SPENDING AFFORDABILITY COMMITTEE
Anne Arundel County
January 29, 2020

The Hon. Steuart Pittman, County Executive
The Hon. Allison Pickard, Chair, County Council
Mr. Ben Birge, Chief Administrative Officer
Mr. Jim Beauchamp, Budget Officer
Ms. Karin McQuade, Controller
The Arundel Center, 44 Calvert Street
Annapolis, Maryland 21401

This report of the Spending Affordability Committee (SAC) for FY 2021 is hereby submitted 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 FY 2021 spending be based on a personal income growth rate projection of 3.7%, which results in a forecasted FY 2021 personal income level of $41,885,893,207 for the County. As shown in the table below, applying the 3.7% growth rate to the FY 2020 adjusted base budget results in a recommended FY 2021 Current Expense (General Fund) budget of $1,698,208,829. This represents a $60.6 million increase over the FY 2020 approved budget, and a $116.1 million increase over the SAC's FY 2020 recommendation. 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 $1,675,435,728. This represents a $33.5 million increase over the SAC's FY 2020 recommendation.

The SAC's recommendation is based on data available as of the drafting of this report. Prior to our testimony to the County Council, currently scheduled for May 1st 2020, 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 FY 2020 Budget	$1,696,131,500
- Appropriated Fund Balance	(53,014,500)
- Rainy Day Fund Contribution	(5,500,000)
Committee's Adjusted Base Budget – FY 2020	$1,637,617,000
Estimated Increase in County Personal Income (FY 2020 to FY 2021)	3.70%
FY 2021 General Fund Appropriation Limit (customary manner)	**$1,698,208,829**
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 – FY 2020	$40,391,411,000
Estimated Increase in County Personal Income (FY 2020 to FY 2021)	3.70%
Forecast Personal Income – FY 2021	$41,885,893,207
Standard Applied in County's Debt Affordability Model	4.0%
FY 2021 General Fund Debt Limit (customary manner)	**$1,675,435,728**

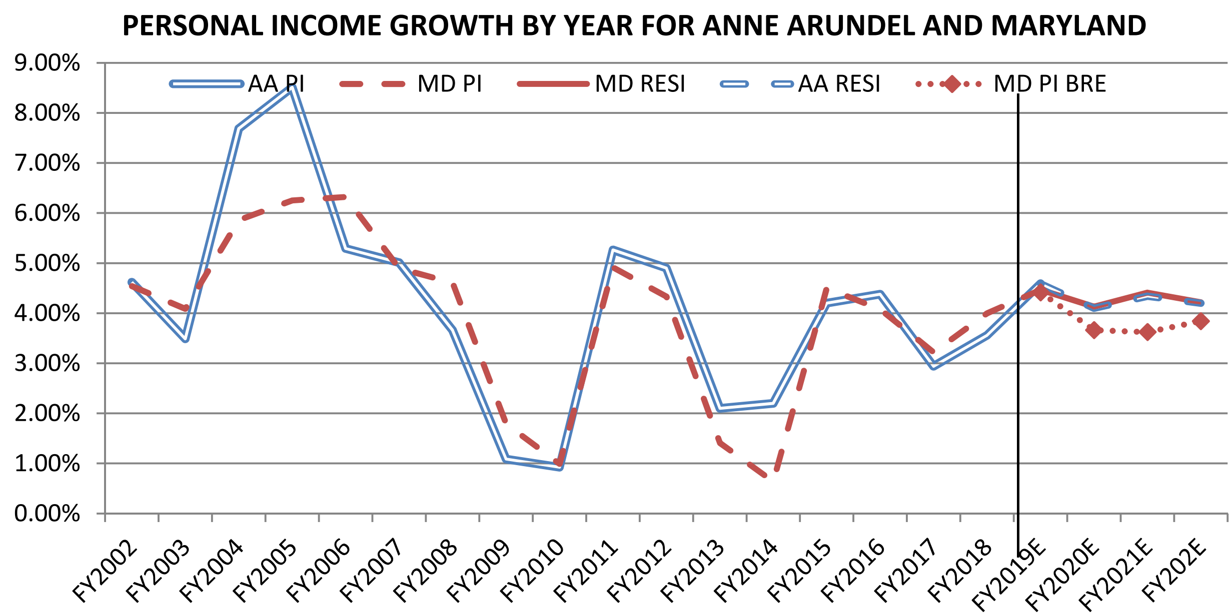
Background

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. In addition, the State Board of Revenue Estimates (BRE) makes its own 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. On average, these estimates project a 3.7% personal income growth rate for FY 2021 for Maryland. RESI projects a higher growth rate (4.3%) for Anne Arundel County.

[1] Page 21, Approved Current Expense Budget and Budget Message for Fiscal Year 2020

Comparison of Personal Income Forecasts (Date of Estimate)		(Fiscal Years)			
		2019	2020	2021	2022
State of Maryland	Board of Revenue Estimates (Dec 2019)	4.4%	3.7%	3.6%	3.8%
	Sage Policy Group (Nov 2019)	4.6%	4.1%	3.4%	3.4%
	Moody's (Nov 2019)	4.5%	3.6%	2.9%	3.1%
	Global Insight (Aug 2019)	4.5%	4.0%	4.0%	4.1%
	RESI of Towson University (Dec 2019)	4.5%	4.1%	4.4%	4.2%
	Average	4.5%	3.9%	3.7%	3.7%
Anne Arundel County	RESI of Towson University (Dec 2019)	4.6%	4.1%	4.3%	4.2%

The following graph shows the actual annual growth rates in personal income from FY 2002 to FY 2018 for Maryland and Anne Arundel County as reported by the BEA, along with the forecasts described above for FY 2019 and beyond. If viewing in black and white, the higher (blue double) line in 2005 is Anne Arundel and the lower (red dashed) line in 2005 is Maryland. For the most recent year where data is available (FY 2018), the BEA reported that the personal income growth rate in Anne Arundel County was 3.6%.



Analysis

The SAC applied its 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 reporting is only available from the BEA through FY 2018, projections for FY 2021 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. It also examined changes over time in forward-looking personal income growth projections.

This analysis showed that, in recent years, the BRE and the four econometric firms have consistently revised downward the estimated personal income growth rate for Maryland as reported data becomes available. For example, in December 2014, the average of the five estimates was 5.4 percent for FY 2017. As shown below, the average estimate dropped to 4.8 percent in November 2015. In December 2016, the average estimate was further decreased to 4.5 percent. ***The actual BEA reported growth rate in Maryland for FY 2017 is 3.2 percent as of December 2019. This is 2.2 percentage points below the estimate made in December 2014.***

Date	Maryland PI Growth for FY 2017	Source
December 2014	5.4%	Maryland State Board of Revenue Estimates, Sage Policy Group, Moody's, Global Insight, and RESI (Estimated)
November 2015	4.8%	
December 2016	4.5%	
December 2019	**3.2%**	BEA (Reported)

As shown below, RESI has also consistently reduced its personal income estimate for Anne Arundel County. Further, as with the Maryland data, actual BEA reported personal income growth is even lower. ***Specifically, the most recent BEA-reported Anne Arundel personal income growth (reported in December 2019) for FY 2017 is 2.9%, vs. an RESI estimate of 5.6% (made in December 2016).*** The numbers are similar for FY 2018.

Estimate / Report Date	Anne Arundel PI Growth		Source
	FY 2017	FY 2018	
December 2016	5.6%	5.0%	RESI (Estimated)
December 2017	3.9%	4.3%	
December 2018	3.5%	4.2%	
December 2019	**2.9%**	**3.6%**	BEA (Reported)

To relate this analysis to previous recommendations made by the SAC, the following table shows estimated personal income growth data estimates presented to the SAC, BEA reported personal income growth, and the SAC's budget recommendation for FY 2017 and FY 2018.

Budget Year	FY 2017	FY 2018
Personal Income Growth Estimate (Dec 2016)	5.6%	5.0%
BEA Reported Personal Income Growth (Dec 2019)	2.9%	3.6%
SAC Budget Recommendation*	**3.0%**	**3.5%**

*January 2017 report for FY 2017, and January 2018 report for FY 2018

The analysis presented above is meant to highlight the uncertainty associated with forward looking growth projections. RESI's annual Economic Outlook for Anne Arundel County provides valuable insight into county employment, wages, real estate and other economic factors. However, by necessity, personal income analysis by RESI and others for the current FY is based on more than two years of estimated data (i.e., because BEA reported data is not yet available). Moreover, as discussed later in this report, the employment data available to RESI is not complete due to reporting restrictions for national security related jobs at Ft. Meade. Therefore, judgement must be applied when making budgeting decisions based on this data. As such, the SAC believes it is likely that actual results for FY 2021 will be lower than currently forecasted. This analysis is a primary factor in the SAC's recommendation to base the FY 2021 budget on a more conservative 3.7 percent growth rate, as compared to RESI's current projection of 4.3 percent. The 3.7 percent matches the average of the five estimates made for Maryland as a whole.

Additional factors leading to the recommendation include the following:

- **Effect of the National Economy –** It is well documented that the national economy (GDP and jobs) has been growing steadily since the last recession in 2008, and that the pace of growth has accelerated since 2017. While this is a positive factor for the County's economic outlook, the SAC remains cautionary. In the past year, there have been various indicators of a potential recession—most notably the inversion of short- and long-term bond rates in August 2019 (https://www.washingtonpost.com/business/2019/08/14/recession-watch-what-is-an-inverted-yield-curve-why-does-it-matter/). While most analysts agree that a recession is unlikely in 2020, the SAC believes the prudent approach is to plan based on more conservative growth expectations and to hedge against a possible recession in 2021 or beyond.

- **Lower Forecasted Growth for 2021 and 2022 –** The average personal income growth estimate for Maryland decreases from 3.9 percent for FY 2020 to 3.7 percent for FY 2021 and FY 2022. If the personal income growth does slow—and the County budget exceeds this growth—tax/fee increases, budget cuts, or both may be required.

- **Job Growth –** Data indicates that Maryland as a whole is at or approaching full employment levels, with an unemployment rate of 3.6 percent in October 2019. While full employment typically results in higher wages, it also potentially slows job growth. RESI projections indicate that Anne Arundel employment levels will remain flat from Q3 2019 through Q2 2024 (***i.e., no job growth for the next 60 months***).

- **Population Growth and Demographics –** Personal Income growth is directly related to the number of workers in the County, which in turn is driven by population growth and age demographics. With respect to population, RESI reduced its December 2018 projection from 0.73 percent annual growth to approximately 0.40 percent. This lower growth projection is more in line with Maryland Department of Planning data presented to the SAC in 2018. This lower population growth projection will have a corresponding effect on personal income growth. Of potentially greater concern is the aging of the County population. Data provided by RESI indicates slightly negative population growth in the 25 to 64 year old demographic from 2019 through 2024 (i.e., the population in the demographic is going ***down***). Conversely, the population aged 65 and older is expected to grow by 3.2% per year over the same time period. Accelerated aging of the County population also represents a risk factor to forward-looking personal income projections.

- **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 the Committee's report for FY 2017). 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 (e.g., insurance, pension, health care). Many of these benefits are not available to part time employees and self-employed individuals. Moreover, self-employed individuals must bear costs that would otherwise be paid by employers, such as employer contributions to Social Security and Medicare. As such, this trend has the potential to negatively impact personal income and disposable income.

- **Real Estate Values –** Real estate taxes are the County's largest source of revenue (44%), with Recordation and Transfer Fees representing the third largest source of revenue (6%). The SAC considered factors that 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, although they are increasing steadily. However, the inventory of homes for sale has decreased approximately 25% since 2015. While the budget recommendation for FY 2021 was not influenced by concerns over the real estate market, the Committee does not see income from home sales as contributing significantly to personal income growth. This topic should continue to be monitored closely given the County's dependence on these revenues.

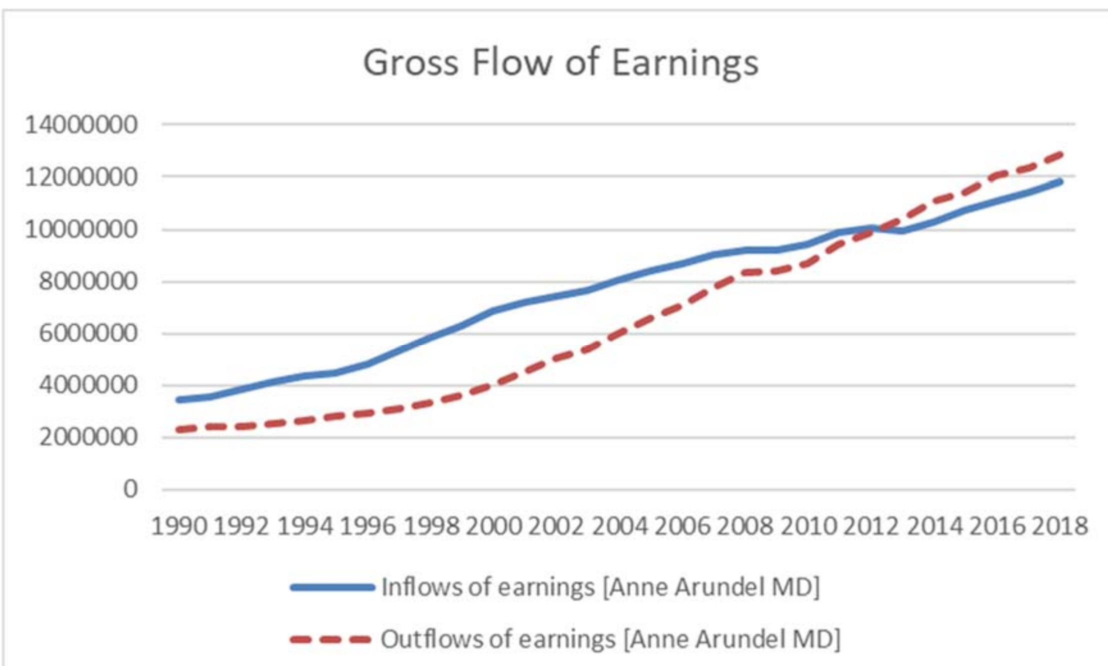
- **Long Term Debt** – The SAC charter includes making advisory recommendations regarding long-term debt. Currently, County debt is in line with the Council approved debt affordability guidelines. However, the SAC is concerned that long-term debt growth has the potential to unduly burden County taxpayers in future years. The County enacted a 30-year bond program in 2015, when interest rates were at historic lows. 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.

- **Impact of Federal Spending –** The SAC has discussed this topic at length in previous reports. As the Committee has said before, the County benefits significantly from Federal discretionary spending. However, 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. The following paragraphs provide additional detail regarding the Committee's discussion on this topic.

Many Government agencies involved in national security do not report employment data to the BLS. As a result, BLS data for Anne Arundel contains significant inconsistencies, potentially impacting the models used by RESI and others. Specifically, the BLS reports that the total labor force in Anne Arundel County is 321,691, and that the unemployment rate in Maryland is 3.6%. Contradicting this data, the BLS also reports that the total number of non-farm jobs in Anne Arundel is 269,538 (i.e., approximately 50,000 fewer jobs than the number of workers in the county). The most likely explanation for this discrepancy is the Government-employed workforce at Ft. Meade, which is estimated at more than 50,000 people.

Underscoring this point, BLS analysis shows that Anne Arundel is a "net importer" of jobs (i.e., more people travel from other counties to Anne Arundel to work than vice versa). As shown below, income outflows (i.e., income earned at jobs within the county by people living outside the county, shown in orange) exceed income inflows (i.e., money earned by residents who work outside of the county, shown in blue) by more than 8%. These two lines began to converge around 2005 during the last round of BRAC and crossed over in 2012 after the U.S. Cyber Command and the Defense Information Systems Agency moved to Ft. Meade. Federal Government analysis shows that 3 of the top 5 places of residence (by Zip Code) for Ft. Meade employees are in Anne Arundel. This does not include workers employed by Government contractors. BLS data indicate that there are 25,527 professional and technical services jobs in Anne Arundel, most of which are likely associated with Ft. Meade.



Integrating this data, the SAC estimates that as many as 30% of Anne Arundel workers derive their income from Federal spending. While this is mostly associated with Ft. Meade, it also includes Government employees at Baltimore-Washington Thurgood Marshall International Airport and the Naval Academy, businesses serving those locations, as well as county residents with Federal jobs outside Anne Arundel. For example, beyond the Ft. Meade workforce, BLS indicates there are 13,204 of reportable Federal Government jobs in Anne Arundel.

Based on the risk exposure Anne Arundel has to employment at Ft. Meade, the SAC recommends that the County continue to pursue policies that minimize the risk of relocation of some or all of Ft. Meade operations to another state. This includes ensuring availability of housing for Ft. Meade workers, affordable state and local resources, controlling cost of living increases, incentivizing business investment, and maintaining adequate infrastructure (roads, etc.). While the date for the next round of BRAC has not been announced, the Government continues to analyze infrastructure costs to identify potential areas for savings (https://www.militarytimes.com/news/pentagon-congress/2017/05/23/trump-s-budget-calls-for-new-base-closing-round-in-2021/). In the last round of BRAC (2005), criteria included the cost of operations and associated manpower implications, the economic impact on local communities, and the ability of infrastructure in the local community to support a military installation (https://fas.org/sgp/crs/natsec/R45705.pdf).

Finally, the SAC notes that in recent years, its budget recommendations have been consistently less than the personal income projections provided by RESI and others, and also less than the actual budgets proposed by the County Executive and enacted by the County Council. Consistent with the SAC charter to consider the ***ability of the taxpayer*** to finance County services and long-term debt, the SAC would like to make two points relative to this topic:

1) In past years, the SAC focused on year-over-year personal income growth and budget projections. This analysis did not consider whether long-term spending has remained in line with personal income (i.e., averaging out year-to-year variations). Data shows that over the last 10 years (2011 to 2020), the County budget has increased at a compound annual growth rate (CAGR) of 3.81%, while personal income over the same period has increased at a CAGR of 3.56% (i.e., spending growth has outpaced personal income growth). Taken over the last 5 years, the discrepancy is even larger (5.01% vs. 3.51%). These trends are of some concern. Further, given that this analysis uses estimated data for the last two years, this gap may increase once the BEA reports data for 2019 and 2020. However, if the FY 2020 budget is removed from this analysis, the opposite is true (personal income grew slightly faster than spending from 2011 to 2019). Going forward, the SAC believes the prudent approach is to strive for consistent year-over-year budget increases, in line with personal income growth. If the County budgets below personal income growth projections, this will provide flexibility in future years in the event revenue from taxes and fees comes in higher than expected.

2) 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 the recommendation to increase the FY 2021 County budget at a rate less than forecasted personal income growth.

Conclusion

Based on the analysis presented above, the SAC recommends an increase of 3.7% in the FY 2021 General Fund budget as compared to FY 2020. This recommendation is less than the personal income growth currently forecast by RESI for Anne Arundel County, but is consistent with the average estimate of the Maryland Board of Revenue Estimates and the State's four econometric modeling firms for the State as a whole. While the Committee believes that the economic outlook for Anne Arundel County remains positive, the 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 and Budget and Management Analyst Hannah Dier. 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 Committee Membership for 2019 to 2020:

District	Name	Resolution #	Appointed on	Term Expires
1	Nicole Butler	34-19	9/16/2019	12/1/2022
2	Ejaz Younas, Vice Chair	19-17	5/1/2017	12/1/2020
3	Deborah Ritchie	34-19	9/16/2019	12/1/2021
4	Donny James	34-19	9/16/2019	12/1/2020
5	Mary Clapsaddle, Secretary	34-19	9/16/2019	12/1/2022
6	David Juppe	34-19	9/16/2019	12/1/2022
7	David James, Chair	45-17	10/16/2017	12/1/2021