MINUTES
BALTIMORE COUNTY SPENDING AFFORDABILITY COMMITTEE MEETING
January 8, 2025

The second meeting of the Spending Affordability Committee (SAC) for FY 2026 was held on Wednesday, January 8, 2025 at 3:30 p.m. Committee members, staff, the consultant, and any other participating government officials in attendance were:

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

Executive Branch Participant: Kevin Reed, Director, Office of Budget and Finance

Chairman Young called the meeting to order.

<u>Approval of the Minutes from the Meeting of December 17, 2024</u>
Mr. Crawford moved that the minutes from the meeting of December 17, 2024 be approved, Councilman Marks seconded the motion, and the motion passed unanimously.

<u>Consultant: Economic Analysis and Personal Income Forecast Update</u>
Highlights of Dr. Basu's update were:

- The national economy has significant and surprising momentum. Dr. Basu stated that he did not expect consumers to spend, employers to hire, nor financial markets to perform as they have over the last few years. He also noted that the financial markets' positive performance has led to wealth flowing through the economy, resulting in business formation and increased household spending.

- The most recent Bureau of Labor Statistics' Job Openings and Labor Turnover Survey (JOLTS) indicated that the number of job openings nationally rose in November 2024 to 8.1 million from 7.8 million in October 2024. There are 1.14 job openings for every unemployed person. National unemployment is 4.2%, Maryland unemployment is 3.1%, and Baltimore County unemployment is 3.3%.
- The tight labor market suggests there will be ongoing and fairly significant wage growth during the year ahead. Overall, personal income growth will be slightly softer because there will not be the significant adjustments to Social Security payments that occurred in prior years. Overall, personal income is projected to grow in the mid-4% range.
- The County will benefit from significant increases in residential property assessments.
- The County's revenue situation "looks quite good."
- The State's financial challenges (an approximate $2.7 billion budget shortfall) could result in less financial support from the State to local governments. The State budget will likely include agency spending cuts and how that will factor into local budgets is unclear.
- The inauguration of President-elect Trump will have financial implications to not just the County but the entire Baltimore-Washington corridor. Vivek Ramaswamy and Elon Musk, who were chosen to lead the Department of Government Efficiency (DOGE), indicated that they may propose $2 trillion in cuts to federal agency spending. While Dr. Basu believes that proposed reductions will total less than $2 trillion, the County is susceptible to cuts because it is home to the Social Security Administration, the Centers for Medicare and Medicaid Services, and to federal workers employed in other jurisdictions.
- Dr. Basu stated that the County's economy will be "fine" in CY 2025 and that FY 2026 will be "challenging but fine" because the County will experience revenue growth, particularly from property taxes.

Discussion:

Mr. Crawford asked for Dr. Basu's economic outlook beyond FY 2026. Dr. Basu stated that there are a lot of unknowns, particularly with potential changes to the implementation schedule of the Blueprint for Maryland's Future, which could be slowed in order to help the State save money in the face of the budget shortfalls. Such a slowdown would also reduce required County-level Blueprint funding. He stated that, in short, the State and local governments must balance their budgets, and cuts will be made to the extent necessary. He reiterated that he thinks the next couple of years will be “okay” because the tax handles are performing; specifically, wages and salaries are increasing and there are capital gains, all of which impact income taxes, and the increases in residential property assessments will positively impact property tax collections.

Mr. Crawford noted that there are increasing economic headwinds and uncertainty (e.g., the potential for increasing interest rates, a smaller labor force supporting an older population) that could impact the County’s debt service ratios and also prompt the County to utilize reserve funds to support the budget. Dr. Basu agreed with Mr. Crawford’s observations. Dr. Basu stated that the County’s economy is “stagnant” – observing that housing prices are rising because of housing supply issues (inventory at only 1.5 months), resulting in limited opportunities for young families to purchase homes. Dr. Basu stated that demographically, the County is becoming older, and in-migration has trended toward lower-income households. Dr. Basu characterized the County’s economy as “not in great shape” despite its rising home values and wages and low unemployment. Dr. Basu also stated that corporate America is optimistic, and he thinks profits and investments will grow.

Dr. Basu stated that County officials should be careful with borrowing because interest rates are going to stay higher for longer. Dr. Basu noted that some of President-elect Trump’s policies, such as tariffs, tax cuts, and mass deportation, will be inflationary.

Councilman Marks asked Dr. Basu to confirm that he believes the County will be “all right” for FYs 2026 and 2027; Dr. Basu said yes, revenues look “pretty good,” and the County will be “all right” as long as it doesn’t spend too much money. Dr. Basu noted that eventually, the macroeconomic circumstances, demographics, and interest rates will catch up to the County fiscally, and the County will be in a worse place.

Chairman Young asked, from a policy perspective, for tangible recommendations that the Committee could advocate or consider. Dr. Basu stated that there is a need to grow the County’s tax base; invest in the County’s marketing and economic development; support public safety initiatives; attract mega-investors; address zoning issues; and create more housing, including for higher-income people (in order to grow the tax base). Chairman Young agreed that that the County needs to improve its marketing and stated that people do want to move here, there are economic opportunities, and the County is safe.

Councilman Marks stated that the County's permitting system needs to be fixed to improve the speed by which permits are processed, as "time is money" for businesses.

Ms. Irwin stated that Dr. Basu's personal income forecast is due next week and asked for an update. Dr. Basu replied that he does not expect the forecast to change significantly from his October forecast.

Mr. Crawford returned the discussion to the County's economic development strategy and stated that the County should focus on marketing but also on understanding the County's key economic development and intellectual capital growth nodes, a change from the County's previous focus on real estate. Dr. Basu replied that real estate can be used as a magnet (depending on zoning) to make deals. Discussion ensued regarding Statewide economic development issues (e.g., infrastructure/energy, competition from other states) and the impact on the County.

Chairman Young thanked Dr. Basu for his presentation.

<u>General Fund Fiscal Update</u>

Ms. Irwin reported that since the last meeting, the County received the audited financial statements for FY 2024. FY 2024 revenues totaled $2.69 billion, an increase of approximately $75 million or 2.9%, over FY 2023 collections, which were strong. Originally, both the Office of the County Auditor (OCA) and the Office of Budget and Finance (OBF) were anticipating a decline in general fund revenues in FY 2024, but income tax collections remained strong and there was solid 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 approximately $7 million of fund balance, which was significantly less than the budget anticipated. As of June 30, 2024, the fund balance totaled approximately $674 million, or 25% of revenues. This fund balance is inclusive of the RSRA, which is set at 10% of budgeted revenues. Ms. Irwin noted that according to bond rating reports and other publications, many jurisdictions now seem to be aiming for a threshold greater than 10% of budgeted revenues (i.e., 15% range).

Ms. Irwin reported that the FY 2025 budget includes revenues of $2.57 billion, a decrease of approximately $116 million, or 4.3%, from the FY 2024 total. OBF's revenue estimate was more conservative than OCA's at the time the budget was submitted, but OCA was also anticipating a revenue decrease in FY 2025. So far, FY 2025 revenue collections are better than expected, primarily due to favorable income tax distributions. As of October 2024, OBF was projecting FY 2025 revenues of approximately $2.64 billion. For FY 2025, OBF budgeted a fund balance drawdown of $215 million, mostly for PAYGO and other one-time (excluded) items; however, as of October 2024, OBF's drawdown projection is less than $150 million and is all for one-time items. Based on all of this high-level information, the County's General Fund appears to be in a sustainable place for FY 2025. OCA is currently projecting FY 2025 revenues upwards of $2.7 billion, including property tax revenues of $1.22 billion (an increase of 4.2%) and income tax revenues of $1.16 billion (an increase of 2.8%). Recordation and title transfer taxes are expected to remain flat. Ms. Irwin reiterated that the General Fund is in a sustainable place because ongoing revenues are supporting ongoing expenses.

Ms. Irwin stated that for FY 2026, property tax revenues are poised to continue to show strong increases based on the State's recent reassessments. Specifically, taxable assessments are growing by an estimated 5.1%. Income tax revenues are also expected to continue to grow, though at a lower rate of 1.6%, based on conservative assumptions regarding the pattern of the State's income tax distributions. Recordation and title transfer taxes are anticipated to rise slightly in FY 2026, marking the first increase since FY 2022, as buyers become accustomed to higher prices and mortgage rates level off. Ms. Irwin noted that OCA is in the process of refining its FY 2026 projections and will provide an update at the Committee's next meeting. Preliminarily, OCA is forecasting revenue growth of approximately $78 million, or 2.9%, to $2.82 billion for FY 2026; this revenue projection exceeds FY 2025 budgeted revenues by more than three times the $78 million year-over-year growth forecast.

Ms. Irwin next presented several fiscal issues impacting spending affordability that were originally discussed as part of OCA's FY 2025 budget analysis. While the FY 2025 budget met the numerical spending affordability guideline, there are cost pressures that will affect future budgets and may require certain trade-offs.

- The funded status of the retirement system is 59%. In FY 2025, the General Fund's retirement system contribution increased by $17.4 million, driven by salary increases that in recent years exceeded actuarial assumptions.
- OPEB funding has climbed to near the "PAYGO" level (i.e., the County is nearly funding the current-year cost for retirees), with a plan to continue to increase Trust Fund contributions in future years.
- The County faces significant waste disposal cost pressures.

- There was a reduction in the Storm Emergencies program budget in FY 2025.
- Some Towson Loop costs (less than $1 million) were funded with ARPA funds in FY 2025; these costs – and certain other costs – likely will return to the General Fund in FY 2026.
- There are elevated vacancy levels, and filling positions creates personnel budget pressures.
- The BCPS budget relied on fund balance of almost $50 million to cover operating expenses.
- Certain debt service pressures are increasing, such as general government and component unit capital lease costs. Future debt service pressure can arise from the ambitious capital program and from relying on reduced PAYGO contributions to the capital budget.

Councilman Marks stated that Governor Moore plans to cut $2 billion from the State budget and asked if specific information regarding the reductions is available. Ms. Irwin stated that while specific information is not yet available, she anticipates a slowdown in certain funding streams, such as planned education funding. She also stated that while the County's General Fund is not significantly exposed to State cuts, to the extent that State funding for component units (County agencies) is reduced, these entities (e.g., the school system) may then turn to the County to cover certain costs.

In addition to the noted cost pressures, Ms. Irwin agreed with concerns raised earlier that the County is facing economic risks, particularly based on the unknowns at the State and federal level.

<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 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.

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. Ms. Irwin also calculated additional scenarios. For example, a "middle of the road" 4.5% growth factor (between the Sage 4- and 5-year averages) yields $117 million in spending growth. Ms. Irwin stated that the level of overall growth being discussed is sustainable for FY 2026 based on current and projected revenue performance.

Chairman Young stated that there will be discussions prior to the Committee's next meeting regarding the blended average of Sage's 4-year and 5-year growth factors; Ms. Irwin stated that she will email the Committee different growth factor scenarios. Mr. Crawford urged caution with utilizing the 4-year growth factor because the County has experienced "great" economic growth during this period; thus, this growth factor is slightly biased toward being high when the County is beginning to face some economic challenges. Chairman Young acknowledged that there are some headwinds to consider when determining which growth factor to utilize. Mr. Crawford stated that one factor the Committee should consider is the County's aggressive capital program, including the amount of cash on hand and status of contracts, and the associated implications for the County's debt.

<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 stated that the County's debt policy is tied to the debt affordability study (DAS) that is issued jointly by OBF and its financial advisor (Public Resources Advisory Group). The October 2024 DAS recommended that the County's debt service to revenues ceiling ratio increase to 10.5% in FY 2026. The DAS ratio includes component unit capital lease costs in its numerator and reflects an end to the County's practice of budgeting interest costs net of bond premium. Ms. Irwin explained that while the financial advisor's debt ratios have included component unit capital lease costs, the Committee's guidelines have always excluded them; these costs have grown in recent years due to BCPS's device leases and the financing of bus purchases. Chairman Young asked if the October 2024 report is prompting the Committee to consider raising the debt service guideline to 10.5%; Ms. Irwin stated that typically the Committee's percentage guidelines align to the County's. She noted that as of the end of FY 2025, OBF is currently projecting that the County's debt service will be at 9.5% of General Fund revenues, including the component unit capital leases; excluding the component unit capital leases, debt service will be under 9.5%. Entering FY 2026, OBF is projecting the County's debt service will be over 10% of General Fund revenues, including the component unit capital leases. Ms. Irwin stated that the County's upcoming debt issuances are planned for March, and costs related to supporting that debt will be factored into the FY 2026 budget.

Mr. Crawford questioned whether the County actually needs to issue as much debt as the recent bond ordinance authorized, considering the County has cash on hand.

Chairman Young stated that he doesn't believe that the County spends money just to spend it. He also stated that the County needs to balance its needs versus wants.

Councilman Marks asked Mr. Reed and/or Ms. Irwin to respond to the following statement: "The Council has authorized capital spending, and the money is not getting out the door." Mr. Reed stated that the County is working on a cash-flow basis, in which the County is only issuing debt as needed in each cash fund. Regarding the planned March issuance of $177 million in CPI debt, much of that amount is for the public schools, and the issuance is also needed to make the cash funds "whole" in the capital budget. Mr. Reed also agreed that the County is not "spending to spend," which is evidenced by the $30 million fund balance at the end of FY 2024; OBF also controls quarterly spending to try to advance the fund balance at a reasonable level each year. Mr. Reed stated that the debt service guideline needs to be increased to 10.5% because OBF no longer offsets budgeted interest costs by applying bond premium funds off-budget. In addition, per its financial advisor, OBF must include the component unit capital lease costs in its debt.

Chairman Young asked when the debt service guideline was last increased. Ms. Irwin replied that it was approximately 10 years ago (the increase was approved in FY 2014, effective for FY 2015). Councilman Marks asked if adjusting the debt service guideline to 10.5% would bring the County in line with Anne Arundel County's policy. Mr. Reed stated that Anne Arundel County's guideline is 11.5%. Mr. Reed noted that the County requested that its financial advisor survey other AAA-rated counties to ensure the County was in the same ballpark with its debt service ratio; the financial advisor recommended 10.5% as a safe level to proceed with the County's "aggressive" capital program.

Chairman Young stated that while the County is trying to maintain the commitments and obligations of an aggressive capital program, there are other pressures to consider. He also noted that there are some needs, including infrastructure improvements, that have been put off for years, and the Council hears from constituents regarding these needs. Chairman Young thanked Mr. Reed for his cooperation during this process.

Mr. Crawford asked whether the rating agencies were consulted in regard to increasing the debt service ratio. Mr. Reed stated that this increase was recommended by the County's financial advisor, and the County shares the advisory report with the rating agencies. He stated that he thinks that the agencies would like to see that the executive and legislative branches' debt policies are in concert and that the County is moving forward with the plan. Chairman Young stated that the County's AAA bond rating must be maintained due to its impact on the County's borrowing costs, and the County should also ensure that it is taking other steps to protect its fiscal stability. Mr. Crawford noted the large unfunded liability in the pension fund.

<u>Conclusion and Next Meeting</u>

Councilman Marks motioned to adjourn the meeting, Mr. Crawford seconded the motion, and Chairman Young adjourned the meeting.

Chairman Young stated that the Committee's next meeting will be January 27, 2025 at 1:00 p.m.