

**SPENDING AFFORDABILITY COMMITTEE**

Anne Arundel County

January 13, 2017

The Hon. Steve Schuh, County Executive  
The Hon. John Grasso, Chair, County Council  
Mr. Mark Hartzell, Chief Administrative Officer  
Mr. John Hammond, Budget Officer  
Ms. Lauren Toney, Acting Controller  
The Arundel Center, 44 Calvert Street  
Annapolis, Maryland 21401

This report of the Spending Affordability Committee (SAC) for FY2018 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 past practice of previous committees and determines that “spending affordability” can best be determined by estimating the growth in collective personal income of County residents in FY2018 (i.e., the total income generated by residents and not average or per capita income). For example, if personal income of our residents should only increase one percent, then County spending should not increase more than that one percent. For FY2018, the SAC is estimating that personal income will grow about 3.5 percent.

<b>Current Expense Budget Recommendation</b>	
(Adjusted Base Budget for Current Year x Estimated Personal Income Growth Rate for Budget Year)	
Approved FY2017 Budget	\$1,447,804,100
- Appropriated Fund Balance	(39,104,100)
- Rainy Day Fund Contribution	(2,000,000)
Committee's Adjusted Base Budget - FY2017	\$1,406,700,000
Estimated Increase in County Personal Income (FY17 to FY18)	3.50%
<b>FY2018 General Fund Appropriation Limit (customary manner)</b>	<b>\$1,455,934,500</b>
<b>Capital Budget Recommendation</b>	
(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 - FY2017	\$37,832,263,000
Estimated Increase in County Personal Income (FY17 to FY18)	3.50%
Forecast Personal Income - FY2018	\$39,156,392,205
Standard Applied in County's Debt Affordability Model	4.0%
<b>FY2018 General Fund Debt Limit (customary manner)</b>	<b>\$1,566,255,688</b>

As shown in the table above, applying the 3.5 percent growth rate to the approved FY2017 budget as adjusted means that the Committee is recommending that the maximum “affordable” appropriation for FY2018 operating budget not exceed \$1,455,934,500. This represents an increase of about \$49 million over FY2017.

For the capital side of the budget, the SAC’s projected personal income growth of 3.5% indicates that the FY2018 General Fund Debt Limit be \$1,566,255,688, or \$449 million more than last year’s level of \$1,117,344,000. This relatively large increase is due primarily to the County increasing the “Debt to Personal Income” debt affordability guideline from three to four percent last spring after the SAC presented our formal report in the preceding January.<sup>1</sup>

**Background**

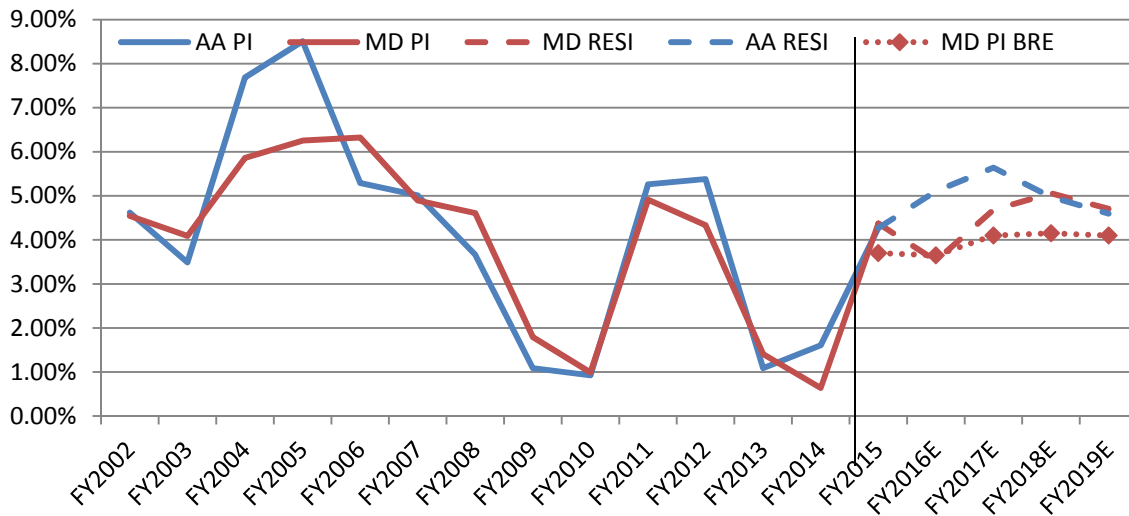
The State of Maryland has historically contracted with about four econometric firms (economic modeling) to provide estimates of personal income and other data for the United States and more specifically Maryland. Based on these four estimates, the State Board of Revenue Estimates makes its own additional estimate for Maryland. One of these four econometric firms, RESI of Towson University, also provides data for Anne Arundel County. The RESI estimates are derived from an economic model known as REMI PI+. This model is based primarily based on personal income, employment and population data available from the Bureau of Economic Analysis, U. S. Department of Labor. These estimates are summarized in the following table:

<b>Comparison of Personal Income Forecasts (Fiscal Years)</b>		2015	2016	2017	2018
<b>State of Maryland</b>	Board of Revenue Estimates (Dec)	3.7%	3.7%	4.1%	4.2%
	Sage Policy Group (Nov)	3.6%	4.1%	4.7%	4.5%
	Moody's (Nov)	3.6%	3.7%	4.9%	5.3%
	Global Insight (Aug)	3.6%	3.6%	4.4%	4.7%
	RESI of Towson University (Dec)	4.4%	3.5%	4.7%	5.1%
	Average	3.8%	3.7%	4.5%	4.7%
<b>Anne Arundel County</b>	RESI of Towson University (Dec)	4.3%	5.1%	5.6%	5.0%

The following graph shows the actual annual growth rates in personal income from FY2002 to FY2015, along with the projections shown in the table above for FY2016 and beyond. If viewing in black and white, the higher or blue line in 2005 is Anne Arundel and the other line is red for Maryland. This graph indicates that a growth rate of about 4 percent or slightly above is expected by the Maryland Board of Estimates for FY18, with a higher growth rate projected by RESI for Anne Arundel County.

<sup>1</sup> Page 21, Approved Current Expense Budget and Budget Message for Fiscal Year 2017

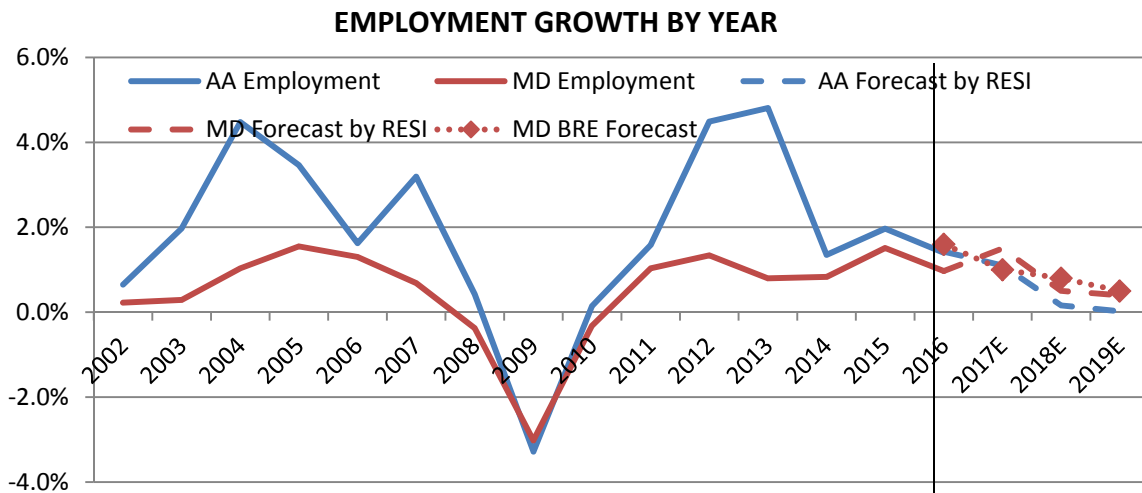
### PERSONAL INCOME GROWTH BY YEAR FOR ANNE ARUNDEL AND MARYLAND



As part of our deliberations, the Committee examined changes over time in forward-looking personal income growth projections. This analysis showed that, in recent years, the Maryland State Board of Estimates and its four econometric firms have had to revise downward their estimated personal income growth for Maryland. For example, in November 2014, the average of the five estimates was 5.4 percent for FY2017. In November 2015, the estimate dropped to 4.8 percent. And this past November, the average estimate was further decreased to 4.5 percent as shown in the table above (note shaded number). At the time of this report, no actual data is available for FY2017. However, based on the most recent preliminary data, it appears that the actual growth in Anne Arundel personal income for FY2017 will be even lower, probably in the 3.75 percent range. Based on these downward revisions, the SAC recommends a more conservative estimate of 3.5 percent for FY2018.

Additionally, we considered the following factors in making our determination:

- ❖ **Federal Budget Policy** - At this time, the incoming President’s budget priorities are at best unclear. By law he is to submit his first budget in February 2017, or after this report has been submitted. Further, it appears that Congress has fallen into the habit of passing short-term continuing resolutions of varying terms creating insecurity and complicating estimates by everyone, professionals and families alike. Sequestration remains a fear. The Fed recently increased interest rates and is expected to increase them further over the next year or so. Due to the heavy reliance of the Maryland and Anne Arundel County economies on Federal spending, this uncertainty represents a significant risk factor for personal income growth in the County.
- ❖ **Employment Growth** - As shown in the following graph, employment growth in Anne Arundel County has outpaced the State (County is top or blue line and State is bottom or red line). Job growth peaked at five percent in 2003, but is projected to decrease over the next several years from about two percent in 2016 to close to zero in 2019.



- ❖ **Consumer Spending and Consumer Confidence** - One factor to be considered in the future is that a number of economic projections are based on lower consumer spending and consumer confidence. For example, nationwide, Kiplinger is expecting to see a slight lowering in retail and food services sales in calendar 2017 and a drop in consumer confidence from 98 to 90.5.<sup>2</sup>
- ❖ **Federal Reserve Policy** - On December 16, 2016, the Federal Reserve announced that it expects the national Gross Domestic Product growth rate to decrease slightly from 2.4 percent in calendar 2016 to 2.0 in calendar 2018. The Fed also expects unemployment to remain a constant 4.7 percent in calendar years 2017 and 2018 and for the personal consumption expenditures rate (inflation) to increase slightly from an expected 1.6 in calendar 2016 to the Fed’s avowed target rate of 2.0 percent<sup>3</sup> inflation in calendar 2017.<sup>4</sup>
- ❖ **Wage Growth** - Average weekly wages in Anne Arundel County have only increased by \$26 over the past seven years, from \$1,045 in 2009 to \$1,071 in 2015 (in 2015 dollars). In the first quarter of 2016, average wages actually decreased very slightly to \$1,068. Thus past wage growth has been less than expected. The impact of the just opening National Harbor in Prince George’s County on Anne Arundel’s gambling industry is unclear.
- ❖ If employment and wage growth are in fact flat or declining for FY2018 and FY2019, personal income growth in Anne Arundel County will be driven by population growth (i.e., more taxpayers) and non-wage income. If true, this data is of concern to the Committee and thus supports a more conservative overall estimate of personal income growth.

**Conclusion**

These factors listed above tempered the SAC’s personal income estimate to be less than is being predicted by

<sup>2</sup> <http://www.kiplinger.com/article/business/T019-C000-S010-retail-sales-consumer-spending-forecast.html>

<sup>3</sup> [https://www.federalreserve.gov/fags/economy\\_14400.htm](https://www.federalreserve.gov/fags/economy_14400.htm)

<sup>4</sup> <https://www.federalreserve.gov/monetarypolicy/files/fomcproitabl20151216.pdf>

four econometric firms and the Maryland Board of Revenue Estimates. However, we are still forecasting a moderate growth rate of 3.5 percent. With inflation averaging a little over one percent for the last five years, the real growth that the SAC is estimating is over two percent. Our point is that we find the econometric models to be highly optimistic. Based on this conclusion and the risk factors cited above, a more conservative estimate is warranted.

The Committee once again extends its heartfelt appreciation to our County employees, especially to Assistant Budget Officer Hujia Hasim and Budget Officer John Hammond. 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,



John W. Spencer, Chair

**Spending Affordability Membership for FY 2016 to 2017:**

<b>District</b>	<b>Name</b>	<b>Resolution #</b>	<b>Appointed on</b>	<b>Term Expires</b>
1	Carl Joe Carrick	70-16	November 21, 2016	December 1, 2018
2	Vacant			2018
3	John W. Spencer, Chair	52-13	December 2, 2013	December 1, 2017
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, Secretary	61-16	September 19, 2016	December 31, 2017