SPENDING AFFORDABILITY ADVISORY COMMITTEE REPORT

FISCAL YEAR 2021

Spending Affordability
Advisory Committee

Committee Members

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Craig Glendenning, Howard County Auditor
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Lonnie R. Robbins, Chief Administrative Officer
Larry Twele, Howard County Economic Development Authority

Howard County Maryland
Spending Affordability
Advisory Committee
Report for Fiscal Year 2021

March 2020

Purpose

County Executive Calvin B. Ball, Ed. D., renewed the Spending Affordability Advisory Committee (the "Committee") through Executive Order in December 2019. The County's Executive's charge to the committee was to:

1. Review in detail the status and projections of revenues and expenditures for the County, not only for fiscal year 2021, but also for fiscal years 2022-2026.

2. Evaluate future County revenue levels and consider the impact of economic indicators such as changes in personal income, assessable base growth, and other data that the Committee considers applicable.

3. Evaluate expenditure levels with consideration of the long-term obligations facing the County, and the best way to pay for them.

The Committee shall present to the County Executive on or before March 1, 2020, a report including:

a. Projected General Fund revenues for the upcoming fiscal year;
b. Recommended new county debt (General Obligation bonds) authorization;
c. An analysis of the long-term fiscal outlook including multi-year projections; and
d. Other findings and/or recommendations that the Committee deems appropriate.

EXECUTIVE SUMMARY

The Spending Affordability Advisory Committee ("Committee") is tasked with making recommendations to the County Executive on revenue projections, General Obligation ("GO") bond authorizations, long-term fiscal outlook, and County revenue and spending patterns. The Committee met from mid-January through late February 2020. During that time, the Committee was briefed by economists, multiple County agencies, and local educational institutions. These meetings helped the Committee develop a better understanding of the County's economic outlook, the needs of individual agencies, revenue sources, debt level, demographic trends, and economic development, as well as long-term fiscal projections and various operating and capital needs.

The Committee reviewed the revenue projections and expenditure requests for FY 2021 and beyond. Based on these presentations, the Committee determined that Howard County ("County") revenue growth is projected to average 2-3% over the next few years but that expenditure requests are considerably outpacing that growth. Future risks include the potential for a weakening national economy over the next two years and the impact of recent local legislation on development-related revenues. Our elected officials have had to make and must continue to make difficult decisions regarding priorities for funding in our County.

As the County has and will continue to face economic and fiscal challenges, the Committee recommends continued caution in both expenditure growth and additional debt authorization.

- Wage growth in this period of economic expansion has been less than past expansionary periods, resulting in slower growth in County personal income tax revenues.

- Historically, the County has benefitted from strong population growth and a highly educated base of professional, high-income residents. This growth has supported the County's strong fiscal position; however, these trends are changing:

    - On the real estate market side, as the supply of developable land has declined, commercial base development capacity is constrained with current zoning, and residential development is in the final stages of a transition from mostly single-family detached housing to an increasing and higher concentration of single-family attached and multi-unit housing. These latter types of development are typically associated with lower property values and lower incomes than average single-family households;

    - On the demographic side, multiple changes, including an aging population, are impacting both revenues and service needs. As residents age from their mid-to-late career period of prime earnings growth and towards retirement, slower growth in County-resident incomes can be expected; and

    - On the policy side, new legislative changes can be expected to slow the rate of County population growth in the near term by simultaneously decreasing the supply of and increasing the costs associated with new development activity.

- Economically, the national economic expansion has been the longest on record. While the probability of a recession in the next six months is considered small, both the Maryland Board of Revenue Estimates ("BRE") and Moody's Analytics ("Moody's") are predicting an economic slowdown in 2021.

County government's revenues are based on two primary revenue streams, property (49%) and income taxes (41%), which together account for 90% of General Fund revenues. For the reasons outlined above, growth at slower than historical rates are likely to continue during the next two to three years. As a result of the trends outlined above, the Committee renews its call for fiscal caution and prudence. The Committee recognizes that maintaining County services at a high level is a core goal; however, growth in the core costs of existing services coupled with demands for new programmatic spending continue to outpace revenue growth. As stakeholders of the County, the Committee members both recognize the importance and benefits of the high-quality services provided by all County agencies and departments. In making our recommendations, the goal of the Committee is not to deny the need for or importance of County spending for programs, but to avoid incurring expenditures beyond the affordable level, in anticipation of future economic downturns and an expected slowdown in revenue growth.

KEY ISSUES & POTENTIAL SOLUTIONS

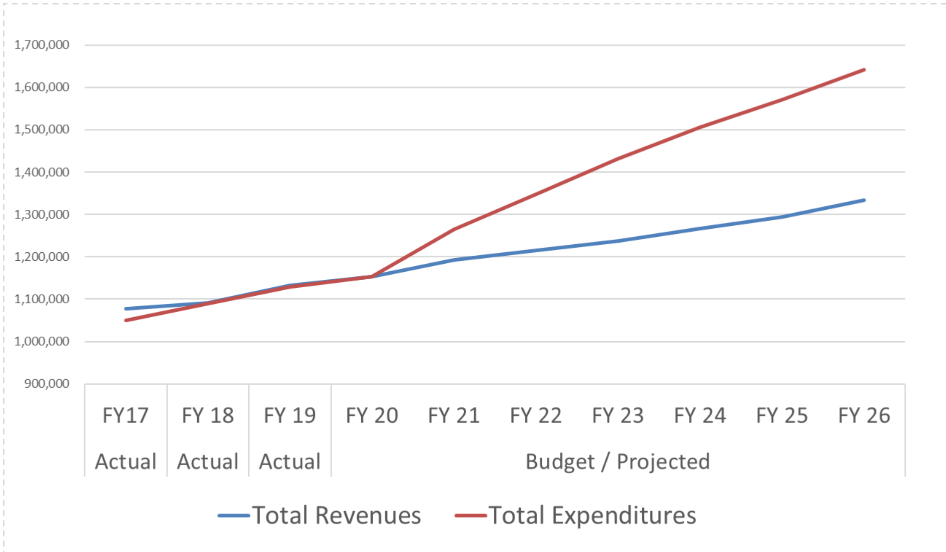
The Committee notes certain major fiscal issues facing the County and makes the following observations and recommendations:

Operating Budget - Requested Expenditures Outpace Revenue Growth

General Fund revenue growth has been steadily slowing with actual revenue growth averaging 2.3% in the past 3 years. A moderate growth forecast of 3.3% in FY 2021 is based on the combination of 2.5% growth in assessable base and a stronger growth in income tax revenue, which is partially benefiting from the lag in impact from federal tax law changes two years ago. However, several factors continue to stress income tax revenue, including a tight labor market and continued net wage loss between residents moving out and moving into the county. Furthermore, recordation taxes, building permits and development fees have shown a significant decline and are expected to see a weak performance in the near term. If there is a recession, revenues will be further stressed. During previous economic recessions, the County experienced revenue losses of $24-$40 million per year.

While growth in revenues over the last decade has slowed significantly, expenditure requests have continued to escalate and exceed available revenues. There is a growing gap between revenues and expenditure requests, making the necessary decisions to align desired funding with fiscal reality increasingly difficult. For FY 2021, there is gap of $74 million in the General Fund based on current expenditure requests and projected revenues. A multi-year projection presented to the Committee based on input from all agencies, including education entities, indicates that the annual structural deficit will likely reach $308 million by FY 2026 without corrective actions. Past County projections presented to this Committee have noted that this structural gap requires both corrective actions and the development of long-term solutions to ensure the needs of the County are being met without shortfalls that require service cuts or other dramatic action in the event of an economic downturn.

Chart 1: Projected Structural Deficit in Operating Budget Without Corrective Actions



Capital Budget – Requests More Than Double Affordable Level; Debt Capacity Depleted

In FY 2021, GO bond-supported capital projects requested by education entities and County agencies totaled $205 million, more than two times the amount approved ($89.8 million) in FY 2020. As of June 30, 2019, the County still had $217 million in previously authorized, but unissued GO bonds, thereby crowding out future debt capacity. The County's Department of Finance projects that debt service payments, as a percentage of total operating budget revenues, will continue to grow over the next 10 years and will exceed the policy ceiling of 10% as soon as FY 2022. This is partly due to a replacement Courthouse to be completed next year but also is attributable to a slowdown in total revenue growth. Debt service payments are projected to continue to outpace growth in revenues and will consume a growing share of total resources. As a result, fewer resources will be available to support all other County services.

Additionally, several revenue resources designated to the Capital Investment Plan ("CIP") have largely been exhausted. This is because of the past issuance of bonds at a level that has obligated most or all projected revenues from those sources for the next 20 years. As a result, absent any change to existing revenue sources and rates, most designated taxes (e.g., building excise tax and transfer taxes) will not be sufficient to support new capital projects in the next 20 years and will be barely enough to fund the annual debt service payments resulting from debt issued years ago.

Key Solutions

- **Tackle revenue options**: The County should continue to explore tax options and conduct annual fee reviews to cover actual costs and maintain critical service needs in the operating budget. Local tax options are limited, especially following multiple revenue enhancement actions taken in 2019-2020. Moreover, approximately 90% of the County's General Fund revenues are generated from property and personal income taxes. The County's personal income tax rate of 3.2% is already at the maximum level allowed; and the property tax rate, including the fire tax, is the second highest in the state. The County also needs to effectively balance resource needs with the management of its tax burden.

- **Prioritize and balance service needs**: With limited growth in revenues, the County must evaluate, prioritize, and realistically address the various service needs. Education has been and should remain the top priority for the County. However, as the County prioritizes education, it must not compromise other services needed by the community. For example, the County's 65+ population has grown 3-4 times faster than student enrollment and total population growth, respectively, and is expected to double in two decades. After all, this County is a "full-service" jurisdiction and must provide resources to households without students; services to those in need; and public safety – police, fire, and emergency medical services - for everyone in the community.

- **Prioritize capital needs and bring them more in line with fiscal reality**: The Committee urges the County to carry out comprehensive long-term capital planning. This includes:

    - evaluating and determining the feasibility of maintaining, renovating, and repairing existing infrastructure while also addressing whether it is practical to initiate new capital projects;
    - balancing service needs, in collaboration with key stakeholders, and bringing total requests (in FY 2021 and also out years) closer to fiscal reality;
    - analyzing and fully accounting for the operating budget impact of capital projects, including staffing and operation and maintenance costs; and
    - continuing to examine previously authorized bonds with a focus on identifying opportunities to close out or reduce the scope of lower priority projects to free up bond capacity.

Acknowledgement of County Actions

Last year, the Committee recommended that the County review taxes and fees for potential revenue enhancement. The Committee acknowledges that the County has taken various actions in the past year to raise revenues, including:

- Fire and Rescue Fund – raised Fire Tax by 6 cents and implemented an EMS Transport Fee that is restricted for the use of the Department of Fire and Rescue Services in FY 2020.

- Environmental Services Fund – raised Refuse Curbside Collection fee from $210/year to $310/year in FY 2020. The Environmental Services Fund is restricted to cover the expenses of waste collection, disposal, recycling, and the County landfill operation.

- Disposable Plastics Reduction Fund - The Council also passed CB64-2019, establishing a 5-cent plastic bag fee in FY 2021.

- School Facilities Surcharge – CB42-2019, passed by the Council in FY2020, will phase in the surcharge increase from the current $1.32/sq. ft. to $4.75/sq. ft. in 2020, $6.50/sq. ft. in 2021, and $7.50/sq. ft. in 2022, with consumer price index adjustments thereafter. The School Facilities Surcharge is designated solely for HCPSS capital projects.

- Transfer Tax – a State enabling bill, which allows the County to increase the transfer tax, is pending General Assembly approval in this session. Once passed by the state, local legislation will be required to increase the local tax. The transfer tax is designated to capital projects for HCPSS, Recreation and Parks, Fire, and Agricultural Land Preservation, and also funds housing programs through the Department of Housing and Community Development.

The Committee also previously recommended limiting new authorized GO bonds to $70 million, given the escalating debt service payments and their impact on available operating budget resources for other critical needs. County-authorized GO bonds in the FY 2020 budget ($89.8 million) exceeded the Committee's recommendation, but represents, nevertheless, the lowest debt level authorized in the annual County CIP budget in the past decade. The Committee acknowledges the County's improved fiscal prudence on authorized capital spending.

RECOMMENDATIONS

1. Projections of Revenue for Fiscal Year 2021

The Committee recommends a budget based on total projected General Fund revenues of $1.19 billion in FY 2021, an increase of 3.3% ($38.1 million) over FY 2020 budget (excluding use of fund balance).

The County is required by law to adopt a balanced budget. The Committee concurs with the Budget Office's projection for FY 2021 of a revenue increase of no more than 3.3% over the FY 2020 budget. Property and personal income taxes make up approximately 90% of the total General Fund revenues. The assessable base for properties will maintain a moderate growth of 2.5% based on latest State data. Income tax revenue is expected to show a relatively strong performance; largely attributable to a (one-time) reconciliation, resulting from the delayed impact of changes in the federal tax law two years ago. Recordation taxes, building permits and development fees have declined significantly in the past several months and are expected to maintain a weak performance.

With growing concerns regarding an economic downturn or recession in 2021 or beyond, the Committee believes that the County should make plans for a potential shortfall. There is a high level of uncertainty on the horizon; therefore, the Committee recommends that the County adopt an FY 2021 budget with expenditures below the projected revenues. Such a decision would provide the County the flexibility to mitigate the impact of any weakened revenues on the delivery of core services, which otherwise could be severe. The Committee believes that the County and all its stakeholders must come to terms with fiscal realities amid the impending uncertainties, followed by taking immediate and proactive steps to manage and control spending.

2. A Recommended Level of New County Debt Authorization

The Committee recommends limiting new authorized General Obligation bonds in FY 2021 to $70 million.

The Committee once again recommends that the County lower its new GO bond authorization to $70 million for FY 2021. As previously stated, the County is facing significant fiscal challenges as growth in revenues can no longer keep up with projected growth in expenditures. Also, as presented by the Department of Finance, the County had $217 million in authorized but unissued bonds at the end of FY 2019. In the next several years, the County will take on significant new debt to finance the Ellicott City Flood Mitigation Plan, the replacement courthouse and the pressing needs for a new Detention Center. Additionally, other high-priority capital needs such as education, the maintenance and renovation of existing facilities and infrastructure loom large. The Committee believes that these significant CIP challenges also offer an opportunity for the County to take a proactive and strategic approach to address immediate and long-term needs and communicate with key stakeholders.

Howard County has approved an average of $95 million a year in GO bond authorization in annual CIP budgets in each of the past five years. In light of the fiscal constraints described above, the Committee recommends that any new or additional revenues designated to CIP (e.g., the increase in the School Surcharge Fee based on CB42-2019) be used to directly fund capital projects as opposed to being used to leverage additional debt authorization. Otherwise, these new revenues would not only fail to provide needed relief in the County's debt burden, but also would increase the total impact of capital projects on the operating budget due to associated staffing and operation and maintenance costs. It is important that the County's overall debt burden be maintained at a reasonable level without impacting the County's capacity to support those service priorities identified in the operating budget. This action also will help to preserve the County's AAA credit rating, allowing the County to borrow at the most favorable terms.

3. Long-Term Fiscal Outlook and Issues

A multi-year revenue and expenditure model developed by the Budget Office suggests that General Fund revenues will likely grow an average of 2.3% in the successive years through FY 2026. This does not account for the potential recession or the impacts of federal and state policies. Given the increased uncertainty we must confront during the next few years, the Committee recommends that the County be more conservative and count on lower rates of revenue growth during FY 2022–FY 2026. The Committee recommends that the County revise its projection down slightly to 2.0% per year through FY 2026 to account for all these potential factors which could negatively impact revenues.

A review of projected multi-year expenditures, based on requests from all departments, agencies and education entities, indicated that requested expenditures will exceed projected revenues by $74 million in FY 2021, and the structural gap will grow to $308 million by FY 2026 without corrective actions. Specifically, FY 2022 and FY 2023 are projected to be difficult, given known commitments that are scheduled for funding, such as:

- projected annual debt service payments for existing and new debt issued to finance capital projects;
- scheduled annual payment for the replacement Courthouse (that will be completed in 2021) based on a 30-year contract;
- state-mandated annual Maintenance of Effort ("MOE") contribution to the Howard County Public School System ("HCPSS")

After fulfilling these obligations, resources available for all other services in the County (including any funding above MOE to HCPSS) will be very constrained in FY 2022 and FY 2023, making those two years extremely challenging. (See Chart 8 on Page 19). The Committee recommends that the County proactively work on developing a multi-year fiscal plan to get ahead of the curve and be better prepared for the challenges of these near-term and future years. The multi-year plan needs to balance service needs and capital projects with resources, producing a sound fiscal structure that will support the County's priorities.

4. Other Recommendations that the Committee Deem Appropriate

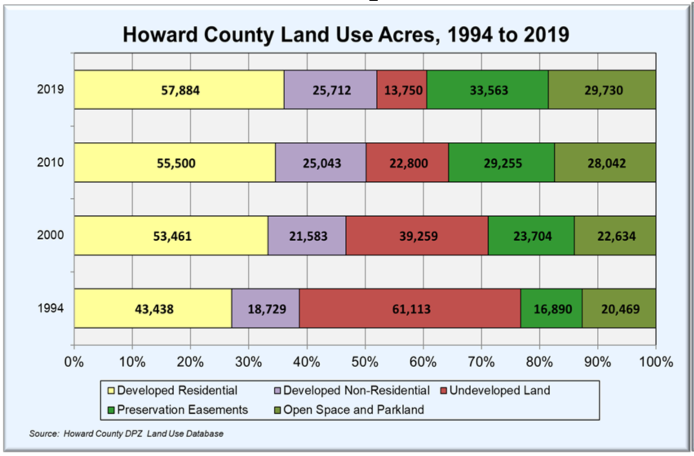
- **Annual Fee Review:** Given the multiple revenue enhancements that the County undertook in FY 2019 and FY 2020, the options for additional revenue enhancements moving forward have become limited. Currently, operating expenses and capital needs continue to outpace projected growth in revenues. The Committee recommends that the County conduct annually a comprehensive review of all fees and built in fee waivers and special exceptions, to identify any potential adjustments to fees, waivers, or special exceptions, with the goal of covering the cost of services provided. Furthermore, given additional revenue enhancement options are limited, the Committee also recommends that the County focus on cost-saving measures, including bringing future expenditure requests in line with revenues.

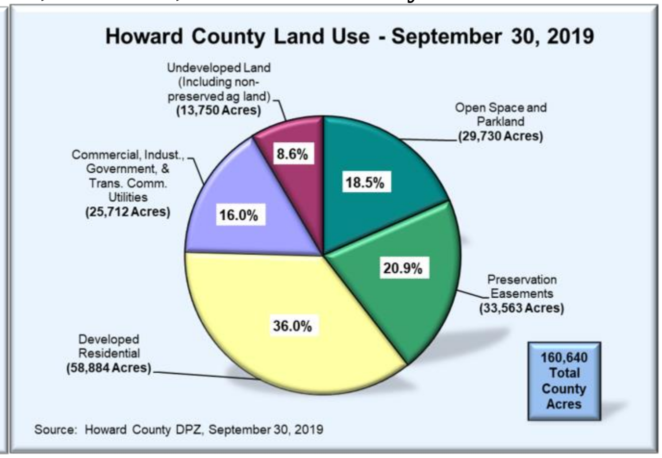
- **Impact Analysis of New Legislation:** The Committee recommends that a fiscal impact analysis accompany any local legislation with the potential for producing a sizable impact on revenues or expenditures and asks that the analysis be shared with the public. If needed, the County may consider hiring consultants to conduct such analysis of major legislation, including tax changes. This will provide a better understanding of the potential impact of such legislation in the current year and in the future. Moreover, the Committee encourages the County to be more strategic and predictable in developing and implementing new policy measures (including taxation), which was cited as an issue of concern by representatives of the business community. Maintaining the County's attractiveness to existing and new investment is critical to increasing the County's future tax base.

- **The General Plan:** The County is currently in the beginning phases of updating the General Plan. The Committee believes that this is especially significant as the County is in a period of transition. What has worked for the County in the past will no longer work moving forward. In developing the General Plan, the County should focus on using the plan to support long-term strategic priorities and improve the County's fiscal outlook, taking into full consideration housing, demographics, employment, land uses, mobility, and business trends. The Committee was informed by the Economic Development Authority, the Department of Planning and Zoning, and the Budget Office, that, in terms of potential growth, the County should focus on increasing the size of the commercial assessable base. This requires addressing land constraints and examining more efficient use of commercially zoned properties (e.g., building height restrictions, parking ratios, etc.). As new residential development will continue to decrease, due to limited developable land and legislative restrictions, the County should enhance its efforts to expand the commercial base and attract businesses to the County. The Committee recommends that in updating the General Plan, the County think creatively about how to maximize revenues, such as considering zoning laws that allow for more commercial development or looking at parking ratios and largely under-used lots that can be repurposed to support more development of this kind.

  Furthermore, the demand for housing in Howard County will likely remain in the years ahead. If Howard County is to remain competitive with neighboring jurisdictions in the Baltimore and Washington region, adequate housing will need to be accommodated. Existing businesses will not have the incentive to grow, nor will new businesses wish to locate in Howard County, if housing for their workers is in short supply. In addition, efforts will need to be made to provide adequate affordable housing to accommodate the full range of worker salaries. The recently initiated Howard County Housing Master Plan update, led by the Howard County Department of Housing, will include updated housing policies. This Housing Master Plan will be incorporated as an element of the General Plan update.

Chart 2: Undeveloped Land Decreased to 13,750 acres, or 9% of County Land in 2019





- **Multi-Year Projections & Strategic Planning:** The Committee believes that the County needs to work jointly with all stakeholders to develop a long-term fiscal approach that addresses the priority needs of the community and is fiscally sustainable. Following the Committee's recommendations last year, the County developed a multi-year projection of both revenues and expenditures, incorporating input from all stakeholders of County revenues such as County agencies, the HCPSS, the Howard Community College (HCC), and the Howard County Library System (HCLS). The County predicted a significant structural gap between revenues and expenditures in out years. Beginning in 2022, multiple key revenue sources in the General Fund associated with new development will be impacted by known legislative changes, while service costs as well as the County's population and need for services will continue to grow. There comes a point in which expenditures can be reduced only so much without adversely impacting services. (See Chart 1 on Page 3 for multi-year projections before corrective actions, and Chart 8 on Page 19 for multi-year projection details based on balanced budget)

- **Multi-Year Capital Plan:** The Committee recognizes that the County has accepted its prior recommendation to move towards a more realistic CIP multi-year plan and has narrowed the gap between requested and affordable CIP plans in out years. The Committee also acknowledges the County's effort to reduce the amount of authorized but unissued bonds. The efforts, however, remain insufficient as requested funding for out years continues to significantly outpace available funding. The Committee makes the following recommendations in hopes that they would be instituted in time for incorporation in the FY 2021-2026 capital budget.

  - **Capital Expenditures:** The Committee recommends that the County make continued progress in developing its FY 2021-2026 CIP to keep it more in line with current and projected funding availability. While this is the first step to control and plan for CIP expenditures, the Committee also believes that the County must comprehensively analyze and quantify the impact of capital projects on the operating budget. The Committee recommends that the County include an operating budget impact analysis in evaluating all capital projects. For example, when considering the capital budget for a new facility, the County must assess the new cost of operations for that facility in its multi-year operating budget plan, including an increase in staff, operating and maintenance, and all other costs associated with running the facility. This type of analysis must be completed for all planned capital projects to better understand their operating budget impact in future years on an already stressed General Fund.

- **Capital Revenues:** The Committee acknowledges that the County has taken positive steps to increase revenues for capital-related projects. However, as stated earlier, the Committee strongly recommends that new or enhanced funding designated for capital projects be applied to reduce the total debt supported by non-designated funding in operating budget funds, rather than be used to increase new debt or expand capital projects. The Committee also believes that all stakeholders of Howard County should come together to determine key capital and infrastructure priorities and the appropriate funding mechanisms.

- **General Obligation Bond Study:** The Committee urges the County to continuously review its existing authorized GO bonds in order to determine whether additional deauthorization is advisable and would allow the County to free up debt capacity. The Committee acknowledges that since its recommendation three years ago, the County has decreased authorized but unissued bonds from $381 million to $217 million. However, the current financial climate will require even more fiscal prudence. The Committee is recommending the continuation of this effort to free up debt capacity where possible since resources available for CIP financing will continue to be stressed.

- **Increase County Fund Balance**: As the County heads into an uncertain economic future, including a potential recession or economic downturn, maintaining and growing a healthy fund balance will be critical to allowing the County budget flexibility to address upcoming economic challenges and unforeseen risks. Increasing the fund balance will help the County maintain its current level of services and commitment to priorities without having to make severe cuts to critical constituent services. Growing the fund balance is also critical to maintaining the County's AAA bond rating, as it demonstrates to the credit-rating agencies that the County has the capacity to face an economic downturn without drastic actions or dipping into the Rainy-Day Fund (which is currently equivalent to only 3.5 weeks of cash flow). It is imperative that the County avoid dipping into the Rainy-Day Fund, which would be perceived negatively by rating agencies and potentially damage the County's overall fiscal position.

  By County Charter, the County must maintain the Rainy-Day Fund at 7% of the previous fiscal year's audited General Fund expenditures. The County's financial advisors recommended that the County add another 3% policy reserve on top of the Rainy-Day fund, taking the total reserve to 10% of audited expenditures in the General Fund. The Committee concurs with this advice and recommends that the County develop a multi-year plan to increase the total reserve to 10%. As of the close of the last fiscal year, June 30, 2019, the fund balance in the Rainy-Day Fund is approximately $74 million. The 10% target would require that the County contribute an additional $32 million to reach that target. The Committee understands the County's current fiscal reality and understands that this cannot be accomplished in one year, however, it recommends that the County create a plan to phase-in increases to bring the fund balance to that target.

- **Howard County Public School System (HCPSS) Budget and Balanced Needs:** County funding to HCPSS is approximately 58% of the total General Fund budget, including debt service and health benefits for HCPSS employees and retirees. Total County spending on education, including HCPSS, Howard Community College (HCC), and Howard County Library System (HCLS), represents approximately 64% of the General Fund budget. The Superintendent's FY 2021 budget requested County funding in the amount of $670.4 million, which is $63.2 million higher than the amount approved in the FY 2020 budget. Excluding the request of $9 million one-time funding to address the HCPSS Health & Dental Fund deficit, the total requested increase in on-going County funding is $54.2 million (8.9% growth) over the FY 2020 budget or $43.8 million above the state-mandated MOE increase of $10.4 million.

The Board of Education ("BOE") approved request for FY 2021 County funding is $657.2 million, representing a $50 million increase over the County Council approved budget in FY 2020. Excluding $6 million in one-time funding to address the HCPSS Health & Dental Fund shortfall, the BOE is seeking an increase in on-going County funding of $44.0 million (7.2% growth) or $33.6 million higher than the required MOE amount.

Both budget requests - the Superintendent's and the BOE's – for increased County funding far outpace the County's entire General Fund revenue annual growth in FY 2021. To fully fund such a request would likely result in either significant cuts to County services or major tax increases, both imposing daily impacts on County stakeholders. The requested annual increases by HCPSS are unaffordable in FY 2021, based on fiscal reality, and are unsustainable, based on the fiscal outlook for future years. Howard County is a full-service jurisdiction that needs to balance all service needs of the community. The Committee recommends that the County use caution in committing any funding above the required MOE to HCPSS for recurring expenditures. Any amount above MOE level would increase the annual base and make it more challenging in future years to support both the entire County and HCPSS operating budgets.

The Committee continues to urge HCPSS to develop a budget request that acknowledges the financial realities in the County. All County departments and agencies are required to submit budget requests that reflect current fiscal realities and HCPSS should not be exempted. The Committee recommends that the HCPSS prioritize their needs and find innovative solutions to live within the available funding sources while continuing to deliver quality services with enhanced accountability and efficiency.

Another issue facing the HCPSS, which was not discussed in depth by the Committee, is the potential impact of the Kirwan Commission recommendations and resulting legislative initiatives on future budgets. While the analysis by the State Department of Legislative Services (DLS) of the Kirwan-related Blueprint for Maryland's Future (SB1000) indicates that due to significant County investment into HCPSS year after year, current and projected County funding to HCPSS should be more than sufficient to meet the projected local matching required for additional state funding, there remain a number of uncertainties as to future fiscal impacts on both state and local funding.

- **County Services:** The Committee discussed all constituent services and whether, during these times of fiscal uncertainty, the County is delivering the "same level of services" year after year. The Committee recommends that the County continue to track and provide key performance indicators, through HOCODash portal, the budget document and other publications, to evaluate core services and monitor whether the County is providing the same level of service for core services every year. With declining revenues, tighter budgets, and a County population that continues to grow, the Committee believes that the County should have the performance and financial data to define what "same level of service" means.

- **Spending Affordability Advisory Committee:** The Committee recommends that the County make the Spending Affordability Advisory Committee a standing committee that weighs in on budget and County economic-related decisions throughout the fiscal year.

- **Outreach and on-going meetings:** In some years, members of the Committee met with various county organizations, businesses, and the media to engage and educate the public regarding the County's financial health and the challenges it faces, such as those in cited this report, and seek their input regarding potential options and solutions. The Committee recommends that the County and members of the Committee join together to strengthen these efforts to educate the public on the County's long-term fiscal outlook and projected challenges. Making the Committee a standing committee with regular meetings and communications with the County could help in these community outreach efforts.

We would like to thank all the Committee members for their time and effort providing valuable insight and thoughtful ideas which will help inform County decision makers as they undertake today’s challenges and opportunities. We also want to thank all the presenters who shared valuable information and analysis with the Committee.

II. DETAILS / BACKGROUND

1. Economic Outlook

The Howard County Budget Office retained Richard Clinch, PhD, Director of the Jacob France Institute at University of Baltimore to prepare a County personal income projection through FY 2021 and a report on overall national, state and regional economic trends and their expected impact on the County's economy and government finances. This report was prepared to provide personal income and economic data to inform the County's Spending Affordability Committee and process. The key findings of this analysis are as follows:

National Economy:

- the national expansion continued unabated in 2019, with real GDP growth of 2.3% and employment growth of 1.6%, making this the longest recovery on record;
- both Moody's and the BRE are projecting continued growth for the U.S. economy in terms of both real GDP and employment in 2020, with a potential economic slowdown occurring in 2021;
- Moody's projects that U.S. real GDP will grow by 2.3% in 2019, 1.7% in 2020 and 2.1% in 2021, with BRE projecting real GDP of 2.3%, 2.1%, and 2.0%, respectively; and
- Moody's projects that U.S. employment will grow by 1.5% in 2019, by 9.8% in 2020, and no growth or a decline in 2021, and the BRE projects growth of 1.6%, 1.2%, and 0.8%, over the same period.

State Economy:

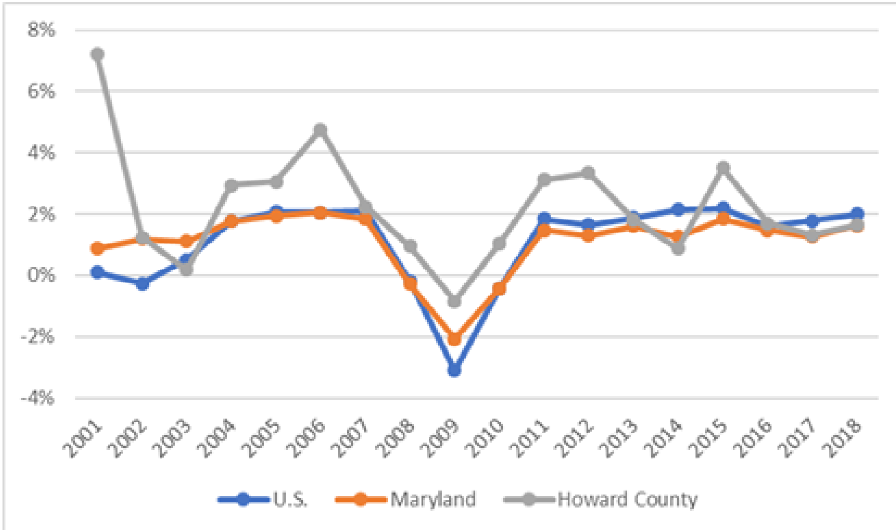
- both Moody's and the BRE are projecting continued, but slower than national, personal income and employment growth in Maryland;
- Moody's projects that Maryland personal income will grow by 3.0% in 2019, 2.9% in 2020, and 2.4% in 2021 and that Maryland employment will increase by 0.4%, 0.5%, and 0.0% over the same period; and
- the BRE projects that Maryland personal income will grow by 3.8% in 2019, 3.5% in 2020, and 3.7% in 2021, and that Maryland employment will increase by 0.8%, 0.6%, ad 0.5%, respectively.

Howard County Economy:

- despite strong growth in County personal income in 2018 and expected growth in 2019, uncertainties call for continued caution in County spending growth. These include: 1) the prospect of an expected slowdown in national economic growth or even a mild recession at the end of 2020 or during 2021; and 2) policy-driven reductions in County new development resulting in slower growth in the County's labor force and base of employed residents which can be expected to reduce growth in County personal income and resulting income tax revenues; and
- County personal income is projected to grow by 5.0% in FY 2019, 3.9% in FY 2020, 3.1% in FY 2021, 2.9% in FY 2022 and by 3.5% in FY 2023. On an annual basis, County personal income is

projected to grow by 4.3% in 2019, 3.5% in 2020, 2.7% in 2021, 3.1% in 2022 and by 3.9% in 2023 and 2024.

Chart 3: Total Employment Growth – U.S., Maryland, and Howard County



- Maryland and Howard County unemployment rates have been below the national average nearly continuously since 2001; however, in the recovery from the Great Recession, the gap narrowed and for most of 2018 Maryland's unemployment rate was actually higher than the national average,

- Howard County's unemployment rate at 2.4 percent remains well below the national (3.7 percent) and Maryland (3.2 percent) rates.

- Maryland lost fewer jobs than the nation in the Great Recession, but its employment growth has consistently lagged the nation throughout the recovery. More troubling is that while employment growth in Howard County has consistently outpaced growth in Maryland, County employment growth has actually lagged the nation for four of the past six years. While County personal income growth has historically outpaced both the nation and Maryland, County personal income growth in the economic recovery has lagged national growth.

- The County currently faces multiple local constraints on growth, including:

    - the County's median household income increased by almost 5% since it's decline in 2017 from $111, 576 to $116,719; however, it is lower than the estimated amount in 2016 and since 2016, the County has dropped from having the second highest estimated median household income to 11th in 2018;

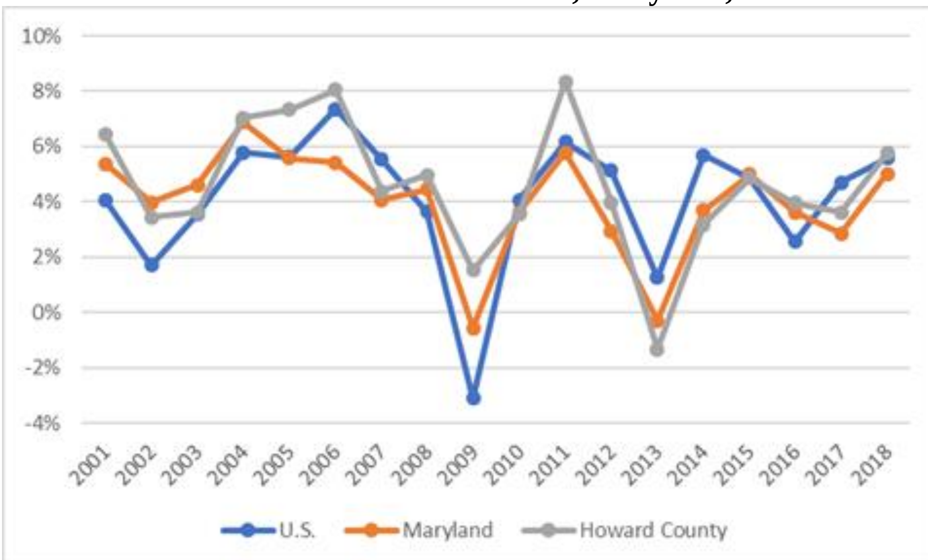
    - workforce is at full capacity with high labor force participation (71%) and very low unemployment (2.4%);

    - after experiencing slower than historical labor force growth, preliminary data indicate a return to historical norms in both the County workforce and base of employed residents in 2019 that is expected to continue in 2020. However, reduced levels of development activity can be expected to slow the rate of population and household growth with a resulting slowdown in the growth of the County's resident labor force and base of employed residents;

- potential impact from anticipated slowdown in population and new development growth in coming years due to legislative changes in recent years; and

- uncertainties on federal spending and policies.

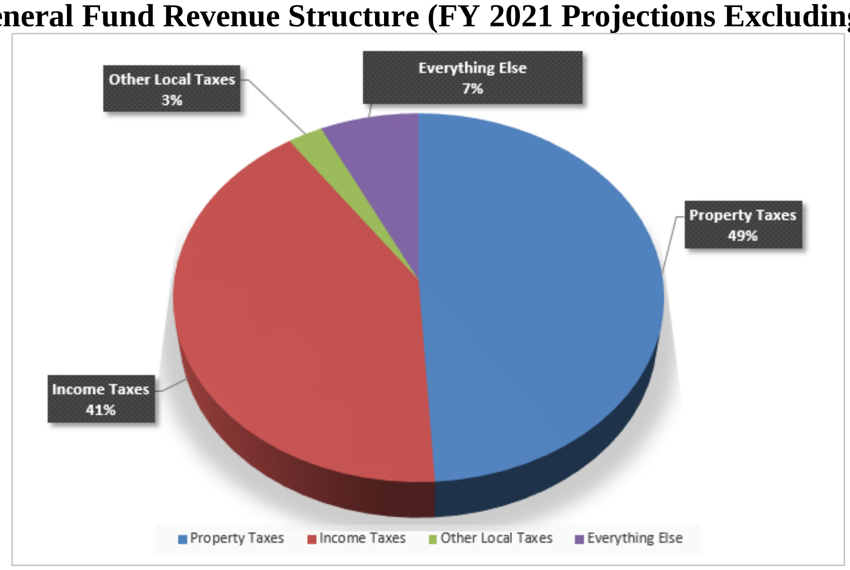
Chart 4: Personal Income Growth – U.S., Maryland, and Howard County



2. Revenue Outlook

Howard County's General Fund revenues rely primarily on two sources, property tax (49%) and personal income tax (41%). These two revenue sources have made up approximately 90% of overall revenues over the last few years and the trend will continue going into FY 2021. The County forecast for General Fund growth in FY 2021 over FY 2020 budget is 3.3%.

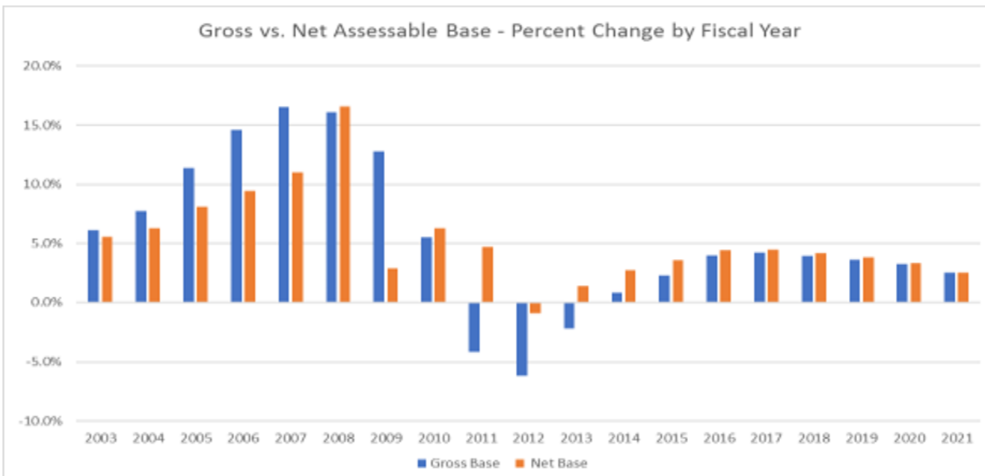
Chart 5: General Fund Revenue Structure (FY 2021 Projections Excluding One-Time Funds)



<u>Property Tax</u> reassessment has continued to slow down and lagged the state average for the fifth straight year. The net assessable base for FY 2021 is projected to grow at 2.5% over FY 2020 continuing the

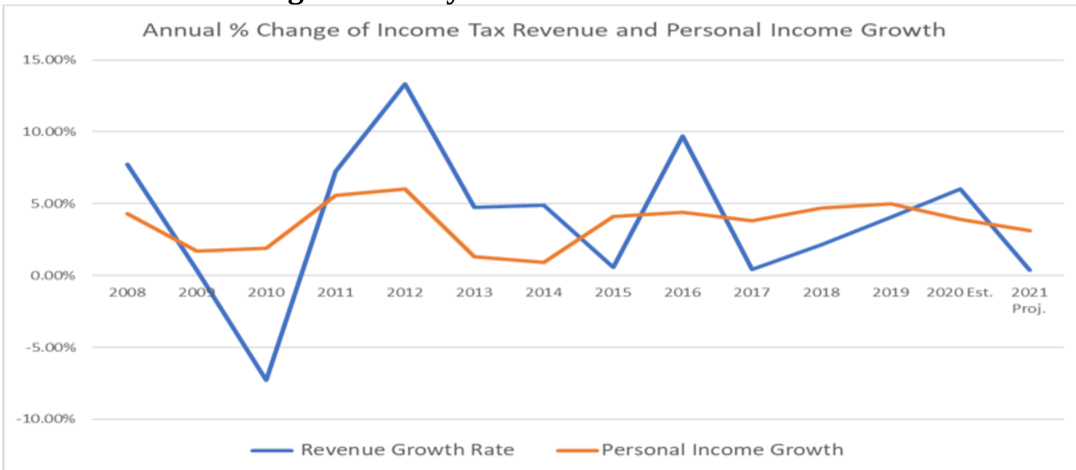
County's slow property tax growth post-recession. The State Department of Assessments and Taxation reassessed Group 2 at 8.3% (state 8.9%) at full value, or 2.8% on average in the next three years. The residential reassessment of 6.7% was slightly lower than the state average of 7.3%. The commercial base reassessment of 14.0% (state 13.5%) continues to outpace the growth of the residential base and continues to be a significant driver of the overall annual assessment growth for the County. One issue that continues to be a concern is that with Homestead tax revenue dropping from over $100 million years ago to less than $1.8 million per year, the County no longer has a cushion and could suffer immediate and significant revenue impact if there is another housing market downturn. Further, property tax growth is expected to slow down starting from 2022, when the four-year moratorium is scheduled to take effect and impact a sizable portion of new development based on more restrictive legislation passed.

Chart 6: County Assessable Base Annual % Change History
(Net assessment reflects taxable base after accounting for the Homestead Credit)



Personal Income Taxes have recovered slightly and continue to increase in FY 2021, partly thanks to delayed revenue impact from the Tax Cuts and Job Act ("TCJA") two years ago. While the County is experiencing a relatively strong performance in FY 2020, the increase is primarily attributed to a reconciliation to 2018 tax due to TCJA and likely be short-lived according to state officials. Looking forward, the shift in demographics of lower income employees replacing higher income and retirement level employees continue to be a concern for income tax increases in the long run. Two other major concerns are on the horizon: the first being the impact of passed legislation that will slow development in the County through FY 2026, potentially slowing both household growth and the resident labor force; and, the second being the uncertainty of an economic downturn. The current economic expansion is the longest on record and an economic slowdown at a minimum and possibly a mild recession remains possible through 2021. Both the Maryland Board of Revenue Estimate's and Moody's are projecting a slowdown of the national economy in 2021, which could impact revenues in FY 2021 and beyond. Income tax remains the most volatile key revenue source in the operating budget due to a significant gap between personal income growth and income tax growth on an annual basis (see Chart 7). This adds to the difficulty and risks in income tax projections.

Chart 7: Annual % Change of County Income Tax Revenue vs Personal Income Growth



Starting in the second half of FY 2021, the County will begin its repayment of its historical liabilities of the Wynne decision. The County has taken into account the negative impact of the Wynne case in its revenue growth projections in out years, The County has outstanding historical liabilities (approximately $9 million) to be paid off in the next several years based on processed and approved cases by the State Comptroller's Office. In addition, taxpayers' applications based on the Wynne decision is estimated to result in revenue losses of approximately $1.5- $2.0 million per year in County income taxes.

Other Revenues, overall, are projected to either stay relatively flat or experience minor growth. Some revenues, such as the Recordation Tax, building permits and development fees and charges have experienced a decline and are expected to see a weak performance continuously. Other taxes, such as the Hotel/Motel tax and the Admissions and Amusement tax have seen a relatively strong performances and are projected to continue this performance into FY 2021. The Governor's FY 2021 proposed State Aid budget increased by 5.3% over FY 2020, with the majority of the aid dedicated to education.

3. Debt Indicators

In order to determine Howard County's relative debt position, the Committee in past years has evaluated the County's debt based on measures used and published by Moody's Investor Service and International City/County Management Association publications. Four measures have been used to evaluate the County's debt burden and debt affordability:

- Debt measured as a percent of the County's assessable base. The current County charter limit is set at 4.8 percent of assessed value.
- Debt measured against the population on a per capita basis. Per capita debt exceeding $1,200 (unadjusted for inflation over the past 10 years) may be considered excessive by rating agencies.
- Per capita debt measured as a percent of the jurisdiction's per capita personal income. This measure should not exceed 10 percent in the view of many analysts.
- Debt Service as a percent of current revenues. This is the most important debt indicator among the four listed. Ten percent or below is considered an appropriate level, with 15 percent and above regarded a danger point.

The latest values of these four debt indicators are listed below. (Note: The previous year's measures are shown in brackets []).

Measure #1: Debt as a Percent of the Assessable Base

As of June 30, 2019, [2018], Howard County had an assessable base of **$53,412,616,240** [$51,518,005,000] and a General Obligation (GO) Debt of **$1,203,728,872 [**$1,162,521,552]. This means that the ratio of debt to base was **2.25%** [2.26%] of assessed value versus the 4.8% limit. Preliminary projections indicate that this measure will remain relatively low in coming years.

Measure #2: Debt measured against the population on a per-capita basis.

As of June 30, 2019, [2018], Howard County had a population of 326,286 [323,293] and a General Obligation Debt of **$1,203,728,872 [**$1,162,521,552] generating a per-capita debt of **$3,689** [$3,596].

Measure #3: Per-capita debt measured as a percent of per-capita income

As of June 30, 2019, [2018], Howard County residents had an estimated per-capita personal income of **$78,066** [$75,826] and a per-capita debt of **$3,689** [$3,596] equaling a per-capita debt of **4.73%** [4.74%] of per-capita income.

Measure #4: Debt Service as a percent of current revenues.

In FY 2019 [2018], the County received **$1,245,231,468** [$1,212,554,099] in revenues from the General Fund, Fire and Rescue Fund, and Environmental Service Fund and paid debt service of **$115,306,337 [**$104,019,112]. Thus, debt service equaled **9.26%** [8.58%] of current revenues. This debt indicator is the most important measure of the four, indicating not only debt affordability but also the ability of the General Fund to support other strategic priorities (after dedicating resources to debt obligations).

This indicator is projected to grow continuously partly driven by existing authorized but not issued GO bonds and increased current and future capital needs from HCPSS and the County. Partly due to the one-time effort of the new courthouse project, the County is expected to exceed the 10% policy target in FY 2022 – FY 2030. After that this indicator is expected to trend down and fall below 10%. It is worth noticing that 10% is a self-imposed policy ceiling and exceeding it temporarily is not predicted to cause any immediate changes in County credit ratings. Nevertheless, the Committee is aware of the tight debt capacity based on current revenue streams and CIP needs, and encourages the County to closely monitor this indicator and avoid it going too high for too long.

4. Multi-Year Projections

The County's budget office developed multi-year projections based on historical trends and anticipated drivers of revenue growth and expenditures. Preliminary projections show that General Fund revenue growth will continue a moderate growth averaging 2.3% per year during the FY 2022 - FY 2026 period. The Committee remains concerned, especially considering future economic uncertainty and the potential legislative impact on new development associated revenues. As a result, the Committee recommends taking a prudent approach and revising the future year revenue projections down slightly to 2% per year through FY 2026.

On the expenditure side, total requests, incorporating input from all departments and agencies including education entities, exceed projected revenues significantly during the FY 2020 – FY 2026 period before corrective actions. Major cost drivers include increased needs in education, growth in compensation and fringe benefits for all employees, debt service payments to support capital projects, and ever-increasing needs of the community. A few known commitments, including the State-mandated annual MOE funding increase to HCPSS, the growing annual debt service payments to fund capital projects, and the annual payments to start in FY 2022 and FY 2023 for the new courthouse, add to the challenges, indicate that revenues available to support all other services will be very limited in the next several years.

It is imperative that the County continues to work with key stakeholders to find ways to live within its means while supporting critical services. It is time for the County, as a whole, to review core processes and services and find efficiencies in order to reduce costs instead of simply raising more revenues to meet service needs. At the same time, we must find ways to use the County's excellent resources to continue to attract high quality businesses, employees, and residents.

As in all models, the multi-year projection scenarios listed are based on a set of assumptions that could change when new information becomes available or the impact of changes in policy are considered. Nevertheless, this modelling provides a tool useful in identifying the affordable level of growth and understanding the implications of different scenarios.

Howard County Revenue/Expenditure Growth Projections Model

The County's Budget Office develops multi-year projections for its General Fund. The following model shows preliminary revenue projections for FY 2021 – FY 2026. In terms of expenditures, the County is required to pass a balanced budget annually with the expenditures staying within projected revenues. Projected revenues in out years beyond FY 2021 average 2% growth per year based on SAAC recommendation, slightly below recent experiences of the audited General Fund revenues, which averaged a 2.3% growth in the past three years. In the next few years, General Fund revenues will likely be impacted by a potential economic downturn and a slowdown in various revenues generated from new development due to local legislative changes.

Details of the multi-year revenue projections and one possible expenditure scenario that match the projected revenue growth are shown in the table below. It is worth mentioning that the County is scheduled to fund a few known commitments that will initiate projects and/or require greater funding in near future, including:

- projected annual debt service payments for capital projects;

- scheduled annual payment for the new Courthouse, including capital financing and operating and maintenance based on a 30-year contract; and

- mandated annual MOE contribution to HCPSS (tentatively assuming 1.5% student enrollment growth or the average in the past decade).

After fulfilling those obligations, revenues available for all other services of the County (including for any above-MOE funding to HCPSS) will be constrained in FY 2022 and FY 2023, making those two years particularly challenging.

Chart 8: General Fund Multi-Year Projections

Revenues	Projected					
($ in thousands)	***FY21***	***FY 22***	***FY 23***	***FY 24***	***FY 25***	***FY 26***
Property Taxes	584,771	591,790	603,172	615,993	628,313	640,879
Income Taxes	492,181	506,215	521,452	532,225	544,785	557,092
Other Local Taxes	30,050	31,950	28,750	29,050	28,550	28,550
State Shared Taxes	3,686	3,796	3,910	4,027	4,148	4,273
Charges / Permits	36,241	36,567	36,896	37,228	37,563	37,901
Investments/Transfers	45,091	45,542	45,997	46,457	46,922	47,391
Total Revenues	***1,192,020***	***1,215,860***	***1,240,177***	***1,264,981***	***1,290,280***	***1,316,086***
% Growth	**3.3%**	**2.0%**	**2.0%**	**2.0%**	**2.0%**	**2.0%**
	Projected					
Expenditure - Balancing Total Revenues	***FY21***	***FY 22***	***FY 23***	***FY 24***	***FY 25***	***FY 26***
Debt Service	*129,398*	*140,316*	*152,513*	*160,481*	*165,772*	*169,737*
Courthouse payment *		*10,340*	*15,547*	*15,653*	*15,763*	*15,870*
HCPSS - MOE level (assume 1.5% growth)	*617,600*	*626,864*	*636,267*	*645,811*	*655,498*	*665,331*
All Other (HCPSS above MOE funding, HCC, HCLS, and 26 County agencies)	*445,022*	*438,340*	*435,850*	*443,036*	*453,247*	*465,148*
All Other % Growth		**-1.5%**	**-0.6%**	**1.6%**	**2.3%**	**2.6%**
Total Expenditures	***1,192,020***	***1,215,860***	***1,240,177***	***1,264,981***	***1,290,280***	***1,316,086***

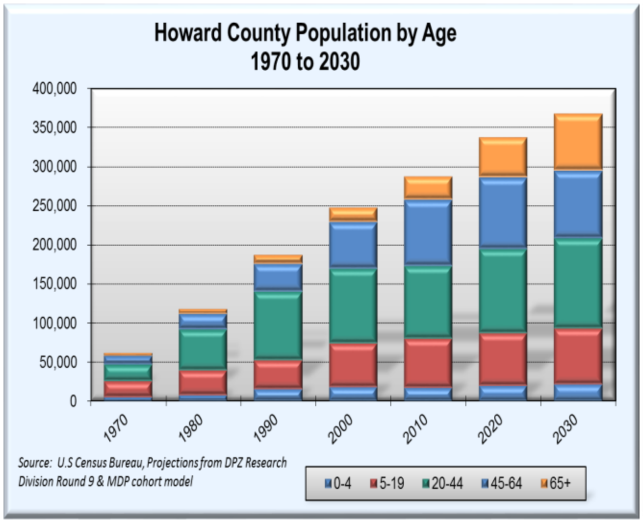
*Courthouse annual payment starts in FY 2022 based on a 30-year contract to cover construction financing and annual operating and maintenance. The new Courthouse project was approved in 2017 by elected officials from all three branches of the government to replace the existing courthouse built in 1843 to address security and capacity deficiency. The project is delivered through an award-winning Public-Private-Partnership with completion scheduled in 2021.

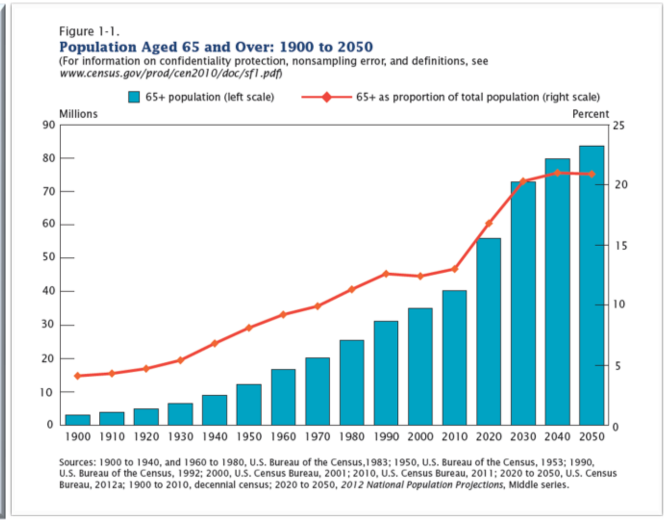
5. **Demographic and economic development trends**
The Department of Planning and Zoning's presentation on key demographic and economic trends continues to emphasize the concerns that this Committee has had over the last few years. These trends will have significant impact on the County's near and long-term fiscal condition and should be a basis for the development of the operating and capital budgets.

Examination of the County's demographics clearly indicates that our population is aging. While this is a national trend and not restricted to Howard County, the County's population is aging much faster than other jurisdictions. Reports by the Maryland Department of Planning and the U.S. Census Bureau both project that the population over the age of 65 will nearly double by 2050, growing nationally from 43 million in 2012 to 84 million in 2050. The County's Department of Community Resources and Services conducted a similar study and has projected that the population over the age of 65 will double within the County by 2025.

While the County encourages aging in place, an increase of residents over the age of 65 presents new fiscal challenges that the County cannot overlook. As residents retire and age in place, they tend to pay less County personal income tax after retirement due to less taxable income. Also, as this demographic continues to grow, the County needs to increase core services that specifically target and support this group of residents.

Chart 9: County Population by Age **Chart 10: Population 65+ Historical Trend**



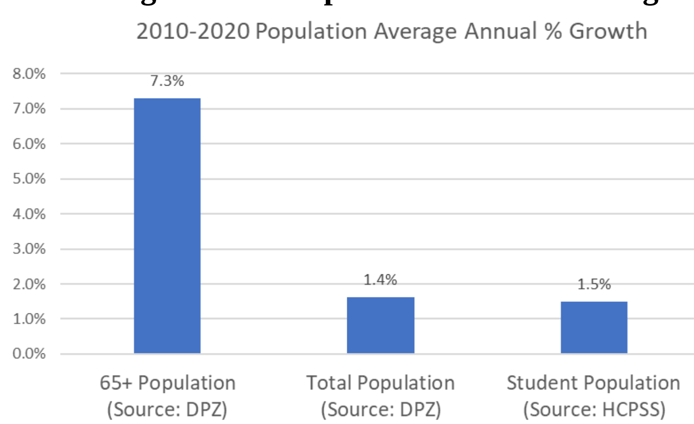


Another demographic challenge is the increase in the number of school-aged children. Based on data provided by the HCPSS, the growth rate in student enrollment from 2010 to 2020 (projected) averages 1.5% per year. Latest HCPSS report as of 2019 indicated that new development contributed 38% of total enrollment growth in 2017 and 2018 and is expected to generate 31-33% of total new enrollment growth in 2019 and 2020; the rest of the enrollment growth came from existing properities including resale and births. The report has not been updated to reflect the Board’s approved school year 2020/2021 boundaries yet. An updated projection built upon new housing, resale, births, exemptions etc., based on the the newly adopted school boundaries won’t be available until the release of the HCPSS 2020 Feasibility Study.

This enrollment growth rate, coupled with a slowdown in County revenue growth, places the HCPSS under increased pressure to effectively meet student needs. Consequently the County’s budgets are pressured from both ends of the demographic spectrum: increasing operating and infrastructure needs for the HCPSS, and rising service demands for aging adults.

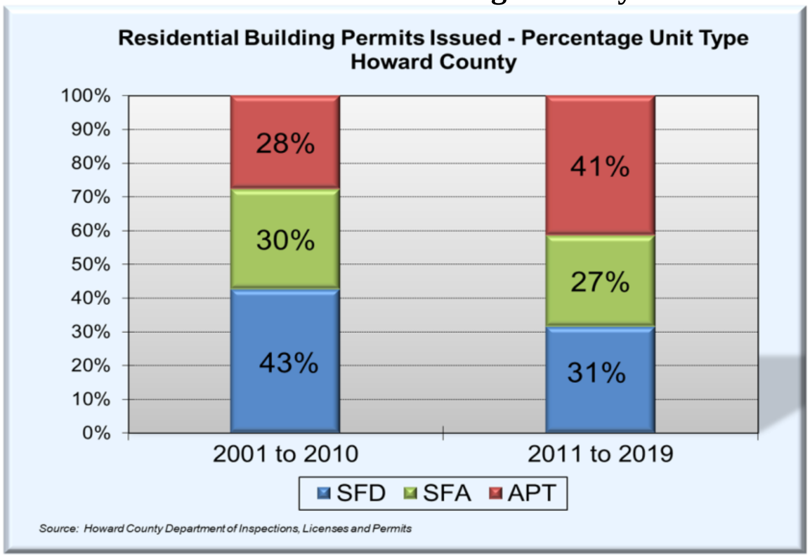
Moreover, the County’s overall population has been growing largely at the same rate as the student enrollment since 2010, demanding an increase in the full spectrum of County services ranging from public safety, public works, and health and human services to recreation and parks. How to address and balance these competing community needs with limited resources will remain a critical challenge for the County.

Chart 11: Average Annual Population Growth During 2010-2020



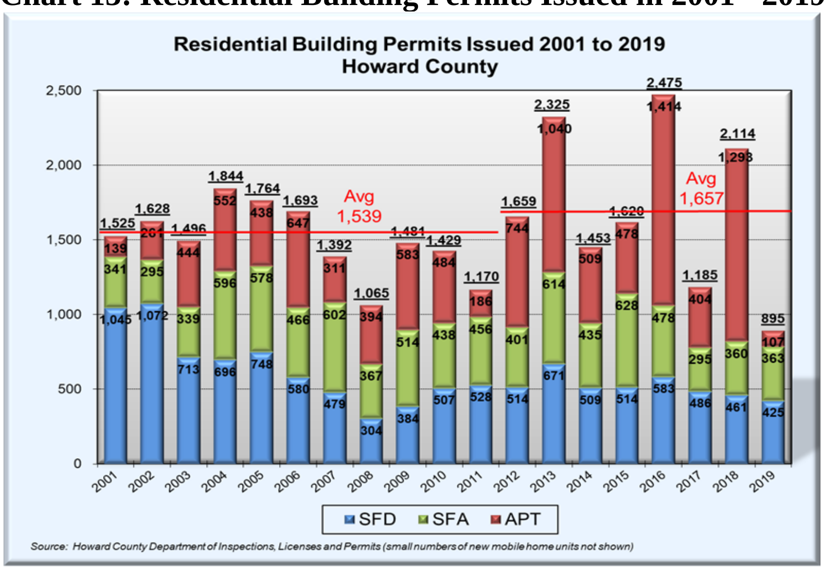
Another land use trend the Committee learned is the gradual shift of planned development activity from less single-family to more multi-family housing. The main factor contributing to this shift is the limited amount of additional land capacity for single-family detached residential development and the current policies and resulting zoning in the Columbia Village Centers and the Route 1 and Route 40 corridors.

Chart 12. Residential Permits Issued – A Shift from Single Family Detached to Multi-Family Units



One more issue observed recently is a significant drop in new building permits issued in 2019. It is too early to predict whether this indicates a new trend of decreasing permits and new constructions in the near future, but worth attention as it may impact not only revenues in FY 2020, but also potentially various revenues associated with new development or permits and fees in FY 2021 and beyond. New pre-submission community meetings since July 2019, when the stricter School capacity test went into effect, have shown a significant reduction in new housing plans. Since the development process takes about three years to complete, the primary impact on the county's budget will likely begin in 2022 - 2023.

Chart 13: Residential Building Permits Issued in 2001 - 2019



(SFD – Single Family Detached; SFA – Single Family Attached; APT- Apartment; MH – Mobile Homes)