SPENDING AFFORDABILITY COMMITTEE
Anne Arundel County
January 15, 2019

The Hon. Steuart Pittman, County Executive
The Hon. Andrew Pruski, Chair, County Council
Mr. Ben Birge, Chief Administrative Officer
Ms. Jessica Leys, Acting Budget Officer
Ms. Karin McQuade, Controller
The Arundel Center, 44 Calvert Street
Annapolis, Maryland 21401

This report of the Spending Affordability Committee (SAC) for FY2020 is hereby submitted to you in accordance with Section 610 of the Anne Arundel County Charter. This section requires in part that "The Committee shall make advisory recommendations to the Office of the Budget, the County Executive, and the County Council relating to spending affordability including County spending levels to reflect the ability of the taxpayer to finance County services and long-term debt." Section 610 also tells the Spending Affordability Committee to "…examine current capital projects, the five-year capital improvement program, per capita wealth, debt service, pay-as-you-go funding and alternative sources of funding."

Committee Recommendation

The SAC has followed the practice of previous committees that "spending affordability" can best be determined by estimating the growth in personal income of County residents. The committee uses the definition of personal income provided by the U.S. Department of Commerce, Bureau of Economic Analysis (BEA), which is "income received by persons from all sources" (e.g., wages, employment benefits, business income, and investment income) whether taxable or not. To avoid placing additional financial burden on County residents, spending growth should remain in-line with personal income growth. For example, if personal income of our residents should only increase one percent, then County spending should not increase more than that one percent. Simply put, if County spending were to increase faster than personal income, additional taxes and fees from County residents would likely be needed to support that spending.

Using this methodology, the SAC recommends that FY2020 spending be based on a personal income growth rate projection of 3.75%, which results in a forecasted FY2020 personal income level of $41,047,481,925 for the County. As shown in the table below, applying the 3.75% growth rate to the FY2019 adjusted base budget results in a recommended FY2020 Current Expense (General Fund) budget of $1,582,064,038. This represents a $57.2 million increase over FY2019. With respect to the Capital Budget, County budget policy stipulates the General

Fund Debt Limit be less than 4% of forecasted personal income.[1] This results in a recommended General Fund Debt Limit of $1,641,899,277. This represents a $69.8 million increase over FY2019.

The SAC's recommendation is based on data available as of the drafting of this report. The SAC agreed to meet again prior to our testimony to the County Council, currently scheduled for May 1st 2019. At that time, the SAC will examine actual economic data from the most recent quarter to determine if any adjustments to our recommendations are warranted.

Current Expense Budget Recommendation	
(Adjusted Base Budget for Current Year x Estimated Personal Income Growth Rate for Budget Year)	
Approved FY2019 Budget	$1,589,938,300
- Appropriated Fund Balance	(58,557,300)
- Rainy Day Fund Contribution	(6,500,000)
Committee's Adjusted Base Budget - FY2019	$1,524,881,000
Estimated Increase in County Personal Income (FY19 to FY20)	3.75%
FY2020 General Fund Appropriation Limit (customary manner)	**$1,582,064,038**
Capital Budget Recommendation	
(Personal Income Forecast for Current Year x Estimated Personal Income Growth Rate for Budget Year x Standard)	
Average of RESI (Regional Economic Studies Institute of Towson University) Quarterly Forecasts for County Personal Income - FY2019	$39,563,838,000
Estimated Increase in County Personal Income (FY19 to FY20)	3.75%
Forecast Personal Income - FY2020	$41,047,481,925
Standard Applied in County's Debt Affordability Model	4.0%
FY2020 General Fund Debt Limit (customary manner)	**$1,641,899,277**

Background

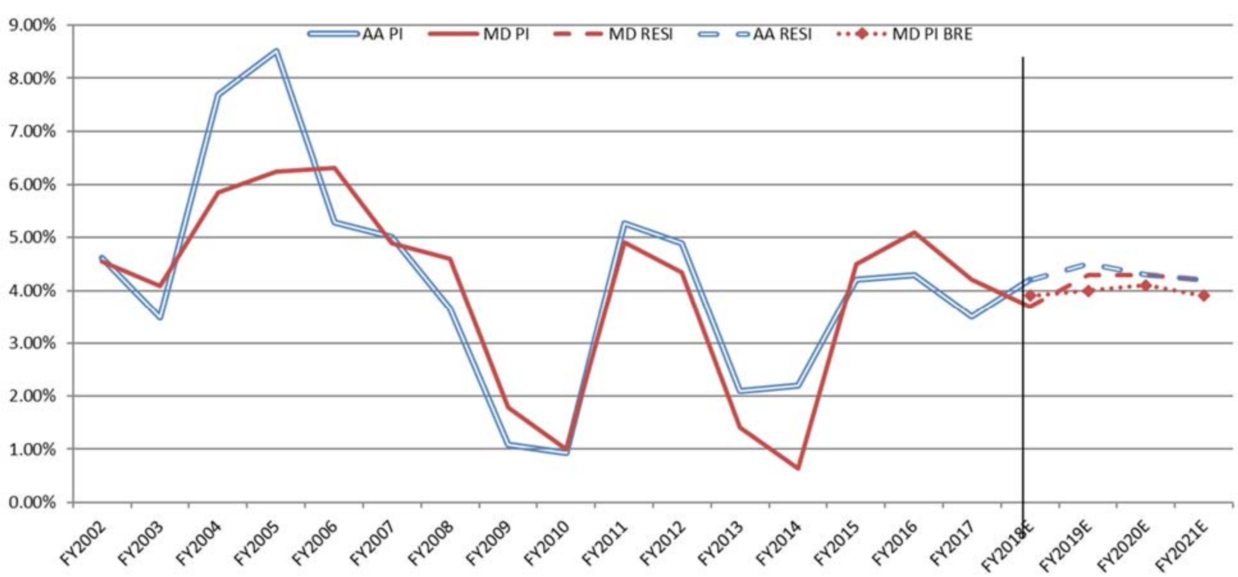
Historically, the State of Maryland has contracted with four firms (Sage Policy Group, Moody's, Global Insight, and the Regional Economic Studies Institute [RESI] of Towson University) to provide economic data and personal income estimates. Based on these four estimates, the State Board of Revenue Estimates makes its own additional estimate for Maryland. One of these firms, RESI, also provides data and forecasts for Anne Arundel County. The RESI estimates are derived from an economic model known as REMI PI+. This model is informed by personal income data from the BEA, employment data from the Bureau of Labor Statistics (BLS), and population data from the U.S. Census Bureau. The following table summarizes the most recent personal income growth estimates for Maryland and Anne Arundel County. As shown, these forecasts project a 4.0% personal income growth rate for FY2020 for Maryland, with a slightly higher growth rate (4.3%) projected by RESI for Anne Arundel County.

[1] Page 21, Approved Current Expense Budget and Budget Message for Fiscal Year 2019

Comparison of Personal Income Forecasts (Date of Estimate)		(Fiscal Years)			
		2018	2019	2020	2021
State of Maryland	Board of Revenue Estimates (Dec 2018)	3.9%	4.0%	4.1%	3.9%
	Sage Policy Group (Nov 2018)	4.0%	3.8%	3.4%	3.6%
	Moody's (Nov 2018)	4.0%	4.1%	3.7%	2.8%
	Global Insight (Aug 2018)	3.9%	4.1%	4.6%	4.4%
	RESI of Towson University (Dec 2018)	3.7%	4.3%	4.3%	4.2%
	Average	3.9%	4.1%	4.0%	3.8%
Anne Arundel County	RESI of Towson University (Dec 2018)	4.2%	4.5%	4.3%	4.2%

The following graph shows the actual annual growth rates in personal income from FY2002 to FY2017 for Maryland and Anne Arundel County as reported by the BEA, along with the forecasts described above for FY2018 and beyond. If viewing in black and white, the higher (blue) line in 2005 is Anne Arundel and the lower (red) line in 2005 is Maryland. For the most recent year where data is available (FY2017), the actual personal income growth rate in Anne Arundel County was 3.5%.

PERSONAL INCOME GROWTH BY YEAR FOR ANNE ARUNDEL AND MARYLAND



The SAC applied our collective experience and background in business, economics, finance, and Federal/State/ Local government to assess the forecasts provided by the State's four econometric modeling firms. Because full year personal income actuals are only available for FY2017, projections for FY2020 are based on 2 years of estimated data. These estimates are continuously revised as new data becomes available. As such, the SAC compared actual BEA-reported personal income growth in Maryland and Anne Arundel County to previous forecasts. We also examined changes over time in forward-looking personal income growth projections.

This analysis showed that, in recent years, the Maryland State Board of Revenue Estimates and their four econometric firms have had to revise downward their estimated personal income growth for Maryland as actual data becomes available. For example, in December 2014, the average of the five estimates was 5.4 percent for FY2017. In November 2015, the estimate dropped to 4.8 percent. In December 2016, the estimate was further decreased to 4.5 percent. The actual growth rate in Maryland for FY2017 came in at 4.2 percent, based on the latest BEA data. This is 1.2 percent below initial estimates made 2 years earlier.

With respect to FY2018, the average of the five estimates reported in December 2017 was 4.4 percent for Maryland. In December 2018, this estimate dropped to 3.9 percent, continuing the trend of downward revisions made to these forward-looking estimates.

Similar to the Maryland projections, RESI has reduced their personal income forecast for Anne Arundel County. For example, in December 2016, RESI forecast growth rates in Anne Arundel of 5.1, 5.6 and 5.0 percent for FY2016 through FY2018. In December 2017, RESI reported actual personal income growth in Anne Arundel County of 4.0 percent for FY2016, and reduced their FY2017 and FY2018 forecasts to 3.9 and 4.3 percent respectively. In December 2018, RESI reported actual FY2017 personal income growth in Anne Arundel as 3.5 percent (vs. the 3.9 percent estimate made 12 months earlier) and reduced their FY2018 projection to 4.2 percent.

Based on this analysis, the SAC believes it is likely that actual results for FY2020 will be lower than currently forecast. This analysis is the primary factor in the SAC's recommendation to base the FY2020 budget on a more conservative 3.75 percent growth rate, as compared to RESI's current projection of 4.3 percent.

Additional factors leading to our recommendation include the following:

- **Lower Forecasted Growth for 2020 and 2021 –** The average growth estimate for Maryland decreases from 4.1 percent for FY2019 to 4.0 percent for FY2020, and 3.8 percent for FY2021. This may be related to a slowing job market. Data indicates that Maryland as a whole is approaching full employment levels, with an unemployment rate of 4.1 percent in October 2018. While full employment typically results in higher wages, it also potentially slows job growth. RESI projections indicate that Anne Arundel employment levels will peak in 2019 and then remain flat through 2023 (*i.e., no job growth for the next 45 months*). The SAC believes it prudent to maintain steady year-over-year growth in the County budget. As such, we recommend budgeting below currently forecasted personal income growth for FY2020. If the economy does slow, this will allow the County to maintain a more consistent year-over-year budget while mitigating concern of a potential revenue shortfall. Conversely, if revenue outperforms projections, this will provide the County with additional budgeting flexibility.

- **Lack of Growth in High Paying Employment –** Overall, annual wages in Anne Arundel County increased nearly $2,300 from 2017 to 2018, outpacing inflation. While positive, the largest industry in Anne Arundel County remains Food Services and Drinking Places, with an average annual wage of only $20,696. The second largest industry in the County is Professional and Technical Services, with an average annual wage of $103,636. However, the SAC notes that overall employment in the 15 highest paying industries in the County (including Professional and Technical Services, Data Processing, Hosting, and Telecommunications), ***decreased*** by 0.9% last year. This trend is surprising, as the Committee would have expected Federal spending at Ft. Meade to have spurred more growth in the technology sector overall. Instead, tech companies such as Amazon are choosing to expand their local presence in Virginia (https://www.forbes.com/sites/forbesrealestatecouncil/2018/12/05/why-crystal-city-virginia-was-an-easy-choice-for-amazons-hq2/#3e4843b55387). The SAC believes the County should consider opportunities to increase the number of high paying jobs in the County when formulating long-term economic development policy.

- **Shift from Full Time W-2 Employment to Part Time and Self Employment –** While data on part time and self-employment (i.e., 1099) was not presented, the SAC believes that increasing numbers of County residents fall into these categories (a trend first noted in our report for FY2017). For example, recent estimates indicate the number of self-employed workers nationwide will reach 42 million by 2020, approaching a third of the total workforce (https://nypost.com/2018/03/25/self-employment-is-a-rising-trend-in-the-american-workforce/). As noted above, the BEA definition of personal income includes employment benefits (insurance, pension, employer's contribution to social security, etc.). Because many of these benefits are not available to part time employees and self-employed individuals, this trend has the potential to negatively impact personal income.

- **Population and Job Growth –** RESI estimates that per capital personal income will grow 3.5% from FY2019 to FY2020. Therefore, in order to achieve higher growth at the County level, it is necessary for the county population to grow and that there be jobs available to expand the workforce. In their latest report, RESI indicates average wage growth of 3.9% (2017 to 2018), projected population growth of 0.73 percent (FY2019 to FY2020), and slightly negative employment growth of minus 0.14 percent (FY2019 to FY2020). Should any of these parameters come in lower that projected, it directly impacts personal income. With respect to projected population growth, the Committee reviewed data presented in the Draft Anne Arundel County 2017 Land Preservation, Parks and Recreation Plan[2] from the U.S. Census Bureau and Maryland Department of Planning Round 8A Population Projections. This data indicated a population growth rate through 2035 of approximately 0.5 percent vs. RESI's 0.73 percent projection. Further, this same data showed the percentage of retirees (persons aged 65 and older) living in the County increasing from 13 percent of the population in 2015 to 21 percent of the population in 2035. Lower than projected population growth and accelerated aging of the County population both represent risk factors to forward-looking personal income projections.

[2] Page II-9, Draft Anne Arundel County 2017 Land Preservation, Parks and Recreation Plan http://www.aacounty.org/departments/recreation-parks/lpprp/index.html#.Wk61AAjF-h4.aolmail

On a related note, the SAC recommends the County ensure that all planning and budgeting are using a consistent population growth model.

- **Impact of Federal Spending –** Many Government agencies involved in national security do not report employment data to the BLS, potentially impacting the models used by RESI and others. However, it is the sense of the SAC that the County's economy is heavily dependent on Federal spending. This is driven by employers located in the County (e.g., Government employees at BWI, the Naval Academy, and Ft. Meade, as well as businesses serving those locations). It also driven by residents who commute to Federal and related jobs outside the County. In 2013, it was estimated that 60% of Ft. Meade's 56,000 member civilian workforce lives in Anne Arundel County (https://www.capitalgazette.com/cg2-arc-5a4e7b95-81bf-5953-92a0-b9db8c70b503-20131001-story.html). At the state level, the Maryland Comptroller's Office estimates that direct and indirect federal paychecks account for 10 percent of state income tax revenue (https://www.wbaltv.com/article/partial-government-shutdown-has-big-impact-on-marylands-economy/25728433). While the County benefits significantly from Federal discretionary spending, the SAC notes that such spending typically increases about 2% year-over-year (i.e., less than forecasted personal income growth). Further, County reliance on Federal spending creates risk exposure in the event of continued/future Government shutdowns, sequestration or similar budget policy changes, or if future rounds of Base Realignment and Closure (BRAC) move jobs out of Maryland.

- **Real Estate Values –** Real estate taxes are the County's largest source of revenue, with Recordation and Transfer Fees representing the third largest source of revenue. The SAC considered whether or not changes in interest rates, U.S. Tax Code or other factors might impact these revenues going forward. Data presented by RESI shows that Anne Arundel home sale prices and the number of homes sold still remain below pre-2007 levels, and are recovering slowly. RESI also noted that County foreclosure rates actually increased last year. While our budget recommendation for FY2020 was not influenced by concern of a crash in the real estate market, we also do not see rising real estate values as contributing significantly to personal income growth. This topic should continue to be monitored closely given the County's dependence on these revenues.

- **Effect of the National Economy –** It is well documented that the national economy has been growing steadily since the last recession in 2008, and that the pace of growth has accelerated in 2017 and 2018. While this is a positive factor for the County's economic outlook, the SAC remains cautionary. As noted above, we believe the prudent approach is to plan based on more conservative growth expectations and to hedge against a possible slowdown in 2019 and recession in 2020.

- **Long Term Debt** – The SAC charter includes making advisory recommendations regarding long-term debt. Current County debt is in line with the Council approved debt affordability guidelines. However, the SAC is concerned that long-term debt growth has the potential to unduly burden County taxpayers in future years. The County enacted a 30-year bond program in 2015, when interest rates were significantly lower than they are today. The County also changed debt affordability guidelines to require that tax supported debt be less than 4.0 percent of projected personal income (vs. 3.0 percent in previous budget years). The SAC's more conservative estimate of personal income results in a lower debt affordability recommendation.

Finally, consistent with the SAC charter to consider the ability of the taxpayer to finance County services and long-term debt, the SAC notes that the analysis presented above does not include evaluation of other demands on personal income. In other words, under the methodology used above, County spending is considered "affordable" if it remains consistent as a percentage of overall personal income. However, even if taxes and fees paid to the County remain stable, increased costs in other areas (health care, insurance, tuition, federal and state taxes, etc.) potentially mean that less discretionary income is available to County residents. While this is a subjective consideration, it nonetheless supports our recommendation to increase the FY2020 County budget at a rate less than forecasted personal income growth.

Conclusion

Based on the analysis presented above, the SAC recommends an increase of 3.75% in the FY2020 General Fund budget as compared to FY2019. This recommendation is less than the personal income growth currently forecast by the Maryland Board of Revenue Estimates and the State's four econometric modeling firms. While we believe the economic outlook for Anne Arundel County remains positive, our recommendation is based on a measured approach that maintains steady growth while hedging against a potential downturn and allowing the County budgeting flexibility in future years should revenues exceed expectations.

The Committee once again extends its heartfelt appreciation to our County employees, especially to Assistant Budget Officer Hujia Hasim. The quality of governmental services that they provide is second to none. We sincerely hope that the evidence assembled for this report will help manage expectations and inform fair and just analysis of the difficult choices facing our elected leaders.

Sincerely,

David G. James, Chair

Spending Affordability Membership for 2018 to 2019:

District	Name	Resolution #	Appointed on	Term Expires
1	Carl Joe Carrick	70-16	November 21, 2016	December 1, 2018
2	Ejaz Younas, CPA-CISA-MSc, Secretary	19-17	May 1, 2017	December 1, 2020
3	Vacant			
4	Jerome W. Klasmeier	66-16	July 7, 2016	December 1, 2020
5	J. Timothy Connolly, Vice Chair	42-15	October 1, 2015	December 1, 2018
6	Jerry L. Pesterfield	42-15	October 1, 2015	December 1, 2018
7	David G. James, Chair	45-17	September 19, 2016	December 31, 2021