

Economics Group

Special Commentary

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Cleveland: Things Are Starting to Look Up

Cleveland’s economy has faced a constant stream of challenges over the past few decades, which has left the area with modest gains in good times and outsized job losses when national economic conditions weakened. The region’s factory sector has lost 90,000 jobs since the early 1990s and the resulting loss of income has made it much more difficult for the metro area to gain solid momentum. In fact, nonfarm payrolls remained flat in Cleveland during much of the past decade, even as the economy grew solidly across much of the country.

Employment growth remains exceptionally modest today but appears to be taking a turn for the better. The nearly simultaneous announcements that Cleveland will host the 2016 Republican National Convention and that LeBron James would rejoin the Cleveland Cavaliers NBA team has lifted spirits in the area and helped focus attention on the more positive attributes of Northeast Ohio. The region’s manufacturing sector is also showing signs of regaining its footing. Manufacturing accounted for nearly half of all job gains during the first two years of the recovery, reflecting improvement in the region’s automotive and steel industries. Hiring in Cleveland’s factory sector has moderated more recently but is still up 1.1 percent over the past year.

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More growth appears to be on the way. Team Northeast Ohio, a site selection consultancy, recruited a record high 16 new or expanded operations during 2013, including expansions by Nestle USA, Six C Fabrications, Pepperidge Farm and Cristal USA. Although manufacturing still plays an outsized role in the region’s economy, it is unlikely to be the primary engine of growth. Factory jobs provide Cleveland with a steady base of relatively well-paying jobs. Northeast Ohio is well positioned to benefit from the growth in the region’s energy exploration business, provided local steel producers can compete with low-cost imports. The U.S. Department of Commerce recently placed duties on imports of tubular steel from South Korea and eight other nations.

Figure 1

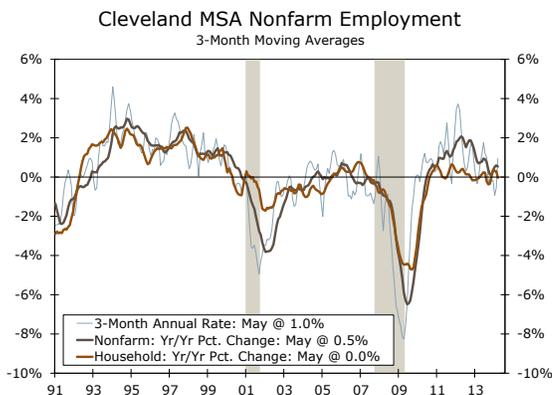
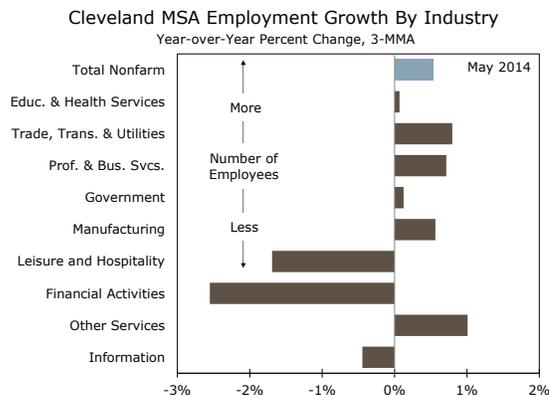


Figure 2



Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Together we'll go far



While nearly every discussion of Cleveland’s economy starts with its historically important manufacturing sector, the two largest drags on the local economy more recently have been financial services and the leisure and hospitality sector. Financial services have faced some temporary setbacks with sizable layoffs at Bank of America. Job losses in the leisure and hospitality sector are likely more temporary and may have been adversely affected by the harsh winter weather. Both industries appear poised to rebound as a broader economic recovery takes hold and fuels local demand. Of course, the leisure and hospitality industry also stands to benefit from the return of LeBron James and preparations for the Republican National Convention.

High Visibility Events Help Focus Attention on the “New” Cleveland

Cleveland is capitalizing on its current strengths and leaders are working to redevelop the metro area as a destination for businesses and tourists alike. The flurry of construction in downtown Cleveland is a testament to these efforts. More than \$400 million of projects, including a new convention center, which was completed at the end of 2013, highlight the growing optimism in the region. The new convention center is encouraging other new projects, including a new 31-story, 600-room Hilton hotel that will employ about 2,800 construction workers during the building phases and eventually 450 full-time hotel and related staff.

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Downtown Cleveland is quickly becoming a popular destination for events and conventions, including the Republican National Convention, which will be held in the area in 2016. The event will bring thousands of visitors to the region and provide Cleveland with a national platform to showcase the region’s renaissance. In addition to the potential political advantages of bringing the RNC to Cleveland, the region’s low costs, ample venue space, including stadiums, lakefront property and tourist attractions like the Rock and Roll Hall of Fame, all make Cleveland an attractive place for such large-scale conventions. Cleveland will also host the Gay Games this August, which will attract thousands of visitors and also take advantage of the metro area’s numerous facilities and attractions.

While hosting high-profile events focuses a great deal of positive attention on the region, the loss of Cleveland’s hub status may deter some would-be travelers who will now require a connecting flight. United closed its small hub in Cleveland back in June, reducing its local flights from 200 per day to around 72. Easy access had been a key selling point for businesses looking to relocate or setup new operations in an area. Without a major airline hub, Cleveland faces an even greater uphill battle. Other airlines have added flights to the region, however, which may limit the sting.

Figure 3

Cleveland Leisure & Hospitality Employment



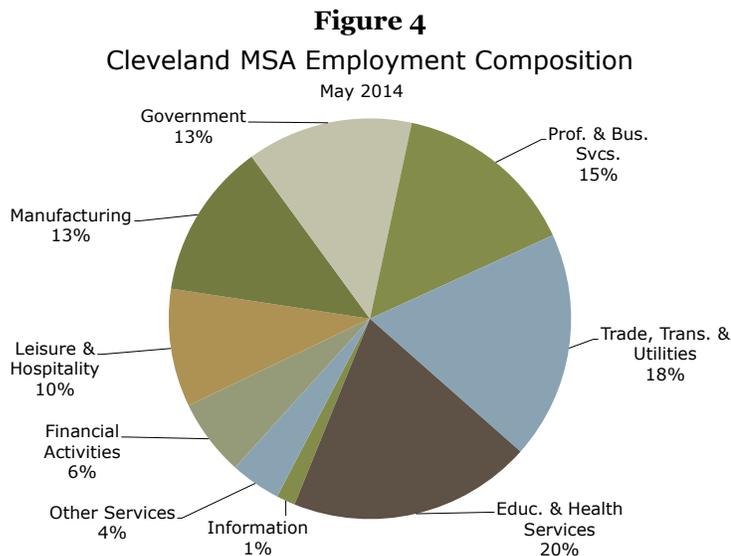
Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Health Care Hits a Bump in the Road but Keeps Going

Health care remains the most important industry for Cleveland but has faced some headwinds more recently, with new regulations pressuring health care providers to reduce costs. Employment in health care has been essentially flat over the past year, showing just how difficult things have gotten. The Cleveland Clinic, which has about 40,000 employees and is the largest single employer in the metro area, laid off 200 workers, sent 700 into early retirement, and is not filling 500 open positions in an effort to trim \$330 million from its budget.

Demographics remain favorable for the industry. Cleveland's older and aging population will inevitably demand more health services than it does presently and a rise in the number of insured patients should theoretically help the large hospitals in the area capture more revenue. In addition, the Global Health Center for Innovation, which was built adjacent to the convention center, is specially designed to showcase the region's many innovations in the medical field. Future growth will come from better capitalizing on the expertise that is already present in Cleveland. Local area health care startups attracted about \$200 million in investment over the past two years and are contributing to the strong growth in professional, scientific and technical services employment, which includes research and development positions.

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Source: U.S. Department of Labor and Wells Fargo Securities, LLC

Home Prices Rise Though Sales Slump

With only a modest improvement in the labor market, home sales have struggled and are even lower today than they were a year ago. The decline reflects a modest rise in interest rates, still tight credit underwriting and a decline in investor demand amid fewer available distressed homes. While sales have moderated, home prices continue to improve. The most recent data from CoreLogic show home prices rising 6.2 percent over the past year. Prices still have a long way to go to reach their prerecession level and are currently 18.0 percent below that previous peak. A large proportion of homeowners still owe more on their mortgage than their home is worth, with 23.9 percent of homes with a mortgage currently in a negative equity position. This is well above the national average and has shown no signs of improvement over the past nine months.

Demand for apartments remains very strong, driving the vacancy rate down to 3.0 percent. The low apartment vacancy rate has not spurred a great deal of new construction. Rents are still relatively low and large national apartment developers are still primarily focusing on high-growth markets. That said, there has been increased apartment development activity in and around

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downtown Cleveland, as older properties have been redeveloped and new projects have been added along the Cuyahoga River.

Figure 5

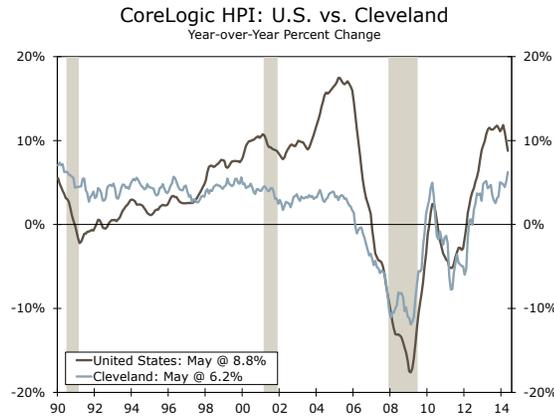
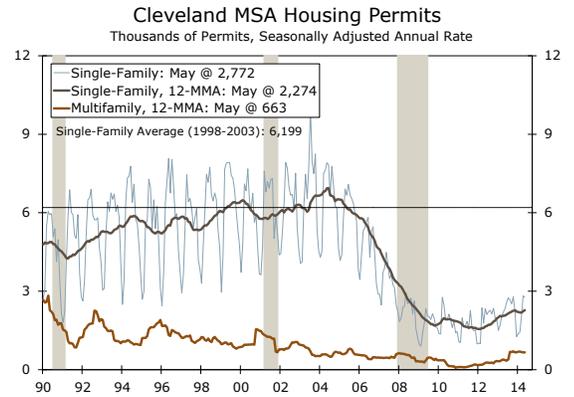


Figure 6



Source: CoreLogic, U.S. Department of Commerce and Wells Fargo Securities, LLC

Summary and Outlook

Northeast Ohio fell on hard times as the nation’s manufacturing sector endured tough times. Rebalancing takes time and even after an economy has been repositioned it often takes some time for those outside the region to take notice. Cleveland finally appears to be catching a break. The recent selection of Cleveland to host the 2016 Republican National Convention, which was followed quickly by LeBron James’ decision to come back to the Cavaliers, has brought a wave of positive national attention. The action should provide the region an opportunity to showcase the revival of downtown Cleveland and the waterfront, which has been reinvigorated by more than \$4.5 billion in new investment over the past five years.

Changes to Cleveland’s economy are more than cosmetic. The industrial sector has been bolstered by the recovery of the nation’s motor vehicle industry and other parts of the factory sector are doing better as well. The region has also become more diverse. The biomedical industry has recovered its losses from the recession and account for a larger share of the economy. Despite recent downsizing at the Cleveland Clinic and cost cutting in the industry in general, the longer-run trajectory should be a positive one, thanks to additional health care coverage and an aging population. More jobs could result from new facilities meant to foster innovation in the industry. Cleveland should also see more growth in its leisure and hospitality sector. The region is adding new hotels ahead of the RNC and continues to see new entertainment venues open along the waterfront.

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