SPENDING AFFORDABILITY COMMITTEE

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Report of the Spending Affordability Committee

Fiscal Year 2016

Baltimore County, Maryland

February 13, 2015

BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE

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Councilman, 4th District

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SPENDING AFFORDABILITY COMMITTEE

February 13, 2015

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) 2016.

For FY 2016, the Committee recommends a base spending guideline of $1,810,276,036, derived from a personal income growth rate of 3.50%. This guideline represents maximum potential growth of $61,217,064 over estimated FY 2015 base spending. The Committee further recommends that total debt outstanding not exceed 2.5% of FY 2016 estimated assessed property value and that debt service not exceed 9.5% of FY 2016 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 modest economic growth in the areas of employment, housing activity, and personal income. Development continues to sprout throughout the County, and consumers have shown optimism as gas prices have fallen, yielding more disposable income. This positive news is tempered by an awareness that the economy has been underperforming; growth rates do not reflect the momentum one would expect by this point in an economic recovery. Moreover, the Committee's consultant has noted that the County economy would be directly affected by State government downsizing, similar to how the County economic indicators reflect any contractions in federal government activity. With the Maryland General Assembly presently considering Governor Hogan's first State budget proposal, county governments are keenly aware of the potentially significant impact of the proposed reductions to State aid. Under the proposed State budget, according to the State Department of Legislative Services, Baltimore County would see $18.5 million in reductions from current law funding levels. Other jurisdictions (e.g., Baltimore City) are more severely impacted by proposed budget reductions, and the possibility exists that the General Assembly will make modifications to restore some aid to those jurisdictions, which could increase the Baltimore County impact. Although the County's General Fund is not directly affected by many of these reductions (such as formula aid to BCPS and Program Open Space reductions), the Committee is aware of the indirect effect of such reductions; as restricted programs are reduced, a greater burden can fall on the General Fund to maintain current service levels. Accordingly, the Committee urges the County Executive to be especially cautious in making new General Fund commitments in the months to come.

Taking these concerns into account, Committee staff developed its usual conservative revenue forecast for the current and upcoming fiscal years, projecting that ongoing County revenues will be sufficient to fund ongoing expenses in both FY 2015 and FY 2016, even when considering the County's plans to fund a 5% cost-of-living adjustment (COLA) for teachers and principals and a 3% COLA for all other employees. This year's Committee was unanimous in its approval of a guideline phase-in of the FY 2016 employee COLA cost. The Committee is keenly aware that County employees, including teachers and police officers, have experienced no COLA since January of 2010, despite the fact that the cost of funding a COLA would have been affordable, falling under the spending guideline, in prior years. In order to ensure that funding the planned FY 2016 COLA would not jeopardize the County's ability to meet its other base spending obligations, which potentially could include new spending obligations mandated by the State, the Committee sought to provide additional budget flexibility for FY 2016 and approved a four-year phase-in of the estimated $52 million COLA cost under the spending guideline. For FY 2016, at least 25% of the COLA cost, or $13 million, must fall within the spending guideline to ensure budgetary compliance with the Committee's recommendation. For FY 2017, at least 50% of the FY 2016 COLA cost, or $26 million, must fall within the guideline; for FY 2018, at least 75%, or $39 million, must fall within the guideline; and by FY 2019, before the budget is passed onto the next elected County Executive, the full cost of the FY 2016 COLA must fall within the guideline. We expect that this flexibility over the current term will be sufficient to meet the County's needs, and we plan to reevaluate available revenues and surplus levels each year to ensure that this approach remains prudent.

After modifying debt affordability policies last year, the Committee maintained those policies for FY 2016. Specifically, the Committee recommends that total debt outstanding during FY 2016 not exceed 2.5% of total assessed property value of $79,237,782,000, or $1,980,944,550, and that debt service expenditures not exceed 9.5% of General Fund revenues, or $173.9 million based on projected revenues totaling $1,830.6 million. These ratios are consistent with the "ceiling" recommendations of the County's debt consultant, as set forth in its report dated January 23, 2015. The Committee is cognizant that the County's debt service to revenues ratio, excluding debt service related to pension obligation bonds, is projected to approach the "ceiling" level by 2018. Accordingly, the Committee continues to advise that the County maintain its fiscally conservative budgeting practices. Such fiscal prudence has allowed property and income tax rates to hold steady for 26 years and 22 years, respectively—an achievement that many jurisdictions cannot claim—and has resulted in the County's recently reaffirmed AAA rating from all three bond rating agencies.

For the County's financial accomplishments, I am appreciative of County Administrative Officer Fred Homan, Budget and Finance Director Keith Dorsey, as well as County Executive Kevin Kamenetz, and our collaborative working relationship. For their partnership in exercising legislative 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 David Marks and the Honorable Julian Jones. I would also like to thank Mr. Edwin Crawford and Mr. Robert Johnson, who both brought valuable perspective to the Committee. And, I especially appreciate the diligent staff support provided by the Office of the County Auditor.

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 2016.

Sincerely,

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

INTRODUCTION

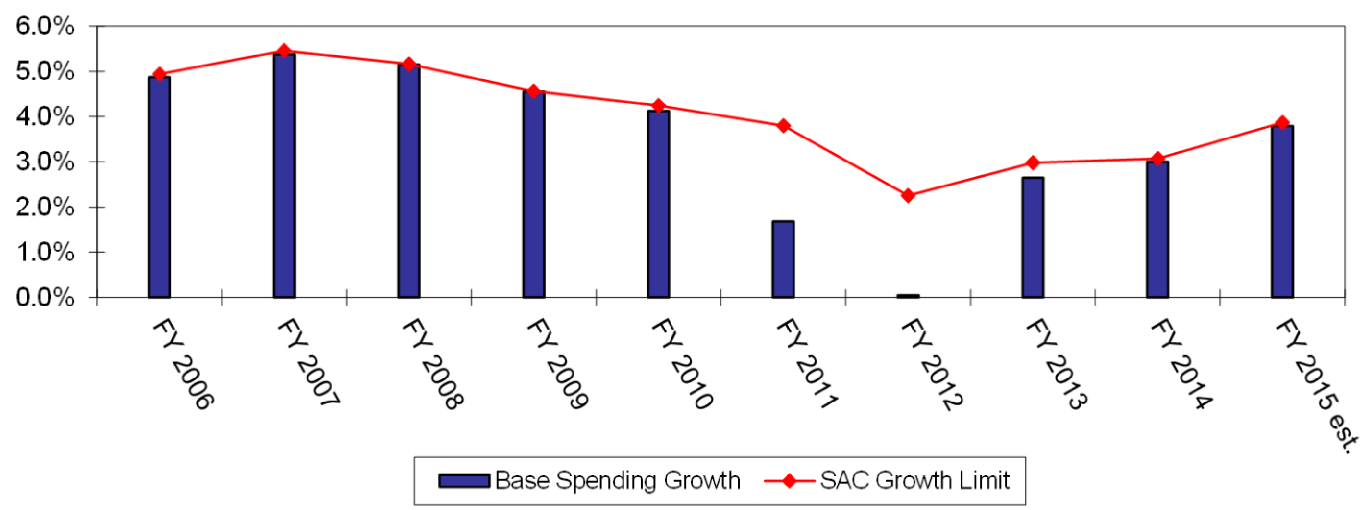
The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed the growth of the County's economy.

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 3.50%, bringing the FY 2016 spending limit to $1,810.3 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) 2016, the Committee recommends that base spending not exceed $1,810,276,036 based on an estimated County personal income growth rate of 3.50% applied to estimated final FY 2015 base-year spending of $1,749,058,972 (Figure 4). This guideline allows for maximum spending growth of $61,217,064 over estimated final FY 2015 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 smooths 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. Two supplemental appropriations totaling $2,637,589 were enacted after the budget was adopted, and planned spending will be increased by these supplemental appropriations.

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 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 approved a 4-year phase-in of the planned FY 2016 COLA. Both the cost of the COLA in excess of the phase-in amount and any OPEB funding in excess of 90% of the ARC are excludable appropriations when determining budgetary compliance with the FY 2016 spending guideline.

During its deliberations, the FY 2016 Committee recognized that while an employee cost-of-living adjustment (COLA) would have been affordable under the FY 2012 spending guideline, the County instead focused on ensuring budget stability. Since that time, surplus has grown significantly and revenues have fully recovered. In light of these factors, recognition of the planned FY 2016 COLA for County government and component unit employees will be phased-in over 4 years, in 25% increments, until the full amount is recognized by FY 2019 (Figure 3). The cost of the COLA in excess of the phase-in amount is excludable from base spending at the discretion of the Administration. In addition, the Committee noted that should the County's FY 2016 budget include funding for its other post-employment benefits (OPEB) obligation in excess of 90% of the annual required contribution (ARC), the Committee's OPEB phase-in policy (Figure 3) would be triggered whereby any appropriations above 90% of the ARC could be excluded from FY 2016 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 2015 and FY 2016; 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 2015 and FY 2016. The County's General Fund surplus, as projected, will exceed 16% of budgeted revenues by the end of FY 2015 (more than 11% of budgeted FY 2015 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 2016 as the County's share of teachers' pension costs climbs to nearly $30 million with the full implementation of the cost-sharing mandate. 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 and continues to bear the increased cost of lowering its assumed rate of return on investments. The annual required contribution (ARC) for retiree health benefits, formally known as other post-employment benefits (OPEB), is fully funded in FY 2015. While the most recent actuarial valuation of the County's OPEB costs yields a slightly reduced ARC for FY 2016, this significant cost pressure is only expected to increase over time. The planned FY 2016 employee cost-of-living adjustment (COLA) also represents an on-going cost pressure. In addition, while the economy is growing modestly, there is concern on the revenue side, particularly in light of the State's current fiscal challenges. Further, potential long-term fiscal effects of the County's changing demographics generate concern from both revenue and expenditure perspectives. 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 2016 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 2016 or future years. Accordingly, the Committee endorses the Administration's adopted policy of striving to produce an unreserved General Fund balance (surplus) near 8% 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 annual required contribution (ARC) 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.

Phase-In of COLA in Recognition of Fiscal Responsibility:

- An employee cost-of-living adjustment (COLA) would have been affordable under the FY 2012 spending guideline; however, the County instead focused on implementing cost-saving measures and ensuring future budget stability over the FY 2012 - FY 2015 period. During that time, surplus has grown to historically high levels, and revenues have fully recovered. In light of these factors, recognition of the planned FY 2016 COLA for County government and component unit employees will be phased-in over 4 years, in 25% increments, until the full amount is recognized by FY 2019. The cost of the COLA in excess of the phase-in amount is excludable from base spending.

Figure 4. FY 2016 Spending Guideline

FY 2015 Base Spending		
General Fund Appropriations	$	1,862,304,046
General Fund Supplemental Appropriations		2,637,589
Estimated Final Spending		1,864,941,635
General Fund Exclusions:		
Local Matching Appropriations		
Local Matching Funds		(6,053,080)
Capital Project Appropriations		
PAYGO		(51,223,665)
Reserve Fund Appropriations		
Contingency Reserve		(1,000,000)
One-Time-Only Appropriations		
3% Employee Bonus		(39,944,384)
Fire and Corrections Employee Bonus		(93,972)
Excluded OPEB Appropriations (Phase-In, Year 8)		(5,667,200)
Baltimore County Public Schools State-Approved One-Time Costs		(11,900,362)
Total Exclusions		(115,882,663)
FY 2015 Base Spending		1,749,058,972
Personal Income Growth 5-Year Average	x	1.0350
FY 2016 Spending Guideline	$	1,810,276,036
Maximum Spending Growth	***$***	***61,217,064***

Calculation of the FY 2016 COLA Phase-In Amount

FY 2016 is the first year of a 4-year phase-in for recognizing FY 2016 COLA growth under the guideline; at least 25% of the FY 2016 amount budgeted for employee COLAs shall be considered spending subject to the FY 2016 guideline. Thus, a FY 2016 COLA totaling $52 million would result in a minimum FY 2016 COLA phase-in amount of $13 million.

Calculation of the FY 2016 OPEB Phase-In Amount

FY 2016 is the ninth year of the 10-year phase-in period for recognizing OPEB funding under the spending guideline; at least 90% of the annual required contribution (ARC) shall be considered spending subject to the guideline. If FY 2016 General Fund OPEB appropriations are less than the 90% phase-in amount, the entire amount appropriated for OPEB shall be included in spending subject to the guideline. Thus, a FY 2016 OPEB ARC of $106.3 million would result in a minimum FY 2016 OPEB phase-in amount of $95.7 million.

ECONOMIC GROWTH

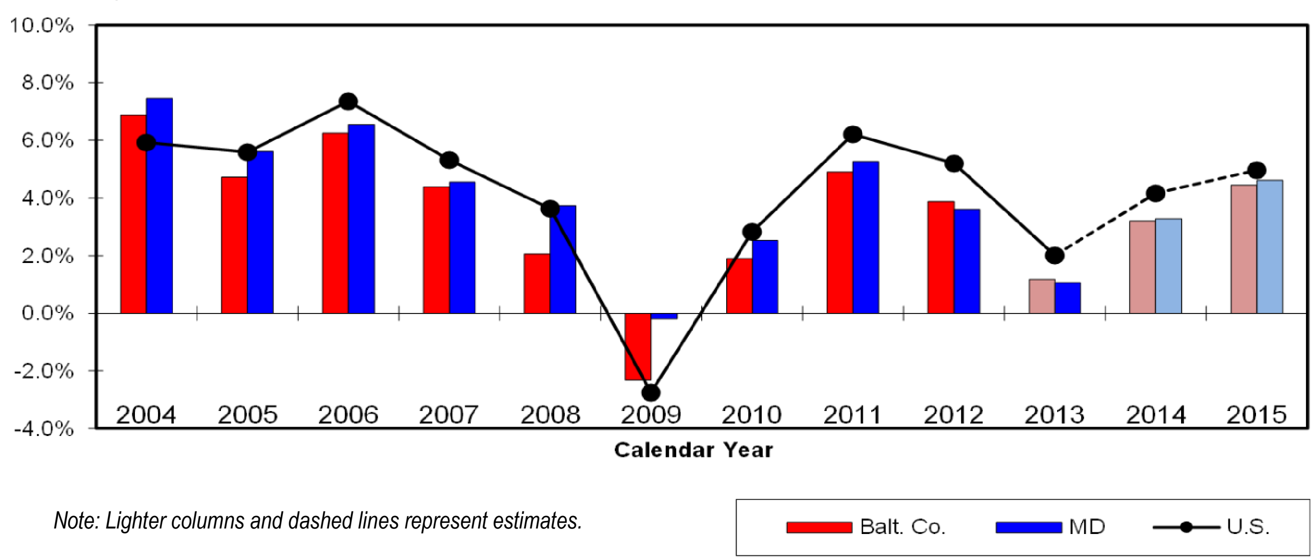
Personal income growth is expected to accelerate in FY 2016.

Prior to adopting its FY 2016 personal income growth rate, the Committee reviewed current and projected economic conditions to gain an understanding of the basis for the personal income estimates and forecast of its consultant (Sage Policy Group, Inc.). In its report dated January 15, 2015, the consultant predicts that Baltimore County personal income will grow 4.16% in FY 2015, which is 5 basis points below its Maryland FY 2015 personal income growth forecast of 4.21%. These rates remain less than the pre-recession 5.85% growth achieved in the County during FY 2006 but represent a significant acceleration from the estimated FY 2014 growth rate of 1.46%. For FY 2016, the consultant predicts higher growth in both the State (4.93%) and the County (4.79%), with State growth exceeding County growth by 14 basis points. Over the 2004 to 2014 period, estimated County personal income increased at an average annual rate of 3.5%, compared to 4.1% in both Maryland and the U.S. (Figure 5).

In light of the mostly positive performance among various local economic indicators, Baltimore County Economic Advisory Committee members predict modest growth for CY 2015.

The January 14, 2015 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 2015, with some sector representatives expressing optimism for accelerated growth. The panel reported positive signs from the labor market and stated that companies seem more willing to invest in employees and are converting temporary workers to full-time employees. However, it was noted that wages have seen little improvement since the recession and that the labor force, particularly the male component, continues to decline. The retail representative was upbeat in reporting a flat performance in 2014 compared to 2013 for his store's sales of luxury goods, and the panel observed that many retailers have bounced back from the recession and are doing well. 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, and first-time home buyers have finally reemerged as an active force in the County. Commercial real estate has also been showing modest improvement, with flattening available inventory leading to higher rents.

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



Note: Lighter columns and dashed lines represent estimates.

Estimate Source: Sage Policy Group, Inc., January 2015

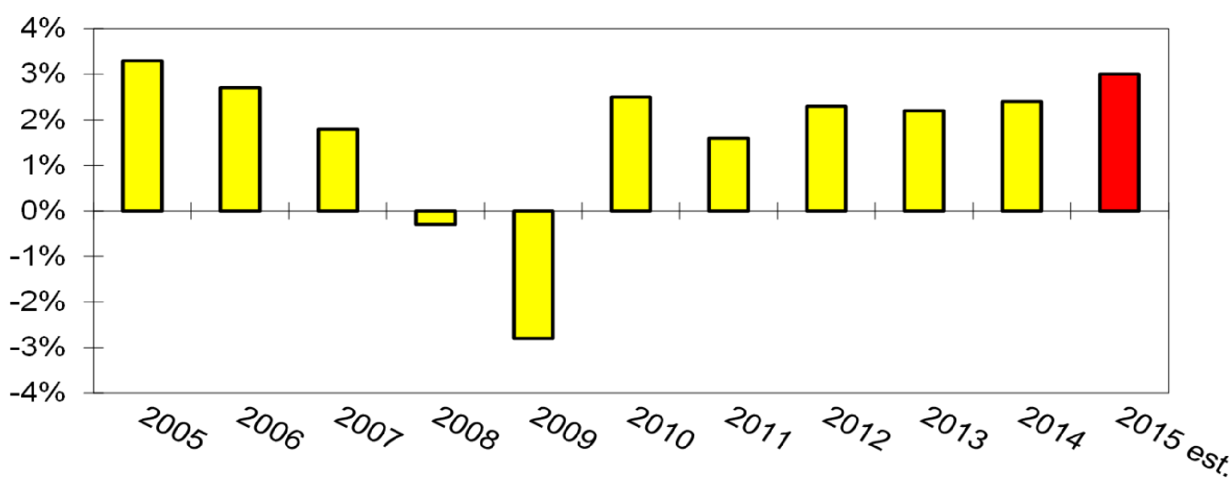
Real Gross Domestic Product (GDP) grew at an average annual rate of 1.6% from CY 2005 to CY 2014. For CY 2015, real GDP is expected to increase by 3.0%.

Projections for the local economy are influenced, to a large degree, by the underlying performance of the national and state economies. While the economy continues to expand following the recent recession, many sectors are still performing below pre-recession levels. In addition, while the national labor market seems to be rebounding, the regional labor market is performing below expectations for this stage of post-recession recovery. The continued slow job growth in the region is due in part to the contraction of federal spending that has been seen over the last 4 years. Federal fiscal challenges are expected to remain a source of concern in the near term. Real Gross Domestic Product (GDP) is projected to increase by 3.0% in CY 2015, according to the Federal Reserve Bank of Philadelphia's November 2014 *Survey of Professional Forecasters*, despite upbeat growth in the last three quarters of CY 2014, due not only to federal fiscal concerns but also the potential for slower export growth and diminished capital investment by the U.S. energy sector. Still, CY 2015 is expected to mark the sixth consecutive yearly increase in GDP, following growth of 2.2% in CY 2013 and 2.4% in CY 2014. Over the last decade, real GDP grew by an average of 1.6% annually from CY 2005 to CY 2014, including contractions of -0.3% in CY 2008 and -2.8% in CY 2009 (Figure 6).

Employment growth in the State and County continues to lag that of the nation, and unemployment rates remain high.

Employment increased by 0.5% among Baltimore County residents, by 0.1% among Maryland residents, and by 1.9% nationally on an annual average basis from CY 2013 to CY 2014—the fifth consecutive increase for the County and the State and the fourth consecutive increase for the nation. Employment growth in the State and County has lagged that of the nation over the last 2 years, and regional unemployment rates remain well above pre-recession levels, with only moderate job gains expected during CY 2015. Baltimore County's and Maryland's unemployment rates were 5.4% and 5.3%, respectively, in December 2014 and averaged 6.0% and 5.8%, respectively, for all of CY 2014. For CY 2015, Sage Policy Group, Inc. predicts that County employment will grow 0.7%, compared to population growth of 0.4%. The expectation that County employment growth will exceed population growth is a positive sign for the local economy and should yield further declines in the unemployment rate. In Maryland, employment growth is expected to be slightly slower than population growth in CY 2015.

Figure 6. Real Gross Domestic Product: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters*, November 2014*

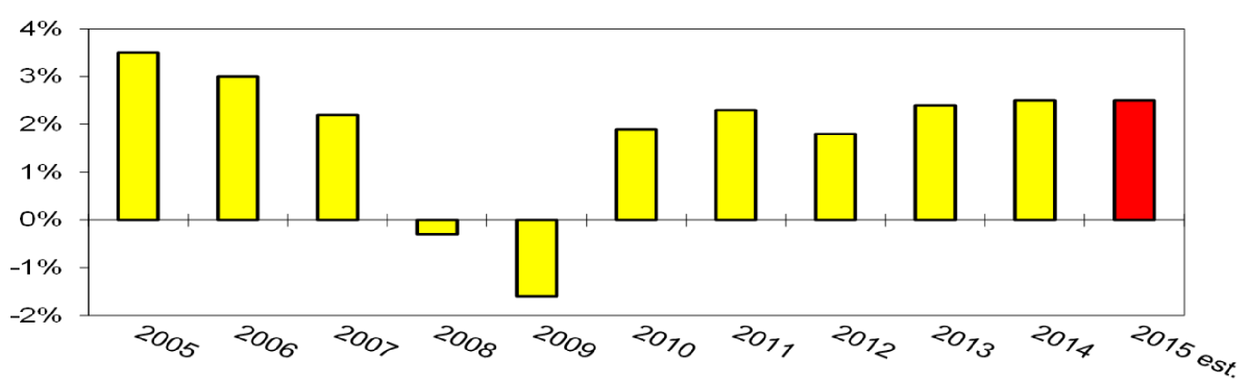
Consumer spending increased at a rate of 2.5% in CY 2014, the fifth consecutive annual increase following two annual declines.

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 2.5% in CY 2014, the fifth consecutive yearly increase, with a 4.3% increase in 2014:Q4. In December 2014, national unemployment reached its lowest level (5.6%) since May 2008, which, combined with rapidly falling gasoline prices, provides 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 increased sharply in January 2015 following an increase in December 2014, reaching its highest level since August 2007, with the "Present Situation 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 was much more favorable than in December 2014. Consumers provided a more positive assessment of current business and labor market conditions. The Conference Board further noted that "consumers also expressed a considerably higher degree of optimism regarding the short-term outlook for the economy and labor market, as well as their earnings."

Most economic indicators are continuing to show positive gains, leading to increased optimism and expectations of improved performance in CY 2015.

The national economy's most significant challenges in the coming months are stagnant wage growth and adapting to headwinds from some sectors of the global economy. Forecasters participating in the Federal Reserve Bank of Philadelphia's November 2014 *Survey of Professional Forecasters* project 5.6% unemployment during CY 2015, down from 6.2% in CY 2014. Some economists caution that the decreasing unemployment rate may be due to workers dropping out of the labor force and note that increased employment isn't translating into meaningful wage growth. The *Survey* anticipates improved growth in consumer spending and GDP in CY 2015 and future years. GDP growth is expected to reach 3.0% during CY 2015, compared to 2.2% growth in CY 2013 and 2.4% growth in CY 2014. The Maryland and Baltimore County economies are likely to continue to expand modestly along with the national economy, with the biggest threats to the regional recovery being State budgetary pressures and lingering areas of high REO/foreclosure activity putting a damper on the housing market. In this regard, the Committee's consultant concluded in its January 2015 report that while Baltimore County's economy will continue to improve in 2015, some momentum may be lost due to State spending cutbacks.

Figure 7. Real Consumer Spending: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters, November 2014

GENERAL FUND REVENUES AND SURPLUS

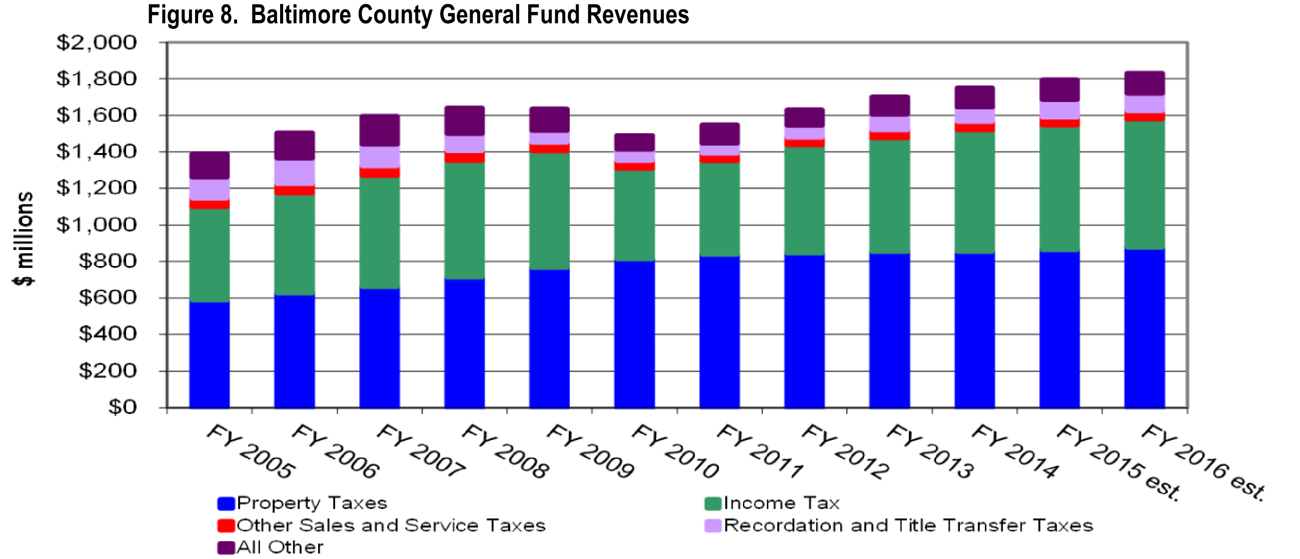
FY 2015 General Fund revenues are projected to increase by $43.7 million, or 2.5%, over FY 2014 totals. This projection is $9.6 million higher than current-year budgeted revenues.

FY 2015 projected revenues total $1,793.8 million, an increase of $43.7 million, or 2.5%, over FY 2014 revenues (Figures 8 and 9). This projection represents an increase of $9.6 million, or 0.5%, over FY 2015 budget estimates. The projected revenue increase primarily reflects the collection of a reconciling income tax distribution in November that was $12.3 million lower than the previous year, but $12.7 million more than anticipated, along with steady growth in income tax withholdings and estimated payments. This modest growth in income tax revenue is expected to continue, a result of continued economic recovery and positive indicators in the labor market. In addition, property-related transaction tax revenues (i.e., title transfer and recordation tax revenues) are showing continued growth due to increased home sales and rising prices. Growth in property tax revenues has slowed significantly because of minimal gains in assessed values. Slightly higher-than-anticipated revenue collections are expected to allow the County to finish FY 2015 utilizing less than the $78.1 million in surplus funds budgeted for use during the fiscal year.

FY 2016 General Fund revenues are projected to increase by $36.8 million, or 2.1%, from the revised FY 2015 estimate.

FY 2016 General Fund revenues are projected to reach $1,830.6 million, up approximately $36.8 million, or 2.1%, from the revised FY 2015 revenue estimate and up $46.4 million, or 2.6%, over budgeted FY 2015 revenues. The modest increase in FY 2016 General Fund revenues is due to the impact of a moderately expanding economy offset slightly by reductions to State aid. FY 2016 income tax revenue is forecast to be 5.0% greater than FY 2014 actual collections due to continued gains in the job market combined with anticipated modest gains in wage growth, which has been stagnant in recent years. Property tax revenues are expected to increase slightly due to the State's recent reassessment of the County's eastern region, which showed modest growth that was partially offset by an increase in Homestead Property Tax Credits. This reassessment is the second that has reflected positive growth following four years of decreases; however, there are still some areas where distressed properties are constraining growth. Property-related transaction tax revenues are expected to show modest gains from continued growth in both sales volume and prices. The State aid reductions implemented in recent years are expected to be compounded in FY 2016, with direct funding to Local Health and Police Aid reduced to FY 2014 levels.

Figure 8. Baltimore County General Fund Revenues



Sources: FY 2008 to FY 2014 Baltimore County Comprehensive Annual Financial Reports

Figure 9. General Fund Revenue Forecast, FY 2015-FY 2016 ($ Million)

REVENUE SOURCE	FY 2014 Actual	FY 2015 Budget	FY 14 - FY 15 Bud.	FY 2015 Revised	FY 14 - FY 15 Rev.	FY 2016 Estimate	FY 15 Bud.- FY 16	**FY 15 Rev.- FY 16**
Property taxes	$853.3	$866.9	1.6%	$865.0	1.4%	$878.8	1.4%	1.6%
Income taxes	667.9	687.8	3.0%	682.0	2.1%	702.0	2.1%	2.9%
Recordation & title transfer taxes	80.0	78.0	-2.5%	95.0	18.8%	97.7	25.3%	2.8%
Other Sales and Service taxes	44.4	43.6	-1.8%	44.4	0.0%	44.4	1.8%	0.0%
Intergovernmental aid	43.5	42.9	-1.4%	42.0	-3.4%	41.8	-2.6%	-0.5%
Service charges	11.1	11.5	3.6%	11.1	0.0%	11.5	0.0%	3.6%
Licenses & permits	4.9	4.9	0.0%	4.9	0.0%	5.0	2.0%	2.0%
Fines, forfeitures & penalties	5.1	4.9	-3.9%	5.1	0.0%	5.1	4.1%	0.0%
Interest on investments	1.0	0.6	-40.0%	1.0	0.0%	1.0	66.7%	0.0%
Other	38.9	43.2	11.1%	43.3	11.3%	43.3	0.2%	0.0%
TOTAL	**$1,750.1**	**$1,784.2**	**1.9%**	**$1,793.8**	**2.5%**	**$1,830.6**	**2.6%**	**2.1%**

Note: Totals may not add due to rounding.

The FY 2016 revenue projection is approximately $20.3 million higher than the Committee's spending guideline.

The FY 2016 revenue projection is approximately $20.3 million higher than the Committee's FY 2016 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 2014 surplus totaled $199.5 million, excluding $85.2 million in the RSRA.

As of June 30, 2014, the surplus totaled $199.5 million, or 10.7% of the FY 2015 General Fund budget. This amount does not include $85.2 million in the Revenue Stabilization Reserve Account (RSRA). In addition, $78.1 million of surplus was assigned as a source of funding for the FY 2015 budget.

The FY 2015 surplus is projected to total $206.7 million, excluding $87.6 million in the RSRA.

The projected June 30, 2015 surplus, assuming FY 2015 revenues of $1,793.8 million, totals $206.7 million, or 11.5% of projected FY 2015 revenues (Figure 10). This amount does not include an estimated $87.6 million in the RSRA. The surplus will be available as a source of funding for the FY 2016 budget.

Figure 10. Estimated General Fund Surplus, FY 2015

($ in Millions)

FY 2014 General Fund Surplus (excluding RSRA funds)		**$ 199.5**
FY 2015 Revenue Estimate (per Adopted Budget)	1,784.2	
FY 2015 Revision	9.6	
FY 2015 Revised Revenue Estimate	1,793.8	
FY 2014 General Fund Balance Designated to Fund FY 2015 Appropriations	78.1	
FY 2015 Total Funding		1,871.9
FY 2015 Adopted Budget		(1,862.3)
FY 2015 Interest Transfer to the RSRA		(2.4)
FY 2015 Estimated General Fund Surplus		**$ 206.7**

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 guidelines.

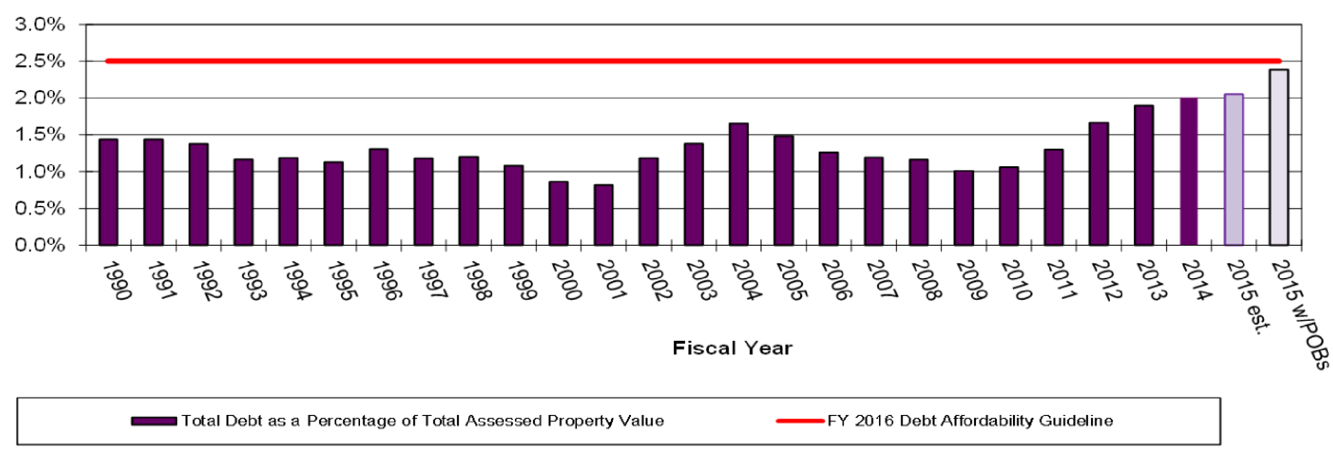
Beginning in FY 2015, the Committee raised its limitations on both guidelines based on a recommendation from the County's debt consultant, Public Resources Advisory Group (PRAG) that an upward adjustment was warranted and would be in line with other counties with AAA (highest possible) credit ratings. During this year's deliberations, the Committee did not consider any changes to its maximum recommended debt ratios.

Total Debt Outstanding Guideline

The Committee recommends that total debt outstanding not exceed $1,980,944,550, or 2.5% of total assessed property value of $79,237,782,000.

The ratio of total debt outstanding to total assessed property value is a measure of debt affordability. From FY 1990 to FY 2015, total debt outstanding has ranged from 0.8% (FY 2001) to 2.1% (FY 2015) 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. Beginning in FY 2015, the Committee raised its limitation on total debt outstanding from 2.2% to 2.5% of total assessed property value. **Accordingly, the Committee recommends that total debt outstanding during FY 2016 not exceed $1,980,944,550, or 2.5% of total assessed property value of $79,237,782,000.**

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 2015, which is shown with and without POBs, which were issued in both FY 1988 and FY 2013. FY 2015 debt outstanding is an estimate. *Sources: Baltimore County Comprehensive Annual Financial Reports; Baltimore County Office of Budget and Finance; Maryland State Department of Assessments and Taxation.*

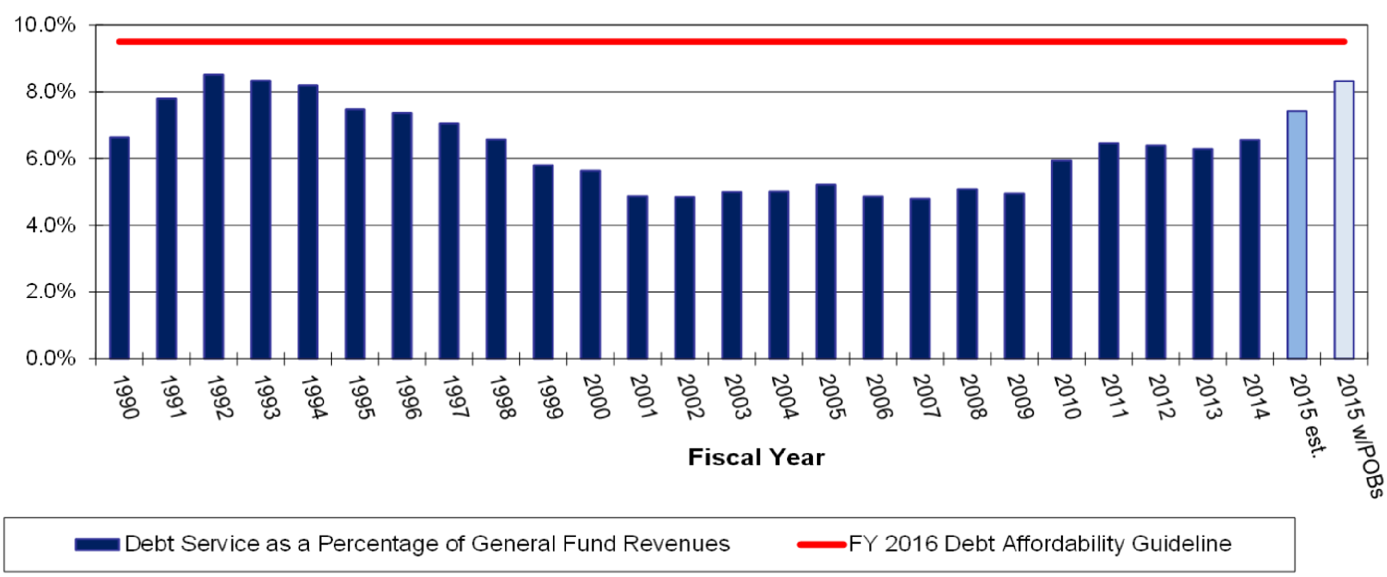
Debt Service Guideline

The Committee recommends that debt service not exceed $173.9 million, or 9.5% of projected revenues totaling $1,830.6 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 2015, the amount spent or budgeted for debt service ranged from 4.8% to 8.5% of total General Fund revenues (Figure 12). Beginning in FY 2015 the Committee raised its limitation on total debt service from 9.0% to 9.5% of total General Fund revenues. **Accordingly, for FY 2016, the Committee recommends that debt service expenditures not exceed $173.9 million based on projected revenues totaling $1,830.6 million.**

The ratio of debt service to total General Fund revenues from FY 1990 to FY 2015 is shown below in Figure 12. The decrease in this ratio, beginning in the mid-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, as increased debt issuance to finance capital projects, along with less available PAYGO, has resulted in additional debt and the associated debt service costs. 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 2015, which is shown with and without POBs issued in both FY 1988 and FY 2013. FY 2015 ratio is an estimate. *Sources: Baltimore County budget documents; Baltimore County Comprehensive Annual Financial Reports; Baltimore County Office of Budget and Finance; Baltimore County Office of the County Auditor.*