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BALTIMORE COUNTY FISCAL DIGEST

GENERAL FUND REVENUES & THE ECONOMY

Baltimore County, Maryland

March 20, 2008

April 3, 2008

Honorable Members of the Baltimore County Council

Gentlemen:

I am pleased to submit the Baltimore County Fiscal Digest as of March 20, 2008. This report provides an updated County General Fund revenue projection for FY 2008 of $1.603 billion, which is marginally above FY 2008 budget estimates. Additionally, this report includes a preliminary FY 2009 revenue forecast. FY 2009 General Fund revenues are projected to total $1.655 billion, an increase of $51.9 million, or 3.2%, over estimated FY 2008 revenues. This revenue growth primarily reflects anticipated gains in the County's two principal revenue sources, property and income taxes, in FY 2009.

Our forecast for FY 2008 title transfer and recordation tax revenues is unchanged from our December estimate, which showed a 15% decline due to the recent turmoil in the mortgage credit market. The disruptions in financial markets continue to negatively affect the County's housing market. At the January 24, 2008 meeting of the Baltimore County Economic Advisory Committee, members expressed uncertainty and concern with regard to the economic outlook and the adverse effects that poor credit conditions may have on the local economy for the first half of 2008. However, despite an attitude of caution toward the local, regional, and national economies, it was generally agreed that conditions should improve through the third and fourth quarter and into 2009, bringing about an anticipated upswing in the housing market. Accordingly, FY 2009 title transfer and recordation tax revenues are forecast to remain flat at $100.4 million based on the expectation that the housing market will begin to turn around by the end of CY 2008.

As of June 30, 2007, the County's General Fund surplus totaled $133.9 million, excluding $80.0 million in the Revenue Stabilization Reserve Account and $57.5 million designated to fund one-time spending (e.g., PAYGO capital spending) in the FY 2008 budget. Based on our projections, we expect the General Fund surplus to total $131.9 million at the end of FY 2008, excluding an estimated $84.0 million in the Revenue Stabilization Reserve Account. Our next update will include revised revenue forecasts for FY 2008 and FY 2009 and will coincide with the issuance of the County Council's Budget Message.

Respectfully Submitted,

Mary P. Allen
County Auditor

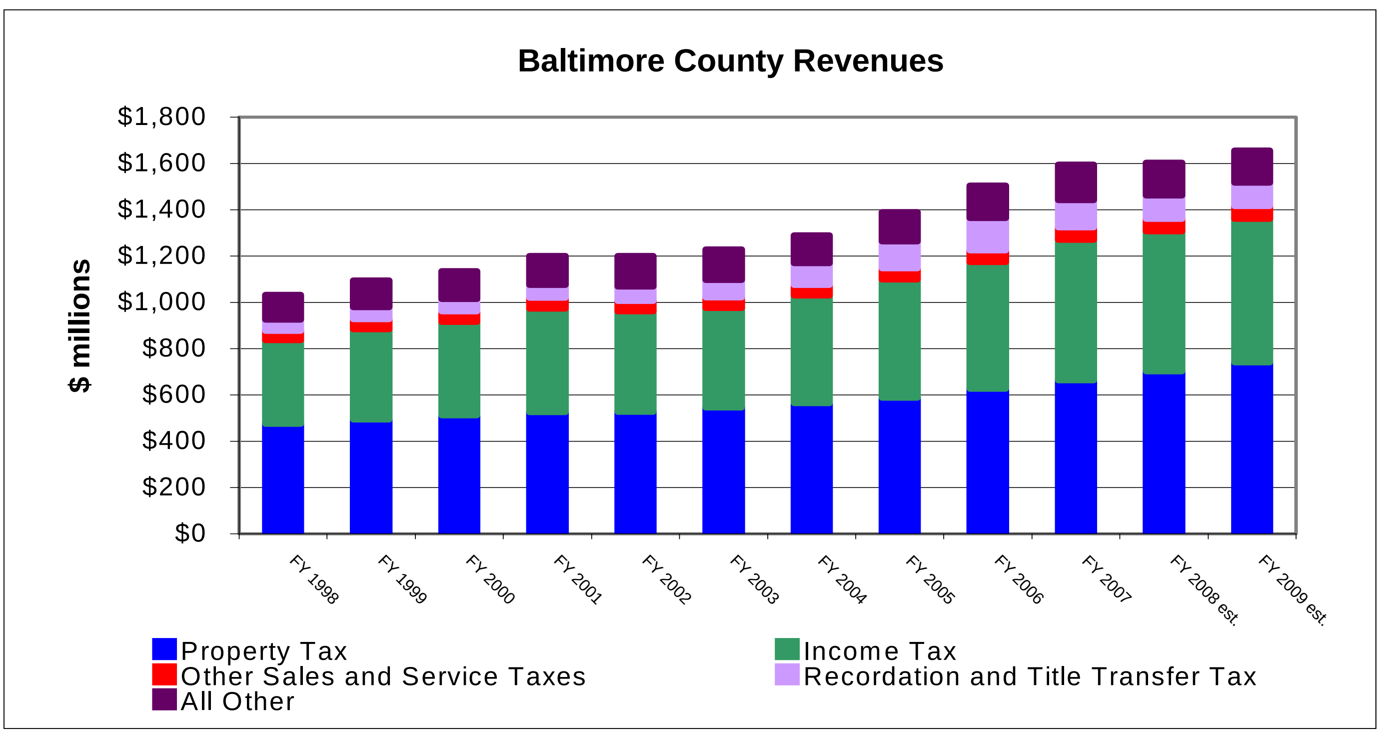
cc: Baltimore County Spending Affordability Committee, Baltimore County Economic Advisory Committee

REVENUE HIGHLIGHTS

FY 2008 County General Fund revenues over the first seven months (July through January) totaled $1.083 billion, $44.9 million, or 4.3%, above collections over the same period last year. Property tax revenues showed strong gains of 6.2% through January. Income tax revenues, which have been reported through February, demonstrate even stronger year-to-date gains of 9.0%. Property-related transaction tax revenues declined by approximately $14.0 million, or 19.9%, due to the continued slowdown in the number of real estate transactions.

FY 2008 General Fund revenues over the entire year are forecast to increase by $7.2 million, or 0.5%, to $1.603 billion. This forecast is significantly lower than the year-to-date growth of 4.3% primarily due to the change in the State's income tax distribution ratio for Baltimore County, which began to affect County revenues late in FY 2007. This revenue projection is approximately the same as our December forecast. The FY 2008 revenue forecast includes a $17.7 million decline in property-related transaction revenues due to recent turmoil in the mortgage/credit market which has negatively affected the County's housing market. The forecast further includes strong gains of $39.8 million in property tax revenues, reflecting significant gains in property values in recent years combined with the smoothing effect of the Homestead Credit (4% increase cap). The County's surplus as of June 30, 2007 totaled $133.9 million, excluding $80.0 million in the Revenue Stabilization Reserve Account (RSRA) and $57.5 million designated to fund one-time spending (e.g., PAYGO capital spending) in the FY 2008 budget. The County's surplus as of June 30, 2008, excluding an estimated $84.0 million in the RSRA, is projected to total $131.9 million, or 8.2% of budgeted FY 2008 revenue.

FY 2009 General Fund revenues are forecast to increase by $51.9 million, or 3.2%, to $1.655 billion. This projected rate of growth is below the FY 2004 to FY 2007 annual growth rates, but considerably higher than the projected FY 2008 growth rate. General Fund revenue growth in FY 2009 primarily reflects anticipated gains in the County's two principal revenue sources, property and income taxes, which are projected to increase by 5.5% and 2.5%, respectively. Property-related transaction tax revenues are expected to be flat due to continued slowing in the housing market prior to an anticipated increase in activity in early CY 2009. The forecast takes into consideration State aid reductions, as well as the State law change in the definition of taxable income, which are expected to reduce FY 2009 General Fund revenues by approximately $15 million.



COUNTY GENERAL FUND REVENUE

General Fund revenue increased by 6.1% in FY 2007. However, FY 2007 revenues are particularly high due to a State income tax revenue distribution that exceeded actual experience. Accordingly, FY 2008 revenues are expected to grow by just 0.5%, followed by 3.2% revenue growth in FY 2009.

($ Millions) Revenue Source	Actual FY 2007	FY06-07 Change	Est. FY 2008	FY07-08 Change	Est. FY 2009	FY08-09 Change
Property Taxes	$663.3	5.8%	$703.1	6.0%	$741.8	5.5%
Income Taxes	607.9	11.0%	604.2	-0.6%	619.5	2.5%
Sales & Service Taxes	52.4	3.1%	54.3	3.6%	56.0	3.1%
Recordation Taxes	43.5	-13.0%	38.1	-12.4%	38.1	0.0%
Title Transfer Taxes	74.7	-16.3%	62.3	-16.6%	62.3	0.0%
Investment Income	17.4	14.5%	12.3	-29.3%	10.4	-15.4%
Intergovernmental	80.6	2.8%	81.2	0.7%	79.2	-2.5%
All Other	55.9	21.0%	47.4	-15.2%	47.5	0.2%
Total Revenue	$1,595.7	6.1%	$1,602.9	0.5%	$1,654.8	3.2%

Prevailing economic conditions coupled with a cautious economic outlook for the State and Baltimore region suggest variable performance across the County's different revenue streams.

The Baltimore County Economic Advisory Committee (BCEAC) was less upbeat at its January 2008 meeting than it was at previous meetings about prospects for the year. On the positive side, the Committee noted that regional employment remains strong, the commercial real estate market is performing well, and although the residential real estate market continues to perform poorly, active inventories in the region are on the decline and loans remain available to those with decent credit. Also, in the longer-term, both the regional and county economies will benefit from the positive stimulus of the federal government's implementation of the Base Realignment and Closure (BRAC) Commission recommendations. Further, the Committee noted that although the U.S. economy is likely to remain slow during the first half of 2008, conditions are expected to improve in the second half of the year. However, the Committee's economic outlook ranged from uncertain to decidedly poor over the next few months, for a number of reasons as noted below:

The retail sector experienced a weak holiday season and expressed a cautious outlook for coming months.

- **Retail has been slow in recent months,** and the holiday season was weak across most sectors. Consumers have appeared both price–conscious and credit-conscious, and there is concern that the poor economic news will continue to have a negative impact on consumers in the coming months. As a result, local retailers expressed a need to keep inventories "in check."

The housing market is slowing and will likely continue to struggle for at least the next few months. Property-related transaction tax revenue is expected to decline in FY 2008, followed by flat revenues in FY 2009.

- **The local residential real estate market is slow compared to recent years,** and is likely to remain slow for at least the next few months. Declines in home sales are being seen in all price ranges, though less expensive homes that are priced correctly are more likely to sell. In the Baltimore region many homes have been pulled off the market in recent months due to a lack of sales. This is causing inventories to decline, which is a positive sign for the market. Still, due to the continuing decline in the number of residential real estate transactions in the region, County property-related transaction tax revenues are expected to decrease in FY 2008, followed by flat revenues in FY 2009. However, these revenues are still expected to exceed pre-housing-boom levels. Property tax revenues react more slowly to the declining real estate market because the effects of recent increases in property values will be gradually experienced over the next several years due to the annual 4% limit on tax increases for owner–occupied homes pursuant to the Homestead Property Tax Credit Program.

Potential economic threats include rising gasoline prices, inflation, and the uncertain direction of interest rates.

- **Some near-term economic threats loom**, including high gasoline prices, inflation outpacing income growth, and the uncertain direction of interest rates. Higher gasoline and energy prices are making consumers nervous as they watch their real income fall, and the consumer generally accounts for over two-thirds of total economic activity. In addition, rising inflation could put pressure on interest rates, which have been declining in recent months in an effort to make credit more accessible.

NATIONAL ECONOMIC INDICATORS

In 2007:Q4 the U.S. economy grew at an annualized rate of 0.6%.

After a 2.2% increase in 2007, GDP growth is expected to slow to 1.8% in 2008 before rising to 2.8% in 2009.

Real U.S. Gross Domestic Product (GDP) in 2007:Q4 increased at an annualized rate of 0.6% to an annualized level of $14.1 trillion. This quarter, along with 2007:Q1 which also showed 0.6% growth, represents the weakest quarterly performance since 2002:Q4 when GDP increased by 0.2%. This rate of growth follows a strong performance in 2007:Q3 when GDP grew by 4.9%. Factors contributing to 2007:Q4 GDP growth included strong federal, state and local government spending and continued export growth. The predominant factor weighing negatively on fourth quarter growth was weak residential fixed investment, which fell 25.2%, the worst performance since a 35.1% decline in 1981:Q4. For all of 2007 real GDP grew by 2.2%, compared to 2.9% and 3.1% in 2006 and 2005, respectively, and a ten-year average of 2.9%. The February 12, 2008 release of the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters* shows projected real GDP growth in 2008 at 1.8% (the slowest growth since 2002), and projected real GDP growth in 2009 at 2.8%. Most economists are expecting growth to slow through the first two quarters of this year. Slower national economic growth usually equates to a weaker job market and a softer stock market. In light of this national forecast and the slow housing market, BCEAC members expressed views ranging from uncertain to negative with regard to the local economic outlook for the remainder of 2008.

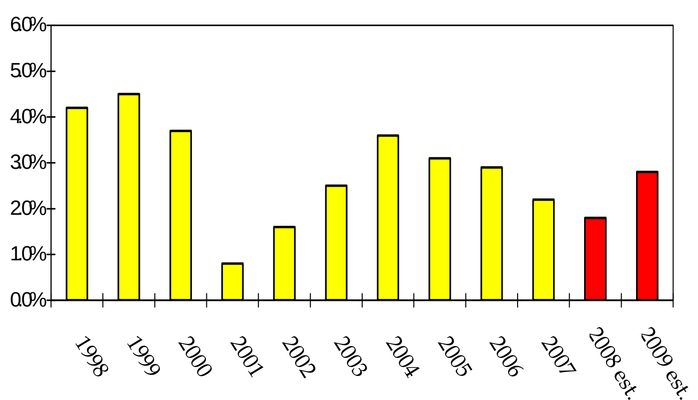
Consumer spending grew at an annualized rate of 1.9% in 2007:Q4.

Consumer spending, which accounts for slightly more than two-thirds of all U.S. economic activity, registered a below-average performance in 2007:Q4, increasing at an annualized rate of 1.9%. This increase follows growth of 2.8% in 2007:Q3. In 2007:Q4, consumer spending for durable goods registered an annualized increase of 2.3%, while spending on non-durable goods and services increased at annualized rates of 1.4% and 2.1%, respectively. The BCEAC retail representatives have expressed concern about sales through the first half of 2008, noting the impact of poor economic news on consumers' willingness to spend.

Consumer confidence, which declined five out of six months from August to January, fell sharply in February.

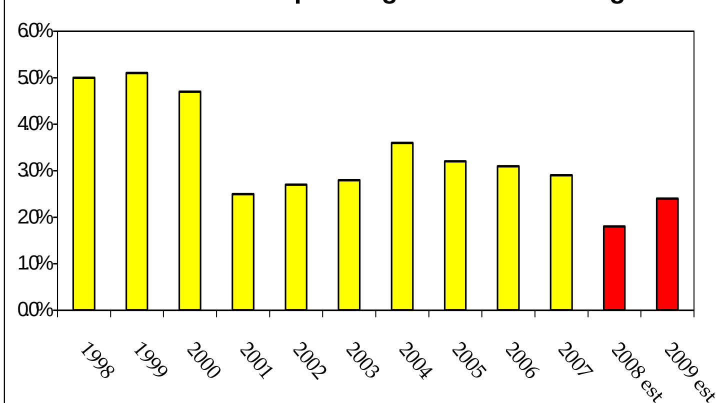
Consumer confidence, after declining in five of the previous six months, fell sharply in February 2008, based on a survey of 5,000 U.S. households by The Conference Board (a well-known economic research organization). The Conference Board noted that this decline was fueled by "less favorable business conditions and a sharp rise in the number of consumers saying jobs are hard to get." In addition, consumers' expectations have deteriorated and are now at a seventeen-year low, and the Conference Board reported that "the risk of a recession continues to increase."

Real GDP: Annual % Change



Estimate Source: *Survey of Professional Forecasters*, February 2008

Real Consumer Spending: Annual % Change



Estimate Source: *Survey of Professional Forecasters*, February 2008

The Federal Reserve's Federal Open Market Committee took steps to lower interest rates by 75 basis points at its March 18, 2008 meeting.

There are some indications that inflation risks remain despite slowing economic growth.

Interest rate targets were lowered by 75 basis points to 2.25% at the March 18, 2008 meeting of the Federal Reserve's Federal Open Market Committee (FOMC), following a total reduction of 225 basis points over the previous five months. The September meeting marked the first time the target was cut since June 2003 when the FOMC cut the rate to 1.0% in an effort to counter a recession induced by collapsing stock prices and technology investment. The recent rate cuts come at a time when turbulent housing and credit markets appear to be slowing the U.S. economy and softening the labor market. The decision was intended to help mitigate some of the risks to economic activity that have arisen from the disruptions in financial markets and to promote moderate growth over time. Despite its steps to cut interest rates, the FOMC warns that it will continue to be necessary to monitor inflation developments carefully. The FOMC also cites further weakening in the economic outlook and continued "downside risks to growth" in its recent decision, and most private economists believe that this statement supports the possibility of additional interest rate cuts in the near future.

INTEREST RATE CHANGE FROM JULY 2007 TO FEBRUARY 2008

	Basis Points*
90-Day Treasury Bills	-279
10-Year Treasury Bonds	-126
30-Year Conventional Mortgage	-78

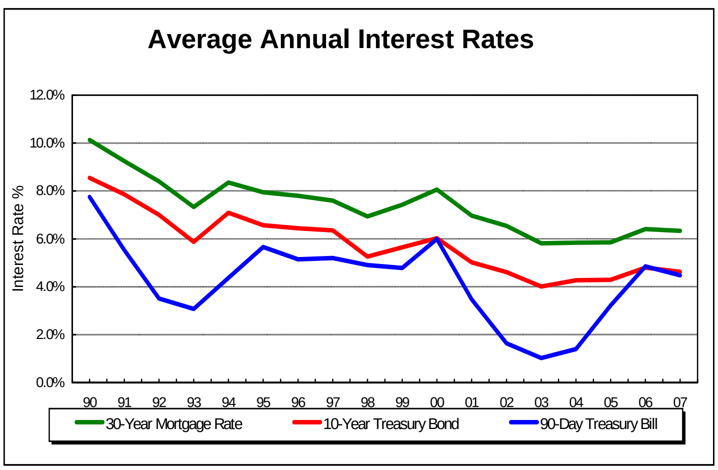
* A basis point is equal to .01 percentage point.

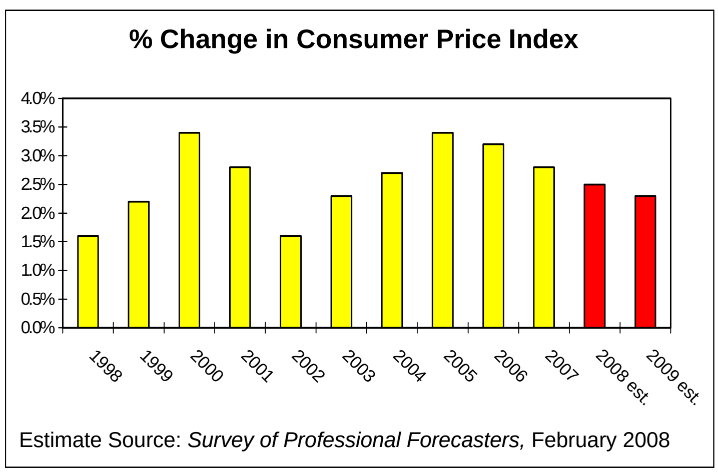
There is a possibility of additional interest rate cuts in the near future due to downside risks to economic activity.

The short-term direction of interest rates will depend on both inflation and the condition of financial markets, a point confirmed by the FOMC's March 18, 2008 press release. The FOMC stated that it will continue to assess the downside risks to economic activity caused by weakening financial markets and credit conditions and will act in a timely manner as needed to promote sustainable economic growth and price stability.

From February 2007 to February 2008, consumer inflation was 4.0%. However, inflation is forecast at 2.5% and 2.3% for CY 2008 and CY 2009, respectively.

Inflation, as measured by the Consumer Price Index-All Urban Consumers, was 4.0% over the February 2007 to February 2008 period, down from the January year-over-year comparison of 4.3%. Core inflation (which excludes food and energy inflation) was 2.3% over the February 2007 to February 2008 period. For CY 2007 and CY 2006, the CPI increased by 2.8% and 3.2%, respectively. The current year-over-year inflation forecast for CY 2008 and CY 2009 is 2.5% and 2.3%, respectively, according to the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*, February 2008. The same survey projected that inflation will average 2.5% annually over the 2008 to 2017 period, compared to the average CPI increase of 2.6% over the 1998 to 2007 period.





Estimate Source: *Survey of Professional Forecasters*, February 2008

THE LOCAL ECONOMY IN PERSPECTIVE

EMPLOYMENT

Although the County's labor market is healthy, there is some evidence that County employment growth has been impacted by the recent economic downturn.

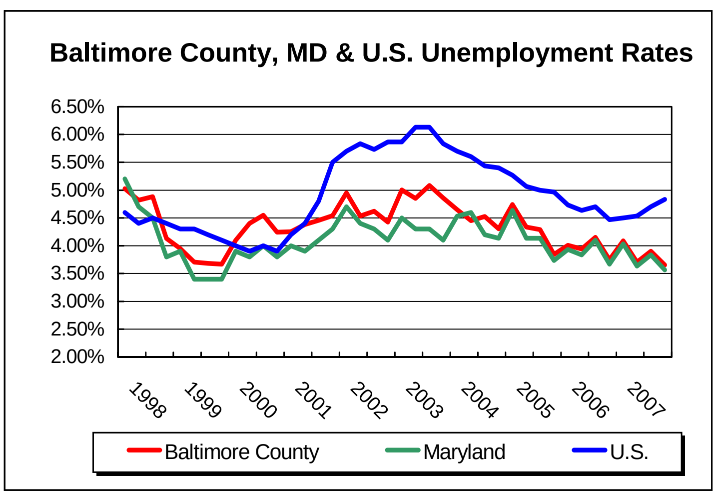
Employment, as measured by place of residence, is high for both Baltimore County and Maryland, but the growth in employment has recently moderated according to revised employment data. Over the December 2006 to December 2007 period, Baltimore County residential employment decreased by 3,808 persons, or 0.9%, while Maryland residential employment decreased by 29,207 persons, or 1.0%. Monthly year-over-year employment changes in Baltimore County in 2007 ranged from –1.1% to 1.7%, compared to a range of 2.1% to 3.6% in 2006; thus there is some evidence that local employment growth has been impacted by the recent economic downturn. Still, the high employment level for Baltimore County residents would suggest solid long-term growth in personal income and income tax collections for the County.

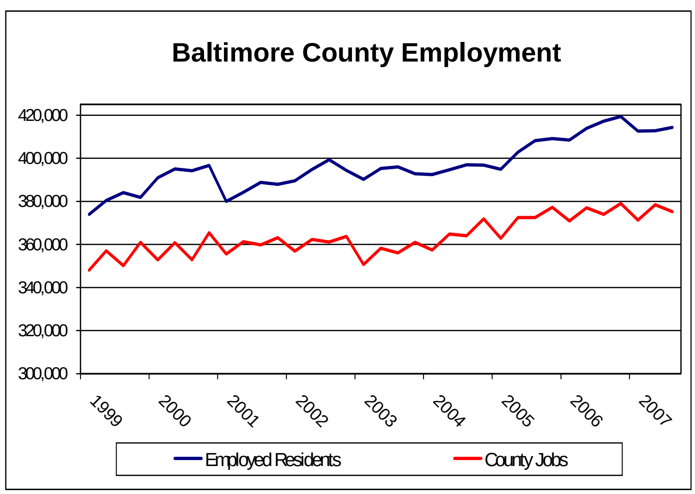
The number of County jobs increased by 0.3% over the 2006:Q3 to 2007:Q3 period, while County employer payrolls were up by 3.5%. In CY 2007 and CY 2008 County jobs are forecast to increase by 1.0% and 1.6%, respectively.

County jobs data show that from 2006:Q3 to 2007:Q3, the number of jobs in Baltimore County increased by 0.3% and payrolls rose by 3.5%, while at the state level, jobs rose by 0.7% and payrolls increased by 4.7%. Over this same period, Baltimore County employers added 1,224 positions to their payrolls. Specifically, there were 2,838 job gains in professional and business services, 2,263 in education and health services, and 1,088 in leisure and hospitality, offset by job losses of 1,788 in manufacturing, 1,785 in the local government, 1,131 in the state government, and 1,060 in the federal government. Nationally, non-farm payrolls increased by 1,404,000 jobs, or 1.0%, from 2006:Q3 to 2007:Q3. National payroll numbers have been declining in CY 2008. The January 2008 employment forecast from RESI (the economic research and consulting division of Towson University) predicts that in CY 2008, both County and State jobs will increase by 1.6%, after increasing by 1.0% and 1.3%, respectively, in CY 2007.

The County's December unemployment rate was 3.5%, slightly above the state unemployment rate but below the national rate.

The unemployment rate among County residents was 3.5% in December 2007, down from 3.7% a year earlier and slightly above the current state unemployment rate of 3.4%. By any standard these rates are extraordinarily low. Within the Baltimore-Towson Metropolitan Statistical Area (MSA) the unemployment rate in December 2007 was 3.6%. The MSA unemployment rate is strongly influenced by Baltimore City's unemployment rate, which stood at 5.5% in December. Excluding Baltimore City, the MSA December 2007 unemployment rate would have been 3.1%. Nationally, the seasonally adjusted unemployment rate was 4.8% in February 2008, up from 4.5% in February 2007. BCEAC members remain optimistic about the county's employment situation and low unemployment rate. They note that jobs are available; however, employers are finding it increasingly difficult to secure qualified candidates to fill their vacancies.





PERSONAL INCOME

RESI estimates that County PI growth was 5.8% in FY 2007 and will be 4.8% and 4.6% in FY 2008 and FY 2009, respectively.

Recent long-term personal income (PI) forecasts indicate that County and State PI will likely move closely in tandem over the FY 2007 to FY 2010 period as they did over the 1995 to 2005 period. Short-term, RESI's January 2008 personal income forecast shows PI in Baltimore County increasing by 5.8% and 4.8% in FY 2007 and FY 2008, respectively, compared to Maryland, where PI increased by 5.5% in FY 2007 and is expected to increase by 5.0% in FY 2008. Longer-term, PI in Baltimore County is expected to grow by 4.6% in FY 2009, compared with 4.8% in the State. RESI's January PI growth estimate for FY 2008 showed a significant downward revision from its October estimate (32 basis points in both Baltimore County and Maryland), while the FY 2009 growth forecast showed a slight upward revision of 9 basis points for Baltimore County and 10 basis points for Maryland. Despite such revisions, these estimates represent strong growth. As PI grows, so does the county's base from which personal income tax revenue is derived, providing a positive outlook for income tax receipts for FY 2008 and beyond.

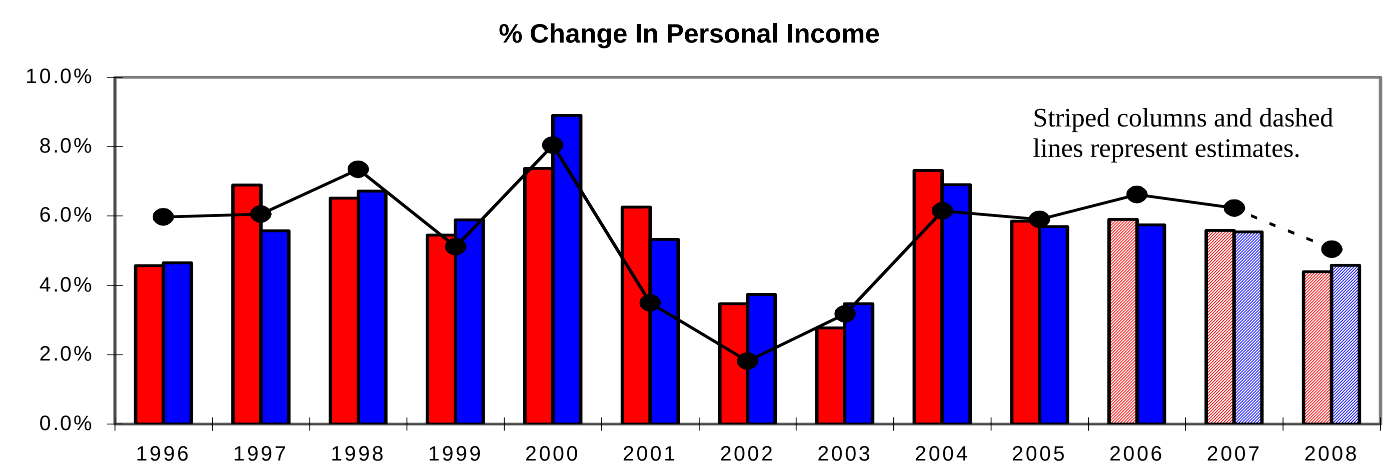
PI growth in Maryland continues strong but is currently being outperformed by the U.S.

PI growth estimates at all levels have recently been subject to downward revision due to uncertainties in the economy.

Over the 2000 to 2005 period, PI in Maryland and Baltimore County increased at a considerably faster pace than it did nationally — 27.8% in Maryland, 28.4% for Baltimore County, and 22.2% nationally. The most recent quarterly reading for Maryland PI shows PI in the State increasing by 5.6% over the 2006:Q3 to 2007:Q3 period, while PI in the U.S. increased by 6.4% over the same period. (County data are reported only annually.) Given the uncertainties and potential threats to the national, state, and local economies, PI growth forecasts at all levels have recently been subject to downward revisions, and further reductions could follow when new forecasts are produced. Nationally, in 2007:Q4, wages and salaries composed 54.4% of PI. PI's other important components consist of government transfer payments (14.8%), interest income (9.9%), and dividend income (7.0%). Capital gains and losses are not included in the personal income calculation.

The County's Spending Affordability Committee adopted a spending growth rate of 4.56% for FY 2009, which is 60 basis points less than the 5.16% adopted for FY 2008.

For FY 2009, the County Spending Affordability Committee adopted a spending affordability growth index of 1.0456 (4.56%) based on RESI's January 2008 PI forecast for FY 2009. This growth index is 60 basis points lower than the Committee's FY 2008 spending affordability growth index of 1.0516 (5.16%), which was based on RESI's FY 2008 PI forecast as of January 2007. RESI's January 2008 PI growth forecast for FY 2008 showed a downward revision of 34 basis points (4.82%) from last year's FY 2008 forecast.



Estimate source: RESI, January 2008 (MD State and Baltimore Co.)
Economy.com, October 2007 (U.S.)

EXISTING HOME SALES

In February 2008, the number of existing Baltimore County homes sold decreased by 33.6% from a year earlier.

The average price of existing homes sold in Baltimore County rose 8.5% from February 2007 to February 2008.

Existing home sales in Baltimore County in FY 2007 totaled 9,333 units, 15.7% below FY 2006, and the second consecutive yearly decline after eight consecutive yearly increases that started in FY 1998. The number of homes sold in the County in February 2008 totaled 409 units, down 33.6% from a year earlier. The average price of an existing home sold in the County in February 2008 was $316,108, up 8.5% from February 2007, following a year-over-year price decrease of 5.9% in January 2008. The average price increase in February may be artificially high due to the fact that expensive homes constituted a larger percentage of the County's sales last month than they did a year earlier. Meanwhile, the active inventory in February rose by 30.4% from February 2007. However, according to the BCEAC residential representative the County's housing inventory leveled off in the winter months because homeowners took their homes off the market due to a lack of sales.

February 2008 pending existing home sales were down 15.9% compared to a year earlier.

Pending existing home sales in February 2008 totaled 615, down 116 units, or 15.9%, from February 2007, following a 35.6% decrease from January 2007 to January 2008. These decreases are occurring despite a considerably high active inventory. Pending home sales for CY 2007 were below year-earlier levels for all twelve months, with December 2006 marking the most recent year-over-year monthly increase.

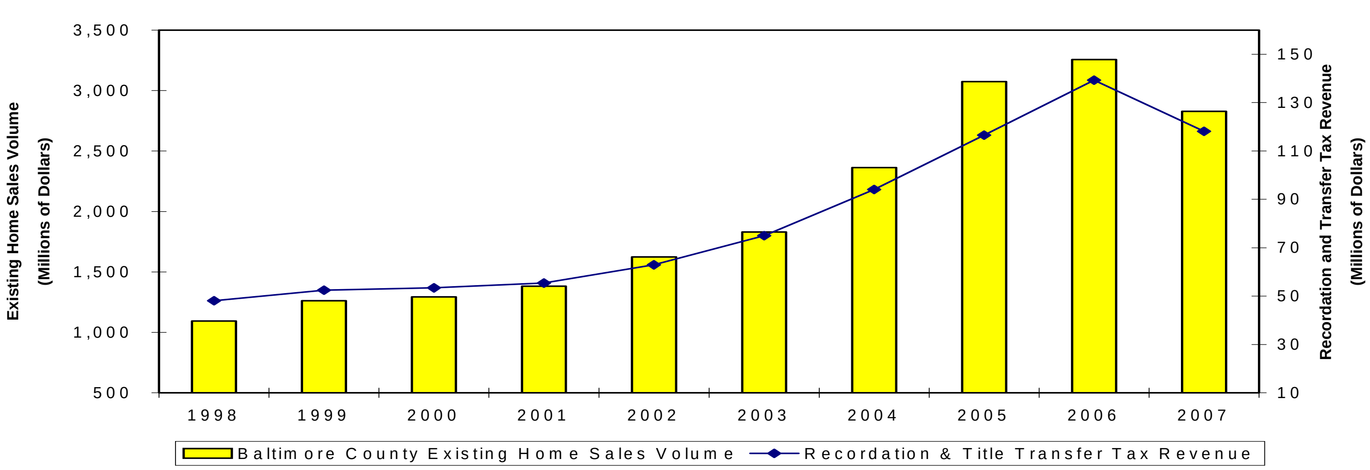
Reflecting higher home prices and lower mortgage interest rates, the monthly mortgage payment for the average-priced County home sold was 4.3% higher in February 2008 versus February 2007.

Mortgage interest rates in February 2008 were 5.92%, down 37 basis points from February 2007 when rates were 6.29%. Over this same period, the average price of an existing home sold in Baltimore County increased by 8.5%, compared to a decrease of 3.9% for Maryland. The combination of higher home prices and lower mortgage interest rates caused the monthly payment for the average-priced Baltimore County home (financed with a 30-year conventional mortgage loan) to increase to $1,879 in February 2008, 4.3% above the February 2007 level.

Property-related transaction tax revenues fell 15.2% in FY 2007. The current projection shows a 15% decline in these revenues in FY 2008, followed by flat revenues in FY 2009.

Property-related transaction tax revenues (recordation and title transfer tax revenues) totaled $118.1 million in FY 2007, a decrease of 15.2% from the record-setting $139.3 million in FY 2006, reflecting a lower level of housing transactions at only slightly higher prices. For FY 2008, property-related transaction tax revenues are projected to decline by approximately 15% based on expectations that the housing market will remain slow for the next several months. These revenues are expected to remain flat in FY 2009.

Baltimore County Existing Home Sales Volume and Recordation and Title Transfer Tax Revenue: Fiscal Years 1998—2007



CONSTRUCTION

The total value of construction permits issued in 2007:Q3 decreased from a year earlier.

Construction permits issued in Baltimore County in 2007:Q3 totaled $239.7 million, which is $110.2 million, or 31.5%, below 2006:Q3 and 8.2% below the last four-year third quarter average value of construction permits. The 2007:Q3 permit level, which reflects declines in most construction sectors, follows an all-time third quarter high in 2006:Q3 when County construction permits totaled $349.9 million. While residential construction has been down significantly in the past five quarters compared to recent years, non-residential construction is holding steady and exceeded the last four-year third quarter average in 2007:Q3. BCEAC representatives agreed that commercial construction remains steady. Four new non-residential permits were issued for $5 million or more in the third quarter of 2007: a $12.0 million shell office building in Sparks, a $6.9 million school building for Villa Julie College in Reisterstown-Owings Mills, a $6.0 million office/retail facility in Randallstown, and a $5.0 million shell office building in Arbutus-Lansdowne. Construction employment represented 7.1% of County jobs in 2007:Q1 and had an average wage rate 14.2% above the County average. Thus, construction activity supports quality jobs and adds to the region's personal income growth.

The current level of newly-issued building permits remains high enough to support construction employment and contribute to the region's personal income base.

New non-residential building permit activity increased in 2007:Q3.

New non-residential building activity in 2007:Q3, perhaps the most volatile component of new construction, saw the value of permits increase to $53.8 million, up $7.0 million, or 15.0%, over 2006:Q3. There were ten projects totaling $1 million or more in 2007:Q3, including the four large projects mentioned above.

Additions, alterations, and repairs activity in 2007:Q3 fell 38.8% to $131.2 million.

Additions, alterations, and repairs (AAR) activity in 2007:Q3 totaled $131.2 million, down $83.2 million, or 38.8%, from 2006:Q3 but just 6.8% below the last four-year third quarter average. Residential AAR permits fell 14.1% from 2006:Q3 to 2007:Q3, while non-residential AAR permits dropped 43.9% over the same period. The number of AAR permits fell just 8.6%, indicating that the value of individual permits issued is low compared to recent years.

In 2007:Q3, the number and value of new multi-family and single-family residential building permits fell significantly compared to a year earlier.

New residential building permit data show that the total number of permits issued in 2007:Q3 decreased by 35.9%, with multi-family unit permits down 84.2% and single-family unit permits down 31.2% from a year earlier. The total dollar value of the new residential building permits issued in 2007:Q3 decreased by $34.0 million, or 38.2%, to $54.8 million.