010. Economists attribute the revenue slowdown for governments to slow income tax growth, even slower sales tax growth, and a decline in corporate tax revenue.

Overall, spending by states totaled $786 billion for 2016, a 3.7 percent increase over the previous year. California's budget represents approximately $170 billion of that total. Although 2016 marks the sixth straight year of post-recession spending growth for state and local governments, the year also realized a slowdown from 2015 when spending increased by 4.4 percent over the previous year. Furthermore, when accounting for inflation, 32 states are still spending less than they did before the Great Recession, and total state spending has yet to surpass pre-recession levels. For 2017, total state revenue projections are anticipated to increase by an estimated 3.6 percent to $809 million; however, that projection is expected to decline during budget projection revisions in the second quarter of 2017.

The same GDP reports that demonstrate economic progress also show that states and local governments have subtracted from the pace of real economic growth in three of the past four quarters—a condition of weak state tax-revenue growth, including an outright year-over-year decline in the second quarter of 2016. In effect, state tax revenues have been unable to outpace inflation over the past year, the worst performance for government earnings since the Great Recession.

So how can state and local taxes be in recession when the rest of the economy is in expansion? Economists believe the growth disconnect is twofold and attributable to both structural and one-time factors.

The first source of decline may largely be temporary and is related to the price for goods—a factor that is particularly relevant to sales taxes, which have been the largest underperformer for most states over the past year and a half. The price for goods impacts sales taxes because sales taxes are levied as a percentage of overall taxable value. Thus, even though consumers may have more money in their pockets and are buying a greater number of goods, the value of those goods is not growing in line with expectations—in fact, taxable value may be declining.

Typically, when a business cycle reaches the point the nation is now experiencing, low unemployment and rising wages push prices—and therefore tax collections—higher. However, the extraordinary strength of the U.S. dollar and the decline in the energy industry are holding prices well below expansionary levels at approximately 1.7 percent annually; and because goods make up the greatest share of all taxable sales, deflationary pressures are actually weakening sales-tax collections. For example, housing construction is a major driver of sales taxes because of the large durable goods purchases that go into building and furnishing a new home. Last year the number of housing starts increased significantly, which should have resulted in stronger sales tax collections. However, the prices of most goods used in new home construction declined significantly—lumber prices, for example, were down by more than 10 percent at one point in 2016. So even though more housing units were being built, the sales tax collections from each unit were much less than the year before.

With inflation expectations rising, the price of goods may begin to increase. However, a second and structural component of state and local tax revenues has grown more volatile and disconnected from the underlying economics—a feature that is likely to impact tax collections for some time to come.

1. First, states have become increasingly reliant on highly progressive personal income taxes. Many economists believe an efficient tax structure should have some progressivity, but a side effect is increased volatility. By making tax structures more progressive, states are relying on a smaller set of higher-income taxpayers for a larger portion of their revenues. This set of taxpayers typically has some of the most volatile incomes. A taxpayer in the top 1 percent of the income distribution can make $10 million one year and very easily lose $10 million the next. It is no anomaly then that some of the states with the biggest income tax surprises (like California) are also those with some of the most progressive tax codes.

2. Secondly, many states are increasingly relying on a rising number of targeted tax incentives to promote economic development. These incentives can be effective at spurring local growth, but they can also create a scenario in which the fastest-growing parts of an economy are growing tax-free. California eliminated community redevelopment agencies in 2012, substantially reducing this effect going forward in relation to ongoing development in the state. However, the stream of revenue of former redevelopment agencies has been diverted to other taxing agencies, eliminating that revenue as a driver of economic expansion. Furthermore, the lack of a redevelopment platform in California has hurt the state's ability to pursue a significant expansion of economic development, which would eventually spur income and sales tax revenues down the road.

These influences appear to be the primary cause of weak government performance since emerging from the Great Recession, and a recalibration of state and local budgets to address revenue stagnation.

- California employers capped off a solid year of job growth in 2016 by adding a net 3,700 jobs during the month of December, as recently reported by the Employment Development Department. The unemployment rate was 5 percent, down from 5.3 percent in November. The national jobless rate was 4.7 percent in December.

  A rising minimum wage, as well as new labor laws mandating paid sick leave and increasing the liability for labor violations, have not prevented employers in the state from adding to their payrolls. There may be some effect of the higher minimum wage on the extent to which some industries are hiring, but it has not stopped employers from hiring.

  Trade, transportation, utilities, and the hospitality industries had the strongest showings last month. Combined, those sectors saw a net increase of 20,900 jobs over the past year. Five industries lagged behind, cutting 24,100 jobs combined. Professional and business services, usually one of the strongest sectors, cut 8,600 jobs, the most of any industry in the state.

The state added jobs at a rate of 2 percent since December 2015, slightly more than the national growth rate of 1.9 percent. Growth in the state has slowed as the economy inches closer to full employment—a situation where nearly all of the people in the market for a job have one. Last December, the state posted a 12-month job growth rate of 2.9 percent.

Manufacturers in the state eliminated the most jobs last year, losing a net 7,600 employees. The state's unemployment rate fell to 5.2 percent last month from 5.9 percent at the end of 2015, even as more and more people started looking for work.

Locally, the unemployment rate in San Bernardino and Riverside Counties was 5.2 percent in December 2016, down from a revised 5.5 percent in November 2016, and below the year-ago estimate of 5.9 percent. Between November 2016 and December 2016, total non-farm employment increased from 1,421,100 to 1,430,700 a gain of 9,600 jobs. Agricultural employment increased by 1,300 jobs. Trade, transportation, and utilities registered the greatest month-over gain, adding 4,800 jobs.

Transportation and warehousing (up 3,300) and retail trade (up 1,900) noted all the additions. Wholesale trade declined by 400 jobs over the month. A rise of 4,000 jobs was reported in leisure and hospitality. Accommodation and food services (up 2,300 jobs) accounted for roughly 58 percent of the increase, with most of the gains in food services and drinking places (up 1,900). Arts, entertainment, and recreation added 1,700 jobs.

Three other super sectors recorded month-over gains, including government (up 1,900), professional and business services (up 1,800), and manufacturing (up 300).

COMMUNITY DEVELOPMENT DEPARTMENT/ ECONOMIC DEVELOPMENT

- On Monday, the Montclair Planning Commission unanimously approved a Conditional Use Permit to allow for Revolt Brewery, Montclair's second microbrewery. Since July 2014, the applicant has successfully been operating a 1,089 square foot wholesale store, Revolt Home Brew Supply, at 8939 Vernon Avenue, Unit C, within a multiple tenant business park near the northeast corner of Arrow Highway and Vernon Avenue. This approval allows the expansion of its business by adding craft beer brewing with a 500 square foot interior tasting/sampling area in the adjoining Unit N, for a combined lease space of 2,171 square feet.

The sampling of beer would be restricted only to products manufactured on-site. No other alcoholic beverages would be allowed for tasting or sale on the premises.

All on-site consumption would occur inside the interior tasting area. Exterior beer consumption is strictly prohibited given the existing site and building configuration does not have potential to add outdoor seating and is constrained by required parking space drive aisles that must remain clear to vehicles.

Future special events with food trucks are planned and would be approved administratively with the Special Outdoor Event permit application reviewed by various City staff and the Department of Alcoholic Beverage Control.

Revolt Brewery is expected to open in early spring.

- With mall traffic declining steadily, department store giant Macy's is looking to downsize to a more defensible footprint. Back in August, the company announced plans to close about 100 stores. Last week, it identified about two-thirds of the locations that will be shuttered. Most of those will close within the next few months.

  The main goal of closing stores is to better align Macy's brick-and-mortar footprint with consumer shopping trends. However, a secondary benefit is that these store closures will free up a lot of excess real estate that Macy's can sell. That process has already begun and is likely to continue at a rapid pace this year.

  The quality of Macy's real estate spans a wide range. At one end of the spectrum, Macy's sprawling flagship store in Manhattan is probably worth billions of dollars. At the other end, Macy's owns some stores in dead or dying malls that are virtually worthless. For example, it recently unloaded one store in Springfield, Ohio, for the paltry sum of $200,000.

  A few of the stores that Macy's is closing this year are getting the ax specifically because they are sitting on valuable real estate. Selling these will generate the vast majority of Macy's real estate proceeds. On the other hand, most of the stores slated for closure are located in subpar malls and thus are not worth very much.

  In the past three months, Macy's has made big progress in selling off some of its city-center real estate. In November, the company announced that it would sell the building containing its men's store in San Francisco for $250 million in a deal expected to close this month. It will lease back the space for two or three years while it moves the men's department into its main San Francisco store across the street.

  At the same time, Macy's also disclosed that it had signed a contract to sell its downtown store in Portland, Oregon for $54 million. That store will close in the next few months.

  More recently, Macy's decided to close its Minneapolis flagship store and sell that building. Terms of the deal have not been officially announced, but the sale price was a little more than $40 million, according to the *Minneapolis Star Tribune*.

Macy's has also sold several stores to mall owner General Growth Properties in the past few months. In late October, Macy's announced that it had sold 5 stores to General Growth for $46 million during Q3. The bulk of the value probably came from just one of the properties: a store at Tysons Galleria outside of Washington, D.C.

More recently, Macy's sold its store at San Francisco's Stonestown Galleria to General Growth for about $41 million. This store (along with the Tysons Galleria store) will remain open on a short-term lease while General Growth finalizes its redevelopment plans.

Macy's has also sold a handful of stores to other real estate companies. Just this week, The Howard Hughes Corporation announced it had purchased the Macy's store and parking lot at Landmark Mall in Alexandria, Virginia, for an undisclosed price. This lays the groundwork for a full redevelopment of this valuable site.

CBL & Associates has also purchased three Macy's stores in its mall portfolio. These are all in lower-quality malls, though, so the combined sale price was just $5 million.

Finally, the Pennsylvania Real Estate Investment Trust (PREIT) recently stated it is in negotiations to buy three Macy's stores. At one mall, PREIT hopes to bring in a replacement department store. At the other two, both located in the Philadelphia suburbs, PREIT is looking for non-traditional mall tenants in order to transform those malls into "lifestyle centers" focused as much on entertainment as shopping.

In total, Macy's fourth quarter real estate sales are on pace to bring in $400 million to $500 million.

The top 150 to 200 properties in Macy's real estate portfolio (out of its more than 700 locations) account for the vast majority of its real estate value. However, these stores are strongly profitable despite the company's recent struggles.

- Retailers are reeling from weak holiday sales.

Macy's, Sears, Target, Kohl's, and JCPenney are among the many companies that have reported lackluster sales during the critical holiday period.

In the wake of the disappointing season, Macy's and Sears are now collectively closing more than 200 stores, and analysts say JCPenney could shut down as many as 300 stores within the next couple years.

Target has slashed its fourth-quarter sales and earnings outlook, and the mall-based retailer, The Limited, just shut down all 200 of its stores.

Department stores, which were hit hard by plunging shopper traffic and sales declines, are now on pace for "the worst results since the recession," according to Morgan Stanley analysts.

It's not as if people were not spending money over the holidays. In fact, overall holiday spending rose 4 percent in the U.S. to $658.3 billion, compared to last year, according to the National Retail Federation. That number includes $122.9 billion in online sales, which jumped 12.6 percent over last year.

This highlights a big problem in retail: many department stores and big-box retailers are still primarily reliant on in-store sales for revenue, when all the holiday spending growth is happening online.

Take Target for example: in the months of November and December, Target's same-store sales fell 3 percent, while online sales soared more than 30 percent. But Target's ecommerce sales are still only a fraction of its overall sales, so the growth online could not offset the losses in stores. As a result, overall comparable sales—including online and in stores—fell 1.7 percent.

These kinds of losses during the holiday season are brutal for retailers.

The months of November and December account for as much as 30 percent of retailers' annual sales, according to the National Retail Federation.

That is why so many retailers are now announcing store closures in the wake of the holiday period. They need to cut their losses on unprofitable stores—or even marginally profitable stores—and invest more in growing their ecommerce businesses.

According to Morgan Stanley analysts, department store fundamentals continue to materially erode, and specialty apparel retailers, like Gap and Abercrombie & Fitch, are also in trouble.

Off-price retailers like TJ Maxx offer an added threat with their deep discounts that undercut Macy's, Target, and others on price.

The result of these pressures will drastically alter the retail landscape over the next several years. Physical stores will not completely disappear, but they will continue to decline in number as retailers race to catch up to Amazon and adapt to customers' changing shopping habits.

HUMAN SERVICES DEPARTMENT

- Yesterday, the Montclair Senior Center held its monthly birthday party, "Fun in the Snow." More than 190 seniors enjoyed a delicious lunch, birthday cake, hot chocolate, and games.

  Photos are shared on Page 12.

POLICE DEPARTMENT

- Last night, the Montclair Police Department received an award from Pomona Valley Workshop (PVW) as "Outstanding Employment Partner," in recognition of a commitment to improve the lives of individuals who have intellectual disabilities. Chief Robert Avels was honored to accept the award at PVW's Annual Association Dinner held at the Doubletree Hotel in Claremont. Also in attendance to represent the City of Montclair were Mayor Pro Tem Carolyn Raft, Council Member John Dutrey and Anne Dutrey, and Council Member Trisha Martinez.

- On February 7 from 2 p.m. to 8 p.m. at the Montclair Senior Center, the Montclair Police Department will participate in its second "Battle of the Badges" blood drive with the American Red Cross.

  Battle of the Badges is an opportunity for all badge-carrying personnel, along with their friends, families, and co-workers, to positively impact our community by participating in a friendly competition to see who can donate the most blood and ultimately help save the most lives. Not everyone was able to donate the first time around for various reasons, but the significant turnout placed us in a competitive position with our neighboring cities. Our goal this year is to collect 48 pints of blood.

  Although walk-ins are welcome, signing up with Lt. Brandon Kumanski will ensure a much faster process. Please contact him by email, bkumanski@cityofmontclair.org, or phone 909-448-3605 to reserve your appointment time. Identification is required to donate.

  A flyer is included on Page 13.

ECS:spa

"You can't be brave if you've only had wonderful things happen to you."
~ Mary Tyler Moore

JANUARY 2017

31	City Manager's Staff Meeting City Hall Conference Room	9:00 a.m.

FEBRUARY 2017

01	Community Action Committee Meeting Council Chambers	7:00 p.m.
06	City Council Workshop Council Chambers	5:45 p.m.
06	City Council Meeting Council Chambers	7:00 p.m.
13	Planning Commission Meeting Council Chambers	7:00 p.m.
14	City Manager’s Staff Meeting City Hall Conference Room	9:00 a.m.
15	Safety Committee Meeting City Hall Conference Room	10:30 a.m.
16	Public Works Committee Meeting City Hall Conference Room	4:00 p.m.
16	City Council Workshop – Proposition 64 Council Chambers	6:00 p.m.
20	Presidents’ Day – City Offices Closed	
21	Real Estate Committee Meeting City Hall Conference Room	5:30 p.m.
21	Code Enforcement/Public Safety Committee Meeting City Hall Conference Room	6:15 p.m.
21	City Council Meeting Council Chambers	7:00 p.m.
23	Midyear Budget Review Council Chambers	6:00 p.m.
27	Planning Commission Meeting Council Chambers	7:00 p.m.


January
Senior Center
Birthday Party
Happy Birthday Seniors

Answer the call …

…Give blood in honor of everyday heroes.

American Red Cross

Battle of the Badges Blood Drive

Montclair Police Department

Location: Montclair Recreation Senior Center.
5111 Benito St.
Montclair, CA 91763

Tuesday, February 07, 2017
2:00 PM to 8:00 PM

Please schedule your appointment by contacting Lt. Brandon Kumanski at bkumanski@cityofmontclair.org or call 909-448-3605 or visit www.redcrossblood.org and use sponsor code: BADGESOCAL

All donors will receive a Battle of the Badges T-shirt and other promotions.

Streamline your donation experience and save up to 15 minutes by visiting RedCrossBlood.org/RapidPass to complete your pre-donation reading and health history questions on the day of your appointment.

[] Order ID: • Qty: 1 of 1 • 00628565 15

redcrossblood.org | 1-800-RED CROSS | 1-800-733-2767 | facebook.com/redcrossblood | @RedCross

Individuals who are 17 years of age (16 with parental permission in some states), meet weight and height requirements (110 pounds or more, depending on their height) and are in generally good health may be eligible to give blood. Please bring your Red Cross blood donor card or other form of positive ID when you come to donate. Theme012.Size005 | 2012/08