BALTIMORE COUNTY
FISCAL DIGEST

GENERAL FUND REVENUES
&
THE ECONOMY

Baltimore County, Maryland

March 26, 2012

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April 4, 2012

Honorable Members of the Baltimore County Council

Ladies and Gentlemen:

I hereby submit the Baltimore County Fiscal Digest of General Fund Revenues and the Economy as of March 26, 2012. This report summarizes current economic conditions affecting the County and includes an updated FY 2012 General Fund revenue estimate and the same preliminary FY 2013 General Fund revenue projection provided in the FY 2013 Spending Affordability Committee report.

Over the last month, projections for FY 2012 income tax collections have changed slightly due to a lower-than-anticipated fourth quarter distribution, received in late February. This change yields a $9.9 million decrease in the FY 2012 income tax forecast included in the Spending Affordability Committee's report, resulting in a revised income tax forecast of $560.8 million. All other revenues have come in as anticipated, bringing the total FY 2012 General Fund revenue forecast to $1,598.0 million, an increase of $50.1 million, or 3.2%, over FY 2011 collections.

FY 2013 General Fund revenues are projected to total $1,557.6 million, a decrease of $40.4 million, or 2.5%, from the current FY 2012 revenue estimate. The projected decline, which represents the first decline since FY 2010 and the third decline in the last two decades, primarily reflects an anticipated decline in income tax revenues resulting from the State's distribution method. In addition, growth in property tax revenues is expected to continue to slow due to falling assessment values, and the State aid reductions enacted in recent years are expected to continue in FY 2013 due to the State's budgetary challenges.

The State's options for making additional reductions to the County's General Fund are limited; however, the State's FY 2013 budget will include a shift of teacher pension costs to local jurisdictions. This shift will likely include the "normal cost" (the current-year, earned-benefits cost for active teachers – the responsibility for library and community college pensions will remain with the State, as will the unfunded liability cost) and will be phased in over a number of years. The House and Senate budget plans differ as to the logistics of the phase-in, as well as the details of an income tax increase and other minor budget items. The two versions of the State budget are now being discussed in a conference committee, and a final decision on the budget bill and all other pending legislation must be made by April 9th. In addition, both the Senate and the House have already passed a Maintenance of Effort bill that, in the event that a county fails to meet minimum education funding levels, authorizes the Comptroller to withhold that county's income taxes and redirect the money to the local school board in order to make up the difference. These State actions cannot be portrayed in our revenue forecast but will nonetheless have a significant impact on the County's General Fund.

We will continue to monitor economic activity and revenue collections, particularly income tax distributions and State legislation that may impact current and future budgets. Our next update will include revised revenue projections for FY 2012 and FY 2013 and will coincide with our office's budget overview presentation to the Council, scheduled for May 1, 2012.

Respectfully submitted,

Lauren M. Smelkinson

Lauren M. Smelkinson, CPA
County Auditor

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

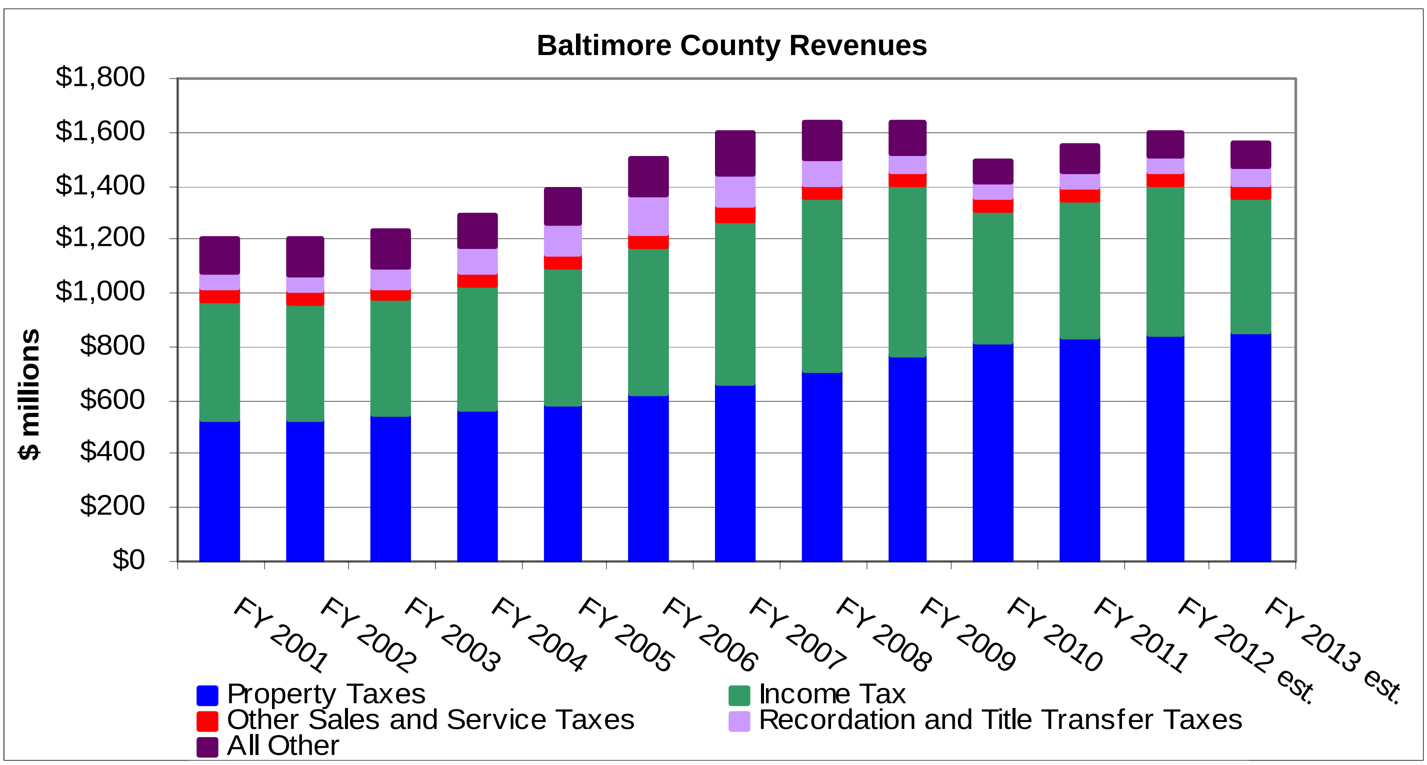
REVENUE HIGHLIGHTS

Unassigned General Fund Balance (Surplus) as of June 30, 2011 totaled $80.6 million, or 5.0% of the FY 2012 General Fund budget. This amount does not include $60.6 million that was assigned as a source of funding for the FY 2012 budget. In addition to the Surplus balance, the Revenue Stabilization Reserve Account (Rainy Day account) balance totaled $84.6 million as of June 30, 2011. The Surplus balance and Rainy Day amounts together totaled $165.2 million, or 10.3% of the FY 2012 General Fund budget.

FY 2012 County General Fund revenues through early March totaled $1,283.6 million, approximately $66.4 million, or 5.5%, above collections over the same 8-month period the prior year. This increase is primarily due to year-to-date gains in income and property tax revenues of $57.9 million and $17.2 million, respectively. The higher-than-anticipated increase in income tax revenues is due to strong final payments and a decline in refunds at the State level for tax year 2010. In addition, recent increases in the number of homes sold in the County have caused property-related transaction tax revenues (i.e., title transfer and recordation tax revenues) to increase by $7.4 million, or 21.7%, through early March.

FY 2012 General Fund revenues for the entire year are expected to total $1,598.0 million, an increase of $50.1 million, or 3.2% over FY 2011 collections. This projection represents an increase of $54.8 million, or 3.5%, over FY 2012 budget estimates. The projected revenue increase is primarily due to higher-than-anticipated income tax revenues, as previously mentioned. FY 2012 income tax collections are expected to grow 9.0% over FY 2011 collections. In addition, property-related transaction tax revenues are coming in above expectations, with a projected annual increase of 18.0%. Growth in property tax revenues has slowed significantly because the annual 4% growth limit pursuant to the local Homestead Property Tax Credit Program has caught up with declining assessed values. This subdued growth creates a challenge for the County because in recent years property tax revenues have comprised more than 50% of the County's general fund budget. In addition, the State aid reductions implemented in recent years are continuing in FY 2012 and are estimated to total $44.3 million.

FY 2013 General Fund revenues are projected to reach $1,557.6 million, a decrease of $40.4 million, or 2.5%, from the current FY 2012 revenue estimate but up $14.4 million, or 0.9%, over budgeted FY 2012 revenues. The projected 2.5% revenue decline in FY 2013, which represents the first decline since FY 2010 and the third decline in the last two decades, primarily reflects an anticipated decline in income tax revenues resulting from the State's distribution method. In addition, growth in property tax revenues is expected to continue to slow due to falling assessment values. Property-related transaction tax revenues are expected to show modest gains based on the expectation that the housing market has finally hit bottom and sales volume will continue to recover in FY 2013 while prices remain flat. The State aid reductions enacted in recent years are expected to continue in FY 2013 due to the State's budgetary challenges.



REVENUE FORECAST & ECONOMIC OUTLOOK

FY 2012 General Fund revenue growth represents a continued rebound from the pronounced decline in FY 2010, primarily due to a significant increase in income tax collections resulting in part from the State's distribution method. FY 2013 revenues are expected to decline due to a corresponding decrease in income tax revenues combined with nearly flat property tax collections.

($ Millions) Revenue Source	Actual FY 2011	FY10-11 Change	Est. FY 2012	FY11-12 Change	Est. FY 2013	FY12-13 Change
Property Taxes	$ 837.1	2.8%	$ 847.7	1.3%	$ 852.8	0.6%
Income Tax	514.7	3.8%	560.8	9.0%	508.7	-9.3%
Sales & Service Taxes	43.1	-0.7%	43.8	1.6%	43.8	0.0%
Recordation Tax	18.3	-8.5%	20.9	14.2%	22.4	7.2%
Title Transfer Tax	35.7	-12.9%	42.8	19.9%	45.8	7.0%
Intergovernmental	34.2	10.7%	31.5	-7.9%	32.5	3.2%
All Other	64.8	46.2%	50.5	-22.1%	51.6	2.2%
Total Revenue	$ 1,547.9	3.9%	$ 1,598.0	3.2%	$ 1,557.6	-2.5%

The Baltimore County Economic Advisory Committee (BCEAC) expressed mixed sentiments with respect to the economic recovery at its January 2012 meeting, noting that some sectors are performing well while others appear to have stalled. The Committee observed that some companies are hiring, manufacturers who export continue to perform well, and the local residential real estate market appears to be gaining traction. On the other hand, the commercial real estate market continues to see no new development, job uncertainty remains prevalent in many industries, and local small businesses continue to hold back on expansion plans due to uncertainties regarding the economic climate. To compound these challenges, if federal government downsizing materializes, the Baltimore region would be disproportionately affected due to its heavy reliance on federally-funded jobs. Members' near-term outlook for the local economy remains cautious due in part to the following factors:

- While consumer confidence is slightly improved, **consumers continue to have a pessimistic view of current economic conditions**. Consumer confidence is critical to a sustained recovery because the consumer generally accounts for over two-thirds of total economic activity. While some local stores successfully attracted customers and gained market share during the holiday season, other retailers continued to struggle. Many consumers remain cautious due to continued uncertainty in the job market.

- **The number of unemployed workers remains high,** and local unemployment rates are expected to be high by historical standards for the foreseeable future. On the other hand, the County has experienced some year-over-year job gains in the last few months, and the demand for employees is increasing in some sectors. The professional and business services and education and healthcare sectors continue to be sources of job gains, while even previously strong sectors such as local government, information technology, and financial services are experiencing downsizing.

- **Local residential real estate prices remain low,** and in light of the high volume of distressed sales, it is predicted that prices will be flat for the foreseeable future. Year-over-year home sales have experienced an increase in recent months, resulting in a significant decline in inventory levels. Pending home sales are also seeing double-digit increases. Due to the prolonged decline in the value of residential real estate transactions in the region, County property-related transaction tax revenues fell for the fifth consecutive year in FY 2011; however, this trend is expected to reverse in FY 2012 and FY 2013 as a result of increased transaction volume. Property tax revenues have reacted more slowly to the declining real estate market because of the annual 4% growth limit for owner–occupied homes pursuant to the local Homestead Property Tax Credit Program. However, the annual 4% growth limit has caught up with falling assessed values, and growth in property tax revenues is expected to slow significantly in FY 2012 and FY 2013.

NATIONAL ECONOMIC INDICATORS

In 2011:Q4, the U.S. economy grew at an annualized rate of 3.0%.

After growing by 1.7% in 2011, real GDP growth is expected to accelerate slowly in 2012 and 2013.

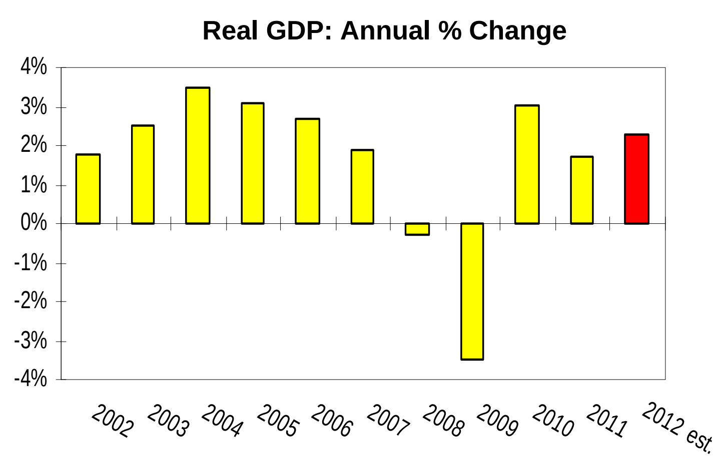
Real U.S. Gross Domestic Product (GDP) in 2011:Q4 increased at an annualized rate of 3.0%. This quarter's performance represents an acceleration from the 2011:Q3 annualized increase of 1.8%. The major factor contributing to the acceleration in 2011:Q4 was a resurgence in residential fixed investment and consumer spending on durable goods, which grew by 11.5% and 15.3%, respectively. This acceleration, however, is tempered by a decline in government spending, primarily driven by contractions in both federal defense spending and state/local spending. Also, non-residential structures investment fell by 2.6% following growth of 14.4% in 2011:Q3. For all of 2011, real GDP grew by 1.7%, a deceleration from the 3.0% growth experienced in 2010 but slightly higher than the 10-year average growth of 1.6%. The February 2012 release of the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters* projected real GDP growth of 2.3% for all of 2012, a slight downward revision from the November 2011 forecast, followed by an unchanged projection of 2.7% growth in 2013. Economists project GDP growth for the next five quarters to be stable. Despite this stability, and the fact that the recession, as defined by the National Bureau of Economic Research, concluded in June 2009, a persistently weak labor market (8.3% unemployment projected for 2012) has collared U.S. economic growth.

Real consumer spending grew at an annualized rate of 2.1% in 2011:Q4.

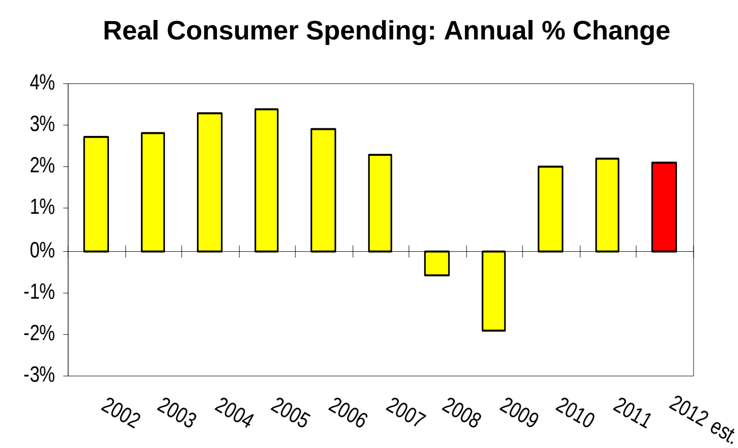
Real consumer spending, which accounts for roughly two-thirds of all U.S. economic activity, increased at an annualized rate of 2.1% during 2011:Q4 following an increase of 1.7% in 2011:Q3. After collapsing in 2011:Q2, consumer spending on durable goods grew 5.7% in 2011:Q3 and then accelerated to 15.3% growth in 2011:Q4. Over the same time period, growth in consumer spending on non-durable goods was essentially stagnant, while growth in services decelerated from 1.9% to 0.7%. Despite mixed messages regarding consumer spending nationally, members of the BCEAC were encouraged by a positive report from the local retail representative.

Consumer confidence increased in February following a decline in January.

Consumer confidence, based on a survey of 5,000 U.S. households by The Conference Board (a well-known economic research organization)**,** rose in February following a decline in January. The Conference Board noted that consumer confidence has almost reached levels last seen in February 2011. The Board also reports that "despite further increases in gas prices, [consumers] are more optimistic about the short-term outlook for the economy" than they have been in recent months. Consumers also appear less pessimistic regarding current business and labor market conditions, which is a positive sign for consumer spending.



Estimate Source: *Survey of Professional Forecasters*, February 2012



Estimate Source: *Survey of Professional Forecasters*, February 2012

The Federal Reserve's Federal Open Market Committee (FOMC) held interest rate targets between 0% and 0.25% at its March 13, 2012 meeting.

Long-term inflation expectations remain stable, and the FOMC anticipates moderate economic growth in the coming quarters.

Interest rate targets were maintained between 0% and 0.25% at the March 13, 2012 meeting of the Federal Reserve's Federal Open Market Committee (FOMC). The current interest rate target range, which has been in place since the FOMC's December 2008 meeting, is the lowest since the FOMC's 1954 inception, and will likely remain in place through late 2014. The FOMC believes information received since its previous meeting in January suggests that the economy has been "expanding moderately," with improved labor market conditions and continued advancement in household spending and business investment. However, the unemployment rate remains high and depressed growth persists in the housing sector. Additionally, while strains in global financial markets have eased recently, they continue to pose significant downside risks to the national economy. Despite these negative factors, the FOMC expects moderate economic growth to continue in the coming quarters and anticipates that the unemployment rate will decline gradually over time. Long-term inflation expectations remain stable, with only a brief uptick due to the recent increase in oil and gas prices.

INTEREST RATE CHANGE FROM FEBRUARY 2011 TO FEBRUARY 2012

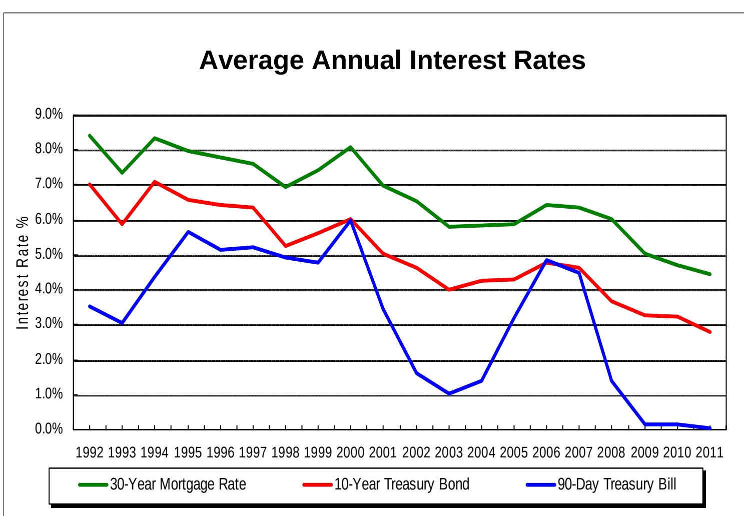
	Basis Points*
90-Day Treasury Bills	-4
10-Year Treasury Bonds	-161
30-Year Conventional Mortgage	-106

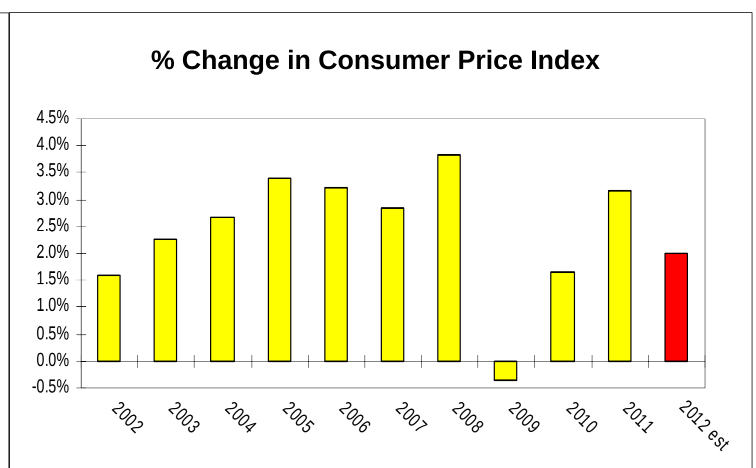
* A basis point is equal to .01 percentage point.

Short-term interest rates are likely to stay near 0%. Weak economic conditions such as high unemployment and low rates of resource utilization, combined with a subdued inflation outlook, will likely "warrant exceptionally low levels for the federal funds rate" for an extended period.

From February 2011 to February 2012, consumer inflation was 2.9%. Inflation is forecast at 2.0% and 2.2% for CY 2012 and CY 2013, respectively.

Inflation, as measured by the Consumer Price Index-All Urban Consumers (CPI-U), was 2.9% over the February 2011 to February 2012 period. Year-over-year consumer price growth has slowed from a recent high of 3.9% in September 2011. Recent price growth has been largely driven by increases in food and transportation costs. Core inflation (which excludes food and energy inflation) was 2.2% over the February 2011 to February 2012 period. For CY 2011 the CPI-U increased by 3.2%, following an increase of 1.6% in CY 2010. The current year-over-year inflation forecast for CY 2012 is 2.0%, followed by 2.2% for CY 2013, according to the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters*, February 2012. The *Survey* projects that annual inflation will average 2.3% over the 2012 to 2021 period.





Estimate Source: *Survey of Professional Forecasters*, February 2012

LOCAL ECONOMIC PERSPECTIVE

EMPLOYMENT

County employment is beginning to recover, but has not yet reached pre-recession levels.

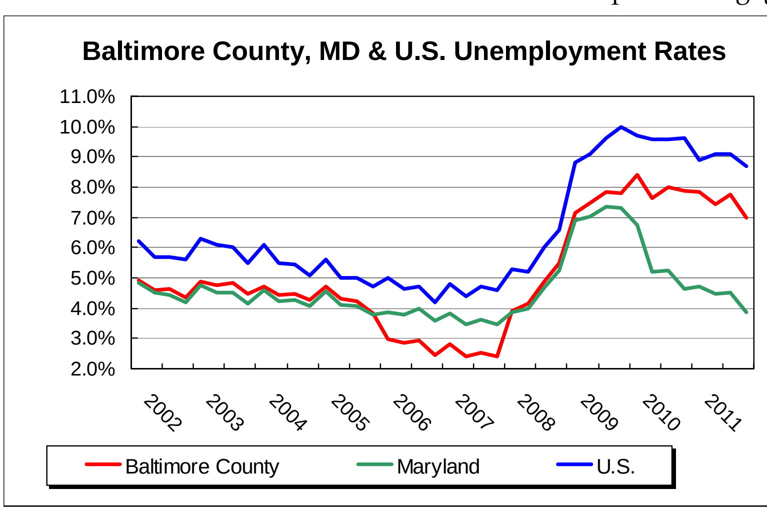
Employment, as measured by place of residence, has been slowly increasing on a year-over-year basis in both Baltimore County and Maryland. Over the January 2011 to January 2012 period, Baltimore County residential employment increased by 21,294 persons, or 5.5%, while Maryland residential employment increased by 22,066 persons, or 0.8% (the Baltimore County increase is subject to revision when the 2011 data are benchmarked to the 2011 Current Population Survey). January 2012 marked the fifth consecutive month of employment gains in Baltimore County, the longest streak of increases since 2007, yet employment remains well below pre-recession levels. Continued job growth is needed to bolster State and local income tax collections in FY 2013 and future years.

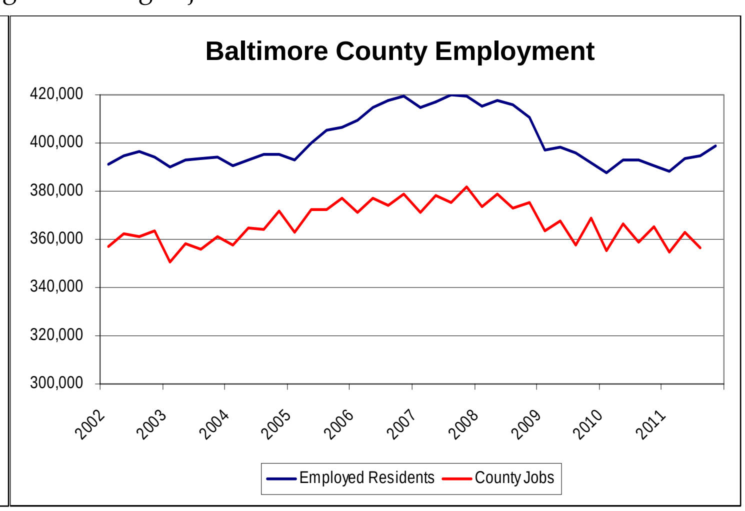
The number of County jobs decreased by 0.6% over the 2010:Q3 to 2011:Q3 period, while County employer payrolls grew 5.1%.

County jobs data show that from 2010:Q3 to 2011:Q3, the number of jobs in Maryland increased by 0.9%, while jobs in the County fell by 0.6% as Baltimore County employers cut over 2,200 positions. Payrolls grew 5.1% in Baltimore County and 8.9% at the State level. Nationally, non-farm payrolls increased by approximately 1.8 million jobs, or 1.4%, from 2010:Q4 to 2011:Q4. The pace of job growth is beginning to increase, with the nation adding an average of 153,000 jobs per month in CY 2011 and preliminary estimates showing 284,000 and 227,000 job gains nationally in January 2012 and February 2012, respectively. However, even at this rate of monthly job gains it will take years to replace the jobs lost during the recession. Sage Policy Group, Inc. (the Spending Affordability Committee's economic consultant) predicts job growth of 0.5% and 0.8% in the County and Maryland, respectively, in CY 2012. These forecasts do not keep pace with anticipated CY 2012 population growth of 0.9% in the County and 1.0% in Maryland.

The County's January 2012 unemployment rate was 7.4%, which is higher than the State unemployment rate but below the national rate.

The unemployment rate among County residents was 7.4% in January 2012, down from 8.1% a year earlier and higher than the current State rate of 7.0%. As of November 2011, the County had the 15th lowest unemployment rate out of the 24 local jurisdictions in Maryland. Within the entire Baltimore-Towson Metropolitan Statistical Area (MSA), the unemployment rate in January 2012 was 7.3%. The MSA unemployment rate is strongly influenced by Baltimore City's unemployment rate, which stood at 10.3%. Excluding Baltimore City, the January 2012 MSA unemployment rate was 6.6%. Nationally, the seasonally adjusted unemployment rate was 8.3% in January 2012, the lowest national unemployment rate since February 2009. BCEAC members noted that the demand for employees is increasing in some sectors, and that local workforce development centers are continuing in their attempts to reengage discouraged job-seekers.





PERSONAL INCOME

The Spending Affordability Committee's economic consultant currently projects that County personal income growth was 4.60% in FY 2011 and will be 4.00% in FY 2012.

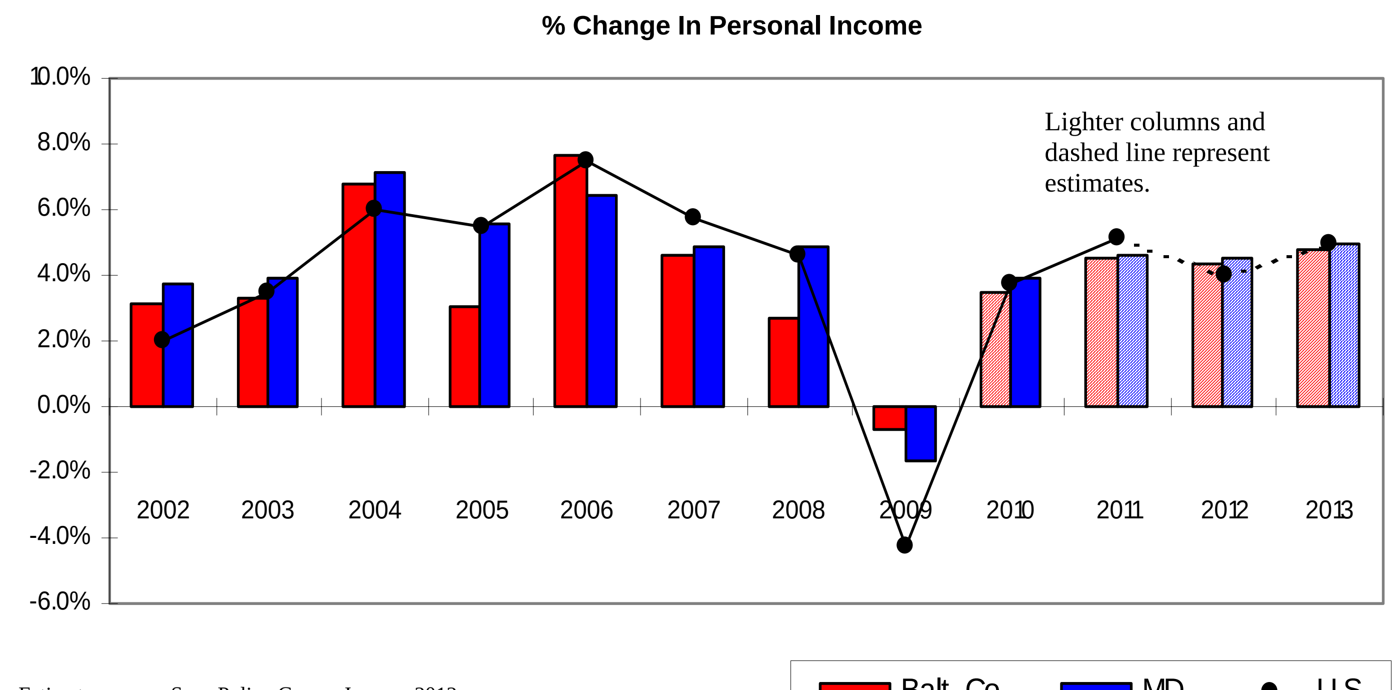
Sage Policy Group, Inc. (Sage), the Spending Affordability Committee's economic consultant, predicts in its January 2012 report that Baltimore County's personal income (PI) will increase by 4.00% in FY 2012, following an estimated increase of 4.60% in FY 2011. These rates represent a substantial improvement from the FY 2010 estimated growth rate of 1.10%. Maryland's PI is forecast to increase by 4.10% in FY 2012, lower than its estimated growth of 4.92% in FY 2011 and 10 basis points above the forecast for the County. Longer term, PI in Baltimore County is expected to grow by 4.80% in FY 2013, which, while demonstrating continued improvement, is still far from the 6.19% growth achieved in FY 2007. In comparison, PI in the State is expected to grow by 4.99% in FY 2013.

The long-term growth of personal income is uncertain given high unemployment and limited consumer spending.

Over the 1999 to 2009 period, PI in both Maryland and Baltimore County increased at a faster pace than national PI, with total increases of 61.4% in Maryland, 55.3% in Baltimore County, and 50.8% nationally. The most recent quarterly reading for Maryland shows that PI increased by 0.9% from 2011:Q3 to 2011:Q4, slightly higher than the national PI increase of 0.8% over the same period. (County data are reported annually.) Despite the accelerating PI growth projections, the continued uncertainty in the employment sector indicates that actual PI growth is likely to remain volatile. Nationally, in 2011:Q4, wages and salaries comprised 51.8% of PI. Old-age/disability/health insurance benefits, which make up 12.8% of PI, have seen an increase of 0.7% since 2010:Q4. Meanwhile, unemployment benefits have decreased 22.2% over the same time period.

The County's Spending Affordability Committee recommended a spending growth limit of 2.98% for FY 2013.

For FY 2013, the County's Spending Affordability Committee recommended a spending growth rate limit of 2.98% based on a 5-year average of Sage's January 2012 estimates of annual County PI growth for FY 2009 to FY 2013. Sage's January 2012 forecast of annual County PI growth for FY 2014 is 5.01%. Based solely on this forecast and the estimated growth in prior years, the projected maximum spending growth recommendation would be 3.90% for FY 2014.



Estimate source: Sage Policy Group, January 2012

EXISTING HOME SALES

In February 2012, the number of existing Baltimore County homes sold increased by 33.2% from a year earlier.

The median price of existing homes sold in Baltimore County fell 10.3% between February 2011 and February 2012.

February 2012 pending home sales were up 34.2% compared to a year earlier.

Reflecting both lower mortgage interest rates and lower home prices, the monthly mortgage payment for a median-priced County home sold was 20.9% lower in February 2012 versus February 2011.

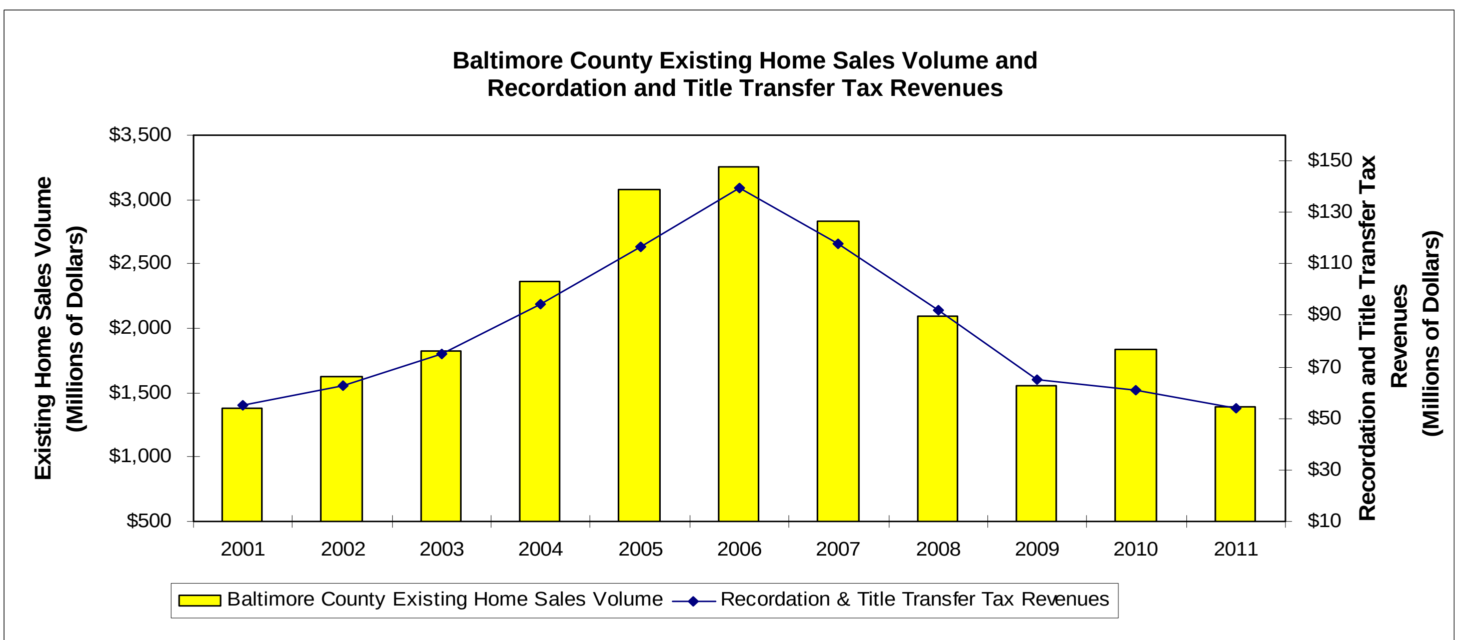
Property-related transaction tax revenues fell 11.5% in FY 2011, marking the fifth consecutive year of declines. These revenues are expected to turn around in FY 2012, with further gains anticipated in FY 2013.

Existing home sales in Baltimore County totaled 6,088 units in CY 2011, 1.3% below CY 2010 sales. However, homes sales began to pick up in the second half of CY 2011 and into CY 2012. The number of homes sold in February 2012 rose 33.2% from a year earlier to 425 units. This increase could be partially due to the mild winter in the Baltimore region. Prices remain low, with the median price of an existing home sold in the County dropping to $182,000 in February 2012, down 10.3% from February 2011. Meanwhile, the active inventory in February 2012 fell 26.9% from February 2011. Due to the high volume of foreclosures on the market, the BCEAC residential real estate representative predicted that prices will remain flat in most of the region for the foreseeable future, with the possibility of a slight rebound in the central part of the County.

Pending existing home sales in February 2012 totaled 706, up 180 units, or 34.2%, from February 2011, following a 21.6% increase in January 2012.

Mortgage interest rates (for 30-year conventional mortgages) in February 2012 were 3.89%, down 106 basis points from February 2011 when rates were 4.95%. Over this same period, the median price of an existing home sold in Baltimore County fell 10.3%, compared to an increase of 2.0% for Maryland. The combination of lower home prices and lower mortgage interest rates caused the monthly payment for the median-priced Baltimore County home (financed with a 30-year conventional mortgage loan) to fall to $857 in February 2012, 20.9% below the February 2011 level of $1,084 (principal and interest only). Mortgage rates are expected to remain flat for the remainder of CY 2012.

Property-related transaction tax revenues (recordation and title transfer tax revenues) totaled $54.0 million in FY 2011, a decrease of 11.5% from FY 2010 collections and 61.2% lower than peak collection levels experienced in FY 2006. FY 2012 property-related transaction tax revenues are expected to total $63.7 million, up 18.0% from FY 2011 levels, reflecting increased demand at slightly lower prices. These revenues are expected to increase again in FY 2013 due to a continued recovery in sales volume, with a projected increase of 7.1%.



CONSTRUCTION

The total value of construction permits issued in 2011:Q4 increased 10.9% from a year earlier, reflecting an increase in non-residential construction.

Construction is among the most volatile components of the County's economy. Construction permits issued in Baltimore County in 2011:Q4 totaled $138.3 million, $13.6 million, or 10.9%, above 2010:Q4. The 2011:Q4 permit valuation, which reflects a varied performance across construction sectors, follows a year-over-year decline of 12.3% in 2011:Q3. New residential construction remains weak, falling 56.3% from 2010:Q4 to 2011:Q4. Meanwhile, new non-residential construction saw an increase of $5.4 million, or 280.6%, from a very weak performance in 2010:Q4. Despite this increase, new non-residential construction remained weak in the County in 2011:Q4, with the only permit valued at or above $500,000 issued for a parking garage in Arbutus-Lansdowne ($6.2 million). In addition, two new non-residential construction permits valued at or above $300,000 were issued in the County in 2011:Q4, including new office buildings in Cockeysville-Timonium ($400,000) and in Towson-Loch Raven ($300,000).

Additions, alterations, and repairs activity in 2011:Q4 rose 43.1% from a year earlier to $111.4 million.

Additions, alterations, and repairs (AAR) activity in 2011:Q4 totaled $111.4 million, up $33.6 million, or 43.1%, from 2010:Q4 but still 13.0% below the average of 4th quarter activity over the last 7 years. The total value of residential AAR permits fell 8.4% from 2010:Q4 to 2011:Q4, while the value of non-residential AAR permits rose 61.7% over the same period.

In 2011:Q4, the total number of new residential building permits fell 65.6% compared to a year earlier, while the dollar value of these permits fell 56.3%.

New residential building permit data show that the total number of permits issued in 2011:Q4 decreased by 65.6% from the number issued in 2010:Q4. Multi-family unit permits fell from 64 units to 0 units and single-family unit permits fell from 198 units to 90 units. The total dollar value of the new residential building permits issued in 2011:Q4 fell $25.4 million, or 56.3%, from 2010:Q4 values, following a 34.0% year-over-year decrease in 2011:Q3. The decrease in permit values as well as the decrease in the number of permits issued demonstrates the weakness of the housing market. Additionally, the value of new residential building permits in 2011:Q4 remains well below the 7-year average of 4th quarter activity.

Construction employment represented 6.3% of County jobs in 2011:Q3 (the most recent data available).

Construction employment represented 6.3% of County jobs and had an average wage rate 15.0% above the County average in 2011:Q3 (the most recent data available). While the number of jobs available remains low by historic standards, construction activity continues to support high quality jobs.