

16. CURRENT ECONOMIC CONDITIONS

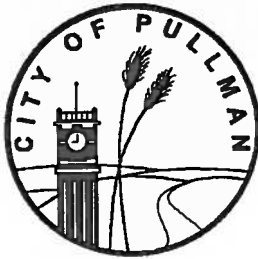
STAFF REPORT

QUESTIONS FROM COUNCIL ON STAFF REPORT

DISCUSSION

ACTION TAKEN

NOTES:



CITY OF PULLMAN

HIGH Tech, HIGHER Education, HIGHEST Quality of Life


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MEMORANDUM

TO: Mayor and City Council

FROM:  John Sherman, City Supervisor

RE: Current Economic Conditions

DATE: February 10, 2012

Attached is the February 2, 2012, Economic Review from the Washington State Economic and Revenue Forecast Council. With respect to current economic conditions it states:

In the three months since the November forecast, events have unfolded as expected in the baseline scenario. We continue to see a muddle-through economy, with low growth, high unemployment and weak confidence. Despite the relatively small change in the economic forecast, the high level of downside uncertainty in the baseline remains the same as before.

The Washington economy is recovering as expected in the November forecast. There have been no major developments since November that have altered the outlook significantly.

Also attached is information that was presented at the recent Association of Washington Cities (AWC) Cities Legislative Action Conference. With respect to the state of Washington budget for the 2011-2013 biennium, which runs from July 1, 2011, through June 30, 2013, it notes that total expenditures are \$31.7 billion. In order of magnitude, the major expenditure categories are K-12 at 43 percent of the budget, Human Resources at 38 percent of the budget, Higher Education at 7.6 percent of the budget, General Government at 2.6 percent of the budget, Other at 7% of the budget, and Natural Resources at 1 percent of the budget.

The revenue for the 2011-2013 state of Washington is also \$31.7 billion and breaks down as follows: Retail Sales & Use Tax at 49.5 percent, B&O Tax at 21.6 percent, Other at 14.2 percent, Property Tax at 11.8 percent, and the Real Estate Excise Tax (REET) at 2.9 percent. This demonstrates the state's over reliance on the retail sales and use tax. An attached January 31 article on the decision by Moody's Investors Service to change the outlook for Washington's debt ratings from stable to negative stated:

Moody's noted that the state's reliance on a sales tax has made it challenging during a recession that has impacted consumer confidence.

Turning back to the expenditure side of the state budget, of the \$31.7 billion budget, only \$8.7 billion is not protected from cuts. The areas not protected from cuts are Other Human Services at \$4.16 billion, Higher Education at \$1.8 billion, Department of Corrections at \$1.23 billion, Other at \$888 million, and Other K-12 at \$613 million. It should be noted that Other includes legislative agencies, governmental operations, natural resources, transportation, other education, and other appropriations.

The bottom line is that we continue to be in a slow recovery and that the legislature has to cut \$1.5 billion out of the \$8.7 billion that is not protected. On the positive side, the attached building permit figures show improvement over last year's figures.

The next state revenue forecast from the Washington State Economic and Revenue Forecast Council is due to be released on Thursday, February 16 and Finance Director Bill Mulholland will give his 2011 year-end financial report at the city council meeting on Tuesday, February 28.

**Economic & Revenue Forecast Council
State of Washington**



Economic Review: February 2, 2012

Executive Summary

- In the three months since the November forecast, events have unfolded as expected in the baseline scenario. We continue to see a muddle-through economy, with low growth, high unemployment and weak confidence. Despite the relatively small change in the economic forecast, the high level of downside uncertainty in the baseline remains the same as before.
- Factors outside the state are the reason for the high downside risk. The biggest threat to the U.S. and Washington economies remains the sovereign debt crisis in Europe. It is likely that Europe will enter another recession or is already in one. If the sovereign debt crisis leads to a financial crisis, the U.S. economy will enter a new recession as well.
- The weakness in Europe has contributed to a slowdown in Asia as well. We expect China in particular to slow. So far it looks as though they will experience a soft landing as growth is intentionally slowed to prevent an overheating economy. If this is not managed properly and the Chinese economy experiences a hard landing, this could create another global recession.
- Political gridlock in Washington D.C. has left fiscal policy up in the air. Congress extended the payroll tax cut and emergency unemployment benefits, but only for two months, thereby maintaining the maximum possible uncertainty. We should see renewed negotiations as this month unfolds. Our current forecast discounts the possibility of any significant discretionary fiscal policy prior to the next general election. We have therefore removed from our forecast Global Insight's assumption that the current payroll tax cut and unemployment benefits will be extended after February 2012.
- Unlike the discordant notes from fiscal policy, the stance of monetary policy has been quite clear. At their meeting on January 25, the Federal Open Market Committee indicated they expect to maintain the target fed funds rate at the lower bound "at least through late-2014" in order to provide additional accommodation to the economy. However, it continues to look as if the economy is caught in a classic "Liquidity Trap" where monetary policy playing a lone hand has lost its effectiveness. In such conditions, for macroeconomic policy to be effective, both monetary and fiscal policies need to be working in tandem. That does not appear likely right now.
- Data releases since the November forecast have been encouraging. Real gross domestic product grew at a seasonally adjusted annualized rate of 2.8% in the fourth quarter, the strongest rate since the winding down of the stimulus. Real consumer spending grew 2.0% in the fourth quarter. Still, the sustainability is questionable since real final sales increased at just a 0.8%

rate. Most of the growth in GDP for the quarter came from inventories which contributed 1.9 percentage points to the total 2.8% rate.

- Housing remains weak, although the worst is now behind us. Housing starts fell 4.1% in December, to a 657,000 annual rate, still the second-highest monthly reading since April 2010. More importantly for the future, housing permits are improving. Single-family permits climbed to their highest level in 12 months. Multi-family permits are faring even better than the single-family permits. Despite declining 3.7% in December, a clear upward trend is discernable. New home sales, which are a small fraction of the market, fell 2.2% to 307,000 (SAAR) units. Existing home sales rose 5.0% to 4.6 million (SAAR) units, the third consecutive monthly increase. The Case-Shiller 20-city index declined in November, and was 3.7% below a year ago. Prices are expected to stay weak as more foreclosed properties hit the market.
- Real GDP is now above its pre-recession peak, but it is being produced with 6.2 million fewer jobs. Growth in jobs has been excruciatingly slow in this recovery. As we go to press, the employment situation report for January is not yet available to us. The December employment report's establishment survey showed job growth picking up with the economy gaining 200,000 (SA) net new jobs that month. Private sector gains of 212,000 were partially offset by public sector job losses of 12,000. The unemployment rate continued to trend down but remains elevated at 8.5%.
- Industrial production grew 0.4% (SA) in December, following a 0.3% (SA) decline in November. The Institute for Supply Management's manufacturing Purchasing Managers Index for December increased 1.2 percentage points to 53.9, the highest reading since June 2011. Readings above 50 indicate growth. The non-manufacturing index which increased six-tenths of a percentage point to 52.6 also indicates continuing growth in services. Core capital goods orders (i.e. durables excluding aircraft and military) which are a proxy for business investment, increased 2.9% in December, after declining 1.2% in November and 0.9% in October.
- Consumer confidence has shown signs of firming in recent months, but remains at levels typically associated with recessions rather than recoveries. The Conference Board's index dropped to 61.1 in December, although the recent trend remains positive. The University of Michigan consumer sentiment measure moved up to 74.0, the fifth consecutive month the index has increased.
- January light motor vehicle (LMV) sales increased 4.6% to 14.2 million (SAAR) units. The trend remains positive although this is more due to replacement demand rather than a return of confidence. The average light vehicle on the road remains over 10 years old.
- The Blue Chip Consensus real GDP growth forecasts, our objective starting point each forecast cycle, are now at 2.2% and 2.6% for 2012 and 2013 compared to 2.1% and 2.8% in our November forecast. This is our first forecast for the 2013-15 biennium. The Blue Chip forecast for real GDP growth in 2014 and 2015 is 2.9% per year.

- The Washington economy is recovering as expected in the November forecast. There have been no major developments since November that have altered the outlook significantly. The state's economy is likely to outperform the U.S. in the near term. Boeing and Microsoft are both hiring again. The aerospace sector has added 11,500 jobs since May 2010, which is nearly double the 6,000 lost during the recession, while the software sector has added 1,800 jobs since December 2009, making up for most of the 2,500 jobs lost during the recession. Export growth is slowing but still strong. Total exports in the fourth quarter through November were up by 17 percent year-over-year. Exports of transportation equipment (mostly Boeing planes) account for nearly 50 percent of the state's exports and were up 27 percent from the previous year. Exports other than transportation equipment were up 9 percent. Boeing has approximately seven years of commercial orders on the books.
- On the downside, construction, which has a disproportional impact on revenue, remains weak. While no longer falling, employment in the construction sector is flat. Government employment continues to decline, especially at the state and local level. The state's economy is also vulnerable to potential adverse national and global developments.
- We have two months of new Washington employment data since the November forecast was released. Employment growth in November and December was slightly better than the November projection. The Washington economy added a total of 6,500 jobs in the final two months of the year compared to the 4,300 net new jobs expected in the forecast. The private sector added 7,800 jobs (we had expected 4,600) but the public sector lost 1,300 jobs (we had expected a loss of 300). The manufacturing sector continues to show strong employment growth, adding 3,600 jobs of which 2,300 were in aerospace but construction employment declined by 400. Private service-providing industries added the majority of new jobs in the two month period at 4,600 jobs. We had expected an increase of 3,700 private-service-providing jobs.
- Housing construction remains weak but the fourth quarter was slightly better than expected in the November forecast. Single-family permits averaged 13,900 units (SAAR) which is higher than our forecast of 11,500 units for the quarter. Multi-family permits were also slightly higher than expected, averaging 8,600 units compared to the 8,000 expected for the quarter. Overall permits averaged 22,500 units compared to 19,400 expected in the November forecast. We continue to believe the trend is positive in multi-family housing due to rising rents and declining apartment vacancies. The near-term outlook for single-family construction is flat to negative.
- The Bureau of Economic Analysis (BEA) has released estimates for personal income through the third quarter of 2011. The preliminary BEA estimate for the third quarter of 2011 is \$900 million (0.3%) lower than predicted in the November forecast.
- Both headline and core inflation rates in Seattle are higher than in the U.S. and higher than we expected in our November forecast. The main reason for higher inflation in Seattle than in the U.S. is shelter costs. Shelter costs rose 3.0% over the year in Seattle compared to 1.9% for the U.S.

- We continue to believe the Washington economy will outperform the U.S. economy. Washington is benefitting from strong export growth and hiring at both Boeing and Microsoft. We have raised our Washington job growth forecast for 2012 and 2013 to 1.6% and 2.0% from 1.2% and 1.9% in the November forecast. We also raised our forecast for personal income growth to 3.0% and 4.8% from 2.8% and 4.7% in November. Our initial forecast for 2014 and 2015 calls for job growth of 1.9% in each year and income growth of 6.0% and 5.9%. While our baseline forecast is similar to the November forecast, considerable uncertainty remains.

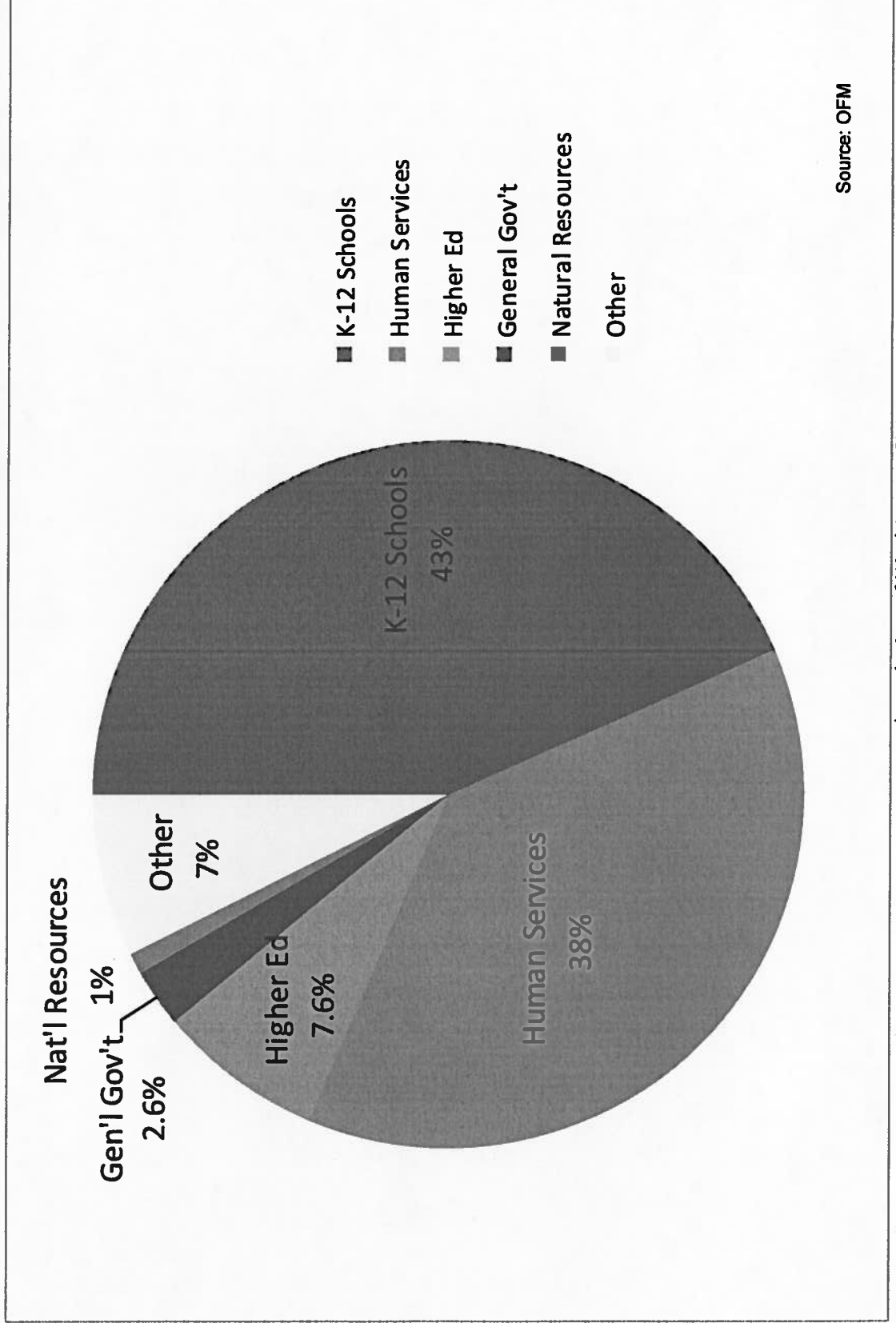
Downside Risks:

- The level of uncertainty in the baseline is high. Downside risks are still very elevated.
- The European sovereign-debt crisis takes a turn for the worse, with Greece exiting the Eurozone.
- A European banking crisis that affects U.S. banks.
- A hard landing in China.
- Turmoil in the Strait of Hormuz.
- Unexpected events – natural disasters, political upheaval, etc.

Upside Risks:

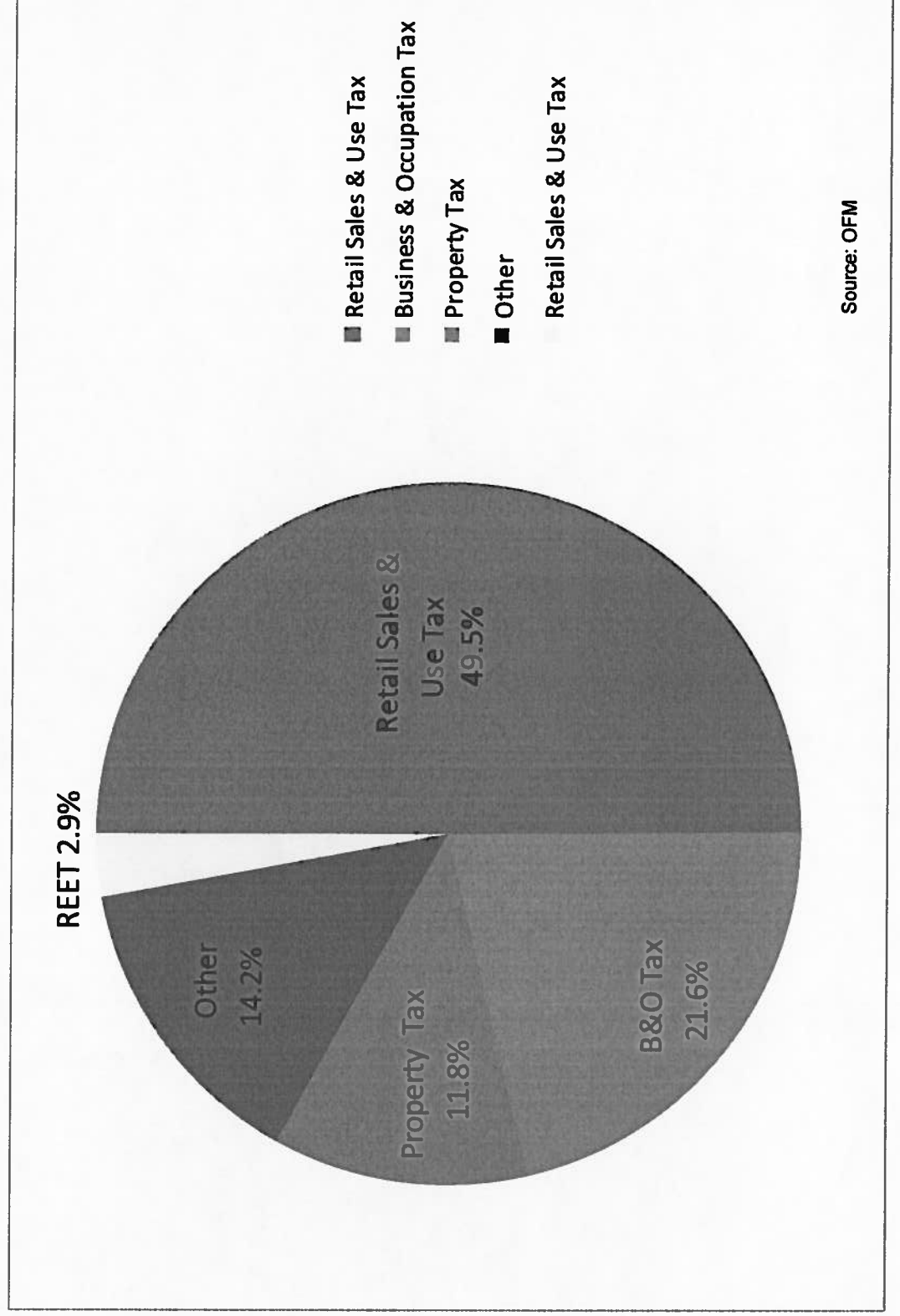
- Underlying pent-up demand continues to drive the recovery.
- Hiring picks up, and triggers a virtuous cycle.
- Greek debt restructuring is successful, the rest of the Eurozone provides sufficient, credible, and early support to stabilize financial markets and prevent any contagion.
- European governments are able to build a firewall around their banks, so the sovereign debt crisis does not turn into a banking crisis.
- Political gridlock in the nation's capital eases.
- An extension of the payroll tax cuts and unemployment insurance benefits.

State Budget: 2011-13 Expenditure Estimates - \$31.7 B

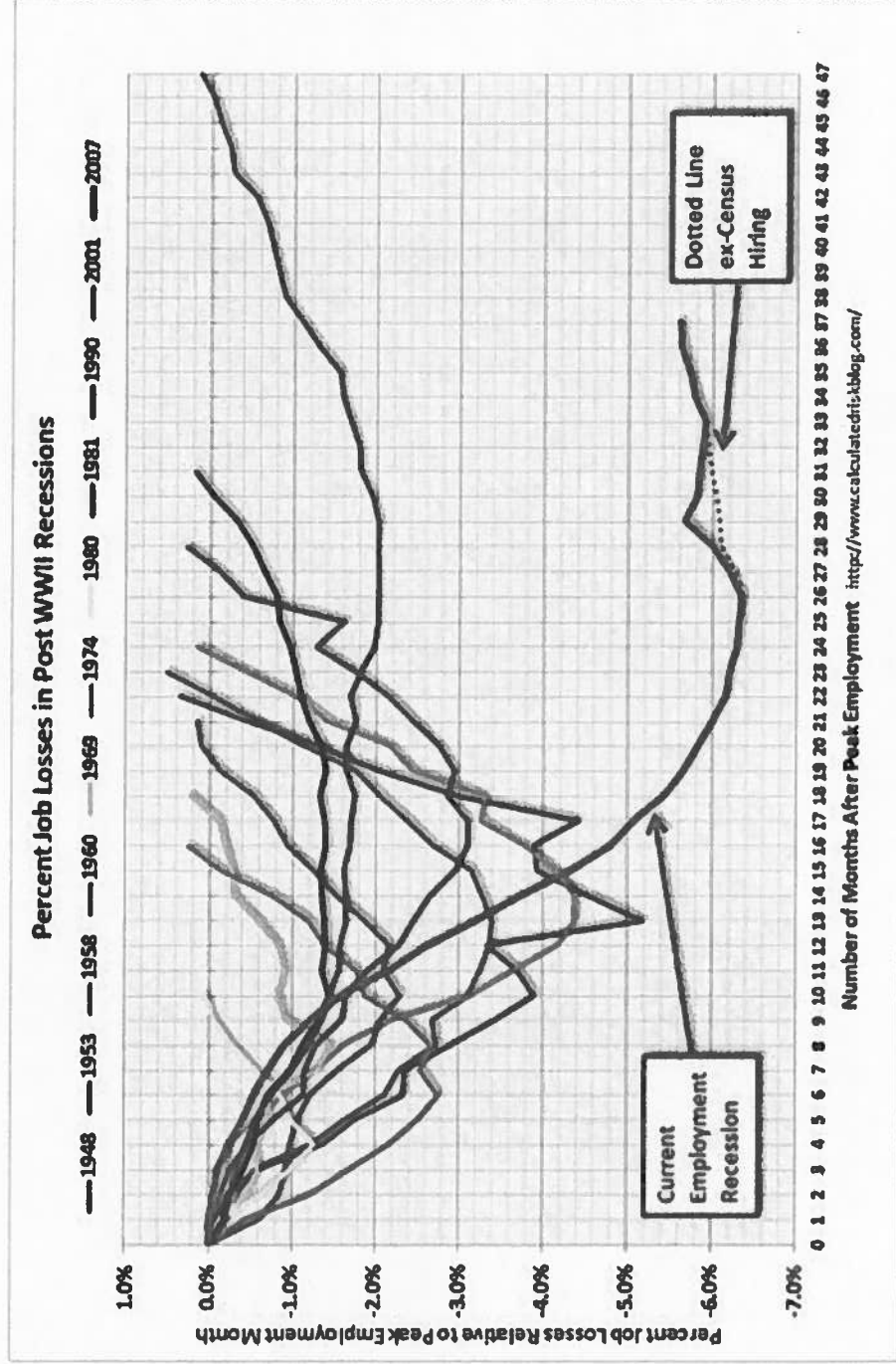




State Budget: 2011-13 Revenue Estimates - \$31.7 B



The "Great Recession" continues



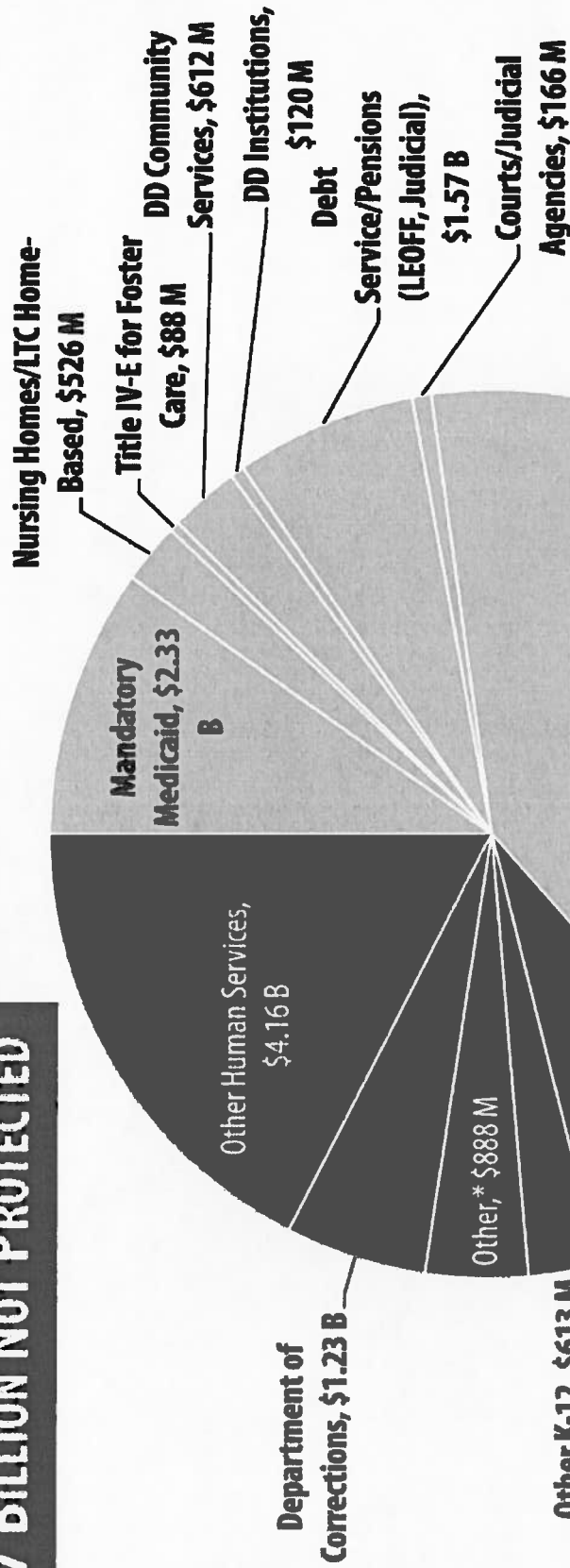
Source: Washington Economic & Revenue Forecast Council

Status of the budget

- Shortly after 2011-13 budget was approved, a \$2B revenue shortfall was identified.
- Governor called a special session for November 28, 2011.
- During Special Session, Legislature approved Early Actions Savings bill with \$480 million in budget adjustments – $\frac{1}{4}$ of the way there.
- Roughly \$1.5 billion shortfall to address this session.
- Governor's proposal includes a $\frac{1}{2}$ cent temporary sales tax increase to go before the voters.

State Budget - Nearly 2/3 Protected

\$8.7 BILLION NOT PROTECTED



*Other includes legislative agencies, gov't operations, nat'l resources, transp. other education, and other appropriations



Cities' 2010 state shared revenues with Governor's proposal

- Liquor Excise Tax - \$20.3 million (permanently eliminate)
- Liquor Profits - \$31.5 million (per I-183, appropriate "comparable period" + \$10 M)
- Municipal Criminal Justice - \$12.1 million (no change)
- Streamlined Sales Tax Mitigation - \$13.4 million (permanently reduce by 10%)
- City-County Assistance - \$6.6 million (no change)
- Annexation Sales Tax Credit - \$5.3 million (permanently reduce by 10%)

- **Preserve our long-standing partnership** when it comes to revenue sharing such as the liquor taxes and profits, a source of revenue we have shared with the state for more than 70 years.
- We realize **we are not immune to the cuts** that everyone is taking during this long recession.
- **Apply any cuts to our revenue uniformly and across the board** rather than wholesale elimination of any one source of revenue.
- **Make cuts temporary rather than permanent** as the Governor has proposed. If you wish to permanently eliminate revenue streams, these decisions should be made thoughtfully and provide cities the ability to replace those revenues with others that are of equal value to the cities' general funds.

THE SPOKESMAN-REVIEW

January 31, 2012

State's budget troubles lead to lower debt ratings

The Spokesman-Review

OLYMPIA – Two agencies have changed the outlook for Washington's debt ratings from stable to negative, citing the state's ongoing budget troubles.

Moody's Investors Service said in its rationale released Monday that the state faces challenges in fixing structural budget problems, noting that Washington faces a revenue shortfall at a time when other states are reporting no budget problems or only minor gaps.

"The outlook revision to negative from stable reflects the magnitude of the revenue falloff that continues to challenge the state as it struggles to recover from the recession," Moody's statement said.

Fitch Ratings has also changed its outlook from stable to negative, releasing its explanation in a note Friday.

Moody's has an Aa1 rating on Washington's general obligation bonds, and Fitch's rating is AA+. Each is one notch below the best possible rating.

Moody's noted that the state's reliance on a sales tax has made it challenging during a recession that has impacted consumer confidence. The agency cited other challenges, including reliance on the cyclical aerospace industry, above-average debt ratios and frequent voter initiatives that add to budget challenges.

Washington lawmakers are working to close a roughly \$1 billion budget deficit and want to leave several hundred million dollars as a buffer.

"As recognized by the rating agencies, the Legislature has historically done an excellent job in making budgetary adjustments to meet revenue shortfalls," said Washington state Treasurer James McIntire. "We fully expect them to do the same now."

Standard & Poor's has a stable outlook on Washington's debt.

CITY OF PULLMAN BUILDING DEPARTMENT MONTHLY REPORT FOR JANUARY 2012

	2012					2011				
	JANUARY		YEAR TO DATE			JANUARY		YEAR TO DATE		
	# OF PERMITS	# OF UNITS	VALUATION	# OF PERMITS	# OF UNITS	VALUATION	# OF PERMITS	# OF UNITS	VALUATION	# OF PERMITS
NEW CONSTRUCTION										
Residential:										
Single Family	5	5	1,089,107	5	5	1,089,107	2	2	308,081	2
Townhouse	0	0	-	0	0	-	0	0	-	0
Duplex	1	2	320,786	1	2	320,786	0	0	-	0
Multi-Family	0	0	-	0	0	-	0	0	-	0
Added Unit	0	0	-	0	0	-	0	0	-	0
Mobile Home	0	0	-	0	0	-	0	0	-	0
Group Quarters	0	0	-	0	0	-	0	0	-	0
SUBTOTAL:	6	7	1,409,893	6	7	1,409,893	2	2	308,081	2
Church	0	0	-	0	0	-	0	0	-	0
Commercial	0	0	-	0	0	-	0	0	-	0
School	0	0	-	0	0	-	0	0	-	0
Public	0	0	-	0	0	-	0	0	-	0
Garage/Carport	1	1	22,482	1	1	22,482	1	1	12,960	1
SUBTOTAL:	1	1	22,482	1	1	22,482	1	1	12,960	1
REMODELS/ADDITIONS										
Church	0	0	-	0	0	-	0	0	-	0
Commercial	0	0	-	0	0	-	0	0	-	0
Public	1	1	6,000	1	1	6,000	2	2	65,203	2
School	0	0	-	0	0	-	0	0	-	0
Residential	2	2	21,500	2	2	21,500	5	5	87,754	5
Miscellaneous	4	4	28,250	4	4	28,250	3	3	27,000	3
Tenant Improvements	3	3	127,095	3	3	127,095	0	0	-	0
SUBTOTAL:	10	10	182,845	10	10	182,845	10	10	179,957	10
DEMOLITIONS - Res.	0	0	-	0	0	-	0	0	-	0
DEMOLITIONS - Other	0	0	-	0	0	-	0	0	-	0
SIGNS	1	1	8,000	1	1	8,000	0	0	-	0
MECH. & PLUMB.	6	6	46,489	6	6	46,489	7	7	28,210	7
OTHER	1	1	-	1	1	-	8	8	-	8
BUILDING TOTALS:	25	7	1,669,709	25	7	1,669,709	28	2	529,208	28
INSPECTIONS										
Building	103	103	-	103	103	-	74	74	-	74
Mechanical	20	20	-	20	20	-	18	18	-	18
Plumbing	20	20	-	20	20	-	8	8	-	8
Miscellaneous	4	4	-	4	4	-	2	2	-	2
Special Inspections	3	3	-	3	3	-	0	0	-	0
Life Safety	0	0	-	0	0	-	0	0	-	0
Erosion	0	0	-	0	0	-	2	2	-	2
TOTAL INSPECTIONS:	150	150	-	150	150	-	104	104	-	104
FEES COLLECTED			\$18,489.07			\$18,489.07			\$5,757.12	
										\$5,757.12

17. 2012 GOAL-SETTING PROCESS

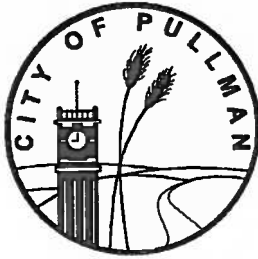
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MEMORANDUM

TO: Mayor and City Council

FROM:  John Sherman, City Supervisor

RE: Discussion of 2012 Goal-Setting Process

DATE: February 9, 2012

At the City Council meeting on January 10, 2012, we discussed the 2012 City Council goal-setting process. It was noted that the goal-setting notebooks would be distributed at the City Council meeting on February 14. We appreciate all the input that we have received for the City Council's consideration.

Last year we held the initial City Council retreat on Saturday, March 12 at the Fireside Grille. With respect to scheduling the initial retreat this year, there are a couple of factors that you might want to consider. The new City Councilmember for Ward 2 is due to be selected at the City Council meeting on February 28. WSU Spring Break runs from March 12-16.

Would you like to consider holding the initial City Council retreat on Saturday, March 24? Do you have a preference in terms of location?