SPENDING AFFORDABILITY COMMITTEE
Anne Arundel County
January 30, 2015

The Hon. Steve Schuh, County Executive
The Hon. Jerry Walker, Chairman, County Council
Mr. John R. Hammond, Acting Chief Administrative Officer, Budget Officer
Mrs. Julie Mussog, Controller
The Arundel Center, 44 Calvert Street
Annapolis, Maryland 21401

This report of the Spending Affordability Committee (SAC) for fiscal year 2016 is hereby submitted to you in accordance with Section 610 of the Anne Arundel County Charter. Section 610 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."

Committee Recommendation

The Committee has followed the past practice of previous committees and determines that "spending affordability" can best be determined by estimating the growth in personal income of County residents in FY 2016. Personal income is based on data collected by the Bureau of Labor Statistics, U. S. Department of Labor. As shown in Appendix A, the Committee estimates that personal income of our County will grow 4.5 percent from FY 2015 to FY 2016. Hence, the calculations of the General Fund Appropriation Limit and the General Fund Debt Limit are as follows:

Current Expense Budget Recommendation	
(Adjusted Base Budget for Current Year x Estimated Personal Income Growth Rate for Budget Year)	
Approved FY2015 Budget	$1,349,416,700
- Appropriated Fund Balance	(36,391,000)
- Rainy Day Fund Contribution	(3,300,000)
Committee's Adjusted Base Budget - FY2015	$1,309,725,700
Estimated Increase in County Personal Income (FY15 to FY16)	4.50%
FY2016 General Fund Appropriation Limit (customary manner)	**$1,368,663,357**
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 - FY2015	$36,307,000,000
Estimated Increase in County Personal Income (FY15 to FY16)	4.50%
Forecast Personal Income - FY2016	$37,940,815,000
Standard Applied in County's Debt Affordability Model	3.0%
FY2016 General Fund Debt Limit (customary manner)	**$1,138,224,450**

This means that the Committee recommends that for FY 2016 the County not collect more than $1.369 billion in general fund revenues (taxes, fees and grants) and that the general fund debt not exceed $1.138 billion. To exceed these levels would increase the funding burden on our County residents.

Background

The Committee's expectation that County personal income will grow 4.5 percent in FY 2016 is based on econometric models provided to the State of Maryland by three private firms, the State's own Board of Revenue Estimates, and RESI of Towson University. These estimates only addressed Maryland on a statewide basis. There was no breakdown by county. Statewide estimates of personal income tend to fall below the same estimates for Anne Arundel County. However, RESI also prepares a report specifically targeted to Anne Arundel County.

As shown in Appendix A, statewide estimates vary. In calendar year 2015, the range in personal income growth varies from 3.8 to 5.2 percent. And in calendar year 2016, estimates range from 4.1 to 6.4 percent. To convert from a calendar year basis to a County fiscal year 2016 basis would result in an average statewide estimate of 4.6 percent. The RESI fiscal year 2016 estimate for Anne Arundel County is 4.9 percent. The Committee finds that historically recent estimates provided by the econometric firms tend to be more optimistic than actuals. Thus, similar to last year, the Committee finds that an estimate of about one half percent less than the professional estimate will be a prudent approach and hereby recommends the 4.5 percent rate.

Please see Appendix A for further detail and factors affecting growth in Anne Arundel County.

In recent years, the SAC has focused attention on long term threats to the County's financial health posed by:

- Other Post Employment Benefit (OPEB) obligations,
- Aging infrastructure, and
- State mandates for financing public education.

The SAC was pleased to see the OPEB problem addressed through the passage of Bill No. 85-13, the culmination of many years of collaboration between the County Executive, the County Council, and representatives of the County Workforce. The OPEB package provided for under this legislation will substantially reduce the cost of the benefit and develops a long term plan to pay for the promised benefits. The County needs an OPEB package that is competitive with surrounding jurisdictions and private industry in order to retain talent. Employees need assurance that funds will be available to fulfill OPEB promises post retirement. The SAC is hopeful this legislative action achieves this goal, and that the County's OPEB obligations become fully funded; as are the County's pension obligations.

Accumulated depreciation as a percent of total depreciable assets has increased from 43% as of June 30, 2008 to 52.0% as of June 30, 2014. The accumulated deficit for the maintenance and renovation of capital assets, including schools, roads and other essential County infrastructure, was highlighted in the SAC report for FY 2010 as approaching $2 billion and growing at a rate of nearly $100 million per year. The lack of a plan to bring the system into balance was highlighted as unacceptable then, and remains so today. Even though this topic was not discussed by the SAC members this year, the Committee plans to revisit the issue in upcoming fiscal year.

In recent years, the SAC has devoted the majority of its schedule to understanding and analyzing the State funding formula for public education. The fundamental concern is that the State Foundation funding formula shortchanges students in Anne Arundel County. While three of the four guiding principles set forth in the Final Report of the Thornton Commission are faithfully implemented in the funding formula, equity is not. Equity in funding means that taxpayers and property owners are treated alike throughout the State.

Contrary to this basic principle, taxpayer support for education is, on average, 6.3% of net income in Anne Arundel County while it is only 4.4% in Howard County. Similarly, support for education from property owners in Anne Arundel County is, on average, 9.6 cents per $100 of assessed value while it is just 6.9 cents in Howard County. A more comprehensive description of this problem was provided in the SAC report for FY 2013, and a summary was provided in FY 2014 report.

It is the opinion of the SAC that County officials are prudently monitoring fund balances and revenues, and maintaining the strict fiscal discipline that is necessary in a moderately recovering economic environment. The maintenance of a fully funded Revenue Reserve Fund is evidence of such fiscal discipline. The SAC notes this Revenue Reserve Fund was instrumental in weathering the Great Recession and, while recognizing contributions to this Fund over the past two years, encourages its full replenishment.

The mission and membership of the SAC is contained in Appendix B.

The SAC wishes to extend its heartfelt appreciation to our County employees. 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,

Michael W. Owen, Chairman

Appendix A
Economic Outlook and Recommendations for Spending Affordability

The Regional Economic Studies Institute (RESI) at Towson University's predicts increases in personal income of 5.3% and 4.6% in CY 2015 and CY 2016, respectively. This translates to a forecasted growth of 4.95% for FY 2016.

Comparison of Personal Income Forecasts					
	Calendar Year:	2013	2014	2015	2016
State of Maryland	Board of Revenue Estimates (Dec)	1.1%	3.3%	3.8%	4.1%
	Sage Policy Group (Nov)	1.1%	3.2%	4.9%	5.0%
	Moody's (Nov)	1.1%	2.7%	5.2%	6.4%
	Global Insight (Aug)	1.1%	3.0%	4.0%	4.8%
	RESI of Towson University (Dec)	1.1%	2.9%	4.2%	3.6%
Anne Arundel County	RESI of Towson University (Dec)	1.3%	4.1%	5.3%	4.6%
	Fiscal Year:	2013	2014	2015	2016
Anne Arundel County	RESI of Towson University (Dec)	3.3%	3.5%	5.0%	4.9%

The SAC recommends applying a 4.5% multiplier in the customary formula which multiplies baseline spending in the current fiscal year (FY 2015) by a forecast growth in County personal income for the budget fiscal year (FY 2016). In establishing the customary recommendation to limit outstanding long-term debt, the SAC applies the 4.5% multiplier to the average of the RESI quarterly forecasts of personal income in FY 2015.

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In the report *Analysis of December 15, 2014 General Fund Estimate*, the Maryland Bureau of Revenue Estimates stated:

> "Regional issues and slowing global growth will restrain Maryland employment growth in the near-term. Growth will receive a boost as the rate of federal government job losses is reduced, or at least flat lines, in the near future. Further employment growth is derived from continued improvement for the broader, national economy. An improving job market is expected to reduce labor markets slack; thereby, increasing employer job competition and placing upward pressure on wages. However, average wage growth remains subdued relative to non-recessionary periods. Aggregate income growth benefits from increased employment as well as a moderate rebounding from specific fiscal cliff issues that distorted growth in 2012 and 2013."

Table 1: Employment Growth

	Anne Arundel	MD	US
2013Q1	5.0%	1.0%	1.7%
2013Q2	5.2%	0.9%	1.6%
2013Q3	4.9%	0.7%	1.8%
2013Q4	4.2%	0.6%	1.8%
2014Q1	1.3%	0.2%	1.7%
2014Q2	0.4%	0.8%	2.0%

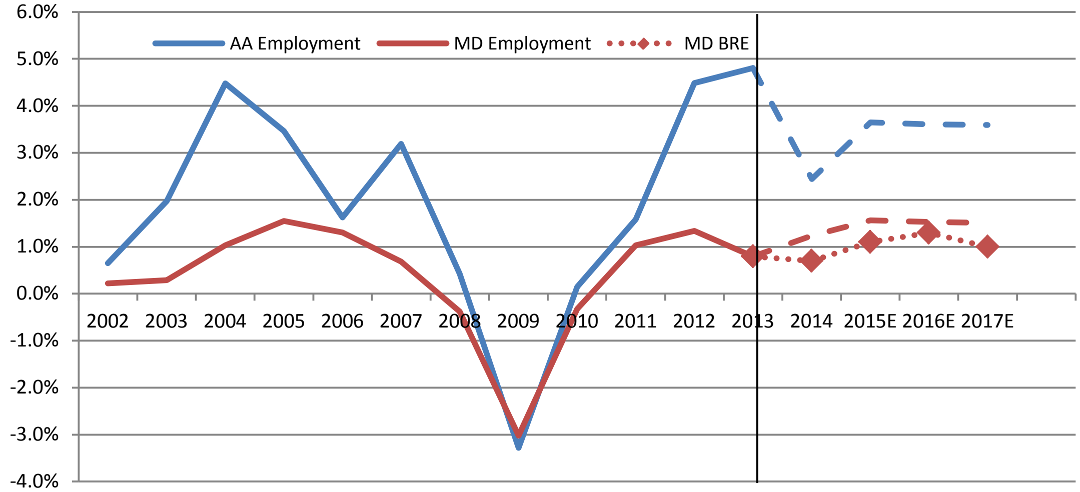
The regional headwinds that have subdued the State recovery are also being felt in Anne Arundel County. While the State's recent economic performance has significantly lagged the nation as a whole, Anne Arundel County has seen relatively strong growth during calendar year 2013. As shown in Table 1, left, Anne Arundel County's employment has historically grown at a greater rate than the nation as a whole. However, according to the Quarterly Census of Employment and Wages from the Bureau of Labor Statistics, 2014 employment and wage growth has slowed significantly. County employment growth has slowed to 0.8% through the first two quarters of 2014 compared to 1.9% for the nation, marking the first time the nation has outpaced the County since the fourth quarter of 2006. In addition to slowing employment growth, Anne Arundel County has also seen muted wage growth thus far in 2014, growing only 1.5%, the weakest start to a year since the depths of the recession in 2009.

Table 2: Wage Growth

	Anne Arundel	MD	US
2013Q1	6.6%	0.5%	2.2%
2013Q2	7.4%	2.3%	3.7%
2013Q3	7.2%	1.1%	3.7%
2013Q4	5.9%	-0.4%	1.7%
2014Q1	1.1%	2.0%	5.6%
2014Q2	1.9%	2.4%	4.1%

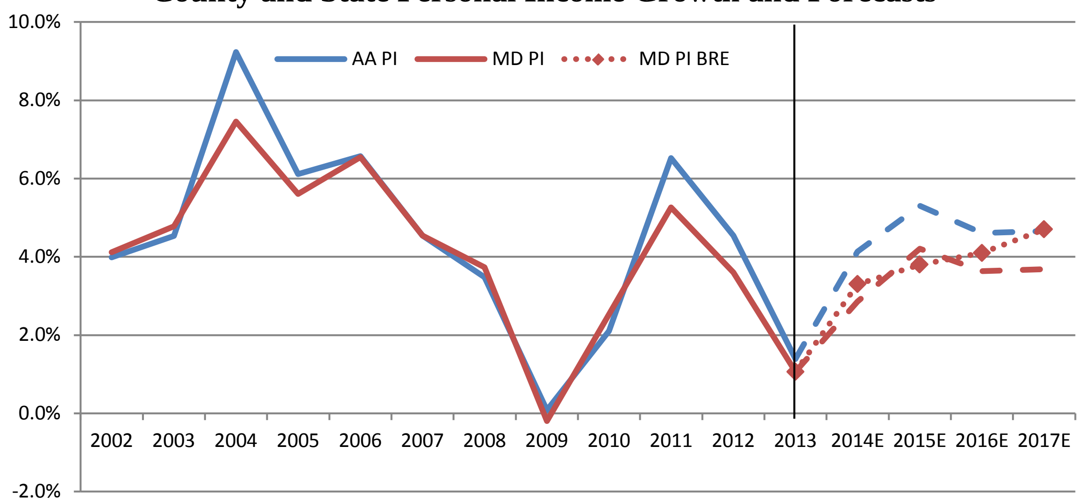
Looking forward, Anne Arundel County's economic condition is expected to improve. While the State's Bureau of Revenue Estimates (BRE) paints a weaker picture for the State's employment, Anne Arundel County is expected to return to its historical trend of outpacing the State's employment growth for the next several years. As shown in Figure 1, below, according to the Regional Economic Studies Institute (RESI), Anne Arundel County's employment is anticipated to increase 2.4% in 2014, followed by 3.6% the following three years.

Figure 1
County and State Employment Growth and Forecasts



Although growth in our County's employment and wages were slow in 2014, RESI indicates higher growth for the near future. Additionally, as shown in Figure 2, the BRE and RESI expect Personal Income growth to remain moderately strong. Using the information based in this report, the Committee's recommendations for spending affordability is 4.5%.

Figure 2
County and State Personal Income Growth and Forecasts



Appendix B
Mission and Membership of Spending Affordability Committee

Mission

The Spending Affordability Committee was established through a Charter amendment approved by the voters of Anne Arundel County at the General Election in November 1990. The Committee is charged with making 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.

Consistent with this mission, the Committee has historically provided the Office of the Budget, the County Executive, and the County Council with a recommended General Fund Current Expense Budget appropriation limit and a recommended General Fund debt limit. In addition to these recommended spending affordability limits, the Committee has also provided comments on a wide-ranging array of issues related to the County budget, County operations, and the County's capital infrastructure.

Membership

The Spending Affordability Committee consists of seven residents from each County Council district who are knowledgeable in the field of economics, finance, fiscal planning, or a related field. These residents are appointed to the Committee by the County Executive and confirmed by resolution of the County Council. The Committee members elect their own chairman. The district memberships consist of four- year scattered terms, and a person may not serve for more than two successive terms. The current membership is shown below:

District	Name	Year Appointed	Term Expires
1	Alvin Tilghman	2006	2014
2	Joseph Robert Sapp	2012	2016
3	John W. Spencer	2013	2017
4	Aaron Klebanoff	2013	2016
5	Michael W. Owen, Chair	2011	2014
6	Jack Nelson	2013	2014
7	Jason Johnson	2014	2018