October 2, 2023

The Honorable Angela Alsobrooks, County Executive
The Honorable Thomas E. Dernoga, 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 Office of Management and Budget (OMB) for General Fund revenue for the next fiscal year (FY). This letter summarizes the Committee's preliminary findings and recommendations on spending limits for FY 2025.

Based upon a review of various economic and revenue information and trends, the Committee concurs with the preliminary OMB General Fund revenue projection of $4.54 billion in FY 2025, an increase of only $25.1 million or 0.6% above the FY 2024 Approved Budget due to outside aid. Projected County-sourced revenue of $2.5 billion in FY 2025 represents a decrease of -$57.6 million or -2.2%. (See **Exhibit 1**). Based upon the forecasted revenues, the Committee's preliminary spending limit recommendation is $4.54 billion. The Committee understands that this spending limit will present a significant and growing shortfall of revenue to meet required and expected expenditures. Therefore, the Committee, although charged with recommending spending limits, feels compelled to highlight its concern with the projected large gap between revenues and spending, and highlight an area where revenues can be increased and urge the County to begin reducing expenditures.

Exhibit 1

Prince George's County
Summary of Current and Projected General Fund Revenue
($ in Millions)

	FY 2022 Actual	FY 2023 Unaudited	FY 2024 Approved	FY 2025 Forecast	FY 22-23 % Change	FY 23-24 % Change	FY 24-25 % Change
County-Sourced Revenues							
Subtotal County-Sources	$2,362.6	$2,362.2	$2,562.0	$2,504.4	0.0%	8.5%	-2.2%
Subtotal w/o Fund Balance	2,362.6	2,362.2	2,505.3	2,504.4	0.0%	6.1%	0.0%
Outside Aid							
Subtotal Outside Aid	1,601.9	1,895.8	1,951.6	2,034.3	18.3%	2.9%	4.2%
Grand Total	**$3,964.6**	**$4,258.0**	**$4,513.6**	**$4,538.7**	**7.4%**	**6.0%**	**0.6%**
Grand Total w/o Fund Balance	**3,964.6**	**4,258.0**	**4,456.9**	**4,538.7**	**7.4%**	**4.7%**	**1.8%**

Source: Prince George's County Office of Management and Budget

The projected deficit is due in part to revised revenue estimates, but also due to the higher funding requirements imposed by the State's Blueprint for Maryland's Future initiative. Most concerning is the deficit gap widens, from -$183 million in FY 2025 to -$387 million in FY 2030, and the Committee believes that the County will need to address it through a combination of unspecified General Fund revenue increases, spending reductions and very limited use of fund balance only for one-time spending. To this end the Committee feels strongly that the County begin adopting cost containment actions in the current fiscal year.

The Committee is also concerned that projected property tax revenues will not cover the increased spending needs from the Stormwater Management Enterprise Fund, to address State mandates and the effects of climate change. Without higher property tax revenue dedicated to that Fund, the already stressed County General Fund will need to provide additional resources. Finally with respect to reserve levels, the Committee recommends that the County continue to increase the level of the policy reserve from 3% to 4% of general fund spending in FY 2025. A three-year phase-in from 2% to 5% was recommended by the Committee in its January 2023 letter. In combination with the 5% Charter-required reserve, it is important that the County strive to achieve a combined 10% reserve level so that it can have the resources to maintain critical government operations for emergency purposes and to help maintain its "AAA" bond rating.

Economic Outlook

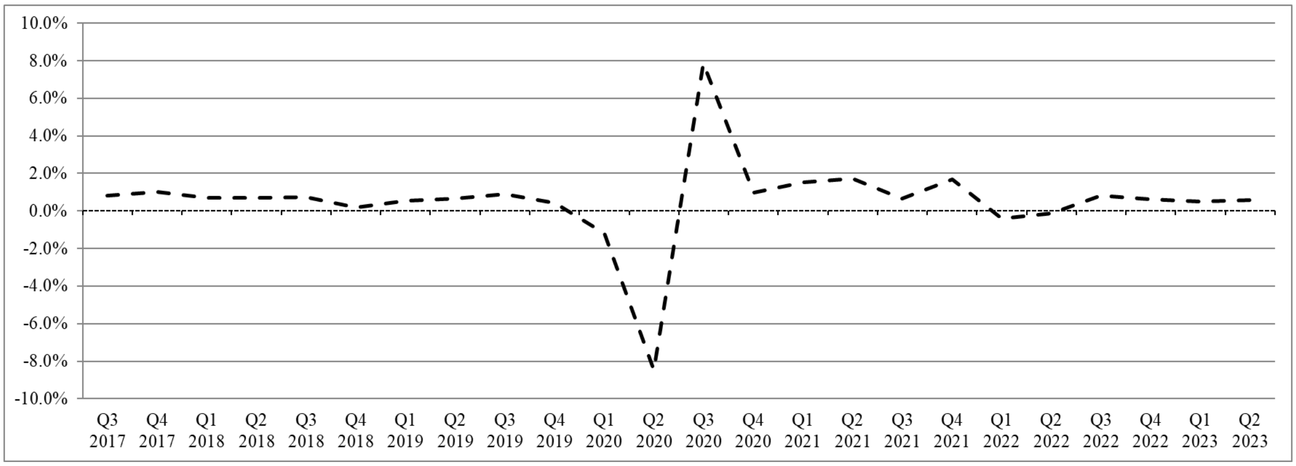
Following the pandemic, a shortage of labor required employers to raise wages while supply chain issues constrained the availability of goods. This resulted in higher inflation than the country had seen in 40 years. To address cost growth, the Federal Reserve Board has raised interest rates 11 times since the spring of 2022. Inflation has decreased but not quite to the 2% target level. Mortgage rates in the range of 7% have had a significant downward effect on home sales. Federal stimulus programs, which were critical to maintaining businesses and consumer income during the recession, also influenced income tax revenue. With the end of stimulus aid, County revenues are being impacted.

The pandemic caused U.S. Gross Domestic Product (GDP) to fall in the second quarter of calendar year (CY) 2020, due to nationwide shutdowns. As the economy re-opened, economic activity rebounded and then stabilized. Although GDP decreased in the first and second quarters of CY 2022, which has historically been an indication that the U.S. is experiencing a recession, unemployment has remained very low, and GDP has since rebounded to pre-pandemic levels. **Exhibit 2** illustrates GDP trends before and following the global pandemic.

In March 2020 the closure of the economy due to the pandemic caused the loss of 20 million jobs. The economy began to re-open in the summer of 2020 and the mass distribution of vaccines in 2021 led to an uneven recovery of employment as seen in **Exhibit 3**. Spurred by rising wages due to higher inflation and labor shortages, employment levels surpassed pre-pandemic levels in the fall of CY 2022, standing at over 156 million jobs as of June 2023. There continues to be more job openings than available workers; a result thought to be a combination of retirements, deaths, long-COVID, caregiving and other factors.

Exhibit 2

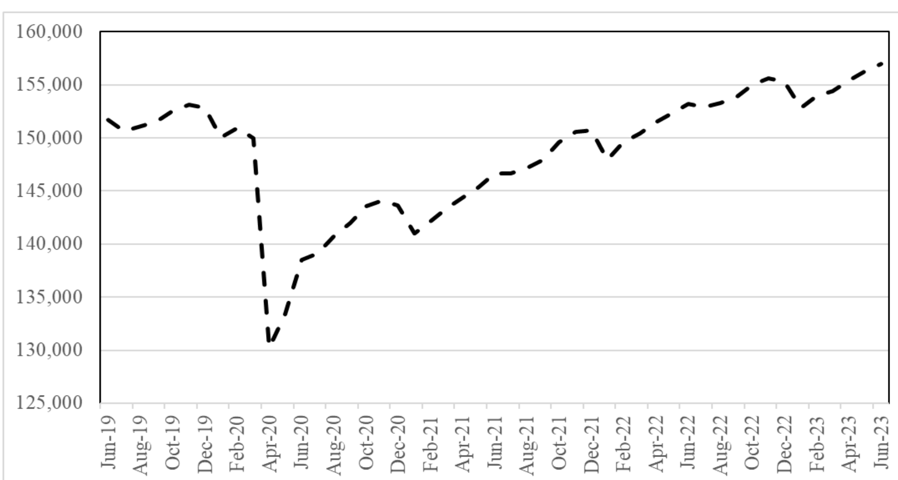
National Gross Domestic Product
CY 2017 3rd Quarter – CY 2023 2nd Quarter



Source: Bureau of Economic Analysis

Exhibit 3

United States Non-Farm Monthly Payroll Employment Change
CY 2019 2nd Quarter – CY 2023 2nd Quarter
(in Thousands)

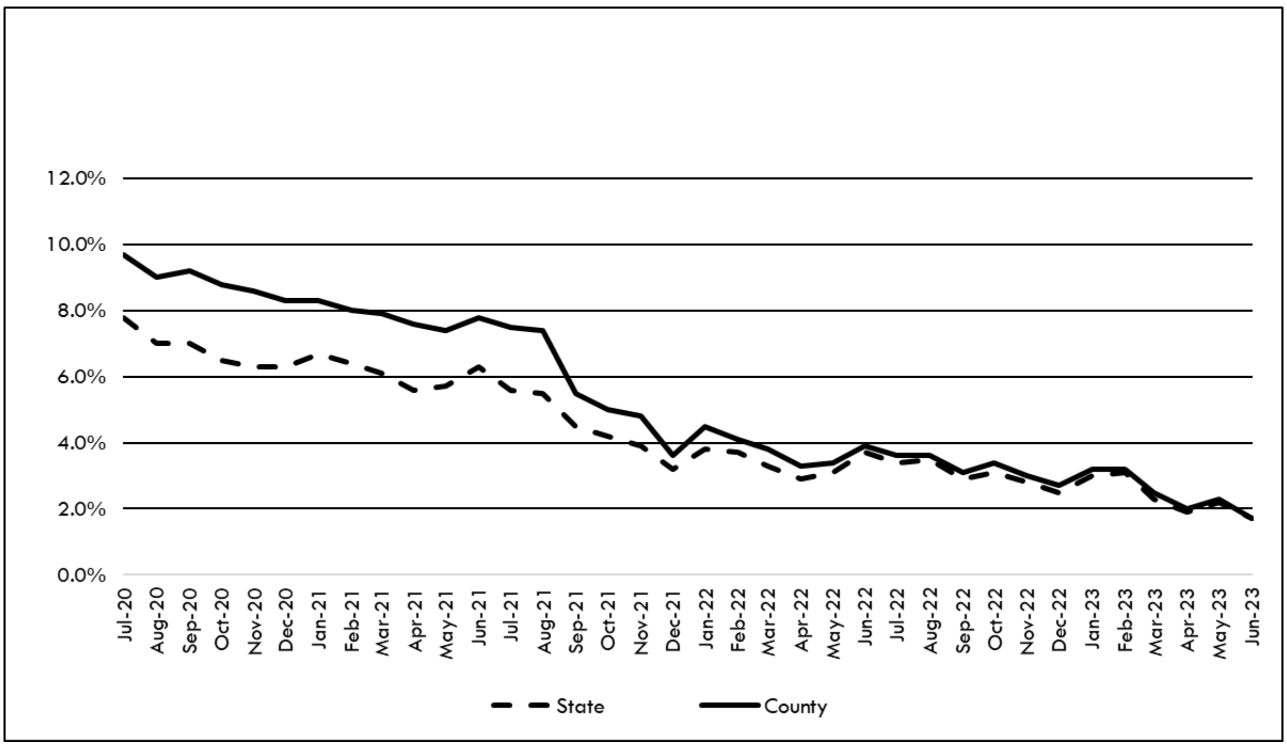


Source: Bureau of Labor Statistics

Exhibit 4 compares the unemployment rate in the County with the statewide average. From March 2020 to March 2022 unemployment levels in the County were higher than the State, due to a variety of factors. But as the economy rebounded there have been more jobs than job seekers and unemployment rates have plunged to record low levels. As of June 2023, the unemployment rate was 1.7% for both the County and the State. This rate is much lower than pre-pandemic levels. Low unemployment is important for consumer spending, which is a large component of the economy.

Exhibit 4

Unemployment Rate
Prince George's County vs. State of Maryland
July 2020 – July 2023

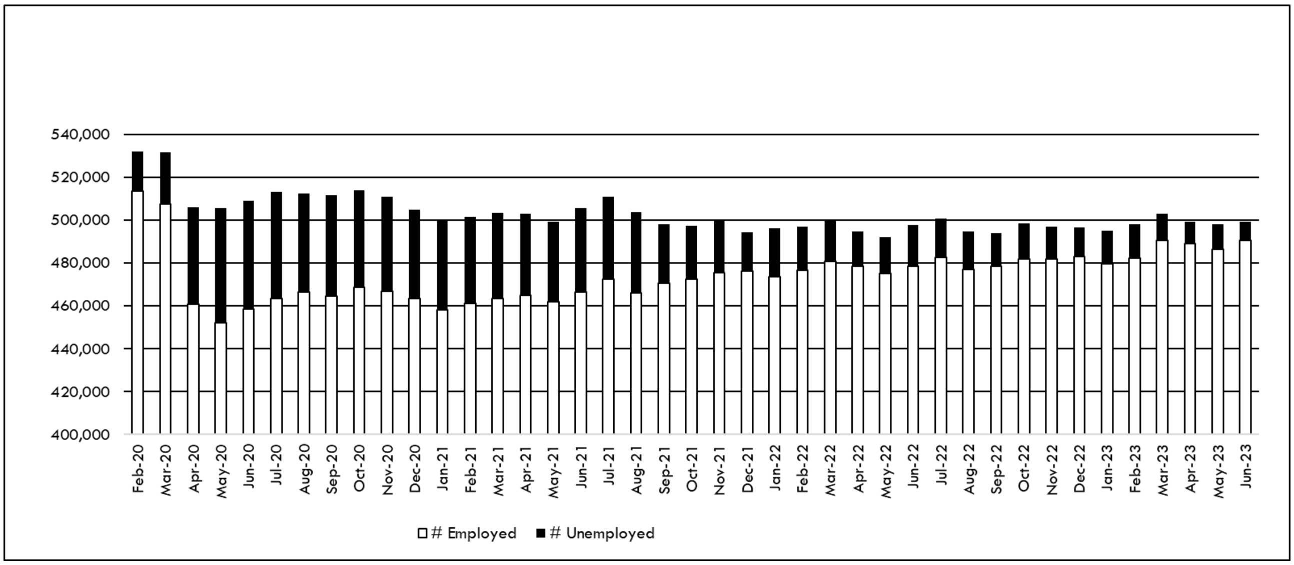


Source: Maryland Department of Labor

Exhibit 5 provides data on the County's labor force. At its peak in February 2020, the total number of employed and unemployed residents stood at approximately 532,000. For the rest of CY 2020 it averaged 512,000; a decrease of about 20,000 either working or seeking employment. The unemployment rate was higher during the national shutdown, reaching 12% by May 2020. While employment levels have grown to record high levels, the size of the County labor force plateaued at around 499,000. As of June 2023, the labor force stood at 499,125. Unless there is population growth within the County, the labor force may remain at this level. This could limit income tax revenue only to the level of wage growth.

Exhibit 5

Prince George's County Labor Force Trends
February 2020 – June 2023



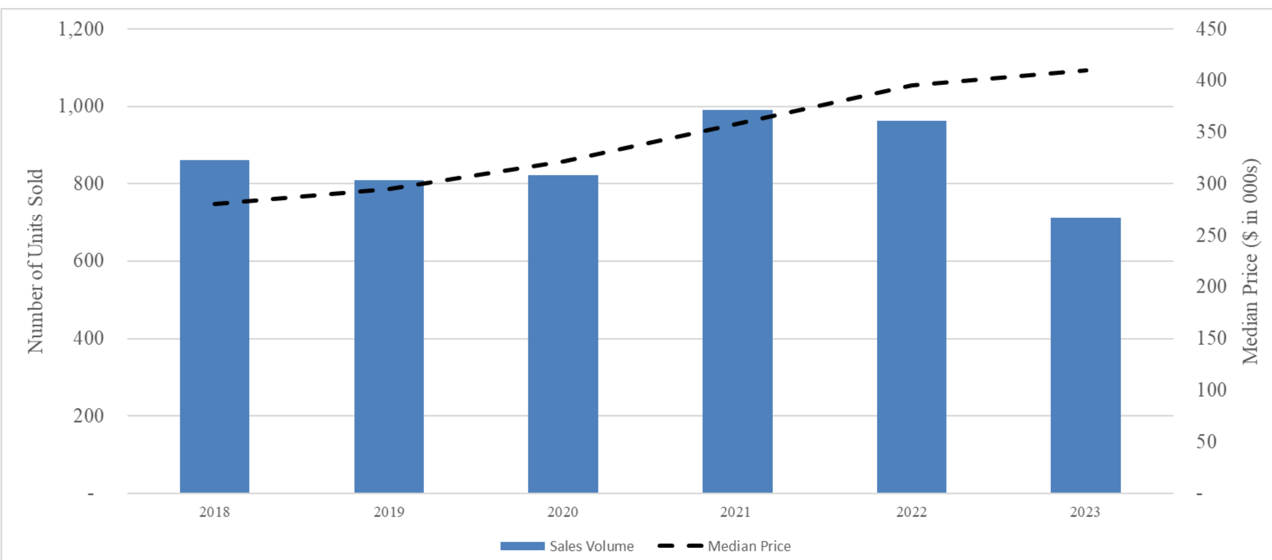
Source: Maryland Department of Labor

Real estate trends are highlighted in **Exhibit 6**. Before the pandemic, home sales in the County averaged 838 per month with a median home price of $295,000 in FY 2019. A combination of low mortgage interest rates (at least until the spring of 2022), the need for larger residences with home offices or space for online school, and the entrance of millennials into the real estate market all contributed to a large increase in home sales (averaging nearly 1,000 a month in FY 2021 and FY 2022) and growth in home prices. In FY 2023 following three years of double-digit price growth, the median home in the County cost about $410,000. Since March 2022 the Federal Reserve Board raised interest rates 11 times, causing mortgage rates to rise to the 7% range. As a result, home sales have declined 30%, to about 700 per month in FY 2023 with a corresponding negative impact on transfer and recordation revenue.

A moratorium on foreclosures was in effect from early in CY 2020 through August 2021. The State began reporting data in the first quarter of CY 2022. For the entire calendar year, the County experienced an average of 405 foreclosures, which was about 21% of the statewide total. So far, the average number of foreclosures is well below pre-pandemic levels, but as a percentage of statewide foreclosures the County experience is consistent with historical trends.

Exhibit 6

Prince George's County
Median Sales Price and Sales Volume
FY 2018 – FY 2023
($ in Millions)



Source: Metropolitan Regional Information Systems

Revenue Outlook

OMB projects that County-sourced General Fund revenue will decrease in FY 2025 by -$57.6 million, or -2.2% exclusive of the use of fund balance.

Major County-Sourced Revenue

Property Tax

Real property tax revenues are projected to increase by 4.0% in FY 2025 to $1,033.3 million compared with the FY 2024 budget. Although home prices and assessed values continue to grow, real property tax revenue to the General Fund is limited by the Homestead Tax Credit. For FY 2025 this is expected to be set at 3%. The State Department of Assessments & Taxation estimates that the County has $108.8 million in unused real property tax capacity. Some growth in the tax base is also expected due to new construction of housing coming on the market.

Personal property tax revenues are projected to grow by $0.9 million, or 1.0% in FY 2025 to $90.1 million. This is based on the March 2023 estimate of the assessable base of personal property in the County for FY 2024, with some expectation for growth in the value of the base.

Income Tax

Income tax revenue grew strongly in FY 2021 and 2022 due to a combination of federal stimulus funding to businesses and individuals during the pandemic, higher capital gains and wage growth due to labor shortages and higher inflation. Some level of growth in estimated payments was anticipated based on federal and State changes in tax law pertaining to Pass-Through Entities. Revenue in FY 2023 instead decreased by -$40.0 million, to $737 million, in line with historical growth trends; a trend that resulted in revenue write-downs by the federal, State and other County governments. In retrospect the income tax experienced a revenue bubble which has served to inform the forecast moving forward. On the positive side the County is experiencing record low levels of unemployment and wage growth has continued, albeit at lower levels than immediately following the re-opening of the economy. The forecast projects that the income tax increases to $763.6 million in FY 2024, rising to $790.2 million in FY 2025. This is in line with pre-pandemic growth rates.

The Disparity Grant is estimated to decline by -$28.5 million, or -28.9%. Revenue from the grant was substantially higher in FY 2024 based on tax year 2022 data. Counties that are below 75% of the statewide income tax per capita receive a grant. Historically the County has been in the 66%-67% range relative to the statewide average but for FY 2024 this disparity fell to 60%. The forecast assumes that this disparity will narrow but will remain below the historical average.

Transfer and Recordation Taxes

Rising mortgage rates, which have risen to the range of 7%, resulted in a decrease in home sales of approximately -26% in FY 2023. At the same time, the relatively low inventory of homes for sale has caused the median price of homes in the County to grow from approximately $300,000 prior to the pandemic to about $435,000 in August 2023. Since there is a direct correlation between interest rates and home sales, further rate hikes by the Federal Reserve Board could be expected to further dampen home sales and erode Transfer & Recordation tax revenue. The forecast projects a loss of a combined -$23.8 million or -11.6% in FY 2025. This reflects the transfer of $11.3 million to the Housing Investment Trust Fund in accordance with County law, that requires that the greater of $10.0 million or 20% or Recordation taxes be applied to that purpose.

Other County-Sourced Revenue

Use of Money and Property: Due to higher interest rates, interest income is anticipated to grow by $12.0 million in FY 2025, offset by reduced revenue from the rental of County-owned property.

Charges for Services decline by -$16.6 million, or -23.8%. Federal legislation which provided increased aid during the pandemic also authorized a higher Medicare match for emergency transportation costs. However, the increased match was for only a three-year period, which ends at the close of FY 2024.

Other Financing Sources The forecast does not presently assume any use of fund balance for FY 2025. The Committee recognizes that due to the magnitude of the gap between revenues and spending, a small amount of reserves may be needed for one-time purposes, to balance the budget.

Outside Aid Revenue

Board of Education, Community College and Library aid is expected to grow due to formula changes in State law. The Blueprint for Maryland's Future is estimated to increase State aid for the Board of Education by approximately $80 million dollars in FY 2025, with continued growth in the out years. Outside aid to the Community College is assumed to grow by 2%, and aid to the Memorial Library is projected to rise by 1%. State aid to the library only grows on a per capita basis.

Preliminary Revenue Forecast

Exhibit 7 summarizes the General Fund forecast for FY 2024 and FY 2025. Although revenue increases overall due to higher State aid to the Board of Education, as outlined above, decreases are projected from the State Disparity Grant, Transfer & Recordation taxes and Charges for Services. Additional risks to the forecast include the potential for higher mortgage rates, which may further erode Transfer & Recordation tax revenue, and potential actions by the State government to address a structural General Fund budget shortfall estimated at -$418 million in FY 2025 and growing to -$1.8 billion by FY 2028.

Exhibit 7

Prince George's County
Current and Projected General Fund Revenue
FY 2022 – FY 2025
($ in Millions)

($ in Millions) **County Sourced Revenues**	**FY 2022 Actual**	**FY 2023 Unaudited**	**FY 2024 Approved**	**FY 2024 Estimated**	**FY 2024 Approved vs. Estimated $ Change**	**FY 2024 Approved vs. Estimated % Change**	**FY 2025 Forecast**	**24 App vs 25 Est $ Change**	**24 App vs 25 Est % Change**
Real Property Tax	$923.4	$955.3	$993.4	$1,005.5	$12.1	1.2%	$1,033.3	$39.9	4.0%
Personal Property Tax	84.2	93.0	89.2	89.2	0.0	0.0%	90.1	0.9	1.0%
Income Tax	777.0	737.9	777.2	763.6	-13.6	-1.7%	790.2	13.0	1.7%
Disparity Grant	36.3	43.7	98.5	98.5	0.0	0.0%	70.0	-28.5	-28.9%
Transfer Tax	168.5	128.3	152.1	129.0	-23.1	-15.2%	135.5	-16.7	-11.0%
Recordation Tax	73.2	42.7	52.4	43.2	-9.2	-17.6%	45.4	-7.1	-13.5%
Energy Tax	74.9	79.2	88.3	88.3	0.0	0.0%	89.2	0.9	1.0%
Telecommunications Tax	13.4	13.6	12.2	13.5	1.4	11.1%	13.5	1.4	11.1%
Other Local Taxes	24.8	24.7	24.6	25.1	0.5	2.1%	25.6	0.9	3.8%
State-Shared Taxes	8.5	7.6	9.7	9.2	-0.5	-5.2%	10.7	1.1	11.0%
Licenses and Permits	76.5	83.6	81.1	80.1	-1.0	-1.2%	81.4	0.3	0.4%
Use of Money and Property	-1.6	30.4	10.9	20.8	9.9	91.2%	20.8	9.9	91.2%
Charges for Services	59.2	63.0	69.7	69.9	0.2	0.3%	53.1	-16.6	-23.8%
Intergovernmental Revenue	34.9	40.6	36.3	36.8	0.5	1.3%	36.4	0.0	0.1%
Miscellaneous Revenue	9.5	18.5	9.8	9.9	0.1	1.0%	9.4	-0.4	-4.3%
Other Financing Sources	0.0	0.0	56.7	56.7	0.0	0.0%	0.0	na	na
Subtotal County Sources	**$2,362.6**	**$2,362.2**	**$2,562.0**	**$2,539.2**	**-$22.8**	**-0.9%**	**$2,504.4**	**-$57.6**	**-2.2%**
Subtotal w/o Fund Balance	**$2,362.6**	**$2,362.2**	**$2,505.3**	**$2,482.5**	**-$22.8**	**-0.9%**	**$2,504.4**	**-$0.9**	**0.0%**
Outside Aid									
Board of Education	$1,516.1	$1,812.7	$1,857.0	$1,857.0	$0.0	0.0%	$1,937.9	$80.9	4.4%
Community College	76.6	73.2	85.1	85.1	0.0	0.0%	86.8	1.7	2.0%
Library	9.2	9.9	9.6	9.6	0.0	0.0%	9.6	0.1	1.0%
Subtotal Outside Aid	**$1,601.9**	**$1,895.8**	**$1,951.6**	**$1,951.6**	**$0.0**	**0.0%**	**$2,034.3**	**$82.7**	**4.2%**
Grand Total General Fund	**$3,964.6**	**$4,258.0**	**$4,513.6**	**$4,490.8**	**-$22.8**	**-0.5%**	**$4,538.7**	**$25.1**	**0.6%**

Source: Office of Management and Budget

The largest risk to the forecast would come from additional interest rate hikes by the Federal Reserve Board, which would further raise mortgage rates and potentially reduce the level of home sales and thus Transfer & Recordation tax revenue. Inflation remains above the target inflation rate and one or two additional increases in interest rates are being discussed despite 11 rate hikes since March 2022.

Fiscal Outlook

As seen in **Exhibit 8**, the County closed FY 2022 with General Fund revenues above spending by $128.8 million, resulting in an unassigned balance of $336.6 million. The combination of the 5% restricted reserve, 2% committed reserve and unassigned balance totaled 16.1% of expenditures. Higher-than-expected spending in FY 2023 is anticipated to require the use of $48.7 million in fund balance, reducing reserves to 13.3% of spending. Because the FY 2024 budget appropriated $56.7 million in unassigned balance, this further reduces reserves to an estimated 11.4% of spending.

Exhibit 9 illustrates the gap between ongoing revenues and spending between FY 2022 and FY 2030. Income and property tax revenue continue to represent the largest components of County-sourced revenue. Lower inflation at the end of FY 2023 will result in the Homestead Tax Credit being set at the 3% level in FY 2025. Income tax attainment was much higher in FY 2021 and FY 2022 than the long-term trend, because of federal stimulus aid during the pandemic and capital gains revenue. FY 2023 income tax levels have returned to the long-term trend line: a reduction of -$40.0 million below the FY 2022 attainment. Disparity Grant revenue was also higher than normal in FY 2024 for these same reasons and is expected to return to historical levels. Spending for education, employee compensation and baseline operating needs grow at faster levels than revenue.

Stormwater Management Enterprise Fund

Among its charges, County statute authorizes the Committee to make a recommendation on the level of General Fund spending in FY 2025. While Enterprise Funds are not specifically under the purview of the Committee, demands on the Stormwater Enterprise Fund represent a potential call on General Fund resources at a time when the County needs to address a large shortfall in that Fund. State mandates and the effects of climate change require the County to expend funds for stormwater-related improvements; more than doubling since FY 2020. The Stormwater Management Enterprise Fund faces its own fiscal challenges, operating in a negative cash position currently, despite having its own dedicated property tax. Absent an increase in this revenue source, the County General Fund will be required to provide an estimated $60 million annually in financial support. **To protect the General Fund, the Committee recommends that the County consider an increase to the dedicated property tax for the Stormwater Fund.**

Exhibit 8

Prince George's County
General Fund Pro Forma
FY 2022 – FY 2024
($ in Millions)

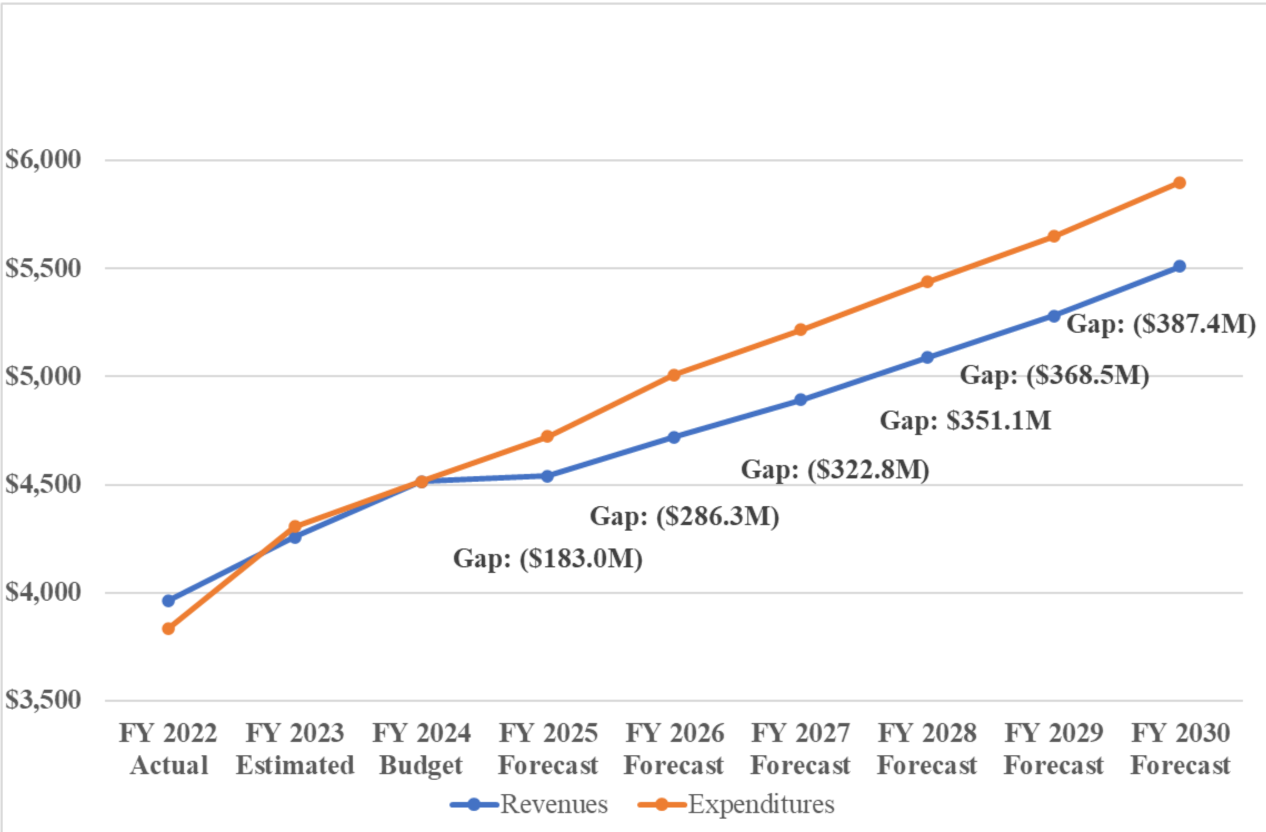
	FY 2022 Actual	FY 2023 Estimated	% Change	FY 2024 Approved	$ Change	% Change
Revenues	$3,964.6	$4,258.0	*7.4%*	$4,513.6	*$255.7*	*6.0%*
Expenditures	3,835.7	4,306.7	*12.3%*	4,513.6	*207.0*	*4.8%*
Surplus/(Deficit)	128.8	-48.7		0.0	*48.7*	*-100.0%*
Fund Balance	**FY 2022 Actual**	**FY 2023 Estimate**		**FY 2024 Estimate**		
Committed (5%)	$214.9	$215.3		$225.7		
Committed (2%/3%)	86.0	86.1		135.4		
Unassigned	336.6	271.3		154.9		
Total	**$637.5**	**$572.8**		**$516.0**		
Fund Balance as % of General Fund Expenditures	16.1%	13.3%		11.4%		

*Note: the FY 2023 estimated expenditures are based on unaudited end-of-year spending as of 9/8/2023 and include use of $16.0 million in unassigned fund balance for Other Post-Employment Benefits. The FY 2024 estimate reflects $56.7 million in unassigned fund balance appropriated in the approved budget.

Source: Office of Management and Budget

Exhibit 9

Prince George's County General Fund Forecast
FY 2022 Actual – FY 2030 Estimated
($ in Millions)



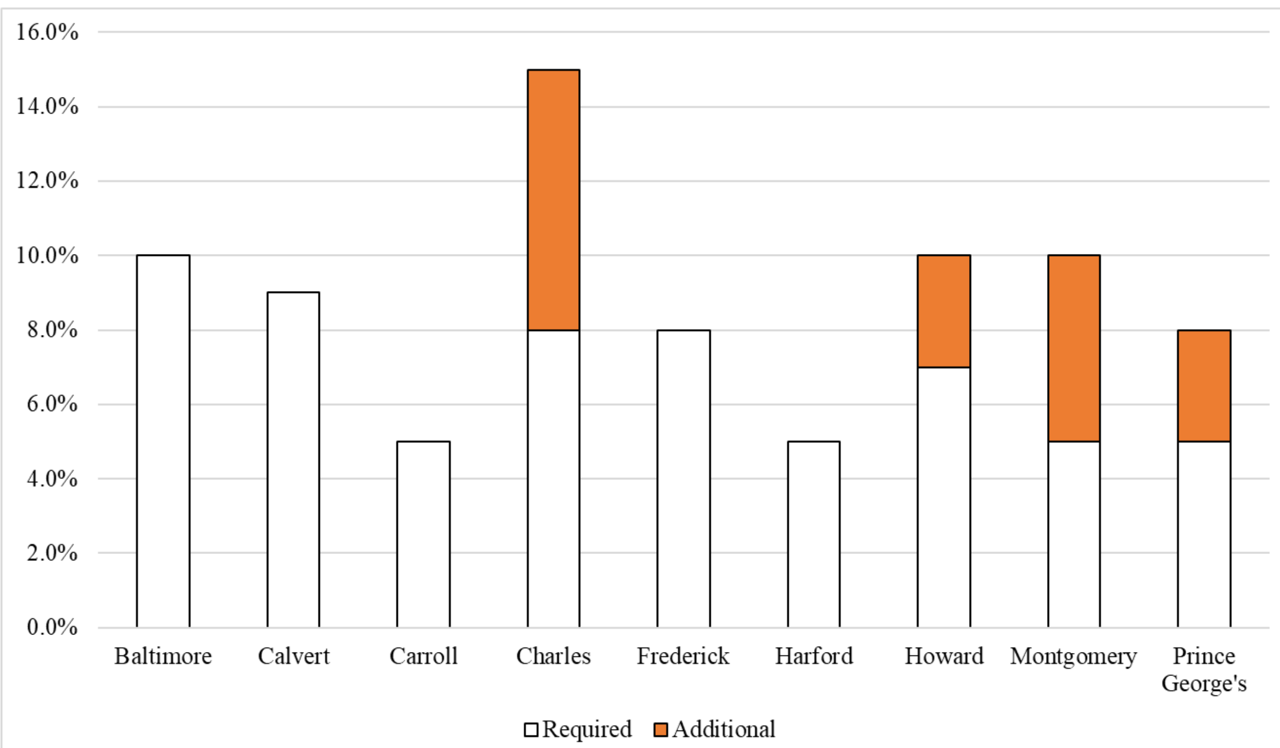
Source: Office of Management and Budget

Fund Balance and Reserve Fund Levels

In its January 2023 letter, the Committee recommended that the County increase its combined reserve levels to 10%. This consists of the 5% Charter-required reserve and a three-year phase-in of the policy reserve to 5%, in one-percentage point increments, over FY 2024-2026. The purpose of the additional reserves is to enable the County to maintain operations during periods of emergency, revenue volatility or other unforeseen circumstances. As seen in **Exhibit 10**, most of the other County governments in Maryland that are rated "AAA" by the three bond rating agencies maintain reserves of 10% or more. A second reason for higher balances is to help maintain the County's AAA bond rating.

Exhibit 10

Comparison of Reserve Fund Levels in Maryland Counties
With "AAA" Bond Ratings



Source: Office of Management and Budget

The Committee recognizes that the County successfully increased the policy reserve to 3% in FY 2024 and recommends that this reserve be increased to 4% in FY 2025.

Conclusion and Recommendations

The County faces financial challenges due to revised revenue estimates and spending pressures that include unprecedented spending on k-12 education mandated by the State's Blueprint for Maryland's Future initiative. Resources are also needed to maintain competitive employee compensation, to maintain current operations and address the need for other services for the County's residents. Although the economy is strong, buoyed by low unemployment, continued wage growth, lower inflation and strong consumer spending, higher interest rates have impacted housing sales and additional interest rate hikes by the Federal Reserve Board could further reduce consumer demand and lead to higher unemployment. Global reductions in oil production also represent a threat to continued economic growth.

Based upon a preliminary review of various economic information and revenue trends, the Committee recommends a preliminary General Fund revenue projection of $4.54 billion in FY 2025, an increase of $25.1 million or 0.6% above the FY 2024 budget. This includes spending from County-sourced revenue of $2.5 billion, which decreases by -$57.6 million or -2.2%. It will be incumbent upon the County to identify a combination of revenue enhancements and spending reductions sufficient to produce a balanced budget for FY 2025. The Committee urges the County to begin adopting cost containment actions in the current fiscal year, to begin addressing the projected shortfall. The Committee further recommends consideration of an increase in the dedicated property tax supporting the Stormwater Enterprise Fund, so as to not require additional General Fund support in the future. Finally, a continued phase-in of the policy reserve to 4% is important to maintain the County's "AAA" bond rating and to allow for sufficient reserves to maintain operations during emergencies.

The Committee wishes to thank both the Executive and Legislative Branches of government for the opportunity to review the County's economic and revenue forecast. We believe that we have performed adequate due diligence in reviewing the revenue estimates for FY 2025 and believe them to be reasonable.

Respectfully,

Robert R. Hagans Jr., Chairman

Terri K. Bacote-Charles, Member

Stephen A. Brayman, Member

Brad Frome, Member

Henry W. Mosley, Member