

2010 ALBANY COUNTY EXECUTIVE BUDGET

INTRODUCTION AND HIGHLIGHTS

Economic Forecast

MICHAEL G. BRESLIN

County Executive



VOLUME I

ECONOMIC FORECAST

2007 Executive Budget, Economic Forecast

“Of particular concern are increasing debt levels and the end of the housing boom...Rising [housing] prices contributed to housing equity, much of which was refinanced and that, along with personal debt, usually in the form of credit card debt, supported increased consumer spending.”

“Overall personal savings rates have continued to fall and are a significant risk factor to an economy that was kept afloat during the post 9/11 recession by consumer spending.”

2008 Executive Budget, Economic Forecast

“Last year, we warned of increasing debt levels and the end of the housing boom. In particular, we warned of consumer spending that was dependent on both personal debt and housing related debt. We warned of a slowing economy, declining home sales and consumer spending. Regrettably, all of these projections have come to pass and the national economy shows signs of fragility, particularly due to significant reversals in the housing market.”

2009 Executive Budget, Economic Forecast

“For several years, we have warned of the threat that rapidly expanding debt in the U.S. poses to the nation’s economy...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 would 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, increased expenditures and increased challenges to County staff.*”

“Simply put, unsustainable trends cannot be sustained.”

Introduction

This section of the budget provides a description of economic conditions as context for the overall budget strategy for 2010 and for some of the specific estimates contained in the budget. The County’s revenues are affected by economic conditions. Because the County’s primary role is aiding individuals and families facing social and economic distress, economic conditions also have a substantial impact on County expenditures.

Overview

The large-scale economic and financial events of the past 18 months substantially affect Albany County. Though they dramatically affected the local economy and Albany County’s finances, those wrenching events are well enough known. This section will focus on the long-term fallout of these events. As context, we note the following:

- New York State’s finances are heavily dependent on Wall Street. Suffering from its own revenue losses, New York State’s 2009-2010 budget reduced aid to Albany County by approximately \$7.8 million. Governor Patterson has already announced that New York State is again facing an operating deficit and has called for an additional spending reduction.
- As of mid-year, the County’s total sales tax revenues were *down* 6.19 percent from 2008. Annualized, this would produce a shortage of \$12.05 million in 2009. Although not yet definitive, early indications are that the third quarter of 2009 will be at least as bad as the prior two quarters. As of October 7, sales tax revenues are down 7.27 percent compared to 2008. Even when the economy stabilizes, there will be a lag before there is any benefit from increasing taxable sales and sales tax receipts.
- At the Federal level, a number of programs have been enacted to combat the current recession. However, none of these programs are anticipated to affect sales tax revenues in any meaningful way. For example, we estimate the popular “Cash for Clunkers” program will increase 2009 sales tax revenues by approximately \$275,000. However, as the program is intended to accelerate automobile sales in 2009, most of the revenue gains in 2009 will be offset by *reduced* sales in 2010.

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- The New York State Common Retirement Fund has lost approximately 30 percent of its value over the past year due to declines in the financial markets. The fund has two primary sources of revenues: returns on investments, and contributions by local government participants. Because the fund has lost so much value, Albany County, and other government entities, will have to increase contributions dramatically in 2010 and beyond. The 2010 appropriation for retirement contributions is an increase of \$4.9 million over the prior year. A similar increase is expected in 2011.
- Compared to July of 2008, approximately 3,100 fewer County residents are employed in July of 2009. As will be explained in further detail, unemployment is generally a lagging economic indicator, meaning unemployment typically increases after a recession is underway and does not decrease until a recovery has already begun to occur.
- Along with high unemployment rates, long-term unemployment is unusually severe. As of August, over three percent of the labor force had been unemployed 26 weeks or more. This is the highest rate of long-term unemployment since data became available – in 1969.
- While a number of prominent economists have stated their belief that gross domestic product will grow during 2010, and the financial markets have recovered at least temporarily, there is virtually no debate about short-term recoveries in employment and growth in wages. Put bluntly, unemployment is expected to remain high and wages are not expected to increase.
- Although the national savings rate has increased and consumer debt has begun to decrease from the unsustainably high levels seen in recent years, consumers remain indebted and the probability of an immediate consumer driven recovery is highly unlikely. This downturn in consumption began in 2008 and has remained firmly in place.
- Despite the increase in the savings rate, available data suggest that households are not saving more total dollars than in prior years. This phenomenon is because total earnings have declined as the savings rate has increased.
- In recent years health care costs have been rising at alarming rates. These trends force consumers to curtail discretionary spending further to pay for health care related expenses. Due to this, even if consumers continue to spend at current levels, a greater share of their spending will not be subject to sales taxes.
- The build-up of unsustainable levels of debt was a long process that occurred over decades. Thus this problem cannot and will not be addressed over the short-term. It will take consumers years and years to pay down their debts, and many individuals and families will have considerably less disposable income during this period.

In summary, the current sales tax trends represent a fundamental change in both consumption patterns and overall consumption of consumer goods. While the high unemployment has had a sudden impact on sales tax receipts, the more important long-term factors may be the reductions in debt-fueled spending and the increase in the savings rate. Both of these issues result in lower sales tax revenues for Albany County. This budget acknowledges this fundamental economic shift and begins restructuring Albany County government accordingly.

Sales Tax Collections

Many goods and services purchased in Albany County are subject to sales tax. The total sales tax rate is eight percent. New York State collects the entire eight percent and retains four percent for its own purposes. Of the sales taxes distributed to Albany County, 60 percent is retained for County purposes (2.4 percent of taxable sale price) and 40 percent is distributed to municipalities. The municipalities within Albany County received their share of the 40 percent based on their population, as reported in the latest decennial census.

Sales taxes in Albany also represent a disproportionate relationship to property taxes. In 2007, Albany's sales tax receipts represented a higher ratio to property taxes than any other county. Albany's sales taxes were 3.65 times its property taxes. This compared to a statewide average of 1.48. Erie County ranked second with a ratio of 3.11.

Albany County is more dependent on sales tax revenues than most counties in New York and its finances thus more susceptible to variation in receipts. In 2007, sales taxes produced 43.3 percent of the County's total revenue compared to

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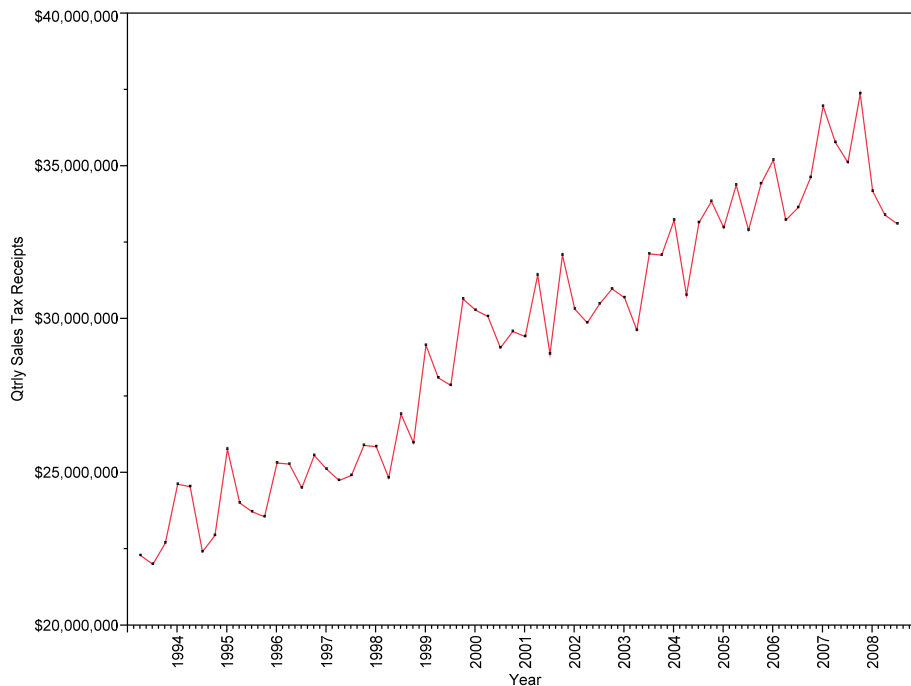
a statewide average of 32.9 percent. In only two counties in New York did sales taxes represent a higher proportion of total revenue (Erie, 45.7 percent and Suffolk, 45.4 percent).

Similarly, Albany's sales taxes per capita were high and its property taxes per capita were low. In 2007, Albany received sales tax revenues of \$809 per County resident. This contrasted to a statewide average of \$621 per capita. Albany ranked second to Warren County's \$837. This is not to say that there are no complaints about total property taxes including school and other municipal property taxes. Nor is it to say that counties with higher property taxes do not suffer from bitter complaints about them. It is to say that the taxpayers, by their spending behaviors are signaling that they are stretched. Therefore it cannot be used an argument for increasing the County property tax.

Statewide, counties collected \$420 per capita in property taxes. Albany collected \$221 per capita, ranking 54th with only Otsego and Saratoga slightly below.

Given Albany's dependence on sales tax revenue, a sharp downturn in sales tax receipts will have a proportionately greater effect than in other New York counties. And a sharp downturn is what has occurred.

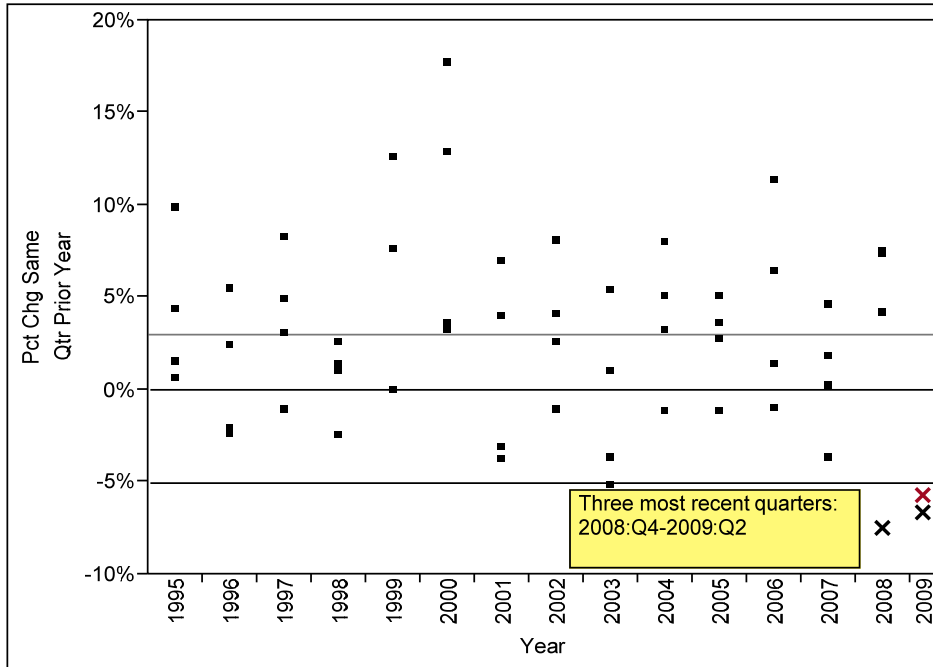
Chart 1: Trend of Quarterly Sales Tax Revenue, Albany County, After Distribution of 40 Percent Municipal Share, 1993-2009, Q2



As outlined in the Department of Management & Budget's 2nd Quarter memo on sales tax revenues 2009 sales tax collections have been far below 2008 levels (<http://www.albanycounty.com/budget/fmr/2009/pdf/20090720.pdf>). At that time, the Department estimated the County share of sales tax revenues, on an annualized basis, would be \$12.05 million below 2008 levels. Beginning in the 4th quarter of 2008 and continuing through the 2nd quarter of 2009, Albany County experienced the three worst quarters of sales declines when compared to the same quarter of the prior year. See Chart 2.

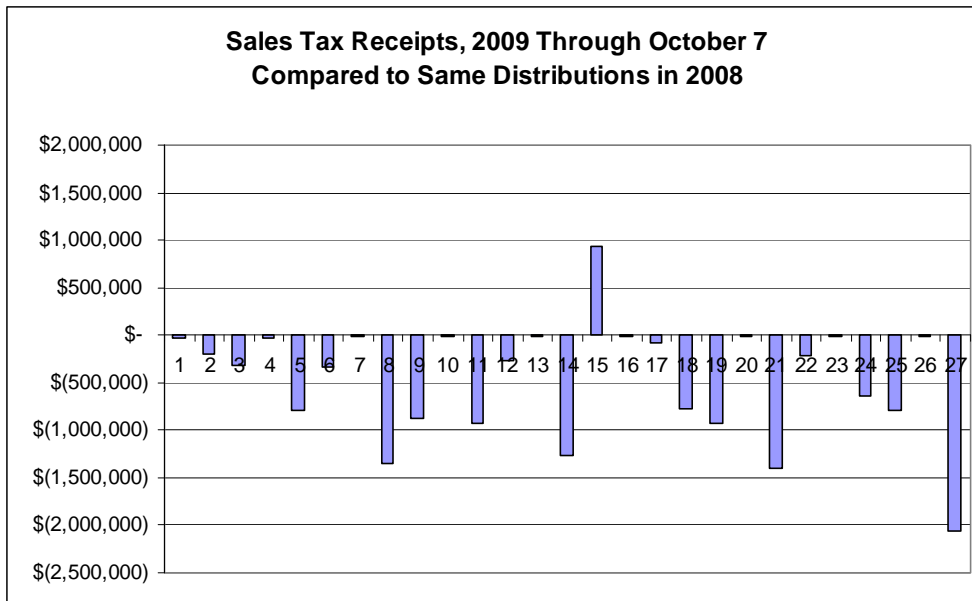
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Chart 2: Percent Change Quarterly Sales Tax Revenue Compared to Same Quarter in the Prior Year, Albany County, After Distribution of 40 Percent Municipal Share, 1993-2009, Q2



The pattern has been consistent throughout 2009. With only one exception, every distribution of sales tax receipts that Albany County has received in 2009 has been below that for the same period in 2008. Through early October of 2009, sales tax receipts are 7.27 percent below receipts for the same period in 2008.

Chart 3:



As mentioned in the introduction, unemployment is a lagging economic indicator. As the economy slows, firms generally do not reduce employment at the same pace, so the unemployment rate tends to remain fairly stable as the economy enters a recession. However, unemployment typically remains elevated after the economy has improved, as firms are

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generally reluctant to expand employment until the prospects of longer-term growth appear secure.

Because of the time lag between economic growth or decline and changes in unemployment, unemployment will very likely remain high in 2010. Unemployment will reduce income. Reduced income will lead to reduced sales and that will lead to reduced sales tax revenues.

The 2010 Budget proposes sales tax revenues of \$228.6 million, with an accompanying County share of \$137.1 million. This amount is \$13.3 million, or 5.5 percent less than the 2009 adopted budget. The 2010 budgeted figure represents less than one percent growth relative to the current trend for 2009 receipts and that growth will begin later in 2010.

Federal and State Aid

In 2009, Albany County budgeted for \$87.1 million in State Aid and \$58.6 in Federal aid. In the months that followed, New York State's budget crisis became more acute, and passage of the state budget ultimately led to a reduction of aid to Albany County of \$7.8 million in 2009.

The 2010 Executive Budget proposes \$80.3 million in State Aid revenue. Approximately \$3 million of this year-to-year change is due to reductions in Medicaid payments to the Nursing Home. New York State also eliminated local administrative funding for the certain social and human services functions. The overall impact of this change on Albany County is approximately \$4 million.

Lastly, New York State is currently facing an operating deficit estimated at approximately \$3 billion. As such, future cuts in State aid are a distinct possibility.

Budgeted Federal Aid for 2010 is \$2.8 million higher than 2009. This is related to a State effort to substitute Federal for State dollars in reimbursing social services programs and in Medicare associated with Nursing Home operations. Note that the Albany County Nursing Home will receive \$8.2 million (partially counterbalanced by a DSS Medicaid contribution of 50 percent) in Inter-governmental transfer (IGT) revenue in 2010, but this revenue does not extend to 2011.

Mortgage Recording Taxes

Albany County levies taxes on all mortgages recorded. Tax revenue is thus generated from both home purchases and refinancing activity.

Historically, Albany County has not had the ability to differentiate taxes collected through home purchases versus refinancing. Fortunately, due to the assistance of the County Clerk, we now have the ability to make this differentiation, and hope this will enable us to better understand and forecast this revenue for budgeting purposes.

The taxes collected are primarily a function of two factors: the health of the housing market and the availability of low-interest financing. While the regional housing market has slowed dramatically, Albany County has remained fairly stable in comparison. As reported by the Greater Capital Association of Realtors, as of July the total number (year-to-date total) of residential closed sales was 6.7 percent lower than the same period of 2008, and 24.6 percent lower than 2007 levels.

Despite declines in the number of closed sales, sale prices remain reasonably stable. Median sale prices in 2009 are equivalent to both 2007 and 2008 levels. We believe this is largely due to the influence of New York State government on the local economy, which is a stable employer in comparison to the private sector.

As of August of 2009, Albany County has collected \$2.48 million in mortgage recording taxes, which is a decline of \$0.48 million (19.4 percent) as compared to the same period of 2008. These trends in 2009 will likely continue into 2010.

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Hotel Occupancy Taxes

As noted in prior years, the hotel occupancy tax is unique amongst those taxes levied by Albany County because residents generally are not subject to this tax.

In 2008 the tax rate was 6 percent. On January 1st, 2009 the tax rate declined to 3 percent. It is anticipated the tax will be restored to the prior rate of 6 percent during November of 2009.

Hotel occupancy taxes totaled \$6.99 million in 2008, a slight increase from the total of \$6.81 in 2007. At the end of the 2nd quarter, 2009 receipts totaled \$1.70 million, largely the result of the tax rate being lower than prior years. However, adjusting for the decline in the tax rate revenues remained at levels consistent with prior years.

The strength of the market is also reflected by occupancy rates. The annual occupancy rate for hotel/motel rooms in Albany County was 50.8 percent in 2008, and 48.0 percent at the end of the 2nd quarter of 2008. Through the first two quarters of 2009, the occupancy rate was 45.7 percent.

We project that occupancy rates will remain consistent with 2008 and 2009 levels, and anticipate the tax rate will be 6 percent for the duration of the year.

Interest Earnings

Historically, Albany County has earned a substantial amount of revenue through interest earned on invested funds. This revenue is a function of two primary factors: cash balances held in the various County accounts, and market interest rates.

Due to a number of factors, including the declines in sales tax revenues, the County's cash balances are substantially lower than previous years. Further, due to the Federal Reserve Board's efforts to stimulate the economy, market interest rates have been at or near historical lows during 2009. As result, interest earnings are a mere fraction of previous years, as shown in the graphic at right.

In some recent months interest earned has not been sufficient to cover banking fees. This is related to low interest rates and recent cost increases for banking services. Recently, the Federal Depository Insurance Corporation (FDIC) increased fees, collected from banks, to insure deposits. The fee increases are related to the recent large number of bank failures, and are placed in a deposit insurance fund to help insure confidence in the Country's banking system. These fee increases, in part, will ultimately be borne by individuals and organizations that utilize banking services.

We do not anticipate any dramatic increases in County cash holdings during 2010. Additionally, as reported in Blue Chip Economic Indicators, a strong majority of market economists are not expecting increases in the Federal funds rate, which largely determines short-term interest rates, in the near term. As a result, due to our low cash balances and no expectation of rising interest rates, expected 2010 interest earnings are \$420,000.

Retirement Contributions

Albany County must make payments to the New York State Common Retirement Fund to meet obligations to both current and future retirees. These funds are then pooled with contributions from New York State government and numerous municipal governments and invested. In the spring of 2008, the value of the funds assets totaled \$154 billion. In contrast, the current value of the fund is \$116.5 billion – a decline of over 30 percent.

As a result of these losses, municipal governments will be required to contribute substantially more in 2010 and beyond. The 2010 budget for retirement is based on rate sheets provided by the State Comptroller's Office, which allows for the development of an accurate cost estimate. This estimate is shown in the chart below.

In 2010 alone, absent any other changes, the increase in retirement costs represents a property tax increase of 7.2 percent over the 2009 property tax levy.

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For 2011 and future years, the New York State Division of the Budget has forecasted their expectations for future cost increases. Their current expectation is for pension contribution rates to grow from 7.3 percent of payroll in 2009-2010 to 24.1 percent in 2012-2013. Absent any legislative changes to the program and assuming payroll is held constant, this represents a retirement obligation of \$29.4 million in 2013. Absent any other changes in County government, this would result in a property tax increase of 26.4 percent.

We do not claim to have any insight into the future performance of financial markets which might allow us to provide an estimate of retirement costs beyond 2010. This section is included to further highlight the reliance of Albany County on the performance of the broader economy.