SPENDING
AFFORDABILITY
COMMITTEE

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Report of the Spending Affordability Committee

Fiscal Year 2015

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Baltimore County, Maryland

February 12, 2014

BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE

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Councilman, 1st District

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Councilman, 4th District

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SPENDING AFFORDABILITY COMMITTEE

February 12, 2014

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) 2015.

For FY 2015, the Committee recommends a base spending guideline of $1,749,369,880, derived from a personal income growth rate of 3.87%. This guideline represents maximum potential growth of $65,178,217 over estimated FY 2014 base spending. The Committee further recommends that total debt outstanding not exceed 2.5% of FY 2015 estimated assessed property value and that debt service not exceed 9.5% of FY 2015 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 its guidelines do not represent targets 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 disclosed continued signs of moderate economic growth in the areas of falling unemployment, increased housing activity, and modest gains in personal income. New development is occurring throughout the County; in Lansdowne, for example, a new 130,000-square-foot Kaiser Permanente medical center recently opened for business. The Committee is encouraged that national leaders have reached a budget agreement, ending years of fiscal uncertainty. This positive news is tempered somewhat by concerns that the economy has been underperforming; the Committee's economic consultant has observed that growth rates do not reflect the momentum one would expect by this point in an economic recovery and has warned of the possibility that the economy will not improve much beyond its current level of performance.

Ongoing County revenues are expected to be sufficient to fund ongoing expenses in both FY 2014 and FY 2015. However, the Committee is still aware that the County's General Fund operating budget is experiencing both cost pressures and revenue concerns. A particular area of cost pressure is spending on retirement benefits, which is expected to increase in FY 2015 as the County's share of teachers' pension costs climbs to $21 million (before reaching nearly $25 million in FY 2016 when the cost-sharing mandate is fully implemented). The cost of the County's Retirement System is also expected to be higher, as the System continues its recovery from the asset losses sustained during the recession. The annual required contribution for retiree health benefits, formally known as other post-employment benefits (OPEB), most likely will be fully funded in FY 2015 at an expected cost of $120 million. In addition, while the economy is growing modestly, there is concern on the revenue side, particularly due to stagnant property tax revenues. In the past, the County could rely on property tax revenue growth in excess of 4% due to the year-to-year smoothing effect of the Homestead Tax Credit Program (which limits the growth in a homeowner's tax bill for owner-occupied properties to 4% per year and delaying the effects of increased home values experienced during the housing boom on revenues). However, with the housing market downturn, the County's reassessments have shown declines, suppressing property tax revenue growth; the forecast for FY 2015 reflects only 0.5% growth over FY 2014 budgeted property tax revenues. Further, potential long-term fiscal effects of the County's changing demographics generate concern from both revenue and expenditure perspectives.

In addition to operating budget pressures, the County is faced with the prospect of approaching established debt guidelines in future years, a result of both increased capital projects debt and a lack of growth in the County's assessable base. The Committee's debt guidelines are intended to ensure that the County does not overextend itself and that the County maintains its coveted AAA bond rating, which enables borrowing at favorable interest rates. At the same time, meeting the County's infrastructure needs, particularly those pertaining to aging and overcrowded school facilities, is critical to local economic growth. The County Council shares the County Executive's desire to modernize and air condition our schools and to aggressively address school overcrowding in a fiscally prudent manner, and the legislative branch is aware that the primary means of financing such infrastructure needs is through borrowing. The County's debt consultant, Public Resources Advisory Group (PRAG), recently indicated in its analysis that an upward adjustment of the County's target and ceiling debt levels is warranted and would be in line with the policies and practices of other AAA counties. PRAG's recommendations are to increase the County's ceiling for debt as a percentage of the assessable base from 2.2% to 2.5% and to increase the County's ceiling for debt service as a percentage of General Fund revenues from 9.0% to 9.5%. The Administration has indicated that it is developing its FY 2015 capital budget and five-year program consistent with PRAG's recommendations. The Committee agrees that these changes are justified and voted to update its guidelines to be consistent with the debt consultant's recommendations. The Committee will continue to monitor the County's debt ratios, including its debt-to-personal-income ratio, which has risen above the consultant's recommended ceiling in recent years but has not resulted in a lack of compliance with Committee guidelines.

Even with a generally positive economic outlook and enhanced debt guidelines, the Committee advises that the County maintain its fiscally conservative budgeting practices, which have allowed property and income tax rates to hold steady – an achievement that many jurisdictions cannot claim. Fortunately, the County's surplus closed FY 2013 at its highest level ever and is expected by the end of FY 2014 to climb to $284 million, not including an additional $85 million in the County's Rainy Day account. These surplus funds provide the County with financial security as well as an opportunity to address one-time expenditures, such as PAYGO contributions to the capital budget and a one-time bonus of 3% for our dedicated County employees, who have not had a cost-of-living-adjustment since FY 2010. During our process this year, the Committee recognized that the 3% bonus that County employees are scheduled to receive in November 2014 is one-time in nature and therefore, at the discretion of the Administration to exclude from FY 2015 spending subject to the guideline. Great appreciation is due to County employees and labor unions for their cooperation and sacrifices over the years as the County has continued to address its cost pressures in a fiscally sound manner.

Since the Committee's most recent meeting in late January, the County has received reaffirmation of its coveted AAA-rated status from all three ratings agencies. For 25 years and 21 years, respectively, Baltimore County has avoided increases in its property tax and income tax rates. The County's workforce is reduced and at its lowest number of employees in 25 years. Meanwhile, the County's effectiveness at serving its citizens has continued to grow due to investments in technology and other efficiency improvements. The County is truly doing more with less, and for these accomplishments, I am thankful for County Administrative Officer Fred Homan, Budget and Finance Director Keith Dorsey, as well as County Executive Kevin Kamenetz, and our collaborative working relationship.

Legislative oversight is also critically important to ensuring efficient and effective governing. For their partnership in exercising oversight, and for their time and thoughtful contributions to the Committee's process this year, I would like to thank my fellow Councilmembers who served on the Committee, the Honorable Kenneth Oliver and the Honorable David Marks. I would also like to thank Edwin Crawford and Benjamin Brooks, who both brought new ideas and valuable perspective to the Committee. And, I commend County Auditor Lauren Smelkinson and her staff for both their year-round efforts to enable legislative oversight and their diligent staff support to the Committee.

I also would like to acknowledge the contribution of Mr. Anirban Basu, who again served the Committee both as its economic consultant and as the Chairman of the Baltimore County Economic Advisory Committee. Finally, many thanks to all members of the Baltimore County Economic Advisory Committee for volunteering their time and providing their insights on the pulse of the local economy.

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 2015.

Sincerely,

Tom Quirk
Chairman, Spending Affordability Committee
Councilman, 1st District

INTRODUCTION

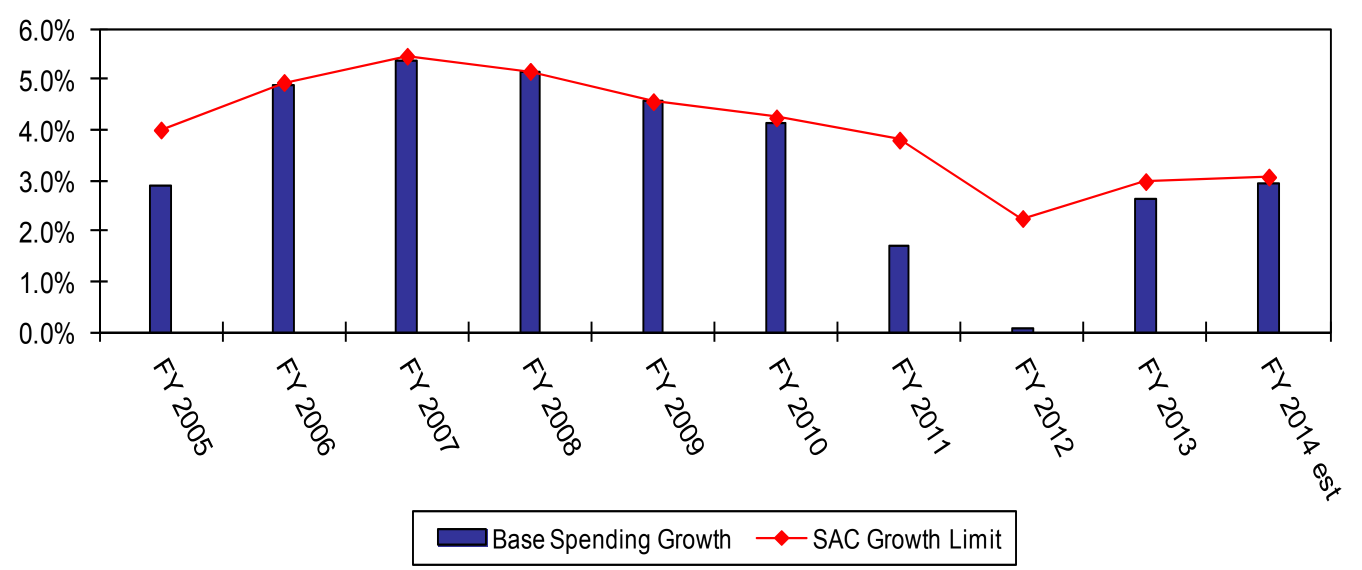
The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed the growth of the County's economy.

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 that base spending growth not exceed 3.87%, bringing the FY 2015 spending limit to $1,749.4 million.

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) 2015, the Committee recommends that base spending not exceed $1,749,369,880 based on an estimated County personal income growth rate of 3.87% applied to estimated final FY 2014 base-year spending of $1,684,191,663 (Figure 4). This guideline allows for maximum spending growth of $65,178,217 over estimated final FY 2014 spending.**

The Committee utilizes a 5-year average of annual personal income growth rates to determine 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. There are a number of long-term advantages associated with 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 utilizes an "estimated final spending" methodology to determine base-year spending.

Committee policy further provides 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. For the current fiscal year, no significant reductions in planned spending are anticipated, and the Administration has not suggested that any supplemental appropriations or future budget appropriation transfers are planned to affect FY 2014 base-year spending.

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.

The Committee recognized that the planned 3% bonus for County employees and any OPEB funding in excess of 80% of the ARC are excludable appropriations when determining budgetary compliance with the FY 2015 spending guideline.

During its deliberations, the Committee recognized that the 3% bonus that County employees are scheduled to receive in November 2014 is one-time in nature and therefore, at the discretion of the Administration to exclude from FY 2015 spending subject to the guideline. In addition, the Committee noted that should the County's FY 2015 budget include funding for its other post-employment benefits (OPEB) obligation in excess of 80% of the annual required contribution (ARC), the Committee's OPEB phase-in policy (Figure 3) would be triggered whereby any appropriations above 80% of the ARC could be excluded from FY 2015 spending subject to the guideline, also at the discretion of the Administration.

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
\- 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)

SPENDING POLICY RECOMMENDATIONS

Ongoing revenues should be sufficient to fund ongoing expenses in both FY 2014 and FY 2015; however, the Committee continues to urge fiscal restraint due to significant cost pressures and revenue concerns.

The Committee has been informed that ongoing County revenues should be sufficient to fund ongoing expenses in both FY 2014 and FY 2015. The County's General Fund surplus, as projected, will stand at record high levels by the end of FY 2014, reaching more than 21% of budgeted FY 2014 revenues (more than 16% of budgeted FY 2014 revenues, when excluding the Rainy Day account). However, the Committee is still aware that the County's General Fund operating budget is experiencing both cost pressures and revenue concerns. A particular area of cost pressure is spending on retirement benefits, which is expected to increase in FY 2015 as the County's share of teachers' pension costs climbs to $21 million (before reaching nearly $25 million in FY 2016 when the cost-sharing mandate is fully implemented). The cost of the County's Retirement System is also expected to be higher, as the System continues its recovery from the asset losses experienced during the recession. The annual required contribution for retiree health benefits, formally known as other post-employment benefits (OPEB), is planned to be fully funded in FY 2015 at an expected cost of $120 million. The 3% bonus to County employees planned for November 2014 will be "one-time," as salary scales and pension benefits will not increase until FY 2016, when a 3% cost-of-living adjustment (COLA) takes effect. In addition, while the economy is growing modestly, there is concern on the revenue side, particularly due to stagnant property tax revenues. Further, potential long-term fiscal effects of the County's changing demographics generate concern from both revenue and expenditure perspectives, and the County's aging schools and other infrastructure benefit from PAYGO contributions of surplus funds to the capital budget. For these reasons, the Committee reaffirms its conservative fiscal policy recommendations, as follows:

The Committee recommends that the County maintain a sufficient reserve on hand in case an unexpected revenue shortfall occurs in FY 2015 or future years. The Committee also recommends that the County Executive avoid underfunding essential items and 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 occurs in FY 2015 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.

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 Federal or other restricted programs (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 is excludable from base spending.

Figure 4. FY 2015 Spending Guideline

FY 2014 Base Spending		
General Fund Appropriations	$	1,724,491,528
General Fund Supplemental Appropriations		-
		1,724,491,528
General Fund Exclusions:		
Local Matching Appropriations		
Local Matching Funds		(5,683,280)
Federal Restricted Funds		-
Capital Project Appropriations		
PAYGO		(26,560,079)
Reserve Fund Appropriations		
Contingency Reserve		(747,000)
One-Time-Only Appropriations		
Baltimore County Public Schools State-Approved One-Time Costs		(7,309,506)
OPEB Accrued Liability (OAL) Appropriations		
In Excess of Phase-In Amount		-
Total Exclusions		(40,299,865)
FY 2014 Base Spending		1,684,191,663
Personal Income Growth 5-Year Average	x	1.0387
FY 2015 Spending Guideline	$	1,749,369,880
Maximum Spending Growth	***$***	***65,178,217***

ECONOMIC GROWTH

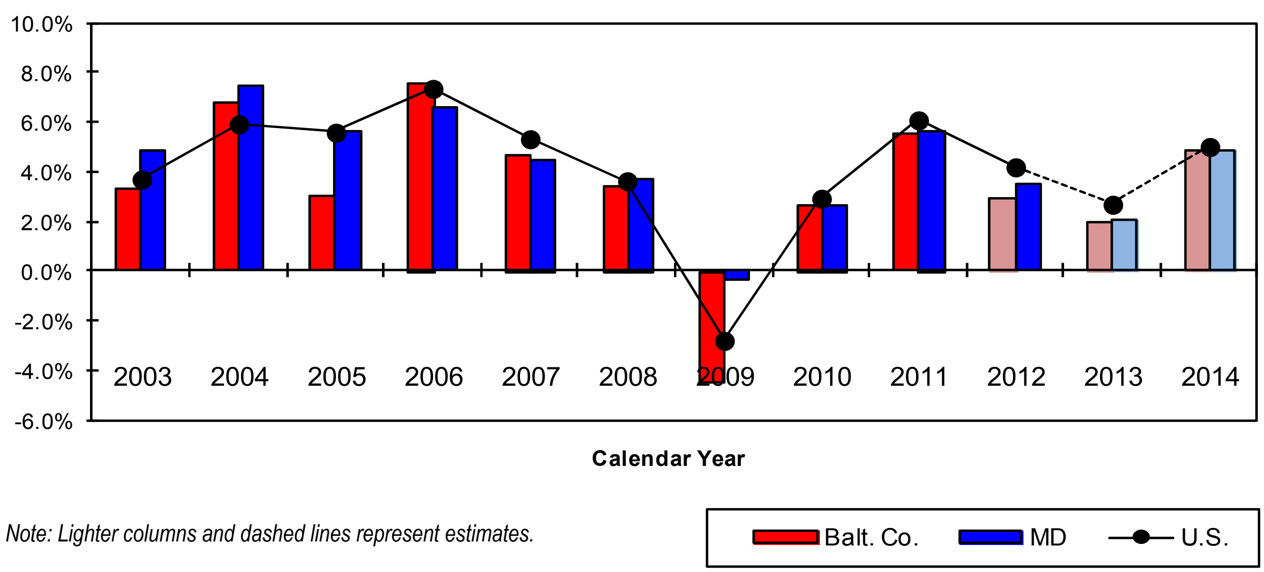
Personal income growth is expected to accelerate in FY 2015.

Prior to adopting its FY 2015 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, 2014, the consultant (Sage Policy Group, Inc.) predicts that Baltimore County personal income will grow 3.23% in FY 2014, which is 18 basis points below its Maryland FY 2014 personal income growth forecast of 3.41%. These rates are significantly less than the pre-recession 6.61% growth achieved in the County during FY 2007 but represent an acceleration from the estimated FY 2013 growth rate of 2.16%. For FY 2015, the consultant predicts higher growth in both the State (5.05%) and the County (4.96%), a shrinking difference of only 9 basis points. Over the 2003 to 2013 period, estimated County personal income increased at an average annual rate of 3.4%, compared to 4.2% and 4.1% in Maryland and the U.S., respectively (Figure 5).

In light of the mostly positive performance among various local economic indicators, Baltimore County Economic Advisory Committee members expressed increased optimism for CY 2015.

The January 13, 2014 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 grow modestly through CY 2014 and expressed greater optimism towards accelerated growth for CY 2015. The panel reported positive signs from the labor market and stated that companies are again converting temporary workers to full-time employees. Further, the County added 11,700 jobs during the first half of 2013. However, the panel reported that wage growth has not kept pace with employment gains and long-term unemployment remains stubbornly high. The manufacturing representative reported uneven activity with spurts of strong growth turning sluggish in recent months, while the retail representative reported a strong holiday season. On the residential housing side, sales activity continues to show strong growth countywide, although results by neighborhoods and zip codes differ significantly. Inventory and the absorption rate (number of days on market) remain low, which positions the market for price gains in CY 2014. Commercial real estate has also been showing modest improvement.

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



Note: Lighter columns and dashed lines represent estimates.

Estimate Source: Sage Policy Group, Inc., January 2014

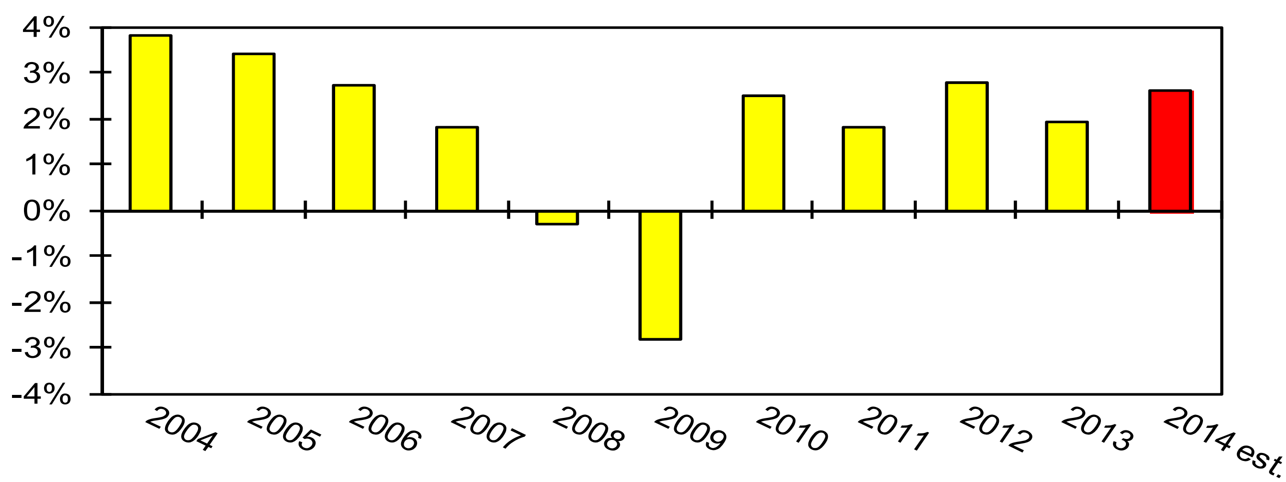
Real Gross Domestic Product (GDP) grew at an average annual rate of 1.8% from CY 2004 to CY 2013. For CY 2014, real GDP is expected to increase by 2.6%.

Projections for the local economy are influenced, to a large degree, by the underlying performance of the national and state economies. The National Bureau of Economic Research determined that the recent U.S. recession ended in June 2009. While the economy continues to expand, many sectors are performing below pre-recession levels. In addition, the labor market and household spending are performing below expectations for this stage of post-recession recovery. Further, the contraction of federal spending will continue to be a source of concern, particularly in this region; however, the recently reached 2-year budget agreement provides some assurance for the near future. Real Gross Domestic Product (GDP) is projected to increase by 2.6% in CY 2014, according to the Federal Reserve Bank of Philadelphia's November 2013 *Survey of Professional Forecasters*, despite more upbeat growth of 4.1% and 3.2% in 2013:Q3 and 2013:Q4, respectively, which seemed to offer optimism that economic performance may be reaching expected levels. Still, CY 2014 is expected to mark the fifth consecutive yearly increase in GDP, following growth of 2.8% in CY 2012 and 1.9% in CY 2013. Over the last decade, real GDP grew by an average of 1.8% annually from CY 2004 to CY 2013, including contractions of 0.3% in CY 2008 and 2.8% in CY 2009 (Figure 6).

Local employment figures have surpassed pre-recession levels. Employment growth, however, continues to lag.

Employment increased by 0.8% among Baltimore County residents, by 0.3% among Maryland residents, and by 1.6% nationally on an annual average basis from CY 2012 to CY 2013—a fourth consecutive increase for the County and the State and the third consecutive increase for the nation. County employment figures have surpassed pre-recession levels; however, unemployment remains well above pre-recession levels, with only moderate improvement expected during CY 2014. Baltimore County's and Maryland's December 2013 unemployment rates were 5.9% and 5.7%, respectively, and averaged 7.0% and 6.6%, respectively, for all of CY 2013. Over the past 10 years, the annual unemployment rates in Baltimore County and Maryland were, on average, 120 and 130 basis points below the national rate, respectively. The *Survey of Professional Forecasters* projects a national unemployment rate of 7.0% in CY 2014 and 6.4% in CY 2015. If the trends between the national and local unemployment rates hold, Baltimore County's and Maryland's rates would fall to 5.8% and 5.7%, respectively, in CY 2014, 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 2013*

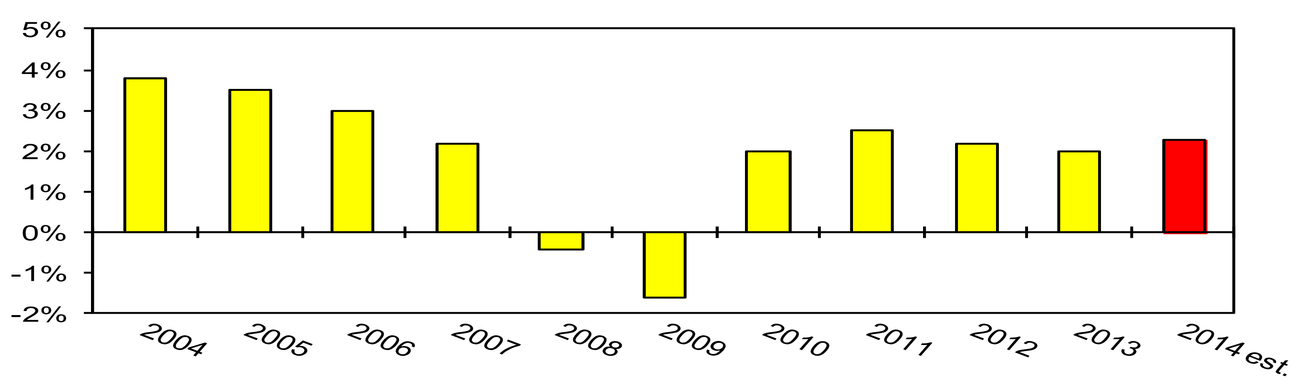
Consumer spending increased at a rate of 2.0% in CY 2013, the fourth consecutive annual increase following two annual declines.

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 2.0% in CY 2013, the fourth consecutive yearly increase, including a 3.3% increase in 2013:Q4. In December 2013, national unemployment reached its lowest level (6.7%) since October 2008, providing a potential 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 posted strong gains in December 2013 and January 2014, after falling in November 2013, with the "Present Situations Index" experiencing the bulk of the increase and the "Expectations Index" increasing by slightly less. The Conference Board signaled that consumers' view of current conditions continues to improve. Consumers view business conditions and the job market more favorably and expect their earnings to increase; however, they are somewhat mixed regarding the outlook for jobs. The Conference Board further noted that "confidence appears to be back on track and rising expectations suggest the economy may pick up some momentum in the months ahead."

Most economic indicators have begun to trend consistently in a positive direction, leading to increased optimism for improved performance in late CY 2014 and early CY 2015.

The national economy's most significant challenges in the coming months are the persistently high unemployment rate and the persistently slower-than-expected growth in many sectors. Forecasters participating in the Federal Reserve Bank of Philadelphia's November 2013 *Survey of Professional Forecasters* project 7.0% unemployment during CY 2014, much lower than the 26-year unemployment high of 10.0% in October 2009, but significantly higher than the pre-recession low of 4.4% in May 2007. Some economists caution that the decreasing unemployment rate may be due to workers dropping out of the labor force. The *Survey* anticipates continued tepid, but improved, growth in consumer spending and GDP in CY 2014 and future years. GDP growth is expected to reach 2.8% by CY 2015, compared to the 1.9% growth in CY 2013 and 2.6% expected growth in CY 2014. The Maryland and Baltimore County economies are likely to continue to recover slowly along with the national economy, with the biggest threat to the regional recovery being the potential of rising interest rates putting a damper on the housing market. In this regard, the Committee's consultant concluded in its January 2014 report that while Baltimore County will see some signs of economic recovery in 2014, the recovery will be far from robust.

Figure 7. Real Consumer Spending: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters, November 2013

GENERAL FUND REVENUES AND SURPLUS

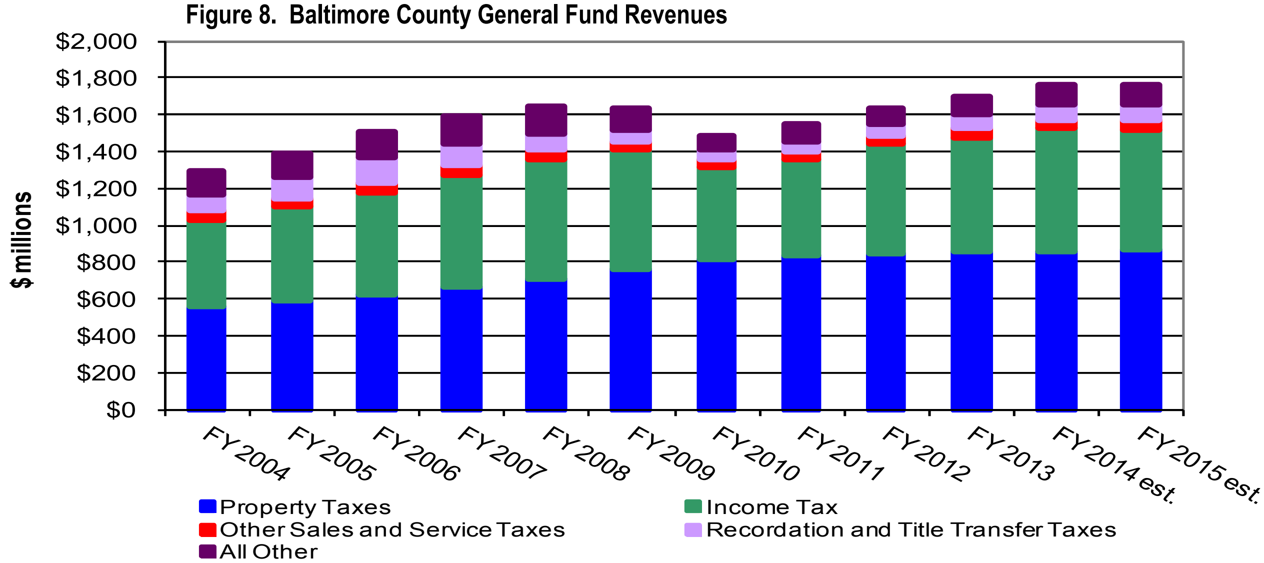
FY 2014 General Fund revenues are projected to increase by $57.5 million, or 3.4%, over FY 2013 totals. This projection is $74.3 million higher than current-year budgeted revenues.

FY 2014 projected revenues total $1,759.3 million, an increase of $57.5 million, or 3.4%, over FY 2013 revenues (Figures 8 and 9). This projection represents an increase of $74.3 million, or 4.4%, over FY 2014 budget estimates. The projected revenue increase primarily reflects the collection of a reconciling income tax distribution in November that was $29.1 million higher than the previous year, along with higher-than-anticipated income tax withholdings and estimated payments. While a large portion of the growth in income tax revenue is likely one-time, a significant component is likely ongoing, a result of the economic recovery. In addition, property-related transaction tax revenues (i.e., title transfer and recordation tax revenues) are showing continued growth due to increased home sales. Growth in property tax revenues has slowed significantly because of declining assessed values. Higher-than-anticipated revenue collections are expected to allow the County to finish FY 2014 without relying on the $39.5 million in surplus funds budgeted for use during the fiscal year.

FY 2015 General Fund revenues are projected to decrease by $2.8 million, or 0.2%, from the revised FY 2014 estimate.

FY 2015 General Fund revenues are projected to reach $1,756.5 million, down approximately $2.8 million, or 0.2%, from the revised FY 2014 revenue estimate but up $71.5 million, or 4.2%, over budgeted FY 2014 revenues. The slight decrease in FY 2015 General Fund revenues, the first revenue decline since FY 2010, is due to an anticipated decrease in income tax revenue. Income tax revenue in FY 2015, while expected to drop from current-year amounts due to the unlikelihood that such a high November distribution will recur, is forecast to be 5.0% greater than FY 2013 actual collections due to the continued economic recovery. Property tax revenues are expected to increase slightly due to the lingering positive effects of the Homestead Property Tax Credit that has buffered the revenue losses from falling assessments, and the State's recent reassessment of the County's central region that grew, albeit modestly. This reassessment is the first to reflect positive growth in four years. Property-related transaction tax revenues are expected to show modest gains from small but steady growth in both sales volume and prices. The State aid reductions implemented in recent years are generally expected to continue in FY 2015; however, the General Fund will continue to receive the $3.6 million in police aid restored last year and a $3 million payment instituted in FY 2013 to partially offset a portion of the teachers' pension costs transferred to the County.

Figure 8. Baltimore County General Fund Revenues



Sources: FY 2008 to FY 2013 Baltimore County Comprehensive Annual Financial Reports

Figure 9. General Fund Revenue Forecast, FY 2014-FY 2015 ($ Million)

REVENUE SOURCE	FY 2013 Actual	FY 2014 Budget	FY 13 - FY 14 Bud.	FY 2014 Revised	FY 13 - FY 14 Rev.	FY 2015 Estimate	FY 14 Bud.- FY 15	**FY 14 Rev.- FY 15**
Property taxes	$853.9	$860.1	0.7%	$854.0	0.0%	$864.5	0.5%	1.2%
Income taxes	624.1	604.3	-3.2%	672.8	7.8%	655.5	8.5%	-2.6%
Recordation & title transfer taxes	83.6	77.5	-7.3%	88.0	5.3%	91.0	17.4%	3.4%
Other Sales and Service taxes	44.5	42.6	-4.3%	44.5	0.0%	44.5	4.5%	0.0%
Intergovernmental aid	37.7	42.8	13.5%	42.2	11.9%	43.0	0.5%	1.9%
Service charges	10.4	10.9	4.8%	10.5	1.0%	10.5	-3.7%	0.0%
Licenses & permits	5.0	4.6	-8.0%	5.0	0.0%	5.0	8.7%	0.0%
Fines, forfeitures & penalties	4.8	4.6	-4.2%	4.8	0.0%	4.8	4.3%	0.0%
Interest on investments	1.3	1.4	7.7%	1.3	0.0%	1.5	7.1%	15.4%
Other	36.6	36.2	-1.1%	36.2	-1.1%	36.2	0.0%	0.0%
TOTAL	**$1,701.8**	**$1,685.0**	**-1.0%**	**$1,759.3**	**3.4%**	**$1,756.5**	**4.2%**	**-0.2%**

Note: Totals may not add due to rounding.

The FY 2015 revenue projection is approximately $7.1 million higher than the Committee's spending guideline.

The FY 2015 revenue projection is approximately $7.1 million higher than the Committee's FY 2015 spending guideline. The excess funds, together with the unassigned General Fund balance (surplus), can be used for spending not subject to the guideline, including local-share matching funds and one-time expenditures such as PAYGO contributions to the capital budget (which reduces programmed borrowing).

The FY 2013 surplus totaled $209.9 million, excluding $85.0 million in the RSRA.

As of June 30, 2013, the surplus totaled $209.9 million, or 12.2% of the FY 2014 General Fund budget. This amount does not include $85.0 million in the Revenue Stabilization Reserve Account (RSRA). In addition, $39.5 million of surplus was assigned as a source of funding for the FY 2014 budget.

The FY 2014 surplus is projected to total $284.0 million, excluding $85.2 million in the RSRA.

The projected June 30, 2014 surplus, assuming FY 2014 revenues of $1,759.3 million, totals $284.0 million, or 16.1% of projected FY 2014 revenues (Figure 10). This amount does not include an estimated $85.2 million in the RSRA. The surplus will be available as a source of funding for the FY 2015 budget.

Figure 10. Estimated General Fund Surplus, FY 2014

($ in Millions)

FY 2013 General Fund Surplus (excluding RSRA funds)		**$ 209.9**
FY 2014 Revenue Estimate (per Adopted Budget)	1,685.0	
FY 2014 Revision	74.3	
FY 2014 Revised Revenue Estimate	1,759.3	
FY 2013 General Fund Balance Designated to Fund FY 2014 Appropriations	39.5	
FY 2014 Total Funding		1,798.8
FY 2014 Adopted Budget		(1,724.5)
FY 2014 Interest Transfer to the RSRA		(0.2)
FY 2014 Estimated General Fund Surplus		**$ 284.0**

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.

The FY 2015 Committee voted to adopt new guidelines recommended by the County's debt consultant.

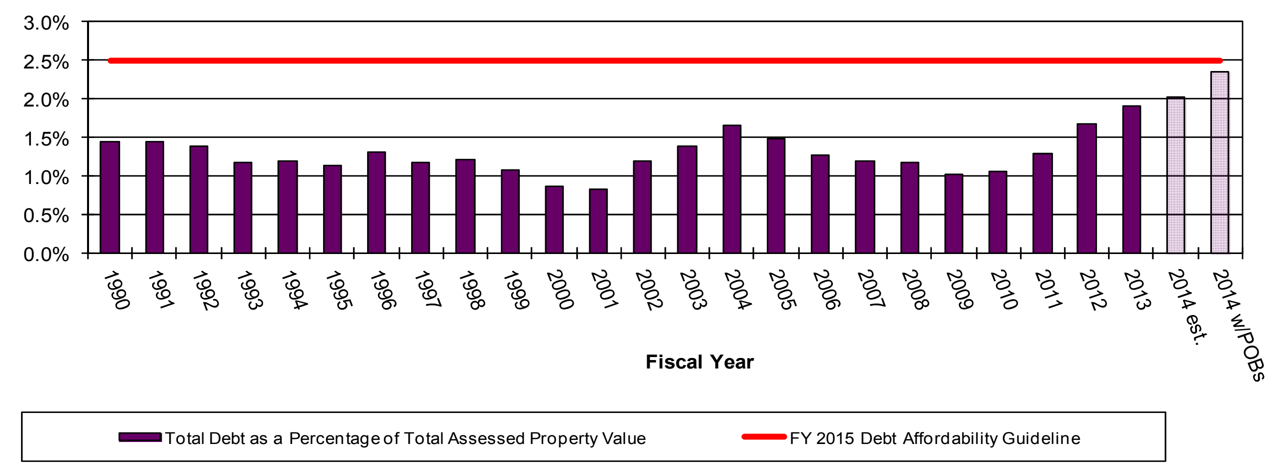
During this year's deliberations, the Administration shared a recommendation from the County's debt consultant, Public Resources Advisory Group (PRAG) that an upward adjustment of the debt guidelines is warranted and would be in line with other counties with AAA (highest possible) credit ratings. The Administration also indicated that the FY 2015 capital budget and five-year program would be structured according to the PRAG recommendation. The Committee agreed that the changes to the guidelines were both justified and necessary, and it voted to adopt PRAG's recommendation making its guidelines consistent with the Administration's. Accordingly, the Committee's guideline for total debt outstanding as a percentage of assessed property value increases from 2.2% to 2.5%, and its guideline for the County's level of debt service as a percentage of total General Fund revenues increases from 9.0% to 9.5%. Prior-year Committees adopted the former guidelines in FY 2007 and FY 2002, respectively.

Total Debt Outstanding Guideline

The Committee recommends that total debt outstanding not exceed $1,952,698,075, or 2.5% of total assessed property value of $78,107,923,000.

The ratio of total debt outstanding to total assessed property value is a measure of debt affordability. From FY 1990 to FY 2014, total debt outstanding has ranged from 0.8% (FY 2001) to 2.0% (FY 2014) of the County's total assessed property value (Figure 11). The total debt outstanding ratio has been rising since FY 2009 as the availability of General Fund PAYGO contributions to the capital budget has decreased and the assessable base has shrunk. As indicated previously, while in recent years the Committee's guideline was set at 2.2%, for FY 2015 the guideline is set at 2.5%. **Accordingly, the Committee recommends that total debt outstanding during FY 2015 not exceed $1,952,698,075, or 2.5% of total assessed property value of $78,107,923,000.**

Figure 11. Total Debt Outstanding as a Percentage of Total Assessed Property Value



Note: Excludes debt related to pension obligation bonds (POBs), metropolitan district bonds, and component unit capital leases not budgeted under Primary Government except for FY 2014, which is shown with and without POBs, which were issued in both FY 1988 and FY 2013. FY 2014 debt outstanding is an estimate. *Sources: Baltimore County Annual Budget Documents; Baltimore County Office of Budget and Finance; Baltimore County Office of the County Auditor.*

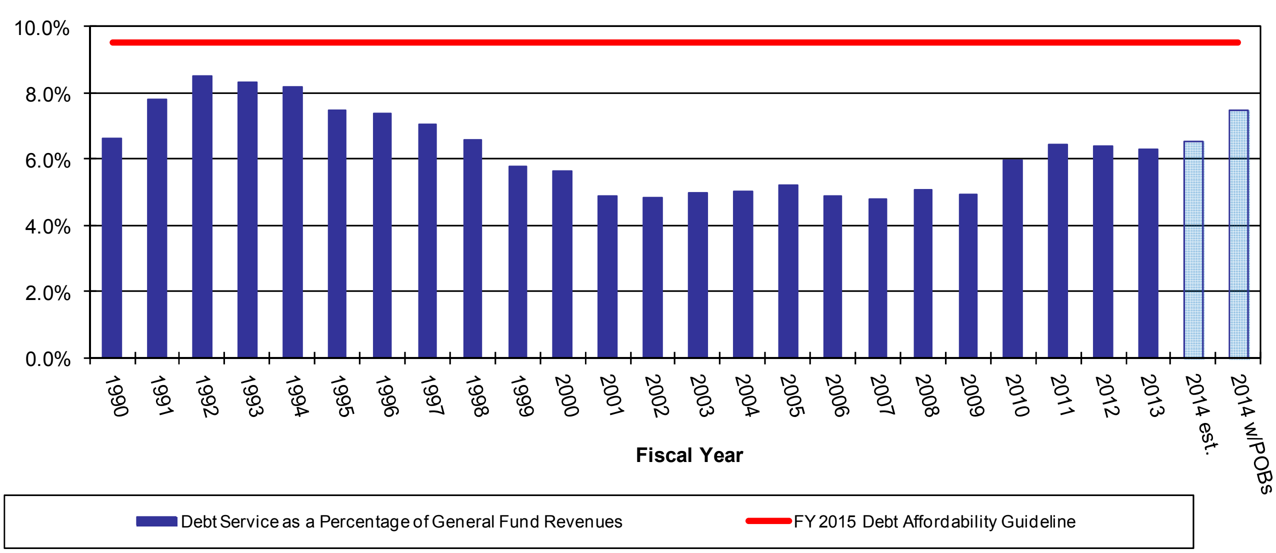
Debt Service Guideline

The Committee recommends that debt service not exceed $166.9 million, or 9.5% of projected revenues totaling $1,756.5 million.

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. From FY 1990 to FY 2014, the amount spent or budgeted for debt service ranged from 4.8% to 8.5% of total General Fund revenues (Figure 12). As indicated previously, while in recent years the Committee's guideline was set at 9.0%, for FY 2015 the Committee guideline is set at 9.5%. **Accordingly, for FY 2015, the Committee recommends that debt service expenditures not exceed $166.9 million based on projected revenues totaling $1,756.5 million.**

The ratio of debt service to total General Fund revenues from FY 1990 to FY 2014 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 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. In recent years the ratio has been rising, 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. The Committee is also aware that budgeted debt service in recent years has not reflected the full amount of the County's debt service cost due to the use of bond premium funds to pay interest costs, which occurs off budget.

Figure 12. Debt Service as a Percentage of Total General Fund Revenues



Note: Excludes debt service related to pension obligation bonds (POBs), metropolitan district bonds, and component unit capital leases not budgeted under Primary Government except for FY 2014, which is shown with and without POBs issued in both FY 1988 and FY 2013. FY 2014 ratio is an estimate. *Sources: Baltimore County Annual Budget Documents; Baltimore County Office of Budget and Finance; Baltimore County Office of the County Auditor.*