AGENDA ITEM 24
May 27, 2010

Introduction

MEMORANDUM

TO: County Council

FROM: Robert H. Drummer, Senior Legislative Attorney

SUBJECT: **Introduction:** Bill 36-10, Finance – Revenue Stabilization Fund – Amendments

Bill 36-10, Finance – Revenue Stabilization Fund – Amendments, sponsored by the Council President at the request of the Executive, is scheduled to be introduced on May 27, 2010. A public hearing is tentatively scheduled for June 22, 2010.

Bill 36-10 would remove the cap on the Revenue Stabilization Fund, modify the mandatory contributions to the Fund; and generally amend the law concerning the Revenue Stabilization Fund. The legislation would help ensure adequate reserve levels by increasing them to 10% over the next ten, or fewer, years. This legislation is intended to strengthen the County's fiscal health, by improving budgetary flexibility and building reserve levels.

Bill No. 36-10
Concerning: Finance – Revenue Stabilization Fund – Amendments
Revised: May 25, 2010 Draft No. 2
Introduced: May 27, 2010
Expires: November 27, 2011
Enacted:
Executive:
Effective:
Sunset Date: None
Ch. _____, Laws of Mont. Co. _____

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: Council President at the Request of the County Executive

AN ACT to:
(1) repeal the limit on the size of the Revenue Stabilization Fund;
(2) modify the requirement for mandatory County contributions to the Revenue Stabilization Fund; and
(3) generally amend the law governing the Revenue Stabilization Fund.

By amending
Montgomery County Code
Chapter 20, Finance
Article XII
Sections 20-65, 20-66, 20-68, 20-69, 20-70, 20-71 and 20-72

By repealing
Montgomery County Code
Chapter 20, Finance
Article XII
Section 20-67

Boldface	*Heading or defined term.*
Underlining	*Added to existing law by original bill.*
[Single boldface brackets]	*Deleted from existing law by original bill.*
Double underlining	*Added by amendment.*
[[Double boldface brackets]]	*Deleted from existing law or the bill by amendment.*
* * *	*Existing law unaffected by bill.*

The County Council for Montgomery County, Maryland approves the following Act:

Sec. 1. Sections 20-65, 20-66, 20-68, 20-69, 20-70, 20-71 and 20-72 are amended and Section 20-67 is repealed as follows:

20-65. Definitions.

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

[(a)] *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.

[(b) *Certified revenues* means revenues derived each fiscal year from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund as certified by the Director on or before June 15.]

[(c) *Debt Service Fund* means the fund used to accumulate funds to pay general long-term debt principal, interest and related costs.]

[(d)] *Director* means the Director of the Department of Finance.

[(e)] *Fund* means the Revenue Stabilization Fund created under this Article.

[(f)] *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.

[(g)] *Income tax* means the County income tax imposed under state law.

[(h)] *Investment income of the General Fund* means income from the investment of revenues that is reported in the General Fund.

[(i)] *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.

[(j)] *Real property transfer* tax means the tax imposed under Sections 51-19 et. seq.

[(k)] *Recordation tax* means the tax imposed under Sections 12-101 et. seq., Tax-Property Article, [Annotated Code of] Maryland <u>Code</u>.

[(l)] *Revised forecast* means any revised projection of total General Fund revenues for the next fiscal year prepared by the Department of Finance.

<u>*Unrestricted General Fund Balance* means the residual portion of the General Fund fund balance that has not been reserved, restricted, or encumbered for later years' expenditures.</u>

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.

<u>(c) The Fund is in addition to any surplus that is accumulated under Section 310 of the County Charter.</u>

20-67. [Fund sources and maximum size.] Reserved.

[(a) The Fund must not exceed 10 percent of the average aggregate annual revenue derived from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund in the 3 preceding fiscal years.

(b) The Director must compute the maximum amount of the Fund annually and report that amount to the County Council not later than June 15.

(c) The Fund is in addition to any surplus that may be accumulated under Section 310 of the County Charter.]

20-68. Mandatory contribution to Fund.

[(a) Subject to the limit set in Section 20-67(a), the] The mandatory annual contribution to the Fund must equal the greater of:

(a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:

(1) the annual percentage increase in the certified revenues projected for the next fiscal year, and

(2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of the amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts; or

(b) an annual amount that does not exceed 0.5 percent of the Adjusted Governmental Revenues for the current year, but which does not

<u>result in the sum of the current year-end projected Unrestricted General Fund Balance and the Fund to exceed 10 percent of the Adjusted Governmental Revenues.</u>

[(b) A growth or decline in certified revenues which results from either an increase or decrease in County tax rates must be:

(1) excluded from revenues projected for the next fiscal year, and

(2) phased in in the average annual percentage increase calculation in the third, fourth, fifth and sixth years.

(c) If actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection, then 50 percent of the excess must be transferred to the Fund if doing so will not result in the 10 percent limit in Section 20-67(a) being exceeded.]

20-69. Discretionary contributions to Fund.

The County Executive may recommend and the County Council may by resolution approve additional contributions to the Fund [if doing so will not result in the 10 percent limit in Section 20-67(a) being exceeded].

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] <u>Fund</u> to the Fund at the end of each fiscal year.

20-71. Interest.

All interest earned on the Fund must be added to the Fund. [However, the Director must transfer interest earned on the Fund when the Fund exceeds 50 percent of the maximum Fund size authorized by Section 20-67(a) to the Debt Service Fund as an offset to the approved issuance of general obligation debt.]

20-72. Use of Fund.

(a) After holding a public hearing and seeking the recommendation of the Executive, and if the Council finds that reasonable reductions in expenditures are not sufficient to offset the shortfall in revenue, the Council may by resolution approved by the Executive transfer an amount from the Fund to compensate for no more than half of the difference between the original projection of total General **[**fund**]** <u>Fund</u> revenues for that fiscal year and a revised forecast of the General Fund revenues projected for the same fiscal year. If the Executive disapproves a resolution within 10 days after it is transmitted and the Council readopts it by a vote of 6 Councilmembers, or if the Executive does not act within 10 days after it is transmitted, the resolution takes effect.

(b) However, a transfer must not be approved unless 2 of the following conditions are met:

(1) The Director estimates that total General Fund revenues will fall more than 2 percent below the original projected revenues.

(2) Resident employment in the County has declined for 6 consecutive months compared to the same month in the previous year.

(3) The **[**local**]** <u>most recent regional</u> index of leading economic indicators<u>, published by the Center for Regional Analysis, George Mason University, or a successor index determined by the Department of Finance,</u> has declined for 3 consecutive months.

(c) The cumulative transfers from the Fund in any single fiscal year must not exceed half of the balance in the Fund at the start of that fiscal year.

(d) The funds transferred may only be used to support appropriations which have become unfunded.

(e) By an affirmative vote of 6 Councilmembers, the Council, after holding a public hearing and seeking the recommendation of the Executive, may transfer amounts from the Fund without regard to the limits and conditions in subsections (a)-(c).

Approved:

Nancy M. Floreen, President, County Council — Date

Approved:

Isiah Leggett, County Executive — Date

This is a correct copy of Council action.

Linda M. Lauer, Clerk of the Council — Date

LEGISLATIVE REQUEST REPORT

Bill 36-10

Revenue Stabilization Fund - Amendments

DESCRIPTION:	The requested legislation removes the cap from the Revenue Stabilization Fund (RSF), retains interest earned in the RSF, and requires mandatory contributions to the RSF to achieve total reserves of 10%.
PROBLEM:	The legislation would help ensure adequate reserve levels by increasing them to 10% over the next ten, or fewer, years.
GOALS AND OBJECTIVES:	This legislation, along with the accompanying "Reserve and Selected Fiscal Policies" Resolution is designed to strengthen the County's fiscal health, by improving budgetary flexibility and building reserve levels.
COORDINATION:	Department of Finance; Office of Management and Budget
FISCAL IMPACT:	To be requested.
ECONOMIC IMPACT:	To be requested.
EVALUATION:	To be requested.
EXPERIENCE ELSEWHERE:	To be researched.
SOURCE OF INFORMATION:	Jennifer Barrett, Director, Department of Finance Joseph Beach, Director, Office of Management and Budget Kathleen Boucher, Assistant Chief Administrative Officer
APPLICATION WITHIN MUNICIPALITIES:	N/A
PENALTIES:	N/A

OFFICE OF THE COUNTY EXECUTIVE
ROCKVILLE, MARYLAND 20850

Isiah Leggett
County Executive

MEMORANDUM

May 21, 2010

TO: Nancy Floreen, President, County Council

FROM: Isiah Leggett, County Executive

Isiah Leggett

SUBJECT: Reserve and Selected Fiscal Policies

In my April 22nd memorandum to the Council on Additional Budget Actions, I notified the Council of the need for revisions to the County's reserve policies. I made this recommendation in light of recent severe reductions in revenues, unanticipated expenditure pressures, and Moody's rating action putting the County on a negative watchlist. All three rating agencies included strong statements of concern regarding the County's reserves and budgetary structural balance in their most recent ratings.

As I indicated to you in April, I have asked for and received a careful review of the County's reserve policies by the County's Financial Advisor, PFM. As a result of that review, I am recommending a set of actions and policies which will set the County on a stronger fiscal path for FY11 and beyond. Attached to this memorandum you will find a resolution specifying these policies for Council's consideration and action, legislation to change the County's Revenue Stabilization Fund law, and a restructured balanced Fiscal Plan showing budgetary levels afforded within projected revenues and my plan for restoration of the County's key reserves to the recommended policy levels.

Specifically, the recommended reserve levels incorporate current and future risks, including:

- Potential for future State actions which may negatively affect the County's revenues and/or place additional expenditure requirements on the County.
- Numerous one-time actions taken to solve the FY10 and FY11 budget challenges.

Recommended Actions

The attached charts (Attachments A and B) provide background on the current status of the County's most key fiscal policies, detailing the recommendations I made to you in April, and those that I am making today. In addition, I will soon be transmitting to you a report from the County's Financial Advisor, PFM, that provides further analysis and detail on the concerns of Moody's and the other Rating Agencies, and the fiscal circumstances that support the need for the recommended actions.

Specifically, I am recommending the following policies and actions, which are further detailed in the attachments:

1. For FY11, budget reserves at the current policy level of 6%, and within 10 years (by 2020), bring total reserves to 10%
2. Bring General Fund reserves to the charter maximum of 5%
3. Require mandatory contributions to the Revenue Stabilization Fund to a combined reserve level of 10%
4. Restore and maintain PAYGO at the policy level of 10% of general obligation bonds planned for issue
5. Budget expenditures for a fiscal year only up to the amount of recurring revenues for that fiscal year
6. Direct one-time revenues exceeding projections to the Revenue Stabilization Fund, PAYGO, Pension or Retiree's Health Benefit pre-funding, and one-time expenditures
7. Achieve a fiscal plan for future years that is structurally balanced – that matches expenditures to available revenues without any draw down of reserves or unanticipated revenues
8. Review budgeting practices for significant, known expenditures, and ensure adequacy of appropriations and possible carry-over provisions for unspent amounts

The combination of these actions is estimated to achieve structural budgetary balance and grow reserve levels to 10% by 2020 or sooner, enough to sustain the County through a variety of the pressures noted above. The reserve amounts I am recommending will also help ensure sufficient working capital through the County's usual fiscal cycle.

I very strongly recommend restoring General Fund reserves to the maximum allowed Charter level, and planning for a series of mandatory contributions to the Revenue Stabilization Fund to achieve a total reserve level of 10%. I recommend we strengthen our policies regarding a balanced budget and use of one-time revenues, and commit to return to our existing PAYGO policy. This set of actions will provide additional flexibility to the County in FY12 and beyond to respond to further adverse economic and fiscal conditions.

These actions are only the beginning of the work before us. I believe that together, we must steer the County back to structurally balanced budgets and return it to its fiscally conservative roots, restoring sufficiently strong reserve levels, to ensure that we do not return to the budget stresses we currently face. I believe the set of recommendations before you will ensure that outcome, and I urge your approval.

Enclosures

Attachment A – Reserve Policies – Overview
Attachment B – Comparison of Fiscal Policies and Practices
Resolution – Reserve and Selected Fiscal Policies
Draft Bill - Revenue Stabilization Fund
Restructured Balanced Fiscal Plan – FY11-16

cc: Duchy Trachtenberg, Chair, MFP Committee
Timothy Firestine, Chief Administrative Officer
Jennifer Barrett, Director of Finance
Joseph Beach, Director, OMB
Stephen Farber, Council Staff Director
Kathleen Boucher, ACAO

ATTACHMENT A

RESERVE POLICIES – OVERVIEW

1. CURRENT POLICIES

Balanced Budget:	expenditures not to exceed resources (including prior year ending fund balance)
Reserves:	6% of combined all tax supported (including outside agencies) and revenue stabilization fund (RSF)
RSF:	mandatory contribution up to cap, investment earnings go to PAYGO
PAYGO:	10% of planned GO Bond issues
One Time Revenues:	whenever possible give highest priority to capital assets or other non-recurring expenditures

2. APRIL 22nd MEMORANDUM

Balanced Budget:	budgeted expenditures should match new revenues projected to occur in that fiscal year
Reserves:	6% for FY11 and ramp up to 8% by end of FY13 General Fund (GF) at Charter Limit – 5% of prior year GF revenues
RSF:	mandatory contributions to RSF to 3% (total of 8%), remove cap
PAYGO:	restore and maintain at 10% policy level
One Time Revenues:	direct in priority order to RSF, PAYGO, Retiree Health pre-funding, and one-time expenditures
Fiscal Plan:	achieve a fiscal plan display that is structurally balanced consistent with balanced budget policy

3. RECOMMENDED – PFM MAY 2010

Balanced Budget:	expenditures not to exceed revenues
Reserves:	6% for FY11, then ramp up combined General Fund and RSF balances over ten years to 10% of adjusted governmental revenues–
RSF:	mandatory contributions up to 10% reserve policy, remove cap, investment earnings retained in RSF
PAYGO:	10% of planned GO Bond issues
One Time Revenues:	applied first to restoring reserves to policy levels or as required by law. If reserves have been fully funded, then one-time revenues should be applied to expenditures which are one-time in nature, PAYGO in excess of the County's targeted goal, or to unfunded liabilities such as Pension or OPEB

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ATTACHMENT B

COMPARISON OF FISCAL POLICIES AND PRACTICES – CURRENT POLICY/PRACTICE vs. RECOMMENDED

	CURRENT POLICY/PRACTICE	**PFM and FINANCE RECOMMENDED POLICIES**
Structurally Balanced Budget	Current Fiscal Policy: ***It is the fiscal policy of Montgomery County to balance the budget. A balanced budget has its funding sources (revenues, undesignated carryover, and other resources) equal to its funding uses (expenditures, reserves, and other allocations). No deficit may be planned or incurred.***	Recommended Policy: ***Montgomery County will have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.***
Reserves	Current Fiscal Policy: ***The County will maintain total reserves for tax supported funds that include both an operating margin reserve and the RSF. For tax supported funds, the budgeted total reserve of the operating margin and the RSF should be at least 6.0 percent of total resources (i.e., revenues, transfers, prior year undesignated and designated fund balance).***	Recommended Policy: ***Montgomery County will have a goal over 10 years (by 2020) of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund to an amount equal to approximately 10% of Adjusted Governmental Fund revenues.*** Higher reserves are recommended in keeping with: 1) revenue volatility 2) expenditure volatility 3) working capital needs 4) more in line with other large AAA jurisdictions
General Fund Reserves	Section 310 of Charter: *With respect to the General Fund, any unappropriated surplus shall not exceed five percent of the General Fund revenue for the preceding fiscal year.*	Retain, but policy reserves above Charter limitation will be included in target for RSF.

ATTACHMENT B (continued)

Revenue Stabilization Fund (RSF)	RSF is currently capped at 10% of average of prior 3 years specific revenue sources. Interest earned is transferred to PAYGO, and mandatory contributions are based on revenues exceeding estimates. (See County Code Ch 20 Article XII) If actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection, then 50 percent of the excess must be transferred to the Fund.	Remove cap, retain interest earned in RSF, and require mandatory contributions to achieve total reserves of 10% and when revenues exceed estimates: ***Mandatory annual contributions to the Fund must equal the greater of:*** ***50 percent of the amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection for these amounts.*** ***An annual amount not to exceed 0.5 percent of the Adjusted Governmental Revenues for the current year, but which does not result in the sum of the current year-end projected Unrestricted General Fund fund balance and the Revenue Stabilization Fund to exceed 10 percent of the Adjusted Governmental Revenues.***
Use of One-time Revenues	Current Fiscal Policy: ***Except for excess revenues which must go to the Revenue Stabilization Fund, the County will, whenever possible, give highest priority for the use of one-time revenues from any source to the funding of capital assets or other nonrecurring expenditures so as not to incur ongoing obligations for which revenues may not be adequate in future years.***	Recommended Policy: ***One-time revenues and revenues in excess of projections will be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or OPEB.***

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ATTACHMENT B (continued)

PAYGO	Current CIP Fiscal Policy: ***It is the County's policy to allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.***	Recommended Policy: (unchanged) ***The County will allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.***
Fiscal Plan	Shows Resources and Uses balanced in the budget year. To the extent uses exceed resources in future years, deficit amounts are displayed as Gaps to be closed in future budgets.	Recommended Policy: ***The County will adopt a fiscal plan that is structurally balanced, and that displays expenditures and other uses of resources within annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.***
Adequacy of budget appropriations	Minimal levels are budgeted for certain known expenditures, not in line with actual experience.	Budget at more realistic levels, possibly in a separate account where unused balance can carry over to next year.

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