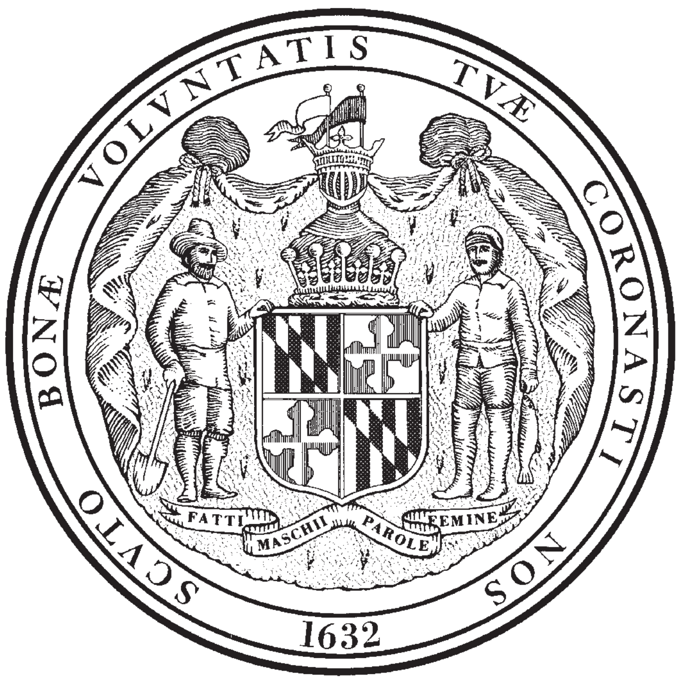
Spending Affordability Committee

2005 Interim Report



Annapolis, Maryland
December 2005

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MARYLAND GENERAL ASSEMBLY
SPENDING AFFORDABILITY COMMITTEE

December 8, 2005

The Honorable Robert L. Ehrlich, Jr.
Governor, State of Maryland
State House
Annapolis, Maryland 21401

Dear Governor Ehrlich:

We are pleased to submit the fiscal policy recommendations of the Spending Affordability Committee made during the 2005 interim. These recommendations were adopted by the committee at its meeting on December 7, 2005. The committee reviewed data concerning the economic condition of the State, revenue and expenditure trends during the past several years, personnel data, the Transportation Trust Fund, and the results of the Capital Debt Affordability Committee report.

Recommendations were made concerning the fiscal 2007spending limit, future budget sustainability, general and reserve fund balances, capital debt, transportation debt, and State positions.

The Spending Affordability Committee has completed its assigned tasks. As required by law, the recommendations of the committee have been submitted to the Governor and the Legislative Policy Committee.

We are most appreciative of the time and effort expended by each member of the committee. A special note of thanks and appreciation is extended to the members of the Citizens Advisory Committee for their valuable assistance and input.

Sincerely,

Senator Edward J. Kasemeyer Presiding Chairman	Delegate Michael R. Gordon House Chairman

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MARYLAND GENERAL ASSEMBLY
SPENDING AFFORDABILITY COMMITTEE

December 8, 2005

The Honorable Thomas V. Mike Miller, Jr., Co-Chairman
The Honorable Michael E. Busch, Co-Chairman
Members of the Legislative Policy Committee

Ladies and Gentlemen:

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Maryland General Assembly
Spending Affordability Committee
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Delegate Michael R. Gordon, House Chairman

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Thomas M. Middleton
Thomas V. Mike Miller, Jr.
Donald F. Munson
Ida G. Ruben
J. Lowell Stoltzfus

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Michael E. Busch
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George C. Edwards
Anne Healey
Sheila E. Hixson
Adrienne A. Jones

Citizens Advisory Committee

H. Furlong Baldwin
Dana M. Jones
Frederick W. Puddester

Staff

Deadra Whayland-Daly

Contents

2005 Spending Affordability Committee Report and Recommendations to the Governor and the Legislative Policy Committee

The Spending Affordability Committee was created in 1982 (Chapter 585, Acts of 1982). The committee is composed of 20 legislative members including the presiding officers, the majority and minority leaders, the chairmen of the fiscal committees (or their designees), and other members appointed by the presiding officers. A four-member citizen advisory committee assists the committee.

The committee's primary responsibility is to recommend to the Governor and the General Assembly a level of spending for the State operating budget that is reflective of the current and prospective condition of the State's economy. Consideration is given to constraining disproportionate growth in State-funded expenditures in any fiscal year which might necessitate or "build in" unsupportable levels of spending in future years. The committee's prior recommendations and legislative action on the operating budget are reflected in the table on the following page.

The committee notes that operating spending in relation to the State's economy, as measured by the personal income statistic, is lower now than when the spending affordability process began in 1982. As illustrated in the chart on page four, throughout much of the 1980s, the ratio remained relatively stable. During the 1990 and 1991 sessions, the combination of increased spending demands and economic slowdown caused the spending ratio to increase. Following the recession, operating spending in relation to personal income fell acutely. With the onset of another recession in calendar 2001, spending in relation to personal income rose again. However, economic recovery, paired with spending restraint, caused the spending ratio to fall in 2003 to about 7 percent. The spending ratio has remained virtually unchanged since 2003.

The committee's statutory responsibility is to consider spending growth in relation to growth anticipated in the State's economy. In its review of the State's economy, the committee considered both income and wealth factors in developing a broad understanding of Maryland's economic position. In determining the spending limit, the committee has considered economic performance, revenue estimates, and budget requirements.

Spending Affordability Committee's Prior Recommendations and Legislative Action on the Operating Budget
($ in Millions)

	Committee Recommendation		Legislative Action	
Session Year	**Growth Rate**	**Amount**	**Growth Rate**	**Amount**
1983	9.00%	$428.0	5.70%	$269.8
1984	6.15%	326.7	8.38%	402.0
1985	8.00%	407.2	7.93%	404.6
1986	7.70%	421.5	7.31%	402.2
1987	7.28%	430.2	7.27%	429.9
1988	8.58%	557.5	8.54%	552.9
1989	8.79%	618.9	8.78%	618.2
1990	9.00%	691.6	8.98%	689.7
1991	5.14%	421.8	5.00%	410.0
1992	No recommendation		10.00%	823.3
1993	2.50%	216.7	2.48%	215.0
1994	5.00%	443.2	5.00%	443.2
1995	4.50%	420.1	4.50%	420.0
1996	4.25%	415.0	3.82%	372.8
1997	4.15%	419.6	4.00%	404.6
1998	4.90%	514.9	4.82%	506.6
1999	5.90%	648.8	5.82%	640.6
2000*	6.90%	803.0	6.87%	800.0
2001**	6.95%	885.3	6.94%	884.6
2002	3.95%	543.2	3.40%	468.1
2003	2.50%	358.2	0.94%	134.1
2004	4.37%	635.2	4.33%	629.0
2005***	6.70%	1,037.1	6.69%	1,036.3

*2000 legislative action does not reflect $266 million of Cigarette Restitution Fund (CRF) appropriations. CRF dollars were excluded because they had not previously been available to the State. The 2000 growth rate including CRF dollars was 9.16%.

**Data from the 2001 session and subsequent years reflect a revised methodology for calculating the spending affordability.

***The committee initially approved a limit of 5.70% but raised the limit to 6.70% in January 2005.

Economy

After three sluggish years following the recession of 2001, the Maryland economy improved significantly in 2004 and continues to grow at a healthy pace in 2005. In 2004, employment in Maryland grew by 1 percent, following three years with employment growth of less than 1 percent. The acceleration in personal income growth was even stronger, rising from 3.9 percent in 2003 to 6.7 percent in 2004. With the pickup in employment, wage and salary income grew 5.7 percent in 2004 versus just 3.9 percent growth in 2003. The Microsoft dividend paid out in the fourth quarter of 2004 helped to lift income from dividends, interest, and rent by 5.5 percent after declining in both 2002 and 2003. In 2005, employment growth has accelerated further from the pace set in 2004. Employment in the first nine months is higher than the same period last year by almost 2.0 percent, an increase of about 49,000 jobs. For the first half of 2005, personal income is up 6.6 percent with wage and salary income rising 6.5 percent.

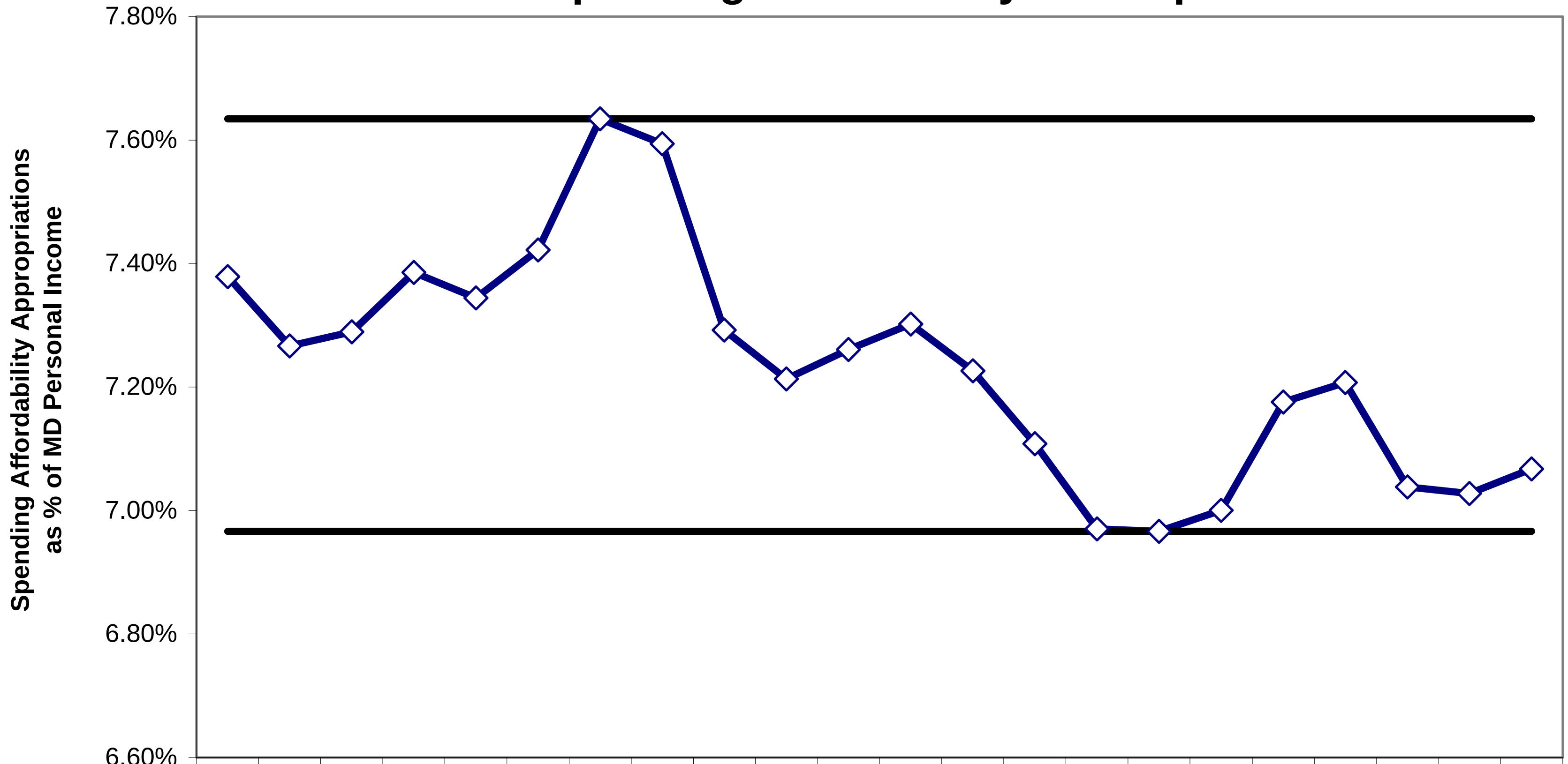
The economic outlook is materially better than the December 2004 forecast that was the basis of the revenue projections from the Board of Revenue Estimates. Although employment growth was actually slightly weaker than expected in 2004, personal income was substantially stronger. Personal income is expected to grow at a very healthy 6.1 percent in 2005. This is slower than the 6.7 percent pace of 2004 due in part to the absence of another Microsoft dividend in 2005 which means income from the dividends, interest and rent category will grow substantially slower. Beyond 2005, the impact of the U.S. Department of Defense's Base Realignment and Closure process, which is expected to bring a net 15,800 direct and indirect jobs to Maryland, will help keep employment growth around 2.0 percent and personal income growth around 6.0 percent.

Revenues

The substantially stronger economy in 2004 helped generate $11.5 billion in general fund revenues in fiscal 2005, exceeding the estimate by $422.5 million. Fiscal 2005 revenues grew 12.6 percent over fiscal 2004. General fund revenues in fiscal 2005 included $151 million in payments to settle back taxes relating to the use of Delaware holding companies under the settlement period established by Chapter 557, Acts of 2004. If one-time revenue is excluded, fiscal 2005 still grew at a very strong 11.3 percent. Over 60 percent of the over-attainment was in the personal and corporate income taxes. The personal income tax exceeded the estimate by $245 million, driven by the significant acceleration of personal income growth in 2004, plus a big increase in income from capital gains estimated to be about 57 percent higher than in 2003. The corporate income tax exceeded the estimate by $61.4 million and grew by 55.9 percent over fiscal 2004 due in part to legislation from the 2004 session (Chapter 556) which altered the tax treatment of Delaware holding companies for tax year 2004 and subsequent years.

The much better than expected performance in fiscal 2005, combined with the higher projected economic growth, results in new revenue estimates for fiscal 2006 that are substantially

Ongoing Spending in Relation to Personal Income
Under Spending Affordability Concept



	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
SA as % of PI	7.38	7.27	7.29	7.39	7.34	7.42	7.63	7.59	7.29	7.21	7.26	7.30	7.23	7.11	6.97	6.97	7.00	7.18	7.21	7.04	7.03	7.07
20-year High	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63	7.63
20-year Low	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97	6.97

above the current official estimates. The Department of Legislative Services (DLS) projects that general fund revenues in fiscal 2006 will be $638 million higher than the current estimate and will grow 4.8 percent over fiscal 2005. If one-time revenue is excluded from both years, fiscal 2006 is expected to grow 5.9 percent. DLS projects that general fund revenues in fiscal 2007 will grow by 4.9 percent over fiscal 2006, or 5.1 percent if one-time revenue is excluded.

Budget Requirements

The committee is projecting a general fund balance of $1.057 billion in fiscal 2006. The positive balance is attributable to continued adherence to spending limits supplemented by one-time transfers, and the carry-forward of fund balance from the prior year. These actions are partially offset by potential deficiency appropriations of about $184 million to address specific anticipated spending shortfalls during fiscal 2006. Areas projected to require deficiency funding include Medicaid reimbursements for providers, foster care placement costs, and inmate medical expenses.

Legislatively mandated increases in education aid and escalating Medicaid expenses underpin the 8.1 percent increase in the operating spending forecast for fiscal 2007. While the forecast does not anticipate a general salary increase for State employees, employment-related expenses increase significantly as health insurance costs escalate, most employees qualify for salary increments, and the State's contribution for employee retirement rises.

The anticipated growth in ongoing revenue alone is not sufficient to cover projected fiscal 2007 and 2008 spending. Operating expenses are expected to exceed ongoing revenues by almost $300 million in fiscal 2007 and $655 million in fiscal 2008. The availability of more than $1 billion in fund balance from fiscal 2006, however, leaves the State with more than enough cash to cover the anticipated spending. The committee projects the State will close fiscal 2007 with cash reserves (from the general fund balance and Rainy Day Fund) of $1.477 billion; or 12 percent of general fund revenues. Cash reserves are expected to dwindle to $805 million, or 6 percent of general fund revenues at the close of fiscal 2008. Beginning with fiscal 2009, the magnitude of the structural budget gap is forecast to stabilize with annual ongoing revenues and operating expenditures each increasing at a rate of 5 percent.

Recommendations

In light of the considerations discussed above, the committee proposes the following recommendations for the 2006 session:

1. Operating Budget

A. Spending Limit and Sustainability

Appropriations subject to the spending affordability limit shall be limited to growth of no greater than 8.9 percent over those approved at the 2005 session. This limit would provide for an $1,469.7 million increase in appropriations at the 2006 session, allowing for total expenditures subject to spending affordability of $17,983.4 million.

Modest revenue growth and an imbalance between ongoing revenues and operating spending have constrained State spending in recent years. The State has provided substantial education aid increases, as mandated by the Bridge to Excellence in Public Schools Act (Thornton legislation), by limiting growth in other areas. Strong revenue growth and increasing cash balances have substantially improved the State's short-term fiscal outlook. The spending limit for the 2006 session will allow the State to continue the phase-in of the Bridge to Excellence in Public Schools Act and meet the current services needs of the remaining programs.

Together, the spending limit and the committee's recommendations (discussed below) to increase reserve fund balances, reduce long-term employee pension and retiree health care liabilities, and provide for a more efficient general obligation bond capital program offer a fiscally responsible approach to meeting current spending needs and improving the State's long-term fiscal condition.

B. Base Adjustments

The committee is aware that spending from special and higher education funds may occur above the limit under the statutory budget amendment process and that operation of this process will, over time, cause the appropriation base used for the spending affordability calculation to understate the true level of spending. **In the past the committee has authorized the Department of Legislative Services to make an adjustment to the calculation to "true up" the base for these fund accounts, and in connection with the budget submitted at the 2006 session, we do so once again. We are, however, concerned by the extent to which the Executive and its agencies have come to rely on piecemeal budget amendments to support basic operating costs.**

These are foreseeable expenses and initiatives which could be funded through a more public process, including the use of deficiency appropriations or inclusion in the original or supplemental budgets. Accordingly, the committee requests that the Administration increase their reliance on the normal budget process for increasing spending and requests that the Department of Legislative Services study the matter and present recommendations to the budget committees during the 2006 session on how the Executive might be encouraged to do so.

2. State Reserve Fund

A. Rainy Day Fund

In addition to its general fund recommendations, the committee also recommends a prudent use of the Revenue Stabilization Account ("Rainy Day Fund") to address general fund needs. Section 7-311 of the State Finance and Procurement Article establishes the Rainy Day Fund to retain revenues for future needs and guard against future tax increases. The statute requires that the fund have a balance of at least 5 percent of the estimated general fund revenues and also allows for the withdrawal of funds.

Reflecting strong growth in the economy, recent revenue projections have been revised upwards. While the revenue situation has improved significantly, it has not improved sufficiently to erase the structural deficit. The committee remains concerned that sufficient funds be available to support State needs in the out years.

Accordingly, the committee recommends that the Rainy Day Fund balance be at least 7.5 percent of general fund revenues. This additional fund balance sets aside approximately $300 million, in excess of the 5 percent minimum recommended by bond rating agencies, to provide additional flexibility in addressing subsequent years spending requirements.

The importance which the bond rating agencies place on maintaining a Rainy Day Fund balance of at least 5 percent of the estimated general fund revenues has changed the practical use of the Rainy Day Fund. Even during times of fiscal distress, maintaining a balance equivalent to 5 percent of general fund revenues is treated as a necessity. Thus, the reserves are not available to meet the statutory goals for the fund. For the Rainy Day Fund to again serve as a short-term revenue source in times of distress, a balance in excess of 5 percent is required. **Therefore, the committee recommends that Section 7-311 of the State Finance and Procurement Article be amended to require that funds be appropriated into the Rainy Day Fund if the fund balance falls below 7.5 percent. This requirement provides the State with a mechanism for ensuring that the Rainy Day Fund balance is well above the amount recommended by the rating agencies, thus providing the State with a more flexible Rainy Day Fund.**

3. Capital Budget

A. General Obligation (GO) Debt

The committee concurs with the recommendation of the Capital Debt Affordability Committee (CDAC) that a maximum of $690 million in general obligation bonds may be authorized at the 2006 session. This level allows for a $20 million increase in spending over the 2005 session authorization and includes $5 million to the Tobacco Transition Program.

The recommendation to increase the authorization by $20 million in the 2006 session reflects a change in application of the CDAC's authorization policy. Previously, CDAC adopted a policy to increase authorizations by $15 million annually. At the time this policy was adopted, the $15 million allowed for 2 percent growth attributable to inflation and 1 percent growth in the program size. As the capital program has grown, the $15 million increase resulted in an ever smaller percentage growth rate. To allow the program to grow 3 percent annually, the committee has now adopted the practice of increasing authorizations 3 percent, instead of a fixed amount (e.g., $15 million annually). While this is not exactly a new policy, this does reflect a change in practice that is expected to result in higher GO bond authorizations.

The committee concurs in the recommendation of the Capital Debt Affordability Committee that $690 million in new general obligation bonds may be authorized at the 2006 session and supports the practice of increasing GO bond authorization by 3 percent annually.

B. Taxable GO Bonds

The State's capital program supports a number of different public policy objectives such as health, environmental, public safety, education, housing, and economic development objectives. Federal government regulations allow the State to issue debt that does not require the buyer to pay federal taxes on interest earnings. Federal laws and regulations limit the kinds of activities that can be supported with proceeds from tax-exempt bonds. To avoid exceeding the private activity limits imposed in the federal regulations, the State has previously appropriated funds in the operating budget instead of issuing debt for private activity programs and projects.

Recent years' fiscal constraints have limited the amount of operating funds available for capital projects. In 2005 the State reached its limit, with respect to private activity exemptions in tax-exempt issuances, and the State sold taxable debt, resulting in higher borrowing costs. The State's 2005 issuances of $45 million in taxable debt cost $1.6 million more than issuing tax-exempt debt. **To reduce borrowing costs and provide for a more efficient capital program, the committee recommends that the State appropriate general funds for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds.**

Current Spending Affordability Committee (SAC) policy is to include revolving loan fund capital programs receiving general funds in the SAC spending limit. The committee is concerned that this could create a disincentive to move funding for these capital programs back into the general fund. **To eliminate a potential disincentive to restore general fund appropriations for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds, it is recommended that SAC exclude PAYGO capital general fund appropriations made in the 2006 legislative session from the affordability calculation. This exclusion should be limited to projects previously funded with taxable GO bonds that are funded with general funds instead.**

C. Public School Construction

The Public School Facilities Act of 2004 (Chapter 307), established a State goal to fully fund school construction projects by fiscal 2013 to meet all minimum required standards as of July 2003. The Act was a response to the November 2003 survey results of the Task Force to Study Public School Facilities; that task force concluded that many Maryland public schools were deficient in some capacity and that the cost to bring schools up to standard would be $3.85 billion. Through the Public School Facilities Act, the State would provide $2 billion of the $3.85 billion over an eight-year period, with the remaining balance funded by local governments. Since the State committed $251.8 million to school construction in fiscal 2006 and currently has committed to $100 million annually in the Department of Budget and Management's *Capital Improvement Program*, authorizing an additional $150 million over the next seven years would fund the shortfall. In a letter outlining his capital budget priorities for fiscal 2007, the Governor has proposed authorizing an additional $50 million in fiscal 2007.

The Act required that CDAC review public school construction needs and make a funding recommendation annually. In its 2005 report, CDAC did not make a specific recommendation to the General Assembly regarding the amount of State debt to authorize for public school construction in fiscal 2007. Based on the CDAC's criteria, however, an additional $150 million of new general obligation bond authorizations for fiscal 2007 alone would not result in a breach of the affordability criteria. Although this additional debt would not exceed debt capacity as currently defined, CDAC warned that it would limit the State's ability to issue debt for other programs, and were it to be repeated annually, could result in a breach of the debt to personal income affordability measure.

The committee is concerned about the adequacy of public school construction funding and notes that additional spending for public school construction is affordable in fiscal 2007, based CDAC criteria. The committee notes, however, that current general obligation bond debt service expenditure projections will put additional pressure on the general fund in the future. The committee recommends that the General Assembly evaluate the proposed fiscal 2007 capital budget and the progress made toward meeting the funding goal established by the Governor and General Assembly in the Public School Facilities Act of 2004 and consider appropriate action to meet the funding goal.

D. Higher Education Debt

For fiscal 2007 the University System of Maryland intends to issue up to $50 million in auxiliary debt and $25 million in academic debt. This level of issuance will result in a debt service ratio within the 5.5 percent of current unrestricted funds and mandatory transfers criterion recommended by the system's financial advisers. Morgan State University plans on issuing $18 million in auxiliary debt. St. Mary's College and Baltimore City Community College do not plan on issuing any debt in fiscal 2007. **The committee concurs in the recommendation of the Capital Debt Affordability Committee that $25 million in new academic revenue bonds may be authorized for the University System of Maryland in the 2006 session.**

E. Transportation Debt

The Maryland Department of Transportation (MDOT) competes with other State capital projects within debt affordability limits. Transportation debt capacity is limited by the constraints on debt outstanding, debt service coverage, the cash flow needs for projects in the capital program, and overall State debt affordability limits.

The committee recommends that the General Assembly continue to set an annual limit on the level of State transportation debt so as to maintain debt outstanding within the 3.2 percent of personal income debt affordability criterion and debt service within the 8.0 percent of revenues debt affordability criterion.

4. Operating Maintenance Exclusion

For the last five years, operating spending by the Department of General Services (DGS) on facilities maintenance projects above a base funding level of $2 million has been excluded from the spending affordability calculation. The exclusion was initially authorized in the committee's December 2000 report, which noted a backlog of operating maintenance projects at State facilities in the magnitude of $47 million. Left unaddressed, the committee recognized that this could lead to further deterioration of the State's infrastructure and to higher costs in the long run.

Despite the exclusion, DGS reported in September 2005 that it currently has a $37.5 million backlog of deferred maintenance and repair work and that $25.1 million is rated as a medium priority (posing a high economic risk). DGS plans to eventually eliminate the backlog by increasing the annual deferred maintenance appropriation to $5 million. DGS projects that an annual appropriation of $5 million would eliminate the medium priority backlog by fiscal 2015 and the entire backlog by fiscal 2019. These projections assume that new projects accumulate at the historical annual average of $2.4 million a year. **In an effort to reduce the backlog, the committee continues to support the exclusion from the spending affordability calculation of operating maintenance spending by DGS above the historical spending level of $2 million. The committee is greatly concerned that more funds have not been allocated to this purpose and encourage the Administration to make greater effort in this regard.**

5. Unfunded Liabilities

A. Exclusion from Spending Limit

Unfunded long-term liabilities associated with the State's workers' compensation claims, retiree health benefit, and employees' and teachers' retirement systems are an impediment to the State's long-term financial well-being. Simply preventing growth in the unfunded liabilities will require a significant investment of State dollars. Failure to develop a plan for addressing the liabilities may ultimately endanger the State's AAA bond rating. **To encourage prudent and timely action, the committee supports excluding from the affordability calculation funds allocated to addressing the State's long-term liabilities.**

B. Retiree Health Insurance

Under new Governmental Accounting Standards Board standards, the State is required to apply an accounting methodology similar to that used for pension liabilities, beginning in fiscal 2008. This methodology requires that the accrued future liability for this benefit be considered when looking at the financial health of the State. Based on a recent analysis prepared for the Department of Budget and Management, the estimated accrued actuarial accrued liability for retiree health benefits is approximately $20.4 billion.

Any amount of the Annual Required Contribution that the State does not pay in a fiscal year will appear on the State's financial statement as an obligation of the State. If no contributions are made beyond the contributions required under the pay-as-you-go contribution system currently employed, the State's obligation will be recorded at $1.65 billion in fiscal 2008 and increase by a similar amount in subsequent years.

The committee encourages the Governor to expeditiously develop a plan for reducing the State's retiree health insurance liability and allocate funds in the fiscal 2007 budget to begin resolving the problem. At a minimum, it is recommended that the Governor implement any recommendations of the Retiree Health Task Force.

C. Employees' and Teachers' Retirement Systems

The State's employees' and teachers' retirement systems are not fully funded and the annual contribution required for fiscal 2007 is not sufficient to meet even the normal cost, the amount required to meet the cost of benefits being earned in the current year. The committee recommends that the Governor implement any recommendations of the Joint Committee on Pensions that would move the employees' and teachers' retirement systems toward full funding.

6. State Employment

A. Position Ceiling

Personnel costs comprise approximately one fourth of the State operating budget, and any effort to permanently reduce personnel spending through position ceilings or other means will help resolve the State's long-term structural budget gap. Position ceilings imposed by the General Assembly for fiscal 2003, 2004, and 2005 have resulted in a decline in the size of the State's regular workforce from 82,087 full-time equivalent positions in fiscal 2002 to 78,490 in fiscal 2006.

Despite the decline in the number of authorized positions, the committee notes that, exclusive of higher education, there are currently almost 4,000 vacant executive branch positions, approximately 1,520 of which are funded in the fiscal 2006 budget. The high number of funded vacant positions suggests that any additional workforce needs can be addressed through a reallocation of existing resources.

The committee anticipates additional workforce needs in fiscal 2007 to staff a new maximum security wing at the Clifton T. Perkins Hospital Center and to complete the caseload initiative at the Office of the Public Defender.

The committee recognizes the continuing necessity of limiting the addition of nonessential positions and recommends an Executive Branch position ceiling (excluding higher education) be maintained at the current level of 52,760 authorized positions.

If the Governor finds it necessary to add positions, these additions should be accommodated by filling existing vacancies or offset with abolitions elsewhere in the State budget. There are currently 3,874 positions vacant in the Executive Branch excluding higher education.

The recommended position limit should be regarded as a ceiling and not a goal. We expect the Governor and the budget committees to undertake as part of their normal process a critical examination of the necessity of each position to the mission of their agencies and of State Government. In particular, we request that special attention be paid to the adequacy or excess of positions allocated to particular agencies, and, within agencies, to the proper relationship of positions allocated to overhead and central office functions as opposed to those providing direct services to citizens.

Part 1

Economic Outlook

Recent Economic Performance

Year-over-year Percent Change

Calendar Year	U.S. Economy GDP	U.S. Economy Employment	U.S. Economy Personal Income	Maryland Economy GSP	Maryland Economy Employment	Maryland Economy Personal Income
2000	3.7%	2.2%	8.0%	2.8%	2.7%	8.9%
2001	0.8%	0.0%	3.5%	4.0%	0.6%	5.3%
2002	1.6%	-1.1%	1.8%	2.8%	0.4%	3.7%
2003	2.7%	-0.3%	3.2%	3.0%	0.4%	3.9%
2004	4.2%	1.1%	5.9%	4.1%	1.1%	6.7%
		Year-to-date			*Year-to-date*	
2005	3.6%	1.7%	6.2%	n.a.	1.9%	6.6%

GDP = inflation-adjusted gross domestic product

GSP = inflation-adjusted gross state product

Note: Data for 2005 is through June for GDP and Maryland personal income, through August for U.S. personal income and Maryland employment and through September for U.S. employment.

Maryland Economic Forecasts

December 2004 Compared to October 2005

Year-over-year Percent Change

Calendar Year	Employment Dec. 2004	Employment Oct. 2005	Personal Income Dec. 2004	Personal Income Oct. 2005
2002	0.4%	0.4%	3.8%	3.7%
2003	0.4%	0.4%	3.8%	3.9%
2004	1.3% *	1.1%	5.6% *	6.7%
2005E	1.9%	1.8%	5.7%	6.1%
2006E	1.6%	1.9%	5.6%	6.4%
2007E	1.4%	2.0%	5.4%	6.1%
2008E	1.3%	2.0%	5.3%	5.8%

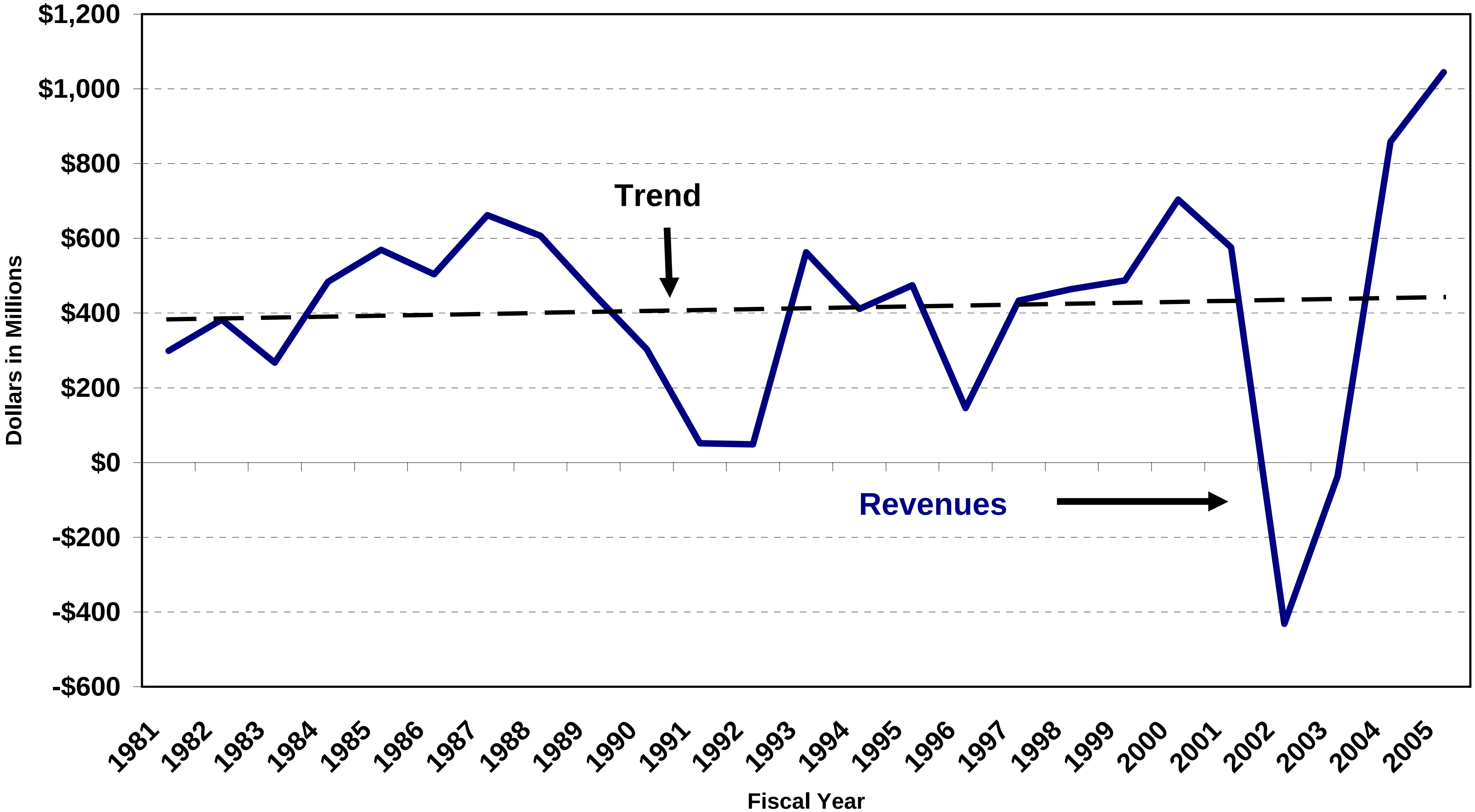
* Estimates

Part 2

General Fund Revenues

Riding the Revenue Roller Coaster

Annual Increase in General Fund Revenues – Constant Dollars



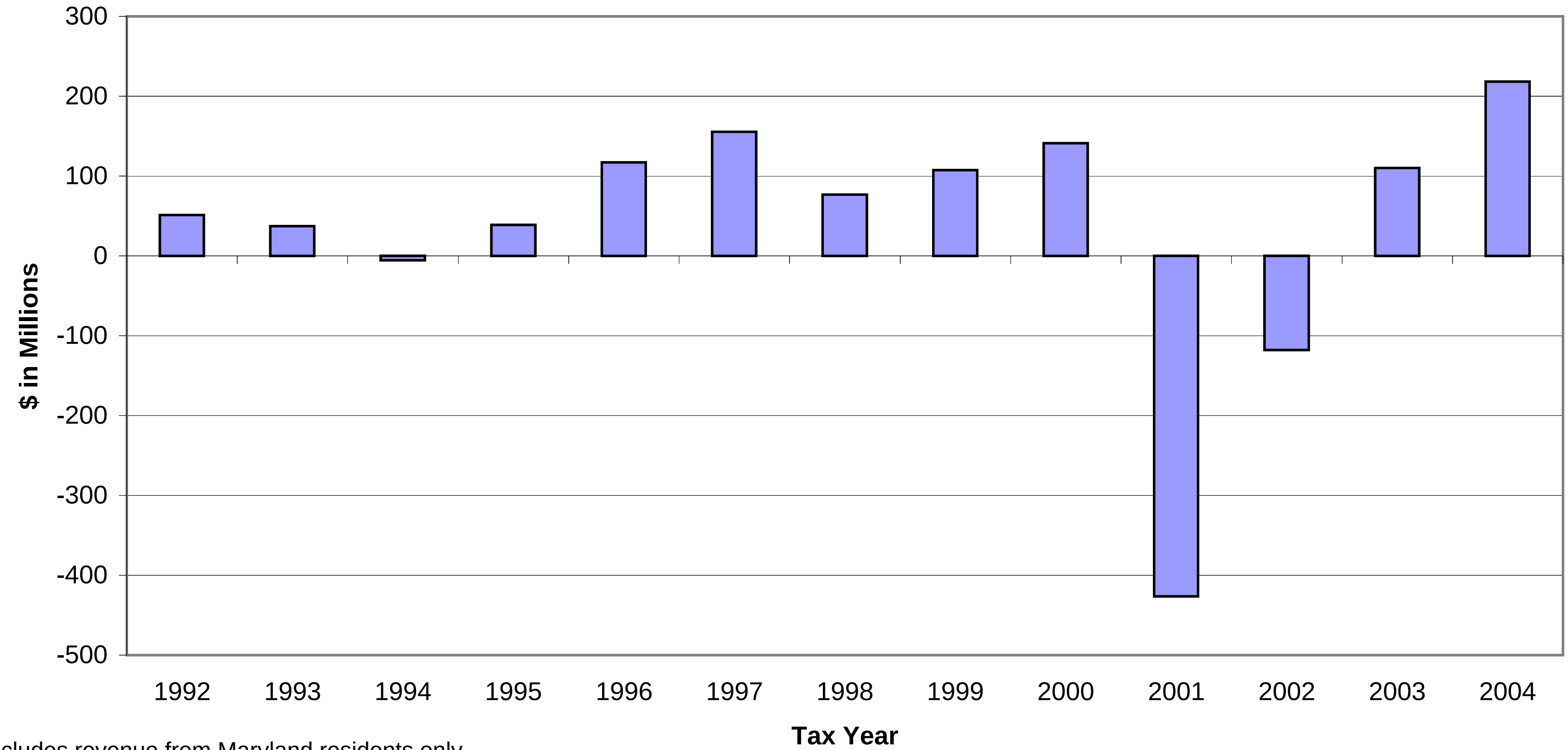
Fiscal 2005 General Fund Revenues
($ in Millions)

Source	Actual FY 2004	Fiscal 2005 Estimate*	Fiscal 2005 Actual	Fiscal 2005 Difference	Percent Change FY 2004-2005
Personal Income Tax	$5,077.6	$5,415.6	$5,660.6	$245.0	11.5%
Sales and Use Tax	2,921.8	3,109.3	3,129.4	20.1	7.1%
State Lottery	436.4	446.2	455.9	9.7	4.5%
Corporate Income Tax	328.6	450.9	512.2	61.4	55.9%
Business Franchise Taxes	190.6	194.9	197.9	3.0	3.8%
Insurance Premiums Tax	260.0	274.1	268.9	-5.2	3.4%
Estate and Inheritance Taxes	153.8	164.3	183.1	18.8	19.1%
Tobacco Tax	272.4	270.2	276.0	5.8	1.3%
Alcohol Beverages Tax	26.9	27.0	27.3	0.4	1.8%
Motor Vehicle Fuel Tax	13.0	13.3	13.2	-0.2	1.0%
District Courts	84.4	84.3	87.4	3.1	3.6%
Clerks of the Court	56.8	47.3	55.5	8.2	-2.4%
Hospital Patient Recoveries	90.9	84.0	85.1	1.1	-6.3%
Interest on Investments	26.6	50.8	64.4	13.6	142.1%
Miscellaneous	301.0	339.9	377.7	37.8	25.5%
Total Current Revenues	**$10,240.7**	**$10,972.1**	**$11,394.7**	**$422.5**	**11.3%**
Delaware Holding Co. Settlements [(1)]	11.5	151.0	151.0	0.0	n/a
Miscellaneous Transfers	2.5	2.3	2.3	0.0	-7.0%
Grand Total	**$10,254.7**	**$11,125.5**	**$11,548.0**	**$422.5**	**12.6%**

* From the Board of Revenue Estimates, March 2005 with adjustments for action at the 2005 legislative session.

(1) In fiscal 2004, a total of $15.2 million in corporate income tax payments were received under the Comptroller's settlement offer relating to the use of Delaware holding companies. Of that amount, $11.5 million went to the general fund and $3.7 million went to the Transportation Trust Fund (TTF). In fiscal 2005, the settlement authorized by SB 187 (2004 session) resulted in payments of $207.8 million and refunds from the Comptroller's settlement program of $9.0 million for a net of $198.7 million. The general fund received $151.0 million and the TTF received $47.7 milion. Because the revenue is of a one-time nature it is not included with the corporate income tax.

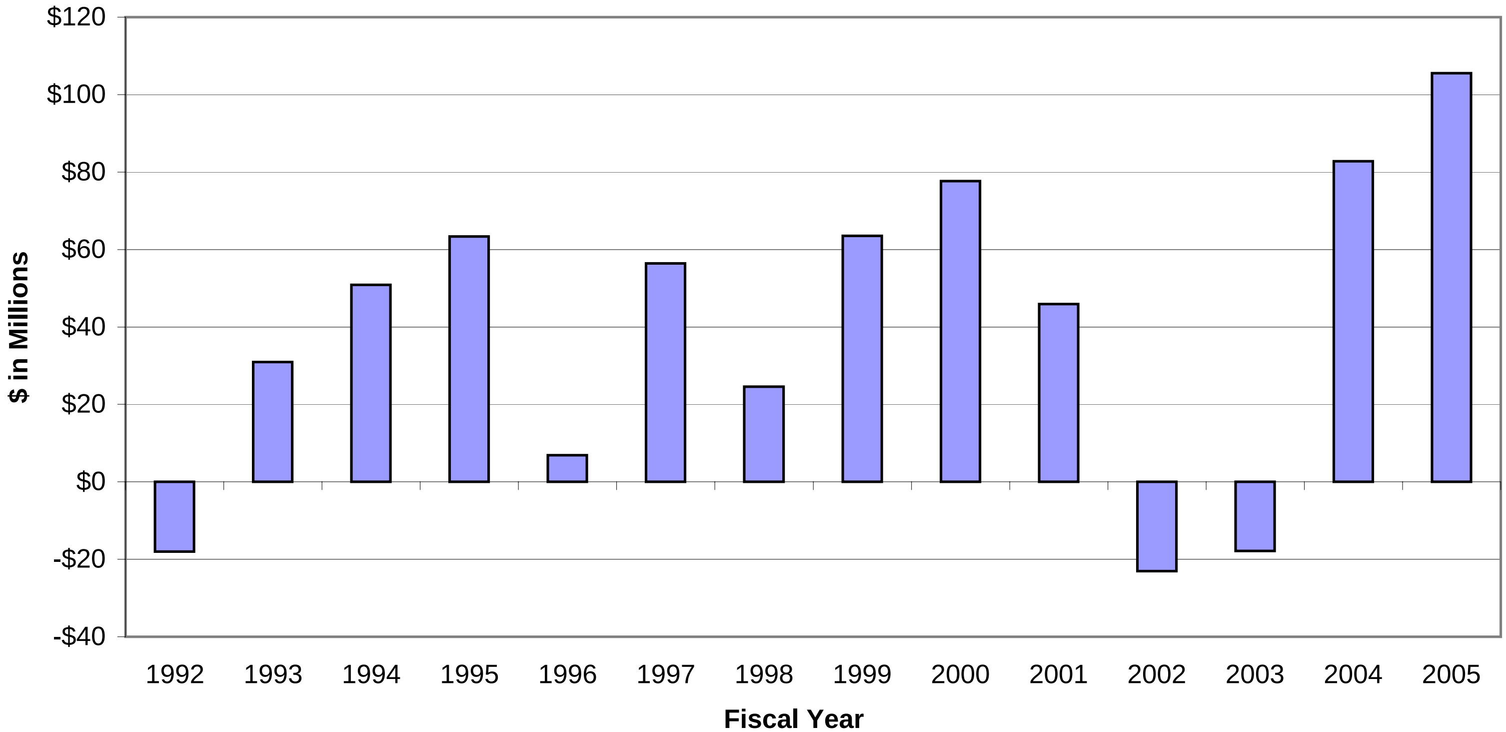
State and Local Personal Income Tax Net Revenue*
Year-over-year Change in Revenue from Capital Gains Income



* Includes revenue from Maryland residents only.

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Year-over-year Change in Total State & Local Personal Income Tax Net Revenue ($ in Millions):													
	339	44	208	211	338	485	290	381	600	-186	-83	270	631
Estimated Revenue from Capital Gains Income as a Percent of Total State & Local Net Revenues:													
	3%	4%	4%	5%	7%	9%	10%	11%	12%	6%	4%	6%	8%

Sales & Use Tax Gross Receipts
Construction, Utilities, and Capital Goods Sectors
Year-over-year Change



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Year-over-year Change in Total Gross Receipts ($ in Millions):		138	103	125	44	109	66	148	201	147	36	18	218	210
Construction, Capital Goods, and Utilities as a Percent of Total Gross Receipts:	30%	29%	31%	32%	31%	33%	33%	33%	34%	34%	32%	31%	32%	33%

Fiscal 2006 General Fund Revenues

($ in Millions)

	Fiscal Year through September			
Source	**FY 2005**	**FY 2006**	**$ Difference**	**% Difference**
Personal Income Tax	$1,055.6	$1,182.0	$126.4	12.0%
Sales and Use Tax	496.3	527.6	31.3	6.3%
State Lottery	100.8	104.2	3.4	3.4%
Corporate Income Tax	105.5	153.9	48.4	45.9%
Business Franchise Taxes	38.8	40.0	1.2	3.1%
Insurance Premiums Tax	62.0	67.3	5.3	8.5%
Estate and Inheritance Taxes	58.9	48.4	-10.5	-17.8%
Tobacco Tax	58.2	56.8	-1.4	-2.4%
Alcohol Beverages Tax	4.6	4.7	0.0	0.9%
Motor Vehicle Fuel Tax	1.1	1.2	0.0	2.2%
District Courts	22.0	22.9	0.9	4.0%
Clerks of the Court	16.9	25.6	8.8	52.0%
Hospital Patient Recoveries (1)	1.3	2.1	0.8	63.7%
Interest on Investments	2.7	15.1	12.4	451.9%
Miscellaneous	29.1	35.6	6.5	22.4%
Current Revenues	**$2,054.0**	**$2,287.5**	**$233.5**	**11.4%**
Delaware Holding Co. Settlements	$45.4			
Total Revenues	**$2,099.4**	**$2,287.5**	**$188.1**	**9.0%**

(1) Includes revenues from Medicare, insurance, and sponsors only.

General Fund Revenue Projections

($ in Millions)

Source	FY 2005 Actual	---- FY 2006 Estimate ---- May*	October	$ Diff.	% Change FY05-06	FY 2007 Estimate	% Change FY06-07
Personal Income Tax	$5,660.6	$5,801.0	$6,127.0	$326.0	8.2%	$6,537.9	6.7%
Sales and Use Tax (1)	3,129.4	3,255.9	3,318.8	62.9	6.1%	3,480.7	4.9%
State Lottery (2)	455.9	463.8	477.6	13.7	4.8%	491.8	3.0%
Corporate Income Tax	512.2	501.3	556.2	54.9	8.6%	589.3	6.0%
Business Franchise Taxes	197.9	194.8	197.7	2.9	-0.1%	199.6	1.0%
Insurance Premiums Tax	268.9	277.3	281.7	4.4	4.7%	292.4	3.8%
Estate and Inheritance Taxes	183.1	160.4	182.9	22.5	-0.1%	193.3	5.7%
Tobacco Tax	276.0	265.7	272.0	6.3	-1.5%	268.2	-1.4%
Alcohol Beverages Tax	27.3	27.4	28.0	0.6	2.3%	28.4	1.6%
Motor Vehicle Fuel Tax	13.2	13.6	13.3	-0.3	1.0%	13.4	1.0%
District Courts (3)	87.4	83.7	89.2	5.4	2.0%	96.9	8.7%
Clerks of the Court	55.5	42.3	54.0	11.6	-2.7%	50.0	-7.4%
Hospital Patient Recoveries	85.1	83.8	83.8	0.0	-1.6%	85.4	2.0%
Interest on Investments	64.4	42.3	108.7	66.3	68.7%	80.2	-26.2%
Miscellaneous	377.7	245.4	279.3	33.9	-26.0%	278.5	-0.3%
Total Current Revenues	**$11,394.7**	**$11,458.9**	**$12,070.0**	**$611.1**	**5.9%**	**$12,686.0**	**5.1%**
Delaware Holding Co. Settlements	151.0	0.0	0.0	0.0	n/a	0.0	n/a
MCI Settlement	0.0	0.0	26.8	26.8	n/a	0.0	n/a
Miscellaneous Transfers	2.3	0.0	0.0	0.0	n/a	0.0	n/a
Grand Total	**$11,548.0**	**$11,458.9**	**$12,096.8**	**$637.9**	**4.8%**	**$12,686.0**	**4.9%**

* From the Board of Revenue Estimates, March 2005, with adjustments for legislative action at the 2005 session.

(1) The vendor credit was halved for fiscal 2003 to 2006, increasing general fund revenues by $14 million to $18 million per year. In fiscal 2007, the vendor credit returns to its previous level, resulting in less general fund revenue relative to fiscal 2006. Fiscal 2007 also reflects the impact of HB 37 (2005 session) which provides for a tax-free period on certain back-to-school items in August 2006.

(2) HB 147 (2005 session) increased the agent commissions from 5.0 to 5.5% starting in Fiscal 2007.

(3) HB 147 (2005 session) increased traffic and criminal court fees from $20.00 to $22.50. In fiscal 2006 that additional revenue goes to the Law Enforcement and Correctional Training Fund. In fiscal 2007 that fund is eliminated and the revenues go to the general fund.

Part 3

General Fund Budget

2007 Baseline Budget Forecast Assumptions

Baseline Budget Concepts

- Current laws, policies, and practices are continued.
- Inflationary increases are recognized.
- Large one-time purchases and nonrecurring PAYGO expenditures are removed.
- Anticipated deficiencies are identified.
- Federal mandates and multi-year commitments are observed.
- Legislation adopted at the prior session is funded.
- Nondiscretionary changes in workload are recognized.
- Full year costs of programs started during the previous year are included.
- Positions and operating expenses associated with new facilities are recognized.
- Employee turnover is adjusted to reflect recent experience.

Caseload Assumptions

	FY 2005	FY 2006	FY 2007	Percent Change FY 06-07
Pupil Enrollment *	828,961	829,007	831,656	0.3%
Medicaid	520,084	526,268	536,310	1.9%
Children's Health	95,019	99,901	101,902	2.0%
Temporary Cash Asst.	65,748	59,053	58,462	-1.0%
Foster Care/Adoption	13,956	14,255	14,628	2.6%

* Data for 2005, 2006, and 2007 reflect 9/03 9/04 and 9/05(est.) full-time equivalent enrollments.

2007 Baseline Budget Forecast Assumptions (Cont.)

Inflation Assumptions

- Employee Health Insurance (11% inflation).
- Medical Contracts and Supplies (5%).
- Prescription Drugs for State Facilities (9%).
- Utilities (8%).
- Motor Vehicle Fuel (34% over fiscal 2006 appropriation).
- Postage (2 cents on standard mail/5.4%).

Employee Compensation

- Merit increases of 2 and 4% based on salary plan.
- Fully fund deferred compensation program.
- No general salary increase for fiscal 2007 (1% equals $27 million in general funds).

Other Assumptions

- Cost increases for the University System of Maryland and Morgan State University are allocated between general funds and tuition and fees based on the current ratio of general funds to tuition and fees.
- No fiscal impact from forthcoming Congressional budget actions is assumed.
- Maintain Cigarette Restitution Fund (CRF) spending at no less than the fiscal 2006 appropriation for each program, restore the tobacco program to the statutorily mandated level, and restore funding for the academic health centers to the fiscal 2005 spending level. Due to litigation which may adversely impact CRF revenues and uncertainty concerning the disposition of $13.4 million of CRF spending authorized in the Budget Reconciliation and Financing Act of 2005, the baseline sets aside as a reserve $26 million of anticipated CRF revenues.

Fiscal 2006 Deficiencies
($ in Millions)

	Dollars
Medicaid: Pay fiscal 2005 bills with fiscal 2006 dollars	$70.0
Medicaid: Fiscal 2006 shortfall due to managed care rate increase ($26 million), underattainment of fiscal 2006 cost containment savings, and development of budget off underfunded fiscal 2005 base	60.0
Foster Care: Lower than budgeted federal fund attainment ($5.6 million) and correcting prior year accounting errors ($23.3 million)	28.9
Public Safety: Underfunding of new inmate medical contract	23.5
Juvenile Services: Underfunding of per diem placements ($14.2 million), fiscal 2005 costs rolled into fiscal 2006 ($4.4 million), and programming changes at Hickey ($1.5 million)	20.1
Vehicle Fuel	5.6
MSDE: Higher than anticipated utilization of services by participants in autism waiver	2.9
Homeowner's Tax Credit Program: Chapter 588, Acts of 2005	1.5
Public Defender: Panel attorneys	1.0
Other	0.7
Subtotal	***$214.1***
Education Aid: Overfunding of formulas	-10.1
Dedicated Purpose Fund: $20 Million reserved to pay fiscal 2005 Medicaid bills	-20.0
Total	**$184.0**

State Expenditures – General Funds
($ in Millions)

Category	Work Appr. FY 2005	Leg. Appr. FY 2006	Baseline FY 2007	$ Diff. 06 to 07	% Diff. 06 to 07
Debt Service	$0.0	$0.0	$0.0	$0.0	n/a
Aid to Local Governments					
General Government	207.6	210.8	224.8	14.0	6.6%
Community Colleges	184.0	191.7	204.1	12.5	6.5%
Education/Libraries	3,683.2	4,072.6	4,625.5	552.9	13.6%
Health	60.9	61.5	63.5	2.0	3.3%
	$4,135.7	**$4,536.6**	**$5,117.9**	**$581.3**	**12.8%**
Entitlements					
Foster Care Payments	172.5	216.4	241.2	24.8	11.5%
Assistance Payments	75.6	48.6	49.9	1.3	2.7%
Medical Assistance	1,906.8	1,989.9	2,258.7	268.8	13.5%
Property Tax Credits	49.2	49.9	52.1	2.2	4.5%
	$2,204.1	**$2,304.9**	**$2,602.0**	**$297.1**	**12.9%**
State Agencies					
Health	1,224.3	1,237.3	1,287.7	50.5	4.1%
Human Resources	314.9	292.6	296.3	3.7	1.3%
Systems Reform Initiative	36.0	34.1	34.1	0.0	0.0%
Juvenile Justice	176.7	175.5	202.1	26.7	15.2%
Public Safety/Police	973.0	1,000.6	1,095.3	94.6	9.5%
Higher Education	851.0	908.0	965.4	57.5	6.3%
Other Education	286.7	320.7	346.2	25.4	7.9%
Agric./Natl. Res./Environment	130.2	120.1	126.8	6.6	5.5%
Other Executive Agencies	505.6	556.6	551.9	-4.7	-0.8%
Judicial/Legislative	341.9	355.3	370.7	15.4	4.3%
	$4,840.2	**$5,000.8**	**$5,276.6**	**$275.7**	**5.5%**
Deficiencies	0.0	184.0	0.0	-184.0	-100.0%
Subtotal	**$11,180.0**	**$12,026.3**	**$12,996.5**	**$970.2**	**8.1%**
Capital/Heritage Reserve Fund	1.2	22.5	30.8	8.3	36.7%
Reserve Fund	114.7	325.7	643.3	317.6	97.5%
Appropriations	**$11,295.8**	**$12,374.5**	**$13,670.6**	**$1,296.1**	**10.5%**
Reversions	-20.0	-22.0	-20.0	2.0	-9.1%
Grand Total	**$11,275.8**	**$12,352.5**	**$13,650.6**	**$1,298.1**	**10.5%**

Components of Budget Change
($ in Millions)

Summary of Budget Change	Dollars	Share of Growth
Ongoing Requirements/Entitlements	$795.8	68%
Legislation	23.1	2%
Commitments	114.4	10%
State Agency Costs	230.8	20%
Subtotal Operating Budget	**$1,164.2**	**100%**
PAYGO	-1.7	
Appropriation to Reserve Fund	317.6	
Total Baseline Increase in State Expenditures	**$1,480.0**	
Less Deficiency Appropriations	-184.0	
Total	**$1,296.1**	

Detail on Components
($ in Millions)

Ongoing Requirements/Entitlements		**$795.8**
Education Formulas	$468.2	
Medical Assistance – Enrollment, Inflation, MCO Rates	233.3	
Foster Care – Cost of Services and Underfunding in FY 2006	24.8	
Higher Education (St. Mary's College, Community Colleges, BCCC, Sellinger Formula)	16.2	
Disparity Grant for Low Wealth Counties	12.9	
Wage Initiative for Providers Serving Developmentally Disabled – Chapter 722, Acts of 2001	11.2	
Heritage Tax Credit Reserve Fund – Chapter 76, Acts of 2004	10.0	
Library Formula Aid and Retirement	4.4	
Autism Waiver – Costs Rise Due to Medical Inflation	3.5	
Formula Aid to Local Governments for Police Protection and Health	2.9	
Mandated Salary Enhancements for Judges and Legislators	2.4	
Mental Hygiene – Inflation and Utilization Offset by Federal Match for Grey Area Patients Participating in Medicaid Primary Care Waiver	2.1	
Formula for Maryland School for the Deaf	1.4	
Per Diem Reimbursements for Inmates in Local Facilities	1.1	
Private Donation Incentive Program – Fund Deferrals	0.9	
Mandated Increase for Maryland State Arts Council	0.5	

Detail on Components (Continued)
($ in Millions)

Legislation		**$23.1**
Biotechnology Investment Tax Credit – Chapter 99, Acts of 2005	$6.0	
Revenues and Expenses Associated with Correctional Training Center Shift from Special to General Funds, Chapter 444, Acts of 2005	6.6	
Challenge Grants, Chapter 444, Acts of 2005	3.8	
Property Tax Credit Program – Chapter 588, Acts of 2005	1.5	
Adult Education, Chapter 305, Acts of 2005	1.5	
Maryland Public Arts Initiative – Chapter 76, Acts of 2005	1.0	
Other Legislation with Impact Less Than $1 Million	2.7	
Commitments		**$114.4**
Geographic Cost of Education Index	$72.1	
Discontinue Medicaid/Mental Health Hospital Day Limits for Adults	37.5	
Juvenile Services: Dept. of Justice Agreement and Changes at Hickey	5.6	
Lease Payments for Wiring Schools for Technology Project	2.8	
Judiciary: Ongoing Information Technology Projects	2.2	
Annualize Fiscal 2006 Cost of New Community Placements of Developmentally Disabled	2.1	
48 Bed Ward at Perkins Hospital to Open July 1, 2007	2.1	
Increase Staffing Levels at Office of the Public Defender	1.1	
Major Information Technology Projects per DBM Schedule	-11.0	
State Agency Costs		**$230.8**
University System of Maryland (USM) and Morgan State University	$56.8	
Employee Increments ($44 million) and Health Insurance ($32.4 million)	76.1	
State Contribution for Employee Retirment	34.9	
Public Safety's Inmate Medical Contract	25.1	
Juvenile Services – Placement Costs Rise Due to Underfunding	14.6	
Utility and Vehicle Fuel Inflation	8.4	
General Funds Replace One-time Special Funds	6.8	
Scholarships Rise by 5.1% to Keep Pace with Tuition at USM	4.8	
Restore $600 Deferred Compensation Match	3.2	
Public Defender – Hourly Rate for Panel Attorneys Increases	3.1	
Vacancy Rate Adjusted to Reflect Current Experience	-6.3	
Other Changes	3.2	
PAYGO		**-$1.7**
State Reserve Fund		**$317.6**
Unappropriated Fund Balance from Fiscal 2005	$343.6	
Remove One-time Appropriation Related to Projected Deficiencies in the Department of Juvenile Services and Medicaid	-22.0	
Remove One-time Appropriation for Pilot Substance Abuse Case Management Program and Catastrophic Event Fund	-4.0	

Underlying Medicaid Growth Is 7%
General Funds
($ in Millions)

	FY 2006	FY 2007	Change	Percent Change
General Fund Appropriation	$1,990.0	$2,258.7	$268.7	13.5%
Deficiency for FY 2006 Services	60	0		
Revised General Fund Total	**$2,050.0**	**$2,258.7**	**$208.7**	**10.2%**
Remove Enhancements/Fund Shifts				
End Hospital Day Limits		-28.1		
MCHP – Fund Shift as Federal Funds Are Exhausted		-10.0		
Development of Long-term Care Waiver		-5.0		
Primary Care Waiver		-13.5		
Underlying General Fund Growth	**$2,050.0**	**$2,202.1**	**$152.1**	**7.4%**

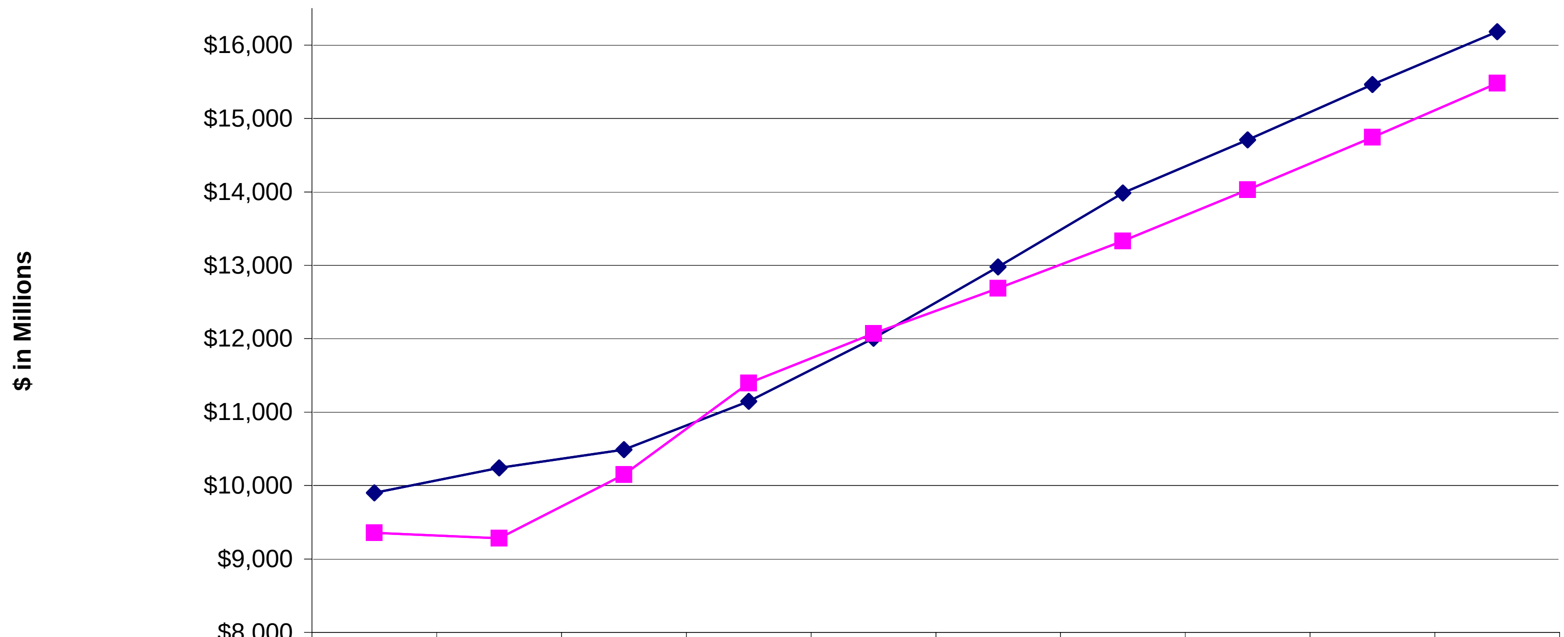
Part 4

General Fund Forecast

General Fund Projections

	Leg. Approp. FY 2006	Baseline FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	Annual Growth Rate FY 07-08	Avg. Annual Growth Rate FY 08-11
Revenues – October 2005 DLS Estimate								
Individual Income	$6,127	$6,538	$6,980	$7,426	$7,880	$8,342	6.8%	6.1%
Sales and Use	3,319	3,481	3,648	3,837	4,028	4,229	4.8%	5.1%
Lottery	478	492	508	526	545	565	3.3%	3.6%
Other	2,147	2,176	2,193	2,239	2,291	2,345	0.8%	2.3%
One-time	27	4	22	29	17	3		
Subtotal	**$12,097**	**$12,690**	**$13,352**	**$14,056**	**$14,761**	**$15,485**	**5.2%**	**5.1%**
Adjustments								
Balance	$1,174	$1,057	$97	$36	$0	$0		
Rainy Day Fund Transfer	0	0	655	95	0	0		
Transfers	139	0	0	0	0	0		
Total Revenues	**$13,410**	**$13,748**	**$14,104**	**$14,188**	**$14,761**	**$15,485**	**2.6%**	**3.2%**
Expenditures								
Debt Service	$0	$0	$0	$19	$56	$58	n/a	n/a
Local Aid – Education\Libraries	4,073	4,626	5,182	5,412	5,630	5,825	12.0%	4.0%
Local Aid – Other	464	492	514	536	559	583	4.4%	4.3%
Entitlements	2,305	2,602	2,788	2,988	3,201	3,429	7.1%	7.1%
State Operations	5,001	5,277	5,521	5,774	6,034	6,308	4.6%	4.5%
Reversions	-22	-20	-20	-20	-20	-20	0.0%	0.0%
Deficiencies	184	0	0	0	0	0		
Subtotal	***$12,004***	***$12,977***	***$13,984***	***$14,709***	***$15,460***	***$16,183***	***7.8%***	***5.0%***
Capital	$23	$31	$33	$3	$2	$2	7.2%	-60.7%
Reserve Fund	326	643	50	50	115	0	-92.2%	-100.0%
Total Expenditures	**$12,353**	**$13,651**	**$14,067**	**$14,762**	**$15,577**	**$16,185**	**3.1%**	**4.8%**
Surplus (Shortfall)	**$1,057**	**$97**	**$36**	**-$574**	**-$817**	**-$700**		
Ongoing Revenues vs. Operating Expenses	**$66**	**-$291**	**-$655**	**-$681**	**-$717**	**-$701**		
Revenue Stabilization Fund								
Ending Balance	$747	$1,380	$769	$707	$740	$775		
As a Percent of Revenues	6.2%	10.9%	5.8%	5.0%	5.0%	5.0%		
Ratio of Operating Revenues to Expenditures	1.01	0.98	0.95	0.96	0.95	0.96		

The Structural Deficit Was Mitigated, but Returns When Education Enhancements Are Implemented in 2008



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Ongoing Spending	$9,901	$10,240	$10,488	$11,148	$12,004	$12,977	$13,984	$14,709	$15,460	$16,183
Ongoing Revenues	$9,356	$9,281	$10,151	$11,395	$12,070	$12,686	$13,329	$14,027	$14,744	$15,482

Fiscal Years

Ongoing Spending   Ongoing Revenues

Maryland's IWIF Long-term Liability Account

	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Estimated Reserves Needed (June 30)	**$194,802,000**	**$212,103,000**	**$222,334,000**	**$231,000,000**	**$240,000,000**	**$249,600,000**
Estimated Long-term Liability Account Balance						
Beginning Balance	$107,518,959	$97,542,503	$4,853,610	$4,188,004	$4,278,573	$14,364,604
State's Contribution (June 30)	20,000,000	20,000,000			10,000,000	
Transfer – 2002 BRFA (June 30)		-39,200,000				
Transfer – 2003 BRFA (June 30)		-75,000,000				
State's Risk Management Office (July 2003)			-800,000			
Interest	4,023,544	1,511,107	134,394	90,569	86,031	287,292
Total Balances at IWIF (June 30)	**$97,542,503**	**$4,853,610**	**$4,188,004**	**$4,278,573**	**$14,364,604**	**$14,651,896**
Balance of Operating Account[1] (June 30)	8,878,842	28,747,480	2,547,781	1,063,952	-1,045,528	-90,544
Unfunded Long-term Liability (June 30)	**$88,380,655**	**$178,501,910**	**$215,598,215**	**$225,657,475**	**$226,680,924**	**$235,038,647**

[1] The balance of the operating account offsets the long-term liability of the State.

- The unfunded long-term liability of the State has increased by 166 percent since fiscal 2002, largely due to transfers out of the account into the general fund in fiscal 2003 and 2004.

- Payment into the long-term liability account is made through agency assessments. In fiscal 2006, after two years without contributions to the account, the Governor chose to appropriate $10.0 million to offset future liability.

- There are no current plans to increase agency assessments in fiscal 2007 to lower the State's long-term liability.

Pension Contribution Rates and Corridor Funding

- Chapter 440, Acts of 2002 established what is known as the "corridor method" of pension funding. By this method, the contribution rates for the Employees' and Teachers' pension systems are frozen at 2002 levels, so long as the systems remain actuarially funded between 90 and 110 percent inclusive. Once a system "falls outside" the corridor, there is an increase in the contribution rate equal to 20 percent of the difference between the true actuarial rate for that year and the prior year's rate.

- The Employees and Teachers' systems have both fallen out of the corridor with actuarial funding levels at the end of fiscal 2005 of 84.9 and 89.3 percent, respectively. Additionally, the current rate for the Employees' system under the corridor is 0.67 percent less that the "normal cost" rate of 7.5 percent which represents the cost of benefits being earned in the current year.

Plan	FY 2005 Rate	FY 2006 Rate	FY 2007 Rate	FY 2007 True Rate	Normal Cost Rate	Actuarial Funding Level	FY 2007 Budget Increase	Contribution Amount below Normal Cost
Corridor-Funded Plans								
Employees	4.73%	5.76%	6.83%	11.11%	7.50%	84.9%	$36.5	$19.1
Teachers	9.35%	9.35%	9.71%	11.17%	7.70%	89.3%	42.5	-
Non-Corridor-Funded Plans								
State Police	0.00%	8.22%	13.83%	13.83%	25.05%*	100.3%	4.9	-
Judges	36.72%	41.12%	42.43%	42.43%	28.15%	79.3%	0.7	-
LEOPS	37.73%	38.47%	40.60%	40.60%	21.25%	59.8%	3.1	-
Aggregate	**7.97%**	**8.46%**	**9.18%**	-	-	87.8%	87.7	19.1

Note: Funding levels reflect State funds only and exclude any municipal contributions or funds.
*State Police Unfunded Actuarial Amortization Rate is -11.22%, which offsets the normal cost rate.

Source: Milliman, USA

Retiree Health Care Liabilities
Shown on State's Financial Statement in Fiscal 2008

- Governmental Accounting Standards Board (GASB) Statement No. 45 will require the State to apply an accounting methodology similar to the one used for pension liabilities to Other Post Employment Benefits (OPEB), including retiree health benefits, beginning in fiscal 2008.

- The Department of Budget and Management contracted with AON Consulting to perform an actuarial valuation of retiree health care liabilities for the Task Force to Study Retiree Health Care Funding Options (established by Chapter 298, Acts of 2005).

- The report submitted by AON estimated the actuarial accrued liability for retiree health benefits is approximately $20.4 billion. Under the GASB 45 standards, this will result in an Annual Required Contribution (ARC) amount of $1.96 billion.

- Any amount of the ARC that the State does not pay in a fiscal year will appear on the State's financial statement as a Net OPEB Obligation (NOO). Because the ARC incorporates the approximately $311 million in costs that the State would have paid for retiree benefits on a pay-as-you-go basis, if no additional contributions are made, the NOO shown on the State's financial statement will be $1.65 billion.

- If the State establishes a mechanism to prefund liabilities similar to the pension system, to the extent the State pays into the fund, the State can use a similar long-term investment return assumption (7.75 percent) as opposed to the return on other State investments (5 percent).

Discount Rate	**5.0% ($ Billions)**	**7.75% ($ Billions)**
Actuarial Accrued Liability for Retiree Health Benefits	$20.4	$13.0
Annual Required Contribution Amount	$1.9	$1.4
Net OPEB Obligation (on Financial Statement)	$1.6	$1.1

Why Does the State Care About GASB 45?

Bond rating agencies will be looking to see how states are dealing with the following OPEB liabilities:

- **Fitch Ratings:** "*… will view OPEB liabilities, like pensions, as soft liabilities, that fluctuate based on assumptions and actual experience. Reality dictates that an entity may opt to defer OPEB funding in times of budget stress. However, indefinite deferrals are damaging to credit quality. While not debt, pension and OPEB accumulated costs are legal or practical contractual commitments that form a portion of fixed costs. Long-term deferral of such obligations is a sign of fiscal stress that will be reflected in ratings.*"

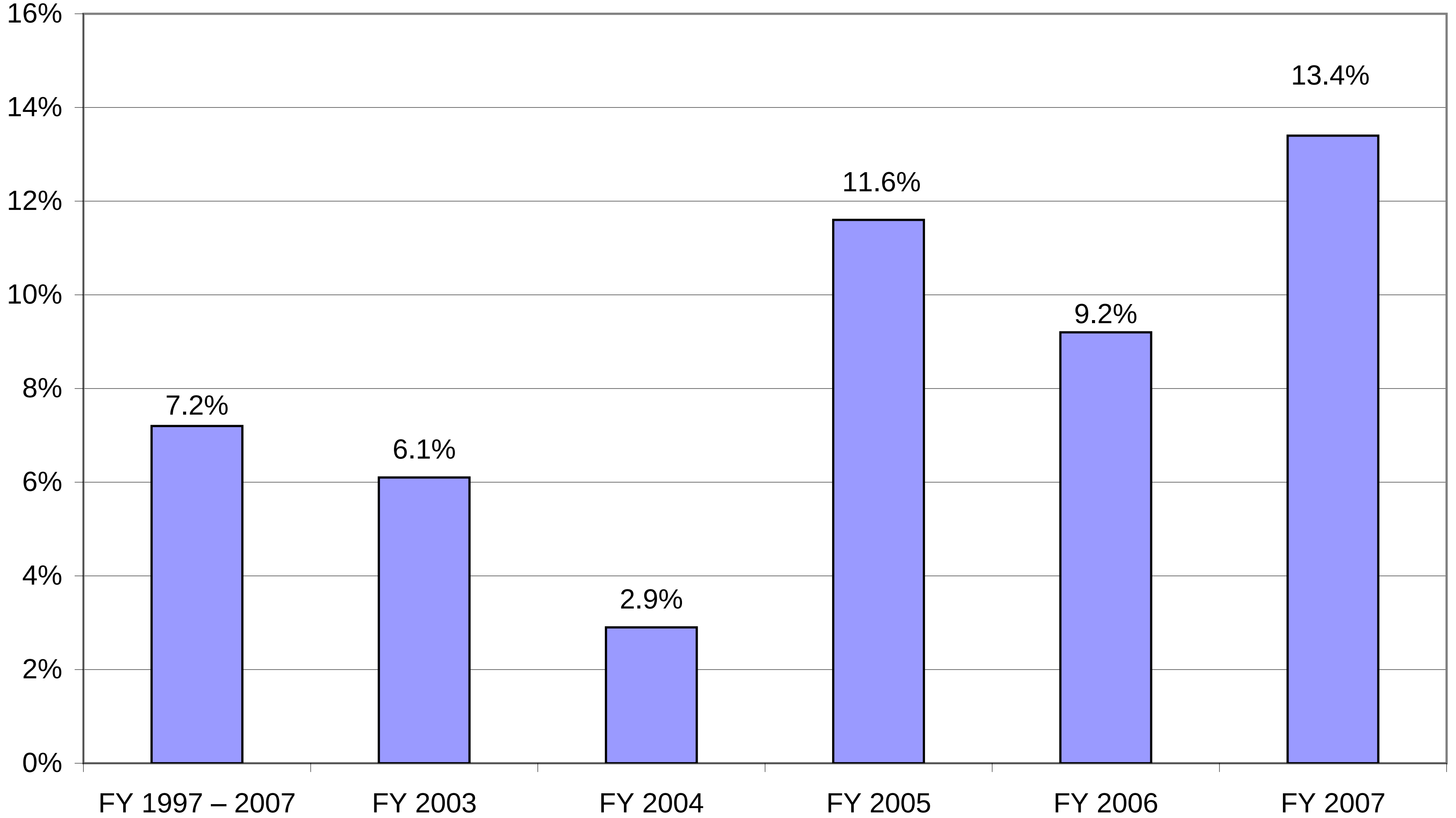
- **Moody's:** "…*does not anticipate that the liability disclosures will cause immediate rating adjustments on a broad scale… It is more likely that rating levels will be affected by observations of changes in OPEB funding measurements over time. Plan for UAAL (unfunded actuarial accrued liability) amortization, amortization periods, use of debt, and differences between actual and required contributions will also figure into the analysis. Issuers' flexibility under relevant statutes or contracts to modify their post-employment health benefit offering will also likely be another focal point… state or local government's effectiveness and initiative in OPEB liability management probably will influence our overall assessment of the government's management strength.*"

- **Standard & Poor's:** "*… will analyze OPEB obligations in the same way it currently evaluates pension obligations. As unfunded actuarial assumed liabilities of public pension plans are considered in the rating process as tantamount to bonded debt of the fund's sponsors, the unfunded OPEB liabilities will be viewed in a similar way… an increasing net OPEB obligation would be a negative rating factor, just as an increasing net pension obligation would be… Close attention will be paid to the newly quantified OPEB unfunded liabilities, given their expected magnitude, and to employers' strategies for managing them.*"

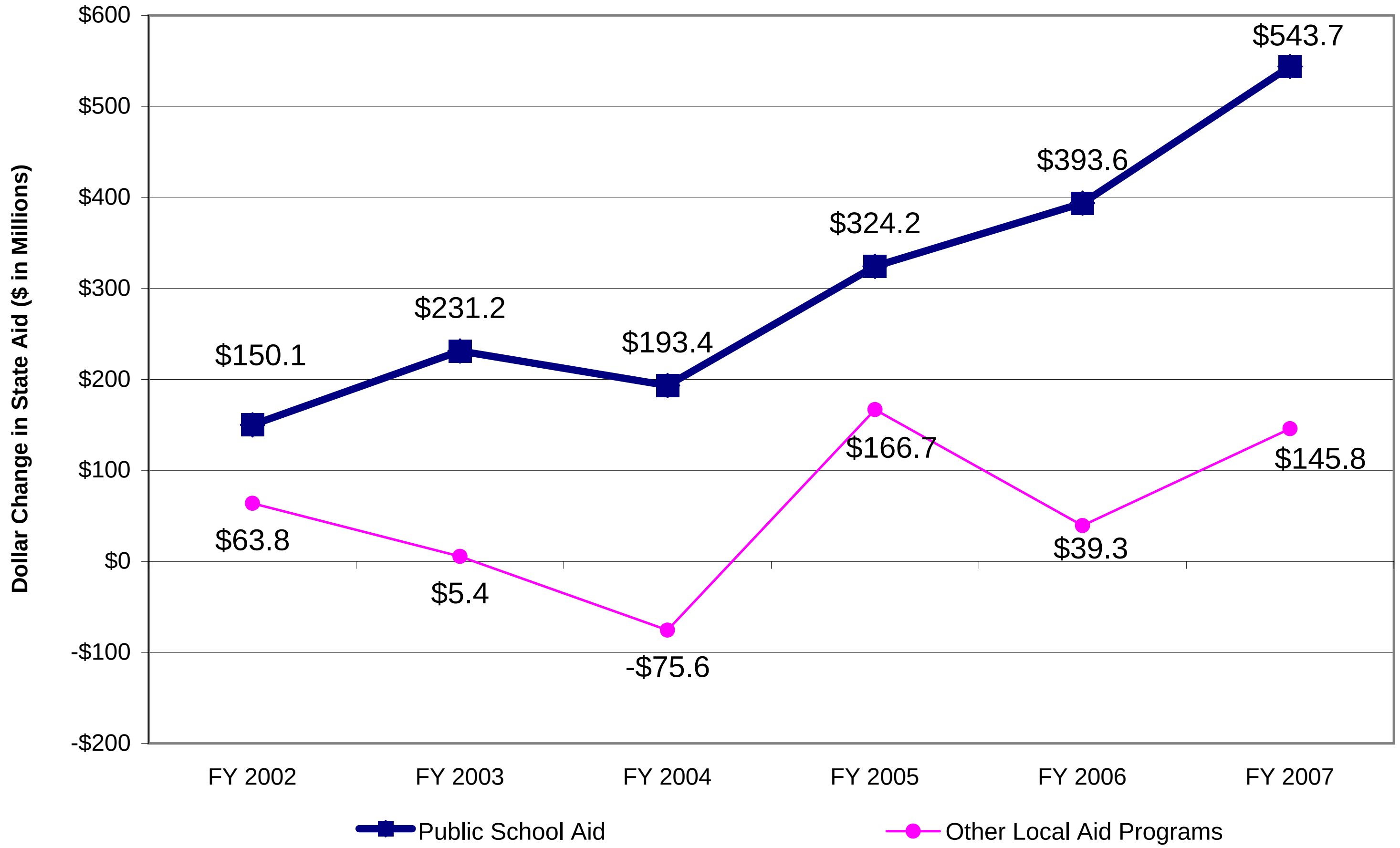
Part 5

Local Government Assistance

Annual Growth in State Aid to Local Governments
General and Special Funds

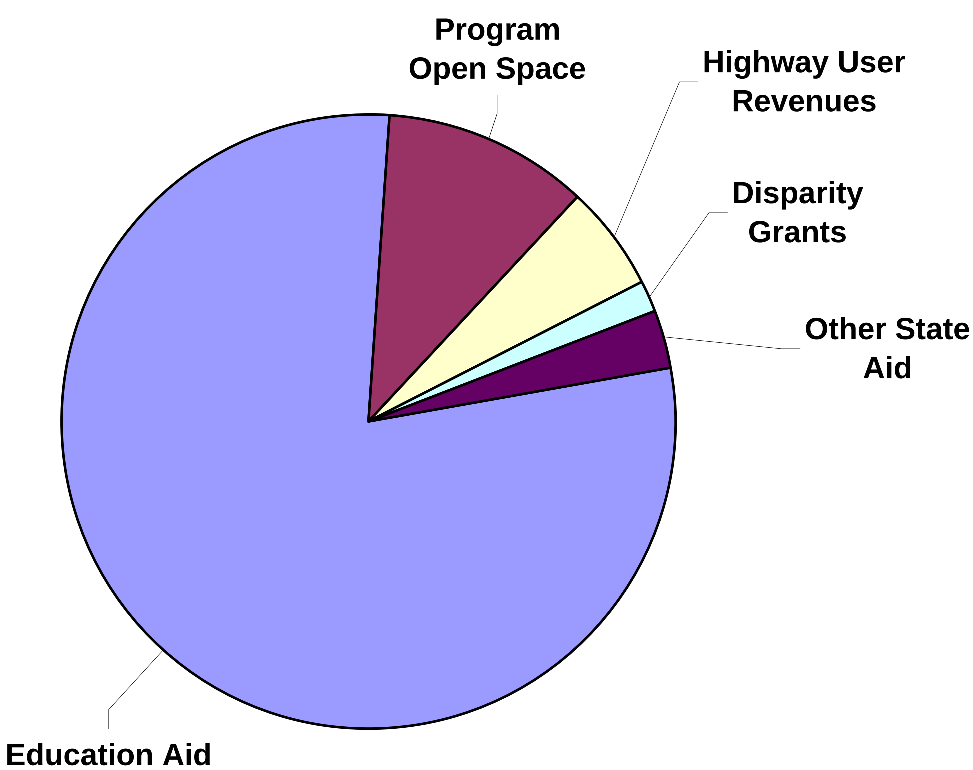


Growth in Education Aid Exceeds Other Programs
General and Special Funds



Programs Driving State Aid Increase in Fiscal 2007
State Funds
($ in Millions)

	State Aid Increase	Percent of Increase
Education Aid	$543.7	78.9%
Program Open Space	74.3	10.8%
Highway User Revenues	38.2	5.5%
Disparity Grants	12.9	1.9%
Other State Aid	20.5	3.0%
Total State Aid Increase	**$689.6**	**100.0%**



State Aid by Governmental Entity

Amount and Percent of Total
State Funds
($ in Millions)

	FY 2007 State Aid Amount	Percent of Total
Public Schools	$4,572.1	78.2%
County/Municipal	950.4	16.3%
Community Colleges	204.1	3.5%
Local Health	63.5	1.1%
Libraries	55.1	0.9%
Total	**$5,845.1**	**100.0%**

Increase in State Aid by Governmental Entity
State Funds
($ in Millions)

	FY 2007 Aid Increase	Percent Increase
Public Schools	$543.7	13.5%
County/Municipal	126.9	15.4%
Community Colleges	12.5	6.5%
Local Health	2.0	3.3%
Libraries	4.4	8.8%
Total	**$689.6**	**13.4%**

State Aid by Major Programs
Fiscal 2005 – 2007
State Funds
($ in Millions)

	FY 2005	FY 2006	Baseline FY 2007	Difference	Percent Difference
Public Schools					
Foundation Program	$2,114.6	$2,308.3	$2,503.1	$194.8	8.4%
Compensatory Aid	488.1	607.2	742.4	135.3	22.3%
Student Transportation	175.5	187.1	203.4	16.3	8.7%
Special Education – Formula	157.6	191.3	234.3	43.0	22.5%
Special Education – Nonpublic	108.8	111.0	119.9	8.9	8.1%
Limited English Proficiency	51.3	67.8	88.7	21.0	30.9%
Guaranteed Tax Base	19.1	38.7	60.2	21.4	55.3%
Geographic Cost Index	0.0	0.0	72.1	72.1	
Other Education Programs	116.5	110.1	101.8	-8.3	-7.5%
Subtotal Direct Aid	**$3,231.5**	**$3,621.4**	**$4,125.9**	**$504.5**	**13.9%**
Retirement Payments	403.2	406.9	446.1	39.3	9.7%
Total Public School Aid	**$3,634.7**	**$4,028.3**	**$4,572.1**	**$543.7**	**13.5%**
Libraries					
Library Aid Formula	$27.8	$28.0	$30.6	$2.6	9.3%
State Library Network	14.2	14.2	15.2	1.0	7.3%
Subtotal Direct Aid	**$41.9**	**$42.2**	**$45.9**	**$3.6**	**8.6%**
Retirement Payments	8.4	8.4	9.2	0.8	9.4%
Total Library Aid	**$50.4**	**$50.6**	**$55.1**	**$4.4**	**8.8%**
Community Colleges					
Community College Formula	$146.6	$154.1	$162.7	$8.6	5.6%
Other Programs	21.4	21.7	23.8	2.1	9.6%
Subtotal Direct Aid	**$167.9**	**$175.9**	**$186.5**	**$10.7**	**6.1%**
Retirement Payments	16.0	15.7	17.6	1.8	11.7%
Total Community College Aid	**$184.0**	**$191.6**	**$204.1**	**$12.5**	**6.5%**
Local Health Grants	**$60.9**	**$61.5**	**$63.5**	**$2.0**	**3.3%**
County/Municipal Aid					
Transportation	$459.1	$538.3	$576.5	$38.2	7.1%
Public Safety	100.1	101.2	102.1	0.9	0.9%
Program Open Space/Recreation	17.3	47.0	121.3	74.3	158.2%
Disparity Grant	93.1	96.6	109.5	12.9	13.3%
Utility Restructuring Grant	30.6	30.6	30.6	0.0	0.0%
Unclaimed Income Taxes	81.0	0.0	0.0	0.0	
Other Grants	9.8	8.1	8.7	0.6	7.2%
Subtotal Direct Aid	**$791.1**	**$821.8**	**$948.7**	**$126.9**	**15.4%**
Retirement Payments	1.6	1.7	1.7	0.0	0.0%
Total County/Municipal Aid	**$792.7**	**$823.5**	**$950.4**	**$126.9**	**15.4%**
Total State Aid	**$4,722.6**	**$5,155.5**	**$5,845.1**	**$689.6**	**13.4%**

Sixteen Counties Changed Local Tax Rates in Fiscal 2006

- 3 Counties Increased Various Local Taxes

Allegany	Transfer Tax
Carroll	Hotel/Motel Tax
Cecil	Recordation Tax

- 8 Counties Decreased Property Taxes

Anne Arundel	Dorchester	Somerset
Baltimore City	Harford	Talbot
Caroline	Montgomery	

- 1 County Decreased Property and Income Taxes

St. Mary's

- 4 Counties Decreased Property Taxes but Increased Hotel/Motel Taxes

Garrett	Kent	Queen Anne's	Wicomico

Number of Counties Changing Local Tax Rates

Comparing Fiscal 2001 and 2006

	Counties with Higher Tax Rate		Counties with Lower Tax Rate	
	Number	**Percent of Population**	**Number**	**Percent of Population**
Property	7	25.6%	12	61.7%
Income[1]	7	42.1%	1	1.7%
Recordation	10	39.0%	0	0.0%
Transfer	2	3.8%	1	0.6%
Admissions/Amusement	2	3.2%	0	0.0%
Hotel/Motel	11	14.7%	0	0.0%

[1] The comparison of income tax rates is from calendar 2002 and 2006.

Assessment Increases Push Local Revenues Upward in Fiscal 2006

County	Full Cash Value Increase Before Cap (Over 3 Years)	Average Annual Increase	County Assessment Cap
Allegany	10.6%	3.5%	10%
Anne Arundel	47.6%	15.9%	2%
Baltimore City	21.6%	7.2%	4%
Baltimore	38.1%	12.7%	4%
Calvert	50.4%	16.8%	10%
Caroline	38.9%	13.0%	10%
Carroll	42.2%	14.1%	7%
Cecil	33.1%	11.0%	10%
Charles	47.2%	15.7%	10%
Dorchester	32.5%	10.8%	10%
Frederick	56.0%	18.7%	10%
Garrett	39.2%	13.1%	5%
Harford	37.6%	12.5%	10%
Howard	48.5%	16.2%	5%
Kent	46.5%	15.5%	5%
Montgomery	65.0%	21.7%	10%
Prince George's	40.1%	13.4%	3%
Queen Anne's	48.3%	16.1%	10%
St. Mary's	37.2%	12.4%	5%
Somerset	49.5%	16.5%	10%
Talbot	47.9%	16.0%	0%
Washington	32.4%	10.8%	10%
Wicomico	21.3%	7.1%	10%
Worcester	26.7%	8.9%	5%
Statewide	**46.6%**	**15.5%**	**10%**

Source: Department of Assessments and Taxation

- The average increase in the full cash value of property reassessed for 2005 was 46.6% statewide, ranging from 10.6% in Allegany County to 65.0% in Montgomery County.

- This is the largest increase in Maryland since the beginning of triennial reassessments in 1980.

- The increase in the full cash value of property is phased-in over a three-year period, resulting in an average annual increase of 15.5%.

- This assessment increase will generate additional revenues for local governments beginning in fiscal 2006.

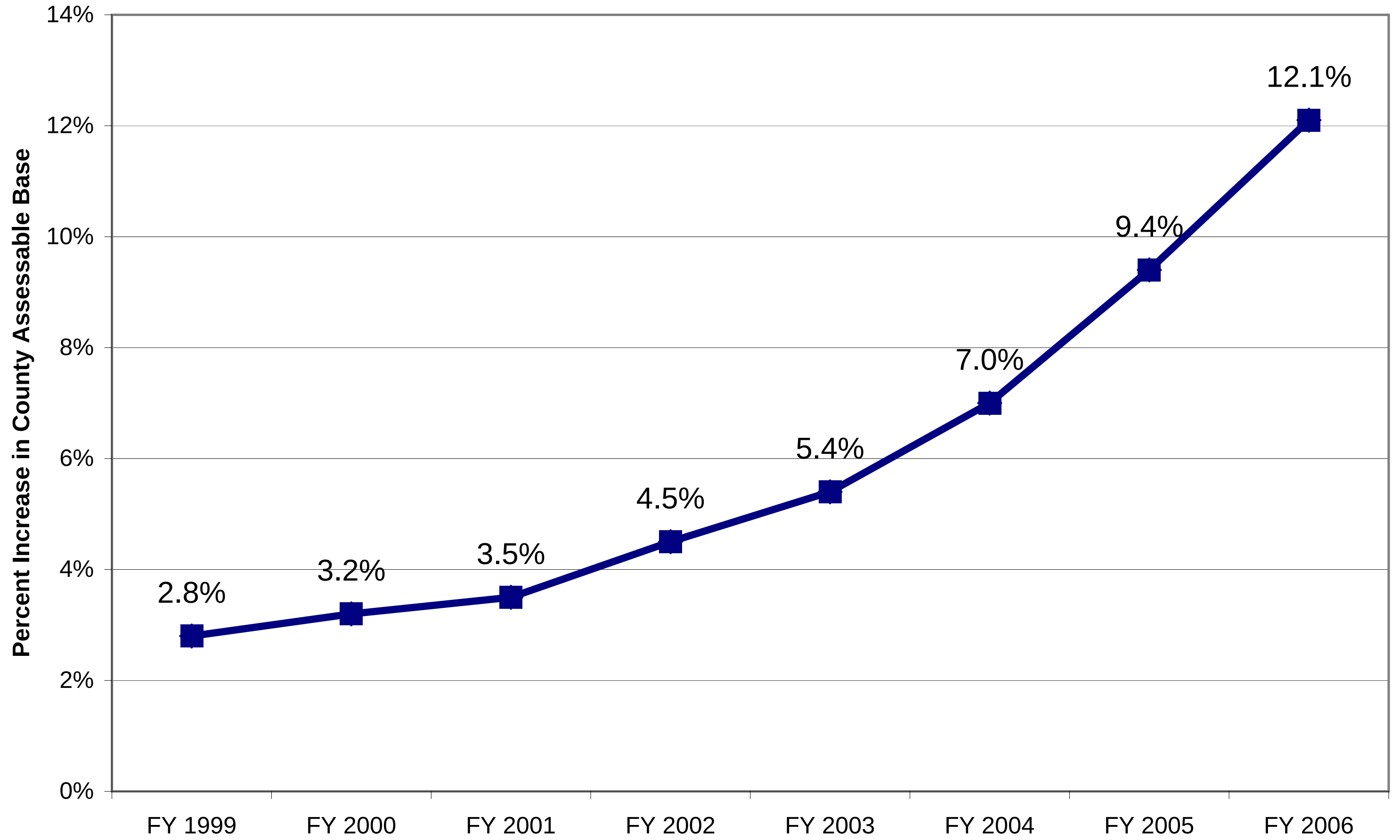
- This growth in property assessments is partially curtailed by the Homestead Property Tax Credit Program which limits the increases in owner-occupied property assessments that are subject to taxation.

- The State requires the cap on assessment increases to be set at 10% for State property tax purposes; however, local governments have the authority to lower the cap.

- In fiscal 2006, 11 of the State's 24 local jurisdictions have assessment caps below 10%, affecting 62% of the State's population.

County Assessable Base Continues to Increase

Fiscal 1999 – 2006



Assessment Process in Maryland
Limits the Impact of Sharp Increases in Property Values

	FY 2001	FY 2006	Percent Change	Annualized Percent Change
Montgomery County				
Average Assessment	$216,682	$306,771	41.6%	7.2%
Tax Rate	$1.02	$0.97	-5.3%	-1.1%
Property Tax Bill	$2,212	$2,966	34.1%	6.0%
Fairfax County				
Average Assessment	$205,753	$444,766	116.2%	16.7%
Tax Rate	$1.23	$1.00	-18.7%	-4.1%
Property Tax Bill	$2,531	$4,448	75.7%	11.9%

- In Montgomery County, property reassessments are conducted every three years, and assessment growth is capped at 10%.

- In Fairfax County, property reassessments are conducted on an annualized basis, and there is no cap on assessment growth.

Local Government Salary Actions in Fiscal 2006

County	County Government COLA	County Government Step	Board of Education COLA	Board of Education Step
Allegany	3.00%	Yes	4.00%	Yes
Anne Arundel[1]	3.00%	Yes	4.00%	Yes
Baltimore City[2]	4.00%	Yes	3.00%	Yes
Baltimore	3.00%	Yes	4.00%	Yes
Calvert	3.00%	Yes	3.60%	Yes
Caroline	5.00%	Yes	3.00%	Yes
Carroll	2.00%	Yes	3.00%	Yes
Cecil	2.00%	Yes	3.00%	No
Charles	4.20%	Yes	4.00%	Yes
Dorchester[3]	5.00%	No	1.50%	Yes
Frederick	3.00%	Yes	3.00%	Yes
Garrett	2.00%	Yes	3.00%	Yes
Harford[4]	3.00%	Yes	3.00%	No
Howard[5]	3.00%	Yes	3.00%	Yes
Kent[6]	n/a	n/a	2.00%	Yes
Montgomery[7]	2.75%	Yes	2.75%	Yes
Prince George's[8]	2.50%	Yes	2.50%	Yes
Queen Anne's	2.00%	Yes	2.75%	Yes
St. Mary's[9]	3.00%	Yes	5.00%	Yes
Somerset	2.50%	Yes	4.00%	Yes
Talbot	0.00%	Yes	1.00%	Yes
Washington[10]	4.00%	No	3.00%	Yes
Wicomico[11]	3.00%	No	4.00%	Yes
Worcester	3.00%	Yes	3.00%	Yes
Number Granting	22	20	24	22

Comments

[1] In Anne Arundel County, police officers and firefighters received a cost-of-living adjustment (COLA) of 2%. School administrators and principals received a 3% COLA.

[2] In Baltimore City, firefighters (IAFF) and police officers (FOP) received a 3% COLA (effective January 1, 2006), and professional employees (MAPS) received a 2% COLA. Salary adjustments for AFSCME, 558 (nurses) have yet to be decided.

[3] In Dorchester County, school administrators received a 3% COLA, but do not have step increases.

[4] In Harford County, while teachers and school administrators did not receive step increases, they did received a market adjustment of 4% to implement a new pay plan.

[5] In Howard County, police officers (IUPA) and firefighters (IAFF) received a 4% COLA, corrections received a 1% COLA.

[6] Kent County is currently undertaking salary restructuring.

[7] In Montgomery County, firefighters (IAFF) and fire management received a 4% COLA.

[8] In Prince George's County, crossing guards, and civilian employees of both the sheriff's office and corrections received a 2.5% COLA, as well as merit increases. Salary adjustments for other bargaining units are in negotiations.

[9] In St. Mary's County, sworn officers received a COLA of 1.5%.

[10] In Washington County, school administrators received a 2.42% COLA, while educational support personnel received a 6% COLA provided that educational support personnel do not receive a COLA in fiscal 2007.

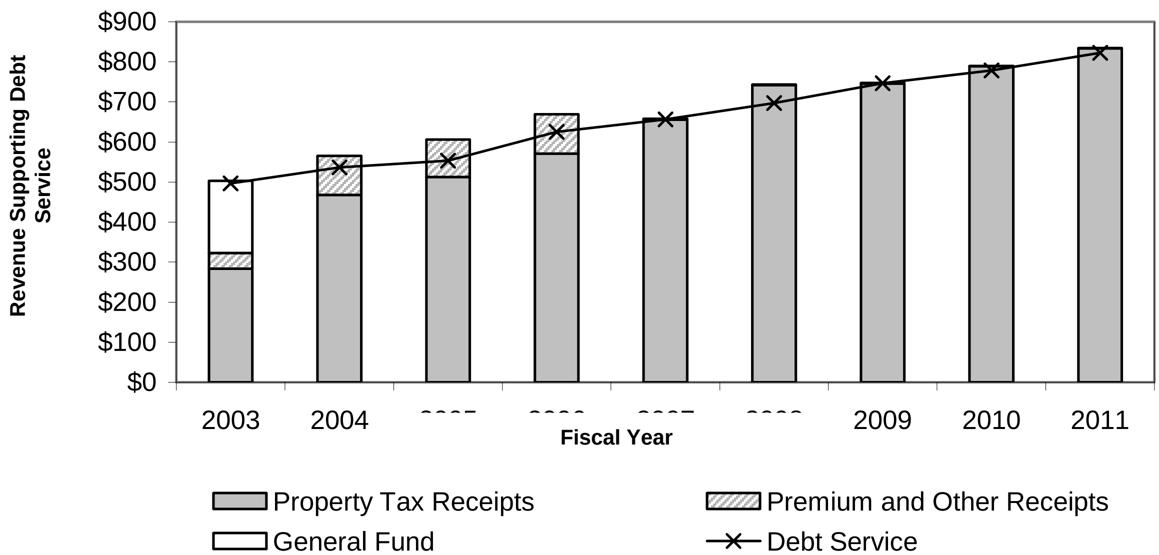
[11] In Wicomico County, teachers received an additional 1% salary adjustment for an additional workday.

Source: Department of Legislative Services October 6, 2005

Part 6

Debt Management

Annuity Bond Fund
Revenues Supporting General Obligation Bond Debt Services Expenditures
Fiscal 2003 – 2011
($ in Millions)



Sources: State Department of Assessments and Taxation, Department of Budget and Management, Department of Legislative Services, November 2005

- In fiscal 2004 the State property tax was increased 4.8 cents.

- Before the tax increase, State property tax receipts supported 57% of debt service costs and general funds supported 36 percent of GO bond debt service costs.

- From fiscal 2004 to 2007, State property taxes combined with bond sale premiums provide sufficient revenues to support GO bond debt service costs.

- Beginning in fiscal 2008, extraordinary growth in property tax assessments increases projected property tax revenues to a level that supports growing debt service costs and provides for a $216 million Annuity Bond Fund balance at the end of the forecast period.

Annuity Bond Fund
Effect of Reducing State Property Tax Rate
Fiscal 2007 – 2011
($ in Millions)

	General Fund Subsidy					
State Property Tax Rate	**FY 07**	**FY 08**	**FY 09**	**FY 10**	**FY 11**	**Total**
No State Property Tax Rate Reduction ($0.132 per $100 of Assessable Base)	$0	$0	$0	$0	$0	$0
One Cent Reduction	0	0	0	17	51	68
Two Cent Reduction	0	18	112	108	115	353
Three Cent Reduction	2	122	167	169	177	637
Reduce to Fiscal 2003 Level ($0.084 per $100 of Assessable Base)	91	222	269	276	290	1,148

Sources: Department of Assessments and Taxation, Department of Budget and Management, Department of Legislative Services, November 2005

- Significant growth in property tax revenues combined with bond sale premiums result in an estimated $127 million balance in the Annuity Bond Fund (ABF) at the end of fiscal 2006, which supports State GO bond debt service.

- Based on current estimates, maintaining the State property tax rate at $0.132 per $100 of assessable base does not require a general fund subsidy. This provides for $216 million fund balance at the end of fiscal 2011.

- Reducing the rate one cent is not projected to have a general fund effect until fiscal 2010, when a $17 million general fund subsidy would be required.

- A two cent reduction does not require general funds until fiscal 2008, when an $18 million subsidy is required. The annual subsidy is projected to increase to over $100 million in subsequent years.

- Reducing the rate back to the fiscal 2003 level requires a general fund subsidy totaling $91 million in fiscal 2007 and over $1.1 billion through fiscal 2011.

General Obligation Bonds

2005 Capital Debt Affordability Committee Recommendations

- The Capital Debt Affordability Committee (CDAC) recommends that the General Assembly authorize up to $690 million in GO bonds in the 2006 legislative session.

- This provides a $20 million increase over the authorization in the 2005 legislative session.

- This represents a change in the committee's authorization policy. Previously, the committee recommended that authorizations increase by $15 million annually. The policy was modified to allow for 3 percent annual increases.

Proposed Debt Levels Meet CDAC Criteria

- CDAC criteria are that:

  - tax-supported debt outstanding should not exceed 3.2 percent of Maryland personal income; and

  - tax-supported debt service payments should not exceed 8 percent of State revenues.

- The table below shows the projections based on authorizing $690 million in fiscal 2007. The proposed authorization meets the affordability criteria:

Fiscal Year	**Debt Outstanding as a Percent of Personal Income**	**Debt Service as a Percent of Revenues**
2006	2.80%	5.69%
2007	2.79%	5.86%
2008	2.91%	5.98%
2009	2.91%	6.35%
2010	2.94%	6.36%
2011	2.92%	6.52%

Total State Debt

Unused State Debt Capacity Is Reduced
($ in Millions)

Debt Outstanding June 30, 2010	January 2005	November 2005	Variance
GO Bonds	$5,760	$5,920	$160
Capital Leases	93	171	79
Transportation Bonds	1,760	1,850	90
Grant Anticipation Revenue Vehicles (GARVEEs)	0	608	608
Stadium Authority Bonds	236	236	0
Bay Restoration Bonds	339	349	10
Total Debt Outstanding	**$8,188**	**$9,135**	**$947**
Estimated Personal Income in 2010	**$301,297**	**$310,234**	**$8,937**
Unused Capacity	**$1,453**	**$792**	**-$661**
Fiscal 2010 Debt Outstanding as Percent of Personal Income	**2.72%**	**2.94%**	**0.23%**

Factors Influencing State Debt Capacity

- Total excess capacity is reduced $661 million since January 2005.
- GARVEE issuances are now included as State debt, reducing capacity by $608 million.
- Policy to authorize more GO bonds adds $160 million in GO debt outstanding, thus reducing unused capacity.
- Increased issuances are offset by higher personal income estimates, which provide an additional $285 million in State debt capacity.

General Obligation Bonds

Taxable Debt Costs More

- The State's capital program supports a number of different public policy objectives such as health, environmental, public safety, education, housing, and economic development objectives. Federal government regulations allow the State to issue debt that does not require the buyer to pay federal taxes on interest earnings.

- Federal laws and regulations limit the kinds of activities that can be supported with proceeds from tax-exempt bonds.

- To avoid exceeding the private activity limits imposed in the federal regulations, the State has previously appropriated funds in the operating budget instead of issuing debt for private activity programs and projects. Recent years' fiscal constraints have limited the amount of operating funds available for capital projects.

- In 2005 the State reached its limit, with respect to private activity exemptions in tax-exempt issuances, and the State sold taxable debt.

- In March 2005, Maryland issued $25 million in taxable debt, all maturing within three years.

  - The True Interest Cost (TIC) was 3.87 percent, which is 125 basis points higher than a comparable tax-exempt issuance (2.62 percent).

  - Taxable debt service costs exceed tax-exempts costs by over $500,000.

- In July 2005, Maryland issued $20 million in taxable debt, all maturing within seven years.

  - The TIC was 4.43 percent, which is 131 basis points higher than a comparable tax-exempt issuance (3.12 percent).

  - Taxable debt issued at this bond sale increased State expenditures by approximately $1.1 million.

General Obligation Bonds

Efficiency Recommendation – Minimize GO Bond Debt Service Budget

Recommend Appropriating Operating Funds Instead of Issuing Taxable Debt

- As a by-product of the most recent fiscal downturn, the State reduced operating budget support for the capital program and has issued taxable debt.

- Taxable debt has resulted in higher borrowing costs. The State's 2005 issuances of $45 million in taxable debt cost $1.6 million more than issuing tax-exempt debt.

- **To reduce borrowing costs and provide for a more efficient capital program, it is recommended that the Administration appropriate general funds for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds.**

Recommend One-time Exclusion to Migrate Taxable Debt Back into the Operating Budget

- Current Spending Affordability Committee (SAC) policy is to include revolving loan fund capital programs receiving general funds in the SAC spending limit.

- This could create a disincentive to move funding for these capital programs back into the general fund.

- **To eliminate a potential disincentive to restore general fund appropriations for capital programs and projects that are not eligible to receive bond proceeds from tax-exempt bonds, it is recommended that SAC exclude PAYGO capital general fund appropriations made in the 2006 legislative session from the affordability calculation. This exclusion should be limited to projects previously funded with GO bonds that are funded with general funds instead.**

General Obligation Bonds' Capital Program

- As required by State Finance and Procurement Article §8-113 the Governor provided a preliminary determination of the allocation of new general obligation (GO) debt for general construction projects, school construction, and other grant and loan capital projects for the upcoming session. The table below compares the Governor's preliminary allocation to the 2005 *Capital Improvement Plan* (CIP) and to recent actual allocations.

Actual and Proposed Allocation of GO Authorizations
Fiscal 2004 –2007
($ in Millions)

	FY 04 Actual	**FY 05 Actual**	**FY 06 Actual**	**FY 07 CIP**	**FY 07 Proposed**
State-owned Projects	$358.5	$274.7	$187.8	$341.5	$343.4
Public School Construction	104.1	114.2	234.4*	97.6	150.0
Grant and Loan Projects	279.9	274.8	248.2	245.6	196.6
Total	**$742.5**	**$663.7**	**$670.4**	**$684.7**	**$690.0**

* Public school construction received a total of $251.8 million which includes $234.4 million in GO ($79.2 million added by the General Assembly), $15 million available in the IAC contingency fund from unexpended school construction funds budgeted in prior years and $2.4 million from the Maryland Stadium Authority budget as required by §13-715.2 of the Financial Institutions Article.

Source: Department of Budget and Management, Department of Legislative Services, November 2005

- The Governor's $150 million preliminary fiscal 2007 allocation for public school construction projects while significantly more than what was planned in the 2005 CIP is also significantly less than the fiscal 2006 amount authorized by the General Assembly.

- The preliminary fiscal 2007 allocation indicates that the additional authorizations proposed by the Governor above the amount planned in the 2005 CIP will be shifted from the amount planned for grant and loan programs. This may indicate that the Administration will propose funding capital grant and loan programs that require the issuance of taxable bonds with PAYGO general funds instead.

Escalating Construction Costs

- Significant inflation in the construction market is driving up the cost of capital projects. Factors influencing construction costs include:
  - ***International Demand for Building Materials:*** Demand for construction materials, particularly in Asia, has contributed to the rising price of construction materials, most notably steel.
  - ***Active Construction Market in Maryland:*** The active construction market in Maryland has caused a tight labor market which is driving up wages.
  - ***Oil Prices:*** Domestic and international demand for oil has contributed to the rising oil prices.
  - ***Impact of Hurricane Katrina and Hurricane Rita:*** Rebuilding efforts are expected to create a great deal of uncertainty concerning the availability and cost of construction materials.
- The table below compares the Building Construction Index (BCI) with the Consumer Price Index (CPI) for the Baltimore regional market. The BCI measures the effects of inflation on construction materials and labor costs, and the CPI is a indicator of inflation in general.

Comparison of Building Construction Index to Consumer Price Index
Calendar 2001 – 2005

Calendar Year	Consumer Price Index	Building Construction Index
2001	2.7%	0.3%
2002	2.2%	2.9%
2003	2.9%	6.9%
2004	2.7%	9.0%
2005	n/a	7.9%

Source: BCI = Engineering New – Record and CPI = Urban Consumer

- The BCI index increased at an annual rate of 8 percent while the CPI grew by slightly less than 3 percent annually from 2003 through 2005. Over the past 24 months ending September 2005, the cost of structural steel products increased at an annual rate of 16.8 percent, concrete products increased by 8.5 percent, gypsum products by 16.9 percent, and lumber products by 8.0 percent.
- Since it can take up to two to three years for a project to proceed from the initial design phase to receipt of construction bids, annual increases in construction costs in the range of eight percent significantly impact the cost of capital projects.

Part 7

Transportation Trust Fund

Fiscal 2005 Closeout Adds to Transportation Trust Fund Balance
($ in Millions)

	Projected FY 2005	Actual FY 2005	Variance
Fund Balance			
Starting Fund Balance	$288.0	$288.0	$0.0
Ending Fund Balance	100.0	245.0	145.0
Change in Fund Balance	**-$188.0**	**-$43.0**	**$145.0**
Gross Tax and Fee Revenue Summary	$2,207.0	$2,214.0	$7.0
Other Receipts and Adjustments	510.0	536.0	26.0
Bond Sale Proceeds	35.0	0.0	-35.0
Bond Premium	0.0	0.0	0.0
Total Revenues and Adjustments	**$2,752.0**	**$2,750.0**	**-$2.0**
Expenditures			
Operating Expenditures	$1,211.0	$1,238	$27.0
Capital Expenditures	964.0	789.0	-175.0
Fund Transfers and Deductions to Other Agencies	159.0	156.0	-3.0
Highway User Revenues to Local Jurisdictions	452.0	456.0	4.0
Maryland Department of Transportation Debt Service	154.0	154.0	0.0
To TTF as Changed Fund Balance	-188.0	-43.0	145.0
Total Funds by Use	**$2,752.0**	**$2,750.0**	**-$2.0**

TTF = Transportation Trust Fund

Source: Maryland Department of Transportation, October 2005

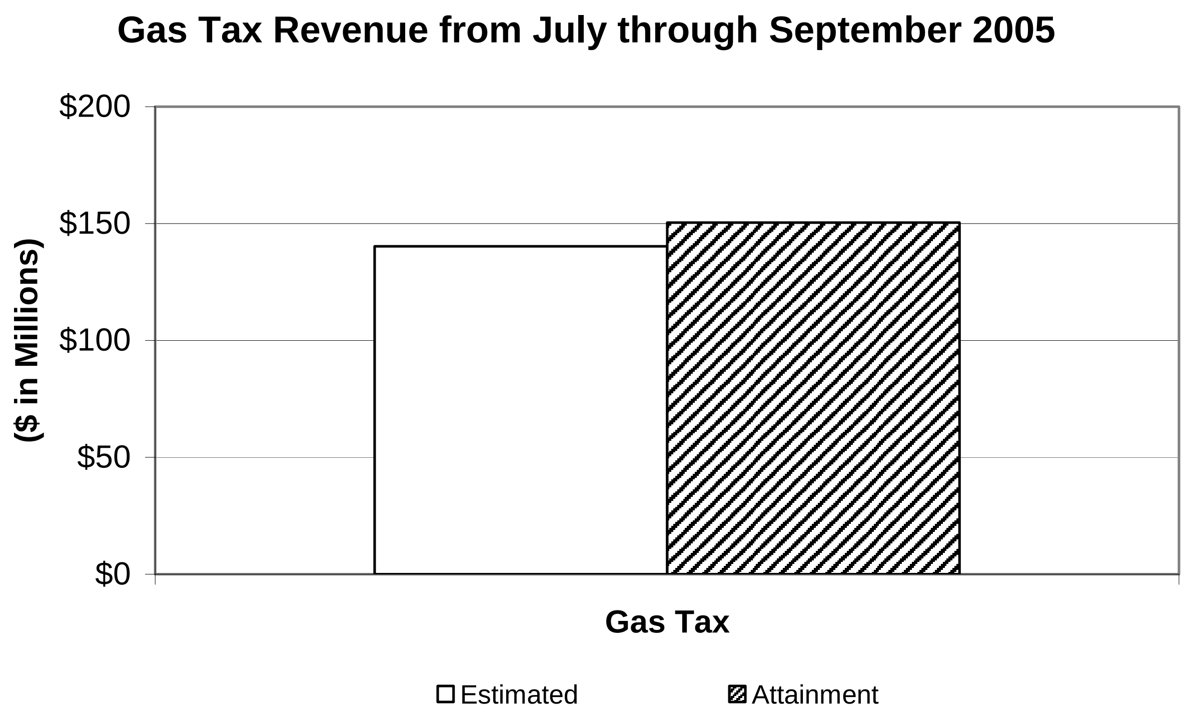
- The Transportation Trust Fund (TTF) closing balance increased by $145 million over projected levels.

- Capital expenditures were $175 million lower than anticipated mainly due to cash flow changes related to ongoing projects. Nearly half of the change is attributable to State Highway Administration (SHA) projects. SHA received a large sum of federal funds at the end of fiscal 2005, which freed up State funds that then rolled forward to fiscal 2006.

- The Maryland Department of Transportation (MDOT) anticipated a bond sale of $35 million, but the bond sale was not necessary and not issued.

- Corporate income tax receipts were $29 million higher than anticipated largely due to the change in the law relating to the use of Delaware holding companies.

People Are Still Buying Gasoline



- Gas tax revenues have come in at higher than anticipated levels.

- Using a six-year average, the gas tax was projected at $140.3 million from July through September 2005. Gas tax revenue for the period came in at $150.4 million ($10.1 million higher than anticipated).

- Given current trends, gas tax revenues are on pace to come in at much higher levels than anticipated for the full year of fiscal 2006.

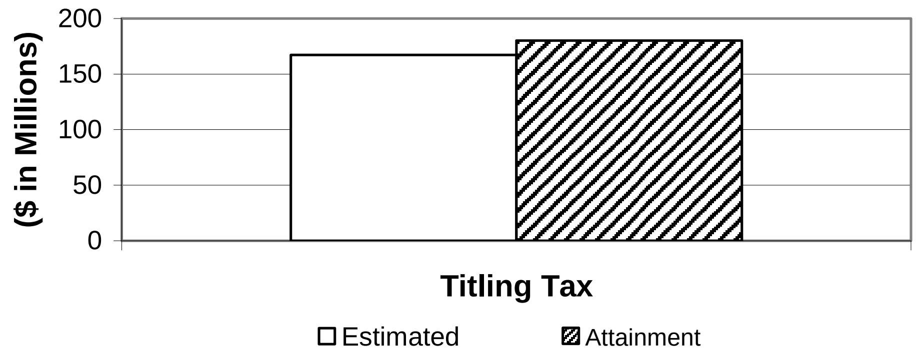
- Although gas tax revenues are up, it is unlikely that the current rate will continue. Only three months of the fiscal year have been recorded, and it will take more data to determine a significant revenue trend.

- The Department of Legislative Services' (DLS) current forecast for gas tax revenues projects nearly 3 percent growth from fiscal 2005 to 2006.

- Even with high gas prices, demand for gas has remained inelastic. Many consumers have chosen to cut back in other areas but continue to purchase gas.

People Are Still Buying Automobiles

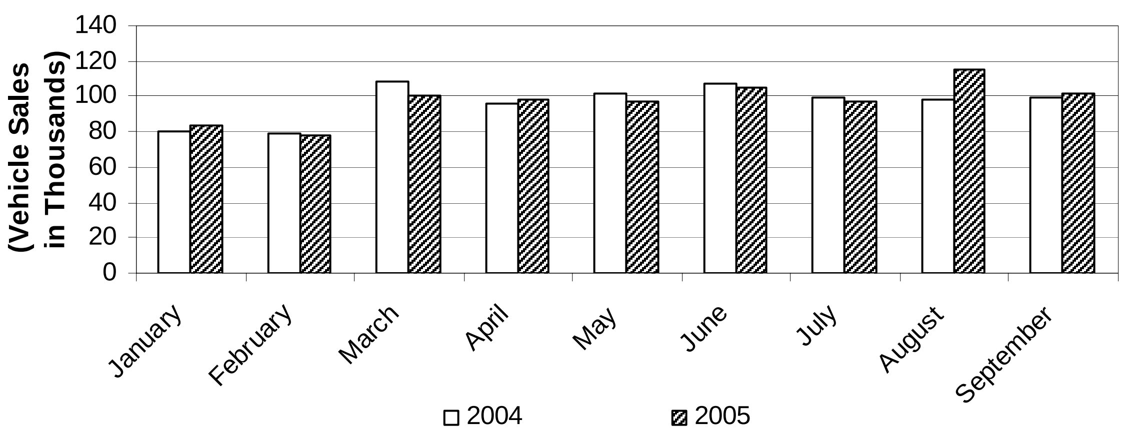
Titling Tax Revenue from July through September 2005



- Using a six-year average, the titling tax was projected at $167.2 million from July through September 2005. Titling tax revenue for the period came in at $180.1 million ($12.2 million higher than anticipated).

- Given current trends, titling tax revenues are on pace to come in at much higher levels than anticipated for the full year of fiscal 2006.

Total Maryland Vehicle Sales in 2004 and 2005



- August was a particularly strong month for vehicle sales. The General Motors "employee discount" promotion and other similar promotions contributed to the high revenue numbers.

- Although titling tax revenues are up, it is unlikely that the current rate will continue. Automakers have reported that October sales are down industry-wide.

- The current DLS forecast projects titling tax revenue growth of just under 4 percent from fiscal 2005 to 2006.

Federal Reauthorization of Transportation Aid

- On August 10, 2005, the President signed "Safe, Accountable, Flexible and Efficient Transportation Equity Act—A Legacy for Users" (SAFETEA-LU). The Act reauthorizes federal surface transportation programs through the end of federal fiscal 2009.

- SAFETEA-LU will provide $286.4 billion in guaranteed funding for federal highway, transit, and safety programs from federal fiscal 2004 through 2009. This is a significant increase over the previous authorization, "Transportation Equity Act for the 21st Century" (TEA-21), which provided $218 billion over a six-year period.

- Although SAFETEA-LU is considered a six-year authorization from federal fiscal 2004 to 2009, in reality it is a five-year bill. Only two months remained in federal fiscal 2005 when the bill was passed. A more useful representation of SAFETEA-LU is that it provides $244 billion in guaranteed funding from federal fiscal 2005 to 2009.

- There are three issues related to SAFETEA-LU of particular interest to Maryland.

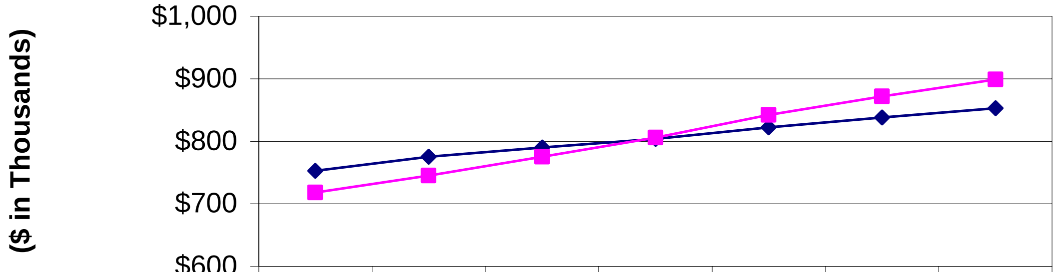
  - **Minimum Guarantee Levels:** Under TEA-21, each state was guaranteed at least 90.5 percent of the federal taxes paid in that state. Under SAFETEA-LU, the minimum guarantee will rise to 91.5 percent in federal fiscal 2007 and to 92 percent in federal fiscal 2008. Maryland, a donor state (receives less funds than it contributes), receives the minimum guarantee amount.

  - **Average Annual Highway and Transit Funding:** The expected average annual highway and transit funding for Maryland will increase under SAFETEA-LU. Under TEA-21, Maryland received an annual average of $443.2 million in federal highway funds. Under SAFETEA-LU, Maryland expects to receive an annual average of $583.2 million, an increase of $140 million (31.6 percent) over TEA-21 levels. For transit, Maryland received an annual average of $100 million for transit formula programs. Under SAFETEA-LU, Maryland expects to receive an annual average of $140 million, an increase of $40 million (40.0 percent) over TEA-21 levels.

  - **Earmarks:** Maryland received 92 highway-related earmarks ($307.7 million) and 21 transit-related earmarks ($295.0 million) for a total of 113 earmarks and $602.7 million. All highway and most transit projects require an 80/20 federal/state match in funds. With the exception of five projects totaling $27 million (including $10 million for the InterCounty Connector), all earmarks count toward Maryland's annual share of highway and transit funding.

DLS Transportation Trust Fund Forecast

Gas and Titling Tax Gross Revenue
Fiscal 2005 – 2011
($ in Thousands)



	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10	FY 11
Gas Tax	$753	$775	$790	$804	$822	$838	$853
Titling Tax	$718	$745	$775	$806	$842	$872	$899

Revenue Assumptions

- ***Gross Taxes and Fees:*** Gas and titling tax revenues historically make up nearly 70 percent of all gross taxes and fees. Other taxes and fees include the corporate income tax, vehicle registration fees, miscellaneous Motor Vehicle Administration fees, and the rental car sales tax. Gas tax revenues are expected to achieve average annual growth of nearly 2.0 percent from fiscal 2006 through 2011. Titling tax revenues are expected to achieve average annual growth of 3.8 percent from fiscal 2006 to 2011.

- ***Debt**:* DLS has adjusted bond sales to increase debt capacity and still stay within the $2 billion debt outstanding limit and the 2.5 net income coverage ratio (net income relative to debt service). MDOT has the ability to issue $1.3 billion in debt from fiscal 2006 to 2011.

Expenditure Assumptions

- ***Operating Budget:*** DLS has allowed for operating budget growth of between 3 and 5 percent for MDOT modes and included annual cost-of-living increases.

- ***Federal Capital Program:*** DLS has assumed an average annual amount of $720 million in federal funds for capital projects from fiscal 2007 through 2011. This number is based on the funding Maryland expects to receive for highways and transit under the new federal transportation authorization.

- ***Total Capital Program:*** Anticipated federal funds, combined with State capital funds, could allow MDOT to maintain an average annual capital program of roughly $1.5 billion from fiscal 2006 through 2011. DLS has removed grant anticipation revenue vehicle (GARVEE) debt service from the capital program.

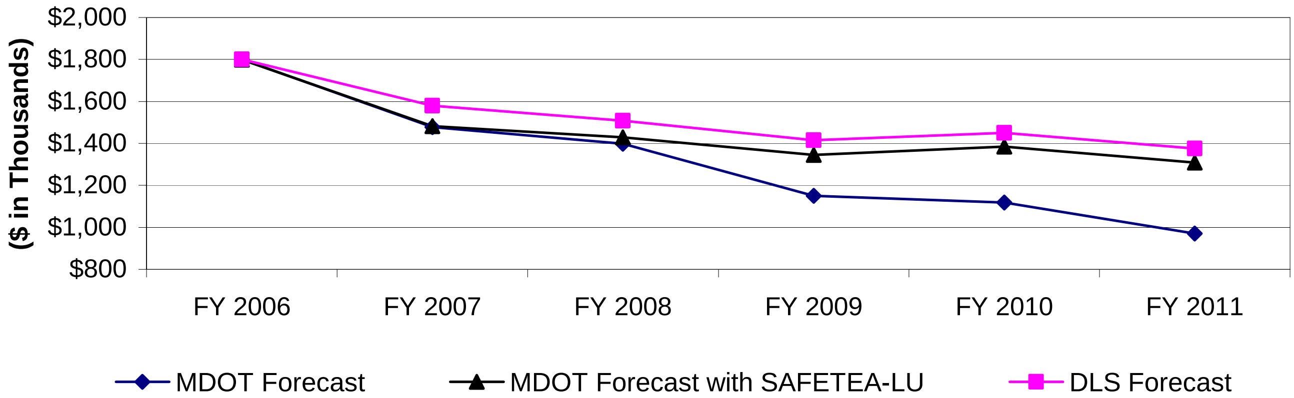
MDOT Capital Program Has Additional Capacity

MDOT January vs. October Forecast
Fiscal 2006 – 2010
($ in Millions)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	Total FY 06 – 10
January Forecast						
State Capital	$1,040	$794	$685	$669	$677	$3,865
Federal Capital	738	662	572	433	441	2,846
Total Capital	1,778	1,456	1,257	1,102	1,118	6,711
October Forecast						
State Capital	1,024	806	739	687	731	3,988
Federal Capital	776	671	600	463	388	2,898
Total Capital	1,800	1,477	1,399	1,150	1,119	6,886
Total Capital Change	**$22**	**$21**	**$142**	**$48**	**$1**	**$175**

- MDOT's January 2005 forecast projected a $6.71 billion total capital program from fiscal 2006 through 2010, and the October 2005 forecast projected a $6.89 billion program during the same period.

Total Capital Program
MDOT vs. DLS Forecast



- The October 2005 MDOT forecast projects a $7.9 billion total capital program from fiscal 2006 through 2011. However, the forecast has not assumed expected federal funds under SAFETEA-LU. If the MDOT forecast is adjusted for SAFETEA-LU less GARVEE debt service, the total capital program is $8.7 billion.

- The October 2005 DLS forecast projects a $9.1 billion total capital program from fiscal 2006 through 2011 and adjusts for SAFETEA-LU and GARVEE debt service. The DLS forecast has assumed higher revenue growth and bond sales, resulting in additional capacity.

InterCounty Connector Update

- The draft environmental impact statement for the InterCounty Connector (ICC) was issued in November 2004. It is expected that the final environmental impact statement will be released in December 2005. After the Final Environmental Impact Statement is issued, a record of decision is expected a few weeks later. It is possible that litigation could delay the project.

- If the ICC project is approved with a build corridor selected by the Federal Highway Administration, right-of-way acquisition could begin in early 2006. Construction could also begin in 2006.

ICC Financing Plan

Source	Amount	Comments
MdTA Bonds	$1,200	Bonds are backed by MdTA revenues.
GARVEE Bonds	750	Assumes issuance of $375 million in fiscal 2006, $325 million in fiscal 2008, and $50 million in fiscal 2010.
TTF and General Fund	445	This amount includes $265 million to be transferred from the general fund (payback of prior transfer from the TTF). The amount also includes roughly $180 million from the TTF.
Federal Funds	18	New federal authorization provides $18 million for the ICC.
Total	**$2,413**	

Woodrow Wilson Bridge Update

- The Woodrow Wilson Bridge project is on budget and on schedule. The project is expected to cost $2.5 billion, financed by Virginia, Maryland, and Washington, DC.

- The Maryland share of the project is $1.3 billion with most of that amount covered through federal funds. Maryland is estimated to receive $1.2 billion in federal funds and provide around $123 million in State-matching funds over the life of the project.

- As of September 30, 2005, the Maryland portion of the project is 49 percent complete and about 93 percent of construction is under contract.

- The outer loop is scheduled for completion by 2006. At that time, all traffic will switch to the new outer loop bridge. The inner loop is scheduled for completion in 2008. At that time, traffic will open to both new bridge spans, with a total of 12 lanes.

Part 8

Land Conservation Funding

Land Conservation Funding

Fiscal 2003 – 2007

	FY 2003	FY 2004	FY 2005	Budgeted FY 2006	Baseline FY 2007
Actual Transfer Tax Revenues	**$140,403,000**	**$181,371,000**	**$237,250,151**	**$229,637,000** *	**$220,406,000** *
Transfer Tax to General Fund	**-$85,925,000**	**-$102,834,000**	**-$189,260,000**	**-$90,000,000**	**$0**
Administrative Expenses	2,924,000	3,486,000	3,984,000	5,835,000	6,612,180
Heritage Areas Authority (DHCD)	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Program Open Space					
Local Land/Recreation Allocation	17,261,000	1,914,000	0	44,753,000	119,081,299
State Land Acquisition	8,925,000	1,500,000	0	24,566,186	82,106,592
State Capital Development	3,859,000	4,524,000	4,863,000	10,891,000	30,957,177
State Park Operating Expenses	950,000	950,000	950,000	2,500,000	1,200,000
Heritage Conservation Fund	851,000	0	0	2,167,814	5,728,445
Rural Legacy	6,363,000	0	0	14,022,000	23,912,349
Agricultural Land Preservation (MDA)	8,059,000	0	0	20,534,000	54,261,109
Total Transfer Tax Allocated in State Budget	**$50,192,000**	**$13,374,000**	**$10,797,000**	**$126,269,000**	**$324,859,151** **
GO Bonds in State Budget to Replace Transfer Tax		53,292,000	23,572,000		
Total Funding in State Budget	**$50,192,000**	**$66,666,000**	**$34,369,000**	**$126,269,000**	**$324,859,151**

* September 2005 estimate.

** Senate Bill 306 (Chapter 473, Acts of 2005) provides that in any fiscal year in which an appropriation or transfer is made to the general fund, if the actual transfer tax revenue collections for the prior fiscal year exceed the budget estimate for the prior fiscal year, the excess shall be allocated in the current fiscal year for Program Open Space, the Agricultural Land Preservation Fund, the Rural Legacy Program, and the Heritage Conservation Fund. According to the Attorney General, this provision should be read prospectively, with effect for fiscal 2007 and thereafter. Therefore, this estimate includes $104,453,151 in fiscal 2005 revenue attained over the original estimate.

Part 9

State Employment

Regular Full-time Equivalent Positions
Fiscal 2006 Allowance to 2006 Working Appropriation

Department/Service Area	FY 2006 Allowance	Specific Legislative Reductions	Section 38 Abolitions and Other Changes[1]	FY 2006 Legis. Approp.	BPW & Other Changes	FY 2006 Working Approp.
Legislative Branch	740	0	0	740	0	740
Judicial Branch	3,328	-30	-7	3,291	0	3,291
Executive Branch:						
Legal	1,601	-36	2	1,567	1	1,568
Executive and Administrative Control	1,540	-29	1	1,512	76	1,588
Financial and Revenue Administration	2,042	-18	-1	2,023	0	2,023
Budget and Management	441	-9	1	433	0	433
Retirement	187	-1	0	186	0	186
General Services	657	-15	0	642	1	643
Transportation	9,087	-19	-56	9,012	0	9,012
Natural Resources	1,377	-3	-7	1,367	0	1,367
Agriculture	429	-1	0	428	0	428
Health and Mental Hygiene	7,548	-3	-27	7,518	56	7,574
Human Resources	7,248	-48	-21	7,180	-217	6,963
Labor, Licensing, and Regulation	1,448	-2	0	1,447	13	1,460
Public Safety and Correctional Services	11,352	-26	-47	11,279	-1	11,279
MSDE and Other Education	1,944	-10	-1	1,933	201	2,134
Housing and Community Development	385	-12	20	393	-73	320
Business and Economic Development	298	-6	0	292	0	292
Environment	956	-3	-5	948	1	949
Juvenile Services	2,119	-31	-3	2,085	-4	2,081
Police and Fire Marshal	2,479	0	-14	2,465	-1	2,464
Executive Branch Subtotal	**53,136**	**-271**	**-158**	**52,707**	**54**	**52,760**
Higher Education	21,353	0	-3	21,350	349	21,699
Total	**78,557**	**-301**	**-168**	**78,088**	**402**	**78,490**

[1] Reductions are net of Section 38 abolitions, additions made through the Board of Public Works, and agency-generated abolitions.

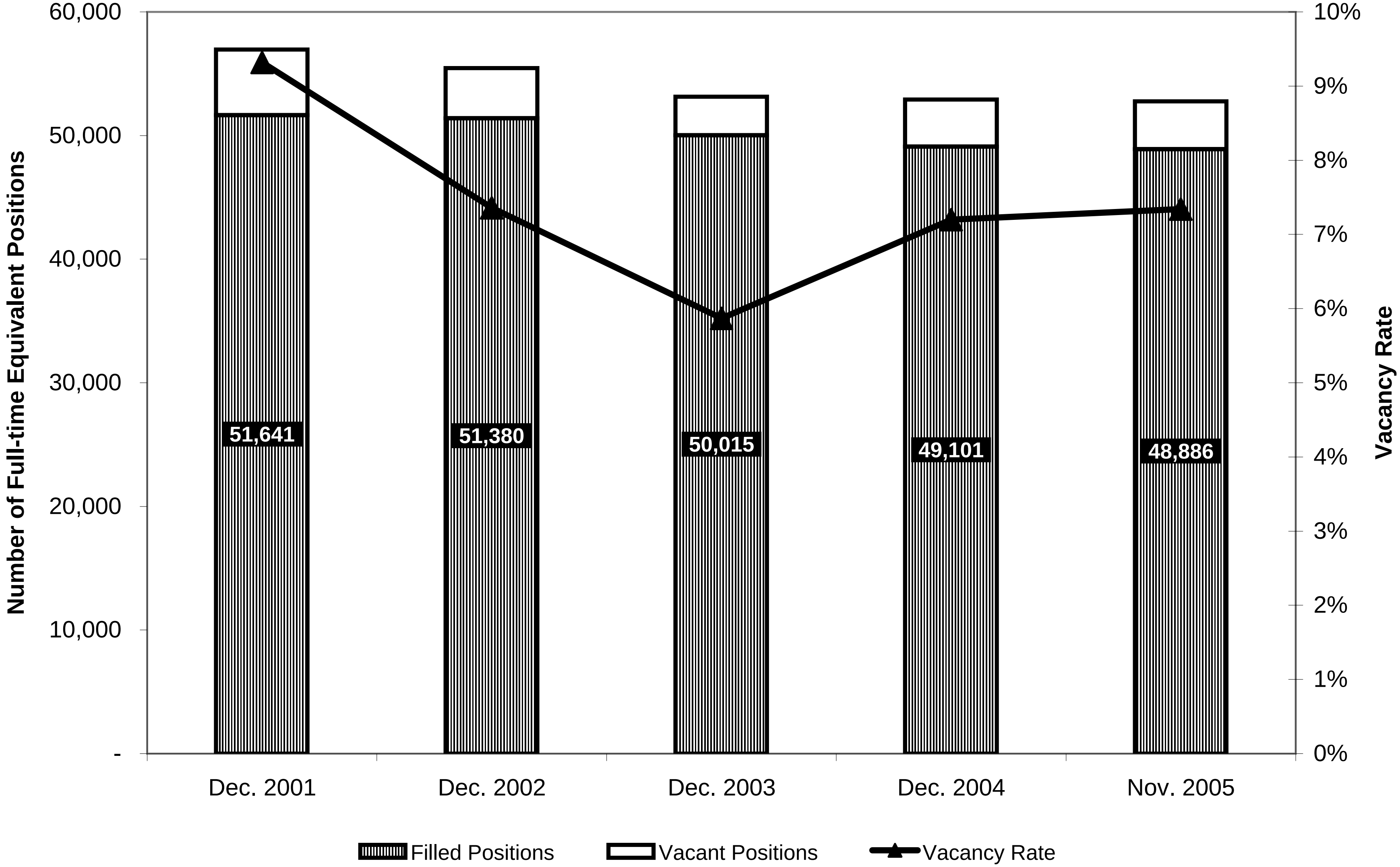
Regular Full-time Equivalent Positions
Fiscal 2002 Actuals to 2006 Working Appropriation

Department/Service Area	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Actual	FY 2006 Working Approp.	Growth Rate FY 02-06 Working
Legislative Branch	730	730	731	740	740	1.4%
Judicial Branch	3,010	3,224	3,224	3,217	3,291	9.4%
Executive Branch						
Legal	1,381	1,397	1,445	1,515	1,568	13.5%
Executive and Administrative Control	1,619	1,604	1,572	1,570	1,588	-1.9%
Financial and Revenue Administration	2,158	2,098	2,032	2,037	2,023	-6.3%
Budget and Management	524	531	472	474	433	-17.5%
Retirement	194	185	181	180	186	-3.9%
General Services	793	807	728	714	643	-18.9%
Transportation	9,538	9,319	9,096	9,028	9,012	-5.5%
Natural Resources	1,629	1,577	1,454	1,415	1,367	-16.1%
Agriculture	480	460	434	431	428	-10.9%
Health and Mental Hygiene	8,536	8,212	7,710	7,548	7,574	-11.3%
Human Resources	8,273	7,729	7,379	7,289	6,963	-15.8%
Labor, Licensing, and Regulation	1,706	1,617	1,519	1,492	1,460	-14.4%
Public Safety and Correctional Services	11,663	11,563	11,231	11,195	11,279	-3.3%
MSDE and Other Education	1,955	2,019	1,892	1,939	2,134	9.2%
Housing and Community Development	449	425	393	409	320	-28.8%
Business and Economic Development	324	318	299	299	292	-9.9%
Environment	1,028	1,032	951	952	949	-7.7%
Juvenile Services	2,123	1,996	1,939	1,963	2,081	-2.0%
Police and Fire Marshal	2,590	2,573	2,480	2,475	2,464	-4.9%
Executive Branch Subtotal	**56,961**	**55,460**	**53,205**	**52,923**	**52,760**	**-7.4%**
Higher Education	21,386	21,403	20,966	21,212	21,699	1.5%
Total	**82,087**	**80,816**	**78,126**	**78,092**	**78,490**	**-4.4%**

Contractual Full-time Equivalent Positions
Fiscal 2002 Actuals to 2006 Legislative Appropriation

Department/Service Area	FY 2002 Actual	FY 2003 Actual	FY 2004 Actual	FY 2005 Wkg Approp.	FY 2006 Leg. Approp.	FY 02-06 Growth Rate
Judiciary	371	390	390	391	359	-3.2%
Legal	99	71	82	110	108	8.9%
Executive and Administrative Control	208	206	205	172	153	-26.5%
Financial and Revenue Administration	35	29	32	42	35	2.0%
Budget and Management	33	27	16	21	12	-63.9%
Retirement	30	24	21	30	32	5.6%
General Services	35	26	24	28	27	-23.5%
Transportation	142	122	110	169	161	13.3%
Natural Resources	332	378	317	439	343	3.4%
Agriculture	36	44	35	47	44	22.3%
Health and Mental Hygiene	409	357	411	489	499	21.9%
Human Resources	111	73	51	135	135	22.0%
Labor, Licensing, and Regulation	176	114	155	178	171	-2.9%
Public Safety and Correctional Services	298	281	235	488	464	55.5%
MSDE and Other Education	218	190	188	184	192	-11.9%
Housing and Community Development	49	50	49	62	66	35.3%
Business and Economic Development	49	47	37	36	32	-33.9%
Environment	32	23	16	46	44	34.7%
Juvenile Services	119	98	306	276	217	82.2%
Police and Fire Marshal	46	32	30	47	45	-2.6%
Subtotal	**2,828**	**2,582**	**2,707**	**3,389**	**3,138**	**11.0%**
Higher Education	6,079	5,700	5,704	5,922	6,117	0.6%
Total	**8,907**	**8,282**	**8,412**	**9,311**	**9,255**	**3.9%**
Non-higher Education Executive Branch Total	**2,457**	**2,192**	**2,317**	**2,998**	**2,779**	**13.1%**

Non-higher Education Executive Branch Positions
Filled and Vacant Positions
December 2001 – November 2005



Vacant Positions, Turnover Rate, and Necessary Vacancies
Fiscal 2006 Legislative Appropriation

Department/Service Area	Turnover Rate	Necessary Vacancies	Vacancy Rate	Vacant Positions[1]	Funded Vacancies/ (Unfunded Filled)
Legislative	1.9%	14	2.6%	19	5
Judiciary	3.0%	98	4.7%	155	56
Legal (no Judiciary)	6.9%	108	11.4%	179	71
Executive and Administrative Control	3.4%	52	6.2%	99	47
Financial and Revenue Administration	3.8%	78	6.2%	125	47
Budget and Management	1.6%	7	10.4%	45	38
Retirement	3.9%	7	8.6%	16	9
General Services	5.1%	33	8.8%	57	24
Transportation	3.6%	326	5.3%	475	149
Natural Resources	6.4%	88	7.9%	108	20
Agriculture	5.0%	21	7.6%	33	11
Health and Mental Hygiene	4.3%	320	8.8%	666	346
Human Resources	4.0%	286	6.0%	420	134
Labor, Licensing, and Regulation	3.4%	49	8.7%	127	78
Public Safety and Correctional Services	5.2%	583	8.6%	972	389
MSDE and Other Education	5.2%	101	5.4%	115	14
Housing and Community Development	2.0%	8	6.6%	21	13
Business and Economic Development	2.8%	8	5.1%	15	7
Environment	3.4%	32	8.2%	78	46
Juvenile Services	7.0%	145	9.2%	192	46
Police and Fire Marshal	4.1%	102	5.4%	133	31
Subtotal	**4.3%**	**2,467**	**7.1%**	**4,047**	**1,581**
Higher Education	2.5%	542	4.1%	863[2]	321
Total	**3.8%**	**3,009**	**6.3%**	**4,911**	**1,902**

[1] The number of vacancies are as of November 1, 2005, with the exception of transportation, which is as of October 1, 2005, and higher education, which is as of September 30, 2005.

[2] Vacancies are for the University System of Maryland, Morgan State, and Baltimore City Community College. Data from St. Mary's College are not available.

Source: Department of Budget and Management

The State Workforce: Considerations for Fiscal 2007

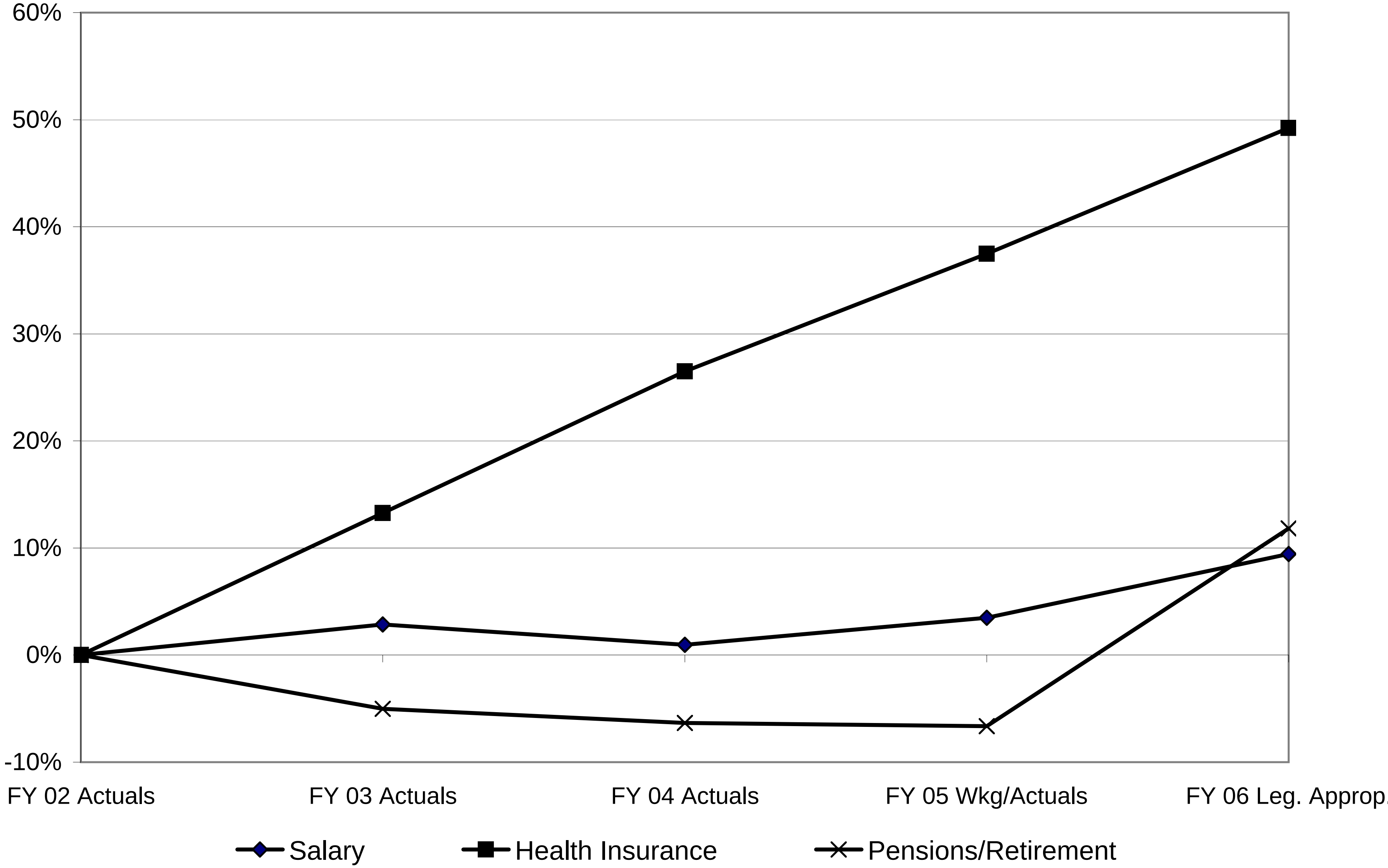
- **The Office of the Public Defender**: The final phase of the three-year Caseload Initiative, for which 85 positions were requested, was scheduled for fiscal 2006. However, 22 of the positions were deleted from the 2006 budget and funds for those positions were used to mitigate the statewide health care funding gap. In fiscal 2007, 22 Public Defender I positions will be added to complete the initiative.

- **Department of Health and Mental Hygiene**: A 48-bed facility at Clifton T. Perkins Hospital Center to accommodate developmentally disabled individuals with forensic involvement is scheduled for opening on July 1, 2007. In the fourth quarter of fiscal 2007, 135.8 new regular and 5.9 full-time equivalent contractual positions are anticipated to staff start-up activities.

- **Contractual Employment:** During the 1998 session the General Assembly passed legislation (Chapter 510 of 1998) authorizing DBM to convert contractual employees to regular positions after six months of satisfactory job performance, if certain requirements are met. Since fiscal 2002, the number of contractual positions in non-higher education Executive Branch agencies has increased by 11 percent, while the number of regular positions has decreased by 7.4 percent. **The Spending Affordability Committee may want to consider its policy to promote the conversion of contractual positions in functions for which there is continuing need in establishing any position cap increase.**

- **Are New Positions Being Filled?**: There were almost 900 new positions created in the fiscal 2005 budget including 139 for higher education institutions. The high number of funded vacant positions suggests that agencies are unable or unwilling to fill them, possibly holding these or other positions open to cover expenditures not related to personnel.

Cumulative Increase in Spending for Major Components of Compensation Since Fiscal 2002



How Has State Employee Health and Prescription Coverage Changed In the Last Year?

- Beginning in January 2005, the Department of Budget and Management implemented a number of changes including:

  - increasing primary doctor's office visit copayments from $5 to $15 for POS and HMO plans and increasing specialist doctor's office visit copayments from $10 or $20 to $25 for all types of plans;

  - increasing emergency room hospital charge copayments from $25 to $50 if emergency criteria are not met and implementing physician's charge copayments of $50 per emergency room visit; and

  - covering for up to 50 rather than 100 visits per year of physical therapy.

- Program restructuring in fiscal 2006 includes:

  - increasing the point-of-service health insurance copremiums from 15 to 17 percent of the total cost;

  - increasing prescription copayments to $5 for generic drugs, $15 for preferred brand name drugs, and $25 for non-preferred brand name drugs from $3, $5, and $10 for the three existing tiers;

  - implementing a $700 spending cap per family for prescriptions;

  - requiring two copayments instead of one copayment for 90 days of medication;

  - implementing a 30-day maximum for the first fill of a new drug;

  - requiring prior authorization for certain medications; and

  - implementing a number of other changes such as required step therapy, managed quantities of drugs, and voluntary mail order and specialty drug pharmacies.

Health, Prescription, and Dental Insurance Spending
Total Cost
First Quarter Fiscal 2005 and 2006

	Fiscal 2005	Fiscal 2006	% Change
Active Employees			
PPO	$47,876,128	$49,903,401	4.23%
POS	36,740,972	36,110,594	-1.72%
HMO	15,458,433	20,229,064	30.86%
MH/SA	2,308,906	2,372,757	2.77%
Subtotal Medical	***$102,384,439***	***$108,615,816***	***6.09%***
Prescription	40,758,340	34,052,917	-16.45%
Dental	4,871,889	5,969,649	22.53%
Subtotal Actives	***$148,014,668***	***$148,638,382***	***0.42%***
Retirees			
PPO	$26,131,960	$24,698,906	-5.48%
POS	9,125,490	9,409,550	3.11%
HMO	2,557,897	3,353,929	31.12%
MH/SA	778,248	668,917	-14.05%
Subtotal Medical	***$38,593,595***	***$38,131,302***	***-1.20%***
Prescription	36,472,724	32,031,752	-12.18%
Dental	1,123,931	1,441,115	28.22%
Subtotal Retirees	***$76,190,250***	***$71,604,169***	***-6.02%***
Total			
PPO	$74,008,088	$74,602,307	0.80%
POS	45,866,462	45,520,144	-0.76%
HMO	18,016,330	23,582,993	30.90%
MH/SA	3,087,154	3,041,674	-1.47%
Subtotal Medical	***$140,978,034***	***$146,747,118***	***4.09%***
Prescription	77,231,064	66,084,669	-14.43%
Dental	5,995,820	7,410,764	23.60%
Total	**$224,204,918**	**$220,242,551**	**-1.77%**

PPO = Preferred Provider Organization
POS = Point of Service
HMO = Health Maintenance Organization
MH/SA = Mental Health and Substance Abuse

Source: Department of Budget and Management

Health, Prescription, and Dental Insurance Enrollment
First Quarter Fiscal 2005 and 2006

Active Employees	**Fiscal 2005**	**Fiscal 2006**	**% Change**
PPO	27,979	29,324	4.81%
POS	27,640	26,257	-5.00%
HMO	13,590	14,208	4.55%
Total Medical	**69,209**	**69,789**	**0.84%**
Prescription	65,725	65,875	0.23%
Dental	58,391	59,785	2.39%
Retirees			
PPO	21,199	22,253	4.97%
POS	7,514	7,862	4.63%
HMO	3,157	3,304	4.66%
Total Medical	**31,870**	**33,419**	**4.86%**
Prescription	31,614	33,078	4.63%
Dental	16,060	17,671	10.03%
Total Enrollment			
PPO	49,178	51,577	4.88%
POS	35,154	34,119	-2.94%
HMO	16,747	17,512	4.57%
Total Medical	**101,079**	**103,208**	**2.11%**
Prescription	97,339	98,953	1.66%
Dental	74,451	77,456	4.04%

Source: Department of Budget and Management

Part 10

Revenue Stabilization Account

State Reserve Fund Activity
Fiscal 2005 – 2007
($ in Millions)

	Rainy Day Fund	Dedicated Purpose Acct.	Catastrophic Event Acct.	Joseph Fund Acct.
Estimated Balances 6/30/05	**$521.4**	**$0.0**	**$7.1**	**$0.0**
Fiscal 2006 Appropriations	249.7	74.0	2.0	0.0
Expenditures				
Reimburse Transportation Trust Fund		-50.0		
Medicaid Deficiencies		-20.0		
DJS Consent Decree		-2.0		
Hurricane Isabel Reconstruction			-0.8	
Fund PAYGO Capital Projects	-45.2			
Transfers to General Fund	0.0			
Estimated Interest	20.9			0.0
Estimated Balances 6/30/06	**$746.8**	**$2.0**	**$8.3**	**$0.0**
Fiscal 2007 Appropriations	593.3	50.0	0.0	0.0
Expenditures				
Reimburse Transportation Trust Fund		-50.0		
Transfers to General Fund	0.0			
Estimated Interest	40.3			0.0
Estimated Balances 6/30/07	**$1,380.4**	**$2.0**	**$8.3**	**$0.0**
Balance in Excess of 5% GF Revenues	**$746.1**			

Source: Department of Budget and Management