Agenda #3G
January 27, 2009
Introduction

MEMORANDUM

January 23, 2009

TO: County Council

FROM: CHS
Charles H. Sherer, Legislative Analyst

SUBJECT: Resolution to approve Spending Affordability Guidelines for the FY10 Operating Budget

<u>The purpose of this agenda item</u> is to introduce the resolution to approve the FY10 spending affordability guidelines. The Council staff calculations are in the resolution on ©2, as calculated in the spreadsheet on ©1. The public will have an opportunity to comment on the guidelines at a public hearing on February 3. The MFP Committee will consider the staff calculations and the public hearing comments on February 9. The deadline for the Council to adopt the guidelines is the second Tuesday in February, which is February 10.

<u>Background</u> On November 6, 1990, the voters amended the Charter to add to section 305 the requirements that "The Council shall annually adopt spending affordability guidelines for the capital and operating budgets, including guidelines for the aggregate capital and aggregate operating budgets. The Council shall by law establish the process and criteria for adopting spending affordability guidelines." The resulting law is in sections 20-59 through 20-63 in the Code, which states that the Council must set **<u>three</u>** guidelines for the operating budget, no later than the second Tuesday in February for the fiscal year starting the following July 1:

1) A ceiling on funding from property tax revenues.

2) A ceiling on the aggregate operating budget, which is defined as the total appropriation from current operating revenues for the next fiscal year, including current revenue funding for capital projects, but <u>excluding</u> appropriations for: specific grants, enterprise funds, tuition and tuition-related charges at Montgomery College, and the Washington Suburban Sanitary Commission. Specific grants

are grants for specific programs which will not be provided if the grants are not received. Note that the aggregate operating budget includes current revenue funding for the capital budget.

3) The allocation of the budget among current revenue funding for the capital budget, debt service, and operating expenses for MCPS, Montgomery College, County Government, and MNCPPC.

In adopting its guidelines, the Council should consider the condition of the economy, the level of economic activity in the County, trends in personal income, and the impact of economic and population growth on projected revenues. There is no provision in the County Code for amending the guidelines. In accordance with Section 20-61 of the County Code, each January, the Finance Director consults with independent experts from major sectors of the economy. These experts advise the County on trends in economic activity in the County and how activity in each sector may affect County revenues. The Director of Finance sends the findings to the Council each March.

June 1 Approval of the Budget Section 305 of the Charter imposes two restrictions on the aggregate operating budget:

1) "An aggregate operating budget which exceeds the aggregate operating budget for the preceding fiscal year by a percentage increase greater than the annual average increase of the Consumer Price Index for all urban consumers for the Washington-Baltimore metropolitan area, or any successor index, for the 12 months preceding December 1 of each year requires the affirmative vote of **six** Council members." The U.S. Department of Labor Bureau of Labor Statistics provides this data. The BLS calculates this index for every odd-numbered month, and the last index each calendar year is for November. In the 18 years starting in FY92, six affirmative votes were required 15 times.

2) "Any aggregate operating budget that exceeds the spending affordability guidelines then in effect requires the affirmative vote of **seven** council members for approval." In the 18 years in which this Charter provision has been in effect, starting in FY92, seven affirmative votes were required 12 times, including 7 of the last 8 years (©4).

June 30 Tax Levy Section 305 of the Charter imposes **one** restriction on property taxes on existing real property: nine (seven until the voters increased the number to nine in November 2008) affirmative votes are required if the amount of property tax on existing real property exceeds the previous year's tax by more than the rate of inflation. The limit applies only to existing real property. "This limit does not apply to revenue from: (1) newly constructed property, (2) newly rezoned property, (3) property that, because of a change in state law, is assessed differently than it was assessed in the previous tax year, (4) property that has undergone a change in use, and (5) any development district tax used to fund capital improvement projects." Finally, the limit does not apply to personal property. (Personal property generally includes furniture, fixtures, office and industrial equipment, machinery, tools, supplies, inventory, and any other property not classified as real property.)

In the 18 years in which this Charter provision has been in effect, starting in FY92, seven affirmative votes were required four times: in FY03-05 and FY09 (©2). In the future, nine affirmative votes will be required to exceed the Charter limit, as noted above.

I. Ceiling on funding from property taxes This is one guideline the Council must set, as explained above.

Types of property and tax rates There are two types of property: real and personal. The tax rate on personal property is 2.5 times the tax rate on real property (rounded up to the nearest tenth of a cent, which is the nearest thousandth of a dollar). The County sets the following tax rates on real and personal property. Numbers 1-3 and 4a are Countywide, the rest are not.

1. General County tax
2. Mass Transit tax
3. Fire tax
4. Three taxes for MNCPPC:
    a. Advance Land Acquisition tax
    b. Metropolitan tax (for Parks)
    c. Regional tax (for Planning)
5. Recreation tax
6. Storm Drainage tax
7. Three Urban District taxes
8. Two Noise Abatement District taxes
9. Four Parking Lot District taxes
10. Two Development District taxes, for the CIP. Since these taxes are for the CIP, they are not included in the following analysis.

Components of property tax Property tax in the next fiscal year has the following three components:

1. Property tax on REAL property that existed in the current year ("old" construction). This is the **only** component that is limited by the Charter
2. Property tax on REAL property that did not exist in the current year ("new" construction)
3. Property tax on PERSONAL property, both old and new

In this memorandum, TOTAL PROPERTY TAX is the sum of these three components. Of the total property tax, less than 1% is for the parking districts (to provide parking lots and garages and related expenses). The remainder is for all other government services.

Charter limit Section 305 of the Charter places a restriction, referred to as the "Charter limit", only on component #1 above: if the property tax on REAL property that existed in the current year (the "old" construction) increases more than the rate of inflation, then the tax rates must be approved by all nine Councilmembers. There is no limit on the increase in personal property tax nor on the amount of tax on new construction. Inflation "...for the 12 months preceding December 1" is used to calculate the Charter limit for the upcoming fiscal year. Property tax at the Charter limit increases roughly at the rate of inflation plus roughly 1% for new construction and personal property.

As noted above, for the 18 years in which the Charter restriction has been in effect, the table on ©2 shows that the Council exceeded the restriction in 4 years and did not exceed it in 14 years.

Current Rates Property tax at current rates increases at the same percentage as the assessable base increases (unless the Council approved a credit in the previous year, in which case the percentage increase is greater than the percentage increase in the assessable base). The Council sets 17 tax rates, for 17 tax districts. Finance calculates property tax at current rates by multiplying the tax rate in the current fiscal year in each district by the estimated assessable base next fiscal year in each district by the collection factor for each district, and then adding the 17 amounts.

Options to reach the Charter limit When the total amount of property tax at the Charter limit is less than property tax at current rates, there are numerous options for reducing property tax to the Charter limit (which applies only to the old real property). The Charter language requires at least two complex calculations that do **not** result in a single amount for the total property tax at the Charter limit. Rather, the total property tax at the Charter limit is one amount if the Charter limit is achieved entirely by credit and another amount if the Charter limit if achieved entirely by reducing the rate. The total property tax at the Charter limit can be any amount in between those amounts if the Charter limit is achieved by some combination of credit and rate reduction. Moreover, the total property tax at the Charter limit can also be any amount above the higher amount if the Charter limit is achieved by **increasing** the rate and giving a credit. The so-called "Charter limit" should be described as the Charter limits!

A more detailed explanation of the various options for reaching the Charter limit follows.

1. Entirely by reducing the rates. In this case, all property (old construction, new construction, and personal) gets a reduction and total property tax is the **least** of any option.

2. By keeping rates the same (current rates) and giving property tax credits only for old/existing owner-occupied principal residence housing. The following groups do **not** get any credit: new construction, commercial property (whether new or old), new and old personal property. Since rates are not reduced in this option, new construction and personal property pay more than they would pay under option 1, so the total property tax under option 2 is the **greatest** of any option. (The effects of the credit are to shift the tax burden: a) from residences with low taxable value to residences with high taxable value; and b) from residential to commercial tax payers.)

3. By both reducing the rates and by giving credits. Total property tax is in-between options 1 and 2.

4. By increasing the rates and by giving a credit that exceeds the increase resulting from the increasing the rates.

History of credits For FY99, the Council approved a property tax credit as an offset to the income tax in the amount of $11.1 million ($50 per household), and none in FY00 – FY05.

For FY06, the Council approved the following reductions from the amount of property tax at current rates to reach the Charter limit:

Reduced the rate 4¢	$50.4 million	
Income tax offset credit	29.4 million	= $116 per household for estimated 254,260 HHs
Expanded circuit breaker credit	6.0 million	
Total	85.8 million	

Finance reported that the actual number of such credits in FY06 was 245,760.

For FY07, the Council approved the following reductions from the amount of property tax at current rates to reach the Charter limit:

Reduced the rate 5¢	$67.2 million	
Income tax offset credit	55.3 million	= $221 per household for estimated 250,000 HHs
Total	122.5 million	

For FY08, the Executive recommended reaching the Charter limit entirely by giving a $613 credit for each owner-occupied principal residence, and the Council agreed:

Income tax offset credit $149.124 million = $613 per household for estimated 243,173 HHs

FY09 The Executive's recommended property tax was $122 million below the amount at current rates and $138 million above the Charter limit (if the limit was achieved entirely by reducing the rates). He recommended achieving his recommended amount by increasing the rate by 7.5¢/$126 million and giving a credit to eligible households totaling $248 million, which is a $1,014 credit to each of the estimated 245,000 eligible households. The net change would have been to reduce property taxes $122 million below the amount at current rates. There were other ways to achieve the Executive's recommended amount, such as entirely by reducing the rates, entirely by giving a credit, or a combination of reducing the rates and giving a credit.

In May 2008, the Council decided to leave the rates unchanged and to give a credit of $579 to each of an estimated 245,000 eligible households, for a total credit of $141.9 million. The result was to decrease property tax from the Executive's recommended amount by $20.0 million, which exceeded the Charter limit by $118.0 million.

Maximum amount of credit State law specifies that the maximum is the amount of income tax resulting from a County income tax rate in excess of 2.6% of Maryland taxable income. The Council set this rate at 3.2%, the maximum the State permits.

Ceiling on funding from property taxes Finance's calculation for property tax in FY10 at the Charter limit are shown below. Council staff recommends setting the guideline at the Charter limit achieved by reducing the rate.

Property tax at the Charter limit achieved by reducing the rate	$1,427.4 million
Property tax at the Charter limit achieved by giving an income tax offset credit	$1,441.0 million

II. Ceiling on the aggregate operating budget This ceiling is 5.9% of personal income in the County, as shown on ©1 (total tax-supported appropriations are 6.0% of PI). The aggregate operating budget is then allocated to debt service, revenue funding for the capital budget, and operating expenses for the agencies as shown on ©1.

a) Debt Service Debt service is a fixed charge that must be paid before making the allocation of any resources to the four agencies. Long-term leases are included, since these payments are virtually identical to debt. Debt service is in the County Government's debt service fund and also in the budget for MNCPPC. The amount of debt service next year is based on the amount of debt currently outstanding and estimated to be issued.

b) Current Revenue Funding for the Capital Budget There are two types of current revenue funding for the capital budget.

i) The first type is funding for capital projects which do not meet the criteria for bond funding and must be funded with current revenue, or not funded at all. Council staff used the amount in the Executive's January 15, 2009 memorandum on the Recommended Capital Budget.

ii) The second type is referred to as "PAYGO from Current Revenue for Bond Offset" (pay as you go), and is funding for projects which are eligible for bond funding, but the Council has decided to use current revenues to decrease the need for bonds. The substitution of current revenues for bonds helps protect the AAA bond rating by reducing the need for bonds and also decreases the operating budget for debt service. The Council's target is 10% of bond funding ($300 million), which is $30 million. Council staff used this target.

c) Operating expenses for the four agencies (agency allocations) Council staff allocated the remainder of the AOB to the four agencies in the same percentage as the Council approved for FY09, as shown on ©1. The FY10 allocations are on ©1.

Overall Spending Target for Community Grants The Council's Grants Coordinator provided the following information.

In December 2007, the County Council set an overall spending target for Community Grants as part of its actions establishing Spending Affordability Guidelines for the Fiscal Year 2009 Operating Budget. The target set by the Council was $2.35 million for Council Community Grants and $2.35 million for Executive Community Grants. In May 2008 the Council approved $2.3 million in Council Community grants that had gone through the Council's grants process and $3 million in Executive-recommended Community Grants.

Does the Committee wish to recommend an overall amount for Community Grants for Fiscal Year 2010 and, if so, at what amount? Does the Committee wish to set an overall target for both Executive-recommended Community Grants and Council Community Grants or solely Council Community Grants? An overall target of $2 million for Council Grants for FY2010 would be a 13% reduction from the amount approved by the Council for Council Grants in the FY09 budget. A target of $2 million for County Executive-recommended Grants would be a 33% reduction from the amount recommended by the County Executive and approved by the Council in the FY09 budget.

Proposed language for the Council Resolution on Spending Affordability Guidelines would state:

> "The Council's intent is that $4 million of the County Government's allocation will be appropriated for Community Grants (this amount excludes Community Service Grants), with Executive-recommended specific Community grants totaling $2 million and Council specific Community grants totaling $2 million."

Schedule

January 27	Introduction
February 3	Public hearing
February 9	MFP discussion and recommendations for the Council
February 10	Council action

SPENDING AFFORDABILITY GUIDELINE FOR THE AGGREGATE OPERATING BUDGET
$millions

I. Calculation of the ceiling on the AOB		FY10	
Projected personal income of County residents in FY10, Finance		67,077	
Projected personal income of County residents in FY10, RESI		66,770	
Average projected PI		66,924	
Times the % of PI the Council assumes residents can afford		5.9%	
= CEILING on the Aggregate Operating Budget		3,948.5	

NOTE: Total affordable tax-supported appropriations would be 6.0% of projected PI.

II. Allocations	FY09 approved	FY10	% change
County Debt Service	248.0	280.3	13.0%
MNCPPC Debt Service	4.7	4.7	0.4%
Current revenue, specific projects	46.3	44.4	-4.1%
Current revenue, PAYGO	5.4	30.0	454.9%
Subtotal, non-agencies	304.4	359.4	18.1%
MCPS	1,937.0	2,004.8	3.5%
College, excluding expenditures funded by tuition	144.8	149.9	3.5%
County Government	1,279.4	1,324.2	3.5%
MNCPPC	106.4	110.2	3.5%
Subtotal, agencies	3,467.6	3,589.1	3.5%
Aggregate Operating Budget	3,772.0	3,948.5	4.7%

Agencies, FY09	$millions	%
MCPS	1,937.0	55.9%
College, excluding expenditures funded by tuition	144.8	4.2%
County Government	1,279.4	36.9%
MNCPPC	106.4	3.1%
Subtotal, agencies	3,467.6	100.0%

Agencies, FY10		
MCPS		2,004.8
College, excluding expenditures funded by tuition		149.9
County Government		1,324.2
MNCPPC		110.2
Subtotal, agencies		3,589.1

III. Ceiling on property tax		
Charter limit if achieved by reducing the rate		1,427.4
Charter limit if achieved by giving an income tax offset credit		1,441.0

Resolution No: ____________
Introduced: January 27, 2009
Adopted: ____________

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: County Council

Subject: Spending Affordability Guidelines for the FY10 Operating Budget

Background

1. Section 305 of the Charter and Chapter 20 of the Montgomery County Code require the Council to set spending affordability guidelines for the operating budget for the next fiscal year.

2. The guidelines must specify:

   a) A ceiling on property tax revenues, which are used to fund the aggregate operating budget.

   b) A ceiling on the aggregate operating budget. The aggregate operating budget is the total appropriation from current operating revenues, including appropriations for capital projects but excluding appropriations for: enterprise funds, the Washington Suburban Sanitary Commission, specific grants for which the spending is contingent on the grants, and expenditures equal to the estimated tuition and tuition-related charges at Montgomery College.

   c) The spending allocations for the County Government, the Board of Education, Montgomery College, the Maryland-National Capital Park and Planning Commission, debt service and current revenue funding of capital projects. As noted above, the College's allocation excludes expenditures equal to the estimated tuition and tuition-related charges.

3. The legislation lists a number of economic and financial factors to be considered in adopting the guidelines, requires a public hearing before the Council adopts guidelines, and requires that the Council adopt guidelines no later than the second Tuesday in February for the fiscal year starting the following July 1.

4. At the public hearing on February 3, 2009, the public had the opportunity to comment on the following guidelines, in millions of dollars.

a) The ceiling on property tax revenues excluding the self-supporting parking districts, at the staff estimate of the Charter limit achieved entirely by reducing the property tax rate: $1,427.4 million

b) The ceiling on the aggregate operating budget and the agency allocations:

	$ million
MCPS	$2,004.8
Montgomery College	149.9
County Government	1,324.2
MNCPPC	110.2
County Debt Service	280.3
MNCPPC Debt Service	4.7
Current Revenue, PAYGO	30.0
Current Revenue, specific projects	44.4
AGGREGATE OPERATING BUDGET	3,948.5

Action

The County Council for Montgomery County approves the following resolution:

1. The spending affordability guidelines for the FY10 Operating Budget in **millions** of dollars are:

a) The ceiling on property tax revenues excluding the self-supporting parking districts, at the staff estimate of the Charter limit achieved entirely by reducing the property tax rate: $X,XXX.X

b. The ceiling on the aggregate operating budget and the agency spending allocations are:

MCPS	
Montgomery College	
County Government	
MNCPPC	
County Debt Service	
MNCPPC Debt Service	
Current Revenue, PAYGO	
Current Revenue, other	
Unspecified reductions	
AGGREGATE OPERATING BUDGET	

3

Resolution No: ____________________

This is a correct copy of Council action.

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Linda M. Lauer, Clerk of the Council

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