OFFICE OF THE COUNTY EXECUTIVE
ROCKVILLE, MARYLAND 20850

Isiah Leggett
County Executive

MEMORANDUM

March 25, 2010

TO: Nancy Floreen, President, County Council

FROM: Isiah Leggett, County Executive

SUBJECT: Additional FY10 and FY11 Budget Actions

Budget Process

I am sending this memorandum to recommend that we jointly take additional actions to strengthen the County's financial position in the current fiscal year and for FY11.

There is no perfect time to formulate a budget. Since I recommended my budget earlier this month, we have already received more bad news that points to additional fiscal deterioration. This includes a dramatic increase in the County's unemployment rate from 5.2% to 6.2% and may signal further erosion of income tax revenue. In addition, Anne Arundel County's bond rating was recently downgraded from a AA+ to a AA rating due to several factors including the deteriorating condition of Anne Arundel's reserves. At the same time, the Department of Finance has been in discussions with the bond rating agencies relative to an upcoming bond sale and is concerned about feedback they have received from the rating agencies on our fiscal position.

Events Subsequent to County Executive's FY11 Budget Transmittal

Increase in County's Unemployment Rate

Last week we learned through the State Department of Labor, Licensing, and Regulation that the County's unemployment rate increased to 6.2%. The unemployment rate which averaged 5.4% between May and December '09, has reached an unprecedented level for the County. Our assumption prior to this announcement was that the unemployment rate reached its peak given a ±0.1 percentage point change either way over the next three months based on the recent national situation and the County's performance since May of last year.

While the data are "not seasonally adjusted", the number of County residents employed in January was 480,493 (↓1.0% from January '09) and the lowest level since 2004. If the January data are an indicator of the employment situation in the near term, we could expect a further strain on income tax revenues over the next six months (particularly the May, June, and July distributions) than we had estimated for the FY11 budget. Our economic assumption for resident employment assumed a modest 0.3% increase for calendar year 2010 for the FY11 Recommended Budget.

This significant increase in the unemployment rate should not be easily dismissed as just "more people entering the labor force". It is in fact, a more accurate estimate of the number of people out of work in the County which contributes to the strain on the County's safety net services and has serious implications for future estimates of income tax revenues.

Anne Arundel County Bond Rating Downgrade

Fitch Ratings, in downgrading Anne Arundel County's bond rating from AA+ to AA noted the following as a basis for their action: "The rating downgrade from 'AA+' to 'AA' reflects Anne Arundel's (the county) continued diminished reserve levels and financial flexibility, underscored by recent failures to achieve structurally balanced budgets. A charter-imposed cap on property tax growth somewhat limits the county's ability to offset other tax and fee revenue declines, although a substantial taxable assessed valuation cushion bolsters the consistency of property tax collections. The county's low income tax rate provides revenue-raising flexibility."[1]

The relevance of this analysis to Montgomery County is obvious given the trend in our own general fund balance and property tax cap limitations. In addition, unlike

[1] Fitch Ratings, Anne Arundel County, Maryland, March 22, 2010, page 1

Anne Arundel County, Montgomery County is at the State authorized maximum income tax rate.

Rating Agency Feedback

As you know, like many jurisdictions, Montgomery County is in the bond market at multiple times during the year. This spring, the County is issuing bonds for its Affordable Housing Acquisition Program and seeking financing for its Ride On Bus fleet. In their analysis of the County's credit worthiness, the ratings analysts have focused their attention on the County's reserve levels, particularly in light of the extraordinary fiscal pressures we have faced this year. As mentioned above, a recent review of another Maryland county's credit, Anne Arundel, highlighted the need for strong reserve levels and a structurally balanced budget.

As stated in the attached press release from Fitch Ratings: " The proposed fiscal 2011 budget includes a proposed energy tax increase as well as furloughs, lay-offs, and programmatic reductions that are intended to eliminate the $780 million deficit, restore $37 million to the RSF, and increase the undesignated general fund balance to $126.9 million. Should the county attain its objectives, it will restore reserves to the modified 5% policy, although Fitch is concerned **that insufficiently conservative revenue projections may impede the county's attainment of its goal.** The county has stated that by fiscal 2012 it will eliminate the currently projected $212 million structural deficit and will restore reserves to its 6% policy. **Fitch's current rating and Stable Outlook assume the county will be successful, but failure to achieve the fiscal 2011 and 2012 financial goals could result in a credit profile that is inconsistent with the current rating category."**[2] *(Emphasis added)*

Recommended Actions

As you are aware, my Recommended FY11 Operating Budget substantially reduced the rate of growth in the County budget. Based on the dramatic decline in income tax receipts, unexpected costs related to snow removal, and other drains on our budget this year, we are projecting a reduction in our general fund reserves to $27.7 million in FY10. These reserves include $10.0 million in the County General Fund and $17.7 million remaining in the Revenue Stabilization Fund.

Based on additional fiscal challenges that relate to a dramatically higher unemployment rate and the strong signals from the bond rating agencies that we demonstrate and implement a plan to meet our reserve targets in FY11 and FY12, I am recommending the following additional actions which total $48.4 million and that this amount be added to the Revenue Stabilization Fund to help restore the balance in that fund:

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[2] Fitch Ratings, Montgomery County, Maryland, March 25, 2010

Fuel Energy Tax Increase - In my Recommended budget I proposed raising an additional $50 million through an increase in the fuel energy tax to begin in FY11. I now recommend that we increase the fuel energy tax to raise an additional $13.6 million in FY10 and $31.8 million in FY11 for total additional revenues of $45.4 million. This will, regrettably, increase the average residential utility bill by approximately $5 per month.

Accelerate FY11 Fund Balance Transfers- I am recommending that we accelerate certain planned FY11 transfers from non-tax supported funds into the County's General Fund in FY10. This will increase General Fund resources by $3.7 million in FY10 and will not compromise the financial position of the funds from which the transfers will be taken.

Reduce FY10 Set Aside - the FY11 Budget includes 63.1 million for snow removal costs. Based on a more recent estimate of snow removal costs, we can reduce this set aside amount by $3 million.

Recommended Use of Additional Resources

The combination of these actions will produce additional resources of approximately $48.4 million for FY10 and FY11. I very strongly recommend that all of these resources be restored to the County's Revenue Stabilization Fund to provide additional flexibility to the County in FY10 and FY11 to respond to further adverse economic and fiscal conditions. I fully appreciate the pressures that the Council is under to support additional spending in FY11 to restore pay increases for County employees, preserve County services at existing levels, address the requests from our non-profit partners, and address other important and meritorious public needs. However, it is imperative for the long term fiscal health of this County that we jointly resist these pressures in order to bring stability and sustainability back to the County's financial condition.

Conclusion

In closing, I want to be clear that I will not support using any of these resources to add back continuing costs into the County's budget. All of these additional resources need to be restored to the County's Revenue Stabilization Fund.

Attachment