Open Work Session
September 3, 2019
Wicomico County Fund Balance Policy

Mr. Wayne Strausburg, Director of Administration, came before Council and said, just by way of background, he and Mrs. Hurley have been discussing this and felt it would be a good idea to revisit the Resolution they sent over some time ago as he thinks the County really has to be mindful of some undercurrents they are facing right now. He explained, they still do not know what the impact of the $15 an hour minimum wage is going to be, both the direct impact on County payroll and also the impact on the private sector, and there is a likelihood that jobs will be shed. He said $15 an hour for a 40-hour work week is close to $33,000 a year before benefits for a minimum wage job, and that is a pretty hefty price. He said they also do not know what the impact will be with the proposed Kirwan mandates for which there is no identified funding stream. He said, based on what they know right now, and from speaking with Mike Sanderson, they anticipate that, at best, the annual recurring cost for Wicomico County is going to be $2 million a year, and that is recurring. He said the State also has the extremely underfunded OPEB trust, and, if Council recalls, they had an underfunded State employee pension trust, and the State down streamed 50 percent of that to the Counties. He said the State currently has and is projected to continue to have a structural deficit. He said, earlier today, Mrs. Hurley circulated an article that appeared in Maryland Matters where Comptroller Franchot urged restraint with respect to spending, and is anticipating a recessionary cycle. He said Andy Schaufele was at Summer MACO along with two other presenters, and their loud and clear message was it is not if they are going to have a recession, but it is when they are going to have a recession, and there were several recession indicators that were disturbing, one of which is the interest rate inversion. He explained, short-term interest rates are higher than long-term interest rates, so the investment community has sidelined their capital because there is great uncertainty about the economic cycle they are entering, so, at some point in time, because that capital is sidelined, it is going to make sourcing of funding for capital projects much more difficult. He said, with all that in mind, they felt it was appropriate to revisit their fund balance policy because that policy was adopted in 1996, and that policy does not work in today's environment. He explained, last year they proposed a 17 percent targeted fund balance for the uncommitted fund balance, and continuing with 5 percent for the rainy day fund, so the two together would be 22 percent. He said, frankly, when they sent that over last year he was fairly comfortable with the 17 percent, but he will tell Council today that he probably thinks that is a little light, and, if it were up to him, he would urge they move that part of it perhaps closer to 20 percent, and to maintain what they call the rainy day fund at the 5 percent. He said, to put that into perspective, when they clear out all the accounting their operating costs take about $11 million dollars a month to run the County, so if they are sitting on $33 million dollars between those two funds, that would run the County for three months. He said, to put that into context, their median household wage is $55,000, so if someone was earning $55,000 a year and had three months in their savings account and lost their job, that would be fairly catastrophic. He said when people say the County has too heavy of a fund balance, he thinks they are not looking at the perspective of three months operating capital for the County if something catastrophic were to occur.

Mr. Strausburg said he will answer any questions Council may have about this, but he really feels they should move something forward where they codify a more robust fund balance policy, and he thinks if they do not do that they are going to regret it in the long run. Mr. McCain said 17 percent is a minimum target, so they can push for more and do not have to have it set in the policy. Mr. Cannon said during the last recession they had 18 to 25 percent. Mr. Strausburg reported, they previewed what they sent Council with the three credit rating agencies last year when they went up to New York prior to the bond sale, and it was met with very positive feedback, and they felt it was an appropriate move for them to be making. Mr. Cannon said everything Council has been given talks about a minimum of 12 and maximum of 17. He then asked if Mr. Strausburg is suggesting their minimum would be 17, to which Mr. Strausburg responded, he is suggesting they ought to think about, in his opinion, a maximum target of 20 for the unassigned fund balance, and a minimum of 12, but he is thinking they should move that to 15. He said, because of the uncertainty, the thing he does not think they want to do is raise the goal too high. He explained, they are using fund balance for one-time capital spending, and they do not want to put themselves in a position where they cannot spend on capital projects that are necessary because it violates the fund balance policy. He said, if it were him, he could live with 17 and 12, but he is not too sure that he would not urge Council to go to 20 and 15.

Mr. Holloway said, when he was reading all of this in the Brief Book, he was expecting Mr. Strausburg to want to drop it to 12 percent. He said they catch a lot of grief regarding education because the County has too much of a fund balance, and apparently the Board of Education does not have much, if any, in reserves, from what he hears, but what they need to be educated on is the reason they get all these new schools and renovations is because the County has a good fund balance, and that looks good in New York when they go to borrow money. Mr. Strausburg said the strong fund balance offsets the street's unhappiness with the revenue cap. He said, again, just to put this into broader context, they will exceed their revenue estimates this year, and they will underspend their expense budget. He said they should have a pretty good handle on the numbers from FY18 by the end of September, so they will put more money back into the fund balance again this year, but they want to be careful about not building too high of a level. He said they have been living on income taxes because their real property tax base has not gotten back to its prerecession levels, to which Mr. Holloway responded, it will once they get done assessing the east side. Mr. Strausburg said the reason their revenue has grown as much as it has is local income tax, and local income tax has been a function of job growth. He said one of the things that has his attention right now is that job growth has really leveled out, and a lot of the jobs that have been added are lower wage scale jobs, so he is concerned about their income tax receipts leveling out. He said he is also concerned that the tax return environment in the State of Maryland is pretty fluid right now because, as Council knows, Maryland's response to the Federal tax code change was, if they take the standard deduction on their Federal return, they have to take the standard deduction on their State return, and that, generally, is a lot of money for the State of Maryland. He said people saved money on their Federal return because of the reductions, but they paid it to Maryland, particularly high wage earners. He said Andy Schaufele was concerned about this as well, and he thinks they are going to see the possibility of some real tax return changes in behavior, so they may have had what the State referred to as a windfall this year, but that may evaporate next year. Mr. Holloway asked what ramifications will they hear from the State by having an increased or higher fund balance, to which Mr. Strausburg responded, he cannot predict that. He said Council will recall when they went into the recession they restricted highway user revenue (HUR) money, but they had to find that money someplace, and the State changed the rules on maintenance of effort, so they adopted what he calls a carrot and stick policy where, if they raise the local income tax rate to the State maximum, they reset their maintenance of effort. He said there is already talk at the State level of increasing a County's ability to raise their local income tax rate, and there is already talk about taking it from 3.2 to 3.5. He said, when the State does not have a revenue source for a massive spending program, one of two things has to happen; either that money has to come from some other place, but when 80 percent of their budget is for education, public safety and health, the other revenue source is an income tax increase, so it would not surprise him at all if Maryland raises the State income tax rate. He said, again, he just thinks there are things out there that they need to be paying very, very close attention to. He said he cannot predict what they are going to do about Kirwan, but all he knows is that the $3.8 billion dollars is not there, the State Comptroller has said it is not there, and the State Governor has said it is not there.

Mr. McCain said he appreciates Mr. Strausburg's comments, and he agrees with him in terms of having the foresight to look at these major issues in front of them, but he thinks 12 and 17 are still pretty appropriate. He said, if he remembers correctly, the percent they had in 1996 was at 3 percent with a goal of 5, so they are going from 3 to 5, to 12 to 17, and they are a County already with the biggest fund balance as a percent of the current revenue. He said, with all that said, whether they are at 12, 15, or 17, they are still way ahead of their peers, and at the bond market or anywhere with those kind of numbers they are going to look at that and say that is great. Mr. Strausburg said it helps their credit rating tremendously. Mr. Hastings asked if that puts a target on their back? He said he would think with the Appropriations Committee and the State looking at them and thinking they have money, why would they cover so much of what they do, to which Mr. Strausburg responded, because this money is used for one-time capital expenditures, and not for operating costs.

Mrs. Acle asked if she heard Mr. Strausburg correctly that education is the largest division of funding, to which Mr. Strausburg responded, 80 percent of their budget goes to education, which is the Board of Education, Wor-Wic, Public Safety, the Library, and Health, and that is 80 percent of their budget. Mrs. Acle said, looking over the Kirwan Commission recommendations, they are suggesting Wicomico County have one-on-one tutoring for every student in middle school and high school to bring up their reading and math levels, so she thinks that is definitely going to cut into the rainy day fund. Mr. Strausburg said they are getting a little bit off track here, but one of the primary concerns he has about the approach being taken on this is that it does not seem to address some core issues they have in their educational system. He clarified, Wicomico County is one of the poorest Counties in the State, and he does not see Kirwan addressing the poverty level that is a significant part of their student body. He said they have children who come to school and the only meals they get in a day are the meals they get at school, so they are not addressing that core issue in this Kirwan study, and they are not addressing what he thinks is a fundamental issue with school discipline. He said their disciplinary policies in public education have eroded since the 1970s. He said he has two daughter-in-laws who are teachers, and they have both said the money does not cause them distress, but the fact that they cannot discipline a student who needs to be disciplined and they do not get support from their administrators, vice principal, or principal is what stresses them out. He said, if they are not going to address these core issues, they are not addressing the raw material. He said they are not addressing the behavioral issues, they are not addressing the poverty issues, and he does not think they are going to significantly change their educational outcomes if they do not address those core issues. He said, from his standpoint, he has a fundamental skepticism that this is going to make a dramatic change in their student outcomes because they are not addressing the kid who comes into school and the only two meals he is getting are at school, and they are not addressing the behavioral issues the teachers have to deal with every day, and they are not addressing some of the socioeconomic factors that, quite frankly, are not moving in the right direction. Mr. Hastings said they could not fix that through Kirwan, and they could not fix that through anything. He said there is not much they can do other than raise the amount of money the individual is getting paid, which is the same reason Mr. Strausburg is upset about the $15 minimum wage. He said there are a lot of poor folks who are poor for a reason, and they cannot turn around to give enough food to their kids, which is why they are moving the direction they are with their education system. He said Mr. Strausburg brings up a good point, but they need to walk and chew gum at the same time, and they need to deal with both of those situations, but until they do that he thinks they are going to have similar outcomes.

Mr. Cannon said he agrees with what Mr. Hastings said about the State looking for any excuse they can to say their balance is too high, but their only argument is they have learned from past experiences. He said they went into a true recession, which he thinks was less threatening at the time than what he sees now because they are looking at a recession on top of all the issues Mr. Strausburg discussed, including minimum wage, Kirwan Commission, etc. He said, should a recession hit equal to the last one, they could see something equal to what they did with the HUR the last time. Mr. Strausburg said the last recession was a speculative bubble that just exploded, and, if people we paying attention, they could see that coming, but it just made no sense at all. He said this one he would call more structural in that it is not going to fix itself over time, and he does not know where their funding sources are going to be.

Mr. Cannon said they recognize the logic, but the State does not always want to listen to that logic. He said, at the end of this proposed Resolution, there is a statement that it shall become effective immediately upon its adoption, but this is not Emergency Legislation, so that is one thing he would want to strike if this were to come back.

Mr. Holloway said Mr. Strausburg said this fund is used for one-time capital projects. He then asked Mr. Strausburg to explain what that means because he thought these funds were supposed to be put in a reserve fund, to which Mr. Strausburg responded, each year when they do the budget they fund their capital projects that are one-time capital projects through either borrowing in the bond market or using what they believe to be excess fund balance. He clarified, he wants to codify how they define excess fund balance because right now excess fund balance is anything over 5 percent of the current general revenue, and that is too low of a threshold. Mr. Holloway asked if Mr. Strausburg is saying if they set a rate of 17 percent that 17 percent will always remain in a reserve fund and never be used for anything, to which Mr. Strausburg responded, unless the Council and the Executive determine there is a state of emergency. He said what they are trying to do, again, is better define what they consider excess fund balance. Mr. McCain asked what they are at right now, to which Mr. Strausburg responded, their unassigned fund balance is $32.7 million, and their rainy day is $7.6 million, so they have $40.3 million dollars. Mr. Holloway asked, if they were at 17 percent and 5 percent, where would they be, to which Mr. Strausburg responded, that would take them to $25 million in unassigned, but they would still have the $7.6 million, so that would take them down about $7-8 million dollars. Mr. Holloway said he thought they were taking it up, to which Mr. Strausburg responded, it would be over, and they would have more in fund balance than their target goal of 17 percent. Mr. Cannon asked how they would drain those funds without lowering taxes, to which Mr. Strausburg responded, they would have to decide on that. Mr. McCain said they are borrowing money every single year, so they would just not borrow as much money, to which Mr. Strausburg added, or they could pay down debt. He said, again, excess fund balance is a moving target, and is based on whatever someone's individual opinion is. He clarified, they are trying to say they have a codified goal of whatever percentage they decide, and anything above that is considered excess fund balance, so it quantifies the term excess fund balance because right now it is anything over 5 percent. He said they could go down to 3 percent, which would be foolish. Mr. Cannon said their debt obligation is pretty high, but it is not beyond what is allowed, as he understands it, and he is surprised they have a debt obligation that is so high when they have reserves that are equally as high. Mr. McCain said he thought their debt obligation was actually low, to which Mr. Strausburg responded there is a 12 percent P&I threshold, and they are right at about 10.5 percent right now. Mr. Holloway said they could use that money to pay off some of the higher interest loans, to which Mr. Strausburg responded, they could pay down debt if they wanted to, but that becomes an exercise in what kind of return they would get on their idle funds versus what the interest rate would be if they paid it down, so it just becomes math. Mr. McCain said they could borrow less. Mr. Strausburg said they could accelerate some capital projects they know they need to address. Mr. Holloway said, as Mr.

Cannon said, they could lower taxes. Mr. Hastings said, while interest is low, accelerating capital projects would make sense, though they cannot really get too much lower, to which Mr. Strausburg responded, he has talked to several financial experts about what they see with the interest rate environment, and they have all said they still think the Fed is going to lower the discount rate again, and they do not see any real increase in the interest rate environment over the next three years. He said, for a guy who came through the Jimmy Carter years of 18 percent interest rates, he looks at 2 percent and says that is almost free money. Mr. Cannon asked if they can still refinance old debt, to which Mr. Strausburg responded, they have looked at everything where it would make sense to refinance. Mr. Cannon asked if the State changed that rule, to which Mr. Strausburg responded, no. He said they do that every year. Mr. McCain said when he started his business 31 years ago interest rates were 18.5 percent. Mr. Holloway said the trouble is that a lot of farmers back then had floating loans at 6 or 7 percent when they borrowed money for their poultry houses, and then it went to 18, and that tanked a lot of people.

Mr. Cannon said, if they put this in action, it sounds like it might easily help them with the Beaver Run scenario, to which Mr. Strausburg responded, it could help them with a lot of things. He said whatever threshold they decide upon and are comfortable with and put in place, he would like to do this after they have the fiscal 2018 results firmed up. Mr. Cannon asked when that will be, to which Mr. Strausburg responded, the audit is not going to be complete until November, but he would think that by the end of September they will have a pretty good handle on where they have landed unaudited. Mr. Cannon said that will be plenty of time to be able to configure this for next year's fiscal budget, to which Mr. Strausburg responded, that is what he was going to say. He said then they would have plenty of time to take a look at their capital needs, go back to the CIP, and agree if they can as to what they feel their idle fund balance is and how it ought to be put to work, and they can incorporate that into the next CIP and next budget cycle. He said there is not any urgency associated with this other than he would like to see them moving along with it and come to a consensus as to what the thresholds ought to be. Mr. Cannon said even Mr. Taylor agrees on the threshold, to which Mr. Taylor responded, he would point out that the Government Finance Officers Association (GFOA) does fund balance guidelines, and he thinks Mrs. Hurley sent that out to Council last week. He said they are having a webinar in about three weeks on setting fund balance guidelines, and how to do what they call a risk analysis. He said he thinks it is $160 if they are not a member, but he would think it would be money well spent, and maybe Council and some of staff would like to come in and listen to it. Mr. Strausburg said they had Davenport actually interface with the GFOA and get best practices, and his recollection is that they determined best practices were anywhere from three months operating cash to six months operating cash. He said, as he said, right now they are above three months if they take their unassigned and rainy day, so they are probably around four months. He said at that time they felt being in the range they were was probably comfortable. He said they ran it past credit rating agencies and they ran it past PKS, and everybody felt pretty good about it, but that was some time ago, and that was before some of the things he talked about earlier, so, from his standpoint, he looks at it today and thinks maybe they should be a little more conservative and raise those thresholds. Mr. Taylor said he sent Mrs. Hurley a brochure on that program if Mr. Strausburg would like it. Mr. Cannon said that is a good idea.

Mr. Cannon said this is a Work Session, of course, and he guesses to some extent there is an ask as far as how much of this Council agrees with or does not agree with. He then asked how this is going to come back to Council, to which Mr. Strausburg responded, maybe they want to wait. Mr. McCain said he would wait until after the three weeks and then talk about the risk analysis and educate themselves, to which Mr. Strausburg responded, he thinks they can talk about it more intelligently after they know what their year-end results are going to be. He said he is working on a five-year forecast under certain assumptions that incorporates things like Kirwan expenditures, use of highway user revenue, and insurance premiums probably escalating on average 8 percent in a year. He said then they will have a model, and can crank that in and take a look at what it looks like in each of the next five fiscal years if these things happen, and that will help them with fund balance policies. Mr. Cannon asked if it would be too premature to try to get this back to Council for their first or second meeting in October, to which Mr. Strausburg responded, no, he thinks he can do that. Mr. Cannon said the first meeting would be October 1, to which Mr. Strausburg responded, he thinks he can have the five-year model by the end of September, and a pretty good handle on their fiscal 2018 results unaudited. Mr. Cannon asked Mr. Strausburg to let Mrs. Hurley know, and they will keep either the first or second meeting open.

Mr. Holloway said they talk about what other Counties do as far as their reserves. He then asked if their risk is greater than other Counties due to the fact they are a poor County, to which Mr. Strausburg responded, just off the top of his head he would say they could look at it in a couple of different ways, but he would say their economy is less volatile than the State at large because they have several basics here. He said, if they lost Perdue, that would be a big problem, but their local economy is a pretty stable economy, albeit a modest economy, so cyclical fluctuations in their economy do not concern him as much as some down streaming from the Federal or State Government of costs they just do not have a revenue source for. He clarified, that is his big concern.

Mr. Cannon said Council appreciates Mr. Strausburg bringing this to their attention, and they will revisit this in October. There was no further discussion.

John T. Cannon, President

Larry W. Dodd, Vice President, District 3

Ernest F. Davis, District 1

Nicole Acle, District 2

Josh Hastings, District 4

Joe Holloway, District 5

William R. McCain, At-Large

Laura Hurley, Council Administrator