State of Maryland
Board of Revenue Estimates
Louis L. Goldstein Treasury Building, P.O. Box 466
Annapolis, Maryland 21404-0466
E-mail: bre@comp.state.md.us

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Minutes of Meeting
September 17, 2009

A meeting of the Board of Revenue Estimates was held in the Assembly Room in the Louis L. Goldstein Treasury Building.

Those present were:

Honorable Peter Franchot, State Comptroller, Chairman
Honorable Nancy K. Kopp, State Treasurer
Secretary T. Eloise Foster, Department of Budget & Management
David F. Roose, Director, Bureau of Revenue Estimates

Those also present were:

Len Foxwell, Chief of Staff
Linda Tanton, Deputy Comptroller
James Arnie, Director, Revenue Administration Division
Sharonne Bonardi, Director, Compliance Division
Bernadette T. Benik, State Treasurer's Office
Mary Christine Jackman, State Treasurer's Office
Melissa Moye, State Treasurer's Office
Marc Nicole, Department of Budget & Management
George Manev, Department of Budget & Management
Senator Ulysses Currie
Theresa Tuznyski, Department of Legislative Services
Carol Novella, Bureau of Revenue Estimates
Andrew Schaufele, Bureau of Revenue Estimates
Matthew Caminiti, Bureau of Revenue Estimates

The meeting was open to the public and members of the media, local government and State officials and other interested parties were in attendance.

Comptroller Peter Franchot called the meeting to order and indicated that Treasurer Kopp was running late due to traffic. Comptroller Franchot recognized Senator Currie who was attending the Board meeting today. The Comptroller also recognized David Roose and the Bureau staff, Revenue Monitoring Committee, and the panel of distinguished business leaders who have joined the meeting today.

Comptroller Franchot commented regarding the revised figures as will be reported by David F. Roose, Executive Secretary, and Board of Revenue Estimates. Comptroller Franchot indicated there is no mystery that David's report will reflect the ongoing, lingering effects of our nation's economic disaster; not one segment of the Maryland economy that was unaffected by the collapse by our nation's housing bubble and the ensuing collapse of the American financial system as we once knew it. There is not one employer in this state that hasn't been affected in some way by the unprecedented loss of homes, jobs, income and wealth, the long range financial security that American people, Maryland citizens have experienced over the last two years. We are going to have a significant another write-down, and yes that does mean more painful and difficult budget cuts on the horizon.

Comptroller Franchot asked Secretary T. Eloise Foster if she had any additional thoughts. Secretary Foster thanked everyone for coming out today and offered a special welcome to the business community for coming out today to update the Board on their outlook as to the status of the economy. Secretary Foster also recognized the members of the Revenue Monitoring committee and their wonderful job under difficult circumstances and publically thanked David Roose and his support from the Comptroller's Office staff, Legislative Services, Treasurer's Office and Budget & Management. "We realize now this is really the worst economic period since the great depression" stated Secretary Foster.

Deputy Treasurer Bernadette Benik spoke for the Treasurer who is delayed due to traffic conditions. Deputy Treasurer Benik thanked the business leaders for taking time out of their schedule to come to the meeting.

Comptroller Franchot turned the meeting over to David Roose to report the September estimates.

"Once again, the Board of Revenue Estimates is meeting to hear bad news. While there has been more discussion in recent days that the nation is likely pulling out of the recession, it will be some time before robust economic growth returns" stated Mr. Roose.

While gross domestic product may show growth in the third quarter, employment and income are likely to remain sluggish well into next year, with the unemployment rate rising above 10%.

While not as hard hit as many other states, Maryland's economy has had its worst period in several decades by some measures, and by others it's approached its worst period in modern economic history.

Official measures of employment show that the State has lost 2% of its jobs, or about 75,000, over the course of the recession.

Official statistics show that personal income increased by 2.2% in the first quarter of 2009, and wage and salary income by just 1.4%.

These are the lowest rates of growth since 1991 for wage and salary income, and since 1958 for total personal income however, the recent release of unemployment insurance data shows that wages actually declined by 2.7% in the first quarter.

This data is one of the major factors in the revision of the official income data, which we will expect will show a decline in the first quarter after revisions.

So overnight, our perception of Maryland's recent economic performance changed dramatically.

The Board is revising its estimate of wage and salary growth from a 0.5% increase in 2009 to a decline of 2.1%; this would be the worst performance in the records, back to 1949 – there have only been two other declines in wage and salary income in the postwar period, in 1954 and 1949.

Similarly, the forecast for total personal income has been revised downward from an increase of 1.3% to a decline of 0.7%; this would be the only decline in total personal income since 1949; the previous low was an increase of just 0.5% in 1954.

Our employment forecast calls for a drop of 2.9% in 2009, followed by a modest drop of 0.4% in 2010 as the expansion struggles to take off. These changes in the economic outlook once again effectively deepen and lengthen the recession and the period before expansion resumes.

The revenue forecast is being revised downward by $683 million in fiscal year 2010. It is important to note that roughly $400 million of this reduction has been expected since early summer. Fiscal year 2009 was roughly $350 million short of the forecast. Carrying that forward, and now expecting a greater impact from the recession, brings us to the $683 million write-down, a decline of 4.5% from 2009 levels.

The income tax forecast is reduced by $480 million; effectively the $304 million shortfall from last year, which came largely from non-wage income being lower than expected and coming into this year, and the forecast decline in wages in calendar year 2009.

Based in part on recent performance, with declines of around 7% the last several months, the sales tax forecast was written down $82 million; we are now expecting a 2.7% decline for the year.

The $16 million increase in the lottery forecast is largely as a result of prize payouts, which were abnormally high last year, coming back to normal levels the underlying sales forecast calls from modest growth of about 2%.

The tobacco tax forecast is reduced by $19 million, partly as a result of the 62 cent increase in the federal tax last April apparently having a larger impact than expected.

Lastly for fiscal year 2010, the interest forecast is being reduced by $35 million due to a continued decline in both interest rates and State balances.

In fiscal year 2011, as the recovery begins, the individual income tax is expected to grow by a modest 3.9%, and the sales tax is forecast to increase by an also modest 3.5%. The 9.3% growth forecast for corporate income tax general fund revenues is solely due to a change in the distribution of collections – roughly $45 million will be distributed to the general fund rather than the higher education investment fund.

Most other revenue sources are expected to grow modestly or decline slightly; the one exception is interest, which is forecast to grow by 28% largely as a result of rising rates. Overall, the general fund is forecast to fall by 4.5% in 2010 and to increase by 3.4% in 2011.

For fiscal year 2010, revenues are expected to fall below fiscal year 2006 levels, and the tepid growth expected in 2011 will leave them below fiscal year 2007 levels. If this forecast is met, 2010 will be only the fourth decline in general fund revenues since 1967; the other three were 2002 and 2003, with a 4.6% and 0.4% drop, last year, which saw the largest decline in Maryland revenues with a 4.9% drop. These are clearly unprecedented times.

Banking and Financial Services

Members of the business community from the Banking and Financial Services spoke on their views of the current economy; William Couper, President, Mid-Atlantic Region, Bank of America, Michael Harreld, President, Greater Washington Region, PNC Bank and Martin Neat, President and CEO, First Shore Federal Savings and Loan Association. Each gave their assessment of the economy.

William Couper

"On September 12, 2008 the S & P 500 closed at 1,251 and closed the following week slightly higher at 1,255 remarkable given what happened during the intervening five business days before dropping like a rock to the ominous 666 in March. We are still nearly 17% below where we were just a year ago. We believe the economy is showing signs of recovery and there is increasing confidence that this is so" stated William Couper.

- Recovery subpar
- Chronic budget deficits
- Lower trends growths
- Higher than normal unemployment
- Borrowers whose mortgages were modified are now falling delinquent due to job loss, etc.
- Rising credit card delinquencies

Treasurer Kopp asked if they actually go back and tie delinquencies with employment. Yes, we have a very elaborate tracking.

Michael Harreld

"Is the worst over?" "Let me remind everybody of the mechanics that happened last year. Most of the residential mortgages that have been made in recent years have been packaged and sold off as securities. When that securities market collapsed and the regulators became very tough on the evaluation on those marketable securities. That caused a loss of $850 billion dollars in capital in the industry. Their tough minded approach, perhaps appropriate, caused a great markdown in those assets.

There are still large books of residential mortgages on the portfolio of banks that are not securitized so the question is, “what happens to those as you get ARMS that are continuing to be reset and as you get evaluations that continue to go down” stated Michael Harreld.

- Residential mortgage issue is still there and particularly big with the community banks
- No securitization of commercial mortgages
- Now bank assets because they can’t be sold
- No longer lender to commercial industry, but partners
- Home equity loans – working capital of middle America
    - ✓ People buy consumer durables with home equity loans
    - ✓ They purchase cars with these loans
    - ✓ Pay for college
    - ✓ Remodel homes
    - ✓ Buy more expensive items
- Credit cards for consumer non durables
- 401K for investments
- Consumers are aggressively paying down their debt

Martin Neat

“First Shore Federal has eight branch offices located on the lower Eastern Shore. We are a traditional savings and loan association, we are a mutual institution and don’t have stock holders, and we still tend to specialize housing finance and federally insured savings products” stated Martin Neat.

- 1600 mortgages, one foreclosure
- Nationally, overall delinquency rate of loans past due by 30 days or more was 8.86% second quarter. That is up 64 basis points from the first quarter
- 4.3% percentage of loans in foreclosure, up almost ½ percent
- Prime fixed rate borrowers made up1/3 of the new foreclosure filings; a year ago they were one in five
- Deposit insurance cost up 400% and earnings are down 25%
- Regulated part of the financial services industry, the part that didn’t create the subprime problems is the easy target
- Equity loans are down about 6%

Residential Real Estate

Comptroller Peter Franchot introduced members of the residential real estate; Michael Owings, Owner and General Manager, Owings Brothers Contracting; Dennis Melby, Long and Foster Real Estate, Greater Capital Area Association of Realtors; Cathy Werner, Broker/Owner, RE/MAX American Dream.

Michael Owings

“We do believe the industry has hit bottom” stated Michael Owings. We felt recovery during the 2nd quarter of this year.

- Six months of inventory which is pretty good
- Very little building going on, everyone is getting rid of existing inventory
- Land developers are looking for valuable deals and replenish inventories; good indicator
- First time homebuyers – 90% of buyers
- Housing prices have leveled off; some areas could see a 6% growth next year
- Up overall in sale price compared to 2008
- We are banking on BRAC; another stimulus adding to our industry
- Lost 3 million construction jobs in the past three years
- Lost 50 – 75% staffing
- 18% of GDP for state
- Credit availability seems to be the real issue for the homebuyers

Dennis Melby

"There are two real estate engines in Maryland that drive the real estate economy; one is Baltimore and the other is the D.C. area" stated Dennis Melby. In real estate there are the best of times and the worst of times except they didn't come at the same time. The best of times was 2005, it was the perfect storm in real estate, and you could sell anything. In 2005 we sold 13,000 single family homes in Montgomery County; by December of 2008 we sold 6,700.

- $500,000 median price 2005, $350,000 median price 2008
- Maryland Association of Realtors had 12.000 members in 2005, in 2009 only 8.000 members
- Brokers have struggled, closed offices in the county
- Settlements up by 18% this year
- Banks selling foreclosed homes
- I think our real estate train in back on track

"Are you in agreements with Mr. Owings, about the impact of the first time homebuyer's tax credit?" asked Comptroller Franchot.

"We feel that was the main reason for the consumer confidence" stated Mr. Melby.

"What do you see in terms of the existing home owners? Are they back out in the market?" asked Secretary T. Eloise Foster.

"The existing home owners have decided that if they can get their prices. If they are in homes purchased around 2005, there homes are upside down right now, that's the problem" stated Mr. Melby.

Cathy A. Werner

"In the past year we have seen jobs, homes, careers gone. We as a company went from three offices, with over 125 realtors to two offices, 50 realtors" stated Cathy Werner. We as a company are back to a 2004 budget.

- $8,000 tax credit is essential; ends in November

- Short Sales are an issue; are like dealing with the wild, wild west**;** each transaction is different
- Foreclosures will continue to flood the market as well as continue to effect home prices
- Over 60% of sales are short sales or foreclosures
- Went from predatory lending to no lending at all

Commercial Real Estate

Comptroller Peter Franchot introduced members of the commercial real estate industry; Richard L. Vogel, Jr., Senior Vice-President, The Whiting-Turner Company; Robert A. Manekin, Senior Vice-President, Manekin, LLC.

Robert A. Manekin

A friend told me to cheer up, things could be worse, I cheered up and sure enough, things got worse. The genesis to the problem we face in the commercial real estate is similar to the sub prime residential problem:

- Poor lending criteria
- Passing along risks
- Cheap money over financing
- Lot cap rates/inflated values

This has been compounded by the poor economy, increased unemployment, excess capacity, increased vacancy rates, negative absorption (more space coming on the market than being taken off the market). The current condition is typified by declining values, flat rentals, tight credit, lack of liquidity, rise of sublet space. Maryland not only surrounds the capital of the free world, it also surrounds the healthiest real estate market in the country, the Washington, D.C. metropolitan area.

- Baltimore region, 46 million sq. ft, Class A – 15% vacant
- Columbia - 16%
- BWI – 18%
- Harford County – 16%
- Absorption – negative
- Opportunities for institutional/government with leased space – 30% cheaper
- D.C. region, 237 million sq. ft, Class A - 12.8%
- MD suburbs – 7.8%
- I 270 corridor – 18%
- No financing for speculative development unless preleasing greater than 50%
- BRAC is more of a stimulus

Richard L. Vogel, Jr.

The Whiting-Turner Company is a Maryland based company with thirty offices nationwide, 5th largest building contractor in the United States.

Celebrating their 100th year in business this year.

- Worst in 37 years
- Projects on hold
- Revenues down 38% from last year
- Whiting – Turner has shifted their work to healthcare, institutional and federal work

Bill Wolfe

Rite Aid is the third largest drug store chain in the country, headquartered in Harrisburg, Pennsylvania. We have seen the economic downturn continuing. Our sales data does not suggest we are in recovery.

- Confidence is low
- Community drug stores run 65 – 70% pharmacy sales
- Front store sales – flat to slightly positive sales, negative and growing
- Consumers buying only what is necessary
- Changing how and where they shop; less expensive brands
- Consumers showing more price sensitivity and awareness
- Less prescriptions being written because of less visits to doctors
- Uncertain what shape recovery will take – some concern about recent consumer behavior becoming permanent
- Uncertainty over impact and direction of health care reform
- Mail order is a problem
- Expansion plans scaled back

Chuck Ferrar

Family run business; fortunate to be in Annapolis. Industry is discretionary.

- Business is flat
- Customers trading down, looking for value
- Twice as many items purchased on sale – 8% compared to 4% last year

Peter Kitzmiller

Mr. Kitzmiller gave everyone an overview of the new car market for 2009 and where do we think it is going to go in the year 2010.

- 2009 sales off about 19% - worse year since 1940. Maryland worse than national market
- 2010 – expecting sales to be up about 11%, not much considering 2009 numbers
- Expect to sell 180,000 new cars in 2010; 160,000 for 2009; 250,000 cars sold in 2007

- Believe there is a significant amount of pent up demand, but will take awhile
- 340 new car and truck dealers; lost around 40 new car dealers; one of two was a big shift
- Cash for Clunkers – disastrous success; one stimulus program that worked exactly the way they wanted it to work; $4,000 average credit; dealers in Maryland submitted about $80 million to the government; reimbursement is extremely slow but dealers are expected to be reimbursed by the end of the month
- Lost about forty Chrysler and General Motors dealers in the state

Pat Donovan

Solomon's Island is basically a destination a lot of people come to. We have seen tourist revenues down 25 – 30% this past season. Less people have come to Solomon's Island historically in April; each year it grows approximately 10% each year. This year about the same as last year. Staff has gone from 64 to 45 this year.

The Comptroller thanked everyone for attending today's meeting and asked if anyone had any questions.

The Treasurer asked Bill Wolfe from the Rite Aid Corporation if mail order pharmaceutical sales have hurt his business.

"That is a significant issue" stated Mr. Wolfe. Mail order obviously operates in terms much more efficient model, in terms of large automated dispensing with considerably less staff and without the face to face with the pharmacists. Retail operating costs are different; mail order delivers a lower cost for the employer and we still see more of a push with that regards.

The Comptroller made a motion to adopt the fiscal year 2010 revenue estimates; Treasurer Kopp seconded the motion; all in favor.

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