GO Committee #1
October 17, 2019

MEMORANDUM

October 14, 2019

TO: Government Operations and Fiscal Policy (GO) Committee

FROM: Gene Smith, Legislative Analyst

SUBJECT: Updating the Fiscal Plan

PURPOSE: Discussion of subject, recommend updates to present at a future GO Committee

Expected Attendees
David Platt, Chief Economist, Department of Finance (Finance)
Chris Mullin, Lead Fiscal and Policy Analyst, Office of Management and Budget (OMB)

I. Introduction and Summary of Recommendations

This report is a continuation from the GO Committee's review of the County's economic indicators and fiscal policies on July 11, 2019.[1] Below is a summary of Council staff recommendations to update the fiscal plan. **The GO Committee should indicate which recommendations it wants to implement**. Council and Executive staff will then present them and the corresponding updates to the fiscal policy resolution to the committee at a future worksession for final approval.

Recommendation 1: Display non-wage income tax revenue. Approximately 30% of the County's income tax revenue is from this volatile source. Separating it from the aggregate income tax revenue provides important context about the County's annual revenue expectations.

Recommendation 2: Display an estimated range for each revenue source. All revenue sources deviate from the June estimate; an estimated range for each revenue source on the fiscal plan will provide a better picture of the likely risk associated with each revenue source.

Recommendation 3: Develop an approach to display an estimate for intergovernmental aid. The fiscal plan currently assumes 0% growth in this revenue source which restricts the ability to balance the fiscal plan in future years.

Recommendation 4: Develop an approach to display estimates for each agency beyond the current fiscal year. The fiscal plan currently aggregates this value in future fiscal years which prevents the Council from displaying approximate expenditures based on the approved budget.

[1] https://www.montgomerycountymd.gov/council/Resources/Files/agenda/cm/2019/20190711/20190711_GO1.pdf

Below is a summary of the fiscal policy items discussed in this report. The GO Committee may schedule additional worksessions related to these items and/or related to other fiscal policy items not included in this report.

1) Updating the fiscal plan summary. Resolution 17-312 requires that the Council approve a structurally balanced budget and fiscal plan (see ©1-4). Council staff provides recommendations to update the fiscal plan to include additional elements that aid in the goal of a structurally balanced fiscal plan.

2) Pay-as-you-go (PAYGO). Resolution 17-312 requires that the County fund the capital budget at 10% PAYGO based on the amount of General Obligation (G.O.) bonds issued that year. Council staff does not recommend any changes to this policy but provides historical context as requested by the GO Committee from July 11.

II. Updating the fiscal plan summary

The Council's Resolution 17-312 states:

"Montgomery County must have a goal of a structurally balanced budget. Budgeted expenditures should not exceed projected recurring revenues plus recurring net transfers in minus the mandatory contribution to the required reserve for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred."

"The County should adopt a fiscal plan that is structurally balanced."

See the Council's approved FY20-25 Tax Supported Fiscal Plan Summary on ©5. The Council approves the fiscal plan each June following its decisions for the operating budget. The June 2019 Fiscal Plan Summary displays a structurally balanced budget (i.e., expenditures do not exceed projected recurring revenues). The fiscal plan summary contains three sections of information.

1) Revenue projections. Executive staff provide estimates for the County's revenues based on historical collection rates and current economic data. **The County's assumptions for revenue growth determine the available resources for agency uses in the later years of the fiscal plan summary.**

2) Non-Operating Budget Uses. This section provides an overview of the resources required to meet the Council's fiscal policy objectives for non-operating budget expenditures, such as debt service, reserves, and other post-employment benefits (OPEB). Estimates for these expenditures are based on current policies and approved expenditures. Growth or reduction to these expenditures directly impact the resources available for agency uses.

3) Agency Uses. This section provides an overview of the allocation to each of the four agencies in the prior and current fiscal year. For the remaining fiscal years of the fiscal plan summary (e.g., FY21-25 on ©5), an aggregate value is shown for all four agencies instead of assigning an estimate for each agency. **This aggregate value is either decreased or increased to structurally balance the fiscal plan summary each year.**

Council staff believes minor updates to the fiscal plan would provide important information regarding the structural balance of the County's six-year fiscal picture. With this information, the Council will be in a better position to understand the future fiscal picture of the County's budget.

A. Detailing Certain Tax Revenue Projections

The County's tax-supported revenue projections are estimated in March with the Executive's recommended budget and in December during the fiscal plan update. The Council typically learns of major deviations from the revenue projections during the December update. In some years, these deviations resulted in the Council acting on savings plan to account for the reduction in revenues.

See ©6 for the difference between the approved budget projection in June and the actual revenue collected for the four largest tax-supported revenues from FY2000-FY2018. Energy and property taxes have very little variance year-to-year (i.e., the June approved value was almost equal to the actual taxes collected), excluding the major downward revision to the assessable base following the Great Recession for property taxes in FY2011. Recordation and Transfer taxes experienced greater fluctuation during the years preceding and following the Great Recession, which was due to the rapid growth and decline of the real estate market. Income taxes, unlike the other three taxes, consistently fluctuates year-to-year.

The primary reason that the County's income tax fluctuates is because non-wage income has an outsized role in the reported income for County residents. During the last sixteen years, non-wage income averages above 30% of all reported income in the County. The average for all Maryland counties, including Montgomery County, is 23%. See ©7 for the annual percent change of wage and non-wage reported income in the County from Tax Year (TY) 2001-2016. Wage income remains mostly in a tight band during the period graphed, while non-wage income fluctuates more often year-over-year.

Accurately accounting for changes in non-wage income will remain a challenge because it is based on individual decisions of a limited group of residents each year. County staff could continue to focus efforts on refining these estimates. **Council staff, however, believes a better approach is to display information differently on the fiscal plan**. Below are two recommendations and one note for the GO Committee to consider and provide direction for future action.

> Display non-wage income separately on the fiscal plan. The easiest step is for the Council to separate wage income estimate, which is more stable, from non-wage income estimates that is less stable. Separating non-wage income from all income tax provides important context for the Council by identifying an amount of the County's revenues that are volatile. **Council staff recommends that the GO Committee direct Council and Executive staff to present options for displaying non-wage income tax separately at a future committee meeting**.
>
> Display an estimated range for revenues. As demonstrated in the attached chart (see ©6), all revenues deviate from the approved values in June. Including an estimated range for each revenue source on the fiscal plan will provide a better picture of the risk associated with each revenue for the County's budget. **Council staff recommends that the GO Committee direct Council and Executive staff to present options for calculating and displaying estimated ranges for each revenue source.**

"Collaring" a portion of the non-wage income tax revenues. State law limits the amount of nonwithholding income tax (e.g., non-wage) revenues that the Bureau of Revenue Estimates may estimate for the State's income tax revenues (i.e., "collaring").[2] The State chose this approach to limit its exposure to a volatile revenue source. The Council could consider a similar approach once it has implanted the first two recommendations.

B. Detailing Certain Non-Tax Revenue

The fiscal plan summary assumes zero percent growth in intergovernmental aid in the future fiscal years (included on ©5 in the "Other Revenues" line). This conservative approach ensures the County does not presume more revenues in the future fiscal years, but it also restricts the ability to accurately display expenditures for the agencies as discussed below. Since the total available for agency use is the last line that is calculated, it is this line that is adjusted to ensure the fiscal plan summary is balanced. From FY2012-FY2020, the County's intergovernmental aid grew at an average 5.0% year-over-year. Council staff believes a reasonable estimate for growth in intergovernmental aid should be included like all other revenues. **Council staff recommends that the GO Committee direct Executive and Council staff to develop an approach to estimate and include growth in intergovernmental aid for the future fiscal years in the fiscal plan summary**.

C. Detailing Certain Expenditure Projections

The fiscal plan summary displays two types of expenditures – non-operating budget uses and resources available for agency use (i.e., operating budget uses). Except for the current year of the budget (e.g., FY20 on ©5), the future years do not provide an estimate for agency use. Council staff believes that this aggregate provides no information about agency use in future fiscal years expenditures, even though, the County has sufficient data to estimate maintenance of effort ("MOE") for Montgomery County Public Schools (MCPS) and Montgomery College (MC) and to estimate the Montgomery County Government based on the future fiscal impact estimates included in the budget publication. Separating these expenditures into each respective agency provides greater clarity about the nature of the County's structurally balanced budget. Also, like all future years' values, any estimate provided for the agencies is based on data at a certain point in time and does not limit the Council's decisions during each annual budget.

Council staff recommends that the GO Committee direct Executive and Council staff to develop an approach to display estimates for each agency in the future fiscal.

III. PAYGO

PAYGO funding is an important tool to reduce the County's debt burden by funding a portion of the Capital Improvements Program (CIP) with current revenue. Resolution 17-312 sets PAYGO at a minimum of 10% of the issued bonds each fiscal year. This funding level was utilized by the Council, but not formalized, in the early- to mid-2000s. The Council formalized the 10% threshold in 2007, reaffirmed it in 2009 with the adoption of a Local Government Debt Policy recommended by the Chief Administrative Officer, and reaffirmed it again with the adoption of Resolution 17-312. Many local

[2] Section 6-104(e) of the State Finance and Procurement Code.

jurisdictions use PAYGO to reduce the long-term burden of debt service on the operating budget; however, there is not a uniform approach or threshold. See the table below for select examples of PAYGO policies by other local jurisdictions.

Jurisdiction	PAYGO Policy
Fairfax County, VA	Project merit based, no set threshold
Frederick County, MD	Attempt 7% of general fund revenues
Loudoun County, VA	Not less than 10% of revenues
Montgomery County, MD	Not less than 10% of issued bonds
Prince William County, VA	Minimum of 10% of general fund revenues

The table below details how different PAYGO thresholds would impact the County's Capital and Operating Budgets based on the current Spending Affordability Guidelines (SAG) established by the Council for FY21. At the current SAG, a one percent change in PAYGO funding will either add or subtract $3.2 million in current revenue funding. **Council staff does not recommend any changes to the PAYGO policy; the Council may always fund PAYGO at a greater percent than the policy envisions.**

FY21 SAG ($ millions)	PAYGO Threshold	Current Revenue ($ millions)
320	5.0%	16.0
320	7.5%	24.0
320	10.0%	32.0
320	12.5%	40.0
320	15.0%	48.0

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Resolution No: 17-312
Introduced: November 29, 2011
Adopted: November 29, 2011

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: Government Operations and Fiscal Policy Committee

SUBJECT: Reserve and Selected Fiscal Policies

Background

1. Fiscal policy corresponds to the combined practices of government with respect to revenues, expenditures, debt management, and reserves.

2. Fiscal policies provide guidance for good public practice in the planning of expenditures, revenues, and funding arrangements for public services. They provide a framework within which budget, tax, and fee decisions should be made. Fiscal policies provide guidance toward a balance between program expenditure requirements and available sources of revenue to fund them.

3. As a best practice, governments must maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning. Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness.

4. In FY10, the County experienced an unprecedented $265 million decline in income tax revenues, and weathered extraordinary expenditure requirements associated with the H1N1 flu virus and successive and historic winter blizzards. The costs of these events totaled in excess of $60 million, only a portion of which was budgeted and planned for.

5. In a memorandum dated April 22, 2010, the County Executive recommended that the County Council restore reserves first to the current 6% policy level for FY11 and also revise and strengthen policy levels in order to more appropriately position the County to weather economic cycles in the future, and to achieve structural balance in future budgets.

6. The County's financial adviser recommended that the County strengthen its policy on reserves and other fiscal policies to ensure budget flexibility and structural stability, and provided specific recommendations, which are reflected below.

7. On June 29, 2010 the Council approved Resolution No. 16-1415, *Reserve and Selected Fiscal Policies*. This Resolution established a goal of achieving the Charter §310 maximum for the reserve in the General Fund of 5% of General Fund revenues in the preceding fiscal year, and of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund Balance to 10% of Adjusted Governmental Revenues (AGR), as defined in the Revenue Stabilization Fund law.

8. The County's reserve policy should be further clarified and strengthened. This resolution replaces the reserve policy established in Resolution No. 16-1415.

Action

The County Council for Montgomery County, Maryland approves the following policies regarding reserve and selected fiscal matters:

1. *Structurally Balanced Budget*

   Montgomery County must have a goal of a structurally balanced budget. Budgeted expenditures should not exceed projected recurring revenues plus recurring net transfers in minus the mandatory contribution to the required reserve for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.

2. *Use of One-Time Revenues*

   One-time revenues and revenues in excess of projections must be applied first to restoring reserves to policy levels or as required by law. If the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures that are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or unfunded liabilities. Priority consideration should be given to unfunded liabilities for retiree health benefits (OPEB) and pension benefits prefunding.

3. *PAYGO*

   The County should allocate to the CIP each fiscal year as PAYGO at least 10% of the amount of general obligation bonds planned for issue that year.

4. *Fiscal Plan*

   The County should adopt a fiscal plan that is structurally balanced, and that limits expenditures and other uses of resources to annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.

5. *County Government Reserve*

(a) **County Government Reserve.** The County Government Reserve has three components. The components of the budgeted reserve at the end of the next fiscal year are:

(i) **Reserve in the General Fund**. The County's goal is that this reserve will be the maximum permitted by §310 of the Charter, which is 5% of revenues in the General Fund in the previous fiscal year;

(ii) **Reserve in the Revenue Stabilization Fund (RSF).** This budgeted reserve at the end of the next fiscal year is the reserve at the beginning of the year, plus interest on the fund balance, plus a mandatory transfer from the General Fund, as defined in the Revenue Stabilization Fund law, plus a discretionary transfer if the Council approves one. The actual amount of the mandatory transfer is calculated in accordance with §20-68 of the Montgomery County Code; and

(iii) **Reserve in the other tax supported funds in County Government.** The budgeted reserve at the end of the next fiscal year for the following funds – Fire, Mass Transit, Recreation, Urban District, Noise Abatement, Economic Development, and Debt Service – and any other tax supported County Government fund established after adoption of this resolution, should be the minimum reserve possible (as close as possible to zero, but not negative), since the Council sets the property tax rate to the nearest one tenth of 1¢.

(b) **Calculation of budgeted reserve as a percent of Adjusted Governmental Revenues.** The target reserve as a percent of Adjusted Governmental Revenues is the sum of the reserves in the General Fund and the Revenue Stabilization Fund divided by Adjusted Governmental Revenues, as defined in the Revenue Stabilization Fund law. The reserves in the other tax supported funds in County Government are not included in this calculation.

(c) **Budgeted reserve as a percent of Adjusted Governmental Revenues.** To reach the County's goal of 10% of AGR in 2020, the annual minimum target goals are:

FY13	6.4%
FY14	6.9%
FY15	7.4%
FY16	7.9%
FY17	8.4%
FY18	8.9%
FY19	9.4%
FY20 and after	10.0%

The Council may make a discretionary transfer each year from the General Fund to the Revenue Stabilization Fund, if necessary, to reach the target goal for each year. The 10% goal for FY20 and after must be reflected in the Revenue Stabilization Fund law.

6. *Reserves in other agencies*

The reserves for the Montgomery County Public Schools (MCPS), the Maryland-National Capital Park and Planning Commission (M-NCPPC), and Montgomery College (MC) are not included in the target reserves for County Government. The County's reserve policies for these agencies are:

(a) **MCPS**. The Council should not budget any reserve for the MCPS Current Fund.

(b) **M-NCPPC**. The reserve in the Park Fund should be approximately 4.0% of budgeted resources. The reserve in the Administration Fund should be approximately 3.0% of budgeted resources. The reserve in the Advance Land Acquisition Debt Service Fund should be the minimum reserve possible, since the Council sets the property tax rate to the nearest one tenth of 1¢.

(c) **Montgomery College**. The reserve in the Current Fund should be 3.0% - 5.0% of budgeted resources minus the annual contribution from the County. The target reserve in the Emergency Plant Maintenance and Repair Fund – as stated in Resolution No. 11-2292, approved by the Council on October 16, 1990 – "may accumulate up to $1,000,000 in unappropriated fund balance, such goal to be attained over a period of years, as fiscal conditions permit."

7. *Reports to Council*

The Executive must report to the Council:

(a) the prior year reserve and the current year reserve projection as part of the annual November/December fiscal plan update;
(b) current and projected reserve balance in the Executive's annual Recommended Operating Budget;
(c) any material changes expected to have a permanent impact on ending reserve fund balance; and
(d) current and projected reserve balances in any proposed mid-year savings plan.

This is a correct copy of Council action.

Linda M. Lauer

Linda M. Lauer, Clerk of the Council

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County Council Approved FY20-25 Public Services Program

Tax Supported Fiscal Plan Summary

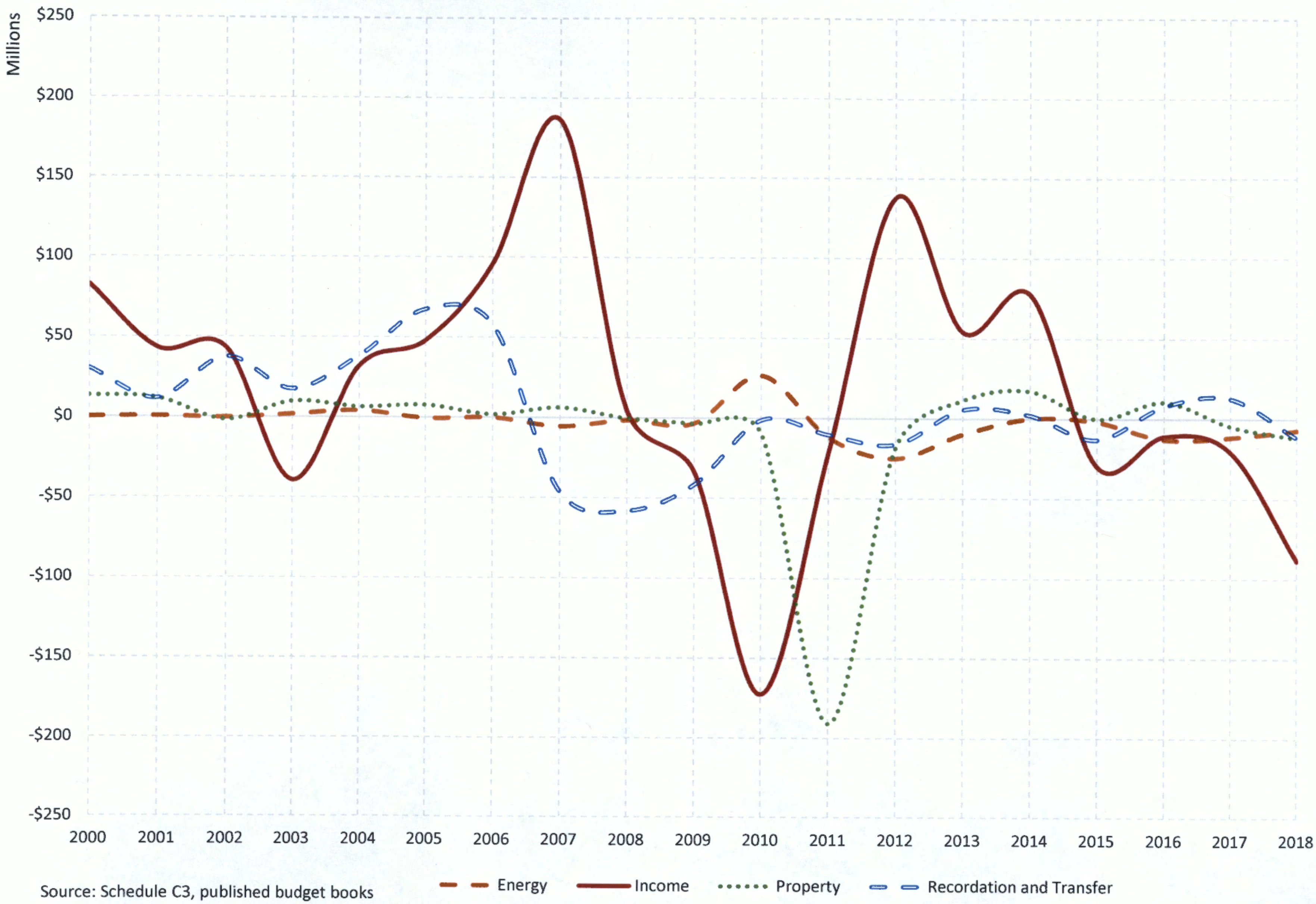
($ in Millions)

		App. FY19 5-24-18	Est. FY19	% Chg. FY19-20 App/App	App. FY20 5-23-19	% Chg. FY20-21	Projected FY21	% Chg. FY21-22	Projected FY22	% Chg. FY22-23	Projected FY23	% Chg. FY23-24	Projected FY24	% Chg. FY24-25	Projected FY25
	Total Revenues														
1	Property Tax	1,808.4	1,786.5	1.6%	1,836.8	3.1%	1,893.8	3.1%	1,951.9	3.5%	2,020.5	3.5%	2,091.4	3.3%	2,160.8
2	Income Tax	1,585.2	1,542.9	3.5%	1,640.3	3.8%	1,702.9	3.5%	1,762.6	4.6%	1,843.2	4.8%	1,930.8	4.7%	2,021.1
3	Transfer/Recordation Tax	162.9	180.6	12.2%	182.8	0.5%	183.7	2.1%	187.7	3.0%	193.3	4.9%	202.7	4.5%	211.8
4	Other Taxes	273.7	278.3	3.5%	283.2	-1.4%	279.3	1.6%	283.7	-1.2%	280.3	1.6%	284.9	-0.7%	283.0
5	Other Revenues	1,098.1	1,110.1	5.0%	1,152.8	-1.1%	1,140.2	0.4%	1,144.6	0.4%	1,149.1	0.4%	1,153.8	0.4%	1,158.5
6	**Total Revenues**	**4,928.3**	**4,898.4**	**3.4%**	**5,095.9**	**2.0%**	**5,199.9**	**2.5%**	**5,330.4**	**2.9%**	**5,486.4**	**3.2%**	**5,663.6**	**3.0%**	**5,835.2**
7															
8	**Net Transfers In (Out)**	**34.9**	**26.1**	**-63.9%**	**16.1**	**2.5%**	**16.5**	**2.7%**	**16.9**	**2.7%**	**17.4**	**2.7%**	**17.9**	**2.7%**	**18.4**
9	**Total Revenues and Transfers Available**	**4,963.3**	**4,924.4**	**3.0%**	**5,112.0**	**2.0%**	**5,216.4**	**2.5%**	**5,347.3**	**2.9%**	**5,503.8**	**3.2%**	**5,681.4**	**3.0%**	**5,853.6**
10															
11	**Non-Operating Budget Use of Revenues**														
12	Debt Service	420.0	416.5	2.4%	430.0	4.6%	449.6	3.0%	463.0	3.4%	478.7	-0.2%	477.8	1.6%	485.5
13	PAYGO	33.0	33.0	-3.0%	32.0	0.0%	32.0	-3.1%	31.0	-6.5%	29.0	0.0%	29.0	0.0%	29.0
14	CIP Current Revenue	35.6	29.5	-6.0%	33.5	158.5%	86.5	-14.4%	74.1	33.5%	98.9	1.0%	99.9	0.0%	99.9
15	Change in Other Reserves	-37.3	-20.2	47.3%	-19.6	100.9%	0.2	1.3%	0.2	15.6%	0.2	6.1%	0.2	-0.3%	0.2
16	Contribution to General Fund Undesignated Reserves	21.1	61.5	-61.4%	8.1	-38.4%	5.0	0.7%	5.1	9.1%	5.5	20.2%	6.6	15.4%	7.6
17	Contribution to Revenue Stabilization Reserves	29.7	32.1	-22.1%	23.1	-82.7%	4.0	100.0%	8.0	35.6%	10.9	12.4%	12.2	-15.6%	10.3
18	Set Aside for other uses (supplemental appropriations)	-4.0	-6.1	148.0%	1.9	942.5%	20.0	0.0%	20.0	0.0%	20.0	0.0%	20.0	0.0%	20.0
19	**Total Other Uses of Resources**	**498.2**	**546.3**	**2.2%**	**509.0**	**17.3%**	**597.3**	**0.7%**	**601.3**	**7.0%**	**643.2**	**0.4%**	**645.8**	**1.1%**	**652.6**
20 21	**Available to Allocate to Agencies (Total Revenues+Net Transfers-Total Other Uses)**	**4,465.1**	**4,378.2**	**3.1%**	**4,603.0**	**0.3%**	**4,619.1**	**2.7%**	**4,746.0**	**2.4%**	**4,860.6**	**3.6%**	**5,035.6**	**3.3%**	**5,201.0**
22	**Agency Uses**														
23															
24	Montgomery County Public Schools (MCPS)	2,444.1	2,425.9	2.9%	2,514.3										
25	Montgomery College (MC)	265.5	261.2	0.0%	265.5										
26	MNCPPC (w/o Debt Service)	128.3	126.5	3.2%	132.4										
27	MCG	1,627.2	1,564.4	3.9%	1,690.8										
28	**Agency Uses**	**4,465.1**	**4,378.2**	**3.1%**	**4,603.0**	**0.3%**	**4,619.1**	**2.7%**	**4,746.0**	**2.4%**	**4,860.6**	**3.6%**	**5,035.6**	**3.3%**	**5,201.0**
29	**Total Uses**	**4,963.3**	**4,924.4**	**3.0%**	**5,112.0**	**2.0%**	**5,216.4**	**2.5%**	**5,347.3**	**2.9%**	**5,503.8**	**3.2%**	**5,681.4**	**3.0%**	**5,853.6**
30	**(Gap)/Available**	**0.0**	**0.0**		**0.0**		**0.0**		**0.0**		**0.0**		**0.0**		**0.0**

Assumptions:

1. Property taxes are at the Charter Limit with a $692 credit. Other taxes are at current rates.
2. Reserve contributions are consistent with legal requirements and the minimum policy target.
3. PAYGO, debt service, and current revenue reflect the Amended FY19-24 Capital Improvements Program.
4. State Aid, including MCPS and Montgomery College, is not projected to increase from FY20-25.

Select Revenues - Difference in Approved Vs. Actual FY2000-FY2018



Source: Schedule C3, published budget books

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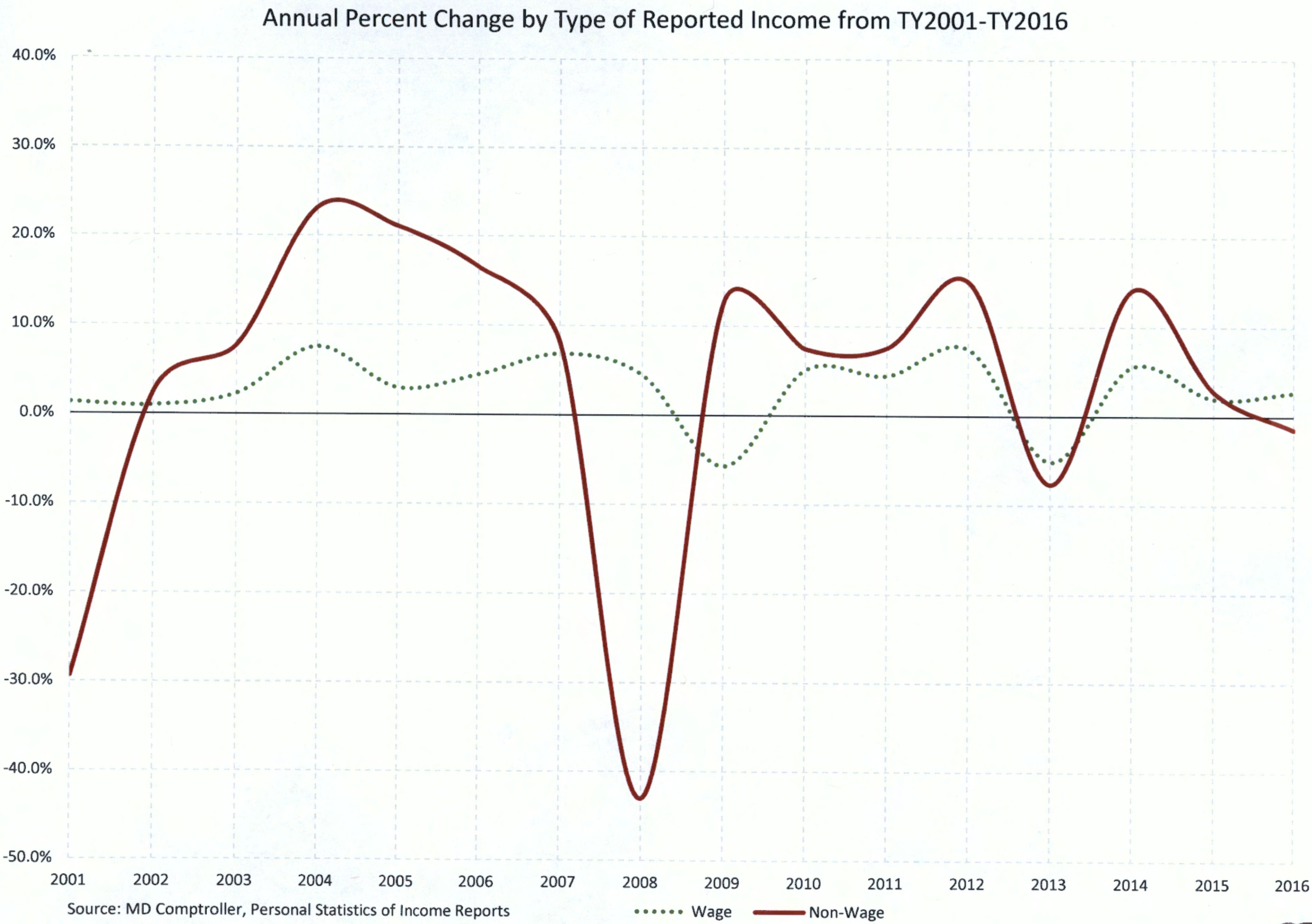

Source: MD Comptroller, Personal Statistics of Income Reports

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