# Issue Papers

# 2006 Legislative Session

**Presentation to the**

**Maryland General Assembly**

**Department of Legislative Services**
**Office of Policy Analysis**
**Annapolis, Maryland**

**December 2005**

**For further information concerning this document contact:**

Library and Information Services
Office of Policy Analysis
Department of Legislative Services
90 State Circle
Annapolis, Maryland 21401

Baltimore Area: 410-946-5400 ● Washington Area: 301-970-5400
Other Areas: 1-800-492-7122, Extension 5400
TDD: 410-946-5401 ● 301-970-5401
Maryland Relay Service: 1-800-735-2258
E-mail: libr@mlis.state.md.us
Home Page: http://mlis.state.md.us

December 2005

Members of the General Assembly:

Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 1, 2005.

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

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

Sincerely,

Karl S. Aro
Executive Director

KSA/mll

# Contents

## 6. Higher Education



## 7. Health and Health Insurance



## 8. Social Programs



## 9. Transportation



## 10. Economic and Community Development

**17. Local Government**

# Operating Budget

## Economic and Revenue Outlook

**The Maryland economy is now in its second consecutive year of strong growth, and the economic outlook is more positive than was forecast in December 2004. Substantial revenue over-attainment in fiscal 2005 and more robust economic growth leads to a $638 million upward revision in the estimate for fiscal 2006 general fund revenues.**

### Economic Outlook

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 1.1 percent, following three years with employment growth of less than 1.0 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. Employer-paid benefits that are included in personal income (such as pensions and health insurance) also grew substantially faster in 2004, rising 10.7 percent compared with 6.2 percent in 2003.

The Maryland economy continues to perform well in 2005. Employment growth has accelerated further from the pace set in 2004. Employment in the first nine months is higher than for 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.

As reflected in **Exhibit 1**, the economic outlook is materially better than the forecast from December 2004 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 and 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. Also, business income of individuals from sole proprietorships and partnerships is up in 2005 but at a slower pace than in 2004. Beyond 2005, the impact of the U.S. Department of Defense's Base Realignment and Closure (BRAC) 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.

**Exhibit 1**
**Economic Outlook**
**Forecasted Year-over-year Percentage Change**

| Calendar | Employment | | Personal Income | |
|---|---|---|---|---|
| **Year** | **Dec. 2004** | **Oct. 2005** | **Dec. 2004** | **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 |

Source: December 2004 is from the Board of Revenue Estimates, and October 2005 is from the Department of Legislative Services. Figures for 2004 are estimates in the December 2004 columns.

## Revenue Outlook

The substantially stronger economy in 2004, combined with some other factors, 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 related to the use of Delaware holding companies under the settlement period established by Chapter 557 of 2004. If one-time revenue is excluded, fiscal 2005 still grew at a very strong 11.3 percent.

More than half of the over-attainment in fiscal 2005 came from the personal income tax, which grew 11.5 percent and exceeded the estimate by $245 million. Most of the overage came in final payments with tax year 2004 returns, which grew by over 40 percent and exceeded the estimate by $198 million (State and local taxes). The strong performance was driven by the significant acceleration of personal income growth in 2004 plus a big increase in income from capital gains, which is estimated to be about 57 percent higher than in 2003.

The corporate income tax was another major source of over-attainment in fiscal 2005, exceeding the estimate by $61.4 million and growing by 55.9 percent over fiscal 2004. Among the factors driving the corporate income tax were strong corporate profit growth over the last several years and the fact that companies applied carry-forward losses against Delaware holding company settlement payments, making those losses unavailable to offset current income. Also significant was Chapter 556 of 2004, which altered the tax treatment of Delaware holding companies for tax year 2004 and subsequent years. Although it is not known at this time how much this legislation contributed to the strong growth of the corporate income tax in fiscal 2005, it likely had a substantial impact.

The much better than expected performance in fiscal 2005, combined with higher projected economic growth, results in new revenue estimates for fiscal 2006 that are substantially above the current official estimates (**Exhibit 2**). 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.

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

| | FY 2006 | | | | FY 2007 | |
|---|---|---|---|---|---|---|
| | **Current Official Estimate** | **DLS Oct. 2005** | **$ Diff.** | **% Change 2005/2006** | **DLS Oct. 2005** | **% Change 2006/2007** |
| Personal Income Tax | $5,801 | $6,127 | $326 | 8.2% | $6,538 | 6.7% |
| Sales and Use Tax | 3,256 | 3,319 | 63 | 6.1 | 3,481 | 4.9 |
| Corporate Income Tax | 501 | 556 | 55 | 8.6 | 589 | 6.0 |
| Lottery | 464 | 478 | 14 | 4.8 | 492 | 3.0 |
| Other | 1,437 | 1,617 | 180 | -9.6 | 1,586 | -1.9 |
| **Total** | **$11,459** | **$12,097** | **$638** | **4.8%** | **$12,686** | **4.9%** |

Source: Board of Revenue Estimates; Department of Legislative Services

For further information contact: Theresa M. Tuszynski Phone: (410) 946/(301) 970-5510

# Operating Budget

## Budget Outlook: Sunny with Storm Clouds Ahead

**At the end of fiscal 2006, it is estimated there will be an ending cash balance in the general fund of $1.06 billion and a Rainy Day Fund balance of $747 million resulting from a cash balance that was planned for during the fiscal 2006 budget process; revenues that significantly exceeded estimates for fiscal 2005; and improved revenue estimates for fiscal 2006. The sunny budget picture is clouded by both potential structural deficits over the next several budget years and significant actual unfunded liabilities. Whether the State will continue to experience tremendous revenue overattainment which could assist in resolving these issues remains uncertain.**

### Economic Recovery Improves the General Fund's Financial Position

The fiscal 2005 closeout reflected better than expected revenue attainment in excess of $400 million, due largely to an improved economy and 2005 fund balance. This unanticipated revenue was partially offset by $37 million in accounting adjustments by the State Treasurer to rectify long standing accounting discrepancies between the general fund balance and the State's main bank accounts. In sum, fiscal 2005 closed with a general fund cash balance of nearly $1.2 billion.

**Exhibit 1**
**Fiscal 2005 Closeout Summary**
**($ in Millions)**

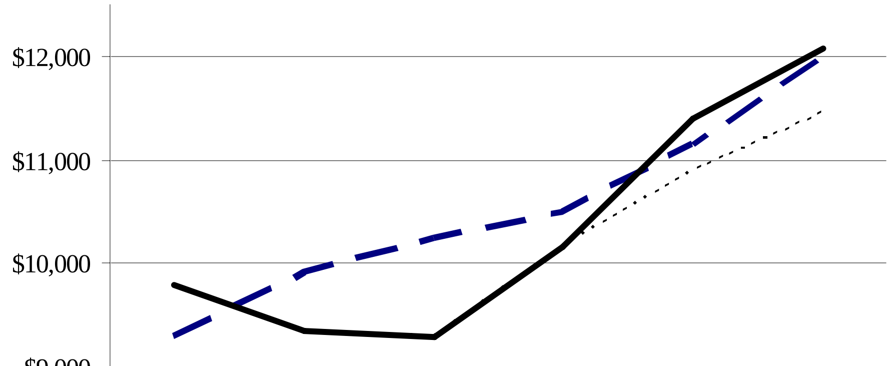
| | |
|---|---|
| Estimated Closing Balance | $776.9 |
| Revenue Overattainment | 422.5 |
| Agency Reversions | 12.0 |
| **Subtotal** | **$1,211.4** |
| Bank Account Reconciliation | ($37.0) |
| **Actual Closing Balance** | **$1,174.4** |

GAAP = Generally Accepted Accounting Principles

Source: Department of Legislative Services

In a business sense, the increase in revenue left the State with nearly a $250 million structural surplus for fiscal 2005, easing the imbalance between ongoing revenues and spending that had existed since fiscal 2002. **Exhibit 2** illustrates the interplay of ongoing general fund revenue and spending in light of recent developments, against a backdrop of the prior year's revenue forecast which had anticipated nominal revenue growth.

**Exhibit 2**
**Ongoing Revenues Compare Favorably with Ongoing Spending in the Short-term**
**Fiscal 2001 – 2006**
**($ in Millions)**




| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|---|---|---|---|---|---|
| Ongoing Spending | $9,295 | $9,901 | $10,240 | $10,488 | $11,148 | $12,004 |
| Ongoing Revenues | $9,802 | $9,356 | $9,281 | $10,151 | $11,395 | $12,070 |
| Ongoing Revenue 2004 SAC | $9,802 | $9,356 | $9,281 | $10,151 | $10,894 | 11,457 |

**Fiscal Years**

Source: Department of Legislative Services

## Curb Your Enthusiasm

While closing with a $1.2 billion general fund surplus is favorable news, future spending commitments could once again place the State budget in structural imbalance. The Department of Legislative Services (DLS) projects revenue growth in the range of 5 percent for fiscal 2006 through 2008, compared with nearly 8 percent growth in ongoing spending during that same period. Expenditure growth continues to be driven primarily by mandated increases in local aid for education associated with the Bridge to Excellence in Public Schools Act (Chapter 288, Acts of 2002) and Medicaid. When fully implemented, aid programs for primary/secondary education will have increased by more than $1.3 billion from fiscal 2003 to 2008. It is estimated that a structural deficit in excess of $600 million will again resurface. **Exhibit 3** illustrates this projected trend.

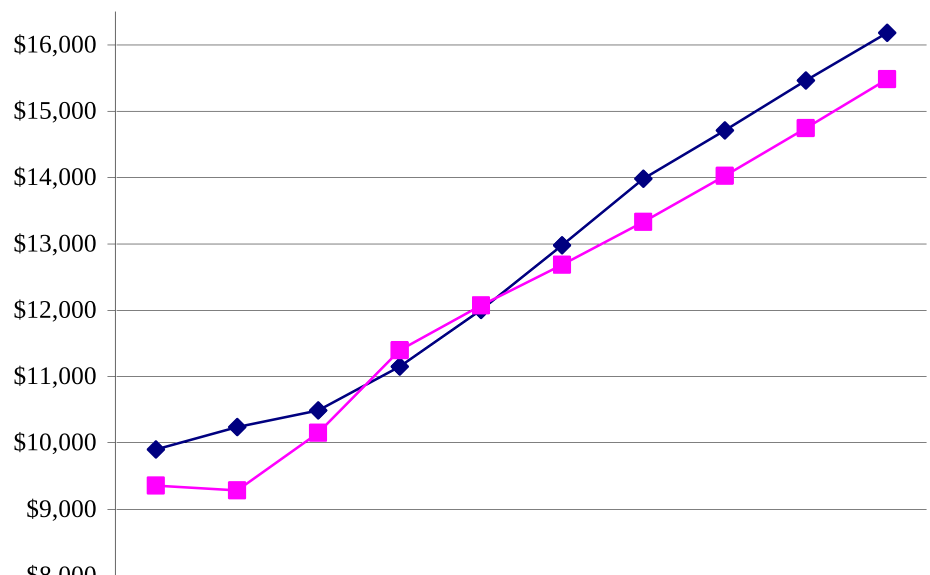
---

**Exhibit 3**

**Projected Spending Outstrips Projected Revenue as Education Funding Growth Is Fully Implemented**

**Fiscal 2006 – 2008**

**($ in Millions)**




| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|
| Ongoing Spending | $9,901 | $10,24 | $10,48 | $11,14 | $12,00 | $12,97 | $13,98 | $14,70 | $15,46 | $16,18 |
| Ongoing Revenues | $9,356 | $9,281 | $10,15 | $11,39 | $12,07 | $12,68 | $13,32 | $14,02 | $14,74 | $15,48 |
| Structural Balance | -$545 | -$959 | -$337 | $247 | $66 | -$291 | -$655 | -$681 | -$717 | -$701 |

**Fiscal Years**

Source: Department of Legislative Services

---

**Exhibit 4** provides the revenue and spending outlook for the fiscal 2006 through 2011 period. As shown, the general fund can expect to close with a positive cash balance at the close of fiscal 2007 plus nearly $1.4 billion in the Rainy Day Fund. However, balancing the fiscal 2008 budget on a cash basis cannot be achieved without a substantial draw on reserves of more than $600 million. Based on current estimates, this can be achieved while also maintaining the statutorily required 5 percent balance in the Rainy Day Fund.

## Exhibit 4
## General Fund Projections
### Fiscal 2006 – 2011

| | Leg. Approp. FY 2006 | Baseline FY 2007 | FY 2008 | FY 2009 | FY 2010 | FY 2011 |
|---|---|---|---|---|---|---|
| **Revenues – October 2005 DLS Estimate** | | | | | | |
| Individual Income | $6,127 | $6,538 | $6,980 | $7,426 | $7,880 | $8,342 |
| Sales and Use | 3,319 | 3,481 | 3,648 | 3,837 | 4,028 | 4,229 |
| Lottery | 478 | 492 | 508 | 526 | 545 | 565 |
| Other | 2,147 | 2,176 | 2,193 | 2,239 | 2,291 | 2,345 |
| One-time | 27 | 4 | 22 | 29 | 17 | 3 |
| **Subtotal** | **$12,097** | **$12,690** | **$13,352** | **$14,056** | **$14,761** | **$15,485** |
| **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** |
| **Expenditures** | | | | | | |
| Debt Service | $0 | $0 | $0 | $19 | $56 | $58 |
| Local Aid – Education\Libraries | 4,073 | 4,626 | 5,182 | 5,412 | 5,630 | 5,825 |
| Local Aid – Other | 464 | 492 | 514 | 536 | 559 | 583 |
| Entitlements | 2,305 | 2,602 | 2,788 | 2,988 | 3,201 | 3,429 |
| State Operations | 5,001 | 5,277 | 5,521 | 5,774 | 6,034 | 6,308 |
| Reversions | -22 | -20 | -20 | -20 | -20 | -20 |
| Deficiencies | 184 | 0 | 0 | 0 | 0 | 0 |
| **Subtotal** | **$12,004** | **$12,977** | **$13,984** | **$14,709** | **$15,460** | **$16,183** |
| Capital | 23 | 31 | 33 | 3 | 2 | 2 |
| Reserve Fund | 326 | 643 | 50 | 50 | 115 | 0 |
| **Total Expenditures** | **$12,353** | **$13,651** | **$14,067** | **$14,762** | **$15,577** | **$16,185** |
| **Surplus (Shortfall)** | **$1,057** | **$97** | **$36** | **-$574** | **-$817** | **-$700** |
| **Annual Change** | | -960 | -61 | -610 | -243 | 117 |
| **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 |

Source: Department of Legislative Services

## Unfunded Liabilities Could Cloud the Sunny Budget Picture

Although estimated cash balances are at a level that would address the structural deficit in both fiscal 2007 and 2008 while also maintaining a 5 percent reserve in the Rainy Day Fund, the fiscal picture for the State for the next two budget years may not be as positive as it appears. A desire to maintain the State's reputation for fiscal prudence will likely result in efforts to address significant unfunded liabilities associated with retiree health insurance as well as the Injured Workers Insurance Fund. Addressing these issues will likely cause the structural deficit to exceed current estimates.

***Retiree Health Insurance:*** Accounting changes effective in fiscal 2008 will require the State to recognize its liability for retiree health insurance. At present, the State funds retiree health insurance on a pay-as-you-go basis. Depending on the assumed rate of return for any funds placed in reserve for this purpose, the liability is expected to range between $13.0 and $20.4 billion resulting in an annual required contribution of between $1.6 and $1.1 billion over current expenditures. The bond rating agencies have indicated that recognition of these liabilities will not result in any immediate rating changes but that indefinite deferral will be a negative rating factor.

***Retirement:*** Overall, the State's liability for pension and retirement systems is underfunded by approximately $4.5 billion, although the systems are actuarially sound. The two largest plans, for State employees and teachers systems, are funded at 85 and 89 percent, respectively.

***Workers' Compensation:*** Transfers from the State's account within the Injured Workers' Insurance Fund were implemented to help balance the budget during the recent economic downturn. Roughly $235 million would be needed to fully fund the State's liability.

In sum, the outstanding liabilities facing the State are considerable. In combination with existing funding commitments, the surplus at the close of fiscal 2005 represents a small portion of the sum necessary to satisfy current obligations. While the presence of the surplus invites overtures for new spending or tax relief, the challenge will be to establish a multi-year plan for addressing use of the current surplus, cash reserves in the State Reserve Fund, and current and future spending needs. Consensus on a long-term strategy will assist in maintaining a balanced general fund budget and in retaining the State's AAA bond rating.

## Conclusion

Better than expected economic activity has helped shore up State finances and resulted in a surplus and structural balance for the current fiscal year. Spending pressure will continue as education aid enhancements are phased in through fiscal 2008, entitlement spending for Medicaid rises, and agency spending needs must be addressed. Moreover, substantial unfunded liabilities exist for retiree health insurance, retirement, and workers' compensation. A multi-year plan will need to be developed to maintain structural and cash balance, provide services, meet future liabilities, and maintain the State's AAA bond rating. This will likely require a mix of cash reserves, service reductions, revenue enhancements, and continued economic growth.

For further information contact: David B. Juppe Phone: (410) 946/(301) 970-5530

# Operating Budget

## Transportation Trust Fund

**Recent federal transportation authorization has provided the Maryland Department of Transportation with an opportunity to expand its capital program. Increased federal funding, combined with a stable revenue outlook for the Transportation Trust Fund and large debt capacity, could allow Maryland to maintain an average total capital program of approximately $1.5 billion from fiscal 2006 through 2011.**

### Fiscal 2005 Closeout

The Transportation Trust Fund (TTF) supports the activities of the Maryland Department of Transportation (MDOT). All taxes, fees, charges, and revenues collected or received by MDOT or any of its modal administrations or units are credited to the TTF, including the cash proceeds from the sale of bonds, any general funds appropriated to MDOT, and the proceeds of any federal grants received by MDOT. MDOT utilizes the funds from the TTF to fund its transportation projects and programs in accordance with annual appropriations.

The TTF closed fiscal 2005 with a fund balance of approximately $245 million, which is $145 million above the expected closing fund balance of $100 million. Corporate income tax revenue was $29 million higher than anticipated due largely to one-time receipts from the Delaware holding company legislation (Chapter 556 of 2004). Capital expenditures were $175 million lower than anticipated due primarily to cash flow changes related to ongoing projects. Cash flow changes are often attributable to projects being deferred to later years and project delays. Additionally, MDOT anticipated a bond sale of $35 million in fiscal 2005, but because of higher than anticipated revenue, bonds were not sold.

### Fiscal 2006 – 2011 TTF Forecast

**Exhibit 1** shows the Department of Legislative Services' (DLS) fiscal 2006 through 2011 TTF forecast. The forecast details expected trends in revenue attainments, debt issuances, and capital expenditures.

The TTF received $753 million in gas tax revenues in fiscal 2005. These revenues are expected to grow by 2.9 percent in fiscal 2006 and achieve average annual growth of nearly 2.0 percent from fiscal 2006 through 2011. Even with high gas prices, demand for fuel has remained inelastic. Many consumers have chosen to cut back in other areas but continue to purchase gas.

The TTF received $718 million in titling tax revenue in fiscal 2005. These revenues are expected to show growth of 3.6 percent in fiscal 2006 and achieve average annual growth of

3.8 percent from fiscal 2006 to 2011. Strong growth in the titling tax is tied to a rebounding economy, including rises in employment growth and personal income.

**Exhibit 1**
## Department of Legislative Services
## Transportation Trust Fund Forecast
**Fiscal 2006 – 2011**

| | Actual FY 2005 | Current Year FY 2006 | Estimate FY 2007 | Estimate FY 2008 | Estimate FY 2009 | Estimate FY 2010 | Estimate FY 2011 |
|---|---|---|---|---|---|---|---|
| **Opening Fund Balance** | **$288** | **$245** | **$100** | **$100** | **$100** | **$100** | **$100** |
| **Closing Fund Balance** | **$245** | **$100** | **$100** | **$100** | **$100** | **$100** | **$100** |
| **Net Revenues** | | | | | | | |
| Taxes and Fees | $1,602 | $1,622 | $1,681 | $1,726 | $1,779 | $1,823 | $1,867 |
| Operating & Misc. | 493 | 432 | 437 | 416 | 429 | 439 | 450 |
| Transfers btw. TTF and GF | 0 | 50 | 0 | 0 | 0 | 0 | 0 |
| MdTA Transfer | 43 | 43 | 43 | 0 | 0 | 0 | 0 |
| ***Net Revenues Subtotal*** | 2,138 | 2,147 | 2,161 | 2,142 | 2,208 | 2,262 | 2,317 |
| Bonds Sold | 0 | 155 | 215 | 240 | 205 | 270 | 240 |
| Bond Premiums | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total Revenues** | **$2,138** | **$2,302** | **$2,376** | **$2,382** | **$2,413** | **$2,532** | **$2,557** |
| **Expenditures** | | | | | | | |
| Debt Service | $154 | $146 | $131 | $141 | $159 | $172 | $193 |
| Operating Budget | 1,238 | 1,277 | 1,343 | 1,410 | 1,479 | 1,549 | 1,622 |
| State Capital | 789 | 1,025 | 902 | 831 | 775 | 811 | 742 |
| **Total Expenditures** | **$2,181** | **$2,448** | **$2,376** | **$2,382** | **$2,413** | **$2,532** | **$2,557** |
| **Debt** | | | | | | | |
| Debt Outstanding | $1,070 | $1,218 | $1,366 | $1,537 | $1,663 | $1,850 | $1,996 |
| Debt Coverage – Net Income | 4.7 | 5.8 | 5.4 | 4.4 | 3.4 | 3.0 | 2.7 |
| **Local Hwy User Revenues (HUR)** | **$559** | **$561** | **$578** | **$592** | **$610** | **$624** | **$638** |
| Transferred to General Fund | 102 | 49 | 0 | 0 | 0 | 0 | 0 |
| **Net HUR to Counties** | **$457** | **$513** | **$569** | **$578** | **$588** | **$596** | **$605** |
| **Capital Summary** | | | | | | | |
| State Capital | $789 | $1,025 | $902 | $831 | $775 | $811 | $742 |
| Federal Capital | 705 | 776 | 677 | 677 | 640 | 640 | 634 |
| GARVEE Debt Service (paid from federal funds) | 0 | 0 | 43 | 43 | 80 | 80 | 86 |
| **Total Capital Expenditures** | **$1,494** | **$1,801** | **$1,622** | **$1,551** | **$1,495** | **$1,531** | **$1,462** |

GARVEE = grant anticipation revenue vehicles

Source: Department of Legislative Services

The TTF received $351 million in vehicle registration fee revenues in fiscal 2005. Registration fee revenues historically do not achieve strong annual growth and are expected to increase by 1.3 percent from fiscal 2006 to 2011. Corporate income tax revenues for the TTF totaled $209 million in fiscal 2005, which includes one-time receipts from the Delaware holding company settlement period. In fiscal 2006, revenues are expected to drop to $176 million and then achieve average annual growth of 3.6 percent through fiscal 2011.

From fiscal 2002 to 2004, a total of $315 million was diverted from the TTF to the general fund. Chapter 430 of 2004 required repayment to the TTF from unappropriated general fund surpluses, and the first repayment of $50 million was made from the general fund to the TTF in fiscal 2006. The remaining $265 million will be transferred directly to the Maryland Transportation Authority to help finance the InterCounty Connector (ICC) project, per Chapters 471 and 472 of 2005.

## Debt Financing

State law establishes the maximum aggregate and unpaid principal balance of consolidated transportation bonds that may be outstanding at any one time. During the 2004 session, increases in vehicle registration fees allowed for this limit to be raised to $2 billion. MDOT did not issue any debt in fiscal 2005 but has the capacity to issue a significant amount of debt from fiscal 2006 to 2011, during which time MDOT could issue up to $1.3 billion in debt and still stay within the $2 billion debt outstanding limit and the 2.5 net income coverage ratio (net income relative to debt service). In fiscal 2011, debt outstanding reaches $1.99 billion and the net income coverage ratio is 2.7.

## Capital Expenditures

The TTF forecast assumes $5.1 billion from fiscal 2006 through 2011 for special fund expenditures on capital projects, an average of $848 million per year. Combined with anticipated federal transportation funding, MDOT could maintain an average annual capital program of roughly $1.5 billion from fiscal 2006 through 2011.

The forecast assumes average annual federal aid of at least $720 million from fiscal 2006 to 2011. It is expected that the recent federal transportation authorization, known as the "Safe, Accountable, Flexible and Efficient Transportation Equity Act – A Legacy for Users" (SAFETEA-LU), will provide Maryland with an annual average of $583 million for highways and $140 million for transit from fiscal 2005 through 2009. The forecast assumes similar levels in fiscal 2010 and 2011, although a new transportation authorization will likely be passed by that time. Anticipated debt service for grant anticipation revenue vehicles (GARVEEs) is also provided in the forecast; GARVEE bond debt service is taken out of the annual federal funds Maryland will receive.

For further information contact: Jonathan D. Martin Phone: (410) 946/(301) 970-5530

# Operating Budget

## Federal Funds Outlook

**Congress has yet to pass a final budget reconciliation bill, but the outlook is beginning to take shape. Although increases in homeland security and transportation spending are likely, states could experience budgetary difficulties in other areas as Congress looks for reductions to offset additional spending on hurricane relief efforts.**

Federal fiscal 2006 is once again the year of the continuing resolution (CR), but this year there may be an end in sight. On November 18, 2005, Congress passed another CR to fund the government through December 17. Already, 6 of the 12 appropriations bills have been signed into law. Conference committees have met and made reports on all but one of the remaining bills, the Defense appropriation.

All the appropriations news is not rosy. The House voted down the conference report on the bill that funds the departments of Labor, Health and Human Services, and Education. The defeat leaves three options. First, members could try returning the bill to conference again. Second, Congressional leaders could attach the bill to the Defense appropriations bill, making it a "minibus." Finally, Congress could apply a year-long continuing resolution to labor, health, human services and the education programs and designate one of several targets as the official fiscal 2006 funding level. Regardless of the option chosen, programs accustomed to experiencing increases will be held at current levels or reduced. Further, it is rumored that there will be an across-the-board cut that would affect all agency budgets. Because it is still alive, the Defense appropriation would be the most likely target for any such cut.

As much as it is the year of the CR, fiscal 2006 is also the year of the hurricane. Hurricanes Katrina, Rita, and Wilma have not only disrupted commerce and the lives of many Americans, they have also altered the landscape for federal budget crafters. In the wake of Hurricane Katrina, Congress convened in September to approve a $62 billion appropriations package for immediate relief and rescue efforts. The Congressional Budget Office estimates that the federal government will spend an additional $150 billion on hurricane relief and rebuilding efforts. This new spending has contributed to what the Office of Management and Budget estimates will be a deficit of $319 billion for fiscal 2005. In turn, this new spending has led to increased calls for spending reductions in other programs to offset spending on hurricane relief efforts and the current federal deficit.

Various House and Senate legislative proposals focus on significantly altering the way entitlement programs are administered by the states. The overall effect on Maryland is unknown at this time, as the House and the Senate have yet to agree on a final budget reconcilliation bill.

## Reconciliation Bills Focused on Entitlement Program Reductions

To make up for hurricane relief spending and partially offset the cost of tax cut legislation, both the House and Senate have introduced new versions of budget reconciliation legislation. The Senate's version includes a total of $39 billion in cuts from various entitlement programs, including Medicaid, Medicare, student loans, and agriculture subsidies, over the next five years. The House bill has been bogged down over various provisions and was recently pulled from the floor.

The House bill includes cuts in roughly the same areas as the Senate bill. However, the House has made deeper cuts than the Senate. The House voted to cut approximately $50 billion from various entitlement programs, including Medicaid, student loans, agricultural subsidies, child support enforcement, and food stamps. Another major difference between the two reconciliation bills is how they treat oil drilling in the Arctic National Wildlife Refuge. The Senate bill includes a provision authorizing the drilling, while the House removed the provision from its version in order to garner enough votes for passage. Although not directly related to the budget, this could be one of the more contentious issues as the two houses try to hammer out a compromise.

## Temporary Assistance for Needy Families Extended but Reductions Are Also on the Table

Both the House and Senate have approved changes to Temporary Assistance for Needy Families (TANF) so that states may better assist families affected by Huricane Katrina. The bill makes $2 billion available to states for the costs of providing emergency cash assistance to evacuees and extends TANF through December 31, 2005. Several hundred Katrina evacuees located in Maryland may be affected by this legislation. At least one proposal would require states to maintain an increasing percentage of TANF recipients that participate in work activities while receiving cash assistance. The penalty for the first failure to meet those requirements could total up to 5 percent of the TANF block grant amount, with a subsequent increase in penalties for additional failures

## The Rise and Fall in Homeland Security Spending

Although entitlement programs are facing spending cuts, homeland security and transportation funding could increase. The recently passed Homeland Security Appropriation Bill included $32 billion in discretionary and mandatory spending for the Department of Homeland Security in fiscal 2006, a $1.4 billion increase. However, funding for the State Homeland Security Grant Program has been cut in half, from $1.1 billion in fiscal 2005 to $550 million in fiscal 2006. Under the grant formula, each state is guaranteed 0.75 percent of the total, or $4.125 million. The remainder of the grant money will be apportioned to the states by the Secretary of Homeland Security based on risk. Guidelines for assessing the risk have not been released, so it is unclear what share of this reduced total Maryland will receive.

## Increased Transportation Spending Authorized

In August 2005, the President signed into law the "Safe, Accountable, Flexible, and Efficient Transportation Equity Act – A Legacy for Users of 2005" (SAFETEA-LU) which authorizes spending on transit, highway, rail, and safety programs through federal fiscal 2009. Under SAFETEA-LU, Maryland expects to receive annual average highway funding of $583 million, an increase of $140 million (31.6 percent) over former levels. Maryland received numerous earmarks under SAFETEA-LU for both highways and transit. The State received 92 highway-related earmarks ($308 million) and 21 transit-related earmarks ($295 million) for a total of 113 earmarks and $603 million. For a more detailed discussion of SAFETEA-LU, see the issue paper under Transportation in Part 9.

For further information contact: T. Ryan Wilson/Netsanet Kibret Phone: (410) 946/(301) 970-5510

# Capital Program

## Debt Affordability

**The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling $690 million for fiscal 2007. This amount includes a $20 million increase resulting from a new 3 percent annual escalation formula established by the committee.**

### Capital Debt Affordability Process

State law requires the five-member Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt on a continuing basis to help ensure that the State's tax-supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the Secretaries of Transportation and Budget and Management, and a public member. Chapter 445 of 2005 also added as nonvoting members the chairs of the Capital Budget Subcommittees for the Senate Budget and Taxation Committee and the House Committee on Appropriations. Tax-supported debt consists of general obligation (GO) debt, transportation debt, Grant Anticipation Revenue Vehicles (GARVEEs), bay restoration bonds, capital leases, Stadium Authority debt, and bond or revenue anticipation notes (BANs/RANs). The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new GO and academic revenue debt for each fiscal year. The committee does not make individual recommendations on the levels of capital leases, transportation debt, bay restoration bonds, or Stadium Authority debt but does incorporate the anticipated levels of these types of debt in its analysis of total debt affordability.

The committee's benchmarks for determining whether State debt is affordable are as follows: (1) total tax-supported debt outstanding should not exceed 3.2 percent of Maryland personal income; and (2) total debt service on tax-supported debt should not exceed 8 percent of revenues. The committee's analysis of debt affordability for the fiscal 2006 through 2011 period indicates that debt outstanding and debt service ratios will remain within the affordability limits for this period as indicated in **Exhibit 1.**

**Exhibit 1**
**Affordability Ratios**
**Fiscal 2006 – 2011**

| Fiscal Year | Projected Debt Outstanding as % of Personal Income | Projected Debt Service as % of Revenues |
|---|---|---|
| 2006 | 2.87% | 5.85% |
| 2007 | 2.84 | 6.07 |
| 2008 | 2.96 | 6.24 |
| 2009 | 2.98 | 6.64 |
| 2010 | 3.04 | 6.67 |
| 2011 | 3.08 | 6.86 |

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, September 2005

## Recommended New Debt Authorizations

The committee has recommended $690 million in new GO debt authorization for the 2006 legislative session, which is $20 million more than was authorized in the 2005 session and reflects a change in application of the committee's authorization policy. In 1992 the committee adopted a policy to increase authorizations $15 million annually. At the time this policy was adopted, the $15 million allowed for a 2 percent growth attributable to inflation and 1 percent growth in the program size. Since 1992, annual increases have generally been $15 million. This year the committee decided to alter the method for determining the annual escalation amount indicating it will now recommend 3 percent annual increases. This methodology provides an additional $20 million in new GO debt authorization in fiscal 2007. The fiscal 2007 recommendation also includes a planned $5 million for tobacco buyout financing, as required by Chapter 103 of 2002. By the end of fiscal 2007, the committee estimates that total GO debt will be just over $5.1 billion.

The University System of Maryland (USM), Morgan State University, and St. Mary's College have the authority to issue debt for academic facilities as well as debt for auxiliary facilities. Proceeds from academic debt issues are used for facilities that have an education-related function, such as classrooms. Debt service for these bonds is paid with tuition and fee revenues. For fiscal 2007, CDAC has recommended $25 million for academic facilities on USM campuses which is equal to the fiscal 2006 recommended amount.

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded from motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and other Maryland Department of Transportation (MDOT) revenues. Total outstanding transportation debt is projected to reach almost $1.3 billion in fiscal 2007. The department also anticipates issuing the first GARVEE (Grant Anticipation Revenue Vehicle) bonds in fiscal 2006. MDOT projects that $351 million in GARVEEs will be outstanding at the end of fiscal 2007. The State pledges anticipated federal revenues to support the GARVEEs debt service.

The Bay Restoration Fund was created in 2004 to provide grants for Enhanced Nutrient Removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. The Maryland Department of the Environment indicates that it intends to issue bay restoration bonds backed by revenue generated under this program in fiscal 2008.

Capital leases for real property and equipment are secured by the assets leased and are paid with appropriations made to the agencies using the leased items. Debt outstanding for leases is expected to be $208 million at the end of fiscal 2007. Finally, Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, the Hippodrome Theater, and the Montgomery County conference center. The facilities' debt service is supported by lottery revenues and other general fund sources. Stadium Authority debt outstanding is expected to be $282 million at the end of fiscal 2007.

For further information contact: Patrick S. Frank Phone: (410) 946/(301) 970-5530

# Capital Program

## Capital Funding Requests Exceed Resources

**Requests for capital project funding in fiscal 2007 exceed the funding available from general obligation bonds and pay-as-you-go (PAYGO) funds by $267 million. It is unclear whether the recent improvement in the State's fiscal condition will result in the inclusion of some limited general fund PAYGO funding in the fiscal 2007 budget.**

### General Obligation Bonds

The Capital Debt Affordability Committee (CDAC) has recommended a $690 million limit on the amount of new general obligation (GO) debt authorizations by the 2006 General Assembly to support the fiscal 2007 capital program. The recommendation is $20 million higher than the authorizations subject to the GO limit for fiscal 2006 and includes $5 million for tobacco buyout financing as required by Chapter 103 of 2002.

The CDAC five-year forecast for new GO debt authorizations reflects two changes in the committee's policy. First, the committee recommended that future year authorizations increase by 3 percent annually rather than $15 million annually assumed in the past. This modification only adds about $5 million annually over what was assumed in the 2004 CDAC report. Second, the committee's recommendation eliminates the drop in authorizations previously planned for fiscal 2010.[1] This recommended change in policy will have a significant impact on the amount of GO authorizations available to support the capital program: approximately $85 million of additional authorizations will be available in both fiscal 2010 and 2011 based on the CDAC's five-year forecast. However, despite the increased authorizations provided in the five-year forecast period, GO bond funding requests exceed the projected limits by $267 million in fiscal 2007 and by almost $1.6 billion during the forecast period. **Exhibit 1** provides a summary of the GO bond requests for the next five years.

[1] The five-year initiative recommended by CDAC in September 2003 to maintain an annual general obligation bond authorization $95 million higher than what was originally recommended by the committee in September 2002 for fiscal 2005 through 2009 was scheduled to expire beginning in fiscal 2010.

## Exhibit 1
# GO Bond Requests: Fiscal 2007 – 2011
### ($ in Millions)

| | Fiscal Years | | | | | | Category |
|---|---|---|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2010** | **2011** | **Total** | **Totals** |
| State Facilities | | | | | | | $560.0 |
| Board of Public Works | 104.8 | 53.7 | 60.4 | 122.0 | 204.8 | 545.7 | |
| Military | 0.0 | 2.7 | 0.9 | 2.7 | 0.0 | 6.3 | |
| Dept. Disabilities/Veterans Affairs | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 8.0 | |
| Health and Social Services | | | | | | | $365.0 |
| Health and Mental Hygiene | 14.3 | 50.1 | 22.5 | 21.9 | 104.4 | 213.2 | |
| University of MD Medical System | 5.0 | 10.0 | 12.5 | 10.0 | 10.0 | 47.5 | |
| Senior Citizen Activity Center | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 7.5 | |
| Juvenile Justice | 5.7 | 7.9 | 47.7 | 7.5 | 4.5 | 73.3 | |
| Private Hospital Grant Program | 3.5 | 5.0 | 5.0 | 5.0 | 5.0 | 23.5 | |
| Environment | | | | | | | $312.0 |
| Natural Resources | 13.0 | 13.0 | 13.0 | 13.0 | 10.0 | 62.0 | |
| Agriculture* | 4.6 | 7.3 | 7.5 | 8.0 | 8.5 | 35.9 | |
| Environment | 37.5 | 39.1 | 39.3 | 39.3 | 37.8 | 193.0 | |
| MD Environmental Service | 2.9 | 4.1 | 3.8 | 5.5 | 4.8 | 21.1 | |
| Education | | | | | | | $1,318.8 |
| Education | 0.0 | 0.8 | 50.5 | 0.0 | 0.0 | 51.3 | |
| MD School for the Deaf | 22.6 | 4.9 | 0.3 | 1.1 | 1.0 | 29.9 | |
| Public School Construction** | 247.6 | 247.4 | 247.6 | 247.4 | 247.6 | 1,237.6 | |
| Higher Education | | | | | | | $1,623.4 |
| University System of MD*** | 151.6 | 168.5 | 110.8 | 222.5 | 211.6 | 865.0 | |
| Baltimore City Comm. College | 0.0 | 26.2 | 1.7 | 1.2.3 | 14.9 | 42.8 | |
| St. Mary's College | 9.2 | 0.8 | 21.9 | 3.7 | 0.0 | 35.6 | |
| Morgan State University | 15.9 | 12.7 | 39.5 | 5.2 | 32.6 | 105.9 | |
| Community Colleges | 75.6 | 154.6 | 112.4 | 95.5 | 83.9 | 522.0 | |
| Southern MD Higher Educ. Center | 0.0 | 0.0 | 0.0 | 0.8 | 10.3 | 11.1 | |
| Private Facilities Grant Program | 9.0 | 8.0 | 8.0 | 8.0 | 8.0 | 41.0 | |
| Public Safety | | | | | | | $523.7 |
| Public Safety | 89.7 | 79.3 | 59.4 | 60.7 | 109.4 | 398.5 | |
| State Police | 11.0 | 13.6 | 6.7 | 0.3 | 9.1 | 40.7 | |
| Local Jails | 7.5 | 15.0 | 48.8 | 9.4 | 3.8 | 84.5 | |
| Housing and Economic Development | | | | | | | $251.0 |
| Economic Development | 20.0 | 20.0 | 20.0 | 20.0 | 20.0 | 100.0 | |
| Housing and Comm. Development | 26.2 | 25.8 | 24.9 | 24.3 | 27.3 | 128.5 | |
| Canal Place | 0.0 | 2.5 | 0.0 | 0.0 | 0.0 | 2.5 | |
| Historic St. Mary's City | 1.2 | 1.3 | 6.1 | 0.7 | 1.0 | 10.3 | |
| Planning | 0.3 | 3.0 | 0.3 | 2.3 | 3.8 | 9.7 | |
| Legislative Initiatives | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 75.0 | $75.0 |
| Miscellaneous | 56.5 | 53.3 | 28.0 | 29.5 | 7.5 | 174.8 | $174.8 |
| **Subtotal Request** | **$953.3** | **$1,048.7** | **$1,017.6** | **$984.4** | **$1,199.7** | **$5,203.7** | **$5,203.7** |
| Tobacco Transition Program | 4.0 | 4.0 | 3.5 | 3.5 | 0.0 | 15.0 | $15.0 |
| **Total Request** | **957.3** | **1,052.7** | **1,021.1** | **987.9** | **1,199.7** | **5,218.7** | **$5,218.7** |
| **Debt Affordability Limits** | **$690.0** | **$710.0** | **$730.0** | **$745.0** | **$770.0** | **$3,645.0** | |

*The Department of Agriculture request does not include the Tobacco Transition Program.
**The Interagency Committee on School Construction received requests in excess of $470 million for fiscal 2007, however, the amount included in the request to the Department of Budget and Management only reflects level funding with fiscal 2006 authorization.
***In addition to the GO bond request, the University System of Maryland has requested academic revenue bond funding of $25.0 million annually for fiscal 2006 – 2010.
Note: Numbers may not sum to total due to rounding.
Source: Department of Budget and Management

## General Fund PAYGO Funding

General obligation bond funds have traditionally been supplemented with State general and special fund capital appropriations pay-as-you-go (PAYGO) funds authorized in the annual operating budget. The use of operating funds to finance capital projects and programs can reduce debt issuance and enables the State to avoid Internal Revenue Service limits on the use of tax-exempt bonds for "private activity" purposes such as economic development and housing programs.[2]

The State's recent fiscal problems have severely curtailed the use of PAYGO general funds. **Exhibit 2** shows the fiscal 2002 though 2006 general fund capital PAYGO appropriation and PAYGO general fund estimates according to the 2005 *Capital Improvement Plan* (CIP) for fiscal 2007 through 2010.

**Exhibit 2**
**General Fund PAYGO**
**Fiscal 2002 through 2006 Appropriations**
**Fiscal 2007 through 2010 CIP Estimates**
**($ in Millions)**

| Function | FY 02* Approp. | FY 03** Approp. | FY 04 Approp. | FY 05 Approp. | FY 06 Approp. | FY 07 – FY 10 Planned |
|---|---|---|---|---|---|---|
| State Facilities | $18.4 | $0.0 | $0.0 | $0.0 | $0.6 | $0.7 |
| Health/Social Services | 5.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Environment | 26.7 | 10.6 | 0.0 | 0.0 | 0.0 | 0.0 |
| Education | 93.4 | 3.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Higher Education | 95.0 | 0.0 | 0.0 | 0.0 | 1.9 | 0.0 |
| Public Safety | 1.7 | 0.0 | 0.0 | 1.0 | 0.0 | 0.0 |
| Housing | 29.4 | 14.4 | 0.7 | 0.0 | 0.0 | 0.0 |
| Economic Development | 39.6 | 20.5 | 8.7 | 0.0 | 0.0 | 0.0 |
| Local Projects | 15.6 | 0.5 | 0.0 | 0.2 | 0.0 | 0.0 |
| **Totals** | **$324.8** | **$49.0** | **$9.4** | **$1.2** | **$2.5** | **$0.7** |

*Reflects the embargo/reversion of $324 million of fiscal 2002 appropriations to the State general fund.
**Reflects the embargo/reversion of $760,000 of fiscal 2003 appropriations to the State general fund.
Source: Department of Budget and Management

[2]Restrictions imposed under the federal Tax Reform Act of 1986 generally prevent the use of tax-exempt bond proceeds to finance environmental, housing, and economic development revolving loan programs. Funding for these items is therefore typically requested from general and special PAYGO funds. Additionally, repayment to counties for school construction costs already incurred (forward funded construction) must be made with PAYGO or other alternatives to tax-exempt debt. PAYGO also may be used to fund any capital project based on fund availability.

The figures indicate the almost complete elimination of the use of PAYGO general funds in the most recent State budgets. Furthermore, the Administration's most current CIP does not provide any PAYGO general funds through 2010 other than a small amount planned for the Department of Veterans Affairs projects which are ultimately reimbursed by the federal government. The policy of forgoing the use of PAYGO general funds to support the State's capital program has resulted in the use of GO bond funds to support traditional PAYGO programs in recent years. For fiscal 2004 through 2006, a total of $118.2 million in GO bond funds have been provided to support programs traditionally funded with PAYGO general funds. The limited use of PAYGO general funds has also resulted in the need to issue taxable debt rather than the traditional tax exempt debt in order to avoid exceeding federal private activity limits. As part of two 2005 bond sales, the State issued $45 million in taxable debt. While the taxable issuances are scheduled to mature more rapidly than the traditional 15-year maturity on tax-exempt issuances ($25 million is scheduled to mature within three years, and $20 million is scheduled to mature within seven years), in order to limit the additional cost of issuing taxable debt, the Department of Legislative Services has calculated the additional cost of the $45 million of issued taxable debt to be $1.6 million over the term of the bonds.

Based on current estimates, at the end of fiscal 2006, there will be an ending cash balance in the general fund of $1.06 billion and a Rainy Day Fund balance of $747 million as the result of a combination of a cash balance that was planned during the fiscal 2006 budget process, revenues that exceeded estimates for fiscal 2005, and improved revenue estimates for fiscal 2006. It is unclear whether these balances will result in the inclusion of any general fund PAYGO projects in the fiscal 2007 budget introduced by the Governor.

# Revenues and Taxes

## Effects of Recent Revenue Measures

**A variety of revenue measures have been enacted in the last three years, generating significant general and special fund revenues. These revenue measures have primarily been in the form of fee increases and tax compliance, as well as an increase in the State property tax in 2003.**

### Revenue Summaries

Measures to enhance or reduce revenues generally take the form of legislation, with changes to the State property tax being a notable exception. During strong economic times in the 1990s and early in this decade, most changes resulted in State revenue reductions. To address the economic downturn that began with the 2001 recession, more recent changes have generated additional revenues, mainly through the State property tax, fees, and tax compliance measures.

**Exhibit 1** shows the estimated annual fiscal impact of revenue changes passed during the 2003 through 2005 sessions, including the special session of 2004. As the exhibit shows, annual total revenue impacts range from a low of $360.4 million in fiscal 2004 to a high of $983.1 million in fiscal 2010. Except for fiscal 2004 and 2005, annual special fund revenues constitute a significant portion of the new revenues, ranging from 65 percent of new revenues in fiscal 2006 to 72 percent in fiscal 2009.

**Exhibit 1**
**Fiscal Impact of Revenue Measures by Fund Type**
**Fiscal 2004 – 2010**
**($ in Millions)**

| Fund Type | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | Cumulative Total |
|---|---|---|---|---|---|---|---|---|
| General Fund | $169.7 | $433.1 | $310.8 | $247.8 | $252.4 | $255.2 | $293.0 | $1,962.0 |
| Special Fund | 190.7 | 482.5 | 578.3 | 601.8 | 627.9 | 662.0 | 690.1 | 3,833.3 |
| **Total** | **$360.4** | **$915.6** | **$889.1** | **$849.6** | **$880.3** | **$917.2** | **$983.1** | **$5,795.3** |

Source: Department of Legislative Services

As a point of comparison, over the period from fiscal 1996 through 2003, major revenue changes resulted in a net cumulative revenue decrease of about $2.5 billion, most of which was in general funds. The phased-in personal income tax reduction enacted in 1997 had the greatest impact, reducing general fund revenues by $2.2 billion over a six-year period from fiscal 1998 to

2003. Measures that reduced revenues were partially offset by $400 million in tobacco tax revenue increases in 1999 and 2002.

**Exhibit 2** summarizes the revenue measures passed during the 2003 through 2005 legislative sessions, including the 2004 special session. The exhibit also shows the fiscal impact in total funds.

**Exhibit 2**
## Significant Revenue Measures
**($ in Millions)**

| | FY 2004 | FY 2005 | FY 2006 | FY 2007–2010 |
|---|---|---|---|---|
| **2003 Session** | | | | |
| State Property Tax | $170.8 | $185.1 | $205.0 | $996.0 |
| Tax Compliance Measures | 97.1 | 46.9 | 42.2 | 161.6 |
| Corporate Filing Fees | 38.4 | 49.9 | 49.9 | 199.7 |
| Income Tax on Sales of Property by Nonresidents | 23.4 | 33.1 | 18.4 | 63.1 |
| Land Records Fees | 18.8 | 18.8 | 18.8 | 75.4 |
| Miscellaneous Fees | 6.0 | 6.1 | 6.3 | 26.7 |
| Heritage Tax Credit Caps | 3.5 | 20.6 | 15.8 | 2.2 |
| **Subtotal, 2003** | **$358.0** | **$360.7** | **$356.5** | **$1,524.7** |
| **2004 Session** | | | | |
| Delaware Holding Co. Legislation and Settlement Period | | $235.4 | $45.8 | $220.0 |
| Motor Vehicle Administration Fees | | 170.3 | 173.3 | 700.4 |
| Decoupling from Federal Tax Provisions | $2.4 | 47.5 | 45.6 | 192.2 |
| Minimum County Income Tax Rate for Nonresidents | | 38.6 | 27.8 | 129.2 |
| HMO Premium Tax | | 28.9 | 74.7 | 381.2 |
| Heritage Tax Credit Caps | | (7.4) | (9.4) | (20.0) |
| Reducing the Sales Tax Vendor Discount by Half | | 16.6 | 17.5 | 0.0 |
| Chesapeake Bay/Wastewater Facilities Surcharge | | 10.0 | 71.1 | 295.8 |
| Miscellaneous Fees | | 12.2 | 11.4 | 47.8 |
| Tax Compliance Measures | | 2.8 | 0.4 | 1.5 |
| **Subtotal, 2004** | **$2.4** | **$554.9** | **$458.2** | **$1,948.2** |
| **2005 Session** | | | | |
| Withholding on Lump Sum Retirement Distributions | | | $25.0 | $13.1 |
| Decoupling from Federal Tax Provisions | | | 18.0 | 99.3 |
| Withholding Rate Changes | | | 8.0 | 14.7 |
| Drinking Driver Program Fee | | | 7.6 | 30.3 |
| Pass-through Entity and Other Tax Changes | | | 8.3 | 11.9 |
| Miscellaneous Fees | | | 5.7 | (11.2) |
| Tax Credits | | | (0.4) | (16.9) |
| Exempt the State from the Motor Fuel Tax | | | (2.3) | (9.1) |
| Tax Compliance Measures | | | 4.5 | 25.4 |
| **Subtotal, 2005** | | | **$74.4** | **$157.5** |
| **Total** | **$360.4** | **$915.6** | **$889.1** | **$3,630.4** |

* Regional Institutions for Children and Adolescents
Note: Numbers may not add to total due to rounding.
Source: Department of Legislative Services

### 2003 Session

During the 2003 session, $358 million in new revenues were generated for fiscal 2004. Tax compliance measures and corporate filing fee increases accounted for 93 percent of the general fund revenues. Almost all the additional special fund revenues were related to increases in the State property tax and land records fees.

### 2004 Session and 2004 Special Session

In 2004, legislation generated an additional $278 million in general funds in fiscal 2005, based on measures that increased general fund revenues by $286 million, offset by measures that reduced general fund revenues by $8 million. Approximately 64 percent of the net increase was related to the Delaware Holding Company (DHC) legislation and one-time revenues from the DHC settlement period. Sixteen percent was related to decoupling from federal tax changes. About 14 percent was the result of imposing the lowest county income tax rate on nonresidents. The offsetting reduction in general fund revenues was primarily related to the Maryland Heritage Structure Rehabilitation Tax Credit.

Legislation also generated an additional $277 million in special funds. DHC legislation contributed about 20 percent of the net increase, and over half of the net increase in special funds (61 percent) was related to fees imposed by the Motor Vehicle Administration. Eleven percent was the result of imposing the insurance premium tax on health maintenance organizations (HMOs).

Although the impacts of the HMO premium tax and Chesapeake Bay restoration/wastewater facilities surcharge (flush tax) were first seen in fiscal 2005, the revenues from these measures increase substantially in fiscal 2006 and beyond.

### 2005 Session

Legislation in 2005 generated an additional $60 million in net general fund revenues for fiscal 2006. The measure with the largest impact in fiscal 2005 (41 percent of the net total) was imposing income tax withholding on lump-sum retirement distributions. The second largest impact (23 percent) came from decoupling from federal tax provisions.

There were two measures that will decrease general fund revenues but not until fiscal 2007. Increasing lottery agent commissions will cost $7.6 million annually beginning in fiscal 2007, and a back-to-school sales tax free shopping period in 2006 will cost $5.5 million in fiscal 2007.

Special fund revenues increased primarily through two sources: a new fee imposed on participants in the Drinking Driver Monitor Program and the decoupling from federal tax changes. These and other measures increase special fund revenues in fiscal 2006 by

$16.6 million, but they are offset by measures that will reduce special fund revenues by $2.7 million – this is primarily the result of exempting the State from the motor fuel tax.

# Revenues and Taxes

## Video Lottery Terminals

**Delaware, West Virginia, and New York currently have several VLT facilities in operation, and Pennsylvania is in the process of implementing a VLT gambling law passed in 2004.**

### 2005 Video Lottery Terminal Legislation

Out of the nearly dozen video lottery terminal (VLT) bills introduced in the 2005 session, two received the greatest attention: SB 205 and HB 1361. Although SB 205, an Administration bill, passed the Senate and HB 1361 passed the House and was amended by the Senate, differences in the bills were not reconciled, and efforts to legalize VLT gambling in the State failed. HB 1361 would have authorized up to 9,500 VLTs at four potential locations, while SB 205 would have authorized up to 15,500 VLTs at seven locations. The Department of Legislative Services estimated that SB 205 and HB 1361 would have generated State revenues of approximately $853 million and $374 million, respectively, once the maximum number of proposed VLTs were operating at full market potential in fiscal 2010.

### Video Lottery Terminal Operations in Nearby States

#### New York

The 2001 Omnibus Gambling Law authorized six Native American casinos and eight VLT facilities at racetracks. Litigation, disputes over the revenue distribution, and uncertainty over the New York Racing Association's authority to operate racetracks have hampered the development of VLT facilities at racetracks.

Legal action challenging the constitutionality of VLTs commenced in January 2002, and in the first round of litigation, the New York Supreme Court declared VLTs to be unconstitutional. The Appellate Division of the New York Supreme Court overturned this decision in July 2004 and declared VLTs constitutional, but ruled that the portion of the legislation directing VLT revenue to horse racing purses and bred funds did not meet the constitutional requirement that lottery proceeds be dedicated exclusively to support public education in the state. In response to this decision, legislation was enacted in 2005 to address VLT facility operator revenue shares and conform the distribution of VLT proceeds to the Appellate Court ruling. In May 2005, the State Court of Appeals upheld VLT gambling at racetracks in its entirety.

The 2005 legislation provides that operators will receive 32 percent of the first $50 million in revenue, 29 percent of the next $100 million, and 26 percent thereafter. All VLT racetrack facilities, except for Yonkers and Aqueduct, also receive 8 percent of the first $100 million in revenue for marketing and 5 percent thereafter. Yonkers and Aqueduct, due to their anticipated higher profitability generated from the New York City market, will receive a flat 4 percent allowance. Facility operators will enter into agreements with the groups representing horsemen and breeders for an allocation of VLT revenue to bred funds and purses.

With the uncertainty surrounding VLTs, racetracks have been slow to develop VLT operations. The first VLT racetrack facility to open was Saratoga, over two years after the legalization of VLTs, and there are currently five facilities in operation. The existing facilities are relatively small in size, ranging from 12,000 to 60,000 square feet; the average size for a VLT racetrack facility in Delaware and West Virginia is approximately 80,000 square feet.

Construction has begun on two down-state VLT facilities that are scheduled for completion in mid-2006 − 4,500 VLTs at Aqueduct Raceway and 5,000 at Yonkers Raceway. The delay in VLT facility openings and lack of facilities near the New York City market caused the state to lower its VLT revenue estimates. In February 2004, the Governor’s budget estimated approximately $918 million in fiscal 2005 VLT revenues; that amount was lowered to $228 million earlier this year.

## Pennsylvania

The Pennsylvania Gaming Act of 2004 authorizes up to 14 VLT racetrack and nontrack locations and a maximum of 61,000 VLTs. Proponents of the law estimate that VLTs will generate $3.0 billion in gross proceeds, with $1.0 billion for the state, once the VLTs are operating at full market potential. At the time of passage, July 2004, analysts were anticipating VLT facilities could be operating by the end of 2005 or early 2006 at the latest.

Implementation of VLTs, however, has proven more difficult than anticipated due to litigation and disputes over the Act’s implementation. The Gaming Act prohibits VLT manufacturers from selling directly to VLT facilities and instead requires them to sell VLTs to state-based distributors; this issue has yet to be resolved by the state’s Gaming Control Board. As a result of the delay in resolving VLT distribution, it is likely racetrack locations will not receive conditional VLT licenses until at least spring 2006. Licensing for stand-alone and hotel casinos is expected to lag several months behind the racetrack locations. Given the probable need for additional construction time, it is unlikely that VLT gambling will begin before late 2006, well over two years after the legalization of VLTs.

Pennsylvania’s VLT gambling revenue was to be used primarily for property tax relief. The Act provided local school districts the option of receiving gambling revenues in exchange for districts meeting certain conditions, including providing property tax relief, imposing an earned income tax, and accepting limits on the ability of districts to increase future tax revenues. Only 111 out of 501 school districts opted in by the May 31, 2005, deadline, frustrating the intent to provide broad property tax relief. In response, Governor Edward Rendell convened a special legislative session in September 2005 to consider amending the gaming law to mandate property tax relief and remove the mandatory earned income tax increase. The legislature has yet to resolve these issues and is also looking at broader issues of property tax relief.

## West Virginia

The West Virginia legislature earlier this year considered legislation authorizing the addition of table games at existing VLT facilities. SB 442 passed the Senate but was not reported from the House Judiciary Committee. Before any table games would have been added, the legislation would have required local voter approval in the four counties in which VLT facilities are currently located. The West Virginia Lottery Commission estimated that the four facilities could have installed a total of up to 152 table games, including 62 at Charles Town. At full implementation, in fiscal 2007, the commission estimated that table games would have generated approximately $126 million in net proceeds, in addition to license and application fees of approximately $230,000 annually. Current VLT facilities in West Virginia generated net revenues of $895 million in fiscal 2005.

## Delaware

Delaware, like West Virginia, considered proposals to expand gambling in response to increased competition from Pennsylvania. In June 2005, however, the House Gaming and Parimutuels Committee tabled legislation that would have expanded gambling beyond racetracks. If the Delaware legislature eventually approves a further expansion of gambling, several groups have expressed an interest in constructing a casino in Wilmington. Current VLT facilities in Delaware generated net revenues of $574 million in fiscal 2005.

**Exhibit 2**
**Delaware and West Virginia VLT Revenues**

| | Net Proceeds ($ in Millions) | Change over FY 2004 | | Net proceeds ($ in Millions) | Change over FY 2004 |
|---|---|---|---|---|---|
| **West Virginia** | | | **Delaware** | | |
| Mountaineer | $254.8 | -1.7% | Delaware Park | $272.2 | 9.2% |
| Wheeling | 189.9 | -1.4 | Dover Downs | 193.0 | 9.6 |
| Tri-State | 65.4 | -3.4 | Harrington | 108.5 | 3.7 |
| Charles Town | 384.5 | 14.6 | | | |
| **West Virginia Total** | **$894.6** | **4.6%** | **Delaware Total** | **$573.7** | **8.3%** |

For further information contact: Robert J. Rehrmann Phone: (410) 946/(301) 970-5510

# Revenues and Taxes

## Corporate Income Tax Reform

**Legislation to reform the corporate income tax has become more prevalent in Maryland and elsewhere in the wake of highly publicized cases involving corporate income tax shelters at both the federal and state levels. The need for additional revenues during the recent economic downturn has led to a heightened concern by state legislatures over the vulnerability of state corporate income taxes to tax planning and avoidance techniques.**

### Introduction

Corporate income tax reform legislation has surged in Maryland and several other states in the wake of highly publicized cases involving corporate income tax avoidance at both the federal and state levels, including the widespread use of so-called "Delaware Holding Companies" and related techniques to shift income among states to avoid state corporate income taxes. Aggressive tax planning by corporations has contributed, at least in part, to a long-term decline in corporate income tax revenues over the past 20 years relative to total taxes collected and the economy, both at the federal and state levels. The need for additional revenues during the recent economic downturn has led to heightened concern by state legislatures about the vulnerability of state corporate income taxes to aggressive tax planning.

### Background

The application of state corporate income taxes to multistate corporate enterprises is complex because of the significant federal constitutional and statutory limitations on the authority of states to tax interstate businesses. In addition to federal constitutional requirements that a corporation must have a sufficient connection or "nexus" with a state before that state can tax the corporation, a federal statute, P.L. 86-272, further limits the jurisdiction of states to impose income taxes on interstate enterprises. A state is prohibited from imposing a net income tax on a person's income derived within the state if the person's activities within the state are limited to protected activities (related to solicitation of orders within the state), as specified in P.L. 86-272.

The Commerce Clause of the U. S. Constitution also requires that a state's corporate income tax be "fairly apportioned" in the case of a multijurisdictional corporation. This requirement is reflected in the allocation of an interstate corporation's income among states through formulary apportionment, if the multistate operations of the enterprise constitute a "unitary business," *i.e.*, where the operations of the business within the state and outside the state are interdependent and contribute to one another.

Under current Maryland law, the application of the "unitary business principle" is limited in the case of affiliated groups of related corporations, because each separate corporation is required to file a separate income tax return and determine its own taxable income on a separate basis. Even though the activities of related corporations may constitute a single unitary business, the affiliated corporations that lack nexus with the State (or are protected from taxation by P.L. 86-272) are not subject to the State's corporate income tax and neither the net income nor apportionment factors of those affiliated corporations are taken into account on the separate corporate income tax return of any related corporation that is subject to the tax.

## Corporate Tax Reform Proposals

Several states have recently enacted legislation similar to the legislation enacted in Maryland dealing with Delaware Holding Companies (Chapter 556 of 2004). An addition modification is required under the Maryland corporate income tax for certain related party payments that are deducted for federal income tax purposes to restrict the ability of corporations to use Delaware Holding Companies to shift income out of state. While Chapter 556 addressed one well-publicized technique for avoiding state income tax in a "separate reporting" jurisdiction such as Maryland, the requirement for separate reporting by each member of an affiliated group of corporations still leaves the Maryland corporate income tax vulnerable to other state income tax avoidance strategies, including other uses of Delaware Holding Companies not addressed by the 2004 legislation, transfer pricing schemes, and the use of subsidiaries to isolate profitable activities of an enterprise from nexus with the State.

Various proposals for further corporate income tax reform have been proposed in Maryland and other states, and several have been adopted, including:

- "combined reporting" under the corporate income tax, in lieu of the separate reporting currently required in Maryland (*e.g.*, Vermont – 2004 legislation provided for mandatory combined reporting; New Jersey – 2002 legislation authorized the requirement of combined reporting if necessary to prevent distortion);

- "throwback" or "throwout" rules to prevent corporations from taking advantage of limitations on state taxing authority to create "nowhere income" that is effectively exempt from state tax (*e.g.*, New Jersey – 2002 legislation which adopted a "throwout" rule);

- alternative taxes on corporations based on book profits, gross receipts, or gross profits to impose minimum taxes on companies with artificially low taxable income (*e.g.*, New Jersey – 2002 legislation that provided an "alternative minimum assessment" based on gross receipts or gross profits; Ohio – 2005 legislation that phased out the corporation franchise tax based on net income, and phased in the imposition of a new commercial activity tax on gross receipts); and

- enhanced state corporate income tax disclosure, including greater public disclosure of tax subsidies intended as economic development incentives (*e.g.*, North Carolina – 2001 legislation that provided for disclosure of annual, company-specific information regarding various tax credits).

During the 2005 session, several bills were introduced related to corporate tax reform – these bills were ultimately referred to interim study by the tax committees. First, Senate Bill 403/House Bill 676 and House Bill 62 would have directly affected the computation of the Maryland corporate income tax for multistate enterprises by requiring mandatory “combined reporting” by affiliated groups of related corporations. House Bill 62 would also have required that foreign affiliates incorporated in a “tax haven” country be included in the combined group for purposes of the Maryland income tax.

Another proposal was Senate Bill 748/House Bill 1135, which would have imposed a minimum tax on corporations based on gross receipts or gross profits, similar to the “alternative minimum assessment” adopted in New Jersey in 2002.

Finally, although not directly related to corporate tax avoidance, Senate Bill 780/House Bill 1066 would have provided greater public disclosure of State corporate income tax information and economic development subsidies, including tax credits and exemptions intended as economic development incentives.

# Revenues and Taxes

## Taxation of Military Retirement Income

**Several proposals to provide additional tax relief for military retirees have been introduced in recent years. While an Administration proposal to exempt all military retirement income from income taxes was unsuccessful during the 2005 session, legislation is expected to be introduced again in the 2006 session.**

### Current Taxation of Military Retirement Income

Under State law, the first $2,500 of military retirement income received by an individual can be subtracted from federal adjusted gross income for the taxable year provided that the individual is at least 55 years of age on the last day of the taxable year and was an enlisted member of the military at the time of retirement. This subtraction is reduced by 50 percent of the amount by which federal adjusted gross income exceeds $17,500, and no subtraction is allowed for an individual having federal adjusted gross income over $22,500.

Maryland law also provides a pension exclusion for individuals who are at least 65 years old or who are totally disabled. Under this pension exclusion, up to a specified maximum amount of taxable pension income ($20,700 maximum for tax year 2004) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received. Given that Social Security benefits are exempt from Maryland income tax, the "Social Security offset" works to equalize the tax treatment of individuals who receive their retirement benefits from different sources.

Social Security benefits and benefits received under the federal Railroad Retirement Act are fully exempt from the Maryland income tax, even though they may be partly taxable for federal income tax purposes. In addition to the special treatment of Social Security and other retirement income, other income tax relief is provided to senior citizens regardless of the source of their income. Each individual age 65 or older is allowed an additional $1,000 personal exemption and can earn more income without being required to file taxes.

### Recent Legislative Proposals

As in previous sessions, the General Assembly considered several proposals in 2005 regarding the taxation of military retirement income. As introduced by the Administration, House Bill 245/Senate Bill 211 (identical to House Bill 270) would have exempted 100 percent of military retirement income from State taxation, if the individual served at least 20 years active duty. The exemption would have been phased in over a five-year period beginning in tax year 2006. As introduced, these bills would have reduced annual State revenues by approximately

$32 million when fully phased in by fiscal 2010. Identical bills were introduced in the 2004 session as Senate Bill 877/House Bill 1182.

As amended and passed by the House of Delegates, House Bill 245 would have exempted 50 percent of military retirement income, phased in over a five-year period beginning in tax year 2007, if the individual served at least 20 years active duty and was an enlisted member at the time of retirement. When fully phased in by fiscal 2011, the amended version of House Bill 245 was estimated to reduce annual State revenues by $10 million. The amended bill was not voted on by the Senate Budget and Taxation Committee.

House Bill 1247 of 2005 would have increased the maximum allowable subtraction modification from $2,500 to $7,500, and the amount at which the subtraction would have been reduced by 50 percent would have increased to $30,000. No subtraction would have been allowed for an individual having federal adjusted gross income over $40,000. The estimated annual reduction in State revenues from the bill was $2 million. The bill received an unfavorable report from the House Ways and Means Committee.

## Other States

Of the 41 states that tax earned income, 32 partially or fully exclude military retirement income from state taxation. **Exhibit 1** summarizes the taxation of military retirement income in Maryland's surrounding states and the District of Columbia.

**Exhibit 1**

**Tax Treatment of Military Retirement Income In Surrounding States**

| **State** | |
|---|---|
| **Delaware** | Any individual 60+ may exclude up to $12,500 of pension income. Any individual under 60 may exclude up to $2,000 of pension income. |
| **District of Columbia** | Individuals 62+ may exclude up to $3,000 of military retired pay. |
| **Pennsylvania** | All retirement income is fully exempt from state taxation. |
| **Virginia** | Military retirement income received by Congressional Medal of Honor recipients is fully exempt from state taxation. |
| **West Virginia** | Individuals may exclude the first $20,000 of military retirement income and the first $2,000 of federal retirement system benefits. |

Source: Department of Legislative Services

For further information contact: Ryan Bishop Phone: (410) 946/(301) 970-5510

# Personnel

## State Workforce and Payroll

**Fiscal 2006 is the fourth year in which limits have been placed on the number of regular and contractual positions, necessitating a reduction of 168 Executive Branch regular positions beyond the 301 deleted by the General Assembly. This mechanism has served to constrain State spending for total employee compensation; however, spending on employee health insurance continues to increase.**

## Budgeted Positions

### Regular Positions

Section 38 of the fiscal 2006 budget bill (Chapter 443 of 2005) established a limit of 52,686 on the number of regular full-time equivalent (FTE) positions that may be filled in non-higher education Executive Branch agencies as of July 1, 2005. This limit required the 2005 General Assembly to abolish 179 vacant positions and 301 specific positions. Section 38 provided that at least 100 of the abolished positions were to be in the executive service, management service, or commission plan in the State Personnel and Management System and in the Maryland Department of Transportation. Primarily due to the use of Executive Branch positions caps and the resulting position abolitions, the regular employee workforce has contracted from 82,087 in fiscal 2002, the year before position caps were used, to 78,490 in the fiscal 2006 working appropriation. As shown in **Exhibit 1**, nearly 80 percent of the decrease is accounted for by three agencies: the Department of Health and Mental Hygiene; the Department of Human Resources; and the Maryland Department of Transportation. Also shown in Exhibit 1, five agencies saw workforce increases since fiscal 2002: the Maryland State Department of Education (MSDE), legal agencies (primarily the Office of the Public Defender); and higher education. Since fiscal 2002, a net total of 3,597 positions have been abolished statewide.

### Fiscal 2006 Additions and Abolitions

To reach the Executive Branch position cap of 52,686 in fiscal 2006, the Department of Budget and Management abolished a net total of 168 positions. The 179 abolitions required during session were offset by the addition of non-State funded positions through actions taken by the Board of Public Works since December 2004. Since the beginning of fiscal 2006, 402 positions have been added, 349 of which are in higher education institutions.

**Exhibit 1**
## Regular Full-time Equivalent Positions
**Fiscal 2002 Actuals to 2006 Working Appropriation**

| Department/Service Area | FY 2002 Actual | 2006 Working Appropriation | Change |
|---|---|---|---|
| Legislative Branch | 730 | 740 | 10 |
| Judicial Branch | 3,010 | 3,291 | 282 |
| **Executive Branch** | | | |
| Human Resources | 8,273 | 6,963 | (1,309) |
| Health & Mental Hygiene | 8,536 | 7,574 | (962) |
| Transportation | 9,538 | 9,012 | (527) |
| Public Safety & Correctional Services | 11,663 | 11,279 | (384) |
| Natural Resources | 1,629 | 1,367 | (263) |
| Labor, Licensing, & Regulation | 1,706 | 1,460 | (246) |
| General Services | 793 | 643 | (150) |
| Financial & Revenue Administration | 2,158 | 2,023 | (136) |
| Housing & Community Development | 449 | 320 | (129) |
| Police & Fire Marshal | 2,590 | 2,464 | (126) |
| Budget & Management | 524 | 433 | (91) |
| Environment | 1,028 | 949 | (79) |
| Agriculture | 480 | 428 | (53) |
| Juvenile Services | 2,123 | 2,081 | (42) |
| Business & Economic Development | 324 | 292 | (32) |
| Executive & Administrative Control | 1,619 | 1,588 | (31) |
| Retirement | 194 | 186 | (8) |
| MSDE and Other Education | 1,955 | 2,134 | 179 |
| Legal | 1,381 | 1,568 | 187 |
| Higher Education | 21,386 | 21,699 | 312 |
| **Executive Branch Subtotal** | **56,961** | **52,760** | **(4,201)** |
| **Total** | **82,087** | **78,490** | **(3,597)** |

## Higher Education

Chapters 239 and 273 of 2004 have provided the University System of Maryland and Morgan State University with autonomy from the General Assembly to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College. By the end of October 2005, the fiscal 2006 impact of these bills has been to add 298 FTE positions at the University System of Maryland, 11 FTE positions at St. Mary's College, and 40 FTE positions at Morgan State University. Higher education and other position changes attributable to the "Rule of 50" (Section 35, Chapter 443 of 2005), through which 50 State-funded positions may be added to the legislative appropriation with Board of Public Works approval, are noted in **Exhibit 2**.

**Exhibit 2**
## Regular Full-time Equivalent Positions
**Fiscal 2006 Legislative to Working Appropriation**

| Department/Service Area | 2006 Legislative Appropriation | BPW and Other Changes | 2006 Working Appropriation |
|---|---|---|---|
| Legislative Branch | 740 | -- | 740 |
| Judicial Branch | 3,291 | -- | 3,291 |
| **Executive Branch** | | | |
| Legal | 1,567 | 1 | 1,568 |
| Executive & Administrative Control | 1,512 | 76 | 1,588 |
| Financial & Revenue Administration | 2,023 | -- | 2,023 |
| Budget & Management | 433 | -- | 433 |
| Retirement | 186 | -- | 186 |
| General Services | 642 | 1 | 643 |
| Transportation | 9,012 | -- | 9,012 |
| Natural Resources | 1,367 | -- | 1,367 |
| Agriculture | 428 | -- | 428 |
| Health & Mental Hygiene | 7,518 | 56 | 7,574 |
| Human Resources | 7,180 | (217) | 6,963 |
| Labor, Licensing, & Regulation | 1,447 | 13 | 1,460 |
| Public Safety & Correctional Services | 11,279 | (1) | 11,279 |
| MSDE and Other Education | 1,933 | 201 | 2,134 |
| Housing & Community Development | 393 | (73) | 320 |
| Business & Economic Development | 292 | -- | 292 |
| Environment | 948 | 1 | 949 |
| Juvenile Services | 2,085 | (4) | 2,081 |
| Police & Fire Marshal | 2,465 | (1) | 2,464 |
| **Executive Branch Subtotal** | **52,707** | **54** | **52,760** |
| Higher Education | 21,350 | 349 | 21,699 |
| **Total** | **78,088** | **402** | **78,490** |

[1] These numbers are net of additions made through the Board of Public Works and of casual abolitions.

## Regular and Contractual Average Compensation and Total Expenditures

### Regular Positions

The budgeted expenditure per regular FTE position in fiscal 2006 is approximately $68,081, of which $48,464 is attributable to salaries, $1,482 to other earnings (*e.g.*, overtime, shift differential, reclassifications), and $17,762 to fringe benefits. Fringe benefits include health insurance, retirement benefits, variable fringes (*i.e.*, Social Security and unemployment compensation), and miscellaneous fringe benefits (*e.g.*, workers' compensation, tuition reimbursement). While the number of regular positions has decreased since fiscal 2002 by 3,999, or 4.9 percent, as demonstrated in **Exhibit 3**, funding devoted to regular employee compensation has increased 12.4 percent. The largest component of this increased spending is health insurance. The State is spending approximately $240 million more in fiscal 2006 than it did four years ago, a 49.2 percent increase. In all, the State is spending $5.3 billion for its regular employee workforce.

### Contractual Positions

The budgeted expenditures per contractual FTE position in fiscal 2006 is approximately $44,168, 2.5 percent more than in fiscal 2002; unlike regular positions, contractual positions do not include health insurance, pensions, or other benefits, with the exception of Social Security, unemployment compensation, and workers' compensation.

As shown in Exhibit 3, from fiscal 2002 to 2006, the number of contractual FTE positions has increased by 348, or 3.9 percent. Section 38 of the 2006 budget also implements a position cap for Executive Branch contractual positions of 2,779 FTE positions. This is the fourth year in which contractual position caps have been used and have served to constrain spending in this area. Spending for contractual positions has increased by $25 million, or 6.5 percent, since fiscal 2002.

**Exhibit 3**
## Fiscal 2002 Actuals to Fiscal 2006 Legislative Appropriation
**($ in Millions)**

| | FY 02 Actuals | FY 06 Leg. Approp.[1] | Change | Growth Rate |
|---|---|---|---|---|
| **Regular Employees** | | | | |
| Full-time Equivalent Positions | 82,087 | 78,088 | -3,999 | -4.9% |
| Regular Salary[1] | $3,458 | $3,784 | $327 | 9.4% |
| Other Earnings (Overtime, Shift Differential, etc.) | 138 | 116 | -22 | -16.1% |
| **Total Salary** | **$3,596** | **$3,900** | **$304** | **8.5%** |
| Health Insurance[1] | $487 | $726 | $240 | 49.2% |
| Pensions/Retirement[1] | 240 | 268 | 28 | 11.8% |
| Variable Fringes (Social Security, Unemployment)[1] | $259 | $287 | $28 | 11.0% |
| Other Fringes | 114 | 105 | -8 | -7.1% |
| Other | $35 | $29 | -$6 | -16.1% |
| **Total Regular Payments** | **$4,729** | **$5,316** | **$587** | **12.4%** |
| **Contractual Employees** | | | | |
| Full-time Equivalent Positions | 8,907 | 9,255 | 348 | 3.9% |
| Contractual Salary[1] | $160 | $175 | $15 | 9.2% |
| Total Fringes[1] | 12 | 14 | 2 | 13.3% |
| USM Contractual | $211 | $220 | $9 | 4.1% |
| **Total Contractual Payments** | **$384** | **$409** | **$25** | **6.5%** |

[1] Turnover and cost containment are distributed among regular salaries, health insurance, pensions/retirement, and variable fringes in fiscal 2005 and 2006.

# Personnel

## Employee Health Insurance Update and 2005 Plan Changes

**In his proposed budget for fiscal 2006, Governor Robert Ehrlich short funded employee and retiree health insurance by $120 million. The General Assembly resolved the shortfall through both budget and health plan restructuring.**

### Background

The State offers a variety of health plans, many on a pre-tax basis, to State employees, retirees, and their qualifying dependents. Eligible individuals may choose from among two preferred provider options (PPOs), three point-of-service (POS) plans, and three health maintenance organization (HMO) plans for their medical coverage. In addition, the State also offers insurance coverage for mental health/substance abuse, prescription drugs, dental, term life, accidental death and dismemberment, and long-term care. For retirees, statute provides that the State will contribute the same subsidy provided to active employees for retirees who have at least 16 years of creditable service. The State does not contribute for term life, accidental death and dismemberment, or long-term care coverage.

### Fiscal 2006 Budget for Employee and Retiree Health Plans

The fiscal 2006 budget proposed by the Governor in the 2005 session essentially "flat-funded" health insurance in fiscal 2006 by providing no additional funds to account for medical inflation or benefit enhancements over funding provided in fiscal 2005. As a result, providing the same health insurance benefits in fiscal 2006 was estimated to result in an approximately $120 million deficit in the budget for State employee and retiree health care.

The methods for closing the general fund portion of the gap, estimated at $72 million, are illustrated in **Exhibit 1**. The General Assembly found available funds within the proposed fiscal 2006 budget for health insurance by reducing the general salary increase from 2.0 to 1.5 percent. Higher education was required to absorb some of the cost and savings from 501 position abolitions were transferred and used only for employee and retiree health insurance. Finally, funds were also made available under the Medicare program.

**Exhibit 1**
## Closing the Fiscal 2006 Health Insurance Funding Gap
## General Funds

| **Program Restructuring** | **General Funds** |
|---|---|
| Increase Rx copayments from $3/$5/$10 to $5/$15/$25, establishing a $700 cap per family, and requiring 2 copayments every 90 days[1] | $31.7 |
| POS copremiums from 15% to 17% | 2.4 |
| **Total Program Restructuring** | **$34.1** |
| | |
| **Budget Restructuring** | |
| 1/2% of 2% COLA | $13.1 |
| PIN reductions and fund transfers | 14.0 |
| Higher education absorption | 3.6 |
| Medicare | 8.5 |
| **Total Budget Restructuring** | **$39.2** |
| | |
| **Total General Fund Savings** | **$73.4** |

[1] This option also includes industry standard tiers, voluntary mail order (2 copayments), smaller network, prior authorization, managed quantities, voluntary specialty drug pharmacy, step therapy, and 30 days for first fill of drugs.

## Program Restructuring Increases Cost Sharing for Employees and Retirees

To make the benefit more comparable to that offered by other employers, adjustments were made to the prescription drug benefit. Prescription copays increased from $3/$5/$10 to $5/$15/$25, with two copayments required for a 90-day supply. However, a $700 cap is placed on the total annual family copays. Programmatic changes were also made to the prescription drug plan by including industry standard tiers, a smaller network, prior authorization and managed quantities for some types of prescriptions, step therapy, and 30 days for the first supply of a maintenance drugs. DBM is also required to provide a voluntary mail order option within the prescription drug benefit plan. Also, the POS premium was increased from 15 to 17 percent. As a result, the State contributes toward the cost of employee and retiree coverage as follows: 80 percent for PPO plans, 83 percent for POS plans, and 85 percent for HMO plans. The BRFA of 2005 provides that, with the exception of the specified program restructuring, no other changes to the State health and prescription drug programs may be made in fiscal 2006 and 2007.

For further information contact: Elizabeth H. Moss/Lori J. O'Brien Phone: (410)946/(301) 970-5510

## Pension Contribution Rates and Funding Levels

**The State Retirement and Pension System earned a 9.5 percent investment return on assets in fiscal 2005. Despite these investment gains, the funded status of the system has decreased from 91.2 percent at the end of fiscal 2004 to 87.8 percent at the end of fiscal 2005. Additionally, the funded status of both the employees' and teachers' systems are outside the 90 to 110 percent funding corridor, causing the contribution rate to increase for a second year in a row for the employees' system and for the first year for the teachers' system since fiscal 2003.**

### Fiscal 2005 Investment Returns and Impact on State Contribution Rates

The State Retirement and Pension System earned investment returns of 9.5 percent on assets in fiscal 2005. This is a decrease from the 16.2 percent investment return in fiscal 2004; however, the 9.5 percent gain exceeds the system's actuarial target of 7.75 percent which is used by the State's actuaries to calculate contribution rates. At the end of fiscal 2005, system assets had increased by $1.9 billion to a total of $32.1 billion. This increase nearly returns the system to the $33.1 billion high set in fiscal 2000. On an actuarial basis, however, the investment return for fiscal 2005 was only 5.9 percent, as all returns are smoothed over a dynamic five-year span. This method mutes the effects of an inordinately high or low rate of investment return for any given year.

Since fiscal 2003, the contribution rates for the two largest systems, the employees' and teachers' systems, are fixed from year to year as long as the funded status (ratio of assets to liabilities) for these systems remains in a "corridor" of 90 to 110 percent. Should the funded status fall out of this corridor, the rates must be adjusted to account for a percentage of the difference between the prior year's rate and the actuarially required rate. The actuarial rate funds both the normal cost (benefits that will be accrued by members during the upcoming year) and a component of any accrued unfunded liability, which is amortized on a 25-year schedule. The 2005 annual actuarial valuation of the State Retirement and Pension System showed that both the employees' and teachers' systems were outside the corridor. The employees' system was outside the corridor for a second year, falling from 89.2 percent funded in fiscal 2004 to 84.9 percent funded in fiscal 2005, and the teachers' system was outside the corridor for the first time, falling from 92.8 percent funded to 89.3 percent funded.

Under the corridor method, the State contribution rate for the employees' system will increase from 5.76 percent of payroll in fiscal 2006 to 6.83 percent in fiscal 2007. For the teachers' system, the State contribution rate will increase from 9.35 percent of payroll in fiscal 2006 to 9.71 percent in fiscal 2007.

Unless future market investment earnings return to the 15 to 20 percent range, the funded status of both systems is estimated to continue to fall (reflecting the smoothing of poor returns in fiscal 2001 through 2003). For these reasons, despite the fiscal 2005 increase in system assets and the investment return above the actuarial assumed rate, the aggregate funded status of the system decreased from 91.2 percent to 87.8 percent on an actuarial basis, which is still actuarially sound. The resulting aggregate State contribution rate in fiscal 2007 will be 9.18 percent of payroll, up from 8.46 percent of payroll in fiscal 2006. **Exhibit 1** shows the new contribution rates and funding level by each individual system as well as the aggregate State system.

**Exhibit 1**
## Employer Contribution Rates
**Fiscal 2006 and 2007**

| Plan | FY 2006 Rate | FY 2007 Rate | Actuarial Funding Level* |
|---|---|---|---|
| Employees | 5.76% | 6.83% | 84.9% |
| Teachers | 9.35 | 9.71 | 89.3 |
| State Police | 8.22 | 13.83 | 100.3 |
| Judges | 41.12 | 42.43 | 79.3 |
| Law Enforcement Officers | 38.47 | 40.60 | 59.9 |
| **Aggregate** | **8.46%** | **9.18%** | **87.8%** |

* Level at the end of fiscal 2005
Note: Funding levels reflect State funds only and exclude any municipal contributions or funds.
Source: Milliman USA

# Personnel

## Three Retirement Issues That Could Prove Costly

**The General Assembly will face three large retirement benefit issues in the near future: (1) retiree health care liabilities under new accounting standards; (2) pension enhancements for teachers and State employees; and (3) recommended alterations to the funding methodology for the State Retirement and Pension System. These issues could result in a significant combined fiscal impact to the State at a time when the structural budget deficit continues to exist.**

### Introduction

During the 2005 session, the General Assembly identified a number of significant retirement benefit issues for consideration during the 2005 interim. Chapter 298 of 2005 established a Task Force to Study Retiree Health Care Funding Options to evaluate the liabilities associated with health benefits provided to retirees of the State. Additionally, language was included in the Budget Reconciliation and Financing Act of 2005 (BRFA) (Chapter 444 of 2005) requiring the Joint Committee on Pensions to study options for enhancements to retirement benefits for teachers and State employees. At the same time, the Board of Trustees of the State Retirement and Pension System (SRPS) undertook a review of the funding methodology for the State's pension contribution rates, which resulted in recommendations to change the methodology currently in effect. Concurrently addressing retiree health care liabilities, pension enhancements, and alterations to the funding methodology for SRPS could result in a significant combined fiscal impact to the State at a time when the structural budget deficit continues to exist.

### State Must Account for Retiree Health Care Liabilities

Maryland currently funds the costs of State retiree health benefits on a pay-as-you-go basis in the State budget each year. However, based on new standards established in the Government Accounting Standards Board (GASB) Statement 45, governmental employers will be required to account for liabilities associated with the employers' commitment to what is referred to as Other Post Employment Benefits (OPEB) such as retiree health insurance. Maryland will be required to account for these liabilities on its balance sheets by fiscal 2008. If the State intends to continue providing retiree health benefits, implementation of GASB 45 will likely require the State to identify an actuarial means to prefund these benefits in order to maintain the State's reputation for fiscal prudence. The cost of prefunding will be in addition to the pay-as-you-go costs associated with existing retirees receiving benefits.

In addition to creating the Task Force to Study Retiree Health Care Funding Options, Chapter 298 also required the Department of Budget and Management to commission an actuarial valuation of the liabilities associated with the GASB 45 standards. This actuarial valuation indicated that the liabilities estimated for the actuarial accrued liability for retiree health benefits, defined as benefits earned as of July 1, 2005, is approximately $20.4 billion. Amortized over a 30-year period, this $20.4 billion liability will result in an Annual Required Contribution (ARC) amount of $1.96 billion. This number incorporates the approximately $311 million in costs that the State would have been obligated to fund for retiree benefits in fiscal 2007. Taking that into account, if no additional contributions are made, the Net OPEB Obligation (NOO) which will appear on the State's financial statement at the end of fiscal 2008 is $1.65 billion.

While GASB 45 does not require prefunding, the liabilities shown on the State's financial statement are significantly lower if there is a prefunding mechanism in place. Additionally, if the State fails to make the full ARC payment in a given year, the deficit will be added to the NOO discussed above and will appear on the State's financial statement. Maryland is not alone among other State and local entities with respect to the OPEB liabilities to be recognized with respect to retiree health care benefits under GASB 45. Any State or local governmental employer that provides a commitment for a retiree health care benefits subsidy will be in a similar posture. The bond rating agencies have indicated that these new liability disclosures are not likely to result in any immediate changes to bond ratings, but it is clear that this issue will be one that these agencies will be watching.

## Pension Enhancement Study

Three bills were introduced in 2005 that addressed enhancements for teachers and State employees – House Bill 1049/Senate Bill 623 and Senate Bill 466. House Bill 1049/Senate Bill 623 provided numerous enhancements primarily to members of the teachers' system, including prospectively increasing the benefit multiplier to 2.2 percent from 1.4 percent in certain circumstances and increasing the employee contribution rate from 2 to 5 percent. The increase in additional liabilities for SRPS resulting from the bill was estimated at $2.3 billion, with amortized first year costs in fiscal 2007 of $131.5 million.

Senate Bill 466 provided for a more conservative enhancement but applied an enhancement to all State employees who are members of the employees' system and all members of the teachers' system. This bill provided for a relatively small increase in the benefit multiplier from 1.4 to 1.75 percent and a comparatively large increase in the employee contribution rate from 2 to 5 percent. The additional liabilities associated with the Senate Bill 466 enhancement, without taking into account the increased employee contribution rate, was estimated at $1.8 billion, with first year costs in fiscal 2007 equal to approximately $130 million. However, the 5 percent increased employee contribution rate would have absorbed this cost entirely, making Senate Bill 466 essentially cost neutral to the State.

The General Assembly included language in the 2005 BRFA that stated a finding by the General Assembly that an enhancement to retirement benefits of public school teachers would enhance the ability for the State and local governments to achieve the requirements for highly qualified teachers under the federal No Child Left Behind Act. The legislation also stated that an enhancement to the pensions of State employees was needed to maintain a high quality workforce. The 2005 BRFA directs the Joint Committee on Pensions to study enhancement options and to recommend legislation providing an enhancement for introduction in the 2006 session.

## SRPS Corridor Funding Methodology Recommendation

Legislation enacted in 2002 altered the State's actuarial funding methodology from one in which the State's pension contribution rates vary from year to year to one in which the rates for the largest systems, the employees' and teachers' systems, remain fixed as long as their funding levels remain within a certain range, or "corridor." The 2004 actuarial valuation for the several systems of SRPS showed that as of June 30, 2004, the funding levels for the employees' and teachers' systems were 89.2 and 92.8 percent, respectively. Based on the corridor funding mechanism, each rate remains equal to the fiscal 2002 certified rate as long as funding remains within the 90 to 110 percent corridor. The mechanism provides that if the funding levels fall out of the corridor, the rates must be adjusted to account for 20 percent of the difference between the prior year's rate and the "true" actuarial rate. Any benefit enhancements or other changes to either plan will require adjustments to the fixed rate.

As a result of the corridor funding methodology, the rate for the employees' system remained fixed at 4.73 percent in fiscal 2003 through 2005. Because the employees' system fell out of the corridor in fiscal 2005, the State contribution rate for the employees' system was increased to 5.76 percent in fiscal 2006. The teachers' system remained over 90 percent funded in fiscal 2005; therefore, the State employer contribution rate remained fixed at 9.35 percent. Milliman USA, the State's pension actuary, has reported that for fiscal 2006 the funding level for the teachers' system has dropped to 89.3 percent, thus increasing the contribution rate from the fixed rate of 9.35 to 9.71 percent. Funding in the employees' system also continued to decrease to 84.2 percent. This decline resulted in an increase in the employer contribution rate, for the second consecutive year, to 6.83 percent.

Due to the increased employer contribution rate for the employees' system as a result of falling outside of the corridor in fiscal 2005, the board of trustees of SRPS convened a subcommittee to study the corridor funding methodology in comparison to an actuarial funding methodology. The subcommittee concluded its work with a recommendation that the board support an immediate transition to the actuarial funding method, and the board voted to accept this recommendation.

In terms of the fiscal impact of the proposed change, Milliman USA estimates that the State will save $181 million as a result of the corridor funding methodology in fiscal 2007. The actual experience of the State under the corridor method in prior fiscal years was a savings of $48.3 million in employer contributions in fiscal 2003 and $100 million in employer contributions in fiscal 2004. Over the near term, the State will continue to experience a savings under the corridor method. These savings will total $1.1 billion by fiscal 2017. After fiscal 2017, however, Milliman estimates that the State will begin to pay a higher contribution amount under the corridor method as opposed to the actuarial method. By fiscal 2038, the contribution under the corridor method will be approximately $1.7 billion more than the actuarial method.

Additionally, although the funded status of SRPS will be slightly lower under the corridor method than the actuarial method beginning in fiscal 2007, full funding of 100 percent does occur under the corridor method in fiscal 2033. Full funding under the actuarial method is estimated to occur in fiscal 2036. As a practical matter, however, full actuarial funding is not required unless and until the State closes the pension system and discharges all liabilities.

## Conclusion

The issue of determining the best funding methodology for the employees' and teachers' systems, coinciding with the issues of prefunding retiree health care benefits, and potentially enhancing pension benefits for teachers and State employees will be extremely difficult. All have significant cost implications to the State. Although prefunding retiree health care costs will not directly affect the State pension contribution rate, a significant pension enhancement to the teachers' and employees' systems will increase both the corridor rate and the actuarial rate.

For further information contact: Susan D. John/Anne E. Gawthrop Phone: (410) 946/(301) 970-5510

# Education

## Adequacy Gap Shrinks as Bridge to Excellence Phase-in Continues

**In the fourth year of the five-year Bridge to Excellence phase-in schedule, State funding for public primary and secondary education is projected to increase by as much as $554 million in fiscal 2007, which will make it the third consecutive year with a record increase in State education aid. Due in large measure to increases in State funding, Maryland has been making significant strides towards achieving its funding targets for public schools.**

### Record Increases in K-12 Education Funding Continue

State education aid is projected to climb by as much as 13.8 percent in fiscal 2007 to nearly $4.6 billion, an increase of $554 million. This boost would mark the third consecutive year with a record-breaking increase in State funding for primary and secondary education. Education aid increased by approximately $385 million (10.6 percent) in fiscal 2006 and by $323 million (9.8 percent) in fiscal 2005. In total, the three-year rise in State funding for education from fiscal 2004 to 2007 is expected to total between $1.2 - $1.3 billion.

The majority of the projected $554 million increase in State education funding reflects growth of $515 million in direct aid to local boards of education. The increase would boost direct aid by 14.3 percent, from $3.6 billion in fiscal 2006 to $4.1 billion fiscal 2007, and would outpace the fiscal 2006 direct aid growth rate of 11.8 percent. The remaining portion of State aid, teachers' retirement costs, is scheduled to increase by 9.7 percent from $406.9 million in fiscal 2006 to $446.3 million in fiscal 2007. Like direct education aid, growth in funding for retirement will exceed the increase from fiscal 2005 to 2006, when retirement payments rose by less than 1 percent.

### Year Four of Bridge to Excellence Phase-in Drives Growth in Funding

Fiscal 2007 is the fourth year of the five-year schedule of funding increases set in the Bridge to Excellence in Public Schools Act of 2002 (Bridge to Excellence), legislation that restructured the State's school finance system. Programs established and enhanced by the Bridge to Excellence are expected to account for more than $3.9 billion in fiscal 2007, 85.8 percent of total State funding for public education and 90.7 percent of the projected fiscal 2007 increases. Similar increases are projected for fiscal 2008, the final year of the phase-in.

As shown in **Exhibit 1**, the largest funding increase, approximately $195 million, is scheduled for the foundation program, the largest State aid formula. Focusing on percentage increases, however, reveals an emphasis on funding targeted to low-wealth jurisdictions and school systems with large populations of students who are at-risk of not meeting State standards. The guaranteed tax base program, which directs State funding to school systems in low-wealth jurisdictions, based on local wealth and the amount of funding provided locally for education, will increase by an estimated 56.1 percent, from $39 million in fiscal 2006 to approximately $60 million in fiscal 2007. Collectively, funding for the compensatory education, special education, and limited English proficiency formulas is expected to increase by $209 million, or 24.5 percent.

**Exhibit 1**
**Estimated State Aid for Education**
**Fiscal 2007**
**($ in Millions)**

| Program | FY 2006 | FY 2007 | Dollar Change | Percent Change | Percent of FY 2007 |
|---|---|---|---|---|---|
| Foundation Program | $2,308.3 | $2,503.1 | $194.8 | 8.4% | 54.7% |
| Cost of Education Index | 0.0 | 72.1 | 72.1 | N/A | 1.6 |
| Compensatory Education | 599.3 | 742.4 | 143.1 | 23.9 | 16.2 |
| Special Education Formula | 190.0 | 234.3 | 44.3 | 23.3 | 5.1 |
| Limited English Proficiency | 66.8 | 88.7 | 22.0 | 32.9 | 1.9 |
| Guaranteed Tax Base | 38.7 | 60.5 | 21.8 | 56.1 | 1.3 |
| Student Transportation | 187.1 | 203.4 | 16.3 | 8.7 | 4.4 |
| Baltimore City Partnership | 14.1 | 0.0 | (14.1) | (100.0) | 0.0 |
| Extended Elementary Ed | 16.9 | 19.3 | 2.4 | 14.3 | 0.4 |
| **Bridge to Excellence Subtotals** | **$3,421.2** | **$3,923.8** | **$502.6** | **14.7** | **85.8** |
| Teachers' Retirement | 406.9 | 446.1 | 39.3 | 9.7 | 9.8 |
| Non-public Special Education | 111.0 | 119.9 | 8.9 | 8.1 | 2.6 |
| Other Programs | 79.1 | 82.5 | 3.4 | 4.3 | 1.8 |
| **Total** | **$4,018.2** | **$4,572.4** | **$554.2** | **13.8** | **100.0** |

Note: Fiscal 2006 figures reflect the most recent formula estimates from Maryland State Department of Education and are $10.1 million below the legislative appropriation. The figures include $4.7 million that could be allocated from the Cigarette Restitution Fund.

Source: Department of Legislative Services

While most Bridge to Excellence funding has been increasing during the five-year phase-in, State aid for the Baltimore City Partnership was being phased out and will be eliminated entirely in fiscal 2007. The Bridge to Excellence Act endeavored to remove programs aimed at single school systems and replace them with a financing system that recognizes the needs of all school systems. Increases in formula funding will more than cover the $14 million reduction in partnership funds. In a similar manner, funding for the extended elementary education program (EEEP) is scheduled for deletion after fiscal 2007, and State aid for pre-kindergarten programs will instead be provided through the compensatory education formula.

## Funding for the Geographic Cost of Education Index Still in Question

The majority of funding projected in Exhibit 1 is mandated; the Governor must include the funding in the fiscal 2007 State budget proposal submitted to the General Assembly. The most notable exception is the geographic cost of education index (GCEI). Funding for the index was envisioned by the legislature when it crafted the Bridge to Excellence Act, but the statutory language did not establish a clear mandate. In 2004, a formula for calculating GCEI aid was enacted, but the funding was left to the discretion of the Governor.

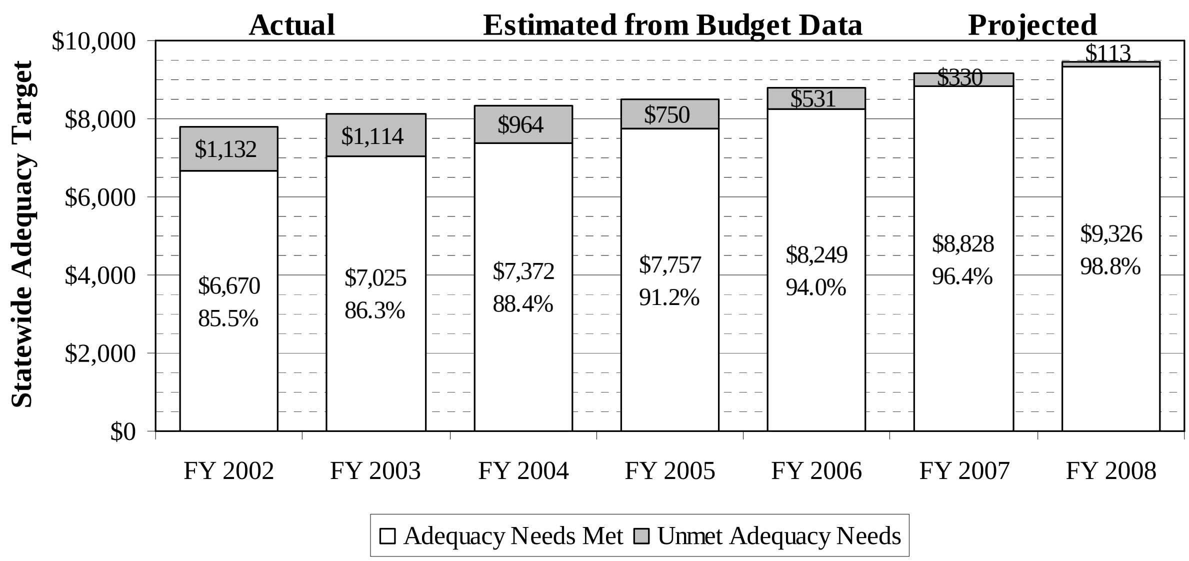
Exhibit 1 includes fiscal 2007 funding for the GCEI at the full statutory formula level of approximately $72 million. If the Governor chooses not to provide funding for the program, State education aid will still increase by an estimated $482 million or 12.0 percent.

## Bridge to Excellence Successful in Narrowing Adequacy Gaps

The primary objective of the Bridge to Excellence legislation was to establish an education finance system that enabled school systems to acquire the resources they need to meet the State's academic performance standards. An empirical estimate of the revenues each school system needs in order to obtain adequate resources was developed by the Commission on Education Finance, Equity, and Excellence (Thornton Commission) and is implicit in the funding structure enacted in the Bridge to Excellence legislation. The estimated needs, referred to as "adequacy targets," can be calculated using total student enrollment, enrollments of at-risk students, and the GCEI to measure regional cost differences. Adequacy targets can be met with federal, State, or local funds received by local boards of education.

As shown in **Exhibit 2**, the statewide adequacy target was $7.8 billion prior to the enactment of the Bridge to Excellence (fiscal 2002), and there was an adequacy gap of $1.1 billion. Due in part to the significant increases in State aid over the last four years, the adequacy gap has shrunk to an estimated $531 million in fiscal 2006 even as the statewide adequacy target has increased to $8.8 billion. The adequacy gap is projected to decrease by an additional $201 million in fiscal 2007 to $330 million. In fiscal 2008, when the Bridge to Excellence phase-in is complete, estimates show an adequacy gap of $113 million or approximately 1.2 percent of the State's target funding level. Differences between projected and actual State, local, and federal funding and movement in the adequacy target could result in different outcomes for fiscal 2007 and 2008.

**Exhibit 2**
## Statewide Adequacy Targets
**Fiscal 2002 to 2008**
**($ in Millions)**




Source: Department of Legislative Services

# Education

## Making the Grade on No Child Left Behind

**Data show continued improvement in both the percentage of students achieving proficiency and the percentage of highly qualified teachers in Maryland, the main goals of the federal No Child Left Behind Act (NCLB). However, with the federal deadline for 100 percent highly qualified teachers looming at the end of the 2005-2006 school year, Maryland and most other states are facing the prospect of failure. The federal government recently announced a possible one-year extension of the deadline for states that are making a good faith effort. A larger proportion of students in grades three through eight tested proficient or higher in reading and math on the Maryland School Assessments in 2005, although national test results show much lower proficiency rates. Across Maryland, the number of schools in improvement dropped slightly from 255 last year to 240 in 2005.**

The main goals of the federal No Child Left Behind Act (NCLB) are achieving 100 percent student proficiency by 2014 and achieving 100 percent highly qualified teachers by 2006. Both goals are challenges for states to achieve. The immediate concern is the 2006 deadline for all teachers to be highly qualified. In addition, each year the State must show that all students are making adequate yearly progress (AYP) in student proficiency.

### Having a Highly Qualified Teacher in Every Classroom

NCLB requires that all teachers in core academic subjects must be "highly qualified" by the end of the 2005-2006 school year. Core academic subjects include English, math, science, reading or language arts, social studies, and art, music, dance, or drama. Early childhood and elementary teachers also must be highly qualified. To meet the highly qualified standard, a teacher must have at least a bachelor's degree, hold a license to teach in the State and must have obtained full State certification or passed the State teacher licensing examination. In addition, a teacher must have expertise in the subject or subjects the teacher is assigned to teach. NCLB provides an alternative for veteran teachers to become highly qualified without requiring passage of a State licensing exam. In October 2003, the State Board of Education adopted an option to achieve the NCLB teacher standard through a highly objective uniform State standard of evaluation (HOUSSE). HOUSSE is designed to provide veteran teachers multiple ways to demonstrate competency in the core academic areas they teach in order to be considered highly qualified.

**Exhibit 1** shows that as of June 2005, none of the counties has met the highly qualified teacher requirement. All but two counties – Dorchester and Washington counties – showed improvement in 2005 over 2004; however, most counties must make significant progress this year in order to meet the requirement. More than half of classes are not being taught by a highly qualified teacher in Baltimore City, and teachers in over one-third of classes are not highly qualified in three other counties (Charles, Dorchester, and Prince George's). The Maryland State Department of Education (MSDE) will begin collecting teacher quality data for the 2005-2006 school year in December 2005 and will report the data in June 2006.

No state has met the highly qualified teacher requirement yet, and many states have expressed concerns to the U. S. Department of Education (USDE) regarding what, if any, sanctions will be applied to states in the likely event that they do not meet the requirement. The NCLB law is silent as to any specific negative consequences a state would experience if the teacher quality standard is not met this summer. In light of these concerns, on October 21, 2005, USDE announced that states that have made a "good faith effort" to meet the requirement will be given an extra year, to the end of the 2006-2007 school year, to achieve the goal. One of the determinants of a good faith effort will be whether steps have been taken to ensure that all subgroups of children are equally likely to be taught by qualified teachers. States must submit extension requests by January 2006.

**Exhibit 1**
## Classes *Not* Taught by Highly Qualified Teachers

| County | Percent of Classes 2004 | Percent of Classes 2005 |
|---|---|---|
| Allegany | 15.0% | 6.4% |
| Anne Arundel | 17.8% | 16.0% |
| Baltimore City | 65.7% | 57.9% |
| Baltimore County | 37.5% | 22.3% |
| Calvert | 22.3% | 14.5% |
| Caroline | 23.5% | 13.0% |
| Carroll | 13.1% | 14.4% |
| Cecil | 22.3% | 13.1% |
| Charles | 49.0% | 40.8% |
| Dorchester | 36.0% | 43.5% |
| Frederick | 34.5% | 13.6% |
| Garrett | 15.0% | 9.9% |
| Harford | 19.9% | 11.1% |
| Howard | 18.3% | 15.8% |
| Kent | 27.0% | 24.9% |
| Montgomery | 25.4% | 19.7% |
| Prince George's | 51.4% | 38.0% |
| Queen Anne's | 27.9% | 18.9% |
| St. Mary's | 29.1% | 10.4% |
| Somerset | 39.5% | 24.2% |
| Talbot | 19.9% | 12.2% |
| Washington | 12.8% | 15.6% |
| Wicomico | 21.8% | 19.5% |
| Worcester | 20.7% | 13.8% |

Source: Maryland State Department of Education

## Achieving AYP under No Child Left Behind

NCLB requires that by the 2013-2014 school year, all students in all subgroups (African American, American Indian, Asian/Pacific Islander, Hispanic, White, special education, free and reduced price meals (FRPM), and limited English proficient (LEP)) reach 100 percent proficiency in reading and mathematics. Each state determines state-specific proficiency standards for its students and establishes intermediate targets in order to achieve AYP each year.

NCLB also requires that each state assess its students in specified grades and in specified subject or content areas. In Maryland, this requirement has been implemented through the Maryland School Assessment (MSA) during grades three through eight and the High School Assessments (HSA) during high school. Combining the results of MSA and HSA with other indicators such as attendance or graduation rates determines whether each school, school system, and the State meet AYP.

### 2005 Maryland State Assessment Results

Beginning with the 2005-2006 school year, in addition to the results of MSA in grades three, five, and eight, the results of MSA in grades four, six, and seven will also count toward AYP. **Exhibit 2** shows that improvement has been made by all students in all grades. The greatest gain in reading was made by students in grades four and five, while students in grade six made the greatest gain in mathematics. Students in special education, FRPM, and LEP continue to perform below their peers.

**Exhibit 2**
**MSA Proficiency Rates**

| | Reading | | | Math | | |
|---|---|---|---|---|---|---|
| **Grade** | **2003** | **2004** | **2005** | **2003** | **2004** | **2005** |
| 3 | 58.1% | 71% | 75.8% | 65.1% | 72.2% | 76.8% |
| 4 | | 75.1% | 81% | | 69.6% | 76.5% |
| 5 | 65.7% | 68.4% | 74.3% | 55% | 63.1% | 69.2% |
| 6 | | 68.3% | 70.3% | | 50.3% | 60.2% |
| 7 | | 67% | 67.2% | | 49.8% | 55.4% |
| 8 | 59.9% | 63.8% | 66.4% | 39.7% | 45.8% | 51.7% |

Source: Maryland State Department of Education

### Comparing MSA Proficiency Rates with National Assessment of Educational Progress Proficiency Rates

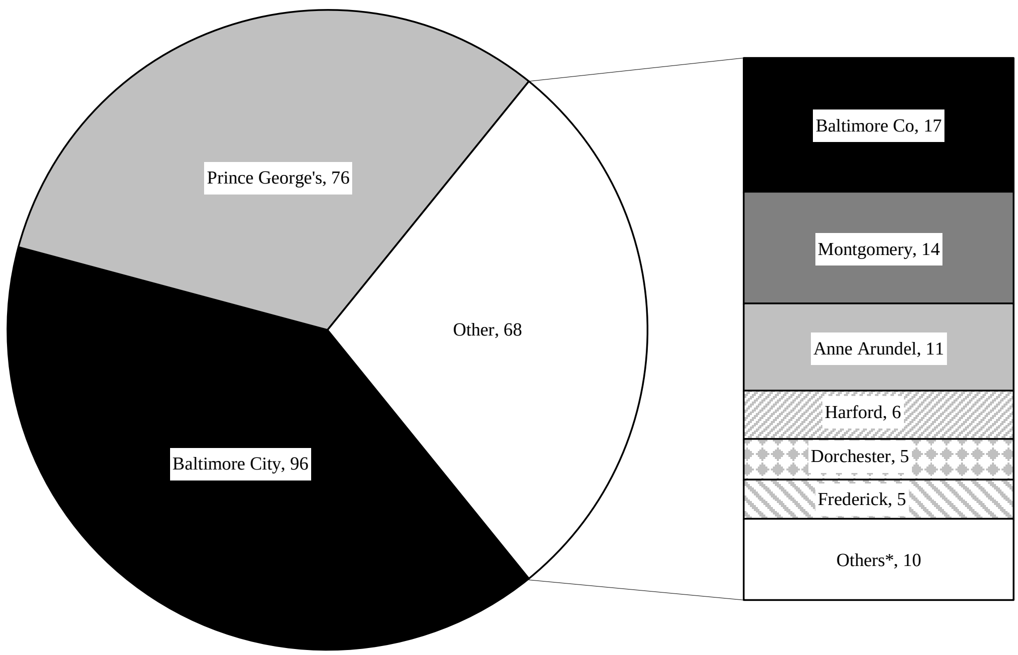
Proficiency rates achieved on MSA indicate much greater student success than proficiency rates reported by the National Assessment of Educational Progress (NAEP) for Maryland. For example, whereas MSA reflects that 81 percent of grade four students are proficient or advanced in reading, NAEP reports that only 32 percent of grade four students are proficient in reading, and that there has been no change in this proficiency rate since 2003. Whereas MSA reflects that 66.4 percent of grade eight students are proficient or advanced in reading, NAEP reports that only 30 percent of students in grade eight are proficient. Similar discrepancies exist between MSA and NAEP data for proficiency rates in mathematics for students in grades four and eight.

Despite the discrepancies between MSA data and NAEP data, MSDE is not discouraged. MSDE reports that the NAEP results are not a fair and accurate representation of the success of students in the State. First, the NAEP sample of students is small in that it includes only 3 percent of the total number of students in the State. In addition, the sample does not include students who attend k-eight schools at which students typically perform better. Second, in the absence of a national curriculum from which to develop a national standard, a national test such as NAEP does not accurately represent what is actually taught – and learned – in the classroom.

### Repeated Failure to Meet AYP – Schools in Need of Improvement

MSDE reports that 329 schools failed to meet AYP this year compared to 277 schools that failed to meet AYP last year. This increase may be attributable to the inclusion of students in grades four, six, and seven for the first time this year. MSDE has designated 241 schools in school improvement this year compared to 255 schools in school improvement last year. (MSDE anticipates that approximately 20 schools may contest these designations on appeal.) As shown in **Exhibit 3**, Baltimore City and Prince George's County have the largest proportion of schools in improvement in the State. Across the State, about 18 percent of schools are in school improvement, *i.e.*, failed to meet AYP at least two consecutive years, in 15 counties. ("Schools in school improvement" includes schools in the school improvement, corrective action, and restructuring phases. It does not include schools that have maintained their status, *i.e.*, met AYP this year after failing AYP last year.)

**Exhibit 3**
**Number of Schools in Improvement by Jurisdiction**
**2005-2006 School Year**




*Others = Allegany (2), Caroline (1), Cecil (1), Kent (2), St. Mary's (2), Somerset (1), and Talbot (1).

Source: Maryland State Department of Education

The majority of schools in school improvement, both last year and this year, failed to meet AYP due to the performance of students in the special education subgroup. Recognizing that this is occurring across the country, USDE has released guidance (to be finalized in January 2006) regarding the adoption of modified standards for a modified test for no more than 2 percent of the special education population who, despite repeated attempts at intervention, are unable to reach the appropriate grade level. Until the guidance is finalized, MSDE has received approval to hear appeals from schools and school systems that have students who would likely fit within this 2 percent of the special education population, as documented by the student's individualized education plan (IEP). If granted, that school would not be considered to be failing to meet AYP due to that student's performance within the special education subgroup.

### New English II Standards Delay Determination of School Systems Meeting AYP

Last fall MSDE combined the grade 9 reading test with the grade 10 English test to create the English II HSA which counts towards AYP. However, the State Board did not set standards for the English II assessment until October 26, 2005. Therefore, the determination of school systems that meet AYP for this year will be delayed until mid-December, following the 30-day appeals period for schools to contest the preliminary determination.

In 2003, all 24 local school systems failed to meet AYP, and in 2004, 15 local school systems failed to meet AYP. MSDE reports that in order to more accurately reflect a failing system rather than a failing group of schools within a system, the methodology for determining whether AYP is met by a local school system has been changed this year. Formerly, if a school system failed to meet AYP in any category or subgroup, the school system would fail. However, this year, a school system will only fail if it fails to meet AYP for reading or math at the elementary, middle, and high school levels. Although the federal government approved this new methodology with the caveat that the state must find a way to compare results from this year with the results of last year and the year before, at this time it is unclear how those comparisons will take place.

# Education

## Update on Baltimore City Public Schools – Finances, Lawsuits, and Facilities

**The Baltimore City Public School System (BCPSS) has reduced its deficit to $23.3 million at the end of fiscal 2005 and appears to be on track to meet the legislative mandate to eliminate the deficit by the end of fiscal 2006. The required legislative performance audit of BCPSS (and Prince George's County) is expected in January 2006. BCPSS and the State returned to court – this time federal court – regarding failure to provide special education services to Baltimore City students with disabilities. U. S. District Court Judge Garbis issued an emergency order in August 2005 to require the Maryland State Department of Education to manage special education services in Baltimore City beginning in the 2005-2006 school year. Finally, BCPSS Board of School Commissioners has voted to reduce BCPSS school space by 2.7 million square feet, or 15 percent, over the next three years. The board is expected to vote on school closures in April 2006.**

### Latest Audit Shows BCPSS on Pace to Eliminate Deficit in Fiscal 2006

The fiscal 2005 audit of the Baltimore City Public School System (BCPSS), released September 26, 2005, shows that BCPSS continued to control expenditures while revenues increased, reducing the deficit at the end of fiscal 2005 to $23.3 million. This is down from a $58.1 million deficit at the end of fiscal 2003.

As shown in **Exhibit 1**, audited revenues increased by $74.3 million in fiscal 2005, while audited expenditures for the education program actually declined for the second year in a row (by $3.8 million from fiscal 2004 to 2005) and remained substantially below the fiscal 2003 level. BCPSS also encumbered $30.1 million for anticipated payments to be made in fiscal 2006 and reserved $15.1 million for contingencies ($9.1 million) and budget stabilization ($6 million).

According to the BCPSS fiscal 2006 operating budget, revenues are expected to grow by $38.8 million in the current school year and budgeted expenditures by $85.8 million. BCPSS also budgeted $10 million for contingencies. In total, revenues are budgeted to exceed expenditures and contingencies by $23.1 million, virtually eliminating the remaining $23.3 million deficit. Chapter 148 of 2004 (Education Fiscal Accountability and Oversight Act of 2004) requires the BCPSS deficit to be eliminated by the end of fiscal 2006. In June 2005, the Maryland Court of Appeals overturned a Baltimore City Circuit Court ruling that would have given BCPSS until fiscal 2008 to eliminate the deficit. Eliminating the deficit by the end of fiscal 2006 is also a requirement imposed by the Memorandum of Understanding (MOU) under which the city provided a short-term $42 million loan in 2004 to alleviate the school system's cash flow crunch and the school system submitted to heightened fiscal supervision by the city. BCPSS repaid $34 million to Baltimore City in August 2004, and the remaining $8 million is due by the end of fiscal 2006.

**Exhibit 1**
**Baltimore City Public School System Finances**
**Fiscal 2003-2006**

| | Audited FY 2003 | Audited FY 2004 | Audited FY 2005 | Budgeted FY 2006 |
|---|---|---|---|---|
| Revenues | $899.6 | $883.0 | $957.3 | $996.1 |
| Expenditures and Transfers | $935.4 | $882.6 | $877.8 | $963.1 |
| Encumbrances and Commitments | 0.0 | 0.0 | 30.1 | 0.0 |
| Contingency and Stabilization Funds | 0.0 | 0.0 | 15.1 | 10.0 |
| **Total** | **$935.4** | **$882.6** | **$923.0** | **$973.1** |
| Year Balance | ($35.9) | $0.4 | $34.3 | $23.1 |
| Beginning Balance | (22.2) | (58.1) | (57.6) | (23.3) |
| Ending Balance | ($58.1) | ($57.6) | ($23.3) | ($0.2) |

Note: General and special funds are shown in the chart; capital and debt service funds are excluded. Revenue and expenditure figures do not include funding for Edison Schools or teachers' retirement payments.

Source: Fiscal 2003, 2004, and 2005 Independent Auditor's Reports and fiscal 2006 Proposed Operating Budget for BCPSS

## Funds Should Be Available to Implement Major Academic Initiatives in Fiscal 2006 through 2008

Budgeted expenditures for fiscal 2006 will increase 9.7 percent over audited fiscal 2005 expenditures, exceeding the fiscal 2003 level for the first time since the 2002-2003 school year. Due to BCPSS's fiscal crisis, one-time fiscal 2006 payments total $41 million, including the addition of $10 million to the contingency fund, the repayment of $8 million to Baltimore City, and the pay down of the remaining $23 million deficit. The availability of these one-time funds in fiscal 2007, as well as two more years of significant State aid increases under the Bridge to Excellence Act in fiscal 2007 and 2008, suggest that BCPSS will be in a very good position to implement major educational initiatives over the next three years, barring any unforeseen circumstances. Among the academic program initiatives BCPSS has budgeted for fiscal 2006 is $20 million for additional school-based staffing, including reduced class sizes in kindergarten and grades four and five, increased elementary and middle school resource teachers, and additional noninstructional aides.

Chapter 148 of 2004 also established a legislative audit requirement for local education agencies (LEAs). BCPSS is one of the first legislative audits being conducted (along with Prince George's County). (Chapter 148 required that LEAs with a general fund deficit of more than

1 percent in fiscal 2003 or 2004 to be in the first group of audits.) The final audit report by the Office of Legislative Audits is expected in January 2006.

## BCPSS and State Return to Federal Court

Since 1988, special education services in Baltimore City, as required under the federal Individuals with Disabilities Education Act (IDEA), have been subject to court oversight under a consent decree issued by the U. S. District Court for Maryland (*Vaughn G., et al. v. Mayor and City Council of Baltimore City, et al.*). The District Court has monitored the school system's progress in implementing the consent decree. Over the years, BCPSS has failed to comply with federal law and court orders, resulting in additional court orders culminating in the appointment of a Special Master to monitor special education services in BCPSS.

The parties to *Vaughn G.* returned to federal court numerous times in 2004 and 2005 regarding the impact of the BCPSS financial crisis on special education services. The plaintiffs, represented by the Maryland Disability Law Center and the Maryland State Department of Education (MSDE), raised concerns that significant numbers of children were experiencing interruptions in the delivery of special education services as required in their Individual Education Plans (IEPs). (Although not a party to the lawsuit, MSDE has the responsibility and authority under IDEA to insure that students with disabilities receive a free appropriate public education.) In June 2005, Judge Garbis requested that all parties involved in the lawsuit submit plans to the court to bring BCPSS special education into compliance with federal law and court orders.

### Interruptions in Services Lead to Court Ordered MSDE Management of BCPSS Special Education

In August 2005, Judge Garbis found BCPSS in contempt of several court orders. BCPSS's rate of interruptions for the 2004-2005 school year was at least 54.2 percent as reported by the Special Master (affecting at least 1,520 students) in June 2005 and acknowledged by BCPSS, far in excess of the requirement that no more than 2 percent of students with disabilities have interruptions in service in any school year. BCPSS was also found in contempt for violating the April 26, 2005, court order under which all interruptions in services were to be identified by June 10, 2005, and all remedial services to be completed prior to the start of the 2005-2006 school year. BCPSS was, to the fullest extent possible, to provide compensatory services to students during the summer. Judge Garbis found that BCPSS did not comply with these orders, providing complete remedial services to less than 300 students.

Judge Garbis also cited deficiencies in BCPSS fiscal management, including federal grant administration and Medicaid reimbursement billings, risking the loss of millions of dollars. MSDE reported in June 2005 that BCPSS was at risk of having $12.26 million, nearly all of its fiscal 2005 Medicaid billings, disallowed by the federal Office of the Inspector General. In addition, MSDE reported that BCPSS has not spent its entire IDEA grants in fiscal 2003, 2004, and 2005, resulting in the return of $230,600 in unspent fiscal 2003 federal funds and a carryover balance in excess of $4.2 million in fiscal 2004.

To insure that the 2005-2006 school year was not a repeat of the previous school year, Judge Garbis issued an emergency order on August 12, 2005, requiring MSDE to execute its Intensive Management and Capacity Improvement Plan (plan) to bring BCPSS into compliance with federal law and court orders with several modifications to minimize the transfer of control from BCPSS to MSDE. MSDE's plan involves bringing in nine administrators from Maryland LEAs to manage BCPSS special education services in the special education function, but also human resources, finance, instruction, transportation, and other related services. MSDE estimates that implementing the administrative components of the plan will cost $1.4 million annually and has requested to use BCPSS' available carryover balances to cover the cost in fiscal 2006.

## BCPSS Board Votes to Close Schools

Since the 1997 State law establishing the City-State Partnership was enacted, the State has recommended that BCPSS consolidate schools and close unneeded school space due to declining enrollment and aging facilities in order to achieve cost savings and operating efficiencies. In October 2005, the BCPSS Board of School Commissioners voted to reduce its school space by 2.7 million square feet, about 15 percent of total operating space, over three years. According to State Public School Construction data, BCPSS has approximately 5.7 million excess square feet based on current enrollment. With the 2.7 million square foot reduction, BCPSS will have the capacity to accommodate over 100,000 students. BCPSS enrollment this year is approximately 89,000 in pre-kindergarten through grade 12 and is projected to decline 2 to 3 percent annually through 2010 based on Department of Planning enrollment projections.

BCPSS has hired a consultant, DeJong & Associates, to analyze BCPSS space needs, solicit community input, and recommend school configurations. BCPSS has created eight community groups to identify schools for closure. Recommendations will be submitted to the BCPSS board in March 2006, and decisions on school closings are scheduled to be made by April 2006. The Interagency Committee on School Construction voted at its November 10 meeting to wait to finalize school construction allocations for Baltimore City in fiscal 2007 until the school closure identification process is complete in April.

For further information contact: Rachel Hise Phone: (410) 946/(301) 970-5510

# Education

## $250 Million Annual Goal for School Construction Met in 2005; Meeting the Goal in 2006 and Beyond Remains a Challenge

**The General Assembly provided $250 million for school construction projects in fiscal 2006, achieving for the first time the annual goal set by the State in the Public School Facilities Act of 2004. The goal was a response to a survey of public school facility needs which found that the cost to bring public schools up to minimum standard would be $3.85 billion, including $2 billion in State funding and the balance in local funding. If the State provides $250 million annually for school construction for eight years, the State's $2 billion goal will be met. The Governor's preliminary allocation for fiscal 2007 is $150 million in general obligation (GO) bonds, significantly less than the General Assembly's fiscal 2006 authorization but more than the $100 million forecasted in the 2005 *Capital Improvement Program*. The Capital Debt Affordability Committee did not make a specific recommendation for school construction funding as it is required by law to do.**

### $250 Million Annual Goal Met by General Assembly in 2005

Chapters 306 and 307 of 2004, also referred to as the Public School Facilities Act of 2004, 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, chaired by State Treasurer Nancy Kopp. The 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 the next eight fiscal years, with the remaining balance funded by local governments.

In 2004, the State had committed to $800 million ($100 million annually) in the Department of Budget and Management's (DBM) *Capital Improvement Program* (CIP), leaving a $1.2 billion shortfall. Increasing the authorization by $150 million annually ($250 million total) for eight years would allow the State to meet the goal.

The 2005 CIP provided $157.4 million for school construction in fiscal 2006 only, returning to the $100 million annual level in the out-years. During the 2005 session, the General Assembly increased the amount to $250 million in fiscal 2006. The General Assembly used several alternatives to achieve the goal, primarily increasing general obligation (GO) bond authorizations for school construction by $79.2 million, which involved both reducing and delaying funds for some capital projects in order to remain within the Capital Debt Affordability Committee's (CDAC) recommended debt limit. Unspent school construction funds from prior years available in the contingency fund provided $15 million and shifting $45.2 million in bond-funded programs to the operating budget as PAYGO, in some cases avoiding the need to issue taxable debt, brought the total to $250 million for school construction projects.

### General Assembly Allocates School Construction Funds for Fiscal 2006

For the first time, the General Assembly made school construction allocations for each county in the fiscal 2006 capital budget bill (Chapter 445 of 2005). Capital budget language also eliminated the Board of Public Works' (BPW) role in approving final project allocations for fiscal 2006 only. The Interagency Committee on School Construction (IAC) was directed to allocate funds based on county priorities for projects that were designated as A or B, *i.e.*, ready to go. The IAC approved allocations totaling $250 million in May 2005 consistent with the capital budget language. All counties have received their full allocations except for Baltimore City and Somerset County; $2.66 million in fiscal 2006 authorizations remains held in reserve for eligible projects in Baltimore City, and $7 million remains for the Tawes Intermediate School in Somerset. At its November 10 meeting, the IAC approved proposals to reallocate the reserved funds when the projects are ready to go.

Section 5 of the fiscal 2006 capital budget bill also permanently added two public members to the IAC, one to be appointed by the President of the Senate and one by the Speaker of the House of Delegates. Previously the IAC consisted of three members, the Secretaries of General Services and Planning and the State Superintendent of Schools, who remains Chair of the IAC. The legislative representatives, Timothy Maloney and Frederick Puddester, began serving on the IAC in June 2005. Section 5 also clarified that the IAC is subject to the Open Meetings Law.

### Achieving $250 Million Goal for Fiscal 2007 Will Be Another Challenge

The Governor's preliminary allocation for fiscal 2007 is $150 million in GO bonds, significantly less than the fiscal 2006 amount authorized by the General Assembly but more than what was planned in the 2005 CIP. Section 5-302 (e) of the Education Article requires the IAC to allocate at least 75 percent of the Governor's preliminary allocation in its December recommendations to BPW. Section 6 of the fiscal 2006 capital budget bill prohibits BPW from allocating more than 75 percent of the Governor's preliminary allocation for fiscal 2007 before May 1, 2006. The combined effect of the laws is that BPW cannot allocate additional school construction funds that may become available in the capital budget submitted by the Governor or as a result of amendments by the General Assembly until May 1, 2006.

The IAC met on November 10 to consider preliminary recommendations for allocating $121.8 million, which is 75 percent of the preliminary fiscal 2007 allocation, including $2.4 million in special funds and $10 million available in the contingency fund. County requests total $752 million for fiscal 2007, compared to $592.6 million in fiscal 2006. The effects of inflation, discussed below, could be contributing to the higher request amount in fiscal 2007. The IAC will meet on December 8 to consider county appeals and will finalize its preliminary recommendations for BPW. BPW is scheduled to meet on January 18, 2006, to hear county appeals of the IAC's recommendations.

### Increasing Construction Costs Reduce Buying Power of $3.85 Billion

As discussed above, a survey of public school facilities was conducted in 2003 for the Task Force to Study Public School Facilities. The statewide figure of $3.85 billion in facility needs was based on July 2004 dollars (for projects funded in fiscal 2005). As with other capital projects in the State, building costs have gone up significantly in the last few years. In response to rising costs, the Public School Construction Program (PSCP) has increased the allowable cost per square foot for building from $140.00 for fiscal 2005 to $190.00 for fiscal 2007, a 35.5 percent increase over the period. (The allowable cost increased 21 percent from fiscal 2006 to 2007 alone.) As a result, projects are more expensive, and fewer (or smaller) projects can be completed with the same amount of funds. Another survey will be conducted in 2007 at which time a new cost estimate will be made.

PSCP staff has indicated that the fiscal 2007 cost allowance was set at the low end of the range considered. Anecdotal evidence suggests that actual bids are running 8-12 percent higher than the allowance, primarily due to the effects of Hurricanes Katrina and Rita and rising gas prices on the construction market. PSCP staff will collect comparative data over the next month and may recommend that the IAC consider increasing the fiscal 2007 allowance.

## Issuing Additional Bonds Is Still Affordable

The Public School Facilities Act requires CDAC to review school construction needs and make a funding recommendation annually. In 2004, the committee recommended to the General Assembly that the State continue to authorize $100 million in public school construction. The committee also analyzed the effect of authorizing an additional $1.2 billion for public school construction. The committee concluded that authorizing this additional debt was affordable under the affordability criteria, yet warned that such a task would limit the State's ability to issue debt for other programs. In addition, the committee cautioned that changes in personal income could breach affordability measures. The committee recommended that alternative funding mechanisms, new revenue streams, or shifting other capital projects be fully explored before considering an additional $1.2 billion in GO bond authorizations.

In its 2005 report, CDAC concludes that some additional authorization remains affordable, although less than $1.2 billion. DLS estimates that $792 million in unused debt capacity is available through fiscal 2011 (the end of the forecast period). However, authorizing debt to the limit of affordability would absorb all of the State's unused capacity and increase the risk that the affordability criteria would be breached if personal income growth is less than projected.

## CDAC Does Not Make Specific Recommendation for School Construction

In its 2005 report, CDAC did not recommend an amount for school construction as it is required by law to do, nor did the committee provide any specific recommendations on how to achieve an annual school construction funding level. CDAC noted that the General Assembly achieved the $250 million goal in fiscal 2006 without increasing the total debt authorized. CDAC also noted that the General Assembly used a combination of alternatives to achieve the goal. The closest the committee came to a recommendation regarding school construction was to note that "relying solely on capital debt is neither sufficient nor necessary. The committee's proposed out-year authorization estimates….provides [sic] additional debt capacity." (2005 CDAC Report, p. 46) DLS estimates that CDAC's proposed authorizations increase GO bond authorizations by $550 million in fiscal 2007 through 2013.

The committee also reviewed the alternatives it suggested last year. Regarding alternative financing sources, Chapters 306 and 307 of 2004 authorized the use of alternative financing methods, such as leasing arrangements with contractors, and allowed all counties to issue bonds for public school construction. The law required the regulations pertaining to these new laws to be promulgated by July 2005. This has not yet occurred. The IAC advises that the regulations are still being developed and should be implemented by the end of fiscal 2006. The IAC has noted that anecdotal evidence suggests that school systems are not pursuing alternative financing methods as they are more expensive than issuing tax-exempt debt over the long-term. New revenues and shifting funds from other projects are the other alternatives suggested by CDAC. DLS will again examine the implications of reducing the current capital program to fund more public school construction when the Governor's capital budget is submitted at the beginning of the 2006 legislative session.

## Another Option – PAYGO

Although not specifically recommended by CDAC, one of the alternatives used by the General Assembly to reach $250 million in fiscal 2006 was the use of available cash (*i.e.*, PAYGO) for certain capital programs and projects. The General Assembly restricted $45.2 million in available funds in the State Reserve Fund for certain programs and projects, freeing up an equivalent amount of GO bonds for school construction. In some cases, the use of PAYGO avoided the need for the State to issue taxable debt, thereby reducing debt service costs.

Using more PAYGO for school construction has another benefit. It provides the State more flexibility to reimburse local education agencies (LEAs) for projects that were forward funded by the county government in prior years. Under federal tax laws, State tax-exempt bond proceeds can only be used to reimburse an LEA if the reimbursement is made within 18 months of the final payment to the contractor. State PAYGO funds can be used without any time restriction. PAYGO funds for school construction have been limited to $2.4 million in special funds (payments from the Maryland Stadium Authority) since fiscal 2004, and the 2005 CIP provides only $2.4 million in PAYGO in fiscal 2007-2010. The lack of PAYGO funds has limited the State's ability to reimburse counties for forward-funded projects.

Currently the State owes $65.9 million to counties for forward-funded projects, of which $59.7 million is owed to Prince George's County and requires PAYGO funds. Tax-exempt bond proceeds can be used to reimburse the remaining $6.2 million owed to Frederick County. The Attorney General's Office has proposed new procedures that could allow the State to reimburse counties using tax-exempt bond proceeds in certain circumstances. However, a county could experience adverse federal tax consequences depending on how the project was financed. The proposed procedures are under review.

For further information contact: Rachel Hise Phone: (410) 946/(301) 970-5510

# Education

## New Charter Schools Open Despite Unresolved Legal Issues

**Fourteen new charter schools opened for the 2005-2006 school year, the first charter schools to be established since the State authorized public charter schools in 2003. The majority of the State's charter schools are in Baltimore City (12), with 2 in Anne Arundel County and 1 (the first charter in the State) in Frederick County. The schools opened this year despite legal issues surrounding the amount of funding a charter school should receive and the status of charter school employees. Both issues were appealed to the State Board of Education and then to the courts, and both remain unresolved. Legislation to clarify these issues is likely to be introduced in the 2006 session.**

Three years ago, the Monocacy Valley Montessori Charter School, located in Frederick County, was the only charter school in the State. Now, after the passage of the Public Charter School Act of 2003, 14 newly chartered schools have opened in 2005. Of the newer charter schools, 12 are located in Baltimore City and 2 are located in Anne Arundel County. Additional charter schools are expected to open in 2006 in Harford, Prince George's, and St. Mary's counties.

The majority of the charter schools that have opened in the State either serve, or intend to serve once they are fully operational, students in kindergarten through grade eight. Seven of the charter schools also serve, or intend to serve, pre-kindergarten students, and one charter school intends to serve students in kindergarten through grade 12 when it is fully operational. According to data provided by the Maryland State Department of Education (MSDE), nearly three-quarters of the students enrolled in Maryland charter schools are African-American. Of the 12 schools in Baltimore City, 7 have been converted from regular public schools (part of the New Schools Initiative) to charter schools.

### The Maryland Public Charter School Program

After five years of considering charter school legislation, Maryland became the fortieth State to authorize public charter schools in 2003. The Maryland charter school law enables public school staff, parents of public school students, nonsectarian nonprofit entities, and nonsectarian institutions of higher education to apply to establish a public charter school.

As with charter schools in other states, public charter schools in Maryland must be nonsectarian and open to all students on a space-available basis. The schools may not charge tuition but are to receive public funds commensurate with other public schools in the school district in which they operate. Charter schools must participate in the State's accountability program, and the professional staff of a charter school must hold the appropriate certification. Further, charter schools must comply with the laws, regulations, and policies that govern other public schools, although a waiver may be requested from the State Board of Education (State Board) on appeal in order to be released from some of these requirements.

Local boards of education (local boards) serve as the primary chartering authorities. The State Board has secondary chartering authority under two specific circumstances: in its appeal review capacity and in authorizing a charter for a restructured school.

## Federal Government Provides Start-up Funds for Charter Schools

One of the advantages of having a state charter school law is that federal funds become available. In an effort to foster charter schools, the federal government authorizes state education agencies to administer grant awards for one-time costs such as furniture, instructional materials, and minor facility modifications. To date, Maryland has been awarded $13.8 million in federal funds to be granted to charter schools. The grant awards are implemented in three phases (pre-planning, planning and design, and implementation) over the course of three years and may total up to $410,000 per charter school. This money is in addition to any money received by a charter school from a local jurisdiction or from the state. As of October 19, 2005, MSDE has awarded 23 pre-planning grants, 17 planning and design grants, and 9 implementation grants totaling $2.9 million.

## Charter Schools Appeal for Additional Funding and Flexibility

During the spring of 2005, three charter school applicants – two in Baltimore City and one in Prince George's County – pursued their right of appeal before the State Board. All three challenged the level of funding provided by the local board and two sought waivers from the requirement that public charter school employees be controlled by the collective bargaining agreements of other public school employees.

### The Requirement for Commensurate Funding of Charter Schools

Section 9-109 of the Education Article requires that a local board "disburse to a public charter school an amount of ... money ... that is commensurate with the amount disbursed to other public schools in the local jurisdiction." Baltimore City and Prince George's County school systems interpreted this law to mean that a charter school would be provided a per pupil allocation consisting of a combination of cash for discretionary use and in-kind services such as special education and security. The charter schools, however, argue that this funding allocation is less than that disbursed to other public schools.

After hearing from both parties, in a revised opinion dated May 26, 2005, the State Board ruled that charter schools shall be funded by dividing the total annual local school system operating budget by the annual September 30 enrollment count for the previous year. This number would constitute the per pupil amount. Acknowledging that some support functions such as data collection and reporting can only be performed by the central office, the State Board authorized the adjustment of the per pupil amount by 2 percent. The total amount of money disbursed to a charter school would be the per pupil amount, less the 2 percent, multiplied by the student enrollment of the charter school.

The local boards appealed to the Circuit Court. Ultimately, the judge held that the funding issue was moot because there was no longer an existing controversy between the parties. (*Baltimore City Board of School Commissioners, et al, v. City Neighbors Charter School, et al*, Circuit Court for Baltimore City, August 2005) Contracts between the charter schools and the local boards had been signed, and this constituted a compromise on the funding issue in the opinion of the court. Regarding the 2 percent funding formula advanced by the State Board in its May opinion, however, the judge held that the local board is not bound by that formula since it was not promulgated by regulation in accordance with the State Administrative Procedures Act, allowing for interested parties to comment.

## The Status of Employees in Charter Schools

The Maryland Public Charter School Program explicitly provides that the employees of a public charter school are employees of the local board and possess all of the associated collective bargaining rights (§ 9-108 of the Education Article). However, some charter schools have required that this law be waived in accordance with the provision in § 9-106 that a charter school may seek a waiver from the laws that govern other public schools. The State Board ruled that the law does allow for such a waiver, and in its revised opinion of May 26, 2005, the State Board provided a procedure by which such an appeal may be sought.

The Baltimore Teachers' Union and AFSCME Local 44 (unions) submitted a petition for judicial review to the Circuit Court as a result of the potential impact the State Board ruling might have on their collective bargaining rights. The judge held that the State Board erred in creating a policy that would affect the unions without allowing for the unions to comment prior to the policy's adoption. Regarding the merits of such a waiver, the judge held that the State Board erred in stating that such a waiver could be sought. The judge explained that while the law states that waivers may be sought for laws that govern *other public schools*, the requirement that public charter school employees be employees of the local board governs *charter schools*, not *other public schools*, and therefore cannot be waived.

An appeal by the charter schools from both the funding decision and the waiver decision is currently pending in the Court of Special Appeals.

## Legislative Study

The Senate Education, Health, and Environmental Affairs Committee has scheduled meetings in November and December to discuss clarifying State law regarding charter school funding and waivers from provisions of the Charter School Program Law (Title 9 of the Education Article). The Office of Policy Analysis, Department of Legislative Services is conducting a survey of school systems to examine the funding retained by the central office for systemwide administrative costs versus funding provided to individual schools. The survey results will be provided to the committee at a November meeting.

# Education

## Governor's Commission on Quality Education Releases Its Final Report

**The Governor's Commission on Quality Education issued its final report in September with 30 recommendations. Several of the recommendations are already being implemented, and many can be implemented through executive or regulatory action. Six of the recommendations require legislation. Lieutenant Governor Michael S. Steele, chairman of the commission, created and appointed four subcommittees that met frequently. The subcommittee meetings were not held in public and were not subject to the Open Meetings Law, since the subcommittees were not officially established by executive order or statute.**

### Commission Created by Executive Order

Governor Robert L. Ehrlich Jr. issued an executive order on September 27, 2004, establishing the Governor's Commission on Quality Education. The "Steele Commission," chaired by Lieutenant Governor Michael S. Steele, was charged with examining critical issues in education and making recommendations to the Governor on or before September 1, 2005. The Steele Commission was comprised of 30 members which included the State Superintendent of Schools, the Secretary of Juvenile Services, the Secretary of Business and Economic Development, the Secretary of Budget and Management, the Secretary of Higher Education, 2 members of the Senate of Maryland, 2 members of the House of Delegates, and 20 members appointed by the Governor. The Steele Commission was charged with examining and making recommendations to (1) enhance the effectiveness of teachers and principals; (2) link schools with their communities; (3) incorporate best practices that will effectively prepare students for postsecondary education and career success; and (4) improve school readiness and early childhood programs.

### Subcommittee Meetings Not Open

Although the Steele Commission held 7 public hearings, 41 site visits, and 4 full commission meetings, most of the commission's policy discussions and recommendations were completed by four subcommittees: (1) Personnel Accountability and Growth; (2) Schools and Community Linkages; (3) Best Practices in Education; and (4) School Readiness and Early Childhood Education. Each subcommittee held at least seven meetings; however, the information presented at those meetings is not available for public review. The subcommittee meetings were considered closed meetings not subject to the Open Meetings Law. The Open Meetings Law does not apply to subcommittee meetings unless the subcommittees are officially established in statute, executive order, etc. As chairman of the commission, Lieutenant Governor Steele created the subcommittees and appointed the members. Since the subcommittee meetings were closed meetings, the Governor's Office considers the information confidential and privileged.

## Steele Commission Recommendations

In its final report issued on September 14, 2005, the commission made 30 recommendations to improve Maryland schools. Some of the recommendations are similar to recommendations made by previous task forces and commissions. Most of the recommendations could be implemented through regulations or changes in policies.

Several recommendations have already been at least partially implemented. For example, Chapter 585 of 2005 transferring the Child Care Administration to the Maryland State Department of Education is related to the recommendation to increase accountability for early childhood programs by consolidating them in one agency. The Maryland Child Care Resource Network has begun implementing the recommendation to improve early child care systems. In January 2005, the Governor launched the "Countdown to Kindergarten" public awareness campaign to promote the importance of early childhood learning. Additionally, Governor Ehrlich implemented one of the recommendations by hosting a Statewide Summit on Mathematics, Science, and Technology on November 17, 2005.

## Recommendations that Require Legislation for Implementation

The Steele Commission made six recommendations that require legislation for implementation. Several of these recommendations could have a significant fiscal impact.

### Develop a New Compensation System for Teachers and Principals

The Steele Commission concluded that Maryland should develop a new compensation system with a statewide framework of minimums and district-specific adaptations. Additionally, Maryland should provide principal compensation packages that are commensurate with their responsibilities and differentiate according to the principal's effectiveness and the difficulty of staffing particular schools. These decisions are currently the purview of the local boards of education through the collective bargaining process.

### Reform the Pension System for Teachers and Principals

The Steele Commission concluded that Maryland should supply a competitive and portable pension plan to attract and retain quality educators and remain competitive with other states. The Joint Committee on Pensions is studying teacher pension reforms and is currently considering various options for teacher pension reform. Options being studied include enhancing the State's defined benefit system with an annual fiscal impact of $60 - $275 million for teachers ($40 - $200 million for State employees). Another option would increase the State contribution to 401(k) accounts to 2 percent of payroll at an annual cost of about $60 million for teachers ($40 million for State employees). Converting to a defined contribution system similar to the Optional Retirement Program provided for higher education employees (7.25 percent of annual earnable compensation) would cost about $330 million annually for teachers (and $250 million for State employees).

## Expand Tuition Waivers

The commission recommended that the State expand tuition waivers for prospective teachers who agree to teach in challenging schools or subject areas experiencing teacher shortages. The State currently provides a bonus to teachers who agree to teach in challenging schools or shortage areas, as well as financial aid to students studying to become teachers. Instituting a tuition waiver program would require legislation similar to waivers currently provided in law for certain military personnel, senior citizens, and foster children. Higher education institutions would want the State to reimburse them for tuition revenues lost as a result of waivers.

## Strengthen Maryland's Public Charter School Law and State Board of Education Regulations

The Steele Commission recommended broad changes to the State's charter school laws. The Steele Commission concluded that the State should allow multiple chartering authorities and allow public charter schools to operate with increased autonomy. For example, the commission concluded that a public charter school should have the flexibility to create its own school calendar or change the length of the school day. Under current law, a charter school may request a waiver from the State Board of Education from these types of requirements.

The Steele Commission also concluded that the State must provide facility funding to public charter schools. The commission noted that eligibility criteria for grants from the United States Department of Education's "State Charter School Facilities Incentive Grants Program" require the State to specify in its charter school law that it provides a per-pupil allotment to public charter schools for facility funding.

## Streamline Decision Making to Advance the Profession

The Steele Commission concluded that the Professional Standards and Teacher Education Board (PSTEB) has not been effective in advancing the teaching profession and meeting the needs of children. The commission recommended reorganizing the statutorily established PSTEB into an advisory board or abolishing the board.

## Delegate Teacher Certification Decisions

The Steele Commission suggested that the State Board of Education delegate certification decisions to local school systems without compromising standards. The Steele Commission concluded that by decentralizing certification, school systems would be empowered to tailor teacher recruitment and placement to the local school systems' specific needs. State law currently requires certificates to be issued by the State Superintendent.

# Higher Education

## Enrollment Growth Rate Projected to Slow as Baby Boom Echo Dissipates; Affordability and Institutions' Capacity to Accommodate New Students Affect Growth

**Enrollment growth continues to be at center stage in higher education discussions. Particular concerns include growth rate trends, growth rates by type of institution, competing models of enrollment projection, and the link between enrollment growth and facility needs. Tuition rates and affordability also play a role in enrollment growth. While the State has shifted financial aid resources to need-based aid, the average award amount has not kept pace with recent tuition increases. As of November 2005, the University System of Maryland has not submitted an operating budget request or set tuition and fee rates for fiscal 2007.**

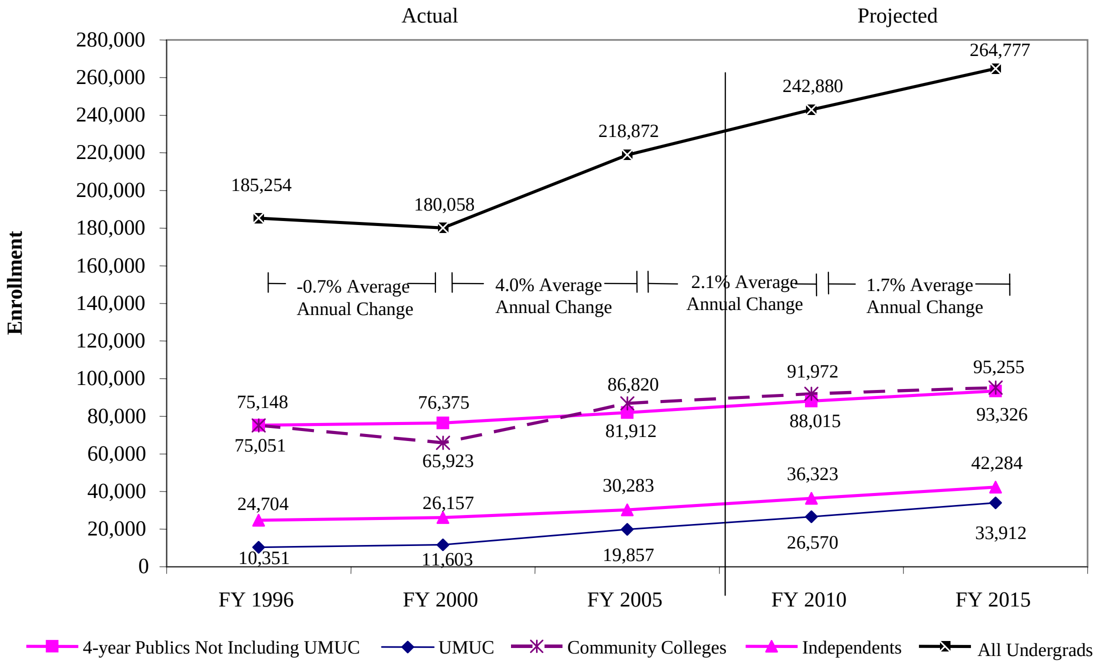
### Projected Enrollment Growth Rates Are Slowing

Total public higher education enrollment – including community college and graduate students – is expected to increase 22.7 percent from fiscal 2005 to 2015. This equates to a 2.1 percent average annual increase, as indicated by data from the Maryland Higher Education Commission's (MHEC) June 2005 projections. These most recent 10-year headcount projections show slightly lower expected growth rates than the 10-year projections from 2004 (22.8 percent total growth, 2.2 percent average annual growth).

**Exhibit 1** shows the last 10 years of undergraduate enrollment along with projections for the next 10 years. While enrollment is expected to grow through fiscal 2015, average annual growth rates are projected to be lower than in recent years. After declining enrollment in the 1990s, fiscal 2000 to 2005 was a time of strong enrollment growth, with the average annual increase for undergraduates reaching 4 percent. However, the average annual increase is projected at 2.1 percent for fiscal 2005 to 2010 and 1.7 percent for 2010 to 2015 representing the ending of the "baby boom echo" population effect.

The undergraduate projections incorporate MHEC data as well as calculations by the Department of Legislative Services (DLS) for community college students (based on MHEC data) and independent undergraduates (based on data from the Maryland Independent College and University Association, or MICUA), since MHEC does not project enrollment for these subgroups. The community college number is limited to students seeking associate's degrees because this analysis is concerned with the colleges' capacity to serve degree-seeking students, particularly those likely to transfer to four-year institutions to further pursue their educational goals. Community colleges also have a mission to provide educational opportunities to nondegree credit-seeking students as well as noncredit seeking students.

**Exhibit 1**
**Undergraduate Headcount Enrollment**




Note: Total undergraduate enrollment includes undergraduates at public four-year institutions, community college students pursuing associate's degrees, and undergraduates at Maryland independent institutions.

Source: Maryland State Department of Education, Maryland Higher Education Commission, Department of Legislative Services

## UMUC Will Have Dramatic Effect on Enrollment

The University of Maryland University College (UMUC) will have a dramatic effect on future enrollment. Altogether, Maryland is expected to gain about 24,000 full-time equivalent students in public higher education institutions through fiscal 2015. Of these new students, most will be undergraduates, but only half of the undergraduates will be full time. This trend reflects the dramatic enrollment rise in part-time online students at UMUC.

From fiscal 2005 to 2015, the UMUC growth rate projected by MHEC is 70.8 percent. Independent institutions are expected to grow at the next highest rate of 39.6 percent, based on MICUA data. Four-year public institutions not including UMUC are expected to grow at 13.9 percent, followed by community colleges at 9.7 percent. Enrollment growth is driven by a number of factors, including the size of the traditional college-age population, or those aged 18 to 24, and institutional decisions related to enrollment levels and tuition rates.

## MHEC and USM Enrollment Projections Still Competing for Attention

MHEC continues to provide the State's official enrollment projections, but the University System of Maryland (USM) has a separate enrollment model. In its budget discussions, USM refers to its full demand model as a representation of what could happen if all potential students are enrolled. The MHEC model represents what is likely to happen, given budget constraints and other factors.

A review of several MHEC projections shows that they compare well to the actual levels that occur. Comparing MHEC's projections from 1996, 2000, and 2003 to actual 2003 enrollment, the projections varied 0.8 percent or less than the actual levels for four-year institutions and community colleges (looking at each group as a whole). The USM demand model generates higher numbers than the MHEC model; through 2011, the demand model projects a 31 percent increase in higher education headcount enrollment while the MHEC model projected a 22 percent increase. The USM demand model numbers were presented in a November 2003 report submitted by USM, the Maryland Association of Community Colleges, and MHEC in response to a *Joint Chairmen's Report* request to study higher education capacity.

USM reported at its fall 2005 Board of Regents and MHEC meetings that it will base its fiscal 2007 budget on funding full demand enrollment. USM intends to pursue a funding arrangement that assigns additional funds based on each additional full-time equivalent student (FTES). USM has not yet provided information on costs per each additional FTES. Furthermore, USM has not decided its enrollment levels for fiscal 2007.

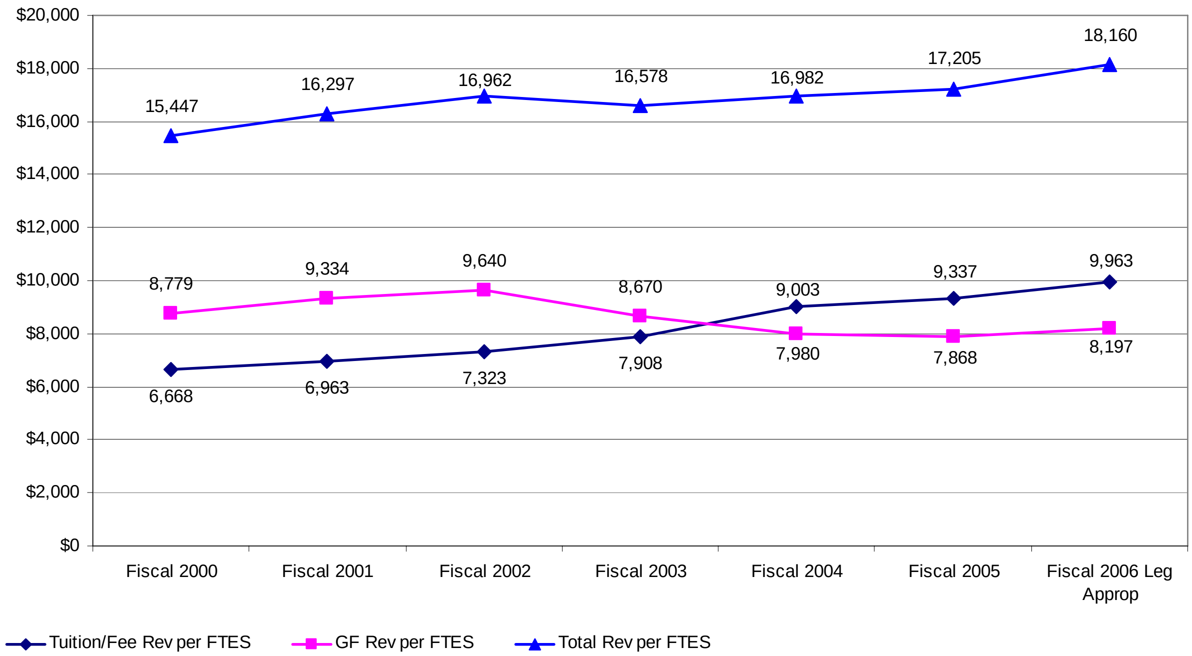
## MHEC Submits Consolidated Budget Without USM Budget; Fiscal 2007 Tuition Rates Unknown for USM

MHEC is required by law to submit consolidated operating and capital budgets for higher education to the Governor and General Assembly each year. At its November 16 meeting, for the second year in a row, the commissioners approved a consolidated operating budget that does not include USM. USM has not yet submitted its fiscal 2007 operating budget request to the Department of Budget and Management (DBM). USM representatives indicated that they are in discussions with the Governor's Office and DBM staff regarding the request and could submit a budget request in mid-December. As a result, USM institutions have not set fiscal 2007 tuition rates (for Fall 2006) as of November 21, 2005. At Board of Regents' meetings in fall 2005, the USM Chancellor indicated that the systemwide weighted average likely will be about 6 percent. Morgan State University (MSU) is proposing a fiscal 2007 tuition and mandatory fee rate of $6,369 for full-time resident undergraduates, a 4.2 percent increase over the 2006 rate of $6,110. The proposed St. Mary's College of Maryland (SMCM) tuition and fee rate (not approved by the Board of Trustees) for fiscal 2007 is $11,695 for resident students, a 7.3 percent increase over the 2006 rate of $10,896.

### Tuition Largest Source of Funds for Most Institutions; State Need-based Aid Awards Did Not Keep Pace with Tuition Increases in Fiscal 2006

Tuition continues to be the largest source of funds, per FTES, at USM institutions and SMCM. At MSU, general funds are the largest source. **Exhibit 2** shows the detail for USM. After three years of cost containment, general funds rose slightly in fiscal 2006 to $8,197 per FTES.

**Exhibit 2**
**USM Tuition and Fee and General Fund Revenues**
**per Full-time Equivalent Student**
**Fiscal 2000 to 2006**




Source: MHEC Trend Book, May 2005; State Budget Books; Fiscal Digest; individual institutions

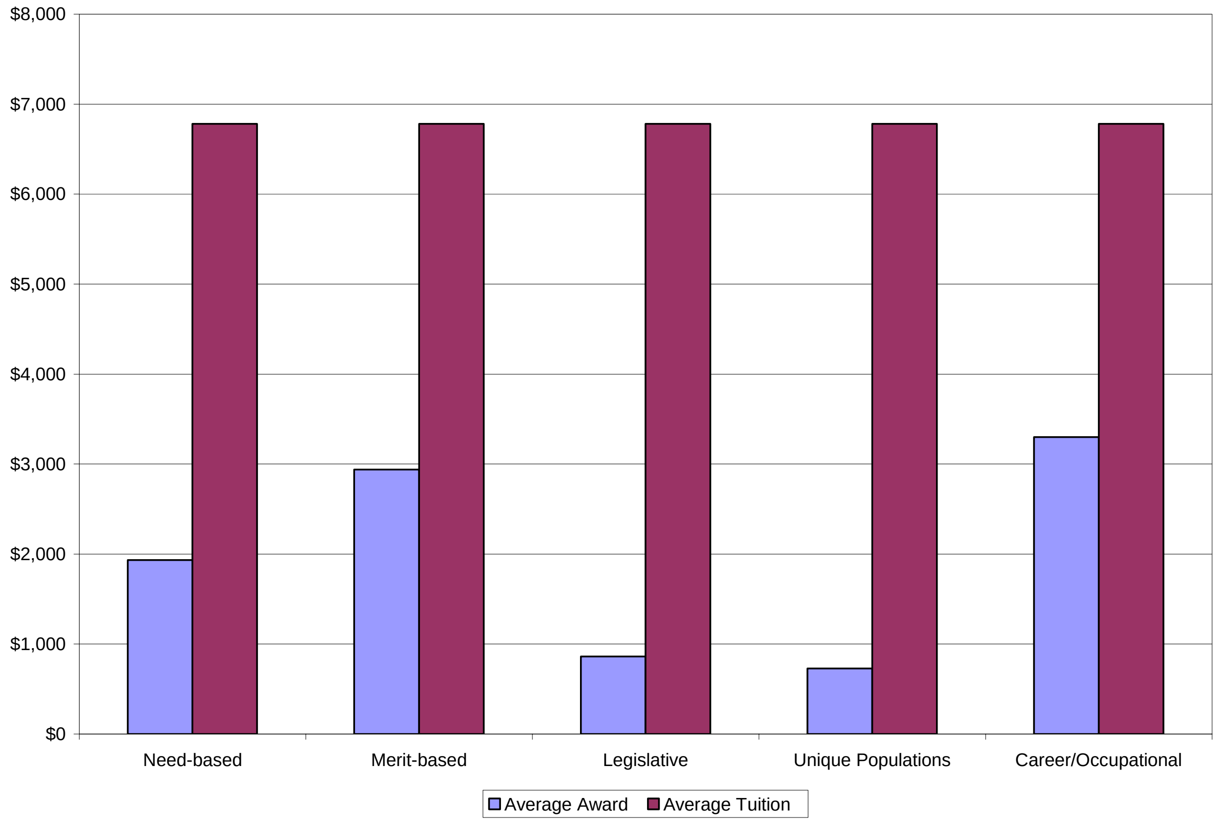
State need-based financial aid increased $14.5 million, or 28 percent, from fiscal 2005 to 2006. In total, the State is providing $66.7 million in need-based aid to students in fiscal 2006, compared to $40.2 million in fiscal 2001, a 66 percent increase over five years. Approximately $5 million of the new need-based aid funds in fiscal 2006 is a result of the continued phase-out of the HOPE Scholarship Program, which is the largest career/occupational-based aid program. The program is scheduled to be completely phased out after fiscal 2008.

Despite the large increase in need-based funding, the average award has not increased significantly. From fiscal 2005 to 2006, the average need-based award increased from $1,864 to $1,933, about 3.7 percent. By comparison, the average unweighted tuition and mandatory fee rate at the Maryland four-year public institutions grew by 7.4 percent (twice the rate) from $6,316 to $6,781. **Exhibit 3** shows the average award for State financial aid programs, excluding loan assistance repayment programs, in fiscal 2006 compared to the average in-State tuition and fees. On average, need-based aid awards covered 29 percent of tuition and fees, with career/occupational scholarships covering the largest portion of tuition and fees at 49 percent.

**Exhibit 3**

**State Aid Average Undergraduate Awards Compared to Average Tuition and Fees at USM, Morgan, and St. Mary's**

**Fiscal 2006**




Source: Maryland Higher Education Commission, Department of Legislative Services

## Link Between Enrollment and Space Needs Is Unclear; MHEC Group Studies Space Planning Guidelines

Higher education enrollment is expected to increase in the coming years, but with current information it is unclear how this translates into building needs to accommodate additional students. USM has indicated that faculty availability, rather than physical space, is its largest constraint to enrollment growth. USM's concerns with physical space center on whether space is functionally adequate. DLS analyzed academic space needs at public colleges and universities (including community colleges) last year and again this year and found that there is little to no shortage of classroom space on most campuses, both in the present and projected in 2015. The greatest needs are in research space. During the 2006 legislative session, DLS will compare campus space needs to the types and amounts of space being requested in the capital budget when reviewing proposed capital projects.

Higher education institutions refer to the State's space planning guidelines in preparing their capital budget requests. The guidelines indicate square footage allowed for each type of room, considering factors such as enrollment. The square footage allowed is multiplied by the institution's weekly student contact hours for each type of space. MHEC has hosted meetings during summer and fall 2005 to discuss the space planning guidelines and facilities inventory systems at public four-year institutions and community colleges. These discussions were prompted by MHEC's *2004 State Plan for Postsecondary Education,* which called for identifying issues and factors that will affect the ability of higher education to accommodate enrollment growth. One of the group's primary topics is the calculation of weekly student contact hours. It appears that there could be variation in how institutions compile the data for this calculation. The MHEC group is reviewing institutions' methods, including the room scheduling computer software used to generate data.

Distance education students, specifically those in online courses, may not be included in space planning calculations because they are not captured by room scheduling software. However, the MHEC group indicates that online courses can have an effect on space needs if additional student services or support staff are needed for the courses and if students use on-campus computer labs to access the courses, for example.

For further information contact: Monica Kearns/Keshia Cheeks Phone: (410) 946/(301) 970-5530

# Higher Education

## Office for Civil Rights Agreement Expires in December

**The Partnership Agreement between the State and the federal Office for Civil Rights (OCR) expires on December 31, 2005. Since fiscal 2002, the State has provided $55.3 million in operating funds specifically to enhance the State's four public historically black colleges and universities (HBCUs), in addition to the State's annual operating budget support to higher education institutions. The State has also provided $335.6 million for capital projects, including over $101 million for the revitalization of Coppin State University. By May 2006, OCR will make a determination as to whether the State has fully implemented the commitments in the agreement.**

### OCR to Review State's Commitments to Diversity in Higher Education

In October 1999, the U. S. Department of Education's Office for Civil Rights (OCR) initiated a review of Maryland's compliance with the State's obligations under federal law, particularly Title VI of the Civil Rights Act of 1964 and the 1992 *Fordice* decision of the U. S. Supreme Court, due to Maryland's status as a state with a formerly racially segregated system of public higher education. Maryland is one of 10 states that formerly operated a dual higher education system in violation of Title VI and applicable federal law.

In 1992 the U. S. Supreme Court issued a decision in *United States v. Fordice* (505 U. S. 717) which set legal standards and requirements for desegregation of a previously segregated higher education system. The court found that race neutral admissions policies alone are not sufficient to determine that a state has effectively desegregated a formerly segregated higher education system and that policies found to be traceable to the formerly segregated system must be reformed to the extent practicable and consistent with sound educational practices. In January 1994, OCR informed Maryland that the *Fordice* decision required a reevaluation of its desegregation efforts in the public higher education system.

In December 2000, the State of Maryland entered into a Partnership Agreement with OCR to eliminate any remaining vestiges of segregation in Maryland's public colleges and universities. Among the commitments the State made in the agreement were specific commitments to enhance the State's four public historically black colleges and universities (HBCUs): Bowie State University; Coppin State University; the University of Maryland Eastern Shore; and Morgan State University. The agreement specifically called for the revitalization of Coppin State based on a study of the college's operating and capital program needs.

OCR has not initiated enforcement action against the State during the period of the Partnership Agreement. At the end of the implementation period on December 31, 2005, the State and OCR will determine if the commitments contained in the Partnership Agreement have been fully implemented. The agreement calls for OCR to assess the State's progress beginning in March 2006 with a final determination by May 2006. If OCR determines that the State has fully implemented the commitments, then OCR will formally acknowledge in writing that Maryland has eliminated all vestiges of segregation in the public system of higher education. If the parties are not able to resolve matters by this process, then both the State and OCR reserve the legal right to utilize other established judicial processes. A summary of the funding specific to HBCUs, including enhancement funds provided under the agreement with OCR, is shown in **Exhibit 1**. The Maryland Higher Education Commission (MHEC) has requested continued funding for the HBCUs in fiscal 2007.

On August 8, 2005, MHEC revealed plans to convene two committees to review the progress made toward the commitments in the Partnership Agreement since December 2000. MHEC requested that the State's four HBCUs submit requests for any additional funds needed to ensure that their institutions are comparable and competitive with similar Maryland Traditionally White Institutions (TWIs) in all facets of their operations and programs as stated in the Partnership Agreement. The first meeting of the HBCU Enhancement Committee is scheduled for November 2005. MHEC will submit a report on Maryland's progress in meeting the Partnership Agreement's commitments to OCR in January 2006.

**Exhibit 1**

## Operating Funding Support Specific to HBCUs

**Fiscal 2002 – 2007**

**($ in Thousands)**

| | FY 2002 | FY 2003 | FY 2004 | FY 2005 | Working FY 2006 | Total FY 02-06 |
|---|---|---|---|---|---|---|
| Access/Success[1] | $4,500 | $6,000 | $6,000 | $6,000 | $6,000 | $28,500 |
| Enhancement Funds | 0 | 3,000 | 5,500 | 6,000 | 6,000 | 20,500 |
| Information Technology Enhancements | 0 | 1,600 | 0 | 0 | 0 | 1,600 |
| Private Donation Incentive Program | 524[2] | 0 | 3,098 | 1,050 | 183 | 4,855 |
| Campus Master Plan Grant | 350 | 0 | 0 | 500[3] | 0 | 850 |
| **Operating Total** | **$5,374** | **$10,600** | **$13,550** | **$13,550** | **$12,183** | **$55,257** |

Note: Fiscal 2002 was the first year State funding was provided toward the OCR Agreement.

[1]Prior to fiscal 2002, $2 million was provided in each of fiscal 1999 and 2000, and $3.1 million was provided in fiscal 2001.

[2]Includes all payments made through fiscal 2002.

[3]Includes Coppin State University revitalization funding.

Source: Department of Budget and Management, Maryland Higher Education Commission, State Operating Budgets

## State's Commitments under the OCR Agreement

The State's commitments under the agreement total more than 20 and fall into 9 broad areas. **Exhibit 2** provides a summary of the major fiscal commitments, most of which were contained in Commitment 9 – HBCU Enhancement.

---

**Exhibit 2**
**State's Commitments under OCR Agreement**

| Commitments | State Actions |
|---|---|
| Need-Based Financial Aid – expand funds available for part-time, full-time, and transfer students, including community colleges; alleviate student difficulties with application processes; explore decentralizing need-based program to campus level. | The State increased funding by $26.5 million or 66% between fiscal 2001 and 2006. Legislation enacted in 2002 established the Decentralized Educational Assistance Grant to allow 2- and 4-year campuses to award need-based grants to students who apply after the March deadline. |
| Graduate Scholarship for HBCU students – consider a program for high-achievers at HBCUs to encourage enrollment in graduate and first-professional degree programs. | No funds have been designated for this purpose as of fiscal 2006. |
| State commits to design measures which ensure that HBCUs are comparable and competitive with TWIs in all facets of their operations, programs, and facilities. Special enhancement funding will be provided through the normal budget process as may be necessary, appropriate, and available, for a limited period of time and not beyond the agreement's term. | $20,500,000 in enhancement funding has been provided to the HBCUs by the State from fiscal 2003 through 2006. Of this amount, Bowie State University received $4,119,152, Coppin State University received $7,563,382, the University of Maryland Eastern Shore received $3,710,282, and Morgan State University received $5,107,184. |
| Access and Success Program – double funding of program to assist retention and graduation rates of students enrolled in HBCUs. | Funding was doubled to $6,000,000 in fiscal 2003. In total, $28,500,000 has been provided by the State from fiscal 2002 through 2006. |
| State's Private Donation Incentive Program – increase the State match to $2 for every $1 raised by HBCUs. | Legislation enacted in 2001 doubled the State match to $2 and extended the deadline for raising matching funds to January 2006 for the HBCUs. $4,855,000 has been provided by the State from fiscal 2002 through 2006. All of the HBCUs have raised sufficient funds to receive the maximum State match except Bowie. |
| Expeditious completion of projects approved to begin at Bowie State (2 projects), UMES (4 projects), and Morgan State (3 projects). | The State provided $91,523,000 in funding towards the expeditious completion of these projects which include a new science building at Bowie State University, a Food Science and Technology Center at the University of Maryland Eastern Shore, and a Science Research Facility at Morgan State University. |

| Commitments | State Actions |
|---|---|
| Governor will request additional State funding to ensure that HBCU facilities are comparable to those at TWIs. | $142,984,000 (excluding funding for projects outlined in the Partnership Agreement and the Coppin Revitalization Plan) has been provided to the HBCUs in the State between fiscal 2002 and 2006. Of this amount Bowie State University received $24,732,429, the University of Maryland Eastern Shore received $9,168,429, and Morgan State University received $109,083,000. An additional $27,250,000 in additional funding has been forecasted in the fiscal 2006 Capital Improvement Program (CIP) for fiscal 2007 – 2010 for Bowie and Morgan. |
| Initiate a study leading to a comprehensive strategic plan for the revitalization of Coppin. | The Coppin Study Team was appointed by the University System of Maryland and the Maryland Higher Education Commission in March 2001 to conduct an independent study of Coppin State University. The Coppin Study Team was to review the following areas: mission; academic programs; student mix; administrative and faculty staffing; institutional advancement; fiscal affairs; and physical plant. Coppin developed a strategic plan based on the study team's 2001 report, which is being implemented. The Coppin Revitalization Plan included 10 major capital projects. Eight projects have received $101,093,000 in fiscal 2002-2006. The CIP includes an additional $79,000,000 in fiscal 2007-2010 to complete the remaining projects, the bulk of it in fiscal 2008 for a new physical education complex. The plan also included operating program initiatives funded through the HBCU Enhancement Funds (discussed above). |

Source: OCR Partnership Agreement dated November 17, 2000; Department of Legislative Services

Recent action by the State that has received criticism from an HBCU is the decision by State Higher Education Secretary Calvin Burnett, Ph.D., to approve the application by Towson University and the University of Baltimore to offer a joint MBA program. An appeal objecting to the Secretary's decision was filed by Morgan State University and argued that the program would duplicate one offered for more than 30 years at Morgan State – and lead to greater segregation at Baltimore-area colleges. On November 9, MHEC voted 10-1 to uphold the decision by Secretary Burnett.

# Higher Education

## University-affiliated Research Park Activity Set to Grow

**The State has invested $25.9 million in university-affiliated research park (UARP) development through fiscal 2006 and is set to invest an additional $20 million over the next four years in the East Baltimore Biotechnology Park (EBBP). UARP in Maryland are in the early stages of development and will not reach full build out for many years. At 2 million net assignable square feet, EBBP will be the largest UARP when completed in 2015. Maryland UARP performance data are not yet available, but the limited available data on university research and development (R&D) and technology commercialization suggest sufficient and growing activity to support UARP development. Maryland Technology Development Corporation (TEDCO) should collect additional R&D and technology commercialization data and report annually to the General Assembly.**

## Characteristics of Maryland's Research Parks

Maryland's university-affiliated research parks (UARPs) are, for the most part, in the initial stages of development. In 2005, two new UARPs began operating: the BioPark at the University of Maryland, Baltimore (UMB) and M Square at the University of Maryland, College Park (UMCP). The University of Maryland Baltimore County's (UMBC) existing park, bwtech@umbc, opened a new building in 2005 that dramatically increased the number of tenant companies.

The other two UARPs are the East Baltimore Biotechnology Park (EBBP), which is affiliated with Johns Hopkins University and is in development, and the Allegany Business Center (ABC), which is affiliated with Frostburg State University (FSU) and is nearly ready for development. Maryland also has the Shady Grove Life Sciences Center, which is owned by Montgomery County and features a significant university research and teaching presence. As shown in **Exhibit 1,** of the planned 6.5 million in net assignable square feet, only 2.1 million has been developed, primarily by Shady Grove. Most of the parks will not reach full build out for many years. All of the managing entities for UARPs are not-for-profit, 501(c) 3s, with the exception of ABC, which is managed by Allegany County.

## Research Park Funds Total $25.9 Million through Fiscal 2006

The State has contributed approximately $25.9 million through fiscal 2006 to develop five UARPs. The funding has been provided primarily through the Sunny Day Program and the capital budget. UMB and UMBC used Sunny Day funds to finance tenant improvements, and M Square used Sunny Days funds to purchase land and to provide infrastructure improvements. To date, the State has provided $13.0 million to EBBP for acquisition and demolition related expenses. The 2005 Capital Improvement Plan includes an additional $20 million for EBBP over the next four years (fiscal 2007 through 2010) to finance acquisition, demolition, and infrastructure, and to provide funds for the planning phase of a new elementary and middle school in the project area. Excluding Shady Grove, the State's investment has leveraged approximately $208.3 million in non-State funding including approximately $37.5 million in investments from private developers.

In addition to providing funds for the development of research parks, the State has also provided funds for the construction and expansion of business incubators which may play an important role in the parks. Presently, the State has 16 business incubators that provide space to more than 169 tenant companies. Since 1994, the State has provided $13.2 million to business incubators affiliated with universities and $14.3 million to six nonuniversity-affiliated business incubators, totaling $27.6 million. TEDCO has also provided an additional $361,000 to local governments, business incubators, and universities for feasibility studies.

**Exhibit 1**
**Maryland Research Park Characteristics**
**As of November 2005 (Fiscal 2006)**

| Research Park/ Date Established | Existing Sq. Ft. | Est. Full Build Out Net Sq. Ft. | Est. Full Build Out | Incubator | Dominant Technology | Total State Funding |
|---|---|---|---|---|---|---|
| UMB Bio Park (2004) | 120,000 | 800,000 | 2017 | Yes[1] | Life Science | $5,000,000 |
| UMBC bwtech@umbc (2001) | 121,100 | 330,000 | 2010 | Yes | High Tech. | 2,650,000 |
| UMCP - M[2] (2005) | 184,317 | 1,680,000 | 2018 | Yes | High Tech. | 5,000,000 |
| EBBP (2004) | 0 | 2,000,000 | 2015 | Yes | Life Science | 13,000,000 |
| ABC (2001) | 0 | 48,000 | 2012 | Yes | High Tech. | 259,000 |
| Shady Grove (1980's) | 1,671,454 | 1,671,000 | Completed | Yes | Life Science | 0 |
| **Total** | **2,096,871** | **6,529,454** | | | | **$25,909,000** |

Note: Development of the research parks is market driven, and thus there is no preconceived timetable for the parks overall future development. However the parks estimate one building every two years.

(1)UMB is planning a bio accelerator. Bio accelerators typically accommodate companies that are further along in the business life cycle and better capitalized.

Source: Individual research parks

## Performance: Maryland Compares Well on Research and Development; Technology Commercialization Has Room to Grow

Performance measures for research parks usually relate to technology commercialization and employment. Since all but one of Maryland's UARPs are new or in development, a statewide view of performance is difficult to assess, particularly for employment. However, some available data on research and development and technology commercialization can begin to paint a picture of Maryland's UARP activity.

In terms of university research and development, Maryland ranks second among five comparable states. In 2000, university research totaled $1.55 billion in Pennsylvania, $1.51 billion in Maryland, $1.49 billion in Massachusetts, $1.04 billion in North Carolina, and $0.59 billion in Virginia. University research and development is not a direct measure of performance at UARPs, but it gives important insight into the technology commercialization opportunities available for the parks.

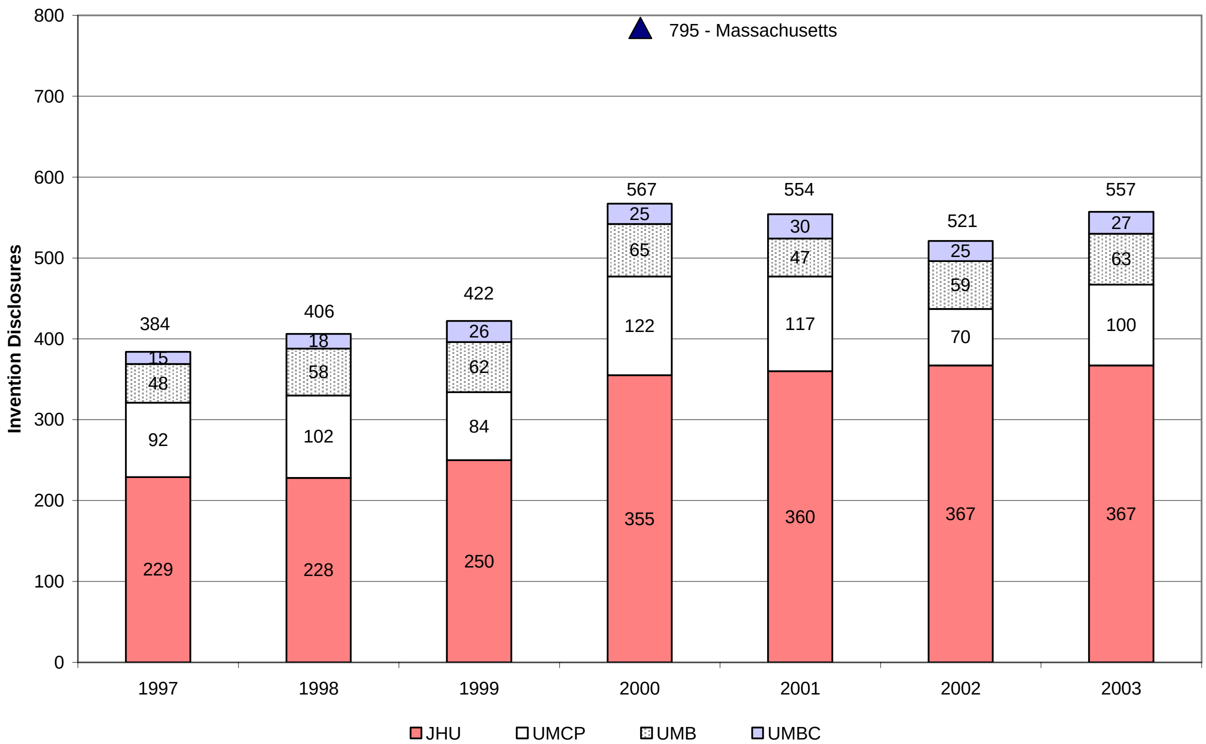
Technology commercialization measures range from invention disclosures to patents to technology license income. In the case of university invention disclosures, which occur at the beginning of the technology commercialization process when a professor discloses a new technology, or invention, to the university. Maryland ranks third among five comparable states. In 2000, the most recent year for which comparative state data is available, Massachusetts led the group with 795 disclosures, followed by Pennsylvania at 757, Maryland at 567, North Carolina at 478, and Virginia at 329. Johns Hopkins University (JHU) consistently accounts for more than half of the Maryland disclosures, as shown in **Exhibit 2**, and is responsible for the increased activity level in 2000-2003. Among Maryland public universities, UMCP has the most disclosures, averaging 98 per year. Disclosures can vary depending on particular research awards and activity. Invention disclosures by faculty are crucial because they represent the initial pool from which universities select inventions to patent and license, from which the universities benefit financially.

## Conclusion: Performance Data Needed as Research Parks Develop

Neither Managing for Results nor Maryland Higher Education Commission peer data include consistent technology commercialization performance measures among UMCP, UMB, and UMBC. In order to evaluate the performance of UARPs and measure the return on the State's investments, UMCP, UMB, and UMBC as well as the University of Maryland Biotechnology Institute and the University of Maryland Center for Environmental Science should annually report to TEDCO on important university technology commercialization measures.

The measures should include invention disclosures, cumulative active licenses and options, and adjusted license income received, among others. Measures of affiliated business incubator performance also should be included. USM and TEDCO should work collaboratively to develop appropriate measures and TEDCO should collect and report those performance measures annually to the General Assembly. (Additional information is available in the full-length version of this paper published as a separate report.)

## Exhibit 2
# Maryland University Invention Disclosures
## 1997 – 2003




Notes: UMBI is not included because it reported data only for 1999 (17 invention disclosures). The University of Maryland Center for Environmental Science does not report data to AUTM. Massachusetts ranks first in 2000 among five comparable states, including Maryland, North Carolina, Pennsylvania, and Virginia.

Sources: Maryland university data from the Association for University Technology Managers (AUTM), as provided by the USM Office. State comparison data from AUTM, as provided by TEDCO.

# Higher Education

## Efficiency Initiatives Continue at University System of Maryland

**In October 2004, the University System of Maryland (USM) completed a major study to improve the efficiency and effectiveness of its institutions to reduce costs and accommodate future enrollment growth. In 2005, USM began implementing many of the efficiency initiatives identified in the study, resulting in cost savings or avoidance of $17.8 million in fiscal 2005 and an estimated $17.1 million in fiscal 2006. Other efficiency initiatives are still being developed, with recommendations expected at the end of fiscal 2006.**

After more than a year of study, the University System of Maryland (USM) unveiled its efficiency and effectiveness (E&E) plan in October 2004. The efficiency plan included more than a dozen initiatives that would generate financial benefits in the form of cash savings, cost avoidance, attainment of new revenues, and reallocation of resources. The plan encompasses a wide range of academic and administrative initiatives that impact every degree granting institution in the system. In September 2005, the system submitted a report on the status and fiscal impact of the efficiency initiatives.

### Status of Academic Initiatives

Five of the USM efficiency initiatives focus on academic programs. The initiatives center on accommodating higher enrollment through higher faculty workloads, expanding online learning, and moving undergraduate students through their courses of study more quickly. USM has established the goal of accommodating an additional 2,100 students at its institutions by fiscal 2008 at no cost to the State. The academic initiatives include:

- **Faculty course loads:** Faculty instructional workloads will reach the mid-point of standards established by the Board of Regents, which will generally result in a 10 percent increase in faculty course load. **Status:** Each institution is charged with meeting the mid-point of workload standards for the 2005-2006 academic year (fiscal 2006).

- **Online learning:** Systemwide committees will identify, develop, and implement online learning opportunities within and among institutions to improve student access and facilitate timely degree completion. **Status:** Each institution has developed a plan for expanding online learning; the USM strategic plan for online learning is under development.

- **Capacity/time to degree:** USM institutions will develop initiatives to accommodate expanded enrollment and promote faster degree completion. **Status:** In February 2005, the Board of Regents adopted policies effective for the 2005-2006 academic year to (1) require first-time freshmen to complete 12 course credits outside the classroom through experiences such as online education, independent study, and internships; (2) limit most baccalaureate degree requirements to 120 credits; and (3) strongly encourage students admitted as first-time freshmen in the spring semester to complete 12 credits toward their degree prior to attending the spring semester.

- **Manage enrollment:** The Board of Regents will devise an enrollment policy that will use tuition differentials to channel more undergraduate enrollments to institutions with excess capacity and to lower-cost institutions. **Status:** Ongoing. The Board of Regents has developed a demand enrollment model that is under review.

- **Enrollment services:** Institutions will use best practice models to streamline enrollment services, including consolidating undergraduate and graduate admissions processes; promoting online admission procedures; and automating grading and billing practices. **Status:** Ongoing. A systemwide committee reviewed best practices and implemented several enrollment initiatives.

## Status of Administrative Initiatives

The administrative initiatives focus on increasing collaboration among institutions and boosting the use of technology. A study by the consulting firm Accenture recommended that the system centralize and integrate a number of functions to take advantage of its size. For the second year in a row, USM has adopted a budget target of 1 percent reduction in State-supported mandatory increases for institutions, resulting in cost savings or avoidance of $17.8 million in fiscal 2005 and an estimated $17.1 million in fiscal 2006. The administrative initiatives include:

- **Information technology and administrative systems:** **Status:** New procurement for the licensing of Microsoft products was awarded in fiscal 2005 resulting in savings of $5 million over five years. New Support Agreement for PeopleSoft products was awarded in fiscal 2005 resulting in savings of $7 million over 10 years. Security and identity management initiatives are ongoing.

- **Energy purchasing and demand management:** USM institutions will purchase energy cooperatively to reduce costs. **Status:** USM issued a request for proposal (RFP) for electricity and a contract was awarded effective July 2005 resulting in expected cost savings of 10 to 20 percent. An RFP for natural gas is under review, and procurement is expected to begin July 2006.

- **Real property:** Development options will be considered for up to 40 properties that do not contribute to USM institutions' master plans. **Status:** The Board has approved the disposition of three properties; evaluations of other properties ongoing.

- **Administrative economies of scale:** USM will study whether a shared services center could decrease transaction costs related to accounts payable and travel, among others. In-house processing of payroll and accounts payable also will be studied. **Status:** Ongoing.

- **Technology commercialization:** USM will generate new revenues and commercial ventures with additional research funds and intellectual property. **Status:** Ongoing. New workgroup proposed to review current practices.

- **Consolidation of University Police Forces:** The Board of Regents' E&E Work Group has recently added the consolidation of institution police forces to the list of efficiency initiatives under review. **Status:** Under study in fiscal 2006.

- **Organizational structure:** A Board of Regents' workgroup studied four institutions to see if their performance could benefit from a new structure. **Status:** The workgroup made the following recommendations: (1) the University of Baltimore should be allowed to expand its mission and serve lower division students; (2) the University of Maryland Biotechnology Institute (UMBI) should remain a constituent institution; however, the Board should consider transferring the Institute for Human Virology from UMBI to the University of Maryland, Baltimore; (3) the University of Maryland Center for Environmental Science should remain a constituent institution; and (4) the University of Maryland University College should stay intact and be afforded greater autonomy from State rules and regulations.

The new efficiency initiatives focus on systemwide functions. Additional financial benefits are expected from ongoing efficiency improvements at individual campuses, on which USM reports annually. The fiscal 2005 Efficiency Efforts Report identifies savings from E&E workgroup initiatives of $17.8 million, ongoing USM efficiency program savings of $30.2 million, and non-tuition and fee revenue enhancements of $28.3 million.

# Higher Education

## Operating Funding Recommended for Regional Higher Education Centers

**At the request of the budget chairs, the Maryland Higher Education Commission (MHEC) has developed a State funding strategy for regional higher education centers (RHECs). Prior to fiscal 2006, only three of the eight centers have received State operating funds. The eighth center, Arundel Mills, was just approved by MHEC in summer 2005. The funding strategy includes a base allocation for each center, per-student funding, and special funding. MHEC plans to request a State appropriation for the RHEC funding strategy in fiscal 2008. For fiscal 2007, MHEC has requested $2 million for the six MHEC-administered centers based on the RHECs' budget requests.**

### Eight Regional Higher Education Centers in Maryland

Eight regional higher education centers are located throughout Maryland. The University System of Maryland (USM) operates two centers, and there are six independent centers that exist in areas not served by comprehensive four-year institutions. A regional higher education center includes participation by two or more institutions of higher education, consists of a variety of program offerings, and offers multiple degree levels. These centers may provide a full range of postsecondary programs and services including lower- and upper-level undergraduate degree programs as well as graduate and professional degree programs. The purpose of regional higher education centers is to provide access to higher education programs in unserved or underserved areas of the State and to respond to the needs of businesses and industries in the areas they serve.

Since 2000, the Maryland Higher Education Commission (MHEC) has been responsible for the coordination of the regional higher education centers (RHECs). This responsibility includes approving the centers' mission statements and ensuring that the programs and courses offered are within the scope of the approved mission statements. In addition, MHEC is responsible for making recommendations for State funding for the centers to the Governor and the General Assembly, as well as administering funds to the non-USM centers, including the Eastern Shore Regional Higher Education Center, the Higher Education and Applied Technology Center (HEAT Center), Laurel College Center, Southern Maryland Higher Education Center, Waldorf Center for Higher Education, and the newly-created Anne Arundel Community College Regional Higher Education Center at Arundel Mills. USM administers operating funding for the universities at Shady Grove and the Hagerstown Center.

Until fiscal 2006, only three of the centers had received State operating funds: Shady Grove; Hagerstown; and Southern Maryland. During the 2005 session, the General Assembly restricted $1 million for the five non-USM centers in the fiscal 2006 budget bill. (Arundel Mills center was established in 2005 after the legislative session). To date, the Governor has released $100,000 for each of the centers ($250,000 each remains withheld by the Governor for the Eastern Shore and Waldorf centers).

## Workgroup Develops Funding Strategy and Revises Guidelines

The 2005 *Joint Chairmen's Report* required MHEC to develop an equitable, consistent, and ongoing funding strategy. MHEC assembled a workgroup with representatives from the centers, USM, the Maryland Association of Community Colleges, and the Maryland Independent College and University Association in order to respond to the 2005 *Joint Chairmen's Report* request for a funding strategy and to revise MHEC's guidelines concerning the centers. MHEC submitted the report entitled *Funding Strategy Proposal for Regional Higher Education Centers* in November 2005.

### Operating Funding Strategy

Since all eight centers are structured and administered in different ways and have diverse missions, governance structures, institutional partners, and academic programs, it was a challenge for the workgroup to develop an equitable funding strategy that takes into account the uniqueness of each of the centers. The workgroup faced an additional challenge in formulating a funding strategy that accounts for centers which are operated by community colleges that already receive State funding through the Cade formula. The report notes that distinctions between RHEC and off-campus extension centers must remain clear for funding purposes. To address this situation, the funding strategy is designed to support center activities for full-time equivalent students (FTES) enrolled in upper division and graduate programs and lower division FTES enrollments in the 2 + 2 (two years of community college plus two years of upper division) programs that are offered at the center. MHEC will work with RHECs to develop a methodology to determine FTES enrolled in 2 + 2 programs.

The proposed funding strategy includes the following components:

- **Base allocation** of $200,000 for each center in order to support the basic operation of the center. The idea is to ensure predictability and consistency in funding for each of the centers.

- **Incentive funding** to encourage the development of baccalaureate and graduate programs. Incentive funding is based on funding per upper division and graduate division FTES enrollment and lower division FTES enrollment in 2 + 2 programs offered at the center. Shady Grove's general fund appropriation per FTES (minus the base allocation amount) is used to set the FTES benchmark.

- **Special funding** designated for initiatives such as the start-up of a new center; support for high need, critical, and special programs to meet regional needs; one-time enhancement funding; and funding for noncapital equipment. Requests for special funding will be examined on a case-by-case basis by MHEC.

- **Leasing costs** based on funding per upper division and graduate FTES at centers that lease facilities.

The funding strategy is only for the operating costs of the centers. MHEC has requested a total of $2 million for the non-USM RHECs in fiscal 2007. Beginning with the fiscal 2008 budget requests, MHEC will review all centers' requests and recommend funding to the Governor and the General Assembly according to the funding strategy. In correspondence to MHEC Secretary Burnett dated November 1, 2005, the Department of Budget and Management indicated that it does not endorse increased State funding for RHECs recommended in the report. **Exhibit 1** shows the amount of State funding the centers received in fiscal 2006 and an estimate of what the centers would be eligible to receive using the new funding strategy, based on fiscal 2005 data, for illustrative purposes only.

**Exhibit 1**
## State Funding for Regional Higher Education Centers

| Center (year established) | FY 2006 State Appropriation | Amount Proposed by MHEC[2] Based on FY 2005 Data |
|---|---|---|
| **Non-USM Centers** | | |
| Arundel Mills (2005) | N/A | $329,816 |
| Eastern Shore (2002) | $100,000[1] | 281,333 |
| HEAT (1995) | 100,000 | 383,698 |
| Laurel Center (2004) | 100,000 | 279,112 |
| Southern Maryland (1995) | 100,000 | 981,144 |
| Waldorf (1997) | 100,000[1] | 507,103 |
| **USM Centers** | | |
| Hagerstown[3] (2005) | 2,000,000 | 501,513 |
| Shady Grove (1996) | 2,831,000 | 2,530,556 |
| **Total** | **$5,331,000** | **$5,794,276** |

[1]Addtional $250,000 each earmarked in the budget has not been released by the Governor as of November 2005.

[2]Includes $200,000 base allocation; incentive funding of $2,146 per FTES based on 2005 enrollment; leasing costs for Arundel Mills, Laurel, and Waldorf. Does not include special funding or lower division 2 + 2 FTES.

[3]Hagerstown opened spring 2005; FTES for one full fiscal year are not available.

Source: Maryland Higher Education Commission, Department of Legislative Services

## RHEC Guideline Revisions

MHEC developed guidelines in 2001 for mission statements, strategic plans, and budget requests for the centers. In order to provide a more comprehensive State policy to guide the growth, development, and State support for the centers, the workgroup reviewed the 2001 guidelines and made revisions. The most significant revisions establish procedures for applying for RHEC status and increased accountability and reporting requirements for centers which receive State funding.

***Application for RHEC Status:*** The revised guidelines establish more specific procedures for applying to MHEC for RHEC status in order to more closely align with statutory requirements for centers. A prospective center must demonstrate the need for certain programs to serve businesses and industries in their proposed location and that the location is unserved or underserved by higher education institutions. The prospective center also must obtain and submit to MHEC a commitment from at least two institutional partners to offer the needed programs at the center. A prospective center must have official designation as a RHEC from MHEC in order to be considered for State funding.

***Reporting Requirements:***

- **Strategic plan:** Each center or prospective center that requests or receives State funding must develop and submit a strategic plan at least once every four years. The strategic plan must be updated if the center has made significant changes to its mission statement.

- **Annual review of budget request:** MHEC's annual review of all the centers' budget requests will consist of (1) an analysis of the funding request to determine if the request is in alignment with the center's mission and strategic plan; and (2) an analysis to determine whether the center's activities are meeting the goals and objectives of its strategic plan.

- **Annual audit:** MHEC will require each center that receives State funding to conduct an annual audit. The audit may be an audit of the individual center or performed as part of a larger entity. The audit must be available to MHEC upon request.

- **Annual report:** An annual report will be due to MHEC on September 1 of each year. The report must describe how funds were used, list and describe the degree programs offered, and provide enrollments for all degree programs for the prior year. Centers receiving special funding must include a report that specifically outlines how the special funds were spent during the fiscal year.

# Health and Health Insurance

## Prescription Drugs

**The new federal Medicare Part D prescription drug benefit will cause drug coverage to be eliminated, restructured, or subsidized in several State programs. Help is available from the Department of Aging and other sources to assist eligible persons understand the altered programs and make decisions that best fit individual needs.**

### New Medicare Drug Benefit Starts January 1, 2006

The passage of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (MMA) created a new Medicare Part D prescription drug benefit effective January 1, 2006. Medicare beneficiaries have from November 15, 2005, through May 15, 2006, to enroll in Medicare Part D. Medicare beneficiaries in traditional Medicare can add "stand-alone" drug coverage, or they can get all of their Medicare benefits, including drug coverage, through a Medicare Advantage health plan. A low-income subsidy is available for single individuals with income below $14,355 and assets below $11,500 and for couples with combined income below $19,245 and assets below $23,000. On September 23, 2005, the federal Centers for Medicare and Medicaid (CMS) announced approval of 18 stand-alone prescription drug plans and four Medicare Advantage Prescription Drug Plans in Maryland. Each plan may offer one or more options for coverage. Premiums, benefits, and cost sharing may vary considerably by plan and option.

MMA directly impacts the following State programs: the Maryland Medical Assistance Program, the Maryland Pharmacy Assistance Program, the Maryland Pharmacy Discount Program, the Senior Prescription Drug Program, and the State Employee and Retiree Health and Welfare Benefits Program.

### Drug Coverage for Dual Eligibles to Shift to Medicare

Beginning January 1, 2006, Medicare beneficiaries who are also enrolled in the Maryland Medical Assistance Program or the Maryland Pharmacy Assistance Program will obtain their prescription drug coverage from a Medicare prescription drug plan or Medicare Advantage Plan. Approximately 90,000 people are affected by this change. Medicare beneficiaries who are eligible for the full range of Medical Assistance benefits (the so-called "full dual-eligibles") will be automatically enrolled in a plan by CMS if they do not make a choice before January 1. Medicare beneficiaries who are enrolled in the Maryland Pharmacy Assistance Program will be automatically assigned to a plan by the Department of Health and Mental Hygiene (DHMH). However, DHMH will send a letter to its enrollees notifying them that, based on their recent drug and pharmacy usage, a different plan may suit them better. Individuals who qualify for a federal low-income subsidy may change plans as often as they like in the first six months.

The Maryland Pharmacy Discount Program, which provides access to prescription drugs at discounted prices for Medicare beneficiaries with household income below 175 percent of the federal poverty level, will terminate on December 31, 2005. DHMH will help these individuals enroll in a Medicare prescription drug plan and apply for a federal low-income subsidy. Those who are not eligible for a full low-income subsidy may continue to receive a State subsidy by enrolling in the Senior Prescription Drug Assistance Program.

## State Medical Assistance Program Liable for Federal Clawback Provision

Due to the shift of prescription drug expenses from the Medicaid to the Medicare Program, MMA includes a provision requiring a state payment to the federal government supporting the Part D benefit. This payment, known as the "clawback," is designed to be 90 percent of estimated state savings in 2006, declining to 75 percent over 10 years. States have questioned the legality of the clawback, as well as the methodology used in calculating it, and some states may challenge the clawback provision in court. Maryland's clawback for calendar 2006 is $79.2 million in general funds.

## Senior Prescription Drug Assistance Program Will Wrap Around the Medicare Drug Benefit

Chapter 282 of 2005 altered the eligibility requirements of the Senior Prescription Drug Program and renamed it to be the Senior Prescription Drug Assistance Program (SPDAP). Beginning January 1, 2006, SPDAP will subsidize the Medicare drug benefit for beneficiaries with household income below 300 percent of the federal poverty level ($28,710 for an individual; $38,490 for a married couple). Under Chapter 282, SPDAP will provide a subsidy of the Medicare drug plan premium and deductible. Enrollment in SPDAP is automatic for individuals enrolled in the Senior Prescription Drug Program. However, enrollees will need to apply to a Medicare prescription drug plan. If they do not choose a drug plan, enrollees may be auto-assigned to a plan.

The Maryland Health Insurance Plan (MHIP), which administers the Senior Prescription Drug Program, sent letters to enrollees and held 10 Medicare Prescription Drug Plan Information Expos, as well as enrollment assistance workshops, throughout the State to help enrollees choose a plan that best serves their needs. Enrollees are also assisted in applying for the federal low-income subsidy. MHIP has selected a new third-party administrator for SPDAP and is negotiating contracts with each prescription drug plan to coordinate benefits. The intent is for the coordination to occur behind the scenes, so enrollees only need to produce their Medicare prescription drug plan card in order to obtain both the federal and State benefit at their pharmacy.

MHIP will introduce emergency legislation at the 2006 session to provide more flexibility in the use of the SPDAP subsidy. Chapter 282 limited the SPDAP subsidy to the prescription drug plan premium and deductible to keep the new State benefit as close to the old

State benefit as possible. Since enactment of Chapter 282, some prescription drug plans have been approved with no deductible, and SPDAP has been effectively limited to subsidizing just the premium in order to be applied in an equitable manner. The emergency legislation is intended to authorize a subsidy of other cost-sharing requirements. The emergency legislation will also extend the sunset on SPDAP until at least December 31, 2007, to allow MHIP to negotiate contracts with prescription drug plans on a calendar year basis, in accordance with the Medicare benefit year.

## State Employee and Retiree Health and Welfare Benefits Program Provides Stability in Drug Coverage and Brings in Additional Federal Revenue

Under MMA, group health plans, such as the State plan, that provide employment-based retiree health care coverage with a drug benefit at least actuarially equivalent to the Medicare Part D plan, will receive a federal subsidy of 28 percent of costs for coverage (above $250 and up to $5,000) per qualified retiree in 2006. A qualified retiree is an individual who participates in the employer's retiree prescription drug benefit plan and who is eligible but not enrolled in a Medicare prescription drug plan or Medicare Advantage drug plan. State prescription drug benefits do meet the actuarial equivalence test.

The State expects to receive between $19.4 and $19.6 million in calendar 2006 from the federal subsidy. The Budget Reconciliation and Financing Act of 2005 (Chapter 444), shifted the allocation of the federal revenue, for fiscal 2006 and 2007 only, from the Postretirement Health Benefits Trust Fund to a new special reserve fund for the purpose of funding the State Employee and Retiree Health and Welfare Benefits Program.

## Department of Aging Offers Assistance to Medicare Beneficiaries and Their Families

The Department of Aging State Health Insurance Assistance Program provides individual assistance to Medicare beneficiaries and their families in understanding Medicare Part D, choosing a prescription drug plan, and obtaining additional help with expenses. The Department of Aging's web site provides information about both State and federal programs for which Medicare beneficiaries may qualify.

# Health and Health Insurance

## Cigarette Restitution Fund Spending

**Many of the tobacco manufacturers that signed the Master Settlement Agreement are threatening to withhold payments to the states, claiming that several provisions affecting smaller manufacturers have not been adequately enforced. These challenges have the potential to reduce payments to Maryland in current and future fiscal years.**

### Tobacco Settlement Revenue

On November 23, 1998, the five major tobacco companies agreed to settle all outstanding litigation with 46 states, 5 territories, and the District of Columbia. Under the Master Settlement Agreement these original participating manufacturers agreed to compensate the states for smoking-related medical costs and conform to certain marketing restrictions. Since 1998, several additional tobacco companies have also entered into the agreement. These companies, known as subsequent participating manufacturers, have brought additional revenue to the states.

#### Recent Actions Threaten Cigarette Restitution Fund Revenues

Recent actions by several subsequent participating manufacturers threaten to reduce the amount of revenue available to the states. These manufacturers contend that manufacturers not participating in the Master Settlement Agreement have exploited legal loopholes to reduce their payments to the states, giving those manufacturers a competitive advantage in the pricing of their products. Approximately $84 million has been placed in escrow by the subsequent participating manufacturers pending resolution of the dispute by an arbitration. This amount, as well as $105 million overdue from the manufacturers, has reduced revenue immediately available to the State of Maryland by $4 million.

The possibility remains that additional companies, including the four original participating manufacturers, will withhold funds based on loss of market share. The Master Settlement Agreement authorizes manufacturers that lose a certain share of the market to withhold three times the amount of their losses. Based on preliminary estimates, an action of this sort has the potential to reduce payments under the Master Settlement Agreement by up to $1.1 billion or 18 percent, of which Maryland's share is approximately $26 million. The reduction would be applied to the fiscal 2006 payment due April 15, 2006. Industry leaders are in the process of reviewing past payments to determine the amount of losses.

It is difficult to anticipate at this time the magnitude or timing of challenges to payments under the Master Settlement Agreement. The nature of these disputes may vary based on state laws, the level of enforcement, and the amount of competition from nonparticipating manufacturers; likewise, the timeline and ultimate disposition of these cases will likely vary by jurisdiction.

## Cigarette Restitution Fund Revenues and Expenditures – Fiscal 2004 to 2006

As shown in **Exhibit 1**, tobacco settlement revenues to Maryland's Cigarette Restitution Fund have averaged approximately $150 million over the last three fiscal years. The uncertainty surrounding the manufacturer payments has the potential to affect revenues and spending in fiscal 2006 including additional spending authorized in the Budget Reconciliation and Financing Act (BRFA) of 2005. After submission of the Governor's budget, estimates of fiscal 2005 and 2006 tobacco settlement revenue were increased, adding $6.2 million to the $7.7 million fund balance already anticipated at the end of fiscal 2006.

**Exhibit 1**
**Cigarette Restitution Fund Revenue and Expenditures**
**Fiscal 2004 – 2006**
**($ in Millions)**

| | **FY 2004 Actual** | **FY 2005 Actual** | **FY 2006 Working Appropriation** |
|---|---|---|---|
| Beginning Fund Balance | $51.0 | $10.5 | $15.4 |
| Settlement Payments | 150.7 | 152.0 | 151.1 |
| **Available Revenue** | **$201.7** | **$162.5** | **$166.5** |
| Payment to Law Offices | -30.0 | -30.0 | -29.9 |
| Prior Year Recoveries | 4.2 | 1.5 | |
| To/From Special Reserve Fund | 13.5 | | |
| **Total Available Revenue** | **$189.4** | **$134.0** | **$136.6** |
| **Total Expenditures** | **$178.9** | **$118.6** | **$122.7** |
| **Ending Balance** | **$10.5** | **$15.4** | **$13.9** |
| Additional Uses Authorized by 2005 Budget Reconciliation Language | | | |
| *Challenge Grants* | | | *$3.5* |
| *Academic Health Centers* | | | *6.7* |
| *Adult Literacy* | | | *1.2* |
| *Summer Youth Connection Program* | | | *0.2* |
| *Family Support Centers* | | | *0.8* |
| *Aid to Nonpublic Schools* | | | *1.0* |
| ***Subtotal*** | | | ***$13.4*** |
| **Revised Ending Balance** | **$10.5** | **$15.4** | **$0.5** |

Note: Numbers may not sum due to rounding.
Source: Department of Budget and Management

Increased revenues were primarily due to higher than anticipated shipments, increased supplemental payments for outside legal counsel from the national arbitration panel, and decreased prior year and fiscal 2005 spending. With a total of $13.9 million unsubscribed, the General Assembly provided for additional spending in the 2005 BRFA, specifying that funds may be appropriated by budget amendment if State attainment of funds exceeded specified levels. As shown in the exhibit, appropriations of $13.4 million were authorized for a variety of purposes.

Despite current challenges, the amount of anticipated revenue appears enough to fund all priorities identified in BRFA while leaving a $500,000 fund balance at the end of fiscal 2006. However, should tobacco settlement payments be reduced, there is a risk that actual revenues will not meet the level necessary to fund the authorized spending.

For further information contact: Stacy A. Collins Phone: (410) 946/(301) 970-5530

# Health and Health Insurance

## Medicaid Enrollment and Expenditure Trends

**Maryland's Medicaid and children's health programs continue to be a major driver of the State budget. The anticipated deficit in the Medical Assistance programs in fiscal 2006 has more than doubled to an estimated $130 million in general funds. A combination of factors is expected to result in growth in these programs that continues to outstrip growth in general fund revenues.**

### Overview

Maryland's Medicaid and children's health programs provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50 percent for Medicaid and 65 percent for the Maryland Children's Health Program (MCHP).

The Medical Assistance (Medicaid/MCHP) budget accounts for about 17 percent of State general fund expenditures and is one of the fastest growing segments of the State budget. Over the next five years, Medicaid costs are expected to rise at a rate of about 8 percent annually while general fund revenues are forecast to grow at a 5 percent clip. Failure to constrain Medical Assistance costs or identify additional revenue streams will ultimately result in Medical Assistance squeezing out funding for other programs.

### Fiscal 2006 Outlook

When the General Assembly completed deliberations on the fiscal 2006 budget, a Medical Assistance deficit of $61 million of general funds was forecast. The Department of Legislative Services (DLS) now anticipates a shortfall of $130 million in general funds.

A myriad of unfavorable events contribute to the shortfall; most significant, actual fiscal 2005 expenses exceeded budget estimates. With the fiscal 2005 appropriation exhausted, the State will pay the remaining bills for fiscal 2005 services with a combination of fiscal 2006 dollars ($50 million general funds) and State dollars reserved in the Dedicated Purpose Fund ($20 million) to pay fiscal 2005 Medicaid bills. Additional general funds are also required due primarily to a calendar 2006 managed care rate increase ($26 million general funds), under attainment of fiscal 2006 cost containment savings ($16 million general funds), and the development of the fiscal 2006 budget off an understated fiscal 2005 base.

Expenditures for fiscal 2006 services are expected to exceed fiscal 2005 costs by about 6.5 percent as cost containment savings and the shift of certain prescription drugs costs for the elderly from Medicaid to Medicare moderate the impact of growth in medical costs (7.6 percent) and enrollment (1 percent).

## Fiscal 2007 Forecast

As shown in **Exhibit 1**, in fiscal 2007, Medical Assistance expenditures of $4.7 billion are anticipated of which almost half will be general funds. General fund spending is expected to grow by about $208.8 million or 10 percent over projected fiscal 2006 costs. Factors contributing to the anticipated expenditure growth include enrollment increases of about 2 percent, changes in medical inflation/utilization (6.5 percent), and a variety of policy and program modifications. Enrollment growth is spurred by a continued rise in the number of children qualifying for Medicaid due to their low incomes. Notable program changes include:

- **Implementation of Medicare Part D:** Beginning in January 2006, Medicare not Medicaid will subsidize prescription drug costs for people who are dually eligible for Medicaid and Medicare. Eliminating Medicaid expenditures on prescription drugs for the elderly will generate federal Medicaid savings of about $60 million over the final six months of fiscal 2006 and $120 million in fiscal 2007. Only minimal general funds savings are anticipated as states are initially required to pay the federal government an amount roughly equivalent to the costs each state would have incurred to continue providing prescription drug coverage through Medicaid.

- **Expansion of Primary Care:** The federal government has agreed to provide matching dollars for previously State-funded primary care and mental health services for low-income uninsured adults. The federal matching funds will allow the State to expand primary care services from 8,000 to 27,000 people. Primary care costs will increase from $7.3 million (all general funds) to $27 million ($13.5 million general funds) and shift from the Family Health Administration to the Medical Assistance budget. Higher general fund expenditures for primary care are offset by $8.9 million of projected savings for the Mental Hygiene Administration which can claim federal dollars for costs previously funded entirely with State dollars.

- **Enhance Physician Rates ($30 million increase):** Chapter 5 of the 2004 special session and Chapter 1 of 2005 earmark a portion of the revenue from the health maintenance organization premium tax to raising Medicaid physician rates. In fiscal 2006, the Medical Assistance Program will spend $60 million ($30 million in State special funds from the premium tax) to raise physician rates; this amount will increase to $90 million in fiscal 2007.

- **Discontinue Hospital Day Limits:** Medicaid regulations currently limit the number of days of hospital coverage for adults to 105 percent of the average length of stay by diagnosis related groups. Narrative included in the 2005 *Joint Chairmen's Report* expressed the intent of the budget committees that the day limits sunset at the close of fiscal 2006. The fiscal 2007 DLS forecast assumes the day limits end at a cost of $56 million ($28 million general funds).

- **Long-term Care Reform Begins:** The State has applied for a federal waiver authorizing a pilot program of managed long-term care. The DLS forecast anticipates development of the pilot will cost $10 million ($5 million general funds) in fiscal 2007. Rollout of the initiative is expected in late fiscal 2007 at the earliest.

**Exhibit 1**

## Medical Assistance Enrollment and Service Year Expenditures*

| | FY 2005 Actual | FY 2006 Estimate | FY 2007 Estimate | % Change FY 06 – 07 |
|---|---|---|---|---|
| Enrollment by Category | | | | |
| Medicaid | 520,084 | 526,268 | 536,310 | 2% |
| MCHP | 95,019 | 99,901 | 101,902 | 2% |
| **Total** | **615,103** | **626,169** | **638,212** | **2%** |
| **Cost per Enrollee** | **$6,490** | **$6,792** | **$7,318** | **8%** |
| **Total Funds ($ in Millions)** | **$3,992** | **$4,253** | **$4,671** | **10%** |

*Expenditures by fiscal year are based on the cost of providing services during that fiscal year rather than the year that the bills were actually paid. Cases and funding associated with the Maryland Pharmacy Program and Kidney Disease Program are excluded from the chart.

Source: Department of Legislative Services

For further information contact: David C. Romans Phone: (410) 946/(301) 970-5530

# Health and Health Insurance

## Mental Health Funding

**Fiscal 2007 marks a potential sea change for community mental health funding. Perhaps for the first time since the implementation of the current carve out of specialty mental health services from the HealthChoice program, the program appears to be on solid financial footing.**

### Background

For the past several years, a common feature of the Mental Hygiene Administration (MHA) budget has been a discussion of ongoing and anticipated deficits in the fee-for-service community mental health services system. Created in fiscal 1998 as a result of the carve out of specialty mental health services from the HealthChoice program, the system had an early history of weak financial accountability. This ultimately translated into significant structural deficits as well as the problem of fully recovering federal funds.

The Department of Legislative Services (DLS) believes that fiscal 2007 appears to mark a departure from the deficits of the past. There are three primary reasons for this:

- Funding in fiscal 2006 appears to be adequate to meet ongoing service needs;

- Cost containment actions put into place by MHA (reducing provider reimbursement rates and enforcing medical-necessity criteria) have had a marked impact on expenditures; and

- A one-time accounting move has enabled MHA to eliminate the $29.3 million federal fund receivable deficit it reported at the end of fiscal 2004. MHA was able to take this action because it had not recovered in excess of $38 million in funds from the former Administrative Service Organization (Maryland Health Partners) after the contract with that provider expired in September 2004. These funds represented an advance to pay claims and related interest earnings. MHA recovered these funds in May 2005 and deposited $6 million to the State's general fund but retained the remainder to offset the federal fund receivable deficit.

It should be noted that the Office of Legislative Audits (OLA) has questioned this action in a recent audit. OLA made a finding that all the funds should have reverted back to the State's general fund. MHA did not specifically respond to this finding in its response.

## Fiscal 2007 Outlook

MHA's fiscal 2007 fee-for-service budget is estimated to grow to $500 million ($274 million in general funds and $226 million in federal funds). This represents growth of 9.4 percent over fiscal 2006. General fund growth is actually lower at 7.5 percent, with federal fund growth anticipated at over 11 percent. A number of factors influence this estimate:

- The relatively strong growth in federal funds is related to the anticipated approval by the Centers for Medicare and Medicaid Services for services currently delivered through the Maryland Primary Care program to be provided under the State's Medicaid waiver. This in turn has a significant impact on the funding for mental health services for Medicaid-ineligible clients. It is estimated that just over $27.1 million in services will be delivered to this population in fiscal 2007, a growth of 4 percent. However, just over $8.9 million of these services will now become eligible for Medicaid reimbursement. Currently, all these services are supported through State general funds;

- For the Medicaid-eligible population, a 5 percent growth in expenditures is anticipated from fiscal 2006 to 2007, an increase of just over $21.5 million ($9.1 million in general funds); and

- One of the cost containment actions taken by the Department of Health and Mental Hygiene during the recent State budget crisis was to impose a limit on the number of hospital days for which Medicaid would provide service coverage – a limit of 105 percent of the average length of stay by diagnosis related groups. The legislature has indicated that this limit should be removed at the close of fiscal 2006. In the MHA budget, the fiscal 2007 cost is $20 million ($10 million in general funds).

## Conclusion

The DLS fiscal 2007 baseline assumes no widespread rate increases for community mental health services other than those mandated by law or regulation. It should be noted that there is increasing pressure to increase provider rates. Many rates have not been increased since fiscal 2000; and as noted above, some rates were significantly reduced. Indeed, MHA recently promulgated a regulation for a modest increase in rates for some child and adolescent psychiatric rehabilitation services. Significant provider pressure can be anticipated for a more widespread rate increase.

However, as a counterpoint, MHA has been very slow in developing performance measures for community mental health services. As a result, there is little data to indicate the success of services provided or to distinguish among providers. This lack of performance accountability may hinder efforts to increase rates despite the general lack of increases in recent years.

---

For further information contact: Simon G. Powell Phone: (410) 946/(301) 970-5530

# Health and Health Insurance

## Healthcare Information Technology

**Healthcare information technology (IT) has gained significant interest at the federal and State level as a means to reduce medical errors, cut healthcare costs, and improve quality. A summary of federal and healthcare IT initiatives is provided.**

According to an Institute of Medicine study, each year up to 100,000 Americans die from mistakes such as misreading illegible prescriptions or treating incorrect patient conditions based on incomplete medical records. In the past few years, federal and state policymakers have shown significant interest in healthcare information technology (IT) as a mechanism not only to reduce medical errors but also to cut healthcare costs and improve the quality of medical care. Although issues such as cost, interoperability, and provider resistance represent significant barriers to implementation, policymakers have made progress in moving towards an interoperable healthcare IT system.

### Federal Initiatives

In April 2004, President George W. Bush issued an executive order creating the position of the National Coordinator for Health Information Technology within the Department of Health and Human Services (HHS) to coordinate and evaluate information technology efforts and to establish technical standards to allow physicians and hospitals to share medical records while ensuring patient privacy. The order calls for the majority of Americans to have interoperable electronic medical records within 10 years. The following developments will assist in this effort:

- In September 2005, HHS announced the membership of the public/private American Health Information Community (AHIC), which was formed to provide input and recommendations to HHS on how to make health records digital and interoperable, and assure the privacy and security of those records.

- In October 2005, HHS established three partnerships through contracts with private, nonprofit entities to address electronic health record certification, interoperability standards, and variations in privacy and security practices. As part of the contracts, these partnerships will report to AHIC.

- An additional HHS partnership, for the development of nationwide health information network architectures, will be awarded later in 2005.

- The Commission on Systemic Interoperability will guide AHIC on the early cases for standards, known as breakthrough cases. (Examples of potential breakthrough cases include adverse event drug reporting and bioterrorism reporting.) In April 2006, AHIC will decide on a suite of standards for a basic set of clinical transactions for breakthrough cases.

- In October 2005, HHS' Agency for Healthcare Research and Quality (AHRQ) announced the award of more than $22.3 million to 16 grantees to implement healthcare IT systems to improve the safety and quality of healthcare. These projects will enable AHRQ to learn from healthcare IT implementation in clinical settings and to use the results to move toward broader implementation of healthcare IT.

- Currently, there is no single approach for measuring the percentage of healthcare providers using electronic health records. The Office of the National Coordinator for Health Information Technology will partner with a major academic institution to better characterize and measure the state of electronic health record adoption and to determine the effectiveness of policies aimed at accelerating adoption of electronic health records and interoperability.

- The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 establishes an electronic prescribing (e-prescribing) program to be used by health care providers who serve Medicare beneficiaries and requires the Secretary of HHS to develop initial uniform standards for electronic prescribing. In October 2005, the Centers for Medicare and Medicaid Services (CMS) announced that a final rule containing the standards for e-prescribing will soon be issued. Although e-prescribing is not required, drug plans participating in the Medicare prescription drug benefit are required to support the e-prescribing foundation standards. CMS will be awarding $6 million to fund e-prescribing pilot programs using the foundation standards.

## Healthcare Information Technology Initiatives in Maryland

To develop a nationally integrated healthcare IT system, it will be necessary to build upon the existing information technology plans developed by states, localities, nonprofits, and private organizations. More than 100 local and regional health information networks nationwide already exist in various stages of development. In addition, 13 states have passed or introduced legislation to create statewide healthcare IT networks. Healthcare IT activity in Maryland has followed the national trend, as legislators have shown increased interest in healthcare IT while various organizations are developing healthcare IT systems. Examples of this activity are provided below.

## Task Force to Study Electronic Health Records

Chapter 291 of 2005 established a 26-member task force to study the current usage and potential expansion of electronic health records in the State, including electronic transfer, electronic prescribing, and computerized physician order entry, and will examine the costs of implementing these technologies. The task force will also study the impact of the current usage and potential expansion of electronic health records in the State on school health records and on patient safety. Findings are due in December 2007.

## Metro DC Health Information Exchange (MeDHIX)

In October 2005, the Primary Care Coalition of Montgomery County received a $448,400 AHRQ grant to develop the Metro DC Health Information Exchange (MeDHIX). MeDHIX will be implemented in three phases to form a regional, web-based electronic health record system, linking Washington, DC area providers who care for the underinsured and their families. MeDHIX will link the electronic health record systems of safety net clinics in the region with each other and with mainstream healthcare providers, forming a regional community of interest focused on the uninsured population and safety net environment. The initial focus of MeDHIX will be in linking emergency room clinicians to safety net clinics in order to increase the knowledge base on which the clinician makes assessments and medications decisions. MeDHIX will also focus on reducing duplicative labs and procedures and reducing unnecessary emergency room visits.

## The Maryland/DC Collaborative for Healthcare Information Technology

The Maryland/DC Collaborative for Healthcare Information Technology (collaborative) is an independent group led by private practice physicians whose mission is to work collaboratively with Maryland and the District of Columbia healthcare providers and organizations to improve quality of care, patient safety, and efficiency through healthcare IT. The primary objective is to implement a secure, Health Insurance Portability Accountability Act of 1996 (HIPAA)-compliant, regional database infrastructure to link all components in a healthcare delivery chain to appropriate and protected health information. In April 2004, the collaborative was awarded a $100,000 planning grant from the Foundation for eHealth Initiative that has been used to establish a program office, set up a web site (www.collaborativeforhit.org), and hire consultants. In August 2005, the collaborative made a presentation to the Health Services Cost Review Commission requesting additional funding.

## Kaiser Permanente's HealthConnect System

Kaiser Permanente has established HealthConnect, an electronic information management and delivery system, for all of its 499,000 Mid-Atlantic region (Maryland, Virginia, and the District of Columbia) members. This electronic medical record system integrates the clinical record with appointments, registration, and billing. Implementation of HealthConnect began two years ago with the addition of flat-screen computers in every Kaiser Permanente exam room. According to Kaiser Permanente, the most difficult element in introducing the system was educating and preparing physicians and staff for the change. By the end of 2005, HealthConnect will be fully implemented in all of the 35 locations and 1,000 doctor's offices in the mid-Atlantic region. HealthConnect will eventually enable patients to check lab results, refill prescriptions, and have secure communications with their doctors online. HealthConnect was part of Kaiser Permanente's $1.8 billion national investment in healthcare IT. Representatives from Kaiser Permanente are currently working with AHIC in the development of national standards for interoperability.

# Health and Health Insurance

## Medicaid Long-term Care Waiver

**In August 2005, the Department of Health and Mental Hygiene submitted a Medicaid waiver application to the Centers for Medicare and Medicaid Services to establish CommunityChoice, which will restructure the State's current delivery of long-term care services from fee-for-service to managed care.**

The delivery of long-term care services currently consumes 30 percent of the State's Medicaid budget, although the population served only represents 5 percent of Medicaid recipients. Faced with fragmentation in the State's health care delivery system, heavy reliance on institutions to deliver the majority of long-term care services, and the escalating cost of long-term care Medicaid spending, the Department of Health and Mental Hygiene (DHMH) sought to restructure the delivery of long-term care services in the State from fee-for-service to managed care.

Chapter 4 of 2004 required DHMH to apply for a waiver from the Centers for Medicare and Medicaid Services (CMS) to establish the CommunityChoice program, a managed care system to provide long-term care services to adults eligible for both Medicaid and Medicare, adult Medicaid recipients who meet the nursing home level-of-care standard, and Medicaid recipients over age 65. The program will operate in two areas of the State and will terminate on May 31, 2008.

### Waiver Application to the Centers for Medicare and Medicaid Services

In August 2005, DHMH submitted a Medicaid waiver application to CMS to establish CommunityChoice, a proposal developed by DHMH in collaboration with the Department of Disabilities (MDD), Department of Aging (MDA), Department of Human Resources (DHR), and stakeholders. For a year prior to the submission of the waiver application, DHMH met with consumers, advocates, providers, and legislators to discuss the proposal. In addition, DHMH convened a CommunityChoice Advisory Group.

The waiver application provides that the CommunityChoice program is intended to promote community-based long-term care services, manage health care costs, coordinate care, and establish accountability. According to DHMH, the CommunityChoice program will benefit from the State's experience in providing managed care Medicaid services though HealthChoice, which has operated since 1997 and serves over 75 percent of Medicaid enrollees. As stipulated by Chapter 4 of 2004, CommunityChoice will be piloted in two areas: Baltimore City/Baltimore County and Prince George's/Montgomery counties.

## CommunityChoice

### Community Care Organizations

Health care under the waiver will be provided by capitated Community Care Organizations (CCO). A CCO must agree to accept the capitation rates and conditions for participation set by the State. The two types of organizations that can qualify as CCOs are certain traditional health maintenance organizations and managed care systems that are authorized to receive medical assistance pre-paid capitation payments and enroll only Medicaid recipients. CCOs will have to meet certain quality and financial standards and will not be allowed to accept enrollees until their provider networks are in place and have been approved by DHMH. CCOs must allow enrollees to select any Medicaid-participating nursing facility. During the transition phase, DHMH will require CCOs to continue to provide and reimburse providers for any medically necessary services until the CCO has been able to assess the enrollee and to develop a plan of care. Each CCO is required to establish a consumer advisory board to receive input from enrollees.

### Enrollee Program Participation

CommunityChoice will coordinate services for individuals who are eligible for full Medicaid benefits and reside in a CommunityChoice service area and are Medicaid recipients age 65 or older, receiving Medicare, or meet a nursing facility or chronic hospital level of care. Most prospective enrollees are currently accessing Medicaid services through the fee-for-service system. CommunityChoice will include individuals who are currently receiving services through the Older Adults Waiver and the Living at Home Waiver. Nursing home residents who qualify for Medicaid by contributing to the cost of their care will be able to maintain their eligibility if they transition into the community. These individuals may be required to continue to contribute toward the cost of care as determined by DHMH. DHMH, in consultation with MDA, MDD, and DHR, will designate local offices to make Medicaid and CommunityChoice eligibility determinations.

DHMH will contract with an independent enrollment broker to enroll Medicaid recipients into CommunityChoice. Eligible individuals will have a choice of at least two CCOs and have 60 days to select a CCO upon notice of their eligibility for CommunityChoice. Each year enrollees will have an opportunity to choose a new CCO or remain with the current CCO. CCOs must accept all individuals who enroll or who are assigned by the enrollment broker.

### Benefits

CommunityChoice will include a comprehensive benefits package, including primary care, acute care, reproductive health and family planning, substance abuse, transportation, and long-term care services. Enrollees are entitled to medically necessary services covered by Medicaid in the State. Medicare will be responsible for primary and acute care services for those individuals eligible for both Medicare and Medicaid. Specialty mental health services and hospice care will be provided through the fee-for-service program. Enrollees who require nursing facility or chronic hospital level-of-care will be able to access home and community-based services that are currently available to individuals enrolled in the Waiver for Older Adults or the Living at Home Waiver. These augmented community support services include care coordination, attendant care, environmental accessibility adaptations, respite care services, consumer and family training, and home delivered meals. The program will not eliminate coverage of existing Medicaid services for any enrollees. In general, for enrollees who require nursing facility level-of-care, CCOs will be required to offer home- and community-based long-term care services before institutional long-term care services.

### Access and Quality

CCOs will be required to develop, monitor, and maintain an adequate network of primary care, specialist, pharmacy, nursing facility, personal care, and home and community-based long-term care providers to meet the needs of enrollees. CCOs must ensure that all enrollees have reasonable travel times to receive Medicaid-covered services. In addition, CommunityChoice will include quality assurance and quality improvement initiatives for long-term care services, and only those CCOs that provide high quality care, have adequate provider networks, are financially stable, and have the necessary administrative and operational infrastructure will be approved by DHMH to participate in CommunityChoice. DHMH will require corrective action and may impose sanctions if a CCO performs below established standards. DHMH will evaluate the performance of the CommunityChoice program on an ongoing basis by reviewing health outcomes, access to care, utilization of services, CCO provider networks, enrollee and provider satisfaction, and CCO systems.

### Financing

CCOs will receive fixed, prospective, risk-adjusted payments. The rates must be actuarially sound, and CCOs will be required to report financial information to the State. Each year, DHMH will audit and monitor a CCO's actual expenses, and the profits and administrative expense allowance will be capped. CCOs may negotiate payment rates with providers, except that CCOs must pay no less than the Medicaid-established rates for nursing facility, medical day care, and hospice services. For residents in assisted living facilities at the inception of CommunityChoice, assisted living providers can negotiate individual rates with CCOs, or they can require the CCOs to pay the Medicaid-established rates. CCOs must reimburse hospitals according to rates established by the Health Service Cost Review Commission.

Assuming that the CommunityChoice waiver is approved by CMS, and the program expands statewide after 2008, DHMH estimates total program expenditures to be $2.77 billion in fiscal 2011, covering 72,155 enrollees. Without the waiver, DHMH estimates that to cover the same population, it would be spending $2.84 billion in fiscal 2011.

# Health and Health Insurance

## Maryland Health Insurance Plan

**Reversing the initial drop in enrollment, the Maryland Health Insurance Plan (MHIP) is seeing a steady increase in applications and the number of individuals covered by the program. Even at the anticipated growth rate, however, the MHIP fund balance will continue to swell, prompting legislative proposals for changes.**

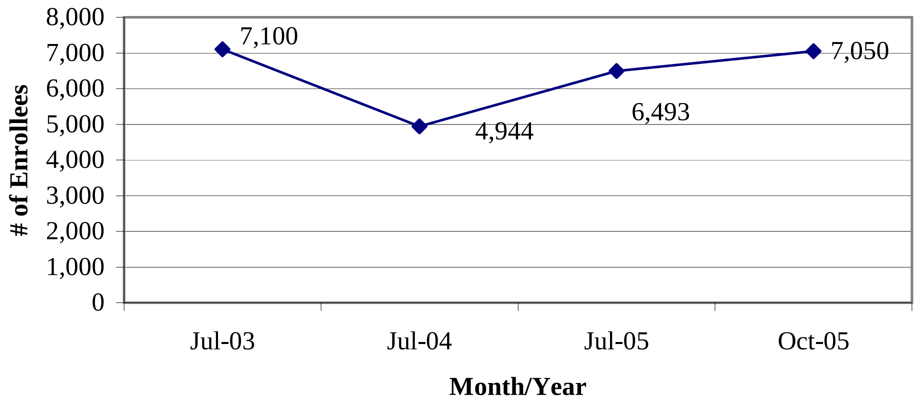
### After Dropping Sharply in the Early Months of Implementation, the Maryland Health Insurance Plan Enrollment Is on the Upswing

The Maryland Health Insurance Plan (MHIP), the State's high-risk pool for medically uninsurable individuals, became operational in July 2003. Funded through an assessment on hospitals, MHIP has the capacity to serve approximately 15,000 enrollees. Enrollment has never approached this level, however, as indicated in **Exhibit 1**. From an initial level of 7,100, enrollment fell steadily throughout 2003 and 2004. High premiums and a small health care provider network contributed to the decline. The MHIP board of directors has taken several steps to make the plan more attractive, and the decline has reversed in 2005. These steps include:

- expanding the provider network;
- lifting the ban on coverage of pre-existing conditions;
- enhancing the benefit package;
- reducing premiums;
- increasing the referral fee paid to insurance producers; and
- marketing the plan to providers, insurance producers, hospitals, and local health departments.

A particularly effective strategy was to work with CareFirst, the State's largest carrier in the individual health insurance market, to enclose a "mini-application" for MHIP with all CareFirst denial notices. MHIP reports that 30 percent of the approximately 500 monthly applications it now receives result from the "mini-application."

**Exhibit 1**
**Maryland Health Insurance Plan Enrollment**
**Number of Enrollees**




Source: Maryland Health Insurance Plan

Additional measures were approved by the board in November 2004 but put on hold, including increasing the premium subsidy for low-income enrollees and instituting a mass marketing campaign. The board delayed implementing these measures pending a market conduct examination by the Maryland Insurance Administration. This examination is now complete, and the board is moving forward with these measures. In November 2005, MHIP began to subsidize the premiums of enrollees with family income up to 225 percent of the federal poverty guidelines ($21,533 for a single person and $28,868 for a married couple). A mass marketing campaign, using radio and print media, will get underway in January or February 2006.

## Despite Increasing Enrollment, the MHIP Fund Balance Continues to Grow

Despite the uptick in enrollment, MHIP continues to accumulate a large fund balance from the hospital assessment, as indicated in **Exhibit 2**. As of June 30, 2005, the balance in the MHIP fund was $88.4 million. In addition to enrollee premium revenue, the hospital assessment is expected to provide an additional $66.8 million in revenues in fiscal 2006. Even with the low-income subsidy, projected fiscal 2006 expenditures are far below the level of funding available. Included in projected expenditures is the spending of up to $15 million, as authorized by Chapters 280 and 343 of 2005, in fiscal 2006 only, for the design and development of a computerized eligibility system for the Medicaid program. While this one-time-only expenditure will reduce the MHIP fund balance and the low-income subsidy will consume additional funds going forward, the imbalance between ongoing revenues and expenditures is expected to persist.

Like a commercial health insurance plan, MHIP needs to maintain a level of reserves against unanticipated losses. Clearly, MHIP can maintain a comfortable level of reserves, fulfill its responsibilities to its enrollees, and still have surplus revenues.

**Exhibit 2**
## Cash Flow Activity for MHIP Fund
**Fiscal 2004 – 2006**

| | Expenditures | Fund Balance |
|---|---|---|
| **Fund Balance 6/30/04** | | $38,325,360 |
| **Fiscal 2005 Activity** | | |
| Revenues | | |
| Hospital assessment | $65,101,080 | |
| Premiums and other | 21,146,439 | |
| Expenditures | -38,767,530 | |
| Change in Non-admitted Assets | 2,558,678 | |
| **Fund Balance 6/30/05** | | $88,364,027 |
| **Fiscal 2006 Projected Activity** | | |
| Revenues | | |
| Hospital assessment | $66,800,000 | |
| Premiums and other | 30,160,800 | |
| Expenditures | | |
| Basic MHIP program | -55,473,587 | |
| Low-income subsidy | -4,578,000 | |
| Projected expenditure for Medicaid eligibility system | -15,000,000 | |
| **Fund Balance 6/30/06** | | $110,273,240 |

Source: Maryland Health Insurance Plan

The Health Services Cost Review Commission (HSCRC) determines the amount of the hospital assessment applicable to MHIP, according to a methodology set in statute. HSCRC is expected to propose legislation for the 2006 session to permit the MHIP board to request a lower amount of funding from the hospital assessment than would otherwise be required by statute in any year in which the full amount of funding is not needed. An amendment that would have accomplished this same purpose was considered and rejected by the House Health and Government Operations Committee in its deliberations on HB 1328 of 2005, a departmental bill that would have made other changes to MHIP. Opponents of the amendment cited the need to safeguard the hospital assessment for medically uninsurable individuals without access to other sources of health care coverage. The assessment falls under the State's federal Medicare waiver, which means that any use of the funds generated by the assessment must keep hospital costs less than what they would be in the absence of the waiver.

The growing MHIP surplus may prompt legislative proposals for alternative uses of the hospital assessment. Possible alternatives include a Medicaid expansion, subsidized insurance coverage of low-income workers, third-party buy-in of MHIP coverage, and electronic medical records.

For further information contact: Linda L. Stahr Phone: (410) 946/(301) 970-5530

# Health and Health Insurance

## Small Group Market Reform

**Concerns about the availability and affordability of health insurance in the small group market have led to several regulatory changes and could result in further changes in the upcoming session.**

Due to the rising cost of health insurance in the small group market and decreasing numbers of enrollees, legislators and other stakeholders have been actively looking at ways to improve or reform the laws regulating the small group health insurance market.

### History of the Small Group Market

Employers with 2 to 50 eligible employees may purchase health insurance through the small group market. Chapter 9 of 1993 was enacted in response to concerns about costs and availability of health insurance for small employers and their employees. The law requires insurers participating in the small group market to offer a Comprehensive Standard Health Benefit Plan (CSHBP) to eligible employers. CSHBP contains benefits that are set by the Maryland Health Care Commission. CSHBP has a statutory floor and ceiling: it cannot contain less benefits than the actuarial equivalent of the minimum benefits required to be offered by a federally qualified health maintenance organization (HMO), and it cannot cost more than 10 percent of the average annual wage in Maryland. Chapter 9 also included several measures to regulate health insurance in the small group market, as follows:

- **Guaranteed issue:** requires insurers to issue health insurance to any small employer group willing to purchase.

- **Guaranteed renewal:** requires insurers to renew all insurance policies in the small group, so long as premiums are paid in a timely manner.

- **Required coverage of preexisting conditions:** prohibits insurers from limiting health insurance coverage for individuals with preexisting conditions.

- **Modified community rating:** allows insurers in the small group market to vary premiums only based on age, geography, and family composition.

- **Rate bands:** allows insurers to vary premium rates, subject to permissible rating factors, by no more than a certain percentage above or below the community rate.

## Recent Legislative Action

Despite the 1993 legislation's comprehensive reform of the small group health insurance market, health insurance costs in this market are close to the statutory cap, and the number of employers and employees purchasing health insurance through the small group market has somewhat declined in recent years. In recent sessions, several bills have passed in response to concerns about the availability and affordability of health insurance through the small group market. These included:

- **Creation of a Limited Benefit Plan (Chapter 287 of 2004).** Due to concerns about the cost of CSHBP and the dwindling numbers of employees enrolled in health insurance through the small group market, Chapter 287 created a Limited Health Benefit Plan that certain small employers can offer to their employees. Benefits under this plan may not exceed 70 percent of the actuarial value of CSHBP as of January 1, 2004.

  A small employer is eligible to offer the limited health benefit plan if the small employer has not provided CSHBP during the year preceding the date of application or the small employer has existed for less than a year, and the average annual wage of the employees of the small employer does not exceed 75 percent of the average annual wage in the State. The Limited Health Benefit Plan became available on July 1, 2005, and the laws providing for the plan are scheduled to terminate on June 30, 2008.

- **Removal of Self-employed Individuals and Sole Proprietors from the Small Group Market (Chapter 347 of 2005).** In the 2005 session, concerns were raised that healthy self-employed individuals or sole proprietors were enrolling in the individual market and enjoying lower premiums. However, self-employed individuals or sole proprietors who had chronic illnesses or who were not as healthy were obtaining health insurance in the small group market, thereby possibly driving up costs for all small group participants. As a result, Chapter 347 prohibits self-employed individuals and sole proprietors from obtaining health insurance in the small group market. However, self-employed individuals or sole proprietors who already hold small group policies on September 30, 2005, are allowed to maintain those policies so long as they maintain their self-employed or sole proprietor status and they do not change policies. The provisions of Chapter 347 are scheduled to sunset on September 30, 2008.

- **Creation of a Joint Legislative Task Force on Small Group Market Health Insurance (Chapter 409 of 2005**). The task force is charged with the study of the use of health status as a factor in adjusting rates, the permissible variation in the community rate, and other topics. The task force is scheduled to meet in November and December of 2005 and is required to report to the General Assembly on its findings and recommendations by January 1, 2006.

## Proposed Maryland Health Care Commission Reforms

The Maryland Health Care Commission (MHCC) is responsible for setting the benefits for CSHBP. If CHSBP is above its statutory ceiling, MHCC must reassess the benefits package in CSHBP so that CSHBP falls within the constraints required by law. In 2004, the actuarial value of CSHBP was slightly above the cap. CSHBP is projected to be slightly below the cap in 2005 but is expected to be again slightly above the cap in 2006.

At its September meeting, MHCC staff expressed concern over the viability of the small group health insurance market. MHCC staff presented the following three short-term options for reform that MHCC could implement through regulation:

- Modify the pharmacy benefit in CSHBP to increase the copays and deductibles for the pharmacy benefit and set a $2,000 maximum for the pharmacy benefit. This option is expected to bring the projected premium rate down to 98.6 percent of the statutory cap by 2006.

- Remove the pharmacy benefit from CSHBP and add a pharmacy discount card. This option is estimated to bring the projected premium rate down to 94.5 percent of the statutory cap by 2006.

- Remove benefits from CSHBP so that CSHBP is at its statutory floor, which is estimated to bring the projected premium rate down to 86 percent of the statutory cap by 2006.

Throughout October 2005, MHCC held town meetings around the State on these options. MHCC will most likely vote on modifications to CSHBP in November 2005.

At its September meeting, MHCC also suggested possible long-term strategies for small group market reform that would require legislation. These strategies included:

- adding health status as a factor to be used in the community rating;

- requiring participation by carriers in reinsurance or risk transfer pools in order to attract new insurers, increase competition, and decrease prices;

- establishing a separate high-risk pool with active health management to bring down costs in the small group market for healthier individuals; and

- establishing a statewide purchasing pool for small employers.

For further information contact: Stacy M. Goodman/Marie L. Grant Phone: (410) 946/(301) 970-5350

# Health and Health Insurance

## Provider Rates

**The Department of Health and Mental Hygiene spends $4 billion annually on provider payments, yet rates vary widely, are set by multiple entities using different methodologies, and have increased at varying intervals.**

### Entities Responsible for Rate Setting and Payment

Three entities are responsible for setting provider rates. For the majority of health care services, the Department of Health and Mental Hygiene (DHMH) sets the rates. Six separate administrations set rates for and/or pay providers, each serving unique populations, providing varying services, using different rate-setting methodologies, and paying different rates. The Health Services Cost Review Commission sets hospital rates, and the Maryland State Department of Education sets rates for out-of-home placements of children and adolescents.

### Rate-setting Methodologies

Seven major rate-setting methodologies are used for health care providers: capitation, case-rates, contracts, cost-based grants, fee-for-service, formulas, and per diems. The use of a particular method is based on what has historically been used, what best suits a particular service, or ultimate programmatic goals.

### Nature of Provider Rate Increases

Provider rates may be generally classified as mandated, negotiated, or discretionary. Mandated rates (1) are set in statute; (2) include a requirement for periodic adjustment or update either in statute or regulation; or (3) are driven by a legislative directive or mandatory funding. Negotiated rates, though based on data, include a degree of conference and negotiation between the rate-setting organization and the providers. Discretionary rates are set by the rate-setting agency, typically in regulation, based on available funds, enrollment, and other factors.

Mandated rates include those for services under the Older Adults Medicaid waiver, which has a regulatory annual inflationary adjustment, and for Medicaid physicians and providers of services to the developmentally disabled, which have received substantial rate increases under legislative directives. Negotiated rates include hospital and managed care organization (MCO) rates. The majority of provider rates are discretionary in that they have no statutory requirement or mandated update factors; and thus, they may be set at the discretion of DHMH according to funding availability and programmatic goals.

## Summary of Major Provider Rate Increases

Over the past five fiscal years, most major health care providers have received annual rate increases. Other providers, such as Medicaid personal care and mental health providers, received at least one rate increase. A few providers, such as private duty nurses, received no rate increases or, in the case of Medicaid pharmacists, actually received rate reductions under DHMH cost containment.

As shown in **Exhibit 1**, for providers that received rate increases, the average increase from fiscal 2002 through 2006 ranged from 1.8 to 7.4 percent, with an average for all providers of 4.5 percent.

**Exhibit 1**
**Comparison of Selected Major Healthcare Provider Rate Increases**
**Fiscal 2003 – 2006**
**Percentage Rate Increase**

| Provider | FY 02 | FY 03 | FY 04 | FY 05 | FY 06 | Average Increase FY 02-06 | FY 06 Budget |
|---|---|---|---|---|---|---|---|
| DDA – Day Services[1] | - | 6.8% | 5.9% | 0.3% | 11.6% | 6.2% | $79,138,764 |
| DDA – Residential Services[1] | - | 11.5% | 5.2% | 1.7% | 11.1% | 7.4% | 302,284,500 |
| DDA – Supported Employment[1] | N/A | - | 4.5% | 5.6% | 7.5% | 5.9% | 57,360,347 |
| Hospitals | 4.0% | 3.2% | 5.3% | 4.8% | 5.0% | 4.5% | 621,529,521 |
| Medicaid – Adult/Medical Day Care | 2.0% | 2.2% | 1.1% | 2.7% | 1.2% | 1.8% | 72,363,725 |
| Medicaid – Home Health | - | 2.1% | 3.3% | 3.3% | 2.5% | 2.8% | 2,500,000 |
| Medicaid – Living at Home Waiver | N/A | 1.7% | 2.5% | 2.5% | 2.5% | 2.3% | 14,100,000 |
| Medicaid – MCOs | 7.9% | 8.5% | 5.3% | 5.8% | 6.3% | 6.8% | 1,588,242,866 |
| Medicaid – Nursing Homes | 12.1% | 7.9% | 4.2% | 3.8% | 6.4% | 6.9% | 872,760,893 |
| Medicaid – Older Adults Waiver | N/A | 2.2% | 2.5% | 2.0% | 2.0% | 2.2% | 66,800,000 |
| Medicaid – Personal Care Providers | 0.0% | 0.0% | 0.0% | 0.0% | 10.0% | 2.0% | 22,300,000 |
| MHA – Outpatient Mental Health[2] | 0.0% | 27.3% | 0.0% | 0.0% | 0.0% | 5.5% | 151,241,829 |
| MHA – Psychiatric Rehabilitation[3] | 0.0% | 0.0% | 0.0% | 0.0% | 20.6% | 4.1% | 101,731,852 |

[1] The Department of Disabilities Administration rate increases includes funding provided under the Wage Initiative.
[2] In fiscal 2003, fees for 30 outpatient services for children and adolescents were increased an average of 27.3%.
[3] In fiscal 2006, psychiatric rehabilitation case rates were increased by 10.3% for intensive support services and 31% for community support services. However, case rates adopted in fiscal 2004 for psychiatric rehabilitation services together with rate reductions for residential rehabilitation providers produced much greater reductions than the gains offered in fiscal 2006.

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

These rate increases can be compared with two benchmarks: the Consumer Price Index for All Urban Consumers (CPI-U) and salary increases for State employees. From fiscal 2002 to 2006, the CPI-U medical care component for Washington-Baltimore increased an average of 3.0 percent per year, while State employee salary increases, when granted, ranged from 1.5 to 4 percent, with an average annual increase of 1.45 percent (no increases were granted in fiscal 2003 or 2004).

Compared with these benchmarks, from fiscal 2002 to 2006, eight major providers (including developmentally disabled providers, hospitals, MCOs, and nursing homes) received average increases above and in some cases twice the rate of inflation. Five providers (including Medicaid adult/medical day care, home health, and the Medicaid waiver programs) received average increases near or below medical inflation. All 13 selected providers received average rate increases above the average salary increase for State employees. Eight providers received average rate increases greater than the highest increase granted to State employees.

## Observations

Several observations can be made about health care provider rates in Maryland:

- **There is no standardization of rates or rate-setting methodologies.**

  DHMH pays multiple providers with no standardization of how rates are set or the level of rates, even for similar classes of providers or services. Some rates are based on the costs incurred by providers, while others are based on availability of funds. Some rates are annually adjusted for inflation, while others are increased on a discretionary basis.

- **Some provider rates have received generous increases, while others lag behind.**

  Hospitals, MCOs, and nursing homes have regularly received rate increases equal to or exceeding the CPI-U and salary adjustments granted to State employees while providers such as private duty nurses have not received rate increases since fiscal 2001.

- **Provider rates depend directly on availability of funding.**

  Provider rates are dependent on allocated funding. Even rates with automatic inflationary adjustments may not be increased without sufficient funding. Rate increases require long-term funding as increases are built into the base rate for future years.

For further information contact: Jennifer B. Chasse Phone: (410) 946/(301) 970-5530

# Health and Health Insurance

## Embryonic Stem Cell Research

**The release of the National Academies guidelines and other reports since the end of the 2005 session may contribute to the debate over the ethics of human embryonic stem cell research.**

State funding of stem cell research and particularly embryonic stem cell research has been a topic of great debate in state legislatures across the country since President George W. Bush announced that federal funding of embryonic stem cell research could only be granted to research using embryonic stem cell lines that existed as of 2001. In Maryland, three bills from the 2005 session (all failed) would have provided for State funding of stem cell research. HB 1356 would have provided funding for adult stem cell research, while HB 1183 and SB 751 would have provided funding for embryonic stem cell research using donated embryos from couples being treated for infertility.

Since the end of the 2005 session, several events have occurred that have contributed to the debate of the ethical implications of embryonic stem cell research. In April 2005, the National Academies released extensive guidelines for institutions engaging in human embryonic stem cell research. Also, there have been reports that suggest that it might eventually be possible to produce embryonic stem cell lines without using new embryos.

### The National Academies Guidelines

In April 2005, the National Academies published Guidelines for Human Embryonic Stem Cell Research, which are a set of detailed suggestions for how institutions that conduct human embryonic stem cell research should regulate that research. The guidelines describe how institutions should proceed with human embryonic stem cell research and what types of research should be allowed under what circumstances.

The guidelines suggest that all institutions that conduct human embryonic stem cell research should establish an Institutional Embryonic Stem Cell Research Oversight (ESCRO) Committee to provide oversight for all aspects of embryonic stem cell research that occurs at a given institution. The guidelines suggest that members of the ESCRO committee should include persons with scientific expertise as well as persons with expertise in the ethical and legal issues involved in embryonic stem cell research.

The guidelines contain detailed suggestions for how cells and embryos should be procured for embryonic stem cell research. Detailed procedures for how autonomous informed consent of donors of cells or embryos should be obtained are set forth. The guidelines also contain ethical limits on reimbursement for procurement of cells or embryos.

The guidelines contain detailed requirements for the derivation of human embryonic stem cell lines. Attempts to derive new embryonic stem cell lines must be approved by the ESCRO committee and be approved by an institutional review board as well if the attempts involve donated embryos or blastocysts. There must be a clear and strong scientific rational for the need to generate new embryonic stem cell lines, and it must be particularly strong if the institution wishes to use nuclear transfer experiments to generate embryonic stem cells. The guidelines also offer detailed suggestions on how to bank and distribute human embryonic stem cell lines.

Finally, the guidelines contain detailed procedures for approval of embryonic stem cell research by the ESCRO committee and other committees, including research involving human embryonic stem cell research involving animals.

## Comparison of HB 1183 and SB 751 to the National Academies Guidelines

HB 1183 and SB 751 most likely would not have met many of the National Academies guidelines primarily because the guidelines propose extensively detailed regulation for human embryonic stem cell research at **all** institutions. HB 1183 and SB 751 primarily pertained to how the State would regulate embryonic stem cell research using State funds. HB 1183 and SB 751 also left many of the details of regulation of State-funded embryonic stem cell research to a Scientific Peer Review Committee and a Stem Cell Research Commission that would have been created by each bill.

The most significant areas not addressed by HB 1183 and SB 751 that are addressed by the guidelines are:

- establishment and duties of ESCRO committees at each institution involved in human embryonic stem cell research;
- procedures for banking and distribution of human embryonic stem cell lines; and
- the proper procedures for handling human embryonic stem cell research involving animals.

HB 1183 and SB 751 also did not include informed consent provisions for donation of embryos or eggs that are as detailed and extensive as the suggestions for informed consent procedure in the guidelines.

The conclusion to the guidelines suggests that stakeholders in human embryonic stem cell research, such as funding agencies, should assess institutional compliance with the guidelines when reviewing applications for funding. This suggests that, at a minimum, bills that would provide funding for human embryonic stem cell research could make any funding contingent on an assessment of an institution’s compliance with the guidelines.

## Summary of Recent Research

Several recent reports have indicated that eventually new embryos may not be needed to generate embryonic stem cell lines. However, scientists involved in this research cautioned that it may be many years before these methods of generating embryonic stem cell lines will be able to produce stem cell lines that could be used in a clinical setting.

In August, a Harvard Stem Cell Institute research team published an article in the *Journal of Science* about its work in converting skin cells into embryonic stem cells. The scientists used a technique that used laboratory-grown human embryonic stem cells to reprogram the genes in skin cells so that the skin cells were converted into human embryonic stem cells. However, the researchers cautioned that this technique is still quite far from being clinically applied. Cells created through this technique have the characteristics of a new embryonic stem cell but still contain the deoxyribonucleic acid (DNA) of the person who donated the skin cell as well as the DNA in the initial embryonic stem cell. The extra DNA would have to be extracted before the hybrid cells could be used to grow into replacement parts to be transplanted into a person.

In October 2005, the *New York Times* reported on Harvard researchers who are conducting research based on the premise of using an egg to create embryonic stem cell lines but in a way that embryos are not produced. The process would use an adult cell and an egg and would remove or alter genes from the adult cell so that an embryo would not be produced. That altered cell would then be added to the egg to generate embryonic stem cell lines. For now, Harvard researchers are testing this idea in mice.

## Conclusion

Funding and regulation of embryonic stem cell research continues to be an issue that it is debated at the State level, given the continuing absence of federal funding and guidance. The release of the National Academies guidelines and reports about the possibilities of creating embryonic stem cell lines without using new embryos add to the debate over ethical decisions that must be made in crafting legislation regarding embryonic stem cell research.

For further information contact: Marie L. Grant Phone: (410) 946/(301) 970-5350

# Health and Health Insurance

## Medicaid Waiver Renewal

**In May 2005, Maryland's HealthChoice waiver was extended for another three years and includes provisions for a primary care program as well as a buy-in program for individuals with disabilities. Despite its renewal, funding for future Medicaid expansions could be limited.**

### Background

Because Medicaid is a federal entitlement under the Social Security Act, states must comply with federal law while administering their Medicaid programs. The federal Centers for Medicare and Medicaid Services (CMS) allows more flexibility in programs by waiving certain portions of current law, known as a Section 1115 waiver, in order to encourage states to find more cost-effective health care delivery methods or to expand coverage to additional populations.

In order to provide more cost-effective health benefits to Medicaid recipients, Chapter 352 of 1996 authorized the Department of Health and Mental Hygiene (DHMH) authority to seek federal approval to provide Medicaid health benefits through a managed care network. DHMH subsequently implemented the HealthChoice program, providing health care services to most Medicaid recipients through managed care organizations (MCOs). The waiver, granted on October 30, 1996, is subject to periodic review and extension by CMS. Maryland's HealthChoice waiver has been renewed twice, in 2001 and most recently in May 2005. The most recent waiver renewal is effective through May 2008.

### DHMH Applies for Two New Programs under Waiver Renewal

As part of the most recent waiver renewal application, DHMH included plans for a primary care program for individuals currently enrolled in the Maryland Pharmacy Assistance Plan (MPAP). DHMH currently provides specified primary care services for MPAP enrollees financed with State general funds only. DHMH also applied for a buy-in program for employed individuals with disabilities. Individuals with disabilities are currently eligible for Medicaid but must also meet low-income criteria. Both programs were approved by CMS. DHMH is focusing on implementing these programs around July 1, 2006.

## Section 1115 Waivers and Budget Neutrality

CMS will not approve a Section 1115 waiver that may result in a higher level of federal spending than would have been the case under a state's fee-for-service Medicaid program. In order to limit a state's access to open-ended federal funding, CMS places a cap on federal funds to enforce its budget neutrality requirements. If a state exceeds this cap, it is liable for all additional program costs without the benefit of any federal matching funds.

Initially, CMS used the Maryland Medicaid program's fiscal 1996 fee-for-service costs for its base year cost projections. CMS permitted the State to allow up to 5.5 percent per capita inflation for the first five years of the waiver. For the waiver's subsequent renewals, CMS approved an annual per capital inflation rate or trend factor of 8.5 percent in 2001 and 7.1 percent in 2005. HealthChoice spending may be over or under this trend factor each year, as long as the cumulative amount is under the target.

## Low Trend Factor Constrains Future Program Expansions

In the past, Maryland has been able to contain HealthChoice inflation within the approved trend factors. Consequently, it had room under the budget neutrality cap to attain additional federal monies for program expansions. When applying for the most recent waiver renewal, DHMH requested an 8.5 percent trend factor based on its projected future growth. Initially, CMS approved only a 6.8 percent trend instead. DHMH argued that the 6.8 percent trend factor placed some of Medicaid's continuing programs in jeopardy as growth in these programs could eventually outstrip growth allowed under this trend factor within the current waiver renewal period. In addition, DHMH argued it would not be able to implement the two new programs it requested in its waiver renewal under the 6.8 percent trend factor.

DHMH was subsequently able to negotiate a 7.1 percent trend factor. DHMH contends that this trend factor provides sufficient room under the budget neutrality cap to meet anticipated growth in existing programs plus allow the implementation of the primary care and buy-in programs. However, DHMH advises that additional expansions in the current waiver renewal period, for example adding specialty care to the primary care waiver, will not be possible.

## Future Program Expansions

While CMS rulings on waiver renewals are generally considered final, the Secretary of Health and Mental Hygiene has written a formal request for reconsideration of the 7.1 percent trend factor. Unless this reconsideration is approved, DHMH does not believe it can accommodate any additional program expansions over the next three years.

For further information contact: Susan D. John Phone: (410) 946/(301) 970-5510

# Social Programs

## Foster Care Caseload Trends

**Despite favorable foster care caseload trends, expenditures continue to rise reflecting increased usage of group home and institutional placements. A fiscal 2006 deficit of $28.9 million is likely, due to under attainment of federal funds ($5.6 million) and prior year claims against federal grants that were denied ($23.3 million).**

The State's foster care and subsidized adoption programs provide temporary and permanent homes for children in need of out-of-home placements due to abuse, neglect, or abandonment. Foster care placements – such as family homes, group homes, and institutions – offer temporary out-of-home care until achievement of a permanency plan. Permanency options include reunification with the family and adoption. Families that accept legal custody of a child with special needs may receive monthly payments under the subsidized adoption program.

### Foster Care and Subsidized Adoption Caseloads

**Exhibit 1** shows that the Department of Legislative Services anticipates an increase of 2.4 percent per year in the combined foster care/subsidized adoption caseload from fiscal 2005 to 2007. The combined increase is the result of a projected increase of 9.5 percent per year in the subsidized adoption caseload moderated by a 4.5 percent per year decline in the foster care caseload. The foster care caseload is decreasing due to a decline in entries and an increase in exits to adoption. Fiscal 2006 marks the first time that subsidized adoptions will make up over half the total caseload.

### Funding

Total program costs increased slightly between fiscal 2004 and 2005 but are expected to increase by over $20 million a year for fiscal 2006 and 2007. These increases are driven primarily by increased utilization of higher end placements in group homes and institutions.

The foster care and subsidized adoption program will likely face a fiscal 2006 general fund deficit of about $28.9 million. This is made up of two distinct pieces.

- Federal Title IV-E (Foster Care) attainment will likely be less than budgeted. Based on the three-year average attainment of IV-E funds, the fiscal 2006 budget overstates IV-E funding by approximately $5.6 million, and general funds will be needed to cover this shortfall.

**Exhibit 1**
## Foster Care and Subsidized Adoption Caseload and Expenditures
**Fiscal 2005 – 2007**

| **Caseload** | **FY 2005** | **FY 2006 DLS Estimate** | **FY 2007 DLS Estimate** | **Average Annual % Change FY 2005 - 07** |
|---|---|---|---|---|
| Foster Care | 7,344 | 7,016 | 6,702 | -4.5% |
| Adoptions | 6,612 | 7,239 | 7,926 | 9.5% |
| **Total** | **13,956** | **14,254** | **14,627** | **2.4%** |
| **Expenditures** | | | | |
| Monthly Cost Per Case | $1,639 | $1,735 | $1,817 | 5.3% |
| **Total Cost ($ in Millions)** | **$274.5** | **$296.7** | **$318.9** | **7.8%** |

Source: Department of Human Resources; Department of Legislative Services

- The Department of Human Resources improperly charged almost $33 million in foster care expenses during fiscal 2002 and 2003 to federal funds. During fiscal 2005, the department paid down this amount by $9.6 million leaving $23.3 million left to be resolved.

## Closure of the Charles Hickey School

**The recent announcement to close the Charles Hickey School was not surprising given the recent record of problems at that facility. However, the decision to close the facility has left several unresolved issues.**

### The Long and Winding Road to the Closure of the Hickey School

The Charles Hickey School (Hickey) in Baltimore County is a residential facility for juvenile offenders with a history of handling the State's most violent juvenile offenders. Programming and conditions at Hickey have long been criticized. In the past three years alone, programming at Hickey has been criticized in a Department of Juvenile Services' (DJS) 2002 performance audit, a 2003 report of the Office of the Independent Juvenile Justice Monitor, and a 2004 investigation by the U. S. Department of Justice (DOJ). Extensive problems with the physical plant were also highlighted in a recent consultants report on DJS facilities.

Since January 2003, the operation of Hickey has been subject to almost constant change. As detailed in **Exhibit 1**, Hickey has moved from operation by an outside contractor with an average daily population of 256 to a State-operated facility and now to the most recent plan to eventually close juvenile justice programming at the campus.

The decision to close Hickey by 2008 was made in June 2005. The impetus for the decision was the agreement signed by the State and DOJ in response to the DOJ's civil rights investigation of conditions at Cheltenham and Hickey. That agreement did not specifically require the State to close either facility but rather noted the need to improve a wide array of services at those facilities. However, with regard to Hickey, Governor Robert L. Ehrlich, Jr. announced plans to phase out programming to committed youth (youth adjudicated delinquent and committed to DJS) by November 30, 2005, leaving a 72-bed secure detention program. The facility would close completely by 2008 when a new 72-bed regional secure detention facility is anticipated to be built.

**Exhibit 1**
**Charles Hickey School**
**A Shifting Strategy**

| Date | Operator | Educational Provider | Programming | ADP |
|---|---|---|---|---|
| January 2003 | Private vendor | Private vendor | Secure detention and pending placement. Committed (minimum and maximum secure) | 256 |
| 2003 session | Private vendor | MSDE | Secure detention and pending placement. Committed (minimum and maximum secure) | 256 |
| 2004 session (fiscal 2005 RFP) | Private vendor | MSDE | Secure detention and pending placement. Committed (minimum and maximum secure) | 264 |
| October 2004 (revised fiscal 2005 plan) | DJS | MSDE | Secure detention and pending placement. Committed (minimum and maximum secure) | 148 |
| November 2005 | DJS | MSDE | Secure detention and pending placement | 72 |
| 2008 | | | | 0 |

ADP = average daily population
MSDE = Maryland State Department of Education
RFP = Request for Proposal

Source: Department of Juvenile Services; Department of Legislative Services

## Ramifications of the Decision to Close Hickey

The June 2005 announcement to close Hickey raises a number of issues.

- What programming will replace that currently provided to committed youth at Hickey? For youth in the minimum secure program, DJS is proposing to utilize a variety of nonresidential programs. For youth in maximum security programs, to the extent possible, youth will be served in existing in-state residential programs. This is particularly true for youth not considered a threat to public safety. However, it is recognized that some youth do pose a threat to public safety and for these youth programming is not currently available in Maryland. DJS proposes to send these youth to out-of-state placements. DJS estimates that up to 48 youth will be placed in out-of-state placements on a daily basis as a result of the closure of the Hickey committed programs. The placement of youth in out-of-state placements has been widely criticized as an unsatisfactory solution even though these placements are intended as a stop-gap measure until a more permanent solution is found. As of November 1, 2005, however, no long-term solution has been identified. An obvious solution would be to re-open the Victor Cullen Academy (something DJS was considering, albeit for a different category of youth, in 2004).

- Will the closure of Hickey further stress DJS's fiscal 2006 budget? DJS's fiscal 2006 budget is already considered underfunded because of the challenge of realizing the savings built into the budget from developing programming alternatives to residential placements. Although the committed program at Hickey was larger than the secure detention/pending placement program, DJS intends to retain 70 percent of the Hickey staff to continue that secure detention/pending placement population and to meet other departmental needs. Thus, any realized savings from the closure of committed programming will be more than consumed by the cost of alternative nonresidential and residential placements for youth that would have otherwise been served in the Hickey committed program.

- What is the status of the Maryland State Department of Education (MSDE) staff at Hickey? MSDE will continue to provide educational services to the secure detention/pending placement population. MSDE has indicated that excess educational staff will be transferred to the Baltimore City Juvenile Justice Center.

- What is the status of the sex offender unit currently housed at Hickey? A private provider operates an accredited 26-bed Residential Treatment Center for sex offenders behind the fence at Hickey. The center only accepts youth from DJS. The Administration has indicated that it intends to close all programming at Hickey. Thus, the sex offender program will operate at Hickey until the secure detention/pending placement program is relocated. At this time, it is unclear what the long-term options are for the operation of in-state sex offender beds. DJS has indicated that it is currently undertaking an assessment of the need for sex offender beds (especially given that many youth in out-of-state placements are sex offenders) as well as where such a program or programs should be located. The department believes that this process will take two years. If, as currently expected, Hickey is closed in 2008, this does not appear to give DJS much opportunity to develop the required programming.

- Where will a new secure detention/pending placement unit be located? DJS has indicated that it is looking to move quickly to develop a 72-bed regional detention facility to replace the programming at Hickey. However, at this time, no location has been announced.

# Social Programs

## Temporary Cash Assistance Caseload and Expenditure Trends

**After remaining stable for several years, Temporary Cash Assistance participation dropped 11 percent in fiscal 2005 and in August fell below 60,000 people for the first time in more than 40 years. The decline follows the implementation of a "universal engagement" policy.**

### Background

Temporary Cash Assistance (TCA) provides monthly cash grants to needy children and their parents or relative caretakers. The program is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections.

### Caseload Trends

In the early years of welfare reform, efforts to transition individuals from welfare to work and a growing economy led to rapid reductions in the number of TCA recipients. After dropping at rates exceeding 20 percent per year during the 1990s, the pace of caseload decline slowed considerably in the early years of this decade. With the economy recovering and the implementation of a universal engagement policy in fall 2003, the caseload began to decline more sharply, falling 3.7 percent in fiscal 2004 and 11 percent in fiscal 2005. Universal engagement requires immediate participation in activities such as up-front job search, assessment of employability, developing an Independence Plan, training, and subsidized employment.

### Fiscal 2006 Forecast

As shown in **Exhibit 1**, the Department of Legislative Services (DLS) estimates an annual average of 59,053 recipients for fiscal 2006, a decline of 10.2 percent from the previous year. The projected decline is based on the caseload decline experience during fiscal 2005 as well as the first two months of fiscal 2006 when the number of recipients dropped below 60,000 for the first time.

**Exhibit 1**
**TCA Enrollment and Funding Trends**
**Fiscal 2005 – 2007**

| | FY 2005 Actual | FY 2006 Appropriation | FY 2006 Estimate | FY 2007 Estimate | FY 06-07 % Change |
|---|---|---|---|---|---|
| Average Monthly Enrollment | 65,748 | 67,647 | 59,053 | 58,462 | -1.0% |
| Average Monthly Grant | $147.24 | $147.37 | $148.98 | $152.69 | 2.5% |
| | | | | | |
| **Funds in Millions** | | | | | |
| General Funds | $43.6 | $43.6 | $16.7 | $16.7 | 0.0% |
| **Total Funds** | **$123.7** | **$123.7** | **$106.4** | **$107.9** | **1.5%** |

Source: Department of Human Resources; Department of Legislative Services

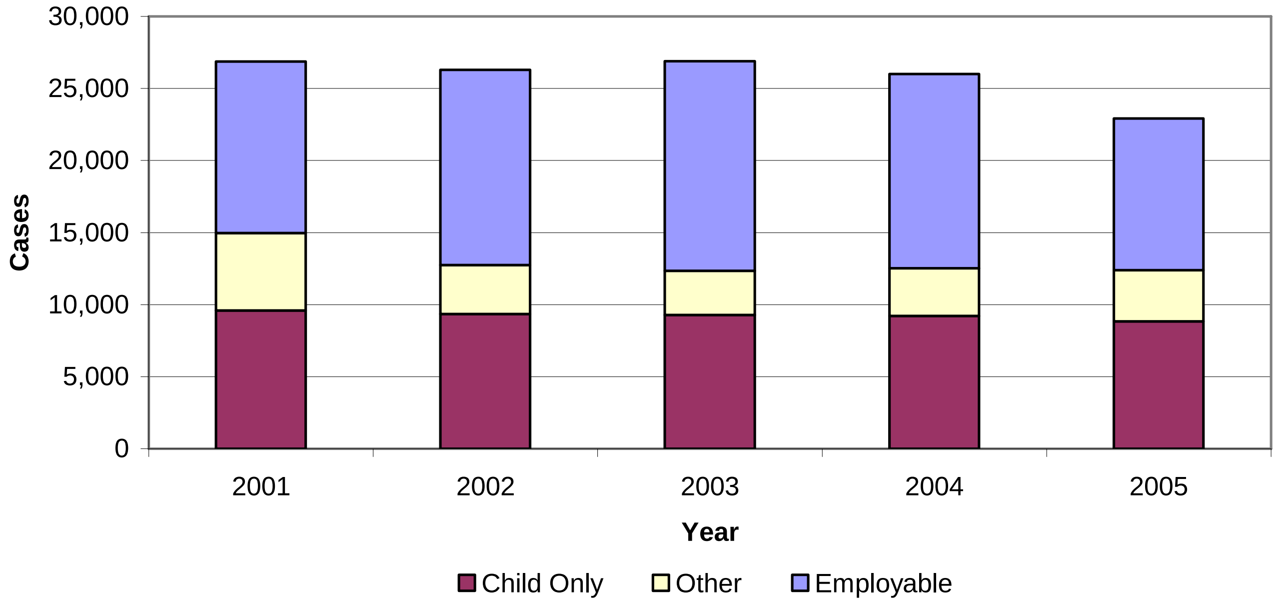
## Fiscal 2007

DLS expects the enrollment decline to moderate in fiscal 2007 because the core caseload – those cases not headed by an employable adult – makes up a greater percentage of the caseload as the caseload declines. DLS estimates an enrollment of 58,462, an average grant of $152.69, and total expenditures of $107.9 million. The estimate of the average grant and the total expenditures reflect the annualized cost of a 1.5 percent increase in the grant amount in October 2005 and another 3.2 percent (equal to the recent increase in the Minimum Living Level) increase in October 2006. General funds remain the same between fiscal 2006 and 2007 because Maryland is nearing the minimum Maintenance of Effort requirement under the TANF program.

## Characteristics of the Current Caseload

To track recipients needing employment services, the Department of Human Resources (DHR) divides the caseload into two main groups: (1) the "core" caseload; and (2) cases headed by an employable adult. The core cases include child only cases, women with children under age one, disabled cases, relative caretakers, and other cases exempted from work requirements. With the exception of women with children under age one, DHR does not expect the core cases to transition off cash assistance by seeking employment. Child only cases, for example, typically leave the rolls after reaching adulthood. As employable adults have successfully entered the labor market, the core cases have represented an increasing percentage of the total TCA caseload. As shown in **Exhibit 2**, while the total caseloads have declined since 2003, the nonemployable core caseload has remained virtually the same. As a result, the nonemployable core caseload as a percent of total caseload has increased from just under 45 percent in 2003 to 54 percent in 2005. The employable caseload declined from just over 54 percent in 2003 to 46 percent in 2005.

**Exhibit 2**
**TCA Caseload Characteristics**
**July Caseloads**




Note: "Other" category includes: Child Under One, Relative Caretaker, Disabled, and Other Exemptions.

Source: Department of Human Resources

In the early years of welfare reform, DHR concentrated on serving those easiest to place in employment. Through its successful efforts, most of these cases have transitioned from welfare to work. Now, the remaining cases headed by an employable adult typically face multiple barriers to employment such as substance abuse and/or mental health issues, poor work histories, low educational attainment, and limited access to transportation and child care. To realize further caseload reductions, DHR must continue to provide intensive services to help these employable adults enter and remain in the labor force.

# Social Programs

## Status of the Office for Children

**The Governor's Office for Children was created by executive order after bills to permanently establish the office failed during the 2005 legislative session.**

### Background

The Governor's Office for Children, Youth, and Families (OCYF) was authorized under Article 49D of the Annotated Code of Maryland. Led by the Special Secretary, the office oversaw State policies for children, youth, and families. The Subcabinet for Children, Youth, and Families, consisting of the Special Secretary and the heads of State agencies providing services to children and their families, was charged with ensuring that services were provided effectively, efficiently, and in an integrated system. The subcabinet maintained a statewide system of interagency budgeting and funding, including the Subcabinet Fund, which supported services preventing unnecessary out-of-home placements of children and other initiatives.

Article 49D required local management boards (LMBs) in each jurisdiction to implement a local interagency service delivery system for children, youth, and families. The Subcabinet for Children, Youth, and Families Resource Fund supported LMBs. Additionally, the State Coordinating Council and local coordinating councils for residential placement of children with disabilities were established.

### 2005 Session

The Governor's Office for Children, Youth, and Families' statutory authority terminated June 30, 2005, as did Article 49D, after the failure of Senate Bill 222/House Bill 293, Administration bills seeking to reauthorize the office as a permanent entity and rename it the Governor's Office for Children (OC).

With the failure of Senate Bill 222 and House Bill 293, provisions in the fiscal 2006 budget took effect reducing the office's budget from $4.0 million to $1.9 million and abolishing 18 of the office's positions.

### Governor's Response

Despite the termination of the office's statutory authority, the office's functions and programs continue today much as they were outlined in the Administration bills. On June 9, 2005, the Governor issued an executive order establishing OC, the Children's Cabinet (formerly the Subcabinet for Children, Youth, and Families), and the Advisory Council for Children. OC's duties under the executive order are to support the Children's Cabinet; promote values, policies, and practices that improve the well-being of Maryland's children and families; partner with LMBs and oversee the Children's Cabinet Interagency Fund (formerly the Subcabinet for Children, Youth, and Families Resource Fund); and help the Children's Cabinet allocate funds for grants to any State agency, local government, LMB, or private organization.

The executive order created the position of executive director as head of OC to replace the Special Secretary position under OCYF. The executive order also requires OC to develop a State three-year plan for integrating children and family services, establish interagency policies to implement the plan, and determine the most efficient way to use funds. The Children's Cabinet must submit the plan to the Governor by October 1, 2006.

With the termination of Article 49D, an emergency regulation was issued by the Department of Health and Mental Hygiene, the Maryland State Department of Education, the Department of Human Resources, and the Department of Juvenile Services to continue the efforts to coordinate improvements in delivering services to children through the LMBs, the local coordinating councils, and the State Coordinating Council.

## Continued Concerns

- Although the office continues to operate, it is no longer codified under State statute. The Joint Committee on Children, Youth, and Families held two hearings during the 2005 interim regarding OC. Some of the concerns raised during the hearings include the following:

- By not codifying OC in statute, the office easily could be eliminated by a subsequent Administration.

- LMBs, previously codified under Article 49D, that are not codified under local resolution or law no longer have statutory authority.

- The State Coordinating Council and the local coordinating councils, also previously codified under Article 49D, no longer have statutory authority.

The joint committee is expected to discuss these concerns further before issuing its 2005 report.

# Social Programs

## State Oversight of Group Homes

**In fiscal 2004, an average of 2,690 children resided in Maryland group homes at a cost of $167 million. Oversight of group homes is inconsistent among three State agencies, and overall the State is not a smart purchaser of group home services. Options for improving oversight of group homes include collection of performance data, enhanced financial accountability, and consolidation of licensing and monitoring responsibilities.**

### Background

For many years, concerns have been raised relating to the licensing, monitoring, and funding of group homes, also known as residential child care programs or community-based homes for children. In 2005 the Senate Budget and Taxation Committee, the House Health and Government Operations Committee, and the Joint Committee on Children, Youth, and Families held briefings on the issue, again bringing the issue of State oversight of group homes to the forefront.

### Overview of Group Homes

In fiscal 2004, Maryland placed 26,263 children in out-of-home placements at a cost of $622 million. Group homes represent one form of out-of-home placements, with an average of 2,690 children residing in group homes each day at an annual cost of $167 million. Group homes offer home-like settings that provide structure and 24-hour supervision, basic care, social work, and health care services. Many group homes utilize community-based ancillary services and enroll children in the local school system. Depending on the facility and the level of intensity of services, group home placements cost between $34,000 and $119,000 per child annually.

### State Oversight of Group Homes

Three State agencies are involved in the licensure, monitoring, and placement of children in group homes: the Department of Health and Mental Hygiene (DHMH), the Department of Human Resources (DHR), and the Department of Juvenile Services (DJS). Each agency licenses, monitors, and places children in group homes according to individual agency standards. DHMH licenses and monitors 167 facilities (34 percent) but places less than 1 percent of the children in group homes. DHR licenses and monitors 305 facilities (62 percent) and places approximately 80 percent of the children in group homes. DJS licenses 20 facilities (4 percent) and places approximately 19 percent of the children in group homes. DJS monitors all facilities in which it places children (124).

### Licensing and Monitoring

To become licensed as a group home, an applicant begins at the Governor's Office for Children (formerly the Governor's Office for Children, Youth, and Families), which serves as a "single point of entry" and refers applicants to the appropriate agency. Licenses are issued for two years and must be obtained for each facility. The licensing agencies monitor group homes by reviewing records, inspecting the facility, and interviewing staff and residents. When a child is placed in a group home, a caseworker from the placing agency (*e.g.*, the local Department of Social Services caseworker for DHR) is assigned to that child and is responsible for visiting the child regularly to monitor the child's progress and the appropriateness of the placement.

If licensing violations are found in group homes, corrective action plans and sanctions are implemented. In fiscal 2004, DHR issued 14 sanctions, including closing six facilities, and placed 73 providers (41 percent) under corrective action plans. DHMH issued 10 sanctions, including the revocation of one license, the surrender of three licenses, and six intermediate sanctions or consent agreements. DJS implemented four moratoriums on placement at facilities with which it contracts, but does not license.

### Rate Setting and Financial Oversight

Rates for group homes are set by the Interagency Rates Committee (IRC), which is staffed by the Maryland State Department of Education (MSDE). Group homes are assigned to a category based on service intensity, detailed budget submissions are reviewed to identify allowable costs, and programs are compared to other providers in the same category and designated as "preferred" or "nonpreferred" based on their relative costs. The IRC establishes a per diem rate for each group home that is paid by all agencies that contract for beds with that home.

The main financial oversight of group homes is the requirement that providers submit annual independent audits to their licensing agencies. However, these audits are reviewed by licensing and monitoring staff rather than the IRC and do not factor into the development of the homes' rates.

## Observations and Options for Improving Group Homes

To support the interim study of group homes, the Department of Legislative Services (DLS) conducted a review of licensing, monitoring, and contracting practices relating to group homes, noting three major observations. First, the State is not a smart purchaser of group home services. Referral practices and provider rates are not standardized nor guided by performance data. Second, there is insufficient financial oversight of group homes. The rate setting process does not include review of audits or actual spending patterns, licensing agencies do not compare budgets submitted by providers to actual spending patterns, and group homes are not required to spend a minimum amount of funding on direct care. Finally, the licensing and monitoring process is disjointed. There is no single agency guiding the system, and there are inconsistent practices and a lack of communication among agencies. There is no single point of entry for complaints about group homes, and, particularly for DHR, there is tension between the dual roles of enforcing licensing standards and maintaining adequate placement capacity.

Based on these observations, DLS offers the following options for improving oversight of group homes:

- consolidate licensing and monitoring of group homes within a single agency (*e.g.*, DHMH's Office of Health Care Quality);
- require DHR, DHMH, and DJS to collect and disseminate performance data from group homes;
- require copies of all provider audits to be submitted to MSDE and used in setting rates;
- require DHR, DHMH, and DJS to report on earnings retained by providers;
- request a report from DHR, DHMH, and DJS on the appropriate percentage of dollars that should be expended on direct care and the feasibility of requiring group homes to spend a minimum percentage of State dollars on direct care;
- address the need to develop additional capacity for group home placements in underserved areas by establishing a single group home grant/loan program; and
- maintain DHR caseworker staffing levels at nationally recommended levels to ensure that children placed in group homes and other out-of-home placements are adequately monitored.

# Social Programs

## Child Welfare Accountability

**News accounts over the past two years have highlighted serious deficiencies with the State's child welfare system. Legislative efforts have resulted in more appropriate staffing levels for the child welfare system and movement toward an outcome-based child welfare system. A legislative workgroup is expected to propose child welfare accountability legislation for consideration during the 2006 session.**

### Background

The State's child welfare system has come under increased scrutiny due to a series of high profile tragedies including the 2004 deaths of twins born to a young woman who had already been in the care of the State's child welfare system. These seemingly avoidable deaths focused public attention on the weaknesses of Maryland's child welfare system including understaffing, an inadequate case monitoring and data reporting system, and oft ignored procedures for handling reports of abuse and neglect. Subsequent newspaper accounts described children sleeping in social service offices and group homes providing a substandard quality of care.

### Child Welfare Accountability Task Force

The 2003 *Joint Chairmen's Report* included narrative directing the Department of Budget and Management to convene a task force to evaluate the child welfare system in Maryland. To conduct this evaluation, the Maryland Task Force on Child Welfare Accountability was created. The task force was chaired by staff from the Annie E. Casey Foundation, and its membership was comprised of representatives from the General Assembly, various State agencies, local departments of social services, and child welfare advocates. In its December 2004 report, the task force outlined 16 specific recommendations that fall into the following three broad categories: (1) a long-term commitment to excellence; (2) an outcome measurement system, and a related county self-assessment system; and (3) a quality assurance system. Included in its specific recommendations, the task force stated that there must be long-term commitment to enhanced and stable funding for the State's child welfare system, and that the State must commit to achieving Child Welfare League of America (CWLA) caseload standards for child welfare caseworkers and supervisors.

## Child Welfare Workgroup

In response to highly publicized cases of child abuse and neglect, the House Committee on Appropriations created the Child Welfare Workgroup, which also met during the 2004 interim, to examine the State's child welfare system. Through a series of briefings, the workgroup developed a number of recommendations that were adopted as either budget language or budget narrative in the fiscal 2006 budget. These recommendations included budget language requiring the Department of Human Resources (DHR) to develop a pilot program for differential response for consideration during the 2006 session. Maryland currently has a uniform response to substantiated cases of child abuse and neglect. Under a system of differential response, the severity of child abuse or neglect being reported would dictate the response of the State. In cases when reports of child abuse or neglect are indicated but not substantiated, differential response seeks to prevent child abuse or neglect by offering services to families at-risk of child abuse or neglect.

## Child Welfare Accountability Legislation

During the 2005 session, the General Assembly considered House Bill 1197 – Child Welfare Accountability Act of 2005. This legislation was based upon the recommendations of the *Child Welfare Accountability Task Force Report*. House Bill 1197 sought to create an outcome measurement system for the delivery of child welfare services as well as a county self-assessment system for local jurisdictions to measure the delivery of child welfare services. House Bill 1197 was passed by the House and the Senate Finance Committee but due to time constraints was never considered by the full Senate.

The House Committee on Appropriations workgroup reconvened during the 2005 interim, with members from the Senate Finance Committee joining the workgroup, to develop child welfare accountability legislation for introduction during the 2006 session. Testimony heard by the workgroup indicated that to effectively allocate resources for child welfare it is necessary to measure the quality of the services being delivered. Therefore, legislation developed by the workgroup will likely focus on developing a child welfare accountability system that relies upon the State working with local jurisdictions to develop outcome measures for the delivery of child welfare services. The workgroup will also consider creating an independent monitor or ombudsman to monitor the State's child welfare system.

The State appears to be making progress in meeting CWLA caseload standards for child welfare caseworkers and supervisors. DHR testified to the workgroup that it is meeting the requirement set forth in budget language by the General Assembly that the department employ at least 1,863 caseworkers and supervisors in an effort to meet CWLA caseload standards.

For further information contact: Malachy Rice/David A. Smulski Phone: (410) 946/(301) 970-5510

# Social Programs

## Juvenile Justice

**The General Assembly continues to focus on conditions at the facilities operated by or under the jurisdiction of the Department of Juvenile Services and is likely to make juvenile services reform a high priority.**

### U. S. Department of Justice Investigation

Reports of abuses at various Department of Juvenile Services (DJS) facilities have been in the news over several years. In August 2002, the U. S. Department of Justice informed then-Governor Parris Glendening that it was investigating the conditions at Cheltenham Youth Facility and Charles H. Hickey, Jr. School (Hickey School). The focus of the investigation was the physical safety, health care, and education of the residents to determine if there were violations of constitutional or federal law.

Investigators conducted inspections of those facilities between April and June 2003 and issued findings of numerous deficiencies relating to violence, lack of services, and understaffing in April 2004. In June 2005, the Department of Justice and DJS reached a settlement agreement regarding the deficiencies in which the State agreed to undertake remedial measures, including:

- ***Suicide Prevention:*** includes suicide risk assessments, additional supervision of youth at risk of self harm, restrictions for suicidal youth, and documentation of suicide precautions;

- ***Protection from Harm:*** includes reporting of staff misconduct and youth-on-youth violence, uses of force, and restraint practices;

- ***Mental Health:*** includes providing adequate mental health treatment, designating a director of mental health for DJS, providing mental health screenings and assessments, and considering mental health issues when making housing decisions;

- ***Medical Care:*** includes providing adequate, appropriate, and timely medical and dental care, including treatment of acute and chronic medical conditions, conducting adequate health assessments for youth on entry or reentry to the facilities, and developing and implementing standards for medication administration; and

- ***Special Education:*** includes providing of special education services under the Individuals with Disabilities in Education Act, screening for special education needs, and individualized education plans.

## Department of Juvenile Services Reform Act of 2005 – Veto by Governor

The General Assembly passed House Bill 979 of 2005 that would have established a joint oversight committee to review the operations of DJS and monitor its progress in developing and implementing the Facilities Master Plan required by Chapter 431 of 2004. The committee also would have been authorized to recommend legislation to improve DJS and investigate any matter concerning DJS or services to juveniles under its jurisdiction.

House Bill 979 was vetoed by the Governor as duplicative of the functions performed by standing committees of the General Assembly. After the veto, the House Appropriations Committee formed a Juvenile Services Workgroup, which has been examining issues such as the closing of the Hickey School, implementation of the Facilities Master Plan, mental health services for youth under DJS jurisdiction, and commitment options for youth with special needs. (More information can be found in the paper "Closure of the Charles Hickey School" elsewhere in this section.)

## Department of Juvenile Services Facilities Master Plan

DJS has contracted with Development Services Group to prepare its Facilities Master Plan. A preliminary report regarding the plan was presented to the General Assembly in January 2005. In addition to making programmatic recommendations, the report set the stage for the decisions necessary to finalize the plan.

The final report from DJS is due to the General Assembly during the 2006 session. Development Services Group has completed tours of all DJS-operated facilities and has held several strategy sessions with DJS staff. The closure of the programs at the Hickey School presents additional challenges to the completion of the plan.

# Transportation

## Major Changes in the Consolidated Transportation Program

**The Maryland Department of Transportation's draft 2006 Consolidated Transportation Program lists all capital projects funded in the current fiscal year as well as those planned for the next five years. Projected State funding in the 2006 draft six-year program decreases by 4.7 percent; federal aid is projected to decrease by 10.8 percent.**

### Overview

The Maryland Department of Transportation publishes an annual *Consolidated Transportation Program* (CTP) that lists all transportation capital projects funded in the current fiscal year and those planned for the next five years. **Exhibit 1** compares last year's proposed six-year program with the six-year program contained in the draft 2006 CTP.

**Exhibit 1**
**Comparison of Proposed Capital Program**
**($ in Millions)**

| | 2005-10 CTP | 2006-11 Draft CTP | Change | Percent Change |
|---|---|---|---|---|
| **State Funds** | | | | |
| Special Funds | $4,848.6 | $4,704.8 | -$143.8 | -3.0% |
| Other Funds* | 846.6 | 724.2 | -122.4 | -14.5 |
| Subtotal State Funds | 5,695.2 | 5,429.0 | -266.2 | -4.7 |
| **Federal Aid** | 3,598.2 | 3,210.1 | -388.1 | -10.8 |
| **Total Funds** | **$9,293.4** | **$8,639.1** | **-$654.3** | **-7.0%** |

*Other funds include proceeds from the sale of bonds issued by the Maryland Transportation Authority and the Maryland Economic Development Corporation, customer and passenger facility charges collected by the Maryland Aviation Administration, and certain types of federal aid that do not pass through the Transportation Trust Fund.

Source: Maryland Department of Transportation, 2006 Draft *Consolidated Transportation Program*

The funding level projected in the 2006 six-year program decreases by $654.3 million (7 percent) from the six-year funding level in the 2005 CTP. Special funds decrease by $143.8 million (3 percent), primarily due to cash flow changes in the capital program. Cash flow changes are often attributable to projects deferred to later years, projects ending, and project delays. In particular, the State Highway Administration and the Maryland Transit

Administration (MTA) had several large construction projects that ended or were decreased. Other funds decrease by $122.4 million (14.5 percent); much of this change is due to progress on Baltimore/Washington International Thurgood Marshall Airport's $1.8 billion construction program. Several large projects were recently completed or are winding down.

## Changes in Federal Aid

Federal aid to Maryland's capital program is estimated to decrease by $388.1 million (10.8 percent). However, these numbers are likely to change given the recent authorization of "Safe, Accountable, Flexible and Efficient Transportation Equity Act – A Legacy for Users" (SAFETEA-LU). Under the new authorization, Maryland expects to receive an average of $583.2 million per year in highway funds from fiscal 2005 through 2009 and will receive additional aid for transit projects. The final 2006-2011 CTP will account for SAFETEA-LU.

## Summary of Major Changes

As shown in **Exhibit 2**, projects totaling $50 million were added to the construction program, a $45.2 million project was moved from the development and evaluation (D&E) program to the construction program, and $14.6 million in projects were added to the D&E program. Exhibit 2 also shows a number of projects that have experienced construction schedule delays; many of these are MTA projects dealing with compliance and negotiation setbacks.

**Exhibit 2**
**Major Changes in the 2006**
***Consolidated Transportation Program***
**($ in Millions)**

**Projects Added to the Construction Program**

| | <u>**Project Description**</u> | <u>**Cost**</u> |
|---|---|---|
| MAA | Concourse D/E Baggage Screening System and Baggage Claim Expansion at BWI | $28.7 |
| SHA | MD 201 Kenilworth Avenue; Bridges over Amtrak, MD 965, and Bever Dam Branch (Prince George's) | 15.4 |
| MPA | Fruit Slip Fill | 3.9 |
| MVA | Accounts Receivable System and Flag Fee Processing | 2.0 |
| | **Total** | **$50.0** |

**Projects Moved from the D&E Program to the Construction Program**

| | | |
|---|---|---|
| MAA | Concourse B/C Baggage Screening System and Baggage Claim Expansion at BWI | **$45.2** |

**Exhibit 2 (continued)**

## Projects Added to the D&E Program

| | Project Description | Cost |
|---|---|---|
| SHA | US 301, Waldorf Planning Study (Prince George's, Charles) | $5.0 |
| MAA | Airport Administrative Office Building at BWI | 4.0 |
| MVA | REAL ID Act Implementation | 3.5 |
| MAA | Runway Safety Area Improvements at BWI | 0.7 |
| SHA | MD 197, Collington Road; MD 450 to Kenhill Drive (Prince George's) | 0.6 |
| SHA | MD 822, University of Maryland Eastern Shore Access Road, Construct roundabouts at MD 675 and College Backbone Road (Somerset) | 0.3 |
| MAA | Midfield Complex – Airport Operations and FBO Facility at Martin State Airport | 0.2 |
| MAA | Midfield Complex – Second Aircraft Hanger at Martin State Airport | 0.2 |
| MAA | Northwest Quadrant Airfield Perimeter Roadway at BWI | 0.1 |
| | **Total** | **$14.6** |

## Construction Schedule Delays

| | Project Description | Comment | Fiscal Year |
|---|---|---|---|
| MAA | Interim Airport Layout Plan Environmental Assessment at BWI | Planning delay result of late contract start | 2005 to 2006 |
| MTA | Owings Mills Joint Development | Delay in construction due to Master Agreement | 2005 to 2006 |
| MTA | Agencywide Elevator Rehabilitation | Delay due to additional repairs and compliance with ADA | 2005 to 2006 |
| SHA | MD 732, Guilford Road; Replace Bridge 13029 over CSX Railroad (Anne Arundel, Howard) | Delay in acquisition of needed Right-of-Way | 2005 to 2006 |
| MTA | Halethorpe MARC Station Improvements | Delay due to pending review of Phase II by Amtrak | 2006 to 2007 |
| MTA | Odenton MARC Station Parking Expansion | Delay due to additional repairs and compliance with ADA | 2006 to 2007 |
| MTA | MARC Maintenance, Layover and Storage Facilities | Delay due to negotiations with railroads | 2008 to 2009 |

ADA – Americans with Disabilities Act
BWI – Baltimore/Washington International Thurgood Marshall Airport
FBO – Fixed Base Operator
MAA – Maryland Aviation Administration
MARC – Maryland Rail Commuter
MPA – Maryland Port Administration
MTA – Maryland Transit Administration
MVA – Motor Vehicle Administration
SHA – State Highway Administration

Source: Maryland Department of Transportation, 2006 Draft *Consolidated Transportation Program*

# Transportation

## Federal Reauthorization of Transportation Aid

**Federal transportation authorization was recently enacted, providing $286.4 billion in guaranteed funding from federal fiscal 2004 through 2009. Maryland will benefit by increases in guaranteed funding, increases in average annual highway funding, and $602.7 million in earmarks.**

### Background

On August 10, 2005, President George Bush signed the "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. The previous authorization, "Transportation Equity Act for the 21st Century" (TEA-21), expired on September 30, 2003. However, recurring disagreement on funding levels and distribution caused a delay in passing new authorization. TEA-21 was extended 12 times, and nearly 2 years passed before SAFETEA-LU was enacted.

SAFETEA-LU will provide $286.4 billion in guaranteed funding for federal highway, transit, and safety programs from federal fiscal 2004 through 2009. This significant increase over TEA-21 will provide $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.

### What Does SAFETEA-LU Mean for Maryland?

There are three issues related to SAFETEA-LU of particular interest for Maryland: (1) the minimum amount of revenue returned to states; (2) average annual highway funding; and (3) earmarks for highway and transit projects.

#### Minimum Guarantee Levels

Federal funding for surface transportation is obtained through the Highway Trust Fund (HTF). The primary source of revenue for the HTF is the 18.4 cents per gallon tax on gasoline and the 24.4 cents per gallon tax on diesel fuel. Although there are other sources of revenue for the HTF such as excise taxes levied on tires and heavy trucks, fuel taxes provide about 90 percent of the revenue.

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. This guarantee is important because Maryland, along with more than a dozen other donor states (states that receive less funds than they contribute) would, in the absence of the guarantee, receive back lesser amounts under the basic transportation aid formulas.

## Average Annual Highway Funding

The expected average annual highway 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. By way of comparison, the average increase in funding for all states is 30.3 percent.

## Earmarks

Maryland received numerous earmarks under SAFETEA-LU for both highways and transit. SAFETEA-LU includes more than $20 billion in money earmarked for some 6,300 specific projects. 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. The Maryland share represents 3 percent of the total dollar amount earmarked.

All highway earmarks count within the minimum guarantee formula. In other words, earmarks received by Maryland count toward the annual average of $583.2 million expected under SAFETEA-LU. There are five Maryland projects that are outside the minimum guarantee formula that amount to $27 million. This includes $10 million for the InterCounty Connector under the National Corridor Infrastructure Improvement Program and $17 million in four projects under the Transportation Improvements section.

All highway earmarks require an 80/20 federal/state match in funds. For example, Maryland received a $12 million earmark for construction and dualization of US 113 in Worcester County. The State contribution is $3 million (20 percent of $15 million total) and the federal contribution is $12 million (80 percent of $15 million total). Transit earmarks for bus projects work the same way; each earmark requires an 80/20 match in funds.

Transit earmarks for new start rail projects do not always follow the 80/20 match. These projects are more dependent on the annual appropriations process, and the split can change depending on the project. For example, Maryland received $102.3 million in an earmark for the Baltimore red line/green line transit project. However, this amount of money may change with the annual appropriations process. Both highway and transit earmarks only represent a portion of the total project cost, with the remaining amount funded through a varying mix of State and federal funds.

For further information contact: Jonathan D. Martin Phone: (410) 946/(301) 970-5530

# Transportation

## REAL-ID Act

**With the passage of the "REAL-ID Act" of 2005, all states will need to meet federal guidelines regarding driver's licenses and personal identification cards; regulations are expected in late 2005. Costs to implement the law in Maryland could be significant.**

### Background

On May 11, 2005, President George Bush signed the Emergency Supplemental Appropriation for Defense, the Global War on Terror, and Tsunami Relief, 2005 (H.R. 1268; P.L. 109-13) which included the REAL-ID Act ("the Act"). The Act requires federal agencies (*e.g.*, airline security and federal buildings) on or after May 11, 2008, to only accept personal identification (ID) cards and/or driver's licenses that have met certification standards. The legislation contains a number of provisions outlining broad requirements for the issuance of driver's licenses or personal ID cards. Specifically, the Act establishes standards for driver's licenses and documents, issuance of driver's licenses and personal ID cards, federal uses, immigration requirements, identity and document verification, data retention and storage, security and fraud prevention, and linkages with state databases. The Act requires the U.S. Department of Homeland Security (DHS), in consultation with the U.S. Department of Transportation, to adopt regulations clarifying the Act's provisions. These regulations are expected to be issued later in 2005.

### What Does REAL-ID Do?

The Maryland Department of Transportation's Motor Vehicle Administration (MVA) is the State entity responsible for issuing State personal ID cards and driver's licenses and as a result will be responsible for implementing the Act. While DHS has the final authority to clarify the Act through regulation, the following are some of its broad provisions.

- **Uniformity of Data:** The Act requires uniformity amongst all states in the design and information contained on a personal ID card and driver's license. For example, personal ID cards or driver's licenses would need to have common machine-readable technology, present an individual's full name, address, and signature, have an identification number, a digital photograph, and contain physical features that would prevent tampering or counterfeiting. The current Maryland license already meets many of the requirements outlined in the Act including an individual's address and signature, a digital photograph, machine-readable technology, and counterfeiting measures. As a result, the changes to the current Maryland license and personal ID card may not be significant.

- **Document Verification:** The MVA will also be required to verify all documents submitted for a personal ID card or driver's license. To do this, an individual will need to present documentation of the individual's date of birth, proof of a Social Security account number, and documentation of the individual's principle residence. The MVA must then verify the validity and completeness of the documentation with each document issuing entity. As a result, individuals are unlikely to have same day service, as the verification process will be time intensive. The document verification aspect of the Act will likely require staff training on how to detect fraudulent documents as well as an understanding of what documents are acceptable.

  As part of the verification process, the MVA will be required to confirm that an individual is legally permitted to reside in the country. Maryland is one of 11 states that do not require individuals to be considered "lawfully present" to obtain a personal identification card or driver's license. To conform to the provisions in the Act, the General Assembly will need to adopt legislation requiring individuals to demonstrate that they are legally residing in the country.

- **Security Measures:** States are also required to adopt data and physical security measures to protect the information collected. For example, each state will have to perform background checks on individuals authorized to manufacture personal ID cards or driver's licenses. States will also be required to maintain digital images of identity source documents for at least 10 years. This information will also need to be made available to all other states for electronic access.

## What Will REAL-ID Cost?

The cost to Maryland to implement the Act is uncertain. In the draft Consolidated Transportation Plan for fiscal 2006 − 2011, the MVA has budgeted $3.5 million to implement the Act. The Act authorizes DHS to provide grants to states to assist in conforming to minimum federal standards. As of late October 2005, the Senate has included $100 million in the DHS appropriation while the House has appropriated $40 million for all 50 states. The bill is in conference and it is unknown how much, if any, assistance Maryland can expect through this grant program.

Chapter 9 of 2004, requires the MVA to set the level of its miscellaneous fees, which includes all fees except the Vehicle Emissions Inspection Program fees, titling taxes, and vehicle registration fees, to cover 95 to 100 percent of its operating and capital expenditures. Any additional capital investment or increased operating expenditures resulting from the Act's implementation will result in fee increases or reductions in other areas. To perform the Act's information verification portion, the MVA will likely need to hire additional staff or contract with a third party to perform these services.

For further information contact: Jonathan D. Martin Phone: (410) 946/(301) 970-5530

# Transportation

## Joint Legislative Commission on the Maryland Port Administration

**The Joint Commission on the Maryland Port Administration has examined several issues relevant to the Port of Baltimore during the 2005 interim. Legislation is anticipated for the 2006 session.**

### Background

During the 2005 session, the General Assembly became concerned with issues relating to the Port of Baltimore, including the resignation of the Maryland Port Administration's (MPA) executive director, security issues, and governance issues. Furthermore, early in the 2005 interim, Mercer Management Consulting completed a report (the Mercer Report) regarding port governance and other relevant port issues. Consequently, the presiding officers established the Joint Commission on the Maryland Port Administration (joint commission) to conduct a comprehensive study of these issues. The joint commission was specifically charged with examining port issues related to governance (including structure and personnel), the adequacy of resources for sustained operations, security and vulnerability, infrastructure (including dredging and dredge material management), the sale of the World Trade Center, and the development of a new cruise terminal in South Locust Point.

### Possible Joint Commission Recommendations

MPA, an agency within the Maryland Department of Transportation (MDOT), operates the Port of Baltimore. The seven-member Maryland Port Commission (MPC), chaired by the Secretary of Transportation, oversees MPA. The joint commission has examined whether this structure limits MPA's flexibility and executive authority and thus hinders MPA's ability to operate in the highly competitive business environment of the maritime industry. The joint commission has considered recommending legislation to recreate MPA as an independent agency free of control by MDOT and oversight by a body, MPC, chaired by the Secretary of Transportation. In the alternative, the joint commission has considered recommending legislation to increase the authority of MPA's executive director.

MPA currently receives its operating funds from MDOT through the Transportation Trust Fund. If legislation were enacted to recreate an independent MPA, the joint commission recognized the need for legislation to establish an independent funding stream for MPA's operational costs. The joint commission examined various solutions to this problem, including granting MPA bonding authority or establishing dedicated funding.

MPA currently operates under a procurement process that requires multiple reviews by MPA, MPC, MDOT, and other outside agencies. This process hampers MPA's ability to compete with other ports, some of which are not bound by their states' procurement laws. As a result, the joint commission has considered recommending legislation to streamline the procurement process for MPA.

According to the Mercer Report, restrictions imposed by MDOT's personnel system "make it difficult to recruit and retain key staff with the industry skills and experience needed to develop and execute port strategy." This problem has been partially addressed by exempting 12 key staff positions from the caps imposed by the State personnel system. The joint commission has considered legislation to increase the number of MPA staff positions exempt from the State personnel system. In the alternative, the joint commission has considered legislation requiring MPA to perform a detailed analysis of additional positions that should be exempt from the State personnel system.

The joint commission is in the process of finalizing its recommendations and should have both recommendations and draft legislation in time for the 2006 session.

For further information contact: T. Patrick Tracy Phone: (410) 946/(301) 970-5350

# Economic and Community Development

## Sunny Day Fund

**Since its inception in 1988, 103 projects, including 3 with multiyear commitments, have received funding from the Sunny Day Fund, for a total commitment of $167.9 million. The number of projects has decreased over the last few years. With about $13.5 million in uncommitted funds available, a few new projects are anticipated during fiscal 2006.**

### Overview

The Economic Development Opportunities Program (Sunny Day) Fund was created in 1988 to enhance Maryland's competitive position with neighboring states. The Department of Business and Economic Development (DBED) administers the fund, which has been increasingly reserved for large-scale projects. The Legislative Policy Committee (LPC) must review and comment on proposed Sunny Day projects before DBED can approve expenditures. The fund provides conditional loans and conditional grants to (1) attract, retain, and expand private-sector enterprises in the State; (2) retain and expand existing public institutions, private institutions, or federal research and development institutes; and (3) establish or attract public institutions, private institutions, or federal research and development institutes to the State.

As shown in **Exhibit 1**, LPC has approved conditional loan and grant funds of $167.9 million for 103 projects in 16 different counties from the Sunny Day Fund since its inception. On a regional basis, approximately 79 percent of the projects and 87 percent of the Sunny Day funds have been targeted to the Washington and Baltimore regions. No new transactions were approved in fiscal 2004, and one new transaction was approved in fiscal 2005. Specifically, in 2005, LPC approved the use of $2 million of Sunny Day funds to assist the University of Maryland Baltimore County with the development of a research and technology park. The level of activity has diminished significantly over the last four years, reflecting reduced appropriations due to State budgetary constraints, as well as a shift to the Maryland Economic Development Authority Assistance Fund for smaller projects.

**Exhibit 1**
**Approved Sunny Day Fund Projects**
**Fiscal 1988 through 2005**

| County | Number of Projects | Total Funding |
|---|---|---|
| Anne Arundel | 9 | $17,050,000 |
| Baltimore City | 12 | 16,413,000 |
| Baltimore | 18 | 30,760,000 |
| Caroline | 1 | 800,000 |
| Carroll | 3 | 4,150,000 |
| Cecil | 1 | 2,275,000 |
| Dorchester | 1 | 1,200,000 |
| Frederick | 3 | 7,500,000 |
| Garrett | 3 | 3,850,000 |
| Harford | 5 | 11,250,000 |
| Howard | 7 | 7,872,000 |
| Kent | 1 | 750,000 |
| Montgomery | 15 | 31,925,000 |
| Prince George's | 7 | 15,425,000 |
| Washington | 6 | 8,400,000 |
| Wicomico | 2 | 3,000,000 |
| Statewide/Regional | 9 | 5,300,000 |
| **Total** | **103** | **$167,920,000** |

Note: Although LPC has approved funding for 129 projects, the actual number of projects that received funds is reduced to 103 due to the withdrawal of 26 projects.

Source: Department of Legislative Services

## Project Requirements and Monitoring

Projects for which Sunny Day funds are requested must contain performance requirements such as job creation and retention and capital investment. The accuracy of this data is critical since loan agreements often provide for forgiveness of all or a portion of the loan if the performance requirements are met. As shown in **Exhibit 2**, full or partial forgiveness has been provided to 33 projects, amounting to $33.2 million of forgiveness against $36.6 million of original loan and conditional grant totals since the program began.

**Exhibit 2**
## Forgiven Loans and Claw-backs
**Fiscal 1988 through 2004**
**($ in Millions)**

| | Number of Projects | Amount | Original Loan Amount |
|---|---|---|---|
| Forgiven Loans | 33 | $33.2 – forgiven | $36.6 |
| Claw-backs | 19 | $11.5 – repaid | $18.7 |

Source: Department of Business and Economic Development

A 2005 legislative audit of DBED's activity between fiscal 2001 and 2004 disclosed significant problems regarding the quality of information related to job creation and retention. Specifically, DBED did not reconcile discrepancies between employment information provided by the Department of Labor, Licensing, and Regulation and the employment information provided by the loan recipient. In some cases, the differences in employment data could have been significant enough to affect the loan forgiveness decision. This audit finding is a repeat finding that was first disclosed in the fiscal 2001 audit of DBED's performance measures and then again in the fiscal 2003 follow-up audit of the same performance measures. In response to these findings, DBED has taken measures to improve its data gathering, including a centralized customer relationship system.

Alternatively, if a project fails to meet established performance requirements, DBED may invoke claw-back provisions that were set forth under the funding agreement. To date, a total of 19 projects have been subject to claw-back, with a total amount repaid of $11.5 million against original funding of $18.7 million. The original funding includes transactions that may have had partial forgiveness, as well as repayment due to nonperformance. Not reflected in Exhibit 2 are three companies in the portfolio that currently are in bankruptcy or have a parent that is in bankruptcy for an aggregate of $8.5 million. DBED continues to monitor the business activities of these distressed operations and will support any potential restructuring resulting in continued employment that stays within the original scope of the projects.

As shown in **Exhibit 3**, based on anticipated principal and interest repayments of $3.8 million, it is likely that $13.5 million will be available to support Sunny Day Fund commitments in fiscal 2006. This is an increase of $7.7 million over the fiscal 2005 available balance primarily due to higher-than-anticipated fiscal 2005 principal and interest repayment.

**Exhibit 3**
## Maryland Economic Development Opportunities Program Fund (Sunny Day Fund)
**($ in Millions)**

| | |
|---|---|
| Beginning Fiscal 2006 Balance | $23.7 |
| Projected Fiscal 2006 Principal and Interest Repayment | 3.8 |
| Operating Expenses for Fiscal 2006 | (1.0) |
| Committed Funds | (13.0) |
| **Total Uncommitted Funds Available (as of October 20, 2006)** | **$13.5** |

Source: Department of Business and Economic Development

# Economic and Community Development

## Hurricane Isabel Disaster Relief Act of 2004

**The Hurricane Isabel Housing Rehabilitation and Renovation Program has provided over $12 million in low-interest loans and other assistance to victims hit hardest by Hurricane Isabel. Financial assistance extends through May 2006. The program has been recognized as a model for recovery efforts in the Gulf Coast states.**

### Background

Chapters 7 and 8 of 2004 created the Hurricane Isabel Housing Rehabilitation and Renovation Program (HIHRRP) in the Department of Housing and Community Development (DHCD) to provide streamlined assistance to residents whose homes were destroyed or severely damaged by Hurricane Isabel in September 2003 and whose insurance coverage and other financial resources fell short of meeting their housing needs. The law restructured existing State housing financial aid programs and created other types of financial assistance so that eligible homeowners can receive assistance from DHCD under three basic forms: low-interest loans for a first or subordinate mortgage to rehabilitate or renovate a primary residence; credit enhancement assistance to maximize eligibility for a loan obtained in the private market to rehabilitate, renovate, or replace a residence; and buy-down assistance to reduce for a limited period of time the amount a borrower pays on a loan obtained in the private market or from DHCD. Financial assistance under HIHRRP commenced March 29, 2004, and was originally scheduled to terminate May 31, 2005.

### Extension of the 2004 Act

While DHCD made progress in setting up and processing applications for financial assistance under HIHRRP, the General Assembly recognized the fact that not all hurricane victims had sufficient time to submit applications for assistance and DHCD needed more time to process all applications. Chapter 599 of 2005 extended the termination date of the Hurricane Isabel Disaster Relief Act of 2004 by one year, to May 31, 2006. In addition, the 2005 legislation added an interim report from DHCD due by September 30, 2005, and a requirement that applications for financial assistance be received by DHCD by September 30, 2005, for consideration for financial assistance through May 31, 2006.

## Interim Report on Assistance Provided by DHCD

### Low-interest Loans

DHCD reports as of September 30, 2005, that nearly all of the allocated funds for HIHRRP have been committed as low-interest loans. Under this assistance program, as shown in **Exhibit 1**, DHCD has made 188 loans to date (37 percent of the 509 total applications received) totaling $12,157,148, primarily to residents of the counties hit hardest by Hurricane Isabel: Anne Arundel County, Baltimore County, and Dorchester County. DHCD reports that it has given priority to families who were relocated into temporary housing by the Federal Emergency Management Agency. Of the applications, 60 percent require no State funding and are closed, and 3 percent are still pending review.

DHCD reports that the initial allocation of funds for HIHRRP was $7.5 million, including $4.5 million from the Special Loan Program and $3 million from the Dedicated Purpose Account of the State Reserve Fund. Due to the overwhelming demand for assistance, DHCD reports that an additional allocation of $800,000 was provided from the Catastrophic Event Account of the State Reserve Fund, and DHCD allocated $5 million from unappropriated special fund balances within the Homeownership Programs Fund. Thus, total allocations to date to HIHRRP are $13.3 million.

### Other Assistance

Under the credit enhancement assistance program, DHCD reports that no funds have been expended because lenders participating in this program have found that applicants already have sufficient value in their properties to meet loan to value requirements and, thus, do not need the credit enhancement available under the program. Under the buy-down assistance program, DHCD reports that it has received 15 applications to date (10 from Baltimore County, 2 from Anne Arundel County, and 1 each from Dorchester, Harford, and St. Mary's counties) and that it has been able to fund this assistance using resources totaling $192,927.

DHCD reports that it was also able to provide financial assistance of $200,000 to two inter-faith groups, Eastern Shore Interfaith Recovery Team (ESIRT) and the Maryland Interfaith Recovery Team (MIRT), which assist homeowners with essential repairs. The work of ESIRT was reportedly finished in September 2004. After some organizational challenges, MIRT apparently began work in 2005 and is continuing to serve families affected by Hurricane Isabel.

**Exhibit 1**
**Maryland Department of Housing and Community Development**
**Implementation of Hurricane Isabel Disaster Relief Act**
**Application State Summary**
**As of September 30, 2005**

| | | Applications Funded | | Applications Closed (No State Funding Required) | | | Applications Under Review | |
|---|---|---|---|---|---|---|---|---|
| | | State Loans Committed/Closed | | | | | | |
| County | Total Applications Received | Number | Dollar | Ineligible | Inactive | Referred to Private Lenders | Under Construction Review | Under Underwriting Review |
| Anne Arundel | 96 | 42 | $2,976,445 | 40 | 0 | 11 | 3 | 0 |
| Baltimore City | 39 | 3 | 48,642 | 34 | 0 | 2 | 0 | 0 |
| Baltimore | 171 | 69 | 4,331,488 | 78 | 0 | 23 | 0 | 1 |
| Calvert | 10 | 2 | 174,243 | 2 | 0 | 1 | 2 | 3 |
| Cecil | 8 | 4 | 253,838 | 4 | 0 | 0 | 0 | 0 |
| Charles | 3 | 0 | 0 | 2 | 0 | 0 | 0 | 1 |
| Dorchester | 84 | 40 | 2,654,405 | 36 | 0 | 2 | 4 | 2 |
| Frederick | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 0 |
| Garrett | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 0 |
| Harford | 7 | 0 | 0 | 7 | 0 | 0 | 0 | 0 |
| Kent | 11 | 3 | 219,644 | 6 | 0 | 1 | 1 | 0 |
| Prince George's | 34 | 4 | 86,443 | 28 | 0 | 2 | 0 | 0 |
| Queen Anne's | 10 | 5 | 360,183 | 5 | 0 | 0 | 0 | 0 |
| St. Mary's | 12 | 5 | 365,619 | 5 | 0 | 1 | 1 | 0 |
| Somerset | 14 | 7 | 425,998 | 6 | 0 | 0 | 0 | 1 |
| Talbot | 8 | 4 | 260,200 | 3 | 0 | 1 | 0 | 0 |
| **Totals** | **509** | **188** | **$12,157,148** | **258** | **0** | **44** | **11** | **8** |

Source: Maryland Department of Housing and Community Development

## DHCD Receives National Award for HIHRRP

In September 2005, DHCD received the President's Award for Innovation from the Council of State Community Development Agencies for HIHRRP. DHCD reports that this is a national award that recognizes the unique and innovative aspects of HIHRRP, and that HIHRRP is being used as a model for recovery efforts in the Gulf Coast states that were impacted recently by Hurricane Katrina.

For further information contact: Laura P. Lodge Phone: (410) 946/(301) 970-5350

# Economic and Community Development

## Maryland Military Installation Strategic Planning Council (BRAC)

**With the end of the Cold War, the federal government has been undertaking a long-term strategy to realign the nation's military, which has resulted in base closures and reassignments. Maryland has a significant number of sizable military installations that have become an integral part of the communities in which they are located. This year's BRAC has yielded mostly positive results for Maryland.**

### The BRAC Process

In 1990, Congress created a process known as Base Realignment and Closure (BRAC) to address an excess capacity of military facilities. BRAC allows for the appointment of an independent commission that evaluates the military's needs and offers recommendations. The 2005 BRAC represents the first major base closure and realignment activity in 10 years. The federal Base Realignment and Closure Commission finished its work and submitted its recommendations to the President on September 8, 2005. The President chose not to require any revisions and submitted the report to Congress a week later. Congress has 45 legislative days (which will expire by mid-November) to either accept or reject the report in its entirety; Congress may not make revisions to the report. If Congress fails to act, the recommendations in the report become binding.

#### Maryland Military Installation Strategic Planning Council

After the current BRAC process was activated, the General Assembly created the Maryland Military Installation Strategic Planning Council in 2003 to coordinate State agency planning in response to any changes caused by BRAC and serve as an advocate for Maryland military facilities in the process. The 19-member council was slated to terminate on December 31, 2005, but its term was extended to December 31, 2007, under Chapter 240 of 2005. The council, comprised of State agency representatives and military installation leaders, participated in BRAC hearings and conducts informational briefings for all affected State agencies to monitor developments in the planning process.

### 2005 BRAC's Effects on Maryland

The commission's report contains several recommendations that affect military installations in Maryland. Based on the BRAC report, the potential effects on Maryland are detailed below. It is widely recognized that the Department of Defense's modeling methodology is outdated and regularly underestimates the impact, and the Maryland Department of Planning expects the final impact to be greater than what is represented here but these are the best estimates at this time.

| Base | Proposed Change | Estimated Employment Change per BRAC Model |
|---|---|---|
| Aberdeen Proving Ground | Absorb certain Army procurement and material management functions currently performed at Ft. Monmouth (NJ). Become a center for electronic warfare research by absorbing functions currently performed at Ft. Belvoir (VA) and absorb Army research institute now at Ft. Knox (KY) | Gain of 1,861 jobs |
| Fort Meade | Absorb the Joint Network Management System Program Office | Gain of 10,231 jobs |
| Martin State Air Guard Station | Reassign eight 130J cargo planes to other bases | Loss of 237 jobs and loss of 8 aircraft |
| Naval Station (Annapolis) | Minor realignment | Loss of 25 jobs |
| Flair Army Reserve Center (Frederick) | Closed | Loss of 37 jobs |
| Fort Detrick | Minor realignment | Gain of 185 jobs |
| National Naval Medical Center | Close the Walter Reed Medical Center (WRMC) in Silver Spring and move several WMRC functions to the National Naval Medical Center in Bethesda | Gain of 4,878 jobs |
| Naval Surface Weapons Station | Minor changes | Gain of 11 jobs |
| Army Research Laboratory | Minor realignment | Loss of 82 jobs |
| Ewvra Sheppard Air Guard Station (Hagerstown) | Minor realignment | Gain of 17 jobs |
| Defense Finance and Accounting Service (Patuxent River) | Closed | Loss of 123 jobs |
| Naval Air Station (Patuxent River) | Minor changes | Gain of 201 jobs |

Source: BRAC Report of 2005

In total, Maryland may gain a minimum of approximately 15,837 and possibly many more new military and civilian jobs as a result of the BRAC recommendations, which will be phased in over a five- to six-year period. With the bulk of the gains at Aberdeen, Fort Meade, and the new Walter Reed National Military Medical Center, most of these jobs are projected to be medical professionals, engineers, and management positions.

## Additional Effects

In addition to the job gain, there will be an influx of the employees' families, which may swell the total number of new residents to over 50,000. Since the bulk of this increase will be concentrated in three geographical areas (primarily Harford, Anne Arundel, and Montgomery counties), there is the potential that the new residents will strain public services and affect the local area job market. The expansion projected by the BRAC decision will prompt discussions of possible expansions (and appropriations) for schools, roads, social services, and environmental systems such as water and sewer.

There are no reliable estimates yet for the infrastructure impact that this influx will have because Congress has not made a final decision to accept the BRAC recommendations (at publication time). The Maryland Department of Planning is waiting for Congress' final disposition before generating its estimates, which will be used by other State agencies in planning any future infrastructure changes. However, the impact will be significant. This is the largest economic impact from a single incident since World War II, and it will permanently change these communities in dramatic ways.

For further information contact: Brian Baugus/Ann Marie Maloney Phone: (410) 946/(301) 970-5530

# Business Regulation

## Horse Racing

**The horse racing industry in Maryland continues to experience changes and challenges. Purse supplements are higher in neighboring states. Further, as a result of video lottery terminals in Pennsylvania, Maryland may lose its distinction as the major racing state in the region. It is anticipated that there will be continued debate regarding Magna Entertainment's proposed restructuring plan to reduce the number of racing days and to sell the Bowie Race Course Training Center.**

### Maryland's Racing Industry at a Glance

Currently most thoroughbred racing in Maryland occurs at Pimlico Race Course in Baltimore City and Laurel Race Track in Anne Arundel County, both owned by Magna Entertainment Corporation (Magna). All standardbred racing occurs at Rosecroft Raceway in Prince George's County and Ocean Downs in Worcester County, which are independently owned. Limited racing also occurs at Timonium and Fair Hill. The State Racing Commission licenses each facility, and State law limits the number of track licensees. An additional track license was awarded to Allegany Racing in Allegany County, which has the same ownership as Ocean Downs. Allegany Racing has yet to begin construction on this track and most likely will not begin construction unless video lottery terminals (VLTs) are approved with Allegany Racing as one of the designated sites.

In addition to wagering at Maryland's racetracks, pari-mutual wagering also occurs at off-track betting facilities located in Frederick, Cecil, and Dorchester counties.

### State Assistance and Actions Regarding Maryland Racing

Horse racing in Delaware and West Virginia is succeeding because other forms of gaming, primarily VLTs, provide revenues for purses. Another way to enhance purses includes government grants. In the past, the General Assembly authorized the use of State funds to enhance racing purses. **Exhibit 1** shows that Maryland's financial support for racing is significantly lower than in Delaware and West Virginia. The purse amounts for Maryland largely come from money wagered on Maryland races. The pressure on Maryland racing is exacerbated by the fact that purse supplements from VLT revenues alone in Delaware and West Virginia have exceeded overall Maryland purses in recent years.

**Exhibit 1**
**Purse Supplements for Maryland, Delaware, and West Virginia**
**2000 – 2004**

| | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|
| **Maryland Racing** | | | | | |
| Overall Purses[1] | $66,977,573 | $53,949,589 | $51,055,640 | $47,555,931 | $38,774,905 |
| **Delaware Racing** | | | | | |
| Purses and VLT Purse Supplements | 57,503,164[2] | 66,977,733 | 79,837,594 | 72,636,289 | 74,320,794 |
| **West Virginia Racing** | | | | | |
| Purses and VLT Purse Supplements | 47,764,460 | 62,620,975 | 72,907,696 | 78,732,457 | 67,617,941[3] |

[1] Includes State purse supplements of $10 million in 2000 and $3.7 million in 2002.

[2] Does not include Harrington Raceway purses.

[3] Purse supplements only and are for fiscal 2005.

Source: Department of Legislative Services, Maryland Racing Commission Annual Reports, Delaware State Government Web Page, and West Virginia State Government Web Page

Although there have been no State funds provided for purse supplements in the past couple of years, the General Assembly has passed legislation allowing for the redirection of some racing revenues for purses at the Maryland Million. With State revenues exceeding expectations, legislation may be introduced during the 2006 session that would provide State funding for purse supplements.

## The Pennsylvania Effect

In addition to pressure from Delaware and West Virginia, Pennsylvania has legalized the placement of 61,000 VLTs in specific locations across the state. Although implementation has been delayed, it is anticipated that by late-2006 VLT gambling will be occurring in Pennsylvania. The number of machines proposed in Pennsylvania far exceeds the number of machines in Delaware and West Virginia, which means the amount of revenue generated in Pennsylvania may be substantial.

As a result of VLTs, Pennsylvania could eclipse Maryland as the major racing state in the region. For example, per day purses at Philadelphia Park are projected to go from $135,000 to $350,000 or higher. Purses at Laurel Park and Pimlico for 2004 were about $162,400 per day.

There is concern in the Maryland racing community that many horse breeders and horsemen will move to Pennsylvania.

## Rebuilding and Reconstituting Maryland Racing

In 2002, the Maryland Jockey Club sold a majority interest to Magna Entertainment Corporation, a company with racing interests across the nation. The sale gave Magna control over Pimlico and Laurel racetracks, a training facility in Bowie, and ownership of the Preakness. To date, Magna has spent approximately $40 million renovating barn areas, roadways, landscaping, and water and electrical systems at Pimlico and renovating and adding a "state-of-the-art" turf course at Laurel Park.

While there seems to be stability in the management of the State's major thoroughbred tracks, Maryland's major standardbred track, Rosecroft Raceway, continues to be in serious financial trouble. In mid-2002, the owners of Rosecroft Raceway decided to sell the track, and since then Rosecroft has been courted by several suitors. As a result of these multiple suitors, the owners of Rosecroft have been involved in several civil suits. Currently, interest in purchasing Rosecroft has waned, and actual racing is occurring only two days per week. To date, representatives of Rosecroft report that all litigation issues have been resolved and that the racetrack is not for sale, unless an extraordinary bidder emerges.

An issue that continues to affect the industry is the revenue sharing agreement between Magna and Rosecroft. For the past several years, based on the amount of business generated, out of all revenues realized by both groups, Magna received 80 percent and Rosecroft received 20 percent. That agreement expired in June 2004, and a subsequent agreement provides that Rosecroft pay Magna 12 percent of its revenue. In return the thoroughbred tracks may continue to receive simulcast signals after 6:15 p.m., and Rosecroft may receive simulcast signals during the day. That agreement expired on December 31, 2004. Since then, frequent contract extensions have continued the practice of Rosecroft paying Magna 12 percent of its revenues.

## Magna Entertainment's Restructuring Plan

In mid-2005, Magna proposed a "Plan for Maryland Thoroughbred Racing – 2006 and Beyond." Most discussions regarding Maryland racing this year have focused on the elements of this plan, which consists of two parts. The first part, which does not require legislation, would have reduced the number of live racing days from 200 days to 112 days in 2006. Racing days, however, must be approved by the Racing Commission. The 112 days would have been split by having 94 days at Laurel and 18 days at Pimlico. Laurel would have a 60-day "winter" meet and a 34-day "fall" meet, and Pimlico's 18 days would have occurred only around the Preakness in May. Magna claims that the new arrangement would have allowed daily purses during racing days to be competitive with surrounding states.

The Maryland horsemen and breeders opposed the reduction, claiming that the reduction in days was draconian and unnecessary. The Racing Commission rejected the proposal during its September meeting and directed the parties to work out the differences. Magna negotiated with the horsemen and breeders, but the parties failed to reach an agreement by the Racing Commission's November 8 meeting. The parties have been directed by the commission to have an agreement by December 1. The negotiations are centering around 160 live racing days in 2006 at Pimlico and Laurel and expense sharing among the parties.

The second part of Magna's proposal, which would require legislation, involves closing the Bowie Training Center. If the center is closed, Magna would realize an annual savings of $2.5 million, with 50 percent of the proceeds from sale of the facility proposed for physical improvements at Laurel. These improvements would include additional stables and barns for the horsemen to make up for those lost at the Bowie facility. The horsemen are concerned about losing the Bowie training facility, and the City of Bowie considers the facility valuable open space. Since the Bowie facility will most likely be the focus of legislative debate during the 2006 session, a more detailed description of the facility follows.

## The Bowie Race Course Training Center

Maryland law currently requires the owner of the Bowie Race Course Training Center to operate the center as a training facility and assume the costs to improve, maintain, and operate the center. No other state imposes a similar requirement. Legislation enacted in 1985 reduced the State wagering tax and closed Bowie for racing purposes but imposed certain requirements on Bowie's owners, such as operating and maintaining the facility. In 1986 Frank DeFrancis and his partners obtained ownership of Bowie and the majority of its real property through the purchases of Laurel and Pimlico. Since then, the Maryland Jockey Club and later, Magna Entertainment have owned and operated the Bowie training facility.

The Bowie Race Course Training Center Facility:

- consists of 178 acres, zoned rural/residential (two houses per acre), a small portion of which is in the flood plain of the Patuxent River;
- includes stalls, housing units, an indoor loping track, a mile outdoor track, a 5/8ths mile track, and other land (an unused grandstand was torn down);
- includes 925 stalls, with 617 filled as of November 2005, and 89 trainers;
- provides housing for 165 residents;
- employs 30 full-time and 12 part-time employees; and

- has about 50 to 100 businesses affiliated with the operations of the center, although many of these same businesses also supply products and services to Laurel and Pimlico.

**The Value of the Bowie Race Course Training Center**

The value of the facility varies by party. The assessed value of the real property is $2.3 million with annual operating costs of about $2.5 million. Since 2000, $2.5 million in capital improvements have been made to the facility, most of which ($1.9 million) went to tearing down the unused grandstand, paving, and sewer connections. The facility provides stalls and training tracks at a location relatively close to the two tracks. The horsemen benefit by having access to a training facility that includes housing for employees, without the obligation to contribute toward fixed costs of the facility, as long as they "meet the eligibility rules that the Commission or a licensee adopts."

The City of Bowie receives, by law, $50 per day when the training facility is open, which amounts to about $18,000 per year. If the facility is closed, however, Bowie would receive a final payment of about $7,500. Bowie recently annexed the property from Prince George's County, so it will receive a portion of the property tax that goes to the county. In light of the pending sale, there are proposals that would rezone or designate the area as "open space." A rezoning or designation would decrease the density to one house for every five acres and, thereby, significantly decrease Magna's potential proceeds from the sale of the facility.

Nevertheless, negotiations are ongoing between Magna and the City of Bowie, Prince George's County, and the Maryland horsemen regarding the fate of the Bowie training facility. In deliberating the closure of the Bowie facility important considerations for the General Assembly are:

- the current market value of the facility could be between $20 to $30 million; and

- there could be an agreement to convert the property to open space or to provide Magna with the ability to legally transfer the development rights of the property to another party for a negotiated price, either of which could be quite valuable.

# Business Regulation

## Retail Electric Restructuring

**The Senate Special Commission on Electric Utility Deregulation Implementation has been assessing the progress of the Electric Restructuring Law. Issues being discussed by the commission include allowing counties and municipalities to aggregate demand as a pilot program, the increase in fuel costs to run power plants, and the impact of the law on large industrial users that directly procure power. With rate cap restrictions expiring for BGE June 30, 2006, after a 7.5 percent reduction in 2000, interest in legislation to regulate total electric rates may resurface.**

### Implementation of Electric Restructuring and Standard Offer Service

The Electric Customer Choice and Competition Act of 1999 ("1999 Act") restructured the electric utility industry in Maryland, introducing "customer choice" of an electric supplier effective July 1, 2000. The electricity industry provides three main services: the generation of electricity; the transmission of that electricity on high-capacity lines to distribution networks; and the distribution of the electricity to customers. Before deregulation, the local electric utilities "bundled" these three services and provided them to their customers within their geographically defined monopoly service territories. While the generation component is deregulated, the transmission and distribution components remain regulated as monopoly services.

Two mechanisms were set in statute to protect customers from rate swings during the transition to customer choice: a mandated rate reduction (from 3 to 7.5 percent of base rates) and a rate cap through July 30, 2003. Settlement agreements negotiated in 1999 between the utilities and interested parties established the actual amount of the rate reduction and extended the date for how long the rate caps are in place.

Customer choice allows the customer to purchase electricity generated by other sources and have the electricity delivered over transmission and distribution lines of the local electric utility. However, the customer has the option to remain with the supplier of the local electric utility under the "standard offer service" (SOS). The commission determined in April 2003 that the market in Maryland had not developed to the point that the commission could relieve the utilities of their SOS obligation. Subsequently, a new settlement was negotiated with each utility to extend the obligation of the utilities to provide SOS in their respective service territories. The extension date varies by utility and customer class within each utility. For some utilities, the obligation to provide SOS ends as early as May 31, 2006, for some customer groups. For other utilities, the obligation ends as late as December 31, 2012, for some customer groups. SOS customers pay a bidded market price that is sufficient to provide the electric company with the opportunity to recover verifiable, prudently incurred costs to procure or produce the electricity plus a reasonable return. The commission reviews final bid results of the utilities' procurement of wholesale electric supply, retail prices charged to customers, and enrollment activity. SOS offering is based on an annual procurement of a portfolio of wholesale bids ranging in length from one to three years.

In March 2005, the commission reviewed the results of the competitive wholesale procurement bid process for residential, commercial, and industrial SOS customers in the territories of the four investor-owned utilities in which the caps were expiring by the end of June 2005. For residential SOS customers, the bid process was only in PEPCO and Delmarva's territories since the price caps for BGE and Allegheny Power had not expired. Of the 20 eligible bidders in the process, 8 suppliers won some portion of the overall load. Generally, in the PEPCO service territory, residential customers experienced a total annual bill increase of 4.5 percent effective July 1, 2005, compared to 16 percent the previous year. Delmarva residential customers had an increase of 5.8 percent on their total annual bill effective July 1, 2005, compared to 12 percent the previous year.

Currently, there are six licensed suppliers actively serving enrolled residential customers, 10 suppliers serving small commercial and industrial customers, 15 suppliers serving mid-size commercial and industrial customers, and 16 suppliers serving large commercial and industrial customers, with overlap among the customer classes. For generation, as of September 30, 2005, 1.5 percent of residential customers (or 1.9 percent of the load) and 6.7 percent (or 54 percent of the load) of commercial and industrial customers have switched to an electric supplier other than the SOS supplier.

All rate cap restrictions have expired for residential, commercial, and industrial customers with the exception of (1) BGE – residential distribution service and residential standard offer service – these rates are frozen (after a 7.5 percent reduction in 2000) until June 30, 2006; and (2) Allegheny Power (Potomac Edison Company) – residential standard offer service – these rates are frozen (after a 7.0 percent reduction in 2000) until December 31, 2008.

## Senate Special Commission on Electric Utility Deregulation Implementation

In January 2005, the President of the Senate of Maryland appointed a Senate Special Commission on Electric Utility Deregulation Implementation. While the Maryland electric restructuring law has been held up as a model by legislatures pursuing similar laws nationally, the President charged the commission with assessing its progress and making recommendations for improvements or modifications to ensure that the intent of the law for a competitive market leading to lower electric utility rates is achieved.

During its five meetings, the commission heard briefings regarding the status of the implementation of the law; the process of procuring the standard offer service power for investor owned utilities and electric cooperatives, including SMECO's portolio management procurement strategy; a proposal to allow a pilot opt-out aggregation program; the process for rate making and the rising costs of commodities used to generate electricity; the experiences in other states with retail market competition; the unintended impact of the law on Eastalco (a large industrial user) in directly procuring power; the competition of the wholesale electric supply market and the implications of the recent federal energy legislation; and the progress of Mirant in its bankruptcy proceedings. The commission also visited the PJM interconnection in Valley Forge, Pennsylvania to learn how this regional transmission organization ensures the reliability of the largest centrally dispatched control area in North America by coordinating the movement of electricity in all or parts of 13 states and the District of Columbia. The commission has scheduled its last meeting for November 29, 2005.

## SMECO Portfolio Management

The announcement of a significant price increase in the SMECO service territory was one of the factors leading to establishment of the Senate special commission. SMECO is the major distributor of electricity in Southern Maryland. It owns and operates transmission and distribution facilities in Charles, Calvert, St. Mary's, and southern Prince George's counties. Unlike an investor-owned utility, the cooperative is owned directly by all of its customers, and any profits accrue as dividends to the customers. Traditionally, electric cooperatives deliver electricity at lower cost than investor-owned utilities, in part because net earnings are paid back to customers rather than to a separate class of shareholder-investors.

Because SMECO owns no generation assets, it must procure electricity from other suppliers. Under the former regulated regime, an electric cooperative would procure electricity from one or more nearby utilities under long-term contracts subject to review by the Public Service Commission (PSC). Because of the risks associated with an electricity market facing instability in fuel supply and pricing, SMECO has now adopted a "portfolio management" procurement strategy. Under this strategy, SMECO procures electricity contracts over varying terms from several different generation sources. Although this might not produce the absolute lowest price for a given period, over time the blending of contracts is intended to spread the risk of increased prices based on fuel cost and other factors over the long term. This method is intended to produce a result similar to that of the SOS auction system for investor-owned utilities, although without the strict market-power oversight mechanism required of the latter process by PSC. If SMECO fails to procure enough long-term power to meet its needs, it bears the risk of making up any shortfall at higher cost on the spot market. SMECO does use a risk management company associated with its national association to assist with procurement of its managed portfolio procurement.

## Proposed Pilot Opt-out Aggregation Program

Aggregation allows customers to benefit from competition by pooling with other customers to negotiate discounted prices for electricity generation. The aggregator is not the supplier but rather an entity through which market-based suppliers may bid on selling electricity to the residential customers whom the aggregating group includes. Under State law, a county or municipality may not act as an aggregator for its residents unless the commission determines there is not sufficient competition within the boundaries of the county or municipality. However, a county or municipality may combine governmental units for the purchase of electricity for use by the governmental units. For example, a county could form a cooperative that would include its school system buildings and other government buildings. Many counties have taken steps to do this; the State has also formed a cooperative to include all State agencies and has invited counties to join that entity.

Legislation proposed in previous sessions would have authorized counties or their municipalities to act as an aggregator that purchases electricity on behalf of its citizens under an opt-out approach. Under this approach, a customer is deemed to have given permission to the county or municipality to act as the aggregator if, after receiving notice, the customer explicitly grants permission by return notice, or if the customer fails to return notice within 30 days after receipt. Several jurisdictions expressed interest in acting as opt-out aggregators (Takoma Park, Greenbelt, Bowie, and Ocean City). Ohio and Illinois are the only two states that currently allow opt-out aggregation.

PSC, in concert with the Maryland Municipal League, has begun to develop a framework for an opt-out jurisdictional aggregation pilot program that would replace SOS for the affected customers. The program would likely begin June 2007. However, before a pilot program could be finalized, the following aspects need consideration: the application and selection process by PSC; the duration of the program; the power supply procurement and contracting method; the retail rate design; the billing and collections services; the service termination or disconnection process; the ability of customers to switch to or from the pilot program; non-discrimination and code of conduct requirements; the interests of low-income customers; the education of consumers; and the reporting requirements.

## Electric Restructuring Results Amid Increasing Fuel Costs

The apparent results of electric restructuring in a climate of rising fuel costs appear mixed. Although electric restructuring under the 1999 Act was expected to reduce retail electricity prices for most consumers, a number of factors in the intervening years have combined instead to increase the retail price of electricity nationwide. In 1999, the restructuring of generation promised to increase opportunities for independent generators to build new, more efficient power plants using natural gas as the clean, economical fuel of choice. However over the next few years, the Enron scandal and the failure of a poorly designed electric restructuring in California scared many investors away from financing new generator construction. Also the cost of fuels used for electricity generation increased with demand for these commodities on the world market and the impact of natural disasters. For example, the price of natural gas has increased from roughly $4 per million British thermal unit (BTU) to recent spot-market prices exceeding $18 per million BTU.

Maryland residential electric consumers who received price cuts during the initial implementation of restructuring now await substantial increases in their monthly electric bills. Joining PEPCO and Delmarva customers whose price caps expired in 2004, BGE customers who remain on its SOS may well experience increased costs of 20 to 35 percent on their monthly bills after their caps expire on July 1, 2006, according to industry observers. The actual increase will depend on the results of the next round of SOS bidding this winter. At this time, competitive suppliers for residential customers in the State are only actively recruiting customers in the PEPCO service territory, calling into question the availability of meaningful choice for residential customers in the rest of the State.

What, then, is the impact of electric restructuring? According to a recent independent study by Cambridge Energy Research Associates, U.S. residential electric customers paid about $34 million less for their electricity consumed over the past seven years than they would have in their former fully regulated environment. These savings, however, do not show up directly on the customer's bill – they are net savings compared with costs calculated under their former rate-of-return regulatory regimes, including the direct pass-through of fuel costs under fuel adjustment clauses. Savings are attributable to increased efficiency of generation operations and the independent operation of freely competitive wholesale markets with transparent pricing information by regional transmission operators such as PJM. The General Assembly in 1999 anticipated that the major beneficiaries of restructuring could well be the industrial and commercial electric customers rather than the residential customers. In order to ensure that the residential customers received a benefit from restructuring, the 1999 Act required price caps to be imposed, at prices three to 7.5 percent below the then-current base rates. Accordingly, many Maryland residential customers were insulated from the effects of rising fuel and electricity costs experienced in other parts of the nation since 1999. For them, as price caps expire, electric restructuring will seem to deliver an increase in costs rather than a decrease.

## Eastalco's Procurement of Power

Aluminum smelting uses electricity as a raw material and thus requires power to be available in bulk around the clock at low cost. Alcoa's Eastalco plant in Buckeystown, in Frederick County, has relied on electricity purchased from Allegheny under a full-service special contract since 1994. Although the contract has been extended several times, most recently during the development of Allegheny's restructuring agreement, Allegheny Power, the holding company's distribution company, notified Alcoa that it will allow the contract to terminate at the end of this year.

In accordance with the structural separation requirements of the 1999 Act and associated affiliate transaction limitations, Allegheny had moved its generation assets to Allegheny Energy, an unregulated subsidiary of its holding company. Allegheny Power states that it is no longer capable of directing any of its low-cost coal-fired generators to supply Eastalco at a price below market. The difference between the cost of electricity to Eastalco under the special contract and current available market prices is estimated to exceed $70 million a year. In addition to generally higher fuel costs, including coal and natural gas, factors that Eastalco alleges influence the increased price of available power include congestion of transmission facilities that lie between Eastalco and low-cost Midwestern generators and PJM's locational marginal pricing model which may make it more attractive for a generator to sell electricity on the open market than to a single customer with a long-term contract. Utilities and PJM, on the other hand, discount this, noting that the PJM market does not govern bilateral electricity contracts and that its market model is transparent and attracts the lowest cost producers, not the highest.

Faced with significantly higher projected energy costs for any electricity procured in the current market, Alcoa has stated that it can no longer economically produce aluminum at the Buckeystown plant in this restructured environment. Although it hopes for a temporary legislative solution to allow it to obtain electricity at a lower rate while working on long-term supply options, Alcoa sent out layoff notices to approximately 600 employees of the Eastalco plant on October 15.

## Anticipated Legislative Proposal

In addition to some of the issues that the commission has been discussing, one previous legislative proposal may be reintroduced in some form during the 2006 session.

### Regulation of Total Electric Rates

The electric restructuring law and implementing settlement agreements capped rates for periods of time that depended on the utility. With residential price caps set to expire in June 2004 in two service territories (PEPCO and Delmarva), legislation was introduced during the 2004 session to soften anticipated price spikes. Senate Bill 739/House Bill 1056 of 2004 would have prohibited the commission, in any year in which a utility is required to provide SOS, from approving rate increases that exceed the previous year's total rate by 10 percent. Utilities would have been able to recoup the difference between the requested rate increase and the 10 percent cap over a period not to exceed four years. The Senate bill was withdrawn, and the House bill was voted unfavorably by the House Economic Matters Committee. With residential price caps set to expire in June 2006 in BGE's service territory, it is likely that some form of rate regulation proposal will be discussed during the 2006 session.

# Business Regulation

## Workers' Compensation

**The Court of Appeals issued two decisions this year related to workers' compensation benefits for undocumented immigrants and firefighters' dependents that could prompt legislation in 2006. While proposed regulations to alter the administration and calculation of medical fees were withdrawn, advocates are asking legislators to address the impact of past revisions to the medical fee guide. Other upcoming legislative issues include enforcement against employers who fail to obtain workers' compensation insurance and revisiting the definition of an accidental personal injury.**

### Court Rulings

#### Undocumented Workers

When Argentine employee Diego Lagos injured his hand while operating a saw, his claim for workers' compensation was appealed by his employer on the basis that Lagos failed to meet federal requirements for legal employment in the United States and, therefore, was not eligible for benefits. The Workers' Compensation Commission (WCC), followed by the circuit court of Montgomery County, determined that State law broadly defines a covered employee to include undocumented residents. The Court of Appeals agreed, ruling that a worker does not have to be legally employed to be eligible for workers' compensation if the injury otherwise meets the test for compensation.

The Appeals decision (*Design Kitchen and Baths v. Lagos*) is not expected to significantly affect claim activity but will likely prompt legislation to bar benefits for undocumented workers, as well as legislation to clarify eligibility for certain benefits. Traditionally, undocumented workers in Maryland who are injured on the job have been eligible for medical payments and lost income, but not certain vocational rehabilitation benefits. State law provides for benefits such as vocational evaluation, counseling, training, and job development for disabled employees; it does not specifically bar undocumented workers.

State laws governing benefits for undocumented workers vary. In over two dozen states, including Maryland, the law does not address whether a covered employee includes "aliens" or "unlawfully employed" workers. Where claims have been contested, courts have generally interpreted the law to include undocumented workers. Two exceptions to this pattern are Virginia and Wyoming. For example, the Supreme Court of Virginia held that an undocumented person could not enter into a contract for hire and, consequently, could not meet the state definition of an employee as a "person...in the service of another under any contract for hire." The Virginia legislature later amended the law to specify that a person is a covered employee "whether lawfully or unlawfully employed."

### Firefighters' Dependents

Another case involving the legislature's intent for workers' compensation benefits was *Johnson v. Mayor and City Council of Baltimore City*. Ernest Johnson was a Baltimore City firefighter who died from colon cancer that was attributed to his employment. Following his death in March 2004, Johnson's wife filed a claim for workers' compensation benefits. Mrs. Johnson also received funding from his service pension plan. The Court of Special Appeals ruled that Mrs. Johnson's workers' compensation benefits must be reduced by the amount of service pension benefits she receives.

The court reasoned that the law does not mention dependents in providing an exception to the offset rule; the only individuals entitled to recover full workers' compensation and pension benefits simultaneously are public safety employees who are still living but unable to work due to an occupational disease. The court issued the same decision in a similar case involving the widow of Daniel Luster, a Baltimore City firefighter who died of pancreatic cancer.

## Medical Fee Guide Regulations: Access to Care

WCC regulates fees and other charges for medical services or treatment. At least once every two years, WCC reviews its guide of medical and surgical fees for completeness and reasonableness and makes appropriate revisions. WCC struggled over the years with this responsibility. Accordingly, the medical fee guide had been unchanged for about eight years, except for a 4 percent "across-the-board" increase a few years ago.

WCC appointed a group of payers and payees in July 2001 to serve on a Fee Guide Revision Committee. Based on this group's recommendations, WCC set reimbursements to medical providers based on 109 percent of the Medicare reimbursement amount for each service, rather than setting the rate for each individual medical care code. This rate, through regulations, became effective September 1, 2004. The regulations also provided requirements on insurers for the timely payment of medical bills to providers.

Some in the workers' compensation community have since complained that injured workers do not have adequate access to care. Increasing numbers of professionals in the medical field are not willing to treat persons injured on the job, thereby, making it very difficult for injured workers to find quality medical care. Under the revised medical fee guide, orthopedic groups are particularly dissatisfied since their reimbursements significantly decreased. An orthopedic provider treating a workers' compensation patient spends a considerable amount of administrative time (known as the "hassle factor") filling out paperwork and discussing the patient's progress with parties who are involved with the workers' compensation system. The provider is not compensated for these administrative burdens, which are not imposed on providers when treating Medicare or health insurance patients.

In an effort to address these concerns, WCC proposed regulations to make certain revisions to the medical fee guide. The regulations would have allowed for payment to certain providers, with approval by WCC, that deviated from the 109 percent reimbursement rate. For varying reasons, the regulations were strongly opposed by the workers' compensation community, and WCC withdrew them in September 2005.

## Workers' Compensation Benefit and Insurance Oversight Committee

In addition to the debate on the fee guide regulations, the oversight committee has discussed the following issues in anticipation of the 2006 session.

- Evaluation of a permanent impairment: Legislation introduced in 2005 would have required WCC to use the most current edition (the fifth edition) of the *AMA's Guide to Evaluation of Permanent Impairments*, instead of the fourth edition (published in 1993) that it now uses. It is not clear how this legislation would affect claim awards.

- Uninsured employers: A 2003 legislative audit found that it was unclear which agency, if any, is required to initiate investigations of uninsured employers. Under current practice, absence of mandatory coverage surfaces only after a claim is filed, prompting action by WCC and payment by the Uninsured Employers' Fund. Several states have increased their enforcement and compliance with coverage requirements. For example, Utah has created a database that matches its unemployment insurance records to data on whether an employer has workers' compensation insurance. Florida uses an extensive investigative office to ensure compliance.

- Health care volunteers: While the law provides workers' compensation for some emergency volunteers, it does not authorize coverage for those who volunteer through the Department of Health and Mental Hygiene.

## Upcoming Legislation

The General Assembly will likely see certain bills coming back next year in some form, particularly ones related to accidental personal injury, penalties against uninsured employers, and the presumption of heart disease and hypertension for public safety officers. Employers may seek legislation to prevent a new medical records law (Chapter 503 of 2005) from applying to workers' compensation claims. Before a doctor can release a patient's medical records in response to a subpoena or court order, he or she must now receive (1) a written assurance from the party seeking the medical records that the patient has not objected to the disclosure and that 30 days have passed since the notice was sent; or (2) a written assurance that any objections by the patient were resolved. This has caused some delay in the processing of claims.

## Accidental Personal Injury

In response to a June 2003 decision by the Maryland Court of Appeals (*Vernell Harris v. Board of Education of Howard County*), the General Assembly has considered several bills that would have narrowed the definition of an accidental personal injury. According to a report issued in March 2005 by WCC, insurers' claim costs could increase 0.5 to 2.4 percent as a result of the decision. While this is much less than some previous estimates, the Injured Workers' Insurance Fund may experience a larger increase. Legislation will likely be reintroduced to further clarify the definition of an accidental personal injury.

For further information contact: Ann Marie Maloney/Karen Benton Phone: (410) 946/(301) 970-5350

# Business Regulation

## Direct Shipments of Wine Across State Lines

**In Maryland, alcoholic beverages may not be directly shipped to a consumer by either in- or out-of state manufacturers. The U. S. Supreme Court recently held that state statutes in New York and Michigan that allowed in-state wineries to sell wine directly to consumers residing in the state but prohibited or restricted this practice by out-of-state wineries discriminated against interstate commerce in violation of the Commerce Clause. This decision may spark renewed interest in legislation related to the direct shipment of alcoholic beverages.**

### Background

Since the Twenty-first Amendment repealed prohibition, states have had the primary role of regulating the sales of alcoholic beverages. Like many states, Maryland has established a three-tiered system governing these sales. A manufacturer must forward its product to a licensed wholesaler, who in turn must deliver the product to a licensed retail dealer for sale to consumers. This system facilitates tax collection and ensures that consumers may only buy alcoholic beverages from licensed in-state entities that are directly accountable to the State. Maryland does not allow the direct shipment of alcoholic beverages to a consumer in Maryland by either in- or out-of-state manufacturers.

Starting in the late 1990s, mail-order sales, by phone or over the Internet, of alcoholic beverages to consumers began to grow throughout the country. In 2002 legislation was enacted in Maryland establishing the direct wine seller's permit. The Comptroller may issue the permit to an out-of-state wine manufacturer, brand owner, importer, or a Maryland agent of the brand owner or importer that holds an alcoholic beverages license or permit from another state or the federal government. A permit holder may sell wine to a consumer in Maryland by phone or over the Internet, as long as the brand of wine has not been distributed in Maryland within the previous two years. However, the permit holder must ship an order of wine to a licensed wholesaler, who must forward the order to a licensed retail dealer for delivery to the consumer.

### Concerns about the Direct Shipment of Alcohol

In Maryland, several concerns have been raised regarding the direct shipment of alcoholic beverages. First, alcohol that is shipped directly to consumers does not pass through the State's three-tier system, resulting in a loss of tax revenue. Second, direct shipment of alcohol to consumers could allow minors uncontrolled access to alcoholic beverages. This concern arises because most suppliers that ship directly to consumers do so by using a common carrier such as UPS, which is not obligated to check the age of the receiving party.

Many consumers, however, have expressed the desire to obtain hard-to-locate alcoholic beverages, most often wines that are not distributed by wholesalers in the State. It is the wine industry that is most affected by the ability or inability to ship directly to consumers. In addition, many Maryland wineries have expressed interest in accessing new in- and out-of-state markets by shipping directly to consumers.

According to the Wine Institute, 14 states have "reciprocal" shipping laws in place, meaning that wineries can ship to consumers who live in those states as long as the wineries' home state also allows out-of-state companies to ship to its residents. A bill to allow Maryland wineries to benefit from reciprocal shipping has not been introduced in the General Assembly. At least 18 additional states allow importation of limited quantities of wine for personal use, though the definition of "limited quantity" varies among the states.

## Federal Constitutional Issues

Article I, Section 8, Clause 3 of the U. S. Constitution (the Commerce Clause) grants Congress the power to regulate commerce among the states. The Commerce Clause has been interpreted not only as a grant of federal regulatory authority, but as prohibiting the states from enacting laws that discriminate against interstate commerce (known as the "dormant Commerce Clause"). The Twenty-first Amendment to the U. S. Constitution, however, grants to the states broad power to regulate the importation of alcoholic beverages.

On December 7, 2004, the U. S. Supreme Court heard arguments addressing this apparent conflict in the companion cases *Swedenburg v. Kelly* and *Granhold v. Heald*. In the former case, New York's alcoholic beverage control law severely restricted direct sales and shipments of wines to New York consumers from out-of-state wineries but allowed direct sales and shipments to New York consumers by licensed in-state wineries. The latter case was similar, involving a prohibition against direct shipping by out-of-state wineries under Michigan's alcoholic beverage law. In both states, out-of-state wineries were able to ship to the states' consumers, but not directly; that is, they were required to go through the states' three-tiered systems.

The question presented to the court in these cases was: "[d]oes a State's regulatory scheme that permits in-state wineries directly to ship alcohol to consumers but restricts the ability of out-of-state wineries to do so violate the dormant Commerce Clause in light of [Sec. 2] of the Twenty-first Amendment?"

On May 16, 2005, the U.S. Supreme Court handed down its decision in the above named cases and held that the laws in both states discriminate against interstate commerce in violation of the Commerce Clause, and that the discrimination is neither authorized nor permitted by the Twenty-first Amendment to the U.S. Constitution.

Legislation may be introduced at the 2006 session to make Maryland a reciprocity state or allow importation of limited quantities for personal use.

# Business Regulation

## Gasoline Price Regulation

**Hurricanes Katrina and Rita battered the nation's oil production and refining markets. Soon after, Maryland gasoline prices, which had typically closely followed the national average price, were among the highest in the nation. The rise in gasoline prices nationwide has focused attention on the gasoline production industry. Numerous states, including Maryland, are investigating whether price gouging or collusion is involved. Maryland has no specific laws against price gouging but has laws against monopolies, collusion, and the sale of gas below cost.**

### The Gasoline Production Process

Gasoline that is consumed in Maryland is the byproduct of a five-step process that includes production, refinement, and transportation. As Maryland is not an oil-producing or refining state; gasoline must be transported to the State.

#### Production and Refining

Approximately 1.5 million barrels per day (bpd) or 27 percent of U. S. oil production is produced in the Gulf of Mexico (in Texas and Louisiana). Currently, global production can be quickly increased by only 1 percent, or less than a million bpd, most of which is in Saudi Arabia. Because of high demand and limited supply, the price of a barrel of oil has increased by over $20 in the past two years.

Crude oil is sent to refineries and is separated and processed into heating oil, kerosene, gasoline, diesel fuel, and other refinery products. U. S. refineries can process 16.9 million barrels of oil per day and meet more than 90 percent of the U. S. demand for gasoline. Approximately two-thirds of Maryland's gasoline supply comes from two pipelines which originate in the Gulf of Mexico − the Colonial pipeline, which runs from the Gulf region through Baltimore to New York, and the Plantation pipeline, running between the Gulf and Newington, Virginia.

#### Wholesale Distribution

As of September 2005, there are 220 active Maryland gasoline dealer licenses, including in-state and out-of-state distributors and major oil companies. For the last year (May 2004 to April 2005) of available data , approximately 22 companies that hold Class A (mostly the major oil companies) or Class D (mostly independent Maryland wholesale distributors) licenses distributed approximately 90 percent of the gasoline to Maryland retail stations. This does not include special fuel such as diesel.

### Retail Distribution

As of September 2005, there are 2,077 retail service stations in the State. On average, these stations sell 8 million gallons of gasoline per day, in addition to 1.5 million gallons of diesel. Approximately two-thirds of all stations sell branded gasoline − gasoline that is affiliated with a major oil company – while the remaining are unbranded gasoline stations. Exxon/Mobil (20 percent), Shell (15 percent), Citgo (13 percent), and BP/Amoco (10 percent) have the largest presence in the State. Unbranded retail stations are a combination of large chain gas stations, such as Sheetz, Royal Farms, Crown, and warehouse clubs; traditional, one-station operations; and specialty fleet management stations. Approximately 54 percent of these stations are one-station operations.

### The Impacts of Hurricanes Katrina and Rita

Soon after Hurricane Katrina, Maryland gasoline prices, which had typically closely followed the national average price, were among the highest in the nation. Hurricanes Katrina and Rita disrupted three portions of the gasoline supply chain directly – crude oil production, refining, and distribution of refined gasoline via pipelines. This in turn impacted wholesale distribution and retail service stations. While the pipelines have been restored, the production and refining have not been restored to pre-hurricane levels.

As of October 24, 2005, approximately 65 percent of Gulf of Mexico oil production and 19.2 percent of the nation's refining capacity were shut down. The U. S. Secretary of the Interior estimated that it may take until 2006 to restore Gulf oil production, and there is no timeline for restoring the refining capacity.

Prior to Hurricane Katrina, gasoline prices in Maryland in 2005 were approximately one-third of a cent higher than the national average price. Since Katrina, Maryland gasoline prices have averaged 14 cents more than the national average. In addition, gasoline prices in Maryland have been 10 cents higher than in Virginia, compared with 8 cents pre-Katrina. Gasoline prices in Washington, DC, however, have increased more than in Maryland since Katrina.

Gasoline prices peaked nationwide on September 2, 2005. At that time, Maryland and Washington, DC had the highest average gasoline retail price of $3.26, compared with a national average of $3.06. During early October, gasoline prices in Maryland began to decrease. On October 13, 2005, Maryland had the sixth highest average gasoline price of $2.94, a reduction of approximately 32 cents, or 10 percent, from the September 2 peak.

## Gasoline Taxation

The State gasoline tax is 23.5 cents per gallon, in addition to the federal gasoline tax of 18.4 cents per gallon. The State diesel fuel tax is 24.25 cents per gallon, in addition to the federal diesel fuel tax of 24.4 cents per gallon. Taxed gasoline is not subject to the State sales tax. In fiscal 2006, the State gasoline tax is projected to contribute $775 million for the Transportation Trust Fund. The State gasoline tax is expected to raise $4.8 billion over the next six years for State and local transportation projects. A typical State driver will pay around $125 in State gasoline taxes annually. The American Petroleum Institute (API) ranks Maryland as having the twenty-fifth highest gasoline tax burden nationally. The excise tax rate (in cents per gallon) for surrounding states is New York (23.2), Pennsylvania (30), West Virginia (27), Delaware (23), Washington, DC (20), Virginia (17.5), and New Jersey (14.5). New York imposes a state sales tax on gasoline sales, which API estimates increases the total state tax burden to 44.5 cents per gallon.

## Gasoline Market Regulations and Laws

### Price Gouging Regulations and Laws in Other States

There are no federal laws on price gouging which are applicable to gasoline sales. Approximately 27 states and Washington, DC have anti-price gouging statutes in the aftermath of an emergency. All of these statutes either specifically mention gasoline and fuel or can be easily interpreted to include fuel. Penalties for violation of price gouging statutes range between $500 and $40,000 per violation. Most states have a fine of between $1,000 to $5,000 per violation. Nine states (California, Arkansas, Louisiana, Maine, Mississippi, Missouri, Oklahoma, South Carolina, and West Virginia) have criminal sanctions for the offense.

### Gasoline Price Regulations in Maryland

While there are no minimum prices or maximum prices set for gasoline, State law prohibits retail service station dealers from selling motor fuel below cost except under limited, short-term circumstances. Further, after September 30, 2009, all producers, refiners, or wholesalers of motor fuel must extend all "voluntary allowances" uniformly to all retail service station dealers supplied and must apportion all gasoline and special fuel uniformly among retailers in case of shortage. Voluntary allowances are temporary price reductions in the wholesale price offered to a retailer in order to enable the retailer to meet the price of a competing retailer.

### Maximum Gasoline Price Regulations Elsewhere

Hawaii and Puerto Rico are the only areas in the U.S. that currently regulate maximum gasoline prices. The Canadian provinces of Prince Edward Island and Newfoundland also limit maximum gasoline prices. On the federal level, gasoline prices have not been regulated since the Nixon Administration's economy-wide wage and price controls. These controls remained in effect from the enactment of the Emergency Petroleum Allocation Act in 1973 to 1981. The gasoline price controls resulted in gasoline shortages, long waiting times, and consumer inconveniences.

# Business Regulation

## Immigration Issues

**Over the last decade, Maryland has seen a significant increase in the number of immigrants moving into the State, including persons who do not have legal residence in the United States. As both legal immigrants and undocumented residents merge into Maryland, the State is tackling abusive labor practices by employers, employment policy questions, and an increasing demand for certain services. Legislators are likely to address some of these issues in the upcoming session.**

### Undocumented Immigrants – Demographic Trends

It is impossible to say with any certainty how many individuals reside in Maryland without legal documentation, such as a visa, a "green" card, or a Social Security number. In a June 2005 report, the Pew Hispanic Center estimates that Maryland is one of six states with an undocumented population of 200,000 to 250,000, whereas an earlier survey by the federal Immigration and Customs Enforcement estimated approximately 60,000. Consequently, predicting the impact that this population will have on public resources such as schools or health services or on employment is a challenge. One tool at policymakers' disposal is a profile of undocumented persons prepared by the Pew Hispanic Center. The profile provides a glimpse of the demographic characteristics of a population that is generally difficult to obtain.

The average undocumented immigrant in the U. S. is likely to be married and fairly young – almost 84 percent of undocumented migrants are under 45. Children and teenagers comprise a larger share (35 percent) of the total undocumented population, compared to the percentage of children in legal immigrant (29 percent) or nonimmigrant families (24 percent). Another dominant characteristic among undocumented residents is lack of education; almost one-third have less than a ninth grade education. Only 25 percent have graduated high school but of this percentage, 15 percent have a college degree.

The report also describes the occupational groups in which undocumented immigrants are concentrated. A majority of undocumented workers in the U. S. are in a construction trade, building service (such as housekeeping or grounds maintenance), or food service. Approximately a quarter of all dishwashers are undocumented, as are 20 percent of all painters, roofers, cement masons/finishers, and construction laborers. Farming and certain types of manufacturing are also common places of employment for undocumented workers.

The demographic trends of undocumented immigrants indicate that providing senior citizen services, particularly elderly health care, will not be a concern in the near future. The family focus of many immigrants signifies that education, child health services, and housing are much larger issues. Occupational conditions and health are also concerns, given the concentration of undocumented workers in jobs such as roofing that pose high safety risks.

Local news reports detailing wage abuses by employers against both legal and illegal immigrants highlight the potential for exploitation, particularly for those who risk deportation by reporting a violation.

## Federal and State Law

### Employment Enforcement

Federal law governing the employment of immigrants and undocumented residents largely preempts state law. States are barred from imposing additional civil or criminal sanctions on employers other than through "licensing and similar laws." Accordingly, Maryland does not specifically prohibit or penalize the hiring of an undocumented worker. State law expressly disallows unemployment benefits for workers who cannot provide proof of legal residence but does not prohibit workers' compensation benefits for an undocumented worker.

Under the federal Immigration Reform and Control Act, a person who knowingly hires, recruits, or refers (for a fee) an unauthorized alien is subject to a civil fine between $250 and $2,000 for each alien who was hired, referred, or recruited. The fine increases to $2,000 to $5,000 per alien for a second offense, and $5,000 to $10,000 per alien for a third offense. The same penalty schedule applies if the employer is convicted of engaging in discriminatory practices, such as refusing to honor an identification document that appears to be genuine. Any person or business that repeatedly engages in hiring or recruiting unauthorized aliens faces a criminal penalty of up to $3,000 per violation or six months imprisonment or both.

### Social Services

In 1996, Congress amended both federal immigration and welfare law in ways that affected both legal and illegal immigrants. An alien who is not considered a "qualified alien" is not eligible for any State or local public benefit, such as retirement, welfare, assisted housing, unemployment benefit, post secondary education, or a grant or professional license, unless the state enacts a law specifically authorizing those benefits.

However, a state or local government can furnish certain kinds of benefits without enacting a separate law, such as short-term, noncash disaster relief or emergency health care (excluding organ transplants). State regulations do require citizenship or legal residence for State-funded temporary disability benefits. The states cannot override federal law for administering federal benefits such as food stamps; these benefits are not available to undocumented residents. Additionally, the federal welfare reform law eliminated full Medicaid coverage for legal immigrants and instituted a five-year waiting period for Medicaid and the children's health insurance program (CHIP) if the immigrant entered the U. S. after August 22, 1996. After the immigrant has been a resident for five years, a state may choose to deny these benefits. Maryland law extends Medicaid benefits to legal immigrant children under the age of

18 and pregnant women, regardless of the length of time they have resided in the country. Benefits are supported entirely by State funds, subject to budget limitations. The Governor eliminated these benefits in the fiscal 2006 budget.

## State Legislative Proposals

Some states have sought to use the limited exceptions to the federal preemption by proposing business licensing sanctions on employers who hire undocumented workers. Some of the proposed laws have drawn criticism from advocacy groups who contend that employer sanctions are not an effective deterrent and that some of the sanctions either duplicate federal law or violate legal immigrants' civil rights. A recent trend in state legislative proposals is to penalize contractors and subcontractors who hire undocumented employees.

Legislation introduced in 2005 in Missouri, Georgia, and Kansas would have also applied the penalties to contracts sponsored by county and city governments. Other states where legislation was proposed include Connecticut, which would have imposed a $1,000 fine (per occurrence) for hiring an "ineligible" alien and New York, which would have allowed state agencies to deny, suspend, or revoke a business license for up to five years if the licensee committed two violations of federal immigration law.

Tennessee, California, Virginia, Kansas, and Florida already have penalties against a person for knowingly employing undocumented workers. A person convicted of hiring an undocumented worker in Tennessee faces permanent revocation of any applicable business license and a permanent ban on participating in state contracts.

## Maryland

Maryland lawmakers have not introduced proposals to penalize employers who hire undocumented immigrants but have passed legislation to create a task force to examine procedures and policies related to drivers' licenses for undocumented residents. Legislators have also sponsored bills to establish task forces to evaluate the impact that undocumented immigrants have on employment and health care, as well as legislation to regulate immigration consultants. In 2003, Governor Robert Ehrlich vetoed legislation that would have provided in-state tuition privileges to undocumented immigrants who graduated from Maryland high schools.

Bills may be introduced in the 2006 session that address various aspects of immigration policy. Following a Court of Appeals ruling to allow workers' compensation benefits for undocumented workers, lawmakers will likely sponsor bills to clarify this law. (For further information about this ruling, see "Workers' Compensation" under this section.) Additionally, the legislation aimed at curbing and penalizing abuses by immigration consultants may resurface. Such a bill might require consultants to return documents provided by their clients and prevent them from providing or claiming to provide legal advice if they are not licensed to do so. Lawmakers may also propose sanctions against employers who hire undocumented workers or support stiffer sanctions against employers who violate State wage requirements by failing to pay, paying the employee insufficient funds, or terminating the employee without providing full payment. It is unclear whether legislation will be introduced to ban day laborer centers from aiding undocumented workers. Two such centers, which provide language classes and employment counseling, operate in Montgomery County and are supported by local and private funding.

## Task Force on Lending Equity within Financial Institutions Providing State Depository Services

**The Task Force on Lending Equity within Financial Institutions Providing State Depository Services anticipates completing its work by the end of November 2005. Its recommendations direct the Treasurer, in its evaluation of which financial institutions to deposit State funds, to consider certain lending and other practices of the institutions to small and minority-owned businesses. The task force intends to introduce legislation which encompasses the recommendations.**

Chapter 114 of 2004 established the Task Force on Lending Equity within Financial Institutions Providing State Depository Services. The purpose of the task force is to (1) develop meaningful criteria for evaluating minority business enterprises' access to credit and capital from financial institutions providing or desiring to provide depository services to the State; and (2) advise the State Treasurer on developing additional or supplemental criteria to be considered in the selection of depositories for State funds. In carrying out its purpose, the task force is required to perform three tasks: (1) identify data to demonstrate whether financial institutions provide adequate access to credit and capital for minority business enterprises; (2) advise the Treasurer in developing additional criteria for selecting financial institutions as depositories; and (3) develop a strategy to implement a lending equity policy.

### Work of the Task Force

Although established in 2004, the task force was not appointed in time to meet before the 2005 interim. The task force began meeting in May 2005 and will have met 10 times by the time it completes its work in late November 2005. In addition to the meetings of the full task force, two work groups made up of task force members worked to develop criteria for evaluating the efforts of financial institutions at reaching out to the minority business community and to collect of information to form the basis of the evaluation.

During its meetings, the task force heard presentations with useful information from several sources. The task force started its work with a briefing from the Treasurer's Office on the current system for procuring depository services, including the criteria used to evaluate responses to the Treasurer's requests for proposals (RFPs). The Governor's Office of Minority Affairs presented information on the findings and recommendations of two other task forces, the Governor's Commission on Minority Business Enterprise Reform and the Centralized Bidder Registration Task Force. The Commissioner of Financial Regulation and the Federal Deposit Insurance Corporation discussed legal and regulatory framework governing the banking industry, as well as the examination process for State and federally chartered institutions. The task force also heard from representatives of the minority business community, State and local small business assistance programs, and the banking industry. Lastly, the Department of the Environment discussed its Water Quality Linked Deposit Program and the Department of Business and Economic Development discussed its inactive linked deposit program, which was established as part of the Maryland Industrial Development Financing Authority Program.

## Task Force Recommendations

The task force has voted on several proposed recommendations regarding the evaluation process and will be including those recommendations, discussed below, in its final report and in legislation at the 2006 session.

### Weight of Financial Institution Evaluation Criteria

Currently, in weighing its evaluation of whether to use a financial institution, the Treasurer grants 75 percent of the weight to technical factors and 25 percent to financial factors. The Treasurer should include an assessment of the institution's activities in the minority business community – an "equity component." Under the recommendation, the technical factors would receive 60 percent of the Treasurer's consideration, financial factors would continue to receive 25 percent, and equity factors would receive 15 percent.

### Lending Discrimination Violations

The task force recommends that the Treasurer consider whether a financial institution has had lending discrimination violations. In this regard, the Treasurer should consider final adjudicated lending discrimination violations that were filed in Maryland during the five years prior to response to the RFP. The Treasurer may use discretion in considering final adjudicated lending discrimination violations that were filed in other states during the five years prior to response to the RFP. The Treasurer may determine how to assess a lending discrimination violation by an affiliate or entity acquired by the financial institution.

### Community Reinvestment Act Ratings

The Community Reinvestment Act (CRA) is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate. Institutions are rated on their lending activities. The Treasurer should consider whether the financial institution had a CRA rating of "substantial noncompliance" or "needs improvement" in its most recent evaluation. Further, for institutions that operate in multiple states, the Treasurer should consider Maryland-specific information that is provided within the Washington, DC-Baltimore Assessment Area Section of the CRA report.

### Participation in State and Federal Lending Programs

The Treasurer should consider whether a financial institution has successfully made loans in State and federal lending programs offered in Maryland to small and minority-owned businesses during the five years prior to response to the RFP.

### Outreach Programs

The Treasurer should consider whether a financial institution demonstrates that it has an active outreach program to small and minority-owned businesses in Maryland during the five years prior to response to the RFP.

### Strategic Partnerships with Technical Assistance Entities

The Treasurer should consider whether the financial institution demonstrates that it has established strategic partnerships and participates with entities whose mission is to provide technical assistance to small and minority-owned business during the five years prior to response to the RFP.

### Pending Items

The task force is currently deliberating whether to recommend that the State establish some sort of linked deposit program to encourage increased lending to the minority business community. Under these types of programs, the financial institution underwrites loans to eligible minority businesses, and the State and the institution enter into an investment agreement for a sum equal to the amount of the loans. The State takes a lower than usual interest rate on its deposits with that institution in return for the institution's below-market rate loans to minority businesses.

# Business Regulation

## Minimum Wage

**The General Assembly passed legislation in the 2005 session requiring nongovernmental employers to pay their employees $6.15 per hour, a dollar higher than the federal minimum wage. However, Governor Robert Ehrlich vetoed the legislation, citing a potentially adverse effect on small businesses. When lawmakers revisit the minimum wage issue in 2006, they face several options, including an override of House Bill 391 and application of the increased State minimum wage to local and State government employees.**

### Background

Despite several proposals to raise the federal minimum wage, Congress has not approved a wage increase since 1997. The lack of federal action has prompted greater discussion in state capitals throughout the country. Last year, 38 states, including Maryland, considered some type of change to the minimum wage, according to the National Conference of State Legislatures. Eighteen states have enacted a minimum wage above the federal level, including five in the last year. Of the states that border Maryland, only Delaware and the District of Columbia have enacted a minimum wage above $5.15. In certain municipalities, such as the City of San Francisco, locally approved minimum wages exceed the state level.

State minimum wages range from $5.70 per hour in Wisconsin to $7.35 per hour in Washington. The structure of minimum wage laws also varies. Minnesota recently enacted a two-tier system that provides a higher minimum wage for employees of larger companies and a lower wage for smaller businesses. A “large” employer with an annual gross volume of sales over $625,000 is required to pay $6.15 per hour; employers with a smaller sales volume pay $5.25 per hour. Some states have also increased the federal training wage for workers under the age of 20 or have created a lower “opportunity” wage for minors.

### House Bill 391

Although Maryland has a minimum wage law, it has traditionally adopted the federal minimum wage, which has been $5.15 per hour for covered employees. Maryland lawmakers passed a bill (House Bill 391) that would, for the first time, create a State minimum wage for private-sector employees. The bill would not have affected the federal “training wage” ($4.25 per hour) that Maryland employers may pay to workers under the age of 20 who are employed for less than 90 days. However, tipped employees, who receive less than the minimum wage, would have received an increase in their minimum wage from $2.38 to $3.08 per hour (50 percent of the minimum wage).

Approximately 1.3 million Maryland workers were paid hourly wages in 2004; of these hourly workers, 24,000, or approximately 1.9 percent, earned wages at or below minimum wage. The Bureau of Labor Statistics estimates there were approximately 2.5 million wage and salary workers in Maryland in 2004. However, not all hourly workers would receive an increase if a minimum wage increase took effect, as certain types of employees are exempt under either State or federal law. For example, commissioned sales people; farm workers; certain seasonal amusement or recreational employees; and salaried executive, administrative, and professional personnel would not be affected. The Department of Legislative Services (DLS) estimated that approximately 55,300 workers would have received an increase in wages (in any amount) under House Bill 391.

## Business Impact

The Governor's veto letter for House Bill 391 cited several reasons for his decision. He first stated that the bill would hurt the least skilled and educated members of the workforce because they would be at risk of losing their jobs if their employer could not recover the increased costs. Governor Ehrlich also stated that the State would be at a competitive disadvantage with neighboring states that do not pay above $5.15 per hour. Lastly, he contended that severing the State wage from the federal wage "sets a dangerous precedent that disrupts the marketplace" by subjecting businesses to both State and federal action on minimum wage.

Small businesses that employ low-wage individuals would have been affected by the bill through increased wage payments and mandatory payroll taxes such as Social Security taxes and unemployment insurance taxes. Wages and mandatory payroll taxes paid by Maryland businesses as a result of the bill would increase by approximately $61 million annually. Even if businesses passed part of these higher labor costs to consumers through higher prices, these businesses could have been impacted by decreased sales. To the extent that increased wages increase worker productivity, businesses would have been less affected by the provisions of the bill. Increased labor costs and taxes can typically be deducted by businesses from federal, State, and local income taxes, mitigating the financial impact.

A majority of minimum wage workers nationally are employed in the service industry, particularly in leisure and hospitality. The highest concentration of minimum wage workers in this industry, approximately 19 percent, are employed at food services and drinking establishments. According to the U.S. Census Bureau, 91 percent, or 6,488, of food services and hospitality businesses in Maryland in 2001 were small businesses.

## 2006 Scenarios

### Override

The House and Senate may attempt to override the Governor's veto when they return to session in 2006. If House Bill 391 passes both houses in the 2006 session, the $6.15 per hour minimum rate will become effective 30 days from the date of passage. The General Assembly cannot amend override legislation in any way; however, lawmakers may introduce supplemental legislation to make further changes to the law in the 2006 session.

### Minimum Wage for Local and State Employees

The Senate minimum wage bill (Senate Bill 89) was amended in the House to apply the new State wage to local and State government employees. The bill passed the House, but the Senate did not take action on the amended bill. Lawmakers may revive this measure by introducing legislation to require State and local governments to pay their employees the State minimum wage.

Generally, neither the State nor local governments would face a significant fiscal impact from a $1 increase in the minimum wage. The State has a minimal number of regular employees who could be affected. The Department of Budget and Management advises that the State, including the University System of Maryland, has several thousand contractual employees who earn less than $6.15 per hour and would be affected. During the 2005 session, DLS advised that State labor costs could increase by $375,000 in fiscal 2006 and $750,000 in fiscal 2007, if House Bill 391 were applied to the State. The increase in fiscal 2007 reflects the delayed effective date of January 1, 2006.

Similarly, Maryland counties and cities typically pay their employees more than the federal minimum wage, with the exception of some part-time, seasonal or recreational employees. Of the seven local governments surveyed by DLS, most indicated that an increase to $6.15 would have minimal or no impact. Prince George's County, for example, would pay about $1,000 more annually for its part-time employees. However, the City of Laurel would incur approximately $23,000 of additional costs for recreational workers.

### Other Wage Issues

Lawmakers may also revive proposals (from the 2005 session) to (1) increase the minimum wage beyond $6.15 per hour; (2) exempt small businesses from the State minimum wage; or (3) substitute a living wage. (In 2004, legislation requiring a $10.50 per hour living wage for public contracts over $100,000 was vetoed by the Governor.)

It is unclear whether funding debates for enforcing both the minimum wage and other employment laws such as the prevailing wage will resurface. The legislature rejected an

Administration proposal in 2005 to eliminate the Prevailing Wage Unit of the Department of Labor, Licensing, and Regulation (DLLR) and established the Employment Standards Service Unit and the Prevailing Wage Unit in State law. While these units, which administer and enforce various State wage laws, existed informally within DLLR, they had not been recognized in the statute. The law also requires a minimum appropriation for the Employment Standards Service Unit ($385,000) and the Prevailing Wage Unit ($315,000) for fiscal 2007 and each year thereafter.

# Public Safety

## Sex Offenders

**Issues concerning sex offenders have received public attention following high profile child abductions and murders by sexual predators in Florida and Idaho and reports that many sex offenders in Maryland have failed to register or update their registrations as required.**

### Nationally

Across the country, cases in which registered sex offenders have failed to update their addresses and have gone on to commit heinous sexual crimes have prompted lawmakers in several states to examine the ways of accounting for these offenders. In 2005, there were two notorious cases of child abduction, molestation, and murder by previously convicted child sex offenders – one in Idaho and the other in Florida. The Florida case, involving a nine-year-old girl named Jessica Lunsford, has led that state to enact new legislation that:

- mandates a 25-year minimum mandatory term of imprisonment followed by lifetime supervision with electronic monitoring for persons convicted of lewd and lascivious molestation of a child under the age of 12 (there had been no lifetime supervision mandate);

- expands from 20 to 30 years the period of time before someone can petition to have the sexual predator designation removed;

- creates a new aggravating circumstance to qualify a sexual predator who commits a murder for a death sentence;

- retroactively requires the court to electronically monitor registered sex offenders and sexual predators whose victims were 15 years of age or younger and who violate their probation or community control and the court imposes a subsequent term of probation and community control; and

- prospectively mandates the court to order electronic monitoring for persons placed on probation or community control who are convicted or previously convicted of various unlawful sex acts against a child 15 years of age or younger or are registered sexual predators.

It is also possible that the U. S. Congress will pass the Children's Safety Act of 2005 (HR 3132) before the end of the year. This federal legislation would, in part:

- require the U.S. Attorney General to (1) maintain a national sex offender registry at the Federal Bureau of Investigation; (2) establish a sex offender management assistance program; and (3) authorize sex offender apprehension grants;

- amend (1) the DNA Identification Act of 1994 to expand the scope of DNA samples to be included in the Combined DNA Index System; and (2) the DNA Analysis Backlog Elimination Act of 2000 to authorize the Attorney General to collect DNA samples from individuals who are arrested or detained under U. S. authority;

- increase penalties for violent crimes against persons under age 18, including death or life imprisonment, if the crime results in the death of a person under that age, and increase penalties for sexual offenses against children;

- require background checks and checks of national crime information databases and state child abuse registries before approval of foster or adoptive placements; and

- establish (1) procedures for the civil commitment of sexually dangerous persons; and (2) mandatory minimum penalties for child sex trafficking.

## Maryland

Maryland first enacted sexual offender registration legislation under the federal Jacob Wetterling Crimes Against Children and Sexually Violent Offender Registration Program during the 1995 session. State sex offender registration laws have been amended and updated several times to remain in compliance with federal regulations and guidelines.

According to the Department of Public Safety and Correctional Services, 4,335 offenders are currently included in the Maryland sex offender registry. About 500 to 600 new offenders are added on an annual basis. The majority of offenders in the registry are required to continue registering for life.

Generally, a person convicted of a sex crime or other specified crime in Maryland, including kidnapping and false imprisonment, is required to register with the State sex offender registry upon release from prison or release from court if the person did not receive a prison sentence. Offenders who are required to register in other states and who come to Maryland are required to register upon entering Maryland. Offenders from other states who may not be required to register in the home state are required to register in Maryland if the crime would have required registration in Maryland if committed in Maryland. Juveniles who are adjudicated as adults and convicted for crimes that require registration are included in the registry. Juveniles who are adjudicated delinquent for these crimes through the juvenile court system are not included in the registry.

Over the summer of 2005, Governor Robert Ehrlich ordered a police check across the State on more than 400 sex offenders who reportedly had moved to Maryland but had not registered. The Associated Press reported that, under this Sex Offenders Compliance and Enforcement (SOCEM) initiative, of the 403 sought, 69 sex offenders were found and ordered to register immediately; 130 were determined to be living outside Maryland; 104 were incarcerated in federal or state prisons; 5 were dead; 7 remained under investigation; and for another 88, there was no information to show they had moved to Maryland.

The Governor has proposed strengthening penalties and increasing oversight of offenders, including the use of global positioning system anklets. At the same time, Maryland's Attorney General has unveiled a plan to require lifetime supervision for the most violent sexual offenders, strengthen community notification of sex offenders, and help build awareness of how people can protect themselves and their children.

In addition, during the 2004 session, a task force was established to study the use of global positioning systems and investigate the feasibility of outfitting sex offenders and other violent criminals with global positioning anklets, which would keep track of their whereabouts at all times. A final report by the task force is to be submitted to the General Assembly by December 31, 2005.

It is expected that several proposals will be introduced during the 2006 session to address issues surrounding sex offenders, including the use of global positioning systems, expanded notification requirements, and permanent supervision.

For further information contact: Guy G. Cherry Phone: (410) 946/(301) 970-5510

# Public Safety

## State Prison System Update

**The Department of Public Safety and Correctional Services continues to face challenges relating to offender management issues, including facility capacities, health care, and recidivism.**

### Background

The Department of Public Safety and Correctional Services (DPSCS), primarily through the Division of Correction (DOC), has the responsibility for operating State correctional facilities. Offenders with sentences of more than 18 months must be incarcerated in a State correctional facility.

### Central Booking

The Baltimore Central Booking and Intake Center (CBIC), operated by DPSCS, processes and houses nearly 100,000 people arrested by Baltimore City Police each year. In April 2005, the Office of the Public Defender filed a lawsuit against the State based on claims that a number of arrestees were not being presented before a court commissioner within 24 hours at CBIC. As a result, Judge John M. Glynn issued a temporary restraining order that forced the State to release suspects who did not see a commissioner within 24 hours of arrest. In the spring and early summer of 2005, at least 80 people were released from CBIC without being charged due to excessive delays.

The capacity of the Baltimore City Central Booking and Intake Center facility upon opening was 811 beds. In fiscal 2005, the average daily population (ADP) was 1,179. ADP peaked in fiscal 2004 at 1,255. In addition to the strain on housing units within the facility, the overpopulation causes delays in processing of detainees because the facility does not have the capacity to manage the number of people being processed. This means that some detainees are not processed properly within the allotted 24-hour time frame.

CBIC has also been the focus of both federal and State homicide investigations this year. An inmate died in May following an incident with correctional officers. As a result of the incident, eight officers in total were dismissed, three of whom have been criminally charged.

## Health Care

DPSCS ushered in a new inmate medical contract in fiscal 2006. The new contract is broken down into six service "modules" (medical, dental, mental health, pharmacy, electronic records, and utilization management) rather than regions as had been done in the past. There are five contractors managing the six modules. The maximum cost of the contracts is $110.7 million. The fiscal 2006 working appropriation provides only approximately $85.2 million for the contracts, resulting in a difference of $25.5 million, if the maximum contract cost is achieved.

## RESTART

Funds for Reentry Enforcement Services Targeting Addiction, Rehabilitation, and Treatment (RESTART) were released in November 2004, and two pilot sites have gone into operation. To date neither is fully staffed. The two pilot sites are the Maryland Correctional Training Center in Hagerstown and the Maryland Correctional Institution for Women in Jessup. To prevent recidivism, RESTART is described as a coordinated approach to serving the needs of inmates before they are released. RESTART initiative programs include expanded educational offerings (including more occupational courses and night and transitional courses), addictions treatment, mental health services, and case management. Additionally, social workers within DOC are working with Division of Parole and Probation employees to develop release plans for an inmate prior to the inmate leaving the correctional institution. There are also a number of community partners that have been recruited to assist with inmate transitioning services before and after release, including the AFL-CIO, Catholic Charities, Girl Scouts of America, and Big Brothers and Big Sisters.

The fiscal 2006 working appropriation includes a total of $5.2 million for the two RESTART pilot programs. The department was allocated $1.2 million of restricted general funds for RESTART and was also allowed to use an additional $500,000 of existing resources and to convert up to 50 correctional officer positions to RESTART positions. However, the department did not use all of the restricted funds and, therefore, reverted approximately $313,000 to the general fund in fiscal 2005. The department estimates that about 8 percent of the Division of Correction population will participate in RESTART in fiscal 2006.

## Maximum Security Housing

The projected maximum security male average daily population for fiscal 2006 is 2,278 inmates. There are currently four institutions that house maximum security inmates and contain a total of 2,443 single cells. The total cell count is adequate to house the fiscal 2006 population; however, DPSCS is planning to implement changes that will affect the availability of maximum security cells.

The first planned change is the movement of the population from the Maryland Correctional Adjustment Center (MCAC) to the new housing unit at the North Branch Correctional Institution (NBCI), scheduled to open February 2006. The department plans to use MCAC to house dislocated detainees during the Baltimore correctional complex construction. Then in 2010, the department plans to demolish the Maryland House of Correction (MHC). The newer of the two principal housing units at MHC opened in 1928. MHC's age causes serious security and operational drawbacks. By the time the facility is demolished, the third and fourth housing units at NBCI are expected to be operational. After these changes, the maximum security cell count is expected to be reduced to 2,224, which is less than the projected fiscal 2006 average daily population.

# Criminal Law

## Methamphetamines

**Methamphetamine has been called "the fastest growing drug threat in the United States." While the known number of abusers in Maryland is small when compared with abusers of cocaine and heroin, the drug continues to move into new populations causing new health and environmental problems.**

### Background

Methamphetamine, also known as "speed" or "meth," is one of the nation's most dangerous illegal drugs. Users on a "binge" may go days without sleep or food. The addiction is insidious and hard to overcome. Chronic methamphetamine abuse leads to significant weight loss, psychotic and violent behavior, heart problems, and brain damage. Addiction to methamphetamine means serious health problems for the user and public health and environmental problems for the community.

Methamphetamine can be produced almost anywhere – from abandoned buildings in rural areas to apartments and even cars in more populated areas. Over the counter cold medicines containing pseudoephedrine are "cooked" with reagents such as iodine and solvents such as paint thinner to make the synthetic drug. While relatively simple and inexpensive to manufacture, the production of methamphetamine is hazardous. Eighty percent of methamphetamine manufactured in the U. S. is produced in sophisticated super labs; however, makeshift "mom and pop" labs make smaller quantities under conditions that often result in toxic explosions, fires, hazardous waste dumping, and child endangerment.

#### Nationwide Problem

Federal officials have called methamphetamine "the fastest growing drug threat in the United States." Its popularity began 20 years ago among biker gangs in the Southwest and is steadily advancing eastward. A 2005 survey of the National Association of Counties reported that over 75 percent of county law enforcement agencies in the Northwest and Southwest named methamphetamine as the number one drug problem. Over half of the agencies in the Midwest made the same report. By contrast, 25 percent of agencies in the Southeast, including Maryland, and 4 percent of Northeast agencies called methamphetamine their primary drug problem.

Methamphetamine-related hospital admissions mirror this trend. Treatment admissions from 1998 to 2002 in California grew from 49 to 200 per 100,000; in Iowa the rate went from 9 to 198 per 100,000. The National Survey of Drug Abuse and Health reports that the number of people seeking methamphetamine-related treatment has increased nationwide from 2 percent in 1993 to 7 percent in 2003. California's increase over 10 years was 30 percent; the number seeking treatment in Arkansas rose 22 percent.

### Methamphetamine in Maryland

To date, methamphetamine's impact in Maryland is minimal, but surrounding areas have seen much more activity with an increasing number of methamphetamine labs seized. One methamphetamine lab was seized in Virginia in 2000 compared to 61 in 2004. The number of labs seized in West Virginia between 2000 and 2004 increased from 3 to 84 and in Pennsylvania from 8 to 63.

As is true nationwide, methamphetamine users in Maryland have historically been concentrated in rural areas. The most likely users are white, working class, in their 20s or 30s, and almost as likely to be female as male. However, use among white-collar professionals and long-distance truckers is increasing.

## Aspects of the Methamphetamine Problem

### Regulation of Precursor Chemicals

Common cold remedies such as Sudafed contain the main precursor chemical, pseudoephedrine, needed to manufacture methamphetamine. Farm supply stores and auto product stores carry other necessary chemicals, including red phosphorous and acid. Forty states place some restriction on the sale of precursor chemicals. For example, Oklahoma and Oregon require a doctor's prescription for the purchase of pseudoephedrine. Other states, including Kentucky, require stores to move pseudoephedrine behind a counter, restrict sales to adults, and keep a computer-based record of purchases.

Five states have established Meth Watch programs. Watch programs team law enforcement and state health officials with retailers to report incidents of theft, suspicious purchases, or clandestine lab operations.

### Dangers to Children

Children found in locations where methamphetamine is manufactured are highly susceptible to inhaling and absorbing the toxic substances, and face serious safety risks from potential lab fires and explosions. Children may be left unsupervised, neglected, or even abused while parents are preoccupied with their addiction. Forty percent of child welfare officials in 2004 reported an increase in out-of-home placements due to methamphetamine use. States have addressed the problem of children being present at illicit drug laboratories by expanding their child endangerment laws to include exposing a child to an illicit chemical substance or establishing a separate offense of drug manufacturing in the presence of a child.

## Environmental Impact

The manufacturing of methamphetamine poses a significant danger to first responders. Poisonous gases are released when the highly flammable and explosive chemicals are "cooked." Every pound of methamphetamine produced generates five to seven pounds of toxic waste. Lab operators have dumped the toxic waste down household drains, in fields, in yards, and on rural roads. Emergency personnel require appropriate training in identifying and handling the contents of a lab as clean up of contaminated sites is critical. Some states (*e.g.*, Kentucky) have made methamphetamine producers civilly liable for clean up costs.

## Maryland's Response to the Methamphetamine Crisis

Currently, Maryland law subjects a person convicted of manufacturing methamphetamine to maximum imprisonment of 5 years and subjects a person convicted of importation to a maximum of 25 years.

Senate Bill 372 of 2005, which did not pass, would have restricted the sale of pseudoephedrine to adults, limited quantities for sale, and required record keeping by pharmacies. This fall the State Board of Pharmacy submitted regulations to require pharmacies to keep single entity pseudophedrine products in the prescription area of pharmacies and allow the purchase of such products only by persons over the age of 18 with proof of age identification.

# Criminal Law

## Human Trafficking

**Human and sex trafficking has been described as a growing underground industry fueled largely by the extreme economic hardship that families face in many parts of the world. Thirteen states have already passed criminal statutes, and several states have created task forces to study the issue.**

## The Problem

Human trafficking is a modern day form of slavery and a lucrative criminal enterprise in today's world economy. It includes the recruitment, transportation, and sale of individuals, usually members of vulnerable populations in countries outside the U. S., for labor. Labor is forced and maintained through violence, threats, and coercion. Living conditions for victims are often prison-like. It is believed that the number of people involved began growing in the early 1990s and that the trend continues to increase. The U. S. is a country of destination for many trafficked persons, the majority of whom are transported from Asia and Latin America, with increasing numbers from the Newly Independent States of the former Soviet Union, Eastern Europe, and other regions.

Human trafficking takes many forms. It involves transporting people within or across borders to, among other things, labor in sweatshops, perform domestic work, work in the sex industry, work in hotels or restaurants, peddle or beg, or work as farm or timber laborers. Victims may also be exploited in mail-order bride or child adoption schemes. In their countries of origin, victims of trafficking commonly experience poverty, oppression, persecution, civil unrest, and lack of opportunity. Victims are often deceived by recruiters and led to believe that the opportunity offered will bring them and their loved ones a better life.

Victims of human trafficking suffer horribly. They are forced to endure a variety of harsh living conditions including poor sanitation, malnourishment, excessive heat or cold, and sleep deprivation. They may be subdued with drugs and subjected to extreme violence. Victims trafficked for sexual exploitation face exposure to sexually transmitted diseases including HIV/AIDS, and some suffer permanent damage to their reproductive organs. Children who are unable to attend school experience reduced economic opportunities and increased vulnerability to being retrafficked in the future. Victims who are able to return to their communities often find themselves stigmatized or ostracized. Recovery from the physical and psychological trauma is extremely difficult, if not impossible.

Victim assistance for trafficked persons is constrained by factors such as laws barring undocumented immigrants from receiving victim-related services and benefits. In addition, trafficked persons generally fear deportation by the Immigration and Naturalization Service or arrest and imprisonment by local law enforcement agencies, precluding them from seeking help.

Victims' fear of removal is exploited by traffickers to keep them isolated and under control. Trafficked persons may in fact be viewed as illegal aliens or may be seen as accomplices to trafficking by the legal system. Other barriers, including culture, language, fear of violence against family in the country of origin, shame, and physical and/or emotional trauma, must also be addressed in order to serve trafficking victims appropriately.

## Possible Solutions

At the international and national level, remedies exist to address human trafficking. In February 2000, the United Nations adopted the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, supplementing the U.N. Convention Against Transnational Organized Crime. In October 2000, the U. S. Congress passed the Trafficking Victims Protection Act of 2000 (TVPA). This law is designed to prevent trafficking, punish traffickers, and protect and assist trafficked persons. TVPA extends assistance and benefits to victims of "severe forms of trafficking" which is defined as "a) sex trafficking in which a commercial sex act is induced by force, fraud, or coercion, or in which the person induced to perform such act has not attained 18 years of age; or b) the recruitment, harboring, transportation, provision, or obtaining of a person for labor or services, through the use of force, fraud, or coercion for the purpose of subjection to involuntary servitude, peonage, debt bondage, or slavery." TVPA protects trafficked persons by providing immigration status (T visa), permission to work, and possible U.S. permanent residence. The Trafficking Victims Protection Reauthorization Act of 2003 amended TVPA to remove obstacles in the process of securing needed assistance, increase benefits to victims of trafficking, increase knowledge about trafficking in persons, enhance prevention efforts, provide greater protection to victims, and increase prosecution.

States have also enacted laws against human trafficking. Proponents of state laws against human trafficking contend that current laws prohibiting kidnapping, rape, sexual offense, prostitution, and the like do not adequately address human trafficking, in part because of the psychological aspect of the coercion that trafficking victims are subjected to and that federal authorities do not have the resources to address all cases of human trafficking that exist. To date, 13 states – Arizona, Arkansas, California, Florida, Illinois, Kansas, Louisiana, Minnesota, Missouri, Nevada, New Jersey, Texas, and Washington – have enacted laws to make trafficking a state offense. Several states, including Colorado, Connecticut, Washington, Idaho, Minnesota, and California, have established task forces to study the issue of human trafficking.

House Bill 1473 of 2005, which sought to prohibit human trafficking in Maryland, was withdrawn by the sponsor. The House Judiciary Committee held a hearing on the issue of human trafficking during the 2005 interim. It is expected that this issue will receive further attention during the 2006 session.

---

For further information contact: Claire E. Rossmark Phone: (410) 946/(301) 970-5510

# Criminal Law

## Identity Theft

**Identity theft is the fastest growing form of financial fraud in America. During the late fall, it is expected that a newly created task force to study issues relating to identity theft will begin meeting to discuss ways to combat the problem.**

### State and Federal Governments Grapple for Ways to Stop the Fastest Growing Form of Financial Fraud

To say that identity theft is the fastest growing form of financial fraud is almost a cliché, but in the twenty-first century information has become the new currency, almost more valuable than cash. With the right information, criminals can get an almost unlimited supply of money and goods through credit accounts and the siphoning of funds from checking and savings accounts, all without ever confronting their victims, who are left to piece together the remnants of their good names. In calendar 2003, the Federal Trade Commission received 214,905 identity theft complaints. In calendar 2004, the number of identity theft complaints increased 14 percent to 246,570. In 2004, 4,612 Maryland residents reported some form of identity theft, with the most common type being credit card fraud. The highest number of identity theft complaints in Maryland came from the State's urban areas, such as Baltimore, Silver Spring, and Laurel.

In addition to the physical theft or loss of credit cards, Social Security numbers, driver's licenses, or other personal information, other ways in which identity information may be stolen include:

- "phishing" or asking for personal or financial information that is supposedly lost or outdated;
- "pharming" or redirecting an Internet user without his or her knowledge or consent to an illegitimate web site that records personal information for fraudulent purposes;
- loss by a data collection company;
- hacking of unencrypted information from a database;
- theft of account information by unmonitored company insiders;
- inadvertent sale or transfer of information to fake entities; and

- loss or theft of computer records during transport.

The prospect of being victimized through the loss or theft of information held by data collection companies has captured national attention. ChoicePoint, a data collection company, exposed information on 145,000 consumers across the country through bogus business accounts that were set up by identity thieves. According to the Privacy Rights Clearinghouse, since disclosure of the ChoicePoint breach in February 2005, there have been at least 83 other breaches of personal information, involving exposure of over 50 million instances of Social Security numbers, driver's license numbers, and credit account numbers.

## National Response

With the specter of ever increasing incidences of identity theft, a number of states have enacted legislation to provide stronger consumer protections. It was a California law, enacted in 2002, requiring disclosure and notification of data breaches that forced ChoicePoint to reveal the compromise of its data. Since enactment of California's law, at least 35 other states have considered this legislation, including Maryland. According to the State Public Interest Research Group (State PIRG), 21 states have enacted notification legislation (Arkansas, California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Louisiana, Maine, Minnesota, Montana, Nevada, New Jersey, New York, North Carolina, North Dakota, Rhode Island, Tennessee, Texas, and Washington – the Georgia notification law applies to data broker agencies only and the Indiana law applies to state agencies only.)

Twenty other states, including Maryland, considered security freeze legislation in 2005. At least 11 states have passed security "freeze" laws. These laws allow consumers to restrict access to their credit reports so that creditors cannot open new accounts without the accountholders' specific consent. The security freeze laws passed in California, Colorado, Connecticut, Louisiana, Maine, New Jersey, and Nevada allow all consumers to freeze their credit report information. The laws passed in Illinois, Texas, and Vermont are limited to identity theft victims, while the Washington law extends its reach to victims of security breaches, as well as identity theft victims. According to State PIRG, the New Jersey law, the strongest security freeze law in the country, requires the implementation of a freeze on consumer information at consumer request and at minimal expense to consumers. The credit bureaus are required to facilitate the quick placement and lift of any security freeze. The New Jersey law also limits the display and use of Social Security numbers, sets standards for the destruction of personal information by businesses, and requires notification of security breaches, as noted above.

## Maryland Response

In Maryland, Chapters 241 and 242 of 2005 established a 21-member legislative task force on identity theft. To date, 14 of the 21 members have been appointed. The task force is charged with studying the problems associated with identity theft in Maryland and the privacy laws in other states. The task force is required to consult with federal agencies, agencies in other states, and identity theft experts during its investigation. The task force must also complete a survey of State agencies to determine compliance with State and federal laws relating to collection and use of Social Security numbers. Findings and recommendations for possible remedies to identity theft must be submitted to the General Assembly by December 31, 2006.

## Federal Response

At the federal level, legislation enacted as the Identity Theft and Assumption Deterrence Act in 1998 made identity theft a federal crime. In 2003, the Fair and Accurate Credit Transactions Act set a national standard requiring truncation of credit and debit card numbers on electronically printed receipts and preempted similar state laws. Congressional bills are under consideration that could set a national standard for notification of data breaches, impose fines on data collection companies that do not comply with notification procedures, and provide credit monitoring services to affected individuals for one year. It is unclear whether federal legislation will preempt existing state legislation or if federal legislation will be enacted before the close of 2005.

For further information contact: Karen D. Morgan Phone: (410) 946/(301) 970-5510

# Criminal Law

## Death Penalty Update

**With a recent Supreme Court decision and pending challenges at both the State and federal levels, capital punishment continues to be a controversial issue.**

### Background

The use of capital punishment continues to be controversial throughout the country. Maryland has grappled with several death penalty issues in recent years, including a gubernatorial moratorium in 2002, a University of Maryland study of the effects of race and jurisdiction in pursuing death penalty eligible cases in the State, and several death penalty appeals at the State level.

Several court challenges to the constitutionality of Maryland's death penalty statute have been attempted in recent years, but in each instance the statutory procedures have been upheld. Still more State and federal court challenges to the death penalty are pending, and legislative proposals to both expand the scope and restrict the implementation of Maryland's death penalty statute have been introduced in recent years and may continue in the 2006 session.

### Recent Supreme Court Cases

The Supreme Court has recently waded back into the death penalty debate with a case involving death penalty eligibility for juvenile offenders. Although Maryland's death penalty statute specifically prohibits death sentences for minors, the fact that the court is actively addressing eligibility criteria may raise some issues for additional challenges in the State.

The Supreme Court ruled in 1989 that the minimum permissible age for the imposition of the death penalty was 16. On March 1, 2005, the Supreme Court ruled in the case of *Roper v. Simmons*, that the execution of a person under the age of 18 years when the crime was committed violates the Eighth Amendment ban on cruel and unusual punishment. The question arose from a Missouri case in which 17-year-old Christopher Simmons was sentenced to death for a murder-robbery. Opponents argue that brain research indicates the adolescent brain is not developed enough to inhibit impulsive behavior. The legal argument in *Roper v. Simmons* centered around the evolving sensibilities in society as to the appropriateness of executing adolescents as evidenced by the large number of states and countries that prohibit the execution of juveniles.

Additionally, the Supreme Court has heard several cases in recent years addressing various procedural aspects of the death penalty. Those appeals have dealt with subjects including jury selection, prosecutorial misconduct, jury instructions, and the weighing of mitigating circumstances.

## Recent State Challenges

Recent death penalty appeals in Maryland have centered on the issue of racial or jurisdictional bias in the imposition of the death penalty. The defendants are basing their appeals on the 2002 University of Maryland study examining the influence of race (of both the victim and the offender) and geography (where the crime occurred and was prosecuted) on the imposition of the death penalty.

The study concluded that there appeared to be disparities in the imposition of the death penalty based on the race of the victim. The study found that, by itself, the race of the offender did not play a clear role in the processing of death penalty cases at any of the stages of prosecution. However, the study did find evidence of disparity when the race of the victim is considered. If a victim is white, the defendant is significantly more likely to receive a notice of intent to seek the death penalty; however, the study found that when the case actually reaches the penalty phase, the race of the victim does not significantly impact the imposition of the death penalty.

Additionally, the study found that the race of the offender and the victim when viewed together has an impact on the imposition of the death penalty. If an African American offender murders a white victim, the offender is substantially more likely to be charged with a capital offense and, therefore, is at a greater risk of a facing a death sentence.

Finally, the study found that geography played a part in the imposition of the death penalty. Some jurisdictions seek the death penalty more than others, thus whether a defendant receives a penalty of death can be affected by where the crime is committed. For instance, the State's Attorney in Baltimore County was found to seek the death penalty more often than in any other county.

Wesley Eugene Baker was convicted and sentenced to death in Baltimore County in 1992 for killing a woman at a Baltimore County shopping center in front of her two grandchildren. Baker filed an appeal in October 2004 alleging that the imposition of the death sentence in his case was racially and geographically biased. In October 2005, the Court of Appeals upheld Baker's death sentence on procedural grounds. The court did not directly address the question of racial or geographical bias. Governor Robert Ehrlich signed a death warrant for Baker for the week of December 5.

The failure of the court to address the issue of bias directly leaves the question open in the case of Vernon Evans, Jr. who, in 1984, was sentenced to death in Baltimore County for the contract killing of two people, including a witness in a federal drug case. In September 2005, attorneys for Evans presented the argument that the death sentence was applied in a racially and geographically biased manner because Evans is African American while the victims were both white and because Evans was tried in Baltimore County.

## Legislation

Several bills were introduced in the 2005 session related to the death penalty, none of which passed. Most would have added to the list of aggravating factors that make an individual eligible for the death penalty. The additions included the commission of more than one murder in the first degree, murder in retaliation for testimony, murder of an off-duty law enforcement officer, murder of victims and witnesses, and murder of a person under a protective order. Additionally, there was a bill to repeal the death penalty in the State.

Given the attention that will be drawn to the findings of the University of Maryland study by the most recent appeals in Maryland's death penalty cases, it is possible that additional legislative proposals will be introduced in the 2006 session.

For further information contact: Kelly G. Dincau Phone: (410) 946/(301) 970-5350

# Civil Proceedings

## Medical Malpractice

**After two years of double-digit medical malpractice insurance premium increases, which prompted legislation in the 2004 special session and the 2005 session, the State's largest medical malpractice insurer has announced that it will not raise rates next year. As the improving climate is analyzed, the debate over tort reform is expected to continue.**

### Maryland Responds to the Medical Malpractice Insurance Crisis

Medical Mutual Liability Insurance Society of Maryland (Medical Mutual), which insures over three-quarters of Maryland's physicians in private practice, received approval from the Insurance Commissioner to increase insurance premiums by 28 percent in 2004 and 33 percent in 2005. The need for these increases, according to Medical Mutual, stemmed from, among other factors, an increase in the severity of paid claims. In response to the insurance costs, doctors threatened to quit or limit their practices or leave the State, prompting Governor Robert Ehrlich to call a special session in December 2004 to address the issue. The General Assembly then passed the Maryland Patients' Access to Quality Health Care Act of 2004 (Chapter 5 of the 2004 special session). The Act was vetoed by the Governor who opposed its revenue source and supported additional tort reform. However, the General Assembly overrode the veto.

Chapter 5 established a fund financed by the repeal of the 2 percent premium tax exemption applicable to health maintenance organizations to limit insurance premium increases, increase fee-for-service rates for health care providers, and increase capitation rates for managed care organizations. The legislation also included numerous other reforms, including ● freezing the cap on noneconomic damages at $650,000 for four years; ● eliminating the "double cap" for noneconomic damages in death cases; ● capping noneconomic damages in death cases with more than one claimant to $812,500 for four years; ● restricting evidence of certain apologies by health care providers; ● imposing stricter qualifications for medical expert witnesses; ● requiring alternative dispute resolution (ADR) before trial; ● requiring a party who does not accept an "offer of judgment" to pay the offeror's costs incurred after making the offer if the verdict at trial is not more favorable than the offer; ● lowering the standard of proof for physician disciplinary actions by the Maryland Board of Physicians; ● authorizing the board to directly fine hospitals for failure to report a disciplinary action against a doctor; ● establishing a "people's counsel" to represent consumers in some insurance rate hearings; ● requiring reports by medical malpractice insurers; and ● requiring the Insurance Commissioner to report to the General Assembly annually on the availability of medical malpractice insurance.

As the 2005 session began, it became clear that certain aspects of Chapter 5 were too complicated to be effective. Consequently, Chapter 1 of 2005 expedited implementation and premium relief to doctors. Among other provisions, the new corrective bill replaced the special fund and reinsurance mechanism in Chapter 5 with the Maryland Health Care Provider Rate Stabilization Fund. Chapter 1 also established a method for using the fund to directly subsidize malpractice insurance premiums of doctors and nurse midwives.

Chapter 1 adjusted other aspects of the special session legislation, including refining and clarifying the claims information required to be reported by medical malpractice insurers and placing additional requirements on Medical Mutual concerning surpluses, commissions, and financial information provided to the Insurance Commissioner. Chapter 1 took effect April 1, 2005, without the Governor's signature.

## Implementation of the New Legislation

### Patient Safety – Reporting by Hospitals

Chapter 5 of the 2004 special session codified a requirement that each hospital report to the Department of Health and Mental Hygiene unexpected occurrences that result in death or serious disability within 5 days of the occurrence or its discovery and report an analysis within 60 days. Failure to report an event or analysis may result in a $500 per day fine. According to the department, in the period from July 1, 2004, to June 30, 2005, only 125 of these events were reported, despite a statistical expectation of 500 to 1,200 reports. The average submission time of the analyses was 70 days, and a significant number have never been received. No fines have yet been assessed.

### Rate Stabilization Fund

To date, three of the State's malpractice insurers (Medical Mutual, NCRIC, and The Doctors Company) have received subsidies from the stabilization fund totaling over $27 million. The State's other malpractice insurer, Medical Protective Company, has not yet filed for a subsidy.

The statutory formula for subsidies anticipates that insurers will apply for rate increases for the foreseeable future, but subsidies from the State will decrease gradually over time. Under the formula a "subsidy factor," expressed as a percentage, is calculated by dividing the aggregate amount of money available for the subsidy by the aggregate amount of premiums that would have been paid at the rate approved during the prior year. As required under the law, the Insurance Administration released on November 1, 2005, a subsidy factor of 25 percent for 2006. In August 2005, Medical Mutual announced to its members that no rate increase for 2006 will be requested from the administration. As a result, the 25 percent subsidy factor will result in a majority (over 62 percent) of its policyholders receiving a larger rather than a smaller subsidy in 2006 than in 2005 and may spur legislation to refine the formula for providing subsidies.

In any case, corrective legislation is likely to be introduced to revise the formula to clear up what the Attorney General recently advised is legislative language inconsistent with the obvious purpose of the statute. See 90 *Opinions of the Attorney General* 117 (2005).

### Claims Data – Reporting by Insurers

MIA has proposed regulations to implement the data reporting requirements for medical malpractice insurers and has created an online closed claims survey form for insurers.

### Alternative Dispute Resolution

In September 2005, the Court of Appeals Standing Committee on Rules of Practice and Procedure proposed changes to the Maryland Rules of Procedure governing ADR to conform to the new statute, including additional qualifications for individuals who conduct ADR. The Conference of Circuit Court Judges formed a committee to implement the new ADR requirements which forwarded its recommendations to the Chief Judge of the Court of Appeals in September 2005.

## Additional Tort Reforms

Medical Mutual reports that current payouts are keeping pace with the previous year, which reflected a significant drop from the year before that. Critics of additional medical malpractice reform proposals emphasize this cooling of malpractice costs in Maryland and a study released in July 2005 by the Center for Justice and Democracy and five other consumer organizations charging that the nation's largest malpractice insurers (Medical Mutual was not included in the study) have overcharged doctors during the past five years.

Concern that the most recent level of payouts may be an aberration rather than a trend, however, may spark efforts to enact further tort reforms, including requiring that certain types of past economic damages (lost wages and medical bills) be reduced if the plaintiff received compensation from any other source (*e.g.*, disability or health insurance); limiting attorney contingent fees; prohibiting certain types of attorney for-profit referrals; requiring "structured" payouts of judgments over time rather than in a lump sum; making an out-of-state medical expert witness accountable to the Maryland Board of Physicians for false testimony; and expanding the restrictions on evidence of apologizing by health care providers.

For further information contact: John J. Joyce/Susan H. Russell Phone: (410) 946/(301) 970-5350

# Civil Proceedings

## Same-sex Civil Unions and Marriages

**A lawsuit filed by several same-sex couples in the Baltimore City Circuit Court alleging that Maryland's prohibition against same-sex marriage violates State constitutional rights is likely to prompt the reintroduction of a constitutional amendment to ban same-sex marriage and legislation to provide that Maryland does not recognize same-sex marriages performed in another jurisdiction.**

### Background

In 1993, the legal status of individuals of the same sex who enter into familial relationships garnered national attention when the Hawaii Supreme Court ruled that its law denying same-sex couples the right to marry violated state constitutional rights. In 1998, voters in Hawaii adopted a constitutional amendment effectively overturning the decision by authorizing the legislature to reserve marriage to couples of the opposite sex.

In April 2000, Vermont became the first state to recognize a parallel system of "civil unions," which provide to same-sex partners the same legal benefits, protections, and responsibilities as married couples. Connecticut became the second state to approve such unions in 2005.

In November 2003, the Supreme Judicial Court of Massachusetts held that barring an individual from the rights and obligations of civil marriage solely because that individual would marry a person of the same sex violates the Massachusetts Constitution. Subsequently, in February 2004, the court ruled that authorizing civil unions for same-sex couples while prohibiting them from marrying also was unconstitutional. As a result, on May 17, 2004, Massachusetts became the first and only state to issue marriage licenses to same-sex couples.

Same-sex marriage is legal in Belgium, Canada, the Netherlands, and Spain.

### Current Maryland Law

Since 1973, Maryland law has provided that only a marriage between a man and a woman is valid in this State. This provision was enacted by Chapter 213 of 1973, after the Attorney General issued an opinion stating that marriage licenses were not to be issued to members of the same sex.

Maryland law does not address civil unions. However, the Court of Appeals has held that the extension of health insurance benefits by a county to same-sex domestic partners of the county's employees is not invalid under State law. *Tyma v. Montgomery County*, 369 Md. 497 (2002).

## Recognition of Same-sex Marriages and Civil Unions from Other States

Under the Full Faith and Credit Clause of the U.S. Constitution, states are required to give full faith and credit to the public acts, records, and judicial proceedings of every other state. Therefore, Maryland generally will recognize foreign marriages that are validly entered into in another state. For example, Maryland will recognize a common law marriage from another jurisdiction, although common law marriages are not valid in Maryland. *Henderson v. Henderson*, 199 Md. 449 (1952).

However, the Full Faith and Credit Clause does not require a state to apply another state's law in violation of its own legitimate public policy. See *Nevada v. Hall*, 440 U.S. 410 (1979) and *Henderson*, 199 Md. at 459 (stating that Maryland is not bound to give effect to marriage laws that are "repugnant to its own laws and policy"). The Office of the Attorney General has advised that the Maryland law prohibiting the performance of same-sex marriages in this State would also prohibit the recognition in Maryland of same-sex marriages from other states and would create a valid public policy exception to the general rule that marriages valid where performed are valid anywhere.

By contrast, according to the Office of the Attorney General, current Maryland law does not prevent the State, in applying the law of other states, from giving recognition to civil unions created in those states.

## Defense of Marriage Act

The federal Defense of Marriage Act of 1996 defines marriage as a legal union between a man and a woman only and allows a state to deny recognition of a public act, record, or judicial proceeding of any other state respecting a relationship between persons of the same sex that is treated as a marriage under the laws of the other state.

According to the National Conference of State Legislatures, 42 states (including Maryland) have passed laws that either prohibit same-sex marriages or deny recognition of same-sex marriages solemnized in another jurisdiction. Eighteen states have adopted constitutional amendments defining marriage as a union only between a man and a woman.

## *Deane, et al., v. Conway, et al.*

In July 2004, nine same-sex couples sued the clerks of the court in five counties contending that the Maryland law banning same-sex marriage is unconstitutional. In the complaint, the plaintiffs allege violation of the prohibition against discrimination based on sex under the Maryland Declaration of Rights, along with violations of due process and equal protection rights.

The lawsuit asks the court for a ruling (1) declaring that the failure of the Maryland statutory code to permit same-sex couples to marry constitutes unjustified discrimination based on sexual orientation and an unjustified deprivation of fundamental rights, including the fundamental right to marry, and therefore constitutes a violation of Article 24 of the Maryland Declaration of Rights; and (2) enjoining the clerks of the courts from refusing to issue marriage licenses to plaintiff couples or other same-sex couples because they are same-sex couples.

A hearing was held on August 30, 2005, but a decision has not yet been rendered in the case.

## Legislative Initiatives

Legislation relating to same-sex marriage is not new in Maryland. Proposals to ban recognition of lawful out-of-state marriages by same-sex couples (House Bill 1268 of 1996, House Bill 398 of 1997, Senate Bill 565 of 1998, House Bill 1128 of 1999, House Bill 531 of 2001, Senate Bill 746/House Bill 728 of 2004, and House Bill 693 of 2005) and proposals to amend the Maryland Constitution to define a valid marriage as a marriage between a man and a woman only (Senate Bill 673/House Bill 16 of 2004 and House Bill 1220 of 2005) have all been unsuccessful.

Measures to legalize same-sex marriage were proposed in the 1998 session (House Bill 1259) and in the 2000 session (House Bill 919) but were unsuccessful.

For further information contact: Lauren C. Nestor Phone: (410) 946/(301) 970-5350

# Environment and Natural Resources

## Air Quality – Stationary and Mobile Sources

**Air emissions from stationary and mobile sources are of continuing concern due to their environmental and health impacts. Legislation addressing emissions from power plants and new motor vehicles has been introduced in recent years and is expected to resurface during the 2006 session.**

While Maryland has made progress in meeting clean air goals, air pollution continues to threaten public health and the health of the Chesapeake Bay. According to the Maryland Department of the Environment (MDE), energy-generating facilities and on-road mobile sources are among the leading sources of air pollution in Maryland and emit several pollutants that have negative impacts on human health and the environment.

### Power Plant Emissions

Under the federal Clean Air Act (CAA), new major stationary sources and existing major sources undergoing major modifications must install additional pollution control technologies. However, many older power plants have been able to avoid upgrading their pollution control technology by claiming that their modifications are "routine maintenance." In addition, several plants are not subject to certain federal performance standards due to their age. As a result, the majority of older power plants have only minimal pollution control technology. Maryland has 19 fossil fuel-fired power plants, including 6 older, coal-fired plants that are not subject to CAA's New Source Performance Standards.

#### Federal, Regional, and State Responses

Recently, there has been a lot of activity regarding multi-pollutant proposals to limit power plant emissions. Several federal rules have been promulgated and proposed in the past year, such as the Clean Air Interstate Rule and the Clean Air Mercury Rule; federal legislation (the Clear Skies Act) has also been introduced. The Ozone Transport Commission, a group of northeastern and mid-Atlantic states, including Maryland, is currently in the process of developing its own multi-pollutant model rule. In addition, three states (Massachusetts, New Hampshire, and North Carolina) have adopted multi-pollutant strategies of their own, and several other states have considered multi-pollutant legislation in recent years.

#### Maryland's Multi-pollutant Legislation

In an effort to address concerns regarding emissions from Maryland's coal-fired power plants, legislation has been introduced in each of the past three legislative sessions. In 2005, Senate Bill 744 and House Bill 1169, as introduced, would have established facility-specific limits on emissions of nitrogen oxides ($NO_x$), sulfur dioxide, mercury, and carbon dioxide ($CO_2$) from specified power plants. The majority of these emission limits would have taken effect in 2011 with additional limits on $CO_2$ effective in 2021. House Bill 1169 was reported unfavorably by the House Economic Matters Committee. Senate Bill 744 was reported favorably with amendments by the Senate Education, Health, and Environmental Affairs Committee but was eventually recommitted to that committee from the Senate floor.

Proponents of the legislation argued that these bills could reduce as much as one-third of the nitrogen entering the Chesapeake Bay; reduce mercury pollution, which can cause developmental problems in fetuses; and reduce ground level ozone, which contributes to a number of health problems, including bronchitis, heart disease, emphysema, and asthma. Furthermore, advocates for limiting power plant emissions claim that a multi-pollutant regulatory approach could be implemented in an economically feasible manner. On the other hand, opponents of the legislation argued that these bills would not solve the problem of pollution transport from other states into Maryland; would disadvantage State power plants competing in the regional electricity market; and would interfere with various federal and regional initiatives to improve air quality.

## Low Emission Vehicles

In order to limit mobile source pollution, the CAA requires the U.S. Environmental Protection Agency to set standards to regulate emissions from new motor vehicles; the federal standards currently in effect in Maryland and nationwide are the Tier 2 standards. The CAA preempts individual state authority to require specific on-board controls. Congress made an exception for California and allows other states to adopt California's standards; in 2004, California adopted the second generation of its low emission vehicle program, CALEV II. To date, eight states (Connecticut, Maine, Massachusetts, New Jersey, New York, Rhode Island, Vermont, and Washington) have adopted CALEV II.

New motor vehicles must be certified by the manufacturer under either Tier 2 or CALEV II. A manufacturer may also choose to "dual certify" the vehicle under both programs so that vehicles may be sold in all jurisdictions. CALEV II and Tier 2 are both designed to limit primarily ozone-producing emissions from new motor vehicles. The programs establish limits on emissions of $NO_x$, particulate matter, non-methane organic gases (NMOG), formaldehyde, and carbon monoxide. Both programs certify vehicles into categories, and both programs are "fleet average" programs, establishing a fleet-wide average emissions standard that must be met. According to MDE, standards for most of the vehicles in CALEV II are similar to the Tier 2 standards. However, CALEV II focuses on NMOG reductions (because ozone formation in California is controlled by NMOG concentrations), whereas Tier 2 focuses on $NO_x$ (to address ozone formation in the Northeast). Two components of CALEV II that are not included in Tier 2 include (1) the Zero Emission Vehicle mandate, which requires that a certain percentage of all vehicles sold be zero emission vehicles; and (2) the greenhouse gas component, which requires manufacturers, beginning in 2009, to limit emissions of gases linked to climate change.

## Maryland's Clean Cars Legislation

Legislation to adopt the CALEV II program in Maryland has been introduced in each of the past three legislative sessions. In 2005, Senate Bill 366 received an unfavorable report from the Senate Judicial Proceedings Committee; the Environmental Matters Committee held a hearing on House Bill 564, but the bill was subsequently withdrawn.

Opponents of the legislation argued that adoption of CALEV II would produce limited benefits over the federal Tier 2 program and would not help Maryland attain federal air quality standards by 2010. In addition, opponents argued that adoption of CALEV II in Maryland would (1) increase the cost of purchasing new motor vehicles; (2) potentially limit the ability of Maryland consumers to purchase certain vehicle models; and (3) encourage consumers to purchase vehicles in other states. Opponents asserted that continuing with the federal Tier 2 program, on the other hand, would provide substantial air quality improvements in a timeframe consistent with the State's air quality plans. Opponents also argued that any strategy to adopt CALEV II should be regional in nature to address pollution transported to Maryland from other states and that Maryland does not need to adopt CALEV II in order to obtain advanced technologies such as hybrid electric or fuel cell vehicles.

Proponents of the legislation, on the other hand, argued that adoption of CALEV II would result in greater emissions reductions when compared to the federal Tier 2 program. As a result, proponents argued that adoption of CALEV II in Maryland would reduce atmospheric deposition of air pollutants to the Chesapeake Bay and result in a decrease in health care costs. Proponents also disputed the argument that adoption of CALEV II would result in higher costs for the purchase of new motor vehicles; some testimony cited research by the California Air Resources Board that estimated that the additional cost of a vehicle would translate to $1 per pound of pollution reduced compared to $5 per pound for other mobile source reduction programs.

For further information contact: Ned Cheston/Nora McArdle Phone: (410) 946/(301) 970-5530

# Environment and Natural Resources

## The Status of Chesapeake Bay Restoration

**While progress has been made, the State still has a long way to go to meet its pollution reduction goals by 2010. Bay restoration will require a significant investment of resources coupled with the implementation of cost-effective strategies.**

### Background

The Chesapeake Bay is America's largest and most productive estuary with 6,000 miles of shoreline and the ability to produce over half a billion pounds of seafood each year. By the early 1980s, however, it became clear that the quality and productivity of the bay was in serious decline. In response to this trend, in 1983, the bay states, the District of Columbia, the Chesapeake Bay Commission, and the federal government signed the first Bay Agreement, which set out a list of broad objectives for bay restoration. A more aggressive agreement was signed in 1987; but, by the end of the 1990s, the bay was still in decline. In 1999, the U.S. Environmental Protection Agency (EPA) identified the bay as an impaired water body. In 2000, the Chesapeake Bay partners negotiated the Chesapeake Bay 2000 Agreement (C2K), which laid out a new framework of bold restoration goals.

### Status

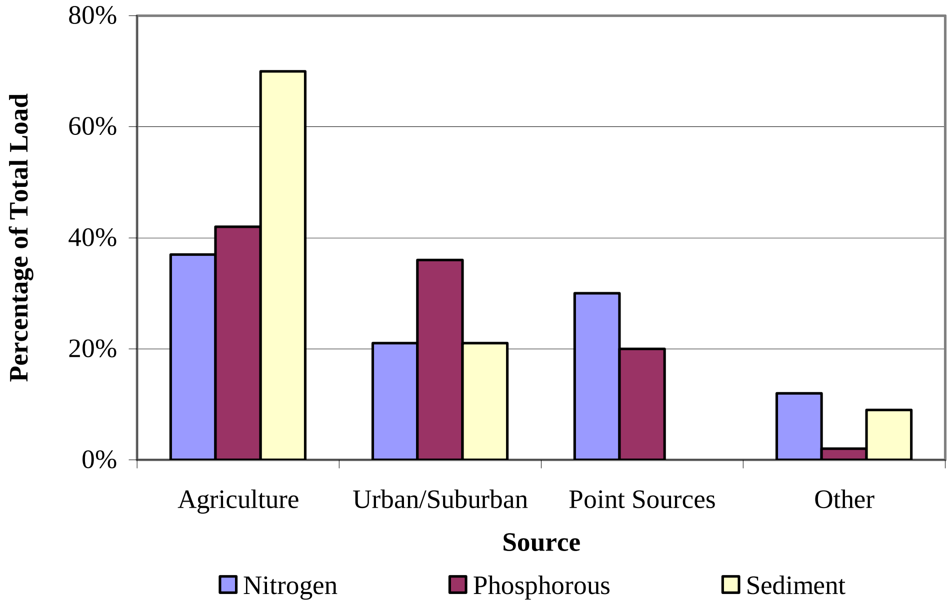
As part of C2K, specific pollution reduction goals have been allocated to the various bay states. Maryland's reduction goals and progress are summarized in **Exhibit 1**. In 2003 Maryland's contribution to the total pollutant load entering the bay watershed was 21 percent of the nitrogen loads and 20 percent of the phosphorous and sediment loads. As shown in **Exhibit 2**, the largest source of Maryland's nutrient and sediment pollution is agriculture, followed by point sources, and then urban/suburban lands.

**Exhibit 1**
**Maryland's Chesapeake Bay Pollution Reduction Goals**

| Pollutant | 1985 Loads | 2003 Loads | 2010 Goal |
|---|---|---|---|
| Nitrogen (million lbs/year) | 82.4 | 57.7 | 37.3 |
| Phosphorus (million lbs/year) | 6.8 | 3.8 | 2.9 |
| Sediment (million tons/year) | 1.3 | 1.0 | 0.7 |

Source: U.S. EPA's Chesapeake Bay Program

**Exhibit 2**
**Maryland's Chesapeake Bay Pollution Loads and Sources**




Source: U.S. EPA's Chesapeake Bay Program

## Strategies

C2K commits the bay watershed partners to "…complete a public process to develop and begin implementation of revised Tributary Strategies to achieve and maintain the assigned loading goals." In April 2004, the Department of Natural Resources (DNR) released Maryland's Tributary Strategy, which outlines basin-specific nutrient and sediment control actions necessary to reduce pollution from a variety of sources. However, an implementation plan for Maryland's Tributary Strategy had not been completed as of October 2005, nearly a year after it was anticipated. In spite of the lack of an implementation plan, numerous efforts are underway to help Maryland achieve the C2K goals. Examples of recent efforts include:

- Bay Restoration Fund – The Bay Restoration Fund was created in 2004 (Chapter 428) to provide grants for Enhanced Nutrient Removal (ENR) upgrades at the State's 66 major wastewater treatment plants (WWTPs). The fund is financed by a bay restoration fee on users of WWTPs, septic systems, and sewage holding tanks. While ENR grants are the fund's primary expenditure, funds are also being dedicated to sewer infrastructure grants, septic grants/loans, and the Maryland Department of Agriculture's cover crop program. While the estimated capital costs for ENR upgrades were originally $750 million, current estimates suggest that costs could exceed $1 billion. In addition, the collection of fee revenues has been slower than anticipated. Current projections by the Maryland Department of the Environment anticipate ENR capital grants totaling $858 million through fiscal 2014. The original goal was to complete all 66 upgrades by 2012.

- Chesapeake Bay Regional Financing Authority – In October 2004, the Chesapeake Bay Watershed Blue Ribbon Finance Panel called on bay states and the federal government to make a six-year, $15 billion investment in the creation of a regional finance authority to prioritize and distribute restoration funds throughout the watershed. In July 2005, the Chesapeake Bay Program's Financing Authority Committee released a paper outlining a potential organizational framework for the financing authority and recommending meetings to discuss the proposed framework and associated implementation issues.

- Corsica River Pilot Project – The recently announced Corsica River Pilot Project seeks to remove this Eastern Shore waterway from the EPA's List of Impaired Waters. This initiative intends to initially focus on reducing nutrient pollution and sediment runoff through urban, suburban, and agricultural best management practices, and restoring bay grasses and oyster habitat. An estimated $19.4 million will be targeted to this project over the next five years.

- Chesapeake Bay Recovery Partnership – In September 2005, DNR announced the creation of a "Chesapeake Bay Recovery Partnership" with Chesapeake Appreciation, Inc., a not-for-profit corporation. The partnership's goal is to raise funds for large scale bay restoration projects. One of the partnership's first fundraising ventures is selling bottled water from a Howard County aquifer.

- New Federal Grant Funds for the Bay – EPA and the National Fish and Wildlife Foundation are currently seeking proposals for $8 million in federal grant funds aimed at demonstrating innovative, sustainable, and cost-effective strategies for reducing nutrient loading into the bay. This pilot grant program expects to make approximately 8 to 12 grants of up to $1 million each.

## Policy Implications

At this time, Maryland is not well positioned to achieve its C2K commitments. According to a draft Tributary Strategy funding analysis, Maryland's existing funding sources will cover only 45 percent of the estimated $10 billion needed to implement the State's strategy through 2010. Also, several of the recent strategies described above may not have an impact for several years, and others could end up costing more than originally anticipated. While some important progress has been made, a significant increase in resources, coupled with the implementation of more cost-effective, high-impact bay restoration strategies could steer the State closer to meeting its C2K goals.

For further information contact: Amanda M. Mock Phone: (410) 946/(301) 970-5530

# Environment and Natural Resources

## Fisheries Management: A Status Report on Oysters

**The possible introduction of a nonnative oyster to the Chesapeake Bay warrants continued monitoring. The Department of Natural Resources (DNR) expects a draft environmental impact statement (EIS) to be released in January 2006.**

### Background

At one time, the Chesapeake Bay has historically beenwas the dominant oyster-producing region in the country, providing jobs for thousands of watermen and often yielding annual harvests of more than two million bushels. The oysters that remained in the Bay at that time played a vital role in maintaining the health of the estuary; they filtered all of the Bay's water within a few days' time, which resulted in the removal of nitrogen and other pollutants. In the last two decades, however, two diseases – MSX and Dermo – have devastated the Bay's oyster population and have nearly destroyed its oyster industry. Today, the oyster population has dropped to less than one-half of 1 percent of its original population; the annual harvest decreased to a low of just 26,500 bushels in 2004 before rebounding to almost 56,000 bushels in 2005. Meanwhile, only a few hundred watermen continue to harvest oysters from the Bay.

### Introduction of Nonnative Oysters to the Chesapeake Bay

As a way to both revive the State's oyster industry and restore the Bay's natural filters, the State is considering introducing a nonnative oyster, the Suminoe (*Crassostrea ariakensis*) or Asian oyster, to the Bay. The Suminoe oyster has shown resistance to MSX and Dermo and grows more quickly, and to a larger size, than the native oyster. A small population of a strain of the Suminoe oyster has been maintained in aquacultures off the coast of Oregon for about 30 years. Despite the Suminoe oyster's survival near Oregon, its possible survival in, and potential impact on, the Chesapeake Bay remains unknown. In a 2004 report, the National Academy of Sciences concluded that additional research was needed before safely predicting the likely effects of a nonnative oyster program. In response, the General Assembly passed legislation in 2005 (Chapter 441) prohibiting the Department of Natural Resources (DNR) from introducing a nonnative oyster without conducting additional research, completing an environmental impact statement (EIS), and having its research and conclusions vetted by an independent oyster advisory panel, the General Assembly, and the public.

DNR, along with Virginia and the U.S. Army Corps of Engineers, voluntarily began preparing an EIS in 2004. The EIS will consider eight different options ranging from continuing the current native oyster restoration program to introducing and propagating a nonnative oyster species while ending native oyster restoration efforts. The original timeframe called for the release of a draft EIS in February 2005; after several delays, DNR now expects that the draft EIS will be available in January 2006. In the meantime, DNR is releasing components of the EIS as they are completed; as of November 1, 2005, DNR had released the results of a cultural analysis and an ecosystem analysis as well as preliminary findings from an economic analysis. The cultural analysis examined the cultural value of the oyster and discussed the possible cultural impact of replacing the native oyster with a nonnative species. The ecosystem analysis determined that, if the Bay's oyster population was revived to 25 times its current size – that is, about the level found between 1920 and 1970 – nitrogen levels would drop by about 11 million pounds each year and underwater grasses, an important component of the Bay's ecosystem, would increase by more than 20 percent. Preliminary information from the economic analysis suggests that restoring the population to those levels would also help the State economically, generating more than $150 million in annual revenue for the oyster industry. DNR is also funding 11 different ecological studies to investigate such topics as the potential travel distance and dispersal rate of Suminoe oyster larvae, the potential spawning interactions between Suminoe and native oysters, and the minimum and maximum water salinity and temperature ranges for Suminoe oyster larvae. These studies are intended to help answer questions about the potential risks of introducing the Suminoe oyster to the Chesapeake Bay.

## Other Issues Relating to Oysters

### Power Dredging

Maryland banned power dredging in 1867 but since 1999 has allowed power dredging in about 30 percent of the Bay. In August 2005, DNR proposed expanding this area to 40 percent as a way to preserve the livelihoods of the few remaining oyster fishermen. Supporters of the proposal also claimed that power dredging could help the native oyster population by removing both diseased oysters and underwater silt on oyster beds. However, the proposal was met with almost immediate criticism from environmentalists and scientists, who countered that increased power dredging could expedite the native oyster's demise. Opponents also maintained that oysters that have survived in the Bay to this point might be more disease resistant and thus should be left in the Bay to form the basis of a recovered population. A number of scientists also disputed the claim that power dredging could help the oyster population. In the face of this opposition, DNR retracted its proposal in September 2005, indicating that it would conduct more research on the possible impact of increased power dredging.

### Endangered Species Status

In response to a January 2005 petition to list the native oyster as threatened or endangered under the federal Endangered Species Act, the National Oceanic and Atmospheric Administration (NOAA) announced in May 2005 that it would review the status of the Eastern oyster along the Atlantic and Gulf coast to determine if the species warrants protection. NOAA had planned on making a recommendation in January 2006. However, in November 2005, the petition was withdrawn, and NOAA announced that it is no longer considering listing the Eastern oyster as an endangered species.

For further information contact: Ryane M. Necessary Phone: (410) 946/(301) 970-5350

# Environment and Natural Resources

## Agriculture – Helping Farmers and the Environment

**Efforts are underway to develop recommendations to help farmers reduce agricultural runoff and maintain economic viability; 2006 legislation is anticipated as a result of the work of the legislative Agricultural Stewardship Commission.**

### Background

According to the Chesapeake Bay Program, in 2003 agriculture in Maryland was the largest source of nutrient and sediment pollution to the Chesapeake Bay, contributing 37 percent of the nitrogen, 42 percent of the phosphorus, and 71 percent of the sediment loads. The next largest source was point sources, followed by urban/suburban lands. The legislature recently addressed the point source contribution with the creation of the Bay Restoration Fund in 2004. Agriculture is seen as one of the next greatest opportunities to improve bay water quality.

Although recent changes to the Water Quality Improvement Act of 1998 have increased farmer compliance with the development and implementation of nutrient management plans, runoff from agricultural lands remains a concern. Imposing additional mandates on farmers without adequate financial support, however, is not seen as feasible. Maryland farmers are struggling to maintain economic viability. They are earning less than ever and receiving less in federal funds. Sky-rocketing property values in the region are putting farmers under more pressure than ever to sell their farms to developers. Since 1950, total farmland acreage in the Chesapeake Bay watershed has declined by 45 percent, and an estimated 90,000 acres of farmland are lost each year to growth and development. Nevertheless, agriculture remains the largest single land use in Maryland, comprising 2.1 million acres, or roughly 33 percent of the State's total land area. In addition, Maryland farms contribute greatly to the State's economy; the value of agricultural products sold in the Chesapeake Bay watershed totaled nearly $8 billion in 2002.

### Maryland Agricultural Commission's Listening Sessions

In response to the increasing pressures threatening the economic viability of agriculture in the State, in February 2005, Governor Robert L. Ehrlich, Jr. asked the Maryland Department of Agriculture (MDA) and the Maryland Agricultural Commission (MAC) to spearhead the development of comprehensive policy recommendations for sustaining agriculture in Maryland. The first step in this process was a mail survey conducted by MDA in May 2005; the survey results served as a starting point, helping MAC get a sense of the major concerns. Because MAC felt that it was important to get stakeholders involved, the second step was a series of listening sessions to seek input on various subjects of importance to farmers. Seven listening sessions were held throughout the State in August. A preliminary review of the issues raised during the listening session process reveals that Maryland farmers are most concerned with profitability, agricultural land preservation, and advancing agriculture through better promotion, advertising, and education. The information developed from the listening session process will be used by MAC as it drafts the framework for a strategic plan to be discussed at an Agricultural Forum on February 13, 2006. Participants in the forum will then develop policy recommendations. A final report is expected in May 2006.

## The Legislative Agricultural Stewardship Commission

Also during the 2005 interim, Senate President Thomas V. Mike Miller, Jr. and House of Delegates Speaker Michael E. Busch formed a joint legislative commission to examine and identify incentives to help farmers implement sound agricultural practices that will help clean up Maryland's rivers and streams, while ensuring the continued viability of farming in the State. The commission began meeting in July and expects to conclude its meetings in December. As of October, a variety of briefings had been held, including:

- an overview by the Chesapeake Bay Commission and the U.S. Environmental Protection Agency's Chesapeake Bay Program on nutrient and sediment pollution, commitments made under the Chesapeake 2000 Agreement to reduce nutrient and sediment loading to the bay, and strategies to achieve those reductions;
- a presentation by MDA on current agricultural water quality programs and funding;
- a report by MAC on the preliminary results of the listening sessions;
- an overview by the Delmarva Poultry Industry, Inc. of the economics of the poultry industry, its environmental successes, and its environmental needs;
- an overview by the Maryland Grain Producer's Association regarding Maryland's grain industry, its relationship with poultry production, and biofuels;
- a briefing by AviTech, LLC, regarding proposed technologies for the poultry industry;
- an overview by the University of Maryland regarding the Maryland Cooperative Extension and its funding history; and
- a summary by the Chesapeake Bay Foundation of a recent report regarding the state of Chesapeake agriculture.

As of late October 2005, the commission was in the process of holding additional briefings and developing draft recommendations. Although the work of the commission is still underway, several budgetary and legislative recommendations to provide financial incentives for farmers are anticipated. Final recommendations and draft legislation are expected in time for the 2006 session.

For further information contact: Ryane M. Necessary Phone: (410) 946/(301) 970-5350

# State Government

## Election Administration

**Implementation of Maryland's statewide electronic voting system moves forward amid efforts by the Governor, the State Board of Elections, and outside independent entities to assess and ensure the system's reliability, accuracy, and security, and as the State board finalizes efforts to implement a statewide centralized voter registration system and other requirements mandated by the Help America Vote Act of 2002.**

### Voter Verified Paper Trail/Audit

Chapter 564 of 2001 required the State Board of Elections (SBE) to select a uniform statewide voting system for voting at polling places. In January 2002, SBE entered into a $55 million contract to purchase over 16,000 electronic touch screen voting units and services from Diebold Election Systems, Inc. By the 2006 election, all local jurisdictions, including Baltimore City, will have implemented the new voting system.

Since 2003, there have been three studies and subsequent reports issued on the vulnerability of the Deibold system. The reports include (1) *Analysis of an Electronic Voting System*, by Aviel Rubin, a computer science professor at The Johns Hopkins University (the Rubin report); (2) an independent review of the Diebold voting system conducted by Science Application International Corporation (SAIC); and (3) a security review conducted by RABA Technologies. All of the reports raised concerns over the vulnerabilities of electronic voting software to hackers or substandard computer code and the ease with which the voting units themselves can be manipulated either physically through tampering or through the use of other electronic devices to intercept and modify election results. As a result, Maryland has received extensive media coverage about the security and accuracy of electronic voting systems which, together with a generally heightened level of public concern, have caused some voters to request an add-on printer that produces a voter-verified paper trail (VVPT) for the electronic voting systems.

VVPT would allow a voter to review a paper printout of the voter's selections and change the selections before casting a final vote. The paper record would serve as the official ballot and be used in the event of a recount, since it is assumed that if a voter specifically verified the document it would be the best indication of voter intent.

Currently, 25 states require the use of a paper trail. Fifteen states require VVPT to be counted as the official record of the vote (Alaska, Arkansas, California, Colorado, Connecticut, Minnesota, New Hampshire, New Mexico, New York, North Carolina, Ohio, Oregon, Utah, Washington, and West Virginia). Nevada and Idaho require a recount of electronic ballots only. Hawaii does not have a recount procedure in place. Missouri and Maine are promulgating regulations to establish procedures for handling paper ballots, and the remaining states have rules about paper ballots but do not use direct recording electronics (DREs).

House Bill 107 of 2005 would have required the State's uniform electronic touch screen voting system to produce a paper record of each vote cast and then allow the voter to inspect, verify, and correct any errors made on the ballot before the paper record is preserved at the polling place. The legislation did not pass, however.

Two related measures, Senate Bill 849/House Bill 479 of 2005, passed the General Assembly and would have required SBE to conduct a study of independent verification systems, including one VVPT system. However, both were vetoed. Regardless, SBE contracted with the University of Maryland, Baltimore County to conduct a technical study of independent verification systems and a public opinion study on voters' attitudes towards electronic voting. SBE indicates that a draft report is expected by December 15, 2006, and the final report is expected in January 2006. SBE has also partnered with the University of Maryland, College Park and Towson University to conduct a usability study to assess how adding a voter verification system would affect election administration and impact voters. Additionally, The John Hopkins University received a five-year grant to establish "A Center for Correct, Usable, Reliable, Auditable, and Transparent Elections" (ACCURATE) to conduct academic research on election issues, including electronic voting systems and VVPT technology.

In view of the widespread interest in VVPT, Diebold has developed a printer add-on prototype that may be used with its current DRE voting system. Projected costs for adding VVPT to Maryland's electronic voting system have been estimated at $6 to $16 million based on other states' costs and estimates for similar upgrades. This upgrade would be subject to the federal voluntary voting system standards to which Maryland is a signatory. However, these standards do not currently include guidelines for paper record printers on DRE voting system units. Any upgrade to the State's current voting system must also undergo a State certification test as well as independent testing and validation at the local level to verify the functionality of the entire voting system.

## Statewide Voter Registration System

Title III of the Help America Vote Act of 2002 (HAVA) requires a state receiving federal funds under the Act for election administration purposes to implement a centralized, interactive, computerized statewide voter registration list (CSVRL). SBE applied for and received a waiver of the January 2004 deadline set by HAVA to complete that task. Instead, SBE is now implementing CSVRL in time for final deployment by January 1, 2006, in accordance with its April 2005 contract for CSVRL with Saber Consulting Services.

The newly implemented CSVRL would replace the current centralized voter registration database (CVRDB), which is an aggregate list of voter registration records that originates from and is maintained at the local (county) jurisdiction level. Under the current arrangement, the central file is created by a weekly upload of local data files to SBE. These files are then merged into the read-only CVRDB. HAVA, however, specifically requires a state voter registration list to be defined, maintained, and administered at the s*tate* level.

The new CSVRL will provide access by local boards of election to electronically stored voter registration data and will support core election administration functions, including (1) new registrations; (2) change of address requests; (3) change of party affiliation requests; (4) absentee ballot requests; (5) mail-in registrations; (6) voter list maintenance activities (checking for duplicates and inactive voters); and (7) automated report production of registration data. **Exhibit 1** displays the major components of a HAVA compliant voter registration system which SBE must implement by the January 2006 deadline.

**Exhibit 1**

**Major Components of a Statewide Centralized Voter Registration List under the Help America Vote Act of 2002**

| | |
|---|---|
| **Official List Designation** | HAVA requires the computerized list maintained by the State to serve as the official voter registration list used in conducting all federal elections in the State. Currently, official registration records are maintained by individual counties. |
| **Single System** | CSVRL must serve as the single system for storing and managing the official registration list. Currently the statewide registration list is stored centrally but managed by local jurisdictions. |
| **Unique Identifier** | CSVRL must be able to assign a 'unique identifier' to each legally registered voter in the State. Currently, 19 of 24 local jurisdictions use unique identifiers at the local level, but there is no statewide identifier. |
| **Coordinated Agency Links** | CSVRL must be coordinated with the databases of the designated voter registration agencies within the State. Currently, State law designates the Motor Vehicle Administration and various social service agencies as voter registration agencies required to offer and accept applications for voter registration. |
| **Electronic Access** | CSVRL must allow any election official within a state, including local officials, immediate electronic access to the information maintained on the electronic voter registration list. Currently, local election officials have read-only access to CVRDB but data is not always current. |
| **Technological Security** | HAVA requires State or local officials to provide adequate technological security measures to prevent unauthorized access to CSVRL. |
| **Use of Driver's License Numbers/Social Security Numbers** | HAVA requires voter registration records to include an applicant's driver's license number or, for non-drivers, the last four digits of the applicant's social security number (SSN). CSVRL will accommodate these requirements. The current voter registration application does not request a driver's license number, and providing a SSN is voluntary. |

Source: Maryland State Board of Elections State Plan, submitted May 2003 in accordance with P.L. 107-252

## Early Voting (Including Absentee Voting)

While at least 35 states have some type of early voting program, the high turnout and long waits in many jurisdictions across the U. S. during the 2004 presidential election has caused a push by jurisdictions to institute early voting or expand existing early voting programs. The duration of early voting varies from state to state, but 10 to 15 days is the average length of time in which voters can cast their ballots. Senate Bill 478/House Bill 1046 of 2005, both vetoed by the Governor, would have provided for a five-day window for early voting prior to a general or primary election in the State.

Early voting can also be accomplished by providing voters the option to vote by absentee ballot, the only form of early voting now recognized under State law. However, in general, current law specifies that a voter is lawfully authorized to vote by absentee ballot only on account of absence on election day from the jurisdiction; accident, illness, or physical disability; death or serious illness of a family member; service in the armed forces; confinement in an institution; status as a full-time student at a college or university located outside the voter's regular precinct but within the student's county of registration; or employment by or service as an official of SBE or a local board on election day. House Bill 622 of 2005 would have repealed all of these eligibility requirements for absentee voting, but it too was vetoed by the Governor.

## Governor's Commission on the Administration of Elections

At the end of the 2005 session, having vetoed several election law reform bills, Governor Ehrlich vowed to establish a commission to study the issues raised in the bills. By executive order issued on October 27, 2005, the Governor established the Governor's Commission on the Administration of Elections. The nine-member bipartisan commission is tasked with (1) examining and analyzing issues related to voter-verified paper trails (*i.e.*, VVPT); (2) reviewing procedures for counting provisional ballots; (3) reviewing early voting programs; (4) examining eligibility requirements for absentee voting; and (5) considering other best practices the commission deems appropriate. The commission must submit recommendations to the Governor and the General Assembly by January 9, 2006.

## Carter-Baker Commission on Federal Election Reform Issues Report

In spring 2005, The American University organized the Carter-Baker Commission to study the electoral process in the U. S. and make findings and recommendations for improvements, including how to raise confidence in the electoral system. The private, bipartisan commission, co-chaired by former President Jimmy Carter and James Baker, a high-level appointee under three former presidents, consisted of 21 members comprised of former members of Congress, scholars, and nonpartisan leaders. In its September 2005 final report, the commission offered 87 recommendations to strengthen the country's electoral process and included proposals to establish a uniform system of voter identification, require some sort of paper trail (*i.e.*, a VVPT) for electronic voting systems, and restore voting rights to ex-felons under certain circumstances.

# State Government

## Task Forces, Study Groups, and Special Legislative Committees

**Various task forces and other entities have been established in recent years to study and make recommendations on issues and topics that are not otherwise covered in these issue papers.**

### Bay Restoration Fund Advisory Committee

The Bay Restoration Fund (BRF) was created by Chapter 428 of 2004 to provide grants for enhanced nutrient removal (ENR) pollution reduction upgrades at the State's 66 major wastewater treatment plants (WWTPs). This law also established a BRF advisory committee to assume the following responsibilities: (1) analyze the cost of nutrient removal from WWTPs; (2) identify additional funding sources; (3) make recommendations regarding the appropriate fee to be assessed in future years; and (4) in consultation with counties, identify septic system and sewage holding tank users and make recommendations regarding the collection of the fee from those users who do not receive water bills. The committee met numerous times over the past year and focused on the following issues: ● methods for identifying and billing septic system users; ● better defining federal government facility involvement; ● responding to increasing ENR upgrade cost estimates; ● identifying best available technology for septic upgrades; and ● monitoring BRF fee collections. The committee is supposed to submit an annual report to the Governor and the General Assembly in January 2006. This report is likely to contain recommendations on the issues summarized above, and these recommendations may prompt legislation during the 2006 session.

### Task Force to Study Criminal Offender Monitoring by Global Positioning Systems

The Task Force to Study Criminal Offender Monitoring by Global Positioning Systems (GPS), established by Chapters 138 and 139 of 2004, is required to study (1) how the State can utilize GPS technology to monitor certain individuals who have committed criminal offenses; (2) how law enforcement can benefit from linkage to such technology to solve crimes and streamline workload; (3) the feasibility of implementing a GPS technology program, including conducting a cost benefit analysis; and (4) the admissibility of evidence and other relevant issues. The task force held several meetings from November 2004 through November 2005. Meeting agendas included presentations from experts in navigation and tracking techniques, electronic monitoring and its use in a correctional setting, and the supervision of sex offenders. The task force also conducted work through four subcommittees. The task force is expected to submit a final report by December 31, 2005.

## Task Force on Missing Vulnerable Adults

The Task Force on Missing Vulnerable Adults, established by Chapter 528 of 2004, met seven times from December 2004 to September 2005. The task force will issue its final report by the end of the year. The draft report recommends:

- using a standardized missing person report form in all law enforcement agencies;
- entering information on every missing person in the State in a statewide database to be used by law enforcement agencies;
- eliminating any delay by a law enforcement agency in taking the report of a suspected missing person and entering the information in the database;
- improving communication between a law enforcement agency and the family of a missing person on how the investigation will proceed and how the family can assist the agency;
- entering DNA information on unidentified bodies in the database;
- requiring the use of permanent identification labeling on orthodontic appliances and dentures as mandated by law in 35 states; and
- by regulation of the Department of Health and Mental Hygiene, requiring nursing homes and long-term care facilities to develop policies to identify and better prevent unescorted patients from leaving.

## Task Force on Business Owner Compensation in Condemnation Proceedings

Chapter 446 of 2004 established the Task Force on Business Owner Compensation in Condemnation Proceedings to study the concept of business goodwill, with a particular focus on small business goodwill, and the appropriateness of developing a method for determining the value of such goodwill for purposes of calculating compensation in condemnation proceedings. The task force has met seven times since January 2005. It has investigated the feasibility of requiring each displacing agency to conduct a study of the impact of condemnation on businesses in the proposed area where condemnation proceedings will take place. It has also examined the appropriateness of establishing a fund to provide financial assistance to businesses affected by condemnation, the feasibility of shortening the condemnation process, the appropriateness of making a legislative proposal applicable statewide or only in Baltimore City, and the circumstances under which condemnation can be used in the State.

The task force also is considering the recent decision of the U.S. Supreme Court in *Kelo v. City of New London*, 125 S.Ct. 2655 (June 23, 2005), upholding the use of eminent domain to condemn private property for economic development and whether to recommend changes to Maryland law in response to the decision.

Although a draft report of the task force's recommendations has been circulated for discussion purposes, a final report was not available at the time of this writing. It is anticipated, however, that the task force will conclude its work by December 31, 2005, and propose legislation for consideration during the 2006 session.

# State Government

## State Comprehensive Plan for Managing for Results

**Maryland's first comprehensive plan for managing for results was issued in February 2005. While the plan with its broad statewide goals is a good first step, a lack of performance data and public accessibility makes it ineffective as an accountability tool. To be effective, the plan must guide ongoing planning and resource allocation decisions.**

### Background

Chapter 452 of 2004 required the Department of Budget and Management to develop a statewide plan for Managing for Results (MFR). In February 2005, the Department of Budget and Management submitted to the budget committees the State's first Comprehensive Plan for Managing for Results.

The plan is an important step in Maryland's progress in implementing a performance-based approach to planning and budgeting. The State's MFR program "emphasizes use of resources to achieve measurable results, accountability, efficiency, and continuous improvement in State government programs." The State Comprehensive Plan provides a singular, integrated statement of priorities and goals for the State, as well as a framework for measuring progress toward those goals. In other words, it attempts to answer the questions, "What do we want for our State?" and "How will we know if we are getting closer to getting what we want?"

The MFR Comprehensive Plan is based on the Five Pillars of the Administration's priorities. The plan includes one goal for each pillar, several key performance areas for each goal, and at least one performance measure in each key area. The plan includes the following five goals:

- **Education:** Maryland citizens will have access to quality educations enabling them to obtain well-paying jobs, to live full and enriched lives, and to serve their communities.

- **Health and the Environment:** Marylanders will be healthy, live in a healthy environment, and benefit from a revitalized Chesapeake Bay.

- **Public Safety:** Maryland communities will be safe and secure.

- **Commerce:** Maryland will be a state where business and commerce thrive, supported by a well-functioning and modern transportation system.

- **Fiscal Responsibility:** The State will allocate its resources effectively and manage spending within available revenues.

## A Long-term View

To be effective, a plan like the State Plan should be enduring. Progress in reaching broad, statewide goals should be sustained and should be measured over extended periods of time. Plan goals should be broadly accepted. In short, such a plan should take a long-term view. The State Plan, in large part, represents such a broad-based, long-term view. The five goals represent areas of consistent priority: education, health and the environment, public safety, commerce, and fiscal responsibility.

Another strength of the State Plan is that it reflects existing accountability frameworks. Specifically, the education measures are consistent with the State educational accountability system and the federal No Child Left Behind (NCLB) requirements. Similarly, most of the environment measures reflect the State's Chesapeake 2000 agreement. Using these measures promotes consistent direction in programming and acknowledges the State's existing commitments. More importantly, it takes advantage of the consensus built through initiatives like the Bridge to Excellence and Chesapeake 2000. This consensus increases the likelihood that the measures will be seen as important for the long term.

## Room for Improvement

The five goals of the State Plan represent areas of consistent priority, and many of the key performance areas and performance measures are also appropriate. There are several areas, however, that deserve attention in the State Plan.

### Poverty

Poverty has an obvious relationship to thriving communities (commerce), healthy babies, children, and adults (health and the environment), and success in school (education). It is also a generally accepted and understood concept. The State Plan includes measures of employment and per-capita personal income, but neither measure relates to the cost of living in Maryland or a particular standard of living. A poverty measure would address whether Maryland residents have access to jobs that pay well enough for a person to make a living and support a family.

### The New Economy

Maryland prides itself on its position in the "new economy," particularly as an emerging center for bioscience and technology. The State Plan includes measures related to the nursing and teaching workforces, employment, port cargo, airport passengers, and even film production. Nowhere does it address whether the State is successfully preparing Maryland residents to participate in the "new economy." To ensure that Maryland residents can fully participate in economic opportunities in these growing sectors, the State should measure its success in preparing a workforce for fields such as bioscience, technology, and aerospace/defense.

**Land Use**

Land use has a strong relationship to both commerce and the environment. It is also the only major element of the Chesapeake 2000 agreement that is not reflected in the key performance areas and measures that support the health and environment goal. The State Plan includes the measure "total acres enrolled in agricultural preservation districts," but the State has invested substantial amounts of money in other land preservation and conservation programs. Including a land use measure in the State Plan would provide data to measure whether that investment is a good idea and whether the programs in place are effective.

**Specific Performance Measures**

In addition to the broad areas discussed above, several measures in the State Plan deserve reconsideration. Specifically:

- Safe schools are a priority among the general public and are key to NCLB. The public safety section of the State Plan should include a measure related to safe schools.

- The health section of the State Plan covers major areas of morbidity, including cancer, vaccine preventable disease, lead poisoning, and HIV. Given current health trends, heart disease and obesity may also be worthy of consideration.

- The State Plan, in the health and environment section, includes a measure of clean air. The current measure relates to one-hour ozone standard, which is no longer used. Consistent with the idea of using measures already in place, using the eight-hour standard – or even the percent of Maryland population living in areas not meeting federal air standards – may be a better choice.

- In the commerce section, the State Plan includes a measure of direct expenditures for film, television, and other production. According to the Department of Business and Economic Development, this industry contributes only $141 million in annual economic impact to the State. The State Plan should reflect other business sectors that play a larger role in the Maryland economy and should omit the film measure.

## Final Thoughts

One of the strengths of the State Plan is its structure around broad, statewide goals. It would be a much weaker plan if it were structured according to State agencies and their missions. Integrating measures from various agency MFR plans is a good beginning to thinking in a more integrated fashion about addressing statewide goals.

Including a variety of measures in the State Plan is not an end in itself. The plan must be used as a planning and budgeting tool if it is to be effective. First, the Executive Branch should consider ways to strengthen the link between the State Plan and its budget proposal. Second, all State Plan measures should be MFR measures within State government to ensure that agency programs align with statewide goals and agency personnel are managing toward those goals.

Finally, Maryland residents and policy makers should have greater access to the State Plan. The Ohio Department of Job and Family Services provides an example Maryland could emulate: its Performance Center web site offers interactive access to the agency's goals, performance measures, and actual data to measure progress and success. Unlike the first State Plan, future versions should contain crosswalks to show where the State Plan measures appear in State agency MFR plans. It should also contain the data associated with each measure to show clearly the State's performance. Publication, broad access to the State Plan, and complete data would help the Plan achieves the statutory goals of "accountability, efficiency, and continuous improvement in State government programs."

# Local Government

## State Aid to Local Governments

**State aid to local governments is projected to increase by 13.6 percent in fiscal 2007. This record increase will provide local governments with an additional $702.1 million to fund education, transportation, and land preservation programs.**

### State Aid Increases in Fiscal 2007

Local government programs and services will benefit from increased State support in fiscal 2007, with most of the new funds being targeted to education, transportation, and land preservation programs. State aid to local governments is projected to total $5.8 billion in fiscal 2007, a $702.1 million or 13.6 percent increase over the prior year. Public schools will receive $554.2 million in new State funding, the largest increase in State funding for public schools in any one fiscal year. County and municipal governments will receive an additional $126.9 million. **Exhibit 1** shows the change in State aid by governmental programs.

**Exhibit 1**
**State Aid to Local Governments**
**($ in Millions)**

| Governmental Entity | FY 2006 | FY 2007 | $ Difference | % Difference |
|---|---|---|---|---|
| Public Schools | $4,018.2 | $4,572.4 | $554.2 | 13.8% |
| County/Municipal | 823.5 | 950.4 | 126.9 | 15.4 |
| Community Colleges | 191.6 | 206.2 | 14.6 | 7.6 |
| Local Health | 61.5 | 63.5 | 2.0 | 3.3 |
| Libraries | 50.6 | 55.1 | 4.4 | 8.8 |
| **Total** | **$5,145.4** | **$5,847.5** | **$702.1** | **13.6%** |

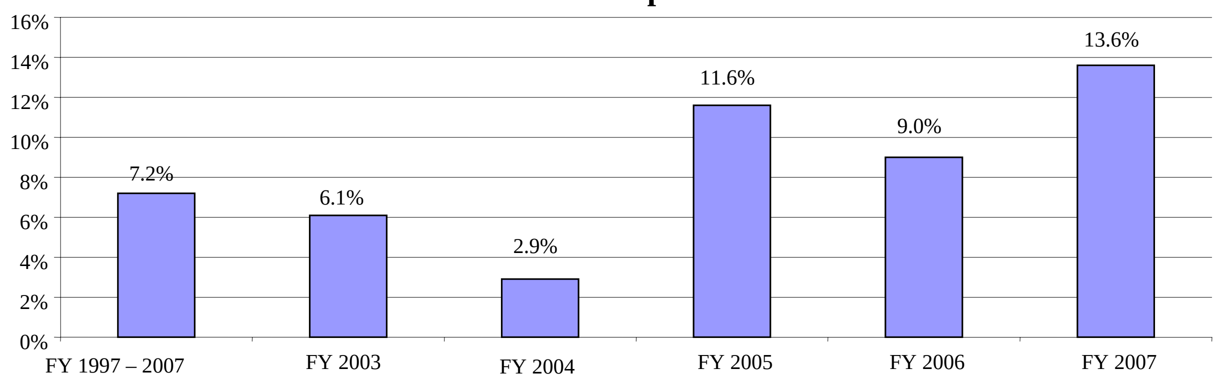
Source: Department of Legislative Services

State aid to local governments continues to be one of the largest and fastest growing components of the State budget. State aid accounts for approximately 27 percent of total State expenditures (general and special funds) and 37 percent of State general fund expenditures. The annual growth in State aid to local governments continues to exceed the annual growth for State agencies. For comparison purposes, total funding for State agencies is projected to increase by 5.6 percent in fiscal 2007 with total State expenditures increasing by 9.1 percent. Legislative

Services forecasts that only Medical Assistance and Juvenile Justice programs will realize a larger funding increase in fiscal 2007.

In addition, the projected increase in State aid in fiscal 2007 is higher than the annual growth rate in prior years. As shown in **Exhibit 2**, State aid increased by 2.9 percent in fiscal 2004, 11.6 percent in fiscal 2005, and 9.0 percent in fiscal 2006. Since fiscal 1997, State aid has increased at an average annual rate of 7.2 percent. State aid increases in fiscal 2007 reflect full funding of State aid programs, including local highway user revenues and Program Open Space which realized sizeable reductions in the past four years. **Exhibit 3** shows the change in State aid by major aid programs.

**Exhibit 2**
**Annual Growth in State Aid to Local Governments**
**General and Special Funds**




Source: Department of Legislative Services

## Public School Funding Accounts for Most of the State Aid Increase

Funding for public schools accounts for most of the increase in State aid (78.9 percent) in fiscal 2007. Public schools are scheduled to receive $4.6 billion, representing a $554.2 million or 13.8 percent increase over the prior year. The anticipated increase in State aid reflects the continuing implementation of Chapter 288 of 2002, commonly referred to as the Thornton legislation. Chapter 288 enhances per pupil State aid through the foundation program, enhances per pupil funding for three special needs populations, provides incentives to low wealth counties to contribute more than the minimum required funding, and phases out certain education programs over a five-year period. In addition, 13 local school systems are projected to receive a total of $72.1 million through the geographic cost of education index (GCEI) formula. GCEI was established by the General Assembly at the 2004 session to recognize regional differences in the cost of education that are outside the control of local jurisdictions. State funding was originally scheduled to begin in fiscal 2005; however, the Governor has yet to include funding for the formula in the State budget.

**Exhibit 3**
## State Aid to Local Governments – Major Aid Programs
**($ in Millions)**

| | FY 2006 | FY 2007 | Dollar Difference | Percent Difference |
|---|---|---|---|---|
| **Public Schools** | | | | |
| Foundation Program | $2,308.3 | $2,503.1 | $194.8 | 8.4% |
| Compensatory Aid | 599.3 | 742.4 | 143.1 | 23.9 |
| Student Transportation | 187.1 | 203.4 | 16.3 | 8.7 |
| Special Education – Formula Aid | 190.0 | 234.3 | 44.3 | 23.3 |
| Special Education – Nonpublic Placements | 111.0 | 119.9 | 8.9 | 8.1 |
| Limited English Proficiency Grants | 66.8 | 88.7 | 22.0 | 32.9 |
| Guaranteed Tax Base | 38.7 | 60.5 | 21.8 | 56.1 |
| Geographic Cost Index | 0.0 | 72.1 | 72.1 | |
| Other Education Programs | 110.1 | 101.8 | -8.3 | -7.5 |
| **Subtotal Direct Aid** | **$3,611.3** | **$4,126.3** | **$514.9** | **14.3%** |
| Retirement Payments | 406.9 | 446.1 | 39.3 | 9.7 |
| **Total Public School Aid** | **$4,018.2** | **$4,572.4** | **$554.2** | **13.8%** |
| **Libraries** | | | | |
| Library Aid Formula | $28.0 | $30.6 | $2.6 | 9.3% |
| State Library Network | 14.2 | 15.2 | 1.0 | 7.3 |
| **Subtotal Direct Aid** | **$42.2** | **$45.9** | **$3.6** | **8.6%** |
| Retirement Payments | 8.4 | 9.2 | 0.8 | 9.4 |
| **Total Library Aid** | **$50.6** | **$55.1** | **$4.4** | **8.8%** |
| **Community Colleges** | | | | |
| Community College Formula | $154.1 | $164.8 | $10.7 | 6.9% |
| Other Programs | 21.7 | 23.8 | 2.1 | 9.6 |
| **Subtotal Direct Aid** | **$175.9** | **$188.6** | **$12.8** | **7.3%** |
| Retirement Payments | 15.7 | 17.6 | 1.8 | 11.7 |
| **Total Community College Aid** | **$191.6** | **$206.2** | **$14.6** | **7.6%** |
| **Local Health Grants** | **$61.5** | **$63.5** | **$2.0** | **3.3%** |
| **County/Municipal Aid** | | | | |
| Transportation | $538.3 | $576.5 | $38.2 | 7.1% |
| Public Safety | 101.2 | 102.1 | 0.9 | 0.9 |
| Program Open Space/Recreation | 47.0 | 121.3 | 74.3 | 158.2 |
| Disparity Grant | 96.6 | 109.5 | 12.9 | 13.3 |
| Utility Restructuring Grant | 30.6 | 30.6 | 0.0 | 0.0 |
| Other Grants | 8.1 | 8.7 | 0.6 | 7.2 |
| **Subtotal Direct Aid** | **$821.8** | **$948.7** | **$126.9** | **15.4%** |
| Retirement Payments | 1.7 | 1.7 | 0.0 | 0.0 |
| **Total County/Municipal Aid** | **$823.5** | **$950.4** | **$126.9** | **15.4%** |
| **Total State Aid** | **$5,145.4** | **$5,847.5** | **$702.1** | **13.6%** |

Source: Department of Legislative Services

## County and Municipal Governments Receive Increased State Support

County and municipal governments are projected to receive $950.4 million in State funding in fiscal 2007, representing a $126.9 million or 15.4 percent increase over the prior year. Program Open Space will receive $119.1 million in fiscal 2007, a $74.3 million increase over the prior year. For the last few years, a portion of State transfer tax revenue that is used to fund Program Open Space has been transferred to the State's general fund. Program Open Space, however, is projected to be fully funded in fiscal 2007.

Local transportation projects will move forward in 2007, as local governments receive $569.4 million in local highway user revenues, a $38.2 million increase over the prior year. This estimate assumes that local highway user revenues will not be transferred to the State's general fund. Over the last four years, over $200 million in local highway user revenues were transferred to the State's general fund to close severe budgetary shortfalls. State funding for disparity grants is projected to increase by $12.9 million, resulting in seven low wealth jurisdictions receiving $109.5 million in fiscal 2007. The police aid formula is projected to increase by $0.9 million, resulting in total funding of $64.8 million. Most other grant programs are projected to be level funded in fiscal 2007.

## Community College, Library, and Health Funding Increases

State aid to local community colleges, libraries, and local health departments will realize sizeable increases in fiscal 2007. State funding under the Community College Cade formula is projected to total $164.8 million in fiscal 2007, a $10.7 million or 6.9 percent increase. This reflects a 2.8 percent increase in student enrollment and a 4 percent increase in the per pupil funding level. Due to legislative enhancements to the library aid formula, State funding for public libraries will increase by 9.3 percent or $2.6 million in fiscal 2007. State funding will total $30.6 million for the library aid formula and $15.2 million for the State library network. Local health grants are projected to total $63.5 million in fiscal 2007, which reflect $56.7 million in formula aid and $6.8 million in annualized salary adjustments.

## State Paid Retirement Costs Increase

Retirement payments for public school teachers, librarians, community college faculty, and certain local officials will total $474.6 million in fiscal 2007, representing a $41.9 million or 9.7 percent increase. This increase is a result of a higher salary base and a higher retirement contribution rate. Retirement costs for fiscal 2007 are based on a $4.9 billion payroll and a 9.71 percent retirement contribution rate.

For further information contact: Hiram L. Burch Jr. Phone: (410) 946/(301) 970-5510

# Local Government

## Local Tax and Salary Actions

**More local governments decreased their tax rates in fiscal 2006 than in previous years, indicating improved local fiscal conditions. Most local governments and all local school systems provided salary enhancements to their employees.**

### Local Government Tax Rates

Sixteen jurisdictions made changes to their local tax rates in fiscal 2006, with three jurisdictions increasing various local taxes, nine reducing local taxes, and four increasing and reducing local taxes. As illustrated in **Exhibit 1**, more jurisdictions reduced property taxes in fiscal 2006 than in prior years. This is primarily due to the significant growth in property assessments in recent years that have pushed local revenues upward. Local income tax rates have remained fairly constant, with only one county lowering its rate in calendar 2006. A comparison of local tax rates for fiscal 2005 and 2006 is provided in **Exhibit 2.**

**Exhibit 1**
**Number of Counties Changing Local Tax Rates**
**Fiscal 2002 – 2006**

| | FY 2002 | | FY 2003 | | FY 2004 | | FY 2005 | | FY 2006 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | ▲ | ▼ | ▲ | ▼ | ▲ | ▼ | ▲ | ▼ | ▲ | ▼ |
| Property | 5 | 3 | 1 | 5 | 4 | 1 | 2 | 6 | 0 | 13 |
| Income | 4 | 0 | 0 | 0 | 6 | 0 | 1 | 1 | 0 | 1 |
| Recordation | 1 | 0 | 2 | 0 | 5 | 0 | 1 | 0 | 1 | 0 |
| Transfer | 0 | 0 | 0 | 0 | 1 | 1 | 0 | 0 | 1 | 0 |
| Admissions/Amusement | 0 | 0 | 1 | 0 | 2 | 0 | 0 | 0 | 0 | 0 |
| Hotel/Motel | 0 | 0 | 0 | 0 | 1 | 0 | 5 | 0 | 5 | 0 |

Note: ▲ represents tax rate increase. ▼ represents tax rate decrease.
Source: Department of Legislative Services

## Exhibit 2
# Local Tax Rates – Fiscal 2005 and 2006

| | Real Property | | Local Income | | Recordation | | Transfer | | Admissions/Amusement | | Hotel/Motel | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **County** | **FY 2005** | **FY 2006** | **FY 2005** | **FY 2006** | **FY 2005** | **FY 2006** | **FY 2005** | **FY 2006** | **FY 2005** | **FY 2006** | **FY 2005** | **FY 2006** |
| Allegany | $1.0007 | $1.0007 | 2.93% | 2.93% | $3.00 | $3.00 | 0.2% | 0.5% | 7.5% | 7.5% | 8.0% | 8.0% |
| Anne Arundel | 0.9410 | 0.9310 | 2.56% | 2.56% | 3.50 | 3.50 | 1.0% | 1.0% | 10.0% | 10.0% | 7.0% | 7.0% |
| Baltimore City | 2.3280 | 2.3080 | 3.05% | 3.05% | 5.00 | 5.00 | 1.5% | 1.5% | 10.0% | 10.0% | 7.5% | 7.5% |
| Baltimore | 1.1150 | 1.1150 | 2.83% | 2.83% | 2.50 | 2.50 | 1.5% | 1.5% | 10.0% | 10.0% | 8.0% | 8.0% |
| Calvert | 0.8920 | 0.8920 | 2.80% | 2.80% | 5.00 | 5.00 | 0.0% | 0.0% | 10.0% | 10.0% | 5.0% | 5.0% |
| Caroline | 0.9520 | 0.9100 | 2.63% | 2.63% | 5.00 | 5.00 | 0.5% | 0.5% | 0.0% | 0.0% | 5.0% | 5.0% |
| Carroll | 1.0480 | 1.0480 | 3.05% | 3.05% | 5.00 | 5.00 | 0.0% | 0.0% | 10.0% | 10.0% | 0.0% | 5.0% |
| Cecil | 0.9800 | 0.9800 | 2.80% | 2.80% | 3.30 | 4.10 | 0.0% | 0.0% | 6.0% | 6.0% | 5.0% | 5.0% |
| Charles[1] | 1.0260 | 1.0260 | 2.90% | 2.90% | 5.00 | 5.00 | 0.0% | 0.0% | 10.0% | 10.0% | 5.0% | 5.0% |
| Dorchester | 0.9300 | 0.9200 | 2.62% | 2.62% | 5.00 | 5.00 | 0.75% | 0.75% | 0.5% | 0.5% | 5.0% | 5.0% |
| Frederick | 1.0000 | 1.0000 | 2.96% | 2.96% | 5.00 | 5.00 | 0.0% | 0.0% | 5.0% | 5.0% | 3.0% | 3.0% |
| Garrett | 1.0360 | 1.0000 | 2.65% | 2.65% | 3.50 | 3.50 | 1.0% | 1.0% | 4.5% | 4.5% | 4.0% | 5.0% |
| Harford | 1.0920 | 1.0820 | 3.06% | 3.06% | 3.30 | 3.30 | 1.0% | 1.0% | 5.0% | 5.0% | 0.0% | 0.0% |
| Howard | 1.1695 | 1.1695 | 3.20% | 3.20% | 2.50 | 2.50 | 1.0% | 1.0% | 7.5% | 7.5% | 5.0% | 5.0% |
| Kent | 1.0120 | 0.9920 | 2.85% | 2.85% | 3.30 | 3.30 | 0.5% | 0.5% | 4.5% | 4.5% | 3.0% | 5.0% |
| Montgomery | 1.0090 | 0.9670 | 3.20% | 3.20% | 3.45 | 3.45 | 1.0% | 1.0% | 7.0% | 7.0% | 7.0% | 7.0% |
| Prince George’s | 1.3190 | 1.3190 | 3.20% | 3.20% | 2.20 | 2.20 | 1.4% | 1.4% | 10.0% | 10.0% | 5.0% | 5.0% |
| Queen Anne’s | 0.9260 | 0.8700 | 2.85% | 2.85% | 3.30 | 3.30 | 0.5% | 0.5% | 5.0% | 5.0% | 3.0% | 5.0% |
| St. Mary’s | 0.8780 | 0.8720 | 3.05% | 3.00% | 4.00 | 4.00 | 1.0% | 1.0% | 2.0% | 2.0% | 5.0% | 5.0% |
| Somerset | 1.0100 | 0.9900 | 3.15% | 3.15% | 3.30 | 3.30 | 0.0% | 0.0% | 4.0% | 4.0% | 5.0% | 5.0% |
| Talbot | 0.5400 | 0.5200 | 2.25% | 2.25% | 3.30 | 3.30 | 1.0% | 1.0% | 5.0% | 5.0% | 4.0% | 4.0% |
| Washington | 0.9480 | 0.9480 | 2.80% | 2.80% | 3.80 | 3.80 | 0.5% | 0.5% | 5.0% | 5.0% | 6.0% | 6.0% |
| Wicomico | 1.0250 | 0.9930 | 3.10% | 3.10% | 3.50 | 3.50 | 0.0% | 0.0% | 6.0% | 6.0% | 5.0% | 6.0% |
| Worcester | 0.7300 | 0.7300 | 1.25% | 1.25% | 3.30 | 3.30 | 0.5% | 0.5% | 3.0% | 3.0% | 4.0% | 4.0% |

[1] In Charles County, a 0.25% transfer tax is imposed for first time homeowners only.

Notes: Real property tax is per $100 of assessed value. Income tax is a percentage of taxable income. Recordation tax is per $500 of transaction.

Source: Comptroller’s Office, State Department of Assessments and Taxation, Department of Legislative Services

## Local Income Tax Rates

St. Mary's County was the only jurisdiction to alter its local income tax rate for calendar 2006, decreasing it from 3.05 to 3.00 percent. Local income tax rates range from 1.25 percent in Worcester County to 3.20 percent in Howard, Montgomery, and Prince George's counties.

## Recordation Tax Rates

Cecil County was the only jurisdiction to change its recordation tax rate, increasing it from $3.30 to $4.10 per $500 of transaction. The range for recordation tax rates is $2.20 per $500 of transaction in Prince George's County to $5.00 per $500 of transaction in seven jurisdictions – Baltimore City and Calvert, Caroline, Carroll, Charles, Dorchester, and Frederick counties.

## Transfer Tax Rates

One jurisdiction, Allegany County, changed its transfer tax rate for fiscal 2006, increasing it from 0.2 to 0.5 percent. Local transfer tax rates range from 0.5 percent in six jurisdictions (Allegany, Caroline, Kent, Queen Anne's, Washington, and Worcester counties) to 1.5 percent in Baltimore City and Baltimore County. Seven counties (Calvert, Carroll, Cecil, Charles, Frederick, Somerset, and Wicomico) do not impose a transfer tax on all property transfers. However, Charles County implemented a 0.25 percent transfer tax for first time homeowners only.

## Admissions and Amusement Tax Rates

No county changed its admissions and amusement tax rate for fiscal 2006. Admissions and amusement tax rates range from 0.5 percent in Dorchester County to 10.0 percent in seven jurisdictions (Baltimore City, and Anne Arundel, Baltimore, Calvert, Carroll, Charles, and Prince George's counties). Caroline County is the only jurisdiction that does not impose an admissions and amusement tax rate.

## Hotel and Motel Tax Rates

Four counties (Garrett, Kent, Queen Anne's, and Wicomico) increased their hotel and motel tax rates for fiscal 2006. In addition, Carroll County implemented a hotel and motel tax for fiscal 2006. Hotel and motel tax rates range from 3.0 percent in Frederick County to 8.0 percent in Allegany and Baltimore counties. Harford County is the only jurisdiction that does not impose a hotel and motel tax.

## Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5 percent or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation can be overridden by an affirmative vote of seven of the nine county council members. In Prince George's County, the general property tax rate is capped at $0.96 per $100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2 percent or the increase in the consumer price index.

## County Salary Actions

An analysis of local government salary actions for county employees and teachers indicates that almost all of Maryland jurisdictions are providing salary enhancements during improving economic times. **Exhibit 3** shows local salary action for fiscal 2006. Twenty-two county governments provided their employees with a cost-of-living adjustment (COLA), while 20 counties provided step increases. Additionally, all 24 boards of education provided COLAs for their teachers, with 22 providing step increases.

## Exhibit 3
# Local Government Salary Actions in Fiscal 2006

| | County Government | | Board of Education | |
|---|---|---|---|---|
| **County** | **COLA** | **Step** | **COLA** | **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] | NA | NA | 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, public safety (detention and 911) received a 10% COLA and public safety (sheriff's office) received a 15% COLA. 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 receive 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

# Local Government

## Property Taxation in Maryland

**Property assessments in Maryland continue to soar resulting in sizeable increases in local property tax revenues. State property tax relief measures, however, have helped to limit the impact of property assessments.**

### Importance of the Property Tax

Local governments collected $4.8 billion in property taxes in fiscal 2004. The property tax is one of the three major revenue sources for county governments, accounting for 25 percent of total revenues, and the second largest revenue source for municipal governments, accounting for 31 percent of total revenues. The property tax is a relatively stable and predictable revenue source for local governments, and due to the sizeable growth in property assessments, local property tax collections should remain strong for the near future.

### Growth in Property Assessments

The soaring real estate market in Maryland fueled by low interest rates and a strong economy has increased the demand for housing throughout the State, which has contributed to record increases in property assessments. Over the last five years, property assessments in Maryland have increased significantly. The average three-year increase in the full cash value of property totaled 10 percent in calendar 2001, 16 percent in 2002, 26 percent in 2003, and 36 percent in 2004. Properties reassessed for 2005 realized an even greater increase of 47 percent statewide, ranging from 11 percent in Allegany County to 65 percent in Montgomery County. This is the largest increase in Maryland since the beginning of the triennial reassessments in 1980. Under the State's triennial assessment process, the increase in the full cash value of property is phased in over a three-year period. **Exhibit 1** shows the average increase in the full cash value of property reassessed for 2005 for each jurisdiction, the average annual increases, and the county assessment cap. **Exhibit 2** shows the growth in county assessable base that is used for property tax purposes.

### State Role in Property Assessments

There is a well-defined statutory relationship between the State and local governments in the administration of the property tax system in Maryland. While property tax revenues are a relatively minor revenue source to the State, the State has assumed responsibility for the valuation and assessment of property. Local governments, on the other hand, levy and collect property taxes. The State takeover of the valuation and assessment function was implemented to provide uniform and equitable assessments of property throughout the State.

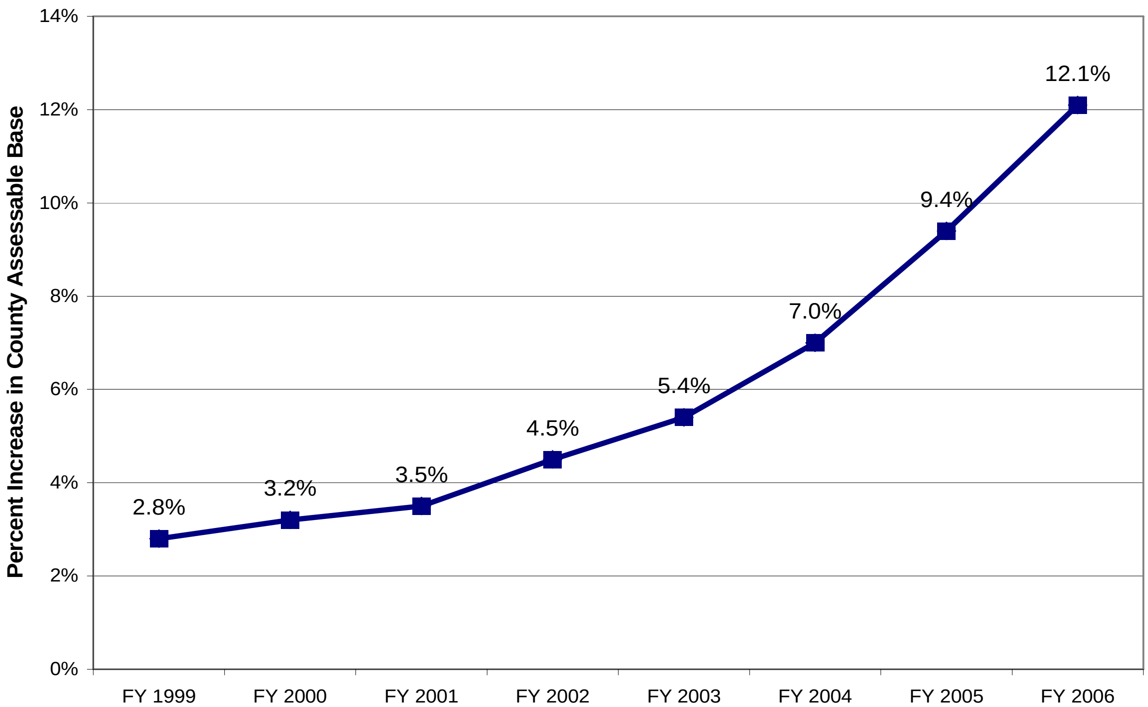
**Exhibit 1**
## Assessment Increases Push Local Revenues Upward in Fiscal 2006

| 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

Real property is valued and assessed once every three years with assessors physically inspecting each property. No adjustments are made in the interim, except in certain cases. Any increase in property values is phased in over a three-year period; however, any decrease is recognized immediately for assessment purposes. Because only one-third of the properties in each county are reassessed in a given year, local governments can rely on prior years’ growth in the other two-thirds of the base to reduce the full impact of any one-year decline in assessable base. Conversely, when market values are rising, assessed values lag behind the current market, resulting in a slower annual growth in the assessable base than the market may indicate. The triennial process and its three-year phase-in schedule provide some cushion for taxpayers during periods of dramatically increasing property values and for local governments during a downturn in the housing market.

**Exhibit 2**
**County Assessable Base Continues to Increase**
**Fiscal 1999 – 2006**




Source: Department of Assessments and Taxation

## Property Tax Relief Measures

The constant increase in property assessments throughout Maryland has led the State, and in some instances the voters, to take action to curtail the rise in property taxes. There are three primary approaches used in Maryland to provide property tax relief to homeowners: (1) the homestead property tax credit program that limits annual assessment increases to all homeowners regardless of income; (2) the homeowners' (circuit breaker) tax credit program and the renters' tax credit program that provide credits for certain individuals who qualify based on a sliding scale of property tax liability and income; and (3) property tax limitation measures that either limit the property tax rate that can be imposed by the county council or the property tax revenue that can be collected. All three approaches have significantly impacted either State or local revenues, and members of the General Assembly have repeatedly introduced legislation addressing these property tax relief measures.

## Comparison of Property Taxation with Other Localities

The financial impact of Maryland's property tax relief measures can be illustrated by comparing property assessments in Maryland with jurisdictions in other states. **Exhibit 3** demonstrates how the triennial assessment process and the homestead property tax credit program in Maryland can limit the impact of sharp increases in property values.

**Exhibit 3**
**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% |

Source: Department of Legislative Services

In Montgomery County, property reassessments are conducted every three years with assessment growth capped at 10 percent. In Fairfax County, Virginia, property reassessments are conducted on an annualized basis, and there is no cap on assessment growth. The increase in property assessments is almost three times higher in Fairfax County than in Montgomery County, even though both counties have similar demographics, income levels, and home prices. From fiscal 2001 to 2006, the average property assessment increased by 41.6 percent in Montgomery County and 116.2 percent in Fairfax County. The overall property tax bill increased by 34.1 percent in Montgomery County compared to 75.7 percent in Fairfax County. Even with sharper reductions in its property tax rate, the average property tax bill in Fairfax County is considerably higher than in Montgomery County.

For further information contact: Hiram L. Burch Jr. Phone: (410) 946/(301) 970-5510

# Local Government

## 2006 Legislative Agenda – Maryland Municipal League

**The Maryland Municipal League (MML) has identified three initiatives for its 2006 legislative agenda: (1) replenishing municipal fiscal resources; (2) protecting municipal planning, zoning, and annexation powers; and (3) protecting municipal eminent domain powers.**

### Replenishing Municipal Fiscal Resources

The Maryland Municipal League (MML) anticipates that State agencies that have suffered major funding reductions during the past three years will be looking to replenish their budgets. MML will work closely with the Governor's Administration, State agencies, and members of the General Assembly to ensure that programs important to municipal corporations will be in the forefront when funding is allocated in the fiscal 2007 State budget. Specifically, MML will advocate for a return to full funding of local highway user revenues, increased funding in the Community Legacy Program, a return to previous funding levels or increased funding in the Community Parks and Playgrounds Program, and retention of current funding under Program Open Space.

### Supporting Responsible and Sustainable Growth

#### Municipal Zoning, Planning, and Annexation Powers

Local governments are under increased scrutiny regarding responsible planning and managing for new growth and development. During the 2005 session, MML opposed legislation that they contend was intended to weaken existing planning and zoning authority and annexation law, including a bill that would have applied a county's adequate public facility ordinance (APFO) in a municipality until the municipality adopts, implements, and enforces adequate public facility legislation. APFOs set capacity standards for public schools, roadways, water/sewer utilities, police, fire, and rescue services, storm drainage, and utilities. If new development is projected to exceed capacity standards in an area, the developer may be required to make contributions for capital improvements as a condition of moving the development forward or the local government may delay the development until the local government provides the capital improvement. MML intends to oppose any similar legislation introduced this year that it feels will erode municipal planning and zoning and annexation powers.

## Eminent Domain

In response to the recent U. S. Supreme Court ruling in *Kelo v. City of New London*, which pertains to local government eminent domain powers, MML believes that legislation may be introduced that will expand the areas for which compensation must be provided when a condemnation occurs and weaken existing law to prevent local governments from using eminent domain powers for economic development purposes.

Municipalities have eminent domain powers under Article 23A of the Annotated Code of Maryland and individual municipalities may be granted urban renewal authority for slum clearance by the General Assembly under the provisions of Article III, § 61 of the Maryland Constitution. Currently, 63 municipal corporations have been granted urban renewal authority for slum clearance, which allows a municipality to create an urban renewal agency, approve an urban renewal plan, and dispose and condemn property in an urban renewal area under certain circumstances. Once a municipal corporation has been granted urban renewal authority, the municipality may also exercise eminent domain powers for individual blighted properties under Article 23A, § 2(b)(37) of the Annotated Code of Maryland. All municipalities also have the authority to acquire by condemnation property needed for public purposes under Article 23A, § 2(b)(24). MML believes that legislation may be introduced that will restrict the use of eminent domain even to address blighted properties and plans to oppose this legislation in an effort to protect local government eminent domain powers.

For further information contact: Georgeanne Carter Phone: (410) 946/(301) 970-5350

# Local Government

## 2006 Legislative Agenda – Maryland Association of Counties

**The Maryland Association of Counties (MACo) has identified four initiatives for its 2006 legislative agenda: (1) protecting State assistance; (2) increasing State funding for public school construction; (3) modifying annexation laws; and (4) expanding the investment authority of local officials.**

### Protecting State Assistance

State aid is the largest revenue source for most county governments, accounting for 26.5 percent of total revenues in fiscal 2004. Local governments depend on State aid to fund many local needs, including transportation projects, public safety services, and land preservation programs. Due to the State's fiscal crisis and mandatory increases in public school funding under the Thornton legislation, State aid to county and municipal governments was reduced from statutory required funding levels in each of the last four years. Most of the reductions affected land preservation and transportation programs. Due to increases in State revenue collections, State aid programs are projected to be fully funded in fiscal 2007. County and municipal governments are projected to receive $950.4 million in State funding in fiscal 2007, a $126.9 million or 15.4 percent increase over the prior year. Due to the significance that State aid has on local budgets, MACo will support plans to fully fund State aid programs.

### School Construction and Renovation Funding

In 2002, the Bridge to Excellence in Public Schools Act established a Task Force to Study Public School Facilities. In completing its charge, the task force undertook an assessment of the current conditions of the State's existing public schools. The assessment indicated that $3.9 billion is needed to bring existing public schools up to standards. In 2004, the General Assembly approved legislation specifying that $2 billion in State funding be provided for public school construction projects by fiscal 2013. To meet this funding level, approximately $250 million in State funds would be needed annually, which is approximately $150 million more than the State's commitment for each of the next four fiscal years.

The fiscal 2006 *Capital Improvement Program* (CIP) for State funding of public school construction shows State funding at $100 million per year from 2007 through 2010, which includes $97.6 million in general obligation bonds and $2.4 million in special funds. Based on these findings, MACo supports a $250 million annual commitment to public school construction. In addition, due to escalating construction costs and the reduction in buying power of current funding levels, MACo supports an additional $150 million in State funding in fiscal 2007 only. Altogether, MACo requests that the State provide $400 million for public school construction projects in fiscal 2007.

## Municipal Annexations

Municipal annexation is the process of legally including within the corporate limits of a city or town an unincorporated area that is outside the municipality. In order to be annexed to a municipality, the area must be contiguous and adjoining to the existing municipal corporate area and not located in another municipality. Certain procedural requirements are provided for in State law regarding annexations, including consent of a percentage of the voters affected.

Annexation is increasingly becoming a popular mechanism for development. In recent years, developers have more frequently partnered with municipalities to annex large tracts of land for development to the objection of the county. MACo believes that this practice arises because the existing annexation law denies the county perspective any meaningful weight in annexation decisions. To create a fair balance, MACo supports legislation to change the existing annexation law to provide reasonable deference to adopted county land use policies and affected citizen concerns. MACo asserts that annexations should be subject to all statutory Smart Growth standards now applicable to counties and development on annexed property should be consistent with county adequate public facility laws and zoning. In addition, existing referendum rights should be extended to citizens living outside the annexing municipality, but proximate to the boundary of the property to be annexed, with a county having the ability to initiate a referendum not just in the property to be annexed, but also in the municipality.

## Public Funds Investment Authority

State law restricts the type of investment products in which local governments are authorized to invest public funds. The State Treasurer is charged with adopting by regulation local government investment guidelines to govern the investment of public funds by local governments. Only a very limited investment may be placed in commercial paper, even that of the highest grade, and none in any composite instruments that include these investments. MACo will support legislation to provide limited authority for investment-grade commercial paper as a minority component of local investment portfolios, thereby providing avenues to better diversification and stronger returns, while protecting the overall integrity of these holdings.

# Local Government

## Development Charges and Adequate Public Facilities Ordinances

**Local governments throughout the nation are increasingly turning to development impact fees and excise taxes to finance the expansion or construction of new public facilities required by residential development. Currently, 15 counties in Maryland impose either a development impact fee or excise tax, and 13 counties have adopted adequate public facilities ordinances.**

### Reasons for Local Impact Fees and Excise Taxes

Development impact fees and excise taxes enable local governments to collect revenue from builders for public facilities required by new residential development. As a result of development charges, local governments are able to shift the costs of new public facilities from existing taxpayers to individuals responsible for the development. In many situations, the use of development charges could eliminate the need for countywide tax increases. Another benefit of development charges is that local officials can collect the needed revenue for the expansion or construction of new public facilities prior to the construction of any new residential development. In this manner, payment of an impact fee or excise tax may be required by local officials prior to the issuance of a building permit or approval of a subdivision plat.

Local governments in Maryland must obtain explicit authority from the General Assembly before imposing a development impact fee or excise tax. One exception to this restriction applies to code home rule counties, which have already received authority from the General Assembly to impose such charges. Fifteen counties currently impose either a development impact fee or excise tax which generated approximately $99.2 million in revenues in fiscal 2005. The primary services funded by these charges include public school construction, transportation, parks and recreation, and water/sewer utilities. **Exhibit 1** shows the counties that impose either a development impact fee or excise tax and the revenues generated by such charges.

### Differences Between Impact Fees and Excise Taxes

An impact fee involves a more complex process that requires a jurisdiction to justify the fee amount in relation to the potential impact that the new development would have on the jurisdiction. Before imposing an impact fee, a jurisdiction must conduct a study that measures the impact that the new development will have on various public services. In addition, there must be a nexus between the impact of the new development and the fee amount; and there must be a geographic nexus between where the fee is collected and where the funds are spent. A jurisdiction cannot collect the impact fee in one part of the county and spend the funds elsewhere.

A development excise tax is a more straightforward approach in financing capital projects resulting from new development. A jurisdiction can set the tax amount at any reasonable level, and there does not have to be a geographic nexus between where the fee is collected and where it is spent. The excise tax can be imposed on activities and in amounts authorized by the General Assembly.

**Exhibit 1**

**Maryland Counties with Development Impact Fees or Excise Taxes**

| County | Type | FY 2006 Rate Per Dwelling | FY 2005 Estimated Revenues |
|---|---|---|---|
| Anne Arundel | Impact Fee | $4,617 | $10,508,900 |
| Calvert | Excise Tax | 12,950 | 6,021,600 |
| Caroline | Excise Tax | 4,486 | 398,300 |
| Carroll | Impact Fee | 6,836 | 3,403,200 |
| Charles | Excise Tax | 10,247 | 1,181,500 |
| Dorchester | Excise Tax | 3,671 | 846,200 |
| Frederick[1] | Both | 10,487 | 12,418,900 |
| Harford | Impact Fee | 6,000 | N/A |
| Howard[2] | Excise Tax | See note | 12,807,800 |
| Montgomery[3] | Excise Tax | 16,250 | 16,166,100 |
| Prince George’s | Excise Tax | 12,706 | 26,233,300 |
| Queen Anne’s | Impact Fee | 6,363 | 1,511,500 |
| St. Mary’s | Impact Fee | 4,500 | 3,417,900 |
| Talbot | Impact Fee | 5,152 | 762,500 |
| Washington | Excise Tax | 13,000 | 3,546,200 |
| **Total** | | | **$99,223,900** |

Notes:
[1] Roads tax ranges from $0.10/sq.ft to $0.25/sq.ft.
[2] Roads tax is $0.80/sq.ft. School surcharge is $1.03/sq.ft.
[3] Excise tax represents $8,250 for transportation and $8,000 for schools.

Source: Department of Legislative Services, Local Government Survey

## Adequate Public Facilities Ordinances

In addition to development charges, county and municipal governments with planning and zoning authority may impose an adequate public facilities ordinance (APFO). An APFO establishes capacity standards for public schools, roadways, water/sewer utilities, police, fire and rescue services, storm drainage, and utilities. If new development is projected to exceed capacity standards in an area, the developer may be required to make contributions for capital improvements, such as building additional classrooms for a public school or constructing new roadways, as a condition of moving the development forward. Another option would be for the county or municipality to delay the development until the respective government provides the capital improvements. APFOs have been adopted in 13 counties, with several municipalities adopting their own ordinances. **Exhibit 2** lists the counties that have adopted APFOs.

**Exhibit 2**
**Counties with Adequate Public Facilities Ordinances**

| | | | | |
|---|---|---|---|---|
| Anne Arundel | Carroll | Harford | Prince George’s | Washington |
| Baltimore | Charles | Howard | Queen Anne’s | |
| Calvert | Frederick | Montgomery | St. Mary’s | |

Source: Maryland Department of Planning

House Bill 1205 of 2005 would have required a municipality to be governed by the county APFO until the municipality adopts an ordinance that meets minimum specified standards and requirements. Specified standards and requirements included provisions for the impact of any development or growth within the municipality that affects public schools and roadways located in the county.

This legislation addressed the concerns that county governments had with developers circumventing county APFO requirements by locating proposed developments in municipalities without or with less stringent APFO requirements. As a consequence of the new development, county governments are confronted with needed infrastructure improvements without receiving funds from developers to offset the cost of the improvements. In addition, development within a municipality could lead to further over crowding in public schools or other county services. Public school construction is one local government function that could be affected by an APFO. Most or all APFOs include provisions for adequate public school capacity. Public school construction is mostly funded by the State and county governing body. Generally, municipalities do not provide funding for public school construction.

The House Environmental Matters Committee did not take action on the legislation; however, this issue continues to be of importance to both the Maryland Association of Counties and the Maryland Municipal League.

For more information contact: Hiram L. Burch Jr. Phone: (410) 946/(301) 970-5510

# Local Government

## Emergency Preparedness of Local Governments in Maryland

**In the aftermath of the failed federal response to Hurricane Katrina, State and local government officials must evaluate their emergency preparedness plans to ensure that adequate procedures are in place to respond to emergency situations, including the safe evacuation of individuals with special needs.**

### Emergency Management Agencies in Maryland

Local governments are the primary first responders to emergency situations in Maryland, whether the situation involves terrorist attacks, accidents, or natural disasters. Local emergency management agencies exist in all 24 jurisdictions, including separate agencies for Annapolis and Ocean City. These agencies regularly participate in training exercises and have developed plans involving various disaster scenarios. If local responders are overwhelmed by an incident, mutual aid agreements are in place with established guidelines and procedures for local officials to call surrounding jurisdictions and/or State agencies for assistance. The local responder has command and control of the response until relinquished as detailed in the Emergency Powers Act.

The State response to any major emergency or disaster is coordinated by the Maryland Emergency Management Agency (MEMA). This includes supporting local governments as needed or requested and coordinating assistance with the Federal Emergency Management Agency (FEMA). In a major emergency or disaster, the Director of MEMA activates the State Emergency Operations Center (EOC) to support local governments as necessary or requested. Representatives from various State agencies are present in the EOC and have the authority to make decisions, allocate resources, and spend monies necessary for emergency responses.

It is generally assumed that the quickest the federal government can respond with assistance to any major emergency or disaster is 72 hours after the event. State and local jurisdictions build into their planning that they must be able to respond on their own for a three-day period. The federal government can only lawfully intervene in a state if there is an armed insurrection or when it is invited by the state.

### Emergency Management Exercises and Evacuation Plans

In April 2005, the U. S. Department of Homeland Security issued its *National Planning Scenarios* report. Created for use in federal, state, and local homeland security preparedness, the report presents 15 disaster scenarios but does not preclude the states or local authorities from adding to the list as their situation may merit. The scenarios are as follows: 2 nuclear or radiological incidents; 5 biological incidents; 4 chemical incidents; 2 natural disasters; 1 massive explosion; and 1 cyber incident. To this list Maryland planners have added one natural disaster (ice storm) and a variety of localized scenarios such as a dam break.

Of the 15 disaster scenarios listed in the *National Preparedness Scenarios* report, 8 require some level of evacuation, 7 of which are post event (*e.g.*, earthquake) or are concurrent with the event (*e.g.*, chemical spill). Only one, a major hurricane (a category three or higher), requires or allows a pre-event evacuation. Maryland has felt the effects of small hurricanes and tropical disturbances 26 times since 1900 but has not been directly hit with a major hurricane or by any lesser hurricane since 1950.

Each Maryland county and Baltimore City, Annapolis, and Ocean City have Emergency Action Plans, which are on a continuous updating cycle so that by the end of every third year the plan has been completely reviewed and updated as necessary. These plans include procedures for evacuating certain special needs populations such as hospitalized patients and prison inmates. The effects of failing to safely evacuate individuals with special needs were clearly demonstrated earlier this year in New Orleans days after the landfall of Hurricane Katrina.

In the aftermath of Hurricane Katrina, State and local officials across the nation are reviewing their own disaster response plans to ensure that adequate provisions are in place to handle individuals with special needs. In October 2005, the County Executive of Fairfax County, Virginia, the largest local government in the Washington-Baltimore Area, made a comprehensive presentation to the county's board of supervisors that identified eight special populations that could be severely affected during a disaster, as listed in **Exhibit 1.** Initiatives in Fairfax County include using about 1,600 county-owned school buses to transport individuals to shelters, providing citizen guides on emergency preparedness in seven languages, conducting a full-scale evacuation exercise of its correctional facility, and having county staff go door-to-door handing out fliers, as was done during Hurricane Isabel and other events.

**Exhibit 1**
## Special Populations Requiring Government Assistance During Emergencies

- People reliant on public transportation
- People with disabilities
- People communicating in languages other than English
- Economically disadvantaged people
- Incarcerated people
- People affected by the Digital Divide
- People in medical facilities
- Animals

Source: Fairfax County Government

## Resources Needed to Adequately Respond to Emergency Situations

Maryland has made progress addressing its major emergency response issues including interoperable communications, cross jurisdiction and across State aid agreements, better coordination through the 24-7 emergency operation center and the Maryland Coordination and Analysis Center (MCAC), and a streamlining of the management structure. However, while federal and State funding has increased in recent years to address emergency preparedness issues, State and local jurisdictions still have a variety of needs, with the two most significant being interoperable communications and specialized training for emergency responders.

For further information contact: Brian Baugus/Hiram L. Burch Jr. Phone: (410)946/(301) 970-5530

# Local Government

## Impact of the *Kelo* Case on the Power of Eminent Domain

**The U. S. Supreme Court's June 2005 decision in *Kelo v. City of New London, Connecticut*, interpreting the "takings clause" of the Fifth Amendment to the U. S. Constitution, and reaction to that decision by the U. S. Congress and by other states, prompts intense interest in and a fresh look at the laws of Maryland and its local governments on the use of the power of eminent domain.**

### The *Kelo* Case

This past June, the U. S. Supreme Court, in a closely divided five to four decision, ruled in *Kelo v. City of New London, Connecticut* that the city was allowed to exercise its power of eminent domain under a state law to require several homeowners to vacate their properties to make way for mixed use development. The court maintained that, even though all the property at issue was not planned to be used by the general public, the city's development plan for the area, which was designed to bring comprehensive and appreciable economic benefits including new jobs and increased tax revenue, had sufficient "public purpose" so as not to constitute a violation of the Takings Clause under the Fifth Amendment to the U. S. Constitution.

### Eminent Domain in Maryland

#### Constitutional and Statutory Law

The power to take, or condemn, private property for public use is one of the inherent powers of state government. The courts have long held that this power, known as "eminent domain," is derived from the sovereignty of the state and does not require constitutional authority for its existence. However, both the U. S. Constitution and the Maryland Constitution contain express limitations on the exercise of this inherent authority. The Fifth Amendment to the U. S. Constitution provides "…nor shall private property be taken for public use, without just compensation." Article III, Section 40 of the Maryland Constitution provides that "[t]he General Assembly shall enact no Law authorizing private property, to be taken for public use, without just compensation, as agreed upon between the parties, or awarded by a Jury, being first paid or tendered to the party entitled to such compensation."

The Maryland Constitution also includes provisions that allow the State and designated local governments to take private property for certain purposes before paying just compensation, known as "quick take," and allow the General Assembly to authorize a county or municipal corporation to take property as part of an urban renewal project for slum clearance and redevelopment in blighted areas.

The Annotated Code of Maryland contains dozens of provisions regarding the power of eminent domain applicable to various units of State government, counties, municipal corporations, other local governmental units created by State law, and various public utilities. Title 12 of the Real Property Article and Title 12 of the Maryland Rules provide the procedures to be followed when a condemning authority takes property under most circumstances.

## Case Law

The Court of Appeals of Maryland has broadly interpreted the constitutional requirement that a taking be for a "public use," and has consistently been deferential to legislative judgment in the grant and exercise of the power of eminent domain. The court has been reluctant to limit "public use" to its literal meaning – "use by the public" – but rather has regularly recognized takings that accomplish a "public benefit" or "public purpose." Maryland case law also indicates that while a government may not simply take private property from one person and convey it to another person, such a transfer, even if the property is not blighted, would not necessarily be unlawful if it is an incidental or secondary part of a comprehensive, well-formulated plan to benefit the public such as a plan for economic development or urban renewal.

## Exercise of the Power of Eminent Domain

Historically, the power of eminent domain has been exercised by the State primarily for the construction of roads, streets, and highways. More recent examples include the construction by the Maryland Stadium Authority of the Camden Yards baseball and football stadiums and the Hippodrome Theater in Baltimore City. The Maryland Economic Development Corporation, even though charged with the task of encouraging increased business activity and commerce and promoting economic development in the State and authorized by law to condemn property, reports that it has not exercised the eminent domain power.

According to preliminary responses to surveys conducted this interim by the Maryland Municipal League and the Maryland Association of Counties, local governments also have seldom exercised the power of eminent domain. When utilized, the purposes have been reportedly for small, targeted public projects – for example, to construct an airport, a fire station, or a parking lot. On a larger scale, Baltimore City has exercised condemnation powers for the redevelopment of the Inner Harbor and the Charles Center. In 2000, Baltimore County attempted to exercise eminent domain powers for revitalization in three aging residential areas; however, this project was petitioned to a local referendum and was rejected by the county voters at the general election that year by a margin of more than two to one and did not move forward.

## Recent Developments

### Interim Advice from the Office of the Attorney General of Maryland

This summer, letters from the Office of Counsel to the General Assembly in the Office of the Attorney General advised that Maryland case law has long reflected the views on eminent domain expressed by the majority in the *Kelo* case. Specifically, the office notes that the Maryland courts have long recognized that property, whether or not blighted, can be condemned for economic development purposes, but that a taking cannot be justified on the basis of a pretext of a public benefit. One letter notes that if there is any impact from *Kelo* in Maryland, there might be closer judicial scrutiny on the question of whether or not a project is for a "public use;" however, there is no guarantee that this will occur. Another letter states that, as pointed out by the majority in *Kelo*, the General Assembly may place restrictions on the exercise of the power of eminent domain. For example, either by statute or constitutional amendment, the General Assembly may restrict the categories of public uses for which the power of eminent domain may be exercised.

### Reaction by the United States Congress and Other States

Shortly after the publication of the *Kelo* decision, several measures were introduced in Congress to limit or contradict the holding. Within days of the *Kelo* decision, an overwhelming majority in the House voted to adopt a resolution disagreeing with the Supreme Court's decision. One piece of legislation passed by the House (House Rules 4128) prevents states and localities that receive federal economic development funds from exercising their power of eminent domain to take private property for economic development purposes; moreover, the federal government also is prohibited from taking private property for economic development purposes. Similar legislation has been introduced in the Senate (Senate Rules 1313).

According to the National Conference of State Legislatures, since the *Kelo* decision, 12 states have considered legislation to restrict the use of eminent domain. Measures in three of those states (Alabama, Delaware, and Texas) have been enacted to prohibit, with certain exceptions, the use of eminent domain on private property for economic development purposes or for the transfer to another private party.

### Task Force on Business Owner Compensation in Condemnation Proceedings

While the creation of this task force (Chapter 446 of 2004) pre-dates the *Kelo* case, it is important to note that the final report of the task force is due at the end of this year to the Governor and the General Assembly. Among other matters, the task force is charged with studying the appropriateness of making a legislative proposal on business owner compensation in condemnation proceedings applicable statewide or only in Baltimore City, and the circumstances in which condemnation can be used in the State.