ECONOMIC FORECAST

INTRODUCTION

This section of the budget provides a description of economic conditions as context for the overall budget strategy for 2009 and for some of the specific estimates contained in the budget. Clearly both directly and indirectly economic conditions influence revenue, Given the County's large role in aiding families and individuals facing social and economic stress, economic conditions also significantly affect County expenditures, particularly in social and related services.

OVERVIEW – PROLOGUE

We usually note that Albany's economy is not as volatile as the nation's. The ups are not as high and the lows are not as low. Much more than other communities, we rely on public sector employment which is more stable than that of the private sector. Similarly, during the housing boom, growth in home prices was not as rapid in the Capital District as in many other communities.

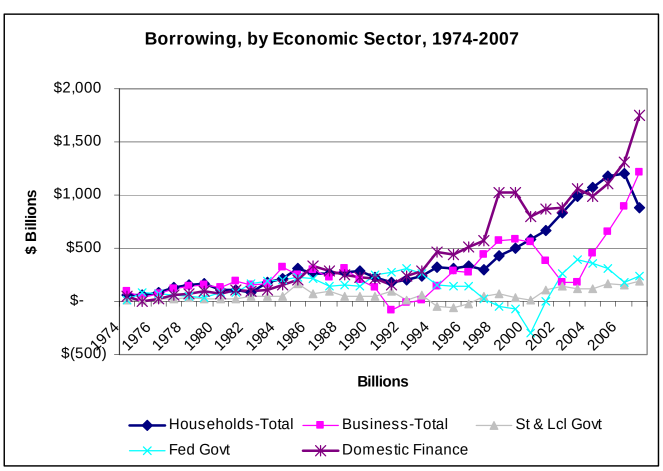
However, Albany is not entirely isolated from the rest of the State, U.S. and world economies. The interrelated nature of modern economies will almost certainly have an especially significant effect on Albany County in 2009 and 2010.

For several years, we have warned of the threat that rapidly expanding debt in the U.S. poses to the nation's economy. Two years ago, we warned of increasing debt levels and the end of the housing boom. In last year's Economic Forecast, we warned again "of consumer spending that was dependent on debt both personal debt and housing related debt."

The growth in debt was clearly becoming unsustainable. Aside from the potential risk to economic conditions generally, this posed a very specific risk for Albany County. Given the degree to which the County relies on Sales Tax revenue, debt based consumption that generates sales tax revenues could not and cannot continue indefinitely. A very large proportion of debt growth has been household home mortgage and consumer credit debt. Those debts, and particularly consumer credit, have fueled consumption that generated sales tax revenues, but at an unsustainable rate.

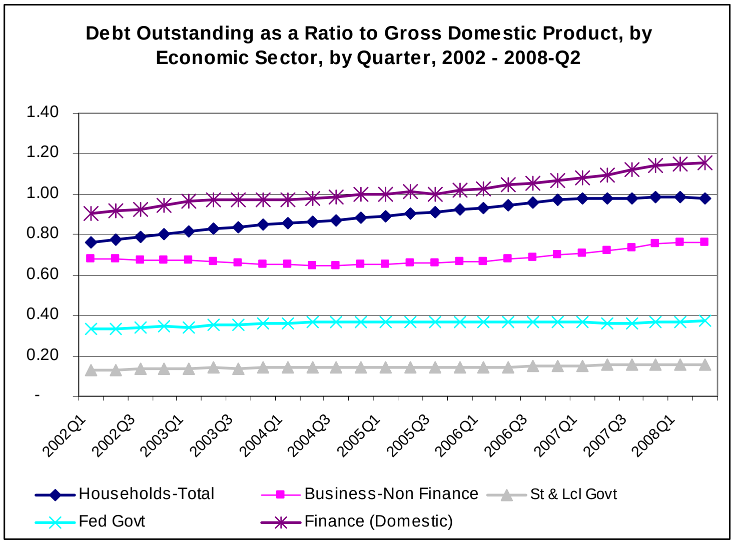
Our concerns were two-fold, the threat to the nation's and New York's economies and the potential ripple effects on County revenue and second, the effects an economic downturn will likely have on the numbers and status of the economically vulnerable who are the County's primary concern. For many living at the edge, the slightest economic stress brings them to County offices. At a minimum, these people are financially stressed, and are often socially and personally stressed. The net effect is reduced revenues, increase expenditures and increased challenges to County staff.

Borrowing more than doubled (up 253 percent) in the twenty years from 1977 to 1997, but tripled (up 309 percent) in the mere ten years that followed. The finance sector of business grew the fastest, followed by households (home mortgages and consumer credit). Of interest to county officials, borrowing by state and local government was the most stable and grew the least.



Source: Federal Reserve Statistical Release, Z.1., Flow of Funds Accounts of the United States, 9/18/2008

Even more important, private sector debt in all major sectors grew faster than Gross Domestic Product, a measure of the economy's carrying capacity. and for the financial sector of economy this continued into 2008. In contrast, even with the run-up in Federal deficits since 2001, outstanding debt of both Federal and state and local governments has remained relatively stable since the beginning of 2002, growing from 46 percent to 53 percent of GDP. In contrast, the home mortgages alone grew from the equivalent of 76 percent to 98 percent of GDP. Although the change was slight, outstanding household debt, as a percentage of Gross Domestic Product, began to fall during the first half of 2008. This was the result of a significant fall in new home mortgage obligations.



Source: Federal Reserve Statistical Release, Z.1.,
Flow of Funds Accounts of the United States, 9/18/2008
U.S. Department of Commerce, Bureau of Economic Analysis

Simply put, unsustainable trends cannot be sustained.

In far too many cases, much of the debt was incurred because the housing price bubble and caused many to take on more debt than the underlying value of the home.

In 2007 the "housing bubble" burst and its effect on the credit markets began to roil the economy. Many experts predicted a "soft landing" in 2008, suggesting the national economy would remain sluggish - but a recession would be avoided, unemployment would remain at low levels, and credit markets would continue to function normally.

OVERVIEW – THE IMMEDIATE CRISIS

On a larger scale the extensive news coverage and public awareness of the recent paralysis in financial markets cannot but have a significant effect on consumer confidence – and thus their consumption patterns. The converse of "consumer confidence" is consumer fear and when consumers see financial risk, they save rather than spend. Given the excess spending of the last decade, we believe this adjustment is both necessary and inevitable, but it will be wrenching. The same economic inter-connectedness that accelerated the crisis will compound the response. Sales will fall. In real, inflation adjusted terms, sales are already falling. As a result, prices will also fall or stabilize. As a result, economic activity will slow even further and Albany County's primary source of revenue will fall. The most direct potential effect on Albany County that concerns us is household debt because of its effect on Personal Consumption Expenditures (PCE) and their effect on sales tax revenues.

These issues came to a head as we were completing this Budget.

Financial markets froze up. Banks and other financial institutions began hoarding cash, and interest rates for overnight inter-bank lending leapt to unprecedented rates. Public bond offerings generated either no buyers or very high interest rates.

ECONOMIC FORECAST

The Federal Government, after an extraordinary debate and with unusual speed, enacted a massive ($700 billion) package labeled, depending on the position of the speaker or writer, a "bailout" or a "rescue." The bill was signed exactly one week before this Budget is due, preventing even the most cursory analysis of its calming effects on financial markets, much less the overall economy.

One effect is certain, though not measurable at this time. New York State's dependence on Wall Street for revenue has placed it in an immense vise. Approximately 20 percent of the State's revenue comes from New York based finance firms and their employees. The fallout has already created a huge budget gap for New York State and we have no doubt that some of that fallout will fall on Albany and other county governments.

The importance of Wall Street's economic health to New York State finance is clear in the following quote from David Paterson, who, at the time, had been New York's Governor less than two months.

> I found out that the 20 largest taxpayers to this state, the 20 banks and corporations that pay the largest amount in state taxes for the final quarter in 2006 … they paid in March 2007, $533 million into the New York State treasury. Do you know how much they paid this March (2008)? $72 million. That's 14 percent of what they paid last year.
>
> New York Governor David Paterson, *New York Daily News*, May 15, 2008

They'll probably pay even less in March of 2009.

In 2008, approximately 18 percent of Albany County's budgeted revenue was from State Aid. During the course of the current year, that has been reduced three times already, and it may well be reduced again, due to the accelerating effects of the financial crisis on New York State. Moreover, nearly nine percent of the County's revenue comes from Federal Aid. While Federal Aid is often independent of State actions and policy, much of it is tied by formula and law. For example, in some programs the State sets prices for health services or cash grants for public assistance clients. In seeking to reduce its own financial burden, the state may reduce those rates, prices or grants and Federal Aid would be reduced in concert.

Because of the uncertainty regarding potential State actions, this Budget is based on the State's current rules and financial formulas. That is likely to be the highest risk assumption in the entire Budget. Reductions in State Aid could easily cost the County between $2.5 and $5.0 million without taking into consideration Departmental and Miscellaneous revenue that results from payment for services provided by County agencies. Such revenue would particularly include Medicaid payments for the Nursing Home and Mental Health clinic.

In addition, because Albany is the State's Capital, nearly 21 percent of New York State's full-time equivalent employees work in Albany County (33,782/161,752 in 2007). Any layoffs, workforce reductions or other actions that affect total compensation of State employees would ripple quickly and directly into Albany County.

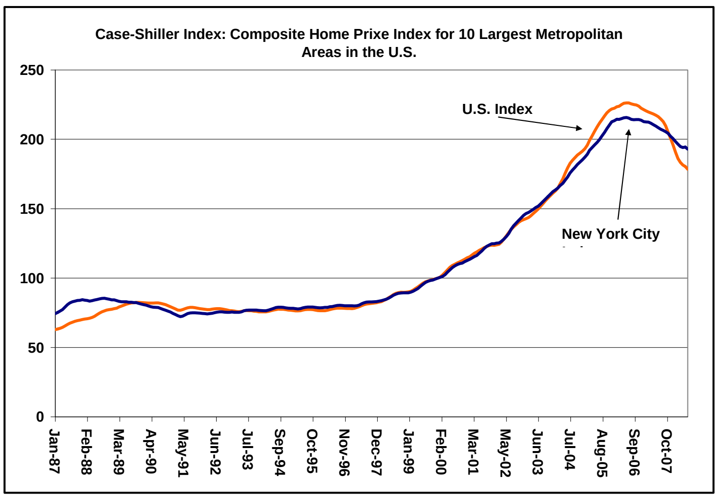
Unfortunately, we have also recently witnessed substantial shocks to the housing and credit markets, resulting in a series of bankruptcies amongst several venerable banking institutions and investment banks. The Federal government, including the Federal Reserve Bank and Treasury, has responded using all of their available tools: direct equity investment in troubled firms, assumption of "bad" mortgage-backed securities, a series of interest rate cuts to provide a short-term stimulus, short-term loans to banks to ensure liquidity remains adequate, and the aforementioned $700 billion "rescue" package.

The overwhelming majority of economists predict that a recession is likely, and many believe the U.S. economy is already contracting. We believe that we are either already in a recession or will be shortly. We also believe that Albany's historical immunity from economic volatility will be tried due to the focused effects of the current economic upset on New York State government. Reductions in State Aid are likely and Capital District located State employees are likely to spend less.

ECONOMIC FORECAST

The downturns in the financial services sector have been closely tied to the bursting of the housing market bubble in 2007. Beginning in late 2007 and continuing into 2008, steep declines in housing prices have been realized by homeowners. Nationwide, sale prices of existing homes have declined by 9.5 percent since August of 2007. This is the 2nd consecutive year that sale prices have declined substantially. The Case-Shiller index provides an accurate picture of trends in the national housing market. The index is a composite of the 20 largest metropolitan housing markets in the U.S. As shown in the chart below, the index began to decline late in 2006, although initial declines were modest. In recent months the index has declined dramatically, and many major metropolitan markets have yet to show signs of recovery. The New York City metropolitan area has its own index value, and losses in the value of real estate have mirrored national trends.

Nationally, construction of new homes peaked at 1.72 million in 2005. As of the end of the 2nd quarter of 2008, a total of 355,000 homes had been constructed. Sales of existing homes have also declined from levels realized in 2005. Most experts do not expect a large-scale recovery for several years, as there is a large inventory of homes for sale and corrections in the credit markets have forced the mortgage industry to tighten credit standards. The end result is that fewer individuals are able to secure mortgages, thus lowering demand for housing.



Source: S&P/Case-Shiller Home Price Indices
Released September 30, 2008

New York State, which realizes a substantial portion of its tax revenues from the financial services sector, has already realized dramatic declines in revenues. To quote an old axiom: when Wall Street sneezes New York catches a cold. The state 2008-2009 operating budget contained $80.9 billion in spending, in line with revenue forecasts that are closely tied to Wall Street – approximately 20 percent of state revenues are paid by companies and individuals in the financial services sector. For the current state fiscal year, the State Comptroller now estimates that revenues may be down by $3.5 billion. Beginning April 1, 2009, the state faces a deficit of approximately $5.5 billion.

In August, the Governor called for a special legislative session to address this issue, resulting in $427 million in budget cuts, including state aid payments to municipalities. All state agencies have been directed to cut spending by over 10 percent, and a hiring freeze is in place. More recently, due to the further deterioration of the financial services sector, the Governor is again calling for additional budget cuts – totaling $1.2 billion.

In 2009, we this project that will contribute to a decline of $3.5 million in state aid payments, mostly affecting the Department of Social Services, Children, Youth and Families, and Mental Health. However, we can only budget for those actions by the state that have already been undertaken. Due to this, the proposed $1.2 billion in additional state budget cuts is not reflected in the 2009 budget, as we cannot predict what revenues will be impacted. Across the state, other Counties are facing this same dilemma.

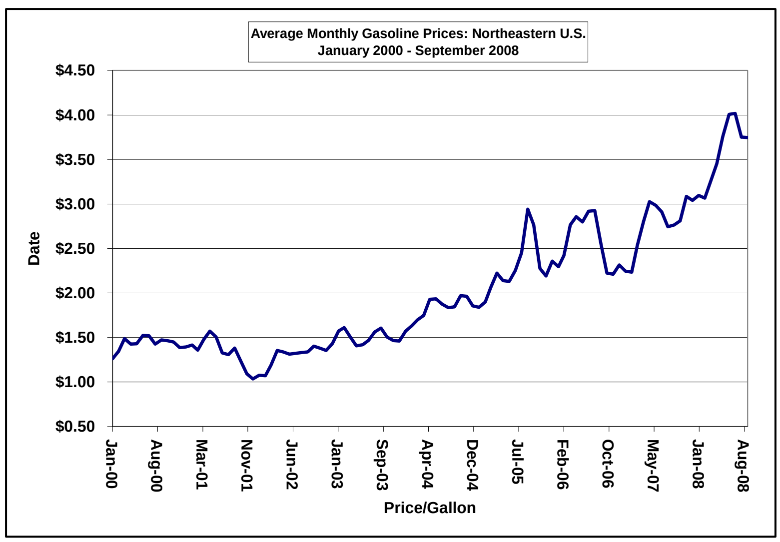
Annual Inflation Rate: September 2007 - August 2008	
All items	5.4%
Food & Beverages	5.9%
Housing	3.8%
Apparel	1.7%
Transportation	12.1%
Medical care	3.3%
Recreation	2.4%
Education & Communication	3.6%
Other Goods & Services	4.1%
Special indexes	
Energy	27.2%
Food	6.1%
All items Less Food & Energy	2.5%

ECONOMIC FORECAST

The state budget cuts made to date are considered permanent. State officials are concerned about the prospect of a recession that would impact revenues for many years. On average, the New York State economy is not as robust as the national economy. In the Governor's first quarter budget update he noted that a typical U.S. recession lasts 11 months – while the typical New York State recession lasts 25 months.

As mentioned previously, the County relies on sales tax revenues to fund revenues, and sales tax revenues serve as an important economic indicator. At the end of September, Albany County's sales tax collections were 4.8 percent higher than the same period for 2007. While this is a bright spot for Albany County government, the growth in sales tax revenues is not a reflection of a vibrant local economy. Rather, in recent months inflation has reached levels not witnessed in nearly two decades. As such, Albany County residents are forced to spend more on food, gasoline, clothing, and other essential goods. In essence, inflation is a regressive tax on consumption, meaning it imposes a greater burden on the poor than the wealthy.

According to the Bureau of Labor Statistics, Inflation over the past year, shown in the chart above, has been 5.4 percent. The increases in inflation have largely been caused by increases in the price of crude oil, which ultimately impacts the prices of other fuels, along with the production and transportation of commodities. In the short term, the reduced demand that will follow economic stagnation or recession will help to moderate inflationary pressures on energy prices. However, energy costs are a significant long range challenge to County operations and to Albany County residents, especially those economically disadvantaged.



Source: Energy Information Administration
Average Prices for East Coast Conventional Gasoline Prices

The high fuel prices also have a direct impact on the cost of County operations. As compared to 2008, the 2009 budget contains an additional $1.4 million in fuel related cost increases – a 12.3 percent increase.

Local unemployment has also increased to levels not seen for many years. According to the New York State Department of Labor, the August 2008 unemployment rate was 5.1 percent - a level not seen since January of 1992. In August of 2008 approximately 8,250 individuals were unemployed in Albany County, an increase of 2,300 individuals as compared to August of 2007. Governor David Patterson has also discussed the possibility of state layoffs. If enacted, many of the employees affected would undoubtedly be Albany County residents.

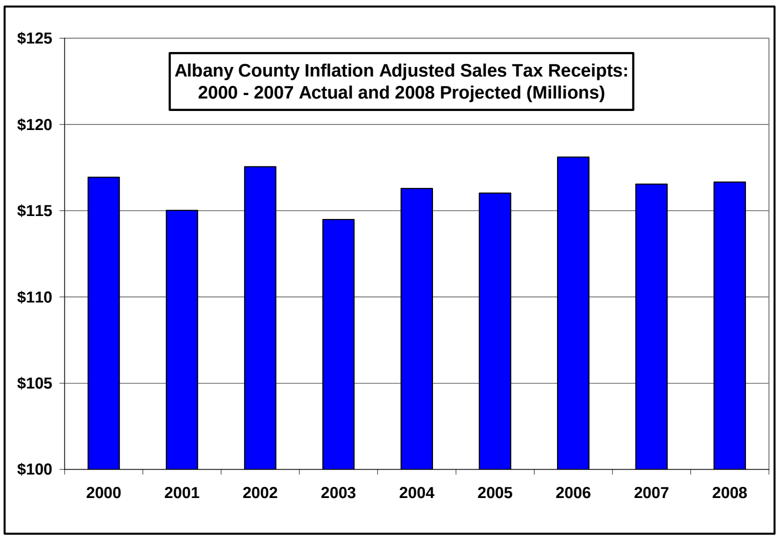
The local housing market, which did not realize sharp price increases in recent years, has remained steady. Year to date, sale prices have increased by 2.1 percent as compared to 2007. However, the number of listings has increased while closed sales have decreased, suggesting that inventory is rising and prices may ultimately decline as supply outstrips demand. Further, the number of homes in foreclosure continues to rise. In the first half of 2008 there were a total of 1,062 foreclosures in the 5-County Capital Region, a 27 percent increase over the same period for 2007.

All of the issues discussed above impact Albany County revenues and expenditures. The general outlook for 2009 is that revenue sources will not increase substantially, and state aid will decline by a minimum of 5.8%. Additionally, weakening economic conditions, especially increasing levels of inflation and unemployment, will create an influx of individuals and families seeking assistance from County health and human service agencies – the same agencies that are facing state aid budget cuts.

The following sections directly address how economic conditions are impacting major County revenue streams.

CONSUMER SPENDING AND SALES TAX COLLECTIONS

As compared to the same period in 2007, sales tax revenues have increased by 4.6 percent. Notably, inflation has also increased by 4.6 percent during this same period. As such, sales taxes have only increased due to inflationary effects – not due to real economic growth. As shown in the chart below, in recent years County sales tax receipts have not increased after adjusting for inflation.



Source: Albany County and the Bureau of Labor Statistics

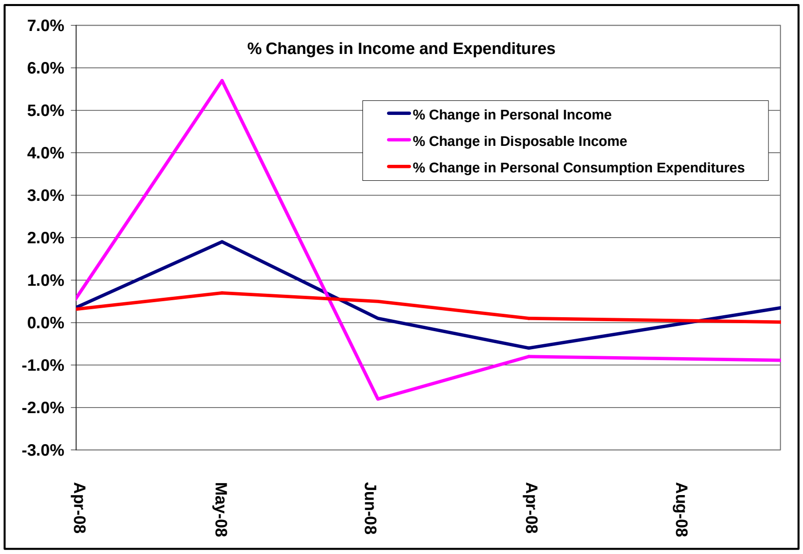
This lack of non-inflationary growth in sales tax revenues is even more striking in light of the Federal economic stimulus package enacted in 2008, which provided single tax filers with a $600 Federal tax rebate and married couples with $1,200. These rebates were provided in hopes of inducing economic growth. Unfortunately, the positive effects of this stimulus were simultaneously eroded by the increases in inflation.

The 2009 sales tax forecast is lower than year-to-year growth realized in 2008. This is primarily due to two factors: changes in consumer behavior, and the lack of a defined Federal stimulus package for 2009.

Given the looming prospect of a recession and the recent, negative news related to the economy, and high inflation, consumers have shown signs that their spending patterns are changing. For example, at the end of the 1st quarter of 2008 gasoline demand had declined by 1.3 percent as compared to 2007 – the first decline in 17 years. This decline is due to two primary factors: Americans are driving slightly less and purchasing smaller, more fuel efficient vehicles.

Changing in spending are also being reported by major retailers, as individuals and families are purchasing less luxury foods and increasing their consumption of inexpensive staples. For example, at the end of the 2nd quarter, Wal-Mart, known for low prices, had realized a 10.4 percent increase in sales as compared to 2007 sales. In comparison, The Limited Brands, a holding company for several higher-end retailers (Bath & Body Works, Victoria's Secret, The Limited, and others), recently reported a 17.2 percent decrease in sales.

ECONOMIC FORECAST



Source: Bureau of Economic Analysis
Personal Income, Disposable Income, and Personal Consumption Expenditures

The impact of inflation on incomes and spending is reflected in recent data provided by the Bureau of Economic Analysis. As shown in the chart above, changes in personal income and expenditures have been very low – at times turning negative – in recent months. The very recent turmoil on Wall Street will only exacerbate this trend.

Because personal consumption expenditures are not increasing, and inflation is hovering near 5 percent - Americans are actually consuming less. Approximately 70 percent of the economy is directly tied to consumer expenditures. Due to the trends in personal income and personal consumption expenditures, many economists believe that the economy is currently contracting – and this trend will continue into the 4th quarter of 2008 (meeting the classical definition of a recession).

Year	Sales Tax Collections (County Share)	Year-to-Year Change	% Change
2007	$ 138,499,991	N/A	N/A
2008[1]	$ 143,962,101	$ 5,462,110	3.9%
2009 Forecast	$ 145,113,798	$ 1,151,697	0.8%

1: 2008 figures includes a forecast for 4th quarter revenues.

In summary, we anticipate that these changes will result in a modest increase in sales tax collections in 2009 relative to 2008 collections. Further, we believe this increase will be less than the rate of inflation.

Over the long-term, demographic trends do not suggest that sales tax receipts will grow at a rate greater than inflation. This is due to the overall aging of the population, specifically related to the retirement of the baby boom generation. From 2000 to 2007 the population of County residents age 50 and over increased by approximately 10,000 individuals, an increase of 11.1 percent. During this same period, total population grew by only 1.6 percent. On average, individuals earn their highest incomes while in their 50s. Their incomes decline dramatically in future years as they retire and rely on savings and fixed income sources. In the case of Albany County, as this large demographic group begins to retire their spending will decline accordingly.

ECONOMIC FORECAST

EMPLOYMENT

The most recent national employment data showed a dramatic drop in employment. In September, non-farm payrolls fell 159,000, the ninth consecutive monthly decline. While unemployment has crept up, the shock of recent economic events has not yet had a large, direct effect in Albany. However, the portents are still there. Between August and September of this year, the number of unemployed in the Albany-Schenectady-Troy Metropolitan Area grew as fast as the growth in the number of employed. The unemployment rate was five percent, up approximately a percentage point from 2007. In August and September, the number unemployed was higher than in August and September of 2007 by approximately 5,000.

HOUSING MARKET AND MORTGAGE RECORDING TAX COLLECTIONS

The housing market in Albany County has – to date – withstood the shocks that have resulted in significant downturns in other markets. In part, this was because the local real estate prices did not escalate to the same degree as other markets during the bubble years. Thus, any correction in prices is likely to be less significant (if a correction occurs at all). However, the greater factor was likely related to the impact of New York State government on the local economy.

Year	Mortgage Recording Tax Collections	Year-to-Year Change	% Change
2007	$ 4,941,867	N/A	N/A
2008[1]	$ 4,258,016	$ (683,851)	-13.8%
2009 Forecast	$ 4,260,000	$ 1,984	0.0%

1: 2008 figures includes a forecast for September through December.

Compared to the same period in 2007, year-to-date sale prices have increased from $200,700 to $205,000 – a modest 2.1 percent change. However, the number of sales has declined by 20.6 percent, suggesting that the inventory of homes for sale is increasing and future market prices may decline as a result. The decline in sales has had a negative impact on Albany County's mortgage recording tax receipts. At the end of August, mortgage recording tax receipts totaled $2.96 million, compared to $3.44 million for the same period in 2007, a decline of over $475,000, or 13.8 percent. The 2009 mortgage recording tax forecast assumes that the prevailing trends in 2008 will continue into 2009.

LOCAL TRAVEL AND HOTEL/MOTEL REVENUES

The hotel occupancy tax is unique amongst those taxes levied by Albany County because the tax is primarily paid by non-residents.

The hotel occupancy tax currently stands at six percent; this tax was increased from five percent to provide a funding source for construction of the proposed Albany Convention Center, which would increase local tourism spending to the benefit of hotels and motels in the region. A study of the regional hotel/motel market by Smith Travel Research reports that vacancy rates remained unchanged in 2007 despite the addition of rooms. Albany County hotel/motel tax revenues clearly indicate that the strong market has continued into 2008.

Year	Hotel/Motel Tax Collections	Year-to-Year Change	% Change
2007	$ 6,712,296	N/A	N/A
2008[1]	$ 7,340,399	$ 628,102	9.4%
2009 Forecast	$ 7,340,000	$ (399)	0.0%

1: 2008 figures includes a forecast for 3rd & 4th quarter revenues.

At the end of the 2nd quarter of 2008, receipts totaled $3.1 million – an increase of approximately $270,000 (9.4 percent) compared to 2007 receipts for the same period. The end of year 2008 forecast assumes this trend continues, and hotel/motel revenues total $7.3 million. This figure is also used for the 2009 budget forecast.

The hotel/motel market is strongly driven by actions of the State Governor and Legislature. As the state's fiscal situation has deteriorated, those interested in influencing state policies have been forced to spend additional time in Albany. Other factors influencing the market include fuel prices and the exchange rate. As fuel prices have increased, Smith's Travel Research has reported an increase in "staycations," or vacations lasting less than one week that don't involve long-distance travel. Regarding exchange rates, although there is no data available for Albany County, other Counties in New York have reported increased visits from Canadian consumers who are able to take advantage of favorable exchange rates.

Two of the six percent of the Hotel/Motel tax, levied to support debt service payments for the Civic Center, is scheduled to sunset on January 1, 2009. Assuming that the two percent is restored no later than mid-year, the 2009 estimated revenue is $6.1 million. We also propose drawing approximately $120,000 from reserves to fund debt service payments in 2009, rather than increasing the County tax levy. However, the annual debt service payments are approximately $3.8 million, and the reserve fund contains a scant $2.3 million. Given this, the County will face a substantial fiscal burden in future years if this tax is not restored.

BRIGHT SPOTS AND THE LONGER TERM

Of particularly great importance is Albany's and the region's emerging role as a center for nanotechnology research and development. Last year's decision by International Sematech to move their headquarters to Albany's Nanotechnology Center at SUNY was a significant indicator that Albany is becoming the hub of such work. As we were completing this Budget, Advanced Micro Devices, Inc., announced that, with a new partner in the government of Abu Dhabi, it would proceed with building a $4.6 billion dollar computer chip factor in nearby Malta, Saratoga County. This plant will employ approximately 1,500 people and will further cement the region's reputation as a center of high-tech development.

Albany's housing prices did not grow to near the same degree as in many communities around the country, and therefore homeowners did not take on the same degree of debt. Albany residents did take on sub-prime mortgages, but we suspect to a smaller degree than in many other areas. This will make it easier to recover. Also, New York State has a long history of providing stable employment opportunities to Capital Region residents.

Despite the great financial challenges to New York State government, Albany's place as the State's Capital will continue to provide ballast to the local economy. Indeed, we expect that the interests of a wide array of groups concerned about the State Budget will bring them to Albany generating sales tax and hotel/motel tax revenue.

CONCLUSION

Despite the immediate challenges, we remain optimistic regarding Albany's longer term future. We are not isolated from the economic turbulence of the State, the nation, and the world. However, the combination of the stability brought by Albany's being the Capital combined with the energy generated by a rich educational community and a rapidly expanding technology sector still offer the promise of a vital and healthy economy.