Albemarle County, Virginia

October 31, 2010

QUARTERLY ECONOMIC INDICATORS

COVERING Q1 OF FY 2010/11

INSIDE THIS ISSUE:

Special points of interest:

- Unemployment slightly increases; stays below U.S. and Virginia levels.
- Total employment drops, but the finance & insurance and real estate sectors gain.
- Unsold housing inventory increases in Albemarle; prices remain under downward pressure.
- New residential and commercial building permits jump; but the spike is misleading.
- Sales tax revenues rise sharply; hotel/motel tax revenues drop sharply.
- U.S. consumer confidence dips; U.S. leading economic indicators grow at steady pace.

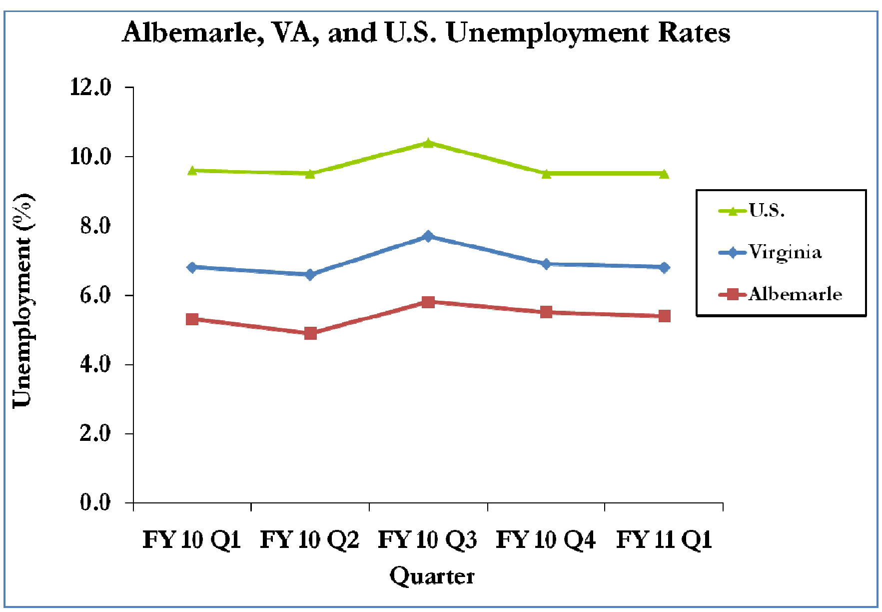
UNEMPLOYMENT RATE RISES SLIGHTLY

Albemarle County's non seasonally-adjusted unemployment rate rose slightly from 5.3% in FY 2010 Q1 to 5.4% in FY 2011 Q1, the latest complete quarter for which Virginia Employment Commission data exists. This small increase was in contrast to the stability exhibited in Virginia's rate, which remained at 6.8%, and the slight decline in the U.S. rate, which went from 9.6% to 9.5%, during the same period. Please see the graph below.

The upward "blip" in the County's rate of unemployment reflects the fact that, between FY 10 Q1 and FY 11 Q1, the County's civilian labor force fell by 198 workers, while the actual number of unemployed workers increased by 18. The small rise in the County's unemployment rate, although unfortunate, does contain at least one piece of good news: Albemarle's rate remains lower than the state and U.S. rates, a testament to the resilience of the County's economy. This situation parallels the relative rankings of the local, state, and national unemployment rates during the 1990-91 and 2001 recessions.

An important point to know about the unemployment rate is that this figure historically has tended to peak *after* the officially-designated end of recessions. In the case of Albemarle County, the unemployment rate peaked 11 months after the end of the 1990-91 recession and, topped out 21 months after the close of the 2001 recession. The official designation of the end of the "Great Recession" was June 2009, the last month of FY 09 Q4. If history were to repeat itself, we would expect the County's unemployment rate to reach its highest level sometime between May of 2010 (in FY 10 Q4) and March of 2011 (in FY 11 Q3).

The problem with relying on history for guidance is that every recession is different; the aftermath of the "Great Recession" might not be comparable to the aftermath of previous recessions. One difference in the current post-recession era, for example, involves the extension of unemployment benefits that were initiated in response to the "Great Recession." Some economists think that this extension might represent a disincentive for unemployed workers to find new jobs and, as a result, might prolong the currently elevated rates of unemployment.



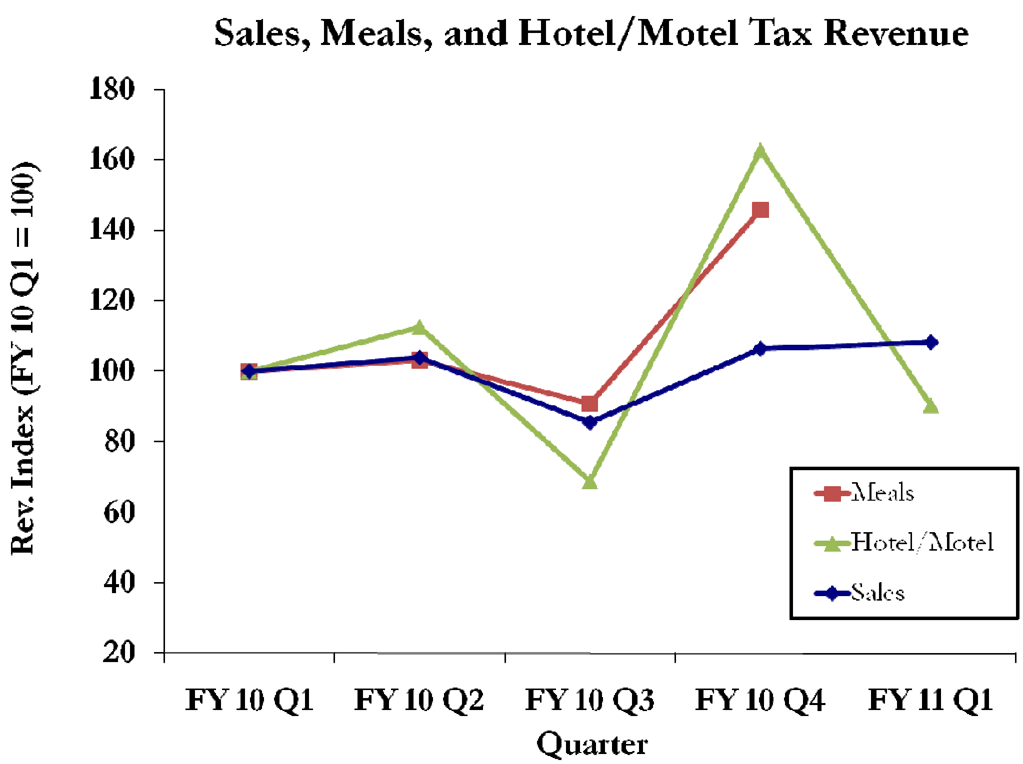
Sales tax revenues rise; hotel/motel tax revenues fall

Tax revenues offer a good indication of the state of the County's economy. Changes in sales, meals, and hotel/motel tax revenues in particular offer a reasonable approximation of strength or weakness in local economic conditions, since these revenue streams reflect the underlying consumption of many goods and services. At the national level, private consumption represents roughly 70% of all economic activity; the exact local percentage is not known but is thought to be a major component of Albemarle's economy. There exists *very* mixed news with regard to the performance of hotel/motel revenues and sales tax revenues between FY 10 Q1 and FY 11 Q1, the last quarter for which complete data exists.

Hotel/motel tax revenue dropped by about 9.7% between these quarters. (Note that the large increase between FY 10 Q3 and FY 10 Q4, shown on the graph below, reflects the seasonal impact of the University of Virginia graduation ceremonies, which take place in May of each year). This substantial drop in Q1-to-Q1 performance of hotel/motel tax revenue calls into question whether or not the County's tourism industry has bottomed out. If tourism did not bottom out, then we would expect to see meals tax revenue fall between the quarters in question. Data for meals tax revenue, unfortunately, was not available at the time of publication.

As for sales tax revenue, this item fared far better than did hotel/motel revenue. Between FY 10 Q1 and FY 11 Q1 the County's sales tax revenue grew by about 8.2%. The strength of this number is consistent with the timing of the officially-designated end of the "Great Recession" (see GDP story, page 6). Note that the increase in sales tax revenue, however, coincided with a small *decrease* in U.S. consumer confidence between the two quarters (see Consumer Confidence & Leading Economic Indicators story, page 5). This situation highlights the fact that, although a positive relationship is thought to exist between consumer expectations about the future, on the one hand, and current consumption, on the other hand, this relationship is not entirely perfect, especially if we compare changes in confidence at the *national level* with changes in *local* consumption. In the present case, at the national level consumer confidence tapered off a bit Q1-to-Q1, but consumption in Albemarle County, at least as measured by sales tax revenue, increased. (Hotel/motel tax revenue, as already noted, behaved in a way that was consistent with the *direction*, if not the *magnitude*, of the change in consumer confidence).

It should be pointed out that a number of factors might be influencing consumer behavior in such a way that growth in private consumption will be limited in the next several quarters. One factor almost certainly is the state of the labor market. Even though the U.S. economy has bottomed out and begun a modest recovery, the rate of growth in the economy has not been sufficient to bring down the unemployment rate (see Unemployment Rate, page 1). This uncertain employment environment clearly would not encourage consumers in Albemarle County to increase their purchases goods and services. A second factor that could be working against growth in consumption in the County involves ongoing weakness in the local real estate market (see Housing Prices story, page 3). As housing values have declined, Albemarle consumers likely feel less wealthy than they did during the "boom" years and, consequently, probably are spending less than they would if their housing-related wealth had not fallen with the housing market.



UNSOLD HOUSING INVENTORY RISES; PRICES REMAIN UNDER PRESSURE

Prices in Albemarle's housing market continue to face downward pressure as the result of an ongoing surplus in the supply of unsold homes. As a general rule of thumb, a residential real estate market is in equilibrium when a five or six month supply of unsold homes exists in that market. The term "equilibrium" means that prices are stable, with no tendency to rise or fall.

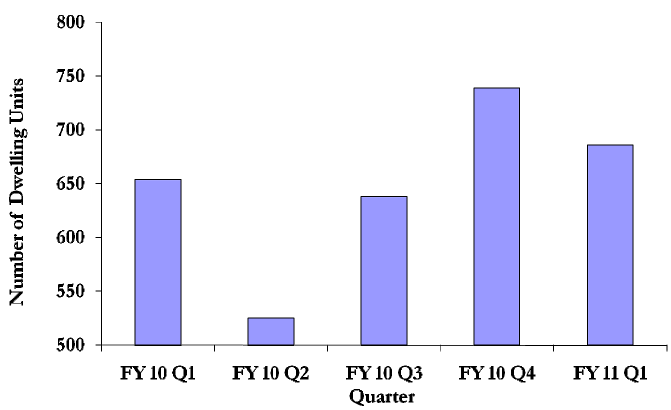
In the case of Albemarle County, as of the end of FY 11 Q1, there existed an 11.12 month supply of unsold single family detached dwelling units, compared with an 8.76 month supply in FY 10 Q1. Note that Q4 of FY 10 marked the end of the federal government's homebuyer tax credit; the marked increase in inventory from FY 10 Q1 to FY 11 Q1 likely reflected the expiration of the tax credit, which essentially subsidized the purchase of housing. The surplus of single family units for sale in FY 11 Q1 indicates that downward pressure on prices continues to exist in this segment of the housing market. Single family detached homes account for roughly two-thirds of the County's total housing stock, so this situation has broad implications for Albemarle.

In order to understand how this 11.12 month number is calculated, consider the information contained in Graphs I through III below. As shown on Graph I, in FY 11 Q1, there were 686 single family homes for sale in Albemarle. During this quarter, as shown on Graph II, an average of about 62 homes sold each month. These numbers mean that, at the rate at which homes sold during the quarter, it would have taken about eleven months to sell all of the homes that were on the market, i.e., there was about an eleven month supply of unsold inventory, as shown on Graph III.

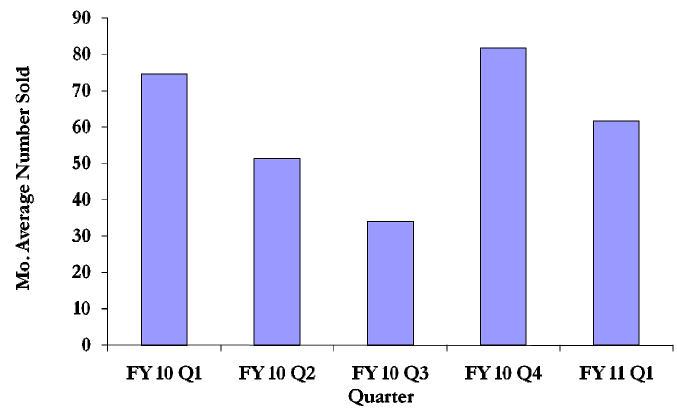
The downward pressure on home prices that persisted during the course of the past year is reflected in the Charlottesville MSA home price data shown in Graph IV, below. The U.S. Federal Home Finance Administration's Home Price Index (HPI) for the *region* declined by about 5% between FY 09 Q4 and FY 10 Q4. It is worth emphasizing, however, that this FHFA data includes outlying counties, not just Albemarle, and covers only purchases or re-financings in which conforming mortgages were involved.

These two quirks in the HPI numbers mean that (a) the data from the outlying counties, where the region's housing prices, according to local Realtors, have declined the most, might be influencing the regional index number disproportionately; and (b) the HPI numbers likely do not include a significant portion of sales or re-financings that took place in Albemarle County, since Albemarle tends to have a larger percentage of higher-end homes than do the outlying jurisdictions, and the sale or re-financing of higher-end properties in many cases involves the use of "jumbo" mortgages, rather than conforming mortgages.

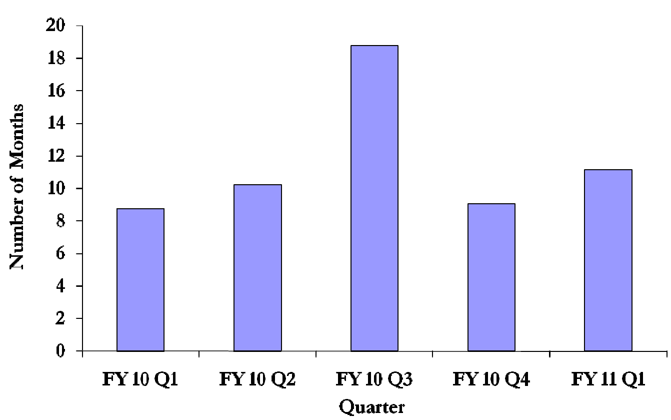
Graph I -- Single Family Homes for Sale



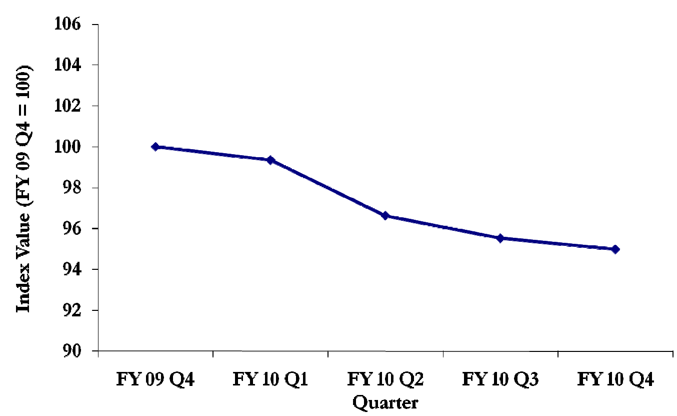
Graph II -- Mo. Avg. No. of S. Family Homes Sold



Graph III -- Mos. Supply Unsold S. Fam. Homes



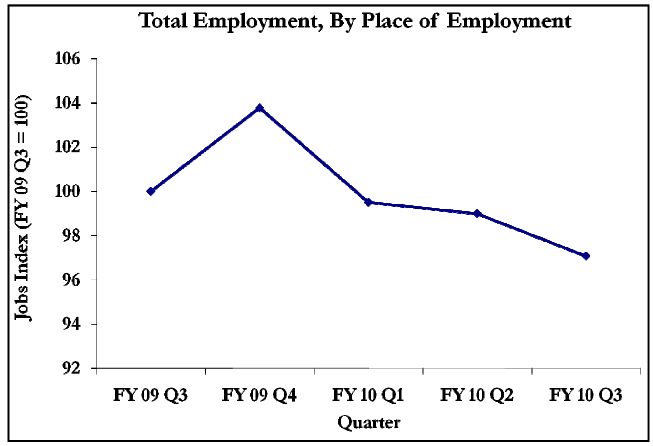
Graph IV -- FHFA Price Index for the C-Ville MSA



TOTAL EMPLOYMENT FALLS, BUT FINANCE, REAL ESTATE GAIN

The Virginia Employment Commission produces data showing the total number of full- and part-time jobs in Albemarle County, by place of employment, but this data, unfortunately, is usually several quarters behind the most recent quarter and, consequently, does not provide as much timely information as does the VEC unemployment rate data, which is fairly current. According to the most recently available total employment numbers, between FY 09 Q3 and FY 10 Q3, the total number of jobs in Albemarle fell from 48,446 to 47,033 for a net loss 1,413 jobs, or about 3% of the employment base. An examination of the various employment sectors reveals that the retail trade and manufacturing categories experienced the largest drops in the *absolute number* of jobs. The net loss in the retail trade sector came to 440 jobs (8%), while the net loss in the manufacturing sector equaled 399 jobs (14.3%). The drop in retail trade employment is not surprising given that, during the time period in question, sales tax revenue in the County declined. (Note: Sales tax revenue has grown in subsequent quarters. Please see Tax Revenue story, page 2).

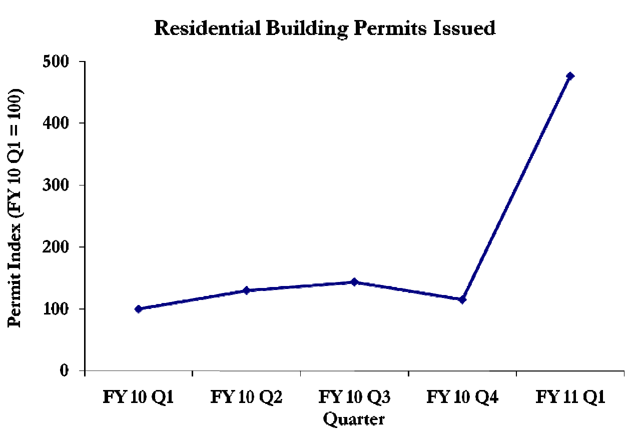
Other sizable employment categories that had large *percentage* losses included administrative & waste services (296 jobs, or 16.4%), agriculture (a loss of 46 positions, or 11.2%), and the construction sector (289 jobs, or 10.7%). Interestingly, two sectors that were at the root of the cause of the "Great Recession" actually managed to *grow* between FY 09 Q3 and FY 10 Q3; the finance & insurance sector experienced a net gain of 55 positions (6.2%) while the real estate category had a net addition of 38 jobs (5.7%). These modest net gains between FY 09 Q3 and FY 10 Q3 suggests that the *worst* of the recession in the two sectors has passed, although real estate generally is not out of the woods yet (see Housing Price story, page 3), despite gains in construction (see New Construction story below).

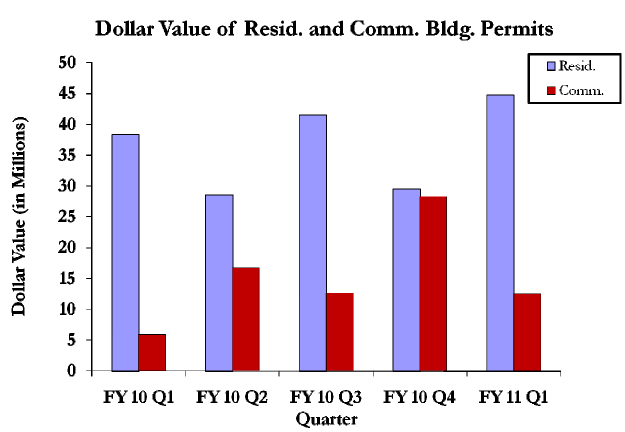


"The fact that the finance & insurance and real estate categories were able to eke out modest net gains in employment between FY 09 Q3 and FY 10 Q3 suggests that the worst of the recession in these sectors has passed."

NEW CONSTRUCTION JUMPS, BUT INCREASE IS MISLEADING

The number of building permits issued, and the total dollar value of these permits, offers a decent, but not *perfect*, forward indication of the quantity and nature of new construction in the County. On the residential side of the market, the number of building permits issued between FY 10 Q1 and FY 11 Q1 spiked by 376%. According to the County's Department of Community Development, however, over 300 of the 381 permits issued in FY 11 Q1 were for two projects only: Arden Place and Treesdale, which are comprised mostly of apartments and townhouses. The relative scarcity of new *single family home* building permits reflects a market response to the surplus of unsold single family detached inventory in the County's housing market (see story on Page 3). The total *dollar value* of residential permits increased by a more modest 17% between FY 10 Q1 and FY 11 Q1. On the non-residential side, meanwhile, the dollar value of permits issued jumped by about 111% between FY 10 Q1 and FY 11 Q1. This spike, again, is misleading since, in the base quarter of FY 10 Q1, the County experienced a very depressed level of non-residential construction. According to the County Assessor, non-residential capitalization rates have been increasing in recent quarters. These increases indicate an underlying surplus of commercial property, so the volume of non-residential construction likely will be modest in the coming year.



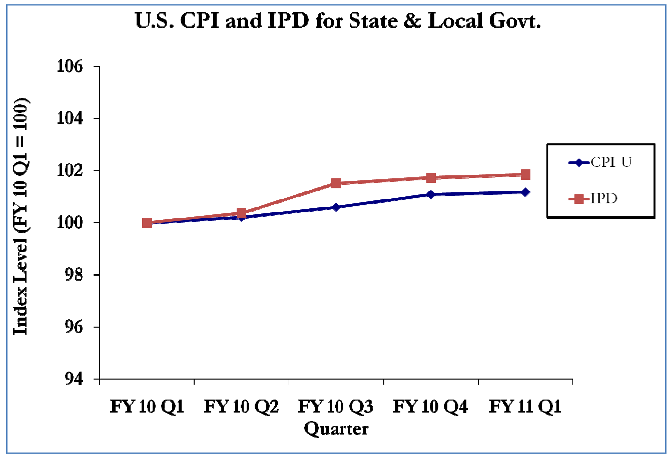


U.S. PRICE INDICES POST MODERATE INCREASES

The U.S. Consumer Price Index (CPI) and the Implicit Price Deflator (IPD) for state and local governments rose slightly between FY 10 Q1 and FY 11 Q1. The increase in CPI came to 1.18%, while the rise in the IPD equaled 1.85%. The year-over-year increases in these indices seem to reflect a diminished prospect of price deflation. Potential price deflation has motivated the U.S. Federal Reserve to keep nudge interest rates to historically low levels, in order to stimulate demand for goods and services.

Although CPI and the IPD both measure changes in prices, the two indices track price changes in two different market baskets of goods and services. The Consumer Price Index pertains to goods and services that *households* are likely to purchase, while the Implicit Price Deflator pertains to goods and services that *state and local governments* are likely to purchase. Households, for example, might buy items such as diapers, and barber services, while state and local governments are more likely to buy things such as police radios and traffic lights. Clearly, there exists some overlap between the two market baskets; households, as well as state and local governments, buy products such as personal computers, pens, and motor vehicles.

The differences that exist in the two sets of market baskets, however, typically generate numbers that do not coincide with each other, especially in the long run. As shown on the graph, IPD increased by only slightly more than did the CPI between FY 10 Q1 and FY 11 Q1. At first glance this situation would seem to suggest that the two price indices move pretty much in tandem over time, but the cumulative impact of differences in annual rates of change can render large long-term gaps between CPI and IPD price levels. Between FY 06 Q1 and FY 11 Q1, for example, CPI increased by 10.9% while IPD for state and local government rose by 18.2%, or at a rate that was about 67% higher than Consumer Price Index's rate of growth.



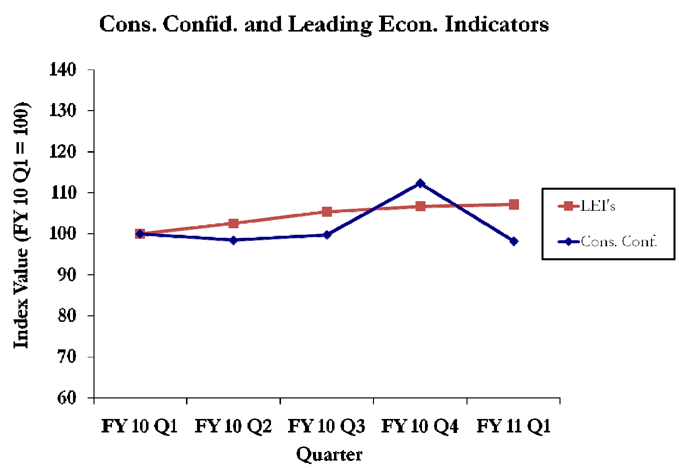
"The Consumer Price Index (CPI) pertains to goods and services that households are likely to purchase, while the Implicit Price Deflator (IPD) pertains to goods and services that state and local governments are likely to purchase."

CONSUMER CONFIDENCE DIPS; LEI'S GROW STEADILY

The Conference Board, a nonprofit organization that tracks business and economic trends, publishes a U.S. Consumer Confidence Index, as well as a set of U.S. Leading Economics Indicators (LEI's). The numbers in these data sets offer a general idea about the direction of U.S. macroeconomic trends and, by extension, Albemarle County's economic prospects.

Changes in consumer confidence should shadow changes in consumption. As shown in the graph, consumer confidence dipped by about 2% between FY 10 Q1 and FY 11 Q1. This drop *contrasted* with the *growth* that took place in U.S. GDP between FY 10 Q1 and FY 11 Q1 (see story on page 6), and a rise in local consumption, as measure by the County's sales tax revenue (see story on page 2).

The U.S. Leading Economic Indicators, on the other hand, rose by about 7% between FY 10 Q1 and FY 11 Q1. The LEI's include items such as weekly manufacturing hours, interest rates, and orders for capital goods. Interestingly, the improvement in the LEI figures largely *outpaced* the 4.3% growth in U.S. GDP that took place between FY 10 Q1 and FY 11 Q1. The 7% increase in the LEI's, along with the fact that the LEI's consistently rose between each of the quarters during this time period, suggests that the economic recovery that began at the end of FY 09 Q4 might be somewhat stronger than has been anticipated.



The 7% rise in the Leading Economic Indicators, vs. 4.3% growth in U.S. Gross Domestic Product, suggests that the economic recovery that began at the end of FY 09 Q4 might be somewhat stronger than has been anticipated.

U.S. GDP Expands by 4.36% During Q1-to-Q1 Period

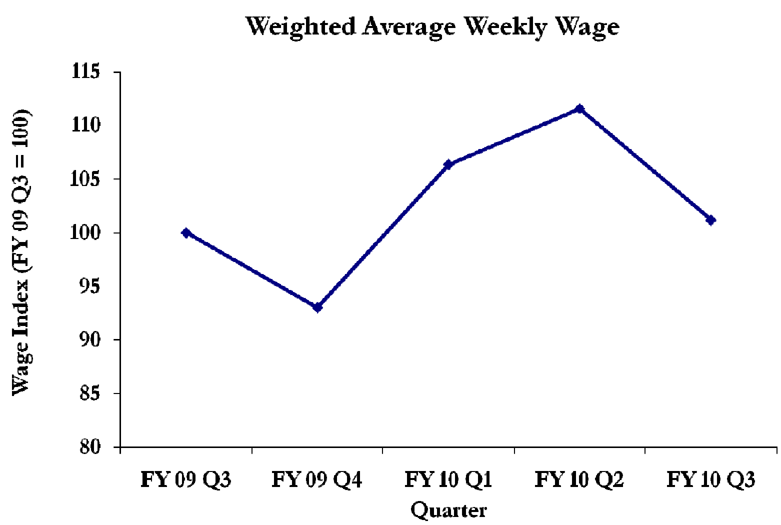
U.S. Gross Domestic Product (GDP) represents the total dollar value of all the goods and services produced within the United States. Between FY 10 Q1 and FY 11 Q1, U.S. GDP rose from $14.115 trillion to $14.730 trillion, or by 4.36%, consistent with the continuation of the recovery from the severe national recession that began in December of 2007. It is worth noting that U.S. GDP has grown in each of the quarters since FY 09 Q4, the officially-designated end of the recession. Many economists now think that the recovery has reached a self-sustaining phase and that the U.S. will not experience a "double dip" recession.

Despite this seemingly good news, two scenarios, either separately or together, could derail the recovery: (1) a sovereign default in one or more of the Euro Zone countries; and (2) an inflation-fighting, government-induced slowdown of China's economy. Even without these two scenarios, the question remains as to whether or not the current U.S. economic recovery will be sufficiently strong to bring down the country's unemployment rate in coming quarters.

Note that the U.S. Bureau of Economic Analysis (BEA), the entity that calculates U.S. GDP, also calculates a GDP figure for Virginia, as well as regional GDP data for the Charlottesville MSA, but this information is done only on an annual basis and is not completed until well after the end of the calendar year. This regional GDP data will be tracked annually by the County.

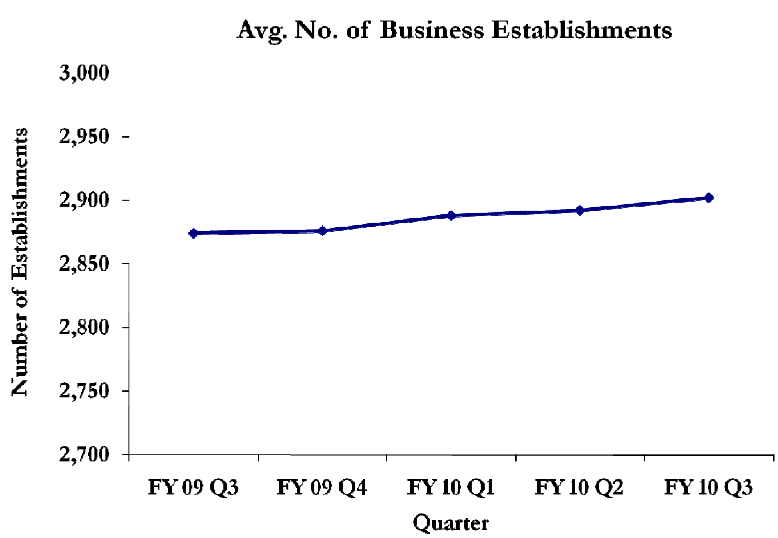
Weighted Average Weekly Wage Rises Slightly

The weighted average weekly wage gives a *rough* idea about changes in the earnings of the "typical" worker in Albemarle. The most relevant comparison involves the same quarter between years, since the weighted average weekly wage can be influenced by changes in seasonal employment. Between FY 09 Q3 and FY 10 Q3, the weighted average weekly wage rose by 1.18% in nominal terms, but this growth could have resulted from job losses in low-paying sectors, such as construction, rather than an improvement in wages. Given the fact that the County's unemployment rate remains elevated (see story, page 1), Albemarle should not expect to see strong growth in the weighted average weekly wage in quarters to come.



Number of Businesses is Relatively Flat

Changes in the average number of businesses that exist in Albemarle in each quarter renders an approximate estimate of business formation in the County. The Virginia Employment Commission does not generate this data in a timely manner but, between FY 09 Q3 and FY 10 Q3, the number of businesses in Albemarle was essentially flat (going from 2,874 to 2,902 or an increase of just under 1%). This percentage change, although small, at least was in the right direction. Previously, between FY 08 Q3 and FY 09 Q3, Albemarle experienced *declines* in the number of businesses.



Albemarle County is a community of 94,000 people, located 116 miles southwest of Washington, DC, and 72 miles northwest of Richmond. Founded in 1744, Albemarle surrounds the City of Charlottesville, and is the home of the University of Virginia, the University of Virginia Medical Center, and Thomas Jefferson's Monticello. The County's resident labor force of 52,000 is well-educated; 53% of the population aged 25 or older has at least a bachelor's degree. Industries that have expanded in Albemarle in recent years include biotechnology and national defense intelligence. The County's location at the intersection of Interstate 64 and U.S. Highway 29, the availability of air service to several major hubs from the Charlottesville/Albemarle Airport, and AMTRAK passenger rail service to the northeast corridor help support Albemarle's role as a transportation hub in Central Virginia. The County's natural beauty and historical importance, additionally, continue to attract visitors from around the world.

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The Albemarle Quarterly Economic Indicators *is published in the middle of February, May, August, and November by the Albemarle County Office of the County Executive, 401 McIntire Road, 4th Floor, Charlottesville, VA 22902. For additional information about this newsletter, please contact Steven A. Allshouse, Coordinator of Research and Analysis at (434) 296-5841 or at sallshouse@albemarle.org.*

Summary & Analysis

The U.S. economy has begun to recover from the severe recession that started in FY 08 Q2, and the incipient recovery bodes well for Albemarle. The National Bureau of Economic Research (NBER), the organization that designates the official beginning and end of business cycles, has determined that the "Great Recession" ended in FY 09 Q4. Since that time, U.S. Gross Domestic Product (GDP) has expanded each quarter [see story, page 6].

It is worth noting that, in terms of GDP at least, the U.S. economy already has *fully* recovered from the recession. (The term "recovery" means that economic conditions are improving, while "full recovery" means that the economic activity has returned to the level that existed prior to the beginning of the recession). In FY 08 Q2, at the official beginning of the recession, total U.S. GDP stood at $14.291 trillion. By FY 09 Q4, at the depth of the recession, GDP had contracted to $14.035 trillion but, by FY 11 Q1, the U.S. economy had grown to $14.730 trillion, a gain of $439 billion over the level that existed at the start of the recession. As impressive as this performance has been, however, several challenges exist that the U.S. economy must overcome before the expansion begins to have the look and feel of a true recovery for most people and businesses. In the case of individuals, the biggest hurdle involves the job market. Workers in the U.S. will be disinclined to purchase goods and services if the national unemployment rate remains elevated. For businesses, particularly small enterprises, the recovery will not feel authentic until the availability and terms of credit improve, and orders for goods and services increase at a sustained, robust rate.

Locally, Albemarle's quarterly indicators offer some glimmers of hope that the County's economy is recovering but, as might be expected during the course of a weak expansion, the signals remain mixed. Sales tax revenues grew robustly Q1-to-Q1 but, at the same time, hotel/motel tax revenues dropped substantially from their year-ago level. This situation offers conflicting evidence that consumption, which is thought to be a major portion of the County's economy, is making a rebound [see story, page 2]. The unemployment rate, likewise, offers mixed signals. The rate did not increase substantially between FY 10 Q1 and FY 11 Q1 but unemployment remains high [see story, on page 1].

The County's housing market for single family detached dwelling units, meanwhile, remains problematic, but two new *multifamily* residential projects did result in a spike in the issuance of new building permits during the course of FY 11 Q1 [see Housing Market story, page 3 and New Construction story, page 4]. On the non-residential side of the real estate market, the County in recent quarters has experienced strong construction activity, but this strength was the result of three major projects at the University of Virginia Medical Center and Martha Jefferson Hospital. These projects now either are finished or are nearing completion, and rising capitalization rates for non-residential properties, suggest that there will be weakness in the County's non-residential real estate market in the coming year [see New Construction story, page 4].

The County's economic picture, in general, remains mixed. This situation does not come as surprise, since the U.S. economy continues to struggle to find its footing, and the success of the U.S. Federal Reserve System's recent efforts to avoid deflation and stimulate growth via quantitative easing remains to be seen. A reasonable forecast for the next several quarters would be that the County's economy will grow slowly, as businesses and consumers maintain a cautious outlook and behave accordingly.