

A00
Payments to Civil Divisions of the State

Operating Budget Data

	(\$ in Thousands)				
	FY 2002	FY 2003	FY 2004	FY 03 - 04	FY 03 - 04
	<u>Actual</u>	<u>Approp.</u>	<u>Allowance</u>	<u>Change</u>	<u>% Change</u>
General Funds	\$123,853	\$149,901	\$146,096	-\$3,804	-2.5%
FY 2003 Deficiencies	0	415	0	-415	-100.0%
Adjusted General Funds	123,853	150,315	146,096	-4,219	-2.8%
Adjusted Grand Total	123,853	150,315	146,096	-4,219	-2.8%

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Issues

Disparity Grant Funding Exceeds Statutory Amount: Funding for the Disparity Grant Program in fiscal 2004 exceeds the statutory amount by \$14.2 million. Of this amount, \$2.9 million is provided to three counties that do not qualify for the program. In addition, several counties qualifying for the program receive discretionary grants that result in the counties receiving more funding in fiscal 2004 than the amounts received in fiscal 2003. In light of the current fiscal constraints, providing disparity grant funding to counties that do not statutorily qualify for the program and providing discretionary grants to qualifying counties that result in more funding in fiscal 2004 than the amounts received in fiscal 2003 is not affordable. Accordingly, the Department of Legislative Services recommends that the grants to these counties totaling \$5.0 million be eliminated.

Education Maintenance of Effort Requirement Impacts Disparity Grants: The General Assembly required during the 2002 session that \$11.9 million of the funding increase in fiscal 2003 be earmarked for public schools in fiscal 2003. The General Assembly adopted budget language that excluded the targeted funding from counting towards the local maintenance of effort requirement for public schools. However, since the maintenance of effort calculation is codified in Section 5-202 of the Education Article, separate legislation is necessary to exempt the disparity grant funds from the maintenance of effort calculation in fiscal 2004.

State Aid Comprising an Increasing Share of General Fund Expenditures: State aid to local governments accounted for 31% of general fund expenditures in fiscal 2002 and 36% in fiscal 2004. Due primarily to the significant increase in State education funding required under the Thornton legislation, State aid to local governments will account for over 40% of general fund expenditures in fiscal 2008. Even with a substantial increase in revenues and the curtailment of State services as reflected in the budget, the continual increase in State assistance to local governments will be difficult to afford without re-examining the fiscal relationship between the State and its local governments. The Department of Legislative Services recommends that the State retain a portion of local income tax revenues in fiscal 2004.

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Recommended Actions

	<u>Funds</u>	<u>Positions</u>
1. Reduce funds for disparity grants.	\$ 5,000,001	
2. Adopt legislation excluding disparity grant funding from maintenance of effort.		
3. Adopt legislation requiring the State to retain a portion of local income tax revenues. State assistance to local governments is consuming a larger share of general fund expenditures. The fiscal relationship between the State and local governments must be re-examined.		
Total Reductions	\$ 5,000,001	

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Operating Budget Analysis

Program Description

Several State grant programs providing funds to Maryland's counties and municipalities are budgeted under payments to civil divisions of the State. These programs include disparity grants, a grant to Baltimore City equal to \$5 of each security interest-filing fee collected by the Motor Vehicle Administration (MVA), and grants to partially offset the cost of the property tax exemption for personal property used to generate electricity for sale. The State pays the employer retirement cost for certain local officials and employees. Beginning in fiscal 2000, these costs are also budgeted under payments to civil divisions.

Fiscal 2003 Actions

Proposed Deficiency

There is a fiscal 2003 general fund deficiency appropriation of \$414,769 for Baltimore City's share of security interest-filing fees collected by MVA. This results from fiscal 2002 actual revenue attainments exceeding the estimates (\$214,769) and an increase in the projections for fiscal 2003 (\$200,000).

Governor's Proposed Budget

The proposed fiscal 2004 budget for payments to civil divisions is \$146.1 million. This is a 2.8% decrease over the fiscal 2003 working appropriation of \$150.3 million. As **Exhibit 1** shows, most of the decrease occurs in the disparity grant formula. Disparity grant funding decreases by \$4.3 million or 3.8% in fiscal 2004. Baltimore City's share of security interest-filing fees decreases by \$0.1 million or 4.4%. Funding for the electricity generating equipment property tax grant remains constant, while funding for the retirement costs of certain county employees increases by \$0.3 million or 19.9%.

Exhibit 1

**Governor’s Proposed Budget
Payments to Civil Divisions of the State
(\$ in Thousands)**

	FY 2002 <u>Actual</u>	FY 2003 <u>Approp.</u>	FY 2004 <u>Allowance</u>	FY 03 - 04 <u>Change</u>	FY 03 - 04 <u>% Change</u>
General Funds	\$123,853	\$149,901	\$146,096	-\$3,804	-2.5%
FY 2003 Deficiencies	0	415	0	-415	-100.0%
Adjusted General Funds	123,853	150,315	146,096	-4,219	-2.8%
Adjusted Grand Total	123,853	150,315	146,096	-4,219	-2.8%

Where It Goes:

Grants

Decrease in disparity grant per statutory formula	-\$18,524
Increase in discretionary disparity grant	14,176
Decrease in estimated Baltimore City share of security interest filing fees	-140
Increase in retirement contribution for certain official and county employees	269

Total **-\$4,219**

Note: Numbers may not sum to total due to rounding.

Disparity Grant

The disparity grants address the differences in the capacities or abilities of the counties to raise revenues from the local income tax. Counties with per capita local income tax revenue less than 75% of the State’s average receive grants, assuming all counties impose a 2.54% local income tax rate. Aid received by a county equals the dollar amount necessary to raise the county’s per capita income tax revenues to 75% of the State average.

As determined under Article 24, Section 9-1101, disparity grant funding would have totaled \$96.7 million in fiscal 2004. This is an \$18.5 million or 16% decrease from the statutory amount in fiscal 2003. Based on the statutory formula, nine jurisdictions (Baltimore City and Allegany, Caroline, Dorchester, Garrett, Prince George's, Somerset, Washington, and Wicomico counties) would receive grants in fiscal 2004. The proposed fiscal 2004 budget includes \$110.8 million for disparity grants, which includes \$96.7 million in statutory grants and \$14.2 million in discretionary grants. The discretionary grants are to

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partially offset the reduction in State funding due to the transfer of \$102.4 million in local highway user revenues from the Transportation Trust Fund to the State's general fund. A portion of the discretionary grants (\$2.9 million) goes to three counties (Anne Arundel, Kent, and Queen Anne's) that do not statutorily qualify for disparity grants. The rationale for providing discretionary grants to these counties is to ensure that the jurisdictions do not realize a net decrease in State assistance in fiscal 2004. The discretionary grant is contingent upon the enactment of legislation transferring \$102.4 million of local highway user revenues to the general fund and requiring local governments to reimburse \$10 million of the cost of real property tax administration.

The fiscal 2004 grant under the statute is based on population estimates for July 2001 and calendar 2001 local income tax revenues raised from a 2.54% local income tax rate. **Exhibit 2** shows the calculation of the fiscal 2004 disparity grant. The decrease in the statutory required funding amount is due to the narrowing of the disparity in per capita income tax revenues between less affluent counties and other counties in Maryland. As shown in **Exhibit 3**, per capita income tax revenues decreased by 4.1% statewide in calendar 2001. Four disparity grant jurisdictions (Baltimore City and Allegany, Prince George's, and Wicomico counties) realized decreases less than the average, and four other disparity grant counties (Caroline, Garrett, Somerset, and Washington) experienced an increase in their per capita income tax revenues. Dorchester County was the only disparity grant recipient to have a reduction in its per capita income tax revenues greater than the statewide average. The largest decreases in per capita income tax revenues in calendar 2001 occurred in the more affluent jurisdictions, such as Howard, Montgomery, and Talbot counties.

The State began providing disparity grants in fiscal 1992 to counties whose per capita local income tax revenues were less than 70% of the statewide average. Baltimore City and five counties (Allegany, Caroline, Dorchester, Garrett, and Somerset) qualified for the grants. Funding for disparity grants totaled \$8.6 million in fiscal 1992. Legislation enacted in 1992 placed the disparity grant formula in statute for fiscal 1993 and subsequent years. Legislation enacted in 1996 guaranteed that, beginning in fiscal 1998, each county's per capita local income tax yield would be 75% of the statewide average, rather than 70%. This change made two counties, Washington and Wicomico, eligible for disparity grants. In fiscal 2001, Prince George's County became eligible for disparity grants, and Washington County became ineligible due to increases in its per capita local income tax yields. For fiscal 2002, Washington County became eligible for the program again. **Exhibit 4** shows the level of funding for disparity grants since fiscal 1992.

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Exhibit 2
Calculating the Fiscal 2004 Disparity Grant

County	Population July 2001	Adj. Income Tax Revenue TY 2001	Per Capita Tax Yield	Per Capita Grant	Statutory Grant	Discretionary Grant	Total Grant	Prior Year's Grant	Difference	Percent Difference
Allegany	75,200	\$17,005,812	\$226.14	\$92.34	\$6,943,812	\$702,716	\$7,646,528	\$7,590,374	\$56,154	0.7%
Anne Arundel	497,200	242,244,674	487.22	0.00	0	1,600,000	1,600,000	0	1,600,000	0.6%
Baltimore City	644,300	134,756,960	209.15	109.33	70,439,086	6,037,631	76,476,717	76,035,628	441,089	0.6%
Baltimore	764,600	344,027,001	449.94	0.00	0	0	0	0	0	
Calvert	77,300	33,820,990	437.53	0.00	0	0	0	0	0	
Caroline	30,100	7,586,402	252.04	66.44	1,999,817	195,048	2,194,865	2,456,358	-261,493	-10.6%
Carroll	153,800	66,776,188	434.18	0.00	0	0	0	0	0	
Cecil	88,000	29,663,576	337.09	0.00	0	0	0	0	0	
Charles	123,000	48,508,557	394.38	0.00	0	0	0	0	0	
Dorchester	30,900	7,609,288	246.26	72.22	2,231,714	147,287	2,379,001	1,854,882	524,119	28.3%
Frederick	200,500	94,492,675	471.29	0.00	0	0	0	0	0	
Garrett	30,000	6,998,125	233.27	85.21	2,556,246	2,089,043	4,645,289	3,010,417	1,634,872	54.3%
Harford	222,200	93,727,648	421.82	0.00	0	0	0	0	0	
Howard	255,300	157,526,600	617.03	0.00	0	0	0	0	0	
Kent	19,300	6,764,918	350.51	0.00	0	1,075,000	1,075,000	0	1,075,000	
Montgomery	888,400	578,982,257	651.71	0.00	0	0	0	0	0	
Prince George's	812,800	252,963,763	311.23	7.25	5,896,001	1,171,474	7,067,475	14,753,100	-7,685,625	-52.1%
Queen Anne's	41,500	18,267,652	440.18	0.00	0	180,000	180,000	0	180,000	
St. Mary's	87,500	31,916,055	364.75	0.00	0	0	0	0	0	
Somerset	25,000	4,100,090	164.00	154.48	3,861,886	565,536	4,427,422	4,288,581	138,841	3.2%
Talbot	34,200	16,979,198	496.47	0.00	0	0	0	0	0	
Washington	133,300	42,360,479	317.78	0.70	92,777	157,788	250,565	1,987,118	-1,736,553	-87.4%
Wicomico	86,200	24,818,704	287.92	30.56	2,634,189	254,369	2,888,558	3,203,426	-314,868	-9.8%
Worcester	48,200	17,902,747	371.43	0.00	0	0	0	0	0	
Total	5,368,800	\$2,279,800,359	\$424.64		\$96,655,528	\$14,175,892	\$110,831,420	\$115,179,884	-\$4,348,464	-3.8%
Target (75%)			\$318.48							

Prepared by: Department of Legislative Services

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Exhibit 3

Disparity Grant Factors – Fiscal 2004 Calculations

County	Adjusted Local Revenues		Population		Per Capita Tax Yield		Percent Change
	CY 2000	CY 2001	July 2000	July 2001	CY 2000	CY 2001	
Allegany	\$17,303,836	\$17,005,812	74,930	75,200	\$230.93	\$226.14	-2.1%
Anne Arundel	249,281,992	242,244,674	489,656	497,200	509.10	487.22	-4.3%
Baltimore City	140,299,142	134,756,960	651,154	644,300	215.46	209.15	-2.9%
Baltimore	356,216,085	344,027,001	754,292	764,600	472.25	449.94	-4.7%
Calvert	32,582,879	33,820,990	74,563	77,300	436.98	437.53	0.1%
Caroline	7,434,880	7,586,402	29,772	30,100	249.73	252.04	0.9%
Carroll	65,197,611	66,776,188	150,897	153,800	432.07	434.18	0.5%
Cecil	29,345,498	29,663,576	85,951	88,000	341.42	337.09	-1.3%
Charles	46,616,891	48,508,557	120,546	123,000	386.71	394.38	2.0%
Dorchester	8,336,029	7,609,288	30,674	30,900	271.76	246.26	-9.4%
Frederick	90,505,210	94,492,675	195,277	200,500	463.47	471.29	1.7%
Garrett	6,905,406	6,998,125	29,846	30,000	231.37	233.27	0.8%
Harford	94,777,277	93,727,648	218,590	222,200	433.58	421.82	-2.7%
Howard	165,479,728	157,526,600	247,842	255,300	667.68	617.03	-7.6%
Kent	6,780,387	6,764,918	19,197	19,300	353.20	350.51	-0.8%
Montgomery	622,048,488	578,982,257	873,341	888,400	712.26	651.71	-8.5%
Prince George's	251,536,539	252,963,763	801,515	812,800	313.83	311.23	-0.8%
Queen Anne's	17,963,251	18,267,652	40,563	41,500	442.85	440.18	-0.6%
St. Mary's	29,957,169	31,916,055	86,211	87,500	347.49	364.75	5.0%
Somerset	3,933,186	4,100,090	24,747	25,000	158.94	164.00	3.2%
Talbot	18,912,672	16,979,198	33,812	34,200	559.35	496.47	-11.2%
Washington	41,842,040	42,360,479	131,923	133,300	317.17	317.78	0.2%
Wicomico	24,918,094	24,818,704	84,644	86,200	294.39	287.92	-2.2%
Worcester	18,048,124	17,902,747	46,543	48,200	387.77	371.43	-4.2%
Total	\$2,346,222,414	\$2,279,800,359	5,296,486	5,368,800	\$442.98	\$424.64	-4.1%

Prepared by Department of Legislative Services

Exhibit 4

State Funding for Disparity Grants
Fiscal 1992 through 2004

County	FY 1992	FY 1993	FY 1994	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Allegany	\$370,000	\$1,281,750	\$1,637,429	\$1,987,382	\$2,032,596	\$2,375,837	\$3,592,611	\$3,885,678	\$4,206,580	\$5,099,138	\$5,264,420	\$7,590,374	\$7,646,528
Anne Arundel	0	0	0	0	0	0	0	0	0	0	0	0	1,600,000
Baltimore City	7,396,000	18,344,250	29,695,890	34,822,600	37,027,987	37,608,294	50,506,101	51,473,147	56,517,265	61,013,229	64,361,931	76,035,628	76,476,717
Baltimore	0	0	0	0	0	0	0	0	0	0	0	0	0
Calvert	0	0	0	0	0	0	0	0	0	0	0	0	0
Caroline	109,000	381,750	612,812	852,456	818,556	901,235	1,493,402	1,625,591	1,834,748	2,170,977	2,316,232	2,456,358	2,194,865
Carroll	0	0	0	0	0	0	0	0	0	0	0	0	0
Cecil	0	0	0	0	0	0	0	0	0	0	0	0	0
Charles	0	0	0	0	0	0	0	0	0	0	0	0	0
Dorchester	86,000	406,500	647,687	881,526	843,047	957,817	1,290,582	1,357,021	1,462,155	1,668,683	1,928,463	1,854,882	2,379,001
Frederick	0	0	0	0	0	0	0	0	0	0	0	0	0
Garrett	243,000	882,750	1,413,266	1,420,854	1,428,125	1,458,779	2,029,289	2,177,813	2,326,328	2,585,412	2,999,791	3,010,417	4,645,289
Harford	0	0	0	0	0	0	0	0	0	0	0	0	0
Howard	0	0	0	0	0	0	0	0	0	0	0	0	0
Kent	0	0	0	0	0	0	0	0	0	0	0	0	1,075,000
Montgomery	0	0	0	0	0	0	0	0	0	0	0	0	0
Prince George's	0	0	0	0	0	0	0	0	0	4,775,506	6,879,315	14,753,100	7,067,475
Queen Anne's	0	0	0	0	0	0	0	0	0	0	0	0	180,000
St. Mary's	0	0	0	0	0	0	0	0	0	0	0	0	0
Somerset	344,000	1,203,000	2,067,096	2,272,400	2,097,023	2,211,700	2,734,070	2,954,585	3,246,259	3,524,771	3,754,928	4,288,581	4,427,422
Talbot	0	0	0	0	0	0	0	0	0	0	0	0	0
Washington	0	0	0	0	0	0	229,353	195,976	207,670	0	676,132	1,987,118	250,565
Wicomico	0	0	0	0	0	0	150,295	446,216	577,823	788,963	1,108,345	3,203,426	2,888,558
Worcester	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	\$8,548,000	\$22,500,000	\$36,074,180	\$42,237,218	\$44,247,334	\$45,513,662	\$62,025,703	\$64,116,027	\$70,378,828	\$81,626,679	\$89,289,557	\$115,179,884	\$110,831,420
Percent Change		163.2%	60.3%	17.1%	4.8%	2.9%	36.3%	3.4%	9.8%	16.0%	9.4%	29.0%	-3.8%

Prepared by Department of Legislative Services

Electric Generating Equipment Property Tax Grant

Legislation restructuring Maryland’s electric utility tax system was enacted in 1999 (Chapters 5 and 6, Acts of 1999). Beginning with fiscal 2001, the legislation phases in over two years a 50% personal property tax exemption for machinery and equipment used to generate electricity for sale. To partially offset the revenue losses, the legislation provides grants to the counties impacted by the exemption. The dollar amounts of the grants when the exemption is fully phased in are written into the statute (Article 24, Section 9-1102). In fiscal 2001, the counties received half the amounts for a total of \$15.3 million. In fiscal 2002 and subsequent years, the grants total \$30.6 million. **Exhibit 5** shows the allocation of the grants for fiscal 2004. The Town of Williamsport will receive 35% of Washington County’s allocation.

Exhibit 5

Electric Utility Generating Equipment Property Tax Grants

<u>County</u>	<u>Fiscal 2004</u>
Anne Arundel	\$7,820,202
Baltimore City	453,421
Baltimore	1,794,835
Calvert	6,096,574
Charles	2,522,612
Dorchester	187,442
Garrett	11,907
Harford	860,767
Montgomery	2,765,553
Prince George’s	7,744,806
Washington	357,082
Total	\$30,615,201

Source: Department of Legislative Services

Baltimore City Share of Security Interest-Filing Fees

Beginning with fiscal 1998, Baltimore City receives a grant equal to \$5 of each security interest-filing fee collected by MVA. This grant is pursuant to Chapter 163, Acts of 1996. The legislation also revised the allocation of highway user revenues between Baltimore City and the other subdivisions. In addition, the legislation was contingent on the enactment of other legislation increasing aid under the disparity grant

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formula (Chapter 173, Acts of 1996). The proposed fiscal 2004 budget includes \$3.0 million for Baltimore City. The budget also includes a fiscal 2003 deficiency appropriation to cover fiscal 2002 actual attainment and a projected increase in fiscal 2003 costs.

Retirement Costs for Certain Officials and County Employees

Under State law (Sections 22-205 and 23-201 of the State Personnel and Pensions Article) appointed or elected officials of the State are eligible to be members of the State employees' retirement systems. The statute specifies that this provision applies to State's Attorneys and sheriffs. Over the years, judicial decisions and Attorney General's opinions have interpreted these provisions to include the following officials: county treasurers, county commissioners, orphans court judges, bingo board members, and license and liquor commissioners. The statute also provides that certain employees of the Sheriff's Office of Baltimore City are to be included in the State employees' retirement systems. Another provision (Section 26-201 of the State Personnel and Pensions Article) makes Baltimore City deputy sheriffs eligible for the Law Enforcement Officers' Pension System. The State pays the retirement benefits for these officials and employees, but prior to fiscal 2000, the State did not appropriate funds for the employer contributions. Language in the fiscal 1999 budget bill (Chapter 109, Section 32, Acts of 1998) required that the funding be provided in the budget beginning with fiscal 2000.

The proposed fiscal 2004 budget includes \$1.6 million for employer retirement costs associated with these locally paid officials and employees. The amount is based on the June 30, 2002, salary base for these employees increased by 5%. No growth factor is applied to the salary base for judges. **Exhibit 6** shows the calculation. This is similar to the approach used to determine the State retirement payments for local teachers, community college faculty, and librarians. **Exhibit 7** shows the employer contributions allocated on a county-by-county basis in fiscal 2004.

Exhibit 6

Computation of Retirement Costs

<u>Retirement System</u>	<u>Salary Base June 30, 2002</u>	<u>Increased by 5%</u>	<u>Contribution Rate</u>	<u>Cost</u>
Employees Retirement/Pension	\$4,892,587	\$5,137,216	4.73%	\$242,990
Law Enforcement Officers Retirement/Pension	3,209,670	3,370,154	35.13%	1,183,935
Orphans' Court Judges	452,259	452,259*	43.74%	197,818
Total				\$1,624,743

*Fiscal 2002 salary amount is not increased by 5%.

Source: Department of Budget and Management

Exhibit 7

State Paid Retirement Costs for Locally Paid Officials and Employees

	<u>Allocation of Appropriation</u>
Allegany	\$7,219
Anne Arundel	28,395
Baltimore City	1,381,288
Baltimore County	7,560
Calvert	29,087
Caroline	5,438
Carroll	4,967
Cecil	7,124
Dorchester	8,524
Garrett	298
Howard	39,271
Kent	2,334
Montgomery	4,805
Prince George's	75,323
Queen Anne's	5,115
Washington	4,491
Wicomico	8,138
Worcester	5,366
Total	\$1,624,743

Note: County-by-county allocation is based on June 30, 2002 salaries.

Source: Department of Budget and Management

Issues

1. Disparity Grant Funding Exceeds Statutory Amount

The proposed fiscal 2004 budget includes \$110.8 million for the disparity grant program, \$14.2 million above the statutory required funding amount. The discretionary grant is to partially offset the reduction in State funding due to the transfer of \$102.4 million in local highway user revenues from the Transportation Trust Fund to the State's general fund. A portion of the discretionary grant (\$2.9 million) goes to three counties (Anne Arundel, Kent, and Queen Anne's) that do not statutorily qualify for disparity grants. In addition, several counties qualifying for the program receive discretionary grants that results in the counties receiving more funding in fiscal 2004 than the amounts received in fiscal 2003. The rationale for providing discretionary grants to these counties is to ensure that the jurisdictions do not realize a net decrease in State assistance in fiscal 2004. As shown in **Exhibit 8**, Allegany, Garrett, Kent, and Somerset counties would realize a net decrease in direct State aid without the discretionary disparity grant. Anne Arundel and Queen Anne's counties would still realize a marginal increase in direct State aid absent the discretionary grant.

In light of the current fiscal constraints, providing disparity grant funding to counties that do not statutorily qualify for the program and providing discretionary grants to qualifying counties that result in more funding in fiscal 2004 than the amounts received in fiscal 2003 is not affordable, and the Department of Legislative Services recommends that the grants to these counties totaling \$5.0 million be eliminated.

Exhibit 9 shows the recommended reduction to the discretionary disparity grant by county. This recommendation eliminates the \$2.9 million in discretionary funding provided to the three counties that do not qualify for the program. The nine disparity grant counties would realize a \$2.1 million decrease in their discretionary grants based on each county's allocation of funding in the prior year.

2. Education Maintenance of Effort Requirement Impacts Disparity Grants

The disparity grant program increased by \$25.9 million or 29% in fiscal 2003 pursuant to the statutory formula. The Department of Legislative Services recommended that the grant be reduced by \$11.8 million. Instead of reducing the program's funding, the General Assembly required that \$11.9 million of the funding increase be earmarked for public schools in fiscal 2003. The General Assembly adopted budget language that excluded the targeted funding from counting towards the local maintenance of effort requirement for public schools. However, since the maintenance of effort calculation is codified in Section 5-202 of the Education Article, separate legislation is necessary to exempt the disparity grant funds from the maintenance of effort calculation in fiscal 2004.

The local maintenance of effort requirement requires a local government to appropriate at least as much funding per pupil to the local board of education as it appropriated in the previous fiscal year in order to receive an increase in State education aid under the foundation and compensatory aid programs. Non-recurring costs may be excluded from the maintenance of effort if approved by the State Board of

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Education. In addition, the board may grant a county government experiencing fiscal problems a temporary or partial waiver of the maintenance of effort requirement.

The earmarking of the disparity grant to public schools boosted the local appropriation to the boards of education in eight disparity grant counties by \$11.9 million. Due to the maintenance of effort provision, this allocation to the boards of education must be maintained even though disparity grant funding is decreasing in fiscal 2004. This may require the county to use a significant portion or its entire disparity grant in fiscal 2004 to meet the maintenance of effort requirement. In one county (Washington), the entire disparity grant in fiscal 2004 would not meet the local maintenance of effort requirement. The county would have to use additional local funds to meet the requirement. In Prince George's County, approximately 75% of the county's fiscal 2004 disparity grant would have to be used to meet the maintenance of effort requirement. Accordingly, this would leave only a portion of the county's disparity grant for county government purposes. Furthermore, continuing last year's earmarking of disparity grant funding to public schools would significantly reduce the offsetting of highway user revenue decreases by the discretionary disparity grant funding. **Exhibit 10** shows the potential fiscal impact of the local maintenance of effort requirement in each county. To compound this situation, State aid to public schools in fiscal 2004 will increase by \$214 million or 7.8% while State aid to county and municipal governments will decrease by \$66 million or 9.4%. **To alleviate this situation, the Department of Legislative Services recommends that legislation be adopted to exclude the disparity grant funding targeted to public schools in fiscal 2003 from the local maintenance of effort requirement for fiscal 2004.**

Exhibit 8

Increase in Direct State Aid without Discretionary Disparity Grant

<u>County</u>	<u>FY 2004 Increase in Direct State Aid</u>	<u>Discretionary Disparity Grant</u>	<u>Direct Aid Increase Without Grant</u>
Allegany	\$306,929	\$702,716	-\$395,787
Anne Arundel	2,017,467	1,600,000	417,467
Baltimore City	17,321,836	6,037,631	11,284,205
Baltimore	15,368,263	0	15,368,263
Calvert	4,461,015	0	4,461,015
Caroline	575,857	195,048	380,809
Carroll	3,323,949	0	3,323,949
Cecil	2,177,888	0	2,177,888
Charles	7,388,648	0	7,388,648
Dorchester	857,990	147,287	710,703
Frederick	5,826,462	0	5,826,462
Garrett	264,887	2,089,043	-1,824,156
Harford	7,898,645	0	7,898,645
Howard	11,917,662	0	11,917,662
Kent	196,077	1,075,000	-878,923
Montgomery	19,410,942	0	19,410,942
Prince George's	26,742,954	1,171,474	25,571,480
Queen Anne's	266,871	180,000	86,871
St. Mary's	3,957,868	0	3,957,868
Somerset	170,757	565,536	-394,779
Talbot	2,087,504	0	2,087,504
Washington	2,494,965	157,788	2,337,177
Wicomico	3,855,870	254,369	3,601,501
Worcester	2,096,905	0	2,096,905
Unallocated	8,591,221	0	8,591,221
Total	\$149,579,432	\$14,175,892	\$135,403,540

Note: Counties in bold realize a decrease in direct State aid if the discretionary disparity grants are eliminated.

Source: Department of Legislative Services

Exhibit 9

Recommended Reduction of Discretionary Disparity Grant

<u>County</u>	<u>FY 2004 Allowance</u>	<i>DLS Recommended Action</i>		<u>Total Reduction</u>	<u>Share of Allowance</u>	<u>Share of Reduction</u>
		<u>Non-Qualifying Reduction</u>	<u>Allocated Reduction</u>			
Allegany	\$7,646,528	\$0	\$141,356	\$141,356	7.1%	6.6%
Anne Arundel	1,600,000	1,600,000	0	1,600,000		
Baltimore City	76,476,717	0	1,416,015	1,416,015	70.8%	66.0%
Baltimore	0	0	0	0		
Calvert	0	0	0	0		
Caroline	2,194,865	0	45,745	45,745	2.0%	2.1%
Carroll	0	0	0	0		
Cecil	0	0	0	0		
Charles	0	0	0	0		
Dorchester	2,379,001	0	34,544	34,544	2.2%	1.6%
Frederick	0	0	0	0		
Garrett*	4,645,289	0	56,063	56,063	4.3%	2.6%
Harford	0	0	0	0		
Howard	0	0	0	0		
Kent	1,075,000	1,075,000	0	1,075,000		
Montgomery	0	0	0	0		
Prince George's	7,067,475	0	274,748	274,748	6.5%	12.8%
Queen Anne's	180,000	180,000	0	180,000		
St. Mary's	0	0	0	0		
Somerset	4,427,422	0	79,866	79,866	4.1%	3.7%
Talbot	0	0	0	0		
Washington	250,565	0	37,006	37,006	0.2%	1.7%
Wicomico	2,888,558	0	59,658	59,658	2.7%	2.8%
Worcester	0	0	0	0		
Total	\$110,831,420	\$2,855,000	\$2,145,000	\$5,000,000	100.0%	100.0%

- Garrett County receives a hold harmless grant to ensure that its direct State aid in fiscal 2004 does not fall below the amount received in fiscal 2003. All other disparity grant counties receive more direct State aid in fiscal 2004 than they received in fiscal 2003. The share of allowance and reduction calculations do not include non-qualifying disparity grant counties.

Source: Department of Legislative Services

Exhibit 10

Impact on Disparity Grant Funding from Local Maintenance of Effort Requirement

County	Fiscal 2003 Funding			Fiscal 2004 Funding			County Difference Fiscal 2003 - 04
	Total Grants	Targeted to Public Schools	County Government	Total Grants	Maintenance of Effort Requirement	County Government	
Allegany	\$7,590,374	\$497,884	\$7,092,490	\$7,646,528	\$497,884	\$7,148,644	\$56,154
Anne Arundel	0	0	0	1,600,000	0	1,600,000	1,600,000
Baltimore City	76,035,628	4,326,695	71,708,933	76,476,717	4,326,695	72,150,022	441,089
Baltimore	0	0	0	0	0	0	0
Calvert	0	0	0	0	0	0	0
Caroline	2,456,358	140,125	2,316,233	2,194,865	140,125	2,054,740	-261,493
Carroll	0	0	0	0	0	0	0
Cecil	0	0	0	0	0	0	0
Charles	0	0	0	0	0	0	0
Dorchester	1,854,882	0	1,854,882	2,379,001	0	2,379,001	524,119
Frederick	0	0	0	0	0	0	0
Garrett	3,010,417	10,626	2,999,791	4,645,289	10,626	4,634,663	1,634,872
Harford	0	0	0	0	0	0	0
Howard	0	0	0	0	0	0	0
Kent	0	0	0	1,075,000	0	1,075,000	1,075,000
Montgomery	0	0	0	0	0	0	0
Prince George's	14,753,100	5,325,793	9,427,307	7,067,475	5,325,793	1,741,682	-7,685,625
Queen Anne's	0	0	0	180,000	0	180,000	180,000
St. Mary's	0	0	0	0	0	0	0
Somerset	4,288,581	164,435	4,124,146	4,427,422	164,435	4,262,987	138,841
Talbot	0	0	0	0	0	0	0
Washington	1,987,118	876,584	1,110,534	250,565	876,584	-626,019	-1,736,553
Wicomico	3,203,426	562,430	2,640,996	2,888,558	562,430	2,326,128	-314,868
Worcester	0	0	0	0	0	0	0
Total	\$115,179,884	\$11,904,572	\$103,275,312	\$110,831,420	\$11,904,572	\$98,926,848	-\$4,348,464

Source: Department of Legislative Services

3. State Aid Comprising an Increasing Share of General Fund Expenditures

State aid to local governments, primarily for education, is the fastest growing component of the State general fund budget. Local governments will realize a \$2.1 billion increase in State aid over the next five years. Between 2004 and 2008, State aid will increase by 9.5% annually compared to 6.7% for entitlements, 3.7% for mandated State operations, and 2.6% for non-mandated State operations. State aid will consume an even larger share of general fund expenditures. While State aid to local governments accounted for 31% of general fund expenditures in fiscal 2002 and 36% in fiscal 2004; by fiscal 2008 State aid to local governments will account for over 40% of general fund expenditures.

The significant increase in State aid results from the new education funding required under the Thornton legislation enacted last year (Chapter 288, Laws of 2002). Under the legislation, it is estimated that the State will provide \$1.3 billion in new funding for public schools by fiscal 2008. With these increases the State will be assuming a larger role in funding public schools. Even with a substantial increase in revenues and the curtailment of State services as reflected in the budget, the continual increase in State assistance for public schools will be difficult to afford without re-examining the fiscal relationship between the State and its local governments.

To meet the funding targets established under the Thornton legislation while maintaining vital State services and programs, the Department of Legislative Services recommends that in fiscal 2004, the State retain a portion of local income tax revenues. The State share would total approximately 0.1% of net taxable income in fiscal 2004. This would increase State revenues by \$91.5 million in fiscal 2004. The amount of revenue retained by the State will account for approximately 3.5% of local income tax revenues in 2004. **Exhibit 11** shows the projected impact on State and local revenues.

A similar approach was used during the fiscal crisis in 1992 when the State instituted a \$50 million unallocated aid reduction based on local wealth. Recognizing the impact of this and other aid reductions, the State granted the counties additional income tax authority beginning with calendar 1993. The maximum local income tax rates were increased from 50% to 60% of an individual's State tax. However, given that the State has recently reduced its personal income tax rates to reduce its reliance on that source, it is not recommended that the caps applicable to local rates be adjusted at this time.

Exhibit 11

Impact of Retaining Portion of Local Income Tax Revenues

<u>County</u>	<u>Net Taxable Income 2001</u>	<u>State Share at 0.1%</u>	<u>Estimated TY 04 Local Income Tax Collections</u>	<u>% of Tax Retained By State</u>
Allegany	\$694,141,626	\$694,142	\$19,500,000	3.6%
Anne Arundel	9,656,495,287	9,656,495	253,800,000	3.8%
Baltimore City	5,694,124,537	5,694,125	134,200,000	4.2%
Baltimore	13,769,282,261	13,769,282	394,300,000	3.5%
Calvert	1,360,987,191	1,360,987	36,000,000	3.8%
Caroline	312,413,038	312,413	8,000,000	3.9%
Carroll	2,661,531,548	2,661,532	77,400,000	3.4%
Cecil	1,192,786,769	1,192,787	34,400,000	3.5%
Charles	1,945,311,059	1,945,311	57,200,000	3.4%
Dorchester	316,103,590	316,104	7,900,000	4.0%
Frederick	3,767,620,541	3,767,621	115,800,000	3.3%
Garrett	287,001,874	287,002	7,500,000	3.8%
Harford	3,743,998,602	3,743,999	118,800,000	3.2%
Howard	6,248,517,539	6,248,518	158,500,000	3.9%
Kent	273,087,987	273,088	7,100,000	3.8%
Montgomery	23,004,089,104	23,004,089	700,100,000	3.3%
Prince George's	10,284,482,754	10,284,483	311,200,000	3.3%
Queen Anne's	730,775,443	730,775	21,200,000	3.4%
St. Mary's	1,281,177,391	1,281,177	41,000,000	3.1%
Somerset	172,250,209	172,250	5,200,000	3.3%
Talbot	680,386,890	680,387	12,400,000	5.5%
Washington	1,709,673,851	1,709,674	48,900,000	3.5%
Wicomico	1,015,967,416	1,015,967	30,900,000	3.3%
Worcester	724,242,753	724,243	8,700,000	8.3%
Total	\$91,526,449,260	\$91,526,449	\$2,610,000,000	3.5%

Source: Department of Legislative Services

Recommended Actions

	<u>Amount Reduction</u>	<u>Position Reduction</u>
1. Reduce funds for disparity grants. In light of the current fiscal constraints, providing disparity grant funding to counties that do not statutorily qualify for the program and discretionary grants in excess of the funding levels in fiscal 2003 is not affordable.	\$ 5,000,001	GF
2. Adopt legislation to exclude disparity grant funding targeted to public schools in fiscal 2003 from the local maintenance of effort requirement for fiscal 2004.		
3. Adopt legislation requiring the State to retain a portion of local income tax revenues. State assistance to local governments is consuming a larger share of general fund expenditures. The fiscal relationship between the State and local governments must be re-examined. The State share would total 0.1% of net taxable income in fiscal 2004.		
Total General Fund Reductions	\$ 5,000,001	

Current and Prior Year Budgets

Current and Prior Year Budgets Payments to Civil Divisions of the State (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2002					
Legislative Appropriation	\$123,790	\$0	\$0	\$0	\$123,790
Deficiency Appropriation	63	0	0	0	63
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	\$123,853	\$ 0	\$ 0	\$ 0	\$123,853
Fiscal 2003					
Legislative Appropriation	\$150,315	\$0	\$0	\$0	\$150,315
Budget Amendments	0	0	0	0	0
Working Appropriation	\$150,315	\$ 0	\$ 0	\$0	\$150,315

Note: Numbers may not sum to total due to rounding.

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Appendix 2

**Object/Fund Difference Report
Payments to Civil Divisions of the State**

<u>Object/Fund</u>	<u>FY02 Actual</u>	<u>FY03 Working Appropriation</u>	<u>FY04 Allowance</u>	<u>FY03 - FY04 Amount Change</u>	<u>Percent Change</u>
Objects					
12 Grants,Subsidies,Contr	\$ 123,852,653	\$ 149,900,588	\$ 146,096,364	-\$ 3,804,224	-2.5%
Total Objects	\$ 123,852,653	\$ 149,900,588	\$ 146,096,364	-\$ 3,804,224	-2.5%
Funds					
01 General Fund	\$ 123,852,653	\$ 149,900,588	\$ 146,096,364	-\$ 3,804,224	-2.5%
Total Funds	\$ 123,852,653	\$ 149,900,588	\$ 146,096,364	-\$ 3,804,224	-2.5%

Note: Fiscal 2003 appropriations and fiscal 2004 allowance do not include cost containment and contingent reductions.

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Fiscal Summary Payments to Civil Divisions of the State						
<u>Unit/Program</u>	<u>FY02 Actual</u>	<u>FY03 Legislative Appropriation</u>	<u>FY03 Working Appropriation</u>	<u>FY02 - FY03 % Change</u>	<u>FY04 Allowance</u>	<u>FY03 - FY04 % Change</u>
01 Disparity Grants	\$ 89,289,557	\$ 115,179,884	\$ 115,179,884	29.0%	\$ 110,831,420	-3.8%
01 Security Interest Filing Fees	2,797,685	2,750,000	2,750,000	-1.7%	3,025,000	10.0%
01 Retirement Contribution - Certain Local Employees	1,150,210	1,355,503	1,355,503	17.8%	1,624,743	19.9%
01 Electricity Generating Equipment Property Tax Gran	30,615,201	30,615,201	30,615,201	0%	30,615,201	0%
Total Expenditures	\$ 123,852,653	\$ 149,900,588	\$ 149,900,588	21.0%	\$ 146,096,364	-2.5%
General Fund	\$ 123,852,653	\$ 149,900,588	\$ 149,900,588	21.0%	\$ 146,096,364	-2.5%
Total Appropriations	\$ 123,852,653	\$ 149,900,588	\$ 149,900,588	21.0%	\$ 146,096,364	-2.5%

Note: Fiscal 2003 appropriations and fiscal 2004 allowance do not include cost containment and contingent reductions.