

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF POLICY ANALYSIS
MARYLAND GENERAL ASSEMBLY

Warren G. Deschenaux
Executive Director

April 6, 2017

The Honorable Thomas V. Mike Miller, Jr.
The Honorable Michael E. Busch
Co-Chairs, Legislative Policy Committee

Gentlemen:

Section 2-1008 of the State Government Article requires that the Department of Legislative Services (DLS) report to the Legislative Policy Committee by June 1 on the extent to which the budget, as enacted by the General Assembly, conforms to the recommendations of the Spending Affordability Committee (SAC).

The following is a summary of SAC's major recommendations found in its 2016 interim report with an evaluation by DLS as to the extent the budget, as enacted during the 2017 session, conforms to these recommendations.

Operating Budget

Spending Limit and Sustainability

Recommendation: Slower than anticipated economic growth resulted in the downward revision of general fund revenues and the return of a sizeable structural imbalance for fiscal 2018 and subsequent years. Baseline budget projections estimated a structural deficit of \$377 million in fiscal 2018. In recognition of this outlook, SAC recommended that the budget, as introduced and enacted, reduce the structural deficit for fiscal 2018 by at least 50%, leaving a structural gap of no more than \$189 million. In addition, the committee recommended that the Administration prepare a detailed report with specific proposals for achieving structural balance in fiscal 2019.

Evaluation: Actions by the Governor and the legislature reduced the fiscal 2018 structural shortfall by \$340 million, as shown in **Exhibit 1**, exceeding SAC's recommendation. This results in an estimated remaining structural deficit of \$38 million. In addition, the budget committees adopted narrative requesting the Department of Budget and Management (DBM) to report by July 1, 2017, on how the Administration intends to resolve the structural deficit in fiscal 2019. **The General Assembly complied with this recommendation of the Spending Affordability Committee.**

Exhibit 1
Spending Affordability Analysis
Conference Committee
Fiscal 2018
(\$ in Millions)

| | | |
|---|-----------------|-----------------|
| Target | | |
| Estimated Structural Gap (December 2016) | | \$377 |
| Target Reduction | | \$189 |
| Revenues | \$17,224 | |
| Small, Minority, Women-Owned Business Account | -\$16 | |
| Other One-time Items | -1 | |
| Subtotal | | \$17,207 |
| Spending | \$17,217 | |
| One-time Spending | | |
| Rainy Day Fund | -\$10 | |
| Pay-as-you-go Capital | -10 | |
| Supplemental Budget No. 1 One-time Spending | -1 | |
| Other Ongoing Spending | 4 | |
| Temporary Fund Swaps | | |
| Hospital Deficit Assessment | \$25 | |
| Medicaid Cigarette Restitution Fund Funding | 16 | |
| Other Temporary Fund Swaps | 4 | |
| Subtotal | | \$17,245 |
| Amount Reduced from Structural Shortfall | | \$340 |
| Surplus/(Deficit) | | -\$38 |

Fund Balances

Recommendation: SAC recommended that the balance in the Revenue Stabilization Account (also known as the Rainy Day Fund) be maintained at 5% of estimated revenues and authorized the use of any funds above that balance to address imminent cash shortfalls in fiscal 2017 and 2018. In addition, the committee recommended that the General Fund maintain a minimum ending balance of at least \$100 million for fiscal 2018.

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Evaluation: Final legislative action resulted in an estimated closing general fund balance of \$100.2 million in fiscal 2018, consistent with the minimum balance of \$100.0 million recommended by SAC. As shown in **Exhibit 2**, the Rainy Day Fund achieves a balance of \$860.3 million in fiscal 2018, which equals 5% of estimated general fund revenue. **The General Assembly complied with these recommendations of the Spending Affordability Committee.**

Exhibit 2
State Reserve Fund Activity
Fiscal 2017-2018
(\$ in Millions)

| | <u>Rainy Day Fund</u> |
|---|------------------------------|
| Estimated Balances June 30, 2016 | \$832.4 |
| Fiscal 2017 Appropriations | \$235.3 |
| Transfer to the General Fund | -170.0 |
| Excess Revenue/Transfer ¹ | -80.0 |
| Estimated Interest | 14.8 |
| Estimated Balances June 30, 2017 | \$832.6 |
| Fiscal 2018 Appropriation | \$50.0 |
| Contingent Reduction | -40.0 |
| Estimated Interest | 17.7 |
| Estimated Balances June 30, 2018 | \$860.3 |
| Percent of Revenues in Reserve | 5.0% |

¹The fiscal 2017 budget bill restricted approximately \$80.0 million from within the Rainy Day Fund appropriation to fund other projects and programs. With the Administration's decision to not release those funds for the identified purposes, the restricted funds will revert to the General Fund at the close of fiscal 2017.

Revenue Volatility

Recommendation: A recent review of Maryland's revenue structure determined that nonwithholding personal income tax revenues are extremely volatile and difficult to accurately forecast. A workgroup consisting of staff from DBM, DLS, and the Board of Revenue Estimates (BRE) recommended that the State consider limiting estimated revenues from nonwithholding income tax revenues by placing a cap, or collar, on the amount of nonwithholding income tax revenues assumed during the budget process. SAC recommended that legislation be considered during the 2017 session to mitigate the impact of revenue volatility on the State budget.

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Evaluation: Legislation was introduced during the 2017 session by the Administration, the Senate Co-Chair of the Spending Affordability Committee, and the Chair of the House Appropriations Committee to address the concerns regarding revenue volatility. Each piece of legislation received consideration before the budget committees. Chapter 4 of 2017 (HB 503) requires BRE to calculate the share of general fund revenues represented by nonwithholding income tax revenues from the State individual income tax, beginning with the revenue estimate for fiscal 2020. At the end of fiscal 2020, and each fiscal year thereafter, if general fund revenues for the fiscal year are less than BRE's March estimate, the amount of nonwithholding income tax revenues that exceeds a specified capped nonwithholding estimate must be applied to close the revenue gap, and any remainder must be deposited into the Rainy Day Fund and/or the newly established Fiscal Responsibility Fund as specified in the bill. Revenues from the Fiscal Responsibility Fund are to be appropriated in the second following fiscal year to specified pay-as-you-go capital projects. **The General Assembly complied with the recommendation of the Spending Affordability Committee.**

Capital Budget

General Obligation Debt

Recommendation: Due to concerns regarding the potential for diminished purchasing power within the capital program, SAC did not concur in the recommendation of the Capital Debt Affordability Committee (CDAC) to keep general obligation (GO) bond authorizations at \$995 million each year through fiscal 2026. Instead, SAC recommended that new GO bond authorizations not exceed \$1,065 million in fiscal 2018 and that out-year annual authorization be allowed to increase by no more than 1%, in order to ensure that capital spending does not outpace State property tax revenues.

Evaluation: New GO debt totaling \$1,089.0 million is authorized in the Maryland Consolidated Capital Bond Loan of 2017. This is offset by de-authorizations totaling \$24.4 million for a total of new GO bonds of \$1,065.0 million, which is consistent with the SAC limit. An additional \$4.8 million in Qualified Zone Academy Bonds, which is full faith and credit debt of the State but not counted in the SAC limit, is authorized in separate legislation. **The General Assembly complied with the recommendation of the Spending Affordability Committee.**

Higher Education Debt

Recommendation: SAC concurred in the recommendation of CDAC that \$32 million in new academic revenue bonds may be authorized for the University System of Maryland (USM) in the 2017 session.

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Evaluation: \$32 million of new academic revenue bonds were authorized in the 2017 session for projects within USM in HB 717 (passed). **The General Assembly complied with the recommendation of the Spending Affordability Committee.**

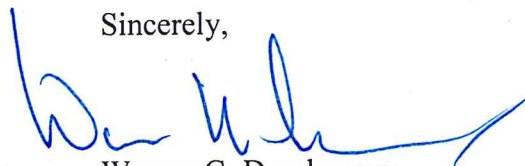
State Employment

Limits on Workforce Growth

Recommendation: SAC found that given the State's fiscal condition, 80,323 positions are appropriate for the delivery of State services. The fiscal 2018 budget should not exceed this maximum number of positions across all functions (including the Executive, Legislative, and Judicial branches and higher education). Agencies should make maximum use of existing vacant positions to address staffing needs. The Governor should use the budget and his authority to abolish and create positions to reallocate personnel resources as necessary to address service needs. Layoffs should be avoided as sufficient opportunities for savings should exist within the existing State workforce authorization. In addition, the committee recommended language be included in the fiscal 2018 budget regarding chronic staffing issues plaguing State agencies.

Evaluation: The fiscal 2018 State workforce complement is 80,100 regular positions. This includes the legislative reduction of 23 positions, including 19 positions in the Judiciary, 3 positions in the Department of Aging, and 1 position in the Uninsured Employers' Fund. The final complement is 223 positions below the cap. In addition, multiple actions were adopted to address staffing concerns among State agencies. Within DBM, the budget committees adopted narrative requesting data on employee churn and a thorough and statewide evaluation of the chronic understaffing issues within State agencies, including proposed recommendations for improving hiring and retention. Agency specific actions addressing staffing concerns were also adopted within the Department of Health and Mental Hygiene and the Department of Public Safety and Correctional Services. **The General Assembly complied with the recommendation of the Spending Affordability Committee.**

Sincerely,



Warren G. Deschenaux
Executive Director

WGD/RJR/kjl

cc: Members, Spending Affordability Committee
Secretary David R. Brinkley