Marc Elrich
County Executive

Michael J. Coveyou
Director

DEPARTMENT OF FINANCE

MEMORANDUM

February 15, 2023

TO: Marc Elrich, County Executive

FROM: Michael Coveyou, Director
Department of Finance

SUBJECT: Revenue Estimating Group Report for February 15, 2023

As chairperson of the Revenue Estimating Group, I am pleased to transmit to you the Group's February report.

The Revenue Estimating Group was established in March 2021 per Bill 6-21 and requires the Group to provide quarterly reports to the County Executive and County Council each year on February 15, May 15, September 15 and December 15. This February 15th report focuses on fiscal 2023 year-to-date tax revenues through the end of December and the economic assumptions to be used for the fiscal year 2024 recommended budget.

The next report is due in May and will review the fiscal year 2024 recommended budget tax revenue forecast. We welcome your feedback on the contents and format of this report and future reports. Please feel free to contact me with any questions that you my have at 240-777-8870.

MC/nbf
Enclosure

cc: Members of the Revenue Estimating Group (Addendum I attached)

ADDENDUM I

Members of the Revenue Estimating Group

Michael J. Coveyou, Director, Department of Finance
Richard Madaleno, Chief Adminstrative Officer, Office of the County Executive
Jennifer R. Bryant, Director, Office of Management and Budget
Marlene Michaelson, Executive Director, Office of the County Council
Chris Cihlar, Director of the Office of Legislative Oversight

Designees and Technical Committee members:
Nancy B. Feldman, Chief, Division of Fiscal Management (Dept. of Finance)
Dennis Hetman, Fiscal Manager, Division of Fiscal Management
David Platt, Chief Economist, Division of Fiscal Management
Todd Fawley-King, Fiscal Policy Analyst, Division of Fiscal Management
Jake Weissman, Assistant Chief Administrative Officer, Office of the County Executive
Josh Watters, Deputy Director, Office of Management and Budget
Chris Mullin, Budget Manager, Office of Management and Budget
Mary Beck, Capital Budget Manager, Office of Management and Budget
Craig Howard, Deputy Director, County Council Staff
Aron Trombka, Senior Legislative Analyst, Office of Legislative Oversight
Stephen Roblin, Performance Management and Data Analyst, Office of Legislative Oversight

Marc Elrich
County Executive

Michael J. Coveyou
Director

DEPARTMENT OF FINANCE

MEMORANDUM

February 15, 2023

TO: County Council

FROM: Michael Coveyou, Director
Department of Finance

SUBJECT: Revenue Estimating Group Report for February 15, 2023

As chairperson of the Revenue Estimating Group, I am pleased to transmit the Group's February report.

The Revenue Estimating Group was established in March 2021 per Bill 6-21 and requires the Group to provide quarterly reports to the County Executive and County Council each year on February 15, May 15, September 15 and December 15. This February 15th report focuses on fiscal 2023 year-to-date tax revenues through the end of December and the economic assumptions to be used for the fiscal year 2024 recommended budget.

The next report is due in May and will review the fiscal year 2024 recommended budget tax revenue forecast. We welcome your feedback on the contents and format of this report and future reports. Please feel free to contact me with any questions that you may have at 240-777-8870.

MC/nbf
Enclosure

cc: Members of the Revenue Estimating Group (Addendum I attached)

ADDENDUM I

Members of the Revenue Estimating Group

Michael J. Coveyou, Director, Department of Finance
Richard Madaleno, Chief Adminstrative Officer, Office of the County Executive
Jennifer R. Bryant, Director, Office of Management and Budget
Marlene Michaelson, Executive Director, Office of the County Council
Chris Cihlar, Director of the Office of Legislative Oversight

Designees and Technical Committee members:
Nancy B. Feldman, Chief, Division of Fiscal Management (Dept. of Finance)
Dennis Hetman, Fiscal Manager, Division of Fiscal Management
David Platt, Chief Economist, Division of Fiscal Management
Todd Fawley-King, Fiscal Policy Analyst, Division of Fiscal Management
Jake Weissman, Assistant Chief Administrative Officer, Office of the County Executive
Josh Watters, Deputy Director, Office of Management and Budget
Chris Mullin, Budget Manager, Office of Management and Budget
Mary Beck, Capital Budget Manager, Office of Management and Budget
Craig Howard, Deputy Director, County Council Staff
Aron Trombka, Senior Legislative Analyst, Office of Legislative Oversight
Stephen Roblin, Performance Management and Data Analyst, Office of Legislative Oversight

Montgomery County Maryland Revenue Estimating Group
Quarterly Report
February 15, 2023

Executive Summary

- Economic assumptions for Fiscal Year 2023 ("FY23") were revised lower in the December Fiscal Plan update presented to County Council on December 13, 2022 due to the anticipation of a mild recession in calendar year 2023 ("CY23").
- FY23 revised total tax revenues were forecast to exceed the approved budget by $22.6 million (+0.5%) primarily due to the income tax exceeding its forecast. As of the end of December tax revenues are near the revised estimates.
- Economic assumptions for 2024 continue to assume a mild recession begins during CY23. A review of economic assumptions from Moody's Analytics indicates that a mild recession in 2023 may decrease 2023 resident employment by less than 1%, while total personal income continues to grow at moderate pace of 4.6%. The forecast for 2024 assumes a return to growth of 1.1% for resident employment and total personal income growth of 3.6%.
- Economic assumptions that effect real estate related taxes include the volume of single-family home sales. In 2023 and 2024 single-family volume has been revised to be slightly better than assumed previously, however, home sales are estimated to decrease 16.2% in 2022 and 22.9% in 2023 before beginning to increase in 2024 by 14.8%.

Year to Date for the Period Ended December 31, 2022

Income tax receipts for the first half of FY23 were approximately 28% of the forecast in the December Fiscal Plan update.[1] At this half-way point in the fiscal year income tax receipts averaged approximately 38% of the annual forecast during fiscal years 2011- 2021. The FY23 receipts percentage is lower than the average due to the timing of income tax distributions to the County from the State of Maryland.

[1] Income tax receipts are accounted for on a modified accrual basis on an August through July fiscal year. Income taxes collected through December 31 reflect 5 months from August through December. Other taxes shown in the table are on a cash basis on a July through June fiscal year.

Starting in FY22 the State Comptroller's office had difficulty processing all the complex tax returns from pass-through-entities (i.e. S-Corps, partnerships) in time to distribute the related income taxes to counties in November and January, as it had in the past. As a result, the Comptroller made a special distribution of the pass-through-entity tax year 2020 income taxes in March of 2022. Since the special distribution had been expected by the County the prior November, it was treated as an on-going revenue for the FY23 budget and built into the FY23 income forecast.

For FY23, the State Comptroller again was unable to process the complex pass-through-entity tax returns in time to distribute related income taxes to the County in November as expected. This resulted in a shortfall in the November reconciling distribution (reflecting tax year 2021 filings) versus the November forecast. At the time, we believed that this was a timing issue rather than an income tax revenue issue.

As part of the County's normal end of January 2023 income tax distribution (and not shown in the table below), the State Comptroller paid $238.6 million to the County, of which $229.9 million was the tax year 2021 final reconciling income tax distribution. For all of FY23 the December Fiscal plan income tax forecast included $171 million from tax year 2021 reconciliation revenue. Even though the Department of Finance had anticipated an increase in the tax year 2021 final distribution of approximately $75 million due to additional income tax liability from tax year 2021 for which income tax revenues had not been distributed by the State Comptroller, the actual distribution exceeded this amount.

Because the January 2023 income tax distribution is related to tax year 2021 filings, it is not necessarily representative of the County's income tax receipts for the remainder of FY23, which will be primarily from income tax withholdings and estimated tax payments. Additionally, looking forward to FY24 when income tax from tax year 2022 filings will be received, there is risk to the income tax forecast due to the significant decline in equity markets and asset prices experienced in tax year 2022. These risks will be considered in the FY24 income tax revenue forecast in the recommended budget.

The Maryland Board of Revenue Estimates December 15, 2022 report[2], 'Estimated Maryland Revenues', included the following comment addressing non-wage income:[3]

> "Non-wage income grew at a rapid pace over the course of the pandemic. In tax year 2021, we estimate the capital gains income grew by about 60%. This increase is attributable to the fact that the stock market, like asset prices generally, quickly recovered from their decrease early in the pandemic. Over the course of calendar 2022, however, the S&P 500 has fallen by about one-fifth. Even with an expected decline in capital gains income over the next years, non-wage income comprises an elevated share of the State's revenue collections. This income is far more volatile and unpredictable than other types

[2]https://www.mdbre.gov/BRE_reports/FY_2023/December%202022%20Board%20Report%20(Website%20Version%20V1).pdf

[3] The State of Maryland's description of non-wage income differs from the BEA definition. The State of Maryland includes capital gains in their description, while BEA does not.

of income. In conjunction with the elevated uncertainty over the economic outlook, nonwage income contributes to a heighted risk to the forecast."

TAXES	Year-to-Date (through December) (1)	FY23 Approved Budget	Fiscal Plan Update Dec-22	YTD Share FY23 Approved	YTD Share Fiscal Update
Property Tax (includes MNCPPC)	$1,864,963,750	$1,951,354,013	$1,923,178,401	95.6%	97.0%
Income Tax	$544,107,664	$1,870,513,400	$1,955,854,198	29.1%	27.8%
Transfer Tax	$60,994,752	$154,749,748	$132,338,928	39.4%	46.1%
Recordation Tax (G.F.)	$30,706,018	$74,157,991	$62,962,486	41.4%	48.8%
Fuel and Energy Tax	$71,850,536	$186,479,565	$187,534,164	38.5%	38.3%
Telephone Tax	$22,441,214	$54,591,229	$55,163,156	41.1%	40.7%
Hotel/Motel Tax	$8,306,304	$21,725,087	$18,556,726	38.2%	44.8%
Admissions Tax	$1,156,785	$2,677,768	$3,522,465	43.2%	32.8%
E-Cigarette Tax	$485,335	$1,147,657	$917,659	42.3%	52.9%
TOTAL	$2,605,012,359	$4,317,396,457	$4,340,073,079	60.3%	60.0%

NOTE (1): data from MoCo accounting systems; provided by the Treasury Division, Department of Finance

Property taxes collected to date are near 97% of the December Fiscal Plan revised forecast since the final regular property tax due date passed on December 31, 2022. During the second half of the fiscal year ad valorem property taxes that may be received include delinquent payments, taxes for construction projects in process or completed and personal property taxes. The County has a long history of collecting over 99%[4] of its property taxes each year.

Transfer and recordation taxes

At the end December recordation and transfer tax collections were approximately 46% and 49%, respectively, of the reduced December Fiscal Plan estimates. Year-over-year transfer taxes are down 36% and volume is down 38% while recordation tax revenue is down 31% and volume is down 60%. Rising federal funds rate, interest rates and mortgage rates have had a negative impact on these real estate-based taxes.

Other tax revenues collected through December 31 are on target considering expected seasonality and recovery from pandemic lows. Fuel energy tax and telephone tax collections were approximately 39% of the December Fiscal Plan estimates. Hotel/motel tax collections are approximately 38% of the approved budget but 45% of the December Fiscal Plan estimate. Hotel/motel tax is seasonal, typically with higher receipts after the winter season. In December the annual estimate was decreased from $21.7 million to $18.6 million due to a slower uptake in business travel, room rates and occupancy than assumed in the approved budget.

[4] See Montgomery County Annual Comprehensive Report, June 30, 2022. Table 11
https://www.montgomerycountymd.gov/Finance/Resources/Files/data/financial/cafr/FY2022_ACFR.pdf

Economic Assumptions for FY24

Bureau of Economic Analysis ("BEA") data revision

The economic assumptions discussed in this Group's December 15, 2022 report and upon which the December Fiscal Plan revisions were built, are tracking close to expectations. In the two months that have elapsed since the Fiscal Plan was updated, some economic data for calendar years 2017 to 2021 has been revised by the BEA and as a result the forecast for the subsequent years starts from the revised 2021 base level, (including 2022, for which final data is not yet available). Key changes in calendar year 2021 final data are:

- Total personal income ('TPI') decreased by 3.1%
- Wage and salary income (a component of TPI) decreased by 1.4%
- Non-wage income (a component of TPI) decreased by 4.5%

As a result of this lower 2021 revised BEA data annual growth rates for these key economic variables have changed for 2022 and 2023:

- Resident employment is slightly lower in 2022 (0.1% lower growth) and 2023 (to -0.4%, down by 0.3 percentage points) than December's growth rates. Change in future year growth rate assumptions are due to a combination of the revisions in the 2017 to 2021 BEA data plus changes in economic and financial conditions in the County and are discussed further below under *FY24-29 Economic Assumptions*.
- Total personal income growth rate for 2022 is now a decrease of 0.7% from 2021 compared to +2.2% in December but returns to growth in 2023 at a higher growth rate than in December of 4.6% vs. 1.4%.
- Wage and salary income growth rate for 2022 is now 4.7% vs. 8.5% in December, however, in 2023 the growth rate is higher than December at 3% vs. 0.3%.
- Non-wage income[5] growth rate in 2022 is weaker than in December at -5.3% vs. -3.1% but shows a positive trend in 2023 growing at 6.2% compared to 2.4% previously. The two-year average of 2022 and 2023 growth assumption for December was -0.4% and is now +0.4%, a small but positive change.

Other economic assumptions that are drivers of the tax revenue forecast are not sourced to BEA, including, capital gains, sales of existing single-family homes and median sales price of single-family homes. Any changes in these assumptions for the FY24 budget are due to changes in the outlook for these factors.

[5] The majority of non-wage income includes i) proprietor's income ii) dividends, interest and rent and iii) transfer payments.

FY24-29 Economic Assumptions

The economic assumptions that will be applied to develop the FY24 budget revenue forecast are shown below. The data points for 2021 for resident employment and total personal income are BEA's revised 2021 data and are an update of those that were used for the December Fiscal Plan estimates. The economic forecast continues to assume a mild recession begins at some time during 2023.

Resident Employment is one of the key components in forecasting income tax revenue. For 2023-29 resident employment is assumed to grow at a similar pace as was assumed in December with positive growth rates in all years except 2023, where a -0.4% decline is assumed. A turnaround to positive growth begins in 2024 at 1.6% and then 2.0% in 2025, with subsequent years mostly below 1% per year. Average annual growth from 2023-2029 is 0.9% per year.

Total Personal Income is also a key component in forecasting income tax revenue. The assumption for total personal income remains positive in all years of the forecast, averaging 4.0% per year from 2023-2029. The growth rate in 2023 of 4.6% is higher than the December forecast of 1.4%, however, the average of 2022 and 2023 is similar with the 2-year average of 1.8% in December compared to 2.0% in the current assumptions.

Sales of existing single-family homes and median sales price of single-family homes are key components in forecasting property tax and transfer and recordation tax revenues. The assumption for the volume of single-family home sales in 2023 and 2024 has been updated to be slightly improved than assumed previously, however, home sales are estimated to decrease 16.2% in 2022 and 22.6% in 2023 before beginning to increase in 2024 at 14.8%. Smaller increases from 2025-2029 average 3.5% per year. In addition to single-family homes, transfer and recordation taxes are derived from non-residential transfer activity and the recordation tax is also applied to other instruments that are recorded in land records.

FY24 Budget - Key Economic Assumptions

						Percentage change Year-Over-Year							
		2021	2022 (est.)	2023 forecast	2024 forecast	2022	2023	2024	2025	2026	2027	2028	2029
Resident Employment	*December 2022*	517,358	531,293	530,546	540,522	2.7%	-0.1%	1.9%	1.7%	0.7%	0.7%	0.7%	0.6%
	FY24 budget	517,358	530,593	528,656	537,021	2.6%	-0.4%	1.6%	2.0%	0.9%	0.7%	0.7%	0.6%
Total Personal Income ($mm)	*December 2022*	100,960	103,140	104,570	109,120	2.2%	1.4%	4.4%	5.5%	4.2%	3.8%	3.8%	3.7%
	FY24 budget	97,825	97,170	101,656	105,329	n/a**	4.6%	3.6%	4.6%	4.4%	3.9%	3.5%	3.2%
Median Existing Home Sales (thou.)	*Dec. 2022*	13.731	9.295	7.687	9.326	-32.3%	-17.3%	21.3%	3.5%	-3.4%	3.5%	5.3%	3.3%
	FY24 budget	13.827	11.590	8.968	10.295	-16.2%	-22.6%	14.8%	3.3%	0.0%	6.6%	5.5%	1.9%
Median Sales Prices ($)	*December 2022*	561,424	593,540	527,194	547,272	5.7%	-11.2%	3.8%	-0.7%	0.9%	3.5%	5.9%	5.1%
	FY24 budget	559,814	586,307	556,483	536,527	4.7%	-5.1%	-3.6%	-1.1%	2.0%	2.2%	3.5%	3.9%
						Forecast (%)							
CPI-U Washington MSA (%)	*December 2022*	4.0	7.2	4.2	1.4				1.9	2.2	2.2	2.3	2.3
	FY24 budget						4.0	2.3	2.1	2.2	2.2	2.3	2.3

FY24 budget data for 2021 is actual data, as revised by BEA in November 2022 for resident employment and total personal income

Risks to the Economic Assumptions

Any forecast is subject to both positive and negative risk factors. The County's budget assumptions and revenue forecast are no exception. There are several key economic risks that could negatively impact the County in 2023 and beyond.

- A recession that is deeper and/or longer than the mild recession assumed in the forecast.
- Failure of Congress to raise the debt ceiling – a U.S. debt default.
- Employment that declines more than forecast due to events such as:
  - resurgence of COVID-19
  - global economic instability due to Russia/Ukraine war and food and fuel shortages
  - hostilities in other parts of the world impact the U.S. directly or indirectly including additional supply chain disruptions.
- Slower personal income growth due to:
  - reduced corporate profitability and persistent inflation that the Fed is not able to tame.
  - capital gains decline more steeply than expected in the face of market volatility.
- Assessed values grow more slowly than forecast due to:
  - persistent high mortgage rates causing reduced housing affordability and reduced home sales.
  - uncertainty of commercial property assessments and new construction as offices downsize with remote work becoming structurally more permanent.

There are also developments that could have a positive impact on economic activity in 2023 and beyond and result in revenues exceeding revised budget assumptions.

- A successful soft landing of the national economy as engineered by The Fed results in a rapid decrease in interest and mortgage rates that contribute to strengthening in real estate activity.
- Further diminution of the COVID-19 pandemic contributing to improvement in labor force participation and broad-based wage gains
- Improvement in Montgomery County specific economic factors that are revenue drivers, including increased resident employment, personal income, and capital gains.

The Revenue Estimating Group

Section 20-84 was added to the Montgomery County Code in March 2021 pursuant to Bill 6-21. Section 20-84 established a Revenue Estimating Group (the "Group") to review and forecast County revenues and provide for the membership and duties of the Group. The Group must submit reports to the County Executive and the County Council on revenue projections and quarterly attainment of revenue on February 15, May 15, September 15, and December 15.