OFFICE OF MANAGEMENT AND BUDGET

Isiah Leggett
County Executive

Jennifer A. Hughes
Director

MEMORANDUM

March 31, 2014

TO: Interested Readers

FROM: Jennifer A. Hughes, Director

SUBJECT: FY15-20 Fiscal Plan

Executive Summary:

The County Executive's recommended budget, released on March 17, 2014, closed a $166 million budget gap, raising the cumulative amount of budgetary shortfalls resolved in Mr. Leggett's eight proposed budgets to over $2.9 billion. The measures adopted to balance previous budgets and enhance long-term fiscal stability, though necessary, have required sacrifice by employees and residents alike in terms of reduced pay and benefits, service cuts, and tax increases. In his proposed FY15 operating budget, the County Executive's approach was to maintain his commitment to the prudent fiscal policies mutually agreed to with the County Council, and to strategically restore critical services in public safety, education, youth programs, libraries, and services for the most vulnerable including seniors. His proposed budget also funds compensation improvements for the County's employees, consistent with the second year of the County's collective bargaining agreements. Reserves continue to be increased, ramping up to the minimum policy level of 10 percent, and the recommended budget also funds retiree health benefits at the required level, completing a multi-year funding plan that began at the beginning of Mr. Leggett's administration in FY08. The County Executive's recommended budget is a balanced approach to meet the expanding needs of a growing population in a fiscally responsible manner.

The County Executive recommends an average weighted property tax rate of $0.996 per $100 of assessed value, which is a 1.4 cent reduction from the current year, and a $692 credit for each owner-occupied residence to support a progressive property tax structure in the County. The average County homeowner will see a $17 reduction in property taxes in FY15. This recommendation maintains overall property tax revenues at the limit allowed by the County's Charter.[1]

[1] Section 305 of the County Charter limits the growth in real property tax revenues in a fiscal year to the rate of inflation, excluding new construction, development districts, and other minor exceptions. The Council may override this limitation with an affirmative vote of nine Councilmembers.

The County Executive recommends continuation of the energy tax rates the Council approved in May 2014. The energy tax is more broad-based than either property or income taxes since it includes taxes on energy usage of institutions and facilities, such as the federal government, that otherwise would not be taxed. Because of its broader base, this tax lowers the overall tax burden on residents and businesses in the County. Total spending increases 3.3 percent in FY15, and tax supported spending across all agencies increases 3.4 percent. This increased level of tax supported spending reflects inclusion of $105.1 million for retiree health insurance pre-funding.

While this budget positions Montgomery County for the future, it is likely additional measures to rebalance revenues and spending will be necessary, given the State's minimum funding requirement for public schools and Montgomery College, anticipated current revenue requirements for the capital improvements program, continued Federal budget uncertainty, and the pending Maryland Court of Appeals ruling that would require granting a credit for out-of-state income taxes paid against the local income tax liability.[2] This challenge is evident in the current fiscal plan, which projects a reduction of 0.4 percent in resources available to fund agency spending in FY16.

Background:

The recommended FY15-20 fiscal plans for the tax supported and non-tax supported funds of the agencies of County government are provided for your information. Many of these fiscal plans were initially published in the FY15-20 Recommended Operating Budget and Public Services Program (March 17, 2014).[3] As in past years, this information is intended to assist the County Council and other interested parties as the County Executive's recommended budget is considered during the Council's budget worksessions this spring.

Interested readers should note that the fiscal plans included in this publication are not intended to be prescriptive, but are instead intended to present one possible outcome of policy choices regarding taxes, user fees, and spending decisions. Other important assumptions are explained in footnotes at the bottom of each fiscal plan display. One significant benefit of presenting multi-year projections is that the potential future year impacts of current policy decisions can be considered by decision makers when making fiscal decisions in the near term. The County's fiscal policies support:

- prudent and sustainable fiscal management: constraining expenditure growth to expected resources;
- identifying and implementing productivity improvements;
- avoiding the programming of one-time revenues to on-going expenditures;
- growing the local economy and tax base;
- obtaining a fair share of State and Federal Aid;
- maintaining prudent reserve levels;
- minimizing the tax burden on residents; and
- managing indebtedness and debt service very carefully.

---

[2] Maryland State Comptroller of the Treasury v. Brian Wynne, No. 107, September Term 2011. The Maryland tax code allows a credit for income taxes paid to other states with respect to the state income tax, but not the county income tax. Under both federal and Maryland law, a subchapter S corporation is deemed to "pass through" its income to its shareholders who are taxed on that income at the shareholder's level. The Court of Appeals held that the failure to allow a credit with respect to the county income tax for out-of-state income taxes paid to other states on "pass through" income earned in those states violates the Commerce Clause of the United States Constitution.

[3] In addition to these two documents, the reader is encouraged to review other County fiscal materials such as the Comprehensive Annual Financial Report for the year ended June 30, 2013; the Annual Information Statement published by the Department of Finance; and Economic Indicators data. Budget and financial information for Montgomery County can also be accessed on the web at www.montgomerycountymd.gov/omb.

The Recommended Budget is consistent with the fiscal policies recommended by the County Executive and approved by the County Council in June 2010. These policies include building total reserves to 10 percent of Adjusted Governmental Revenues[4] by 2020 (including mandatory contributions to the Revenue Stabilization Fund), fully funding PAYGO[5], and increasing contributions to pre-fund retiree health insurance up to full funding of the annual required contribution by FY15.

Fiscal Plan for the Tax Supported Funds:

The recommended fiscal planning objectives for FY15-20 for the tax supported funds are:

- Adhere to sound fiscal policies.
- Tax supported reserves (operating margin and the Revenue Stabilization Fund) are at the policy level of maintaining an unrestricted General Fund balance of 5 percent of the prior year's General Fund revenues and increasing the Revenue Stabilization Fund consistent with the requirements of Section 20-65 of the Montgomery County Code. Reserve contributions include a portion in the designated General Fund reserve to provide a contingency in the event of an unfavorable outcome in the Wynne case.
- Maintain property taxes at the Charter limit by assuming an average weighted property tax rate of $0.996 per $100 of assessed value and a $692 credit to each owner-occupied household.
- Assume property tax revenues at the Charter Limit during FY16-20 in the fiscal plan using the income tax offset credit.
- Manage fund balances in the non-tax supported funds to established policy levels where applicable.
- Assume current State aid formulas, but continue successful strategies to increase State (and Federal) operating and capital funding.
- Maintain priority to economic development and tax base growth:
  - Seize opportunities to recruit and retain significant employers compatible with the County's priorities;
  - Give priority to capital investment that supports economic development/tax base growth.
- Maintain essential services.
- Limit exposure in future years to rising costs by controlling baseline costs and allocating one-time revenues to one-time expenditures, whenever possible.
- Manage all debt service commitments very carefully, consistent with standards used by the County to maintain high credit ratings and future budget flexibility. Recognize the fixed commitment inherent in all forms of multi-year financing (long-term bonds, shorter-term borrowing, and lease-backed revenue bonds) that must be accommodated within limited debt capacity.
- Program PAYGO to be at least 10 percent of anticipated General Obligation Bond levels to contain future borrowing costs in FY16-20.
- For capital investment, allocate debt, current revenue, and other resources made available by the fiscal objectives above according to priorities established by policy and program agendas.
- For services, allocate resources consistent with policy and program agendas.

---

[4] The tax supported revenues of the County Government, Montgomery County Public Schools (less the local contribution), Montgomery College (less the local contribution), Maryland-National Park and Planning Commission, and the County Government's Capital Projects and Grants Funds.

[5] Current revenue that is substituted for debt in capital projects that are debt eligible or used in projects that are not debt eligible or qualified for tax-exempt financing is referred to as PAYGO, or "pay as you go" funding. The County's policy is to program at least 10 percent of planned General Obligation bond issues as PAYGO in the capital budget.

The major challenges for FY15-20 will be to contain on-going costs, preserve essential services, and continue making targeted improvements to critical service areas including public safety, education, the social safety net, affordable housing, and transportation within projected available resources.

Fiscal Plans for the Non-Tax Supported Funds:

By definition, each of the non-tax supported (fee-supported) funds is independent, covering all operating and capital investment expenses from its designated revenue sources. The fiscal health of each fund is satisfactory, though looking ahead some funds will need to meet expected challenges by increasing fees and/or reducing expenditures.

Conclusion:

Montgomery County's long term fiscal health is strong as a result of its underlying economy and the financial management policies endorsed by its elected officials. Nonetheless, the County will continue to face significant challenges in the years ahead. The FY15-20 Fiscal Plans reflect these challenges in their assumptions and projections.

Comments on the Fiscal Plans that follow are encouraged. Office of Management and Budget and Finance staffs of the County government, and Finance staff of the other agencies, are available to assist in the Council's deliberations.

JAH:ae

Attachment: FY15-20 Fiscal Plan for Montgomery County, Maryland

c: Isiah Leggett, County Executive
Members, Montgomery County Council
Timothy L. Firestine, Chief Administrative Officer
Dr. Joshua Starr, Superintendent, Montgomery County Public Schools
Dr. DeRionne P. Pollard, President, Montgomery College
Francoise Carrier, Chair, Montgomery County Planning Board
Jerry N. Johnson, General Manager, Washington Suburban Sanitary Commission
Stacy Spann, Executive Director, Housing Opportunities Commission
Keith Miller, Executive Director, Revenue Authority
Joseph F. Beach, Director, Department of Finance
Bonnie Kirkland, Assistant Chief Administrative Officer
Stephen Farber, Council Administrator