



October 21, 2009

The Honorable Edward J. Kasemeyer, Senate Chair
Joint Committee Workgroup to Study
State, County, and Municipal Fiscal Relationships
Suite 3 West, Miller Senate Office Building
Annapolis, MD 21401

The Honorable Adrienne A. Jones, House Chair
Joint Committee Workgroup to Study
State, County, and Municipal Fiscal Relationships
312 Lowe House Office Building
Annapolis, MD 21401

Dear Senator Kasemeyer and Delegate Jones:

Thank you for the opportunity to present before the Joint Workgroup on October 8 and for providing additional time to accommodate MACo's panel. During our prescribed time for our presentation, the county officials sought to address a number of issues of interest to county governments, but were necessarily limited in their scope.

This document responds to several questions posed to MACo panelists at the October 8 meeting as well as some additional issues communicated by staff.

Presentation Topics for MACo to the Joint Legislative Workgroup to Study State, County, and Municipal Fiscal Relationships

What is MACO's view of the current fiscal relationship between the State, county, and the municipality?

MACo believes that the State, counties, and municipalities have a productive, long-standing fiscal relationship and is very appreciative of assistance received through direct State aid, as well as other grant programs and support. Driven by budgetary constraints in the most recent fiscal years, this relationship has been somewhat strained due to significant reductions in distributions in transportation, public safety, land preservation, and public health.

What are the fiscal constraints that counties and municipalities have in place?

Currently, five jurisdictions (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have charter limitations on property taxes. Other State-mandated limits and tax credits pose challenges. For example, county income taxes are a broad revenue source in Maryland (more so than in any other state) but are limited to a rate of 3.2% by State law. Over 2 million Maryland residents already pay this maximum rate, and 3 out of 5 residents pay a rate at 3% or higher (very near the maximum level allowed under

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State law), significantly impeding the ability of counties to rely on income tax revenues as an option to backfill budget cuts.

In addition, the State imposes a number of tax credits and exemptions from the property tax, removing some property that would otherwise be taxable from the tax rolls. Tax credits are imposed on a variety of real and personal property, generally related to the nature of the property's owner or the property's effective use.

Finally, county and municipal governments are required under the State's "Constant Yield" law to publicly advertise a "Notice Of Tax Increase" in any year where its rate exceeds the constant yield tax rate (CYTR), and hold a public hearing on the matter. Failure to comply with the detailed requirements of this law results in the State imposing the CYTR for that jurisdiction for the upcoming year.

What is the division of services and tax differentials associated with this division that are provided by the county vs. those provided by municipalities?

The division of services and tax differentials varies by county and municipality. Seventeen counties currently provide a property tax set-off in the form of a tax rate differential or a tax rebate. A tax rate differential is basically a reduced county property tax within a municipality and a tax rebate is given in the form a direct grant to a municipality for providing services. The division of services provided by a county or municipality is largely determined by the needs of its population. Large municipalities may provide the same level of public safety and land use services as a county, though no municipality in Maryland provides the full range of services supported by county governments. In many cases, municipal governments may provide street maintenance, sanitation and waste collection, while the county provides other services.

What are the different considerations for small/large and urban/rural counties?

When determining the level of services to provide to constituencies, local jurisdictions consider the demographics of its population and the services wanted or needed. Many times the type of service will not change based on the size of the jurisdiction; it may just be a smaller number of individuals benefiting from a service because the population is smaller. For example, the seven "One-Maryland" or distressed counties have very similar demographics in terms of income and unemployment, but the size of the populations varies significantly. Similar services may be provided to assist constituencies in finding employments or preventative health care. However, caseloads will be much different in size.

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Every Maryland county provides a substantial base of services that, while varying in need across jurisdictions and demographics, constitute the lion's share of county budgets and commitments. Among these major areas are primary and secondary education, libraries, community colleges (either within the county or via regional institution with multiple supporting counties), primary law enforcement, other public safety including courthouse support, public roads and infrastructure, utility-style public works, and land use planning and oversight.

What types of aid provided by the State are unique to Maryland? Should this aid be continued in the same manner, adjusted or phased out after a certain time to allow county budgets to be adjusted to take on additional responsibility?

All states provide some level of funding to local governments, but the degree and range of this aid is clearly a state-by-state decision, evolving over long time periods. Nearly every state affords some "patchwork" of services spread across the State and its county and other local governments. To determine the manner in which this aid is provided and whether it is unique, MACo staff would be happy to work with the Work Group members, and make available any resources we may have through the national organization, the National Association of Counties.

One element of Maryland's State/county fiscal relationship that is unusual is the respective proportion of support for primary and secondary education funding. In many states, particularly the many (or which Maryland is one) with a constitutional mandate for public education, the State is the majority partner in supporting education funding, with local jurisdictions playing the lesser role. However, in Maryland, despite the State constitutional mandate, county funding has historically been the largest source of financial support for public schools.

The January 2002 Final Report of the Commission on Education Finance, Equity and Excellence (Thornton Commission) found that the locals provided 54% of education funding in FY 2002 to the State's 41% (the remaining 5% coming from the federal government). The State has worked to correct a disparity in the State-local share of education funding -- the Thornton Commission recommended achieving a State-local-federal share of 49-47-4 by FY 2007, and the legislation enacted pursuant to those recommendations sought to make gains in that direction. As the State support for education has increased, both as a share of the State budget and as a share of the total funding to Maryland's schools, the State has seen gains in both equity and adequacy that have helped Maryland secure marked gains in student achievement, and a #1 national ranking for its public schools by multiple metrics.

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While MACo as an organization is better equipped to respond to specific proposals, we would observe that substantial shifts in current local distributions, or allowing State commitments to be “phased out after a certain time” would necessarily require counties to adjust either by eliminating or abridging the services currently supported by State funding, or to offset the funding reductions by additional county tax revenues. Given the “essential” nature of many local government functions, in many cases counties worry that a shift of funding responsibilities, or a reduction in State support, simply translates to more locally-raised tax revenues supplanting the former State effort.

What long-term plans do counties have to address budget shortfalls so the current situation does not continue to be cyclical?

Many counties, in recent years, have actively directed one-time revenues in excess of forecasts toward one-time projects or expenditure, rather than ongoing operating expenses and salaries. Among the most volatile revenues in the typical county budget are those affected by real estate activity – transfer taxes, recordation taxes, and income taxes (via capital gains) attributable to property sales. When the Maryland real estate market enjoyed a vigorous growth in recent years, most counties realized revenues in these areas beyond budgeted projections – affording opportunities to fund capital projects on a pay-as-you-go basis rather than through conventional borrowing, and other one-time spending. As a result, many counties avoided the resulting drop-off (due to cooling of these markets and revenues) as a structural budget imbalance

As the State is currently doing, the counties are analyzing their current budget situation to determine the best way to manage with declining revenues. The possibility of further reductions in FY 2011 and the elimination of federal stimulus funds in FY 2012 have counties acutely aware of the severity of the budget situation. While some are thinking in the long term, most are trying to manage through the next two years.

How are you using short term Stimulus money to leverage dollars for the future?

Counties and Baltimore City have received federal stimulus money in the form of direct aid and grants to fund K-12 education, community colleges, transportation projects, economic development, and energy innovation. In most cases these dollars are not leveraging funds for the future since they have been used to offset general fund increases in the State budget or because of specific grant eligibility criteria. Stimulus dollars used for education purposes will only exist for two years. In FY 2012, the State will need to determine how the programs implemented or expanded with these funds will continue. It has been thought by some that federal stimulus money for transportation projects could be used to offset the reductions in Highway User Revenues. However, the project requirements present a barrier. Federal funds can only be used on roads classified as

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major collectors, for safety improvement projects on any road, and on bridge projects. Local jurisdictions are responsible for maintaining many miles of roads, many of which do not fall into one of these categories. A few of the rural jurisdictions, (Allegany, Caroline, Charles, Kent) were not able to use all of their allocated funds and passed them on to municipalities.

The creation and issuance of Recovery Zone Bonds will provide longer lasting benefit through revitalization efforts. These bonds provide tax incentives and lower borrowing costs for local governments and private entities. There are two types of bonds, Recovery Zone Economic Development Bonds (RZEDB), which can be used to finance economic development; and Recovery Zone Facility Bonds (RZFB), which can be used to finance depreciable property. Maryland's counties and Baltimore City have received \$208,860,000 in aggregate volume cap allocation for RZEDBs, and \$313,291,000 in aggregate volume cap allocation for RZFBs. These bonds must be used in designated recovery zones, which are areas of significant poverty, unemployment, general distress, and economic distress because of a military base closure or realignment or home foreclosures. Areas can also be designated as empowerment zones or renewal communities.

One area of federal "stimulus" funding that presents opportunity for long-term savings for counties and other recipients is energy efficiency. A variety of federally supported programs are anticipated to provide long-term savings in energy usage for public schools, county facilities, and many other buildings and ancillary equipment. MACo has worked with the Maryland Energy Administration to help guide the distribution and usage of such funds, and is hopeful that long-term savings – both monetary and in energy/carbon terms – will be realized from this effort.

What are your expectations for the workgroup and does MACo have additional suggestions for what the Workgroup ought to be looking at and studying?

MACo expects the workgroup to have an open dialogue on issues impacting local government and to comprehensively examine county finances. MACo understands the State's fiscal challenges and hopes this approach to the workgroup will foster a positive State and local relationship to address the challenges that lie ahead.

There is one issue in particular where MACo would like to see some discussion and that is the Maintenance of Effort (MOE) law and waiver process. When the General Assembly codified the waiver process, all parties believed that it would provide a balanced process for a financially stressed county to waive all or part of its MOE requirement. However, based on the State Board of Education's summary denial of all three waiver requests earlier this year, MACo feels that the waiver process is neither

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objective nor balanced and must be reformed. Meanwhile, counties are faced with a budget requiring school funding to be “maintained” while other areas of the county budget are being slashed. In dire economic times the counties need greater flexibility to address budgetary shortfalls.

October 8, 2009 Briefing Follow-Up

How many county offices, local boards of education, and other local entities work collaboratively to purchase services, manage benefit plans, or pool other resources to achieve economies of scale?

MACo contacted its membership to determine what steps are being undertaken to pool resources to generate cost savings. Howard County and the Howard County Public School System recently completed a joint bid for their respective 457(b) Plans. Each has a separate plan because they operate as separate entities, however, they did get excellent pricing due to bidding together and pooling of resources.

Montgomery County has a number of joint programs including electricity procurement, fuel purchases, wind energy purchases, workers compensation and liability insurance, printing services, health benefits procurement, shared use of interagency space, and police training, to name a few.

As more information is compiled, MACo will share it with the Workgroup.

Does your county have an elected or non-elected official who either participates in or observes the collective bargaining process between your local board of education and the employee representative?

In a brief survey, the counties and Baltimore City overwhelmingly responded that they do not have a representative who participates in or observes the collective bargaining process between their local board of education and the employee bargaining unit.

What will the impact be on county revenues due to falling property assessments?

For nearly every Maryland County the property tax is the largest source of own-source revenue. Projecting the revenues from property taxes is a function of several components: growth or decline in the assessable base, new construction or other newly-added property, and the effects of property tax credits and exemptions.

The core data counties use for forecasting the assessable base is provided by the State Department of Assessments and Taxation (SDAT). SDAT revises its assessable base

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estimate for the current year and its forecast for the coming year semiannually, each March and November. In addition, SDAT conducts the annual reassessments of properties on its statutory three-year cycle, and distributes information about the reassessments in December of each year, at roughly the time that new assessment notices are sent to property owners. While counties make efforts to track local demographic, economic, and permitting information to help anticipate new construction, the most essential data is that distributed by SDAT. Counties typically augment this raw data with their own estimates of credits and exemptions granted under various laws that effect the actual property tax yield derived from a certain assessable base level.

Historically, Maryland's property tax structure has served to shield homeowners from abrupt increases in tax burden, principally by way of the Homestead Property Tax Credit (commonly called "assessment cap") and the three-year phase-in of assessment increases. The overall nature of these protections is to lessen the immediate impact of the economic cycle on property tax revenues in the very short run. In the current environment of widely declining assessments, local governments are forecasting significant declines in tax revenues from commercial and other non owner-occupied property, but a lesser drop-off from owner-occupied residences. Over time, the reduction in assessments will manifest in property tax revenues, and typically these effects linger beyond the immediate budget cycle, more so than revenue sources like income and sales taxes.

Do counties have the budgeting practice of funding vacant positions?

MACo has conducted preliminary inquiries into this issue, and will continue to explore the issue. To our current knowledge, no county provides direct funding for positions that are identified as vacant at the time of a budget's proposal or enactment, and are expected to remain vacant through the budget year. Of course, in the regular cycle of budgeting any government, some approved and funded positions are likely vacant at any given time – but this ordinary event does not trigger a “vacant but funded” status for county positions that we have identified.

On a related matter, MACo is also unaware of any county that employs a “turnover” assumption within the budget comparable to that used by State agencies. This may be a function of the scales involved, where most county budgets do not reach the scale necessary to provide the statistical inferences afforded by larger employee totals.

As we gather more information on these subjects, we will gladly share any meaningful findings with the Work Group members.

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Provide comments as to what MACo would suggest doing differently in terms of State aid provided to counties?

As stated above, MACo is very appreciative of the State aid provided and would like to see the state/county fiscal relationship continue to be strengthened. We hope this workgroup provides a forum for us to work together cooperatively to address the issues of equity, disparity, and affordability in State funding of the many services delivered primarily through local governments.

In the aggregate, the general tendency to employ a collective term such as “local aid” to reference funding to both the local governments themselves, as well as to the semi-independent agencies that counties fund but does not manage, misrepresents the fiscal structure established by the State. A recent element of this frustration for many local officials is that while the State has protected education aid from reductions, the reduction to local government aid is seemingly guided by a “local share of the State budget” that includes education. Counties have always supported education as a top priority -- most counties put more money into education than all other budget categories combined. However, when roughly half of every county budget has been taken off the table for reductions, it results in a jurisdiction being forced to take even deeper reductions in other critical program areas, such as public safety, even though some efficiencies could have been achieved in the education area.

Compounding this frustration is county concern over the Maintenance of Effort (MOE) waiver process. When the General Assembly codified the waiver process in statute, the counties believed that it would provide a balanced process for a financially stressed county to receive flexibility under the MOE requirement, rather than be faced with the loss of State funding. However, based on the State Board of Education’s summary denial of all three waiver requests earlier this year, MACo feels that the waiver process is neither objective nor balanced and should be reformed. Meanwhile, counties are faced with a budget requiring school funding to be “maintained” while other areas of the county budget are being slashed. The practical effect of the MOE law in the current environment of overall budget decline, we believe, exceeds the original intentions and concerns of the General Assembly addressed by its establishment.

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Again, thank you for the opportunity to present before the Workgroup on October 8. We look forward to working with the Work Group as it discusses these issues of intergovernmental financing. Please contact me if you have any questions regarding the responses in this letter, or other matters relevant to the Work Group's efforts.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Sanderson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Michael Sanderson
Executive Director