SPENDING
AFFORDABILITY
COMMITTEE

400 Washington Avenue
Towson, Maryland 21204
410-887-3196
410-887-5791 (Fax)

Report of the Spending Affordability Committee

Fiscal Year 2010

Table of Contents

Baltimore County, Maryland

February 13, 2009

BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE

Honorable Kevin B. Kamenetz, Committee Chairman
Councilman, 2nd District

Honorable S.G. Samuel Moxley
Councilman, 1st District

Honorable John Olszewski, Sr.
Councilman, 7th District

Mr. John F. Gaburick
President, Valley Lighting

Dr. Roy T. Meyers
Professor, Department of Political Science, UMBC

BALTIMORE COUNTY ECONOMIC ADVISORY COMMITTEE

Anirban Basu, Committee Chairman, and Chairman and CEO, Sage Policy Group, Inc.
Carol Brooks, Business Services Manager, Baltimore County Office of Workforce Development
James Jarosz, Baltimore Business Banking Regional Manager, M & T Bank
Mark Habicht, President, Kirk-Habicht Company
Michael Kemper, Senior Vice President, Bank of America
Kerry Lidard, Area Manager, Kelly Services
T. Ross Mackesey, Vice President, New Homes Division, Coldwell Banker Residential Real Estate
Scott Tavegia, Customer Experience Manager, Best Buy, Timonium
Jain A. Trader, Vice President/Store Manager, Macy's East
David Uhlfelder, Certified Public Accountant

STAFF

Mary P. Allen, CPA, County Auditor
Elizabeth J. Irwin, Director, Fiscal and Policy Analysis
Terri K. Bacote-Charles, Principal Analyst
Michelle F. Ganjon, Senior Analyst
Carrie B. Vivian, Senior Analyst
Marie B. Jeng, Staff Analyst
Philip S. Gear, Staff Analyst

SPENDING AFFORDABILITY COMMITTEE

February 13, 2009

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 (FY) 2010.

For FY 2010, the Committee recommends a base spending guideline of $1,617,445,259 derived from a personal income growth rate of 4.24%. This guideline represents maximum potential growth of $65,790,176 over FY 2009 base spending. The Committee further recommends that debt service not exceed 9% of FY 2010 estimated General Fund revenues and that total debt outstanding not exceed 2.2% of FY 2010 estimated assessed property value. These guidelines are meant to limit spending such that the cost of government services does not exceed 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 maximum levels not to be exceeded.

In determining its fiscal guidelines, the Committee reviewed current and projected conditions of the national, state, and local economies. This review found that the U.S. economy is in a deep and profound recession, and that the Maryland economy is not immune to the woes facing the nation. It is not yet known when the economy will rebound or the extent to which governmental actions will help revive it, but a recovery is not expected during the current calendar year. The Committee's economic consultant expects the recession to continue in Maryland through calendar year (CY) 2009 and forecasts economic recovery during CY 2010. Last month, the economic consultant significantly reduced its prior forecast of County personal income growth for FY 2009 and FY 2010 from 4.81% and 4.34%, respectively, to 2.42% and 2.34%. At its January 16, 2009 meeting, the Baltimore County Economic Advisory Committee expressed great pessimism and predicted that the County's recession would worsen before showing signs of improvement during CY 2010.

In light of the sudden and dramatic drop in projected personal income growth, the Baltimore County Spending Affordability Committee analyzed personal income growth trends and concluded that a longer-term personal income growth average is a more stable measure of the annual growth rate. Such a stabilizing approach is appropriate to minimize the possibility that the County would have to cut services to comply with the spending guideline even though projected revenues would be sufficient to maintain the current level of services. The personal income growth rate over the 5-year period of FY 2006 through FY 2010 averaged 4.24% annually. The Committee used this annual average of personal income growth in calculating the FY 2010 spending guideline and adopted the policy of utilizing a 5-year average of personal income growth as the annual growth rate for calculating the guideline for future years. In conjunction with this analysis, the Committee noted that the County's projected revenues would be sufficient to fully fund projected ongoing expenditures for FY 2010.

In its discussions this year, the Committee recognized that such revenue availability during these severe recessionary times is due largely to the County's strict adherence to Committee guidelines over the years, which has resulted in a financially sound budget structure for FY 2010 for the County's General Fund operating budget. With this history of fiscal restraint, the County has positioned itself well for the current economic downturn to ensure that County government services can be maintained at current levels in FY 2010.

This year, the Committee also considered a number of other policy and procedural issues. Most significantly, the Committee amended its phase-in policy regarding the annual required contribution for the accrued liability related to Other Post Employment Benefits (OPEB) by extending the phase-in period from 5 to 10 years. During the phase-in period, the appropriations to fund the OPEB accrued liability are gradually included in base spending subject to the guideline each year. The extended guideline phase-in period allows the County to continue its plan to fully fund the OPEB liability contribution over 5 years and manage the magnitude of other spending pressures facing the County. Additionally, the Committee did not approve for FY 2010 an exclusion for certain costs previously funded by Medicaid because they did not represent a clear case of one-time spending. The report provides further detail related to the various policy and procedural issues that the Committee considered this year.

I would like to thank my fellow Council members who served on the Committee for their time and commitment to this year's challenging and thought-provoking process. I would further like to express my gratitude to long-standing Committee member John Gaburick, whose experience and institutional knowledge were essential to our deliberations, and to new member Roy Meyers, whose expertise in the field of public policy and government budgeting practices provided insight and fresh ideas to the process. Also, I would like to acknowledge the efforts and critical information provided by the Economic Advisory Committee chaired by esteemed economist Anirban Basu. Thanks are also due to the Committee's staff for their analytical scrutiny of Committee policies and preparation of thorough meeting notes, and to RESI Research and Consulting – Towson University, which provided economic analysis and forecasting services to the Committee.

We are hopeful that this report will be given careful consideration in the development and review of the County's operating and capital budgets for FY 2010.

Sincerely,

Kevin B. Kamenetz

Kevin B. Kamenetz
Chairman, Spending Affordability Committee
Councilman, 2nd District

INTRODUCTION

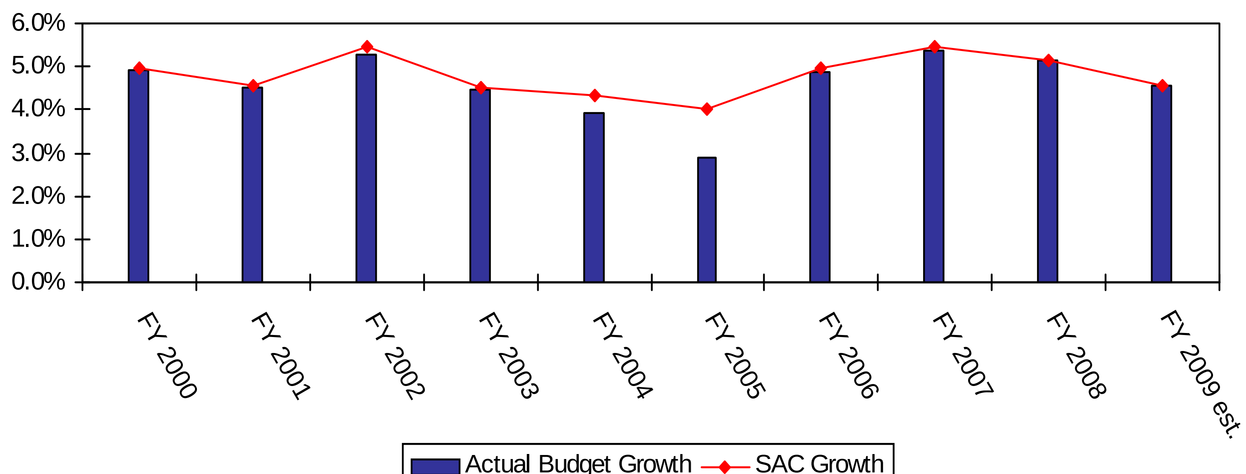
The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed the growth in the County's economy.

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 to the County Council and the County Executive relative to the formulation of the County budget. Committee guidelines are intended to set recommended maximum County spending levels that should not be exceeded (Figure 1); however, the law states that the Committee's recommendations may be exceeded by the County Council if a rationale for doing so is provided.

Figure 1. SAC Spending Growth Compliance, Most Recent 10 Years



SPENDING GUIDELINE

The Committee recommends base spending growth of 4.24%, or $66 million, for FY 2010 based on an analysis of County personal income growth.

The spending 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 spending affordability growth factor (Figures 2 and 3). **For fiscal year 2010, the Committee recommends that base spending not exceed $1,617,445,259 based on a County personal income growth rate of 4.24% (Figure 4).** This guideline allows for maximum spending growth of $66 million over FY 2009 base-year spending. Since its inception, the Committee has used personal income growth as its gauge of economic growth in Baltimore County and, prior to FY 2010, relied solely on the forecast of personal income growth for the upcoming fiscal year as the measure of annual growth. For FY 2010, the Committee continues to use personal income growth as its gauge of economic growth but has changed its measure of growth to be the average of the annual growth forecasts for the upcoming and current fiscal years and the annual growth estimates for the 3 preceding fiscal years. Continuing to rely on personal income as a gauge of economic growth fulfills the edict of the Spending Affordability law to control County spending so that the level of County spending is consistent with the economic growth of the County. Baltimore County Code, Section 2-3-102(a).

During its FY 2010 deliberations, the Committee adopted a policy change for determining its spending affordability growth factor.

The Committee deemed this change in the measure of economic growth appropriate for a number of reasons. First, using an average of annual growth rates provides a longer-term perspective to personal income growth than a single-year forecast. The Committee believes that a longer-term perspective increases stability in the growth factor from year to year by smoothing out the significant fluctuations in personal income growth resulting from the economic highs and lows that occur from time to time. Second, the Committee recognized that the 2.34% forecasted FY 2010 growth rate would have produced a spending guideline that was considerably below the level of spending required to continue providing the current level of County government services. Such a reduction in services may be warranted if the projected level of County revenues could not support maintaining the same level of services. However, the Committee was aware that projected revenues would be sufficient to fund a budget that would maintain the same level of County government services and, if revenues were to fall short of projections, that the County has sufficient reserves (surplus funds) to support the budget without reducing government services. Therefore, the Committee found that it was not appropriate to rely solely on the personal income forecast for the upcoming fiscal year and adopted a 5-year average to provide a more stable growth rate for FY 2010 and future fiscal years. Finally, since personal income forecasts and estimates are often revised as new data become available, using the average annual growth rate over the 5-year period improves the accuracy of the measure of economic growth by incorporating the most recent estimates of annual personal income growth. Accordingly, the Committee's FY 2010 recommended 4.24% growth in spending is equal to the average Baltimore County personal income growth for FY 2006 through FY 2010 as reported by RESI Research and Consulting - Towson University (RESI) as of January 15, 2009. This growth rate is 32 basis points below the FY 2009 spending growth rate of 4.56%.

Instead of being based solely on the consultant's forecast of personal income growth for the upcoming fiscal year, the FY 2010 spending affordability growth factor of 4.24% is equal to the average Baltimore County personal income growth for FY 2006 through FY 2010, as estimated by RESI.

The Committee's senior member did not support the growth factor policy change.

The Committee was not unanimous in its approval of the growth rate policy change. Specifically, the Committee's senior member, who has been a member of the Committee since its inception, did not support the change. During Committee deliberations, he noted that in previous years, the Committee consistently used the upcoming year's personal income growth forecast despite the personal income surges and slowdowns anticipated. He asserted that the Committee's allowable spending should, and always did until FY 2010, reflect the current economic times. He further attributed the Committee's deviation from this consistent approach to an interest by other Committee members in accommodating "higher spending levels" for County government.

The policy change results in allowable dollar growth in base spending for FY 2010 that is approximately $30 million greater than the single-year forecast would yield.

Four of the five Committee members believe the policy change is warranted in light of an analysis of projected General Fund revenues and expenditures and because of its smoothing and refining effects.

The Committee Chairman and three other Committee members that compose the Committee's majority believe that the use of a five-year average of annual personal income growth legitimately represents the growth in the County's economy. The Committee's majority further believes that this policy change is warranted in light of its analysis of the County's projected expenditures and revenues. The majority acknowledges that the policy change results in allowable dollar growth in base spending for FY 2010 that is approximately $30 million greater (i.e., approximately $66 million, rather than $36 million, in growth) than the single-year forecast would yield. The majority is aware that the dissenting Committee member believes that poor economic times call for cutbacks in spending for both the private and public sectors, but the majority believes that a cutback in spending by Baltimore County, given its current revenue and reserve outlook, is unnecessary. Moreover, the majority believes that a five-year averaging approach is preferable, over the long term, to the upcoming-year forecast because of its smoothing and refining effects. The Committee majority is also aware of the dissenting member's concern that future growth in the County's base spending beyond FY 2010 could be affected by this policy change as a result of the low percentage growth anticipated for FY 2010. For example, based on current RESI estimates and forecasts for FY 2007 through FY 2012, spending growth for FY 2012 would be limited to 4.17% despite a FY 2012 personal income growth forecast of 6.27%. However, the Committee majority believes that stabilizing spending growth from year to year in this way is desirable. Further, the Committee majority believes that the adoption of a five-year average annual growth factor policy complies with the Committee's statutory obligation to recommend a level of County spending that is consistent with the economic growth of the County.

Figure 2. Calculation of the Spending Guideline

The spending guideline for the upcoming fiscal year is calculated by applying the spending affordability growth factor to the current 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 3 for detail)
Base Spending (current fiscal year)
x Personal Income Growth Factor
Spending Guideline (upcoming fiscal year)

Figure 3. 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.

Certain 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 General Fund revenues.

- Contingency Reserve Appropriations are excludable to the extent they represent a reserve for unforeseen needs (e.g., emergencies) and are not earmarked for a specific purpose or program unless the specific purpose or program meets one of the other criteria for exclusion. If contingency reserve 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 Department of Education for items excluded from the State's maintenance of effort requirement) 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 began funding its obligation for other post employment benefits (OPEB) on an accrual basis. Due to the significant unfunded accrued liability for OPEB, recognition of the additional annual required contribution resulting from the OPEB accrued liability will be phased-in over 10 years, in 10% increments, until the full amount is recognized by FY 2017. Actual funding in excess of the phase-in amount will be excluded from base spending.

Figure 4. FY 2010 Spending Guideline

FY 2009 Base Spending			
General Fund Appropriations, Excluding OPEB Accrued Liability	$	1,700,217,375	
General Fund OPEB Accrued Liability (OAL) Appropriation		19,310,835	
Total General Fund Appropriations		1,719,528,210	(A)
General Fund Exclusions:			
Local Matching Appropriations			
Local Share - State & Federal Grants		(7,221,022)	
Department of Education - Federal/Restricted Program		(198,428)	
Capital Project Appropriations			
PAYGO		(138,500,000)	
Reserve Fund Appropriations			
Contingency Reserve		(776,576)	
One-Time-Only Appropriations			
Department of Education - State-approved exclusions from maintenance of effort		(12,256,475)	
FY 2009 Department of Education appropriations for shifted Medicaid costs [1]		(8,920,626)	
OPEB Accrued Liability (OAL) Appropriations in Excess of Phase-In Amount [2]		0	
Total General Fund Exclusions		(167,873,127)	(B)
FY 2009 Base Spending (A - B)		1,551,655,083	(C)
Personal Income Growth 5-Year Average	x	1.0424	(D)
FY 2010 Spending Guideline (C x D)	$	1,617,445,259	(E)
Maximum Spending Growth (E - C)		***$65,790,176***	

Calculation of the FY 2010 OPEB Accrued Liability Phase-In Amount

The phase-in amount for FY 2010 (the third year of the phase-in period) is equal to 30% of the actuarial estimate of the annual required contribution (ARC) for the OPEB accrued liability (OAL). Any FY 2010 General Fund OAL appropriations in excess of the 30% phase-in amount shall be excluded from spending subject to the guideline. If FY 2010 General Fund OAL appropriations are less than the 30% phase-in amount, the entire amount appropriated for OAL shall be included in spending subject to the guideline. Based on the most recent actuarial estimate, the FY 2010 OAL phase-in amount is $18,962,700, calculated as follows:

Most recent actuarial estimate of Annual Required Contribution (ARC) for OPEB	$	148,892,000
- Current Normal Expense (PAYGO) Portion of the ARC		(85,683,000)
OPEB Accrued Liability (OAL) Portion of the ARC		63,209,000
x FY 2010 OAL Phase-In Percentage		30%
FY 2010 OAL Phase-in Amount	$	18,962,700

[1] Although excluded from FY 2009 base spending, the shifted Medicaid costs shall not be excluded from FY 2010 base spending subject to the guideline as explained later in this report.

[2] None of the FY 2009 OAL appropriation is excluded because the amount appropriated ($19,310,835) was less than the FY 2009 phase-in amount ($25,283,600), which was based on 40% (2nd year of 5-year phase-in period) of the OAL portion ($63,209,000) of the ARC.

Certain appropriations are not subject to the Committee's spending guideline because they do not represent ongoing County program obligations.

It is important to note that the base spending amount to which personal income growth is applied excludes certain significant appropriations (Figure 3). 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 that the expenditure 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 earmarked expenditure. Given the nature of these appropriations, they should not be limited by the growth in the County's economy but rather by some other factor, such as available surplus or projected revenues. Accordingly, such appropriations are not subject to the Committee's spending guideline.

Special education services previously funded by Federal Medicaid funds are subject to the Committee's FY 2010 spending guideline because such costs are now known to be ongoing in nature.

During its deliberations this year, the Committee reconsidered the issue of excluding from base spending subject to the guideline the costs of medical and other services to special education students previously funded by Medicaid. Last year, the Committee allowed a temporary exclusion of these costs from FY 2009 base spending subject to the guideline. The temporary exclusion was allowed pending further information regarding whether this cost shift would be reversed or whether the County's General Fund would continue to fund these costs. Because the Committee learned this year that Medicaid funding for an estimated $8.9 million of costs will not be restored, and it is uncertain whether Medicaid funding for an estimated $1.6 million of costs will continue beyond April 2009, it expects County General Fund spending for these services to special education students to continue on an ongoing basis for FY 2010 and beyond. Therefore, due to the ongoing nature of these costs, the Committee determined that the costs should be included in base spending subject to the guideline in FY 2010.

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

As in past years, the Committee believes that base-year 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, four budget appropriation transfers totaling $4,214,639 (as of February 2, 2009) have been made to the adopted FY 2009 General Fund operating budget. Of this amount, $31,531 represents additional FY 2009 base spending since the time of budget adoption in May 2008. Despite a projected revenue shortfall for FY 2009, base-year spending is not expected to decrease because of the sizable pay-as-you-go (PAYGO) appropriation ($138.5 million) to the capital budget, which was to be supported by a combination of revenues ($91 million) and surplus ($47.5 million). The revenue shortfall could be addressed in a number of ways, such as increasing the reliance on surplus to fund the PAYGO appropriation.

ECONOMIC GROWTH

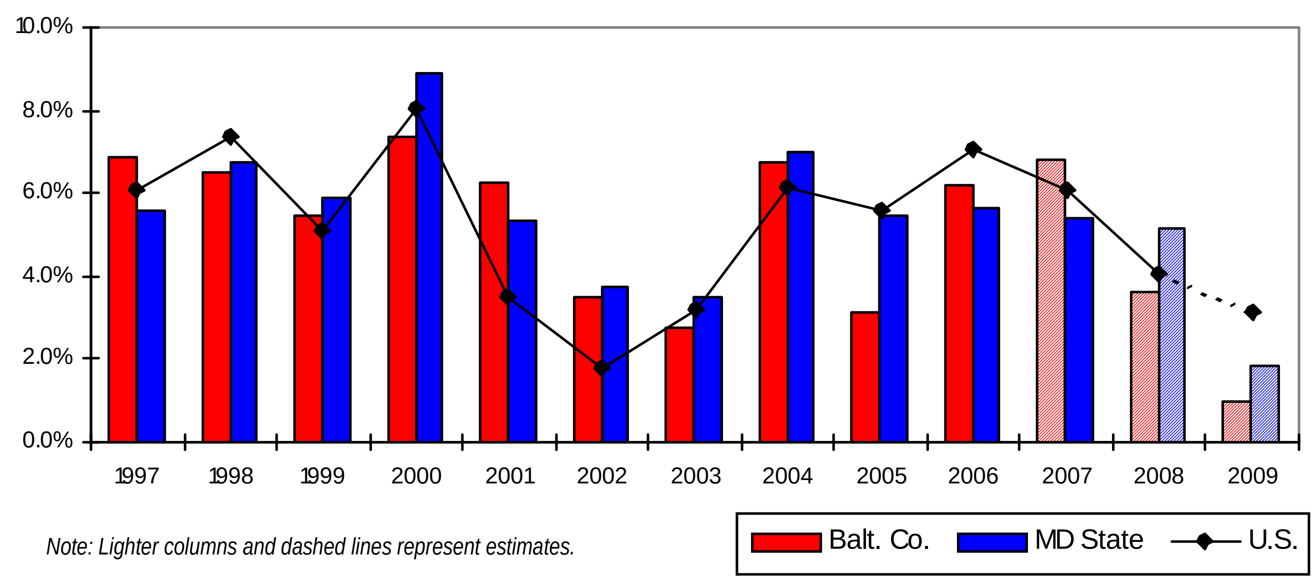
Personal income growth estimates have dramatically declined in recent months due to the economic downturn.

Prior to adopting its FY 2010 personal income growth rate, the Committee reviewed current and projected economic conditions to gain an understanding of the basis for the consultant's personal income estimates and forecast. As of January 15, 2009, the consultant (RESI Research and Consulting – Towson University) lowered its Baltimore County personal income growth forecast for FY 2009 from 4.56% to 2.42%, which is 18 basis points below its revised Maryland growth forecast of 2.60% for FY 2009. Similarly, RESI projects that FY 2010 personal income growth in the State (2.61%) will exceed the County personal income growth (2.34%) by 27 basis points. Over the 1997 to 2008 period, estimated County personal income increased at an average annual rate of 5.4%, compared to 5.7% and 5.3% in Maryland and the U.S., respectively (Figure 5).

Extreme pessimism emerged as the theme for the January 16, 2009 meeting of the Baltimore County Economic Advisory Committee.

The January 16, 2009 meeting of the Baltimore County Economic Advisory Committee (BCEAC) provided further insight into local economic conditions. The BCEAC members predicted that the economic downturn will persist locally, nationally, and globally through the remainder of calendar year (CY) 2009. The panel expects increased job losses as well as a continued decline in the retail sector. However, members see the potential for stronger economic performance for Central Maryland in future years, reflecting the expected growth resulting from the Federal Government's implementation of the Base Realignment and Closure (BRAC) Commission recommendations. Additionally, members have observed the economic advantages associated with Maryland's proximity to Washington, D.C., including the local advantage of being home to the Social Security Administration headquarters. Members warned, though, that extreme pessimism should be the theme emerging from their meeting.

Figure 5. National, State, and Local Personal Income Growth



Note: Lighter columns and dashed lines represent estimates.

Estimate Source: RESI Research and Consulting—Towson University, January 2009

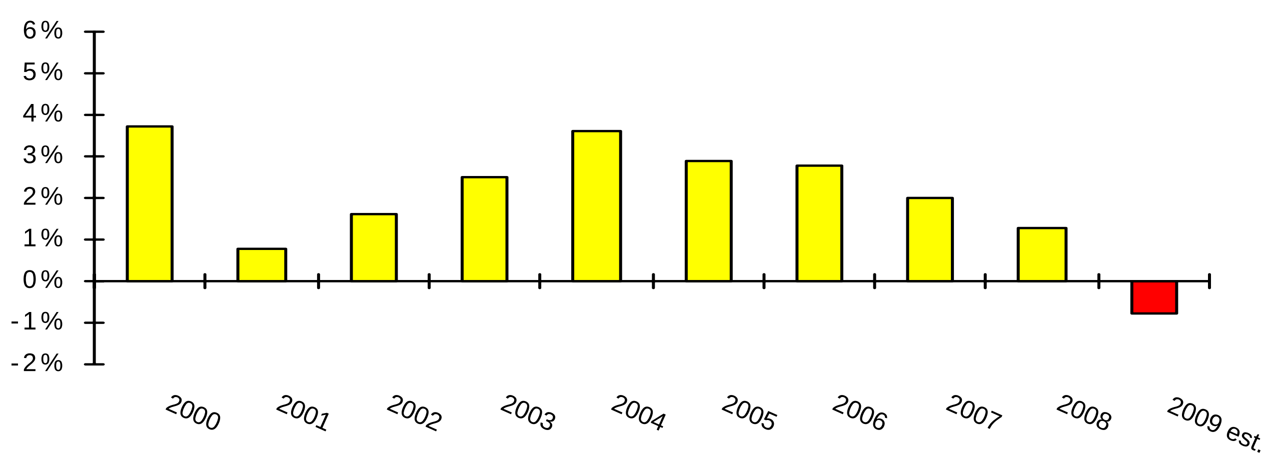
Real Gross Domestic Product (GDP) grew at an average annual rate of 2.6% from CY 1999 to CY 2008. For CY 2009, real GDP is expected to decline by 0.8%.

Projections for the local economy are influenced, to a large degree, by the underlying performance in the national and state economies. Nationally, the housing market continues to decline, financial markets are frozen due to scarce credit despite unprecedented government efforts through increased spending and policy activity, and in CY 2009 consumer spending is expected to decline for the first time since CY 1991. In December 2008, the National Bureau of Economic Research announced that the U.S. has been in a recession since December 2007. The last U.S. recession was an eight-month downturn from March to November 2001. Emerging from that recession, real GDP grew by an average of 2.4% annually from CY 2002 to CY 2008, yielding an annual average of 2.6% over the last 10 years from CY 1999 to CY 2008. After increasing by 2.0% in CY 2007 and 1.3% in CY 2008, real GDP is projected to decline by 0.8% in CY 2009, according to the Federal Reserve Bank of Philadelphia's December 2008 *Livingston Survey*, the oldest continuous survey of economists' expectations in the U.S. (Figure 6).

Unemployment rates have risen considerably since this time last year.

Employment among Baltimore County residents decreased by 0.2%, Maryland employment remained unchanged, and national employment decreased by 0.3% on a year-over-year annual average basis from CY 2007 to CY 2008. However, the State and local labor markets have undoubtedly begun experiencing the effects of the current economic recession. Baltimore County's and Maryland's December 2008 unemployment rates were 5.8% and 5.6%, respectively – well above average – and are likely to continue rising in coming months. The January 2009 employment forecasts by RESI suggest that in CY 2009, employment in Baltimore County and Maryland will decrease by 0.8% and 0.9%, respectively, while U.S. employment will decrease by 2.5%. The projected decrease in County employment, along with small anticipated increases in wages and salaries, supports the low Baltimore County personal income growth forecast for FY 2010.

Figure 6. Real Gross Domestic Product: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Livingston Survey*, December 2008*

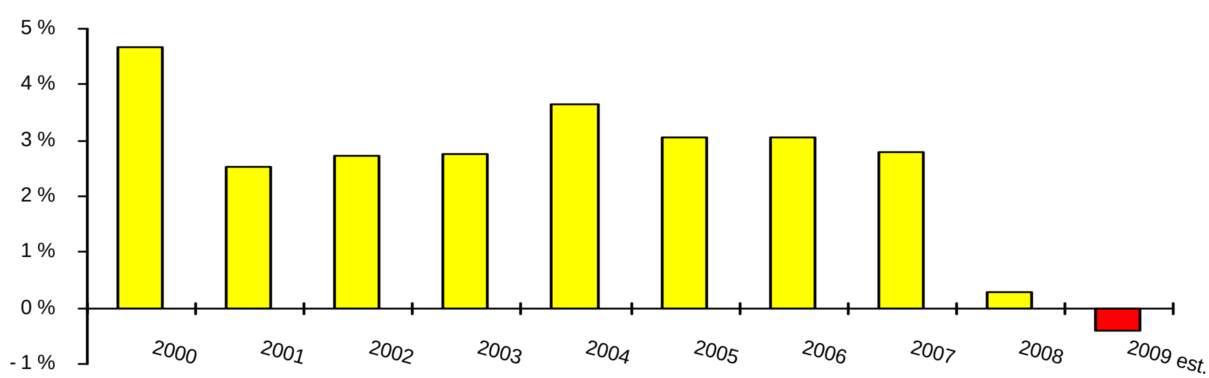
Consumer confidence remains at all-time lows as consumers' expectations for future employment and business conditions continue to deteriorate.

Consumer spending, which typically accounts for slightly more than two-thirds of all U.S. economic activity, is the primary determinant of future economic performance (Figure 7). Consumer spending increased at a rate of just 0.3% during CY 2008, the slowest annual growth rate since CY 1991. In January 2009, national unemployment reached its highest level (7.6%) since September 1992, putting pressure on consumers to decrease spending. Additionally, the level of confidence consumers have about current and future business conditions, in part, determines the strength or weakness of consumer spending. Consumer confidence, based on a survey of 5,000 U.S. households by the Conference Board, decreased in December 2008 and continued to reflect all-time lows in January 2009. Specifically, January showed a decrease in the Expectations Index along with a slight decrease in the Present Situation Index. According to the Conference Board, in general "consumers remain quite pessimistic about the state of the economy and about their earnings." The Conference Board further observed that "until we begin to see considerable improvements in the Expectations Index, we can't say that the worst of times are behind us."

Continued economic decline is anticipated for CY 2009, with some hope that a Federal fiscal stimulus will prompt a recovery in CY 2010.

The national economy faces numerous challenges in the coming months. Forecasters participating in the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters* adopted a more pessimistic outlook for consumer spending, GDP, and employment growth for CY 2009 in the November 2008 report compared to earlier editions. These forecasts reflect continued slowing in household and commercial investment, frozen credit markets, and a stagnant housing market. The same survey is projecting consumer expenditures to contract by 0.4% in CY 2009, compared to an increase of 0.3% in CY 2008. The State and County economies are likely to continue to decline along with the deteriorating national economy. In this regard, the BCEAC concluded at its January 2009 meeting that the remainder of CY 2009 will bring further struggles for Baltimore County, with no sector surviving the recession unscathed. Most economists agree that some Federal fiscal stimulus is needed to revive the economy, but officials must first come to an agreement on the details of the rescue package.

Figure 7. Real Consumer Spending: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters, *November 2008*

GENERAL FUND REVENUES AND SURPLUS

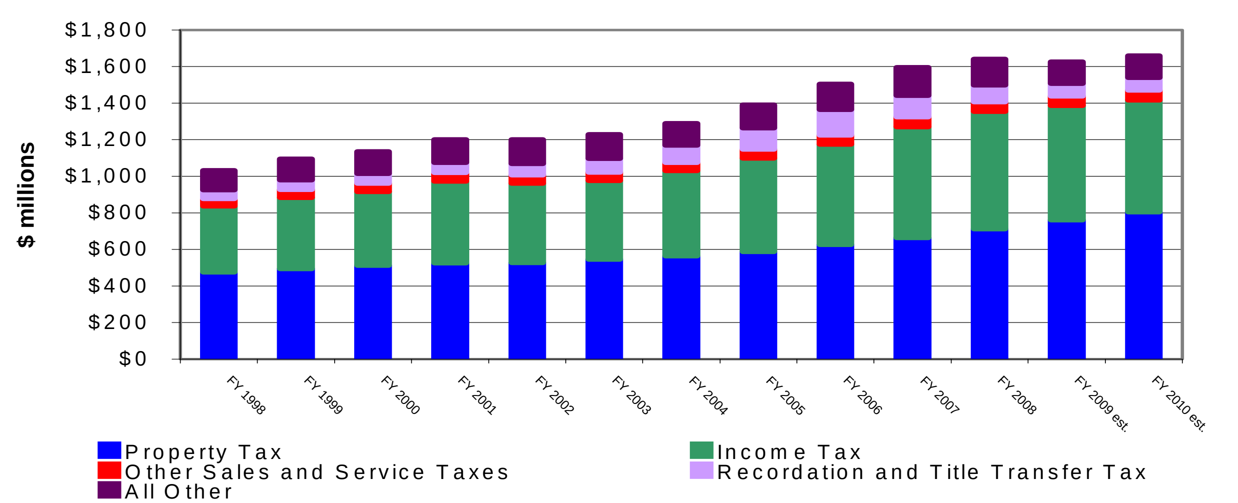
FY 2009 General Fund revenues are projected to decrease by $15.1 million, or 0.9%, from FY 2008. This projection is $47.1 million short of current-year budgeted revenue estimates.

FY 2009 projected revenues total $1,625.0 million, a decrease of $15.1 million, or 0.9%, from FY 2008 totals (Figures 8 and 9). The projected revenue decline reflects lower income tax revenues due to stagnant wage growth, the absence of capital gains, and declining employment levels, as well as a continued decline in property-related transaction tax revenues (i.e., title transfer and recordation tax revenues) due to the slow housing market. Estimated decreases in State aid to the General Fund totaling $7.0 million ($4.8 million in depressed highway user revenues and $2.2 million in State budget cuts) also contribute to the decline. The FY 2009 projected revenues are $47.1 million less than the budget estimates. This revenue shortfall could be addressed in a number of ways, such as decreasing the amount of current revenues ($91 million) available to fund the PAYGO appropriation to the capital budget and increasing reliance on fund balance (surplus) to support the PAYGO appropriation.

FY 2010 General Fund revenues are projected to increase by $33.1 million, or 2.0%, over the revised FY 2009 estimate.

FY 2010 General Fund revenues are projected to reach $1,658.1 million, down approximately $14.0 million, or 0.8%, from budgeted FY 2009 revenues, but up $33.1 million, or 2.0%, over the revised FY 2009 estimate. The projected rate of growth in FY 2010 General Fund revenues is below the FY 2004 through FY 2008 annual growth rates, but above the projected negative growth rate in FY 2009. General Fund revenue growth in FY 2010 primarily reflects anticipated gains in the County's property tax revenues, partially offset by a decline in income tax revenues resulting from the continued impact of declining employment levels and capital losses. Property-related transaction tax revenues are forecast to be flat due to the expectation that the housing market will "bottom out" in late CY 2009, resulting in an increase in activity by early CY 2010. State aid reductions are also expected to impact FY 2010 General Fund revenues, though to a lesser extent than FY 2009 reductions.

Figure 8. Baltimore County General Fund Revenues



Sources: FY 2003 to FY 2008 Baltimore County Comprehensive Annual Financial Reports

Figure 9. General Fund Revenue Forecast, FY 2009-FY 2010

($ Million)

REVENUE SOURCE	FY 2008 Actual	FY 2009 Budget	FY 08 - FY 09 Bud.	FY 2009 Revised	FY 08 - FY 09 Rev.	FY 2010 Estimate	FY 09 Bud.- FY 10	FY 09 Rev.- FY 10
Property taxes	$713.1	$757.0	6.2%	$761.2	6.7%	$804.9	6.3%	5.7%
Income taxes	641.0	647.2	1.0%	625.0	-2.5%	612.5	-5.4%	-2.0%
Recordation & title transfer taxes	91.8	81.7	-11.0%	68.3	-25.6%	68.3	-16.4%	0.0%
Other Sales and Service taxes	53.1	55.0	3.6%	52.7	-0.7%	53.6	-2.6%	1.6%
Licenses & permits	3.9	5.5	41.0%	4.1	5.1%	4.2	-23.6%	2.4%
Fines, forfeitures & penalties	3.1	3.7	17.6%	3.0	-4.7%	3.6	-2.7%	20.0%
Services charges	9.7	10.2	5.2%	8.7	-10.3%	8.7	-14.7%	0.0%
Interest on investments	12.5	8.7	-30.4%	7.5	-40.0%	8.0	-8.0%	6.7%
Intergovernmental aid	78.4	78.4	0.0%	70.9	-9.6%	70.8	-9.7%	-0.2%
Other	33.4	24.7	-26.0%	23.6	-29.3%	23.6	-4.5%	0.0%
TOTAL	$1,640.1	$1,672.1	2.0%	$1,625.0	-0.9%	$1,658.1	-0.8%	2.0%

Note: Totals may not add due to rounding.

The FY 2010 revenue projection is $40.7 million higher than the Committee's spending guideline.

The FY 2010 revenue projection is $40.7 million higher than the Committee's FY 2010 spending guideline. The excess funds, together with unreserved, undesignated fund balance (surplus), can be used for spending not subject to the guideline, including local-share matching funds, one-time expenditures such as PAYGO contributions to the capital budget (which reduces programmed borrowing), and funding the County's OPEB accrued liability in excess of the Committee's phase-in amount.

The FY 2008 General Fund surplus totaled $118.5 million, excluding $82.9 million of RSRA funds.

As of June 30, 2008, the undesignated, unreserved General Fund balance (surplus) totaled $118.5 million, or 7.2% of General Fund revenues. This amount excludes $139.4 million of General Fund balance that is designated for various purposes, which consist of $82.9 million for the Revenue Stabilization Reserve Account (RSRA), $47.5 million as a source of funding for the FY 2009 Budget, and $9.0 million of net bond premium designated for debt service.

The FY 2009 General Fund surplus is estimated to total $69.4 million, excluding $85.0 million in the RSRA.

The projected June 30, 2009 undesignated, unreserved General Fund balance (surplus) totals $69.4 million, or 4.3% of FY 2009 estimated revenues (Figure 10). This amount, plus an estimated $85.0 million in the RSRA, totals $154.4 million, or 9.5% of FY 2009 estimated revenues.

Figure 10. Estimated General Fund Surplus, FY 2009

($ in Millions)

FY 2008 General Fund Surplus (excluding RSRA funds)		$ 118.5
FY 2009 Revenue Estimate (per Adopted Budget)	1,672.1	
FY 2009 Revision	(47.1)	
FY 2009 Revised Revenue Estimate	1,625.0	
FY 2008 General Fund Balance Designated to Fund FY 2009 Appropriations	47.5	
FY 2009 Total Funding		1,672.5
FY 2009 General Fund Appropriations		(1,719.5)
FY 2009 Interest Transfer to the RSRA		(2.1)
FY 2009 Estimated General Fund Surplus		$ 69.4

SPENDING POLICY ISSUES AND RECOMMENDATIONS

In addition to the growth rate policy action described earlier in this report, the FY 2010 Committee adopted two other policies related to the spending guideline.

During its FY 2010 deliberations, the Committee extended its phase-in plan for incorporating other post-employment benefits (OPEB) accrued liability appropriations into the spending guideline.

The Committee amended its existing 5-year phase-in plan to a 10-year phase-in plan for incorporating other post-employment benefits (OPEB) accrued liability appropriations into the spending guideline. This decision was made in recognition of the magnitude of spending pressures facing the County, including the County's continued plan to fully fund its OPEB liability over the 5-year period of FY 2008 to FY 2012. As a result of this policy change, recognition of the additional annual required contribution resulting from the OPEB accrued liability will be phased in over 10 years, in 10% increments, until the full amount is recognized by FY 2017. Accordingly, for FY 2010, spending subject to the guideline includes General Fund OPEB accrued liability appropriations up to 30% of the actuarial estimate of the annual required contribution for the OPEB accrued liability.

The Committee also adopted policy clarification language for its Contingency Reserve exclusion policy.

The Committee also adopted a policy to clarify that the General Fund Contingency Reserve appropriation exclusion applies only to the portion of the appropriation that represents a reserve for unforeseen needs (e.g., emergencies) and does not apply to any portion of the appropriation that is earmarked for a particular purpose unless that purpose meets other exclusion criteria established by the Committee. The impetus for the adoption of this policy clarification language was the exclusion by the County Executive of $4 million of police salary and benefit costs, required by binding arbitration, that were budgeted in the FY 2009 Contingency Reserve Program. Since these costs represent ongoing expenditures, the County Council included them in base spending subject to the guideline. The FY 2010 Committee's policy clarification is consistent with the County Council's action during the FY 2009 budget process.

The Committee continues to recommend that the budget adequately fund essential operating items and avoid funding ongoing commitments with surplus funds.

In addition to these spending guideline policies, the Committee reaffirms its long-standing recommendations that the County Executive submit a General Fund budget which: **(1) avoids under-funding essential operating budget items in order to fund other initiatives; and (2) avoids funding ongoing operating expenses with surplus funds.**

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 total General Fund revenues; 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 the Committee's guidelines.

Debt Service Guideline

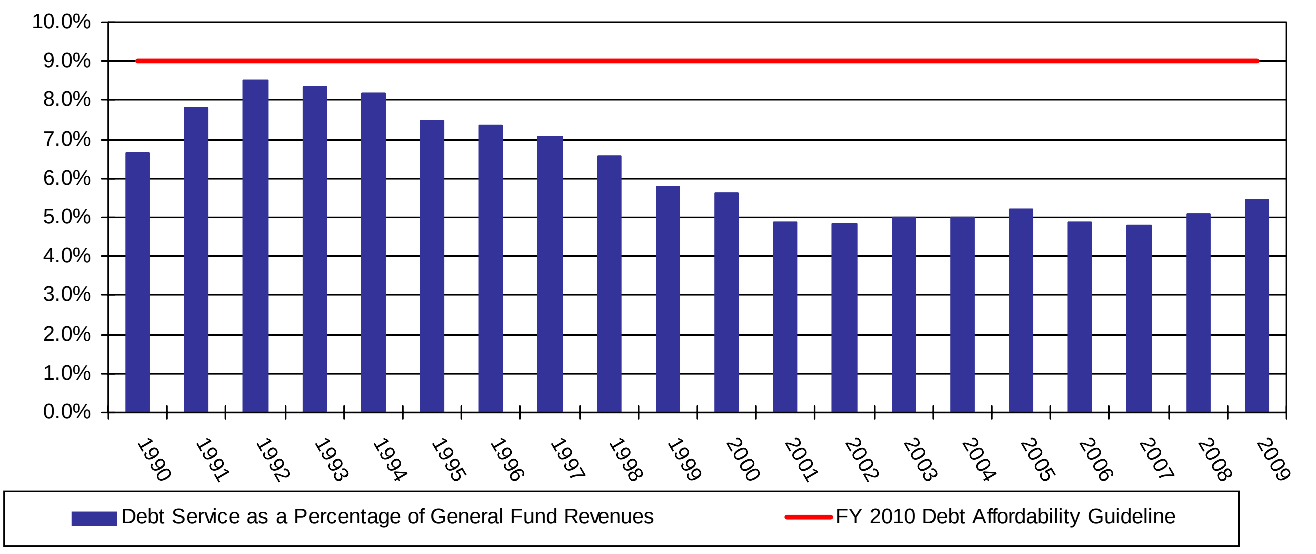
The Committee recommends that debt service not exceed 9% of total General Fund revenues.

The ratio of debt service to total General Fund revenues 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 10%) suggests that the debt burden is too heavy. The Administration's financial guidelines historically have set a target range for debt service expenditures at 8% to 9% of total General Fund revenues. From FY 1990 to FY 2009, the amount spent or budgeted for debt service ranged from 4.8% to 8.5% of total General Fund revenues (Figure 11). The Committee has established a policy that debt service should not exceed 9% of total General Fund revenues. **Accordingly, for FY 2010, the Committee recommends that debt service expenditures not exceed $149,229,000 based on projected revenues totaling $1,658,100,000.**

The decrease in the ratio of debt service to total General Fund revenues beginning in the 1990s reflects increased use of PAYGO to fund capital projects, rather than a reduction in County capital spending.

The ratio of debt service to total General Fund revenues from FYs 1990 through 2009 is shown below in Figure 11. 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 finance the County's capital budget. Specifically, from FY 2000 through FY 2009, the County has budgeted $888.3 million in PAYGO funding, compared to $185.2 million in the preceding 10-year period. However, had the County issued bonds in lieu of relying on PAYGO during this same FY 2000-FY 2009 period, the County would have incurred additional interest expense totaling approximately $421.9 million over the life of the bonds.

Figure 11. Debt Service as a Percentage of Total 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 2009 ratio is an estimate.
Sources: Baltimore County Annual Budget Documents; Baltimore County Office of Budget and Finance; Baltimore County Office of the County Auditor

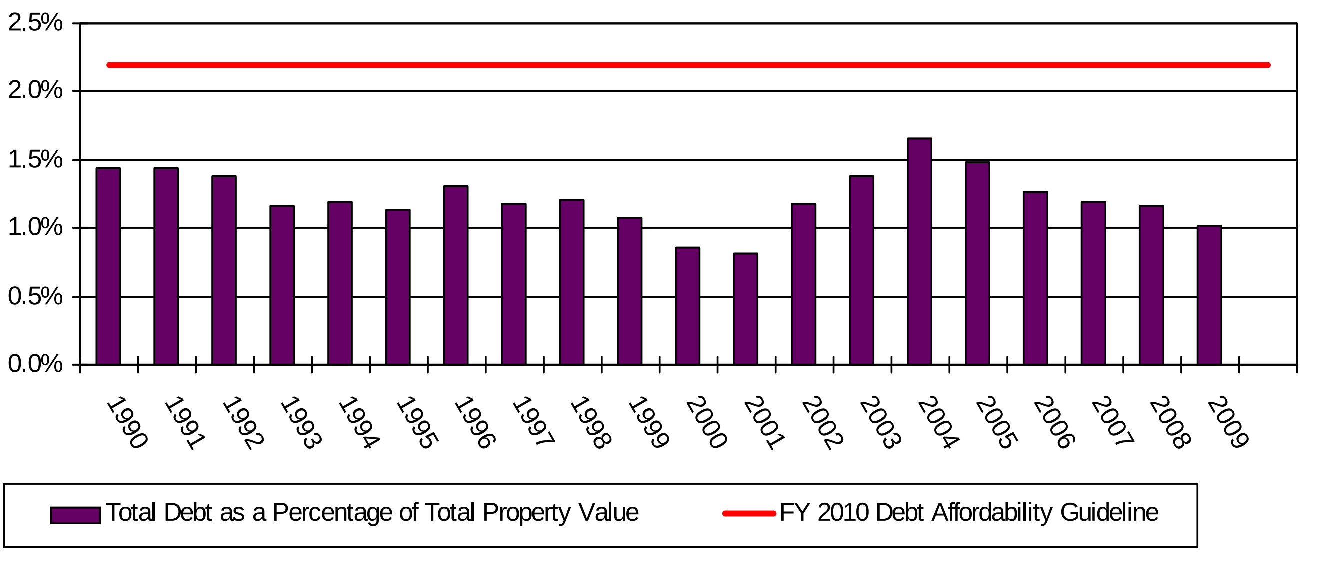
Total Debt Outstanding Guideline

The Committee recommends that total debt outstanding not exceed 2.2% of total assessed property value.

The ratio of total debt outstanding to total 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 total assessed 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 assessed property value, including real and personal property, based on a study prepared by the County's independent financial consultant. From FY 1990 to FY 2009, total outstanding debt has ranged from 0.8% to 1.7% of the County's total assessed property value (Figure 12).

In accordance with the Committee's policy that total outstanding debt should not exceed 2.2% of total assessed property value, **the Committee recommends that total debt outstanding during FY 2010 not exceed $1,960,637,690, or 2.2% of total assessed property value of $89,119,895,000.**

Figure 12. Total Debt as a Percentage of Total Assessed Property Value



Note: Excludes debt related to pension funding, metropolitan district bonds, and component unit capital leases not budgeted under Primary Government; FY 2009 debt outstanding is an estimate.
Sources: Baltimore County Annual Budget Documents; Baltimore County Office of Budget and Finance; Maryland State Department of Assessments and Taxation