DEPARTMENT OF FINANCE

Isiah Leggett
County Executive

Jennifer E. Barrett
Director

April 8, 2010

Honorable County Executive, and
Members of the Montgomery County Council

Ladies and Gentlemen:

I am pleased to present the findings of the Eleventh Annual Business Advisory Panel that was convened on February 26, 2010. 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

Jennifer E. Barrett
Director of Finance

JEB:cmc

Enclosures

Office of the Director

101 Monroe Street, 15th Floor • Rockville, Maryland 20850 • 240-777-8860 • 240-777-8857 FAX
www.montgomerycountymd.gov

FINDINGS OF THE ELEVENTH ANNUAL
BUSINESS ADVISORY PANEL
FEBRUARY 26, 2010

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 26, 2010. 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 asked to provide comments to a paper prepared by the Department that analyzed the County's economy and provided assumptions about the economic outlook for the next six years. The paper analyzed a number of economic indicators including employment, personal income, real estate, inflation, 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.

The Center for Regional Analysis (CRA), George Mason University, presented a perspective on the national, regional, and Montgomery County economy. CRA stated that the national recession has been over for seven or eight months ending in either May or June of last year. The composite of national economic leading indicators has increased each month for the past eleven months (April – February) and gross domestic product (GDP) is expected to increase three percent during the first quarter of this year. The second quarter's GDP will be stronger than the first and will be a better indicator of future economic growth. The inventory cycle is ending, and the manufacturing index (Institute for Supply Management) has increased since May of last year. However, there are still weak sectors in the economy.

While some of the economic sectors are doing better, it is the labor market that is the last sector to recover. The decline in national unemployment rate to 9.7 percent in January is not a trend, and job growth will get worse before it gets better. The national unemployment rate will be between 8.8 and 9.0 percent one year from now. When the job market improves, CRA suggests that the housing market also will improve. Finally, while the economy begins to recover and expand, the fiscal recovery will not commence until eighteen to twenty-four months later.

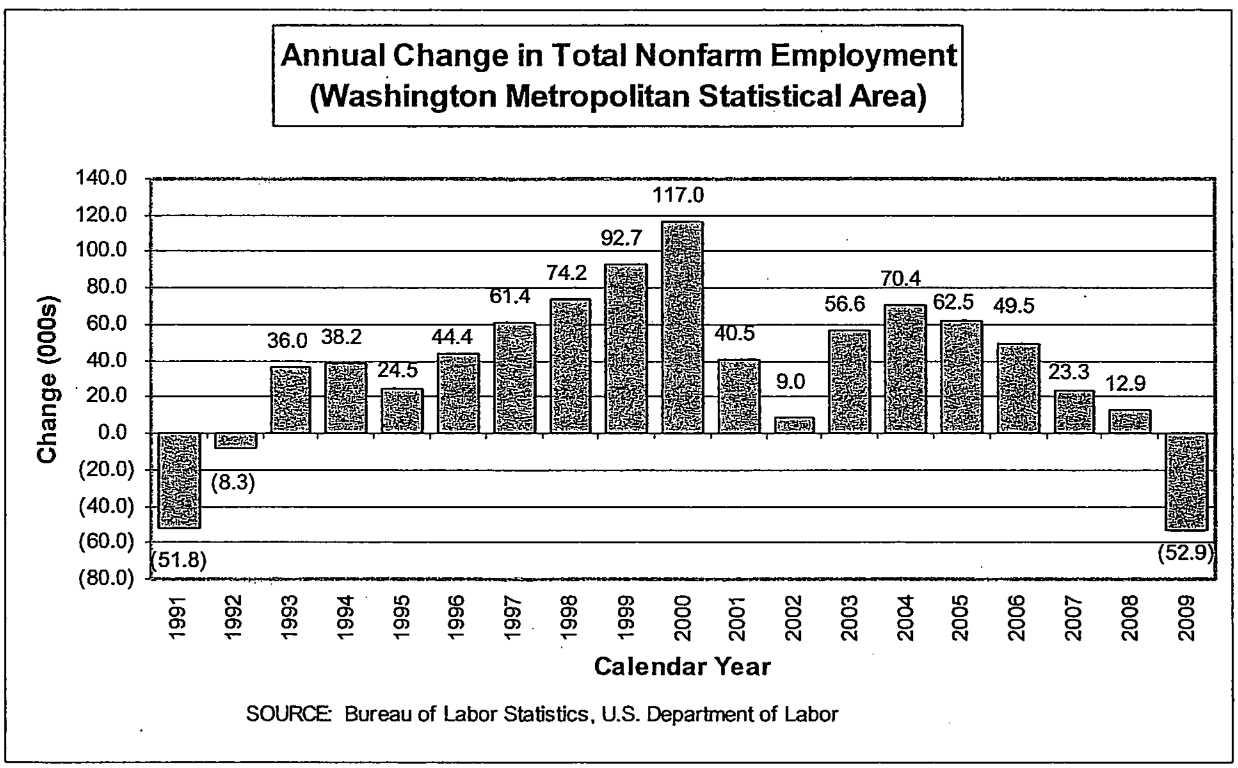
The region's economy lost jobs during the past year. There are 50,000 more unemployed in the area compared to one year ago. Construction and retail sectors are still losing jobs while health and education, a sub-sector of professional services, and government are gaining jobs.

Post-meeting Update

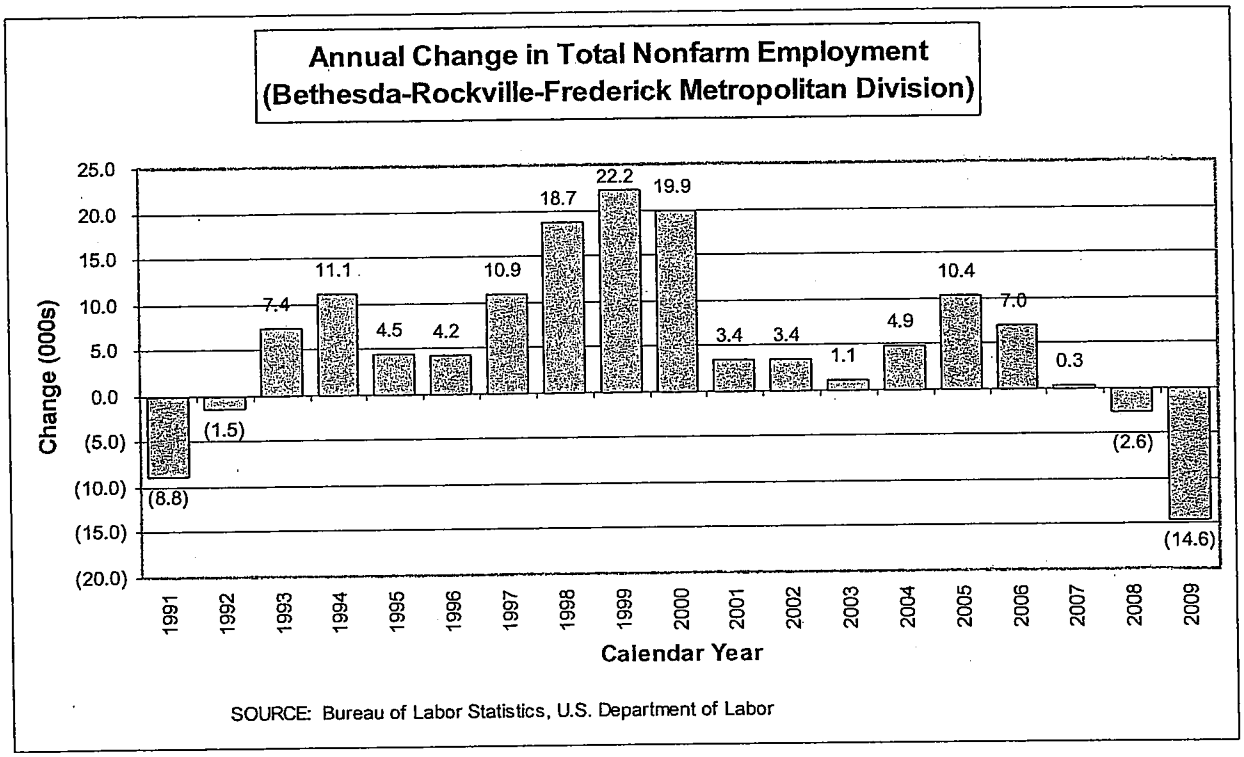
Since the meeting of the Business Advisory Panel in late February, the Bureau of Labor Statistics, U.S. Department of Labor, revised the establishment series, i.e., non-farm employment data, starting with April 2008. While the revisions do not change the points discussed or conclusions reached during the meeting, it is appropriate to present those revisions.

Salient points about the revisions include:

- The metropolitan region lost nearly 53,000 jobs in 2009. That decline is the largest decrease in 20 years of record keeping by BLS. Each of the major sectors except three lost jobs during the period: retail (↓1,800 jobs), construction (↓23,400), financial services (↓6,800 jobs), business services excluding the scientific and technology sub-sector (↓10,500), and the leisure sector (↓4,200). Three sectors gained jobs in 2009: business services – scientific and technology (↑2,300 jobs), education and health services sector (↑9,400), and government (↑14,000).



- The Bethesda-Rockville-Frederick metropolitan division, a portion of the metropolitan region, lost nearly 15,000 jobs in 2009. Similar to the metropolitan region, each of the major sectors except for three mentioned earlier shed jobs during this period. Construction led the decrease (↓6,200 jobs) followed by retail (↓4,600), then business professional services excluding scientific and technology sub-sector (↓2,400). Financial activities (↓1,900) and leisure sector (↓1,000) round out the declines. Three sectors, business professional services – scientific and technology (↑900 jobs), education and health services sector (↑2,000) and government (↑2,000) were the only major sectors to add jobs. The decline in non-farm employment of nearly 15,000 was the largest decline since BLS has data about the metropolitan division since 1990.



- Secondly, the unemployment rate for the metropolitan region jumped from 5.6 percent in January 2009 to 6.9 percent in January of this year. Employment based on the labor force series, i.e., survey of households, for the metropolitan region shows the same trend as the establishment series. Over the past year, the number of residents employed declined from 2,913,899 in 2008 to a preliminary 2,832,287 – a decline of over 81,000. However, BLS is in the process of revising this series, therefore, the resident employment for 2008 and 2009 may be adjusted over the next few months.

Finally, the CRA discussed factors that could lead to growth in the metropolitan region and Montgomery County. Those factors include the addition of top-end jobs, specifically in the scientific and technology services sector, and an increase in the number of part-time jobs. Montgomery County, in the opinion of the CRA, is reverting to a more suburban environment – more residential and less non-residential.

The representative from the Washington Metropolitan Council of Governments (COG) discussed recent developments in commercial construction. According to COG's latest report (June-July 2009), there were 402 new commercial projects started in the Washington metropolitan area. Those projects will add approximately 37.3 million square feet of office space at a cost of $6.3 billion. Of the new starts, office space is the dominant sector. Between 2007 and 2008, the amount of new construction increased nearly 4.5 million square feet or 14 percent. Additional commercial space doubled in the jurisdictions of Arlington County, Fairfax County, the City of Alexandria, and the District of Columbia between 2007 and 2008. COG estimates that there were fewer projects undertaken in 2009.

After CRA's and COG's presentations, the participants discussed the economic outlook for Montgomery County. The major discussion point regarding the County's economy is: where is the sustainable growth engine for the County, i.e., what private sectors are the sources for job growth? Currently, the public sector is the only source of growth in the County. Because of this concern about private sector growth, the discussion also questioned Finance's assumptions of growth in payroll employment in 2011 and beyond. While the payroll data showed an increase in professional services in 2009, that increase occurred in the scientific and technology sub-sector. According to participants, some professional firms are downsizing at an unprecedented rate. Law firms in particular have downsized by 20 percent. Only those companies that have a presence in international markets will see improvement in companies' revenues. It appears from the discussion that tax revenues for tax year 2009 may be just as challenging as the previous year. This outlook will have an effect on local income tax revenues. Since capital gains recognition experienced a significant decline in 2008, that loss will carry forward for the next few years. As such, tax revenues will lag behind the overall economy for the next two years.

After the discussion of the County's economic outlook, the discussion focused on specific industry sectors of the County's economy.

II. Specific Industry Sectors

Residential and Commercial Real Estate

The first sector that the participants discussed was the current situation in the housing and commercial real estate markets. To date, home sales are up 22 percent and average home prices are down 14 percent. Because of the dramatic increase in home sales, inventories have declined 46 percent. The inventory-to-sales ratio for existing homes averaged slightly above 3 months during the second half of 2009 and the number of days on the market averaged 84 days during the second half of last year compared to 102 days during the same period in 2008. The participants suggested that home prices have stabilized and are cautiously optimistic that the housing market will rebound in terms of sales and prices. One indicator of a rebound in the market is that nationally homebuilders are in the demand for lots, which could be viewed as an early precursor for a rebound in residential construction. However, employment is the major economic driver in home sales. Unless the employment situation begins to improve both locally and nationally, the housing market may experience only modest improvement over the short term.

The participants also discussed the current and future state of the commercial real estate market. The first topic discussed was the outlook for companies and commercial space. According to the participants, one-third of the businesses are giving up space. Three biotechnology companies no longer have facilities in the County. Vacancies are up and rents are down. For example, one twenty-one year tenant and another seventeen-year tenant have closed. The commercial market is witnessing under-leveraged/under-financed tenants, tighter financial rules such as letters of credit and bridge financing, more companies moving into Class B space, and tenants downsizing. Overall there will be less construction square footage per person in the County.

The discussion then focused on the County's growth philosophy and regulatory environment--specifically the permitting and inspection process. The participants contend that permits are too expensive and take too long to obtain. The concerns expressed by participants relate to what are perceived as new or stepped up enforcement actions by the Departments of Permitting Services and Fire and Rescue Services, which the participants view as unreasonable. Specific examples were provided about the effects that the permitting process has on the costs of construction by changing the original permitting orders. Participants asserted that the environmental designs imposed on new construction do not consider costs and the water quality standards imposed by the State add to the costs with no apparent benefit. [[Note: Interdepartmental meetings are in progress to address the concerns raised, and a recent change in the State regulations for water quality will provide some relief.]]

Hotel Industry

There will be an increase in the supply of hotel rooms in the County. Specifically, Hilton is planning to build 3 to 4 hotels which will add 400 rooms to the current supply. However, there have been challenges to the hotel industry during the past three years. The occupancy rate declined from 65 percent in calendar 2006 to 61 percent in 2009. Revenue per available room (REVPAR) was down from $83 per room in 2006 to $77 in 2009. Business activity in the County has remained flat for the last 3 to 5 years, and hotel activity in Rockville is down 20 percent. Because of the weak activity, there has been a job freeze in the industry for the past twelve months.

Financial Sector

Even with the credit crisis, banks that specialize in the commercial sector are lending to small businesses. Not all community banks are at risk and commercial real estate (CRE) is not an issue among some of the banks. However, if a bank has 300 percent of its capital reserves in CRE, they are considered at risk. Large commercial banks have invested in apartment buildings and large strip malls, but not all banks lend to such ventures. The issue in lending activity is not the supply of funds but the fall in demand. Most of the demand is from individuals or businesses moving from one lender to another. Banks, particularly community banks, have come under greater scrutiny and therefore conduct more sensitivity analysis in terms of reserve requirements for CRE loans.

Other Sectors

The participants from the health and professional business sectors provided an assessment of their industry and companies. The health sector in the economy has experienced an increase in demand but revenues and profitability are down. As discuss earlier, the employment situation in the health services sector has been "protected" from the economic downturn. Salaries are scheduled to increase between 1 and 1.5 percent for health employees, excluding management, and productivity has also increased. On the demand side, there is anticipated a six-fold increase in capacity for senior patients and an increase in in-patient and emergency cases. The challenge in the County is the supply of medical facilities to meet the growing demand. The participants stated that while some hospital facilities are expanding, there is a need for another hospital in the County.

The professional business sector, especially the science and technology sub-sector, is also experiencing growth. One of the businesses has renewed its lease and will increase employee salaries beginning this spring. Sales are expected to increase by 9 percent after being flat last year.

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 there is weak demand for loans. While the economic cycle has improved starting the latter part of last year, the fiscal-revenue cycle may not improve until late 2011 or even 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.

Attendees
Business Advisory Panel
February 26, 2010

Mr. Lawrence N. Rosenblum, CPA
Grossberg Company, LLP

Mr. Scot R. Browning
President and CEO
Capital Bank

Mr. Gary Vogan
Chief Financial Officer
Holy Cross Hospital

Mr. Michael Moran
Chief Executive Officer
Greater Capital Area Association of Realtors

Ms. Kelly Groff
Executive Director
Conference and Visitors Bureau
of Montgomery County, MD, Inc.

Mr. Chris Zindash
General Manager
Crowne Plaza

Dr. Stephen S. Fuller
Director, The Center for Regional Analysis
School of Public Policy
George Mason University

Mr. Greg Goodwin
Regional Planner
Department of Human Services, Planning and Public Safety
Metropolitan Council of Governments

Mr. Paul Chod
Corporate President, General Partner of Real Estate affiliates
Minkoff Development Corporation

Mr. Bradley Chod
Vice President
Minkoff Development Corporation

Ms. Sally Sternbach
Executive Director
Rockville Economic Development, Inc.

Mr. John Muir
Senior Vice President
Hughes Network Systems

Mr. Bryant Foulger
Vice President
Foulger Pratt Companies

Ms. Lisa Fadden
Vice President, Public Affairs
Montgomery County Chamber of Commerce

MONTGOMERY COUNTY

11TH ANNUAL

BUSINESS ADVISORY PANEL

FEBRUARY 26, 2010

MEETING

WHERE:	MONTGOMERY COUNTY DEPARTMENT OF FINANCE EXECUTIVE OFFICE BUILDING 15TH FLOOR 101 MONROE STREET ROCKVILLE, MARYLAND 20850 (240) 777-8877
WHEN:	FRIDAY, FEBRUARY 26, 2010

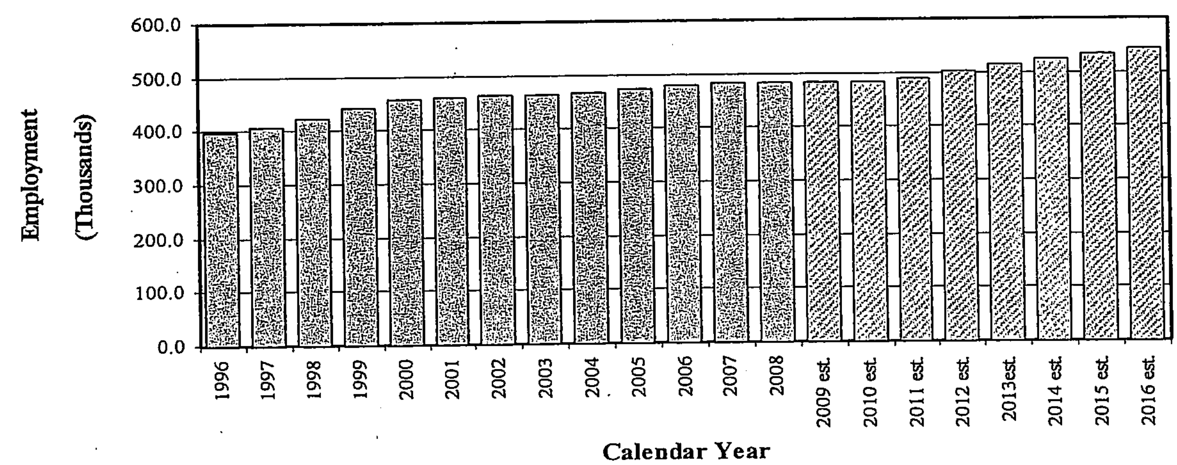
AGENDA

9:00 A.M.	WELCOME AND OPENING REMARKS
9:15 A.M.	ROUNDTABLE DISCUSSION BY PANEL PARTICIPANTS
10:45 A.M.	CONCLUDING REMARKS
11:00 A.M.	ADJOURNMENT

ECONOMIC CONDITIONS AND OUTLOOK

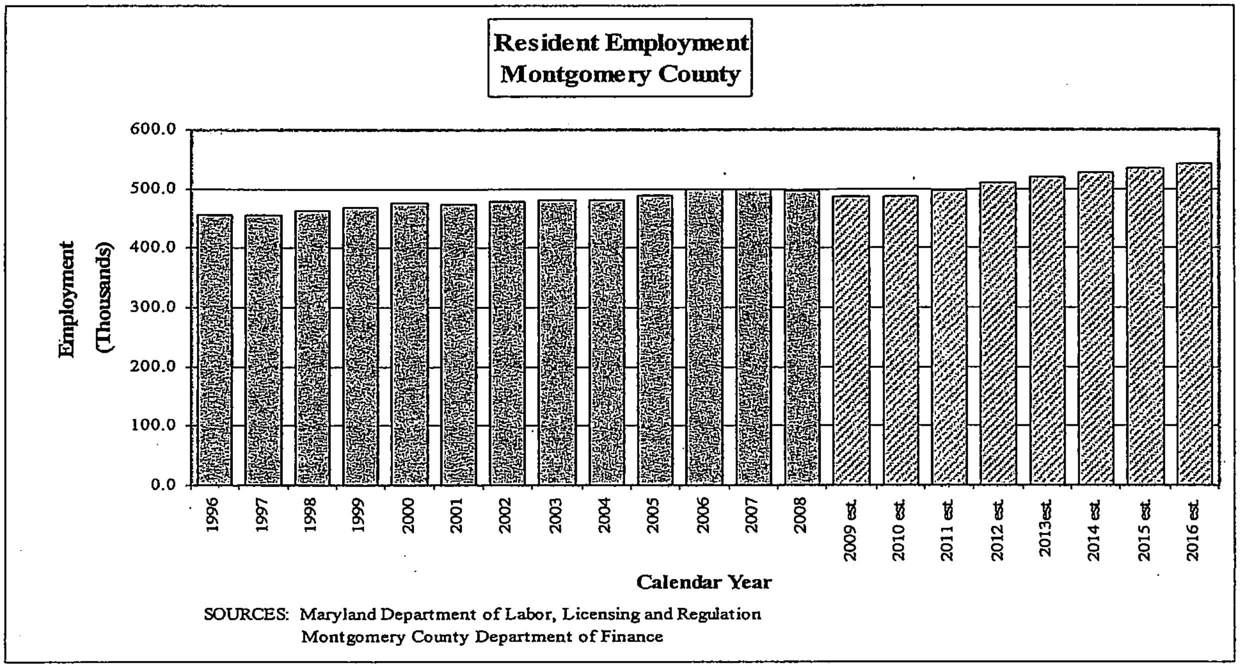
Impacted by the national recession, Montgomery County's economy continued to experience a slowdown in 2009. The primary reasons for the economic slowdown were the continuing decline in housing prices, a reduction in residential and non-residential construction, and a decline in resident employment and as a result an increase in the unemployment rate.

Employment. During the past fourteen 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 an average of 3.59 percent per year, and a period a weak growth between 2000 and 2009 estimate with an average annual growth rate of 0.55 percent. The Department of Finance (Finance) assumes payroll employment to grow, on average, 1.73 percent per year between 2009 and 2016. In terms of the number of jobs added to the County's total payroll employment, an average of 8,757 jobs per year is estimated between 2009 and 2016 with most of that growth occurring between 2012 and 2014.

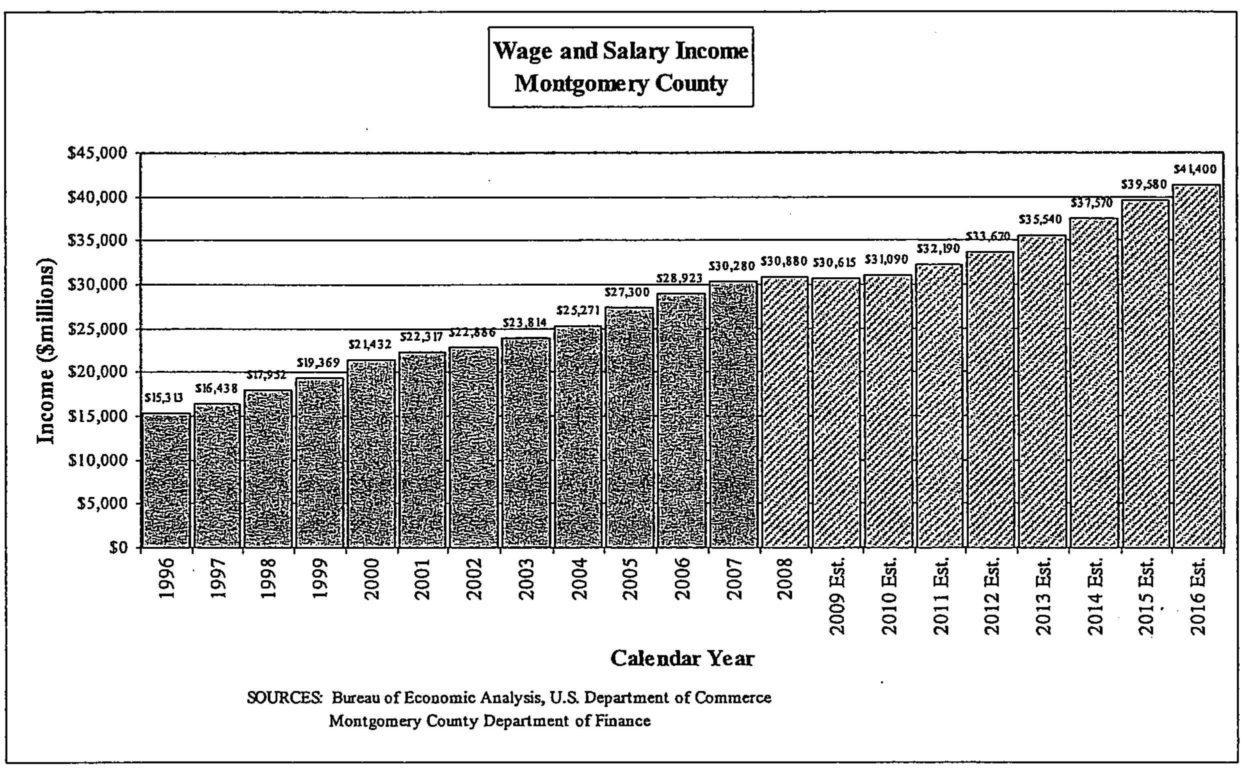


SOURCES: Bureau of Labor Statistics, U.S. Department of Labor
Montgomery County Department of Finance

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). Following declines in employment between 2007 and 2009 estimate, Finance assumes that employment is expected to increase at an average annual rate of 1.56 percent from 2009 to 2016.

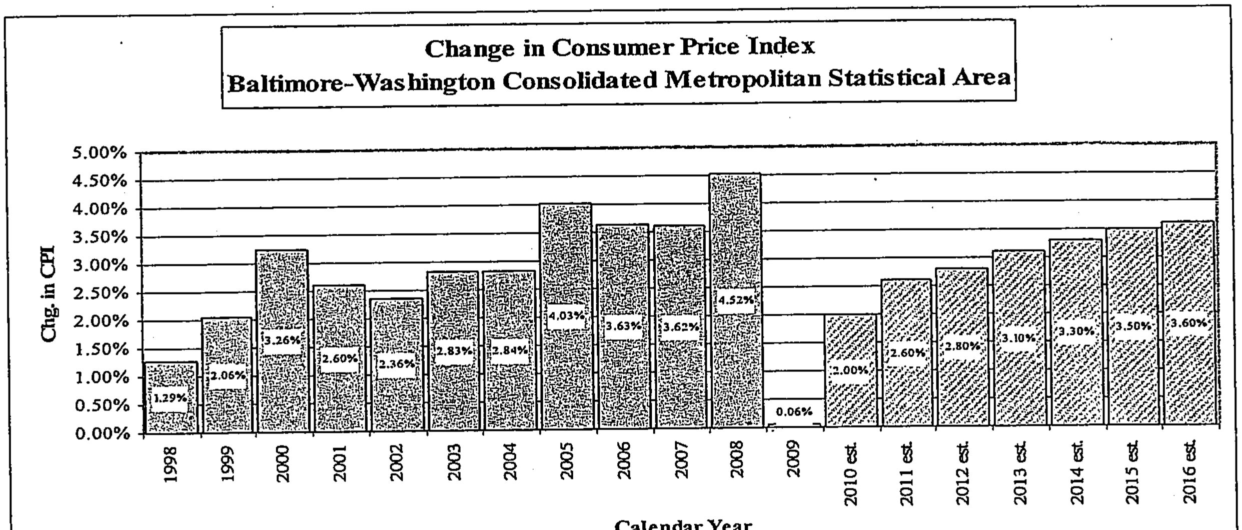


Finance expects that wage and salary income to grow, on average, 4.41 percent per year between 2009 and 2016, with total wage and salary income reaching $41.4 billion dollars by 2016.



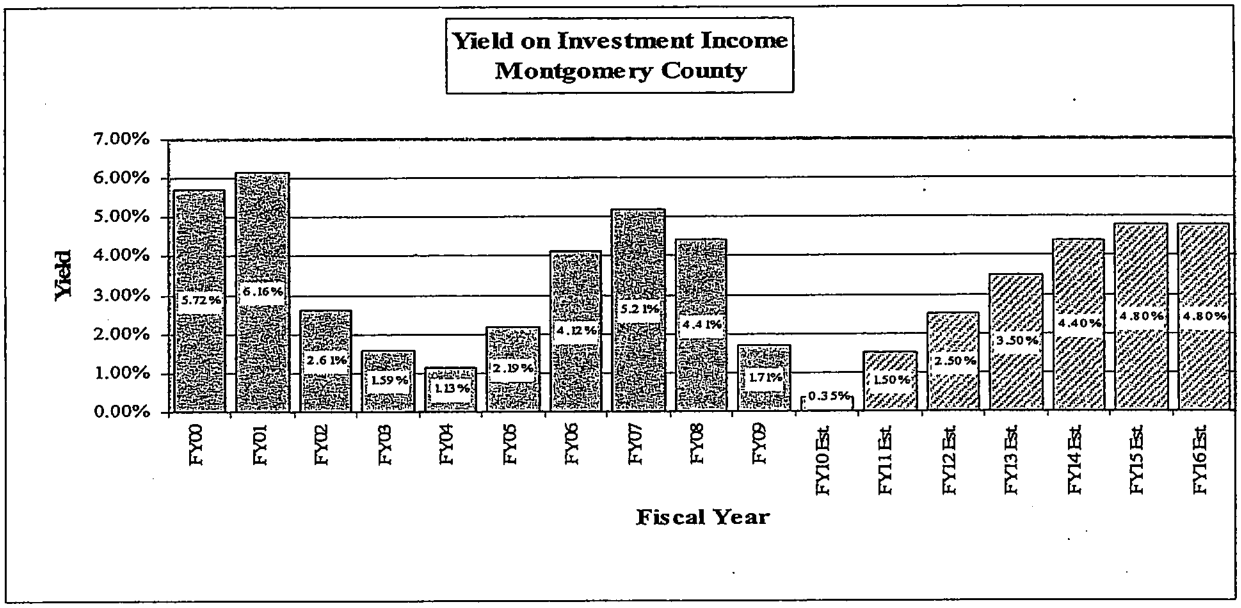
- ***Personal Income.*** Finance estimates that total personal income will grow at an average annual rate of 4.46 percent from 2009 to 2016, which is lower than the thirteen-year average between 1996 and 2009 (5.63%). By 2016, Finance assumes that total personal income will reach $89.7 billion.

- ***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 above the national average in 2009 (0.06% compared to -0.57% through November, respectively). While the low inflation rate was largely attributed to a decline in energy prices during 2009, the "core" inflation rate, which is the CPI excluding the volatile food and energy prices, increased 1.88 percent for the region through November compared to the nation's 1.72 percent. Finance assumes that overall inflation, which is the percent change in the annual regional index, will gradually increase from 2.00 percent in 2010 to 3.60 percent by 2016.

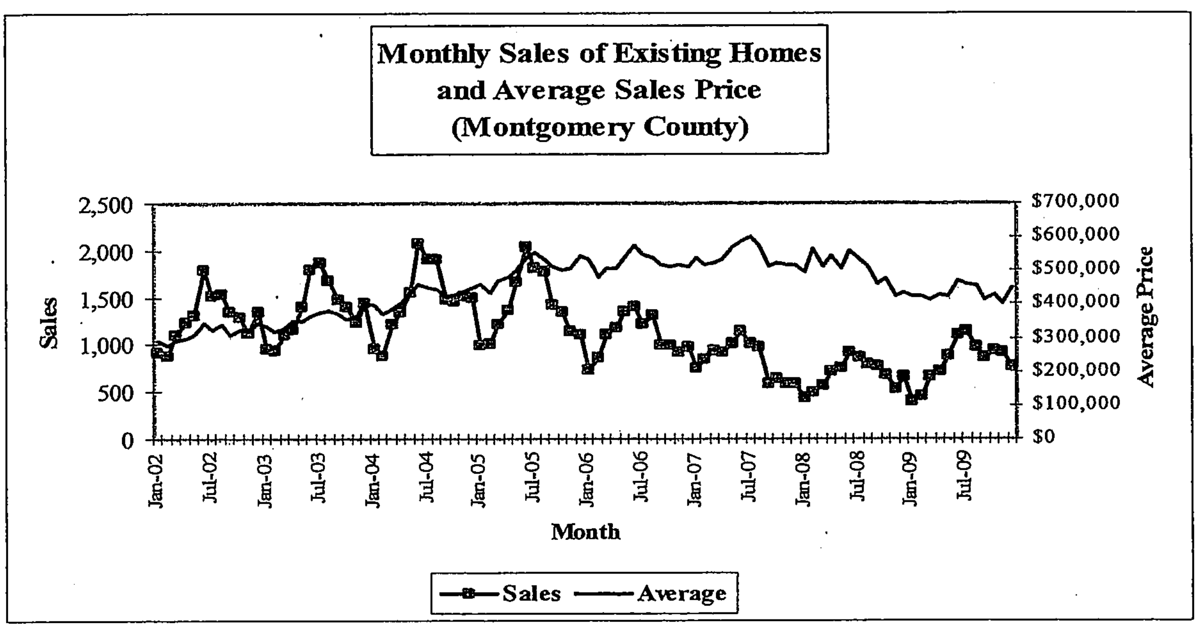


SOURCES: Bureau of Labor Statistics, U.S. Department of Labor
Montgomery County Department of Finance

- ***Interest Rates.*** From September 2007 to December 2008, the Federal Reserve Board, through its Federal Open Market Committee, aggressively cut the 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 this year at which time interest rates may increase modestly during the final quarter. 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 0.35 percent on its short-term portfolio for fiscal year (FY) 2010 and 1.50 percent for FY2011.

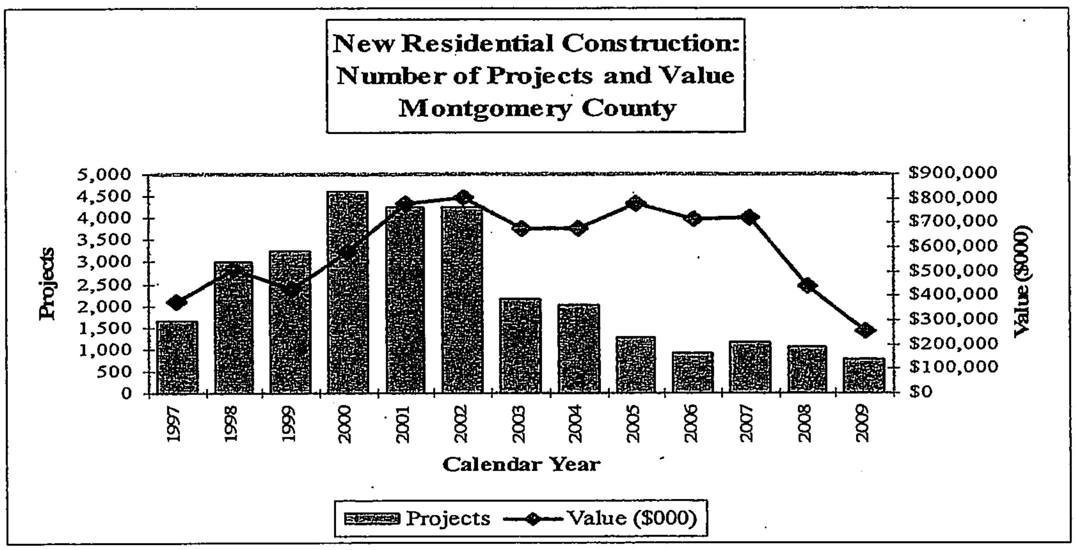


- ***Real Estate Market.*** The housing market in Montgomery County experienced two different trends in 2009: 1) a dramatic increase in home sales since March 2009, and 2) a continued decline in the average sales price. Existing home sales increased 20.08 percent in 2009 which followed declines of 23.45 percent and 18.25 percent in 2007 and 2008, respectively. 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 7.56 percent in 2008 and 13.75 percent in 2009.



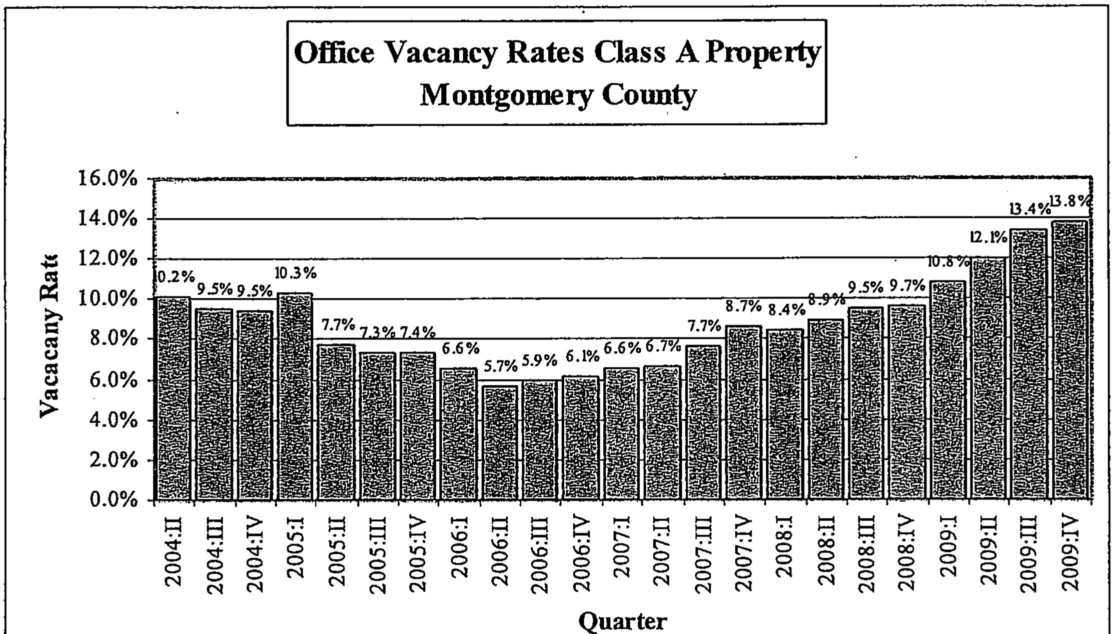
- ***Construction.*** Construction is a cyclical activity that can have a significant effect on a local economy and employment owing to secondary and tertiary effects on construction supply and service industries. Permits and starts are key indicators of the near-term economic condition of the housing industry and are considered crucial 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 additional residential property declined 41.59 percent, which followed a decrease of 39.00 percent in 2008. The value of new residential construction stood at $256.6 million in 2009, which was significantly below the previous five-year average of $665.3 million.



The value of new non-residential construction in the County added to the property tax base decreased 39.67 percent in calendar year 2009 from $569.5 million to $343.6 million. The dramatic decreased in the value was led by commercial construction ($323.1 million in 2008 compared to $127.3 million in 2009 - ↓60.60%). 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 12.2 percent in 2009 from $246.4 million to $216.3 million.

The decline in non-residential construction can be attributed to an increase in the vacancy rate for Class A property during 2009 reaching its highest level of 13.8 percent by the fourth quarter. While that rate is the same as the regional average, it represents an uninterrupted series of increases for the County that began in the first quarter of 2008.



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

DISCUSSION FRAMEWORK

The economic assumptions provide a framework for the Department of Finance's revenue projections for 2011 through 2016. 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
- Foreclosures
- Prices
- Loan conditions – commercial sector
- Short sales

Income

- Capital gains

Industry Sectors

- Business activity
- Employment outlook
- Construction industry outlook
- Banking–Small business lending

Risk to the Forecasts (Assumptions)

- Employment
- Interest rates
- Inflation
- Stock market
- Residential/Commercial development
- Bankruptcies: (residential and commercial)