Department of Legislative Services

Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 60 (Senator Peters)
Budget and Taxation Appropriations

State Debt - Annuity Bond Fund - Use of Bond Premiums

This bill expands the authorized use of State bond sale premiums transferred to the Annuity Bond Fund (ABF) to include capital projects or any other use authorized by the Internal Revenue Code (IRC). **The bill takes effect June 1, 2021.**

Fiscal Summary

State Effect: State finances are not likely to be materially affected. The bill is authorizing in nature and generally conforms statutory provisions to current guidance from the State's bond counsel, as discussed below.

Local Effect: Local government finances are not likely to be materially affected.

Small Business Effect: None.

Analysis

Current Law: ABF is primarily dedicated to meeting the debt service requirements on State general obligation (GO) bonds. After the expenses of each State bond sale have been paid, any remaining premium from the bond sale is transferred to ABF. Other ABF revenues include State property tax revenues; federal subsidies; repayments from certain State agencies, subdivisions, and private organizations; and appropriated general funds.

Section 8-132 of the State Finance and Procurement Article specifies that any premium from the sale of State bonds transferred to ABF may be used to pay debt service on State bonds. Even so, the General Assembly may authorize the use of bond premium for other purposes and, in recent years, has authorized the use of bond premium for specified capital projects through language included in the State capital budget bill.

Federal tax laws and regulations place various restrictions on allowable uses of tax-exempt bond proceeds, including bond premium. Allowable uses include specified interest payments and capital projects, among others.

State Fiscal Effect: The State has generally relied on the State's bond counsel for guidance on the use of bond premium. In October 2020, the State Treasurer's Office (STO) advised the Department of Legislative Services (DLS) that the State's bond counsel had changed its advice regarding the use of bond sale premiums to pay debt service. Bond counsel now advises that bond sale premium may only support debt service payments for capitalized interest. State GO bonds do not have principal payments until the third year after the sale; thus, these first three years' interest payments are considered capitalized interest. Bond counsel had previously advised that bond premium may support debt service payments for capitalized interest from other bond sales. Thus, the new guidance limits the amount of bond sale premium that may be used for debt service.

Bond sale premiums have increased in recent years, and DLS anticipates that bond sales will continue to generate premiums in fiscal 2021 and 2022. Under the bill, bond sale premium in excess of the amount that may be applied to debt service under the current guidance may be allocated to capital projects and other allowable uses. As discussed above, the General Assembly has, on recent occasions, authorized the use of bond premium in the capital budget bill, and the fiscal 2022 capital budget includes bond funding from GO bond premium for capital projects.

Thus, the bill is not expected to materially affect State finances, as it generally aligns State statute with bond counsel's interpretation of existing federal requirements and codifies allowable uses of bond premium that are reasonably anticipated in the absence of the bill.

However, bond sale premiums are difficult to estimate as they are driven by interest rates, which can be volatile. To the extent that bond sale premium exceeds budgeted amounts in a given fiscal year, under the bill, excess bond premium may be allocated to purposes other than debt service through the budget amendment process. Such funds may be used toward capital projects or to reduce the issuance of future bond issuances, for example. To the extent that the bill affords the State greater flexibility to allocate unexpected GO bond premium toward uses allowed under IRC, the State is in an enhanced position to comply with federal tax law requirements and may potentially avoid tax rebates or other tax penalties as a result. Any such impact cannot be predicted, as it depends on the actual amount of future bond premiums, the extent to which such proceeds are anticipated in the budget enacted by the General Assembly, and any rebates or penalties that may be assessed by the Internal Revenue Service in the absence of the bill. However, for purposes of this fiscal and policy note, it is assumed that such a scenario is unlikely.

Additional Comments: In February 2021, in response to the 2020 *Joint Chairmen's Report*, DLS, STO, and the Department of Budget and Management jointly issued a report on bond premiums realized at GO bond sales. The full report can be found here.

Additional Information

Prior Introductions: None.

Designated Cross File: HB 887 (Delegate Chang) - Appropriations.

Information Source(s): Comptroller's Office; Maryland State Treasurer's Office; Department of Budget and Management; Department of General Services; Department of Legislative Services

Fiscal Note History:	First Reader - January 22, 2021
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