AGENDA ITEM #11
December 1, 2009

MEMORANDUM

November 25, 2009

TO: County Council

FROM: Stephen B. Farber, Council Staff Director SBF

SUBJECT: Update on Economic Indicators and County Fiscal Plan

OMB Director Joseph Beach, Finance Director Jennifer Barrett, and their colleagues will join the Council for this update on economic indicators and the County Fiscal Plan for FY10-11. This packet focuses on the economic indicators update on ©1-21 prepared by Chief Economist David Platt. **The Fiscal Plan update will be transmitted on November 30 and will be included in an addendum to this packet.**

National Indicators

The national economic indicators suggest that the economy is no longer in the free fall of one year ago and, while still weak in critical areas, is somewhat more stable. The revised growth in real gross domestic product of 2.8 percent in the third quarter contrasts with the four previous quarters, which showed successive declines of 2.7, 5.4, 6.4, and 0.7 percent.

The sharp upturn of the stock market since its March low, as outlined on ©4, reflects in part aggressive cost-cutting and improved productivity, but the employment picture remains dismal. The national unemployment rate rose in October to 10.2 percent, the highest in 26 years, while the rate including underemployed and discouraged workers rose to 17.5 percent. These rates are expected to rise further and, after they peak, to fall very slowly. Credit availability and housing show some signs of improvement, but the picture is decidedly mixed, with 23 percent of homeowners now "underwater," owing more on their mortgages than their houses are worth. Concern persists that commercial real estate may be the next heavy shoe to drop. Whether growth can be self-sustaining when the massive governmental props recede is an open question.

The impact of these conditions on state and local revenues has been severe. The Rockefeller Institute reports that 44 states showed an 11 percent year-over-year decline in revenues for the third quarter of 2009. Those with the highest unemployment rate percentages, such as Michigan (15.1), Nevada (13.0), California (12.5), and South Carolina (12.1), show especially large declines, as does the District of Columbia (11.9). Even states with much lower rates, including Maryland (7.3) and Virginia (6.6), have serious revenue shortfalls. Recent developments in California, where a $21 billion budget gap has re-emerged, include an 18 percent pay cut for the top 12 state elected officials and a 32 percent increase in university fees.

Regional and County Indicators

The regional indicators on ©6-10 show the continued softness in both the labor market and the housing market. The County indicators on ©12-21 confirm this picture. The County's September unemployment rate was just 5.3 percent, but that was more than double the April 2008 rate of 2.5 percent. Resident employment in September was down 9,600 (1.9 percent) from a year earlier. Total home sales are projected to increase by 13.7 percent in 2009, but this follows successive declines of 20.5, 23.5, and 17.8 percent in 2006-2008. Meanwhile the average sales price is projected to fall 15.0 percent, following increases of 4.4 and 3.9 percent in 2006-2007 and a decline of 8.4 percent in 2008. Not surprisingly, as shown on ©17, new residential construction has fallen by 79.3 percent from the recent peak in 2005, while non-residential projects have also shown a large decline. The vacancy rate for Class A property, which was 5.7 percent in the second quarter of 2006, has risen to 13.4 percent.

These indicators help to explain the weakness in County income tax revenue, which the Council reviewed on November 24.[1] It is a key factor in the sharp increase in the County's projected $370 million budget gap for FY11 (the estimate for the Council's last fiscal update on September 29) to a gap that, depending on the factors included, could approach or exceed $600 million. As noted above, OMB's current projection of the FY11 gap and supporting data will be available on November 30 and will be included in an addendum to this packet.

This packet also includes on ©22-26 a November 25 memo from Ms. Barrett about the Revenue Stabilization Fund in response to questions raised by Mr. Elrich on November 24.

Also joining the Council for the December 1 fiscal update, to provide perspectives on the economy from the private sector, will be William G. Robertson, President and CEO of Adventist HealthCare and Chair of the Economic Development Committee of the Montgomery County Chamber of Commerce, and Greg Hourigan, owner of the (appropriately named) Hard Times Café in Bethesda.

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[1] See http://www.montgomerycountymd.gov/content/council/pdf/agenda/col/2009/091124/20091124_3-1.pdf for the packet on this issue.

Montgomery County, Maryland

ECONOMIC INDICATORS

Presentation to the Montgomery County Council

Department of Finance

December 1, 2009

National Economic Indicators

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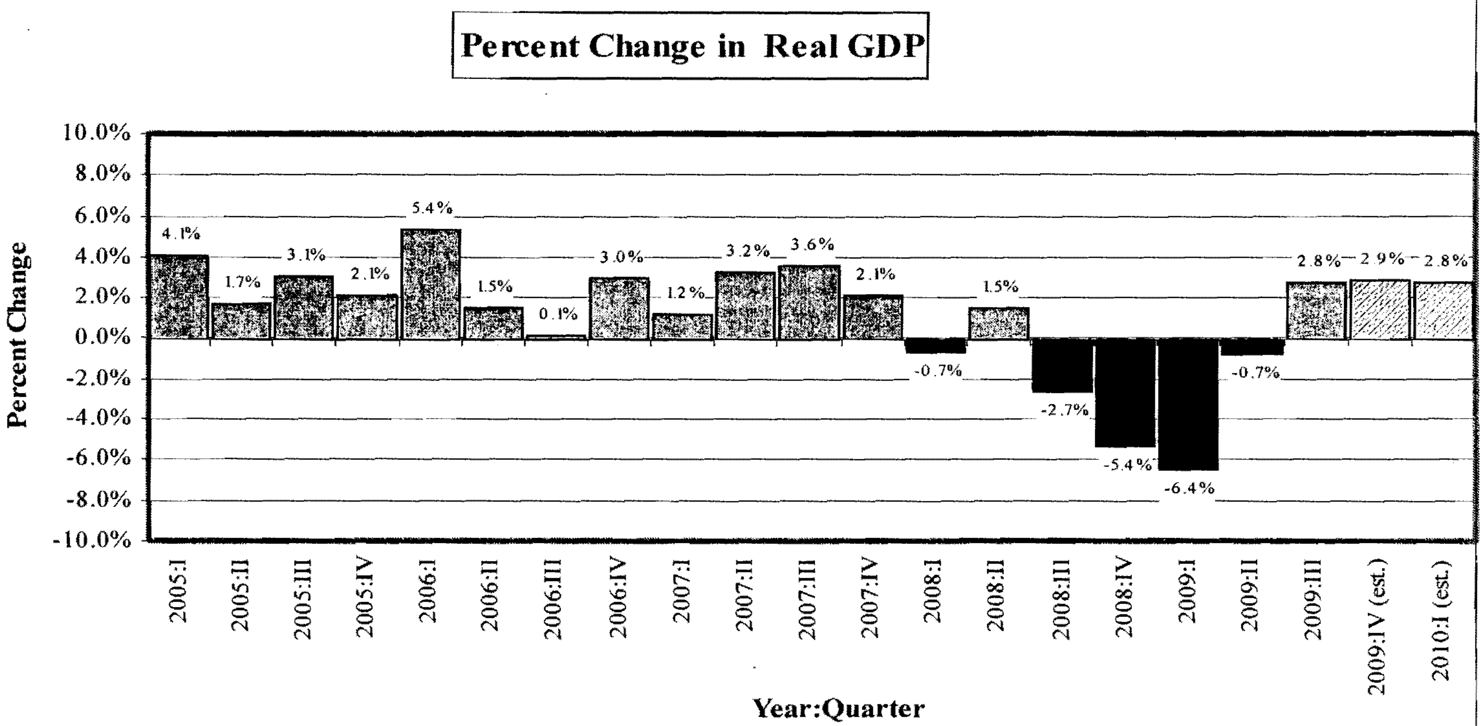
BEA reported that real GDP increased a revised 2.8 percent during the third quarter. On average over 50 economists surveyed by *The Wall Street Journal* earlier this month expect GDP to increase 2.9 percent this quarter and 2.8 percent during the first quarter of next year.



SOURCE: Bureau of Economic Analysis, U.S. Department of Commerce. Hatched bars from *Wall Street Journal* survey conducted November 6-10.

NOTE: Percent changes are at annual rates.

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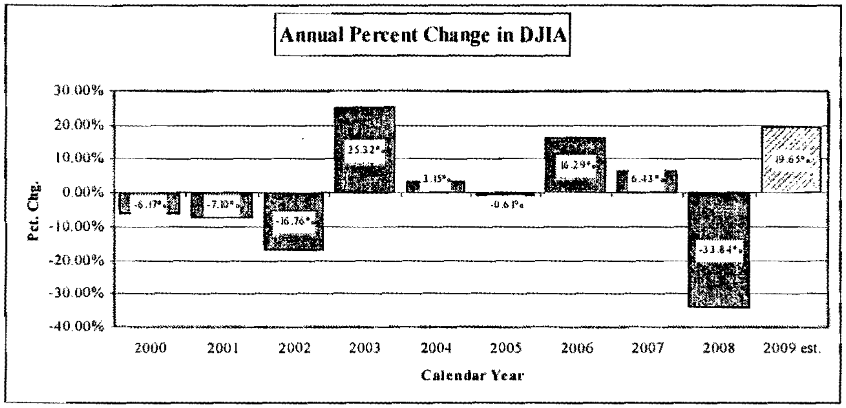
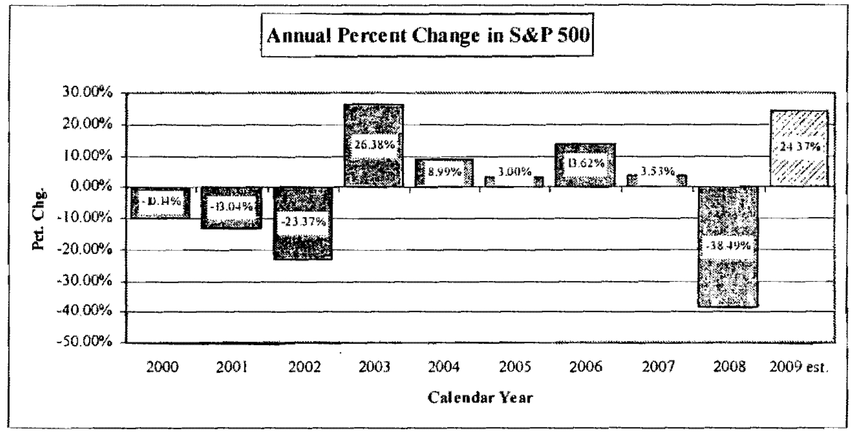
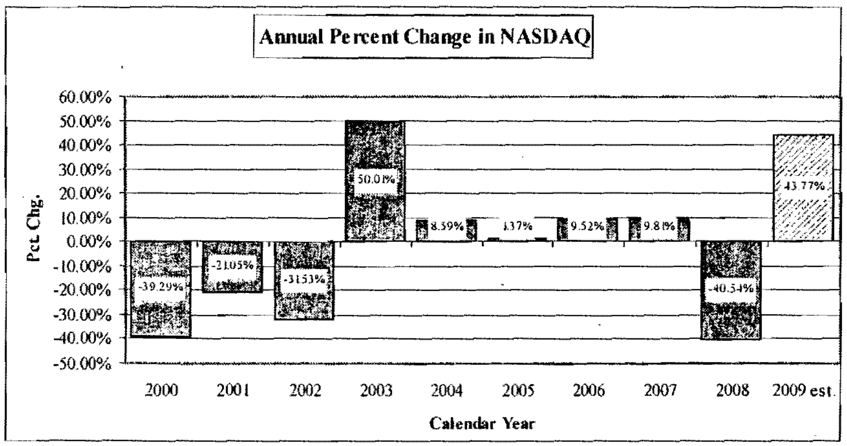
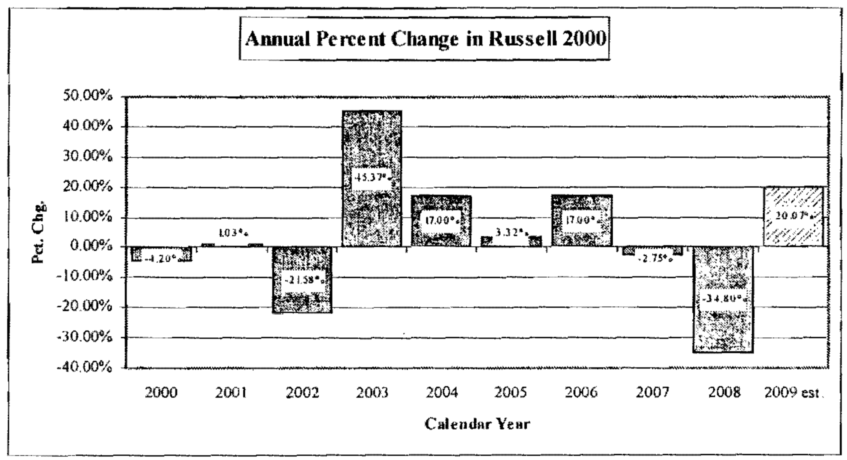
Due to the dramatic growth in the stock market since the trough on March 9th, all four stock indices have increased between 57 percent (DJIA) and 71 percent (NASDAQ). Because of that dramatic growth, Finance estimates that the stock market will experience its best performance since 2003.



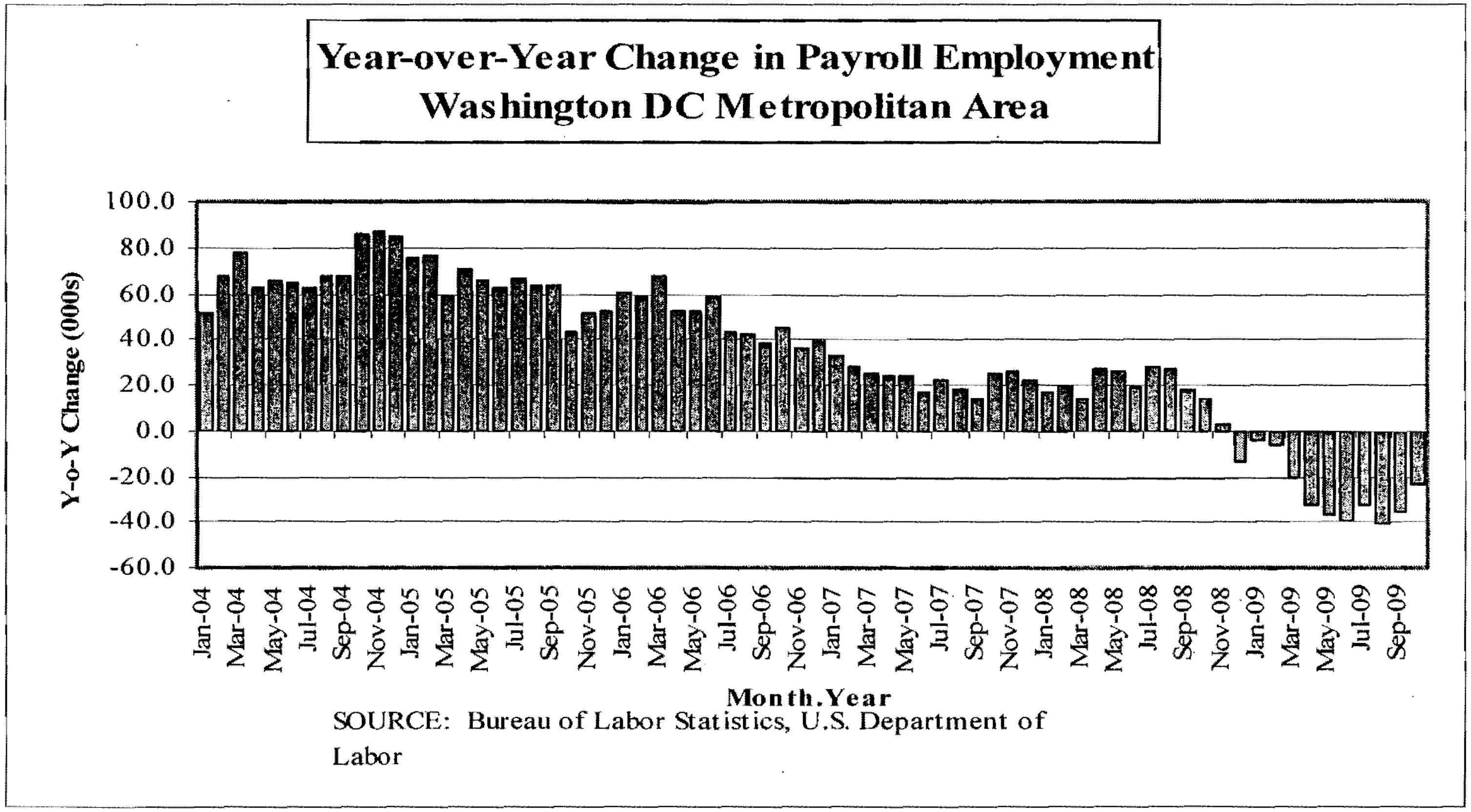






Regional Economic Indicators

Employment in the metropolitan region stood at nearly 2.996 million in October compared to 3.020 million in September '08 - decline of 24,000.



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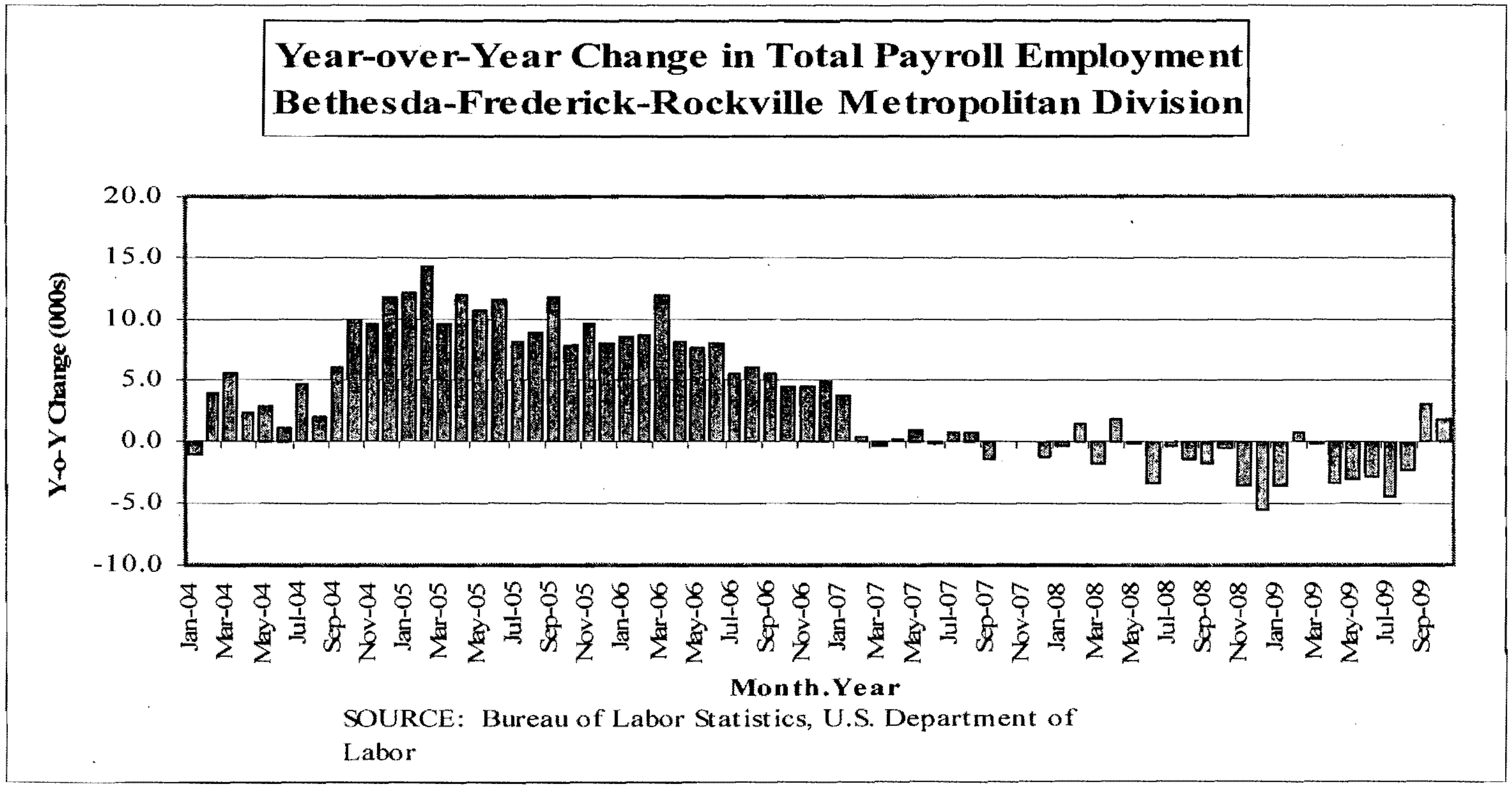
Payroll employment for Montgomery and Frederick counties stood at 578,300 in October - an increase of 1,800 jobs since October '08. The professional and business services sector experienced a significant increase of 8,100 jobs since October '08. For the first ten months of this year, monthly payroll employment averaged 573,500 – a 0.2 percent decline over the same period last year.



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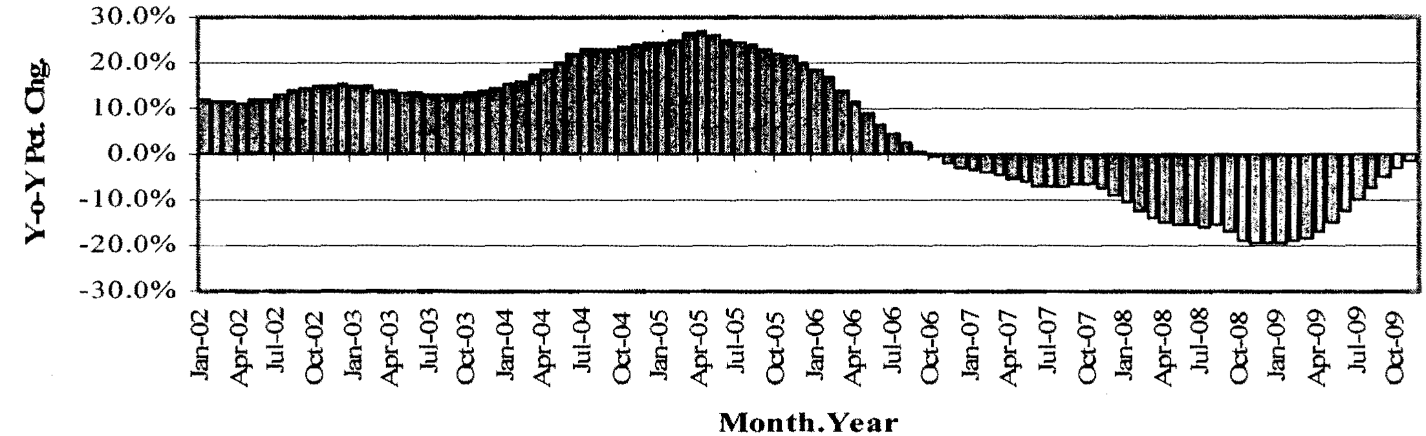
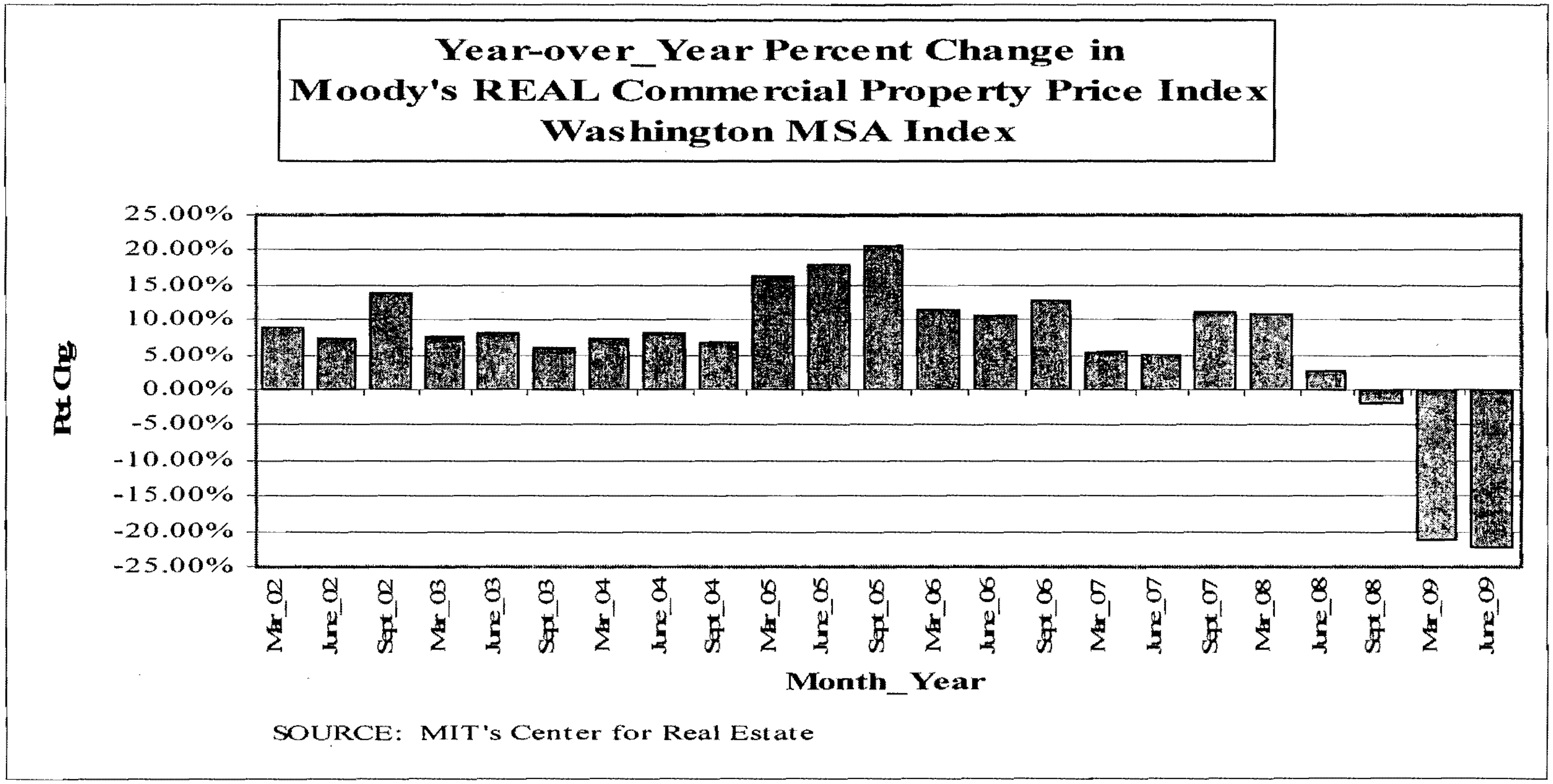
Based on the Case-Shiller® index, home prices in the Washington metropolitan region decreased 5.0 percent in September compared to September '08. While the year-over-year percent change in the index declined, the index increased 8.7 percent between March and September of this year.



NOTE: S&P/Case-Shiller price index is a registered trademark of Standard and Poor's. Data for October 2009 and November 2009 extrapolated from Chicago Mercantile Exchange futures data.

Based on the Moody's REAL® Commercial Property Index, prices for commercial property in the Washington metropolitan area decreased 22.3 percent in June compared to June '08.



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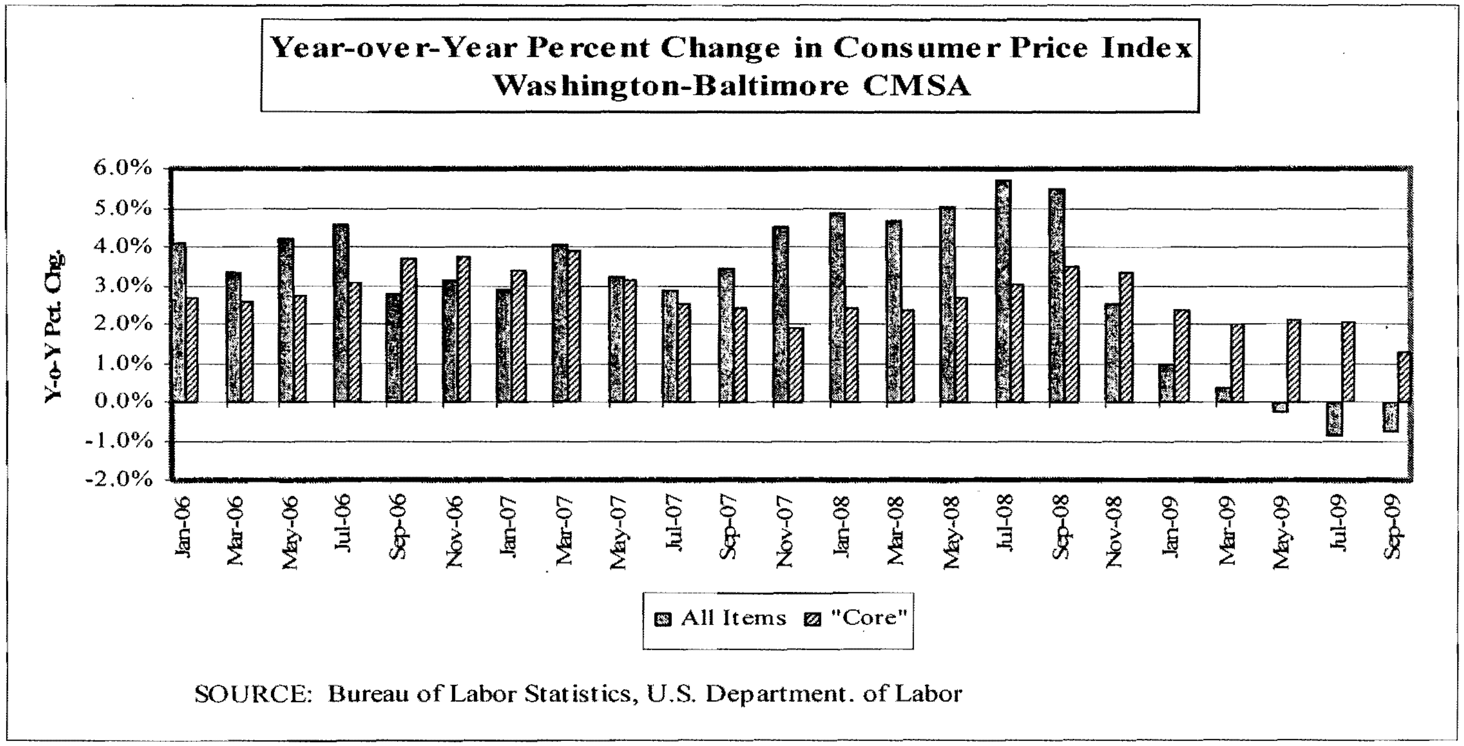
Because of the dramatic decrease in energy prices, the overall consumer price index for the Washington-Baltimore consolidated region declined 0.8 percent in September compared to September '08. For the calendar year (January through September), the index *decreased* 0.1 percent compared to a 5.12 percent increase in 2008.



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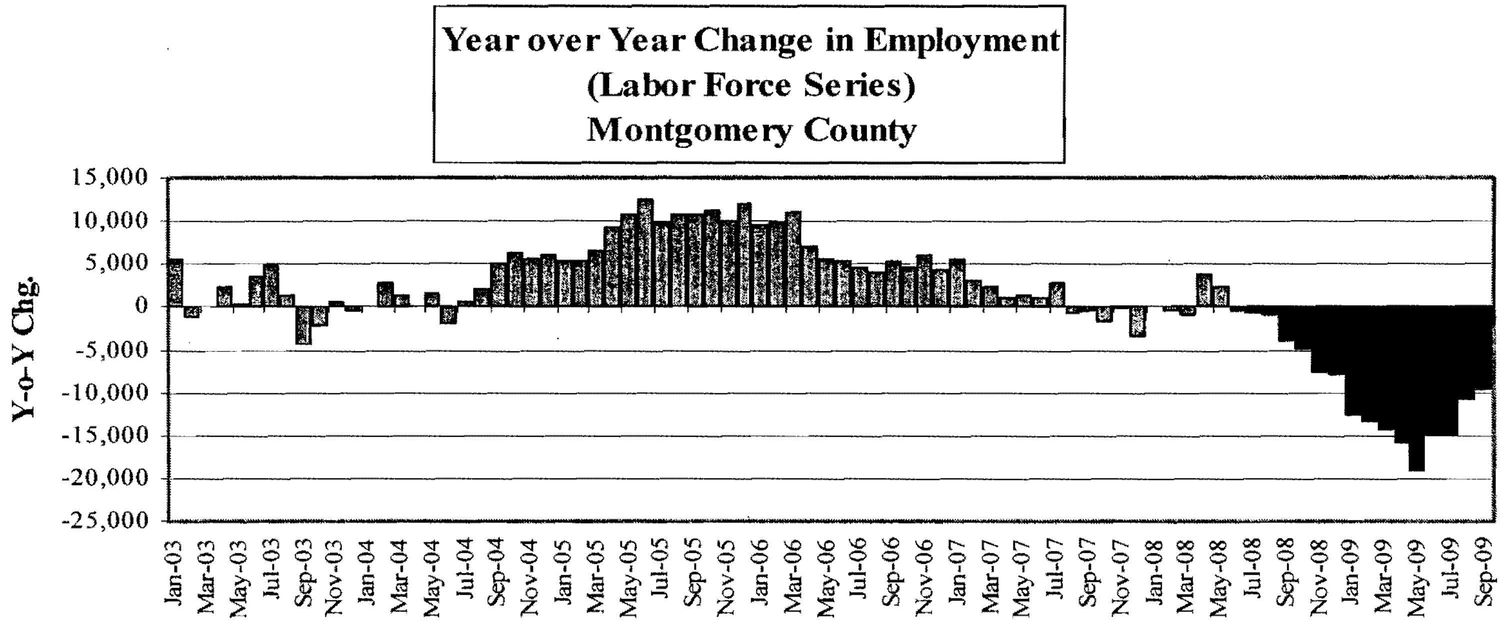
Montgomery County
Economic Indicators

Resident employment in Montgomery County was 484,500 in September compared to almost 494,100 in September '08 - a decline of 9,600 (↓1.9%). Since May of last year, the year-over-year change in the County's monthly employment declined each month.



SOURCES: Bureau of Labor Statistics, U.S. Department of Labor
Montgomery County Department of Finance

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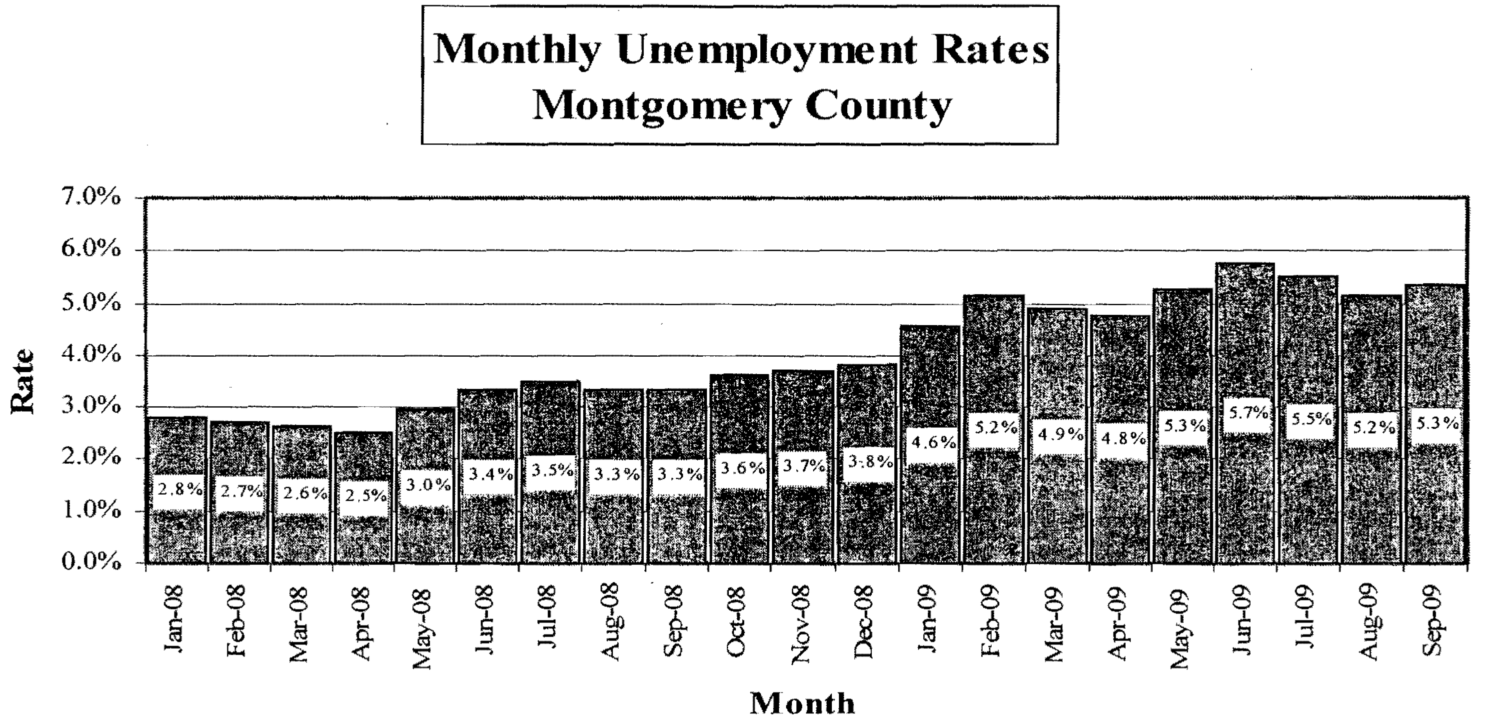
Because of the steady decline in the County's employment, the unemployment rate has jumped from 2.5 percent in April 2008 to 5.3 percent in September of this year.



SOURCE: Bureau of Labor Statistics, U.S. Department of Labor
NOTE: Data are not seasonally adjusted

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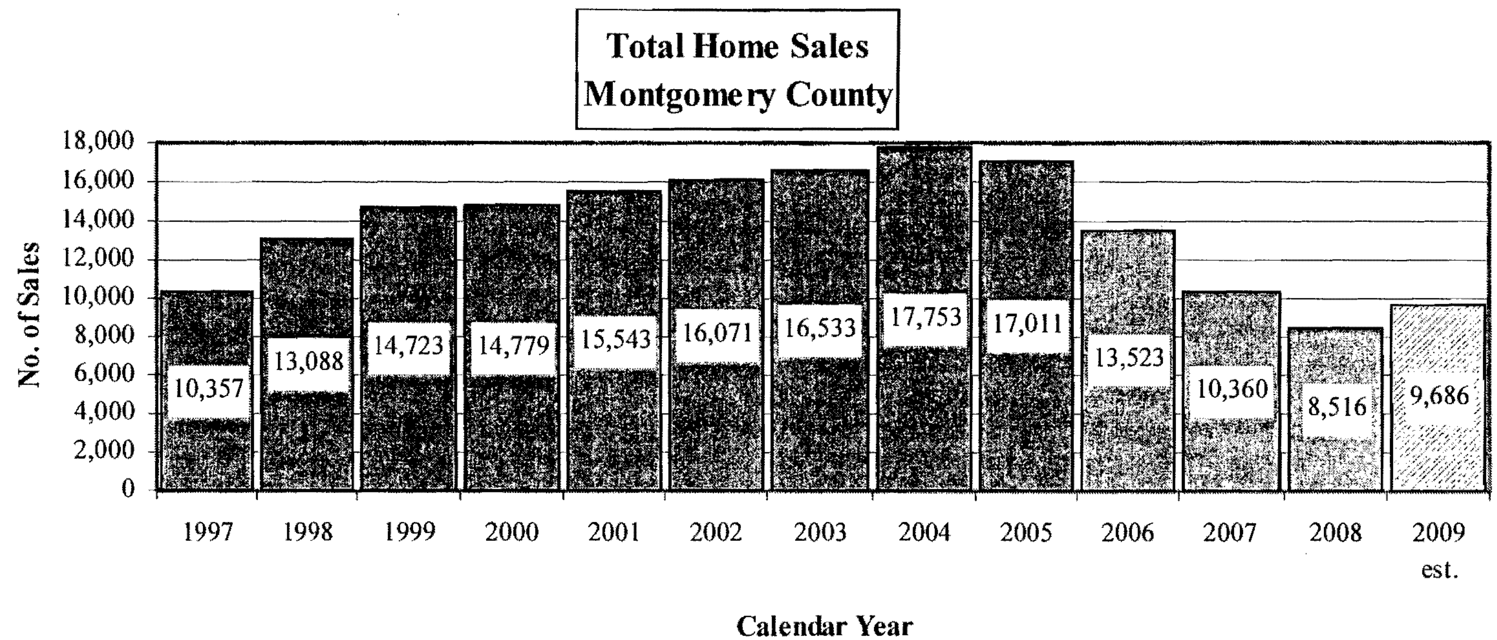
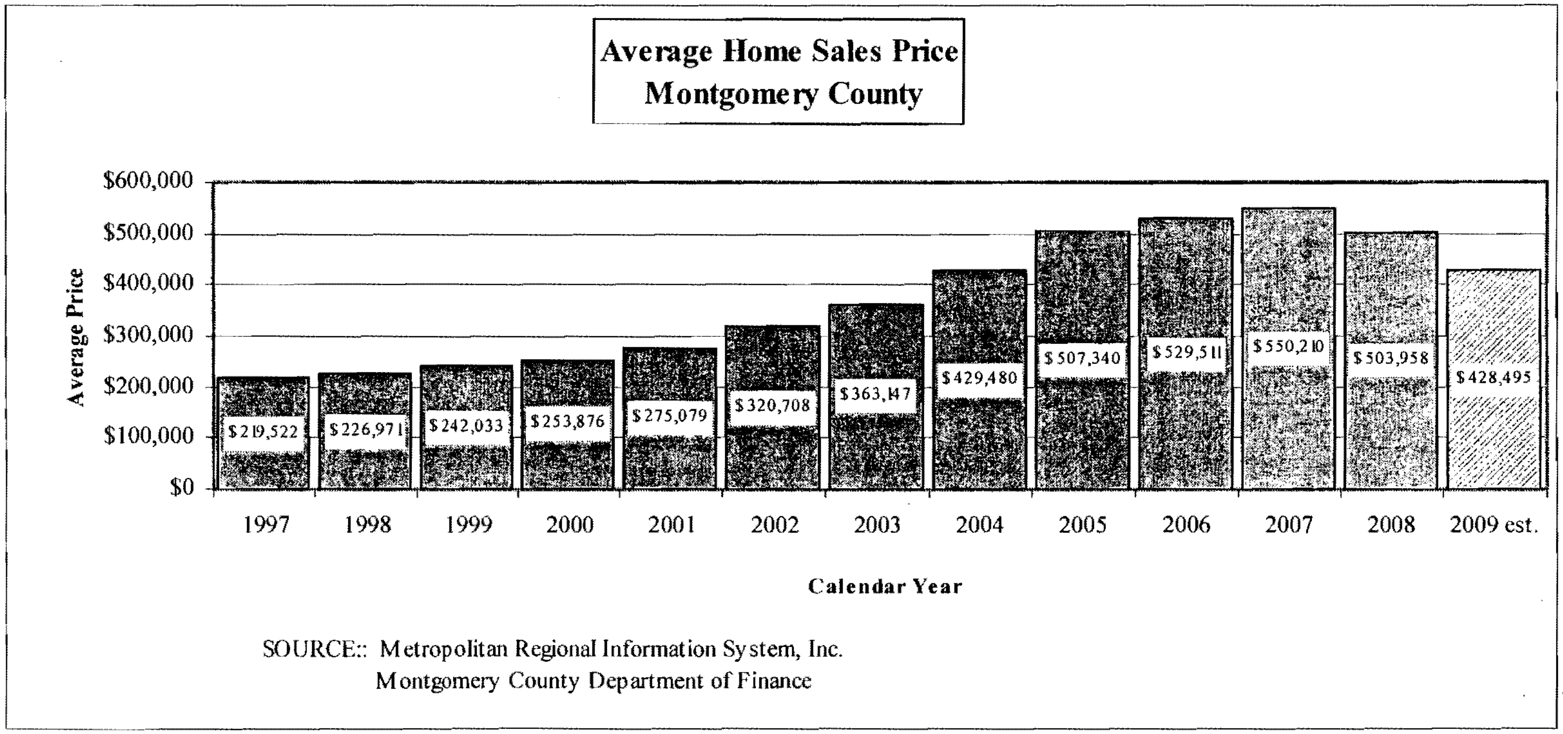
With home sales increasing at an average monthly rate of 150 units between March and September compared to the same period last year, total home sales are projected to increase 13.7 percent in 2009 compared to declines of 20.5 percent (2006), 23.4 percent (2007), and 17.8 percent (2008).



SOURCES: Metropolitan Regional Information System, Inc.
Montgomery County Department of Finance

While the sales of existing homes in the County is expected to increase in 2009, the average sales price is projected to decline 15.0 percent, which follows increases of 4.4 percent (2006), 3.9 percent (2007), and a decrease of 8.4 percent (2008).



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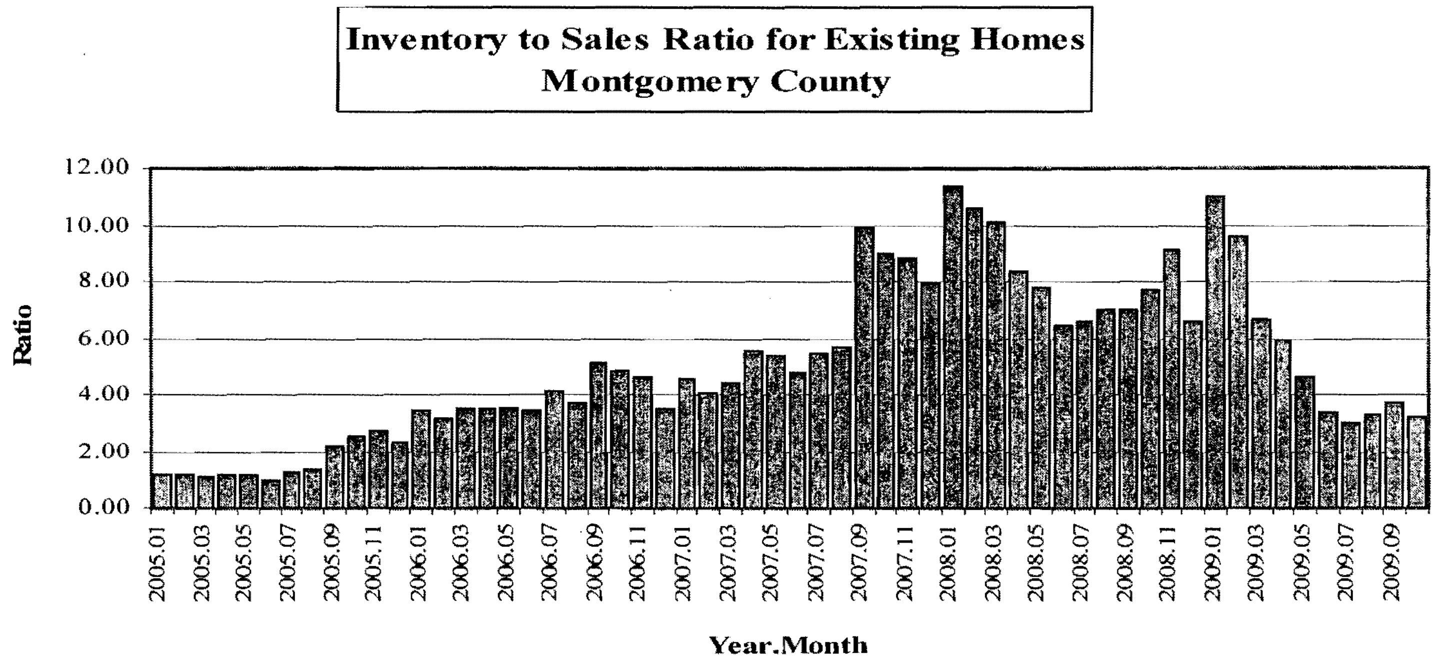
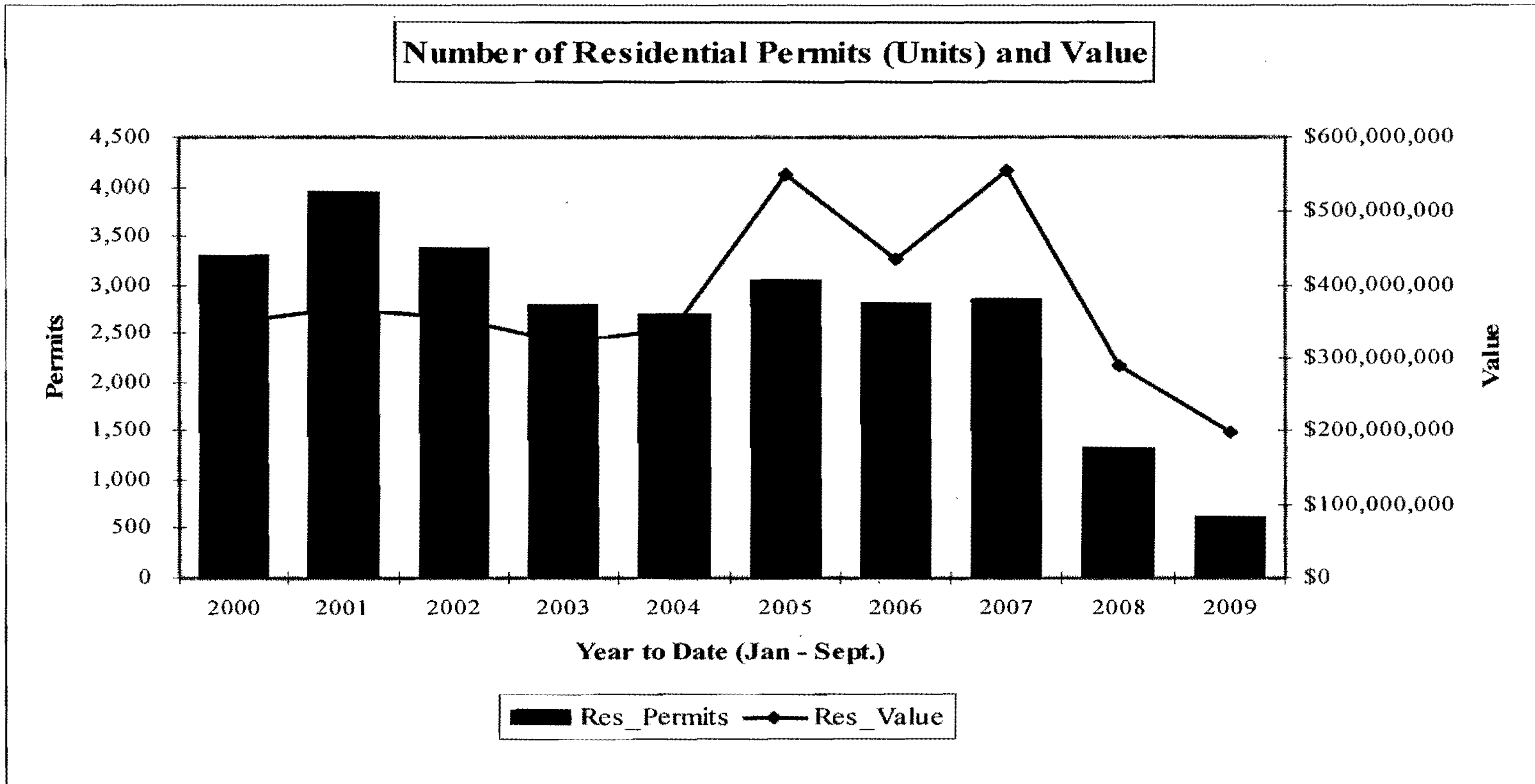
The inventory of existing homes for sale has declined significantly from its recent peak of an eleven-month supply in January to slightly more than a three-month supply in October. The latest inventory figure remains below the 7-month figure of October 2008.



SOURCES: Metropolitan Regional Information System Inc.
Greater Capital Area Association of Realtors
Montgomery County Department of Finance

The decline in home sales over the previous years coupled with the increase in the inventory of homes for sale affected new residential construction. The number of residential permits (units) declined from the recent peak of 3,100 in 2005 (January to September period) to 632 in 2009 – a decrease of 79.3 percent.



SOURCE: Census Bureau, U.S. Department of Commerce

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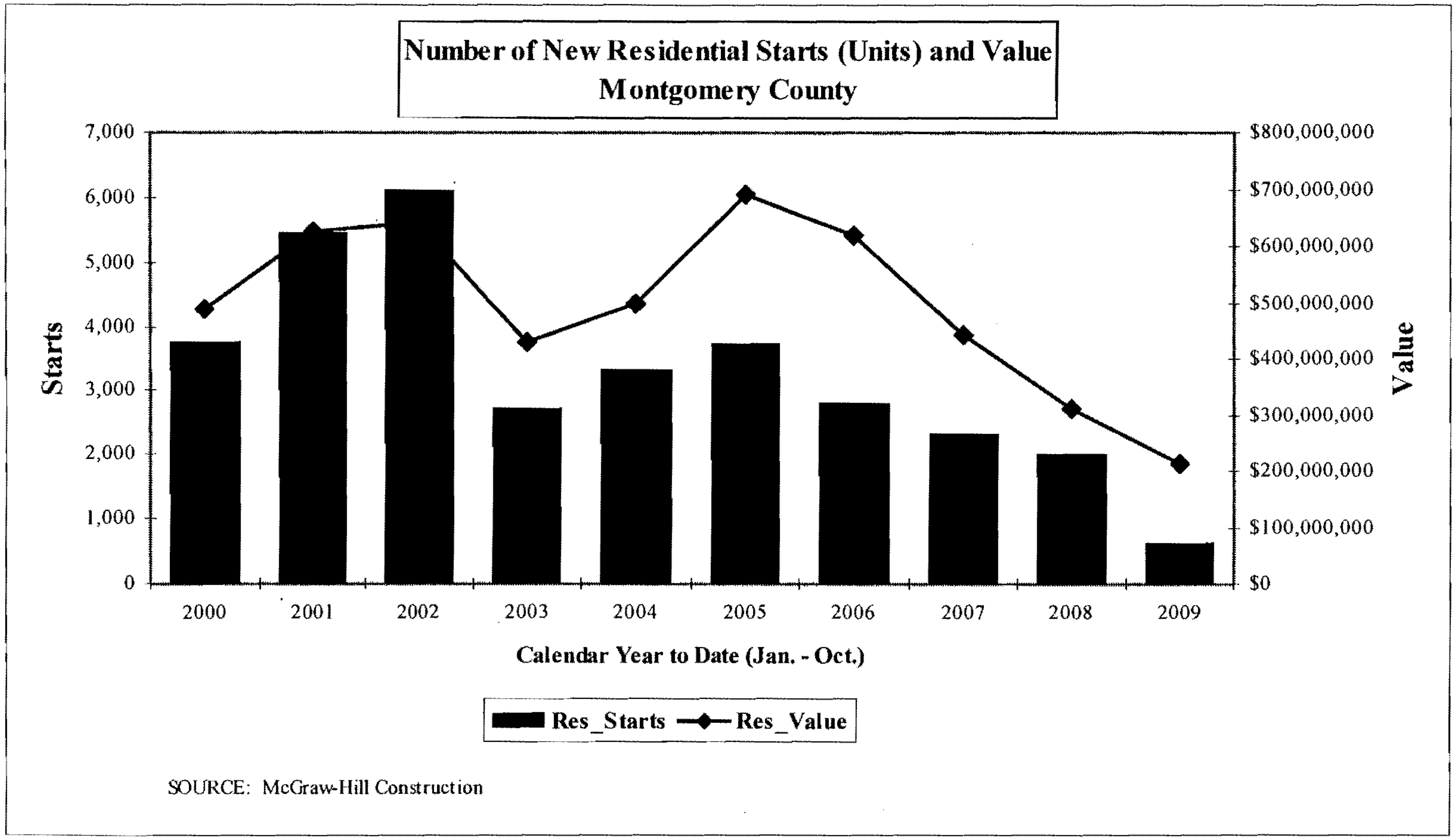
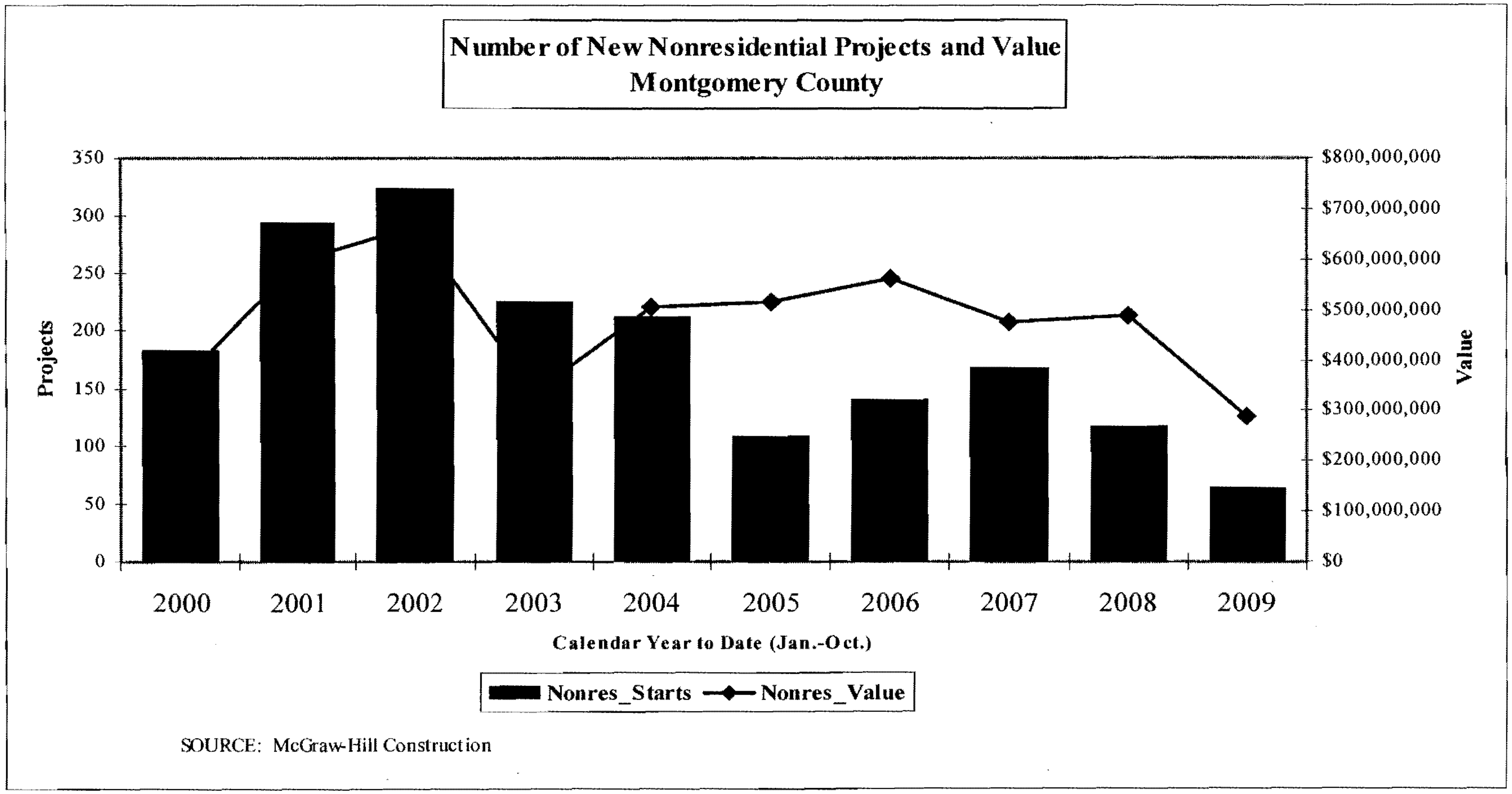
The decline in the number of permits is also mirrored in the number of residential construction starts. The number of new units under construction declined from slightly more than the recent peak of 3,700 units in 2005 (January to October) to 645 units this year – a decrease of 82.7 percent.



The number of non-residential projects during the January to October period has declined from a recent peak of 168 in 2007 to 64 in 2009 to date (↓61.9%). Also the additional value decreased from $476.8 million in 2007 (January to October period) to $289.1 million so far this year (↓39.4%).



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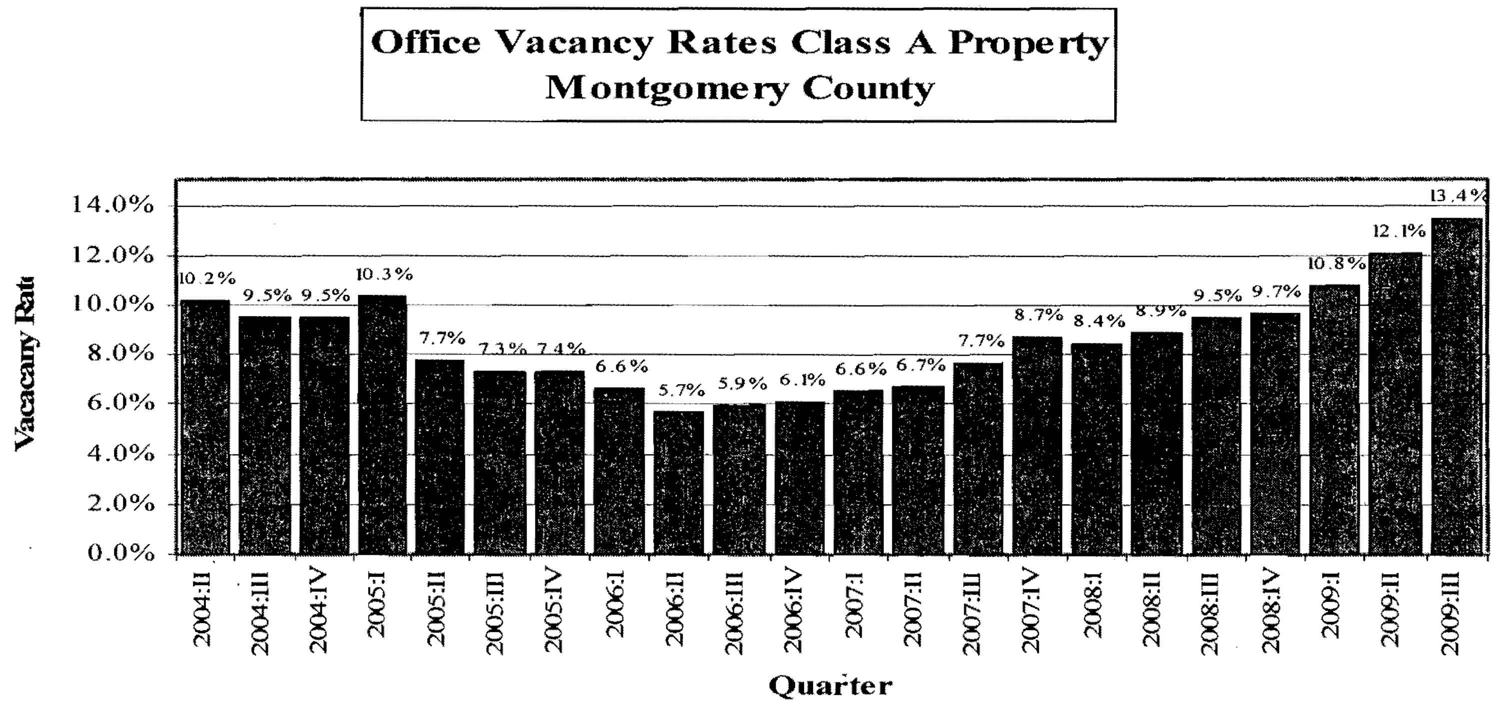
The decrease in non-residential construction is attributed to the steady increase in the vacancy rates of Class A property in the County. Since the second quarter of 2006, that rate increased from 5.7 percent to over 13 percent during the third quarter of this year.



SOURCES: Planning Division, MNCPPC-MC
Montgomery County Department of Finance

Summary

- Employment:
  - The County's unemployment rate has risen by 2 percentage points during the past year (through September) to 5.3%.
  - Because the unemployment rate is a lagging indicator in terms of an economic recovery, it may not improve significantly over the next calendar year. As the national unemployment rate reached 10.2 percent in October, employment will remain a drag on the economy for the foreseeable future.
  - The County's resident employment was 484,500 in September – a decline of 9,600 from September 2008. With a decline in resident employment and possibly slow recovery, both factors will have a significant effect on income tax revenues in FY10 and possibly FY11.
- Construction:
  - With the value of new construction starts for residential projects below $215 million to date in 2009 compared to less than $311 million over the same period last year, additional property assessments from new construction could, by FY11, be at their lowest level in over 10 years.
- Inflation:
  - While the recent figures for inflation are a welcome relief to the local consumer, it will have a significant effect on the amount of property tax revenues under the Charter Limit in FY11. Currently the index is less than a 0.1 percent annual rate (or essentially flat) for calendar year 2009.
- Housing Sales and Average Sales Prices:
  - Home sales are expected to increase 13.7 percent which was attributed to strong sales in March through October.
  - Average sales prices are expected to decrease 15.0 percent in 2009. The decline in average prices has offset the increase in the volume of sales thereby lessening the amount of increase in residential transfer tax receipts.

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DEPARTMENT OF FINANCE

Isiah Leggett
County Executive

Jennifer E. Barrett
Director

MEMORANDUM

November 25, 2009

TO: Phil Andrews, President,
Montgomery County Council

FROM: Jennifer Barrett, Director of Finance J Barrett

SUBJECT: Revenue Stabilization Fund

The purpose of this memorandum is to respond to the Council's request for information about the Revenue Stabilization Fund. As noted by Mr. Farber, the Revenue Stabilization Fund was created following the revenue shortfalls experienced during the recession of 1990-1991. In FY91, the County experienced a revenue shortfall equal to eight percent of General Fund revenues or $90 million. The County's General Fund reserve dropped to $2 million from $77 million the prior year. This was also the year in which the County received a "negative outlook" on the GO bond rating because of "marginal" fiscal reserves.

As I noted yesterday, our current reserve policy is based on the combined balance of the General Fund and the Revenue Stabilization Fund (RSF). Any amount drawn from the RSF in FY10 would need to be restored to the General Fund in FY11. Our FY10 budget plan to end with a reduced, 5% combined reserve level was to be a one-time solution to the budget challenges. With the current revenue shortfalls, and a slower and flatter recovery expected, the County already will be challenged in restoring budgetary structural balance and healthier, policy level reserves. Our already identified revenue shortfalls are expected to cause significant pressure in particular on the General Fund. Any draw on the RSF at this time will simply exacerbate this situation. The RSF needs to be retained intact for the real possibility of further revenue reductions or other unanticipated shortfall events during the remainder of FY10 and over the course of the recovery.

I have attached an excerpt from the County Code regarding the Revenue Stabilization Fund. I look forward to our continued discussion of this important issue during our fiscal update next week.

JEB:cmc

Attachment: County Code- Revenue Stabilization Fund

cc: Timothy Firestine, Chief Administrative Officer
Joseph Beach, Director, Office of Management and Budget
Stephen Farber, Council Staff Director

Office of the Director

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Article XII. Revenue Stabilization Fund.

Sec. 20-64. Findings and declaration of purpose.

Montgomery County, along with the State of Maryland and its other political subdivisions, has recently experienced substantial funding shortfalls. The State, in order to allow its political subdivisions greater budgetary and fiscal flexibility in addressing those shortfalls, has authorized political subdivisions to establish "rainy day" or reserve accounts to accommodate future funding shortfalls.

It is in the best interest of the citizens of the County that a Revenue Stabilization Fund provide the County with greater budgetary and fiscal flexibility to address funding shortfalls.

The Revenue Stabilization Fund created in this Article is designed to accrue a balance during periods of economic growth and prosperity, when revenue collections exceed estimates. The Fund may be drawn upon during periods of economic slowdown, when collections fall short of revenue estimates. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-65. Definitions.

In this Article the following terms have the following meanings, unless the context clearly indicates a different meaning:

(a) *Actual total revenues* means the combined total of income tax, real property transfer tax, recordation tax, and investment income as reported in the County's annual financial report.

(b) *Certified revenues* means revenues derived each fiscal year from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund as certified by the Director on or before June 15.

(c) *Debt Service Fund* means the fund used to accumulate funds to pay general long-term debt principal, interest and related costs.

(d) *Director* means the Director of the Department of Finance.

(e) *Fund* means the Revenue Stabilization Fund created under this Article.

(f) *General Fund* means the general operating fund of the County which is used to account for all revenues and expenditures, except revenues and expenditures required to be accounted for in another fund.

(g) *Income tax* means the County income tax imposed under state law.

(h) *Investment income of the General Fund* means income derived from the investment of revenues from the General Fund.

(i) *Original projection* means the projection of total General Fund revenues for the next fiscal year approved by the County Council in the "Schedule of Revenue Estimates and Appropriations" resolution or any similar resolution.

(j) *Real property transfer* tax means the tax imposed under Sections 51-19 et. seq.

(k) *Recordation tax* means the tax imposed under Sections 12-101 et. seq., Tax-Property Article, Annotated Code of Maryland.

(l) *Revised forecast* means any revised projection of total General Fund revenues for the next fiscal year prepared by the Department of Finance. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-66. Revenue Stabilization Fund.

(a) The Director may establish a Revenue Stabilization Fund to support appropriations which have become unfunded.

(b) The Fund is continuing and non-lapsing. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-67. Fund sources and maximum size.

(a) The Fund must not exceed 10 percent of the average aggregate annual revenue derived from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund in the 3 preceding fiscal years.

(b) The Director must compute the maximum amount of the Fund annually and report that amount to the County Council not later than June 15.

(c) The Fund is in addition to any surplus that may be accumulated under Section 310 of the County Charter. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-68. Mandatory contributions to Fund.

(a) Subject to the limit set in Section 20-67(a), the mandatory annual contribution to the Fund must equal 50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:

(1) the annual percentage increase in the certified revenues projected for the next fiscal year, and

(2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.

(b) A growth or decline in certified revenues which results from either an increase or decrease in County tax rates must be:

(1) excluded from revenues projected for the next fiscal year, and

(2) phased in in the average annual percentage increase calculation in the third, fourth, fifth and sixth years.

(c) If actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection, then 50 percent of the excess must be transferred to the Fund if doing so will not result in the 10 percent limit in Section 20-67(a) being exceeded. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-69. Discretionary contributions to Fund.

The County Executive may recommend and the County Council may by resolution approve additional contributions to the Fund if doing so will not result in the 10 percent limit in Section 20-67(a) being exceeded. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-70. Transfer of contributions.

The Director must transfer the mandatory contributions required by Section 20-68 and any discretionary contributions under Section 20-69 from the General fund to the Fund at the end of each fiscal year. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-71. Interest.

All interest earned on the Fund must be added to the Fund. However, the Director must transfer interest earned on the Fund when the Fund exceeds 50 percent of the maximum Fund size authorized by Section 20-67(a) to the Debt Service Fund as an offset to the approved issuance of general obligation debt. (1993 L.M.C , ch. 41, § 1.)

Sec. 20-72. Use of Fund.

(a) After holding a public hearing and seeking the recommendation of the Executive, and if the Council finds that reasonable reductions in expenditures are not sufficient to offset the shortfall in revenue, the Council may by resolution approved by the Executive transfer an amount from the Fund to compensate for no more than half of the difference between the original projection of total General fund revenues for that fiscal year and a revised forecast of the General Fund revenues projected for the same fiscal year. If the Executive disapproves a resolution within 10 days after it is transmitted and the Council readopts it by a vote of 6 Councilmembers, or if the Executive does not act within 10 days after it is transmitted, the resolution takes effect.

(b) However, a transfer must not be approved unless 2 of the following conditions are met:

(1) The Director estimates that total General Fund revenues will fall more than 2 percent below the original projected revenues.

(2) Resident employment in the County has declined for 6 consecutive months compared to the same month in the previous year.

(3) A local index of leading economic indicators has declined for 3 consecutive months.

(c) The cumulative transfers from the Fund in any single fiscal year must not exceed half of the balance in the Fund at the start of that fiscal year.

(d) The funds transferred may only be used to support appropriations which have become unfunded.

(e) By an affirmative vote of 6 Councilmembers the Council after holding a public hearing and seeking the recommendation of the Executive may transfer amounts from the Fund without regard to the limits and conditions in subsections (a)-(c). (1993 L.M.C., ch. 41, § 1.)