BALTIMORE COUNTY FISCAL DIGEST

GENERAL FUND REVENUES & THE ECONOMY

Baltimore County, Maryland

December 23, 2008

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January 7, 2009

Honorable Members of the Baltimore County Council

Gentlemen:

I am pleased to submit the Baltimore County Fiscal Digest of General Fund Revenues and the Economy as of December 23, 2008. This report provides final FY 2008 and projected FY 2009 General Fund revenues and summarizes economic conditions affecting the County.

Final FY 2008 General Fund revenues totaled $1.64 billion, which was $39.9 million higher than the budget estimates and reflected growth of 2.8% over FY 2007. The unreserved, undesignated General Fund balance (surplus) as of June 30, 2008 totaled $118.5 million, excluding $82.9 million in the Revenue Stabilization Reserve Account (RSRA), $47.5 million designated as a source of funding for the FY 2009 budget, and $9.0 million of net bond premium designated for debt service. The $118.5 million of surplus funds combined with the $82.9 million of RSRA funds total $201.4 million, or 12.3% of General Fund revenues—well above the 5% minimum deemed prudent by bond rating agencies.

Economic conditions have drastically changed since our August 2008 Fiscal Digest Report, and these changes have altered our previous FY 2009 General Fund revenue projections. The revised projection of FY 2009 General Fund revenues totals $1.657 billion, which reflects a modest increase of $16.9 million or 1.0% over final FY 2008 revenues. The revised revenue projection is below budget estimates for the year by $15.2 million or 0.9%. Income tax revenues are projected to be $6.2 million or 1.0% below budget estimates for the year while recordation and transfer tax revenues are projected to be $3.4 million or 4.2% below budget estimates. While the negative variance in budget to projected revenue of $15.2 million may be noteworthy, it is also important to note that budgeted revenues exceed the total of budgeted ongoing operating costs, excluding PAYGO capital projects, by $91 million. The FY 2009 General Fund budget includes $138.5 million for PAYGO capital projects funded by $91 million of revenues along with $47.5 million of General Fund surplus. The amount of revenues budgeted for PAYGO capital projects allows a number of options for addressing the projected revenue variance without affecting spending for ongoing operating costs.

The Baltimore County Economic Advisory Committee generally agreed at its October 2008 meeting that local economic conditions are not likely to improve in CY 2009. We will continue to monitor General Fund revenues to determine the impact of rapidly changing economic conditions and any additional State aid cuts that may occur as a result of the State's worsening deficit projections. Our next revenue and economic update will be provided to the Spending Affordability Committee for its February 2009 report and will include a preliminary revenue forecast for FY 2010.

Respectfully submitted,

Mary P. Allen

Mary P. Allen
County Auditor

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

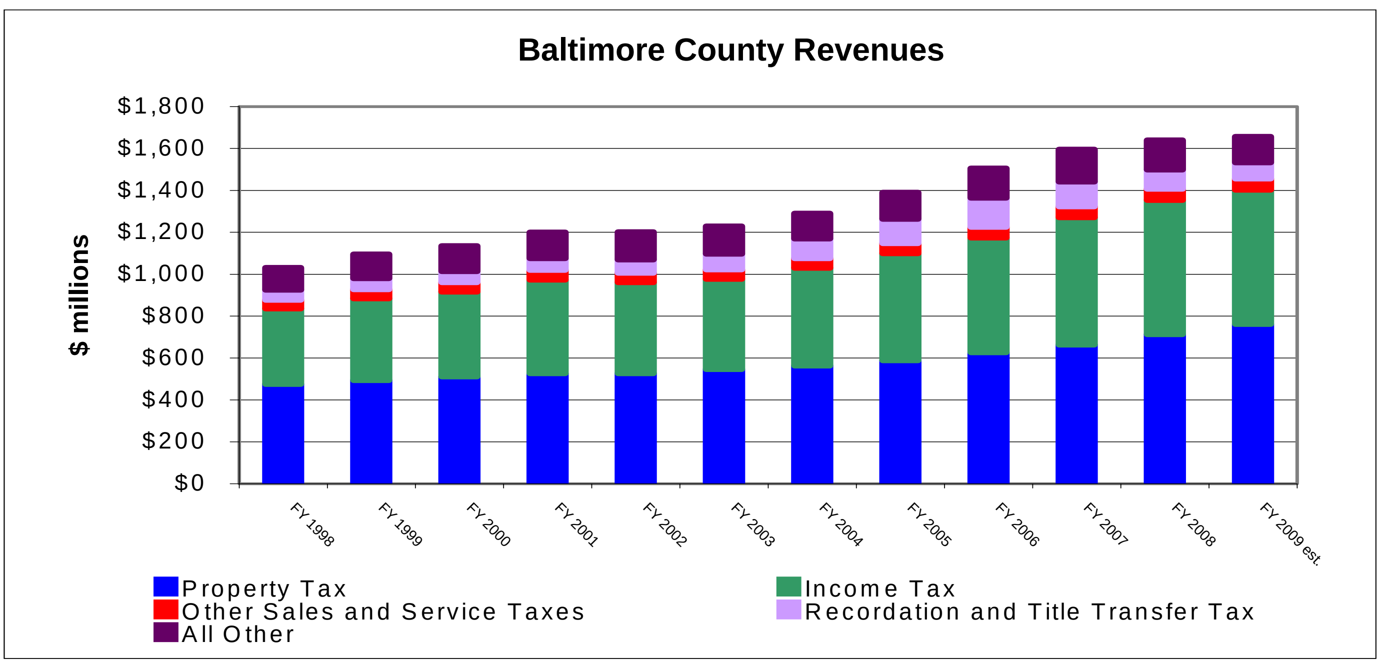
REVENUE HIGHLIGHTS

FY 2008 County General Fund revenues totaled $1.640 billion, an increase of $44.3 million, or 2.8%, over FY 2007 revenues. The County's two principal revenue sources, property taxes and income taxes, grew by 7.5% and 5.4%, respectively. Property-related transaction tax revenues declined by 22.3% due to continued slowing in the housing market.

Unreserved, undesignated General Fund balance (surplus) as of June 30, 2008 totaled $118.5 million, excluding $82.9 million in the Revenue Stabilization Reserve Account (RSRA), $47.5 million designated to fund one-time spending (e.g., PAYGO capital spending) in the FY 2009 budget, and $9.0 million of net bond premium designated for debt service.

FY 2009 County General Fund revenues over the first five months (July through November) totaled $1.030 billion, approximately 2.8% above collections over the same period last year. Property tax revenues demonstrated strong growth of 6.3% through November. Income tax revenues, which have been reported through September withholdings and declarations, have shown weak year-to-date growth of 0.7%. Property-related transaction tax revenues declined by approximately 23.6% through November, due to the continued slowdown in the number of real estate transactions.

FY 2009 General Fund revenues for the entire year are expected to increase by a modest $16.9 million, or 1.0%, to $1.657 billion due to strong growth in property tax revenue greatly offset by declines in property-related transaction tax and various other revenues. Specifically, the County's property tax revenues are expected to increase by $48.1 million, or 6.7%. The strong growth in property tax revenues reflects significant increases in property values in recent years combined with the smoothing effect of the Homestead Credit (4% increase cap). Income tax collections are expected to be flat due to both changes in the definition of taxable income at the State level as well as weak economic and job market conditions. Property-related transaction tax revenues (recordation and title transfer taxes) are expected to decline by $14.5 million, or 16%, due to the turmoil in the mortgage/credit market, which has negatively affected the County's housing market. The weak economy is also expected to result in decreases totaling more than $15 million in various other revenue sources, including investment income and revenue from licenses and permits. Policy changes (e.g., rental housing licensing and parking fines) at the County level have minimally affected the FY 2009 forecast. State aid reductions to date have been relatively minor. The possibility of additional reductions in State aid will be monitored over the coming weeks and months as the State confronts its growing deficit.



REVENUE FORECAST & ECONOMIC OUTLOOK

General Fund revenue growth has slowed significantly. The slow growth in FY 2009 is buoyed only by the reliable growth in property tax collections, which results from the smoothing effect of the local Homestead Tax Credit Program's 4% annual growth cap.

($ Millions) Revenue Source	Actual FY 2007	FY06-07 Change	Actual FY 2008	FY07-08 Change	Est. FY 2009	FY08-09 Change
Property Taxes	$663.3	5.8%	$713.1	7.5%	$761.2	6.7%
Income Taxes	607.9	11.0%	641.0	5.4%	641.0	0.0%
Sales & Service Taxes	52.4	3.1%	53.1	1.3%	53.7	1.1%
Recordation Taxes	43.5	-13.0%	33.4	-23.2%	26.0	-22.2%
Title Transfer Taxes	74.7	-16.3%	58.4	-21.8%	51.3	-12.2%
Investment Income	17.4	14.5%	12.5	-28.2%	7.8	-37.6%
Intergovernmental	80.6	2.8%	78.4	-2.7%	76.6	-2.3%
All Other	55.9	21.0%	50.2	-10.2%	39.3	-21.7%
Total Revenue	$1,595.7	6.1%	$1,640.1	2.8%	$1,656.9	1.0%

The Baltimore County Economic Advisory Committee (BCEAC) expressed pessimism at its October 2008 meeting. On the positive side, the Committee noted that some sectors are still adding jobs around the State, money and credit remain available to credit-worthy borrowers, oil prices have moderated, and first-time homebuyers remain active in pursuing homes that are priced correctly. 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. However, the Committee noted that despite any federal government interventions, the U.S. economy is likely to continue to decline for the next 6 to 9 months, and that weak conditions could continue through the first half of FY 2010. The Committee's economic outlook is pessimistic for a number of reasons, as noted below:

Prevailing economic conditions are expected to yield below-average performance in County revenues.

- **Consumer pessimism and its ill effects are growing,** as the consumer generally accounts for over two-thirds of total economic activity. This pessimism prevails as people observe job losses in a variety of sectors, continued instability in financial markets, and declining home values and investment portfolios.

- **The employment situation is declining**, with many companies reducing their staffing and lowering their projected earnings due to widespread consumer retrenchment, particularly in the auto industry and the markets for other durable goods**.** Over the last few months several large stores have gone out of business, and any that fail to attract market share during the holiday season are likely to follow. The Committee agreed that poor economic news may continue to have a negative impact on both consumer and business spending through FY 2009.

- **The local residential real estate market remains slow,** and is likely to continue to decline for at least the next few months. Declines in home sales are present in all price ranges. In the Baltimore region active inventories are beginning to level off, primarily due to seller fatigue. This leveling-off of available inventory is expected to slow the decline in home prices. 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 again in FY 2009. Property tax revenues react more slowly to the declining real estate market because the effects of recent increases in property values are gradually experienced over several years due to the annual 4% growth limit for owner–occupied homes pursuant to the local Homestead Property Tax Credit Program.

- **The recovery in the financial sector is expected to be slow**, prolonging the credit crisis as well as the economic downturn.

NATIONAL ECONOMIC INDICATORS

In 2008:Q3 the U.S. economy contracted at an annualized rate of 0.5%.

Real U.S. Gross Domestic Product (GDP) in 2008:Q3 decreased at an annualized rate of 0.5% to a nominal level of $14.4 trillion. This quarter's performance represents a significant decrease from the 2008:Q2 quarterly performance of 2.8%. The major factors contributing to the 2008:Q3 GDP contraction are a significant drop in personal consumption expenditures, the eleventh straight residential fixed investment contraction (-16.0%), and the first decrease in nonresidential fixed investment (-1.7%) since 2006:Q4. For all of 2007, real GDP grew by 2.0%, compared to 2.8% in 2006, and a ten-year average of 2.9%. The November 17, 2008 release of the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters* shows real GDP declining at a projected annualized rate of 2.9% in 2008:Q4, with growth projected at 1.4% for all of 2008 (the slowest annual growth since the brief recession in 2001) followed by a contraction of 0.2% in 2009. In spite of current government spending and policy activity to bolster the economy, many economists are lowering growth rate forecasts for the close of 2008, and a majority project a negative year-over-year growth rate for 2009 due to an expected average unemployment of 7.4% in that year. In light of this national outlook and the unchanging credit market, BCEAC members expressed pessimism with regard to the local economic outlook for the remainder of 2008 and into 2009.

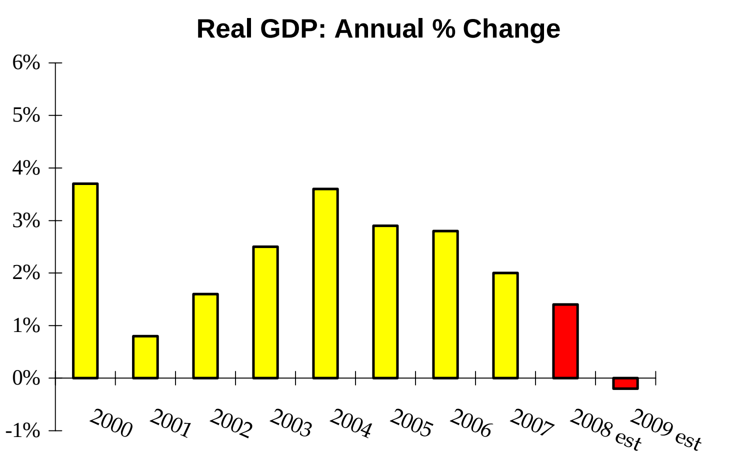
After a 2.0% increase in 2007, real GDP growth is expected to slow to 1.4% in 2008 before falling to a 0.2% decline in 2009.

Real consumer spending turned negative for the first time since 1991:Q4, declining at an annualized rate of 3.8% in 2008:Q3.

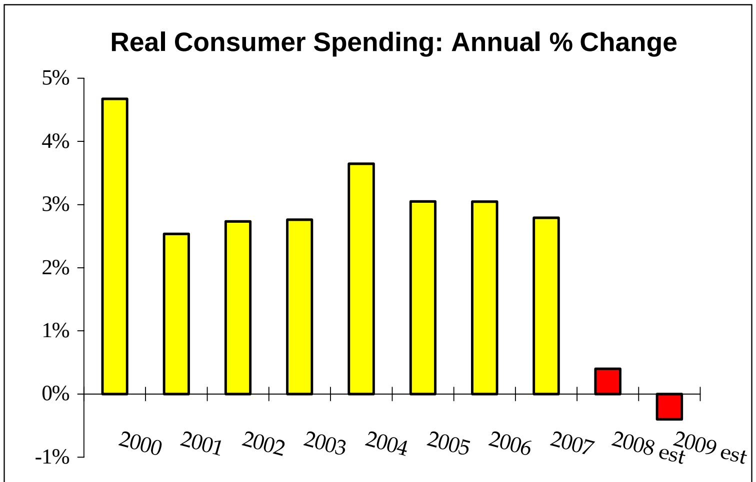
Consumer spending, which accounts for approximately two-thirds of all US economic activity, decreased at an annualized rate of 3.8% during 2008:Q3 after a growth rate of 1.2% in 2008:Q2. This decline represents the first negative quarter in consumer spending since 1991:Q4. In 2008:Q3, real consumer spending on durable goods, non-durable goods, and services fell by 14.8%, 7.1%, and 0.1%, respectively. The BCEAC retail representatives anticipated the impact of negative economic news on consumers' willingness to spend during the holiday season.

Consumer confidence, after reaching an all-time low in October, increased moderately in November.

Consumer confidence, after declining to an all-time low in October 2008, showed a moderate increase in November 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 increase was primarily due to an improvement in consumers' short-term outlook for business and labor market conditions as gas prices continue to fall and inflation worries lessen. Nonetheless, the Conference Board reports that consumers remain pessimistic and "the possibility that economic growth will improve in the first half of 2009 remains highly unlikely."



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



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

The Federal Reserve's Federal Open Market Committee (FOMC) lowered interest rate targets approximately 0.75 percentage points during its December 15 and 16, 2008 meeting.

Interest rate targets were cut approximately 75 basis points from the 1% rate established at the October 28 and 29 meeting to a range between 0% and 0.25% at the December 15 and 16, 2008 meeting of the Federal Reserve's Federal Open Market Committee (FOMC). The Federal Funds Rate had been cut approximately 175 basis points since the emergency meeting on October 8, 2008 held in coordination with several foreign central banks to stem the spreading worldwide credit crisis. This new rate target is the lowest since the Committee's inception in 1954 and comes at a time of weak economic activity driven by a significant decrease in personal consumption expenditures and a worsening labor market. The decision to further lower the rate reflects falling exports, weakening foreign economies, and the inability of households and businesses to obtain credit, despite authorization of the Troubled Asset Relief Program (TARP) under the Emergency Economic Stabilization Act, which was signed on October 3, 2008. The Committee further announced plans to support financial and housing markets by purchasing large quantities of debt and mortgage-backed securities, and perhaps long-term Treasury securities. The FOMC expects inflation to continue to moderate in the coming months due to "declines in the prices of energy and other commodities and weaker prospects for the economy."

Because of decreasing energy and commodity prices, inflation has moderated.

INTEREST RATE CHANGE FROM JULY 2007 TO NOVEMBER 2008

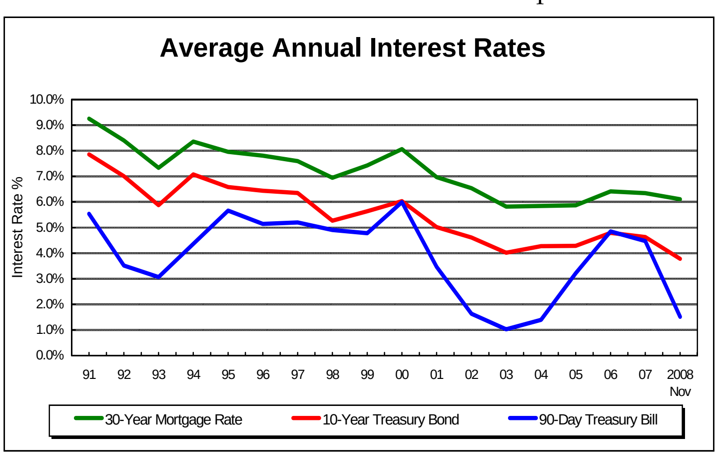
	Basis Points*
90-Day Treasury Bills	-477
10-Year Treasury Bonds	-147
30-Year Conventional Mortgage	-61

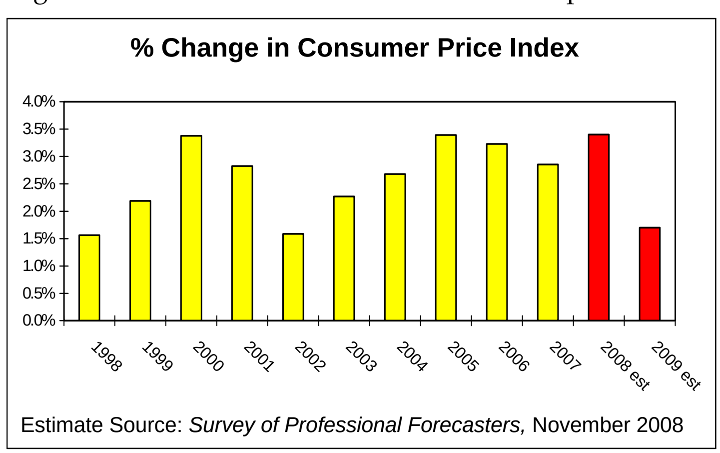
* A basis point is equal to .01 percentage point.

Short-term interest rates are likely to stay near 0%, depending on the condition of financial markets. The FOMC took the extraordinary step to forecast that continuing weak economic conditions will likely "warrant exceptionally low levels of the federal funds rate for some time."

From November 2007 to November 2008, consumer inflation decreased to 1.1%. Inflation is forecast at 3.4% and 1.7% for CY 2008 and CY 2009, respectively.

Inflation, as measured by the Consumer Price Index-All Urban Consumers, was 1.1% over the November 2007 to November 2008 period, down from the October year-over-year comparison of 3.7%. The November rate signals an overall inflation rate decline of 4.5 percentage points since July 2008 when inflation reached 5.6%, the highest year-over-year comparison in 10 years. Core inflation (which excludes food and energy inflation) decreased slightly to 2% over the November 2007 to November 2008 period. For CY 2007 and CY 2006, the CPI increased by 2.9% and 3.2%, respectively. The current year-over-year inflation forecast for CY 2008 is 3.4%, followed by a downward revision to 1.7% for CY 2009, according to the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*, November 2008. The November survey also projects 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.





LOCAL ECONOMIC PERSPECTIVE

EMPLOYMENT

The employment level in the County is declining, demonstrating that County employment has been impacted by the recent economic downturn.

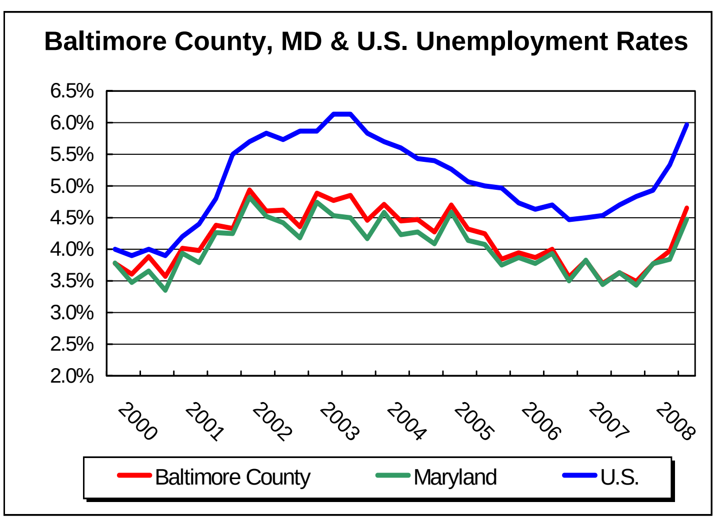
Employment, as measured by place of residence is falling for both Baltimore County and Maryland. Over the October 2007 to October 2008 period, Baltimore County residential employment decreased by 4,292 persons, or 1.0%, while Maryland residential employment decreased by 24,939 persons, or 0.9%. September 2008 marked the first month in which year-over-year employment has declined in Baltimore County since December 2007, and employment hasn't fallen by more than 0.3% since October 2003. Thus there is strong evidence that local employment has been affected by the recent economic downturn. A decline in employment in Baltimore County could threaten County personal income growth and income tax collections.

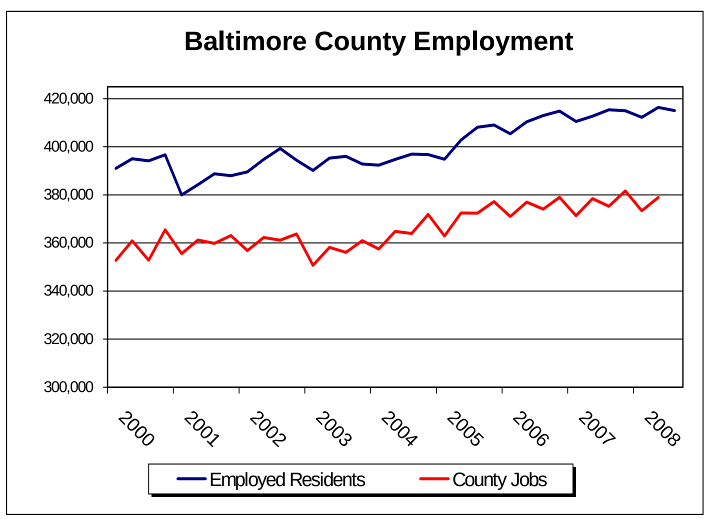
The number of County jobs increased by 0.1% over the 2007:Q2 to 2008:Q2 period, while County employer payrolls were up by 2.4%. In CY 2008 County and State jobs are forecast to increase by 0.5%, followed by no change at the County level and an increase of 0.1% at the State level in CY 2009.

County jobs data show that from 2007:Q2 to 2008:Q2, the number of jobs in Baltimore County increased by 0.1% and payrolls rose by 2.4%, while at the State level, jobs rose by 0.1% and payrolls increased by 3.0%. Over this same period, Baltimore County employers added 456 positions to their payrolls. Nationally, non-farm payrolls increased by 200,000 jobs, or 0.1%, from 2007:Q2 to 2008:Q2. National payroll numbers declined by an average of 174,000 jobs per month during the first eleven months of CY 2008, with job losses nearly quadrupling over the last 5 months compared to the first half of the year. The October 2008 employment forecast from RESI (the economic research and consulting division of Towson University) predicts that in CY 2008, County and State jobs will both increase by 0.5%, followed in CY 2009 by no change in jobs at the County level and an increase of 0.1% at the State level. These estimates are considerably lower than those presented in the July 2008 forecast.

The County's October unemployment rate was 5.1%, slightly above the state unemployment rate but well below the national rate.

The unemployment rate among County residents was 5.1% in October 2008, up from 3.5% a year earlier and slightly more than the current State rate of 4.9%. Within the Baltimore-Towson Metropolitan Statistical Area (MSA), the unemployment rate in October 2008 was also 5.1%. The MSA unemployment rate is strongly influenced by Baltimore City's unemployment rate, which stood at 7.7% in October. Excluding Baltimore City, the October 2008 MSA unemployment rate was 4.5%. Nationally, the seasonally adjusted unemployment rate was 6.7% in November 2008, up from 4.7% in November 2007. BCEAC members noted that both local and national unemployment could continue to rise in the coming months as more companies are forced into hiring freezes and layoffs as a result of the economic downturn.





PERSONAL INCOME

RESI currently estimates that County personal income growth was 5.1% in FY 2008 and will be 4.8% and 4.3% in FY 2009 and FY 2010, respectively. However, it is likely that FY 2009 and FY 2010 estimates will be revised downward in the coming weeks.

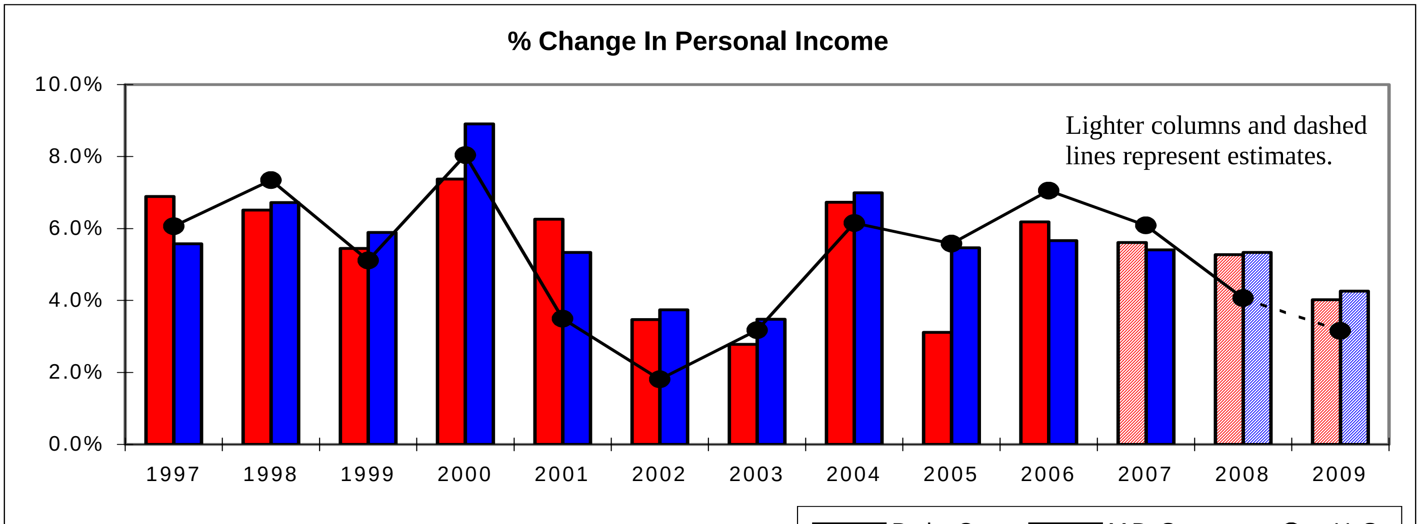
RESI's October 2008 forecast shows personal income (PI) in Baltimore County increasing by 5.1% and 4.8% in FY 2008 and FY 2009, respectively, compared to Maryland, with PI increases of 5.2% and 5.0% in FY 2008 and FY 2009, respectively. RESI's October PI growth estimate for FY 2007 showed a downward revision of 30 basis points from its July estimate for Baltimore County, while the FY 2008 growth estimate showed no change and the FY 2009 forecast was an upward revision of 21 basis points. The FY 2008 and FY 2009 PI growth for Maryland showed upward revisions of 29 and 22 basis points, respectively. Longer-term, PI in Baltimore County is expected to grow by 4.3% in FY 2010, compared with 4.6% in the State. These estimates continue to represent strong growth; however, due to increased job losses resulting from the prolonged economic downturn, it is likely that PI growth estimates for FY 2009 and FY 2010 will be revised downward in the coming weeks. Thus, a cautious outlook for County income tax receipts seems prudent.

PI growth in Maryland continues strong, outperforming both Baltimore County and the U.S.

Over the 2001 to 2006 period, PI in Maryland increased at a faster pace than it did nationally, while PI growth in Baltimore County fell a bit short of national growth, with total increases of 28.0% in Maryland, 26.0% nationally, and 24.3% in Baltimore County. The most recent quarterly reading for Maryland shows PI increasing by 3.8% over the 2007:Q3 to 2008:Q3 period, while PI in the U.S. increased by 3.7% over the same period. (County data are reported only annually.) Given the contractions in national, state, and local economies, PI growth forecasts at all levels likely will be subject to downward revisions when new forecasts are produced. Nationally, in 2008:Q3, wages and salaries composed 54.0% of PI. Government transfer payments (15.4% of PI) has increased in the past 2 quarters, likely due to an increase in unemployment benefits' claims. 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 22 basis points higher than the current 4.34% forecast for FY 2010.

For FY 2009, the County Spending Affordability Committee adopted a spending affordability growth rate of 4.56% based on RESI's January 2008 forecast. RESI's October 2008 PI growth forecast of 4.81% for FY 2009 showed an upward revision of 25 basis points from the January forecast. The October 2008 PI growth forecast for FY 2010 was 4.34%, 47 basis points below the FY 2009 growth forecast and 66 basis points below the FY 2010 forecast of 5.00% reported in July 2008.



Estimate source: RESI, October 2008

EXISTING HOME SALES

In November 2008, the number of existing Baltimore County homes sold decreased by 39.0% from a year earlier.

Existing home sales in Baltimore County in FY 2008 totaled 6,877 units, 26.3% below FY 2007 and the lowest home sales total since FY 1995 when existing home sales totaled 5,921. The number of homes sold in the County in November 2008 totaled 341 units, down 39.0% from a year earlier, marking the steepest decline in home sales the County has seen during the present housing downturn. The average price of an existing home sold in the County in November 2008 was $278,591, down 12.3% from November 2007, following a year-over-year price decrease of 4.2% in October 2008. Meanwhile, the active inventory in November rose by 6.0% from November 2007. The BCEAC representative indicated that homes in Baltimore County priced under $350,000 are selling more quickly than higher-priced homes, with only 14% of contracts containing contingencies. This indicates that the first-time buyer market is active, while the move-up market remains slow.

The average price of existing homes sold in Baltimore County fell 12.3% from November 2007 to November 2008.

Pending existing home sales in November 2008 totaled 395, down 100 units, or 20.2%, from November 2007, following a 32.9% decrease in October 2008 and a 0.7% increase in September 2008. September 2008 marked the first year-over-year monthly increase in pending home sales since December 2006. Despite high active inventory, pending home sales have been below year-earlier levels since the beginning of CY 2007, excluding September 2008.

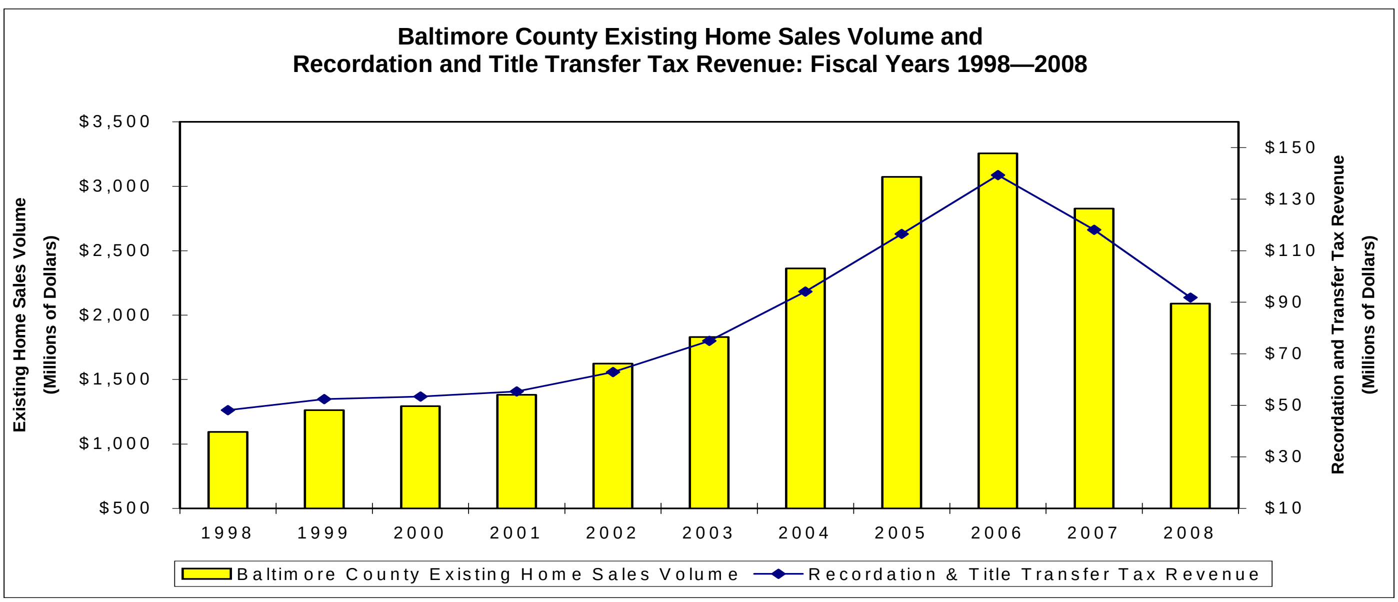
November 2008 pending existing home sales were down 20.2% compared to a year earlier.

Mortgage interest rates (for 30-year conventional mortgages) in November 2008 were 6.09%, down 12 basis points from November 2007 when rates were 6.21%. Over this same period, the average price of an existing home sold in Baltimore County decreased by 12.3%, compared to a decrease of 10.7% for Maryland. The combination of significantly lower 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 decrease to $1,686 in November 2008, 13% below the November 2007 level.

Reflecting significantly lower home prices and lower mortgage interest rates, the monthly mortgage payment for the average-priced County home sold was 13% lower in November 2008 versus November 2007.

Property-related transaction tax revenues (recordation and title transfer tax revenues) totaled $91.8 million in FY 2008, a decrease of 34% from the record-setting $139.2 million in FY 2006, reflecting a lower level of housing transactions at lower prices. For FY 2009, property-related transaction tax revenues are projected to fall by approximately 16% from FY 2008 levels due to a continued decline in the number of local real estate transactions.

Property-related transaction tax revenues fell sharply (34%) over the past two years (from FY 2006 to FY 2008) and are expected to decline an additional 16% from FY 2008 to FY 2009.



CONSTRUCTION

The total value of construction permits issued in 2008:Q3 decreased 11.4% from a year earlier.

Construction permits issued in Baltimore County in 2008:Q3 totaled $212.3 million, which is $27.4 million, or 11.4%, below 2007:Q3 and 17.3% below the average value of 3rd quarter construction permits over the last 4 years. The 2008:Q3 permit valuation, which reflects a mixed performance among construction sectors, follows year-over-year increases of 28% in 2008:Q2 and 17.7% in 2008:Q1. The 2008:Q3 year-over-year decrease in permit values also follows a 10.6% quarter-over-quarter increase in 2008:Q2 from 2008:Q1. After falling 18.9% in 2008:Q2 from the previous year, residential construction increased 66.5% in 2008:Q3. However, commercial construction showed a sharp decrease of 60.4% in a similar year-over-year comparison. Four new non-residential construction permits valued at $1 million or more were issued in the third quarter of 2008: a $1.1 million future bank building in Bowleys Quarters, a $1.5 million shell building in Lochearn, a $5.8 million new automobile dealership building in Cockeysville-Timonium, and a $6.5 million shell office building in Reisterstown-Owings Mills. Construction employment represented 7.1% of County jobs in 2008:Q3 and had an average wage rate 16.5% above the County average. Thus, construction activity supports quality jobs and adds to the region's personal income growth.

The current level of building permits remains stable, supporting construction employment and contributing to the region's personal income base.

New non-residential building permit activity decreased by 60.4% in 2008:Q3.

New non-residential building activity in 2008:Q3, perhaps the most volatile component of new construction, saw the value of permits decrease to $21.3 million, down $32.5 million, or 60.4%, from 2007:Q3. (There were ten projects totaling $500,000 or more in 2008:Q3, including the four large projects mentioned above.)

Additions, alterations, and repairs activity in 2008:Q3 fell 24% from a year earlier to $99.7 million.

Additions, alterations, and repairs (AAR) activity in 2008:Q3 totaled $99.7 million, down $31.4 million, or 24%, from 2007:Q3 and 27.1% below the average of 3rd quarter activity over the last 4 years. The total value of residential AAR permits fell 8.5% from 2007:Q3 to 2008:Q3, and the value of non-residential AAR permits fell 28.8% over the same period.

In 2008:Q3, the number of new multi-family residential building permits rose significantly while single-family permits fell compared to a year earlier.

New residential building permit data show that the total number of permits issued in 2008:Q3 increased by 121.1%, due to an increase in multi-family unit permits. The total dollar value of the new residential building permits issued in 2008:Q3 increased by $36.5 million, or 66.5%, to $91.3 million.