

IN RE: WAIVER REQUEST OF  
MONTGOMERY COUNTY

BEFORE THE  
MARYLAND  
STATE BOARD  
OF EDUCATION  
Opinion No. 2010-1

## OPINION

### INTRODUCTION

We preface our Maintenance of Effort (MOE) decision for FY 2011 with some general comments and guiding principles.

We see on the horizon increased downward pressure on local governments' budget. State funding will likely decrease; counties may be asked to fund a larger share of local teacher pension costs; federal stimulus funding will likely cease. We anticipate that the downward budget pressure will cause counties to shift their budget burdens to the schools and will seek to reduce school budgets further. As these pressures build a legislative solution that fashions a statewide approach will become necessary.

For fiscal year 2011, however, just 2 of the 24 counties in Maryland requested an MOE waiver. We commend the efforts of the 22 counties to hold true to their promise to fund adequately the education of their children. We know, however, that all 24 counties are struggling in this difficult economic time. These two counties may be the proverbial canaries in the coal mine – each returning for the second consecutive year to request MOE waivers.

In considering these waiver requests, we take seriously our role as leaders and advocates for full funding of education in Maryland. Indeed, it might seem more congruent with that role to deny the requests and let the cards fall where they may. We are cognizant that granting the requests could easily open the flood gates to future MOE waiver requests. We have concluded, however, that the issues before us are more complex than a simple grant or denial of the waiver. They require a careful look at the MOE statute, its policy objectives, and how it works. In our decision, therefore, we will point out the significant flaws in the MOE statute and the impact of those flaws on the counties, the local boards and on our decision. We urge the General Assembly to address the flaws in the statute before the law becomes unworkable. The flaws in the law include:

- (1) The penalty provision victimizes the local school system and presents a Hobson's choice requiring the school system to support the waiver request to avoid the penalty.
- (2) If the State Board grants a waiver, the next year's MOE amount cannot be based on the local appropriation in the year of the waiver, but must be based on the appropriation for

the prior fiscal year or the second prior fiscal year, whichever is greater. But, if the State Board denies a waiver and the county refuses to fully fund MOE, the MOE amount in the next year can be based on the lower appropriation of the year in which the waiver was denied.

- (3) MOE ratchets up every year so that funding in excess of MOE in one year becomes the starting base for MOE in the next year. The more generously a county funds its school system, the greater its yearly MOE requirement becomes.
- (4) An inflation factor is not built into the MOE funding formula so that flat funding of the MOE requirement does not keep pace with inflation and short changes the school budget.

### PROCEDURAL BACKGROUND

On March 23, 2010, the State Board established a process and procedure to govern the MOE waiver requests. Counties were directed to express their intent to file a waiver request by April 1, 2010. All MOE waiver briefs and documents were to be filed by May 10, 2010 and contain the following information:

- (1) A narrative of no more than 25 pages explaining all the evidence presented, why it demonstrates that the county's fiscal condition "significantly impedes" the county's ability to fund MOE and why it is unique from the general economic crisis that affects all counties in the State.
- (2) The amount the county proposes to appropriate to its school operating budget and the amount the county is required to appropriate to meet the maintenance of effort requirement;
- (3) Information detailing the county's projected fiscal condition for FY 2011 as compared to the current FY 2010;
- (4) If applicable, information regarding statutory or other limitations impacting the county's ability to raise revenues and documentation of efforts taken by the county to overcome these impediments to raise the revenues necessary to meet maintenance of effort requirements;
- (5) A copy of the County's most recent audited financial statement;
- (6) The county's projected expenditure plan for FY 2011, as well as the current fiscal year expenditure plan;
- (7) A description and explanation of the unique external environmental factors such as loss of a major business or industry or unique economic strains and how they impact the FY 2011 county budget;
- (8) A description and explanation of the effect of the recession on all county tax bases and other revenue generating streams of income in FY 2010 and projected for FY 2011;

- (9) The amounts in each of the county's reserve funds, rainy day funds, or any other savings-type fund and the reasons why such funds are not available to meet MOE requirements including specifically any legal prohibitions on accessing those funds;
- (10) Additional information in support of the waiver request as the county considers necessary including the amount the county has overfunded MOE in the past; the local board of education position on the waiver request; loss of a significant revenue source; loss of industry; unique, severe, and unanticipated expenditures that impacted the county's budget; and any reduction in bond rating or other indicators of severe financial distress;
- (11) A description and explanation of all public meetings on the MOE waiver request and any community support for the waiver;

On April 1, 2010, five counties filed an intent to request a waiver of their MOE funding obligations. The five counties were: Montgomery, Dorchester, Wicomico, Talbot, and Frederick. Talbot, Frederick, and Dorchester ultimately withdrew their intent notices.

The local board's Response was filed on May 10, 2010. The State Board of Education held a public hearing on May 25, 2010 to give the county government, and the local board the opportunity to present oral argument.

#### **A. Maintenance of Effort History**

##### **▪ Law and Regulations**

In 2009, for the first time, we interpreted the statute and regulations governing maintenance of effort. *See, e.g., In Re: Waiver Request of Montgomery County*, MSBE Waiver Request No. 2009-1. We explained that since 1984 the MOE requirement had been a component of the public school funding law. Chapter 85, Laws of Maryland 1984. Letter to Ecker, 76 Md. Op. Atty. Gen. 153 (Mar. 6, 1991). To meet the MOE requirement, the county governing body must appropriate local funds to the school operating budget in an amount no less than the product of the county's full-time equivalent enrollment for the current fiscal year and the local appropriation on a per pupil basis for the prior fiscal year. Md. Educ. Code Ann. §5-202(d)(1)(ii). The local appropriation for the prior fiscal year for a county is calculated on a per pupil basis by dividing the county's highest local appropriation to its school operating budget for the prior fiscal year by the county's full-time equivalent enrollment for the prior fiscal year. Md. Educ. Code Ann. §5-202(d)(2).

We explained that the Bridge to Excellence Act, which sets forth the education funding formula, recognizes that the local share will vary depending on the wealth of the county. *See, e.g., Md. Educ. Code Ann. §§5-502(a)(7) & (8); 5-210.* But, we emphasized that State/local sharing of the costs of education is the cornerstone of education funding in Maryland. Indeed, in 2002 when the Commission on Education Finance, Equity and Excellence published its comprehensive report ("a/k/a, Thornton Commission Report") on how to achieve a level of constitutionally adequate funding for education in Maryland, it stated:

Although meeting the adequacy goals adopted by the Commission will require a significant increase in State aid over the next five years, funding the public schools remain a shared responsibility between State and local governments. Reaching adequate funding, therefore, will require additional local funding for the schools.

Thornton Commission Report at 73.

Thus, we said that when a county government requests a waiver from paying its maintenance of effort in full, we must consider carefully the full implications of that request, not only at the local level, but statewide as well, because “any crumbling in the cornerstone of the State/local share formula for funding education can affect the structural soundness of the education funding formula going forward.”

We reviewed the law and regulations that govern the waiver of maintenance of effort noting that the law establishes that the county may obtain a waiver of MOE if the State Board determines “that the county’s fiscal condition significantly impedes the county’s ability to fund the maintenance of effort requirement.” Md. Educ. Code Ann. §5-202(d)(7). After that law passed, the State Board promulgated regulations that explained the factors the State Board would consider in making its decision. They are:

- (a) External environmental factors such as a loss of major industry or business;
- (b) Tax bases;
- (c) Rate of inflation to growth of student population;
- (d) The maintenance of effort requirement relative to the county’s statutory ability to raise revenues.

COMAR 13A.02.05.04(C)(2).

The very same law and regulation remain on the books today. In the 2009-2010 session of the General Assembly, efforts were made to change the statute, but those efforts failed. Specifically, after the State Board denied the FY 2010 requests for a waiver of MOE, seven bills were introduced in the General Assembly to address future MOE waiver issues. The first issue of concern was the \$23.4 million penalty that the existing MOE statute required to be imposed on Montgomery County Public Schools for the county’s failure to meet MOE. *See* Md. Educ. Code Ann. §5-213. Thus, SB 403, SB 476, HB 632 and HB 223 were introduced to waive the penalty.

House Bill 223 and Senate Bill 476 passed and were signed into law. 2010 Laws of Maryland, Chapter 73. That law also established a Committee to study the appropriate way calculate the penalty in the future. The Committee will issue a report on December 31, 2010.

Bills setting forth more comprehensive approaches to the MOE waiver issue were also introduced.

- SB 310 – set forth specific factors for the State Board to consider and would have added the State Superintendent into the decision making process.
- HB 410 – would have waived MOE for FY 2011 for all counties.
- HB 1131 – would have changed the MOE waiver appeal process to allow an appeal of the State Board’s decision to the Office of Administrative Hearings.

Despite much discussion in the legislative session, none of those bills passed. Although SB 310 did not pass, on April 22, 2010, the Co-Chairs of the Joint Legislative Workgroup to Study State, County and Municipal Fiscal Relationships requested the State Board to consider evidence of the seven factors contained in the Senate Bill 310:

- a county governing body’s history of exceeding the required maintenance of effort amount;
- the existence of an agreement between a county governing body and a county board that a waiver should be granted;
- significant reductions in State aid to a county and municipalities of the county for the fiscal year for which a waiver is applied;
- external environmental factors such as a loss of a major employer or industry affecting a county or a broad economic downturn affecting more than one county;
- a county’s tax bases;
- rate of inflation relative to growth of student population in a county; and
- maintenance of effort requirement relative to a county’s statutory ability to raise revenues.

April 22, 2010 Letter to James DeGraffenreidt, Jr. from Workgroup Co-Chairs.

The Maintenance of Effort Filing Notice that the State Board issued on March 25, 2010, however, included each of those factors, as well as the factors required under the current statute and regulation.<sup>1</sup>

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<sup>1</sup> The letter from the Co-Chairs also requested that the Board respect the provision included in the conference committee report on Senate Bill 310 that requires the participation of the State Superintendent in evaluating the waiver requests. The language reads as follows: *The State Superintendent shall provide a preliminary assessment of a waiver application to the State Board prior to any public hearing.* We must decline that request because of very short time period for review and decision here and because SB 310 did not become law.

## B. Burden of Proof

In presenting evidence that a county's fiscal condition significantly impedes its ability to fund MOE, the county has the burden of proof by a preponderance of the evidence. COMAR 13A.02.05.04C(3).

The standard of proof by a preponderance of the evidence is defined in the Maryland Pattern Jury Instructions as follows:

To prove by a preponderance of the evidence means to prove that something is more likely so than not so. In other words, a preponderance of the evidence means such evidence which, when considered and compared with the evidence opposed to it, has more convincing force and produces in your minds a belief that it is more likely true than not true.

If you believe that the evidence is evenly balanced on an issue, then your finding on that issue must be against the party who has the burden of proving it. (MPJI-Cv 1:7).

See also *Coleman v. Anne Arundel County Police Dept.*, 369 Md. 108, 127n. 16 (2002).

Thus, for the county to prevail in its request for a waiver, we must be convinced that it is more likely than not that events in the county have affected the county's fiscal condition such that it "significantly impedes the county's ability to fund the maintenance of effort requirement" for fiscal year 2011.

## C. Factual Background

Montgomery County's submission contains the following facts related to the factors we will consider in deciding this waiver request.

### **AMOUNT PROPOSED TO APPROPRIATE TO SCHOOL OPERATING BUDGET AND AMOUNT REQUIRED TO MEET MOE.**

- The County's FY 2011 recommended operating budget of \$2,125,542,225 includes 1,415,085,344 for K-12 public education. (p.1)<sup>2</sup>
- The waiver requested is \$138,848,943(8.9% of the total MOE).
- The local school system has agreed to absorb an additional \$24 million reduction by using its carry over to cover the reduction.

### **(1) TAX BASES AND REVENUE GENERATING STREAMS**

- Income tax collections were down by more than \$265 million in FY 2010. (p.4)

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<sup>2</sup> All page references are to the County's narrative submission.

- The steep decline in income tax revenues has been caused by a “disproportionately high decline in high income taxpayers.” (p.5)
- The County has higher proportion of high net worth individuals than other jurisdictions. (p.5)
- \$4 billion decline in the income of tax payers with \$500,000 or more of income resulted in \$150 million loss income tax revenue. (p.5)
- There is expected reduction of \$24.5 million in income tax revenue distributed from State Comptroller’s Office. That reduction is greater than the reduction for the rest of the State. (p.4)
- For FY 2011, the County is experiencing an operating budget short-fall of \$995 million which is about 26% of the County’s tax-supported budget. (p.4)
- The Board of Public Works has reduced state aid for non-education projects in Montgomery County by \$18 million in FY 2010 and by \$32 million in FY 2011.

**(2) EXTERNAL ENVIRONMENTAL FACTORS/ECONOMIC DOWNTURN**

- 5.7% unemployment in March 2010, (by comparison Maryland unemployment is 8.1%, (DLLR) [www.dllr.maryland.gov/lmi/laus/maryland.shtml](http://www.dllr.maryland.gov/lmi/laus/maryland.shtml) (viewed May 5, 2010).
- Average home sale prices declined by 13.8% in CY 2009 and by 8.4% in CY 08.
- New construction value decreased \$600 million in CY 2009. (p.7)
- Federal Reserve rate cuts have reduced estimated FY 10 tax-supported investment income by 95% since FY 08. (p.8)

**(3) ABILITY TO RAISE REVENUE**

- Local ordinance Section 305 Montgomery County charter requires unanimous vote of 9 members of county council to increase real property tax revenue beyond inflation, and the County does not support raising property taxes. (p.12).
- Income tax is currently at 3.2% which is the State maximum rate. (p.12)
- County Executive will propose increase in local fuel energy tax of 100% to raise \$51.3 million and wireless phone tax to raise \$11.853 million. (p.12)

**(4) RAINY DAY FUND/RESERVES**

- The county projects it will end FY 2010 with a zero balance in its general fund, using \$82 million of the County’s Rainy Day fund to cover the projected deficit. (p.10)
- The balance in the Rainy Day Fund at the end of FY 2010 will be \$37.7, constituting a reserve of 1.5% of the county’s \$2.5 billion budget. (p.10)

- Based on projected expense and tax increases for FY 2011, the County projects a general fund balance of \$121.5 million and a balance of \$92.8 million in the Rainy Day Fund. (p.10)

**(5) FUNDING IN EXCESS OF MOE**

- The County supports education, in addition to MOE, by funding approximately \$100 million in school construction projects and by paying \$37 million to operate specific programs in support of public schools, i.e., school safety, wellness, etc. (p.3)
- From FY 01 through FY 09, the County reported that it exceeded MOE by \$576.8 million. (p.2)
- As reflected in the chart below, Statewide MOE data for all counties is available from FY 2003 to 2009. During this time period Montgomery County exceeded MOE by a total of \$420,362,000.

**Increases Above MOE - Fiscal 2003-2009**  
(\$ in Thousands)

County	FY03	FY04	FY05	FY06	FY07	FY08	FY09	Total FY03-09
Allegany	\$1,188	\$356	\$149	\$1,245	\$971	\$1,474	\$345	\$5,727
Anne Arundel	13,416	5,963	22,742	36,481	36,848	24,135	37,415	177,001
Baltimore City	4,068	1,403	3,964	6,175	5,545	6,168	8,348	35,672
Baltimore	11,284	4,496	5,289	18,442	15,049	13,415	33,893	101,869
Calvert	2,344	205	2,540	4,066	4,975	3,833	6,018	23,981
Caroline	139	31	280	274	171	330	25	1,250
Carroll	4,205	158	1,494	7,129	8,274	6,486	12,632	40,378
Cecil	2,686	709	969	3,007	2,613	444	5,229	15,656
Charles	2,464	0	2,954	7,784	10,185	9,616	9,216	42,218
Dorchester	893	0	0	358	1,145	139	895	3,431
Frederick	4,596	3,249	5,073	9,015	12,742	12,974	11,570	59,219
Garrett	760	2,062	923	612	1,121	2,346	1,703	9,528
Harford	5,949	0	4,835	20,017	13,030	12,911	13,714	70,456
Howard	9,744	10,490	13,307	22,994	26,101	26,951	23,440	133,028
Kent	975	50	779	818	1,249	1,638	1,497	7,005
Montgomery	26,039	34,005	75,743	41,759	98,844	75,442	68,531	420,362
Prince George's	6,773	275	5,932	22,163	37,751	7,402	184	80,480
Queen Anne's	1,439	1,094	1,237	646	1,170	3,488	3,120	12,193
St. Mary's	74	0	1,154	2,222	4,528	3,472	2,546	13,995
Somerset	1	17	0	0	47	0	103	169
Talbot	1,615	0	499	1,197	1,952	2,163	2,263	9,689
Washington	2,580	2,814	2,308	42	4	0	2,927	10,676
Wicomico	567	562	0	445	639	997	707	3,917
Worcester	2,978	660	4,810	3,461	5,612	4,472	7,420	29,413
<b>Total State</b>	<b>\$106,774</b>	<b>\$68,601</b>	<b>\$156,980</b>	<b>\$210,355</b>	<b>\$290,567</b>	<b>\$220,295</b>	<b>\$253,742</b>	<b>\$1,307,314</b>

Source: Department of Legislative Services



- As shown on the chart below, from FY 2003 to 2009, Montgomery County's average funding of MOE was 4.80% above the required amount of MOE. The County ranked ninth of the 24 counties in exceeding MOE from FY 2003-2009.

Maryland State Department of Education - Division of Business Services  
Percent Appropriated in Excess of MOE Level FY 2003 to FY 2009

	FY2003	Rank	FY 2004	Rank	FY 2005	Rank	FY 2006	Rank	FY 2007	Rank	FY2008	Rank	FY2009	Rank	Multi-Year Avg.	Rank
Statewide*	2.78%		1.71%		3.79%		4.88%		6.42%		4.58%		5.07%		4.17%	
Simple Mean**	3.61%		1.62%		2.98%		4.52%		5.54%		4.88%		5.40%		4.08%	
Median***	3.55%		0.76%		2.81%		4.51%		6.63%		5.05%		5.59%		4.22%	
Maximum	7.82%		13.17%		10.04%		12.88%		10.10%		11.90%		11.38%		7.65%	
Minimum	0.01%		0.00%		0.00%		0.00%		0.00%		0.00%		0.03%		0.28%	
Allegany	4.88%	7	1.39%	8	0.58%	21	4.50%	11	3.68%	17	5.48%	11	1.23%	21	3.16%	16
Anne Arundel	3.62%	12	1.55%	7	5.61%	4	8.34%	2	8.19%	4	4.95%	13	7.28%	6	5.75%	5
Baltimore City	1.10%	19	0.71%	13	2.04%	14	3.22%	18	2.98%	19	3.22%	16	4.21%	17	2.66%	18
Baltimore	2.10%	18	0.81%	12	0.94%	20	3.35%	17	2.57%	20	2.25%	18	5.65%	12	2.51%	19
Calvert	3.32%	14	0.27%	16	3.26%	8	5.03%	10	5.86%	15	4.24%	15	6.40%	11	4.06%	13
Caroline	1.29%	22	0.29%	15	2.61%	13	2.48%	19	1.48%	21	2.77%	17	0.21%	23	1.59%	22
Carroll	3.96%	10	0.14%	18	1.23%	19	5.75%	7	6.25%	13	4.64%	14	8.73%	3	4.36%	12
Cecil	5.28%	5	1.30%	10	1.72%	17	5.20%	9	4.26%	16	0.69%	22	8.20%	4	3.81%	14
Charles	2.81%	16	0.00%	21	3.00%	12	7.48%	3	8.97%	3	7.64%	4	6.79%	10	5.24%	7
Dorchester	6.30%	4	0.00%	22	0.00%	23	2.38%	20	7.53%	7	0.84%	21	5.40%	14	3.21%	15
Frederick	3.11%	15	2.08%	6	3.13%	10	5.29%	8	7.04%	11	6.31%	9	5.29%	15	4.63%	10
Garrett	5.10%	6	13.17%	1	5.25%	5	3.57%	16	5.96%	14	11.90%	1	7.94%	5	7.53%	2
Harford	4.25%	9	0.00%	22	3.24%	9	12.88%	1	7.39%	8	6.92%	7	6.95%	9	5.95%	4
Howard	3.49%	13	3.53%	3	4.20%	6	6.87%	4	7.21%	10	6.85%	8	5.52%	13	5.38%	6
Kent	7.82%	1	0.36%	14	6.04%	3	5.08%	6	9.03%	2	11.23%	2	9.52%	2	7.16%	3
Montgomery	2.48%	17	3.09%	5	6.62%	2	3.40%	15	7.74%	5	5.50%	10	4.74%	16	4.80%	9
Prince George's	1.46%	20	0.06%	19	1.23%	18	4.53%	12	7.94%	6	1.40%	20	0.03%	24	2.32%	20
Queen Anne's	4.59%	8	3.23%	4	3.50%	7	1.72%	21	3.02%	18	8.62%	3	7.08%	8	4.54%	11
St. Mary's	0.14%	23	0.00%	22	2.02%	15	3.71%	14	7.24%	9	5.15%	12	3.55%	18	3.11%	17
Somerset	0.01%	24	0.20%	17	0.00%	22	0.00%	24	0.56%	23	0.00%	24	1.21%	22	0.25%	24
Talbot	6.67%	3	0.00%	20	1.93%	16	4.48%	13	7.01%	12	7.33%	5	7.13%	7	4.94%	8
Washington	3.77%	11	3.95%	2	3.05%	11	0.05%	23	0.00%	24	0.00%	23	3.45%	19	2.04%	21
Wicomico	1.30%	21	1.25%	11	0.00%	23	0.96%	22	1.24%	22	2.06%	19	1.43%	20	1.19%	23
Worcester	5.69%	2	1.39%	9	10.04%	1	6.71%	5	10.10%	1	7.23%	6	11.38%	1	7.65%	1

\* Statewide reflects the total amount in excess of MOE divided by the aggregate MOE requirement.

\*\* Simple mean is the average of the 24 percentages.

\*\*\* Median reflects the breakpoint where 12 counties fall above this level and 12 fall below.

- From FY 2003 to 2009, the statewide multi-year average funding of MOE was 4.17% above the required amount of aggregate MOE. The multi-year mean funding in excess of the MOE amount was 4.08% and the median was 4.22%. (Id).
- From FY 2003 to 2009, the maximum multi-year average of funding in excess of MOE was 7.65%. (Id).

### (6) DESCRIPTION OF PUBLIC MEETINGS ON MOE WAIVER REQUEST AND COMMUNITY SUPPORT

- No evidence presented.

## **(7) LOCAL BOARD OF EDUCATION SUPPORT**

- The local board supports the waiver request with one condition - - that the waiver is for one year only.

## **(8) EFFECT OF THE WAIVER ON QUALITY OF PUBLIC SCHOOLS**

- 96% of the Board of Education request for FY 2011 will be funded, net of a request from the Board for \$37.2 million for a reserve account. (p.11)
- Areas not funded include \$42.9 million for prefunding retiree health insurance and \$25.8 million for teacher merit pay for a total of \$68.7 million of the requested MOE waiver. The County states that the local board will specify the other areas to be reduced. (p.11)
- At the hearing, Dr. Weast explained the budget cutting mechanisms he and the local board have used, including cutting administrative services, reducing supplies and materials, and increasing class size by one pupil.

### **D. Legal Analysis**

The County asserts that it has made significant budget cuts in FY 2010 including abolishing 466 positions, furloughs, eliminating wage increases, reducing four agencies' budgets by \$100 million; using \$82 million in the Rainy Day fund to cover the deficit. It projects more major budget reductions for FY 2011. (p.8)

Undoubtedly, the impact on county services has been substantial. The County explains that it has already cut some essential services:

- Eighteen Bus routes (three weekday, 10 Saturday, and five Sunday) eliminated and another 16 reconstructed, saving \$2.7 million.
- Reduce bus route frequency on 16 weekday routes and 3 Saturday routes.
- Transportation vouchers to low income residents reduced by half.
- One Fire and Rescue truck and one ambulance taken out of service and a recruit class cancelled.
- Forty Police positions, including 24 sworn officers will be eliminated including eliminating 16 of the 33 officers stationed in Montgomery County Public Schools.
- Four satellite police sub-stations closed.
- Thirty-three Corrections positions eliminated.
- Library Hours reduced by 8.7 percent and library materials reduced by over 40 percent.(p.9)

Meeting MOE would, in the County's view, mean "unacceptable deeper reductions in locally funded services, including public safety, services to the most vulnerable residents, post-secondary education, library, and recreation services....Further reduction simply cannot be made." (p.9)

We do not and cannot sit as a Super-Executive or County Council to determine where or when budget reductions will be made. Our role is to decide whether Montgomery County has

presented a preponderance of evidence that its fiscal condition significantly impedes its ability to fund MOE in full. To do so we consider the evidence presented as to each MOE waiver factor.

### **Funding in Excess of MOE**

The County first argues that it has done more than its fair share of funding its schools. Over the course of the last seven years, it has exceeded MOE by \$420 million.

We note, however, that most if not all counties overfunded MOE in the past seven years. *See* charts on pp. 8 & 9 herein. That was the prevailing expectation reflected in the Thornton Commission Report. The Thornton Commission addressed the important role of exceeding MOE in achieving adequate funding:

In recent years, aggregate county support for education has substantially exceeded the maintenance of effort requirement. Meeting adequacy goals by fiscal 2007 will require that counties continue to exceed maintenance of effort. The Commission estimates that if counties provide increases in education funding comparable to the increases provided from fiscal 1997 to 2000, most school systems would meet or exceed adequacy goals by fiscal 2007. . . . [T]he Commission believes strongly that maintenance of effort only establishes the minimum funding level. Achieving adequate funding will demand that counties continue to display the level of commitment to public education that the majority of counties have repeatedly demonstrated in the past.

Thornton Commission Report at 73.

We can compare Montgomery County's funding of MOE to other counties' funding in order to determine whether Montgomery County's funding in excess of MOE was greater than the statewide average or that of other comparable high-wealth counties.

**Percent Appropriated in Excess of MOE Level FY 2003 to FY 2009**

Comparison: Statewide, Montgomery, Worcester, Talbot Counties

<b>FY</b>	<b>Statewide</b>	<b>Montgomery</b>	<b>Rank</b>	<b>Worcester</b>	<b>Rank</b>	<b>Talbot</b>	<b>Rank</b>
<b>2003</b>	2.78%	2.48%	17	6.69%	2	6.67%	3
<b>2004</b>	1.71%	3.09%	5	1.39%	9	0.00%	20
<b>2005</b>	3.79%	6.62%	2	10.04%	1	1.93%	16
<b>2006</b>	4.88%	3.40%	15	6.71%	5	4.48%	13
<b>2007</b>	6.42%	7.74%	5	10.10%	1	7.01%	12
<b>2008</b>	4.58%	5.50%	10	7.23%	6	7.33%	5
<b>2009</b>	5.07%	4.74%	16	11.38%	1	7.13%	7

Source: Chart p.9 herein.

As the chart reflects, Montgomery County exceeded the Statewide average percentage in excess MOE in 2004, 2005, 2007, and 2008. When compared to Worcester County, however, another high-wealth county, Montgomery County exceeded Worcester County's effort only in 2004 and Worcester County far exceeded Montgomery County's efforts every other year.

Montgomery County also exceeded the Statewide multi-year average which was 4.17%. Montgomery County's multi-year average was 4.80%. Ten other counties exceeded that multi-year average – Anne Arundel (5.75%); Charles (5.24%); Carroll (4.38%); Garrett (7.53%); Harford (5.95%); Howard (5.38%); Kent (7.16%); Queen Anne's (4.54%); Talbot (4.94%); and Worcester (7.65%). See chart p. 9.

We note that MOE amounts are not adjusted for inflation. We asked Montgomery County to provide us information on the effect inflation would have had on the MOE amount in relation to the amount MOE was overfunded. They provided the following:

**Increase Above Maintenance of Effort vs. Estimated Consumer Price Index Increases**

Fiscal Year	MOE	CPI(Fiscal Year)	MOE w/CPI	CPI Increase	DLS Increase Above MOE**	DLS Increase +/- vs. CPI Increase
FY03	1,050,704,474	2.81%	1,080,202,492	29,498,018	26,039,000	(3,459,018)
FY04	1,101,609,837	2.50%	1,129,132,043	27,522,206	34,005,000	6,482,794
FY05	1,144,305,145	3.55%	1,184,926,161	40,621,016	75,743,000	35,121,984
FY06	1,224,249,858	4.07%	1,274,046,334	49,796,476	41,759,000	(8,037,476)
FY07	1,290,342,636	3.37%	1,333,775,905	43,433,269	98,844,000	55,410,731
FY08	1,373,676,059	4.35%	1,433,425,459	59,749,400	75,442,000	15,692,600
FY09	1,452,496,404	2.15%	1,483,757,842	31,261,438	68,531,000	37,269,562
<b>TOTAL</b>				<b>281,881,823</b>	<b>420,363,000</b>	<b>138,481,177</b>

\* For the Baltimore-Washington Region, from the Montgomery County Department of Finance

\*\*From the State of Maryland's Department of Legislative Services

The chart reflects that Montgomery County's funding of MOE exceeded the Consumer Price Index increases every year except 2003 and 2006.<sup>3</sup>

The County asserts that if this Board denies a waiver request to a County that has experienced "a dramatic decline in tax revenues as a result of a deep, broad based recession. . . [it will create] a strong fiscal incentive. . . not to fund local education above the MOE mark." (p.3). Therefore, it argues that a denial of the waiver will ultimately undermine the "cornerstone of the State/local share for funding education rather than provide support to that cornerstone." (p.3)

Essentially, the County has argued for flexibility in good times and bad. When times were good, the County funded its schools above the inflation level and far in excess of its MOE requirement. Now, when times are bad, the County seeks approval of reductions in MOE to spread the effect of the difficult economic times over all its sectors and services.

We will consider that argument in light of the current economic conditions in Montgomery County.

**Tax Base/External Environmental Factors/Economic Downturn**

The County presented facts centering on the impact of the recession on Montgomery County's tax base. We review that impact through the lens of three of the decision-making factors—the tax base factor, external environmental factors, and the economic downturn factor.

In our MOE decisions last year, we looked at each of the three factors we consider here.

<sup>3</sup> The county, however, did not reflect on the chart the cumulative effect that inflation would have had on each succeeding year's MOE amount.

- **Tax Bases**

We explained that the regulation provided no internal guidance on the parameters for consideration under the “Tax Base” factor. But, the statutory requirement that a county show that its fiscal condition “*significantly*” impedes its ability to fund MOE in full, we believed, provided the parameter. Because the county needed to establish that significant impediments exist, we looked for evidence of significant impacts on the county’s tax bases such as, evidence of the complete loss of one tax base or significant losses across all or most of a county’s tax bases because such losses could “significantly impede” a county’s ability to fund MOE in full.

- **External Environmental Factors**

We explained that the term “external environmental factors” could be read two ways - - broadly to include a general, severe economic downturn, or narrowly to include only extraordinary economic events unique to the county requesting the waiver. The regulation itself provided some guidance on how to interpret the term “external environmental factors.” The regulation qualified that term with the phrase “such as a loss of major business or industry.” That qualification provided an example of the type of external environmental factor that could be considered in deciding the waiver request. That qualification, we concluded, limited the expansiveness of the term “external environmental factor.”

- **Economic Downturn**

The Co-Chairs of the Workstudy Committee asked that we also consider the “broad economic downturn affecting more than one county.” As we explained in the FY 2010 MOE decisions, the recession and its impact on local revenues was a factor to consider. When we considered this factor in FY 2010, however, we noted that the recession impacted all counties in Maryland and that 21 of the 24 counties did not request a waiver of MOE. Considering the recession as a factor, we looked for evidence that the county requesting the waiver had experienced a serious, significant economic impact that was different from the generalized economic impact experienced by other counties in Maryland.

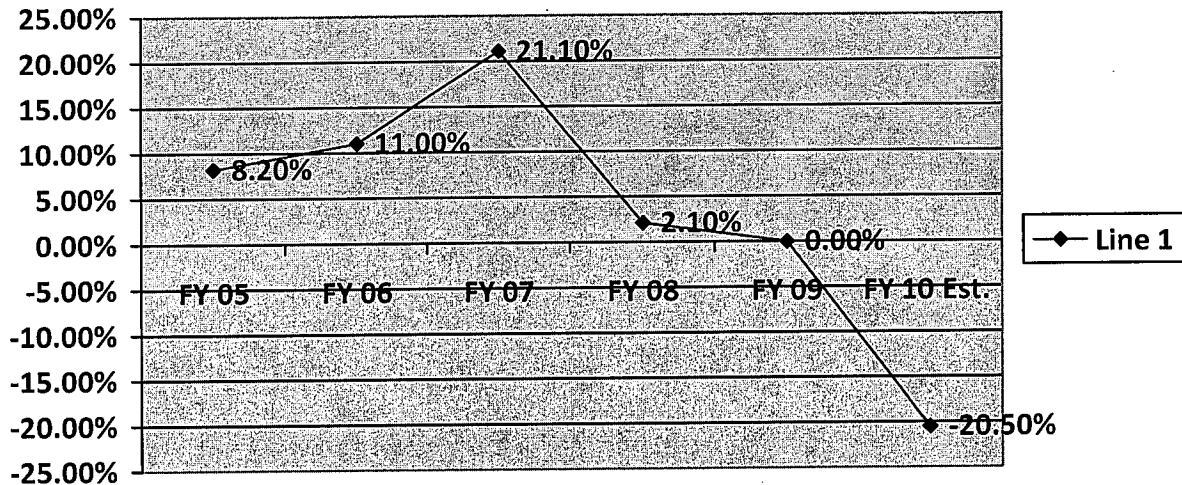
In Montgomery County, one event crosses over all three factors – the \$4.6 billion decline in 2007-2008 of taxable income from tax payers with \$500,000 or more of income resulting in a \$150 million decrease in income tax revenue. The County asserts that the decline “contributed to reducing income tax collections by over \$265 million in the current year” (p.4)

In addition, in March 2010, the Comptroller notified the County that the expected distribution of income tax revenues would be reduced by \$24.5 million. (p.4). The Comptroller attributed the reduction to “factors which are unique to county and are currently under investigation...” (p.4). At the hearing and in its submission, Montgomery County explained that for a local government, its revenue structure is “unusually dependent on income tax revenue...” (p.5). The County argues that because it has a “proportion of high net worth individuals higher than other jurisdiction, [t]he recent recession and changes in the State’s tax code have adversely impacted Montgomery County disproportionately.” (p.5)

The County equates the decline of \$4.6 billion in net taxable income to “the loss of a major employer of industry in the county.”

We agree with the County that a \$4.6 billion decline in taxable income is much like a loss of a major employer of industry in the county. That event had an impact on the tax base that is significant. The chart below graphically demonstrates that impact on FY 2010 in which the county estimates a 20.5% reduction in income tax revenues.

**Income Tax Revenues**



Source: Montgomery County Submission p.5.

Montgomery County’s revenue structure is highly dependent on income tax revenues which in FY 2009 funded 33.5% of the budget. The County projects that in FY 2011, income tax revenue will cover only 28% of the budget.

**Ability to Raise Revenue**

The County asserts that because of legal barriers it cannot raise property taxes to cover the loss of income tax revenues. We recognize that Sec. 305 of the County charter requires an unanimous vote to levy an ad valorem tax on real property that will produce revenue that exceeds certain limits. Those limits do not apply to revenue generated on five types of property including, newly constructed property, newly rezoned property, property that has undergone a use change. However, it matters not whether there is any property taxing option open to the County, the County Council does not support a property tax increase. (p.12)

The County Executive has proposed two types of fee increases - - an increase in local fuel energy tax of 100% to raise \$151.3 million and a wireless phone tax increase to raise \$11.853 million for a total of \$163.8 million. The County will not put any of the revenue toward funding

MOE. The County Executive's top priority for the FY 2011 budget was to restore greater amounts of funds to reserve accounts "to protect against further deterioration in the County's revenue stream and preserve the County's AAA bond rating." (p.5)

In considering the relationship between the MOE requirement and the county's statutory ability to raise revenue, we noted last year that the regulation directs the county to explain "statutory prohibitions for raising revenue." COMAR 13A.02.05.04A(3)(c). The regulation does not establish, however, whether a prohibition on raising revenue should be weighted as a positive or negative factor in considering a waiver request.

In last year's decisions, we recognized that in some counties in Maryland there are locally imposed caps on taxes and/or other significant locally imposed impediments to increasing taxes. We did not opine on the propriety of those locally imposed prohibitions or impediments.

We referred to the Thornton Commission Report and the concerns the Commission expressed on the issue of locally imposed impediments to tax levies.

The Commission is concerned, however, that some local property tax policies may impede the ability of counties to sufficiently fund education during the five-year phase-in of the Commission's funding proposal . . . [F]ive charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenue growth. With the exception of Montgomery County, the limits can only be adjusted through a charter amendment . . . .County governments have three basic strategies for enhancing funding: (1) utilize annual increases in revenues from the county's existing tax structure; (2) raise tax rates or levy a new tax; and (3) reorder budget priorities to provide a larger budget share to education. The existence of a property tax rate or revenue limitation may constrain the use of the first two strategies, thereby impeding a county's ability to sufficiently increase education funding to meet adequacy goals.

*Id.* at 73-75.

With all those considerations in mind, last year we gave little weight to locally imposed prohibitions and impediments to tax levies. We did, however, give great weight to evidence of taxing limitations that the General Assembly imposes on a county by statute. For example, county income taxes are capped by State statute at 3.2%.

Although Montgomery County has a property tax limitation of sorts built into the voting requirements for a property tax increase, it does tax income at the State cap level of 3.2% and the resources for its budget have consistently been derived from a strong income tax base. Moreover, the County Executive has proposed two fee increases that will result in \$163.8 million



in revenue. Most of that revenue, however, will be used to replenish the Rainy Day Fund and general reserves.

### **(7) Rainy Day Fund/General Reserve Funds**

In this FY 2011 round of waiver requests, we have asked for information about reserves and rainy day funds and why such funds were not available to meet MOE requirements.

A rainy day fund and a general reserve fund are important fail-safes for addressing unanticipated expenses and deficits. Those funds also support a county's bond rating.

We recognize the importance of a good bond rating, particularly in borrowing money at the lowest possible interest rates. An AAA bond rating is the highest rating an entity can get. It is a coveted rating. The ranges of possible bond ratings are:

- Aaa Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.
- Aa Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.
- A Obligations rated A are considered upper-medium grade and are subject to low credit risk.
- Baa Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.
- Ba Obligations rated Ba are judged to have speculative elements and are subject to high credit risk.
- B Obligations rated B are considered speculative and are subject to high credit risk.
- Caa Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.
- Ca Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.
- C Obligations rated C are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.

*See Moody's Rating Symbols and Definitions, p. 8 (June 2009) at Moody's.com visited May 6, 2010.*

The chart below shows that in Maryland only six counties - - Baltimore, Charles, Garrett, Howard, Montgomery and Prince George's have AAA bond ratings from one or more of the three bond rating agencies. The nineteen remaining counties' bond ratings range from AA+ to Baa 1.

In order to understand the place of each county in the bond rating scheme, the bond ratings for all counties are set forth here:

COUNTY	BOND RATING FY 2010 (Unless noted otherwise)
ALLEGANY	Baa 1 (MOODY'S); A- (S&P)
ANNE ARUNDEL	AA (FITCH); AA/NEGATIVE OUTLOOK (MOODY'S)
BALTIMORE CITY	A+ (FITCH); (MOODY'S); AA- (S&P)
BALTIMORE	AAA (FITCH); MOODY'S & S&P
CALVERT	AA+ (FITCH); Aa2 (MOODY'S); AA+ (S&P)
CAROLINE	A2 (MOODY'S); A (S&P)
CARROLL	AA+ (FITCH); Aa2 (MOODY'S); AA+ (S&P)
CECIL	Aa3 (MOODY'S); AA (S&P)
CHARLES	AAA (FITCH); Aa2 (MOODY'S); & AA/POSITIVE OUTLOOK (S&P)
DORCHESTER	A2 (MOODY'S); A+ (S&P)
FREDERICK	AA- (FITCH); Aa2 (MOODY'S); AA+ (S&P)
GARRETT	Aaa (MOODY'S); AAA (S&P)
HARFORD	AA+ (FITCH); Aa1 (MOODY'S); AA+ (S&P)
HOWARD	AAA (FITCH), MOODY'S & S&P
KENT	A (MOODY'S) 2007-2008
MONTGOMERY	WATCH LIST Aaa (MOODY'S); AAA/STABLE OUTLOOK (S&P)
PRINCE GEORGE'S	AA+ (FITCH); Aa 1 (MOODY'S); AAA (S&P)
QUEEN ANNE'S	AA (FITCH); A1 (MOODY'S)
ST. MARY'S	AA (FITCH); Aa3 (MOODY'S); AA (S&P)
SOMERSET	NOT FOUND
TALBOT	AA+ (FITCH); Aa3 (MOODY'S)
WASHINGTON	AA- (FITCH); Aa3 (MOODY'S) AA (S&P)
WICOMICO	A+/STABLE (FITCH); A2 (MOODY'S); AA-/STABLE (S&P)

Source: County websites visited May 6, 2010.

The County explained that because of “revenue volatility and significant reductions in reserve levels...the County has been placed on a watch list for possible downgrade of its AAA bond rating by Moody’s investor services.” (p.9). Moody’s states in its April 5, 2010 bond ratings memos that “Placement on a watch list for possible downgrade reflects deterioration of the county’s financial position driven primarily by income tax revenue shortfalls, which is expected to result in the use of a significant portion of the county’s General Fund and Revenue Stabilization Fund as of FY 2010 (year ends June 30<sup>th</sup>).” The memos also state that in the future Moody’s will set the appropriate bond rating in light of the county’s ability to mitigate its deficit, steps taken to restore a structurally balanced operation, and the development of plan to restore “financial flexibility.”

The County asserts that the depletion of reserve funds to meet MOE requirements “will almost definitely result in the loss of the County’s AAA bond rating.” (p.10). Therefore, the County has decided to protect the AAA bond rating by using the revenue from the fee increase to increase the Rainy Day Fund from \$37,680,370 to \$92.8 million in FY 2011. It also projects to end FY 2011 with a General Fund balance of \$121.5 million. (p.10)<sup>4</sup>

We will not second guess the decision to protect the bond rating using the fee increases for the Rainy Day Fund and the general revenues rather than for funding MOE. As we said, we are not the County Executive or County Council.

### **Support for the Waiver**

The local board, in its response to the waiver request, and at the hearing explained that it supports the waiver request. In many respects, the support may be based on a Hobson’s Choice. If the waiver is not granted, and the County refused to fund MOE, the law requires that a penalty be imposed on the local board. For FY 2011, MSDE calculates that that penalty would likely be approximately \$41million. Thus, the school system would be twice victimized in this MOE dispute.

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<sup>4</sup> Even when the County increases its Rainy Day Fund and reserves, it asserts that State law precludes spending those dollars because “the Rainy Day Fund may only be used to support appropriations that have become unfunded.” (p.10). The County cites Article 24 §9-1201 of the Maryland Annotated Code as precluding the County from spending reserves to fund MOE. The statute says, in pertinent part, that “a reserve account is an account or fund in which funds are retained to support appropriations which have become unfunded.” Md. Code Ann. Art. 24 §9-1201(b).

As the simplest level, it appears to us that MOE has been partially “unfunded” by the County’s reduction in the local board’s budget. Therefore, we do not see the State statute as precluding the use of reserves for funding MOE.

## **Effect of Legislative Response to MOE Issue**

In consideration of this Hobson's Choice, we have added as a factor the effect of the legislative response to MOE issue. In the 2010 legislative session, the only MOE-related bill that passed was the one waiving the penalty to be imposed on the Montgomery County Public School System. The penalty was calculated on the amount of State-only dollars that resulted in a possible penalty of \$23.4 million. See *In Re Montgomery County Council*, MSBE Op. No. 10-05. One other county failed to meet its MOE requirement - - Prince George's - - but the school system did not receive an increase in State aid in FY 2010. Therefore, no penalty could be imposed.

We have considered the actions of the last General Assembly as predictive and as guidance to us. Clearly, the legislature does not want to punish the school system which is the victim of county's failure to meet the MOE target. Yet, the law as it exists today requires that result. As we said in 2010:

The MOE law penalizes the school system and the students it serves, not once, but twice. First, the County's failure to comply with MOE law shifted \$79.5 million away from the classroom into debt service payments. Next, that non-compliance by the County will lead to a significant withholding of funds - - again draining dollars away from the students and the classroom.

*In Re Montgomery County Council*, MSBE Op. No. 10-05.

## **Effect of Waiver in Quality of Public Schools/and the Race to the Top Competition**

Montgomery County adds an additional factor for us to consider. It asserts that its proposed waiver request will not affect the quality of public education in Montgomery County because 96% of the local board's budget request will be funded.

In addition, at the hearing Dr. Weast, the Superintendent, stated that the budget reduction of \$138 million would not affect the quality of education.

As to the Race to the Top Competition, Montgomery County Public School System is not participating in Maryland's Race to the Top effort. Therefore, the county's failure to fully fund the school system will not be detrimental in the State's Race to the Top effort. We note, however, that the local board's responsibility to fund at the federal MOE level is not alleviated by any decision we make here.

## **CONCLUSION**

We have considered all the evidence and arguments and conclude that Montgomery County has met the burden of proof to warrant granting the waiver. The loss of \$4.6 billion in its taxable income base is a unique circumstance that makes it more likely than not that events in the county have effected the County's financial situation that it significantly impedes the County's ability to fund the maintenance of effort requirement. That loss alone is equivalent to the loss of an industry in the County. This loss of the tax base, coupled with the statutory income tax cap

appears to differentiate Montgomery County's fiscal climate from other counties in Maryland. Moreover, the County's consistently high-level funding in excess of the MOE target, in comparison to other counties, exacerbates the County's ability to fully fund MOE in FY 2011. For these reasons the waiver is warranted.

A second rationale also supports granting of the waiver. In this second rationale, we gave substantial weight to flaws in the statute that penalize the Montgomery County Public Schools because the County government cannot meet its MOE requirement. The negative effects of the MOE statute as applied to the school system if the waiver were not granted are compelling. Without the waiver, the statute would require the school system to pay a penalty of \$41 million, its increase in State aid, on top of the \$138 million reduction in MOE. This would effectively reduce the school system's budget \$179 million in a single year, which we believe would severely impact the delivery of educational services to the students. This required loss of funding to the schools appears unfairly and disproportionately to affect students and school system personnel.

Because of an additional flaw in the statute, if we deny the waiver, the current statute would exacerbate the continued downward pressures on the County anticipated in FY 2012. In FY 2012, State funding will likely decrease for the County, counties may be asked to share in local teacher pension costs, and federal stimulus funding will likely cease. As a result, we predict that the continued external downward pressures will cause counties to shift their budget burdens to the schools and will seek to reduce school budgets even further. As we explained the flaw previously, the law states:

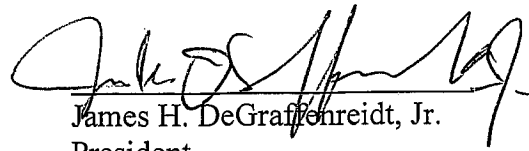
If the State Board of Education grants a county a temporary waiver or partial waiver from the provisions of the subsection for any fiscal year, the minimum appropriation of local funds required under this subsection for the county to be eligible to receive the State share of the foundation program for the next fiscal year shall be calculated based on the per pupil appropriation for the prior fiscal year or the second prior fiscal year, whichever is greater.

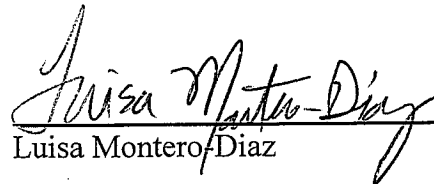
MD Educ. Code Ann §5-202(d)(7)(v).

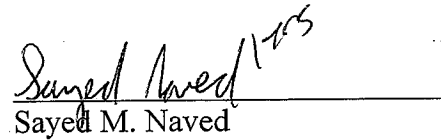
By granting the requested waiver, the county will likely start FY 2012 with a much higher MOE base than if we were to deny the waiver. The statute offers no such funding protection to the school system if we deny the waiver. Thus, the school system would effectively be penalized a third time when, in FY 2012, the County's MOE base would reflect the \$138 million reduction in MOE funding for FY 2011.

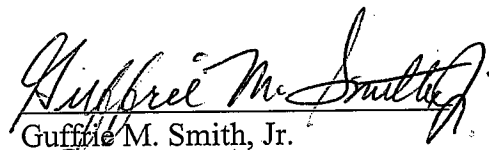
Again, for the reasons we have stated in this decision, and because it is clear from the actions of legislature in the 2010 session signaling that penalizing the school system is not palatable, we urge the General Assembly to correct what appears to be an almost unworkable and unfair statute.

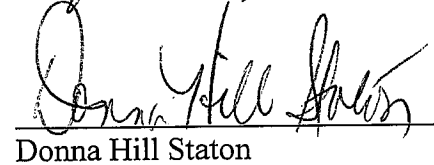
For all the reasons stated herein, we **GRANT** the request for a waiver of the maintenance of effort.

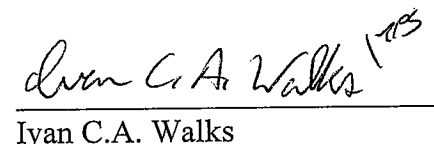
  
James H. DeGraffenreidt, Jr.  
President

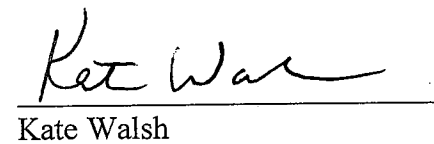
  
Luisa Montero-Diaz

  
Sayed M. Naved

  
Guffie M. Smith, Jr.

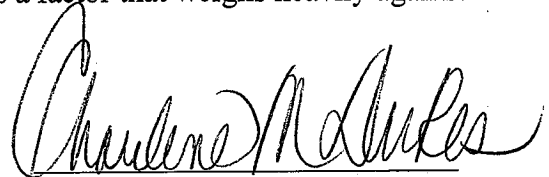
  
Donna Hill Staton

  
Ivan C.A. Walks

  
Kate Walsh

Dissent:

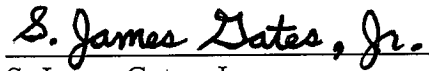
It is our view that Montgomery County did not meet its burden of proof to be granted a waiver. We point out that in FY 2011 Montgomery County will impose fee increases that will raise \$163.8 million. It is our view that Montgomery County's decision to use those revenues to replenish the Rainy Day Fund rather than to meet MOE is a factor that weighs heavily against granting the waiver.



Charlene M. Dukes  
Vice President



Mary Kay Finan



S. James Gates, Jr.



David H. Murray



Madhu Sidhu

June 22, 2010