Issue Papers

2008 Legislative Session

Department of Legislative Services 2007

Issue Papers

2008 Legislative Session

Presentation to the

Maryland General Assembly

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December 2007

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, 2007.

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/ncs

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Operating Budget

Economic and Revenue Outlook

The Maryland economy is growing at a moderate pace but is expected to slow under the weight of the contracting housing market. Weak year-to-date performance and slower economic growth result in a baseline forecast of less than 5 percent general fund revenue growth over the next two years. Legislation from the 2007 special session will increase general fund revenues by an estimated $367 million in fiscal 2008 and $837 million in fiscal 2009.

Economic Outlook

The Maryland economy marked its third straight year of healthy growth in 2006. Total personal income grew 5.7 percent in 2006, the same as in 2005. Employment rose by 1.2 percent, slowing from the 1.5 percent pace in 2005. Industries related to the housing market, such as real estate agents and certain finance companies, experienced job losses especially in the second half of 2006. The retail trade sector also posted a year-over-year drop in employment in the second half of 2006.

The data available for 2007 present a somewhat mixed picture of the Maryland economy. Through October, employment is up 1.1 percent but growth has picked up in recent months. Employment grew 0.9 percent in the first quarter, 1.1 percent in the second quarter, and 1.3 percent in the third quarter. Total personal income grew 5.8 percent in the first half of 2007. Wage and salary income is up 5.7 percent compared to growth of 5.4 percent in 2006. The Maryland housing market continues to contract sharply. According to data from the Maryland Association of Realtors, sales have fallen 21.0 percent through October on top of a 21.0 percent decline in 2006.

The economic outlook is for slower growth compared to the forecast from December 2006 that was the basis of the revenue projections from the Board of Revenue Estimates (**Exhibit 1**). Part of this is due to the weaker employment growth in 2006 and year-to-date in 2007 than was previously estimated. The continuing contraction in the residential housing market will weigh on the economy, resulting in projected employment growth of less than 1 percent in 2008. Economic growth should rebound in 2009 in response to further interest rate cuts by the Federal Reserve and a bottoming out of the housing market. The impact of the U.S. Department of Defense's Base Realignment and Closure (BRAC) process will begin to be felt in 2010.

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

Calendar	Employment		Personal Income	
Year	Dec. 2006	Oct. 2007	Dec. 2006	Oct. 2007
2004	1.2%	1.2%	7.2%	6.9%
2005	1.4%	1.5%	6.3%	5.7%
2006	1.4%	1.2%	6.6%	5.7%
2007 Est.	1.3%	1.0%	5.8%	5.7%
2008 Est.	1.5%	0.8%	5.7%	5.4%
2009 Est.	1.8%	1.6%	5.8%	5.7%
2010 Est.	1.8%	1.6%	6.0%	5.6%

Source: December 2006 is from the Board of Revenue Estimates. October 2007 is from the Department of Legislative Services. Figures for 2006 are estimates in the December 2006 columns.

Revenue Outlook

Fiscal 2007 general fund revenues exceeded the estimate by $75.0 million or 0.6 percent. General fund revenues totaled $12.9 billion in fiscal 2007, an increase of 4.4 percent over 2006. Excluding one-time revenues, ongoing revenues grew 4.6 percent in 2007. The personal income tax grew 7.7 percent over 2006 and exceeded the estimate by $85.0 million.

The sales tax was the biggest source of weakness, falling short of the estimate by $37 million and growing just 1.9 percent over 2006. Law changes relating to the tax-free week for back-to-school items in fiscal 2007 and the reduced vendor credit in fiscal 2006 distort the year-over-year comparison. Adjusted for law changes, sales tax receipts grew around 2.6 percent in 2007, the weakest growth since 2003. The construction sector fell 4.6 percent, reflecting the contracting housing market.

Fiscal 2007 was a difficult year for the lottery. General fund lottery revenues fell 1.5 percent, the first decline since fiscal 1999. Sales grew just 1.1 percent, while prize payouts were up 2.3 percent. Agent commissions were increased from 5.0 to 5.5 percent as required by legislation passed at the 2005 session. The Mega Millions game had just one large jackpot in 2007, and sales consequently fell 15.5 percent. Sales for the Instant game were up 2.4 percent, the slowest pace since 1998. A new vendor contract and conversion to a new inventory system created some issues, but sales picked up considerably towards the end of the fiscal year.

For fiscal 2008, total general fund revenues through October are up 2.3 percent over the same period in 2007. However, a number of things are distorting the year-over-year comparison.

The fiscal 2007 revenues reflect the impact of the tax-free week for back-to-school items; there was no tax-free week in fiscal 2008. Fiscal 2007 also reflects extraordinarily large estate tax payments from a small number of estates. In fiscal 2008, the corporate income tax includes the payment of a large one-time refund. After adjusting for these items, the year-to-date growth in general fund revenues is about 4.3 percent.

The significant under attainment in the sales tax in fiscal 2007, combined with the moderate year-to-date performance and the expectation of slowing economic growth, results in a general fund baseline forecast of less than 5.0 percent growth for both fiscal 2008 and 2009 (**Exhibit 2**).

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

		Fiscal 2008			Fiscal 2009	
	Current Official Estimate	**DLS Oct. 2007**	**$ Diff.**	**% Change 2008/2007**	**DLS Oct. 2007**	**% Change 2009/2008**
Personal Income Tax	$7,041	$7,072	$31	5.9%	$7,517	6.3%
Sales and Use Tax	3,623	3,517	-106	2.8%	3,680	4.6%
Corporate Income Tax	598	576	-22	-2.4%	598	3.9%
Lottery	499	497	-3	4.9%	510	2.7%
Other	1,677	1,702	25	-4.3%	1,710	0.5%
Baseline Total	**$13,438**	**$13,363**	**-$74**	**3.3%**	**$14,016**	**4.9%**
Special Session 2007	0	367	367	n/a	837	128.0%
Total	**$13,438**	**$13,730**	**$292**	**6.1%**	**$14,853**	**8.2%**

DLS = Department of Legislative Services.

Source: Board of Revenue Estimates; Department of Legislative Services

Legislation passed at the 2007 special session (Chapters 3 and 6) made numerous changes to the State's revenue structure. In the personal income tax, three new brackets were

added, and the personal exemption was increased for low- and middle-income taxpayers but lowered for upper-income taxpayers. In addition, the refundable earned income credit was expanded. The corporate income tax rate was raised, and a distribution of revenues from the corporate income tax was added for the newly created Higher Education Investment Fund in fiscal 2008 and 2009.

The sales tax was increased from 5.0 to 6.0 percent, and the vendor credit was capped at $500 monthly; the vendor credit provision sunsets at the end of fiscal 2011. Beginning in fiscal 2011, the legislation provides for annual sales tax holidays for energy efficient appliances and clothing and footwear costing less than $100. The sales tax base was expanded to include computer services beginning in fiscal 2009 and sunseting at the end of fiscal 2013. A new distribution of 6.5 percent of sales tax revenues will be made to the Transportation Trust Fund. In other provisions, the legislation from the special session increased the tax rate for cigarettes from $1.00 to $2.00 per pack. A 20.0 percent State admissions and amusement tax will be imposed on the net receipts from electronic bingo and tip jars.

In total, general fund revenues are projected to be higher by $367 million in fiscal 2008 as result of legislation passed at the special session. In fiscal 2009, the additional general fund revenue totals an estimated $837 million, reflecting a full year impact.

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Operating Budget

Budget Outlook: Enactment of a Long-term Fiscal Plan Brightens Outlook

Faced with a continuing structural deficit estimated as high as $1.7 billion for fiscal 2009, the Governor issued an executive order convening a special session to address the State's budget woes. Final action at the session yielded a mix of revenue and spending actions that are projected to fully close the gap between ongoing revenue and spending by fiscal 2012. Portions of the plan are contingent upon voter approval of a constitutional amendment to permit video lottery terminals.

Background

The State has faced annual structural deficits to varying degrees since the recession of 2001 when general fund revenues decreased in both fiscal 2002 and 2003. The problem was exacerbated by legislation adopted at the 2002 session that phased in significant increases in local education aid by fiscal 2008. While better than expected economic activity in fiscal 2005 and 2006 temporarily mitigated the problem, the past six sessions witnessed a combination of one-time and ongoing revenue and spending actions pending consensus on a longer term solution. The 2003-2006 sessions saw the Ehrlich Administration propose a series of reductions, fee increases, use of one-time fund balances, and several unsuccessful attempts to enact legislation to permit the implementation of video lottery terminals. The Governor did not support major tax increases, which were contemplated by the legislature.

The fiscal 2007 budget closed with an undesignated general fund surplus of $156.5 million, fueled in part by $75.0 million in higher than anticipated revenue growth. However, that budget had a nearly $500.0 million structural shortfall between ongoing revenues and ongoing spending. Projections for fiscal 2008 and 2009 estimated structural imbalances of $1.0 billion and $1.5 billion, respectively. Growth in local education and library aid alone consumed the entire increase in general fund revenues in fiscal 2008, and growth in this aid plus Medicaid expenses nearly match projected fiscal 2009 revenue growth. One of the education aid cost drivers was an inflation factor that was increasing at a much higher rate than expected.

At the 2007 session, newly elected Governor Martin O'Malley requested additional time to develop a plan to solve the budget problem. The interim was punctuated by legislative study of the deficit. Hearings were held to consider revenue options, a "Doomsday" budget option if only spending cuts were considered, and the impact of spending mandates. This set the stage for the special session of 2007.

2007 Special Session

On October 15, 2007, Governor O'Malley issued Executive Order 01.01.2007.23 to convene a special session beginning October 29, 2007. The Administration proposed six bills to raise general fund revenues, modify selected statutory mandates, implement limited health care expansion, provide additional transportation funding, place before the voters a constitutional amendment to authorize video lottery terminals, and provide for the operational and regulatory framework for the proposed VLT program.

After three weeks of hearings and deliberation, the legislature completed action on a fiscal plan to address the long-term structural deficit. Much of the Administration's initial proposal remained intact, although not all the proposals were adopted. The major revenue and spending highlights in the plan include the following:

- increasing the sales tax from 5 to 6 percent and expanding it to cover computer services;
- raising the corporate income tax from 7.00 to 8.25 percent, dedicating a portion to higher education capital needs;
- making the income tax more progressive, with a top rate of 5.5 percent. Higher rates are offset by an increase in the refundable earned income tax credit and higher personal income tax exemptions;
- raising the tobacco tax by $1 per pack; and
- implementing video lottery terminals, contingent on voter approval of a constitutional amendment. If approved, 15,000 machines at five locations would be authorized. The majority of the State's share would be dedicated to an Education Trust Fund.

For fiscal 2009, the plan will raise approximately $900 million in net general fund tax revenues. Another $460 million will be raised through special fund sources, chiefly due to a portion of the sales tax and an increase in the titling tax dedicated to the Transportation Trust Fund.

A total of $550 million in spending reductions were also adopted as part of the fiscal package. This includes a net $154 million through a statutory change to education funding formulas to freeze inflation adjustments for two years (offset by additional spending for supplemental grants and 60 percent implementation of the Geographic Cost of Education Index); $240 million in unspecified reductions to be implemented by the Administration; $77 million from a one-time surplus in the State's health care account; and a number of smaller actions including elimination of the $30 million Electricity Generating Equipment Property Tax grant and the elimination of 500 Executive Branch positions and $10 million. **Exhibit 1** illustrates the Administration's proposal and final action by the legislature.

Exhibit 1
Special Session Fiscal Plan
Fiscal 2009
Administrative Proposal vs. Final Legislative Action

	Administration		General Assembly Final	
	General Fund	All Funds (DLS Estimate – All Funds)	General Fund	All Funds
Taxes				
Sales Tax Rate	$688	$688	$406	$688
Sales Tax Base Expansion	59	59	200	214
Vendor Discount Cap	-	-	14	15
Tax Holidays	-18	-18	0	0
Subtotal Sales Tax	**$729**	**$729**	**$620**	**$917**
Electronic Bingo	-	-	5	5
Personal Income Tax, Net of Credits	85	85	29	29
Corporate Tax Rate	0	112	85	140
Combined Reporting	28	42	0	0
Tobacco Tax Rate	164	164	162	162
Vehicle Titling Tax Rate	0	145	0	94
Property Transfer	0	14	0	14
Motor Fuel Tax Indexing	0	28	0	0
Grand Total Taxes	**$1,006**	**$1,319**	**$901**	**$1,361**
New Spending				
Health*	$39	$39	$39	$39
Transportation Trust Fund	0	339	0	405
Higher Education Investment Fund	0	59	0	56
Chesapeake Bay 2010 Fund	0	0	0	50
Video Lottery Terminal Start-up Costs	3	3	3	3
Subtotal New Spending	**$42**	**$440**	**$42**	**$553**
Cuts (Excluding Board of Public Works)				
Education	-$191	-$191	-$154	-$154
Health Fund Transfer	-82	-82	-77	-77
Other**	-153	-153	-319	-319
Subtotal Cuts	**-$426**	**-$426**	**-$550**	**-$550**

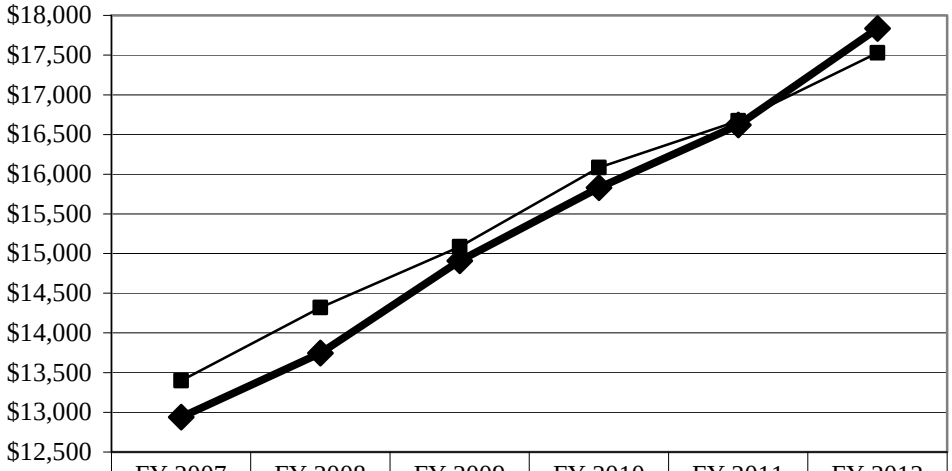
*Does not include federal funds and one-time transfer from the Maryland Health Insurance Plan in fiscal 2009.
**Includes $105 million in unspecified reductions under the Administration plan and $240 million under the final plan.

Source: Department of Legislative Services

Fiscal 2008 through 2012 Forecast: A Long-term Solution Is Enacted

As illustrated in **Exhibit 2**, a positive structural surplus is projected in fiscal 2012. The long-term forecast is shown in **Exhibit 3**. The forecast anticipates that throughout the period, the State will also maintain at least a 5 percent balance in the Rainy Day Fund.

Exhibit 2
Legislative Action Closes the Structural Deficit by 2012
($ in Millions)



	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Ongoing Revenue	$12,940	$13,747	$14,908	$15,829	$16,622	$17,836
Ongoing Spending	$13,400	$14,322	$15,086	$16,084	$16,671	$17,529

Source: Department of Legislative Services

Conclusion

Since 2002, the State has managed a general fund structural deficit on an annual basis. Estimated at approximately $1.7 billion for fiscal 2009, Governor-elect O'Malley requested additional time to consider alternatives for addressing the shortfall at his first session. The Governor called for a special session that began October 29, 2007, and lasted three weeks. At its conclusion, legislative action resulted in a plan that raised $900 million in new revenues and included $550 million in spending reductions for fiscal 2009. Part of the plan relies upon passage of a constitutional amendment in 2008 to implement video lottery terminals. Long-term projections indicate that the actions at the special session would yield a structural surplus by fiscal 2012.

Exhibit 3
General Fund Projections
Administration Plan – Video Lottery Referendum Approved
($ in Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Revenues						
Fund Balance/Transfers	$1,365	$285	$518	$291	$18	$0
Transfer from Rainy Day Fund	0	998	140	74	76	72
One-time Revenues	154	0	0	0	0	0
Subtotal	**$1,519**	**$1,283**	**$658**	**$364**	**$94**	**$72**
Ongoing Revenues	$12,940	$13,363	$14,016	$14,811	$15,606	$16,431
Revenue Adjustments – Legislation	0	0	0	0	0	0
Subtotal	**$12,940**	**$13,363**	**$14,016**	**$14,811**	**$15,606**	**$16,431**
Special Session Actions						
New Revenues		**$383**	**$892**	**$1,018**	**$1,016**	**$1,404**
Total Revenues	**$14,459**	**$15,029**	**$15,566**	**$16,193**	**$16,716**	**$17,908**
Spending						
Operating Spending	$13,217	$14,244	$15,260	$16,081	$16,901	$17,666
Additional Reductions		**-5**	**-550**	**-568**	**-660**	**-695**
Initiatives		**16**	**98**	**188**	**231**	**358**
Multi-year Commitments	183	115	278	384	200	200
Operating Spending – Legislation	0	0	0	0	0	0
One-time Board of Public Works Operating Reduction	0	-49	0	0	0	0
Subtotal	**$13,400**	**$14,322**	**$15,086**	**$16,084**	**$16,671**	**$17,529**
PAYGO Capital	$136	$27	$42	$41	$43	$39
Appropriation to Reserve Fund	638	163	147	50	50	50
Subtotal	**$775**	**$190**	**$189**	**$91**	**$93**	**$89**
Total Spending	**$14,174**	**$14,512**	**$15,275**	**$16,175**	**$16,764**	**$17,617**
Ending Balance	**$285**	**$518**	**$291**	**$18**	**-$49**	**$290**
Rainy Day Fund Balance	$1,432	$680	$746	$787	$828	$870
Balance over 5% of GF Revenues	790	-8	0	0	0	0
Balance %		4.9%	5.0%	5.0%	5.0%	5.0%
Structural Balance	-$460	-$575	-$178	-$255	-$50	$307

Source: Department of Legislative Services

Operating Budget

Transportation Trust Fund Overview

The Transportation Trust Fund closing balance for fiscal 2007 exceeded estimates, primarily due to lower than expected capital expenditures. However, revenue enhancements adopted during the 2007 special session will allow for significant increases in both the operating and capital programs, although the level of debt outstanding will continue to be somewhat constrained by State debt limitations.

Fiscal 2007 Closeout

The Transportation Trust Fund (TTF) generated $2.2 billion in State-sourced funds in fiscal 2007. The TTF end-of-year cash balance totaled $187 million, which exceeded estimates by $81 million. Lower than expected expenditures, largely from the capital program, resulted in the higher than expected closing fund balance. Capital expenditures were $133 million less than projected due to the acceleration in the schedule of highway projects eligible for federal funding as well as changes in ongoing projects. Lower than expected expenditures were somewhat offset by lower than expected revenue attainment. Titling tax revenues came in $11 million less than expected due to the impact of the housing market slowdown, higher gas prices, and the inability of auto manufacturers to offer rebates due to their weak financial conditions.

Revenue Impacts of the 2007 Special Session

Chapter 6 of the 2007 special session was enacted to provide additional revenues to the TTF, amongst other general fund revenue raising measures. **Exhibit 1** provides a summary of the actions taken and the revenue impacts in the fiscal 2008 through 2013 period.

Exhibit 1
Special Session Revenue Impacts
Transportation Trust Fund
Fiscal 2008-2013
($ in Millions)

Additional Revenue	2008	2009	2010	2011	2012	2013
Increase in Titling Tax from 5 to 6% – Dedicated to TTF	$73	$141	$149	$156	$163	$169
Increase in Titling Certificate Fee ($23 to $50)	16	33	34	34	35	36
Allowance for Full Trade-in Value – Titling Tax Revenue Reduction	-43	-83	-88	-93	-96	-98
Sales Tax Dedication – 6.5% of Total Revenues	0	297	312	327	343	359
Ending Certain General Fund Transfers		15	15	16	16	17
Total TTF Revenues	**$46**	**$403**	**$422**	**$440**	**$461**	**$483**
State Share	**$38**	**$419**	**$439**	**$458**	**$479**	**$502**
Local Share	**+$8**	**-$16**	**-$17**	**-$18**	**-$18**	**-$19**

TTF= Transportation Trust Fund

Source: Department of Legislative Services

By fiscal 2013, the Department of Legislative Services (DLS) estimates that the additional revenues provided to the State share of the TTF will exceed $500 million. Almost all the additional revenue will be used by the Maryland Department of Transportation (MDOT) to support and enhance the capital program. Language in Chapter 6 directs MDOT to provide a report as part of its fiscal 2009 budget allowance that details how and when the additional revenues provided will be spent.

Transportation Trust Fund Forecast

Exhibit 2 shows the DLS fiscal 2008 through 2013 TTF forecast. The forecast details the expected trends in revenue attainment, debt issuance, and capital expenditures. Overall tax and fee revenues are estimated to be relatively flat in fiscal 2008; however, the additional

revenues provided from Chapter 6 of the 2007 special session will allow MDOT to maintain and expand its capital program.

Over the six-year period, DLS estimates net taxes and fees to the department will total approximately $12.7 billion, with an annual average growth rate of 2.9 percent from fiscal 2009 to 2013. Compared to the September 2006 MDOT forecast, this represents an increase of $2.0 billion over the six-year period due to the revenue increase. Absent the additional revenues, DLS estimated a significantly slower rate of growth in the titling tax and corporate income tax, which may be attributed to weaknesses and changes in the housing and credit markets.

Debt Financing

Debt issuances by MDOT are constrained by a total debt outstanding limit of $2.6 billion and by two coverage tests that administratively require the prior year's pledged taxes and the net income of MDOT to be two-and-a-half times greater than the maximum debt service in a given fiscal year. As part of Chapter 6, MDOT's debt outstanding limit was increased from $2.0 billion to $2.6 billion to recognize the additional bonding capacity associated with the revenue increase.

Through the policy of the Capital Debt Affordability Committee (CDAC), MDOT debt is also limited by a broader limit of total State debt outstanding, which cannot exceed 3.2 percent of personal income. Based upon current State debt levels, MDOT will be limited to $2.0 billion debt outstanding in the near-term unless changes are made to State debt limits. Future debt issuances will be constrained by either the CDAC limit or the $2.6 billion debt outstanding limit, as opposed to any coverage tests. The level of debt outstanding will directly impact the size of the capital program.

In fiscal 2008, DLS estimates a bond sale of $290 million and then a smaller bond sale of $205 million in fiscal 2009 due to available cash and the timing of new capital project expenditures. Bond sales could increase throughout the forecast period and total $440 million in fiscal 2013, with debt outstanding reaching $2.6 billion in fiscal 2013.

Capital Expenditures

Assuming debt outstanding is permitted to reach $2.6 billion, DLS estimates that the six-year transportation capital program will total $9.9 billion, which is an increase of approximately $2.2 billion compared to MDOT's fall financial forecast. Under the $2.0 billion debt outstanding limit, the six-year capital program would total $9.3 billion, for an increase of $1.6 billion compared to the MDOT fall forecast.

Special funds for the capital program will likely remain relatively steady throughout the six-year period or experience a slight decline. Initially, MDOT is unlikely to be able to spend all the available funding as it takes a number of years for projects to move to the actual construction phase. As a result, unlike in prior years, the additional revenues to the TTF will allow for a more even special fund cash flow to the capital program. Federal funds have been conservatively estimated due

to the uncertainty of future federal funding estimates; as a result, most of the decline in the capital program may be attributed to these estimates.

Exhibit 2
Department of Legislative Services
Transportation Trust Fund Forecast
Fiscal 2008-2013
($ in Millions)

	Actual 2007	Current 2008	Estimate 2009	Estimate 2010	Estimate 2011	Estimate 2012	Estimate 2013
Opening Fund Balance	**$235**	**$187**	**$100**	**$100**	**$100**	**$100**	**$100**
Closing Fund Balance	**$187**	**$100**	**$100**	**$100**	**$100**	**$100**	**$100**
Net Revenues							
Taxes and Fees	$1,609	$1,648	$2,083	$2,146	$2,208	$2,270	$2,332
Operating and Miscellaneous	488	499	498	500	513	524	537
MdTA Transfer	13	-20	-13	-25	0	0	0
Net Revenues Subtotal	2,110	2,127	2,568	2,621	2,721	2,794	2,869
Bonds Sold	100	290	205	300	350	420	440
Bond Premiums	3	0	0	0	0	0	0
Total Revenues	**$2,213**	**$2,417**	**$2,773**	**$2,921**	**$3,071**	**$3,214**	**$3,309**
Expenditures							
Debt Service	$115	$122	$140	$153	$172	$203	$231
Operating Budget	1,397	1,461	1,579	1,629	1,688	1,748	1,802
State Capital	753	921	1,053	1,140	1,212	1,262	1,279
Total Expenditures	**$2,265**	**$2,504**	**$2,773**	**$2,922**	**$3,072**	**$3,213**	**$3,312**
Debt							
Debt Outstanding	$1,111	$1,332	$1,461	$1,683	$1,949	$2,268	$2,596
Debt Coverage – Net Income	6.1	4.1	3.3	4.4	3.8	3.4	3.1
Local Highway User Revenues (HUR)	**$555**	**$562**	**$554**	**$567**	**$580**	**$591**	**$606**
Transferred to General Fund	0	0	0	0	0	0	0
Net HUR to Counties	**$555**	**$562**	**$554**	**$567**	**$580**	**$591**	**$606**
Capital Summary							
State Capital	$753	$921	$1,053	$1,140	$1,212	$1,262	$1,279
Net Federal Capital (Cash Flow)	710	699	557	535	470	404	333
Subtotal Capital Expenditures	**$1,463**	**$1,620**	**$1,610**	**$1,675**	**$1,682**	**$1,666**	**$1,612**
GARVEE Debt Service	0	36	74	84	84	84	84

TTF = Transportation Trust Fund, MdTA = Maryland Transit Authority, GF = General Fund, GARVEE = Grant Anticipation Revenue Vehicle

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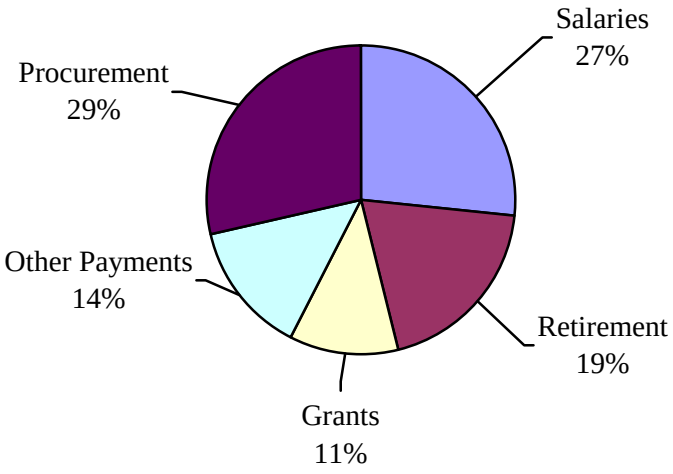
Operating Budget

Federal Funds Outlook

The federal government contributes significantly to Maryland's economy as an employer, as a customer of commercial services, and as a provider of funds for a host of social, health, environmental, and transportation programs. Continued disagreements amongst policymakers on Capitol Hill are complicating efforts to determine the level of expected federal funding for Maryland in the near term.

Maryland has benefited greatly from federal largesse in recent years, ranking among the top five of all states in defense spending and federal workforce salaries. Maryland ranked third in per capita federal funds among all states, behind only Alaska and Virginia, in federal fiscal 2005. A total of $66.7 billion flowed into the State in federal fiscal 2005, according to the recently released *Consolidated Federal Funds Report* from the U.S. Census Bureau. Federal retirement, disability, and salary expenditures accounted for approximately two-thirds of the money, while other direct payments (mostly Medicare) equaled $10.6 billion, and grants totaled $8.6 billion (see **Exhibit 1** for the distribution of spending). Furthermore, federal spending grew at a faster pace in Maryland from 1996 to 2005 than did federal spending as a whole. Maryland's share of federal funds rose at an annual average of 6.7 percent, compared to the national rate of 5.6 percent.

Exhibit 1
Sources of Federal Spending in Maryland
Federal Fund 2005



Source: U.S. Census Bureau, *Consolidated Federal Funds Report*

Federal Government Contribution Highest for Defense, Health, and Space

The outlook for federal spending in Maryland largely hinges on the growth or contraction in a few industries. Defense spending is particularly important to Maryland; the State receives 4.1 percent of all Department of Defense (DOD) expenditures, with only California, Virginia, Texas, and Florida receiving larger shares. Procurement expenditures were $21.8 billion in federal fiscal 2005 in Maryland, which was the second highest among all states on a per capita basis. Of this amount, DOD spent almost $11.0 billion, while $3.4 billion came from the Department of Health and Human Services (HHS), and $1.7 billion from the National Aeronautics and Space Administration. These expenditures are fueled at least in part by military and diplomatic operations in Iraq and Afghanistan. The Congressional Budget Office (CBO) estimates that since September 2001, Congress and the President have authorized approximately $600.0 billion in spending for war and anti-terrorism efforts and related veterans benefits.

In addition to buying health and defense services from Maryland companies, the U.S. government also contributes to the State's economy through the salaries paid to federal employees in these sectors. In 2005, DOD accounted for almost 30 percent of the $20.0 billion in federal salary and wage expenditures in Maryland, while HHS salaries accounted for 22 percent. HHS also administered $5.4 billion in grant funds in Maryland, comprising almost 63 percent of the $8.6 billion of federal grants in Maryland in federal fiscal 2005.

Nondefense Spending in Federal Fiscal 2008 Facing Vetoes

In May 2007, the Office of Management and Budget conveyed a veto threat to Congress for any bill that exceeded the President's proposed budgetary limits. However, both houses of Congress chose to ignore this threat and approved higher increases in many policy areas. The Congressional budget plan calls for a 3.1 percent overall increase in nondefense spending over 2007 funding levels (after adjustments for inflation).

The President followed through on the threat, vetoing the federal fiscal 2008 appropriations bill for labor, education, and health agencies, as it contained approximately $10 billion more in spending than the amount proposed by the Administration and an overall 5 percent increase in discretionary spending. The legislation funds several large-scale programs such as Low Income Energy Assistance, No Child Left Behind, Community Services Block Grants, and Pell Grants, as well as job training and health services; the majority of these programs would be funded at higher levels than last year. The House failed to override the veto, so the fate of the legislation is still unknown.

Entitlement programs are operating at the fiscal 2007 level under a continuing resolution agreed to by Congress and the President. Medicaid is not currently affected by the continuing resolution because each year's appropriations bill provides funds for the first quarter of the next fiscal year. The State Children's Health Insurance Program (SCHIP) 10-year funding cycle ended in fiscal 2007, but states with unspent allocations may use them during fiscal 2008, according to Federal Funds Information for States. SCHIP legislation that was vetoed by the

President is currently being revised in Congress; the new bill would limit eligibility to three times the federal poverty level but allow states to use certain income disregards that could increase eligibility.

In other areas such as criminal justice programs, Congress has provided mixed results. Funding for Byrne Justice Assistance Grants, which support a wide range of state and local programs for crime prevention, drug treatment, and corrections improvement, was boosted by 27 percent, but funding for the State Criminal Alien Assistance Program (SCAAP) was reduced substantially. SCAAP reimburses state and local governments for salary costs incurred to incarcerate undocumented criminal aliens with certain convictions for violations of state or local law.

At publication time, federal spending in fiscal 2008 was proceeding at 2007 levels under a continuing resolution, and only one appropriations bill (Defense) had been signed into law. All 12 remaining federal appropriations bills for fiscal 2008 (excluding supplemental appropriations for combat operations) have passed the House and 7 have passed the Senate.

Outlook

The outcome of the Congressional showdown with the White House over discretionary funding levels will determine federal support for environmental, social, law enforcement, labor, and health programs over the next federal fiscal year. In the longer term, the withdrawal of troops overseas could signal a slowdown in defense spending in the State; however, the recommendation of the Base Realignment and Closure Commission to transfer several military operations to installations in Maryland could bring as many as 45,000 new jobs into the State through 2011, according to the Governor's office.

Overall, in the near term, it appears that Maryland will continue to enjoy a significant federal economic presence, though no substantial increases are expected in federal support for domestic policy programs. The federal government's fiscal health is currently steady – the deficit will decline in 2007 for the third year in a row, and federal revenues are expected to slightly exceed estimates in 2007 and 2008.

However, caution over the long term may be in order. "Over the long-term, the [federal] budget is on an unsustainable path," CBO warns in its August 2007 budget and economic forecast, citing the rapid growth in Medicare and Medicaid spending. CBO anticipates that "attaining fiscal stability in the coming decades will almost certainly require some combination of reductions in the growth of spending and increases in taxes as a share of the economy."

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Capital Program

Debt Affordability

The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling $935 million for fiscal 2009. This represents a $125 million increase from the $810 million limit recommended for fiscal 2008. Twenty-five million of the increase is the result of the 3 percent annual escalation, and $100 million is recommended for the purpose of expanding the capital program.

Capital Debt Affordability Process

State law requires the 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 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. 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 8.0 percent of revenues. The committee's analysis of debt affordability for fiscal 2008 through 2013 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 2008-2013

Fiscal Year	Projected Debt Outstanding As % of Personal Income	Projected Debt Service As % of Revenues
2008	2.83%	5.76%
2009	3.06%	6.27%
2010	3.11%	6.38%
2011	3.15%	6.52%
2012	3.15%	6.66%
2013	3.11%	6.74%

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, October 2007

Recommended New Debt Authorizations

The committee has recommended $935 million in new GO debt authorization for fiscal 2009, which is $125 million more than was authorized in fiscal 2008. Of the total increase, $25 million represents a 3 percent annual increase resulting from an automatic escalation formula adopted by the committee prior to the 2006 session. The remaining $100 million increase was recommended for the purpose of supporting demand for capital program funding. The committee further recommended that $50 million of the $100 million additional authorization be tied specifically to increased authorization levels for school construction projects. The Governor, in a letter to the Presiding Officers required by statute, indicated that he intends to earmark $300 million of GO debt for school construction in the fiscal 2009 budget, which is $150 million more than previously planned in the State's *Five-year Capital Improvement Program* and $50 million more than the $250 million annual funding goal set in the 2004 Public School Facilities Act. The recommendation also includes a planned $3 million for tobacco buyout financing, as required by Chapter 103 of 2001. By the end of fiscal 2009, the committee estimates that total GO debt will be just under $5.8 billion.

The University System of Maryland (USM), Morgan State University, and St. Mary's College of Maryland have the authority to issue debt for academic facilities as well as auxiliary facilities. 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 the 2008 session, CDAC recommends $33 million for academic facilities on USM campuses, which is $8 million more than the amount recommended by the committee in its 2006 report for the 2008 session. Of the additional authorization, $5 million represents a commitment to use academic debt to help fund the construction of a new School of Journalism building at the University of Maryland, College Park. This additional debt was programmed for fiscal 2008 but was deferred and used for other USM projects. Budget language added to the 2007 capital budget bill expressed the intent that the CDAC account for the additional academic debt in its recommendation for the 2008 session.

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. The gross outstanding aggregate principal amount of Consolidated Transportation Bonds is limited by statute to $2.0 billion. Total outstanding transportation debt is projected to reach over $1.7 billion in fiscal 2009. The department also issued the first GARVEE bonds in fiscal 2008. Chapters 471 and 472 of 2005 limit the total amount of GARVEEs that can be issued at $750 million. MDOT issued $325 million of GARVEE bonds in late fiscal 2008 and anticipates issuing the remaining $425 million during fiscal 2009. The State pledges anticipated federal revenues to support the GARVEEs debt service, and statute specifies that the bonds are considered tax-supported debt.

The Bay Restoration Fund was created by Chapter 428 of 2004 to provide grants for Enhanced Nutrient Removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. The amount of total issuances is capped at $545 million. The Maryland Department of the Environment indicates that the estimated issuance stream is $50 million, $70 million, $170 million, $225 million, and $30 million in fiscal 2008 through 2012, respectively.

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 $264 million at the end of fiscal 2009.

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 $272 million at the end of fiscal 2008.

Review of Affordability Criteria

In response to a request from the General Assembly, the committee reviewed the debt affordability criteria and the impact these criteria have on funding the State's capital program. The committee recognized that its recommended debt authorization levels will push the debt outstanding to personal income ratio very close to the 3.2 percent threshold. The committee noted that a contributing factor is the identification of GARVEE and Bay Restoration Bonds as tax-supported debt, the inclusion of which was not contemplated just a few years ago. Alternatively, the debt service as a percentage of revenues criteria offers greater unauthorized debt capacity. Most states focus on debt service to revenues criteria due to the ability to control both variables – revenues and debt service through the authorization process.

While unauthorized debt capacity is declining, the demand for capital project funding continues to increase. In conclusion, the committee recommended the continued study and reevaluation of the State's debt criteria. Options may include increasing the 3.2 percent personal income to debt outstanding criteria, establishing a separate criteria for tax-supported debt that does not include GARVEE and Bay Restoration Bonds, or knowingly breaching the present limit temporarily to support vital State objectives.

Capital Program

Capital Funding Request Exceed Resources

Although adjustments to the Capital Debt Affordability Committee forecast will add $640 million in additional authorizations over a five-year period beginning in fiscal 2009, general obligation bond funding requests will still exceed the projected limits by $296.1 million in fiscal 2009 and by more than $2.3 billion over the five-year forecast period.

General Obligation Bonds

The Capital Debt Affordability Committee has recommended a $935 million limit on the amount of new general obligation (GO) debt authorizations by the 2008 General Assembly to support the fiscal 2009 capital program. The recommendation is $125 million higher than the authorizations subject to the GO limit for fiscal 2008 and includes $3 million for tobacco buyout financing as required by law (Chapter 103 of 2001 as amended by Chapter 47 of 2006).

Despite the increased authorizations provided in the five-year forecast period, GO bond funding requests exceed the projected limits by $296.1 million for fiscal 2009 and by more than $2.3 billion during the forecast period. **Exhibit 1** provides a summary of the GO bond requests for the next five years.

Exhibit 1
GO Bond Requests: Fiscal 2009-2013
($ in Millions)

	Fiscal Years						Category
	2009	2010	2011	2012	2013	Total	Totals
State Facilities							$929.7
Board of Public Works	$159.3	$187.2	$176.0	$216.5	$160.0	$899.0	
Military	0.0	5.7	0.9	0.0	16.1	22.7	
Department of Disabilities	1.6	1.6	1.6	1.6	1.6	8.0	
Health and Social Services							$693.8
Health and Mental Hygiene	$71.3	$119.7	$99.1	$20.9	$40.2	$351.2	
University of MD Medical System	22.5	20.0	15.0	25.0	25.0	107.5	
Senior Citizen Activity Center	2.6	1.5	1.5	1.5	1.5	8.6	
Juvenile Justice	29.1	15.7	95.2	58.0	3.5	201.5	
Private Hospital Grant Program	5.0	5.0	5.0	5.0	5.0	25.0	
Environment							$344.5
Natural Resources	$24.0	$24.0	$24.0	$24.0	$24.0	$120.0	
Agriculture*	6.0	12.0	7.5	8.0	8.5	42.0	
Environment	32.5	27.5	26.0	26.0	27.5	139.5	
MD Environmental Service	0.0	8.3	4.7	14.8	15.2	43.0	
Education							$1,485.1
Education	$5.0	$5.0	$5.0	$5.0	$7.4	$27.4	
MD School for the Deaf	4.2	1.7	1.2	0.1	1.9	9.1	
Public School Construction**	250.0	250.3	280.0	315.3	353.0	1,448.6	
Higher Education							$2,328.3
University System of MD***	$100.2	$229.4	$250.4	$167.3	$287.1	$1,034.4	
Baltimore City Community College	2.2	37.6	2.6	2.3	27.0	71.7	
St. Mary's College	6.7	2.4	3.0	26.7	41.1	79.9	
Morgan State University	74.4	54.7	113.7	99.8	28.9	371.5	
Community Colleges	135.2	167.4	136.6	143.1	114.6	696.9	
Southern MD Higher Educ. Center	1.3	13.8	0.8	0.0	0.0	15.9	
Private Facilities Grant Program	11.0	12.0	12.0	12.0	11.0	58.0	
Public Safety							$668.0
Public Safety	$44.8	$83.0	$125.8	$114.1	$123.0	490.7	
State Police	19.0	8.9	8.3	1.2	7.8	45.2	
Local Jails	37.7	43.0	39.3	10.2	1.9	132.1	
Housing and Economic Development							$89.4
Economic Development	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	
Housing and Comm. Development	11.5	9.5	9.0	9.0	9.0	48.0	
Canal Place	0.0	0.0	2.1	0.0	0.0	2.1	
Historic St. Mary's City	1.4	0.0	0.2	12.0	9.2	22.8	
Planning	1.7	6.7	1.0	1.4	5.7	16.5	
Legislative Initiatives****	125.0	125.0	125.0	125.0	125.0	625.0	$625.0
Miscellaneous	45.9	59.3	13.0	12.0	7.0	137.2	$137.2
Subtotal Request	**$1,231.1**	**$1,537.9**	**$1,585.5**	**$1,457.8**	**$1,488.7**	**$7,301.0**	
Debt Affordability Limits	**$935.0**	**$960.0**	**$990.0**	**$1,020.0**	**$1,050.0**	**$4,955.0**	
Variance	**-$296.1**	**-$577.9**	**-$595.5**	**-$437.8**	**-$438.7**	**-$2,346.0**	

*The Department of Agriculture request includes the Tobacco Transition Program.

**The Interagency Committee on School Construction received requests ranging from a high of $854.0 million for fiscal 2009 to a low of $642.0 million for fiscal 2013; however, the amount included in the request to the Department of Budget and Management reflects base funding of $250.0 million plus 12 percent attributable to construction escalation.

***In addition to the GO bond request, the University System of Maryland has requested academic revenue bond funding of $27.0 million for fiscal 2008 and $27.0 million annually for fiscal 2010-2013.

**** These figures represent an estimated average of the total funding requests received through legislative local bond bills.

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

General Fund Support for the Capital Program

GO 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 enable 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. 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 may also be used to fund any capital project based on fund availability.

Exhibit 2 shows the general fund capital PAYGO appropriations for fiscal 2004-2008 and PAYGO general fund estimates according to the 2007 *Capital Improvement Program* (CIP) for fiscal 2009-2012. Despite an increase in the fiscal 2007 budget, the use of general funds to support the capital program remains at historically low levels.

Exhibit 2
General Fund PAYGO*
Fiscal 2004-2008 Appropriations
Fiscal 2009-2012 CIP Estimates
($ in Millions)

Function	2004 Approp.	2005 Approp.	2006 Approp.	2007 Approp.	2008** Approp.	2009-2012 Planned
State Facilities	$0.0	$0.0	$0.6	$21.6	9.6	72.8
Health/Social	0.0	0.0	3.0	0.0	0.0	0.0
Environment	0.0	0.0	0.0	15.1	7.3	26.8
Education	0.0	0.0	0.0	0.0	2.0	0.0
Higher Education	0.0	0.0	1.9	19.1	0.0	0.0
Public Safety	0.0	1.0	0.0	1.4	0.0	0.0
Housing	0.7	0.0	0.0	40.0	8.3	76.2
Econ. Development	8.7	0.0	0.0	8.9	0.0	62.0
Local Projects	0.0	0.2	0.0	30.1	0.0	0.0
Total	**$9.4**	**$1.2**	**$5.5**	**$136.2**	**$27.2**	**$237.8**

*Figures exclude general fund appropriations made to the Heritage Tax Credit Fund.
**Figures include reductions taken by the Board of Public Works.

Source: Department of Budget and Management

The policy of forgoing the use of PAYGO general funds to support the State's capital program 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 were provided to support programs traditionally funded with PAYGO general funds. This policy resulted in the issuance of $60.0 million of taxable GO debt in the two 2005 and first 2006 State GO bond sales in order to avoid exceeding federal private activity limits. For the fiscal 2008 budget, the Spending Affordability Committee excluded general fund appropriations that would otherwise require the issuance of taxable bonds from the affordability calculation. The current CIP reflects continued low utilization of general funds in future budgets.

Capital Program

State Considers Green Building Program

The Maryland Green Building Council was established by executive order in 2002. The Department of Budget and Management reviews requests for construction of high-performance buildings. To date, general obligation bonds have been authorized for one construction project, and the State continues to study how to cost-effectively construct high-performance buildings. Legislation enacted in 2007 requires the council, in cooperation with the Department of General Services, to advise the General Assembly and the Governor on ways for using green building strategies on State construction projects. The report is due by February 1, 2008.

Executive Order 01.01.2001.02, signed by then Governor Parris Glendenning, officially established the Maryland Green Building Council. The council in turn established the High Efficiency Green Buildings Program which required that eligible buildings constructed by the State meet minimum standards of efficiency based on the U.S. Green Building Council's (USGBC) Leadership in Energy and Environmental Design (LEED) Green Building Rating System. USGBC is a national coalition of building industry leaders formed to promote construction that is environmentally responsible. USGBC established LEED as a self-assessment tool that measures the extent to which a building meets green building criteria on six dimensions: sustainable sites, water efficiency, energy and atmosphere, materials and resources, indoor environmental quality, and innovation and design process. The latest LEED system rating scale includes four ratings: platinum (52-69 points), gold (39-51 points), silver (33-38 points), and certified (26-32 points).

At the time, Maryland was the first state to officially adopt the LEED system standards to its building projects. Despite the early and ambitious start, the State never fully embraced the council's green building program principles. Instead, due in large part to concerns regarding the cost premium associated with green building design and construction, the State established a green building pilot program consisting of three projects: two at St. Mary's College in Southern Maryland, and a Department of Natural Resources capital development project at Gunpowder Falls State Park. Budgetary constraints forced the delay of each project, and while completion of each is anticipated in 2009, it will be several years thereafter before any required evaluation measurement data will be available.

Several subsequent attempts to enforce the use of green building technologies similarly met with failure. However, enactment of legislation in 2005 (Chapter 459) reestablished some commitment to design and construct State buildings using green technologies. This legislation allows State agencies that request a capital appropriation for preliminary planning and design to propose that a building be constructed as a high-performance building. The Department of Budget and Management (DBM) is required to review the request to determine whether the justification is practicable and fiscally prudent. Thus far, only one project, the Morgan State

University New Center for the Built Environment and Infrastructure Studies building, has received DBM endorsement. During the 2007 session, the legislature authorized that the building be built as a high-performance building.

The 2007 session produced several legislative proposals to officially institute a high-performance building program. Most of what was proposed was amended out of what eventually became Chapters 115 and 116 of 2007. However, the bill codified the Maryland Green Building Council within the Department of General Services to advise the Governor and the General Assembly on strategies for using green building technologies in State construction projects. In a report due to the General Assembly by February 1, 2008, the council must:

- evaluate current green building technologies;
- recommend cost-effective green building technologies that the State may consider incorporating into the construction of new State facilities; and
- develop a list of building types for which green building technologies should not be applied.

Much of the difficulty associated with implementing a State green building program can be traced to cost concerns. However, recent green building case studies suggest that the initial investment is returned 10 times over during the lifecycle of the building.[1]

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[1] *The Costs and Financial Benefits of Green Buildings, A Report to California's Sustainable Building Task Force*, October 2003.

Revenues and Taxes

Comparative Tax and Revenue Rankings

Total State and local government revenues and spending levels in Maryland are relatively low compared to other states.

State and Local Government Spending and Revenues

As reflected in **Exhibit 1**, total State and local government spending and revenues in Maryland are not high compared to other states. Maryland ranks generally in the middle of all states in total state and local government revenues and spending measured on a per capita basis and near the lowest in revenues and spending as a percentage of total income of residents. However, Maryland relies more on tax revenues than most states and less on nontax revenue sources.

Exhibit 1
Maryland State and Local Government Spending and Revenues
2004-2005

	MD Rank % of Total	MD Rank Per Capita	MD Rank % of Personal Income
Total Spending	n/a	31	51
Total Revenues	n/a	19	49
Revenues			
Taxes	3	9	36
Intergovernmental from Federal Government	41	35	46
Charges and Utilities[1]	46	45	49
Miscellaneous[2]	36	33	49

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

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

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

Source: *State and Local Government Finances*, U.S. Bureau of the Census (June 2007)

State and Local Taxes Compared to Neighboring States

Exhibits 2 and **3** compare Maryland's State and local tax revenues to other states in the region. Maryland's reliance on the income tax is high (third on both a percentage of income and a per capita basis) compared to other states, primarily reflecting the statewide local income tax. Maryland ranks thirty-sixth among all states in overall state and local tax revenues as a percentage of personal income and ninth in overall taxes on a per capita basis.

Generally, Maryland ranks in the bottom half of all states with respect to property taxes, corporate income taxes, and sales taxes measured on a percentage of income basis. Maryland ranks twenty-eighth in property taxes, fifteenth for corporate income taxes, and forty-third on sales taxes measured on a per capita basis.

Exhibit 2
Maryland State and Local Tax Revenues
Comparison to Selected States
2004 and 2005 Tax Revenues As a Percentage of Personal Income

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales and Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Percent	3.7%	3.7%	0.7%	4.1%	0.7%	1.1%	14.0%
Rank	16	4	7	17	15	5	3
New Jersey							
Percent	5.0%	2.2%	0.6%	2.7%	0.4%	0.3%	11.2%
Rank	4	33	8	44	40	23	16
Maryland							
Percent	**2.4%**	**3.9%**	**0.3%**	**2.5%**	**0.3%**	**0.8%**	**10.2%**
Rank	**41**	**3**	**28**	**45**	**47**	**7**	**36**
Virginia							
Percent	3.0%	2.9%	0.2%	2.7%	0.6%	0.4%	9.8%
Rank	28	16	41	43	24	18	41
Delaware							
Percent	1.6%	3.0%	0.8%	1.3%	3.1%	0.8%	10.5%
Rank	50	14	5	50	1	9	26
Pennsylvania							
Percent	3.1%	2.6%	0.4%	3.2%	0.7%	0.6%	10.6%
Rank	25	18	19	41	10	14	24
North Carolina							
Percent	2.4%	3.1%	0.5%	3.5%	0.4%	0.2%	10.1%
Rank	40	12	12	35	39	30	37
West Virginia							
Percent	2.1%	2.5%	1.0%	4.6%	0.7%	0.7%	11.6%
Rank	44	27	2	11	11	10	11
United States Average	**3.3%**	**2.4%**	**0.4%**	**3.8%**	**0.6%**	**0.4%**	**10.7%**

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n/a," the state does not have that tax.

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

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

Source: *State and Local Government Finances*, U.S. Bureau of the Census (June 2007)

Exhibit 3
Maryland State and Local Tax Revenues
Comparison to Selected States
2004 and 2005 Tax Revenues Per Capita

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales and Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Amount	$1,951	$1,972	$342	$2,187	$358	$572	$7,383
Rank	4	1	4	4	3	3	1
New Jersey							
Amount	2,206	945	256	1,176	184	124	4,890
Rank	1	16	6	30	25	20	5
Maryland							
Amount	**1,001**	**1,638**	**144**	**1,030**	**132**	**331**	**4,276**
Rank	**28**	**3**	**15**	**43**	**43**	**6**	**9**
Virginia							
Amount	1,109	1,104	80	1,010	218	135	3,657
Rank	21	11	38	44	15	19	21
Delaware							
Amount	577	1,108	296	482	1,144	287	3,894
Rank	44	10	5	50	1	7	15
Pennsylvania							
Amount	1,079	924	137	1,099	252	217	3,710
Rank	22	18	17	37	8	12	20
North Carolina							
Amount	744	972	147	1,087	138	62	3,149
Rank	39	15	14	39	38	32	34
West Virginia							
Amount	556	646	255	1,219	189	194	3,030
Rank	45	34	7	27	22	14	36
United States Average	**$1,132**	**$813**	**$145**	**$1,293**	**$192**	**$123**	**$3,698**

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47). If the rank is "n/a," the state does not have that tax.

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

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

Source: *State and Local Government Finances*, U.S. Bureau of the Census (June 2007)

Revenues and Taxes

Video Lottery Terminals in Maryland and Surrounding States

After several years of debate, video lottery terminal legislation was enacted into law – a constitutional amendment to be considered by the voters in 2008 and an implementation bill contingent on passage of the amendment. While Delaware has made no recent significant changes to its video lottery terminal program, Pennsylvania's program continues to expand and two video lottery terminal facilities in West Virginia now have table games.

Maryland Legislation – 2007 Special Legislative Session

Governor Martin O'Malley introduced two pieces of video lottery terminal (VLT) gambling legislation which passed during the 2007 special session – House Bill 4 (Chapter 5) and Senate Bill 3 (Chapter 4).

House Bill 4 is a constitutional amendment that will be submitted to the voters at the November 2008 general election proposing that the General Assembly may only authorize expanded forms of gambling subject to the following restrictions: • a maximum of 15,000 VLTs may be authorized; • a maximum of five VLT facility licenses may be issued at locations specified in the bill; and • VLT facilities shall comply with all applicable planning and zoning laws of the local jurisdictions. Under the amendment, the General Assembly may not authorize any additional forms or expansion of commercial gambling except through enactment of legislation passed by a majority of each house of the General Assembly, which would then be subject to voter approval via referendum. The constitutional amendment does not apply to currently authorized forms of gambling.

Senate Bill 3 establishes the operational and regulatory framework for the proposed VLT program. Enactment of Senate Bill 3 is contingent on ratification of House Bill 4 by the voters of Maryland. VLT oversight will be provided by a nine-member State Lottery Commission, and the commission will own/lease the VLTs and the central monitor and control system. Allocation of the gross VLT revenues, after payouts to bettors, is as follows:

- **Business Investment:** 1.5 percent to a small, minority, and women-owned business investment account;
- **State Lottery:** 2 percent to the Lottery for administrative costs, with other costs provided for in the annual State budget;
- **Local Government:** 5.5 percent to local governments where a video lottery facility is operating, 18 percent of which would go for 15 years (starting in fiscal 2012) to

Baltimore City through the Pimlico Community Development Authority and to Prince George's County for the community surrounding Rosecroft ($1 million annually);

- **Horse Racing Industry:** 7 percent to a purse dedication account to enhance horse racing purses and funds for the horse breeding industry, not to exceed $100 million annually; and 2.5 percent for an eight-year period to a Racetrack Renewal Account, not to exceed $40 million annually;
- **Licensee (Operator):** 33 percent to video lottery operation licensees; and
- **Education Trust Fund:** the remainder to the Education Trust Fund (48.5-51.0 percent).

Revenues accruing to the Education Trust Fund are to be used for the Bridge to Excellence in Public Schools Act funding (including the Geographic Cost of Education Index), public school construction, and public higher education construction, including community colleges.

Pennsylvania

VLT gambling continues to expand in Pennsylvania, albeit at a pace that has been slower than expected since VLT gambling was first authorized in 2004. Current law authorizes up to 14 VLT facility licenses and a maximum statewide total of 61,000 VLTs. Of the 14 licenses, 7 are reserved for racetracks, 5 are for nontrack locations, and 2 are for resort licenses. Six facilities are currently operating – five racetracks and one nontrack location. **Exhibit 1** lists the current facilities, the current number of VLTs in each facility, and calendar 2007 revenues to date (after payouts to bettors). The facilities are generally operating in temporary facilities or facilities that are undergoing renovation and/or expansion.

Exhibit 1
Pennsylvania VLT Facilities in Operation as of November 2007

		Calendar 2007		
Facility	**Open Date**	**Revenue ($ Millions)**	**# of VLTs**	**Average Win per Day**
Mohegan Sun	November 2006	$164.80	1,203	$423
Philadelphia Park	December 2006	262.70	2,402	352
Chester Downs	January 2007	263.50	2,790	295
Presque Isle	February 2007	132.20	2,000	230
The Meadows	June 2007	110.60	1,788	348
Mt. Airy	October 2007	16.50	2,523	133
Total		**$950.40**	**12,706**	

In addition, Hollywood Casino at Penn National located in Greater Harrisburg expects to begin operating in February 2008.

In December 2006, the Pennsylvania Gaming Control Board awarded the five nontrack licenses to two entities in Philadelphia, HSP Gaming (SugarHouse Casino) and Philadelphia Entertainment and Development Partners, LP (Foxwoods Casino); one in Pittsburgh, PITG Gaming, LLC (Majestic Star); and two at-large licenses, Mount Airy, LLC in the Poconos and Sands Bethworks Gaming, LLC in Bethlehem. The four facilities that have not yet opened anticipate opening in 2009.

The original applicants for the two available resort licenses withdrew their applications. The board is currently in the process of awarding the licenses to the four applicants currently vying for the resort licenses. Two applicants are from the Poconos region, one is located in King of Prussia northwest of Philadelphia, and one is located in southwest Pennsylvania east of Pittsburgh.

Delaware and West Virginia

The West Virginia General Assembly passed legislation in early 2007 authorizing table games, subject to local referendum, at the State's four existing VLT racetrack facilities. In the summer of 2007, voters approved table games for the Mountaineer, Tri-State, and Wheeling Island VLT facilities; however, the voters of Jefferson County rejected table games for the Charles Town VLT facility. Wheeling Island currently has 20 poker tables, and Mountaineer has 37 poker games and plans to introduce 50 table games in early 2008. Tri-State currently has no immediate plans to install table games. Delaware continues to have VLTs at three racetrack facilities: Delaware Park, Dover Downs, and Harrington Raceway.

Exhibit 2 provides information on the number of VLTs and total net proceeds after payouts to gamblers at Delaware and West Virginia facilities in fiscal 2007.

Exhibit 2
Delaware and West Virginia VLT Racetrack Revenues
Fiscal 2007

	Net Proceeds	Change over FY 2006	VLTs	Average Win per Day
Delaware:				
Delaware Park	$294.7	5.8%	3,034	$266
Dover Downs	214.4	5.5	2,708	217
Harrington	123.6	2.5	1,577	215
Delaware Total	**632.2**	**5.1%**	**7,318**	**$237**
West Virginia:				
Mountaineer	249.5	-1.1%	3,200	$214
Wheeling Island	200.5	1.8	2,298	239
Tri-State	66.3	5.4	1,759	103
Charles Town	460.8	7.1	4,324	292
West Virginia Total	**$977.1**	**3.7%**	**11,581**	**$231**

Source: Delaware and West Virginia State Lotteries

Revenues and Taxes

Overview of Special Session Tax Actions

As part of a package of measures to address the State's structural budget deficit, legislation was adpted during the 2007 special session to provide rate increases and other significant revisions under the individual and corporate income taxes, the sales and use tax, the tobacco tax, the motor vehicle titling tax, and recordation and transfer taxes, estimated to provide additional State tax revenues of over $1.3 billion annually, including over $900 million annually for the general fund.

Introduction

As part of a package of measures to address the State's structural budget deficit, legislation was adopted and subsequently enacted during the 2007 special session to significantly revise several major State taxes and provide substantial additional State tax revenues for both the general fund and the Transportation Trust Fund. After calling for the special session, the Governor introduced a variety of tax proposals, including a restructuring of the individual income tax and tax rate increases under the corporate income tax, sales and use tax, tobacco tax, and motor vehicle titling tax. The Administration's proposals also included combined reporting for multistate corporations under the corporate income tax, expansion of the sales and use tax in the area of services, and the imposition of recordation and transfer taxes on the transfer of controlling interests in real property owning entities.

Although the General Assembly modified the Governor's proposals, Chapters 3 and 6 (Senate Bill 2 and House Bill 5) of the 2007 special session provide for tax rate increases and significant structural changes under several major State taxes, estimated to provide over $900 million annually in additional general fund revenues and over $1.3 billion annually in additional total State revenues.

Individual Income Tax

The Governor proposed a significant restructuring of income tax rates and income brackets, raising the current thresholds for the applicability of lower marginal rates and imposing higher marginal rates for higher income levels. Under the Administration's proposal, lower income amounts (up to $15,000, or $22,500 for joint returns, heads of households, and surviving spouses) would have been subject to marginal rates less than the current 4.75 percent rate applicable to all income in excess of $3,000, while new higher rates would have been applicable to higher income amounts (6 percent starting at $150,000 of income, or $200,000 for joint returns, and 6.5 percent applicable to income in excess of $500,000). The Governor's income tax proposals also included increasing the percentage used to calculate the refundable earned income credit (EIC) for qualified low-income individuals, an increase in the additional

exemptions allowed to blind and elderly taxpayers, and a new refundable $50 State income tax credit for lower income individuals.

Following public hearings in House and Senate committees, the Governor's proposal was amended to reflect the consensus of the General Assembly. Chapter 3 (Senate Bill 2) establishes new individual income tax brackets and rates beginning in tax year 2008, with the top rate set at 5.5 percent, as seen in **Exhibit 1.**

Exhibit 1
State Individual Income Tax Rates, as Enacted by Chapter 3 of the 2007 Special Session

Single, Dependent Filer, Married Filing Separate		Joint Returns, Head of Household, or Surviving Spouse	
Rate	**Maryland Taxable Income**	**Rate**	**Maryland Taxable Income**
2.00%	$1 - $1,000	2.00%	$1 - $1,000
3.00%	$1,001 - $2,000	3.00%	$1,001 - $2,000
4.00%	$2,001 - $3,000	4.00%	$2,001 - $3,000
4.75%	$3,001 - $150,000	4.75%	$3,001 - $200,000
5.00%	$150,001 - $300,000	5.00%	$200,001 - $350,000
5.25%	$300,001 - $500,000	5.25%	$350,001 - $500,000
5.50%	Excess of $500,000	5.50%	Excess of $500,000

Source: Department of Legislative Services

Chapter 3 also alters the personal exemption amount provided under the individual income tax, increasing the amount allowed for each exemption from $2,400 to $3,200 for individuals having federal adjusted gross income of up to $100,000 ($150,000 for joint filers), but gradually phasing down the amount allowed for each exemption for individuals with higher incomes, to $600 for taxpayers with incomes above $200,000 ($250,000 for joint filers).

In addition, Chapter 3 increases the refundable earned income credit as originally proposed by the Governor and expands eligibility for the refundable EIC to qualifying individuals without dependents.

Corporate Income Tax

In addition to the proposed restructuring of the individual income tax, the Administration proposed legislation to increase the corporate income tax rate from 7 to 8 percent and require multistate corporate groups to use the combined reporting method to determine Maryland taxable income, taking into account the income and apportionment factors of all members of the corporate group engaged in a unitary business. The proposal was amended by the General Assembly to increase the tax rate for corporations to 8.25 percent. In lieu of requiring combined reporting for multistate corporate groups, Chapter 3 provides for enhanced reporting of corporate data to the Comptroller and also establishes a business tax study commission to review and evaluate the State's business tax structure.

Sales and Use Tax

The Administration's original tax proposals included an increase in the sales and use tax rate from 5 to 6 percent as well as an expansion of the sales and use tax to a few additional services, including physical fitness, tanning and massage services, and real estate management services. As enacted, the legislation included the sales tax rate increase to 6 percent (Chapter 6) and substituted computer services for the services included under the original proposal as taxable services (Chapter 3). In addition, although not reducing the sales and use tax vendor credit as originally introduced, the new law limits the vendor credit to a maximum of $500 for any return through June 30, 2011. The provision imposing the sales and use tax on computer services takes effect July 1, 2008, and sunsets after five years. (For a more detailed discussion of the sales tax on computer services see separate issue paper on Sales Tax on Services.)

The original sales and use tax proposal also included various annual sales tax holidays for tax-free shopping, including two tax-free weekends for the sale of energy-efficient appliances and two tax-free weeks for clothing and footwear costing not more than $100. The Administration's proposal was scaled down to provide for one annual tax-free weekend for the purchase of energy-efficient appliances and one annual tax-free week for clothing and footwear. Under Chapter 6, the implementation of the tax-free holidays is delayed until fiscal 2011.

Tobacco Tax

Part of the Governor's original proposal was a $1.00 per pack increase in the State tobacco tax. Chapter 6 as enacted includes this tax increase, from the current $1.00 per pack to $2.00 per pack, effective January 1, 2008.

Transfers of Controlling Interest – Recordation and Transfer Taxes

The Administration's tax package included a proposal to impose recordation and transfer taxes on the transfer of a "controlling interest" in specified real property owning entities. The "controlling interest transfer tax" has been proposed numerous times in order to prevent the widespread avoidance of recordation and transfer taxes for transfers of commercial real estate that has developed over the years through transfers of ownership interests in entities owning the real estate instead of a direct transfer of the property. The controlling interest transfer tax as proposed by the Governor was included in Chapter 3 as enacted, effective July 1, 2008.

Transportation Funding

In addition to the major changes discussed above, Chapter 6 provides additional funding for transportation by increasing the motor vehicle excise tax rate from 5 to 6 percent, altering the current distribution of certain transportation revenues, and distributing a portion of the increased revenues resulting from the sales and use tax rate increase to the Transportation Trust Fund. (For a more detailed discussion of these transportation tax and revenue changes see separate issue paper on the Transportation Trust Fund Overview.)

Summary of Revenue Actions

Exhibit 2 illustrates the tax and revenue related actions taken during the 2007 special session.

Exhibit 2
Summary of Special Session Revenue Actions
Fiscal 2009
($ in Millions)

	General Fund	All State Funds[1]
New Revenues		
Sales Tax Rate	$406	$687
Sales Tax – Base Expansion	200	214
Vendor Discount Cap	14	15
Tax Holidays	0	0
Subtotal Sales Tax	**$620**	**$916**
Electronic Bingo/Tip Jars	5	5
Income Tax – Rates/Brackets	197	197
Income Tax – Personal Exemption	(130)	(130)
Earned Income Tax Credit	(39)	(39)
Seniors/Low-income Taxpayers	0	0
Tax Clearance - Lawyers	1	1
Subtotal Income Tax	**$29**	**$29**
Corporate Tax – Rate	85	140
Corporate Tax – Combined Reporting	0	0
Tobacco Tax – Rate	162	162
Vehicle Titling Tax – Rate	0	145
Vehicle Titling Tax – Trade-in Offset	0	(83)
Vehicle Titling Certificate Fee	0	33
Property Transfer Tax (Controlling Interest)	0	14
Motor Fuel Tax – Indexing	0	0
Video Lottery Start-up Costs	(3)	(3)
Grand Total New Revenues	**$897**	**$1,358**

[1]Exclusive of federal funds.

Revenues and Taxes

Sales Tax on Services

As the sales tax base has eroded over time and the growth in sales tax revenues has not kept pace with the growth in personal income, as least in part due to a greater consumption of nontaxable services, Maryland has looked more closely at the taxation of various services. During the 2007 special session, the General Assembly debated the taxation of a variety of services currently not taxed, ultimately imposing the sales tax on various computer services.

Background

Maryland's sales and use tax is the State's second largest source of general fund revenues, accounting for approximately $3.8 billion in fiscal 2008. Historically, the sales and use tax has been imposed broadly on the sale or use of tangible personal property, but only narrowly on a few specifically enumerated taxable services. Over the past few decades, the growth in sales and use tax revenues has not kept pace with the growth in personal income, as the tax base has eroded due to several causes. One major contributing factor cited for the erosion of the sales tax base is a major shift that has occurred in the national economy from the consumption of goods, the traditional base of the tax, to a greater consumption of services. Broadening the sales tax base by imposing the tax more broadly on services has been suggested as a way to provide better balance in the State's sales tax structure, to make the tax more reflective of the overall economy, and to improve the stability, neutrality, and horizontal equity of the tax.

Current Taxation of Services

Under current law, several enumerated services are defined as "taxable services" subject to the Maryland sales and use tax. These include, among others, wireless telecommunications services, security services, commercial building cleaning services, credit reporting services, and pay-per-view television.

Among surrounding jurisdictions, New Jersey, Pennsylvania, West Virginia, and the District of Columbia tax a broad range of repair services, including automotive repairs. Pennsylvania and West Virginia tax some business services, and West Virginia also taxes some personal services. Delaware, which does not have a general sales tax, is considered to have a broad taxation of services under its gross receipts tax, which applies to most businesses.

2007 Special Session

During the 2007 special session, the General Assembly considered extending the sales and use tax to a variety of additional services. Legislation was considered in both chambers that would have extended the sales and use tax to real property management services, landscaping services, certain personal services, and certain repair services.

The tax legislation that was ultimately enacted addressing the taxation of services (Chapter 3) extended the sales and use tax just to computer services. Computer services is defined as computer facilities management and operation; custom computer programming; computer system planning and design that integrate computer hardware, software, and communication; technologies; computer disaster recovery; data processing, storage, and recovery,; and hardware or software installation, maintenance, and repair.

The definition of computer services excludes certain types of services that otherwise could be included in the definition, such as Internet access, typing or data entry, and computer training. The installation, maintenance, or repair of tangible personal property that includes computer hardware or software as a component part is also excluded. Also excluded are computer services provided in connection with other specified types of services, typically banking and financial related services, business management or other administrative services, various professional services, and telecommunications services.

Chapter 3 repealed the sales and use tax exemption for sales of custom computer software services and optional computer software maintenance contracts, but exempts computer services that are to be used by an individual in a home school program. In addition, Chapter 3 did not alter the sales and use tax exemption for the sale of a computer program that is intended to be reproduced for resale or incorporated into another computer program for sale.

Taxation of Computer Services

Connecticut and Pennsylvania each imposed similar taxes on computer services. Both states did so as part of a larger effort to broaden the sales and use tax base to include various services. The issue of whether the service being provided is a computer service or another type of consulting service has arisen in both states. Connecticut imposes a sales and use tax on certain business related services at varying rates. The issues that often arise relate to the appropriate tax rate to be imposed or whether an exemption may be applicable. In Pennsylvania, the tax on computer services was repealed in 1997. An issue that arose there was the proper tax treatment of professional services that also met the definition of a computer service. Prior to repealing the tax, regulations were issued that attempted to clarify how the tax applied when the computer service being provided was incidental to the otherwise nontaxable service. Maryland has addressed this issue by excluding various professional services from the definition of computer services.

The proper tax treatment of computer software is an issue that numerous states are currently considering. Many states, including Maryland, treat computer software as taxable personal property when the software is sold in a tangible medium form. However, states vary on the treatment of software when the software is transferred in electronic form. Businesses have begun to require more specialized software; this often involves using custom computer programming services to create either specialized software packages or to manipulate prepackaged canned software. An issue may arise regarding taxability when a sale is classified as a sale of software in electronic form and not as providing custom computer programming services. Issues such as these are expected to be addressed in regulations developed by the Office of the Comptroller. The office has established an intra-office committee to develop the regulations and has already solicited input from various of the affected interests. Preliminary regulations could be published by April.

State Retirement and Pension System Investment Performance and Contribution Rates

The State Retirement and Pension System (SRPS) earned 17.6 percent returns in fiscal 2007. These high returns allow the system to maintain the aggregate contribution rate steady, at 11.1 percent. The SRPS board voted for the third consecutive year to end the corridor funding method and resume full actuarial funding. This would add $14 million to the annual contribution, which totals $1.03 billion under the corridor method. The board also changed the actuarial method used to calculate liabilities, which reduced the asset-to-liability ratio, or funded status, from 83.3 to 76.7 percent.

State Pension Contribution Rates Hold Steady

Four straight years of solid investment returns and favorable results from the mandated actuarial experience study combined to hold fiscal 2009 pension contribution rates virtually unchanged from their fiscal 2008 levels. Despite these positive developments, the system's funded status (the ratio of projected assets to projected liabilities) declined due to a change in actuarial methodology.

As shown in **Exhibit 1**, the employer contribution rate for teachers will increase from 11.60 percent in fiscal 2008 to 11.70 percent in fiscal 2009, while the contribution rate for State employees will decrease from 8.86 percent in fiscal 2008 to 8.71 percent in fiscal 2009. The aggregate State contribution rate, including contributions for law enforcement officers and judges, increases marginally from 11.10 percent in fiscal 2008 to 11.14 percent in fiscal 2009. Based on projected payroll growth, the SRPS actuary estimates that total State pension contributions will increase by $73.7 million, from $956.9 million in fiscal 2008 to $1,030.6 million in fiscal 2009.

Exhibit 1
State Pension Contribution Rates
Fiscal 2008 and 2009

	2008		2009		
Plan	**Rate (%)**	**$ in Millions**	**Rate (%)**	**$ in Millions**	**Actuarial Funding Level***
Teachers	11.60%	$635.7	11.70%	$691.4	78.4%
Employees	8.86%	260.6	8.71%	273.1	73.2%
State Police	15.44%	13.0	21.16%	17.7	84.9%
Judges	44.12%	16.5	43.61%	17.0	76.6%
Law Enforcement Officers	41.74%	31.1	36.60%	31.4	56.0%
Aggregate	**11.10%**	**$956.9**	**11.14%**	**$1,030.6**	**76.7%**

* As of the end of fiscal 2007.

Note: Contribution rates and funding levels reflect State funds only, excluding municipal contributions.

Source: Segal Co.

Banner Year for SRPS Investments Contributes to Stable Rates

SRPS investments earned 17.6 percent returns for fiscal 2007, the fourth consecutive year that returns have exceeded the system's actuarial target of 7.75 percent. The 17.6 percent return exceeds the fiscal 2006 return of 10.4 percent and represents the highest one-year rate of return since 1997. Total system assets reached $39.4 billion at the end of fiscal 2007, a new fiscal year high that surpassed the previous high of $34.4 billion established in fiscal 2006.

When investment returns exceed the actuarial target, they create an actuarial surplus that can result in lower State pension contributions, assuming that the plan's actual experience conforms to other actuarial assumptions. To protect the system from sharp spikes in investment returns in any given year, the system uses a smoothing mechanism that spreads out investment returns or losses over five years. This smoothing mechanism yields an actuarial rate of return, which represents the five-year average return. Because SRPS investments endured three consecutive years of negative or weak returns from fiscal 2001 through 2003, fiscal 2007 represents the first time in six years that the actuarial rate of return (8.54 percent) exceeds the system's actuarial target. As a result, the pension fund's investment performance was a key factor in restraining the growth of State pension contribution rates.

Favorable Pension Plan Experience Also Contributes to Stable Rates

Maryland law requires SRPS to conduct an actuarial experience study at least every five years to assess whether the assumptions used to measure the plan's assets and liabilities are consistent with actual experience. Segal Co., the SRPS actuary, completed the most recent experience study in July 2007, which covers fiscal 2002 to 2006. Based on trends observed over that time period, Segal recommended lowering both the assumed inflation rate and the assumed payroll growth rate from 4.0 to 3.5 percent, respectively. Segal also recommended adjusting expected retirement rates to reflect the reality that more teachers and State employees are deferring their retirement. The net result of these changes, all of which were approved by the SRPS board, was that projected pension liabilities, and therefore State contribution rates, were lower than they would have been using the previous assumptions.

SRPS Board Proposes Plan to End Corridor Funding at Minimal Cost

Since fiscal 2003, the contribution rates for the two largest systems, the employees' and teachers' systems, remained fixed from year to year as long as the funded status for these systems remained in a "corridor" of 90 to 110 percent. As Exhibit 1 shows, both systems are currently outside their respective corridors. Under the corridor method, the contribution rates for both systems are now adjusted upwards each year, but only by 20 percent of the difference between the prior year's rate and the true actuarial rate for the coming fiscal year. Although this approach has kept contribution rates from rising as fast as they would have under full actuarial funding, contribution rates under the corridor method are projected to surpass what they would have been under a full funding approach as early as fiscal 2013.

For three consecutive years, SRPS trustees have voted to recommend that the State abandon the corridor method and resume full actuarial funding of the pension system. Compared with corridor funding levels, State pension contributions under full actuarial funding would have increased by $181 million in fiscal 2007 and by $162 million in fiscal 2008. However, the board's proposal for fiscal 2009 includes several features that lower the cost of resuming full actuarial funding to $14 million in the first year. The plan's key feature is the extension of the amortization period for the system's accrued liabilities from the current 25-year schedule to a 30-year schedule, which is still actuarially sound. This approach reduces annual pension contributions by spreading the State's payments of those liabilities over a longer time period.

New Actuarial Method Lowers System's Funded Status

On the advice of its actuary, SRPS changed the actuarial method it uses to calculate its projected liabilities, a key factor in determining employer contribution rates. The actuary noted that the old method (aggregate entry age normal) was no longer accepted by the Internal Revenue Service for tax-exempt pension plans, whereas the new method (individual entry age normal) is the most common actuarial method used by public pension plans. However, the old

method treated projected employee pension contributions as system assets, whereas the new method allocates employees' contributions toward paying off liabilities accrued in the current year. Since employee contributions are no longer counted as assets, the system's asset-to-liability ratio, or funded status, dropped from 83.3 to 76.7 percent. This had no effect on the employer contribution rates because the new methodology simply shifted its accounting of employee contributions from one component of the employer rate to another.

Personnel

State Workforce and Payroll

Since fiscal 2002, the number of State positions has increased slightly, at a rate of 0.1 percent annually. Decreases in the Executive Branch have been offset by increases in the Judiciary and higher education. In response to the budget shortfall projected in fiscal 2009, the Board of Public Works deleted 147.4 positions early in fiscal 2008. Statewide salary and fringe benefits have grown 4.3 percent annually since fiscal 2002. Health and retirement costs, which increased almost 8.9 percent annually, have grown considerably more than salaries and wages, which increased 3.5 percent annually.

Budgeted Positions

Regular Positions

Regular full-time equivalent (FTE) positions requested by the Administration and authorized by the General Assembly are set when the State budget is enacted. Section 38 of the fiscal 2008 budget bill limits position growth above that level by allowing the Board of Public Works (BPW) to authorize no more than 50 additional positions during fiscal 2008, outside of exempted provisions for hardship, manpower statutes, block grants, new facilities, and/or emergencies. The total does not include higher education institutions, the Maryland Aviation Administration, and the Maryland Port Administration.

Budget spending limits, position caps restricting growth, and attrition have decreased the nonhigher education Executive Branch workforce from 56,417 positions in fiscal 2002 to 53,733 in the fiscal 2008 working appropriation.

Exhibit 1 shows that 81 percent of the decrease is attributable to five agencies: the Department of Human Resources; the Department of Health and Mental Hygiene (DHMH); the Maryland Department of Transportation; the Department of Natural Resources; and the Department of Labor, Licensing, and Regulation. These reductions, however, have been overtaken by new positions in higher education institutions, the Department of Public Safety and Correctional Services (DPSCS), the Judicial Branch, the Maryland State Department of Education (MSDE) and other public education agencies, and legal agencies (primarily the Office of the Public Defender).

Exhibit 1
Regular Full-time Equivalent Positions
Fiscal 2002-2008 Working Appropriation

Department/Service Area	2002 Fiscal Digest	2008 Working Approp.	Change
Legislative Branch	729	747	18
Judicial Branch	3,021	3,498	478
Subtotal	**3,750**	**4,245**	**496**
Executive Branch			
Legal	1,368	1,591	223
Executive and Administrative Control	1,606	1,673	67
Financial and Revenue Administration	2,168	2,034	-134
Budget and Management	517	443	-74
Retirement	194	203	10
General Services	725	645	-80
Transportation	9,551	9,091	-461
Natural Resources	1,631	1,357	-275
Agriculture	480	447	-34
Health and Mental Hygiene	8,552	7,630	-921
Human Resources	8,288	7,049	-1,238
Labor, Licensing, and Regulation	1,706	1,473	-233
Public Safety and Correctional Services	11,163	11,642	479
Housing and Community Development	450	316	-134
Business and Economic Development	323	280	-43
Environment	1,034	945	-89
Juvenile Services	2,123	2,240	117
Police and Fire Marshal	2,590	2,473	-117
MSDE and Other Education	1,950	2,203	253
Executive Branch Subtotal	**56,417**	**53,733**	**-2,683**
Higher Education	20,843	23,584	2,741
Total	**81,009**	**81,562**	**553**

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

Fiscal 2008 Additions and Abolitions

Actions that affected position levels during fiscal 2008 have come from three sources:

- adjustments related to Section 46 of the fiscal 2008 budget bill;
- agency actions at BPW; and
- the Administration's cost containment action taken at the July 11, 2007 BPW meeting.

Section 46 limits position growth for agencies with a turnover percentage greater than 8 percent. Twelve new positions disallowed under this rule during the 2007 session were later restored, adding to the position levels noted in the legislative appropriation. Also, nine positions have been created through BPW by agencies demonstrating need. Therefore, 21 positions have been added thus far in fiscal 2008 outside of higher education.

The July BPW cost containment action had the most significant impact on personnel totals in the first half of fiscal 2008. As **Exhibit 2** shows, 147.4 positions were abolished at that time. Higher education institutions, DHMH, DPSCS, and MSDE saw the largest absolute reductions. When the cuts are viewed as a percentage of the total agency workforce, the largest reductions were in the Department of Aging, the Maryland Department of Planning, and the Department of Business and Economic Development. The total salary value for nonhigher education related cuts was approximately $8.8 million.

2007 Special Session

As of October 2007, 1,728 vacant positions were being funded in excess of the rate necessary to meet turnover rates in the Executive Branch. House Bill 1 of the 2007 special session requires the Governor to submit a plan to BPW to eliminate 500 vacant positions across State government in order to identify savings of $5 million in general funds in fiscal 2008. The bill exempts positions in public higher education, DPSCS (738 funded vacancies), and helicopter pilots in the Department of State Police (2 funded vacancies) from the reduction process. The specific positions to be eliminated will be determined by BPW in January 2008.

Higher Education

Chapters 239 and 273 of 2004 provided the University System of Maryland and Morgan State University with autonomy to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College. By the end of October 2007, the fiscal 2008 effect of these bills has been to add 330 FTEs to higher education facilities, after netting out the July 11, 2007 BPW reduction of 26 positions and a 17-position abolition at the University of Maryland Center for Environmental Science. Of the new positions, 19 originated in Morgan State University, 4 in St. Mary's College, and 307 in the University System of Maryland.

Exhibit 2
Board of Public Works Positions Abolished – July 11, 2007

	PINs Cut	# Vacant	% of Total PINs	$ Salary Value of Deleted PINs*
Office of Public Defender	1.0	1.0	0.1%	-$33,577
Office of the Attorney General	1.0	1.0	0.4	-57,294
Department of Aging	3.0	3.0	5.1	-174,664
Maryland Department of Planning	3.0	1.0	1.6	-149,198
Military Department	1.0	1.0	0.3	-40,935
Office of Administrative Hearings	1.0	0.0	0.8	-34,188
Department of Budget and Management	1.0	1.0	0.2	-64,557
Department of General Services	1.0	1.0	0.2	-86,474
Department of Natural Resources	10.0	8.0	0.7	-550,762
Department of Health and Mental Hygiene	25.0	19.0	0.2	-1,321,138
Department of Human Resources	3.0	3.0	0.0	-149,500
Department of Labor, Licensing, and Regulation	6.4	3.4	0.4	-236,677
Department of Public Safety and Correctional Services	30.0	30.0	0.3	-4,025,890
State Department of Education	21.0	21.0	0.9	-1,105,607
University System of Maryland	26.0	20.0	0.1	unavailable
Department of Business and Economic Development	10.0	8.0	3.4	-601,140
Department of Environment	3.0	1.0	0.3	-158,588
Department of Juvenile Services	1.0	1.0	0.0	-76,251
Total	**147.4**	**123.4**		**-$8,866,440**

PIN: Personnel Identification Number

*Salary data omit higher education figures, which were not published.

Source: Board of Public Works

Regular Position Compensation Expenditures

Budgeted salary expenditures grew to $4.26 billion in fiscal 2008, a 23.32 percent total increase from fiscal 2002 salary levels, as shown in **Exhibit 3**. The portion of the growth in State employee salaries attributable to general salary increases (COLAs) represents 7.29 percent of the total, with the balance stemming from merit increases, hiring actions such as reclassifications, and changes in the composition of the workforce.

Health insurance and retirement expenditures, which grew by 61.06 percent and 66.75 percent, respectively, posted the highest total percentage growth. In fact, the fiscal 2008 working appropriation allotment for the employees retirement and pension systems alone was larger than the State's fiscal 2002 expenditure for all the pension systems combined. The lone indicator that did not experience an increase was overtime earnings.

Exhibit 3
Regular Employee Compensation
Fiscal 2002 Actual to 2008 Legislative Appropriation
($ in Millions)

	2002 Actual	2008 Leg. Appr.	% Change	% of Salary Growth from GSI
Earnings				
Salary	$3,458	$4,265	23.32%	7.29%
Other Earnings	113	104	-8.45%	
Earnings Subtotal	3,571	4,368		
Other Compensation				
Health*	487	784	61.06%	
Retirement/Pensions	240	400	66.75%	
Salary-dependent Fringe	259	319	23.52%	
Agency-related Fringe	100	111	12.00%	
Other Compensation Subtotal	1,085	1,615		
Total Compensation	**$4,656**	**$5,983**	28.50%	

GSI: general salary increase
*Fiscal 2008 legislative appropriation is adjusted to reflect expenditure of previously accumulated fund balances.

Other Earnings = overtime and shift differentials
Health = employee and retiree health insurance
Retirement/Pensions = all pension/retirement systems
Salary-dependent Fringe = Social Security and unemployment compensation
Agency-related Fringe = deferred compensation match, workers' compensation, and tuition waivers

Personnel

Retiree Health Care Liabilities

Beginning in fiscal 2008, new accounting standards require the State to account for liabilities associated with State employee retiree health care on its annual financial statements. The most recent valuation indicated that the State's retiree health liabilities exceed $14.5 billion. Compliance with the new standards would require the State to contribute $1.1 billion each year toward funding these liabilities. Similarly, 20 counties in Maryland indicate that their combined retiree health liabilities could be as much as $10.8 billion. As the State continues to set aside a portion of the required funding in fiscal 2009, a Blue Ribbon Commission has been charged with making recommendations on how to address this significant fiscal challenge.

Background

Chapter 433 of 2006 established the Blue Ribbon Commission to Study Retiree Health Care Funding Options. Membership includes legislators, elected officials and appointees of the Executive Branch, and members of the public with expertise in either funding retiree health benefits, the economics of affordable retiree health care programs, or investing pension fund assets.

Chapter 433 directs the commission to contract with an actuarial consulting firm to conduct an actuarial valuation of the liabilities associated with Government Accounting Standards Board (GASB) Statement 45 and provide ongoing services to the commission throughout its two years' existence. Further, Chapter 433 specifically charged the commission with the following duties:

- commissioning another actuarial valuation that illustrates the Annual Required Contribution (ARC) as both a fixed dollar amount and also as a percentage of payroll;

- reviewing the specific legal obligations of the State to provide retiree health benefits to existing retirees, fully vested individuals, active employees, and new employees;

- studying the cost drivers associated with the State's unfunded retiree health care liabilities which provide the basis for the unfunded accrued liability as well as the ongoing normal/service costs;

- reviewing the current health care benefit levels for both employees and retirees and how the benefits compare to benefits provided under Medicare, by private employers, and by other public employers, with a particular emphasis on whether the various levels are appropriate, equitable, and sustainable;

- reviewing the eligibility requirements for retiree health benefits with a particular emphasis on whether the requirements are appropriate and equitable;

- reviewing alternative vehicles for providing health benefits to retirees including Voluntary Employees' Beneficiary Associations, Section 401(h) accounts, Section 115 trusts, Health Reimbursement Arrangements, and Health Savings Accounts; and

- recommending a multiyear implementation plan to address full funding of the State's obligations under GASB 45 as soon as is practical.

GASB 45 Statement

The standards of GASB 45 require governmental employers 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 currently funds the costs of State retiree health benefits on a pay-as-you-go basis in the State budget each year. However, under GASB 45 standards, Maryland is now required to account for these OPEB liabilities on its balance sheets.

The benefits to be valued for the purposes of OPEB liabilities are the retiree health benefits as understood by the State and the employees. The financial reporting under GASB 45 provides that employers must commission an actuarial valuation of OPEB liabilities every two years. Once a valuation is done, an ARC amount will be calculated that represents the annual payment by the employer that would be necessary to fund the normal costs accrued for that year (liability for current and future benefits earned by employees in that year) in addition to an amount that represents the amortization of any unfunded OPEB liabilities (benefits earned to the date of the valuation).

Actuarial Valuation of Retiree Health Care Liabilities

In October 2006, the commission hired Buck Consulting Firm to conduct a second actuarial valuation and provide ongoing services to the commission throughout its two-year existence. The first actuarial valuation on the State's retiree health care liabilities was done in the summer of 2005 and was conducted by AON Consulting. The report submitted by AON indicated the liabilities estimated for the actuarial accrued liability for retiree health benefits, defined as benefits earned as of July 1, 2005, were approximately $20.4 billion. In January 2007, Buck presented its completed actuarial valuation to the Senate Budget and Taxation Committee and the House Committee on Appropriations. Buck determined that the current actuarial accrued liability for retiree health benefits as of July 1, 2006 is $14.5 billion. Buck also estimated that the $14.5 billion liability amortized over a 30-year period, plus other specified costs required under the GASB standards, would result in an ARC amount of $1.11 billion.

Buck attributed the difference between the 2005 and 2006 valuations to differences between various demographic and economic assumptions made by Buck and AON that are based on the actual State Retirement and Pension System plan experience.

Update on Blue Ribbon Commission

In August 2007, the commission held its first meeting, at which time it received a presentation by Buck that compared their 2006 actuarial valuation findings to AON's 2005 findings. In addition, Buck also presented a preliminary overview of various cost-saving strategies with regard to the State's retiree health care liabilities. Also at the August meeting, the commission received an update on the status of retiree health benefits and liabilities in other AAA-bond rated states.

In September 2007, the commission held its second meeting where it received several briefings, including (1) an update on the status of retiree health benefits and liabilities of the State's counties and municipalities; (2) an overview on the retiree health benefits offered by the State; (3) an overview of Medicare Part D; (4) a brief presentation on retiree health benefits in the private sector; and (5) the legal obligation of the State with regard to providing retiree health benefits. It is anticipated that the commission will continue to meet through the end of 2007 and throughout the spring of 2008.

Retiree Health Benefits in Maryland Local Government

As a governmental employer, Maryland is not alone with respect to the OPEB liabilities to be recognized under GASB 45. Any governmental employer, including counties and municipalities throughout the State, that provides a commitment for retiree health care benefits subsidies are in a similar position. **Exhibit 1** provides the OPEB liability and annual required contribution for each county.

Exhibit 1
Cost Estimated Post Employment Liabilities

County	OPEB Liability	Annual Required Contribution	Reported Figures Include: County	Schools	Libraries	Community College	Notes
Allegany	$37,279,000	$3,578,000	●				2
Anne Arundel	1,270,024,474	117,573,000	●	●	●	●	
Baltimore City	not available	not available		actuarial analysis pending			
Baltimore County	1,800,000,000	150,000,000	●	●	●	●	
Calvert	154,081,095	13,268,655	●	●			
Caroline	73,454,000	6,715,000	●	●			1
Carroll	266,800,000	17,074,000	●	●	●		
Cecil	45,827,000	4,275,000	●	●			
Charles	$86,228,000	36,810,000	●	●			1
Dorchester	20,355,837	2,203,464	●				
Frederick	416,676,000	44,302,000	●	●	●		
Garrett	46,570,000	2,997,000	●	●		●	
Harford	457,655,000	47,000,000	●	●	●		
Howard	476,600,000	53,000,000	●	●	●	●	
Kent	not available	not available		actuarial analysis pending			
Montgomery	2,600,000,000	240,000,000	●	●	●	●	3
Prince George's	2,170,000,000	85,000,000	●	●	●	●	4
Queen Anne's	66,334,000	6,598,000	●	●			
St. Mary's	214,000,000	12,800,000	●	●	●		5
Somerset	not available	not available		actuarial analysis pending			
Talbot	not available	not available		actuarial analysis pending			6
Washington	135,754,000	10,660,000	●	●			
Wicomico	74,400,000	5,000,000	●	●			
Worcester	121,618,486	17,014,392	●	●			
Statewide Total	**10,833,656,892**	**875,868,511**					

1 Values are the "unfunded" liability, as indicated by the county's actuarial study.
2 No estimate yet available for county component units, including schools and libraries.
3 Includes all tax-supported agencies, including county portion of Maryland-National Capital Park and Planning Commission.
4 ARC figure represents county employees only.
5 Board of Education/library figure assumes an unfunded liability, though county has started making payments to do both.
6 County has "pre-funded" $6.35 million.

Source: Maryland Association of Counties, surveys in June and September, 2007

Education

More Moderate Increase in State Education Aid Projected for Fiscal 2009

On the heels of four consecutive years of record-breaking increases, State funding for public primary and secondary education is expected to increase by $175 million in fiscal 2009, the smallest increase since the enactment of the Bridge to Excellence in Public Schools Act of 2002. Although the growth in aid for fiscal 2009 was expected to be much smaller than the increases from recent years due to the completion of the Bridge to Excellence phase-in in fiscal 2008, the Budget Reconciliation Act passed during the 2007 special session constrained growth in education spending. The Act did, however, guarantee at least a modest increase in total State aid for each school system.

State Education Funding Set to Increase by Approximately $175 Million

In fiscal 2009, State aid for primary and secondary education is projected to increase by $175.1 million to a total of $5.34 billion. The boost would represent an increase of 3.4 percent over the fiscal 2008 funding level of $5.17 billion, making it the lowest increase since implementation of the Bridge to Excellence in Public Schools Act of 2002. The additional State aid includes growth of $119.7 million in the funding that is provided directly to local boards of education, increasing direct State aid from $4.60 billion in fiscal 2008 to $4.72 billion in fiscal 2009, a 2.6 percent increase. Teachers' retirement, which is paid by the State on behalf of local school systems, is expected to grow from $566.4 million to $621.8 million, an increase of $55.4 million or 9.8 percent.

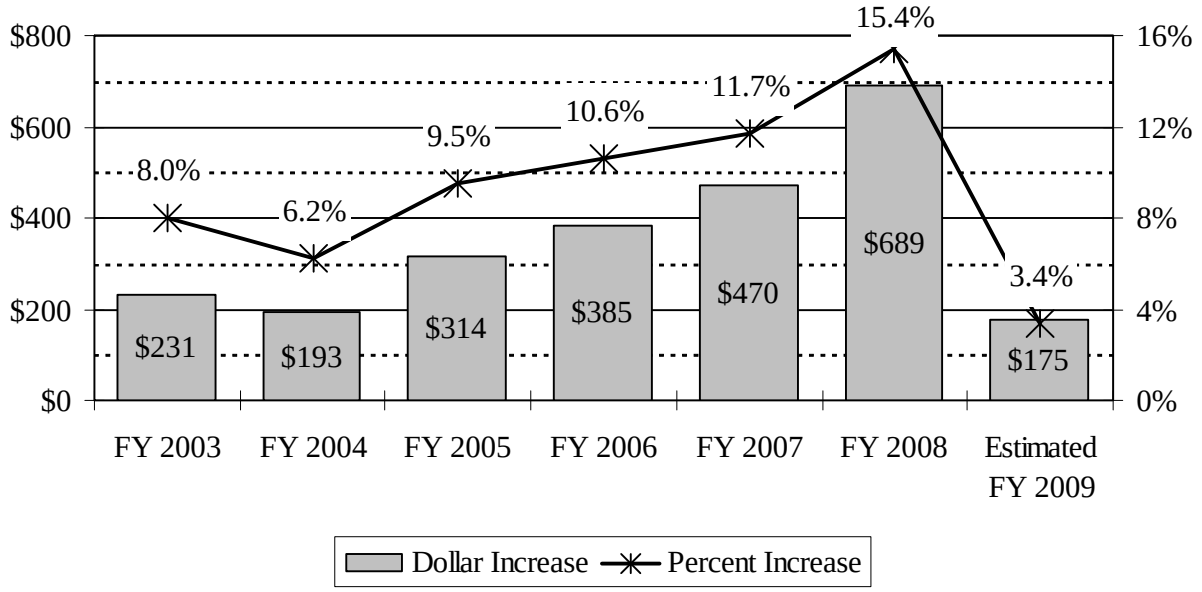
The leveling off of education aid in fiscal 2009 after four consecutive years of record increases is not unexpected. Fiscal 2008 is the final year of the Bridge to Excellence phase-in schedule, and the Act intentionally boosted spending significantly from fiscal 2003 to 2008 through annual enhancements to the major State aid formulas. Beginning in fiscal 2009, increases in Bridge to Excellence aid were to be determined solely by inflation and enrollment changes and were expected to be considerably lower than they were during the Act's implementation. Initial education aid estimates for fiscal 2009 projected an increase of approximately $327.0 million, less than half of the fiscal 2008 increase of $688.6 million but not significantly different from the annual increases in fiscal 2005 and 2006. However, ongoing budget problems led to efforts during the special session to constrain the growth in spending for education and other State programs.

Budget Reconciliation Act Adjusts State Funding Formulas

Changes made through the Budget Reconciliation Act (Chapter 2 of the 2007 special session) will reduce the increase in direct State education aid by eliminating annual inflationary adjustments to the per pupil funding level in fiscal 2009 and 2010. To mitigate the impact of the

two-year inflation freeze, the Budget Reconciliation Act (BRA) established supplemental grants that will ensure at least 1.0 percent annual increases in State funding for each local school system in accordance with a formula codified in the legislation. Additionally, the Administration committed to an accelerated phase-in of the geographic cost of education index (GCEI), a discretionary component of the Bridge to Excellence funding structure that has never been funded. In total, changes to the education aid formulas made in the BRA and the additional GCEI funding promised by the Administration combined to reduce projected fiscal 2009 spending by $151.9 million, leaving an expected increase of $175.1 million for fiscal 2009. Annual increases in State education aid since the enactment of the Bridge to Excellence legislation are displayed in **Exhibit 1**.

Exhibit 1
Annual Increases in State Aid for Education
Fiscal 2003 to 2009
($ in Millions)



Aid Increase Mostly Attributable to GCEI and Teachers' Retirement Funding

Changes in education funding for individual State aid programs are projected in **Exhibit 2**. Of the $119.7 million increase projected for direct State education aid, nearly two-thirds (63.7 percent or $76.3 million) will fund a 60 percent phase-in of the GCEI formula. Although the GCEI concept was part of the initial Bridge to Excellence legislation and a discretionary GCEI formula has been in statute since 2004, funding for the formula has never been provided. Other projected direct aid increases include the new supplemental grants

established in the BRA (an estimated $17.3 million) and an additional $11.5 million for the guaranteed tax base (GTB) program.

Exhibit 2
Estimated State Aid for Education
Fiscal 2009
($ in Millions)

Program	FY 2008	FY 2009	Dollar Change	Percent Change
Foundation Program	$2,782.7	$2,772.7	($10.0)	(0.4%)
Geographic Cost of Education Index	0.0	76.3	76.3	--
Compensatory Education	902.1	902.7	0.6	0.1
Special Education Formula	280.0	278.7	(1.4)	(0.5)
Limited English Proficiency	126.2	135.0	8.8	7.0
Guaranteed Tax Base	78.9	90.4	11.5	14.6
Student Transportation	219.0	225.2	6.2	2.8
Supplemental Grants	0.0	17.3	17.3	--
Nonpublic Special Education	125.2	128.6	3.4	2.7
Other Programs	87.5	94.5	7.0	8.0
Direct Aid Subtotal	**$4,601.6**	**$4,721.4**	**$119.7**	**2.6%**
Teachers' Retirement	566.4	621.8	55.3	9.8%
Total Education Aid	**$5,168.1**	**$5,343.1**	**$175.1**	**3.4%**

Funding for the foundation formula, the largest education aid program, and the three at-risk programs (the special education, compensatory education, and limited English proficiency formulas) are all impacted by the fiscal 2009 inflation freeze enacted by the BRA. Consequently, changes in funding for the formulas will depend on changes in total student enrollment (for the foundation program) and the enrollments of the specific at-risk populations (for the at-risk programs). Statewide enrollment is down slightly, which is reflected in a decrease in funding for the Foundation Program. Even with an increase of $8.8 million projected for the limited English proficiency formula due to rapidly growing enrollments in this segment of the student population, combined State aid under the four formulas is expected to decrease by approximately $2.0 million. The student transportation formula, which was not affected by changes made through the BRA, retains its annual inflationary increase and will increase by $6.2 million.

In addition to direct aid, State funding for teachers' retirement is expected to increase by $55.3 million due primarily to 8.8 percent growth in the teacher salary base. The State contribution rate for the program also increases slightly, from 11.6 percent in fiscal 2008 to

11.7 percent in fiscal 2009. Combined, the GCEI and teachers' retirement payments make up more than three-quarters of the total education aid increase.

State aid increases for each school system are displayed in **Exhibit 3**. As guaranteed by the supplemental grants established in the BRA, each county will realize an increase of at least 1.0 percent, with projected increases ranging from 1.1 percent in Talbot County to 7.7 percent in Montgomery County.

Exhibit 3

Projected Fiscal 2009 Increases in State Education Aid by County

($ in Thousands)

		Change in …			
School System	**FY 2008 Total Aid**	**Direct Aid**	**Teachers' Retirement**	**FY 2009 Total Aid**	**FY 2009 Percent Increase**
Allegany	$89,233	$491	$614	$90,338	1.2%
Anne Arundel	311,023	3,428	5,768	320,219	3.0
Baltimore City	886,391	11,454	7,110	904,954	2.1
Baltimore	578,121	4,596	4,402	587,120	1.6
Calvert	95,576	1,506	689	97,771	2.3
Caroline	45,114	244	372	45,730	1.4
Carroll	158,394	1,540	1,548	161,481	1.9
Cecil	107,359	1,846	853	110,057	2.5
Charles	160,142	4,943	1,596	166,681	4.1
Dorchester	32,858	207	188	33,254	1.2
Frederick	221,058	7,835	2,381	231,274	4.6
Garrett	28,271	130	252	28,653	1.4
Harford	230,929	972	2,549	234,450	1.5
Howard	221,294	5,283	3,448	230,026	3.9
Kent	11,895	85	110	12,090	1.6
Montgomery	511,959	29,938	9,390	551,287	7.7
Prince George's	981,280	28,156	10,399	1,019,835	3.9
Queen Anne's	34,075	548	213	34,836	2.2
St. Mary's	98,805	1,357	777	100,939	2.2
Somerset	25,410	151	189	25,749	1.3
Talbot	13,070	26	113	13,209	1.1
Washington	147,728	3,658	932	152,318	3.1
Wicomico	113,628	2,981	895	117,505	3.4
Worcester	22,192	(30)	534	22,697	2.3
Unallocated	42,269	8,399	0	50,667	19.9
Total	**$5,168,074**	**$119,743**	**$55,322**	**$5,343,139**	**3.4%**

Education

Achievement of No Child Left Behind Standards Challenging for All

No Child Left Behind, the federal government's far-reaching education law, is now in its sixth year of implementation. With a strong tradition of school and student accountability, Maryland was better positioned than most states to implement the new law. Still, school systems across the State are struggling to meet lofty goals of 100 percent proficiency for all students and a highly qualified teacher in every classroom.

Nearly six years after its enactment in January 2002, the federal No Child Left Behind Act (NCLB) continues to challenge schools and school systems across the country and in Maryland. The Act requires states to set standards and measure students' progress toward the achievement of the standards. To reach these goals, the law also requires that all core curriculum classes be taught by highly qualified teachers. Although Maryland's educational policies – including the State funding increases granted in Bridge to Excellence in Public Schools Act of 2002 and the State Board of Education's continual focus on accountability – have put it in a better position than most states to implement NCLB, attainment of the NCLB goals has been elusive.

Achieving Adequate Yearly Progress Under No Child Left Behind

NCLB establishes a goal of having 100 percent of students reach proficiency in reading and mathematics by the 2013-2014 school year. Each state determines its own proficiency standards and establishes intermediate performance targets for each school year prior to 2014. Students must be assessed annually in grades three through eight and again in high school. Performance data must be disaggregated into eight subgroups of students: African American; American Indian; Asian/Pacific Islander; Hispanic; White; special education; free and reduced price meals (FARM); and limited English proficient (LEP).

The Maryland School Assessments (MSAs) are used to measure the performance of students in grades three through eight, and the High School Assessments (HSAs) are used for high school students. Combining scores on the MSAs with attendance rates and scores on the HSAs with high school graduation rates determines whether each school, school system, and the State as a whole make adequate yearly progress (AYP) toward 100 percent proficiency. Maryland was one of the first states to have its assessment system fully approved by the U.S. Department of Education (USDE).

2007 Assessment Results Mostly Positive

The 2007 MSA results for grades three through eight are shown on **Exhibit 1**. Since 2004, when testing at all required grade levels was implemented, proficiency rates had consistently increased. However, there were slight declines in the seventh grade reading and third grade math scores between 2006 and 2007. Proficiency rates have historically been higher in the lower grades than the higher grades and that trend remained true in 2007. Students in several subgroups continue to perform below their peers, but gains have been made in closing the proficiency gap, most notably for special education, LEP, and FARM students in the lower grades.

Exhibit 1
Maryland School Assessment Results
Percentage of Students Demonstrating Proficiency
2004 to 2007

	Reading				Math			
Grade	**2004**	**2005**	**2006**	**2007**	**2004**	**2005**	**2006**	**2007**
Three	71.3%	76.1%	78.3%	80.5%	72.6%	77.1%	79.1%	78.6%
Four	75.1	81.2	81.8	86.0	69.6	76.8	82.1	86.0
Five	68.6	74.6	76.6	76.7	63.4	69.5	73.4	78.3
Six	68.3	70.7	71.9	76.5	50.3	60.5	65.6	71.9
Seven	67.0	67.6	71.1	70.2	49.8	55.7	60.1	61.3
Eight	64.2	66.7	67.0	68.2	46.1	52.1	55.0	56.7

Source: Maryland State Department of Education

For high schools, HSA scores in English and algebra are used to determine the achievement of AYP. Between 2006 and 2007, there was over a 10 percentage point increase in students demonstrating proficiency on the English 2 HSA. The algebra results, however, did not show improvement. A total of 63.5 percent of first time test takers in 2007 demonstrated the necessary proficiency, a slight decline from 66.6 percent in 2006. Beginning with the class of 2009, HSAs take on new importance because Maryland high school students will be required to pass HSAs in English, algebra, biology, and government or receive a minimum aggregate score on the tests in order to graduate with a Maryland high school diploma. (Please see separate issue paper on high school assessments.)

Inability to Meet AYP and Assignment to School Improvement Status

The Maryland State Department of Education (MSDE) determines annually whether schools and school systems make AYP based on MSA and HSA scores, as well as attendance and graduation rates. If schools fail to achieve AYP for two consecutive years, they are assigned to school improvement. Continued failure to meet AYP targets moves schools and school systems through a progression of steps that ultimately includes corrective action and restructuring. Schools move out of improvement status when they meet AYP targets for two consecutive years.

During the 2006-2007 school year, nearly 80 percent of Maryland schools met AYP targets. AYP results for 2007 show 233 schools (176 elementary and middle schools and 57 high schools) in improvement status, the same number in improvement last school year. Although the total number of schools in improvement remained constant, the number of elementary and middle schools in improvement status increased from 166 to 176 while the number of high schools in improvement decreased from 67 to 57. Furthermore, the number of schools entering improvement status decreased from 45 in 2006 to 36 in 2007.

Exhibit 2 shows the number of schools in improvement in each local school system. Of the 233 schools in improvement, 93 schools are located in Baltimore City and 68 are located in Prince George's County. These two local school systems account for 69.1 percent of the schools in improvement in the State. Nearly half of all schools in Baltimore City (47.0 percent) are in improvement status. Prince George's County showed some positive gains from the previous school year with 68 schools (31.9 percent) in improvement, down from 83 schools (44.6 percent) in 2006. Both of these school systems have been placed in corrective action due to their inability to meet established performance targets. The systems had their corrective action plans approved by the State Board of Education in December 2006 as part of the comprehensive master plans that every system must submit. Although they are much smaller school systems, 38.5 percent of Dorchester County schools and 33.3 percent of Somerset County schools are in improvement. These systems have not been placed in corrective action.

Exhibit 2
Schools in Improvement Status 2007-2008 School Year

School System	Year 1 or Year 2	Corrective Action	Restructuring	Total Schools in Improvement	Percent of Schools in Improvement
Allegany	1			1	3.6%
Anne Arundel	5	2	1	8	6.6
Baltimore City	21	6	66	93	47.0
Baltimore	8	2	4	14	8.3
Caroline	1			1	10.0
Cecil	4			4	13.8
Dorchester	3	2		5	38.5
Frederick	1		1	2	3.1
Harford	2	1	1	4	7.7
Howard	2			2	2.8
Kent		2		2	25.0
Montgomery	21	1	1	23	11.3
Prince George's	25	12	31	68	31.9
St. Mary's	1		1	2	7.7
Somerset	3			3	33.3
Wicomico	1			1	4.0
Total	**99**	**28**	**106**	**233**	**16.3%**

Note: State total number of schools includes 186 schools from the 8 school systems with no schools in improvement.

Source: Maryland State Department of Education

Of the 106 schools in restructuring, the final and most severe phase of school improvement, 66 are located in Baltimore City and 31 are in Prince George's County. Statewide, 84 of the 233 schools in improvement are elementary schools, 92 are middle schools, and 57 are high schools.

Providing a Highly Qualified Teacher in Every Classroom

NCLB also requires all teachers in core academic subjects to be "highly qualified." Core academic subjects include English, reading or language arts, mathematics, science, foreign languages, civics and government, economics, arts, history, and geography. 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 have obtained full State certification or passed the State teacher licensing examination.

In addition, a teacher must have expertise in each subject the teacher is assigned to teach. Veteran teachers may be deemed "highly qualified" without passing a State licensing exam if they can demonstrate competency in core academic areas.

No state met the goal of providing a highly qualified teacher in every classroom by the end of the 2005-2006 school year, the deadline established by NCLB. In October 2005, in response to concerns expressed by many states about the consequences of missing the deadline, USDE announced a one-year extension for states that demonstrated a "good faith effort" to meet the highly qualified teacher requirement. States requesting an extension submitted revised plans for accomplishing the goal by the end of the 2006-2007 school year, with special attention paid to placing highly qualified teachers in schools with high concentrations of disadvantaged students. In August 2006, USDE granted Maryland a one-year extension, accepting its Revised State Plan as one of nine model plans. In July 2007, USDE pledged not to penalize states financially for not reaching the goal of 100 percent of classes taught by highly qualified teachers, as long as the states continue to make progress toward attaining this goal.

As shown in **Exhibit 3**, Maryland continues to improve on this NCLB goal, as the percentage of classes not taught by highly qualified instructors declined from 20.6 percent in 2006 to 17.8 percent in 2007. In 2007, 11 counties reduced the percentage of classes not taught by highly qualified teachers to less than 10 percent: Allegany, Caroline, Carroll, Cecil, Frederick, Garrett, Montgomery, St. Mary's, Talbot, Washington, and Worcester. In 2006, only four school systems met this threshold.

Exhibit 3

Percentage of Classes *Not* Taught by Highly Qualified Teachers

School System	2006	2007	School System	2006	2007
Allegany	2.8%	2.5%	Harford	10.7%	11.8%
Anne Arundel	15.5	15.9	Howard	11.0	11.6
Baltimore City	53.2	47.0	Kent	17.1	17.3
Baltimore	16.5	12.5	Montgomery	14.5	9.5
Calvert	13.0	12.7	Prince George's	37.9	33.7
Caroline	10.5	5.0	Queen Anne's	15.3	16.3
Carroll	10.8	9.8	St. Mary's	6.7	5.8
Cecil	10.5	9.8	Somerset	31.0	28.6
Charles	27.0	18.3	Talbot	8.1	8.8
Dorchester	33.1	38.3	Washington	10.9	9.8
Frederick	10.7	9.6	Wicomico	25.5	13.1
Garrett	6.7	5.2	Worcester	10.8	8.4
			Statewide Total	**20.6%**	**17.8%**

Source: Maryland State Department of Education

The counties that struggle the most to achieve AYP are also lagging behind in teacher qualification goals. Baltimore City and Dorchester, Prince George's, and Somerset counties have the highest percentage of courses not taught by highly qualified teachers. The struggle to find qualified teachers in these school systems, each of which has a high proportion of economically disadvantaged students, is related to the ongoing statewide issue of teacher qualifications in high-poverty schools. Since 2004 when MSDE began monitoring the proportion of classes not taught by highly qualified teachers, the percentage for high-poverty schools has been significantly higher than for low-poverty schools. In 2007, 9.9 percent of classes in low-poverty schools were not taught by highly qualified teachers, compared to more than one-third of the classes in high-poverty schools. Although the percentage of classes not taught by highly qualified teachers has declined in both high- and low-poverty areas in the last four years, there has been only a minimal reduction in the gap between the two figures.

Education

State Board of Education Hears from Public on High School Assessments

With an eye toward the 2009 graduating class, the first that will be required to pass the high school assessments in order to earn a Maryland high school diploma, the General Assembly required the State Board of Education to hold five regional hearings to inform the public about the assessments and hear the public's views on the subject. After completing the hearings in September and taking time for additional study and deliberation during its September and October meetings, the State board voted 8-4 in October to retain the high school assessments as a graduation requirement. In addition, the State board provided an alternative for students who do not pass the assessments.

Background

The Maryland High School Assessments (HSAs) consist of four end-of-course tests designed to measure school and individual student academic performance in English, algebra/data analysis, biology, and government. Statewide planning and development of the HSAs began nearly 15 years ago with the goal of raising high school standards and replacing the Maryland Functional Tests, which were being used at the time as high school graduation requirement. After years of development, HSAs were field tested in 2000 and 2001 and students' scores began to appear on their high school transcripts in 2002. In 2004, the State Board of Education voted to make passage of the HSAs a graduation requirement, beginning with students entering ninth grade in fall 2005 (the class of 2009). Under the regulations adopted by the State board, students will be required to pass each of the four tests or achieve a minimum combined score on the tests to earn a Maryland high school diploma.

In response to concerns among legislators about the approaching 2009 graduation class, language in the 2007 *Joint Chairmen's Report* required the State Board of Education to hold five regional public hearings "to educate the public about current policies and potential changes to the HSA as a graduation requirement and to hear the public's concerns." Hearings were held in September 2007 in Baltimore City and Allegany, Charles, Prince George's, and Talbot counties.

Concerns and Views Expressed at the Hearings

- **Denial of High School Diplomas Based on HSA Performance:** Many participants at the hearings believed that it was not fair for a student to be denied a Maryland high school diploma if the student passes all of the required courses but fails to achieve a passing score on the HSAs. Participants also mentioned that some students do not perform well on standardized tests despite doing well in their coursework. Several participants questioned the ability of the HSAs to adequately measure and reflect

students' abilities. Other participants suggested that the State board should implement a weighted assessment that incorporates students' HSA results and grade point averages.

Advocates of the HSA requirement stated that the tests promote consistency in teaching throughout the State and make students more goal-oriented. Some of the participants mentioned that awarding high school diplomas without ensuring that students have mastered the core skills and knowledge in the curriculum dilutes the significance of a Maryland high school diploma. Proponents of the HSAs also mentioned that, in order to compete in a global economy, high standards need to be set for all students in Maryland.

- **Modified High School Assessments and Groups with Specific Needs:** Some parents of special education students expressed their frustration that modified HSAs have yet to be developed despite specifications in students' Individualized Education Programs for modified tests. Some participants at the hearings advocated that special education students and English language learners should not be required to pass the HSAs in order to graduate.

- **School Resources Devoted to the High School Assessment:** A number of participants stated that teachers are "teaching to the test" rather than implementing a well-rounded curriculum and allowing for the freedom of interactive and enticing lessons. Students who do not pass the tests are sometimes placed into remedial groups that go over coursework on the test, thus delaying their progress toward completing the rest of the curriculum. Other participants suggested that the remediation structures needed to help students pass the tests are insufficient in some school systems.

- **Faster Turnaround of Scores:** Several parents, teachers, and school officials expressed their dismay over the time it takes to receive HSA results. It typically takes nine weeks to grade the tests, resulting in last-minute changes to class schedules for students who did not pass the tests. Participants offered suggestions such as faster turnaround of scores, providing teachers with more detail on individual student performance, and more timely opportunities for students to retake the tests.

The Maryland State Department of Education (MSDE) has been able to address some of the concerns voiced at the public hearings. In September 2007, the department, after receiving input from local superintendents and other stakeholders, decided to implement a purely multiple choice format for HSAs beginning in May 2009. The department estimates that this change, along with the use of a new test provider, would shorten the grading time for HSAs from nine weeks to three weeks. In addition, MSDE reports that modified HSAs should be widely available in January 2008. Finally, to address concerns about HSA pass rates and the availability of effective remediation, students will be given the opportunity to take each HSA up to five times per year and students who are having difficulty passing the tests will be provided online remediation tools available on the Maryland State Department of Education web site.

Subsequent State Board Decisions and Changes to the HSA Requirements

In October 2007, after a significant amount of additional study and discussion, the State board voted 8-4 to retain the HSAs as a graduation requirement. Members of the State board argued that, although the HSAs are not a panacea for deficiencies in Maryland's public schools, they are an important tool in the effort to ensure a consistent and adequate education for all Maryland students. The State board also noted that it hopes HSAs will increase accountability, ensure the value of a Maryland high school diploma, and prepare students for future academic and job-related pursuits. Finally, board members expressed a concern that not using HSAs as a graduation requirement could result in students not taking the tests seriously.

In the process of reviewing the HSAs, the State board did make two modifications to the policies that had been place. The board voted favorably to implement the Bridge Plan for Academic Validation, thus providing a student who is unable to pass the HSAs with the option of completing a subject-based project in lieu of passing the assessments. This option would only be available to students who have met other graduation requirements (such as successful completion of all coursework, attendance, and the service learning requirements), have taken the assessment(s) in question at least two times, and have demonstrated good faith participation in all applicable remediation or academic assistance programs. The board also altered the minimum score requirement. Previously, a student could qualify for graduation with a qualifying combined score on the four tests as long as a minimum score on each test was achieved. The qualifying combined score option is retained but with no minimum required scores for individual tests.

Education

Charter Schools to Receive More Funding

A recent Maryland Court of Appeals ruling sided with the State Board of Education in the board's creation of a funding formula for local boards of education to use in determining allocations to charter schools. The ruling has resulted in funding increases for charter schools in Baltimore City and Prince George's County. The additional funding, along with federal charter school grant funds recently acquired by the State, could lead to an increase in the number of charter schools from the 30 that currently operate in the State.

Court of Appeals Ruling Yields New Funding Formula

In a 7-2 ruling, the Maryland Court of Appeals upheld the State Board of Education's (State board) funding model for charter schools, thereby rejecting separate funding models developed by the Baltimore City Board of School Commissioners (city board) and the Prince George's County Board of Education (PGCBE). The State board's funding model requires that, for each student they enroll, charter schools receive funding equal to the total annual school system operating budget (including all federal, State, and local funds) divided by the total number of students in the school system. It allows local school boards to deduct up to 2 percent from that amount for central office administrative functions and only requires local school boards to distribute federal funds to charter schools when they qualify for the funds under federal rules. The city board and PGCBE had each proposed alternative models that provided reduced funding levels to charter schools but also provided specific in-kind services to charter schools in their jurisdictions (including, for example, special education and meal services).

Although the ruling specifically relates to charter school funding formulas in the two affected school districts, it also upheld the State board's status as the arbiter of the "true intent and meaning" of State education law. The Maryland State Department of Education (MSDE) indicates that it intends to apply the State board's charter school funding model to all charter schools in the State, but only when disputes between charter schools and local boards of education are brought before it. It has not issued new guidance to local school boards in response to the Court of Appeals ruling. Instead, MSDE hopes that local school boards and their charter schools can reach agreement on appropriate funding levels. MSDE will get involved only in instances where agreement between a local board and a charter school cannot be reached and the charter school appeals to the State board for a ruling.

Two School Districts Increase Per-pupil Allocations to Charter Schools

Although the Court of Appeals' ruling applies to all charter schools in the State, only two of the six local school systems that have charter schools operating during the 2007-2008 school year have changed their per-pupil allocation for charter schools in response to the court's ruling.

They are the city board and PGCBE, the two boards directly affected by the ruling. The other four school boards report either that they were already using the State board's charter school funding formula before the ruling, or they will revisit their formulas when their current contracts with charter schools expire.

PGCBE increased its per-pupil allocation for charter schools from $6,136 to $8,914, an increase of $2,778 for each student. With 873 Prince George's County students enrolled in charter schools, the total increase in funding for charter schools is $2.4 million for the 2007-2008 school year. The new figure does not include transportation funds, and some charter schools indicate that the omission of those funds from the funding formula could provoke further disputes between charter schools and the school board. For the 2007-2008 school year, PGCBE continues to provide special education services on an in-kind basis (with appropriate adjustments made to school allocations).

The city board increased its per-pupil allocation to charter schools by $700, representing the board's estimate of the total cost of in-kind services it had been providing to charter schools. With 5,591 Baltimore City students enrolled in charter schools, the total increase in funding for charter schools is $3.9 million for the 2007-2008 school year. The city board continues to retain restricted federal funds, including special education and Title I compensatory education funds. It provides those services to charter schools on an as-needed basis, although it may revisit that arrangement during the 2008-2009 school year.

Thirty Charter Schools Operating in Maryland

Since the passage of the Maryland Public Charter School Act of 2003, 31 newly chartered schools have opened in the State. One additional charter school in Frederick County predated the State legislation. Two of the new schools have closed, leaving 30 charter schools operating during the 2007-2008 school year. Of these, 22 charter schools are located in Baltimore City, 4 are in Prince George's County, and there is 1 each in Anne Arundel, Frederick, Harford, and St. Mary's counties. Statewide enrollment in charter schools stands at 7,216 students. 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.

The Maryland public 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. The schools must be nonsectarian and open to all students in the local school system on a space-available basis. The professional staff of a charter school must hold appropriate certification, and they have the same rights as other public school employees with respect to employee organizations. Charter schools must comply with the laws, regulations, and policies that govern other public schools, although waivers from some rules may be requested through an appeal to the State board.

Regarding accountability, charter schools are subject to the federal No Child Left Behind Act and must participate in the State's accountability program. Of the 24 charter schools operating during the 2006-2007 school year that are still open in 2007-2008, 10 made adequate yearly progress (AYP) on the tests and 12 did not make AYP; students in 2 schools did not take the State assessments because they serve only students younger than grade three, the earliest grade that is assessed.

Federal Government Provides Start-up Funds for Charter Schools

To help with the continued implementation of the still relatively new public charter school law, Maryland received its second federal grant in 2007. The grant totals $18.2 million, and is to be awarded over three years as start-up funds for new and prospective charter schools. The first proposals from new charter school developers are due to MSDE by January 2, 2008. The federal grants are designed to cover one-time start-up expenses such as furniture, instructional materials, and minor facility modifications. Under the State's previous federal grant, all 31 charter schools that opened in the State since 2003 received start-up funds. Federal charter school funds have been distributed by MSDE in three phases: preplanning (up to $10,000); planning and design (up to $100,000); and implementation (up to $300,000).

Higher Education

Commission to Develop the Maryland Model for Funding Higher Education Continues Its Work

The commission met throughout 2007 to develop a funding model for higher education in Maryland. The commission sought input from national experts, higher education stakeholders, and the business community in evaluating current funding for higher education and other states' models. To address its charge related to appropriate funding for the State's public Historically Black Institutions (HBI), a request for proposals to hire a consultant was issued but no bids were received. The commission's final report is due December 31, 2007; however, due to delays in the HBI study, the Presiding Officers have approved an extension and legislation will be introduced to extend the commission into 2008 with a final report deadline of December 1, 2008.

Background

The Commission to Develop the Maryland Model for Funding Higher Education was established by the Tuition Affordability Act of 2006 (Chapter 57). The commission membership includes the Lieutenant Governor, senators, delegates, cabinet secretaries, college presidents, higher education association presidents and executive directors, members of the business community, and members of the public. The commission is charged with three main objectives: (1) to develop an effective statewide framework for higher education funding; (2) to review options and make recommendations relating to the establishment of a consistent and stable funding mechanism for higher education to ensure accessibility and affordability while at the same time promoting policies to achieve national eminence at all of Maryland's public institutions of higher education; and (3) to review options and make recommendations relating to the appropriate level of funding for the State's Historically Black Institutions (HBIs) to ensure that the institutions are comparable and competitive with other public institutions.

Commission Will Work Toward a Final Report in 2008

The commission held its first meeting in January 2007 and began meeting on a regular basis during the 2007 interim. The deadline for the commission to submit a final report is December 31, 2007; however, the Presiding Officers have granted permission to extend the commission deadline to December 1, 2008, because the commission cannot complete its charge by the original deadline. The commission will submit an interim report by the end of this year and legislation will be introduced during the 2008 session to extend the final report deadline to December 1, 2008.

Work of the Commission During the 2007 Interim

Commission Meetings

During the 2007 interim, the commission was presented with information on a variety of topics relating to higher education funding such as the 2004 State Plan for Higher Education; the funding guidelines and funding formulas used in Maryland; higher education formulas and funding in other states; student financial assistance in Maryland; higher education capital funding in Maryland; the fiscal impact of fully funding State law and the goals for higher education in Maryland; the State's fiscal outlook and structural deficit; the role of higher education in the future of United States' competitiveness; and an overview by each segment of higher education explaining the mission of the segment, who the segment serves, future opportunities and challenges for the segment, and the pros and cons of the current funding model for the segment.

In July, the commission held a Symposium on Developing a Maryland Model for Funding Higher Education. Three representatives from national education and legislative organizations gave panel presentations and addressed certain questions that were posed by the commission through a national higher education consultant who served as the moderator. Several key issues emerged from the symposium that could be grouped under four main categories: how the appropriate share of higher education costs borne by students, government, and others should be determined; the need to balance quality with access and affordability; accountability of higher education to the State, its citizens, and its students; and other general issues such as the need to focus on State demographics and the need for better communication between workforce development and higher education.

Commission Workgroups

As several key themes emerged from the symposium and from the other commission meetings, four workgroups were established to focus on particular areas relevant to higher education funding. Each workgroup consists of approximately six commission members and the workgroups are focusing on the following areas: appropriate funding shares, accountability, economic competitiveness/workforce, and capital investment. The workgroups began meeting in September and will share the results of their preliminary work with the full commission at the commission meeting in December. However, the majority of their information gathering and analysis will not be completed and shared with the full commission until 2008 in order to inform the recommendations of the commission in the final report in 2008.

Charge Relating to HBI Funding

In order to properly address the commission's charge relating to funding for HBIs, the commission decided to hire a consultant with HBI and higher education finance expertise. Drafting the Request for Proposals (RFP) to hire the consultant was more complicated than anticipated, and the RFP was released in August 2007, later than expected. In order to give the consultant enough time to complete the report, the commission decided that the deadline in the

RFP for the consultant's final report should be May 2008. While that time schedule was not within the commission's original deadline, the commission felt strongly that the consultant should be given sufficient time to conduct a thorough study. However, to complicate matters further, when the RFP was released no bids were received. The commission is currently pursuing other options to partner with organizations that have HBI and higher education expertise but no plans have been finalized at the present time.

Special Session Actions Related to Higher Education

The commission will consider the actions taken by the General Assembly regarding higher education funding during the 2007 special session. The Tax Reform Act of 2007 (Chapter 3) created the Higher Education Investment Fund (HEIF) within the Maryland Higher Education Commission (MHEC) to (1) invest in public higher education and workforce development; and (2) keep tuition affordable for Maryland students and families. The HEIF may only be used to supplement general fund appropriations to public senior higher education institutions, for related capital projects, and for workforce development initiatives administered by MHEC. Chapter 3 increased the corporate income tax rate from 7.0 to 8.25 percent beginning January 1, 2008, and distributes a portion of the increased revenue to the HEIF. The HEIF will receive $16 million in fiscal 2008 and $55.5 million in fiscal 2009, which represents 6 percent of total corporate income tax revenues in fiscal 2009. Distribution of the corporate income tax revenues to the HEIF is intended to continue in future years if the General Assembly determines the distribution would be affordable and fiscally prudent and adopts legislation to accomplish this objective.

The Budget Reconciliation Act of 2007 (Chapter 2) required noncapital HEIF appropriations to be included in the calculation of State funding for the Cade, Baltimore City Community College, and Sellinger formulas. Any noncapital HEIF appropriations to the institutions in fiscal 2009 would flow through to the community college and nonpublic higher education formulas beginning in fiscal 2010.

The commission will continue meeting throughout the 2008 interim and will submit a final report by December 1, 2008.

Higher Education

State Funding for Enrollment Growth at Institutions of Higher Education

The State began funding enrollment growth in the University System of Maryland (USM) on a per student basis in fiscal 2007. The General Assembly adopted a variable cost methodology to calculate fiscal 2008 general funds for enrollment growth at certain USM institutions. The methodology assumes that the "marginal" cost of each additional student is zero, but as more students enroll, certain variable costs increase. USM objects to the variable cost calculation and is expected to request additional enrollment funds in fiscal 2009.

State Funding to Support Enrollment Growth

For the first time, the University System of Maryland (USM) institutions received general funds on a per student basis specifically to support enrollment growth, called the Enrollment Funding Initiative (EFI). Each institution's enrollment was expected to grow; therefore, each institution received general funds as part of the EFI. In total, an additional 3,386 full-time equivalent students (FTES) were expected in fiscal 2007.

To calculate how much general funds to request, USM used an average cost methodology by calculating the amount of total general funds per FTES received in the prior fiscal year at each institution. For some institutions, USM adjusted the average cost to reflect whether most enrollment growth was anticipated at the undergraduate level or at a regional higher education center such as the Universities at Shady Grove, thus costing less. The average cost per FTES in fiscal 2007 ranged from $1,077 at University of Maryland University College (UMUC) to $12,000 at University of Maryland, Baltimore (UMB). Overall, USM received $14.9 million to support enrollment growth in fiscal 2007.

The fall 2006 enrollment at USM institutions exceeded the 3,386 FTES goal by a net additional 887 FTES. Six institutions did not meet the individual enrollment goals, and five institutions exceeded the goals. Of particular importance to USM's overall growth was the success of UMUC, which exceeded its target of 1,325 FTES by an additional 966 FTES. The institutions that did not meet the enrollment target received excess general funds under the EFI, and the institutions that exceeded the target did not receive the appropriate funding level.

The fiscal 2008 budget request for the institutions was adjusted according to each institution's attainment of the fiscal 2007 enrollment targets. Those that exceeded the target got additional funds, and funds were deducted from the total budgets of the institutions that did not meet the target. In total, USM institutions received a net $443,275 less in general funds in fiscal 2008 due to fiscal 2007 attainment.

For fiscal 2008, USM established a new EFI enrollment growth target of 1,740 FTES for five institutions, rather than all of the degree-granting institutions. These five institutions were UMB, University of Maryland, College Park (UMCP), Towson University, Salisbury University, and UMUC. In the fiscal 2008 budget, USM requested an average cost per FTES that ranged from $1,800 at UMUC to $12,800 at UMB and UMCP. Overall, after adjusting for fiscal 2007 attainment, USM requested $6.8 million to support enrollment growth in fiscal 2008. However, in recognition of a lower estimated cost to support enrollment growth, discussed below, the General Assembly appropriated $4.7 million in fiscal 2008 while still requiring USM to grow by 1,740 FTES. The General Assembly did not specify how this $2.0 million reduction should be allocated among the institutions, but allowed USM to decide. USM did not allocate the reduction to reflect the variable cost methodology. Under the variable cost methodology, UMUC would have received a higher per pupil amount than USM's request. However, UMUC's general funds were reduced by $0.5 million. The other four institutions were reduced by less than the marginal cost methodology amount.

Preliminary fall 2007 enrollment shows that four of the five institutions are expected to meet or exceed the enrollment target. Only UMUC is expected to fall short of its target by 706 FTES. Overall, it is expected that enrollment at these five institutions will exceed the target of 1,740 FTES by a net 177 FTES.

How Much Does One Additional Student Cost an Institution?

USM based its answer to this question on the average general funds that the institution receives on a per student basis. However, the Department of Legislative Services (DLS) conducted a variable cost study in 2006 to more accurately calculate a per FTES general fund rate by examining specific aspects of each institution's expenditures that are related to instruction and other student support services. The study was updated in the 2007 interim. This alternative methodology examines costs that are affected by additional students and excludes costs that are not affected by additional students, *i.e.*, fixed costs. This approach recognizes that certain fixed costs included in the USM average cost methodology are not affected by additional students, but that several years of enrollment growth require additional general funds to augment the tuition and fee revenues paid by the new students. Several other states, such as California, use this method to determine approximate enrollment funding for public universities.

DLS concluded that when the enrollment of an established institution of higher education increases by one student, there would likely be no increase in what the institution must spend to adequately support the education of that student. This is known as the marginal cost, and it is zero.

However, as the enrollment at an institution continues to grow, there will be additional costs. For instance, there will be a need to hire additional faculty and to increase spending for instructional equipment, academic support, student services, and other variable costs associated with additional students. Eventually, after a number of years of significant enrollment growth, even fixed costs per student relating to classroom space and administrative overhead will

increase. When an institution incurs these additional variable and fixed costs depends in part on the size of the institution relative to the growth in enrollment. For instance, a larger institution would be able to absorb more students than a smaller institution before experiencing increased costs.

DLS developed a methodology to calculate the variable cost of additional students at the USM institutions. The calculation provides a per student cost for hiring faculty and increasing funding for the instruction of the students, academic support, and student services. Two options were calculated to reflect the reality of hiring faculty. One option included adjunct faculty and one option included only full time faculty. In the short term, institutions hire adjunct faculty to accommodate enrollment growth. Adjunct faculty is generally paid less than full time faculty and generally do not receive employment benefits. Hence, the variable cost including adjunct faculty is less than the variable cost not including adjunct faculty.

The General Assembly's Decision

When the variable cost methodology was presented at budget hearings during the 2007 session, USM objected to the use of the methodology, citing a concern that the methodology would prevent USM institutions from attaining the funding guidelines. The funding guidelines are an indication of the institution's general fund support as compared to its peers. While DLS acknowledges and agrees that if the only increase in an institution's operating budget is the result of funding enrollment growth at the variable cost rate, then funding guidelines will not be attained. However, funding enrollment growth is only a small portion of the State's support for USM. Additionally, if State funds are being requested for enrollment, then the amount of funds provided for enrollment growth should be related to the actual cost of the additional students. Attainment of the funding guidelines is a separate policy decision and should be analyzed separately from the analysis of enrollment growth.

During the 2007 session, the General Assembly adopted the variable cost methodology by funding enrollment growth at the higher of the two options: the per student general fund rate not including adjunct faculty. The General Assembly also adopted budget bill language that required the five USM institutions to continue to grow by a total of 1,740 FTES in fiscal 2008 as originally planned.

USM has indicated that it will request State funding for enrollment growth in fiscal 2009 using its average general funds per FTES approach. In addition, USM may seek additional funds to supplement the "variable cost" funding rate applied to enrollment growth in fiscal 2008.

Higher Education

State Continues Access and Affordability Efforts

From fiscal 2002 to 2006, resident undergraduate tuition rates increased significantly at Maryland's public four-year institutions. In an effort to make postsecondary education affordable, the General Assembly passed legislation in 2006 and 2007 prohibiting public four-year institutions from increasing tuition rates in the 2006-2007 and 2007-2008 academic years. In addition, State need-based financial aid has increased in recent years, helping to mitigate the increasing costs of higher education.

Background

The most important factors students and families consider when determining whether they can afford to pay for postsecondary education are the tuition rate at the desired institution of higher education and the availability of financial aid to help students pay tuition and other higher education costs. From fiscal 2002 to 2006, in-state tuition rates at Maryland's four-year public institutions of higher education increased significantly, nearly 9 percent on average each year. During that time, *Measuring Up*, the national report card for higher education, published two reports noting the lack of low-priced college options available in Maryland.

State Takes Steps to Address Increasing Tuition Rates

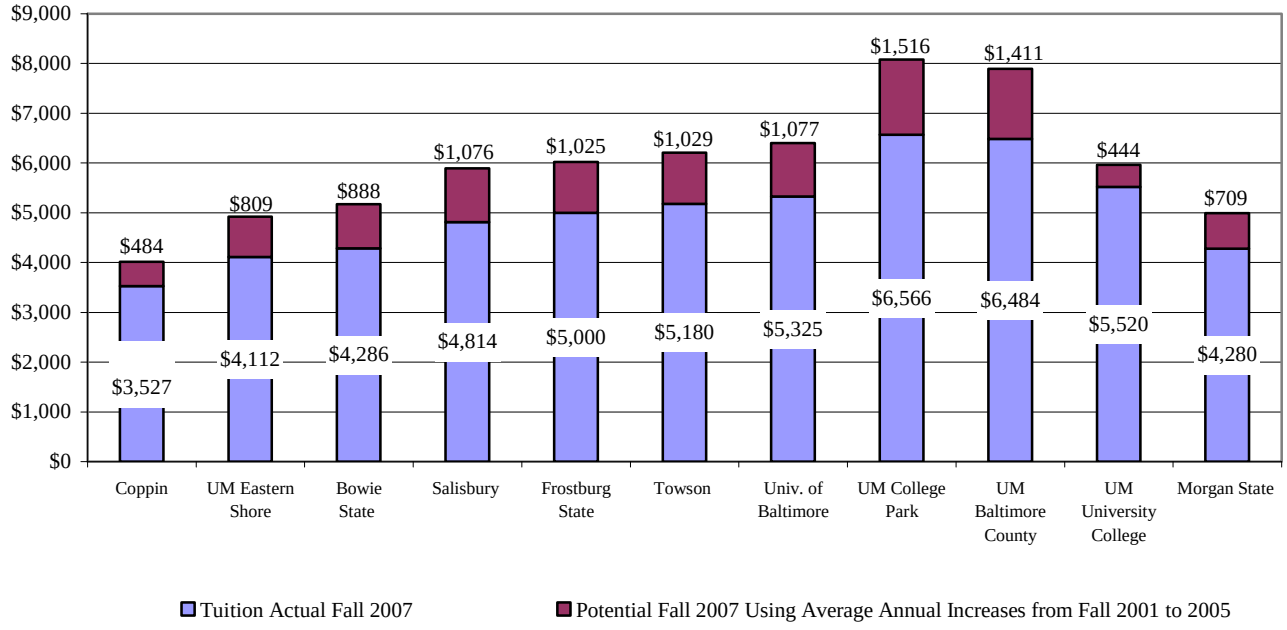
In response to the escalating cost of tuition from fall 2001 to 2005, the Tuition Affordability Act of 2006 (Chapters 57 and 58) was enacted to freeze tuition during the 2006-2007 academic year at fall 2005 rates for in-state undergraduates attending University System of Maryland (USM) institutions and Morgan State University (MSU). The Act also limited the fall 2006 resident tuition increase at St. Mary's College of Maryland (SMCM) to 4.8 percent. General funds were used to offset the loss of tuition revenues for USM, MSU and SMCM.

To continue the progress made in fiscal 2007, the Tuition Affordability Act of 2007 (Chapter 294) extended the freeze through the 2007-2008 academic year for USM institutions and MSU, and the fiscal 2008 budget included an additional $16.2 million in general funds to cover the loss of tuition revenue. Although SMCM was not a part of the fiscal 2008 tuition freeze, the college increased its tuition by 5.0 percent in the 2007-2008 academic year, which was fairly consistent with the increase in the previous school year of 4.8 percent.

To demonstrate the impact of the two-year inflation freeze, **Exhibit 1** shows the estimated tuition rate increase for USM institutions and MSU in fall 2007 if average annual percentage increases from fall 2001 to 2005 continued for two additional years. The exhibit suggests that tuition at the institutions would have been significantly higher, approximately 19

percent higher on average, if tuition rates had continued to increase at the pace set from fall 2001 to 2005. According to the Washington Higher Education Coordinating Board *Tuition and Fee Rates* report, despite the tuition freeze in fiscal 2007 (data for fiscal 2008 is not yet available), Maryland still ranked high nationally for resident undergraduate tuition and mandatory fee rates, and the State had not made significant progress toward improving its tuition rankings. In fiscal 2002, Maryland tuition rates ranked sixth-highest nationally for master comprehensive institutions and tenth-highest for the flagship university (University of Maryland, College Park). By fiscal 2007, the ranking for comprehensive institutions had moved up to fifth nationally, but dropped to fourteenth among flagship universities.

Exhibit 1
Potential Fall 2007 Increases in Public Four-year Tuition Rates



Source: University System of Maryland, Department of Legislative Services

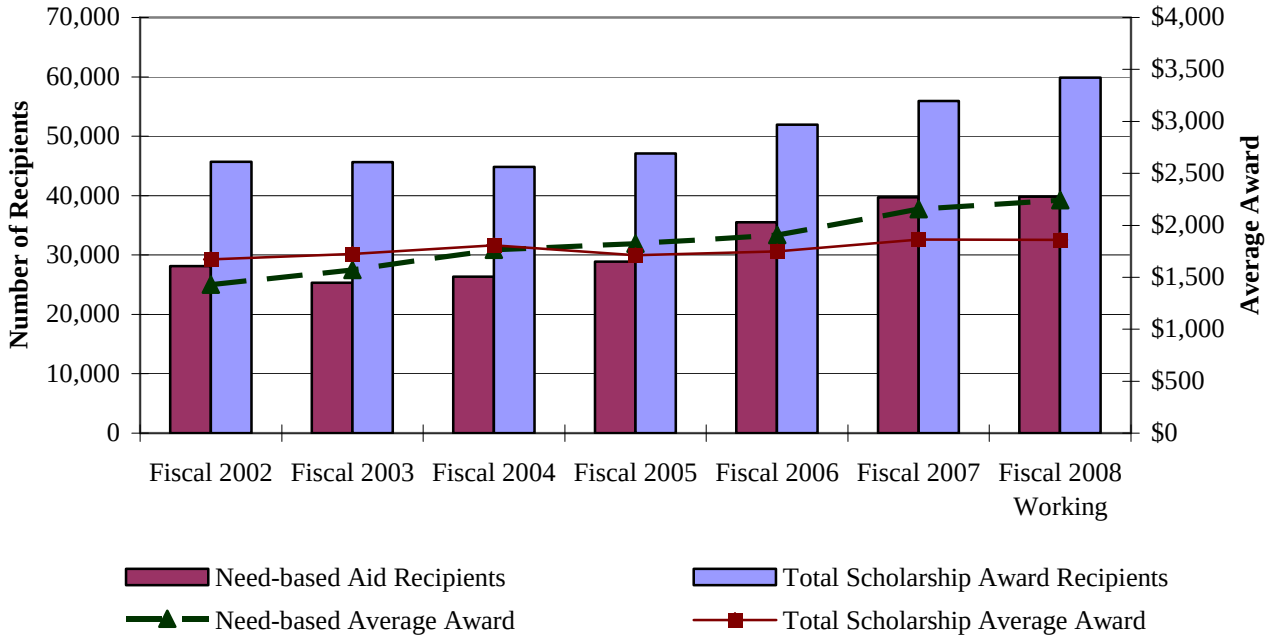
State Financial Aid

Another key variable impacting the affordability of Maryland's higher education institutions is the level of financial assistance awarded to students with financial need. There are several scholarships and grant programs offered by the State, and need-based aid in particular has been a high priority for Maryland in recent years with State funding for these programs realizing significant increases since fiscal 2004.

As shown in **Exhibit 2**, the average award for need-based aid has steadily increased since fiscal 2002, providing some relief from the tuition increases that occurred during this period. However, the number of recipients decreased from fiscal 2002 to 2003, before increasing slightly in fiscal 2004 and exceeding fiscal 2002 numbers in fiscal 2005. Many students were placed on a waiting list for need-based aid during these periods. With significant increases in need-based aid recipients in fiscal 2006 and 2007; however, there were no students on the wait list during these two years. This trend is similar for all scholarships, which includes merit-based, career, legislative, and unique populations.

Exhibit 2

State Aid Average Award Amount and Recipients



Source: Maryland Higher Education Commission

At a September meeting of the Commission to Develop the Maryland Model for Funding Higher Education, the Office for Student Financial Assistance made several recommendations to further improve the State's need-based aid programs, including an increase in the maximum award amount for the largest need-based program. The commission will submit a final report in 2008 including recommendations to improve access and affordability in higher education.

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Higher Education

Community Colleges Request Large Increase in State Capital Support

Community colleges are requesting more than double what the State is projecting to spend on capital projects. To better direct State dollars, the budget committees requested that community colleges prioritize projects. The community colleges submitted a prioritized list of capital projects as part of the fiscal 2009 budget request. Proposed capital projects are developed out of a need for space based on current and projected enrollment, as well as programmatic and other needs of a campus. On a per student basis, some smaller colleges show a space need on par with that of the largest colleges.

Community College Capital Request Outpaces State Funding

The capital request from community colleges has far outpaced how much the State has dedicated to the program in recent years. The fiscal 2009 request amounts to $135.2 million while the State has projected less than half of that amount, $60.0 million, in the 2007 *Capital Improvement Program* (CIP). Moreover, based on the current CIP, the next five years will see an average of $139.4 million in the community college capital request with the State's funding level expected to remain level. A new CIP will be presented by the Governor with the fiscal 2009 capital budget. In response to the capital request growth and the lack of prioritization among the community colleges, the 2007 *Joint Chairmen's Report* requested that the Maryland Association of Community Colleges (MACC) submit a combined request with capital projects ranked in priority order.

The prioritization method developed by MACC and submitted to the budget committees in August takes into account a number of factors and weights. A summary of the formula can be found in **Exhibit 1**. An additional weight is assigned to each project based on the college's priority and is added to the calculation resulting from the formula. Finally, projects are ranked in priority order based on their aggregate weight. However, a project in the completion stage (*i.e.*, equipment) is moved to the top of the list if it is the college's first priority.

Currently, the State's projected fiscal 2009 allocation of $60.0 million will cover only the first six projects requested. The seventh lifts the request to $64.5 million. To cover each school's top priority, $104.3 million is needed. The colleges and the budget committees are concerned that the growth in capital needs far outpaces the State's ability to fund them.

Exhibit 1
Community College Prioritization Formula

Factor	Description (and Weight Assignment)	Weight
Type of Project	Renovation (4), Utilities (3), New Construction (2), or Site Improvement (1)	10%
Phase of Project	Acquisition (1), Design (2), Design + (3), Construction (4), Completion (5), or Life Safety (6)	25%
Age of Facilities (Building/Campus)	Building age in years for renovations or average age of campus/college for new construction, utilities, or site improvement	5%
Facilities (Usage)	Academic/Instructional (3), Student Support (2), or Institutional Support (1)	10%
Facilities Capacity vs. Needs (current and future)	Academic/Instructional (3), Student Support (2), or Institutional Support (1)	40% (20% current, 20% future)
Five-year Funding History	The community college's proportion of total community college capital funding over the past five years.	10%
		100%

Source: Maryland Association of Community Colleges

Enrollment

Community colleges' capital requests are driven by space needs for students, as well as programmatic and other campus needs and the county's ability to provide its share of project costs. There is a great variance in size among Maryland's community colleges. Garrett is the smallest, with 394 full-time day equivalent (FTDE) students, and Montgomery is the largest at 10,517 in fiscal 2007, the most recent data available. FTDE enrollment measures the number of students on campus between 8:00 a.m. and 5:00 p.m. and is used by the State in determining space needs. **Exhibit 2** shows current and projected FTDE enrollment at the State's community colleges. The four largest colleges, Anne Arundel, Community College of Baltimore County (CCBC), Montgomery, and Prince George's, account for 60 percent of total community college FTDE enrollments. They are projected to remain the largest in fiscal 2017, teaching 58 percent of FTDE students.

Exhibit 2
Community College FTDE Enrollment
Fiscal 2007 Actual and 2017 Projected

College	Actual FY 2007	Projected FY 2017	% Change	% of Total FTDE (FY 2007)
Allegany	1,695	1,990	17.4%	3.5%
Anne Arundel	5,947	6,728	13.1	11.7
Baltimore City (BCCC)	2,268	2,852	25.7	5.0
Carroll	1,441	1,774	23.1	3.1
Community College of Baltimore County (CCBC)	7,650	8,349	9.1	14.5
Cecil	766	957	24.9	1.7
Chesapeake	939	957	1.9	1.7
College of Southern Maryland (CSM)	2,352	2,840	20.7	4.9
Frederick	1,766	2,028	14.8	3.5
Garrett	394	430	9.1	0.7
Hagerstown	1,518	1,922	26.6	3.3
Harford	2,413	2,835	17.5	4.9
Howard	2,944	3,727	26.6	6.5
Montgomery	10,517	11,722	11.5	20.4
Prince George's	5,740	6,865	19.6	11.9
Wor-Wic	1,162	1,618	39.2	2.8
Total	**49,512**	**57,594**	**16.3%**	**100.0%**

Source: Maryland Higher Education Commission

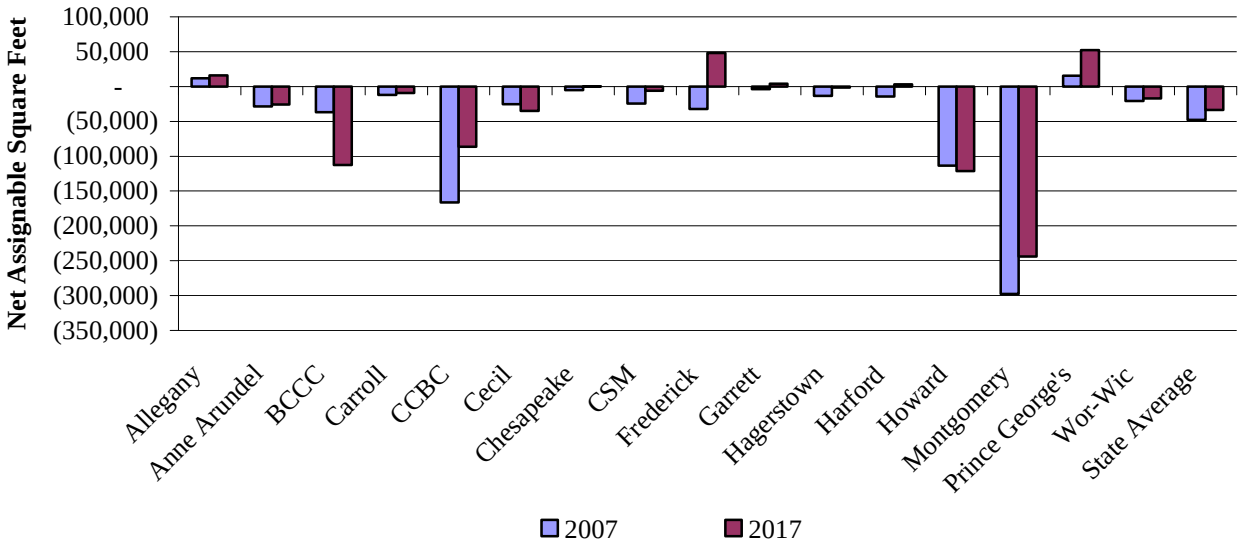
Space Needs at Community Colleges

The Maryland Higher Education Commission (MHEC) calculates the space needs of community colleges. The space guidelines are formula based and exclude students in noncredit courses, part-time programs, and nighttime classes. Taking into account the amount of time students spend in contact with teachers or weekly student contact hours (WSCH), the guidelines have different multipliers based on the type of course, how the space is being used, and the size of the school. WSCH are multiplied by the appropriate factor to get an estimate of space needed, or needed net assignable square feet (NASF), for each college.

The most recent data on current and projected needs in total classroom, laboratory, and office space are shown in **Exhibit 3**. While the majority of colleges have space deficits, two colleges, Allegany and Prince George's, currently have a surplus with six others projected to

have one in fiscal 2017. CCBC, Howard, and Montgomery, all large colleges, have space deficiencies of over 100,000 NASF, with Montgomery alone accounting for 220,621. In the fiscal 2017 projections, Montgomery remains the largest by far with a 243,900 NASF deficit. Looking specifically at classroom space needs, 10 of the 16 colleges currently have a surplus, and 13 are projected to have surplus classroom space in fiscal 2017.

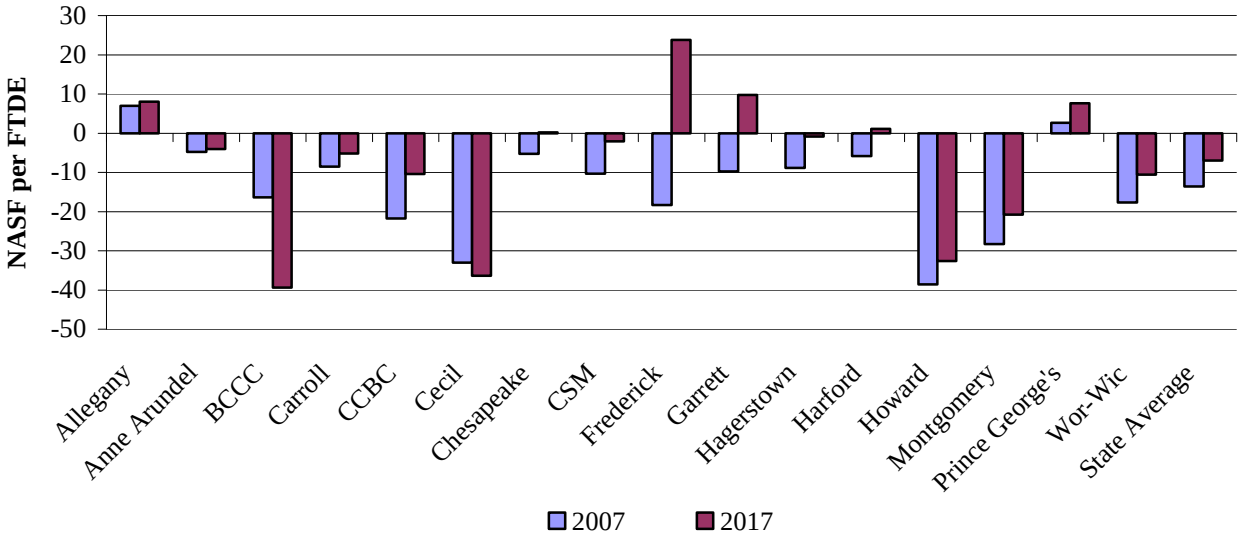
Exhibit 3
Community College Space Surplus/Deficiency
Fiscal 2007 Actual and 2017 Projected



Source: Maryland Higher Education Commission

In terms of total space needs, the largest colleges clearly have the greatest need. It may be useful to compare space needs on a per student basis, however. That is, how much space a college needs *per* FTDE. **Exhibit 4** shows the data presented in this manner. Although Montgomery has the largest total need, Howard's space need per FTDE exceeds that of Montgomery both currently and projected in fiscal 2017. Additionally, despite having lower enrollments, some of the smaller colleges have space needs on par with the larger colleges. Cecil, currently the State's second smallest community college, has a space need per FTDE that exceeds Montgomery's.

Exhibit 4
Community College Surplus/Deficiency NASF per FTDE
Fiscal 2007 Actual and 2017 Projected



Source: Maryland Higher Education Commission

Projections Depend on Fully Funded CIP

With a few exceptions, most colleges are projected to reduce space deficiencies and move closer to, or into, surpluses. These projections assume, however, that the community colleges' capital request is fully funded in the future. These projections are based on the colleges' master plans, including projects not yet proposed to the State. If State funding remains at $60.0 million per year and fewer projects are approved than proposed, space deficiencies will not reduce as quickly as projected and may even increase for some colleges if students enroll at community colleges in the numbers projected.

Workgroup Focusing on Community College Space Guidelines

Compared to other states, Maryland's guidelines for community colleges require more space per student, resulting in lower space efficiency. To investigate this matter, a workgroup was convened by MHEC in 2007 and has been meeting to recommend changes to the State's space guidelines. The workgroup has met several times to review the guidelines and consider revisions, but to date, recommendations have not been finalized. It is possible updated guidelines could show the State's community colleges have fewer space deficiencies than currently projected.

Higher Education

Nurse Support Program II Addresses Increasing Need for Nurses

To help alleviate a critical demand for bedside nurses, the State has established the Nurse Support Program II in an effort to increase nursing enrollment and faculty. In the first two rounds of grants under the new program, 16 institutional initiatives have been funded through the program. In addition, a statewide initiative is attempting to narrow the gap between the salaries of nurse faculty and practicing nurses.

Background

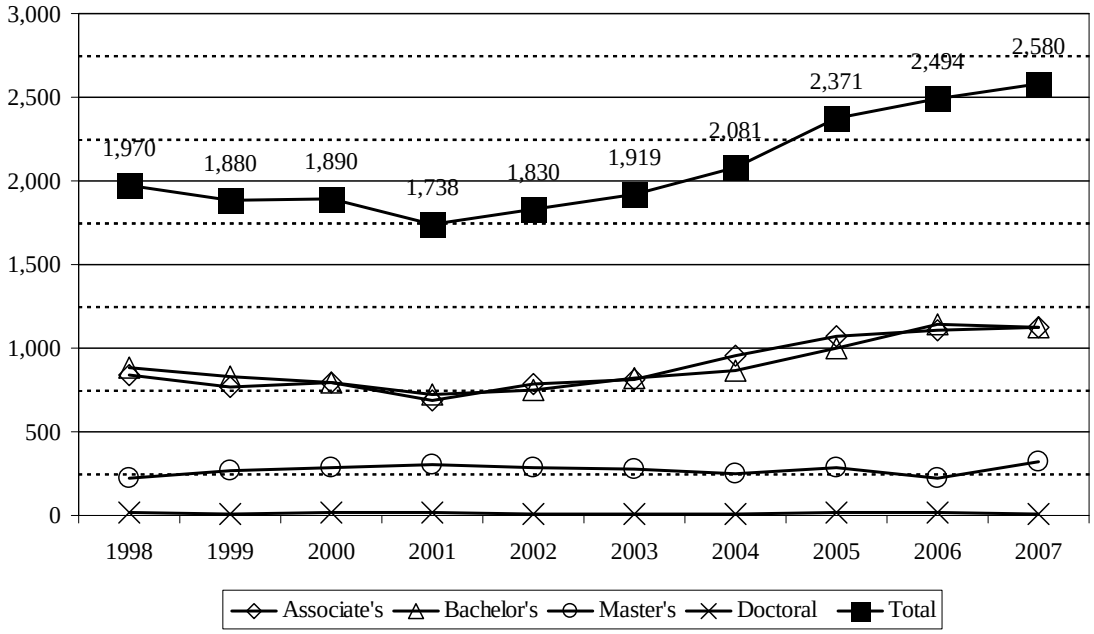
Like most states, Maryland is facing an increasing need for nurses. Maryland's institutions of higher education (IHEs) have been unable to keep up with the growing demand for nursing education and are admitting less than half of all qualified applicants. In fall 2005, 2,357 qualified applicants were not admitted to nursing programs, while 79 percent of the nursing programs in the State met or exceeded their enrollment capacity.

Despite the continued gap between the supply of and demand for nurses, IHEs have responded to the call for more nurses by steadily increasing the number of nursing students who have earned degrees since 2001. (See **Exhibit 1**.) However, the number of graduates from master's and doctoral level nursing programs has fluctuated over the last 10 years. This unstable trend in the awarding of graduate-level nursing degrees is particularly troubling because the scarcity of bedside nurses has been linked to the critical shortage of nursing faculty. If the pattern continues, it may impact the supply of nurse faculty and limit the ability of nursing programs to expand enrollment.

Nurse Support Program II

The Nurse Support Program II (NSP II) was established to increase the number of bedside nurses in Maryland hospitals and the nurse faculty necessary to train these nurses. NSP II is a 10-year program that annually will provide approximately $8.8 million to support nursing programs. Funding for NSP II is generated through a 0.1 percent increase in the rates at all hospitals in the State. The rate increase was adopted by the Maryland Health Services Cost Review Commission (HSCRC) and began July 1, 2005. The revenue collected from the rate increases will be used to award competitive institutional grants, implement statewide initiatives, and administer NSP II. Legislation enacted in 2006 (Chapter 221) created a nonlapsing special fund for program revenues so that funds can be carried forward and awarded in future years. In addition to establishing the fund, the legislation requires that a portion of the funds be used to attract minorities to nursing and nurse faculty careers in Maryland and to retain minorities working in this field.

Exhibit 1
Trends in the Number of Degrees Awarded at Maryland Institutions by Type of Degree



Source: Maryland Higher Education Commission

Competitive Institutional Grants Awarded

Competitive Institutional Grants are designed to increase the structural capacity of Maryland nursing schools through shared resources, innovative educational designs, and streamlined processes. In the first round of funding in fiscal 2007, seven projects were selected jointly by the Maryland Higher Education Commission (MHEC) and HSCRC to receive program funds. The programs were chosen because of their potential to address multiple aspects of the nursing shortage by accelerating the number of Associate Degree Nursing (ADN) graduates, increasing the pipeline of ADN to Bachelor of Science Nursing students, and creating pathways to nurse faculty positions through Master of Science Nursing and doctoral programs. Approved fiscal 2007 grant amounts total $6.2 million to be awarded over multiple years.

Twenty-three proposals were received for the fiscal 2008 NSP II Competitive Institutional Grants. MHEC and HSCRC staff reviewed the proposals based on the criteria set forth in the request for applications, the comparative outcomes of each initiative, the geographic distribution of programs, and the emphasis placed on attracting and retaining minorities in nursing and nurse faculty careers. Nine proposals were selected, including initiatives impacting the West, Central, and Eastern Shore regions of the State; initiatives addressing minority student

recruitment and retention; and initiatives encouraging more males to choose nursing as a career. The fiscal 2008 grant amounts total $5.9 million.

As shown in **Exhibit 2**, the Competitive Institutional Grant initiatives funded in the first two rounds are expected to increase nursing enrollments by more than 3,000 students. Of that number, approximately 690 would be eligible to serve as clinical instructors or full-time nursing faculty after completing master's and doctoral level programs.

Exhibit 2

Projected Additional Nursing Enrollments from Competitive Institutional Grant Initiatives

	Round 1 Grants	Round 2 Grants
Undergraduate Nursing Programs		
Associate's Degree Nursing	146	974
Registered Nurse – Bachelor of Science Nursing	298	425
Bachelor of Science Nursing	120	450
Subtotal	**564**	**1,849**
Graduate Nursing Programs		
Registered Nurse – Master of Science Nursing	0	71
Clinical Nurse Educator	0	14
Master of Science Nursing	220	80
Doctoral Science Nursing	125-184	125
Subtotal	**345-404**	**290**
Total	**909-968**	**2,139**

Source: Maryland Higher Education Commission

Nursing Faculty Fellowships Will Address Recruitment and Retention

Despite the gains expected from the Competitive Institutional Grants, salaries remain a barrier in recruiting and retaining nurse faculty. Data provided on master's prepared nurses in the 2004 National Sample Survey of Registered Nurses raises some concern about the competitiveness of nurse faculty salaries. Compared with other nurses who have the same educational credentials, master's prepared nurse faculty are paid 33 percent less than nurse anesthetists, 17 percent less than head nurses and nurse midwives, and approximately 12 percent less than nurse practitioners and clinical nurse specialists.

In an effort to address the issue of salary competitiveness, HSCRC set aside funding in NSP II for statewide initiatives, including new Nursing Faculty Fellowships. Individuals who are offered a full-time, long-term contract to serve as clinical track nursing faculty may be eligible to receive a maximum of $20,000 over three years, with $10,000 distributed the first year and $5,000 in each of the next two years, assuming continuous employment in good standing. Currently, 23 new Nursing Faculty Fellowships have been awarded at a cost of approximately $300,000.

Higher Education

The Office for Civil Rights Partnership and Maryland Higher Education Commission Program Review

Legislation has been introduced the past two years to change the academic program approval process for higher education. Approval of a joint master of Business Administration program by the Maryland Higher Education Commission (MHEC) over objections that the program was unnecessarily duplicative prompted the legislation. Differences in the bill considered in 2007 were not resolved, but spurred by the legislation, MHEC has convened a workgroup to review the program approval process, and recommendations are expected in Spring 2008. Meanwhile, as part of its charge related to funding historically black institutions (HBIs), a legislative executive commission is contracting for a study of the programs, facilities, and resources at the HBIs and traditionally white institutions (TWIs). The study is expected to be completed in Summer 2008.

Eliminating the Remnants of *de jure* Segregation in Higher Education

With the *Brown v. Board of Education* decision of 1954, the Supreme Court declared segregation in public education to be a violation of the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution. Although this decision spurred changes within primary and secondary education systems, it took another 15 years before any efforts at change took place within higher education systems.

Office for Civil Rights Partnership with Maryland

In 1969, the United States Office for Civil Rights (OCR) required Maryland, 1 of 10 states, to submit a plan for approval by OCR to address removing all vestiges of its formerly segregated system of higher education. OCR asserted that Maryland (and these other states) had a responsibility to "adopt measures necessary to overcome the effect of past segregation" and that it would not be enough "that an institution maintain a nondiscriminatory admissions policy if the student population continues to reflect the formerly *de jure* racial identification of that institution."

Over the course of the next 20 years, Maryland submitted and resubmitted various plans to OCR in order to enhance its public historically black institutions (HBIs), which are Bowie State University, Coppin State University, Morgan State University (MSU), and the University of Maryland Eastern Shore. In 1991, Maryland reported full or substantial compliance with all of the elements of its previous plans. Nearly 10 years passed before a response was received from OCR.

In December 2000, the State and OCR entered into a partnership agreement that included a commitment from the State to further enhance its four HBIs and to improve higher education opportunities for African American students. Although this partnership agreement expired on December 31, 2005, the State has not yet been released from its obligations under the agreement.

U.S. v. Fordice

In the meantime, in 1992, the Supreme Court decided *U.S. v. Fordice,*[1] a Mississippi lawsuit that had been initiated in 1975 relating to Mississippi's efforts at desegregating its formerly *de jure* system of segregation in higher education. The Supreme Court analyzed four areas of Mississippi's higher education system: admission standards; program duplication; institutional missions assignments; and continued operation (funding) of all eight public universities. In its decision, the Supreme Court specifically advised that if policies and practices were without "sound educational justification and can be practicably eliminated" then Mississippi has not satisfied its burden of proof relating to dismantling its prior system of segregation. However, the Supreme Court also advised that if policies and practices were traceable to a prior *de jure* system of segregation, these policies and practices could be maintained but only in very limited and narrow circumstances. The burden, in these instances, was on the state to prove that the educational goals could not have been accomplished through less segregative means.

MHEC Program Review

The Maryland Higher Education Commission (MHEC) is responsible for approving or disapproving new academic programs proposed by higher education institutions in the State. When a new academic program is proposed, MHEC and other institutions may object to the new program for several reasons, one of which is that the program would unreasonably duplicate an existing program. Additionally, MHEC must comply with federal laws regarding unnecessary duplication and may only allow for such if there is sound educational justification.[2] If the objection cannot be resolved, a final recommendation on implementation of the proposed program must be made by MHEC.

Joint Masters of Business Administration Program at Towson University and the University of Baltimore

A 2005 decision by the Secretary of Higher Education authorized Towson University, a traditionally white institution (TWI) to offer a joint Masters of Business Administration (MBA)

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[1] *United States v. Fordice*, 505 U.S. 717 (1991).

[2] "Unnecessary duplication" is a federal standard set forth in *United States v. Fordice*, 505 U.S. 717 (1992) that prohibits a traditionally white institution in close geographic proximity to an HBI from offering bachelor's level nonbasic liberal arts and sciences courses or master's and doctorate level courses that are broadly similar to courses already offered at an HBI unless there is a sound educational justification for the duplication.

program with the University of Baltimore (UB). This decision resulted in an appeal to the full commission by MSU, which has had an MBA program for over 30 years and, like Towson and UB, is located in the Baltimore area. MSU claimed that the new MBA program would unnecessarily duplicate its program and would lead to further segregation in Baltimore-area universities. In November 2005, MHEC members affirmed the Secretary's decision to allow Towson and UB to implement the new joint MBA program.

Towson reports that 391 students have enrolled in the joint MBA program since its inception. In its first year, 30 students identified Towson as their 'home' institution. However, because students take classes on both campuses and in order to clarify and emphasize the collaborative nature of the program, in its second and future years, students will no longer declare a home institution. The first graduates of the joint MBA program will be awarded degrees in the spring of 2008.

Responses and Reactions to the MHEC Decision

Judicial Remedies Sought

MSU maintains that it can pursue legal proceedings against the State in circuit court without authorizing legislation. However, the Attorney General's Office has advised that judicial review of MHEC's November 2005 decision is not permitted under current law.

On October 13, 2006, the Coalition for Equity and Excellence in Maryland Higher Education filed suit in Baltimore City against the State alleging, among other things, that the decision to allow the joint MBA program at Towson and UB violates federal law. Included among the charges was the claim that the joint MBA program at Towson and UB was an "unnecessary academic program duplication" of an existing program at MSU. The case was removed to federal court on October 23, 2006, but was closed, administratively, in January 2007. Despite being closed, the court authorized any plaintiffs to reopen the case at any time prior to December 31, 2007. No pleadings have been filed, but the coalition reports the intention to do so.

Legislative Remedies Sought

In response to the MHEC decision to allow the joint MBA program at Towson and UB to move forward, legislation was introduced during both the 2006 and 2007 sessions. The 2006 legislation would have enabled an institution directly affected by what is believed to be an unreasonably duplicative academic program to appeal a decision of MHEC to the circuit court; however, the bill was vetoed by the Governor. The 2007 legislation also would have provided an avenue of appeal to an aggrieved institution. The Senate version of the bill authorized judicial review in the circuit court of MHEC's decision regarding the joint MBA program at Towson and UB and all future MHEC decisions regarding unnecessary duplication. The House version of the

bill permitted MSU to file an appeal regarding the joint MBA program determination, which would set in motion a process of mediation and binding arbitration. If the parties were unable to resolve the dispute through mediation, the dispute would be submitted to binding arbitration and an arbitration panel consisting of three members chosen by the parties would resolve the dispute. The House version of the bill did not permit appeals of future MHEC determinations; however, the bill required MHEC to convene a workgroup to review the academic program approval process and make recommendations to the General Assembly regarding the program approval and appeal process prior to the 2008 session. The differences in the two versions of the bill were not resolved in time for final passage.

Recent Developments

On December 17, 2007, the Attorney General's Office issued an opinion regarding whether a State higher educational institution may sue another State higher educational institution in circuit court. The opinion holds that current law does not allow for this in the specific context of higher education, but that the General Assembly has authorized such a suit in other contexts (e.g., see Environment Article § 20-601 et seq. in which an enforcement action may be brought against a 'person', inclusive of governmental agencies, for the violation of certain environmental laws). Additionally, the opinion further addresses whether judicial review of a decision of MHEC may be sought. The opinion affirms previous advice from the Attorney General's Office that current law expressly denies judicial review of a commission decision regarding program duplication; however, the Constitution does not prohibit legislation that would grant the right for judicial review of a commission decision. Therefore, legislative action would be needed to permit higher education institutions to sue each other or to authorize judicial review of MHEC's decision.

MHEC Program Review Workgroup

Although legislation requiring MHEC to review the program approval process did not pass, MHEC still undertook this assignment during the interim of 2007. Workgroup members included two representatives from each segment of higher education: the University System of Maryland, MSU, St. Mary's College of Maryland, community colleges, independent institutions, and private career schools. The workgroup met numerous times and has been reviewing the criteria used and procedures followed when considering new academic programs. The workgroup anticipates finalizing its recommendations in late spring 2008.

Commission to Develop the Maryland Model for Funding Higher Education

As part of its charge relating to the funding of HBIs, the Commission to Develop the Maryland Model for Funding Higher Education (commission) included an examination of the programs, resources, and facilities at both TWIs and HBIs in its Request for Proposals (RFP) from contractors with expertise in HBIs. Unfortunately, when the RFP was released, no bids were received. The commission is currently pursuing other options to partner with organizations

that have HBI expertise, but no plans have been finalized yet. However, the study is scheduled to be completed in summer 2008. For more information, see the issue paper on the commission on page 79.

Health and Health Insurance

Medicaid Enrollment and Expenditure Trends

Medicaid continues to be a major consumer of general fund revenues and one of the fastest growing segments of the State budget. In fiscal 2008, there is an anticipated deficiency of $18.5 million in the Medical Assistance programs. Expenditure growth in fiscal 2009 is anticipated to be almost 10 percent.

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 15.0 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 7.6 percent annually while general fund revenues are forecast to grow at a rate of 5.4 percent.

Fiscal 2008 Outlook

The fiscal 2008 Medical Assistance budget of $4.8 billion ($2.2 billion of general funds) appears to be $30.2 million ($18.5 million in general funds) less than the anticipated need. The need for additional fiscal 2008 funding is attributed to:

- a 4.4 percent calendar 2008 managed care rate increase ($19.8 million of general funds);

- inpatient hospital costs for fee-for-service enrollees in fiscal 2007 increasing significantly higher than originally assumed in fiscal 2007. This was a function of both the cost and utilization of inpatient services. Based on the actual experience of inpatient costs in fiscal 2007, fiscal 2008 inpatient expenditures are estimated to increase by $14.1 million in general funds;

- the Temporary Cash Assistance (TCA) caseload is anticipated to remain level from fiscal 2007 to 2008, whereas it had been assumed that the TCA caseload would decrease 5 percent as it has in recent years. The most recent actual data for TCA enrollment indicates a leveling off of the downward trend in enrollment. Also, economic forecasts for Maryland are predicting a slowdown, which usually indicates that TCA enrollment will increase; and

- the budget reductions approved by the Board of Public Works removed $9.3 million in special funds from the Medicaid budget. It is expected these funds will need to be replaced with general funds.

These increased costs were somewhat offset by the impact of the federal requirement for citizenship documentation and lower than anticipated enrollment in the Primary Adult Care, Employed Individuals with Disabilities, and the Medicare Premium Assistance Programs.

Fiscal 2009 Forecast

As shown in **Exhibit 1**, for fiscal 2009, Medical Assistance expenditures of just over $5.3 billion are anticipated of which almost half will be general funds. Overall costs will increase by 9.8 percent. General fund spending is expected to grow by about $238.9 million, or 10.7 percent, over projected fiscal 2008 costs. Factors contributing to the anticipated expenditure growth include enrollment increases of almost 2.7 percent and changes in medical inflation/utilization (5.0 percent). Enrollment growth is spurred by a continued rise in the number of children qualifying for MCHP and the enrollment for TCA remaining level rather than decreasing. The forecast also assumes the State will:

- ***End Hospital Day Limits:*** Medicaid regulations currently limit the number of days of hospital coverage for adults to 120 percent of the average length of stay by diagnosis related groups. When the day limits were first implemented in fiscal 2004, they were scheduled to sunset at the close of fiscal 2005. While the target savings from day limits has been reduced since fiscal 2005, the limits have not been eliminated. The fiscal 2008 allowance included funding to end hospital day limits, but cost containment measures continued hospital day limits through fiscal 2008. Since pressure has been mounting to end day limits, the fiscal 2009 Department of Legislative Services' forecast assumes the inclusion of $61.4 million ($30.7 million in general funds) to end day limits in the Medicaid budget.

- ***Exhaust MCHP Dollars:*** The State will exhaust all available federal block grant dollars for MCHP before the close of the fiscal year. Coverage will continue, but the level of federal match will fall. Dropping the federal match from 65 to 50 percent for part of the year is expected to increase general fund expenses by $23.9 million.

- ***Enhance Physician Rates ($31.7 Million Increase):*** Chapter 5 of the 2004 special session and Chapter 1 of 2005 earmark an increasing portion of the revenue from the Health Maintenance Organization premium tax to raising Medicaid physician rates. In fiscal 2008, the Medical Assistance Program will spend about $130 million ($65 million in special funds from the premium tax) to raise physician rates and reimburse Medicaid Managed Care Organizations for their tax payments; this amount will increase to $150 million in fiscal 2009.

Exhibit 1
Medicaid Enrollment and Service Year Expenditures*

	FY 2007 Actual	FY 2008 Estimate	FY 2009 Estimate	FY 07-08% Change
Enrollment by Category				
Medicaid	519,688	528,243	541,486	2.51%
MCHP	105,935	113,175	117,348	3.69%
Total	**625,623**	**641,418**	**658,834**	**2.72%**
Cost Per Enrollee	**$7,396**	**$7,573**	**$8,092**	**6.85%**
Total Funds ($ in Millions)	**$4,627**	**$4,857**	**$5,331**	**9.76%**

*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 associated with the Maryland Primary Adult Care Program and the Kidney Disease Program are excluded from the chart.

Source: Department of Legislative Services

Health and Health Insurance

Expanding Access to Health Care Coverage

As the rate of employer-based health insurance continues to decline in the State and nationwide, policymakers continue to look for ways to expand access to health care coverage. In November 2007, the General Assembly passed a health expansion bill that provides increased eligibility for Medicaid and a subsidy program for very small businesses.

Health Care Coverage Trends in the United States and in Maryland

According to U.S. Census Bureau estimates released in August 2007, the number of people in the country without health insurance increased from 44.8 million (15.3 percent of the population) in 2005 to 47.0 million (15.8 percent) in 2006. A reduction in employment-based health insurance was a key factor in the growing problem of uninsurance.

While Maryland has a lower percentage of people without health insurance than the nation as a whole, the trend is similar. Marylanders without health insurance increased from an average of 677,000 (12.5 percent of the population) in 2001-2003 to 755,000 (13.5 percent) in 2004-2006. Over time, Maryland, like the country as a whole, has experienced declining employment-based health insurance. Employment-based coverage declined from 71.0 percent of the State's population in 2001-2003 to 67.8 percent in 2004-2006.

As in most other states, large employers in Maryland typically offer health insurance to their employees. Small firms, however, are a different story. In 2005, only 51.0 percent of Maryland firms with fewer than 50 employees offered health insurance according to the federal Medical Expenditure Panel Survey. In Maryland firms with fewer than 10 employees, only 42.2 percent of firms offered insurance. The Maryland Health Care Commission's (MHCC) report on carrier experience in the small group health insurance market for 2006 shows continuing stagnation in the market. The number of employers offering health insurance and the number of covered lives have fallen more than 10.0 percent below the peak levels of the late 1990s. The average premium rose between 7.0 and 9.0 percent for an employee-only plan, while the average premium rose between 8.0 and 16.0 percent for a family plan.

In comparison to other states, Kaiser Family Foundation data show that a relatively small percentage of Marylanders receive their health care coverage from Medicaid. Nine percent of the Maryland population, including 20 percent of children and 5 percent of adults, are covered by Medicaid. Only five states have a lower overall Medicaid percentage, and only four states have a lower Medicaid percentage for adults. Maryland's high per capita income partially explains the low overall Medicaid coverage percentage, but Maryland's financial eligibility standard for adults applying for Medicaid has been among the most stringent in the country. An adult with dependent children had to have income below about 42 percent of the federal poverty level

(about $7,000 for a family of three) to qualify. A childless adult is ineligible for Medicaid, unless he or she qualifies as a result of disability or age.

Recent Developments Across the Country

Developments in Other States

Several states, including Massachusetts, Vermont, Maine, Montana, and Washington, have taken action to expand health care coverage, primarily through Medicaid expansions and subsidies for small employers and the working poor. California, Illinois, and Colorado have proposed legislation or established blue-ribbon commissions to significantly expand coverage.

Implementation of Health Care Expansion in Massachusetts

In 2006, Massachusetts enacted legislation with the intent of providing near-universal access to health care coverage to Massachusetts residents through a variety of private and public insurance market reforms. The legislation created a mandate on individuals to purchase insurance and a mandate on employers to purchase health insurance for their employees. The legislation also expanded MassHealth, the Massachusetts Medicaid program, and created a program called Commonwealth Care that offers free and subsidized private health coverage for low-income Massachusetts residents who are not eligible for MassHealth. The legislation also created Commonwealth Choice, a central location for individuals and small employers to purchase private health insurance plans. The Commonwealth Connector (Connector) was created to administer many aspects of the new programs created by the legislation.

The Massachusetts law expands MassHealth for children up to 300 percent of the federal poverty level (FPL) and lifted enrollment caps for adults. As of March 2007, MassHealth enrollment had increased by 53,000 enrollees.

Massachusetts opened Commonwealth Care in October 2006 to individuals with incomes below 100 percent of FPL and in January 2007 to individuals with incomes below 300 percent of FPL. People with incomes below 150 percent of FPL pay no premiums or deductibles and limited co-pays. Adults with incomes between 150 and 300 percent of FPL pay premiums on a sliding scale, currently between $35 and $105 per month for each adult enrolled. They also must pay co-pays for services. As of November 1, 2007, 132,919 people were enrolled in Commonwealth Care. Of these enrollees, 28,349 people were responsible for paying premiums for their health plan.

In March 2007, the Connector selected six private insurers to offer three tiers of plans through Commonwealth Choice. The three tiers vary in premiums and cost-sharing. Premiums also vary depending on the enrollee's age and location. Commonwealth Choice opened enrollment in May 2007 for coverage beginning on July 1, 2007. As of November 1, 2007,

10,199 people had enrolled in private health insurance plans through Commonwealth Choice. Of these enrollees, 7,592 were subscribers and 2,599 were dependents.

The mandate on individuals in Massachusetts to purchase health insurance took affect on July 1, 2007; however, because residents are not required to show proof of their health insurance until filing their 2007 tax returns, Massachusetts residents effectively have until the end of 2007 to purchase health insurance. An estimated 60,000 individuals may be exempt from the mandate if they cannot obtain coverage in their region of residence that is affordable, as defined by the Connector.

Massachusetts has budgeted $1.752 billion for the health expansion in fiscal 2008, including $338 million in state general funds. Other funding for the expansion comes from federal matching funds, cost-sharing, and fees.

Developments in Maryland

2007 Regular Session

Several bills introduced during the 2007 regular session aimed to expand Medicaid or private health insurance coverage. Two health care expansion bills, Senate Bill 149 and House Bill 754, each died in the opposite house. However, House Bill 1057 (Chapter 639 of 2007) was ultimately enacted thereby extending health insurance coverage on a parent's policy for adult dependent children up to age 25.

Howard County

Not willing to wait for the State or federal government to act, Howard County has announced its own plan to provide health care to 2,000 uninsured residents. The plan will offer primary care services, discount prescriptions, and hospital care to participants for a monthly fee of $50 or $85, based on income, and a $10 payment per prescription. The plan will get underway in July 2008. It is expected to cost $500,000 in local funds in its first year, with an additional $700,000 coming from private donations and $1.6 million coming from fees paid by plan participants.

2007 Special Session

Maryland is receiving support from the State Coverage Initiatives (SCI) program for State-level planning to expand coverage. Funded by the Robert Wood Johnson Foundation, the SCI has included Maryland among 14 states receiving technical assistance for health expansion planning efforts. A three-day meeting sponsored by SCI in September 2007 and attended by representatives of the Administration and the chairs of the health committees of the General Assembly, produced consensus among the attendees on an overall strategy for expanding health

care coverage in the State. The strategy was incorporated in Senate Bill 6/House Bill 6 of the 2007 special session. Senate Bill 6, passed by the General Assembly on November 19, 2007, and signed into law by the Governor, expands access to health care in the following ways:

- expands Medicaid eligibility to parents and caretaker relatives with household income up to 116 percent of FPL;
- incrementally expands Medicaid benefits over five years to childless adults with household income up to 116 percent of FPL; and
- establishes a Small Employer Health Insurance Premium Subsidy Program (Subsidy Program), administered by MHCC, in consultation with the Department of Health and Mental Hygiene.

The subsidy program subsidizes insurance premiums for small employers and the employees of small employers that have not offered health insurance for at least 12 consecutive months. To be eligible for a subsidy, a small employer must (1) have from two to nine full-time employees; (2) meet salary and wage requirements determined by MHCC; (3) establish a certain payroll deduction plan; (4) agree to offer a wellness benefit as required by MHCC; and (5) meet any other requirements established by MHCC.

The expanded coverage is funded through a combination of general funds, one-time surplus funds from the Maryland Health Insurance Plan, redeployed savings in hospital uncompensated care, and federal matching funds. The estimated impact on the State's general fund is $39 million in fiscal 2009, increasing as the plan is incrementally expanded to $275 million in fiscal 2013.

Future Health Care Expansion Efforts in Maryland

As a result of either legislation or legislative request, MHCC and other agencies are studying a variety of options for expanding coverage and containing health insurance costs. Reports are due to the General Assembly before the 2008 session on:

- mandating individuals to obtain health insurance;
- establishing a health insurance exchange;
- reducing the high rate of uninsurance among young adults;
- reforming the standard benefit plan in the small group insurance market;
- determining the appropriate role of the three health regulatory commissions with regard to uncompensated care; and
- managing chronic care and promoting wellness.

The findings and recommendations of these studies could frame the discussion for any future expansion of health care coverage in the State.

Health and Health Insurance

Prince George's County Health System

After the failure to secure a permanent financing plan to reinvigorate the Prince George's County Health System in the 2007 session, the 2007 special session provides another opportunity to resolve the problems surrounding this hospital.

Background

The Prince George's County Health System consists of a number of parts: Prince George's Hospital Center, a 269-bed acute-care hospital and regional referral center; Laurel Regional Hospital, a 138-bed acute-care community hospital; the Gladys Spellman Specialty Hospital and Nursing Center, a 110-bed comprehensive care and chronic care facility; the Bowie Health Center, a deregulated ambulatory surgery center and rate regulated emergency care facility; and Dimensions Surgery Center. These facilities are owned by Prince George's County but operated by Dimensions Healthcare System, Inc. Dimensions has a lease agreement with the county through 2042.

In recent years, the system has struggled financially primarily due to losses at the Prince George's Hospital Center. Most of these losses are attributed to the fact that 50 percent of the patient mix at Prince George's Hospital Center is uninsured or covered by Medicaid.

Recent State Support

As shown in **Exhibit 1**, in recent years the State has provided significant operating and capital support for the hospital system. In most cases, State support was tied to an even greater level of support from Prince George's County. In addition to the direct State funding shown in Exhibit 1, the system received hospital rate support that added $10 million in revenues over the same period.

However, despite this government support, the system's finances remain parlous. As noted in its 2006 audited financial statements, Dimension's "reliance on government and other grant funding to support its operations, its substantial capital needs, significant unfunded pension obligations, limited cash resources, and its continued net asset deficiency raise substantial doubt about its ability to continue as a going concern."

Exhibit 1
Prince George's County Health System – State Support
Fiscal 2003-2007
($ in Millions)

Fiscal Year	State Support		County Support Tied to State Support
	Operating	**Capital**	
2003	$2.0		$3.0
2004			
2005		$4.3	20.0 over four years
2006	1.3	5.0	
2007	10.0	4.0	15.0
Total	**$13.3**	**$13.3**	**$38.0**

Source: February 20, 2004 Memorandum of Understanding between the State of Maryland and Prince George's County; Department of Health and Mental Hygiene; Department of Legislative Services

House Bill 510 of the 2007 Session

In order to secure the long-term future of the system, House Bill 510 of the 2007 session, among other things, would have established a Prince George's Hospital Authority as a State entity to develop a long-term strategy for delivering hospital services and related health care in the county. During deliberations on the bill, it was estimated that the combined fiscal 2007 to 2014 operating and capital support needed to stabilize and transform the system (including the building of a new hospital to replace Prince George's Hospital) totaled some $375 million. As part of the final deliberations on the bill, the State offered to provide almost $14 million in immediate operating support, $85 million in capital support, and rate support of just over $56 million.

However, all of the State's financial support was contingent on the enactment of House Bill 510 or other legislation establishing the appropriate oversight structure. Indeed, $20 million was appropriated to the Dedicated Purpose Account (DPA) in the fiscal 2008 budget to provide immediate support to Prince George's Hospital if that legislation was successful. If not, the budget provided that this funding was to be used to ensure the orderly closure of Prince George's Hospital. Ultimately no agreement could be reached on House Bill 510 leaving the $20 million in the DPA for the closure of the facility.

House Bill 1 and Senate Bill 6 of the 2007 Special Session

During the 2007 special session, unsurprisingly, the status of the system re-emerged. The system's cash position remains weak and could weaken further depending on the success of the system's efforts to negotiate with the Internal Revenue Service concerning pension payments. Patient volumes have fallen and recruitment and retention of employees is increasingly difficult given the uncertain future of the system. Although the system is back-filling with agency employees, this is an expensive solution and creates inefficiencies.

House Bill 38 introduced in the 2007 special session put the hospital authority concept back on the table. However, this bill was not heard during the special session. Instead, language was included in House Bill 1, the Budget Reconciliation Act, authorizing the Governor to transfer the $20 million still available in the DPA to the Department of Health and Mental Hygiene (DHMH). DHMH would in turn provide a grant to an independent entity with authority over the system until the facilities in the system and the obligation to provide the services currently provided by the system are transferred to a new owner or operator. However, the grant cannot be made until a long-term comprehensive solution to the system's problems is reached either through legislation or a memorandum of understanding between the State and Prince George's County.

The language also requires that the comprehensive solution must address issues concerning transfer of ownership and maintaining current service obligations; a plan for the system's current assets; a mechanism for a steady revenue stream to meet operating needs, debt support, and pension obligations; and a mechanism to ensure equitable and sustainable funding from the county and the State.

Similar language was added to Senate Bill 6 providing the same contingency to proposed grants of $10 million in each of fiscal 2011, 2012, and 2013, for a total State commitment from fiscal 2008 to 2013 of $50 million.

Conclusion

Actions taken in the 2007 special session have provided both an opportunity and framework for the development of a long-term solution to the financial problems of the Prince George's County Health System. However, there is still much that needs to be done to effectuate that solution, and until that solution is in place, the system will likely continue to limp along from one financial crisis to the next.

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Health and Health Insurance

State Children's Health Insurance Program Reauthorization

Stalled efforts to reauthorize the State Children's Health Insurance Program (SCHIP) threaten federal funding for the Maryland Children's Health Program, while federal policy changes impose new burdens on Maryland to continue covering children with family incomes above 250 percent of the federal poverty guidelines (FPG).

Background

The State Children's Health Insurance Program was established in 1997 to help states initiate and expand health insurance coverage to children. Since 1998, the State has received an annual federal block grant to support the Maryland Children's Health Program (MCHP). The State may claim federal block grant dollars to cover 65 percent of MCHP costs.

MCHP offers comprehensive health care coverage to low-income children under the age of 19 with family incomes that exceed the standard for Medicaid but are at or below 300 percent of the FPG. (See **Exhibit 1.**) Families with incomes above 200 percent of the FPG are enrolled in the MCHP Premium Plan and are required to pay a monthly family contribution of $42 to $53 depending on income. Health care coverage for MCHP enrollees is provided through HealthChoice managed care organizations. More than 100,000 children are enrolled in MCHP.

Exhibit 1
2007 Federal Poverty Guidelines

Family Size	200% FPG	250% FPG	300% FPG
1	$20,420	$25,525	$30,630
2	$27,380	$34,225	$41,070
3	$34,340	$42,925	$51,510
4	$41,300	$51,625	$61,950

Source: *Federal Register*, Vol. 72, No. 15, Wednesday, January 24, 2007

Congressional Reauthorization Efforts

Federal fiscal 2007, which ended September 30, 2007, was the final year of SCHIP's initial 10-year authorization period. Accordingly, the program must be reauthorized for funding to continue. To date, congressional efforts to reauthorize SCHIP have failed. The Children's Health Insurance Program Reauthorization Act of 2007 (CHIPRA) passed Congress but was vetoed by the President. A veto override was unsuccessful. A revised SCHIP reauthorization bill was subsequently introduced (H.R. 3963); however, the bill did not pass with a veto-proof majority and President George W. Bush has expressed his intent to veto the bill. Summaries of the two bills are provided below.

Children's Health Insurance Program Reauthorization Act of 2007

CHIPRA would have increased federal funding over the next five years from the current allotment of $25.0 billion to $61.4 billion financed by a 61-cent increase in the federal tobacco tax. The Act also would have (1) provided a new formula for distributing SCHIP funds among states based on a state's projected need for funds; (2) shortened the length of time states have to spend their allotment of funds from three to two years; (3) provided incentive bonuses for states to encourage enrollment in SCHIP and Medicaid; (4) established a contingency fund to provide states with supplemental funds when they face an SCHIP funding shortfall; (5) simplified enrollment procedures relating to citizenship documentation; (6) set aside $100 million for outreach; and (7) prohibited approval of state waivers to cover parents or childless adults with SCHIP funds while providing a transition period for states with existing waivers.

President Bush indicated that he vetoed the bill for three reasons. First, the reauthorization was too expansive and allowed for coverage of children in families far beyond the target population of 200 percent of the FPG. Second, some research indicated that one out of every three children moving into SCHIP would be "crowd-out" enrollees, *i.e.*, enrollees who dropped existing private coverage in favor of public coverage. Finally, the proposed funding source, an increased federal tobacco tax, was unstable, and the contingency fund threatened the fundamental structure of SCHIP as a grant program providing capped allotments versus an entitlement program.

H.R. 3963: A Revised CHIPRA

In late October, Congress considered a revised version of CHIPRA, H.R. 3963. This legislation is also funded by an increase in the federal tobacco tax but differs from CHIPRA in four major ways. First, the bill focuses coverage on the lowest income children by prohibiting SCHIP coverage above 300 percent of the FPG and targeting financial incentives for increasing enrollment to children eligible for Medicaid. Second, the bill clarifies and strengthens the citizenship documentation requirement for SCHIP-eligible children. Third, the bill prohibits coverage of childless adults under SCHIP by the end of 2008 (nine months earlier than CHIPRA). Finally, the bill includes additional measures to reduce "crowd-out," such as

adopting best practices to limit substitution of coverage and encouraging states to adopt premium assistance options.

Under H.R. 3963, Maryland would receive approximately $178.8 million in federal SCHIP funding, as well as an additional $7.3 million in redistributed unspent funds from other states, for a total allotment of $186.1 million. This allotment would allow Maryland to cover an additional 20,000 children under MCHP.

Continuing Resolution Extends SCHIP Temporarily

In the absence of permanent reauthorization, SCHIP will continue through December 14, 2007, under a continuing resolution (H.J. Resolution 52). The continuing resolution provides states with SCHIP funding at federal fiscal 2007 levels. Under the continuing resolution, Maryland will receive $72.4 million in federal SCHIP funding for federal fiscal 2008, which began October 1, 2007. This allotment is $90.0 million below estimated federal spending on MCHP of $162.4 million.

If no new federal funds are invested in the program through reauthorization efforts, Maryland will exhaust its federal SCHIP allotment by March 2008, and the 65 percent federal SCHIP matching rate will no longer be available. Maryland will have to use the Medicaid matching rate of 50 percent federal funds/50 percent general funds for remaining MCHP expenditures, at an increased cost to the general fund of $12.2 million in fiscal 2008 and $23.0 million in fiscal 2009.

New Requirements on States to Cover Children Over 250 Percent of the FPG

While stalled reauthorization efforts threaten the availability of federal funds, recent policy changes by the federal Centers for Medicare & Medicaid Services (CMS) may threaten states', including Maryland's, ability to continue covering children with family incomes over 250 percent of the FPG.

On August 17, 2007, CMS sent a letter to state health officials imposing new requirements on states that cover or wish to cover children with family incomes above 250 percent of the FPG. Under these new guidelines, states must enroll at least 95 percent of children in the state below 200 percent of the FPG who are eligible for Medicaid or SCHIP, prove that the number of children insured through private employers has not decreased by more than 2 percent over the prior five-year period, and adopt five specific crowd-out strategies: (1) waiting periods of at least one year between dropping private coverage and enrollment; (2) cost sharing that, compared to the cost sharing required by competing private plans, is not more favorable to the public plan by more than 1 percent of family income; (3) monitoring health insurance status at the time of application, including coverage available through a noncustodial parent; (4) verifying family insurance status through insurance databases; and (5) preventing

employers from changing dependent coverage policies that would favor a shift to public coverage. States must amend their SCHIP state plan or Section 1115 demonstration waiver in accordance with these policies within 12 months or CMS may pursue corrective action.

According to the Department of Health and Mental Hygiene, these rules will prevent Maryland from continuing to cover children with family incomes over 250 percent of the FPG. There are currently approximately 3,700 children in MCHP with family incomes between 250 percent and 300 percent of the FPG. The State is participating in legal action to prevent CMS from implementing these rules.

Health and Health Insurance

Access to Dental Care

In 2007 attention was brought to the issue of dental access because a 12-year-old Prince George's County child died from the results of an untreated tooth infection. Since then, the General Assembly adopted the Oral Health Safety Net Program, and the Department of Health and Mental Hygiene established the Dental Action Committee.

Background

Under Maryland's Medicaid coverage, children through the age of 20 and pregnant women receive a comprehensive oral health benefit including preventative care, but adult dental services are not covered. Managed care organizations (MCOs) are not reimbursed for providing an adult dental benefit, although all seven of the MCOs offer basic oral health services to adults.

However, the issue of dental access came to the forefront in Maryland in 2007 with the untimely death of a 12-year-old Prince George's County child who had an untreated tooth infection that spread to his brain. At the time the child fell ill, the child's Medicaid coverage had lapsed. Nonetheless, when covered by Medicaid, the mother said it took her seven months to obtain dental treatment for another child that appeared to have more serious dental problems.

Concern over dental access in Maryland is not new. Nor is the problem isolated to the Medicaid population. For example, the *2000-2001 Survey of the Oral Health Status of Maryland School Children* conducted by the Department of Pediatric Dentistry, University of Maryland, Baltimore College of Dental Surgery, and the Department of Health and Mental Hygiene's (DHMH) Office of Oral Health, found that:

- 42 percent of all Maryland children (kindergarten, 3rd, 9th, and 10th grades) had untreated decay; and

- 53 percent of Maryland children in kindergarten and 3rd grade had untreated decay in their primary teeth.

In response to the tragic death of the 12-year-old youth, numerous actions were taken to address the issue of dental access in Maryland. First, during the 2007 regular session, the General Assembly passed a bill establishing the Oral Health Safety Net Program. Then, over the summer, DHMH formed a Dental Action Committee (DAC).

Oral Health Safety Net Program

The Oral Health Safety Net Program will be administered by DHMH's Office of Oral Health. The program will award grants to local health departments, federally qualified health centers, and entities providing dental services within State facilities to increase dental provider capacity for the underserved. Priority is to be given to grant proposals that are targeted to regions of the State where oral health services are most scarce for low-income, disabled, and Medicaid populations. The program will provide $1.2 million in grants annually from fiscal 2009 through 2011. The program is set to terminate on September 30, 2011.

To evaluate the effectiveness of the program, the Office of Oral Health is directed to conduct annual evaluations of the program and submit an annual report to the Governor and the General Assembly on the results of the evaluation. Also, at the end of the program, DHMH is to conduct a statewide follow-up survey concerning the oral health status of school children in the State.

In addition to administering the grants, the Office of Oral Health is directed to contract with a licensed dentist to provide expertise in dental public health issues for the office. Also, the Office of Oral Health should provide appropriate continuing education courses for providers that offer oral health treatments to underserved populations.

Dental Action Committee

DAC consists of a broad-based group of stakeholders concerned about children's access to oral health services. The committee was charged with developing recommendations in four targeted areas: (1) Medicaid reimbursements and alternative models; (2) public health strategies; (3) oral health education and outreach to parents and caregivers; and (4) provider participation, capacity, and scope of practice. The primary needs identified by DAC are more dental providers in the State, more dental treatment services, and more targeted case management.

The committee came up with seven main recommendations in the four targeted areas.

Medicaid Reimbursements and Alternative Models

The committee identified low provider participation as the main barrier to comprehensive oral health services for Medicaid enrollees. It is assumed that this is due to low reimbursement rates, missed appointments, and lack of awareness among enrollees about the benefits of basic oral health care. To be sure, provider reimbursement rates appear low. For example, the committee compared Maryland's Medicaid reimbursement rates to other states and the American Dental Association's (ADA) South Atlantic region charges. All Maryland's Medicaid reimbursement rates are below the twenty-fifth percentile of the ADA's South Atlantic charges, and many are below the tenth percentile. As a result, DAC recommended that Medicaid increase

the dental reimbursement rates to the fiftieth percentile of the ADA's South Atlantic charges for all dental codes and index the reimbursement rates to inflation.

The second DAC recommendation made in the area of Medicaid reimbursements and alternative models is to carve dental services out of the seven MCOs and provide dental benefits through one statewide single vendor dental administrative services only (ASO) provider. Under the proposed model, the ASO will not be placed at risk for the cost of the services provided as is currently the case for MCOs.

Public Health Strategies

Only half of Maryland's local health departments (LHDs) have clinical dental services available onsite, and only 9 LHDs provide dental care to Medicaid enrollees. In addition, only 10 of the 16 federally qualified health centers (FQHC) offer dental services. As a result, the committee recommended DHMH ensure that each local jurisdiction has a LHD dental clinic and a community oral health safety net clinic.

The other recommendation DAC made in the area of public health strategies was to incorporate dental screenings with school-based vision and hearing screenings for public school children and/or require dental exams prior to school entry.

Education and Outreach for Parents and Caregivers

The sole recommendation in the area of education and outreach for parents and caregivers is for DHMH to develop a unified culturally and linguistically appropriate oral health message for use throughout the State. The message is to be used to educate parents and caregivers of young children about oral health and the prevention of oral disease.

Provider Participation, Capacity, and Scope of Practice

To address the lack of dentists in the public health setting, DAC recommended changing the supervision requirements for dental hygienists working in the public health setting. Specifically, DAC recommended allowing dental hygienists to perform screenings, prophylaxis, fluoride varnish, sealants, and x-rays without the supervision of a dentist.

The other recommendation made in this area is to provide training to dental and medical providers on oral health risk assessments, educate parents/caregivers about oral health, and to assist families in establishing a dental home for all children. This recommendation did meet some resistance from the dental professionals because they felt that if an oral risk assessment was conducted by a non-dental medical professional, then parents may feel their child's dental needs had been met when the oral health risk assessment is a superficial screening that will not detect all dental problems.

Next Steps

DAC recommendations were submitted to the Secretary of DHMH for his consideration on September 11, 2007. Also, DAC proposed that the committee continue to meet quarterly to assist DHMH with the implementation of the recommendations and to evaluate the department's progress toward establishing a dental home for every low-income child in the State.

In a briefing to the House Health and Government Operations Committee, DAC reported that on October 4, 2007, the Community Health Resources Commission awarded $1.5 million in dental expansion grants to six counties and one community health system, helping to implement the committee's public health strategies.

Conclusion

The combination of the Oral Health Safety Net Program and the implementation of DAC recommendations should improve the dental access for low-income children in the State. However, even with the implementation and adequate funding of these recommendations, the State has a long way to go to ensure adequate dental access and usage throughout the State. Issues not considered by these oral health initiatives are:

- providing dental coverage for all Medicaid adults;
- improving access to specialized dental care throughout the State;
- ensuring an adequate supply of pediatric dentists; and
- encouraging dental coverage and usage for all populations.

Health and Health Insurance

Hospital Rates

Maryland's performance on the Medicare all-payor waiver test has fallen below the minimum 10 percent desirable level and is projected to remain below that threshold. This has prompted action to alter hospital rates and work to improve waiver performance.

Maryland's Hospital All-payor System

In 1977, the Health Services Cost Review Commission (HSCRC) negotiated a Medicare waiver with the federal government. The waiver exempts Maryland hospitals from Medicare's prospective payment system that reimburses hospitals on a diagnosis-based method. Under the waiver, Medicare agrees to reimburse hospitals at the rates set by HSCRC. The waiver allowed Maryland to establish an "all-payor" system, in which every payor for hospital care pays the same rates for hospital services. As a result, hospitals annually realize an estimated $700 million in Medicare reimbursements above that which would be received absent the all-payor system.

To maintain the waiver, HSCRC must ensure that the rate of growth in Medicare payments to Maryland hospitals from 1981 to the present is no greater than the rate of growth in Medicare payments to hospitals nationally over the same time period. If Maryland's cumulative rate of growth equals or exceeds national growth in Medicare payments per discharge, the all-payor system will enter a three-year corrective period. During that time, HSCRC must reduce hospital rates to bring payment growth below Medicare nationally and return Medicare "overpayments" back to the federal government.

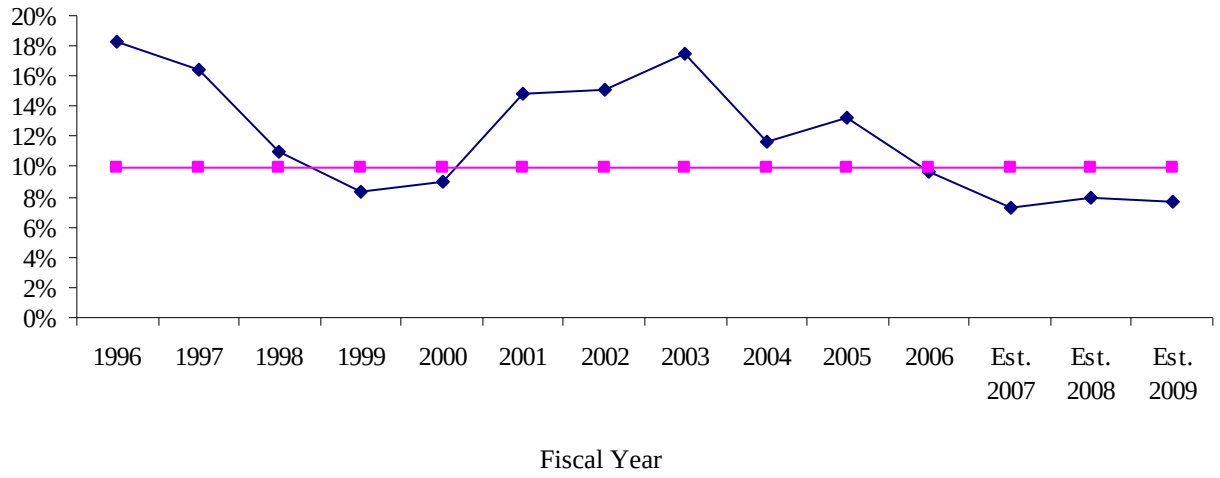
Measuring Waiver Performance

The primary measure used to monitor waiver performance is the relative waiver margin calculation, a test performed using an independent economic model that assumes a flat rate of growth in Medicare payments per case. The result of the test is the relative waiver margin or "waiver cushion," which represents the amount Medicare payments to Maryland could grow, assuming zero growth in Medicare payments nationally, before the State failed to meet its waiver requirements. HSCRC has determined that 10 percent is the lowest desirable level for the waiver margin. The larger the margin, the more flexibility HSCRC has to adjust rates while simultaneously weathering Medicare payment trends.

As shown in **Exhibit 1**, over the past decade, the waiver cushion has fluctuated from a low of 8.34 percent in 1999 to a high of 18.3 percent in 1996. As of June 2006, the waiver cushion was 9.65 percent. Maryland Medicare payments could therefore grow, in the absence of

national growth, up to 9.65 percent before the waiver would be jeopardized. The waiver margin is projected to fall to a low of 7.27 percent in 2007 (final calculations have not been made).

Exhibit 1
Waiver Margin Performance Since 1996



Note: The 10 percent minimum threshold for the waiver margin is an HSCRC target.

Source: Health Services Cost Review Commission

Hospital Revenue Update Factors

In April 2006, HSCRC staff recommended a hospital revenue update factor that would allow hospitals to increase their charges by 5.35 percent in fiscal 2008 and 2009. The commissioners opted for and approved an update factor of 5.65 percent. In April 2007, the chairman of HSCRC proposed a 6.25 percent update factor, which was adopted by the commissioners.

Erosion in Waiver Cushion Performance

In May 2007, HSCRC staff grew concerned that four specific issues would put waiver margin performance in jeopardy: (1) the 6.25 percent update factor; (2) the continuation of Medicaid day limits; (3) a change in the methodology used by the federal Centers for Medicare & Medicaid Services (CMS) to calculate and update the U.S. Medicare payment figure; and (4) a proposed change by CMS that would reduce Medicare payments nationally, thereby limiting the amount of growth possible in Maryland rates. HSCRC staff projected that these changes would result in substantial erosion of the waiver cushion to approximately 6.33 percent by June 2009.

The Medicaid day limits are a cost containment action that provides approximately $68 million in savings to the Medicaid program but is detrimental to waiver performance in that these costs are shifted to other payers including Medicare thereby inflating the growth in Medicare payments which forms part of the waiver test.

The current rate agreement between HSCRC and hospitals provides that, if the waiver cushion is estimated to fall below 7 percent, HSCRC may take action to restore the minimum waiver cushion and reverse any further deterioration of waiver performance. Using this authority, HSCRC staff recommended that the update factors be reduced from 6.25 to 4.5 percent in fiscal 2008 and 2009 to restore a waiver cushion of 10 percent. Specifically, the staff recommendations were to (1) limit case mix growth in fiscal 2007 to 1.65 percent; (2) reduce fiscal 2008 approved inpatient revenue growth from 6.25 to 4.5 percent; (3) provisionally reduce the fiscal 2009 approved revenue growth to 4.5 percent; and (4) lift the moratorium on full rate reviews no later than April 1, 2008.

Corrective Action Task Force Recommendations

Following these recommendations, a Corrective Action Task Force (CATF) was formed at the request of the Maryland Hospital Association (MHA). This task force was made up of representatives of HSCRC, hospitals, and payors. CATF met five times from August through October to identify options for improving waiver test performance. CATF focused on three major options: an MHA proposal, a modified MHA proposal with a fiscal 2009 volume adjustment, and a payor proposal. CATF recommended that HSCRC conduct a study of the financial conditions of hospitals in the winter of fiscal 2008 and investigate longer-term initiatives to improve waiver performance.

HSCRC Final Corrective Action Measures

Upon review of CATF recommendations, HSCRC adopted final corrective action measures in October 2007. The commission selected the modified MHA proposal with fiscal 2009 volume adjustments. Under this action, the hospital update factor will be reduced from 5.0 to 4.0 percent for inpatient rates, and hospitals will receive a 1.25 percent allowance for case mix adjustment, bringing the total inpatient update factor to 5.25 percent. For outpatient rates, the update factor is increased from 3.42 to 4.0 percent. A prospective variable cost volume adjustment will also be applied to hospital rates beginning in fiscal 2009. The volume adjustment is intended to address rapid growth in Maryland hospital volumes. Hospitals will be paid $0.85 on the dollar for every new admission, with the remaining $0.15 per admission assumed to be covered in the hospital's overall base rate. The update factor reduction will result in $64.0 million less in revenue increases (0.53 percent) for hospitals for fiscal 2008. These actions should result in a waiver cushion of 7.25 percent by the end of fiscal 2009.

Still Room for Improvement on Waiver Performance

While these measures will improve waiver performance, additional actions will be necessary to restore the minimum 10 percent cushion. CATF will reconvene in early 2008 following the financial conditions of hospitals study to deliberate additional initiatives. A major option under consideration is the elimination of Medicaid day limits, which would require restoration of funding in the Medicaid budget but could improve waiver performance by an additional 1 percent. Additional adjustments, such as further reductions to hospital revenue update factors, may also be necessary.

Health and Health Insurance

Rosewood

Rosewood, the State's largest residential center for individuals with disabilities, has been subject to a series of negative reports from the Office of Health Care Quality (OHCQ). These reports raise questions both about the quality of care being provided at the facility as well as the potential loss of significant Medicaid recoveries.

Background

In addition to funding services for individuals with disabilities in the community, the Department of Health and Mental Hygiene's (DHMH) Developmental Disabilities Administration (DDA) provides services to individuals with disabilities in four State-operated residential centers: Rosewood Center, Holly Center, Potomac Center, and Brandenburg Center. The centers must be licensed to operate in Maryland and must be certified to participate in the Medicare and Medicaid programs.

Residents of these centers include forensic patients, who are mentally retarded individuals who have committed a crime and are placed in the custody of DHMH by the court. Forensic patients are committed to DHMH because the court found that the defendant:

- could be endangered by confinement in a prison;
- is found incompetent to stand trial because of mental retardation and is a danger to self or others; or
- is not criminally responsible because of mental retardation.

Until recently, forensic patients were housed only at the Rosewood Center. These patients are co-mingled with nonforensic patients.

Longstanding Concerns

The placement of forensic patients in a facility that also houses nonforensic patients has always been contentious. Criminal charges of Rosewood forensic residents include murder, sex offenses, drug offenses, assault, theft, and arson. If ordered by the court, DDA has no choice but to provide the forensic patient with appropriate care. Although the total number of patients at Rosewood has been declining since fiscal 2002, the forensic population, as well as forensic evaluations requested by the courts, had been increasing. In fiscal 2007, however, DDA evaluated 92 patients, 25 less than in fiscal 2006. DDA has also had limited success in moving

some forensic patients into appropriate community placements. As of August 2007, there are 168 residents at Rosewood, 33 of which are court-ordered placements.

Forensic and nonforensic patients are co-mingled in six cottages comprising the Paca Unit. Residents reside in buildings according to the profiles for those cottages. Only juvenile residents (18 years or younger) are not permitted to co-mingle with the forensic patients. All Paca Unit buildings have security windows to help prevent a resident elopement, and in most cases the front doors and the doors between the wings are locked. Additionally, more aggressive patients receive one-on-one staffing. DDA reports that it is not possible to completely segregate forensic patients from the nonforensic patients due to the current cottage structures and configurations at Rosewood. However, when necessary, DDA does have some capacity to separate individuals to better meet their needs. Although forensic patients comprise approximately 20 percent of the total patient population at Rosewood, they have contributed to a greater percentage of the most recent violent incidents.

OHCQ Annual Re-certification Surveys and Other Investigations

During the fall of 2006, the Office of Health Care Quality (OHCQ), the State's health care facility regulatory agency, conducted an annual re-certification survey of the Rosewood Center to determine compliance with federal and State regulations. As a condition of receiving federal matching Medicaid funds, facilities such as Rosewood must ensure that clients are not subject to physical, verbal, sexual, or psychological abuse or punishment.

The survey found that Rosewood was not in substantial compliance with federal regulations related to client protections and issued a Notice of Immediate Jeopardy, which would result in the termination of about $17 million in Medicaid funding if the immediate jeopardy was not adequately resolved by October 18, 2006. OHCQ surveyors determined that Rosewood staff failed to protect six clients from physical abuse by other clients and from self injury. Of the six individuals, two were court-ordered forensic patients. Surveyors also noted that the facility did not thoroughly investigate incidents and had not implemented effective preventative measures to protect individuals. This level of noncompliance represented an immediate jeopardy to the health and safety of the six individuals identified. Aside from these individuals, the facility was found to be in substantial compliance with the federal regulations although some systemic deficiencies do exist. On October 17, 2006, OHCQ confirmed the abatement of the immediate jeopardy.

In addition to the immediate jeopardy finding, OHCQ also identified other systemic deficiencies primarily related to the protection of client rights, staff treatment of clients, and staff management of inappropriate client behavior. DDA addressed the deficiencies in a corrective plan of action submitted to OHCQ in November 2006.

In January 2007, OHCQ re-inspected Rosewood and again found conditions of immediate jeopardy noting that clients were not protected from harm and that client rights were not protected. OHCQ determined that Rosewood failed to develop and implement revised

treatment plans to prevent harm to residents and did not investigate several incidents. As a result, OHCQ banned admissions to Rosewood for 30 days so the facility could devote its full attention to outstanding problems and meet the needs of existing residents.

On May 1, 2007, OHCQ investigated a medication error at Rosewood and issued a standard level deficiency. Later in May, OHCQ again investigated a complaint and again issued standard level deficiencies on behavior management and individual plans. Standard level deficiencies are considered "lower" level deficiencies.

In August 2007, OHCQ conducted its annual full-facility survey of Rosewood, and the findings mirrored those of the previous year. OHCQ's survey included a finding of immediate jeopardy regarding client protections and client rights. The finding centered on a forensic patient, whose behavior of threatening and violent acts against residents and staff was first identified during the January re-inspection survey. OHCQ noted that as of last January, there was no behavior plan and staff was ill-equipped to manage the person's behavior. OHCQ did confirm that the finding was abated by the end of August.

In September 2007, as a result of the August survey, OHCQ issued several full deficiencies that could again affect Medicaid funding. Rosewood was found out of compliance with seven of eight Federal Conditions of Participation. Problems included deficiencies on the physical environment and treatment deficiencies. OHCQ required that an independent monitor oversee Rosewood and once again imposed a ban on admissions (a ban that resulted in DDA placing forensic patients at the Potomac Center and other State institutions). As of late October 2007, OHCQ plans to conduct a follow-up survey shortly, and instituted reporting requirements from the monitor. If Rosewood fails to comply, once again $17 million of federal Medicaid funds are at risk.

Fallout

For the past several years, advocates for serving individuals with disabilities in the community have urged that DDA facilities, particularly Rosewood, be closed, and that residents be provided with appropriate community placements. Although the census of residents at State DDA facilities has gone down over the years, the institutional placement of forensic patients by the courts continues to be problematic and controversial. At the urging of certain advocacy organizations, House Bill 970 passed the General Assembly during the 2007 session and required a plan for residents serving in the most integrated setting appropriate to their needs and a plan for the disposition of the Rosewood property. DHMH is required to report back to the General Assembly no later than December 1, 2007. Nevertheless as a result of most recent OHCQ survey, it can be expected that community advocates will strengthen their call to close Rosewood.

Health and Health Insurance

Response to Virginia Tech Shooting

In the aftermath of the Virginia Tech shooting, attention has been focused on access to mental health records and access to guns by people with mental illness.

On April 16, 2007, Virginia Tech student Seung Hui Cho shot to death 32 students and faculty, wounded 17 people, and killed himself. Throughout his life, Cho displayed signs of mental health problems and received psychiatric counseling. In 2005, Cho was judged to be a danger to himself and was ordered to outpatient treatment. This determination made Cho ineligible to purchase a firearm under federal law. However, since Virginia law did not clearly require the reporting of individuals who had been ordered into outpatient mental health treatment to the National Instant Criminal Background Check System, this information was not accessible by the firearms dealer who sold the firearms to Cho.

The Virginia Tech shooting prompted states, including Maryland, to examine how to balance assisting individuals with mental illness with the need to protect public safety. The incident has raised questions regarding laws related to access to firearms by the mentally ill and the confidentiality of health records. In addition, states are examining methods to reduce the stigma associated with mental illness and to encourage individuals to seek treatment.

Access to Firearms by the Mentally Ill

Access to firearms by mentally ill individuals is governed by federal and State law. In Maryland, under Maryland law and in conjunction with federal law, a person is prohibited from possessing a firearm by reason of mental illness if that person:

- has spent more than 30 consecutive days in an institution for treatment of a mental disorder on a voluntary basis, unless the person presents a recent physician's certificate certifying that the person is capable of possessing a firearm without undue danger to the person or another;

- suffers from a mental disorder and has a history of violent behavior against the person or another, unless the person presents a recent physician's certificate certifying that the person is capable of possessing a firearm without undue danger to the person or another;

- has been adjudicated to be a danger to self or others, unable to manage his or her own affairs, insane in a criminal case, incompetent to stand trial, or not guilty by lack of mental responsibility; or

- has been involuntarily committed to a mental institution.

National Instant Criminal Background Check System

The National Instant Criminal Background Check System (NICS), established by the Brady Act in 1998, is a database consisting of the names of people who are prohibited from possessing firearms. Dealers can contact the NICS and find out immediately whether receipt of a firearm by a particular person would violate federal or state law. Maryland has voluntarily provided information relating to mental illness to the NICS if a person is declared incompetent to stand trial or not criminally responsible. However, to date Maryland has only submitted three records to the NICS, a very small percentage of the total pool of persons declared incompetent or not criminally responsible. Only 16 states submit a significant amount of information to the NICS.

Federal Response to the Virginia Tech Tragedy

In response to the Virginia Tech tragedy, President George W. Bush directed key members of the administration to meet with educators, mental health experts, law enforcement, and state and local leaders to make recommendations for change. In the June 2007 *Report to the President on Issues Raised by the Virginia Tech Tragedy* the following key findings were made:

- critical information sharing faces substantial obstacles;
- accurate and complete information on individuals prohibited from possessing firearms is essential to keep guns out of the wrong hands;
- improved awareness and communication are key to prevention; and
- it is critical to get people with mental illness the services they need.

In response to the lack of information provided to the NICS by the states, the federal NICS Improvement Amendments Act of 2007 was introduced to require states to report to the NICS their lists of mentally ill people who are prohibited from buying firearms. The penalty for noncompliance would be up to 5 percent of the amount that would otherwise be allocated to a state under Section 506 of the Omnibus Crime Control and Safe Streets Act of 1968. The Act has passed the House of Representatives and as of November 2007 is being considered by the Senate.

Maryland Response to the Virginia Tech Tragedy

Executive Branch Workgroup

In the wake of the Virginia Tech tragedy, Maryland's Office of the Attorney General determined that the perpetrator of the shootings probably could have purchased a firearm since the state police had no method to access health information from the state's Criminal Justice Information System. Members of the Executive Branch, including the Office of the Governor, Office of the Attorney General, Department of State Police (DSP), and Department of Health and Mental Hygiene (DHMH), formed a workgroup to examine whether Maryland's existing laws related to purchasing firearms were being enforced. The workgroup examined data sharing among agencies and found that there was no exchange of mental health information between DSP and the Mental Hygiene Administration (MHA).

DSP has developed regulations to require each application to purchase a firearm to include a new form that is the applicant's written authorization to DHMH to allow DSP access to certain mental health records. The regulations authorize DSP to check whether a prospective gun buyer has a mental health history that would prohibit the buyer from obtaining a gun under current law. Under the regulations, DSP would query MHA's database by an applicant's name, gender, and date of birth. The regulations have been reviewed by the Administrative, Executive, and Legislative Review Committee and will go into effect in December 2007. However, it should be noted that this query will, initially at least, only reveal applicants who have spent 30 consecutive days in a State institution for treatment of a mental disorder. Queries will not yield data on applicants with mental disorders who have not been institutionalized or on those treated on an inpatient basis for more than 30 days in non-State institutions.

Mental Health Transformation Grant Funding for Mental Health First Aid

Mental Health First Aid is the help provided to a person developing a mental health problem or in a mental health crisis and is given until appropriate professional treatment is received. While individuals are often knowledgeable of common physical health problems, there is widespread ignorance of mental health problems. In an effort to assist individuals in providing initial support for someone with a mental health problem, a Mental Health First Aid (MHFA) training course has been developed and implemented in every state and territory in Australia. Participants in the course include teachers, nurses, government employees, and members of the general public.

As part of Maryland's response to the tragedy at Virginia Tech and through the State's federal Transformation Grant, DHMH has developed a memorandum of understanding between DHMH and the MHFA program in Australia. DHMH has pursued this effort to make the public more aware of mental illness and the resources available to individuals and their families. Representatives from DHMH attended a meeting along with 12 other states at which individuals from Australia presented information on the MHFA. In collaboration with the University of

Maryland at Baltimore's Department of Psychiatry, DHMH will evaluate and support a MHFA program that is designed to meet Maryland's needs.

House of Delegates Workgroup

In June 2007, the Speaker of the House of Delegates established the Workgroup to Study Maryland Law Regarding Access to Firearms and Sharing of Health Information. The workgroup, consisting of five delegates and numerous stakeholders, has held and will continue to hold a series of briefings during the 2007 interim to examine issues including appropriate access to firearms and mental health records, the effect of the State's laws on individuals seeking mental health treatment, and improving the safety of the State's schools and workplaces. The workgroup discussions have included presentations on relevant federal and State law and updates from the Executive Branch workgroup. The workgroup will also examine the mental health resources available to students in the higher education system and ways to encourage mental health treatment and reduce stigma. The workgroup intends to make recommendations to the General Assembly prior to the 2008 legislative session.

Social Programs

Foster Care Caseload Trends

Foster care caseloads are expected to continue to drop in fiscal 2009, while subsidized adoptions increase. Total costs for both programs are expected to increase by a modest 2.5 percent.

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 (DLS) anticipates a decrease of 0.3 percent per year in the combined foster care/subsidized adoption caseload from fiscal 2007 to 2009. The combined decrease results from a projected decrease of 4.0 percent per year in the foster care caseload moderated by a 3.0 percent per year increase in the subsidized adoption caseload. The foster care caseload is decreasing due to a decline in entries and an increase in exits to adoption. Fiscal 2006 marked the first time that subsidized adoptions made up over half the total caseload.

Funding

Total program costs are expected to increase at a slower rate from 2007 through 2009 than was experienced from 2006 to 2007. Total program costs are expected to increase $7.1 million between fiscal 2008 and 2009 compared with increases of $27.5 million and $9.6 million between fiscal 2006 to 2007 and 2007 to 2008, respectively.

Exhibit 1
Foster Care and Subsidized Adoption Caseload and Expenditures
Fiscal 2007-2009

	2007	DLS Estimate 2008	DLS Estimate 2009	Average Annual % Change 2007-2009
Caseload				
Foster Care	6,591	6,327	6,074	-4.0%
Adoptions	7,153	7,296	7,588	3.0%
Total	**13,744**	**13,623**	**13,662**	**-0.3%**
Expenditures				
Monthly Cost Per Case	$1,980	$2,057	$2,094	2.8%
Total Cost ($ in Millions)	**$326.6**	**$336.2**	**$343.3**	**2.5%**

Source: Department of Human Resources; Department of Legislative Services

Social Programs

Temporary Cash Assistance Caseload and Expenditure Trends

Temporary Cash Assistance caseloads are expected to remain constant in fiscal 2009. Expenditures will see a modest 2.5 percent increase.

Background

Temporary Cash Assistance (TCA) provides monthly cash grants to needy children and their parents or caretaker relatives. 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 a rapid reduction in the number of TCA recipients. After dropping at rates exceeding 20.0 percent per year during the 1990s, the pace of caseload decline slowed considerably in the early years of this decade. With the recovering economy and the implementation of a universal engagement policy in the fall of 2003, caseload decline accelerated again, falling by 3.7 percent in fiscal 2004, 11.0 percent in fiscal 2005, and 14.7 percent in fiscal 2006. The caseload decline slowed in fiscal 2007 with a decline of 6.3 percent. Universal engagement requires participation in activities such as up-front job search, assessment of employability, developing an independence plan, training, and subsidized employment.

Fiscal 2008 Forecast

As shown in **Exhibit 1**, the Department of Legislative Services (DLS) estimates an annual average caseload of 50,138 for fiscal 2008, nearly identical to the previous year's actual number. This caseload projection is based on the experience of 2007 during which the decline in caseloads slowed and then reversed. During the final three months of the year, caseloads increased in each month.

Exhibit 1
TCA Enrollment and Funding Trends
Fiscal 2007-2009

	2007 Actual	2008 Approp.	2008 Estimate	2009 Estimate	2008-2009 % Change
Average Monthly Enrollment	50,149	50,847	50,138	50,138	0.0%
Average Monthly Grant	$164.43	$173.45	$185.42	$190.04	2.5%
Funds in Millions					
General Funds	$11.8	$11.8	$7.0	$7.0	0.0%
Total Funds	105.8	105.8	111.6	114.4	2.5%

Source: Department of Human Resources; Department of Legislative Services

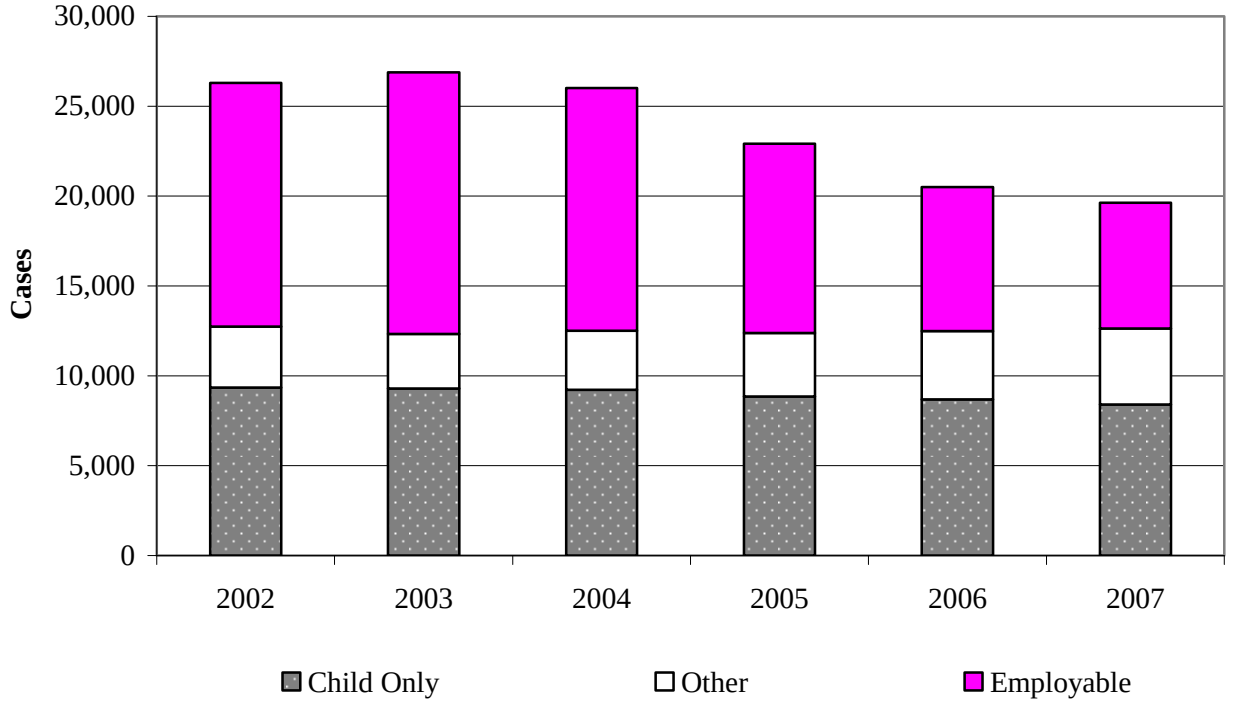
Fiscal 2009

DLS expects the caseload to remain unchanged in fiscal 2009 based on an expected slowdown in the general economy and because the core caseload – those cases not headed by an employable adult – now make up nearly two-thirds of cases (see following section). DLS estimates a caseload of 50,138, an average grant of $190.04, and total expenditures of $114.4 million. The estimate of the average grant and the total expenditures reflect an increase in the grant amount of 3.3 percent in fiscal 2009, which is equal to the recent increase in the Maryland Minimum Living Level. General funds remain the same between fiscal 2008 and 2009 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, caretaker relatives, 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 non-employable core caseload has remained virtually the same. As a result, the non-employable core caseload – as a percent of total caseload – has increased from just under 46 percent in 2003

Exhibit 2
Characteristics of the Current Caseload



July Caseloads

Note: "Other" category includes Child Under One, Relative Caretaker, Disabled, and Other Exemptions; caseload numbers differ from enrollment in that cases often involve more than one person.

Source: Department of Human Resources

to 64 percent in 2007. The employable caseload declined from just over 54 percent in 2003 to 36 percent in 2007.

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.

Juvenile Justice Issues

Populations served by the Department of Juvenile Services show some stability, but the department continues to face significant budget deficits.

Population Trends

Key population trends for the Department of Juvenile Services (DJS) are shown in **Exhibit 1**. A number of points may be made from the exhibit:

Exhibit 1
Department of Juvenile Services
Population Trends
Fiscal 2004-2008 (YTD)

CD/EM: Community Detention/Electronic Monitoring
YTD: year-to-date

Source: Department of Juvenile Services; Department of Legislative Services

- Through the first four months of fiscal 2008, there are no dramatic changes in overall populations handled by the department compared to fiscal 2007. Indeed, all populations are slightly lower.

- Interestingly, there is little change in most of the populations between fiscal 2004 and 2008, except for the use of residential committed care. These placements are down both due to the closure of committed programming at the Hickey School (which accounted for almost 130 youth in fiscal 2004 compared to fiscal 2008), as well as lower per diem utilization (private provider residential placements for youth adjudicated delinquent) particularly in group homes and residential treatment. Ironically, the drop in per diem placement utilization has not been mirrored by a decline in per diem spending. As will be discussed below, spending on per diem placements has grown significantly in recent years, resulting in significant deficits for the department.

- Over the period shown in Exhibit 1, there are two negative trends: the increased use of out-of-state placement (averaging 124 on a daily basis in fiscal 2008 to date, up from 58 in fiscal 2004); and increased numbers of youth in pending placement status, either in secure or community settings (averaging 219 on a daily basis in fiscal 2008 to date, up from 171 in fiscal 2004).

  It might seem strange that more youth are pending placement in fiscal 2008 even though there are far fewer youth in committed placements. This may be a function of the types of placements that are now considered appropriate for youth versus those that are currently available. The pending placement problem may be somewhat alleviated with the opening of new programming at Victor Cullen. However, that programming will not be fully phased in until the final quarter of fiscal 2008.

  Certainly, the apparent miss-match between available and required programming is part of the reason for the increased use of out-of-state placements. The closure of the Hickey School committed programming, for example, left the State no maximum secure committed facilities for males thus requiring out-of-state placements for that category of offender.

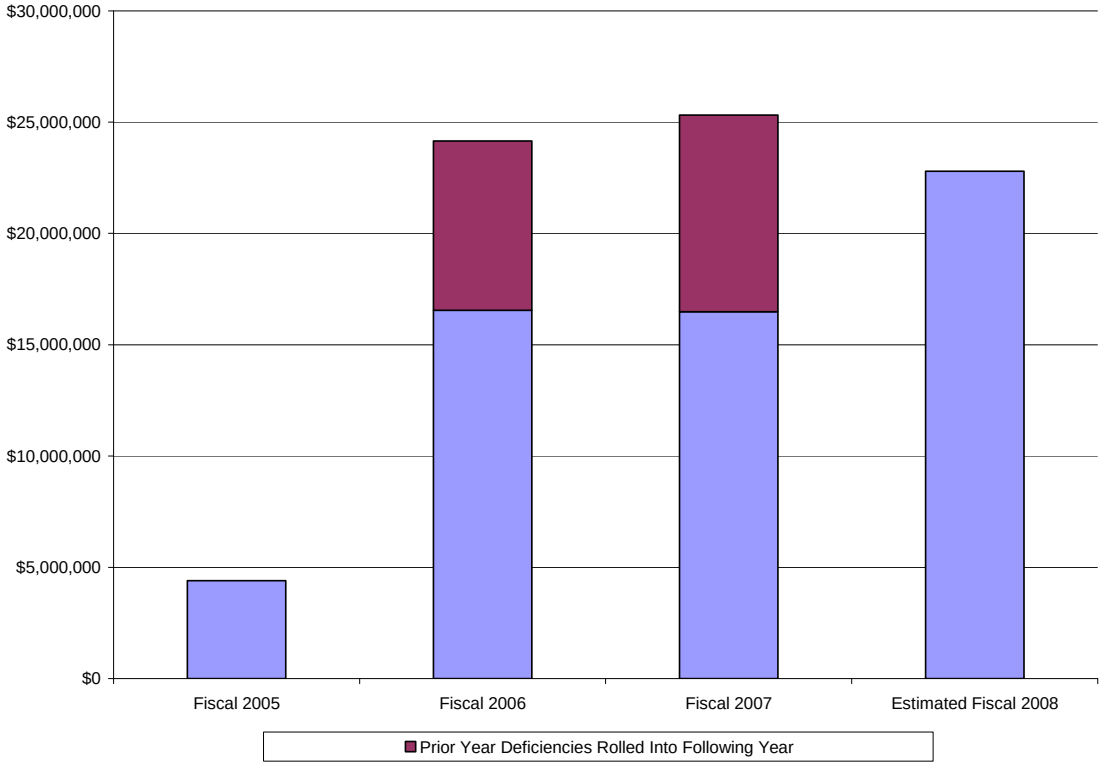
Budget Problems Continue to Abound

During fiscal 2007 close-out, DJS reported that over $8.8 million in fiscal 2007 bills were rolled over into fiscal 2008 because the department had no funds to cover these expenditures. This roll-over of deficits, and deficits in general, have unfortunately become a regular occurrence for DJS in recent years (see **Exhibit 2**). As in the past, most of the deficit rolled over into the current year as well as an estimated additional $16.0 million deficit in the current year relates to higher than budgeted expenditures for per diem committed placements. The type of per diem placements that continue to be used by DJS typically involve the provision of more services and are thus more expensive.

Added to this known and anticipated fiscal 2008 deficit in per diems is an additional estimated $6.6 million deficiency related to the re-opening of the Victor Cullen Academy. Although the Governor included $6.8 million in a supplemental budget in the 2007 session for the re-opening of Cullen, the actual cost of re-opening the facility and operating it in fiscal 2008 is

anticipated to be almost $19.0 million. Some of these costs will be borne by other agencies or spread out over several years through the use of lease-purchase agreements, but a significant deficiency is still anticipated.

Exhibit 2
Department of Juvenile Services Deficiency Appropriations
Fiscal 2005-2008 (Estimated)



Source: Department of Juvenile Services

Conclusion

The significant deficits faced by DJS may serve to undermine the administration's ability to make quick changes to programming. Further, many of the current proposals being made by DJS to improve programming involve significant capital improvements (although DJS still has not submitted a revised facilities master plan to the Department of Budget and Management as required by Chapter 498 of 2007). It is also unclear to what extent these capital proposals will be funded.

Social Programs

Truancy/Children in Need of Supervision (CINS)

Programs and policies exist across the State to combat truancy; however, the problem of children failing to attend school persists. Proposals are expected to further address the issue and possibly expand existing programs.

Background

Truancy, or unexcused absence from school, is a problem nationwide. A recent Department of Justice report cites truancy as a significant risk factor for substance abuse, delinquency, gang activity, and dropping out of school. In another study, the department found that approximately two-thirds of serious violent offenders and half of serious nonviolent offenders had been truants. A 2007 report from the National Center for School Engagement in Colorado cited a number of studies showing that effective truancy reduction programs can produce a marked decline in delinquent acts committed by school age youth.

In Maryland, a "habitual truant" is a student who is unlawfully absent more than 20 percent of the school days in a marking period, semester, or school year. According to the Maryland State Department of Education, the statewide truancy rate for the 2006-2007 school year was 19,648, or 2.2 percent of public school students. While over half of the local school systems reported truancy rates of less than 1 percent, the highest truancy rates were in Baltimore City (9.2 percent), Prince George's County (4.2 percent), Kent County (3.2 percent), Wicomico County (1.8 percent), and Somerset County (1.4 percent).

Primarily, the local school systems and, in some counties, a truancy reduction pilot program through the court address the problem of truancy. While the Department of Juvenile Services (DJS) has authority to bring habitual truants to juvenile court, it rarely does.

Criminal Action against Parent

Under §7-301 of the Education Article, a child is required to attend school from the age of 5 years to the age of 16 years. A parent or guardian who fails to ensure that a child attends school regularly is guilty of a misdemeanor and is subject to a fine not exceeding $500, imprisonment not exceeding 30 days, or both. The court may suspend the parent's or guardian's sentence and establish terms and conditions that promote the child's attendance in school.

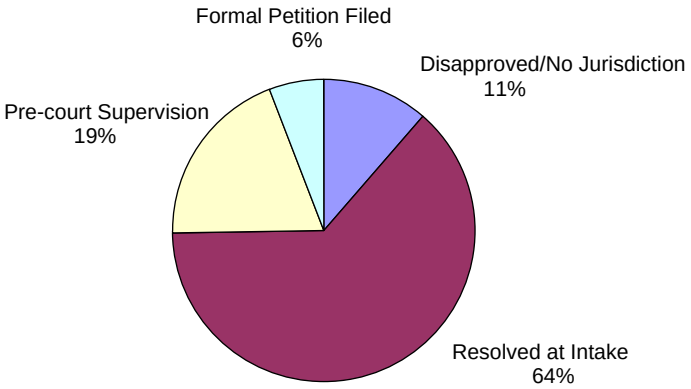
Children in Need of Supervision

State law provides a mechanism for addressing truancy through the filing of a Child in Need of Supervision (CINS) petition with the juvenile court. Under the Juvenile Causes subtitle, a child may be a "child in need of supervision" if the child is required by law to attend school and is habitually truant.

A DJS intake officer determines whether to file a petition alleging that a habitually truant child is a child in need of supervision or whether the case may be resolved informally through the provision of services. If the intake officer files a petition, the juvenile court is required to hold an adjudicatory hearing. If the child is adjudicated a CINS, the juvenile court must hold a hearing to determine the child's disposition. Possible dispositions include (1) placing the child on probation or under supervision at home or in the custody of a relative or other fit person; (2) committing the child to the custody of DJS, the Department of Health and Mental Hygiene, or a public or private licensed agency; (3) ordering the child and parent or guardian to participate in counseling or rehabilitative services; or (4) adopting a treatment service plan for the child.

Statistical data received from the DJS indicates that the department rarely files formal CINS petitions for truancy. **Exhibit 1** illustrates the percentage distribution of truancy referrals made to DJS for fiscal 2001-2007. Less than 6 percent of all truancy referrals resulted in a formal filing of a CINS petition over the past seven fiscal years. According to DJS policy, chronic truancy is considered a family problem and is an issue that is more appropriate for intervention and treatment by local school systems.

Exhibit 1
Percentage Distribution of Truancy Referrals
Fiscal 2001-2007



Source: Department of Juvenile Services

Approaches to Solving the Problem of Truancy

Maryland's truancy situation has prompted several legislative and local school initiatives designed to address the problem.

Truancy Reduction Pilot Program

Chapter 551 of 2004 authorized a three-year Truancy Reduction Pilot Program (TRPP) in the juvenile courts in Dorchester, Somerset, Wicomico, and Worcester counties. Families enter TRPP when a school official files a civil petition alleging that a child who is required to attend school has failed to do so without lawful excuse. For students under age 12, prior to participation in TRPP, a criminal charge must be filed against the student's legal custodian and dismissed or placed on the inactive docket prior to participation in the pilot program.

In making a disposition on a truancy petition, the court may order the student to (1) attend school; (2) perform community service; (3) attend counseling, including family counseling; (4) attend substance abuse evaluation and treatment; (5) attend mental health evaluation and treatment; or (6) comply with a curfew set by the court. Following the disposition hearing, a review hearing is scheduled to review family assessment findings and determine appropriate services. Participants are eligible for "graduation" from the TRPP when they have remained in the program for 90 days without any unexcused absences.

Chapter 648 of 2007 extended the term of the existing TRPP and authorized the establishment of a TRPP in the juvenile courts of Harford County and Prince George's County. All TRPPs under the legislation are scheduled to sunset on June 30, 2009.

Learner's Driving Permits

In accordance with Chapters 562 and 563 of 2007, a student under the age of 16 years with more than 10 unexcused absences during the prior school semester may not receive a learner's permit to drive. However, because a student must be 15 years, 9 months of age before obtaining a learner's permit, and compulsory attendance is required only until the age of 16 years, in practice, a habitual truant will only be restricted from obtaining a permit for up to 3 months.

Local School Initiatives

State law requires school systems to develop intervention strategies and procedures to deal with absenteeism. Interviews conducted with 13 local systems revealed the use of the following school-based intervention strategies: (1) parent notification and parent/teacher conferences; (2) home visits; (3) referrals to counseling or tutoring; and (4) referrals to local State's Attorneys Offices.

The most notable local school initiative is that employed by the Baltimore City Public School System. In November 2003, Baltimore City opened a Truancy Assessment Center (B-TAC). Police who find that a child is unlawfully absent from school transport the child to B-TAC while the parents of the child are contacted. At B-TAC, the child meets with school police officers, guidance counselors, and staff of the local department of social services and DJS. Social workers at B-TAC evaluate whether the child needs mental health counseling, academic tutoring, medical care, housing, or other services.

Conclusion

While programs and policies exist to combat truancy, the problem of children failing to attend school persists. State laws geared to address the issue, such as the filing of a CINS petition in the juvenile court, are seldom utilized. Other statewide measures to address truancy by linking it to driving privileges have only minimal effectiveness because the age of compulsory attendance terminates at age 16. The most significant efforts to reduce truancy are primarily occurring at the local level in programs such as the truancy court pilot program and various local school initiatives.

During the upcoming legislative session, it is anticipated that legislation to strengthen and possibly further expand the current truancy court pilot program will be introduced. In addition, the legislature may wish to study the issues surrounding the nonuse of the CINS statute in greater depth.

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Social Programs

Energy Assistance Funding

The Electric Universal Services Program is expected to grow significantly in fiscal 2008 as a result of the 47 percent electrical rate increase experienced by Baltimore Gas & Electric customers. The program is expected to have a $6.1 million deficiency in fiscal 2008. With only ratepayer funds available in fiscal 2009, the program will need $28.2 million in additional funding.

Electric Universal Services Program

The Electric Universal Services Program (EUSP) is one of two energy assistance programs administered by the Department of Human Resources (DHR). EUSP provides assistance to households in paying electric bills, and the program is funded through fees imposed on residential and commercial ratepayers.

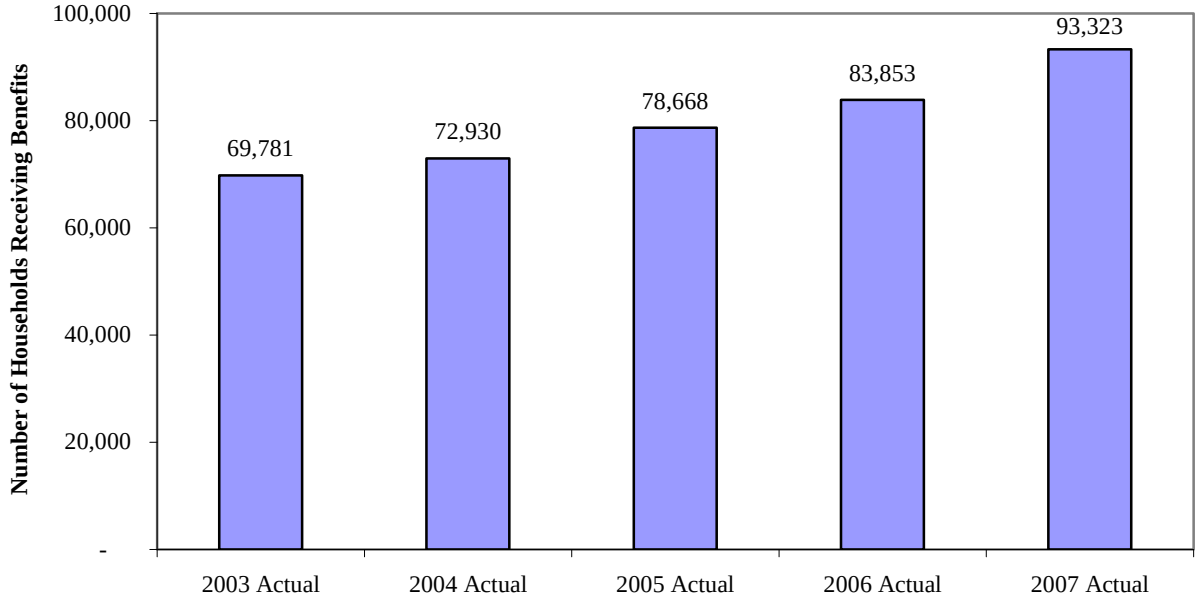
As shown in **Exhibit 1**, EUSP has experienced an average annual growth rate of 7.6 percent since fiscal 2003. The growth in the program is the result of electric rate increases and DHR's outreach efforts.

Demand for EUSP

At the beginning of fiscal 2008, Baltimore Gas & Electric (BGE) customers experienced a 47 percent rate increase over the fiscal 2007 rates. Since demand for energy assistance is primarily related to the increased cost of energy and roughly half of the households in Maryland receive their electricity from BGE, the 47 percent rate increase is expected to have a significant impact on EUSP. The impact is anticipated to be two-fold. First, the average benefit amount for BGE customers should increase to take the 47 percent rate increase into account. Second, demand for energy assistance is expected to grow because low-income households may have trouble absorbing the additional cost of electricity.

In fiscal 2007, EUSP provided benefits to only 21.9 percent of the eligible households. Estimates for fiscal 2008 indicate that increased demand for the program coupled with the increased cost of electricity will increase the cost of EUSP by 11.4 percent, or $6.3 million. In fiscal 2009, it is expected that demand for EUSP will be moderate, and costs are estimated to grow by 4.0 percent.

Exhibit 1
Number of Households Certified for EUSP
Fiscal 2003-2007



EUSP: Electric Universal Services Program

Source: Department of Human Resources

Funding

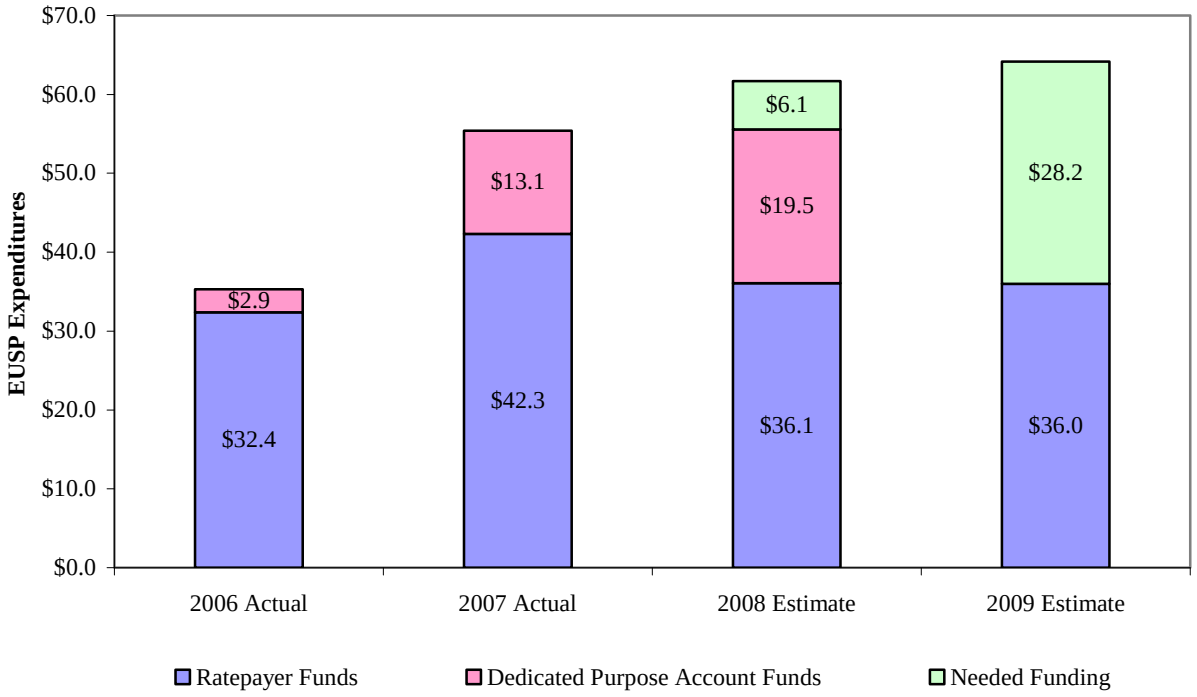
In the past, the only funding source for EUSP was special funds from fees imposed on commercial and residential ratepayers. During the 2006 special session, the General Assembly increased the amount collected from ratepayers from $34 million to $37 million. Also, during the fiscal 2007 budget process, $36 million in general funds and Energy Overcharge Restitution Fund (EORF)[1] funds were put into the State's Dedicated Purpose Account to augment the energy assistance budget as needed in the upcoming years.

DHR will exhaust the special funds from the Dedicated Purpose Account in fiscal 2008. Additionally, it is estimated that DHR will need a $6.1 million deficiency appropriation. This leaves the ratepayer funds as the only available funding for EUSP in fiscal 2009, which by statute are capped at $37.0 million. Of this amount, $36.0 million will be available for EUSP with $1.0 million going to the Weatherization Program in the Department of Housing and

[1] The Maryland Energy Administration administers the EORF, which is composed of federal court settlement monies from oil and gas producers who have violated federal regulations.

Community Development. As shown in **Exhibit 2**, if EUSP grows by 4.0 percent in fiscal 2009, then the program will need $28.2 million in additional funding. Without additional funding, EUSP will be reduced by 41.7 percent in fiscal 2009, which translates into roughly 38,000 households.

Exhibit 2
EUSP Expenditures and Funding Sources
Fiscal 2006-2009



EUSP: Electric Universal Services Program

Source: Department of Legislative Services

EUSP Workgroup

The EUSP Workgroup, three senators from the Senate Finance Committee and three delegates from the House Economic Matters Committee, met in October 2007 to receive an update on the program. Presentations from the Public Service Commission (PSC), the Office of Home Energy Programs in DHR, and the Office of the People's Counsel all recommended changes to the program. Recommendations of the agencies included (1) increasing the funding for the program; (2) continuing the arrearage retirement assistance component, while either

removing the existing cap of $1.5 million from statute or allowing PSC to establish the annual allocation of arrearage funds up to a higher maximum dollar amount of $3 million (in the form of a transfer from the bill assistance component allocation); (3) repealing the language in statute that restricts eligibility for arrearages to be paid only once and, thereby, allowing customer eligibility for an arrearage benefit after seven years from the receipt of the original benefit; and (4) removing or revising statutory language that authorizes bill assistance "at a minimum of 50 percent of the determined need" which has caused confusion among the parties involved in the program. Lastly, PSC discussed the challenges that it has in providing oversight over one program within an office (OHEP) under a second agency (DHR). In addition to being awkward and inefficient, PSC contends that it has no particular expertise regarding social service programs, and proper oversight would require resources better used for other PSC duties.

Major Changes in the Draft Consolidated Transportation Program

The Maryland Department of Transportation's draft 2008 *Consolidated Transportation Program* (CTP) lists all capital projects funded in the current fiscal year as well as those planned for the next five years. The 2008 draft CTP totals $8.5 billion, a $501.7 million decrease from the 2007 CTP, but does not include revenues provided in the 2007 special session.

Overview

The Maryland Department of Transportation publishes an annual 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 six-year program with the six-year program contained in the draft 2008 CTP. The draft CTP does not program revenues resulting from the 2007 special session.

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

	2007-2012 CTP	2008 -2013 Draft CTP	Change	Percent Change
State Funds				
Special Funds	$4,835.6	$4,731.7	-$103.9	-2.1%
Other Funds*	849.3	774.2	-75.1	-8.8%
Subtotal State Funds	**$5,684.9**	**$5,505.9**	**-$179.0**	**-3.1%**
Federal Aid	3,320.1	2,997.4	-322.7	-9.7%
Total Funds	**$9,005.0**	**$8,503.3**	**-$501.7**	**-5.6%**

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

Source: Maryland Department of Transportation, 2008 Draft *Consolidated Transportation Program*

The total funding level in the 2008 six-year program decreases by approximately $502 million (5.6 percent) from the six-year funding level in the 2007 CTP.

Special funds decrease by $103.9 million (2.1 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. The State Highway Administration's (SHA) special fund capital program decreases $128.5 million in the 2008 draft CTP. This decline is largely due to a number of large projects ending, in particular the Woodrow Wilson Bridge and associated projects, with few major construction projects being added to the program.

Federal funds decrease by $322.7 million (9.7 percent), based upon special federal funds for the Woodrow Wilson project declining as the project comes to completion. SHA's federal funds for the capital program decrease $241.0 million, and the Maryland Transit Administration (MTA) decreases approximately $63.0 million. The federal fund decline is due to uncertainty regarding future federal funding prior to the next federal authorization in federal fiscal 2009 as well as an additional year of the Grant Anticipation Revenue Vehicle debt service payments for the InterCounty Connector.

Summary of Major Changes

As shown in **Exhibit 2**, projects totaling $156.2 million were added to the construction program, and $9.0 million for one MTA project was added to the development and evaluation program.

Exhibit 2
Major Changes in the 2008 CTP
($ in Millions)

Projects Added to the Construction Program		
MTA	Light Rail Vehicle Mid-Life Overhaul	$14.0
MTA	For Computer-aided Dispatch and Automated Vehicle Location Systems	12.1
MTA	Closed Circuit TV Improvements	16.5
MTA	Southern Maryland Commuter Bus Initiative	31.2
WMATA	Dedicated Metro Funding – Federal Davis Bill	50.0
SHA	MD 35, Ellerslie Road; Bridge over Branch of Wills Creek (Allegany)	2.0
SHA	MD 28, Tuscarora Road, MD 28 over Washington Run (Frederick)	2.2
SHA	I-270, Eisenhower Memorial Highway; I-270 Over Doctor Perry Road (Frederick)	8.0
SHA	MD-5, Branch Avenue; Widen MD 5 from MD 373 to US 301 (Prince George's)	13.5
SHA	I-70, Eisenhower Memorial Highway; Bridges over Black Rock Road (Washington)	6.7
Total		**$156.2**
Projects Added to the Development and Evaluation Program		
MTA	Assessment of Transit Needs for Maryland Base Realignment Commission	$9.0

Source: Maryland Department of Transportation, 2008 Draft *Consolidated Transportation Program*

Transportation

InterCounty Connector

After facing several lawsuits, major construction of the InterCounty Connector began in November 2007. The Maryland Transportation Authority indicates that the total cost of the project remains at $2.4 billion, and there has been little change in the financing plan. Construction is expected to be completed in 2012.

Background

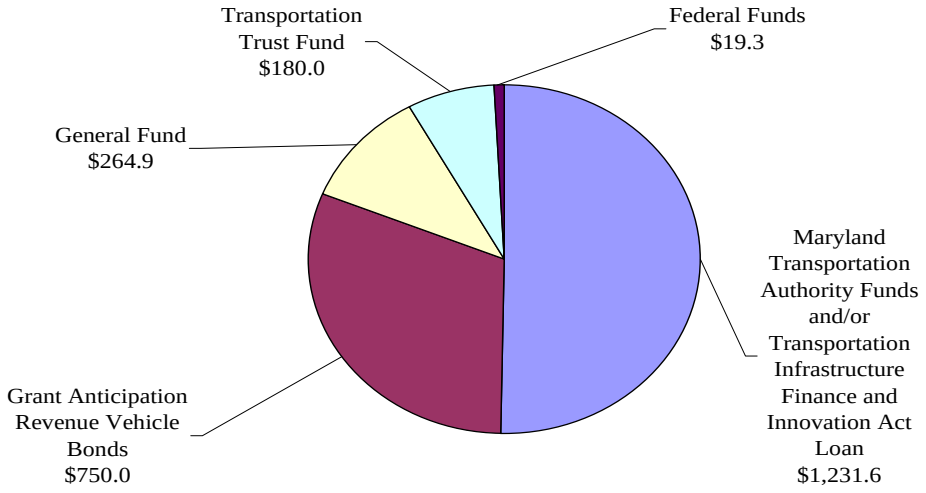
The InterCounty Connector (ICC) is an 18.8 mile, controlled access highway with accommodations for express bus service connecting the I-270/I-370 corridor in Montgomery County with the I-95/US 1 corridor in Prince George's County. The ICC will be owned and operated by the Maryland Transportation Authority (MdTA). The State Highway Administration (SHA), acting on behalf of MdTA, is managing the planning, environmental approvals, design, and construction administration. Both MdTA and SHA are the project sponsors. The six-lane (three lanes each way) highway will be one of the State's first facilities to be fully electronic. All users will pay tolls electronically, either through the use of an E-ZPass transponder or video tolling, in which an image of the vehicle's license plate is captured and the owner of the vehicle is mailed a bill. Since there will be no toll booths, cash payments will not be possible. Toll rates for the facility have not been established; however, the ICC will be one of the first facilities in Maryland to utilize congestion pricing, where toll rates vary based on current congestion levels.

Funding

Chapters 471 and 472 of 2005 provide a financing plan for the ICC, which includes the general fund, the Transportation Trust Fund (TTF), Grant Anticipation Revenue Vehicle (GARVEE) bonds, federal funds, and MdTA toll revenue bonds and/or a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan. As shown in **Exhibit 1**, in the first annual update to the financial plan submitted to the Federal Highway Administration (FHWA), MdTA reports that the cost of the project remains at $2.4 billion and the funding sources remain the same. Although estimates for construction costs have increased nearly $105.0 million since the initial finance plan was submitted to FHWA in 2006, right of way purchases have decreased by nearly the same amount, maintaining the project's total cost estimate at $2.4 billion. The funding plan has seen a slight increase in federal funds and a corresponding decrease in MdTA bonds.

In June 2007, MdTA issued the first of two series of GARVEE bonds. The issuance received favorable investment grade ratings (AAA from Standard & Poor's; AA from Fitch Ratings; and Aa2 from Moody's Investment Services). A total of $341.9 million was deposited into the project fund (bond issuance of $325.0 million plus a net premium of $16.9 million). The second issuance of GARVEE bonds for $408.1 million is expected in the fall of 2008.

Exhibit 1
InterCounty Connector Finance Plan
($ in Millions)



Source: Maryland Transportation Authority

The financing plan includes $264.9 million in general funds, as repayment of funds borrowed from the TTF in fiscal 2003 and 2004. Chapters 471 and 472 of 2005 also require payment of at least $50.0 million in fiscal 2007 through 2010. A balance of $211.9 million is yet to be repaid. The latest financial plan expects a projected payment of $85.0 million from the general fund in fiscal 2009.

Project Schedule

Construction of the ICC is divided into five distinct design-build contracts to allow for more competitive bidding and simultaneous construction on multiple parts of the highway. The contracts are not being built in order from west to east; rather, the timeline for contracts depends on the complexity of each contract and the estimated time to complete. In March 2007, Contract A, from I-370 to Georgia Avenue (MD 97), was awarded, and major construction of the $478.7 million contract began in November 2007. This portion of the highway will be completed and open to traffic in 2010. In November 2007, the second major contract was awarded. The $513.9 million Contract C runs from US 29 to I-95, and construction on that portion of the highway is expected to begin early in 2008. The remaining three contracts are in

various stages of the procurement process. The entire length of the ICC is expected to open to traffic in 2012

Lawsuits Affecting the Project

In December 2006, separate actions were filed in two different U.S. District Courts challenging certain federal agency and metropolitan planning organization environmental analyses and decisions relating to the ICC. Maryland was not named as a defendant in either case, but successfully filed motions to intervene and consolidate the cases. In November 2007, a federal judge dismissed both lawsuits, finding that Maryland had adequately addressed all environmental concerns, but an appeal is possible. A pending lawsuit filed in Maryland alleges a violation of State law requiring that other alternatives be adequately considered. The State filed a motion to dismiss, to be heard in early 2008.

Transportation

REAL-ID Act Update

While not yet final, regulations proposed in March 2007 for the implementation of the REAL-ID Act will require several legislative changes to comply with the requirements of the Act, including allowing background checks for employees of the Motor Vehicle Administration and establishing what identity documents are required for the issuance of a driver's license in Maryland. Importantly, the proposed regulations also extend many of the deadlines for compliance by the states.

Background

On May 11, 2005, President George W. Bush signed into law the REAL-ID Act. The Act requires federal agencies to accept only compliant personal identification (ID) cards for official purposes (*e.g.*, boarding aircraft or entering federal facilities) on or after May 11, 2008. The legislation contains a number of provisions outlining broad requirements for the composition and issuance of ID cards, as well as the development of information technology systems to enhance document authentication and data verification capabilities. On March 9, 2007, the U.S. Department of Homeland Security (DHS) published proposed regulations for implementation of the REAL-ID Act.

Key Features of the Proposed Regulations

Major elements of the Act's provisions as amplified by the proposed regulations are set forth below.

- **Implementation:** Recognizing the difficulties that states faced under the Act's time frames for compliance, the proposed regulations ease many of the deadlines. DHS now proposes to require the initial submission of a state certification package by February 11, 2008, for final approval by May 11, 2008. States would then be allowed to phase in the issuance of compliant ID cards over a five-year period for the convenience of drivers with recently renewed driver's licenses. The regulations would also allow for an extension of the initial certification submission deadline until December 31, 2009, upon a showing of adequate justification. Whether or not a state is granted an extension, the proposed regulations stipulate that REAL-ID compliant cards will be required for official use by federal facilities no later than May 11, 2013.

- **Lawful Presence:** As part of the initial application process, all applicants would be required to establish their lawful presence in the United States through the production of one of the following documents: certified copy of birth certificate, consular report of

birth abroad, U.S. certificate of citizenship, U.S. certificate of naturalization, or an unexpired passport, permanent resident card, employment authorization document, or foreign passport with a valid U.S. visa affixed. This proposed mandate would impose a new burden on applicants for driver's licenses in Maryland and would require a statutory change by the General Assembly.

- **REAL-ID Card Standards:** DHS has proposed that each state's ID card consist of a uniform set of nine data elements and security features and has sought additional comment on the need for uniformity in design and color schemes for each state ID card.

- **Information Technology Systems Development:** The proposed regulations state that the deployment of information technology systems is the highest priority of DHS for the implementation of the Act. Responding to privacy and security concerns, the proposed regulations also state that the majority of information that would be needed for implementation of the Act is already being collected or exchanged by existing state and federal databases. Therefore, DHS emphasizes that its primary focus is only on the need for connectivity between state-to-state data exchanges and to a new federated querying service. The regulations favor state-created rules for the exchange of personal information rather than the collection and retention of data and source documents in a centralized, federal document repository. The proposed querying service would also streamline information requests by merging all information for an applicant into a single consolidated report. The efficiency of the system is predicated on allowing for only a short list of acceptable documents that would need to be authenticated and verified.

- **Security:** Part of the proposed state certification process is the submission of a consolidated security plan. The plan would subject the Motor Vehicle Administration (MVA) facilities to international security standards. MVA personnel would be required to undergo background checks of criminal and financial records. While MVA would have discretion to determine which employees would require background checks, DHS would retain control over what constitutes a disqualifying offense. Enabling background checks for MVA personnel would require revision of current law. Finally, the proposed regulations mandate minimum security features and independent adversarial security testing for the ID cards and consider the need for encryption technology to restrict the access of commercial entities to personal information contained in the barcode.

Economic Impact of Implementation

According to information provided in the proposed regulations, the most recent cost estimate for the implementation of the REAL-ID Act is approximately $17.2 billion over 10 years. This includes approximately $10.8 billion to the states, $6.0 billion to individuals, and $450 million to the federal government. The proposed regulations estimate that new customer services will total $5.3 billion, or 48.8 percent, of total state costs; card production will total $4.0 billion, or 36.9 percent, of total state costs; and information technology systems will total

$1.1 billion, or 10.5 percent, of total state costs. The National Conference of State Legislatures (NCSL) has estimated the cost of implementing REAL-ID at $11.0 billion, but this estimate is for a five-year period. According to MVA, the most recent cost estimate for Maryland is between $80 million and $100 million over a five-year period for a one-tier system, or between $60 million and $80 million if MVA is allowed to continue to issue non-compliant ID cards to those who request it. MVA is awaiting publication of the final regulations from DHS before it produces a final itemized cost estimate for Maryland.

State Actions

To date, 12 state legislatures have adopted laws rejecting compliance with REAL-ID or urging Congress to repeal the Act. An additional 12 states have similar legislation currently pending. The other 26 states have either defeated such legislative proposals or have proceeded to study compliance and implementation of the Act. The National Governors Association, NCSL, and the American Association of Motor Vehicle Administrators (AAMVA) have been collaborating for several years to study the Act's provisions and fiscal impacts and to make recommendations to DHS. Generally, this coalition of state groups has been opposed to the Act, although AAMVA continues to urge its members to move forward with implementation.

Final Regulations

The REAL-ID Act final regulations and refined cost estimates are expected to be released late in 2007. In November, 2007 DHS Secretary Michael Chertoff and other DHS policy officials commented on the likelihood of several changes to the final regulations including extended deadlines for certain classes of individuals, as well as a lower estimated fiscal impact on states due to relaxed ID card and information technology systems standards.

Conclusion

The proposed regulations have provided guidance on many of the provisions of the REAL-ID Act, including a clearer division between state and federal responsibilities. Many of the concerns regarding feasibility of implementation by the states have been addressed through the extension of deadlines.

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Economic and Community Development

Sunny Day Fund

Since its inception in 1988, 106 projects, including three multi-year commitments, have received funding from the Sunny Day Fund, for a total commitment of $173.5 million. The number of new projects has decreased over the last few years. With no money appropriated to the fund for several years, the fund only receives money from minimal repayments of loans.

More Than $173 Million Awarded Since 1988; No New Projects Were Approved in 2007

The Economic Development Opportunities Program (Sunny Day) Fund was created in 1988 to enhance Maryland's competitive position with neighboring states. The fund provides conditional loans and grants to attract, retain, and expand private-sector enterprises or institutions, public institutions, and federal research and development institutes.

As shown in **Exhibit 1**, the fund has provided $173.5 million in conditional loans and grants since its inception (includes modifications to amounts of loans and grants and excludes withdrawn projects). No new projects were approved in fiscal 2007, while projects totaling $10.9 million were approved in fiscal 2006. However, in fiscal 2007, two projects were modified. One project, the University of Maryland College Park (Prince George's County) NanoCenter, increased committed funds by $1,909,841; the original approval of this project in June 2006 was for $1,744,659, making the total cost of the project $3,654,500. The second project, Marriott International (Montgomery County), reduced committed funds by $3.5 million; the original approval (as modified in June 2002) was for $12.5 million, making the total cost of the project $9.0 million.

The level of Sunny Day activity has diminished in recent years, reflecting reduced appropriations due to State budgetary constraints, as well as a shift of activity to the Maryland Economic Development Authority Assistance Fund. The average Sunny Day amount awarded from fiscal 1995 to 2000 was $27.0 million, whereas the average from fiscal 2001 to 2007 was $7.2 million.

A total of 106 projects in 16 counties have been approved. In terms of geographic distribution, about 75 percent of the projects and 80 percent of the funds have been targeted to the Washington and Baltimore regions. The Department of Business and Economic Development (DBED) administers the fund, and the Legislative Policy Committee reviews and comments on proposed Sunny Day projects before DBED may approve expenditures.

Exhibit 1
Approved Sunny Day Fund Projects
Fiscal 1988-2007

County	Number of Projects	Total Funding
Anne Arundel	6	$15,474,000
Baltimore City	20	24,502,000
Baltimore	16	26,629,000
Caroline	1	800,000
Carroll	4	5,072,000
Cecil	1	2,275,000
Dorchester	3	2,283,000
Frederick	5	16,250,000
Garrett	3	3,850,000
Harford	5	11,130,000
Howard	7	7,115,000
Kent	1	750,000
Montgomery	15	25,895,000
Prince George's	7	18,332,841
Washington	6	8,400,000
Wicomico	2	3,000,000
Statewide/Regional	4	1,751,000
Total	**106**	**$173,508,841**

Notes: No project funding was approved in fiscal 2007.
Although the Legislative Policy Committee has approved funding for 135 projects, the actual number of projects receiving funds is reduced to 106 due to the withdrawal of 29 projects. If the withdrawn projects are included, the total approved is $209.9 million.

Source: Department of Business and Economic Development

All Projects Must Meet Performance Requirements; Forgiven Loans Total $52.0 Million So Far

Projects receiving Sunny Day funds must meet certain performance requirements such as job creation and retention and capital investment. If performance requirements are met, the loan agreements often provide for forgiveness of all or a portion of the repayment due. As shown in **Exhibit 2**, full or partial forgiveness has been provided to 43 projects, amounting to $51.9 million against $60.0 million of original loans since the program began.

Exhibit 2
Forgiven Loans and Claw-backs
Fiscal 1988-2007
($ in Millions)

	Number of Projects	Amount	Original Loan Amount
Forgiven Loans	43	$51.9 – forgiven	$60.0
Claw-backs	22	$12.3 – repaid	$21.0

Source: Department of Business and Economic Development

If a project fails to meet performance requirements, DBED may invoke claw-back provisions set forth in the funding agreement. To date, 22 projects have been subject to claw-back, with $12.3 million repaid against original funding of $21.0 million. Not reflected in Exhibit 2 are three companies that currently are in bankruptcy or have a parent in bankruptcy, representing an aggregate loan amount of $8.9 million. DBED monitors these distressed operations and supports potential restructuring that would help meet employment requirements.

The accuracy of DBED's performance data is crucial because forgiveness and claw-back decisions hinge on it. The agency has had challenges with performance data collection and control that are part of the State's Managing for Results process. Legislative audits of fiscal 2001 and 2003 data disclosed major problems with job creation and retention figures, including significant double-counting. DBED has improved its data collection methods, primarily through installation of a new agencywide computer system, but data control procedures are still lacking. In the 2007 session, the General Assembly restricted $1.0 million of the agency's fiscal 2008 general fund appropriation until it establishes control procedures that satisfy the Department of Budget and Management, among other provisions.

Sunny Day Fund Balance Estimated at $6.7 Million as of October 2007

As shown in **Exhibit 3**, an estimated $6.7 million is available for Sunny Day awards in fiscal 2008 as of October 23, 2007. Repayments of principal and interest are expected to be $1.8 million in fiscal 2008, and committed funds amount to $17.2 million.

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

Beginning Fiscal 2008 Balance	$22.8
Projected Fiscal 2008 Principal and Interest Repayment	1.8
Projected Operating Expenses for Fiscal 2008	-0.7
Committed Funds	-17.2
Total Uncommitted Funds Available (as of October 23, 2007)	**$6.7**

Source: Department of Business and Economic Development

Economic and Community Development

Base Realignment and Closure (BRAC)

Under the 2005 BRAC plans, Maryland stands to gain about 20,000 direct new jobs, in addition to over 40,000 indirect jobs. Preparations are underway at both the State and local levels to accommodate this significant influx of residents. In addition to the Maryland Military Installation Council, a BRAC Subcabinet and a Joint Legislative Committee on BRAC were established to oversee and coordinate the various aspects involved with the transition.

The Maryland Military Installation Council

In order to address an excess capacity of military facilities, the U.S. Congress created a process in 1990 known as Base Realignment and Closure (BRAC). The final plans regarding military installations nationwide became effective in November 2005.

In 2003, the State created the Maryland Military Installation Strategic Planning Council (Chapter 335), consisting of 19 representatives of State agencies and federal military installations, to serve as an advocate for military facilities located in Maryland and coordinate State agency planning in response to changes caused by BRAC. After the approval of the 2005 BRAC plans, the State renamed the council the Maryland Military Installation Council (MMIC) and extended the termination date of the council through December 31, 2011 (Chapter 634 of 2006). The 2006 law also increased the membership of the council to 22 members by including representatives of local liaison organizations. MMIC is staffed by the Department of Business and Economic Development (DBED). At its meetings in 2007, MMIC addressed regional base realignment and closure preparedness by hearing briefings from all Maryland installations on their mission activities and on the workforce needs of incoming BRAC personnel. MMIC's annual report is due December 31 of each year.

BRAC Subcabinet

Chapter 6 of 2007 created a 10-member BRAC Subcabinet in State government chaired by the Lieutenant Governor. The subcabinet, comprised of eight State secretaries of cabinet departments and the Superintendent of Schools, is charged with a number of tasks, including:

- coordinating and overseeing the implementation of all State action to support the mission of military installations affected by BRAC;

- coordinating and overseeing the development of BRAC-related initiatives in various areas, including workforce readiness, education, business development, health care

facilities and services, community infrastructure and growth, environmental stewardship, workforce housing, and transportation;

- working with local jurisdictions affected by BRAC to facilitate planning, coordination, and cooperation with the State;
- collaborating with and reviewing the recommendations of MMIC;
- working with Maryland's congressional delegation to obtain federal funds to support the missions of military installations in the State; and
- making policy and budget recommendations to strengthen State support of military installations in the State.

The subcabinet is required to submit an annual report and terminates December 31, 2011. The subcabinet is staffed primarily by DBED.

The subcabinet held a number of public meetings throughout the State since May 2007 and is in the process of reviewing action plans submitted by the nine jurisdictions that will experience the greatest growth as a result of BRAC – Anne Arundel, Baltimore, Cecil, Frederick, Harford, Howard, Montgomery, and Prince George's counties and Baltimore City. Based upon the local plans, the subcabinet will prepare and implement a statewide plan for legislative and budgetary BRAC priorities. The subcabinet intends to complete this comprehensive plan and submit it to the Governor by December 1, 2007.

Joint Legislative Committee on BRAC

Chapter 469 of 2007 established the Joint Committee on Base Realignment and Closure consisting of six members of the House of Delegates and six members of the Senate. The committee is required to provide continuing legislative oversight of the State's response to BRAC-related opportunities and changes. In cooperation with local and State units, it must also oversee and participate in developing systems and processes that fast track the approval of BRAC-related:

- transportation infrastructure;
- water and sewer infrastructure;
- State and local planning processes;
- affordable housing options;
- education facilities, including public school and community college construction; and
- health care facilities and infrastructure.

The committee attended a meeting of the BRAC subcabinet in August 2007 and is expected to hold an organizational meeting prior to the start of the 2008 session. It is expected that legislation will be introduced during the 2008 session to add two more delegates and two more senators as members of the committee.

2005 BRAC Impact on Maryland

The 2005 BRAC plans impact many of the federal military installations in the State, resulting in an estimated 19,536 to 20,836 direct new jobs and placing Maryland among the largest beneficiaries nationally. These changes at each of the State's installations are detailed in **Exhibit 1** and are expected to be phased in over a five- to six-year period. The bulk of the gains are expected at Aberdeen Proving Ground, Andrews Air Force Base, Fort Meade, and the National Naval Medical Center, and most of these jobs are projected to be medical professionals, engineers, and managers. An additional 40,000 or more indirect jobs could be created through contractors and related services. It is further estimated that Maryland will gain approximately 28,000 households by the time the BRAC process is complete.

Preparations by State Agencies

Under the coordination of MMIC, State agencies are taking steps to prepare for the significant influx of military personnel, civilian employees, contractors, and families in the affected areas. The Maryland Department of the Environment is engaged in assessing adequacy of water and wastewater systems and securing funding for necessary upgrades. The Maryland Department of Planning conducted a study of the employment and residential growth associated with BRAC-related changes at the affected military installations and the impact of that growth on housing supply and demand and water and sewer, power, fiber optic, transportation, and school systems. The Maryland State Department of Education has put in place a comprehensive plan to ensure that Maryland schools are ready for the children and families that will be part of BRAC. The Maryland Department of Transportation has assessed traffic and other transportation needs in the growth areas; held coordinating meetings with county planners, military alliances, and base personnel; and identified and begun work on specific BRAC-related traffic and transit projects. In addition, the Department of Housing and Community Development is working to develop and market home ownership and rental assistance programs for the expected new residents.

Exhibit 1
Impact of BRAC on Maryland
Proposed Base Changes and Estimated Employment Changes

Base	Proposed Base Changes	Estimated Employment Change per BRAC Model
Aberdeen Proving Ground (Harford County)	Absorb Army Test and Evaluation Command currently located in Alexandria, VA; become a center for electronic warfare research by absorbing functions currently performed at Ft. Monmouth, NJ and Ft. Belvoir, VA; absorb Army research institute now at Ft. Knox, KY	Gain of 10,426 jobs
Andrews Air Force Base (Prince George's County)	Relocation of Air Force District of Washington; realignment of Air Force headquarters from Arlington, VA; other moves	Gain of 2,000 jobs
Fort Meade (Anne Arundel County)	Absorb the Defense Information Systems Agency as well as the Army's adjudication and media activities	Gain of 6,000 jobs
Martin State Air Guard Station (Baltimore County)	Reassign 8 130J cargo planes to other bases	Loss of 237 jobs (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 (Frederick)	Minor realignment	Gain of 185 jobs
National Naval Medical Center (Bethesda)	Close the Walter Reed Medical Center (WRMC) in Silver Spring and move several WRMC functions to the National Naval Medical Center	Gain of 1,200 – 2,500 jobs

Exhibit 1 (continued)

Base	Proposed Base Changes	Estimated Employment Change per BRAC Model
Naval Surface Weapons Station (White Oak)	Minor changes	Gain of 11 jobs
Army Research Laboratory (Adelphi)	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: Department of Business and Economic Development

Preparations by Local Governments

The affected jurisdictions – Anne Arundel, Baltimore, Cecil, Frederick, Harford, Howard, Montgomery, and Prince George's counties and Baltimore City – have been actively engaged in BRAC preparation efforts. They have been meeting and working with MMIC and the subcabinet, and each has prepared a BRAC action plan. Many counties have established a web site relating to BRAC; created a BRAC office, task force, or implementing commission; and/or appointed a BRAC director. A number of the counties have also applied for and received federal grants to address BRAC-related issues such as transportation, housing, utilities, services, and education.

Business Regulation

Horse Racing

The horse racing industry in Maryland continues to experience challenges, mostly from video lottery terminals enhancing purses in neighboring states. With Pennsylvania joining Delaware and West Virginia in providing this type of gaming at racetracks, Maryland may lose its distinction as the major horse racing state in the region. While the industry has made adjustments to improve its well-being, the industry is heavily counting on the authorization of slots.

Maryland's Racing Industry at a Glance

Currently, most horse racing in Maryland occurs at Pimlico in Baltimore City and Laurel Race Track in Anne Arundel County, which are thoroughbred tracks run by the Maryland Jockey Club. All standardbred racing occurs at Rosecroft 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 licensees. An additional track license was awarded to Allegany Racing in Allegany County, which is owned by the same persons that own Ocean Downs. Allegany Racing has yet to begin construction and most likely will not unless slot machines 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 several off-track betting facilities located in Frederick, Cecil, and Dorchester counties. A fourth off-track betting facility is located on a boat docked on the Potomac River in Southern Maryland.

Exhibit 1 includes some selected statistics relating to Maryland racing. The exhibit shows that purses improved in calendar 2006. The amount wagered on live racing also remained relatively stable in 2006, even though the number of live racing days continued to decline. The purse increases and stable betting amounts may be due to fewer racing days and the new turf course installed at Laurel Park.

Preliminary numbers indicate, however, that the 2007 figures will all be lower than the 2006 figures. For example, the number of live racing days was reduced to 180. The Maryland Jockey Club also reported that live wagering and simulcast wagering on Maryland races were down by 8.6 and 8.4 percent, respectively, during the spring of 2007, and that track revenues were down by $1.7 million from the same period in 2006. During the summer of 2007, the Maryland Jockey Club also reduced purses across the board by $2,000 to cover a $3.0 million purse deficit for the fall meet. Finally, the Pimlico Special, a $500,000 Grade 1 stakes race, was cancelled during Pimlico's spring meet.

Exhibit 1
Maryland Racing Statistics
Calendar 2003 to 2006

	2003	2004	2005	2006
Purses				
– Thoroughbred	$40,419,961	$32,947,195	$35,622,202	$40,158,123
– Standardbred	7,135,970	5,827710	5,159,140	6,212,865
Live Racing Days				
– Thoroughbred	217	205	203	192
– Standardbred	162	156	137	146
Amount Bet on Live Racing				
– Thoroughbred	$43,881,203	$38,584,051	$40,980,761	$40,993,431
– Standardbred	10,278,915	8,324,216	6,824,672	6,550,292
Total Amount Wagered				
– Thoroughbred Tracks	308,725,477	293,654,786	298,571,616	279,809,857
– Standardbred Tracks	144,598,814	131,111,251	140,789,277	130,058,631

Source: Maryland Racing Commission 2006 Annual Report

State Assistance and Actions Regarding Maryland Racing

Horse racing in Maryland's neighboring states is succeeding because other forms of gaming, primarily slot machines, enhance purses. Another way to enhance purses includes government grants. Although more common in the past, 2002 was the last year the General Assembly authorized the use of State funds to enhance racing purses, when $3.7 million was designated for purses. The purse amounts in Maryland largely come from money wagered on Maryland races, while purses in Delaware, West Virginia, and Pennsylvania consist of a combination of money wagered on races and purse supplements. Although Maryland has not provided State funds for purse supplements in recent years, some racing revenues were redirected for purses for the Maryland Million races.

The Pennsylvania Effect

The most recent significant event affecting Maryland racing is occurring in Pennsylvania. Maryland's racing industry was already experiencing pressure from Delaware and West Virginia. Pennsylvania legalized the placement of 61,000 slot machines in specific locations across the state, including five racetracks. Starting with a harness track in the Pocono Mountains in late 2006, slot machine gambling is now occurring in Pennsylvania at several locations. The number

of machines far exceeds the number of machines in Delaware and West Virginia, which means the amount of revenue generated in Pennsylvania, will be substantial. As a result of slot machines in Pennsylvania, the state could eclipse Maryland as the major racing state in the region.

The Maryland racing community believes that many horse breeders and horsemen will be lured to Pennsylvania. The impending bounty has lead Pennsylvania to tighten its breeding rules by requiring that dams and foals spend more time in the state to qualify for state-bred winnings. The most recent breeding statistics for 2006 indicate that Pennsylvania has surpassed Maryland for the first time in the birth of thoroughbred foals with 1,139 live births compared to 812 live births in Maryland. In fact, the number of foals born and registered in Maryland has dropped by a third from 2000 to 2006, while the number of foals born and registered in Pennsylvania grew by 23 percent over the same period. Maryland still has a higher number of quality stallions, but that number has also gone down from 92 in 2003 to 64 in 2006.

An Industry Comes Together

Maryland was plagued by industry infighting among track owners, horse breeders and owners, and horsemen. An issue that significantly affected the industry for many years was a revenue sharing agreement between the Maryland Jockey Club and Rosecroft. The two parties recently signed a 15-year agreement whereby, out of the revenues realized by both groups, the Jockey Club receives 80 percent and Rosecroft receives 20 percent. The agreement also eliminated the "6:15" rule that prevented any evening and night racing at Laurel or Pimlico racetracks, and in return Rosecroft may conduct racing during the day. Legislation was enacted in 2007 that formally repealed the "6:15" rule. Other prior disagreements between the Maryland Jockey Club and thoroughbred horsemen and breeders have also been resolved.

Progress, Changing Partners, and Other Matters

In 2002, the Maryland Jockey Club sold a majority interest to Magna Entertainment Corp, 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. Magna recently added a much lauded "state-of-the-art" turf course at Laurel Park. In 2007, several developments occurred regarding Magna's ownership of the Maryland Jockey Club. First, Magna announced a major financial restructuring to pay off $700 million in debt. While part of the restructuring includes selling off assets such as land adjacent to Laurel Park, details of this proposal are not yet known. In addition, Magna announced in the fall of 2007 that it was exercising its option to buy out its minority partners and acquire full control over the Maryland Jockey Club. By purchasing the partners' 49 percent share, Magna ended 20 plus years of involvement of the DeFrancis family ownership of the 264-year-old Maryland Jockey Club. Subsequent to the buy-out, Magna also fired the Maryland Jockey Club's president, much to the chagrin of breeders, horsemen, and others with interests in Maryland racing.

While it appears that the State's major thoroughbred tracks did as well as circumstances permitted, Maryland's major standardbred track, Rosecroft Raceway, experienced far more difficulty. In mid 2002, the owners of Rosecroft Raceway decided to sell their beleaguered harness track. As a result of multiple suitors, the owners of Rosecroft were involved with several civil suits. Eventually, all Rosecroft's litigation issues were resolved, and in 2006 Rosecroft officials reported that the racetrack was not for sale, unless an extraordinary bidder emerged. In 2007, Penn National, a nationwide gaming company based in Pennsylvania, offered to purchase Rosecroft from Cloverleaf Enterprises. As part of its purchase agreement, Penn National, which also owns Charles Town Races and Slots in West Virginia, agreed to:

- pay purses of $6.5 million for the first three years of a six-year period;
- pay purses of $5.5 million for years four through six of the period; and
- conduct not less than 100 live racing days a year.

The purchase was approved by the Maryland Racing Commission. Penn National, however, terminated the agreement when Rosecroft was not included as a site for slot machines under the constitutional amendment passed by the General Assembly during the 2007 special session.

The horse racing industry has also found itself tied up with the immigration debate that has polarized the nation. As a result of immigration curbs, all segments of the industry, including breeders, horsemen, and the tracks, are having difficulty hiring barn workers, back stretch employees, and other related workers. As a result, existing employees are working longer hours, which further stresses the moribund industry. Lastly, the outlook for 2008 is a mixed bag. In October 2007, the Maryland Jockey Club announced that for the 2008 winter meet at Laurel Park, the number of racing days will be reduced from 75 to 60 days, Sunday racing will be eliminated, and racing will only occur four days a week.

2007 Special Session

In late 2007, the Governor convened a special session of the General Assembly to deal with the State's fiscal situation. Part of the Governor's proposal was to bring the long simmering slot machine issue to the voters by proposing to amend the Maryland Constitution to authorize VLTs at five locations. The Governor's slot machine package also included money for racing purses and capital track improvements. The racing industry was heavily counting on the Governor's slot machine proposal, which would provide up to $100,000,000 to the industry.

During the special session, the General Assembly passed the constitutional amendment and a bill that establishes the operational and regulatory framework, which is contingent on voter approval of the constitutional amendment at the 2008 general election. If approved, 7 percent of slot machine revenues, but not exceeding $100,000,000, will be dedicated to racing purses and 2.5 percent over an eight-year period will be dedicated to capital improvements. Eighty percent of the purse funds will go to the thoroughbred industry and 20 percent to the standardbred industry; out of the funds dedicated to each industry, 85 percent will go to purses while 15

percent will go to the respective bred funds. Specifically, the following provisions will affect Maryland racing, as a condition of receiving any aid:

- State licensed tracks must maintain a specified minimum number of racing days;
- if a slot machine licensee also holds a racing license and the licensee owns the Preakness, the Preakness must remain in Maryland and, with certain exceptions, must run the Preakness at Pimlico Race Course;
- the license holder for Laurel Park must continue to permit the Maryland Million to run at Laurel Park; and
- racing licensees must submit quality improvement and marketing plans to the Racing Commission.

In addition, if a slot machine license is awarded to the owners of Laurel Park, that license will be revoked if the Preakness is moved outside of the State. The owners of Laurel Park must also continue to annually promote and run the Preakness at Pimlico Race Course, and annually run the Maryland Million at Laurel Park.

Business Regulation

Retail Electric Restructuring and Electricity Rates

Retail electric competition has not significantly developed in the residential sector, although it has done so for commercial and industrial customers. PSC reports will address concerns and recommendations on returning to regulation or substantially modifying the procurement of electricity for residential retail customers. Constraints in generation and transmission capacity will result in high prices for the foreseeable future.

Rates, Alternative Suppliers, and Competition

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland, introducing "customer choice" of supply services and setting a mandated rate reduction and a cap on the reduced rates. All rate cap restrictions have now expired for residential, commercial, and industrial customers except for Allegheny Power's residential standard offer service ("SOS") customers. With the expiration of price caps, customers are subject to market rates.

The exact amount of a price increase depends on the results of SOS wholesale electric supply auctions which use a bid request process for the load obligations of each utility. Bid offers with the lowest price are selected. Due to significant increases in the prices of commodities used to generate electricity in late 2005, SOS rates significantly increased for the 2006 auctions. The magnitude of the increase was dramatic for BGE customers whose rate caps were expiring at this time. As a result, the General Assembly convened in special session on June 14, 2006, to pass comprehensive energy legislation, addressing electric industry restructuring, SOS, and rate stabilization plans. In order to mitigate significant increases of SOS between July 2006 and May 2007, Chapter 5 of the 2006 special session mandated a 15 percent cap on the rate increase on the total electric bill for BGE residential customers and enacted a process to defer a portion of the BGE rate increase with the deferred amount to be repaid in accordance with Public Service Commission (PSC) proceedings.

Exhibit 1 shows the percent increases for the average annual total bill of a residential consumer for the auctions to procure power during the period from July 1, 2004, to May 31, 2008, for the three investor-owned utilities whose rate caps expired during that period.

Exhibit 1
Percent of Rate Increase for the Average Annual Total Bill**
SOS Auctions for Residential Load
July 1, 2004 – May 31, 2008

	Date Rate Caps Ended	2004 Auctions: July 1, 2004 – May 31, 2005	2005 Auctions: June 1, 2005 – May 31, 2006	2006 Auctions: June 1, 2006 for PEPCO/Delmarva; July 1, 2006 for BGE – May 31, 2007
PEPCO	June 30, 2004	16%	4.5%	39%
Delmarva	June 30, 2004	12%	5.8%	35%
BGE	June 30, 2006	Not applicable	Not applicable	72%*

	2007 Auctions: June 1, 2007 – May 31, 2008	Average Estimated Annual Bill: June 1, 2007 – May 31, 2008
PEPCO	6.9%	$1,789 (at average consumption of 950 kWh/month)
Delmarva	5.1%	$1,853 (at average consumption of 1,100 kWh/month)
BGE	50.4%	$1,746 (at average consumption of 1,000 kWh/month)

Notes:
*Under Chapter 5 of the 2006 special session, the actual increase billed to customers was limited to 15 percent; the remainder was deferred under Rate Stabilization Plan I.
**Average annual total bill includes distribution, transmission, and SOS costs.

Source: Public Service Commission

During the transition period which aimed to give the electric industry time to switch to a competitive market, electric suppliers were unable to compete with the below-market rates in effect under the rate caps. Although electric restructuring has primarily benefited big electricity users, such as industrial customers and State and local government operations, suppliers only slowly started to enter the market for residential customers as the price caps expired. For residential customers, as of November 2007, more than 20 companies are licensed with PSC as suppliers in the State, and many of these are licensed in more than one service territory. However, only a handful of these suppliers are actively seeking new residential customers.

Although a truly competitive market has not developed, as of November 2007, BGE customers have at least 14 plan alternatives to SOS offered by four suppliers; Delmarva has at least 6 alternative plans offered by two suppliers; and Pepco has 9 alternative plans offered by three suppliers. Most of these plans have a “green” energy component which generally causes

the cost to be higher than SOS. As of November 2007, the price to compare for BGE's SOS is $.1086/kWh, Delmarva's SOS is $.1069/kWh, and Pepco's SOS is $.1089/kWh. As a result of the entrance of competitive suppliers, almost 28,000 BGE residential customers (2.5 percent of total customers), almost 25,000 PEPCO residential customers (5.3 percent of total customers), and almost 1,100 Delmarva residential customers (0.6 percent) had switched from SOS by the end of June 2007.

Reports Anticipated from the Public Service Commission

Chapter 5 of the 2006 special session mandated PSC to complete several reports to assist the General Assembly in assessing the impact of electric restructuring on the State and in altering it for the benefit of consumers. PSC was required to study actions taken to implement restructuring and study the impact of potential changes such as reregulating electric generation or allowing local aggregation. The majority of the studies required by the bill were not completed by the start of the 2007 legislative session, leaving much uncertainty as to the ideal structure of the electric industry in the State. Accordingly, Chapter 549 of 2007 (Senate Bill 400) was enacted to require the current PSC to initiate new proceedings to review and evaluate certain requirements of Chapter 5, including the review and evaluation of any orders that were issued under the 2006 enactment. The bill also requires PSC to conduct additional studies and complete reports on electric industry reregulation, assess the availability of adequate transmission and generation facilities to serve the electrical load demands of all customers in the State, and consider the implications of establishing an office of retail market development and establishing a long-term goal for energy efficiency and conservation, among many other matters.

A preliminary report identifying the issues relating to options for reregulation as required by Chapter 5 of the 2006 special session, including discussion of costs and benefits of returning to a regulated electric supply market is due December 1, 2007. A final report containing the complete set of evaluations, findings, and recommendations required under Chapter 5, as amended by Senate Bill 400, is due December 1, 2008.

In response to the passage of Senate Bill 400, PSC has conducted numerous proceedings. PSC found that the power purchased by BGE for SOS reflected wholesale market conditions at the time, but the procurement process approved by PSC was poorly designed. The rate caps masked market conditions. The wholesale market does not appear to work to the advantage of the Maryland consumer and requires further investigation. The SOS auction process needs to be improved, possibly utilizing a managed portfolio approach.

PSC and a handful of economic studies have noted the impact of PJM's locational marginal pricing system ("LMP"), a system that has increased the cost of electricity in areas having substantial congestion in generation and transmission capacity. (The PJM Interconnection is the regional grid operator.) The Federal Energy Regulatory Commission has addressed this congestion by imposing mandatory charges in areas, including central Maryland, in order to spur construction of new transmission facilities to serve congested areas. In addition,

PJM has developed a system to provide incentives for construction of new generation and transmission facilities in its recently implemented reliability pricing mechanism ("RPM"). RPM is a market system in which electricity suppliers bid to provide capacity in future years. As noted by PSC, although initial models of RPM forecasted a moderate and decreasing impact of RPM in central Maryland, in contrast to the equally congested market in New Jersey, the most recent two rounds of RPM bidding have resulted in much higher than expected capacity prices in central Maryland, higher even than in New Jersey. In response to concerns raised by the PJM independent market monitor, and to perceived disparities between earlier forecasts and the actual results of auctions in PJM's new RPM, PSC is including a closer look at PJM market operations and their effect on Maryland consumers in the economic studies and reports due to the General Assembly under Senate Bill 400.

PSC has hired a consultant to study re-regulation options with costs and benefits, stranded cost settlements, options to build or buy new generation with a cost-effective analysis, and impacts of wholesale market design in Maryland rates.

Adequacy of Generation and Energy Efficiency Measures

The Governor's Energy Summit held on July 25, 2007, initiated discussions about the State's energy challenges. The Maryland Energy Administration's (MEA) summary of the proceedings states: "*Summit participants noted that Maryland faces a number of energy challenges, including skyrocketing prices, electricity demand far outpacing new generation, congested transmission lines and the absence of coordinated energy planning. Panelists warned that, given current consumption patterns and existing generation capacity, Maryland could face electricity shortages and rolling blackouts as soon as 2011*." Following the summit, the Governor directed MEA to develop a strategic energy plan that would include policy options to promote affordable, reliable, and clean energy.

Further discussions regarding the need to increase energy efficiency and electricity supply and possible solutions were presented at the PSC's Planning Conference on Maryland's Energy Future held on July 26 and 27, 2007. It was evident from these discussions that while energy efficiency measures aimed at lowering demand are a large part of the solutions, these measures alone cannot solve the pending demand over supply imbalance that the State faces.

As the fifth-largest net importer of electricity in the United States, Maryland purchases more than a quarter of its electricity from other states. Obtaining power from other states, such as Pennsylvania and West Virginia, is costly for Maryland ratepayers due to transmission congestion costs. Maryland's increasing dependence on energy from outside the State will cause further congestion in the transmission system. PJM has projected transmission overloads for 2012, warning that Maryland should construct three new 600 megawatt power plants in the next decade to maintain its energy status quo. Combined with the elimination of price caps, the added congestion costs cause Maryland ratepayers to continue to pay among the highest marginal prices in the PJM grid.

Adding to the supply scarcity in Maryland is the possibility that some of the State's current generation facilities may not be operational for much longer. About 46 percent of the power plants are age 37 or older. Pepco Energy Services recently announced it plans to retire two of its aging power plants, taking 800 megawatts of generation power out of the grid. No new large-scale power plants have been built in over a decade. Although Competitive Power Ventures, Inc. plans to build a new 600 megawatt gas-fired power plant in Charles County, it will not be operational for four years. It should be noted that even though an electricity supplier may plan to retire an older power plant, under its operating agreements PJM may require the plant to continue to operate if needed to support system reliability, both on physical and economic grounds.

To assist with the supply scarcity challenge, the Governor announced in July 2007 new energy efficiency goals for the State of Maryland aimed to save taxpayers money, reduce stress on Maryland's energy markets, and improve the environment. Under the "EmPOWER Maryland" initiative, the State of Maryland is charged with reducing energy consumption by 15 percent by the year 2015. The initiative contains seven steps to help State government reduce power consumption: (1) improve building operations; (2) expand use of energy performance contracting; (3) increase the State Agency Loan Program under the Maryland Energy Administration; (4) require energy efficient buildings; (5) purchase Energy Star products; (6) expand the Community Energy Loan Program; and (7) ensure accountability by providing a StateStat process to help State agencies track their progress and assist in achieving the statewide energy efficiency goals.

To enhance electric reliability and improve transmission capacity, Pepco Holdings has recently announced its proposal to build a 230-mile interstate power line. The 500-kilovolt line, known as Mid-Atlantic Power Pathway will connect Northern Virginia to Maryland, cross the Delaware Peninsula, and link the power grid in southern New Jersey. The $1 billion project is anticipated to be completed in seven years, creating an annual savings of about $125 million in congestion costs. In addition, two high-voltage transmission projects are in planning and permitting stages in the Dominion and AEP service territories that will import electricity from low-cost generating stations in the Ohio River valley into central Maryland, Virginia, and Pennsylvania. However, the timetable for these transmission projects is uncertain in the face of considerable local opposition in Northern Virginia, through which these transmission lines must pass.

Business Regulation

Workers' Compensation

Workers' compensation premiums are anticipated to decrease slightly as fewer claims are being filed, despite projected increases in wages, an aging workforce, and rising medical costs. Legislative proposals introduced during the 2008 session will likely include the compensation impact of reopening a permanent partial disability case, the wage benefit under a minor tier permanent partial disability case, the prohibition of vocational rehabilitation services for undocumented workers, and the administration of the State's workers' compensation claims by the Injured Workers' Insurance Fund.

Maryland's System Stays on Course but Costs Continue to Rise

Maryland employers may pay a little less in workers' compensation insurance premiums in 2008, despite decreases in the prior two years. The pure premium rate filed by the National Council on Compensation Insurance reflects a 1.7 percent overall drop for most industries in 2008, compared to a 5.2 percent decrease for 2007 and a 5.7 percent decrease in 2006. Pure premium rates, one component of overall premium rates, are set at a level necessary to prefund projected claim loss payments to injured workers.

The good news is that fewer claims are being filed, continuing a trend from last year, and insurers are receiving slightly more in premiums than the amount they are required to pay for wage losses. According to an annual review of costs by Actuarial & Technical Solutions, Inc., Maryland was the ninth lowest in workers' compensation comparative costs for both manufacturing and office operations in 2007. Conversely, Maryland ranks only twentieth (out of 46 states) for average total benefits per employee.

Due to projected wage increases and an aging workforce, indemnity benefits will likely become more expensive in the future. Medical fees are also rising, partly from a national trend of rising hospital and drug costs, as well as from the costs associated with treating more severe injuries incurred by older workers. (Maryland's population between 45 and 64 years of age is expected to peak in 2011.) The State's litigation costs and rate of attorney involvement are consistently higher than those in many other states. Indemnity claim costs in the State average over $19,000 per claim when an attorney is involved compared to $7,600 without an attorney.

Legislation Likely to Surface in 2008

Issues that are likely to surface during the 2008 session include several proposals introduced during the 2007 session, the ruling in a recent court case, and a policy question raised by the Office of Legislative Audits (OLA). The Workers' Compensation Benefit and Insurance

Oversight Committee anticipates reviewing some of these issues at its two meetings scheduled in November and December 2007.

Permanent Partial Disability (PPD)

When a covered employee sustains a permanent partial disability as a result of an accidental injury that is covered under the Maryland workers' compensation law, the employee is entitled to compensation. Examples of a PPD include the loss (or lost use) of a body part or a partial loss of vision. PPD accounts for 11 percent of Maryland's workers' compensation claims, compared to 9 percent in the District of Columbia, 5 percent in Virginia, and 8 percent nationally.

PPD compensation is determined by the nature and severity of the disability according to a three-tiered system that was created as part of a comprehensive reform of the workers' compensation system. Each tier progressively expands both the number of weeks over which compensation is paid and the compensation amount. Until *Del Marr v. Montgomery County*, 397 Md. 308 (2007), a worker whose disability worsens and is moved through the reopening of the case from the minor tier to the higher compensated middle tier could, in some cases, receive previously awarded compensation at the new, higher rate. However, the Court of Appeals held in Del Marr that if the Workers' Compensation Commission (WCC) reopens a case and enters a new award to reflect a change in an employee's condition, the new award will not affect the compensation amount paid prior to the entry of the new award. Current law already provides that the amount of compensation previously awarded and paid may not increase in a case where an employee is moved from the middle tier to the serious tier.

House Bill 1261 of 2007 would have affected the first tier of permanent partial disability benefits, those awarded for 75 weeks or less. The bill would have increased the maximum benefit for covered employees awarded compensation from $114 to one-fifth of the average weekly wage, currently equivalent to $170. The change would have been prospective, applying to claims filed after October 1, 2007 (the bill's effective date). This change would allow the amount to annually increase automatically rather than requiring a change in statute. The legislation was heard by the Economic Matters Committee, but no action was taken.

Coverage of Undocumented Employees

The State statute is silent on whether undocumented workers are eligible for any type of workers' compensation benefits. In 2005, the Court of Appeals (*Design Kitchen & Baths v. Lagos, 388 Md. 718, 882A.2d 81)* upheld a lower court 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. While the court case largely settled the issue of coverage for medical bills and lost income, the debate over restricting vocational rehabilitation benefits continues.

While courts across the country have generally ruled that injured undocumented workers are entitled to medical and wage replacement, they have issued varying opinions on vocational

rehabilitation. In 2001, a Nevada court (*Tarango v State Industrial Commission*) denied vocational benefits to an undocumented worker, citing both preemption of federal law as well as the fact that a legal state resident would have been required to accept the modified job offered by the employer and would not be eligible for the services sought by Tarango.

However, in *Gayton v. Gage Carolina Metals* (2002*)*, a North Carolina appeals court refused to terminate benefits to an undocumented worker, stating that it is the employer's burden to prove that there are jobs that the claimant is capable of obtaining, but for his illegal status. "Until the employee reaches this "but for" situation," the court wrote, "the employer may perform any vocational rehabilitation to place the employee in a position where, if the employee were a legal alien, he could be employed."

Undocumented workers in Maryland who are injured on the job have generally not been awarded vocational rehabilitation benefits by WCC as a matter of practice. A worker in Maryland who qualifies for vocational rehabilitation is assigned to a provider for vocational assessment and a recommendation for services to return the employee to "suitable gainful employment." Vocational rehabilitation services include vocational assessment, evaluation, and counseling, as well as rehabilitation plan development, and job development. Yet, federal law makes it unlawful for a person to hire, recruit, or refer for a fee, anyone who is not authorized to work in the United States or to continue to employ a person once their unauthorized status is known. Whether it would be a violation of federal law for the State to provide any of these services has not been determined. Senate Bill 12 of 2007, as amended by the Senate Finance Committee, would have allowed an undocumented worker to qualify for both medical and indemnity benefits, but not vocational rehabilitation services. The Senate did not take action on the bill.

Workers' Compensation Administration for State Employees

In a review of the State Treasurer's Office, OLA raised a policy issue regarding the fact that the State's contract for handling worker's compensation claims filed by State workers has never been subject to a competitive bid process. The Injured Workers' Insurance Fund (IWIF), an independent State agency, has long been the State's claim administrator. IWIF began as the State Accident Fund in 1914 and later became an independent agency in 1988. It also handles claims for private companies and is the largest provider of workers' compensation insurance in the State, reporting a net income of $48 million in calendar 2006.

Between fiscal 2004 and 2006, the State paid IWIF $30.6 million for administering claims totaling $105 million. OLA commented that competitive bids are not required for contracts between units of State government; however, "considering the significant amounts paid to IWIF annually, as well as the availability of this service from private insurance companies, we believe that a competitive bid process should be used to determine if the State is receiving a fair price…" IWIF's most recent agreement with the State to administer claims was approved by the Board of Public Works in 1990.

OLA also questioned the practice of allowing IWIF to hold long-term liability funds in reserve, rather than the Treasurer, which is responsible for administering the State's agreement with IWIF. As of August 30, 2006, IWIF held $25 million in an interest-bearing account. Legislation may be necessary to authorize the Treasurer to hold those funds.

Business Regulation

Unemployment Insurance

The Committee on Unemployment Insurance Oversight continues to monitor the status of the reformed system and plans to discuss legislative proposals pending in Congress that may impact unemployment benefits and funding provisions for the states. Due to the healthy balance in the trust fund, it is anticipated that employers will continue for calendar 2008 to pay from the tax table with the lowest rates.

Legislative Oversight of the Unemployment Insurance Trust Fund and System

In 2002, the federal government passed legislation designed as a stimulus package in the aftermath of increased unemployment after September 11, 2001. The legislation included a distribution (known as the Reed Act distribution) of $8.0 billion to the states. Funds were to be used to pay unemployment benefits or to enhance unemployment insurance (UI) benefits. Allowable uses also included administration of UI and employment services programs. Maryland received approximately $142.9 million of that Reed Act allotment. The allotment was placed in the State's Unemployment Insurance Trust Fund where it staved off an employer surcharge trigger. It also enabled the Unemployment Insurance Division in the Department of Labor, Licensing, and Regulation to use other funds to increase unemployment benefits in fiscal 2003.

The amount of federal unemployment insurance funds allocated to each state is based on workload indicators of the states' unemployment insurance divisions such as initial claims filed, appeals, and decisions rendered. The positive economic condition of Maryland has led to a decline in federal funds for UI administration costs. Fiscal restraints at the federal level appear to be a contributing factor as well. Included in the State's fiscal 2008 budget is $111.2 million in Reed Act funding to replace lost federal funds to support the cost of administering the UI program and to a lesser extent, some costs associated with employment services. About $119.3 million of the original Reed Act distribution will remain in the trust fund.

Legislation enacted in Maryland in 2005 (Chapter 169) altered the UI charging and taxation system by creating a series of experience tax rate tables that are based on the balance in the UI trust fund. The legislation provides that if the balance of the UI trust fund exceeds 5 percent of total taxable wages in the State, as it did in 2006, the lowest tax rate would be imposed. Because of this change, in addition to the use of Reed Act funds in the UI account for operational costs, the General Assembly concluded that additional oversight of the UI account balance is warranted. Committee narrative was adopted within the *Joint Chairmen's Report* requiring the division to report on aggregate inflows, outflows, and balances of the UI trust fund on a quarterly basis to allow the committees to monitor changes in the financial position of the fund.

Created to monitor the changes under the 2005 legislation, the Committee on Unemployment Insurance Oversight has scheduled a meeting for mid-November 2007. As was the case for calendar 2007, the balance of the trust fund (as measured on September 30, 2007) is anticipated to be at a level that will allow employers to pay tax rates from the lowest tax rate table (Table A) in calendar 2008. Table A provides a minimum tax rate of 0.3 percent, or $25.50 per employee; in calendar 2005, employers paid from Table B where the lowest tax rate is 0.6 percent. Approximately 66.4 percent of employers qualify for the minimum tax rate each year. In addition to hearing the status of the trust fund, the oversight committee will hear more about the legislative proposals pending in Congress, as described below.

Legislative Proposals Pending in Congress

Congress May Offer States Funds to Expand UI Benefits

Under federal legislation proposed this year in both the House and Senate, several thousand more workers in Maryland would be eligible for unemployment insurance benefits if the State accepts additional Reed Act funds that would only be available if benefits are expanded in certain ways. The Unemployment Insurance Modernization Act would reauthorize the federal unemployment insurance surtax (paid by employers) that would provide a total of $7 billion in incentive payments (over five years) to encourage states to expand benefit eligibility. (As of November 2007, the House Ways and Means Committee passed the UI Modernization Act as part of legislation that reauthorizes the federal Trade Adjustment Assistance program; no action has occurred in the Senate.)

Both versions would award a state one-third of its total possible allotment if the state alters the base period used for calculating benefits to include the most recent calendar quarter. Many states, including Maryland, use the first four of the last five quarters of employment as the base period. Two-thirds of the remaining allotment would be awarded if the state adopts at least two of four additional changes specified by the legislation. These changes may include (1) making part-time workers eligible for benefits; (2) providing coverage to individuals who separate from work for compelling family reasons (illness of a family member, safety reasons due to domestic violence, change in spouse's employment location); (3) providing benefits for at least 26 weeks or half the of the individual's total wages during the base period; or (4) adding a $15 weekly allowance (minimum) to UI payments for dependents.

Of the benefits proposed in the legislation, Maryland has already enacted benefits for 26 weeks and an allowance for dependents under the age of 16; however, the dependents' allowance ($8 per week) is below the $15 required by the bill. The Congressional Research Service estimates that Maryland would be eligible for up to $130 million (excluding administrative grants) if it enacted all the changes required by the legislation. If the State enacted only the base period provision, it would be eligible for up to $43 million.

Providing eligibility for part-time workers was one of several benefits considered by the Committee on Unemployment Insurance Oversight in 2003 and 2004 as part of an overall reform of the State's system but was never adopted. Its estimated impact on the trust fund in 2003 was approximately $37 million to cover 16,000 workers. The committee also reviewed the possibility of an alternative base period to include the most recent calendar quarter.

Nationwide, part-time workers received UI benefits at a rate of 29 percent, compared to 50 percent for full-time workers in a study conducted by the General Accounting Office (GAO). The GAO report, released September 2007, also indicates that low-wage workers (earning less than $8.97 in 2003) were found to be over twice as likely to be unemployed than higher wage earners but half as likely to receive unemployment benefits. Thirty states now allow UI benefits for part-time workers, according to the National Law Project.

Federal Legislation Would Lengthen Layoff Notices, Expand Aid to Workers Affected by Trade Activity

Action is pending on a bill (HR 3796) in Congress that would change federal law regarding layoffs to require an employer to give 90 days (rather than 60 under current law) written notice to employees and government agencies before ordering a plant closing or mass layoff. Job losses by part-time workers would be counted toward the number of jobs that trigger the notice requirement. Employers who fail to comply with the notice requirement would be liable for certain damages paid to the employee. The bill authorizes the Secretary of Labor to investigate complaints filed by employees and requires the employer to post notices about complaint filing procedures and other provisions of the law. HR 3796 also enables long-term or older employees to obtain COBRA health insurance coverage for longer than 18 months.

Congress is also reviewing changes to the Trade Adjustment Authorization Act (TAA), which was created in 1962 to provide income protection, a limited health care benefit, and job training for qualified workers who lose their jobs as a result of import competition or certain shifts of production overseas. Workers only qualify for TAA assistance after their UI benefits are exhausted. The program was expanded considerably in 2002 but has been criticized for administrative problems, as well as inadequate coverage of workers affected by global trade policies. Current legislation would make it easier for service sector workers who lose their jobs to be eligible for benefits.

Workers Classification Likely to Surface in 2008 Session

As the number of independent contractors grows in the United States (accounting for over 7 percent of the U.S. workforce in 2005), so does interest in whether workers are being properly classified as employees or independent contractors. The classification makes a significant difference in the employment protections and benefits that are available to workers as contractors are typically exempt from federal requirements governing minimum wage, overtime,

health insurance, pensions, unionization, and medical leave, as well as workers' compensation and unemployment insurance benefits. Employers do not have to pay Social Security or unemployment taxes for independent contractors, nor do they have to pay workers' compensation insurance. The U.S. Department of Labor reported to Congress that undocumented workers are particularly vulnerable to wage violations, including misclassification. According to GAO, misclassification occurs in several industries, including janitorial services, construction, and hospitality.

Legislation introduced in the special session of 2007 (HB 12) would authorize the Maryland Department of Labor, Licensing, and Regulation to investigate complaints regarding possible misclassification of construction workers and issue stop work orders. The bill would also impose penalties on employers of construction workers who are found to be improperly classified as an independent contractor. No single test currently exists to determine how a worker should be classified; court rulings have provided criteria for case-by-case determinations.

Business Regulation

Task Force on the Availability and Affordability of Property Insurance in Coastal Areas

As a result of record storms that cost billions of dollars in damage to the Gulf Coast and Eastern Seaboard, insurers have begun to react with efforts that mitigate coastal losses of future storms. In Maryland, one major insurer announced that it would stop issuing new policies in the State's coastal areas; other insurers have reacted by implementing other underwriting standards aimed to mitigate losses. The Task Force on the Availability and Affordability of Property Insurance in Coastal Areas was created to study the impact of the recent actions of insurers. Although the work of the task force is not yet complete, some policy implications are apparent.

Background

Since the record storm seasons of 2004 and 2005 caused billions of dollars in damage to the Gulf Coast and Eastern Seaboard, several of the nation's largest insurers have stopped renewing homeowner's policies in some regions of the country considered at-risk for future hurricanes and floods. In Maryland, insurers continue to renew homeowner's insurance policies in coastal areas – areas most at-risk for future hurricanes and floods. However, in January of 2007, Allstate was the first of several insurers in Maryland to announce that it would stop issuing new policies in the coastal areas of the State. In response to these actions, Chapter 486 of 2007 established the Task Force on the Availability and Affordability of Property Insurance in Coastal Areas to examine the continued availability and affordability of property insurance in coastal areas of the State. The six-member task force consists of four members of the General Assembly, the Maryland Insurance Commissioner, and the People's Insurance Counsel.

Specifically, the task force is charged with studying:

- the availability and affordability of homeowner's insurance and other property insurance in coastal areas of the State, including the Eastern Shore and Southern Maryland, and whether there is sufficient competition within those areas;
- the current number and types of insurers in the coastal markets, including admitted carriers, excess and surplus lines carriers, residual market mechanisms, captives and the reinsurance market, and the types of products offered;
- the competition and rate adequacy in the coastal markets for storm-related perils;
- the impact of coastal markets on the availability and affordability of property insurance in noncoastal areas and the costs associated with spreading property insurance risks among homeowners across the entire State;

- the regulatory framework within the State for the pricing and underwriting of property insurance, including the use of named storm deductibles;
- the development and evolution of storm modeling and its use by the insurance industry in the assessment of potential losses from significant storms and the need for a regulatory framework in the use of storm modeling;
- potential structural protections for properties in coastal areas that would result in the mitigation of storm damage in coastal areas and the extent to which such mitigation has had a beneficial impact on the availability and affordability of property insurance in other states;
- the ability of the State to influence patterns of real estate development in coastal areas in a manner that minimizes future exposure of the State and Maryland residents to severe storm damage to property;
- the effectiveness, cost, and long-term viability of alternative market mechanisms, such as limited coverage products, wind pools, the expansion of residual market mechanisms, and catastrophe funds that have been implemented or are being considered in other states or by the federal government;
- initiatives adopted in other states to increase availability and affordability of property insurance in coastal areas; and
- any other matter the Commissioner deems relevant to the availability and affordability of homeowner's insurance in coastal areas of the State.

The task force, which terminates on May 31, 2008, is expected to report its findings and recommendations to the Governor, Senate Finance Committee, and House Economic Matters Committee by December 31, 2007.

Work of the Task Force

As of November 7, 2007, the task force had met three times and had covered all of the study topics with which the task force was charged. The task force heard from a variety of representatives, including Maryland insurance regulators; a South Carolina insurance regulator; insurance and reinsurance associations; an insurance rating service; an advisory organization on actuarial and statistical policy; building and home safety associations; a certified inspector for Florida and South Carolina; consumer groups; insurers; agents and agent associations; catastrophe loss modeling, consulting and risk management companies; a Florida mitigation association; and the Joint Insurance Association. Because the task force has not yet completed its work, specific recommendations are unknown at this time.

Maryland Insurance Market

Although over 100 insurance companies issue homeowner's insurance policies in the State, approximately 85 percent of policies issued in the State are insured by 10 insurance

groups. Frequently, policy changes implemented by one of these insurance groups are adopted in a similar fashion by the other insurance groups, thereby affecting the vast majority of homeowner's insurance policies in the State.

While many states are experiencing cancellations and nonrenewals on homeowner's policies in coastal areas, this had not been the experience in Maryland. What Maryland has experienced has been the alteration of underwriting guidelines in coastal areas. These changes, governed by statute, must be filed with the Commissioner. The changes must be reasonable and have an objective basis. Once a change to an insurer's underwriting guidelines is filed with the Commissioner, the insurer may apply the change immediately, a system also known as "file and use." Under the file and use system, the Maryland Insurance Administration (MIA) reviews the filing to ensure compliance with the law and to ensure that the change is justified.

The most recent underwriting guideline changes filed by homeowner's insurers in Maryland with MIA include (1) limiting the number of new policies an insurer will issue; (2) placing minimum limitations on the distance a home must be from tidal waters; and (3) requiring a deductible equal to a percentage (*i.e.*, up to 3 or 5 percent) of the homeowner's insurance policy limits for damage caused by a windstorm or when the National Weather Service names a tropical storm or declares a hurricane watch or warning, also known as a "named storm deductible."

Other State Actions and National Programs

South Carolina and Florida, states with considerable coastal exposures, have implemented significant insurance reform initiatives aimed at ensuring the availability and affordability of homeowner's insurance in their states. These initiatives include (1) state tax credits for homeowner catastrophe savings accounts; (2) state-sponsored catastrophe funds; (3) grant programs for the retrofitting of homes in order to make homes more resistant to loss from future weather events; (4) state tax credits for costs associated with retrofitting homes in order to mitigate losses from future weather events; and (5) mandatory credits or discounts on a homeowner's policy premium if the homeowner has retrofitted the home to mitigate losses from future weather events.

National programs with the goal of property loss mitigation for weather-related events stress the importance of strong building codes and strict enforcement of these codes.

Storm Modeling

Under Maryland law, the premium rate that an insurer charges may not be excessive, inadequate, or unfairly discriminatory. In order to ensure that an insurer complies with this statutory requirement, the insurer employs the use of an actuarially sound formula to determine the premium rate that the insurer will charge. One factor of this actuarially sound formula is the total expected costs that an insurer may experience.

Most insurers utilize the services of catastrophe modeling companies to determine total expected costs. Catastrophe modeling companies use data from prior catastrophes, including information regarding the specific type of catastrophe, such as a hurricane, the estimated damages from the catastrophe, and the estimated potential insured losses. Using a proprietary formula, a catastrophe modeling company uses the data to determine the total expected costs of an insurer for a specific catastrophe.

Currently, only Florida requires catastrophe modeling companies to be certified by the state.

Policy Implications

Although the work of the task force is not yet complete, some policy implications are apparent. Task force members questioned the file and use system for underwriting guideline changes made by insurers. The task force could propose legislation requiring approval by the Commissioner prior to an insurer's implementation of certain underwriting changes. In addition, the task force questioned the manner in which insurers implement a named storm deductible. Testimony received by the task force from three different insurance groups identified three different triggering mechanisms for a named storm deductible. Legislation could be introduced providing for uniformity in the application of a named storm deductible. Finally, task force members expressed interest in premium discounts to homeowners who build or retrofit homes to mitigate losses from weather events. The task force may propose mandatory insurance premium discounts to homeowners who have made these structural changes to their homes.

Business Regulation

Lending Practices and Home Ownership Preservation Efforts

As the real estate market conditions have turned, a significant number of foreclosure events have been realized nationwide and in Maryland. Most of the foreclosures involve subprime loans and nonbank loan originators. Some lending practices on nontraditional loans have contributed to the mortgage meltdown. Despite market-driven corrections that have already taken place, the General Assembly may want to make statutory changes to strengthen lending practices and regulatory oversight.

Good Real Estate Market Conditions Turn Bad

Due to good real estate market conditions over the last five years, the traditional mortgage market has evolved from mortgages primarily originated and provided by local banks and financial institutions to mortgages originated through mortgage brokers for nonbank lenders. Through new products, such as "exotic" and other nontraditional mortgages, lenders began to ease borrowing restrictions to allow lower credit borrowers to qualify for mortgages, greatly expanding the subprime market. Subprime loans, which are higher-cost loans, provide opportunities for a wide range of higher-risk borrowers. Consumers with lower credit scores and higher loan-to-value and debt-to-income ratios found that they qualified for mortgages. Further, lenders made loans to customers based on less stringent or no income and asset verification requirements. With the influx of new loans, lenders began to package the loans and sell them to Wall Street as securities to investors. By packaging risky loans with nonrisky loans to spread the risk, investors found the low-risk securities to be attractive, allowing lenders to make even more loans.

During calendar 2006, the real estate market began to realize a turn of events as sales of housing and home prices declined and interest rates increased. Terms of many of the "exotic" and other nontraditional loans included adjustable rates whereby the consumer pays a low interest rate for 2 or 3 years, followed by 27 or 28 years of higher interest rates that are generally tied to the market. As the low interest rate period ended, many borrowers found that they were unable to make the payments due during the high interest rate period. Further, borrowers realized that they were unable to refinance due to prepayment penalties or sell their property due to the lower value of their property. Investors of rental property found that they were unable to get the rent needed to pay their mortgages and were unable to sell due to the depressed resale market.

Accordingly, many borrowers filed for foreclosure. According to RealtyTrac, states with high foreclosure rates include Nevada, Colorado, Georgia, Michigan, California, Florida, Arizona, Ohio, Texas, and New Jersey. Generally, Maryland ranks about thirty-seventh highest in number of foreclosures (about 12,680 for calendar 2007, as of the end of September 2007, as compared to about 3,500 for calendar 2006). Prince George's County accounts for about

24 percent of all foreclosures in the State, Baltimore City accounts for about 16 percent, Montgomery County accounts for about 12 percent, and Baltimore County accounts for about 10 percent. About 13 percent of mortgage loans originated in Maryland are subprime loans; a little more than 50 percent of the foreclosures involve subprime loans. As the foreclosure filings mounted, lenders did not receive payments from borrowers, forcing them to curtail the number of new loans, decrease the products available to borrowers with low credit scores, and tighten overall lending practices and standards. Wall Street investors also responded by pulling out of the risky mortgage market.

The public outcry concerning the number of foreclosures sparked the Senate Finance Committee and the House Economic Matters Committee to review whether statutory changes should be made as a result of the lending practices that may have contributed to the mortgage meltdown. Also, the Senate Judicial Proceedings Committee and the House Environmental Matters Committee have been reviewing the situation, concentrating mostly on the foreclosure process. *For more information regarding the issues surrounding the foreclosure process, see the Issue Paper entitled "The Foreclosure Process in Maryland" under the Civil Proceedings Heading.*

Lending Practices That Contributed to the Mortgage Meltdown

Most of the foreclosures have involved subprime loans and nonbank loan originators, known as brokers. As is the case nationally, the subprime market has grown in Maryland allowing more homeownership opportunities for those who did not have access to credit only five years earlier. Due to the easing of the qualification requirements, some borrowers were steered into loans they could not afford or into higher cost loans. Under the qualification requirements set by the lenders, brokers are paid an up front commission without regard to future consequences of the loan. The following are some of the lending practices that may have contributed to the mortgage meltdown:

- Contract terms include a low fixed "teaser" interest rate for two or three years that turns into an adjustable interest rate that is much higher for the remaining life of the loan ("2/28" or "3/27").

- Prepayment penalties apply if a borrower wants to pay off or refinance before two or three years.

- Borrowers qualify for a loan based on the lowest terms of the loan (based on the interest rate charged during the first two or three years or on the amount paid for an "interest-only" loan).

- Brokers do not verify employment income used to qualify borrowers for a loan.

- Insurance and taxes are not included in escrow, requiring the borrower to come up with the funds to pay these unexpected significant expenses when they become due.

- Although provided with a good faith estimate of loan terms and costs prior to settlement, borrowers are unaware or do not understand that their loan is to be subject to additional fees or higher interest rates.

- Borrowers do not fully understand the ramifications of the mortgage terms, especially since they are told that they qualify for the loan based on their income level.

Actions by State Government to Preserve Home Ownership

As a result of the onslaught of foreclosures, in June 2007 Governor O'Malley appointed the Homeownership Preservation Task Force and created the Homeowners Preserving Equity (HOPE) initiative within the Department of Housing and Community Development (DHCD).

At the same time, due to complaints filed with the Attorney General's Office, the Attorney General established a Working Group on Lending Practices in Maryland to provide input to the Attorney General on issues relating to lending practices. The group is comprised of a wide variety of interested parties, including consumer interest groups, mortgage lenders, financial institutions, brokers, realtors, and State and federal agencies. As of November 2007, the working group has not announced its recommendations.

Homeownership Preservation Task Force

The Homeownership Preservation Task Force, chaired by the Department of Labor, Licensing, and Regulation (DLLR) and DHCD, is comprised of representatives of nonprofit organizations; foundations; housing advocates and counselors; representatives from the federal, State and local governments; government sponsored enterprises (Fannie Mae, Freddie Mac); mortgage lenders; mortgage insurance companies; mortgage services companies; and industry associations (Maryland Bankers Association, Maryland Mortgage Bankers Association, and Maryland Association of Realtors). The task force was charged with (1) analyzing data to plan for current and future needs of Maryland families regarding homeownership; (2) developing a wide-ranging list of financial resources and programs available to homeowners to minimize the number of foreclosures; (3) recommending ongoing outreach, counseling, and educational programs and activities that focus on foreclosure prevention and direct support to homeowners; and (4) reviewing the current laws and regulations in Maryland and recommending appropriate foreclosure protocols, including legislative actions.

In late October 2007, the task force issued its draft recommendations. The recommendations that specifically relate to reforming lending practices and improving regulatory oversight are aimed at providing accountability for all players in the mortgage industry. That is,

the task force recommends tracking the transactions of mortgage lenders and originators by requiring them to put their license number on any recorded security instrument they originate. Currently, if a loan is sold after the loan is settled, it is difficult to determine if a specific originator has an inappropriately high number of loans ending in foreclosure. A tracking system would allow the Commissioner of Financial Regulation (CFR) to target its investigations to originators that have a significant number of originated loans that ended in foreclosure or default. Further, the task force recommends actively promoting DHCD's Maryland Mortgage Program as a safer alternative to high-cost loans and providing outreach and education efforts that include coordinating all public and private resources available to Maryland (*i.e.*, establishing a centralized web site resource for consumers with information about financial and homeownership education and financial assistance).

Homeowners Preserving Equity (HOPE)

HOPE was created to assist homeowners in protecting the equity in their homes and to assist DLLR's efforts in aggressively enforcing predatory lending laws. A total of $111 million is to be provided for mortgage assistance and education efforts. DLLR is to issue $100 million in taxable bonds for use by homeowners facing foreclosure in refinancing their mortgage; $10 million from the Maryland Housing Fund (the State's mortgage insurance fund) to encourage private sector lenders to refinance additional home loans by backing those companies if the homeowners end up defaulting; and $1 million from the Maryland Affordable Housing Trust for grants to nonprofit organizations to counsel homeowners in trouble. Several states have a program that includes low cost loans, assistance with closing costs, assistance with refinancing, and counseling (Pennsylvania, Ohio, California, Connecticut, and Indiana).

Proposals to Alter Lending Practices

In light of the mortgage meltdown, mortgage lenders have instituted stricter borrowing standards to mitigate further damage. There has been a sharp decline in the occurrence of adjustable-rate mortgages and other nontraditional loans, as well as an increase in fixed-rate mortgages. Full documentation loans, which require the borrower to present all necessary documents, including income verification, to be considered for the loans, are prevailing in the market. Further, there has been a heightened awareness by consumers as to the loan terms of the mortgages they accept, particularly with subprime loans. Despite these market-driven corrections that have already taken place, the General Assembly may want to make statutory changes to ensure that a future crisis (with yet to be determined nontraditional products that may enter the market) may be avoided. Various proposals that strengthen lending practices and regulatory oversight in Maryland are summarized below.

Adopt Federal Guidelines

Federal guidelines called "Statement on Subprime Mortgage Lending" currently apply to federally chartered banks and their mortgage subsidiaries. They do not apply to State chartered independent mortgage companies or State chartered banks or their mortgage affiliates. Changes made in June 2007 to the guidelines now require the qualification of a borrower for exotic and nontraditional mortgages to be at the higher amount (at the highest interest rate; or on the interest and principal of an interest-only loan). Lenders must evaluate the borrower's repayment ability, and the lender should ensure that the borrower has sufficient information to clearly understand the loan terms and risks before issuing the loan. Stated income and reduced documentation loans should be utilized only if there are mitigating factors that clearly minimize the need for verification of repayment capacity. Repayment penalties should not extend beyond the initial reset date, and institutions must provide borrowers with a reasonable period of time (typically, 60 days prior to the reset date) to refinance their loans without penalty. Other states, including Colorado and Delaware, have recently passed legislation to require their respective state banking boards to adopt rules incorporating the guidelines on exotic and nontraditional mortgage products risks into state regulations, thereby applying the guidelines to state regulated financial institutions and mortgage brokers.

Establish Separate Licensure of Brokers and Lenders

A bifurcated licensing structure for brokers and lenders would help to track bad actors. Currently, a licensed mortgage lender may be a mortgage broker, mortgage lender, or mortgage service, making it impossible to determine with whom a borrower is dealing. With a separate licensing structure, brokers and lenders could be required to include their license number on all loan documents. Mortgage lenders could be required to report the number of foreclosures by broker. CFR could use the foreclosures data to audit and investigate the brokers and lenders with the most foreclosures.

Regulate Mortgage Lenders That Buy Leads Based on Credit

If a broker pulls a credit report for a prospective borrower, the credit bureaus sell the personal information (name and address) to mortgage lenders that buy leads. The lenders, generally not located in the State, will then solicit the borrower and offer a better deal that may be considered predatory. The Federal Credit Reporting Act allows credit bureaus to sell leads, preempting states that attempt to prohibit this practice. Connecticut and Maine passed legislation that regulates the behavior of the mortgage lenders that buy the leads; these laws require the lenders to act in a certain way and disclose certain information. The appropriate state regulator may then regulate this behavior and go after the bad mortgage lenders.

Require Brokers to Act in Good Faith/Fair Dealing for the Borrowers' Interests

Criteria could be included in the law for the determination of whether a broker acted in good faith. Several states have adopted this practice. Some consumer groups recommend requiring a fiduciary duty standard (or a suitability standard); however, this has been opposed as brokers feel that it is too high of a standard to meet. Minnesota and Maine have a standard that requires brokers to have a reasonable degree of certainty that the borrower can afford the loan. At the front line, brokers may have the best perspective on the borrower's ability to repay.

Require Education/Counseling for Borrowers with Low Credit Scores or Borrowers in High Cost Loans

In 2006, Illinois initiated a pilot program based on certain zip codes; it has now been changed through legislation to include an entire county (about 3.5 million people) beginning in July 2008. The law requires a prospective borrower of a nontraditional loan to spend an hour or two with a credit counselor before going to settlement. First-time homebuyers and borrowers refinancing their homes must attend counseling if the mortgage terms contain provisions that adjust the interest within three years or kick in a prepayment penalty for borrowers who want to pay down the principal ahead of schedule.

Ban Prepayment Penalties on Subprime Loans

Some lenders contend that borrowers receive a lower interest rate if the loan terms include a prepayment penalty provision. However, mortgage brokers are allowed an extra commission, known as a "yield spread premium" for loans that include a prepayment provision. About 35 states regulate prepayment penalties, with at least 10 banning them. Recently, North Carolina and Minnesota passed legislation to ban prepayment penalties on subprime loans.

Require Escrow for Taxes and Insurance

To make loan payments low, generally subprime loans do not require an escrow for property taxes or hazard insurance. Once the tax or insurance bill comes due, the borrower has difficulty coming up with the entire payment.

Establish Lender Liability for Broker Acts and Omissions

To make lenders more accountable and responsible for abusive loans they originate either themselves or through a broker, the unfair and deceptive trade practices law could be amended. Lenders have the expertise to ensure that brokers are originating loans that may not fail.

Conclusion

It is anticipated that during the 2008 session the Governor or DLLR and the Attorney General will introduce legislation incorporating many of these proposals to alter lending practices.

Public Safety

Sex Offenders

The 2006 federal legislation on sex offenders commonly referred to as the "Adam Walsh Act" and the implementing guidelines/regulations will require several changes to current State law in order to reach compliance. However, to date, the exact changes necessary remain unclear as the final federal guidelines/regulations have not been released.

Background

Following several high-profile sexual assault cases, far-reaching State and federal legislation has been enacted to more strongly punish and more closely monitor sex offenders. The federal Adam Walsh Child Protection and Safety Act of 2006 is meant to protect the public, in particular children, from violent sex offenders through a more comprehensive, nationalized system for registration of sex offenders. The Act calls for conformity by the states with various aspects of sex offender registration provisions, including registration by specified juvenile offenders, specific information to be collected from registrants, verification, duration of registration, access to and sharing of information, and penalties for failure to register. The U.S. Attorney General is required by the Act to issue guidelines and regulations to interpret and implement the legislation. Proposed guidelines were published on May 30, 2007. The period for public comment on the proposed guidelines ended on August 1, 2007. Final guidelines have not yet been published.

Under the Act, the failure of a state to substantially implement the federal requirements within three years (July 2009) could result in a 10 percent reduction in the Byrne law enforcement assistance grant to that state. (According to the Governor's Office, the total fiscal 2008 Byrne fund revenue for Maryland is about $4.3 million; down from $7.3 million in fiscal 2007.) The U.S. Attorney General may authorize up to two one-year extensions of the deadline. A number of new grant programs are authorized under the Act to assist states with implementation and ongoing registration operations. The Act also provides a funding bonus of 10 or 5 percent to a state complying within one year or two years, respectively. However, to date, only funds for the administrative implementation of the Act have been appropriated. No federal money has been appropriated for bonuses or state grant purposes.

Maryland's Compliance with Federal Requirements

Until the final guidelines/regulations are issued, definitive State action necessary for compliance (including statutory changes) is not entirely clear. However, under the proposed guidelines, it appears that the following modifications to current State law, among others, would be needed to meet the new federal standards.

Length of Registration

The federal law divides the classes of sex offenders into a three-tiered system. Under that system, registration is for 15 years, 25 years, or life depending on whether the offense is classified as Tier I, Tier II, or Tier III, respectively. Under current State law, Maryland classifies its sexual offenders into four classifications, and registration is for 10 years or life, depending on the offense. Additionally, under current Maryland law, most registrants are required to reregister every six months, while Tier I offenders in the federal system must reregister quarterly. It may be necessary to completely revamp Maryland's classification system to align it more closely with the federal requirements.

Registration Deadlines

The federal Act requires the offender to appear in person in at least one required jurisdiction not later than three business days after each change of (1) name, (2) residence, (3) employment, or (4) student status and inform the jurisdiction of all changes in information required in the registry. Current Maryland law allows written notice within five days after the change occurs. The federal law also requires that initial registration must occur before release, while Maryland law allows registration "on or before" the date of release.

Application of Registration Requirement to Juvenile Offenders

The federal law applies to juvenile offenders adjudicated delinquent if the offender is 14 years of age or older at the time of the offense and the offense adjudicated was comparable to or more severe than aggravated sexual abuse or was an attempt or conspiracy to commit such an offense. Under current State law, registration requirements only apply to juvenile offenders who have been tried as adults.

Registry Information

The federal Act requires that the registry contain extensive information for each offender, including palm prints, Internet identifiers and addresses, travel and immigration documents, professional licensing information, vehicle information, and physical description of the offender. This information is not required to be included in the registry under current Maryland law.

Homeless Persons

Because the Act defines the term "resides" to mean "the location of the individual's home or other place where the individual habitually lives," the residency registration requirements are extended to circumstances where the offender is homeless, living on the street, or moving from shelter to shelter, or when the place of residence itself moves from place to place, such as a mobile home, trailer, or houseboat. Accordingly, sex offenders must register (1) in any jurisdiction in which they have a home; and (2) in any jurisdiction in which they habitually live

(even if they have no home or fixed address in the jurisdiction, or no home anywhere). Maryland law does not currently account for the homeless offender population.

Retroactivity

The Act's provisions are applied to all sex offenders, including those whose convictions predate the enactment of the Act. Generally, Maryland offenders need not register if their offense occurred prior to October 1, 1995. Exceptions are made for individuals who were under the supervision of the criminal justice system on October 1, 2001, or have out-of-state registration responsibilities.

The Department of Public Safety and Correctional Services is currently developing legislative initiatives for the 2008 session to address State compliance with the requirements of the Walsh Act. However, due to the complexities of the Act and the many issues it involves, a collaborative approach involving public safety, public health, law enforcement, victims' rights, and judiciary representatives will likely be necessary to substantially implement the federal standards.

Public Safety

State Prison System Update

The Department of Public Safety and Correctional Services continues to face challenges relating to capacity and staffing at State correctional facilities.

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.

Facility Update

Closing the Maryland House of Correction

The Maryland House of Correction (MHC) was closed in March 2007 due to the facility's antiquated design and safety concerns. A total of 986 inmates were transferred out of the institution, with 97 inmates transferred to out-of-state facilities. A total of 362 positions were reassigned to other DOC institutions in the Jessup area or within a 50-mile distance. Transferring staff to other institutions has helped reduce vacancies, fill most positions at the Jessup institutions, and reduce overtime costs.

Even though the facility is no longer housing inmates, operation of the hospital building, two Maryland Correctional Enterprises shops, and the maintenance unit is still necessary. This results in an annual operating cost of approximately $1.8 million. The impact on housing and the management of inmates given the 1,200 bed loss includes:

- higher number of inmates on tiers and in programs, recreation, food services, and healthcare areas at each DOC facility;
- a potential increase in disputes among inmates and staff due to larger facility population;
- reduced ability to separate disruptive inmates; and
- increased workload on facility staff.

Future plans for the facility include the demolition of the MHC main building and development of a site for a new updated prison. Although plans for the new facility are still in the early stages, DPSCS included a request for demolition design funds in its fiscal 2009 Capital Budget Plan.

Opening the North Branch Correctional Institution

Construction on the final two 256-cell housing units at the North Branch Correctional Institution in Cumberland is scheduled to be completed by April 2008. The operational opening of the facility is largely dependent on the ability to fill vacant correctional officer positions; however, Housing Unit (HU) 3 is expected to house inmates by the end of fiscal 2008, with HU 4 coming online during the first quarter of fiscal 2009. According to an operating budget impact statement submitted with the Governor's fiscal 2007 capital budget, full operation of the 1,024-cell facility requires an additional $4.8 million and 105 new positions in fiscal 2009. The two HUs currently operational are housing approximately 628 inmates as of October 2007, including 56 inmates transferred from the closing of MHC.

Re-entry Service Provision to Pre-release Inmates

Re-entry Services Targeting Addiction, Rehabilitation, and Treatment (RESTART) programming began at two pilot sites in January 2005, with an evaluation of the program and its impact on recidivism expected in 2009. Budget bill language for fiscal 2007 restricted RESTART expansion to only pre-release inmates who had participated in a minimum of 12 months of services at either of the two pilot sites. According to DPSCS, very few RESTART services are currently being provided in the pre-release facilities due to these restrictions and struggles with filling new positions. During the 2007 session budget hearings, DPSCS indicated the intention to shift away from RESTART programming and focus more on providing traditional reentry and transitional services to inmates. As a result, the budget committees did not renew the restrictions from the fiscal 2007 budget bill language and allowed service provisions for all pre-release facilities.

The fiscal 2008 budget includes $671,000 for expansion of reentry services to pre-release facilities. In order to implement the reentry services plan, DPSCS estimates needing an additional $2.3 million. This includes $1.4 million for an additional substance abuse treatment center and increased use of risk assessments, in addition to 25 new positions.

The new services to be provided include:

- *transition services*: provision of applications for resources and entitlements, proper identification documentation, and assistance in finding housing and employment;

- *mental health transition*: support and guidance for staying medically compliant, creating continuity of care, and locating mental health services once in the community for those individuals with a diagnosed mental illness;

- *additional case management functions*: social skills training including how to apply for a job, manage finances, and cognitive restructuring (Thinking for Change Program);

- *aftercare support services*: continuation of support programming and counseling for inmates who received prior substance abuse treatment and cognitive behavior restructuring programs; and

- *substance abuse treatment services*: conversion of a pre-release facility into a therapeutic community treatment center to be administered through a private contractor.

According to DPSCS, approximately 4,200 inmates, or 30 percent of all released inmates, are released through the pre-release system each year. At a minimum, DPSCS would like to provide the basic transition services to this entire population, meaning that all 4,200 inmates would receive discharge plans and proper community connections for such things as employment, housing, and medical and pharmacy assistance before release to the community. Opening another substance abuse therapeutic community would allow an additional 512 inmates to receive treatment each year.

Correctional Officer Recruitment and Retention

Due to an insufficient applicant pool and an increasing number of correctional officer (CO) vacancies, which resulted in significantly increased overtime expenditures and correctional officer resignations, the General Assembly approved implementation of a variety of enhancements for correctional officers in fiscal 2006. Preliminary data collection indicates that these combined enhancements have had a positive impact on correctional officer recruitment and retention.

The correctional officer sign-on bonus is an award of a total of $1,000 to newly hired COs, awarded in $500 increments after six months and again after 12 months of satisfactory service. DPSCS paid 1,352 sign-on bonuses totaling $676,000 from January 1, 2006, through June 30, 2007. From calendar 2005 to 2006, the total number of applicants tested increased approximately 47 percent, and the number of COs hired increased more than 16 percent. As of June 30, 2007, more than 2,500 applicants had been tested, with nearly 20 percent being hired.

The correctional officer retention bonus is designed to enhance the retention of employees in the CO II through CO Major classifications by awarding $500 to persons employed for at least 12 months who have received at least a “meet standards” rating on the most recent performance evaluation and have had less than five unscheduled absences during the designated 12-month period. DPSCS paid 2,509 retention bonuses totaling $1,254,000 through June 30, 2007. CO II resignations declined from 8.9 to 7.9 percent from calendar 2005 to 2006. In the first six months of calendar 2007, less than 3.0 percent of CO IIs have resigned.

The finder’s fee bonus is an award of a total of $500 for DPSCS employees who refer qualified applicants for CO I positions. The bonus is awarded in $250 increments after the referred employee completes 6 months and 12 months of satisfactory service. The first payment

was made in June 2006. Since then, there have been over 2,700 referrals which have resulted in nearly 600 new hires. The department has paid a total of 321 finder's fee bonuses totaling $80,250.

Criminal Law

Identity Theft

Maryland responded to the identity theft problem in the 2006 and 2007 sessions by enacting new legislation, including identity theft passport, security freeze, and breach notification laws. A Maryland task force to study identity theft is expected to make additional recommendations before the 2008 legislative session.

Maryland Responds to Identity Theft Problem

In response to reports that about three million Americans and tens of thousands of Marylanders suffer from identity fraud annually, several laws were enacted in 2006 and 2007 to give Maryland consumers additional protections from this crime.

Identity Theft Passport Program

Chapter 607 of 2006 established an "identity theft passport" program that provides a card or certificate issued by the Attorney General verifying the identity of a person who is a victim of identity fraud. A person with an identity theft passport may present it to a law enforcement agency to help prevent arrest or detention for an offense committed by another person using the passport owner's personal identifying information. Once available, a passport may also be presented to a creditor to aid in the investigation of a fraudulent account or fraudulent charges on an existing account held by the passport owner. The program, which was made contingent on the appropriation of sufficient funds in the State budget for fiscal 2008 for the Office of the Attorney General (OAG), has now been funded. OAG is expected to make the program available to the public in early 2008.

Security Freeze Law

A law allowing a Maryland consumer to "freeze" or restrict access to the consumer's consumer report (commonly known as a credit report) was adopted at the 2007 session (Chapters 307 and 308). Beginning January 1, 2008, a consumer may elect to place a security freeze on the consumer's credit report by written request sent by certified or electronic mail, or over the Internet under specified circumstances. Beginning January 1, 2010, the statute requires a consumer reporting agency to accept a request made by telephone. If a consumer wants to temporarily lift a security freeze to allow access to the consumer's credit report while a freeze is in place, or remove a security freeze, the consumer must follow specified procedures and the consumer reporting agency must comply within three business days after receipt. After January 31, 2009, the consumer reporting agency must comply with a request for a temporary lift within 15 minutes after receiving the request. A consumer reporting agency may charge a fee of up to $5 for placement, temporary lift, or removal of a security freeze. However, if the consumer

presents, at the time of the request, a police report alleging that the consumer is a victim of identity theft or an identity theft passport, no fees may be assessed. The OAG web site is expected to provide details for how Maryland consumers may employ credit freezes in January 2008.

Security Breach Notification Law

Another law enacted in 2007 requires a Maryland business to protect an individual's personal information and notify a consumer if the consumer's personal information was acquired as a result of a security system breach (Chapters 531 and 532 of 2007). A business is now required to take reasonable steps to protect against unauthorized access or use of personal information when destroying records containing a customer's personal information. The law also requires a business that owns or licenses the personal information of a Maryland resident to implement and maintain security protocols to protect personal information from unauthorized access, use, modification, or disclosure. Notification of a breach may be given in writing or over the telephone. Notification is also authorized by electronic mail or substitute notice if specified conditions are met. If a business is required to give notice of a breach to 1,000 or more individuals, the business must also notify nationwide consumer reporting agencies of the timing, distribution, and content of the notices. All businesses in the State are subject to the provisions of the law. Governmental agencies are not subject to these requirements. A violation of the new law is an unfair or deceptive trade practice under the Maryland Consumer Protection Act.

Motor Vehicle Administration "V" Program

In September 2007, the Motor Vehicle Administration began a "V" indicator program. After a victim files a police report and signs the authorization form, the program permits an identity theft victim to have a "V" placed on his/her driver's license and record to alert law enforcement personnel. The program has been recognized by the American Association of Motor Vehicle Administrators as one of the first identity theft programs incorporating driver's licenses in the country.

Maryland Identity Theft Task Force to Report Findings

The Task Force to Study Identity Theft was created in 2005 to study the problems associated with identity theft in Maryland. Since the task force was not fully appointed until August 2006, it was unable to meet more than once during the 2006 interim. Based on the recommendations of the interim report of the task force, issued in December 2006, the termination date for the task force was extended to January 31, 2008.

The task force has been meeting regularly during the 2007 interim and has received testimony from a variety of State and federal agencies, citizens, business associations, consumer advocates, and law enforcement agencies and officials on the nature of the identity theft problem in Maryland. The task force is considering a number of recommendations for additional legislation suggested by different witnesses, including increasing penalties for identity theft,

making the unauthorized possession of another's mail a State crime, easing certain rules of evidence in prosecutions of identity fraud, outlawing the private possession of "skimmers" (portable equipment used to intercept electronic credit transaction information), and authorizing the forfeiture of proceeds from an identity fraud crime.

The task force is expected to report findings and recommendations to the General Assembly by December 31, 2007.

Federal Developments

Federal Identity Theft Task Force

In April 2007, the Federal Identity Theft Task Force published a *Strategic Plan* for combating identity theft. The task force was comprised of 17 federal agencies and co-chaired by the U.S. Attorney General and the Chairman of the Federal Trade Commission (FTC). The plan recommends 31 initiatives, focusing on prevention through improvements in data security and customer authentication, victim assistance to ensure victims have the means and support to restore their identity, and deterrence through stronger tools to punish identity thieves. In the public sector, the plan recommends that federal agencies improve internal data security processes, develop breach notification systems, and reduce unnecessary uses of Social Security numbers. The task force also recommends that state and local governments eliminate the unnecessary use and display of Social Security numbers. For the private sector, the task force proposed that Congress establish national standards for data security and breach notification that would preempt the numerous state laws on these issues. The plan recommends that the federal task force study the feasibility of a nationwide system that would allow an identity theft victim to verify his/her identity, similar to the Maryland "passport" program. The plan recommends that the FTC assess state laws that grant consumers the right to place credit freezes on their credit reports to determine whether a federal law would be appropriate. Finally, the plan includes various recommendations for strengthening the ability of law enforcement to combat identity theft including assistance to state and local governments.

Criminal Law

Death Penalty

Implementation of the death penalty in Maryland was effectively halted when the Court of Appeals ruled that execution protocols must be subject to public scrutiny or specifically exempt from such scrutiny. Meanwhile, actions of the U.S. Supreme Court further cloud the legitimacy of lethal injection execution procedures.

Maryland Court of Appeals

The Court of Appeals filed four opinions in December 2006 as the result of an appeal by Vernon Evans, Jr., an African American sentenced to death in Baltimore County for the contract killing of two white people. Mr. Evans claimed his death sentence was illegal because it was based on an unconstitutional race-based selective prosecution as described in the 2002 study of death penalty implementation by the University of Maryland. Mr. Evans also sought an injunction against the use of the current execution protocol of the Department of Public Safety and Correctional Services (DPSCS). The Court of Appeals, as it had done in an earlier case, rejected the race-based constitutional challenge. However, the court held that DPSCS execution protocols directing the administration of lethal injection are ineffective until either (1) the protocols are adopted as regulations according to the Administrative Procedure Act (APA); or (2) the General Assembly statutorily exempts the protocols from the requirements of the APA. In effect, the decision caused a moratorium on the imposition of the death penalty in Maryland until either DPSCS or the General Assembly acts. To date, new regulations on lethal injection procedures have not been issued.

Legislative Proposals

Several bills were introduced in the 2007 session that related to the death penalty. Two would have repealed the death penalty and converted any current death sentence to a sentence of life imprisonment without the possibility of parole. Two other bills were introduced to exempt the execution protocols of DPSCS from the requirements of the APA, including any execution manuals. Yet another bill was introduced to expand the death penalty by adding the first degree murder of a victim, juror, witness, or officer of the court to the list of aggravating factors to be considered for death penalty eligibility. None of these bills passed.

Recent Federal Court Actions

In June 2006, the U.S. Supreme Court decided in *Hill v. McDonough*, 547 U.S. 573 (2006) that a death row inmate may challenge lethal injection procedures as a civil rights claim. In the Florida case, Hill claimed that the chemicals used in the lethal injection could inflict severe and unnecessary pain. However, the U.S. Supreme Court also held that a civil rights action brought to challenge the manner of execution does not entitle the defendant to an automatic stay of execution and the defendant must still satisfy all the requirements for a stay. Hill was executed on September 20, 2006, without an evidentiary hearing in federal court on his challenge to the lethal injection procedure.

Vernon Evans, Jr. also filed a civil rights claim in the U.S. District Court of Maryland arguing that the use of lethal injection violates the ban on cruel and unusual punishment in the Eighth Amendment to the U.S. Constitution. The basis of the argument is that the combination of chemicals is inhumane and the execution is performed by correctional officers who are not medically trained. Evans also argued that his veins are so badly damaged from years of drug abuse that the lethal injection could cause extreme pain without careful attention. The federal claim is still pending. U.S. District Judge Benson E. Legg put the case on hold once the Maryland Court of Appeals ordered a halt to executions in the State.

In addition, the U.S. Supreme Court is scheduled to hear the Kentucky case of *Baze v. Rees, cert. granted*, 552 U.S. ___ (2007) in early 2008. The issue in that case involves whether certain lethal injection procedures, including the current three-drug combination used in a majority of states, violate the prohibition against cruel and unusual punishment in the Eighth Amendment to the U.S. Constitution due to the risk of unnecessary pain and suffering in carrying out the execution. The Supreme Court may address how to evaluate a claim that a state's method of lethal injection violates the Eighth Amendment.

Although the Supreme Court has heard several cases in the past year addressing various procedural aspects of the death penalty, the Supreme Court's recent action in *Berry v. Epps*, stay granted (October 30, 2007), 552 U.S. __ (2007) staying the execution of a Mississippi prisoner who was scheduled to die by lethal injection has led some to speculate that state and lower federal courts will interpret the action as a signal that executions in their jurisdictions should be postponed pending the Supreme Court's decision in *Baze*.

Criminal Law

Gangs

While anti-gang legislation enacted in 2007 and a gang database being implemented may help in the fight against gangs, accurate statistics on the extent of the problem in the State remain unavailable.

Maryland Gang Prosecution Act of 2007

Concern over the increase in perceived gang activity in Maryland served as a catalyst for the enactment of the Maryland Gang Prosecution Act of 2007 (Chapter 496) which created separate offenses relating to criminal gangs and authorized the Attorney General to aid in investigations and prosecutions at the request of a State's Attorney for a county. The Act prohibits a person from (1) participating in a criminal gang[1] knowing that the members of the gang engage in an ongoing pattern of criminal gang activity;[2] or (2) knowingly or willfully directing or participating in the commission of an underlying crime, or act by a juvenile that would be an underlying crime if committed by an adult, committed for the benefit of, at the direction of, or in association with a criminal gang. A violator is guilty of a felony and subject to imprisonment not exceeding 10 years, or 20 years if death to a victim occurs, and/or a fine not exceeding $100,000.

The Act also requires the Attorney General and the Maryland State Attorneys' Association to report to the General Assembly by January 1, 2008, on their recommendations for more legislation to assist in the prosecution of gang activity.

GangNet Database

In December 2006, the Washington-Baltimore High-Intensity Drug Trafficking Area program received federal grant money to administer GangNet, an Internet-based networking and gang database throughout Maryland, DC, and Virginia. GangNet allows information on gang members (*e.g.*, identities, vehicles, tattoos, gang symbols, and locations) to be shared across jurisdictional lines in gang-related cases. The database can perform link-diagram analyses that show relationships among gang members and their positions within the hierarchy of the gangs.

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[1] "Criminal gang" is defined as a group or ongoing association of three or more persons whose members (1) individually or collectively engage in a pattern of criminal gang activity; (2) have as one of their primary objectives or activities the commission of one or more underlying crimes; and (3) have in common an identifying sign, symbol, name, leader, or purpose.

[2] "Pattern of criminal gang activity" is defined as the commission of, attempted commission of, conspiracy to commit, or solicitation of two or more specified underlying crimes (*e.g.*, assault, extortion, drug manufacture or distribution, witness intimidation, firearm possession) provided the crimes were not part of the same incident.

Participating law enforcement agencies enter information in the database based on the criteria they establish as to what constitutes a gang member. The utility of the database is dependent on the quality of the data entered by the agencies. The information contained in the database is not accessible to the public.

Reliability of Maryland Criminal Gang Statistics

Despite alarming media reports and claims that the gang problem has grown in all parts of Maryland in recent years, reliable statistics on the number of gangs and their membership and the extent of criminal activity related to gangs remains unavailable. For example, "Maryland Gangs" (gangs.umd.edu), a web site developed by the University of Maryland's Public Safety Training and Technical Assistance Program under a grant from the Governor's Office of Crime Control and Prevention, advises that "Gangs are an *increasing threat* to our nation's youth and to those living in the State of Maryland." The web site concedes, however, that since "most Maryland jurisdictions do not specifically track gang-related crime…*there are few reliable statistics regarding the extent of gang-related crime in Maryland.*" (emphasis added).

There are no standardized statewide criteria used for determining gang membership. Criteria used by Maryland State Police (MSP) include self-admission of gang membership, gang tattoos and attire, frequenting known gang areas, and participation in known gang activity. According to the Office of the Attorney General (OAG), local law enforcement and social service agencies gather data through the use of interviews with criminal defendants, witnesses, informants, and victims, as well as police reports and civilian complaints.

Also, despite concern regarding juveniles involved in gang activity, MSP and OAG report that State law enforcement agencies do not statistically distinguish between "youth" and "adult" street gangs, as most gangs tend to focus on recruitment across all age groups.

The Department of Juvenile Services (DJS) reports increased gang activity in Baltimore City, and Wicomico, Cecil, and Washington counties. DJS advises that its staff members are trained to identify gang members during the intake process, and information about known or suspected youth gang involvement is included in juvenile case files. However, the data gathered in individual case files is not recorded in a manner that can be aggregated easily for reporting purposes. Staff of DJS focus on increasing community awareness regarding youth involved in gangs by communications to law enforcement agencies and local school systems.

Street Gangs

Based on investigations, interviews with active gang members, and information received from gang enforcement personnel and allied agencies, MSP considers the four most active street gangs in the State to be the Bloods, Crips, Mara Salvatrucha (MS-13), and the 18th Street Gang. Additional gangs identified as having a street presence in Maryland include Black Guerilla

Family, Vatos Locos, Surenos 13, Dead Man Incorporated, All about Money, and the Brown Pride Locos.

The Office of the State's Attorney's for Baltimore City also is gathering street gang data from across the State. Although the exact methodology used by each jurisdiction from which the data is being obtained is unknown, the data indicates that street gangs are present in Cumberland; Baltimore City; and Baltimore, Harford, Howard, Montgomery, and Prince George's counties.

Exhibit 1 shows street gang presence by locality. However, the exhibit reflects the inconsistency in gathering and reporting gang-related data discussed above.

Exhibit 1
Street Gang Presence by Locality

Locality	Number of Gangs	Number of Gang Members
Cumberland	Not Reported	40
Baltimore City	170	1,300 adult; 1,000 youth
Baltimore County	35	140 to 350
Harford County	Not Reported	290
Howard County	Unknown	Unknown
Montgomery County	45	1,100
Prince George's County	50	400

Source: Office of the Attorney General; Department of Legislative Services

Prison Gangs

The State's prison gang situation resembles that of the street gang population in many respects. However, the prison system is a more static and controlled environment and consequently standardization and identification of gang members is somewhat more refined. The Department of Public Safety and Correctional Services (DPSCS) designates gangs as Security Threat Groups (STGs), and defines them as "three or more individuals who possess a common distinctive goal, symbolism, or philosophy; pose a present or potential threat to the safety of staff, inmates, or the public; and possess identifiable skills or resources used to engage in unauthorized or criminal activities either within the prison system or in the community."

Prison gang data is gathered by both gang intelligence and correctional officers in a variety of ways. Initial identification of an inmate as a gang member may occur on intake at the Maryland Reception, Diagnostic, and Classification Center through the use of a validation

worksheet point system in which an individual is assessed points based on having or displaying gang paraphernalia, tattoos, signs, colors, or symbols; a previous identification as a gang member or association with known gang members; being named by another individual as being a gang member; or an admission of gang membership from the inmate. An inmate who receives at least 2 to 9 points is considered an "associate" of a gang and an inmate with 10 or more points is considered a "validated" member. An inmate who is validated as a gang member remains on DPSCS's list permanently, regardless of whether the inmate denounces the gang, changes affiliation, or is released.

Through the use of the validation point system, in the past fiscal year, DPSCS identified over 2,300 STG participants, of which 1,861 are validated gang members and 522 are associate inmates. Altogether these inmates represent approximately 10 percent of the State prison population. DPSCS cites rapid increases in the number of STG participants, although solid statistics have not been recorded, and are not readily accessible or accurately maintained. The current numbers were provided via counts performed by Division of Correction intelligence, but through the use of the Facility Incident Reporting Manager system, DPSCS's Intelligence Coordinating Unit is hoping to be able to gather more accurate information and thorough statistics.

According to DPSCS, the identified STG members participate in 260 different gangs that exist within the prison system, including historic prison gangs, neighborhood street gangs, nationally recognized gangs, and drug gangs. According to DPSCS, the most prevalent STGs currently are the Bloods, Crips, Black Guerilla Family, Dead Man, Inc., and Murder Inc. DPSCS also reports that gang activity appears to be present in Baltimore City and every county.

Future Efforts and Pending Federal Legislation

Gathering, coordination, and sharing of accurate information is widely agreed to be necessary for successfully identifying and addressing gang activity. To that effect, DPSCS is collaborating with State and local law enforcement agencies to develop a plan. Once fully implemented, GangNet hopefully will aid law enforcement agencies.

Pending federal legislation (the Gang Abatement and Prevention Act, S. 456) would commit $1.1 billion for law enforcement, including $447 million for prevention efforts, to attack gang problems. As passed by the U.S. Senate, the bill also would criminalize gang activity and outlaw recruitment for the purpose of committing a crime for a gang.

Criminal Law

Sentencing Reform – Drugs

While the "war on drugs" of the 1980s and 1990s resulted in tougher sentences for drug offenses including mandatory sentences, more recent legislation has focused on reducing drug imprisonment and increasing access to treatment. As the issue of drug addiction and the problems that follow continue to be a dilemma for the State, additional proposals are expected during the 2008 session.

The War on Drugs

In the 1980s and 1990s, fueled by the rise in popularity of crack cocaine and the 1986 death of University of Maryland basketball star Len Bias of a cocaine overdose, there was a national trend to impose more severe penalties on drug dealers and users. During this "war on drugs," Maryland and other states, as well as the federal government, enacted tougher sentences for drug offenses including mandatory minimum sentences.

Maryland Law

Since 1982, Maryland law has mandated a minimum 10-year nonsuspendable, nonparolable sentence for offenders convicted a second time of distributing, manufacturing, possessing with intent to distribute, or dispensing Schedule I or Schedule II narcotics or hallucinogens. Legislation enacted in 1988 established a 25-year mandatory minimum sentence for third-time offenders and a 40-year mandatory minimum sentence for fourth-time offenders. Potentially significant fines may also be imposed. A repeat offender is subject to a two-year mandatory minimum sentence for distributing a drug that is not a narcotic or hallucinogen. Other mandatory minimum sentences apply to volume dealers, drug kingpins, offenders who possess or use a firearm while engaging in drug trafficking, and repeat offenders who distribute drugs near a school.

The New Movement – Treatment, Not Incarceration

In recent years, many have come to believe that the war on drugs has not been successful. Prison populations have multiplied, recidivism is high, and addiction is widespread. In 2003, a commission convened by the American Bar Association called on Congress to repeal mandatory minimum sentences, and in 2006, the U.S. Conference of Mayors passed a resolution opposing mandatory minimum sentences for drug crimes. At least 18 states have now rolled back mandatory minimums or restructured penalties for drug offenses.

Advocates for repealing mandatory minimum sentences argue that locking up nonviolent drug offenders instead of treating their addictions does not cause permanent behavioral changes or improve community safety, prevents judges from addressing individual cases, and unfairly punishes low-level dealers who get the same amount of time in jail as major distributors. In addition, it is argued that incarceration is significantly more expensive than drug treatment and is therefore not cost effective.

Maryland has not changed its mandatory minimum penalties for drug offenses, but in 2004 the General Assembly passed Chapter 238, an Administration measure designed to redirect substance abusers from prison and into treatment. Among other things, that legislation encouraged prosecutors to divert defendants to treatment by creating a system of case dismissals and suspensions with treatment conditions, streamlined the process through which substance-addicted defendants are committed to the Department of Health and Mental Hygiene for treatment, and required counties to establish local alcohol and drug abuse councils to coordinate identification of treatment needs and delivery of services.

Since the passage of Chapter 238, Maryland has made modest progress in reducing drug imprisonment and increasing access to treatment. However, the State's fiscal crisis has prevented growth in treatment spending, and the demand for State-funded treatment far exceeds the supply. The State's Alcohol and Drug Abuse Administration will spend about $136 million for treatment and prevention in fiscal 2008, but most of this funding is distributed to local jurisdictions that generally use the money to help noncriminal substance abusers. Moreover, few inmates receive drug treatment while in prison.

Recent Legislative Action

Various bills have been introduced in recent years to modify or eliminate mandatory minimum sentencing for repeat drug offenders. Most recently, in 2007, House Bill 992 passed the General Assembly but was vetoed by the Governor on policy grounds. The bill would have repealed the prohibition against parole applicable to the 10-year mandatory minimum sentence for a second conviction of drug distribution, if the person was not convicted of a crime of violence arising out of the incident that resulted in the mandatory minimum sentence. Under the bill, a defendant would be eligible for parole after serving two and a half years. The bill was a top priority of the Legislative Black Caucus, due to concern that African Americans make up a majority of defendants jailed on drug charges, and was aimed at low-level nonviolent addicts who sell drugs to support their habits. The reasons cited by the Governor for vetoing the bill included that (1) despite the bill's applicability to nonviolent criminals, drug dealers participate in activities that fuel violent crime and murder; (2) Maryland law already allows two-time offenders opportunities to receive drug treatment services in lieu of mandatory sentences; and (3) the bill seeks to aid addicted individuals but does not require individuals to receive drug treatment services or make progress in addressing the public health and public safety issue of drug addiction.

Also in 2007, House Bill 548 sought to alter the penalty for a first offense of drug possession, requiring the court to stay the entering of judgment and place the defendant on probation, contingent on completion of a drug treatment program. The bill, which was modeled after California's Proposition 36, received an unfavorable report from the House Judiciary Committee.

Civil Proceedings

Medical Malpractice

After enactment of legislation at a special session in 2004, the medical malpractice insurance market dramatically improved. One aspect of the improved market, a dividend recently announced by the State's largest medical malpractice insurer, has generated controversy relating to the State subsidy of malpractice insurance premiums.

Background

In a special session in 2004, the General Assembly addressed what many called a medical malpractice "crisis." Rate increases in insurance premiums (28 percent in 2004 and 33 percent in 2005) had been approved by the Maryland Insurance Commissioner for the Medical Mutual Liability Insurance Society of Maryland (Medical Mutual), which insures between 70 and 75 percent of physicians in private practice in the State. According to Medical Mutual, the increases stemmed from, among other factors, an increase in the severity of paid claims. In response to the increases, doctors threatened to quit, limit their practices, or leave the State. Over a veto by the Governor, the Maryland Patients' Access to Quality Health Care Act of 2004 (Chapter 5 of the 2004 special session) became law.

Chapter 5 established a fund financed by the repeal of the 2 percent premium tax exemption applicable to health maintenance organizations. The purposes of the fund were to limit insurance premium increases, increase fee-for-service rates paid by the Maryland Medical Assistance Program to health care providers, and increase capitation rates for managed care organizations participating in the program. Chapter 5 also included changes to procedures in medical malpractice cases; changes to the disciplinary processes of the Maryland Board of Physicians; establishment of a "people's counsel" to represent consumers in some insurance rate hearings; and requirements that medical malpractice insurers report claims information to the Commissioner and the Commissioner report annually to the General Assembly on medical malpractice insurance. For a cause of action for a medical injury arising on or after January 1, 2005, noneconomic damages were limited to the then current level of $650,000 ($812,500 in wrongful death actions with more than one claimant or beneficiary) and frozen at those amounts for four years, through calendar 2008. Annual increases of $15,000 ($18,750 in wrongful death actions with more than one claimant or beneficiary) resume on January 1, 2009.

Chapter 5 was modified by Chapter 1 of 2005. Among other provisions, the new Act replaced the special fund and disbursement mechanism in Chapter 5 with the Maryland Health Care Provider Rate Stabilization Fund and established a method for using the fund to directly subsidize insurance premiums of doctors and nurse midwives.

Maryland's Medical Liability Climate Turnaround

Medical Malpractice Payouts Dropping

Medical Mutual reported in September 2007 that while its paid claims remained high, it experienced a reduction in both the frequency of claims reported and the frequency of claims closed with payment.

Similarly, Aon Global Risk Consulting, which conducts an annual study of medical liability claims, reported that payouts in Maryland peaked in 2003 and have declined every year since then. It also reported claims dropped 28 percent in the last three years, compared with a national decline of 18 percent.

Competition Among Insurers

In 2006, a new insurer, the Maryland Healthcare Providers Insurance Exchange, was authorized by the Commissioner to issue medical liability insurance, giving physicians a broader choice of insurers. While another provider, NCRIC, after acquisition by ProAssurance, limited issuance of its policies to the District of Columbia and began withdrawing from the State, Medical Assurance Company, Inc., began providing insurance for NCRIC's former policyholders. Currently there are six insurers from which to choose when physicians and surgeons obtain medical liability coverage.

Although Medical Mutual remains the largest provider of medical professional liability insurance to physicians and surgeons in the State, its total market share of liability insurance for all State health care providers fell from 45.62 percent in 2005 to 42.99 percent in 2006.

Rate Stabilization

Chapter 1 of 2005 created a formula for State subsidies of insurance premiums. 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. When the subsidy program was enacted, it was anticipated that insurers would increase their rates for the next several years, with the amount allocated for subsidies decreasing as follows:

Fiscal 2006	$52 million for 2005 policies
Fiscal 2007	$45 million for 2006 policies
Fiscal 2008	$35 million for 2007 policies
Fiscal 2009	$25 million for 2008 policies

There was lower than expected utilization of the subsidy for 2005 policies, and subsidies of only $36.2 million were paid. In 2005, Medical Mutual announced that there would not be any rate increase for 2006 policies and, as a result of the 25 percent subsidy factor, over

62 percent of its policyholders received a larger subsidy in 2006 than in 2005. For 2006 policies, there was slightly higher utilization of the subsidy than expected and $47.1 million was paid.

For 2007 policies, the subsidy factor was determined to be 17 percent, and Medical Mutual's subsidies totaled $22.7 million. Medical Mutual also announced an 8 percent reduction in its base rate for 2007 policies. When the reduction in the base rate was combined with the subsidy, Medical Mutual's policyholders did not experience an increase in premiums in 2007.

Medical Mutual Announces Dividend

After realizing surpluses of $43.7 million in 2005 and $45.9 million in 2006, Medical Mutual announced in September 2007 its intent to declare a dividend of $68.6 million. Medical Mutual proposed that it • give $21.5 million of the dividend to the State; • fund the entire subsidy of $22.7 million for 2007 policies; • not participate in the subsidy program in 2008; and • distribute the remainder of the dividend, $24.4 million, to policyholders renewing their policies on January 1, 2008.

The Commissioner blocked the dividend pending a hearing before the Commissioner to resolve whether a portion of the dividend may be returned to the policyholders of Medical Mutual or whether the entire dividend must be returned to the State. After conducting two hearings on November 20, 2007, the Commissioner ruled that the entire $68.6 million dividend is payable to the State. The Commissioner, however, delayed his order for 30 days and invited Medical Mutual "to rescind its dividend declaration and propose a solution to mitigate rates next year."

On December 13, 2007, the Commissioner and Medical Mutual announced that the insurer would cut premiums by 8 percent for 2008 and return $84 million to the State. In addition to the rate cut, Medical Mutual would distribute $13.8 million in dividends to doctors against 2008 premiums. That would mean most Maryland doctors would pay the same amount for liability coverage in 2008 as they did in 2007.

The $84.0 million represents the amount that Medical Mutual received in the prior three years and would have received in 2008 in premium subsidies. Citing several additional months of data showing flat claims payouts, Medical Mutual increased its previously announced total dividend to $97.9 million, enough to repay the State fully for the subsidy and to give doctors enough of a dividend to keep their liability payments the same as 2007.

Legislative Proposals

The turnaround in the medical liability market may lead to proposals to raise the limits on noneconomic damages in medical malpractice actions. Even without enactment of additional legislation, the current limits of $650,000/$812,500 will increase by $15,000/$18,750 on January 1, 2009, and each year thereafter in accordance with Chapter 5 of 2004. On the other hand,

despite the recent turnaround, proposals to extend the freeze on yearly increases or to eliminate them entirely may be introduced.

Civil Proceedings

Same-sex Marriages, Civil Unions, and Domestic Registries

The Court of Appeals held that State law providing that only a marriage between a man and a woman is valid and constitutional, but the General Assembly will continue to grapple with the issue.

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 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 under State law as married couples.

In 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. In 2004, the court ruled that authorizing civil unions for same-sex couples while prohibiting them from marrying also was unconstitutional. As a result, Massachusetts became the first and only state to issue marriage licenses to same-sex couples.

State Responses

Spurred by the decisions in Hawaii and Massachusetts, legislatures and courts around the country grappled with the issue of whether to grant the right to marry or the protections of marriage to same-sex couples.

Court Decisions

State courts that have considered challenges from same-sex couples claiming that matrimony is a constitutional right have yielded conflicting results. For example, the New Jersey Supreme Court recently determined that same-sex couples are constitutionally entitled to receive the same benefits and protections as married couples. On the other hand, the highest courts in Washington and New York found no constitutional right to marriage or its benefits. Legal challenges are currently pending in California, Connecticut, and Iowa.

Constitutional Amendments

According to the National Conference of State Legislatures, 41 states (including Maryland) have laws that either prohibit same-sex marriages or deny recognition of same-sex marriages solemnized in another jurisdiction. However, because statutory bans have been viewed as providing only minimal protection against a constitutional challenge, after Massachusetts began issuing marriage licenses, many states rushed to amend their constitutions to limit marriage to couples of the opposite sex. To date, 27 states have adopted constitutional amendments defining marriage as only between a man and a woman. Only the state of Arizona has rejected a ballot initiative to ban same-sex marriage.

Civil Unions and Domestic Registries

In 2005, Connecticut became the second state to enact a law establishing civil unions. Similarly, in response the state's high court ruling, the New Jersey legislature adopted legislation in 2006 authorizing civil unions. New Hampshire passed similar legislation, which will take effect January 1, 2008.

California enacted a law in 1999 authorizing couples to register as domestic partners and claim all the state benefits conferred on husbands and wives. Oregon has also adopted a domestic registry. Hawaii, Maine, and Washington have domestic registries that allow same-sex couples to claim only certain benefits, including hospital visitation rights and inheritance without a will.

Unlike traditional marriages, civil unions and domestic registries do not provide the marriage benefits available under federal law in numerous areas, such as Social Security, family medical leave, federal taxation, and immigration policies.

Federal Law

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.

Maryland Law

Maryland law provides that only a marriage between a man and a woman is valid in this State. This law 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 valid under State law. *Tyma v. Montgomery County*, 369 Md. 497 (2002).

Conaway, et. al v. Deane et al.

In July 2004, nine same-sex couples filed suit in Baltimore City against the clerks of the circuit courts from five counties, contending that the State law banning same-sex marriage is unconstitutional. The plaintiffs alleged 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.

On January 30, 2006, the Circuit Court for Baltimore City held that the State statute defining marriage is unconstitutional and violates Article 46 of the Maryland Declaration of Rights because it discriminates based on gender against a suspect class and is not narrowly tailored to serve any compelling governmental interests. Article 46 of Maryland's Declaration of Rights is commonly referred to as Maryland's "Equal Rights Amendment" and prohibits abridgment of equal rights under State law because of sex.

The ruling was stayed pending an appeal, which the Office of the Attorney General immediately filed with the Court of Special Appeals. Before the intermediate court could decide the appeal, the Court of Appeals issued a writ of *certiorari*, and, on September 18, 2007, issued an opinion reversing the judgment of the circuit court and upholding the State's marriage statute. *See Conaway, et. al v. Deane, et. al.* (No. 44, Sept. Term 2006).

The Court of Appeals held that the Equal Rights Amendment was intended to prevent discrimination based on gender, not sexual orientation. The court found that the marriage statute does not discriminate on the basis of gender because it prohibits equally both men and women from marrying a person of the same sex.

The court also determined that under constitutional principles, sexual orientation is not a suspect or quasi-suspect classification, nor is same-sex marriage a constitutionally protected fundamental right. Therefore, Maryland's statute will pass constitutional muster so long as it is rationally related to a legitimate governmental interest. The court held that the marriage statute is rationally related to the State's legitimate interest in fostering procreation and encouraging the traditional family structure. However, in conclusion, the court cautioned that the opinion "should by no means be read to imply that the General Assembly may not grant and recognize for homosexual persons civil unions or the right to marry a person of the same sex." *Id.* at p. 109.

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.

Proposed Legislation

Legislation relating to same-sex marriage is not new in Maryland. In the past several years, numerous proposals to ban recognition of lawful out-of-state marriages by same-sex couples and proposals to constitutionally define a valid marriage as a marriage only between a man and a woman have all been unsuccessful. Measures to legalize same-sex marriage have been proposed infrequently and without success.

In addition, legislation that would have conferred hospital visitation and medical decision making rights on same sex and opposite sex couples by establishing a Life Partnership Registry in the Department of Health and Mental Hygiene was passed by the General Assembly in 2005, but was ultimately vetoed. *See* Senate Bill 796 of 2005.

In light of the court's decision in the *Conaway v. Deane* case, a flurry of legislative activity on the issue of same-sex marriage during the upcoming legislative session is anticipated. Opponents of same-sex marriage have vowed to reintroduce a constitutional amendment to prohibit same-sex marriage, while proponents are expected to propose legislation to legalize same-sex marriage or to confer the rights and benefits of marriage on same-sex couples through civil unions.

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Civil Proceedings

The Foreclosure Process in Maryland

A rise in defaults on home mortgages focused attention on the State's foreclosure process and is expected to prompt introduction of several proposals aimed at preserving homeownership.

Background

In June 2007, the Governor established the Homeownership Preservation Task Force to develop an action plan to address rising foreclosures and preserve homeownership in Maryland. The Legal and Regulatory Reform Workgroup of the task force reviewed existing laws, regulations, and practices relating to mortgage lending and foreclosures and developed recommendations to promote homeownership. The Attorney General also formed a workgroup to provide input on issues relating to lending practices in Maryland. In addition, the Senate Finance and Judicial Proceedings committees and the House Economic Matters and Environmental Matters committees held hearings during the 2007 interim to examine various aspects of mortgage lending practices and the foreclosure process.

Current Law

Maryland's current foreclosure process, from the first foreclosure filing to final sale, is among the shortest in the nation. Maryland is a quasi-judicial state, meaning that the authority for a foreclosure sale is derived from the mortgage or deed of trust, but a court has oversight over the foreclosure sale process.

An action to foreclose is commenced by the filing of an order to docket in the circuit court for the county where the property is located. The homeowner is not entitled to be personally served with process. Notice of the filing of the action is required to be sent to the homeowner by certified and first-class mail; however, the lender is not required to show that the notice was actually received. Written notice of the foreclosure sale must also be sent by certified and first-class mail not earlier than 30 days and not later than 10 days before the date of the sale, but actual notice is not required. The homeowner is not entitled to a hearing before the sale – the only recourse under State law to challenge the lender's claim of default is to file a motion for injunction to stay the sale.

Notice of the sale is required to be published in a newspaper of general circulation once a week for three successive weeks before the sale. A sale can conceivably occur within 15 days after the filing of the order to docket, but this rarely occurs in actual practice. The person making the sale must file a report of the sale with the court within 30 days. The homeowner may

file exceptions to the ratification of the sale. Objections are generally based on the insufficiency of the sales price. However, the sales price must be so low as to "shock the conscience of the court" in order to set aside the sale.

Legislative Proposals

Homeownership Preservation Task Force

The Homeownership Preservation Task Force made a number of recommendations to improve the foreclosure process that are expected to be included in legislation introduced in the 2008 session, including:

- prohibiting a lender from initiating a foreclosure proceeding until at least 90 days after the date of default;
- requiring a lender to send the homeowner a notice of intent to foreclose by certified and first-class mail at least 45 days before filing an order to docket;
- requiring the court to send a notice of the filing of the order to docket to the homeowner and to the address of the residential property;
- prohibiting a foreclosure sale from taking place until at least 45 days after an order to docket is filed; and
- requiring a lender to accept a payment to cure a default up until one business day before the sale.

Other Proposals

Consumer advocates contend that the short timeframes and weak notice provisions in current law seriously limit a homeowner's options to avoid foreclosure by, for example, working out a payment plan with the lender or selling the house. In addition, filing a request for an injunction is expensive, time consuming, and not a realistic option for most homeowners. Advocates are expected to propose reforms that go beyond those recommended by the task force, including requiring a notice of intent to foreclose with specified information 90 days before the docketing of a foreclosure action; requiring personal service of the order to docket on the homeowner and/or posting notice on the property; providing a meaningful opportunity for a homeowner to raise good faith defenses prior to sale; and establishing the right to a hearing.

Environment and Natural Resources

Chesapeake Bay Restoration

Recent reports indicate that there is little chance that the goals for the restoration of the Chesapeake Bay will be met by 2010 as agreed upon by the signatories to the Chesapeake 2000 Agreement. Since the enactment in the 2007 special session of an additional stream of revenue dedicated to the implementation of the State's tributary strategies, the focus in the 2008 session will be on the effective distribution of those funds.

Background

While the Chesapeake Bay is America's largest and most productive estuary, its health has declined significantly over the past several decades due to nutrient and sediment pollution. In 1999, the U.S. Environmental Protection Agency (EPA) identified the bay as an impaired water body. In 2000, the Chesapeake Bay partners (the bay states, the District of Columbia, the Chesapeake Bay Commission, and EPA) negotiated the Chesapeake 2000 Agreement (C2K), which specified restoration goals to improve the bay and remove it from the EPA's List of Impaired Waters. As part of C2K, specific pollution reduction goals have been allocated to the various bay states. Maryland's reduction goals are summarized in **Exhibit 1.** The largest source of Maryland's nutrient and sediment pollution is runoff from agricultural lands, followed by urban runoff and point sources.

Exhibit 1
Maryland's Pollutant Reduction Goals

Pollutant	1985 Loads	2005 Loads	2010 Goal
Nitrogen (million lbs/yr)	82.4	56.2	37.3
Phosphorus (million lbs/yr)	6.8	3.8	2.9
Sediment (million tons/yr)	1.3	1.0	0.7

Source: U.S. Environmental Protection Agency's Chesapeake Bay Program

Strategies

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 every source with the aim of achieving the nutrient reduction goals established in C2K. Following the development of the Tributary Strategy, the tributary teams

and the State of Maryland began to develop Maryland's Tributary Strategy Statewide Implementation Plan. A draft implementation plan was released in February 2006, and a final version of the implementation plan was released in August 2007. The purpose of this plan is to chart Maryland's course for achieving the Tributary Strategy goals in the areas of point sources, stormwater, septic systems, growth management, agriculture, and air deposition. The plan also includes strategies to achieve, maintain, and monitor water quality goals. It is anticipated that the plan will be updated as new funding sources and technologies emerge and understanding of the response in water quality to actions taken in the watershed improves.

Achieving and Maintaining Reduction Goals Will Be Difficult

While numerous efforts to restore the bay's water quality are underway, the State is expected to fall short of its C2K goals absent further action. The Chesapeake Bay Foundation (CBF), for example, estimated in 2007 that upon full implementation of efforts to upgrade wastewater treatment plants using the Bay Restoration Fund, full implementation of emissions limits under the Healthy Air Act, and continued implementation of cover crop planting and agricultural best management practices at current levels, the State's nitrogen pollution will have been reduced by approximately half of the amount estimated to be needed to meet the State's C2K goal. CBF's 2007 *State of the Bay* report paints a dismal picture, finding that the health of the bay is, in fact, going in the wrong direction.

Increases in population and development in Maryland will make achieving and maintaining Tributary Strategy goals even more difficult. According to EPA's Chesapeake Bay Program, progress in reducing pollution from urban/suburban runoff has actually declined in the bay watershed due to population growth and related development.

Financing the Restoration of the Chesapeake Bay

A draft funding analysis developed in 2004 as part of the Tributary Strategy process estimated that just over $10 billion would have been needed to meet the Tributary Strategy goals by 2010, with a funding shortfall of just over $6 billion. While some of the information contained in that analysis may be outdated, it gives an indication of the relative magnitude of the funding needs associated with the different pollution sectors. The majority of the funding shortfall, for example, was attributed to reducing pollution from urban/suburban runoff (stormwater) and septic systems, which are collectively responsible for about one-quarter of the nitrogen loading to the bay in Maryland (urban/suburban runoff is also responsible for significant phosphorus and sediment loading). Agriculture, which is the largest source of nutrient and sediment loading to the bay in Maryland, made up a smaller portion of the shortfall, as pollution reduction measures for that sector are generally more cost-effective.

The creation of a fund to finance bay restoration efforts was proposed in both the 2007 regular and special sessions. The concept was originally proposed as a fund that would be financed by an "impervious surface fee" on new development in the State – intended to have a

nexus with the urban/suburban runoff caused by impervious surfaces. The bill (House Bill 1220) passed in the House during the 2007 regular session but was not acted on by the Senate.

In the 2007 special session, a Chesapeake Bay 2010 Trust Fund was included in tax-related House and Senate bills (House Bill 5 and Senate Bill 2) seeking to address the State's structural deficit. The fund was subsequently established through the enactment of House Bill 5, capitalized with a portion of existing revenues from the motor fuel tax and the sales tax on short-term vehicle rentals (expected to generate just over $50 million for the fund in fiscal 2009). The bill, while stating that the funding must be used for implementation of the State's tributary strategy, does not give more specific direction for how the funding must be spent.

A separate bill, House Bill 23, which was passed by the House during the special session but was not acted on by the Senate, would have established how the funding generated in House Bill 5 would have been distributed. The bill outlined a process involving the BayStat program where a plan would have been developed each year, allocating funding to most effectively reduce nutrient loading to the bay, with specified minimum funding requirements for agricultural best management practices and grants to local governments. BayStat is a joint project of the Maryland Department of Agriculture, the Maryland Department of the Environment, DNR, and the Maryland Department of Planning established by executive order in February 2007 as an accountability process for measuring and evaluating State initiatives directed toward restoring the bay.

Potential 2008 Legislation

While House Bill 23 failed, it appears likely that legislation with a similar purpose will be introduced in the 2008 regular session, defining more specifically how the money in the Chesapeake Bay 2010 Trust Fund will be spent. The use of BayStat could be proposed again as a resource for directing money from year to year toward activities that will contribute most to nutrient and sediment pollution reduction. Another concept included in House Bill 23 that could be considered, is the potential issuance of bonds to finance restoration activities, leveraging the tax revenues accruing to the fund.

Other issues that may be addressed relate to the allocation of funding between State and local government, whether the allocation of funds should be based on a formula or be competitive, how to ensure that what is funded has measurable results, how to ensure flexibility where needed, and how to target the money to particular best management practices or areas.

In addition to legislation regarding the Chesapeake Bay 2010 Trust Fund, other legislation affecting bay restoration is expected. Possible initiatives relate to strengthening the State's Critical Area law, improving enforcement of agricultural nutrient management plans, and retaining and expanding forests in the Chesapeake Bay watershed.

Environment and Natural Resources

Air Quality

After the enactment in Maryland of several significant legislative proposals to reduce levels of greenhouse emissions from power plants and automobiles, there has been a shift in focus to a more regional approach to reducing emissions. Also, the recently appointed Commission on Climate Change has been meeting and is expected to make numerous recommendations, including legislation, for consideration in the 2008 session.

Background

In an effort to protect the health of its citizens and halt the impacts of climate change on its natural resources, there have been numerous recent endeavors to try to improve air quality in Maryland. The enactment of the Healthy Air Act in 2006 and the Maryland Clean Cars Act of 2007, once fully implemented, will reduce levels of greenhouse gas emissions from power plants and automobiles in the State. The Maryland Energy Administration's EmPOWER Maryland program aims to reduce electricity consumption in the State by 15 percent by 2015, which could reduce carbon dioxide emissions by as much as 35 billion pounds. As the potential impacts of global climate change become more evident, ultimately improving the air quality in Maryland will require a more regional approach to reducing emissions.

A Shift in Focus

According to the International Panel on Climate Change, there is now near scientific consensus that the world's temperatures are climbing and that human activities are contributing to the increase. However, the potential causes and consequences of climate change cross state and national boundaries. In April of 2007, the State became a participating member of the Regional Greenhouse Gas Initiative (RGGI), which is a cooperative effort by nine Northeast and Mid-Atlantic states to discuss the design of a regional cap-and-trade program for carbon dioxide emissions from power plants. By joining RGGI, Maryland signaled a shift in its focus on improving air quality from a statewide approach toward a more regional and global approach. Because the federal government is doing little to require reductions in greenhouse gas emissions, over 15 states have now set their own reduction goals.

This shift in focus is necessary because Maryland and the Chesapeake Bay (Bay) may be particularly vulnerable to the effects of climate change. A new report by the Center for Integrated Environmental Research at the University of Maryland indicates that the Mid-Atlantic may be hit harder by global warming than any other region in the United States. Major storm events and sea level rise could cause shoreline erosion and put many areas of the State under water. Warming water temperatures in the Bay could lead to irreversible damage of the eco-system and a loss of aquatic life. Specifically, the report claims that a 20-inch rise in sea

levels by 2100 could lead to as much as $58 billion in damages to coastal communities, significantly affecting watermen, fisheries, and the Chesapeake Bay eco-system. Further, it posits that by 2025, the region's tourism industry could lose upwards of $405 million a year.

Commission on Climate Change

In response to these concerns, Governor O'Malley established the Commission on Climate Change by executive order on April 20, 2007. The commission is charged with collectively developing an action plan to address the causes of climate change, prepare for the likely consequences and impacts of climate change to Maryland, and establish firm benchmarks and timetables for implementing the commission's recommendations. The commission consists of a number of the Governor's cabinet secretaries as well as members of the General Assembly. The commission is supported by working groups that are charged with:

- undertaking an assessment of climate change impacts, calculating Maryland's carbon footprint, and investigating climate change dynamics with the assistance of the University System of Maryland;

- working together with the Maryland Department of the Environment, the Maryland Energy Administration, and a broad set of stakeholders, including renewable and traditional energy providers and the business community, to develop a comprehensive greenhouse gas and carbon footprint reduction strategy; and

- coordinating with the Maryland Departments of Natural Resources and Planning, and a comprehensive group of planners, emergency responders and environmental organizations, as well as business and insurance representatives, to develop a strategy for reducing Maryland's vulnerability to climate change, with an initial focus on sea level rise and coastal hazards.

The commission is expected to release a report that recommends legislation to establish an office of climate change to require the reduction of greenhouse gas emissions in the State by 25 percent by 2020 and to set a regulatory goal of reducing greenhouse gas emissions by 90 percent by 2050. The report is also expected to recommend legislation to adopt an Energy Efficiency Performance Standard, increase lighting efficiency stands, and amend the State's Renewable Portfolio Standard to encourage more investment in renewable energy sources. Finally, the report is expected to contain recommendations for early executive action that do not require legislation, which include reducing greenhouse gas emissions in State government, improving education and outreach related to climate change and energy efficiency, and incentivizing green building

Update on Implementation of Clean Cars Act of 2007

Although the General Assembly passed the Maryland Clean Cars Act of 2007 during the 2007 legislative session, the regulations necessary to implement the program cannot go into effect without approval by the U.S. Environmental Protection Agency (EPA). EPA is currently reviewing over 60,000 written comments on the regulations, which have been adopted in a number of other states, and is expected to issue a decision before the end of 2007.

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Environment and Natural Resources

Fisheries Management

The vitality of the State's fisheries continues to challenge policymakers. In an effort to address current concerns, the General Assembly may consider legislation during the 2008 session that aims to (1) improve the health of the blue crab population while sustaining the commercial crabbing industry; and (2) protect the State's waters from the introduction of non-native and invasive species.

Status of State Fisheries

Maryland is home to a diverse range of aquatic species, and the Department of Natural Resources (DNR), Fisheries Service is responsible for managing commercial and recreational fishing. Two of the most well-known and valuable species are Maryland blue crabs and native oysters. However, in recent months, a few unusual non-native species have made headlines as well.

Crabs

***Blue Crab*:** In 2006, the statewide harvest was 28.1 million pounds. This represents a decrease of 32 percent from the 1996 harvest, as well as one of the lowest harvests ever recorded. However, it is also a 30 percent increase over the historical low of 21.0 million pounds landed in 2000. In addition, in 2006, for the second consecutive year, the exploitation rate (percentage of crabs removed from the population by fishing) of the blue crab met the 2001 target set by the Bi-State Blue Crab Advisory Committee.

According to the most recent winter dredge survey conducted by DNR, however, the number of crabs in the Chesapeake Bay continues to remain at low levels. In fact, the 2006 reproduction levels were the second lowest since the survey began in 1989. Additionally, the Chesapeake Bay Stock Assessment Committee's 2007 *Chesapeake Bay Blue Crab Advisory Report* predicts, due to low reproduction levels, that the 2007 harvest will likely exceed the exploitation target. As a result of its findings, the committee recommends that management jurisdictions, with the aid of stakeholders, develop a comprehensive management plan that specifies management actions for rebuilding the crab population, for promoting sustainability, and for ensuring the blue crab does not become overfished.

***Ghost Crab Pots*:** "Ghost" crab pots are crab pots that are lost during storms or have been accidentally cut loose from their buoys by boat motors. While more data and survey areas are needed to quantify the impact of "ghost" crab pots, there is concern that they have a detrimental effect on the commercial and recreational fishery in the Chesapeake Bay because they continue to capture crabs, as well as other creatures such as turtles and fish. The National Oceanic and Atmospheric Administration (NOAA) and the Virginia Institute of Marine Science

are currently assessing the impacts of ghost crab pots and the stress they impose on the health and economy of the Bay.

Oysters

***Native Oysters*:** The 2006 oyster harvest of 154,436 bushels was nearly six times greater than the record low harvest in 2004 and more than double the 2005 harvest. At its peak, the Bay's oyster population acted as a natural filter, removing 133 million pounds of nitrogen annually. Largely due to two diseases, MSX and Dermo, the oyster stock has been severely depleted. Today, the oyster population has dropped to less than one-half of 1 percent of its original population, and the few remaining oysters remove only about 250,000 pounds of nitrogen from the Chesapeake Bay each year. On a positive note, DNR's 2006 fall survey observed an oyster mortality rate of 16 percent, which is the lowest it has been since 1989 and much lower than its peak in 2002.

***Non-native Oyster*:** Maryland, Virginia, and the U.S. Army Corps of Engineers are voluntarily preparing an environmental impact statement (EIS) on the possible introduction of the Suminoe oyster to the Chesapeake Bay. The draft EIS is expected to be released in May 2008.

Non-native and Invasive Species

Chinese Mitten Crab

In June 2006, for the first confirmed record for the Chesapeake Bay, a boater captured a mature male Chinese Mitten Crab, a species native to East Asia. DNR has raised concern that the Chinese Mitten Crab is a potential invasive species that may cause negative impact to the Bay's ecology. While only a single animal has been captured within the Chesapeake Bay, DNR, the Smithsonian Environmental Research Center, the U.S. Fish and Wildlife Service, and NOAA have coordinated a joint effort to investigate the status of this species.

Rusty Crayfish

In 2007, the Rusty Crayfish, a species native to portions of the Ohio River, was discovered in the Monocacy River watershed and the Maryland portion of the Susquehanna watershed. DNR describes this species as aggressive, non-native, and invasive. Additionally, DNR has raised concern about the species potential impact on other native crayfish, sportfish, and other aquatic species. This species has invaded and devastated local aquatic ecosystems within 14 states and portions of Canada. In 2007, DNR commenced a study to survey the Monocacy River for this species to assess the ecological impacts.

Environment and Natural Resources

Growth Management

Maryland's incentive-based approach to growth management has not had much success in controlling where and how growth occurs. The influx of growth associated with the Base Realignment and Closure is expected to exacerbate the already existing challenges associated with population growth and development. As the Administration and others continue to look for new strategies to manage growth more effectively, smart growth is likely to garner attention during the 2008 session.

Background

Managing growth is one of the most significant environmental challenges currently facing the State. It has become an issue of concern to citizens from Western Maryland to the Eastern Shore, and it is gaining more attention than ever with the federal government's decision to expand operations at Aberdeen Proving Ground in Harford County and Fort George G. Meade in Anne Arundel County as part of the Base Realignment and Closure (BRAC).

The area's population increases by about 100,000 each year, and growth associated with BRAC is projected to add up to 60,000 new jobs and as many as 28,000 new households to the State. However, traffic congestion in the Baltimore and Washington metropolitan areas already costs Maryland residents approximately $3.1 billion annually, according to a report by the Texas Transportation Institute. In addition, overcrowded schools are causing students to be redistricted every few years, local officials are struggling with imposing building moratoriums, and residents are paying more than ever for a new home due to, in some cases, rapidly increasing impact fees.

New development associated with population growth is also leading to loss of forest and farmland in the State and hampering crucial Chesapeake Bay (Bay) restoration activities. According to the U.S. Environmental Protection Agency, new development is increasing nutrient and sediment loads into the Bay at rates faster than restoration efforts are reducing them.

Growth management has proven especially difficult on Maryland's Eastern Shore, where it is estimated that about one in five acres could be developed as more than 70,000 new homes are built for the 150,000 new residents expected over the next two decades. A general lack of resources is making it difficult for a number of small towns and municipalities on the Eastern Shore to keep up with daily planning operations.

The fact that Maryland's Eastern Shore is home to some of the most environmentally sensitive areas of the State has also led to conflicts between the State and local governments. In 2006, a proposed residential and resort development just outside of Cambridge was denied by the State Critical Area Commission for its potential negative impact on the Little Blackwater River

and the Blackwater National Wildlife Refuge, despite the fact that the project had received all the necessary local approvals and was projected to increase the tax base in Dorchester County by as much as $1 billion. Then, in May 2007, the Board of Public Works rejected a key wetlands permit for a proposed residential development on Kent Island because a portion of the project was located within the Critical Area, even though the development was located inside the Queen Anne's County's Priority Funding Area (PFA).

Local governments exercise primary authority over local planning and zoning. The Economic Growth, Resource Protection and Planning Act of 1992 was enacted under the premise that local comprehensive plans were the best place to establish priorities for growth and resource conservation. However, by the mid-1990s, State officials grew concerned that the environment and quality of life in Maryland were not adequately protected under a purely local growth management structure.

Smart Growth

In 1997, the General Assembly passed five pieces of legislation and budget initiatives – Priority Funding Areas, Brownfields, Live Near Your Work, Job Creation Tax Credits, and Rural Legacy – known collectively as "Smart Growth." In general, Smart Growth directs the State to target programs and funding to support established communities and locally designated growth areas and to protect rural areas.

Recently, however, critics allege that Smart Growth, as passed in 1997, has been ineffective in many areas of the State. While about three-fourths of all building permits for new homes from 1990 to 2004 were issued for development inside PFAs, three-fourths of the land developed for new homes in the same time frame was outside PFAs. Further, a recent report by the National Center for Smart Growth Research found the reporting of growth-related spending by State agencies under Smart Growth to be inadequate, which makes it difficult to determine whether State funds are indeed being targeted in designated growth areas. The O'Malley Administration has pledged to take another look at Smart Growth and has already revived the Office of Smart Growth, which had been dormant for the last four years. In addition, the Governor's Planning and Smart Growth Transition Work Group developed a number of recommendations intended to make Maryland the national leader in planning and smart growth.

Water Resources

In some parts of Maryland, a lack of water resources is dictating where new growth occurs. According to the Maryland Geological Survey, Charles County could run out of drinking water by 2030 because its population growth is depleting the underground supply. Similarly, construction was halted in parts of Carroll and Frederick counties when it was discovered that rapid growth in the area was using up the water supply. In response to this rapid growth and simultaneous demand for water, the General Assembly passed Chapter 381 of 2006, which added

a water resources planning element to local comprehensive plans. This element is intended to ensure that water resources will be adequate to sustain any new development, with the idea that new development cannot be allowed if it will overwhelm existing resources. The Maryland Department of the Environment is providing technical assistance to local governments to develop the water resources element of the comprehensive plan.

Implications for the 2008 Session

While significant growth management legislation has not been introduced in the General Assembly since the 1990s, there are strong indications that there is growing interest in how to more effectively track and manage growth in the State. Legislation or budget language requesting State agencies to comply with Smart Growth reporting requirements is likely in the 2008 session. Additionally, numerous State agencies are looking at land use and population projections and trying to develop a strategy for handling growth.

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The Status of Land Preservation Programs

New methodology is being used to target the State's land acquisitions under Program Open Space. There continues to be interest in using POS funds for improvements to State parks as well as for other purposes, some of which may lead to legislation in 2008. Full funding of agricultural land preservation is offset by increasing land prices and concerns about agritourism restrictions on farms. Legislation to fully establish a critical farms program is expected to be considered in the 2008 session.

Land Preservation Goals

The State manages a number of programs designed to preserve and protect the amount of open space, rural resource land, key habitat land, forested space, and agricultural lands, often in partnership with local governments, including the Maryland Agricultural Land Preservation Program (MALPP) and Program Open Space (POS).

In 2002, based on a report by a task force to study MALPP, the General Assembly passed Senate Joint Resolution 10 which set a goal of tripling the amount of protected agricultural land in Maryland by 2022. The programs included in the goal were MALPP, GreenPrint, Rural Legacy, and local preservation programs. As **Exhibit 1** shows below, the 2022 goal is approximately 1,000,000 acres (approximately three times the cumulative acreage as of April 2002), and the programs have reached approximately half of this goal.

Exhibit 1
Agricultural Land Conservation (Acreage)
Calendar 2002, 2007, and 2022 Goal

Programs	April 2002	September 2007	2022 Goal
MALPP	208,910	265,690	
GreenPrint	4,700	22,464	
Rural Legacy	29,740	54,000	
Local programs	99,983	150,098	
Total Acres (Cumulative)	**343,333**	**492,252**	**≈1,030,000**

Source: Maryland Agricultural Land Preservation Foundation

Maryland Agricultural Land Preservation Program

The Maryland Agricultural Land Preservation Foundation (MALPF) was established by the Maryland General Assembly in 1977 as part of the Maryland Department of Agriculture in order to implement MALPP. The foundation purchases agricultural preservation easements that forever restrict development on prime farmland and woodland. By the end of fiscal 2006, MALPF will have helped landowners permanently protect from development 250,370 acres on 1,816 farms.

As a result of the restoration of full funding for fiscal 2007, applications for participation in MALPP increased by 202 from fiscal 2006 to 2007, and the number of easements and preserved acreage acquired in fiscal 2007 nearly doubled from the previous year. However, increasing acquisition costs per acre, which have tripled since 2002, have kept the new acreage acquired from matching the percentage increase in funding. Additionally, some farmers have been reluctant to participate in MALPP because of limits it poses on commercial opportunities on their farms, particularly those related to agritourism. MALPF is currently developing policies to make it easier for farmers to participate in MALPP, which will likely include allowing a farmer to exclude from the easement that portion of the property used for agritourism.

Program Open Space

POS was established by the General Assembly in 1969 with State and local funding components and is part of the Department of Natural Resources. POS purchases outdoor recreation and open space areas for public use. As of October 9, 2007, POS had purchased 257,694 acres for public use. POS received full funding in fiscal 2007, which was the first time it had received full funding since diversions to the general fund began in fiscal 2003 and which allowed for 3,912 more acres to be purchased than in the previous year. As summarized below, there have been numerous recent events affecting the use and administration of POS funds.

Three recent land purchases have received significant attention within the last year, prompting the creation of a new targeting methodology for land acquisitions under POS. A $10.3 million land purchase of 728 acres in Dorchester County along the Little Blackwater River received attention because of the high acquisition cost and questionable legitimacy of the State purchasing a significant portion of the proposed Blackwater Resort Communities property after the Critical Area Commission denied the requested growth allocation for the part of the development plan within the Critical Area. A $5.0 million purchase ($4.6 million in State funds) of 271 acres in Queen Anne's County, known as the Kudner property, also raised questions, including how the purchase was proposed to the State and by whom, whether the land was appraised at too high a value for its development capacity, and why the county was willing to provide $400,000 in funding above the State-appraised value of $4.6 million. The $7.2 million 74-acre Langenfelder purchase, a ferry terminal, and industrial site at the northern tip of Kent Island in Queen Anne's County, was the third such purchase. The attention surrounding this acquisition appeared to be due to the quality of the land to be purchased and the temporary lease-back arrangement with the owner of the land.

The proposed new targeting methodology for land acquisitions under POS involves a rigorous three step process. A set of ecological criteria will be applied across the State using a geographic information system to determine the lands with the highest ecological value. Next, a set of management criteria will be used to narrow conservation prospects to a small number of regions. Finally, a parcel level screening will allow for targeting land purchases within the selected regions. The new targeting methodology is being piloted as a guide for how funding may be targeted to the most efficient best management practices in order to reach the State's Chesapeake Bay restoration sediment and nutrient reduction goals established under the Chesapeake 2000 Agreement.

There has also been renewed interest in POS funds being used to assist with capital improvements to State parks. The Maryland State Parks Funding Study, prepared in response to a request in the *Joint Chairmen's Report*, was recently released. Included in the study's recommendations was a suggestion that a higher percentage of the POS revenues that are allocated for capital development be utilized to reduce the backlog of infrastructure improvements. This recommendation was addressed, in part, by Chapter 1 of the 2007 special session, which requires the greater of $21 million or 20 percent of POS funds to be appropriated to operate State parks and forests each year.

Finally, a recently approved plan to install 14 artificial turf fields in Anne Arundel and Howard counties using approximately $7 million from POS has sparked some legislative discussion as to whether this is an appropriate use of POS funds.

Potential Legislation for the 2008 Session

Several legislative proposals relating to POS and MALPF are likely to be introduced in the 2008 session. POS legislation would increase the percent of POS local funds that may be used for development projects from 75 to 100 percent once the local acquisition goals are met. Additionally, there is interest in prohibiting the use of POS funds for the purchase and installation of artificial turf fields.

Legislation is also likely to be introduced to fully authorize the creation, implementation, and funding for a Critical Farms Program by MALPF. MALPF recommends creating a Critical Farms Revolving Account with funding of $4 million annually in general funds for four years for a total Revolving Account of $16 million. Other funding options could include MALPF's share of any over-attainment in revenues from real estate transfer taxes or any other sources established by the Governor or legislature.

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An Overview of the Regulation of False or Misleading Political Speech

Legislatures may regulate false or misleading political speech within narrow limits. Statutes regulating false or misleading political speech should at a minimum contain an "actual malice" intent standard that requires that the false speech be published with either knowledge of its falsity or with reckless disregard for its truth or falsity. Some courts have required additional elements drawn from the law of defamation.

Background

The use of false or misleading speech in political campaigns has been a recurring feature of U.S. elections. For example, following the contentious presidential election of 1828, Andrew Jackson accused his opponents of causing the death of his wife through vicious published attacks on the validity of his marriage. More recently, in Maryland's 2006 general election, candidates accused their opponents of misrepresenting their political affiliation in campaign literature and engaging in harassing telephone tactics. Some commentators have taken the view that most false and misleading campaign speech is simply part of the rough-and-tumble nature of American politics and remains incapable of regulation. Nevertheless, multiple state and federal laws continue to try to regulate political speech.[1]

Legal Framework

The basic judicial analysis of a statute regulating false or misleading political speech begins with an inquiry into the type of speech regulated. Courts will differentiate between statutes that regulate speech protected by the First Amendment to the U.S. Constitution and statutes that regulate unprotected speech. Statutes that regulate speech protected by the First Amendment are subject to rigorous judicial scrutiny of the interests the state seeks to protect and the means used to protect those interests. By contrast, statutes that regulate speech unprotected by the First Amendment face a lesser standard of review.

In the context of political campaigns, courts have limited the category of unprotected speech to false or misleading speech communicated with *actual malice*; that is, speech told with knowledge or reckless disregard of the statement's falsity. This standard is drawn from the law of defamation. The standard was first articulated in the landmark U.S. Supreme Court case *New York Times v. Sullivan* (1964), in which a public official from Alabama filed suit for libel against the *New York Times* for publishing an advertisement by a civil rights group containing some inaccuracies. The court held that public officials may not recover damages for defamatory

[1] *See* Department of Legislative Services, *An Overview of the Regulation of False or Misleading Political Speech* (2007), Exhibit 1 and 2 (list of state laws prohibiting false political speech regarding candidates).

falsehoods relating to their official conduct unless they prove by clear and convincing evidence that the statements are made with knowledge that the statements in question are false or made with reckless disregard for whether or not the statements are false. The *Sullivan* standard is a basic constitutional requirement to which any statute purporting to regulate false or misleading political speech must adhere. A statute that regulates constitutionally protected speech must show that the law is no more restrictive than necessary to protect a compelling state interest – a standard of review that, in the context of regulating political speech, is an extremely difficult obstacle to overcome.

Other lower courts reviewing state statutes are divided on how closely a statute must follow the law of defamation. For example, in *McKimm v. Ohio Election Commission* (2000), the Supreme Court of Ohio upheld Ohio's false campaign speech statute, holding that a bare actual malice standard provided sufficient protection for "robust criticism of public officials in their conduct of government affairs." By contrast, in *Rickert v. Public Disclosure Commission* (2007), the Washington Supreme Court struck down the State of Washington's false speech regulation statute. Four justices signed the plurality opinion, which strongly disapproved of any state-sponsored censorship of speech, while four justices would have upheld the statute. A decisive concurring opinion disagreed with the plurality and asserted that defamatory speech could permissibly be regulated but agreed with the plurality's result and voted to strike down the statute. The concurrence found that the statute encompassed constitutionally protected nondefamatory speech. Presumably, the concurrence agreed with the lower appellate court's decision that the statute was unconstitutional, as it lacked a requirement drawn from the law of defamation that the candidate be damaged by the false statements.

Conclusion

Although it is possible to regulate false or misleading political speech, any such statute must be narrowly drawn to ensure that it survives judicial review. Such a statute is likely to face significant legal challenges from civil liberties advocates. Consequently, the narrow range of speech not protected by the First Amendment, the high standard of evidence of the candidate's intent in publishing the speech, and the close scrutiny applied by a court to a statute regulating protected speech should limit the statute's scope only to the most blatant cases of false or misleading political speech.

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State Government

Election Administration

State, local, and federal election officials – along with federal and State policymakers and the judiciary – continue to grapple with issues relating to election administration, including the reliability and accuracy of voting equipment, election manpower, and voter identification at the polling place.

2006 Elections

During the 2006 primary election in Maryland, a number of issues arose relating to election administration, including problems with newly implemented e-pollbook voter check-in devices; local board difficulties associated with the recruitment and subsequent attendance of some election judges at the polls, which resulted in a delay in opening of some polling places; and challenges attributed to inadequate training for election judges. However, by most accounts, these issues were addressed and largely corrected prior to the general election.

Since the initial problems with the e-pollbook devices were corrected, the State Board of Election (SBE) reports that indications from the 2007 Baltimore City primary election are that their performance has improved still further. In addition, local boards of election undertook significant recruiting and training efforts between the 2006 primary and general elections to improve the staffing of polling places. Nonetheless, the challenge of providing sufficient numbers of well-trained election judges likely will continue to be a concern for local boards in future elections.

A larger than expected number of absentee ballot requests prior to the 2006 general election posed yet another challenge to election officials. The unprecedented demand exceeded the ability of the State's voting system vendor (who also was supplying the absentee ballots) to print the ballots in a timely manner. The backlog resulted in some absentee voters not receiving their absentee ballots in time to meet the "before election day" mailing deadline. SBE has addressed this problem by securing a local vendor to print Maryland absentee ballots for future elections. Using a local, dedicated vendor rather than the printing company used by the State's voting system vendor (who also supplies printing needs for other clients of the vendor) is expected to better serve the State's absentee ballot needs.

2007 Legislation

During the 2007 regular session, a number of election-related proposals were put forth and ultimately enacted into law, including:

- an earlier presidential primary date;
- a commitment to the National Popular Vote Agreement;
- restored voting rights for certain persons convicted of a crime but not actually serving a court-ordered sentence for a felony conviction;
- a constitutional amendment at the 2008 presidential general election allowing for early voting in Maryland; and
- a requirement, contingent on sufficient funding being provided in the fiscal 2009 budget, that the State's voting system produce a "voter-verifiable paper record" for the 2010 gubernatorial elections.

Other election related proposals also were put forth but ultimately were unsuccessful, including measures to reduce the possibility of absentee ballots not being received and returned by voters in a timely manner, to improve election judge training, and to address the delayed opening of polling places.

Voting Machines

In recent years, direct-recording electronic (DRE) touchscreen voting machines have been heavily scrutinized both in Maryland and nationwide. DRE usage increased significantly following the complications experienced in the 2000 presidential elections and the enactment of the Help America Vote Act of 2002 (HAVA), which provided funding to states to upgrade voting systems. The security of the machines and the integrity of the voting results produced by them have been studied repeatedly and both discounted and defended. Critics have advocated that DRE machines should be required to produce independent, voter-verified paper records (or a "voter-verified paper audit trail") with which to verify the machines' accuracy or that DRE machines should not be used at all. **Exhibit 1** provides a general overview of state voting system usage and voter-verified paper audit trail (VVPAT) requirements.

As previously noted, during the 2007 regular session, legislation was adopted requiring the State's voting system to provide a specified "voter-verifiable paper record," effectively mandating transition to an optical scan voting system prior to the 2010 gubernatorial elections, providing sufficient funds are appropriated in the fiscal 2009 budget to implement the transition. Around the same time, Florida enacted legislation requiring that optical scan systems be used statewide beginning with the 2008 presidential election (though touchscreen machines will be used during an interim period by voters with disabilities), a change-over that will require 15 Florida counties that had adopted touchscreen voting systems to abandon them.

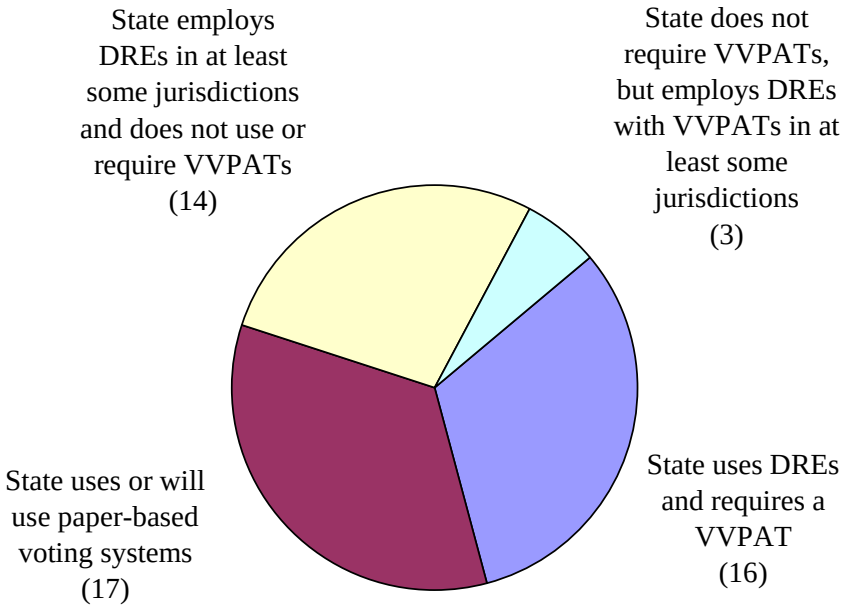
Prior to the enactment of Florida's legislation, a voting irregularity occurred in the 2006 general election in Sarasota County, Florida, where 18,000 "undervotes" (ballots where votes were cast for other contests, but not the one in question) were recorded in a congressional race decided by less than 400 votes. The discrepancy spawned various investigations and lawsuits and the formation of a Congressional task force to determine whether the DRE voting systems on

which the ballots were cast contributed to the large number of undervotes. As of November 2007, the issue was still being investigated by the task force.

Elsewhere, in March of 2007, the California Secretary of State began a well publicized "top-to-bottom review" of California's voting machines, leading to the decertification and subsequent recertification (with conditions) in August 2007 of the different DRE models used in various California counties. The actions of the Secretary of State resulted in significant voting system changes in a number of the counties. The review uncovered a number of security vulnerabilities in the systems. However, as has been the case with previous DRE security studies, it was followed by debate over the amount of access to the machines that was provided to the reviewers in a simulated hacking scenario and whether under those circumstances the results reflected realistic security vulnerabilities since security procedures that would be implemented during an actual election process were not accounted for.

Finally, with the approaching presidential election, federal legislation also gained traction in 2007. Most notably H.R. 811, the "Voter Confidence and Increased Accessibility Act of 2007," as reported in the U.S. House of Representatives, generally would require that voting systems use or produce a voter-verified paper ballot for the November 2008 elections. Concerns about the legislation, not the least of which are the practical implications of attempting to transition in such a short period away from paperless, DRE touchscreen voting systems prior to the November 2008 presidential elections, have been expressed by election officials nationwide. Consequently, a representative of the National Association of Counties indicates that it appears unlikely that federal legislation to require a transition prior to the November 2008 elections will be enacted inasmuch as the House has not voted on H.R. 811 as of mid-November 2007.

Exhibit 1
State Voting System Usage and VVPAT Requirements



State (or at least some jurisdictions in the state) uses DREs and requires a VVPAT	Alaska, Arizona, California, Colorado, Hawaii, Illinois, Iowa, Missouri, Nevada, New York, North Carolina, Ohio, Utah, Washington, West Virginia, Wisconsin
State uses or will use paper-based voting systems	Alabama, Connecticut, Florida[1], Idaho, Maine, Michigan, Minnesota, Montana, Nebraska, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon (vote-by-mail), Rhode Island, South Dakota, Vermont
State employs DREs in at least some jurisdictions and does not use or require VVPATs	Arkansas[2], Delaware, District of Columbia, Georgia, Indiana, Kansas, Kentucky, Louisiana, **Maryland**[3], New Jersey[4], Pennsylvania, South Carolina, Tennessee, Texas, Virginia
State does not require VVPATs but employs DREs with VVPATs in at least some jurisdictions	Massachusetts, Mississippi, Wyoming

VVPAT: Voter-verified paper audit trail.

[1] Florida law allows voters with disabilities to use touchscreen voting systems until 2012.
[2] Arkansas uses DREs both with and without VVPATs.
[3] Chapter 548 of 2007 requires a transition to a voting system that provides voter-verifiable paper records in 2010, if sufficient funding is included in the fiscal 2009 State budget to implement the transition.
[4] New Jersey's deadline for DREs to have VVPATs is January 1, 2008.

Source: electionline.org, September 2007

Election Audits

Post-election audits have been an issue closely related to controversies over DRE touchscreen machines. Efforts to ensure that DRE machines provide an independent, voter-verified paper record have often included post-election audits of the voter-verified paper records as an accompanying requirement to ensure the accuracy of results. While those efforts seemingly over time have shifted more toward a goal of eliminating the use of DRE machines in favor of optical scan machines (as evidenced by the laws passed in Florida and Maryland in 2007), post-election audits have been advanced as having value even with respect to paper ballot-based election systems – which too conceivably can be susceptible to vote-counting errors – to help ensure the integrity of elections and public confidence in the results.

While the State's DRE machines do not produce voter-verified paper records, SBE regulations require a post-election audit of various election materials to be conducted by local election directors. The vote-counting capability of the voting system is also verified in a specified number of precincts either (1) by comparing the vote totals from the election management system, the vote totals from individual voting units, and the post-election audit results; or (2) through the use of an election management system different from the one used for the official tabulation of votes.

SBE also has obtained a grant from the Pew Charitable Trusts to research and develop a comprehensive post election audit process based on professional auditing principles, detailed statistical analysis, and election administration expertise. The final plan is expected to detail a process that will provide assurance both that votes were counted accurately and that only eligible voters cast ballots in an election. The final report and audit plan is due in October 2008, and SBE hopes to test the audit plan following the November 2008 presidential election.

Election Judges

The problems experienced during the 2006 primary election in Maryland relating to election judge recruitment, staffing, and training brought attention to the challenges State and local election officials may face in staffing polling places on election day. Election judge work continues to become more complex with new technology and evolving laws and requirements, contributing to the difficulty of providing a proficient election judge workforce to administer the election day process.

A recent report by electionline.org addressing the nationwide challenge of recruiting, training, organizing, and mobilizing poll workers found that methods of and responsibility for training election judges vary among states and local jurisdictions, with training generally being a local responsibility, but with varying levels of state involvement in preparing training materials and in conducting training. The report also found that poll worker compensation varies, but is almost universally low given the length of the workday, and noted that problems with election judge recruitment and absenteeism are experienced nationwide.

In Maryland, SBE develops the election judge training program which is carried out by each of the local election boards for their judges. A new approach to election judge training was used by Baltimore County for the 2006 elections in which it partnered with the Schaefer Center for Public Policy at the University of Baltimore to conduct election judge training classes in a manner similar to a professional training program. The program was also used to retrain Baltimore City election judges prior to the 2006 general election. Online training is another approach that the electionline.org report mentions some states are using and others are considering.

According to information compiled by SBE, in 2006, chief election judge salaries ranged from $120 to $300 with a median salary of $175 and salaries for regular election judges ranged from $110 to $250 with a median salary of $145. Compensation for training was generally in the range of $25 in most counties (with some local boards considering the compensation for training as included in the judges' election day salary). Local boards are allowed to set the compensation of election judges within limits authorized by the county's governing body, though specific salaries or salary limits are set out in State law for some counties.

Over the years, local election boards in Maryland have attempted to recruit younger election judges, particularly high school and college students, with mixed success and have employed various other strategies including working with party central committees, county governments, and nonprofits to recruit judges. After meeting with local election officials about their different recruitment strategies, SBE has developed a State recruitment plan to help with the recruitment process, including creative strategies like using the web sites MySpace and Craig's List to attract younger judges and exploring corporate partnerships.

Voter Identification

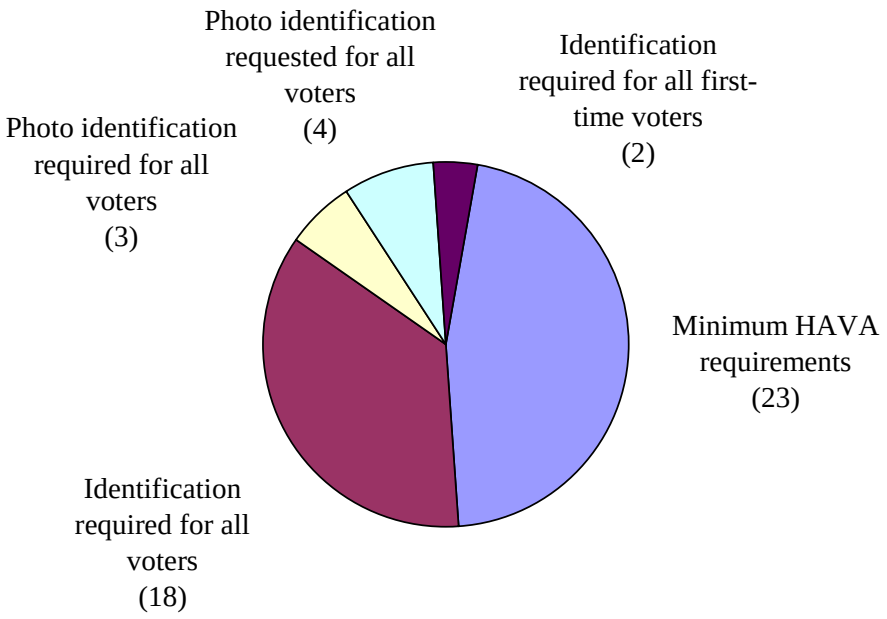
A number of states require or request some form of identification from voters before they may vote a regular ballot in an election. All states are also subject to federal requirements under HAVA that identification generally be required of first-time voters who register by mail. Photo identification requirements, which exist in a few states and have been proposed in a number of others, have been a matter of significant debate in recent years over the extent to which the type of voter fraud that the requirements ostensibly guard against occurs and whether the requirements disenfranchise voters who cannot afford, or who do not have access to, photo identification. **Exhibit 2** provides a general overview of state voter identification laws.

Florida, Georgia, and Indiana currently require some form of photo identification in order to cast a regular ballot; otherwise, a voter must cast a provisional ballot. Hawaii, Louisiana, Michigan, and South Dakota request photo identification, though if a voter cannot provide identification, the voter may sign an affidavit and cast a regular ballot.

A number of legal challenges were made to voter identification laws – primarily involving photo identification requirements – prior to the November 2006 elections. As a result, photo identification requirements in Missouri and Georgia were struck down or enjoined from

enforcement. On the other hand, challenges to voter identification requirements in Arizona (which allow several identification options) and Indiana (which allows photo identification only) were not successful in stopping their implementation during the November 2006 elections. Since then, Georgia's photo identification requirement has been restored after the state supreme court reversed on jurisdictional grounds a lower court determination that the requirement was unconstitutional. In addition, a previously unenforced photo identification requirement in Michigan, which requires voters to provide photo identification or sign an affidavit prior to voting, was upheld by the Michigan Supreme Court and is now required of voters. A court challenge over Indiana's photo identification requirement that began prior to the 2006 elections has been appealed to the U.S. Supreme Court which has agreed to review the case and is expected to issue a ruling by July 2008.

Exhibit 2
State Voter Identification Laws



Minimum HAVA (Help America Vote Act) requirements (identification required of first time voters who registered by mail and did not provide identification with their registration application)	California, District of Columbia, Idaho, Illinois, Iowa, Maine, **Maryland**, Massachusetts, Minnesota, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oklahoma, Oregon, Rhode Island, Utah, Vermont, West Virginia, Wisconsin, Wyoming
Identification required for all voters	Alabama, Alaska, Arizona, Arkansas, Colorado, Connecticut, Delaware, Kentucky, Missouri, Montana, New Mexico, North Dakota, Ohio, South Carolina, Tennessee, Texas, Virginia, Washington
Photo identification required for all voters (voters without proper ID offered provisional ballots)	Florida, Georgia, Indiana
Photo identification requested for all voters (voters without proper ID can sign affidavits and cast regular ballots)	Hawaii, Louisiana, Michigan, South Dakota
Identification required for all first-time voters	Kansas, Pennsylvania

Source: electionline.org, September 2007

Election Day Registration

Election day voter registration (EDR) was available in seven states during the 2006 elections: Idaho, Maine, Minnesota, Montana, New Hampshire, Wisconsin, and Wyoming. Although a number of these states have a preelection deadline for registration by mail or at a voter registration agency, registration nonetheless is open on election day at each polling place. Montana, which first made EDR available during the November 2006 election, does not allow registration at each polling place, but a person may register and vote after the preelection deadline at a county elections office through the close of polls on election day.

Pursuant to Chapter 61 of 2006, in December 2006 the Office of the Attorney General and SBE compiled a joint report on EDR. According to the report, EDR promises a higher voter turnout because of its appeal to younger voters, geographically mobile citizens, and late-interest voters. The report estimated that EDR could increase voter turnout by anywhere from 1 to 3 percent, likely would account for as much as 15 percent of total registration, and also likely would require two to three additional election judges at each polling place on election day. The report further noted that a constitutional amendment would be necessary in order to implement EDR in Maryland given that provisions in the Maryland Constitution contemplate a time interval between the close of voter registration and an election.

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State Government

Application of the State Open Meetings Act and the Public Information Act to the University of Maryland Medical System Corporation

The Education Article explicitly states that the University of Maryland Medical System Corporation *is not* a public body; therefore, UMMSC *is exempted from* the requirements of the Open Meetings Act. In contrast, the Public Information Act requires only that a regulated entity be a "unit or instrumentality" of State government; consequently, given the State's significant interaction with UMMSC and the broad scope of the PIA, it is probable that UMMSC *is subject to* the PIA.

Background

During the 2007 session, the General Assembly considered legislation that would have subjected the University of Maryland Medical System Corporation (UMMSC) to the Maryland Public Information Act (PIA). Introduced in response to concerns by the Maryland Minority Contractors Association, Inc. that UMMSC had violated the State minority business enterprise program regulations by restricting bidding to nonminority-owned businesses, Senate Bill 911/House Bill 1373 sought to ensure that UMMSC was subject to the PIA.

Established in 1984 as a private, nonprofit corporation, UMMSC provides inpatient and outpatient care, medical education, community health services, and emergency medical treatment in Baltimore and the surrounding area. Components of the system include the University of Maryland Medical Center, the Baltimore-Washington Medical System, Kernan Hospital, Maryland General Health Systems and Hospital, and University Specialty Hospital.

Legal Framework

Two threshold questions must be answered to determine whether UMMSC is subject to either the Open Meetings Act (OMA) or the PIA. First, is UMMSC a "public body" for the purposes of the OMA? Second, is UMMSC an "instrumentality" of the State for purposes of the PIA? While the plain language of the State code exempts UMMSC from the OMA, the applicability of the PIA is a closer case.

With regard to the OMA, the term "public body" is defined under that law as an entity that, *inter alia*, consists of more than two individuals and is created by a State statute, criteria that clearly applies to UMMSC. But, the statute that creates UMMSC also clearly states that UMMSC is not a public body; moreover, under the OMA the definition of "public body" does not include the governing body of a hospital. Thus, the OMA does not apply to UMMSC.

Turning to the PIA, it is probable, though not certain, that UMMSC is subject to the PIA. The PIA applies to any entity that is a "unit or instrumentality" of State government or a political subdivision. Although UMMSC is not a public agency but a corporation, a nonprofit entity incorporated under the State's general corporation law may be considered a unit or instrumentality of a political subdivision for purposes of the PIA if there is a sufficient nexus linking the entity to the State.

While no specific factor automatically identifies a corporation as an instrumentality of the State, courts tend to engage in a general analysis of the nature of the relationship between the entity and the State or local government. Courts will apply the PIA if the links between the State or local government and the entity make clear that the entity "was established, and is maintained, as an agent or tool of [the entity] to accomplish [the entity's] ends or purposes." As to UMMSC, some factors point to the State's intent to relinquish control over UMMSC while other factors indicate that the State still controls UMMSC. Given the broad remedial purpose of the statute, including the requirement that the PIA "shall be construed in favor of permitting inspection of a public record," it is probable, though not certain, that UMMSC is subject to the PIA.

Local Government

State Aid to Local Governments

Local governments will realize a slight increase in State aid in fiscal 2009, most of which is targeted to public schools, libraries, and community colleges. State aid is projected to total $6.6 billion in fiscal 2009, a $121.8 million or 1.9 percent increase over the prior year.

State Aid in Fiscal 2009

Local governments will receive approximately $6.6 billion in State aid in fiscal 2009, which represents a 1.9 percent increase from the prior year resulting in an additional $121.8 million in State support for local programs and services. Local school systems will receive a record $5.3 billion in State support, a $175.1 million increase over fiscal 2008. State aid for libraries and local community colleges will increase by over 7 and 11 percent respectively in fiscal 2009, resulting in an additional $4.4 million for public libraries and $26.7 million in additional funding for local community colleges. Local health departments will receive a $1.8 million or 2.7 percent increase over the prior year, whereas State aid for counties and municipalities will decrease by $86.1 million or 9.1 percent. **Exhibit 1** shows the change in State aid by governmental entity for fiscal 2009.

Exhibit 1
State Aid to Local Governments
($ in Millions)

Governmental Entity	FY 2008	FY 2009	$ Difference	% Difference
Public Schools	$5,168.1	$5,343.1	$175.1	3.4%
Counties/Municipalities	942.5	856.4	-86.1	-9.1%
Community Colleges	241.7	268.4	26.7	11.0%
Local Health Departments	66.6	68.3	1.8	2.7%
Libraries	61.6	66.0	4.4	7.1%
Total	**$6,480.5**	**$6,602.3**	**$121.8**	**1.9%**

Source: Department of Legislative Services

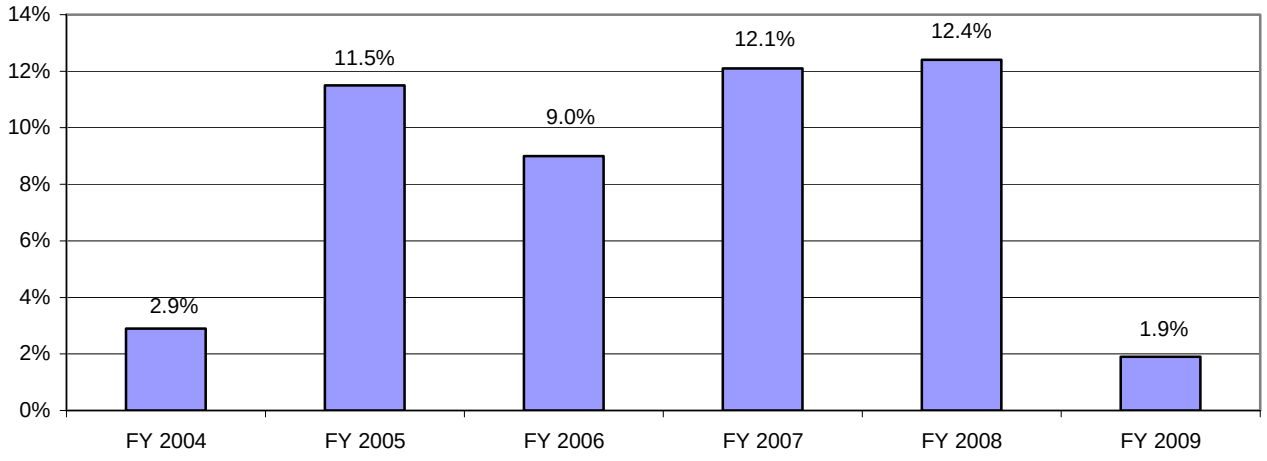
2007 Special Session

After several years of record increases in State aid (**Exhibit 2**), the General Assembly approved legislation at the 2007 special session that reduces funding for several State aid programs beginning in fiscal 2009. Education aid is reduced by $151.9 million from statutory

funding levels, whereas State aid to counties and municipalities is reduced by $63.9 million. The reduction amount for each county is shown in **Exhibit 3.** Even with these reductions, most local governments will still realize an increase in State aid in fiscal 2009, with most increases targeted to public schools, libraries, and local community colleges. **Exhibit 4** shows the net fiscal effect on State aid to local governments in fiscal 2009.

Other approved legislation will affect local revenues from three taxes – income, transfer, and recordation. The Tax Reform Act of 2007 imposes recordation and transfer taxes on the transfer of real property through the sale of a "controlling interest" in specified corporations beginning in fiscal 2009. This provision is expected to raise an additional $48.2 million in local tax revenues. In addition, the legislation alters the regular personal income tax exemption resulting in a $39.2 million local revenue loss in fiscal 2008 and $82.4 million in fiscal 2009. **Exhibit 5** shows the net fiscal effect on local revenues from both the tax changes and State aid reductions. In total, local governments will realize a $250 million reduction in local tax revenues and State aid in fiscal 2009, which equals approximately $45 per resident.

Exhibit 2
Annual Growth in State Aid to Local Governments
General and Special Funds



Source: Department of Legislative Services

Exhibit 3

Fiscal Effect on State Aid to Local Governments in Fiscal 2009

County	Education Aid	Program Open Space	Highway User Revenues	Electric Utility Tax Grants	Total Effect
Allegany	-$3,053,900	-$193,900	-$192,900	$0	-$3,440,700
Anne Arundel	-9,579,800	-2,063,300	-830,100	-7,820,200	-20,293,400
Baltimore City	-16,099,100	-1,850,300	-7,131,700	-453,400	-25,534,500
Baltimore	-21,757,500	-2,334,100	-1,128,600	-1,794,800	-27,015,000
Calvert	-3,304,700	-204,500	-170,200	-6,096,600	-9,776,000
Caroline	-1,696,600	-90,800	-133,400	0	-1,920,800
Carroll	-4,867,900	-463,400	-377,400	0	-5,708,700
Cecil	-4,478,600	-238,800	-208,600	0	-4,926,000
Charles	-5,699,700	-420,400	-267,700	-2,522,600	-8,910,400
Dorchester	-613,400	-77,400	-147,900	-187,400	-1,026,100
Frederick	-7,878,100	-479,300	-495,500	0	-8,852,900
Garrett	-163,400	-95,500	-167,000	-11,900	-437,800
Harford	-8,031,100	-686,500	-437,000	-860,800	-10,015,400
Howard	-7,291,200	-1,217,100	-417,300	0	-8,925,600
Kent	235,900	-57,800	-74,900	0	103,200
Montgomery	-9,865,600	-3,065,600	-1,177,400	-2,765,600	-16,874,200
Prince George's	-29,340,200	-2,637,600	-1,026,800	-7,744,800	-40,749,400
Queen Anne's	-1,188,100	-123,400	-154,000	0	-1,465,500
St. Mary's	-4,185,400	-232,500	-205,400	0	-4,623,300
Somerset	-980,800	-55,800	-88,800	0	-1,125,400
Talbot	-404,800	-129,400	-121,900	0	-656,100
Washington	-6,317,700	-365,100	-319,000	-357,100	-7,358,900
Wicomico	-4,616,600	-243,900	-243,600	0	-5,104,100
Worcester	-709,500	-230,100	-182,900	0	-1,122,500
Total	**-$151,887,800**	**-$17,556,500**	**-$15,700,000**	**-$30,615,200**	**-$215,759,500**

Source: Department of Legislative Services

Exhibit 4

Change in State Aid to Local Governments in Fiscal 2009

County	FY 2008	FY 2009 Baseline	Difference Over Prior Year	Percent Difference	FY 2009 Adj. Special Session	FY 2009 Total	Difference Over Prior Year	Percent Difference
Allegany	$115,602,343	$119,882,870	$4,280,527	3.7%	-$3,440,700	$116,442,170	$839,827	0.7%
Anne Arundel	410,357,956	428,758,933	18,400,977	4.5%	-20,293,400	408,465,533	-1,892,423	-0.5%
Baltimore City	1,247,143,721	1,283,948,355	36,804,634	3.0%	-25,534,500	1,258,413,855	11,270,134	0.9%
Baltimore	704,646,045	736,574,476	31,928,431	4.5%	-27,015,000	709,559,476	4,913,431	0.7%
Calvert	113,890,271	119,530,957	5,640,686	5.0%	-9,776,000	109,754,957	-4,135,314	-3.6%
Caroline	56,199,036	59,055,346	2,856,310	5.1%	-1,920,800	57,134,546	935,510	1.7%
Carroll	189,110,806	197,570,775	8,459,969	4.5%	-5,708,700	191,862,075	2,751,269	1.5%
Cecil	125,748,599	133,117,876	7,369,278	5.9%	-4,926,000	128,191,876	2,443,278	1.9%
Charles	187,907,083	200,266,931	12,359,848	6.6%	-8,910,400	191,356,531	3,449,448	1.8%
Dorchester	44,282,940	45,531,674	1,248,733	2.8%	-1,026,100	44,505,574	222,633	0.5%
Frederick	259,272,752	278,252,216	18,979,464	7.3%	-8,852,900	269,399,316	10,126,564	3.9%
Garrett	42,204,398	42,935,390	730,992	1.7%	-437,800	42,497,590	293,192	0.7%
Harford	272,504,629	284,812,789	12,308,159	4.5%	-10,015,400	274,797,389	2,292,759	0.8%
Howard	266,709,865	282,094,411	15,384,545	5.8%	-8,925,600	273,168,811	6,458,945	2.4%
Kent	17,005,573	17,023,177	17,603	0.1%	103,200	17,126,377	120,803	0.7%
Montgomery	649,097,332	698,663,232	49,565,900	7.6%	-16,874,200	681,789,032	32,691,700	5.0%
Prince George's	1,125,012,225	1,193,986,609	68,974,384	6.1%	-40,749,400	1,153,237,209	28,224,984	2.5%
Queen Anne's	44,203,278	46,314,974	2,111,696	4.8%	-1,465,500	44,849,474	646,196	1.5%
St. Mary's	114,047,978	120,351,225	6,303,247	5.5%	-4,623,300	115,727,925	1,679,947	1.5%
Somerset	36,111,153	37,423,713	1,312,560	3.6%	-1,125,400	36,298,313	187,160	0.5%
Talbot	21,651,224	22,275,116	623,892	2.9%	-656,100	21,619,016	-32,208	-0.1%
Washington	176,383,741	188,258,468	11,874,727	6.7%	-7,358,900	180,899,568	4,515,827	2.6%
Wicomico	133,307,511	142,769,076	9,461,565	7.1%	-5,104,100	137,664,976	4,357,465	3.3%
Worcester	34,653,767	35,715,884	1,062,116	3.1%	-1,122,500	34,593,384	-60,384	-0.2%
Unallocated	93,457,342	102,957,531	9,500,189	10.2%	0	102,957,531	9,500,189	10.2%
Total	**$6,480,511,570**	**$6,818,072,003**	**$337,560,433**	**5.2%**	**-$215,759,500**	**$6,602,312,503**	**$121,800,933**	**1.9%**

Source: Department of Legislative Services

Exhibit 5

Fiscal Effect on Local Governments in Fiscal 2009

County	Local Tax Revenues: Controlling Interest	Local Tax Revenues: Personal Exemption	Local Tax Revenues: Total Tax Revenues	State Aid Programs	Total Impact	Per Capita Impact
Allegany	$166,200	-$1,144,500	-$978,300	-$3,440,700	-$4,419,000	-$61
Anne Arundel	4,633,900	-6,251,000	-1,617,100	-20,293,400	-21,910,500	-43
Baltimore City	4,702,800	-9,355,600	-4,652,800	-25,534,500	-30,187,300	-48
Baltimore	8,553,600	-12,215,200	-3,661,600	-27,015,000	-30,676,600	-39
Calvert	176,200	-1,186,700	-1,010,500	-9,776,000	-10,786,500	-121
Caroline	88,200	-517,200	-429,000	-1,920,800	-2,349,800	-72
Carroll	489,300	-2,700,900	-2,211,600	-5,708,700	-7,920,300	-47
Cecil	235,800	-1,549,400	-1,313,600	-4,926,000	-6,239,600	-63
Charles	542,600	-2,092,900	-1,550,300	-8,910,400	-10,460,700	-74
Dorchester	203,300	-492,300	-289,000	-1,026,100	-1,315,100	-42
Frederick	1,076,400	-3,480,700	-2,404,300	-8,852,900	-11,257,200	-50
Garrett	158,600	-451,400	-292,800	-437,800	-730,600	-24
Harford	1,349,100	-3,973,000	-2,623,900	-10,015,400	-12,639,300	-52
Howard	2,922,200	-2,935,100	-12,900	-8,925,600	-8,938,500	-33
Kent	104,500	-300,100	-195,600	103,200	-92,400	-5
Montgomery	12,594,500	-11,152,200	1,442,300	-16,874,200	-15,431,900	-17
Prince George's	7,648,100	-15,298,200	-7,650,100	-40,749,400	-48,399,500	-58
Queen Anne's	173,900	-657,200	-483,300	-1,465,500	-1,948,800	-42
St. Mary's	564,800	-1,532,900	-968,100	-4,623,300	-5,591,400	-57
Somerset	28,500	-354,700	-326,200	-1,125,400	-1,451,600	-56
Talbot	342,300	-434,700	-92,400	-656,100	-748,500	-21
Washington	535,600	-2,348,900	-1,813,300	-7,358,900	-9,172,200	-64
Wicomico	270,200	-1,587,700	-1,317,500	-5,104,100	-6,421,600	-70
Worcester	647,800	-373,700	274,100	-1,122,500	-848,400	-17
Total	**$48,208,400**	**-$82,386,200**	**-$34,177,800**	**-$215,759,500**	**-$249,937,300**	**-$45**

Source: Department of Legislative Services

Local Government

Local Tax and Salary Actions

Local tax rates remained relatively stable in fiscal 2008, while most county governments and local boards of education provided salary enhancements to their employees.

Local Government Tax Rates

Eight counties changed various local tax rates in fiscal 2008, with five decreasing rates and three increasing them. As shown in **Exhibit 1**, five jurisdictions reduced property taxes in fiscal 2008 due to growth in property tax assessments that have pushed local revenues upward, and one increased its property tax rate. Local income tax rates remained relatively constant for tax year 2007, with only one county increasing its rate. Two counties increased their recordation tax rates. A comparison of local tax rates for fiscal 2007 and 2008 is provided in **Exhibit 2**.

Exhibit 1
Number of Counties Changing Local Tax Rates
Fiscal 2004-2008

	FY 2004		FY 2005		FY 2006		FY 2007		FY 2008	
	▲	▼	▲	▼	▲	▼	▲	▼	▲	▼
Real Property	5	1	2	6	0	13	0	17	1	5
Local Income	6	0	1	1	0	1	0	1	1	0
Recordation	5	0	1	0	1	0	0	0	2	0
Transfer	1	1	0	0	1	0	0	0	0	0
Admissions/Amusement	2	0	0	0	0	0	0	1	0	0
Lodging	1	0	5	0	5	0	0	0	0	0

Note: ▲ represents a tax rate increase; ▼ represents a tax rate decrease.
Source: 2007 Local Government Tax Rate and Salary Action Survey, Department of Legislative Services

Exhibit 2

Local Tax Rates – Fiscal 2007 and 2008

County	Real Property FY 2007	Real Property FY 2008	Local Income CY 2007	Local Income CY 2008	Recordation FY 2007	Recordation FY 2008	Transfer FY 2007	Transfer FY 2008	Admissions/ Amusement FY 2007	Admissions/ Amusement FY 2008	Hotel/Motel FY 2007	Hotel/Motel FY 2008
Allegany	$0.983	$0.983	2.93%	3.05%	3.00	3.25	0.5%	0.5%	7.5%	7.5%	8.0%	8.0%
Anne Arundel	0.918	0.891	2.56%	2.56%	3.50	3.50	1.0%	1.0%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.288	2.268	3.05%	3.05%	5.00	5.00	1.5%	1.5%	10.0%	10.0%	7.5%	7.5%
Baltimore	1.100	1.100	2.83%	2.83%	2.50	2.50	1.5%	1.5%	10.0%	10.0%	8.0%	8.0%
Calvert	0.892	0.892	2.80%	2.80%	5.00	5.00	0.0%	0.0%	1.0%	1.0%	5.0%	5.0%
Caroline	0.870	0.870	2.63%	2.63%	5.00	5.00	0.5%	0.5%	0.0%	0.0%	5.0%	5.0%
Carroll	1.048	1.048	3.05%	3.05%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Cecil	0.960	0.960	2.80%	2.80%	4.10	4.10	0.0%	0.0%	6.0%	6.0%	5.0%	5.0%
Charles	1.026	1.026	2.90%	2.90%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Dorchester	0.896	0.896	2.62%	2.62%	5.00	5.00	0.75%	0.75%	0.5%	0.5%	5.0%	5.0%
Frederick	1.064	1.064	2.96%	2.96%	5.00	6.00	0.0%	0.0%	5.0%	5.0%	3.0%	3.0%
Garrett	1.000	1.000	2.65%	2.65%	3.50	3.50	1.0%	1.0%	4.5%	4.5%	5.0%	5.0%
Harford	1.082	1.082	3.06%	3.06%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	0.0%	0.0%
Howard	1.140	1.150	3.20%	3.20%	2.50	2.50	1.0%	1.0%	7.5%	7.5%	5.0%	5.0%
Kent	0.972	0.972	2.85%	2.85%	3.30	3.30	0.5%	0.5%	4.5%	4.5%	5.0%	5.0%
Montgomery	0.916	0.916	3.20%	3.20%	3.45	3.45	1.0%	1.0%	7.0%	7.0%	7.0%	7.0%
Prince George's	1.319	1.319	3.10%	3.10%	2.20	2.20	1.4%	1.4%	10.0%	10.0%	5.0%	5.0%
Queen Anne's	0.800	0.770	2.85%	2.85%	3.30	3.30	0.5%	0.5%	5.0%	5.0%	5.0%	5.0%
St. Mary's	0.857	0.857	3.00%	3.00%	4.00	4.00	1.0%	1.0%	2.0%	2.0%	5.0%	5.0%
Somerset	0.940	0.940	3.15%	3.15%	3.30	3.30	0.0%	0.0%	4.0%	4.0%	5.0%	5.0%
Talbot	0.500	0.475	2.25%	2.25%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	4.0%	4.0%
Washington	0.948	0.948	2.80%	2.80%	3.80	3.80	0.5%	0.5%	5.0%	5.0%	6.0%	6.0%
Wicomico	0.942	0.881	3.10%	3.10%	3.50	3.50	0.0%	0.0%	6.0%	6.0%	6.0%	6.0%
Worcester	0.7000	0.700	1.25%	1.25%	3.30	3.30	0.5%	0.5%	3.0%	3.0%	4.0%	4.0%

Note: The real property tax rates shown for Charles, Frederick, Howard, Montgomery, and Prince George's counties include special tax rates. Real property tax is per $100 of assessed value. Income is a percentage of taxable income. Recordation tax is per $500 of transaction.
Source: 2007 Local Government Tax Rate and Salary Action Survey, Department of Legislative Services

Property Tax Rates

For fiscal 2008, five jurisdictions – Baltimore City and Anne Arundel, Queen Anne's, Talbot, and Wicomico counties – decreased their real property tax rates, while one county (Howard) increased its tax rate. Real property tax rates range from $0.475 per $100 of assessed value in Talbot County to $2.268 per $100 of assessed value in Baltimore City.

Local Income Tax Rates

Allegany County was the only jurisdiction to alter its local income tax rate for calendar 2008, increasing it from 2.93 to 3.05 percent. Local income tax rates range from 1.25 percent in Worcester County to 3.20 percent in Howard and Montgomery counties.

Recordation Tax Rates

Two counties increased recordation tax rates for fiscal 2008 – Allegany County increased its rate from $3.00 to $3.25 per $500 of transaction, and Frederick County increased its rate from $5.00 to $6.00 per $500 of transaction. The range for recordation tax rates is $2.20 per $500 of transaction in Prince George's County to $6.00 per $500 of transaction in Frederick County.

Transfer Tax Rates

No county changed its transfer tax rate for fiscal 2008. Local transfer tax rates range from 0.5 percent in six counties (Allegany, Caroline, Kent, Queen Anne's, Washington, and Worcester) 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 property transfers.

Admissions and Amusement Tax Rates

No county changed its admissions and amusement tax rate for fiscal 2008. Admissions and amusement tax rates range from 0.5 percent in Dorchester County to 10.0 percent in six jurisdictions – Baltimore City, and Anne Arundel, Baltimore, 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

No county changed its hotel and motel tax rate for fiscal 2008. 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 may 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

Almost all Maryland jurisdictions provided salary enhancements to their employees in fiscal 2008. Twenty-three county governments provided their employees with a cost-of-living adjustment (COLA), while 20 counties provided step increases. Moreover, each board of education provided COLAs and step increases for its teachers. **Exhibit 3** compares local salary actions in fiscal 2007 and 2008, while **Exhibit 4** shows specific local salary actions for fiscal 2008. Most counties (14) provided their employees with a COLA of at least 3 percent, while the majority of local boards of education (13) provided teachers with at least 5 percent. For comparison purposes, the State provided its employees with a 2 percent COLA in fiscal 2008.

Exhibit 3
Local Government Salary Actions – Summary
Fiscal 2007 and 2008

	County Government		Public Schools	
COLA Amount[1]	FY 2007	FY 2008	FY 2007	FY 2008
No COLA	0	1	0	0
1% to 2.9%	5	9	0	0
3% to 3.9%	8	8	7	3
4% to 4.9%	8	4	9	8
5% to 5.9%	1	1	3	8
6% and Greater	2	1	5	5

COLA: Cost-of-living adjustment
[1] The COLA amount includes market adjustments.

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Exhibit 4
Local Government Salary Actions in Fiscal 2008

	County Government Generally		Board of Education Teachers	
County	**COLA**	**Step**	**COLA**	**Step**
Allegany[1]	2.5%	Yes	6.5%	Yes
Anne Arundel[2]	3.0%	Yes	6.0%	Yes
Baltimore City[3]	4.0%	Yes	3.5%	Yes
Baltimore	3.0%	Yes	4.0%	Yes
Calvert	3.8%	Yes	4.5%	Yes
Caroline	2.0%	Yes	5.0%	Yes
Carroll	2.0%	Yes	7.0%	Yes
Cecil[4]	0.0%	Yes	4.5%	Yes
Charles	2.3%	Yes	5.0%	Yes
Dorchester	1.5%	Yes	4.0%	Yes
Frederick	2.0%	Yes	4.5%	Yes
Garrett	6.0%	No	6.0%	Yes
Harford	3.0%	Yes	4.0%	Yes
Howard[5]	3.0%	Yes	5.0%	Yes
Kent[6]	Varies	Varies	5.0%	Yes
Montgomery[7]	4.0%	Yes	4.8%	Yes
Prince George's[8]	2.5%	Yes	5.0%	Yes
Queen Anne's[9]	Varies	Yes	5.0%	Yes
St. Mary's	3.8%	Yes	3.8%	Yes
Somerset[10]	2.5%	Yes	5.0%	Yes
Talbot[11]	3.7%	No	3.6%	Yes
Washington[12]	3.5%	No	7.0%	Yes
Wicomico	4.0%	No	4.0%	Yes
Worcester	5.0%	Yes	5.0%	Yes
Number Granting	23	20	24	24

Source: Department of Legislative Services

Comments

[1] Allegany County roads employees received a 3% COLA, animal control employees and E-9-1-1 employees received 5%, and nursing home employees received 4.8%.
[2] Anne Arundel County teaching assistants, and board of education secretaries, operations, maintenance, and food service employees received a 3% COLA.
[3] In Baltimore City, negotiations for firefighters and police officers are pending.
[4] While Cecil County employees in general did not receive a COLA in fiscal 2008, county public safety employees received a 6% COLA.
[5] In Howard County, police officers received a 5% COLA, fire and rescue employees received 6%, and corrections employees and dispatchers received 4%.
[6] In Kent County, grades 1-4 received a salary market adjustment of $3,000, grade 5 received $2,000, and grades 6-10 received $1,500 on March 28, 2007. Kent County law enforcement officers' salaries were adjusted to the State Police salary scale (an average 5-6% increase). School administrators and board of education support staff received a 4% COLA.
[7] Montgomery County police officers received a 7.5% COLA while fire and rescue employees received 5%.
[8] Salary adjustment shown for county employees is for nonrepresented general schedule employees only. Negotiations for all Prince George's County government bargaining units are either pending or have not yet been approved.
[9] Queen Anne's County employees received the greater of $900 or 1.5% of salary.
[10] Somerset County school administrators and board of education classified employees received a 4% COLA.
[11] Talbot County school administrators and board of education support staff received a 2.3% COLA.
[12] Washington County board of education support personnel received a 5% COLA while school administrators received 4 to 7%, depending on the position. The county did not indicate whether county government employees received merit or step increases.

Local Government

2008 Legislative Agenda – Maryland Municipal League

As the State addresses its fiscal challenges, the Maryland Municipal League will seek to protect current levels of State funding to municipalities. Simultaneously, MML will explore more legislative options to expand municipal revenue raising authority and seek authority to allow all local jurisdictions to implement automated radar camera technology to help apprehend speeders in residential districts and school zones.

Protecting and Enhancing Municipal Revenues

The Maryland Municipal League (MML) is exploring options to protect the existing fiscal resources of municipalities that may be the target of State budget cuts while at the same time pursuing legislative options that would expand municipal revenue raising authority. This legislative priority is purposefully broad, and MML's Legislative Committee has been given wide latitude to assess and react to the State budgetary landscape during both the 2007 special session and the 2008 session.

Among the revenue raising options being explored by MML are measures to allow municipalities to impose hotel or motel rental taxes, building excise taxes, and street utility fees. Other options include legislation to (1) address municipal tax differentials; (2) grant a direct allocation to municipalities from the State for Program Open Space; (3) grant municipal governments an exemption from the State gasoline tax; (4) address the underassessment of commercial properties; and (5) divert a portion of the county share of recordation and transfer taxes collected by the county for properties sold within municipalities in the county.

Speed Monitoring Systems – Radar Cameras

State law authorizes the use of automated radar camera systems to help apprehend speeders in just three local jurisdictions – Montgomery County and the cities of Rockville and Gaithersburg. Automated radar camera systems in these jurisdictions are approved for use only in residential districts and school zones, and the results thus far have demonstrated improvements in driver behavior and traffic and pedestrian safety statistics.

In the past, MML has supported legislation that would have authorized local governments throughout the State to use automated radar camera systems to help apprehend speeders. It is MML's position that the need for speed control is especially critical in residential districts and school zones, and it will work to enact legislation in 2008 to grant all local

governments the authority to use automated radar camera technology to issue speeding citations in residential districts and school zones.

Local Government

2008 Legislative Agenda – Maryland Association of Counties

As the State addresses its structural deficit, the Maryland Association of Counties urges the State to continue its commitment to increase funding for public school construction or, at a minimum, protect State aid. In addition, MACo urges General Assembly action on measures relating to (1) the payment of applicable transfer and recordation taxes by commercial property owners on the sale of commercial property; (2) additional investment options for local governments to use to satisfy federal accounting rules applicable to the disclosure and funding of long-term employee obligations for retiree health and other post-employment benefits; and (3) local government authority to implement traffic speed monitoring technology.

Background

Each year, the Maryland Association of Counties (MACo) selects up to four issues as its legislative initiatives for the upcoming regular session. This year, MACo has made its first initiative contingent on the resolution of Maryland's structural deficit during the 2007 special session. If the General Assembly resolves Maryland's structural deficit, MACo will urge the General Assembly to continue to make school construction funding a priority; if the General Assembly does not make significant progress, however, MACo will emphasize protecting State aid. MACo's remaining three priorities involve transfers of controlling property interests, post-employment benefit funding options, and enforcement authority for traffic speed monitoring technology.

School Construction and Renovation Funding

Provided the General Assembly resolves Maryland's structural deficit in the 2007 special session, MACo strongly urges increased funding for school construction. In 2004, the State pledged an eight-year commitment to fund the counties' wide-ranging school construction and renovation needs inventoried in the School Facilities Act. However, rapidly escalating construction costs and an increasing student population make funding these projects a challenge. The State recently increased its school construction and renovation funding, and the counties have responded by also significantly boosting their share of funding for local projects. Seeing these projects to completion will require continued effort. Consequently, MACo requests the General Assembly to remain steadfast and make school construction and renovation funding a high priority through the duration of the period outlined under the School Facilities Act.

Transfers of Controlling Property Interests[1]

When individuals sell residential or commercial property, transfer and recordation taxes are paid on the value of that sale. The revenues raised support both land preservation and infrastructure improvements. An increasingly common tax avoidance technique for commercial property involves the use of "single purpose entities" (most often a limited liability company) whose ownership or membership interest may be sold without any new filing of land records. As a result, no taxes are collected, thereby leaving the owners of residential and taxpaying commercial properties to subsidize public services on behalf of large commercial entities using controlling interest transfers. MACo requests that the General Assembly make transfer and recordation taxes apply to real estate entity transfers the same way the taxes apply to simple transfers.

Post-employment Benefit Funding Options

New Government Accounting Standards Board (GASB) accounting rules require greater disclosure of long-term employee obligations such as retiree health benefits and other post-employment benefits. Governments are approaching this significant fiscal challenge in a variety of ways. While State law currently authorizes limited methods of use and investment of public funds, counties may need broader statutory authority to establish mechanisms to properly "set off" funding for these long-term purposes. MACo will encourage the State to consider a number of options, including clarifying the relationship of Other Post-Employment Benefits with respect to Maintenance of Effort calculations and the creation of cooperative investment vehicles.

Enforcement Authority for Traffic Speed Monitoring Technology

Maryland's use of traffic signal monitoring technology has been shown to reduce violations, accidents, and injuries at affected intersections. Similar technology, used to deter speeding on public roadways, may also reduce accidents and injuries. Local governments may also implement protections for special vehicle classes or non-owner operation. MACo encourages the State to authorize local governments to implement speed monitoring cameras and issue civil citations to vehicle owners for registered violations.

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[1] This issue may be resolved during the 2007 special session.

Local Government

Immigration's Impact on Maryland State and Local Governments

Immigration related issues continue to confront officials at all levels of government. To gain a better understanding of how international immigration is affecting communities in Maryland and the types of government services and programs currently available to the State's immigrant communities, the Department of Legislative Services will issue a preliminary report in January 2008 that summarizes various issues relating to immigration.

Introduction

Immigration has emerged as a major issue in legislatures at the national, state, and local levels in recent years. Most of the debates over immigration policy focus on the status of undocumented immigrants. The undocumented immigrant population in the United States has increased significantly since 2000, according to the U.S. Department of Homeland Security, which estimates that this population numbered 8.5 million in 2000 and 11.6 million in 2006, an increase of 37 percent. In addition, 17.6 million legal immigrants were living in the United States in 2006.

The failure of Congress to enact comprehensive reforms of the nation's immigration laws prompted many state and local governments to consider their own measures. While some states and localities enacted restrictive measures aimed at undocumented immigrants, others offer new services and benefits to immigrants, including those who are undocumented. More than 1,400 bills relating to immigration were introduced in state legislatures as of July 2007, with 182 becoming law, according to the National Conference of State Legislatures. The number of immigration bills introduced and enacted more than doubled compared with 2006.

Immigration in Maryland

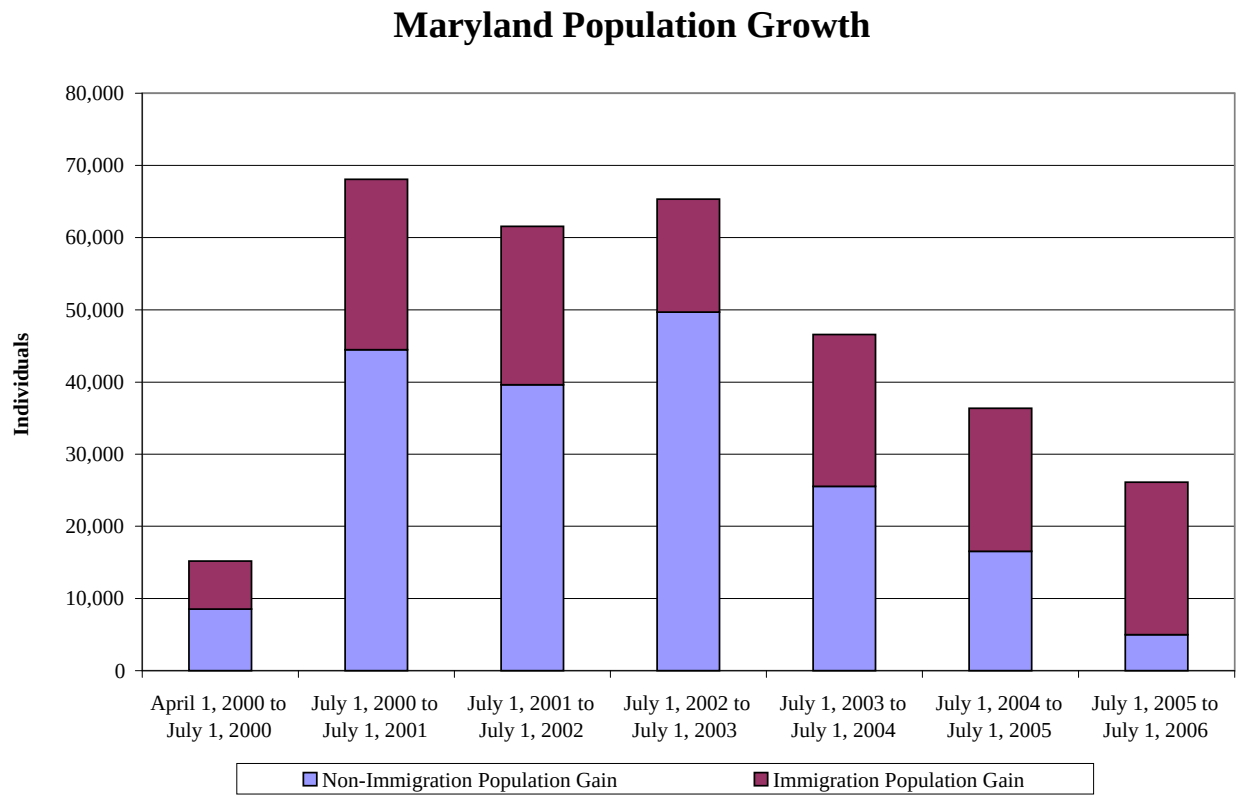
Maryland continues to be a major destination for immigrants. International immigration added 129,730 people to the State's population between 2000 and 2006, according to population estimates prepared by the U.S. Census Bureau. This was the fifteenth largest gain from immigration among all states during that period.

Immigration to Maryland is concentrated in the Washington metropolitan area, especially Montgomery and Prince George's counties. Between 2000 and 2006, Montgomery County added 62,627 people through international immigration, while Prince George's County added 29,602. Montgomery and Prince George's counties gained more than twice as many people through immigration than the rest of the State combined from 2000 to 2006.

A significant portion of Maryland's immigrants are undocumented, according to the Pew Hispanic Center, a nonpartisan research organization. The center estimated that there were between 225,000 and 275,000 undocumented immigrants in Maryland in 2005, meaning Maryland had the eleventh largest number of undocumented immigrants among the states that year, according to the center.

Impact of Immigration on Population Growth

Immigration has contributed significantly to Maryland's population growth in recent years, with international immigration accounting for 41 percent of Maryland's total population growth between 2000 and 2006, according to U.S. Census Bureau population estimates. During that period, Maryland gained a total of 319,221 residents, of whom 129,730 came to the State through immigration.



The impact of immigration on population growth varies greatly among Maryland's jurisdictions; it is most pronounced in Montgomery County, a major destination for immigrants. Between 2000 and 2006, immigration accounted for 108 percent of Montgomery County's population growth, which means that without immigration, the county would actually have lost

population during the period. In Prince George's County, another major destination for immigrants, 73 percent of the county's population gain was due to immigration.

Report on Immigration in Maryland

The Department of Legislative Services will issue a preliminary report in January 2008 that summarizes various issues relating to immigration including:

- federal and state responsibilities in immigration matters;
- factors contributing to immigration to Maryland;
- State and national demographic trends;
- constitutional and civil rights requirements;
- business and economic impacts;
- effect on government services relating to education, health and human services, courts and criminal justice, transportation, and zoning and code enforcement; and
- summary of legislative action at the federal, state, and local levels.

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