



DEPARTMENT OF FINANCE

Marc Elrich
County Executive

Michael J. Coveyou
Acting Director

April 10, 2019

Honorable County Executive, and
Members of the Montgomery County Council

Ladies and Gentlemen:

I am pleased to present the findings of the Twentieth Annual Business Advisory Panel that was convened on February 21, 2019. The enclosed report was prepared by the County's Department of Finance pursuant to Article XI, Section 20-61 of the Montgomery County Code.

The report consists of a summary of the panel's advice, a list of the panelists, the information package that the Department of Finance sent to the panelists in advance of the meeting, and a presentation prepared for the Panel by Andrew Schaufele, Director, Bureau of Revenue Estimates, Office of the Comptroller of Maryland. The information package includes the agenda for the meeting, concise statements by the Department on the economic outlook, and a framework for discussion.

I believe that the accompanying material accurately reflects the economic advice given by the Business Advisory Panel.

Sincerely,

Michael J. Coveyou, Acting Director
Department of Finance

Attachments

**FINDINGS OF THE TWENTIETH ANNUAL
BUSINESS ADVISORY PANEL
FEBRUARY 21, 2019**

Pursuant to Article XI, Section 20-61, of the Montgomery County Code, the Department of Finance (Finance) convened the twentieth annual meeting of the Business Advisory Panel (BAP) on February 21, 2019. The County Council of Montgomery County established the BAP in 1999 to seek the advice of industry experts in key sectors of the County's business community concerning the current and future state of the County's economy. The law requires that the Director of Finance convene the panel annually and relay the panel's advice to the County Executive and County Council. This report provides such advice.

The BAP members representing real estate, finance, health services, government, economic development, and trade associations, were joined by the County Executive, Marc Elrich.

The meeting was structured to allow all participants to provide a briefing on the local, state, and regional economic trends and to share their insights about future economic prospects in the County. The participants also discussed Finance's economic assumptions for the next six fiscal years. For purposes of this report, the results of the discussions are presented in three parts. The first part discusses Finance's economic assumptions and the Director of the Bureau of Revenue Estimates' (BRE), Comptroller of Maryland, outlook for the Maryland economy and an update on the individual income tax. The second section discusses the participants' discussion of the presentations by Finance and BRE. The third and final section discusses issues about the local and regional economies.

The County Executive opened the meeting by addressing the goal of reforming how the County conducts business. Such topics included a review of the building codes, reducing the time to issue permits, and no waivers on environmental requirements. An issue the County Executive mentioned is to generate more small business centers throughout the County, such as an incubator program, for non-high-tech businesses.

I. Current Economic Conditions and Future Economic Assumptions

Finance asked the participants to provide comments to a paper prepared by staff that analyzed the County's economy and provided assumptions about the economic outlook for the next six years. The paper analyzed several economic indicators including employment, personal income, real estate, inflation, construction, and interest rates. A detailed report on the County's economy and economic assumptions follows these findings. The following is a summary of those assumptions:

Payroll Employment. Payroll employment will continue to increase from CY2018 to CY2025 and grow at an average annual rate of 0.8 percent over that period. This is

the same average annual growth rate of 0.8 percent experienced between CY2011 and CY2018.

Resident Employment. Resident employment will also increase at an average annual rate of 0.8 percent from CY2018 to CY2025. However, that rate is slightly below the average annual rate of 1.0 percent between CY2011 and CY2018.

Wage and Salary Income. Wage and salary income will grow at an average annual rate of 3.6 percent between CY2017, the latest date for which actual data are available from the Bureau of Economic Analysis, U.S. Department of Commerce, and CY2025. Total wage and salary income are estimated to reach \$50.7 billion by CY2025.

Personal Income. Total personal income in Montgomery County will grow at an average annual rate of 4.1 percent from CY2017 to CY2025. By CY2025, total personal income will reach \$125.4 billion.

Inflation (annual average). The overall regional inflation index will steadily increase from 2.04 percent in CY2018 to 2.70 percent by CY2025.

Interest Rates. The target rates were increased three times in 2017 by 25 basis points to reach 1.25-1.50 by December 2017 and four times in 2018 to reach 2.25-2.50 by December 2018. Since the yield on the County's short-term investments is highly correlated with the federal funds rate, the County earned an average of 0.39 percent in investment income on its short-term portfolio for FY2016, an average of 0.71 percent in FY2017, and an average of 1.34 percent in FY2018 with estimated increases to 2.30 percent for FY2019 and to 2.45 percent by FY2025. This assumption is based on no rate increases in the targeted federal funds rate by the FOMC for the remainder of FY2019.

Maryland Economy

The Director of BRE presented an economic outlook on the national economy, the Maryland economy, BRE's economic forecast for the Maryland economy, and selected income tax data to the County Executive and the participants. A copy of the BRE Director's presentation is included in this report. Highlights of that presentation are:

- **Economic and Demographic Data**
 - While the post-Great Recession recovery and expansion is currently 116 months old, it has experienced slower growth in gross domestic product (GDP) compared to the previous post-recession recoveries and expansion cycles.
 - Because of the length of the current recovery and expansion cycle, there is discussion of a risk of a recession. BRE noted that "nobody can predict recessions with any sort of accuracy." However, if a recession would occur, it could reduce State revenues by 4 to 6 percent.

- National GDP is expected to grow at an average annual rate of 2.4 percent between CY2018 and CY2022. This rate is greater than the average annual growth rate of 1.9 percent between CY2000 and CY2009 and greater than the average annual growth rate of 2.2 percent between CY2010 and CY2017. The rate between CY2018 and CY2022 is attributed to growth in employment of 0.9 percent and in labor productivity of 1.4 percent.
- BRE's forecast for selected economic indicators from the Board of Revenue's December 2018 report are:
 - ***Personal income:*** 4.2 percent (CY2019), 4.0 percent (CY2020), 3.8 percent (CY2021), and 3.9 percent (CY2022);
 - ***Payroll employment:*** 0.8 percent (CY2019), 0.6 percent (CY2020), 0.4 percent (CY2021), and 0.5 percent (CY2022); and
 - ***Average Wage:*** 4.0 percent (CY2019), 3.9 percent (CY2020), 3.3 percent (CY2021), and 3.5 percent (CY2022).
- BRE's conclusions:
 - Near-term outlook looks strong given a moderate correction at the end of 2018.
 - Because of heading to the "peak" of the business cycle, optimistic economic indicators have growth decelerating to 2.0 percent annual growth.
 - Because of the length of the recovery and expansion, the risk of a recession is heightened.
- **Income Tax Data.**
 - In tax year 2017, 2,759 Maryland taxpayers representing 0.1 percent of the total number of taxpayers also represented 8.5 percent of total Maryland income tax collections. Of the total of nearly 27,600 Maryland taxpayers representing 1.0 percent of the total number of Maryland taxpayers, they represented 21.0 percent of total income tax collections.
 - Quarterly estimated payments statewide declined 32 percent during the fourth quarter of tax year 2018 from the fourth quarter of tax year 2017. In comparison, quarterly estimated payments increased over 30 percent during the fourth quarter of 2017 from the fourth quarter of 2016. BRE suggests that the dramatic change in the estimated payments in TY2017 and TY2018 could be attributed to taxpayer behavior in response to the

Tax Cut and Jobs Act of 2017 and the stock market correction during the latter part of CY2018.

- BRE presented an analysis of the economic impact of the federal government shutdown between December 22, 2018 and January 25, 2019 – the longest period for a shutdown. BRE’s analysis is presented on chart 30 of BRE presentation that accompanies this report.
- According to data provided by BRE, the average federal adjusted gross income and adjusted for inflation for Montgomery County income tax returns was \$105,000 compared to less than \$70,000 statewide, excluding Montgomery County in TY2017. Median federal adjusted gross income and adjusted for inflation for Montgomery County income tax was approximately \$52,500 compared to approximately \$43,000 statewide, excluding Montgomery County in TY2017.
- The share of Montgomery County taxpayers claiming the refundable earned income tax credit was 8 percent starting in TY2009 compared to over 10 percent statewide, excluding Montgomery County.

II. Discussion of Presentations

- The breakdown of new construction residential units
 - During the past five years, the number of residential starts for multi-family housing units represented 73 percent of the total new residential construction starts in Montgomery County compared to 27 percent of single-family units (Source: Dodge Data and Analytics, McGraw-Hill).
- Mobility of sales of homes – “in” versus “out” growth
 - The Greater Capital Area Association of Realtors (GCAAR) and the Metropolitan Regional Information System (MRIS) provide monthly and annual data on the sales of existing homes and average and median sales prices. However, data on mobility are not available through these sources.
- Resident employment – share of proprietor employment
 - In 2007, proprietor employment represented 24.1 percent of total resident employment in Montgomery County. By 2017, that latest date for which data are available, proprietor employment represented 28.6 percent of total employment (Source: Bureau of Economic Analysis, U.S. Department of Commerce).
- Resident employment – 25-54 age cohort as a share of total population is declining while the elderly share of the total population is increasing.
 - The share of total employment in the 25-54 age cohort for Montgomery County declined from 68.6 percent in CY2007 to 64.4 percent in CY2017 (Source: American Community Survey, Bureau of the Census).

- Resident employment – the issue about the value of the increase in employment, concern that they are lower paying jobs, less mixed-use and more retail jobs, and different types of employment by sector.
 - The Maryland Department of Labor, Licensing and Regulation (DLLR) provides wage data by occupation. For 2017, the median wage for all occupations in Montgomery County was \$52,600. DLLR provides wage data for 22 occupation groups. From those data, one could determine if the growth in employment in the County is in lower paying jobs (Source: Occupational Employment and Wages, Montgomery Workforce Region).

- Resident employment – the GDP value of the jobs
 - The value of real gross domestic product for the County was \$186,600 per total payroll employment in CY2012 and increased to \$188,800 by CY2015 (the latest date for which County real GDP are available). However, there are differences by industry sector. The GDP/employment ratio for the services-producing sector increased from \$192,800 in CY2012 to \$196,200 in CY2015. However, GDP/employment for the goods-producing sector declined from \$163,000 in CY2012 to \$156,000 in CY2015.

- Employment/Income – average wage growth has recently outpaced inflation, but historical trend in wages is flat with fewer workers in the highest pay groups replaced by younger workers with lower pay.

- Starts in office construction – flat but an increase in value
 - In CY2017, the number of office and banking construction starts were 84 and the added value of the new construction was \$250.4 million. In CY2018, the number of starts decreased to 77 but the added value of the new construction was \$716.5 million (Source: Dodge Data and Analytics, McGraw-Hill).

- Building block chain technology.

- Capital gains – 50 percent of capital gains come from 260 households.
 - For the five years from CY2012 to CY2016, capital gains in Montgomery County represented 41.1 percent of total statewide capital gains. However, in CY2016, the County’s capital gains decreased 13.4 percent from \$4.171 billion to \$3.613 billion.

III. Specific Industry Sectors

The representative from Visit Montgomery stated that there was an increase in hotel-motel occupancy and a 3.8 percent growth in hotel-motel revenues in 2017. There is a preference for lodging in the County for Airbnb accommodations.

The representative from the health services industry noted that hospitals are under a revenue cap. There is an incentive to merge utilization of facilities due to either a penalty or reward for total cost of care. The future of health care in Montgomery County is the health sector working together with such programs, community-based health, and encouraging residents to remain in nursing homes rather than rotating back and forth to a hospital. The hiring of experienced nurses has been difficult as well as overall hiring of medical professionals.

Representatives from the real estate, financial industry, and regional government association commented on the current outlook for housing/real estate:

- There is a need for more affordable housing
- An issue in residential real estate is the issue of vacant home insurance
- Sales are sluggish in the down County
- There is an option to provide a housing voucher
- The regional impact on housing from the Amazon HQ2 Headquarters in Crystal City to outlying jurisdictions such as Arlington County, District of Columbia and Montgomery County.

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- Federal government shutdown resulted in lost income to federal contractors (Please see BRE's presentation in Chart #30 for a discussion and analysis of the impact of the federal government shutdown);
- There was an additional loss for the commercial/retail business such as restaurants; and
- Good news is that federal contractors are expanding into the commercial market.

Finally, participants discussed the outlook for employment and jobs in the County:

- There is an increase in jobs but at a lower income level; and
- Among the growth in private sectors jobs, hospitality ranks second among non-federal government jobs and educational services ranks third. Both sectors are leading the business and professional services.

IV. Conclusion

The representatives expressed cautious optimism regarding the region's and County's economy. While the economic forecasts by Finance show growth in employment and income, the major issues discussed by the participants are the types of jobs created in the County, the lack of affordable housing, the decline in the working age population between the ages of 25 and 54, the percent of income tax from high income taxpayers and capital gains, and the risk of a recession.

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**Participants
Business Advisory Panel
February 21, 2019**

Mr. Marc Elrich
Montgomery County Executive

Ms. Fariba Kassiri
Office of the County Executive

Mr. Alexandre Espinosa
Director
Montgomery County Department of Finance

Mr. Andrew Schaufele, Director
Bureau of Revenue Estimates
Comptroller of Maryland

Ms. Annice Cody
President
Holy Cross Health Network(s)
Holy Cross Hospital

Mr. Paul DesJardin, Director
Community Planning and Services
Metropolitan Washington Council of Governments

Mr. Edward Harrington
Regional President MD/DC
John Marshall Bank

Ms. Georgette Godwin
President and Chief Executive Officer
Montgomery County Chamber of Commerce

Ms. Kelly Groff
President and Chief Executive Officer
Visit Montgomery

Mr. Edward R. Krauze, ESQ
Chief Executive Officer
Greater Capital Area Association of Realtors

Mr. David Petr
Chief Executive Officer
Montgomery County Economic Development Corporation

Mr. Ben Edson
CEO/Founder
VariQ

Mr. Zachary Trupp
Public Policy and Political Affairs Associate
Greater Capital Area Association of Realtors

COUNTY STAFF:

Mr. Dale Tibbitts
Special Assistant
Office of the County Executive

Mr. Rob Hagedoorn
Chief, Fiscal Management Division
Montgomery County Department of Finance

Ms. Mary Casciotti
Fiscal and Policy Analyst
Division of Fiscal Management
Montgomery County Department of Finance

Ms. Laurie Boyer, CEcD
Economic Development Manager
Division of Fiscal Management
Montgomery Department of Finance

Mr. David Platt
Chief Economist
Division of Fiscal Management
Montgomery County Department of Finance

Gene Smith
Legislative Analyst
Montgomery County Council

MONTGOMERY COUNTY

20TH ANNUAL

BUSINESS ADVISORY PANEL



FEBRUARY 21, 2019

MEETING

WHERE: COUNTY EXECUTIVE'S CONFERENCE ROOM
EXECUTIVE OFFICE BUILDING
2nd FLOOR
101 MONROE STREET
ROCKVILLE, MARYLAND 20850
(240) 777-8877

WHEN: THURSDAY, FEBRUARY 21, 2019

AGENDA

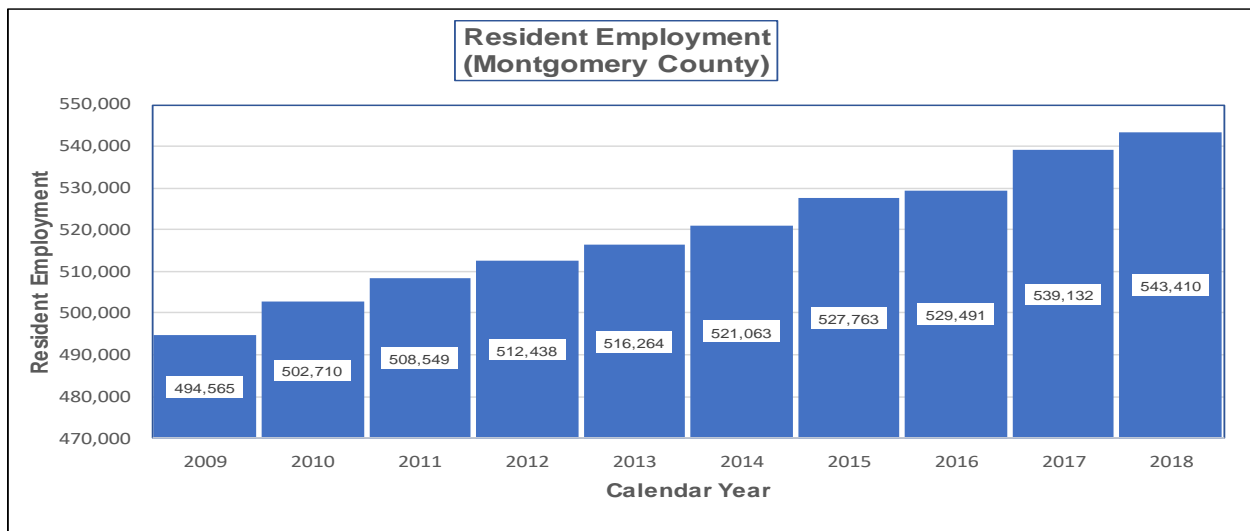
- 9:00 A.M. Introduction, Alexandre Espinosa, Director,
Montgomery County Department of Finance
- 9:05 A.M. Opening Remarks by Marc Elrich, County Executive
- 9:20 A.M. Presentation of Department of Finance economic assumptions
- 9:30 A.M. Presentation by Andrew Schaufele, Director, Bureau of Revenue
Estimates, Comptroller of Maryland
- 10:00 A.M. Roundtable discussion by participants
- 11:30 A.M. Adjournment

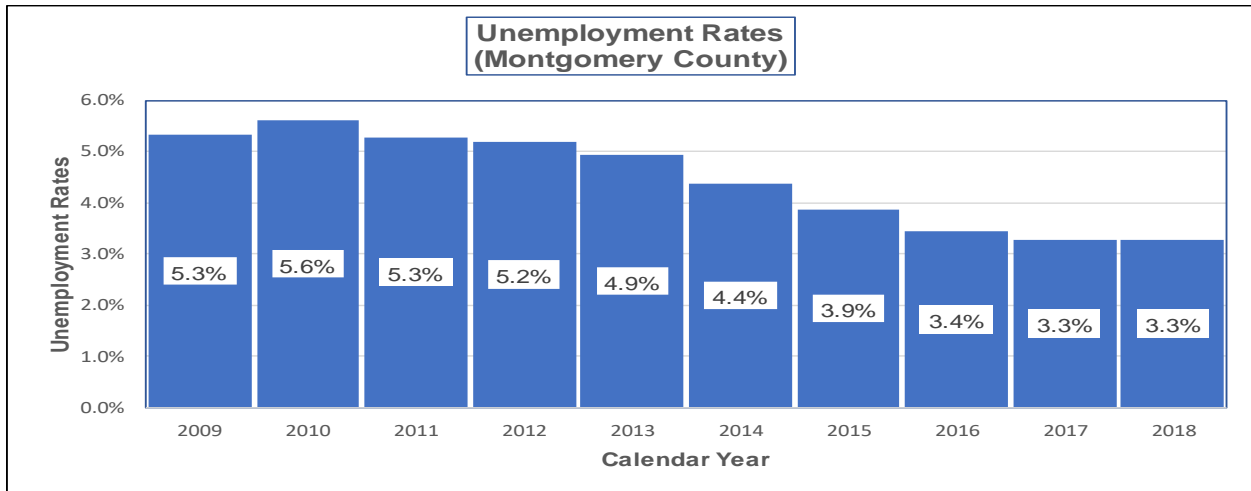
ECONOMIC CONDITIONS AND OUTLOOK

Montgomery County's economy generally experienced positive economic performance during 2018. Some of the areas of strength included an increase in resident employment, a decline in the unemployment rate, an increase in the median sales price for an existing home, an increase in the construction of residential housing, an increase in the added values of new construction for residential and non-residential properties, and a modest increase in retail sales. However, partially offsetting those increases, the County experienced a decline in the number of sales of existing homes.

Employment Situation

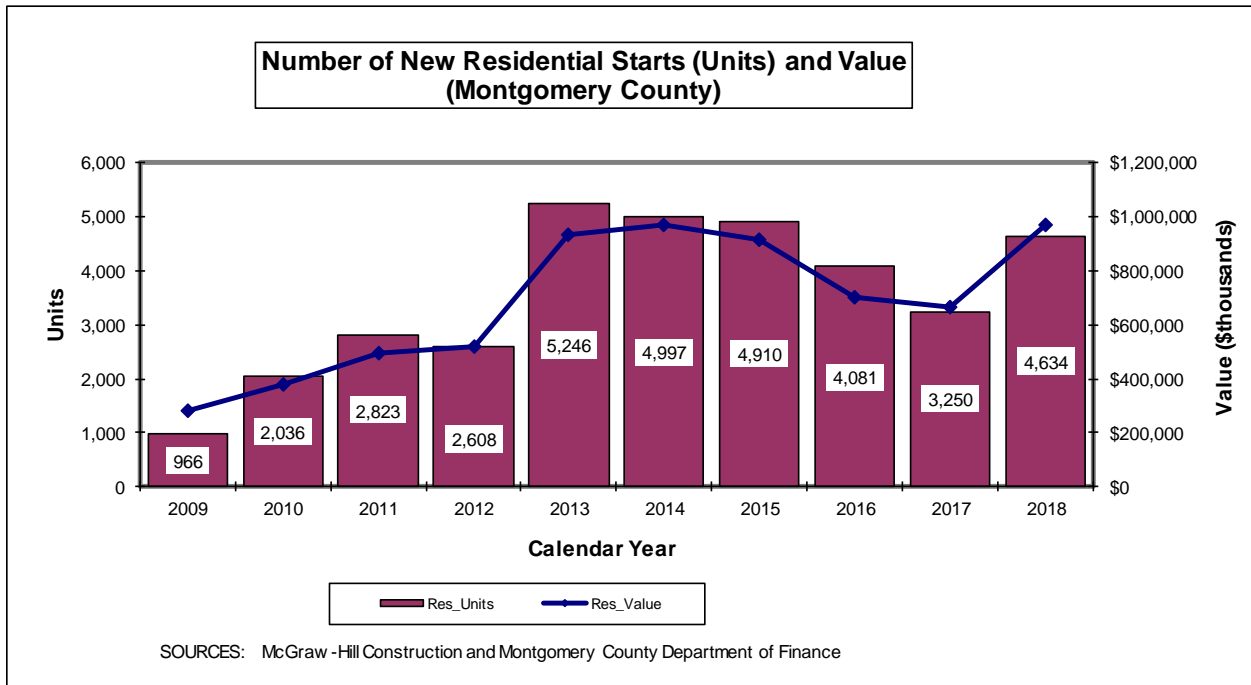
Based on data from the Maryland Department of Labor, Licensing and Regulation (DLLR) and the Bureau of Labor Statistics, U.S. Department of Labor, resident employment (labor force series and not seasonally adjusted) in 2018 increased by nearly 4,300 from 2017 ($\uparrow 0.8\%$). The County's unemployment rate at 3.3 percent was the lowest rate and remained at its lowest level in the past ten years





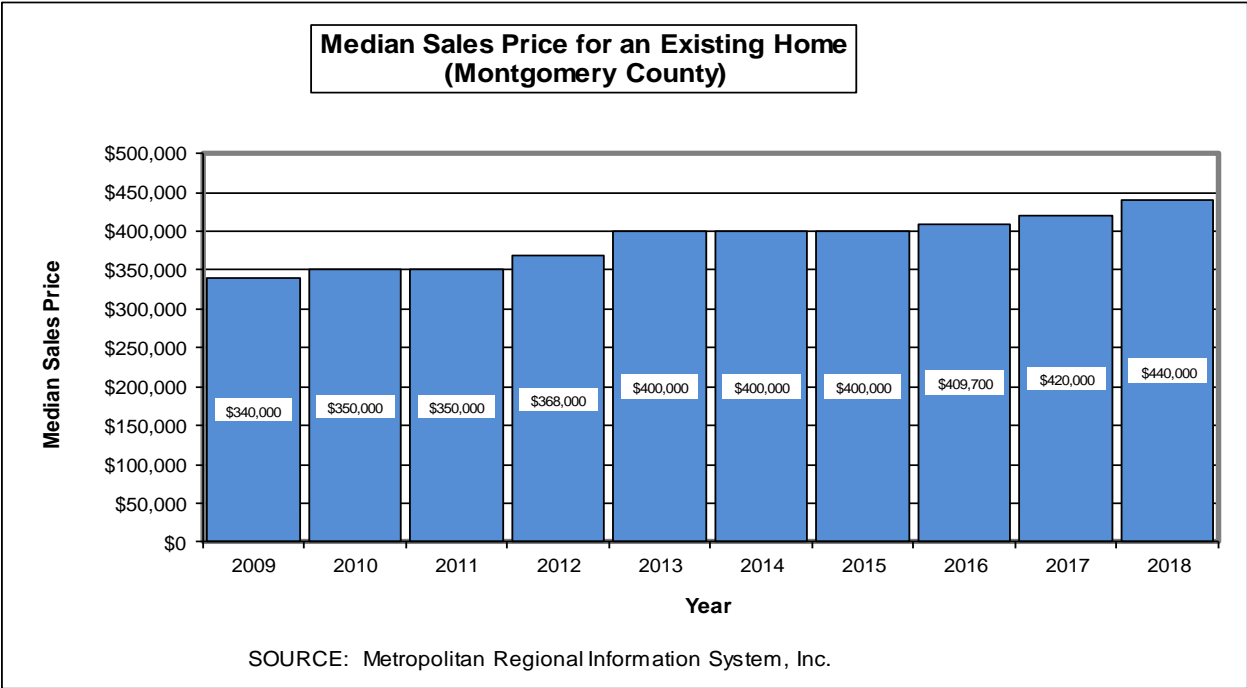
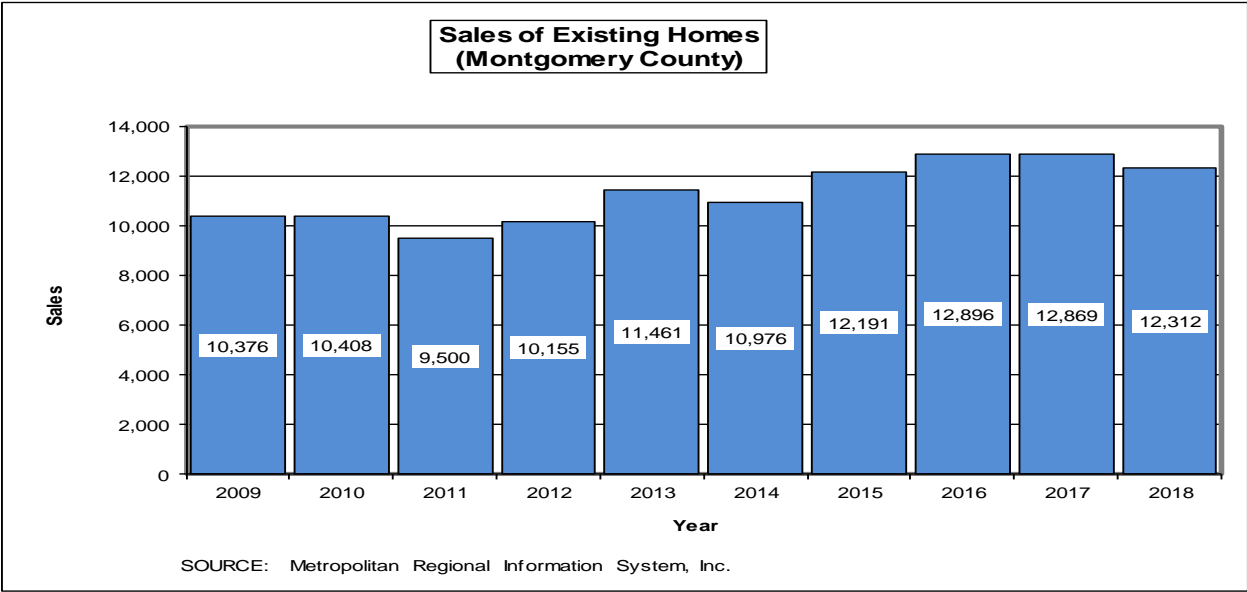
Construction Activity

The construction of new residential units increased nearly 43 percent in 2018 and total value added increased from \$664.7 million in 2017 to \$972.6 million in 2018 (↑46.3%). The total value added from non-residential projects increased from \$965.8 million in 2017 to \$1,581.2 million (↑63.7%).



Residential Real Estate

During calendar year 2018, existing home sales decreased 4.3 percent which followed a modest 0.3 percent decrease in 2017. The median sales price for existing homes increased 4.8 percent in 2018 following an increase of 2.5 percent in 2017.



Retail Sales

Using sales tax receipts as a measure of retail sales activity in the County, retail sales, including assessment collections, increased 0.8 percent in 2018 from 2017. Purchases of nondurable goods, which include food and beverage, apparel, general merchandise, and utilities and transportation, increased a modest 0.1 percent during this period while sales of durable goods were up 2.8 percent. The increase in nondurable goods purchases was solely attributed to the increase in apparel goods (↑4.8%), while the increase in purchases of durable goods was largely

attributed to an increase in automobile sales and products (↑5.7%), and building and industrial supplies (↑3.7%).

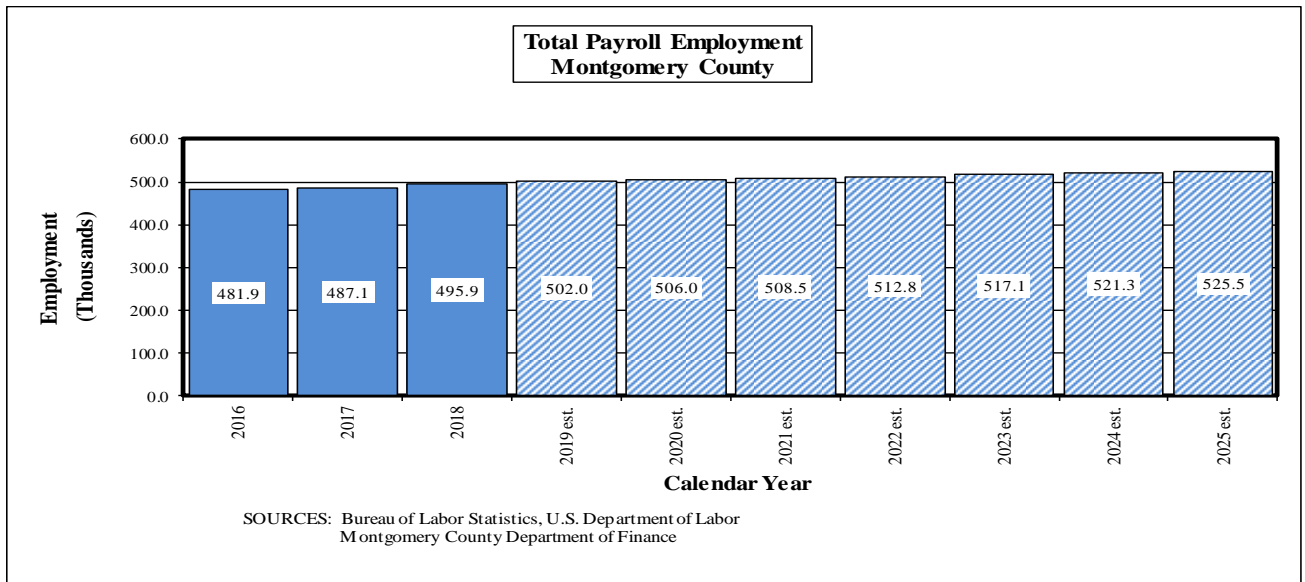
CONCLUSION

The major economic indicators confirm that the County’s economy experienced generally positive performance during 2018. That performance included a strong increase in residential employment, a decline in the unemployment rate, and an increase in the median sales price for an existing home, and increases in added value of new residential and non-residential construction but partially offset by a decline in the number of sales of existing homes.

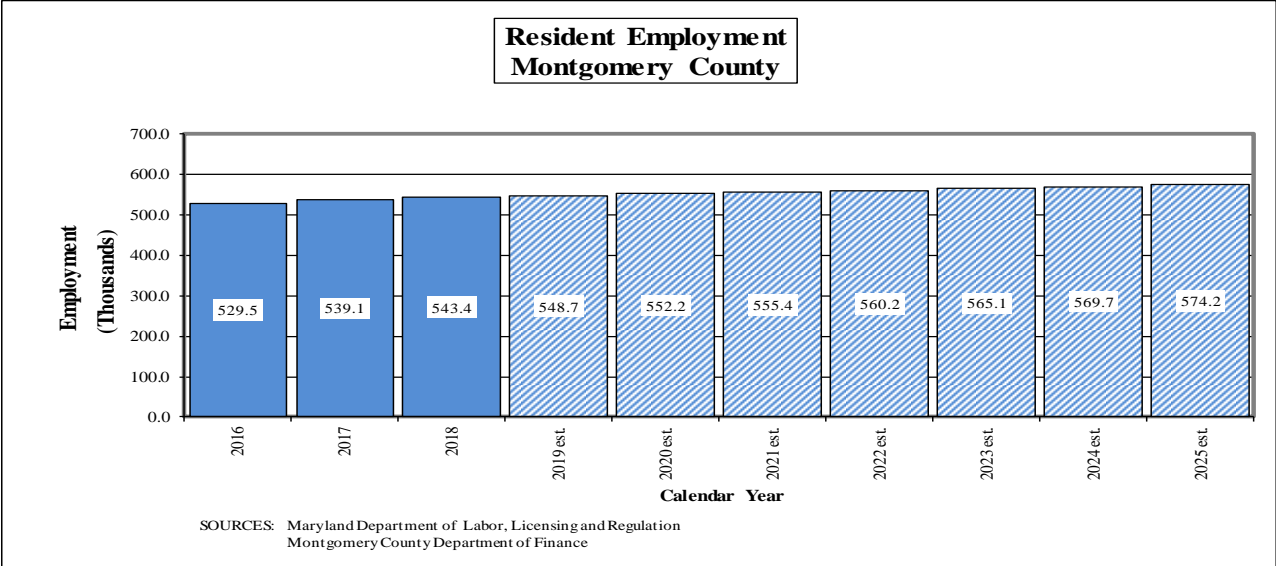
ECONOMIC OUTLOOK

The Department of Finance (Finance) forecasts that Montgomery County’s economy will continue to improve through the next six years.

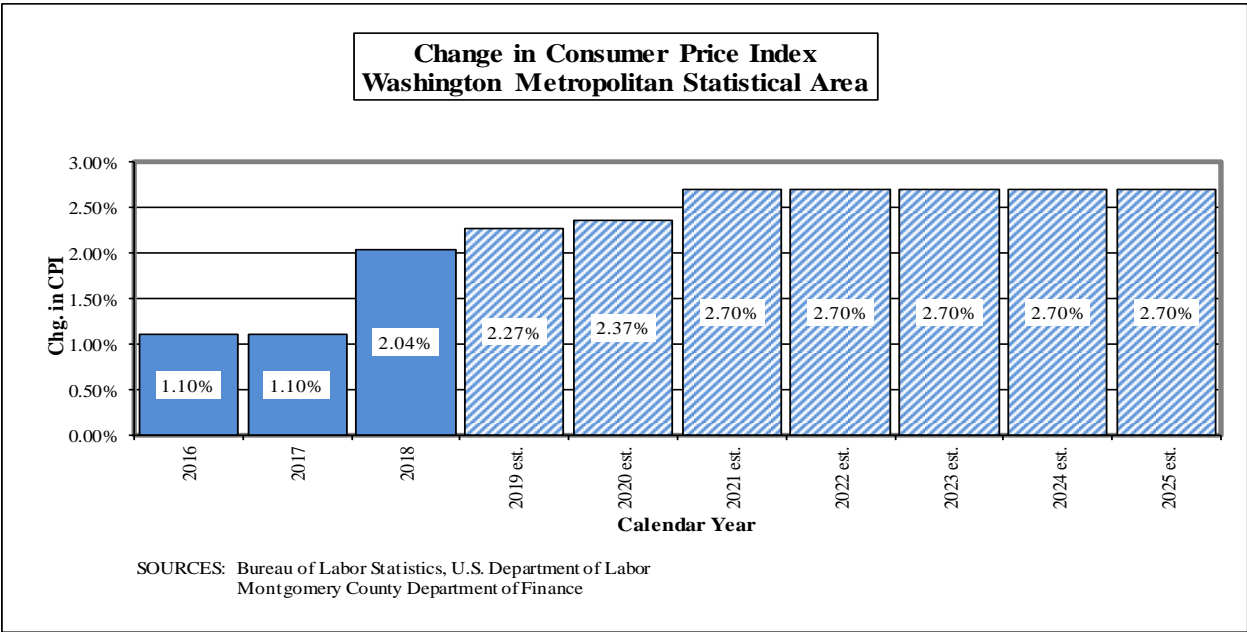
Employment. Finance assumes payroll employment will continue to increase from CY2018 to CY2025 and grow at an average annual rate of 0.8 percent over that period. This is the same average annual growth rate of 0.8 percent experienced between CY2011 and CY2018.



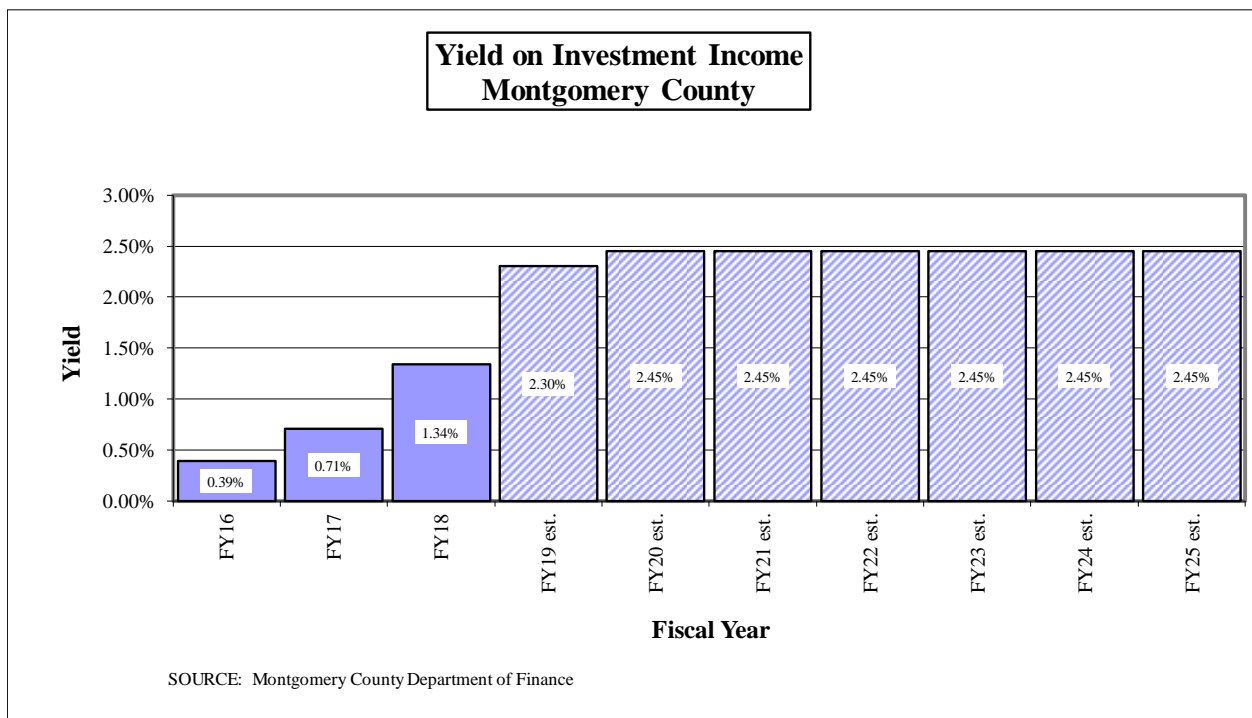
Finance assumes that resident employment will also increase at an average annual rate of 0.8 percent from CY2018 to CY2025. However, that rate is slightly below the average annual rate of 1.0 percent between CY2011 and CY2018.



- Personal Income.** Finance assumes that total personal income in Montgomery County will grow at an average annual rate of 4.1 percent from CY2015 to CY2024. By CY2025, total personal income will reach \$125.4 billion.
- Wage and Salary Income.** Finance assumes that wage and salary income will grow at an average annual rate of 3.6 percent between CY2017 and CY2025. Total wage and salary income are estimated to reach \$50.7 billion by CY2025.
- Inflation (annual average).** Finance assumes that the overall regional inflation index will steadily increase from 2.04 percent in CY2018 to 2.70 percent by CY2025.



- Interest Rates.** The target rates were increased three times in 2017 by 25 basis points to reach 1.25-1.50 by December 2017 and four times in 2018 to reach 2.25-2.50 by December 2018. Since the yield on the County’s short-term investments is highly correlated with the federal funds rate, the County earned an average of 0.39 percent in investment income on its short-term portfolio for fiscal year (FY) 2016, an average of 0.71 percent in FY2017, and an average of 1.34 percent in FY2018 with estimated increases to 2.30 percent for FY2019 and to 2.45 percent by FY2025. This assumption is based on no rate increases in the targeted federal funds rate by the FOMC for the remainder of FY19.



DISCUSSION FRAMEWORK

The economic assumptions provide a framework for the Department of Finance's revenue projections for FY2019 through FY2025. The following issues create the framework for the discussion that is the focus of the Business Advisory Panel. In order to gain a better understanding of the direction of the major industrial sectors in our county and region, it would be helpful if the participants of the Business Advisory Panel comment on our assumptions and discuss the major economic trends in the next six years that affect their industry sector. The following list of items, if applicable to your sector, may be used to focus your discussion:

Risk to the Forecasts (Assumptions)

- Recession Risk in 2020
- Impact of federal government shutdown – both short term and long term
- Federal and state government fiscal policies in response to Tax Cuts and Jobs Act
- Employment, both government and private
- Interest rate policy by FOMC
- Inflation outlook
- Domestic stock market volatility and impact to non-wage income
- Health insurance changes

Income

- Tax Cuts and Jobs Act (H.R. 1)
- Capital gains
- Estimated payments
- Tax Policy Changes: Federal and State
- Demographic Shifts: Aging of the Population and Migration

Real Estate

- Residential construction
- Commercial construction
- Prices/rents
- Vacancy rates and office space
- Loan conditions – residential and commercial sectors
- Affordable housing