

MEMORANDUM

TO: Board of County Commissioners
FROM: Daniel C. Holler, County Manager
DATE: March 2, 2006
RE: The State of Douglas County

Background

The economic recovery that started in 2003, in the State and the Nation continued as expected through 2004 and 2005. Nevada's taxable sales were up 13.7% from Fiscal Year (FY) 04 to FY05, following a 15% increase over the previous fiscal year. Statewide growth continues for the first six months of FY06, showing a 14.2% increase. Only one county saw a drop in sales tax revenues from FY04 to FY05 (Mineral).

Gaming revenues are also growing statewide with an increase of 8.4% for FY05 over FY04. Gaming win for the first six months of FY06 were up 12.19%. Gaming win in Northern Nevada has even increased, with Washoe County up 6.06% for the first 6 months of FY06, following only .51% increase from FY04 to FY05. South Lake Tahoe win was down 3.32% from FY04 to FY05. However, win was up 2.93% for the first 6 months of FY06. The Carson Valley Area (Carson Valley and Carson City) is up 8.88% for the first 6 months in FY06, with gaming win up 11.67% from FY 04 to FY05.

New private sector jobs in Nevada grew by over 63,000 in 2005, again leading the nation in percentage job growth. Assessed values going into FY07 are up for each county with the exception of Lander County, which saw a drop in Net Proceeds of Minerals.

Douglas County has generally shared in Nevada's economic prosperity. Over the past two years the County has relied on the positive financial position to meet budgetary needs. Going into 2005 the outlook for the County was bright, allowing the County to focus on meeting the current and future needs of the community. The State of the County was characterized as "Good." However, the current state of the County has shifted to one of uncertainty with signs of fiscal stress.

Douglas County's Economic Overview

The County's financial status has been pressured from external factors and continued to experience sluggish growth or decline in tourism. Conservative financial policies, management, and practices, implemented over the past few years allowed for a stable FY06 budget.

The strength and/or weakness of our economy are reflected in a number of key indicators. Compared to the past two years, the County experienced a larger number of negative economic indicators again with the majority of lagging indicators related to tourism. Douglas County's fiscal indicators include the following changes from FY04 to FY05:

Revenue Trends:

- Taxable sales up 7.2% (compared to 15.6% last year)
- Assessed Value up 7.6% (Property tax caps limited revenues)
- General Fund operating revenues up 7.8%
- General Fund property tax up 6.1% (compared to 11.0% increase last year)
- Building permit revenues up 9.5%
- Gaming revenues down 0.6% (follows a drop of 8.9% last year)
- Gas tax revenues down 2.5% (last year was up 2.0%)
- Room tax revenues down 0.8% (follows a drop of 1.9% last year)
- South Tahoe gaming win down 3.3%
- Carson Valley win up 11.7% (strong gains from new openings in Carson City)

As a service providing organization, primary costs are personnel related. FY05 personnel costs accounted for 55% of total operating expenditures and 77% of General Fund operating expenditures. Key expenditure indicators include the following:

Expenditure Trends:

- General Fund operating expenditures up 8.4% (compared to only 3.7% last year)
- County salary and wage cost up 5.1%
- Medical insurance cost up 21.7%
- Workers compensation down 6.0%
- County personnel cost up 5.9%
- Senior Services expenditures up 7.6%
- East Fork Fire/Paramedic Districts operating expenditures up 5%

The economic indicators reflect a mix of factors impacting the fiscal stability of the County. The County's manufacturing and related industrial development continued in 2005. There were small increases in the service industry, including automotive, professional, personal care, health care and home services. Construction was generally stable, with permits for single-family homes in 2005 at 537. This is under the 555 average experienced from 2000 through 2005.

The retail and commercial sectors grew at a slower pace as measured by a 7.2% increase in taxable sales. Our tourism industry continues to struggle and is an area of concern for economic growth. This is seen in the steady decline in room tax revenues over the past few years and

limited increases or declines in some of the key sales tax categories (i.e. eating and drinking is down 4.9% for the first 6 months of FY06).

The strength of the County’s economy has a direct impact on the budget and the ability to provide services. It is the stability and growth of the budget that translates into the ability to provide public services. This includes having attractive and appealing parks and recreational opportunities, meeting the needs of seniors (i.e. transportation, meals, and social activities), feeling safe, wildland fire protection, clean neighborhoods, good schools, safe streets, efficient water and sewer systems, and job and housing opportunities - to note just a few of the attributes of what makes our community a desirable place to be.

Douglas County’s Economy

The financial health of Douglas County is tied directly to our economy. To understand our economy and the dynamics that work together to support government services, there are four broad areas to review. These include the development of primary jobs, the retail/commercial sector, tourism and hospitality industry, and the construction industry including both housing and commercial projects.

Primary Job Growth

The development of primary jobs and related business activity is emerging as one of the County’s strongest assets. The growth in a diversified wage base enhances the overall health of the local economy. To the extent that these wages are at or above the average wage, we find real growth in the quality, not just quantity, of economic growth. Growth in primary jobs will bring added wealth to a community by importing money into our economy. Wealth importing jobs usually include manufacturing, wholesale, transportation, mining, and agriculture. Tourism serves as a wealth generator, but the wage base is generally lower. Transfer payments may enhance the wealth of a community depending on if they are generated outside of the market area (i.e. retirement, social security, rents, dividends, interest, and medical payments). This is an area that benefits Douglas County.

A second tier level that may generate wealth includes financial services, insurance, real estate, and State and Federal government. The third level generally consists of retail, services, construction, and local government, all of which tends to be more reactive to the other wealth generators. As a service, health care may cross categories. To have an increasing viable economy, growth at all levels is necessary. The following chart provides an overview of Douglas County employment base.

Year	2000	2001	2002	2003	2004	2005
Employment Average	20,840	20,676	20,802	21,031	21,321	21,224
Labor Force Average	21,740	21,698	21,879	22,118	22,262	22,183
Unemployment Average	4.1%	4.7%	4.9%	4.9%	4.2%	4.3%

Source: Nevada Department of Employment, Training & Rehabilitation

The manufacturing sector makes up approximately 7.8% of the County's employment base, with 9.1% provided by the construction industry. The leisure and hospitality industry provides approximately 40.7% of our job base, a drop of 1.8% from last year. Trade, transportation, and utilities make up 14.4%, which is a growth sector. Government makes up 10.6% and professional and business services provide 7.1%. (Data is from the 2nd quarter 2005).

Growth in primary jobs will continue with the location of new firms and construction of facilities within our business parks. This past year approximately 420,000 square feet of industrial/commercial space was reviewed by the County. The projects are in various approval or construction stages. Two larger companies are planning to locate in the Carson Valley with one 180,000 square foot facility receiving design approval. The growth in primary jobs supports the development and expansion of other service related businesses and the retail sector.

The challenges facing Douglas County's ability to continue to support this level of new business investment will be availability of a well-trained workforce, cost of comparable investment in the region, affordability of the County as a place to live, and more recently, the availability of land. Continued investment in the County's infrastructure is also needed. If not addressed, our transportation/road system may become a limiting factor. Overall, the outlook is for steady, but slow growth in the manufacturing and related businesses for 2006.

Retail/Commercial/Business

The retail and commercial sector of our economy has gone through a significant change over the past 5-7 years. The development of national level retailers in north Douglas County has added a new dynamic to the local economy. This highlights the desire of residents for this type of a regional retail center. The next significant step will be the development of additional land in north Douglas County. A proposed project fell through this past year, but the site is being considered again. The challenges to a successful development are substantial, including infrastructure needs, land assembly, increased competition and increasing interest rates. A successful project will bring with it the addition of not only retail stores, but entertainment, office and home development as well. The County's growing reliance on sales tax revenues will continue to put pressure on bringing forward larger retail centered projects.

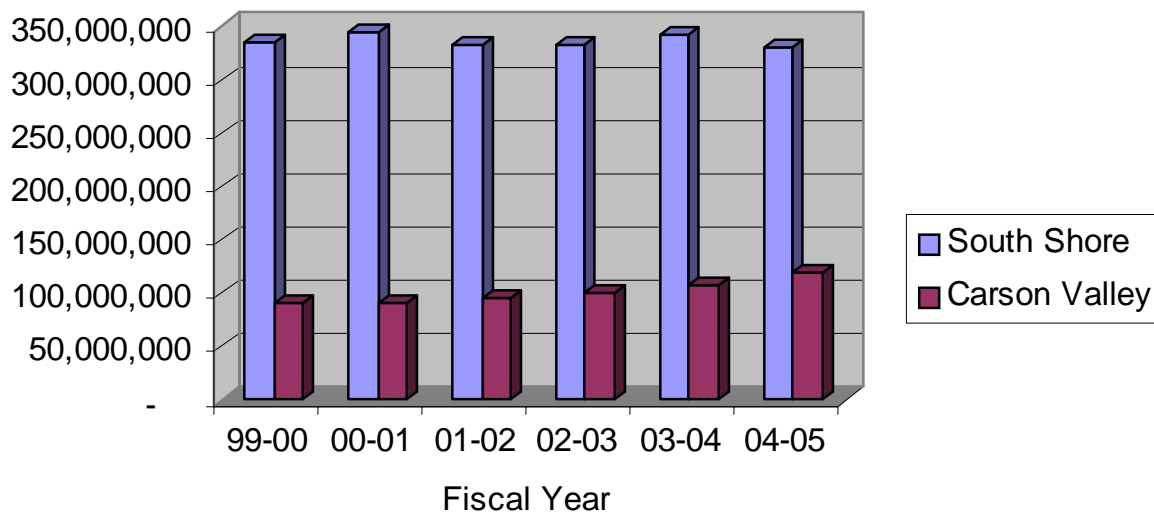
Commercial property development in the Minden/Gardnerville area has seen a mix of new building and filing of existing ones over the past few years. A new project such as the Minden Village has added substantially to the space available in the core of the Carson Valley. This activity will continue.

Tourism

Tourism is still the County's single largest industry. Tourism represents 7 of our top 11 employers. The "leisure and hospitality" industry provides about 40.7% of our job base, down slightly from last year. The other 4 largest employers are GE/Bently, the School District, Wal-Mart and Douglas County. The single largest category for taxable sales is eating and drinking, generating 21% of total taxable sales, down slightly from 22% last year. Nearly 100% of the room tax is generated from tourism, which has been declining for the past several years. The County receives annual gaming license revenues of approximately \$1.765 million, which is also experiencing slight declines from previous years.

The gaming establishments at Lake Tahoe dominate our tourism industry. However, the market includes other casinos, hotels, and restaurants providing the key indicators for tourism's health. Douglas County offers a number of other activities and attractions for visitors, such as: boating, fishing, hiking, biking, skiing, ballooning, soaring, golf, time-shares, off-roading, shooting, hunting, and a destination for special occasions and events. Even with everything Douglas County has to offer tourists, the industry is headed for difficult times. This is reflected in a continued drop in room tax revenues, and a lack of significant growth in key sales tax categories. The drop in room taxes reflects lower room rates and occupancy level. There is little ability to grow in the higher demand seasons due to a lack of hotel space. During the other 6-months of the year, occupancies are consistently at a lower level. The Carson Valley has seen small increases in room tax revenues, but a decline in the number of rooms being rented.

Gaming Win



Casino revenues drive our primary tourism market. The Tahoe market peaked in 2000 with \$352 million in gaming win. The win for 2005 was \$335.4 million. The market is relatively flat and faces a challenging future. The opening of Thunder Valley in California, and future planned Indian casinos in California, will continue to impact northern Nevada's gaming market.

The Carson Valley/Carson City gaming market has seen a steady increase in gaming win (\$119.4 million in FY05). The growth has been driven primarily through expansions and the opening of the Fandango in Carson City. Expansions have placed greater pressure on the local market with the ability to absorb gaming expansions becoming more difficult. The ability to fill hotel rooms is also more difficult, with occupancy rates slipping from FY04 to FY05. The expansion of gaming in California will continue to place pressure on our smaller market, as well as Tahoe and Reno markets.

The County's role in addressing the drop in tourism is limited, but not without influence. Five responses regarding the decline in tourism have been discussed in the last 3 years. The most important element is working to develop Tahoe, along with the Carson Valley/Topaz areas as a "Destination". Lake Tahoe and Carson Valley have implemented aggressive campaigns to establish a "brand identity" for each location. The expansion of the destination resort concept

outside of the summer and ski seasons is a significant challenge. This requires quality lodging, dining, and entertainment. People will need attractive and appealing reasons to come to our region, be that for hiking, biking, golfing, soaring, special events etc. The overall experience will need to be one that they want to repeat.

Second is to continue to develop the concept of “Appointment Marketing”. This means creating a specific event or entertainment experience that will attract a specific customer on an invitation basis. This may include a direct individual marketing effort or opening an event to the general public through marketing efforts. This may include selling a concert event, golf tournament, or specific activity (i.e. Eagles and Ag Tour). These types of events are growing.

Third, the area needs to focus on creating a more dynamic general events calendar. Classic examples are the Celebrity Golf Tournament and the July 4th celebration. These events draw the local population, as well as people from out of the area. The key to developing new events is to coordinate the event with the time of year when the bed base (rooms rented) is not at full capacity. The goal is to give visitors a dynamic general calendar of events to attend each year during Lake Tahoe’s “off” season. To be successful community support and involvement is needed.

Fourth, a strategic effort needs to be made to expand the bed base as a means of growing the number of customers available at any given time. One strategy is the development of time-shares or other tourist accommodations (campground, RV parks etc.) to attract a broader range of visitors. These types of units bring in a different customer base and don’t rely on the need to fill traditional hotel rooms throughout the year. Douglas County is lacking in outdoor accommodations.

Finally, there is a need to create new venues for activities. This has been discussed in the terms of a convention center at Tahoe and a performing arts center in Carson Valley. Other endeavors include the reconstruction of the V & T Railroad, and the establishment of the Dangberg Home Ranch museum and event area.

A combination of these strategies will be vital to reviving our tourism industry and diversifying it away from gaming. It is in Douglas County’s best financial interest to see that quality opportunities are provided to our visitors, thereby creating an experience that makes Douglas County special and attractive to the tourism customer.

Housing

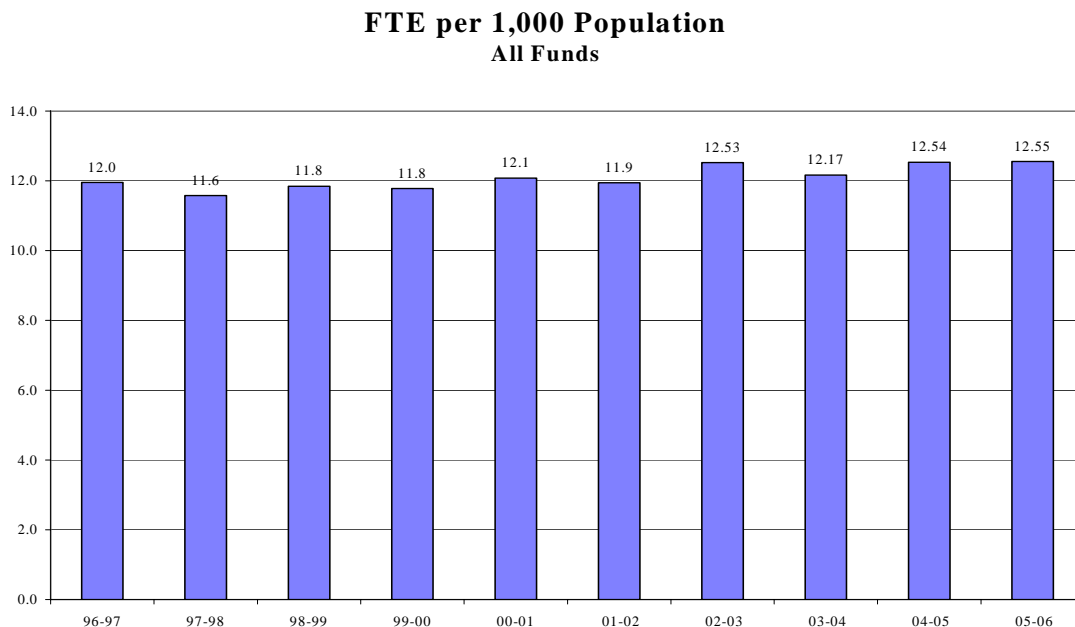
Residential housing is the single largest investment in the County as measured by total assessed value. Housing comprises about 77.3% of our assessed value, thereby providing the largest share of our property tax revenues. In 2005, we saw 624 dwelling units permitted. The housing market was more reflective of historical trends with 537 single-family home permits issued, 76 multi-family units and 11 manufactured homes. This compares to total units in 2004 of 578 and 652 in 2003. The demand for single-family housing remains solid, but has seen some slowing as interest rates move up. Douglas County continues to be a desirable place to live but there is a growing challenge for more affordable housing.

The average price of a home in the East Fork Township has seen substantial increases, with the median sales price for 2005 at \$382,500. The median at Lake Tahoe was \$825,000. The following chart shows the number of sales and median price for the last six years.

Y e a r	T o t a l S a l e s	M e d i a n S a l e s P r i c e
2 0 0 0	9 7 9	1 7 1 , 5 0 0
2 0 0 1	1 , 1 2 5	1 8 2 , 9 0 0
2 0 0 2	1 , 0 7 7	2 0 8 , 3 4 6
2 0 0 3	1 , 1 8 5	2 5 0 , 0 0 0
2 0 0 4	1 , 2 9 5	3 1 2 , 5 0 0
2 0 0 5	1 , 0 7 3	3 8 2 , 5 0 0

The expectation for basic public services continues to grow, as does the request for enhanced levels of service, such as paved streets, dust/mud control on dirt roads, recycling, low cost water and sewer, code enforcement, cable TV, storm drainage, speed controls, and traffic enforcement. The nature of how some services are provided will need to change. A smaller population of young adults directly impacts the volunteers who are capable to participate in our volunteer fire departments. New residents often do not realize the fire station in their neighborhood is a volunteer station. To meet growing demands in fire and emergency medical services, a number of new personnel have been added to the East Fork Fire and Paramedic Districts. This is to cover for volunteer shortages and to add 24 hour coverage in South Douglas County.

The County has done well in maintaining an overall flat ratio of employees per 1,000 population. The comparison of employees per 1,000 population for all funds is shown in the following chart. Over the past 5 years, the ratio has stayed around 12 employees per 1,000 population.



While the demand for additional services exists, the willingness to pay for them is limited. There is constant pressure to keep tax rates low, to limit increases in fees and charges, and to have “someone” else pay. Over the past several elections, the voters have said “no” to new revenues to purchase open space, to maintain roads or build new ones, or to fund a senior center, recreation center, and performing arts facility complex. The one exception was the approval of a 50-cent a square foot tax on new commercial development. The County does not levy or impose a number of other revenue alternatives commonly levied in other Nevada counties (i.e. 5-cent gas tax, ¼ cent sales tax for roads, ¼ cent sales tax for infrastructure and schools, general business licenses, or the majority of the utility operator fees). This places more pressure on the County to manage costs and to enhance our existing revenue sources. The strength of our economy directly impacts a number of revenues due to the financial structure of Douglas County.

Financial Structure

The financial structure of Douglas County is complex. As a geographic area there are 37 units of government, 31 that may levy separate property taxes, and 26 that share in the allocation of State Consolidated Taxes (CTX). The tax burden for any given business or home will fluctuate depending on their location within the County.

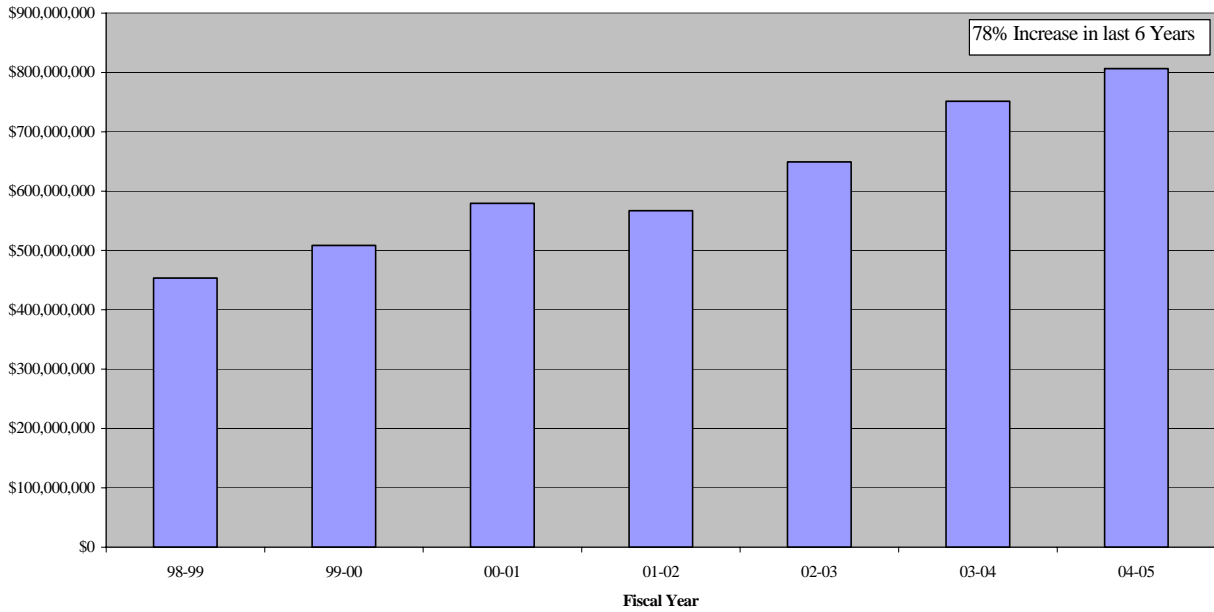
Douglas County’s fiscal health is driven by a number of key revenue sources. Three revenue sources dominate the County’s budget: 1) state consolidated taxes or sales tax; 2) property taxes, and 3) room taxes. The fourth revenue source area is the charges for services driven by the County’s utility systems and related customer fees and charges. In 2005, utility rates were held flat, except for new water systems. This year rates will need to increase for some utility systems. A number of Community Development related fees saw substantial increases.

State Consolidated Tax

State Consolidated Tax (CTX) is the single largest source of revenue for Douglas County’s General fund and contributes substantially to a number of other agencies. CTX is made up of six revenue sources, including BCCRT and SCCRT (sales tax), Cigarette and Liquor Tax, Real Property Transfer Tax (RPPT), and Motor Vehicle Privilege Tax (MVPT). The State minimum sales tax rate is 6.5%. The County’s tax rate is 6.75%. The extra .25% was added after receiving voter approval and is dedicated to parks, airport, library and seniors (PALS). The County does not levy a variety of other sales tax increments for purposes such as open space, roads, transportation, infrastructure, and schools. CTX revenues are allocated to the County and other agencies based on State law.

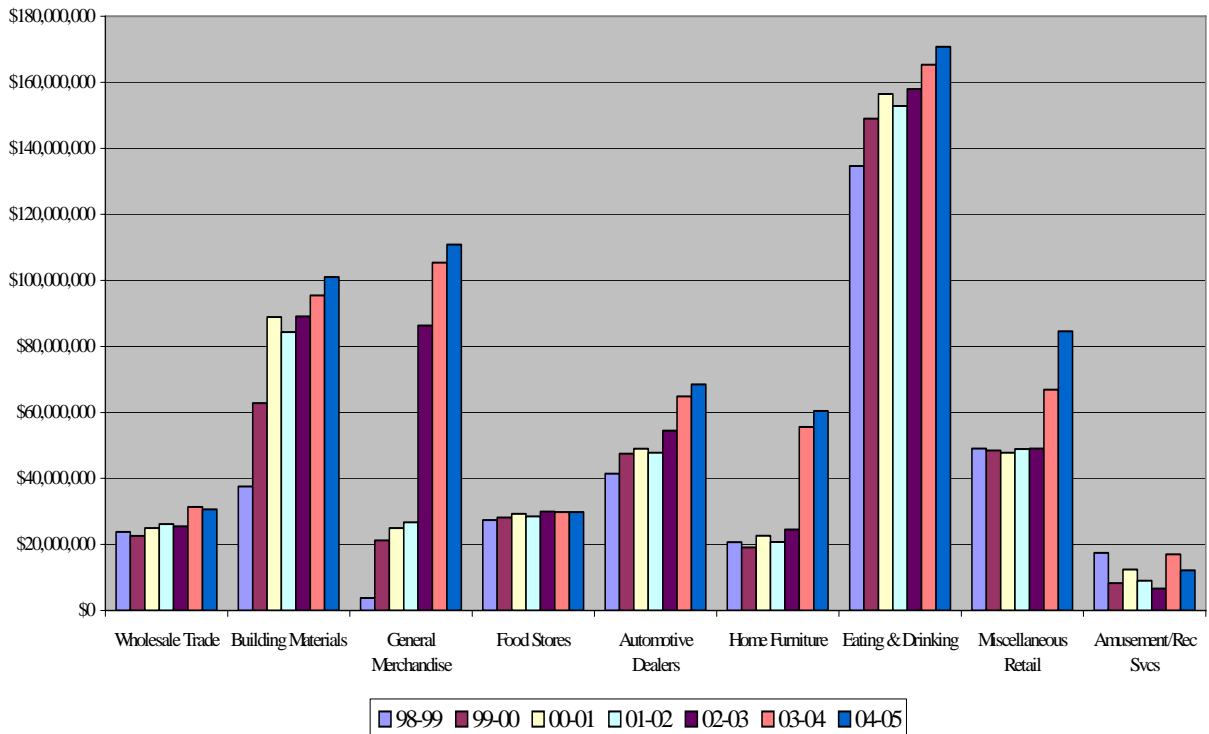
The County has enjoyed a continued growth in CTX revenues. The increase is primarily due to the guaranteed amount of the 1.75-cent supplemental city/county relief tax (SCCRT – sales tax) distributed to the County. The ½ cent BCCRT (basic city/county relief tax) has also seen solid growth. The growth in SCCRT is formula driven using CPI and growth in population, or the statewide growth in SCCRT.

Taxable Sales



Taxable sales in FY 99 were \$454 million and have increased to \$805.3 million in FY 05. Approximately 57% of taxable sales are accounted for in 4 categories: Eating & Drinking Places; General Merchandise Stores; Building Materials, and Miscellaneous Retail. Growth in a number of key areas is highlighted in the following graph.

Taxable Sales by Category



Property Tax

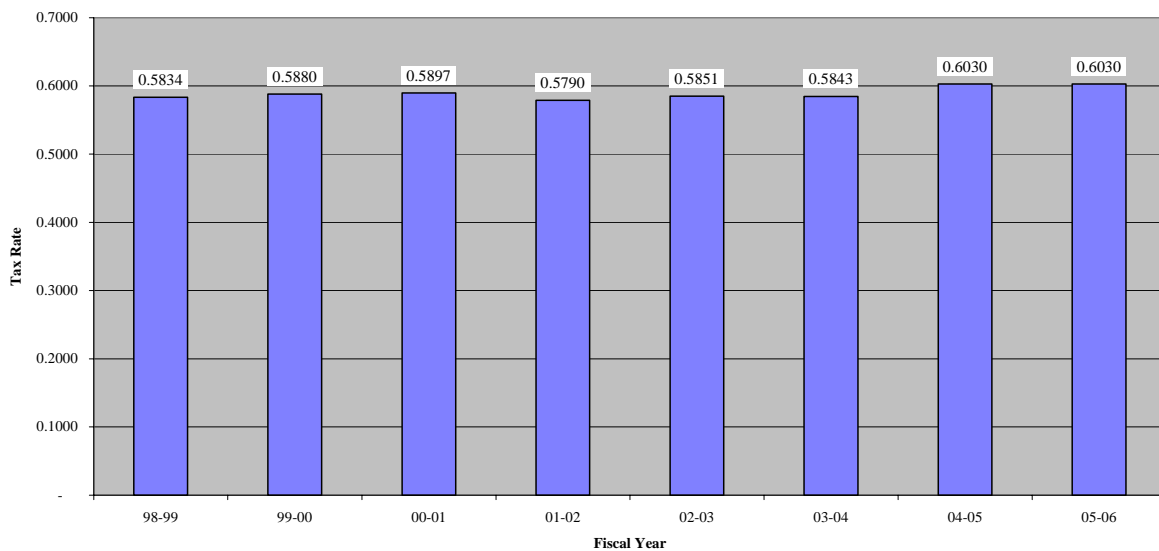
Property tax revenues are based on the tax rate levied and the assessed value, less the newly abated amounts. Owner occupied homes have a 3% cap in their property tax bill with other properties capped at 8%. This change in State law has benefited property owners, but placed greater financial pressure on the County to fund services. The assessed value for FY 06-07 is projected to be over \$3 billion and is broken down as follows:

	03-04	04-05	05-06	% of Total	Preliminary 06-07	% of Total
Vacant Land	118,152,326	119,374,426	150,681,433	6.1%	213,479,330	7.0%
Residential	1,363,778,087	1,471,566,838	1,851,301,355	75.0%	2,363,579,869	77.3%
Tourist Commercial	180,348,642	182,297,081	178,708,403	7.2%	160,681,420	5.3%
Commercial/Industrial	132,674,707	145,773,819	157,617,142	6.4%	188,569,524	6.2%
Agriculture	19,948,549	20,469,689	23,945,181	1.0%	26,995,950	0.9%
Other	110,743,195	103,701,325	105,633,198	4.3%	104,973,137	3.4%
Total	1,925,645,506	2,043,183,178	2,467,886,712	100.0%	3,058,279,230	100.0%

The County does levy the full range of residential construction taxes on new homes. This includes \$1,600 for schools, \$1,000 for parks, and \$500 for roads. A \$0.50 per square foot tax levied for roads on non-residential construction was implemented in 2004.

Douglas County is a low property tax county. The average overlapping tax rate continues to be one of the lowest in the State. However, the rate has less importance under the new tax bill cap. The 10-year tax rate strictly for County operations is provided in the following chart. This rate has remained relatively flat. It is anticipated the rate for FY07 will be substantially increased as it only impacts new development.

County Tax Rate History



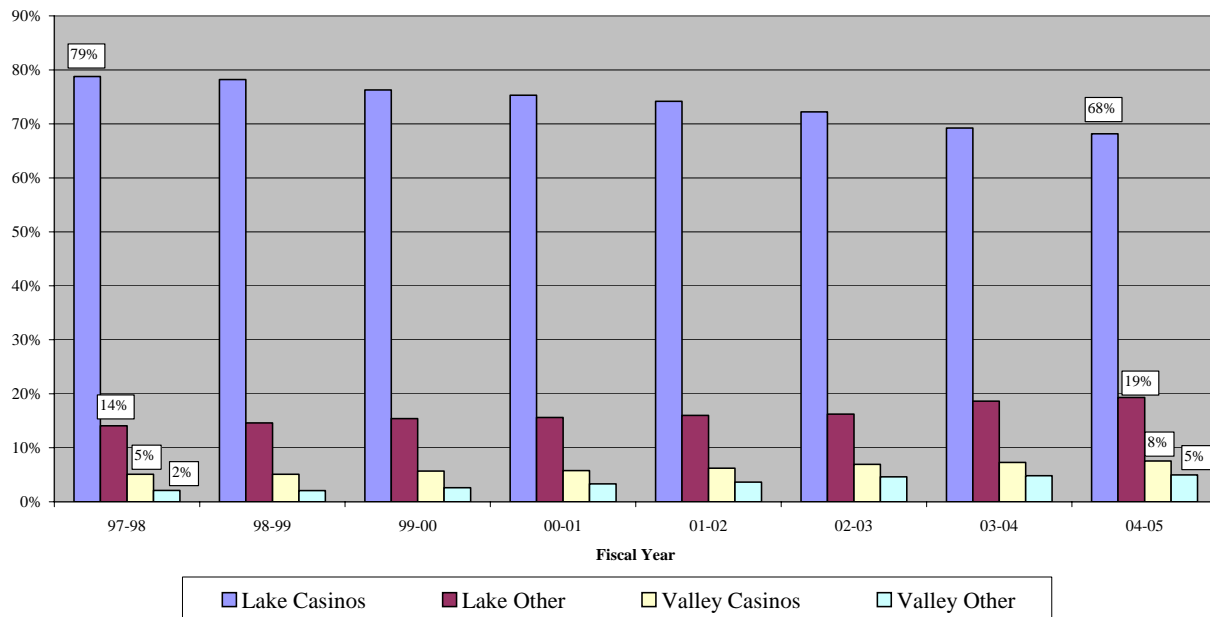
Room Tax

Room tax revenues are on a decline driven by consistent drops from Tahoe operations, which account for the vast majority of the revenue. With the lack of growth in room nights sold and the

limited increase in room rates, room tax revenues will continue to be flat or declining. Filling rooms in the off-season is becoming more difficult, as is filling rooms during mid-week during parts of the summer. Tahoe has a limited room base to further growth in the high seasons, and there is a lack of a year-round market in the Valley to drive new room nights.

The loss of room tax revenue is significant due to the fact that it funds a large part of our parks/recreation, senior services, and library services. These services are also funded from the ¼ cent sales tax, which has seen strong growth. Revenue growth has not kept up with the cost of services. This has required the shifting of tax resources away from these services and increases user fees. Operational funding for capital improvements has also been limited. The required shifting of room tax revenue to fund promotion has placed additional strain on the remaining revenues to meet service needs. To meet service requirements, additional funding will be necessary in the coming years or very difficult choices in our service mix will need to be made. The following chart provides an overview of historical Revenue Collections by Area.

**TOT Revenue Collections
% by Area**



The decline in revenue is clearly seen in Lake Tahoe’s casino room tax collections, which has continuously declined over the past several years. The decline in Room Tax revenue continues to be an area of concern and has the potential to have even deeper reductions based on new operations opening in Northern California. As with last year the County needs to be ready to take a proactive role in working with the industry to maintain market share.

The Future

Where does all of this leave us going into 2006, the next fiscal year, and beyond? The financial outlook for Douglas County is not as positive as it was one year ago. The State has capped property tax revenues, the growth in sales tax has slowed and tourism continues to struggle. The

diversification of the tax base has provided areas of growth but has signs of stress. The fiscal forecast for the county has a much greater element of uncertainty.

The most significant challenge will continue to be the health of our tourism industry and the recent slow down in sales tax growth. At the same time we are experiencing a growing reliance on sales tax revenues. If this area stagnates or declines, so will several key revenues. Industry within Douglas County will continue to expand. The greatest challenges will be providing a skilled workforce, and an affordable place to live. The commercial/retail sector has the potential to be a future bright spot for the County. Housing should continue at a normalized rate of growth. The reliance on building related revenues is real and of some concern.

The County will continue to manage its finances in a conservative fashion. This is seen in consistent balanced budgets resulting in actual revenues coming in slightly ahead of expenditures. This allows for a stable or growing fund balances and reserves that are used to meet unforeseen needs, cash flow requirements and generates interest income.

We will continue to receive requests for more traffic enforcement and control (i.e. signals); more road repairs and new roads, which will continue to be under-funded; and new personnel in a number of departments, several of which will receive careful consideration. We will continue to experience cost increases for employees, services, energy, etc. This past year there was increased investment in public safety with the addition of 6 sworn positions in the Sheriff's Office and continued planned growth of personnel in East Fork Fire and Paramedic Districts. There will be a continued request for added personnel in the Sheriff's Office. A complete review of the judicial center is needed and within a couple of years a second East Fork Township Justice Court may be required.

In the next fiscal year, there are a number of key areas that will need to be considered for enhancement to meet current and future organizational and public needs. Over the past two years, the East Fork Fire and Paramedic Districts have added personnel and equipment to better meet the needs of our community, and to take a more proactive role in fire prevention. Some additional steps will need to be taken in FY 06-07.

The growth in the County's technology and use of computer systems to more effectively meet work demands has placed added demands on the ability to manage that technology. As the County relies more and more on technology to enhance services, the support structure will need improvement. This will mean keeping up with an aggressive computer replacement program and adding support staff. One position was added in FY05-06.

There will continue to be increased demands on Douglas County's senior services and transportation programs. Senior services are quickly outgrowing the physical infrastructure used to provide services (i.e. the senior center). This will need to be addressed within the next two years to enable the current level of senior services. We are experiencing greater demands in our Social Services as well.

A number of planning efforts will also continue. This includes the 10-year Master Plan update, the USGS water study and modeling work, NDOT Highway corridor study and the county transportation element update and the TRPA Plan update.

The items noted here only touch on a few areas that will be highlighted in the FY 06-07 budget, as will other areas that each department feels is in need of more support. The County as well as others are experiencing an increased competitive market for attracting and retaining employees. The cost of living in Douglas County and the surrounding region has made this more difficult and is a growing challenge. The financial strength of the County will be critical in our ability to meet these and other challenges.

Conclusion

The growth of the County will continue both as a community and as an organization. A number of service requirements will need to be met in the coming year. This will require the continued prioritization of public services based on the current and future financial capability of the County. Douglas County is in a position to continue as high quality community, but will see increasing cost pressures. The actions taken in the past, required vision and leadership that will need to continue into the future. Providing expanded public services will require creativity. Our success will depend on the ability to set and achieve short-term and long-term goals.

Douglas County will progress into 2006 with a less sure footing than in the past few years, but has a number of the right tools in place to succeed in the coming year. We have the potential for solid economic gains and improvements. An expanded and diversified economy will broaden Douglas County's financial base. Success in this area will allow the County to focus on meeting the current and future needs of the community as desired by residents, businesses and visitors who live, work and recreate in Douglas County.

Daniel C. Holler
Douglas County Manager