MONTGOMERY COUNTY
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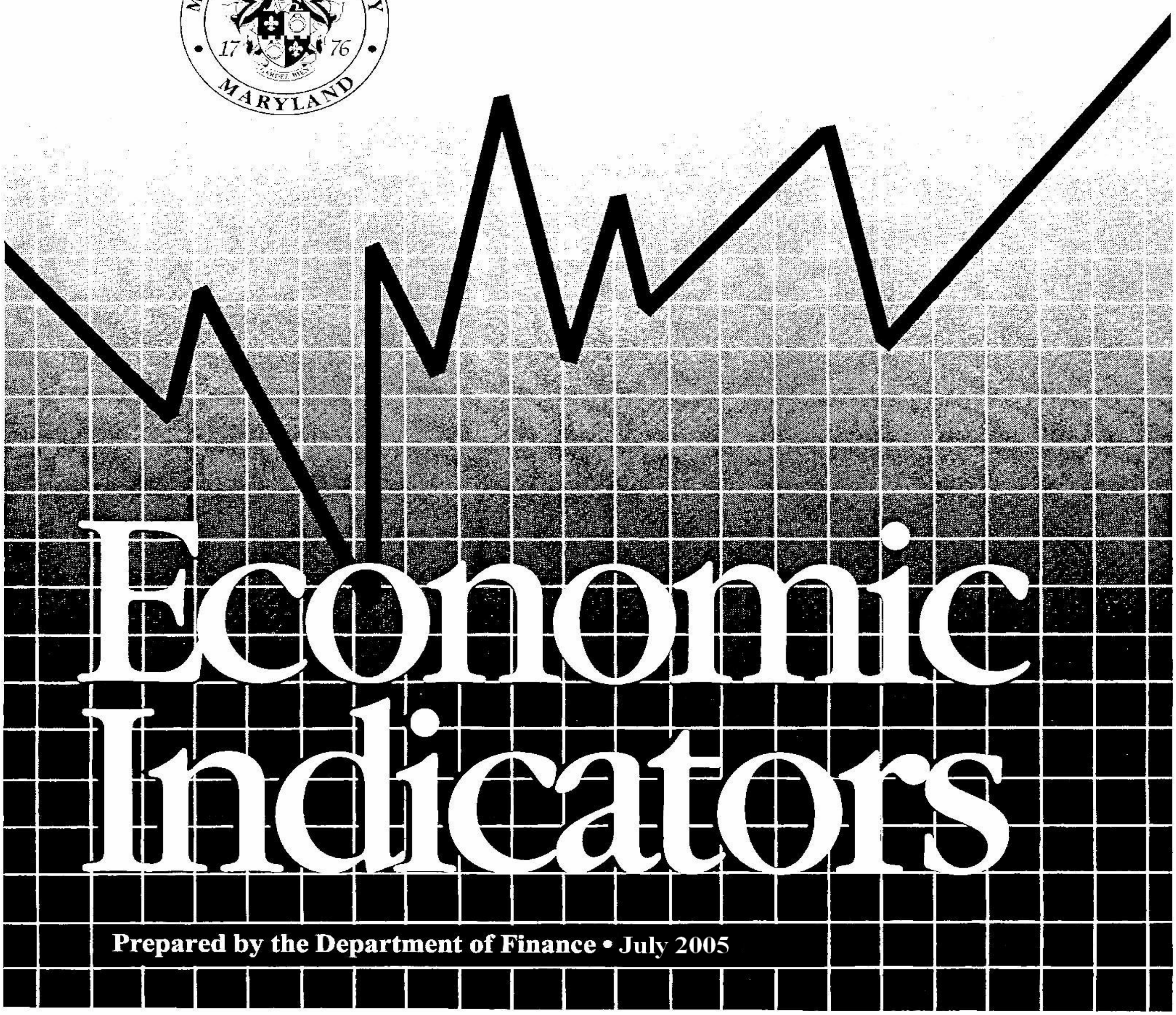
MARYLAND



Economic Indicators

Prepared by the Department of Finance • July 2005

The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.

This report is also available through the Internet on the Montgomery County Web Page:
http://www.montgomerycountymd.gov

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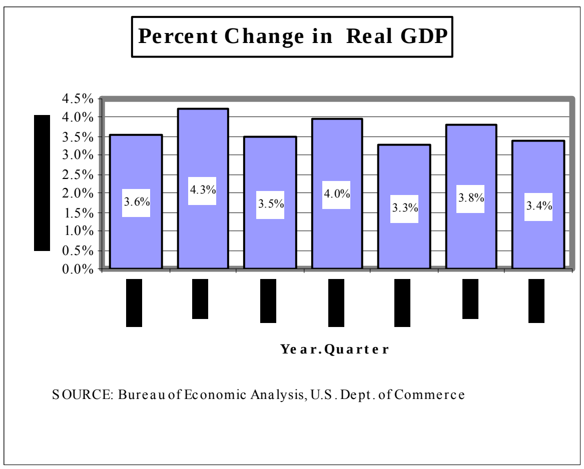
ECONOMIC OVERVIEW

According to the latest economic data, the U.S. economy grew at a 3.4 percent rate during the second quarter of 2005 albeit at a slightly lower rate compared to the first quarter of this year and all of 2004. Based on preliminary data from the Bureau of Economic Analysis, U.S. Department of Commerce, purchases of durable goods (↑8.3%), business investment in equipment and software (↑11.0%), and investment in residential housing (↑9.8%) fueled the increase. The rate of 3.4 percent follows the revised 3.8 percent for the first quarter and 4.2 percent for 2004.

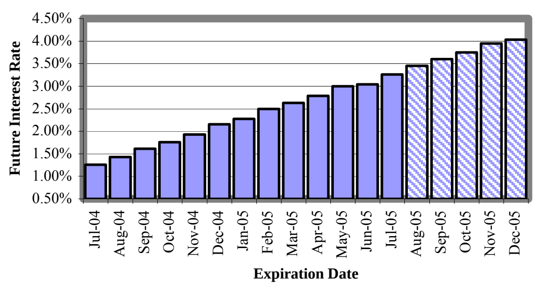


In its June survey of economists by *The Wall Street Journal*, an average of the responses suggested that the economy will grow 3.5 percent during the third quarter. However, that survey was conducted before economic data for June were available. At the time of the survey, the economy was experiencing a "soft patch" that began in late winter and continued through May. The second quarter growth was attributed to the strong performance of the economy in June. For example, industrial production was up a strong 0.9 percent compared to no change in April through May, sales of existing home were up 2.7 percent in June compared to May and 4.4 percent over June 2004, home prices continued their double-digit growth with median prices up 14.7% over June 2004. The economy added 146,000 jobs in June, retail sales were up 1.7 percent over May and 10.4 percent since June 2004, consumer confidence experienced its second monthly increase, and new orders for nondefense goods excluding transportation were up 3.8 percent in June — the largest one month gain since January (↑4.4%).

However, certain indicators continued to cast a pall on the expansion. Foremost among such indicators were energy prices, particularly oil and gasoline. The price per barrel for West Texas Intermediate Crude was up 12.9 percent in June to $56.26 per barrel — the highest monthly average price ever and surpassing the previous high in March by nearly $2. The median sales price of a new home; which includes either a fully detached, semidetached, rowhouse, or a townhouse but excludes a multi-family unit such as a condominium, was $214,800 in June (↓5.5% from May), which followed $227,400 in May (↓6.6% from the April peak of $232,600).

With the strong economic performance in June, the members of the Federal Open Market Committee (FOMC) of the Federal Reserve (Fed) were reassured about the strength of the economic expansion. Following several "soft" economic indicators during the months of April and May, spending and production in June indicated that the overall expansion remained firm. Even with volatile energy prices, the economy appeared resilient. While inflation in the core consumer prices abated during May and June, most FOMC participants anticipated a modestly higher rate of inflation this year than last as higher energy, commodity, and import prices are passed through to core prices. It is against this economic backdrop that the FOMC raised the target rate on federal funds in late June an additional 25 basis points to 3.25 percent. With that increase, the Fed has raised the target rate 25 basis points nine times since June 2004. The federal funds futures market anticipates three more 25-basis point increases during the remainder of the year such that by December the target rate could reach 4 percent ─ the highest level since May 2001.

Federal Funds Rate and Federal Funds Futures (30 Day)



SOURCE: Federal Reserve Bank of St. Louis (solid bars) and the Chicago Board of Trade (CBOT) as of 7/31/05.

However, while the FOMC raised the target rate on federal funds over the past year, long-term interest rates have remained at the same level creating what the Chairman of the Fed calls a "conundrum." Before the FOMC raised the target rates, the spread or difference between the 10-year U.S. Treasury bond and the federal funds rate was 372 basis points (or 3.72 percentage points). As of June, the spread was only 96 basis points (or .96 percentage point) ─ the smallest difference since the end of the 2001 recession. In fact, the yield on a 10-year Treasury declined from 4.73 percent in May 2004 to 4.00 percent in June. This "conundrum" has led analysts to believe that the Fed is not concerned that the yield curve could become "inverted" by year end, which portends impending economic weakness. The members of the FOMC contend, rather, that the economy is positioned for further expansion.

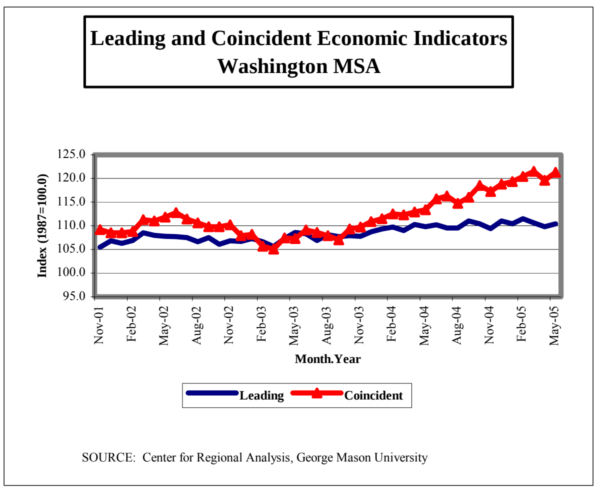
The persistent unresponsiveness of the 10-year Treasury to rate hikes in the federal funds, assuming there is an association, or correlation, between capital markets and money markets, has also affected mortgage rates. Because of the strong association between the 10-year Treasury and 30-year fixed rate mortgages, mortgage interest rates remained at or near the 6 percent level since the beginning of the year. At such historic rates, the housing market continues to experience a boom both in home prices and record high homeownership rates.

While long-term interest rates have remained quiescent during the first half of this year, the stock market had not broken out of its doldrums at the end of June. As of June 30, all four major stock market indices were below their December 30th levels (DJIA ↓4.71%, NASDAQ ↓5.45%, S&P 500 ↓1.70%, and Russell 2000 ↓1.83%). However, because of a very strong June economic performance, the major indices experienced significant improvement in July such that all of the indices except the DJIA (↓1.32%) were positive for the year (NASDAQ ↑0.43%, S&P 500 ↑1.84%, and Russell 2000 ↑4.32%).

Similar to the national economy, which achieved a sustainable growth rate of 3.4 percent during the second quarter, the regional economy also continued its expansion during the year. Over the past five months ending in May, the latest date for which data are available, the Washington Coincident Index, which represents the current state of the Washington economy, increased 7.0 percent, which was nearly the same rate as in 2004. The expansion that started in mid-2003 is greater than the one during same period that followed the 1990-

91 recession. With the leading index slowing to a rate below 1.00 percent for the year, the regional economy is expected to experience a slight deceleration during the second half of this year and into 2006.

The hallmark of the region's economy is its ability to create jobs. For the twelve-month period ending in May, the economy generated nearly 84,500 jobs and has led the nation in job creation. According to the Center for Regional Analysis (CRA), the types of new jobs "continue to reflect a disproportional gain in higher wage jobs." Professional and business service jobs experienced the largest growth. Between April 2004 and April 2005, 27,300 (or 32.3%) of new jobs came from that sector. Because of the housing boom in the region, the construction industry added 7,500 jobs.



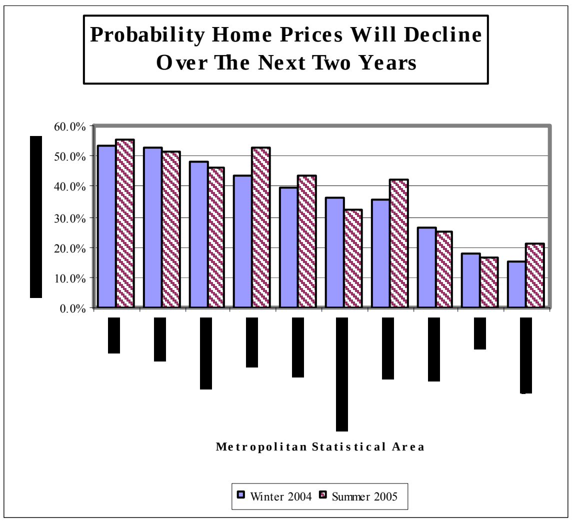
Job growth in the region is expected to continue as long as federal spending contributes to that growth. In a recent report by Dr. Stephen Fuller, Director, CRA, "federal spending constitutes at least one-third of the Washington metropolitan area economy and procurement outlays account for the largest and fastest growing source of this federal spending." According to Dr. Fuller, federal procurement totaled $50 billion during FY2004 ─ an increase of 18.4 percent over FY2003. Montgomery County's federal contractors received procurement awards totaling $6.6 billion (or 13.2% of the total), which represent an increase of $1.7 billion or 34.7 percent.

While federal procurement remains a driving force in the region's economy, the U.S. Secretary of Defense (SECDEF) recommended a round of base closures and realignments, known as BRAC. Based on the SECDEF's recommendation, CRA suggested modifications to the recent round of forecasts published by the Washington Metropolitan Council of Governments (COG). Those modifications forecast a decline of 15,000 jobs by the year 2010.

Montgomery County is expected to experience very little job loss under the CRA recommended forecast compared to the current round of estimates prepared by COG. According to the recommended changes, total payroll employment in the County is expected to reach 564,850 by 2010 down approximately 150 jobs from the previous forecast of 565,000, or less than 30 jobs per year.

The strong employment growth in the region has generated strong demand for housing as reflected in the double-digit price appreciation. Housing prices increased from an average of $313,000 in 2003 to $376,000 in 2004, an increase of 20.1 percent. That rate followed steadily increasing double-digit growth rates of 10.5 percent in 2001, 13.6 percent in 2002, and 13.8 percent in 2003. With such dramatic increases in home prices, the concern is whether there is a housing bubble. Recent data from PMI Mortgage Insurance suggest that the likelihood of a decline in housing prices in the region is nearly 21 percent. While that probability is less than some other major metropolitan areas such as Boston, San

Francisco, Los Angeles, and Minneapolis, it has increased since last winter when the probability was 15 percent. The significant increase suggests that housing prices in the Washington metropolitan area may be reaching levels that are not sustainable even with the dramatic growth in employment. If home prices continue to rise at double-digit rates, the risk that prices will decline over the next two years increases significantly.



MONTGOMERY COUNTY ECONOMIC INDICATORS

The County's economy during the first half of 2005 generally experienced significant improvement compared to the first six months of 2004. Employment among the County's residents grew significantly during the January-June period, residential construction rebounded during the first half of 2005 compared to the same period last year, and housing prices continued to increase significantly during the first half of the year.

Employment Situation

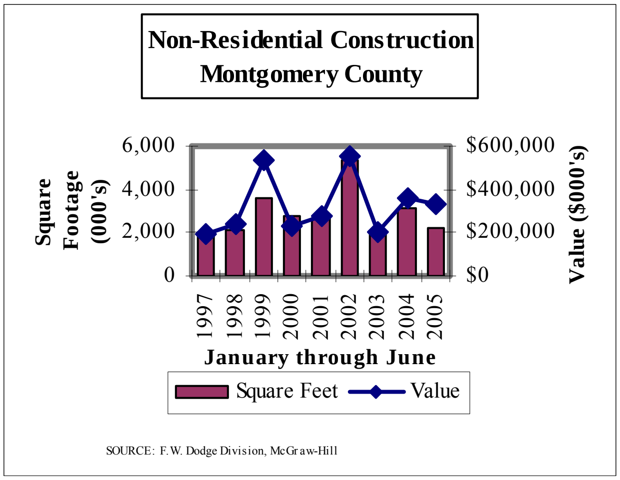
The employment situation in Montgomery County experienced modest improvement during the first half of 2005. Data based on a new series constructed by the Bureau of Labor Statistics, U.S. Department of Labor, showed that employment in the Bethesda-Frederick-Gaithersburg metropolitan division increased 1.9 percent over the twelve-month period ending in May. Over the January-May period this year, employment grew at the same rate of 1.9 percent compared to the same period in 2004. To date, employment growth in the metropolitan division may exceed the 0.7 percent increase experienced in 2004.

Data based on the unemployment insurance program, or ES-202 Program, showed that payroll employment in the County increased 1.1 percent during 2004, the latest period for which data are available. That rate is slightly better than the 0.9 percent experienced in 2003. All of the increase in payroll employment occurred in the private sector which gained over 5,000 jobs during the year. Most of that gain was in the professional and business services sector (↑2.0%), the education and health services sector (↑5.1%), and the construction industry (↑2.4%).

The final employment data series, the labor force series, reported that employment based on place of residence grew 2.4 percent during the first half of this year (January-June) compared to the same period last year and slightly higher than the 2.1 percent for all of 2004. However, because BLS is revising the County's labor force series for 2001 through 2003, comparison to previous years is not meaningful. With the modest improvement in resident employment, the unemployment rate for the County continues to remain one of the lowest in the State with a six-month average of 3.3 percent compared to the 4.4 percent statewide and 5.3 percent for the nation.

Construction Activity

During the first half of 2005, construction activity in the County experienced two different cycles. Non-residential construction starts, which consists of commercial (stores and food service, warehouses, office and bank buildings, garages and service stations, and hotels and motels), manufacturing, education and science, dormitories, medical, and other buildings were down 7.6 percent in total value during the January-June period compared to the same period last year. This rate follows a 27.1 percent increase in 2004. The amount of square footage added to the County's non-residential property based also declined during the first half of 2005 (↓27.9%) compared to the first half of 2004.

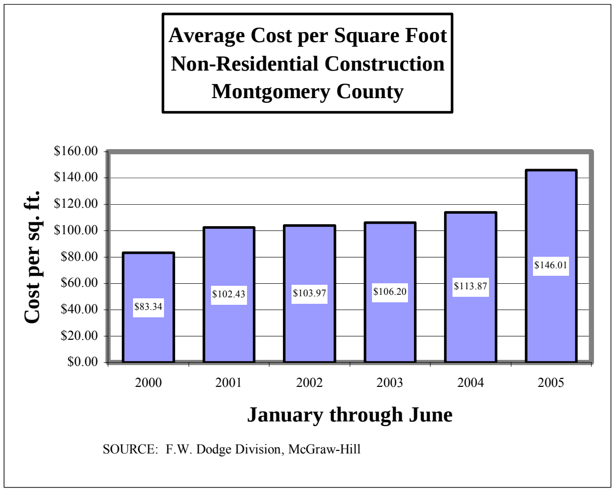


The primary reason for the decline in non-residential construction was attributed to the dramatic decrease in the addition of commercial building space, particularly office and bank building. That decline in the rate of additional office space is responsible for the small increase in the amount of inventory for office space, which grew very little from 28.7 millions square feet in June 2004 to 29.1 millions square feet.

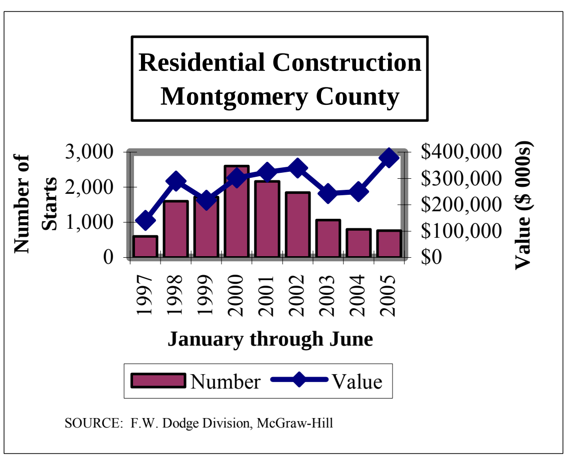
While the amount of additional office space increased only 1.4 percent, the amount of Class A space that was vacant dropped from 2.9 million square feet as of June 2004 to 2.3 million square feet as of June 2005 or 20.7 percent. Because the adsorption rate of 20.7 percent exceeded the 1.4 percent rate of additional inventory, the County experienced a significant drop in the vacancy rate of Class A office space from over 10.2 percent as of June 2004 to 7.7 percent in June 2005 ─ a decline of 2.5 percentage points. At the same time, the amount of office space inventory increased very modestly from 28.7 million square feet in June 2004 to 29.1 million square feet as of June 2005.

For the first half of 2005, the amount of additional square footage of commercial property declined 56 percent compared to the first half of the previous year. Construction of office and bank building space was off by nearly 92 percent. That decline follows three consecutive years in which the amount of additional office space declined from 2.4 million square feet in calendar year 2001 to less than 750,000 square feet in 2004 ─ a decline of nearly 70 percent.

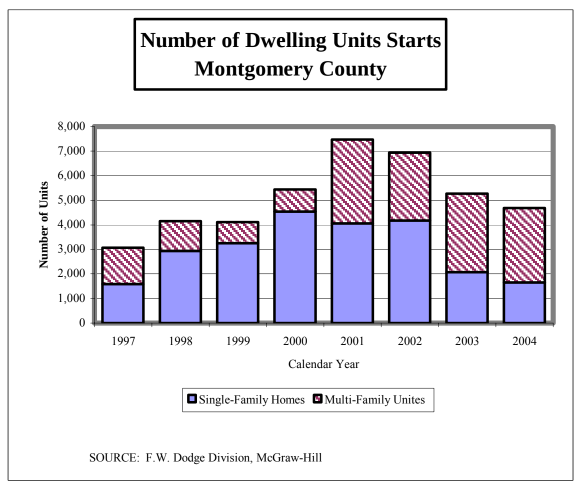
While the amount of non-residential space has experienced a volatile pattern in the past five and half years, the cost per square foot has not. Because of the dramatic price increases for construction materials such as lumber, sheet metal and other metal products, and concrete in 2004 and the early part of this year, the cost per square foot has accelerated from $83.34 during the January-June period in 2001 to $146.01 during the same period in 2005, with most of that increase between 2004 and 2005. That dramatic increase is mainly attributed to the cost per square foot for the construction of office and bank buildings, which increased from $99.35 per square foot during the January-June 2000 period to $148.47 during the first half of this year while overall commercial construction costs declined during the first half of 2004 compared to the same period in 2003.



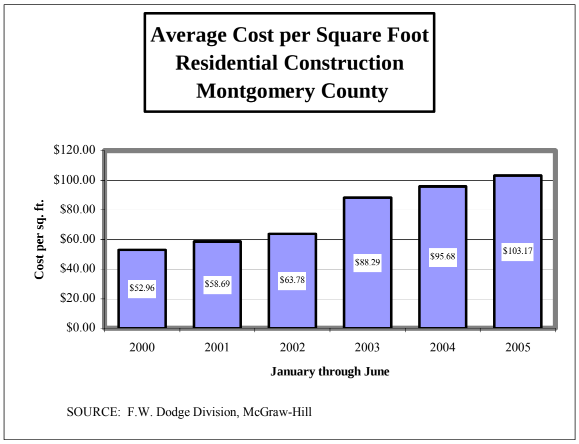
Unlike non-residential activity, residential construction experienced a significant construction boom during the first half of 2005, which was a reversal of 2004. During the first six months of this year, the number of permits (↑43.0%) and the value of construction starts (↑51.4%) were up dramatically compared to 2004.



Led by the growing demand for condominiums, construction of multi-unit housing accelerated in the past two years. With the prices of single-family detached units beyond the reach of many new households, the construction of multi-family units has increased from 487 units during the first half of 2003 to over 1,500 units during the same period this year — a threefold increase. At that rate, the total number of multi-family units under construction in the County could reach nearly 3,900 units by the end of the year, which surpasses the 3,400 units constructed in 2001. This estimation is based on the fact that the recent moratorium imposed by the County government on new construction caused by certain projects exceeding the specifications in the County's site plan agreements will be resolved within a short-period of time. If not, the rate of residential construction during the second half of this year may not meet the rate experienced during the first half.

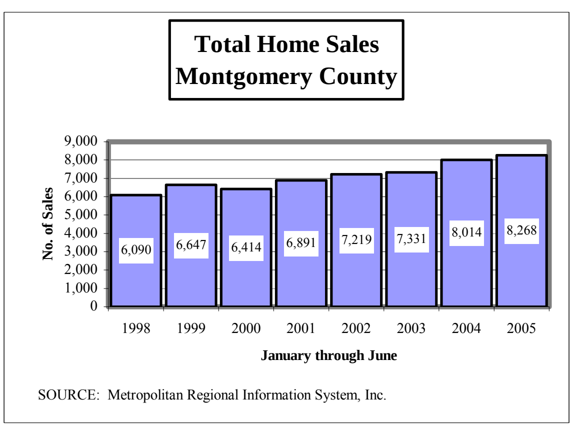


Cost per square foot of new residential space also increased dramatically in the past four years. In the first six months of 2000, the average cost per square foot was $55.96. The average increased dramatically such that by 2005 it reached $103.17 per square foot — with most of that increase occurring that past three years. The dramatic increase in cost of new homes can be attributed to the accelerating costs of construction materials.

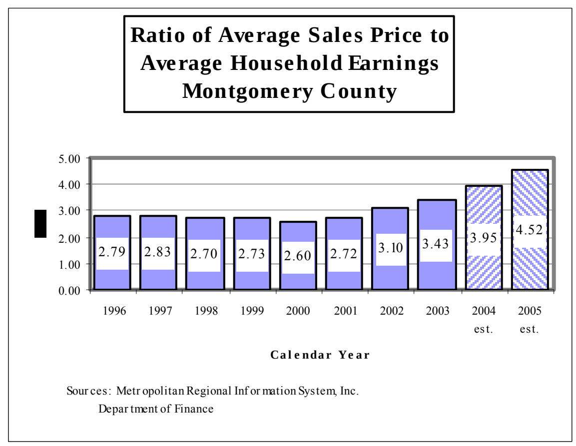


Residential Real Estate

Homes sales in the County increased 3.2 percent during the first half of 2005 compared to the same period in 2004. Home sales of approximately 8,300 units to date have far exceeded sales during the prior seven years. Average home prices have risen 17.3 percent during the first half of the year compared to the same period as last year, and median prices accelerated 19.0 percent during the same period. With an average home price of nearly $540,000, home values have doubled over the past four years.



However, in contrast to the dramatic rise in house prices, personal income by County residents has not kept pace. Based on the latest income data from the Bureau of Economic Analysis, U.S. Department of Commerce, personal income increased only 3.5 percent per year between 2000 and 2003 and earnings increased 4.1 percent per year over the same period. While at the same time, home prices increased at an average annual rate of nearly 12 percent or three times the rate of growth in earnings. As such the ratio of average earnings per household received by County residents to average home prices accelerated from 2.60 in 2000 to 3.43 in 2003.



Based on the projected average sales prices and earnings for 2005, that ratio could reach an astonishing 4.52 — a significant level compared to the late 1990s and early 2000s. The increase in the ratio means that Montgomery County households, particularly first-time home buyers, are stretching their incomes to the maximum in order to meet rising real estate prices. Coupled with innovative mortgage financing instruments, there is the possibility that new homebuyers are at risk if home prices decline or moderate significantly in the near term.

As stated previously, interest rates on 30-year fixed rate mortgages are associated closely with the 10-year U.S. Treasury Bond. As of July 22, the rate on a 30-year fixed rate mortgage was 5.73 percent compared to the rate of 4.28 percent for the 10-year government bond. The Mortgage Bankers Association (MBA) and the National Association of Home Builders (NAHB) expect mortgage rates to end the year at 5.7 to 5.8 percent and an average 6.1 percent in 2006. With mortgage rates holding relatively steady over the next year and a half, low financing costs will continue to fuel demand for housing as new homebuyers enter the market. The issue is whether those potential buyers will have incomes to match current and rising home prices.

SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date 2005	Year To-Date 2004	2004
Leading Indicators						
National	June	0.9%		(See footnote below)		1.3%
Washington MSA	May	0.5%		0.8%		2.1%
Coincident Indicators						
National	June	0.2%		(See footnote below)		3.5%
Washington MSA	May	1.4%		7.0%		7.1%
Consumer Confidence Index						
National	June	2.5%		9.8%		8.3%
South Atlantic Region	June	2.4%		9.0%		11.4%
Consumer Price Index						
All Items (nsa)						
National	June	2.5%		3.0%		2.7%
Washington - Baltimore CMSA	May	4.0%		3.8%		2.8%
Core CPI (nsa)						
National	June	2.0%		2.2%		1.7%
Washington - Baltimore CMSA	May	3.8%		3.5%		1.8%
Retail Trade						
National (sales - nsa)	June	10.4%		7.2%		7.6%
Washington MSA (sales - nsa)	Apr	5.5%		5.9%		6.4%
Maryland (sales tax)	May	5.1%		6.3%		9.1%
Montgomery County (sales tax)	May	4.3%		5.3%		6.7%
Employment						
National (labor force data - nsa)	June	142,456,000	139,861,000	140,421,167	138,191,667	139,252,000
- Percent Change		1.9%		1.6%		1.1%
Bethesda-Federick-Gaithersburg (establish.)	May	568,400	558,000	560,600	550,100	557,700
- Percent Change		1.9%		1.9%		0.7%
Montgomery County (labor force data)	June	494,971	483,385	488,519	478,639	481,555
- Percent Change		2.4%		2.1%		n.,m.
Montgomery County (adjusted)*	Dec. '04	458,671	450,405	449,353	444,591	444,591
- Percent Change		1.8%		1.1%		0.9%
Unemployment						
National (nsa)	June	5.2%	5..8%	5.3%	5.7%	6.0%
Maryland (nsa)	June	4.3%	4.4%	4.4%	4.3%	4.2%
Bethesda-Federick-Gaithersburg (nsa)	May	3.1%	3.1%	3.3%	3.2%	3.2%
Montgomery County (nsa)	June	3.4%	3.5%	3.3%	3.2%	3.1%
Construction						
Construction Starts - Montgomery County						
Total ($ thousand)	June	$94,184	$103,017	$707,103	$605,946	$1,259,919
- Percent Change		-8.6%		16.7%		11.0%
Residential ($ thousand)	June	$41,564	$76,350	$377,706	$249,529	$677,705
- Percent Change		-45.6%		51.4%		-6.7%
Non-Residential ($ thousand)	June	$52,620	$26,667	$329,397	$356,417	$582,214
- Percent Change		97.3%		-7.6%		27.1%
Building Permits (Residential)						
National	June	207,948	190,997	1,070,972	1,012,069	2,070,077
- Percent Change		8.9%		5.8%		11.2%
Maryland	June	3,310	2,825	17,143	13,609	28,384
- Percent Change		17.2%		26.0%		-5.8%
Montgomery County	June	413	95	2,510	1,755	3,798
- Percent Change		334.7%		43.0%		-17.3%
Building Permits (Non-Residential)						
Montgomery County	June	215	186	1,257	959	1,966
- Percent Change		15.6%		31.1%		9.3%
Real Estate						
National						
Sales (saar)	June	7,330,000	7,020,000	7,030,000	6,610,000	6,784,000
- Percent Change		4.4%		6.4%		9.7%
Median Price	June	$219,000	$191,000	$200,167	$178,667	$185,200
- Percent Change		14.7%		12.0%		9.3%
Montgomery County						
Sales	June	2,040	2,073	8,268	8,014	17,753
- Percent Change		-1.6%		3.2%		7.4%
Average Price	June	$536,098	$434,633	$488,256	$416,352	$429,480
- Percent Change		23.3%		17.3%		18.3%
Median Price	June	$440,000	$377,900	$402,213	$337,998	$355,000
- Percent Change		16.4%		19.0%		20.1%
Average Days on the Market	June	20	18	27	25	26

NOTES:

(nsa): not seasonally adjusted

(adjusted): ES-202 series adjusted for noneconomic coding revisions by DLLR

(saar): seasonally adjusted at annual rates

***Employment data under 2005 and 2004 pertain to 2004 and 2003 respectively**

METROPOLITAN AREA OFFICE MARKET

Office Vacancy Rate by Jurisdiction and Class, 06/05

Jurisdiction	Class A	Class B	Class C	Total
Loudon	10.63%	9.28%	2.18%	9.64%
Fairfax	8.66%	10.73%	3.97%	9.19%
Frederick	6.50%	11.22%	16.57%	9.55%
Alexandria/Arlington	10.69%	6.80%	18.76%	10.18%
Montgomery	***7.72%***	***8.60%***	***7.34%***	***8.07%***
District of Columbia	6.41%	6.37%	0.63%	5.80%
Prince George's	10.11%	9.40%	12.60%	10.20%
Metropolitan Area	8.16%	8.23%	7.23%	8.10%

Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudoun	591,239	387,558	11,630	990,427
Fairfax	5,331,500	3,282,097	110,756	8,724,353
Frederick	156,851	210,971	100,141	467,963
Alexandria/Arlington	2,835,010	1,299,513	1,117,915	5,252,438
Montgomery	***2,245,137***	***2,303,643***	***441,528***	4,990,308
District of Columbia	4,145,898	2,752,713	78,012	6,976,623
Prince George's	921,521	848,877	426,402	2,196,800
Region	16,227,156	11,085,372	2,286,384	29,598,912

Office Space Inventory by Jurisdiction and Class (sq.ft.)

Jurisdiction	Class A	Class B	Class C	Total
Loudoun	5,563,692	4,176,789	533,482	10,273,963
Fairfax	61,531,716	30,577,577	2,789,210	94,898,503
Frederick	2,414,028	1,879,659	604,426	4,898,113
Alexandria/Arlington	26,512,566	19,120,733	5,958,583	51,591,882
Montgomery	***29,080,348***	***26,775,132***	***6,013,385***	61,868,865
District of Columbia	64,679,988	43,204,412	12,324,242	120,208,642
Prince George's	9,118,717	9,030,940	3,383,553	21,533,210
Region	198,901,055	134,765,242	31,606,881	365,273,178

Share of Office Space Inventory by Jurisdiction and Class

Jurisdiction	Class A	Class B	Class C	Total
Loudon	54.2%	40.7%	5.2%	100.0%
Fairfax	64.8%	32.2%	2.9%	100.0%
Frederick	49.3%	38.4%	12.3%	100.0%
Alexandria/Arlington	51.4%	37.1%	11.5%	100.0%
Montgomery	***47.0%***	***43.3%***	***9.7%***	***100.0%***
District of Columbia	53.8%	35.9%	10.3%	100.0%
Prince George's	42.3%	41.9%	15.7%	100.0%
Metropolitan Area	54.5%	36.9%	8.7%	100.0%

Note: Office Space inventory includes leasable and owner-occupied space.
Totals exclude non-classified space.
Vacant means "direct vacant" and does not include sublease space.

Source: Montgomery County Department of Planning, Research and Technology Center
Data compiled from Realty Information Group commercial space data file, 6/17/05

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