October 1, 2024

The Honorable Angela Alsobrooks, County Executive
The Honorable Jolene Ivey, Chair, County Council

In accordance with Subtitle 10, Division 1A of the County Code, the Spending Affordability Committee (SAC) 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 2026.

Based upon a review of various economic and revenue information and trends, the Committee concurs with the preliminary OMB General Fund revenue projection of $4.73 billion in FY 2026, an increase of $143.3 million or 3.1% above the FY 2025 Approved Budget. Projected County-sourced revenue of $2.63 billion in FY 2026 represents growth of $28.1 million or 1.1%. (See **Exhibit 1**). Based upon the forecasted revenues, the Committee's preliminary spending limit recommendation is $4.73 billion. Similar to the FY 2025 forecast, when the Committee recommended closing a projected -$171 million shortfall largely through spending reductions, it will be challenging for the County to continue to scale back its commitments. The outyear forecast illustrates that the County has made laudable progress in closing the structural shortfall between ongoing revenues and spending. Continued progress is essential to ensuring that the budget attain a sustainable path.

Exhibit 1

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

	FY 2023 Actual	FY 2024 Unaudited	FY 2025 Approved	FY 2026 Forecast	FY 23-24 % Change	FY 24-25 % Change	FY 25-26 % Change
County-Sourced Revenues							
Subtotal County-Sources	$2,401.1	$2,556.2	$2,600.3	$2,628.4	6.5%	1.7%	1.1%
Subtotal w/o Fund Balance	2,401.1	2,499.5	2,565.4	2,628.4	4.1%	2.6%	2.5%
Outside Aid							
Subtotal Outside Aid	1,773.6	1,964.1	1,988.3	2,103.5	10.7%	1.2%	5.8%
Grand Total	**$4,174.7**	**$4,520.4**	**$4,588.6**	**$4,731.9**	**8.3%**	**1.5%**	**3.1%**
Grand Total w/o Fund Balance	**4,174.7**	**4,463.6**	**4,553.7**	**4,731.9**	**6.9%**	**2.0%**	**3.9%**

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

The Committee is encouraged that the annual rate of growth in the forecast is approximately the same for revenues and spending from FY 2026 – FY 2031, but this does not address a projected -$152 million gap in the FY 2026 budget. Most spending growth is based on the need to annualize current year compensation expenses, address higher fringe benefit costs, pay for State-mandated education formula growth and fund agency operating expense growth. Although the Committee is not legally empowered to opine on County revenues, it increasingly seems that the County has insufficient revenues to pay for the level of services desired by the citizens of the County. Charter restrictions on the property tax rate and requirements that further limit real property assessments to the lesser of inflation or 5% constrain the County's largest revenue source when many costs grow faster than inflation. The local income tax rate is also capped by State law at 3.2%, which is the rate assessed by the County. The State has not increased this cap subsequent to enacting the Blueprint for Maryland's Future, which imposed substantially higher k-12 spending requirements on local governments.

The Committee is also concerned with the level of unfunded liabilities in the County – chiefly that there is no annual funding dedicated to addressing the $1.7 billion retiree health care liability. Efforts to address the shortfall in the Risk Management Fund should also be considered. County law also requires a recommendation on appropriate levels of fund balances and reserves. The County relied upon fund balance for both the FY 2024 and FY 2025 budgets. This is a trend that the Committee has opposed. In May 2024 one of the bond rating agencies issued a negative outlook for the County's bond rating based on the use of fund balance for ongoing expenses, in which it noted that "the negative outlook reflects the county's expected decline in fund balance driven by structurally imbalanced operations that will persist through fiscal 2025. A fiscal 2026 budget that continues this trend…will pressure the credit profile." In FY 2026 the Committee feels strongly that no fund balance be used for any purpose. Related to this is the final phase-in of the policy reserve to 5% in FY 2026, representing the final leg of the Committee's recommendation from 2023. A 10% reserve level, consisting of 5% for the Charter reserve and 5% for the policy reserve, will prepare the County for future economic downturns and demonstrate to the rating agencies the importance that the County places on adequate cash reserves.

Required Committee Recommendations

Section 10-112.22 of County Code stipulates the duties and responsibilities of the SAC. The October 1st letter to the County Executive and County Council is required to include the following:

1. A ceiling on general fund spending allocations.
2. Separate maximum general fund spending allocations for:
    a. The Board of Education.
    b. Debt Service.
    c. All other general government expenditures.
3. Appropriate levels of general fund reserves and fund balance.

Exhibit 2 summarizes the Committee's recommendations, including a ceiling on general fund spending of $4.731.9 billion, with the proviso that this ceiling may be increased to the extent that additional revenue is recognized or estimated to be recognized.

Exhibit 2

Prince George's County
FY 2026 Spending Ceiling Recommendation
($ in Millions)

	FY 2024 Unaudited	**FY 2025 Budget**	**FY 2026 Projected**	FY 2026 Projected v. FY 2025 Budget
Debt Service Obligations	$ 170.6	$ 184.3	$ 194.8	5.7%
Board of Education	2,813.5	2,798.8	2,943.4	5.2%
Other (less cost containment)	1,555.6	1,605.5	1,593.7	-0.7%
TOTAL	**$4,539.7**	**$ 4,588.6**	**$ 4,731.9**	**3.1%**
% Change		1.1%	3.1%	

	FY 2024 Unaudited	**FY 2025 Budget**	**FY 2026 Projected**	FY 2026 Projected v. FY 2025 Budget
<u>Board of Education</u>				
County Contribution	$ 943.1	$ 909.8	$ 941.1	3.4%
Outside Aid	1,870.5	1,889.0	2,002.3	6.0%
TOTAL	**$2,813.5**	**$ 2,798.8**	**$ 2,943.4**	**5.2%**
% Change		-0.5%	5.2%	

Notes:
1. Debt service amounts do not include Certificates of Participation (COP) payments shown under "Other".
2. The Board of Education FY 2026 amount is based on OMB's preliminary recommendation based on the assumption that total and special enrollments return to pre-pandemic levels. This assumption may be revised as additional data and projections become available.

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

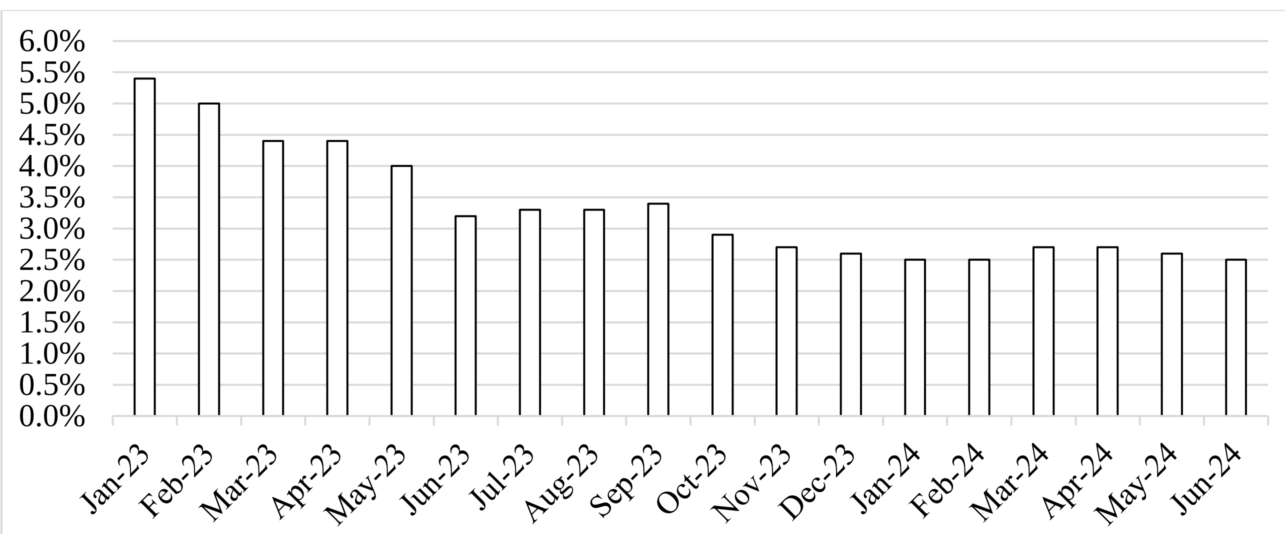
Economic Outlook

The state of the economy is generally positive. Unemployment is low, the labor force is showing signs of increasing and both wages and consumer spending have continued to grow. Offsetting the positive news is the effect of high interest rates, which have caused home sales to decline about one-third from the peak of 1,000 homes sold per month in calendar year 2021. Consumer confidence is also low, in part because price increases over the past few years have not returned to pre-pandemic levels. Potential cuts in State aid also are a growing threat to County revenue, as the State addresses a large projected budget shortfall.

The pandemic led to shortages of manufactured goods caused by supply chain disruptions. With too much money in the economy chasing too few goods inflation began to rise in the spring of 2021, peaking at 9.1% in June 2022. The Federal Reserve Board began raising interest rates in March 2022, ultimately increasing them 11 times to reduce consumption. The goal was to reduce inflation to 2%, though the Board's preferred measure is personal consumption expenditures which is a broader measure of goods than the Consumer Price Index for Urban Consumers. **Exhibit 3** shows the trend in personal consumption expenditures. The rate of growth steadily decreased and has been stable through calendar 2024. As a result, the Board adopted a 50-basis point cut in the rate in September 2024 with an expectation of future cuts.

Exhibit 3

Personal Consumption Expenditures
January 2023 – June 2024

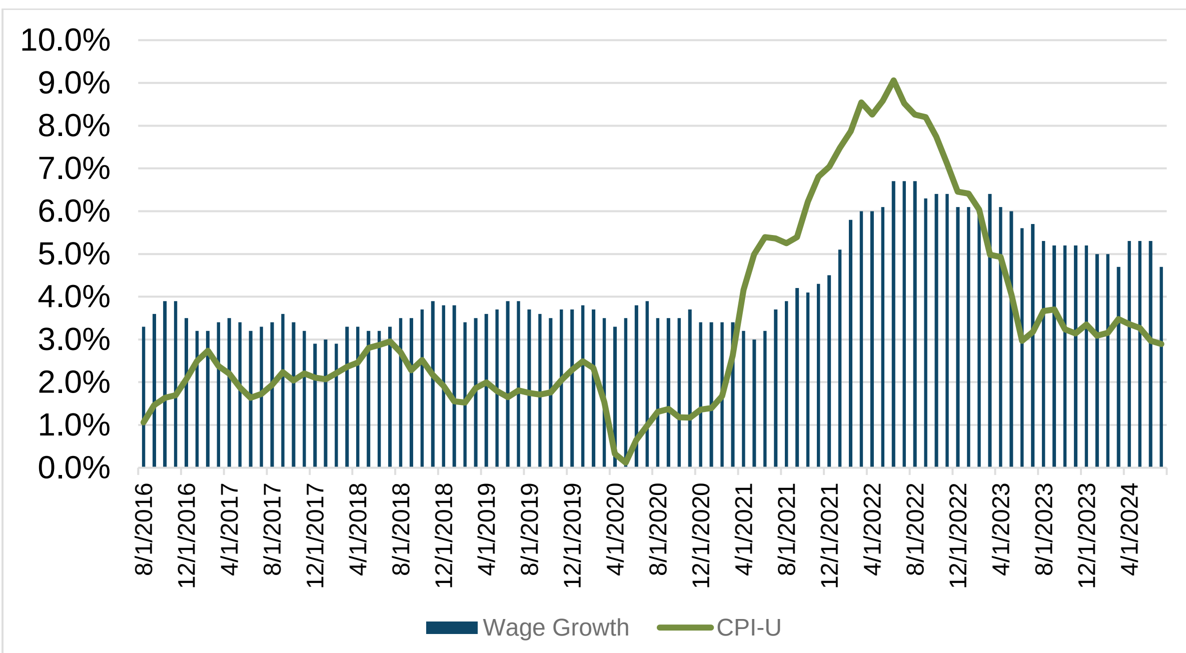


Source: Bureau of Economic Analysis

Exhibit 4 shows the three-month average of median wage growth compared to inflation. Prior to the pandemic nominal wage growth was in the 3% to 4% range, while inflation varied from 1% to 3% a year. Until the end of calendar year 2020 though, wages grew faster than inflation (i.e., real wage growth). During the period of higher inflation covering calendar years 2021 and 2022, prices grew faster than wages and as a result consumers lost purchasing power. Higher prices and labor shortages caused employers to raise wages. The data shows in Exhibit 4 that since calendar 2023 real wages have continued to grow. Even though prices remain higher, for example for food, wages have grown faster than inflation and consumers should be in better position to afford the cost increases.

Exhibit 4

Three-Month Moving Average of Median Wage Growth vs. Year-Over-Year Change in the Consumer Price Index
August 2016 – July 2024



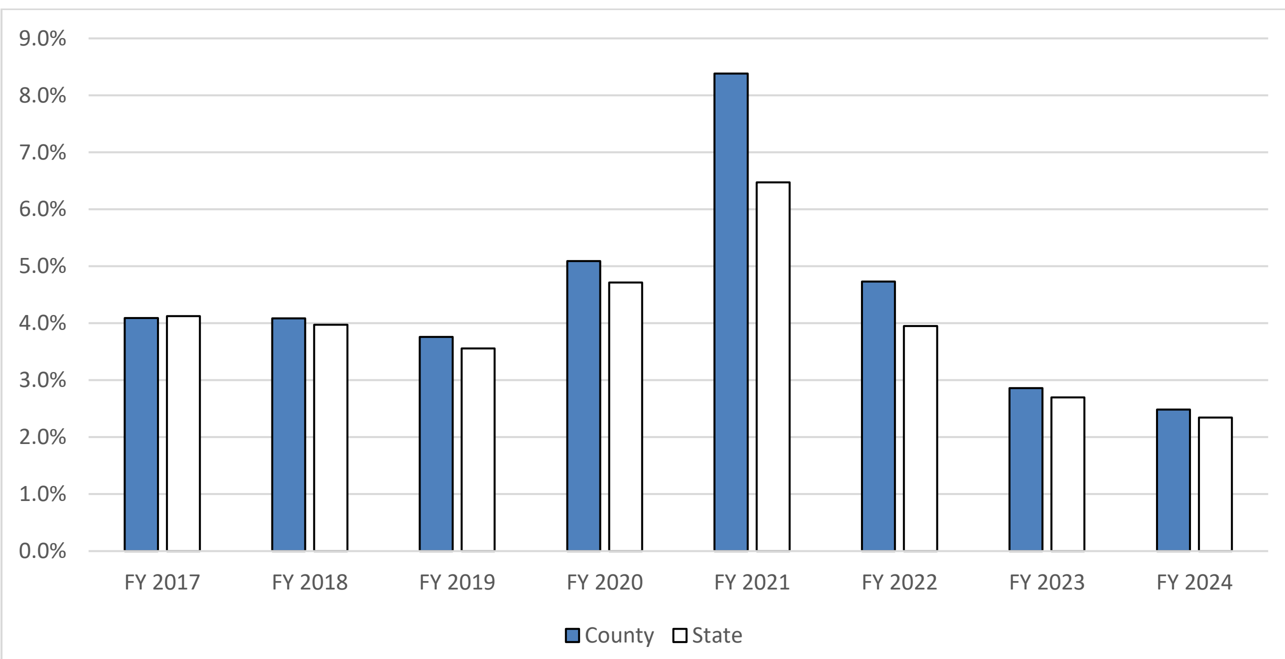
Source: Federal Reserve Bank of Atlanta

Exhibit 5 compares the annual unemployment rate in the County with the statewide average. During the pandemic when the economy was largely closed, annual unemployment exceeded 8% in the County compared to 6.5% statewide. In the past the County unemployment rate generally moved in tandem with the State, with the County typically 10 to 20 basis points higher. A number of reasons may explain why the County rate increased to nearly 200 basis points higher than the State in FY 2021. This includes more residents choosing to stay home as caregivers, more jobs in the hard-hit leisure and hospitality industry, the impact of COVID-19 or other factors. Unemployment rates reached record low levels in both the County and State in FY 2023 and FY 2024.

Although the annualized rates are very low, recent monthly data has begun to rise which could also reflect a growing labor force participation rate. In July 2024 the County unemployment rate stood at 3.5% and the State rate was 3.3%. These are still low by historical standards.

Exhibit 5

Unemployment Rate
Prince George's County vs. State of Maryland
FY 2017 – FY 2024

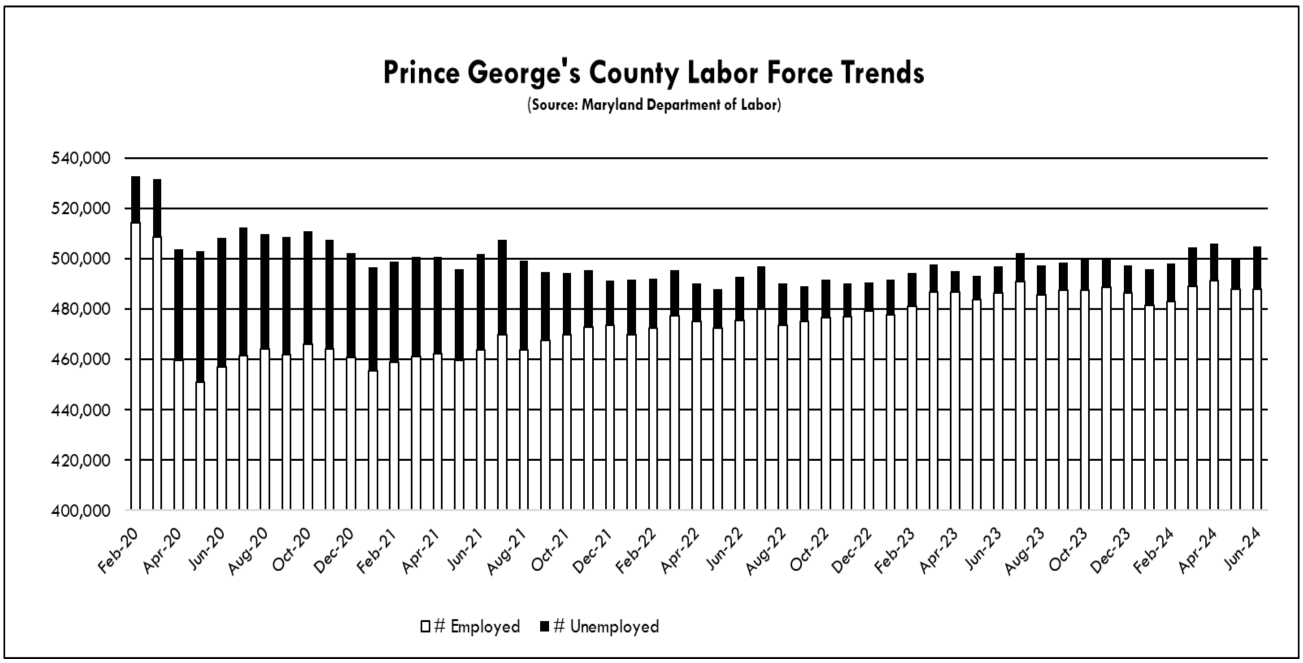


Source: Maryland Department of Labor

Exhibit 6 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 533,000. After the economy re-opened the labor force averaged 494,000 in FY 2022 and 493,000 in FY 2023; a decrease of about 40,000 workers. This is likely due in part to a lack of childcare, the need for caregiving, retirements, deaths and long covid. In FY 2024 the labor force showed signs of growth, increasing to an average of 500,000. As of July 2024, the labor force stood at just under 513,000.

Exhibit 6

Prince George's County Labor Force Trends
February 2020 – June 2024



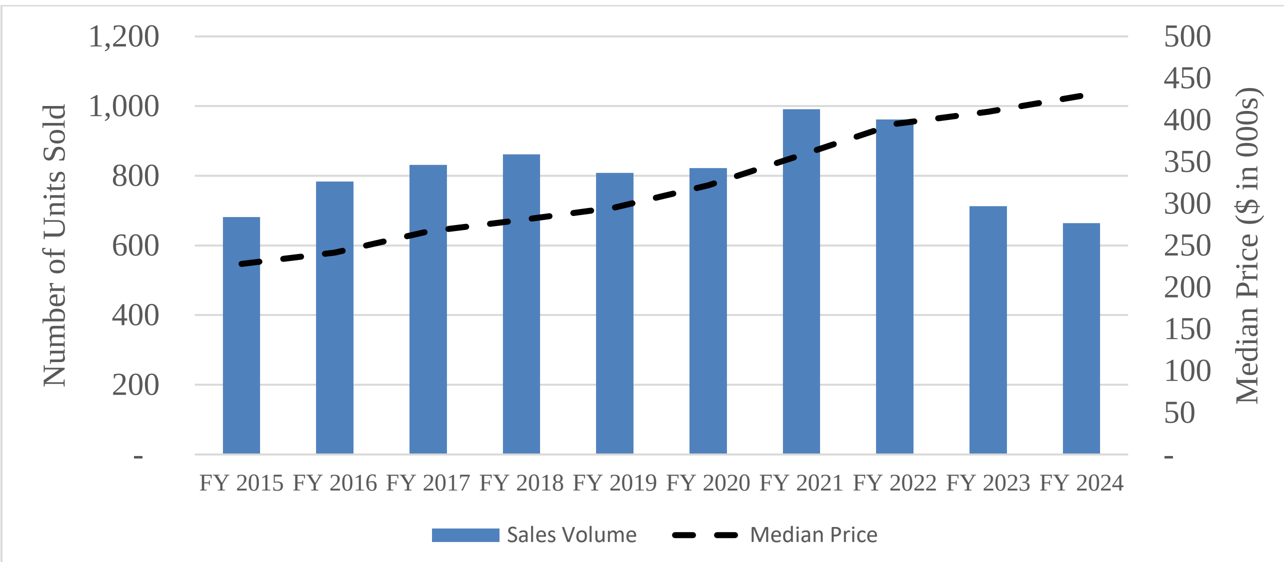
Source: Maryland Department of Labor

Real estate trends are shown in **Exhibit 7**. In calendar year 2021 home sales averaged 1,000 per month. Interest rates were low, and the pandemic spurred a need for larger spaces for home offices and Internet-based education. After the Federal Reserve Board raised interest rates 11 times to address high inflation, mortgage rates rose to the range of 7%. Home sales in the County fell by 33% compared to calendar year 2021. This decrease resulted in a significant decline in Transfer & Recordation tax revenue. In September 2024 the Federal Reserve Board cut interest rates by 50 basis points, but mortgage rates had already been declining in anticipation. Since the inventory of homes for sale is still relatively low, it is not clear that lower mortgage rates will immediately result in higher home sales.

Moody's Analytics had reported that some 60% of mortgages were locked into low fixed rates. Rates may need to continue decreasing for these homeowners to add their homes to the available inventory. In the short-term it is more likely that lower interest rates result in higher prices.

Exhibit 7

Prince George's County
Median Sales Price and Sales Volume
FY 2015 – FY 2024



Source: Metropolitan Regional Information Systems

In FY 2023 and FY 2024 foreclosures have averaged in the range of 600 homes per quarter, which is roughly 22% of the statewide total. This percentage is consistent with pre-pandemic historical trends. However, the number of foreclosures is significantly lower compared to prior years, when the average was as high as 2,500 foreclosures per quarter.

Revenue Outlook

OMB projects that County-sourced General Fund revenue will increase in FY 2026 by $28.1 million, or 1.1% exclusive of the use of fund balance.

Major County-Sourced Revenue

Property Tax

Real property tax revenues are projected to increase by 3.5% in FY 2026 to $1,086.3 million compared with the FY 2025 budget. Per the County Charter, the Homestead Tax Credit is to be set at 3% for the next fiscal year. At this level the County has $113.3 million of unrealized property tax revenue. The projection is higher than the tax credit cap to account for new construction which adds to the existing base and commercial property, albeit smaller, not being subject to homestead limitations.

Personal property tax revenues are projected to grow by $0.9 million, or 1.0% in FY 2026 to $93.3 million. This is based on the March 2024 estimate of the assessable base of personal property in the County for FY 2025, with some expectation for growth in the value of the base.

Income Tax

Revenue for FY 2026 is estimated at $850.3 million, which is $60.0 million or 7.6% above the FY 2025 approved budget of $790.2 million. However, the actual attainment for FY 2024 came in at $788.3 million, which was roughly $25 million higher than forecast. Using this higher base for FY 2024 suggests that the FY 2025 budget is understated. OMB’s revised estimate for the current fiscal, FY 2025, year now approximates $818 million. This estimate is premised on growth of 3.9% in each of FY 2025 and FY 2026, which is based on the 20-year average growth rate in Net Taxable Income for the County.

The Disparity Grant is estimated to decline by -$6.7 million, or -9.7%. The County receives a grant because it’s income tax per capita is below 75% of the statewide average. Prior to the pandemic the County was at around 67% of that average, but in the two years following the pandemic the average fell to about 60% using the data for FY 2024 and around 64% for the data used for the FY 2025 grant. The forecast assumes that the County returns to about the 67% disparity level, resulting in a modest decline in revenue in FY 2026.

Transfer and Recordation Taxes

Transfer & Recordation tax revenue is projected at $166.0 million in FY 2026, essentially flat relative to the approved FY 2025 budget. Home sales are down 33% from the 2021 peak, and although interest rates have begun to fall it is not expected to appreciably increase home sales yet. The inventory of homes for sale remains low by historical standards and is not expected to grow until either building increases substantially or mortgage rates fall to a level where existing homeowners relinquish low mortgage rates that were locked-in before the pandemic. Lower mortgage rates should cause home prices to rise, as buyers bid up the existing inventory. This may slightly increase tax revenue, but the volume of monthly sales is the main driver for this tax source. There is also a noticeable decline in the sales of stabilized multifamily transactions.

Other County-Sourced Revenue

Disparity Grant: The County realized a large increase in this formula-based grant when federal stimulus funds and capital gains temporarily inflated the gap in per capita income tax amounts for FY 2024. The disparity shrank in the subsequent tax year data, leading to a decrease of -$29.2 million. The forecast assumes a further decline of -$6.7 million from this formula based on the expectation that income disparities approach historical levels.

Energy Taxes: The forecast assumes growth of $5.4 million, or 6.1%, largely due to rate increases for electricity. Taxes on electricity comprise the largest component of this revenue source.

Use of Money and Property: As the Federal Reserve Board cuts interest rates, the County's interest earned on short-term investments can be expected to decline. The FY 2026 forecast assumes that interest rates fall to an average of 3%, which is the range thought to not influence economic decision-making. As a result, a reduction of -$9.0 million is estimated from lower returns.

Intergovernmental Revenue: Revenue declines by -$15.7 million, or -30.1%. In FY 2025 the County included $10.2 million in Federal American Rescue Plan Act funds to general fund spending to ensure that unspent allocations are obligated by the federal deadline of December 31, 2024. Once obligated, funds can be spent until December 31, 2026. Another $2.4 million in one-time Federal Emergency Management Agency reimbursement for pandemic-related expenses was also received in FY 2025. Finally, a decrease in the State Aid for Police Protection funding is expected. In FY 2023-FY 2025 the current and prior Governors added discretionary funding to the statutory formula. However, since the State is facing a projected $1.7 billion cash shortfall in FY 2026 it is expected that no additional discretionary funds will be continued in FY 2026 and beyond.

Other Financing Sources The forecast does not presently assume any use of fund balance for FY 2026.

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 $113.3 million dollars in FY 2026, with continued growth in the out years (though this is accompanied, notably, by a mandated increase in County spending on education of approximately $31.3 million in FY26). 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 8 summarizes the General Fund forecast for FY 2025 and FY 2026. Overall, revenue is expected to increase by $143.3 million or 3.1%. Most growth is based on State aid to the Board of Education which grows according to the statutory formulas under the Blueprint for Maryland's Future program. County-sourced revenue is projected to climb $28.1 million or 1.1%. Most of the County's tax and fee revenue growth is found in the real property tax and income tax. Smaller increases are also found in the energy tax, personal property tax, transfer & recordation taxes and other local taxes. This growth is offset by -$40.0 million, which was fund balance usage in FY 2025. The forecast is assuming no use of fund balance in FY 2026. Other decreases are expected from intergovernmental revenues, the disparity grant and use of money and property.

The largest risk to the forecast comes from the projected shortfall of -$1.7 billion in the State's budget forecast. The County forecast already assumes that discretionary police aid will not continue to be funded next year. If the State proposes to change any of the statutory State aid formulas, it will require budget reconciliation legislation at the 2025 session. OMB will monitor the budget closely for any potential impacts on County revenues. County tax credits also erode the tax base. Real property tax credits for the elderly (CB-029-2022) reduced revenue by approximately $11 million a year starting in FY 2024 and a new credit for public safety employees (CB-087-2023) will reduce ongoing revenue starting in FY 2025 by an indeterminate amount.

Fiscal Outlook

As seen in **Exhibit 9**, the County closed FY 2023 with General Fund revenues above spending by $43.8 million, resulting in an unassigned balance of $407.6 million. The combination of the 5% Charter-required reserve, 2% policy reserve and unassigned balance totaled 17.0% of expenditures. In addition to the use of $56.7 million of fund balance in the FY 2024 Approved Budget, spending by the end of the year exceeded revenues by another $19.3 million for a potential total use of funds balance of $76.0 million in FY 2024. Combined, these actions reduce reserves to 13.9% of spending. In addition to $5.1 million from assigned balance, the FY 2025 budget also appropriated $34.9 million in unassigned balance, further reducing reserves to an estimated 13.0% of spending.

Exhibit 8

Prince George's County
Current and Projected General Fund Revenue
FY 2023 – FY 2026
($ in Millions)

($ in Millions)					FY 2025			FY 2026	
County Sourced Revenues	**FY 2023 Actual**	**FY 2024 Unaudited**	**FY 2025 Approved**	**FY 2025 Sept Est**	**Approved-Forecast $ Change**	**Approved-Forecast % Change**	**FY 2026 Forecast**	**Approved-Forecast $ Change**	**Approved-Forecast % Change**
Real Property Tax	$974.6	$1,008.7	$1,049.2	$1,056.7	$7.4	0.7%	$1,086.3	$37.1	3.5%
Personal Property Tax	91.5	93.4	92.4	92.4	0.0	0.0%	93.3	0.9	1.0%
Income Tax	737.9	788.3	790.2	818.7	28.5	3.6%	850.3	60.0	7.6%
Disparity Grant	43.7	98.5	69.3	69.3	0.0	0.0%	62.6	-6.7	-9.7%
Transfer Tax	128.3	111.0	122.5	115.2	-7.3	-5.9%	123.7	1.2	0.9%
Recordation Tax	42.7	34.5	42.0	39.4	-2.6	-6.2%	42.4	0.4	0.9%
Energy Tax	79.0	69.0	89.2	93.6	4.5	5.0%	94.6	5.4	6.1%
Telecommunications Tax	14.2	12.4	14.0	14.0	0.0	0.0%	14.0	0.0	0.0%
Other Local Taxes	27.8	35.2	31.2	31.2	0.0	0.0%	31.7	0.5	1.7%
State-Shared Taxes	7.9	7.7	10.9	11.1	0.2	1.8%	9.9	-1.0	-9.2%
Licenses and Permits	83.8	74.2	79.3	76.5	-2.9	-3.6%	76.9	-2.5	-3.1%
Use of Money and Property	38.3	37.3	37.2	37.8	0.5	1.4%	28.3	-9.0	-24.1%
Charges for Services	72.7	67.5	72.1	70.3	-1.9	-2.6%	70.1	-2.1	-2.9%
Intergovernmental Revenue	41.1	52.3	52.3	54.0	1.7	3.2%	36.6	-15.7	-30.1%
Miscellaneous Revenue	17.7	9.5	8.4	8.6	0.2	2.4%	7.9	-0.5	-5.7%
Other Financing Sources	0.0	56.7	40.0	40.0	0.0	0.0%	0.0	-40.0	-100.0%
Subtotal County Sources	**$2,401.1**	**$2,556.2**	**$2,600.3**	**$2,628.7**	**$28.4**	**1.1%**	**$2,628.4**	**$28.1**	**1.1%**
Subtotal w/o Fund Balance	**$2,401.1**	**$2,499.5**	**$2,565.4**	**$2,593.8**	**$28.4**	**1.1%**	**$2,628.4**	**$63.0**	**2.5%**
Outside Aid									
Board of Education	$1,682.2	$1,870.5	$1,889.0	$1,889.0	$0.0	0.0%	$2,002.3	$113.3	6.0%
Community College	81.7	85.1	89.8	89.8	0.0	0.0%	91.6	1.8	2.0%
Library	9.7	8.6	9.5	9.5	0.0	0.0%	9.6	0.1	1.0%
Subtotal Outside Aid	**$1,773.6**	**$1,964.1**	**$1,988.3**	**$1,988.3**	**$0.0**	**0.0%**	**$2,103.5**	**$115.2**	**5.8%**
Grand Total General Fund	**$4,174.7**	**$4,520.4**	**$4,588.6**	**$4,617.0**	**$28.4**	**0.6%**	**$4,731.9**	**$143.3**	**3.1%**

Source: Office of Management and Budget

Exhibit 10 illustrates the gap between ongoing revenues and spending between FY 2023 and FY 2031. Income and property tax revenue continue to represent the largest components of County-sourced revenue. Lower inflation at the end of FY 2024 again results in a 3% Homestead Tax Credit level for FY 2026. Spending for education, employee compensation, fringe benefits and baseline operating needs grow at faster levels than revenue.

Exhibit 9

Prince George's County
General Fund Pro Forma
FY 2023 – FY 2025
($ in Millions)

	FY 2023 Actual	FY 2024 Unaudited	% Change	FY 2025 Approved	$ Change	% Change
Revenues	$4,174.7	$4,520.4	*8.3%*	$4,588.6	*$68.2*	*1.5%*
Expenditures	4,130.9	4,539.7	*9.9%*	4,588.6	*48.9*	*1.1%*
Surplus/(Deficit)	43.8	-19.3		0.0		
Fund Balance	**FY 2023 Actual**	**FY 2024 Unaudited**		**FY 2025 Approved**		
Committed (5%)	$214.9	$227.0		$229.4		
Committed	86.0 2.0%	136.2 3.0%		183.5 4.0%		
Unassigned	407.6	269.3		184.6		
Total	**$708.5**	**$632.4**		**$597.5**		
Fund Balance as % of General Fund Expenditures	17.0%	13.9%		13.0%		

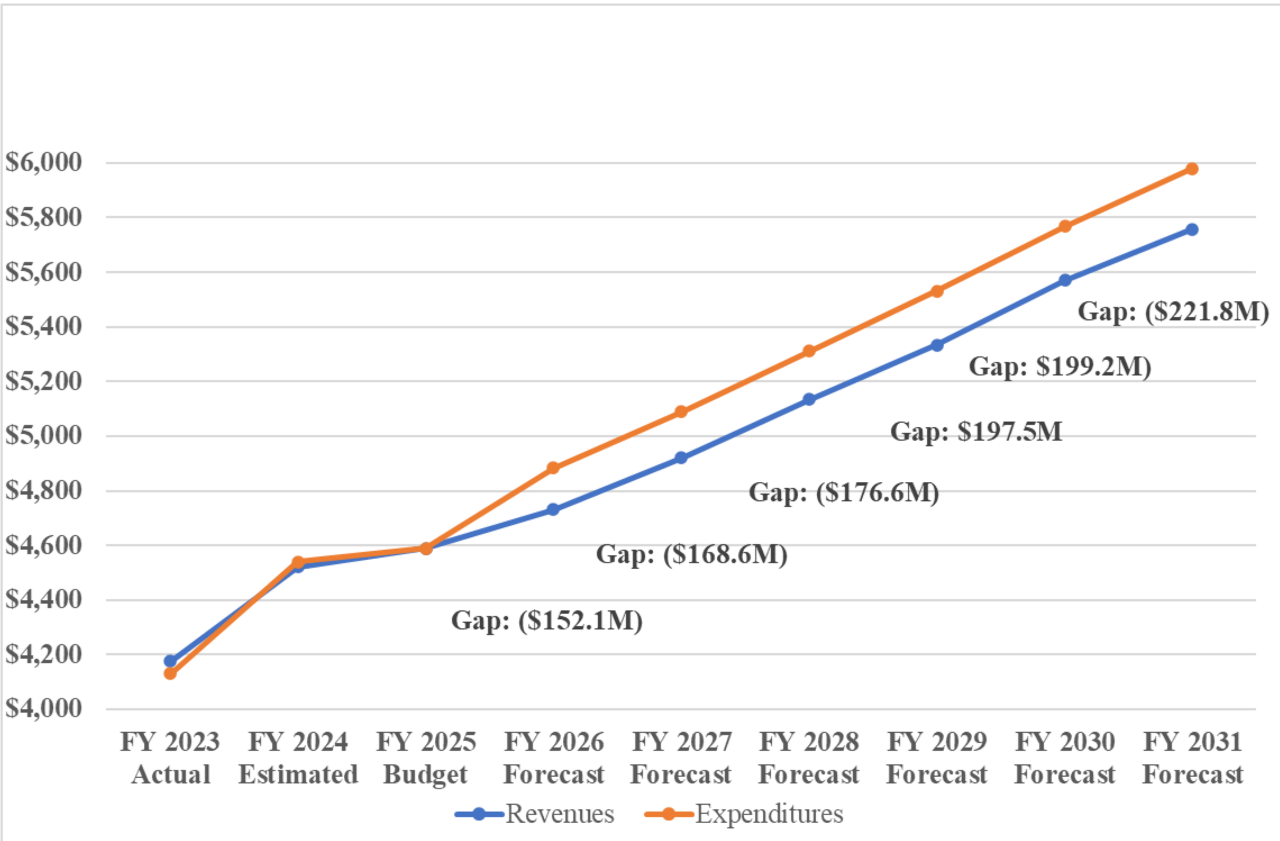
*Note: the estimated expenditures for FY 2024 are based on unaudited end-of-year spending as of 9/4/2024 and reflects use of $56.7 million in unassigned fund balance. FY 2025 includes use of $34.9 million in unassigned fund balance appropriated in the approved budget.

Source: Office of Management and Budget

Exhibit 10 shows that there continues to be a structural shortfall between ongoing revenues and spending. A gap of $152.1 million is projected for FY 2026, growing to $221.8 million by FY 2031. Although the shortfall is significant, it is smaller than the gap projected last year for the FY 2022-2030 period. This is due in part to slightly higher than forecasted income tax revenues in FY 2024. This higher base served to increase revenue projections in future years. Chapters 969 and 970 of the Acts of Maryland of 2024 also reduced the shortfall, by allowing the County to use telecommunications and energy tax proceeds toward the required local k-12 contribution instead of above the formulas.

Exhibit 10

Prince George's County General Fund Forecast
FY 2023 Actual – FY 2031 Estimated
($ in Millions)



Source: Office of Management and Budget

Unfunded Liabilities

The Committee reviewed trends in the level of unfunded liabilities for the FY 2019-FY 2023 period. At the end of FY 2023 the County had $3.7 billion in unfunded liabilities, consisting of pensions, retiree health care (a.k.a. Other Post-Employment Benefits, or OPEB) and the Risk Management Fund which pays for workers' compensation claims and other obligations. The Committee notes the following:

- $1.8 billion in liabilities are related to pension funding, which are 58.9% funded. Most of this liability rests with the police and fire pensions. The County makes annual contributions to each plan, and many plans, are expected to be fully funded by 2045.
- $1.7 billion in OPEB liabilities, which are 5.0% funded. The County currently pays the normal cost for retiree health care, which satisfies annual expenses but makes no progress on the level of this unfunded liability.
- $200 million in Risk Management Fund liabilities, which have grown by $32.7 million since FY 2020. Agency budgets include funding for risk management expenses, but costs have continued to grow.

The Committee is concerned that there is no dedicated annual funding to address the OPEB unfunded liability and recommends that the County establish an annual appropriation in agency budgets for this purpose. Consideration should also be given to increasing the annual agency contribution to the Risk Management Fund.

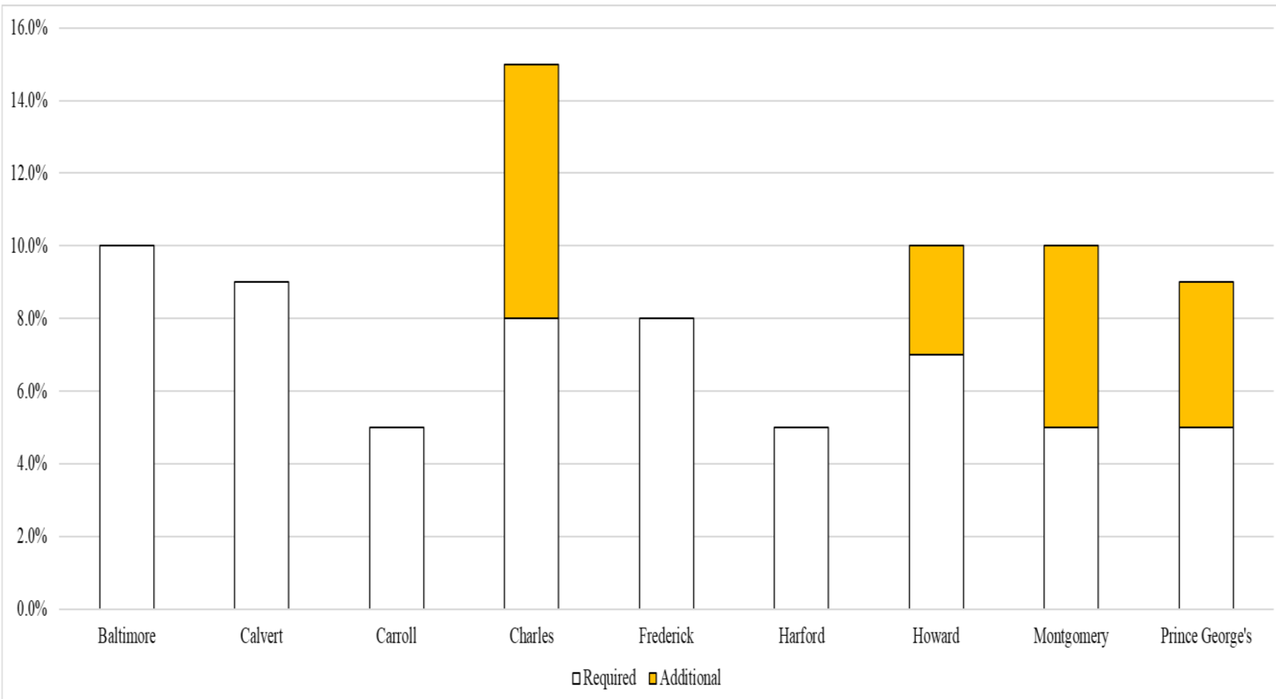
Fund Balance and Reserve Fund Levels

Two years ago, the Committee proposed that the County increase its reserves to a total of 10% of spending, to better prepare for the next economic downturn and to maintain the County's bond rating. This consists of the Charter-required 5% reserve and a phased-increase of the policy reserve from 2% to 5% by FY 2026. The County has made progress in implementing this recommendation, achieving a 9% reserve level (5% Charter/4% policy). **Exhibit 11** illustrates the County's reserve levels relative to the other County governments in Maryland that are rated "AAA" by the three bond rating agencies. The planned increase to 10% will put the County on par with Baltimore, Howard and Montgomery Counties.

The Committee has consistently recommended that the County limit its use of fund balance. State mandated spending caused the County to use fund balance in both FY 2024 and FY 2025. This reliance on one-time revenues led one of the bond rating agencies to issue a negative outlook for the County in May 2024. The potential loss of its AAA bond rating would not only affect the County's reputation but would also increase the interest rate on future County bond issuances and place added pressure on efforts to balance the budget. Thus, the final phase-in of the policy reserve to 5% in FY 2026 takes on greater importance in demonstrating that the County is fiscally responsible.

Exhibit 11

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



Source: Office of Management and Budget

The Committee applauds the County's progress in increasing its policy reserve to the 4% level and recommends that it be increased to 5% in FY 2026. It also recommends that the County not use any fund balance in FY 2026.

Conclusion and Recommendations

Current economic conditions are positive, and actions taken by the County in balancing the FY 2025 budget have improved the fiscal outlook relative to prior projections. However, a structural gap of $152 million remains to be addressed in the FY 2026 budget and there are potential risks to this outlook if the State proposes reductions in State aid when it submits its FY 2026 budget to the General Assembly in January 2025. The Committee is pleased that the County has worked to increase its level of reserves to 9% in FY 2025 and looks forward to the final phase-in to 10% in FY 2026.

Two other areas of concern for the Committee relate to unfunded liabilities and the structure of County revenues. First, the County has over $3.7 billion in unfunded obligations, of which about $1.7 billion represents retiree health care liabilities. While the $1.8 billion in pension liabilities are being addressed over a multi-year period in annual agency budgets, no such mechanism exists for retiree health care which is only 5% funded. The Committee is also concerned that the unfunded liability in the Risk Management Fund continues to grow. Secondly, County revenues are constrained by the provisions of the Tax Reform Initiative by Marylanders (TRIM), and the need for taxpayer approval of rate increases and separately by the Homestead Tax credit cap. These limits are exacerbated by legislation in recent years granting real property tax credits which further erode the County's ability to pay for services.

The Committee's recommendations for FY 2026 are as follows:

- **Based upon a preliminary review of various economic information and revenue trends, the Committee recommends a preliminary General Fund revenue projection of $4.73 billion in FY 2026, an increase of $143.3 million or 3.1% above the FY 2025 budget. This includes spending from County-sourced revenue of $2.63 billion, which rises by an estimated $28.1 million or 1.1%. Unless the County can achieve greater revenue flexibility, most budget balancing actions will need to again come from spending reductions. The Committee does not support the use of fund balance in FY 2026. The size of the shortfall suggests that permanent actions, including the elimination of programs or agencies, will need to be considered. The Committee suggests that a hiring freeze or other cost containment efforts be adopted in the current fiscal year to ensure that fund balance is not further drawn down in FY 2025 or FY 2026. As Moody's noted in its last bond rating, the County's "ability to regain structural balance and stabilize reserves in its fiscal 2026 budget will be key to its future credit trajectory."**

- **The Committee reiterates its commitment to increasing the policy reserve from 4% to 5% in FY 2026. The final phase-in is important to maintain the County's "AAA" bond rating and to allow for sufficient reserves to maintain operations during emergencies.**

- **The Committee is concerned about the level of unfunded liabilities and recommends that the County identify a funding source to dedicate to its $1.7 billion retiree health care liability.**

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 2026 and believe them to be reasonable.

Respectfully,

Henry W. Mosley, Chair

Stephen A. Brayman, Member

Brad Frome, Member

Robert R. Hagans Jr., Member