April 2, 2009

Honorable County Executive, and
Members of the Montgomery County Council

Ladies and Gentlemen:

I am pleased to present the findings of the Tenth Annual Business Advisory Panel that was convened on February 24, 2009. The enclosed report was prepared by the County's Department of Finance pursuant to Article XI, Section 20-61 of the Montgomery County Code.

The report consists of a summary of the panel's advice, a list of the panelists, and the information package that the Department of Finance sent to the panelists in advance of the meeting. The information package includes the agenda for the meeting, concise statements by the Department on the economic outlook, and a framework for discussion.

I believe that the accompanying material accurately reflects the economic advice given by the Business Advisory Panel.

Sincerely,

Jennifer E. Barrett

Enclosure

FINDINGS OF THE TENTH ANNUAL
BUSINESS ADVISORY PANEL
FEBRUARY 24, 2009

Pursuant to Article XI, Section 20-61 of the Montgomery County Code, the Department of Finance (Department) convened a meeting of the Business Advisory Panel (BAP) on February 24, 2009. The County Council of Montgomery County established the BAP in 1999 to seek the advice of industry experts in key sectors of the County's business community concerning the current and future state of the County's economy. The law requires that the Director of the Department of Finance convene the panel annually and relay the panel's advice to the County Executive and the County Council. This report provides such advice.

The BAP consisted of members representing real estate, technology, finance, academia, and government and trade associations. The meeting was structured to allow participants to brief the panel on the local economic trends and to share their insights about future economic prospects in the County. The participants also discussed the Department's economic assumptions for the next six fiscal years. For purposes of this report, the results of the discussions are presented in two parts. The first part discusses the participants' professional judgments about the County's economy and the Department's economic assumptions. The second section discusses the participants' points about their respective industry sectors.

I. Current Economic Condition and Future Economic Assumptions

The participants were requested to provide comments to a paper prepared by the Department that analyzed the County's economy and provided assumptions about the economy over the next six years. The paper analyzed a number of economic indicators including employment, personal income, real estate, inflation, retail sales, construction, and interest rates. Because of the current national and regional economic climate, a majority of the discussion by the participants focused on the outlook for the region's economy. While each participant provided a perspective on his or her particular business sector, those perspectives were couched in view of the current and future economic climates and their affect on the County's fiscal outlook.

The Center for Regional Analysis (CRA), George Mason University, presented a perspective of the Washington area economy as well as the County's economy. The Center's forecast for the regional economy suggested that the economic cycle and the fiscal cycle are not contemporaneous. The fiscal cycle lags the economic cycle by a year. About the current national economic recession, CRA assumes that real GDP could decline 6.0 percent during this quarter and decrease 2.7 percent for the year. February marked the fifteen month of the recession that began December 2007 making it the second largest economic recession in the post-Depression era after the 1982 recession, which lasted sixteen months. CRA assumes that the national economy will increase 2.0 percent in 2010 and 3.0 percent the following year.

Since employment lags the economic recovery by six to nine months, the trough of the unemployment cycle could occur during the second quarter of CY2010 and some analysts suggest the national rate could reach 10.5 percent by then.

Salient points about the region's economy included:

- It continues to outperform the national economy but follows the same growth pattern. For example, in 2006 the national economy grew 2.8 percent while the region's economy grew slightly less than 4.0 percent. In 2008, the national economy grew a meager 1.1 percent compared to the region's 2.0 percent. As stated previously, CRA estimates that the national economy will contract 2.7 percent this year while the region's economy could grow between 1.0 and 2.0 percent.

- Job creation in the metropolitan region has slowed but has not declined. Over the past year, the region's businesses and government added only 16,700 jobs − the lowest number of new jobs since 2002 (9,700). The favorable labor market, which averaged nearly 23,000 jobs per year during the five years prior to 2008 (2002 – 2007), was attributed to federal spending particularly procurement. During that period, federal procurement increased at an average annual rate of 9.2 percent per year with northern Virginia experiencing a rate of 11.3 percent per year compared to Montgomery County's 5.6 percent. Most of that increase occurred between 2002 and 2004. CRA estimates that federal procurement in the Washington region increased 7.1 percent in 2008 but none of that increase was targeted for the Maryland suburbs. In fact, federal procurement declined 9.3 percent in 2007 for the Maryland suburbs and 14.9 percent for Montgomery County.

- As stated previously, the region's economy added 16,700 jobs in 2008. However, eighty-five percent of that increase occurred in the public sector (↑14,200), while the private sector added only 2,500 jobs. For the Bethesda-Frederick-Rockville metropolitan division (formerly named the Bethesda-Frederick-Gaithersburg metropolitan division), payroll employment declined by 1,300. While the public sector added 2,500 jobs, it helped offset the decline of 3,800 jobs in the private sector.

- CRA also stated that the inventory of existing homes for sale, while a significant issue the past few years, has moderated in Fairfax County with a 4.5-month supply given that it takes nine months to construct one. While the average foreclosure rate in the metropolitan region was approximately 225 per 10,000 units in January, Montgomery County, at approximately 80 per 10,000 units, ranked among the lowest of the ten regional jurisdictions. While the economic fundamentals in the region such as the low unemployment rate compared to the nation, steady but weak job growth particularly in the public sector, and increases in wages and salaries; it has been the psychological factors of the market, i.e., the uncertainty of the local economy, particularly weak employment in the private sector, and the continued national recession that have overtaken those fundamental factors in explaining the current situation of the housing market.

II. Specific Industry Sectors

Real Estate

The participants discussed the current housing market and suggested that the residential real estate market in Montgomery County will continue to experience challenges through the remainder of 2009. To date, led by the decline in the average sales price (↓18.0%) for an existing home, the total dollar volume of home sales has declined 25.0 percent and 8.5 percent decline in sales. As stated earlier, the issue with the housing market is not because of economic fundamentals; rather, buyer psychology has superseded those fundamentals. It is unclear whether the market has bottomed out from its recent lows; according to the participants, the fundamentals of low mortgage rates and affordability would make it a buyer's market, except no one is buying because lending standards have tightened eligibility due to the sub-prime crisis. The participants are hoping that the market will begin to recover by next fall. The effects of the depression in the housing market are felt by the number of brokers who have left because of thin profit margins and very low volume of sales. Membership in the realtor's organization also has dropped significantly. Inventory of existing homes for sale in Montgomery County is at an all time high such that the average days on the market reached 118 in February or a 9.5-month supply. However, the economic stimulus package should assist first time buyers with the home-buyer's credit.

The participants also discussed the current and future state of the commercial real estate market. To put the current commercial market into a proper perspective, the participants compared the current conditions to the weak market in the early 1990s that resulted in the Resolution Trust Corporation taking receivership of commercial properties. At that time rents were down thirty percent, mortgage rates increased by 200 basis points, but there was not a financial crisis. The commercial market in 2008 and 2009 is slightly different compared to the early 1990s:

- Vacancies will continue to increase to the end of this year. During the fourth quarter of last year, the vacancy rate for Class A property was 9.7 percent, the highest rate since the first quarter of 2005.
- Because of higher vacancies, expenses have increased.
- Construction costs are the same as in 2007, but development costs have increased, in part, because of higher impact tax rates.
- Homebuilding industry is either reducing its workforce or dismantling the business.
- Loan-to-value ratios are down 65 percent which require more equity in the firm's capital structure.
- To date, there have been no commercial foreclosures or defaults on loans in the County.
- Tenants are requesting concessions such as five-months' free rent.
- Some tenants have excess capacity and are also reducing their workforce.

Hotel Industry

There had been no net growth in the supply of hotel rooms in 2007 to 2008. Occupancy was up nine percent from 2007 to 2008 and the room rate had increased by four dollars. However, the weekend leisure business is down considerably due to the weak economy. The hotel sector assumes there will be no increase in the supply of hotel rooms in 2009 and little or no growth in demand. Because of the weakening demand, the occupancy rate could fall to 61.0 percent from a peak of 68.0 percent in 2004.

Financial Sector

Even with the credit crisis, banks that specialize in the commercial sector are lending to small businesses. While such banks do not specialize in one particular sector, there has been no decrease in lending. The general conclusion among the participants was that small banks in the County are lending to current and new customers and that trend could continue into the future. They have not experienced issues that have plagued the much larger banks because of their clientele and lending practices.

III. Other Comments and Conclusions

Overall the participants were mixed in their outlook for the County's economy. One participant was slightly bullish about the local economy especially in the Rockville area. Business to government is positive while the participants were pessimistic about business to business activity and very pessimistic about business to consumer. While the small banks are increasing their lending to small businesses, the participants commented that more failures in the retail sector are in the offing. Landlords are "carrying" tenants at this point. Commercial activity in Rockville has stopped and any approved projects will not begin anytime soon. The income and profits for businesses in the County were down in 2008 and are expected to decrease in 2009 and remain flat in 2010. This three-year cycle confirms the difference between the economic cycle and the fiscal cycle discussed above. While the economic cycle may improve during the latter part of this year, the fiscal-revenue cycle may not improve until 2010 or later. If such conditions occur, the outlook for local revenue growth, particularly with the income tax, could remain weak over the next few fiscal years.

LIST OF PARTICIPANTS
BUSINESS ADVISORY PANEL
FEBRUARY 2009

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MONTGOMERY COUNTY

10TH ANNUAL

BUSINESS ADVISORY PANEL

FEBRUARY 24, 2009

MEETING

WHERE: MONTGOMERY COUNTY DEPARTMENT OF
ECONOMIC DEVELOPMENT
SUITE 800
111 ROCKVILLE PIKE
ROCKVILLE, MARYLAND 20850
(240) 777-2000

WHEN: THURSDAY, FEBRUARY 24, 2009

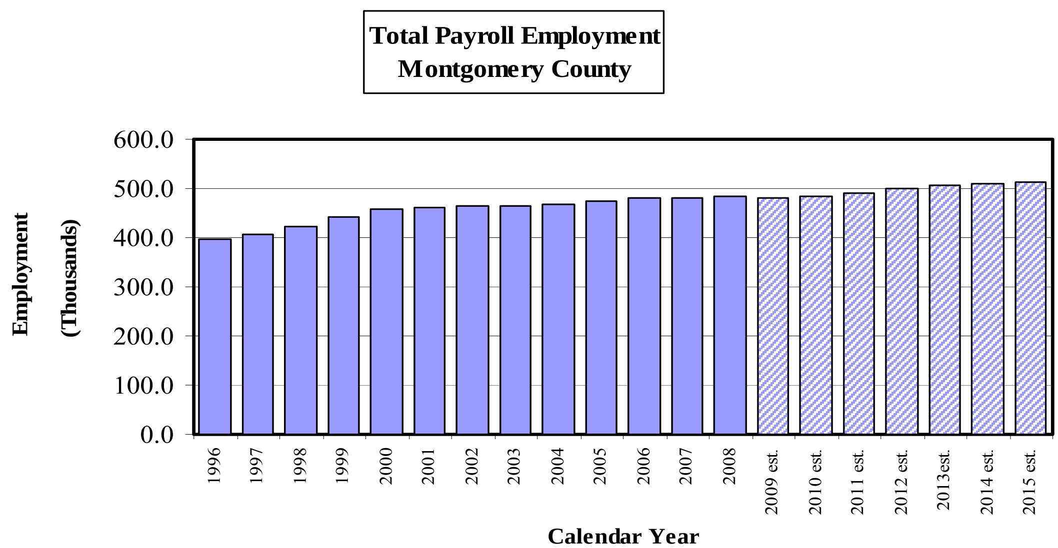
AGENDA

8:30 A.M.	WELCOME AND OPENING REMARKS
8:45 A.M.	ROUNDTABLE DISCUSSION BY PANEL PARTICIPANTS
10:15 A.M.	CONCLUDING REMARKS
10:30 A.M.	ADJOURNMENT

ECONOMIC CONDITIONS AND OUTLOOK

Montgomery County's economy continued to experience a slowdown in 2008. The primary reasons for the economic slowdown were the continuing decline in housing sales, a reduction in residential construction, and little or no growth in employment

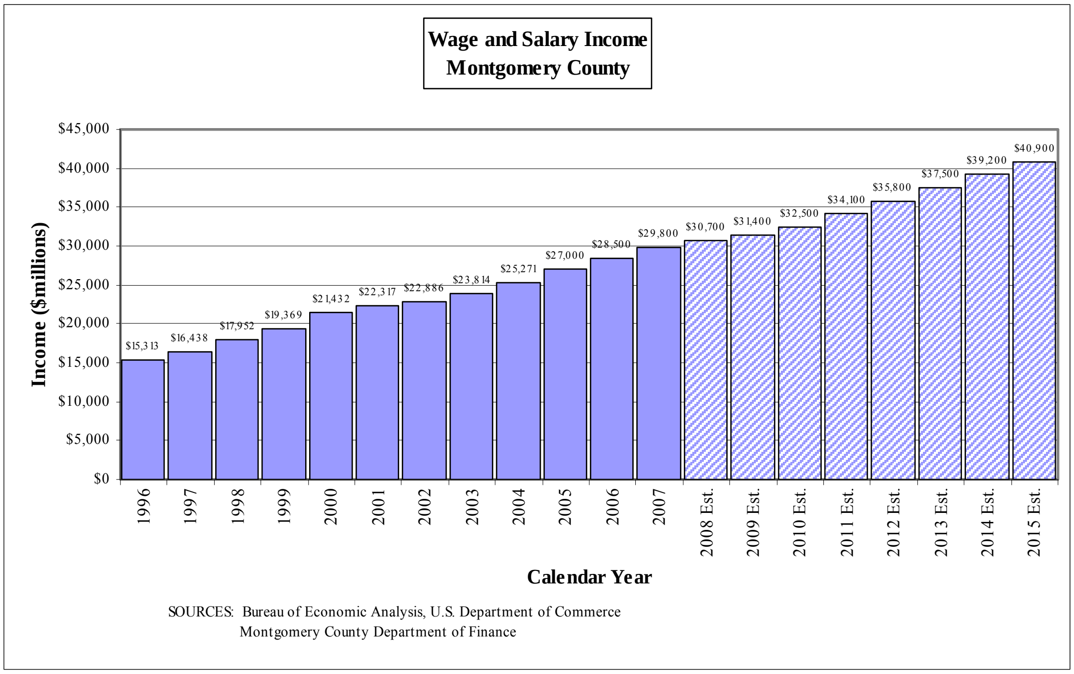
Employment. During the past thirteen years, total payroll employment in Montgomery County, which is based on the survey of establishments, experienced two distinct cycles: significant growth from 1996 to 2000 of 3.59 percent per year, and a period a weak growth between 2000 and 2008 with an average annual growth rate of 0.65 percent. The Department of Finance (Finance) assumes payroll employment to grow, on average, 0.88 percent per year between 2008 and 2015. In terms of the number of jobs added to the County's total payroll employment, an average of 4,350 per year new jobs are added between 2008 and 2015, well below the average of 7,065 per year between 1996 and 2008.



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

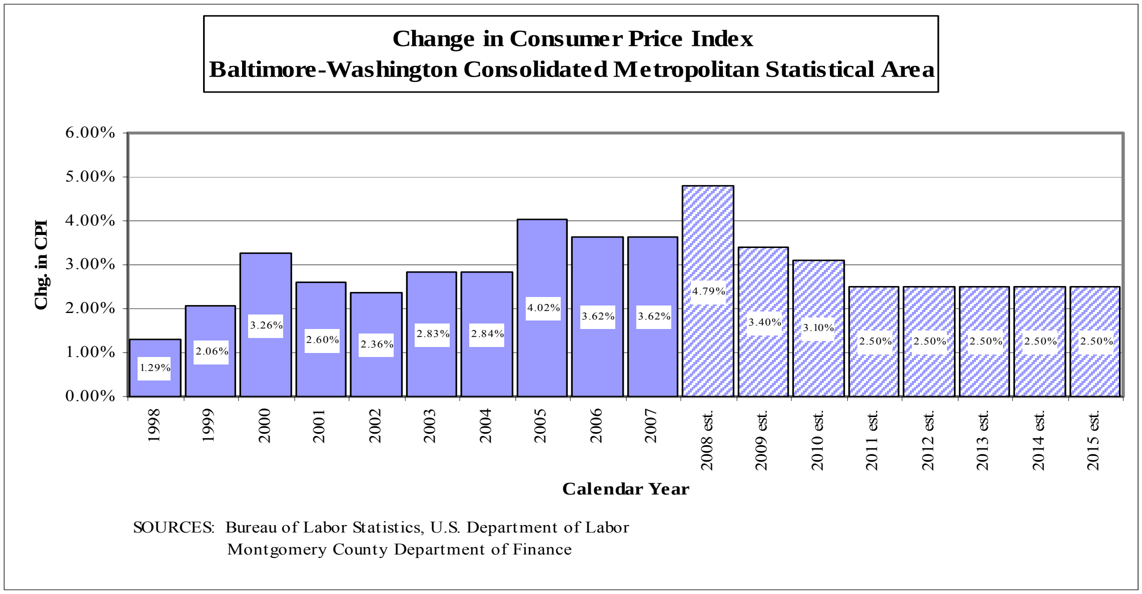
Resident employment in the County, which is based on a survey of County households, provides a slightly different picture of employment growth. For example, resident employment grew only 1.10 percent, on average, between 1996 and 2000 (compared to the 3.59 percent for payroll employment and 0.56 percent, on average, between 2000 and 2008 (compared to 0.65 percent for payroll employment). Following no employment growth in 2007 and 2008 and because of weak economic conditions in 2009, Finance assumes that employment is expected to decline 0.3 percent in 2009 followed by a modest increase of 0.8 percent in 2010.

From 2000 through 2008, average weekly wages are expected to increase from $840 to $1,210 − an average annual increase of 4.67 percent. Finance estimates that average weekly wages will increase from $1,210 to $1,575 by 2015 − an average annual increase of 3.84 percent. Finance assumes that wage and salary income is expected to grow 4.18 percent per year between 2008 and 2015, therefore, total wage and salary income is expected to reach $40.9 billion dollars by 2015.

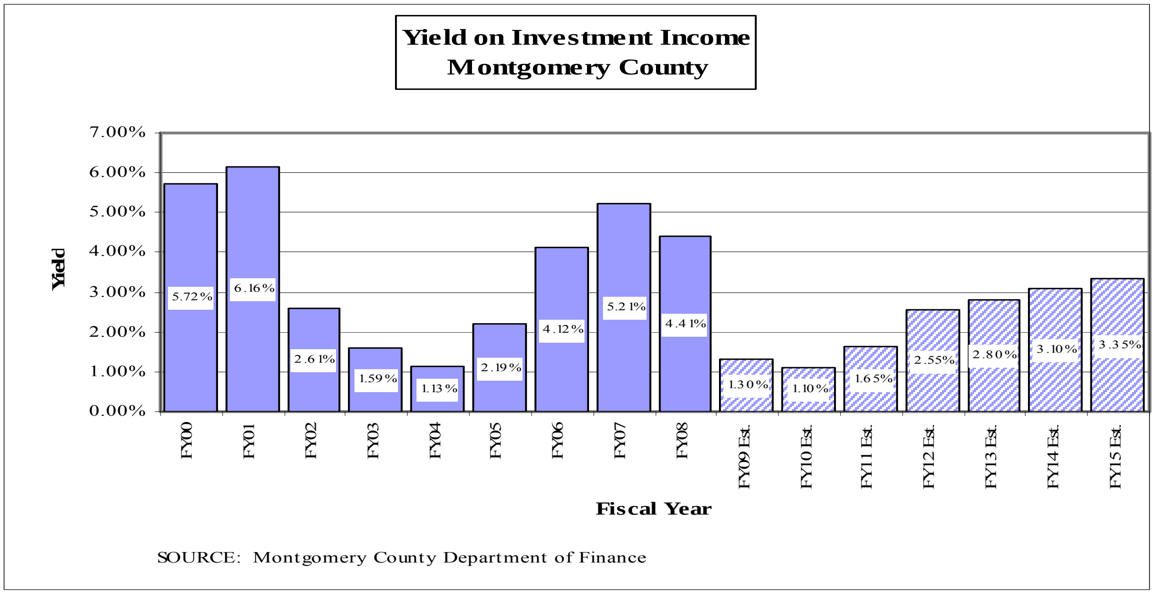


- ***Personal Income.*** With modest increases in employment and average weekly wages between 2008 and 2015, Finance estimates that total personal income will grow at an average annual rate of 4.60 percent, which is lower than the twelve-year average between 1996 and 2008 (6.02%). By 2015, Finance assumes that total personal income will reach $89.5 billion.

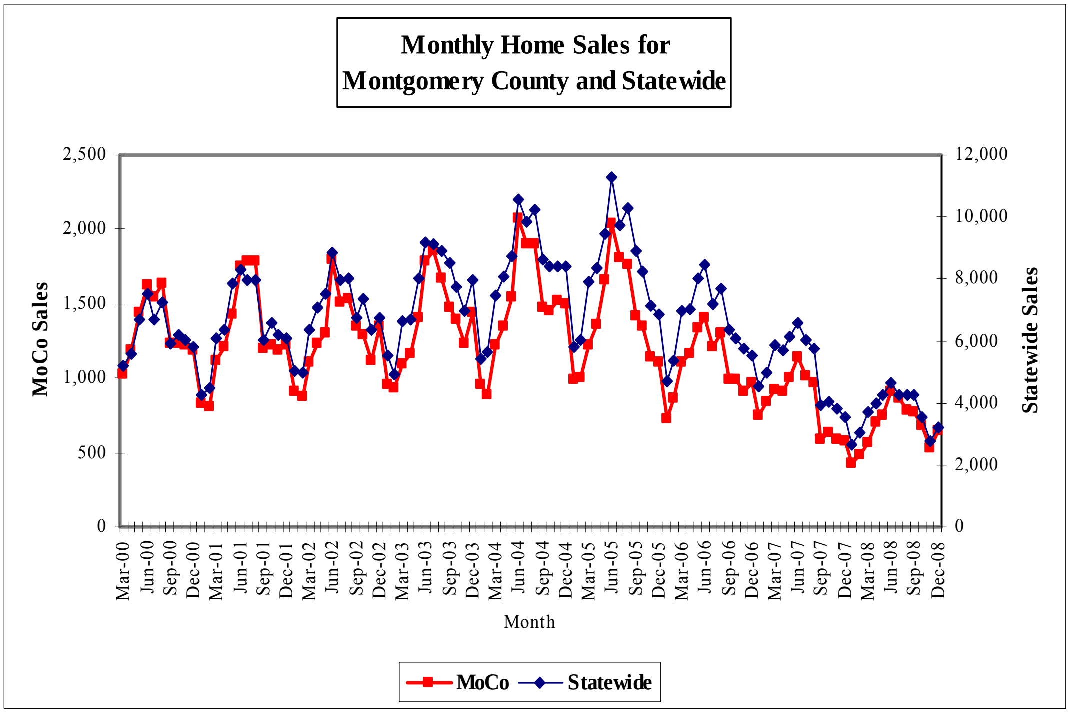
- ***Inflation (annual average).*** As measured by the Consumer Price Index for All Urban Consumers (CPI-U), inflation in the Washington-Baltimore consolidated statistical metropolitan area was slightly above the national average in 2008 (4.79% compared to 4.18% through November, respectively). While overall price increases were largely attributed to high energy prices during the first half of 2008, the "core" inflation rate, which is the CPI excluding the volatile food and energy prices, increased 2.89 percent for the region through November compared to the nation's 2.35 percent. Finance assumes that overall inflation rate, which is the percent change in the annual regional index, will moderate gradually from 4.79 percent in 2008 to 2.50 percent by 2015.



- ***Interest Rates.*** Beginning September 2007 to January of this year, the Federal Reserve Board, through its Federal Open Market Committee, has aggressively cut the effective target rate on federal funds from 5.25 percent to a range of 0.00-0.25 percent. The ten rate cuts were in response to the credit crisis that has significantly affected the financial markets (both bonds and stock markets) and the national economy since the summer of 2007. Based on data from the Federal Funds futures market (Chicago Board of Trade), Finance assumes that the FOMC will maintain its current position of an effective target rate of 0.00-0.25 percent through the first three quarters of calendar year 2009 at which time interest rates may increase modestly during the final quarter of this year. Since the yield on the County's short-term investments are highly correlated with the federal funds rate, Finance estimates that the County will earn an average of 1.30 percent on its short-term portfolio for fiscal year (FY) 2009 and 1.10 percent for FY2010 – the lowest yield since FY04.



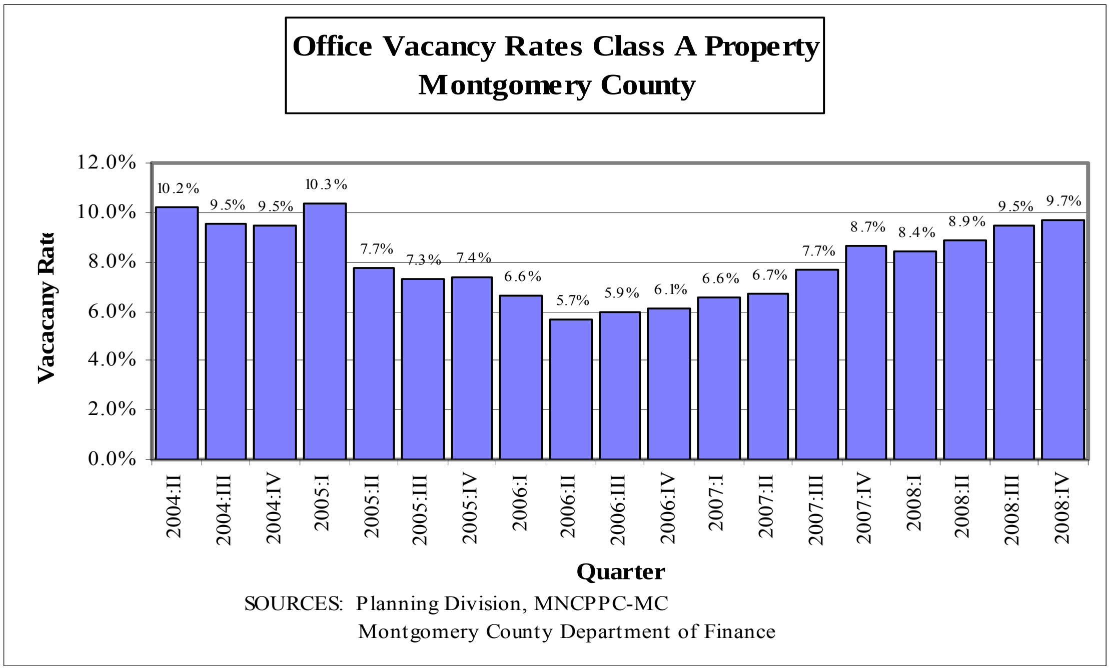
- ***Real Estate Market.*** The housing market in Montgomery County experienced a continued decline in sales and a decline in the average sales price in 2008. Existing home sales declined 20.6 percent in 2008 which followed declines of 20.5 percent and 23.4 percent in 2006 and 2007, respectively. Total sales of approximately 8,300 units in 2008 were at their lowest level in over twelve years. After four consecutive years of double-digit price increases between 2002 and 2005 and modest increases of 4.4 percent in 2006 and 3.6 percent in 2007, the average selling price decreased 7.9 percent in 2008.



- ***Construction.*** Construction is a cyclical activity that can have a significant effect on a local economy and employment owing to secondary and tertiary effects on construction supply and service industries. Permits and starts are key indicators of the near-term economic condition of the housing industry and are considered leading indicators for the local economy. Of lesser note, new single-family home sales and construction outlays are important indicators for monitoring the level of current investment activity. Construction starts measure initial activity as opposed to permits, which measure planned activity. However, permits and starts closely track each other and therefore, a four-month moving average provides a more reliable indicator of the housing trend compared to month-to-month changes. The primary source of construction data is McGraw-Hill Construction, formerly known as Dodge Analytics.

  The value of new non-residential construction in the County added to the property tax base increased 71.5 percent in calendar year 2008 from $693.7 million to $1,189.4 million. The dramatic increase in the value was led by two hospital and health facilities ($661.5 million). Excluding those facilities, the additional value of non-residential construction declined 22.0 percent. In 2007, the value of new commercial activity was $406.4 million but by 2008, that value declined to $319.2 million (↓21.5%). The value of other non-residential construction, which includes manufacturing, education and science, hospital and health treatment facilities, added to the property tax base decreased 22.7 percent in 2008 from $270.0 million to $208.8 million.

The decline in non-residential construction can be attributed to an increase in the vacancy rate for Class A property in the fourth quarter of 2008 to its highest level since the first quarter of 2005. While that rate is slightly below the regional average of 11.0 percent, it represents an uninterrupted series of increases that began in the second quarter of 2006.



The value of additional residential property declined 40.2 percent, which followed a modest increase of 0.8 percent in 2007. The value of new residential construction stood at $430.1 million in 2008, which was significantly below the previous five-year average of $712.7 million. Because of the high inventory-to-sales ratio for existing homes experienced in 2008, Finance assumes that the value of new residential construction will decline in calendar year 2009 to the level experienced prior to the housing construction boom that began in 2001.

DISCUSSION FRAMEWORK

The economic assumptions provide a framework for the Department of Finance's revenue projections for 2010 through 2015. The following issues create the framework for the discussion that is the focus of the Business Advisory Panel. In order to gain a better sense of the direction of the major industrial sectors, it would be helpful if the participants of the Business Advisory Panel could comment on our assumptions and discuss the major economic trends that affect your industry sector in the next six years. The following list of items, if applicable to your sector, may be used to focus your discussion:

Real Estate

- Residential
- Commercial
- Non-traditional mortgages and foreclosures
- Prices
- Credit conditions − commercial sector

Federal Government

- Fiscal stimulus package

Income

- Capital gains

Industry Sectors

- Business activity
- Employment outlook
- Construction industry outlook

Risk to the Forecasts (Assumptions)

- Employment
- Interest Rates
- Inflation
- Stock market
- Economic Development