SPENDING AFFORDABILITY COMMITTEE
Anne Arundel County
January 28, 2021

The Hon. Steuart Pittman, County Executive
The Hon. Sarah Lacey, Chair, County Council
Mr. Matt Power, Chief Administrative Officer
Mr. Chris Trumbauer, Budget Officer
Ms. Karin McQuade, Controller
The Arundel Center, 44 Calvert Street
Annapolis, Maryland 21401

This report of the Spending Affordability Committee (SAC) for Fiscal 2022 is hereby submitted in accordance with Section 610 of the Anne Arundel County Charter. This section requires in part that "The Committee shall make advisory recommendations to the Office of the Budget, the County Executive, and the County Council relating to spending affordability including County spending levels to reflect the ability of the taxpayer to finance County services and long-term debt." Section 610 also tells the Spending Affordability Committee to "…examine current capital projects, the five-year capital improvement program, per capita wealth, debt service, pay-as-you-go funding and alternative sources of funding."

Committee Recommendation

The SAC has followed the practice of previous Committees that "spending affordability" can best be determined by estimating the growth in personal income of County residents. The Committee uses the definition of personal income provided by the U.S. Department of Commerce, Bureau of Economic Analysis (BEA), which is "income received by persons from all sources" (e.g., wages, employment benefits, business income, and investment income) whether taxable or not. To avoid placing additional financial burden on County residents, spending growth should remain in-line with personal income growth. For example, if personal income of our residents should only increase one percent, then County spending should not increase more than that one percent. Simply put, if County spending were to increase faster than personal income, additional taxes and fees from County residents would likely be needed to support that spending.

Using this methodology, the SAC recommends that Fiscal 2022 spending be based on a personal income growth rate projection of 2.0%, which results in a forecasted Fiscal 2022 personal income level of $43,063,785,960 for the County. As shown in the table below, applying the 2.0% growth rate to the Fiscal 2021 adjusted base budget results in a recommended Fiscal 2022 Current Expense (General Fund) budget of $1,714,087,050. This represents a $33.6 million increase over the Fiscal 2021 approved budget, and a $15.9 million increase over the SAC's Fiscal 2021 recommendation (made prior to the onset of coronavirus disease 2019 [COVID-19] related impacts). With respect to the Capital Budget, County budget policy stipulates the General Fund

Debt Limit be less than 4% of forecasted personal income.[1] This results in a recommended General Fund Debt Limit of $1,722,551,438. This represents a $47.1 million increase over the SAC's Fiscal 2021 recommendation.

The SAC's recommendation is based on data available as of the drafting of this report. Prior to our testimony to the County Council, currently scheduled for May 1, 2021, the SAC will examine actual economic data from the most recent quarter to determine if any adjustments to our recommendations are warranted.

Current Expense Budget Recommendation	
(Adjusted Base Budget for Current Year x Estimated Personal Income Growth Rate for Budget Year)	
Approved Fiscal 2021 Budget	$1,719,224,300
- Appropriated Fund Balance	(37,746,800)
- Rainy Day Fund Contribution	(1,000,000)
Committee's Adjusted Base Budget – Fiscal 2021	$1,680,477,500
Estimated Increase in County Personal Income (Fiscal 2021 to Fiscal 2022)	2.0%
Fiscal 2022 General Fund Appropriation Limit (customary manner)	**$1,714,087,050**
Capital Budget Recommendation	
(Personal Income Forecast for Current Year x Estimated Personal Income Growth Rate for Budget Year x Standard)	
Average of RESI (Regional Economic Studies Institute of Towson University)	
Quarterly Forecasts for County Personal Income – Fiscal 2021	$42,219,398,000
Estimated Increase in County Personal Income (Fiscal 2021 to Fiscal 2022)	2.0%
Forecast Personal Income – Fiscal 2022	$43,063,785,960
Standard Applied in County's Debt Affordability Model	4.0%
Fiscal 2022 General Fund Debt Limit (customary manner)	**$1,722,551,438**

Background

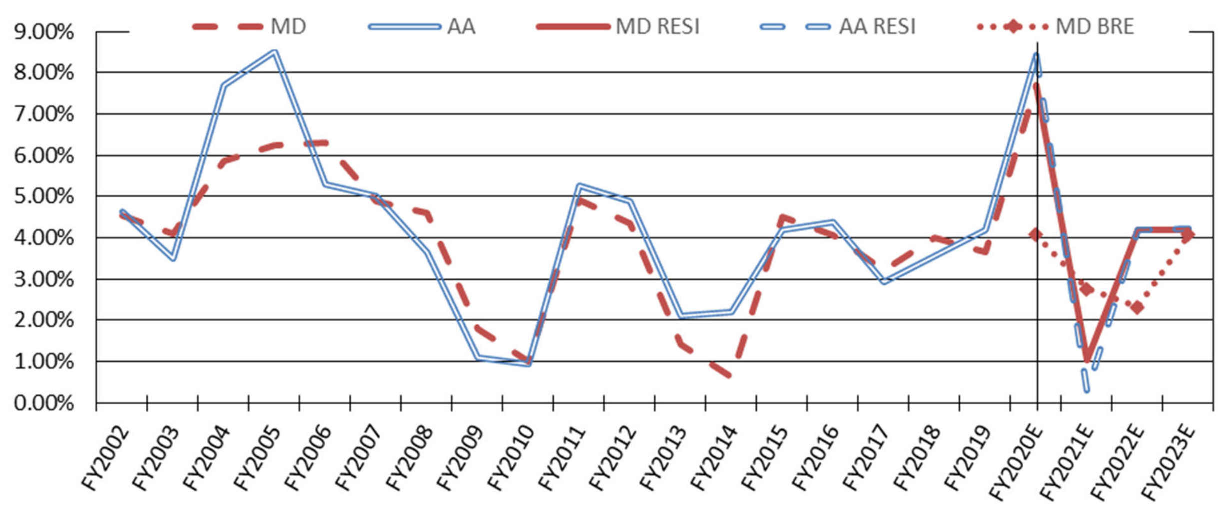
The State of Maryland has contracted with four firms (Sage Policy Group, Moody's, IHS Markit-Global Insight, and the Regional Economic Studies Institute [RESI] of Towson University) to provide economic data and personal income estimates. In addition, the State Board of Revenue Estimates (BRE) makes its own estimate for Maryland. To supplement this data, Anne Arundel County contracts with RESI to provide County-specific data and forecasts. The RESI estimates are derived from an economic model known as REMI PI+. This model is informed by personal income data from the BEA, employment data from the Bureau of Labor Statistics, and population data from the U.S. Census Bureau. The following table summarizes the most recent personal income growth estimates for Maryland and Anne Arundel County. On average, these estimates project a 2.5% personal income growth rate for Fiscal 2022 for Maryland. RESI is an outlier and projects a higher growth rate (4.2%) for both the State and Anne Arundel County.

[1] Page 21, Approved Current Expense Budget and Budget Message for Fiscal Year 2021.

Comparison of Personal Income Forecasts (Date of Estimate)		(Fiscal Years)			
		2020	2021	2022	2023
State of Maryland	Board of Revenue Estimates (Dec 2020)	4.1%	2.8%	2.3%	4.1%
	Sage Policy Group (Nov 2020)	4.2%	2.9%	2.0%	3.6%
	Moody's (Nov 2020)	3.9%	3.2%	2.0%	3.6%
	Global Insight (Nov 2020)	4.3%	2.9%	2.0%	3.8%
	RESI of Towson University (Dec 2020)	7.7%	1.0%	4.2%	4.2%
	Average	4.8%	2.6%	2.5%	3.9%
Anne Arundel County	RESI of Towson University (Dec 2020)	8.4%	0.3%	4.2%	4.2%

The following graph shows the actual annual growth rates in personal income from Fiscal 2002 to Fiscal 2019 for Maryland and Anne Arundel County as reported by the BEA, along with the forecasts described above for Fiscal 2020 and beyond. If viewing in black and white, the higher (blue double) line in 2005 is Anne Arundel County and the lower (red dashed) line in 2005 is Maryland. For the most recent year where data is available (Fiscal 2019), the BEA currently reports that the personal income growth rate in Anne Arundel County was 4.2%. Note that this data is subject to potential updates by the BEA in future reports.

PERSONAL INCOME GROWTH BY YEAR FOR ANNE ARUNDEL COUNTY AND MARYLAND



Analysis

The SAC members applied our collective experience and background in business, economics, finance, and Federal/State/Local government to assess the forecasts provided by the State's four econometric modeling firms. Because full year personal income reporting is only available from the BEA through Fiscal 2019, projections for Fiscal 2022 are based on 2 years of estimated data. These estimates are continuously revised as new data becomes available. Further complicating this analysis for Fiscal 2022 is the economic volatility caused by the COVID-19 pandemic. For example - as shown in the table above, current personal income projections swing from 8.4% in

Fiscal 2020 to 0.3% in Fiscal 2021. In its presentation to the SAC on 9 December 2020, RESI urged caution regarding forward looking personal income projections. While its models currently predict 4.2% growth for Fiscal 2022, RESI explicitly stated that these numbers are soft. RESI further recommended that budgetary planning for Fiscal 2022 assume personal income growth of no more than 3% (this comment was made verbally and not included in its written report).

Based on our analysis, the SAC recommends Fiscal 2022 budget planning be based on a personal income growth rate of 2.0%. This matches the estimates made for Maryland as a whole by Sage, Moody's, and IHS Markit-Global Insight. While it is possible that Anne Arundel County will outperform these estimates, the SAC recommends a conservative approach. This will help preserve budgeting and spending flexibility, while hedging against the risk of structural deficits should COVID-19 or other factors continue to impact Anne Arundel County in future years. The following paragraphs provide rationale for our recommendation, focusing on three areas:

- Economic Impact of COVID-19
- Long-Term Spending and Personal Income Growth Trends
- Other Factors

Economic Impact of COVID-19. In terms of the real-world economic impact in Maryland from COVID-19, an estimated 150,000 jobs were lost over the past year and unemployment levels rose to 7.8% in October 2020, vs. 3.4% in October 2019. Anne Arundel County fared relatively better, losing only ~1,000 net jobs over the past year. However, this is the first time in recent years that the County has not experienced steady year-over-year job growth. Anne Arundel County's job performance during COVID is primarily due to our reliance on Federal Government spending – a factor noted in the past several SAC reports. For example, most workers at Fort Meade have been covered under the Federal Coronavirus Aid, Relief, and Economic Security (CARES) Act as essential personnel, and not lost their jobs. The impact has been significantly worse in other sectors. Specifically, more than 4,500 jobs have been lost in Anne Arundel County combined across the restaurant, retail, accommodation, and related industries. These losses primarily affect lower wage earners.

One counter-intuitive result from COVID-19 is that personal income and County income tax revenue for Fiscal 2020 both exceeded projections. While this may seem positive, data suggests that these increases were driven almost entirely by the effects of Federal stimulus. BEA data for Maryland as a whole supports this conclusion. As shown in the table below, personal income in Maryland increased by 6.2% ($24.9B) for the second quarter of 2020 vs. the previous quarter, despite a significant rise in unemployment. Federal stimulus programs, such as direct payments, enhanced unemployment benefits, and various loan and grant programs for small businesses helped drive this increase. Some of these benefits, such as unemployment, are taxable. In its calculations, the BEA includes taxable unemployment benefits in the "Personal Current Transfer Receipts" component of personal income. As shown, Transfer Receipts increased more than 75.9% ($42.7 billion) in the second quarter of 2020, while workplace earnings dropped 6.2% ($16.6B) and dividends, interest and rental income dropped 1.6% ($1.2B). Transfer Receipts continued to have a disproportionate effect on personal income in the third quarter of 2020.

PERSONAL INCOME ESTIMATES FOR MARYLAND BY MAJOR COMPONENT

Component of Personal Income	2019:Q4	2020:Q1	2020:Q2	2020:Q3
Personal Income ($M)	394,583	399,450	424,349	418,441
Net Earnings ($M)	262,640	266,246	249,674	265,871
Dividends, Interest, and Rent ($M)	76,757	76,985	75,762	75,119
Transfer Receipts ($M)	55,186	56,219	98,913	77,450

Because of this, the positive personal income growth reported by BEA for 2020 is not truly indicative of the economic health of the State or Anne Arundel County. Rather, this data indicates that Maryland personal income would almost certainly have decreased in Fiscal 2020 without Federal stimulus (e.g., if Transfer Receipts had remained relatively consistent, Maryland personal income for the trailing twelve months would have dropped by more than $17B in the second quarter of 2020). While not directly correlated, the SAC believes that County income tax revenue would have also decreased without Federal stimulus. As such, our budget recommendation for Fiscal 2022 does not count on future rounds of Federal stimulus. This is consistent with the approach recommended by the BRE for Maryland as a whole (Ref. MARYLAND REVENUE ESTIMATES, published by the BRE, December 2020).

These concerns increase when looking at projected job growth. In previous years, RESI projected flat job growth in Anne Arundel County through 2024 (reference SAC report for Fiscal 2021 [29 January 2020]). In its December 2020 presentation to the SAC, RESI extended this outlook, predicting that employment in Anne Arundel County will not return to pre-pandemic levels until 2025. In other words, jobs lost in areas such as restaurants, salons, and retail stores are likely gone for the next 5 years. Further, as Federal stimulus expires it will no longer offset lost wages and lost business income. As a result, there is substantial risk that personal income growth will slow in 2021 and beyond.

Long-Term Spending and Personal Income Growth Trends. Analysis of the personal income growth vs. spending growth over the past 10 years further supports our 2% recommendation for Fiscal 2022. The SAC report for Fiscal 2021 was the first to include such an analysis. The primary reason for this is that personal income reports and estimates are frequently updated as actual data becomes available. For example, estimated personal income growth may be 4.0% when budget decisions are made. However, when actual results are reported two years later, growth may come in at only 3.5%. Therefore, if the budget had assumed 4.0% growth, then that budget would have outpaced actual personal income growth. The second reason to look at long-term trends is to account for fluctuations in the approved budget, such as we saw in Fiscal 2020 (budget growth was higher than projected personal income growth) and in Fiscal 2021 (budget growth was lower than projected personal income growth). To account for these fluctuations, the SAC analyzed budget trends over multiple years to determine if County spending growth is in line with personal income growth. In other words, if spending growth out-paces personal income growth in a single year, it is not necessarily cause for concern. However, if spending growth consistently out-paces personal income growth, then it is likely to adversely affect the ability of the taxpayer to finance County services and long-term debt.

With this in mind, analysis provided by the Office of Budget shows that the compound annual growth rate (CAGR) for County spending from 2012 to 2021 was 4.25%. Over the same period, the CAGR for personal income was only 3.51%. County spending increased even faster over the past five years, with a CAGR of 4.54% from 2017 to 2021. Over the same period, personal income grew at a CAGR of only 3.84%. This data clearly indicates that County spending is increasing faster than personal income. Coupled with the lingering economic effects from COVID-19, this increases the possibility that taxes and fees will have to increase in future years to support County spending. The SAC's recommendation for Fiscal 2022 of 2% seeks to avoid placing further burden on County residents, especially those most impacted economically by the COVID-19 pandemic.

Other Factors. The SAC analysis for Fiscal 2022 focused primarily on the economic impacts of COVID-19 and long-term budget trends described above. However, we would like to reiterate other considerations that pose long-term risk to County economic growth.

- **Population Growth and Demographics.** As noted in previous SAC reports, County population growth is slowing. RESI projects annual population growth on the order of 0.5%, and its estimates have steadily declined over the past several years. At the same time, the percentage of the population aged 65 and older is growing at a much faster pace. These demographic changes are likely to have a negative effect on personal income.
- **Shift from Full Time W-2 Employment to Part Time and Self Employment.** Given the economic impact of COVID-19, this trend is likely to continue with a corresponding negative effect on personal income.
- **Real Estate.** RESI-provided data indicates the Anne Arundel County real estate market is strong. The numbers and average price of homes sold at their highest level since 2002, and the inventory of homes for sale in Anne Arundel County is at its lowest level since 2002. This data supports a positive outlook with respect to revenues from property taxes and recordation fees. That said, analysis by the Maryland BRE indicates some concern that property tax revenues may be affected by commercial property value corrections (due to lost rent because of COVID-19) (Ref. MARYLAND REVENUE ESTIMATES, published by the BRE, December 2020). Also of concern is the potential for increased foreclosures when the COVID-19 moratorium on foreclosures is lifted.
- **Impact of Federal Spending.** As noted in previous SAC reports, as much as 30% of County jobs are directly tied to Federal spending (primarily at Ft. Meade). In 2020, this was a tremendous positive for the County, as this spending insulated us from the economic effects of COVID-19. Because of this, the SAC reiterates our previous recommendation that the County continue to pursue policies that minimize the risk of relocation of some or all of Ft. Meade operations to another state.

Conclusion

Based on the analysis presented above, the SAC recommends an increase of 2.0% in the Fiscal 2022 General Fund budget as compared to Fiscal 2021. This recommendation is less than the personal income growth rate currently forecasted by RESI for Anne Arundel County, but is consistent with the average estimate of the State's econometric modeling firms for Maryland as a whole. This recommendation is driven primarily by COVID-19 related uncertainty, and the possibility that COVID-19 related economic impacts may persist for the next several years. The SAC is also concerned that compound annual County spending growth has outpaced compound annual personal income growth over the last 10 years.

The Committee once again extends its heartfelt appreciation to our County employees, especially to Budget Administrator Hujia Hasim and Budget and Management Analyst Hannah Dier. The quality of governmental services that they provide is second to none. We sincerely hope that the evidence assembled for this report will help manage expectations and inform fair and just analysis of the difficult choices facing our elected leaders.

Sincerely,

David G. James, Chair

Spending Affordability Committee Membership for 2020 to 2021:

District	Name	Resolution #	Appointed on	Term Expires
1	Nicole Butler	34-19	9/16/2019	12/1/2022
2	Ejaz Younas, Vice Chair	19-17	5/1/2017	12/1/2020
3	Deborah Ritchie	34-19	9/16/2019	12/1/2021
4	Donny James	34-19	9/16/2019	12/1/2020
5	Mary Clapsaddle, Secretary	34-19	9/16/2019	12/1/2022
6	David Juppe	34-19	9/16/2019	12/1/2022
7	David James, Chair	45-17	10/16/2017	12/1/2021