Montgomery County Council

Committee: Directly to Council
Committee Review: N/A
Staff: Craig Howard, Deputy Director
Purpose: To make preliminary decisions – straw vote expected

AGENDA ITEM #3
May 16, 2023
Worksession

SUBJECT

FY24 Compensation Operating Budget: Revenue Stabilization Fund

EXPECTED ATTENDEES

- Mike Coveyou, Director, Department of Finance
- Nancy Feldman, Department of Finance
- Josh Watters, Office of Management and Budget
- Chris Mullin, Office of Management and Budget

DESCRIPTION

As part of the April 11 FY24 Operating Budget Overview, the Council reviewed the Executive's recommendation for a one-time deferral in the County's mandatory contribution to the Revenue Stabilization Fund. The Council stated it would return to this issue later in the budget process to determine if it supports that Executive's recommendation.

SUMMARY OF KEY ISSUES

- **Revenue Stabilization Fund.** The County's reserves consist of two primary components: 1) the Revenue Stabilization Fund (RSF), and 2) General Fund undesignated reserves. Together, the combined amount in these two components must equal 10% per the fiscal policy. The General Fund undesignated reserve is the most liquid of the two components and includes the unappropriated portion of the County's tax-supported revenues each year. The County Charter restricts this amount to a maximum of 5% of tax revenues from the prior year.

  The RSF is created in County Code and is best understood as the County's "Rainy Day Fund." The law states that the County must make an annual mandatory contribution to the RSF that is the greater of: a) 50% of excess revenues (in the income tax, transfer tax, recordation tax, and General Fund investment income) or b) an annual amount equal to the lesser of 0.5% of AGR or the amount needed to obtain a total reserve of 10% of AGR. Use of the RSF is more restrictive than the General Fund reserves. Specifically:

  - The County can only use RSF funds by an affirmative vote of seven Councilmembers, after a public hearing.
  - The Council is expected to receive an update on relevant economic indicators and seek the Executive's recommendation before approving the use of RSF funds.
  - Use of the RSF, if approved by the Council, is restricted to appropriations that have become unfunded during the fiscal year.

- **Executive Recommendation.** The Executive's recommended budget estimates total FY23 ending reserves at approximately 14.0% of AGR, with 10.0% in the RSF ($604 million) and 3.9% in the unrestricted General Fund reserves ($238 million). **To achieve this allocation between the RSF and unrestricted reserves, however, the Executive recommends the Council approve a one-time deferral for FY23 of the mandatory contribution to the RSF due to excess revenues.** Executive Branch staff provided the following explanation for this recommendation:

  Absent this one-time deferral, estimated total reserves would still be 14.0% of AGR, but 11.0% would be in the RSF and 2.9% would be in the unrestricted General Fund. Once transfers are made to the RSF, those resources can only be accessed during emergencies – i.e., when appropriations become unfunded. By not making the FY23 mandatory contribution, more resources are available in the unrestricted General Fund reserves for the Council and Executive to respond to unanticipated shortfalls or urgent expenditures that may occur during the course of the fiscal year. In FY24, there is no assumption of a mandatory transfer, as reserves are projected to be above 10.0%, so no additional contribution is needed to achieve 10% reserves. The CE recommended budget estimates investment income in the RSF at $16.6 million in FY23 and $26.2 million in FY24 - all of that would remain in the fund.

  The table below shows reserves by category as recommended by the Executive compared to what they would be without the one-time deferral.

  Comparison of Reserve Allocations

Reserves Category	CE Rec: With one-time deferral		Without one-time deferral	
	FY23	FY24	FY23	FY24
Unrestricted General Fund	238.0	85.2	175.2	22.4
Revenue Stabilization Fund	604.0	630.2	666.8	693.0
Total	**842.0**	**715.4**	**842.0**	**715.4**

  The County Executive has also requested that the Department of Finance, Office of Management and Budget, and the Office of the County Attorney work with the Council during FY24 to review and determine if any updates to the Revenue Stabilization Fund law should be considered.

- **Implementation.** If the Council supports the Executive's one-time RSF deferral for FY23, it will need to implement this change via the following proposed budget resolution language prepared by the Office of the County Attorney:

  For FY 2023, the Director of Finance shall not make the mandatory contribution in the amount of 50% of excess revenue to the Revenue Stabilization Fund, as required by County Code Section 20-68. Such excess revenue, in lieu of the mandatory contribution, must be designated as General Fund unrestricted reserve. This action is a one-time action for FY 2023 only, due to the Revenue Stabilization Fund maintaining a total reserve of 10 percent of the Adjusted Governmental Revenues.

STAFF RECOMMENDATION

Council staff recommends the following:

- **Support the Executive's proposed one-time deferral of the mandatory contribution to the Revenue Stabilization Fund (RSF) in FY23 due to excess revenues.** Approving the one-time deferral will provide the County with more flexibility in FY24 without negatively impacting the County fiscal position.

- **Support a more detailed review of the RSF law during FY24 to determine whether any changes or updates are warranted.** As the Council has done previously with other fiscal policy elements, it makes sense to periodically review and assess whether updates or changes are required – especially given the fact that the funds in the RSF alone are now projected to be sufficient to achieve the 10% reserve policy target.

This report contains:

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Article XII. Revenue Stabilization Fund. [1]

Notes

1 ***Editor's note***—This article is derived from 1993 L.M.C., ch. 41, § 1. Section 2 declared the provisions effective fiscal year 1995, i.e., July 1, 1994.

Sec. 20-64. Findings and declaration of purpose.

Montgomery County, along with the State of Maryland and its other political subdivisions, has recently experienced substantial funding shortfalls. The State, in order to allow its political subdivisions greater budgetary and fiscal flexibility in addressing those shortfalls, has authorized political subdivisions to establish "rainy day" or reserve accounts to accommodate future funding shortfalls.

It is in the best interest of the citizens of the County that a Revenue Stabilization Fund provide the County with greater budgetary and fiscal flexibility to address funding shortfalls.

The Revenue Stabilization Fund created in this Article is designed to accrue a balance during periods of economic growth and prosperity, when revenue collections exceed estimates. The Fund may be drawn upon during periods of economic slowdown, when collections fall short of revenue estimates. (1993 L.M.C., ch. 41, § 1.)

Sec. 20-65. Definitions.

In this Article the following terms have the following meanings, unless the context clearly indicates a different meaning:

Actual total revenues means the combined total of income tax, real property transfer tax, recordation tax, and investment income, as reported in the County's annual financial report.

Adjusted Governmental Revenues means tax-supported County Governmental Funds revenues, plus revenues of the:

(1) County Grants Fund;

(2) County Capital Projects Fund;

(3) tax supported funds of the Montgomery County Public Schools, not including the County's local contribution;

(4) tax supported funds of Montgomery College, not including the County's local contribution; and

(5) tax supported funds of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission.

Director means the Director of the Department of Finance.

Excess revenue means the amount, if positive, by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the fiscal year exceed the original projections for these amounts.

Fund means the Revenue Stabilization Fund created under this Article.

General Fund means the general operating fund of the County which is used to account for all revenues and expenditures, except revenues and expenditures required to be accounted for in another fund.

Income tax means the County income tax imposed under state law.

Investment income of the General Fund means income derived from the investment of revenues from the General Fund.

Original projection means the projection of total General Fund revenues for the next fiscal year approved by the County Council in the "Schedule of Revenue Estimates and Appropriations" resolution or any similar resolution.

Real property transfer tax means the tax imposed under Sections 52-19 et. seq.

Recordation tax means the tax imposed under Sections 12-101 et. seq., Tax-Property Article, Maryland Code.

Revised forecast means any revised projection of total General Fund revenues for the next fiscal year prepared by the Department of Finance.

Total reserve means the sum of the reserve in the Fund plus the Unrestricted General Fund Balance.

Unrestricted General Fund Balance means the residual portion of the General Fund fund balance that has not been reserved, restricted, or encumbered for later year's expenditures.(1993 L.M.C., ch. 41, § 1; 2010 L.M.C., ch. 33, § 1.)

Sec. 20-66. Revenue Stabilization Fund.

(a) The Director may establish a Revenue Stabilization Fund to support appropriations which have become unfunded.

(b) The Fund is continuing and non-lapsing.

(c) The Fund is in addition to any surplus that is accumulated under Section 310 of the County Charter. (1993 L.M.C., ch. 41, § 1;

2010 L.M.C., ch. 33 § 1.)

Sec. 20-67. Reserved.

Editor's note—Former Sec. 20-67, derived from 1993 L.M.C., ch. 41, § 1, was repealed by 2010 L.M.C., ch. 33, § 1.

Sec. 20-68. Mandatory contributions to Fund.

The mandatory annual contribution to the Fund must equal the greater of:

(a) 50 percent of any excess revenue; or

(b) an annual amount equal to the lesser of 0.5 percent of the Adjusted Governmental Revenues or the amount needed to obtain a total reserve of 10 percent of the Adjusted Governmental Revenues. (1993 L.M.C., ch. 41, § 1; 2010 L.M.C., ch. 33, § 1.)

Sec. 20-69. Discretionary contributions to Fund.

The County Executive may recommend and the County Council may by resolution approve additional contributions to the Fund. (1993 L.M.C., ch. 41, § 1; 2010 L.M.C., ch. 33, § 1.)

Sec. 20-70. Transfer of contributions.

The Director must transfer the mandatory contributions required by Section 20-68 and any discretionary contributions under Section 20-69 from the General Fund to the Fund at the end of each fiscal year. (1993 L.M.C., ch. 41, § 1; 2010 L.M.C., ch. 33, § 1.)

Sec. 20-71. Interest.

All interest earned on the Fund must be added to the Fund. (1993 L.M.C , ch. 41, § 1; 2010 L.M.C., ch. 33, § 1.)

Sec. 20-72. Use of Fund.

By an affirmative vote of 7 Councilmembers, the Council, after holding a public hearing, reviewing relevant economic indicators, and seeking the recommendation of the Executive, may transfer any amount from the Fund to the General Fund to support appropriations which have become unfunded. (1993 L.M.C., ch. 41, § 1; 2010 L.M.C., ch. 33, § 1; 2022 L.M.C., ch. 40 , § 1.)

Revenue Stabilization

On June 29, 2010, the Montgomery County Council enacted Bill 36-10 amending the Montgomery County Code (Chapter 20, Finance, Article XII) that repealed the limit on the size of the Revenue Stabilization Fund (Fund), modified the requirement for mandatory County contributions to the Fund, and amended the law governing the Fund. Mandatory contributions to the Fund are the greater of 50 percent of any excess revenue, or an amount equal to the lesser of 0.5 percent of the Adjusted Governmental Revenues (AGR) or the amount needed to obtain a total reserve of 10 percent of the Adjusted Governmental Revenues. Adjusted Governmental Revenues include tax supported County Governmental revenues plus revenues of the County Grants Fund and County Capital Projects Fund; tax supported revenues of the Montgomery County Public Schools, not including the County's local contribution; tax supported revenues of Montgomery College, not including the County's local contribution; and tax supported revenues of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission. All interest earned on the Fund must be added to the Fund. For FY22 and FY23, funds received by the County to broadly respond to the COVID-19 pandemic under H.R. 748, the Federal Coronavirus Aid, Relief, and Economic Security (CARES) Act, and H.R.1319 the American Rescue Plan Act (ARPA) are excluded from the calculation of Adjusted Government Revenues for the purposes of calculating the mandatory contribution to the Fund. The FY24 Recommended Budget estimates that the Revenue Stabilization Fund balance will be $603.9 million in FY23 and the balance is estimated to increase to $630.2 million in FY24.

Other Uses

This category is used to set aside funds for such items as possible legal settlement payments and other special circumstances such as set-aside of revenues to fund future years.

Reserves

The County may maintain an unrestricted General Fund balance of up to five percent of prior year's General Fund revenues (pursuant to Charter § 310) and a combined unrestricted General Fund balance plus the Revenue Stabilization Fund balance of 10% of AGR. This budget satisfies the County's policy to maintain the budgeted total reserve of the unrestricted General Fund and Revenue Stabilization Fund at 10 percent of Adjusted Governmental Revenues after utilizing reserves in excess of the policy level to bridge FY24 forecasted mild recession and maintain services.

REVENUE ASSUMPTIONS

Projections for revenues are included in six-year schedules for County Government Special Funds and for Montgomery College, M-NCPPC, and WSSC in the relevant sections of this document. See the MCPS Budget Document for six-year projections of MCPS funds. Projections for revenues funding County government appropriations are provided to the Council and public as fiscal projections. Such projections are based on estimates of County income from its own sources such as taxes, user fees, charges, and fines, as well as expectations of other assistance from the State and Federal government. The most likely economic, demographic, and governmental policy assumptions that will cause a change in revenue projections are included in this section.

TAX SUPPORTED REVENUES

Tax supported revenues come from a number of sources including but not limited to property and income taxes, real estate transfer and recordation taxes, excise taxes, intergovernmental revenues, service charges, fees and licenses, college tuition, and investment income. In order of magnitude, however, the property tax and the income tax are the most important with 47.3 percent and 42.7 percent, respectively, of the estimated total tax revenues in FY24. The third category is the energy tax estimated for the General Fund with 4.3 percent share. In fact, these three revenue sources represent 94.3 percent of total tax revenues. Of the total tax-supported revenues, property tax and income tax are also the most important with 36.5 percent

While the County's reserve policy was successful in providing an adequate reserve to weather the financial implications of recessions, storms, and a pandemic, it did not adequately anticipate how the reserves should be managed once the 10 percent goal was achieved. For instance, a sustainable fund balance policy has a mix of funding in both undesignated reserves, which may be used to pay for unanticipated expenditures throughout the fiscal year, and our Revenue Stabilization Fund (RSF), which is used only in the case of appropriated revenue shortfalls. Under current fiscal conditions, if we were to only have 10 percent of adjusted governmental revenues in reserve, all of that would be locked away in the RSF and would not allow the Council to have the flexibility to provide mid-year budget amendments. Now that the County has exceeded the 10 percent fund balance target for three years, the County Executive has asked the Department of Finance, the Office of Management and Budget, and the Office of the County Attorney staff to work with the County Council to update the policy and the Revenue Stabilization Fund law to better reflect our current circumstances as we strive to balance fiscal prudence with residents' needs and a desire to limit unnecessary taxation.

Regarding OPEB expenses, the County has determined that the Actuarially Determined Contribution (ADC) amount, as well as the overall level of assets in the OPEB Trust, requires a shift from the current policy of solely building the Trust to a policy that allows for continued growth, utilization, and maintenance of the Trust. In FY23 and FY24, the actuarial analysis assumed a utilization of Trust assets of $12.6 million and $17.4 million, respectively, to pay for a portion of retiree health care expenses based on the funded status of the plan. The County did not utilize any Trust assets in FY23, resulting in total funding to the OPEB Trust that exceeded the ADC by $12.6 million. In FY24, the County will provide total funding to the OPEB Trust that exceeds the ADC by $17.4 million. The County Executive will continue to work with the County Council to finalize a long-term OPEB funding and utilization policy that ensures the fund's sustainability to fulfill the Trust's purpose of paying a portion or all of retiree health care expenses.

The Office of Management and Budget coordinated with the Office of Racial Equity and Social Justice to incorporate racial equity considerations into the budgeting process, systems, and meetings, and into the decision-making process. Departments were asked to consider how their programs considered racial/ethnic disparities and/or disproportionalities in their outcomes; how programs sought to address identified inequities; potential programmatic disproportionate effects on communities of color and low-income communities and how those effects could be mitigated; and how programs could build capacity to engage with marginalized communities. A chapter on Racial Equity later in this publication provides more details on the process and outcomes of this effort.

The Office of Management and Budget also incorporated climate change considerations into the budgeting process, systems, meetings and decision-making process. For example, departments were asked if their programs reduce greenhouse gas emissions, increase the resiliency of County infrastructure to withstand future impacts of climate change, sequester carbon, or provide other environmental benefits related to climate change. A chapter on Climate Change later in this publication provides more details on the process and outcomes of this effort.

To develop the Recommended Amended FY23-28 Capital Improvements Program (CIP), the County prioritized increased investments in schools, affordable housing, early care centers for young children, facilities to address barriers to residents' well-being, and maintenance of core infrastructure. Priority was given to projects that advanced racial equity, social justice, and efforts to counter climate change and its impacts.

Regarding County debt limits, generally, the County continues to reduce the amount of annual General Obligation debt issued to limit the impact to the operating budget. In FY24 and FY25, the Recommended Amended CIP assumes an additional $20 million a year ($40 million total) in General Obligation debt to address construction cost inflation and to ensure that the County is able to commit State Built to Learn funding for school construction before interest rate increases further erode the amount of available school construction funds. After this modest increase, the County Recommended Amended CIP assumes a return to the gradual reduction in debt that had previously been assumed. The County is aggressively pursuing State and Federal funding to support school construction, economic development-oriented transportation projects, and public health and corrections facilities as a strategy to provide needed infrastructure without an undue tax burden. Increases in non-County funding sources have helped the County mitigate the impact of construction cost