

Department of Legislative Services
Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE

Senate Bill 924 (Senator Serafini)
Budget and Taxation

County Boards of Education - Private Financing Authority

This bill authorizes local school boards to seek and obtain private financing to cover all or part of the costs associated with any public school facility project or capital lease for equipment, without the approval of any State agency or entity or any other proceedings or conditions. The aggregate principal amount of private financing outstanding may not exceed 5.0% of the board's annual operating budget, and projected annual debt service may not exceed 2.5% of its annual operating budget. The term of any private financing may not exceed 10 years.

The bill takes effect July 1, 2015.

Fiscal Summary

State Effect: No direct effect on State expenditures or revenues is likely, but the State may be at some financial risk to the extent that local school boards default on repayment of private financing.

Local Effect: Local school boards have greater flexibility to secure private financing for public school construction projects and equipment without the approval of their county governing bodies. To the extent that private financing is more expensive than tax-exempt debt, the cost of individual school construction projects or equipment may increase.

Small Business Effect: Minimal.

Analysis

Bill Summary: Private financing must be authorized by a resolution of the local school board, and financing may be secured by a financial instrument by and between the local school board and a lender. The authorizing resolution must:

- describe the projects to be financed or refinanced;
- provide the maximum amount to be borrowed;
- describe the sources of payment of debt service; and
- require that proceeds from the private financing be invested in accordance with an investment policy adopted by the board.

The resolution may contain additional provisions specified by the bill.

The board must establish a trust fund to hold the proceeds of private financing secured under the bill. Payment of debt service must be made from and secured solely by (1) fees or revenues generated by an activity of the local school board; (2) proceeds from the private financing and investment earnings; (3) a grant or gift received by the local school board; (4) reserves or other funds; (5) any money that may be applied to paying debt service, including an appropriation by the State or the governing body of the county; or (6) any source of funds to which the county board has access for that purpose.

Any private financing must state on its face that it does not create or constitute any indebtedness or obligation of the State, of the county's governing body, or any other political subdivision of the State (except the local school board). The private financing does not constitute a debt or obligation of the General Assembly, nor does it pledge the faith and credit of the State. All expenses incurred from private financing under the bill are considered operating costs of the local board.

Current Law/Background: For a description of current financing arrangements for school construction projects in the State, please see the **Appendix – State Funding for Public School Construction Projects**.

As noted in the appendix, all requests for funding submitted to the Interagency Committee on School Construction (IAC) must be approved by the governing body of the county in which the local school board is located. Moreover, all plans and designs for public school construction projects must be reviewed and approved by IAC before receiving State funds. Under the bill, a local school board may use private financing to fund projects that are not approved by either the local governing body or IAC. As local school boards receive their operating funds from the local governing body and do not have taxing authority to raise revenue, circumvention of the local governing body may be problematic to the extent that

a local school board does not secure other outside funding to pay debt service on private financing.

State law authorizes the use of alternative financing arrangements in order to finance, speed delivery of, transfer risks of, or otherwise enhance the delivery of public school construction projects. Alternative financing arrangements include:

- sale-leaseback arrangements;
- lease-leaseback arrangements;
- public-private partnership agreements;
- performance-based contracting;
- preference-based arrangements; and
- design-build arrangements.

Regulations adopted by the Board of Public Works require that projects using alternative financing meet requirements regarding the advantages of the project to the public. All qualifying projects must also meet the same educational and design standards applied by IAC to other public school construction projects. A local school board may not use alternative financing arrangements without the approval of the county's governing body.

State Fiscal Effect: Each year, IAC receives more than 200 requests for planning or funding approval for public school construction projects seeking State funding. Each request undergoes a thorough assessment by the Public School Construction Program (PSCP), the Maryland State Department of Education, and the Department of General Services. It cannot be determined from the bill whether local school systems would opt to use private financing to cover the local share of funding required for IAC-approved projects, or whether they would use private financing to pay for entire projects outside the scope of current IAC procedures. Any projects funded outside IAC approval would not be eligible for State reimbursement; thus, the Department of Legislative Services (DLS) assumes local boards would use private financing primarily for projects or equipment that are ineligible for State funding.

Given that the bill gives local school boards autonomy to secure private financing without the approval of local governing bodies or IAC, DLS anticipates that any school board that opts to use this authorization will do so to fund entire projects that are not eligible for State funding, resulting in little or no direct effect on PSCP. To the extent that local school boards do opt to use local financing to expand the number of project requests they submit to IAC, PSCP may require additional staff to conduct the necessary reviews, if the number of project requests grows substantially.

Although the bill specifically states that any private financing is not a debt of the State and is not a pledge of the faith and credit of the State, creditors involved in a default by a local

school system may seek either legal or legislative relief from the State. Thus, in the event of a default, the bill may ultimately require additional expenditures by the State to reimburse creditors, although the State could seek authority to intercept education aid due to a local board to satisfy any outstanding debt (the State has this authority now for outstanding court judgments).

Local Fiscal Effect: Local school boards currently have the authority to obtain private financing but typically must obtain the approval of their county’s governing body – either in advance or through the county budget approval process. For instance, Prince George’s County Public Schools uses lease financing for certain equipment and buses, but the debt is capped at 5.0% of its operating budget. Several school systems have entered into energy performance leases for school facility improvements that reduce energy costs, *e.g.* window replacement, HVAC system. Thus, the bill provides added flexibility to obtain private financing. To the extent that a local school board obtains financing and uses its operating funds to pay debt service, less funding is available for other operating costs unless the county provides additional funds in the school board’s budget.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Dorchester, Garrett, and Prince George’s counties; Baltimore City; Maryland State Department of Education; Maryland Association of Counties; Public School Construction Program; Department of Legislative Services

Fiscal Note History: First Reader - March 23, 2015
md/rhh

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Appendix – State Funding for Public School Construction Projects

Subject to the final approval of the Board of Public Works (BPW), the Interagency Committee on School Construction (IAC) manages State review and approval of local school construction projects. Each year, local systems develop and submit to IAC a facilities master plan that includes an analysis of future school facility needs based on the current condition of school buildings and projected enrollment. The master plan must be approved by the local school board. Subsequently, each local school system submits a capital improvement plan to IAC that includes projects for which it seeks planning and/or funding approval for the upcoming fiscal year, which may include projects that the local system has forward funded. In addition to approval from the local school board, the request for the upcoming fiscal year must be approved by the county's governing body. Typically, the submission letter to IAC contains signatures of both the school board president and either the county executive and county council president or chair of the board of county commissioners.

Based on its assessment of the relative merit of all the project proposals it receives, and subject to the projected level of school construction funds available, IAC makes recommendations for which projects to fund to BPW. By December 31 of each year, IAC must recommend to BPW projects comprising 75% of the preliminary school construction allocation projected to be available by the Governor for the upcoming fiscal year. Local school boards may then appeal the IAC recommendations directly to BPW. By March 1 of each year, IAC must recommend to BPW and the General Assembly projects comprising 90% of the allocation for school construction submitted in the Governor's capital budget. Following the legislative session, IAC recommends projects comprising the remaining school construction funds included in the enacted capital budget for BPW approval, no earlier than May 1.

The State pays at least 50% of eligible costs of school construction and renovation projects, based on a funding formula that takes into account numerous factors including each local school system's wealth and ability to pay. The Public School Facilities Act (Chapters 306 and 307 of 2004) requires that the cost-share formula be recalculated every three years. The first recalculation occurred in 2007, the second recalculation occurred in 2010, and the third, begun in 2013, was completed in 2014. **Exhibit 1** shows the State share of eligible school construction costs for all Maryland jurisdictions for fiscal 2015, which was determined by the 2010 recalculation, and for fiscal 2016 through 2018, as determined by the 2014 recalculation. Reductions in the State shares for Allegany, Cecil, and St. Mary's counties are phased in over two years because of the magnitude of the reductions.

Exhibit 1
State Share of Eligible School Construction Costs
Fiscal 2015-2018

<u>County</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
Allegany	93%	88%	83%	83%
Anne Arundel	50%	50%	50%	50%
Baltimore City	93%	93%	93%	93%
Baltimore	50%	52%	52%	52%
Calvert	56%	53%	53%	53%
Caroline	78%	80%	80%	80%
Carroll	58%	59%	59%	59%
Cecil	69%	64%	63%	63%
Charles	63%	61%	61%	61%
Dorchester	69%	76%	76%	76%
Frederick	60%	64%	64%	64%
Garrett	50%	50%	50%	50%
Harford	63%	63%	63%	63%
Howard	60%	55%	55%	55%
Kent	50%	50%	50%	50%
Montgomery	50%	50%	50%	50%
Prince George's	62%	63%	63%	63%
Queen Anne's	50%	50%	50%	50%
St. Mary's	64%	59%	58%	58%
Somerset	82%	100%	100%	100%
Talbot	50%	50%	50%	50%
Washington	71%	71%	71%	71%
Wicomico	96%	97%	97%	97%
Worcester	50%	50%	50%	50%
Maryland School for the Blind	93%	93%	93%	93%

Source: Public School Construction Program

Chapters 306 and 307 also established the State's intent to provide \$2.0 billion of funding for school construction by fiscal 2013, an average of \$250.0 million each year for eight years. As a result, Public School Construction Program (PSCP) funding increased from \$125.9 million in fiscal 2005 to \$253.8 in fiscal 2006, and has remained above the \$250.0 million target each year since, which resulted in significant increases in school construction assistance to local school boards. As a result, the State achieved the \$2.0 billion goal ahead of schedule. **Exhibit 2** shows annual State public school construction funding from fiscal 2007 through 2015, by county.

The Governor's proposed fiscal 2016 budget includes \$250.0 million in general obligation bonds and \$30.0 million in pay-as-you-go general funds for PSCP. The fiscal 2016 *Capital Improvement Program* includes \$250.0 million annually for the program in fiscal 2017 through 2020.

Exhibit 2
State Public School Construction Funding
Fiscal 2007-2015
(\$ in Thousands)

County	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY2015
Allegany	\$18,650	\$412	\$0	\$0	842	\$727	\$1,999	\$2,496	\$6,597
Anne Arundel	22,675	27,827	27,420	25,020	26,200	32,400	33,349	34,870	36,200
Baltimore City	39,436	52,665	41,000	27,733	28,559	41,000	46,102	39,478	35,329
Baltimore	35,053	52,250	40,985	28,000	29,000	39,000	47,394	52,068	34,561
Calvert	2,723	12,644	7,824	8,181	8,450	7,317	7,129	5,577	2,653
Caroline	2,935	2,426	8,100	6,000	3,767	235	756	7,788	0
Carroll	8,282	8,219	11,741	10,520	8,444	9,079	15,211	4,874	3,915
Cecil	8,271	9,533	2,674	1,538	1,744	2,830	1,915	1,268	8,194
Charles	10,200	13,170	11,704	8,898	8,335	9,180	12,480	9,426	8,200
Dorchester	872	6,137	10,400	6,469	5,436	3,639	979	1,590	768
Frederick	17,942	18,728	14,759	16,226	14,000	16,532	19,254	20,163	15,901
Garrett	1,235	6,243	3,020	666	0	382	319	134	0
Harford	11,096	16,238	14,751	16,253	13,835	17,040	16,573	13,214	12,791
Howard	17,808	23,206	18,265	18,262	18,290	26,936	32,811	25,931	20,772
Kent	3,479	1,335	0	388	0	104	123	95	817
Montgomery	40,040	52,297	53,312	28,350	30,183	42,000	43,794	38,592	39,950
Prince George's	37,425	52,250	41,000	28,200	29,500	40,348	42,192	39,371	38,539
Queen Anne's	3,000	3,925	4,951	3,947	5,750	5,374	649	4,371	5,112
St. Mary's	5,495	9,806	7,266	4,028	6,600	3,354	3,172	7,472	11,876
Somerset	12,022	5,153	0	6,000	6,000	3,371	289	3,811	2,752
Talbot	2,405	2,038	0	436	344	135	35	634	0
Washington	4,478	8,970	9,368	7,965	7,970	8,571	9,117	8,494	7,467
Wicomico	4,178	8,143	12,960	13,170	9,975	1,864	11,290	13,327	10,991
Worcester	6,872	8,213	5,483	403	0	165	166	4,882	0
MD School for the Blind							2,800	6,063	14,733
Bond Premium	6,100								
Statewide					500		100	500	660
Total	\$322,672	\$401,828	\$346,983	\$266,653	\$263,724	\$311,583	\$349,997	\$347,277	\$318,778
Amount Over \$250M	\$72,672	\$151,828	\$96,983	\$16,653	\$13,724	\$61,583	\$99,997	\$97,277	\$68,778

Note: Includes new general obligation bonds, pay-as-you-go funds, and reallocated funds that were previously authorized. Counties receiving \$0 did not request any eligible projects to be funded in that year.

Source: Department of Legislative Services