

Department of Legislative Services
 Maryland General Assembly
 2017 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 197 (The President)(By Request - Administration)
 Budget and Taxation

Creation of a State Debt - Qualified Zone Academy Bonds

This Administration bill authorizes the Board of Public Works to issue \$4,823,000 in interest-free Qualified Zone Academy Bonds (QZABs) by December 31, 2017, and grant the proceeds to the Interagency Committee on School Construction (IAC) and the Maryland State Department of Education (MSDE) for the renovation, repair, and capital improvements of qualified zone academies, including public charter schools, as defined in the federal Internal Revenue Code. Proceeds from the sale of QZABs must be spent no later than three years after the issuance of the bonds.

The bill takes effect June 1, 2017.

Fiscal Summary

State Effect: No effect in FY 2017. Bond revenues and expenditures by IAC increase by \$4.82 million in FY 2018 from the issuance of QZABs, less any transaction fees; although QZAB expenditures are likely spread out over three years, they are shown entirely in FY 2018 because the distribution across years cannot be estimated. Annuity Bond Fund expenditures increase by an estimated \$160,800 in FY 2018 and then by \$321,500 for each of 14 years, with one additional payment of \$160,800,000 in the sixteenth year to pay off the principal on the QZABs. IAC and MSDE can administer the QZAB program with existing budgeted resources.

(in dollars)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Bond Rev.	\$4,823,000	\$0	\$0	\$0	\$0
SF Expenditure	\$160,800	\$321,500	\$321,500	\$321,500	\$321,500
Bond Exp.	\$4,823,000	\$0	\$0	\$0	\$0
Net Effect	(\$160,800)	(\$321,500)	(\$321,500)	(\$321,500)	(\$321,500)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local school board revenues and expenditures for school renovation increase by \$4.82 million for FY 2018 through 2020 from the distribution of QZAB proceeds.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). The Department of Legislative Services concurs with this assessment.

Analysis

Bill Summary: IAC and MSDE may use QZAB proceeds provided by the Board of Public Works for the following purposes, in accordance with criteria established under the Aging Schools Program:

1. for competitively awarded grants by IAC to eligible school systems for qualified academies, including public charter schools; and
2. for targeted grants awarded by MSDE to eligible school systems for qualified academies, including public charter schools, under the Breakthrough Center Program.

Current Law: The federal Tax Reform Act of 1997 created QZABs as a new type of debt instrument to finance education projects. Financial institutions, insurance companies, and investment houses are the only entities allowed to purchase the bonds, which provide for a federal tax credit instead of interest earnings. The program has been extended several times, most recently by the Protecting Americans from Tax Hikes Act of 2015, which included \$400 million of additional QZAB authorization for each of calendar 2015 and 2016. This bill authorizes the sale of Maryland's 2015 federal allocation. Under current federal guidelines, QZAB funds may be used only to rehabilitate or repair school facilities, provide equipment, develop course materials, or train teachers and other school personnel; they may not be used for new construction. They can be used only for qualified zone academies, which are defined as public schools that (1) are designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and prepare students for college and the workforce and (2) require students to meet the same academic standards and assessments as other students in the same school system. Qualified zone academies must either be located in a federal Enterprise or Empowerment Zone or have at least 35% of their student population qualify for free or reduced-price meals.

Maryland has allowed QZAB proceeds to be used only for renovation and repair (brick-and-mortar) projects as part of the Aging Schools Program administered by IAC. However, Chapter 707 of 2009 expanded the use of *previously* authorized QZABs to

include equipment, which is an authorized use under Section 1397E (revised and recodified as Section 54E by the federal Tax Extenders and Alternative Minimum Tax Relief Act of 2008) of the Internal Revenue Code. Chapter 707 also authorized MSDE to allocate QZAB funds to local education agencies. QZABs are issued with the full faith and credit of the State. Therefore, QZABs are considered State debt. For purposes of calculating State debt affordability, QZABs are included in the State's calculation of general obligation bond debt outstanding and debt service.

Chapter 96 of 2011 first authorized the use of QZABs for public charter schools, and each successive authorization has also included charter schools.

Background:

Qualified Zone Academy Bonds

Maryland first authorized the sale of QZABs in Chapter 322 of 2000. Additional issuances were authorized by Chapter 139 of 2001, Chapter 55 of 2003, Chapter 431 of 2005, Chapter 585 of 2007, Chapter 523 of 2010, Chapter 96 of 2011, Chapter 3 of the first special session of 2012, Chapter 426 of 2013, Chapter 475 of 2014, Chapter 401 of 2015, and Chapter 198 of 2016. The allocation under Chapter 585 of 2007 was sold over two years.

Federal law requires that QZAB projects receive a 10% private-sector match, which may be in the form of cash, in-kind goods such as equipment or technology, services such as help developing a curriculum, and internships or field trips. While Maryland law authorizes QZABs to be spent on brick-and-mortar projects and – in the case of QZABs authorized before 2009 – equipment, federal law also allows spending on curriculum development and training for teachers and other school personnel.

To date, Maryland's allocation under the federal program has totaled \$101.5 million from 12 prior-year bills that authorized the sale of the bonds; including interest earned on QZAB proceeds, it brings total proceeds for the State to \$104.5 million, as shown in **Exhibit 1**. Omitting the most recent sale, which was completed in December 2016, 96.4% of QZAB proceeds had been spent through February 22, 2017. Due to some local school systems' poor track records in spending their allocations, QZAB funds have been awarded using a competitive grant process rather than proportionately based on the Aging Schools Program's statutory allocation since the 2011 sale.

Exhibit 1
QZAB Proceeds and Expenditures as of February 22, 2017

Year of Sale	<u>Proceeds</u>	<u>Interest Income</u>	<u>Proceeds + Interest</u>	<u>Expenditures</u>	<u>Unexpended Balance</u>	<u>Percent Expended</u>
2001	\$18,097,984	\$1,321,125	\$19,419,109	\$19,419,109	\$0	100.0%
2004	9,043,000	979,857	10,022,857	10,007,197	15,660	99.8%
2006	4,378,000	327,855	4,705,855	4,705,355	500	99.9%
2007	4,986,000	131,528	5,117,528	5,117,528	0	100.0%
2008	5,563,000	73	5,563,073	5,563,073	0	100.0%
2009	5,563,000	13,752	5,576,752	5,576,752	0	100.0%
2010	4,543,000	13,209	4,556,209	4,556,209	0	100.0%
2011	15,731,348	107,897	15,839,245	15,839,245	0	100.0%
2012	15,166,643	55,498	15,222,141	15,222,141	0	100.0%
2013	4,546,100	12,640	4,558,740	4,558,740	0	100.0%
2014	4,622,100	22,131	4,644,231	3,544,687	1,099,544	76.3%
2015	4,621,000	22,239	4,643,239	2,152,795	2,490,444	46.4%
2016	4,680,000	0	4,680,000	709,552	3,970,448	15.2%
Total	\$101,541,175	\$3,005,777	\$104,546,952	\$96,986,516	\$7,560,436	

QZAB: Qualified Zone Academy Bond

Notes: In anticipation of closing the 2008 QZAB account, the interest was transferred to the proceeds column. As \$593,868 of the expenditures for the 2001 QZAB account was spent on nonqualified projects, this amount must be deducted from expenditures for federal tax purposes, reducing the percent expended to 96.7%.

Source: Interagency Committee on School Construction

Aging Schools Program

Eligible Aging Schools Program expenditures include asbestos and lead paint abatement; upgrade of fire protection systems and equipment; painting; plumbing; roofing; upgrade of heating, ventilation, and air-conditioning systems; site redevelopment; wiring schools for technology; and renovation projects related to education programs and services. Projects must cost at least \$10,000 to be funded through the program. MSDE and IAC review aging schools project requests submitted by local school systems, approve eligible projects, and determine if additional review of any construction documents will be required.

The Governor's proposed fiscal 2018 capital budget includes \$6.1 million for the program, which is allocated in statute to each local school system based on each county's proportion of pre-1970 square footage in public school facilities.

Breakthrough Center

The Breakthrough Center's primary focus is to efficiently coordinate MSDE's resources for 16 schools and their 20 feeder schools in Baltimore City and Prince George's County. Without the center, schools and districts have to work with different MSDE divisions to access different resources. Furthermore, the Breakthrough Center coordinates resources from government and private-sector partners and provides funding for supplemental instructional support, such as job-embedded professional development for teachers. To provide long-term support, the Breakthrough Center develops multiyear memoranda of understanding signed by the participating schools, districts, and MSDE that specify the roles and responsibilities of each.

While the center's focus is on low-performing schools, it is launching voluntary statewide initiatives and will offer webinars and e-learning communities, all centered on what works in school improvement. The center plans to develop evaluation mechanisms, and the results will be an important measure of MSDE's targeted assistance. The center's pilot phase was completed in summer 2010, and full operation began in fiscal 2011. Beginning with the 2011 QZAB allocation, IAC has worked with MSDE to identify large projects in schools that are targeted for intervention by the Breakthrough Center so that eligible capital costs associated with the improvement efforts can be funded with QZAB proceeds. Therefore, in addition to the competitive grant process noted above, a portion of the QZAB proceeds is distributed to schools being assisted by the Breakthrough Center.

Public Charter Schools

Public charter schools are public schools that provide alternative approaches to learning to improve student academic performance. They operate under the supervision of a local board of education and, with certain exceptions, in accordance with the laws and regulations that govern other public schools. Local school boards must give public charter schools a per-student amount of county, State, and federal money that is commensurate with the amount given to other public schools in the same jurisdiction. The State Board of Education or a local board may give surplus educational materials, supplies, furniture, and other equipment to a public charter school. Public charter schools do not receive a specific allocation for capital facilities, but schools located in buildings owned by the local board are eligible for State capital funding through IAC.

There are approximately 50 public charter schools in the State. Many public charter schools are located in former public school buildings, especially in Baltimore City. Some

public charter schools lease space in private buildings. Under the bill, any public charter school in Maryland could be eligible to receive QZAB funds if it meets the qualifications.

State Fiscal Effect: Bond revenues and expenditures increase by up to \$4.82 million in fiscal 2018 from the issuance of QZABs, with the funding distributed to local school systems, either through competitive grants or the Breakthrough Center, for eligible school renovation and repair projects, including public charter schools. The State is required to repay the principal on the bonds within 15 years after the date of issuance. As QZABs are tax-credit bonds, the State is responsible for repaying only the principal. However, federal arbitrage rules prohibit the State from earning interest on the proceeds of tax-credit bonds. Therefore, debt service payments consist of annual payments of \$321,533 from the Annuity Bond Fund with the intent of paying off the full \$4.82 million at the end of the 15-year period. However, in fiscal 2018, only one of two annual payments is made, due to the timing of the sale of the bonds, so fiscal 2018 Annuity Bond Fund expenditures are only \$160,767. When the Annuity Bond Fund is unable to fully fund the debt service on bonds issued by the State, general funds are used to pay the remaining amount. The Governor's proposed fiscal 2018 budget includes \$263.0 million in general funds for debt service payments.

Local Fiscal Effect: Local school revenues and expenditures for public school renovation and repair increase by up to \$4.82 million over three years beginning in fiscal 2018. Distribution of the QZAB proceeds among local school systems will be determined by a competitive grant process administered by IAC and also by the Breakthrough Center. There is no local match for QZABs, although local school systems must raise private-entity matches equal to 10% of their QZAB distributions in order to receive the QZAB funds.

Additional Information

Prior Introductions: None.

Cross File: HB 153 (The Speaker)(By Request - Administration) - Appropriations.

Information Source(s): Maryland State Department of Education; Public School Construction Program; Board of Public Works; Department of Legislative Services

Fiscal Note History: First Reader - February 26, 2017
mm/rhh

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Creation of a State Debt – Qualified Zone Academy Bonds

BILL NUMBER: SB197/HB153

**PREPARED BY: GLO
(Dept./Agency/GLO)**

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

 X WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND
SMALL BUSINESSES

OR

 WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND
SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS