MARYLAND ASSOCIATION OF COUNTIES, INC.

BILL NO.: House Bill 87

TITLE: Budget Reconciliation and Financing Act of 2012

POSITION: **OPPOSE**

DATE: March 1, 2012

COMMITTEE: Appropriations & Ways and Means

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The Maryland Association of Counties (MACo) **OPPOSES** House Bill 87. This bill is the Budget Reconciliation and Financing Act (BRFA), reconciling various provisions incorporated into the Administration's FY 2013 fiscal plan, bringing the proposed budget into balance for the year.

MACo appreciates the difficult task before you in constructing a balanced budget. However, MACo is extremely concerned with components of the BRFA and their future effect on local governments. These components include a shift of teacher pension costs to the counties, the county offsets, language to flat fund programs through FY 2017, among others. MACo's testimony will address these areas.

Teacher Pension Shift – The Governor's proposed budget includes a massive and immediate shift in teacher pension costs to county governments. This proposed shift is occurring all at once, not a phased-in approach like previous proposals and it would not be considered as a part of the county's reaching Maintenance of Effort since it is not an appropriation to the school budget. Education budgets are already stretching county budgets and creating massive disparities between county and school staff. This proposal will affect that even more.

Counties disagree that shifting funding responsibility does anything to improve the sustainability of state pension funding, it simply relocates these cost burdens – away from the level of government that has complete control over benefit levels and investment decisions; 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. Counties also differ with the Administration's claim that a "sharing of retirement costs will incentivize locals to consider the impact of salary decisions on retirement benefits." County governments have no control over the setting of teacher salaries, and do not even have a seat at the table to negotiate benefits and terms.

The Administration correctly points to three cost drivers for pensions: benefit design/employee cost sharing, investment performance, and growth in teacher salaries. None of these elements are within county government control. MACo will elaborate on this point here.

Benefit Design/Employee Cost Sharing – Plan design and employee contribution rates are entirely a creation of state law. A DLS presentation provides a historical overview of what has occurred in these areas over the years. Although new plans were created in the early 1980's to control costs, many benefit enhancements were made through legislation. The most recent benefit enhancement occurred in 2006 adding $1.9 billion to the system's actuarial accrued liabilities. Local governments had no control or say in enacting these benefit enhancements.

Investment Performance – The State Retirement and Pension System (SRPS)'s investments are managed by a state-appointed Board. As the SRPS became fully funded by the end of FY 2000, the system experienced significant losses in FY 2001 and 2002. With the economic downturn of 2008, the SRPS experienced a 22% decline in asset value and a -20% return on investments in FY 2009. A DLS presentation on the funding of Maryland's SRPS refers to 2000 – 2010 as "The Lost Decade." The SRPS earned annualized returns of 2.1% during this timeframe. Again, local governments played no role in making these investment decisions.

Growth in Teacher Salaries – Teacher salaries have been fueled by state funding formulas. A very clear policy direction was set by the State to better recruit and retain qualified teachers, to reduce classroom sizes, and to improve the share of fully certificated classroom teachers. The Bridge to Excellence legislation ("Thorton") was enacted in 2002 to achieve gains in public education equity and adequacy by altering and increasing education funding significantly from FY 2002 to FY 2008. During this time frame, state funding increased by 78.9%, or $2.2 billion. It should be no surprise that staff employed by local systems increased by 8,274 positions, or 15.5%. Whereas, local funding also increased during this time frame, that was the expectation of the State.

County Offsets – A series of actions have been proposed in the Governor's budget to "mitigate" some portion of the pension costs newly shifted onto local governments. However, these are only for one year after which county costs will escalate by nearly $70 million immediately in FY 2014, and rise in each subsequent year thereafter, reaching over $358 million by the end of the projection, FY 2017.

MACo also questions whether the offsets will generate the estimated amount of revenue or whether it's going to the counties at all. MACo's concerns are enumerated below.

Federally funded teachers – HB 87 relieves the school boards from the requirement to pay pension costs for federally funded teachers, but provides no offsetting funding relief to county governments who will be picking up these costs.

Forgives repayment on income tax reserve – MACo has advocated for the elimination of this requirement, however not as an offset to teacher pension costs. Counties have always argued that repayment of this fund was unnecessary.

Cap on income tax deductions and phase-out of exemptions – These tax changes are being proposed to address the state's budget deficit and generate local revenues to offset teacher pension costs. However, income levels affected by these changes are being met with opposition and any softening in these brackets will reduce county revenue. In addition, estimated revenue is based on 18 months for FY 2013 and will drop roughly by a third in FY 2014 and beyond. Lastly, higher earners' late-filing extensions mean some revenue may not be realized until FY 2014. Revenue generated from this proposal will cover a smaller portion of teacher pension costs forcing local governments to cover a larger share in the first year.

Recordation Tax and Indemnity Deeds of Trusts – MACo has advocated for the closing of this loophole, as a more general matter of providing greater tax fairness for the many individuals and business that currently pay recordation taxes on secured borrowing. The transactions subject to the proposed tax law would vary greatly from one year to the next, making it very difficult to build a budget on these figures. Contemplating these highly variable county-by-county revenue figures suggests unwise budgeting practices.

Unfunded Liability of the System – According to a letter recently received by the DLS, under a GASB Exposure Draft (meaning that the report is not yet final), it appears counties would be liable for approximately 25% of the state system's unfunded actuarial liability should a portion of teacher pension costs be transferred to local governments. This represents a massive and unwarranted shift of toxic liabilities onto a level of government that was never empowered to guide those decisions. HB 87 already forces local governments to pick up costs they have no control over. This will also place the unfunded liability on their books possibly affecting creditworthiness and eventually bond ratings.

Flat Funding at the FY 2012 Level - Section 15 of HB 87 would create an uncodified but sweeping provision essentially overriding nearly all formula or statutory direction of funding for the next five year period. The Department of Legislative Services has been unable to fully quantify the far reaching implications of this proposed amendment, but its effects could be among the most profound of the BRFA legislation. MACo urges the General Assembly to focus on the State budget situation and the reasonable extension of today's economic climate, rather than make permanent the long-term policy decisions that may upend policy priorities even beyond the current fiscal challenges. Budget-driven suspension of identified formulas is a reasonable component of a budget reconciliation bill, but a multi-year elimination of an undefined list of programs extends beyond the reasonable breadth of this year's budget reconciliation.

Funding for Court Judgments – A recent Court of Appeals opinion found that the State is responsible for satisfying court judgments against a school board. However, HB 87 is shifting this funding responsibility to local governments and precludes local governments from reducing those items in the proposed school budget. This represents another shift in funding responsibility to local governments where they have no say or control over actions of a school board.

Previous Deep County Cuts Carried Over – The Governor's proposed budget is carrying through more than $400 million in continued reductions to transportation, public safety, health departments, local correctional centers, and other local functions. Cumulatively, including the proposed FY 2013 budget, local governments have foregone approximately $1.8 billion in State aid since FY 2010. Adding in the cost shifts of FY 2012 and a possible teacher pension shift, local governments could forego well over $2 billion in aid, being forced to depend on depleted local resources to maintain essential services.

Other Changes Affecting Local Governments – Lastly, MACo is concerned with language in HB 87 that is amending two Maryland Department of the Environment Programs, the Community Right-to-Know Funds and the Recycling Trust Fund to give MDE greater flexibility in funding emergency response activities of the department and the land management administration. Local governments currently receive funding from these programs to fund local emergency planning committees and improvements in recycling programs. These actions, combined with others that may be carried out administratively by State agencies, places increased burdens on local governments at a time when they can least afford them.