MINUTES
BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE MEETING
December 17, 2024

The first meeting of the Spending Affordability Committee (SAC) for FY 2026 was held on Tuesday, December 17, 2024 at 3:30 p.m. Committee members, staff, and the consultant in attendance were:

Chairman:	Honorable Pat Young
Members:	Honorable David Marks
	Honorable Julian E. Jones, Jr. (virtual)
	Edwin Crawford
	Dr. Deborah Carter
Committee Staff:	Lauren Smelkinson
	Elizabeth Irwin
	Carrie Vivian
	Ronit Rubin
	Rayven Vinson
	Kris Urs
	Reginald Sullivan
Consultant:	Dr. Anirban Basu, Sage Policy Group

Chairman Young called the meeting to order. He thanked the Committee staff for its work in preparation for the meeting and congratulated Ms. Smelkinson on her upcoming retirement.

Approval of the Minutes from the Meeting of January 30, 2024

Councilman Marks moved that the minutes from the meeting of January 30, 2024 be approved, Mr. Crawford seconded the motion, and the motion passed unanimously.

Consultant: Economic Analysis and Personal Income Forecast Update

Highlights of Dr. Basu's update were:

- The national economy vastly outperformed Dr. Basu's (and other economists') expectations over the last couple of years. In October 2022, Bloomberg economists' forecasting index indicated that the probability of recession was 100% due to the disappointing performance of U.S. equity markets and rising interest rates; however, the downturn has not occurred. In 2023, the U.S. economy grew 2.5%, and projections indicate that the U.S. economy will grow 2.8% in 2024 due to the record stock market and wealth gains in both the financial and housing markets.

- Retail sales were up 0.7% in November 2024, ahead of expectations (without auto sales, retail sales were still up 0.2%) – indicating that the consumer, which represents 2/3 of the economy, is continuing to spend.
- Employers are still hiring; according to the Bureau of Labor Statistics, the nation added 277,000 jobs in November 2024. The national unemployment rate is 4.2%. The economy will enter 2025 with "plentiful" momentum.
- The Federal Reserve began cutting interest rates in September 2024 and likely will cut interest rates again by a quarter percentage point at its December 18, 2024 meeting. The incoming presidential administration's policies (i.e., tariffs, tax cuts, deportations) are largely inflationary, with the exception of deregulation (including of the U.S. energy sector) which could subtract from inflation; however, the tariffs will help finance potential domestic tax cuts. Accordingly, interest rates likely will stay higher for longer in 2025; the bond market presently anticipates that the Federal Reserve will cut interest rates two times at most in 2025 (as opposed to a pre-September 2024 estimation of six times).
- While the U.S. has added 7 million jobs since February 2020 (when the economy shut down due to the pandemic), Maryland has lost 18,300 jobs. By comparison, Northern Virginia added 87,000 jobs, and Maryland's D.C. suburbs added 3,100 jobs (mostly in Frederick County). Baltimore County is losing population, and its low 3.1% unemployment rate is due to the fact that people have left the labor force and aren't actively looking for work. Unlike the nation, Baltimore County has not outperformed expectations because the County is unable to accommodate a meaningful share of the nation's economic growth, as there is not enough housing stock alongside a declining population available to fill jobs. Thus, the County's economy is "quite flat."
- Sage Policy Group's personal income forecast for Baltimore County is 4.85% for FY 2025 and 4.2% for FY 2026. Wages and salaries make up half of personal income, and they are expected to grow healthily due to the tight labor market.
- Because the County has a slow-growth economy, there is a predicament with trying to maintain the triple-A bond rating as the population declines.

- For future fiscal years, the County is facing budgetary challenges due to the significant State budget shortfall (and unlikely State tax increase) and potential budget reductions at the federal level.

Discussion:

Mr. Crawford asked about the potential impact of the incoming administration's Department of Government Efficiency (DOGE), particularly on Montgomery County. Dr. Basu stated that many of the largest components of the federal budget (e.g., Social Security, interest on debt) are dispersed across the country and do not have a centralized impact on Maryland; in addition, these items are difficult to cut, so DOGE could focus on other areas such as energy, the National Institutes of Health, the Food and Drug Administration, and education, which all have a Maryland footprint. In addition, Dr. Basu stated that federal government expenditure patterns have shifted over time, with less bureaucracy in the D.C. metro area; thus, while Maryland is no longer benefitting from disproportionate government expenditures, it also will disproportionately suffer from the cuts that are likely to be proposed. Dr. Basu observed that Montgomery County's economy is already flat, and Prince George's County and Baltimore City have been losing population; he concluded that although there are some brighter spots, such as Frederick and parts of Cecil County, overall, Maryland is in "ragged" shape. Dr. Basu also reminded the Committee that Moody's Analytics warned that it could downgrade the State's triple-A bond rating.

Councilman Marks noted that Sage Policy Group's report states that St. Louis is leading in growth and asked for clarification, given its similarities to Baltimore. Dr. Basu stated that St. Louis is an industrial center, and cities in the Midwest, including St. Louis, Detroit, and Chicago, have been experiencing construction employment growth due to supply chain investments. Dr. Basu stated that big investments haven't happened locally, with the exception of Tradepoint Atlantic, which is largely completed.

Chairman Young asked which employment sectors were impacted by Maryland's 18,300 lost jobs. Dr. Basu stated that most sectors (e.g., manufacturing, financial) were affected, except for healthcare and government, which added jobs and offset losses in other sectors. Dr. Basu stated that expanding employers cannot find people to hire.

Dr. Carter asked whether Sage Policy Group incorporated the impact of artificial intelligence (AI) into its analysis. Dr. Basu stated that the analysis does not incorporate AI because AI does not significantly impact the economy over the course of a year. Mr. Crawford noted that Maryland is not positioned as well as other locations in terms of the electrical generation infrastructure needed to accommodate the AI/data center industry.

Noting that the tariffs will effectively serve as a sales tax, Mr. Crawford asked whether Sage Policy Group incorporated the impact of potential tariffs to be imposed by the incoming presidential administration into its analysis. Dr. Basu indicated that its analysis does not incorporate this impact because the tariffs are speculative at this point. Discussion ensued regarding supply chains, logistics, overseas manufacturing, tariffs, and cost efficiencies and economic benefits of relocating manufacturing to the U.S. Dr. Basu reiterated that tariffs may bring inflation but observed that they also likely bring more industrial capacity to the U.S.

Chairman Young asked Dr. Basu for his thoughts on the key factors the Committee should keep in mind while developing FY 2026 recommendations. Dr. Basu responded with four points: County officials will need to hunt for budgetary efficiencies; there will be pressure to increase County taxes, but the County is already losing population; County officials should revive economic development and market the County; and County officials should review the County's housing policies because the County is in need of housing at affordable price points and increased density to attract young families. Chairman Young commented that people would like to move to the County, but there is a housing shortage. Dr. Basu advised that the County needs investors and mega projects.

Mr. Crawford asked Dr. Basu to clarify his position on land development within the County. Dr. Basu replied that he considers the Urban Rural Demarcation Line (URDL) to be "sacred," and the County should focus on infill development and move forward with making decisions on projects (e.g., Lutherville Station) in order to grow the County's tax base.

Mr. Crawford noted the County's slow growth, stating that the County's personal income growth is "not bad," job growth is "horrible," unemployment is "very good," while the labor force participation rate is stagnant largely as a result of the age structure (which includes many retirees). Mr. Crawford advised the Committee and Council to be cautious because of upcoming revenue problems to the school system, and in light of serious cost pressures, including the unfunded liability of the Retirement System, and the pace of capital projects (which could be slowed). He noted that no government has ever grown its way out of a revenue problem inside its budget by increasing spending. Chairman Young agreed that there are a lot of factors for the Committee to consider in conjunction with a new County Executive who will have their own priorities. Dr. Basu concluded on an optimistic note, stating that residential property tax collections should be strong, and predicting that if mortgage rates fall, there will be a “crescendo” of sales volume leading to increased recordation and transfer taxes.

Chairman Young thanked Dr. Basu for his presentation and also thanked Mr. Crawford for mentioning the pension system’s unfunded liability; Chairman Young noted that the Committee has been working to address this issue.

<u>General Fund Fiscal Update</u>

Ms. Irwin reported that the FY 2025 adopted budget was in compliance with the Committee’s adopted debt and spending numerical guidelines. Ms. Irwin noted that the Committee’s policy is to exclude component unit capital leases from the debt guidelines, but the County’s debt affordability consultant (Public Resources Advisory Group (PRAG)) includes component unit capital lease debt in its reports. The Committee has a longstanding policy to exclude the leases because they are not under the control of the County’s Office of Budget and Finance (OBF). Chairman Young asked about the “fair difference” since PRAG incorporates the debt into its calculation and the Committee omits it. Ms. Irwin stated that while it is additional debt, it is not an apples-to-apples comparison; although the PRAG report projects the County’s debt service to revenues ratio may exceed 9.5% by the end of FY 2025, the FY 2025 budget is still in compliance with the Committee’s debt service guideline as the Committee calculates it.

Ms. Irwin reported that based on the audited financial records, FY 2023 General Fund revenues totaled approximately $2.62 billion, an increase of $140 million, or 5.7%, over FY 2022 revenues. This positive revenue performance, together with budget savings of approximately $37 million, yielded a $23 million fund balance drawdown. Ms. Irwin reminded the Committee that entering FY 2023, the budget was anticipating drawing down fund balance by more than $165 million. Thus, FY 2023 experience (including some budgetary liquidations) resulted in unassigned fund balance of $431 million, plus approximately $250 million in the Revenue Stabilization Reserve Account (RSRA). This reflects a surplus of approximately 27% of revenues.

In regard to FY 2024 revenues, Ms. Irwin reported that the unofficial FY 2024 revenue projection by the Office of the County Auditor (OCA) is $2.67 billion, an increase of approximately $55 million or 2.1%, over FY 2023 collections. Ms. Irwin noted that originally, both OCA and OBF were anticipating a decline in general fund revenues in FY 2024, but income tax collections remained strong and there was growth in property taxes and investment income. In addition to higher-than-budgeted revenues, FY 2024 spending was approximately $30 million below budgeted expenditures; as a result, the budget relied on only $10 million of fund balance (significantly less than the budget anticipated). Mr. Crawford asked Ms. Irwin if spending comes in under the budget, are the remaining funds encumbered in the budget for future use; Ms. Irwin responded that the $30 million reflects encumbrances (and would be roughly $40 million without encumbrances). Ms. Irwin reported that as of June 30, 2024, the (unaudited) fund balance totaled approximately $671 million, or 26% of revenues (including the RSRA, which must be at 10% of budgeted revenues).

Ms. Irwin reported that the FY 2025 budget includes revenues of $2.57 billion, a decrease of approximately $97 million or 3.6% from the FY 2024 unofficial total. Ms. Irwin noted that OBF's revenue estimate was more conservative than OCA's at the time the budget was submitted, but OCA was also anticipating an FY 2025 revenue decrease. Ms. Irwin stated that so far, FY 2025 revenue collections are better than expected, primarily due to favorable income tax distributions; she noted that as of October 2024, OBF was projecting revenues of approximately $2.64 billion. OBF budgeted an FY 2025 Fund Balance drawdown of $215 million mostly for PAYGO one-time excluded items; however, as of October 2024, OBF's drawdown projection is under $150 million and is all for one-time items. Ms. Irwin indicated that based upon all of this (high-level) information, the County's General Fund appears to be in a sustainable place for FY 2025. She noted that OCA is currently in the process of updating its projections for FY 2025 and FY 2026.

<u>Preliminary FY 2026 Spending Guideline</u>

The Committee's spending guideline is a recommendation for the maximum level of General Fund spending for ongoing purposes. The OCA is currently working on preparation of the preliminary FY 2026 spending guideline.

The spending guideline typically is calculated by multiplying the previous year's estimated base spending by a multi-year average personal income growth factor. Last year, the Committee utilized a blended average of County-level personal income forecasts by Sage

Policy Group (5-year average) and Moody's Analytics (3-year average) for development of the 4.36% growth factor. In prior years, the Committee typically relied on a 4-year average of the Sage Policy Group forecast alone.

Using Sage Policy Group's most recent report (October 15, 2024), the preliminary 4-year average (FY 2023-FY 2026) personal income growth rate factor for FY 2026 is 4.93%, which would yield growth of $129 million; the 5-year average is 3.98%, resulting in $104 million in growth. Ms. Irwin noted that OBF indicated that as of November 2024, its consultant (Moody's Analytics) forecasted 5.21% growth, which would result in $136 million of spending growth. The Committee also compares the spending growth to anticipated revenues for the upcoming fiscal year to ensure that the guideline is recommending a maximum spending level that does not exceed anticipated revenues.

Mr. Crawford asked the Committee how to handle the blips that were the result of the pandemic. Chairman Young reminded the Committee that it utilized the blended average in FY 2025 for a smoothing effect. Ms. Irwin stated that the County has spending needs and fund balance and as long as there is enough revenue, Committee staff have been comfortable with the Committee removing the low year from the average; last year, the Committee opted to use the blended average because the four-year average was reflective of a low year.

Mr. Crawford urged caution because the future of the economy is unknown. He stated that budgetary decisions (e.g., cost-of-living adjustments) impact the pension system. Ms. Irwin noted that the Committee also makes spending policy recommendations, which are just as important as the numerical spending guideline itself, because the recommendations advise against utilizing surplus funds for ongoing expenses. Mr. Crawford also cautioned against the County increasing its debt service commitment beyond the Committee's guideline.

<u>Preliminary FY 2026 Debt Guidelines</u>

Ms. Irwin presented the preliminary debt guidelines, based on existing Committee policies. The debt guidelines are based on two commonly utilized debt affordability indicators. The policies are: (1) Debt Service should not exceed 9.5% of total General Fund revenues; and (2) Total Debt Outstanding should not exceed 2.5% of total assessed property value.

Ms. Irwin noted that in recent years, the County's total debt for Consolidated Public Improvements has been decreasing because the County has been putting significant amounts of General Fund PAYGO funding into the capital budget. The increase in debt service for FY 2025 is related to OBF following the Committee's recommendation to cease the practice of offsetting budgeted interest costs by applying bond premium funds off-budget; thus, the FY 2025 General Fund budget includes the full amount of debt service interest costs rather than just the net amount. Ms. Irwin stated that OCA is keeping an eye on debt ratios because of the County's significant capital program and the additional debt the voters authorized via the 2024 ballot.

Mr. Crawford reiterated his advice to be cautious with debt and suggested examining the pace of capital projects, and total of contracts already signed, to determine which projects actually need to utilize borrowed funds, by year. He noted that the County's debt authorization plan is not a cash flow plan. The difficulty with the County's approach to capital budgeting is that it does not reflect the cash flow needs over the upcoming five-year period. Chairman Young agreed with Mr. Crawford's point, and he noted that he just had a similar conversation prior to the meeting. Chairman Young stated that he is looking forward to working with the new County Executive, as well as with OBF, to prioritize projects and maintain existing commitments.

Conclusion and Next Meeting

Chairman Young thanked OBF for its collaboration. Chairman Young stated that the Committee's next meeting will be January 8, 2025 at 3:30 p.m.

Councilman Jones thanked everyone for their participation. Ms. Irwin thanked OCA and OBF staff. Councilman Marks motioned to adjourn the meeting, Mr. Crawford seconded the motion, and the motion passed unanimously.