Open Work Session
Fund Balance Policy/10-Year Financial Model
November 19, 2019

Mr. Wayne Strausburg, Director of Administration, came before Council. Mr. Cannon said Council appreciates Mr. Strausburg taking the initiative to put this in place because a fund balance policy is important. Mr. Strausburg said, first of all, he apologizes for the data dump, but he felt it was important for Council to have a broad view of what he believes their fiscal environment is going to look like in the next three to five-year cycle. He said they did a ten-year projection, but a ten-year projection probably loses a lot of validity after about the third or fourth year because it is very hard to project what is going to happen in the out years, particularly in an environment that is very fluid, but they put this together. He said this model is now a model they can use year after year, update it any time they want to update it, and it rolls to the Departmental level. He said, if they want to take a look at what County finances would look like under varying assumptions, this model will produce that all the way down to the Departmental line by line detail, which he thinks is critically important as they are in very fluid times. He clarified, he does not anticipate they are going to make any decisions today on fund balance policy because he thinks it would be prudent of them to wait until they see what the Legislature is going to do with Kirwan, and Kirwan is probably the biggest elephant in the room right now, and is still very fluid. He said he served on the MACO subcommittee that followed Kirwan, and they met on a weekly basis, and it is still very fluid, and it is still subject to what the Legislators are going to do, which is anybody's guess, but it is something, obviously, that they have to pay very close attention to.

Mr. Strausburg said, in terms of the ten-year forecast model they have produced, he wants to go through the assumptions they made. He said, first of all, on the revenue side, they assumed fairly level employment. He said, if they look at Dave Ryan's SWED report that comes out on a monthly basis, they will see that their employment plateaued. He said it is rising somewhat, but they are not seeing the kind of growth they saw coming out of the recession, so they assumed a 1 percent annual growth in local income taxes. He said, for property base trends and resultant revenue he simply assumed the two-year annual growth they are subject to under the revenue cap. Mr. Holloway asked if the 2 percent has been the average over the past five years, to which Mr. Strausburg responded, he used 2 percent just because that is what they are limited to under the revenue cap. Mr. Holloway asked if that is where it is prior to today, to which Mr. Strausburg responded, no. Mr. Holloway asked what the growth has been, to which Mr. Strausburg responded, they still have not recovered to the pre-recession base. He said, in the last triennial they had about a 6 percent growth in base, and they will probably see that in the next two cycles, so, in terms of what their property tax revenue increases have been, they have tried to live in the past several cycles with the revenue cap limit. He said, in terms of projecting it, he made that assumption because that is really the upward limit. Mr. Holloway said he just wonders what it has been in the past, to which Mr. Strausburg responded, he can get that for him, but he does not know it off the top of his head. He said, just from a forecast standpoint, he was trying to show Council what it would look like if they make reasonable assumptions. He said he ran these assumptions by Davenport and Associates, their credit advisors, and they had a good give and take. He said he did not want to be too conservative, but, on the other hand, he wanted to be realistic, and Davenport felt that what they landed on was a fairly good set of assumptions still subject to conversation. He said, from an expense standpoint, he assumed a 2 percent annual rate of inflation in 2020, which is about where they have been running, but then after 2020 looking at a quarter of a point increase up to a 4.5 limit, and 4.5 percent has been the historic level of inflation in the Country over the past five decades. He said, again, he thought that was a reasonable assumption on the inflation side. Mr. McCain said he thinks they reference it as the CPIU, which, actually, measures growth in government expenses and so forth, to which Mr. Strausburg responded, the CPIU is all urban consumers. Mr. McCain said there is one that takes out the general items and focuses on governmental because they are dealing with health costs, and things of that nature, which tends to exceed it quite a bit. Mr. Strausburg said, again, he is being cautiously optimistic here. He said he thinks it is reasonable to assume, and it is not only the cost of inflation to the government, but it is cost of inflation for consumers, so that impacts discretionary spending, and cost of inflation for businesses, so it impacts not only the government itself, but it impacts their entire economy. He said, speaking of health, the forecast nationally for health costs increases is 6 percent. He said they factored in 8 percent because the Lower Shore health experience is not as good as the national average, and they have a much higher incidence on the Lower Shore of cancer, diabetes, and coronary issues. He said 8 percent has been their run rate, so they forecast that 8 percent out.

Mr. Strausburg said, for compensation assumptions, they assumed 2 percent to address both inflation and the increase in the minimum wage because the $15 an hour minimum wage increase is going to produce wage scale compression. He said, again, frankly, he thinks 2 percent a year over the 10-year period may be a bit below what it may actually turn out being. He said for their Departmental operating cost trending, they took a look at their past five years trending and assumed they will continue to perform at that same level over the forecast period. He said for capital spending and borrowing capacity, fed discount rates, and impact on borrowing rate he assumed 4 percent in 2021, and he is, personally, looking at the presidential election in 2020 and what may happen with interest rates following that election. He said he thinks Council saw the fed chairman say late last week that the feds' efforts at quantitative easing of their manipulation of the fed discount rate is pretty much done, and that they have done as much as they can. He said, if they enter another recessionary cycle, they are going to have to grow themselves out of that recessionary cycle, and they will not be able to manipulate a recovery through fed actions. He said, again, if they return to 4 percent interest rate and then 4.5 percent after, when they look at that in historic terms, that is still a fairly low interest rate environment.

Mr. Strausburg said, in terms of fund balance policy, he assumed they would maintain unassigned at 17 percent of recurring revenue, and the rainy day policy where it is right now, which is 5 percent of recurring revenue. He said, for borrowing capacity and annual debt service, he just took it to the 12 percent policy limit and backed into that for what their ability to borrow would be. He said what he did with CIP pay go was defaulted. He said, assuming the revenue projections and operating expense projections they have, and looking at their annual operating margin after they pay their debt and what is left over for pay go capital, they are going to see in the ten-year projection that there is going to be an awful lot of pressure on capital spending if these assumptions turn out to be valid assumptions.

Mr. Cannon said Mr. Strausburg has the debt services listed as maxing out at 12 percent, to which Mr. Strausburg responded, 12 percent P&I on an annual basis. Mr. Cannon then asked if that is maxed out, to which Mr. Strausburg responded, that is as high as they can go by policy. Mr. Cannon said he thought with measures they have been taking over the last few years, especially with the large increase in pay go funding, that the whole objective was to pay down the debt to avoid getting to the 12 percent, but it seems like Mr. Strausburg's projections are going in just the opposite direction, to which Mr. Strausburg responded, no, what he is really trying to do is show the sensitivity. He clarified, he is not suggesting that this is what they are going to borrow, but he is suggesting what it would look like if they go to their maximum borrowing capacity. Mr. McCain said Mr. Strausburg is doing this for demonstration purposes, not recommending, to which Mr. Strausburg responded, it is a sensitivity study. Mr. Cannon said he just thought that was what Mr. Strausburg was anticipating, to which Mr. Strausburg responded, no. Mr.

Cannon asked if Mr. Strausburg is talking about worst case scenario, to which Mr. Strausburg responded, yes, he is trying to show Council what it could look like under these assumptions. He said, if they want to make different assumptions, they can put that into this forecast model and produce a completely different ten-year forecast, but for right not he was trying to be realistically conservative.

Referring to his slide, Mr. Strausburg called Council's attention to the 2020 estimate. He said their net operating is $18,303,000 million, and their existing debt service would be $14,552,000. He said, in general terms, if they do not want to go into fund balance, this gives them $3.5 million for pay go if they want to look at it that way. He said, going to 2021, they have a net operating margin of $16,500,00, and debt service of $15,700,000. He said what they see in 2021, again, assumes the assumptions are right, particularly with regard to how the Kirwan funding mandate is going to play out, and that is something they just do not know right now. He said he met with Mr. Jesse Reid and Mr. Micah Stauffer from the Board of Education, and they got the base 2030 spending in 2020 dollars. He said, at that time, the Kirwan Commission was anticipating that base, which added about $2 million dollars to Wicomico County, would increase at a rate of about 2.4 percent annually over the phase-in period, but that assumes a smoothing of that growth. He said they know that smoothing is not going to occur because, in order to get the results from Kirwan that are desired, they have to frontload a lot of that spending, so they do not know what the funding curve is going to look like, and they do not know yet what the State is going to pick up, and how much they are going to downstream to the County. He said, if they look at 2021, from there on out they will see the cash funded capital evaporates, and they really do not have any ability to fund capital expenditures through pay go if these assumptions are correct, so that funding of capital expenditures is going to have to come through borrowing. He said, to answer Mr. Cannon's question, that is why he went back to look at if they are going to be under that kind of pressure with infrastructure spending, they are going to assume their 12 percent P&I limit and drop that number in. He clarified, again, this is just simply a forecast exercise to demonstrate that he thinks they will have significant pressure on their ability to fund capital infrastructure if these assumptions are correct.

Mr. Strausburg said, to go back to something he said at a meeting with Secretary Schultz, what will be critical for the County in any event, regardless of this, is that they are going to have to grow their way to increased revenue, which will require water and sewer in the designated growth area, and that is a critical component because they have to build their base, and the only way to build their base at any reasonable rate under State regulations is to provide public water and sewer. He said that will not only build their base, but also maintain water and sewer in corridors that are already under pressure with regard to failing septic. He said it is a model that he wanted Council to see because he thinks it sets the stage for a very cautious approach to this year's capital improvement plan, and also their operational budget. He said he does not think they will have the requisite information they need with regard to State actions until they are well into their budget cycle, so he thinks, from the Administration's standpoint, they are going to take a very cautious, conservative approach to budgeting this year. He clarified, not that they have not in past years, but there are issues on the horizon that they really need to be paying very, very close attention to. He said the other thing he will mention to Council is that he is concerned about two pretty significant revenue sources, the first being highway user revenue. He said, under the current Legislation where they are getting increases annually in highway user revenue, that sunsets in 2023, and, absent any new Legislation, they reset to 10 percent, which is a big hit for the County. He said the other thing he is concerned about is disparity grant. He explained, there was a lot of discussion during the Kirwan Commission meetings about the disparity in wealth, and that disparity in wealth had to be taken into account in terms of how much local funding would be imposed on the Counties. He said, after interfacing yesterday with Michael Sanderson, his concern is the Legislature looking at disparity grants, and if they have factored wealth differential in the Kirwan funding mandate, they may now say they have handled that. He said the disparity grant is low hanging fruit for the State to help the State fund its share, which is $7.5 to $8 million dollars a year. He said, to put that into context, that is 11 to 12 cents on their property tax rate, which is sobering, so they need to pay very close attention to that. He said they need to lobby their Delegation and anybody else they can to do as much as they can to ensure that disparity grant is not negatively impacted, and that there is some reasonable continuing restoration of highway user revenue because they need both of those to keep their infrastructure in shape. Mr. Cannon said it sounds like Mr. Strausburg has worked his way up to 25 percent. Mr. Strausburg asked, 25 percent of what, to which Mr. Cannon responded, of the maximum. He said Mr. Strausburg was trying to figure out what his variables would be.

Mrs. Acle said she went to the SWED meeting on economic growth, and how education directly impacts that. She said, in sitting through all of the Kirwan meetings, they have great plans, but she did not see much accountability on the financial end, and what the plan is for that. She said she was wondering what Administration plans to do to make sure these funds are implemented correctly, and monitoring how they are spent over the cycle so they do not run out of money. She said 17 Counties had to pay back a portion of their disparity funding because they were not allocating it appropriately in education. She said she does not know if Wicomico is one of those, but that is just showing that, if they are not monitoring the spending, this will come back to the local Government to make up that balance. Mr. Strausburg said that is a very, very complex topic, but, just going off the top of his head, the vast majority of local Board of Education spending decisions are really made at the State level, and there is not a whole lot of leeway at the local level for how the Board of Education money is spent. He said the Board of Education provides the County with an excellent comprehensive annual financial report. He said, in terms of getting deeper into how the Board of Education is spending its money, he is not prepared to really offer an opinion on that because so much of it is subject to State authority. Mrs. Acle said she agrees that it is State authority, but locally how they are actually implementing it would be the question, and she just wanted to make sure that the Administration has a plan on how they are going to oversee this large amount. She said it is over 50 percent of their tax dollars, to which Mr. Strausburg responded, he just really cannot comment on that right now because they have not gotten that far down the road, and they are still trying to figure it out. Mr. McCain said he has seen in presentations that only 10 percent is discretionary, and 90 percent is nondiscretionary. Mr. Strausburg said he thinks the question Mrs. Acle is asking is if the mandated spending is being spent in the manner in which it is supposed to be spent, and that is a question he just cannot answer.

Mr. Cannon said, based on what Mr. Strausburg was talking about earlier, he remembers Mr. Strausburg throwing around 15 and 20, but he seems to have settled here on 12 to 17, and he knows they are just looking at a work in progress. He then asked if Mr. Strausburg thinks 15 to 20 is a more representable figure, to which Mr. Strausburg responded, somewhere in the data dump he gave Council he had a sensitivity on what it looked like. He said in their latest audited figures as of June 30, 2018, their unassigned fund balance was $32.7 million dollars, and their recurring revenue was $135.9 million, so if they adopted an unassigned fund balance policy of 17 percent, that would equate to $23.1 million, and they are already $9.6 million above that threshold. He said, if they adopted an unassigned of 20 percent, that takes them to $27.2 million, so they would be $5.5 percent over that threshold. He said their current unassigned fund balance is at 24.1. He said he was trying to demonstrate, with where they stand right now, and going back to the fact that under the assumptions they have made, pay go capital gets very, very scarce, so they would not recommend they get cavalier about fund balance in terms of spending fund balance because he thinks they need to protect that fund balance to the extent they can so they can weather anything that is unexpected from a capital standpoint as they move forward. Mr. Holloway asked how that will affect their bonding if they drop to those figures. He said, reading

Standard and Poor's, they, basically, brag about Wicomico County's fund balance, and they use that as one of the reasons they are rated the way they are. He then asked Mr. Strausburg what he thinks about that, to which Mr. Strausburg responded, he thinks adopting a fund balance policy of between 17 and 20 percent unassigned, which is something he went through with Davenport, that is a pretty strong fund balance policy, and he does not think it would negatively impact them on their credit rating. He said he is more concerned about protecting the fund balance dollars themselves in the event they need those fund balance dollars because, again, as he casts this forward, assuming the assumptions are right, generating the kinds of surpluses they have been generating in the past several budget cycles is going to become more problematic. He said Council may recall at the last meeting when they discussed this he mentioned where they have really had strong revenue growth has been in local income tax revenue, and not so much property tax revenue. He said, when their job growth begins to level off, they cannot anticipate that kind of continued local income tax growth unless they have a fairly strong jobs generation effort going on. He said that is part of the reason they are so focused on the Airport, and it is also part of the reason they are very, very focused on water and sewer because that will generate that growth and those jobs, but that will not happen quickly. He said his major concern right now is the next two to three budget cycles as they are trying to grow into what he would call the new normal.

Mr. McCain said, in reference to Mr. Holloway's question, the percent they are talking about is still a very strong percent, and they would still be one of the strongest in the State, if not the strongest. He said he does not know the exact number, but he was told there were ten other Counties that have a higher bond rating than Wicomico County, but they have a lower percentage of funds than Wicomico County, and there are other reasons why they have that high bond rating, but, as a percent, Wicomico is very strong regardless. Mr. Strausburg said Wicomico County is one tick below AAA, and the reason comparable Counties have a higher bond rating than Wicomico County is their revenue production capability. He said they are typically metroplex Counties, and they have a more diverse economy, a stronger job base, and a stronger wealth base, so that is what gets them the AAA as opposed to Wicomico County being one step below AAA. He said, from an interest rate standpoint, it really does not make any difference. He said they have typically sold at a lower true interest cost rate than most of the AAA rated Counties, and part of that is because of their financial results on an annual basis, their fund balance, and the fact that they have a very stable economy. He explained, Wicomico's economy is not as volatile as a metroplex County might be because they have three mainstays here that are not going to be cyclical. He said what hit them hard in the last recession, and hit everybody hard, was that they had this speculative boom in real estate, and it was a bubble that eventually had to burst, and it did burst big time. He said, as they go through what people are anticipating as their next recession, they are not anticipating that it would be the type of hard recession they had the last time, but it will be what he would call a structural recession where it is not a bubble that bursts, but the fundamentals have to recover, and that takes a bit more time. He said they sat in on the conference call with the GFOA on how they build a fund balance policy based on what could happen, and what their threats are. He said he actually thinks the biggest wild card, and the biggest threat this County faces right now is Annapolis. He clarified, the biggest financial threat Wicomico County faces is mandated spending and/or taxation changes at the State level. He said that is probably the biggest threat to their County's finances, and they have very little control over that.

Mr. Hastings said, to him, one of the biggest wild cards in his mind is the Federal government. He said they keep continuing to kick the can down the road, but their national debt is ungodly, and that created the structural debt in the past, which is why the State had to do what it has had to do, and then kick it down to the Counties. He then asked where all the smart people are going when it comes to federal dollars because that, to him, is a big challenge that he does not think anyone is really talking about, to which Mr. Strausburg responded, when there is a structural deficit at the federal level, and they have a structural deficit at the State level, and they have candidates running on a platform of massive increased spending, that is very disconcerting, and he is a fairly conservative guy from a financial standpoint. He said the math eventually does not work, and he thinks the math already is not working, but they just have not faced up to the fact that they are writing checks they cannot cash.

Mr. McCain said, to get into the point of how susceptible they are with what happens at the State level, getting to the Board of Education, which is the biggest part of their budget, when they were at the Blueprint presentation, one of the slides showed where they are today in terms of what percent of their current Board of Education is County dollars, which he thinks is something like 22 to 23 percent, and about 72 or 73 percent is from the State. He said, at the end of 10 years of the blueprint, 11 percent will be County contribution, and 82 percent will be State of Maryland. He said the thing is, what goes on at the State is what dictates what goes on at their County level. Mr. Strausburg said, again, that assumes that the State has the revenue stream to support that level of State spending, to which Mr. McCain responded, that is what the blueprint is, but the State becomes an even bigger player for the County. Mr. Strausburg said, if they go back to Thornton, that was never fully funded, and Kirwan is, basically, ten times Thornton with no identified revenue source. He said he does not know where the State could cut services, and he certainly does not know where the County could make any real meaningful cuts to services without getting into essential services, which is counterproductive. He said the question in his mind is, at the State level and at the County level, where is the revenue going to be produced that will support this spending. He clarified, he is not arguing whether the spending is well intended and is going to yield proper results because he is not an educator, but what he is looking at is where the revenue string is to support what the Kirwan Commission wants to see done. Mr. McCain said that just goes back to Mr. Strausburg's point that what goes on at the State is going to have a huge influence on the County because they do not have control over it, to which Mr. Strausburg responded, which is why he says the State is the biggest threat to their local finances. Mr. McCain said he agrees with Mr. Strausburg.

Mrs. Acle asked how the equitable services in Maryland affects education because, although they are one of the lowest funded in the County, they are also the second highest at the State level, so she is not sure how that would come into play with Kirwan, and having additional State dollars be put towards education, to which Mr. Strausburg responded, that is a function of the wealth formulas. He explained, based on the 2019 Department of Legislative Services County Government statistics, Wicomico County ranks 22nd out of 24 jurisdictions in wealth. He said, when they say the State funds this disproportionate amount of educational funding at the County level, they have to bear in mind that the State formulas on per student funding are homogenous, and are applied across all 24 jurisdictions, and they have very wealthy jurisdictions that pull those numbers up, and they have very poor jurisdictions like Wicomico and Somerset where they are expected to meet the State average. He said the State recognizes those disparities in wealth, and that is part of the reason there is a discrete disparity grant, but it is also part of the reason the State funds a higher proportion of their per pupil course because they recognize that disparity in wealth. Mrs. Acle asked if they have had a significant cut in the Department of Health dollars, to which Mr. Strausburg responded, he does not think they have had a significant cut, but he would say he does not think the State funding, particularly for mental health, has kept pace with what is going on in the environment. He said with mental health, addictions, and the homeless population, he does not think the State, and County as a result, have kept pace with what the true costs of those needs are. He said he thinks at times they do not recognize the costs of mental health issues, homelessness, poverty, and addictions. He said there are a lot of costs associated with those that are not immediately seen. He said, if they look at the Detention Center, probably 75 to 80 percent of the population have mental health and/or addiction issues, and the costs of housing and caring for those detainees is enormous. He said he is not saying that number is hidden, but it is embedded in the Detention Center's budget, and is not immediately apparent to the general public that it is a huge cost, and whether they are addressing it in the way they should address it. He said he thinks they are not addressing it as a society, not just this County or State, but the entire country where they have a crisis with regard to mental health and homelessness, and they are paying for it.

Mr. Cannon said, on the descriptions in reference to funding and restricted funding, Mr. Strausburg mentioned obligation, but he did not see OPEB. He then asked if OPEB should have been in there as a part of restricted funding, to which Mr. Strausburg responded, their OPEB is fully funded. Mr. Cannon asked, as a long-term policy? Mr. Strausburg then asked if Mr. Cannon is asking if they should establish a threshold for not letting their OPEB funding fall below a certain percent? Mr. Cannon said they could do that, but it is a little more general in terminology where it says restricted fund balance represents that portion of the fund balance that is spendable, but must be used as directed by a third party. He said, technically, he guesses, due to the governing principles of GASB, they have to maintain OPEB at a certain level. He said Mr. Strausburg has rate stabilization and health insurance and encumbrances, and he thought maybe OPEB might also go into that area. Mr. Strausburg said the OPEB coverage is built into the profit loss model. He said, their expenditures anticipate they will continue to spend or contribute to OPEB at a level that keeps their funding where it is, so it is embedded here. Mr. Cannon said he understands, but he did not know if it also was something that needed to be included in the Resolution itself, but that is up to Mr. Strausburg, to which Mr. Strausburg responded, he would have to give that some thought. Mr. Cannon said his guess is OPEB is already established as a separate policy procedure, to which Mr. Strausburg responded, one of the things the credit agencies and the purchases of their bonds really appreciates is the fact that their pension plan is fully funded, and he thinks, talking off the top of his head, with the close of FY20 their OPEB is going to be fully funded. He said they need to keep that there so, if Mr. Cannon is asking whether they should establish that as a policy, that is certainly worth discussing. Mr. Cannon said, if they are looking at establishing fund policies as a whole, that is an integral part of the bigger picture, but he is just throwing that out there. Mr. Strausburg said, casting this forward with future Executives and Councils, he thinks it would be misguided to begin to underfund pension and OPEB because the cash is there at the moment and, in the long run, that is going to come back to haunt them. He said, if Mr. Cannon is saying they want to protect their fund balance so maybe they also want to look at protecting those two reserves, that is certainly worth discussing.

Mr. Holloway said, in reading the Standard and Poor report, it is pretty interesting, but they make a statement about the management financial practices, and it says bimonthly budget updates including budget to actuals that Councilmembers receive, but they do not receive those, so how did that get in there? Mr. Strausburg asked what year that was, to which Mr. Holloway responded, 2017. Mr. Strausburg said Mr. Holloway may not have seen them, but he used to see them, and they are going to reestablish that. Mr. Holloway said he thinks, really, that Council ought to start getting a financial statement every month because he thinks that would be helpful to them, to which Mr. Strausburg responded, he does not have a problem with that, and he thinks the public ought to see it. Mr. Holloway said he just wondered how something like that got in there when they know that has not been happening. He then asked if someone said it has been happening, to which Mr. Strausburg responded, it is from 2017. Mr. Holloway said they were not getting them then either. He then asked if Mr. Strausburg is saying he is not responsible for that, to which Mr. Strausburg responded, he is saying that was in 2017, and he does not remember what was said and was not said by Standard and Poor.

Mr. Holloway asked what the Board of Education's situation is on OPEB because he heard that it is not good, to which Mr. Strausburg responded, it is not. He said he does not remember the exact percentage, but, compared to the State, their local Board is better than most jurisdictions in the State, but that is sort of like saying they are the tallest pigmy. He said OPEB funding for Boards of Education across the State is not strong, and eventually, again, going back to the State being their biggest threat, that is going to come home to roost at some point in time because it will necessarily have to because of the aging of the workforce. He said, at some point in time, that is going to have to be funded. Mr. Dodd said the Board of Education was fine until the State dropped it back on the Counties, or they were better anyway, to which Mr. Strausburg responded, that was pension. He said the State funds the legacy portion of the pension plan, and the County shares 50 percent of the annual reoccurring expenditures, and he thinks that is on the order of about a half a million dollars a year impact on the County's budget just off the top of his head. 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