Budget Blog Series: Setting the State’s Capital Debt Limit

October 22, 2012 Robin Clark Eilenberg County Budgets

In formulating the State’s Capital budget each year, the Capital Debt Affordability Committee is required to review the size and condition of State debt on a continuing basis and to submit to the Governor by October 1 an estimate of the total amount of new general obligation debt that may be authorized for the next fiscal year. This year, the Committee recommended a debt limit of $1.075 billion in state general obligation bonds for Fiscal 2014.

This blog is the beginning of a series on the State’s capital budget process, which will look more closely at the criteria used to establish an appropriate debt level for the upcoming fiscal year and issues that may be considered in doing so.

Capital Debt Affordability Committee

The Capital Debt Affordability Committee (CDAC) was created in 1978 by the General Assembly in response to concern over increasing state debt. As described by the Department of Legislative Services,

Creation of the Capital Debt Affordability Committee was an outgrowth of two events: the dramatic increase in outstanding debt during the mid-1970s and the release of the Department of Fiscal Services’ two-year study in 1974 on the State’s debt picture titled, An Analysis and Evaluation of the State of Maryland’s Long-Term Debt: 1958-1988.

The purpose of CDAC is to recommend the amount of new general obligation debt that may prudently be authorized. CDAC is made up of seven members, six serve ex officio, and one member is appointed by the Governor. Members vote on capital debt recommendations by October 1 of each year based on established criteria, and in consideration of the following:

- the amount of additional general obligation debt that will be authorized during the next fiscal year;
- capital program needs during the next 5 fiscal years;
- projected debt service requirements for the next 10 years;
• criteria established or used by recognized bond rating agencies in judging the quality of State bond issues;
• on a continuing basis, the size and condition of higher education debt, taking into account any debt issued for academic facilities as part of the committee’s affordability analysis;
• other factors relevant to the ability of the State to meet its projected debt service requirements for the next 5 years or relevant to the marketability of State bonds; and,
• the effect of new authorizations on each of the factors enumerated above.

CDAC’s recommendations are the beginning of a series of budget reviews and recommendations to the Governor and the General Assembly that occur throughout the fall. These include a Department of Legislative Services analysis of debt affordability, a Spending Affordability Committee report on the appropriate level of new general obligation debt authorization for the coming year, and a Department of Budget and Management, Division of Capital Budgeting draft Five-year Capital Improvement Program (referred to as the CIP).

CDAC and these other government bodies are all making recommendations, not rules. The recommendations may be disregarded by the Governor or General Assembly — ultimate control over the state budget rests with them.

Debt Affordability Criteria

There are two debt capacity guidelines used by the committee. The criteria were first put into place in 1979, and most recently modified in 2008. The Department of Legislative Services describes the process for changing the criteria, which included expert consultations and public meetings.

As it reviewed the criteria, the committee consulted with rating agencies, investment bankers, and its financial advisor. The Capital Debt Affordability Committee met in public a half dozen times in 2007 and 2008 to discuss debt policy and the criteria. The committee determined that two criteria were no longer appropriate and recommended revising the criteria. . .

The original criteria limited the state debt to 3.2% of the state’s wealth and limited debt service to 8% of state revenues. The state’s wealth is estimated based on personal incomes. The new criteria,
which are still in use today, allow the state’s debt to grow to 4% of the state’s wealth, but maintain the 8% limit for debt service payments.

The Governor and the General Assembly are not bound by the recommendation of the Committee, and the guidelines themselves are voluntary. However, the recommendations are loosely adhered to. Last year, CDAC performed the same assessment and found that the State could take up to $1.08 billion in general obligation bonds. During the 2012 session, the Governor’s budget bill allotted $1.1 billion in general obligation bonds and the General Assembly ultimately adopted $1.075 billion.

**State Debt Across the Nation**

Maryland is not alone in its borrowing; almost all states take debt each year, despite constitutional and statutory provisions requiring balanced budgets. As *Governing Magazine* reports, there are a variety of state budget laws and they vary in their strictness. In many cases, instead of strictly balancing their budgets each year, states base their borrowing on expected revenues. *Governing* quotes, "They compare the expenditures they can expect to the cash they expect to take in," . . . Byron Schlomach, director of the Center for Economic Prosperity at the Goldwater Institute, explains it. "There are uncertainties in both of those, and the estimates can be adjusted to be realistic or unrealistic."

The *Chicago Tribune* quotes Moody’s 2012 report in finding that state debt slowed dramatically in 2011, but was expected to grow slightly in 2012,

"Although both state revenues and personal income generally will grow in the next year, low debt capacity and heightened fiscal management concerns will result in less new borrowing than experienced in the past several years."

The article cites heightened fiscal management concerns and low debt capacities as reasons for a minimal increase in state debt nationwide. Consideration of Maryland’s debt affordability criteria and fiscal concerns were both raised at Maryland’s recent CDAC hearings.

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Budget Blog Series: Spending Affordability and the State’s Fiscal 2014 Baseline Budget

November 6, 2012 Andrea Mansfield Sequestration, State Budget and Fiscal Issues

This item is the second of a series on the State’s operating budget process. The first article highlighted some of the changes that could arise in the Governor’s Fiscal 2014 budget with respect to county governments. This discussion will look more closely at the spending affordability process and how the Department of Legislative Services (DLS) calculated the State’s Fiscal 2014 general fund shortfall and structural deficit.

Spending Affordability Committee

The Spending Affordability Committee (SAC) was created in 1982 from an outgrowth of proposals by the General Assembly to control growth of the operating budget. These proposals looked at using economic indicators to tie the growth of ongoing State spending to the growth of the Maryland economy. Although the SAC makes a recommendation on the level of new debt authorizations and the level of state personnel, the primary responsibility of the SAC is to recommend a target for budget growth to the Governor and General Assembly based on the current and prospective condition of the state’s economy.

Each year, the SAC, composed of members of the General Assembly and three public members, typically holds three meetings. The first meeting, which usually includes all members of the House and Senate fiscal committees, examines the relationship between ongoing general fund revenues and general fund expenditures for the upcoming fiscal year. The second meeting usually examines the state’s debt capacity, the capital budget, the Transportation Trust Fund, and other issues affecting the state’s budget such as federal sequestration. The SAC makes its recommendations in the third meeting. The Governor and General Assembly are not required to follow the SAC recommendations, but typically they comply.

At its first meeting on October 17, the Department of Legislative Services (DLS) briefed the SAC providing members with a general overview of revenues and expenditures for Fiscal 2014. Based on their forecast of revenue and expenditures, DLS is projecting a $247 million general
fund shortfall between fiscal 2013 and 2014 and a general fund structural deficit of $638 million. The remaining section of this blog article will discuss how DLS arrived at its projections and calculated the general fund shortfall and structural deficit.

**Forecasting Ongoing Revenues**

Each year, DLS forecasts estimated general fund revenue using a number of economic indicators and information from the Board of Revenue Estimates (BRE). The BRE, composed of the State Treasurer, State Comptroller, and the Secretary of the Department of Budget and Management, reviews the recommendations of the Bureau of Revenue Estimates each year and officially submits revenue projections to the Governor three times a year: March, September, and December. These estimates project how much general fund revenue will increase or decrease from one fiscal year to the next. General fund revenue sources include the personal income tax, sales and use tax, state lottery, corporate income tax, and alcohol tax, to name a few. In its analysis, DLS uses the September revenue estimate for the purpose of projecting a general fund surplus or shortfall for the upcoming fiscal year.

For Fiscal 2014, DLS is projecting general fund revenue growth of 2.7%, for a total of $15,317.5 billion.

**Calculating Ongoing Expenditures**

To calculate ongoing general fund expenditures for the upcoming fiscal year, DLS constructs what is known as the baseline budget. A baseline budget assumes the following about all programs in the budget: 1) they will be fully funded at statutory amounts; 2) inflationary increases will occur in budgeted programs; 3) program deficiencies are funded; 4) employees will receive salary adjustments; 5) employee benefits will increase by certain inflationary adjustments; and 6) utility and other basic operational costs will increase. These costs are added onto the legislative appropriation for the current fiscal year to project expenditures in the upcoming year.

Since a number of programs in the general fund budget are being funded through special funds, DLS calculated its baseline inclusive of these funds. The State’s Fiscal 2014 baseline budget is $17,611.5 billion, which is $1,180.5 billion more than Fiscal 2013. The increases in the baseline budget can be...
attributed to the following: 1) ongoing requirements and entitlements; 2) new legislative requirements; 3) state agency costs; 4) agency programmatic and operating expenses, and 5) the reserve fund. The largest increases include: 1) in debt service, $160 million; 2) teachers retirement, $97.6 million; 3) medical assistance, $95.7 million; and 4) education and library formulas, $95.4 million.

Calculating the Fiscal 2014 General Fund Budget Shortfall

To calculate the state’s general fund budget shortfall and structural deficit, DLS looked specifically at ongoing general fund revenues and expenditures, but then made adjustments for the Budget Restoration Fund. The Budget Restoration Fund was created during the May 2012 Special Session as a pass-through account for tax revenue generated by HB 1302, State and Local Revenue and Financing Act of 2012. The Attorney General determined that these revenues could not be brought directly into the general fund since an adjustment would need to be made to the budget that passed in April. Instead, the revenue was directed by law to special funds and then transferred to the general fund through a budget amendment.

This calculation gets further idled by higher than expected revenues from the closeout of Fiscal 2012 and projected revenues for Fiscal 2013. Making one time transfers of this temporary excess would make it easier to close a one year budget gap, but would do little to bring down ongoing expenditures to close the overall structural deficit.

To calculate the one year budget shortfall of $247 million, DLS subtracts overall expenditures ($16,326 billion), which includes an appropriation to the Reserve Fund, from total revenue available ($16,079), which includes balances and transfers. The structural deficit of $638 million is calculated by subtracting ongoing operating costs and deficiencies ($15,955 million) from ongoing revenues ($15,317 million). The chart on page 17 of the SAC briefing document provides an overview of this analysis.
Budget Blog Series: Bleak Forecast Continues for Local Aid and Revenues

November 19, 2012 Andrea Mansfield County Budgets, State Budget and Fiscal Issues

As previously reported on Conduit Street, the Spending Affordability Committee meets each year to set a target for State spending in the upcoming fiscal year’s budget to ensure that the rate of growth in spending does not exceed the rate of growth of the State’s economy. This year, local tax rates and salary actions were discussed in the second meeting along with information on local government revenues. Similarly to last year, this information continues to present a bleak budget picture for our local governments.

State Aid to Local Governments

Page 18 of the briefing document begins examining State aid to local governments. Based upon baseline projections prepared by the Department of Legislative Services, local governments will see an increase in aid in FY 2014 of $257.3 million. However, it is important to note what has occurred from FY 2008 to FY 2014, and what constitutes this increase:

In the Fiscal 2014 baseline, total State aid is over $6.9 billion, or 40% of the State’s general fund. However, funding for public schools makes up 87% of that aid, while the county/municipal category is 7.5%. In addition, when comparing Fiscal 2008 to 2014, funding for education has grown by 12.1%, while funding for the county/municipal category has dropped by 43.7%.

As to be expected, public schools are projected to receive the largest portion of the increase in Fiscal 2014, $167 million. Funding for county/municipal governments will see an increase of $53.1 million due to the following contributing factors: impact aid for video lottery terminals; baseline assumptions that police aid and inflationary increases to local health departments (both a part of the teachers’ pension offsets) will be restored; Program Open Space; and Highway User Revenues (HUR).

Note, however, that the increase in HUR is not from a policy change to restore these funds (diverted from local governments each of the last four years), but is simply reflecting a modest transportation revenue increase. In addition, funding from video lottery terminals goes to a small number of specified jurisdictions to address needs created by the locations of these facilities.
Local Revenue

The briefing document shows revenue growth for local governments to be lower than the State’s projected revenue growth. This is due in part to the stagnant status of local government’s largest revenue source: the property tax. Property tax revenue is estimated to grow by .1% from Fiscal 2012 to Fiscal 2013 – resulting in a drop from the prior year estimated growth of .7%. State property tax revenues are estimated to decline at a rate of -0.3% in Fiscal 2014 and -0.8% in Fiscal 2015. They are also expected to experience 1.1% growth in Fiscal 2016; 1% growth in Fiscal 2016; and remain flat at 2.5% growth from Fiscal 2018 to Fiscal 2022. These expectations suggest that local governments have a number of difficult years ahead.

While income taxes are estimated to increase, recordation/transfer taxes are estimated to be fairly flat. It is doubtful that this revenue will be enough to offset losses in local property tax revenues.

MACo hopes that State policy makers keep this revenue picture in mind as they make budgetary decisions affecting county governments over the next couple months and during the upcoming legislative session.