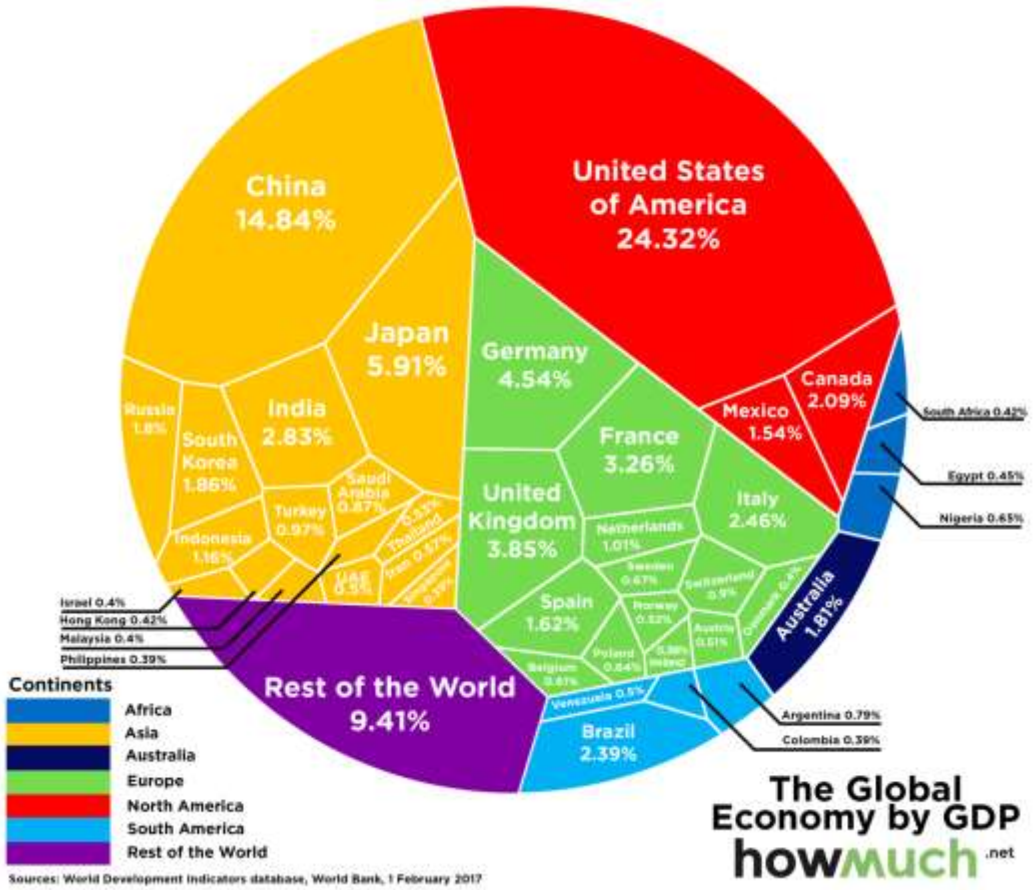
Economic Outlook

REMAINDER OF FY2018-19 &

FISCAL YEAR 2019-20

Why is the economic outlook important?



World economies are so much more interdependent now than in any of our memories.

- The chart at left is current, with US GDP at 24.3% of worldwide GDP.
- In 1998, US GDP stood at 29.0%.
- In 1968, it was 37.3%.

It is important to understand the trends that are beyond our control ***so that we can better shape policy that is within our control*** to deal more effectively with our environment.

US economy

Home Price Growth Downturn
U.S. Leading Home Price Index Growth (%)
Trade Protectionism and Its Methods with Examples, Pros, and Cons
Why Protectionism Feels So Good, But Is So Wrong
Trade Protectionism and Its Methods
Will the Flattening Yield Curve Lead to Recession?
IMF Downgrades Outlook for World Economy to 3.7 Percent Growth

State Level: Standard & Poor's Market Intelligence

A September 2018 report from S&P Global that focused upon ***state-level governments*** makes four main points.

1. "A majority of states have insufficient reserve balances to weather the first-year effects of a moderately severe recession."
2. "Still, most have an adequate capacity to make 'fiscal adjustments' in response to a downturn."
   - i.e., rate increases,
   - RIFs, hiring freezes, etc.
   - Remember that advance refundings to reduce debt service are gone.
3. "Expansion of economic growth in 2018 has reduced the likelihood of a recession in the next 12 months."
4. "Evaluating fiscal strength now is relevant because *larger federal deficits and a still-low fed funds rate imply there could be less counter-cyclical support in the next downturn*."

(Published Sep. 18, 2018)

Local Governments

"These trends come at a time when cities have not yet regained losses from the Great Recession and face uncertainty from federal and state partners. Despite these challenges, cities continue to balance their budgets, remain resilient and serve as engines of national economic growth."

General fund expenditures are outpacing revenues, a trend anticipated to continue into next year. Although revenues are not in decline, they grew only 1.25 percent in FY 2017, and are expected to stagnate in FY 2018. Expenditures grew 2.16 percent in FY 2017, with growth for FY 2018 budgeted at 1.97 percent.

All major tax sources grew slower in FY 2017 than in FY 2016, and all are expected to grow less than one percent in FY 2018. In FY 2017:

- Property tax revenues grew 2.6 percent, compared to 4.3 percent in FY 2016
- Sales tax revenues grew 1.8 percent, compared to 3.7 percent in FY 2016
- Income tax revenues grew 1.3 percent, compared to 2.4 percent in FY 2016

Cities continue to rely on the same revenue generating actions as they have in the past, namely increasing service fee prices (41%) and property tax rates (28%). This year, fewer cities are instituting new types of fees (18 percent this year versus 26 percent last year).

Employee wages (88%), public safety (78%) and infrastructure (71%) are the most common areas for which cities increased spending. Fewer cities this year are contracting or privatizing city services and more are increasing spending on personnel and workforce expansion.

By and large, it is too soon to tell specifically how provisions of the Federal Tax Cuts and Jobs Act of 2017 will impact city finances, except for advance refunding bonds. Thirty-five percent of city finance officers are already seeing negative fiscal impacts associated with the elimination of tax-exempt advance refunding bonds. Sixty one percent report that the loss of this fiscal tool will have negative impacts on future fiscal health.

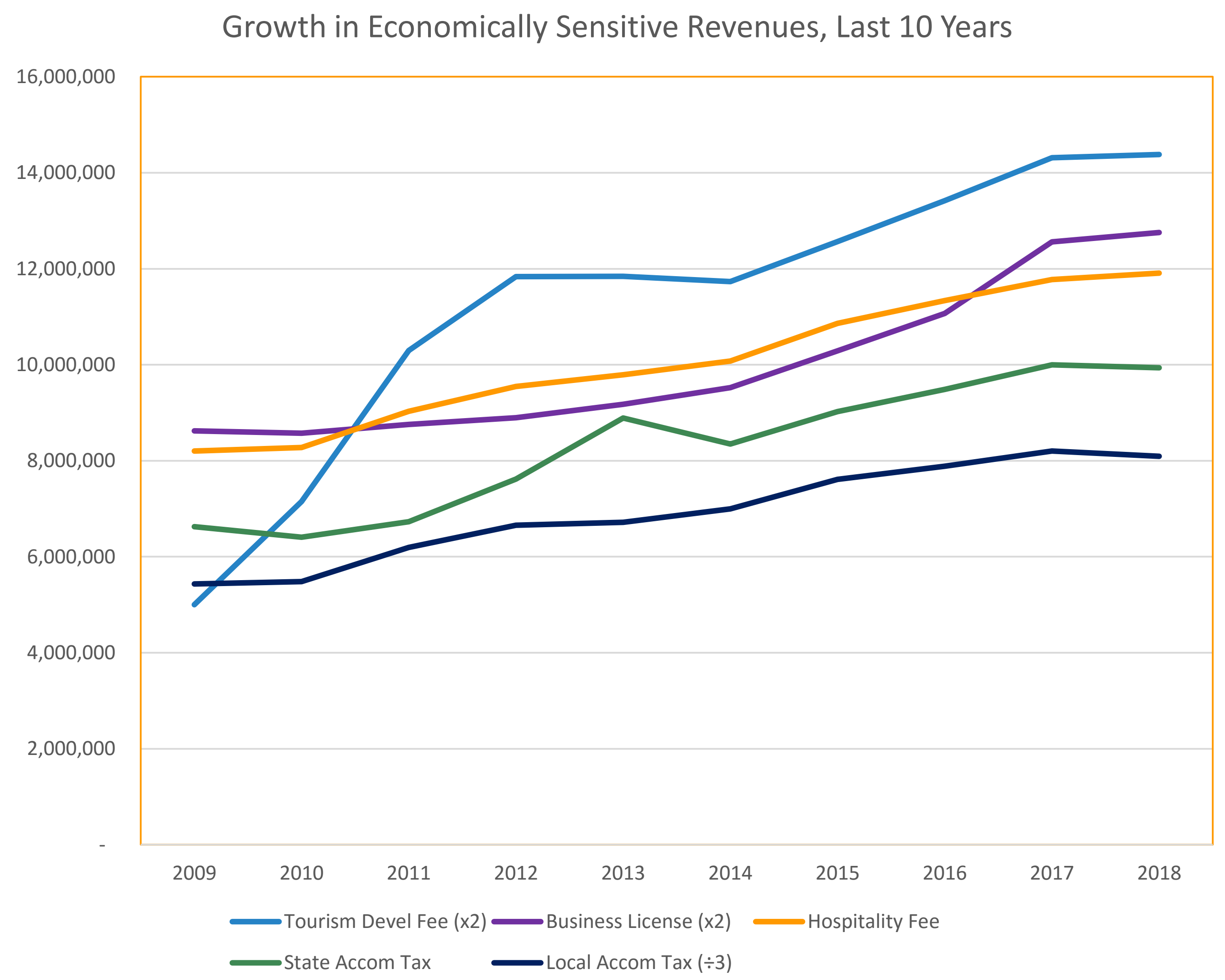
Local trends in economically sensitive revenues

The City has seen steady upward trends for nine of the past ten years, with a couple of notable exceptions.

1) After leveling off in 2012-13, TDF picked up again in 2014-15. This coincides with the residential housing boom and generally improving economy through that time period.

2) State-wide Accommodations Tax 2013 peak ($8.8 million) is due to one-time revenue. Trend is otherwise steady through 2017.

All revenues in this group slowed in FY2018.



City’s reserve balances

General Fund balance is in the mid-range of City’s policy objective (17%-18% vs Policy of 15%-20%).

Specific capital reserves for emergencies (about $2.9 million prior to Hurricane Matthew in 2016) are in use and we are awaiting their replenishment.

- Response to Hurricane Matthew cost $4.1 million.
- To date, FEMA has approved and paid $512,000 of an estimated $3.1 million of reimbursable costs.

Solid Waste Fund bore the brunt of the Hurricane Matthew recovery expenses.

Water & Sewer Fund had about $1 million in emergency repairs post-Florence.

Short-term signs for optimism?

Sales tax revenues (TDF), which had been off by a cumulative total of 0.9% for January-June 2018, were up by 1.7% over the prior year for the 1st fiscal quarter.

Business License receipts for the 1st quarter of FY2019 exceeded 1st quarter 2018 by $377,000, or 29.2%. We believe that some of this increase is due to timing of payments that were due for the May 2018 renewal but some, mostly construction and related licenses, reflects FY2019 growth.

Prior to September, when Hurricane Florence struck, ADRs and RevPAR were showing moderate increases over the prior year in the Brittain Center's reports.

What to watch for…

In February 2010, I discussed an article from *The Economist* showing that this market has long been a reliable indicator of when the economy may be reaching an inflection point.

Highlights of that presentation were

"Take heart, when underwear sales improve, recovery cannot be far *behind.*

As of May 2009, there was evidence that the recession was *bottoming out.*

Since then, men's underwear sales have *taken off*, indicating that economic recovery is finally underway."

So on the basis of this news, the US economy may still be good for another year or two…

Global Market Study on Men's Underwear: BRIC to Witness Highest Growth by 2020

Undergarments are worn beneath the outer clothes and help to avoid soiling of outerwear. Men's undergarments are generally of two types, which include upper wear and lower wear. For undershirt, we include vests, sleeved vests and muscle vests. For briefs, we include regular briefs, trunks and boxer shorts. In winters, long underwear is preferred to provide extra warmth.

The men's underwear market is segmented into

- Men's Underwear Market, by Age Group
- Men's Underwear Market, by Region
- Men's Underwear Market, by Distribution Channel

This report covers global men's underwear market performance in terms of revenue contribution. This section additionally includes PMR's analyses of key trends, drivers, restraints and opportunities, which are influencing the global men's underwear market. Impact analysis of the key growth drivers and restraints, based on the weighted average model, is included in this report to better equip and arms clients with crystal clear decision-making insights.

Growing disposable income, preference for branded underwear that offers better fit and comfort are major factors driving demand for premium underwear, thereby fuelling the growth of the men's underwear market. Major trends in the men's underwear market are increased the adoption rate of functional underwear, consistent investment in branding and marketing and the surge in acquisitions and mergers.

And after that *brief* diversion…

Inflection Points and their Implications for Local Policy

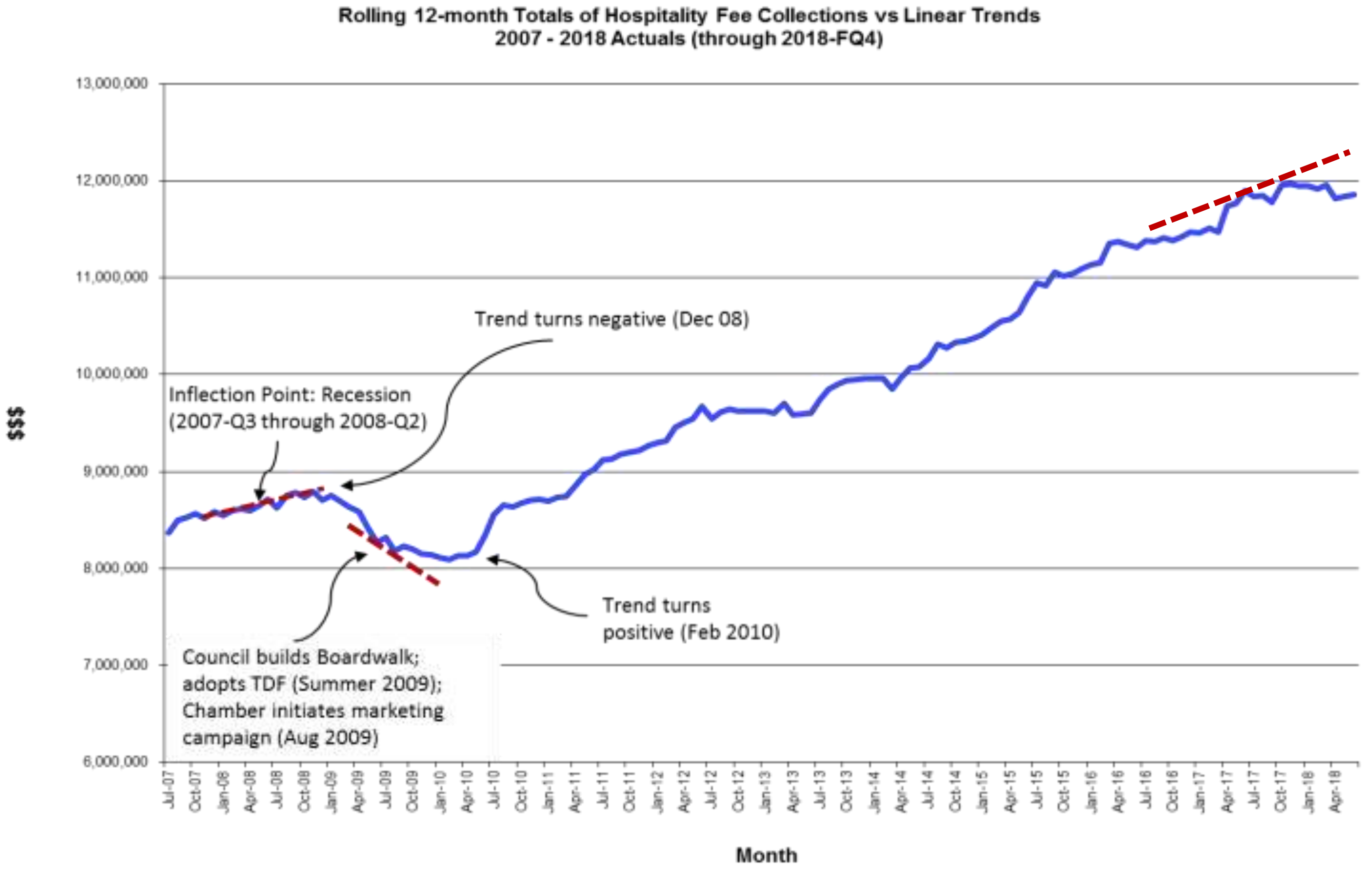
Questions for upcoming budget:

Using Hospitality Fee collections as an economic indicator, where do we see significant inflection points?

Does an inflection point always signal a change in direction of growth, i.e., “+ to –” or “– to +”?

How do we respond when we encounter a possible inflection point?

In business terms, an inflection point can be considered a turning point after which a dramatic change, *with either positive or negative results*, is expected.

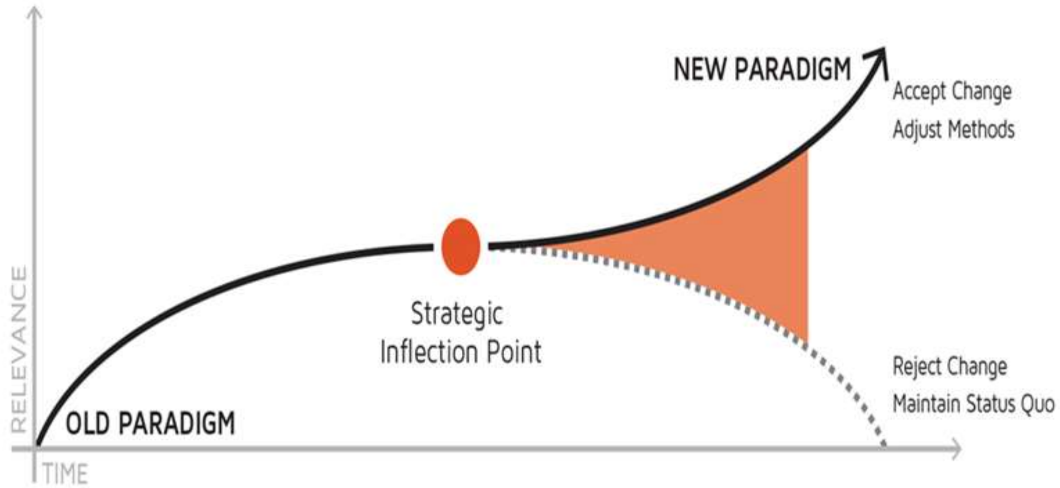


Economic Inflection Points and Public Policy

In 2009, the City was presented with declining revenue and increasing expenditures.

Council reacted by

1. **Making some fairly standard responses to recession:**
   - hiring freeze,
   - use reserves to maintain liquidity and stability in work force and service delivery, while
   - deferring capital outlays, and
   - restructuring debt at long-term savings with advance refundings.
2. **Making a "paradigm shift"** by *accepting the changes* that were occurring and *adjusting methods*.



When we are in an upward trend, an inflection point can be

1) a signal of impending decline, or
2) an opportunity to develop a new paradigm.

The 2009 “paradigm shift”

City took additional actions to

- Solicit ideas for productivity improvements/savings from throughout City staff.
- Assess and restructure revenues and expenditures to improve structural balance in the “new normal.”

Do counterintuitive things that prepared the City to take advantage of the recovery when it began:

- Build a boardwalk, offering a new feature for tourists;
- Use a combination of SRF and ARRA borrowing to lay storm water collection pipe under the boardwalk in preparation for further outfall work; and
- Adopt the TDF to replace grant money the state had cut as a source for funding out-of-state marketing, grant property tax relief to City residents and fund additional tourism-related capital projects.

Bottom lines…

A consensus seems to be emerging that economic growth will slow further over the next year or so but a recession is not likely until 12-24 months out.

Revenue growth prospects are in the “flat to low” range for the coming year, here as elsewhere.

Prospects for slowing economy are greater than for further expansion beyond 2020, with some limited possibilities to affect future growth with local policy.

Nationally, larger federal deficits and forfeiture of significant parts of the income tax base in the 2017 tax reductions will complicate future recovery efforts.

Staff are preparing now for a possible slowdown by

Initiating a “soft freeze” on re-hiring of vacant positions.

Restructuring insurance and OPEB costs.

Examining outsourcing opportunities for some internal services where an opportunity for savings exists.

Looking for opportunities for “current refundings” of some debt.

Positioning the city to take advantage of a possible downturn by having some shovel-ready projects, locking in lower costs of construction and borrowing for long-term savings.

The End