

Hobbs, Ong & Associates APPLIED ANALYSIS

PUBLIC FINANCE

R E P O R T

This Public Finance Report offers a progress report on Nevada's arduous road to economic recovery, along with an update on tax collections in the months since the 2011 Legislature adjourned and some observations on the state's new economic development process.

There are three ways to address budget shortfalls – to cut expenses, to raise revenue; or, less finite and more hopeful, to bank on “growing” out of deficits through economic recovery. Gathering political support for either of the first two can be daunting, but virtually everyone hails the prospect of economic recovery. What would recovery look like in the context of Nevada's state budget? Some might define it as merely the cessation of further decline in public revenue; while others may define it as restoration of revenue levels enjoyed before the deepest recession in 80 years. Though this discussion is in context of the state budget, it also serves as a surrogate for challenges faced by counties and cities, since the same economy drives state and local fiscal affairs.

CURRENT ECONOMIC INDICATORS

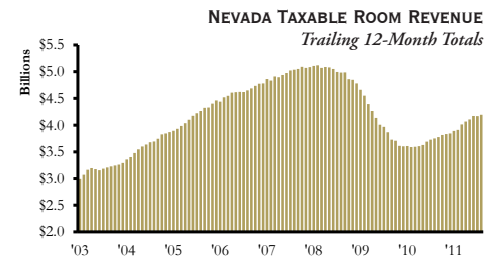
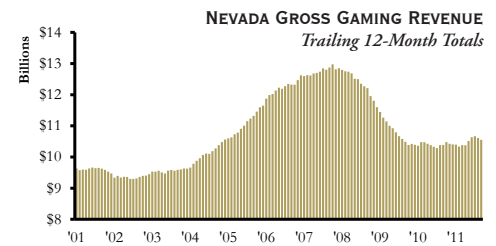
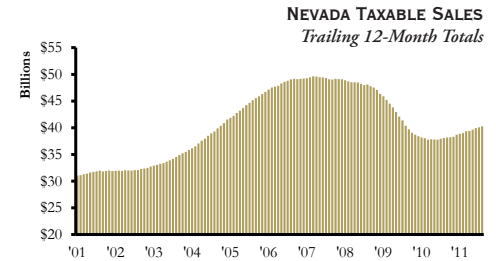
The Nevada economy is showing faint signs of recovery, but the indicators are still too mixed to warrant unbridled celebration.

Taxable sales continue to rise modestly. After the calamity of FY 2009 and FY 2010, in which sales tax revenues fell in 22 out of 24 months, Nevada enjoyed increases in every month of FY 2011, ending the year with a 5.7 percent overall gain; and, the first two months of FY 2012 produced a 5.2 percent increase over the same months in FY 2011. This is good news. However, these advances should be viewed with some caution, as construction of utilities in rural areas has been a strong factor in the returns, and increases in Clark and Washoe counties have recently lagged the statewide average. Finally, if last year's growth rate were to continue unchanged, Nevada's sales tax revenue in 2016 would be the same as in 2007, a stark reminder of the size of the “bubble”.

After finishing FY 2011 with a 3.3 percent gain over the previous year, year-to-date gross

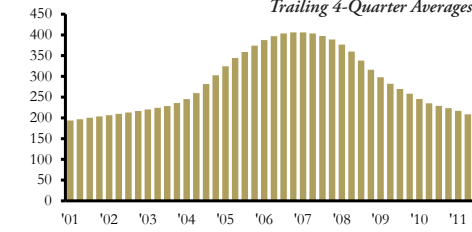
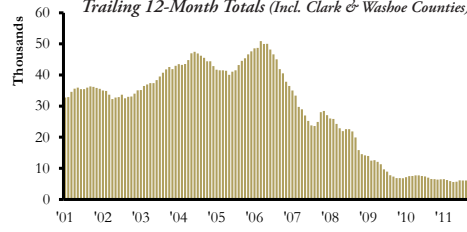
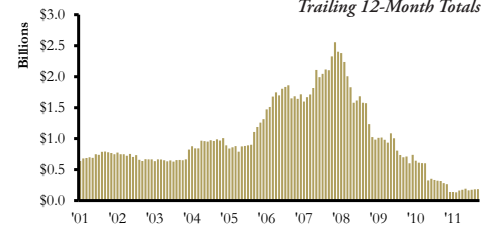
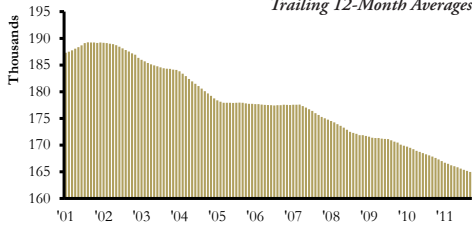
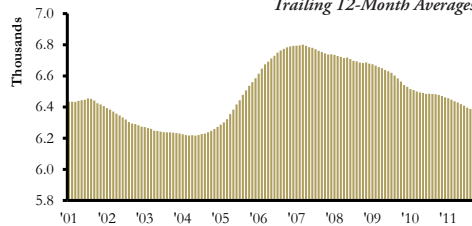
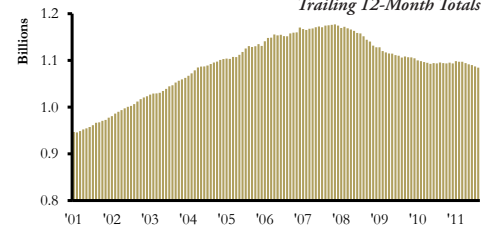
gaming fee collections have declined 5.5 percent in FY 2012, largely from baccarat play on the Las Vegas Strip, a component of gaming revenue which can swing widely from

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TRAILING 3-Months/Quarterly Series	Most Recent Data Available	INDICATOR VALUES			GROWTH RATES	
		Current 3-Month Period/Qt.	Previous 3-Month Period/Qt.	Same 3-Months/Quarter Prev. Yr.	VS. Previous Period	VS. Same Period Prev. Yr.
Nevada Taxable Sales (1)	Aug-11	\$10,430,118,942	\$10,381,365,021	\$9,795,727,129	0.5% ▲	6.5% ▲
Nevada Gross Gaming Revenue (1)	Sep-11	\$2,610,878,520	\$2,632,672,204	\$2,692,002,100	-0.8% ▼	-3.0% ▼
Taxable Rooms Revenue (1)	Aug-11	\$1,059,073,920	\$1,114,160,419	\$972,082,968	-4.9% ▼	8.9% ▲
Nevada Housing Price Index	Q2 2011	189.9	205.2	222.8	-7.5% ▼	-14.8% ▼
Nevada Residential Housing Units Permitted (1)	Sep-11	1,180	2,017	1,221	-41.5% ▼	-3.4% ▼
Clark County Commercial Permit Valuation (1)	Sep-11	\$28,975,286	\$41,512,358	\$8,462,798	-30.2% ▼	242.4% ▲
Slot Machines in Nevada (2)	Sep-11	163,791	163,756	166,215	0.0% ▲	-1.5% ▼
Gaming Tables and Games in Nevada (2)	Sep-11	6,343	6,385	6,455	-0.7% ▼	-1.7% ▼
NV Taxable Gasoline Gallons of Gasoline (1)	Aug-11	284,980,000	279,010,000	291,900,000	2.1% ▲	-2.4% ▼
NV Private Sector Establishment-based Empl. (2)	Sep-11	970,867	969,933	965,100	0.1% ▲	0.6% ▲
Quarterly Wage Payments	Q1 2011	\$9,616,742,168	\$10,673,696,075	\$9,219,231,365	-9.9% ▼	4.3% ▲
Cigarette Packages (1)	Aug-11	32,632,800	32,213,700	31,782,000	1.3% ▲	2.7% ▲
Gallons of Liquor (1)	Aug-11	23,942,591	23,412,166	23,285,393	2.3% ▲	2.8% ▲
Estimated Value of Real Property Transferred (1)	Aug-11	\$5,277,862,736	\$5,277,868,464	\$5,270,845,036	0.0% ▼	0.1% ▲
Estimated Value of Vehicles (1)	Aug-11	\$2,115,608,197	\$2,092,018,491	\$2,318,747,563	1.1% ▲	-8.8% ▼

NOTES: (1) Trailing 3-month totals. (2) Trailing 3-month averages.

NEVADA HOUSING PRICE INDEX
Trailing 4-Quarter AveragesNEVADA RESIDENTIAL HOUSING UNITS PERMITTED
Trailing 12-Month Totals (Incl. Clark & Washoe Counties)CLARK COUNTY COMMERCIAL PERMIT VALUATIONS
Trailing 12-Month TotalsNEVADA SLOT MACHINE COUNTS
Trailing 12-Month AveragesNEVADA GAMING TABLE AND GAME COUNTS
Trailing 12-Month AveragesNEVADA TAXABLE GALLONS OF GASOLINE
Trailing 12-Month Totals

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month to month. The outlook for gaming as a whole is generally toward gradual, though fitful, recovery. If last year's growth rate were to continue unchanged, Nevada's gross gaming fee collections in 2018 would be the same as in 2007, giving further pause to notions of restoring public services to pre-recession levels.

While gaming revenue continues to be viewed with some wariness, other tourism measures have shown steady signs of improvement. In September, Las Vegas visitor volume increased once again for a 4.7 percent year-to-date gain over calendar 2010. McCarran International Airport passenger counts increased 8.7 percent in September, the ninth consecutive month of advance, boosting the year-to-date gain to 4.5 percent.

In September, Nevada's unemployment rate remained flat at 13.4 percent, seasonally adjusted; with total employment also virtually constant. Slight gains were made in leisure and hospitality and construction, the latter of which may be an early sign of hope that the bleeding may have stopped in the hardest-hit industry. Looking ahead at construction demand, the number of new home closings, though still anemic by historical standards, has risen more than twice as fast on a percentage basis than closings of existing homes since the beginning of the calendar year, a trend worth watching as we await any hint of housing recovery. On the dark side, however, the commercial market offers little prospect for construction employment, as

vacancy rates crept higher in the third quarter, to 25.2 percent for office and 10.8 percent for retail, and fell slightly to 18.0 percent for industrial space. Rental rates in all three sectors continue to fall.

In September, the median closing price for existing single family homes rose slightly to \$104,200, 11.5 percent less than last year, and 63.8 percent less than the peak level in 2007. Of note, new home closings rose slightly as a percentage of total closings for the month, to 7.4 percent compared to 5.7 percent in May, as cited in the previous public Finance Report. Comparisons of closings and pricing between new and existing homes will

continue to be watched, as both investors and potential owner-occupants contemplate their next steps.

STATUS QUO IN THE NEAR TERM

Only six months of tax receipts has been processed since March, when revenues were last tallied for legislative projections. While it is far too early for predictions, some preliminary observations may be made.

Looking past the plethora of temporary revenues, Rainy Day Fund transfers, fiscal diversions, and borrowing authority enacted to make the state general fund appear "balanced";

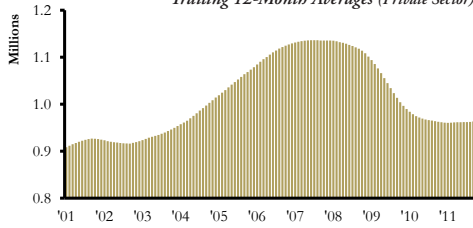
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**TRAILING
12-Months Series**

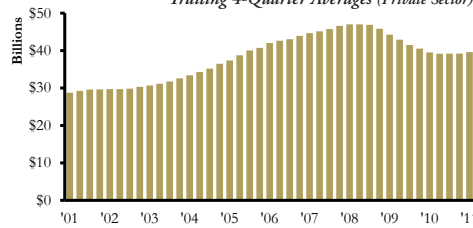
	Most Recent Data Available	INDICATOR VALUES			GROWTH RATES		
		Current 12-Month Period	Previous 12-Month Period	Same 12-Months Previous Year	VS. Previous Period	VS. Same Period Prev. Yr.	
Nevada Taxable Sales (3)	Aug-11	\$40,271,199,277	\$40,087,101,879	\$38,085,302,426	0.5%	5.7%	
Nevada Gross Gaming Revenue (3)	Sep-11	\$10,553,566,886	\$10,607,479,480	\$10,388,513,002	-0.5%	1.6%	
Taxable Rooms Revenue (3)	Aug-11	\$4,193,300,611	\$4,168,531,280	\$3,749,738,269	0.6%	11.8%	
Nevada Housing Price Index	Q2 2011	208.7	216.9	235.1	-3.8%	-11.2%	
Nevada Residential Housing Units Permitted (3)	Sep-11	6,117	6,067	6,588	0.8%	-7.1%	
Clark County Commercial Permit Valuation (3)	Sep-11	\$185,105,151	\$180,791,242	\$315,145,000	2.4%	-41.3%	
Slot Machines (4)	Sep-11	164,993	165,172	167,852	-0.1%	-1.7%	
Gaming Tables and Games (4)	Sep-11	6,381	6,388	6,482	-0.1%	-1.6%	
NV Taxable Gasoline Gallons of Gasoline (3)	Aug-11	1,084,570,000	1,087,260,000	1,095,670,000	-0.2%	-1.0%	
NV Private Sector Establishment-based Empl. (4)	Sep-11	963,367	962,358	963,808	0.1%	0.0%	
Quarterly Wage Payments	Q1 2011	\$39,578,221,171	\$39,180,710,368	\$39,506,644,874	1.0%	0.2%	
Cigarette Packages (3)	Aug-11	124,086,000	123,662,700	125,947,800	0.3%	-1.5%	
Gallons of Liquor (3)	Aug-11	89,490,791	88,322,674	88,379,942	1.3%	1.3%	
Estimated Value of Real Property Transferred (3)	Aug-11	\$20,081,436,600	\$20,049,803,827	\$20,546,127,800	0.2%	-2.3%	
Estimated Value of Vehicles (3)	Aug-11	\$8,470,649,839	\$8,540,854,792	\$9,023,933,974	-0.8%	-6.1%	

NOTES: (3) Trailing 12-month totals. (4) Trailing 12-month averages.

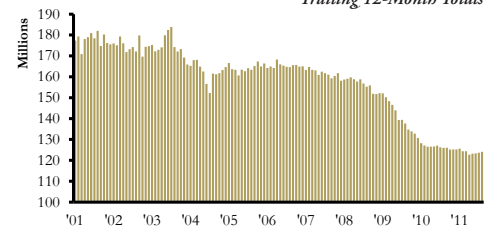
NEVADA ESTABLISHMENT EMPLOYMENT
Trailing 12-Month Averages (Private Sector)



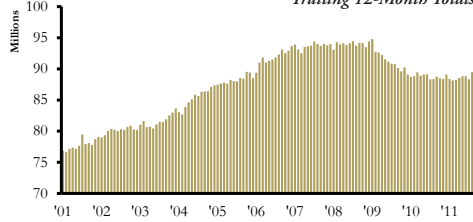
NEVADA WAGE PAYMENTS
Trailing 4-Quarter Averages (Private Sector)



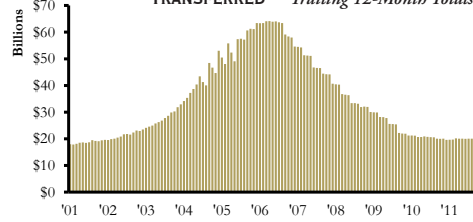
NEVADA CIGARETTE PACKAGES PURCHASED
Trailing 12-Month Totals



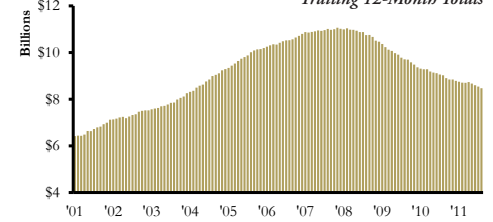
NEVADA GALLONS OF LIQUOR PURCHASED
Trailing 12-Month Totals



NEVADA ESTIMATED VALUE OF REAL PROPERTY
TRANSFERRED — Trailing 12-Month Totals



NEVADA ESTIMATED VALUE OF VEHICLES
Trailing 12-Month Totals



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if that portion of the revenue structure which is not scheduled to expire grows only at its present rate, it appears unlikely Nevada can avoid another gap between current expenditures and permanent revenue in 2013. Taxable sales, gaming, and the remainder of the tax base would have to recover nearly twice as fast as they have in the past year to equal or exceed the amount of budget gimmicks under which we now operate. Accordingly, chances appear slim that such measures will be found altogether unnecessary in 2013, absent some form of revenue enhancement – a tax increase – or more expenditure reductions. Given the sluggish jobs and housing markets, there is as yet no compelling evidence to suggest such an increase in existing public revenue will materialize, and these gimmicks, or successor gimmicks, may be in play once again.

A FOUNDATION FOR LONG TERM ECONOMIC DEVELOPMENT

Nevada's historical approach to economic development has been both credited for the state's historical rate of growth and reviled for its reliance on a single selling point, low taxes. The most caustic criticism came from those who saw the preexisting system as a clearing-house for awarding tax breaks to businesses unworthy of such benefit.

Governor Brian Sandoval's opening message to the 2011 Legislature emphasized the need to redouble Nevada's economic development efforts; and the Legislature responded by passing Assembly Bill 449, creating the Board of Economic Development to include

voting representation of the Governor, Lieutenant Governor, and Secretary of State, private sector members appointed by the Governor and legislative leadership; and non-voting members representing the Nevada System of Higher Education and the Nevada Department of Employment Training and Rehabilitation. The Governor or his designee will chair the Board, and the Governor has appointed the Executive Director of the Office of Economic Development within the Governor's office. While the organization may seem complex, its objectives appear clear – to elevate economic development as a core function of the Governor's office, to give legislative leadership a say in the direction of the agency, and to involve those who provide higher education and who bring a high level view of the job markets.

In addition, the Nevada Catalyst Fund was created, and \$10 million was provided for grants, loans, and other uses intended to foster economic development. The legislation also allows acceptance of other monies to augment these efforts. Notably, the Catalyst Fund has not been scheduled to revert to the general fund at the end of any fiscal year – a status accorded to only the most sacrosanct of appropriations.

CONCLUSION

Status quo is not encouraging. Nevada has a narrowing tax base and is reluctant to tax to the level of our wants or cut expenses to the level of real revenue. The state's economy has at last proven even more vulnerable than

others, and yet the state continues to rely on temporary revenue in support of basic, recurring services. Today's fiscal imbalances will not be solved if today's tax base and economy are held constant. Lawmakers have not been able to change the former; but, as stated, the concept of "growth" is more easily digested than cutting costs or raising taxes, and policy makers have agreed on some form of substantive change. A new framework for economic development is now taking form. Let us hope that those lofty ideals can be translated into tangible results. ■

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