County of Fairfax, Virginia

# Financial Forecast

This section includes:



FY 2009

Advertised Budget Plan

# Financial Forecast Summary

The following forecast provides preliminary revenue and disbursement projections for FY 2010 through FY 2012. The forecast assumes no change in the Real Estate Tax rate of $0.89 per $100 of assessed value. Economic assumptions used to develop the forecast are detailed below. The current forecast projects that County General Fund revenue in 2010 will experience no growth over FY 2009. Revenue growth is projected to rise less than 1 percent in FY 2011 and less than 2.0 percent in FY 2012. These modest rates of growth are due to continued decline in residential real estate property assessments in FY 2010 and FY 2011 and no change in residential values in FY 2012. Excluding Real Estate Tax revenue, all other categories are anticipated to increase 1.0 percent in FY 2010, 1.9 percent in FY 2011 and 2.2 percent in FY 2012.

Assuming funding for basic compensation and inflationary adjustments as well as support of County obligations in debt service, Metro and other transfers, County disbursements are anticipated to require funding increases of 4 to 5 percent annually. As a result, without changes in spending and/or revenue enhancements, this forecast indicates that shortfalls of $200 million would occur in each year.

# Revenue Forecast

### *Overall Economic Assumptions*

There is much uncertainty regarding the length and extent of the current economic downturn. National economic growth in the fourth quarter of 2007 was the weakest since 2002. The decline in the economy is deepening and the odds of a recession are increasing. Because Real Estate Tax revenue comprises 60 percent of total County General Fund revenues and residential real estate makes up nearly three quarters of the total real estate base, assumptions as to when the housing market and general economy turn around is critical to this forecast. Economic projections for the national and local economies were reviewed from a variety of sources in the development of these revenue estimates such as the Blue Chip Economic Forecasts that incorporates economic projections from a panel of approximately 50 forecasters, Kiplinger, Global Insight, National City and the National Association of Realtors. Fairfax County specific projections are obtained from Moody's Economy.com and George Mason University's Center for Regional Analysis.

Moody's Economy.com predicts that Fairfax County's economy will be at a standstill in 2008 and experience modest growth in 2009 through 2012. Dr. Stephen Fuller from the Center for Regional Analysis forecasts that the County's economy will expand in 2008 albeit at the slowest pace since 2002. Fuller predicts moderate growth through the remainder of the forecast period. Job growth is expected to slow considerably in 2008 on the national and local level. Economy.com predicts a slight job loss in Fairfax County in 2008 and a slight employment gain in 2009. Job growth is projected to be strong in 2010 as the economy improves and proposed facility changes from Base Realignment and Closure (BRAC) should be well underway. In August 2007, the Army signed a decision that authorizes more than 4,200 jobs at Fort Belvoir and 8,500 at the Engineering Proving Ground by 2011.

### *Residential Housing Market*

The slowdown in the County's residential housing market which began in mid-2006 worsened in 2007. The number of homes sold dropped to under 14,000 from 16,314 in 2006. Based on preliminary Metropolitan Regional Information System (MRIS) data, the overall average sales price is expect to fall approximately 1.0 from 2006. While this data provides a gauge of the housing market, changes in the average price are affected by the mix of homes sold in a particular month. Another measure of the housing market indicates a steeper decline for the area. The November 2007 S&P Case-Shiller Home Price Index for the Washington Area shows a decline in the prices for existing single family homes of nearly 8 percent compared to November 2006. This index uses a repeat sales price technique that matches each price change of the same home over a 20-year period.

The number of homes for sale stabilized in 2007. On average, there were approximately 7,300 homes for sale each month of 2006 and 2007. This level represents over twice as many homes for sale compared to 2005. As of year-end 2007, there was estimated to be an 8-month supply of homes on the market While the number of homes on the market leveled off, the time it took to sell a home was higher in each month of 2007 compared to the same month of 2006. In December 2007, a home in Fairfax County was on the market an average of 112 days according to MRIS, compared to 97 days in December 2006 and to just 38 days in December 2005.

A record 4,527 homes were foreclosed in Fairfax County in CY 2007, up from just 198 properties in 2005 and nearly eight times the number foreclosed in 2006. Based on market activity in 2007, residential assessments fell 3.38 percent in FY 2009. Foreclosures were not a dominate factor in the market in 2007 but have become a larger share of total homes sold. During the first quarter of 2007, foreclosures comprised just 9.5 percent of total homes sold, but by the fourth quarter of 2007 foreclosures made up nearly 42 percent of homes sold in the County. Consequently, distress sales and foreclosures will have a greater impact on residential assessments beginning in FY 2010 and potentially lingering in FY 2011. As such, this forecast includes a projected drop of 4.0 percent in the value of residential property in FY 2010 and a further decline of 2.0 percent in FY 2011. Assessments are projected to stabilize in FY 2012. Mortgage interest rates are expected to remain relatively low on a historical basis throughout the forecast period and are not expected to affect the affordability of homes.

### *Nonresidential Real Estate*

The nonresidential real estate market began to soften in 2007. Leasing activity during the first six months of 2007 in Fairfax County was down 26 percent compared to the first six months of 2006. Nearly 1.6 million square feet of office space was delivered in the first half of 2007 bringing the total County inventory to 106.3 million square feet. Due to the additional office space, the County's direct office vacancy rose from the year-end 2006 rate of 7.7 percent to 8.5 percent at mid-year 2007. Including sublet space, the mid-year 2007 overall office vacancy rate was 10.2 percent, up 1 percentage point over the 9.2 percent at year-end 2006. An additional 4.7 million square feet of new space in 25 buildings was under construction at mid-year 2007 and the office vacancy rate is likely to rise further as this space comes on-line. According to the Economic Development Authority (EDA), 18 of the 25 buildings under construction were 100 percent speculative. EDA anticipates that new building starts will be limited to build-to-suit, or pre-leased projected until most of the current speculative building is absorbed. A rise in vacancy rates and an abundance of office space in Fairfax County and the Northern Virginia area will slow the growth in nonresidential property values over the forecast period. Nonresidential values are projected to increase 4.75 percent in FY 2010, down from 7.00 in FY 2009. Nonresidential values are expected to advance at a 3.00 percent pace in FY 2011 and FY 2012.

### *New Construction*

The Real Estate Tax base will also be impacted by new construction in the County. Normal Growth or new construction increased the tax base by 1.53 percent in FY 2009. Building permits issued, an indicator of future construction, have declined over 30 percent during the last six months compared to the same time the prior year. Residential construction is projected to slow during the forecast period resulting from low demand based on declining job growth and the current oversupply of homes on the market. There are 14 office buildings that are scheduled to be completed in calendar year 2008 affecting the nonresidential growth component of the FY 2010 real estate base. Office construction has already slowed and nonresidential growth is projected to be lower in FY 2011 and FY 2012. Just four office projects broke ground in the first six months of 2007 with completion expected in 2009 (FY 2011). Overall, increases to the Real Estate Tax base due to new construction are projected to be 1.0 percent in FY 2010 and 0.90 percent in FY 2011 and FY 2012.

### *Total Real Estate*

In FY 2009, the total Real Estate Tax base rose by a modest 0.51 percent as the increases in nonresidential property values and the impact of new construction more than made up for the decrease in residential property values. In FY 2010, the total Real Estate Tax base is expected to decline 0.80 percent as more moderate increases in nonresidential property values and new construction will be unable to offset the projected decline in residential property values. The real estate base is anticipated to rise a slight 0.20 percent in FY 2011. As the housing market stabilizes, the overall real estate tax base is projected to rise 1.75 percent in FY 2012.

### *Personal Property Taxes*

Personal Property Tax revenue, which represents 15.6 percent of total General Fund revenue, is anticipated to experience a drop of 0.29 percent in FY 2009 primarily due to a decline in vehicle purchases The Virginia Automobile Dealers Association reported that new model vehicle registrations in Fairfax County fell 8.8 percent in 2007. Consumers are less able to finance vehicles with home equity lines of credit or mortgage refinancing due to the housing downturn. Nationwide, fewer vehicle sales are projected for calendar year 2008 by the Blue Chip Economic Forecast. In addition, the National Association of Automobile Dealers' economist, Paul Taylor has indicated that Northern Virginia could see a drop of 1 percent in vehicle sales in calendar year 2008 which will impact FY 2010 receipts. Personal Property Tax revenues are expected to decline 0.5 percent in FY 2010. As the economy improves, slight growth is anticipated in FY 2011 of 0.75 percent and 1.50 percent in FY 2012.

### *Other Major Revenue Categories*

Business, Professional and Occupational License revenue is projected to increase 4.5 percent in FY 2009 and FY 2010. Growth in FY 2011 is expected to rise to 5.0 percent based on employment growth during calendar year 2010 and remain at 5.0 percent in FY 2012. Sales Tax receipts are projected to rise 3.0 percent each year of the forecast based on Economy.com's estimated growth in Fairfax County retail sales. Recordation and Deed of Conveyance taxes, which are paid for recording deeds are anticipated to fall over 20 percent in FY 2008. The FY 2009 estimate is maintained at this level. Lower sales prices expected in FY 2009 are projected to be offset with an increase in the number of homes sold and an up-tick in refinancing. The revenue in these categories is expected to remain at this level for the remainder of the forecast period.

Revenue from Land Development Services Building and Permit fee revenue is projected to fall over 20 percent in FY 2008 based on current collection trends. Construction activity is anticipated to decline in FY 2009, and revenue is projected to decrease 1.0 percent. Construction activity and revenue are forecasted to stabilize in FY 2010 and rise a modest 1.0 percent in FY 2011 and FY 2012. Other Permit and Fees and Regulatory Licenses categories are expected to experience modest growth throughout the forecast period.

Interest earned on investments is expected to decrease in FY 2010 based on a forecast of continued Federal Reserve cuts in interest rates. After a reduction of 1.25 percent in January 2008, the federal funds rate stands at 3.0 percent. Most economists expect that the rate will be cut in March by 25 to 50 basis points County investments are projected to earn an average annual yield of 2.00 percent in FY 2010. As the economy begins to expand, the Fed is expected to gradually raise interest rates to keep inflation low. This forecast predicts that the yield earned on investments will increase to 2.50 and 2.75 percent in FY 2011 and FY 2012, respectively.

Due to project budget shortfalls, the Commonwealth of Virginia reduced funding to localities in FY 2008. The County's funding was decreased approximately $1.6 million in FY 2008 from the Commonwealth's earlier estimates. Revenue included in the <u>FY 2009 Advertised Budget Plan</u> and throughout this forecast maintains revenue at the reduced FY 2008 level. The elimination of ABC profits to localities, representing a reduction of $0.5 million in FY 2009, is also continued through FY 2012. Revenue from the Federal government is also expected to remain level with FY 2009 throughout the forecast period. Since the majority of the revenue from the state and federal governments are reimbursements associated with expenditure requirements, any additional increase in revenue is expected to be more than offset with expenditure increases. There are several downside risks to this projection. The Commonwealth's budget situation is expected to worsen and additional locality cuts may be required. Also, the spending priorities of a new federal administration beginning in 2009 may impact Fairfax County's funding directly and indirectly through federal procurement spending.

Based on the assumptions and estimates detailed above, General Fund revenues are projected to experience no increase in FY 2010 and rise just 0.86 percent in FY 2011. As the housing market stabilizes in calendar year 2010, FY 2012 receipts are expected to rise 1.9 percent. Revenue growth rates for individual categories are shown in the following table:

## PROJECTED REVENUE GROWTH RATES

| Category | FY 2008 | FY 2009 | FY 2010 | FY 2011 | FY 2012 |
|---|---|---|---|---|---|
| Real Estate Tax - Assessment Base | 4.15% | 0.51% | -0.80% | 0.20% | 1.75% |
| Equalization | 2.47% | -1.02% | -1.80% | -0.70% | 0.85% |
| Residential | -0.33% | -3.38% | -4.00% | -2.00% | 0.00% |
| Nonresidential | 13.57% | 7.00% | 4.75% | 3.00% | 3.00% |
| Normal Growth | 1.68% | 1.53% | 1.00% | 0.90% | 0.90% |
| Personal Property Tax - Current[1] | -0.41% | -0.29% | -0.50% | 0.75% | 1.50% |
| Local Sales Tax | 3.09% | 4.00% | 3.00% | 3.00% | 3.00% |
| Business, Professional and Occupational, License (BPOL) Taxes | 4.80% | 4.50% | 4.50% | 5.00% | 5.00% |
| Recordation/Deed of Conveyance | -20.10% | 0.00% | 0.00% | 0.00% | 0.00% |
| Interest Rate Earned on Investments | 4.53% | 3.68% | 2.00% | 2.50% | 2.75% |
| Building Plan and Permit Fees | -12.15% | -1.00% | 0.00% | 1.00% | 1.00% |
| Charges for Services | -0.15% | 7.70% | 2.00% | 2.00% | 2.00% |
| State/Federal Revenue[1] | -9.02% | 0.25% | 0.00% | 0.00% | 0.00% |
| **TOTAL REVENUE** | **1.41%** | **0.45%** | **0.00%** | **0.86%** | **1.94%** |

[1] The portion of the Personal Property Tax reimbursed by the Commonwealth as a result of the Personal Property Tax Relief Act of 1998 is included in the Personal Property Tax category for the purpose of discussion in this section.

## Disbursement Forecast

Anticipated growth in expenditure requirements will exceed revenue projections during the forecast period. Inflationary pressures alone are expected to outstrip revenue growth projections in FY 2010 through FY 2012. Rising health care and energy costs are expected to further strain the County's budget. Budgetary measures will be necessary in order to fund these and other basic costs of operating County government such as pay for performance for employees, market rate adjustments for contractors, and required contributions for retirement. Based on requirements for basic operations including but not limited to compensation and benefits, contract inflationary adjustments, fuel, utilities, and debt service the forecasted disbursement increase for FY 2010 is between 4 and 5 percent. In addition, based on requirements for School operations the transfer to Schools is also forecasted to increase between 4 and 5 percent in FY 2010. The annual increase of 4 to 5 percent for disbursements in combination with the need to fund recurring offsets to the approximately $51 million in one-time reserves utilized to balance the FY 2009 budget and the projected flattening of the revenue stream, results in a forecasted shortfall for FY 2010 of over $200 million. The projected shortfalls in FY 2011 and FY 2012 are also projected to be approximately $200 million based on expenditure requirements and projected revenue growth.