

MFP COMMITTEE #4
July 27, 2009

MEMORANDUM

July 24, 2009

TO: Management and Fiscal Policy Committee

FROM: Stephen B. Farber, Council Staff Director *SBF*

SUBJECT: Update on the County Fiscal Situation for FY10-11

OMB Director Joseph Beach, Finance Director Jennifer Barrett, and their colleagues will join the Committee for this update on the County fiscal situation for FY10-11. They will discuss the County Executive's July 24 memo on ©1-2 and related fiscal data on ©3-10. See ©2 in particular for the Executive's comments on the need, given the County's fiscal prospects, for a FY10 Savings Plan and/or employee furloughs that extend to all agencies.

Overall Fiscal Context

Even as the economy struggles toward recovery – a recovery that many analysts think may be both tepid and “jobless” – governments at all levels feel the impact of two lagging indicators: unemployment and revenues. Today's separate packet on economic indicators provides sobering data in this regard.¹ The County's June unemployment rate, just announced, is 5.7 percent. This rate, while low compared to rates elsewhere, is well over double the County's rate in November 2007, 2.5 percent. In fact, until January 2009, the County's rate had not reached even 4 percent at any time in at least 20 years, including recession years.

As for revenues, governments at all levels are feeling a severe squeeze. Lagging federal revenues, combined with massive stimulus spending, have created record federal deficits. State revenues, according to the Rockefeller Institute, fell 11.7 percent in the first quarter of 2009, the sharpest decline on record, and were down sharply again in the second quarter. Most local governments have felt similar pressures.

¹ The extremely high June national unemployment rate of 9.5 percent (seasonally adjusted), which is expected to exceed 10 percent later this year, does not capture the gravity of the rates in such states as Michigan (15.2 percent), Rhode Island (12.4 percent), Oregon (12.2 percent), South Carolina (12.1 percent), Nevada (12.0 percent), California (11.6 percent), Ohio (11.1 percent), North Carolina (11.0 percent), and Florida (10.6 percent). Maryland's rate, while problematic, is much lower (7.3 percent). A broader measure of unemployment, including discouraged and underemployed workers, is now at 16.5 percent nationally. It is at 19.2 percent in Michigan and above 15 percent in 9 other states. These measures too are expected to rise further.

Maryland's current revenue estimate for FY09-10 shows a writedown of **\$700 million** compared to the April estimate, with a further writedown possible in September. See Mr. Deschenaux's July 8 letter on ©11-13, which also refers to the State's large structural deficit in FY11 and future years. On July 22 the Board of Public Works responded by taking budget actions totaling \$281.5 million.² The Governor said that after he has communicated with State employee organizations and local governments, the Board will make additional reductions of \$400 million or more before Labor Day.

These problems, while significant, do not compare with the travails of some other states. For example, California, after forcing itself to issue IOUs for contractors' bills and tax refunds, finally addressed its \$26 billion deficit with a combination of deep cuts to education, social services, and other programs, new burdens on local governments, and short-term accounting measures. The budget impasse in Pennsylvania has threatened "payless paydays."

County Revenue Update

County revenues for FY09, which are not yet final, appear to be largely on track and do not reflect the kind of FY09 writedown just made by the State. See the data from Finance on ©5-10. Total tax collections through June, including investment income and highway user revenue, were 4.4 percent above the same period in FY08. The chief factor was property tax revenue, which was up sharply because the Charter limit in FY09 was exceeded by \$118 million. Otherwise collections were **down** 1.3 percent, with income tax revenue flat, consumption tax revenue up slightly, and other revenue – transfer and recordation tax, investment income, and higher user – down sharply.

These results are a clear reflection of current economic realities. Income tax revenue mirrors lack of employment growth and continued weakness in capital gains. Energy tax revenue is up only because of the "carbon surtax" approved in May 2008. The decline in hotel/motel and admissions tax revenue is not surprising. The slump in investment income reflects the fall in interest rates, while the decline in highway user revenue results from State budget actions.

While it is too early in the fiscal year to revisit total revenue estimates for FY10, there are **two important straws in the wind** for FY10-11. With regard to **State aid**, the reductions to be announced next month by the Board of Public Works – and possible follow-up reductions in both FY10 and FY11 – will have a large impact. Another key issue for FY11 is **property tax revenue**, which will almost surely be restricted to the Charter limit. Finance's current estimate is for an increase of 3.2 percent in FY11 to \$1.485 billion. But with the CPI increase used for the Charter limit calculation likely to be minimal, and with the value of new construction down, the actual Charter limit may be considerably lower. Permissible property tax revenue could therefore be as much as **\$40 million** less than currently projected.

² The largest of these actions were savings of \$75 million due to enhanced federal Medicaid match, \$34 million from lower Medicaid payments to hospitals, nursing homes, and other health care providers, and \$40 million from higher education reductions.

FY10 County Operating Budget

The FY10 aggregate operating budget approved by the Council – not including the \$79.5 million in Maintenance of Effort-related debt service for school construction that was appropriated to the MCPS budget – was \$3.73 billion. It was **down 1.1 percent** from FY09, the first decrease in 18 years. The FY10 budget for County Government alone was **down 2.2 percent**. Within County Government, many departmental budgets were down 5 percent or more. Tax-supported workyears were down 3.7 percent (general fund) and 2.0 percent (special funds).

The largest single gap-closing measure in the FY10 budget was the elimination of general wage adjustments (COLAs) for all agencies, saving \$125 million.³ Other large savings came from departures from County policies on reserves (\$40 million), PAYGO for the capital program (\$30 million), and retiree health benefits pre-funding (\$98 million compared to the 5-year phase-in policy set in 2007 and \$54 million compared to the 8-year policy set in 2008). **A key question for the FY11 budget is whether continuing revenue pressures from the weak economy will again require use of these gap-closing measures.**

One important goal in the FY10 budget was to **minimize employee layoffs**. In this regard the agencies have been largely successful. The College and M-NCPPC report that the positions they abolished were vacant, not filled. MCPS' preliminary report is that all potentially displaced employees have been placed, with the exception to date of two non-certificated employees, one or both of whom may yet be placed.

For County Government, there were **two categories** of potential layoffs: the class of part-time bus operators, which DOT decided for management reasons to replace with full-time operators, and all other employees. In the latter category, of potentially displaced employees who sought placement, only one was not placed and elected termination instead. In the part-time bus operator category, of employees who sought placement, four were not placed and elected termination, while eight were not placed, elected leave without pay, and may be placed later. OHR did excellent work in finding jobs for all other potentially displaced employees. The Retirement Incentive Program that was proposed to make room for displaced employees was not needed to achieve this result.

Outlook for FY11

In his memo on ©1-2, the Executive outlines the outlook for FY11 and comments on the need for a FY10 Savings Plan and/or employee furloughs that extend to all agencies. He notes that given past budget reductions, a meaningful FY10 Savings Plan may require service reductions and mid-year employee layoffs, and that any furloughs should extend to all agencies to achieve equity and meaningful savings.

³ This was a key contribution by agency employees. Moreover, position abolishments have created a heavier workload for many employees. At the same time, agency employees, unlike many others in this economy, have benefited from job security, annual step increases, no furloughs, and no reduction in salaries, benefits, or work hours. In County Government, concession agreements with unions resulted in some increases in compensatory time and annual leave, and in also in some costly proposals: a Retirement Incentive Program, expansion of the Personal Patrol Vehicle program for police officers, and an "imputed" COLA to calculate retirement benefits. The Council deferred action on the first two of these proposals and approved the third.

The current edition of OMB's Fiscal Plan Summary is on ©3. It is important to note that each edition of the Fiscal Plan reflects a snapshot in time, and that with each edition the picture will change.

This edition, like the one included in the Executive's FY10 recommended budget in March, shows a gap in FY11 of about **\$370 million**. Projected agency spending is based on Major Known Commitments, including compensation, not on the 10-year average rate of growth. Other assumptions in this edition are retiree health benefits pre-funding at the revised scheduled amount for FY11 (\$64.5 million, a much lower amount than shown in previous valuations), reserves restored to the 6 percent level, and PAYGO restored to the policy level of 10 percent of the planned bond issue.

These assumptions, which confirm important County fiscal policies, are a valid place to start, and there are strong arguments for adhering to them. But as noted above, the Executive and Council concluded that pressures in FY10 required a departure from these policies. The same conclusion in FY11 would reduce the gap by **\$140 million** or more.

The gap could be further reduced by making different assumptions about the projected 4.7 percent total increase in agency spending, which includes 3.6 percent for MCPS, 7.5 percent for the College, 3.4 percent for M-NCPPC, and 6.1 percent for County Government. The expenditure projections for MCPS and the College combined are **\$57 million** above Maintenance of Effort requirements. On the other hand, several factors not currently assumed in this edition could sharply increase the gap, including State aid reductions, County revenue declines, fuel or other price spikes, a potential State penalty related to FY10 Maintenance of Effort for MCPS, and employee pay increases (no new general wage adjustments are assumed).

The list of FY10-11 fiscal issues on ©4 includes these potential elements of risk and makes other useful points about the County's limited options and flexibility, the need for an exit strategy, and a possible FY10 Savings Plan and furloughs.⁴

Longer-Term Structural Changes

Savings plans and furloughs are important but short-term measures. There are strong arguments for making longer-term structural changes, but such changes have proven hard to implement here and elsewhere. One new effort of this kind is the joint labor-management **Cost-Efficiency Study Group** included in this year's MCGEO concession agreement. See the text on ©16. Another kind of effort being attempted in Oregon and other states is a "reset" to establish what the state should fund and what it can no longer afford. Maryland's new **Joint Legislative Workgroup to Study State, County, and Municipal Fiscal Relationships** may fall in this category. See the description on ©17-20. Efforts of this kind can have large implications for local governments – in Maryland, for example, on issues like the funding of teacher pensions.

⁴ Furloughs in state and local governments in this region and around the nation, as well as the private sector, have been widespread during the past year. Recently announced furloughs include the Anne Arundel County Public Schools. See the June 17 letter to AACPS employees on ©14-15.

For local governments, efforts to make longer-term structural changes must include a systematic focus on (1) productivity improvement (which private sector firms must have to compete and survive) and (2) salary and benefit costs, which here comprise four-fifths of the budget. The County's experience over the last decade has been that these costs, which are largely set in collective bargaining, are affordable when times are good and revenue growth is strong. But in downturns like the current one they are not, and fault lines between the County's promises to employees and its ability to pay for them begin to emerge. Now, absent an economic recovery that is robust and has staying power, these fault lines will deepen.

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OFFICE OF THE COUNTY EXECUTIVE
ROCKVILLE, MARYLAND 20850

Isiah Leggett
County Executive

MEMORANDUM

July 24, 2009

TO: Phil Andrews, President, County Council

FROM: Isiah Leggett, County Executive

SUBJECT: FY10-11 Fiscal Update

Attached please find the materials requested for the Fiscal Update for the Management and Fiscal Policy and the County Council for this coming week. As the attached materials indicate, significant challenges and difficult choices remain for Montgomery County in managing the current year budget, as well as in developing the FY11 budget. The attached fiscal plan projection is not based on a "rate of growth" for FY11 expenditures, but rather is based on estimated FY11 expenditures at "Major Known Commitments"¹ for all County tax-supported agencies. At this time, the fiscal analysis shows a gap of \$370 million. This gap is before considering other factors including:

- additional State Aid reductions in FY10 and FY11 (these reductions are, unfortunately, a certainty, though the specific amount is not known yet);
- further deterioration in local revenues (e.g. property, income, and transfer and recordation taxes); and
- other unanticipated events (e.g. fuel price spikes, extraordinary stock market losses, etc).

Preliminary indications are that FY09 tax-supported revenue collections for the operating budget are, generally, on target with the March projections. This means that we can not reasonably expect any budgetary relief from future increases in local revenues, and will monitor indicators carefully for the possibility of a slower than anticipated recovery. The fact that we are on tract with our revenue estimates does not alter the projected \$370 million gap for FY11. The expenditure projections contain approximately \$57 million of expenditures for Montgomery County Public Schools (MCPS) and Montgomery College (MC) above Maintenance of Effort (MOE) requirements.

¹ Estimates of obligations prepared by each agency on labor agreements, operating costs of capital facilities, or other contractual, policy, or programmatic commitments that can reasonably be identified and quantified.

Phil Andrews, President, County Council
July 24, 2009
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While additional time is needed to evaluate economic and fiscal data due to the already clear magnitude of the problem, we will need to implement an FY10 Savings Plan and/or employee furloughs in FY10. I do not approach either issue lightly though. Given, the position and service reductions made in preparing the FY10 Operating Budget, we will be very constrained in our options for an FY10 savings plan. Increases in lapse, elimination of nearly 400 positions, and other budgetary reductions have removed much of the flexibility that previously existed for instituting mid-year savings plan. For an FY10 savings plan, service reductions and mid-year employee layoffs may be required to achieve any meaningful and reasonably achievable savings.

As indicated in my FY10 Recommended Budget, employee furloughs may be an option, or supplement to a savings plan, since it would result in only temporary service reductions and would provide a source of feasible savings to carry forward into FY11. However, any furlough should be implemented across all tax supported agencies to ensure equitable treatment of employees and to produce substantive savings.

In closing I want to stress that, jointly, we have reduced cumulative gaps of nearly \$1.2 billion in the last three years. I believe by continuing to work together we will produce a balanced budget in FY10 and FY11 that preserves essential services in education, public safety, and our social services safety net and aligns our ongoing expenditures with our resources.

c: Timothy L. Firestine, Chief Administrative Officer
Kathleen Boucher, Assistant Chief Administrative Officer
All County Government Department Heads and Merit Directors
Dr. Jerry D. Weast, Superintendent, Montgomery County Public Schools
Royce Hanson, Planning Board Chairman, Maryland-National Capital Park and Planning Commission
Brian K. Johnson, Ed.D., President, Montgomery College

FY10-15 Public Services Program Tax Supported Fiscal Plan Summary

(\$ in Millions)								
	App. FY09	Est. FY09	% Chg. FY09-10	% Chg. FY09-10	App. FY10	% Chg. FY10-11	Projected FY11	
	5-22-08	5-21-09	Rec/Bud	Rec/Est	5-21-09			
1	Total Resources							
2	Revenues	3,776.3	3,708.6	0.8%	2.6%	3,804.9	1.5%	3,863.8
3	Beginning Reserves Undesignated	143.4	158.8	-19.5%	-27.3%	115.5	-34.1%	76.2
4	Beginning Reserves Designated	6.2	6.7	-100.0%	-100.0%	-	0.0%	-
5	Net Transfers In (Out)	33.3	32.7	11.9%	14.0%	37.2	-79.1%	7.8
6	Total Resources Available	3,959.3	3,906.8	0.0%	1.3%	3,957.7	-0.3%	3,947.7
7	Less Other Uses of Resources (Capital, Debt Service, Reserve)	424.1	397.3	-14.6%	-8.8%	362.2	35.1%	489.2
8	Available to Allocate to Agencies	3,535.2	3,509.5	1.7%	2.4%	3,595.4	-3.8%	3,458.5
9	Agency Uses							
10	Montgomery County Public Schools (MCPS)	1,937.0	1,917.9	4.3%	5.3%	2,020.1	3.6%	2,092.2
11	Montgomery College (MC)	212.4	205.7	2.4%	5.7%	217.5	7.5%	233.9
12	MNCPPC (w/o Debt Service)	106.4	103.9	0.2%	2.6%	106.6	3.4%	110.2
13	MCG	1,279.4	1,281.9	-2.2%	-2.4%	1,251.2	6.1%	1,327.5
14	Subtotal Agency Uses	3,535.2	3,509.5	1.7%	2.4%	3,595.4	4.7%	3,763.8
15	Retiree Health Insurance Pre-Funding							
16	Montgomery County Public Schools (MCPS)							30.9
17	Montgomery College (MC)							0.8
18	MNCPPC (w/o Debt Service)							3.6
19	MCG							29.2
20	Subtotal Retiree Health Insurance Pre-Funding							64.5
21	Subtotal Other Uses of Resources (Capital, Debt Service, Reserve)	424.1	397.3	-14.6%	-8.8%	362.2	35.1%	489.2
22	Total Uses	3,959.3	3,906.8	0.0%	1.3%	3,957.7	9.1%	4,317.6
23	(Gap)/Available	-	-			-		(369.9)

Notes:

1. FY11 property tax revenues are at the Charter Limit.
2. Projected agency spending is based on Major Known Commitments including compensation.
3. Retiree health insurance pre-funding is assumed at the scheduled FY11 amounts.
4. Reserves are restored to the policy level of 6% of total resources in FY11.
5. PAYGO is restored to the policy level of 10% of the planned bond issue in FY11.

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FY10-11 Fiscal Issues

Risk and Uncertainty (Not included in fiscal plan projections):

- State Aid Reductions
 - Not included in projections, but could be significant
 - Timing of announced cuts: August 2009 through April 2010
- Local Revenue declines: Income, Transfer/Recordation, and Property tax (estimated \$40 million reduction at Charter limit due to reduced inflation)
- MOE Penalty: If the SBOE finds the County did not satisfy MOE requirements the penalty could range from \$33 M. to \$57 M.
- Fuel or other Price Spikes

Lack of Options/Flexibility

- Savings Plan limits: lapse reductions, vacant position reductions, MC311 cuts
- Large transfers from Liquor Control and other funds already taken in FY10
- Reserves are already dangerously low in light of risks
- Cash flow limitations
- Very little discretion in terms of tax increases – “tax room”
- Impact Taxes: Actual FY09 Receipts were significantly under budget (\$26.5 million) and will be for FY10-14 as well and will need to be replaced with tax supporting funding or addressed through project delays.
- Further service reductions and additional layoffs may be required given the foregoing and the pending imposition of further state aid reductions.

Exit Strategy

- Need to present rating agencies with a plan for restoring reserves, OPEB, and PAYGO and aligning expenditures with revenues over the long term.
- Need to leave the recession with a stronger fiscal position as we did in early 90's with Revenue Stabilization Fund, Retirement Savings Plan, Changes in Health Insurance premium share, and “tax room”

Savings Plan

- Previous savings plans have relied heavily on lapse which is severely restricted due to additional lapse reduction of \$2.7 million across departments and MC311 reductions of \$1.875 million.
- Relies on inter-agency cooperation in attaining savings plan targets
- Service reductions and mid-year layoffs may be required to produce meaningful and reliable savings or...

Furloughs

- Furloughs, across all agencies, should be seriously considered as an alternative to further service reductions and layoffs

**Quarterly Update on Revenue Estimates
Montgomery County
FY 2009**

Reported through June 2009

Revenue Update

- **Through June Fiscal Year 2009 Results:**

- Total tax collections through June, including investment income and highway user revenue, totaled \$2.537 billion and were 4.4% above the same period in FY08 due primarily to property tax collections. Excluding property tax revenues, collections were \$1.581 billion and down 1.3% from the same period of FY08. (Please note: the data are not the final revenues for FY09).
- Income tax collections through July stood at \$1.292 billion and approximately \$377,000 (0.0% change) above collections for the same period in FY08.
- The General Fund (G.F.) portion of property tax collections (including penalties and interest) was \$955.5 million (↑20.4%) through June compared to the same period in FY08. The double-digit growth is a function of three factors: (1) increase in G.F. taxable assessments (↑11.2%), increase in G.F. real property rate (from \$0.627 to \$0.661), and a decrease in the credit (from \$613 to \$579).

- **Transfer and Recordation Taxes:**

- Collections from the transfer tax (excluding condominium conversions) through June of FY09 were \$64.8 million, or 18.9% below the same period last year.
- Collections from the recordation tax (excluding the CIP portion and the rate premium) were \$39.5 million, a decrease of 27.7% over last year.

Revenue Update

- **Transfer and Recordation Taxes (continued):**

- The decrease in the transfer and recordation taxes is due to continued decline in average sales prices and mortgage activity. Total recordation tax collections decreased 27.7%, while collections from mortgage refinancing decreased 39.9%.
- The volume of transfers, not including condo conversions, was down 4.7% in FY09 compared to last year, and the volume of recordation tax transactions (excluding CIP portion and rate premium) was down 11.0% compared to fiscal year 2008.
- The combined amount of revenues from the transfer and recordation taxes (excluding condo conversions, CIP portion, and rate premium) through June was \$104.3 million compared to \$134.5 million compared to the same period last year (↓22.5%).

Revenue Update

- **Consumption Taxes:**

- Total revenues from the consumption taxes (fuel/energy, hotel/motel, telephone, and admissions) totaled \$145.0 million through June of FY09, which were 6.5% above the same period in FY08.
- Fuel/energy tax collections totaled \$100.7 million through June and 9.4% above FY08 attributed mainly to the rate increases for electricity, natural gas, fuel oil, and liquid propane gas.
- Collections from the telephone tax were \$27.0 million and 2.5% above the previous fiscal year.
- Collections from the hotel/motel tax are 2.3% below the same period last year.
- Collections from the admissions tax through June were down 6.5% compared to the same period last year.



Revenue Update

- **Other Revenues:**

- Revenues from the County's pooled investment income were \$11.9 million through June of this fiscal year and 72.2% below the same period last year.
- Highway user revenues received to date were \$28.3 million and 12.4% below the same period in FY08.

Revenue Summary Sheet

MAJOR REVENUE COLLECTIONS FISCAL YEAR 2009					
<u>TAXES :</u>	REPORTING PERIOD	FY09 est. (1)	FY08	VARIANCE FY09/FY08	PERCENT CHANGE
	INCOME (2)	June	\$1,291,716,935	\$1,291,339,613	\$377,322
PROPERTY (General Fund)(3)	June	955,547,094	793,413,228	162,133,866	20.4%
TRANSFER (excl. condo conversion)	June	64,771,739	79,888,741	(15,117,001)	-18.9%
RECORDATION (excl. School CIP and Premium)	June	39,510,143	54,618,377	(15,108,234)	-27.7%
FUEL/ENERGY(4)	June	100,730,089	92,090,632	8,639,456	9.4%
HOTEL/MOTEL	June	15,622,316	15,985,986	(363,670)	-2.3%
TELEPHONE	June	26,995,094	26,333,074	662,020	2.5%
ADMISSIONS	June	1,657,192	1,771,901	(114,710)	-6.5%
<u>MISCELLANEOUS :</u>					
INVESTMENT INCOME	June	\$11,913,861	\$42,849,042	(\$30,935,181)	-72.2%
HIGHWAY USER	June	28,291,859	32,286,258	(3,994,399)	-12.4%
<u>TOTAL</u>		\$2,536,756,321	\$2,430,576,851	\$106,179,470	4.4%

SOURCE: All revenue data, excluding income tax data, from FAMRS109 report for fiscal period: 12 2009 dated July 18, 2009.

NOTES:

- (1) Revenue data for FY09 excluding income taxes revenues (see footnote 2) are through June and **are not final for the fiscal year**.
- (2) Includes July distribution.
- (3) Property Tax for General Fund includes adjustment for the income tax offset (rebate).
- (4) Fuel/Energy tax rates increased 10% (electricity, fuel, and steam) and 5% (natural gas and L.P. gas) in FY09.



Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF POLICY ANALYSIS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Director

July 8, 2009

The Honorable Thomas V. Mike Miller, Jr.
President of the Senate

The Honorable Michael E. Busch
Speaker of the House

The Honorable Ulysses Currie
Chairman
Senate Budget and Taxation Committee

The Honorable Sheila E. Hixson
Chairman
House Ways and Means Committee

The Honorable Norman H. Conway
Chairman
House Appropriations Committee

Lady and Gentlemen:

I am writing to report that it appears that the State budget is once again being overwhelmed by the deteriorating economy. Data presented today to the Revenue Monitoring Group show fiscal 2009 general fund revenue collections through June 30 lagging the budget estimate by nearly \$400 million. The final fiscal year results will not be known until final sales tax and personal income tax withholding revenues are counted in August.

While fiscal 2009 is still likely to end in the black, the implications of underattainment in fiscal 2009 for the fiscal 2010 budget are considerable and adverse. The fiscal 2010 budget was predicated on a balance of \$437 million being carried forward from fiscal 2009. The collections data indicate that the actual carry-forward will be about \$40 million. Taking into account the reduction in carry-forward, and the fact that the budget as passed anticipated an \$88 million fund balance at the end of fiscal 2010, when fiscal 2009 is closed, the 2010 budget automatically will be out of balance by roughly \$300 million.

But the bad news will not end there. The fiscal 2009 results also strongly suggest that the budget estimate for fiscal 2010 revenues is overstated as well. An official estimate incorporating the 2009 results and the most recent available economic forecasts will be available in mid-September. In the meanwhile, let us assume the adjustment will be roughly comparable to the fiscal 2009 underattainment of \$400 million. Combining the fiscal 2009 results with a potential revision of fiscal 2010 revenues of \$400 million would put the fiscal 2010 budget about \$700 million or 5% out of balance.

(11)

July 8, 2009

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Addressing a shortfall of this magnitude will be a daunting task, all the more so as it occurs as the Executive is trying to formulate the 2011 budget. (We already estimate that the fiscal 2011 budget has a cash shortfall in excess of \$1 billion before any further revenue write-down.) The Administration has solicited reduction proposals from the agencies and has stated its intention to recommend budget reductions to the Board of Public Works early in the fiscal year. The next scheduled board meetings occur on July 22, August 5, and August 26.

It is unclear, however, what magnitude of reductions or other actions the Administration will propose. At a minimum, it is to be hoped the budget proposal taken to the board will close the gap resulting from the 2009 revenue shortfall as doing so will restore the budget to balance based on the results known so far, and the official March forecast for fiscal 2010.

This balance will be fleeting, however, because new, and almost certainly lower, revenue estimates will be made in September putting the budget officially out of balance once more. Accordingly, the Administration should be encouraged to promptly develop and present an aggressive plan to restructure the 2010 budget to a sustainable level and carry forward those changes into the 2011 budget it is formulating. As any significant restructuring is likely to require statutory changes to be made, this process should also proceed in full consultation with the legislature.

Even as the problem is addressed, it is reasonable to ask how our budget can get so far out of whack so fast. In my view, a large part of the problem rests with the interaction of our revenue structure and the budget calendar. Roughly half of our general fund revenue is derived from the personal income tax, a sizeable portion of which is paid in April when final payments are due. Knowing the April result before the budget is passed could greatly aid the accuracy of the revenue estimate on which the budget is based. For instance, this year we knew by mid-May that collections were more than \$200 million behind the estimate. A budget passed with this knowledge would not be so far out of balance as we believe the fiscal 2010 budget will be. Resolving this issue, however, will require a change to the Constitution, or to statutory law to authorize the session to stand in recess and to allow the 90-day session to conclude in May.

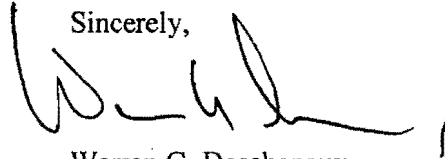
Another source of the problem, however, is with the data upon which our forecasters rely. In short, the economics profession has not distinguished itself in this recession, particularly the commercial and academic economic forecasters upon which we rely. They were slow to recognize the recession and have consistently failed to anticipate the pace and depth of the unraveling which has occurred. It is also the case, however, that our local forecasting process, to which the Department of Legislative Services contributes, has been reluctant to get too far ahead of the consensus view when forecasting revenues. The confluence has resulted in a succession of write-downs and under-attained revenues over the last two years.

July 8, 2009

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The situation confronting Maryland is extremely challenging and will only get more so as the stimulus is withdrawn. In Maryland's case, the current shortfall is only a modest prelude to the resolution of an underlying structural gap of around \$2 billion (about 15% of the current budget). As indicated above, prompt action is called for. If the budget is to be cut, for most ongoing items, sooner is better than later. State general funds are spent at an average rate of \$39 million a day, \$275 million a week, and \$1.1 billion a month. The longer the delay, the proportionately deeper the cut must be to yield the same dollars. At the same time, the action required must be substantial and durable. The present course of State finances is plainly unsustainable. In magnitude and urgency, it is equivalent, if not more substantial, than that which precipitated the special session of 2007. Addressing the immediate problem and the State's underlying structural infirmity will require no less an effort.

Sincerely,



Warren G. Deschenaux
Director

WGD/jhf

cc: Karl S. Aro



June 17, 2009

Dear AACPS Employees:

Since the Fiscal Year 2010 budget was first presented by Dr. Maxwell in December, the Board of Education and Superintendent have worked diligently to craft a plan that, as best as possible, meets the growing needs of our students and school system. We have worked with county and state officials to help address those needs while recognizing the fiscal difficulties facing our county, state, and nation.

Throughout this process, we have had two priorities: to preserve jobs, and to continue to provide programs of rigor and relevance that will guide our students to successful futures. The task has not been easy. The budget developed by the County Executive and adopted by the County Council is over \$40 million less than the one approved by our Board in February. We have had to make difficult choices to ensure that we can continue to do essential things like paying our healthcare claims and utility bills.

While the County Executive has been able to provide merit pay increases to many employees and to avoid furloughs, we are not as fortunate. **The budget adopted by our Board of Education today avoids layoffs**, but we are forced into a position where we can provide no salary increases to any employees and where we must impose furloughs for all employees except school bus drivers and aides, who are only contracted to work the same number of days that school is in session for students. This is a regrettable action, but a shared sacrifice that is a far better alternative than a reduction in our work force that would inflict more pain both on those who would be without jobs and those who remain employed in our system.

That willingness to share in this sacrifice has been demonstrated by the leadership roles that the Association of Educational Leaders, the Secretaries and Assistants Association of Anne Arundel County, and the American Federation of State, County, and Municipal Employees have taken in working with us to shoulder the load. We have reached agreements with all three bargaining units, and will continue to work toward an amicable agreement with the Teachers Association of Anne Arundel County.

The number of furlough days for employees – which are necessary because we must come up with money to meet our self-funded healthcare obligations – will be differentiated by job group, with the system's more senior and generally higher-paid employees incurring more furlough days than some other groups. The majority of furlough days, which will be designated by the school system, will be taken before students return from the summer break, thus minimizing the impact on school and classroom operations. Specific details on furlough days can be found in documents accompanying this letter.

This budget will continue to move our school system forward. We will be able to start the new Science, Technology, Engineering and Math magnet program at South River High School, add the second year of the STEM magnet at North County High School, and implement the Performing and Visual Arts

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All Employees
June 17, 2009
Page 2

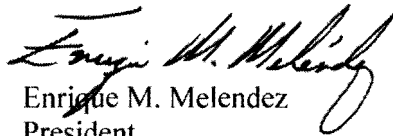
magnet program at Bates Middle School. Through cuts in other areas, we are able to fund an upgrade of our student information system that will allow us to remain compliant with reporting mandates and allow parents to more closely monitor their children's grades.

For the first time in recent memory, this budget adds no new positions to our system, a fact that will modestly increase class sizes. We have eliminated approximately 10 vacant positions in addition to the 200 positions we cut a year ago. We have further reduced professional development, consulting services, and the purchases of equipment and office supplies. And we are continuing, for the third consecutive year, a rolling hiring freeze on non-school-based positions.

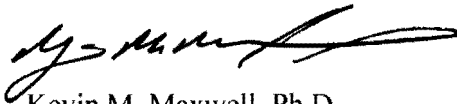
The coming year will be one of great challenge for us. Those challenges do not, however, change our goals. Our employees are the reason our school system is held in such high regard across the State of Maryland. As we have shared in the bounty of plentiful budgets in years past, we must share in the pain of these tough economic times. Despite the difficulties, we have full confidence that our employees will continue to show their mettle, and that the dedication, passion, and commitment of such a wonderful group of people will continue to provide an outstanding education for all of our students.

Thank you for everything you do for our students and our school system every day.

Sincerely,



Enrique M. Melendez
President
Anne Arundel County Board of Education



Kevin M. Maxwell, Ph.D.
Superintendent
Anne Arundel County Public Schools

EMM/KMM/bm

EXCERPT FROM THE MCGEO CONCESSION AGREEMENT APPROVED BY THE COUNCIL
ON MAY 13, 2009

* * *

ARTICLE 55 – COST EFFICIENCY STUDY GROUP

The parties shall establish a study group consisting of the Local 1994 President and two (2) other Union representatives; the Director of OHR and two (2) other employer representatives and the purpose of the group shall include, but not be limited to any of the following:

- (1) Evaluate the service delivery model for each agency/program/department which employ bargaining unit members;
- (2) Evaluate the supervisory/management structure in each agency/program/department which employ bargaining unit member, to include the supervisor to employee ratio;
- (3) Evaluate the technology, equipment, and tools supplied to bargaining unit members to perform their duties and responsibilities;
- (4) Evaluate the County Executive branch's operating budget to identify potential cost reductions that will not adversely impact same services;
- (5) Evaluate the cost effectiveness of current contracts with outside vendors who perform services that can otherwise be performed by bargaining unit members or via other more cost effective ways;

The study group's charge shall be to identify potential cost savings and/or productivity/efficiency enhancement/improvements. Any cost savings shall be dedicated to maintaining services. The study group shall have its first meeting no later than July 30, 2009.

* * *

THOMAS V. MIKE MILLER, JR.
PRESIDENT OF THE SENATE



MICHAEL E. BURCH
SPEAKER OF THE HOUSE

MARYLAND GENERAL ASSEMBLY
STATE HOUSE
ANNAPOLIS, MARYLAND 21401-1991

July 20, 2009

Mr. Warren Deschenaux
Director, Office of Policy Analysis
Department of Legislative Services
90 State Circle
Annapolis, Maryland 21401

Dear Mr. Deschenaux:

We are writing to you regarding our plans to appoint a *Joint Legislative Workgroup to Study State, County, and Municipal Fiscal Relationships*. As you know, the deteriorating national economic condition and its effect on Maryland continues to present tremendous challenges to our State. When the General Assembly Session concluded in April of this year, the State had lost almost \$3.5 billion in revenues in the prior 12-month period. This amount was almost 25 percent of the total General Fund budget for fiscal 2009 which ended June 30th.

In addition to significant reductions taken during the interim of last year, the General Assembly further constrained spending and reduced the budget by over \$840 million. Working with the Governor, the leadership of the General Assembly left this Session with a \$100 million fund balance and maintained \$650 million in our Rainy Day Fund. Earlier this year, the State's triple-A bond rating was once again affirmed by all three rating agencies.

Unfortunately, since the 2009 Session, the State has lost as much as \$800 million more in revenues. This number is offset by the \$100 million fund balance left by the General Assembly's work on the budget but still leaves a \$700 million deficit. The Governor has announced his intention to address this deficit promptly with reductions at the Board of Public Works this month.

Our record of strong fiscal management and planning has served Maryland well. As compared to the financial condition of many other states, Maryland is far better positioned. It is General Assembly's long record of fiscal management and planning which has now compelled us to call for a thoughtful examination of the fiscal relationship between the State and local governments. The State allocates over 40 percent of its General Fund revenues to units of local government and given the financial forecasts, it is time that the structure and sustainability of these commitments are reviewed.

From the State's perspective, in recent years, we have reduced funding to local government in an ad hoc manner and generally on a temporary basis. In almost each of the last seven years, some reduction in funding to local government has been required. Additionally, sharing of traditionally State-only tax bases such as the income tax with local government often magnifies disparities among jurisdictions while simultaneously reducing the State's capacity to address them.

At the same time, counties and municipalities have raised issues over recent years that relate to their fiscal relationship with the State and with each other. Municipalities have expressed concern that their revenue base is too narrow to support operations and they have been unable to reach agreement with the counties on a solution. Counties are pressured to meet commitments to school boards, libraries, health departments and community colleges while they are also confronting an adverse economy and State mandates for support of those local entities. The albeit necessary State aid reductions on an ad hoc basis results in uncertainty in the local budget process as the levels of State support are unpredictable.

Additionally, property tax rate limitations and Homestead property tax assessment limitations imposed in some jurisdictions create additional local funding pressures resulting in increased demand for State support. All of these issues raise questions as to both the structure and sustainability of the current relationships between the State, county and municipal forms of government in Maryland. For these many reasons, we are appointing the attached roster of General Assembly members to a *Joint Legislative Workgroup to Study State, County, and Municipal Fiscal Relationships*, and would ask that it be staffed by the Office of Policy Analysis.

We have also attached items that we would ask that the Joint Workgroup include in their review and recommendations. Maryland is indeed challenged by the recession but unlike many states, we have responsibly managed the State through these times of economic stress. We have done so while maintaining the success of key investments such as education. We all know that the necessary budget decisions that will be made in the near future will not be easy and look forward the Workgroup's recommendations and assistance in these matters.

Please feel free to contact us with any questions you may have. It is through continued fiscal prudence and management that the State will endure, will revive, and will emerge stronger and best poised to move forward into the new economy.

Sincerely,


Thomas V. Mike Miller, Jr.


Michael E. Busch

Enclosure

cc: Governor Martin O'Malley
Karl Aro

Secretary Eloise Foster
Michael Sanderson

Joseph Bryce
Scott Hancock

Items of Review by the Joint Legislative Workgroup to Study State, County and Municipal Fiscal Relationships

Among other items to be reviewed, the Joint Workgroup is asked to examine the following items and provide recommendations as appropriate to result in a more fair, efficient, and sustainable financial relationship between the State, County and Municipal forms of government in Maryland:

- Evolution and current distribution of governmental responsibilities among units of government, including State assumption or delegation of responsibilities;
- Evolution and current distribution of current State funding and assistance provided to counties and municipalities, including State assumption or delegation of responsibilities;
- A comparison of the major forms of State aid to county and municipal governments and the manner in which these items are funded or provided for in other states;
- Analysis of revenue structure of State, county and municipal governments in the aggregate and by unit of government, including an analysis of variation among counties and municipalities;
- Analysis of the fiscal capacity of State, county and municipal governments in the aggregate and by unit of government, including an analysis of variation among counties and municipalities;
- Analysis of the expenditures of State, county and municipal governments in the aggregate and by unit of government, including an analysis of variation among counties and municipalities and across major policy and program areas
- Analysis of the employment in State, county and municipal governments in the aggregate and by unit of government, including an analysis of variation among counties and municipalities and across major policy and program areas;
- Analysis of the comparative benefits of types of municipal forms as compared to special taxing districts within counties to provide specific services to residents of a sub-county area; and
- Analysis of the impact of spending, tax and revenue limitations of the system of State, county and municipal finance.

**Joint Legislative Workgroup to Study
State, County, and Municipal Fiscal Relationships**

Senator Edward J. Kasemeyer, Co-Chair
Delegate Adrienne A. Jones, Co-Chair

Senator Ulysses Currie
Senator James E. DeGrange, Sr.
Senator Robert J. Garagiola
Senator Allan H. Kittleman
Senator Richard S. Madaleno, Jr.
Senator Thomas McM Middleton
Senator Nathaniel J. McFadden
Senator Donald Munson

Delegate Norman H. Conway
Delegate Kumar Barve
Delegate Sheila E. Hixson
Delegate Marvin E. Holmes
Delegate Maggie McIntosh
Delegate Anthony J. O'Donnell
Delegate Justin D. Ross
Delegate Steven R. Schuh

MFP COMMITTEE #4
July 27, 2009

ADDENDUM

MEMORANDUM

July 27, 2009

TO: Management and Fiscal Policy Committee

FROM: Stephen B. Farber, Council Staff Director *SBF*

SUBJECT: Update on the County Fiscal Situation for FY10-11

This addendum includes the following information:

1. On ©1, a list of Major Known Commitments by Agency prepared by OMB. Please note lines 7-8, Potential or Negotiated FY11 Compensation (FY10 Level), and lines 9-10, which list the FY10 GWAs (COLAs) and step increases that were not funded.
2. On ©2-3, a summary of key points regarding furloughs in the April 14, 2009 report on furloughs and buyouts prepared by the Office of Legislative Oversight. Go to http://www.montgomerycountymd.gov/content/council/olo/reports/pdf/brief_buyouts_olo_2009-9.pdf for the complete report.

	A	B	C	D	E	F	G
1	Major Known Commitments by Agency						
2							
3			MCPS	MCG	College	MNCPPC	Total
4	FY10 Appropriation		2,020,078,263	1,251,173,090	217,549,063	106,646,100	3,595,446,516
5	Debt Service Reimbursement		(79,537,322)				(79,537,322)
6	FY10 Appropriation (net)		1,940,540,941	1,251,173,090	217,549,063	106,646,100	3,515,909,194
7	Potential or Negotiated FY11 Compensation:						
8	(FY10 Level)						
9	General wage adjustment		84,775,000	28,847,581	6,984,015	2,682,200	123,288,796
10	Steps/service increments		18,859,068	5,513,250	2,313,659	910,900	27,596,877
11	Projected group insurance cost increases		26,048,866	8,500,000	628,500		35,377,366
12	Projected retirement cost increases		2,195,092	17,000,000			19,195,092
13	Retiree health insurance pre-funding		30,942,250	29,154,000	803,000	3,628,350	64,527,600
14	Other projected bargaining costs		400,000	593,820			993,820
15	Elimination of one-time items			(6,655,160)			(6,655,160)
16	Cost increase due to enrollment		6,537,580		1,236,305		7,773,885
17	Operating impact of new facilities		417,396	661,020	3,202,161		4,280,577
18	Annualizations						0
19	Annualization of FY10 increments			2,178,450			2,178,450
20	Other position annualizations			276,350	1,000,035		1,276,385
21	GE Facility Maintenance			717,440			717,440
22	MCFRS – FROMS contract			(306,630)			(306,630)
23	Programmatic set-asides						0
24	Master Lease payment reductions			(1,371,120)			(1,371,120)
25	Community Grants			3,226,520			3,226,520
29	Working Families Income Supplement			1,455,200			1,455,200
30	Election cycle changes			4,104,840			4,104,840
35	County Attorney Disparity Study			500,000			500,000
46	Inflation:						
47	Energy/utility costs			682,070	159,576		841,646
48	Fuel/rate increases			3,069,320			3,069,320
49	Contracts			560,830			560,830
50	Instructional materials/other		5,420,285				5,420,285
51	Nonpublic placements		2,105,578				2,105,578
52	Other				600,000		600,000
53	Other inescapable cost increases:						
54	Self-insurance, workers compensation		2,447,053	6,811,890	25,000		9,283,943
55	Maintenance, transportation, etc.		2,407,573				2,407,573
59			182,555,741	105,519,671	17,152,251	7,221,450	313,099,113
60							
61	Total		2,123,096,682	1,356,692,761	234,701,314	113,867,550	3,829,008,307
62	Percent increase		9.4%	8.4%	7.9%	6.8%	8.9%

A RESEARCH BRIEF ON FURLOUGHS AND BUYOUTS

OFFICE OF LEGISLATIVE OVERSIGHT MEMORANDUM REPORT 2009-9

APRIL 14, 2009

In these difficult economic times, many state and local governments are reluctantly turning to employee layoffs in order to reduce operating expenses and balance their budgets. Furloughs and buyouts represent two alternative strategies being used by employers to reduce compensation costs, and downsize or restructure the workforce:

- A furlough is the placement of an employee in a temporary non-duty, non-pay status to achieve budget savings.
- A buyout is any type of financial incentive provided by an employer to encourage employees to voluntary leave their jobs either through retirement or resignation.

Montgomery County has historically worked very hard to minimize the use of layoffs. To further the Council's understanding of how furloughs and buyouts work in practice, the Council requested the Office of Legislative Oversight to prepare a research brief about these two strategies, including the reported experiences of other jurisdictions.

FURLOUGHS - REPORTED ADVANTAGES AND DOWNSIDES

The use of furloughs has expanded during the past year as a relatively common employer response to the current economic downturn. The most commonly cited advantages and downsides to using furloughs as a budget savings strategy are listed in the table below.

Commonly Cited Advantages
<ul style="list-style-type: none">• A furlough provides immediate and predictable savings.• A furlough may serve to minimize or even avoid the use of layoffs.• A furlough is a temporary adjustment that does not require changes to the current size or structure of the workforce.• Employees tend to prefer furloughs vs. other forms of compensation reductions that pay employees less for the same amount of work.• A furlough can be structured to provide some additional savings in operating costs by closing facilities on certain days.
Commonly Cited Downsides
<ul style="list-style-type: none">• Furloughs do not deliver long-term savings from a structural change in the workforce.• Furloughs can result in grievances and/or lawsuits from employee organizations.• Furloughs can result in increased overtime expenses to maintain services or to "make up" the work missed during a furlough.• Furloughs typically result in some amount of less work being performed.

COMMON DESIGN QUESTIONS

Furloughs are not all structured identically. However, while each furlough plan has its unique characteristics, there are common design questions to address if/when a furlough plan for County Government employees is before the Council for consideration. The key questions are:

1. How much budget savings does the furlough need to achieve?
2. Is the furlough going to be voluntary or mandatory?
3. How many furlough hours or days are there going to be? Should the number of furlough hours or days be the same for all employees?
4. Should furlough days be designated or subject to employee choice (i.e., rolling)? Should there be any incentives or options as to when furloughs are taken?
5. Should certain employees be exempt from the furlough, e.g. certain job types or classes, employees earning less than a certain amount?
6. How should the compensation adjustment be taken out of employees' paychecks?
7. How should the calculation of employee benefits be treated as a result of a furlough?

In deciding how to answer these questions, the Council must weigh three potentially-competing factors: budget savings; adverse impacts on employees (both in terms of wages and morale); and changes in productivity and levels of service delivery.

LESSONS LEARNED

Based on information compiled about furlough plans being implemented by other public sector employers, OLO identified the following recurring themes or "lessons learned":

Furloughs provide immediate budget savings without reducing the size of the workforce. Jurisdictions that are implementing furloughs report they are achieving their targeted reduction in compensation costs, either immediately or in the near future. By design, a furlough does not require an employer to reduce the size or change the structure of the workforce.

Employers can design a furlough in ways that mitigate some of the negative effects on employees, especially the financial loss for those earning lower salaries. Typical strategies used to mitigate the adverse impacts of furloughs on employees include protecting employee benefits and spreading out the salary loss over multiple pay periods. Other strategies include exempting employees who earn less than a certain amount and/or requiring higher-paid employees to take more furlough days than lower-paid employees.

Not much is documented about the impact of furloughs on productivity. The use of rolling furloughs and exempting certain employees are design approaches intended to minimize service disruptions. Some jurisdictions strive to maintain service levels to the public by providing incentives for employees to take their furlough days on pre-existing holidays.

While employees prefer voluntary vs. mandatory furloughs, voluntary furloughs may not achieve the desired level of cost savings. The obvious downside to voluntary furloughs is that there is unlikely to be 100% participation and the resulting cost savings is smaller.

Some furloughs have resulted in legal challenges from employees unions. Three of the eight jurisdictions reviewed experienced legal challenges to their furlough plans with varied results.