Southeast Minnesota
Economic and Business Conditions Report
Third Quarter 2018

This issue is part of a series for the six planning areas of Minnesota –
Central, Northeast, Northwest, Southeast, Southwest, and Twin Cities.
The Southeast Minnesota Planning Area consists of 11 counties:
Dodge, Fillmore, Freeborn, Goodhue, Houston, Mower, Olmsted, Rice, Steele, Wabasha, and Winona.

Office of the Minnesota
Secretary of State

School of Public Affairs
Research Institute
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EXECUTIVE SUMMARY

Solid economic growth over the next several months is expected in the Southeast Minnesota planning area according to the prediction of the Southeast Minnesota Index of Leading Economic Indicators (LEI). The leading index rose by 3.33 points in the third quarter as four index components recorded positive values. An increase in the number of Rochester area residential building permits and fewer initial jobless claims helped drive the LEI higher in the third quarter. In addition, an improvement in consumer sentiment and an increase in new filings of incorporation and LLC also made a favorable impact on the leading index. The Minnesota Business Conditions was the only index component to weigh negatively on the LEI in the third quarter.

There were 880 new business filings with the Office of the Minnesota Secretary of State in Southeast Minnesota in the third quarter of 2018 — representing an 11.1 percent increase from one year ago. 49 new regional business incorporations were filed in the third quarter, 7.5 percent fewer filings than prior year levels. At a level of 583, third quarter new limited liability company (LLC) filings in Southeast Minnesota were 26.5 percent higher than in the third quarter of 2017. With 208 filings, new assumed name activity was 10 percent below what was seen in the same quarter last year. There were seven fewer new filings for Southeast Minnesota non-profit over the last three months compared to one year earlier.

Sixty-one percent of new business filers in the Southeast Minnesota planning area completed the voluntary Minnesota Business Snapshot (MBS) survey in this year's third quarter. Results of this voluntary survey indicate that 7.8 percent of new filers come from communities of color and 6.7 percent are veterans. Only 2.6 percent of new filers come from the disability community and 4.7 percent of new filings are made by the immigrant community. Forty-three percent of new business filings in Southeast Minnesota in this year's third quarter were initiated by women. MBS results also show that most new business filers in Southeast Minnesota have between 0 and $10,000 in annual gross revenues (although 45 new filers have revenues in excess of $50,000). The most popular industries for new businesses in Southeast Minnesota are retail trade, real estate/rental/leasing, construction and other services. Employment levels at most new firms are between 0 and 5 workers, and one-half of those starting a new business consider this a part-time activity.

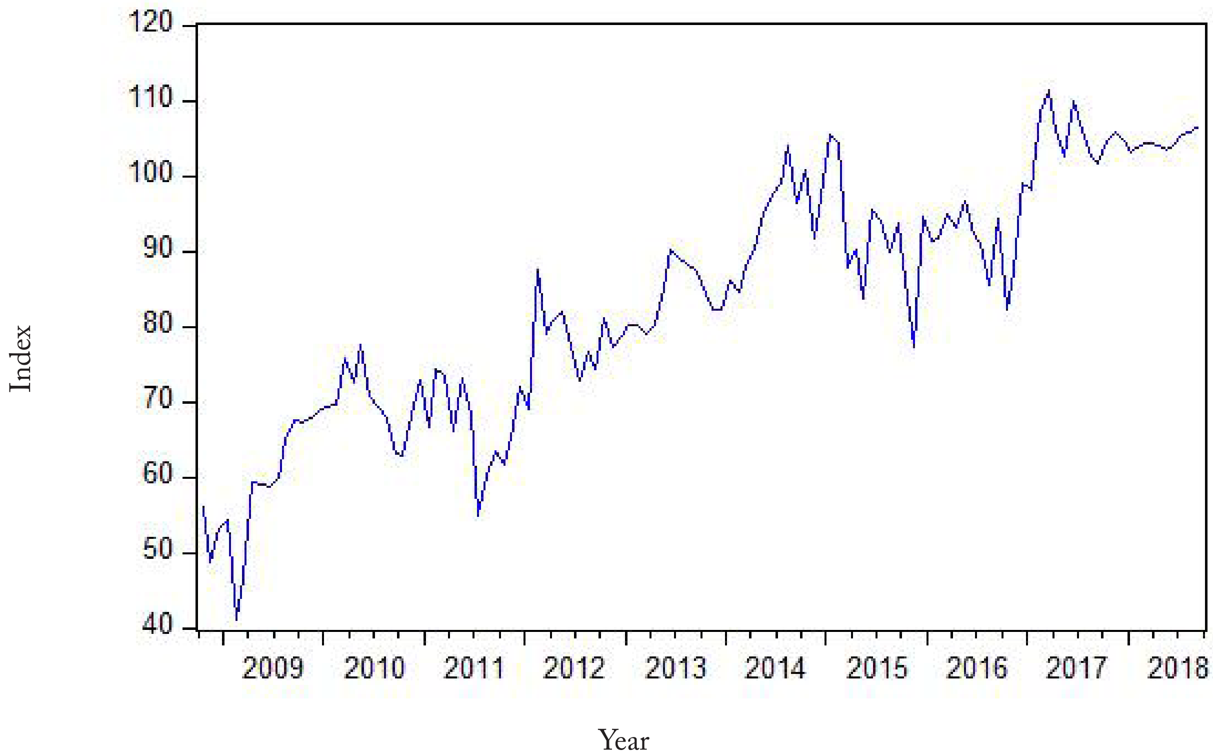
Employment of Southeast Minnesota residents declined by 0.3 percent over the year ending September 2018. The regional unemployment rate was 2.1 percent in September, well below the 2.6 percent level recorded one year earlier. Initial claims for unemployment insurance in September 2018 fell by 10.3 percent from one year earlier and the Southeast Minnesota labor force decreased by 0.8 percent. The job vacancy rate in Southeast Minnesota remains elevated as labor shortages continue to plague this region of the state. The planning area's annual bankruptcies were 11.8 percent higher than one year ago.

Data from the Rochester area—the largest market in Southeast Minnesota—were mixed. A small increase in overall employment, a lower unemployment rate, a larger labor force, higher overall new business filings, declining initial jobless claims, and a larger valuation of residential building permits favorably impacted the city's outlook. On the negative side was a year-over-year decline in education/health and manufacturing sector employment, lower average hourly earnings, and a reduction in average weekly work hours.

SOUTHEAST MINNESOTA LEADING ECONOMIC INDICATORS INDEX

The SCSU Southeast Minnesota Leading Economic Indicators (LEI) index is designed to predict performance of the regional economy with a four-to-six month lead time. The LEI finished 3.33 points higher in the third quarter, and is now 3.6 percent above its level of one year earlier. As can be seen in the accompanying figure, the LEI has flattened out in recent quarters. While Rochester MSA education/health sector employment has declined in recent months (and initial jobless claims increased earlier in the year), overall fundamentals in the Southeast economy appear to remain strong, so the recent levelling out of the LEI should not cause major concerns about longer-term economic performance in this region. It should be noted that the labor force is declining in this planning area (which is constraining employment growth) and annual bankruptcies rose at a double-digit rate in the third quarter.

SCSU Southeast Minnesota Index of Leading Economic Indicators (December 1999 = 100)



Components of SCSU Southeast Minnesota Leading Economic Indicators Index

Component of Index	Contribution to LEI, 3rd quarter 2018	Contribution to LEI, 2nd quarter 2018
Minnesota Business Conditions Index	-2.48	-1.32
Southeast Minnesota initial claims for unemployment insurance	0.32	4.80
Southeast Minnesota new filings of incorporation and LLCs	2.44	-1.58
Rochester MSA residential building permits	1.92	1.68
Consumer Sentiment, University of Michigan	1.13	-1.90
TOTAL CHANGE	**3.33**	**1.67**

Four components of the LEI had a positive reading in the third quarter. A rise in Rochester area residential building permits and a reduction in regional initial jobless claims helped lift the leading index. A strengthening of consumer sentiment and an increase in new filings of incorporation and LLC also helped improve the region's outlook. The Minnesota Business Conditions Index (compiled by Creighton University), which serves as a general measure of statewide business conditions, was the only indicator with a negative value in this quarter's index.

SCSU Southeast Minnesota Leading Economic Indicators Index

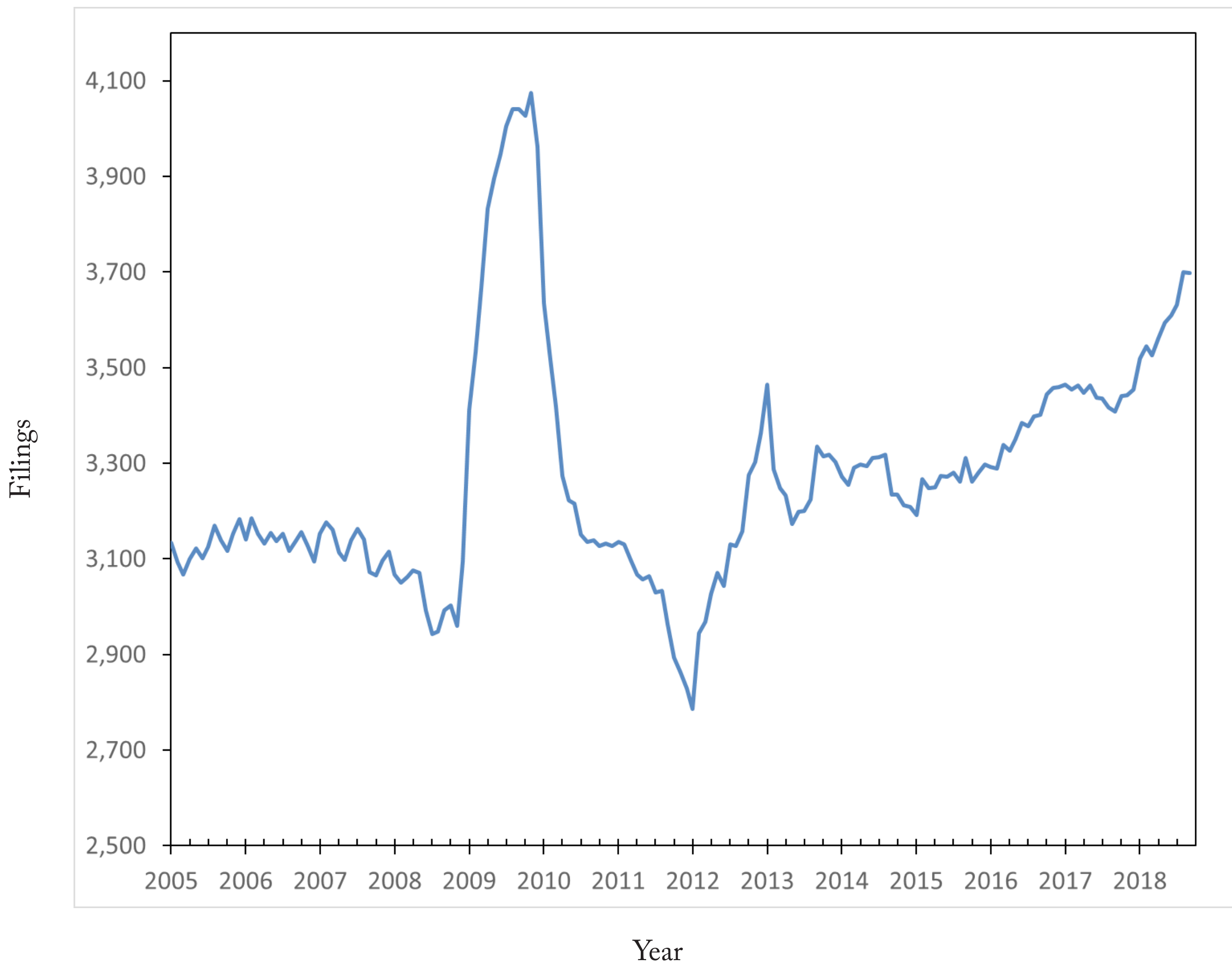
	2018	2017	Percentage change
Minnesota Business Conditions Index September	54.9	59.4	-7.6%
Southeast Minnesota initial claims for unemployment insurance September	733	817	-10.3%
Southeast Minnesota new filings of incorporation and LLCs Third Quarter	632	514	23.0%
Rochester MSA single-family building permits September	42	40	5.0%
Consumer Sentiment, University of Michigan September	100.1	95.1	5.3%
Southeast Minnesota Leading Economic Indicators Index September (December 1999 = 100)	108.5	104.7	3.6%

SOUTHEAST MINNESOTA BUSINESS FILINGS

Third quarter new business filings rose 11.1 percent to a level of 880. As can be seen in the accompanying graph, the 12-month moving total of new business filings in Southeast Minnesota has generally trended upward since the beginning of 2012. The abrupt increase in new filings in the middle of 2008 is largely a result of increased new LLC filings. This outlier (resembling a shark fin) is related to considerably higher filings in the construction industry due to legal and regulatory issues and appears to be a one-time only transitory event seen in the data in all regions of Minnesota.

Note: The graphs in this section show the 12-month moving total for the various new business filings in Southeast Minnesota that are registered with the Office of the Minnesota Secretary of State. Doing so removes seasonal patterns in the data.

Total New Business Filings—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2017	IV: 2017	I: 2018	II: 2018	III: 2018	2018 Quarter III: Percent change from prior year
Southeast Minnesota Total New Business Filings	792	844	1,004	970	880	11.1%

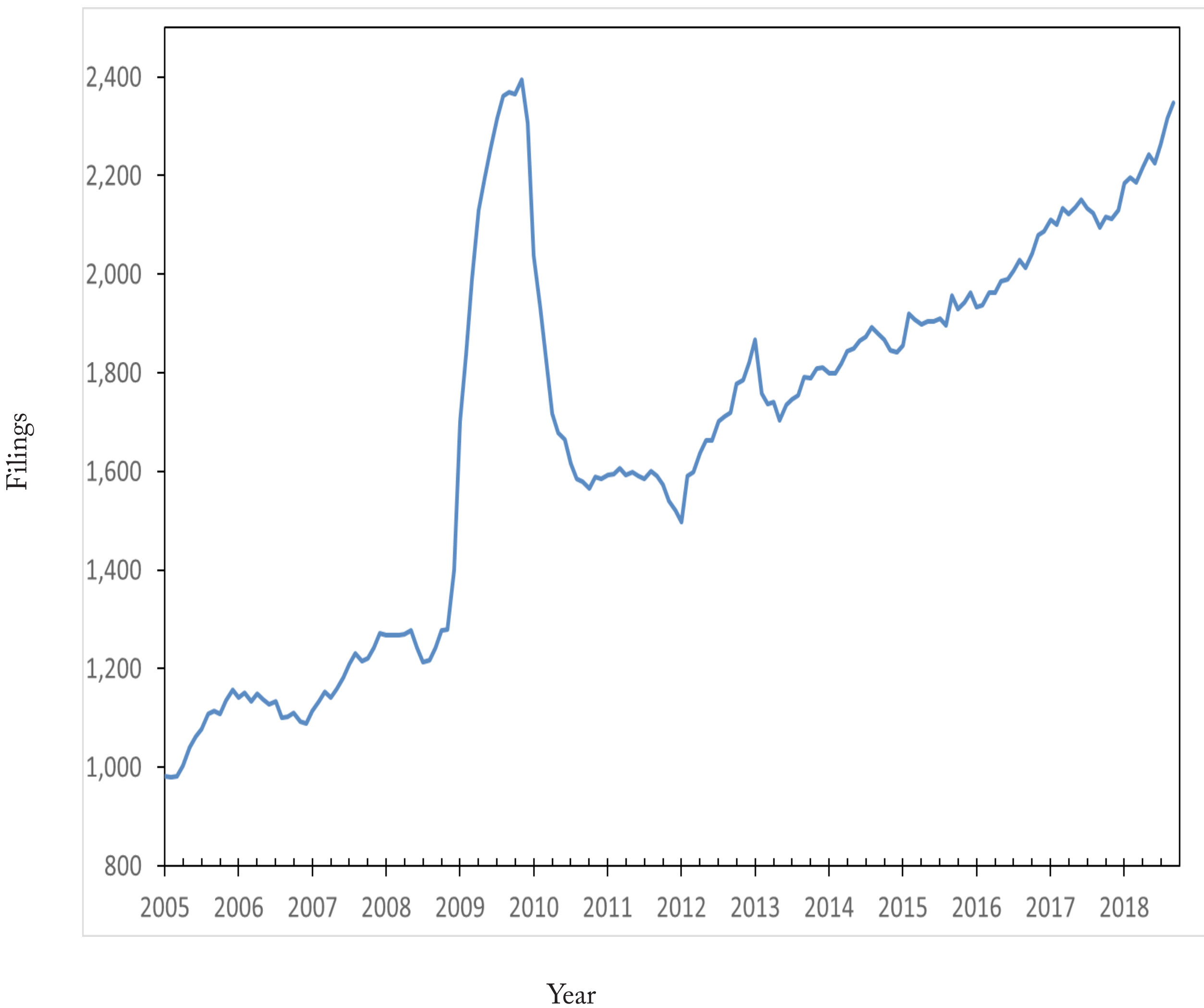
After levelling off for nearly five years, the moving total of new business incorporations once again began to slowly trend downward in Southeast Minnesota at the end of 2016. However, the moving total of new incorporations appears to once again be levelling out in 2018. New filings of incorporation actually fell by 7.5 percent compared to one year earlier in the third quarter.

New Incorporations—Southeast Minnesota Planning Area
(12-month moving total)

Quarter	III: 2017	IV: 2017	I: 2018	II: 2018	III: 2018	2018 Quarter III: Percent change from prior year
Southeast Minnesota New Business Incorporations	53	47	64	53	49	-7.5%

There has been a move in Southeast Minnesota, as in all of the state, away from the traditional incorporation form of business organization towards the LLC. While new business incorporations remain an important indicator of new business formation in Southeast Minnesota, LLCs are increasingly useful in evaluating regional economic performance. As seen below, there is a considerable upward trend in LLCs in Southeast Minnesota. With the exception of the outlier period in 2008-2009, new LLC formation has shown a fairly steady rate of growth since 2005. Third quarter LLC filings surged by 26.5 percent over their year earlier level as the 12-month moving total of this series continued to trend upward.

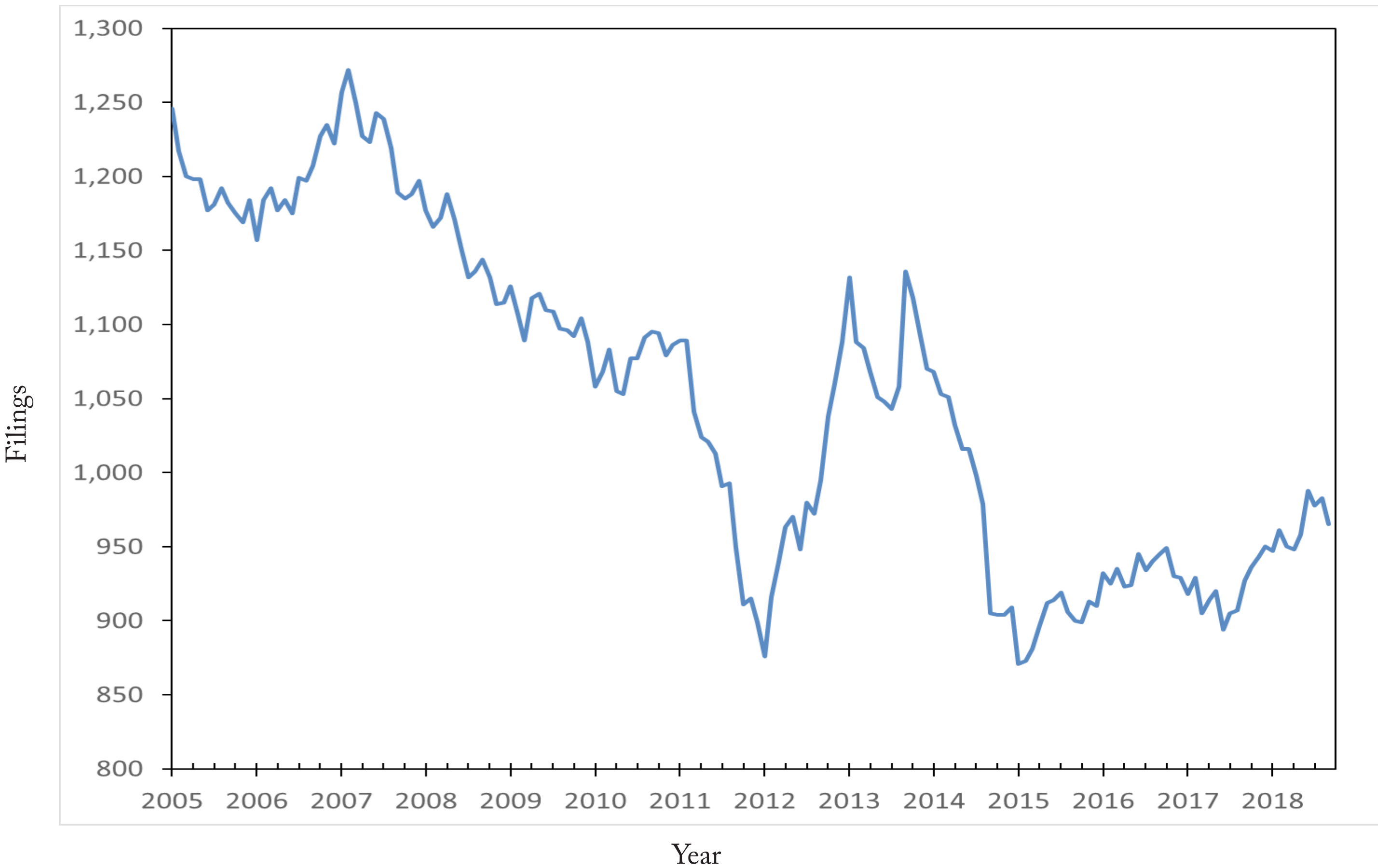
New Limited Liability Companies—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2017	IV: 2017	I: 2018	II: 2018	III: 2018	2018 Quarter III: Percent change from prior year
Southeast Minnesota New Limited Liability Companies	461	528	643	594	583	26.5%

On a year over year basis, assumed names, which include sole proprietors or organizations that do not have limited liability, fell by 10 percent in Southeast Minnesota in the third quarter. As can be seen in the accompanying graph, after increasing in 2012, this series moved downward until the beginning of 2015, at which time it started to slowly increase. The 12-month moving total of assumed names turned down through much of 2017, but has now tended to increase over the past year. The series still remains well below the level observed 10 years ago.

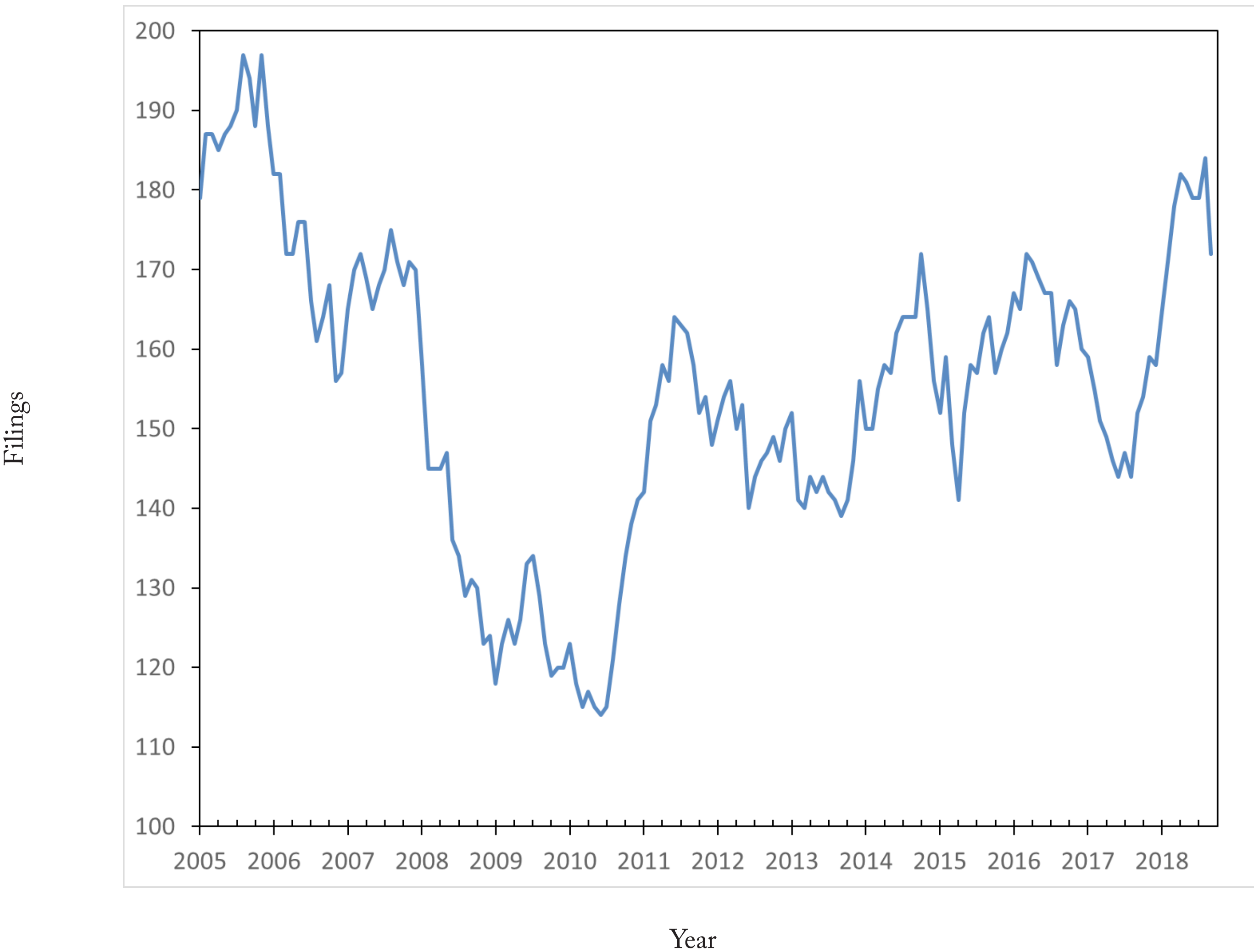
New Assumed Names—Southeast Minnesota Planning Area (12-month moving total)



Quarter	III: 2017	IV: 2017	I: 2018	II: 2018	III: 2018	2018 Quarter III: Percent change from prior year
Southeast Minnesota New Assumed Names	231	228	246	283	208	-10.0%

The moving total of new Southeast Minnesota non-profits registered with the Office of the Minnesota Secretary of State has been volatile over the past several years. As can be seen in the accompanying graph, this series had turned downward since the beginning of 2016, but has recently moved upward. The number of newly formed non-profits totaled 40 in the recent quarter (a 14.5 percent decrease over the third quarter of 2017).

New Non-Profits—Southeast Minnesota Planning Area (12-month moving total)



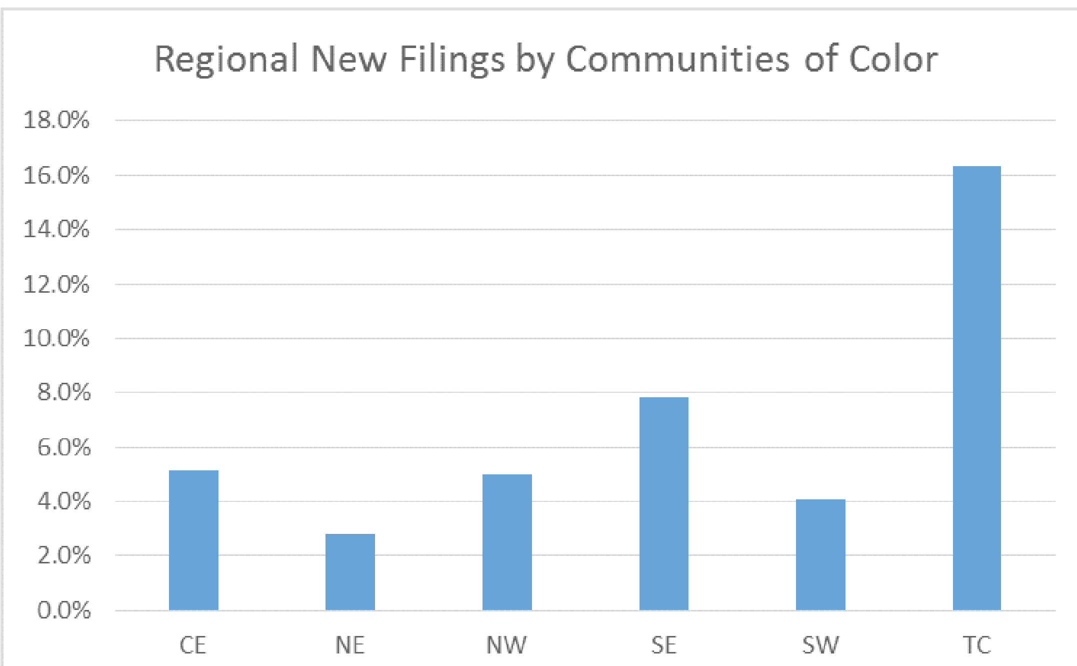
Quarter	III: 2017	IV: 2017	I: 2018	II: 2018	III: 2018	2018 Quarter III: Percent change from prior year
Southeast Minnesota New Non-Profits	47	41	51	40	40	-14.5%

MINNESOTA BUSINESS SNAPSHOT SURVEY RESULTS

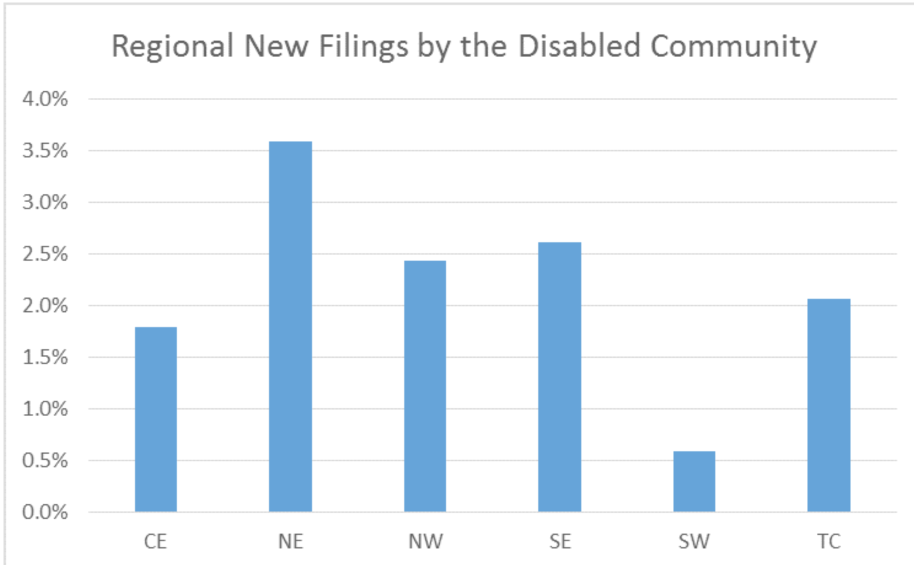
In Fall 2016, the Office of the Minnesota Secretary of State initiated a short voluntary survey (known as Minnesota Business Snapshot) for both new and continuing business filers. Questions found in the survey address basic questions related to the background of business filers, industry classification, employment levels and annual revenue of the filer, and whether the business is a full- or part-time activity for the filing entity. While a comprehensive analysis of this promising new data set is the beyond the scope of this regional economic and business conditions report, the survey results do provide useful additional background information to complement the business filing data.

To match up the Minnesota Business Snapshot (MBS) information with the data analyzed in this report, only surveys accompanying new filings in the third quarter of 2018 are analyzed. For the entire State of Minnesota, the overall response rate for this voluntary survey is approximately 61 percent. This yields thousands of self-reported records in this emerging data set. For Southeast Minnesota, 61 percent of new business filers also completed at least some portion of the MBS survey. The results are reported in this section.

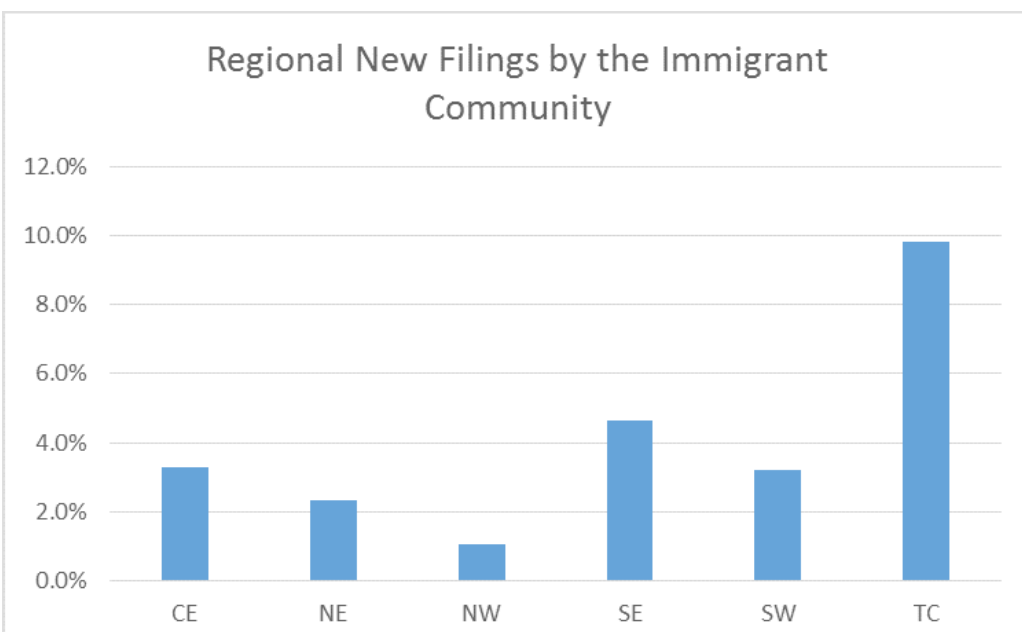
About 7.8 percent of those new filers completing the MBS from the Southeast Minnesota planning area report being from a community of color. This is a considerably lower percentage than in the Twin Cities, but is higher than all other outstate regions of Minnesota.



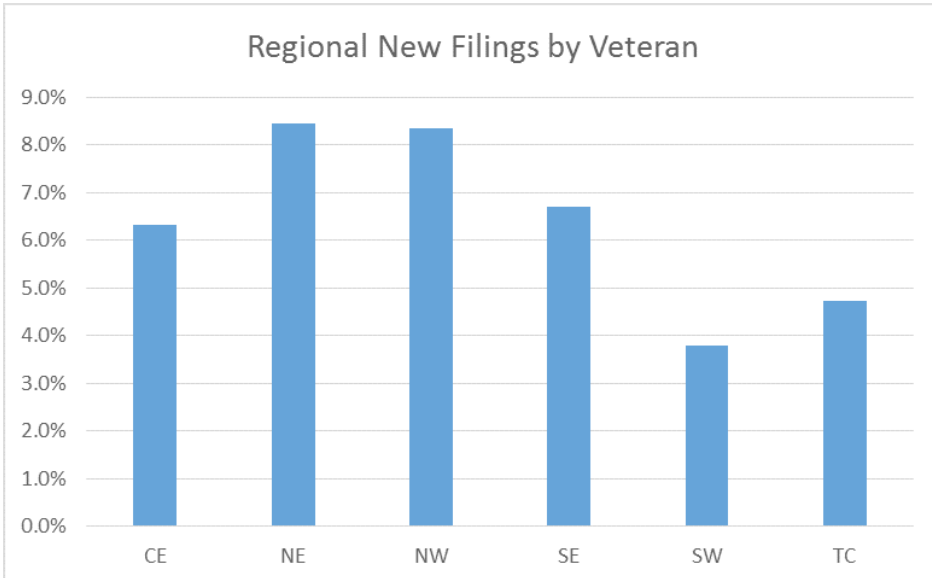
Only 2.6 percent of Southeast Minnesota's new filers are from the disability community.



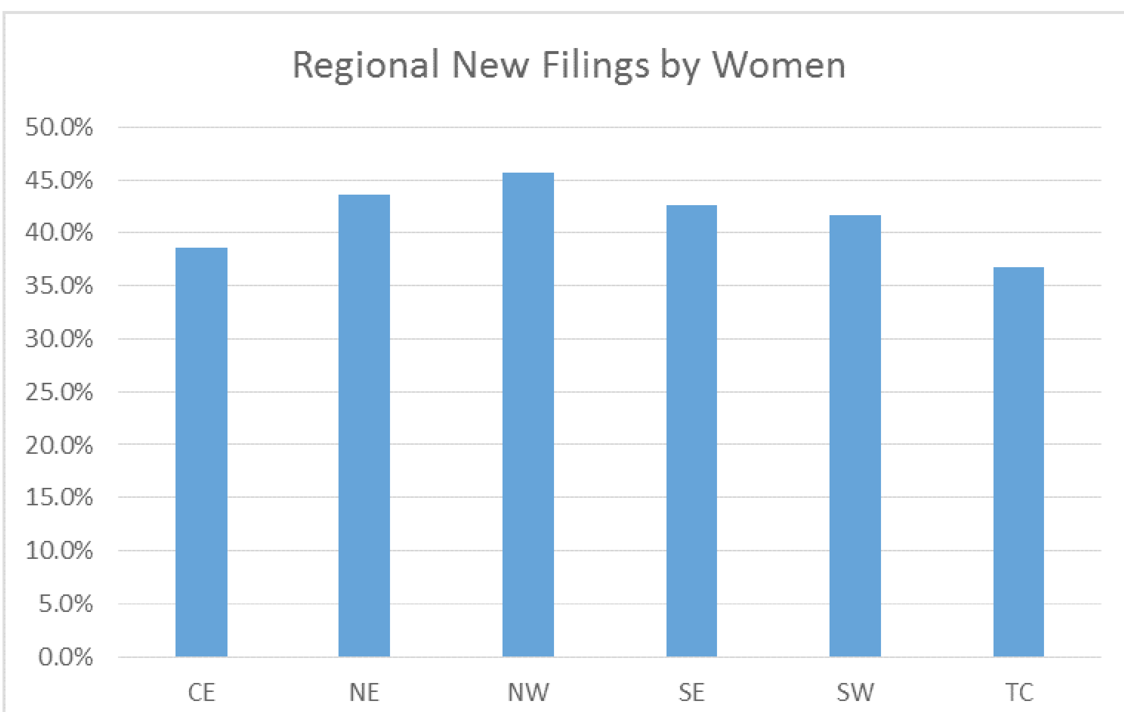
4.7 percent of new business filings in Southeast Minnesota come from the immigrant community. This is a larger percentage than is found in most other portions of the state.



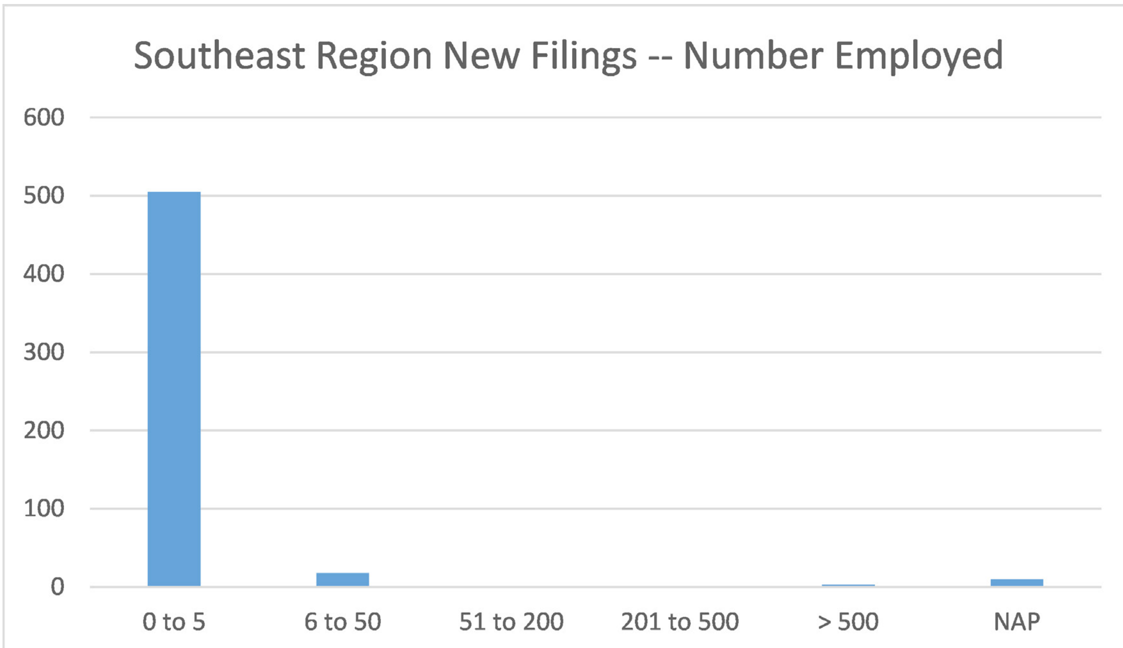
6.7 percent of new filings in Southeast Minnesota come from military veterans.



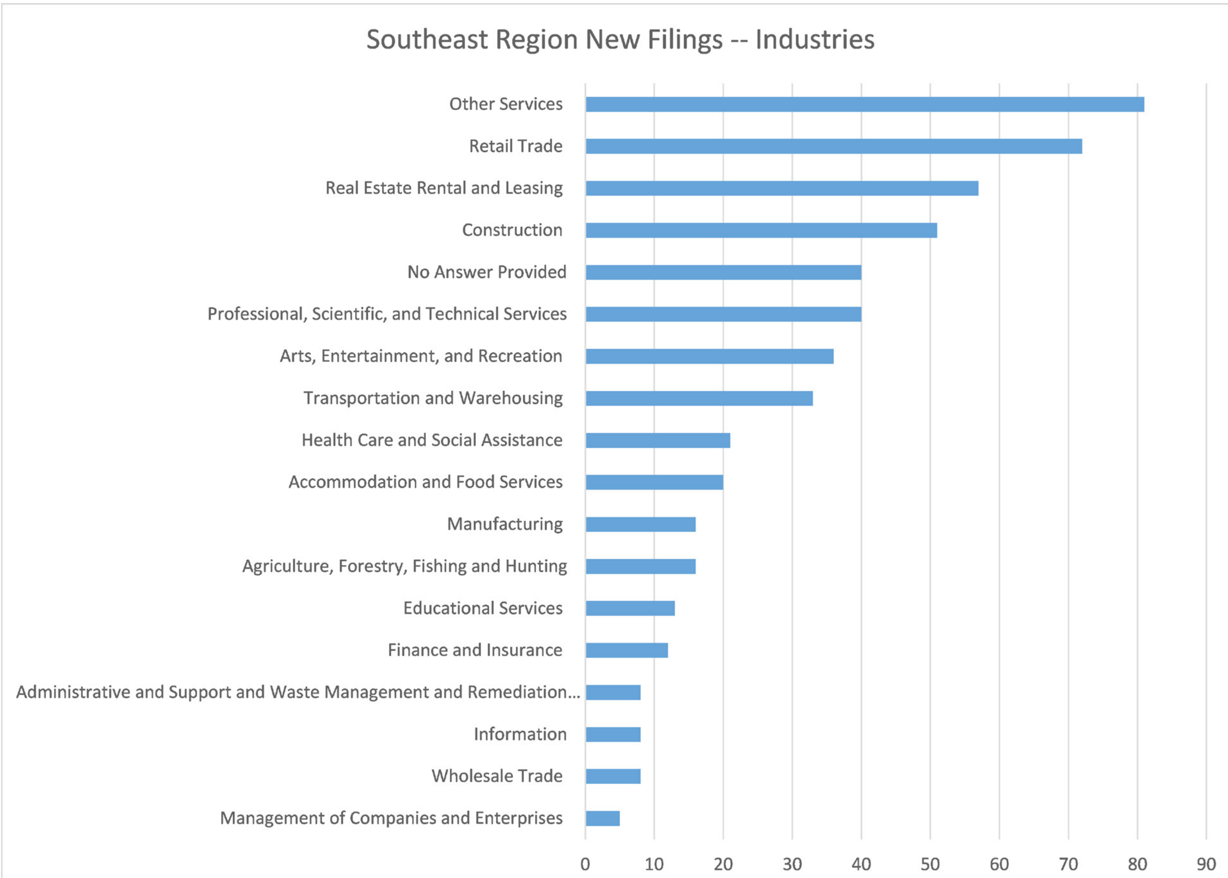
Woman owners represented 42.6 percent of the new business filings in Southeast Minnesota in the third quarter of 2018.



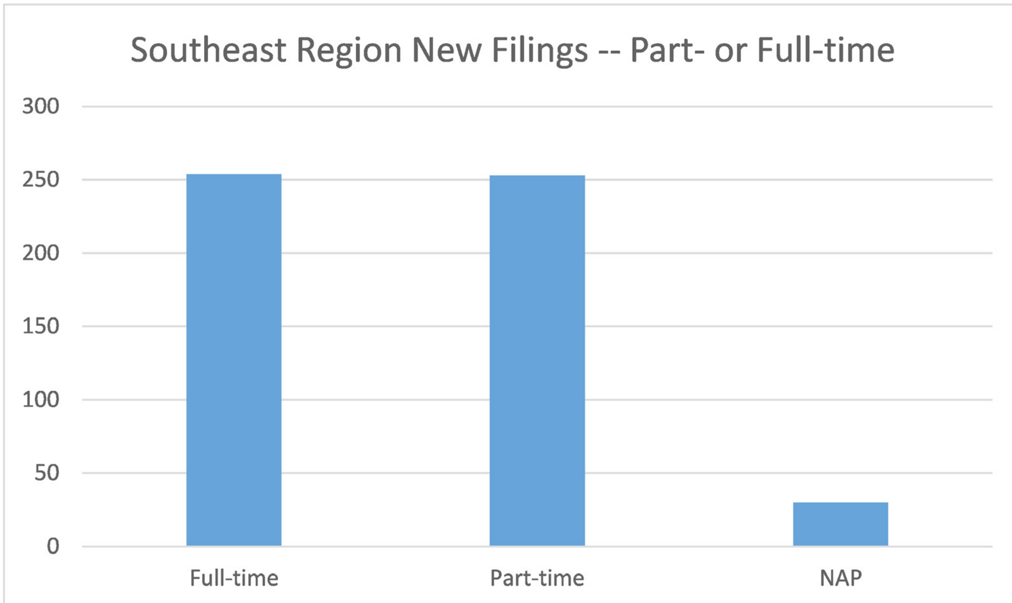
While not all of those participating in the survey completed all portions of the Minnesota Business Snapshot (those not responding to a particular question are represented in this section by “NAP”—no answer provided), 527 responses were tallied to a question asking the new business filer to indicate the range of employment at the business. As expected, most new businesses start small—employment at most companies submitting a new filing ranges from 0-5 employees.



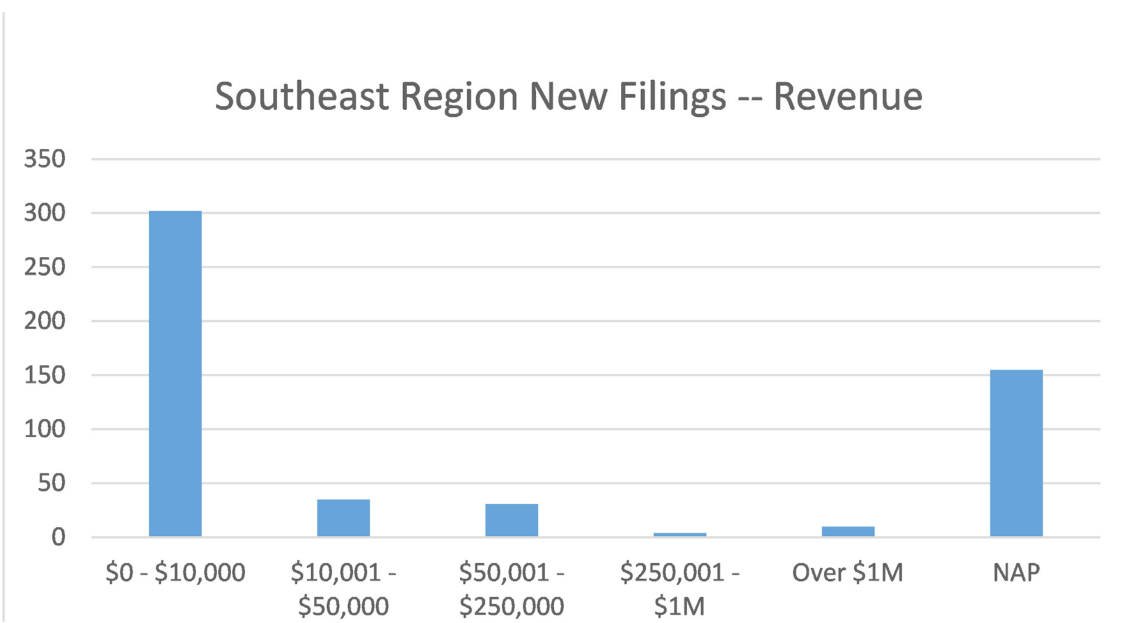
Using the North American Industry Classification System (NAICS), businesses submitting new filings were asked to identify the industry in which their company was operating. While a range of industries were reported, retail trade, construction, real estate/rental/leasing and "other services" lead the way. Since businesses are often unsure of their industrial classification, the "other services" category is likely to represent a "catch-all" category for service-related businesses who were unable to specify their industry. Forty new firms did not provide an answer to this survey item (see "NAP").



Nearly 50 percent of those new business filers who filled out a response on the MBS survey on full- and part-time business ownership status report they are part-time business owners.



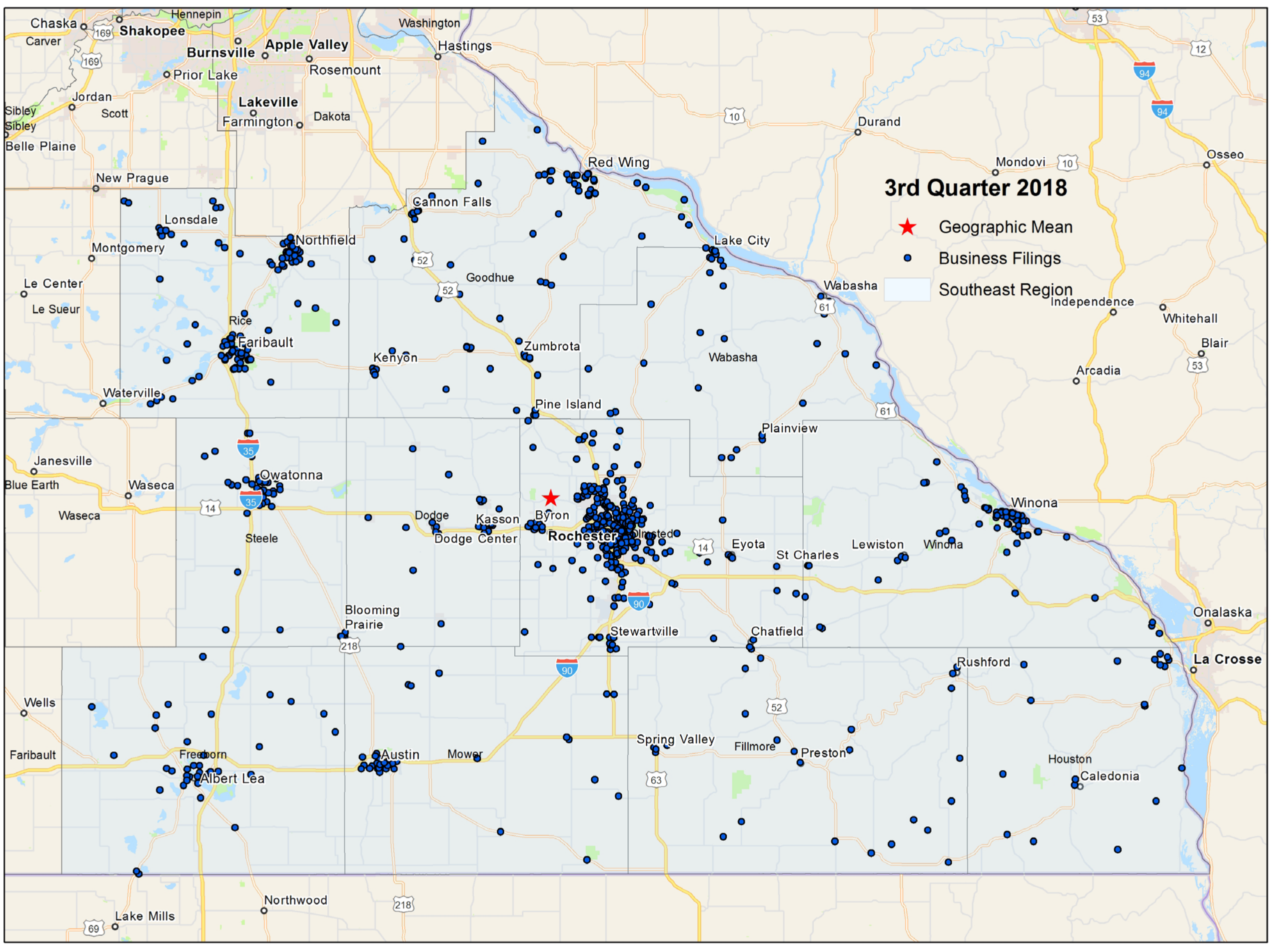
155 new filers in Southeast Minnesota did not provide an answer to the MBS item that asked them to report the company's revenue. Of those businesses that answered the question, the largest share report revenues less than $10,000. Forty-five firms report annual revenues in excess of $50,000.



MAPS

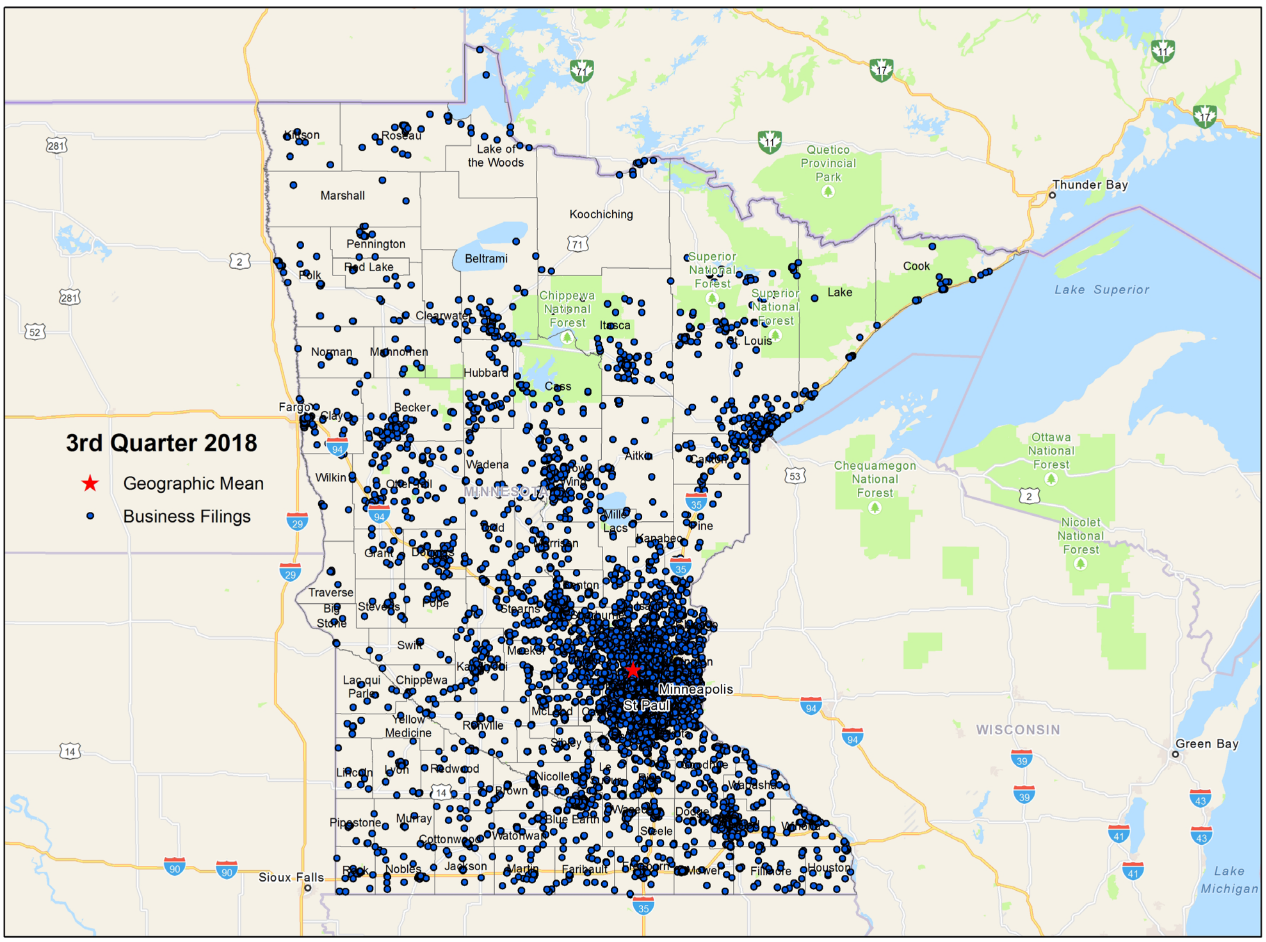
The first map shown below is a visual representation of new business filings around the Southeast Minnesota planning area in the third quarter of 2018. The densest areas of new business formation are in the Rochester metro. Owatonna, Faribault, Northfield, Albert Lea, Austin, Winona, and Red Wing also generated multiple new business filings. Well-traveled roadways are also a predictor of new business formation in Southeast Minnesota.

Southeast Minnesota Planning Area--New Business Formation--Quarter 3: 2018



The second map shows new business filings for the state as a whole. This visual aid demonstrates the considerable extent to which the Twin Cities metro area dominates new business formation in the state. The map shows how the Twin Cities metro stretches along roadways into the Southeast, Southwest and Central planning areas. The map demonstrates the importance of cities and roadways in encouraging economic development. St. Cloud now appears to be integrated into the Twin Cities metro as the I-94/US-10 corridor continues to be a magnet for new business formation. There is also considerable new business formation in the southern part of the state, particularly in Rochester and between the Twin Cities and Mankato. The importance of Interstates 90, 94, and 35 as well as US-10 and MN 61 (along the North Shore) in new business filings is also easily seen in this map.

Minnesota--New Business Formation--Quarter 3: 2018

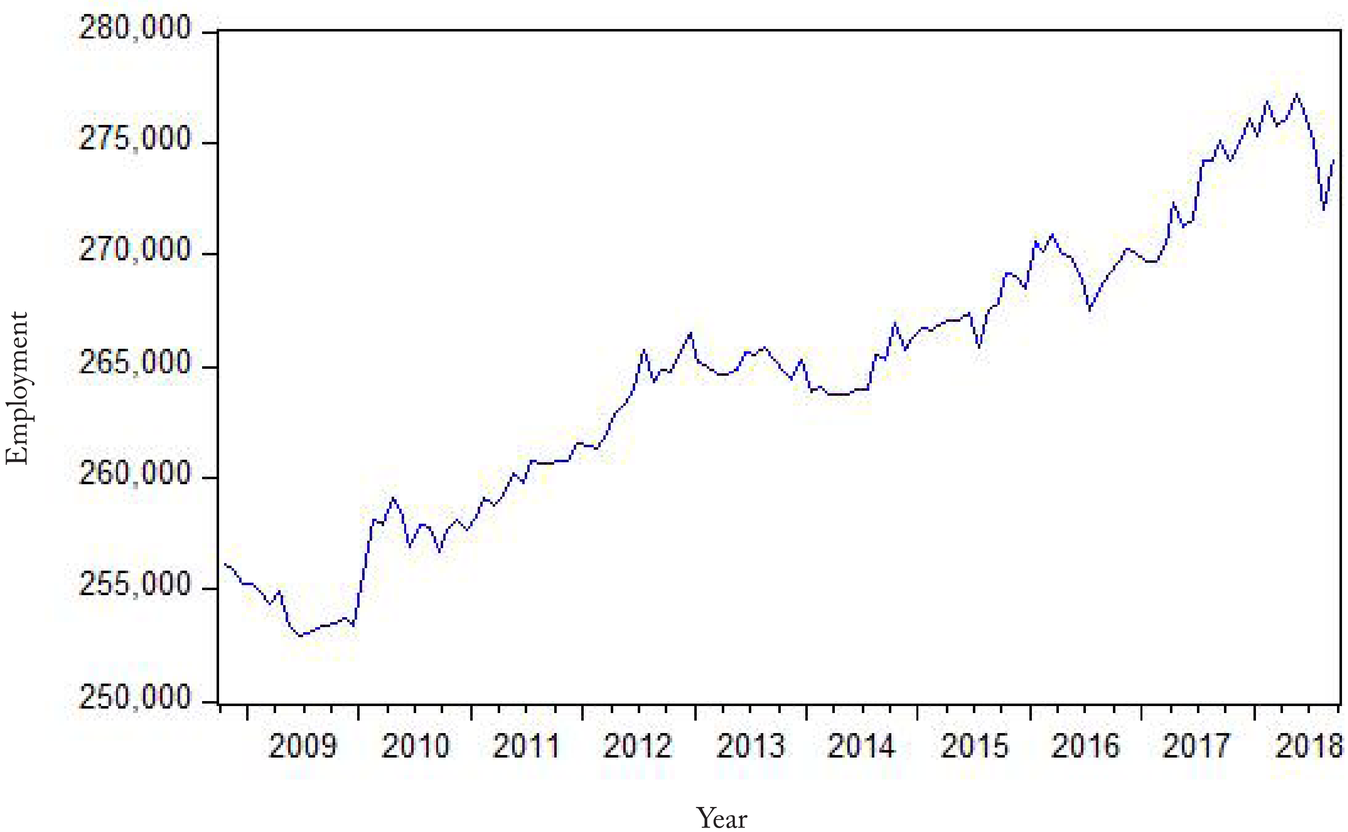


SOUTHEAST MINNESOTA LABOR MARKET CONDITIONS

Employment of those living in the Southeast Minnesota planning area contracted by 0.3 percent over the past year as the planning area has reached full employment and its labor force has begun to decline. As shown in the accompanying graph, the 12-month moving average of total employment had been trending upward (with some brief interruptions) since the end of the Great Recession, but has declined in recent months.

Note: seasonally adjusted labor market data are typically not available to evaluate regional economic performance so some series have been created to illustrate seasonal patterns of the regional labor market. Graphs of these indicators are found in this section of the report. Tabular data are not seasonally adjusted.

Employment—Southeast Minnesota Planning Area (12-month moving average)



Month	September 2017	April 2018	May 2018	June 2018	July 2018	August 2018	September 2018
Employment (Not seasonally adjusted)	274,643	275,109	277,588	278,419	278,194	272,916	273,884

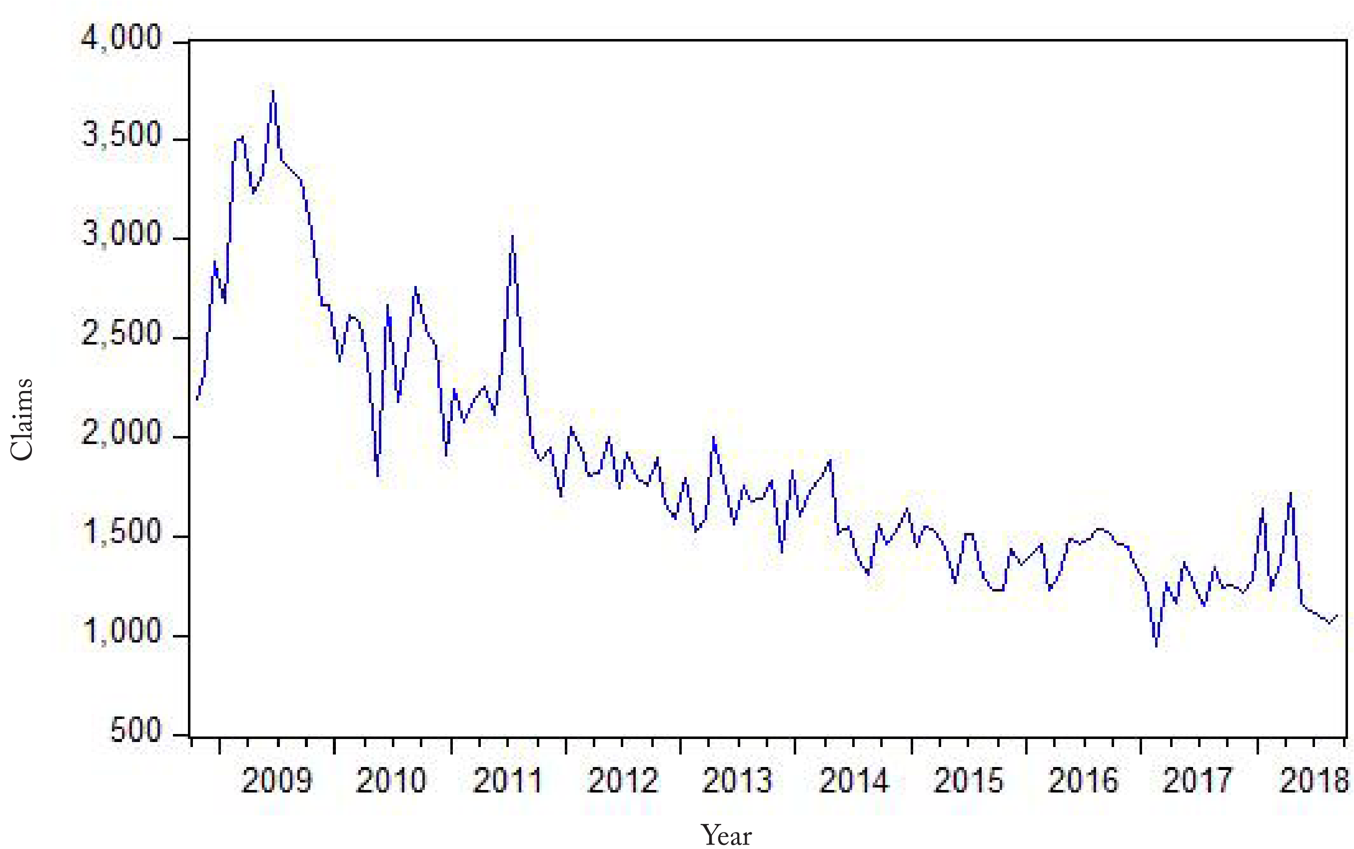
The seasonally adjusted unemployment rate in Southeast Minnesota continued its long-term decline in the third quarter. The non-seasonally adjusted unemployment rate stands at 2.1 percent, well below the 2.6 percent rate observed one year ago.

Unemployment Rate, seasonally adjusted—Southeast Minnesota Planning Area

Month	September 2017	April 2018	May 2018	June 2018	July 2018	August 2018	September 2018
Unemployment Rate (Not seasonally adjusted)	2.6%	2.8%	2.3%	2.7%	2.5%	2.4%	2.1%

New claims for unemployment insurance in September 2018 were 10.3 percent lower than one year earlier. On a seasonally adjusted basis, these claims have leveled out for the last several quarters.

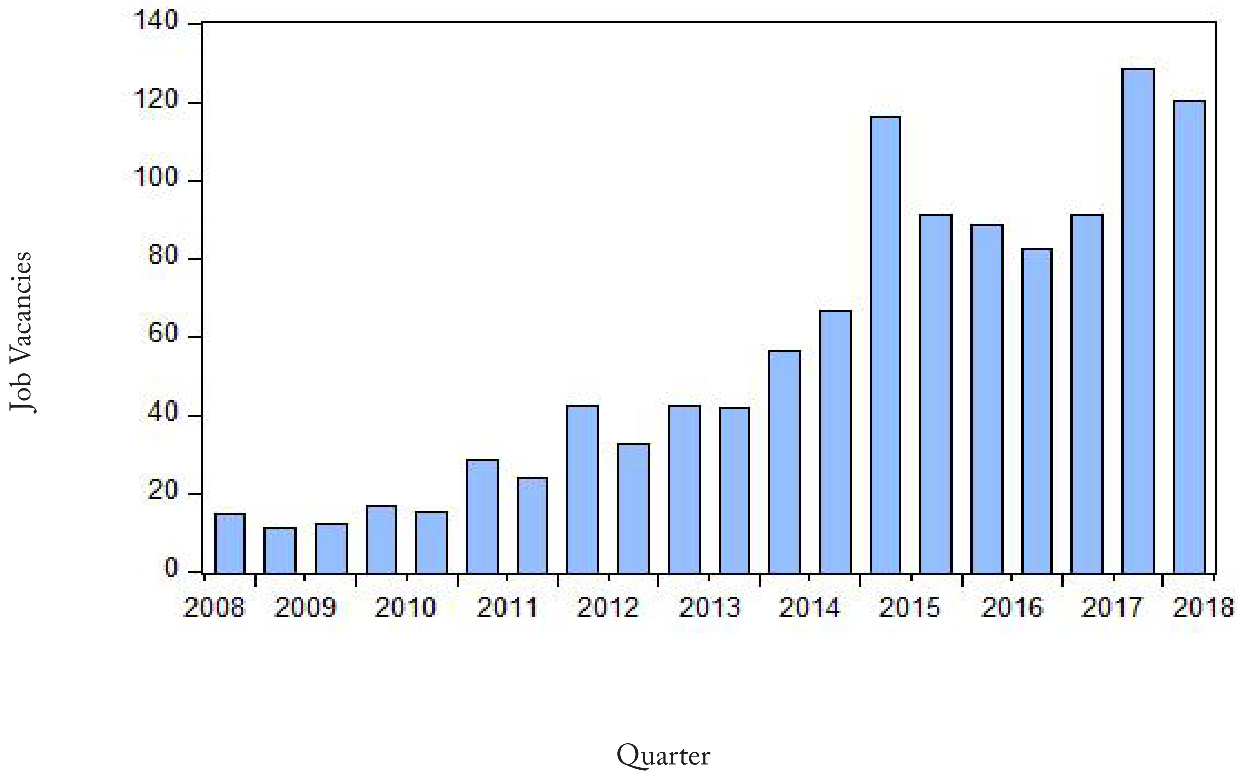
Total Initial Claims for Unemployment Insurance, seasonally adjusted— Southeast Minnesota Planning Area



Period	September 2017	April 2018	May 2018	June 2018	July 2018	August 2018	September 2018
Initial claims (Not seasonally adjusted)	817	1,132	930	1,001	808	699	733

With continuing labor shortages being reported across the state, it is no surprise that the rate of job vacancies per 100 unemployed remains elevated in Southeast Minnesota. There are now more job vacancies than unemployed workers in the region. Even if every person experiencing unemployment in Southeast Minnesota were qualified to fill available job openings, there still would be insufficient workers to meet firms' demands for labor. Elevated job vacancy rates are being experienced all around the state.

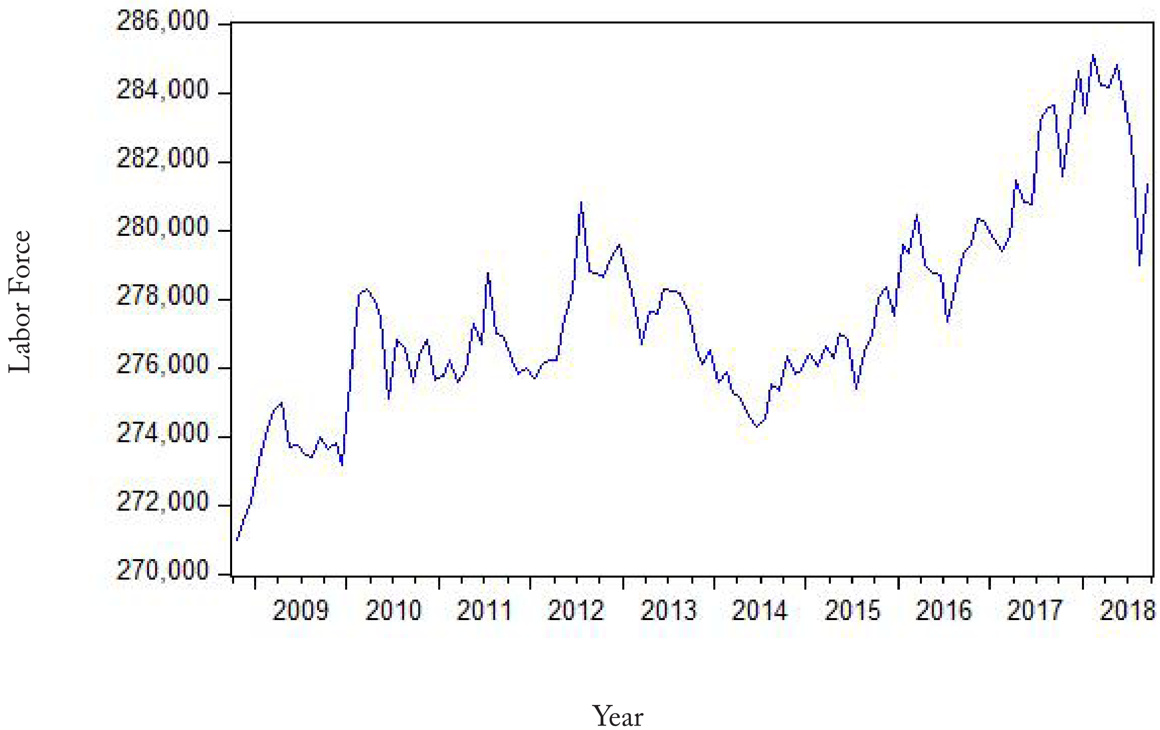
Job Vacancies per 100 Unemployed ---Southeast Minnesota Planning Area



Quarter	2015:IV	2016:II	2016:IV	2017:II	2017:IV	2018:II
Job Vacancies per 100 Unemployed	105.28	91.73	94.44	95.23	158.47	129.9

The Southeast Minnesota labor force decreased by 0.8 percent over the past year. The 12-month moving average of the regional labor force had steadily increased since the beginning of 2014, but has now experienced a precipitous decline in recent months.

Labor Force—Southeast Minnesota Planning Area (12-month moving average)

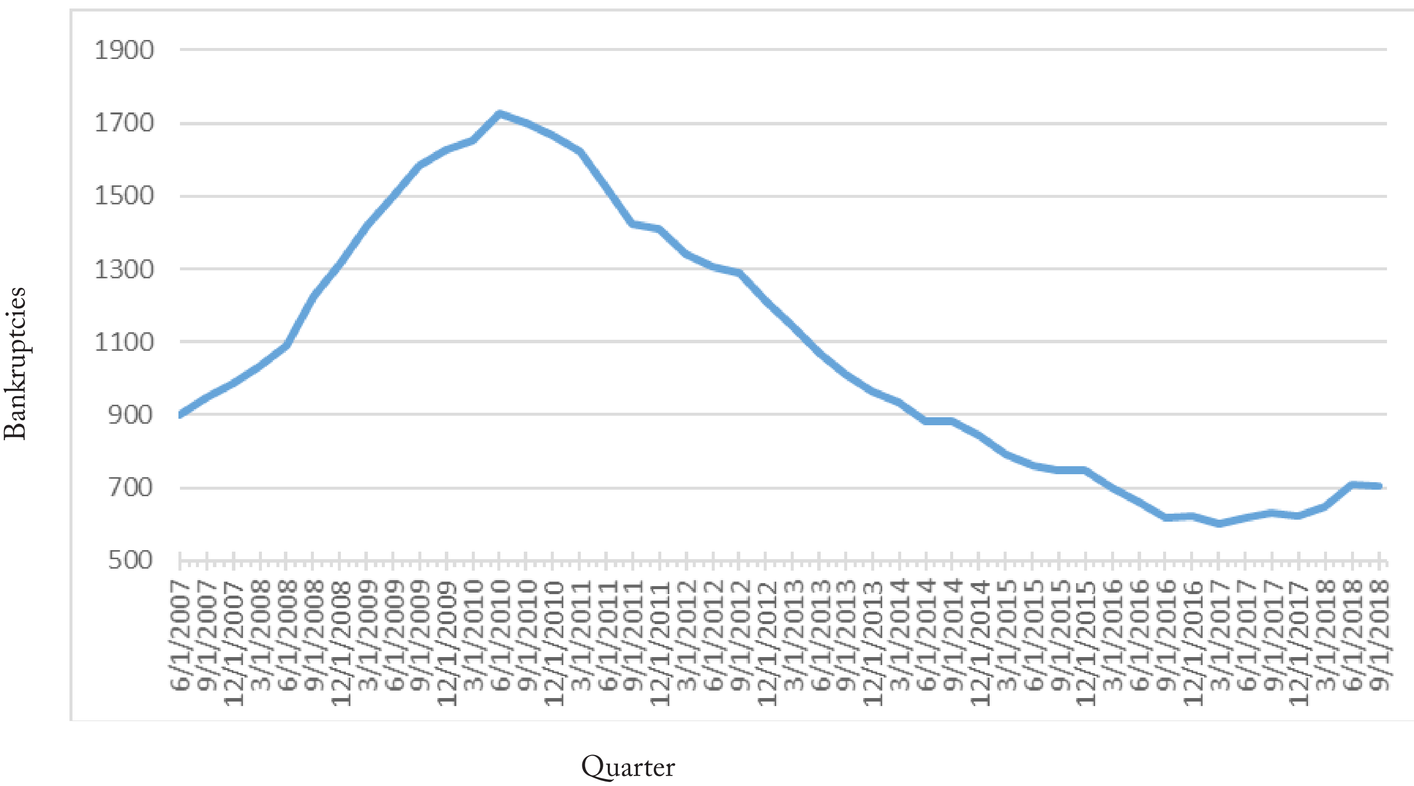


Year (September)	2013	2014	2015	2016	2017	2018
Labor Force (Not seasonally adjusted)	276,355	273,889	275,375	277,689	281,879	279,638

SOUTHEAST MINNESOTA BANKRUPTCIES

The figure below shows the 12-month moving total for Southeast Minnesota bankruptcies since the second quarter of 2007 (shortly before the beginning of the Great Recession). As can be seen in the figure, this moving total increased through the second quarter of 2010, and steadily declined until the end of 2016. Annual bankruptcies in this region bottomed out in 2017 and have now started to rise. With 703 bankruptcies over the past twelve months, annual bankruptcies in Southeast Minnesota are now more than 11 percent above their level of one year ago.

Southeast Minnesota Bankruptcies (12-month moving total)



Year (Third Quarter)	2013	2014	2015	2016	2017	2018
Annual Bankruptcies (not seasonally adjusted)	1,011	883	749	618	629	703

ECONOMIC INDICATORS

Rochester MSA Indicators	Period Covered	Current Period	Prior Year	Annual Percent Change	Long-Term Average (since 1999, unless noted)
Labor Market					
Employment	September 2018 (m)	121,133	120,652	0.4% ↑	0.9%
Manufacturing Employment	September 2018 (m)	10,725	10,734	-0.1% ↓	-2.7%
Educational and Health Employment	September 2018 (m)	48,533	49,184	-1.3% ↓	2.5%
Average Weekly Work Hours--Private Sector	September 2018 (m)	32.8	34.1	-3.8% ↓	33.2 (since 2007)
Average Earnings Per Hour--Private Sector	September 2018 (m)	$35.08	$36.70	-4.4% ↓	3.5% (since 2007)
Unemployment Rate	September 2018 (m)	1.9%	2.5%	NA ↓	3.6%
Labor Force	September 2018 (m)	120,459	119,804	0.5% ↑	0.6%
Initial Jobless Claims	September 2018 (m)	290	318	-8.8% ↓	NA
Business Formation					
Total New Business Filings	Third Quarter 2018 (q)	440	389	13.1% ↑	337 (since 2000)
New Business Incorporations	Third Quarter 2018 (q)	24	23	4.3% ↑	44 (since 2000)
New Limited Liability Companies	Third Quarter 2018 (q)	298	229	30.1% ↑	164 (since 2000)
New Assumed Names	Third Quarter 2018 (q)	100	116	-13.8% ↓	110 (since 2000)
New Non-Profits	Third Quarter 2018 (q)	18	21	-14.3% ↓	19 (since 2000)
Rochester Residential Building Permit Valuation	September 2018 (m)	66,464	36,437	82.4% ↑	NA

(m) represents a monthly series
(q) represents a quarterly series

Southeast Minnesota contains the Rochester MSA, an area that derives much of its employment from the educational and health sector. This sector continues to be a pillar of economic vitality for Rochester (and for Southeast Minnesota). However, year-over-year overall employment in the Rochester area increased by only 0.4 percent in September 2018 and employment in the key education/health sector contracted by 1.3 percent (the long-term average employment growth in this sector is 2.5 percent). Note that the share of employment in Rochester's educational and health sector has increased from 29.4 percent in September 1999 to 39.9 percent today, so this sector is vital to economic growth in the Rochester MSA. The overall number of new business filings rose 13.1 percent as new LLCs increased by more than 30 percent. The value of residential building permits surged in the Rochester area but average weekly work hours and hourly earnings contracted. The MSA unemployment rate fell to 1.9 percent and the labor force grew 0.5 percent. Initial jobless claims fell.

STATE AND NATIONAL INDICATORS

MINNESOTA Indicators	Sep 2018	Jun 2018	Sep 2017	Change from one quarter ago	Annual Change
Nonfarm payroll employment, SA	2,974,700	2,965,600	2,934,600	0.3%	1.4%
Average weekly hours worked, private sector	34.4	34.1	34.1	0.9%	0.9%
Unemployment rate, seasonally adjusted	2.8%	3.1%	3.3%	NA	NA
Earnings per hour, private sector	$29.38	$28.77	$28.58	2.1%	2.8%
Philadelphia Fed Coincident Indicator, MN	137.84	135.96	132.59	1.4%	4.0%
Philadelphia Fed Leading Indicator, MN	1.98	2.32	2.02	-14.7%	-2.0%
Minnesota Business Conditions Index	60.0	58.8	59.4	2.0%	1.0%
Price of milk received by farmers (cwt)	$17.50	$16.20	$18.00	8.0%	-2.8%
Enplanements, MSP airport, thousands	1,533.7	1,753.0	1,522.7	-12.5%	0.7%
NATIONAL Indicators	Sep 2018	Jun 2018	Sep 2017	Change from one quarter ago	Annual Change
Nonfarm payroll employment, SA, thousands	149,500	148,931	146,963	0.4%	1.7%
Industrial production, index, SA	109.0	107.5	103.2	1.4%	5.6%
Real retail sales, SA ($)	201,436	201,377	197,691	0%	1.9%
Real personal income less transfers, billions	13,548.8	13,487.6	13,229.5	0.5%	2.4%
Real personal consumption expenditures, bill.	13,006.0	12,884.1	12,628.4	0.9%	3.0%
Unemployment rate, SA	3.7%	4.0%	4.2%	NA	NA
New building permits, SA, thousands	99.4	121.6	103.3	-18.3%	-3.8%
Standard & Poor's 500 stock price index	2,901.5	2,793.6	2,492.8	3.9%	16.4%
Oil, price per barrel in Cushing, OK	$70.23	$70.98	$49.82	-1.1%	41.0%

Most categories of economic performance found in the State and National Indicators table are favorable. For the state as a whole, there was growth in employment, a lower seasonally adjusted unemployment rate, and increased enplanements at the Minneapolis-St. Paul airport compared to September 2017. Two of the three indicators series reported in the table are higher. Year-over-year, average hourly earnings and weekly work hours rose. Milk prices are lower than one year ago, but were higher than three months earlier.

The national economic indicators found in the table are also highly favorable. Stock prices rebounded through the end of September (although the fourth quarter has not been charitable to stockholders) and employment has increased. Real income and consumer expenditures have expanded and the national unemployment rate continues to fall. Industrial production rose but the number of new building permits declined. Oil prices were higher in September than one year earlier, but have recently declined in the fourth quarter.

The Southeast Minnesota Quarterly Economic and Business Conditions Report is a collaboration between the Office of the Minnesota Secretary of State and the School of Public Affairs Research Institute (SOPARI) of St. Cloud State University. All calculations and text are the result of work by SOPARI, which is solely responsible for errors and omissions herein.

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