

LOS ANGELES SMALL BUSINESS ATTITUDES SURVEY

Fall 2018 | Issue No. 2



1ST CENTURY BANK



1ST CENTURY BANK IS A DIVISION OF MIDFIRST BANK, ONE OF THE NATION'S LARGEST PRIVATELY HELD FINANCIAL INSTITUTIONS.

The combination of private ownership, a strong capital base and local market focus, as well as expertise, allows 1st Century Bank to provide greater scale and opportunity for its clientele. 1st Century Bank's exceptional service model provides uniquely flexible, local decision-making that has distinguished it in the Los Angeles market.

Founded in 2007, Beacon Economics is an independent research and consulting firm dedicated to delivering accurate, insightful and objectively-based economic analysis. Leveraging unique proprietary models, vast databases and sophisticated data processing, the company specializes in services like industry analysis, economic policy analysis, economic impact analysis and real estate market analysis. Beacon Economics equips its clients with both the data and analysis required to understand the significance of on-the-ground realities and make informed business and policy decisions based on them.

*Small businesses
are the beating
heart of our
economy*

– Eric Garcetti, Mayor
City of Los Angeles

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1st Century Bank and Beacon Economics are excited to release the fall 2018 Small Business Attitudes Survey. This semi-annual survey and report reflects an ongoing collaboration between 1st Century Bank and Beacon Economics and seeks to better understand the aspirations, perceptions and concerns of the small business community in Southern California.

In this fall's survey and report, we find sustained optimism among Los Angeles' small businesses with expectations for continued economic growth—at the local (89 percent), national (85 percent) and global (75 percent) levels—remaining strong.

The effects of a low unemployment rate and tight labor market are evident in the shifting experiences of small businesses looking to hire. Over the past six months, 12 percent of small businesses indicate they have seen a decrease in qualified candidates, and 19 percent report having job openings that have remained unfilled. The struggle for qualified talent led 21 percent of respondents to report they are incurring increased costs associated with recruiting candidates for open positions.

This report also examines how small businesses are reacting to the implementation of the recently passed federal tax law, the *Tax Cuts and Jobs Act* of 2017. Survey respondents have an overwhelmingly favorable opinion of the law (79 percent) and similarly believe the law will have a positive impact on their businesses (71 percent). The story, however, is more complicated when it comes to the law's limitation on the State and Local Tax (SALT) deduction, with 19 percent of small businesses indicating they believe the limitation will have a negative impact on their business and 9 percent indicating they are uncertain about the impact.

As the holiday shopping season enters its peak, small businesses don't see consumer spending as a major concern in part due to a strong sense of broader economic optimism. Other national headline topics do present as concerns, however, for small businesses, with nearly seven in ten reporting anxiety surrounding healthcare costs (68 percent), interest rates (70 percent) and commodity prices (67 percent).

Finally, as this summer saw the convening of the Global Climate Action Summit in San Francisco, the survey indicated a majority of respondents expect California climate change policy to have a positive impact on their businesses (51 percent), while only 12 percent expect it to have a negative impact on their businesses moving forward.

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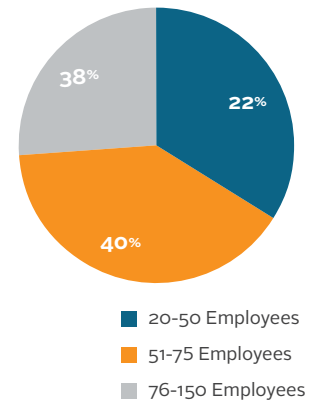


WHO WE STUDIED

Survey Respondents



Company Size



Most small businesses in Los Angeles broadly believe the economy will continue to strengthen

KEY FINDINGS

TIGHT LABOR MARKET:

Continued economic growth is powering small business optimism. However, in Los Angeles, a low unemployment rate and tight labor market are evident in the shifting experiences of small businesses looking to hire.

- 12 percent of small businesses have seen a decrease in qualified candidates
- 12 percent report having seen job openings remain unfilled over the past six months
- 21 percent of firms report increased competition for talent from peer firms when hiring
- 26 percent report that qualified candidates have increased salary expectations
- 21 percent of firms have incurred increased recruiting costs given the tight labor market

FEDERAL TAX CUTS:

Nearly eight in ten respondents (79 percent) had an overwhelmingly favorable opinion of the *Tax Cuts and Jobs Act* of 2017. While the legislation is still being fully implemented, 71 percent of respondents believe the law will have a positive impact on their businesses.

- 46 percent of respondents reported that the passage of the law had resulted in employee raises or bonuses
- 46 percent indicated an expansion of operations
- 39 percent were expecting increased profits as a result of the law's passage
- 34 percent of firms responded the passage of the law had allowed for paying down an outstanding debt
- 33 percent indicated they were undertaking capital improvements

The changes in tax policy weren't uniformly viewed as positive for small businesses. One in five respondents (19 percent) viewed the law's limiting of the State and Local Tax (SALT) deduction as having a negative impact on their business.

CONCERNS: HEALTHCARE, INTEREST RATES AND COMMODITY PRICES

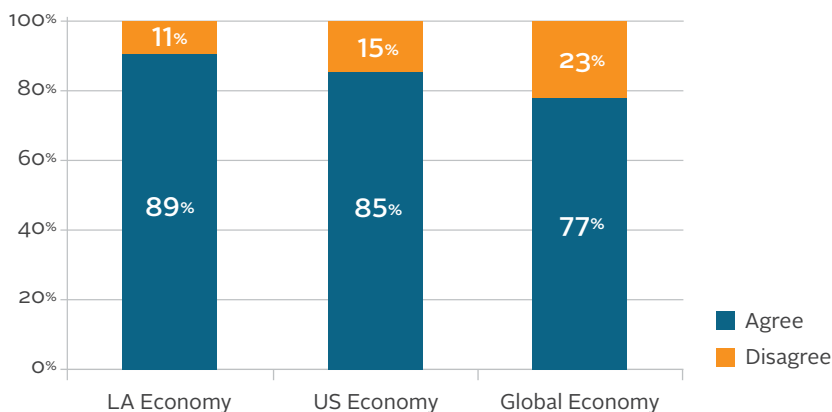
Most small businesses in Los Angeles broadly believe the economy will continue to strengthen; however, there are a few specific economic issues giving pause to small businesses in Los Angeles:

- 70 percent noted they had concerns about recent trends in interest rates
- 68 percent reported concern about healthcare costs
- 67 percent expressed concern about commodity prices over the next six months

ECONOMIC OUTLOOK

Small business optimism in the economy continues to climb. 89 percent of respondents believe the local Los Angeles Economy will continue to improve over the next six months. Optimism is strongest for the local Los Angeles economy; however, there is an overwhelming consensus regarding continued improvement domestically (85 percent) and globally (77 percent).

The Economy Will Improve Over the Next Six Months



THE 1ST CENTURY SMALL BUSINESS INDICES

1st Century Small Business survey respondents are asked to reflect on business conditions over the last six months and provide feedback for the outlook over the next six months. The tables in this section of the report display a diffusion index calculated as the percentage of responses reporting “rising” minus the percentage reporting “falling.” The index has a possible range of +100 (all “rising” responses) to -100 (all “falling” responses), with 0 indicating an even mix of “rising” and “falling” responses.

INDEX MEASURES

SALES

Small businesses have seen a drop in observed sales between spring 2018 and fall 2018, dropping by 8.1 to a net observed sales index of 38.6. However, companies’ outlook six months forward expect a rebound with an expected net sales index of 66.6.

Percent of total respondents reporting that over the **past 6 months**, the **sales** of their firms’ products or services have been:

Survey	Rising	Unchanged	Falling	1st Century Sales Index
Fall 2018	49.3	40	10.7	38.6
Spring 2018	56	34.7	9.3	46.7

Expected trend over the **next 6 months**:

Survey	Rising	Unchanged	Falling	1st Century Sales Index
Fall 2018	71.3	24	4.7	66.6
Spring 2018	70.7	26.7	2.7	68.0



PROFIT MARGINS

The profit margins index has dropped from 44.0 to 30.0 between spring 2018 and fall 2018, as observed by small business survey responses. They are expected to rebound into 2019, with an anticipated profit margin index reported at 56.0.

Percent of total respondents reporting that over the **past 6 months**, their firms' **profit margins** have been:

Survey	Rising	Unchanged	Falling	1st Century Profit Margin Index
Fall 2018	40.7	48.7	10.7	30.0
Spring 2018	54.0	36.0	10.0	44.0

Expected trend over the **next 6 months**:

Survey	Rising	Unchanged	Falling	1st Century Profit Margin Index
Fall 2018	65.3	25.3	9.3	56.0
Spring 2018	79.3	16.7	4.0	75.3

PRICES CHARGED

The 1st Century prices charged index has gone up by 8.0 since the spring survey, reaching 40.7. The trend is expected to continue, with an outlook index for the next six months of 57.3.

Percent of total respondents reporting that over the **past 6 months** **prices charged** by their firms have been:

Survey	Rising	Unchanged	Falling	1st Century Prices Charged Index
Fall 2018	46.0	48.7	5.3	40.7
Spring 2018	40.7	51.3	8.0	32.7

Expected trend over the **next 6 months**:

Survey	Rising	Unchanged	Falling	1st Century Prices Charged Index
Fall 2018	60.0	37.3	2.7	57.3
Spring 2018	58.0	33.3	8.7	49.3

MATERIALS COST

The cost of material inputs based on the observed responses for the materials index has gone up by 5.4, reaching 43.4 in the fall of 2018.

Percent of total respondents reporting that **materials cost** at their firms over the past **6 months** has been:

Survey	Rising	Unchanged	Falling	1st Century Net Rising Index
Fall 2018	50.7	42.0	7.3	43.4
Spring 2018	49.3	39.3	11.3	38.0

Expected trend over the next **6 months**:

Survey	Rising	Unchanged	Falling	1st Century Net Rising Index
Fall 2018	62.0	31.3	6.7	55.3
Spring 2018	54.0	35.3	10.7	43.3

EMPLOYMENT

The Employment Index was reported to be 32.0 as of fall 2018, an increase of 7.4 from the last reported responses in spring 2018. Employment is expected to continue rising, with an outlook index for the next six months anticipated at 54 based on survey responses.

Percent of total respondents reporting that over the **past 6 months employment** at their firms has been:

Survey	Rising	Unchanged	Falling	1st Century Employment Index
Fall 2018	38.7	54.7	6.7	32.0
Spring 2018	37.3	50.0	12.7	24.6

Expected trend over the next **6 months**:

Survey	Rising	Unchanged	Falling	1st Century Employment Index
Fall 2018	59.3	35.3	5.3	54.0
Spring 2018	57.3	36.7	6.0	51.3

CAPITAL SPENDING

The capital spending index has dropped to 41.4 from 46.0 between spring 2018 and fall 2018. Small businesses are reportedly expecting an increase in capital spending in the upcoming six months, with an outlook index of 57.3 reported.

Percent of total respondents reporting that over the **past 6 months** their firms' **capital spending** has been:

Survey	Rising	Unchanged	Falling	1st Century Capital Spending Index
Fall 2018	50.7	40.0	9.3	41.4
Spring 2018	53.3	39.3	7.3	46.0

Expected trend over the **next 6 months**:

Survey	Rising	Unchanged	Falling	1st Century Capital Spending Index
Fall 2018	65.3	26.7	8.0	57.3
Spring 2018	50.7	35.3	14.0	36.7

WAGES AND SALARIES

The wages and salaries index has gone up by 6.7 over the past six months—reaching 34.7 in the fall of 2018, as compared with 28 in the spring of the same year. Small businesses reported with confidence that wages and salaries would continue rising, with the expected outlook for the next six months reported at 60.

Percent of total respondents reporting that in the **past 6 months** their firms' **wages and salaries** have been:

Survey	Rising	Unchanged	Falling	1st Century Wages and Salary Index
Fall 2018	42.0	50.7	7.3	34.7
Spring 2018	34.7	58.7	6.7	28.0

Expected trend over the **next 6 months**:

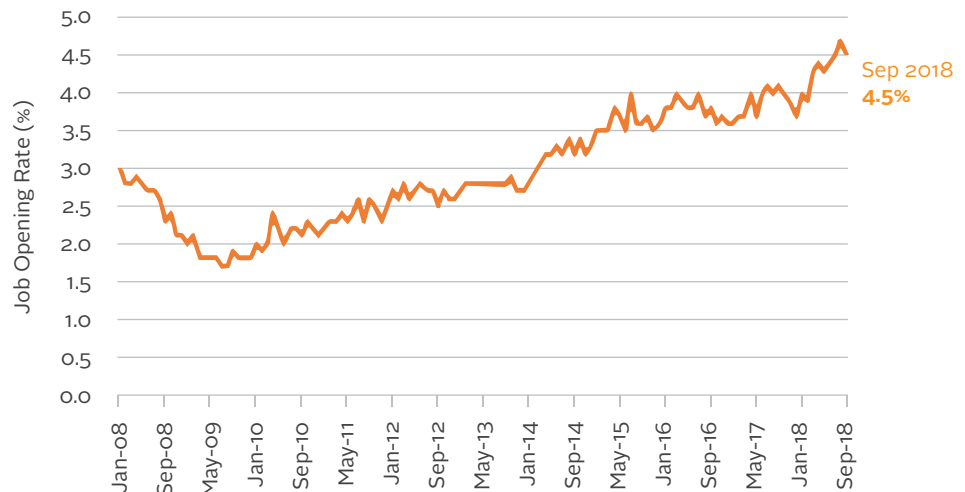
Survey	Rising	Unchanged	Falling	1st Century Wages and Salary Index
Fall 2018	64.7	30.7	4.7	60.0
Spring 2018	56.0	38.7	5.3	50.7

EMPLOYMENT AND HIRING

Recent labor market reports reveal the ongoing challenge that U.S. employers currently face in filling job vacancies. The number of job openings nationally has been routinely pushing into record territory, with nearly every industry suffering from a lack of workers, from the tech sector to healthcare to restaurants. These problems are compounded in California, which has consistently outpaced the nation in terms of job growth and economic activity.

California's unemployment rate declined to 4.1 percent in the latest employment numbers, a new historic low

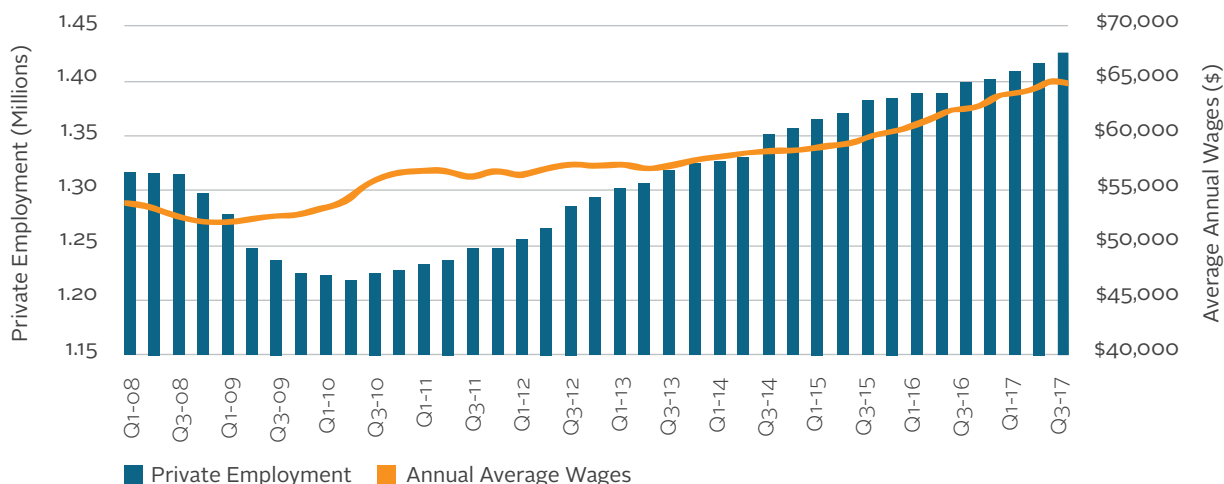
National Job Opening Rate for Total NonFarm Employment



Source: Job Openings and Labor Turnover Survey, Bureau of Labor Statistics

California's unemployment rate declined to 4.1 percent in the latest employment numbers, a new historic low, despite a 34,300 increase in the state's labor force over the month. However, labor force growth remains modest from a year-over-year perspective, growing by just 4,900 from September 2017 to September 2018.

Private Employment and Wages, City of Los Angeles
Q1-2008 to Q3-2017



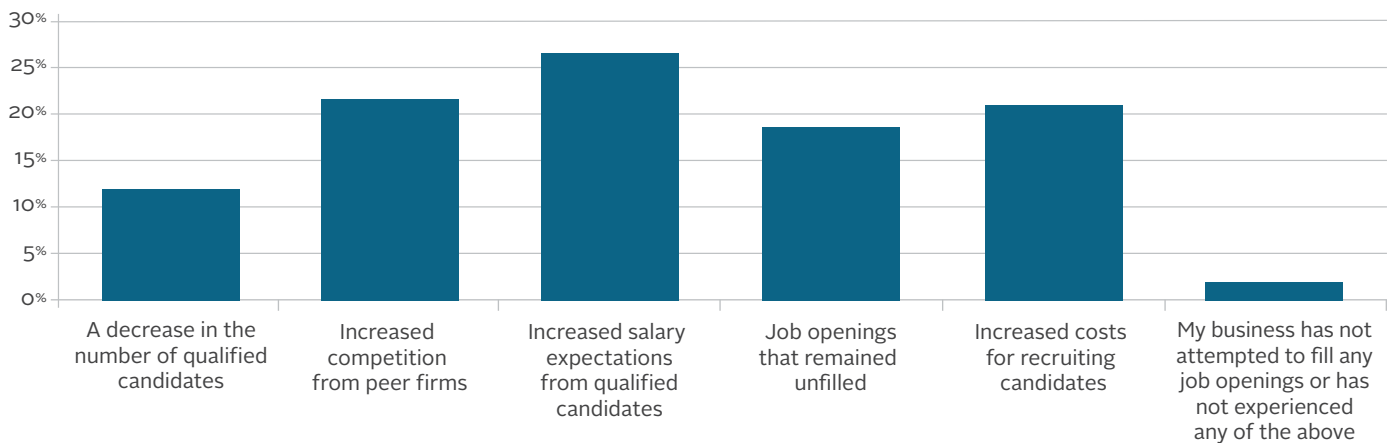
Source: California Employment Development Department; Analysis by Beacon Economics

The nation's slowing job growth is not due to a lack of labor demand—the job openings rate has been at or near an all-time high for the last few months as reflected in the graph, National Job Opening Rate for Total NonFarm Employment. Instead, the slowdown in employment growth stems from a lack of available workers. The U.S. unemployment rate is now 4.1 percent, the lowest in 45 years with the exception of a few months during the massive tech bubble of the late 1990s—and today, the nation is not experiencing a major bubble of any kind.

The labor shortage is hardly a surprise. Since the baby boomer generation there has been a sharp slowing in the growth of the working age population—from 1.5 percent in 1995 to half a percent over the last few years. The nation's workforce today is also, on average, considerably older, which partly accounts for the decline in the participation rate. Anecdotal evidence suggests a sharp slowing in the inward flow of immigrants. Job creation continues to be addressed in public policy, despite the lack of workers to fill positions (creating jobs is not the problem today). This labor shortage will benefit workers in terms of wage growth—but will also slow economic growth in the years to come.

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Hiring Experiences for Firms Over the Past Six Months

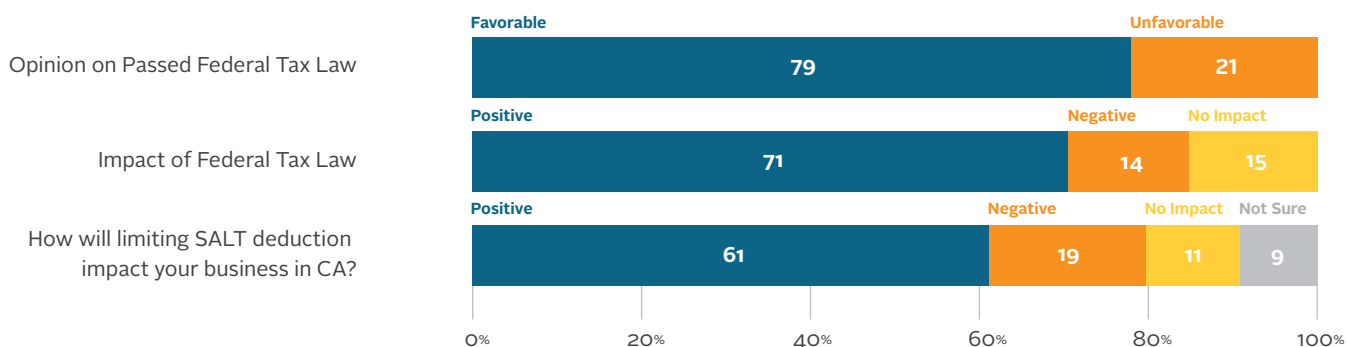


The effects of a low unemployment rate and tight labor market are evident in the shifting experiences of small businesses looking to hire. Over the past six months, 12 percent of small businesses indicate they have seen a decrease in qualified candidates, and 19 percent report having job openings that have remained unfilled. The struggle for qualified talent led 21 percent of respondents to report they are incurring increased costs associated with recruiting candidates for open positions.

FEDERAL TAX LAW CHANGES

In 2017, Congress passed, and the President signed, legislation to reform and cut federal taxes. Nearly eight in ten respondents (79 percent) had an overwhelmingly favorable opinion of the *Tax Cuts and Jobs Act* (79 percent). While the legislation is still being fully implemented, 71 percent of respondents believe the law will have a positive impact on their business. 46 percent of respondents reported that the passage of the law had resulted in employee raises or bonuses and 46 percent indicated an expansion of operations.

Respondents' Feelings on Recent Federal Tax Law



Thirty-three percent indicated they were undertaking capital improvements as a result of the changes produced by the tax law

39 percent of small business respondents reported expectations of increased profits in the new fiscal year as a result of the law's passage. Along with expanding operations and employee raises, 34 percent of firms responded the passage of the law would allow for paying down of outstanding debt. Thirty-three percent indicated they were undertaking capital improvements as a result of the changes produced by the tax law.

The changes in tax policy weren't uniformly viewed as positive for small businesses. One in five respondents (19 percent) viewed the law's limiting of the State and Local Tax (SALT) deduction as having a negative impact on their business, and 9 percent were unsure of whether the changes to the deduction would have a positive or negative impact on their business operations.

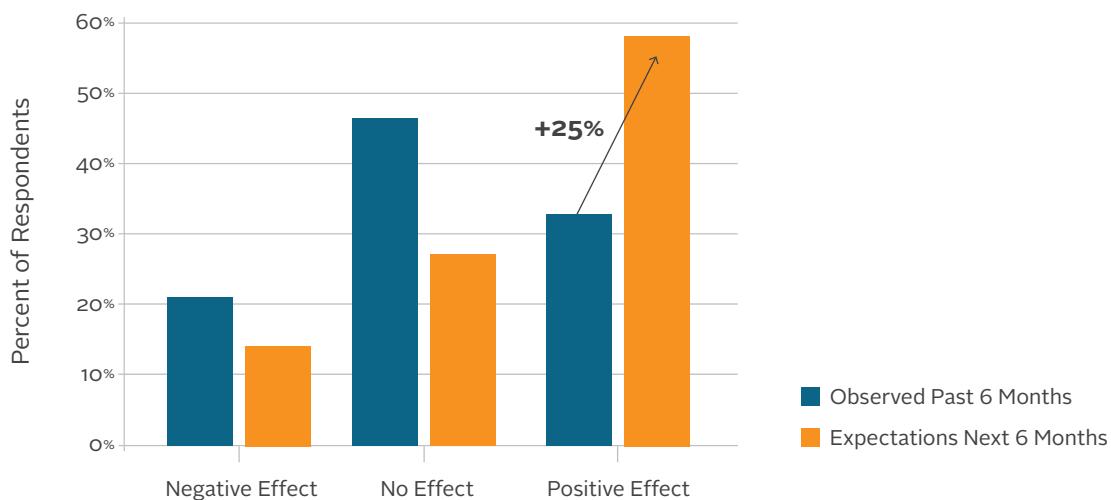
TRADE POLICY

Based on the many pronouncements from and about the Trump Administration renegotiating international trade agreements and imposing trade restrictions, how will California's economy cope with changes in U.S. trade policy? After all, the state is home to the largest port complex in the western hemisphere, and the Logistics industry is a significant employer, with over a half million workers in California. Beyond the Logistics industry itself, there are also countless industries that export their goods (and services), including agriculture, aircraft and computers, computer software, tourism and even Hollywood intellectual property such as movies, television programming and other entertainment products.

The value of California's exports amounted to \$172 billion in 2017, which is equivalent to 6.3 percent of the state's Gross State Product. Many of the industries exporting these goods employ large numbers of workers who create high-value products and services that contribute to the overall economy. While the announced and already-implemented trade restrictions may have an adverse impact on those industries, the impact on the broader California economy is likely to be modest in the near-term, possibly shaving fractional amounts off of the state's overall growth rate. This is not intended to diminish the significance of the potential impact that recent trade restrictions could have on individual sectors of the state economy, but rather address fears that these restrictions may cause a recession.

The value of California's exports amounted to \$172 billion in 2017

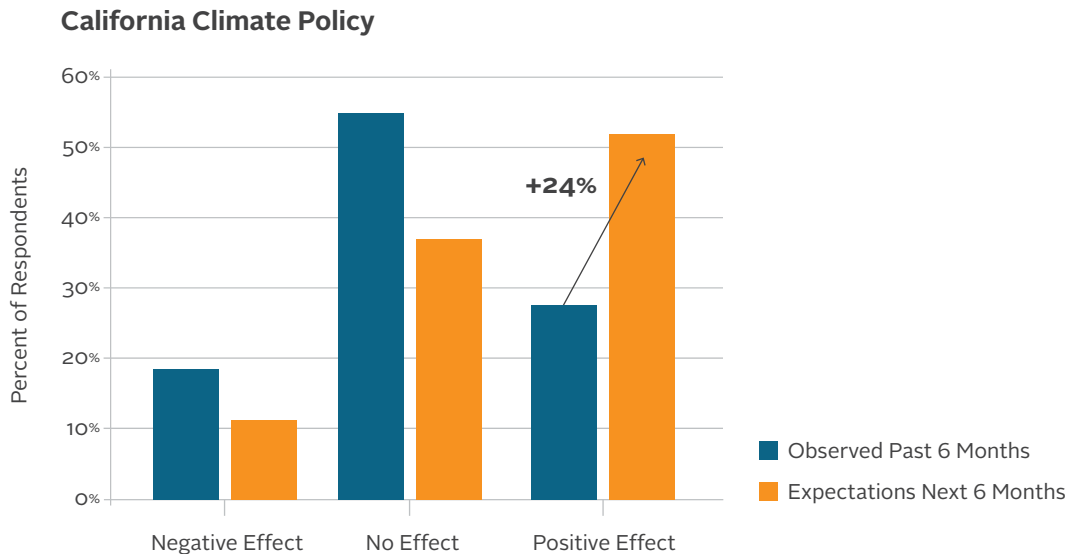
Federal Trade Policy



For the industries in the fall 2018 Small Business Attitudes survey, attitudes about federal trade policy were decidedly mixed. Over the past six months, 32 percent of respondents felt trade policy had a positive effect on their business while 20 percent indicated they believed it had a negative effect. 47 percent noted they had felt no effect over the last six months, however, that number drops to 27 percent as firms look forward.

CALIFORNIA CLIMATE POLICY

A majority (51 percent) of business leaders surveyed in fall 2018 expect California's climate policy to have a positive effect on their firms over the next six months. 37 percent anticipate no effect and only 12 percent anticipate a negative effect, based on survey response. These figures paint a different picture than that of the last six months, for which a majority (55 percent) of business leaders indicated that California's climate policy had no observed effect.

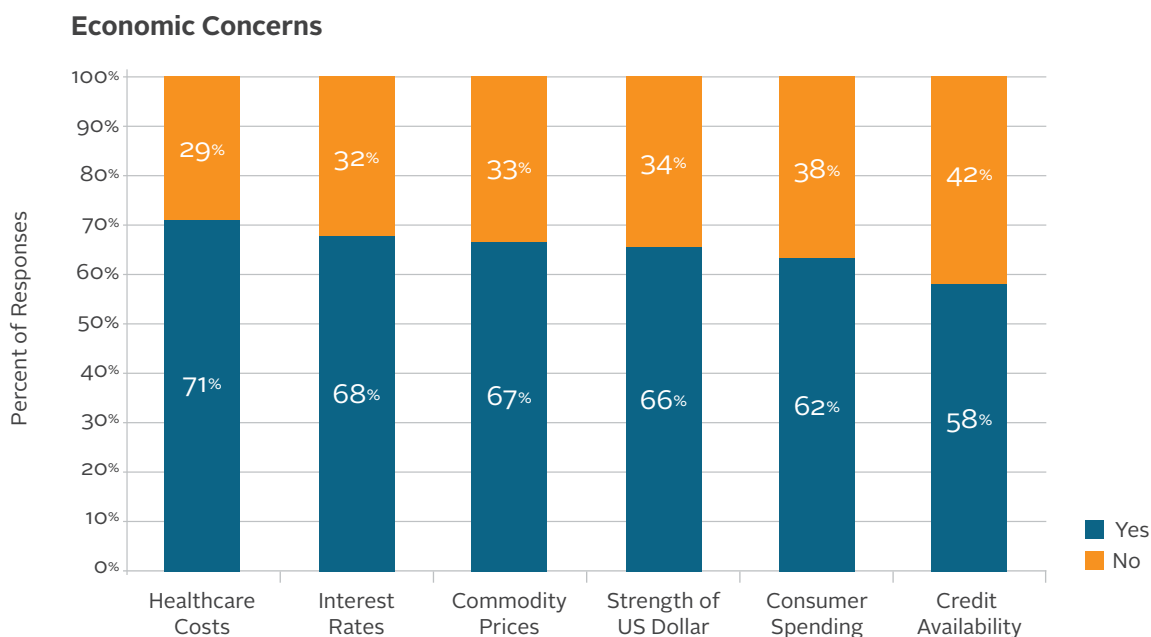


Climate policy has been and resolutely remains a key economic priority for California

While California has quietly led the country on climate policy for some time, the timing of the Global Climate Action Summit held in September 2018 and organized by California governor Jerry Brown reframed the state's leadership on the topic in more global terms. It also signaled to the business community and others that climate policy has been and resolutely remains a key economic priority for California. Summit organizers were keen to demonstrate that climate policy and greener business are not only feasible goals, but lucrative ones. Leaders of some of the world's biggest multinational corporations like Walmart and Unilever were present at the Summit to announce new programs around cleaner supply chains, as a line between "green" and globally competitive was drawn for Summit onlookers.

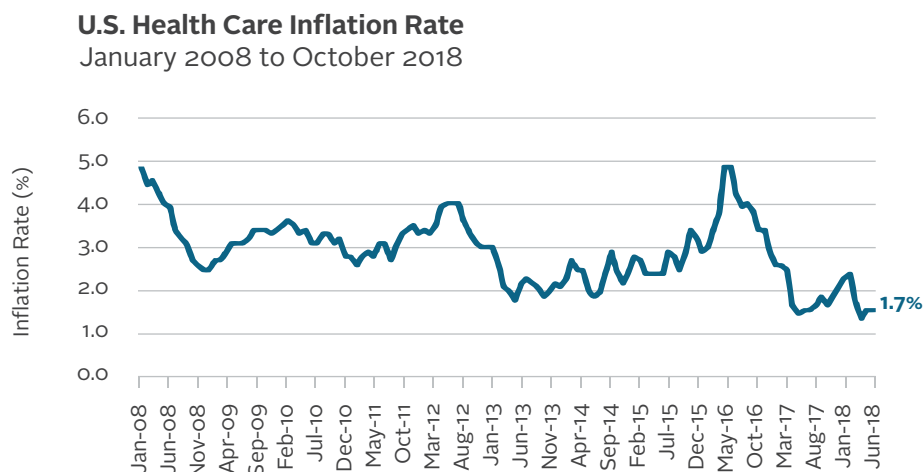
Both the stability of climate policy in California, despite broader instability on the topic, and the high-profile buy-in from public and private sector leaders alike in California may be two factors influencing small business leaders' perception that the state's climate policy is going to be good for business over the next six months.

BROAD ECONOMIC CONCERNS REMAIN FOR SMALL BUSINESS



HEALTHCARE COSTS

Rising healthcare costs continue to put pressure on small business and government budgets. Healthcare expenditures are expected to continue rising, and 68 percent of respondents expressed concern about the impact of healthcare costs on their small business.

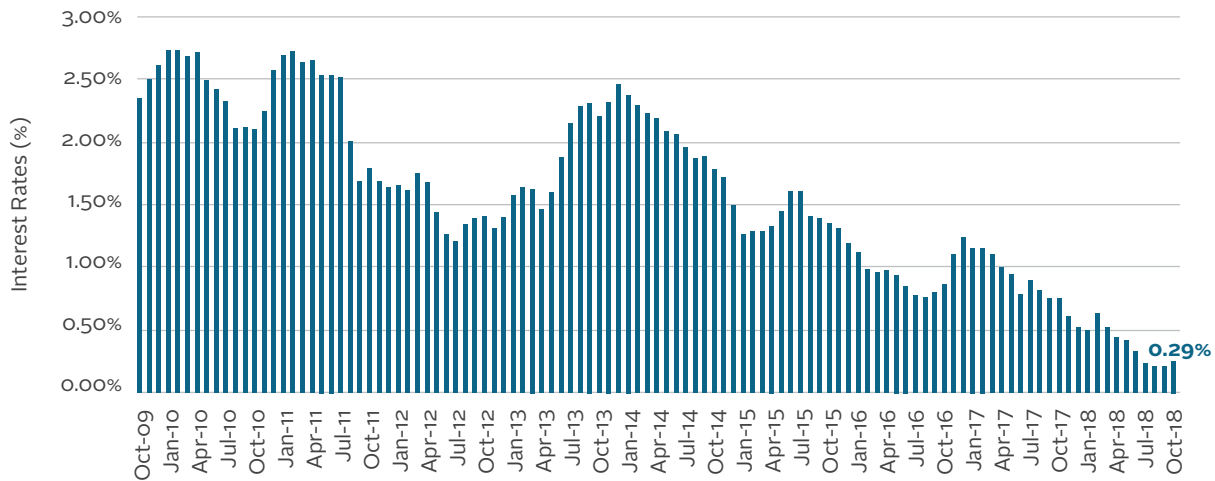


INTEREST RATES

The continued improvement of the U.S. economy over the past few months is likely to keep the Fed's interest rate policy of tightening the interest rate. 70 percent of respondents noted they had concerns about recent trends in interest rates.

10-Year Treasury (Minus 2-Year) Constant Maturity Interest Rates

October 2009 to October 2018



Source: Federal Reserve Bank of St. Louis

COMMODITY PRICES

Higher interest rates, the strengthening of the U.S. dollar, along with trade disruptions have caused commodity prices to fluctuate. Energy commodity prices increased, while non-energy commodities declined in the third quarter of 2018. 67 percent of fall 2018 survey respondents expressed concern about commodity prices over the next six months.

Crude Oil Prices

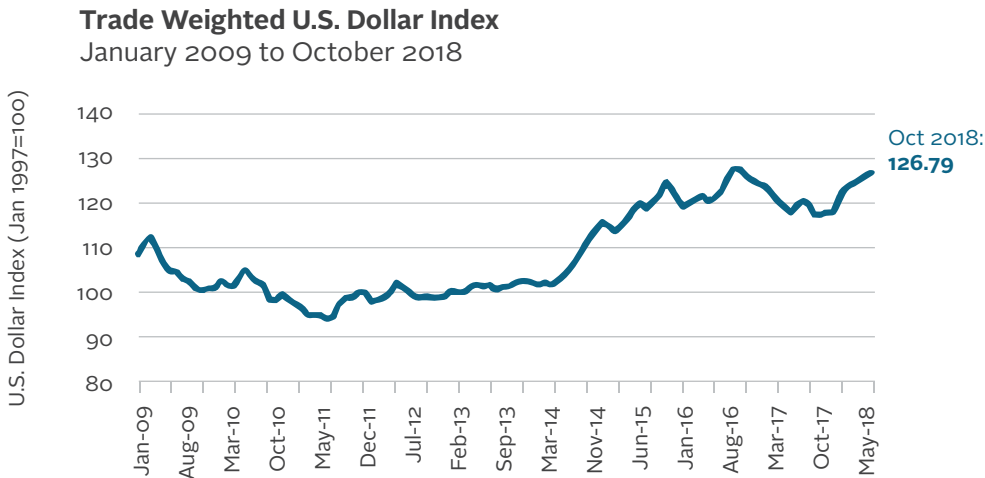
January 2009 to October 2018



Source: Federal Reserve Bank of St. Louis

STRENGTH OF THE U.S. DOLLAR

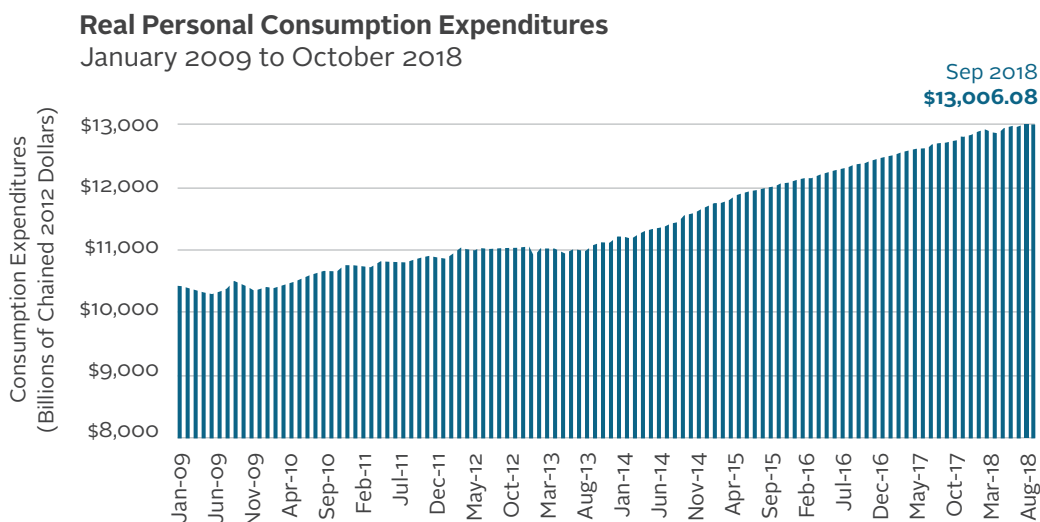
Strengthening of the U.S. dollar has placed pressure on exports as they become more expensive.



Source: Board of Governors of the Federal Reserve System

CONSUMER SPENDING

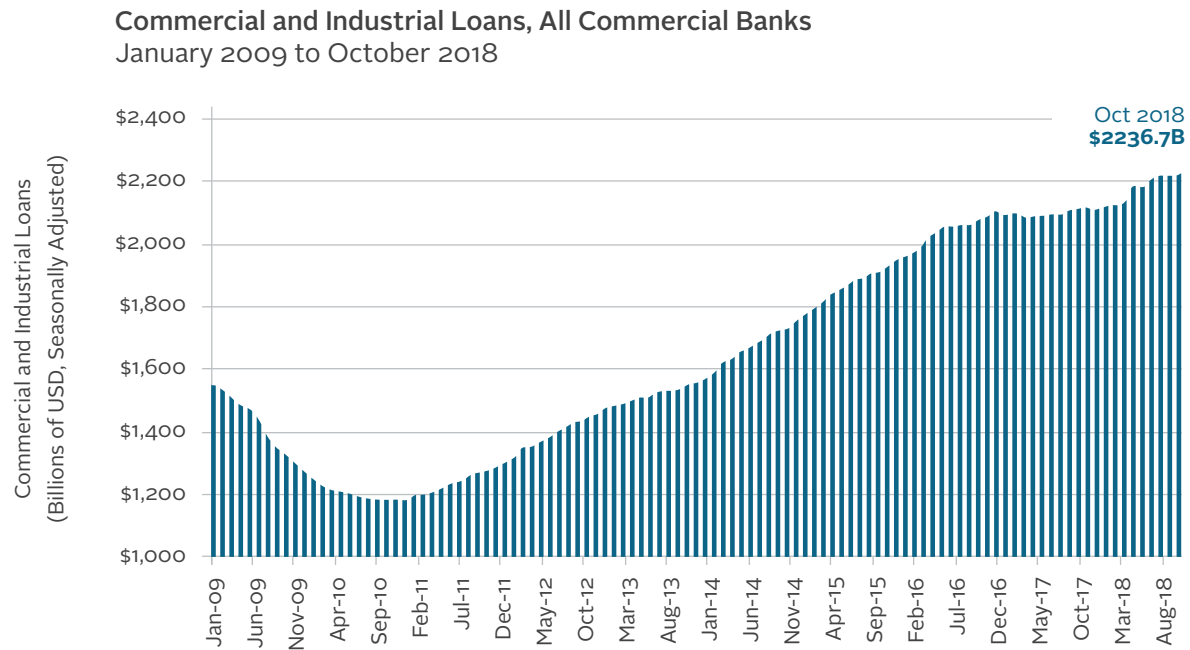
Increased wages and employment gains are likely to continue pushing consumer spending up—which has been a large driver in GDP growth.



Source: Federal Reserve Bank of St. Louis

CREDIT AVAILABILITY

While loan growth is expanding, credit availability still remains tight compared to levels in the early 2000s. Respondents were more mixed in concerns over credit availability in the next six months— 62 percent expressed concern, while 38 percent didn't see it as an immediate worry.



Source: Federal Reserve Bank of St. Louis



METHODOLOGY

The fall 2018 survey had a sample size of 150 respondents: 30 respondents each from industries of NAICS identification 51, 52, 53, 54 and 56.

NAICS 54

Professional, Scientific and Technical Services

- Offices of Lawyers
- Offices of Certified Public Accountants
- Other Accounting Services
- Architectural Services
- Landscape Architectural Services
- Engineering Services
- Interior Design Services
- Graphic Design Services
- Custom Computer Programming Services
- Computer Systems Design Services
- Administrative Management and General Management Consulting Services
- Marketing Consulting Services
- Advertising Agencies
- Public Relations Agencies

NAICS 52

Finance and Insurance

- Commercial Banking
- Securities Brokerage
- Portfolio Management
- Investing Advice
- Insurance Agencies and Brokerages

NAICS 53

Real Estate Rental and Leasing

- Lessors of Residential Buildings
- Lessors of Nonresidential Buildings
- Offices of Real Estate Agents and Brokers

NAICS 56

Administration

- Office Administration

NAICS 52

Information

- Motion Picture & Video Production
- Motion Picture & Video Distribution
- Teleproduction & Other Postproduction Services
- Other Motion Picture & Video Industries
 - Bookings agencies, motion picture
 - Bookings agencies, motion picture or video productions
 - Film libraries, motion picture or video, stock footage
 - Film processing laboratories, motion picture
 - Film restoration services
 - Laboratory services, motion picture
 - Libraries, motion picture stock footage film
 - Libraries, videotape, stock footage
 - Motion picture bookings agencies
 - Motion picture film laboratories
 - Motion picture film libraries, stock footage
 - Motion picture film reproduction for theatrical distribution
 - Motion picture laboratories
 - Reproduction of motion picture films for theatrical distribution
 - Stock footage of film libraries
 - Videotape libraries, stock footage
- Data Processing, Hosting & Related Services

Respondents were CEO level or equivalent: COO, CFO, managing partner or similar. All respondents were from businesses with 20 to 150 employees and a physical office in the City of Los Angeles. Surveys were conducted in English and fielded on October 29, 2018; results were compiled on November 13, 2018.



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