SPENDING
AFFORDABILITY
COMMITTEE

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

Report of the Spending Affordability Committee

Fiscal Year 2012

Table of Contents

Baltimore County, Maryland

February 15, 2011

BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE

Honorable John Olszewski, Sr.
Councilman, 7th District, Committee Chairman

Honorable Tom Quirk
Councilman, 1st District

Honorable David Marks
Councilman, 5th District

Roy T. Meyers, Ph.D.
Professor, Department of Political Science, UMBC

Carlotta J. Oliver
Managing Director, Business Development and Client Service, Profit Investment Management, LLC

BALTIMORE COUNTY ECONOMIC ADVISORY COMMITTEE

Anirban Basu, Committee Chairman, and Chairman and CEO, Sage Policy Group, Inc.
Mark Habicht, President, Kirk-Habicht Company
Michael Kemper, Senior Vice President, Bank of America
Kerry Lidard, Area Manager, Kelly Services
T. Ross Mackesey, Sales Manager, Long and Foster Real Estate, Inc.
J. Lawrence Mekulski, Principal, KLNB, Inc.
Jain A. Trader, Vice President/Store Manager, Macy's East
David Uhlfelder, CPA

STAFF

Lauren M. Smelkinson, CPA, County Auditor
Elizabeth J. Irwin, Deputy County Auditor
Michelle F. Ganjon, Senior Fiscal and Policy Analyst
Marie B. Jeng, Senior Fiscal and Policy Analyst
Carrie B. Vivian, Senior Fiscal and Policy Analyst
Philip S. Gear, Fiscal and Policy Analyst

SPENDING AFFORDABILITY COMMITTEE

February 15, 2011

Honorable Members of the Baltimore County Council
Honorable Kevin Kamenetz, 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) 2012.

For FY 2012, the Committee recommends a base spending guideline of $1,633,889,458 derived from a personal income growth rate of 2.25%. This guideline represents maximum potential growth of $35,953,558 over estimated FY 2011 base spending. The Committee further recommends that total debt outstanding not exceed 2.2% of FY 2012 estimated assessed property value and that debt service not exceed 9% of FY 2012 estimated General Fund revenues. These guidelines are meant to limit spending such that growth in 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.

When the Committee convened this year, circumstances were substantially different than they were in the previous year. At this time last year, the Committee was aware that the County was facing an unprecedented revenue shortfall, and it was not aware of the former Administration's plans for addressing a shortfall of this magnitude. Accordingly, and appropriately, the Committee paired its spending guideline recommendation with a number of highly cautionary fiscal policy recommendations. The executive branch's success in weathering last year's budgetary storm is now evident. Through a series of transfers from other funds, General Fund unexpended surplus levels were maintained. At the same time, negotiations with labor unions resulted in a shared understanding of the fiscal challenges facing the County and the sacrifices required to ensure long-term budgetary solutions. Concessions by labor groups included increases in employee contributions to the County's retirement system, changes in health insurance offerings, and foregone cost-of-living increases for FY 2011 and FY 2012. These concessions were paired with a commitment by the executive branch that layoffs and furloughs would be avoided over the same period. Such sacrifices and fiscal prowess are a credit to both the County's workforce and its managers. Maintaining its conservative fiscal stance, the Committee commends these wise decisions while also recognizing the occasional necessity and prudence of using one-time funding to support ongoing costs during difficult economic times.

The FY 2012 spending guideline reflects the Committee's long-standing policy of applying a personal income growth factor to estimated final base-year spending. Although current projections indicate a moderate revenue shortfall of approximately $35.8 million for FY 2011, the Committee does not anticipate expenditure cutbacks of this magnitude for FY 2011 in light of sufficient available fund balance. As a result, the Committee did not reduce FY 2011 base-year spending for any anticipated General Fund reversions. The Committee did feel compelled to consider the State's budgetary imbalance and the possible effects of such (i.e., any resulting transfer of responsibility for currently State-funded costs, such as teachers' pension costs) on the County's compliance with the FY 2012 spending guideline. In light of the timing of this report, which occurs prior to the State's budget decisions for FY 2012, and an awareness that the County has ample surplus funds to weather a cost transfer for at least a single "adjustment" year, the Committee approved an exclusion from base spending subject to the FY 2012 guideline of any new State-transferred costs that would necessarily increase the County's FY 2012 budget.

During its deliberations this year, the Committee considered a policy issue related to the expenditure of off-budget funds for ongoing general government purposes. This issue came to the Committee's attention after the Council approved Bill 67-10, a bond ordinance. The ordinance stated that any earnings derived from the investment of bond proceeds may be treated as general revenues and applied to the general purposes of the County and allowed the County Executive or Administrative Officer to designate specific expenditures to be paid from such earnings. Prior to the Council's approval of the bill, at the Council's request, the Administration provided its interpretation of this language, which indicated that approval of Bill 67-10 would constitute authorization of the expenditure of such bond premium funds so that a separate appropriation of funds would not be necessary. The Council asked the Committee to consider this issue because the off-budget expenditure of such designated funds would escape the Spending Affordability process. Accordingly, the Committee approved a policy to require consideration of such off-budget expenditures for general government purposes as being subject to the spending guideline for the year in which such spending occurs. Based on the Administration's indication that it plans to expend during FY 2011 the $10.5 million that the County received as a result of the November 2010 bond sale, in calculating its FY 2012 spending guideline the Committee considered the planned expenditure of such funds as a component of FY 2011 base-year spending. The Committee notes that the County remains compliant with the FY 2011 spending guideline after considering this additional $10.5 million in planned spending for FY 2011.

In determining its fiscal guidelines, the Committee reviewed current and projected conditions of the national, state, and local economies. This review disclosed improvement in the local and national economies, with momentum for the coming year, but it also revealed underlying weaknesses in the labor and housing markets. At its January 4, 2011 meeting, the Baltimore County Economic Advisory Committee was generally optimistic, anticipating slow growth throughout 2011 and into 2012. This year's Spending Affordability Committee was encouraged by reports of declining unemployment and growth potential due to BRAC relocation activity.

This year's Committee maintained the policy of utilizing a 5-year average of annual personal income growth rates, noting that the use of 5-year averaging smoothes out economic fluctuations, stabilizes spending growth over time, and corrects for revisions over time to current and prior year personal income growth forecasts. The Committee's economic consultant currently forecasts accelerating personal income growth rates for each fiscal year over the FY 2011 to FY 2014 period, reaching a projected 4.80% growth rate in FY 2014; the Committee's averaging approach includes projections through FY 2012 in determining its growth factor for the FY 2012 spending guideline calculation.

I would like to thank my fellow Council members who served on the Committee, Councilman Quirk and Councilman Marks, for their time and thoughtful contributions to this year's process. I would also like to express further gratitude to Dr. Roy Meyers, whose expertise in the field of public policy and government budgeting practices continued to benefit the Committee, and to Ms. Carlotta Oliver for generously returning to the Committee for a second year. Additionally, I would like to acknowledge the contribution of Mr. Anirban Basu, who served the Committee this year both as the Chief Executive Officer of Sage Policy Group, Inc., the economic consultant to the Committee, and as the Chairman of the Baltimore County Economic Advisory Committee, which continued to provide, under his leadership, real-time data on the pulse of the local economy. Thanks to all members of the Baltimore County Economic Advisory Committee for their voluntary participation and their important contributions. Finally, many thanks are also due to County Auditor Lauren Smelkinson and the Fiscal and Policy Analysis Division of the County Auditor's Office for its diligent staff support 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 2012.

Sincerely,

John Olszewski Sr.

John Olszewski, Sr.
Chairman, Spending Affordability Committee
Councilman, 7th District

INTRODUCTION

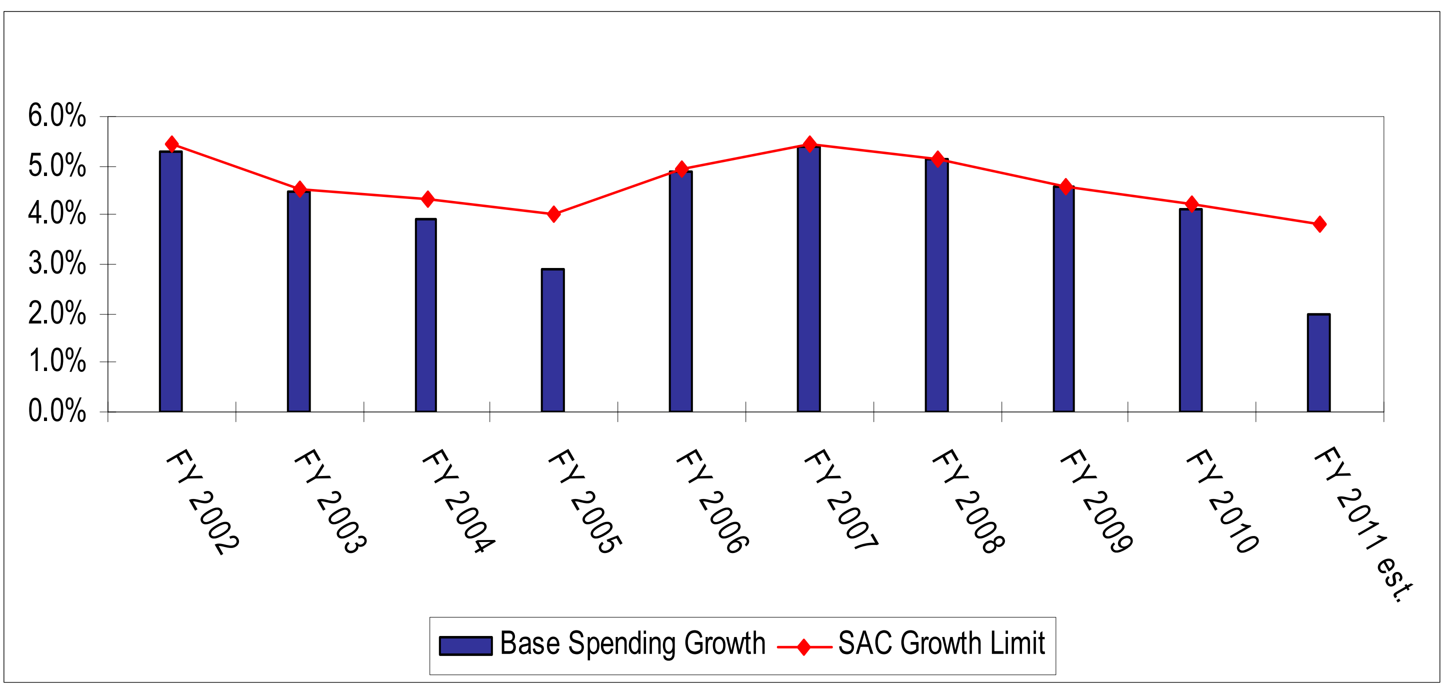
The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed the growth in the County's economy.

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 amounts or growth levels for County spending that should not be exceeded (Figure 1); however, the law states that the County Council may exceed the Committee's recommendations if it provides a rationale for doing so.

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



SPENDING GUIDELINE

The Committee recommends base spending growth of 2.25%, or $1,633.9 million, for FY 2012.

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 (FY) 2012, the Committee recommends that base spending not exceed $1,633,889,458 based on an estimated County personal income growth rate of 2.25% applied to estimated final FY 2011 base-year spending of $1,610,668,694 (Figure 4). This guideline allows for maximum spending growth of $35,953,558 over estimated final FY 2011 spending.**

SPENDING POLICY ISSUES AND RECOMMENDATIONS

The Committee maintains the policy of utilizing a 5-year average of annual personal income growth rates for determining its personal income growth factor.

In FY 2010 the Committee changed its measure of growth in the County's economy from a forecast of personal income growth for the upcoming fiscal year to 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. For FY 2012, the Committee maintains this policy of utilizing a 5-year average of annual personal income growth rates and notes that there are a number of long-term advantages of maintaining this policy. Specifically, the use of 5-year averaging smoothes out economic fluctuations, stabilizing spending growth over time, and it corrects for revisions over time to current and prior year personal income growth forecasts.

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

The Committee adopted a new policy to include "off-budget" expenditures for general government purposes as spending subject to the guideline in the year the spending occurs.

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 or decreases due to planned expenditure reductions in response to detrimental economic events that are known or estimated prior to the adoption of the guideline. Additionally, this year, the Committee adopted a policy to consider the expenditure of "off-budget" funds for general government purposes, including the "off-budget" expenditure of bond premium funds, as being subject to the guideline for the year in which the spending occurs. Based on the Administration's indication that it plans to expend during FY 2011 the $10,519,186 that the County received as a result of the November 2010 bond sale, the Committee considered the planned expenditure of such funds as a component of base spending for FY 2011. For the current fiscal year, no supplemental appropriations are anticipated, nor are any significant reductions in planned spending anticipated, despite a projected revenue shortfall, because sufficient unreserved fund balance is available to offset such a shortfall at fiscal-year end.

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 (current fiscal year)
\+ Supplemental Appropriations and Planned "Off-Budget" Spending
\- Estimated General Fund Reversion due to detrimental economic events
\- 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)

Newly transferred costs from the State are excluded from the Committee's FY 2012 guideline. The Committee defers the related multi-year policy issue to the FY 2013 Committee for further deliberation.

This year, in light of the timing of the Committee's report, which must occur prior to the State's budget decisions for FY 2012, the Committee felt compelled to consider the possibility that new costs could be passed to the County from the State (due to the State's budgetary imbalance) in FY 2012. Such new costs could affect the County's ability to comply with the spending guideline. For example, in the event that responsibility for the full amount of teachers' pension costs (roughly $100 million) were to be transferred to the County, compliance with the FY 2012 spending guideline would be difficult if not impossible without noticeably affecting County government service levels. For this reason, and in light of a background awareness that the County has ample surplus funds to weather such a transfer for at least a single "adjustment" year, the Committee approved an exclusion from base spending subject to the FY 2012 guideline of any such State-transferred costs. The Committee approved this exclusion as a "one-time" allowance for FY 2012, and it deferred the question of the multi-year implications of any such State cost transfer to the FY 2013 Committee.

The Committee acknowledges the occasional need to utilize surplus for ongoing expenses during economic downturns and reaffirms its other fiscal policy recommendations.

During its deliberations, the Committee learned that ongoing County revenues are insufficient to fund ongoing expenses for the second consecutive year. Historically, the Committee has recommended that the County Executive submit a General Fund budget that avoids the practice of funding ongoing operating expenses with one-time sources of funding. However, the Committee acknowledges the occasional necessity of utilizing surplus for ongoing expenses during economic downturns. The Committee, therefore, finds it important to reaffirm and refine its longstanding fiscal policy recommendations, as follows:

The Committee strongly recommends that the County maintain a sufficient reserve on hand in case an unexpected revenue shortfall reoccurs in FY 2012. The Committee also recommends that the County Executive avoid underfunding essential items and that he minimize the use of one-time revenue sources to fund ongoing expenses.

- The Committee recommends that the County maintain a sufficient reserve on hand in case an unexpected revenue shortfall reoccurs in FY 2012 or future years. Accordingly, the Committee endorses the Administration's adopted policy of striving to produce an unreserved General Fund balance (surplus) near 7% of revenues in these volatile economic times including a revenue stabilization reserve equal to 5% of revenues; establishing a floor level for surplus funds at 3% of revenues; and ensuring that the balance of surplus funds does not fall to the 3% floor level for 2 consecutive years.

- The Committee recommends that the County Executive avoid under-funding essential operating budget items in order to fund other initiatives.

- The Committee recommends that the County Executive strive to submit a General Fund budget that minimizes reliance on one-time sources of funding, such as surplus funds, for ongoing operating expenses.

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. 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.

Figure 3. Spending Affordability Committee Definition of Base Spending

Base spending: General Fund spending 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.

FY 2012 Newly Transferred State Costs:

- Any new costs that are passed to the County from the State (due to the State's budgetary imbalance) in FY 2012 are excluded from FY 2012 base spending. Such costs are not currently estimable in light of the challenging and rapidly evolving FY 2012 State budget process.

Figure 4. FY 2012 Spending Guideline

FY 2011 Base Spending		
General Fund Appropriations, Excluding OPEB Accrued Liability		$ 1,600,149,508
General Fund OPEB Accrued Liability Appropriation		-
General Fund Supplemental Appropriations		-
Appropriations Subtotal		1,600,149,508
Estimated Off-Budget Expenditure of Bond Premium Funds		10,519,186
Estimated General Fund Reversion Due to Revenue Shortfall		-
Estimated Final Spending		1,610,668,694
General Fund Exclusions:		
Local Matching Appropriations		
Local Matching Funds		(7,364,366)
Federal Restricted Funds		(48,428)
Capital Project Appropriations		
PAYGO		(2,600,000)
Reserve Fund Appropriations		
Contingency Reserve		(1,000,000)
One-Time-Only Appropriations		
Baltimore County Public Schools State-Approved One-Time Costs		(1,720,000)
OPEB Accrued Liability (OAL) Appropriations		
In Excess of Phase-In Amount		-
Total Exclusions		(12,732,794)
FY 2011 Base Spending		1,597,935,900
Personal Income Growth 5-Year Average	x	1.0225
FY 2012 Spending Guideline		$ 1,633,889,458
Maximum Spending Growth		***$ 35,953,558***

Calculation of the FY 2012 OPEB Accrued Liability Phase-in Amount

FY 2012 is the fifth year of the 10-year phase-in period for recognizing the OPEB accrued liability (OAL) funding under the spending guideline. Therefore, the phase-in amount for FY 2012 is equal to 50% of the actuarial estimate of the annual OPEB accrued liability. Any FY 2012 General Fund OAL appropriations in excess of the 50% phase-in amount shall be excluded from spending subject to the guideline. If FY 2012 General Fund OAL appropriations are less than the 50% phase-in amount, the entire amount appropriated for OAL shall be included in spending subject to the guideline. The FY 2012 OAL phase-in amount is $31,604,500, calculated as follows:

	Estimated Annual OPEB Accrued Liability (OAL)	$ 63,209,000
x	FY 2012 OAL Phase-In Percentage	50%
	FY 2012 OAL Phase-In Amount	$ 31,604,500

ECONOMIC GROWTH

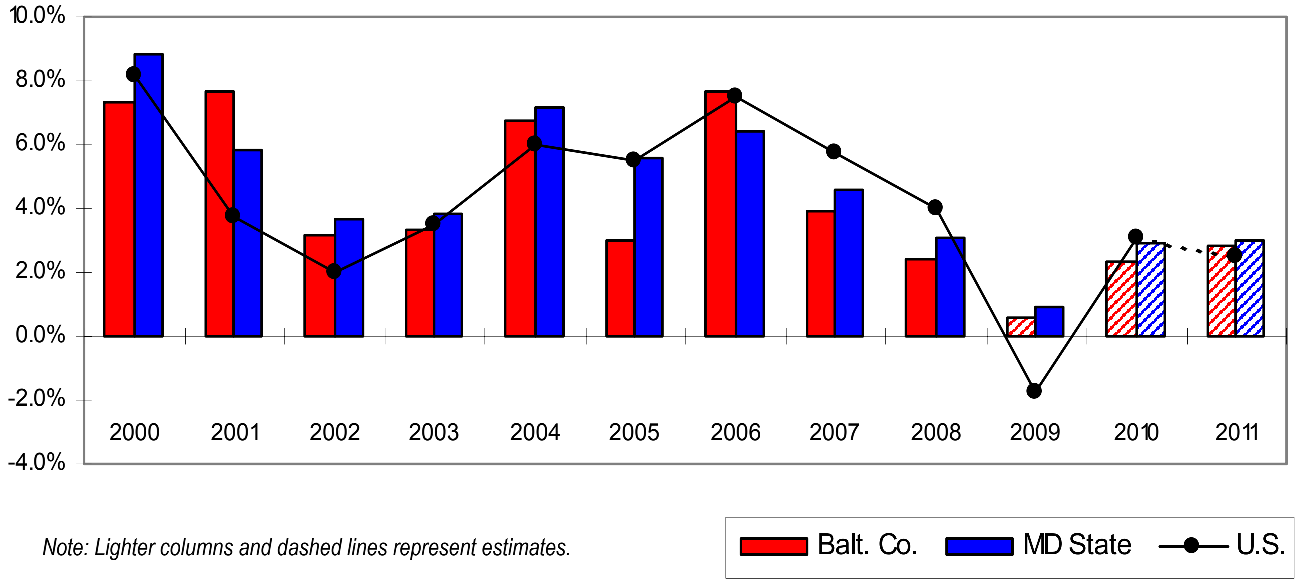
Personal income growth estimates are rising for FY 2011 and FY 2012, but remain low compared to historic averages.

Prior to adopting its FY 2012 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. In its report dated January 15, 2011, the consultant (Sage Policy Group, Inc.) predicts that Baltimore County personal income will grow 2.71% in FY 2011, which is 34 basis points below its Maryland FY 2011 personal income growth forecast of 3.05%. Similarly, the consultant projects that FY 2012 personal income growth in the State (3.33%) will exceed the County personal income growth (3.13%) by 20 basis points. Over the 2000 to 2010 period, estimated County personal income increased at an average annual rate of 4.4%, compared to 4.8% and 4.3% in Maryland and the U.S., respectively (Figure 5).

In light of observed growth in a variety of sectors, the Baltimore County Economic Advisory Committee expressed optimism regarding the economic recovery at its January 4, 2011 meeting.

The January 4, 2011 meeting of the Baltimore County Economic Advisory Committee (BCEAC) provided further insight into local economic conditions. The BCEAC members predicted that the economy will continue to recover, albeit slowly, through the remainder of calendar year (CY) 2011 and into CY 2012. The panel reported that companies are beginning to hire, and that even though unemployment will remain high by historical standards for the foreseeable future, the unemployment rate is trending downward. The manufacturing sector, which is often considered a leading indicator for the overall economy, has seen evidence of growth in orders in recent months. In addition, members noted that anecdotal data suggest a strong 2010 holiday season in the retail sector, which is a positive sign for the commercial real estate market. On the residential side, the panel reported that rising interest rates were creating a sense of urgency among potential buyers, leading to a recent uptick in sales; however, it is unclear if this trend will continue. Members see the potential for a 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. For the first time in more than 3 years, members were optimistic about the near-term outlook for the local, regional, and national economies.

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



Note: Lighter columns and dashed lines represent estimates.

Estimate Source: Sage Policy Group, Inc., January 2011

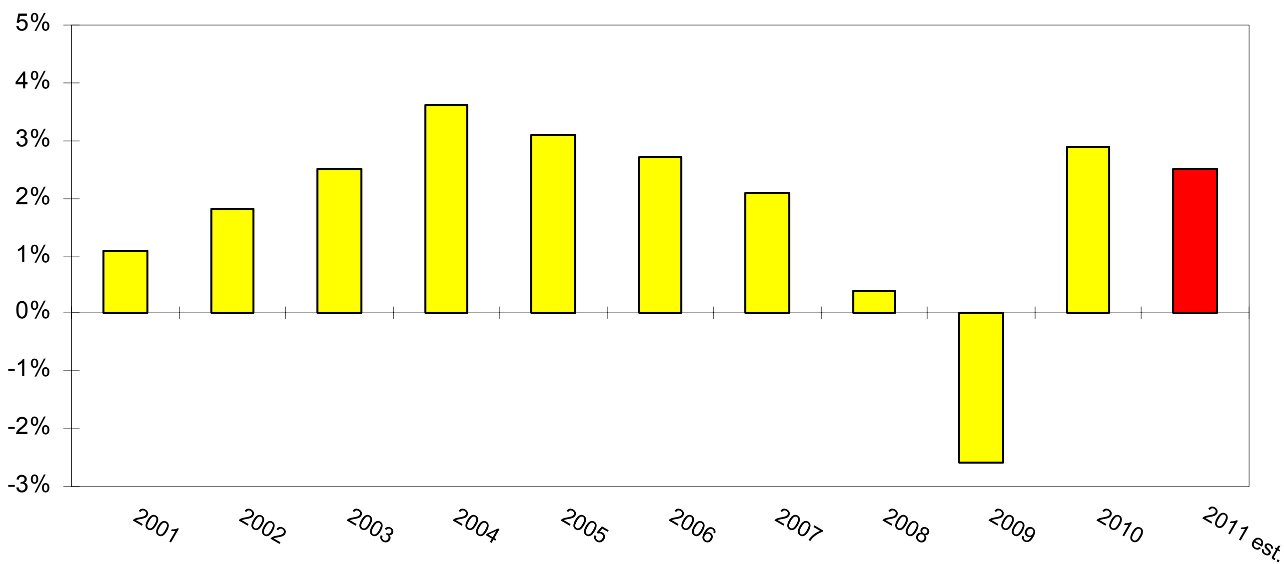
Real Gross Domestic Product (GDP) grew at an average annual rate of 1.8% from CY 2001 to CY 2010. For CY 2011, real GDP is expected to increase by 2.5%.

Projections for the local economy are influenced, to a large degree, by the underlying performance of the national and state economies. Nationally, the housing market continues to be unpredictable, and household spending is increasing. In CY 2011, consumer spending is expected to increase for the second consecutive year after falling in CY 2008 and CY 2009. However, unemployment continues to hover around 9.5% and credit markets remain constrained despite unprecedented government efforts via increased spending and policy activity. In September 2010, the National Bureau of Economic Research announced that in the U.S. the recession began in December 2007 and ended in June 2009, the longest recession since World War II. The previous U.S. recession was an eight-month downturn from March to November 2001. Emerging from that recession, real GDP grew by an average of 2.6% annually from CY 2002 to CY 2007, yielding an annual average increase of 1.8% over the last decade from CY 2001 to CY 2010. After contracting 2.6% in CY 2009 and then growing 2.9% in CY 2010, real GDP is projected to increase by 2.5% in CY 2011, according to the Federal Reserve Bank of Philadelphia's November 2010 *Survey of Professional Forecasters* (Figure 6).

Unemployment rates have fallen since this time last year.

Employment decreased by 1.4% among Baltimore County residents, by 1.2% among Maryland residents, and by 0.5% nationally on a year-over-year annual average basis from CY 2009 to CY 2010. While employment is still decreasing, it is doing so at a markedly slower pace than during the same period from CY 2008 to CY 2009. Baltimore County's and Maryland's December 2010 unemployment rates were 7.8% and 7.1%, respectively, and averaged 7.9% and 7.4%, respectively, for all of CY 2010. Over the past 10 years, the annual unemployment rates in Baltimore County and Maryland were, on average 120 and 140 basis points below the national rate, respectively. The *Survey of Professional Forecasters* projects a national unemployment rate of 9.3% in CY 2011 and 8.7% in CY 2012. If the trends between the national and local unemployment rates hold, Baltimore County and Maryland are already below the upper range of possible unemployment for CY 2011 (8.1% and 7.9%, respectively), a positive sign for the local economy.

Figure 6. Real Gross Domestic Product: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters*, November 2010*

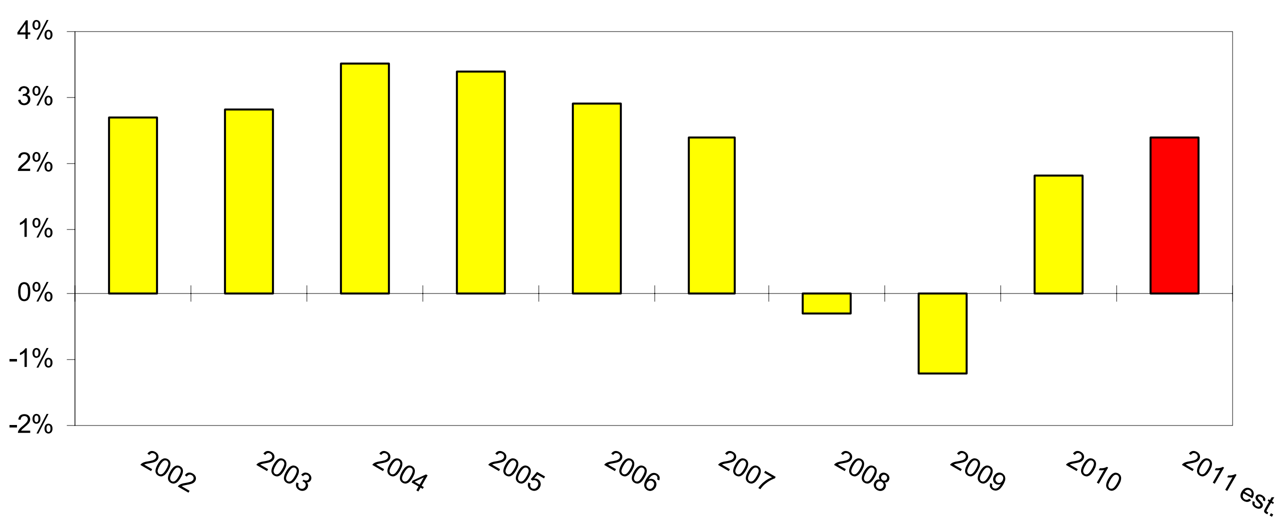
Consumer spending increased at a rate of 1.8% during CY 2010, after declining in CY 2008 and CY 2009.

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 1.8% during CY 2010, the first increase since CY 2007. In December 2010, national unemployment reached its lowest level (9.4%) since May 2009, indicating some small impetus for increased consumer spending. Consistent with this employment report, based on a survey of 5,000 U.S. households by the Conference Board, consumer confidence increased in January 2011 to a level that has not been seen since May 2010. The increase in consumer confidence saw corollary increases in both the "Present Situation" and the "Expectations" indices. The Conference Board signaled that expectations that the economy will rebound in the short-term are increasing, noting that while "pessimists still outnumber optimists, the gap has narrowed." The Conference Board further observed rising expectations of improvements in both business conditions and the labor market.

Disparate economic indicators such as rising consumer spending and persistently high unemployment levels have led many to expect a slow recovery in CY 2011.

The national economy's most significant challenge in the coming months is a persistently high unemployment rate. Forecasters participating in the Federal Reserve Bank of Philadelphia's November 2010 *Survey of Professional Forecasters* project 9.3% unemployment during CY 2011, reflective of the slow pace of recovery since the 26-year unemployment high of 10.1% in October 2009. The *Survey* anticipates more unambiguously positive trends in consumer spending and GDP during CY 2010, projecting expenditures to expand by 2.4% in CY 2011, compared to the 1.8% increase in CY 2010. However, the continued high unemployment rate, unstable housing market, and tight credit market will temper the positive effects of rebounding spending and GDP growth. The State and County economies are likely to continue to recover slowly along with the national economy. In this regard, the BCEAC concluded at its January 2011 meeting that CY 2011 will see economic recovery within Baltimore County, the depth of which will be determined by the labor market recovery.

Figure 7. Real Consumer Spending: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters, November 2010

GENERAL FUND REVENUES AND SURPLUS

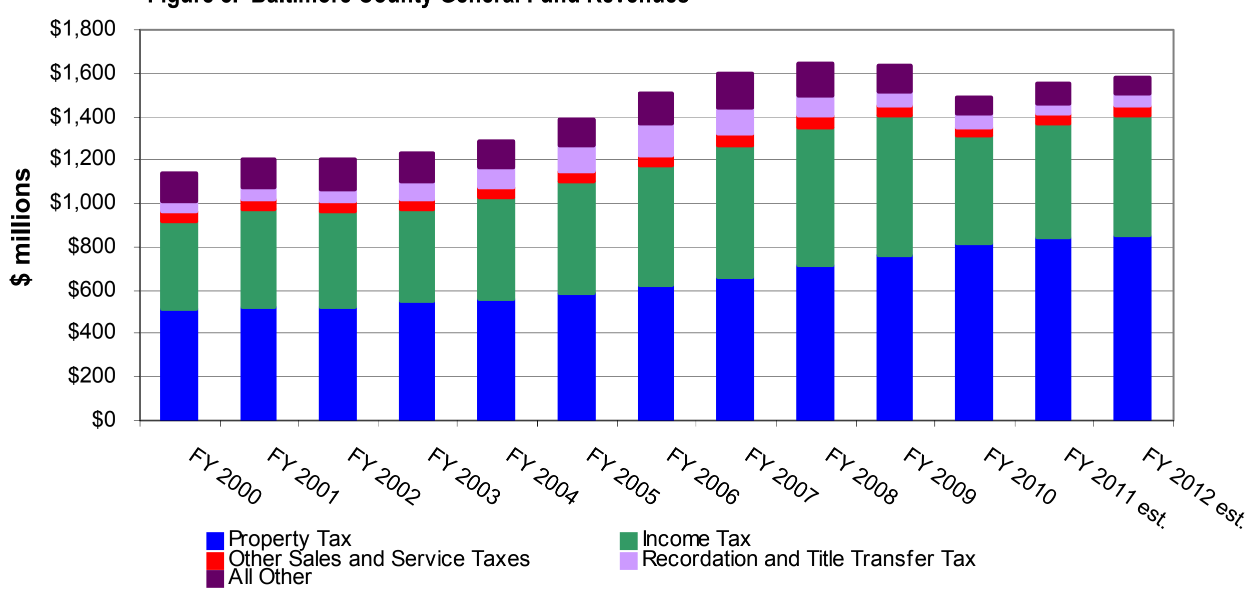
FY 2011 General Fund revenues are projected to increase by $65.5 million, or 4.4%, from FY 2010 totals. This projection is $35.8 million short of current-year budgeted revenues.

FY 2011 projected revenues total $1,554.9 million, an increase of $65.5 million, or 4.4%, from FY 2010 totals (Figures 8 and 9). This projection represents a shortfall of $35.8 million, or 2.3%, from FY 2011 budget estimates. The projected revenue shortfall is primarily due to lower-than-anticipated income tax revenues due to the State reconciling an over distribution in FY 2010, the second consecutive year that such a reconciliation has been necessary. In addition, property-related transaction tax revenues (i.e., title transfer and recordation tax revenues) are not meeting expectations. Shortfalls in these two revenue categories are partially offset by bond premium revenues from the November 2010 bond sale as well as small increases in other minor revenue categories. FY 2011 is expected to be the third consecutive year in which actual revenue collections fall short of original budget estimates; however, the Committee notes that the County has sufficient fund balance to make up for the shortfall, and that it is necessary and prudent to use surplus funding during difficult economic times.

FY 2012 General Fund revenues are projected to increase by $28.9 million, or 1.9%, over the revised FY 2011 estimate.

FY 2012 General Fund revenues are projected to reach $1,583.8 million, down approximately $6.9 million, or 0.4%, from budgeted FY 2011 revenues, but up $28.9 million, or 1.9%, over the revised FY 2011 estimate. The projected rate of growth in FY 2012 General Fund revenues is below the FY 2004 through FY 2008 annual growth rates as well as the projected growth rate for FY 2011, but above the growth rates for FY 2009 and FY 2010. General Fund revenue growth in FY 2012 primarily reflects a continuation of the rebound in County income tax collections following the steep decline in FY 2010, combined with subdued gains in the County's property tax revenues due to declining assessments. Property-related transaction tax revenues are also expected to show modest gains due to the expectation that the housing market has finally hit bottom and sales volume will begin to recover in FY 2012 while prices remain flat. The State aid reductions implemented in recent years (estimated at $40.2 million in FY 2011) are expected to continue in FY 2012 as a result of the State's budgetary challenges.

Figure 8. Baltimore County General Fund Revenues



Sources: FY 2005 to FY 2010 Baltimore County Comprehensive Annual Financial Reports

Figure 9. General Fund Revenue Forecast, FY 2011-FY 2012

($ Million)

REVENUE SOURCE	FY 2010 Actual	FY 2011 Budget	FY 10 - FY 11 Bud.	FY 2011 Revised	FY 10 - FY 11 Rev.	FY 2012 Estimate	FY 11 Bud.- FY 12	**FY 11 Rev.- FY 12**
Property taxes	$814.1	$841.4	3.4%	$843.3	3.6%	$850.9	1.1%	0.9%
Income taxes	495.7	560.0	13.0%	521.4	5.2%	555.7	-0.8%	6.6%
Recordation & title transfer taxes	61.0	61.0	0.0%	51.9	-14.9%	54.5	-10.7%	5.0%
Other Sales and Service taxes	43.4	46.4	6.9%	45.4	4.6%	46.1	-0.6%	1.5%
Intergovernmental aid	30.9	28.5	-7.8%	33.3	7.8%	31.4	10.2%	-5.7%
Services charges	9.5	9.7	2.1%	9.8	3.2%	10.0	3.1%	2.0%
Fines, forfeitures & penalties	3.7	3.4	-8.5%	3.8	3.8%	3.9	16.4%	2.6%
Licenses & permits	3.1	3.0	-3.2%	3.1	0.0%	3.2	6.7%	3.2%
Interest on investments	0.9	4.1	355.6%	1.2	33.3%	2.0	-51.2%	66.7%
Other	27.2	33.3	22.3%	41.7	53.3%	26.1	-21.6%	-37.4%
TOTAL	**$1,489.4**	**$1,590.7**	**6.8%**	**$1,554.9**	**4.4%**	**$1,583.8**	**-0.4%**	**1.9%**

Note: Totals may not add due to rounding.

The FY 2012 revenue projection is $50 million lower than the Committee's spending guideline.

The FY 2012 revenue projection is $50 million lower than the Committee's FY 2012 spending guideline. In light of this anticipated gap, the Committee fully expects the Administration to propose and implement a responsible financial plan that will both minimize the spending in excess of County revenues that is necessary to conduct County business and limit the use of fund balances.

The FY 2010 General Fund surplus totaled $109.2 million, excluding $84.4 million of RSRA funds.

As of June 30, 2010, the undesignated, unreserved General Fund balance (surplus) totaled $109.2 million, or 6.8% of the FY 2011 General Fund budget. This amount excludes $84.4 million that was designated for the Revenue Stabilization Reserve Account (RSRA). In addition, $9.4 million of General Fund balance was designated as a source of funding for the FY 2011 budget.

The FY 2011 General Fund surplus is projected to total $62.2 million, excluding $85.0 million in the RSRA.

The projected June 30, 2011 undesignated, unreserved General Fund balance (surplus), assuming a FY 2011 revenue shortfall of $35.8 million, totals $62.2 million, or 4.0% of projected FY 2011 revenues (Figure 10). This amount, plus an estimated $85.0 million in the RSRA, totals $147.2 million, or 9.5% of projected FY 2011 revenues. Any reversions and/or use of other fund balances that are not part of General Fund would impact projections for the General Fund balance as of June 30, 2011.

Figure 10. Estimated General Fund Surplus, FY 2011

($ in Millions)

FY 2010 General Fund Surplus (excluding RSRA funds)		**$ 109.2**
FY 2011 Revenue Estimate (per Adopted Budget)	1,590.7	
FY 2011 Revision	(35.8)	
FY 2011 Revised Revenue Estimate	1,554.9	
FY 2010 General Fund Balance Designated to Fund FY 2011 Appropriations	9.4	
FY 2011 Total Funding		1,564.3
FY 2011 Adopted Budget	(1,600.2)	
FY 2011 Off-Budget Expenditure of Bond Premium Funds	(10.5)	
FY 2011 Estimated Final Spending		(1,610.7)
FY 2011 Interest Transfer to the RSRA		(0.6)
FY 2011 Estimated General Fund Surplus		**$ 62.2**

DEBT GUIDELINES

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

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 total debt outstanding as a percentage of assessed property value; and (2) the County's level of debt service as a percentage of total General Fund revenues. Actual debt service expenditures and the amount of total debt outstanding have consistently remained below the Committee's guidelines.

Last year, the Committee requested that its staff review the debt policies of other triple-A bond rated jurisdictions in order to reassess the appropriateness of its guidelines in light of changing economic circumstances. Based on this review, during this year's deliberations, the Committee concluded that both its debt outstanding and debt service guidelines are on the conservative side, which is desirable, and did not consider any specific changes to its maximum recommended debt ratios.

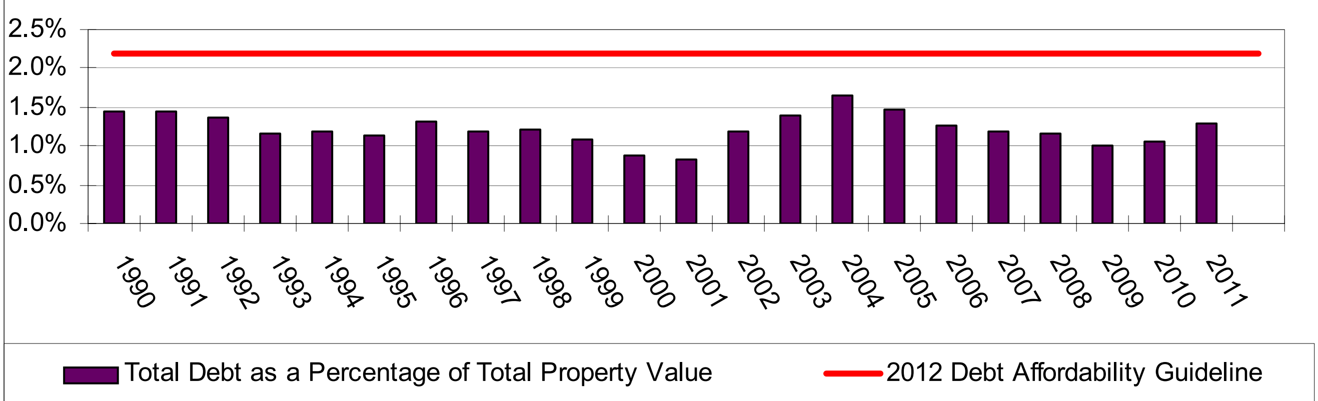
Total Debt Outstanding Guideline

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 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 total 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 2011, total debt outstanding has ranged from 0.8% to 1.7% of the County's total assessed property value (Figure 11).

In accordance with the Committee's policy that total debt outstanding should not exceed 2.2% of total assessed property value, **the Committee recommends that total debt outstanding during FY 2012 not exceed $1,865,775,164, or 2.2% of total assessed property value of $84,807,962,000.**

Figure 11. 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 2011 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

Debt Service Guideline

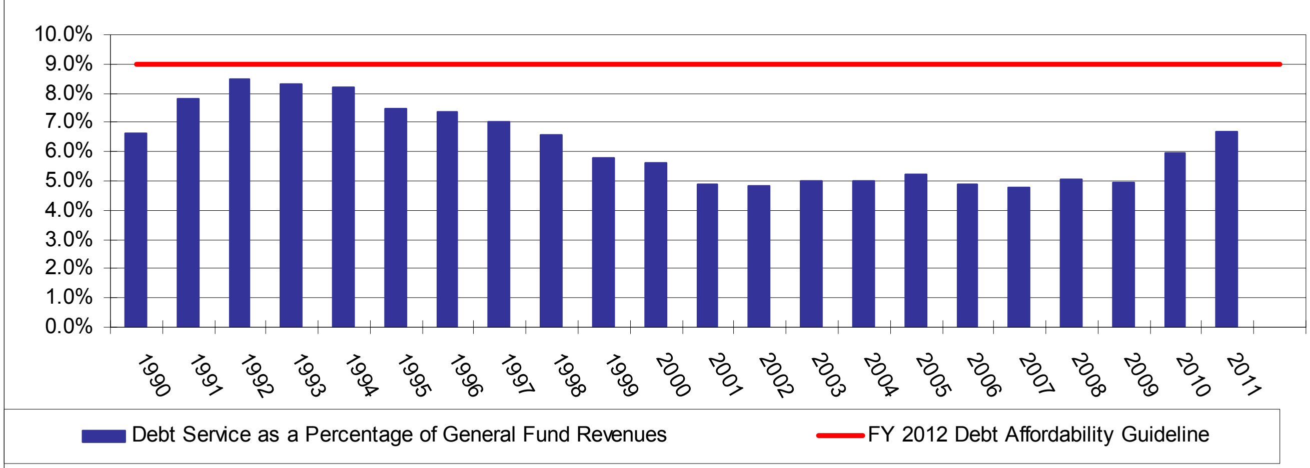
The Committee recommends that debt service not exceed 9% of total General Fund revenues.

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 2011, the amount spent or budgeted for debt service ranged from 4.8% to 8.5% of total General Fund revenues (Figure 12). The Committee has established a policy that debt service should not exceed 9% of total General Fund revenues. **Accordingly, for FY 2012, the Committee recommends that debt service expenditures not exceed $142.5 million based on projected revenues totaling $1,583.8 million.**

The recent rise in the ratio of debt service to total General Fund revenues reflects the challenging economic times, which have resulted in lesser availability of PAYGO funding and a lower General Fund revenues denominator.

The ratio of debt service to total General Fund revenues from FYs 1990 through 2011 is shown below in Figure 12. 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. Such PAYGO usage also allowed the ratio to remain steady, hovering at around 5%, from FY 2001 to FY 2009, despite an aggressive capital budget over that period. Most recently, during FY 2010 and FY 2011, the ratio has begun to rise, largely due to the challenging economic times, which have resulted in diminished General Fund revenues, and accordingly, less available PAYGO funding to offset the need for debt issuance.

Figure 12. 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 2011 ratio is an estimate.
Sources: Baltimore County Annual Budget Documents; Baltimore County Office of Budget and Finance; Baltimore County Office of the County Auditor