MARYLAND ASSOCIATION
OF COUNTIES, INC.

**Presentation to the
House Ways and Means Committee
Local Aid Briefing
February 1, 2011**

Thank you for the opportunity to speak with you today regarding the state of local government finances and challenges local governments will face over the next several years. The following individuals will present their perspectives on many pressing issues facing local governments, as well as respond to any questions.

Isiah Leggett, County Executive, Montgomery County
Ingrid M. Turner, Council Chair, Prince George's County
Andrew Mackel, Deputy Director of Finance, Wicomico County
Michael Sanderson, Executive Director, MACo

Considering the State's $1.6 billion budget deficit, local governments are appropriately concerned about local effects of the State budget. Local revenue sources are in dramatic decline, county budgets are already stressed by personnel costs and essential services – but the biggest unknown for every local government is the effect that the State's budget may have on local finances. We hope our presentation today will provide a better understanding of the fiscal challenges local governments are struggling with as they work to balance their budgets.

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 this year declined by a statewide average of 22% after a statewide decline of almost 20% last year. 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 in recent years, 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."

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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 $570 million, while funding for education and libraries, entitlements, and state agencies has increased significantly. **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 the Governor's proposed budget.

It's being argued that local governments, counties in particular, can accommodate additional reductions because some jurisdictions have made different budget decisions than has the State in recent years. This is simply not a true depiction. Almost all counties denied employee COLAs and merit increases in FY 2011. One-third enacted furloughs and layoffs, and over two-thirds eliminated vacant positions totaling over 1,000. Many counties increased fees, enacted across the board reductions, or increased other taxes to balance budgets. The four counties that actually reduced property tax rates this past year each coupled them with these cost-cutting actions. In addition, over half of the counties dipped into rainy day and reserve funds. **Exhibit 2.**

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. While the General Assembly adopted some one-time remedies in the 2010 Session and the State Board granted waivers to two counties that requested waivers, the core issues of the current waiver system remain. Legislation is needed to replace the current waiver system with a clearer and fairer process for evaluating county hardships in waiver requests.

It should also be noted, that while State revenues have seemingly turned the corner, local revenues quite clearly have not. The State's largest revenue sources, the income tax and the sales tax, are expected to grow 4.7% and 3.4%, respectively. Overall State revenue growth is estimated to be 3.3% for FY 2012. The counties' largest revenue source, the property tax, is expected to be flat at best. Until property assessments and housing prices rebound, counties will be facing even more difficult revenue situations than the State, and will find it extremely difficult to accommodate additional budget reductions and cost shifts arising from State budget resolution.

Pensions

As counties try to cope with declining revenues and reductions in State aid, there is widespread and understandable fear that more may be shifting their way. Although the Governor has stated that a cost shift to the counties would not be included in his proposed budget, a transfer of an escalating portion of teacher pension costs to the counties passed the Senate this past session and a Commission has evaluated such a shift as part of its interim recommendations. If the Senate proposal were adopted and fully phased-in, this proposal would be equivalent to a five cent increase in the typical county's property tax rate. **Exhibit 3.** 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.

The employer contribution rate, which is principally a function of the Pension System's funding status and the benefits offered, has been the far more meaningful element causing growth in these costs. The State decision to elevate benefit levels during the 2006 legislative session necessarily and predictably 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.

Highway User Revenues

Maryland's local governments have a direct impact on the transportation system of our state, yet they are faced with many challenges in helping to oversee and maintain this system. Whereas, some jurisdictions may fund transportation through a combination of State and local sources, and others rely solely on State funding, HUR is a significant component used to fund and maintain this system. Local governments are responsible for more than 80% of Maryland's road miles, but recent actions to HUR have significantly reduced the funding to maintain roadways and fund operations.

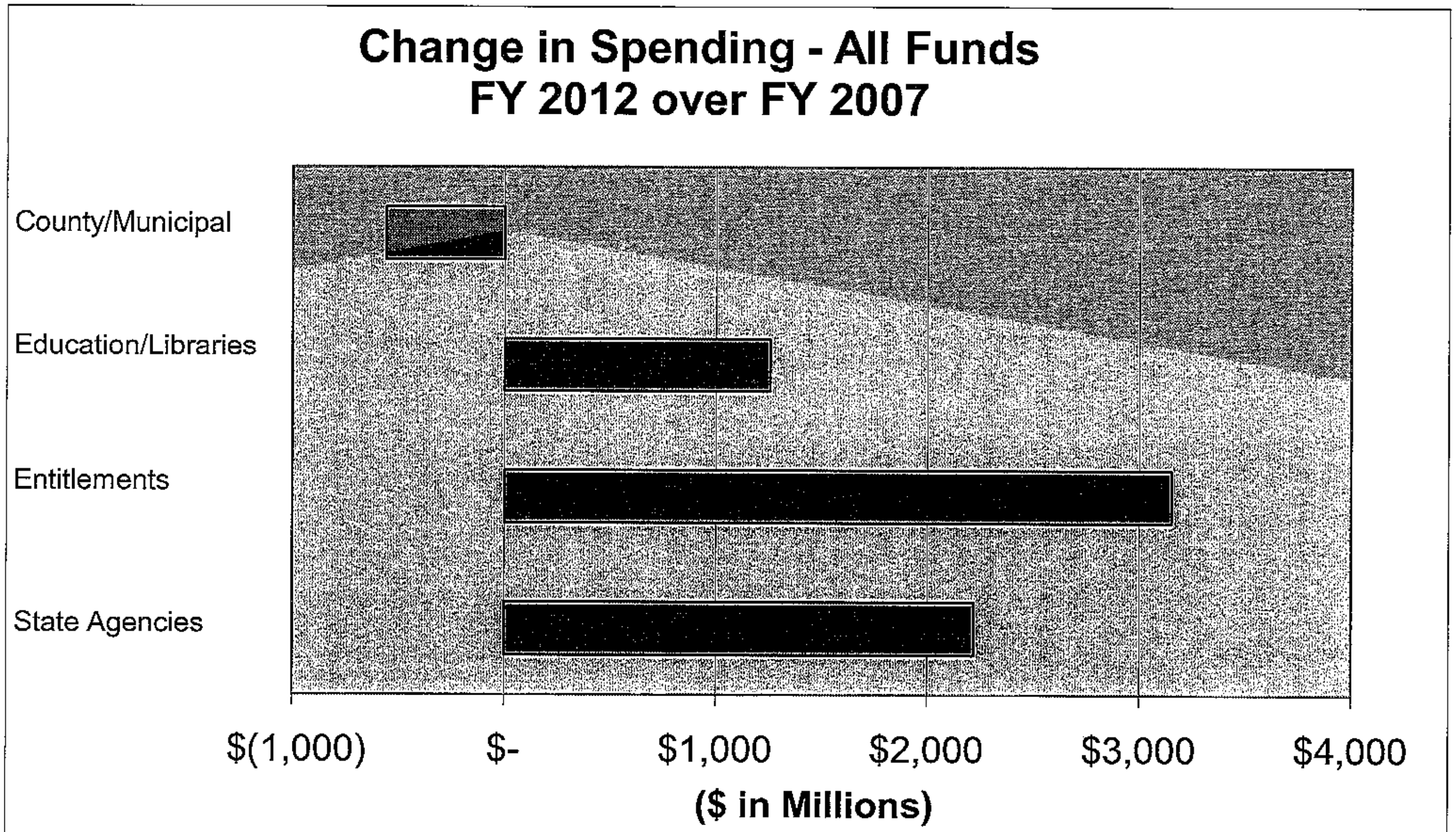
Maryland's citizens do not know where State road maintenance stops and local road maintenance begins. They simply know that they pay taxes on their vehicles and fuel, and have an expectation of travel on good roadways. Transportation must be operated as one system with State and local roadways being maintained adequately. MACo believes that reductions to HUR are creating a dual system where State roadways are being maintained and local roads are falling short.

Since FY 2007, annual HUR funding to local governments has fallen by over $420 million, or 76%. The most drastic action was taken in FY 2010 when the Board of Public works reduced these distributions by 95% for most jurisdictions. Then during the 2010 General Assembly session, these deep reductions were extended permanently, sending two-thirds of the traditional local HUR distributions to the State's General Fund. This creates a perplexing irony to the taxpayer: the State is transferring gas tax revenues to its General Fund, forcing local governments to raid their property tax revenues to maintain any semblance of a local transportation program.

In closing, MACo and its members understand the challenge of balancing the FY 2012 budget. Counties have made good faith efforts to avoid simply "saying no" to being part of a reasonable State budget solution – and anticipate once again illustrating the local effects of budget cuts and cost shifts as part of MACo's advocacy. We do hope to keep communication open as we address the challenges of FY 2012 and beyond.

Thank you for giving us the opportunity to speak with you today.

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