

Economic News Briefing

Week Ending April 26, 2008

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Taxation and Budget Reform Commission

The Taxation and Budget Reform Commission (TBRC) completed its work this week and placed six amendments to the Florida Constitution on the November 2008 ballot. The most significant of these proposed amendments, from an economic impact perspective, is former State Senator John McKay's Amendment 5 – the local school “property tax swap.” If approved by the voters, this amendment will shift a significant share of the burden of financing K-12 public education from private property owners to consumers and businesses, diminish Florida's ability to compete in the national and global economy, and reduce the State's economic growth. Those are the findings of the economics consulting firm hired by the TBRC to serve as its staff economists.

The elimination of local school property taxes (the “required local effort” or “RLE”) would begin in the 2010-2011 fiscal year, and the amount of financial resources to replace the RLE has been estimated at between \$9 billion and \$11 billion. The TBRC's economists estimated \$9.6 billion in RLE. Amendment 5 provides a future legislature with several options for replacing the RLE. These options may be summarized as: 1) an increase of up to one percentage point to the sales and use tax rate in existence on January 6, 2009; 2) eliminate some current exemptions on goods and services, with certain exceptions and conditions; and 3) reduction in spending in other areas of the state budget or revenues identified or created by the legislature. Except for the limitation on the permissible increase in the sales tax rate, the legislature is given broad authority in deciding how it will deal with the financial implications of eliminating the RLE.

The additional penny sales tax is projected to raise approximately \$4.6 billion and another \$4 billion might be raised from eliminating current exemptions on goods more likely to be purchased by businesses rather than consumers. That leaves an approximately \$1 billion gap that would have to be filled by taxing business services or reducing state spending in other areas. Reliance on taxing services and/or reductions in other areas of the state budget will be larger if the legislature decides not to raise the sales tax rate by 1 percent or chooses to maintain many of the current sales tax exemptions.

The elimination of the RLE will save residential property owners living in the state \$4.7 billion on an after-income-tax basis and will save owners of commercial property \$2.4 billion (before income taxes), according to the analysis by the TBRC's staff. The legislature, however, must raise taxes and/or cut state spending by an estimated \$9.6 billion in FY2010-11. Without cuts in state spending, Amendment 5 represents a net tax increase of about \$2.5 billion. Facing the prospects of such a large tax increase, it is

hard to conceive of a future legislature not opting for significant spending cuts. That is perhaps actually the financing approach preferred by many of the proponents of Amendment 5.

The combination of sales tax increases and spending reductions from the passage of Amendment 5 would reduce employment and income growth within Florida. The analysis from the TBRC's economists indicates statewide employment would be lower than it would be otherwise by approximately 51,000 in the third year after eliminating the RLE. This estimate is based on 90 percent of the replacement funding for the RLE coming from increases in sales taxes and only 10 percent from reduced spending in non-education areas of the state budget. If the elimination of the RLE were to be financed entirely through reductions in non-education areas of the state budget, then employment would be lower than otherwise by 113,000 in the third year after eliminating the RLE. Not surprisingly, roughly 85 percent of those job losses would occur in the public sector under that scenario.

After the TBRC's economic consultant's presentation of the macroeconomic impact of Amendment 5, the Chair of the TBRC granted the principal sponsor's request for another analysis by an economist selected by the sponsor. That analysis argued that elimination of the RLE would immediately increase private property values in the Florida by ten times the size of the RLE in the current fiscal year or \$80 billion. Elimination of the RLE, according to the subsequent analysis, would stimulate migration to Florida and increase the state's population by 57,000, generating \$9.7 billion in new residential and non-residential construction – notwithstanding current conditions and trends in this sector of the economy. According to that analysis, replacing the RLE entirely with higher sales taxes would create 34,700 jobs statewide in the third year after eliminating the RLE and 72,500 jobs in the 5th year. This subsequent analysis, however, is based on unreasonable assumptions unsupported by historical experience or empirical research.

Amendment 5 does not directly affect county property tax collections, except for a reduction from 10 percent to 5 percent in the current cap on the annual growth in the taxable assessed value of non-residential private property. The broadening of the sales tax base by elimination of some exemptions could bring additional, albeit modest, revenues from sales tax revenue sharing and local option sales taxes. The more significant impacts to the County are likely to be: 1) economic growth would be adversely affected by the net increase in business taxes due to a higher sales tax rate, the potential loss of exemptions on items that consumers and businesses purchase, and the potential taxation of business services; 2) income disparity would grow from the shift in the local school tax burden from property owners to renters through higher sales taxes; and 3) fiscal pressures would increase from the potential loss of state transfers to local governments to the extent that replacement of RLE is accomplished via spending cuts in non-education portions of the state budget.

Miami-Dade County's economy is largely based on small businesses. Approximately 80 percent of the private (non-farm) businesses in Miami-Dade County have less than 10 employees, and about two-thirds have less than 5 employees. Forty (40) to 50 percent of businesses with less than 10 employees are found in service industries that could be affected by a tax on services. One can expect that the burden of higher sales taxes and compliance costs associated with any new tax on services will be especially challenging for small businesses. Florida has tried a services tax before and Michigan tried one last year – both failed and were quickly repealed.

Approximately 40 percent of the County's households were renters in 2006 and that proportion is likely to be higher now and in FY2010-11 when Amendment 5 would take effect. This indicates, of course, that 40 percent (perhaps more) of the County's households would not receive any savings from elimination of

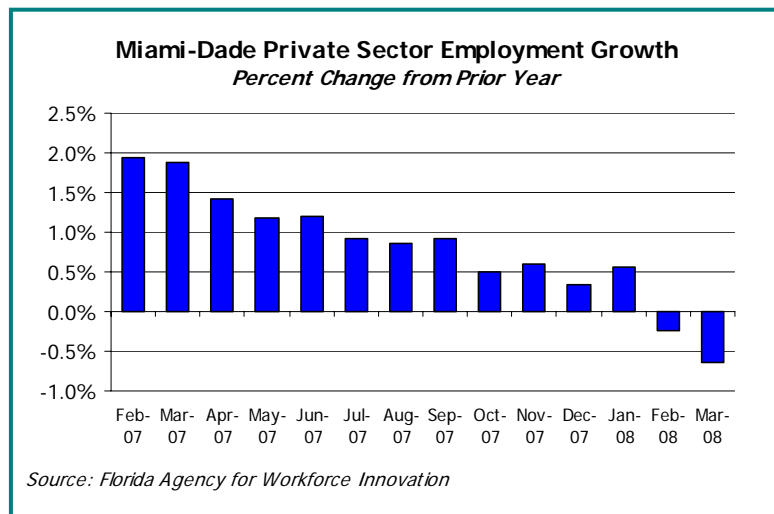
the RLE, but would suffer the financial effects of higher sales taxes and possibly lower government services. This shift in the tax burden widens the income gap between high and low income residents. The median household income of renters was less than half the median income of homeowners in 2006 (\$25,489 vs. \$55,192 for homeowners).

Amendment 5 contains a “hold education harmless” provision intended to prevent the legislature from funding the replacement of the RLE by reducing the amount of education financing that the state provides from other funding sources. If the legislature chooses to replace the RLE by reducing state spending in FY2010-11, then it must cut from programs excluding K-12 public education. State financial transfers to local governments not mandated by federal laws or regulation would be on the table of potential budget cuts. Miami-Dade receives approximately 9 percent of general fund revenues from state and federal government transfers and the bulk of those transfers come from the state. Those County programs that depend on state funding for a large share of their budget would be a risk if Amendment 5 is approved.

Local Employment Beginning to Contract

Total payroll employment in Miami-Dade County fell by 0.3 percent in March when compared to March of 2007.¹ Employment growth began to slow considerably at the beginning of this past summer, but March was the first month since November 2003 that we have seen a year-over-year decline in total employment. The emerging decline in total employment reflects job losses in the private sector, but, unlike in February, growth in public sector employment was not enough to prevent a decline in total employment. Public sector job growth in March continued to offset weakness in the private sector, but they are also beginning to demonstrate a retrenchment as state and local governments begin adjusting to shrinking budgets.

Private sector employment in March was down by 0.6% from the prior year, continuing the decline in employment witnessed in February (-0.2%). These two consecutive months of decline reflect a similar pattern developing in the national labor market, but the loss of jobs locally has not yet been as sharp. Employment in the local construction industry continued to lead the decline in jobs, falling 15 percent below the prior year’s level. Manufacturing industry employment was down 4.3 percent compared to a year ago. Employment in transportation, warehousing and utilities also experienced a slight decline.



¹ Comparisons to the employment in the same month of the prior year are used to distinguish business cycle fluctuations and longer term trends from normal seasonal fluctuations in employment. March employment levels are typically higher than February and January levels.

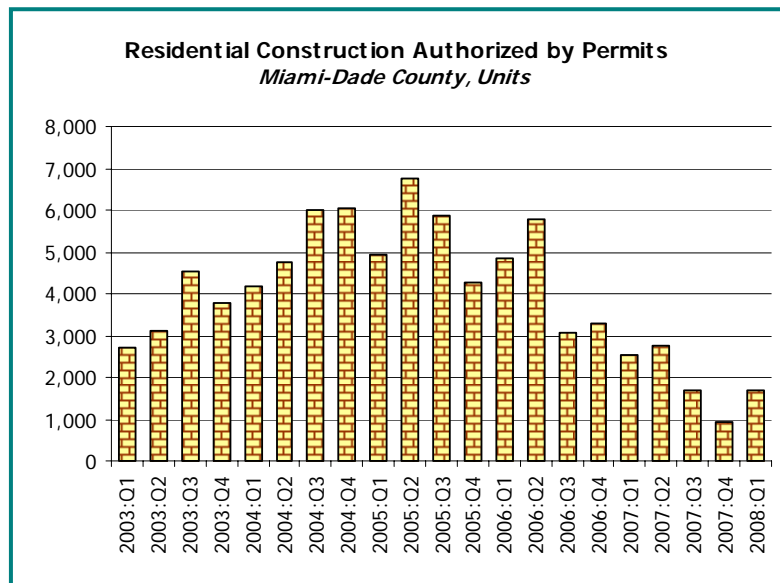
We are also now beginning to see a significant deceleration in the growth of private sector service jobs, led by slow growth in the retail and wholesale industries. March employment in private sector services was just 0.6% above employment a year ago. Employment growth in retail and wholesale fell to just 0.5% compared to the prior year. Retail and wholesale industry employment growth had been in the 1.5% to 2.5% range in the 12 months that ended this January.

Household survey data from the Bureau of Labor Statistics showed that Miami-Dade’s unemployment rate held steady at 3.9% in March. But the low unemployment rate obscures the weakness being experienced in the local labor market. Since October of last year the local unemployment rate has either declined or held steady because growth in the labor force has diminished just as employment growth has slowed. Approximately 10,000 workers lost (or left) their jobs between February and March, but the labor force contracted by a similar number. (In order to be counted as unemployed, a person without a job must be actively seeking employment.) Had it not been for the contraction in the labor force, the reduction in employment would have led to a significant rise in local unemployment rates.

Local Residential Construction Activity Continues to Decline

The long decline in the residential construction and real estate sector in Miami-Dade has not yet appeared to hit bottom. Residential construction units authorized by permit were down again in March when compared to a year ago. The latest data shows a decline of 31 percent compared to March 2007. The March decline in permits was similar to the decline seen in February. Building permits for just 542 residential units were observed in March compared to 740 units authorized by permit in March of 2007, and substantially below the average 1,823 permits per month issued in 2005. Although units authorized by permits in the first 3 months of this year are running well below the first 3 months of 2007, permits in the first quarter were much higher than in the final 3 months of 2008.

Sales of existing single family homes in Miami-Dade continued to fall in March, with realtors reporting only 276 sales – less than half the number of sales one year ago. Sales of single family homes fell by 18 percent during the first 3 months of 2008 compared to the last 3 months of 2007, and were 50 percent below the first 3 months of 2007. The median price of a single family home in March was \$337,900, slightly higher than February but still 12 percent below prices in March 2007.



The number of condo units sold through realtors in the first quarter of this year is down by nearly one half from the first quarter of last year. Transaction prices are approximately the same as in the first quarter of 2007.

U.S. Economic Indicators Continue to Point to Weakening Economy

Economic data released last week portray a slumping U.S. economy. New home and existing home sales in the U.S. continue to indicate that the recession in the national residential real estate market is not yet over. New home sales in March fell to their lowest levels since the recession of the early 1990s and the inventory of unsold units reached a level not seen in a little more than a quarter century. The decline in sales was experienced in all four regions of the country. The drop in sales and prices both suggest further job losses and contraction in the industry. Further downward pressure on prices will not, of course, help stanch the large and rising numbers of mortgage foreclosures and the problems they are creating in the financial market.

Orders for durable goods, a leading indicator of future manufacturing activity, fell in March for the third consecutive month. A number of components in the index, however, showed a recovery from declines observed in January and February, and some previously reported reductions were revised to reflect less of a decline than initially reported. Overall it seems that manufacturing activity is currently flat, but showing indications of a potential contraction in the coming months.

Consumer confidence, weighed down by higher prices for necessities and weak labor market conditions, reached a 26 year low in April according to a national survey regularly conducted by the University of Michigan. More consumers were pessimistic about economic conditions six-months from now, and are also more concerned about inflation than they were last month. The survey indicates that confidence has been on a clear downward trend for 15 months. The decline in confidence, job losses in the first three months of this year and rising food and fuel prices suggest that consumer spending, which accounts for over 70 percent of total spending in the economy, will continue to decline in the months ahead.

Problems in the mortgage market continue to impact the financial sector. Bank of America reported its third consecutive quarter of decline in earnings, and it expects significant losses from its consumer credit business as borrowers fall behind and eventually default on credit card and installment loan debt. The American Bankers Association has indicated that delinquencies on non-mortgage credit are rising. The problems in the financial market extend beyond the U.S. A number of European countries, led by Ireland, Spain and England, are now facing housing market problems similar to those in the U.S., along with their associated impacts on the financial markets. Credit Suisse reported this week that it wrote down \$5.3 billion in bad investments, and realized a quarterly loss of \$2.1 billion. Banks around the world have written down \$300 billion in assets since the summer of last year, and this trend does not appear to be over yet.