

# Economic Background: Short Term and Long Term Issues

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# Context: Economic Crisis

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- 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

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- 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

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- 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



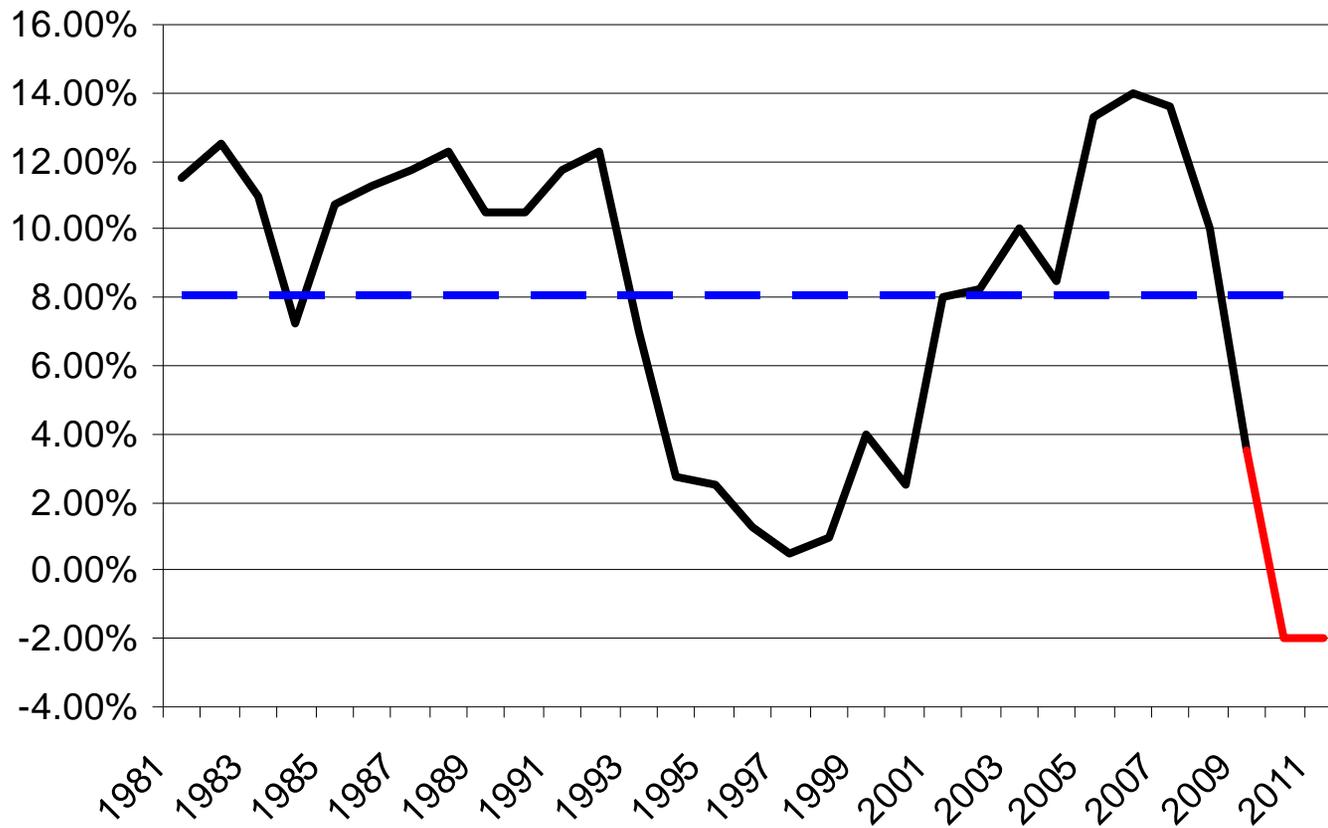
# 2009 Regional Forecast

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- Local recession began 2<sup>nd</sup> 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

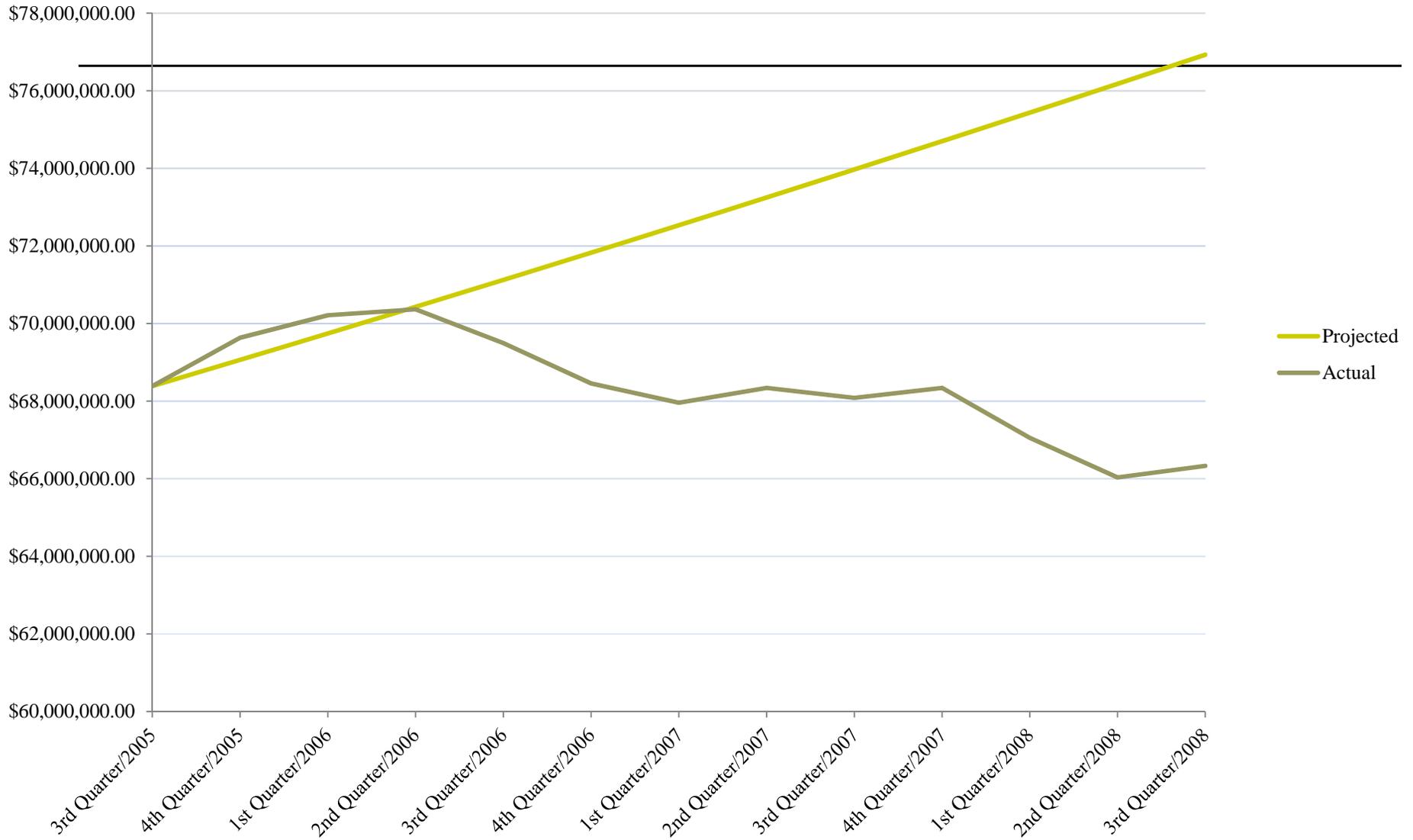
# Property Tax Growth 1981-2011

— Historical    - - - Average    — Projected





## Projected Vs. Actual Sales Tax Revenue



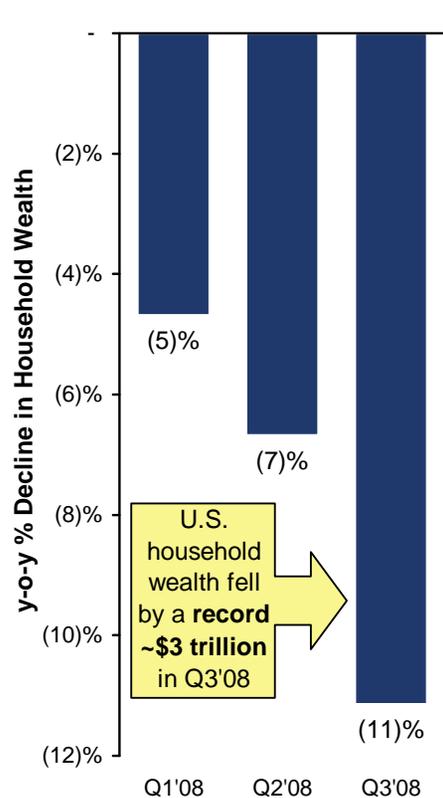
# National Economic Outlook

## A Year of Consumer Deleveraging

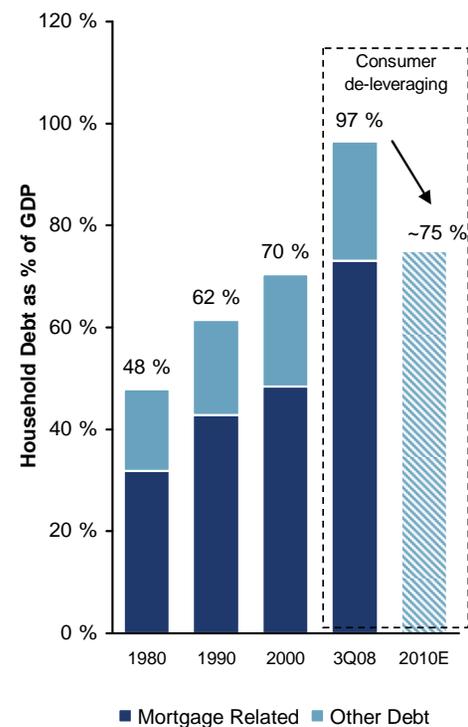
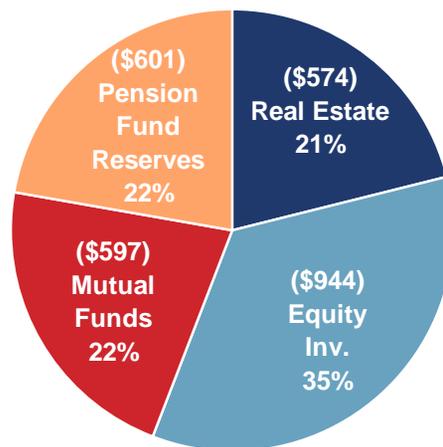
Rapid Declines in Household Wealth...

...Driven by Plummeting Real Estate Values and Investment Losses...

...As Consumers Grapple With Significant Accumulated Debt



Key Components of Decline in Household Wealth in Q3'08 (\$ in billions)<sup>1</sup>



Source: GS Research, Federal Reserve

<sup>1</sup> Dollar amounts represent declines in market value since Q2'08.



# Deleveraging and Deflation

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- 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

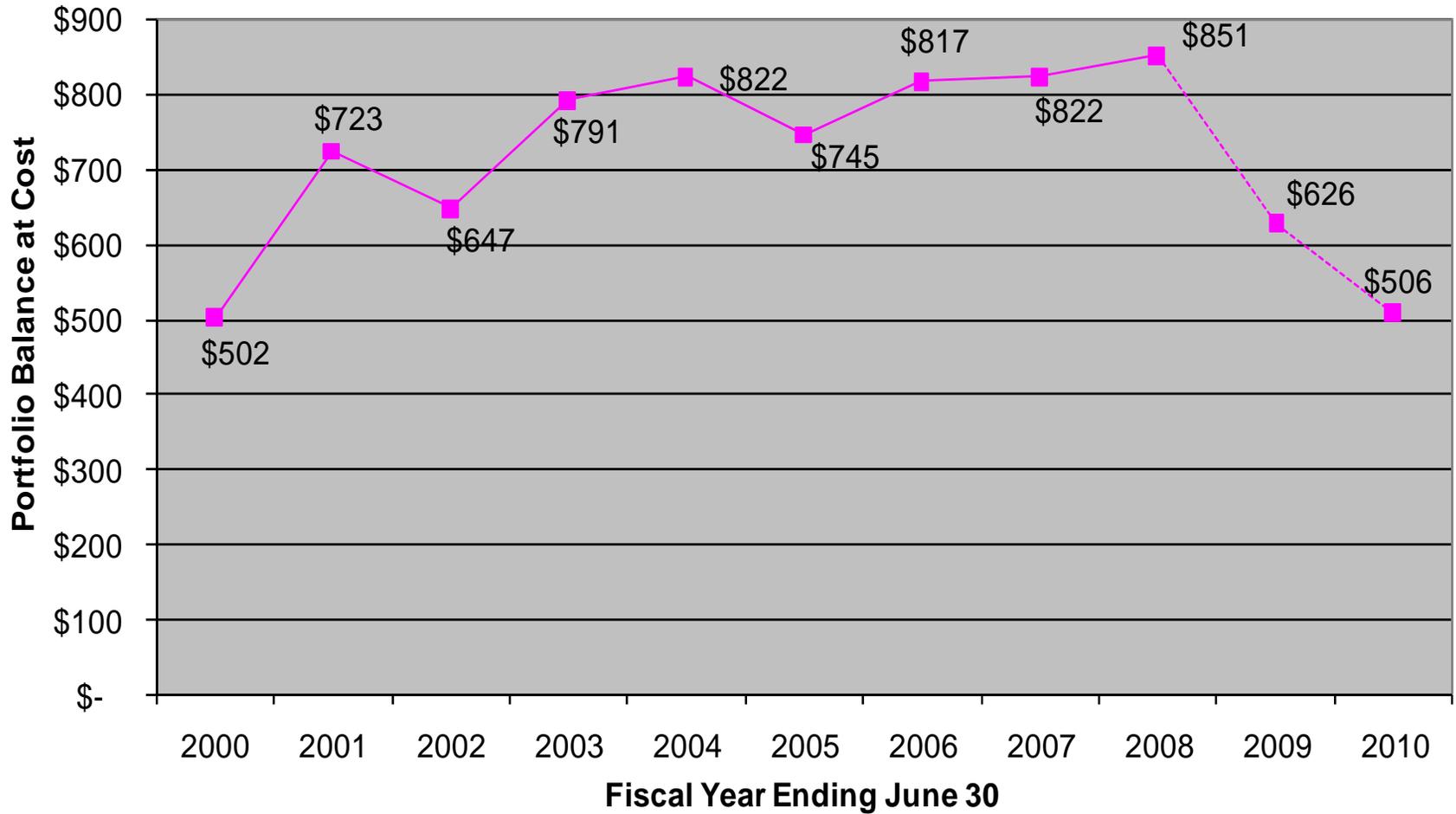


# Pension Cost Increases

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- 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

### City Investment Pool A Cash Position (in Millions)





# Weakening Cash Position

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- 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

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- 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

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- ❑ 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