Issue Papers
2013 Legislative Session

Department of Legislative Services 2012

Issue Papers

2013 Legislative Session

Presentation to the

Maryland General Assembly

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Department of Legislative Services
Office of Policy Analysis
Maryland General Assembly

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December 2012

Members of the General Assembly:

Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 1, 2012.

Following each paper is an identification of the staff who worked on a particular topic. If you should need additional information, please do not hesitate to contact the appropriate staff person.

We trust this information will be of assistance to members of the General Assembly.

Sincerely,

Karl S. Aro
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Operating Budget

Economic and Revenue Outlook

The outlook for Maryland's economy is dependent to a large degree on actions Washington takes to allow or avert significant fiscal austerity measures scheduled for 2013 under current law. Since the end of the legislative session, the general fund revenue estimate for fiscal 2013 has been revised up by $181 million; however, the projected rate of growth for general fund revenues has been revised down for both fiscal 2013 and 2014.

Economic Outlook

The recession that began in December 2007 officially ended in June 2009. Lasting 18 months, the recession was the longest and deepest of the post World War II period. Although there have been significant improvements since 2009, economic growth has been slow and tentative. Since the trough, inflation-adjusted gross domestic product has increased 6.7% and finally exceeded the pre-recession peak in the fourth quarter of 2011, four years after the recession began. Since bottoming out in February 2010, employment has increased by 4.3 million jobs, or 2.8%, but remains 4.5 million jobs short of the pre-recession peak. Private sector jobs are up 4.7 million since the trough (3.8%), but government jobs are down 2.1%, just under a half a million jobs. Personal income has grown 3.2% in the first 8 months of 2012 while growth in wages is 3.3%.

Most economists expect modest growth in the U.S. economy for the remainder of 2012. The biggest concern is the potential for significant federal fiscal austerity in 2013 that could send the economy back into a recession. Bush-era income tax cuts, along with the payroll tax cut and various provisions from the 2009 economic stimulus bill, are all set to expire at the end of 2012. In addition, automatic spending cuts, known as sequestration, required by the Budget Control Act as part of the 2011 agreement to raise the debt ceiling are scheduled to take effect in January 2013. The combination of tax increases and spending cuts would sharply and quickly reduce the federal budget deficit, a level of fiscal contraction that would push the economy into recession. Moody's Analytics, Inc. has estimated such a scenario would result in the U.S. economy contracting by 1.1% between the fourth quarter of 2012 and the second quarter of 2013. Employment would fall over the course of 2013 by 2.6 million jobs relative to a scenario where all tax cuts are extended and the spending reductions cancelled. The U.S. unemployment rate would again rise to over 9.0%. It is likely that a deal will be struck to cancel or delay some or all of this fiscal contraction either in the lame duck session of Congress after the election or in the early part of 2013. The Moody's Analytics estimates are based on the fiscal austerity being permanent. If action is taken by early 2013, the impact on the economy will likely be minimal.

In Maryland, taking into account expected revisions, employment in 2011 rose by almost 1.1% (26,000 jobs), the first annual increase since 2007. In September 2012, the Board of

Revenue Estimates issued a revised economic forecast for Maryland, its first since December 2011 **(Exhibit 1)**. The Board of Revenue Estimates' (BRE) new forecast is little changed from December 2011. The only major change relates to the payroll tax cut. In December 2011, BRE assumed the tax cut would expire at the end of 2011 which, at the time, was current law. The tax cut was extended through 2012, and BRE's September forecast reflects the tax cut expiring at the end of 2012. Because payroll taxes are subtracted in the calculation of personal income, the tax cut raised personal income, and its expiration will, therefore, lower it. BRE, in both its December and September forecasts, included an estimate of the direct effect of federal sequestration budget cuts taking place in 2013.

Exhibit 1
Maryland Economic Outlook
Year-over-year Percentage Change

Calendar	Employment		Personal Income	
Year	Dec. 2011	Sep. 2012	Dec. 2011	Sep. 2012
2009	-3.0%	-2.9%	-1.6%	-2.2%
2010	-0.4%	-0.2%	3.9%	3.5%
2011	1.1%	1.1%	5.4%	5.0%
2012E	0.9%	0.9%	2.9%	3.8%
2013E	0.9%	0.9%	3.5%	3.3%
2014E	1.5%	1.5%	4.5%	4.5%
2015E	1.8%	1.8%	5.3%	5.1%

Note: The figures for 2011 under the Dec. 2011 columns are estimates.

Source: Board of Revenue Estimates

Revenue Outlook

Fiscal 2012 general fund revenues were above the estimate by $329.7 million. General fund revenues totaled $14.3 billion in fiscal 2012, an increase of 3.6% over fiscal 2011. Both the sales tax and the highway user revenue (HUR) were impacted in fiscal 2012 by legislative changes that distort the year-over-year growth rate. For the sales tax, the tax on alcoholic beverages was increased from 6.0 to 9.0%, and the distribution to the Transportation Trust Fund (TTF) was eliminated. The share of HUR going to the general fund was lowered in fiscal 2012 to 11.3% from 23.0% in fiscal 2011. Adjusted for these law changes, baseline general fund growth in fiscal 2012 was 4.6%.

The personal income tax accounted for about half of the overattainment, exceeding expectations by $117.0 million and growing 7.1% over fiscal 2011. Sales tax revenues exceeded the estimate by $20.8 million and grew 10.5%, although baseline growth was a weak 2.7%. General fund lottery revenues grew 7.4% over fiscal 2011 and were above the estimate by $33.6 million. Net sales were up 4.7% while prize payouts grew just 3.4%.

Fiscal 2013 general fund revenues through September 2012 are up 9.1% from last year. This includes revenues that will be transferred to the Budget Restoration Fund as required by the Budget Reconciliation and Financing Act of 2012. Changes in the distribution of corporate income revenues distort the year-to-year comparison. In fiscal 2013, the share of the corporate income tax going to the TTF drops to 9.5% (excluding the first 15.15% of net receipts) from 24.0% in fiscal 2012. Adjusting for that law change, general fund revenues are still up a strong 7.9%. Personal income tax revenues grow 8.2%, but growth in withholding was just 2.0%. General fund lottery revenues are down 3.5% as net sales are up 2.8%, and prize payouts are up 4.9%. Sales are up strongly for the Pick 4, Racetrax, and Instant games, but Keno sales are down 10.3%, likely reflecting sales lost to competition from the Maryland Live video lottery facility, which opened in June 2012.

In September 2012, BRE raised its estimate for fiscal 2013 general fund revenues by $180.6 million but also lowered the expected growth rate over fiscal 2012 from 5.0 to 4.6% **(Exhibit 2)**. The growth over fiscal 2012 was calculated before the transfer of $276.5 million to the Budget Restoration Fund. General fund revenue growth is expected to be 2.7% in fiscal 2014. Adjusted for the changing distribution of corporate income tax and highway user revenues, growth is projected to be 5.1% in fiscal 2013 and 3.3% in fiscal 2014.

Exhibit 2
Maryland General Fund Revenue Forecast
($ in Millions)

	Fiscal 2013				Fiscal 2014	
	BRE Mar. 2012	**BRE Sep. 2012**	**$ Diff.**	**% Change 2013/2012**	**BRE Sep. 2012**	**% Change 2014/2013**
Personal Income Tax	$7,553	$7,651	$98	7.5%	$7,967	4.1%
Sales & Use Tax	4,126	4,128	2	2.2%	4,259	3.2%
Corporate Income Tax	741	822	80	27.1%	784	-4.6%
Lottery	514	536	22	0.0%	544	1.4%
Other	1,793	1,771	-21.9	2.1%	1,763	-0.5%
Total	**$14,727**	**$14,908**	**$181**	**4.6%**	**$15,318**	**2.7%**

BRE: Board of Revenue Estimates

Note: The estimate from March has been adjusted for actions taken at the 2012 legislative sessions. The fiscal 2013 estimates show general fund revenues before the transfer of $276.5 million to the Budget Restoration Fund required by the Budget Reconciliation and Financing Act of 2012 (Chapter 1, 2012 First Special Session).

Source: Board of Revenue Estimates

Operating Budget

Budget Outlook

The State's fiscal picture has improved. Fiscal 2012 closed out with $231 million more than expected, and revenues were revised upward in fiscal 2013 by nearly $200 million. Moderate improvement in the economy has also led to reduced caseloads for State entitlement programs. Actions taken to increase revenues and a statewide referendum to add table games aids revenue projections. Achieving cash balance each year appears manageable, and the general fund structural deficit is on track to decline from $417 million to $154 million by fiscal 2018. However, downside risks to the forecast exist. These include significantly higher expense for general obligation bond debt service, the effects of federal actions to address deficits and expiring tax cuts, and the direction of the economy.

Background

Fiscal 2012 closed with a general fund balance of $551 million. General fund revenues totaled $14.3 billion, an increase of 5.3% over fiscal 2011. As seen in **Exhibit 1**, the personal income tax accounted for almost the entire overattainment, exceeding expectations by $117 million. This was largely due to higher than expected final payments and lower refunds. Corporate income tax revenue was $66 million higher based on gross receipts and lower refunds. The State Lottery saw gross sales rise by 4.7%, contributing approximately $34 million. The sales and use tax was also slightly higher. A combination of additional revenues, transfers, and reversions resulted in $231 million in higher fund balance in fiscal 2012.

Exhibit 1
Fiscal 2012 Estimated vs. Actual General Fund Revenue Performance
($ in Millions)

	Fiscal 2012 Estimated	Fiscal 2012 Actual	Change
Personal Income Tax	$6,997.7	$7,114.7	$117.0
Corporate Income Tax	580.5	646.5	66.0
State Lottery	502.7	536.3	33.6
Sales and Use Tax	4,018.5	4,039.3	20.8
Other	1,928.7	1,921.1	-7.7
Total	**$14,028.1**	**$14,257.9**	**$229.7**

Source: Department of Legislative Services

Fiscal 2013 Activity

Exhibit 2 illustrates that fiscal 2013 is projected to end with a general fund balance of $482 million, which is $282 million greater than expected when the budget was enacted in the 2012 session. This higher balance is the result of a combination of fiscal 2012 fund balance and revised revenues offset by the need for estimated deficiencies to address potential spending shortfalls. As noted, $231 million in additional balance came from the fiscal 2012 closeout. Added to that is approximately $181 million in revenue projected for fiscal 2013 by the Board of Revenue Estimates in September 2012. The Department of Legislative Services (DLS) has estimated that a deficiency appropriation is needed due to spending shortfalls approaching $123 million in general funds in the current fiscal year. Most of this is due to deferred payment of fiscal 2012 expenditures by the Department of Human Resources, student assessment costs, public safety and juvenile services operational costs, and smaller shortfalls across various agencies.

Exhibit 2

Evolution of the Fiscal 2013 General Fund Balance

($ in Millions)

		Fiscal 2012
Estimated Closing Balance (July 2012)		**$200**
Revenue		
Fiscal 2012 Closeout	$231	
September 2012 BRE Revenue Revision	181	
Lottery Agent Commissions (Ch.1 2nd Special Session of 2012)	-4	
Transfers		
Revised Sustainable Communities Tax Credit	-2	
Spending		
DLS Estimated Fiscal 2013 Deficiencies	-123	
Revised Closing Balance (November 2012)		**$482**

BRE: Board of Revenue Estimates
DLS: Department of Legislative Services

Source: Department of Legislative Services

Fiscal 2013 to 2018 Forecast

Exhibit 3 provides the DLS general fund forecast through fiscal 2018. The fiscal outlook has improved markedly in the short term based on revenue revisions, the expectation of continued bond premiums offsetting the need for general fund support for debt service, and additional video lottery terminal revenue following the approval of a voter referendum to add table games and to modify machine ownership. Approval of a sixth casino site would also yield license revenue in fiscal 2014. The general fund structural deficit is estimated at $417 million.

Between fiscal 2015 and 2018, the structural deficit is expected to continue to decrease, falling below $200 million. Reduced entitlement spending plays a significant role, as both Medicaid and Temporary Cash Assistance caseloads are expected to fall. The full phase-in of the sixth casino site and revenue revisions, which carry throughout the forecast timeframe, represent major elements in the forecast as well.

Despite the improved outlook, there are potential downside risks. First, the State has been authorizing higher levels of general obligation bonds each year. Debt service expense on these bonds is expected to outpace the growth in the State's share of the property tax, which is dedicated to repayment. By fiscal 2018, it is expected that $537 million in additional general fund spending will be needed to support debt service. Action at the federal level to address expiring tax cuts and possible sequestration could negatively impact the State's revenues due to the prevalence of federal employees and contractors, as well as direct federal aid levels to State government. Finally, while the economy has continued to recover from the recession of 2008, unemployment remains high in the United States and growth in Europe and Asia is stalling.

Conclusion

The State's fiscal picture has begun to brighten, as fiscal 2012 closed out with $231 million more than expected, and revenues were revised upward in fiscal 2013 by nearly $200 million. Moderate improvement in the economy has also led to reduced caseloads for State entitlement programs. A statewide referendum to add table games aids revenue projections in the short term, and the addition of a sixth casino site buttresses the long-term outlook. Achieving cash balance each year appears manageable, and the general fund structural deficit is on track to decline from $417 million to $154 million by fiscal 2018. However, downside risks to the forecast exist. This includes significantly higher expense for general obligation bond debt service, the effects of federal actions to address deficits and expiring tax cuts, and the direction of the economy. Actions to achieve structural balance should not be foresworn. Whether the State's property tax rate should be increased to fully pay debt service in upcoming years represents a major policy decision.

Exhibit 3
General Fund Projections
Fiscal 2013-2018
($ in Millions)

	Actual 2012	Working 2013	Baseline 2014	Estimate 2015	Estimate 2016	Estimate 2017	Estimate 2018	Avg. Annual Change 2014-18
Revenues								
Opening Fund Balance	$990	$551	$482	$0	$0	$0	$0	
Transfers	239	169	280	68	63	57	54	
One-time Revenues/Legislation	15	0	0	0	0	0	0	
Subtotal One-time Revenue	**$1,244**	**$721**	**$762**	**$68**	**$63**	**$57**	**$54**	**-48.4%**
Ongoing Revenues	$14,258	$14,908	$15,317	$15,942	$16,715	$17,455	$18,186	
Subtotal Ongoing Revenue	**$14,258**	**$14,908**	**$15,317**	**$15,942**	**$16,715**	**$17,455**	**$18,186**	**4.4%**
Total Revenues and Fund Balance	**$15,502**	**$15,628**	**$16,079**	**$16,010**	**$16,777**	**$17,512**	**$18,240**	**3.2%**
Ongoing Spending								
Operating Spending	$14,982	$14,979	$16,049	$16,895	$17,623	$18,324	$19,071	
VLT Spending Supporting Education	-101	-286	-372	-623	-663	-753	-788	
Multiyear Commitments	7	0	57	57	57	57	57	
Budget Restoration Fund Spending	0	430	0	0	0	0	0	
Subtotal Ongoing Spending	**$14,888**	**$15,123**	**$15,734**	**$16,329**	**$17,018**	**$17,628**	**$18,341**	**3.9%**
One-time Spending								
PAYGO Capital	$48	$1	$0	$1	$1	$1	$1	
Appropriation to Reserve Fund	15	23	371	50	50	50	50	
Subtotal One-time Spending	**$63**	**$23**	**$372**	**$51**	**$51**	**$51**	**$51**	**n/a**
Total Spending	**$14,951**	**$15,146**	**$16,106**	**$16,380**	**$17,069**	**$17,679**	**$18,392**	**3.4%**
Ending Balance	**$551**	**$482**	**-$27**	**-$370**	**-$292**	**-$166**	**-$152**	
Rainy Day Fund Balance	$673	$703	$766	$798	$835	$873	$910	
Balance Over 5% of GF Revenues	-40	-43	0	1	0	0	1	
As % of GF Revenues	4.72%	4.71%	5.00%	5.01%	5.00%	5.00%	5.00%	
Structural Balance	**-$630**	**-$215**	**-$417**	**-$387**	**-$303**	**-$172**	**-$154**	

GF: general fund
PAYGO: pay-as-you-go
VLT: video lottery terminals

Source: Department of Legislative Services

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Operating Budget

Transportation Trust Fund Overview

The Transportation Trust Fund's ending cash balance for fiscal 2012 exceeded estimates, and future annual average growth in transportation revenues is estimated at just over 3%. The Department of Legislative Services estimates, however, that this modest revenue growth will create constraints on debt issuances and a reduced transportation capital program through fiscal 2018.

Fiscal 2012 Closeout

The Transportation Trust Fund (TTF) ended fiscal 2012 with a fund balance of $187 million, $87 million higher than the $100 million projected. The higher fund balance is attributable to spending being less than projected by $132 million, offset by revenues coming in $45 million less than anticipated.

Capital budget expenditures were $117 million less than estimated due to cash flow changes in projects and the State Highway Administration spending federal funds before special funds. Minor changes in operating budget spending, debt service, and deductions result in a net decrease of $15 million.

Tax and fee revenues came in $5 million higher than expected. Motor fuel tax revenues were $10 million less than anticipated largely due to an accounting change from fiscal 2011 that reduced the fiscal 2012 revenue estimate. Titling tax revenues were $3 million less than estimated. These revenue declines were more than offset by a $19 million increase in the TTF share of the corporate income tax. Other revenues that came in higher included operating revenues and federal reimbursements from several weather-related events. With spending being less than anticipated, the department was able to reduce its projected bond sale by $130 million.

Fiscal 2013-2018 Transportation Trust Fund

Exhibit 1 shows the fiscal 2013 through 2018 TTF forecast by the Department of Legislative Services (DLS). The forecast details the expected trends in revenue attainment, debt issuance, and capital expenditures. Compared to the Maryland Department of Transportation's (MDOT) forecast, DLS assumes less robust revenue growth; higher operating budget spending for employee compensation, transit services, and winter maintenance; and reduced bond sales due to the constraints of the department's bond coverage ratios. As such, DLS projects a special fund capital program that is approximately $2.3 billion less than MDOT's plan over the six-year period.

Exhibit 1
Transportation Trust Fund Forecast
Fiscal 2012-2018
($ in Millions)

	Actual 2012	Est. 2013	Est. 2014	Est. 2015	Est. 2016	Est. 2017	Est. 2018	Total 2013-2018
Opening Fund Balance	**$221**	**$187**	**$100**	**$100**	**$100**	**$100**	**$100**	
Closing Fund Balance	**$187**	**$100**	**$100**	**$100**	**$100**	**$100**	**$100**	
Net Revenues								
Taxes and Fees	$1,801	$1,912	$2,074	$2,139	$2,193	$2,210	$2,242	$12,770
Operating and Miscellaneous	566	495	491	492	501	509	519	3,007
Net Revenues Subtotal	***$2,317***	***$2,407***	***$2,565***	***$2,631***	***$2,694***	***$2,719***	***$2,761***	***$15,777***
Bonds Sold	$115	$100	$70	$40	$30	$0	$0	$240
Total Revenues	**$2,447**	**$2,507**	**$2,635**	**$2,672**	**$2,724**	**$2,719**	**$2,761**	**$16,018**
Expenditures								
Debt Service	$174	$180	$199	$213	$216	$230	$220	$1,258
Operating Budget	1,572	1,660	1,740	1,857	1,965	2,079	2,196	11,497
State Capital	736	754	696	599	543	411	345	3,348
Total Expenditures	**$2,482**	**$2,594**	**$2,635**	**$2,672**	**$2,724**	**$2,719**	**$2,761**	**$16,108**
Debt								
Debt Outstanding	$1,459	$1,565	$1,504	$1,397	$1,271	$1,093	$919	
Debt Coverage – Net Income	3.4	3.5	3.2	3.6	3.3	3.1	2.9	
Local Highway User Revenues	**$148**	**$158**	**$166**	**$170**	**$174**	**$174**	**$177**	**$1,018**
HUR Transfer to GF	$187	$0	$0	$0	$0	$0	$0	$187
Capital Summary								
State Capital	$736	$754	$696	$599	$543	$411	$345	$3,348
Net Federal Capital (Cash Flow)	690	835	769	514	368	350	359	3,195
Subtotal Capital Expenditures	***$1,426***	***$1,589***	***$1,465***	***$1,113***	***$911***	***$761***	***$704***	***$6,543***
GARVEE Debt Service	$87	$87	$87	$87	$87	$87	$87	$525

GARVEE: Grant Anticipation Revenue Vehicle
GF: general fund
HUR: highway user revenue
TTF: Transportation Trust Fund

Revenues

Over the six-year period, DLS estimates net tax and fee revenue will total $12.8 billion, with an annual average growth rate of 3.2%. DLS estimates that titling tax revenues will have an average annual growth rate of 4.6% over the six-year period. Due to less robust estimates of short-term growth, DLS assumes $355 million less in revenue over the six-year period. Compared to MDOT's forecast, other revenue sources that are projected to be less include the motor fuel tax and miscellaneous motor vehicle fees. Motor fuel tax revenues are estimated to be $34 million less than MDOT's estimate, with an average annual growth rate of 1.1%. Miscellaneous Motor Vehicle Administration (MVA) fees are $48 million less than MDOT's estimate, because under current law, revenues cannot exceed 100% of eligible MVA expenditures (which DLS assumed in its estimate).

Expenditures

Operating and debt service expenditures are the first draw on TTF revenues. Over the six-year period, operating and debt service expenditures are estimated to total $12.8 billion. Compared to MDOT's forecast, the DLS forecast assumes that operating budget expenditures will be $573 million higher than MDOT's. As previously indicated, higher operating budget growth is due to estimates for transit-related expenditures, winter maintenance, and employee compensation. Operating budget expenditures are expected to grow by 5.8% compared to tax and fee growth of 3.2%. With operating budget growth outpacing revenue growth, the department's ability to issue debt is constrained. As a result of reduced debt issuances, DLS estimates that debt service costs will be $244 million less than in MDOT's forecast.

Debt Financing

Debt issued by MDOT supports the capital program. Debt issuances are limited by a total debt outstanding cap of $2.6 billion and two coverage tests that require the prior year's pledged taxes and net income to be at least two times greater than the maximum debt service in a given fiscal year. DLS assumes the net income coverage ratio will be 2.5 times through fiscal 2022. MDOT assumes a net income coverage ratio of 2.5 times through fiscal 2019. Due to DLS' lower estimates of revenue and higher estimated operating budget spending, the level of net income is reduced, and debt issuances for the capital budget are constrained. Over the six-year period, DLS estimates that bond sales will total $240 million or $1.62 billion less than estimated by MDOT.

Capital Expenditures

DLS estimates that the total special and federal capital budget will total $6.5 billion over the six-year period, approximately $2.3 billion less than MDOT's estimate in the draft 2013-2018 *Consolidated Transportation Program*. As previously discussed, the smaller capital budget is attributable to lower revenue estimates and higher estimates for operating expenses, which in turn constrain future debt issuances.

While it is unlikely that the department will reduce its capital program by $2.3 billion, the DLS forecast illustrates the impact of the risks associated with the department's financial forecast. Specifically, if revenues or spending do not meet the estimate, there could be significant reductions made to the capital program. Furthermore, MDOT's current financial forecast likely represents the best case scenario for revenues and spending. As a result, little in the way of new capital projects will be added to the capital program in the coming fiscal years.

Operating Budget

Federal Funds Outlook

In fiscal 2013, federal funds total $9.3 billion. The extent to which federal fund support changes over the next year is unclear. To date, none of the federal fiscal 2013 appropriations bills has been enacted. In August 2011, President Barack H. Obama signed the Budget Control Act, which puts in place a process for reducing the federal deficit. If sequestration takes effect, federal funding in the Maryland budget would be reduced by $117.6 million.

Federal Appropriations in State Fiscal 2013

The fiscal 2013 federal fund legislative appropriation totals $9.3 billion. **Exhibit 1** shows the distribution of the federal funds by department/service area.

Exhibit 1
Federal Funds in Fiscal 2013 Legislative Appropriation
($ in Millions)

Department/Service Area	Fiscal 2013 Legislative Appropriation
Judicial and Legal Review	$6.3
Executive and Administrative Control	205.3
Budgetary and Personnel Administration	56.9
General Services	1.1
Transportation	924.2
Department of Natural Resources	31.9
Agriculture	4.7
Health and Mental Hygiene	4,658.8
Human Resources	1,772.9
Labor, Licensing, and Regulation	163.8
Public Safety and Correctional Services	36.4
Public Education	1,051.7
Housing and Community Development	262.2
Business and Economic Development	2.1
Environment	81.9
Juvenile Services	8.3
State Police	0.4
Public Debt	12.0
Total Federal Funds	**$9,280.9**

Source: *Fiscal Digest of the State of Maryland for the Fiscal Year 2013*

Federal Fiscal 2013 Budget

Congress did not enact any of the 12 appropriation bills to fund the federal government prior to the October 1, 2012 start of federal fiscal 2013. To maintain operations of the federal government, Congress passed, and on September 28, 2012, President Barack H. Obama signed, a Continuing Resolution (CR) bill to provide funding for six months at the $1.047 trillion level authorized by the Budget Control Act of 2011 (BCA). This level of funding allows for a 0.0612% across-the-board increase over fiscal 2012 funding levels for most programs. The CR also extended for six months the authorizations for the Temporary Assistance for Needy Families program and for programs included in the farm bill that were set to expire on September 30, 2012. Both the CR and the authorization extensions terminate March 28, 2013.

Sequestration Set to Begin January 2013

Congress passed the BCA to provide for an increase in the U.S. debt ceiling and to put in place a process of automatic spending reductions, known as sequester, to reduce spending by up to $1.2 trillion over nine years should Congress and the President fail to enact deficit reduction legislation of at least that amount. The automatic reductions were thought to be sufficiently draconian to ensure that an agreement on deficit reduction would be reached. However a Joint Select Committee, which was tasked with devising a deficit reduction plan, was unable to reach agreement. Absent the required spending reductions, sequestration is scheduled to take effect January 2013.

The sequester will require spending reductions of approximately $109 billion per year for federal fiscal 2013 through 2021 split evenly between defense and nondefense spending. Many mandatory and a few discretionary programs are exempt. **Exhibit 2** lists select programs exempt from or subject to sequestration.

Exhibit 2
Select Programs Exempt from or Subject to Sequestration

Programs Exempt from Sequestration

- Most Transportation Programs
- Medicaid (Vendor Payments and Administration)
- Pell Grants
- Children's Health Insurance Program (CHIP)
- Most Child Nutrition and Supplemental Nutrition Assistance Programs

Programs Subject to Sequestration

- Education (Elementary, Secondary, Vocational, and Higher)
- Employment and Training
- Energy
- Environment
- Agriculture
- Justice

Programs Exempt from Sequestration	**Programs Subject to Sequestration**
• Most Child Care, Child Support Enforcement, Foster Care, and Adoption Assistance Programs	• Housing/Community Development
	• Social Services (Non-mandatory Programs)
• Temporary Assistance for Needy Families	• Health (Non-Medicaid/CHIP Programs)
	• National Forests/Mineral Leasing
	• Defense

Source: National Conference of State Legislatures

Across-the-board reductions will be used for fiscal 2013, and in following years, the reductions will be established through the normal appropriations process. The Office of Management and Budget reported the following estimated percentage cuts to nonexempt funding:

- 8.2% to nondefense discretionary funding;
- 2.0% to Medicare funding (plans and providers);
- 7.6% to other nondefense mandatory funding;
- 9.4% to defense discretionary funding; and
- 10.0% to defense mandatory program.

Under authority granted by the BCA, the President has indicated that personnel accounts within the defense spending will be exempted from sequestration. This does not reduce the amount of defense spending reductions but rather allocates the required reductions among the other defense spending categories.

If sequestration takes effect, federal funding in the Maryland budget would be reduced by approximately $117.6 million in the first year. **Exhibit 3** shows the estimated reductions by federal agency.

Exhibit 3
Estimated Federal Fund Reductions by Federal Agency in Maryland Budget Due to Sequestration
($ in Millions)

Federal Agency	**Federal Fiscal 2013**
Department of Agriculture	-$8.936
Appalachian Regional Commission	-0.010
Department of Commerce	-0.237
Department of Education	-45.447
Department of Energy	-0.044
Environmental Protection Agency	-4.782
Department of Health and Human Services	-30.976
Homeland Security	-0.927
Department of Housing and Urban Development	-15.209
Department of Interior	-0.175
Department of Justice	-0.797
Department of Labor	-9.647
Various Arts and Humanities	-0.414
Total	**-$117.602**

Note: Due to the three-month overlap with the federal fiscal year, these reductions may take effect during State fiscal 2013 and/or 2014.

Source: Federal Funds Information for States; Department of Legislative Services

Although several proposals have been made by both the Administration and various units of Congress, no agreement has been reached. Modifying or eliminating sequestration will require enactment of federal legislation. It is reported that Congress may address sequestration and other matters during a lame-duck session following the November elections.

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Operating Budget

Constraining Operating Budget Spending

At the 2008 session, the forecast estimated a general fund budget of $17.5 billion by fiscal 2013. Since then, executive and legislative actions have reduced projected general fund spending by over $3 billion. These actions cut across all parts of the budget, including adoption of new special fund revenues that replaced a portion of Medicaid and mandated education aid, cuts to Medicaid and State agencies, changes in statutory formulas, position abolitions, facility closures, and denial of employee steps and general salary increases. Discretionary aid to higher education was level funded, and bond premiums eliminated the need for general fund support of debt service.

Background

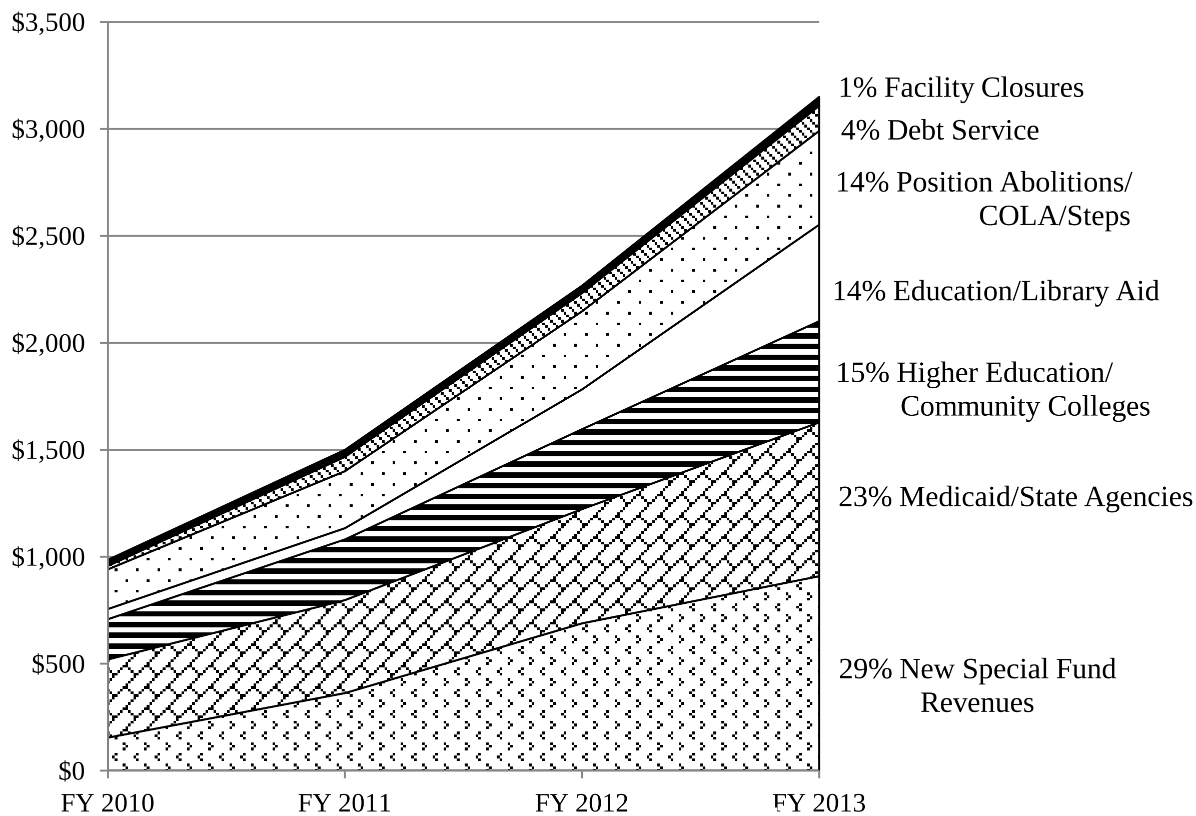
At the 2007 special session, a combination of revenue increases and spending reductions was adopted which was intended to fully resolve the general fund structural deficit that the State had been grappling with since the 2001 recession. The Great Recession of 2008 caused ongoing general fund revenue to fall 5% in fiscal 2009 and remain flat in fiscal 2010, at the same time that spending increased due to higher Medicaid and Temporary Cash Assistance caseloads. Projections of the structural shortfall grew to as high as $3 billion based on the Department of Legislative Services (DLS) forecast prepared in December 2009 for the Spending Affordability Committee. Efforts to address the shortfall involved ongoing and one-time spending reductions, changes in mandated formulas, tax and fee increases, use of general fund balance, revenue diversions, and fund transfers.

Constraining Fiscal 2013 Spending Projections

At the 2008 session, the DLS long-term general fund forecast estimated that fiscal 2013 spending would reach $17.5 billion. This current services projection was built upon the fiscal 2009 budget and included adjustments for statutory formulas, caseload estimates, new facilities, inflation, and general salary increases. Since then, the combined actions of the Governor and the General Assembly constrained general fund spending by over $3.0 billion. Actions affected all portions of the budget, as shown in **Exhibit 1**. This included:

- ***Special Fund Revenues:*** Over $900 million, or 29%, was due to the adoption of new ongoing special fund revenues, which replaced the need for general funds. The largest components were hospital assessments, which replaced general funds in Medicaid and Video Lottery Terminal gaming proceeds which support local education aid;

Exhibit 1
Constraining Growth in General Fund Spending from Baseline Estimates
Fiscal 2010-2013
($ in Millions)



COLA: cost-of-living adjustment

Source: Department of Legislative Services

- ***Reductions to State Agencies and Medicaid:*** Cuts to State agencies and Medicaid, excluding facility closures and position abolitions, accounted for over $700 million, or 23%, of actions. Examples include cutbacks in general operating expenses; higher employee cost sharing of health insurance, retirement, and prescription co-pays; level funding of community health provider costs; and changes in local aid such as local jail reimbursements. Medicaid budgets were constrained through reductions in areas such as managed care organization rates, delay of Medicaid expansion, and lower enrollment;

- ***Education Aid:*** Constraint in aid to higher education, community colleges, and K-12 education accounted for more than $900 million, or 29%, of total savings. In the 2008 forecast, discretionary higher education grants were projected to increase annually by the Higher Education Price Index. In actuality, funding has been held to the same level since fiscal 2009. Aid to community colleges and private universities and colleges were similarly constrained because statutory formulas are linked to State four-year higher education aid. Growth in local education and library aid was also reduced, in most cases constraining increases in formula components based on inflationary growth factors;

- ***Position Abolitions/Salary Constraint:*** Over 2,700 positions were abolished in the Executive Branch, exclusive of facility closures. This represents over $400 million in general fund savings, or 14%, of the total. In most cases, across-the-board reductions were prorated across all agencies, with the largest losses in the Department of Health and Mental Hygiene, the Department of Human Resources, and the Department of Public Safety and Correctional Services. The 2008 forecast also assumed annual step increases and 2% general salary increases, but these were not provided except for a 2% increase for one-half of fiscal 2013;

- ***Debt Service:*** Debt service on general obligation bonds is paid from the State share of the property tax. It was estimated that $117 million in general funds would be needed by fiscal 2013, but a low interest environment has yielded bond premiums which have obviated the need for general fund support to date. This was 4% of the total; and

- ***Facility Closures:*** Since fiscal 2009, the State has closed or reduced capacity at nearly two dozen facilities, resulting in savings of $42 million, or 1%, of the total actions.

Conclusion

Compared to the long-term forecast prepared by DLS after the 2008 session, executive and legislative actions have reduced general fund spending projected for fiscal 2013 by over $3 billion. Budgetary constraint affected all parts of the budget including State agency operations, Medicaid and other entitlement programs, local aid including formula-based education and library funding, and higher education. State employees were impacted by position abolitions; no allowance for general salary increases or steps; and higher costs for retirement, health care, and prescription drugs.

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Capital Budget

Debt Affordability

The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling $1,075.0 million for fiscal 2014. This is the same level that was recommended for fiscal 2013 and keeps debt service payments below 8% of revenues. The Treasurer's Office estimates that total tax-supported debt service will be $1.4 billion in fiscal 2014. General obligation bond debt service is projected to total $988.3 million in fiscal 2014. Total State debt outstanding is projected to be $11.5 billion at the end of fiscal 2014, of which $8.3 billion is general obligation bond debt.

Capital Debt Affordability Process

State law requires the Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt to ensure that the State's tax-supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the Secretary of the Maryland Department of Transportation (MDOT), the Secretary of the Department of Budget and Management (DBM), and a public member. Chapter 445 of 2005 added, as nonvoting members, the chairs of the Capital Budget Subcommittees for the Senate Budget and Taxation Committee and the House Appropriations Committee.

Tax-supported debt consists of general obligation (GO) debt, transportation debt, Grant Anticipation Revenue Vehicles (GARVEE), bay restoration bonds, capital leases, Stadium Authority debt, and bond or revenue anticipation notes. The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new GO and academic revenue debt for each fiscal year. The committee does not make individual recommendations on the levels of capital leases, transportation debt, bay restoration bonds, or Stadium Authority debt but does incorporate the anticipated levels of these types of debt in its analysis of total debt affordability.

Affordability Criteria and Ratios

CDAC began evaluating State debt in 1979. In consultation with rating agencies, investment bankers, and its financial advisor, CDAC has adopted policies to limit State debt outstanding to 4% of personal income and State debt service to 8% of State revenues. **Exhibit 1** shows the CDAC's State debt affordability analysis. The analysis assumes similar estimates for GO bonds, transportation debt, GARVEEs, bay restoration bonds, and Stadium Authority debt issuances.

Exhibit 1
Affordability Ratios
Fiscal 2013-2022

Fiscal Year	Projected Debt Outstanding As a Percent of Personal Income	Projected Debt Service As a Percent of Revenues
2013	3.41%	6.65%
2014	3.46%	6.96%
2015	3.43%	7.16%
2016	3.34%	7.45%
2017	3.26%	7.55%
2018	3.21%	7.62%
2019	3.15%	7.44%
2020	3.08%	7.20%
2021	3.01%	7.12%
2022	2.94%	7.15%

Source: Department of Legislative Services, November 2012

Increasing New Debt Authorizations

On October 1, 2012, the committee recommended that fiscal 2014 GO debt authorizations be limited to $1,075 million. This is an increase of $150 million over the planned authorization. This increase was proposed by DBM. The department asserted that it is affordable based on State criteria. DBM also noted that there are "shovel-ready projects," interest rates are low, capacity is squeezed by legislative pre-authorizations, and capital budget provides operating budget relief. The committee estimates that total GO debt will be $8.3 billion at the end of fiscal 2014. GO bond debt service payments are projected to total $988 million in fiscal 2014.

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded from motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and other MDOT revenues. The gross outstanding aggregate principal amount of Consolidated Transportation Bonds is limited by statute to $2.6 billion. CDAC projects that total outstanding transportation debt is projected to reach $2.0 billion in fiscal 2014. Transportation bond debt service is projected to be $216 million in fiscal 2014. The department also issued GARVEE bonds in fiscal 2008 and 2009. Chapters 471 and 472 of 2005 limit the total amount of GARVEEs that may be issued at $750 million. The State pledges anticipated federal revenues to support the GARVEE debt service, and statute specifies that the bonds are considered tax-supported debt. GARVEE debt outstanding is projected to be $416 million at the end of fiscal 2014. GARVEE debt service costs are estimated to be $87 million.

The Bay Restoration Fund was created by Chapter 428 of 2004 to provide grants for enhanced nutrient removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. In fiscal 2008, the first $50 million in bay bonds was issued. The Maryland Department of the Environment indicates that the estimated issuance stream is $50 million, $150 million, $160 million, $100 million, and $20 million in fiscal 2013 through 2017, respectively. The department estimates that $231 million in bonds will be outstanding at the end of fiscal 2014. Debt service costs are projected to be $9 million in fiscal 2013.

Capital leases for real property and equipment are also considered State debt if the revenues supporting the debt are State tax revenues. Examples of capital leases include the St. Mary's County Multi-service Center, the MDOT Headquarters Office Building, and the Prince George's County Justice Center. Debt outstanding for leases is expected to be $295 million at the end of fiscal 2014. Capital lease payments are estimated to be $36 million in fiscal 2014.

The final category of State debt is Stadium Authority debt. Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, the Hippodrome Theater, and the Montgomery County Conference Center. The facilities' debt service is supported by lottery revenues and other general fund sources. Stadium Authority debt outstanding is expected to be $171 million at the end of fiscal 2014. Debt service payments are projected to be $33 million in fiscal 2014.

The University System of Maryland (USM), Morgan State University, and St. Mary's College of Maryland have the authority to issue debt for academic facilities, as well as auxiliary facilities. Unlike the other authorizations, Academic Revenue Bonds are not considered to be State debt; instead, they are a debt of the institutions. Proceeds from academic debt issues are used for facilities that have an education-related function, such as classrooms. Debt service for these bonds is paid with tuition and fee revenues. For fiscal 2013, CDAC recommends $32 million for academic facilities on USM campuses. This is the same level that was recommended in fiscal 2013.

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Capital Budget

Capital Budget Outlook

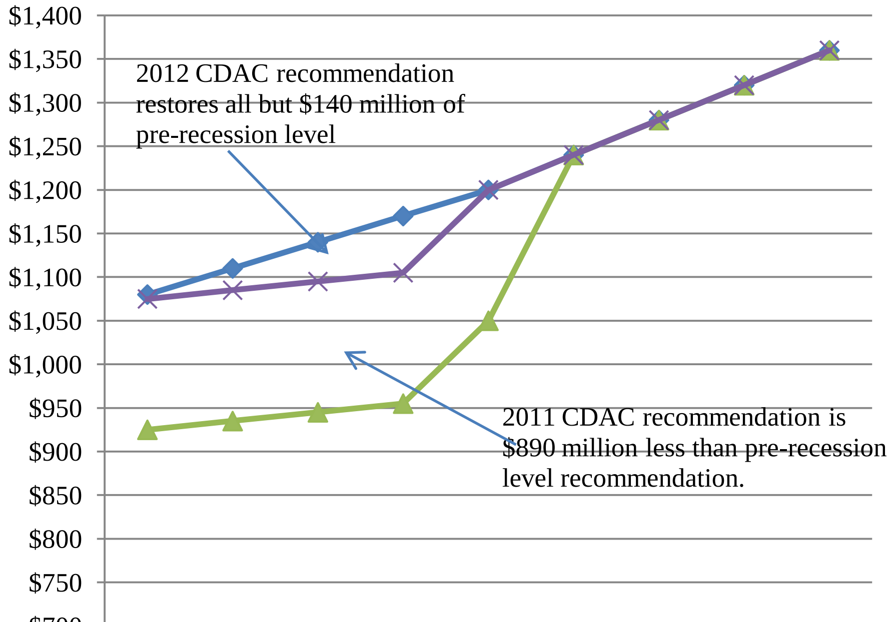
The negative fiscal climate of the past several years reduced the State's debt capacity and resulted in reduced levels of general obligation bond authorizations recommended by the Capital Debt Affordability Committee and programmed into the State's five-year *Capital Improvement Program*. In addition, fiscal pressures led directly to decisions to use some of the State's general obligation bond authorizations to fund capital expenditures normally funded in the operating budget with pay-as-you-go capital appropriations. However, revenue growth in the more recent improved fiscal outlook provides additional debt capacity within the affordability limits.

Citing available debt capacity within the State's affordability limits, increased employment and revenue that additional infrastructure investments would generate, and the need to fund projects accelerated by the General Assembly in the 2012 session, the Capital Debt Affordability Committee (CDAC) voted to increase the amount of new general obligation (GO) bond authorizations through the five-year capital planning period. The CDAC's recommendation would increase annual new GO bond authorizations by $150 million for the 2013 through 2017 sessions, for a total increase of $750 million over what the committee recommended last year. Although increased authorizations could fund capital priorities that otherwise would likely continue to be deferred, consideration may also be given to using the increased authorizations to help with transportation capital needs in the absence of any decisions to increase revenues, such as the gas tax, that typically support transportation infrastructure spending.

Improved Fiscal Climate – Increased Levels of GO Bond Authorizations Recommended

The CDAC's recommendation not only increases the level of new GO bond authorizations in excess of last year's recommendation but also almost restores GO bond authorizations to levels previously recommended by the committee and programmed in the State's five-year *Capital Improvement Program* prior to the recession-induced write down before the 2010 session. **Exhibit 1** illustrates recent CDAC recommended GO bond authorization levels. Were the committee's 2011 recommendation carried forward to 2012, authorization levels would be $890 million less over the next five fiscal years relative to the committee's September 2010 recommendation. However, shortly after CDAC made its September 2010 recommendation, it became increasingly apparent that the negative fiscal and economic climate was pushing the State to within and above the affordability limits, and consequently, the

Exhibit 1
Effect of New Policy on General Obligation Bond Authorizations
2014-2022 Legislative Sessions
($ in Millions)



	2014	2015	2016	2017	2018	2019	2020	2021	2022
Sept 2009 Recommendation	$1,080	$1,110	$1,140	$1,170	$1,200	$1,240	$1,280	$1,320	$1,360
Dec 2011 Recommendation	$925	$935	$945	$955	$1,050	$1,240	$1,280	$1,320	$1,360
Dec 2012 Recommendation	$1,075	$1,085	$1,095	$1,105	$1,200	$1,240	$1,280	$1,320	$1,360

CDAC: Capital Debt Affordability Committee

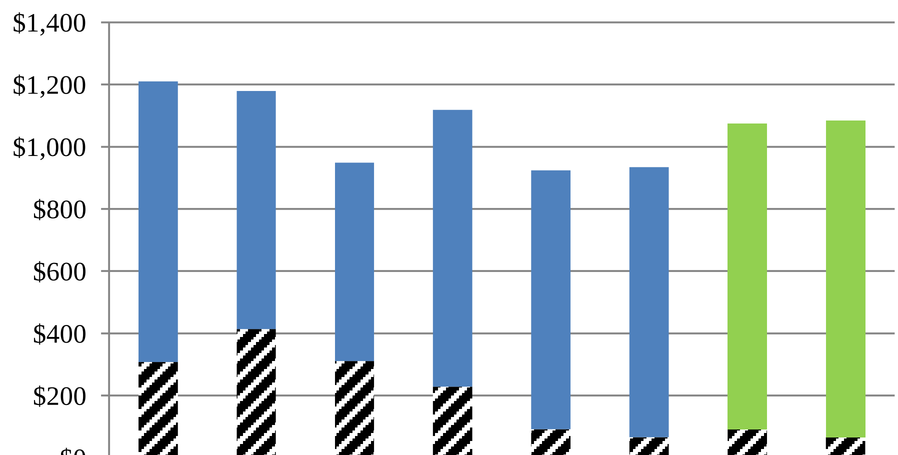
Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, 2009, 2011, and 2012

committee revised downward, its recommendation for the forecast period which is reflected in the lower 2011 recommended levels. With an improved economic forecast, the CDAC's 2012 recommendation essentially restores authorization levels almost to pre-recession levels – falling just $140 million short of what was recommended by the committee in September 2009 prior to the write down. Beginning in the 2018 session, the committee's current long-term forecast sets authorization levels to return to what was forecast by the committee in September 2009 prior to the write down. This is noteworthy because even under the lower authorization levels reflected in the 2010 and 2011 recommendations, the forecast assumed a return to the higher pre-recession authorization levels.

Structural Deficit Likely to Continue to Put Pressure to Use GO Bonds to Assist with the Operating Budget

Although increased GO bond authorizations could help fund capital projects that have been deferred in recent years, an additional consideration is the continued use of some of the authorizations as a means of assisting with the balancing of the operating budget. **Exhibit 2** shows the degree to which GO bonds have been used as a budget balancing instrument. For fiscal 2010 through 2013, approximately $1,262 million, representing 28% of the total GO bond authorizations, has been allocated to replace the transfer of special funds such as the transfer tax and Bay Restoration funds to the general fund. Because the GO bond replacement of prior transfers is scheduled over multiple fiscal years, a portion of the GO authorizations planned for the 2013 and 2014 sessions, $91 million and $66 million, respectively, is already essentially obligated. Although the fiscal climate reflects improvement, it is likely that similar use of GO bond authorizations as an operating budget balancing instrument will be considered as part of the budget solution in the 2013 session.

Exhibit 2
Use of General Obligation Bonds for Operating Budget Relief
Fiscal 2010-2013 Actual and Fiscal 2014-2015 Estimated
($ in Millions)



	2010	2011	2012	2013	2014 Est1	2015 Est1	2014 Est2	2015 Est2
Program Funding	$902.7	$765.4	$637.8	$890.6	$833.1	$869.0	$983.1	$1,019.0
Operating Relief	$308.1	$414.3	$311.3	$228.8	$91.9	$66.0	$91.9	$66.0

Source: Department of Legislative Services, *The 90 Day Report*

Capital Budget

Public-private Partnerships

In Maryland and across the nation, the need to maintain and replace aging infrastructure comes face-to-face with tough budgetary challenges. Public-private partnerships offer an alternative form of financing these projects. Public-private partnerships are long-term agreements in which the public sector assigns to the private sector the right to design, build, finance, operate, and/or maintain an infrastructure asset for a defined period of time per some type of financial arrangement. Although the private sector may finance the project up front, it receives a return on its investment through project revenues or payments from the public sector over the life of the contract.

Attempts to Establish a Public-private Partnership Framework in Maryland

Legislation in the 2010 session (Chapters 640 and 641) represent the State's first attempt at a comprehensive statutory framework for public-private partnerships (P3). Chapters 640 and 641 created a new definition of P3s, created separate titles in the State Finance and Procurement and Transportation articles for P3s, created a legislative notification process for P3 projects, and required debt impact analyses of P3 projects. In addition, Chapters 640 and 641 established the Joint Legislative and Executive Commission on Oversight of Public-private Partnerships. In 2011, the commission conducted an evaluation of how other states and countries have used P3s. In particular, the commission was tasked with making recommendations concerning the appropriate manner of conducting legislative monitoring and oversight of P3s and recommendations concerning the broad policy parameters within which P3s should be negotiated. In January 2012, the commission issued its final report, and in the 2012 legislative session, House Bill 576 and Senate Bill 358 were introduced encompassing the commission's recommendations. Although the bills ultimately failed, similar legislation is expected to be reintroduced during the 2013 session.

Use of Availability Payments Considered

One particular form of a P3 that has garnered attention is the use of availability payments. For P3 projects where project revenues are nonexistent or insufficient to provide an appropriate return on investment, the public sector may make payments directly to the private partner. These payments may take the form of availability payments. P3s utilizing availability payments are currently being considered for two types of projects in Maryland. The first is for the construction of several new transit lines, and the second is the renovation and replacement of schools.

New Transit Lines

Over the past several years, the State has committed significant planning and engineering resources to construct three new transit lines: the Red Line, Purple Line, and Corridor Cities Transitway. However, the Maryland Department of Transportation's (MDOT) *Consolidated Transportation Program* does not show any funding beyond fiscal 2014 for the construction of the transit lines because the State has not yet identified sufficient revenue to pay for its share of the costs. Since federal and State transportation funds are limited, MDOT is exploring several alternative financing methods, including a P3.

School Construction

In June 2012, a report commissioned by the Baltimore City Public Schools found that 50 of Baltimore City's 182 schools are in poor condition or underused and should be closed or rebuilt. The report identified \$2.45 billion in school infrastructure needs over the next 10 years. One method of dealing with the city's funding needs currently under examination by the Interagency Committee on School Construction is through a P3, which could include the use of availability payments. There are, however, several issues that need to be considered in the context of using availability payments to finance school construction projects. Foremost among these issues is whether availability payments would count as State debt, which is currently constrained by debt affordability limits, and a constitutional provision which limits the maturity of State debt to no more than 15 years.

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Revenues and Taxes

Comparative Tax and Revenue Rankings

Based on data compiled by the U.S. Census Bureau, Maryland's overall revenue and spending levels in fiscal 2010 were moderate compared to other states. Maryland remains uniquely reliant on tax revenues, however, with a strong dependence on the income tax.

State and Local Government Revenues and Spending

As reflected in **Exhibit 1**, total State and local government revenues and spending in Maryland are not generally high compared to other states. When comparing all states and the District of Columbia using fiscal 2010 data, Maryland ranks twentieth and nineteenth, respectively, in total state and local government revenues and spending measured on a per-capita basis and forty-ninth and forty-eighth, respectively, in revenues and spending as a percentage of personal income of residents. However, Maryland relies more on tax revenues and less on nontax revenue sources than most states.

Exhibit 1
Maryland State and Local Government
Revenues and Spending
2009-2010

	Maryland Rank Percent of Total	Maryland Rank Per Capita	Maryland Rank Percentage of Personal Income
Total Revenues	n/a	20	49
Total Spending	n/a	19	48
Revenues			
Taxes	3	9	27
Intergovernmental from Federal Government	31	29	44
Charges and Utilities[1]	45	47	50
Miscellaneous[2]	45	39	50

[1]Charges include higher education tuition fees, and auxiliary revenues; public hospital revenues; sewer and trash collection; highway tolls; and other user charges and fees. Utilities include gross receipts of publicly owned utilities (water, gas, electric, and transit).

[2]Miscellaneous revenues include interest earnings, net lottery revenues, liquor store revenues, rents, royalties, fines and forfeitures, special assessments, sale of property, and other.

Note: For the rankings, 1 indicates the highest and 51 the lowest.

Source: Annual Survey of State & Local Government Finance, U.S. Census Bureau (September 2012); Population from the U.S. Census Bureau (December 2011); Personal income data from the U.S. Bureau of Economic Analysis (September 2012)

State and Local Tax Revenues Compared to Neighboring States

Exhibits 2 and **3** compare Maryland's State and local tax revenues in fiscal 2010 to other states in the region. Maryland's reliance on the income tax is high (third on both a percentage of income basis and a per-capita basis) compared to other states, primarily reflecting the statewide local income tax. Maryland ranks twenty-seventh among all states in overall state and local tax revenues as a percentage of personal income and ninth in overall tax revenues on a per-capita basis. Generally, Maryland ranks in the bottom half of all states with respect to property taxes and sales taxes measured on a percentage of income basis. Maryland ranks eighteenth in property taxes, ninth for corporate income taxes, and fortieth on sales taxes measured on a per-capita basis. These comparisons only incorporate the impact of changes made to taxes in Maryland and other states through fiscal 2010.

Exhibit 2
Maryland State and Local Tax Revenues
2009-2010 Tax Revenue as a Percentage of Personal Income
Comparison to Selected States

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes [1]	License Fees	Other Taxes [2]	All Taxes
Delaware							
Percent	1.9%	2.6%	0.4%	1.3%	3.6%	0.3%	10.1%
Rank	48	17	8	50	1	15	24
District of Columbia							
Percent	4.3%	2.6%	0.8%	3.2%	0.3%	0.6%	11.7%
Rank	11	16	4	38	49	8	8
Maryland							
Percent	**3.0%**	**3.6%**	**0.3%**	**2.4%**	**0.3%**	**0.4%**	**10.0%**
Rank	**33**	**3**	**21**	**44**	**44**	**12**	**27**
New Jersey							
Percent	5.6%	2.3%	0.5%	2.6%	0.4%	0.2%	11.5%
Rank	3	23	7	43	40	19	9
North Carolina							
Percent	2.6%	2.8%	0.4%	3.6%	0.5%	0.1%	9.9%
Rank	39	10	13	24	26	47	29
Pennsylvania							
Percent	3.1%	2.6%	0.4%	3.2%	0.6%	0.3%	10.2%
Rank	32	14	14	36	14	13	22
Virginia							
Percent	3.2%	2.4%	0.2%	2.3%	0.4%	0.2%	8.8%
Rank	28	19	33	45	32	24	44
West Virginia							
Percent	2.3%	2.6%	0.4%	4.1%	0.5%	1.0%	11.0%
Rank	43	15	11	12	21	4	12
United States Average	**3.6%**	**2.1%**	**0.3%**	**3.5%**	**0.5%**	**0.2%**	**10.3%**

[1]Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and others.

[2]Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47).

Source: Annual Survey of State & Local Government Finance, U.S. Census Bureau (September 2012); Population from the U.S. Census Bureau (December 2011); Personal income data from the U.S. Bureau of Economic Analysis (September 2012)

Exhibit 3
Maryland State and Local Tax Revenues
2009-2010 Tax Revenues Per Capita
Comparison to Selected States

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes [1]	License Fees	Other Taxes [2]	All Taxes
Delaware							
Amount	$739	$1,008	$163	$526	$1,424	$118	$3,979
Rank	46	15	8	50	1	16	22
District of Columbia							
Amount	$3,073	$1,830	$543	$2,248	$182	$438	$8,315
Rank	1	2	2	3	31	4	2
Maryland							
Amount	**$1,460**	**$1,729**	**$154**	**$1,182**	**$155**	**$171**	**$4,851**
Rank	**18**	**3**	**9**	**40**	**38**	**11**	**9**
New Jersey							
Amount	$2,812	$1,173	$233	$1,300	$187	$102	$5,807
Rank	2	9	7	30	28	17	6
North Carolina							
Amount	$897	$955	$135	$1,231	$184	$19	$3,421
Rank	39	18	16	36	30	47	35
Pennsylvania							
Amount	$1,258	$1,051	$152	$1,293	$251	$138	$4,144
Rank	28	12	10	31	12	13	18
Virginia							
Amount	$1,401	$1,079	$98	$1,029	$197	$80	$3,885
Rank	22	11	27	44	24	22	25
West Virginia							
Amount	$744	$821	$128	$1,309	$173	$316	$3,490
Rank	45	24	20	29	32	6	33
United States Average	**$1,428**	**$842**	**$139**	**$1,394**	**$208**	**$94**	**$4,105**

[1]Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premiums taxes, public utility gross receipts taxes, and others.

[2]Includes death and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47).

Source: Annual Survey of State & Local Government Finance, U.S. Census Bureau (September 2012); Population from the U.S. Census Bureau (December 2011); Personal income data from the U.S. Bureau of Economic Analysis (September 2012)

Revenues and Taxes

Video Lottery Terminals and Table Games – Overview

Video lottery terminal (VLT) facilities in Anne Arundel, Cecil, and Worcester counties are currently operating, with the facilities in Allegany County and Baltimore City scheduled to open in 2013 and 2014, respectively. Senate Bill 1 of the second special session of 2012 made numerous changes to the State's gaming program including authorizing a sixth VLT license in Prince George's County and table games at VLT facilities, subject to voter approval (Question 7). On November 6, 2012, the voters of Maryland approved Question 7 by a 52% to 48% margin.

Award of Video Lottery Operation Licenses and Operation of Video Lottery Terminals

The Video Lottery Facility Location Commission (Location Commission) has awarded video lottery operation licenses for the five video lottery terminal (VLT) facility locations in Baltimore City and Allegany, Anne Arundel, Cecil, and Worcester counties, as authorized by the voters by constitutional amendment in 2008.

Cecil County

Penn Cecil Maryland Inc. (Penn Cecil) was awarded a license to operate a VLT facility with 1,500 VLTs in Perryville in Cecil County. The facility opened to the public with 1,500 VLTs on September 27, 2010. Penn Cecil has generated $87.2 million in gross gaming revenues in calendar 2012, as of October 31, 2012.

Worcester County

Ocean Enterprise 589, LLC (Ocean Downs) was awarded a license to operate a facility with 800 VLTs at Ocean Downs Racetrack in Worcester County. The facility opened with 750 VLTs on January 4, 2011, and has now placed into operation its full complement of 800 VLTs. Ocean Downs has generated $43.3 million in gross gaming revenues in calendar 2012, as of October 31, 2012.

Anne Arundel County

PPE Casino Resorts, LLC was awarded a license to operate a facility with 4,750 VLTs adjacent to the Arundel Mills Mall in Anne Arundel County. In June 2012, the Maryland Live! facility opened with 3,171 VLTs. As of October 2012, the facility has placed into operation its full complement of 4,750 VLTs. The Maryland Live! facility has generated $159 million in gross gaming revenues as of October 31, 2012.

Allegany County

On April 26, 2012, Evitts Resort, LLC (Evitts) was awarded a video lottery operation license to own and operate a video lottery facility adjacent to the Rocky Gap Lodge and Resort, subject to certain contingencies. However, Evitts, unable to secure the requisite construction financing for the facility, was subsequently granted approval from the Location Commission to instead operate a facility with 500 VLTs in the lodge's existing conference center space, again subject to certain contingencies. That facility is currently scheduled to open in spring 2013.

Baltimore City

On July 31, 2012, the Location Commission awarded the Baltimore City video lottery operation license to CBAC Gaming, LLC for a facility with 3,750 VLTs, subject to certain contingencies. That facility is currently scheduled to open in the second quarter of 2014.

Senate Bill 1 of the Second Special Session of 2012

During a special legislative session in August 2012, the General Assembly passed comprehensive gaming legislation (Senate Bill 1) that included various provisions subject to voter approval by referendum at the November 2012 general election (Question 7). On November 6, 2012, the voters of Maryland approved Question 7 by a 52% to 48% margin. The Department of Legislative Services estimates that the various provisions of Senate Bill 1 related to VLTs and table games will increase Education Trust Fund (ETF) revenues by $175 million in fiscal 2017 and $199 million in fiscal 2019.

Provisions Related to a VLT Facility in Prince George's County

With approval of Question 7, the Location Commission is authorized to award a license for a video lottery facility in Prince George's County within a geographic radius that includes both National Harbor and Rosecroft Raceway. Under the legislation, an applicant for the Prince George's County license may request to operate a maximum of 3,000 VLTs and receive up to 38% of VLT proceeds.

Upon the issuance of a Prince George's County video lottery operation license, the Anne Arundel County and Baltimore City licensees would receive an additional 8% and 7% of VLT revenues, respectively, for certain marketing and capital improvement allowances. Furthermore, if a license is awarded in Prince George's County, Senate Bill 1 reduces the percentage of VLT revenues distributed to the Purse Dedication Account for horse racing purses and bred funds from 7% to 6%.

Table Games at Video Lottery Facilities

With approval of Question 7, video lottery operation licensees will be permitted to offer table games. Prior to the issuance of a Prince George's County video lottery operation license, 80% of table game revenues will be distributed to licensees, and the State's ETF will receive the remaining 20% of table game revenues. After a Prince George's County license is issued, the 20% distribution to the ETF will be reduced to 15%, and 5% of table game revenues will be distributed to the local jurisdictions where VLT facilities are located.

Maximum Number of VLTs Statewide and Facility Hours of Operation

With approval of Question 7, the authorized maximum number of VLTs in the State is increased from 15,000 to 16,500, and video lottery facilities may operate 24 hours per day, seven days a week.

Procurement of VLTs

Prior to enactment of Senate Bill 1, VLTs and associated equipment and software were owned or leased by the State. Under Senate Bill 1, the Baltimore City and Prince George's County licensees will be required to purchase or lease VLTs and related equipment at their respective facilities. Upon the expiration of the State's master contract with VLT manufacturers in March 2015, the licensees in Anne Arundel and Cecil counties will also be responsible for procuring their own VLTs. However, the State will continue to own and/or lease machines for the facilities in Allegany and Worcester counties, unless either licensee requests to procure its own VLTs.

Allegany and Worcester Counties – Distribution of VLT Licensee Proceeds

Prior to Senate Bill 1, distributions to video lottery operation licensees (except for the Allegany County licensee), could not exceed 33% of VLT revenues. The Allegany County licensee received 50% of VLT proceeds, which was subsequently reduced to 33% after 10 years of operations. Senate Bill 1 increases the Allegany County licensee's share of VLT revenues after 10 years of operations from 33% to 43%, subject to meeting certain annual capital investment requirements.

Under Senate Bill 1, the Worcester County licensee will receive 43% of revenues generated at that facility beginning in fiscal 2014, subject to meeting certain annual capital improvement requirements.

State Lottery and Gaming Control Commission

Senate Bill 1 reconstitutes the nine-member State Lottery Commission as a seven-member State Lottery and Gaming Control Commission (SLGCC). The SLGCC will generally perform functions formerly carried out by the State Lottery Commission as well as new functions specific to gaming including additional regulatory and research responsibilities.

Instant Ticket Lottery Machines for Certain Veterans Organizations

Senate Bill 1 authorizes the SLGCC to issue certain veterans' organizations a license for up to five instant ticket lottery (pull tab) machines. Veterans' organizations in Eastern Shore counties and in Montgomery County are not eligible; however, certain Eastern Shore nonprofit organizations are currently allowed to operate up to five slot machines, provided that at least half of the proceeds are distributed to charity.

Gaming in Surrounding States

Delaware

Three racetrack facilities with slightly more than 6,600 VLTs are operating in Delaware. In early 2010, Delaware authorized table games for the state's three existing VLT racetrack facilities – Delaware Park, Dover Downs, and Harrington Raceway. Facing increased competition in the Philadelphia region along with the recent opening of Maryland Live! in Anne Arundel County, Delaware's fiscal 2012 VLT revenues declined 5.4% from the prior year while table game revenues declined a modest 0.5%. In its most recent annual report, Dover Downs notes that increased regional competition, particularly from Maryland Live!, will significantly impact the casino's visitation numbers and profitability. Dover Downs estimates that approximately 42.0% of the casino's total gaming proceeds come from Maryland patrons.

Facing declining gaming revenues and increased competition among neighboring states, Delaware passed legislation that legalizes online casino gaming and lottery sales for individuals within the state beginning in 2013. The Delaware Gaming Competitiveness Act of 2012 hopes to take advantage of recent interpretations of federal law that suggest that states are no longer prohibited from offering online gaming products, provided such activities comply with state law.

Pennsylvania

There are 11 racetrack and nontrack facilities with approximately 26,800 VLTs operating in Pennsylvania. Under legislation passed in January 2010, most VLT facilities in Pennsylvania are authorized to have up to 250 table games. In fiscal 2012, Pennsylvania's 11 licensed facilities operated a total of 1,035 table games that generated $665.4 million in total revenue, an average of $642,944 per table game. With the opening of the Valley Forge Casino Resort as Pennsylvania's eleventh licensed facility, Pennsylvania's fiscal 2012 table game revenues increased $157.2 million from the prior year, a year-over-year increase of 31%. Fiscal 2012 VLT revenues also increased 5.6% to $2.47 billion, while the average win-per-day per VLT increased slightly from $253 in fiscal 2011 to $255 in fiscal 2012.

West Virginia

There are five facilities with approximately 8,500 VLTs operating in West Virginia. Limited numbers of VLTs are also available at licensed West Virginia bars, clubs, and fraternal organizations (limited video lottery). In fiscal 2012, 7,531 of the 9,000 authorized limited VLTs were operating at 1,542 licensed locations throughout West Virginia, generating over $400 million in annual revenue.

In 2007, West Virginia authorized the state's four existing VLT racetrack facilities to offer table games, subject to voter approval via local referendum. The Greenbrier Resort became the state's fifth VLT location with table games in 2009. West Virginia's fiscal 2012 table game revenues increased $28.5 million from the prior year, a 14.2% year-over-year increase, while fiscal 2012 VLT revenues increased by 4.9%. Moderate growth in the West Virginia gaming market over the past year is largely attributable to increased fiscal 2012 VLT and table game revenues at the Hollywood Casino at Charles Town. That facility generated $160.2 million in annual table game revenues – a 23.5% increase from fiscal 2011 – and accounted for approximately 71.0% of the total table game revenue generated throughout the state. Charles Town's fiscal 2012 VLT revenues totaled $409.3 million – a 3.1% increase over the prior year – and approximately 53.0% of statewide VLT total revenue.

Revenues and Taxes

Online Gaming

In 2011, the U.S. Department of Justice determined that federal law did not prohibit states from offering casino or lottery games online to customers within a state's borders. In light of this opinion, several states, including Delaware, are moving forward with or considering online gaming programs. The Maryland Lottery is currently working on a program to sell traditional lottery games online to customers within the State.

Recent Federal Developments

In 2009, officials from the New York State Lottery and the Illinois Governor's Office sought clarification from the U.S. Department of Justice (DOJ) regarding their proposals to establish Internet-based lottery sales platforms using out-of-state transaction processors and whether their respective in-state Internet lottery programs would violate the Interstate Wire Act of 1961 (Wire Act) and the Unlawful Internet Gambling Enforcement Act (UIGEA). New York's proposal involved the sale of virtual lottery tickets to adults that would be delivered over the Internet to computers or mobile phones within the state. Illinois sought to implement a similar pilot program to sell lottery tickets over the Internet with intrastate sales restricted by geo-location technology.

In a September 2011 memorandum opinion, DOJ determined that the Wire Act's prohibitions, which had been previously cited to declare online gaming illegal in the United States, only apply to sports-related gambling activities in interstate and foreign commerce. Specifically, DOJ ascertained that interstate transmissions of wire communications that do not relate to a sporting event fall outside the reach of the Wire Act. Because the New York and Illinois proposals did not involve wagering on sporting events or contests, DOJ determined that the proposals are not prohibited by the Wire Act. The recent DOJ interpretation of the Wire Act, combined with specific exemptions in the federal UIGEA, provides for Internet "bets or wagers initiated and received or otherwise made exclusively in a single state...when placed in accordance with the laws of such state."

Gaming Developments at the State Level

According to the National Conference of State Legislatures, at least seven states have introduced legislation authorizing online gaming and lotteries in light of the DOJ ruling. In 2011, Nevada became the first state to enact legislation authorizing online casino gaming. In June 2012, the Nevada Gaming Commission issued its first licenses for online wagering and licensed two companies to test interactive gaming equipment for the state. Nevada's online gaming regulations require licensees to prove that their systems are capable of identifying players by location and that players are of legal age (21 and over). Companies must also safeguard against money laundering, problem gambling, and player collusion.

In June 2012, Delaware became the second state to approve online gaming when Governor Jack A. Markell signed the Delaware Gaming Competitiveness Act of 2012. Beginning in 2013, the Delaware Lottery may sell electronic versions of traditional lottery ticket games online to individuals 18 years of age and older that are physically located within the state. Under the Act, Delaware's existing video lottery licensees may also establish branded websites or networks to offer online casino gaming to individuals 21 years of age and older who are physically present in Delaware. The Act requires the Delaware Lottery to utilize appropriate technology to ensure that players are legally eligible to engage in Internet gaming. The Delaware Lottery must promulgate regulations that provide for the secure and effective administration of Internet gaming, including the type, number, payout, wagering limits, and rules of Internet lottery games.

In 2011, Virginia enacted legislation that makes illegal the sale of Internet access for the primary purpose of gambling. In Maryland, Chapter 603 of 2012 similarly altered the definition of an illegal slot machine to specify that the illegality of a machine, apparatus, or device is determined regardless of whether it delivers a game through the Internet or offers Internet or other services. Such changes to states' laws particularly target so-called "sweepstakes cafes" featuring machines that tend to mimic slot machines and are offered for use to those who purchase Internet time.

Online Sales of Maryland Lottery Games

In a September 2012 report required by the General Assembly, the Maryland State Lottery Agency (State Lottery) outlined its objective to provide an e-commerce platform, or "iLottery," to allow for the purchase of traditional lottery games through personal computers and mobile devices. As the report indicates, Minnesota, New York, and North Dakota offer the purchase of lottery subscriptions via their websites, and Illinois offers both subscription and same-day online purchase of traditional lottery games.

Under the proposal, customers would sign up for an account, fund their "digital wallet," and browse and purchase same-day games and subscriptions. The iLottery would also allow account holders to track their transactions and play history, as well as claim winnings online. The State Lottery envisions offering draw games (such as Pick 3 and Mega Millions), monitor games (such as Keno and Racetrax), and electronic instant tickets, some of which would mimic traditional scratch-off tickets.

The State Lottery indicates that it would employ secure software to verify the age of online lottery players (18 and over) as well as their presence within Maryland and would also adopt practices aimed at assuring that individuals using iLottery features comply with relevant rules and regulations. In the report, the State Lottery also expresses a commitment to promoting responsible gaming through its iLottery option, including access to voluntary exclusion resources and the ability for an individual to customize time and/or spending limits.

The report briefly outlines plans to integrate iLottery sales with traditional brick-and-mortar retail sales. Preventing substantial losses for traditional lottery retailers, providing secure and accurate verification systems, and marketing online sales are among the challenges that would be presented by pursuing an iLottery program. Although the State Lottery has sufficient statutory and regulatory authority to proceed with iLottery, there may be further discussion of the subject during the 2013 session.

Revenues and Taxes

Sales Tax – Online Sales and Sales of Digital Products

States are limited in their authority to require remote sellers to collect sales and use taxes from online sales. As a result, the expansion of electronic commerce in recent years has resulted in an erosion of the sales and use tax base in Maryland and other states. While a number of states have made efforts to require remote sellers to collect these taxes, and also to impose the sales tax on digital products, several federal legislative measures are pending to explicitly authorize states to require the collection of sales taxes on online sales or to limit the authority of states to tax digital products.

Background

Pursuant to past U.S. Supreme Court rulings, most notably in the 1992 case *Quill Corp. v. North Dakota*, Internet and mail-order retailers were only required to collect sales tax from purchases made by out-of-state customers if the retailer maintained a physical presence (*e.g.*, a store, office, or warehouse) in the customer's home state. When a remote seller is not required to collect the sales tax, the customer is ultimately responsible for paying the use tax on the purchase. However, the rate of customer use tax compliance is very low and the tax is difficult to enforce. As the magnitude of online purchases has grown significantly, the inability of state and local jurisdictions to require remote sellers to collect sales tax has led to an erosion of state and local sales and use tax bases and also created an unlevel playing field for "brick and mortar" businesses. According to the Comptroller, Maryland lost an estimated $200 million in sales and use tax revenues from remote sales in 2010.

In addition, the expansion of the digital goods market, which includes computer software, music, videos, or other electronic files, has further eroded the State's sales and use tax base. Digital goods are generally not taxable in Maryland if they are downloaded online. The Comptroller estimates that the Maryland market for sales of digital goods will approach $200 million in 2013.

Online Sales

Streamlined Sales and Use Tax Agreement

The primary objection to requiring remote sellers to collect sales taxes is the complexity of collecting the tax in a vast number of taxing jurisdictions throughout the country. There are thousands of state and local taxing jurisdictions with different sets of definitions, tax rates, and administrative practices. The Streamlined Sales and Use Tax Agreement (SSUTA) was created in an effort to simplify and modernize sales and use tax collection, and thus overcome the burden on remote sellers to collect and remit taxes from remote sales. Twenty-four states have passed legislation that conforms to the SSUTA, although Maryland is not one of those states. The agreement simplifies sales and use tax collection amongst other provisions, uniform product definitions, and centralized administration of tax collections.

In the Quill decision, the U.S. Supreme Court ruled that the U.S. Congress could pass legislation to expressly authorize states to require remote sellers to collect the sales tax on online sales. Under existing State law, Maryland will adopt the agreement if the authority to require remote sellers to collect taxes on remote sales is provided by federal law.

Federal Legislation

The Marketplace Equity Act, the Marketplace Fairness Act, and the Main Street Fairness Act have recently been introduced at the federal level to authorize states to extend sales and use tax collection responsibility to certain remote sellers.

Marketplace Equity Act

The Marketplace Equity Act (H.R. 3179) would authorize states to require sellers who do not meet a state's small seller exception to collect and remit sales taxes on sales to in-state customers without regard to the seller's location. The Act requires states to implement a simplified system for the administration of a remote seller's sales and use tax collection responsibilities. A state would be required to have a single statewide blended rate that includes the state rate and local rates, a maximum state rate (exclusive of tax imposed by local jurisdictions), or a destination rate, which would be the sum of the state rate and the local rate into which the sale is made. Remote sellers with gross annual receipts nationwide not exceeding $1 million, or not exceeding $100,000 in the state, would be exempt from collection responsibilities.

Marketplace Fairness Act

The Marketplace Fairness Act (S. 1832) would authorize SSUTA full-member states and states that meet a separate set of simplification requirements to require sales tax collection by remote sellers. The alternative simplification requirements stipulate that, among other provisions, a state must provide a single state-level agency to administer all sales and use tax laws and a uniform sales and use tax base among the state and its local taxing jurisdictions. A remote seller with annual gross receipts from total remote national sales of $500,000 or less in the preceding calendar year would be considered a small seller and, therefore, be exempt from collection responsibilities.

Main Street Fairness Act

The Main Street Fairness Act would authorize SSUTA member states to require sellers, other than sellers that qualify for a small seller exception, to charge and remit sales tax on sales to customers in those member states. The authority is subject to meeting certain required thresholds, specific operational aspects, and minimal simplification requirements. The small seller exception exempts businesses with less than a certain amount in national remote sales revenue from the collection requirements. The governing board of the SSUTA would determine the small seller exception threshold.

Potential Revenue Impacts on Maryland

In a study published in November 2011, the Comptroller reviewed the potential State revenue impacts of the Marketplace Equity Act and the Main Street Fairness Act. The study estimated that Maryland's sales tax revenue would have increased by $173 million in fiscal 2013 if Congress adopted the Marketplace Equity Act. Revenues gained from collection of the sales tax by remote sellers would be somewhat offset by other changes required in State law to comply with the Act, most notably the repeal of the increase in the sales tax on alcoholic beverages enacted in 2011.

If the Main Street Fairness Act were enacted, the Comptroller estimated that State sales tax revenues would have increased by $123 million in fiscal 2013. Revenues gained would again be somewhat offset by other changes required in State law to comply, including the repeal of the increase in the sales tax on alcoholic beverages and other changes required to conform with the SSUTA.

Laws and Legislation in Maryland and Other States

The *CCH Multistate Tax Guide* indicates that 20 out of 46 states with a state sales tax, including the District of Columbia, may create nexus for an out-of-state seller that uses a website to make sales to a state's residents. A handful of states, including New York and California, have enacted legislation which defines "nexus" and "affiliate" in a manner that out-of-state remote vendors may legally become taxable without having a physical presence within a state. Other states have required remote sellers to report transactions with those states' residents in order to minimize use tax compliance costs or attempted to improve use tax collection and compliance efforts.

Legislation has been introduced in Maryland in recent years, most recently in the Budget Reconciliation and Financing Act of 2012, that would require the collection of sales and use taxes by a remote seller based on an affiliate relationship in the State. If affiliate-nexus legislation were enacted in Maryland, it is estimated that revenues could increase annually by $20 million.

Digital Products

Federal Legislation

The Digital Goods and Services Tax Fairness Act (S. 971/H.R. 1860) is being considered by the 112th Congress. The Act would prohibit states and local jurisdictions from imposing taxes on the sales or use of certain digital goods or services delivered electronically to a customer. Additionally, it prohibits state and local jurisdictions from taxing revenues generated by businesses that take and fulfill orders for, provide billing services for, or deliver digital goods and services on behalf of sellers of digital products or services. The legislation defines a digital product as a product that is obtained electronically by the buyer and delivered by means other than tangible storage media through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities. The Congressional Budget Office estimates that the bill would reduce total state and local sales tax revenues on all goods and services by a magnitude of between 1% and 2% in 2013.

Laws and Legislation in Maryland and Other States

The *CCH Multistate Tax Guide* indicates that 33 of the 46 states with a state sales tax, as well as the District of Columbia, tax downloaded computer software. In addition, 23 states and the District of Columbia impose sales taxes on the sale of digital books, music, movies, or software.

A provision of the Budget Reconciliation and Financing Act of 2012 would have imposed the State sales tax on sales of digital products in the State. If a 6% sales tax were imposed on digital products, revenues could increase by approximately $6 million annually.

State Retirement and Pension System Investment Performance and Contribution Rates

The pension fund's fiscal 2012 return on investments was 0.4%. This is the first time in three years that the system did not realize its targeted return. The system's asset valuation policy smoothes gains and losses over five years. Consequently, the plan recognizes only a small portion of the gains. The plan's funded status declined to 64.4%, compared to 64.7% at the end of fiscal 2011. To improve the system's funded status, the legislature adopted pension reform in the 2011 session. Savings generated from the reform have been reinvested in the pension system to improve its funded status.

European Debt Crisis and Weak United States Recovery Hold Down Investment Performance

The State Retirement and Pension System's (SRPS) investment return for the year ended June 30, 2012, was 0.36%, the first time in three years that investment returns did not achieve the system's 7.75% investment return target. The weak performance was driven primarily by weak performance of both domestic and international equities. The system's public equity holdings, which made up slightly more than 40.0% of the portfolio, returned -6.78% for the year. Fixed income holdings, which made up almost one-fifth of the system's holdings, maintained strong returns in a low-yield environment, earning 8.25% for the year. The fund's real estate and private equity holdings continued a modest recovery from the financial crisis of fiscal 2008, returning 8.73% and 7.49%, respectively. In total, the plan slightly outperformed its policy benchmark by eight basis points; all returns are net of fees.

The System's Financial Condition Remains Largely Unchanged, but Should Improve

The SRPS's funded status (the ratio of projected actuarial assets to projected actuarial liabilities) was largely unchanged, dropping slightly from 64.7% at the end of fiscal 2011 to 64.4% at the end of fiscal 2012. Total system liabilities were $53.7 billion, with an unfunded liability of $19.6 billion; the State's share of the unfunded liability (not including municipal governments) is $18.6 billion.

The funded status continues to reflect the staggered recognition of substantial investment losses in fiscal 2008 and 2009, which hold down the actuarial value of assets. However, benefit and funding reforms passed during the 2011 session, as well as the prospect of stronger investment returns as the economy continues to recover, should be reflected in an improved funded status. Moreover, the recognition of past investment losses will end with the fiscal 2013 valuation. Under current policies, the fund is still expected to reach an 80% funded ratio by fiscal 2023.

Funding Reforms and Actuarial Assumption Changes Prompt Increased Contributions

Exhibit 1 shows that the employer contribution rate for teachers will increase from 15.3% in fiscal 2013 to 17.94% in fiscal 2014, and the contribution rate for State employees will increase from 14.05% in fiscal 2013 to 16.84% in fiscal 2014. The aggregate State contribution rate, including contributions for public safety employees and judges, increases from 15.8% in fiscal 2013 to 18.54% in fiscal 2014. Based on projected payroll growth and other factors, the SRPS actuary estimates that total State pension contributions will increase by $203 million (13.1%), from $1.55 billion in fiscal 2013 to $1.75 billion in fiscal 2014.

Exhibit 1
State Pension Contribution Rates
Fiscal 2013 and 2014

	2013		2014	
Plan	**Rate (%)**	**$ in Millions**	**Rate (%)[1]**	**$ in Millions**
Teachers	15.30	$982	17.94	$1,129
Employees	14.05	447	16.84	532
State Police	64.57	51	71.95	59
Judges	61.18	25	50.73	21
Law Enforcement Officers	50.14	44	57.72	51
Aggregate	**15.80**	**$1,549**	**18.54**	**$1,752**

[1]Fiscal 2014 contribution rates are pending final certification by the State Retirement and Pension System's Board of Trustees; the rates exhibited are those recommended by the board's actuary.

Note: Contribution rates and dollar amounts reflect State funds only, excluding municipal contributions. They also reflect the required reinvestment of savings generated by the 2011 pension benefit reforms.

Source: Gabriel, Roeder, Smith & Co.

The single biggest reason for the increase in contribution rates and dollar contributions to the pension fund is the statutory requirement that savings generated by the 2011 pension benefit reforms (Chapter 397) be reinvested in the pension system to improve its funded status. In accordance with Chapter 397, $120.0 million of the savings was retained for budgetary relief in fiscal 2012 and 2013, with the remainder being reinvested in the pension fund. Beginning in fiscal 2014, however, the amount of the reinvestment is fixed at $300.0 million. After accounting for budgetary savings in fiscal 2013, the reinvestment totaled $191.4 million. The increase of $108.6 million in reinvested savings (the difference between $191.4 million and $300.0 million) accounts for more than half of the year-over-year increase in State pension payments.

The second biggest factor contributing to the increase in State contributions to the pension fund was a change in actuarial demographic assumptions adopted by the board in response to the periodic experience study conducted in 2011. State law requires the board to conduct an experience study at least every five years to examine the extent to which actuarial assumptions used to calculate the system's assets and liabilities reflect actual experience. The study found differences between many demographic assumptions used by the board and actual experience, including retirement rates, disability rates, mortality rates, and other similar factors. In spring 2012, the board voted to adopt its actuary's recommendation to adjust those assumptions to better conform to actual experience, and those revised assumptions were first used in the June 30, 2012 actuarial valuation, which determine the contribution rates to be used in fiscal 2014. Combined, these assumption changes added approximately $24.3 million (12% of the total increase) to the State's contribution. Weak investment returns, among other factors, also contributed to the increase, but their effect was less significant than the reinvestment and assumption changes.

Changes to Funding Model May Generate Savings

The 2012 *Joint Chairmen's Report* (JCR) included narrative instructing the Department of Legislative Services (DLS) and the State Retirement Agency (SRA) to develop a joint plan to phase out the corridor funding method and adjust appropriate actuarial funding assumptions in a manner that maintains the goals of the 2011 pension reform. DLS and SRA have been meeting frequently and reviewing analyses by the system's actuary. In accordance with the JCR narrative, they will present a plan to the Joint Committee on Pensions in November 2012 that phases out the corridor, adjusts actuarial assumptions, and generates both short- and long-term savings for the State.

Personnel

State Workforce and Payroll

Since fiscal 2002, the number of State positions has decreased from 81,113 to 79,231. Declines in State agency positions were offset by increases in higher education, judicial, and legislative positions. Personnel costs increased by 49% from fiscal 2002 to 2013. Salary costs increased 36%, budgeted State health care subsidies increased 109%, and retirement contributions increased 175%.

Budgeted Regular Positions

Regular full-time equivalent (FTE) positions are requested by the Administration and authorized by the General Assembly when the State budget is passed. Section 32 of the fiscal 2013 budget bill limits position growth above that level by allowing the Board of Public Works to authorize no more than 100 additional positions during the 2013 fiscal year, outside of exempted provisions for hardship, manpower statutes, block grants, new facilities, and/or emergencies. The total does not include higher education institutions, the Maryland Aviation Administration, and the Maryland Port Administration.

Budget spending limits, position caps restricting growth, attrition, and abolitions prompted by budgetary constraints have decreased the nonhigher education Executive Branch workforce from 55,980 FTE positions in fiscal 2002 to 50,271 in the fiscal 2013 legislative appropriation. Additionally, yet to be included in this tally are these agencies' share of a reduction required by the Budget Reconciliation and Financing Act that instructed Governor Martin J. O'Malley to abolish 64 positions by January 1, 2013. The distribution by agency of these abolitions has yet to be determined, but Executive Branch agencies and higher education institutions will participate in this reduction in workforce.

Exhibit 1 shows that three major agencies represent almost two-thirds of the net decrease: the Department of Human Resources, the Department of Health and Mental Hygiene, and the Maryland Department of Transportation. These reductions, however, have been offset by new positions created in higher education institutions, the Judicial Branch, and legal agencies (primarily, the Office of the Public Defender).

Exhibit 1
Regular Full-time Equivalent Position Changes
Fiscal 2002 Actual to Fiscal 2013 Legislative Appropriation

Department/Service Area	2002 Actual	2013 Legis. Appropriation	2002-2013 Change
Health and Human Services			
Health and Mental Hygiene	8,555	6,446	-2,109
Human Resources	7,364	6,539	-825
Juvenile Services	2,123	2,133	10
Subtotal	***18,041***	***15,118***	***-2,923***
Public Safety			
Public Safety and Correctional Services	11,663	11,050	-612
Police and Fire Marshal	2,590	2,393	-197
Subtotal	***14,252***	***13,443***	***-809***
Transportation	9,538	8,730	-809
Other Executive			
Legal (Excluding Judiciary)	1,364	1,499	135
Executive and Administrative Control	1,603	1,579	-23
Financial and Revenue Administration	2,151	1,973	-178
Budget and Management and Information Technology	517	451	-66
Retirement	194	205	12
General Services	793	576	-217
Natural Resources	1,618	1,296	-323
Agriculture	480	384	-96
Labor, Licensing, and Regulation	1,706	1,650	-56
Maryland State Dept. of Education and Other Education	1,956	1,897	-59
Housing and Community Development	416	317	-99
Business and Economic Development	324	225	-99
Environment	1,028	931	-97
Subtotal	***14,149***	***12,981***	***-1,168***
Executive Branch Subtotal	***55,980***	***50,271***	***-5,709***
Higher Education	21,393	24,727	3,335
Position Reduction*	0	-100	-100
Executive and Higher Education Subtotal	***77,373***	***74,899***	***-2,474***
Judiciary	3,010	3,585	575
Legislature	730	748	18
Grand Total	**81,113**	**79,231**	**-1,881**

*The General Assembly instructed the Governor to abolish 64 positions across the Executive Branch and higher education institutions by January 2013, but the distribution by agency of these positions has yet to be determined.

Note: Numbers may not sum due to rounding.

Source: Department of Budget and Management; Department of Legislative Services

Higher Education

Chapters 239 and 273 of 2004 provide the University System of Maryland (USM) and Morgan State University with autonomy from the General Assembly to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College of Maryland. By the end of October 2012, the fiscal 2013 impact of these laws was the addition of 243 FTE positions to higher education facilities, all of which originated in USM.

Regular Position Compensation Expenditures

The budgeted expenditure for salaries totals $4.69 billion in fiscal 2013, a 35.6% total increase from the actual level of salaries in fiscal 2002, as is shown in **Exhibit 2**. Yet, the cost of fringe benefits continues to grow at a much greater pace than that of salaries. The State subsidy for employee and retiree health insurance was the fringe benefit area posting the largest absolute growth since fiscal 2002, as it has increased by $529.3 million, or 108.8%. Several years of double-digit percent increases on the cost side and the exhaustion of previously held balances caused the majority of this growth.

Exhibit 2
Regular Employee Compensation
Fiscal 2002 Actual to 2013 Legislative Appropriation
($ in Millions)

	2002 Actual	**2013 Leg. Appr.**	**2002 to 2013 $ Change**	**2002 to 2013 % Change**
Earnings				
Salary	$3,458.0	$4,687.5	$1,229.5	35.56%
Other Earnings[1]	113.2	124.4	11.2	9.92%
Earnings Subtotal	***$3,571.1***	***$4,811.9***	***$1,240.7***	
Other Compensation				
Health[2]	$486.7	$1,016.0	$529.3	108.76%
Retirement/Pensions[3]	239.9	659.4	419.5	174.85%
Salary-dependent Fringe[4]	258.6	355.9	97.3	37.64%
Agency-related Fringe[5]	99.5	93.9	-5.6	-5.63%
Other Compensation Subtotal	***$1,084.7***	***$2,125.2***	***$1,040.5***	
Total Compensation	**$4,655.8**	**$6,937.1**	**$2,281.2**	**49.00%**

[1] Overtime and Shift Differentials.
[2] Employee and Retiree Health Insurance.
[3] All Pension/Retirement Systems.
[4] Social Security and Unemployment Compensation.
[5] Other Post Employment Benefits, Deferred Compensation Match, Workers' Compensation, and Tuition Waivers.

Note: Excludes nonbudgeted agencies.

Source: Department of Budget and Management; Department of Legislative Services

Retirement contributions made by the State have grown by 174.9% since fiscal 2002, making it the area of employee compensation with the largest percent increase over the time period. The increase is primarily due to investment losses that raise the required employer contribution level and enhancements enacted in 2006 that raised the benefit multiplier. In light of these accelerating long-term liabilities and their concomitant current expenditure requirements, pension reform enacted in the 2011 session made significant changes to the benefit structure and funding mechanism of the pension system. For more detail on the status of the pension system, see the Pension Performance Issue Paper.

Personnel

Pension Funding

The State Retirement and Pension System is approaching a point where the combined effects of the corridor funding method and prior investment losses are substantially increasing employer contributions. Changes to phase out the corridor funding method, alter the amortization of unfunded liabilities, and update the actuarial assumptions used in determining the State's annual contributions can result in a substantial reduction in the overall cost of the system while maintaining more affordable and sustainable benefits.

Background

During the 2011 interim, the Board of Trustees for the State Retirement and Pension System made a proposal to the Joint Committee on Pensions (JCP) to change the amortization of unfunded pension liabilities and to phase out the corridor funding method. The board indicated that the proposal would significantly reduce the size of employer contributions to the pension system going forward. JCP has been supportive of the board's desire to move away from the corridor funding system, but the high cost of doing so has made any transition prohibitive. However, the new liability outlook provided by the 2011 pension reforms provides an opportunity to rework the funding policy. The 2012 *Joint Chairmen's Report* (JCR) requires that the Department of Legislative Services (DLS) and the State Retirement Agency (SRA) examine the funding method, amortization of unfunded liabilities, and the actuarial assumptions of the State Retirement and Pension System (SRPS).

Elements of System Funding

Corridor Funding Method

Chapter 440 of 2002 enacted a change to the funding of SRPS with respect to the Teachers' Pension System (TPS) and the Employees' Pension System (EPS). The funding method, referred to as corridor, made changes to the way in which the State's contribution rates to TPS and EPS are determined. Under the corridor method, the State contribution rate for those systems remains static as long as the system has a funded status between 90% and 110%; the contribution rate for a given fiscal year is the same rate as it was for the prior fiscal year. When the funded status falls outside the corridor, the contribution rate is not the actuarially determined rate for that fiscal year, but rather the rate used in the prior fiscal year plus 20% of the difference between the actuarial rate and the prior year's rate.

The corridor funding method has the effect of reducing the annual employer contribution for TPS and EPS below the actuarial required rate, though it has mitigated short-term spikes in contribution rates resulting from unprecedented poor market conditions since its enactment. However, the result of the underfunding and severe investment losses of calendar 2008 and 2009 is catching up, resulting in escalating contribution rates for TPS and EPS. Even with the reforms to benefits under Chapter 397 of 2011, the employer contribution is expected to reach just under $4 billion in fiscal 2035 under the present funding structure. By the time the system's funded status hits 80%, the projected contribution is expected to be almost $3 billion in fiscal 2025.

The main obstacle to exiting the corridor methodology has long been the cost. Providing the funds to repay the totals underfunded in the past has been expensive, amounting to nearly hundreds of millions of dollars annually in times of constrained budgetary resources.

Amortization of Unfunded Liabilities

To offset the impact of the switch, the board proposal alters the amortization policy employed by SRPS for its liabilities. Currently, SRPS has two bases that must be amortized: the unfunded liability base extant as of July 2000 and the amount that has emerged in subsequent years. The pre-July 2000 portion is being amortized over a 20-year closed period. The liabilities for all subsequent years are amortized on separate 25-year closed periods, with each year creating a new base. A closed amortization period sums all outstanding liabilities and sets an end date when all the liabilities included in the base must be paid off, including new liabilities generated in each year. The proposal suggested a switch to a new, unified 25-year closed amortization base for all past liability sets, essentially beginning the financing of past obligations anew. This refinancing technique offsets the increased cost of paying a greater share of the actuarially determined rate each year by spreading payments due in the near-term under the current amortization structure across a new 25-year unified base. The savings associated with a change in the amortization make it possible to phase-out the corridor method while also reducing the employer contribution to a more manageable amount.

Actuarial Assumptions

The system's actuarial assumptions create the rule set for how SRPS values its assets and liabilities. These assumptions help determine the amount that the State is required to contribute in each year to meet its obligations. They are also exclusively under the purview of the board, and JCP does not have an opportunity to opine on the merit of alternative assumption levels. At least every five years, the board is required to conduct an actuarial study of the experience of the system and adopt appropriate changes to align the actuarial assumptions with reasonable expectations based on system experience. Changes in the actuarial assumptions have an effect on the employer contribution.

Demographic Assumptions

The demographic assumptions are factors based on what happens to people, such as life expectancy, rates of retirement and disability, and payroll. During the 2012 interim, the board updated its demographic assumptions to reflect the experience over the past four years. This change had the effect of increasing the employer contribution rate.

Economic Assumptions

The economic assumptions are factors based on what happens to money. Over the interim, the board considered making changes to the inflation and investment return assumptions but decided to maintain the current assumptions of 3.0% inflation and an investment return assumption of 7.75%. A reduction in the inflation assumption would result in a decrease in employer contributions, while a reduction in the investment return assumption would result in an increase in employer contributions.

2012 Interim Joint Study

During the 2012 legislative session, the budget committees directed DLS and SRA to conduct a joint study to develop a plan to phase out the corridor funding method and adjust all pertinent actuarial assumptions to improve the financial stability of the system. The JCR requires DLS and SRA to report on the findings of this study to JCP during the 2012 interim.

Based on preliminary assessments, it is anticipated that the study will find that a change to a 25-year amortization schedule, phasing out the corridor funding method over a 10-year period, and changes to the economic assumptions by lowering the assumed inflation rate and investment return assumption would yield significant reductions in employer contribution rates when compared to the current funding structure. Reductions in single-year contribution amounts exceed $1 billion in out-years when compared to the current funding structure. Additionally, such changes would not substantially affect the State's target date for reaching 80% system funding, while preserving current benefit levels.

Education

State Education Aid

State aid for primary and secondary education is expected to increase by approximately $166.8 million in fiscal 2014 to a total of $6.0 billion. Despite the recent enactment of laws constraining State costs for teachers' pensions, retirement costs make up more than half of the projected increase in aid, at an estimated $97.5 million, while aid provided directly to local school boards is expected to increase by 1.4% or $69.3 million. A change in the methodology for calculating net taxable income, which is used to compute local wealth, has been considered by the legislature for several years and would result in further increases to direct State education aid if adopted in the upcoming session.

Education Aid Projected to Increase by $166.8 Million

Public schools are expected to receive an estimated $6.0 billion in fiscal 2014, representing a $166.8 million (2.9%) increase over 2013. Despite recent pension reform and local cost-sharing initiatives, teachers' retirement payments made by the State on behalf of local school boards are expected to increase by $97.5 million, representing 58.4% of the increase. Aid that flows directly to local school boards is projected to grow by $69.3 million (1.4%). The increase in direct aid is driven by an expected rise in the per pupil foundation amount and projected enrollment increases.

Foundation and Most Other Direct Aid Programs Will Increase Slightly

The foundation program is projected to total $2.8 billion in fiscal 2014, an increase of $36.6 million (1.3%) over fiscal 2013, as shown in **Exhibit 1**. The increase is attributable to enrollment growth of an estimated 0.4% (3,400 full-time equivalent students) and a 1.0% increase in the per pupil foundation amount. The Budget Reconciliation and Financing Act (BRFA) of 2010 (Chapter 484) limits increases in the per pupil foundation amount to 1.0% for fiscal 2013 through 2015. Without the 1.0% cap, the per pupil amount would increase by approximately 1.4%.

After the foundation program, in fiscal 2014 the compensatory education and limited English proficiency formulas are projected to have the largest dollar increases among the direct aid programs. A portion of the increase in each program is due to projected enrollment growth, and the rest of the increases can be attributed to the increase in the per pupil foundation amount. The compensatory aid program provides additional funding to local school boards based on enrollment of students eligible for free and reduced-price meals and is expected to reach $1.2 billion in fiscal 2014, representing a $32.2 million (2.8%) increase. The limited English proficiency program provides additional resources based on local counts of English language learners and is expected to increase by $15.7 million (8.8%) to $193.1 million.

Exhibit 1
Estimated State Aid for Education
Fiscal 2013 and 2014
($ in Thousands)

Program	**FY 2013**	**Estimated FY 2014**	**$ Change**	**% Change**
Foundation Program	$2,810,405	$2,847,003	$36,598	1.3%
Geographic Cost Adjustment	128,753	130,541	1,788	1.4%
Supplemental Grant	47,657	46,496	-1,161	-2.4%
Compensatory Ed Program	1,146,261	1,178,442	32,181	2.8%
Special Ed Formula	266,495	270,403	3,908	1.5%
Nonpublic Placements	113,898	116,418	2,520	2.2%
Limited English Proficiency	177,406	193,075	15,669	8.8%
Guaranteed Tax Base	44,206	46,031	1,825	4.1%
Student Transportation	251,329	252,913	1,584	0.6%
Aging Schools	31,109	6,109	-25,000	-80.4%
Other	68,172	67,587	-585	-0.9%
Direct Aid Subtotal	**$5,085,691**	**$5,155,017**	**$69,327**	**1.4%**
Teachers' Retirement	755,545	853,034	97,488	12.9%
Total	**$5,841,236**	**$6,008,051**	**$166,815**	**2.9%**

Offsetting smaller increases in other direct aid programs, the Aging Schools Program is projected to decline by $25.0 million (80.4%). The program provides funds to local school boards for improvements, repairs, and maintenance of public school buildings. Chapter 444 of 2012, the fiscal 2013 capital budget, provides an additional $25.0 million above the $6.1 million statutory minimum for the Aging Schools Program, for a total of $31.1 million. The 2014 baseline budget assumes the $6.1 million funding level for the program and assumes funding in the form of general obligation bonds. The rest of State education aid will be supported with special funds from the Education Trust Fund and State general funds.

Retirement Costs Grow Despite Pension Reforms and Cost-sharing

In an effort to constrain rapidly escalating teachers' retirement costs and reduce the long-term liabilities of the State Retirement and Pension System (SRPS), changes to the State's pension structure have been enacted in each of the last two years. The 2011 BRFA (Chapter 397) altered the benefit structure for teachers and other professional school employees (along with the benefits provided to State employees) by increasing employee contributions to the system and decreasing pensions for employees hired after July 1, 2011. The legislation requires that $300 million of the savings from the reform be reinvested in the system each year beginning in fiscal 2014. Chapter 397 also requires each local school board, along with the community colleges and all State agencies, to share in the administrative costs of the State Retirement Agency (SRA) in proportion to its active membership in SRPS.

Further cost-sharing was approved in the 2012 BRFA (Chapter 1 of the first special session). Chapter 1 phased in school board payments of the annual normal cost over four years. The payments required from each school board for fiscal 2013 through 2016 are specified in the legislation, and county maintenance of effort payments to the school boards increase to help support the cost-sharing initiative. After fiscal 2016, each school board is responsible for paying the actual normal costs associated with its employees.

Despite these cost-saving measures, State retirement payments for public school teachers and other professional personnel continue to grow. The costs will total an estimated $853.0 million in fiscal 2014, representing a $97.5 million increase (12.9%) from the prior fiscal year. This increase is due to an increase in the State contribution rate (from 13.29% to 14.71%), as well as an estimated $68.1 million increase from fiscal 2013 to 2014 in the required reinvestment of pension reform savings. The school salary bases used to calculate the required payments actually decreased 2.0% from $5.7 billion in June 2011 to $5.6 billion in June 2012. In addition to the State's share of teacher pension costs, local school boards will contribute approximately $186.5 million to the payments in fiscal 2014. This represents an increase of $36.8 million over the combined fiscal 2013 local share and includes $173.2 million for the local share of pension contributions and $13.3 million toward SRA administrative costs.

Calculation of Net Taxable Income

The majority of State education aid is distributed through formulas that allocate funding to the 24 local school boards inverse to local wealth per pupil. Local wealth includes net taxable income (NTI) and the assessable property tax base. Under current law, the NTI measure is based on returns filed on or before September 1 of each year. In recent years, a number of proposals have been discussed that would base the NTI calculation on returns filed through November 1, aligning the date with the automatic income tax extension deadline of October 15 (changed from August 15 beginning with tax year 2005). However, using a more complete NTI data set also results in a reallocation of State education aid in which some counties receive more aid and some receive less.

Legislation introduced in prior years has suggested using the November 1 date to capture NTI data for the education aid formulas, a change that, in isolation, would result in an additional $13.3 million in additional direct State aid in fiscal 2014 under current estimates. However, assuming trends from prior years continue, Montgomery and Baltimore counties would each receive less aid than they do with the current September 1 NTI date. In recent years, legislation has been introduced that would require State education aid formulas to be calculated twice, once using an NTI amount based on tax returns filed by September 1 and once using an NTI amount based on tax returns filed by November 1, with each local school board then receiving the greater of the results from the two calculations. A provision that would have had the same impact was included in the version of Senate Bill 892 that was passed by the Senate during the 2012 regular session before ultimately running out of time in the House. If implemented, this methodology would yield an increase of approximately $40 million in education aid annually, and 18 to 20 local school boards would receive additional State aid.

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Education

Maintenance of Effort Law Revised

Chapter 6 of 2012 made significant changes to the State's nearly 30-year-old maintenance of effort (MOE) law, which requires Baltimore City and the 23 counties to maintain funding for their local school boards from one fiscal year to the next. Chapter 6 holds counties accountable for meeting minimum school funding levels, while also enabling some counties to realize additional flexibility by applying to the State Board of Education for a broader one-year MOE waiver or two new types of MOE waivers now available under the law. The initial year following enactment of Chapter 6 saw no counties follow through on waiver requests, and it appears that all counties will meet the minimum school funding levels in fiscal 2013.

Overview of Revised Maintenance of Effort Requirements

Established in 1984, the maintenance of effort (MOE) law requires each county government (including Baltimore City) to provide at least as much per pupil funding for the local school board as was provided in the prior fiscal year. In 1996, the law was modified to allow a county to apply to the State Board of Education for a one-year waiver of the MOE requirement if the county's fiscal condition significantly impedes its ability to fund the full MOE amount. Counties first requested waivers beginning in 2009 due to the severe economic recession. This initial "testing of the waters" identified several concerns with the MOE law, many of which were addressed by Chapter 6 of the 2012 regular session.

Chapter 6 aligns the timeline for submitting waiver requests with the end of the annual legislative session, refines the existing MOE waiver process, establishes two new types of MOE waivers, and alters the penalty for not meeting the MOE requirement. The legislation also differentiates MOE expectations to recognize counties that have consistently demonstrated strong commitments to funding their schools. Two counties initially applied for fiscal 2013 MOE waivers under the new rules, but both later withdrew their requests.

Three Waiver Options

Prior to the enactment of Chapter 6, the factors that the State Board of Education had to consider when determining whether to approve an application for a one-year MOE waiver were specified in regulation. Chapter 6 codifies and expands the factors to include consideration of a broad economic downturn, a county's history of exceeding its required MOE amount, and reductions in State aid to the county and its municipalities. These additional factors require the State board to make a broader analysis when deciding whether to grant a waiver. The new law also clarifies that a one-year waiver does not reduce the required MOE amount for future fiscal years. However, two new types of waivers, rebasing waivers and recurring cost waivers, allow for ongoing reductions to a county's MOE amount.

A county that is granted a one-year MOE waiver and provides above-average support to the local school board (relative to its local wealth) may request a rebasing waiver. The waiver requires a county to demonstrate ongoing problems with meeting MOE through an additional set of factors the State board must consider. If the State board grants a rebasing waiver, the law allows for a limited, ongoing decrease to the county's required MOE amount. The State board may grant a multiyear rebasing waiver that encompasses up to three years. The amount by which a county's MOE requirement may be reduced is tiered based on the county's education effort and may not exceed 3% in any one fiscal year. However, rebasing waivers may not allow a county to provide funding that represents less than the State average education effort level, as established during the previous five years.

Finally, to encourage efficiencies and cooperation among county governments and school systems, the new law establishes a third waiver option that, like the rebasing waiver, allows a county to reduce its ongoing MOE amount. To qualify, a county and the local school board must identify specific reductions to recurring costs. The State board is required to grant the waiver when a county and the local school board have agreed to the reductions and have agreed on the amount of the waiver. In certain circumstances, the local employee union must also agree.

Revised Penalty Assessment and Process

The law altered the MOE penalty to allow the State to intercept a county's local income tax revenues in the amount by which the county is below MOE in the current year and forward the funds directly to the local school board if the county does not receive a waiver from the MOE requirement and does not fund the full MOE amount. This ensures annual MOE funding to the local school board, except in years when the State board grants a waiver from the requirement.

Adjusting MOE to Reflect Increases in County Wealth

Beginning in fiscal 2015, Chapter 6 requires a county that has an education effort below the five-year statewide average education effort to increase the MOE payment to the local school board in years when its local wealth base is increasing. The required increase will be the lesser of the increase in a county's per pupil wealth, the average statewide increase in per pupil local wealth, or 2.5%. This provision ensures an increase in the amount a county provides to the local school board concomitant with an increase in county wealth.

All Counties Meet Fiscal 2013 MOE Requirement

Although the State board was able to certify that the school appropriations of all counties and Baltimore City have met the fiscal 2013 MOE requirement, the unique path to certification for several jurisdictions is described below. First, seven counties did not meet their minimum MOE funding levels in fiscal 2012, and Chapter 6 required these counties to return to the higher MOE levels that had been established in earlier years for their fiscal 2013 appropriations. Two of these counties, Kent and Wicomico, applied to the State board for a waiver from the fiscal 2013 MOE requirement. Kent County requested a one-year waiver of $860,171, 5.1% lower than the required MOE level. However, shortly after requesting a waiver, the county commissioners were able to approve a budget that satisfied the MOE requirement, and the waiver request was withdrawn. Wicomico County requested a waiver of $6.9 million, 16% lower than the required amount calculated by the county, but the Budget Reconciliation and Financing Act (BRFA) of 2012 passed in the May 2012 special session included a provision that allows a county that maximizes its fiscal 2013 taxing authority to use the actual fiscal 2012 county school appropriation as the base for calculating the fiscal 2013 MOE amount. With county actions to alter tax rates, this provision lowered the required MOE amount for Wicomico County to $36.4 million, and the county withdrew its waiver request.

Chapter 6, which was enacted more than a month before the BRFA, included a similar provision that based the required fiscal 2013 appropriation on the actual fiscal 2012 school appropriation for a county that had the maximum local income tax rate (3.2%) and did not make MOE in fiscal 2012. Two counties, Montgomery and Queen Anne's, utilized this provision to lower their required fiscal 2013 MOE appropriations. Chapter 6 also authorized a county with a locally imposed cap on its property taxes to exceed the cap in order to fund education. For fiscal 2013, Talbot County raised its property tax rate by 4.3 cents per $100 of assessed value. Under the authority of Chapter 6, 60% of the increase, or 2.6 cents, will fund education.

The 2012 BRFA requires local school boards to make payments toward teachers' retirement costs and increases required county (and Baltimore City) school appropriations to account for these additional costs. Despite signaling its intent to fully fund the required MOE amount, Baltimore City had not appropriated the additional amount required by BRFA as of November 1, potentially triggering the MOE penalty provisions. However, Baltimore City ultimately made the required adjustments to its MOE appropriation in mid-November and was, therefore, certified by the State board to have met its MOE requirement.

MOE Dispute in Anne Arundel County Is Resolved

In early July, the State board found the Anne Arundel County appropriation to be approximately $5.0 million less than required (including the teachers' retirement payment required by the 2012 BRFA) and notified the county of its noncompliance. The county appealed this determination, arguing that its appropriation of $5.0 million from the school board's unappropriated fund balance should be allowed to satisfy a portion of the required total. The State board denied the appeal and gave Anne Arundel County 60 days in which to appropriate this amount. If the county did not meet this timeline, the State board would submit a notice of noncompliance to the Comptroller, who would have been required under the revised MOE penalty provisions to divert $5.0 million in local income tax revenues from the county to the county school board. However, within the 60-day timeframe, the county council unanimously approved an additional appropriation to the school board that satisfied the fiscal 2013 MOE requirement.

Education

Race to the Top Targets Critical Education Initiatives

The Education Reform Act of 2010 made significant changes to Maryland's teacher and principal evaluation processes and helped the State to land a $250 million federal Race to the Top (RTTT) grant. Educator evaluation models were piloted in seven school systems last year and were refined over the summer by the Maryland Council for Educator Effectiveness in preparation for statewide field testing underway this school year and full implementation in the 2013-2014 school year. Ensuring that students are prepared for college and careers is another focus of the State's RTTT grant, and the State has made significant progress toward developing standards that position students for success in college and careers, as well as assessments to measure whether students meet the standards and whether they are college- and career-ready.

Changes to Teacher and Principal Evaluations

Maryland received a $250 million federal Race to the Top (RTTT) grant in August 2010. RTTT funds were awarded to states competitively to encourage specific educational reforms that include improving instruction, especially in low-performing schools. Competition for RTTT funds spurred legislative reforms around the country, including changes to educator evaluation procedures that require school systems to link the evaluations with student growth measures. Maryland followed suit with the passage of the Education Reform Act of 2010 (Chapter 189). The Act requires the State Board of Education to adopt regulations establishing general standards for performance evaluations of certified teachers and principals and requires student growth to be a significant component in the evaluations. The redesign of teacher and principal evaluations was one of the primary reforms identified in Maryland's RTTT application. Recommendations for the new educator evaluation systems were developed by the Maryland Council for Educator Effectiveness (MCEE), which the Governor established by executive order on June 1, 2010.

Field Testing of New Evaluation System

During the 2011-2012 school year, seven local school systems (Baltimore City and Baltimore, Charles, Kent, Prince George's, Queen Anne's, and St. Mary's counties) conducted pilot teacher and principal performance evaluation systems. On June 1, 2012, MCEE issued its final recommendations for a Statewide Educator Evaluation System. In response to the feedback from the seven pilot systems, MCEE made four changes to the recommendations it had initially made in June 2011. First, the initial recommendation for determining a rating for student growth provided for a student growth measure that was a combination of State growth measures (30%) and local growth measures (20%). Local superintendents, union representatives, and other stakeholders provided feedback that clear assessment measures were not always available, specifically for grade levels and content areas that are not a part of the Maryland School Assessments. Additionally, there is often difficulty in distinguishing between a State measure and a local measure. For example, for grade and content areas in which State assessments are administered, a local school system may not administer local assessments. Accordingly, the State assessment may be the only common assessment among the schools in the local school system and may constitute both a local measure and a State measure. In response, in its final recommendations MCEE endorsed a 50% "blended" State/local growth measure. Furthermore, in the grades and subjects in which a State assessment is administered, MCEE endorsed the mandatory use of the assessment as one of the multiple measures of student growth.

Second, MCEE initially recommended that for a teacher to be rated as effective in the overall evaluation, the teacher must be rated as effective in the student growth measure. The pilot systems requested equal weighting of the student growth and professional practice components in the evaluation because the pilot systems concluded that the student growth component should not override the professional practice component. MCEE agreed to the request for equal valuation of the two components.

Third, in response to concerns raised by the pilot systems regarding the cost of yearly teacher and principal evaluations, MCEE agreed to conduct evaluations within a three-year cycle. All teachers and principals will be evaluated on both professional practice and student growth in the first year of the three-year cycle. For the last two years of the cycle, teachers rated as ineffective during the first year, all nontenured teachers, and all principals will receive annual evaluations on professional practice and student growth. Tenured teachers rated highly effective or effective in the first year will receive annual evaluations on student growth only. Their professional practice rating in the first year of the cycle will be carried over and included in the total rating for the last two years of the cycle.

Fourth, the initial recommendations of MCEE established three tiers of evaluation ratings: highly effective, effective, and ineffective. Some pilot systems suggested adding a developing/approaching effectiveness tier. MCEE agreed that a local school system could choose to adopt the fourth category. However, MCEE noted that a teacher should only be allowed to be in the developing/approaching effectiveness tier for a very limited amount of time.

The Maryland State Department of Education (MSDE) will continue to provide technical assistance and professional development to teachers, principals, and their respective evaluators on the new evaluation process. Field testing of the evaluation systems throughout the State began in the 2012-2013 school year. Full statewide implementation of the evaluation system is scheduled to begin in the 2013-2014 school year.

State Board of Education Adopts Evaluation Regulations

The Education Reform Act requires the State Board of Education to adopt regulations establishing general standards for performance evaluations of certified teachers and principals. On June 26, 2012, the State board approved regulations that effectively implement MCEE's performance evaluation recommendations. Beginning with the 2013-2014 school year, the regulations require that (1) teacher and principal evaluations meet the minimum general standards set forth in the regulations; and (2) all local school boards that signed the RTTT application count performance evaluation criteria for student growth as 50% of an evaluation. If a local school board and the exclusive employee representative do not reach agreement on the evaluation system, the regulations require the school board to adopt the Model State Performance Evaluation Criteria. The model specifically addresses criteria for student growth and professional practice. The student growth component will count for 50% of an evaluation, may not be based solely on an existing or newly created exam, and must be based on multiple measures, such as aggregate class growth scores, student learning objectives, and a schoolwide performance index. The professional practice component will also count for 50% of an evaluation. For teachers, this component includes planning and preparation, classroom environment, instruction, and professional responsibility. For principals, the component will include the outcomes in the Maryland Instructional Leadership Framework and outcomes developed by the Interstate School Leaders and Licensure Consortium. The regulations sunset on September 30, 2014, subject to review by the State board and re-promulgation of the regulations.

Assessments to Measure College Readiness

The Maryland RTTT application emphasized various areas of State reform, including the adoption of standards and assessments that prepare students to succeed in college and the workplace and to compete in the global economy. The Common Core Standards are a group of high-quality academic standards in English/language arts and mathematics that define both the knowledge and skills all students should have acquired at the conclusion of each grade level to be on track for success in college and careers. The standards were created through a joint initiative led by states and have been adopted by more than 40 states, including Maryland. During the 2010-2011 school year, in order to define the content and skills that students need to master, educators throughout Maryland collaborated to establish the Maryland Common Core State Curriculum Framework in English/language arts and mathematics. The framework is the basis of the new State curriculum. During the 2011-2012 school year, teachers representing local school systems assisted in the development of model units and lessons aligned to the standards. MSDE conducted Educator Effectiveness Academies in the summer of 2011 and 2012 to provide professional development to teachers from every school in the State. Academies are scheduled to continue through 2013. The standards will be implemented statewide by the 2013-2014 school year.

MSDE also participates in the Partnership for Assessment of Readiness for College and Careers (PARCC). PARCC is a consortium of 24 states that is designing an assessment system aligned with the Common Core Standards for English/language arts and mathematics. According to MSDE, the PARCC assessments will measure student progress and track status on a trajectory toward college- and career-readiness. The assessments will be computer-based and are designed to evaluate higher order skills, including critical thinking, communications, and problem solving. PARCC will be used in lieu of the Maryland School Assessments beginning in the 2014-2015 school year. Beginning in 2014, MSDE will provide online toolkits to teachers to assist them in designing instructional content that is aligned with the new curriculum and assessments. The State Superintendent of Schools and the University System of Maryland

Chancellor participate in the PARCC governing board that will set the threshold scores for the PARCC assessments. The "cut scores" set by the board will be used to determine whether a student passes the test and whether a student is ready for credit-bearing courses at the college level in each subject (*i.e.*, the student does not need remediation).

Education

School Construction Block Grant Proposal

Legislation was proposed in the 2012 session to allow Baltimore City to receive State school construction funds as a block grant, rather than the project-based funding provided under current law, in order to leverage other debt to meet significant public school facility needs. The bill raised a number of issues that are being studied by a workgroup, with a final report due in December 2012.

Public School Construction

State school construction funding is almost exclusively financed by tax-exempt general obligation bonds. The amount of State funding for school construction is established each year in the State capital budget. 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. This funding formula must be recalculated every three years – for fiscal 2013 through 2015, the State share of school construction costs in Baltimore City is 93% (the second-highest level of State support in the State).

The awarding of State funds for school construction is a project-based process managed by the Interagency Committee on School Construction (IAC), subject to final approval by the Board of Public Works (BPW). In awarding funding for the projects, IAC considers a facilities master plan for each local school system and a capital improvement plan that includes projects for which the school system seeks planning and funding approval, including projects that the local governing body has agreed to fund in the upcoming year. 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 determines which projects to recommend to BPW for State funding.

Baltimore City Public Schools' Construction Needs

In 2011, the Baltimore City Public Schools (BCPS) commissioned Jacobs Project Management to conduct a comprehensive districtwide assessment of its facilities, consisting of an enrollment projection review, capacity analysis, an education adequacy assessment, a building condition assessment, and a review of all site and building systems with a life cycle renewal forecast. BCPS currently enrolls approximately 84,000 students in 194 schools, including 33 charter and 15 transformational schools, with a fiscal 2013 operating budget that totals $1.31 billion. In conducting its study, Jacobs Project Management assessed the condition of each building owned by BCPS and evaluated the cost of upgrading or replacing each building and maintaining it over 10 years to develop a metric called a "facility condition index" or FCI that ranges from 1% to 100%. A score of less than 10% is good, 11%-30% is average, 31%-50%

is poor, 51%-74% is very poor, and a facility with a score of 75% or more is a candidate for replacement.

The final report, commonly referred to as the "Jacobs Report," was released in June 2012 and contains a number of significant findings described below. It should be noted that Baltimore City does not currently have a facilities master plan; however, one is expected in the next few months as a result of the Jacobs Report.

- The 10-year FCI for BCPS is 60% and reflects facilities in very poor condition.

- Total need, including education adequacy, facility condition, and 10-year life cycle costs, is $2.452 billion. Of this amount current facility condition costs total $1.441 billion, while 10-year life cycle (building system replacement) costs total $1.011 billion.

- The overall utilization of city schools of 66% represents a significant amount of unused space within the district. Of the 43,662 empty seats in the district, most (25,666) are in high school facilities. High school campuses have a very low utilization percentage of 51%; middle school campuses have the lowest utilization of 43%; and elementary school and K-8 campuses have a utilization rate of approximately 80%.

School Construction Block Grant for Baltimore City

During the 2012 session, legislation was proposed that would allow Baltimore City to receive its school construction funding as a block grant in order for BCPS to leverage State funds with additional debt. The bill was not acted upon by either chamber. Instead, the budget committees requested in the *Joint Chairmen's Report* that IAC lead a group to study the proposal. This report is due to the budget committees on December 1, 2012. The General Assembly will need to examine a number of issues relating to this proposal, which represents a complete change in how the State finances school construction projects. Three of the major issues are discussed below.

Creation and Governance of a Third-party Entity for School Construction Purposes

While the idea of providing block grants for school construction projects in Maryland is new, the concept is not a new one nationally. In Greenville, South Carolina, a third-party entity was formed to serve as an independent vehicle for alternative financing for school construction. In that instance, a nonprofit entity issued over $1 billion in debt to pay for the reconstruction of all Greenville school facilities in just six years. The school district entered into an installment purchase agreement with the nonprofit that allowed Greenville to pay for the new and renovated schools with structured annual payments over 25 years. One of the issues that the workgroup is examining is whether to create a nonprofit entity, as in the case of Greenville, or to approach the financing of school construction through another type of entity, such as a school construction authority. In creating this entity, the General Assembly will need to consider issues of governance and accountability.

Potential Impact on the State's Bond Rating and Other Legal and Tax Implications

In order to implement a block grant program, the proceeds from issuing State bonds would be used to pay for the debt service on bonds issued by a third party. The impact of this financing structure on the State's debt limit, long-standing State policy on the use of debt, bond ratings, and tax-exempt status of State bonds under federal tax law will need to be examined. The workgroup is studying these issues as well as the advantages and disadvantages of issuing tax-exempt or taxable debt.

Impact on the Public School Construction Program and Other Counties

The school construction needs of Baltimore City are significant, as described in the Jacobs Report. To the extent that these projects can be accomplished quickly, savings may be realized by avoiding construction cost escalation and lowering maintenance costs. However, in order for a third-party entity to issue bonds for school construction, it will need to receive a guaranteed amount of funds annually for the life of the debt. The legislation introduced during the 2012 session would have guaranteed Baltimore City an annual block grant of at least $32 million for school construction. That represents roughly the average amount received by the city since fiscal 2006, when the State began implementing the 2004 Public School Facilities Act's goal of $2 billion for public school construction by fiscal 2013. The State has provided more than $250 million for school construction each year since fiscal 2006 – exceeding $300 million in five of the past eight years – and achieved the $2 billion goal ahead of schedule. It is not clear whether that level of funding can or will be sustained in the future. Since the City-State Partnership began in fiscal 1998, Baltimore City has received on average 10% to 11% of the total school construction funds annually, ranging from $10 million to a high of $52.7 million depending on the total funding provided. If Baltimore City is guaranteed a certain amount of funding for school construction and if State funding for school construction declines, Baltimore City's share of State school construction dollars relative to other jurisdictions could increase significantly. The Governor's preliminary allocation of the capital budget for school construction in fiscal 2014 is $250 million.

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Education

Age of Compulsory School Attendance Set to Increase

Chapter 494 of 2012 phases in an increase in the compulsory school attendance age and, with limited exceptions, will require children to stay in school until graduation or age 18 by the 2017-2018 school year. Recognizing the impact the change will have on local school systems and the need for careful planning and preparation, the General Assembly required the Maryland State Department of Education to prepare and submit a number of reports before the increases take place. The bill also requires the Maryland State Department of Education and the Department of Labor, Licensing, and Regulation to develop a GED Options Program, which would allow students to take GED preparation courses while still enrolled in school.

2012 Legislation Phases In Increases in Compulsory School Attendance Age

An average of approximately 9,500 students per year dropped out of Maryland public high schools from the 2000-2001 school year to the 2010-2011 school year. Current statutory provisions governing school attendance require that a child attend public school regularly until at least the age of 16 unless the child is otherwise receiving regular, thorough instruction at an alternative setting (*i.e.*, a private or home school). Bills to increase the age of compulsory school attendance have been introduced almost every year for more than a decade, but concerns about the impact on schools and the additional costs associated with adding to school enrollments derailed previous versions of the legislation. In passing Senate Bill 362 of 2012 (Chapter 494), the General Assembly attempted to address some of the concerns through a phased-in schedule that includes several studies and reports before the age for mandatory school attendance actually increases.

Chapter 494 increases the age of compulsory school attendance in two phases, requiring students to stay in school until they are 17 years old beginning with the 2015-2016 school year and 18 years old beginning with the 2017-2018 school year unless they have graduated or otherwise completed high school. The legislation includes a number of exemptions from the requirement and gives the State Superintendent of Schools the authority to waive the compulsory attendance age requirement for a student.

Legislative Reports Required

The implementation dates for the increases in the compulsory school age were delayed in Chapter 494 to give local school systems and the Maryland State Department of Education (MSDE) time to assess the impact of the legislation and develop interventions, services, and alternative options for students who would otherwise drop out of high school. Numerous reporting requirements were established to help the State prepare for and monitor the implementation of the legislation. By December 1, 2012, MSDE must update its *Drop Out Prevention Resource Guide*; report on a methodology for estimating the number of students that will remain in school and estimate State aid increases based on the methodology; and review data from other states that have increased their compulsory age of attendance during the last decade. In 2013, MSDE must submit (1) a compilation of reports prepared by local boards of education and recommend programs, interventions, and services that are necessary prior to the implementation of the legislation; and (2) a report on successful early education interventions, best practices for parental education and involvement, and alternative educational pathways. Subsequent reports are required once implementation of the age increases begins.

Depending on the initiatives recommended by MSDE, costs could be significant and will likely begin in fiscal 2015, following the 2013 reports on needed interventions. Once the age increases start, State costs will increase due to higher student enrollment counts resulting from the retention of students who would otherwise drop out. State education aid is expected to increase by approximately $35 million in fiscal 2018 as a result of the increased age and by roughly twice that amount by fiscal 2020, when the costs will be fully phased in.

GED Options Program

Also by December 1, 2012, the legislation requires MSDE, in consultation with the Department of Labor, Licensing, and Regulation, to develop a GED Options Program and request departmental legislation necessary to implement the program. The GED Options Program allows a student to participate in a GED preparation program without dropping out of school, a benefit the traditional GED program does not offer. MSDE has been studying the program in order to meet the December deadline. However, the GED Options Program has not been viewed as an appropriate path for students who are dropping out of high school early, having earned only a few credits toward graduation. The program is instead targeted to high school juniors and seniors, who are only a few credits short of the necessary credits to graduate. Presently, 69% of Maryland students who drop out of school do so at age 16, and the vast majority of these students are in the ninth or tenth grade with many credits left to fulfill before graduation. The GED Options Program, therefore, would only be appropriate for a small percentage of students targeted by the legislation. The GED program might be more useful as one of several options available to students at risk of dropping out of high school.

A new version of the GED Options Program, revised to include the common core curriculum and college readiness standards that Maryland is in the process of implementing, will be available in 2014. This raises the possibility of waiting to employ the program until the program's standards are aligned with the State's expectations for high school students.

Higher Education

College Completion Goal and Funding

As Maryland pursues the goal that 55% of adults hold a college degree in order to meet workforce demands, a recent report projects that 52% of Marylanders will hold a degree by 2025, raising questions about institutional projections for enrollment and funding needed to meet the goal. The State and public institutions of higher education are pursuing strategies to increase the completion rate, including redesigning developmental courses, supporting reverse transfer initiatives, encouraging "near completers" to complete their degrees, and developing a framework for performance funding. Reducing the time to degree and credits earned by students seeking degrees, particularly at community colleges, are two strategies that can increase attainment in the short-term.

55% Completion Goal

The Governor set a goal that at least 55% of Marylanders ages 25 to 64 hold at least an associate's degree by 2025. This coincides with the President's goal for the United States to have the highest degree completion rate in the world by 2020. These goals are not only necessary for the country to remain globally competitive but for individuals to be competitive in the job market. According to the Georgetown University Center on Education and the Workforce, 66% of Maryland jobs will require postsecondary education by 2018. Maryland's current degree attainment rate is 44.7%, up from 44% in 2009.

According to the Lumina Foundation's 2012 progress report, *A Stronger Nation Through Higher Education*, if the "current rate of degree production continues, 52% of Maryland's adult population…will hold a college degree in 2025." This compares to the previous estimate of 48%. If the new projection proves accurate, it raises questions about how much additional enrollment growth is truly needed to achieve the 55% goal. The report further states that about 21% of the adult population in the State had gone to college but did not receive an associate or bachelor degree and that "encouraging and helping these adults to complete degrees would go a long way to helping Maryland" reach its goal. This suggests resources may be best used to encourage these adults to complete their degrees rather than to increase new enrollment. Maryland is using grant funds to "reclaim" adults who have accumulated college credits, in some cases enough to receive an associate's degree, but have not received a degree.

Cost of Proposed Completion Strategy

In order to achieve the 55% completion goal, Maryland institutions need to award 58,000 degrees annually. The University System of Maryland (USM) and Morgan State University (MSU) plan to increase completion through enrollment growth, mainly due to improved retention efforts and new enrollments beyond projected levels. (St. Mary's College of Maryland (SMCM) has not set specific degree targets.) USM plans to increase annual degree production by 40.6% or nearly 8,100 degrees by 2020. To achieve this, USM states it needs to increase enrollment 25.9% during this time period. MSU plans to increase the number of degrees by 850 by 2021, more than doubling the number of degrees awarded in fiscal 2010. As with USM, this will be achieved by increasing enrollment 47.5%, or 3,143 students, and by improving its 6-year graduation from 33.8% to 50.0% within the next 10 years.

In order to increase degree production, USM and MSU state additional funds are needed to ensure programs and services are in place that will enhance student retention. USM estimates it would require an additional $168.3 million through a combination of State funds and tuition revenues between fiscal 2012 and 2016, but did not provide estimates of funds required after fiscal 2016. MSU projects it will require an additional $202.1 million in State funds and tuition revenues over a 10-year period.

Each community college campus sets an individual completion target with a combined goal of increasing degree production 58% by 2025. As with the four-year institutions, this will be accomplished primarily by increasing student retention; however, the colleges have not estimated the cost of meeting the target.

Complete College America – Measuring Completion

Complete College America (CCA) works with states to increase the number of citizens with degrees and close the attainment gaps for traditionally underrepresented populations. Part of a $1.0 million CCA grant Maryland received in 2010 requires the submission of data on various metrics that measure an institution's productivity. Two metrics – the average time and credits to a degree – measure how well institutions perform in graduating students in a timely fashion.

The average time to degree at a public four-year institution is relatively close to 4 years with an average of 4.3 and 4.7 years for full- and part-time students, respectively. Although 2 years is the goal for an associate's degree, the average length of time to degree is 3.8 and 5.0 years for full- and part-time students, respectively. In terms of number of credits, the average for a bachelor's degree was 124 and 126 credits for full- and part-time students, respectively; compared to a 120 credit goal for USM (MSU and SMCM have not adopted 120-credit policies). For community college students, the longer time enrolled translated into significantly more credits earned toward the standard 60-credit general education program, with an average of 75 and 76 credits for full- and part-time students, respectively.

State Efforts to Advance Completion

Various efforts are underway to improve student outcomes, which ultimately increase degree production. Maryland received grants from CCA and the Lumina Foundation to redesign entry level, large lecture courses that typically have high costs and failure rates, at the community colleges and four-year institution levels. While both grants focus on redesigning developmental math courses, the Lumina grant includes the redesign of science courses and the CCA grant funds 15 course redesign fellows who will assist faculty in redesigning courses. Since the redesigned courses have only recently been piloted at the community colleges, data is not yet available on the impact these courses have on student retention and progression.

The Maryland Higher Education Commission (MHEC) has focused the $500,000 Complete College Maryland grant provided in the fiscal 2013 State budget on "near completers" – Marylanders with college credits who have not received a degree – through a competitive grant process. The results of the grants are not yet available but are intended to help translate the 21% or 651,000 Maryland adults with some college into degree recipients. In addition, the State recently received an additional $500,000 grant from USA Funds to support "reverse transfer" initiatives that award associate's degrees to students who transferred from a community college to a four-year university without a degree and subsequently earned enough credits to receive an associate degree.

While the Governor established the 55% completion goal as a priority, the current State Plan for Postsecondary Education does not specifically reflect this goal. Efforts are currently underway to revise the 2009-2013 plan to incorporate the completion goal and include recommended actions to achieve the goal. Another effort being undertaken by an MHEC workgroup, which can help further the goal, is the development of a framework for State funding that rewards institutional and student performance based on metrics developed by the workgroup. This performance based funding model requested by the *Joint Chairmen's Report* is intended to encourage institutions to focus their resources on those efforts that will increase degree production. The workgroup's report is due to the legislative budget committees by December 15. One of the issues the workgroup will address is how to target or incentivize degree production to meet State workforce needs, particularly in the science, technology, engineering, and math fields.

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Higher Education

College Affordability

State funding for the largest need-based student aid program has remained essentially level since fiscal 2009, while the number of applicants has grown 63%. This has resulted in more than 35,000 students on the waitlist for State need-based financial aid in fiscal 2013, with only a few thousand more likely to receive aid. As the impact of the global recession continues to be felt, students have also demonstrated greater financial need. Meanwhile, legislation to convert the Charles W. Riley Program from tuition reimbursement to a scholarship may be introduced in the 2013 session after 2012 legislation was vetoed by the Governor.

Despite Moderate Tuition Growth, Student Need for Financial Aid Grows While State Funding Is Flat

Maryland had the smallest tuition increase in the nation from fiscal 2008 to 2013, according to a 2012 College Board report, and currently ranks as the twenty-seventh most expensive state for public four-year institutions compared to eighth in 2005. Despite this progress, due in part to Maryland's in-state tuition freeze from fiscal 2007 to 2010 and tuition buy-downs to 3% increases since fiscal 2011, financial aid still has a significant impact on the affordability of higher education for Maryland students. Funding for the State's largest need-based financial aid program, Educational Excellence Awards (EEA), grew rapidly between fiscal 2006 and 2007 due to a policy shift away from merit- and career-based aid to need-based. However, it has remained level funded at approximately $76 million annually since fiscal 2009. By fiscal 2013, funding had decreased by 0.5% despite rising tuition and fees and growing demand for need-based aid due to the ongoing impact of the global recession.

Total State support for need-based student financial assistance is $82.7 million in fiscal 2013, or 5.2% of total higher education spending. **Exhibit 1** shows trends in EEA appropriations and the number of EEA applications from fiscal 2009 to 2013. While appropriations for State need-based aid remained level, student need grew significantly over this period. The number of EEA applicants increased over 63% between fiscal 2009 and 2013, and those applying demonstrated greater financial need. This can be measured by the Expected Family Contribution (EFC) of students receiving State awards. In general, a lower EFC means a student has greater financial need, and the Maryland Higher Education Commission (MHEC) makes EEA awards beginning with the students who qualify with the lowest EFC. Between fiscal 2009 and 2013, the "EFC awarded" level fell 90%. To date, MHEC has awarded fiscal 2013 EEA grants to students with EFCs up to $1,000, while the same funding in fiscal 2009 reached students with EFCs up to $10,300.

Exhibit 1
Educational Excellence Awards
Fiscal 2009-2013

	Fiscal 2009	Fiscal 2011	Fiscal 2013	% Change
Appropriation	$76,742,322	$75,933,546	$76,396,170	-0.5%
EEA Applicants	109,314	145,944	178,603	63.4%
Initial EFC Awarded	10,300	2,500	1,000	-90.3%
Waitlist as of May 1	4,846	18,504	35,795	638.7%
Amount to Fund Waitlist	$10,610,175	$30,265,038	$71,375,230	572.7%

Source: Maryland Higher Education Commission

As a result of growing demand and level funding, the EEA waitlist has grown by over 30,000 students or about 639% between fiscal 2009 and 2013. The amount of funding necessary to cover all waitlisted students in the current fiscal year, $71 million, is nearly equal to the funding for the entire EEA program. Some students on the waitlist do receive aid from declined awards. In fiscal 2011, over 4,000 students moved off the waitlist, but in fiscal 2012 this number fell to just over 2,000. Declined awards make up the majority of financial aid funding that is not spent each year and carried forward to the next year. The Need-Based Student Financial Assistance Fund (NBSFAF) is a special fund that was created in 2011 to better account for these unused financial aid funds. In the fiscal 2013 State budget, $4.3 million was appropriated from NBSFAF to level fund financial aid programs due to a loss of federal funds. This left a balance of approximately $5 million – before any carry forward funds are added from fiscal 2012 or 2013 – that is available in fiscal 2014 for need-based financial aid programs. MHEC reports that the fund currently has a balance of $13.6 million and that it plans to request using approximately half of the balance to fund students on the fiscal 2013 waitlist.

Changes in Pell Grant Eligibility with No Change in Maximum Award Limit Impact of State Aid

The Pell grant, a federal program, is an extremely important source of need-based aid for many Maryland students. Because State need-based programs such as EEA are applied to student need after the federal Pell grant is considered, federal funding for the Pell grant program has a significant impact on how far State need-based financial aid will stretch. For academic year 2012-2013, the maximum Pell grant is $5,550, the third year of no adjustment despite tuition and fee increases nationally. The federal fiscal 2012 budget significantly restricted eligibility retroactively by reducing the time a student may receive a Pell grant from 18 to 12 semesters and dropped the Automatic Zero EFC threshold from $30,000 of annual family household income to $23,000. Additionally, Congress eliminated the "double Pell grant" that allowed students to receive a second Pell award within a single calendar year to pursue summer coursework to expedite graduation. All three rule changes went into effect on July 1, 2012.

Institutions that serve needier student populations, such as Maryland's four historically black institutions (HBIs) and community colleges, are concerned that these changes will lead many students to stop pursuing higher education. While at all Maryland public four-year institutions an average of 32% of the student body receives Pell grants, Pell recipients make up between 40% and 60% of students at HBIs and nearly 60% at community colleges. HBIs partly attribute the new Pell changes to decreasing enrollments in fall 2012.

Revising the Charles W. Riley Program

During the 2012 regular session, Senate Bill 365 as passed by the General Assembly proposed changing certain aspects of the Charles W. Riley Fire and Emergency Medical Services Tuition Reimbursement Program. The Riley program provides financial aid for firefighters and ambulance or rescue squad members pursuing studies in fire service or emergency medical services (EMS) technology. For an eligible student, the Riley program disburses financial aid only after the student completes an eligible course and one year of public service in the fire or EMS field. This means a student enrolling in a course in the 2012-2013 academic year would be reimbursed in fall 2014.

One aspect of the legislation would have converted the program into a scholarship that is provided to students prior to enrollment, while retaining the one-year service requirement, within the existing appropriation for the program. The bill would have repealed the tuition reimbursement program effective July 1, 2012. However, it was determined that students who enrolled in eligible courses in the 2010-2011 academic year with an expectation of receiving tuition assistance could not be reimbursed (in fall 2012) because the program no longer existed. Likewise, students who were enrolled in the 2011-2012 academic year would not have received tuition reimbursement under the bill. For the 2012-2013 academic year, no tuition reimbursements or scholarships would have been provided. The revised scholarship program would have made its first awards to students taking classes in the 2013-2014 academic year. Due to these issues, the Governor vetoed the legislation. Legislation may be introduced in the upcoming session to minimize the number of years in which neither tuition reimbursements nor scholarships would be provided if the program is converted to a scholarship.

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Higher Education

Maryland Longitudinal Data System

The State's efforts to develop a comprehensive data system that spans across education and the workforce, known as the Maryland Longitudinal Data System (MLDS), are well ahead of the December 2014 deadline. An MLDS website is anticipated to go live in early 2013 with limited data dashboard reports. MLDS has been developed to initially address 15 policy questions that affect education and the workforce, and the required data privacy and security policies are in place. The next steps include establishing the MLDS Center with an executive director to move MLDS from the technical phase to the data analysis and policymaking phase.

System Development Ahead of Schedule

Chapter 190 of 2010 established the Maryland Longitudinal Data System (MLDS) to contain individual-level student data and workforce data from all levels of education and the State's workforce. The legislation also established the Maryland Longitudinal Data System Governing Board and a center within State government to serve as a central repository for the data, ensure compliance with federal privacy laws, perform research on the data sets, and fulfill education reporting requirements and approved public information requests. The development of MLDS is ahead of schedule and will be operational well before the statutorily required December 2014 deadline.

Much of the infrastructure needed to link the data from the State agencies and higher education institutions has been completed, as well as the framework necessary to access the data via a website, including separate login portals for policymakers, researchers, and parents. Testing of the dashboard analytics system for several of the critical education policy questions developed by the governing board began in September 2012. Another subset of the analytic dashboards should be ready for review by early 2013. Completion of this phase of the project required the development of an encrypted, multiagency individual crosswalk identification table and electronic transcripts from most local education agencies and higher education institutions. The MLDS website is anticipated to go live in early 2013 with limited, prepared data dashboard reports, but the data will not be searchable.

The timeline for the project has been accelerated due to considerable interest in MLDS, including from the Governor, and receipt of significant federal funding for the project. In July 2012, the State was awarded almost $4.0 million by the federal Statewide Longitudinal Data Systems (LDS) grant program to aid in linking postsecondary and workforce data with the State's prekindergarten through high school (P-12) data system. MLDS is also a main component of the State's $250 million federal Race to the Top grant received in August 2010. The State also received approximately $6 million in federal LDS grant funds in 2006 and 2009, and a $1 million U.S Department of Labor grant for the project in 2010. A portion of the recent grant funds is being used to replace the outdated data information systems at the Maryland Higher Education Commission (MHEC). Previous grant funds were used by the Maryland State Department of Education (MSDE) to develop a student-level P-12 data system.

Data Privacy/Security Policies and Policy Questions Developed

Privacy and data security issues, including compliance with the federal Family Educational Rights and Privacy Act (FERPA), were a major consideration in the creation of MLDS. Prior to beginning system testing, as required by Chapter 190, the center's governing board submitted to the Governor and the General Assembly the inventory of individual student data proposed to be maintained in the system, the privacy policies of the center, and a data security and safeguarding plan for the center. Chapter 190 requires the center to ensure routine and ongoing compliance with FERPA and other relevant privacy laws and policies, including the required use of de-identified data (in which individual-level identity information, including State-assigned student identifiers and Social Security numbers has been removed) in data research and reporting; the required disposition of information that is no longer needed; the assurance of data security; and the implementation of guidelines and policies that prevent the reporting of other potentially identifying data. The center is also required to provide for the performance of regular audits for compliance with data privacy and security standards.

To meet these requirements, an expert was hired to develop the center's data security and safeguarding plan. The plan establishes that the center must employ the concept of "least privilege," that is, allowing only authorized accesses for users (and processes acting on behalf of users) that are necessary to accomplish assigned tasks in accordance with the MLDS mission and functions. The plan also outlines policies to limit access to authenticated authorized users and requires the center to assign an employee as the privacy officer.

To further reduce privacy concerns and in response to the technical issues experienced by other states that attempted to capture all state data into a single system, the scope of the data in the MLDS data warehouse is limited by the policy questions it is designed to answer. The governing board, working in consultation with the Governor's P-20 Council, has developed 15 priority policy questions that MLDS has been designed to address. These policy questions include whether Maryland students are academically prepared for college and graduate in a timely fashion; whether financial aid programs are effective in supporting access and success; and whether students are successful in the workplace. Some of the questions will require the State agencies, particularly MHEC, to expand their data collection efforts. The MLDS data inventory documents the specific data elements included in MLDS. The scope of the data incorporated into MLDS is not permanent and could be updated if new policy questions are added.

Currently, the database contains both aggregate data sets and de-identified, encrypted student and workforce data. Data associated with an individual are not available for viewing in the MLDS database, and workforce-related data are only retained for five years after an individual leaves school.

FERPA compliance concerns of institutions of higher education have been addressed through limiting the personally identifiable information entered into MLDS and by assuring the institutions that the redisclosure of personally identifiable information to the center is permitted according to revised FERPA regulations. FERPA governs the protection and permissible uses of student administrative data, including the disclosure and transfer of personally identifiable information in education records. The FERPA regulations were revised in December 2011 to reconcile them with the federal laws (*e.g.*, Race to the Top) that incentivized the development and use of state longitudinal data systems. The revised regulations clarified that FERPA does not prevent the redisclosure of personally identifiable information to researchers as part of agreements with FERPA-permitted entities to conduct studies for, and on behalf of, educational agencies and institutions.

Center Needs a Home and Budget

Chapter 190 required that the center be an independent unit within State government. As of October 2012, proposals for the physical and administrative placement of the center are being evaluated by the governing board. The center will likely be located at a higher education institution or a State agency. The governing board is also conducting a search for an interim director for the center. There is funding for the interim director and some initial research planning through July 2013, but a source of funding beyond that point has yet to be determined.

The director, under the direction of the governing board, will determine the center's next steps – moving the center from a primarily technical development phase to a primarily policy and decisionmaking phase. Prior to the center becoming fully operational, initial policy decisions will need to be made on how to present the data and the level of access to the data that will be permitted to the public, teachers, parents, researchers, and other interested parties. Other initial tasks for the director include developing the center's initial research agenda, policies to approve outside data requests, and the center's research team. These decisions require more direct involvement than the governing board can provide.

To succeed in meeting expectations, the center needs operating funds. The federal funding only covers one-time development costs, not ongoing costs such as personnel to operate the center. The placement of the center, the scope of the research agenda, and the desired response time of the center will help determine the operational funding needed. The fiscal note for Chapter 190 estimated approximately $1 million would be needed to operate the center beginning in fiscal 2014, with an additional $900,000 in annual costs at MHEC and MSDE to oversee data collection and linkage. The governing board has projected a $2 million annual budget, including State appropriations, agency contributions, and chargeback fees for data and report requests.

Higher Education

State Approvals Needed for Expansions

State oversight of higher education is designed to coordinate available resources effectively and efficiently, but recent actions by higher education institutions appear to circumvent the oversight structure and weaken statewide coordination efforts. The actions include plans to build a new off-campus facility for the Baltimore City Community College, the construction of a Towson University building on the campus of Harford Community College, and a proposal to award degrees at the University of Maryland Center for Environmental Sciences. Laws governing higher education coordination may need to be strengthened if institutions continue to challenge the State's established oversight processes.

State Oversight of Higher Education

State oversight is generally intended to limit duplication and promote efficiencies in higher education. Maryland's oversight of higher education is mainly based in three bodies, the Maryland Higher Education Commission (MHEC), the Department of Budget and Management (DBM), and the General Assembly. MHEC is the State's coordinating board for higher education. Under State law, all academic programs offered by public institutions must be reviewed and approved by MHEC. The law also identifies all of the public higher education institutions and their authority to award degrees. In terms of facilities, the General Assembly must approve nearly all public academic facilities, whether they are financed with State debt or institutional resources. DBM's Office of Capital Budgeting reviews and approves the detailed plans and scope for new academic facilities and renovations.

Recent Actions Appear to Circumvent Oversight Process

Recent proposals from several institutions appear to be circumventing the established oversight structure, whether deliberately or not. If proper procedure is not followed, it is possible that the State would be asked to fund programs and facilities that it did not actually approve.

Baltimore City Community College East Side Location

For many years, Baltimore City Community College (BCCC) has discussed the need for a presence on the east side of Baltimore City. The college notes the region has higher than average unemployment, lower than average income, and very low rates of college completion. There is also little access to quality higher education available in that area. BCCC has identified an abandoned public high school (known as the Gompers Building) as a possible location, but it comes with a $26 million cost estimate for purchasing and renovating the property into usable academic space.

Instead of requesting funds in the capital budget through DBM, BCCC proposed that the Maryland Economic Development Corporation (MEDCO) issue debt in the necessary amount, acquire and renovate the property, and then lease it back to BCCC. Higher education institutions have utilized MEDCO to finance nonacademic facilities such as residence halls in which the property is under a long-term lease with MEDCO. However, MEDCO is not currently authorized to perform these kinds of financing deals for properties that it will own, and granting the proper authority would require legislation before the debt could be issued. Legislation to provide the necessary authority was introduced in the 2012 session and passed the House of Delegates (House Bill 1109), but no action was taken in the Senate.

If the college were to proceed without prior approval from the Governor and General Assembly, the State would become responsible for supporting a major new academic facility without giving formal approval. Even with approval from the General Assembly to acquire and renovate a facility on Baltimore City's east side, BCCC would still need to receive program approvals from MHEC. The college reports that it plans to offer 10 programs, including health information technology, construction, and phlebotomy. Although BCCC is authorized to offer these programs on its main campus, MHEC must separately review and approve all programs to be offered at off-campus locations. MHEC reports that it has not been contacted by BCCC regarding the proposed site or its programs, and DBM has not been contacted regarding renovation plans.

The University System of Maryland (USM) finances academic projects outside of the State budget by issuing $32 million in academic revenue bonds annually to renovate and construct academic facilities at its constituent institutions. Each year, the system introduces legislation listing the specific academic projects requiring authorization and the total amount of funding required. BCCC received statutory authority to issue academic revenue bonds in 2009 (Chapter 213) with legislative approval, but to date, BCCC has not used the authority.

Towson University Building on Harford Community College's Campus

Although USM regularly requests and receives the necessary approvals when issuing academic debt, the system has also had issues with receiving the proper approvals. The concept of a Towson University (TU) dedicated facility with the purpose of offering upper-level undergraduate courses on Harford Community College's (HCC) west campus took shape in 2006. Discussions culminated with the signing of a memorandum of understanding in December 2008 outlining the responsibilities of each institution for the construction of an academic building to be owned and operated by TU.

Initially, the facility was considered a public-private partnership (P3) between HCC and MEDCO with TU entering into a leasing agreement with MEDCO. During the 2010 legislative session, concerns were raised that by entering into such a relationship, TU found a way to circumvent policies and procedures governing the oversight of the establishment of a branch campus and, therefore, did not seek formal approval for construction or for programs to be offered at the site. As a result, in fall 2010 TU submitted site specific program and capital plans to MHEC and DBM.

Other Maryland institutions raised concerns over one institution having an exclusive facility on HCC's campus. As a result, the plans MHEC approved provided Morgan State University with an option to co-own or lease space in the new facility in order to offer programs and courses there. TU will finance the proposed $28 million facility by drawing down a portion of its fund balance. The facility is scheduled to be completed by fall 2014.

Research Center Desires Degree-granting Authority

At its June 2012 meeting, the University System of Maryland Board of Regents approved a request by the University of Maryland Center for Environmental Science (UMCES) to seek accreditation from the Middle States Commission on Higher Education to award a joint graduate degree with University of Maryland, College Park (UMCP) in Marine-Estuarine-Environmental Sciences, which is currently administratively housed at UMCP. UMCES indicated it will begin the first phase of the accreditation process, which involves an information session with Middle States to determine if it is ready to pursue accreditation or if institutional changes are necessary first. According to the Middle States website, a candidate for accreditation must provide written documentation that it is authorized to operate as an educational institution and award postsecondary degrees. However, as a research institute under current law, UMCES does not have the degree-granting authority that the other constituent institutions of USM have.

Although State law requires the Governor and General Assembly to approve new institutions and grant them the authority to award degrees, the item approved by the Board of Regents made no mention of seeking approval to grant degrees from the Governor, legislature, or MHEC. This change in the UMCES mission also raises the question of efficiency.

Is Stronger Oversight Needed?

Maryland's oversight structure covers the creation of degree programs and new academic facilities, but in recent years colleges have started to find ways around the proper approvals, whether deliberately or not. The roles of MHEC and the General Assembly may have to be clarified to ensure that new academic buildings and programs receive the proper approval prior to funding requests. It may be possible that more strict or clear rules are required in order for the designated State oversight bodies to maintain their intended roles in planning and managing higher education.

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Higher Education

Maryland Approves In-state Tuition Rates for Undocumented Students

Maryland voters approved the Maryland DREAM Act at the November general election, clearing the way for individuals who meet the law's requirements to pay in-state tuition rates at community colleges and public four-year institutions for the next academic term. Initially enacted in 2011, the law was petitioned to referendum.

Voters Affirm the DREAM Act

The Maryland DREAM Act was enacted in 2011 (Chapter 191). The law authorizes certain individuals, including undocumented immigrants, regardless of residency status, to pay in-state tuition rates at Maryland public higher education institutions. Prior to passage of the law, in-state tuition rates and policies at most community colleges and public four-year institutions of higher education did not include individuals who were unable to establish permanent residency. Because of their inability to establish permanent residency, many immigrants, including both documented and undocumented immigrants, were considered nonresidents for tuition purposes regardless of how long they had lived in Maryland or how many years they or their parents or guardians had filed Maryland income tax returns.

In July of 2011, the State Board of Elections certified that opponents of the Maryland DREAM Act had gathered enough petition signatures in accordance with the Maryland Constitution to refer the Act to referendum at the 2012 general election. On November 6, 2012, the voters of Maryland approved Question 4 and affirmed the law by a statewide vote, with 58% of voters supporting the measure. With passage of the referendum, individuals who meet the requirements of the law will qualify for in-state tuition rates beginning with the next academic term.

Requirements of the DREAM Act

Under the law, individuals must meet several requirements in order to qualify for in-state tuition, first at a community college, and then by transferring to a public four-year institution.

Community Colleges

Community college tuition rates are set by State regulations and the boards of trustees for the community colleges. There are three levels of tuition at community colleges: in-county, out-of-county, and out-of-state. In general, there is a three-month residency requirement for individuals to qualify for in-county community college tuition rates. In order to qualify for *out-of-county* tuition at a Maryland community college under Chapter 191, an individual must have attended a Maryland high school for at least three years and either graduated from a

Maryland high school or received the equivalent of a high school diploma in Maryland. Further, the individual must provide the community college with documentation that the individual or the individual's parent or guardian has filed a Maryland income tax return annually (1) for the three years during which the individual attended high school in the State; (2) during any period between graduation from high school in the State and registration at a community college; and (3) during the period of attendance at the community college. An affidavit must be provided to the community college stating that the individual will file an application to become a permanent resident within 30 days after the individual becomes eligible to do so, if the individual is not a permanent resident. Additionally, documentation must be provided that the individual has registered with the Selective Service System if required to do so. Finally, the individual must register at the community college within four years after graduating from high school, or within four years after receiving the equivalent of a high school diploma in Maryland, and not earlier than the fall 2011 semester.

An individual may pay *in-county* community college tuition under Chapter 191 if the individual meets the above requirements and attends a community college supported by the county in which the high school from which the individual graduated is located, or in the case of an individual who received the equivalent of a high school diploma, the individual attends a community college supported by the county in which the high school most recently attended by the individual is located.

Public Four-year Institutions

In general, individuals qualify for in-state tuition at public four-year institutions when they can document that they have lived continuously in Maryland for at least 12 consecutive months. Under the new law, an individual who meets the above community college requirements and is awarded an associate's degree by, or earned 60 credits at, a community college in the State is eligible for the in-state tuition rate if the individual (1) provides the institution a copy of the affidavit regarding filing an application to become a permanent resident; (2) provides the institution documentation regarding the annual filing of Maryland income tax returns by the individual or by the individual's parent or guardian up to and including the period of attendance at the institution; (3) attended a community college not earlier than the fall 2010 semester; and (4) registers at the institution within four years after graduating from, or achieving 60 credits at, a community college in the State. Individuals paying the in-state tuition rate under the law are counted as out-of-state students for the purposes of determining the number of Maryland students enrolled at an institution.

Veterans

For honorably discharged veterans of the U.S. Armed Forces, Chapter 191 extends the time period from one year to four years after discharge during which these veterans may present documentation to qualify for in-state tuition at public institutions of higher education in the State. The required documentation includes evidence that the veteran attended a Maryland high school for at least three years and documentation that the veteran graduated from a high school in the State or received the equivalent of a high school diploma in the State.

Implementation of the DREAM Act

The governing boards of the community colleges and public four-year institutions must adopt policies to implement the law. The Attorney General's Office advises that although implementation of the July 1, 2011 effective date of Chapter 191 was stayed pending the outcome of the petition to statewide referendum, with the passage of the referendum, individuals who meet the requirements of the law will be entitled to in-state tuition rates at the beginning of the next academic term immediately following the passage of the referendum. For most institutions, students may qualify for in-state tuition beginning with the 2013 spring semester; some institutions offer a condensed academic term between the fall and spring terms. Further, individuals who meet the requirements of the law and attended a community college beginning with the fall 2010 semester may be eligible for in-state tuition at a public four-year institution of higher education in the next academic term immediately following passage of the referendum if the individual was awarded an associate's degree by, or achieved 60 credits at, the community college.

The fiscal impact of the law will affect State funding for community colleges beginning in fiscal 2015, when enrollments from the 2012-2013 academic year will be used to calculate formula funding. The Department of Legislative Services has estimated that approximately 370 full-time equivalent students (FTES) will qualify for in-state rates in the first year, increasing State community college funding by approximately $736,000. The number of additional FTES qualifying for in-state tuition is likely to more than double the following year, when a full academic year of additional students will be included in the community college count and new students enter community colleges. By fiscal 2017, the additional State funding for community colleges is estimated at approximately $3 million. As soon as the current fiscal year (2013), community colleges and public four-year institutions may receive less tuition revenue due to students who were previously paying out-of-state rates but now qualify for in-state tuition; however, to the extent more students enroll at the institutions who were not previously enrolled because they could not afford the cost of paying out-of-state rates, tuition revenues may increase.

Health and Health Insurance

Implementation of Federal Health Care Reform in Maryland

Maryland is one of a handful of states that has been aggressively implementing many aspects of the federal Patient Protection and Affordable Care Act so that it can open enrollment in its own health benefit exchange beginning October 1, 2013. Prior sessions have seen significant legislative activity and more can be expected in the 2013 session to ready the State for full implementation of the federal law, including legislation to establish a mechanism to finance the health benefit exchange, expand Medicaid eligibility, and amend provisions of the Insurance Article to bring them into compliance with the insurance market reforms of the federal law.

State Implementation

Unlike many other states, which have moved slowly or left implementation to the federal government, Maryland has moved forward aggressively to implement the federal Patient Protection and Affordable Care Act (ACA). In the past three years, for example, legislation was enacted to bring the State's insurance law into compliance with new federal consumer protections; give the Insurance Commissioner enforcement authority over these new measures; standardize health insurance premium rate review and approval; create a federal high-risk pool as a component of the Maryland Health Insurance Plan; authorize the Community Health Resources Commission to provide technical assistance to safety net providers; discontinue prescription drug benefits for retired State employees who are also Medicare beneficiaries in 2020, when the Medicare "donut hole" is eliminated; establish the Maryland Health Benefit Exchange; and create a process for selection of the benchmark plan of essential health benefits for health insurance plans offered to individuals and small employers.

Maryland Health Care Reform Coordinating Council

To oversee and coordinate health care reform implementation in Maryland, Governor Martin J. O'Malley established, by executive order, the Maryland Health Care Reform Coordinating Council in 2010. The council is comprised of top officials from the Executive Branch as well as key legislators. In September 2012, the council selected the State employee health benefit plans as the benchmark plan of essential health benefits for the State. The benchmark plan will set the standard for the covered benefits that must be included in health insurance plans offered in the individual and small employer markets in the State.

Maryland Health Benefit Exchange

Established in 2011 as an independent unit of State government, the Maryland Health Benefit Exchange (MHBE) will help individuals and small employers and their employees shop for affordable health insurance. According to a 2012 study by the Hilltop Institute, by 2016, MHBE will help an estimated 184,000 individuals purchase health insurance and provide qualifying individuals with $687 million in federal premium and cost-sharing subsidies. After doing marketing research, the MHBE Board of Directors chose the brand name "Maryland Health Connection" as the public face for the exchange. MHBE has also been successful in receiving federal grants to finance its activities, including a $123 million Level 2 Implementation Grant in August 2012.

Much of the grant money will be used to develop and implement an information technology system or "HIX" to determine eligibility and enroll eligible individuals in Medicaid or a Qualified Health Plan offered through the Maryland Health Connection. MHBE is reporting progress on the implementation of the HIX although there are significant project risks: compressed timelines; the need for interoperability with existing State systems and a to-be-created federal data hub; and the need for additional federal policy guidance.

In accordance with 2012 legislation, MHBE has also moved forward with adoption of interim procedures for certifying health benefit plans as Qualified Health Plans in the Maryland Health Connection, adoption of regulations for Exchange navigators to assist individuals and small employers in purchasing qualified health plans in the Maryland Health Connection, and studies of financing mechanisms and continuity of care (described in more detail below).

Medicaid

In addition to providing for a significant expansion of Medicaid, the ACA has offered other financial incentives for innovative programming that the State has taken advantage of, including (1) pursuing two options available under the ACA to shift the balance away from nursing homes and toward home- and community-based services (the State Balancing Incentive Payments Program, which provides a 2% enhanced match on eligible home- and community-based services between federal fiscal 2012 and 2015, and the Community First Choice State Plan Option that offers a 6% enhanced match for three years for home- and community-based attendant services); and (2) developing chronic health homes that are intended to encompass all of the medical, behavioral, and social supports needed by Medicaid beneficiaries with multiple chronic conditions. Services provided through Chronic Health Homes include case management, care coordination, transitional care, support services, referral services, and information technology for care coordination. Services are eligible for a 90% federal match for a period of eight quarters after the State Plan amendment is approved for chronic health home services.

Supreme Court Decision

On June 28, 2012, in *National Federation of Independent Business v. Sebelius,* 567 U.S.__ (2012), the U.S. Supreme Court ruled on two issues regarding the ACA. Although the court found that the individual mandate to buy health insurance was not a valid exercise of Congress's power under the Commerce Clause and the Necessary and Proper Clause of the

U.S. Constitution, the court did uphold the individual mandate as a constitutional exercise of Congress's general taxing power. Second, the court ruled that the expansion of Medicaid exceeded Congress's authority under the Spending Clause of the U.S. Constitution. The court determined that the appropriate remedy was to prohibit the Secretary of Health and Human Services from withholding all Medicaid funding if a state does not participate in the expansion. The Secretary may, however, withdraw funds provided under the ACA if a state chooses to participate in the Medicaid expansion but fails to comply with its requirements. Also, the ruling does not affect the ability of the Secretary to withhold Medicaid funds provided under other statutory provisions if a state fails to comply with Medicaid requirements not related to the expansion.

Therefore, Maryland may choose whether or not to participate in the Medicaid expansion. If it chooses not to participate, it would still receive federal funding for its current program as long as it complies with nonexpansion Medicaid provisions. It should be noted that there is no legal requirement that Maryland enact legislation to participate in the Medicaid expansion; however, all previous expansions of its Medicaid program have been done through legislation.

On the Horizon for the 2013 Session

Key decisions and modifications to existing law need to be made in 2013 for the State to be ready for the major health care reform implementation date of January 1, 2014.

Maryland Health Benefit Exchange

While legislation enacted in 2011 and 2012 put in place the major components of MHBE, modifications and clarifications may be needed in several areas, such as insurance carrier certification, navigator certification, and call center employee status. Most importantly, the General Assembly needs to pass a mechanism for financing MHBE when federal law requires it to be self-sustaining on January 1, 2015. Chapter 152 of 2012 established a joint legislative and executive committee to study and make recommendations on financing mechanisms. The study is due to the Governor and General Assembly by December 1, 2012. To assist in the study, MHBE hired the Wakely Consulting Group and reconvened its Finance and Sustainability Advisory Committee to develop and analyze financing models. The joint committee recommends an assessment on insurance carriers in the individual and the small group markets to support the variable costs of MHBE and some combination of an assessment on insurance carriers in the large group market, a modest assessment on health care providers, and an increase in the tobacco tax to support the fixed costs of MHBE. The joint committee recommended that an assessment on hospitals not be considered as a funding source, due to impact on the State's Medicare waiver.

Medicaid

As noted above, the Supreme Court's decision on the ACA gives states a choice as to whether or not to expand Medicaid eligibility. Maryland health care leaders have declared their intent to move forward with the expansion. While not required, any implementing legislation would:

- expand income eligibility up to 133% of the federal poverty level (the ACA requires the first 5% of income to be disregarded in determining eligibility, effectively raising the income threshold to 138% of poverty) and provide those individuals with the full Medicaid benefit package (the ACA allows for a limited package for those newly eligible under the ACA); and

- raise the eligibility age from 21 to 26 for young adults who have aged out of the foster care system.

It is estimated that 154,000 additional individuals will be enrolled in Medicaid in the first full year of implementation (2015).

In addition to legislation to expand eligibility for Medicaid, the General Assembly may consider legislation to promote continuity of care between the public health care coverage programs (Medicaid and the Maryland Children's Health Program) and commercial health insurance, both inside and outside MHBE. Chapter 152 of 2012 required MHBE and others to conduct a study, including a cost-benefit analysis, of establishing requirements for continuity of care in the State's health insurance markets. A report on the study is due by December 1, 2012.

Insurance Market Reforms

Several provisions of the Insurance Article need to be brought into compliance with the ACA, including:

- raising required coverage of children from age 25 up to age 26;

- repealing provisions that authorize pre-existing condition exclusions;

- repealing certain provisions relating to out-of-state association policies; and

- revising the definitions of "small employer" and other terms.

Additionally, the General Assembly will need to decide whether to continue to allow self-employed individuals enrolled in a small employer plan as of September 2005 to remain covered under the plan after December 31, 2013. Chapter 347 of 2005 altered eligibility for insurance in the small employer market and required employers to have at least two employees to be eligible. Self-employed individuals already covered were permitted to keep their plan but this provision will sunset at the end of 2013, unless the General Assembly acts.

Maryland Health Insurance Plan

The Maryland Health Insurance Plan (MHIP) is the State's insurer of last resort for individuals who cannot obtain health insurance through an employer or, due to a pre-existing medical condition, the individual health insurance market. The State subsidizes enrollee-paid premiums for MHIP coverage with revenue from an assessment on hospitals, yielding approximately $135 million in fiscal 2013. MHIP also administers the federal high-risk pool authorized by the ACA for individuals who have not had health insurance coverage for at least six months. The Senior Prescription Drug Assistance Program for Medicare beneficiaries also falls under MHIP. MHIP and MHBE signed a memorandum of understanding (MOU) in September and October 2012 to promote coordination of effort between the two agencies. Under the MOU, the Executive Director of MHBE will assist the MHIP Board of Directors in the recruitment and hiring of a new Executive Director for MHIP and oversee the work of MHIP staff. The action was precipitated by the departure of key MHIP staff and the likely need to continue MHIP only until 2014.

The General Assembly has three important issues to decide relating to MHIP:

- whether, when, and how to terminate health insurance coverage offered by MHIP, which currently has approximately 20,000 health insurance policies;
- what to do with the MHIP assessment on hospitals; and
- if the decision is to terminate MHIP, where to house the Senior Prescription Drug Assistance Program, which has a budgeted enrollment of 26,865 in fiscal 2013.

Although MHIP enrollees should be able to transition into commercial insurance policies in 2014, there has been discussion about continuing the MHIP hospital assessment to subsidize health insurance premiums in the individual market.

Small Employer Health Benefit Plan Premium Subsidy Program

Enacted at the 2007 special session, the Small Employer Health Benefit Plan Premium Subsidy Program, known as the Health Insurance Partnership, provides a premium subsidy to small employers as an incentive to provide health insurance to their employees. The premium subsidy is targeted to the smallest employers, with 2 to 9 employees whose average wage is below $50,000, and which have not previously offered health insurance. The program has had only limited success, enrolling 416 businesses and their 1,887 employees and dependents as of October 31, 2012. As tax credits are available to small employers under the ACA (albeit with somewhat different requirements, including a minimum employer contribution to premium), the General Assembly may wish to discontinue the Health Insurance Partnership Program.

Health and Health Insurance

Medicaid Population and Financing Trends

Use of Medical Assistance programs remains high, although the rate of growth in the program has fallen sharply from the double digit growth experienced during the 2007 through 2009 recession. The fiscal 2014 budget projections include estimates of the growth anticipated as a result of the federal Patient Protection and Affordable Care Act.

Overview

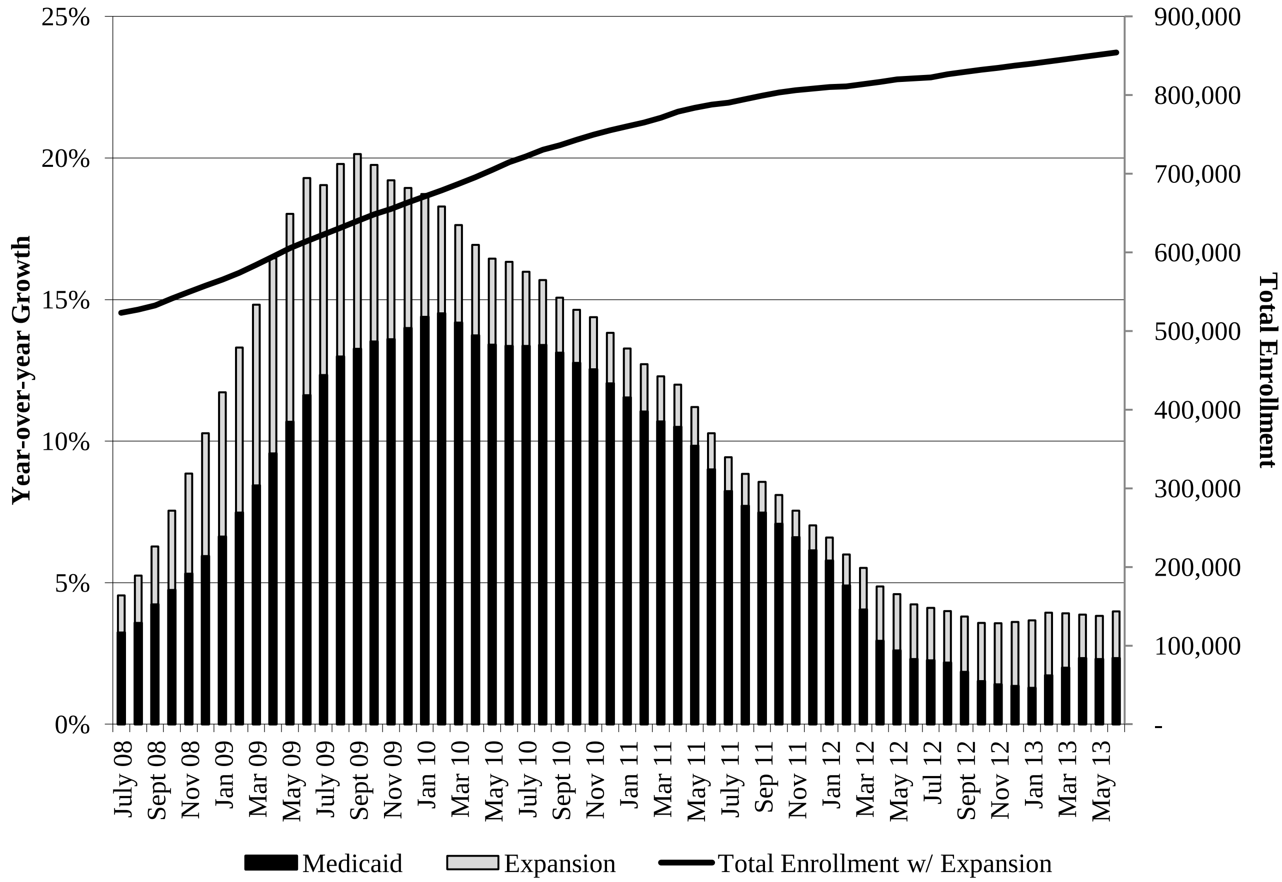
Maryland's Medical Assistance programs (Medicaid, Maryland Children's Health Program (MCHP), Primary Adult Care (PAC), Employed Individuals with Disabilities, *etc*.) provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50% for Medicaid and 65% for MCHP. The fiscal 2014 Medicaid baseline estimate also includes the impact of the federal Patient Protection and Affordable Care Act (ACA) which allows the expansion of Medicaid to 138% of the federal poverty level effective January 1, 2014. Under the ACA, States availing themselves of that opportunity will benefit from an enhanced match rate for certain new coverage groups.

Fiscal 2013 Outlook

The fiscal 2013 Medical Assistance programs working appropriation of just over $7.0 billion (just under $2.4 billion in general funds) appears to be sufficient to meet projected need. Further, the Medical Assistance programs appear to have adequate accrual from fiscal 2012 to cover bills received in fiscal 2013 for services rendered in fiscal 2012.

Expenditures for fiscal 2013 services are not expected to exceed the fiscal 2013 appropriation, based on several factors: an anticipated gradual slowing and then leveling off in the increase in program enrollment (see **Exhibit 1**), a small but continued increase in the use of managed care to serve program enrollees, the impact of cost containment actions in the fiscal 2013 budget, a continuing decline in inpatient expenditures, higher than anticipated pharmacy rebates, and a scheduled managed care organization (MCO) rate reduction of 1.1% in calendar 2013. Costs per enrollee are anticipated to increase by less than 1.0% between fiscal 2012 and 2013.

Exhibit 1
The Pace of Medicaid Enrollment Growth Continues to Slow
Fiscal 2009-2013



Note: "Expansion" comprises parents whose income does not exceed 116% of the federal poverty level, made eligible under Chapter 7 of the 2007 special session. Data excludes enrollment in the Maryland Children's Health Program and Primary Adult Care Program.

Source: Department of Health and Mental Hygiene; Department of Legislative Services

Fiscal 2014 Forecast

In fiscal 2014, expenditures for the Medical Assistance programs are estimated to be just under $7.8 billion, an 11.7% increase over the fiscal 2013 estimate. This estimate is based on a variety of factors including continued moderation of enrollment growth of the existing Medicaid/MCHP program (2.38%), continued constraints on medical inflation/utilization including the ongoing effects of cost containment such as MCO rate reductions in the first six months of the fiscal year, the assumption of only modest rate increases in calendar 2014, a modest assumption of continued growth in the percentage of Medicaid enrollees served in managed care, and costs associated with the anticipated expansion of Medicaid under the ACA.

While the U.S. Supreme Court upheld the constitutionality of most of the ACA, it did find that the federal government could not require the participation of states in Medicaid expansion to 138% of the federal poverty limit (FPL). While a small number of states have initially indicated that they will not be participating in the expansion of Medicaid (in spite of the fact that in the initial years, all costs will be borne by the federal government), Maryland has indicated that it will be expanding coverage and also that it will be offering the standard Medicaid benefit package to this population. The Department of Legislative Services (DLS) anticipates that in fiscal 2014, the Medicaid expansion will result in the addition of just over 135,000 new enrollees (including enrollment due to the "woodwork effect" *i.e.*, enrollment of individuals who are already eligible but for whatever reason remain not enrolled). Over half of the new enrollees are existing PAC enrollees who will now be eligible for full Medicaid benefits. This equates to a 16.6% increase in enrollees in the full Medicaid/MCHP program (see **Exhibit 2**). The medical costs of most of these new enrollees (childless adults and all adult enrollees between 116% and 138% of FPL) will be reimbursed at 100% federal funds. In addition, the State will no longer be required to support the PAC program. Taken together, DLS estimates increased expenditures in the second half of fiscal 2014 of $492 million. This increase is made up of general fund savings of $32 million and an increase in federal fund expenditures of $524 million.

As a result of all these changes, general fund need is expected to grow by $224 million (9.4%). It should be noted that $95 million of this amount reflects the need to replace fiscal 2013 special funds from the Budget Restoration Fund in fiscal 2014. Nonetheless, special fund support in fiscal 2014 is expect to continue at a high level (just under $900 million) primarily derived from a variety of provider assessments (on MCOs, hospitals, and nursing homes).

Exhibit 2
Enrollment and Service Year Expenditures*
Fiscal 2012-2014

	2012 Actual	2013 Estimate	2014 Estimate	2013-2014 % Change
Enrollment by Category				
Medicaid	723,004	736,570	746,264	1.32%
MCHP	103,011	109,506	112,157	2.42%
Medicaid Expansion to Parents	84,908	102,188	112,407	10.00%
Expansion under ACA (beginning January 1, 2014, including woodwork effect)			135,233	n/a
Total	**912,935**	**950,277**	**1,108,075**	**16.61%**
Cost Per Enrollee	**$7,047**	**$7,093**	**$6,791**	**-4.26%**
Cost Per Enrollee Excluding ACA Expansion		**$7,093**	**$7,229**	**1.91%**
Total Funds ($ in Millions)	**$6,433**	**$6,741**	**$7,525**	**11.64%**

MCHP: Maryland Children's Health Program
ACA: Patient Protection and Affordable Care Act

*Expenditures by fiscal year are based on the cost of providing services during that fiscal year rather than the year that the bills were actually paid. Cases and funding associated with the Maryland Primary Adult Care Program and the Kidney Disease Program are excluded from the chart, which explains any difference between expenditures cited in the main body of the text versus the chart. Fiscal 2014 average cost per enrollee is artificially lowered by the growth in enrollees in the second half of the fiscal year due to the ACA. For purposes of comparison, data with and without that expansion, are shown.

Source: Department of Legislative Services

Health and Health Insurance

Behavioral Health Integration

The Department of Health and Mental Hygiene recently completed a review of potential models that would integrate behavioral health (substance abuse and specialty mental health) care delivery. A recommendation has been made to the Secretary, and his decision on which model to pursue is anticipated before the 2013 session. A related initiative, the development of chronic health homes for persons with behavioral health problems, is also moving ahead.

Background

It has long been understood that there is a high prevalence of co-occurring substance abuse and mental health conditions. Lifetime prevalence of co-occurring disorders among individuals seeking substance abuse treatment has been estimated from 25.0% to over 50.0%. National surveys reveal 51.4% of those surveyed with a lifetime substance abuse disorder also reported a lifetime mental health disorder, and 50.9% of those with a mental health disorder reported having a substance abuse disorder. However, all too often, not only are behavioral health services delivered in separate systems, those systems are poorly integrated with other medical care. For public health programs, such as Medicaid, this lack of integration is particularly disconcerting given that a small number of individuals in this program disproportionately consume a large percentage of overall spending. Many of these individuals have multiple chronic conditions, frequently including behavioral health problems.

Integration of Behavioral Health: 2011 Interim Study

During the 2011 interim, a consultant working for the Department of Health and Mental Hygiene (DHMH) reiterated issues with the current delivery system that have been long understood including poor alignment of benefit design and management, fragmentation of purchasing and financing, uncoordinated care management, a lack of performance risk, and a lack of integrated care management across the systems.

The study reviewed a variety of models and systems operating in other states but ultimately offered two options.

- The preferred option was to provide a Medicaid behavioral health benefit managed by health plans through a “protected carve-in” as part of the HealthChoice program.

- The second option was the development of an insurance and performance risk-based “carve-out” extended to all behavioral health services.

Integration of Behavioral Health: 2012 Interim Study

At the end of the 2011 interim, DHMH opted for an additional study of the issue. Since the department envisaged one agency to oversee the financing of medical, substance abuse, and mental health services, namely the Medicaid program, the Deputy Secretary for Health Care Financing was charged with leading the review of financing and integration options.

That review focused on three system options, including those previously recommended in the 2011 consultant's report.

- A protected carve-in, whereby all behavioral health services would be delivered through the HealthChoice program by managed care organizations.

- The carve-out of substance abuse services from the HealthChoice program combined with the current carve-out of specialty mental health services to be delivered either through:

  - a single insurance risk behavioral health plan funded through a capitated payment; or

  - a single fee-for-service performance risk behavioral health plan.

- A risk-based population carve-out that would identify individuals with serious behavioral health problems and deliver all care (behavioral and somatic) through a risk-based entity.

After initially recommending a carve-out of all behavioral health services using a capitated insurance risk model, the final report opted for the fee-for-service performance risk carve-out, with performance risk borne by both the manager of the plan and by service providers. This recommendation is currently being reviewed by the Secretary of Health and Mental Hygiene.

If DHMH proceeds with this model, there are many outstanding questions that remain to be answered including which services will be included under a carved-out model; how services to the uninsured will be managed; how provider rates will be developed both for mental health and substance abuse services; what outcomes will be utilized to measure performance, how performance will be utilized at both the plan and provider level, and how outcomes will be actually collected; how care will be coordinated between the behavioral health plan and managed care organizations; and how the system will be administered at both the local and State level and what that administration means in terms of State support for local mental health and substance abuse agencies. These and other questions will form the next phase of integration efforts.

Although DHMH does not need legislation to immediately move forward with integration efforts, it will need to procure a new management entity and possibly amend other aspects of existing law related to behavioral health financing. It is unclear on the timing of the next steps and if any legislation will be introduced in the 2013 session.

Chronic Health Homes

DHMH used its behavioral health integration discussions not only to move forward on its system reform proposals, but also to move ahead in taking advantage of a provision of the federal Patient Protection and Affordable Care Act (ACA) that allows states to promote health homes for Medicaid enrollees with chronic conditions. Section 2703 of the ACA authorizes Medicaid programs to provide the following six services to eligible enrollees:

- comprehensive care management;
- care coordination and health promotion;
- comprehensive transitional care/follow-up;
- patient and family support;
- referral and community and social support services; and
- use of health information technology to link services, if applicable.

Eligible Medicaid beneficiaries include individuals who have two or more chronic conditions, one chronic condition and risk for a second, or a serious and persistent mental health condition. States are required to track and report outcomes and calculate cost savings. In addition, designated providers must report quality measures as a condition of reimbursement. The provision includes an enhanced federal funding rate of 90% funding for coordination services for eight quarters, after which the federal funding rate lowers to the traditional 50% funding level. Funding was included in the fiscal 2013 budget to take advantage of this opportunity with a view to a January 1, 2013 start.

As stated above, part of the behavioral health integration public stakeholder process included a workgroup in order to make a recommendation on a new health home service under the ACA. The workgroup was charged with defining the services to be provided, establishing the qualifications for eligible consumer populations and providers, and recommending a basic payment methodology structure. The workgroup met four times during spring and summer 2012 and included representatives of approximately 70 government offices, health programs, and advocacy groups.

As a result of the stakeholder process, the workgroup issued recommendations related to the establishment of a chronic health home service in Maryland. The recommendations limit eligibility to individuals diagnosed with an opioid substance use disorder that is being treated with methadone or buprenorphine in an outpatient methadone treatment program who also have one other chronic health condition, such as a serious and persistent mental illness, diabetes, cardiovascular disease, or obesity. Also eligible are individuals with a serious and persistent mental illness that impairs their ability to live in their customary setting, maintain employment or attend school without support, or manage the effects of their mental illness. The six services mandated by the ACA as listed above would be provided.

As for provider qualifications, health homes would be required to:

- be licensed as a psychiatric rehabilitation program or outpatient methadone treatment program;
- be enrolled as a Maryland Medicaid provider;
- be accredited as a health home by the Commission on Accreditation of Rehabilitation Facilities; and
- within three months of service initiation, have a contract or memorandum of understanding with a community inpatient facility to formalize discharge and transitional planning.

Health home providers would be required to propose a delivery model that the State determines to have a reasonable likelihood of being cost effective and would have to meet certain staff ratios. The workgroup recommended a three-phase system for reimbursement based on actuarially sound per member, per month (PMPM) payment with alternative PMPM mechanisms for outreach and engagement, intensive care management, and ongoing care management.

DHMH is currently developing the State Plan Amendment to implement the proposed chronic health homes initiative.

Health and Health Insurance

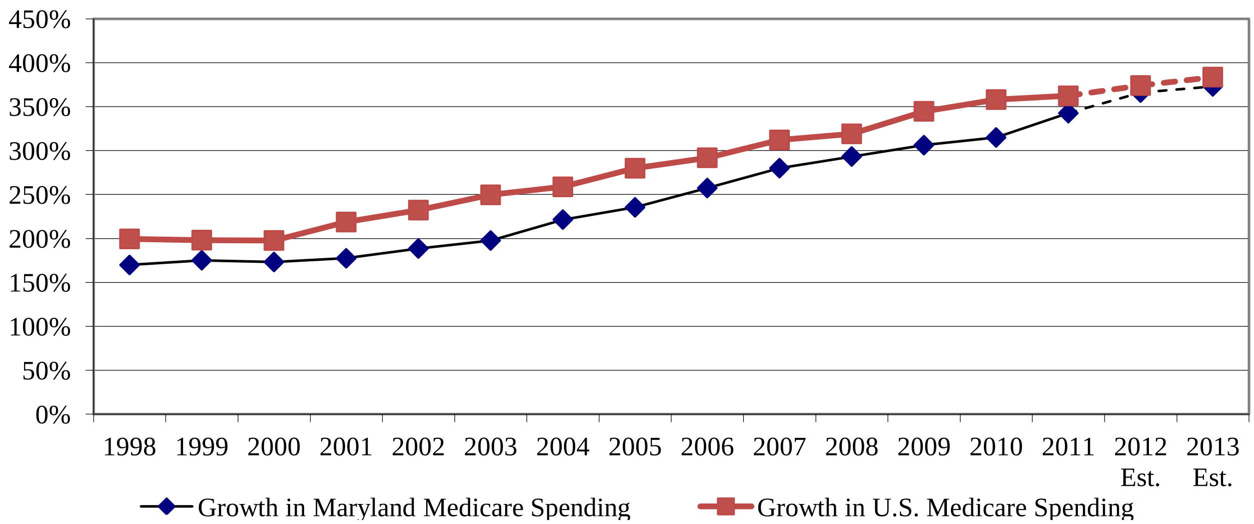
Status of Maryland's Medicare Waiver and the "All-payor" System

Maryland's hospital rate-setting system operates under a federal Medicare waiver that requires Maryland to keep growth in Medicare inpatient per case charges lower than the national average. In recent months, Maryland's waiver performance has deteriorated, prompting the State to explore modernizing and renegotiating the terms of the waiver.

Maryland's Medicare Waiver: Origin of the "All-payor" System

The authority of the Health Services Cost Review Commission (HSCRC) to standardize rates for all payors, including Medicare and Medicaid, was established in 1980 by federal legislation. At this time, Maryland is the only state with an all-payor, rate-regulated system. To maintain the waiver, the rate of growth in Medicare inpatient per-case charges to Maryland hospitals from 1981 to the present must remain no greater than the rate of growth at hospitals nationally over the same time period. **Exhibit 1** illustrates the growth of Medicare spending between fiscal 1998 and 2013. As of June 2011, the most recent data available, the cumulative growth of Maryland Medicare inpatient per-case charges has been 342.6%, compared to national growth of 362.3%. However, estimates for fiscal 2012 and 2013 project narrowing of this gap.

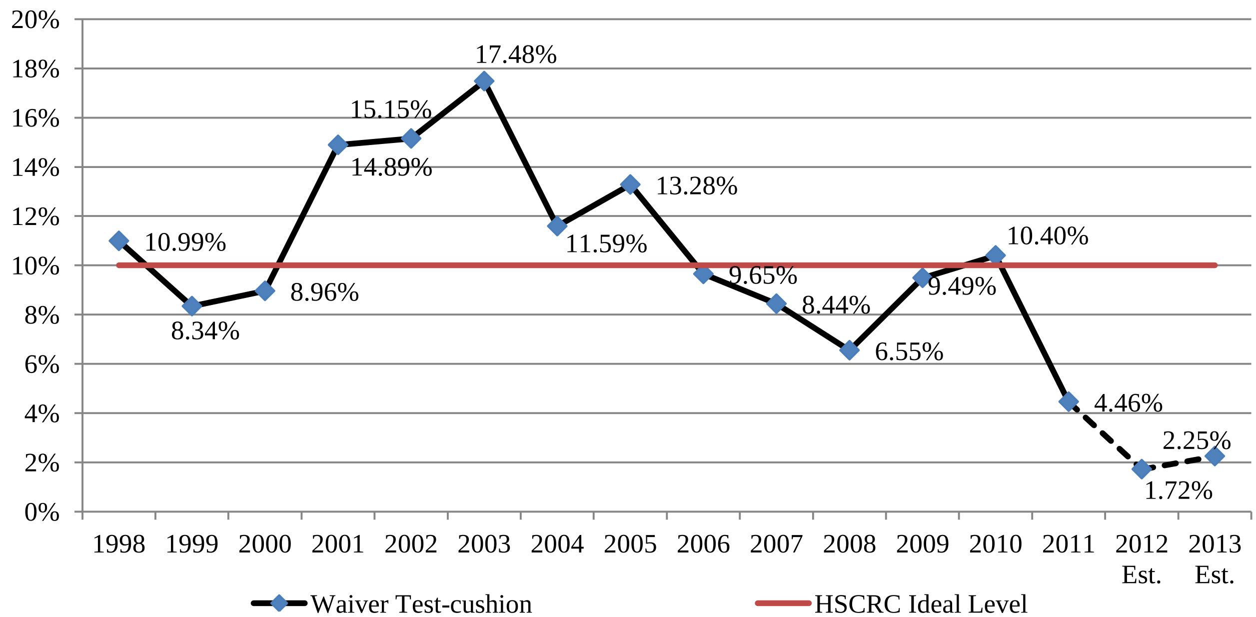
Exhibit 1
Medicare Inpatient Spending Growth – Maryland vs. National Average
Fiscal 1998-2013



Source: Department of Health and Mental Hygiene

HSCRC measures Maryland's waiver performance using the "waiver cushion" test. This represents the amount that Medicare inpatient per-case charges to Maryland could grow, assuming zero national growth, before the State failed to meet its waiver requirements. HSCRC has determined that 10.0% is the ideal level for the cushion. The larger the cushion, the more flexibility HSCRC has to adjust rates while simultaneously weathering Medicare payment trends. **Exhibit 2** displays Maryland's performance on the waiver cushion since fiscal 1998. While the cushion has fluctuated below and above 10.0% over the past decade, in fiscal 2011, the cushion fell to 4.46%, and estimates indicate that it will continue to hover close to 0.0% in fiscal 2012 and 2013.

Exhibit 2
Medicare Waiver Cushion
Fiscal 1998-2013



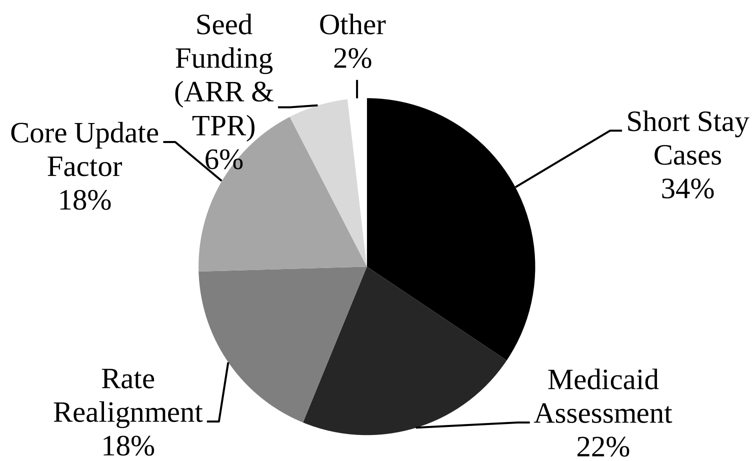
HSCRC: Health Services Cost Review Commission

Source: Department of Health and Mental Hygiene

Waiver Performance Erosion Due to Several Factors

Erosion of the waiver cushion is attributed to a combination of factors including Medicare cuts at the national level and increases in Maryland's charge per case for inpatient stays. According to HSCRC, for the year ending February 2012, the average charge per case grew by 8.69%, more than twice the 4.3% estimated last year. As shown in **Exhibit 3**, growth is attributable to funding for the Medicaid assessment (22.0%), rate realignment that has resulted in increased inpatient revenues (18.0%), a core update to hospital rates to cover inflation (18.0%), and seed funding for the Admission-Readmission Revenue (ARR) and Total Patient Revenue (TPR) programs (6.0%), which are intended to reduce overall health care spending. However, the largest single contributor to increased rates has been the policy for short-stay cases (34.0%). Inpatient stays of less than 24 hours are excluded from the charge per case methodology. As a result, the remaining cases are now more expensive on average. Further contributing to erosion in the cushion is the revised federal forecast, which projects lower case mix growth nationally, resulting in a drop on waiver performance.

Exhibit 3
Factors Contributing to Fiscal 2012 Charge Per Case Growth
Year Ending February 2012



ARR: Admission-Readmission Revenue
TPR: Total Patient Revenue

Note: Total charge per case growth was 8.69%.

Source: Department of Health and Mental Hygiene

Short-term Actions to Protect the Waiver

For the short-term, HSCRC has tightened control of the rate-setting system to improve the waiver cushion. In March 2012, HSCRC approved three emergency measures: (1) realignment of revenues between inpatient and outpatient hospital settings to capture changes in patterns of care not reflected in cost reports used to develop fiscal 2012 rates; (2) suspension of the charge per visit methodology, which limited the rate of increase in the revenue per outpatient visit on the condition that a new or revised outpatient constraint system be implemented by fiscal 2014; and (3) inclusion of one-day stay cases in the calculation of case mix (a measurement of each hospital's average patient acuity) for fiscal 2012.

In June 2012, HSCRC approved a net increase in hospital revenues of 0.3% for fiscal 2013, which included a 1.0% cut to impatient rates aimed at improving waiver performance and a 2.59% increase in outpatient rates. According to the Maryland Hospital Association, which advocated for this bifurcated update factor, hospitals are willing to accept losses on inpatient revenue if they are able to obtain reasonable outpatient revenue increase, even if the net increase remains below the rate of inflation.

HSCRC in Process of Renegotiating Waiver

While these emergency actions have resulted in marginal improvement in anticipated waiver performance, in the long-term, State officials and stakeholders recognize the need to modernize the State's waiver test. According to HSCRC, the drive for efficiency in health care has shifted from seeking to reduce resource use within an individual hospital stay to managing episodes of care across multiple settings and additional focus on prevention and population health. HSCRC has adopted rate-setting methodologies to encourage improved provision of services across settings by reducing preventable readmissions and providing capped revenue for hospital services to encourage provision of care at lower levels of acuity. Unfortunately, these steps are out-of-sync with the existing waiver and its focus on the average Medicare charge per case payment in Maryland compared with the national average.

To address erosion in the waiver cushion long-term, HSCRC has met with payors, the Department of Health and Mental Hygiene, and hospitals since mid-2012 to discuss modernization of the waiver to align the incentives with improved quality, improved population health, and lower growth in the cost of care. HSCRC is in the process of renegotiating the terms of the waiver with the federal Centers for Medicare and Medicaid Services. HSCRC is exploring a more holistic approach such as per-capita or per-beneficiary spending on a variety of services rather than a sole focus on per-case costs for inpatient stays. Recommendations have also been proposed by stakeholders including (1) reexamination and realignment of the current governmental differential (Medicare and Medicaid receive a 6% discount on hospital rates) to improve the waiver cushion and reduce Medicaid reliance on hospital assessments; (2) an overhaul of the outpatient pricing system; (3) adoption of case targets and real case mix governors for short stay cases; (4) implementation of more standardized pricing of services among hospitals; (5) reduction of incentives for volume and unnecessary utilization; and (6) alignment of physician incentives with hospital incentives.

Waiver modernization will most likely be implemented through a federal Center for Medicare and Medicaid Innovation grant rather than through federal legislation. As of November 2012, although it is hoped that waiver negotiations conclude soon, the details of any waiver change proposal to the federal government have not been disclosed.

Health and Health Insurance

Board of Physicians Consultant's Report

The 2011 sunset evaluation of the State Board of Physicians identified significant challenges facing the board relating to complaint resolution and other matters. At the direction of the Secretary of the Department of Health and Mental Hygiene, the board engaged a consultant to conduct a review of the board. This issue paper examines recommendations in the consultant's report and compares them to Department of Legislative Services' recommendations.

2011 Sunset Evaluation

In 2011, the Department of Legislative Services (DLS) performed a full sunset evaluation of the Maryland Board of Physicians (MBP) and the related allied health advisory committees. In its evaluation, DLS identified significant challenges facing the board, including a growing backlog of complaints and an ongoing increase in the timeline for complaint resolution. DLS offered 46 recommendations relating to licensing, complaint resolution, board resources, and other issues. DLS recommended, moreover, that the termination dates for MBP and the related allied health advisory committees be extended for only one year due to the board's failure to implement key recommendations and requirements from previous sunset evaluations and sunset legislation, comply with several statutory requirements, and adopt regulations even when required by law. Although legislation was introduced during the 2012 legislative session to implement the statutory changes recommended in the sunset evaluation and to extend the board and allied health advisory committees, it did not pass.

University of Maryland Review

Given the depth of concerns raised by the DLS sunset review, the Secretary of the Department of Health and Mental Hygiene directed the board to conduct an independent review of the board and provide guidance regarding (1) the board's complaint resolution process; (2) how to respond to the sunset evaluation recommendations; and (3) how to meet board statutory responsibilities. That review was undertaken by the University of Maryland, Baltimore (UMB). In July 2012, UMB issued a report containing 18 recommendations derived from the sunset evaluation and other sources of information. Most of the recommendations relate to the board's complaint resolution procedures, and the most significant of these calls for the establishment of two separate panels to hear disciplinary cases. Those panels would act separately and have the authority to make a final determination in a case. If the first panel handled the case during the investigative stage, the second would handle it after charges were issued and vice versa. DLS generally concurs with the UMB findings and takes no issue with the UMB recommendations.

Recommendations for the 2013 Session

Since the 2011 sunset review, the board has made significant progress in implementing several of the nonstatutory sunset recommendations proposed by DLS and in improving board functions. Nonetheless, legislative action is required in 2013 at the very least to prevent the termination of the board and most of its related allied health advisory committees after July 1, 2013. The legislation could also include the implementation of a number of recommendations made by both UMB and DLS to better the work of the board as well as ensuring that the board implements statutory requirements. **Exhibit 1** outlines the 2011 sunset evaluation recommendations and the UMB recommendations that require legislative action. Some of the DLS recommendations from 2011 have been modified based on actions taken by MBP or other considerations. Nevertheless, DLS recommends that the General Assembly:

- extend the termination dates for the board and the related allied health advisory committees to July 1, 2018;

- require DLS to conduct a direct full evaluation of the board and related allied health advisory committees by October 30, 2016;

- require the board to submit an annual report to the Senate Education, Health, and Environmental Affairs and the House Health and Government Operations committees and DLS in 2013 through 2018 that provides an update on the progress of the board in implementing the 2011 sunset evaluation recommendations and other specified matters; and

- implement any statutory changes from Exhibit 1 with which the General Assembly concurs.

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Exhibit 1

Recommendations from Reviews of the State Board of Physicians That Require Legislative Action

UMB-1	Establish two separate panels to hear disciplinary cases, each acting separately.
UMB-4 & *DLS-5*	*Require a representative of the allied health professions advisory committee to participate as an ex-officio member in board disciplinary processes when a member of their profession is the subject of a disciplinary proceeding.*
UMB-9	Authorize the board to use only one peer reviewer in standard of care cases, other than for exceptional cases.
UMB-11	Adopt a "statement of policy" guiding the actions of the State Board of Physicians (MBP).
UMB-12	Increase the board size from 21 to 22 members, make a change in board composition, and divide disciplinary matters between the two panels.
UMB-14	Consolidate and more clearly delineate the duties and powers of the board.
DLS-4	Repeal the requirement that the board assess physician assistants a fee to fund the rehabilitation program.
DLS-14	Require MBP to disclose notice of initial denial of a physician license application on its website and the filing of charges on the physician licensee profiles with a disclaimer.
DLS-15	Require MBP to disclose the filing of charges against an allied health licensee and notice of initial denial of an allied health license application to the public, with a disclaimer.
DLS-16	Codify the requirement that MBP give the complainant in a case the opportunity to appear before the board during a case resolution conference.
DLS-19	Authorize MBP to seek and require MBP to have a warrant for entry into private premises for the purpose of investigating formal complaints that allege a person is practicing, attempting to practice, or offering to practice medicine without a license.
DLS-25	Require MBP to provide online profiles on allied health licensees and require that allied health licensee profiles, to the extent possible, contain the same information that is provided on physician profiles.
DLS-31	*Require that the advisory committee submit an annual report to the board and that the board provide to the advisory committee chair on a biannual basis a report on disciplinary matters involving allied health professionals.*
DLS-34	*Prohibit the appointment of an individual to an advisory committee or the board if the individual is providing or has provided services to the board for remuneration unless a waiver is granted by the Governor.*
DLS-36	*Require MBP to adopt regulations by December 31, 2012, that govern (1) exceptions to licensure for the purpose of consultation; and (2) exemptions from licensure fees. Adopt budget bill language in the 2014 legislative session to withhold funds from MBP until the regulations are adopted if MBP fails to adopt the regulations as required.*

DLS-37	Require the board to amend its regulations to conform to current practice by December 31, 2013. Adopt budget bill language in the 2014 legislative session to withhold funds from MBP until the regulations are adopted if MBP fails to amend the regulations as required.
DLS-38	Allow for current MBP practice regarding the requirement of postgraduate medical training for licensure and in cases of the failure to pass the required examination to be consistent with the Maryland Medical Practice Act.
DLS-40	*Require the board to (1) work with the Maryland Insurance Administration, the Office of the Attorney General, the Maryland Health Care Commission, and the Department of Health and Mental Hygiene's Office of the Inspector General to determine the appropriate entity for investigating and enforcing the Maryland Self-referral Law; and (2) report the findings to the Department of Legislative Services (DLS) in a subsequent follow-up report.*
DLS-41	Authorize MBP, rather than require the circuit courts, to impose civil fines against alternative health systems that fail to report as required so that the civil fine provisions related to reporting by hospitals and related institutions and alternative health systems are the same. Clarify how the court reporting requirement is to be enforced and place the requirement in a separate statutory section.
DLS-42	Clarify that all entities required to report to the board under §§ 14-413 and 14-414 of the Health Occupations Article are to report every six months even if the entity has not taken disciplinary action against or denied privileges to a licensee.
DLS-46	*Extend the termination date for MBP and related allied health advisory committees until July 1, 2018. Require DLS to conduct a direct full evaluation of the board and related allied health advisory committees by October 30, 2016. Require MBP to submit an annual report to the Senate Education, Health, and Environmental Affairs and the House Health and Government Operations committees, as well as to DLS, by December 1 of each year between 2013 and 2018 that provides an update on (1) any changes to the discipline process that have been implemented and the effect of those changes on the complaint backlog and complaint resolution times; (2) the progress of the board in procuring and implementing a new information technology system to improve data management; (3) a long-term financial plan and financial data for the preceding fiscal year; and (4) the progress in the board in implementing the 2011 sunset evaluation recommendations and any statutory changes affecting the board.*

Notes: The references in column one refer to the original report and recommendation number; DLS refers to the *Sunset Review: Evaluation of the State Board of Physicians and the Related Allied Health Advisory Committees, Department of Legislative Services, November 2011*; UMB refers to the *Report to the Maryland Board of Physicians Submitted by the University of Maryland, Baltimore, July 2012*. Recommendations in italics have been modified by DLS.

Source: University of Maryland, Baltimore; Department of Legislative Services

Health and Health Insurance

Developmental Disabilities Issues

Significant additional State resources are being spent on addressing the needs of individuals on the Developmental Disabilities Administration's waiting list. However, the administration continues to have difficulty with financial oversight. This difficulty may not change until the current provider payment system is reformed.

New Fiscal 2012 Funding to Address the Waiting List

In the 2011 session, the legislature appropriated an additional $15 million to the Developmental Disabilities Administration (DDA) for fiscal 2012 based on its concern over the lack of services available to meet the demand from individuals with developmental disabilities. Funding was provided through Chapter 571 of 2011, which increased the State sales and use tax rate imposed on alcoholic beverages from 6 to 9% and required a supplementary appropriation of $15 million for DDA to fund services to individuals on DDA's waiting list. Specifically, funding had to be used to assist individuals in the Crisis Resolution and Crisis Prevention categories of the waiting list.[1] The $15 million supplementary appropriation was also partially matched by federal funds based on the number of individuals served in the Crisis Resolution category.

Ultimately, in fiscal 2012, DDA spent an additional $18.0 million in general funds and $5.0 million in matching federal funds to serve those on the waiting list, exceeding its $15.0 million general fund appropriation by $3.0 million. As shown in **Exhibit 1**, DDA used $12.1 million to place individuals in the Crisis Resolution category into ongoing services, doubling the number of placements over fiscal 2011. All individuals in the Crisis Prevention category of the waiting list were eligible for up to $10,000 in one-time assistance for Services of Short Duration (SSD). DDA used $10.9 million to provide SSD to 1,172 individuals in the Crisis Prevention category.

DDA was able to increase placements due to the implementation of an expedited process of initiating services. This new process streamlined the initial assessment of needs, the individual plan development, and the funding process. DDA also implemented new procedures to review challenging cases at the department level and coordinated additional supports through various service delivery systems, such as mental health services, to meet unique needs.

[1] The DDA waiting list is comprised of adults and children with developmental disabilities who are waiting to obtain DDA-funded community-based services within the next three years. Prior to placement on the waiting list, an individual must be determined eligible for DDA funding based on definitions found in State law. Once determined eligible for DDA funding, the individual is placed on a waiting list which is broken down into three priority categories: Crisis Resolution, Crisis Prevention, and Current Request. Individuals in the Crisis Resolution category are in need of immediate ongoing assistance, while those in the Crisis Prevention category are in need of one-time funding and are considered at risk of going into crisis in the next year. Individuals within the Current Request category include those who are not considered at risk.

Exhibit 1
Individuals Receiving DDA Services through the Alcohol Tax
July 1, 2011 through June 30, 2012

	Crisis Resolution	Crisis Prevention	Total
Placements	286	1,172	1,458
General Fund Costs ($ in Millions)	$7.1	$10.9	$18.0
Federal Fund Costs ($ in Millions)	$5.0	$0	$5.0

Source: Developmental Disabilities Administration

It should be noted that due to increased outreach efforts by DDA, more people came onto the waiting list in fiscal 2012 than in fiscal 2011. In total, 322 people were added to the Crisis Resolution category in fiscal 2012, compared to 163 in fiscal 2011. Similarly, 667 people were added to the Crisis Prevention category in fiscal 2012, as compared to 588 in fiscal 2011. As of September 24, 2012, 93 people were in the Crisis Resolution category, and 1,343 people remained in the Crisis Prevention category.

Fiscal 2011 Budget Closeout and the 2012 Legislative Session

At the same time that DDA has been working to address the waiting list, significant concerns have emerged about the administration's fiscal capability. Specifically, during the 2011 budget closeout process, the Department of Health and Mental Hygiene (DHMH) learned that there was a $38.3 million general fund surplus because DDA was inappropriately charging expenditures to the prior fiscal year to avoid reverting funds to the State's general fund. Of this amount, the agency eventually reverted $25.7 million. Instead of reverting the remaining $12.6 million in general funds, the agency decreased federal fund expenditures by $12.6 million and increased general fund spending by the equivalent amount, allowing DDA to carry forward an estimated $12.6 million in unspent federal funds into fiscal 2012. Furthermore, $3.3 million in special funds was cancelled in fiscal 2011 as DDA failed to utilize monies available under the Waiting List Equity Fund and prior year grants.

After reviewing actual federal fund expenditures for fiscal 2011, in March 2012, DHMH reported that the actual amount of the surplus carried forward into fiscal 2012 was $13.3 million. Based on its budget projections, DHMH concluded that DDA would not be able to spend its full appropriation. Therefore, actions taken through the supplemental budget reappropriated the $13.3 million of surplus funds in fiscal 2013. Other actions were also taken in order to prevent the reversion of general funds in fiscal 2012. For instance, the Budget Reconciliation and Financing Act of 2012, for fiscal 2012 only, authorized DHMH to transfer up to $5.0 million in unexpended funds to a dedicated account for specified uses in fiscal 2013 within the Community Services Program of DDA and the Office of Health Care Quality. Furthermore, a total of $4.6 million was transferred by budget amendment to the Community Health Resources Commission for one-time infrastructure grants for developmental disability providers.

Fiscal 2012 Budget Closeout

Ironically, after taking numerous actions noted above to move general funds out of fiscal 2012 into fiscal 2013, DDA reported a $5.4 million general fund deficiency at fiscal 2012 closeout. The department identified the following reasons as to why a deficit developed in the Community Services Program: (1) an unanticipated surge in SSD requests at the end of the fiscal year led the agency to exceed its $15.0 million supplemental appropriation under the Alcohol Tax by $3.0 million as noted above; and (2) Requests for Service Change for additional services exceeded attrition expectations, resulting in a $2.4 million deficiency. Based on federal fund attainment, the general fund shortfall may fluctuate.

DHMH's attempts to prevent the reversion of general funds as late as May 2012 during the first special session when juxtaposed to the outcome of the fiscal 2012 budget closeout, highlights DDA's inability to accurately budget despite changes in fiscal oversight.

Changes in DDA's Fiscal Oversight

In October 2011, the Office of the Inspector General (OIG) at DHMH issued a report that confirmed the fiscal 2011 budget reversion and commented on the underlying causes of DDA's underspending. Among other things, OIG noted the current DDA provider payment system is out of date, creating underlying weaknesses in the agency's financial accounting system. Due to the size of DDA's budget, OIG recommended that DHMH consider options for reconfiguring the DDA fiscal support structure, including a new system for generating and monitoring provider service delivery data and payment reconciliations.

In response to OIG's recommendations, DHMH has taken several steps to improve fiscal oversight within DDA. For instance, DDA awarded a contract to a forensic auditor to determine how long the agency was underspending and anticipates the results of the report in the near future. The agency has also implemented new fiscal policies to improve budget projection methodology by increasing coordination with DHMH's budget office and the department's General Accounting Division. While these corrective actions have been made to improve financial oversight, the fiscal 2012 deficiencies indicate these changes have not resolved the agency's budgeting issues and underscore OIG's concerns regarding the provider payment system.

Underlying Weaknesses in DDA's Payment System

DDA's current payment system was adopted in 1987 after DHMH was instructed by the General Assembly to develop an alternative to the agency's quarterly grants system and was subsequently codified in calendar 1994. The payment system has two components: (1) the client component, or the cost of direct care to clients; and (2) an administrative component. The rate paid to a provider results from the integration of the client component and the administrative component. The payment system works by estimating the costs a provider will incur in the coming fiscal year to serve its clients. DDA pays these costs to providers upfront (prospectively). Providers then submit documentation of their expenses, and at the end of the year, DDA and providers reconcile actual costs with the prospective payments using the provider's audited cost reports. If actual costs were less than the prospective payments, a provider reimburses DDA; if actual costs were greater than the prospective payments, DDA reimburses the provider.

A major component of DDA's recent budgeting inaccuracies is due to an inherent problem with the prospective payment process. Since payments are issued one quarter in advance, there is always the possibility that the payment will differ from actual expenses. Thus, DDA will have always overpaid or underpaid providers at the close of the year. Indeed, DDA has encountered difficulties budgeting since the current payment system was adopted both in terms of significant deficits and also surpluses.

Despite DDA's fiscal history and numerous audit findings, the weaknesses in the agency's budgeting system have received less attention due to numerous executive and legislative priorities. For instance, a six-year waiting list initiative began in fiscal 1999 after several years of budget surpluses. Similarly, a total of $81 million was appropriated through the Wage Initiative from fiscal 2003 to 2007 to eliminate the wage disparity between State and private direct-service workers. These efforts to increase funding, however, have masked the underlying problems with the DDA payment system and fiscal oversight capability. Indeed, it can be argued that the additional funding and the desire of all parties to see additional spending in the DDA system prompted fiscal decisions to preserve DDA funding, which led to the recent budget condition in the fiscal 2011 and 2012 closeouts.

Efforts to Change the Payment System

DHMH has indicated that until DDA's payment system changes, the agency will continue to encounter difficulties when forecasting DDA's expenditures throughout the fiscal year. Furthermore, the 2012 *Joint Chairmen's Report* requires DHMH to submit a report on financial oversight in DDA by December 1, 2012. Specifically, the report must advise the budget committees of DDA's option to reconfigure its fiscal structure based on the recommendations of an independent consultant. DHMH advises that the agency issued a request for proposals (RFP) to restructure DDA's payment system. The initial method for procuring a consultant did not result in any bidders for the contract, and DHMH had to reissue an RFP; as of November 8, 2012 the agency had not yet procured a consultant.

Health and Health Insurance

Regulation of Facilities Performing Surgical Procedures

Recent incidents at unregulated facilities performing surgical procedures have, in the case of abortion services, prompted new regulations and in the case of cosmetic surgical centers may result in legislation.

State Regulation of Surgical Abortion Clinics

Background

In August 2010, a Maryland-licensed physician performed an abortion at American Women's Services (AWS) in Elkton, Maryland in which the physician perforated the patient's uterus and bowel and subsequently transported the patient to the hospital in a personal vehicle. AWS provided abortion services in several states including New Jersey, Pennsylvania, Virginia, and Maryland. The incident revealed that the owner of AWS, a physician who was not licensed in Maryland, often provided abortion services over a two-day period across State lines. The incident revealed limitations on the ability of state agencies to regulate abortion procedures that occurred across State lines. State law required an abortion to be performed by a licensed physician; however, doctor's offices and free-standing health care clinics where abortions were performed were not licensed by the Department of Health and Mental Hygiene (DHMH).

Department of Health and Mental Hygiene Response

State law authorizes DHMH to adopt regulations related to the abortion procedure that are both necessary and the least intrusive to protect the life or health of the woman and are not inconsistent with established medical practice. In response to the August 2010 incident, DHMH, in collaboration with stakeholders, developed regulations to increase oversight of surgical abortion facilities.

In July 2012, regulations were adopted to increase oversight of surgical abortion facilities. The regulations require surgical abortion facilities that perform abortions on site on a routine basis to obtain a license from DHMH. Modeled after regulations followed by outpatient surgical facilities, the regulations authorize DHMH to inspect and fine facilities and to close facilities in extreme circumstances. The regulations require the facilities to employ an administrator and medical director and require physicians and other health professionals working in the facility to be licensed in the State. In addition, surgical abortion facilities are required to meet specified guidelines related to anesthesia, emergency services, laboratory and pharmaceutical services, transport of patients to hospitals, maintenance of medical records, and the establishment of a quality assurance program.

State Regulation of Cosmetic Surgery Centers

Background and Current Law

In September 2012, three individuals who underwent liposuction at Monarch Medspa in Timonium, Maryland contracted infections of group A staphylococcus and were hospitalized. One of the patients subsequently died from the infection. Upon determining that the infections were contracted at Monarch Medspa, DHMH and the Baltimore County Department of Health closed the facility. However, the department's ability to inspect and close the facility was possible only after the infections were reported by the hospitals. Of note, while inspecting the Monarch Medspa facility, DHMH observed probable deviations from standard infection control practices.

The regulatory environment related to cosmetic surgery centers provides for limited DHMH oversight. Physicians and nurses who perform cosmetic surgery in the State must be licensed, and State law authorizes the Board of Physicians to discipline licensees who perform cosmetic surgical procedures in offices or facilities that are not accredited by specified accrediting organizations or that are not certified to participate in the Medicare program.

However, many cosmetic surgery centers are not subject to licensure or inspection by DHMH. The department has authority over ambulatory surgical centers, defined in State law as "any center, service, office facility, or other entity that (1) operates primarily for the purpose of providing surgical services to patients requiring a period of postoperative observation but not requiring overnight hospitalization; and (2) seeks reimbursement from payors as an ambulatory surgery center." Since many cosmetic surgery centers bill patients directly, these facilities are not required to obtain a license from DHMH.

The Maryland Health Care Commission lists the cosmetic surgery centers that are certified by the Centers for Medicare and Medicaid Services for Medicare participation as ambulatory surgical centers. Some surgical centers seek voluntary accreditation; accredited centers are generally subject to inspection by the accrediting organization.

Department of Health and Mental Hygiene Response

Although DHMH has specific statutory authority to adopt regulations governing the abortion procedure, there are gaps in DHMH's authority to regulate other types of surgical centers. In October 2012, DHMH sent out a request for public comment related to the oversight of outpatient surgical centers, including cosmetic surgical centers. The department has submitted specific questions for public comment including:

- whether the authority of the State Board of Physicians to discipline physicians who perform cosmetic surgical procedures in offices or facilities offers adequate protection to the health and safety of surgery patients;

- the potential benefits of including additional surgery centers among the centers currently regulated by DHMH as freestanding ambulatory care facilities;

- the types of surgery centers that should be included if the State were to expand oversight to additional centers;

- the potential risks and challenges to including additional surgery centers under State oversight; and

- whether DHMH should support legislation to expand State oversight of surgical centers.

The public comment period is now closed, and based on the feedback received, DHMH may request legislation related to the oversight of procedures performed in cosmetic surgery centers.

Health and Health Insurance

Regulation of Compounding Pharmacies

A recent outbreak of fungal meningitis, traced back to medications made by a Massachusetts compounding pharmacy, has prompted states and the federal government to review oversight of these entities. The Maryland State Board of Pharmacy is expected to propose strengthening existing controls in the 2013 session.

Background

In September 2012, tainted steroid shots caused an outbreak of fungal meningitis (a potentially fatal inflammation of the tissue surrounding the spinal cord) among those who had received the injectable medications. The shots were all produced by the New England Compounding Center in Massachusetts. As of November 9, 2012, the outbreak had affected 438 individuals and caused 32 deaths nationwide, including 23 cases and 1 death in Maryland. According to the Department of Health and Mental Hygiene (DHMH), as many as 1,100 patients in Maryland may have been injected with contaminated steroids. Seven medical facilities in the State have been identified as having received contaminated medications from the center. Since becoming aware of the contaminated drugs, DHMH and the affected facilities have notified approximately 1,700 patients of their potential exposure.

This event led to a massive recall and raised questions regarding the safety and regulatory oversight of compounding pharmacies such as the one in which the contamination originated.

Current Regulation of Compounding Pharmacies

The traditional role of compounding pharmacies was to customize physician-prescribed drugs for specific patients with needs that could not be met by commercially available drugs. In recent years, however, the role of compounding pharmacies has expanded and such facilities have been relied upon to address local drug shortages. According to the International Academy of Compounding Pharmacists, the compounding industry makes up an estimated 1 to 3% of the prescription market in the United States.

Although the U.S. Food and Drug Administration (FDA) regulates drug manufacturers, the extent of FDA's authority over compounding pharmacies has been the subject of dispute. Rather, compounding pharmacies are regulated by the boards of pharmacy in the states in which they are located. However, each state has different standards and requirements.

The Maryland State Board of Pharmacy has adopted regulations that pertain specifically to sterile pharmaceutical compounding. These regulations establish standards and requirements regarding personnel, equipment, procedures, labeling, recordkeeping, training, and quality assurance. The board has also developed separate inspection forms for sterile compounding pharmacies that reflect these regulations. Compounding pharmacies – like all licensed, in-state pharmacies – are required to be inspected annually by the board. The board generally meets its annual inspection obligations.

The board does not currently inspect facilities outside of the State, although it is authorized to investigate complaints of out-of-state facilities. In addition, recent legislation (effective October 1, 2012) required nonresident pharmacies licensed in Maryland to employ at least one Maryland-licensed pharmacist who is designated as the pharmacist responsible for providing pharmaceutical services to patients in Maryland. In addition, the legislation expanded the board's authority over nonresident pharmacies by (1) repealing the requirement that the board defer disciplinary action until after certain actions had been taken by the resident state; and (2) broadening the scope of disciplinary actions that may be taken against nonresident pharmacies.

Response from the Board of Pharmacy

The board has indicated that it will explore several options to address the regulatory lapses that were related to the recent outbreak. Specifically, the board is considering (1) requiring nonresident pharmacies that engage in sterile compounding to be inspected by a reputable entity prior to being issued an initial or renewed State permit; (2) expanding regulations and proposing statutory amendments to require nonresident sterile compounding pharmacies to meet Maryland's sterile compounding laws; and (3) reviewing, with DHMH, possible reporting requirements for pharmacies that engage in sterile compounding.

The board has advised that it will review its options at its meeting on November 28, 2012, and will then make recommendations to the legislature regarding ways to strengthen its regulations. In addition, DHMH has advised that it intends to advocate for stronger regulation of compounding pharmacies by FDA.

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Social Programs

Public Assistance Population and Financing Trends

Temporary Cash Assistance caseloads are expected to fall in fiscal 2013 and 2014. Demand for the Supplemental Nutrition Assistance Program (formerly food stamps) continues to grow but at a much slower rate.

Background

The 2007 to 2009 economic recession led to dramatic increases in caseloads for public assistance programs, notably Temporary Cash Assistance (TCA) and Supplemental Nutrition Assistance Program (SNAP), formerly known as Food Stamps. TCA provides monthly cash grants to needy children and their parents or caretaker relatives. TCA is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections. SNAP helps low-income people buy the food they need for good health. Benefits under SNAP are provided entirely with federal funds.

Temporary Cash Assistance Caseload and Funding Trends

Since fiscal 2007, the TCA average monthly caseload has increased each year, an unsurprising trend given the recession and weak recovery especially as it relates to employment. However, it appears the caseload peaked in fiscal 2012 when the average monthly caseload grew just 0.3% over the prior year. Annual caseload growth through the five years ending in fiscal 2012 is as follows:

Fiscal 2008	2.4%
Fiscal 2009	13.5%
Fiscal 2010	15.7%
Fiscal 2011	7.1%
Fiscal 2012	0.3%

As shown in **Exhibit 1**, the Department of Legislative Services (DLS) is projecting that the average monthly TCA caseload will decrease in both fiscal 2013 and 2014 at an average monthly rate of 1.2%, which equates to an annual decrease of 13.3% in fiscal 2013 and a decrease of 13.8% in 2014. From December 2011 through August 2012, the caseload decreased at an average rate of 1.7% per month.

Exhibit 1
Temporary Cash Assistance Enrollment and Funding Trends
Fiscal 2012-2014

	2012 Actual	2013 Approp.	2013 Estimate	2014 Estimate	2013-2014 % Change
Average Monthly Enrollment	72,413	71,243	62,759	54,112	-13.8%
Average Monthly Grant	$174.45	$174.33	$175.45	$175.76	0.7%
Funds in Millions					
General Funds	$25.0	$39.0	$21.3	$4.1	-80.9%
Total Funds	**$151.1**	**$149.0**	**$131.4**	**$114.1**	**-13.1%**

Source: Department of Human Resources; Department of Legislative Services

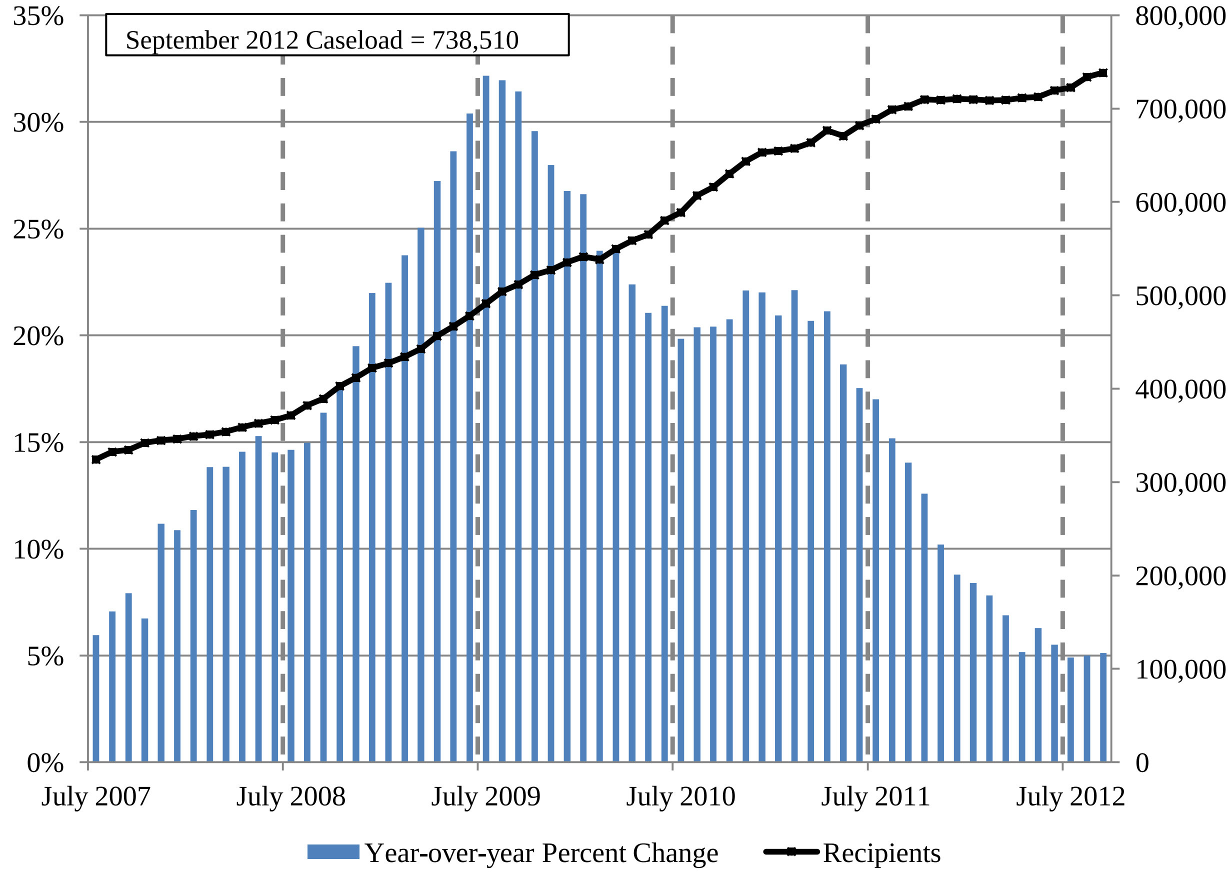
The fiscal 2014 average monthly grant amount includes a 1% increase to ensure that the TCA benefit, in combination with the SNAP benefit, equals at least 61% of the Maryland Minimum Living Level as required by statute.

DLS is projecting a surplus of $17.7 million in TCA funding in fiscal 2013 since the budget assumes a much slower caseload decline than has been experienced for the past six months. In fiscal 2014, the smaller projected caseload will allow a reduction in general fund support as TANF funding once again covers the bulk of the program spending.

Supplemental Nutrition Assistance Program Caseload Trends

The weak economy, combined with increased outreach efforts, has led to steady increases in the number of SNAP recipients since the beginning of fiscal 2007. As shown in **Exhibit 2**, the caseload grew at an increasing rate in fiscal 2007 and 2008 and has continued to grow, albeit at a slower rate, from fiscal 2010 through 2012. In July 2007, there were 324,220 people receiving food stamp assistance. By September 2012, this number had grown to 738,510. This 100% federally funded benefit resulted in nearly $1.1 billion in spending in Maryland in fiscal 2012.

Exhibit 2
Supplemental Nutrition Assistance Program Caseload
July 2007-September 2012



Source: Department of Human Resources; Department of Legislative Services

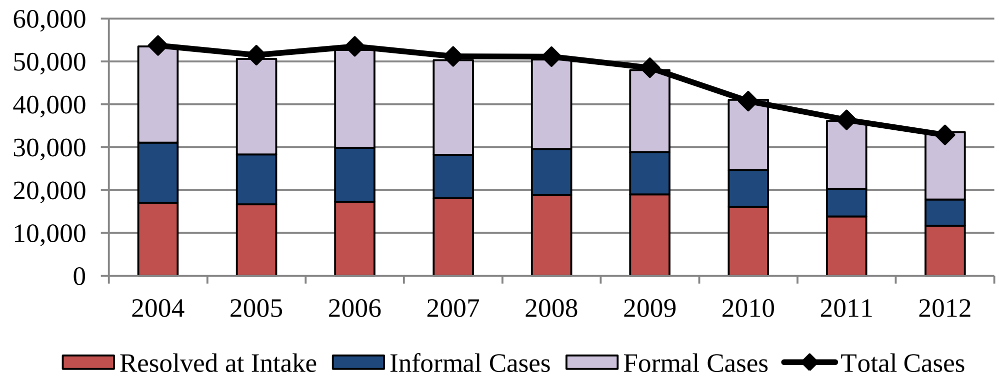
Department of Juvenile Services Population Trends

The number of complaints handled by the Department of Juvenile Services fell again in fiscal 2012, but the more serious cases are making up a greater percentage of the total. Fewer youth are being held in secure detention as the department makes progress in reducing youth in detention pending a permanent placement. However, issues remain in developing committed residential capacity.

General Caseload and Population Trends

Exhibit 1 details the total number of complaints received by the Department of Juvenile Services (DJS) in recent years, as well as complaint disposition.

Exhibit 1
Juvenile Complaints and Complaint Dispositions
Fiscal 2004-2012



Note: Total complaints typically are 1% to 2% higher than the sum of those resolved at intake and the informal and formal caseload. The difference relates to jurisdictional issues or cases in which a decision is not recorded.

Source: Department of Juvenile Services; Department of Legislative Services

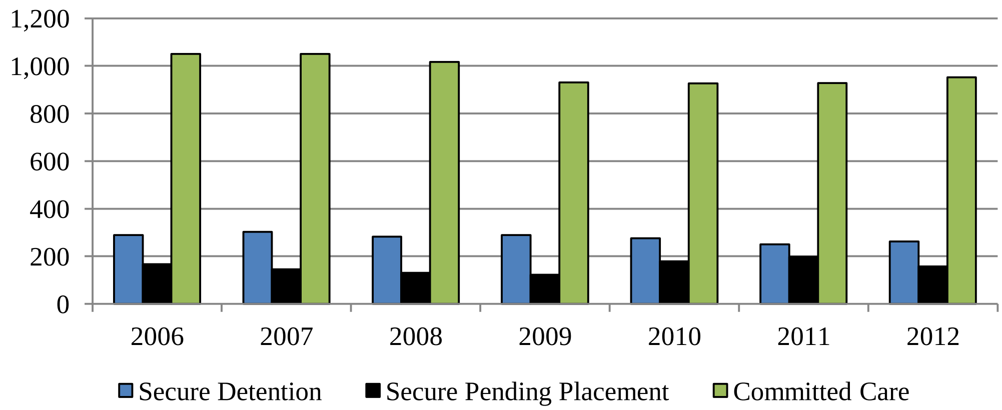
- The total number of complaints continues to decline. DJS handled less than 40,000 complaints for the second consecutive fiscal year. The nearly 33,000 complaints in fiscal 2012 reflect a 10% reduction compared with fiscal 2011 and a 39% reduction from the most recent peak of approximately 53,500 complaints in fiscal 2006.

- All types of complaint dispositions continued to decline in fiscal 2012 because fewer total complaints were referred to the department. Cases resolved at intake and those that require some form of intervention but do not rise to the level of court intervention (the informal caseload) fell by 15% and 4%, respectively. Similarly, these cases continue to account for a smaller proportion of the total caseload, representing 36% and 19% of total complaint dispositions.

- Formal caseloads, those where DJS believes court intervention is required, decreased only 1%. The proportion of formal cases has increased consistently since fiscal 2010. As a percent of total case dispositions, formal caseloads accounted for the majority of dispositions in fiscal 2012, increasing from 44% to 48%.

In terms of youth requiring out-of-home placements, **Exhibit 2** illustrates trends for certain pre- and post-disposition residential placements.

Exhibit 2
Selected Average Daily Population Trends
Department of Juvenile Services
Fiscal 2006-2012



Source: Department of Juvenile Services; Department of Legislative Services

- Overall, the population of youth held in secure detention facilities declined by 6% in fiscal 2012. This is primarily attributable to a 20% reduction in the number of post-disposition youth held in secure detention facilities pending a permanent residential placement. The average population in fiscal 2012 was 158 youth pending placement, compared to 198 youth pending placement in fiscal 2011.

- Despite the continued reduction in complaints, the utilization of secure detention facilities for pre-disposition youth increased in fiscal 2012 by 5% to an average daily population of 263 youth. DJS is conducting a statewide evaluation of the use of secure detention to identify potential solutions for reducing the pre-disposition detention population. A final report is required for submission to the General Assembly by June 15, 2013.

- After declining for five consecutive years, the average daily population of youth in committed residential placement continued to increase for the second consecutive fiscal year, growing by 3% to an average population of 952 youth. Approximately 13% of the committed care population, or an average daily population of 122 youth, was in out-of-state residential placements. This reflects only a 1% increase over the number of youth placed out-of-state in fiscal 2011, but a 22% increase over the most recent low of an average of 100 youth in out-of-state placements in fiscal 2010.

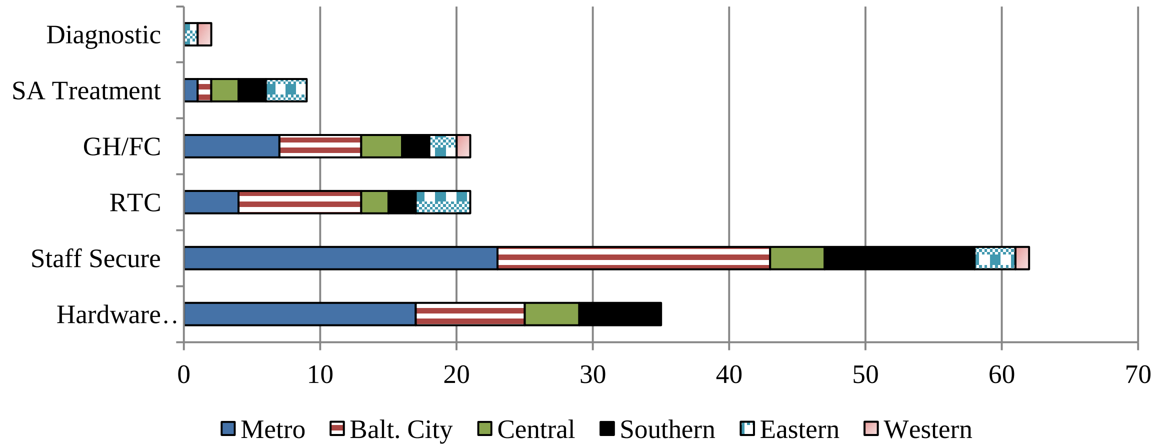
Ongoing Committed Capacity Issues

The lack of available committed residential placements continues to place pressure on the capacity of DJS' aging detention facilities. The pending placement population declined in fiscal 2012 as a result of the department's efforts to more efficiently identify and place youth in appropriate residential programming, regardless of whether that meant sending the youth to an out-of-state placement. DJS is optimistic that the enactment of Chapter 198 of 2012, which provided the department the authority to directly transfer a youth from one committed placement to another without having to return to a detention facility in a pending placement status, will also have a positive impact on the pending placement population.

As of August 2012, DJS had an average daily population of 142 youth in its detention facilities pending placement in a residential program, accounting for nearly 38% of the total detention population. **Exhibit 3** shows a snapshot of the pending placement population for August 15, 2012, delineated by the type of program the youth is pending placement for and the youth's region.

According to the department, waiting lists exist for nearly every type of placement, regardless of whether it is a State run or private program, in-state or out-of-state. As seen in the exhibit, the greatest need is for staff and hardware secure bed space primarily for youth in the Metro and Baltimore City regions.

Exhibit 3
Committed Capacity Need for Pending Placement Youth
August 15, 2012



GH/FC: Group Home/Foster Care
RTC: Residential Treatment Center
SA: Substance Abuse
Source: Department of Juvenile Services

DJS has two capital projects in its facilities master plan to address the need for additional committed capacity, one of which was included for funding in the fiscal 2013 capital budget. Specifically, $3 million in general obligation bond funding was approved for the acquisition of property to site a new Baltimore Regional Treatment Center. DJS has yet to identify a site for the Baltimore Regional Treatment Center. Indeed, this center has been proposed for a number of years (funding was first proposed in the fiscal 2010 capital budget), and no site has ever been found. Consequently, the legislature added restrictive language to the appropriation allowing the department, until December 31, 2012, to seek a site for the facility, after which time the funds are only available to fund design of a treatment facility in the Metro Region on the grounds of the Cheltenham Youth Facility.

In addition to the department's capital construction pursuits, DJS has submitted a statement of need seeking additional committed capacity from private providers. The department is in the process of reviewing the responses.

Social Programs

Funding of Home Energy Programs

Available funding for energy assistance programs has stabilized after several years of decline. Demand for the programs may also be peaking. At the same time, efforts are underway to reform the current programs. Experience from other states, including requiring applicants to receive weatherization services, offers some potential for reform.

Background

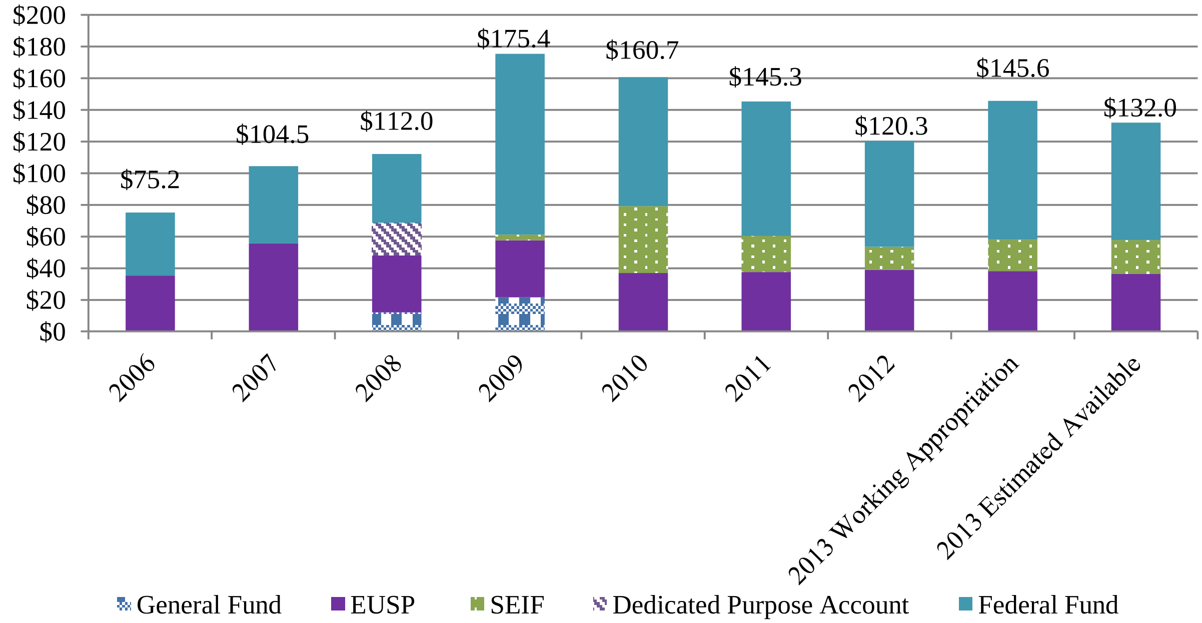
The Department of Human Resources operates two energy assistance programs through the Office of Home Energy Programs (OHEP). The Maryland Energy Assistance Program (MEAP) operates with funds from the federal Low Income Home Energy Assistance Program (LIHEAP) and provides bill payment, crisis assistance, and furnace repair/replacements for a variety of energy sources. The Electric Universal Service Program (EUSP), funded primarily through a surcharge on the bills of electric customers, and the Strategic Energy Investment Fund (SEIF), composed primarily of revenue from the Regional Greenhouse Gas Initiative (RGGI) carbon dioxide emission allowance auctions, provides bill payment and arrearage assistance to customers. These programs serve households with incomes at or below 175% of the federal poverty level. Arrearage assistance is available to households only once every seven years.

Funding Trends

As shown in **Exhibit 1,** expenditures of OHEP peaked in fiscal 2009 due to a confluence of additional funding sources and demand. In that year, LIHEAP was funded at $5.1 billion nationally, the highest level in program history, which allowed Maryland to ultimately expend $114.3 million of LIHEAP funds, more than twice the amount spent in any other recent year. In addition, $21.5 million in general funds, which are not typically available to the program, were made available due to high demand. OHEP also received its first allocation from SEIF in that year.

Since fiscal 2009, expenditure levels of OHEP began to decrease, falling by 31.4% between fiscal 2009 and 2012. In the years after fiscal 2009, OHEP's share of the proceeds from the RGGI auctions increased, but general funds were no longer available to the program. Despite the higher share of SEIF available to the program, the actual dollar value of available SEIF decreased after fiscal 2010 due to falling allowance prices and fewer auctioned allowances selling. In addition, federal LIHEAP funds available to Maryland have fallen. LIHEAP funding nationally was reduced to $4.7 billion in federal fiscal 2011 and $3.5 billion in federal fiscal 2012. As a result, Maryland's share of LIHEAP funding shrank, and only $66.9 million was expended in fiscal 2012.

Exhibit 1
Office of Home Energy Programs Funding and Expenditure History
Fiscal 2006-2013 Estimated
($ in Millions)



EUSP: Electric Universal Service Program

SEIF: Strategic Energy Investment Fund:

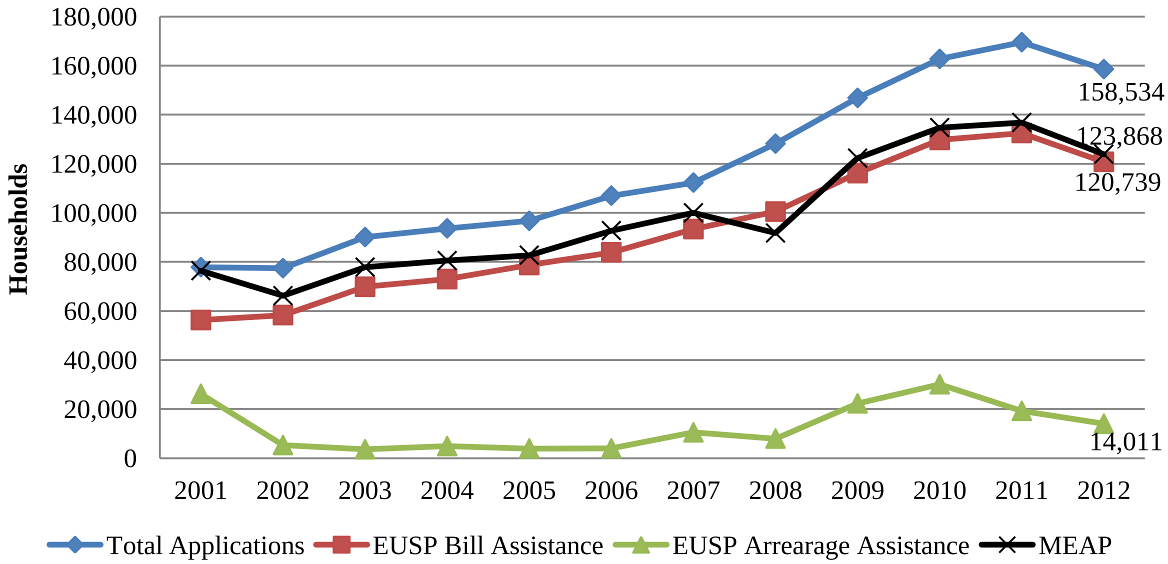
Source: Governor's Budget Books; Fiscal Digest for the State of Maryland For the Fiscal Year 2013; Department of Legislative Services

The federal fiscal 2013 continuing resolution, which provides funding for federal programs through March 27, 2012, essentially level funded programs at the federal fiscal 2012 level. Based on this, Maryland could expect to receive similar levels of LIHEAP as in fiscal 2012, and will be able to use approximately $9.7 million of federal fiscal 2012 funding carried forward from fiscal 2011. Funding available from SEIF is expected to increase modestly, as a result of a transfer from the SEIF administrative expense account as authorized in the Budget Reconciliation and Financing Act of 2012. In general, OHEP appears poised in fiscal 2013 to have higher expenditures than fiscal 2012. However, the level of spending would remain far below the levels of fiscal 2009-2011.

Households Receiving Benefits

From fiscal 2001 to 2011, the bill payment energy assistance programs experienced increases in the number of households receiving benefits in nearly all years (see **Exhibit 2)**. Households receiving EUSP bill payment assistance more than doubled, while MEAP assistance increased by 79.1%. The growth was particularly dramatic following fiscal 2006 due to such factors as rapidly increasing utility costs, the effects of the recession, and changes in the eligibility limits. In fiscal 2012, households receiving benefits decreased by approximately 9.0% in both the EUSP bill payment assistance and MEAP. The mild winter weather likely contributed to this decrease.

Exhibit 2
Application and Benefit Provision History
Fiscal 2001-2012



EUSP: Electric Universal Service Program MEAP: Maryland Energy Assistance Program

Note: Fiscal 2012 numbers are preliminary and subject to adjustment.

Source: Department of Human Resources

Households receiving arrearage assistance held relatively steady for several years due to a statutory cap on the amount of EUSP funds available for this program. The addition of other funding sources and high demand later led to the removal of the cap. As a result, the number of households receiving this assistance spiked, peaking in fiscal 2010. The decline in funding noted earlier led to an informal cap on the program, reducing the households receiving benefits. In fiscal 2012, although a cap had a limiting effect on the program, fewer households applied for the benefit. Although it is early in fiscal 2013, the number of applications for each program type has continued to decline. It is unclear whether this will continue throughout the year, especially given anticipated returns to more normal winter temperatures.

Benefit Level Adjustments

To accommodate the declining funding levels while demand increased or was projected to increase, OHEP reduced the percent of a household's bill that is paid in each fiscal 2010 through 2012 for EUSP bill assistance. The share of bills paid through MEAP has also generally decreased. In fiscal 2012, MEAP benefits were decreased substantially with the expectation of a significant reduction in available LIHEAP funds, the average EUSP bill assistance benefit decreased by 25.1% and MEAP by 28.4%. Ultimately, LIHEAP was available at a higher level than assumed, and OHEP was able to partially restore benefits to electric and natural gas customers. In fiscal 2013, EUSP bill assistance benefits are expected to remain at the lower fiscal 2012 level. MEAP benefits have not been determined as of this writing.

Public Service Commission Review and Options for Improving Programs

Due to concerns as to whether the current energy assistance programs were appropriately funded and fulfilling the intended purposes, the Public Service Commission (PSC) decided in January 2012 to undertake a comprehensive review. Staff recommendations for changes to the State's energy assistance programs are anticipated by November 2012. In addition to the ongoing review of energy assistance programs in Maryland, PSC is in the process of determining an allocation of the $113.5 million funding from the Customer Investment Fund, created by the PSC order approving the merger of Exelon Corporation and Constellation Energy Group. One proposal by the State for a portion of the funding ($44.0 million) is to target energy efficiency activities of high energy users participating in EUSP that are ineligible for other Department of Housing and Community Development (DHCD) weatherization and energy efficiency assistance. As of this writing, PSC has not determined an allocation of this funding.

Another option for improving the efficiency of the energy assistance programs would be for the State to strengthen the ties between the weatherization and Low-income Energy Efficiency programs of DHCD. Currently, applicants may opt for a referral to the Weatherization Assistance Program at the time of application for energy assistance, but this is not required. Four states require either LIHEAP recipients or participants in a state energy assistance program to accept weatherization assistance or the state energy efficiency program if offered.

Social Programs

Child Support Enforcement

A recent legislative audit of the Child Support Enforcement Administration was critical of the Administration's use of enforcement tools available to it. Performance data supports the notion that there is plenty of room for improvement in various aspects of child support enforcement.

2011 Child Support Enforcement Administration Audit

In September 2011, the Office of Legislative Audits released a fiscal compliance audit for the Department of Human Resources (DHR), Child Support Enforcement Administration (CSEA) covering the period September 1, 2007, to October 20, 2010. The audit contained 11 findings, 5 of which were repeated from the previous audit. The majority of audit findings related to CSEA's use of enforcement procedures and concluded that the agency did not utilize an assortment of enforcement tools as effectively as possible. For example, the audit found that CSEA was not always using occupational license suspension as a collection enforcement tool and was not utilizing its authorization to seize bank account funds to the full extent authorized by statute. While taking corrective actions on the audit findings, CSEA continued to study best practices of child support collection in order to identify additional ways to improve performance. DHR has set a goal for CSEA to be in the top 10 in performance in each measure. DHR states that given Maryland's relative wealth, the State should perform better in child support collections.

Maryland Performance in National Measures

The U.S. Department of Health and Human Services, Administration for Children and Families, Office of Child Support Enforcement (OCSE) provides incentive payments to states for performance in five areas: (1) paternity establishment (either statewide or children in the State child support caseload born to unwed parents); (2) support order establishment; (3) percent of current support paid; (4) percent of cases with arrears for which a payment is received on arrears; and (5) cost-effectiveness of the program. States receive incentives based on performance in each area, with an 80% performance goal being the norm.

Exhibit 1 provides information on Maryland's recent performance on some of these measures. National averages are not yet available for federal fiscal 2012. As shown in the exhibit, Maryland exceeded the preliminary national average in support order establishment and current support paid in each year; however, Maryland performed below the national average in cases paying on arrears. In addition, Maryland exceeded the 80%

Exhibit 1
Maryland Child Support Performance versus National Performance
Federal Fiscal 2008-2012

	2008	2009	2010	2011	2012
Percent of Cases in State Child Support Caseload with Support Orders	80.13%	81.28%	82.82%	82.9% (27)	83.41%
Preliminary National Average of State Child Support Caseload with Support Orders	79.17%	79.49%	80.08%	80.96%	
Percent of Current Child Support Paid	64.58%	64.89%	64.46%	64.7% (16)	65.68%
Preliminary National Average of Percent of Current Child Support Paid	61.94%	61.85%	62.05%	62.54%	
Percent of Cases with Arrears for Which a Payment Is Received	62.86%	63.57%	61.57%	61.57% (26)	64.05%
Preliminary National Average of Cases with Arrears for Which a Payment Is Received	63.45%	63.51%	62.11%	62.34%	

Note: Parentheses represent national rank with 1 representing the best performance and 51 the lowest performance.

Source: Department of Human Resources

performance goal in only one of these three measures. In federal fiscal 2011, Maryland's relative performance rankings were as follows: 27 of 51 in support order establishment; 26 of 51 in cases paying on arrears; 16 of 51 in current support paid; 34 of 49 in paternity establishment for the State caseload; 22 of 32 for statewide paternity establishment; and 39 of 51 for cost effectiveness.

Changes under Consideration

There are a number of potential ways that have been proposed to improve child support enforcement performance:

- In recent sessions, legislation has been introduced which would have created a process for the reporting of names of individuals receiving a gaming payout to CSEA for use in enforcing child support orders. Maryland currently has a process in place for intercepting lottery winnings of individuals who have won more than $600 in certain cases. According to reviews completed in Maine and Pennsylvania, several states have processes in place for intercepting or reporting gaming payouts including Colorado, Iowa, New Jersey, New Mexico, New York, and North Dakota. Louisiana has also enacted legislation to allow for the interception of gaming winnings. Although the exact mechanisms and requirements vary, according to the reports several of the states have set a trigger (such as the $600 requirement for the filing of a W-2G) before interception. The Maine report noted that in 2009, Iowa was able to intercept eight payouts totaling $43,117. Although the most recent effort, House Bill 385, was not acted upon, it is possible that this issue will resurface in the 2013 session.

- At a September 2012 presentation to the Joint Committee on Welfare Reform, DHR presented additional draft concepts under consideration to increase collections, including the garnishment of retirement accounts.

- DHR is also considering simplifying the process for establishing paternity and affidavits of support. Currently, if a child is born to parents who were married at the time of conception, there is a rebuttable presumption that the child is the legitimate child of the husband. An unmarried mother and father may establish paternity by signing an affidavit of parentage; otherwise paternity can only be established through a judicial process, which may include an order for genetic testing. Some states streamline this process by allowing paternity to be established through a genetic test without court involvement. For example, Florida can issue an Administrative Order of Paternity and direct the Office of Vital Statistics to add the father's name to a birth certificate upon genetic test results proving biological fatherhood. Upon receipt of genetic testing results, Ohio's child support enforcement agency must issue an administrative order establishing paternity when testing results indicate a 99% or greater probability that the individual is the father of the child. Iowa can prepare an administrative order of paternity for the court's approval if the probability of paternity is over 95%.

- Another concept proposed to the Joint Committee on Welfare Reform is to streamline the affidavit of support process by developing a strictly administrative method of establishing the affidavit. Currently, once specified criteria have been met, including the establishment of paternity, CSEA is authorized to complete an affidavit of support. The affidavit must then be filed with the clerk of a circuit court for the court's approval. According to information compiled by OCSE, 28 states require a support obligation to be established through a judicial process, while the remaining states, including Virginia, authorize a support obligation to be established administratively in some cases.

Transportation

Alternative Financing for the Proposed Major Transit Lines

While the Red Line, Purple Line, and Corridor Cities Transitway are nearing the construction stage, the State has not developed viable strategies to fund these projects. There are numerous alternative financing and revenue options that the State could pursue to construct the transit lines.

Background

Over the past several years, the State has committed significant planning and engineering resources to developing the Red Line, Purple Line, and Corridor Cities Transitway (CCT). These three projects are briefly described below.

- The Red Line is a proposed 14-mile, east-west light rail line running from Baltimore County's Woodlawn employment and commercial centers through downtown Baltimore City to the Johns Hopkins Bayview Medical Center Campus.

- The Purple Line is a proposed 16-mile light rail line extending from Bethesda in Montgomery County to New Carrollton in Prince George's County.

- The CCT is a proposed 15-mile bus rapid transit line extending along a north-south corridor from the Shady Grove Metrorail station to just south of Clarksburg in Montgomery County.

The Red and Purple Line projects have completed initial planning activities and are poised to begin the final design phase, assuming adequate State and federal funding is secured. The federal government has authorized the Red and Purple lines to move into the preliminary engineering phase and granted expedited review to the Red Line. By mid-2013, the State must submit finalized financial plans showing how it intends to pay for the projects in order to be eligible for the federal funding assumed by the State for construction. To date, the State has neither identified specific financial strategies nor secured sufficient new funding to do so. The CCT project is still in the initial planning phase and is not expected to be ready to present a financial plan to the federal government for another two years.

Financing Options

While motor fuel taxes have been the primary revenue source for transportation at both the State and federal level, the buying power of this revenue source has eroded significantly as inflation and fuel efficiency standards increase. Furthermore, policymakers have not increased the motor fuel tax rate in 20 years. Other traditional transportation revenues such as the titling tax and registration fees have declined or stagnated in recent years due to the recession.

In response to increasing demands for new projects and maintenance of aging systems, and declining availability of state and federal funds, state and local governments across the country are considering a variety of alternative strategies to finance transit project development. Various revenue sources and financing options that Maryland may consider to construct the three proposed transit lines are summarized below.

Public-private Partnerships (P3) Utilizing Availability Payments: P3s are long-term agreements in which the public sector assigns to a private-sector company the right to design, build, finance, operate, and/or maintain an infrastructure asset for a defined period per some type of financial arrangement. Although the private sector may finance the project up front, it receives a return on its investment through project revenues or payments from the public sector over the life of the contract. These payments may take the form of availability payments. Availability payments provide compensation to the private sector on a periodic basis *(e.g.,* quarterly or annually) based on the project being available for use and performance standards being met as per the contract. An availability payment can be structured to cover just the capital costs of a project, or both the capital and ongoing operating cost, depending on the contract.

Transportation Infrastructure Finance and Innovation Act (TIFIA): The federal TIFIA program provides credit assistance at below market rates through direct loans, loan guarantees, and lines of credit. The TIFIA program targets large projects, generally in excess of $50 million. To date, 27 projects nationwide have been partially funded with TIFIA credit assistance, including 4 intermodal projects, 18 highway projects, and 5 transit projects. In Maryland, construction of the InterCounty Connector was partially funded with a TIFIA loan.

Value Capture: Value capture generally refers to the concept of using the increase in land value due to construction of a transit project to pay for the construction of that project. Many mechanisms can be used to capture the increase in land value, including special taxing districts, developer fees, joint development, and tax increment financing. The revenue from these different mechanisms is then used to pay the debt service on bonds used to construct a project.

Local Option Revenues: In Maryland, common sources of local revenue for transportation purposes include property taxes and general funds. However, local governments throughout the United States are using a variety of approaches to fund transportation including:

- traditional taxes and fees, such as the local option sales tax, vehicle registration fees, advertising revenues, and motor fuel tax;

- less common business activity, and related sources such as income, payroll, employer, hotel/lodging, real estate transfer, and mortgage recording taxes, and car rental fees; and

- revenue streams from projects such as transit-oriented development, land value capture, impact fees, and special assessment districts.

General Fund Revenues/General Obligation Bonds: Across the country, several local jurisdictions and states support transit through general fund transfers or dedicating a portion of revenue that otherwise would go to its general fund. For example, Pennsylvania and Massachusetts dedicate a portion of state sales tax revenues to transit services. Similar to using general fund revenues to support transit, general obligation (GO) bonds could also be used to support the construction of a transit facility. Previously Maryland has used general funds and GO bonds for the construction of the InterCounty Connector.

2013 Policy Issues

The following issues may merit consideration when determining how the State should fund transit construction in the near future.

- Under the current schedule, the State must demonstrate how it will fund the construction of the three transit lines by summer 2013. Absent a State revenue increase or federal aid, it is unlikely that the transit lines can be constructed.

- Current plans show all three transit lines being constructed simultaneously; however, the State may be required or decide to construct only one of the transit lines at a time, effectively reducing the amount of additional revenue needed.

- Raising transportation revenues on the national and state level has proven to be politically difficult. Instead of relying on traditional revenue sources like the motor fuel and titling tax, it is likely that state and local governments will be required to raise revenues and pursue alternative financing tools.

- Options like P3s using availability payments and federal TIFIA credit assistance are financing options only; they still require additional revenue and cost more than State financing. If the State does pursue alternative financing tools as discussed, new revenue will likely still be required to construct the transit lines since alternative financing tools are not a sufficient stand alone revenue source to construct the transit line. Other options require the State to either repay a loan or to pay a private entity for work; however, there is no revenue currently available for repaying a loan or a private entity.

- Since the Capital Debt Affordability Committee recently increased the State's debt authorization by $150 million annually for the next five years, the General Assembly could consider dedicating a portion of the increased authorization to the transit lines.

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Transportation

Overview of the Draft *Consolidated Transportation Program*

The Maryland Department of Transportation's 2013 draft *Consolidated Transportation Program* lists all capital projects funded in the current fiscal year and those planned for the next five years. Spending over the six years totals $9.8 billion, a $101.7 million decrease from the fiscal 2012 *Consolidated Transportation Program*. The draft *Consolidated Transportation Program* does not include construction funding for the major transit lines nor is there funding for major highway construction projects after fiscal 2017.

Overview

The *Consolidated Transportation Program* (CTP) is Maryland's six-year capital budget for transportation projects. It is updated annually and includes all major and minor capital projects that the department, its modal administration, and the Washington Metropolitan Area Transit Authority (WMATA) are undertaking in the current year and over the next five-year planning period. Capital projects for the Maryland Transportation Authority (MTA) are also included in the CTP but are excluded from this analysis. **Exhibit 1** compares six-year spending contained in the 2012 CTP to the draft 2013 CTP.

Exhibit 1
Comparison of Six-year Capital Spending
Fiscal 2012-2018
($ in Millions)

	2012-2017 CTP	2013-2018 CTP	Change	Percent Change
Special Funds	$5,528.2	$5,675.4	$147.2	2.7%
Federal Funds	3,344.9	3,194.6	-150.3	-4.5%
Other Funds*	1,017.1	918.5	-98.6	-9.7%
Total Funds	**$9,890.2**	**$9,788.5**	**-$101.7**	**-1.0%**

CTP: *Consolidated Transportation Program*

*Other funds include funds from customer and passenger facility charges and certain types of federal aid that do not pass through the Transportation Trust Fund.

Source: Maryland Department of Transportation 2012 Final *Consolidated Transportation Program*, 2013 Draft *Consolidated Transportation Program*

The total funding level in the 2013 draft CTP decreases by $101.7 million (-1.0%) from the 2012 CTP. This net decrease is due to the following:

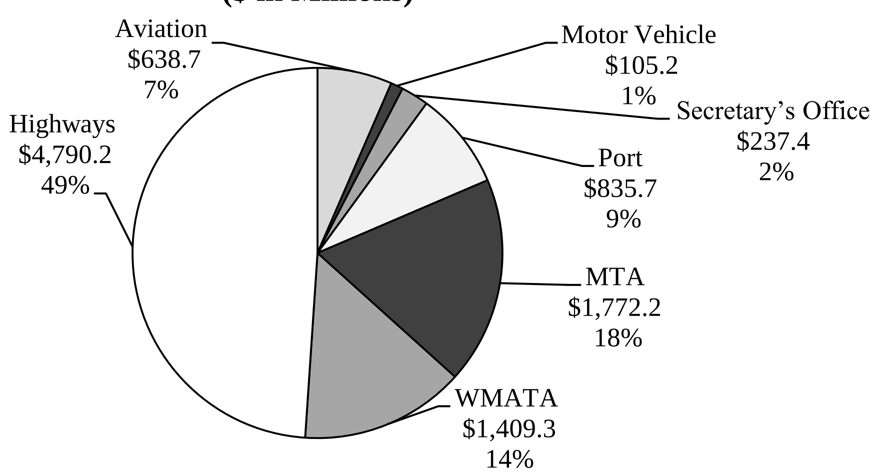
- a $147.2 million increase in special funds due to cash flow carryover from the fiscal 2012 CTP and revenue growth;

- a $150.3 million decrease in federal funds due to federal aid that was assumed for the planning of the major transit lines not materializing and spending from the American Recovery and Reinvestment Funds ending; and

- a $98.6 million decrease in other funds largely due to several large projects at the Maryland Aviation Administration ending.

Exhibit 2 shows the Maryland Department of Transportation's (MDOT) total capital spending for the entire six-year period by mode. As is typical, the State Highway Administration (SHA) receives just under half of total capital funding, and transit (including both MTA and WMATA) receives just under one-third of the funding.

Exhibit 2
Total Capital Spending by Mode
Fiscal 2013-2018
($ in Millions)



Total Capital Spending: $9.8 Billion

MTA: Maryland Transit Administration
WMATA: Washington Metropolitan Area Transit Authority

Note: Totals may not sum due to rounding.

Source: Maryland Department of Transportation, 2013 *Draft Consolidated Transportation Program*

Major Project Changes

The following is a summary of the major project changes in the 2013 draft CTP.

- In total, $78.4 million worth of construction projects were added to the 2013 draft CTP. Most of the projects added were to SHA for bridge replacement projects across the State.

- Two projects totaling $60.2 million were moved from the development and evaluation program to the construction program. The largest project is the Kirk Bus Facility Replacement project in Baltimore City costing $53.0 million.

- The Base Realignment and Closure intersection improvement near the Bethesda Naval Center was moved from the construction program to the development and evaluation program. Instead of using State funds, MDOT is planning to use federal Department of Defense funding which should be reflected in the final 2013 CTP.

Major Projects Not Funded

The 2013 draft CTP does not include funding for several major projects. Several notable examples are summarized below.

- After 2017, the 2013 draft CTP does not include any funding for major highway projects or for the planning of new highway projects. In other words, beginning in fiscal 2018, the highway capital program will be solely focused on system preservation types of projects.

- The State continues to move forward with planning for the construction of three major transit lines: the Red Line, the Purple Line, and the Corridor Cities Transitway. The 2013 draft CTP does not include funding for construction of the transit lines.

- The State has several environmental projects that it must implement including chromium ore remediation at the Port of Baltimore and the Watershed Implementation Plan (WIP). It appears that there is adequate funding for the chromium ore remediation and short-term WIP efforts. There is still a risk that WIP funding needs could be greater than currently projected.

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Business Regulation

Workers' Compensation Insurance

The workers' compensation system in Maryland continues to be stable with a modest increase in workers' compensation insurance premiums for employers in 2013. Several legislative issues governing workers' compensation in the 2013 session may relate to the cancer presumption for firefighters and related personnel, the insurer's of last resort membership in the designated rating organization, and prescription drug cost management.

Workers' Compensation System Is Relatively Stable

The Maryland Insurance Administration (MIA) recently approved a 3.8% increase in the pure premium rate that employers will pay in 2013 for workers' compensation insurance. As a component of overall premium rates, pure premium rates are set at a level necessary to prefund projected claim loss payments to injured workers. MIA's approval of the National Council on Compensation Insurance (NCCI) pure premium rate filing marks the fourth consecutive increase to the amount that employers in the State pay for workers' compensation insurance. Despite these increases, the cumulative rate change from 2007 to 2013 is slight (2%), which indicates a relatively stable market in the State. The State's workers' compensation insurer of last resort, the Injured Workers' Insurance Fund (IWIF), follows a different ratemaking approval process and reports that its rates on average will not change for policies issued or renewed on January 1, 2013.

Impact of the *Sanchez* Decision

Section 9-742(a) of the Maryland Workers Compensation Act authorizes the Workers' Compensation Commission (WCC) to retain jurisdiction over three types of issues in a case when other issues are being appealed. Those issues include requests for (1) additional medical treatment; (2) temporary total disability benefits, provided the benefits were granted in the order on appeal and were terminated by the insurer or self-insurer pending adjudication or resolution of the appeal; and (3) approval of a proposed settlement. However, the Maryland Court of Appeals held in *Potomac Abatement, Inc., et al. v. Sanchez,* 424 Md. 701 (2012), that WCC retains jurisdiction to hear new issues while other issues in the same claim are pending on appeal as long as WCC has not taken evidence or rendered a decision on the issues raised. The court reasoned that the General Assembly did not intend § 9-742(a) to limit WCC's "ongoing jurisdiction to grant relief," based on § 9-736(b) of the Act, which states that WCC has "continuing powers and jurisdiction over each claim under this title."

WCC reports that the decision has had minimal impact on its workload and administration of cases despite initial concerns among members of the workers' compensation community that the jurisdictional expansion would create confusion and lead to inconsistent outcomes. As of October 2012, WCC's jurisdiction under *Sanchez* has been raised and decided in 22 cases. These cases have related to issues such as worsening of a permanent partial disability, vocational rehabilitation, maximum medical improvement, and causal connection of a body part or medical condition.

Anticipated 2013 Legislation

The 2013 session may address follow-up reports required by several pieces of workers' compensation legislation that passed during the 2012 regular session. These are discussed below.

Medical Presumptions for Firefighters and Related Personnel

Legislation passed during the 2012 session altered the occupational disease presumption for firefighters and related personnel to remove pancreatic cancer and to include multiple myeloma, non-Hodgkin's lymphoma, brain cancer, testicular cancer, and breast cancer. The legislation delayed the effectiveness of the changes until June 1, 2013, to allow time for a medical expert to review relevant studies and medical literature. Although the stakeholders agreed on a medical expert, the expected release of the study results in late 2014 may prompt legislation in the 2013 session to further delay the effective date of the presumption changes.

Additionally, the Department of Legislative Services (DLS) will present research on rebuttability standards for occupational disease presumptions in other states to the Joint Committee on Workers' Compensation Benefit and Insurance Oversight. The committee intends to consider the codification of a rebuttability standard at the same time it considers the results of the medical expert's study.

Insurer of Last Resort Membership in Rating Organization

IWIF is exempt from Title 11 of the Insurance Article, which requires insurers to (1) file and gain approval of their rates by the Insurance Commissioner; and (2) belong to a workers' compensation rating organization. The conversion legislation preserved this exemption but required MIA to study and report whether Chesapeake should be required to join NCCI, the designated workers' compensation rating organization. On October 1, 2012, MIA recommended that Chesapeake (1) become subject to Title 11; (2) report its experience to NCCI on a phased-in basis over a five-year period; and (3) develop a merit rating plan to lessen the impact of the transition on insureds. Legislation may be introduced to implement the recommendations contained in the follow-up report.

Prescription Drug Cost Management

Physician dispensing of repackaged pharmaceuticals increases costs for the workers' compensation system in many states where physicians are not bound by state fee schedules and pharmacy cost controls. According to a study by the Workers' Compensation Research Institute released in July 2012, physicians directly dispensed 35% of all medications prescribed to injured workers in Maryland, representing 47% of total spending on pharmaceuticals for workers' compensation claims. The report determined that in Maryland from 2007 to 2011, prices paid for physician-dispensed prescriptions increased while prices paid to pharmacies changed little or fell. For example, the average price per pill paid to physicians for Vicodin increased 78% while the price paid per pill to pharmacies for the same drug fell 8%.

WCC previously proposed two sets of regulations that would have established a pharmaceutical fee schedule. Several states have lowered overall workers' compensation costs by implementing similar measures. The AELR Committee, however, did not approve either set of regulations. Further discussion or legislative action may occur this session to address the issue of rising, inflated prescription drug costs.

Worker' Compensation Insurance Benefit and Oversight Committee Activities

The Joint Committee on Workers' Compensation Benefit and Insurance Oversight evaluates and examines the structure for workers' compensation and benefits in Maryland. The committee will meet in mid-November to discuss the following issues:

- DLS' review of other states' occupational disease presumption statutes, including rebuttability standards;
- MIA's report on whether Chesapeake should comply with NCCI rating policies;
- impact of *Sanchez* on the administration of claims;
- workers' compensation rates for 2013 (NCCI and IWIF/Chesapeake); and
- repackaging and physician distribution of pharmaceuticals.

The committee intends to meet again during the 2013 session to discuss new legislation.

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Business Regulation

Unemployment Insurance

Due to the more favorable employment picture in the State and lower claims activity, the Unemployment Insurance Trust Fund has replenished sufficiently to allow Maryland employers to pay from a lower tax table in calendar 2013. Federally funded benefits are winding down. The Joint Committee on Unemployment Insurance Oversight is anticipated to discuss the implementation and impact of recent legislation and a recent audit of the Division of Unemployment Insurance regarding improper payments.

Unemployment insurance (UI) provides temporary, partial wage replacement benefits to persons who are unemployed through no fault of their own and who are willing to work, able to work, and actively seeking employment. Funding for the program is provided by employers through UI taxes paid to both the federal government for administrative expenses and to the states for deposit in their respective UI trust funds.

The UI Trust Fund and Outlook for Employer Taxes in Calendar 2013

Legislation enacted in Maryland in 2005 altered Maryland's UI charging and taxation system by creating a series of experience tax rate tables that are based on the balance in the Maryland UI trust fund. An employer's unemployment experience determines the rate charged within each table. If the balance of the UI trust fund exceeds 5% of total taxable wages in the State (as measured on September 30 of the current year), the lowest tax rate table (Table A) is used to calculate employer rates for the following calendar year. In Table A, employers pay a minimum of 0.3% (on the first $8,500 of annual wages of each employee) and a maximum of 7.5% ($25.50 to $637.50 per employee). The highest tax table (Table F) is used when the balance of the UI trust fund is not in excess of 3% of the total taxable wages. In Table F, employers pay a minimum of 2.2% and a maximum of 13.5% ($187 to $1,147.50 per employee).

The balance of the UI trust fund has fluctuated over the years, growing in good economic times to over $1 billion in each of calendar 2007 and 2008, and diminishing in bad economic times to a level that required the UI trust fund to borrow $133.8 million from the federal government in February 2010. Despite an infusion of $126.8 million of federal modernization incentive funds in May 2010 and with the repayment of the borrowed funds by December 2010, the balance of the UI trust fund remained at a level that required Maryland employers to pay from the highest tax table from 2010 through 2012.

The main driver of the decline of the UI trust fund balance in recent years was the increased claims for UI benefits resulting from the economic downturn. The State's unemployment rate rose from 3.6% at year-end 2007 to 7.6% at year-end 2009, from which it has declined slightly. As of July 2012, Maryland's rate was 7.2%. Average monthly payouts from the UI trust fund grew from $36 million in calendar 2007 to a high of $89 million in calendar 2009 (peaking at $115 million in March 2009). Average monthly payouts decreased in 2010 ($75 million) and in 2011 ($69 million). Initial claims grew from about 222,000 in calendar 2007 (18,500 monthly average) to a high of over 416,000 in calendar 2009 (35,000 monthly average). Initial claims began to fall in calendar 2010 to 376,836 (31,000 monthly average) and again in calendar 2011 to 345,317 (29,000 monthly average). In fiscal 2012 (calendar year data not yet available), initial claims fell to 335,000, for an approximately 28,000 monthly average.

Exhibit 1 shows the balance of the UI trust fund on September 30 of each year since 1999, the annual payout amounts since 1999, and Maryland's seasonally adjusted unemployment rate each year since 1999. Also shown in Exhibit 1 are the tax tables employers paid from during calendar 2006 to 2012 and will pay from during calendar 2013. Due to the more favorable employment picture in the State and lower claims activity, employers will pay from Table C in calendar 2013. The range of rates for Table C is 1.0% to 10.5% on the first $8,500 in wages paid.

Exhibit 1

Maryland's Unemployment Rate, UI Trust Fund Balance, and Annual Benefit Payouts

Calendar 1999-2013

Tax Calendar Year	Percentage Unemployment Rate at End of Year[1]	UI Trust Fund Balance as of Prior September 30 ($ in Millions)[2]	Tax Rate Table in Effect	Annual Benefit Payouts[3] ($ in Millions)
1999	3.5	$741.6		$265.0
2000	3.5	815.8		261.4
2001	4.5	882.8		394.5
2002	4.4	866.9		498.9
2003	4.3	824.7		512.1
2004	4.3	638.5		430.8
2005	3.8	703.6		384.7
2006	3.7	883.1	B	383.5
2007	3.6	1,032.5	A	433.3
2008	5.8	1,057.8	A	785.2
2009	7.6	895.4	B	1,068.8
2010	7.4	301.7	F	900.7
2011	7.3	273.4	F	716.8
2012	7.2	460.2	F	767.3
2013	N/A	794.5	C	N/A

[1]Data is from DOL: unemployment rate for 2012 is as of July 2012.
[2]Data is from DLLR: calendar 2003 includes $142.9 million of Reed Act funds provided by the federal government. Calendar 2010 includes $133.8 million in borrowed funds (February 2010) and $126.8 million in federal modernization funds (May 2010); borrowed funds were repaid in full by December 2010.
[3]Data is from DOL; 2011 payout amount is as of September 30, 2012.

Note: The historic high unemployment rate for Maryland was 8.3% in August 1982, and the historical low was 3.3% in March 2000.

Source: U.S. Department of Labor (DOL); Department of Labor, Licensing, and Regulation (DLLR)

Federally Funded Benefits

The federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 made significant changes to the federally funded extended benefits (EB) program, allowing relatively lower unemployment rate states like Maryland to qualify. Under the federal Act, the federal government will reimburse states for 100% of EB costs for weeks of unemployment through December 2012, depending on the state unemployment rate. The federal Act permits states an additional trigger that would allow eligible workers in states that do not already qualify to receive federally funded EB. In Maryland, Chapter 170 of 2011 establishes an additional "on" indicator based on a State average rate of total unemployment of at least 6.5%, to make UI claimants eligible to receive up to 13 weeks of 100% federally funded EB.

Eligible claimants may receive up to 26 weeks of regular UI benefits from the State UI trust fund. In addition to State UI benefits, in 2008, federal law established emergency unemployment compensation benefits (EUC) for 47 weeks for UI claimants who have exhausted regular UI benefits for a total of 73 weeks of regular and EUC. Under the federal Middle Class Tax Relief and Job Creation Act of 2012, as of June 2012 EUC is comprised of three tiers: Tier 1 – 20 weeks; Tier 2 – 14 weeks if the State unemployment rate is at least 6%; and Tier 3 –13 weeks if State unemployment rate is at least 7%.

Once EUC is exhausted, claimants may receive an additional 13 weeks of benefits through the EB program, for a total of 86 weeks of benefits. In State law, EB applies to weeks of unemployment beginning after January 2, 2010, and ending four weeks prior to the last week for which 100% federal funding is available. EB may not be payable based on a State "on" trigger established under Chapter 170 for any week of unemployment beginning before October 1, 2011. Chapter 170 also establishes standards for a "high unemployment period," under which up to seven additional weeks of EB payments may be paid to claimants under specified conditions. The State average rate of total unemployment must be at least 8% for eligible claimants to receive the additional weeks. As of April 21, 2012, Maryland claimants are no longer eligible for EB since Maryland's unemployment rate has declined. Chapter 170 established a fund that included an appropriation of $1.6 million to be used to reimburse county and municipal corporations for EB payments that are ineligible for federal reimbursement.

Maryland triggered "off" of Tier 3 EUC in June 2012, as the EUC three-month average total unemployment rate had dropped below the 7% trigger. The last payable week was the claim week ending June 23, 2012. Under the 2012 federal act, as of September 2, 2012 EUC changed to be: Tier 1 – 14 weeks; Tier 2 – 14 weeks if the State unemployment rate is at least 6%; and Tier 3 – 9 weeks if State unemployment rate is at least 7%. In September 2012, the State was notified by the U.S. Department of Labor that Maryland's latest three-month average total unemployment rate is 7%. As a result of this current rate, Maryland triggered back "on" to Tier 3 EUC as of Sunday, October 7, 2012. Tier 3 EUC provides only 9 weeks of benefits. These weeks are not payable to claimants who have already received 47 weeks of Tiers 1, 2, and 3 EUC but are payable to claimants who received 34 weeks of Tiers 1 and 2 EUC or claimants who are still in EUC claim status and eligible for the 34 weeks. New EUC claimants are entitled to 28 weeks of Tiers 1 and 2, as well as the 9 weeks of Tier 3 EUC. Since the EUC program ends by federal law December 29, 2012, not all eligible claimants will be able to receive all weeks of EUC unless the program is extended.

Joint Committee on Unemployment Insurance Oversight

The Joint Committee on Unemployment Insurance Oversight monitors laws and policies that affect the State unemployment system, including administrative and federal funding issues and studies other potential legislative changes to UI benefits. The joint committee anticipates holding a 2012 interim meeting in late November. In addition to discussing the status of the UI trust fund and unemployment system and federally funded benefits, the joint committee anticipates discussing the following:

- the tax tables for calendar 2013;
- the implementation of Chapter 2 of 2010 that modernized the UI system;
- the impact of Chapter 170 of 2011 which allowed claimants to receive federally funded extended benefits and created a fund to reimburse counties and municipal corporations for extended benefits that were not eligible for federal reimbursement;
- the implementation of Chapter 53 of 2012 that allows an individual to be eligible for UI benefits if that individual voluntarily left employment because of domestic abuse;
- the Legislative Audit of the Division of Unemployment Insurance that found the division's use of computer matching techniques to detect improper payment could be improved; and
- a proposal for unemployment benefits for individuals unable to work due to cancer.

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Business Regulation

Ban on Grocery Store Alcoholic Beverages Sales

Many states allow grocery stores to sell beer only; beer and wine only; or beer, wine, and liquor. With some exceptions, grocery stores in Maryland are not allowed to sell beer, wine, and liquor. If this changes, small liquor stores fear that large grocery stores would flood the market with high-volume product. Recent developments signal interest in the matter.

Background

Other States

Currently, 21 states allow grocery stores to sell beer, wine, and liquor, including three surrounding states (Delaware, New Jersey, and West Virginia). Another 14 states (including Virginia) and the District of Columbia allow grocery stores to sell only beer and wine. Finally, 9 states (including Pennsylvania) allow grocery stores to sell only beer.

Of the 35 states that allow the sale of wine in grocery stores, 6 states restrict the sale of wine to only low-alcoholic content (in Alabama, the alcoholic beverage content must not be more than 14.9% by volume; in Idaho, Montana, and Vermont, the content must not be more than 16%; in Mississippi, the content must not be more than 6.3%; and in Ohio, the content must not be more than 21%.) Of the 44 states that allow the sale of beer in grocery stores, 5 states may sell only "low-point" beer (the alcoholic content is typically 3.2% or 4.0%).

One state (Alaska) that does not allow the sale of beer, wine, or liquor in a grocery store allows a package store to be physically connected to the grocery store, as approved by the State Alcoholic Beverage Control Board.

Maryland

In 1962, the Maryland General Assembly passed a law prohibiting chain stores, supermarkets, discount houses and other similar establishments from selling alcoholic beverages. Specifically, Article 2B, § 9-102(a-1) prevents an alcoholic beverages license from being issued "to," "for use in conjunction with," or "[for use] upon the premises of" such an establishment. The ban has remained unchanged for 50 years.

Some exceptions are allowed, however. Talbot County licenses grocery stores and convenience stores, enabling those establishments to sell beer and light wine, in any quantity, to consumers. Additionally, in some counties, grocery stores, or liquor stores adjoining grocery stores, that sold alcoholic beverages before the ban was established have been allowed to continue to do so. Such "grandfathered" establishments operate in Anne Arundel, Montgomery, and Prince George's counties, for example.

Arguments For and Against the Ban

It is not difficult to understand why this ban has been so strongly supported by small independent liquor store owners. The advantages enjoyed by a grocery store or other large establishment selling alcoholic beverages are considerable. A large establishment can afford to buy alcoholic beverages in large quantities from wholesalers, take advantage of the volume discounting offered by those wholesalers, and pass the cost savings on to customers. A large establishment has larger space to store products and is able to offer customers greater product selection. Operating on a large scale may mean lower employee costs. Perhaps the most significant advantage is customer convenience. At a grocery store, a harried dinner planner can purchase groceries and wine at the same time and avoid making a separate trip to a liquor store.

The impact of grocery stores selling alcoholic beverages is a matter of contention. Opponents of the ban point to a recent study by the Food Marketing Institute, the national trade association for food retailers and wholesalers. The study examined states in which grocery stores are allowed to sell wine and concluded that liquor stores have successfully competed with those stores. According to the study, specialty wine and liquor retailers sell more higher-margin products than grocery stores. Consumer research indicates that wine consumers typically buy wine in several price segments; thus, these two retail channels are complementary, the study states. Allowing grocery stores to sell wine, the study continued, would generate thousands of new jobs and more money in additional wages in food retailing, wine production, and distribution and allied industries.

Proponents for continuing the ban in Maryland, however, dispute these findings, countering that small liquor stores must sell both high-volume and specialty products to remain viable. Large grocery stores would undermine that strategy by flooding the market with high-volume product.

Recent Developments

Three significant incidents involving grocery stores and alcoholic beverages sales occurred this year.

- In April, the Baltimore City Board of Liquor License Commissioners granted a license renewal to The Cellars, a liquor store in Locust Point. The Cellars is separated only by glass doors from the Harris Teeter grocery store in the McHenry Row development and is operated on a daily basis by employees of the grocery store, which is paid a management fee by The Cellars. Harris Teeter, however, does not own any interest in the liquor store and is a separate business entity.

When the board granted the license renewal, it disallowed a protest that was filed, ruling that the protestors were disqualified because they were not residents, commercial tenants, or real estate owners "in the immediate vicinity" of The Cellars. Opponents against the granting of the renewal have sought judicial review of the disqualification. Currently, the issue is before the Circuit Court for Baltimore City.

- In July, the Howard County Alcohol Beverage Hearing Board denied an alcoholic beverages license for a store that sought to sell beer, wine, and liquor from leased space on the second floor of a recently opened Wegmans grocery in Columbia. The applicant has not sought judicial review of the decision.

- In the 2012 legislative session, a bill sponsored by the Prince George's County Delegation would have authorized the County Board of License Commissioners to grant a Class D beer and light wine license to a grocery store or similar type of premises in the City of Bowie. The delegation, however, amended the bill before it was sent on to the House Economic Matters Committee. As enacted, the legislation (Chapter 137 of 2012) does not deal with alcoholic beverages licenses but rather amends the county's entertainment permit issued to alcoholic beverages license holders.

Given the ongoing demand throughout the State for upscale grocery stores to become established in urban neighborhoods and that grocery stores, however, are reluctant to make such a move without being allowed to enter the lucrative alcoholic beverages market, this issue is likely to spur discussion in the 2013 session.

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Business Regulation

Title Insurance

The Maryland Insurance Administration is studying the adequacy of closing or settlement protection practices currently used within the State's title insurance industry and in other states. The study will focus on remedies for the theft by a title insurance producer of closing or settlement funds held in escrow. It is reported that 14 jurisdictions require a title insurer to provide closing or settlement protection that indemnifies the parties to a closing or settlement for an additional fee charged to the buyer at closing or settlement.

Background

During the 2012 legislative session, the Maryland General Assembly passed House Bill 866 (Chapter 683) to require the Insurance Commissioner to study the closing or settlement protection practices currently used within the State's title insurance industry. The study will focus on remedies for the theft by a title insurance producer of closing or settlement funds held in escrow. Chapter 683 is the most recent measure in a line of legislation over the years aimed at enhancing consumer protection within the title insurance industry.

Title insurance is unique among insurance policies because it protects against events that occurred prior to the inception of the policy. Thus, title insurance generally protects against any defect not discovered by a title search, but not the theft of closing or settlement funds. The Insurance Article defines "title insurance" as "insurance of owners of property or other persons that have an interest in the property against loss by encumbrance, defective title, invalidity of title, or adverse claim to title." In a white paper drafted in support of House Bill 866, the Maryland Land Title Association (MTLA) notes that the current statutory definition does not include "conducting settlements, the handling of settlement funds, or guaranteeing the protection of those funds."

A title insurance producer actually performs many tasks, some of which may fall outside of the Insurance Article's definition, including (1) underwriting the policy's risk; (2) collecting the title insurance policy premiums; (3) issuing the title insurance policies; (4) conducting the settlement or closing; and (5) holding funds in escrow for mortgage payoffs, taxes, closing costs, commissions for real estate broker services, and other costs related to settlement or closing. Maryland courts have held that title insurance producers are only agents for title insurers when performing tasks associated with the actual policy and not closing or settlement services. Therefore, title insurers are not liable for any misappropriation related to the closing or settlement services. Maryland law has some protections against theft by a title insurance producer. A title insurance producer must obtain an appointment from a title insurer and is subject to the regulation and examination of the Maryland Insurance Administration (MIA). Both a title insurer and title insurance producer must be licensed by MIA. Title insurance producers must also file with the Commissioner a blanket fidelity bond and a blanket surety bond or letter of credit of $150,000. This protects against a misappropriation of closing or settlement funds but only to the extent of the $150,000.

Commission to Study the Title Insurance Industry in Maryland

As noted above, the title insurance industry has received heightened scrutiny in recent years, due in large part to a significant rise in property foreclosure rates in many areas, including Maryland. Prompted by concerns regarding illegal sales tactics and a U.S. Government Accountability Office Report, Chapters 356 and 357 of 2008 created the Commission to Study the Title Insurance Industry in Maryland to make recommendations for changes to laws relating to the title insurance industry.

The commission released its report in January 2010 and made seven recommendations aimed at enhancing consumer protection. Chapter 740 of 2010 enacted six of these recommendations. Chapter 740 required the Commissioner to study the feasibility of a guaranty fund aimed at remunerating victims of theft of escrow account funds, examine the current rate review and approval process for title insurance premiums, and adopt regulations detailing the manner in which a title insurer must perform an examination of each of its appointed title insurance producers. Chapter 740 also required that MIA and the Department of Labor, Licensing, and Regulation collaborate to develop the "Title Insurance Consumer's Bill of Rights" in order to explain a consumer's rights and responsibilities in a real estate closing and share complaint information regarding real estate closings.

The 2010 Act also made statutory changes. The bill exempted title insurance producer independent contractors from the requirement to file a blanket fidelity bond, blanket surety bond, or letter of credit with the Commissioner, but prohibited the title insurance producer from using an independent contractor who is not covered under the title insurance producer's bond or letter of credit. Lastly, the Act explicitly stated that a title insurance producer is the legal principal of the independent contractor and, thus, liable for all of the independent contractor's actions.

Study of Closing or Settlement Protection Services

House Bill 866/Senate Bill 724 of 2012, as introduced, would have addressed the commission's concerns regarding a lack of remedy for the victims of theft of escrow account funds. The bills would have required a title insurer to provide closing or settlement protection to a protected party (defined by the bill as a lender, borrower, seller, or buyer who is a party to a transaction in which a title insurance policy will be issued). The bills also would have required a domestic title insurer to provide closing or settlement protection that would indemnify the protected party only in the event the closing or settlement protection funds were lost due to theft, misuse, or misappropriation by title insurance producers (and employees of the title insurance producers) who hold funds in escrow. The cost of the protection would have been at least

$50 per closing or settlement and borne by the buyer at closing or settlement. Title insurers would have been required to create and maintain reserves or surplus to be used for losses.

MIA voiced concerns about the initial version of the bill, including that the $50 premium was unsupported by any actuarial foundation and the bill was unclear as to whether this amount would be the limit of the title insurer's liability. MIA indicated that the title insurers should pay for the protection, as a cost of doing business, by purchasing higher limits of fidelity and surety bonds. However, the title insurers responded that these higher limit bonds are not available. Currently, title insurers are issuing closing or settlement protection letters to parties of a real estate transaction indicating that the parties are protected if closing or settlement funds are not properly disbursed due to misappropriation by a title insurance producer. MIA's testimony states that a $50 limit would not protect lenders and consumers to the extent of current law.

Amidst these and other concerns, House Bill 866 was amended and enacted as Chapter 683 to require the Commissioner to perform a study of the closing or settlement protection practices currently used within the title insurance industry. The Commissioner is required to report the study's findings, along with any recommendations for changes to these practices, by December 1, 2012.

Closing or Settlement Protection in Other States

Closing or settlement protection has been addressed by other states. According to MTLA, 13 states and the District of Columbia currently require closing or settlement protection. The protected parties include the lender and buyer in a real estate transaction in each of the 14 jurisdictions. In addition to protecting the lender and buyer, eight of the states also protect the seller and Illinois protects both the seller and the borrower. The protection costs per closing or settlement vary with $25 as the minimum fee and $100 as the maximum fee.

Business Regulation

Renewable Energy and Related Initiatives and Electric Customer Choice

Offshore wind and the State's Renewable Energy Portfolio Standard are likely to be addressed again in the 2013 session. The Maryland Energy Administration must report on whether to set EmPOWER targets beyond 2015, and two workgroups convened by the Public Service Commission must report recommendations to the General Assembly by the end of 2012.

Offshore Wind

The Administration's second consecutive attempt to promote an offshore wind farm, Senate Bill 237/House Bill 441 of 2012 (both failed), would have supported a substantially smaller project than that proposed in similar legislation in 2011. The 2012 legislation would have specified that an amount of statewide retail electricity sales, not to exceed 2.5%, be derived from offshore wind energy each year beginning in 2017. As passed by the House, House Bill 441 would have allowed a project of approximately 200 megawatts and would have included a window of maximum projected rate impacts of $1.50 per month for an average residential customer and 1.5% for a nonresidential customer.

A qualifying wind farm would have generated Offshore Wind Renewable Energy Credits (REC) which are the generation attributes of one megawatt-hour of electricity derived from offshore wind energy. An offshore wind farm of a size consistent with the rate-cost caps in the legislation would have had the potential to produce between 5% and 8.5% annually of the energy needed to comply with Maryland's Renewable Energy Portfolio Standard (RPS).

Renewable Energy Portfolio Standard

Maryland's RPS requires that renewable sources generate specified percentages of Maryland's electricity supply each year, increasing to 20% by 2022, including 2% from solar power. Electricity suppliers must submit REC equal to the percentage specified in statute each year or pay an alternative compliance payment equivalent to the supplier's shortfall. Maryland's RPS operates on a two-tiered system with a carve-out for solar energy and corresponding REC for each tier.

While the term "renewable energy" generally brings to mind energy sources such as wind, solar, or geothermal, in practice, Maryland's Tier 1 RPS obligations have been met largely by black liquor, hydroelectric, landfill gas, and wood and waste solids. As shown below in **Exhibit 1**, for compliance year 2010, the State relied heavily on black liquor (42.8%) and hydroelectric (32.7%) sources, and to a lesser extent, wood and waste solids (17%) and landfill gas (5.8%). Wind (0.9%) and solar (0.8%) remain the smallest sources of Tier 1 REC.

Exhibit 1
Energy Sources of REC Retired for Maryland RPS Compliance

	Tier 1 Sources				
	2006	**2007**	**2008**	**2009**	**2010**
Black Liquor	25.0%	37.7%	37.63%	28.3%	42.8%
Hydroelectric	17.0%	6.0%	17.06%	33.8%	32.7%
Landfill Gas	19.8%	21.4%	14.85%	11.4%	5.8%
Solar	0.0%	0.0%	0.02%	0.2%	0.8%
Wind	0.0%	0.0%	0.50%	1.4%	0.9%
Wood and Waste Solids	38.2%	35.0%	29.94%	24.8%	17.0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Further, Maryland electricity suppliers obtained the majority of Tier 1 REC from surrounding states. Virginia, Michigan, and New York were among the largest sources of REC submitted for the 2010 compliance year – a continuation of a general trend from 2008 and 2009. In 2010, Maryland-located sources supplied only 3.6% of Tier 1 REC used for compliance.

EmPOWER Maryland

In 2008, the General Assembly passed the EmPOWER Maryland Energy Efficiency Act, which set a target reduction of 15% in per-capita electricity consumption and demand by 2015 from a 2007 baseline. However, the Act also directed the Maryland Energy Administration (MEA), in consultation with the Public Service Commission (PSC), to determine whether electricity consumption and peak demand reduction targets should be set beyond 2015, and to advise the legislature on the feasibility of setting energy savings targets for natural gas companies. A draft report was released in September 2012 which details the progress of the program through 2011. The final report with MEA's recommendations is due to the Senate Finance and House Economic Matters committees by December 31, 2012.

Public Service Commission Workgroups

After the 2012 session, the Senate Finance Committee requested that the stakeholder Net Metering Working Group (established by PSC in 2011) meet to discuss whether a net energy metering program for "community energy-generating facilities," as specified under Senate Bill 595 of 2012 (failed) could be a workable net energy metering program in the State. The working group met five times and prepared written findings and recommendations regarding the specified net energy metering program, which PSC must present to the committee by December 1, 2012. In addition, Chapters 573 and 574 of 2012 require PSC to convene a workgroup to study and make recommendations on developing a mechanism to allow tenants to pay for utility services when the landlord responsible for utility payments defaults on the responsibility. PSC advises that as of September 2012 the workgroup has agreed on a number of recommendations. PSC must present its findings and recommendations by December 1, 2012.

Business Regulation

Reliability of the Electric Distribution System and Electric and Gas Infrastructure Improvements

Several major outage events have occurred in recent years, highlighting the issues of electric reliability, electric company revenue collection in the event of service disruptions, and electric company infrastructure investment cost recovery. Whether to allow smart meter opt-outs remains undecided by the Public Service Commission. With increased focus on electric reliability, it is likely that these issues, in addition to gas company infrastructure investment cost recovery, will be topics of discussion during the 2013 session.

The Maryland Electricity Service Quality and Reliability Act of 2011 (Chapters 167 and 168) required the Public Service Commission (PSC) to adopt regulations implementing service quality and reliability standards for the delivery of electricity to retail customers by electric companies. In response, PSC initiated an administrative docket, Rulemaking (RM) 43, to implement or modify standards including service interruption, downed wire repair, and service quality standards; vegetation management standards; annual reliability reporting; and availability of penalties for failure to meet the standards.

Major Outage Events and Storm Response

Several major outage events have occurred in the State in recent years, prompting responses from both the General Assembly and PSC. Most recently, a "derecho" storm on June 29, 2012, severely impacted electrical service to a large portion of the State, especially in the BGE and PEPCO service territories. High sustained wind speeds with gusts in excess of 65 miles per hour resulted in downed trees, broken telephone poles, and significantly damaged electric distribution infrastructure. Based on the definition of "major outage event," most utilities in the State were required to file a written report on the outage and subsequent repair services. **Exhibit 1** below shows information related to service restoration for each utility that filed a report. Full copies of each of the reports can be found on PSC's website under Case No. 9298.

Exhibit 1
Summary Statistics – Utility Major Outage Event Reports
June 29, 2012 Derecho Storm

	Total Maryland Customers	Maximum Concurrent Interruptions	Customer Interruption Hours	Average Duration per Customer (Hours)	Duration of Major Outage Event
BGE	1,240,173	429,841	28,643,177	37.6	8 Days, 15 Hours
Delmarva	194,945	28,059	436,823	8.7	3 Days, 19 Hours
PEPCO	534,601	410,679	20,465,930	26.0	8 Days, 6 Hours
SMECO	151,800	56,424	1,203,860	14.5	3 Days, 19 Hours

Source: Major Outage Reports Filed in PSC Case No. 9298

Revenue Decoupling and Outage Events

Decoupling of electric company rates separates electric company profits from energy sales volume. Generally, distribution rates charged to customers fluctuate to allow the company to receive an expected rate of return or revenue per customer regardless of the kilowatt-hours of sales. If a utility receives higher-than-expected revenue in one month, a *reduction* is applied to a subsequent bill. Similarly, if a utility receives lower-than-expected revenue in one month, an *increase* is applied to a subsequent bill. These adjustments are "rolled into" the distribution rates on customer bills and, therefore, do not appear as separate line items.

In February 2011, due to its concerns that revenue decoupling may have unwittingly eliminated a critical incentive to restore electrical services quickly, PSC initiated proceedings (Case Nos. 9257 through 9260) to investigate how electric companies calculate their monthly distribution rates under decoupling mechanisms. In January 2012, PSC issued Order No. 84653 which required that the electric companies modify their tariffs so that decoupling revenue is not collected beyond 24 hours after the commencement of a "major storm" (10% of a company's customers or 100,000, whichever is less, without power). PSC noted that electric companies are still allowed to collect revenue for lost kilowatt-hours for blue sky outages, short-term outages of less than 24 hours, and for storms that do not meet the "major storm" threshold.

Executive Order to Study and Report on Options to Improve the Resiliency of Maryland's Electric Distribution System

On July 25, 2012, the Governor issued Executive Order 01.01.2012.15 directing the Governor's Energy Advisor, in collaboration with the Maryland Energy Administration, the Power Plant Research Program, the Maryland Emergency Management Administration, and the staff of PSC to solicit input and recommendations from experts regarding (1) placing supply and distribution lines underground; (2) options, costs, and benefits for other distribution infrastructure investments; and (3) options for financing and cost recovery for capital investments to the electric distribution system. On September 24, 2012, the workgroup issued a report, *Weathering the Storm, Report of the Grid Resiliency Task Force* with recommendations for legislative changes, regulatory reforms, and other policy changes. Recommendations in the report include:

- improving RM 43's reliability requirements and accelerate RM 43's reliability investments;
- evaluating statewide vegetation management regulations and practices beyond RM 43;
- allowing a tracker cost recovery mechanism for accelerated and incremental investments;
- implementing a ratemaking structure that rewards reliability in excess of established reliability metrics and penalizes failure to reach those metrics;
- determining cost-effective levels of investment in resiliency by PSC;
- conducting an inquiry into the graying of the utility workforce by PSC; and
- formally charging by the Governor the Energy Future Coalition with the development of a "Utility 2.0" pilot proposal.

Reliability Surcharge Mechanisms – Electric and Gas Companies

In 2012, PSC denied requests for surcharges for electric distribution infrastructure investments by PEPCO and Delmarva (Case Nos. 9285 and 9286). The surcharges, known as Reliability Investment Mechanisms, would have accelerated the recovery of costs associated with certain reliability capital expenditures. PSC declined to authorize the surcharge for either electric company in those cases, consistent with its decisions in other cases involving infrastructure surcharges. For example, in 2011, PSC denied Washington Gas Light Company's request for an accelerated pipe replacement plan and associated surcharge in addition to a rate increase (Case No. 9267) and also denied Delmarva's request for a reliability surcharge (Case No. 9249). Further, PSC denied BGE's request for accelerated cost recovery of expenses related to smart meters (Case No. 9208) in 2010, and Delmarva's request for surcharge recovery outside of rates for pension and other employment costs (Case No. 9192) in 2009.

Legislation authorizing gas companies to file a plan with PSC requesting authorization of a cost-recovery surcharge for proposed infrastructure replacement projects was introduced in 2011 and 2012 (failed in both years). According to a 2012 report by the American Gas Association, 19 states have full infrastructure cost-recovery mechanisms for gas companies. Senate Bill 541/House Bill 662 of 2012 would have authorized gas companies to file a plan with PSC requesting authorization to include a surcharge on customers' bills to recover specified costs associated with proposed eligible infrastructure replacement projects. The bills would have established a limit for the monthly surcharge of $2 per month for all gas customers.

Smart Meter Installation Opt-outs

PSC authorized BGE to deploy smart meters in August 2010 under Case No. 9208. BGE's initiative will install over two million electric meters and gas modules, the majority of which will be installed by 2014. PSC later authorized PEPCO to deploy smart meters in September 2010 and Delmarva Power and Light in May 2012. SMECO also has a PSC-approved pilot program in a section of its service territory. However, in both the general public and the General Assembly there remains some concern about the widespread deployment of smart meters. House Bill 878 of 2012 (failed) would have required electric companies to offer an "opt-out" option from smart meter installations. In May 2012 PSC issued an interim order (No. 84926) allowing customers to opt-out of smart meter installations until such time as the commission makes a final ruling.

Public Safety

DNA Testing of Arrestees

The current system of collecting a DNA sample from individuals charged with a crime of violence or felony burglary or an attempt to commit those crimes will be reviewed by the U.S. Supreme Court after the statute, as applied to arrestees, was struck down by the Court of Appeals. The ongoing litigation coincides with the scheduled 2013 sunset of the statute.

All states require individuals convicted of certain crimes to provide a DNA sample. In addition, according to the National Institute of Justice, laws authorizing collection of DNA samples from individuals arrested for or charged with certain qualifying offenses have been enacted by 28 states and the federal government. Constitutional challenges to laws requiring DNA collection from convicted criminals under the Fourth Amendment (prohibiting unreasonable searches and seizures), Eighth Amendment (prohibiting cruel and unusual punishment), and the Ex Post Facto Clause (prohibiting criminalization or punishment of behavior that was not criminal or punishable at the time of its commission) of the U.S. Constitution have been largely unsuccessful. Federal and state courts are divided, however, on the constitutionality of requiring arrestees to submit to DNA sample collection. In April 2012, the Maryland Court of Appeals struck down the State's DNA collection statute as applied to arrestees when it held in *King v. State,* 425 Md. 550 (2012) that the DNA sample taken from Alonzo Jay King, Jr. was an unconstitutional search as applied to the facts in that case.

DNA Collection Requirements

In Maryland, DNA samples are collected from individuals convicted of a felony, fourth degree burglary, or breaking and entering a vehicle. A DNA sample must also be collected from an individual who is charged with a crime of violence or felony burglary or an attempt to commit those crimes. State law defines a "crime of violence" to include several specific crimes, including abduction, arson, kidnapping, manslaughter, murder, rape, carjacking, first or second degree sexual offense, and various types of assault. DNA samples are collected by a trained designee at (1) a facility specified by the Secretary of State Police for samples collected at the time the individual is charged; (2) the correctional facility where the individual is confined; (3) a facility designated by the director of the crime laboratory for an individual on probation or not sentenced to imprisonment; or (4) a suitable location in a circuit court at the time of sentencing.

Chapter 465 of 2002 expanded the applicability of the DNA sample submission requirement from an individual convicted of a specified "qualifying crime of violence" to an individual convicted of a felony or the misdemeanors of fourth degree burglary or breaking and entering a motor vehicle. Chapter 240 of 2003 eliminated the sunset date of Chapter 465, which would have terminated September 30, 2003. Chapter 337 of 2008 required the collection of DNA samples from individuals charged (but not yet convicted) with a crime of violence or felony burglary; made various changes relating to postconviction review and the collection, processing, destruction, and use of DNA samples and records; and imposed certain reporting requirements on the Department of State Police, local law enforcement agencies, and the Office of Legislative Audits relating to DNA collection and testing. Chapter 337 will terminate December 31, 2013, if its provisions are not continued.

Storage, Use, and Destruction of Samples

The State Police Crime Laboratory is required to store and maintain each DNA identification record in the statewide DNA database. Matches between evidence samples and database entries may only be used as probable cause and are not admissible at trial unless confirmed by additional testing.

A sample collected from an individual charged with a crime of violence or felony burglary may not be tested or placed in the database system before the first scheduled arraignment date, unless the individual consents to or requests testing prior to the arraignment for the sole purpose of having it checked against a sample that has been processed from the crime scene or the hospital. If all qualifying criminal charges are determined to be unsupported by probable cause, the DNA sample must be immediately destroyed, and notice that the sample was destroyed must be sent to the defendant and the defendant's counsel of record. Any DNA samples and records generated as part of a criminal investigation or prosecution must be destroyed or expunged automatically from the State DNA database within 60 days if a criminal action begun against the individual relating to the crime does not result in a conviction, is finally reversed or vacated and no new trial is permitted, or results in the granting of an unconditional pardon. A DNA sample or record may not be automatically destroyed or expunged if the criminal action is placed on the *stet* docket or the individual receives probation before judgment.

To guard against the improper use of DNA information, disclosure of DNA information to unauthorized persons, obtaining DNA information without authorization, and testing of a DNA sample for information that does not relate to the identification of an individual are misdemeanor offenses punishable by maximum penalties of five years incarceration, a $5,000 fine, or both. In addition, willfully failing to destroy a DNA sample for which notification has been sent stating that the DNA sample has been destroyed or for which destruction has been ordered is a misdemeanor offense punishable by imprisonment not exceeding one year or a fine not exceeding $1,000. Searching the statewide DNA database for the purpose of identifying an offender in connection with a crime for which the offender may be a biological relative of the individual from whom the DNA sample was acquired is also prohibited.

King v. State

In *King v. State*, the Court of Appeals reviewed its previous decision upholding the DNA collection statute as applied to individuals convicted but found that the presumption of innocence for arrestees affords them greater protections. According to the court, mere arrestees have an expectation of privacy to be free from warrantless searches of their biological material and the vast amount of personal information contained within that material. The court cited the expungement provisions in the DNA collection law as evidence of the superior privacy rights of individuals who have not been convicted. Stopping short of holding the law unconstitutional on its face, the court found that taking the DNA sample from King was an impermissible search as applied to that case but recognized that very limited circumstances may exist in which collection of DNA would be necessary to identify an arrestee who has altered his or her fingerprints or facial features. Police initially suspended DNA collection from arrestees in the wake of the ruling.

The State appealed the *King* decision to the U.S. Supreme Court, and Chief Justice Roberts issued an opinion in July granting a stay of the decision, saying that there was a "fair prospect" the Supreme Court would grant certiorari and overturn the decision. Following the Roberts opinion, police resumed collecting DNA samples from arrestees. On November 9, 2012, the Supreme Court agreed to review the Court of Appeals decision. Oral arguments are expected to be heard in early 2013.

Potential Legislation

Pending the final outcome of the *King* case, the Department of State Police has expressed support for legislation to repeal or extend the 2013 termination of Chapter 337 of 2008. It is expected that civil liberties groups will oppose any such efforts.

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Public Safety

State Correctional System

The Department of Public Safety and Correctional Services is in the process of a departmental reorganization. At the same time, the department continues to work toward construction of the Dorsey Run Correctional Facility in Jessup and deconstruction of the Maryland House of Correction as well as a solution regarding construction of the Baltimore Youth Detention Center.

Departmental Reorganization

The Department of Public Safety and Correctional Services (DPSCS) is currently in the process of a departmental reorganization. The reorganization is intended to regionally integrate operations in order to improve service delivery and re-entry transition into the community.

DPSCS administration will now include the Office of the Secretary and a new Office of the Deputy Secretary for Operations. The Division of Correction and the Division of Parole and Probation will no longer act as individual agencies; instead, three regional offices will each be in charge of both the corrections and community supervision functions. The Central Region, composed of Baltimore City and Baltimore County, will also be responsible for detention services. All three regions will fall under DPSCS Operations. All other agencies – the Maryland Parole Commission, Inmate Grievance Office, Criminal Injuries Compensation Board, Police and Correctional Training Commissions, and the Maryland Commission on Correctional Standards – will remain the same.

The budget for fiscal 2014 will be presented to reflect the reorganized structure. Statutory amendments will be required to implement the reorganization.

Baltimore City Youth Detention Center

The State of Maryland is responsible for operating the pretrial and detention functions for the City of Baltimore. Youth who are detained in the adult criminal justice system in Baltimore are currently held in the juvenile unit at the Baltimore City Detention Center (BCDC). According to a 2000 investigation by the U.S. Department of Justice (DOJ), the conditions in the current detention center facility do not provide adequate program or education space for youth charged as adults and do not comply with sight and sound separation requirements. In 2003, BCDC voluntarily initiated a commitment to change the environment of the facility, and a Memorandum of Agreement (MOA) was reached between DOJ and DPSCS in January 2007. DPSCS was granted an extension to the MOA providing an additional two years (beginning in April 2012) to achieve compliance. DPSCS has determined that the most efficient and cost-effective way to address the DOJ concerns is through construction of a new Youth Detention Center (YDC).

The goal of building a detention center specifically for youth charged as adults is to have a facility that can be operated to both acknowledge the seriousness of the charges and address the unique needs of the juvenile population. The youth held at BCDC are between the ages of 14 and 18 and are charged as adults for serious felonies, including first degree assault, carjacking, robbery, and attempted murder. Currently, BCDC has insufficient space to provide satisfactory medical, programming, psychology, education, recreation, storage, dietary, and housing services for a youth charged as adult population.

In accordance with the original population projections submitted to the Department of Budget and Management in 2007, the new facility was designed to provide bed space for 180 youth. During the 2011 legislative session, the General Assembly restricted a portion of the previously authorized construction funding until a report was provided presenting a new population analysis. DPSCS commissioned the National Council on Crime and Delinquency (NCCD) to conduct the new population analysis. The findings were released in May 2011, forecasting the need for 117 beds over the next 30 years as opposed to 180 beds.

Concern has been raised about whether either projection is appropriate. Criminal justice data tends to be cyclical and facilities are operational for 30 to 50 years; therefore, peaks and valleys in population numbers should be taken into consideration when developing facility population projections. The NCCD study is based mainly on the two most recent years when population numbers are trending down, while the 2007 projection was based upon years in which the number of youth charged as adults was increasing. Neither analysis is based upon all years of data.

Meanwhile, certain juvenile advocacy groups and others are opposed to the construction of the YDC and have vocalized their desire for the authorized funding to be repurposed for school construction and community programs. Some advocates have suggested that all youth be processed and held in Department of Juvenile Services facilities while awaiting resolution of their charges. Others have questioned whether juveniles should be charged as adults in any circumstance. As a result, the legislative discussion has been broadened to two issues – whether to build the facility and, if so, to what capacity.

Recently, in response to language added to the 2012 Maryland Consolidated Capital Bond Loan (MCCBL), DPSCS conducted an evaluation of the potential for renovating the currently vacant Baltimore Pre-Release Unit for Women (BPRU-W) instead of building a new YDC. The results of the evaluation showed BPRU-W would be an inadequate option, even as a temporary location for the youth charged as adult population, mainly due to an insufficient footprint. The facility would need additional space for intake/visitation, education, recreation, medical care, and beds. In addition, the security level of the facility would need to be increased.

Another issue is that BCDC is the only State-run detention center in Maryland. The other detention centers around the State are operated by local authorities and are required to comply with the same laws and standards regarding youth pending action in adult court. Of the 146 youth charged as adults in Maryland being housed at adult facilities on August 28, 2012, 43 were in Baltimore City. To the extent that any change in statute arising out of this matter is necessary, it would not only affect the youth housed in Baltimore City but also the youth housed in other jurisdictions statewide.

Since the start of this project, the State has authorized approximately $32.7 million and pre-authorized an additional $62.7 million toward the design and construction of the YDC. Approximately $10.3 million has been encumbered by the department for the design and preliminary site work. During the 2012 legislative session the MCCBL de-authorized and repurposed $16.9 million of the construction funding, leaving $5.5 million for the department to redesign the facility to a 120 bed capacity. Approximately $600,000 of the remaining $5.5 million is currently restricted pending a decision from the budget committees regarding the BPRU-W evaluation. Both the House Appropriations Capital Budget Subcommittee and the Senate Budget and Taxation Committee held hearings on the issue during the interim.

During the 2012 legislative session, legislation was introduced to address the issues raised by advocates; House Bill 1122 was passed requiring the Department of Juvenile Services to produce a report by December 1, 2012, to examine the impact of absorbing the youth charged as adult population.

Further action is pending a decision by the legislative fiscal committees. In any event, a solution to this dilemma must be determined swiftly in order to meet the April 2014 DOJ compliance deadline.

Capital Construction Update

Dorsey Run Correctional Facility

Dorsey Run Correctional Facility in Jessup is a new minimum security correctional complex due to open in July 2013. DPSCS anticipates the first of two 560-bed compounds at Dorsey Run will be operational within the first three months of fiscal 2014 and, therefore, requires $8.4 million in general funds and an additional 117 positions in fiscal 2014. Each compound consists of an administrative building plus two buildings housing 280 beds each. Once complete, the entire facility will provide a total of 1,120 new minimum security beds.

Maryland House of Correction Deconstruction

In 2007 the Maryland House of Correction was decommissioned. DPSCS will deconstruct the building in order to salvage materials for sale. Inmate labor will be used after appropriate training to dismantle, remove, and load materials. The department is estimating that 40 inmates will be trained and then used at the contractor's discretion. Direct supervision by correctional officers will be discussed and outlined in detail once a specific contractor is chosen.

The project involves deconstruction of 14 out of the 16 total buildings; two buildings – the hospital building and an adjacent holding/waiting area building – will not be deconstructed at this time. DPSCS has not identified a use for the site once the deconstruction is complete.

Public Safety

Handgun Permits – "Good and Substantial Reason" Requirement

A U.S. District Court decision finding the State's statutory standard ("good and substantial reason") for issuance of a handgun permit by the Maryland State Police unconstitutional is the subject of an appeal before the U.S. Court of Appeals for the Fourth Circuit.

Generally, in order to wear, carry, or transport a handgun in Maryland, a person must possess a permit issued by the Secretary of State Police. While there are several qualifications that must be met for the issuance of such a permit, the denial of applications for permits to carry a handgun on the basis that the person does not have a "good and substantial reason" has been an issue considered by the legislature for many years. An ongoing federal court case challenging the constitutionality of Maryland's "good and substantial reason" requirement, however, could alter Maryland's handgun permitting law.

Current Law

To be issued a permit to carry a handgun by the Maryland State Police (MSP), an applicant (1) must be an adult; (2) must not have been convicted of a felony or misdemeanor for which a sentence of imprisonment for more than one year has been imposed or, if convicted, must have been pardoned or been granted relief under federal law; (3) if younger than 30, must not have been committed to a facility for juveniles for longer than one year or adjudicated delinquent for a crime of violence, a felony, or a misdemeanor that carries a statutory penalty of more than two years; (4) must not have been convicted of a controlled dangerous substance violation and must not presently be an addict, a habitual user of a controlled dangerous substance, or an alcoholic; (5) must not exhibit a propensity for violence or instability that may reasonably render possession of a handgun a danger to the applicant or another; and (6) must have a good and substantial reason to wear, carry, or transport a handgun. "Good and substantial reason" includes a finding by MSP that the permit is necessary as a reasonable precaution against apprehended danger.

Although Maryland law requires a person to be issued a permit to wear, carry, or transport a handgun, whether concealed or not, there are eight exceptions to that requirement. Two of the exceptions include authorizing a person to wear, carry, or transport a handgun, provided that the handgun is unloaded and in an enclosed case or enclosed holster when being transported, if the person is (1) transporting the handgun to or from a legal place of sale or a repair shop or between the person's home or business or (2) wearing, carrying, or transporting the handgun in connection with an organized military activity, target practice, sport shooting event, hunting, or trapping. Further, a person may wear, carry, or transport a handgun if the person is in the person's home, place of business, or other property that the person owns or is a supervisory employee who is wearing, carrying, or transporting the handgun under specified circumstances.

Permit Applications

There are about 14,000 active handgun permits in Maryland. Since 2009, MSP has received an average of about 1,800 initial and 2,100 renewal nonpolice-related applications per year, including renewal applications from retired law enforcement personnel. It generally takes MSP less than two days to receive the results of a national criminal history records check from the Federal Bureau of Investigation and approximately 135 days to process, investigate, and issue a permit. MSP has denied an average of 214 nonpolice-related applications each year between 2008 and 2010, or 5.6% of applications, on the basis of a finding that the person did not have a "good and substantial reason" for the permit.

A handgun permit application costs $75; two years after the initial permit and every three years thereafter, a $50 renewal fee is due. In addition, the applicant must pay for fingerprint-based federal and State criminal history background checks for initial applications ($52) and renewals ($24).

Woollard v. Gallagher

In *Woollard v. Gallagher* (No. 12-1437), the United States Court of Appeals for the Fourth Circuit is considering the constitutionality of Maryland's "good and substantial reason" handgun permit requirement.

On Christmas Eve 2002, Raymond Woollard's son-in-law, Kris Lee Abbott, broke into Mr. Woollard's home. During the incident, Mr. Woollard grabbed his shotgun and aimed it at Mr. Abbott, who was under the influence of drugs and attempting to steal a set of car keys. Subsequent to a struggle in which Mr. Abbott took the shotgun from Mr. Woollard, Mr. Woollard's son retrieved a different gun and pointed it towards Mr. Abbott while Mrs. Woollard called the police. Two and a half hours later, the police responded to Mr. Woollard's home, which was located in a remote part of Baltimore County.

In 2003, Mr. Woollard applied for and was issued a permit to carry a handgun for personal protection. Mr. Woollard renewed his permit in 2006, shortly after Mr. Abbott was released from prison. When Mr. Woollard sought to renew his permit again in 2009, however, the Handgun Permit Unit of MSP denied his renewal application because Mr. Woollard could not produce any current evidence of "apprehended fear." Mr. Woollard first appealed the decision informally and then appealed formally to the Handgun Permit Review Board. Ultimately, the board concluded that Mr. Woollard did not produce any evidence of threats occurring outside of his home and thus did not have a "good and substantial reason" to wear, carry, or transport a handgun.

On July 29, 2010, Mr. Woollard filed a civil action in the United States District Court for the District of Maryland against the Secretary of State Police and three members of the Handgun Permit Review Board in their official capacity. The complaint alleged that Maryland's handgun permitting law violates the Second Amendment and the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution. After both sides presented oral arguments and filed motions for summary judgment, on March 2, 2012, the court issued an opinion that Maryland's "good and substantial reason" requirement infringes on an individual's right to bear arms under the Second Amendment. In the court's analysis, the "good and substantial reason" requirement was not sufficiently tailored to Maryland's interest in public safety and crime prevention and, therefore, violates the Second Amendment. The court, however, rejected Mr. Woollard's Equal Protection claim, finding that the Second Amendment provided the proper framework for analysis. After the District Court issued its opinion, the defendants filed an appeal in the U.S. Court of Appeals for the Fourth Circuit seeking to overturn the finding that Maryland's handgun permitting law violates the Second Amendment. On August 2, 2012, the Fourth Circuit granted Maryland's motion for a stay pending the outcome of the appeal. As a result, Maryland may continue its current handgun permitting practices while the appeal is pending.

Legislative Activity

In response to the *Woollard* case, Senate Bill 21 was introduced during the second special session of 2012. The bill would have repealed the "good and substantial reason" requirement but prohibited the issuance of a permit if the Secretary of State Police finds the permit applicant has exhibited any conduct that indicates the applicant is potentially a danger to the public if issued a permit. The bill also would have prohibited a permit holder from wearing, carrying, or transporting a handgun on specified real property such as a government building, place of worship, school, or public library. The bill was referred to the Senate Rules Committee with no further action taken.

The extent to which there will be additional legislation introduced during the 2013 session will likely depend on the outcome of the *Woollard* case. Oral arguments for the appeal were heard on October 24, 2012.

Access to Regulated Firearms by Mentally Ill Individuals

Nationwide there have been a number of shooting tragedies involving individuals with some indication of mental illness. During the 2012 session, the General Assembly created the Task Force to Study Access of Individuals with Mental Illness to Regulated Firearms. The report of the task force, with findings and recommendations, is due December 31, 2012.

Background

Recent fatal shootings in several states by persons with histories of mental instability who were able to legally purchase and possess firearms have led to several studies and the introduction of legislation in some states. Under federal law, it is unlawful for any person to sell or otherwise transfer any firearm or ammunition to a person knowing or having reasonable cause to believe that the person has been adjudicated as "a mental defective" or has been committed to a mental institution. Current state laws vary, but most states prohibit a person from possessing a firearm if the person has been adjudicated mentally ill or mentally incompetent or committed involuntarily to a mental institution.

Current Maryland Law

A person may not possess a regulated firearm, a rifle, or a shotgun if the person was convicted of a crime of violence or a violation of specified controlled dangerous substances offenses. Other factors that disqualify a person from owning a regulated firearm, a rifle, or a shotgun, include (1) suffering from a mental disorder, and having a history of violent behavior against the person or another; and (2) confinement for more than 30 days to a mental health facility. However, a person for whom these factors apply may nevertheless possess a firearm if the person has a physician's certificate stating that the person is capable of possessing such a weapon without undue danger to the person or to another. Similar requirements are in place with respect to the acquisition of a State regulated firearms dealer's license. A firearms dealer's license allows a person to engage in the business of selling, renting, or transferring regulated firearms.

To be issued a permit to wear, carry, or transport a handgun by the Secretary of State Police, an applicant must meet certain criteria, including not exhibiting a propensity for violence or instability that may reasonably render possession of a handgun a danger to the applicant or another.

There are 242 State-regulated firearm dealer licensees in Maryland and about 14,000 active handgun permits in the State.

Task Force

Chapter 131 of 2012 established a Task Force to Study Access of Individuals with Mental Illness to Regulated Firearms, with three specified areas of concern to consider. The task force is staffed by the Governor's Office of Crime Control and Prevention (GOCCP) and must report its findings and recommendations by December 31, 2012. The task force has established three workgroups and has assigned them the following tasks:

- The first workgroup will study the adequacy of State laws and policies relating to the access of law enforcement officers to mental health records and whether, and to what extent, the State should expand access of law enforcement officers to certain mental health records. This group will identify gaps in information sharing among agencies and propose technical and legislative solutions, if necessary.

- The second workgroup will study whether existing statutory and regulatory provisions adequately protect the public, as well as the civil rights of individuals with mental illness. This workgroup will make recommendations, as appropriate, and will evaluate research regarding various types of mental illness, including the propensity for violence to one's self or others.

- The third group will study the adequacy of State laws and policies relating to the access of individuals with a history of mental illness to all regulated firearms. This workgroup will consider whether, and to what extent, there should be further limits on the access of individuals with a history of mental illness to regulated firearms. The group will compare Maryland's Public Safety Article to statutes in other states and federal law to help identify best practices.

While the extent to which the interim work of the task force will lead to the introduction of legislation in 2013 is unknown, it is likely that its work and recommendations will generate and underpin debate on handgun permits during the legislative session. For all of its undertakings and possible recommendations, the task force has expressed a desire to balance public safety considerations with protections for an individual's right to possess a firearm.

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Criminal Law

Synthetic Drugs

A large number of compounds found in synthetic stimulants, synthetic cannabinoids, and synthetic hallucinogens were added to the federal list of Schedule I controlled substances in July; however, new formulas continue to be created. State and local health officials continue to express concern about these products as they are linked to potentially severe adverse reactions and abuse.

Background

In recent years, the public has seen the proliferation of new synthetic, designer drugs, with innocent names like "bath salts," "spice," and "smiles," that until recently could be found at local convenience stores or smoke shops and remain widely available over the Internet. These products, said to mimic the effect of illegal drugs, were once totally legal. The federal government and many states have moved to change that, but always seem to be one step behind the ability of suppliers to create new products in an attempt to skirt prosecution.

Synthetic Stimulants (Bath Salts)

Mephedrone and Methylenedioxypyrovaleron (MDPV) (sometimes categorized as "substituted cathinones") are synthetic psychoactive stimulants that can produce side effects such as increased blood pressure, delusions, paranoia, and psychosis. The substances are sold in powder and tablet form and are chemically similar to compounds found in the khat plant indigenous to eastern Africa. They have amphetamine-like qualities, and users often report experiencing effects similar to cocaine, ecstasy, and methamphetamines. Mephedrone and MDPV have been sold in convenience stores, gas stations, and online for \$25-\$50 per 50-milligram packet. They are often marketed as "bath salts" or "plant food" and have street names like "zoom 2," "aura," "cloud nine," and "meow-meow."

Emergencies related to the drugs have surged: the American Association of Poison Control Centers received more than 6,100 calls about bath salt drugs in 2011 – up from just 304 the year before – and more than 1,700 calls in the first half of 2012. Use of these drugs has spread across the country with reports stretching from Maine to California. There are no official federal estimates on deaths connected with the drugs, many of which do not show up on typical drug tests. But police reports have implicated the drugs in several cases.

Synthetic Cannabinoids (Spice, K2)

Synthetic cannabinoids are chemically engineered substances that are similar to THC, the active ingredient in marijuana. When smoked or ingested these substances are said to produce a high similar to marijuana. The substances are typically sprayed onto dried herbs and sold in convenience stores or smoke shops under names like “spice,” “K2,” or “potpourri.” Synthetic cannabinoids are becoming a popular alternative to marijuana. A University of Michigan study found that 11.4% of high school seniors reported using synthetic marijuana in the past year. The American Association of Poison Control Centers reported that the number of calls related to synthetic marijuana more than doubled from 2010 to 2011. Synthetic cannabinoids have been linked to hallucinations, tachycardia, kidney failures, and seizures.

Synthetic Hallucinogens (2C-1, Smiles)

As new synthetic compounds emerge, federal and state agencies often need to scramble to update their lists of banned substances. For example, reports have surfaced of a new synthetic drug that is rapidly expanding across the country. 2C-1, or “Smiles,” is a powder-like substance that, when ingested, is said to mimic the hallucinogenic effects of LSD and ecstasy. Unlike cocaine and other drugs that produce immediate reactions, the effects of “Smiles” are often delayed and can lead to overdosing. The drug has been linked to very high blood pressure, rapidly accelerating heart rates, kidney failure, and even death, including a recent suspected murder/suicide involving an actor on a popular cable television drama. Since 2C-1 is a novel drug, only recently becoming popular in the United States, law enforcement and hospitals face difficulties in detecting the chemical compound.

Other States

According to the National Conference of State Legislatures, at least 42 states (including Maryland) have banned certain bath salt chemicals, and at least 41 states have legislation outlawing chemical substances related to synthetic cannabinoids.

Actions by Federal Government

On July 9, President Obama signed the Synthetic Drug Abuse Prevention Act of 2012 into law as part of S. 3187, the Food and Drug Administration Safety and Innovation Act. This legislation banned compounds found in synthetic stimulants, synthetic marijuana, and synthetic hallucinogens. These designer drugs are now on the Drug Enforcement Agency’s Schedule I, making it a federal crime to manufacture, possess, distribute, import, or export these chemicals or products containing them. In announcing the signing of the Act, the Office of National Drug Control Policy encouraged states that have not already done so to incorporate these substances into their state drug schedules "to ensure that state law enforcement agencies have full authority to act against these substances."

Maryland Law

In 2012 Maryland enacted Chapter 384, adding the chemical compounds in "bath salts" to the State's Schedule I. Additionally, under Maryland law, if the federal government adds a substance to the federal Schedule I, it is automatically considered a Schedule I substance in the State unless the Department of Health and Mental Hygiene (DHMH) objects to the designation. Since DHMH has not raised objections to the Synthetic Drug Abuse Prevention Act, the synthetic cannabinoids and hallucinogens designated by federal law as Schedule I substances are currently illegal in Maryland.

Several local jurisdictions are also looking to address the use, sale, and possession of synthetic drugs. In 2011, the Ocean City mayor and council enacted ordinances 2011-25 and 2011-26 to prohibit the use, sale, and possession of synthetic drugs in the ocean resort community.

Criminal Law

Representation by Office of the Public Defender

Representation by the Office of the Public Defender became a major issue just prior to the beginning of the 2012 legislative session when the Court of Appeals issued its decision in *DeWolfe v. Richmond*, holding that an indigent defendant was entitled under the Maryland Public Defender Act to public defender representation at the bail hearing portion of an initial appearance. A further ruling in this area by the Court of Appeals is expected, and a legislative task force has begun its work on a variety of issues relating to representation of indigent defendants.

Background

When an individual is arrested, he or she must go before a judicial officer for an initial appearance. The judicial officer, usually a District Court commissioner, has a number of duties at the initial appearance, among which is to determine whether there was probable cause for the arrest and, if so, whether the defendant should be released on his or her own recognizance, on bail, or not at all. Under the Maryland Rules, a defendant who is denied pretrial release by a District Court commissioner or who for any reason remains in custody after a District Court commissioner has determined conditions of release must be presented to a District Court judge immediately if the court is in session or, if the court is not in session, at the next session of the court. Historically, the Office of the Public Defender (OPD) has not provided representation to indigent defendants at the initial appearance phase in any jurisdiction in the State. Prior to 2012, public defender representation was provided to indigent defendants at bail review only in Montgomery and Harford counties and Baltimore City.

DeWolfe v. Richmond

In *DeWolfe v. Richmond*, No. 34 (September Term 2011), the Maryland Court of Appeals held on January 4, 2012, that under the then-effective version of the Maryland Public Defender Act, no bail determination may be made by a District Court commissioner concerning an indigent defendant without the presence of counsel, unless representation by counsel is waived.

The plaintiffs in the case represent a class of indigent criminal defendants who were arrested, detained at the Central Booking and Intake Facility in Baltimore City (CBIF), brought before a commissioner for initial bail hearings, and requested and were denied representation by counsel at the initial bail hearings. The facts were undisputed that the initial appearances of criminal defendants in Baltimore City were not conducted in a courtroom, open to the public, or recorded. The initial appearances occurred in a small room at CBIF, with the defendant and the commissioner on opposite sides of a plexiglass window talking through a speaker system. The commissioner was not required to give Miranda warnings. The commissioner could ask the defendant about residence, family, employment history, and community ties, and the answers could have been used against the defendant at trial. Evidence was presented that the commissioner's initial bail decision often was not modified by the District Court judge on bail review.

The January 4, 2012 opinion was based on the wording of the Maryland Public Defender Act, including language that OPD must represent an indigent defendant "in all stages" of a criminal proceeding. The court did not address the plaintiffs' federal and State constitutional claims of a right to representation. However, the Circuit Court for Baltimore City had previously held, based on *Rothgery v. Gillespie County*, 554 U.S. 191 (2008), that indigent arrestees have a federal and State constitutional right to be appointed counsel at initial appearance.

Activity During 2012 Legislative Session

The *DeWolfe* decision sparked a heated debate during the 2012 session of the General Assembly. There was much concern about how the State would fund the obligation of OPD to begin representing people at the initial appearance phase. It was estimated that the cost to OPD alone (aside from costs that would be incurred by the Judiciary, the Department of Public Safety and Correctional Services, State's Attorneys offices, law enforcement agencies, and local correctional facilities) would exceed $27 million annually. On the other hand, serious questions were raised about whether people do possess a constitutional right to legal representation at initial appearance, regardless of cost. This debate prompted broader questions about and scrutiny of Maryland's criminal justice system, including the District Court commissioner and pretrial release systems. A number of bills were introduced to attempt to counteract or mitigate the effect of the *DeWolfe* decision. The Senate Judicial Proceedings and the House Judiciary committees spent a considerable amount of time exploring these issues and meeting with stakeholders including the Office of the Public Defender, the Judiciary, law enforcement agencies, State's Attorneys, and civil liberties advocates.

Ultimately, the General Assembly passed SB 422 and HB 261 (Chapters 504 and 505) of 2012, which were signed into law by the Governor on May 22, 2012. These bills (1) amend the Public Defender Act to specify that OPD is required to provide legal representation to an indigent defendant at a bail hearing before a District Court or circuit court judge but is not required to represent an indigent criminal defendant at an initial appearance before a District Court commissioner; (2) prohibit a statement made during an initial appearance before a District Court commissioner from being used as evidence against the defendant in a criminal or juvenile proceeding; (3) codify the rule that a defendant who is denied pretrial release by a District Court commissioner or who remains in custody after a District Court commissioner has determined conditions of release must be presented to a District Court judge immediately if the court is in session or, if the court is not in session, at the next session of the court; (4) require a police officer to charge by citation for specified offenses if certain conditions are met; (5) authorize a District Court commissioner to issue an arrest warrant based on an application for a statement of charges filed by an individual only if specified criteria are met; (6) establish the Task Force to

Study the Laws and Policies Relating to Representation of Indigent Criminal Defendants by the Office of the Public Defender; and (7) require specified entities to develop a format and procedures to record specified citation data and require the Maryland Statistical Analysis Center within the Governor's Office of Crime Control and Prevention to analyze citation data for five years beginning January 1, 2013.

Subsequent Developments

On August 22, 2012, the Court of Appeals issued an order stating its intention to rule on the issue of whether the plaintiffs in the *DeWolfe* case are entitled, under the recently amended Public Defender Act, to relief on the basis of the federal and/or State constitutional right to counsel provisions. Oral argument will be scheduled in the January 2013 session of the court.

The task force created by Chapters 504 and 505 of 2012 met for the first time on October 16, 2012. Various witnesses provided overviews of the *DeWolfe v. Richmond* litigation, the legislation, the District Court commissioner system, and the pretrial release system; others gave updates on the status of efforts to implement the different components of the legislation. Workgroups were established and a second meeting was scheduled for December 4, 2012. An interim report of the task force was submitted November 1, 2012, and a final report is due November 1, 2013.

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Courts and Civil Proceedings

Liability for Personal Injury or Death Caused by Dog

A ruling by the Court of Appeals in a personal injury case that pit bull dogs are inherently dangerous has raised questions about the fairness of breed-specific laws and whether strict liability is an appropriate standard of liability to impose on a person who owns, keeps, or has control over a dog. The General Assembly failed to reach consensus on legislation to address the court decision during the second special session of 2012.

Background

Prior to April 2012, in order for a person to hold a dog owner liable for damages as a result of being attacked by the owner's dog, the person had to show that the dog had a vicious propensity that was known to the owner. On April 26, 2012, the Court of Appeals modified this common law rule with respect to attacks by pit bulls and mixed-breed pit bulls and established a strict liability standard with respect to the owning, keeping, or controlling of such dogs. (*Tracey v. Solesky*, 427 Md. 627 (2012)).

In *Tracey v. Solesky*, the Court of Appeals held that, on proof that a dog involved in an attack is a pit bull or a mixed-breed pit bull and that the owner, or other person having the right to control the dog's presence on the premises, knows, or has reason to know, that the dog is a pit bull or a mixed-breed pit bull, that person is strictly liable for the resulting damages caused to a plaintiff who is attacked by the dog.

Justifying the change from the common law rule to a strict liability standard in pit bull cases, the majority opinion noted the number of cases involving serious maulings by pit bulls that had reached the appellate courts and cited precedents holding that the common law is subject to change not only by the General Assembly but also by the court in light of "modern circumstances or increased knowledge." To that end, the court reviewed related cases from other jurisdictions and a number of recent studies that associated attacks by "pit bull-type" dogs with significantly higher mortality rates, higher hospital charges, and a higher risk of death compared to attacks by other breeds. These sources, as well as "numerous instances of serious and often fatal attacks by pit bulls throughout the country, and especially in Maryland," persuaded the court that the common law needed to be changed to a strict liability standard in relation to pit bulls and mixed-breed pit bulls. Remanding the case, the court ordered the trial court to apply the new rule.

The dissenting opinion accused the majority of unjustifiably violating the doctrine of *stare decisis*, which requires judges to follow precedent in all but the most unusual situations. The dissent called the new rule "unworkable" and questioned how it could be applied without a definition of what constitutes a "mixed-breed" pit bull. These issues, the dissenters argued, are best resolved by the Maryland General Assembly.

Attorneys for the defendant landlord in the case filed a motion for reconsideration with the Court of Appeals on May 25, 2012. The motion asked the court to immediately rule on the motion to reconsider its original decision in the *Solesky* case or, alternatively, consider holding its decision on the motion pending the conclusion of the General Assembly's second special session of 2012.

Creation of Legislative Task Force on Court Decision

The *Solesky* ruling drew sharp criticism from dog owners, animal advocacy groups, landlords, and insurers. Common complaints about the decision included (1) the court's departure from *stare decisis*; (2) the application of a different standard of liability to pit bulls and mixed-breed pit bulls based on questionable statistics and scientific studies; (3) the lack of guidance in the opinion as to what constitutes a pit bull or a mixed-breed pit bull; and (4) the consequences of immediately holding landlords to a higher level of liability for dogs that are permitted under leases currently in effect without consideration to the lengthy legal process needed to remove a dog from a rental property.

Concerns were raised that the court decision would lead to pit bull owners being threatened with eviction from rental housing and having to choose between their homes and their pets, animal shelters being overrun with abandoned pit bulls, and pit bulls being euthanized.

In response the General Assembly formed the Task Force to Study the Court Decision Regarding Pit Bulls. The task force met on two occasions in June 2012. During its initial meeting, the task force heard testimony from a series of panels regarding the impact of the court's ruling. Common themes in the testimony included (1) imposing greater liability on all dog owners and emphasis on more responsible dog ownership (including spaying and neutering) in lieu of breed-specific standards; (2) the lack of guidance in the opinion as to what constitutes a pit bull or a mixed-breed pit bull; and (3) the ruling's effect on the rental market, including higher rents and insurance premiums for landlords and potential bans on all dogs in rental properties.

Second Special Session of 2012

Though the task force did not propose a bill of its own, several legislators introduced bills during the second special session of 2012 to address the *Solesky* decision. The bills varied in their approaches; some would have restored the common law rule prior to the *Solesky* decision, while others would have imposed strict liability on all dog owners under specified circumstances. However, the General Assembly failed to reach a consensus during the brief special session.

Recent Developments

On August 21, 2012, the Court of Appeals reconsidered its original decision and limited the application of its original ruling in the *Solesky* case to purebred pit bulls. As a result, owners of purebred pit bulls and landlords of tenants who own purebred pit bulls are strictly liable for the actions of those dogs, while the traditional common law rule applies to owners of mixed-breed pit bulls and other breeds of dogs and their landlords.

The court's revision of its original ruling did little to calm public anxiety over the ruling. Animal advocates and landlords commented that because the original and revised decisions do not define what constitutes a "pit bull," the court gave little direction to dog owners, landlords, and others affected by the ruling, and enforcement of the ruling will be difficult and arbitrary. Some animal experts noted that there is no such thing as a purebred pit bull, since that term refers to a category of dogs, some of which are mixed breeds, rather than a specific pure breed recognized by the American Kennel Club. Other experts and advocates explained the difficulty in identifying a dog's breed by sight and feared that the ruling's lack of direction will lead to erroneous enforcement.

Several news reports emerged of landlords banning pit bulls from rental properties and animal shelters preparing for an influx of pit bulls as a result of the court's decision. For example, in August 2012, the management at Armistead Gardens, a housing cooperative in Baltimore City, informed its 1,500 residents that purebred pit bulls and mixed-breed pit bulls are banned from the neighborhood effective immediately and tenants who fail to get rid of their pit bulls face eviction. In September 2012, a resident of Armistead Gardens filed a lawsuit in federal court against the State and the management company and requested a temporary stay on the eviction of residents and a temporary restraining order against the *Solesky* decision. The resident claims in his lawsuit that the decision by the Court of Appeals unconstitutionally overrode and violated his property rights in his pit bull and deprived him of his right to procedural due process by failing to provide a standard to evaluate what constitutes a pit bull. On October 14, 2012, the resident added the Governor, the Attorney General, and the Chief Judge of the Court of Appeals as defendants in the lawsuit, claiming that they failed to fulfill their duty to ensure that laws are faithfully executed and to uphold the Maryland Constitution and U.S. Constitution. The federal court is considering whether or not to issue an injunction on the neighborhood's ban pending adjudication of the case.

The Task Force to Study the Court Decision Regarding Pit Bulls met again in October in an attempt to develop a consensus on legislation for the 2013 session.

Courts and Civil Proceedings

Contributory Negligence

Maryland is one of five U.S. jurisdictions that apply the "contributory negligence" defense to civil negligence cases. However, a case before the Court of Appeals may abolish the defense and substitute a system of comparative fault.

Background

On September 10, 2012, in the case of *Coleman v. Soccer Association of Columbia, et al.*, No. 9, September Term 2012, the Court of Appeals heard oral arguments on whether the court should retain Maryland's "contributory negligence" defense for civil negligence cases (which provides that a defendant cannot be held liable for damages if the plaintiff's negligence contributed in any degree to the plaintiff's injuries) or whether the State should switch to a "comparative fault" system (which apportions liability between negligent parties according to their proportionate shares of fault). In *Coleman*, the plaintiff was injured when an improperly secured soccer goal fell on top of him after he jumped up and grabbed the crossbar. The jury found that the soccer association was negligent in not properly maintaining the goal, but also that Coleman was contributorily negligent and, therefore, barred from recovery. The Court will now decide whether the contributory negligence defense that Maryland retains will remain in effect or be replaced by a version of the comparative fault system.

Contributory Negligence

Contributory negligence is conduct on the part of an injured party that falls below the standard to which the injured party should conform for self-protection and is a legally contributing factor (along with the defendant's negligence) in bringing about the plaintiff's harm. Traditionally at common law and under Maryland case law for 165 years, a plaintiff's contributory negligence totally precludes any recovery by the plaintiff for damages. In addition to Maryland, four other jurisdictions (Alabama, North Carolina, Virginia, and the District of Columbia) retain the contributory negligence defense.

The contributory negligence defense has often been criticized for being unjust and outmoded. Even the slightest amount of contributory negligence by the plaintiff that contributes causally to an accident bars all recovery for even the most blatantly negligent acts by a defendant. Courts have sought to mitigate the harsh results of the contributory negligence defense by establishing various limits and exceptions to its application.

Comparative Fault

The term comparative fault refers to a system of apportioning damages between negligent parties according to their proportionate shares of fault. Beginning in 1969, there was a sharp increase in the adoption of comparative fault in jurisdictions across the country, both by statute and by judicial decision. Today, 46 states have adopted some form of comparative fault. Under a comparative fault system, a plaintiff's negligence that contributes to causing the plaintiff's damages will not prevent recovery but instead will only reduce the amount of damages the plaintiff can recover.

There are three major versions of comparative fault: "pure" comparative fault, "modified" comparative fault, and "slight/gross" comparative fault. Under a pure comparative fault system, each party is held responsible for damages in proportion to the party's fault. Regardless of the level of the plaintiff's own negligence, the plaintiff can still recover something from a negligent defendant. It makes no difference whose fault was greater.

Under a modified comparative fault system, each party is held responsible for damages in proportion to his or her fault, unless the plaintiff's negligence reaches a certain designated percentage of fault (usually 50% or 51%). If the plaintiff's own negligence reaches this percentage bar, then the plaintiff cannot recover any damages. Jurisdictions applying a modified comparative fault system must also choose how fault is compared in lawsuits involving multiple parties. Some jurisdictions compare the plaintiff's negligence to each defendant's separately. Other jurisdictions compare the plaintiff's negligence with the cumulative negligence of all the defendants.

Comparative fault may also be applied using a "slight/gross" system. Under this system, the fault of the plaintiff and the defendant is only compared if the plaintiff's negligence is "slight" and the defendant's negligence is "gross." In all other scenarios, the plaintiff cannot recover anything. South Dakota is the only state that currently uses a slight/gross system.

Changing Negligence System by Judicial Decision or Legislation

Many state courts have taken the position that the adoption of comparative fault should occur through legislative action, while others, often noting that contributory negligence itself was created judicially, have adopted and applied a rule of comparative fault by judicial decision. Among the 46 states that have abandoned contributory negligence in favor of comparative fault, 12 states made the change through judicial decisions, and 34 jurisdictions made the change through legislation. Some jurisdictions that originally adopted comparative fault systems through judicial decisions later codified those systems through legislation.

Rules Committee Report

In a letter dated November 8, 2010, the Chief Judge of the Court of Appeals asked the court's Standing Committee on Rules of Practice and Procedure to determine whether the court could replace the doctrine of contributory negligence with a form of comparative fault through the issuance of new rules or if the change would have to be made through a judicial decision. The request also called on the committee to study the judicial and economic consequences of such a change, as well as the impact of a change to comparative fault on related legal principles.

On April 15, 2011, the committee submitted its report to the court. The committee stated its belief that the doctrines and legal principles of contributory negligence and comparative fault are matters of substantive law that do not fall within the "ambit of practice, procedure, or judicial administration" and, therefore, are not subject to rule making by the Judicial Branch. The committee advised the court that to the extent that contributory negligence is a common law doctrine, the doctrine could be changed by judicial decision.

Potential Impact of *Coleman*

Over the years, the General Assembly has considered a number of bills that would have adopted a comparative fault system. In the event that *Coleman* overturns the current standard and adopts comparative fault, there may be legislative initiatives to reverse the court's ruling and return Maryland to a contributory negligence system or, alternatively, to apply comparative fault principles to liability of multiple defendants.

Courts and Civil Proceedings

Maryland Legal Services Corporation Funding

An increase in filing fee surcharges for civil cases, enacted in 2010, has helped the Maryland Legal Services Corporation maintain grant funding levels for legal services providers during the recent recession. The increase in surcharges terminates at the end of fiscal 2013, and it is unlikely that the Maryland Legal Services Corporation will be able to maintain its grant funding level if the increase is allowed to expire.

Background

The Maryland Legal Services Corporation (MLSC) was established in 1982 to make grants to organizations providing civil legal services to indigent residents of the State. Grant revenue is generated from the following sources:

- **Interest on Lawyer Trust Accounts (IOLTA):** Maryland Rule 16-604 requires that all Maryland attorneys deposit funds received from a client or third person into an attorney trust account with an approved financial institution. The interest on those accounts is paid into the MLSC Fund.
- **Filing Fees:** In accordance with §§ 7-202 and 7-301 of the Courts and Judicial Proceedings Article, a surcharge on certain circuit and District Court filing fees is deposited into the MLSC Fund.
- **General Funds:** Section 11-401 of the Human Services Article requires that the Governor transfer $500,000 annually from abandoned property funds to the MLSC Fund. Although the source of the money is general funds, it is appropriated as special fund revenue to MLSC.
- **MLSC Reserve Fund:** Any revenues in excess of expenses may be deposited to the MLSC Reserve Fund regardless of the source. MLSC is permitted to transfer MLSC Fund revenues into the MLSC Reserve Fund rather than grant it to legal services organizations. It is MLSC policy to maintain at least 50% of its total annual anticipated grant commitments in the MLSC Reserve Fund; however, the reserve fund has dropped below that threshold in recent years due to transfers to the MLSC Fund that were necessitated by declining IOLTA revenue.
- **Donations:** While not a significant source of revenue, MLSC receives donations to support its mission.

The funds collected from IOLTA, filing fees, and abandoned property funds are deposited by the Administrative Office of the Courts into the MLSC Fund, which MLSC then grants out to various organizations that provide the legal assistance services. In fiscal 2011, operating grants of $15.9 million were awarded to 34 legal services providers that opened more than 140,000 new cases (a 9% increase over the prior year) and provided legal assistance in matters such as foreclosure, eviction, elder care, domestic violence, child custody, employment, food stamps, and veterans benefits. **Exhibit 1** contains the revenue and expenditure figures for MLSC from fiscal 2008 through its projection for fiscal 2014.

Filing Fee Surcharges

As a result of the economic recession and the subsequent decline in interest rates, revenues from IOLTA earnings began to decline in fiscal 2009, resulting in a structural imbalance of $2.6 million in that fiscal year. As a result, MLSC transferred $800,000 from its reserve fund to maintain grant activity levels. In fiscal 2010, the structural imbalance improved slightly due to a decrease in grants; however, MLSC still needed to transfer $1.5 million in reserves to address the gap in revenues.

Due to declining IOLTA revenue, as well as an increasing demand for legal services, the General Assembly passed Chapter 486 of 2010, which increased the maximum surcharge on civil cases filed in circuit courts from $25 to $55. In the District Court, the maximum authorized surcharge also increased from $5 to $8 for summary ejectment cases and from $10 to $18 for all other civil cases. The higher maximum surcharge increased filing fee revenues and allowed MLSC to increase grant funding to pre-2010 levels while relying less heavily on its reserve fund. It should be noted, however, that MLSC has spent from its reserve every year since 2009.

Unless the General Assembly acts, the increases in the surcharges enacted in 2010 expire at the end of fiscal 2013. The expiration of the surcharge increases, coupled with the fact that the number of case filings subject to this surcharge have been declining as well, will lead to an estimated 45% drop in filing fee revenue for MLSC in fiscal 2014 and an estimated 39% overall drop in total MLSC Fund revenue. Furthermore, IOLTA revenue is projected to decline even further as banks continue to lower the interest rates associated with these accounts.

The expiration of the surcharge increases and the decline in IOLTA revenues are projected to have a major effect on the level of grant expenditures, as demonstrated in Exhibit 1. Should the termination of Chapter 486 become effective, MLSC would not be able to maintain its current funding level in fiscal 2014, even if it spent the entirety of its reserve funds in that fiscal year.

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Exhibit 1
Maryland Legal Services Corporation
Operating Revenues and Expenses
Fiscal 2008-2014

	2008	2009	2010	2011	2012	2013 Est.	2014 Est.
Revenues							
Interest on Lawyers Trust Accounts	$6,723,236	$3,951,000	$2,276,000	$2,524,000	$2,547,333	$2,000,000	$1,800,000
Filing Fee Surcharge	7,475,582	7,898,000	8,091,722	12,942,300	12,792,952	12,750,000	7,018,315
Abandoned Property Fund	500,000	500,000	500,000	500,000	500,000	500,000	500,000
MLSC Fund Carryover from prior year	1,874,182	1,073,000	0	0	0	0	0
Interest Paid to State					(8,572)		
Total MLSC Fund Revenue	**$16,573,000**	**$13,422,000**	**$10,867,722**	**$15,966,300**	**$15,831,713**	**$15,250,000**	**$9,318,315**
Transfers							
Transfer from Reserve Fund	$0	$800,000	$1,507,000	$646,120	$1,281,071	$175,767	($0 - $4,070,036)[1]
Cy Pres Award[2]						664,000	
Total Revenue & Transfers	**$16,573,000**	**$14,222,000**	**$12,374,722**	**$16,612,420**	**$17,112,784**	**$16,089,767**	**($9,318,315-$13,388,315)**
Expenses							
Grants	$13,784,550	$15,000,000	$11,740,000	$15,904,977	$16,394,822	$15,334,756	($9,354,201-$15,334,756)[3]
Operating Expenses	664,286	722,488	703,743	707,443	717,962	755,211	755,211
MAHT Refund[4]					194,146		
Total Expenses	**$14,448,836**	**$15,722,488**	**$12,443,743**	**$16,612,420**	**$17,112,784**	**$16,089,967**	**($10,109,412-$16,089,967)**
Dividends, Market Value				*$1,001,289*			
Available Reserves on June 30	*$7,219,000*	*$5,380,000*	*$4,592,000*	*$5,593,550*	*$4,245,903*	*$4,070,136*	*($0-$4,070,136)*

Notes:
(1)The exact dollar amount of reserve transfer funds is determined by the MLSC Board of Directors.
(2)Cy Pres award is a one-time payment out of a national class action lawsuit in Washington State.
(3)Fiscal 2014 grant projections reflect a range of a 39% decline (should the sunset in Chapter 486 of 2010 go into effect and increased surcharges expire) to flat funding (if sunset in Chapter 486 of 2010 is repealed and increased surcharges continue and MLSC continues spending from reserves).
(4)The Maryland Affordable Housing Trust (MAHT) refund reflects funds mistakenly paid to MLSC.
Source: Maryland Legal Services Corporation

Courts and Civil Proceedings

Assisted Reproduction

Maryland does not have a comprehensive statute that governs assisted reproduction. As a result, courts must determine the legal parentage of children born as a result of assisted reproduction on a case-by-case basis.

Background

Assisted reproduction is a method of achieving pregnancy other than by sexual intercourse. Forms of assisted reproduction include artificial insemination, in vitro fertilization, and surrogacy. The science of assisted reproduction has vastly outpaced the law. While the legal implications of a couple using assisted reproduction to aid in the conception of a child using only the couple's own genetic material are few, complicated legal issues concerning parentage arise, for example, where third parties contribute genetic material or where a surrogate agrees to gestate a child for the couple.

Maryland Law

Maryland does not have a comprehensive statute on assisted reproduction. Artificial insemination is addressed in the Estates and Trusts Article, which provides that a child conceived by artificial insemination of a married woman with the consent of her husband is the legitimate child of both of them for all purposes. Additionally, Chapter 649 of 2012 prohibits a person from using the sperm or eggs of a known donor after the donor's death for purposes of assisted reproduction without the prior written consent of the donor.

Under Maryland law, the status of surrogacy contracts is unclear as there is little statutory regulation of them. In *In re Roberto d.B.*, 399 Md. 267 (2007), the Court of Appeals held that the name of a genetically unrelated gestational host of a fetus, with whom the genetic father contracted to carry in vitro fertilized embryos to term, was not required to be listed on the birth certificate when a child is born as a result. The court also noted that "surrogacy contracts, that is, payment of money for a child, are illegal in Maryland" under § 3-603 of the Criminal Law Article, which prohibits the sale of a minor, and § 5-3B-32 of the Family Law Article, which prohibits the payment of compensation in connection with an adoption.

Laws of Other States

State laws vary tremendously. Among those states that have enacted statutes, many have adopted some form of the Uniform Parentage Act promulgated by the National Conference of

Commissioners on Uniform State Laws. The original Uniform Parentage Act, approved in 1973, established that, if a donor provides semen to a licensed physician for use in the artificial insemination of a married woman (other than the donor's wife), the donor is not the father. The 2002 Uniform Parentage Act updated and expanded the original Act to include egg and sperm donors and in vitro fertilization. Under the Act, a donor (of sperm or egg) is not a parent of a child conceived by means of assisted reproduction. A father-child relationship is created between a man and the resulting child if the man provides sperm for, or consents to, assisted reproduction by a woman with the intent to be the parent of her child. The 2002 Act also contained an optional provision legalizing and regulating surrogacy agreements; however, this option has not been widely adopted.

Other states have taken individualized approaches, with states at one end of the spectrum providing a detailed regulatory framework favorable to the regulation and enforceability of assisted reproduction agreements and states at the other end of the spectrum banning and even criminalizing surrogacy agreements. Michigan law, for example, provides that surrogacy is a felony punishable by five years imprisonment and/or a $50,000 fine.

Finally, some states' statutes are silent with regard to the legal implications of assisted reproduction, leaving the courts to sort out the thorny issues surrounding the legal parentage of the children on a case-by-case basis, resulting in costly litigation and uncertainty for the parties.

Legislative Activity

The General Assembly has been grappling with the complicated and controversial issues surrounding assisted reproduction for years. In the mid-1980s, several bills were introduced to both ban and to regulate surrogacy, and all were defeated. During the 1992 and 1994 sessions, the legislature passed identical bills that would have provided that a surrogate parentage contract was void and unenforceable as against State policy. Both bills were vetoed by the Governor. Most recently, Senate Bill 508/House Bill 873 of 2012, based on the American Bar Association Model Act Governing Assisted Reproductive Technology (which no state has adopted), would have established specified procedures for the regulation and enforcement of surrogacy agreements.

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Environment and Natural Resources

Chesapeake Bay Restoration and Growth Management

The State has developed a detailed plan for achieving federally required bay pollution reduction goals and is on track to meet those goals. However, strategies for funding the restoration efforts and effectively offsetting the impact of future growth are still under development and may face significant hurdles.

Background

In December 2010, the U.S. Environmental Protection Agency (EPA) established a Chesapeake Bay Total Maximum Daily Load (TMDL), as required under the federal Clean Water Act and in response to consent decrees in Virginia and the District of Columbia. The TMDL sets the maximum amount of pollution the bay can receive and still attain water quality standards. It also identifies specific pollution reduction requirements; all reduction measures must be in place by 2025, with at least 60% of the actions in place by 2017. The final target pollution loads for the five major basins in Maryland are shown in **Exhibit 1**. From 2010 levels, the State must reduce nitrogen loads to the bay by 22.0%, phosphorus loads by 14.9%, and sediment loads by 1.9%.

Exhibit 1
Final Target Pollution Loads for Maryland's Major Basins
(Million Pounds Per Year)

Major Basin	Nitrogen	Phosphorus	Sediment
Susquehanna	1.19	0.06	64
Eastern Shore	11.82	1.02	189
Western Shore	9.77	0.55	243
Patuxent	3.10	0.24	123
Potomac	15.29	0.94	731
Total	**41.17**	**2.81**	**1,350**

Source: Maryland's Phase II Watershed Implementation Plan

To achieve the TMDL, a robust assessment and planning framework was established. Bay jurisdictions committed to developing two-year milestones to assess progress toward achieving the pollution reduction goals in the TMDL. Furthermore, EPA required each bay jurisdiction to develop watershed implementation plans (WIP) detailing the strategies and specific actions that will be implemented to reduce pollution. Phase I WIPs were completed in 2010, and more detailed Phase II WIPs were completed in early 2012. A Phase III WIP, which must be submitted to EPA in 2017, will ensure that all practices are in place by the 2025 deadline.

Progress to Date

Maryland achieved its first set of milestone goals, completed the two required WIPs, and is on track to achieve its 2012 through 2013 milestone goals. Several legislative and regulatory changes were implemented recently that have positioned the State well to achieve its short-term bay restoration commitments. Specifically, over the last year, the State (1) generally doubled the bay restoration fee, which funds upgrading wastewater treatment plants (WWTP) and septic systems, and planting cover crops on farmland; (2) required the installation of best available technology for nitrogen removal on new septic systems in additional areas; (3) required specified local governments to establish stormwater remediation fees to provide additional funding for stormwater management activities; and (4) established more rigorous requirements concerning the use of manure, biosolids, and other organic nutrient sources on crop fields.

Ongoing Challenges

Despite the recent legislative and regulatory actions the State has taken, several policy challenges remain. Specifically, the State lacks a clear strategy for financing all the required restoration actions and managing new pollution associated with future growth.

Paying for Restoration Actions

The estimated cost associated with implementing Maryland's Phase II WIP is $14.8 billion, as shown in **Exhibit 2**. As illustrated, two major sectors are expected to demand significant State and local government funding throughout this period: stormwater retrofits and septic systems. While the State has taken steps to increase funding for these and other sectors, it is still working to identify new revenues and financing strategies to cover anticipated costs. In early 2012, the Department of Legislative Services estimated that the funding shortfall for WIP implementation is approximately $8.3 billion between fiscal 2010 through 2017, with WWTP upgrades and stormwater retrofits representing the majority of the need.

Exhibit 2
Estimated Phase II Watershed Implementation Plan Costs
Calendar 2010-2025
($ in Millions)

Sector	Cost
Agriculture	**$928**
Municipal Wastewater	**$2,368**
Major Municipal Plants	2,306
Minor Municipal Plants	62
Stormwater	**$7,772**
Maryland Department of Transportation	1,500
Local Government	6,272
Septic Systems	**$3,723**
Upgrades	2,459
Connections	1,176
Pumping	88
Total	**$14,791**

Source: Maryland's Phase II Watershed Implementation Plan

Managing Growth

To comply with the bay TMDL, bay jurisdictions must not only reduce existing pollution loads but also *maintain* reduced pollution loads as population growth and new development occurs. Maryland plans to manage new pollution loads in the future by (1) upgrading major WWTPs to accommodate sewage from new development, up to a certain amount; and (2) establishing a strategy by the end of 2013 to offset pollution loads from development. While efforts to upgrade major WWTPs with enhanced technology have been underway for quite some time, the State is still developing a strategy to manage pollution from new infrastructure development, as described below.

The Maryland Department of the Environment released a draft growth offset strategy for public comment in July 2012 that proposes aggressive new requirements for offsetting the pollution associated with development and redevelopment projects. The draft strategy identified the State's existing nutrient trading program as a key tool for helping developers meet offset requirements. Public comments were accepted on the draft strategy through October 1, 2012, but the final strategy is not expected in 2012. Instead, in the short-term, priority is being given to implementing Chapter 149 of 2012, which seeks to steer residential growth toward areas served by public sewer by prohibiting a jurisdiction from approving certain major residential subdivisions unless it adopts specified land use/growth tier areas.

Policy Implications

While Maryland is on track to meet its bay restoration goals, its ability to pay for restoration efforts and manage growth is still uncertain. Legislation addressing the funding and growth issues described above could be introduced during the 2013 session. In addition, in response to concerns from local governments and other affected entities, legislation scaling back or modifying recent bay restoration legislative and regulatory changes is possible.

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Environment and Natural Resources

Marcellus Shale: An Update on Hydraulic Fracturing in Maryland

Natural gas production from the Marcellus Shale continues to garner significant interest. Proposals relating to hydraulic fracturing that were introduced during the 2012 session may resurface, and the work from the Marcellus Shale Safe Drilling Initiative may spur continued legislative activity in 2013.

Background

The Marcellus Shale formation is a geologic feature in the Appalachian Range which has recently attracted significant attention from the energy industry for its rich natural gas deposits contained within 117 counties in seven states. In Maryland, the formation is located in Allegany, Garrett, and Washington counties; however, the only anticipated areas of gas production are in Garrett and western Allegany counties. Applications for permits to produce natural gas from the Marcellus Shale in Maryland using horizontal drilling and high-volume hydraulic fracturing were first filed with the Maryland Department of the Environment (MDE) in 2010. According to MDE, however, all of the permit applications that had been filed have since been withdrawn.

To address concerns relating to the potential impacts of hydraulic fracturing, several bills were introduced during the 2011 legislative session that would have required further study and the development of regulations prior to the issuance of a permit for gas exploration and production from the Marcellus Shale. None of the bills were adopted, however.

Marcellus Shale Safe Drilling Initiative

Governor Martin J. O'Malley established the Marcellus Shale Safe Drilling Initiative by executive order in June 2011 to ensure that, if drilling for natural gas from the Marcellus Shale proceeds in Maryland, it is done in a way that protects public health, safety, natural resources, and the environment. The executive order directs MDE and the Department of Natural Resources (DNR) to assemble and consult with an advisory commission in the study of specific topics related to horizontal drilling and hydraulic fracturing in the Marcellus Shale. Specifically, the executive order tasks MDE and DNR, in consultation with the advisory commission, with conducting a three-part study and reporting findings and recommendations.

Part I of the study, a report on findings and recommendations regarding sources of revenue and standards of liability for damages caused by gas exploration and production, was released in December 2011. The findings and recommendations of the report led to the introduction of several bills during the 2012 legislative session; the General Assembly passed only one of the bills, however. Chapter 703 of 2012 established a presumptive impact area applicable to areas around a deep shale gas deposit well for which MDE has issued a gas exploration or production permit. In a presumptive impact area, it is presumed that contamination of a "water supply" was caused by the activities of gas exploration or production. The bills that failed would have, among other things:

- established a State-level severance tax on gas production;
- created a revenue source for the ongoing study of the Marcellus Shale Safe Drilling Initiative;
- established gas or oil lease recordation requirements to facilitate public access among the land records;
- required a landman (a person who's responsibilities include meeting with landowners and negotiating leases on behalf of companies seeking to mine or drill on a plot of land) to register with the Department of Labor, Licensing, and Regulation; and
- increased the amount of performance bond coverage that a holder of a permit to drill for gas or oil must maintain.

Two additional parts of the required study are (1) a report with recommendations for best practices for all aspects of natural gas exploration and production in the Marcellus Shale in Maryland; and (2) a final report with findings and recommendations relating to the impact of Marcellus Shale drilling, including possible contamination of groundwater, handling and disposal of wastewater, environmental and natural resources impacts, impacts to forests and important habitats, greenhouse gas emissions, and economic impacts. The best practices and final report are expected to be completed by August 1, 2013, and August 1, 2014, respectively.

Policy Implications

In September 2012, the Marcellus Shale Safe Drilling Advisory Commission established a legislative committee to recommend legislative proposals to the advisory commission for consideration prior to the 2013 session. The topics being discussed by the committee include (1) a surface owner's protection act; (2) financial assurances, including an increase in the cap on performance bonds and a requirement for environmental impairment liability insurance; and (3) recordation requirements for gas and oil leases.

Although no recommendations for legislation had been made as of October 2012, the work of the legislative committee could lead to legislation during the 2013 session. In addition, proposals that were introduced during the 2012 session may resurface. It is also anticipated that legislation establishing a moratorium on hydraulic fracturing will be introduced.

Environment and Natural Resources

Hunting, Fishing, and Boating Fees

The Department of Natural Resources is not generating the special fund revenue needed to support core hunting, fishing, and boating program costs. While alternative program fee structures and approaches have been researched and proposed, no significant changes have been made in recent years. Legislation proposing adjustments to hunting, fishing, and boating fees is anticipated during the 2013 legislative session.

Background

Competition for limited general funds has made it increasingly necessary for the Department of Natural Resources (DNR) to generate additional special fund revenue to support its hunting, fishing, and boating programs. Growing program demands and decreasing fee revenue have prompted DNR to drawdown special fund balances, reexamine program priorities, and limit programs.

Hunting Fees

DNR hunting license and stamp fee revenue is deposited into the State Wildlife Management and Protection Fund and used to fund a variety of wildlife management programs, including surveys, research, hunter training, and enforcement. The fund's reserve balance has declined from $2.5 million in fiscal 2010 to a projected $40,000 in fiscal 2013. DNR has relied on these special fund balances to offset significant reductions in general fund support for wildlife programs. Because the special fund balance is depleted and increased general funds are unlikely, DNR may be required to eliminate wildlife programs and potentially close hunting seasons for some species due to noncompliance with federal or State requirements. A departmental bill, House Bill 1419 of 2012, would have increased hunting license and stamp fees, created and eliminated licenses, and raised an estimated $3.0 million annually for the fund; however, the bill did not pass.

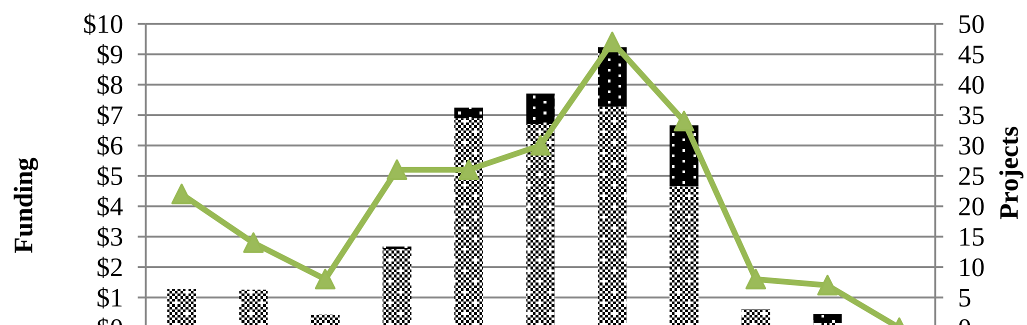
Fishing Fees

DNR fishing license and stamp fee revenue is deposited into the Fisheries Research and Development Fund and the Fisheries Management and Protection Fund and used to fund programs related to fish population monitoring and assessment, buoys and navigation, conservation, habitat protection and restoration, and enforcement. Both special funds are projected to have no end-of-year fund balance in fiscal 2013, primarily due to the fund balances being used to offset general fund reductions in recent years. The Fisheries Service is projected to have a funding deficit beginning in fiscal 2013 that may grow to \$3.2 million by fiscal 2014. Currently, recreational fishing programs are almost entirely funded by recreational fishing fees, while commercial fishing fees support approximately 61% of commercial fishing programs. In accordance with Chapter 435 of 2012, DNR is reviewing existing laws, regulations, fees, and processes associated with commercial fishing licenses and plans to submit a report in December 2012 that recommends legislative and regulatory changes to the commercial fish license and stamp fee structure.

Boating Fees

Revenue from the 5% vessel excise tax is deposited into the Waterway Improvement Fund and used by DNR to finance projects and activities that promote, develop, and maintain Maryland's waterways for boating. The excise tax has not been increased in decades, and boat sales have slumped in recent years, providing insufficient revenue to respond to core program costs. **Exhibit 1** illustrates how the precipitous decline in waterway funding has affected dredging projects. House Bill 1307 of 2012 would have established new and increased existing vessel registration fees to finance boating services, generating approximately \$3.5 million in fiscal 2013 and \$9.4 million in fiscal 2016 and thereafter; however, this departmental bill did not pass. A DNR-commissioned economic study of boating fees is anticipated in December that, among other things, addresses the potential impact of capping the boat excise tax.

Exhibit 1
State Waterway Improvement Program Dredging Funds vs. Number of Channel Projects
Fiscal 2002-2012
(\$ in Millions)



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
General Obligation Bonds	\$0.0	\$0.0	\$0.0	\$0.1	\$0.3	\$1.0	\$2.0	\$2.0	\$0.0	\$0.3	\$0.0
Special Funds	\$1.3	\$1.2	\$0.4	\$2.6	\$6.9	\$6.7	\$7.3	\$4.7	\$0.6	\$0.2	\$0.0
Projects	22	14	8	26	26	30	47	34	8	7	0

Source: Department of Natural Resources; Department of Legislative Services

Policy Implications

Dwindling special fund balances, declining general fund support, and increasing program responsibilities will likely prompt bills that seek to increase and/or restructure DNR's hunting license and stamp fees, commercial fishing license fees, the vessel excise tax, and vessel registration fees during the 2013 legislative session.

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State Government

Commission to Study Campaign Finance Law

The Commission to Study Campaign Finance Law recommends that the General Assembly adopt a wide range of proposals to improve the State's campaign finance laws and enhance public confidence in the campaign finance system, including updating and tightening rules concerning campaign contributions, independent expenditures, slates, campaign finance reports, the State's law designed to combat "pay to play" political corruption, and miscellaneous other issues.

Background

Reform of the State's campaign finance laws has emerged as a major topic of public discussion and legislative interest in recent years. The Attorney General convened an Advisory Committee on Campaign Finance in the fall of 2010 to consider ways to improve the system, with a focus on nonpartisan legal improvements rather than fundamental structural changes. The committee issued a report in January 2011 that included recommendations on a wide range of topics. Legislation embodying several of the committee's recommendations was enacted in 2011, including (1) clarification of the law governing campaign material transmitted through electronic media; (2) authorization of electronic contributions and disbursements by political committees; and (3) reporting of independent expenditures and electioneering communications.

During the 2011 session, the General Assembly also established by resolution the Commission to Study Campaign Finance Law. The commission was given a broad mandate to examine the State's campaign finance laws and address several specific issues. The commission convened in December 2011 and after two meetings issued an interim report in January 2012.

Interim Recommendations

Most of the commission's interim recommendations were enacted into law in 2012. These included (1) lengthening the period of time for a political committee to issue a contribution receipt; (2) requiring the responsible officers of a political committee to update their addresses with the State Board of Elections; (3) allowing political committees to choose to receive notice of campaign finance reports due by electronic mail; (4) requiring employers and membership entities that collect voluntary contributions from their employees or members to transmit each contributor's address to the political committee designated to receive the contribution; and (5) requiring political committees to report the employer and occupation of individuals who contribute a cumulative amount of $500 or more to the committee during an election cycle.

Additional Recommendations

During the 2012 interim, the commission held a series of lengthy meetings to hear testimony from individuals and organizations with expertise in campaign finance or an interest in Maryland's campaign finance laws, receive staff briefings on pertinent issues, and hold discussions to reach consensus on recommendations on various topics described below. The commission may hold a final meeting in December. Consequently, the recommendations outlined below are subject to possible revision and additional recommendations may be added before the commission formally adopts its final report.

Contribution Limits

Contribution limits should be increased from $4,000 to between $5,000 and $7,000 per person (including a business entity or labor organization) to a single campaign finance entity in an election cycle and from $10,000 to an amount as high as $25,000 per individual to *all* campaign finance entities in an election cycle. The General Assembly should consider ways to provide for future adjustments of the limits and whether or not to increase the limit on transfers between political committees in tandem with increases in the contribution limits. Nonfederal out-of-state political committees also should be treated like any other person for purposes of the contribution limits.

Business Entity Contributions

Contributions by business entities under common management or ownership should be considered as being made by a single entity for purposes of the contribution limits. Businesses should be owned or controlled by at least 50% (if not a higher percentage) of the same individuals to be considered a single entity for purposes of contribution limits.

Caucus Committees

The General Assembly should adopt legislation to allow political party caucuses to establish caucus committees, similar to the congressional campaign committees at the federal level. The caucus committees would be allowed to have administrative accounts and special, higher in-kind contribution (*i.e.*, coordinated expenditure) limits similar to those now applicable to the State and local party central committees. Were such legislation enacted, the State Board of Elections should adopt regulations to establish parameters for the accounting of and use of these administrative accounts.

Independent Expenditures

The General Assembly should require additional disclosure of the sources of funds used to finance independent expenditures. Large contributions and expenditures by independent expenditure committees, other independent expenditure entities, and ballot issue committees should be reported rapidly after they are made. Higher penalties should be established for failing to file independent expenditure reports. A lower threshold should be established for reporting independent spending in campaigns for local offices and the General Assembly. The definition of reportable "electioneering communications" should be expanded to include print advertisements, mail, and phone banks. State law should be amended to recognize that contributions to political committees that make only independent expenditures cannot be limited. The definition of "political committee" should be amended to clarify when an entity must register as a political committee.

Enforcement

The statute of limitations for criminal election law offenses should be extended from two to three years. The State Board of Elections should be authorized to issue civil citations for certain minor campaign finance offenses that do not warrant criminal prosecution. A person to whom a citation is issued should have the right to contest the citation in District Court, where the State Prosecutor would assume responsibility for prosecuting the case.

Public Financing

Counties should be authorized to establish public financing of campaigns for county offices. The current system of public financing for gubernatorial candidates should not be repealed. However, public financing should not include judicial elections.

Disclosure of Small Contributions

The General Assembly should enhance disclosure of certain small contributions that under current regulations may be reported as a lump sum without identifying each contributor and the amount of each contribution. Generally, contributions that aggregate to less than $51 in an election cycle may be reported as a lump sum. The General Assembly should consider the following options for improving disclosure of these contributions: (1) require the disclosure of the name of all small contributors but not the contributor's address; (2) allow lump sum reporting only of contributions raised through gambling-related activities, including raffles and spins and chances on paddle wheels or wheels of fortune; (3) limit the total aggregate amount of contributions that may be reported as a lump sum in an election cycle to $10,000; (4) allow the State board to audit the account books of political committees to ensure compliance with recordkeeping requirements; and (5) simplify the contribution receipts law, which is the legal basis for lump sum reporting.

Campaign Finance Reporting Schedule

An additional campaign finance report should be required in gubernatorial and presidential election years in late August. This additional report is justified because the gubernatorial primary has been moved from September to June, creating a long general election campaign period during which no recent campaign finance information will be available until the end of October. A similarly long period between the primary and general elections exists in presidential (and now also in Baltimore City) election years. In addition, the campaign finance report due four weeks before the primary election in presidential years should be restored. It was eliminated when the presidential primary was moved to February because it would have been due shortly before the annual report in January. Now that the presidential primary has been moved to April, a report filed four weeks before the primary would potentially provide new information.

Disclosure of Contributions by Persons Doing Public Business

Title 14 of the Election Law Article is designed to combat "pay to play" political corruption by imposing special disclosure requirements for contributions by persons doing business with the State or its political subdivisions. The commission recommended the following changes to Title 14 to clarify and streamline the law and improve compliance: (1) provide for electronic filing of Title 14 reports; (2) modify the definition of "doing public business" to mean holding a single contract over a certain amount with the State or a political subdivision; (3) exclude grants and licenses from the definition of "contract"; (4) require all persons holding a contract over a certain amount to file a Title 14 report as to whether or not they have made any contributions; (5) require reporting only of contributions to officials of the government with which a person is doing business; and (6) authorize the State board to take additional measures to administer and enforce Title 14, including auditing Title 14 reports, imposing fines for late filing, and consolidating certain functions currently performed by other agencies at the State board.

Slates

The commission engaged in an extensive discussion of whether to regulate the activities of slates. Slates are political committees formed by two or more candidates who wish to join together to conduct joint campaign activities. Transfers between a slate and its members are unlimited. The commission has determined that the law governing the use of slates should be reformed because of the potential for slates to be used to distribute significant amounts of campaign funds to other candidates in excess of the $6,000 transfer limit. Among the options proposed are (1) to establish a limit on transfers between a slate and slate members' campaign finance entities that is higher than the $6,000 general transfer limit and require that the members of the slate be active candidates (however, this limit would not apply to the uniquely styled gubernatorial ticket that by law *must* include the candidates for Governor and Lieutenant Governor as a single unit); (2) to require a slate to disclose which members of the slate benefit from each expenditure; and (3) to limit the formation of slates to circumstances in which the slate members have some form of ballot commonality.

Access to Attorney General Opinions and Advice

Advice of the Attorney General concerning campaign finance matters should be organized and made available to the public, preferably online to the extent practicable. The

Attorney General should exercise his discretion in determining which advice should be made public and relied upon by persons in complying with the law.

Final Report

The commission is required to submit a final report of its findings and recommendations to the Governor and the General Assembly by December 31, 2012. The commission terminates on June 30, 2013.

State Government

Voting Access and Voter Qualifications

A lively campaign season in Maryland and across the nation generates intense scrutiny as the effect of policy changes and legal disputes concerning voting access and voter qualifications – particularly involving voter identification, voter registration, and early voting – are weighed.

Three election administration issues relating to access to voting – voter identification, voter registration, and early voting – have been the subject of policy changes and legal disputes in other states recently.

Voter Identification

Thirty-three states have enacted voter identification (or voter ID) laws that require some form of identifying documentation to be produced by each voter, though the laws in three of those states have yet to take effect. The laws vary in the types of identification that are allowed. The National Conference of State Legislatures indicates that there are two key distinctions between the laws: (1) whether or not a *photo* ID is required; and (2) whether a law is "strict" or not. "Strict" voter ID laws allow a person who does not have identification to vote a provisional ballot, but in order for the provisional ballot to be counted, the voter must return to election officials within a short period of time after the election to show identification. "Nonstrict" voter ID laws allow for some other method for a voter's ballot to be counted if the voter does not have identification, without having to later produce identification to election officials. **Exhibit 1** shows a breakdown of the 33 states' requirements.

The laws in the states listed in italics in Exhibit 1 have not yet taken effect; in most cases, their implementation has been prevented or delayed as a result of the preclearance process under Section 5 of the federal Voting Rights Act or separate court challenges. Section 5 of the Voting Rights Act prevents election practices or procedures in certain states from taking effect until approval ("preclearance") is obtained from the U.S. Department of Justice or in federal court. Of those states subject to Section 5 (for the state as a whole or for some local jurisdictions within the State), South Carolina, New Hampshire, and Virginia have obtained preclearance for their voter ID laws, Texas has been denied preclearance, Mississippi is in the process of seeking preclearance, and Alabama either has yet to seek preclearance or is in the process of seeking preclearance (Alabama's law takes effect in 2014). South Carolina's preclearance was granted in October 2012 and applies for any election beginning in 2013. Pennsylvania and Wisconsin's laws have been blocked, at least temporarily, in state court, as a result of lawsuits challenging the laws' validity on state constitutional grounds.

Exhibit 1
States with Voter Identification Requirements

Photo ID Required or Requested		**Nonphoto ID Accepted**	
Strict	**Nonstrict**	**Strict**	**Nonstrict**
Georgia	Florida	Arizona	Alaska
Indiana	Hawaii	Ohio	Arkansas
Kansas*	Idaho	Virginia*	Colorado
Tennessee*	Louisiana		Connecticut
	Michigan		Delaware
Mississippi*	New Hampshire*		Kentucky
Pennsylvania*	South Dakota		Missouri
South Carolina*			Montana
Texas*	_Alabama*_		North Dakota
Wisconsin*			Oklahoma
			Rhode Island*[#]
			Utah
			Washington

*States that enacted new or more stringent voter ID laws within the last two legislative sessions (2011-2012).

[#] Rhode Island's law is being phased in and will fall in the nonstrict *photo* ID category in 2014.

States listed in italics – These states have enacted laws in that category, but the laws have not yet taken effect. Mississippi, Pennsylvania, and Wisconsin currently have no voter ID law in effect, while South Carolina, Texas, and Alabama have an older nonphoto voter ID law in effect.

Source: National Conference of State Legislatures

Maryland is among the 17 states without a voter ID law. In Maryland, an election judge establishes a voter's identity by requesting that the voter state the month and day of the voter's birth and then comparing it to the voter's voter registration information. The election judge also verbally verifies the voter's residence address. Some first time voters are asked to show identification pursuant to federal law applicable to all states. Numerous bills proposing voter ID requirements have been introduced in the General Assembly in past sessions (*e.g.*, Senate Bill 412, House Bill 113, and House Bill 705 of 2012).

Voter Registration

Two of the primary voter registration issues that have generated controversy in other states recently are voter registration list maintenance (removal of ineligible voters) and voter registration drives. Lawsuits were filed in Florida and Iowa in 2012 in opposition to state efforts to identify and remove noncitizens from the states' voter registration lists. At least one other state, Colorado, undertook similar efforts in 2012. Meanwhile, lawsuits in Florida and Texas challenged restrictions imposed on voter registration drives conducted by independent persons or groups.

List Maintenance

A federal court declined to stop Florida's efforts to remove noncitizens prior to the 2012 November election, concluding that a limitation under federal law on certain voter registration list maintenance within 90 days of an election did not apply to the state's efforts. Federal law, under the National Voter Registration Act and Help America Vote Act, requires states to make certain efforts to ensure that their voter registration lists are accurate and up-to-date and establishes procedural requirements and limitations applicable to those efforts. In Iowa, a couple of months before the election, a state court temporarily stopped implementation of rules governing removal of noncitizens from Iowa's voter registration list until the case (involving state law claims) could be fully litigated.

Maryland's list maintenance processes focus primarily on identifying voters that have moved, either within the State or out of the State, and identifying voters that are deceased or have been convicted of a felony. To improve the accuracy of its voter rolls, Maryland also recently became involved in a project among a number of states to share information that can be used for list maintenance.

Voter Registration Drives

The restrictions on independent voter registration drives in Florida and Texas that were challenged in court differed but generally imposed requirements on those conducting the drives that were considered by the challengers to be burdensome and in conflict with federal constitutional rights and/or federal statutory law. In Florida, some of the challenged restrictions were permanently enjoined; some of the restrictions in Texas were preliminarily enjoined, but that decision is on hold while the case is being appealed.

Maryland law and regulations impose certain requirements on "VRA (voter registration application) distributors," including that they be age 18 on or before the next general election, not receive compensation on a per registrant basis, and deliver completed VRAs to the appropriate local board within five days of receipt or by the next voter registration deadline, whichever is earlier. Election officials also are required to offer instruction to VRA distributors.

Early Voting

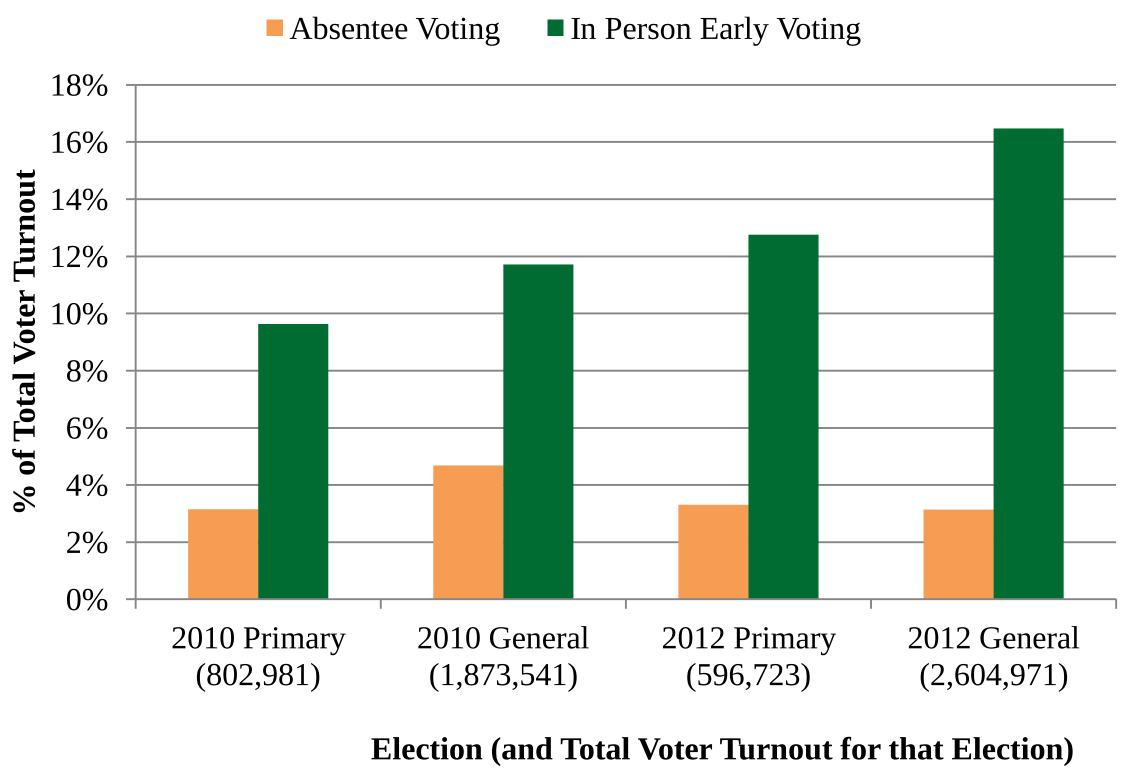
Increasing numbers of Americans are taking advantage of new opportunities to vote before Election Day, either by voting early in person or by casting an absentee ballot. As early voting has become more prevalent, state legislatures and courts have been the scene of sometimes intense debates over the laws and policies that govern the process. Maryland, which allows both absentee voting without an excuse and in person early voting, will likely see legislative initiatives to modify the State's early voting program in the 2013 session of the General Assembly.

In 2008, 33% of the electorate nationwide voted early, in comparison to 15% in 2000. While complete information on early voting nationwide during the 2012 elections was not available as of mid-November, pre-election projections and polling indicated that the percentage of the electorate that would vote early during the 2012 presidential election would turn out to be comparable to, if not higher than, 2008. In person early voting was first offered in Maryland in 2010, and while overall voter turnout over the course of the 2010 and 2012 primary and general elections varied significantly in the State, the percentage of overall turnout in each of those elections that consisted of in person early voters has steadily increased from just under 10% in the 2010 primary election to approximately 16% in the 2012 general election (as shown in **Exhibit 2**). The percentage of overall turnout that has consisted of absentee voters has been relatively consistent, between 3% and 5%.

Currently, 32 states offer in person early voting and 27 states permit absentee voting without an excuse, according to the National Conference of State Legislatures. In addition, Washington and Oregon conduct all elections by mail, and 7 states allow any voter to elect to receive an absentee ballot automatically in all future elections. Overall, 26 states offer both early voting and absentee voting without an excuse, as Maryland does, and only 15 states allow neither early voting or absentee voting without an excuse. In the past 10 years, 11 states began offering early voting, 7 began allowing absentee voting without an excuse, and 6 began allowing voters to choose to automatically receive absentee ballots for all elections.

The schedule of days on which early voting is allowed has been a focus of legislative attention in Maryland and other states in recent years. Maryland law required six days of early voting in the 2010 and 2012 elections. In 2010, early voting centers were open from the second Friday before the election through the Thursday before the election, excluding Sunday. In 2012, early voting was held from the second Saturday before the election through the Thursday before the election, including Sunday. (The Governor altered the schedule for the 2012 general election due to inclement weather, canceling two days of early voting and adding an additional day on the Friday before the election, while also extending voting hours.) The law makes no provision for the schedule of early voting days in future elections. Proposals to alter the schedule of early voting days have been introduced in previous sessions of the General Assembly.

Exhibit 2
Maryland Absentee and In Person Early Voting Turnout
2010-2012



Note: Complete turnout information for the 2012 general election was not available as of mid-November. The 2012 general election information above is based on unofficial results for the presidential race reported by the State Board of Elections, which should be comparable to the overall turnout. The 2012 general election absentee voting percentage is also based on an assumption, since only the total of absentee and provisional ballots is reported in the unofficial results.

Source: State Board of Elections; Department of Legislative Services

States vary greatly in their schedules of early voting days. Nearly all states offer at least a week and a half of early voting, and many offer a longer period. Five states begin early voting in September and continue through November. Only one state (Oklahoma) has a shorter early voting period than Maryland (four days). Nearly all states also have a shorter interval between the end of early voting and Election Day. In Maryland, there are four days from the end of early voting until Election Day. Only one state (Louisiana) has a longer interval between the end of early voting and Election Day (six days). In 12 states, early voting is required on a Saturday. Six states require early voting on both Saturday and Sunday, and in most of the other states, local officials have discretion to allow for weekend early voting.

Much of the recent controversy in other states concerning early voting has centered on the schedule of early voting days. According to the Brennan Center for Justice, bills were introduced in nine states to reduce early voting days for the 2012 election, and reductions in early voting were enacted in five states. In two of those states, Florida and Ohio, the early voting restrictions were challenged in court.

In Florida, legislation passed in 2011 reduced the number of early voting days from 14 to 8, reduced the minimum number of hours of early voting from 96 to 48, and eliminated early voting on the Sunday before the election. In past elections, African Americans had voted early at higher rates than other voters, especially on the Sunday before Election Day. A panel of federal judges refused to allow the eight-day schedule to go into effect in five Florida counties subject to pre-clearance under Section 5 of the Voting Rights Act unless those counties agreed to offer the maximum 96 hours of early voting. The judges said that the effect of reducing both the days and hours of early voting would be to suppress African American turnout. The five counties subject to pre-clearance as well as many other counties, accounting for most of Florida's population, ultimately chose to offer the maximum 96 hours of early voting, but the reduction in the number of early voting days was allowed to go into effect.

In Ohio, the state legislature eliminated early voting on the weekend before the election for all but military and overseas voters. President Obama's reelection campaign challenged the law in court, arguing that all voters should be allowed to vote early on the weekend. A federal district court and the U.S. Court of Appeals for the 6th Circuit held that if Ohio allows military and overseas voters to vote early on the weekend before the election, then all voters must be allowed to vote early during that period as well. The judges said that while allowing military and overseas voters to vote on the weekend was justified, the state had not shown a sufficient reason for excluding all other voters from that opportunity. The U.S. Supreme Court subsequently declined to review the lower court's decision.

Legislation has also been introduced in recent sessions of the General Assembly to expand the number of early voting centers. Maryland law specifies the number of early voting centers that each county must have based on the number of registered voters in that county. States vary in the method they use to determine the number of early voting polling places that are established. In 16 states, a minimum number of early voting polling places are required, but local officials have discretion to establish more locations. Nine states specify one location for early voting, such as the local elections office. Six states, including Maryland, require that a certain number of early voting locations be provided in each local jurisdiction based on the number of registered voters in the jurisdiction.

Reports of long lines at several early voting centers in Maryland during the 2012 general election and the fact that the schedule of early voting days for future elections is not currently specified in the law will likely prompt legislation during the 2013 session altering the number of early voting centers and/or the duration and timing of early voting.

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State Government

Workgroup to Conduct a Review of Disclosure Requirements of the Public Ethics Law

Chapter 620 of 2012 required the Speaker of the House of Delegates and the President of the Senate jointly to appoint an interim workgroup to conduct a comprehensive and coordinated review of public ethics issues. The workgroup is required to (1) address issues related to public ethics disclosures, including public access to these disclosures and required disclosure at the local government level; and (2) submit recommended legislation addressing these issues by December 31, 2012, to the Senate Education, Health, and Environmental Affairs Committee and the House Environmental Matters Committee.

Senate Special Committee on Ethics Reform

In January 2012, the President of the Senate established the Special Committee on Ethics Reform (special committee) to conduct a comprehensive review of the Public Ethics Law and to make recommendations for improving and clarifying the law, the transparency of ethics disclosures and information, the complaint process, and penalties for violations. Given the broad scope of its charge, the special committee narrowed its focus by concentrating on recent ethics issues and issues raised by outside government watchdog groups. Issues addressed by the special committee included barriers to public access to financial disclosure statements and other ethics disclosures and local government disclosure requirements.

Access to Disclosure Statements

Each official and candidate for office as a State official annually is required to file a financial disclosure statement with the State Ethics Commission (commission). The Joint Committee on Legislative Ethics (joint committee) also collects and maintains various legislator conflict disclosure statements. Paper copies of these disclosure statements are available to the public for examination and copying if an individual travels to Annapolis and obtains the documents from the commission or the joint committee. The commission and joint committee are required to maintain a record of the name and home address of any individual who examines or copies a disclosure statement. The official whose disclosure statement is examined may be notified of the record of the examination at the request of the official. Disclosure statements may not be accessed electronically or anonymously, and individuals may be charged a reasonable fee for making copies of these documents.

The special committee agreed that the paper-based storage and access process is obsolete due to the widespread and standard use of electronic information filing and storage. The special committee also determined that the legislator notification requirement has a potential chilling effect on citizen access to public information and should be eliminated. Some special committee members, however, expressed concerns about the highly sensitive and personal information that is reported on the disclosure statements being available online and easily accessible to identity thieves. The special committee agreed that the disclosure statements should be accessible online but that the online content of disclosure statements should be modified due to these security concerns.

The work of the special committee led to the enactment of Chapter 620 of 2012. This legislation requires a State legislator to file conflict and financial disclosure forms *electronically* with the joint committee. In addition, a new form is added to require the disclosure of "any primary employment or business interest and the employer of the legislator or the spouse of the legislator, except for employment as a legislator." The Department of Legislative Services is required to publish the new form and the conflict disclosure forms for public review on the Internet through an online registration program. The legislation retained the legislator notification requirement when a person accesses a disclosure statement online. Information on the forms relating to salary or other consideration will not be published on the Internet, nor will the members' annual financial disclosure statements.

Local Government Disclosure Requirements

Chapter 277 of 2010 required municipalities, county governments, and local boards of education to adopt ethics requirements relating to conflicts of interest, financial disclosure, and lobbying that are "equivalent to or exceed" the existing State requirements. The commission may exempt a municipality or a local board of education or board member from some or all of these ethics requirements under standards related to privacy, ensuring the availability of qualified individuals, or relevance. According to the Maryland Municipal League, almost three-quarters of municipalities are completely or partially exempt from the requirements due to the size of the municipality, budget constraints, or whether the disclosure requirements would discourage people from public service.

Members of the special committee voiced strong concerns about the expense and breadth of the required disclosure requirements on local government officials. Members argued that the part-time nature of many positions, the size of the budgets under local control, the proximity of local officials to constituents, and the small pool of candidates for necessary positions weighed against the broad and detailed disclosure statements required by Chapter 277 of 2010. The consequences of these requirements are being seen in Montgomery County where two members of the Chevy Chase Village Board of Managers resigned in October when the commission refused to exempt the village from the financial disclosure requirements.

In recognition of the challenges faced by smaller jurisdictions, the work of the special committee led to the introduction of Senate Bill 948/House Bill 1177 during the 2012 regular session. These bills would have authorized a county, municipality, or school board to limit the required disclosure of interests in specified businesses by local elected officials, school board members, or certain candidates for elected or appointed local office. Both bills were unsuccessful.

Joint Interim Workgroup on Ethics Reform Issues

Given the short timeframe in which the special committee had to fulfill its charge and the persistent and sensitive nature of the issues addressed, Chapter 620 of 2012 established an interim workgroup to be appointed jointly by the Speaker of the House of Delegates and the President of the Senate. The purpose of the workgroup is to conduct a comprehensive and coordinated review of the disclosure requirements of the Public Ethics Law, including issues related to access to public ethics disclosures and required disclosures for local government entities. The workgroup is required to submit by December 31, 2012, recommended legislation addressing these issues to the Senate Education, Health, and Environmental Affairs Committee and the House Environmental Matters Committee; however, as of mid-November, members had not been appointed.

Local Government

State Aid to Local Governments

State aid to local governments is projected to total $6.9 billion in fiscal 2014, a $257.3 million or 3.9% increase over the prior year.

Local governments are projected to receive $6.9 billion in State aid in fiscal 2014, a 3.9% increase from the prior year resulting in an additional $257.3 million in State support for local programs and services. As in prior years, most of the State aid is targeted to public schools, while funding for counties and municipalities will account for 7.3% of total aid. Local school systems will receive $6.0 billion in State support, or 86.7% of total aid. County and municipal governments will receive $509.1 million, community colleges will receive $302.2 million, libraries will receive $70.2 million, and local health departments will receive $38.2 million. In terms of year-over-year funding enhancements, State aid for public schools will increase by $166.8 million (2.9%); library aid will increase by $3.5 million (5.2%); community college aid will increase by $32.9 million (12.2%); and aid for local health departments will increase by $0.9 million (2.5%). County and municipal governments will realize a $53.1 million (11.7%) increase in State aid. **Exhibit 1** shows the change in State aid by governmental entity for fiscal 2014. **Exhibit 2** shows the change in State aid by major programs.

Exhibit 1
State Aid to Local Governments
($ in Millions)

Governmental Entity	FY 2013	FY 2014	$ Change	% Change
Public Schools	$5,841.2	$6,008.1	$166.8	2.9%
County/Municipal	456.0	509.1	53.1	11.7%
Community Colleges	269.3	302.2	32.9	12.2%
Libraries	66.8	70.2	3.5	5.2%
Local Health Departments	37.3	38.2	0.9	2.5%
Total	**$6,670.6**	**$6,927.9**	**$257.3**	**3.9%**

Source: Department of Legislative Services

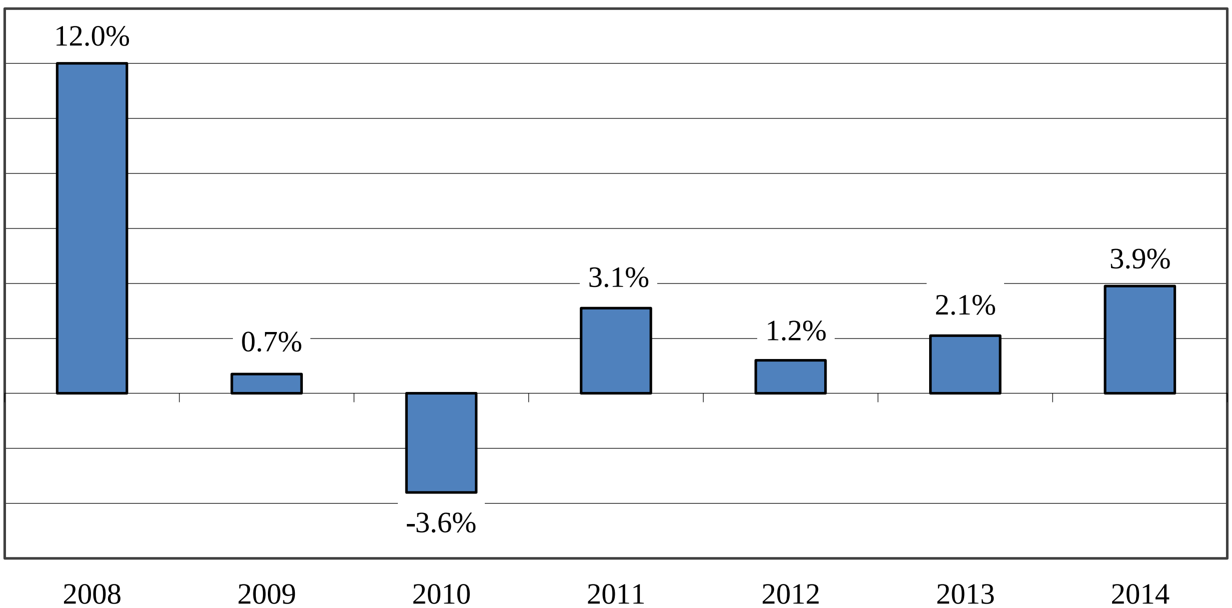
Exhibit 2
State Aid by Major Programs
Fiscal 2012-2014
($ in Millions)

	FY 2012	FY 2013	Baseline FY 2014	$ Change 2013-2014	% Change 2013-2014
Public Schools					
Foundation Program	$2,773.1	$2,810.4	$2,847.0	$36.6	1.3%
Supplemental Grant	47.9	47.7	46.5	-1.2	-2.4%
Geographic Cost Index	127.3	128.8	130.5	1.8	1.4%
Compensatory Aid	1,083.8	1,146.3	1,178.4	32.2	2.8%
Student Transportation	248.2	251.3	252.9	1.6	0.6%
Special Education – Formula Aid	264.3	266.5	270.4	3.9	1.5%
Special Education – Nonpublic Placements	112.8	113.9	116.4	2.5	2.2%
Limited English Proficiency Grants	162.7	177.4	193.1	15.7	8.8%
Guaranteed Tax Base	50.1	44.2	46.0	1.8	4.1%
Aging Schools Program	8.6	31.1	6.1	-25.0	-80.4%
Other Education Programs	69.9	68.2	67.6	-0.6	-0.9%
Subtotal Direct Aid	***$4,948.7***	***$5,085.7***	***$5,155.0***	***$69.3***	**1.4%**
Retirement Payments	833.0	755.5	853.0	97.5	12.9%
Total Public School Aid	**$5,781.7**	**$5,841.2**	**$6,008.1**	**$166.8**	**2.9%**
Libraries					
Library Aid Formula	$33.0	$33.7	$34.0	$0.3	0.9%
State Library Network	15.8	16.1	16.2	0.1	0.9%
Subtotal Direct Aid	***$48.8***	***$49.7***	***$50.2***	***$0.4***	**0.9%**
Retirement Payments	16.6	17.0	20.1	3.0	17.8%
Total Library Aid	**$65.4**	**$66.8**	**$70.2**	**$3.5**	**5.2%**
Community Colleges					
Community College Formula	$194.4	$199.2	$225.4	$26.3	13.2%
Other Programs	36.0	33.0	33.5	0.5	1.5%
Subtotal Direct Aid	***$230.4***	***$232.1***	***$258.9***	***$26.8***	**11.5%**
Retirement Payments	32.6	37.2	43.3	6.2	16.6%
Total Community College Aid	**$263.1**	**$269.3**	**$302.2**	**$32.9**	**12.2%**
Local Health Grants	**$38.3**	**$37.3**	**$38.2**	**$0.9**	**2.5%**
County/Municipal Aid					
Transportation	$154.2	$170.2	$175.2	$5.0	2.9%
Public Safety	88.2	90.6	112.7	22.1	24.4%
Program Open Space/Environment	9.1	15.3	32.6	17.3	112.6%
Disparity Grant	119.7	119.9	121.4	1.5	1.3%
Other Grants	16.7	59.9	67.2	7.3	12.2%
Total County/Municipal Aid	**$387.9**	**$456.0**	**$509.1**	**$53.1**	**11.7%**
Total State Aid	**$6,536.2**	**$6,670.6**	**$6,927.9**	**$257.3**	**3.9%**

Source: Department of Legislative Services

Exhibit 3 shows the annual change in State aid to local governments, beginning with fiscal 2008. The projected growth of 3.9% is significantly below growth exhibited during the final years of the phase-in of the Bridge to Excellence in Public Schools Act of 2002. The relatively low anticipated growth following fiscal 2008 also reflects statutory limitations on growth in State aid resulting from decisions made during the 2007 special session and subsequent sessions. Despite recent decisions on pension reform and on local sharing of retirement funding, teacher retirement aid accounts for more than one third of the increase in State aid from fiscal 2013 to 2014.

Exhibit 3
Annual Change in State Aid to Local Governments
Fiscal 2008-2014



Source: Department of Legislative Services

Exhibit 4 shows that in recent years most of the increases in State support for local governments were targeted to public schools and retirement payments. Since fiscal 2008, State funding for public schools increased by $555.1 million, while funding for retirement payments increased by $313.6 million. However, during this same period, county and municipal governments experienced sizeable reductions in State support, with overall State funding declining by $395.4 million. Local transportation projects funded through highway user revenues experienced the largest budget reductions with overall funding reduced by $361.2 million since fiscal 2008. In fiscal 2008, local highway user revenues totaled $529.7 million compared with $168.5 million in fiscal 2014.

Exhibit 4
State Aid by Governmental Entity
($ in Millions)

Governmental Entity	FY 2008	FY 2014	$ Change	% Change
Public Schools	$4,599.9	$5,155.0	$555.1	12.1%
Libraries	52.2	50.2	-2.0	-3.9%
Community Colleges	219.4	258.9	39.5	18.0%
Local Health	67.0	38.2	-28.8	-43.0%
County/Municipal	904.6	509.1	-395.4	-43.7%
Subtotal – Direct Aid	**$5,843.1**	**$6,011.4**	**$168.4**	**2.9%**
Retirement Payments	$602.9	$916.4	$313.6	52.0%
Total	**$6,445.9**	**$6,927.9**	**$482.0**	**7.5%**

Source: Department of Legislative Services

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Local Government

Local Government Revenue Outlook

Local taxes account for approximately 45% of county revenues and represent the primary local revenue source for most counties. Overall, county governments are projecting a slight increase in local tax revenues in fiscal 2013. However, while local income tax collections continue to rebound, the persistent downturn in home prices has limited property tax collections.

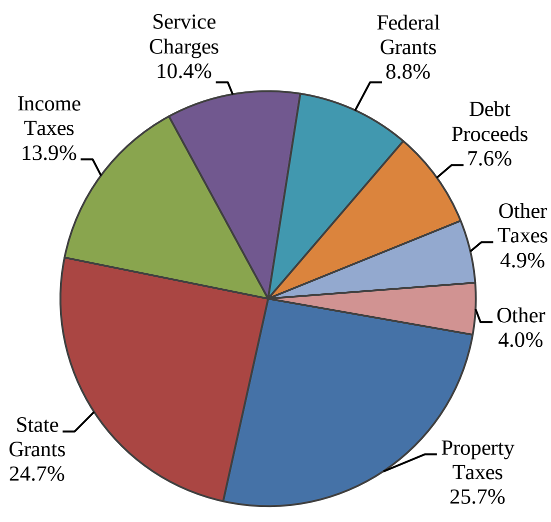
General fund revenues for county governments are projected to total $12.9 billion in fiscal 2013. As shown in **Exhibit 1**, this represents a 1.7% average annual increase over the amount of general fund revenues collected in fiscal 2011. The projected growth in general fund revenues is slightly below the estimated growth in local tax revenues, which include both general and special fund revenues. The average annual increase in local tax revenues is projected at 1.8% in fiscal 2013. In total, local governments are projected to collect $12.2 billion in local tax revenues, a $438.4 million increase since fiscal 2011. **Exhibit 2** shows the limited growth in local tax revenues in fiscal 2011 through 2013.

The local government revenue outlook is influenced by two primary factors: a rebound in local income tax collections due to improvements in the overall State economy; and limited property tax collections due to the persistent downturn in home prices. Local governments are projected to collect $4.3 billion in local income tax revenues in fiscal 2013, a $391.9 million increase since fiscal 2011. This represents an average annual increase of 5.0% over the two-year period. Property tax collections, however, are only expected to increase by $20.0 million over the two-year period, representing an average annual increase of 0.1%. Local property tax collections will remain at $6.7 billion in both fiscal 2011 and 2013. The marginal growth in local property tax collections is a direct result of the downturn in the State's housing market. As shown in **Exhibit 3**, property assessments declined sharply in recent years and are not expected to improve until fiscal 2014 at the earliest.

Two other local revenue sources significantly affected by the downturn in the housing market include recordation and transfer taxes. At the height of the real estate market, local governments collected over $1.2 billion in recordation and transfer taxes, as shown in **Exhibit 4**. By fiscal 2011, collections totaled only $511.8 million. In fiscal 2013, local governments are projecting $532.0 million in recordation and transfer tax collections. This represents a $20.2 million increase over the amount collected in fiscal 2011 and illustrates that recordation and transfer tax collections are beginning to rebound. A more detailed depiction of the growth in local tax revenues in fiscal 2013 is provided in **Exhibit 5**.

Exhibit 1
Limited Growth in Local Tax Revenues
Fiscal 2012 and 2013

Sources of Revenue
Counties and Baltimore City

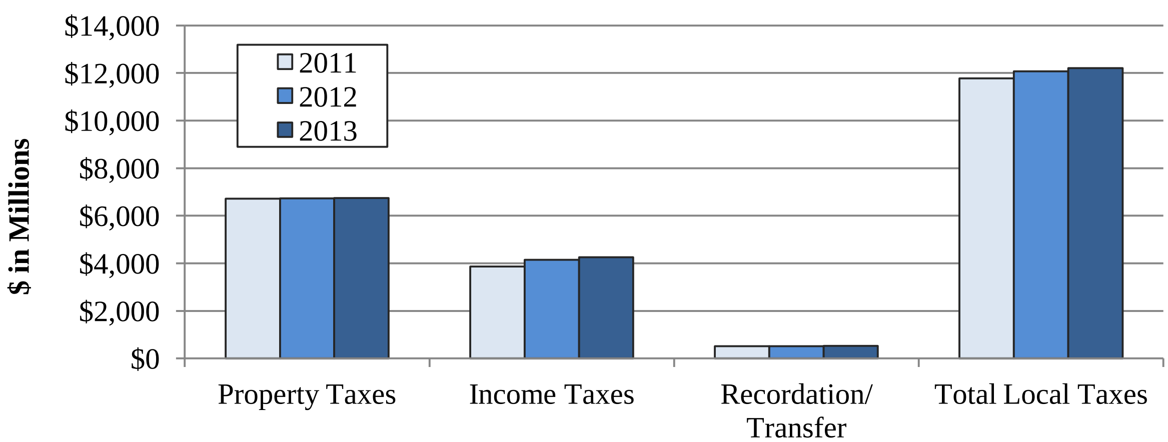


FY 2011 = $27.8 Billion

	Average Annual Change FY 2011-13
Property Taxes	0.1%
Income Taxes	5.0%
Recordation Taxes	1.7%
Transfer Taxes	2.2%
Hotel/Motel Taxes	0.8%
Admissions Taxes	0.5%
Total Local Taxes	1.8%
General Fund Revenues	1.7%

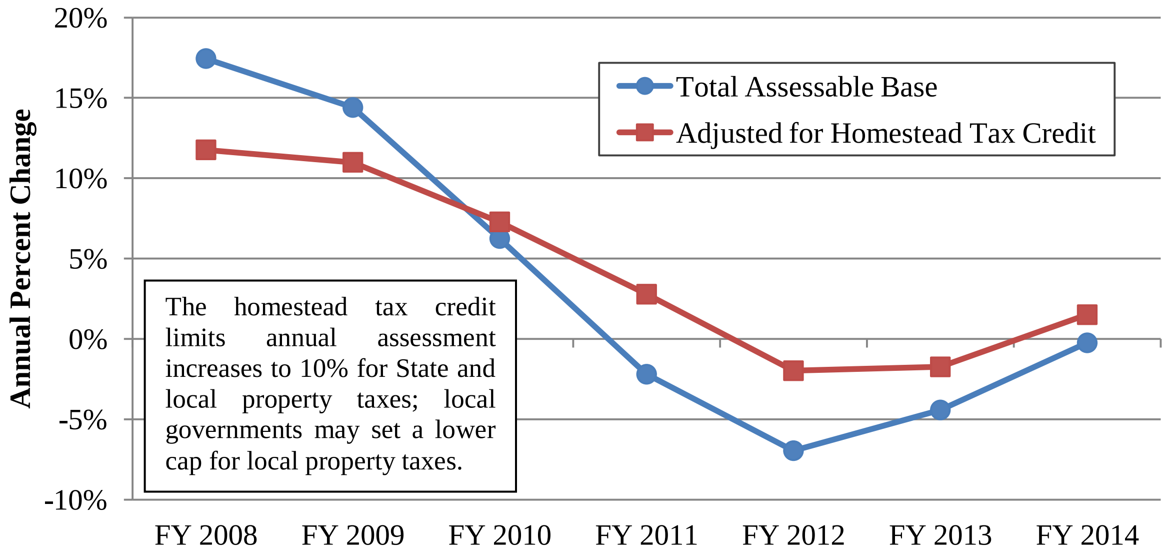
Source: Department of Legislative Services; Maryland County Budget Documents

Exhibit 2
Local Tax Revenue Inches Upwards
Fiscal 2011-2013



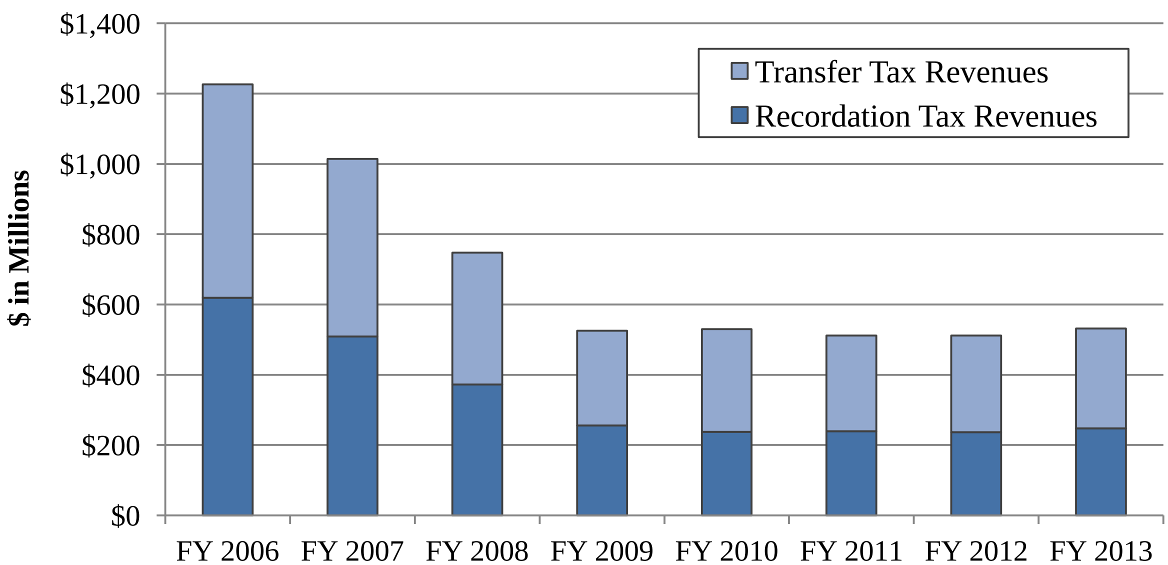
Source: Maryland County Budget Documents

Exhibit 3
Homestead Tax Credit Softened Impact on County Assessable Base



Source: Maryland County Budget Documents

Exhibit 4
Real Estate Meltdown Impacts Recordation and Transfer Taxes



Source: Maryland County Budget Documents

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Exhibit 5
Total Local Tax Revenues – Maryland County Governments
Fiscal 2011-2013

County	FY 2011	FY 2012	FY 2013	$ Change FY 2011-2012	$ Change FY 2012-2013	Average Annual Change
Allegany	$69,365,992	$66,992,978	$67,684,274	-$2,373,014	$691,296	-1.2%
Anne Arundel	1,012,718,122	1,044,885,000	1,077,251,000	32,166,878	32,366,000	3.1%
Baltimore City	1,192,450,695	1,191,511,475	1,184,144,772	-939,220	-7,366,703	-0.3%
Baltimore	1,448,848,945	1,534,999,547	1,520,982,116	86,150,602	-14,017,431	2.5%
Calvert	215,745,005	213,958,680	211,803,264	-1,786,325	-2,155,416	-0.9%
Caroline	36,239,430	35,923,602	36,282,397	-315,828	358,795	0.1%
Carroll	333,823,149	334,322,480	334,638,530	499,331	316,050	0.1%
Cecil	153,291,414	150,846,945	156,787,322	-2,444,469	5,940,377	1.1%
Charles	297,031,129	303,084,500	315,416,900	6,053,371	12,332,400	3.0%
Dorchester	42,287,569	42,726,034	42,733,179	438,465	7,145	0.5%
Frederick	461,017,713	447,469,469	446,535,741	-13,548,244	-933,728	-1.6%
Garrett	63,635,194	63,222,317	63,209,998	-412,877	-12,319	-0.3%
Harford	443,185,476	436,287,411	444,932,874	-6,898,065	8,645,463	0.2%
Howard	860,907,446	874,258,586	911,987,753	13,351,140	37,729,167	2.9%
Kent	40,523,567	39,773,033	40,881,548	-750,534	1,108,515	0.4%
Montgomery	2,903,014,487	3,108,733,835	3,159,461,233	205,719,348	50,727,398	4.3%
Prince George’s	1,394,180,035	1,379,602,600	1,375,232,600	-14,577,435	-4,370,000	-0.7%
Queen Anne’s	92,598,747	100,247,256	101,170,737	7,648,509	923,481	4.5%
St. Mary’s	183,533,062	176,840,305	188,344,241	-6,692,757	11,503,936	1.3%
Somerset	22,905,437	23,100,251	20,816,925	194,814	-2,283,326	-4.7%
Talbot	54,498,914	57,672,650	61,924,000	3,173,736	4,251,350	6.6%
Washington	192,855,390	191,845,693	192,461,660	-1,009,697	615,967	-0.1%
Wicomico	104,155,821	97,776,027	104,781,310	-6,379,794	7,005,283	0.3%
Worcester	156,206,988	151,633,710	153,980,767	-4,573,278	2,347,057	-0.7%
Total	**$11,775,019,727**	**$12,067,714,384**	**$12,213,445,141**	**$292,694,657**	**$145,730,757**	**1.8%**

Local Government

Local Government Tax Actions

Due to limited revenue growth at the local level, nearly half of county governments had to raise at least one major local tax in order to balance their budgets. However, two county governments were able to reduce local property taxes slightly, while one county eliminated its admissions and amusement tax.

Local Government Tax Rates

Several local tax rates were adjusted in fiscal 2013, reflecting, for the most part, an increased need for additional revenue. As shown in **Exhibit 1**, 11 counties changed their local property tax rates, with 9 counties increasing their rates and 2 counties decreasing them. Three counties increased their local income tax rates: Anne Arundel County, which lowered its rate to 2.49% for calendar 2012, raised its rate back to 2.56% for 2013; Talbot County raised its rate to 2.40%; and Wicomico County raised its rate to 3.2%, the highest amount authorized under State law. Prince George's County increased its recordation tax rate to \$2.75 per \$500 of transaction, while Garrett County increased its hotel/motel tax rate to 6.0%. Frederick County eliminated its admissions and amusement tax rate effective February 1, 2013. Local transfer tax rates remained the same for 2013. A comparison of local tax rates for fiscal 2012 and 2013 is provided in **Exhibit 2**.

Exhibit 1
Counties Changing Local Tax Rates
Fiscal 2011-2013

	Fiscal 2011		Fiscal 2012		Fiscal 2013	
	▲	▼	▲	▼	▲	▼
Real Property	2	5	8	2	9	2
Local Income	1	0	1	1	3	0
Recordation	0	0	2	0	1	0
Transfer	0	0	0	0	0	0
Admissions/Amusement	0	0	0	0	0	1
Hotel/Motel	1	0	1	0	1	0

Note: ▲ represents a tax rate increase. ▼ represents a tax rate decrease.
Source: 2012 Local Government Budget and Tax Rate Survey; Department of Legislative Services/Maryland Association of Counties

Exhibit 2
Local Tax Rates – Fiscal 2012 and 2013

	Real Property		Local Income		Recordation		Transfer		Admissions/Amusement		Hotel/Motel	
County	**FY 2012**	**FY 2013**	**CY 2012**	**CY 2013**	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**
Allegany	$0.982	$0.981	3.05%	3.05%	$3.50	$3.50	0.5%	0.5%	7.5%	7.5%	8.0%	8.0%
Anne Arundel	0.910	0.941	2.49%	2.56%	3.50	3.50	1.0%	1.0%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.268	2.268	3.20%	3.20%	5.00	5.00	1.5%	1.5%	10.0%	10.0%	9.5%	9.5%
Baltimore	1.100	1.100	2.83%	2.83%	2.50	2.50	1.5%	1.5%	10.0%	10.0%	8.0%	8.0%
Calvert	0.892	0.892	2.80%	2.80%	5.00	5.00	0.0%	0.0%	1.0%	1.0%	5.0%	5.0%
Caroline	0.870	0.890	2.63%	2.63%	5.00	5.00	0.5%	0.5%	0.0%	0.0%	5.0%	5.0%
Carroll	1.028	1.018	3.05%	3.05%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Cecil	0.940	0.991	2.80%	2.80%	4.10	4.10	$10/deed	$10/deed	6.0%	6.0%	3.0%	3.0%
Charles	1.067	1.121	2.90%	2.90%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Dorchester	0.976	0.976	2.62%	2.62%	5.00	5.00	0.75%	0.75%	0.5%	0.5%	5.0%	5.0%
Frederick	1.064	1.064	2.96%	2.96%	6.00	6.00	0.0%	0.0%	5.0%	0.0%	3.0%	3.0%
Garrett	0.990	0.990	2.65%	2.65%	3.50	3.50	1.0%	1.0%	4.5%	4.5%	5.0%	6.0%

	Real Property		Local Income		Recordation		Transfer		Admissions/Amusement		Hotel/Motel	
County	**FY 2012**	**FY 2013**	**CY 2012**	**CY 2013**	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**
Harford	1.042	1.042	3.06%	3.06%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	0.0%	0.0%
Howard	1.150	1.190	3.20%	3.20%	2.50	2.50	1.0%	1.0%	7.5%	7.5%	7.0%	7.0%
Kent	1.022	1.022	2.85%	2.85%	3.30	3.30	0.5%	0.5%	4.5%	4.5%	5.0%	5.0%
Montgomery	0.959	1.003	3.20%	3.20%	3.45	3.45	1.0%	1.0%	7.0%	7.0%	7.0%	7.0%
Prince George’s	1.319	1.319	3.20%	3.20%	2.50	2.75	1.4%	1.4%	10.0%	10.0%	5.0%	5.0%
Queen Anne’s	0.847	0.847	3.20%	3.20%	4.95	4.95	0.5%	0.5%	5.0%	5.0%	5.0%	5.0%
St. Mary’s	0.857	0.857	3.00%	3.00%	4.00	4.00	1.0%	1.0%	2.0%	2.0%	5.0%	5.0%
Somerset	0.884	0.884	3.15%	3.15%	3.30	3.30	0.0%	0.0%	4.0%	4.0%	5.0%	5.0%
Talbot	0.448	0.491	2.25%	2.40%	6.00	6.00	1.0%	1.0%	5.0%	5.0%	4.0%	4.0%
Washington	0.948	0.948	2.80%	2.80%	3.80	3.80	0.5%	0.5%	5.0%	5.0%	6.0%	6.0%
Wicomico	0.769	0.840	3.10%	3.20%	3.50	3.50	0.0%	0.0%	6.0%	6.0%	6.0%	6.0%
Worcester	0.700	0.770	1.25%	1.25%	3.30	3.30	0.5%	0.5%	3.0%	3.0%	4.5%	4.5%

Notes: The real property tax rates shown for Charles, Frederick, Howard, Montgomery, and Prince George’s counties include special tax rates. Real property tax is per $100 of assessed value. Income is a percentage of taxable income. Recordation tax is per $500 of transaction.

Source: 2012 Local Government Budget and Tax Rate Survey; Department of Legislative Services/Maryland Association of Counties

Property Tax

For fiscal 2013, nine counties – Anne Arundel, Caroline, Cecil, Charles, Howard, Montgomery, Talbot, Wicomico, and Worcester – increased their real property tax rates. Allegany and Carroll counties decreased real property tax rates slightly. Real property tax rates range from $0.491 per $100 of assessed value in Talbot County to $2.268 in Baltimore City.

Local Income Tax

Anne Arundel County increased its local income tax rate to 2.56% for calendar 2013 after decreasing it to 2.49% the previous year. In addition, Talbot County increased its rate to 2.40%, while Wicomico County increased its local income tax rate to 3.2% for calendar 2013, the highest amount authorized under State law. Local income tax rates range from 1.25% in Worcester County to 3.2% in Baltimore City and Howard, Montgomery, Prince George's, Queen Anne's, and Wicomico counties.

Recordation Tax

Prince George's County increased its recordation tax rate to $2.75 per $500 of transaction for fiscal 2013. The range for recordation tax rates is $2.50 per $500 of transaction in Baltimore and Howard counties to $6.00 per $500 of transaction in Frederick and Talbot counties.

Transfer Tax

No county changed its transfer tax rate for fiscal 2013. Local transfer tax rates range from 0.5% in six counties (Allegany, Caroline, Kent, Queen Anne's, Washington, and Worcester) to 1.5% in Baltimore City and Baltimore County. Seven counties (Calvert, Carroll, Cecil, Charles, Frederick, Somerset, and Wicomico) do not impose a tax on property transfers.

Admissions and Amusement Tax

Frederick County decreased its admissions and amusement tax rate from 5.0% to 0.0% effective February 1, 2013. Frederick County will join Caroline County as the only jurisdictions that do not impose an admissions and amusement tax. Currently, admissions and amusement tax rates range from 0.5% in Dorchester County to 10.0% in six jurisdictions – Baltimore City and Anne Arundel, Baltimore, Carroll, Charles, and Prince George's counties.

Hotel and Motel Tax

Garrett County increased its hotel and motel tax rate to 6.0% for fiscal 2013. Hotel and motel tax rates range from 3.0% in Cecil and Frederick counties to 9.5% in Baltimore City. Harford County is the only jurisdiction that does not impose a hotel and motel tax.

Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5% or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation may be overridden by a unanimous vote of all nine county council members. In Prince George's County, the general property tax rate is capped at $0.96 per $100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2% or the increase in the consumer price index.

The counties may exceed the charter limitations on local property taxes for the purpose of funding the approved budget of the local board of education. If a local property tax rate is set above the charter limit, the county governing body may not reduce funding provided to the local board of education from any other local source and must appropriate to the local board of education all of the revenues generated from any increase beyond the existing charter limit. Any use of this authority must be reported annually to the Governor and the General Assembly. This authority was adopted at the 2012 session in order to ensure that counties have the fiscal ability to meet new Maintenance of Effort requirements. In fiscal 2013, Talbot County became the first jurisdiction to exercise this new authority by establishing a 2.6 cent supplemental property tax rate for the local board of education.

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Local Government

Local Government Salary Actions

More Maryland county governments and boards of education provided salary enhancements to their employees in fiscal 2013 than in the previous year. Moreover, no jurisdiction planned to implement furloughs or broad salary reduction plans, and fewer jurisdictions eliminated filled positions resulting in employee layoffs.

County Salary Actions

Six county governments provided their employees with a cost-of-living adjustment (COLA) or general salary increase in fiscal 2013, compared to two in fiscal 2012. Six counties provided step or merit increases in fiscal 2013, compared to four in fiscal 2012. Three counties provided a stipend or bonus to their employees in addition to another salary enhancement in fiscal 2013; two counties gave a stipend or bonus in lieu of other salary enhancements in fiscal 2012. Nine boards of education provided COLAs or general salary increases for teachers in fiscal 2013, compared to two in fiscal 2012. Seventeen boards of education provided step or merit increases in fiscal 2013, compared to nine in fiscal 2012. **Exhibit 1** compares local salary actions in fiscal 2012 and 2013, while **Exhibit 2** shows specific local salary actions for fiscal 2013.

No county governments or boards of education designated service reduction days or implemented employee furloughs in fiscal 2013. However, one board reduced the salaries of four employees, another board transferred two employees to lower paying positions and replaced two retirees with lower-paid new employees, and another board was unable to provide a contracted step increase. In addition, one county government and five boards eliminated approximately 87 positions through employee layoffs; others eliminated positions through attrition, transfers, and retirement incentives. **Exhibit 3** describes the local government furlough, salary reduction, and layoff plans for fiscal 2013.

State Salary Actions

For comparison purposes, the State provided its employees with a 2% COLA in fiscal 2013, effective January 1, 2013. This is the first COLA for State employees since fiscal 2009.

Exhibit 1
Local Government Salary Actions
Fiscal 2012 and 2013

	County Government		Public Schools	
Salary Action	**FY 2012**	**FY 2013**	**FY 2012**	**FY 2013**
COLA/GSI Amount				
No COLA/GSI	22	18	22	15
1% to 2.9%	2	6	2	8
3% and greater	0	0	0	1
Stipend/Bonus[1]	2	3	0	0
Step/Merit Increases	4	6	9	17
Furlough/Salary Reductions	7	0	2	2
Layoffs	5	1	8	5

	State Government		CPI-Urban Consumers	
	FY 2012	**FY 2013**[2]	**FY 2012**[3]	**FY 2013**[3]
COLA Amount[3]	0.0%	2.0%	2.95%	2.05%
One-time Bonus	$750	$0		
Furloughs	No	No		
Step/Merit Increases	No	No		

COLA: Cost-of-living adjustment
CPI: Consumer Price Index
GSI: General Salary Increase

[1]Two counties, Garrett and St. Mary's, provided stipends in addition to a COLA in fiscal 2013. Washington County provided a stipend in addition to a step increase in fiscal 2013.

[2]COLA effective January 1, 2013.

[3]Forecast of the CPI for 2012 (actual) and 2013 (estimate) comes from Moody's Analytics.

Source: 2012 Local Government Salary Action Survey; Department of Legislative Services; Maryland Association of Counties

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Exhibit 2
Local Government Salary Actions in Fiscal 2013

	County Government Generally		Board of Education Teachers	
County	**COLA/GSI/Stipend**	**Step/Merit**	**COLA/GSI**	**Step/Merit**
Allegany	0.0%	No	0.0%	Yes
Anne Arundel[1]	0.0%	No	1.25%	No
Baltimore City[2]	0.0%	Yes	1.5%	No
Baltimore[3]	0.0%	Yes	0.0%	Yes
Calvert[4]	0.0%	No	0.0%	No
Caroline	0.0%	No	0.0%	Yes
Carroll	0.0%	No	0.0%	Yes
Cecil	1.0%	No	0.0%	Yes
Charles[5]	0.0%	Yes	0.0%	Yes
Dorchester[6]	1.0%	No	1.0%	Yes
Frederick[7]	1.0%	Yes	0.0%	Yes
Garrett[8]	2.0% + $500	No	0.0%	No
Harford	0.0%	No	1.0%	Yes
Howard[9]	0.0%	Yes	0.0%	Yes
Kent[10]	0.0%	No	1.0%	Yes
Montgomery[11]	0.0%	No	0.0%	Yes
Prince George's[12]	0.0%	No	2.0%	No
Queen Anne's	0.0%	No	0.0%	No
St. Mary's[13]	2.0% + $500	No	1.5%	No
Somerset[14]	0.0%	No	0.0%	Yes
Talbot	0.0%	No	3.5%	Yes
Washington[15]	$1,000	Yes	0.0%	Yes
Wicomico	2.0%	No	1.0%	Yes
Worcester[16]	0.0%	No	0.0%	Yes
Number Granting	**7**	**6**	**9**	**17**

COLA: cost-of-living adjustment
GSI: general salary increase

Comments:

[1]Anne Arundel County school employees will receive a mid-year 1.25% salary/wage increase, two-day reduction in the work year, and a healthcare premium holiday for one pay period.

[2]Baltimore City school administrators will receive a 3.0% COLA, paraprofessional and school-related personnel will receive a 2.35% COLA, and FOP will receive a 1.5% COLA and 1.5% longevity GSI. CUB employees will be placed on the next full interval above current salary (max. $750). School system is still in negotiations with AFSCME and unaffiliated employees.

[3]Baltimore County is still in negotiations with AFSCME and FOP; all other employee groups will receive step increases.

[4]Calvert County Public Schools is still in negotiations with administrators.

[5]Charles County employees will receive a merit increase equal to 3.0% of the salary midpoint of their current grade. School system employees will receive a step increase.

[6]Dorchester County teachers will receive a 1.0% COLA and a step increase; administrators and support employees negotiated a revised salary scale, resulting in a tiered increase.

[7]Frederick County employees will receive a merit increment; corrections and law enforcement personnel also will receive catch-up based on years of service and firefighters are placed in a new step system.

[8]Garrett County Public Schools was not able to provide a contracted step increase. Roads Department employees (AFSCME) will receive a 4.0% COLA; all nonunion, full-time employees will receive a 2.0% COLA and a $500 bonus.

[9]While Howard County employees in general did not receive a COLA, police officers and sergeants will receive a 2.0% COLA January 1, 2013.

[10]Kent County school employees will receive a 1.0% COLA and step increase January 1, 2013.

[11]While Montgomery County school employees in general did not receive a COLA, employees that did not receive a merit/step or longevity increase will receive a 2.0% GSI.

[12]Prince George's County teachers also receive a one-day reduction in the work year. The school system is still in negotiations with its other employee unions. County and FOP are in arbitration.

[13]St. Mary's County employees will receive a 2.0% COLA and a permanent $500 stipend.

[14]Somerset County teachers and support staff will receive a step increase March 15, 2013; school administrators will receive a $1,000 bonus December 5, 2012.

[15]While Washington County teachers in general will not receive a COLA, teachers already in the top step will receive a 1.0% COLA. Teachers on Step 4 and greater will receive an additional midyear step increase to recover a negotiated, but unfunded increase from 2010. County full-time employees will receive a $1,000 stipend; full time and permanent part-time employees will receive a 3.5% step increase effective January 1, 2013; temporary employees will receive a 3.0% increase upon return to seasonal employment.

[16]While Worcester County teachers and support personnel in general will not receive a COLA or GSI, employees already in the top step will receive a 1.5% increase.

Source: 2012 Local Government Salary Action Survey; Department of Legislative Services; Maryland Association of Counties

Exhibit 3
Local Government Furlough, Salary Reduction, and Layoff Plans in Fiscal 2013

County	Furlough/ Reduction	Layoffs	
Allegany	No	No	School system has eliminated 106.4 positions through attrition over the past three fiscal years; 63 of the positions were eliminated in fiscal 2013.
Anne Arundel	No	No	
Baltimore City	No	Yes	City does not plan any furloughs or salary reductions, but has not determined whether there will be any layoffs. School system does not plan any furloughs or salary reductions, but has indicated that it is currently processing layoffs of up to 46 non-teacher employees. School system is still in negotiations with AFSCME and unaffiliated employees.
Baltimore	No	No	
Calvert	No	No	School system does not plan any furloughs, salary reductions, or layoffs, but is still in negotiations with administrators.
Caroline	No	Yes	County does not plan any furloughs or salary reductions, but laid off one employee.
Carroll	No	Yes	School system does not plan any furloughs or salary reductions, but laid off one employee.
Cecil	No	No	County does not plan to implement any salary reductions, and has indicated that no furloughs or layoffs are planned at this time.
Charles	No	No	
Dorchester	No	No	
Frederick	No	Yes	County does not plan to implement any furloughs or salary reductions, and has indicated that no layoffs are planned at this time. School system laid off two employees and indicated that furloughs and salary reductions are not planned at this time.
Garrett	No	Yes	School system laid off 18 employees, including 11 teachers, and was not able to provide a contracted step increase, but does not plan to implement any furloughs or salary reductions.
Harford	No	No	
Howard	No	No	
Kent	No	No	
Montgomery	No	No	School system indicated that all budget reductions were handled through attrition or transfer and no furloughs, salary reductions, or layoffs are planned.
Prince George's	Pending	Pending	School system does not anticipate implementing any furloughs, but is still in negotiations with some of its employee unions and has not yet determined whether there will be salary reductions or layoffs. County and FOP are in arbitration.
Queen Anne's	No	No	
St. Mary's	No	No	

County	**Furlough/ Reduction**	**Layoffs**	
Somerset	Yes	Yes	School system has not determined whether to implement any furloughs, but had salary reductions resulting from the transfer of 2 employees and the replacement of 2 retirees, and layoffs of 19 employees, including 7 teachers.
Talbot	No	No	County does not plan to implement any furloughs, salary reductions, or layoffs at this time.
Washington	No	No	
Wicomico	Yes	No	School system does not plan any furloughs or layoffs, but reduced salaries and work schedules for 4 pupil personnel workers. School system has also eliminated positions through attrition and retirement incentives.
Worcester	No	No	
Total Jurisdictions Implementing Plans	**2**	**6**	

Source: Department of Legislative Services; Maryland Association of Counties

Local Government

Task Force to Study Rates and Charges in the Washington Suburban Sanitary District

Rising costs and utility rates prompted the General Assembly to establish a task force to study numerous issues confronting the Washington Suburban Sanitary Commission. While a report of its findings and recommendations is due by year end, appointments to the task force have not been finalized.

The Washington Suburban Sanitary Commission

The Washington Suburban Sanitary Commission (WSSC), a bi-county agency established by the General Assembly in 1918, is the eighth largest water and wastewater utility in the country. WSSC provides water and sewer services to 1.8 million residents, comprising most of Montgomery and Prince George's counties (the Washington Suburban Sanitary District).

WSSC has over 460,000 customer accounts, serves an area of approximately 1,000 square miles, and currently employs more than 1,500 people. The commission's fiscal 2013 approved budget is $1.4 billion, which includes $662 million for the operating budget and $788 million for the capital budget. In terms of facilities, the commission operates and maintains three reservoirs, two water filtration plants, seven wastewater treatment plants, and more than 5,500 miles of water main lines and nearly 5,400 miles of sewer main lines.

Recent Issues in the Washington Suburban Sanitary District

Rising Costs and Utility Rates

As WSSC approaches its centennial, replacing its aging infrastructure has become a growing priority. In recent years, a series of headline-making water main breaks have required firefighters to rescue people from gushing water, residents to boil water, and crews to tear into roads to replace shattered pipes. A report issued earlier this year by a consulting firm is currently being reviewed by commission officials with an eye towards reducing costs as soon as the next fiscal year. Recommendations include the imposition of an extra charge to generate revenue dedicated to replacing aging pipes and issuing 30-year rather than 20-year bonds.

After no rate increase between fiscal 1999 and 2004, WSSC customers have faced nine consecutive years of rate hikes, ranging between 2.5% and 9.0%. During the current fiscal year, customers are paying a 7.5% increase. Commission officials are proposing another rate hike, up to 9.5%, for the next fiscal year to pay off debt, repair and replace aging pipes, and cover fixed costs.

Sewer Overflow Consent Decree

At present, WSSC is more than half-way through a 12-year consent decree that requires the commission to reduce and eliminate where possible sewage backups and overflows. The consent decree, signed in 2005, settles a lawsuit brought in 2004 by the U.S. Environmental Protection Agency and several environmental groups under the federal Clean Water Act. The commission is 1 of 65 utilities in the country operating under similar consent decrees to reduce sewer overflows. WSSC reports that while it has achieved significant results to date from sewer pipe inspections and repairs, as well as increased monitoring of grease build-up abatement efforts, much remains to be done.

Legislative Action in 2012

Background

An issue that has received increasing attention from policymakers and the media is the reconciliation of fees assessed on homeowners for newly constructed water and sewer connections with the costs paid by developers for these connections. One of these fees is the front foot benefit charge, a fee typically included in a property tax bill for 23 years. In an effort to shed more light on this question, Chapter 685 of 2012 requires Prince George's County to add a notice on a property tax bill indicating the number of payments remaining for any front foot benefit charge (similar to current practice in Montgomery County) and establishes the Task Force to Study Rates and Charges in the Washington Suburban Sanitary District.

Task Force

The 12-member task force created by Chapter 685 is required to (1) determine whether other states have a cap on water and sewer usage rates; (2) complete a comparison of the rates charged by WSSC with rates charged in other states; (3) determine the effect of a rate cap or prepayment discount on WSSC; (4) study the process developers follow in charging for the construction of and connection to water and sewer facilities; and (5) make recommendations on standards for the construction of and connection to water and sewer facilities.

The task force is required to report its findings and recommendations to the Governor and the Montgomery County and Prince George's County delegations by December 31, 2012. As of mid-November 2012, the appointments to the task force were not completed, so further attention to these matters is likely for the 2013 session.

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Local Government

2013 Legislative Agenda – Maryland Municipal League

The legislative agenda for the Maryland Municipal League includes protecting and restoring State funding to municipal governments and authorizing municipalities to publish legal notices on their websites.

Highway User Revenues

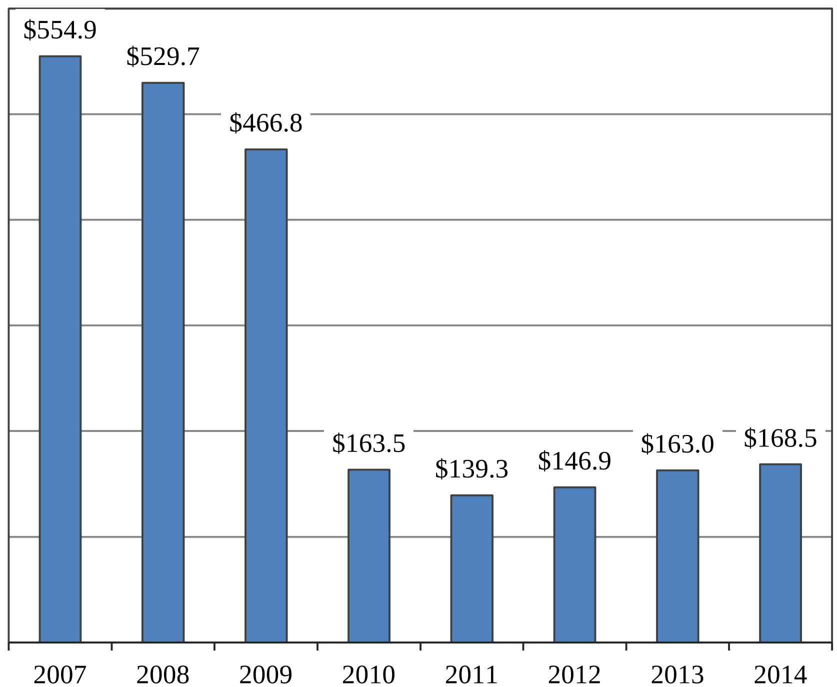
Most municipalities in Maryland rely upon State shared highway user revenues to maintain and improve public roads within their municipal corporate limits, while more than half of all municipalities rely on police aid to assist in providing law enforcement services in their communities. Aside from these two revenue sources, municipal governments in Maryland receive limited State support to finance public services. As a result, most municipal governments in Maryland rely on property taxes and service charges to finance public services. In recent years, Maryland's municipal governments have been subject to reduced State funding resulting from decreases in their share of highway user revenues and police aid to help balance the State's operating budget. Full funding for police aid is anticipated in the upcoming fiscal 2014 State budget. At the 2011 session, the General Assembly increased the share of highway user revenues for municipalities from 0.1% to 0.6% for fiscal 2012 and from 0.3% to 0.4% for fiscal 2013 and beyond. However, this funding share still reflects a sizeable decrease from the share of highway user revenues that was allocated to municipalities in the past.

As shown in **Exhibit 1**, municipalities received $46.8 million in highway user revenues in fiscal 2007, which represented 2.5% of total available funding. By fiscal 2014, the municipal share of highway user revenues will total $7.0 million or 0.4% of total available funding. This reduction in State funding continues to affect the ability of local governments to provide transportation services within their communities. For example, in Annapolis, State funding for local highway maintenance has been reduced from $1.9 million in fiscal 2007 to $0.2 million in fiscal 2011. Consequently, local spending in Annapolis for transportation services has declined from $4.7 million in fiscal 2007 to $3.5 million in fiscal 2011.

Due to the ongoing fiscal outlook, the Maryland Municipal League (MML) has adopted the reinstatement of funding for municipal highway user revenues and the creation of protections to ensure that municipal highway user revenues are not diverted to the State's general fund in the future as one of its 2013 legislative initiatives.

Exhibit 1
Counties and Municipalities Receive Small Share of Highway User Revenues
($ in Millions)

Local Highway User Revenues



Fiscal 2007

MDOT	$1,294.7	70.0%
Baltimore City	226.6	12.3%
Counties	281.6	15.2%
Municipalities	46.8	2.5%
Total Distributions	**$1,849.6**	**100.0%**

Fiscal 2014

MDOT	$1,586.5	90.4%
Baltimore City	135.1	7.7%
Counties	26.3	1.5%
Municipalities	7.0	0.4%
Total Distributions	**$1,754.9**	**100.0%**

Note: Baltimore City is responsible for maintaining essentially all roads in the city. The State maintains 5,228 miles of State roadways within counties and 25 miles within Baltimore City. County governments maintain 21,257 miles of local roadways, while municipalities maintain 2,797 miles of local roadways. Baltimore City maintains 1,912 miles of roadways, including 7 miles along Interstate 83.

Source: Department of Legislative Services

Publication of Legal Notices on Municipal Websites

State law includes several provisions requiring the publication of local government legal notices in newspapers of general circulation. MML contends that the annual cost for all required newspaper advertising is significant, and a less expensive alternative to newspaper advertising is needed to allow local governments to effectively provide public notice of their actions. MML further contends that falling circulation of hard-copy newspapers over time adds emphasis to the need to allow alternative means of providing public notice.

Therefore, MML will seek enactment of legislation to provide discretionary authority to municipal governments to post State-mandated legal notices on their websites in lieu of publishing legal notices in newspapers of general circulation in their communities.

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Local Government

2013 Legislative Agenda – Maryland Association of Counties

The legislative agenda for the Maryland Association of Counties includes protecting and restoring State funding to county governments, expanding local representation in the State Retirement and Pension System, defending local land use autonomy, and applying tax provisions to local governments in a more equitable and fair manner.

County Budget Security

County governments have experienced significant reductions in State funding in recent years. These reductions have affected nearly every essential local service: roads and bridges, law enforcement, health departments, and corrections. Moreover, with each budget cycle, temporary cuts have been made permanent, and State administrative costs have been shifted to the counties without county control of the management of these costs. One of the most recent examples of the trend to shift costs to the counties, teacher retirement, is discussed below.

While understanding that the State continues to face long-term challenges to meet its funding commitments to education, Medicaid, and general government, the Maryland Association of Counties (MACo) maintains that the State remains better equipped to meet its future obligations than the counties because county budgets must rely heavily on property tax revenue which continues to lag behind the persistent sluggishness in the overall economy. Accordingly, MACo urges State policymakers to restore State aid to the counties, ease the financial burdens of prior cost shifts, reinforce capital commitments to schools and other county priorities, and resist creating any new burdens on county budgets and services.

County Voice in State Retirement and Pension System

MACo maintains that the recent shift to the counties of funding responsibility for teacher retirement does nothing to improve the sustainability of the funding; it simply shifts the cost burden to the level of government that has historically played a far lesser role in the system. For example, MACo points out that the counties have minimal representation on the Board of Trustees of the Maryland State Retirement and Pension System, no control in pension plan design changes and benefit enhancement, and no role in investment decisions by the system.

Given this new responsibility of county governments, MACo urges the State to (1) include two seats on the board of trustees that specifically represent the interests of county governments; and (2) ensure that ongoing studies of the system examine investment practices and any other function of the system that has cost implications.

Defense of Local Land Use Autonomy

MACo continues to hold fast to the position that multiple State policy proposals, often developed in the name of environmental protection, threaten the central notion that locally elected officials are best suited to make local land use decisions. For example, the following requirements recently adopted or proposed underscore how county governments must reinforce the importance of local accountability and direct public input: the Chesapeake Bay total maximum daily load requirements; PlanMaryland; limits on septic systems; code enforcement burdens; and the proposed county transportation mandates based on climate change. Moreover, MACo contends that the numerous State land use mandates have burdened local planning staff and impeded the adoption by each county of a comprehensive plan in a timely and effective manner.

In order to best manage these State mandates, MACo will likely seek a two-year moratorium on new land use and environmental initiatives in order to give the counties more time to implement the land use and environmental mandates that have been placed on the counties over the last several years. In addition, MACo will likely seek to move to a cycle for comprehensive planning and zoning that is based on the cycle for the U.S. census.

Tax Application and Fairness to Local Governments

Since State law governs the application and administration of several tax systems that affect local governments, MACo urges various changes to provide counties with more reasonable treatment and administrative flexibility in this arena. Specifically, MACo's priorities include granting local governments the same exemption from motor fuel taxes that the State government receives, exempting local governments from locally imposed gross receipts on heavy equipment rentals, and allowing local government greater flexibility in applying rates and offsets in the personal property tax on business taxpayers.