SPENDING AFFORDABILITY COMMITTEE

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Report of the Spending Affordability Committee

Fiscal Year 2008

Baltimore County, Maryland

February 15, 2007

BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE

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SPENDING AFFORDABILITY COMMITTEE

February 15, 2007

Honorable Members of the Baltimore County Council
Honorable James T. Smith, Jr., County Executive

I am pleased to submit the report of the Spending Affordability Committee, reflecting the Committee's fiscal policy recommendations for Baltimore County for fiscal year 2008.

For fiscal year 2008, the Committee establishes a base spending guideline of $1,484,266,241, based on a personal income growth forecast of 5.16%. This guideline represents maximum potential growth of $72,830,105 over fiscal year 2007 base spending. The Committee also recommends that debt service not exceed nine percent of fiscal year 2008 General Fund revenues (or $146,178,000) and that total debt outstanding not exceed 2.2% of fiscal year 2008 estimated assessed property value (or $1,583,950,566). These guidelines are meant to limit spending such that the cost of government services does not grow at a faster pace than the growth in the county's economy. In making these recommendations, the Committee emphasizes that these guidelines do not represent targeted spending levels but rather maximums not to be exceeded.

In determining its guidelines, the Committee reviewed current and projected conditions of the national, state, and local economies. This review found that the current economic outlook is positive, and that despite some troubling signs emerging within the national economic outlook, fiscal year 2008 is expected to be a good year for the county economy.

Effective for fiscal year 2008, the County is now required to recognize a liability for other post-employment benefits (OPEB), primarily health and life insurance, on an accrual basis rather than its current pay-as-you-go practice. In recognition of this unfunded liability, the major bond rating agencies signaled that in order for the County to maintain its triple-A bond rating, it must begin funding this obligation in the same manner as it funds its pension liability. In FY 2007, the Committee addressed the County's intention to fully fund its annual required contribution by allowing a one-time "advance payment" of surplus funds toward the future OPEB obligation. Because the GASB accounting changes do not take effect until 2008, this payment was not required and was therefore excluded from the spending guideline. Beginning in FY 2008, however, annual payments to the OPEB fund will be an on-going cost and therefore must be included in the guideline. For the purpose of spending affordability, the Committee will allow a five-year phase-in for the incorporation of additional actuarially determined General Fund OPEB funding into its spending guideline. In consideration of the substantial increase in the size of the obligation and its impact on base spending, this phase-in plan calls for recognition of the additional annual required contribution resulting from the General Fund OPEB accrued liability to be included in base spending in 20% increments beginning in FY 2008, to be wholly included in the guideline by FY 2012, and to be maintained as such thereafter.

The Committee also addressed the issue of clarifying expenditures that occur after the budget has been adopted. Currently, each expenditure is examined on a case-by-case basis without any specific guidance on how to treat such expenditures. Accordingly, the Committee adopted GASB definitions of “extraordinary items” and “special items” to further clarify what types of expenditures are excludable from the spending guideline.

Finally, the Committee adopted a policy that formally codifies its current and long-standing practice for treating various reserve funds. Specifically, the Health Insurance Reserve and the other post-employment benefits—OPEB—fund are included under its spending guideline, and the Reserve for Contingencies and the Revenue Stabilization Reserve Account—RSRA are excluded. These policy refinements are further detailed in the body of this report.

I would like to thank my fellow Council members who serve on the Committee for their time and devotion to this year’s process. I would also like to express my gratitude to long-standing Committee member John Gaburick, whose experience, dedication, focus, and insights were invaluable; new Committee member Robert Sweet, for his valuable input; and the Baltimore County Economic Advisory Committee (BCEAC), which is chaired by Anirban Basu, CEO, Sage Policy Group, Inc. and which provides the Spending Affordability Committee with a real-time view of the local economy through quarterly input of top executives from key county business sectors.

Finally, I would like to express my appreciation to the Committee’s staff, for their tireless efforts in providing in-depth analysis and review of Committee policies and in coordinating the Committee’s agenda. In particular, I would like to thank Brian Rowe, County Auditor; Elizabeth Irwin, Director, Fiscal and Policy Analysis; Paul Maihan, Principal Analyst; Scott Gates, Senior Analyst; Carrie Vivian, Staff Analyst; Marie Barnes, Staff Analyst; and Michelle Ganjon, Legislative Specialist.

We hope that this report is given careful consideration in the development and review of the County's operating and capital budgets for fiscal year 2008.

Sincerely,

Kenneth Oliver
Chairman, Spending Affordability Committee

INTRODUCTION

The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed growth in the County's economy.

In March 1990, the Baltimore County Council enacted legislation (Bill 33-90) that established a spending affordability law for Baltimore County to ensure that growth in County spending does not exceed the rate of growth of the county's economy (Baltimore County Code, Sections 2-3-101 to 2-3-107). The law mandates that the Spending Affordability Committee make a recommendation each fiscal year on a level of County spending that is consistent with the County's economic growth. The Committee has implemented this law by establishing both spending and debt guidelines. The spending guideline is a recommendation for the maximum level of General Fund spending for ongoing purposes, or "base spending." The debt guidelines are based on two common debt affordability indicators.

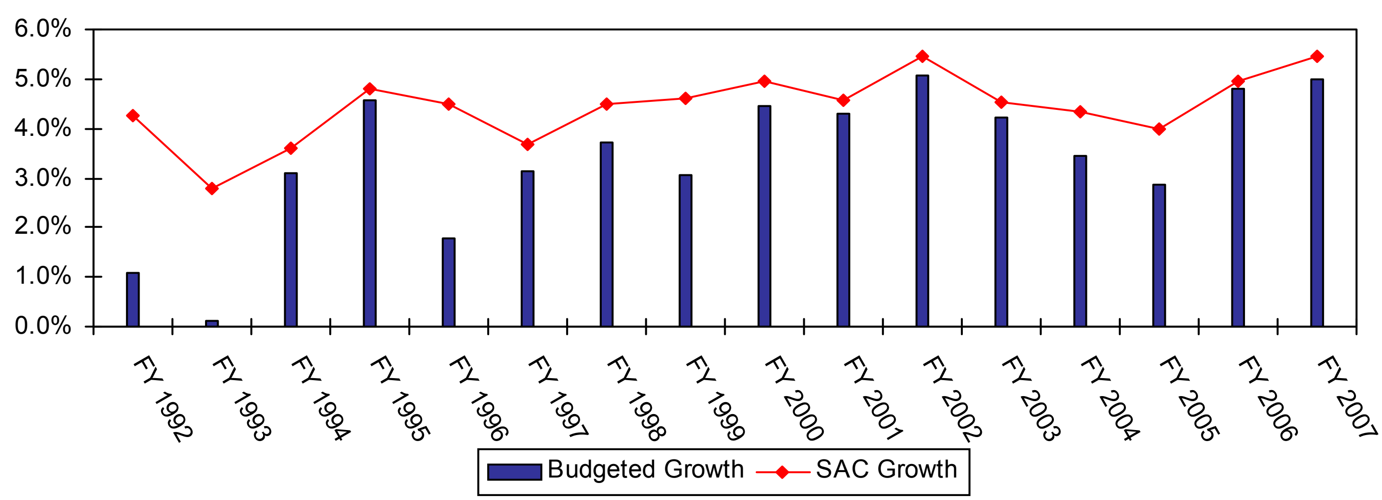
The Spending Affordability Committee submits its report by February 15 of each year in order to provide timely input into the budgeting process.

By law, the Spending Affordability Committee must submit its report to the County Council and County Executive by February 15 of each year. This reporting date allows the Executive ample time to consider the Committee's recommendations before formally presenting the proposed budget to the Council on or before April 16 of each year. The purpose of this report is to provide formal input from the County Council to the County Executive relative to the formulation of the County budget.

In formulating its FY 2008 spending guideline, the Committee reviewed policy issues in an effort to ensure the affordability of all ongoing government services.

Committee guidelines are intended to set recommended maximum County spending levels that should not be exceeded (Figure 1); however, they may be exceeded at the discretion of the County Executive and County Council if a rationale for doing so is provided. Prior to making its FY 2008 recommendations, the Committee reviewed a number of issues, clarifying its stance on what reserve funding and what types of expenditures related to extraordinary or special events are to be excluded from its spending guideline. Furthermore, beginning in FY 2008, the Committee is phasing the County's increased other post-employment benefits (OPEB) General Fund obligation into its spending guideline in 20% annual increments toward the goal of incorporating the full obligation by FY 2012.

Figure 1. SAC Spending Growth and Budgeted Spending Growth Since Committee Establishment



Sources: FY 1992 - FY 2007 SAC Reports; FY 1992 - FY 2006 Adopted Budgets

ECONOMIC OUTLOOK

For FY 2008, personal income, the measure used by the Committee to determine the growth in the economy, is expected to grow by 5.16%. This growth takes into consideration local economic developments.

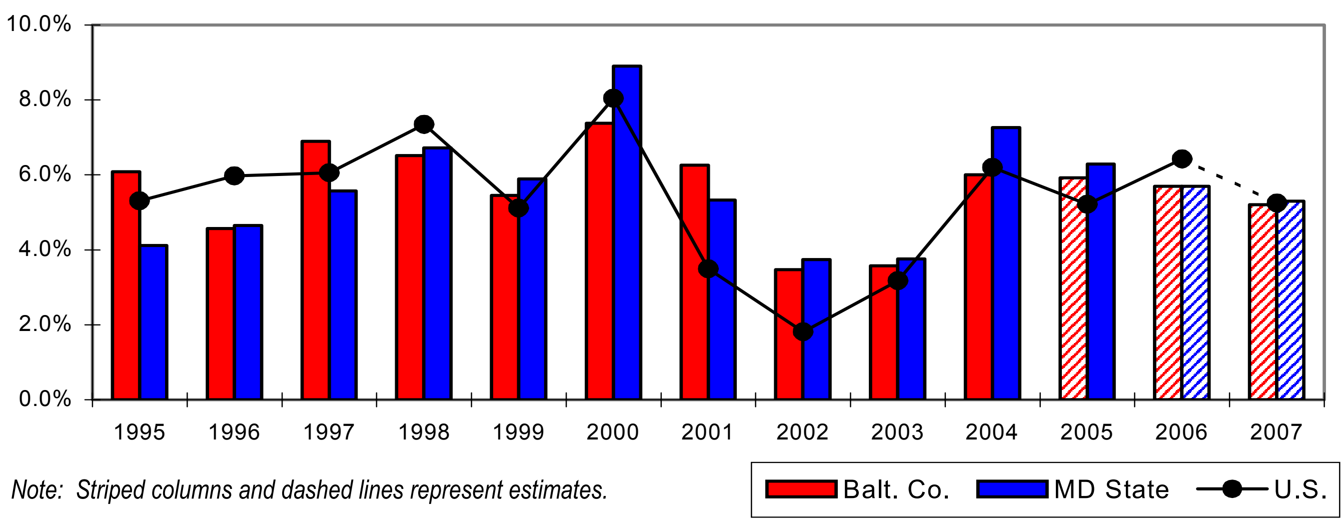
The Committee's FY 2008 recommended 5.16% growth in spending is based on the Baltimore County personal income forecast by RESI Research and Consulting of Towson University (RESI) as of January 16, 2007. This growth is 30 basis points below the FY 2007 spending growth of 5.46%. RESI projects that personal income growth for FY 2007 in the state (5.18%) and the county (5.16%) will be virtually the same. However, in FY 2008 personal income growth in the state (5.41%) is projected to be 25 basis points higher than in the county (5.16%). The higher projected FY 2008 personal income growth rate for the state reflects more rapid growth in two large Maryland counties. Over the 1995 to 2005 period, County personal income increased at an estimated annual rate of 5.6%, compared to 5.7% in Maryland and 5.2% in the U.S. (Figure 2).

The current economic outlook for the U.S., Maryland, and Baltimore County is positive, supporting continued revenue growth.

Prior to adopting its FY 2008 personal income growth rate, the Committee reviewed current and projected economic conditions to ensure that its recommendations would be consistent with the local economic outlook. This review helped to assure that the adopted growth rate for the upcoming fiscal year would be consistent with the best available projections for personal income and overall economic growth. The recent meeting of the Baltimore County Economic Advisory Committee (BCEAC) bolstered this view. The BCEAC members supported the notion that the economy will be growing, perhaps slightly below trend, for the nation, Maryland, and Baltimore County in calendar year 2007. The BCEAC panel sees the potential for an even stronger economic performance for Central Maryland in future years, reflecting the expected growth stimulus of the Federal Government's implementation of the Base Realignment and Closure Commission (BRAC) recommendations. The BCEAC agreed that a major economic impact from BRAC would not likely be felt in 2007 but agreed nonetheless that the current local outlook is positive.

While the Base Realignment and Closure Commission (BRAC) recommendations will stimulate the local economy in the near future, their full impact likely will not be realized for several years.

Figure 2. National, State, and Local Personal Income Growth



Note: Striped columns and dashed lines represent estimates.

Estimate Sources: County and State - RESI, January 16, 2007; U.S. - Moody's Economy.com, October 2006

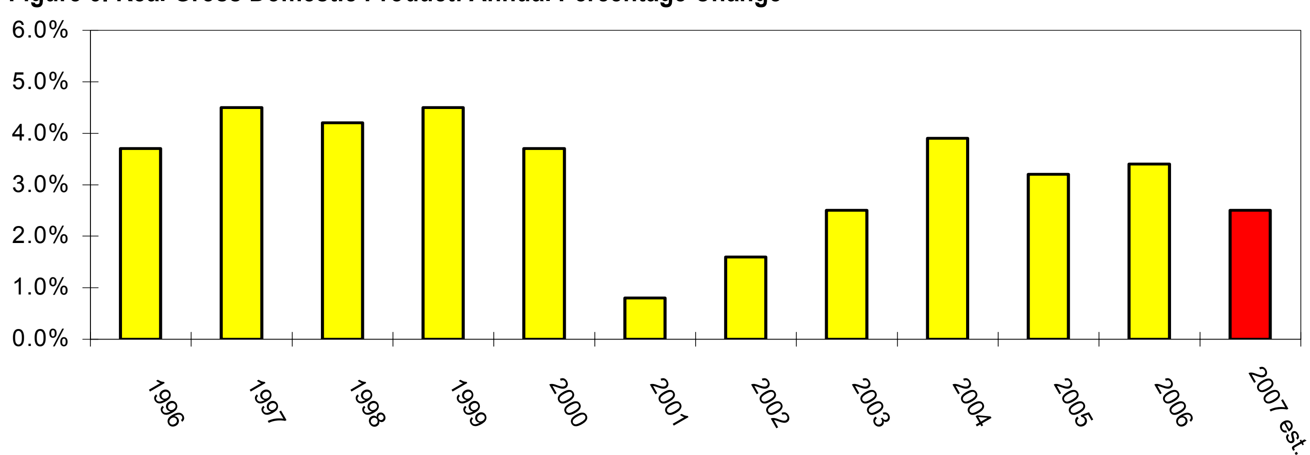
Real Gross Domestic Product (GDP) grew at an average annual rate of 3.2% from 1996 to 2006. For 2007, real GDP is expected to grow by a lesser 2.5%.

The projected strength of the local economy is influenced, to a large degree, by the underlying performance in the national and state economies. Nationally, housing construction is declining, auto sales are weak, and long-term interest rates are well below short-term interest rates. Normally these events are a precursor to a recession. Many economists, however, believe that the problems in the housing and automobile sectors will remain isolated to those areas as producers trim excess inventory in response to a decline in demand. The last U.S. recession was a brief eight-month downturn from March to November 2001. Emerging from the recession, real GDP grew by an average of 2.9% over the 2002 to 2006 period, yielding an average of 3.2% over the previous 10 years. After increasing by 3.2% in 2005 and 3.4% in 2006, real GDP is projected to increase by a lesser 2.5% in 2007, according to the National Association for Business Economics, *NABE Outlook*, November 2006 (Figure 3). Thus, a recession is doubtful but below-trend growth is forecast.

County and state labor markets have been performing well compared to the national labor market. Employment numbers in the county and state have been increasing at a faster pace than at the national level, and the county and state have considerably lower unemployment rates compared to the nation.

Relative to the national market, state and local labor markets have performed well and are expected to continue to perform well. Employment among Baltimore County and State of Maryland residents increased by 2.6% and 3.0%, respectively, on a year-over-year basis from December 2005 to December 2006, while national employment increased by 1.7% over that same period. Reflecting stronger employment growth, Baltimore County's and Maryland's December 2006 unemployment rates were 3.7% and 3.6%, respectively – well below the nation's December 2006 rate of 4.5%. The January 2007 employment forecasts by RESI suggest that in 2007 Baltimore County and Maryland employment will increase by 1.8% and 1.4%, respectively, while U.S. employment will increase by 1.1%. Growth in county employment, along with some increases in wages and salaries, supports the county's healthy personal income growth forecast.

Figure 3. Real Gross Domestic Product: Annual Percentage Change



Estimate Source: National Association for Business Economics, November 20, 2006

Nationally, consumers have positive but cautious expectations that the economy will continue to expand in 2007, and consumer confidence has been increasing slightly in recent months.

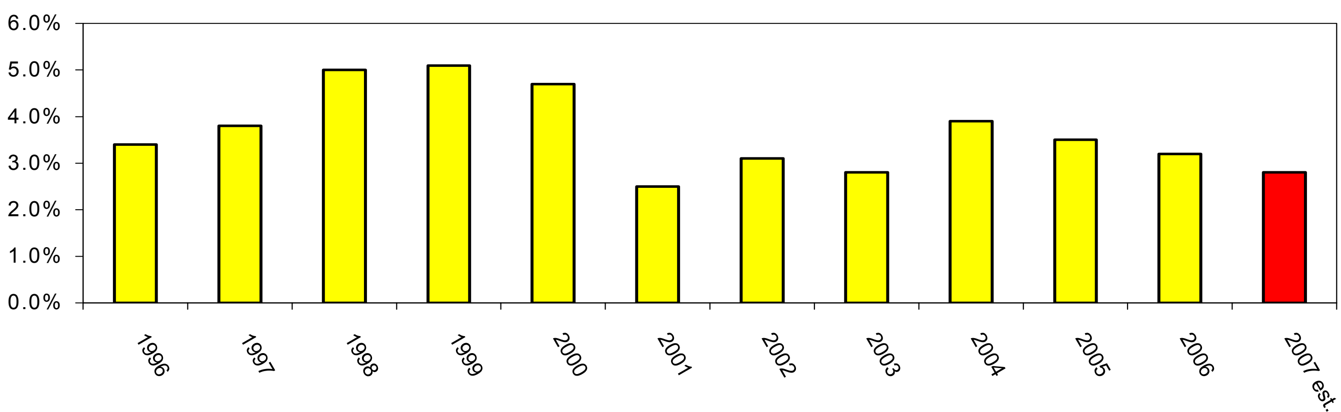
Consumer spending (Figure 4), which typically accounts for slightly more than two-thirds of all U.S. economic activity, will be the primary determinate of future economic performance. The level of confidence consumers have about current and future business conditions, in part, determines the strength of consumer spending. Consumer confidence, based on a survey of 5,000 U.S. households, ended 2006 on a slightly positive note, with both the Present Situation Index and the Expectations Index showing a modest advance. Overall, according to the Conference Board, the report suggests that current economic activity is only moderately better than its "uninspiring performance" earlier in 2006, and given the see-saw pattern of consumer confidence in recent months, it is too soon to declare this increase a genuine sign of better times ahead. Consumer confidence showed slight further improvement in January.

Although the national economy faces some potential challenges, the outlook for the local economy is favorable.

At its most recent meeting, the BCEAC concluded that 2007 should be a good, but slightly below-trend, year in Baltimore County.

While the current expansion is expected to continue, the national economy faces a number of challenges. For example, NABE forecasters adopted a more conservative outlook for consumer spending, GDP, and employment growth for 2007 versus 2006. These forecasts reflect continued slowing in residential construction and private employee compensation, higher interest rates, and high but slightly softening oil prices. NABE is projecting consumer expenditures to increase by 2.8% in 2007 compared to 3.2% in 2006. However, while the national growth rate is moderating, state and county economic growth is likely to be slightly more robust, reflecting recent momentem (e.g., at the Rte. 43 extension) and future benefits from BRAC. In this regard, the January 2007 BCEAC meeting was upbeat and concluded that 2007 should be a good, but slightly below-trend, year. Specifically, the BCEAC pointed to Baltimore County's low unemployment levels, high-quality jobs, and the strong non-residential construction market. The Spending Affordability Committee's 5.16% growth rate reflects such expectations.

Figure 4. Real Consumer Spending: Annual Percentage Change



Estimate Source: National Association for Business Economics, November 20, 2006

SPENDING GUIDELINE

The Committee has adopted growth in personal income as the best available indicator of the growth in the County's economy. For FY 2008, personal income is forecast to increase by 5.16%.

Since its inception, the Committee has adopted personal income growth as its gauge of economic growth in Baltimore County. Accordingly, the spending affordability guideline for a given fiscal year is calculated by multiplying the previous fiscal year's estimated base spending (as defined by the Committee) by the Committee's adopted personal income growth forecast (Figures 5 and 6). As noted previously, personal income growth of 5.16% is based on the January 2007 Baltimore County personal income forecast by RESI Research and Consulting of Towson University (RESI).

Increasing FY 2007 base spending by 5.16% yields a FY 2008 spending guideline of $1,484,266,241, a $72.8 million maximum allowable increase over FY 2007 base spending.

Increasing the FY 2007 base spending level ($1,411,436,136) by personal income growth (5.16%) results in a spending affordability guideline of $1,484,266,241 (Figure 7). This guideline represents a $72.8 million increase over FY 2007 base spending. **Accordingly, the Committee recommends that FY 2008 base spending not exceed $1,484,266,241.**

Certain appropriations are not subject to the Committee's spending guideline because they do not represent ongoing County program obligations and thus such spending is not appropriately linked to the growth in the County's economy.

It is important to note that the base spending amount to which personal income growth is applied excludes certain significant appropriations. These exclusions are made based on the premise that the expenditure is one-time/non-recurring in nature (such as certain contributions to the capital budget) or is required to support a State or Federal program (such as in the case of local share matching appropriations). In some cases, the appropriation may represent only a reserve of funds and not an actual expenditure. Given the nature of these appropriations, related spending should not be measured by the growth in the county's economy but rather by some other factors, such as available surplus or projected revenues. Accordingly, such expenditures are not subject to the Committee's spending guideline.

Figure 5. Calculation of the Spending Guideline

The spending guideline for the new fiscal year is calculated by applying personal income growth to the previous year's estimated base spending (as defined by the Committee). Specifically, the recommended spending limit is calculated as follows:

General Fund Operating Budget Appropriations (previous fiscal year)
\+ Supplemental Appropriations
\- Appropriations not subject to growth in personal income (see Figure 6 for detail)
Base Spending (previous fiscal year)
x Personal Income Growth
Spending Guideline (new fiscal year)

Figure 6. Spending Affordability Committee Definition of Base Spending

Base spending: Total General Fund appropriations less appropriations not subject to personal income growth, as itemized below.

Appropriations not subject to personal income growth :

Local Matching Appropriations:

- Local Share—State and Federal Grants. The total required County General Fund match for all anticipated grants is based on the level (and match provisions) of grant funding. These funds support State and Federal programs (not County programs).

- Education—Federal/Restricted Program. The required County General Fund match for such funds in the Department of Education is similarly based on the level (and match provisions) of grant funding. These funds support a Federal program (not County programs)

Capital Project Appropriations:

- The General Fund contribution to the capital budget, if any, is determined annually based on funds that are available and not otherwise committed to supporting County services. Thus, such expenditures may be viewed as one-time outlays, not subject to personal income growth, provided these contributions are not dedicated to funding operating expenses.

Reserve Fund Appropriations:

- Appropriations to the Revenue Stabilization Reserve Account (RSRA) do not represent expenditures but rather a reserve of funds available in case of an operating deficit. These funds are legally required to equal at least 5% of the General Fund budget.

- Contingency Reserve Appropriations. These funds are appropriated for unanticipated needs (e.g., emergencies) and are not earmarked for a specific purpose or program. As such, this appropriation does not represent an expenditure but rather a reserve for contingencies. If these funds are spent, the nature of the expenditure must be examined to determine its effect on base spending (i.e., one-time vs. ongoing).

One-Time-Only Appropriations:

- Specific exclusions for extraordinary or special items that represent one-time, nonrecurring costs or revenues such as spending by the Board of Education for items excluded from the State's maintenance of effort requirement. Such exclusions are determined on a year-to-year, case-by-case basis.

OPEB Accrued Liability (OAL) Appropriations:

- For fiscal years beginning after June 30, 2007, the County will begin funding its obligation for other post employment benefits (OPEB). Due to the significant unfunded OPEB liability, recognition of the additional annual required contribution resulting from the General Fund OPEB accrued liability will be phased-in over five years, in 20% increments, until the full amount is recognized by FY 2012. Actual funding in excess of the annual increment will be excluded from the spending guideline.

Figure 7. FY 2008 Spending Guideline

		FY 2007	
General Fund Appropriations, Excluding OPEB Accrued Liability	$	1,545,230,560	
General Fund OPEB Accrued Liability (OAL) Appropriation		53,000,000	
Supplemental General Fund Appropriations		10,534,182	
Total General Fund Appropriations		1,608,764,742	
General Fund Additions:			
Revenue Stabilization Reserve Account (RSRA) Transfer		3,785,800	
Total General Fund Additions		3,785,800	
Total General Fund		1,612,550,542	(A)
General Fund Exclusions:			
Local Matching Appropriations			
Local Share - State & Federal Grants		(6,166,346)	
Education - Federal/Restricted Program		(64,000)	
Capital Project Appropriations			
PAYGO		(134,112,000)	
Reserve Fund Appropriations			
Contingency Reserve		(1,000,000)	
RSRA Transfer		(3,785,800)	
One-Time-Only Appropriations			
Baltimore County Public Schools		(5,986,260)	
OPEB Accrued Liability (OAL) Appropriations			
General Fund Appropriations > 20% of OAL		(50,000,000) [1]	
Total General Fund Exclusions		(201,114,406)	(B)
Base Spending (A - B)		1,411,436,136	(C)
Personal Income Growth	x	1.0516	(D)
FY 2008 Spending Guideline (C x D)	$	1,484,266,241	(E)
Maximum Spending Growth (E - C)		***$72,830,105*** [2]	

[1] The FY 2007 Spending Guideline excluded a General Fund contribution totaling $50 million as an advance toward the FY 2008 accrued liability for Other Post Employment Benefits (OPEB). For fiscal years beginning after June 30, 2007, the Spending Guideline will include a five-year phase-in, 20% each year, of the OPEB accrued liability (OAL) until full implementation is achieved by FY 2012. General Fund contributions in excess of that amount will continue to be excluded from the Spending Guideline. For FY 2008, the General Fund exclusion shall be determined as follows:

General Fund Annual Required Contribution (ARC)
- Current Normal General Fund Expense (PAYGO)

OPEB Accrued Liability (OAL)
- Year-one OAL Expense (20%)

Year-one General Fund Exclusion*

* The actual General Fund exclusion shall be based upon the most recent actuarial valuation, including any plan changes adopted for plan years beginning July 1, 2007.

[2] The Maximum Spending Growth of $72,830,105 includes the year-one amount of the five-year phase-in of the General Fund OPEB accrued liability.

Estimated Final Spending

The Committee continues to believe that the estimated final spending methodology is the most appropriate method for determining base spending.

The FY 2008 spending guideline total is not affected by General Fund supplemental appropriations totaling $4,422,000.

As in past years, the Committee believes that base spending should reflect all approved and planned spending, or in other words, "estimated final spending," for the fiscal year. This methodology recognizes that certain adjustments in planned spending may occur after the budget is adopted. Such adjustments may include increases for supplemental appropriations, decreases due to federal or State aid reductions impacting the General Fund, or other shortfalls in local funding that are known or estimated prior to the adoption of the guideline. For this year, six supplemental appropriations totaling $10,534,182 have been made or requested to the adopted FY 2007 General Fund operating budget. Of these six supplemental appropriations, three, totaling $4,422,000, represent non-recurring spending (capital PAYGO) and, thus, are being excluded from the Committee's guideline calculation.

The most recent revenue projections indicate that revenues will most likely exceed budget estimates; therefore, no reduction due to funding shortfalls is anticipated.

Spending Policy Issues and Recommendations

The Committee recommends that essential ongoing services be funded adequately and that surplus not be used to fund appropriations requiring future commitments.

Developing a plan to achieve full funding of its OPEB obligation will help to protect the County's AAA bond rating status.

The Committee will allow for phasing additional General Fund OPEB appropriations into its spending guideline over a five-year period.

For FY 2008, the Committee reaffirms its general recommendations that the adopted budget: **(1) avoid under-funding of essential services or programs in order to fund other initiatives; and (2) avoid funding of ongoing operating expenses with surplus funds.**

Additionally, this year, the Committee adopted a policy regarding the OPEB fund in anticipation of GASB rules compelling local governments to begin accounting for post-employment benefits on an accrual basis, beginning in FY 2008. The Committee finds the Administration's stated intention of achieving full-funding of its OPEB obligation within a few years' time to be responsible, especially given the priority of maintaining the County's AAA bond ratings.

The Committee will allow a five-year phase-in for the incorporation of additional (in excess of pay-as-you-go) required OPEB funding into its spending guideline. In consideration of the substantial increase in the size of the obligation and its impact on base spending, this phase-in plan calls for the recognition of the additional annual required contribution resulting from the General Fund OPEB accrued liability to be included in base spending in 20% increments beginning in FY 2008, to be wholly included in the guideline by FY 2012, and to be maintained as such thereafter. For the first four years, contributions above the required minimum would be excludable from the guideline.

Also, this year the Committee adopted Governmental Accounting Standards Board (GASB) definitions to clarify what constitutes an "extraordinary item" and what constitutes a "special item" of expenditure, and is thereby excludable from the spending guideline. Extraordinary

The Committee also adopted a policy defining extraordinary and special expenditure items — items that by their nature are excludable from the spending guideline.

items (e.g., a Katrina-strength hurricane impacting the County) are both unusual in nature and infrequent in occurrence. Special items are either unusual in nature or infrequent in occurrence and are in the control of management. Expenditures that are justified by circumstances and comport with one of these definitions will be considered by the Committee for exclusion from its guideline. Notwithstanding other Committee policies regarding what is excluded from its guideline, those expenditures falling short of these definitions will be included under the guideline.

The Committee clarified its policy regarding what reserve funding is to be excluded from the spending guideline.

Finally, the Committee took another step in clarifying what is excludable from its spending guideline. In this case, the Committee refined and formalized its long-standing practice regarding which reserve funds are excludable. The Committee decided that Revenue Stabilization Reserve Account (RSRA) appropriations and unexpended appropriations to the Contingency Reserve should be excluded from the guideline because in neither case do these reserves constitute a commitment of future funds; therefore, they do not affect spending affordability. Conversely, because they represent estimated expenditures of funds toward specific and ongoing costs, appropriations to the Health Insurance Fund and to the other post-employment benefits (OPEB) fund are included in the guideline, except for the five-year phased-in exclusion related to the OPEB liability.

DEBT GUIDELINES

The Committee adopts two debt guidelines, one pertaining to debt service and the other to total debt outstanding.

The Committee's debt affordability recommendations provide an enhanced system of checks and balances, further demonstrating the County's fiscal responsibility to its citizens, bond-rating agencies, and others in the financial community. The debt guidelines are based on: (1) the County's level of debt service as a percentage of General Fund revenue; and (2) the County's total debt outstanding as a percentage of assessed property value. Actual debt service expenditures and the amount of total debt outstanding have consistently remained below both the Committee's and the Administration's guidelines.

Debt Service Guideline

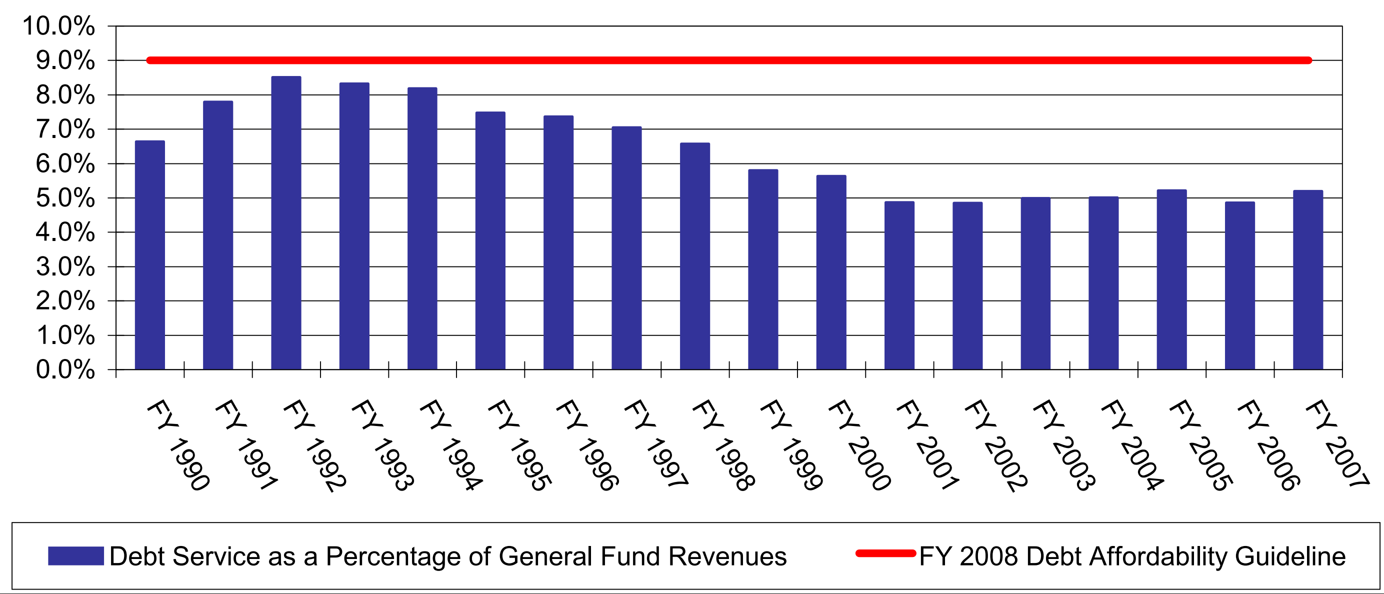
The Committee recommends that debt service not exceed nine percent of General Fund revenue, or $146,178,000.

The ratio of debt service to General Fund revenue is a debt affordability indicator used not only by Baltimore County but by many other jurisdictions. Credit analysts generally concur that a ratio higher than 1:10 (i.e., over ten percent) suggests that the debt burden is too heavy. The Administration's financial guidelines historically have set a target range for debt service expenditures at eight to nine percent of General Fund revenue. From FY 1990 to FY 2007, the amount spent or budgeted for debt service ranged from 4.9% to 8.5% of General Fund revenue (Figure 8). The Committee has established a policy that debt service should not exceed nine percent of General Fund revenue. **Accordingly, for FY 2008, the Committee recommends that debt service expenditures not exceed $146,178,000, based on projected revenues totaling $1,624,200,000.**

The decrease in the ratio of debt service to General Fund revenues beginning in the 1990s reflects increased use of PAYGO to fund capital projects, not a reduction in County capital spending.

The ratio of debt service to General Fund revenues from FYs 1990 through 2007 is shown below in Figure 8. It is notable that the decrease in this ratio, beginning in the mid-to-late 1990s, is not reflective of a reduction in County capital spending, but rather is the result of increased usage of pay-as-you-go (PAYGO) operating budget funds to fund the County's capital budget in recent years. Specifically, from FY 1998 through FY 2007, the County has budgeted $723.3 million in PAYGO funding, compared to $60.3 million in the preceding 10-year period. However, had the County issued bonds in lieu of relying on PAYGO during this same period, the County would have incurred additional interest expense totaling approximately $342.9 million over the life of the bonds.

Figure 8. Debt Service as a Percentage of General Fund Revenues



Note: Excludes debt service related to pension funding, metropolitan district bonds, and component unit capital leases not budgeted under Primary Government; FY 2007 ratio is an estimate.

Sources: Baltimore County Annual Budget Documents; Baltimore County Office of Budget and Finance; Baltimore County Office of the County

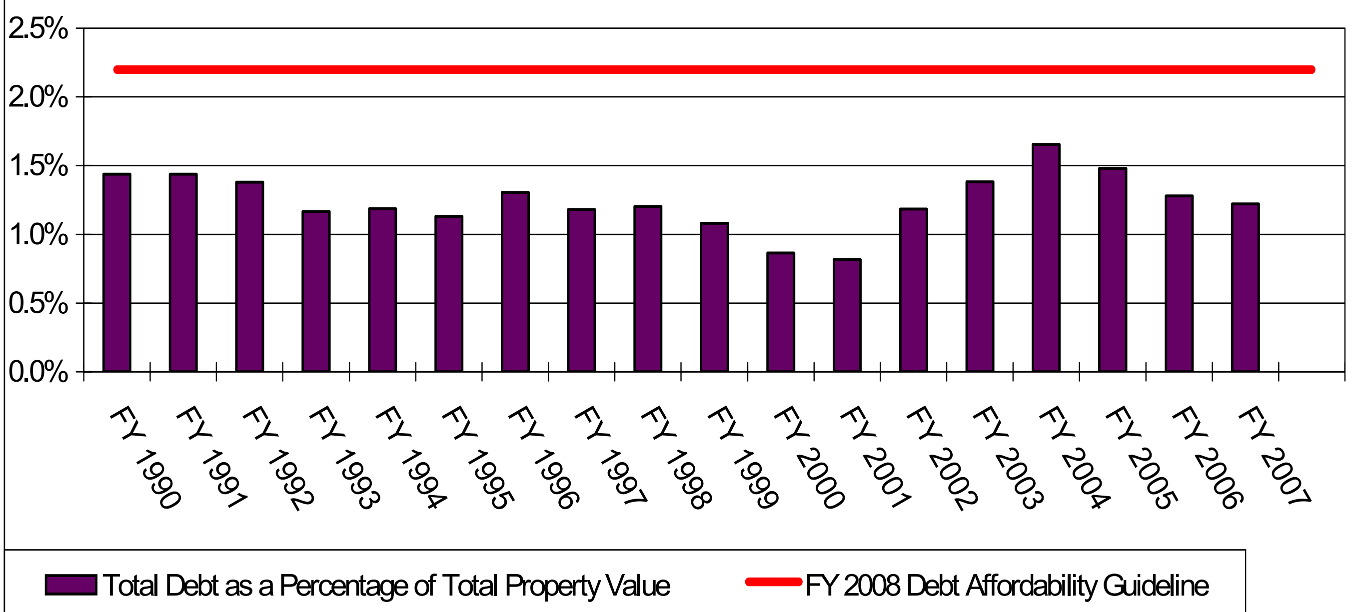
Total Debt Outstanding Guideline

The Committee recommends that total debt outstanding not exceed 2.2 percent of full property value, or $1,583,950,566.

The ratio of total debt outstanding to assessed property value is a second measure of debt affordability. Since 2004, the Administration's financial guidelines have set a target range of 1.8% to 2.2% for debt outstanding as a percentage of full property value. Prior to FY 2007, the Committee's guideline was set at 2.0% and applied only to real property. Beginning in FY 2007 the Committee raised its limitation on total debt outstanding from 2.0% to 2.2% of full property value, based on a study prepared by the County's independent financial consultant. From FY 1990 to FY 2007, total outstanding debt has ranged from 0.8% to 1.7% of the county's full property value (Figure 9).

In accordance with the Committee's policy that total outstanding debt should not exceed 2.2 percent of full property value, **for FY 2008 the Committee recommends that total debt outstanding not exceed $1,583,950,566, based on full property value totaling $71,997,753,000.**

Figure 9. Total Debt as a Percentage of Total Property Value



Note: Excludes debt related to pension funding, metropolitan district bonds, and component unit capital leases not budgeted under Primary Government; FY 2007 debt outstanding is estimated.

Sources: Baltimore County Comprehensive Annual Financial Reports; Baltimore County Office of Budget and Finance; Maryland State Department of Assessments and Taxation

GENERAL FUND REVENUES

FY 2007 General Fund revenues are projected to increase by $62.7 million, or 4.2%, over FY 2006 collections. This forecast also exceeds current-year revenue estimates by $48.8 million.

FY 2007 General Fund revenues are projected to total $1,567.2 million, an increase of $62.7 million, or 4.2%, from FY 2006 totals. FY 2007 General Fund revenues are forecast to exceed budgeted FY 2007 revenues by $48.8 million. The projected revenue growth reflects higher real property values supporting strong property tax revenue growth and higher income tax revenues due to county job growth, gains in personal income, and capital gains distributions. These revenue increases will be partially offset by lower property-related transaction tax revenue (i.e., title transfer and recordation tax revenues) due to a slower housing market.

FY 2008 General Fund revenues are projected to increase by approximately $105.8 million, or 7.0%, over budgeted FY 2007 revenues, and by approximately $57.0 million, or 3.6%, over revised FY 2007 revenue estimates.

FY 2008 General Fund revenues are projected to reach $1,624.2 million, up approximately $105.8 million, or 7.0%, over budgeted FY 2007 revenues, and $57.0 million, or 3.6%, over the revised FY 2007 estimate (Figures 10 and 11). The rate of growth in FY 2008 General Fund revenue would be below the FY 2004 through FY 2007 growth rates. General Fund revenue growth in FY 2008 again reflects impressive anticipated revenue gains in the County's two principal revenue sources, property and income taxes. Higher real property values recorded over the previous five years will continue to support strong property tax revenue growth, and income tax revenue growth will be supported by the expected growth in personal income and employment. Property-related transaction tax revenues are expected to be flat due to the impact of higher mortgage interest rates on housing demand and the refinancing market.

The FY 2008 revenue projection is $144.1 million higher than the Committee's spending guideline.

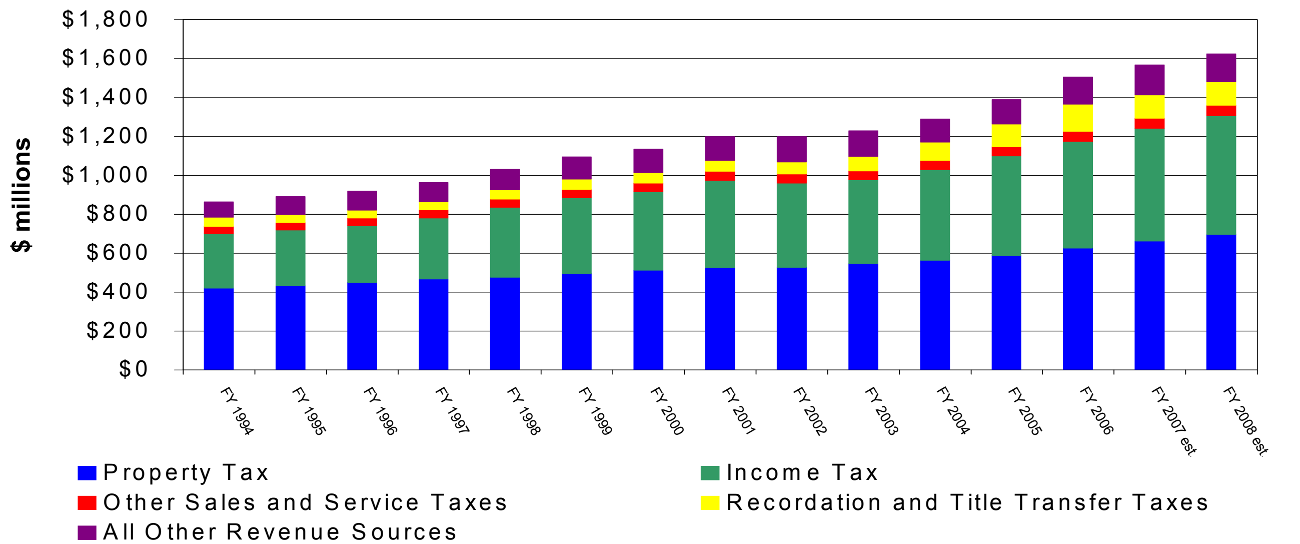
The FY 2008 revenue projection is $144.1 million higher than the Committee's FY 2008 spending guideline. The excess funds, together with other unreserved funds, may be used in several ways: as local-share matching funds; for one-time expenditures such as pay-as-you-go contributions to the capital budget to reduce programmed borrowing; as a contribution toward the County's future retiree benefits liability in excess of 20% of the increased annual required contribution; to provide short-term tax stabilization; or as a refund to taxpayers in the form of a tax-rate reduction.

Figure 10. General Fund Revenue Forecast, FY 2007-FY 2008

($ in Millions)

Revenue Source	FY 2006 Actual	FY 2007 Budget	FY 06 - FY 07 Bud.	FY 2007 Revised	FY 06- FY 07 Rev.	FY 2008 Estimate	FY 07 Bud. - FY 08	FY 07 Rev. - FY 08
Property taxes	$626.7	$653.4	4.3%	$662.3	5.7%	$696.1	6.5%	5.1%
Income taxes	547.9	561.7	2.5%	579.1	5.7%	611.0	8.8%	5.5%
Recordation & title transfer taxes	139.3	105.9	-24.0%	120.4	-13.6%	120.4	13.7%	0.0%
Other sales & service taxes	50.8	50.7	-0.2%	51.5	1.4%	53.1	4.7%	3.1%
Licenses & permits	4.5	4.1	-8.9%	4.2	-6.7%	4.2	2.4%	0.0%
Fines, forfeitures & penalties	4.4	4.3	-2.3%	4.0	-9.1%	4.0	-7.0%	0.0%
Service charges	10.8	10.4	-3.7%	10.4	-3.7%	10.5	1.0%	1.0%
Interest on investments	15.2	20.3	33.6%	20.3	33.6%	14.0	-31.0%	-31.0%
Intergovernmental aid	78.4	79.6	1.5%	83.1	6.0%	83.0	4.3%	-0.1%
Other	26.5	28.0	5.7%	31.9	20.4%	28.0	0.0%	-12.2%
TOTAL	**$1,504.5**	**$1,518.4**	**0.9%**	**$1,567.2**	**4.2%**	**$1,624.2**	**7.0%**	**3.6%**

Figure 11. Baltimore County General Fund Revenues



Source: FY 2003 to FY 2006 Baltimore County Comprehensive Annual Financial Reports

GENERAL FUND SURPLUS

The FY 2006 General Fund surplus was $279.7 million and included $76.0 million in the RSRA.

For FY 2006, the General Fund surplus totaled $279.7 million. This amount included $76.0 million in the Revenue Stabilization Reserve Account (RSRA), which was $6.1 million more than the minimum requirement (five percent of budgeted revenues). The remaining $203.6 million is equal to 14.6% of FY 2006 budgeted revenues.

The FY 2007 General Fund surplus is estimated to total $238.1 million and includes $79.8 million in the RSRA.

For FY 2007, it is estimated that the General Fund surplus will total $238.1 million. This amount includes $79.8 million in the RSRA, which is $3.9 million more than the minimum required. The remaining $158.3 million represents an undesignated, unreserved surplus and is equal to 10.4% of budgeted revenues (Figure 12).

Figure 12. Estimated General Fund Surplus, FY 2007

($ in Millions)

FY 2006 General Fund Surplus (per Baltimore County Comprehensive Annual Financial Report)		**$ 279.7**
FY 2007 Revenue Estimate (per Adjusted Budget)	1,518.4	
FY 2007 Revision	48.8	
FY 2007 Revised Revenue Estimate		1,567.2
FY 2007 General Fund Appropriations (per Adopted Budget)	1,598.2	
FY 2007 Anticipated Supplemental Appropriations	10.5	
FY 2007 Revised General Fund Budget		(1,608.7)
FY 2007 Estimated General Fund Surplus		**$ 238.1**
Revenue Stabilization Reserve Account		$ 79.8
Undesignated Unreserved Surplus		$ 158.3

Appendix A

Implementation Examples of GASB 45 - Other Post Employment Benefits

	FY 2007	FY 2008 General Fund Budget *		
	Guideline	Funding = ARC	Funding < ARC	Funding > ARC
General Fund Appropriations, Excluding OPEB Accrued Liability	$ 1,545,230,560	$ 1,580,370,000 *	$ 1,580,370,000 *	$ 1,580,370,000 *
General Fund OPEB Accrued Liability Appropriation	53,000,000	66,000,000 *	36,000,000 *	96,000,000 *
Supplemental General Fund Appropriations	10,534,182			
Total General Fund Appropriations	1,608,764,742	1,646,370,000 *	1,616,370,000 *	1,676,370,000 *
General Fund Additions:				
Revenue Stabilization Reserve Account (RSRA) Transfer	3,785,800	3,990,000 *	3,990,000 *	3,990,000 *
Total General Fund Additions	3,785,800	3,990,000 *	3,990,000 *	3,990,000 *
Total General Fund	1,612,550,542 (A)	1,650,360,000 *	1,620,360,000 *	1,680,360,000 *
General Fund Exclusions:				
Local Matching Appropriations				
Local Share - State & Federal Grants	(6,166,346)	(6,500,000) *	(6,500,000) *	(6,500,000) *
Education - Federal/Restricted Program	(64,000)	(70,000) *	(70,000) *	(70,000) *
Capital Project Appropriations				
PAYGO	(134,112,000)	(95,750,000) *	(95,750,000) *	(95,750,000) *
Reserve Fund Appropriations				
Contingency Reserve	(1,000,000)	(1,000,000) *	(1,000,000) *	(1,000,000) *
RSRA	(3,785,800)	(3,990,000) *	(3,990,000) *	(3,990,000) *
One-Time-Only Appropriations				
Baltimore County Public Schools	(5,986,260)	(6,000,000) *	(6,000,000) *	(6,000,000) *
OPEB Accrued Liability (OAL) Appropriations				
General Fund Appropriations > 20% of OAL	(50,000,000)	(52,800,000) *	(22,800,000) *	(82,800,000) *
Total General Fund Exclusions	(201,114,406) (B)	(166,110,000) *	(136,110,000) *	(196,110,000) *
Base Spending (A - B)	$1,411,436,136 (C)	$1,484,250,000 *	$1,484,250,000 *	$1,484,250,000 *
Personal Income Growth	x 1.0516 (D)			
FY 2008 Spending Guideline (C x D)	$ 1,484,266,241 (E)			
Over (under) Guideline		***($16,241)*** *	***($16,241)*** *	***($16,241)*** *

<u>Calculating the OPEB Accrued Liability Exclusion:</u>

	Funding = ARC	Funding < ARC	Funding > ARC
FY 2008 General Fund OPEB Appropriation	$ 130,000,000 *	$ 100,000,000 *	$ 160,000,000 *
Normal Current General Fund Expense (PAYGO)	(64,000,000) *	(64,000,000) *	(64,000,000) *
General Fund OPEB Accrued Liability (OAL) Appropriation	66,000,000 *	36,000,000 *	96,000,000 *
Maximum Year-one OAL Expense (20% of OAL)	13,200,000 *	13,200,000 *	13,200,000 *
Year-one OAL Exclusion	$ 52,800,000 *	$ 22,800,000 *	$ 82,800,000 *

<u>Assumptions:</u>

Actuarial General Fund Annual Required Contribution (ARC) = $130,000,000 *

Normal Current General Fund Expense (PAYGO) = $64,000,000 *

General Fund OPEB Accrued Liability (OAL) = $66,000,000 *

Year-one OAL Expense (20%) = $13,200,000 *

**** Amounts shown are for illustrative purposes only.***

<u>Notes:</u>

1 If the General Fund appropriation is less than 20% of the OPEB Accrued Liability (OAL), the OPEB Accrued Liability exclusion equals 0.

2. If the General Fund appropriation exceeds 80% of the OPEB Accrued Liability, the excess appropriation would also be excluded as an advance payment toward the following year's OPEB Accrued Liability expense.

3. In year two of the GASB 45 Implementation (2009), the maximum OAL expense increases to 40% of OAL.