

January 1, 2009

The Honorable Jack B. Johnson, County Executive  
The Honorable Marilyn M. Bland, Chair, County Council

In accordance with Subtitle 10, Division 1A of the County Code, the Spending Affordability Committee has reviewed the preliminary projections of the County's General Fund revenue (FY 2008 Unaudited, FY 2009 Estimated, and FY 2010 Projected) and has the following findings and recommendations for FY 2010:

### SUMMARY

- **The County is currently projected to experience a \$102.3 million General Fund deficit in FY 2010**, if ongoing expenditures are not reduced to meet ongoing revenues. The revenue projection has assumed 1) an overall \$35 million cut in state aid including \$15 million to the Board of Education and an extra lump-sum \$20 million to overall State aid; 2) flat housing sales prices and volumes in FY 2010; and 3) no significant further decline in the overall economy in FY 2010. The actual revenue picture could turn out to be worse if the housing market continues to decline or the economy deteriorates further in FY 2010. In such cases, the General Fund deficit could be larger.
- The County's General Fund revenue growth in FY 2009 and FY 2010 is projected to slow down significantly. **Total General Fund revenues are projected to be \$2.610 billion in FY 2009 and \$2.582 billion in FY 2010, a growth of 0.1% and a decline of 1.1%, respectively, from the previous year, compared with a growth of 7.7% in FY 2008.** Excluding Outside Aid, County Source Revenues are anticipated to decline by 0.7% in FY 2009 and grow by 1.6% in FY 2010.
- Revenues are expected to slow, reflecting declines in the overall economy. The housing market continues to deteriorate, reducing transfer and recordation taxes and construction permit fees. The economic recession is expected to continue to lower income growth, reduce employment, and increase the unemployment rate. State law changes are expected to reduce income tax receipts. Aggressive cuts to interest rates by the Federal Reserve to combat the credit crisis and the sliding economy have substantially reduced the County's investment income. Many other County-source revenues, including telecommunications tax, admission/amusement tax, and hotel/motel tax, have begun to see negative growth. The State's enormous fiscal challenges mean that State aid to the Board of Education, the Community College, the Library, and the County government is expected to receive additional cuts.
- After a mid-year cut in FY 2009, the State is still facing a potential General Fund deficit of around \$0.4 billion in FY 2009 and \$1.9 billion in FY 2010. Although the slots referendum was passed in November, it is not expected to bring substantial revenues to the State until FY

2011. With the large revenue enhancement package passed in the 2007 Special Session, the State essentially has no other choice this time to balance the budget except making significant cuts to entitlement spending, State agency expenditures, and local aid. Local aid makes up 40% of its General Fund budget, and includes aid to local governments, school boards, community colleges and libraries. Among the total local aid that the State distributes, the County receives about 17%. **The exact magnitude and targets of the cuts is not yet known. The current projection assumes an overall \$35 million State aid reduction in FY 2010, a decrease of 3.5% from the FY 2009 approved budget.**

- Due to the significant use of fund balance in recent years and a potential fiscal gap that would require additional use of fund balance in FY 2009, the County's undesignated fund balance is projected to be largely eliminated by the end of FY 2010. Therefore, in FY 2010, the County must avoid another fiscal gap that would eat into the contingency and operating reserves. **The Charter-required 5% contingency reserve and the financial policy-required 2% operating reserve must be maintained.** Any depletion of such reserves could cause bond rating downgrades by Wall Street that would jeopardize the County's fiscal integrity and borrowing capacity in the tightened credit market.
- Under the serious revenue constraints in FY 2009 and FY 2010, the County must maintain its prudent fiscal policies and take stringent measures to make sure that current expenditures stay within current revenues. In order to meet the financial challenges in FY 2009, the County has essentially exhausted all options on the revenue side including increases in taxes, fees, and intergovernmental recoveries, as well as employment of one-time revenue enhancement strategies. In order to reach a balanced budget in FY 2010, **the County must ensure that expenditures are consistent with expected revenues.**
- To balance expenditures with projected revenues, the Committee recommends **a ceiling on total General Fund appropriations for FY 2010 at \$2.582 billion, which includes \$1.632 billion for the Board of Education and \$90.7 million for debt service.**

**The Committee's preliminary revenue recommendations for FY 2010 are:**

(\$ in millions)

	FY 2008 Unaudited	Variance vs. FY07 Actual	FY 2009 Estimated	Variance vs. FY08 Unaudited	FY 2010 Projected Preliminary	Variance vs. FY09 Estimated
<b>COUNTY SOURCE REVENUES</b>						
Property Tax	609.7	11.0%	659.1	8.1%	705.1	7.0%
Income Tax Receipts	404.2	4.2%	410.5	1.6%	397.2	-3.2%
Income Disparity Grant	19.1	19.7%	21.7	13.6%	21.7	-0.1%
Transfer Taxes	98.4	-37.8%	69.9	-29.0%	69.9	0.0%
Recordation Taxes	38.4	-39.7%	28.7	-25.2%	28.7	0.0%
Energy Tax	62.7	15.4%	62.7	0.0%	62.7	0.0%
Telecommunications Tax	47.4	-5.4%	45.7	-3.5%	46.2	1.0%
Other Local Taxes	22.0	13.7%	19.6	-11.1%	20.1	2.8%
State-shared	28.8	-4.5%	27.1	-6.0%	27.6	2.0%
Subtotal Taxes	1,330.7	0.1%	1,345.0	1.1%	1,379.2	2.5%
Licenses and Permits	20.7	-24.6%	16.8	-18.8%	16.9	0.4%
Use of Money and Property	44.5	4.7%	20.1	-54.7%	14.7	-27.0%
Charges for Services	26.8	9.5%	26.2	-2.4%	28.1	7.4%
Intergovernmental Revenue	32.3	7.9%	33.3	3.1%	32.3	-2.8%
Miscellaneous	2.6	-23.6%	3.0	15.5%	3.1	5.5%
Other Financing Sources	28.9	18.5%	31.4	8.6%	25.0	-20.3%
Subtotal Other Sources	155.8	2.4%	130.8	-16.1%	120.2	-8.1%
<b>Subtotal County Sources</b>	<b>1,486.5</b>	<b>0.4%</b>	<b>1,475.8</b>	<b>-0.7%</b>	<b>1,499.4</b>	<b>1.6%</b>
<b>OUTSIDE AID</b>						
Board of Education	1,056.4	20.0%	1,064.4	0.8%	1,031.7	-3.1%
Community College	55.8	8.0%	61.5	10.1%	62.4	1.5%
Library	8.5	12.7%	8.1	-5.0%	8.1	0.0%
Subtotal Outside Aid	1,120.7	19.3%	1,134.0	1.2%	1,102.1	-2.8%
<b>LUMPSUM STATE AID CUTS ASSUMED</b>					<b>(20.0)</b>	
<b>GRAND TOTAL</b>	<b>2,607.2</b>	<b>7.7%</b>	<b>2,609.8</b>	<b>0.1%</b>	<b>2,581.6</b>	<b>-1.1%</b>

Note:

The numbers may not add due to rounding.

**REVENUE ASSUMPTIONS**

**Property Tax**

Despite the continuously weakening real estate market, overall property tax revenues are expected to increase by 8.1% in FY 2009 and 7.0% in FY 2010.

- **Real Property Tax** revenues are projected to maintain a relatively strong but slower growth at 7.9% in FY 2010, compared with 9.5% in FY 2009 and 12.0% in FY 2008, based on the most recent assessable base projection by the State Department of Assessments and Taxation

(SDAT). By January each year the SDAT reassesses one third of the properties in the County and the assessment growth is phased in over the next three fiscal years. The comparatively high assessment values of two thirds of County properties that were reassessed by January 2007 and January 2008 will be carried over to FY 2010. On the other hand, the assessment value of the remaining one third properties that were reassessed recently (data to be released by January 2009) have also been factored into the most recent SDAT projection and have reduced the growth of the overall County real property base.

Another reason for the continuous growth of County property tax revenues in a housing market downturn is the Homestead Tax Credit. The Credit ensures that the annual percentage growth of the taxable assessment value for principal residential homes will not surpass the growth of the Consumer Price Index. Therefore, the difference between the assessment value and the taxable value, although shrinking, leaves room for continuous taxable base growth in FY 2010.

The homestead tax credit policies do not apply to commercial properties, which comprise about 25% of the County's total taxable base. This is a major reason for the County's significant property base growth during the housing market boom. However, the ongoing declines in the value of many commercial properties, together with further declines in residential property values, are expected to bring down the growth of the property base significantly in future years.

The most recent SDAT projection indicates that the County will have an assessment growth of 20.0% for FY 2009 and 12.4% for FY 2010 in terms of the total real property base. This is before deducting the loss due to the Homestead Tax Credit.

- **The Homestead Tax Credit** is expected to result in a revenue loss of \$230.9 million in FY 2010, compared with \$195.4 million in FY 2009. (The Homestead Tax Credit percentage has been adjusted from 3% for FY 2009 to 5% for FY 2010 based on the Consumer Price Index.) The Homestead Tax Credit cap limits the County from fully realizing revenue gains from reassessment growth. The 2007 laws of Maryland (HB436) require homeowners in the State to file applications to the SDAT to qualify for the homestead property tax credit. The credit won't be granted unless an application is filed and the eligibility for such credit is confirmed. According to the implementation steps, approximately two thirds of the County's homeowners need to file applications to qualify for the FY 2010 tax credit.
- **Personal Property Tax** base of the County is projected to decrease by 1.2% in FY 2010, based on the most recent SDAT estimates. Revenues are projected to decrease accordingly. The FY 2009 base is projected to remain flat from FY 2008 but revenues are anticipated to decline slightly due to potential higher default rates and litigation costs.

## **Income Tax**

- **Income tax receipts** are projected to increase by 1.6% in FY 2009 and decrease by 3.2% in FY 2010. This assumes a baseline growth of 1.5% and 1.0%, respectively, for FY 2009 and FY 2010, based on employment and personal income growth trends. In FY 2008, income tax

receipts increased by 4.2% with reconciliations from FY 2007, when the County experienced a tentative income tax revenue loss due to State distribution policy changes in line with the Federal extension of the tax return filing deadline. This growth is overstated based on the fact that part of the FY 2008 revenue loss due to the extended personal income exemptions will not be realized until FY 2009. Excluding the impact of distribution policy, state law, and County tax rate changes, the baseline growth for FY 2008 is around 2.0%. This represents a slowdown from previous years.

The extended personal income exemption is expected to cause significant revenue loss in FY 2009. However, the impact is not likely to be fully realized in FY 2009 as it takes time for all employers to adjust employee withholdings in accordance with the new law. In addition, the State recently decided to maintain the current distribution formula, which may lead to an over-distribution of income tax receipts to local jurisdictions in FY 2009. However, the potential over-distribution in FY 2009 will be corrected by the reconciliations in FY 2010 and following years. Therefore, County income tax receipts are projected to decrease in FY 2010.

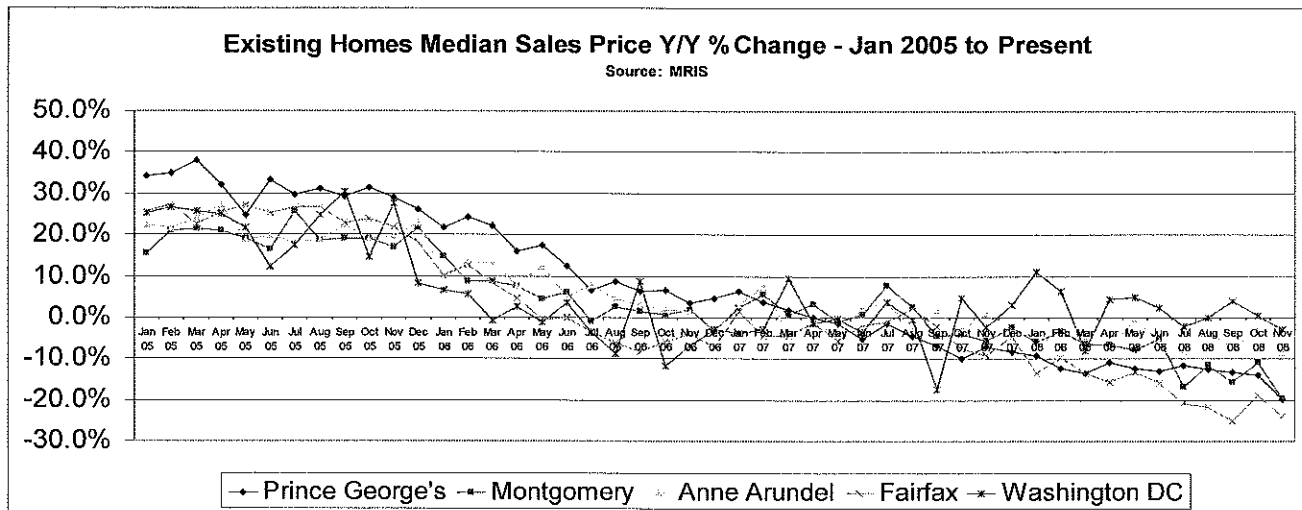
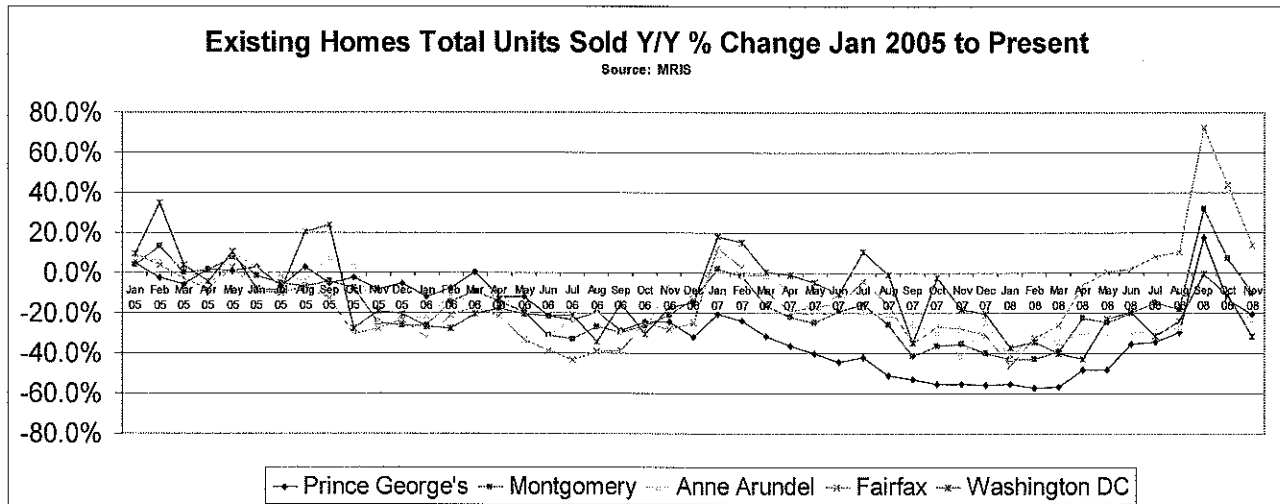
The County reduced its income tax rate from 3.2% to 3.1% in January 2007, and raised it back to 3.2% effective January 2009.

- **The State Income Tax Disparity Grant** in FY 2010 is projected to decrease slightly from FY 2009, based upon calculations done by the State Department of Budget and Management. The disparity grant brings each jurisdiction's per capita income tax level to 75% of the State average. Due to demographic changes and lower capital gains, the County's personal income growth in recent years has been lagging behind the State average, and as a result, the County's disparity grant had been increasing in the past few years. The FY 2010 grant amount, however, is slightly lower than that of FY 2009 due to a slight decrease in County population based on the Census Bureau's estimate for July 1, 2007. (The FY 2010 grant is calculated based on tax year 2007 average local income tax revenues and calendar year 2007 local population.)

### **Transfer and Recordation Taxes**

- Transfer Taxes are expected to decrease by 29.0% in FY 2009 and remain flat in FY 2010. Recordation taxes, which had a rate increase effective on July 1, 2008, are anticipated to decline by 25.2% in FY 2009 and remain flat in FY 2010. The projections assume an estimated 10% further decrease in home sales volume and a 10% additional decrease in home sales price for the remainder of FY 2009, and flat sales prices and volumes in FY 2010.
- The County's real estate market has been continuously weakening. In FY 2008, transfer and recordation tax revenues declined by over 38% from FY 2007. The first five months of FY 2009 experienced a further decline of about 36% from the same months in FY 2008.
- Based on the Metropolitan Regional Information System (MRIS) data, monthly sales volume for existing homes decreased year-over-year by 51% on average in FY 2008, and sales prices decreased by over 9%. The first five months of FY 2009 saw continuous declines in both

sales volume and price by another 18% and 14%, respectively. The existing home inventory in the County is over 7,000 units currently, compared with a normal level of about 1,000 units. Therefore, the local housing market is not expected to bottom out anytime soon. Further decreases in sales price and volume are expected for the rest of FY 2009 and probably part of FY 2010.



## Energy Tax

- Energy Tax revenues are projected to be largely flat from FY 2008 in both FY 2009 and FY 2010, assuming normal weather, slightly higher rates, and slightly lower consumption. The FY 2010 tax revenues are determined by the FY 2010 consumption units as well as the rates that are calculated based on Calendar Year 2008 energy prices. Effective July 1, 2008, the sale and use of energy by the Washington Suburban Sanitary Commission is no longer exempt from the County's Energy Tax, which is projected to bring the County \$0.7 million additional revenues per year.

## Telecommunications Tax

- The Telecommunications Tax is expected to decrease by 3.5% in FY 2009 and increase by 1.0% in FY 2010, based on the decreasing revenue trend in recent months and an assumed stabilization in FY 2010. FY 2008 shows a 5.4% revenue decrease from FY 2007 because of a \$3.1 million one-time gain in FY 2007 from prior year adjustments. Starting in FY 2005, the Telecommunications Tax revenue has factored in up to 10% dedicated for capital budget expenditures authorized by Chapter 187 of the 2004 Laws of Maryland (HB 589).

## Other Local Taxes

Other Local Taxes, which include a few taxes (such as Admissions and Amusement Tax and Hotel/Motel Tax) whose performances are closely related to the economy, are projected to decrease by 11.1% in FY 2009 and increase by 2.8% in FY 2010.

- **Admissions & Amusement Tax** has been fluctuating slightly in recent years based on weather, economic conditions, and local amusement and athletic events. FY 2008 tax revenue was 11.9% higher than that of FY 2007 due to strong revenue collections from athletic events. The revenue is expected to experience a significant decrease in FY 2009 based on considerably lower-than-expected first-quarter collections. It is then expected to grow modestly by 3.0% in FY 2010.
- **Hotel/Motel Tax** is expected to decrease by 3.5% and 1.0%, respectively, in FY 2009 and FY 2010. This projection is based on the decreasing revenue collection in recent months and has factored in the short-term impact of the Presidential Inauguration. (The revenue impact of the National Harbor project is not factored in due to the dedication of hotel/motel taxes in the Special Taxing District to funding bonds issued for infrastructure and the Convention Center.)

## State-Shared Taxes

- The State is projecting a General Fund deficit of about \$0.4 billion in FY 2009 and \$1.9 billion in FY 2010. This is after the Governor and the Board of Public Works' approval of a \$300 million mid-year cut package, which include a \$17 million reduction to local aid, in October 2008. Due to the projected deficit for FY 2010, the State will have to make significant cuts to State programs and local aid in FY 2010. Without knowing the magnitude

and targets of the State's cuts, the current projection tentatively assumes a \$15.0 million cut to the Board of Education (including the 1% mandated increase approved by the 2007 Special Session) and an additional lump-sum \$20 million cut to State aid in FY 2010. The actual cut could be larger than that. It could be concentrated on a few State aid revenues or be distributed to different categories such as state-shared taxes, grants to County governments, or State aid to the Board of Education, Community College and Library.

- Highway User Revenues decreased by 3.7% in FY 2008 due to reductions in gasoline consumption as prices rose. The revenue is projected to decline further by 6.0% in FY 2009 and grow modestly by 2.0% in FY 2010, based on the economic conditions. It should be noted that this projection is before factoring in the possibility that the State may reduce the local share of the revenues as part of its strategy to deal with its own financial pressures. In fact, this happened in FY 2004 when the State faced significant financial challenges.

### **Licenses and Permits**

- License and Permit revenues are projected to drop by 18.8% in FY 2009 and grow by 0.4% in FY 2010, due to an expected continuous decrease in building and street use permits in FY 2009 and an assumed turnaround in FY 2010. Applications for residential and commercial construction permits are anticipated to be continuously weak over the next year based on slow sales and high inventory. According to the Permit Division of the County's Department of Environmental Resources, the average number of residential building permits issued per month for single family homes dropped by 30% on average in FY 2008. The first four months of FY 2009 saw an additional drop of 49% from FY 2008.

### **Use of Money and Property**

- The receipts from Use of Money and Property are expected to drop by 54.7% in FY 2009 and 27.0% in FY 2010. Interest income, in particular, is projected to decrease by 48.4% in FY 2009 and 28.4% in FY 2010. The projection assumes that short-term interest rates will average slightly above 1% in FY 2009 and FY 2010.

### **Charges for Services**

- Charges for Services are expected to decrease by 2.4% in FY 2009 and increase by 7.4% in FY 2010. Significant increases in emergency transportation fees are assumed due to approved rate increases and the conversion to a new collection vendor. The FY 2009 projection has factored in the approximate \$1.0 million mid-year cut to State reimbursements to the County for holding State-sentenced prisoners in County corrections facilities.

### **Intergovernmental Revenues**

- It is anticipated that total intergovernmental revenues will grow by 3.1% in FY 2009 and decline by 2.8% in FY 2010. The increase is mainly due to increased reimbursements from the Maryland-National Capital Park and Planning Commission (M-NCPPC) and from the Revenue Authority for County-provided services starting in FY 2009. The decline in FY

2010 is attributed to the removal of the \$1.1 million fire grant from General Fund to a special revenue fund starting in FY 2010. The Electricity Deregulation Grant, which used to generate \$7.5 million per year for the County, was permanently eliminated by the 2007 Special Session.

- This projection has not factored in any potential impact from additional federal aid to state and local governments due to the unknown timing, magnitude, and nature of such aid at this time.

### **Miscellaneous Revenues**

- Miscellaneous revenues are projected to increase by 15.5% in FY 2009 and 5.5% in FY 2010. The traffic light revenue is assumed to increase in both years due to the introduction of a new vendor and new technology. There are some one-time miscellaneous receipts in FY 2008 that are not anticipated to be realized again in FY 2009 and FY 2010.

### **Other Financing Sources**

- FY 2010 preliminary projection assumes a \$25.0 million use of fund balance. The \$27.2 million use of fund balance approved for FY 2009 includes \$8.0 million for CIP pay-go, \$12.0 million for Dimensions Health Corporation, and \$7.2 million for other one-time operating costs.

### **Board of Education (BOE) Aid**

- Board of Education Aid is tentatively projected to decrease by 3.1% in FY 2010. This assumes a slight decline in the student enrollment number, no use of Board fund balance, and a 1% increase in Federal grants and the Board's own-source revenues (except fund balance). The actual aid amount may vary depending on the actual student enrollment number and the actual magnitude and targets of the State's cuts to local aid. Most of the information will not be available until late in January.

HB1 of the 2007 Special Session froze inflation in the per pupil amount used in the education aid formulas for FY 2009 and FY 2010. It also establishes supplemental grants that ensure a 1% annual increase in State aid for school systems during the two years of the freeze. However, due to the State's severe fiscal constraints in FY 2010, this mandate, together with others, will be reviewed. In FY 2009, the Governor funded 60% of the Geographic Cost of Education Index (GCEI) and intended to fully fund the index in FY 2010. However, this goal will also be reviewed based on the magnitude of the State's potential deficit. The risk of a reduction to the current funding level does exist. Another risk to the County in terms of education aid is that the State may consider transferring part of the teachers' pension cost to local jurisdictions. With a statewide annual liability of over \$600 million and the County's portion of approximately \$95 million, the transfer, if adopted, would pose a serious threat to the County's budget in FY 2010. On the other hand, instead of potential cuts to a few major programs, it is also possible that the State may spread cuts proportionally across the board to different programs.

\$42.9 million is approved in FY 2009 for use of BOE fund balance, although the Board is expected to reduce spending in order not to use all \$42.9 million of fund balance, in accordance with the County's \$14.0 million reduction in the County contribution. The Board is not planning to use any fund balance for FY 2010 based on the Superintendent's budget.

### **Community College Aid**

- Community College Aid in FY 2010 is not expected to grow materially from the FY 2009 budgeted level. This assumes that there will be no Cade Formula increases due to the State's fiscal condition and that the full-time equivalent (FTE) count used in the Cade Formula does not change significantly from the FY 2009 count. No increase in tuition and fees is assumed. Revenue from the Maryland-National Capital Park and Planning Commission is expected to remain stable. The estimated revenue in FY 2009 is \$0.92 million lower than the budget due to the State's mid-year cut.

### **Library Aid**

- Library Aid is expected to remain level in FY 2010. State Aid is not expected to increase due to the State's Fiscal condition under the assumption that the Legislature will not implement scheduled increases to the Library Aid Formula. The Library's own revenue from fees, fines, rentals and other miscellaneous revenue is expected to be constant. The Library may be required to utilize fund balance to pay about \$750,000 of OPEB expense.

## **EXPENDITURE SUMMARY**

- The Committee recommends an overall spending ceiling of \$2.582 billion in FY 2010, which is \$91.9 million or 3.4% lower than the FY 2009 approved budget. The following are spending ceilings as defined by Sec. 10-112.22 of the County Code for FY 2010:

### **Board of Education**

- \$1.632 billion (decrease of \$46.8 million compared with the FY 2009 budget), including \$1.032 billion outside aid (assuming no additional reduction as a share of the lump-sum \$20 million). Outside aid is projected to drop by \$32.8 million or 3.1% from the FY 2009 budget due to the assumed elimination of the 1% increase mandate, no use of Board fund balance, and an additional \$5 million miscellaneous State aid reduction. With a total outside aid of \$1.032 billion, the Board of Education is expected to receive approximately 36.8% of its support from County-Source revenues in FY 2010, compared with 36.6% in the FY 2009 approved budget. However, if the actual outside aid turns out to be lower than \$1.032 billion, the percentage for the County contribution will be higher.

### **Debt Service**

- \$90.7 million (increase of \$19.0 million from the FY 2009 budget, or 26.5%) based on \$100 million new General Obligation Bond (GOB) to be issued in the spring of 2009 (excluding

GOB supported by mass transit and enterprise funds). The FY 2009 budget for debt service was particularly low (at \$71.7 million) because of the one-time use of additional school surcharge funds to support General Fund debt service related to school projects. This one-time approach is not expected to be realized again in FY 2010.

**All Others**

- \$858.7 million (a decrease of \$64.1 million from the FY 2009 budget, or -6.9%) is anticipated for all other spending. This spending category includes all General Fund support for County services and operations except for debt service and payments to the Board of Education listed in the preceding paragraphs. All funding to support these expenditures would come from various revenue sources, with the majority coming from County income and property taxes.

**FUND BALANCE**

- The year-end fund balance for FY 2008 is \$251.8 million, with an undesignated portion of \$65.0 million. The total fund balance amount is expected to be \$204.1 million for FY 2009 and \$179.1 million for FY 2010 (assuming the FY 2010 budget will be balanced without deficit and only \$25.0 million fund balance will be utilized for pay-go and other one-time expenses in FY 2010 and in FY 2011, respectively, which will be reserved at the end of FY 2009 and FY 2010). The following chart shows the projected breakdown between the charter-required 5% contingency reserve, the policy-required 2% operating reserve, and the undesignated fund balance (assuming a balanced budget in FY 2010).

	<b>Actual June 30 FY 2007 Balance</b>	<b>Estimated June 30 FY 2008 Balance</b>	<b>Projected June 30 FY 2009 Balance</b>	<b>Projected June 30 FY 2010 Balance</b>
<b>GENERAL FUND</b>				
Operating Reserve	\$ 49,013,927	\$ 53,358,776	\$ 52,649,200	\$ 51,631,400
Contingency Reserve	122,534,815	133,396,940	131,622,900	129,078,500
Undesignated Fund Balance	103,869,922	65,020,316	19,807,800	(1,630,000)
<b>TOTAL GENERAL FUND</b>	<b>\$ 275,418,664</b>	<b>\$ 251,776,032</b>	<b>\$ 204,079,900</b>	<b>\$ 179,079,900</b>

**POTENTIAL RISKS & CHALLENGES**

- Although this projection has already shown a revenue decrease of 1.1% in FY 2010, the actual revenue decline could be more severe, if the State makes larger cuts to local aid than estimated in order to close the State’s projected \$1.9 billion budget gap. The GCEI funding is considered at risk. There is also discussion about shifting the state-wide \$600 million annual cost for teachers’ pension to local governments.

- The local housing market slump could last longer than what is assumed in this projection. The current projection assumes a continuous weakening in FY 2009 scaled slightly down from the present pace and a gradual bottom-out beginning in mid FY 2010 (or late calendar year 2009). This may not actually begin until the accumulated inventory is consumed. Based on the current housing inventory and monthly sales volume, it will take one year to fifteen months for the inventory level to return to normal, which means a recovery potentially in late FY 2010 (or early to mid calendar year 2010).
- The subprime mortgage crisis and credit crunch have caused huge turmoil on Wall Street. Lenders have become more cautious about extending credit to households and businesses, which could prove a further drag on economic growth. As the crisis unfolds and extends globally, its impact on the economy could be more severe and lasting. The current projection assumes a normalization of the credit market and no further decline in the economy by mid FY 2010 (or late calendar year 2009). If the current crisis in the financial markets is not resolved, the economic recession may last longer and this assumption may no longer hold.
- The projection assumes average short-term interest rates above 1% in FY 2009 and FY 2010. There could be further downward risk based on the recent sharp declines in market interest rates.

## **CONCLUSIONS & RECOMMENDATIONS**

- The fiscal conditions in FY 2010 will doubtlessly be one of the most challenging in the County's history. The budget is expected to drop by \$91.9 million or 3.4% from FY 2009. A potential deficit of \$102.3 million is projected prior to any actions taken to balance the budget. The County will not only face significant reductions in major County source revenue growth, but will also have to absorb part of the State's enormous fiscal deficit. Practically, the County has raised taxes and fees recently and does not have much flexibility for additional tax increases based on both statutory and economic restrictions. On the expenditure side, in order to balance the FY 2009 budget, the County has employed many one-time cost-saving approaches, which cannot be repeated in FY 2010. The County nevertheless must maintain its fiscal accountability under these difficult fiscal circumstances.
- The Committee would recommend the County continue to preserve the Charter required 5% contingency reserve and the financial policy required 2% operating reserve in FY 2010. Depletion of such reserves could possibly cause bond rating downgrades by Wall Street, jeopardizing the County's fiscal integrity and borrowing capacity in a tight credit market. Due to the significant use of fund balance in recent years and a potential fiscal gap that would require further use of fund balance in FY 2009, the County's undesignated fund balance is expected to be eliminated by the end of FY 2010. Therefore, it is critical for the County to make sure that the FY 2010 budget will remain in balance throughout the fiscal year without incurring an additional budget gap that could eat into the operating reserve. In addition, the County is still faced with many long-term liabilities such as the Other Post-Employment Benefit (OPEB) (fully fund retiree benefits with a total liability of \$1 billion and eventually a yearly contribution of approximately \$80 million based on the requirements

of the Government Accounting Standards Board), the risk management fund deficit, as well as potential mandates from the State as they attempt to resolve their own budget deficit.

- Due to the serious revenue constraints in FY 2009 and FY 2010, the Committee again urges the County to explore all options for assuring that spending stays strictly within the revenue limits.
- The Committee suggests that the Office of Management and Budget (OMB) monitor and analyze revenues and expenditures closely on a regular basis and prepare monthly reports for County leadership's review. It is critical to make timely adjustments to revenue and expenditure projections so that additional control mechanisms can be introduced as needed.
- Under significant fiscal constraints and with competing demands for services, the Committee recommends fully utilizing and improving the County's performance management system entitled Charter for Change to realize savings and improve operational efficiency. This is important within the current fiscal environment because the performance management system focuses agency services on achieving specific outcomes which may mean the removal or reduction of services that do not positively affect their outcomes. It also provides an evaluation tool to facilitate more efficient and effective service delivery and allows for prioritization of services. In addition, the County has implemented in FY 2009 a gain-sharing Cost Savings and Incentive Program (CSIP). The program is expected to reduce agency costs through systemic changes that improve efficiency, reduce resource needs, and maintain or improve agency performance.

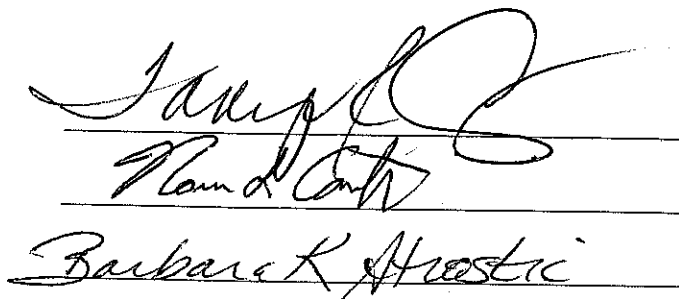
The Committee wishes to thank both the Executive and Legislative Branches of government for the opportunity to review the County's revenue forecast. We believe that we have performed due diligence in reviewing revenue estimates for FY 2009 and FY 2010 and believe them to be reasonable.

Respectfully,

Tanya R. Curtis

Norman Carter

Barbara K. Atrostic



The image shows three handwritten signatures, each written over a horizontal line. The top signature is for Tanya R. Curtis, the middle one is for Norman Carter, and the bottom one is for Barbara K. Atrostic. The signatures are written in dark ink and are somewhat stylized.