

SPENDING
AFFORDABILITY
COMMITTEE

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Report of the Spending Affordability Committee

Fiscal Year 2023



Baltimore County, Maryland

February 15, 2022

BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE

Honorable Tom Quirk, Committee Chairman
Councilman, 1st District

Honorable Julian E. Jones, Jr.,
Chairman, Baltimore County Council
Councilman, 4th District

Honorable David Marks
Councilman, 5th District

Edwin Crawford

Deborah Carter, CPA, Ed.D.

BALTIMORE COUNTY ECONOMIC ADVISORY COMMITTEE

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Rick Botti, Commercial Banking Team Leader, Senior Vice President, First National Bank

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SPENDING AFFORDABILITY COMMITTEE

February 15, 2022

Honorable Members of the Baltimore County Council
Honorable John A. Olszewski, Jr., County Executive

I am pleased to submit the report of the Spending Affordability Committee, reflecting the Committee's fiscal policy recommendations for Baltimore County for Fiscal Year (FY) 2023.

For FY 2023, the Committee recommends a base spending guideline of \$2,382,700,013, derived from a 4-year average personal income growth rate of 4.70% and FY 2022 base spending of \$2,275,740,223. This guideline provides maximum spending growth of \$106,959,790 over the FY 2022 budgeted base spending amount. The Committee further recommends that total debt outstanding not exceed 2.5% of FY 2023 estimated assessed property value and that debt service not exceed 9.5% of FY 2023 estimated General Fund revenues. Committee guidelines intend to limit spending such that growth in the cost of County government services does not exceed the growth in the County's economy. In making these recommendations, we emphasize that our guidelines do not represent targets, but rather maximum "should not exceed" levels. In the event that an adopted budget exceeds Committee guidelines, the County Council must provide an analysis of the over-the-guideline amount and explain the rationale for the decision. This situation occurred with the adoption of the FY 2020 budget in May 2019, when both the executive and legislative branches acknowledged that the General Fund's revenue structure was insufficient to support the County's pressing needs and took the serious step of amending the tax structure to meet those needs. Accordingly, over the past two years, the Spending Affordability Committee adjusted its FY 2021 and FY 2022 spending guideline calculations to account for the adopted tax enhancement. For FY 2023, our guideline approach returns to "normal" – with one exception – an exclusion allowance for any appropriations, over and above actuarially planned contributions, to our County's retiree-related trust funds (for pension and other post-employment benefits).

Along with our spending guidelines, we strongly advise that the Administration adhere to our fiscal policy recommendations. Specifically, this year, we caution the County Executive to be exceptionally careful with across-the-board salary increases in light of the current funded status of the Employees' Retirement System, and we warn employee bargaining groups that there is no more important need for their members (and retirees) than making sure that their Pension Trust Fund is sufficiently funded and stable. The Committee is mindful that by pushing up the compensation of soon-to- retire employees (which drives up their pension benefit allowances), each percentage point of an employee cost-of-living adjustment (COLA) results in an 8-digit increase to the unfunded accrued liability of the pension system. The Committee urges the Executive to be upfront with the County Council about this fiscal impact, well in advance of any votes on such salary scale changes.

Over the past two years, the County has received hundreds of millions of dollars in direct federal aid, flowing mainly to the Gifts and Grants Fund and other non-General Fund programs, to support our local response to the health, social services, public safety, education, and economic challenges stemming from the COVID-19 pandemic. These grant funds – paired with the billions of dollars in federal aid flowing directly to County residents and businesses through enhanced unemployment benefits, forgivable PPP loans, stimulus checks, and child tax credits – provided extraordinary relief to the County's General Fund. In the absence of this massive level of federal support, the County's General Fund would have been strapped, doubly, by the need to meet overwhelming public needs and the loss of critical revenues due to taxpayers' reduced income levels. Instead, the General Fund saw large-scale savings and fund balance accumulation during FY 2020 and FY 2021 result-

ing from facility closures, greater-than-usual staff turnover and grant-eligible expenses, and positive revenue performance – particularly income tax and transfer and recordation taxes. As of June 30, 2021, the County’s unassigned General Fund balance totaled \$316.4 million, not including \$216.2 million in the Revenue Stabilization Reserve Account; these are historically high levels. While current-year revenues are somewhat lower – in part due to timing issues with certain income tax receipts – it is still possible that FY 2022 budget savings will materialize and further contribute to fund balance. The Committee recognizes that it is not in the public’s best interest to squirrel away more than necessary while clear needs exist. At the same time, however, we firmly believe that the County should take a careful and strategic approach to managing these excess funds, to ensure that future budgets remain affordable. Baltimore County has many pressing existing obligations, including debt service to support aging infrastructure, a landfill that is filling up faster than planned, and unfunded liabilities for pensions and retiree health care, which County Government cannot ignore while seeking to address the heavy influx of new needs and requests – and while seeking to keep future budgets affordable to County taxpayers.

To determine the level of spending growth that is affordable to County taxpayers on an ongoing basis, the Committee reviewed various data and forecasts, which show unusually strong economic performance over the past year that is now decelerating, but which our economic consultant expects to rebound soon. We had in-depth discussions about the economic challenges posed by the pandemic, supply chain issues, labor shortages, and especially inflation. The Committee’s economic consultant, Dr. Anirban Basu, estimates that personal income in Baltimore County grew by nearly 5.5% in FY 2020, followed by greater than 7% growth in FY 2021. For 2022, Dr. Basu’s expectation is for subdued growth of less than 2% — mainly because the FY 2021 base measurement level included multiple federal stimulus payments that did not recur in FY 2022. For FY 2023, Dr. Basu projects 4.3% growth, and the 4-year average growth rate for the FY 2020-FY 2023 period is 4.7%. Although the 4-year average reflects some growth related to untaxable income, including the stimulus checks, the Committee is comfortable maintaining its methodology for calculating affordable budgetary growth, both because of its “smoothing” effect, since it incorporates data over several years, and in light of the County’s historically high fund balance.

The Committee is aware that its recommendation for the County to limit growth in ongoing costs to 4.7% means that additional funds will be available for “one-time” purposes such as contributions to the capital budget. As noted, this year, my fellow Committee members and I unanimously approved the use of excess funds for “over and above” contributions to the County’s retiree-related trust funds, in addition to our usual approval of their use towards capital budget expenses. Ensuring the solvency of the retiree trust funds, particularly the Pension Trust Fund, has been a top priority of mine throughout my time on the Council Council. As the County has often prioritized increasing employee salaries to remain competitive with other Maryland jurisdictions, contributions to retirees’ trust funds have not always been sufficient to strengthen funded status – a situation that the County Council is unable to remedy directly since we lack the authority to increase the budget. This Committee has given much attention in recent years to the use of the Other Post-Employment Benefits (OPEB) Trust Fund to cover current retiree health care costs, but less discussion has occurred on the funded status of the Employees’ Retirement System. I would like to take a moment to present my thoughts on this important issue of pension funding.

Pension funding, at face value, is straightforward. You sock away money and invest it, its value grows at a compound interest rate (where the interest is earning interest), and the result is real wealth that becomes available at retirement time. It’s the job of the Board of Trustees (Board) of the Employees’ Retirement System (System) to oversee the fiduciary health of the County’s Pension Trust Fund. The majority of the Board’s composition is Executive-appointed, and the Office of Budget and Finance serves as Board staff. In this regard, the management of the Pension Trust Fund – including investment policies, selection of money managers, actuarial assumptions and methods, service and disability retirements, and System policies and procedures – is largely in the hands of the Administration. The County by law is required to fund its full annual accrued liability payment as determined by the System’s actuary. The actuary ensures that over the long-term funding period, the County is making sufficient contributions to enable liquidation of the System’s full lia-

bility by the end of the funding period. Each year, the Executive's submitted budget must include the actuarially determined employer contribution level, or "annual required contribution" (ARC). From year to year, the ARC may fluctuate due to investment performance and actuarial assumptions and methods. However, the Office of Budget and Finance typically seeks to ensure as much stability as possible in the ARC for budget planning purposes.

For the past couple decades, the County's ARC has been steadily increasing, most dramatically since 2009, when its General Fund portion was less than one-third of the current amount (roughly \$50 million then versus \$155 million now). Despite these increases, the System's funded status – which reflects the ability of its current actuarial value of assets to cover its current actuarial accrued liability – has been declining. Out of concern for this issue, over the past fifteen years, the County has taken several critical steps to set the System on a firm foundation for the future. These steps have included modifying benefit formulas and extending vesting and service requirements for employees hired after 2007, as well as increasing employee contribution percentages. The County also defined two plans (Plans A and B), and issued pension obligation bonds to provide an influx of funding to cover a portion of the liability associated with the pre-2007 hire group (Plan A). More recently, the County codified a requirement for the System's actuary to use a 6.375% assumed rate of return on assets, so that the System's actuarial analyses would not reflect an unrealistic investment return assumption for assets. Other actuarial assumptions and methods, as well as most System policies, are still in the hands of the Board of Trustees. Another variable affecting the System's funded status is employee salary compensation, which can drive up the accrued liability if actual salaries are growing by more than the actuary assumes based on the most recent "experience" study. In recent years, salaries have increased by significantly more than assumed by the actuary, resulting in a higher unfunded accrued liability, greater increases in the County's ARC, and a lower funded status. To "move the needle" by one percentage point in funded status, it would cost approximately \$48 million (based on the System's accrued liability as of December 31, 2020). As of January 1, 2021, the System's funded status was at 63.2%. I believe, and my colleagues on the Spending Affordability Committee have agreed, that improving the System's funded status should be a top budget priority. Accordingly, this year, we are providing an exclusion opportunity for the Administration to allow for a one-time influx of funding into the Pension Trust Fund to assist in raising the System's funded status.

Additionally, the Committee persists in advocating for at least gradual progress toward the goal of bringing all recurring cost commitments on-budget. We are encouraged by the spirit of cooperation that the County Executive has shown by presenting an OPEB funding plan and implementing Labor First benefits plans government-wide, and by committing additional funds as they have become available, above adopted budget amounts for retiree health care. These decisions collectively make the OPEB Trust Fund stronger and better positioned to serve retirees in the future. Consistent with this commitment, the Committee also is providing a guideline exclusion opportunity for the Administration to allow for a one-time influx of funding, above the planned contribution level, into the OPEB Trust Fund.

The Committee continues to express concerns about using debt premium to offset the amount of budgeted debt service, since higher interest rates can lead to a lesser premium amount in future years. Director of Budget and Finance Ed Blades has been collegial in discussing this issue, and we are reassured that the potential unsustainability of debt premium as a revenue source is fully on his radar. Also on Mr. Blades' radar are other impending pressures, including refuse disposal operating budget appropriations that are not fully reflective of the cost to divert waste from the County's landfill, and capital budget needs as the County steps up to provide its share, alongside the State, towards school construction and facilities improvements. Notably, this year, Committee members spent significant time discussing inflationary pressures on the capital budget with the Committee's economist. Dr. Basu suggested that the planning time needed for large capital projects might serve to benefit the County in securing favorable construction bids. In other words, while the County is gearing up to replace Lansdowne High and Dulaney High and to provide a "like new" Towson High, along with maintaining a commitment to all schools across the County by implementing the MYIPAS (multi-year improvement plan for all schools), we must be realistic in our expectations of the likely

timetable for completing this work. In addition to the many schools-related capital projects, there are many non-school projects in the County's capital budget and program, which are also important. We must not neglect any area of the capital budget – in particular, infrastructure needs that are health and safety related – and with all of these areas of need comes a construction bill that reflects the market-driven prices of materials, transportation, and labor.

FY 2023 will mark my final year as Chair of the County's Spending Affordability Committee, a post I have held for over a decade, since early in my first term as a County Council member. I am proud of the "check and balance" role our legislative branch Committee has played during this time, helping to guide the County's budgeting process each year and seeking to ensure the responsible use of taxpayer dollars.

As I like to repeat, year after year, if we want things, we must pay for them. Unlike the federal government, which can recklessly run operating budget deficits that increase debt to more than \$30 trillion (irresponsibly passing on a mountain of debt to our children and grandchildren, kicking the can to the next generation, unlike the pre-Boomer World War II generation, which made great sacrifices to ensure a better future for their kids), we are required, under the Baltimore County Charter, to balance our budget. The full fiscal impact of new budgetary initiatives is not always evident in the first year or two of implementation. For this reason, disclosure of multi-year General Fund impacts is a best practice, especially for indirect impacts, such as the impact of employee salary increases on the Retirement System's accrued liability and on the County's ARC. While most of government's spending is clearly necessary and justified, it is critical to continue to consider the everyday taxpayer, who cannot afford to pay more in taxes.

As always, I would like to thank my fellow Committee members – the Honorable County Council Chairman Julian E. Jones, Jr., the Honorable David Marks, Mr. Edwin Crawford, and Dr. Deborah Carter – for their contributions to this year's process. Thanks also to the Committee's staff including Auditor Lauren Smelkinson, Deputy Auditor Elizabeth Irwin, and the Fiscal and Policy Analysis unit within the Auditor's Office, executive branch staff including Mr. Ed Blades, the members of the Baltimore County Economic Advisory Committee, and that panel's chairman and economic consultant to this Committee, Dr. Anirban Basu. Thanks to all participants for the shared and steadfast commitment to fiscal responsibility.

As in the past, for FY 2023, we are hopeful that this report will receive careful consideration during the development and review of the County's operating and capital budgets.

Sincerely,

A handwritten signature in dark ink, appearing to read "Tom Quirk", written in a cursive style.

Tom Quirk
Chairman, Spending Affordability Committee
Councilman, 1st District, Baltimore County Council

INTRODUCTION

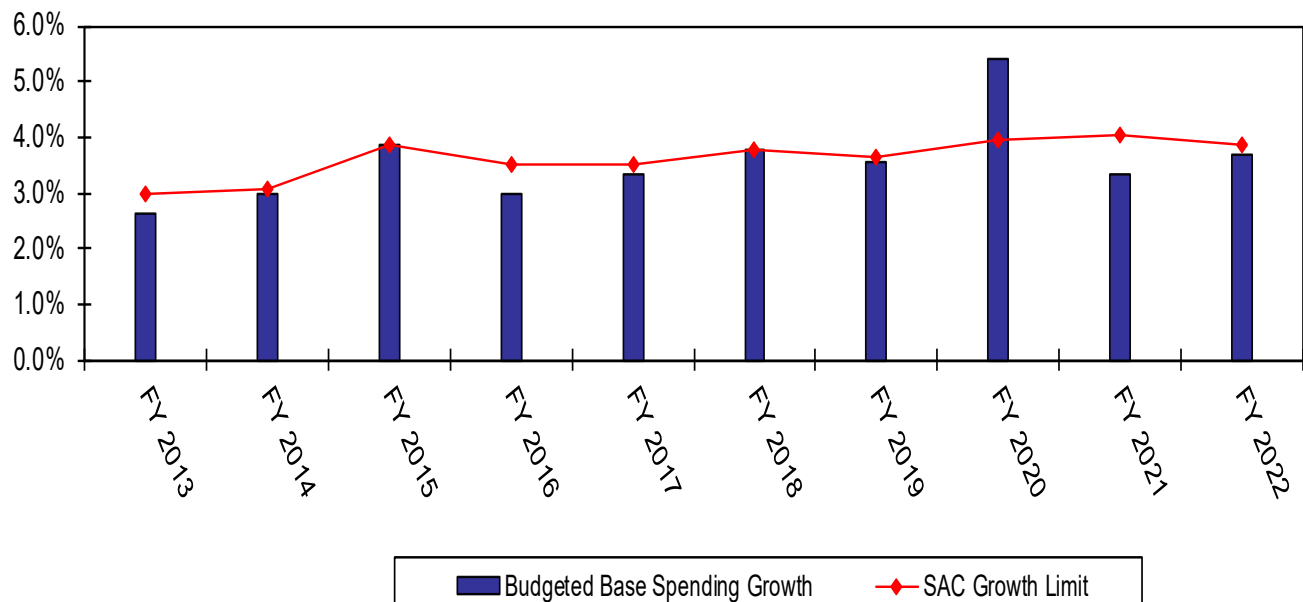
The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed the growth of the County's economy.

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

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. The debt guidelines are based on two commonly utilized debt affordability indicators.

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 County Executive ample time to consider the Committee's recommendations before submitting the proposed budget to the County 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. In Fiscal Year (FY) 2020, the final adjusted budget exceeded the spending guideline by approximately \$29.4 million; the County Council justified its decision to exceed Committee recommendations based on the County's extraordinary operational and infrastructure needs, paired with the establishment of new and enhanced revenue streams. Actual expenditures for FY 2020 fell under the spending guideline, as the County confronted the COVID-19 pandemic and was able to revert more than \$64 million to fund balance by fiscal year-end.

Figure 1. Budgetary Compliance with SAC Spending Guideline



SPENDING GUIDELINE

The Committee recommends that base spending growth not exceed 4.70%, bringing the recommended FY 2023 spending limit to \$2,382.7 million.

The Committee continued to utilize a 4-year average of annual personal income growth rates to determine its personal income growth factor.

The Committee uses an “estimated final spending” methodology to determine base-year spending.

Certain appropriations are not subject to the Committee’s spending guideline because they do not represent ongoing County program obligations. For FY 2023, in consideration of the County’s surplus level and the Administration’s commitment to protecting both retiree pensions and health care benefits, the Committee approved excluding (as “one-time” appropriations) budgeted Retirement System and OPEB Trust Fund contributions above planned actuarially-determined levels.

The spending guideline for a given fiscal year is calculated by multiplying the previous fiscal year’s estimated base spending level (as defined by the Committee) by the spending affordability growth factor (Figures 2 and 3). **For FY 2023, the Committee recommends that base spending not exceed \$2,382,700,013, calculated by applying an estimated County personal income growth rate of 4.70% to FY 2022 base spending of \$2,275,740,223.** This guideline allows for maximum spending growth of \$106,959,790 over the FY 2022 budgeted base spending amount (Figure 4).

For FY 2023, the Committee maintained its use of an average personal income growth rate as its measure of growth in the County’s economy. The average is calculated based on the annual growth forecasts for the current and upcoming fiscal years and the annual growth estimates for a designated number of preceding fiscal years. The FY 2023 growth factor, like the growth factors in recent years, is based on the 4-year average, which includes two preceding fiscal years. Prior to FY 2010, in determining its growth factor, the Committee utilized a single-year forecast, applicable only to the upcoming fiscal year; through FY 2017, the growth factor was based on the 5-year average that included three preceding fiscal years.

Committee policy provides that base spending should reflect all approved and planned spending, less exclusions (see Figure 3), or in other words, “estimated final spending” for the current 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.

A budget’s compliance with the spending guideline is determined by calculating the budget’s base spending amount, which excludes certain appropriations, and by comparing it to the guideline amount. Appropriations that are one-time/non-recurring in nature (such as certain General Fund contributions to the capital budget) or that are required to support a state or federal program (such as local share matching appropriations) are excluded from the base spending amount. Similarly, appropriations that represent only a reserve of funds and not an earmarked expenditure, are excluded from base spending. Historically, the Committee’s rationale for excluding certain appropriations has been that the growth in such appropriations should not be tied to growth in the County’s economy but should instead be guided 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). For FY 2023, the Committee engaged in discussions regarding the availability of surplus funds and the benefits of reducing the County’s net liability associated with its two retiree-related trust funds: the Pension Benefits Trust Fund and the Other Post-Employment Benefits (OPEB) Trust Fund. The Committee unanimously supported excluding FY 2023 appropriations above the planned actuarially determined levels; such exclusions will be reflected when assessing FY 2023 budget compliance with the spending guideline (see page 6).

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 - see Figure 3). 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
- Base Spending (current fiscal year)
- x Personal Income Growth Factor
- Spending Guideline (upcoming fiscal year)

Figure 3. Spending Affordability Committee Definition of Base Spending

Base Spending: 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 10% of budgeted General Fund revenues (with an allowable temporary 7% floor).
- 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, non-recurring 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.

Figure 4. FY 2023 Spending Guideline

FY 2022 General Fund Budget Appropriations	\$ 2,342,871,023
Supplemental Appropriations	-
Total General Fund Budget Appropriations	<u>\$ 2,342,871,023</u>
Estimated Final Spending	<u>\$ 2,342,871,023</u> (A)
General Fund Exclusions:	
Local Matching Appropriations	
Local Matching Funds	(10,598,672)
Capital Project Appropriations	
PAYGO	(53,209,245)
Reserve Fund Appropriations	
Contingency Reserve	(2,272,883)
One-Time-Only Appropriations	
Baltimore County Public Schools ⁽¹⁾	(1,050,000)
Funding for OPEB Above Scheduled Amount ⁽²⁾	-
Funding for ERS Above Annual Required Contribution ⁽³⁾	-
Total Exclusions	<u>(67,130,800)</u> (B)
Base Spending (A - B)	\$ 2,275,740,223 (C)
Personal Income Growth Factor	<u>1.0470</u> (D)
FY 2023 Spending Guideline (C x D)	<u>\$ 2,382,700,013</u>

Maximum Growth in Base Spending \$ 106,959,790

⁽¹⁾ Reflects one-time BCPS costs excluded from the State's maintenance of effort requirement.

⁽²⁾ Effective for FY 2023 budget; amount in excess of the Administration's actuarially generated OPEB funding plan for FY 2023 as of May 2, 2021.

⁽³⁾ Effective for FY 2023 budget; amount in excess of the actuarially generated ERS Annual Required Contribution (ARC) for FY 2023.

SPENDING POLICY RECOMMENDATIONS

The Committee's policy recommendations are that the County maintain a sufficient reserve on hand in case an unexpected revenue shortfall occurs, that the County Executive avoid underfunding essential items, and that the budget minimize its reliance on one-time revenue sources to fund ongoing expenses.

The Committee's recommendations are designed to ensure that the County's General Fund budget is structurally balanced and fiscally sustainable.

In FY 2018 and FY 2019, revenue levels were insufficient to keep pace with both budgeted and off-budget recurring expenses. The budgetary decisions leading to this outcome constituted violations of the Committee's (non-binding) policy recommendations. The outcomes of the FY 2020 and FY 2021 budget years (due in part to pandemic-related savings) were to close the full gap between ongoing revenues and expenses. The FY 2022 budget again anticipated reliance on off-budget funding sources, though it is possible that budget savings will again emerge to close the gap.

The Committee reaffirmed 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. Accordingly, the Committee endorses the County's policy of requiring that the Revenue Stabilization Reserve Account (RSRA) equal 10% of budgeted General Fund revenues, and that the ratio of General Fund balance to revenues does not fall to the floor level of 7% for two consecutive years.
- The Committee recommends that the County Executive avoid underfunding essential operating budget items, including retiree health care, 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. For example, the Committee advises against using debt premium funds to offset debt service interest costs, noting that the avoidance of this practice would result in a lower financing cost for County debt, in addition to being a more sustainable budgeting practice.

These spending policy recommendations, along with the Committee's spending guideline (see pages 2-4) and usual review of General Fund revenues performance (see pages 10-11), are designed to ensure that the County's General Fund budget is structurally balanced and fiscally sustainable. Specifically, the reserve policy is designed to protect against unanticipated costs or revenue shortfalls. The underfunding policy is designed to ensure that essential costs are not deferred in a given budget year in order to incur new obligations, which when added to the full balance of existing obligations would be unaffordable. The one-time funding policy is designed to ensure that recurring costs are supportable by ongoing streams of revenue. Failure to abide by these recommendations can lead to structural budgetary imbalance, which is not sustainable over the long term.

After several years of budgetary non-compliance with the Committee's (non-binding) policy recommendations, the County's management practices resulted in a structural financial imbalance beginning in FY 2018. Specifically, in January 2019, audited FY 2018 data revealed that ongoing General Fund revenues were insufficient to fund the County's ongoing operating expenses (inclusive of both on-budget and off-budget recurring expenses). The structural financial imbalance persisted in FY 2019. Although the FY 2020 and FY 2021 adopted operating budgets did not anticipate a return to structural financial balance, due to an over-attainment of revenues and budget savings largely attributable to the pandemic, FY 2020 and FY 2021 General Fund revenues exceeded ongoing operating expenses (inclusive of both on-budget and off-budget recurring expenses). For FY 2022, base spending appropriations were slightly below the spending guideline level, but the adopted budget again suggested structural imbalance: specifically, in FY 2022, recurring off-budget commitments are estimated to total more than \$60 million (the General Fund retiree health care contribution is more than \$30 million underfunded based on the Administration's budget projections, and the General Fund budget does not cover \$30 million in debt service interest costs that will be paid using debt premium funds).

The Administration has made progress in addressing the structural concerns that the Committee has raised, but additional action is necessary to bring about comprehensive correction. Areas of concern include OPEB, debt service, and refuse disposal costs.

Ongoing revenues should be sufficient to fund estimated guideline expenses in FY 2022 and FY 2023. The Committee endorses the use of any excess revenues and/or General Fund surplus (above legally required and target levels) to seek improvement to the funded status of the Employees' Retirement System and to prevent any drawdown of the OPEB Trust Fund balance.

During the past several budget processes, the Administration has acknowledged the structural concerns raised by the Committee and has begun to present some plans to address budgetary deviations from the Committee's policy recommendations. During the upcoming year, the Committee urges the Administration to increase the comprehensiveness of its planning for correcting deviations from Committee policy recommendations, in order to minimize the detrimental effects of such. In addition to charting the County's course to bringing current retiree health care costs entirely back into the General Fund budget (where they were fully funded as recently as FY 2015), such enhanced planning should eliminate reliance upon debt premium funds to pay debt service interest costs, and it should meet all of the County's other needs (e.g., refuse disposal).

Ongoing County revenues are projected to be sufficient to fund recurring expenses in FY 2023 (see pages 10-11). Consistent with Committee policy, any excess revenues and/or fund balance (above the spending guideline and/or sufficient reserve levels, respectively) should be used for one-time purposes such as PAYGO contributions to the Capital Budget. Additionally, consistent with the Committee's ongoing discussions regarding the funded status of the Employees' Retirement System (ERS), which is in the low sixties, percentage-wise, the Committee endorses the use of any excess fund balance (above legally required and target levels) to reduce the amount of the unfunded accrued liability. The Committee is aware that the budgetary consequence associated with having a lower funded status is having an annual required contribution that is pressured to increase significantly from year to year. In this respect, the County's General Fund portion of its annual required contribution has more than tripled since FY 2009, from less than \$50 million to more than \$155 million in FY 2022. Additionally, the combined portion of the General Fund budget consumed by ERS contributions and debt service payments on the County's POBs totals \$176.0 million in FY 2022, or 7.5% of the FY 2022 General Fund budget, which is more than twice the percentage it was in FY 2009, when these costs combined accounted for just 3.5% of the General Fund budget.

Because it is not the Committee's role to prescribe how the Executive should comply with the Committee's spending guideline, in light of the significant cost pressures both within and outside the General Fund budget, and in light of economic uncertainty given that federal fiscal stimulus effects can be expected to wane over time, the Committee continues to urge fiscal restraint with the use of excess revenues and/or General Fund surplus. Accordingly, for FY 2023 guideline compliance purposes, the Committee approves the (additional) exclusion of FY 2023 appropriations above planned actuarially determined levels for both the Pension (ERS) and the OPEB Trust Funds. The Committee allows for such guideline exclusions in acknowledgement of the current Administration's commitment to ensuring solvency of both funds.

ECONOMIC GROWTH

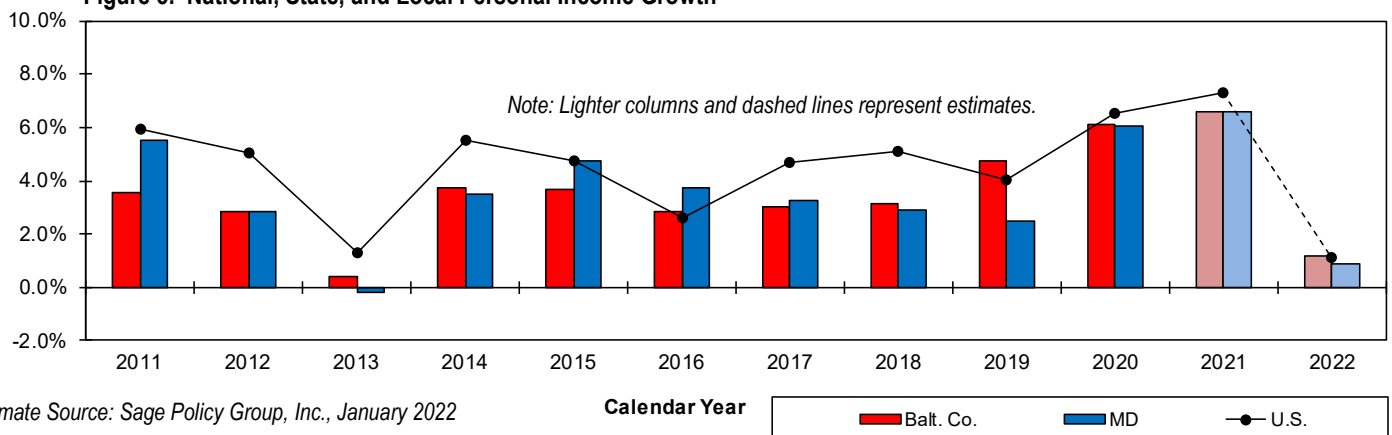
Personal income in the County is projected to increase by 1.90% in FY 2022 and by 4.30% in FY 2023.

Baltimore County Economic Advisory Committee members expressed mixed feelings about the state of the local economy noting that some sectors continue to struggle even as others have held up relatively well.

Prior to adopting a FY 2023 growth rate of 4.70%, based upon 4-year average personal income growth over the FY 2020 – FY 2023 period, the Committee reviewed current and projected economic conditions to gain an understanding of the consultant's personal income estimates and economic forecast (dated January 15, 2022). The consultant, Sage Policy Group, Inc., predicts that in FY 2022, Baltimore County personal income will grow 1.90%, slightly above a 1.76% forecast for Maryland, following growth of 7.13% (estimated) and 7.08%, respectively, during FY 2021. The wide fluctuation in expected growth from FY 2021 to FY 2022 results from the timing of the substantial federal stimulus, pumped into the U.S. economy to combat economic losses stemming from the COVID-19 pandemic. Stimulus checks most pronouncedly affected 2021:Q1, when County personal income increased by an estimated 11.81%. Prior to FY 2021, federal stimulus boosted the County's FY 2020 growth (5.45%) in 2020:Q2, when County personal income grew by an estimated 6.67%. For FY 2023, the consultant anticipates that personal income growth will rebound in both the County (4.30%) and the State (4.25%). Over the 2011 to 2020 period, County personal income increased at an average annual rate of 3.41%, compared to 3.48% in Maryland and 4.55% in the U.S. (Figure 5).

The January 3, 2022 meeting of the Baltimore County Economic Advisory Committee (BCEAC) also provided in-depth insight into local economic conditions. The BCEAC's economist described how numerous interrelated challenges shaped economic performance during 2021, including the pandemic itself, supply chain issues, labor shortages, and – especially – inflation. Despite these challenges, the U.S. economy has continued to grow, and many sectors have held up well. At the same time, despite vigorous growth in employment, the labor force participation rate remains low, and the U.S. economy now supports nearly four million fewer jobs than at its pre-pandemic peak. The leisure and hospitality sector remains the hardest hit as labor shortages, inflation, and rolling waves of COVID-19 transmission have continued to force many businesses to close. These closures, combined with a surge in remote work that will drive many businesses to reevaluate office space needs, could put pressure on the County's commercial real estate values. On the residential real estate side, County home sales and sale prices boomed throughout the entirety of the year as near record-low interest rates and available inventories drove a remarkable sellers' market. The Committee's residential real estate representative anticipates that home sale prices will continue to rise during the coming year but at a decelerated rate, as the market has begun to show some signs of stabilization. Committee members also remarked on the adverse impact elevated inflation, which the Federal Reserve had expected to be transitory, has had on the economy, but reached consensus that it should begin to abate during the coming year.

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



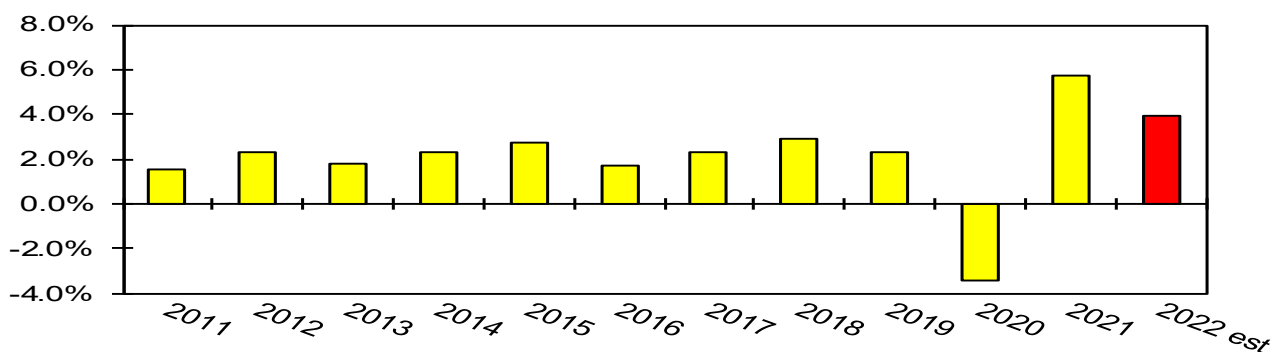
For CY 2022, real GDP is projected to increase by 3.9%, solid growth, but a moderation from 5.7% growth in CY 2021.

Projections for the local economy are influenced, to a large degree, by the underlying performance of the national and state economies. The pandemic period has resulted in a see-saw effect on the overall U.S. economy. After plunging into recession in the first half of CY 2020 and posting an overall negative rate for the full year, real Gross Domestic Product (GDP) exploded during CY 2021, growing at an annualized rate of 5.7% (Figure 6). This increase marks the highest full-year expansion since 1984; the year included three quarterly periods of growth greater than 6.0%. However, the economy's rapid expansion has not come without challenges, as the growth has fueled substantial inflation. In addition, federal stimulus effects, which initially propelled growth, are now waning, exacerbating the impacts of inflation for many. Consumer spending, which plummeted during the contraction period, was the primary driver of the GDP rebound in CY 2021. Gross private investment, particularly in equipment and intellectual property products, also contributed to growth, as businesses built up inventories to combat global supply chain challenges. Over the last decade, real GDP grew by an average of 2.1% annually from CY 2012 to CY 2021. GDP is projected to moderate in CY 2022 and increase by 3.9%, according to the Federal Reserve Bank of Philadelphia's November 2021 *Survey of Professional Forecasters*. However, this deceleration by no means reflects a negative outlook for the near-term growth of the U.S. economy; a modest decrease in growth is unavoidable as the effects of the stimulus wane.

Employment in the State and County saw steady growth during 2021 but still remains below pre-pandemic levels. Employment growth is expected to continue at a modest pace during CY 2022.

Following 12 consecutive months of substantial year-over-year job losses in the County and Maryland, employment rebounded in 2021 and has posted solid year-over-year gains in 8 of the 9 months since. Regionally, the labor market continues to make slow but steady gains since the pandemic-induced collapse; however, the economy still supports 22,606 and 186,828 fewer jobs in the County and Maryland, respectively, as of December 2021 compared to the prior year. On the other hand, the regional labor market has held up comparatively well to the national labor market, with a lesser degree of loss due to an abundance of government, health care, and education jobs. Baltimore County's and Maryland's unemployment rates have begun to approach their pre-pandemic lows, falling to 3.9% and 4.0%, respectively, in December 2021. The unemployment rates in the County and Maryland averaged 5.5% and 5.6%, respectively, for all of CY 2021. However, as explained, these falling unemployment rates do not capture critical underlying issues in the labor market as the labor force participation rate continues to remain low. Most recently, in December 2021, the County and State labor forces provided 21,563 and 175,769 fewer workers, respectively, than they did during their pre-pandemic peaks, due at least in part to an exodus of older workers. For CY 2022, Sage Policy Group, Inc. projects that County and State employment will grow by 3.4% and 2.6%, respectively. These projections suggest that the labor market will continue to grow at a solid pace and cut into the lingering shortfall from pre-pandemic levels.

Figure 6. Real Gross Domestic Product: Annual Percentage



Estimate Source: Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters, November 2021

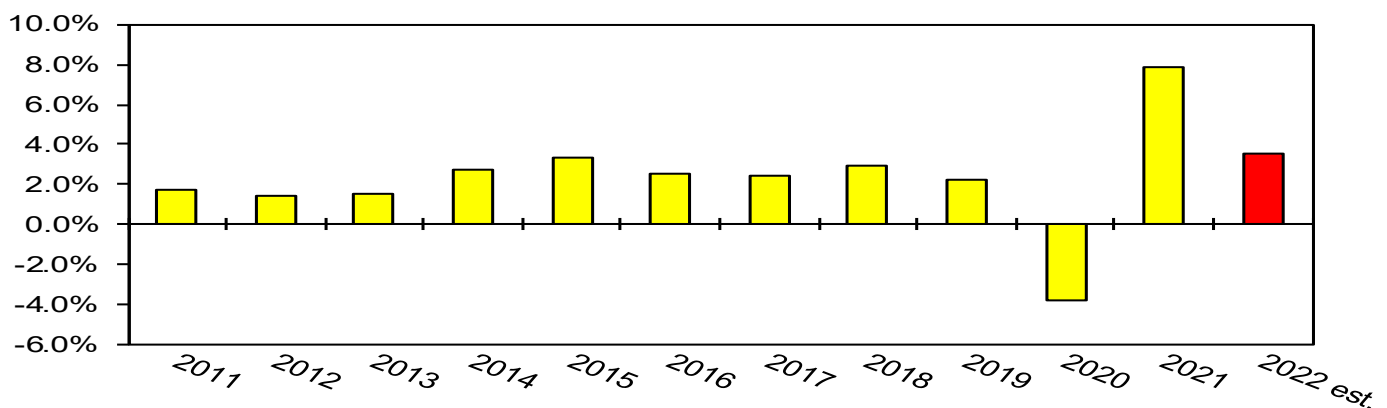
Consumer spending increased at a rate of 7.9% in CY 2021 following the first yearly decrease in 10 years during CY 2020.

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). After falling during CY 2020, the first full-year decrease since 2009, consumer spending surged during CY 2021, posting a full-year increase of 7.9%, as federal stimulus and pent-up demand contributed to an upwelling of consumer activity. Most recently, in 2021:Q4, consumer spending increased at an annualized rate of 3.3%. Consumer spending is expected to increase further in CY 2022, albeit at a moderated pace. Consistent with the unsettled state of the economy amidst the Omicron variant COVID wave, based on a survey of 5,000 U.S. households by the Conference Board, consumer confidence decreased slightly in January 2022, with the “Expectations Index” responsible for the decrease, slightly offset by an increase in the “Present Situation Index.” The Conference Board reported that “the proportion of consumers planning to purchase homes, automobiles, and major appliances over the next six months all increased,” and “concerns about inflation declined for the second straight month, but remained elevated after hitting a 13-year high in November 2021.” However, “[l]ooking ahead, both confidence and consumer spending may continue to be challenged by rising prices and the ongoing pandemic.”

The U.S. economy largely performed well during CY 2021 but struggled through several challenges induced by the lingering pandemic. The Committee’s consultant warns of challenges in the near term but expects continued moderate growth during CY 2022.

From a broader perspective, at this point last year, the U.S. economy was progressing in its recovery from a severe, but brief, recession brought about by the onset of the COVID-19 pandemic in early 2020. Vaccines were recently approved by the federal government, and consumers were looking forward to getting back to “normal.” Nearly a year later, the economy has continued to make significant progress, but some sectors continue to struggle. The national and local economies’ most significant challenges in the coming months are restoring the substantial amount of jobs that remain unfilled since the pandemic-induced exodus of workers, managing inflation, easing strains on supply chains, and adapting to a “new normal” in living with the virus. The Federal Reserve Bank of Philadelphia’s November 2021 *Survey of Professional Forecasters* projects 4.1% unemployment during CY 2022, down from CY 2021 and near pre-pandemic lows. The *Survey* further anticipates solid growth in GDP, albeit at a decelerated pace as the economy moderates from substantial growth in CY 2021. The Committee’s consultant observed, as of January 15, 2021, that the U.S. economy faces several near-term risks, including continuing inflation, rising interest rates, and decelerated federal spending as the impact of stimulus measures that previously drove growth fades. However, the consultant’s expectation is that inflation will dissipate over the course of 2022 and that the labor force is set to expand. The Maryland and Baltimore County economies are likely to follow a similar trend as the national economy, with the expectation for continued moderate growth.

Figure 7. Real Consumer Spending: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia’s Survey of Professional Forecasters, November 2021

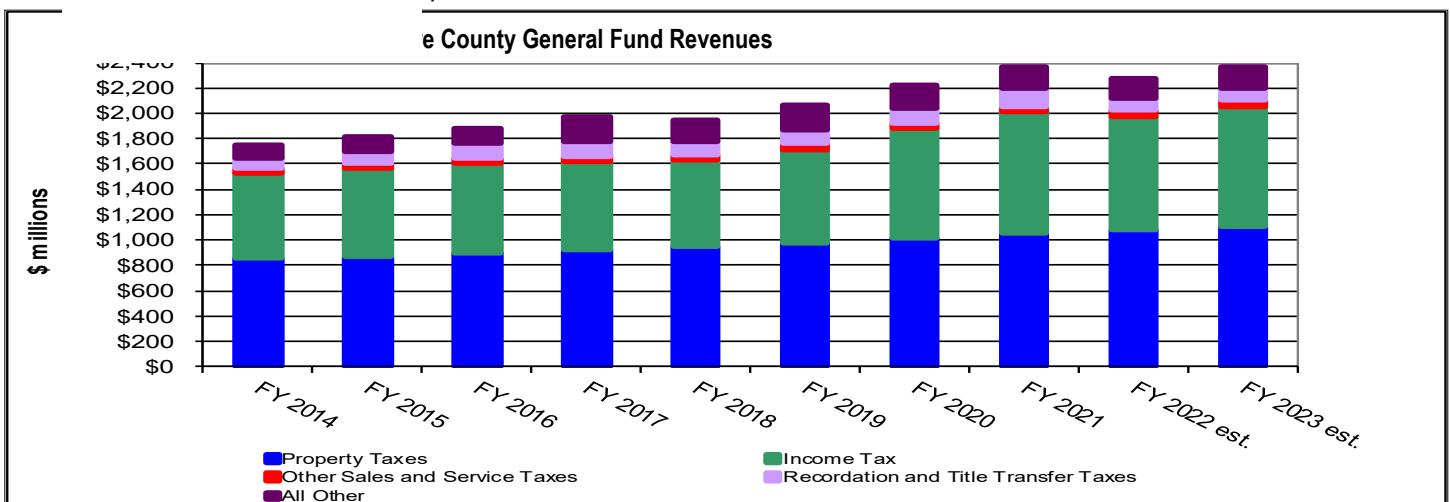
GENERAL FUND REVENUES AND SURPLUS

FY 2022 General Fund revenues are projected to decrease by \$97.7 million, or 4.1%, from FY 2021 totals, but they are \$17.9 million higher than FY 2022 budgeted revenues.

FY 2022 projected revenues total \$2,275.3 million, an increase of \$17.9 million, or 0.8%, over FY 2022 budgeted revenues, and reflecting a decrease of \$97.7 million, or 4.1%, from FY 2021 revenues (Figures 8 and 9). The projected decrease from FY 2021 collections does not represent expected performance issues in the County's economy, but rather a moderation of an unsustainably vigorous revenue performance during FY 2021. Revenue growth in FY 2021 was driven by significant amounts of federal stimulus pumped into the economy, in addition to near record-low interest rates and low housing inventories, which contributed toward a surge in the residential real estate market and a nearly 28% increase in property-related transaction tax revenues (recordation and title transfer tax revenues). In addition to indirect and direct effects of federal stimulus, income tax collections were buoyed by an increase to the County's income tax rate that went into effect January 1, 2020, and a State legislative change affecting how Pass-Thru Entities (PTE) report business income. The reporting change should have a net-zero impact on County revenues upon being in effect for a full year, but initially it caused significant collections to occur in FY 2021 that otherwise would have occurred in FY 2022. After being artificially inflated due to this reporting issue in FY 2021, income tax revenues are projected to total \$895.1 million in FY 2022, a decrease of \$65.6 million, or 6.8%, while property-related transaction tax revenues preliminarily are expected to total \$90.0 million, a decrease of \$56.3 million, or 38.5%, from FY 2021 collections. Meanwhile, continued strong anticipated growth in property tax revenues of \$32.6 million, or 3.1%, will serve to bolster the overall FY 2022 revenue position.

FY 2023 General Fund revenues are projected to increase by approximately \$97.8 million, or 4.3%, over the current FY 2022 estimate.

FY 2023 General Fund revenues are projected to reach \$2,373.1 million, an increase of \$97.8 million, or 4.3%, over the current FY 2022 revenue estimate, and up approximately \$115.7 million, or 5.1%, from FY 2022 budgeted revenues. The FY 2023 projected increase primarily stems from income tax revenue, based on the assumption, consistent with the analysis by the Committee's economic consultant, that the County's labor market will continue to add jobs that were lost during the pandemic and that wages will show accelerated growth. Projected income tax revenue totals \$942.3 million, an increase of \$47.2 million, or 5.3%. In addition, anticipated property tax revenues grow steadily for the ninth consecutive year due to the State's recent reassessment of the County's east region. Specifically, projected property tax revenues total \$1,109.7 million, an increase of \$28.8 million, or 2.7%. Projected property-related transaction tax revenues increase slightly, based on modest assumed growth in home sales and sales prices as previously "frozen out" buyers enter the revitalized market. State aid received by the County's General Fund also should increase slightly in FY 2023, primarily due to police aid, with modest increases expected in transportation and local health revenues.



Sources: FY 2012 to FY 2021 Baltimore County Annual Comprehensive Financial Reports

Figure 9. General Fund Revenue Forecast, FY 2022-FY 2023

(\$ Million)								
REVENUE SOURCE	FY 2021 Actual	FY 2022 Budget	FY 21 - FY 22 Bud.	FY 2022 Revised	FY 21 - FY 22 Rev.	FY 2023 Estimate	FY 22 Bud.- FY 23	FY 22 Rev.- FY 23
Property taxes	\$1,048.3	\$1,072.9	2.3%	\$1,080.9	3.1%	\$1,109.7	3.4%	2.7%
Income taxes	960.7	871.1	-9.3%	895.1	-6.8%	942.3	8.2%	5.3%
Recordation & title transfer taxes	146.3	109.1	-25.4%	90.0	-38.5%	99.0	-9.3%	10.0%
Other Sales and Service taxes	43.9	50.7	15.5%	50.6	15.3%	50.6	-0.2%	0.0%
Intergovernmental aid	57.3	51.8	-9.6%	51.7	-9.8%	54.7	5.6%	5.8%
Service charges	54.7	49.0	-10.4%	49.0	-10.4%	56.1	14.5%	14.5%
Licenses & permits	5.7	5.2	-8.8%	5.7	0.0%	5.7	9.6%	0.0%
Fines, forfeitures & penalties	4.0	3.7	-7.5%	4.0	0.0%	4.0	8.1%	0.0%
Interest on investments	0.6	0.3	-50.0%	0.3	-50.0%	1.0	233.3%	233.3%
Other	51.5	43.6	-15.3%	48.0	-6.8%	50.0	14.7%	4.2%
TOTAL	\$2,373.0	\$2,257.4	-4.9%	\$2,275.3	-4.1%	\$2,373.1	5.1%	4.3%

The FY 2023 revenue projection is slightly below the Committee's recommended FY 2023 spending guideline.

The FY 2021 surplus totaled \$316.4 million, excluding \$216.2 million in the RSRA.

The FY 2022 RSRA is currently projected to total \$225.7 million, with an additional \$239.3 million available in surplus.

The \$115.7 million in projected FY 2023 revenue growth over FY 2022 budgeted revenues exceeds the Committee's recommended \$107.0 million maximum growth in ongoing spending by \$8.7 million. Further, as of June 30, 2021, the County's General Fund unassigned fund balance totaled \$316.4 million, not including \$216.2 million in the Revenue Stabilization Reserve Account (RSRA). Together, these amounts totaled \$532.6 million, or 23.6% of FY 2022 budgeted General Fund revenues.

The projected June 30, 2022 budgetary surplus, assuming revenues of \$2,275.3 million, no supplemental appropriations, and no actions by the Administration to revert appropriations and/or liquidate other funds, totals \$239.3 million, or 10.6% of FY 2022 budgeted revenues (Figure 10). This amount does not include an estimated \$225.7 million in the RSRA, or 10.0% of FY 2022 budgeted revenues. The FY 2022 adopted operating budget projected a FY 2022 budgetary surplus of \$66.9 million, excluding a projected \$226.1 million in the RSRA. The estimated unassigned surplus, which far exceeds the gap between the FY 2023 revenue projection and the Committee's FY 2023 spending guideline, will be available as a source of funding for the FY 2023 budget.

Figure 10. Estimated General Fund Budgetary Surplus, FY 2022

(\$ in Millions)	
FY 2021 General Fund Budgetary Surplus (excluding RSRA funds)	\$ 316.4
FY 2022 Revenue Estimate (per Adopted Budget)	2,257.4
FY 2022 Revision	<u>17.9</u>
FY 2022 Revised Revenue Estimate	2,275.3
FY 2022 Adopted Budget	(2,342.9)
FY 2022 Transfer to the RSRA	<u>(9.6)</u>
FY 2022 Estimated General Fund Budgetary Surplus	<u>\$ 239.3 *</u>

* Total does not foot due to rounding.

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 total assessed property value, and (2) the County's level of debt service as a percentage of total General Fund revenues.

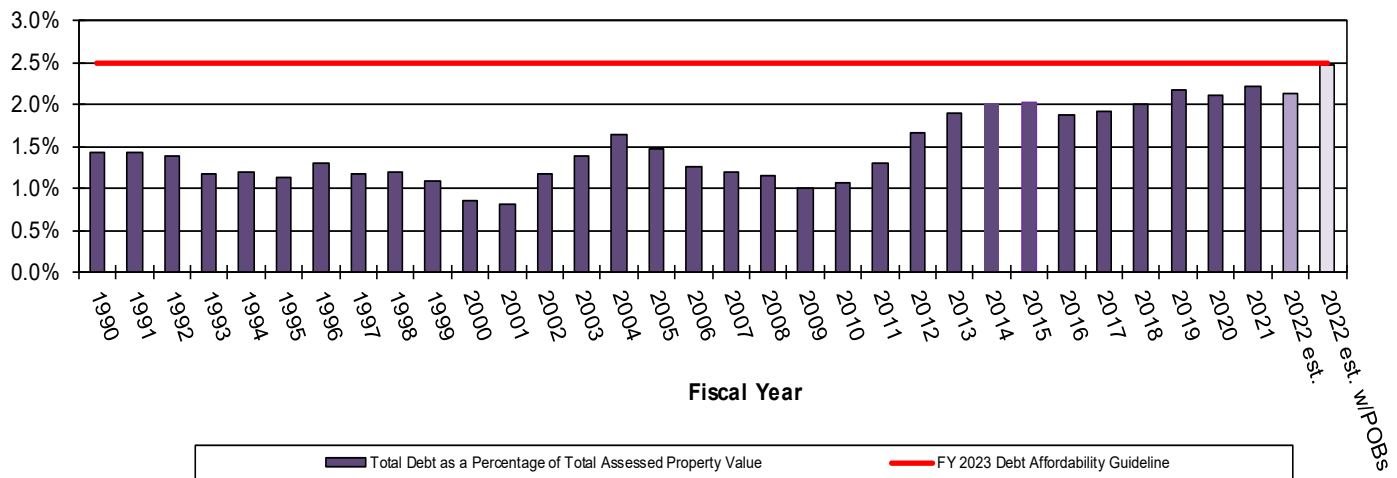
Based on the issuance of up to \$100.0 million in new consolidated public improvement (CPI) debt during FY 2022 as authorized by Bill 98-21, and up to approximately \$95.5 million in new General Fund Equipment COPs proposed under Resolution 11-22, the amounts of total debt outstanding and debt service expenditures are expected to continue to remain below both the Committee's and the Administration's guidelines through FY 2022.

Total Debt Outstanding Guideline

The Committee recommends that total debt outstanding not exceed \$2,456,944,050, or 2.5% of total assessed property value of \$98,277,762,000.

The ratio of total debt outstanding to total assessed property value is a measure of debt affordability. Total assessed property values remained relatively flat in 2021 but are estimated to increase significantly in 2022 due to dramatically rising home assessments as a result of rising home values. At the same time, the County's level of total debt outstanding is estimated to increase only slightly from FY 2021 to FY 2022. For FY 2022, the total debt outstanding ratio is estimated at 2.1%, a decrease from 2.2% in FY 2021. The inclusion of pension obligation bond (POB) debt, which is being shown for informational purposes only, would increase the ratio to 2.47% (Figure 11). The Committee's recommended limitation on total debt outstanding currently stands at 2.5% of total assessed property value. **Accordingly, the Committee recommends that total debt outstanding during FY 2023 not exceed \$2,456,944,050, or 2.5% of total assessed property value of \$98,277,762,000.**

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 2022, which is shown (for informational purposes) with and without POBs, which were issued in Fiscal Years 1988, 2013, and 2017. FY 2022 ratio is an estimate.

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

Debt Service Guideline

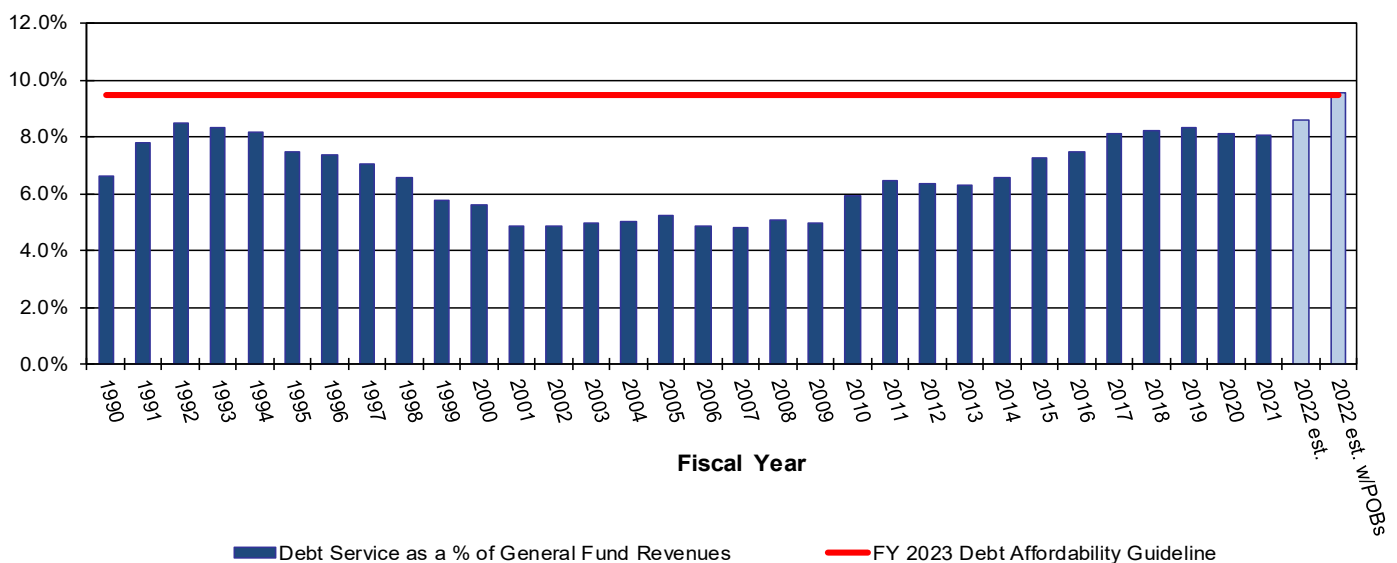
The Committee recommends that debt service not exceed \$225.4 million, based on applying a 9.5% guideline to projected revenues totaling \$2,373.1 million.

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 2013 until FY 2019, the ratio of the County debt service as a percentage of total General Fund revenues had been increasing steadily. The ratio decreased in both fiscal years 2020 and 2021, largely a result of increased income tax collections along with the impact from the federal stimulus in 2021. However, for FY 2022, this ratio is estimated at 8.6%, an historic high, as debt service continues to rise steadily, while FY 2022 revenues are expected to decline from 2021. As noted, this decrease does not represent expected performance issues in the County's economy, but rather moderation of an unsustainably vigorous revenue performance during FY 2021. The inclusion of Pension Obligation Bonds (POBs) debt, which is being shown for informational purposes only, would increase the ratio to slightly above the guideline level (Figure 12). The Committee's limitation on debt service currently stands at 9.5% of total General Fund revenues. **Accordingly, the Committee recommends that debt service expenditures for FY 2023 not exceed \$225.4 million, based on projected revenues totaling \$2,373.1 million.**

Budgeted debt service in recent years has not reflected the full amount of the County's debt service cost due to the use of debt premium funds to pay interest costs, which occurs off-budget. In recent years, the Committee has discouraged this practice, recommending that the County develop a plan to discontinue it.

The ratio of debt service to total General Fund revenues from FY 1990 to estimated FY 2022 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 a substantial capital budget over that period. As previously noted, prior to fiscal years 2020 and 2021 the ratio had been rising steadily, largely a result of the aggressive capital program for school projects. Budgeted debt service in recent years has not reflected the full amount of the County's debt service cost due to the use of debt 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 2022, which is shown (for informational purposes) with and without POBs, which were issued in Fiscal Years 1988, 2013, and 2017. FY 2022 ratio is an estimate.

Sources: Baltimore County budget documents; Baltimore County Annual Comprehensive Financial Reports; Baltimore County Office of Budget and Finance; Baltimore County Office of the County Auditor.