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ST. CLOUD AREA
QUARTERLY
BUSINESS REPORT

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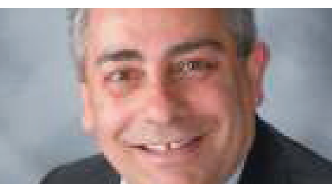
ST. CLOUD ECONOMY REMAINS STRONG

CENTRAL MINNESOTA FIRMS MOSTLY OVERCOME BAD WINTER WEATHER

ABOUT THE AUTHORS



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King Banaian specializes in analyzing data and writing about it in the second portion of this report. Rich MacDonald collects and analyzes responses to the St. Cloud Area Business Outlook Survey, covered in an early portion of the report. Only MacDonald has access to the confidential list of surveyed businesses and the returned surveys. Questions about the survey can be directed to him. Special questions asked in the survey may at times deal with public policy but do not reflect a political agenda of either of the authors.

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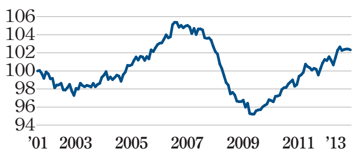
EXECUTIVE SUMMARY

Area economic activity has remained strong despite challenging winter weather that negatively affected almost 70 percent of surveyed firms. Local job creation expanded at a revised 1.7 percent pace over the year ending in January — well above its annual average of 0.9 percent. The January unemployment rate in St. Cloud was 6.1 percent, a favorable improvement from 7.2 percent one year earlier.

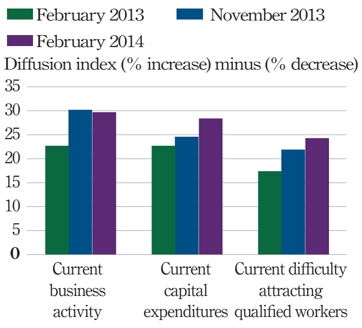
Private sector employment gains in the St. Cloud area were fairly broad-based through January, with strong growth recorded in the local professional/business services, education/health and leisure/hospitality sectors. Annualized employment growth in each of these sectors was 3 percent or greater. Combined, these sectors represent more than 35 percent of area employment. The only sectors of the area economy that experienced employment declines during the past 12 months are government, manufacturing and information sectors.

ST. CLOUD INDEX OF LEADING ECONOMIC INDICATORS



We introduce in this report new versions of the St. Cloud Index of Leading Economic Indicators and the St. Cloud Probability of Recession Index. The new leading indicator series was slightly up in the latest quarter. Two of four indicators in the index were positive; the other two were negative. The new St. Cloud Probability of Recession Index was virtually zero in January, indicating no recession expected this spring.

KEY RESULTS OF SURVEY



Forty-nine percent of 74 surveyed firms experienced improved business activity over the past three months, while 19 percent reported decreased activity. Nearly one-quarter of firms indicate increased difficulty attracting qualified workers, and 31 percent increased capital expenditures.

Survey results of the future outlook continue to be very optimistic. Sixty-five percent of firms expect increased business activity by August, and only 8 percent expect activity to fall. Nearly one-half of firms expect to increase employee compensation, and 41 percent foresee improved national business activity during the next six months.

In this quarter's first special question, more than half of surveyed firms expect an increase of the minimum wage to $10.10 per hour would negatively affect them.

In a second special question, 69 percent of surveyed firms report a negative effect of this winter's weather. Nine percent of firms experienced improved conditions from the abnormally bad winter weather.

Finally, most area firms appear to be unconstrained by credit availability. Most firms have either not had to borrow funds or have had no difficulty obtaining credit.

THE ST. CLOUD AREA BUSINESS OUTLOOK SURVEY

CURRENT ACTIVITY

Tables 1 and 2 report the most recent results of the Business Outlook Survey. Responses are from 74 area businesses that returned the recent mailing in time to be included in the report. Participating firms are representative of the diverse collection of businesses in the St. Cloud area. They include retail, manufacturing, construction, financial, health services and government enterprises, both small and large. Survey responses are strictly confidential. Written and oral comments have not been attributed to individual firms.

Survey responses from Table 1 are improved from one year ago. This quarter's diffusion index on current business activity (its current value is 29.7) is basically unchanged from last quarter and is the highest ever recorded in a February survey. One year ago, the value of the index was 22.7, and in February 2009 (during the depth of the Great Recession), the index was minus 30.5, the lowest value recorded on this item in the 16 years that we have been conducting the survey. A diffusion index represents the percentage of respondents indicating an increase minus the percentage indicating a decrease in any given quarter. For any given item, a positive index usually indicates expanding activity, while a negative index implies declining conditions.

CURRENT EMPLOYMENT

The current employment index also is the highest ever recorded in February. While this survey item is always weaker in the winter, the accompanying chart illustrates how employment has slowly trended upward since bottoming out five years ago. Other measures of local labor market activity show similar strength. The item on length of workweek is the highest ever recorded in the February survey, and the employee compensation index remains elevated (42 percent of surveyed firms report increased compensation over the past three months). Capital expenditures remain solid with nearly one-third of surveyed firms indicating an increase in spending on equipment, machinery, structures, etc., over the past three months. The index on prices received also increased from last quarter, although the clear majority of surveyed firms (77 percent) report no change in current prices received.

Finally, area firms continue to experience difficulty attracting qualified workers. As can be seen in the accompanying chart, the value of this index has continued to rise over the past several years. Almost one-quarter of firms report increased difficulty with worker shortages, and no firms experienced decreased difficulty attracting qualified workers over the past three months. We have often noted that this series appears to follow the general path of area economic activity, so an increase in the value of this index is further evidence of continuing expansion. However, the inability of area firms to find qualified workers will ultimately constrain the potential growth of area economic

CURRENT PRICES RECEIVED

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TABLE 1-CURRENT BUSINESS CONDITIONS

	Febraury 2014 vs. three months ago				November 2013
	Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	Diffusion Index[3]
What is your evaluation of:					
Level of business activity for your company	18.9	32.4	48.6	29.7	30.2
Number of employees on your company's payroll	13.5	54.1	32.4	18.9	16.4
Length of the workweek for your employees	12.2	64.9	23	10.8	15.1
Capital expenditures (equipment, machinery, structures, etc.) by your company	2.7	64.9	31.1	28.4	24.6
Employee compensation (wages and benefits) by your company	2.7	55.4	41.9	39.2	35.6
Prices received for your company's products	4	77	17.6	13.6	5.5
National business activity	4	52.7	33.8	29.8	16.5
Your company's difficulty attracting qualified workers	0	73	24.3	24.3	21.9

Notes: (1) Reported numbers are percentages of businesses surveyed. (2) Rows may not sum to 100 because of "not applicable" and omitted responses. (3) Diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.

Sources: St. Cloud State University Department of Economics and School of Public Affairs Research Institute

MORE ONLINE

The St. Cloud Area Quarterly Business Report has been produced four times each year since January 1999. Electronic access to all past editions of the QBR is available at http://repository.stcloudstate.edu/scqbr/

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TABLE 2-FUTURE BUSINESS CONDITIONS

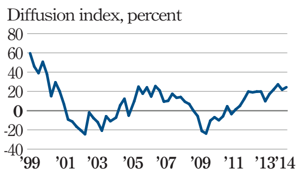
What is your evaluation of:	Six months from now vs. February 2014 Decrease (%)	No Change (%)	Increase (%)	Diffusion Index[3]	November 2013 Diffusion Index[3]
Level of business activity for your company	8.1	25.7	64.9	56.8	58.9
Number of employees on your company's payroll	4	54.1	40.5	36.5	38.4
Length of the workweek for your employees	4	67.6	27	23	1.3
Capital expenditures (equipment, machinery, structures, etc.) by your company	4	54.1	39.2	35.2	24.6
Employee compensation (wages and benefits) by your company	0	50	48.6	48.6	60.3
Prices received for your company's products	5.4	73	18.9	13.5	26
National business activity	1.4	47.3	40.5	39.1	32.9
Your company's difficulty attracting qualified workers	0	75.7	21.6	21.6	27.4

Notes: (1) Reported numbers are percentages of businesses surveyed. (2) Rows may not sum to 100 because of "not applicable" and omitted responses. (3) Diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease. A positive diffusion index is generally consistent with economic expansion.

Sources: St. Cloud State University Department of Economics and School of Public Affairs Research Institute

activity, so this is certainly a measure that will be closely watched in coming quarters.

CURRENT DIFFICULTY ATTRACTING QUALIFIED WORKERS



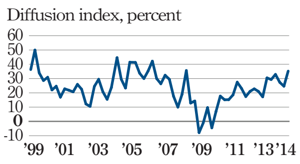
As always, firms were asked to report any factors that are affecting their business. These comments include:

- Health care costs as a result of the Affordable Care Act (Obamacare) had a $272,000 direct financial impact on employee benefits. Disgusting.
- Raw material supply has been limited due to a surge in exports (primarily China) and weather.
- We've experienced limited local demand for construction services.
- Gas prices are fluctuating again. We will need to add fuel surcharges to our customer contracts and invoices.
- It is getting much more difficult to attract and retain production workers. The high unemployment benefits, social programs reduce the incentive to work. Raising the minimum wage is a big concern. Hopefully the Minnesota Legislature will eliminate the three business-to-business taxes. We were already an overtaxed state.
- We have been noticing an increase in accounts receivable. More and more companies, owners and even governments have delayed paying us for one reason or another without paying finance charges to us. All of our suppliers will not waive their finance charges to us, so either we draw from our line of credit to pay our bills or incur finance charges.
- Health care reform is having a positive impact on our business from the standpoint that we (perform services for health insurance companies) and (health care reform) has dramatically increased the number (of jobs we perform for these companies).
- The unknown costs associated with health care in the next couple of years and going forward will remain an uncertainty in the overall business climate. It hasn't prevented our growth at this time, but it is something that could potentially affect our business.
- High propane costs and the uptick in gas prices. This will impact any recovery. People will not buy when there are unstable energy and fuel costs.
- Impacted by local company filing Chapter 11; caused a negative impact on my business operations, although we have survived!
- Cost of (Affordable Care Act) has added costs to employee benefits. Medical device tax has dampened our profitability, albeit a small amount.
- MNsure — I sell health insurance and the MNsure website has been a disaster. Very difficult to read and cannot get clients through the "create an account" process. I am hoping the website will improve for next year's open enrollment.
- More scrutiny and less access to capital has limited our growth.
- The new Consumer Financial Protection Bureau rules and regulations will have a huge impact on business and prices we will need to charge our consumers. The rules and regs mean change-outs to computer hardware and software, policing and reporting to the degree we will have to hire more staff to comply with the reporting. Prices must go up. CFPB hindering more than helping the consumer in many respects — especially financing.
- We are heavily involved in doing appraisals for people impacted negatively by the CAPX powerline in Minnesota.
- It's very difficult to attract employees who want to be fully engaged and work a full week. The attitude seems to be — what will you do for me?

FUTURE OUTLOOK

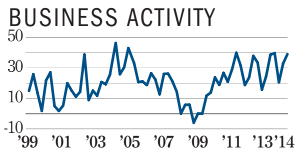
Table 2 reports the future outlook for area businesses. The index of future overall business activity is somewhat weaker than has been recorded in the February Future Business Conditions survey during the past three years. Sixty-five percent of surveyed firms expect increased activity in six months, and only 8 percent of firms expect conditions to worsen. Note that this item is usually seasonally stronger than is recorded in the November survey. This was not the case this year, given the extraordinary future outlook that was recorded in November. While this quarter's future business activity index is below the February readings from the past three years, we see no signs yet that this is indicative of decreased growth. Indeed, this may suggest a maturing local expansion — we are now in the fourth year of recovery from a deep recession, and we can no longer expect a bounce in activity such as that which is experienced in the early stages of recovery.

FUTURE CAPITAL EXPENDITURES



Items in Table 2 reflecting the local labor market outlook remain solid. The indexes on future employee compensation and difficulty attracting qualified workers are basically unchanged from one year ago, although they are weaker than reported in November. In addition, the future employment index is somewhat weaker than was seen in February 2013, although 40.5 percent of firms expect to add workers over the next six months. We also note that the length of the workweek is expected to expand in the future, although this is also a somewhat lower reading than one year ago. As can be seen in the accompanying chart, the expected future capital expenditures series is stronger than it has been for several years. Interest rates remain historically low, so this is a nice opportunity for firms to replace equipment and add capacity.

FUTURE NATIONAL BUSINESS ACTIVITY



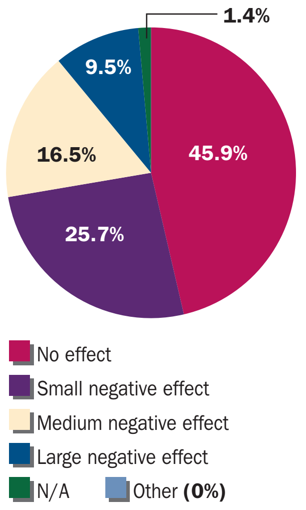
The future prices received survey item has moderated from its big jump in November. This item does not display a particular seasonal pattern, so we were surprised when the index increased from 13.7 in August 2013 to 26 three months later. The index returned to its August level this quarter, causing us to moderate our concerns about future pricing pressures that we discussed last quarter. Finally, expected future national business activity is elevated from prior quarters. Forty percent of surveyed firms expect improved national business activity over the next six months, and only one firm expects national conditions to deteriorate. We note that this is in-line with the generally favorable outlook expected by a variety of economic forecasters.

SPECIAL QUESTIONS

The federal minimum wage has been $7.25 per hour since its last increase in July 2009. There has been plenty of recent discussion in both St. Paul and Washington concerning efforts to increase this rate. In August 2009, we asked area firms how an increase in the federal minimum wage would adversely affect them. At that time, 81.6 percent said "no effect," 10.3 percent indicated "small negative effect," and 3.4 percent felt it would have a "medium negative effect." In 2009, we reported that these results were largely as expected, since we anticipated area firms already were using competitive wage-setting practices and offering wages above the minimum. Indeed, the typical comment by area firms to the special question was that they already paid higher than minimum wage.

President Barack Obama has backed efforts to increase the federal minimum wage to $10.10 per hour, so we thought we would ask firms how this would potentially adversely affect them. Although we didn't give firms the option of expressing how the legislation might benefit them — businesses have never been eager to have legislative mandates in setting wages — we did offer the opportunity for firms to provide "other" responses than those offered. No firms exercised this option. So, given an opportunity to make comparisons to five years ago, we updated the question by asking:

"There has been considerable discussion in recent weeks about efforts to increase the minimum wage. For example, President Obama has backed raising the federal minimum wage to $10.10 per hour. How do you expect your business would be directly and/or indirectly affected by an increase in the minimum wage to $10.10 per hour."



NOTE: Numbers may not add up to 100 due to rounding.

Forty-six percent of respondents replied that this would be expected to have "no effect" on their business, and one firm didn't respond. About 52 percent of firms indicate this would have a negative effect, which breaks down as follows: 25.7 percent would expect a "small negative effect," 16.5 percent indicate a "medium negative effect," and a "large negative effect" would be felt by 9.5 percent of respondents. While a detailed analysis of this issue requires considerably more space than can be committed to these pages, we note the much larger negative response by area firms to this question than we observed in 2009 when the minimum wage hike was a modest $0.70 (10.7 percent). An increase from $7.25 to $10.10 would hike the minimum wage by $2.85 per hour, a 39.3 percent increase. The larger hike means a greater range of effects on area firms. A sample of written comments is found below. Note that we have not included several responses that indicated a large number of firms that already pay above $10.10 per hour.

These comments include:

- This would tend to force up wages; Minnesota is already higher than most areas of the country.
- Though we pay higher than minimum wage, it will affect how much we charge our clients, which will impact business negatively.
- We don't hire anybody at less than $10.10 right now. I do believe this is another negative business aspect which will impact us negatively from a ripple effect. How big is the ripple? Who knows? Many of the nonfriendly business practices being implemented and promoted at the congressional and regulatory levels are tough to draw a line to the exact impact on business on an item-by-item basis. The real impact is cumulative effect of all the business-unfriendly items, which has definitely impacted our willingness to take on additional business risk in both hiring and investment, not to mention softer demand for our products that are tied to the same business risk decisions being made by our customers.
- Have several employees on disability pay, and they will probably have to reduce their hours or lose their disability pay.
- Although our company's wages already exceed $10.10 an hour, our suppliers pay less. Therefore I would expect the prices to us will rise, causing us to charge the

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A NEW LEADING ECONOMIC INDICATOR SERIES

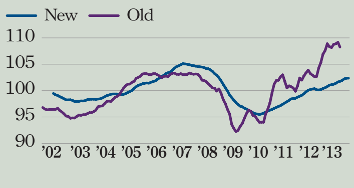
In this issue, we have introduced a new leading economic indicator series for the St. Cloud area. (For the coming year, we will distinguish this as the New St. Cloud Index of Leading Economic Indicators; we will eventually drop the adjective "new.") Here we explain the changes made and the reasons for them.

1. A time series we had used as a leading economic indicator was the number of hours worked in St. Cloud-area manufacturing firms. This series was provided by the Minnesota Department of Employment and Economic Development but is no longer available to us. We reviewed several other time series and concluded that a reliable leading indicator could be found in the employment of professional and business services. That series includes the number of employees supplied by temporary help firms; other regions use it in their leading indicators. We do not get the number of temporary help service employees separated from other professional and business service employees; still, the predictive power of that series, at four-six months out for overall St. Cloud employment, was significant.

2. We have always made seasonal adjustments to data wherever practicable. The adjustments need periodic updating. The last time we had done so was 2008, so this was overdue for an update. This was particularly true for help-wanted advertising, which had changed its behavior over the past 15 years as online advertising has caught on. Trends that we had extrapolated in the mid-2000s were no longer there by 2013; the new seasonal adjustments remove the extrapolation.

3. The timing of leading indicators to the benchmark

NEW VS. OLD ST. CLOUD INDEX OF LEADING ECONOMIC INDICATORS



measure of economic activity in St. Cloud — payroll employment — changed for two reasons. First, there was the severity of the Great Recession and the slow growth of employment since. Almost every model of business cycles has been challenged by the last two recessions as they have exhibited very slow employment growth during recoveries. The experience of the Great Recession allows us to judge timing — the months that pass between changes in the direction of an indicator and change in the direction of employment growth — better than we had before. Second, data revisions in several series have caused us to re-evaluate timing, and some needed adjustment. This has led us to conclude that the index is a much better predictor at a three-four month horizon than for six-eight months. In future reports, we will note the shorter-term forecast offered by the index.

The old and new series can be seen in the nearby graph. As before, we have used a six-month moving average as a filter for removing month-to-month noise in the index. Readers will note the erratic behavior of the old series since 2010, which has bedeviled our ability to predict future movements of the St. Cloud economy. The most noticeable example of this is the false call that was given to the end of the recession in the old index in mid-2009. We have concluded that this was premature and that the local recession ended in spring 2010. Other false signals have happened since then. This issue is removed in the new leading indicator index. We hope this will be a better predictor of recessions going forward.

Similar changes were made to the Probability of Recession Index, including all three of the elements listed above. We have slightly changed the estimation procedure to make the index more likely to give zero and 100 percent readings than before, when readings frequently hovered near 50 percent since the Great Recession. As the new and old probability indexes are not comparable, we do not graph them side-by-side, but as seen elsewhere in this report, the timing of recession predictions is quite similar to that of the New St. Cloud Index of Leading Economic Indicators.

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consumer more.

• I will have to take a good look at my younger employees and if it is worth paying that much to train.

• Increased costs will eventually be passed on. Some purchased items come from industries that still use minimum wage labor. Those items will go up in cost. We will likely not be able to pass those costs on, thus the small negative effect.

• While we pay above the minimum wage, I'm concerned that some of our small-business customers would be affected negatively.

• Even though our starting wage is higher than the proposed increase, I would expect our wage would have to increase.

• I pay above the minimum wage, and I don't eat fast food, which is about to go up if the wage does.

• We currently have a starting wage of $9.75 for many of our light assembly positions. If the minimum moves to $10.10, in order to get qualified employees, we will need to raise the $9.75 to someplace in the $12 area. We can't raise prices to our customers, as we have 3-5 year locked-in price agreements. That will then all be profit we pay out.

• We don't have any employees at that level, but the compression will impact our lower-end wages over time.

• Our current starting wage is $10 for production staff, and after 60 days they get a review and a raise, so the $0.10-per-hour increase won't mean much. However, the thought process for rest of the staff, knowing that the minimum wage has increased by almost $3 an hour, will be expecting similar compensation as well. If that were to happen, my labor costs would skyrocket, as well as all the other costs associated with wages, workers comp, etc., and I will be out of business.

• Anytime mandates are created, in lieu of the market dictating wages, there will be a negative impact. We don't hire minimum wage people, but we work with companies that do, and therefore our cost will go up as well.

• We always pay well above minimum wage. This will drive our client pay rates up.

• We would have to raise entry-level wages (now $8) and adjust others (currently $11-$15) in order to maintain a reasonable pay grid.

• If they raise the minimum wage, all products or services will in turn raise the cost to their customers. Every year, we raise ours to reflect the raises we gave to our employees.

• Overall cost of products and services will increase.

• How will it be paid for?

• None. Side note though — minimum wage increase is good for lower wage workers, but anyone over $13-$15 per hour I don't believe will be impacted; but those in teens and $20s per hour are in most need of increase to spur growth.

• (No effect.) We need to pay our employees livable wages.

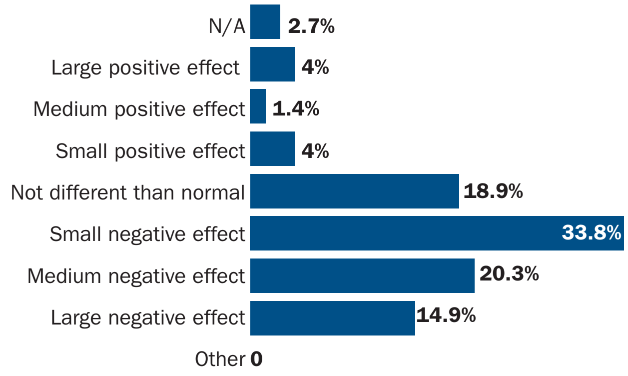
• We have no employees at minimum wage. But will impact (our customers) looking to save money.

The dominant story of the past three months has been the abnormally bad winter weather. Schools have been closed, events have been canceled, transportation has struggled and firms have altered operating schedules. Economic forecasters have noted the effect the weather is having, and it seems that every reported data release has been accompanied by the caveat that bad weather is likely to have affected the numbers. We have never before asked a special question about the weather, so this season's historic temperature and snowfall observations offered the ideal opportunity to see how firms were being affected by unseasonably bad weather conditions. We asked:

"How has this winter's weather affected your business compared to what you normally expect in the winter?"

Sixty-nine percent of firms have been negatively impacted by the weather, and 9.4 percent have experienced an improvement in business conditions. Nineteen percent of firms report no difference than normally occurs in the winter. Fifteen percent of firms report a "large negative effect," and 20 percent have experienced a "medium negative effect." One-third of surveyed firms report a "small negative effect." Four percent of surveyed firms have seen a "large positive effect," and the same percentage report a "small positive effect." One firm indicates that the abnormally bad weather has had a "medium positive effect." While most of the national data that economic decision makers rely upon are seasonally adjusted, the severity of this winter's weather compromises the efficacy of the processes used to adjust economic time series for seasonal patterns. This makes local survey data such as these particularly useful in helping to characterize this "outlier" period. Written comments by area firms are instructive in the many ways in which bad weather has affected their business. We note that we have not included all of the comments about higher energy costs, greater snow removal budgets and production delays.

HOW HAS THIS WINTER'S WEATHER AFFECTED YOUR BUSINESS COMPARED TO WHAT YOU NORMALLY EXPECT IN THE WINTER?



Comments include:

• Days off with pay due to cold weather.

• Our heating and snow removal costs are higher. We have had to shut down our operations on several occasions. Customers have delayed orders and delivery of products as well.

• Snowplow bills, heating bills, days lost of work, roof repairs.

• Nationally, many stores were closed often.

• While revenue and demand hasn't been impacted as much, shipments have been delayed, absenteeism has increased, and we've lost production due to weather-related issues.

• Our business is seasonal with low winter traffic. This winter, that traffic has come to a standstill.

• Substantially higher utility expenses. Slightly higher absenteeism.

• We sell (products for which demand has increased). Extended cold weather increased demand.

• We've lost 12 days of work in the field due to the weather. Hydraulics don't work real well in the extreme cold. No effect on our shop.

• We are very seasonal, and cold winters make us even busier in January and February. We have people (making arrangements) for next year already because this winter has been so harsh!

• Higher costs for heating, disruptions in production schedules, heavy burden on our people.

• We are a construction company, and 95 percent of our work is outside. And what is inside still needs material and supplies that are brought in as needed from the outside. Needless to say, at 20 below zero, we have a hard time heating our work area and materials. Plus it is extremely hard on equipment. Productivity loss goes without saying along with concern for worker safety.

• People don't go out as much in extreme cold. If they don't go out, they don't bring us work.

• Some employees have been more challenged to get to work or have been late for work as a result of the weather.

• Meetings with clients have had to be rescheduled several times.

• Eight percent of our business is done with heavy-duty trucks. The weather has had a negative impact on their number of miles driven.

• Extra cost for snow removal, extra costs for fuel to keep job sites thawed out or heated, and more days off for our workers.

• Energy costs for heating the building and heat-treating surcharges are costing us more.

• Weather has canceled workers, postponed projects, resulting in revenue loss.

• Shut down of companies and labs due to storms dampens product demand and has slowed delivery of some equipment, putting our development schedule behind.

• We were unable to do some projects that may have gone ahead due to ice and snow.

• Lost employee hours and increased utility and snow removal costs.

• Increase in cold and snow helps businesses that thrive off that and in return advertise their products. The only negative affect would be like any other business costs … heating and fuel.

• We have had to close twice because of the distances our employees drive.

• So far only one event has been rescheduled due to weather. We are lucky.

• We are a month behind schedule on two projects.

• Few home purchases.

• Issues in (delivering our product) and declines in … revenues from retailers who suffered in January.

• Home sales down significantly.

• Less (customer) traffic — but very serious and productive traffic.

September 2008 is often cited as the beginning of the most recent financial crisis. Among other things, this was the month that Lehman Brothers failed, Fannie Mae and Freddie Mac were put under government conservatorship, AIG was rescued, and TARP was proposed (and originally rejected) by Congress. We note that earlier in 2008, federal regulators arranged the takeover of Bear Stearns by JP Morgan Chase. This March 2008 event caused increased volatility in financial markets, and it began to look like credit

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flows may be compromised. So, in our May 2008 St. Cloud Area Business Outlook Survey, we asked area firms to report the extent to which business access to loans (and other forms of credit) were affected by recent turmoil in financial markets.

The results from this question became a useful baseline when we asked it again six months later (in November 2008), when we were undeniably in a deep financial crisis. Now, more than five years later, we are no longer experiencing financial crisis, yet Federal Reserve policy continues to be extraordinary. For example, the Fed's target for the federal funds rate remains at the lower bound of 0-0.25 percent, the Fed is only slowly tapering off from its Quantitative Easing 3 bond-buying program, and the Fed's balance sheet has undergone great change since August 2008. Among other things, the Fed now holds more than $3.9 trillion of securities (including $1.6 trillion of mortgage-backed securities). Prior to the full-blown financial crisis, in August 2008, the Fed held only $480 billion of securities (none of which were mortgage-backed instruments). Along with this buildup in Fed assets is a substantial rise in bank excess reserves. Banks now hold $2.5 trillion of excess reserves (these are the funds that are traditionally available to banks to fund lending opportunities) — a huge increase from $2 billion in July 2008.

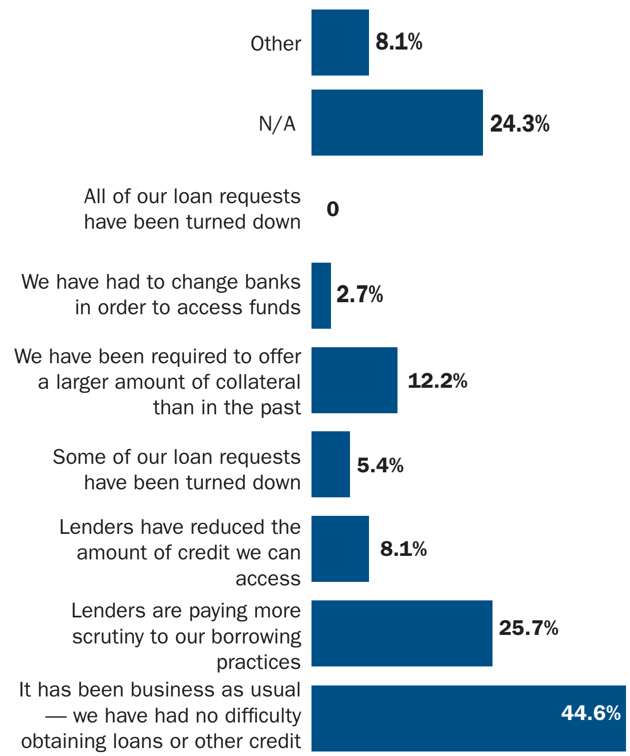
Despite this increase in lending potential, it appears that credit growth has been very modest. Various explanations have been advanced as to why the expansion of credit has been limited, including slack loan demand, heightened regulatory scrutiny of bank lending practices, attractive alternative uses of funds for banks, ongoing financial uncertainty, etc. We decided that it was a good time to see what area firms were experiencing with regard to the availability of credit, so we tweaked the question asked twice in 2008 to read:

"Please indicate how your business' access to loans (or other forms of credit) from banks or other financial service providers has changed since prior to the financial crisis (prior to 2008)."

More than 44 percent of surveyed firms report business as usual in obtaining loans. This question was not applicable for nearly one-quarter of firms (who have presumably not had any recent credit demands). This is a similar result to the May 2008 survey (when 48 percent of firms reported business as usual and 20 percent replied that this was not applicable). Note that the November 2008 survey was not as favorable. At that time, 36 percent of firms reported business as usual and the question was not applicable for 24 percent of firms. It is worth noting, however, that 25.7 percent of firms are currently reporting "lenders are paying increased scrutiny to our borrowing practices." This is higher than the November 2008 survey (17 percent of firms reported increased scrutiny) and the May 2008 survey (20 percent experienced greater scrutiny).

Compared to the 2008 survey, fewer firms currently report that they have had to change banks. A slightly greater percentage of firms currently report that some of their loan requests have been turned down, and a greater percentage are currently required to

PLEASE INDICATE HOW YOUR BUSINESS' ACCESS TO LOANS (OR OTHER FORMS OF CREDIT) FROM BANKS OR OTHER FINANCIAL SERVICE PROVIDERS HAS CHANGED SINCE PRIOR TO THE FINANCIAL CRISIS (PRIOR TO 2008). PLEASE CHECK ALL THAT APPLY.



offer a larger amount of collateral than in the earlier surveys. Written responses to this question are instructive (note that we have not included several responses that indicated that they have had no problem borrowing or that they have not attempted to access loans or other forms of credit):

- Definitely a tougher lending environment.
- We do not use debt to finance operations.
- We attempted to refinance one of our buildings, and they would be willing to refinance but only if more collateral was given. Would not allow us to generate cash from a refinance of our building.
- We do not borrow.
- It is easy to borrow money. The tougher decision is finding a good business opportunity to support the loan.
- We are paying a lot down on principal, but (a) bank wouldn't give an improvement loan for remodel we did last fall — had to get personal loans to do improvements.
- It would be tough to start out with the current bank requirements.
- Overcollateralization is the new normal. The art of personal and community banking seems to be gone.
- We are strong financially and were in a position with an available operating line of credit to ride out the crisis.
- The banking practices have tightened considerably. There is a lot of jumping through hoops to get a small loan or working capital.
- Since we changed to a locally owned, customer service-based bank, we've had no issues with lending. Plus, the fees have dropped dramatically.
- Our corporation went through a refinance of debt, and the refinance (was) much longer and cost more than expected due to the lenders having more strict requirements.
- We have good relationships with our lending partners. They have been willing to work with us when needed.
- I left the national banks in 2007 and aligned myself with a local bank that understands the need to partner rather than use national statistics to manage accounts. Because of the partnership, we have been able to double our business since 2008.
- Credit has tightened!
- Recession had little effect on our business, so access to capital has been normal.
- We have a good relationship with our bank, and they worked with us through the tough times.
- More paperwork.
- Loans are available but with more financial reporting involved.
- Tight lending standards have hurt our business and buyers.
- We are franchised. Our main office sets up our financing.
- We self-finance. No longer seek funding from a bank. It has made our life simpler and less stressful. I wish I had done this a decade or more ago.

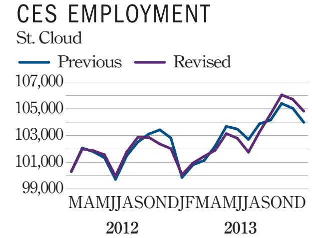
ALL SIGNS POINT TO STRONG SPRING

Last year brought strong employment growth to Minnesota, and St. Cloud was stronger than most. Overall payroll employment in St. Cloud grew 1.7 percent. Outside of manufacturing and information technology, every sector of the private economy gained jobs over the year ending in January 2014. The largest gains were in professional and business services, education and health, retail trade, and leisure and hospitality. Construction employment was stronger elsewhere in the state, but the St. Cloud service sector grew at a faster rate (2 percent) than the Twin Cities or state as a whole.

Growth of employment shown in Table 4 was very strong in 2013. Our unemployment rate is 6.1 percent, the lowest January unemployment rate in the St. Cloud area since January 2008 (prior to the beginning of our most recent local recession). In a separate report, the Minnesota Department of Employment and Economic Development has revised its data upward for payroll employment so that for the 12 months ending December 2013, payroll growth in St. Cloud was 2.75 percent rather than the previously reported 1.14 percent, with an upward revision of 828 jobs in December. Growth was slower in the first half and higher in the second half of 2013 than previously reported, and that acceleration is promising good momentum for 2014.

The remainder of Table 4 reports a mix of good and bad news. On the good

CES EMPLOYMENT



side, initial claims for unemployment insurance have declined 6 percent in the past 12 months, continuing a general improvement of labor market conditions. Employment of individuals living in St. Cloud rose 1.1 percent. On the other hand, help-wanted advertising declined sharply in the final quarter of 2013, and the value of residential building permits fell more than 10 percent. And just as there has been concern over labor market participation more generally in the U.S. economy in the last few years, the labor force fell 0.1 percent in St. Cloud. This does not necessarily mean there has

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been a decline in participation locally; there may simply be more individuals who have reached retirement age. Despite those negative signs, the New St. Cloud Index of Leading Economic Indicators rose 1.1 percent in the past 12 months. (See sidebar for a description of changes to this index.)

Two of the four elements of the New St. Cloud Index of Leading Economic Indicators moved in a positive direction, and two moved in a negative direction. The significant improvement in new claims for unemployment insurance dominated the downward pull of less help-wanted advertising. Professional and business services employment contributed positively to the index, while new business incorporations contributed negatively.

The four elements of the leading indicator index also are elements of the new Probability of Recession Index, along with the Minnesota Business Conditions Index from Creighton University. That measure has moved strongly positive in the last quarter. Its author, Ernie Goss, stated in early March that "expansions for durable goods manufacturers, including medical equipment producers, more than offset pullbacks for food processors" in Minnesota. He also noted that temporary help employment was used in these industries. The combination of factors brought the Probability of Recession Index to virtually nil, meaning we do not foresee a recession in the next four to six months.

We are struck by the optimism shown by local business leaders and the generally strong balance of data in the past few months, despite a very deep, cold winter. We have argued on this page recently that policy uncertainty has caused some holding back of capital expenditures, but that policy environment is now much clearer.

Federal fiscal policy is likely on hold until elections next November.

The Federal Reserve under a new chair, Janet Yellen, is likely to remain stable even if a month or two of bad data should appear. Most new chairs wish to be seen as concerned about inflation, and we do not think Yellen will be any different.

International events, intriguing though they may be, are unlikely to move much of the St. Cloud economy. There is wrangling in St. Paul over repeal of business-to-business taxes, but we believe that will be resolved in the very near future. With fewer uncertainties, good momentum from 2013 and abundant optimism in local business leaders, the spring looks very bright for the St. Cloud area.

TABLE 3 - EMPLOYMENT TRENDS

	St. Cloud (Stearns and Benton)			13-county Twin Cities area			Minnesota		
	15-year trend rate of change	January '13-January '14 rate of change	January '14 employment share	15-year trend rate of change	January '13-January '14 rate of change	January '14 employment share	15-year trend rate of change	January '13-January '14 rate of change	January '14 employment share
Total nonagricultural	0.9%	1.7%	100%	0.5%	1.5%	100%	0.6%	1.9%	100%
Total private	1%	2.6%	84.8%	0.6%	1.6%	86.7%	0.6%	2.2%	84.9%
Goods producing	-0.4%	0.4%	18.4%	-1.4%	2.6%	13.4%	-1.3%	3.7%	14.7%
Construction/natural resources	1.8%	2.2%	4.1%	-0.5%	7.4%	3.1%	0	11%	3.5%
Manufacturing	-1%	-0.2%	14.3%	-1.7%	1.3%	10.3%	-1.6%	1.6%	11.2%
Service providing	1.3%	2%	81.6%	0.9%	1.3%	86.6%	0.9%	1.6%	85.3%
Trade/transportation/utilities	-0.1%	2%	20.4%	-0.3%	1.3%	18%	-0.1%	2%	18.6%
Wholesale trade	1.3%	3.4%	4%	0	1.4%	4.6%	0.4%	2.6%	4.8%
Retail trade	-0.8%	2%	13%	-0.2%	1.3%	9.9%	-0.2%	1.9%	10.4%
Trans./warehouse/utilities	1.1%	0.4%	3.3%	-0.9%	1.1%	3.5%	-0.3%	1.9%	3.4%
Information	-1.6%	-1.5%	1.6%	-1.1%	-0.4%	2.2%	-1.1%	2.7%	2%
Financial activities	2%	1.6%	4.4%	0.6%	-0.3%	7.9%	0.7%	0.1%	6.5%
Professional & business service	3.3%	6.8%	8.4%	0.6%	0	15.1%	0.9%	1.9%	12.3%
Education & health	3%	3%	19.4%	3.7%	3.6%	16.8%	3.3%	2.4%	17.9%
Leisure & hospitality	1.6%	5.4%	8.8%	1.5%	2.4%	9.1%	1.2%	1.5%	8.6%
Other services (excluding govt.)	-0.1%	1.6%	3.4%	0.8%	1.4%	4.3%	0.5%	2.5%	4.3%
Government	0.8%	-3%	15.2%	0.2%	0.6%	13.3%	0.3%	0.4%	15.1%
Federal government	2%	-0.2%	2.1%	-0.7%	-0.9%	1.1%	-0.5%	-1%	1.1%
State government	1.2%	-5.2%	4.6%	0.3%	2.1%	3.7%	0.8%	0	3.6%
Local government	0.3%	-2.4%	-2.3%	0.3%	0.2%	8.5%	0.2%	0.7%	10.4%

Note: Long-term trend growth rate is the compounded average employment growth rate in the specified period.

Sources: Minnesota Department of Employment and Economic Development and author calculations.

TABLE 4 - OTHER ECONOMIC INDICATORS

	2013	2014	Percent change
St. Cloud MSA labor force January (Minnesota Workforce Center)	108,403	108,344	-0.1%
St. Cloud MSA civilian employment # Janaury (Minnesota Workforce Center)	100,601	101,697	1.1%
St. Cloud MSA unemployment rate* January (Minnesota Workforce Center)	7.2%	6.1%	N/A
Minnesota unemployment rate* January (Minnesota Workforce Center)	6.6%	5.7%	N/A
Minneapolis-St. Paul unemployment rate* January (Minnesota Workforce Center)	6%	5.1%	N/A
St. Cloud-area new unemployment insurance claims November-January average (Minnesota Workforce Center)	1,632	1,534.3	-6%
St. Cloud Times help-wanted ad linage November-January average	2,084	1,493	-28.3%
St. Cloud MSA residential building permit valuation In thousands, November-January average (U.S. Department of Commerce)	2,972	2,656	10.6%
St. Cloud index of leading economic indicators January (St. Cloud State University)**	101.3	102.3	1.1%

NOTE: July 2013 LEI estimated under experimental program. See text.

MSA = St. Cloud Metropolitan Statistical Area, composed of Stearns and Benton counties.

- The employment numbers here are based on household estimates, not the employer payroll estimate in Table 3.

* - Not seasonally adjusted

** - October 2001=100

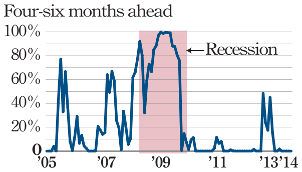
N/A - Not applicable

TABLE 5-ELEMENTS OF ST. CLOUD INDEX OF LEI

Changes from November 2013 to January 2014	Contribution to LEI
New claims for unemployment insurance	3.82%
Professional employment	0.38%
New business incorporations	-1.42%
Help-wanted advertising in St. Cloud Times	-2.06%
Total	0.72%

PROBABILITY OF RECESSION

Four-six months ahead



THE NEXT QBR

Participating businesses can look for the next St. Cloud Area Business Outlook Survey in May. The next St. Cloud Area Quarterly Business Report will appear in the St. Cloud Times on Sunday, June 15.