



DEPARTMENT OF FINANCE

Isiah Leggett
County Executive

Joseph F. Beach
Director

March 30, 2012

Honorable County Executive, and
Members of the Montgomery County Council

Ladies and Gentlemen:

I am pleased to present the findings of the Thirteenth Annual Business Advisory Panel that was convened on February 16, 2012. 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,

Joseph F. Beach
Director of Finance

Enclosures

Office of the Director

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**FINDINGS OF THE THIRTEENTH ANNUAL
BUSINESS ADVISORY PANEL
FEBRUARY 16, 2012**

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 16, 2012. 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, finance, health services, academia, and government and trade associations. The meeting was structured to allow participants to brief the panel on the local and regional 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 indicators for the U.S. economy appear stronger than expected and estimates that the slow recovery in the U.S. economy will continue for the next eighteen months. CRA also noted that inventories continue to decline which suggests continuing employment growth. While growth in payroll employment has been encouraging, CRA notes that national employment must increase by 300,000 per month to decrease the unemployment rate by one percentage point. The national forecast by Global Insight estimates national real gross domestic product (GDP) to increase 2.1 percent in 2012 and 2.3 percent in 2013 – rates of growth needed for growth in payroll jobs. Global Insight forecasts growth in real GDP of 3.3 percent by 2014. One positive indicator of the sustained

economic recovery is that investment in residential construction increased in the last three quarters of 2011.

Regarding the Washington metropolitan economy, CRA stated that growth in payroll employment has lagged national growth (December 2010 to December 2011). The federal government has reduced spending and federal jobs have declined eight months in a row. While investment in residential construction has increased at the national level, it remains at a low level in the Washington metropolitan area. According to data provided by CRA, payroll employment in the Washington area increased by 57,500 between December 2009 and December 2010 but only by 13,400 between December 2010 and December 2011. The retail sector remains depressed and the County lost over 5,500 retail jobs from 2005 to 2010. The construction sector also lost nearly 8,700 jobs from 2006 to 2010 in Montgomery County.

Federal spending totaled \$169.5 billion in the local economy in 2010 - an increase of 7.0 percent. Over the past ten years, federal procurement in the Washington metropolitan area has grown at an average annual rate of 10.1 percent. By contrast, according to CRA, it grew only one percent in 2011. Data provided by CRA suggests that federal procurement for Montgomery County stood at \$9.2 billion in 2010 or 11.3 percent of total procurement for the Washington metropolitan area. Montgomery County is more dependent on non-Department of Defense (DoD) procurement rather than on DoD procurement. In 2010, the percentage of non-DoD procurement for Montgomery County was 72.1 – the same as the ten-year average. A discussion among the participants suggested that the County should focus on non-DoD procurement and on those agencies such as the Food and Drug Administration (FDA) that have a strong presence in the County and the recently announced National Cyber Security Center of Excellence.

Post-meeting Update

Since the meeting of the Business Advisory Panel in February, the Bureau of Labor Statistics, U.S. Department of Labor (BLS), revised the establishment series, i.e., non-farm employment data, starting with April 2007. 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 Washington metropolitan region added 27,100 jobs from December 2010 to December 2011 which followed an increase of 33,500 jobs from December 2009 to December 2010. Overall, the increase was 60,600 from December 2009 to December 2011 – approximately 10,000 less than the previous data from BLS. However, those two-year increases offset the decline in payroll employment of 36,900 from December 2008 to December 2009.
- The Bethesda-Rockville-Frederick metropolitan division (Montgomery and Frederick counties), a portion of the metropolitan region, lost 3,900 jobs from

December 2010 to December 2011 but gained 4,800 from December 2009 to December 2010 – a total increase of only 900 jobs over the two-year period. With such modest growth in payroll jobs, the total number of employees in Montgomery and Frederick counties (563,300) in 2011 remained below the pre-recession level of 574,000 in 2008.

The representative from the Washington Metropolitan Council of Governments (COG) discussed the challenges facing the Washington area in finding housing locations due to the estimated growth in the number of new workers. COG is forecasting growth of 1.3 million new jobs between 2010 and 2040 – an addition of nearly 44,000 jobs per year. COG also expressed uncertainty about the local economy and whether the region is “at a critical juncture” regarding the region’s economic competitiveness. The uncertainty pertains to the fact that the region cannot underestimate the presence of the federal government in the local economy and the challenges regarding federal budgets in the future.

After CRA’s and COG’s presentations, the participants discussed the economic outlook for Montgomery County. Major discussion issues regarding the County’s economy were the real estate market, business development, commercial development, and the financial and health services industries. The discussion from specific industry sectors is discussed below.

II. Specific Industry Sectors

Residential Real Estate

The first sector that the participants discussed concerned the current situation in the housing market. The participant from the realtor’s association stated that average housing prices for existing homes declined last year, specifically during the final quarter of 2011, but mortgage rates remain at historically low levels. Even though the inventory of homes for sale is very low, it is not putting upward pressure on prices. The median price for an existing home in Montgomery County was \$390,000 in 2011. The participant discussed government proposals, specifically Governor O’Malley’s proposal limiting the real estate tax and mortgage interest deductions. The outlook for 2012 is expected to remain the same with a low level of inventory. Consumer confidence regarding purchasing a home remains low and pushing more people into rental units. The industry has lost a number of realtors because of the significant slowdown in the real estate market because of little public interest in purchasing a home and a very small inventory.

Commercial Real Estate and Development

The participants also discussed the current and future state of the commercial real estate market. There is little or no growth in commercial construction. One participant is currently constructing one building in Germantown and another participant has planned

a total of \$250 million of new construction including the first WALMART in the County (Georgia Avenue). Specific issues addressed by the participants were:

1. Construction costs for new buildings are increasing.
2. Tenants are requiring shorter leases with no upfront costs.
3. While interest rates are at an all time low, the developers have increased their down payment and are putting more equity into their investments.
4. Lenders are reluctant to take on leases.
5. Office foreclosures are increasing and are likely to increase over the next twelve to twenty-four months.
6. Vacancies are up.
7. There are currently 4 million square feet of Class A vacant property in the County.
8. Rents are down.
9. Businesses are relocating within the metropolitan area.

Hotel Industry

The hospitality sector increased 8 percent statewide last calendar year and 4 percent in the County. However, while business increased, revenues from the hotel motel tax were down 8 percent for the first four months of FY2012. The federal government has reduced the amount of travel undertaken by its employees which has affected the hotel business in the Washington area. The per diem rate allowed by the federal government is down and the Montgomery County rate has been consolidated with the District of Columbia. The outlook for the spring season looks promising but overall the industry expects flat or modest growth for the entire fiscal year.

Other Sectors

The participant from the health services sector provided an assessment of the industry. One of the challenges facing the health services sector is the growth in the aging population – demand is up but revenues have not kept pace with that increase. The challenges facing the health care industry in Montgomery County are increasing costs with no concomitant increase in revenues and the limited availability of skilled health professionals to meet the increasing demand. The sector is expanding in the County with two projects underway with a value of \$400 million. It is estimated that the facility in Germantown will require 600 full-time-equivalent staff. Also, each project will add 1,000 construction jobs to the County's economy.

Regarding local business conditions in Rockville, a local economic development representative stated that there are no large blocks of vacant space in the community and permitting activity has increased. Companies are hiring and there is a strong entrepreneurial interest in locating in Rockville. While there has been steady economic progress in the local community, it has been slow.

Finally the technology sector is hiring skilled individuals and interns. While the outlook is promising, the profit curve for the industry remains flat. Also, the financial services sector reported that capital gains in Montgomery County have increased.

III. Other Comments and Conclusions

Overall, the participants were mixed in their outlook for the County's economy. The construction industry still faces strong headwinds with rising construction costs and decreasing rents. The real estate market has yet to rebound from the housing crash and the outlook for 2012 remains weak with a low inventory and weak consumer confidence. The growth in federal procurement has decelerated and is well below the 10 percent per year growth rate. The long-term growth in the Washington area economy is expected to remain below its historic rate of 4 percent per year. Finally, the issue of federal sequestration remains a large unknown and therefore a large uncertainty with regard to the area's economy and its competitiveness with other jurisdictions.

MONTGOMERY COUNTY

13TH ANNUAL

BUSINESS ADVISORY PANEL



FEBRUARY 16, 2012

MEETING

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

WHEN: THURSDAY, FEBRUARY 16, 2012

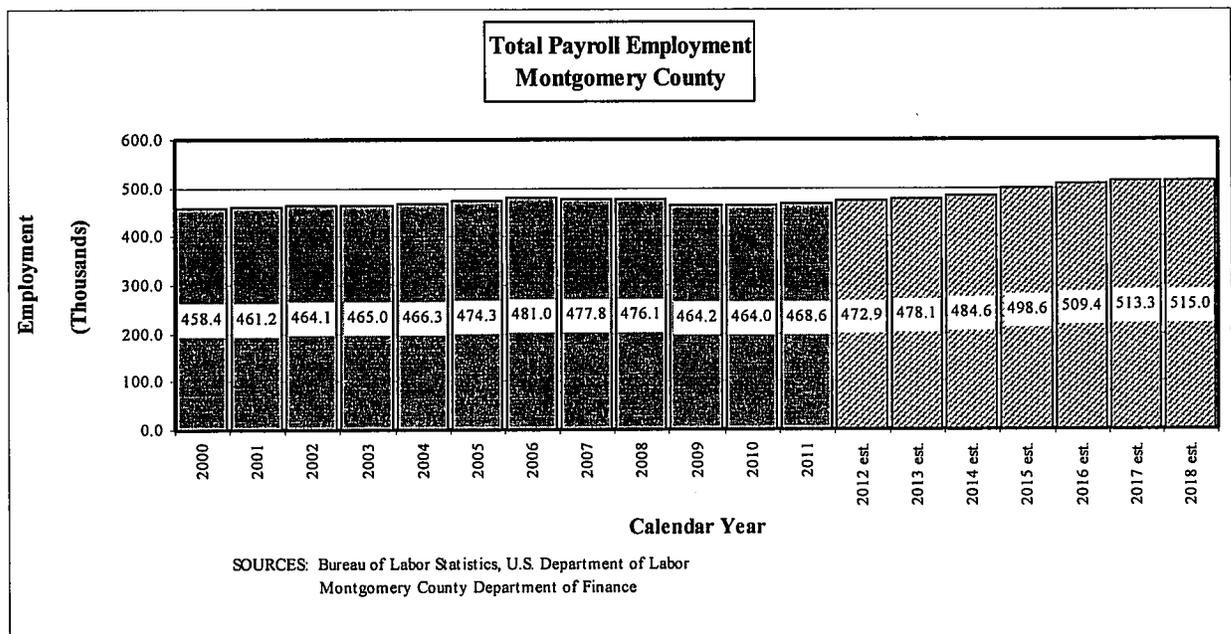
AGENDA

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

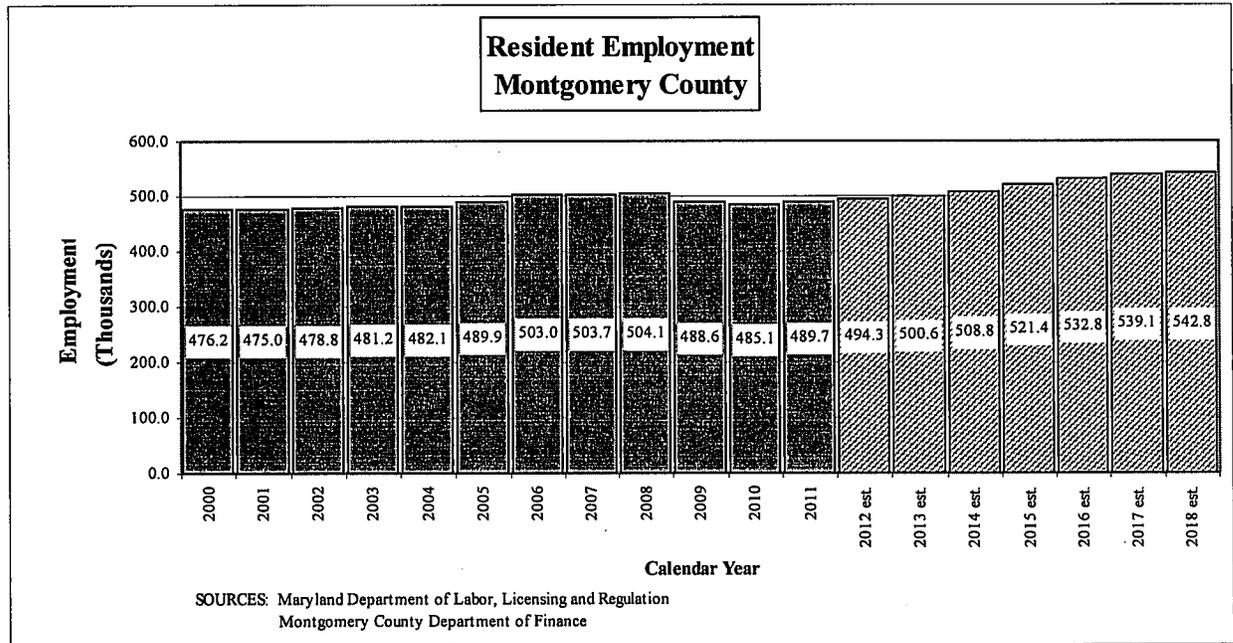
Montgomery County's economy continued to experience a weak recovery in calendar year (CY) 2011. The primary indicators of the weak recovery were a decline in housing sales, modest construction in single-family homes, and unemployment rates that remained at historic high levels. Resident employment showed a modest increase but not enough to substantially offset the high rate of unemployment, and the construction of multi-family units boosted residential construction which helped offset the modest construction in single-family units.

Employment. During the past twelve years (CY2000 – CY2011), total payroll employment in Montgomery County, which is based on the survey of establishments, experienced three distinct cycles: modest growth from CY2000 to CY2006 at an average annual rate of 0.8 percent, a decline from CY2006 to CY2010 at an average annual rate of -0.9 percent, and an increase of 1.0 percent in CY2011. The Department of Finance (Finance) assumes payroll employment will continue to increase from CY2011 to CY2018 and grow at an average annual rate of 1.3 percent over that period. In terms of the number of jobs added to the County's total payroll employment, an average of approximately 6,600 new jobs per year is estimated between CY2012 and CY2018 with most of that growth occurring between CY2015 and CY2016

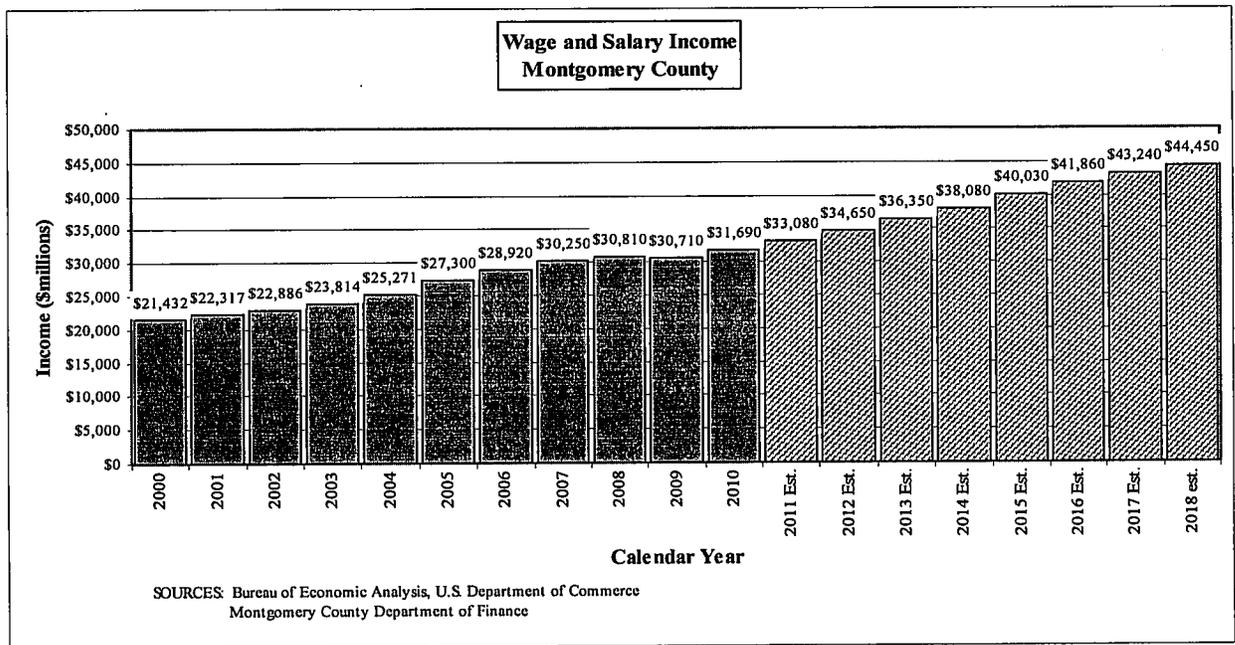


Resident employment in the County, which is based on a survey of County households, provides a slightly different picture of employment growth. For example, resident employment grew at an average annual rate of 0.9 percent between CY2000 and CY2006 (compared to the 0.8 percent for payroll employment). Between CY2007 and CY2008, resident employment in the County experienced no growth and remained at the 503,000-504,000 level during that period while payroll employment declined. Following declines in employment in CY2009 and CY2010 and an increase in CY2011, Finance assumes that

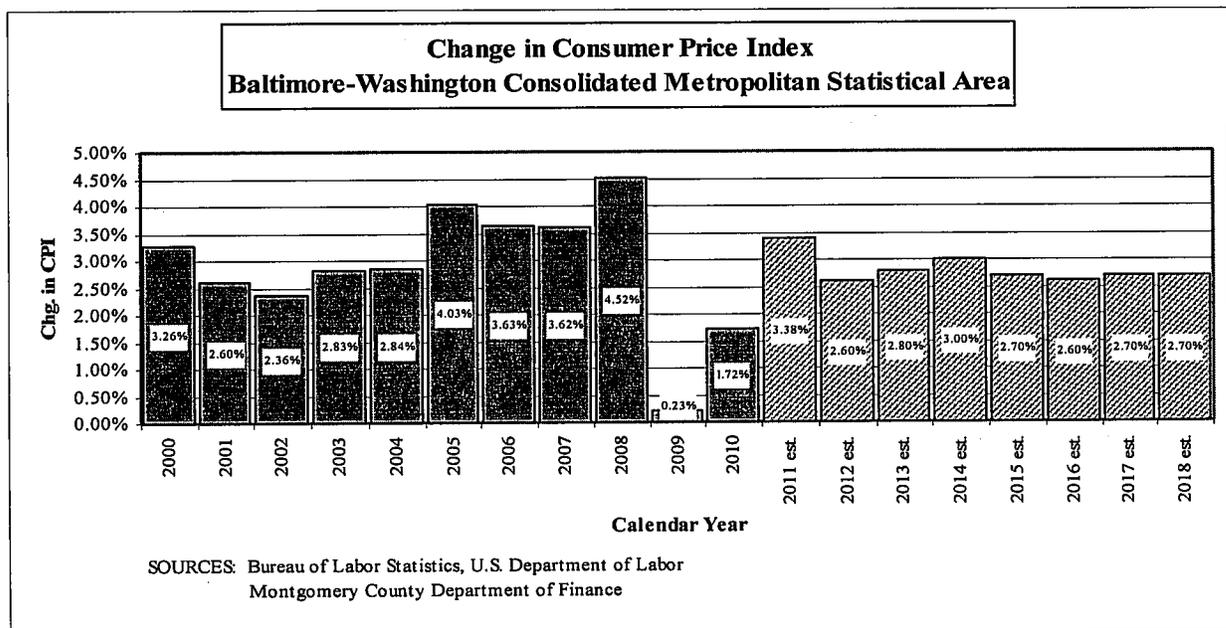
resident employment is expected to increase at an average annual rate of 1.5 percent from CY2011 to CY2018.



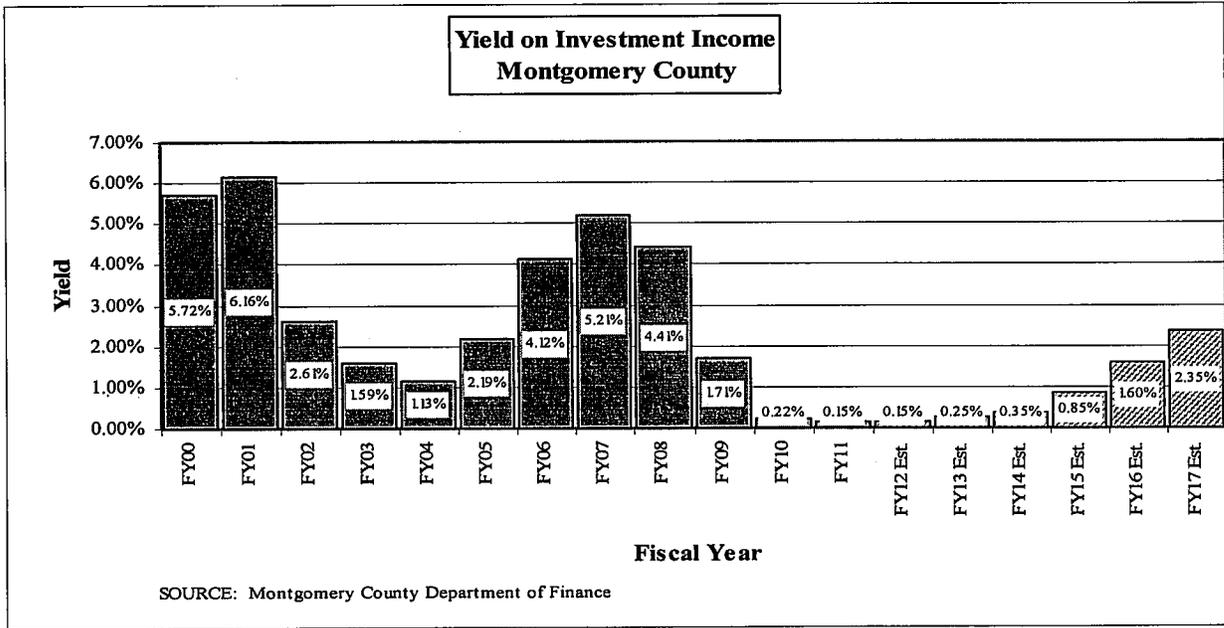
Finance expects wage and salary income to grow at an average annual rate of 4.2 percent between CY2010, the latest date for which actual data are available from the Bureau of Economic Analysis, U.S. Department of Commerce, and CY2018, compared to a rate of 5.0 between CY2000 and CY2006, and a modest rate of 2.3 percent between CY2006 and CY2010. Total wage and salary income is estimated to reach \$44.450 billion by CY2018.



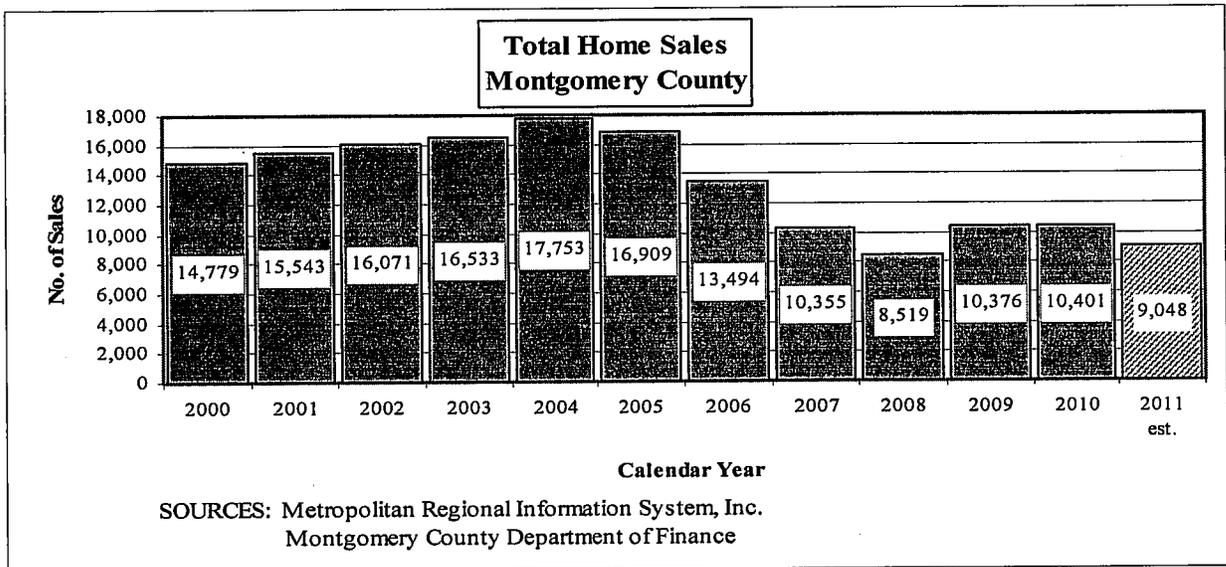
- **Personal Income.** Finance assumes that total personal income in Montgomery County will grow at an average annual rate of 4.6 percent from CY2010 to CY2017, which is slightly greater than the average of 4.3 percent from CY2000 to CY2010. By CY2018, Finance assumes that total personal income will reach \$96.300 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 CY2011 (3.4% compared to 3.2% through November, respectively). The high inflation rate compared to previous years was largely attributed to an increase in the “core” inflation rate (2.4% in CY2011 compared to 1.4% in CY2010 through November, respectively), which is the CPI excluding the volatile food and energy prices. Finance assumes that the overall regional inflation index will decrease from 3.4 percent in CY2011 to 2.6 percent in CY2012, and then gradually increase to 3.0 by CY2014 before settling at 2.6-2.7 percent from CY2015 to CY2018.



- **Interest Rates.** From September 2007 to December 2008, the Federal Reserve Board, through its Federal Open Market Committee (FOMC), 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 had significantly affected the financial markets (both bond and stock markets) and the national economy since the summer of CY2007. Based on its decision at the January 2012 meeting, the FOMC will maintain its current position of an effective target rate of 0.00-0.25 percent through CY2014 at which time interest rates may begin to increase at a moderate rate. Since the yield on the County’s short-term investments are highly correlated with the federal funds rate, Finance assumes that the County will earn an average of less than 0.30 percent in investment income on its short-term portfolio for fiscal year (FY) 2012 and FY2013 with a modest increase to 0.35 percent in FY2014.

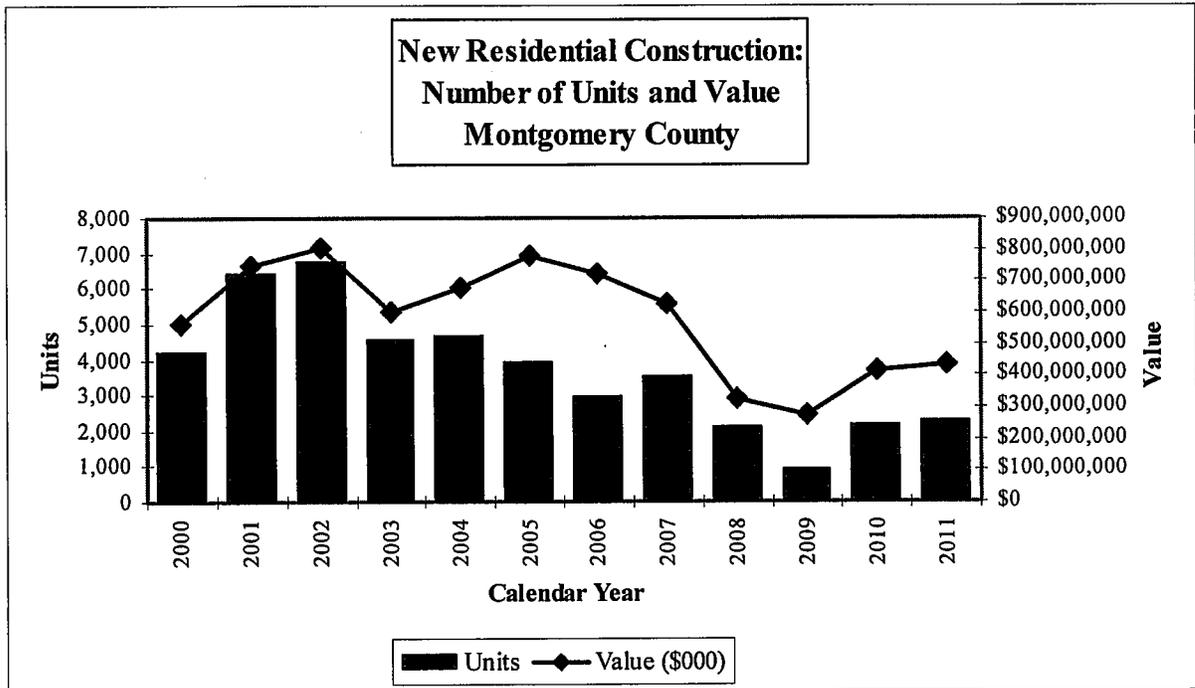


- Real Estate Market.** The housing market in Montgomery County experienced two different trends in CY2011: 1) a dramatic decrease in existing home sales, and 2) an increase in the average sales price for existing homes. Overall, existing home sales decreased 13.0 percent in CY2011 which followed a modest increase of 0.2 percent in CY2010. After two consecutive years of price declines in CY2008 (↓8.4%) and in CY2009 (↓13.8%), housing prices increased 1.7 percent in CY2010 and 2.6 percent in CY2011. However, the increase in CY2011 occurred from January to October of 2011. During the final quarter of CY2011, average home prices declined an average of 6.3 percent compared to the final quarter of CY2010. With home sales also declining in the final quarter, the residential real estate market weakened further during the final three months of CY2011.



- 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. The primary source of construction data is McGraw-Hill Construction, formerly known as Dodge Analytics.

While the value of additional residential property increased a modest 4.8 percent in CY2011 (\$434.3 million), following an increase of 49.9 percent in CY2010, it remained significantly below the \$688.8 million average between CY2000 and CY2007. The number of new single-family units was 605 compared to 676 in CY2010 (↓10.5%). Since CY2007, the construction of new single-family units declined steadily from 978 units to 605 in CY2011. All of the increase in residential construction during the past two calendar years had been in multi-family units.



DISCUSSION FRAMEWORK

The economic assumptions provide a framework for the Department of Finance's revenue projections for 2013 through 2018. 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 construction
- Commercial construction
- Foreclosures/short sales
- Prices/rents
- Vacancy rates
- Loan conditions – residential and commercial sectors

Income

- Capital gains
- Estimated payments

Industry Sectors

- Business activity
- Employment outlook
- Federal government spending and employment (post Super Committee)

Risk to the Forecasts (Assumptions)

- State government: income tax increase and pension shift
- Federal government post Super Committee
- Employment
- Interest rates
- Inflation
- Stock market
- Residential/Commercial development

**List of Participants
Business Advisory Panel
February 16, 2012**

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

Ms. Annice Cody
Vice President Strategic Planning
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.

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

Mr. Bradley Chod
Vice President
Minkoff Development Corporation

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

Ms. Georgette Godwin
President and Chief Executive Officer
Montgomery County Chamber of Commerce

Mr. Thomas J. McElroy
Senior Vice President
Hughes Network Systems

Mr. Bryant Foulger
Managing Principal
Foulger Pratt Companies

Mr. Paul DesJardin
Director, Community Planning and Services
Department of Housing and Planning
Metropolitan Council of Governments

Internal Attendees:

Ms. Nancy Floreen, Councilmember
Chair of the Planning, Housing, and Economic Development (PHED)

Mr. Steve Silverman, Director
Department of Economic Development

Mr. Joseph F. Beach, Director
Department of Finance

Rob Hagedoorn, Treasury Division Chief
Department of Finance

David Platt, Chief Economist
Department of Finance

Michael Coveyou, Policy and Fiscal Projects Manager
Department of Finance