Queen Anne's County

County Commissioners:
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Jack Wilson, District 1
Stephen Wilson, District 2
Robert Charles Buckey, District 3
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County Administrator: Gregg A. Todd
Director of Budget & Finance: Jonathan R. Seeman
Chief Treasury Officer: Marie Lange

DATE: November 1, 2016

TO: County Commissioners

CC: Stephen Wilson, County Commissioner
Gregg A. Todd, County Administrator

FROM: Jonathan R. Seeman

RE: Final Report of the Spending Affordability Committee, FY2018

The Spending Affordability Committee (SAC), established by Ordinance 15-11 in 2015, became effective this fiscal year. It is comprised of three to five members of the community as recommended by the County Administrator and Director of Budget, Finance and Information Technology. This year's inaugural membership includes:

- Anne MacKinnon, former State Delegate and Prince George's County Councilwoman;
- John Wilson, Local Business Owner; and,
- Joe Zimmerman, Secretary-Treasurer, Maryland-National Capital Park and Planning Commission; former Queen Anne's County Director of Finance

Their charge was to recommend spending affordability guidelines which consider the FY2018 operating budget, sustainable debt service, budget forecasts, fund balance and an optimal six year capital program. Three meetings were held in the past six weeks.

The SAC has made 12 recommendations in the areas of the budget (operating and capital); fund balance and debt. They have focused on the major issues affecting affordability. The SAC hereby transmits their report to the Commissioners and looks forward to the opportunity to present their findings and recommendations to you.

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Dear Queen Anne's County Commissioners:

The Spending Affordability Committee (SAC) was briefed on the current state of the County's economy and the status of labor market. It reviewed the County's demographic data from several years for income, unemployment, and the housing market and how it compared to other counties in the state (See Appendix). The SAC is pleased to submit the following observations and recommendations for your 2018 budget deliberations.

Fiscal Stability

In looking at affordability, it is important to note the progress the County has made in the years since the last recession. The County has built up a reasonable level of fund balance after virtually wiping out the County's reserves in FY2011. The County has adopted a Rainy Day Fund law, and a "Special Fund" also designed to protect the fund balance and limit the use of these funds. The County has adopted policies on fund balance, expenditure controls and on County debt. The rating agencies removed the "negative watch" imposed when both the fund balance and the Rainy Day Fund were essentially eliminated. The County now operates under a stable outlook from the rating agencies. The budget is structurally balanced, and has produced surpluses regularly since the end of the recession.

Economy

The County is experiencing strong growth in its hospitality and commercial industries. The unemployment rate decreased to 4.1% in June 2016 from 4.6% a year earlier, and is below the state's average of 4.6%. 2014 Personal Income increased 0.6% from 2013. The housing market has been strong over the past several years – since 2010 the total units sold has increased by 88%; however, the median sold price is stagnating having only increased by 1%. In the past, the county could reliably count on both, the property tax and income tax, having a growth factor. The recession of 2007-2009, has caused a flattening of property values for the period of 2011-estimated 2018.

Operating Budget and Capital Improvement Plan

The SAC was concerned that an aggressive Capital Improvement Plan (CIP) could eventually lead to a tail wagging the dog scenario. The SAC believes the 6 year CIP should reflect real analysis and consideration of future capital needs and the subsequent impacts to future year operating budgets. The SAC strengthened the debt measures, sending a strong message regarding future capital budgets. This message is reinforced by the declining capital fund balance, a significant funding source for the County's recent capital budgets. After several years of use in the $3-6 million range, there is at this time virtually no capital fund balance available for use in FY2018. With the loss of this funding source, even greater pressure is exerted on the use of bond funding.

Therefore the SAC recommends:

- Budget and CIP Recommendation 1: Devise a realistic Capital Improvement Plan (CIP) that adheres to current service demands, provides for long-term planning, and is in line with latest revision of the County's debt capacity policy.
- Budget and CIP Recommendation 2: In preparing the CIP, and prior to issuing debt, there shall be due consideration of future operating costs resulting from the capital improvement, which shall be captured on the Capital Budget Request Forms. If applicable, a 6-year operating forecast shall be established for each project in the plan. The six year operating forecast influences affordability of the CIP in identifying available funds for Paygo as a source of revenue for the capital budget. Debt service is paid for in the operating budget but is of course central to funding the capital budget via debt.
- Budget and CIP Recommendation 3: With regard to the FY2018 operating budget and all future operating budgets, expenditure growth shall not exceed the rate of growth of estimated revenues.
- Budget and CIP Recommendation 4: Pursue solid capital planning conforming to the status of measures longer-term. It is imperative to undertake real planning efforts to prepare a realistic six year plan that conforms to the debt measures throughout the life of the plan. For instance, the County may want to consider some type of short and longer term facility assessment. The debt measures are key to determining affordability; hence the capital planning must extend accurately through the life of the capital program.
- Budget and CIP Recommendation 5: Any recommendation not accepted must be explained in the budget resolution.

County's Debt Policies

The County's current established debt policy has three measures: is 2.5% of the Total Taxable Assessable Base, is $3,000 or less per capita, and generally not exceed 12% of total general fund expenditures. The SAC spent much of their time reviewing and considering these policies. The SAC didn't like a static spending per capita as a measure of debt capacity because over time it will not account for a given county's general wealth. The SAC believes their recommended measurement as well as an added measure that factors in income level strengthen the County's position relative to affordability.

- Debt Recommendation 1: tie the per capita debt threshold (currently at $3,000 per capita) to currently defined per capita income each year as reported by the U.S. Bureau of Labor Statistics or similar agency. This measure shall be a ratio of per

capita debt to per capita income. Maximum threshold of per capita debt to per capita income shall be 8%.

- Debt Recommendation 2: Change the current 12% debt service to total general fund expenditures ratio to "10% debt service to total general fund expenditures ratio over a three-year period with a maximum of 12% in any one year."

- Debt Recommendation 3: No more than one of the three measures may be violated (up to 10% over) in any given year. If such an occasion arises, the operating and/or capital budgets shall be revised to bring measures back in line.

Fund Balances

The County's fund balance is comprised of three primary categories. The Rainy Day Fund is for contingencies to meet emergency needs that are unanticipated and non-recurring. The Rainy Day Fund is set at 7% of budgeted revenues. The "Special Fund" is to be used for certain unanticipated projects or initiatives, can add up to $1 million per year, and has a $4 million cap. The "Unassigned" funds are essentially the category of fund balance that remains, and is not designated for any particular purpose.

- Fund Balance Recommendation 1: Committee reiterates that fund balance should only be used for non-recurring expenditures.

- Fund Balance Recommendation 2: Increase Rainy Day Fund required balance from 7% of operating revenues to 8% of operating revenues of the prior year.

- Fund Balance Recommendation 3: Rename "Special Fund" to "Revenue Stabilization Fund" and set maximum balance to 5% of operating revenues of the prior year. Keep annual transfer to $1 million per year until reaching the 5% cap.

- Fund Balance Recommendation 4: Only use "unassigned" operating fund balance for infrastructure needs and one-time capital improvements as programmed in the CIP.

Concluding remarks

The Committee raised some concerns about affordability going forward and believes the County must be cognizant of the factors contributing to our concerns, and, importantly, the awareness that both the operating and capital budgets most probably are not sustainable under the assumptions and practices of the past several years. Specifically:

Operating

The continuing flatness in property assessments produces a different reality for the County. With the reliance on a single, somewhat volatile source of revenue for virtually all growth suggests more conservative revenue estimates and the need to lower expectations with regard to the larger and more expensive spending areas—particularly employee salaries, benefits, and contributions to the Board of Education. Salary increases of 3% or greater for County employees, and increases to the Board of Education above Maintenance of Effort by significant amounts, will not be sustainable.

Capital

The capital budget is facing several challenges which indicate a need to cut back on spending levels of the past several years. First, capital fund balance has been completely depleted. That essentially eliminates a funding source of $3-6 million. Second, the growth in debt over the past several years, while falling within all debt parameters, puts the County in a position much closer to its debt ceilings based on their current policies. The County will need to limit annual bond issuances to the value of debt retired (approximately $6-8 million per year) plus a growth factor of 2-3%. This would result in annual bond sales of about $10-12 million. The "sustainable" model for debt shows a stabilization of overall debt in the low $140 millions.

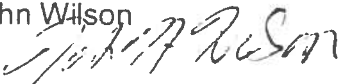
These factors are going to force the County to establish priorities and focus on core service needs. Clearly the levels of capital spending will be lower going forward.

The SAC appreciate the Commissioners asking us to serve on this committee and entrusting us with this work. We are also appreciative of the extensive information that was provided by Jonathan Seeman, and his staff. The SAC has completed its assigned tasks, and as required by county law has submitted its recommendations to the County Commissioners for consideration.

Sincerely,

Anne MacKinnon Welsh

John Wilson



Joe Zimmerman