MARYLAND ASSOCIATION OF COUNTIES, INC.

Presentation to the
Public Employees' and Retirees' Benefit Sustainability Commission
November 15, 2010

Thank you for the opportunity to speak with you today to provide the counties' perspective on State pension issues. The Maryland Association of Counties (MACo) would like to take this opportunity to clarify some of the issues raised during the Commission's discussions and help better inform the Commission of the counties' roles and the challenges they face. The following individuals will present their perspectives on these matters, as well as respond to any questions.

David R. Craig, County Executive, Harford County
Elaine Kramer, Budget Officer, St. Mary's County
Ted Zaleski, Budget Officer, Carroll County
Michael Sanderson, Executive Director, MACo

The issues this Commission is addressing are extremely complex. If it's any consolation, you are not facing them alone. As you know, many states have already made changes to their retirement programs to address their system's unfunded liabilities and increasing costs. You have some options before you to do the very same thing. We understand making these decisions is difficult because some of our county elected officials have already had to make decisions to rein in Other Post Employment Benefits (OPEB) and pension costs. We also understand the budget challenges faced by the State because counties are also experiencing declining revenues, budget reductions, and funding mandates such as Maintenance of Effort (MoE).

During your deliberations, much has been said about teacher salaries and who sets them, county school board relations, and the cost drivers of the retirement system. MACo will address these items and county finances in its testimony.

County/School Board Relations and Teacher Salaries

Counties share funding responsibility for education with the State and federal government, but have limited authority over how the funds are used within the school board's budget. State law gives the school board considerable autonomy overall, and nearly complete autonomy within the broad categories that are guided by the county. Not every state operates in this manner, but this is how the division of responsibility was established in Maryland. This presents a number of different challenges for Maryland compared to other states that may have different funding mechanisms or school boards with taxing authority to raise revenue.

In Maryland, the school board negotiates salaries, creates or eliminates school positions, and sets benefits (except retirement). Counties essentially are charged with defining the affordability of the overall dollar amount of a school board's budget and are forced to weigh those priorities within the broader confines of the county's limited revenue sources.

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It is true that teachers' salaries have increased over the past ten years, but this push on salaries was not an accident. A very clear policy direction was set by the State government (with some parallel directions from federal government policy) to increase salaries in order to recruit and retain qualified teachers, to reduce classroom sizes, and to decrease student-to-teacher ratios.

The Governor's Teacher Salary Challenge Program was enacted in 2000 to provide extra financial incentives to local governments to increase salaries by 4% in FY 2001 and FY 2002. This set a much higher threshold for salary increases in the years following, and clearly established state policy that funding to the classroom – where the overwhelming share of education money is invested on personnel costs – was (and remains) a top state priority.

The Bridge to Excellence legislation ("Thornton") was enacted two years later, seeking to achieve gains in public education equity and adequacy by altering and increasing education funding significantly from FY 2002 to FY 2008. According to the MGT Report, a consultant's evaluation of the effectiveness of Thornton, most of the new revenue received by local school systems went towards competitive salaries and benefits. While counties acknowledge that county appropriations to education also increased during this time frame (an outcome envisioned and supported by the Thornton Commission as part of the expected gains toward funding adequacy), this deliberate infusion of State money clearly had a substantial and intended effect on teacher salaries and the number of staff employed.

During the primary phase-in period of State Thornton funding (FY 2002 to FY 2008), it should surprise no one that staff employed by local school systems increased by 8,274 positions, or 15.5%. Salary increases and position growth was absolutely consistent with the State's often-expressed commitment to the classroom, as well as the new federal direction expressed via its No Child Left Behind law.

County Finances

The recent weakened economy has wreaked havoc on the counties just as it has on the State. However, the counties have been squeezed on multiple sides. Not only has county revenue declined, but State assistance to county and municipal government has also suffered disproportionately as part of the State's budget balancing.

Counties rely on two main tax sources for revenue, the property tax and the income tax. With respect to the property tax, Maryland is currently experiencing the largest decline ever in property assessments and there is no indication that the housing market will return. Properties assessed last year declined by a statewide average of almost 20%, and the comparable decline is expected to be even greater for the current assessment period. For the first time ever, we are going to see property tax revenues actually shrink for many counties (even a majority) who keep the same tax rate.

County income tax revenue has also declined just as it has for the State. Although, income tax revenue is expected to grow slightly, high unemployment and little improvement in the job market give little hope of significant recovery during what appears to many as a modest "jobless recovery."

Lastly, State aid going directly to counties and municipalities in the areas of health, public safety, land preservation, and roadways has been drastically reduced since FY 2007. Direct funding to county and municipal governments from all sources has declined by over $520 million, while funding for education and libraries, entitlements, and state agencies has increased by over $1.3 billion. **Exhibit 1.** Reductions taken in FY 2010 have been carried through to FY 2013 and in some cases have been made permanent. These reductions have already been built into budget forecasts.

Meanwhile, the state's long-standing Maintenance of Effort law requires counties to maintain education funding from one year to the next or risk losing State funding. In effect, this has forced most counties to slash funding for other important services well below prior funding levels, while education funding has essentially been held harmless. To accommodate these reductions, counties have drawn down rainy day and reserve funds, laid off employees, eliminated thousands of additional positions, and implemented furlough and pay reductions. **Exhibit 2.**

As counties try to cope with declining revenues and reductions in State aid, there is fear that more may be shifting their way. A proposal to transfer an escalating portion of teacher pension costs to the counties passed the Senate this past session. This Commission is directed to consider this proposal as a part of its charge. Should a cost shift of this magnitude occur, there is great and justified concern that this would force a number of jurisdictions to dramatically increase property taxes to accommodate the cost. **Exhibit 3** illustrates the effects of the teacher pension proposal that passed the Senate this past session in terms of a penny on the property tax. If adopted and fully phased-in, this proposal would increase county property taxes by an average of five cents or more. For jurisdictions without the capacity or ability to increase local tax rates, the added reductions to non-education services could be overwhelming. While from the State perspective a cost shift may appear to resolve a substantial part of the sustainability of pension funding, it simply relocates these cost burdens – away from the level of government that has complete control over benefit levels and has deliberately guided policy toward wage increases, and toward the level of government that has played the far lesser role in these cost changes.

Cost Drivers

As previous presentations to the Commission have demonstrated, the drivers of teacher pension costs have been several. The substantial growth in the teacher wage base (including both new hires and wage increases) has been completely in keeping with that forecasted by the Thornton fiscal note, correctly assuming that most investment in school funding would translate to wages. Local funding growth has been a modest component of this escalation, far less than the State's policy decision to try to "catch up" to the overall level of county funding for schools, a stated goal of the Thornton legislation.

Whereas, much has been said about teacher salary increases in previous presentations to the Commission, no information has been presented about salary increases for State employees. Although the State employee wage base has not increased at the same rate as the teachers, normal salary adjustments have been provided and the wage base has continued to grow even during FY 2010 and FY 2011. Considering State policy goals with respect to education, you would expect the teacher's wage base to increase at a greater rate, but to leave State employee salaries out of the equation all together is not a fair characterization.

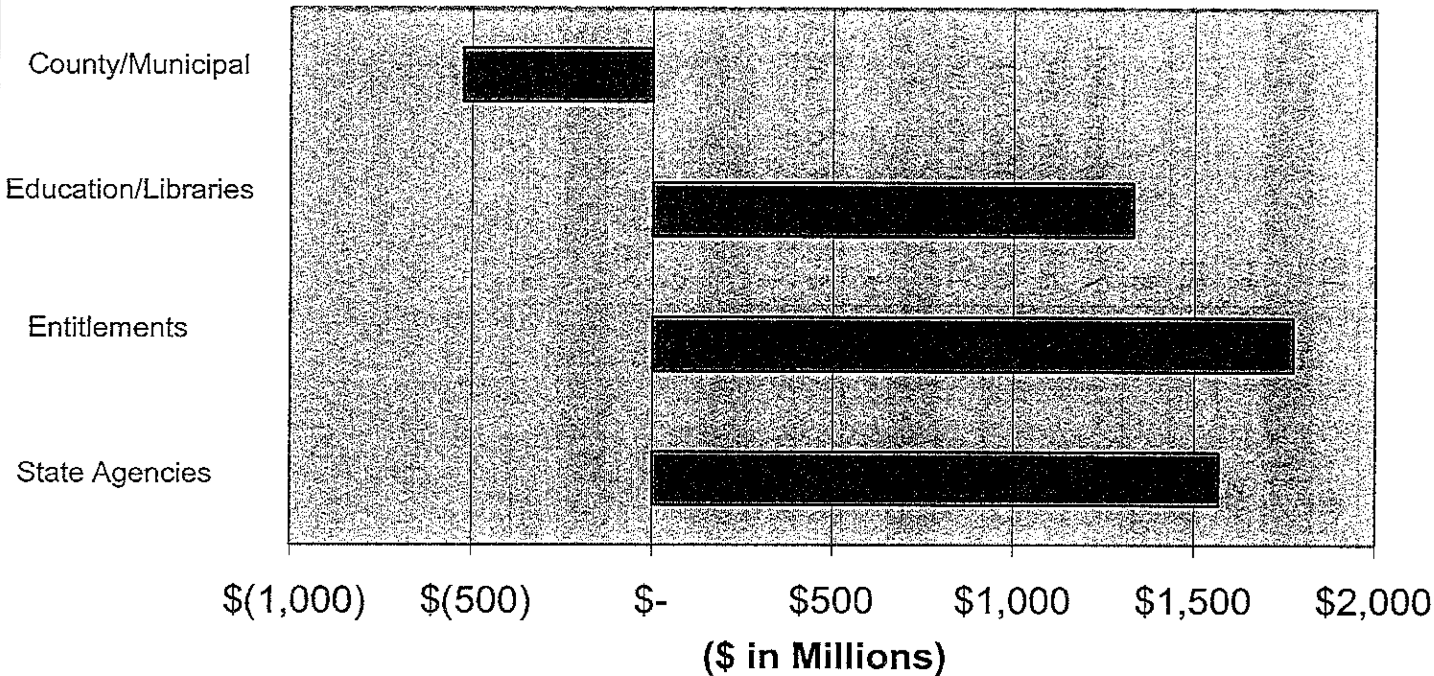
The employer contribution rate has been the more meaningful element causing growth in these costs. This rate is generally a function of the system's funding status and the benefits offered. In general, the benefit levels (such as the "multiplier" used to calculate retiree benefit levels) and all relevant components of the system such as the vesting and full retirement ages, are all fully controlled by the State via statutory policy. The State decision to elevate benefit levels during the 2006 legislative session necessarily caused a multi-year escalation in the contribution rates. And the sudden weakening of equity markets triggered a dramatic surge in contribution rates as the system requires a "catch up" factor to regain stronger funding ratios over time.

Other cost drivers include the average investment return of 2.1% over the past 10 years when the System's assumed rate of return has been 7.75%, and the corridor funding method, which continually underfunds the system. These drivers indicate some structural problems with the System and until these problems are addressed, costs are going to continue to escalate.

As the Commission's work continues, and focus falls onto growth in the costs of pensions (especially for teachers and related employees), it is essential to understand the reasons for these changes in costs. The picture that is developing is one where State policy decisions, not local largesse, have been the overwhelming drivers of these costs.

Again, we would like to thank you for the opportunity to speak with you today. We greatly appreciate the comprehensive and cautious approach the Commission is taking in examining these issues, and we ask that you look to MACo as a resource as you meet and deliberate over the next year.

Exhibit 1



Notes: County/Municipal does not include community colleges and health
Source: Department of Legislative Services, 90 Day Report

Exhibit 2

FY 2011 County Budget Actions – As of July 12, 2010

General Budget Information	Number of Counties
Counties with Budget Shortfall	17
Counties Experiencing Revenue Decline	18
Personnel Actions	
No General COLA for County Employees	22
No Merit Increases for County Employees	21
Enacted Furloughs (range of 3 to 12 days)	8
Enacted Layoffs	7 (902 identified, fewer after retirements and reassignments)
Eliminated Vacant Positions	17 (total positions 1040)
Tax and Fee Actions	
Property Tax Increase	3
Property Tax Decrease	4 (3 due to constant yield)
Other Tax and Fee Increases	11
Education Actions	
Reduced Funding for Education	9
Met or Exceeded MOE	22
Fund Transfers	
Dipped into Rainey Day/Reserve Funds	14

Source: MACo survey May 2010

Exhibit 3

Teacher Retirement Costs Reflected as Penny on the Property Tax

Prepared by the Maryland Association of Counties (2010-11-11)

County	Local Share of Costs	Penny on Tax Rate Generates	Property Tax Equivalence
Allegany	$3,516,480	$410,673	$0.09
Anne Arundel	29,131,830	6,265,500	0.05
Baltimore City	30,143,760	3,190,346	0.09
Baltimore	39,201,281	7,158,192	0.05
Calvert	6,864,569	1,350,000	0.05
Caroline	2,142,623	267,223	0.08
Carroll	10,747,112	2,119,998	0.05
Cecil	5,908,674	1,040,410	0.06
Charles	10,167,023	1,896,326	0.05
Dorchester	1,697,942	323,531	0.05
Frederick	14,296,066	2,847,312	0.05
Garrett	1,590,860	438,834	0.04
Harford	13,822,181	2,601,739	0.05
Howard	24,012,833	4,177,545	0.06
Kent	915,179	272,545	0.03
Montgomery	69,923,861	17,412,015	0.04
Prince George's	45,162,311	9,552,000	0.05
Queen Anne's	2,811,756	898,746	0.03
St. Mary's	5,647,166	1,088,285	0.05
Somerset	1,140,059	174,887	0.07
Talbot	1,529,076	644,045	0.02
Washington	8,164,674	1,229,580	0.07
Wicomico	5,760,812	932,557	0.06
Worcester	3,233,775	1,848,143	0.02
Unallocated	0	0	
Total	**$337,531,903**	**$68,140,432**	**$0.05**

Sources: Department of Legislative Services ; Maryland Association of Counties Budget, Tax Rates, and Selected Statistics - FY 2010