Economic Background: Short Term and Long Term Issues

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Context: Economic Crisis

- Local economic conditions are bad and getting worse
- Early stages of the worst economic downturn since the Great Depression
- Significant negative impacts on the City Budget continuing through FY2012
- Weakening revenue base and increasing contractual or mandated expenditures limit Mayor and City Council’s discretion over service delivery

- Emphasis – Multi-year problem
Impacts on City’s Finances

- Without significant, painful and very difficult actions the gap between expenditures and revenues will continue to grow
- Mayor and City Council must make more difficult decisions than any Council since the 1930s
- Declining Property Taxes
  - Local housing market now impacting tax rolls
- Declining Sales Taxes
  - Very low consumer confidence
  - Retail contraction
  - Increasing unemployment
  - Deleveraging and Deflation
City Financial Challenges

- Higher pension costs
- Weakening cash position
  - New limits on capital project funding
- Borrowing difficult for both public and private development projects
  - Credit crisis continues
  - Higher interest rates, higher equity requirements
  - Virtually impossible to finance projects dependent on development to generate revenue for debt service
    - Particularly housing and retail in Sacramento Region
2009 Regional Forecast

- Local recession began 2\textsuperscript{nd} Quarter 2007
- Will continue to late 2009 or early 2010
- No recovery in real estate market
  - Mid-2010 best case scenario
  - Tax roll impact in FY2012
- Rising unemployment reaching 10\%+
- Retail contraction
Property Tax Growth 1981-2011

- Historical
- Average
- Projected
Projected Vs. Actual Sales Tax Revenue
Rapid Declines in Household Wealth…

Driving by Plunging Real Estate Values and Investment Losses…

…As Consumers Grapple With Significant Accumulated Debt

**U.S. household wealth fell by a record ~$3 trillion in Q3’08**

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**Key Components of Decline in Household Wealth in Q3’08 ($ in billions)**

- **Equity Inv.**: $594 billion (35%)
- **Mutual Funds**: $574 billion (22%)
- **Pension Fund Reserves**: $597 billion (22%)
- **Real Estate**: $574 billion (21%)

**Household Debt as % of GDP**

- 1980: 48%
- 1990: 62%
- 2000: 70%
- 3Q08: 97%
- 2010E: ~75%

Source: GS Research, Federal Reserve

¹ Dollar amounts represent declines in market value since Q2’08.
Deleveraging and Deflation

- Paying down of debt reduces funding for investment, production or consumption
- Deflationary cycle - a real threat
  - Consumers hold back in environment of lowering prices
  - Prices are further lowered and production slows
  - Employment and wages fall continuing the cycle
  - Bottoming out of American economy in Great Depression happened in early 1933, well after the October 1929 stock market crash
Pension Cost Increases

- Pension costs will increase significantly in FY2011 and FY2012
- Catastrophic declines in investment markets have reduced pension fund assets
  - CalPERS (23.06%)
  - SCERS (19.43%)
  - STRS (21.29%)
- Employers must make up unfunded liabilities
- Costs in tens of millions
  - Depends investment performance through end of fiscal year
Weakening Cash Position

- Cash holdings are declining
  - Use of bond proceeds
  - Use of reserves accumulated for capital projects
  - On-going spending in excess of on-going revenues depletes reserves and fund balances

- Cash position still solid
  - Must be more mindful of impacts on cash holdings in capital project planning
  - City must be very careful in advancing funding of State Bond or outside sources projects due to uncertain timing of reimbursement
Economic Stimulus

- Federal economic stimulus proposals
  - May fund important infrastructure projects and provide some employment
  - Marginal impact, on the City’s budget position
- Stimulus and impact on local $140 billion economy will be insignificant
Conclusion

- Unprecedented budgetary and economic challenges
- Bad local economic conditions will worsen
- Recession will last through the end of 2009 under best case scenarios
- Crisis conditions demand crisis actions