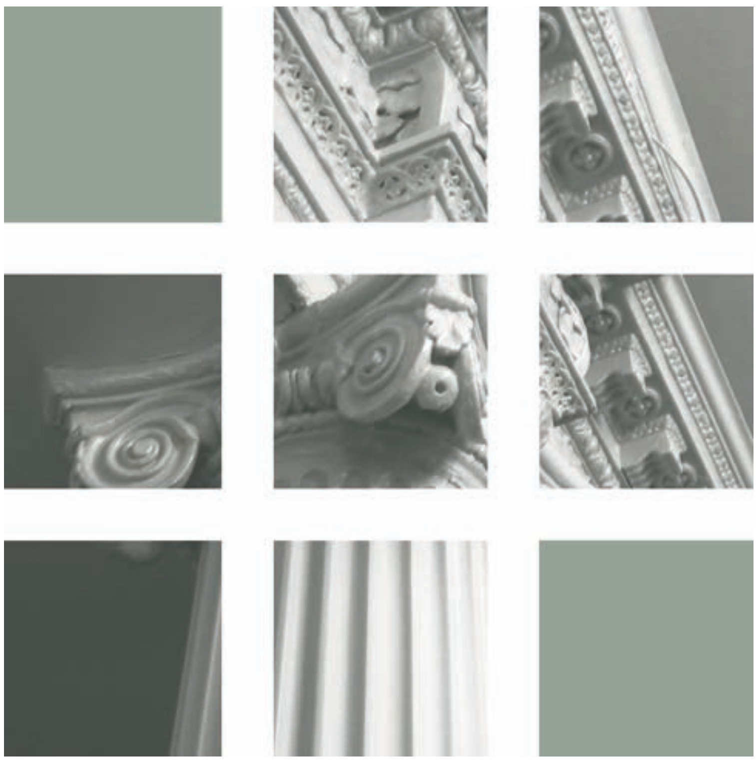
Issue Papers

2010 Legislative Session



Department of Legislative Services 2009

Issue Papers

2010 Legislative Session

Presentation to the

Maryland General Assembly

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2009

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December 2009

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, 2009.

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	Warren G. Deschenaux Director

WGD/ncs

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Economic and Revenue Outlook

The national recession continues to impact the Maryland economy with both employment and income expected to fall in 2009. Only weak growth is projected in 2010. Since the end of the legislative session, the general fund revenue estimate for fiscal 2010 has been revised down by $683 million. Modest growth in fiscal 2011 will still leave revenues below the fiscal 2008 level.

Economic Outlook

The U.S. economy officially entered a recession in December 2007. Since then, the U.S. economy has lost 7.2 million jobs, a decline of 5.2%. The drop in jobs is already worse than in any previous recession in the post-World War II era. The unemployment rate as of September 2009 was 9.8%, the highest since June 1983. Most economists believe the U.S. economy bottomed out in the summer of 2009. Growth in the near term is being supported by government efforts to stimulate the economy through both monetary and fiscal policy, as well as a swing in the inventory cycle as businesses first cut inventories less and then begin to add to inventories. Despite the tentative signs of growth, the unemployment rate is expected to continue rising until the first part of 2010, peaking at just over 10.0%.

Maryland's employment peaked in February 2008 and has since declined by 82,000 jobs, a drop of 3.1%. The Maryland unemployment rate rose from 3.6% at the beginning of 2008 to 7.2% as of September 2009. The unemployment rate is the highest it has been since July 1984. Personal income growth slowed from 4.6% in 2007 to 3.1% in 2008. Wage and salary income growth slowed from 5.0% in 2007 to just 2.4% in 2008. In the first six months of 2009, personal income growth slowed further to 1.2%. Wage and salary income has actually fallen in the first six months of 2009, dropping by 1.1%.

In September, the Board of Revenue Estimates (BRE) issued a revised economic forecast for Maryland, its first since March (**Exhibit 1**). Recognizing the continuing problems in the State's economy, especially in the labor market, the BRE forecasts a 2.9% decline in employment in 2009 and a decline in personal income of 0.7%. Employment is expected to fall slightly in 2010 as weakness in the first half of the year is only partially offset by stronger growth in the second half. Personal income is expected to rise modestly in 2010 as employers restore hours and begin hiring late in the year. Growth picks up considerably in 2011 and 2012 as the economy continues to rebound and the direct impact of the federal Base Realignment and Closure process is felt.

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

Calendar		Employment			Personal Income	
Year	Dec. 2008	Mar. 2009	Sep. 2009	Dec. 2008	Mar. 2009	Sep. 2009
2006	1.3%	1.3%	1.3%	5.8%	5.8%	6.4%
2007	0.8%	0.8%	0.7%	6.3%	6.3%	4.6%
2008	-0.2%	-0.5%	-0.4%	3.9%	3.6%	3.1%
2009E	-2.0%	-2.6%	-2.9%	1.7%	1.1%	-0.7%
2010E	0.1%	-0.2%	-0.4%	3.4%	2.7%	2.5%
2011E	1.5%	1.9%	1.6%	5.9%	5.8%	4.7%
2012E	2.1%	2.1%	2.3%	5.8%	5.7%	5.8%

Source: Board of Revenue Estimates. The figures for 2008 for personal income under the December 2008 and March 2009 columns are the BRE's estimates.

Revenue Outlook

Fiscal 2009 general fund revenues were below the estimate by $347.9 million. General fund revenues totaled $12.9 billion, a decline of 4.8% from fiscal 2008. Most of the underattainment was in the personal income tax, which was under the estimate by $304.3 million. Withholding was slightly below the estimate but the real problems were in quarterly estimated payments and final payments with returns. At the same time, refunds were a bit more than expected. The sales tax exceeded the estimate by $9.5 million but fell 1.5% from fiscal 2008. However, adjusted for law changes, baseline sales tax revenues declined 5.5%, the second year of falling revenues.

Fiscal 2010 general fund revenues through September are down 9.2% from last year. Personal income tax revenues are down 8.4% with quarterly estimated payments down 28.0% and withholding essentially flat with last year. General fund sales tax revenues are down 8.5% through September. The one bright spot is the lottery, where general fund revenues are up almost 18.0% through September due to a significant decline in prize payouts and a 3.1% increase in sales. At this time last year, prize payouts were unusually high for the Pick 3 and Pick 4 games, and the return to more normal prize payouts for those games results in substantial revenue growth. Also contributing to the strong growth in general fund lottery revenues is a reduction in the agent commissions paid from 5.5% to 5.0%.

The significant underattainment in fiscal 2009, the weak year-to-date performance, and deteriorating economic conditions result in a substantial downward revision to the general fund forecast for fiscal 2010 (**Exhibit 2**). In September, the BRE lowered its estimate for fiscal 2010 general fund revenues by $683 million. The BRE now expects revenues to fall 4.5% in fiscal 2010 compared to their previous estimate of a 1.6% decline. General fund revenues are projected to increase 3.4% in fiscal 2011 as economic growth resumes in the later part of calendar 2010 and into 2011.

The largest revision was to the personal income tax, which was lowered by $480 million. This reflects the large underattainment in fiscal 2009 as well as the revised economic forecast which now has income falling in calendar 2009. The corporate income tax was revised down by $61 million reflecting the disappointing performance in fiscal 2009 and the expectation that corporate profits will continue to fall in 2009 relative to 2008. The increase in general fund corporate income tax revenues in fiscal 2011 is due largely to the end of the distribution to the Higher Education Investment Fund. The fund is projected to receive around $40 million in fiscal 2010 but no corporate income tax revenue in fiscal 2011 under current law. If revenues were to be distributed to the fund in fiscal 2011, general fund corporate income tax revenues would be up an estimated 1.1%.

Exhibit 2

Maryland General Fund Revenue Forecast

($ in Millions)

	FY 2010				FY 2011	
	BRE March 2009	BRE Sep. 2009	$ Diff.	% Change 2010/2009	BRE Sep. 2009	% Change 2011/2010
Personal Income Tax	$6,602	$6,122	-$480	-5.5%	$6,358	3.9%
Sales & Use Tax	3,605	3,524	-82	-2.7%	3,647	3.5%
Corporate Income Tax	556	495	-61	-10.1%	541	9.3%
Lottery	507	523	16	10.5%	530	1.4%
Other	1,727	1,651	-76	-7.2%	1,657	0.4%
Total	**$12,997**	**$12,314**	**-$683**	**-4.5%**	**$12,734**	**3.4%**

Source: Board of Revenue Estimates. The estimate from March has been adjusted for actions taken at the 2009 legislative session.

Operating Budget

Budget Outlook

The U.S. economy has been in recession since December 2007. This recession has resulted in substantial reductions in Maryland's projected general fund revenues. The September 2009 revenue estimate projects $12.3 billion in general fund revenues, which is $2.4 billion less than projected in September 2008. In response, $429 million was withdrawn from agency fiscal 2010 general fund appropriations by the Board of Public Works in July and August of 2009. Additional reductions are expected in November 2009. The reductions were necessary in spite of federal stimulus funds, which total $1.1 billion in fiscal 2010. A $2.0 billion cash deficit is projected in fiscal 2011, even with $898 million in federal stimulus funds. The fiscal 2012 cash deficit increases to $2.5 billion as federal stimulus funds end. This deficit is so large that revenue growth alone will not address the general fund shortfall, thus a multi-year approach combining spending and revenue actions and the use of reserves will be needed.

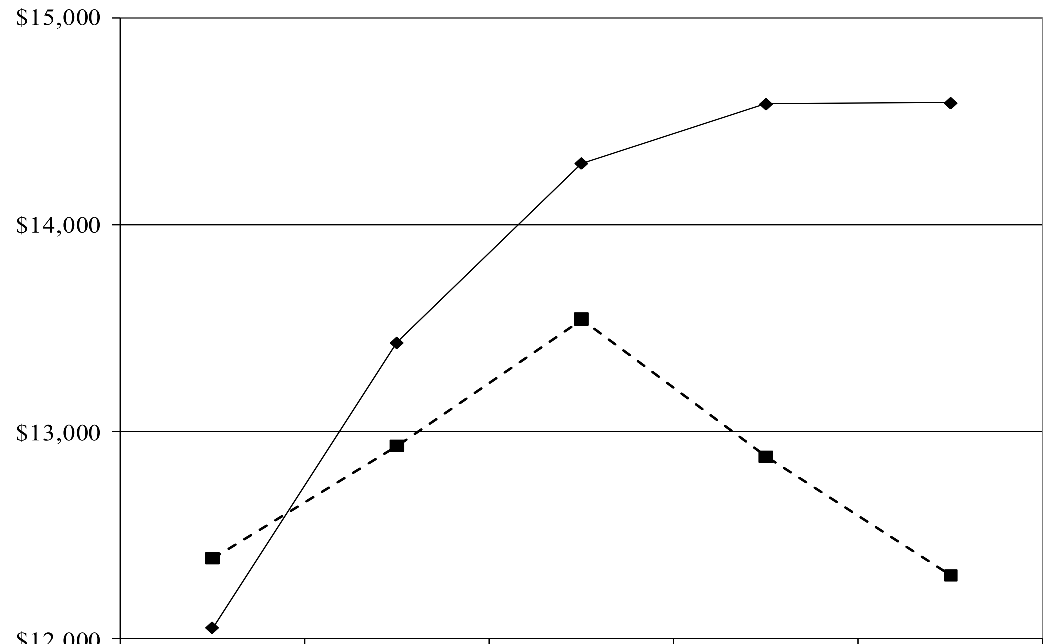
Background

Fiscal 2009 closed with a general fund balance of $87.2 million; about $350.0 million lower than expected. Most of the underattainment was due to continued underperformance of personal income and sales taxes, which are the two largest sources of general fund revenue. The economy has been in recession since December 2007, but conditions turned steadily worse in summer and fall 2008. This was due to a combination of higher gas prices, turmoil in the housing market, and major failures in the financial services sector due to underperforming subprime mortgages and a spike in foreclosures. The ensuing credit crisis touched all facets of the economy.

Beginning in October 2008, the federal government adopted a series of actions to aid financial institutions, the automobile industry, and state governments. The American Recovery and Reinvestment Act of 2009 (ARRA) provided states with an influx of federal dollars through a higher Medicaid matching rate, funds targeted for education spending and other programs, and discretionary funds. Under the ARRA, Maryland received $437 million for fiscal 2009, $1.1 billion for fiscal 2010, and approximately $900 million anticipated for fiscal 2011 that directly supports expenditures that would have been paid from the general fund. The ARRA also provided additional federal funds for new spending for a variety of purposes.

The interplay between general fund revenues and spending is shown in **Exhibit 1**. The budget was in structural balance at the end of fiscal 2006. Spending growth in fiscal 2007 and 2008 was driven in part by the final implementation of the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002). Chapter 288 mandated over $1 billion in higher spending for local aid to education over a multi-year period. Revenue growth in fiscal 2008 did not keep pace with spending growth, despite revenue enhancements passed at the 2007 special session, which went into effect for the last half of that fiscal year.

Exhibit 1
The Evolution of Fiscal 2010 General Fund Revenue Estimates
($ in Millions)



	2006	2007	2008	2009	2010
Ongoing Spending	$12,052	$13,430	$14,298	$14,585	$14,590
Ongoing Revenues	12,390	12,935	$13,545	$12,879	$12,308

Note: Fiscal 2009 and 2010 include federal stimulus funds.

Source: Department of Legislative Services

Fiscal 2010 Activity

Recognizing that fiscal 2009 revenue was underperforming, the Governor undertook actions to reduce general fund spending in fiscal 2010, under the authority of the Board of Public Works (BPW) to reduce appropriations by up to 25% of budgeted programs. In sum, $428.6 million was withdrawn from agency budgets by BPW at meetings in July and August 2009, and over 400 positions were abolished. In formulating his plan for balancing the fiscal 2010 budget, the Governor also proposed $255.8 million in transfers that will require budget reconciliation legislation at the 2010 legislative session. The bulk of this would be derived from reductions in local highway user revenue grants, with a corresponding transfer to the general fund. The Governor also assumes roughly $20.0 million in fiscal 2010 agency reversions as well as some smaller additional revenues.

Fiscal 2010-2015 Forecast

Exhibit 2 provides the Department of Legislative Services (DLS) general fund forecast for the 2009-15 period. Despite the withdrawn appropriations by BPW, DLS projects that the current fiscal year will require an additional $519.0 million in additional revenue or spending actions in order to achieve balance. However, this level of shortfall assumes $278.7 million in deficiency appropriations, as estimated by DLS. Absent these potential deficiencies, DLS estimates that the current fiscal year will require at least $240.0 million in actions to approach balance. The Governor has announced plans to adopt additional spending reductions at the November 17, 2009 meeting of BPW, which are likely to approach $300.0 million.

The fiscal situation for fiscal 2011 and beyond represents a greater challenge. Revenue growth is expected to average 5.1% over the fiscal 2011-15 period, but because of the drop in the revenue base in fiscal 2010, revenue totals are insufficient to meet projected spending. Based on the DLS estimated fiscal 2011 current services budget, an additional $1.2 billion would be needed to meet spending requirements compared with revenue growth of only $426 million. On a cash basis, a shortfall of $2.0 billion is projected. On a structural basis, an ongoing shortfall ranging between $2.2 billion and $2.5 billion is forecast for the fiscal 2012 through 2015 period.

Two elements in the forecast bear additional discussion, pertaining to the ARRA funding and expected revenue from video lottery terminals (VLTs). As shown in Exhibit 2, federal stimulus funding of $1.1 billion is provided in fiscal 2010, declining to about $900 million in fiscal 2011, which is the last year for which funds are authorized. Given the unfavorable long-term fiscal outlook for all states, it is possible that additional stimulus funds could be enacted to extend some level of short-term financial assistance. The forecast also assumes full implementation of VLTs by fiscal 2013 based on initial estimates of 15,000 machines at five locations. The work of awarding licenses is not yet completed, but as of November 2009, license applications have been received for four locations and approximately one-half of the allowable complement of machines. Licenses have been awarded to locations in Cecil County and Ocean Downs and are pending for locations in Baltimore City and Anne Arundel County. The estimate of revenues from VLTs is expected to be revised downward in the out-years of the forecast. Improved economic activity in the third quarter of 2009 also offers a glimmer of hope that a recovery may provide some measure of improvement in the revenue picture.

Exhibit 2
General Fund Projections
Fiscal 2010-2015
($ in Millions)

	Actual 2009	Working 2010	Baseline 2011	Estimate 2012	Estimate 2013	Estimate 2014	Estimate 2015	Avg. Annual Change 2011-15
Revenues								
Opening Fund Balance	$487	$87	$0	$0	$0	$0	$0	
Transfers*	189	707	162	18	14	16	6	
One-time Revenues/Legislation	840	7	0	0	0	0	0	
Subtotal One-time Revenue	**$1,517**	**$800**	**$162**	**$18**	**$14**	**$16**	**$6**	**-56.1%**
Ongoing Revenues	$12,879	$12,308	$12,734	$13,360	$14,170	$14,903	$15,552	
Subtotal Ongoing Revenue	**$12,879**	**$12,308**	**$12,734**	**$13,360**	**$14,170**	**$14,903**	**$15,552**	**5.1%**
Total Revenues and Fund Balance	**$14,396**	**$13,108**	**$12,896**	**$13,378**	**$14,184**	**$14,919**	**$15,558**	**4.8%**
Ongoing Spending								
Operating Spending**	$14,585	$14,629	$15,803	$16,250	$17,024	$17,811	$18,556	
VLT Spending Supporting Education	0	-39	-13	-366	-614	-664	-683	
Subtotal Ongoing Spending	**$14,585**	**$14,590**	**$15,790**	**$15,884**	**$16,410**	**$17,147**	**$17,872**	**3.1%**
One-time Spending								
PAYGO Capital	$14	$0	$1	$1	$1	$1	$1	
Federal Stimulus Funds	-437	-1,102	-898	0	0	0	0	
Appropriation to Reserve Fund	147	140	0	9	16	12	6	
Subtotal One-time Spending	**-$276**	**-$962**	**-$897**	**$10**	**$17**	**$13**	**$7**	**n/a**
Total Spending	**$14,309**	**$13,627**	**$14,894**	**$15,894**	**$16,427**	**$17,160**	**$17,879**	**4.7%**
Ending Balance	**$87**	**-$519**	**-$1,998**	**-$2,516**	**-$2,243**	**-$2,241**	**-$2,322**	
Rainy Day Fund Balance	$692	$642	$637	$668	$708	$745	$778	
Balance Over 5% of GF Revenues	47	26	0	0	0	0	0	
As % of GF Revenues	5.37%	5.21%	5.00%	5.00%	5.00%	5.00%	5.00%	
Structural Balance	**-$1,706**	**-$2,282**	**-$3,057**	**-$2,524**	**-$2,240**	**-$2,244**	**-$2,321**	

* Fiscal 2010 includes $481 million in transfers contingent on legislation.

** Includes $279 million in projected fiscal 2010 deficiencies.

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

Source: Department of Legislative Services

Solving the Structural Deficit

The short-term focus will be on fiscal 2010 and 2011. The Governor is required to submit a balanced budget and as noted, plans to withdraw additional appropriations through BPW in November 2009. Deficiency requests are likely to be closely scrutinized and be funded at levels below those estimated in the DLS baseline forecast. Additional spending adjustments may be necessary at the 2010 session. Moreover, budget reconciliation legislation to implement transfers and statutory changes will be a significant component of the overall financial plan. The Administration may also seek to use some or all of the over $600 million balance in the Rainy Day Fund, which is funded at the minimum 5% of estimated general fund revenues.

Due to the magnitude of projected out-year deficits, achieving long-term balance must involve a combination of revenue and spending actions. Potential revenue actions could include, for example, tax rate or fee increases, expansion of the sales tax base to services, a more progressive restructuring of the personal income tax, repeal of tax credits, or improved tax compliance. Spending actions may require at a minimum a review of spending mandates, State-local intergovernmental relationships, and a review of all services to determine essential spending priorities.

Statutory spending mandates and entitlements account for about two-thirds of the general fund budget. K-12 education and health programs account for about 80% of mandated spending. In the short-term, addressing mandated spending levels is constrained by the ARRA restrictions pertaining to education maintenance of effort and Medicaid eligibility requirements. Local aid programs, comprised largely of mandated education and library aid programs, account for nearly 42% of the fiscal 2010 general fund budget. A **Joint Legislative Work Group on State, County, and Municipal Fiscal Relationships is currently studying local aid and is expected to make recommendations before the 2010 session. Finally, while much of the State budget is dedicated to health- and education-related programs, resources are also applied to housing, public safety, economic development, transportation, and other programs. The structural deficit affords an opportunity to reexamine all programs and services with the aim of eliminating nonessential spending.**

Conclusion

The U.S. economy has been in recession since December 2007; the longest downturn since the Great Depression of the 1930s. General fund revenue has fallen in fiscal 2009 and 2010, opening a large deficit that prompted the Governor to reduce spending through BPW in July and August of 2009. Another round of spending reductions is expected in November. The State faces a challenge to address a projected $2.0 billion cash shortfall for fiscal 2011 and structural deficits ranging from $2.2 billion to $2.5 billion in the out-years. Federal economic stimulus funding has provided short-term assistance which ends in fiscal 2011. While downside risk exists due to overstated revenue from video lottery terminals in the forecast, better than expected economic activity in the third quarter of 2009 may portend an improved revenue picture. Revenue growth alone cannot address the general fund shortfall, thus a multi-year approach combining spending and revenue actions, and the use of reserves will be needed.

Operating Budget

Transportation Trust Fund Overview

While the Transportation Trust Fund's ending cash balance for fiscal 2009 exceeded estimates, transportation revenues have continued to decline due to the continued economic slowdown and are expected to decline again in fiscal 2010. The lower than anticipated revenue attainments and expected modest revenue growth beyond fiscal 2010 will likely create constraints on debt issuances and a reduced transportation capital program through fiscal 2015.

Fiscal 2009 Closeout

The Transportation Trust Fund (TTF) ended fiscal 2009 with a fund balance of $244 million, $144 million more than originally estimated. Tax and fee revenue declined $60 million compared to the January 2009 estimate, with the titling tax experiencing the largest decline at $36 million. Motor fuel tax revenues declined by $5 million, and vehicle registration fees declined by $10 million. Overall, revenues did not meet January estimates due to the continued deterioration of the economy, which impacted vehicle sales and vehicle miles traveled. Other major changes to revenues include higher than estimated miscellaneous revenues, in particular capital reimbursements, and a reduced bond sale.

Expenditures also declined in fiscal 2009 accounting for the increase in fund balance. Capital budget expenditures were $121 million less than the January estimate due to declining revenues, including $75 million in capital reductions and construction delays caused by inclement weather. Operating budget expenditures were $50 million less than expected due to a larger than normal level of cancellations at the end of the fiscal year as part of the Maryland Department of Transportation's (MDOT) cost containment efforts. Highway user revenues were $13 million less than estimated due to revenue underattainment, as described above.

Fiscal 2010-2015 Transportation Trust Fund Forecast

Exhibit 1 shows the Department of Legislative Services (DLS) fiscal 2010-2015 TTF forecast. The forecast details the expected trends in revenue attainment, debt issuance, and capital expenditures. Overall, underlying revenues are expected to decline in fiscal 2010 and then grow from fiscal 2011 to 2015 as the economy begins to recover. While DLS estimates that revenues will recover, the estimates of growth in the outyears are not as robust as the MDOT forecast.

Exhibit 1
Department of Legislative Services
Transportation Trust Fund Forecast
Fiscal 2010-2015

	Actual 2009	Estimate 2010	Estimate 2011	Estimate 2012	Estimate 2013	Estimate 2014	Estimate 2015
Opening Fund Balance	**$53**	**$244**	**$100**	**$100**	**$100**	**$100**	**$100**
Closing Fund Balance	**$244**	**$100**	**$100**	**$100**	**$100**	**$100**	**$100**
Net Revenues							
Taxes and Fees	$1,655	$1,628	$1,703	$1,827	$1,918	$2,021	$2,083
Operating and Miscellaneous	548	508	505	508	527	536	545
Transfers between TTF and GF	0	0	0	0	0	0	0
MDTA Transfer	-30	-30	0	0	0	0	0
Net Revenues Subtotal	*2,173*	*2,106*	*2,208*	*2,335*	*2,445*	*2,558*	*2,627*
Bonds Sold	390	220	130	55	55	45	40
Bond Premiums	12	0	0	0	0	0	0
Total Revenues	**$2,575**	**$2,326**	**$2,337**	**$2,390**	**$2,502**	**$2,603**	**$2,668**
Expenditures							
Debt Service	$142	$151	$165	$185	$190	$210	$230
Operating Budget	1,526	1,574	1,672	1,751	1,835	1,924	2,017
State Capital	716	745	500	454	476	468	420
Total Expenditures	**$2,384**	**$2,470**	**$2,337**	**$2,390**	**$2,502**	**$2,603**	**$2,669**
Debt							
Debt Outstanding	$1,583	$1,725	$1,707	$1,659	$1,603	$1,515	$1,400
Debt Coverage – Net Income	2.5	2.6	2.1	2.1	2.2	2.3	2.4
Local Highway User Revenues	**$466**	**$133**	**$368**	**$469**	**$487**	**$496**	**$510**
HUR Transfer to GF	**$0**	**$320**	**$102**	**$0**	**$0**	**$0**	**$0**
Capital Summary							
State Capital	$716	$745	$500	$454	$476	$468	$420
Net Federal Capital (Cash Flow)	762	928	546	528	444	388	346
Subtotal Capital Expenditures	**$1,478**	**$1,673**	**$1,046**	**$982**	**$920**	**$856**	**$766**
GARVEE Debt Service	40	87	87	87	87	87	87

GARVEE: grant anticipation revenue vehicle
GF: general fund
HUR: highway user revenue
MDTA: Maryland Transportation Authority
TTF: Transportation Trust Fund

Revenues

Over the six-year period, DLS estimates that tax and fee revenues will total approximately $11.2 billion, with average annual growth of 5.1%. Total titling tax revenue declined by 21.0% in fiscal 2009 and is expected to decline by 1.0% in fiscal 2010 before vehicle sales begin to recover in fiscal 2011. However, DLS estimates titling tax revenues will be $373 million less than the MDOT September 2009 forecast. DLS also estimates that motor fuel tax revenues will be $21 million lower due to less robust rates of growth. The downward revisions in revenues can largely be attributed to DLS estimating revenue growth returning to historical levels as the economy recovers, while MDOT assumed a higher level of sustained growth.

Operating and Debt Service Expenditures

Operating and debt service expenditures are the first draw on TTF revenues. Over the six-year period, operating and debt service expenditures are estimated to total $11.9 billion. When compared to MDOT's estimate for operating budget expenditures, DLS estimates that expenditures will be $556 million more, largely due to a higher assumed growth rate for the Maryland Transit Administration for personnel and contracted transit service costs. DLS estimates that the average annual growth rate for operating expenditures is 5.1% compared to net revenue growth of 4.5%. As expenditure growth outpaces revenue growth, less cash is available for the capital program over the six-year period.

Debt Financing

Debt issuances by the department for the capital program are limited by a total debt outstanding cap of $2.6 billion and two coverage tests that require the prior year's pledged taxes and net income to be two times greater than the maximum debt service in a given fiscal year. As a result of DLS estimating less revenue and higher operating budget expenditures, the level of net income is reduced and debt issuances for the capital program are constrained. DLS estimates total debt issuances of $545 million over the six-year period, $880 million less than MDOT.

Capital Expenditures

DLS estimates that the total special and federal fund capital budget will total $6.2 billion over the six-year period, approximately $1.6 billion less than MDOT's estimate in the draft Consolidated Transportation Program. As indicated earlier, the decline is attributable to downward revisions in revenues and higher estimates for operating expenses, which in turn constrain future debt issuances.

In fiscal 2010, the capital program is maintained with a $220 million bond sale and will total $1.67 billion. After fiscal 2010, the capital program declines significantly to $1.04 billion in fiscal 2011 and continues to decline to $766 million in fiscal 2015.

Two issues may impact the capital program. If MDOT implements the cost containment actions proposed in its financial forecast, additional cash would be available for the capital program while easing pressure on the coverage ratios for debt. Another area of uncertainty is the future level of federal aid for the capital program. It is not currently clear as to what future federal aid will be available. If federal aid reductions are made, the capital program would also decline. Conversely, the capital program would increase if additional federal aid is provided.

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Operating Budget

Federal Funds Outlook

As the economy was in a deep recession early in 2009, the federal government enacted the American Recovery and Reinvestment Act of 2009. This led to an increase in federal spending in Maryland. Most significantly, $2.4 billion supports general fund commitments from fiscal 2009 to 2011. These federal funds are temporary; the State will need to either find additional revenues or reduce spending in fiscal 2012. The American Recovery and Reinvestment Act of 2009 also includes $2.0 billion to enhance programs such as transportation, local education, clean water, and food assistance. With respect to federal fiscal 2010, only 5 of the 12 budgets have passed by early November 2009, and much of federal spending is funded through continuing resolutions.

The fiscal 2010 federal fund legislative appropriation totals $9.3 billion. Of that amount, $2.0 billion (21.5%) was authorized by the federal government through the American Recovery and Reinvestment Act of 2009 (ARRA). Funding from the ARRA was instrumental in balancing Maryland's fiscal 2009 and 2010 budget by significantly increasing the federal portion of the budget from 22.0% in fiscal 2008 to 28.9% in fiscal 2010. While some of the increase was likely due to other activities such as the State's recent Medicaid expansion, the bulk of additional funding is due to the ARRA.

The ARRA

In February 2009, President Barack H. Obama signed the ARRA into law. The $787 billion package was designed to slow the declining economy, to assist in the recovery from one of the nation's deepest recessions, to save and create jobs, and to help states close their budget shortfalls to avoid even greater spending cuts and larger tax increases than they were already enacting to balance budgets. At the time, 41 states, including Maryland, faced budget shortfalls in their fiscal 2009 and 2010 budgets, according to the Center on Budget and Policy Priorities.

Stimulus to Maryland

The ARRA's most significant impact on the State budget relates to the $2.4 billion that can support State general fund commitments. These funds support Medicaid, education, and discretionary State spending and are used in place of general funds to sustain State funding from fiscal 2009 to 2011. When the funds are no longer available, Maryland will need to replace the funds or reduce spending.

Exhibit 1 shows the ARRA funding for Maryland for fiscal 2009 and 2010. It also shows that $1.8 billion (40%) of the authorized $4.5 billion in ARRA funding remains to be appropriated, either through budget amendments to the fiscal 2010 budget or as part of the fiscal 2011 budget to be submitted by the Governor. However, appropriated funding proportions vary a great deal from program to program. For example, the majority of the $176 million in the ARRA funding for Title I education programs was appropriated in fiscal 2010, but over half of the State's fiscal stabilization funding for education remains unappropriated. The exhibit includes federal grants for which State and local governments must compete that have been awarded. At this point, it is unclear how much more of these funds the State will receive.

Exhibit 1

Impact of American Recovery and Reinvestment Act on Maryland State and Local Budgets Appropriations Compared to Total Available Funds

($ in Millions)

Program	2009 Approp.	2010 Approp.	Unapprop.	Total ARRA Funding *	Expended as of 9/30/2009
Supporting State General Fund Commitments					
Fiscal Stabilization - Education	$0.0	$295.9	$423.8	$719.7	$139.4
Fiscal Stabilization Discretionary	1.5	107.7	50.9	160.1	15.4
Medicaid	435.0	652.0	506.1	1,593.1	**
Subtotal	**$436.5**	**$1,055.6**	**$980.8**	**$2,472.9**	**$154.8**
Education Grants Appropriated in the State Budget					
Special Education	0.5	107.3	121.6	$229.4	$3.7
Title I	0.0	156.8	19.2	175.9	0.2
Education Technology	0.0	4.3	4.3	8.5	0.0
Subtotal	**$0.5**	**$268.4**	**$145.0**	**$413.8**	**$3.8**
Infrastructure Appropriated in the State Budget					
Highways	0.0	249.0	182.0	$431.0	$36.4
Transit Capital	0.0	93.1	86.2	$179.3	5.8
HOME Investment Partnerships Program	0.0	31.7	0.0	$31.7	0.0
Community Health Centers	0.0	0.0	12.3	$12.3	0.0
Leaking Underground Storage Tanks	0.0	3.7	0.0	$3.7	0.0
Clean Water	0.0	96.0	-0.3	$95.7	0.1
Drinking Water	0.0	27.0	-0.2	26.8	0.0
Subtotal	**$0.0**	**$500.5**	**$280.0**	**$780.5**	**$42.3**

Program	2009 Approp.	2010 Approp.	Unapprop.	Total ARRA Funding *	Expended as of 9/30/2009
Other Grants Appropriated in the State Budget					
State Energy Programs	$1.5	$44.8	$63.2	$109.5	$0.0
Weatherization	6.6	28.1	26.8	$61.4	1.1
Community Services Block Grant	0.0	12.6	1.1	$13.7	0.0
Homelessness Prevention - State	0.0	5.7	0.0	$5.7	0.0
Community Development Block Grant – State	0.0	2.2	0.0	$2.2	0.0
Foster Care	8.6	11.5	2.9	$23.0	**
Child Support Enforcement	0.0	0.0	29.2	$29.2	0.0
Health Centers Increased Demand	0.0	0.0	4.3	$4.3	0.0
Food Assistance – Individuals	34.2	45.0	146.0	$225.2	**
Food Assistance – Other	2.6	2.0	1.6	$6.2	1.1
Temporary Assistance for Needy Families	20.0	0.6	94.0	$114.5	**
Ind. Living, Homeless Education and Work Study	0.4	0.9	5.1	$6.4	0.1
Child Care Development Block Grant	0.0	25.0	-0.9	$24.0	15.4
Vocational Rehabilitation	3.4	3.4	0.0	$6.9	1.0
UI/Workforce Investment/Dislocated Workers	1.8	34.9	7.1	$43.8	6.5
Preventive Health Block Grant/Immunization	0.0	0.0	3.8	$3.8	0.0
AmeriCorps State Program	0.0	1.0	-0.4	$0.6	0.3
Arts Funding	0.3	0.0	0.0	$0.3	0.2
Byrne Grants/Public Safety Grants	0.0	13.1	18.1	31.2	0.1
Subtotal	**$79.5**	**$230.7**	**$401.8**	**$711.9**	**$25.9**
Total State Grants	**$516.5**	**$2,055.2**	**$1,807.6**	**$4,379.2**	**$226.8**
Federal Grants Not Appropriated in the State Budget					
Homelessness Prevention	n/a	n/a	n/a	$60.6	n/a
Community Development Block Grant	n/a	n/a	n/a	$12.5	n/a
Head Start	n/a	n/a	n/a	$7.9	n/a
Lead Hazard Reduction	n/a	n/a	n/a	$0.8	n/a
Public Housing	n/a	n/a	n/a	$48.2	n/a
Subtotal				**$129.9**	
Total Grants for Maryland Governments	**$516.5**	**$2,055.2**	**$1,807.6**	**$4,509.1**	**$226.8** *

*Does not include competitive grant awards.
**The American Recovery and Reinvestment Act of 2009 does not require spending reports for grants going directly to individuals.

Source: Federal Funds Information for the States; Governor's StateStat Office; Department of Legislative Services

Moving Forward

While the stimulus funding has reduced the extent to which states have had to cut spending or increase taxes and fees, 48 states, including Maryland, have addressed or still face shortfalls in their budgets for fiscal 2010, and the Center on Budget and Policy Priorities estimates shortfalls to reach $180 billion in fiscal 2011. Since the direction of the economy remains uncertain and additional federal assistance is unlikely, Maryland, like other states, will likely have to continue spending cuts or implement tax increases just as funds from the ARRA are exhausted in fiscal 2011.

Other Federal Fiscal 2010 Aid for States Remains Unresolved

As of November 12, 2009, just 5 of the 12 federal fiscal 2010 appropriations bills have been signed into law. Most recently, the Interior and Environment Appropriations Bill for fiscal 2010 was signed into law. The bill includes full-year appropriations for water infrastructure and environmental protection programs, but funds the remaining seven appropriations bills under a continuing resolution (CR) at fiscal 2009 levels through December 18, 2009. Agencies without approved budgets had been operating under a CR since October 1 which expired October 31, 2009.

The other four appropriations bills signed into law so far include the agriculture, energy and water, homeland security, and legislative branch bills. While funding was increased slightly in some areas such as the Supplemental Nutrition Assistance for Women, Infants, and Children program, funding for other programs was reduced, such as the weatherization assistance program which was cut by 53% below fiscal 2009 levels. Remaining bills contain a great deal of federal grants to state and local governments in areas such as health, education, and law enforcement.

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Capital Program

Debt Affordability

The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling $990 million for fiscal 2011. This represents a $120 million decrease from the $1.11 billion limit recommended for fiscal 2010. The change represents a $30 million increase to provide the 3% annual escalation offset by a $150 million reduction related to a one-time increase to the fiscal 2010 authorization.

Capital Debt Affordability Process

State law requires the Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt to ensure that the State's tax-supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the Secretaries of the Maryland Department of Transportation and the Department of 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 Appropriations Committee.

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.

Affordability Criteria and Ratios

CDAC began evaluating State debt in 1979. In consultation with rating agencies, investment bankers, and its financial advisor, CDAC adopted policies to limit State debt outstanding to 4.0% of personal income and State debt service to 8.0% of State revenues. The committee's analysis of debt affordability for fiscal 2010 through 2015 indicates that debt outstanding peaks in fiscal 2012 at 3.49% of personal income and debt service peaks in fiscal 2015 at 7.47%, as indicated in **Exhibit 1**.

Exhibit 1
Affordability Ratios
Fiscal 2010-2015

Fiscal Year	Projected Debt Outstanding As a Percent of Personal Income	Projected Debt Service As a Percent of Revenues
2010	3.34%	6.92%
2011	3.41%	7.16%
2012	3.49%	7.15%
2013	3.43%	7.28%
2014	3.32%	7.32%
2015	3.25%	7.47%

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, September 2009

New Debt Authorizations

The committee has recommended $990 million in new GO debt authorization for fiscal 2011, which is $120 million less than was authorized in fiscal 2010. The fiscal 2010 included a one-time, $150 million increase. These authorizations are removed in fiscal 2011. This reduction was offset by a $30 million increase that represents a 3% annual inflationary increase. In its recommendation, the committee expressed its intent to reconvene in December to reexamine the recommended authorization levels. The committee noted that factors such as revenue projections, options to provide operating budget relief through capital authorizations, revised debt service projections, and extension of federal authorizations (such as Build America Bonds) would influence its recommended level of authorizations. Based on the current level of authorizations, the committee estimates that total GO debt will be just over $6.8 billion at the end of fiscal 2011.

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 2010 session, CDAC recommends $27 million for academic facilities on USM campuses.

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 revenues. The gross outstanding aggregate principal amount of Consolidated Transportation Bonds is limited by statute to $2.6 billion. CDAC projects that total outstanding transportation debt is projected to reach $1.9 billion in fiscal 2011. The department also issued GARVEE bonds in fiscal 2008 and 2009. Chapters 471 and 472 of 2005 limit the total amount of GARVEEs that may be issued at $750 million. The

State pledges anticipated federal revenues to support the GARVEEs debt service, and statute specifies that the bonds are considered tax-supported debt. GARVEE debt outstanding is projected to be $597 million at the end of fiscal 2011.

The Bay Restoration Fund was created by Chapter 428 of 2004 to provide grants for enhanced nutrient removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. In fiscal 2008, the first $50 million in bay bonds was issued. The Maryland Department of the Environment indicates that the estimated issuance stream is $150 million, $150 million, and $180 million in fiscal 2010 through 2012, respectively. The department estimates that $335 million in bonds will be outstanding at the end of fiscal 2011.

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 $194 million at the end of fiscal 2011.

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 $235 million at the end of fiscal 2011.

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Capital Funding Requests Exceed Resources

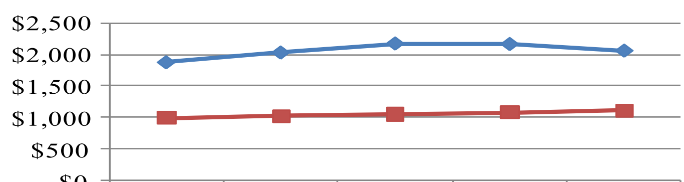
As in previous years, capital budget requests exceed the level of authorizations deemed affordable by the Capital Debt Affordability Committee. Subject to revision in December, the 2010 session authorization limit is $990 million in general obligation bonds. This is $120 million less than the 2009 level. Pay-as-you-go operating funds planned for the capital budget are $1 million.

The State is faced with the task of programming funding for its capital infrastructure needs amidst a fiscal climate marked by declining State revenues, limited general obligation (GO) bond capacity within debt affordability limits, and pressure to shift bondable operating expenditures to the capital budget. These factors compound an already difficult task of prioritizing agency capital requests which annually far exceed Capital Debt Affordability Committee (CDAC) recommended GO bond limits.

Agency Requests Exceed Recommended GO Bond Limits

Agency requests for fiscal 2011 total $1.87 billion, over $884.2 million more than the recommended GO bond debt limit of $990.0 million. Capital requests for the next five years total over $10.3 billion, while the projected debt limit for the same period totals approximately $5.25 billion. **Exhibit 1** illustrates the variance between GO bond fund requests and the recommended level of new GO bond authorizations in each of the next five fiscal years. **Exhibit 2** shows agency requests for the five-year planning period.

Exhibit 1
General Obligation (GO) Bond Requests Fiscal 2011-2015
Compared to Recommended GO Bond Authorization Levels
($ in Millions)



	2011	2012	2013	2014	2015
Request	$1,874.2	$2,029.5	$2,173.0	$2,164.8	$2,059.8
Debt Affordability Limits	$990.0	$1,020.0	$1,050.0	$1,080.0	$1,110.0

Source: Department of Budget and Management

Exhibit 2
General Obligation Bond Requests: Fiscal 2011-2015
($ in Millions)

	2011	2012	2013	2014	2015	Total	Category Totals
State Facilities							**$781.9**
Board of Public Works	$56.4	$147.6	$128.9	$98.0	$179.3	$510.1	
Military	0.0	0.0	3.9	0.0	0.8	4.8	
Department of Disabilities	1.6	1.6	1.6	1.6	1.6	8.0	
Department of Information Technology	72.0	44.0	88.0	63.0	0.0	259.0	
Health and Social Services							**$708.7**
Health and Mental Hygiene	$2.6	$12.2	$13.0	$31.1	$31.5	$110.5	
University of MD Medical System	13.5	10.2	10.5	9.8	5.0	49.0	
Senior Citizen Activity Center	0.5	2.0	2.0	2.0	2.0	8.5	
Juvenile Services	110.2	62.9	164.2	115.9	62.6	515.7	
Private Hospital Grant Program	5.0	5.0	5.0	5.0	5.0	25.0	
Environment							**$433.5**
Natural Resources	$15.0	$15.0	$15.0	$15.0	$15.0	$75.0	
Agriculture[1]	12.5	12.0	12.0	14.0	14.0	64.5	
Environment	51.3	50.9	53.1	51.3	48.0	254.6	
MD Environmental Service	13.2	8.9	4.1	7.8	5.4	39.4	
Education							**$4,196.6**
Education	$25.0	$31.0	$27.5	$5.0	$5.0	$93.5	
MD School for the Deaf	0.3	0.0	0.0	0.0	1.4	1.7	
Public School Construction	742.1	803.9	881.3	841.9	832.2	4,101.4	
Higher Education							**$2,577.0**
University System of MD[2]	$259.8	$375.8	$226.0	$295.6	$303.1	$1,460.3	
Baltimore City Comm. College	14.7	22.3	35.5	20.0	16.3	108.9	
St. Mary's College	0.0	4.0	18.7	18.0	43.7	84.5	
Morgan State University	48.9	48.3	62.5	92.7	76.9	329.3	
Community Colleges	93.1	111.6	81.3	123.7	110.6	520.3	
Southern MD Higher Educ. Center	1.2	13.2	0.8	0.0	0.0	15.3	
Private Facilities Grant Program	10.5	12.0	12.0	12.0	12.0	58.5	
Public Safety							**$692.5**
Public Safety	$53.2	$83.6	$92.8	$117.0	$77.3	423.9	
State Police	48.8	44.9	27.8	37.1	35.1	193.7	
Local Jails	15.0	15.0	15.0	15.0	15.0	75.0	
Housing and Economic Development							**$173.2**
Economic Development	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	
Housing and Comm. Development	28.3	28.9	27.5	26.2	25.5	136.2	
Canal Place	0.0	0.9	1.3	0.0	0.0	2.1	
Historic St. Mary's City	0.2	0.3	17.1	0.1	1.3	17.7	
Planning	1.5	5.4	5.2	1.2	4.0	17.2	
Legislative Initiatives[3]	100.0	100.0	100.0	100.0	100.0	100.0	**$500.0**
Miscellaneous	57.8	56.3	47.5	45.0	31.5	238.0	**$238.0**
Subtotal Request	**$1,874.2**	**$2,029.5**	**$2,173.0**	**$2,164.8**	**$2,059.8**	**$10,301.3**	**$10,301.3**
Debt Affordability Limits	**$990.0**	**$1,020.0**	**$1,050.0**	**$1,080.0**	**$1,110.0**	**$5,250.0**	
Variance	**$884.2**	**$1,009.5**	**$1,123.0**	**$1,084.8**	**$949.8**	**$5,051.3**	

[1] Department of Agriculture request does not include the Tobacco Transition Program

[2]In addition to the general obligation bond request, the University System of Maryland has requested academic revenue bond funding of $27 million annually for fiscal 2011 through 2015.

[3]These figures represent an estimated average of the total funding requests received through legislative local bond funds.

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

Source: Department of Budget and Management

Reduced Availability of General Funds to Support the Capital Program

GO bonds have traditionally been supplemented with State general 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 to 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. **Exhibit 3** shows that the fiscal 2005 through 2010 capital program included almost no general fund contribution. The estimate for fiscal 2011 according to the 2009 *Capital Improvement Program* (CIP) also lacks of general funds.

Exhibit 3
General Fund PAYGO[1]
Fiscal 2005-2010 Appropriations
Fiscal 2011 CIP Estimates
($ in Millions)

Function	2005 Approp.	2006 Approp.	2007 Approp.	2008 Approp.	2009[2] Approp.	2010 Approp.	2011 Planned
State Facilities	$0.0	$0.6	$22.6	$9.6	$0.0	$0.6	$0.0
Health/Social	0.0	3.0	0.0	0.0	0.0	0.0	0.0
Environment	0.0	0.0	15.1	7.3	8.4	0.0	1.0
Education	0.0	0.0	0.0	2.0	0.0	0.0	0.0
Higher Education	0.0	1.9	19.1	0.0	0.0	0.0	0.0
Public Safety	1.0	0.0	1.4	0.0	0.0	0.0	0.0
Housing	0.0	0.0	40.0	8.3	4.3	0.0	0.0
Econ. Development	0.0	0.0	2.5	0.0	0.0	0.0	0.0
Local Projects	0.2	0.0	30.1	0.0	1.0	0.0	0.0
Total	**$1.2**	**$5.5**	**$130.8**	**$27.2**	**$13.7**	**$0.6**	**$1.0**

CIP: *Capital Improvement Program*
PAYGO: pay-as-you-go

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

Source: Department of Budget and Management

Use of GO Bonds to Relieve Pressure on the Operating Budget

For the 2009 session, CDAC recommended a one-time $150.0 million increase in new GO bond authorizations to be used to accommodate the need to shift bondable expenditures from the operating budget to the capital budget. The fiscal 2010 capital budget passed by the General Assembly ultimately included the use of $237.9 million of GO bond authorizations to replace planned general and special fund PAYGO expenditures. This included $102.3 million to replace fiscal 2010 transfer tax revenues and unencumbered Program Open Space fund balance transferred to the general fund through the Budget Reconciliation and Financing Act (BRFA) of 2009, $52.5 million to fund the purchase of Medevac helicopters, $55.0 million to fund the general fund payment to the Transportation Trust Fund for the InterCounty Connector (ICC), and $28.1 million to replace general funds for various grant and loan programs.

Although the committee's recommendation for the 2010 session removes the one-time adjustment, the need to use GO bonds to relieve pressure on the operating budget is likely to resurface in the 2010 session. At a minimum, the 2010 BRFA would require $157 million of GO bonds not already programmed in the CIP for fiscal 2011 to fund the State's obligation to repay the Transportation Trust Fund for expenditures related to the ICC project. There may also be pressure to divert State transfer tax revenues and the revenues from various capital grant and loan funds to the general fund which could require upwards of $120 million of GO bond funds to fully replace. Decisions to increase the limit to allow for additional operating budget relief could occur in December, when the CDAC is scheduled to reconvene and the Spending Affordability Committee is scheduled to issue its final report.

Revenues and Taxes

Comparative Tax and Revenue Rankings

Based on data compiled by the U.S. Census Bureau, Maryland's overall revenue and spending levels in fiscal 2007 were moderate compared to other states. Maryland remains uniquely reliant on tax revenues, however, with a strong dependence on the income tax.

State and Local Government 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. When comparing all states and the District of Columbia, Maryland ranks twentieth in both total state and local government revenues and spending measured on a per-capita basis and forty-ninth in both revenues and spending as a percentage of personal 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
2006-2007

	Maryland Rank Percent of Total	Maryland Rank Per Capita	Maryland Rank Percent of Personal Income
Total Spending	n/a	20	49
Total Revenues	n/a	20	49
Revenues			
Taxes	3	9	31
Intergovernmental from Federal Government	36	33	45
Charges and Utilities[1]	45	47	49
Miscellaneous[2]	45	43	50

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

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

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

Source: *2007 Census of Government Finance*, U.S. Bureau of the Census (September 2009)

State and Local Tax Revenues Compared to Neighboring States

Exhibits 2 and **3** compare Maryland's State and local tax revenues in fiscal 2007 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-first among all states in overall state and local tax revenues as a percentage of personal income and ninth in overall tax revenues on a per-capita basis. Generally, Maryland ranks in the bottom half of all states with respect to property taxes, corporate income taxes, and sales taxes measured on a percentage of income basis. Maryland ranks twenty-fourth in property taxes, thirtieth for corporate income taxes, and forty-third on sales taxes measured on a per-capita basis. These comparisons do not incorporate the impact of changes made to taxes in Maryland or other states since fiscal 2007.

Exhibit 2
Maryland State and Local Tax Revenues
2006-2007 Tax Revenues as a Percentage of Personal Income
Comparison to Selected States

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales and Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
Delaware							
Percent	1.6%	3.1%	0.9%	1.4%	3.0%	0.6%	10.6%
Rank	47	11	6	49	1	12	24
District of Columbia							
Percent	4.0%	3.5%	1.1%	3.5%	0.3%	1.3%	13.8%
Rank	11	5	3	26	45	5	3
Maryland							
Percent	**2.5%**	**4.1%**	**0.3%**	**2.4%**	**0.3%**	**0.7%**	**10.2%**
Rank	**38**	**3**	**41**	**45**	**44**	**9**	**31**
New Jersey							
Percent	4.9%	2.7%	0.7%	2.8%	0.4%	0.3%	11.8%
Rank	3	20	10	42	37	19	8
North Carolina							
Percent	2.3%	3.4%	0.5%	3.5%	0.5%	0.1%	10.3%
Rank	40	8	19	28	26	47	29
Pennsylvania							
Percent	3.2%	2.7%	0.5%	3.1%	0.7%	0.6%	10.8%
Rank	22	19	21	41	8	14	21
Virginia							
Percent	3.0%	3.1%	0.3%	2.6%	0.5%	0.3%	9.7%
Rank	24	12	43	43	27	18	41
West Virginia							
Percent	2.1%	2.5%	1.0%	4.2%	0.7%	0.7%	11.2%
Rank	44	26	5	14	10	8	14
United States Average	**3.2%**	**2.4%**	**0.5%**	**3.7%**	**0.5%**	**0.3%**	**10.7%**

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

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

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

Source: *2007 Census of Government Finance*, U.S. Bureau of the Census (September 2009)

Exhibit 3
Maryland State and Local Tax Revenues
2006-2007 Tax Revenues Per Capita
Comparison to Selected States

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales and Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
Delaware							
Amount	$660	$1,245	$351	$543	$1,201	$245	$4,245
Rank	44	11	5	50	1	11	17
District of Columbia							
Amount	2,579	2,234	710	2,262	203	844	8,832
Rank	1	1	2	4	26	3	1
Maryland							
Amount	**1,165**	**1,912**	**139**	**1,127**	**163**	**310**	**4,817**
Rank	**24**	**3**	**30**	**43**	**35**	**7**	**9**
New Jersey							
Amount	2,483	1,355	334	1,420	207	145	5,944
Rank	2	9	6	22	23	16	6
North Carolina							
Amount	808	1,171	173	1,220	186	28	3,586
Rank	39	14	21	36	32	46	34
Pennsylvania							
Amount	1,245	1,071	184	1,204	274	228	4,208
Rank	20	16	18	37	10	12	18
Virginia							
Amount	1,301	1,330	114	1,109	224	127	4,205
Rank	18	10	38	44	19	18	19
West Virginia							
Amount	628	752	298	1,276	205	212	3,371
Rank	45	33	9	31	24	15	39
United States Average	**$1,272**	**$960**	**$201**	**$1,456**	**$212**	**$133**	**$4,234**

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

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

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

Source: *2007 Census of Government Finance*, U.S. Bureau of the Census (September 2009)

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Revenues and Taxes

Video Lottery Terminals – Overview

After voter approval in November 2008 of a constitutional amendment providing for video lottery terminal (VLT) gambling in Maryland, the Video Lottery Facility Location Commission has spent much of 2009 evaluating proposals for VLT operation licenses. While Maryland is in the initial stage of VLT implementation, Delaware, Pennsylvania, and West Virginia continue to expand gambling opportunities in their states.

Constitutional Amendment and Implementing Legislation

During the 2007 special session, the General Assembly adopted two pieces of legislation pertaining to VLT gambling – Chapter 4 (Senate Bill 3) and Chapter 5 (House Bill 4). Chapter 5 was a constitutional amendment approved by the voters at the November 2008 general election that authorized the expansion of gambling subject to specified restrictions. The constitutional amendment provided that (1) a maximum of five VLT facility licenses may be awarded within specified areas of the State; (2) no more than one facility license may be awarded in any county or Baltimore City; (3) a maximum of 15,000 VLTs may be authorized; and (4) VLT facilities must comply with any applicable planning and zoning laws of a local jurisdiction.

Chapter 4, which was contingent on ratification of Chapter 5, established the operational and regulatory framework for the VLT program. Under Chapter 4, VLT facility operation licenses are awarded by a Video Lottery Facility Location Commission (Location Commission). The State Lottery Commission will oversee VLT operations and will own/lease the VLTs and a central monitor and control system. Chapter 4 allows for a maximum of 15,000 machines, distributed as follows: 4,750 VLTs in Anne Arundel County; 3,750 VLTs in Baltimore City; 2,500 VLTs in Worcester County; 2,500 VLTs in Cecil County; and 1,500 VLTs in Allegany County. In addition, geographic parameters for each jurisdiction within which a VLT facility may be located are provided. The Location Commission may alter VLT allocations if warranted by an evaluation of market and other factors; however, no more than 4,750 VLTs may be placed at any one location.

Video Lottery Operation License Proposals

Submission of Proposals

Pursuant to State law and the request for proposals (RFP) released in December 2008, proposals for video lottery operation licenses were required to be submitted by February 2, 2009. The Location Commission received six proposals on that date – two for Anne Arundel County and one each for the other four locations. On February 12, 2009, the commission determined that four of the six proposals met the minimum requirements of the statute and the RFP – one of the proposals for Anne Arundel County and the proposal for Allegany County were rejected by the commission for failing to meet the minimum requirements, including failing to pay the required license fee.

State Lottery Commission's Qualification of Applicants

Chapter 4 requires the State Lottery Commission to conduct background investigations of the operation license applicants and their principals – the Lottery Commission must qualify an applicant before a license may be awarded by the Location Commission. As of November 2009, the Lottery Commission has found the applicants for a VLT operation license in Anne Arundel, Cecil, and Worcester counties qualified to hold a license. The State Lottery Commission anticipates that the background investigation for the Baltimore City applicant will be completed by the end of November.

Location Commission's Evaluation of Proposals and Award of Licenses

The Location Commission's evaluation of the proposals includes market analyses, economic impact analyses, an analysis of each proposal's financial viability, site visits to proposed facility locations, public hearings, and a review of traffic impact studies by the State Highway Administration.

The Location Commission has awarded two video lottery operation licenses to date. On September 23, 2009, the Location Commission awarded Ocean Enterprise 589 LLC (OE 589) a license to operate a facility with 800 VLTs at Ocean Downs Racetrack in Worcester County. OE 589 paid the initial license fee of $4.8 million for the 800 VLTs and plans to spend $45.0 million to construct a 34,000 square foot VLT facility. The facility is scheduled to open in May 2010 with 600 VLTs, with the full complement of 800 VLTs in place by April 2011.

On October 21, 2009, the Location Commission awarded Penn Cecil Maryland, Inc. (Penn Cecil) a license to operate a facility with 1,500 VLTs in Perryville in Cecil County. Penn Cecil paid the initial license fee of $9 million for 1,500 VLTs and plans to spend $77 million to construct an 86,440 square foot VLT facility and a 29,950 square foot support facility, both scheduled to open in October 2010.

As of November 2009, decisions are still pending regarding the proposals for VLT operation licenses in Anne Arundel County and Baltimore City. The potential award of an operation license to PPE Casino Resorts Maryland, LLC for a facility with 4,750 VLTs adjacent to Arundel Mills Mall depends in part on the Anne Arundel County Council approving zoning legislation for the site. The county council will hear zoning legislation related to the proposed facility on December 7, 2009. The Baltimore City Entertainment Group, LP (BCEG) proposal awaits a completed background investigation and qualification by the Lottery Commission to hold a license. BCEG has also indicated that it plans to modify its proposal from 500 VLTs to 3,750 VLTs, but the Location Commission will require a formal amendment to the proposal and payment of $19.5 million in additional license fees before it can consider awarding a license for

3,750 VLTs. The Location Commission intends to complete its work for the year by its final meeting on December 17, 2009.

Video Lottery Terminals and Other Gambling Opportunities in Nearby States

Maryland's competition for gambling revenues will come primarily from three surrounding states: Delaware, Pennsylvania, and West Virginia. As of September 2009, three racetrack facilities with approximately 8,000 VLTs are operating in Delaware, nine facilities with approximately 25,000 VLTs are operating in Pennsylvania, and four racetrack facilities with approximately 11,000 VLTs are operating in West Virginia. Average win-per-day per VLT for the 12-month period ending September 2009 ranged from $163 to $212 in Delaware, from $189 to $336 in Pennsylvania, and $96 to $238 in West Virginia.

West Virginia also has table games (*e.g.*, blackjack) at three of its four VLT racetrack facilities (excluding Charles Town). Table games are also available at the Greenbrier Resort, which became the state's fifth VLT location in October 2009. Limited numbers of VLTs are also available at licensed West Virginia bars, clubs, and fraternal organizations. Pennsylvania is likely to authorize table games at its VLT facilities in the next few months. Delaware is considering allowing table games, and has recently reinstated parlay (not single-game) betting on National Football League games.

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Personnel

State Retirement and Pension System Investment Performance and Contribution Rates

The pension fund's assets declined 20.0% in fiscal 2009. The decline is largely attributable to the collapse in financial asset values. The aggregate contribution rate increases from 12.62% in fiscal 2010 to 14.33% in fiscal 2011. Although other factors contributed to this increase, much of the increase is due to the decline in the fund's assets. The five-year actuarial smoothing method for valuing assets means that increased contribution rates are expected for at least the next five years, which is expected to increase State appropriations.

Financial Market Collapse Leads to Increased Pension Contribution Rates

Total State pension contribution rates will increase by 13.5% in fiscal 2011, due largely to the collapse of world financial markets. During fiscal 2009, the S&P 500 index lost 26.2%, and the MSCI international index lost 30.9%. As a result, the State Retirement and Pension System's (SRPS) investment return was -20.0%, the second straight year that the system experienced negative investment returns and the largest 1-year loss in more than 20 years. The system's funded status (the ratio of projected assets to projected liabilities) dropped precipitously from 78.6 to 65.0%.

Other factors besides investment returns that contributed modestly to changes in the State's contribution rate include revised actuarial assumptions, plan experience, and the actuarial error reported last year. Revisions to the actuarial assumptions used in calculating plan liabilities were generally technical in nature. They had only a minimal effect on the two largest plans (teachers and State employees), but more significant effects on the State Police Retirement System and the Judges' Retirement System. Plan experience generally was not favorable for all except the judges' plan. Key factors included higher-than-expected retirement rates and retiree cost-of-living adjustments (COLAs). Although salary increases were lower than expected, they were not low enough to offset the effect of higher COLAs and more retirements. Last, the actuarial error that led to an $87 million underfunding of fiscal 2010 pension costs contributed to the increase in fiscal 2011 rates, but only slightly. The $87 million underfunding was added to the system's liabilities and, therefore, amortized over 25 years, adding 0.06 percentage points to the State contribution.

Exhibit 1 shows that the employer contribution rate for teachers will increase from 13.15% in fiscal 2010 to 14.34% in fiscal 2011, and the contribution rate for State employees will increase from 9.93% in fiscal 2010 to 11.69% in fiscal 2011. The aggregate State contribution rate, including contributions for public safety employees and judges, increases from

Exhibit 1
State Pension Contribution Rates
Fiscal 2010 and 2011

	2010		2011	
Plan	**Rate (%)**	**$ in Millions**	**Rate (%)**	**$ in Millions**
Teachers	13.15%	$833	14.34%	$919
Employees	9.93%	320	11.69%	387
State Police	30.79%	28	57.03%	51
Judges	48.89%	20	59.07%	25
Law Enforcement Officers	38.63%	35	47.67%	43
Aggregate	**12.62%**	**$1,236**	**14.33%**	**$1,425**

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

Source: Gabriel, Roeder, Smith & Co.; Cheiron

12.62% in fiscal 2010 to 14.33% in fiscal 2011. Based on projected payroll growth, the SRPS actuary estimates that total State pension contributions will increase by $189 million (15.30%), from $1,236 million in fiscal 2010 to $1,425 million in fiscal 2011. Actual fiscal 2011 contributions may be somewhat less than projected if salary increases continue to lag behind projected rates due to salary freezes at the State level and by local school boards.

Asset Valuation Policy Plays Significant Role in Raising Contribution Rates

Under a long-standing SRPS Board of Trustees policy, the actuarial value of assets (AVA) used to calculate SRPS' unfunded liabilities cannot drop below 80% or exceed 120% of the market value of assets. The AVA is calculated using the five-year smoothing method, whereby investment gains or losses incurred in a given year are recognized over five years. The smoothing method is designed to mitigate the effects of dramatic shifts in investment returns on contribution rates by stretching out their effects over five years. Therefore, the system is still recognizing a portion of the double-digit investment gains it earned in 2006 and 2007, which has kept the AVA well above market value as investment returns drop. The 80/120 collar has never been invoked before, but the dramatic decline in the system's market value of assets prompted the AVA to reach 136% of the market value of assets as of June 30, 2009, thereby exceeding the collar's 120% ceiling.

Adjusting the AVA to conform to the collar resulted in a $4.7 billion reduction, from $39.0 billion to $34.3 billion (with the market value of assets standing at $28.6 billion). The commensurate increase in the system's unfunded liabilities is largely responsible for the dramatic increase in budgeted contribution rates. The General Assembly's consulting actuary advises that in the absence of the collar, budgeted contribution rates actually would have fallen from fiscal 2010 levels.

Pension Funding Challenges Lie Ahead

The five-year smoothing method for valuing assets means that SRPS will be feeling the effects of historic investment losses for at least the next five years. Combining the effects of those losses with the lower funding of the system's liabilities under the corridor funding method for the teachers' and employees' systems and the aging of the State's labor force means that pension costs will likely continue to increase rates for the foreseeable future. Under the corridor funding method passed during the 2002 legislative session, as long as the combined teachers' and combined employees' plans remain below the 90% funding level, employer contributions increase by an amount equal to one-fifth of the difference between the prior year's rate and the "true" actuarial rate required to fully fund the systems. Although the corridor method has kept contribution rate increases to manageable levels, they are creating a future obligation that the State may not be able to afford.

The structure of the corridor method allows for underfunding of the true actuarial rates with the understanding that any gaps will be made up in later years. With the gap between true actuarial rates and corridor rates growing each year, the size of the State's future obligation to make up for those gaps also keeps growing. The decline in the system's funded status from 78.6 to 65.0%, and projections that the funding ratio will continue to approach 50.0% in coming years, are just the latest signs that the State will face a significant fiscal challenge to pay for retiree costs in the years ahead.

Personnel

State Workforce and Payroll

Since fiscal 2002, the number of State positions has decreased from 81,113 to 79,812. Declines in Executive Branch positions were offset by increases in higher education, judicial, and legislative positions. In response to reductions to projected revenue receipts, the Board of Public Works deleted 309 vacant and 318 filled positions in July and August 2009. Personnel costs increased by 34% from fiscal 2002 to 2010. Salary costs increased 27%, health insurance subsidies increased 77%, and retirement contributions increased 91%.

Budgeted Regular Positions

Regular full-time equivalent (FTE) positions are requested by the Administration and authorized by the General Assembly when the State budget is passed. Section 51 of the fiscal 2010 budget bill limits position growth above that level by allowing the Board of Public Works (BPW) to authorize no more than 200 additional positions during the 2010 fiscal year, outside of exempted provisions for hardship, manpower statutes, block grants, new facilities, and/or emergencies. The total does not include higher education institutions, the Maryland Aviation Administration, and the Maryland Port Administration.

Budget spending limits, positions caps restricting growth, attrition, and abolitions prompted by budgetary constraints have decreased the non-higher education Executive Branch workforce from 55,980 FTE positions in fiscal 2002 to 51,650 in the fiscal 2010 working appropriation. As of November 1, 2009, 113 additional positions had been created by BPW for fiscal 2010, all of which were 100% federally funded.

Exhibit 1 shows that three major agencies represent 70% of the net decrease in the Executive Branch – the Department of Human Resources, the Department of Health and Mental Hygiene, and the Maryland Department of Transportation. These reductions, however, have been offset by new positions created in higher education institutions, the Judicial Branch, and legal agencies (primarily, the Office of the Public Defender).

Exhibit 1

Regular Full-time Equivalent Positions

Fiscal Digest 2002 to 2010 Working Appropriation

Department/Service Area	Actual 2002	Working Appropriation (11/09) 2010	Change 2002-2010	% Change 2002-2010
Health and Human Services				
Health and Mental Hygiene	8,555	6,636	-1,919	-22.4%
Human Resources	7,364	6,742	-622	-8.4%
Juvenile Services	2,123	2,254	131	6.2%
Subtotal	**18,041**	**15,632**	**-2,409**	**-13.4%**
Public Safety				
Public Safety and Correctional Services	11,663	11,308	-355	-3.0%
Police and Fire Marshal	2,590	2,416	-174	-6.7%
Subtotal	**14,252**	**13,723**	**-529**	**-3.7%**
Transportation	9,538	9,013	-525	-5.5%
Other Executive				
Legal (Excluding Judiciary)	1,364	1,517	153	11.2%
Executive and Administrative Control	1,603	1,639	36	2.3%
Financial and Revenue Administration	2,151	1,991	-160	-7.4%
Budget and Management	517	451	-66	-12.8%
Retirement	194	204	11	5.4%
General Services	793	598	-195	-24.6%
Natural Resources	1,618	1,303	-315	-19.5%
Agriculture	480	410	-71	-14.7%
Labor, Licensing, and Regulation	1,706	1,691	-15	-0.9%
MSDE and Other Education	1,956	1,952	-4	-0.2%
Housing and Community Development	416	311	-105	-25.2%
Business and Economic Development	324	246	-78	-24.1%
Environment	1,028	970	-58	-5.6%
Subtotal	**14,149**	**13,282**	**-867**	**-6.1%**
Executive Branch Subtotal	**55,980**	**51,650**	**-4,330**	**-7.7%**
Higher Education	21,393	23,834	2,441	11.4%
Judiciary	3,010	3,581	572	19.0%

Department/Service Area	Actual 2002	Working Appropriation (11/09) 2010	Change 2002-2010	% Change 2002-2010
Legislature	730	747	17	2.3%
Grand Total	**81,113**	**79,812**	**-1,300**	**-1.6%**

MSDE: Maryland State Department of Education

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

Fiscal 2010 Abolitions

Two BPW actions, one in July 2009 and the other one in August 2009, contributed an equivalent of 10% of the net reduction in Executive Branch position levels seen since fiscal 2002. The fiscal 2010 budgeted FTE count was lowered by a total of 627 positions between the Administration's two reductions. Of these abolitions, 318 represented filled positions while 309 were vacant. **Exhibit 2** shows the positions abolished by department.

Higher Education

Chapters 239 and 273 of 2004 provide the University System of Maryland (USM) and Morgan State University with autonomy from the General Assembly to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College. By the end of October 2009, the fiscal 2010 impact of these bills was the addition of 161 FTE positions to higher education facilities, all of which originated in USM.

Exhibit 2

Board of Public Works – July and August 2009
Fiscal 2010 Budgeted Position Reductions

	Position Reduction	
	Vacant	**Filled**
General Funds Positions		
Department of Agriculture	7.00	6.00
Department of Business and Economic Development	3.00	8.00
Department of Health and Mental Hygiene	19.50	166.50
Department of Human Resources	1.00	0.00
Department of Labor, Licensing, and Regulation	1.00	1.00
Department of Natural Resources	10.50	27.00
Department of Planning	0.00	1.00
Department of Public Safety and Correctional Services	88.00	0.00
Department of State Police	1.00	4.00
Maryland State Department of Education	2.00	0.00
Maryland State Lottery	1.00	0.00
Office for Children	1.00	0.00
Office of the Public Defender	0.00	4.00
Office of the Treasurer	1.00	1.00
General Fund Subtotal	*136.00*	*218.50*
Special Funds Positions		
Department of Transportation	44.00	22.50
Higher Education Institutions*	128.75	77.00
Total Reductions	**308.75**	**318.00**

* The position abolitions made by the Higher Education institutions were made in conjunction with personnel reductions brought by the Administration to the Board of Public Works in July and August 2009 but were not effectuated at the meetings due to their statutory personnel autonomy.

Source: Department of Budget and Management; University System of Maryland; Department of Legislative Services

Regular Position Compensation Expenditures

The budgeted expenditure for salaries totals $4.38 billion in fiscal 2010, a 26.6% total increase from the actual level of salaries in fiscal 2002, as is shown in **Exhibit 3**. However, this amount is $55.8 million lower than the fiscal 2009 working appropriation reported in fall 2008. Reductions in position complements, employee furloughs, and the absence of cost-of-living adjustments and merit increases are the principal causes of the reversal of a formerly upward trend in salary base.

The cost of fringe benefits, however, continues to grow. The State subsidy for employee and retiree health insurance is the fringe benefit area posting the largest absolute growth since fiscal 2002, as it has increased by $374.3 million, or 76.9%. Several years of double-digit percentage increases on the cost side and the exhaustion of previously held balances caused the majority of this growth. Retirement contributions made by the State have grown by 91.1% since fiscal 2002, making it the area of employee compensation with the largest percentage increase over the time period. The increase is primarily due to enhancements enacted in 2006 that raised the benefit multiplier and, more recently, investment losses that raise the required employer contribution level.

Exhibit 3
Regular Employee Compensation
Fiscal 2002 Actual to 2010 Working Appropriation
($ in Millions)

	Actual 2002	Working Approp. 2010	$ Change 2002-2010	% Change 2002-2010
Earnings				
Salary	$3,458.0	$4,377.8	$919.9	26.6%
Other Earnings[1]	$113.2	$128.7	$15.6	13.8%
Earnings Subtotal	*$3,571.1*	*$4,506.6*	*$935.4*	
Other Compensation				
Health[2]	$486.7	$861.0	$374.3	76.9%
Retirement/Pensions[3]	$239.9	$458.4	$218.5	91.1%
Salary-dependent Fringe[4]	$258.6	$327.5	$69.0	26.7%
Agency-related Fringe[5]	$99.5	$94.6	-$4.9	-5.0%
Other Compensation Subtotal	*$1,084.7*	*$1,741.5*	*$656.8*	
Total Compensation	**$4,655.8**	**$6,248.1**	**$1,592.3**	**34.2%**

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

Note: The fiscal 2010 working appropriation has been reduced by amounts withdrawn at July and August 2009 Board of Public Works meetings. As such, reductions to the Judiciary and Legislature are not reflected because they are anticipated reversions, and cannot by effectuated by the Administration.

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

Education

Moderate Increase in State Education Aid Projected for Fiscal 2011

State aid for public schools is expected to increase by about $137 million in fiscal 2011, an increase of 2.5%. More than two-thirds of the increase ($98 million) is in the teachers' retirement program; direct aid to the local school systems will increase by an estimated $39 million, or less than 1%. The State is using $296 million in one-time federal stimulus funds to support the major education aid formulas in fiscal 2010, and it is anticipated that approximately $412 million in stimulus funds will be used to support the programs in fiscal 2011.

Education Funding Projected to Increase by $137.3 Million

Public schools could receive an estimated $5.6 billion in fiscal 2011, representing a $137.3 million (2.5%) increase over the prior year. Most of the overall increase, $98.1 million, is in teachers' retirement payments, which are paid by the State on behalf of local school systems and are scheduled to increase from $759.1 million to $857.2 million. Aid that flows directly to the local school systems is projected to grow by $39.2 million from $4.75 billion in fiscal 2010 to $4.79 billion in fiscal 2011, an increase of 0.8%. The per pupil foundation amount used in several of the major direct aid formulas is no longer constrained by the inflationary freeze enacted by Chapter 2 of the 2007 special session, but both the Implicit Price Deflator and the Consumer Price Index are negative, freezing the per pupil foundation amount for the third consecutive year.

General funds used to support State education aid are expected to increase by $53.6 million due mainly to a reduction in Video Lottery Terminal (VLT) special fund revenues that are helping to finance education aid in fiscal 2010. VLT revenues are expected to decline from $39.3 million to $12.9 million. Spending from the federal State Fiscal Stabilization Fund (stabilization funds) established in the American Recovery and Reinvestment Act of 2009 increases by an estimated $115.9 million, from $295.9 million to $411.8 million. Stabilization funds are being used in fiscal 2010 and 2011 to support increases over the fiscal 2009 funding levels in the Bridge to Excellence (BTE) formulas and teachers' retirement. In total, the funds are expected to support $411.8 million in education aid in fiscal 2011.

Several Large Direct Aid Programs Expecting Little or No Growth

The per pupil foundation amount, which will remain at the fiscal 2010 level of $6,694 in fiscal 2011, is used in five of the larger State aid formulas (the foundation program, geographic cost of education index, and the compensatory education, special education, and limited English proficiency formulas) that together account for more than three-quarters of total education aid. As shown in **Exhibit 1**, no inflationary growth in the per pupil amount results in limited increases in direct education aid. Funding for the foundation program is projected to increase by $26.4 million or 1.0%. The increase for fiscal 2011 is attributable to a one-time $30.8 million fiscal 2010 reduction in the foundation enacted to recapture State aid overpayments to 17 school systems that resulted from an error in the fiscal 2009 wealth base calculation. The foundation formula projection also assumes a slight decline in enrollment. Similarly, the small reduction in the geographic cost of education index (GCEI) reflects a projected decrease in student enrollment. Using $88.5 million in federal stabilization funds, the discretionary GCEI formula is fully funded in fiscal 2010 for the first time, and the fiscal 2011 baseline likewise assumes full funding with the use of a similar level of federal funds.

The per pupil foundation amount is also used to calculate aid under the three at-risk formulas (the compensatory education, special education, and limited English proficiency formulas), meaning changes in the funding for these formulas will be limited to changes in the at-risk student enrollments. A slight decline in the guaranteed tax base program is mostly due to rapid wealth growth in two counties (Dorchester and Prince George's) that qualified for the program in fiscal 2010 and are not expected to qualify in fiscal 2011.

Exhibit 1
Estimated State Aid for Education
Fiscal 2011
($ in Millions)

Program	FY 2010	FY 2011	$ Change	% Change
Foundation Program	$2,726.7	$2,753.1	$26.4	1.0%
Geographic Cost of Education Index	126.3	126.1	-0.3	-0.2%
Supplemental Grants	51.2	46.5	-4.7	-9.2%
Compensatory Education	940.2	945.1	4.9	0.5%
Special Education Formula	267.4	265.5	-1.9	-0.7%
Limited English Proficiency	148.6	157.8	9.1	6.1%
Guaranteed Tax Base	63.8	56.9	-6.9	-10.8%
Student Transportation	241.5	248.5	7.0	2.9%
Nonpublic Special Education	112.8	118.1	5.3	4.7%
Other Programs	69.4	69.6	0.3	0.4%
Direct Aid Subtotal	**$4,747.9**	**$4,787.1**	**$39.2**	**0.8%**
Teachers' Retirement	759.1	857.2	98.1	12.9%
Total	**$5,689.1**	**$5,832.0**	**$142.9**	**2.5%**

Source: Department of Legislative Services

To mitigate the impact of the two-year freeze in the per pupil foundation amount, Chapter 2 of the 2007 special session established supplemental grants that ensure at least 1% annual increases in State funding for each local school system in both years of the inflationary freeze. After fiscal 2010 the supplemental grants were to be equal to the amount received in fiscal 2010. However, the supplemental grants retain a portion of the wealth base error that was made in fiscal 2009. The Budget Reconciliation and Financing Act of 2009 (Chapter 487) corrects for the mistake in the calculation of the supplemental grants by reducing the grants for eight school systems by $4.7 million in fiscal 2011. The Act also alters future grant amounts to be equal to the fiscal 2011 supplemental grants rather than the fiscal 2010 grants.

Increases in Retirement Costs Dominate Growth in Fiscal 2010 Education Aid

Teachers' retirement costs comprise 71.4% of the projected growth in State education aid for fiscal 2011, increasing 12.9% from fiscal 2010 to 2011. The increases reflect 4.6% growth in the total salary base of school system employees and an increase in the State's retirement contribution rate from 13.15% to approximately 14.19%. Increases over the fiscal 2009 level of $621.8 million are being paid with federal stabilization funds, meaning federal funds will support an estimated $235.4 million in retirement costs in fiscal 2011, 27.5% of total costs for the program.

Potential Funding Cliff Looms in Fiscal 2012

In total, federal stabilization funds are expected to pay for approximately 7.3% of State education aid in fiscal 2011. With the expiration of these funds after fiscal 2011, State funds will have to increase significantly in fiscal 2012 to fully support existing education aid formulas. In anticipation of the large one-year impact, the Budget Reconciliation and Financing Act of 2009 limits inflationary increases in the major education aid formulas to 1% in fiscal 2012. Although this limit will help to mitigate the increase in formula calculations, it does not resolve the need to backfill federal funds that will be used to finance aid formulas in fiscal 2011. In particular, teachers' retirement costs and the GCEI will rely heavily on federal stabilization funds in fiscal 2011, and significant infusions of State funds will be needed to continue to support these programs in fiscal 2012. VLT revenues may help to moderate the need for new general fund support, but they are not expected to replace the federal funds completely.

Geographic Cost of Education Index Recalibration Could Add to Cost of Aid

Chapter 2 of the 2007 special session requires that the GCEI be updated every three years beginning in September 2009. The recalculation must use the most current available data and the same methodology used to develop the existing GCEI indices. In the legislative session that follows the update, the Maryland State Department of Education (MSDE) must recommend legislation to alter the GCEI adjustments used in the formula.

In August 2009, MSDE submitted a report that outlined potential updates to the GCEI given the changes that have occurred in the original inputs. The report was prepared as a revision to the original 2003 report, *Adjusting for Geographic Differences in the Cost of Educational Provision in Maryland*, and was written by the same authors who calculated the GCEI values currently being used in the formula. The report notes that the new GCEI values correlate highly with the values currently in statute, but also observes that the spread between the high and low GCEI values increases in the new index. The original index contained GCEI values ranging from 0.948 in Garrett County to 1.048 in Prince George's County, and the new index shows values ranging from 0.913 to 1.089 in the same two counties. Because of the wider spread in the index values, funding the new GCEI through the existing formula would add an estimated $106.3 million to the cost of the program in fiscal 2011 if new index values are amended into the statute.

Education

State Board of Education Denies Requests for Maintenance of Effort Waivers

A 1996 law that allows counties to apply to the State Board of Education for temporary waivers from their local school system funding responsibilities was tested for the first time in spring 2009. Three counties requested partial waivers that would have reduced local funding for education by more than $100 million, but the State board denied all three requests. The denials could mean reductions in fiscal 2010 State aid to Montgomery and Prince George's counties, the two largest school systems in the State.

Maintenance of Effort History

The maintenance of effort (MOE) requirement was established in 1984 to ensure that the cost of education was shared by the State and the counties and to ensure predictability and stability of funding for local boards of education. The Governor and the General Assembly have provided waivers for the counties and Baltimore City two times since the MOE requirement was established – in 1992 and 1993 – in recognition of the severe economic downturn that occurred in the early 1990s. Chapter 72 of 1996 then waived the requirement for just Wicomico County in fiscal 1996. Also in 1996, the process for requesting a waiver from MOE was established in law by Chapter 175. Regulations governing the waiver process were adopted in 1997, but no waivers were requested until 2009.

The MOE requirement has benefitted local school systems. Since fiscal 2003, even while State support for education has increased significantly, nearly every county has exceeded its MOE requirement each year, with cumulative increases over mandated MOE levels amounting to $1.3 billion from fiscal 2003 to 2009.

Maintenance of Effort Waiver Process

Maryland law requires a county to appropriate local funds for the local school system operating budget in an amount that is not less than the per pupil amount provided in the prior year adjusted for enrollment. Counties must satisfy this requirement to receive any increase in the State share of the foundation funding, including the geographic cost of education index and supplemental grants. However, a county may request that the State Board of Education grant a temporary waiver from this requirement if the "county's fiscal condition significantly impedes the county's ability to fund" MOE. In spring 2009, eight counties requested a waiver of the MOE requirement for the fiscal 2010 operating budget in spring 2009. However, prior to the required public hearing, all but three counties – Montgomery, Prince George's, and Wicomico – withdrew their requests.

The regulations established by the State board for MOE waivers require applicants to provide information regarding the financial situation of the county including the county's required appropriation under MOE and the proposed appropriation for the school operating budget; the county's projected fiscal condition, including revenue from taxes and a projected expenditure plan; and whether the county has statutory prohibitions against raising revenues. After a public hearing, the State board determines whether to grant the waiver request. In order to get a waiver, a county must show by a preponderance of evidence that the "county's fiscal condition significantly impedes the county's ability to fund the maintenance of effort requirement." Regulations allow the board to consider the following factors when making this determination: external environmental factors such as a loss of a major business or industry; tax bases; rate of inflation relative to growth of student population; and the MOE requirement relative to the county's statutory ability to raise revenues. A county may appeal the State board's decision to the circuit court.

Fiscal 2010 Waiver Requests Denied by State Board

The three counties that proceeded with the waiver process requested waivers of about 4% to 5% of the MOE requirement. The following table provides the details.

County	MOE Requirement	Waiver Amount Requested	% of MOE
Montgomery	$1.5 billion	$79.5 million	5.20%
Prince George's	$538.2 million	$23.6 million	4.39%
Wicomico	$50.8 million	$2.0 million	3.94%

The State board determined that, for all three counties, the burden of proof was not met and denied the requests for waivers. The State board interpreted "external environmental factors" to mean an extraordinary event that is unique to the county and not a broad economic downturn. The board found that none of the counties showed evidence of this, but rather only showed a generalized downturn in the economy that was experienced by all counties. The State board also determined that, although the counties may be generating less revenue, they had not experienced complete or significant losses of their tax bases. The State board gave little weight to any locally imposed prohibitions on raising revenues but did acknowledge that the counties were limited by State law to an income tax rate of 3.2%, a rate each of the counties was either at or near. Finally, the State board noted that the conditional support of the Montgomery County Board of Education for the county's waiver request was not a determinative factor because State law requires the local government to levy taxes to support the minimum requirement for school funding.

Status of Fiscal 2010 Maintenance of Effort

Prince George's County filed an appeal with the Circuit Court for Prince George's County to overturn the State board's decision. The county's board of education has filed a motion to dismiss, which will be ruled on by December 18. If the motion to dismiss is denied, then oral arguments on the case will take place June 30, 2010, with the court's decision expected one month later.

The Maryland State Department of Education (MSDE) must certify that a county has met its MOE requirements before the county receives the final payment of State funds in the later part of the fiscal year. Typically, the certification process begins in January. After the State board denied the MOE requests, each county formulated its budget hoping to meet the MOE requirement and avoid reductions in State education aid. Montgomery and Prince George's counties planned to meet MOE by restricting portions of the funds provided to the local school systems and requiring the restricted funds to be used to repay the county for debt service on school facilities. Wicomico County's plan was to pay for debt service from the local school board's school construction fund, which had accumulated surplus funds from prior years. An opinion of the Attorney General was requested to evaluate whether these plans were consistent with law. The Attorney General determined that Wicomico County's plan was permissible but the plans from Montgomery and Prince George's counties were not. The rejection of the method used by Montgomery and Prince George's counties was based on the provision of State law that prohibits the shifting of funds between the school system and the county to "artificially satisfy" the MOE requirement. As a result of the opinion, MSDE may be required to reduce State aid to the local school boards for Montgomery and Prince George's counties unless other remedies are approved by either the county governments or the Governor and the General Assembly before the end of the fiscal year.

Options for Future Waivers

Now that the waiver process has been tested, further refinement of the law and regulations for the process may be needed to ensure that the process established more than 10 years ago works as intended. During the fiscal crisis of the early 1990s, before a waiver process was authorized, the General Assembly provided waivers to all counties in response to significant reductions in local aid. A similar approach could be used as needed in the years ahead by tying local MOE relief to State budget decisions about local aid. If desired, some level of required MOE could be retained to ensure that school systems are not forced to absorb excessive reductions. This could be implemented by allowing counties to reduce their MOE requirements by a set percentage of the total requirement or by permitting counties to return to the required MOE levels from a selected prior fiscal year. The General Assembly could also alter the MOE waiver law to further clarify what factors should be considered, and when waivers should be granted, by the State board. For example, county funding above the required MOE level for one or more years may be a factor that should be considered. Another change could limit the exposure of the local school systems by penalizing counties, rather than school systems, when counties are unable to meet MOE. Currently, a local school system loses local and State funding when the county government does not meet MOE. With the potential for continuing State and local fiscal stress in the coming years, there will likely be some pressure to review the current MOE requirement and the process for obtaining MOE waivers.

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Education

American Recovery and Reinvestment Act Provides Large Boost in Federal Education Funding

The federal American Recovery and Reinvestment Act of 2009 provides nearly $100 billion in support for education through new and existing federal funding streams, including more than $1 billion for Maryland to use in fiscal 2010 and 2011. Funding from the new programs established in ARRA is conditioned on commitments from states to four areas of school reform identified in the legislation. Maryland is using the largest portion of its ARRA allocation to support fiscal 2010 and 2011 increases in State education aid formulas.

Federal Stimulus Legislation

The American Recovery and Reinvestment Act of 2009 (ARRA) was enacted on February 17, 2009, with the goals of stimulating the economy in the short term and investing in essential public services, including education, in the long term. The legislation included $100 billion in funding for public education. The Act created a new funding stream, the State Fiscal Stabilization Fund (SFSF), and increased existing federal education aid formulas, the largest being Title I of the Elementary and Secondary Education Act (Title I) and the Individuals with Disabilities Education Act (IDEA). ARRA also created new competitive grant initiatives for education, most notably the "Race to the Top" (RTTT) program.

In order to access federal aid from SFSF and apply for any new competitive grant program, states must commit to four areas of educational reform. These include:

- making improvements in teacher effectiveness and ensuring that all schools have highly qualified teachers;
- demonstrating progress toward college- and career-ready standards and rigorous assessments that will improve both teaching and learning;
- improving achievement in low-performing schools by providing intensive support and effective interventions in schools that need them most; and
- enhancing statewide data systems to track improvements in student learning, teacher performance, and college and career readiness.

State Fiscal Stabilization Fund

SFSF is a new one-time fund available for use in state and local budgets to help minimize reductions in essential services. ARRA includes $48.6 billion for the fund, which is allocated to the states based on relative shares of school-aged and total population. States must direct 81.8%

of the funds toward early childhood, elementary, secondary, and higher education and the remaining 18.2% to public safety and other government services. The U.S. Department of Education (USDE) is charged with administering the fund.

Maryland's estimated share of the SFSF is $721.2 million for education and $160.1 million for government services. The education stabilization fund must first be used to fund the three priority areas established in ARRA: (1) funding primary and secondary education at the greater of the fiscal 2008 or 2009 amount; (2) funding increases to the primary and secondary education state funding formulas, if the increases were enacted prior to October 1, 2008; and (3) funding higher education at the greater of the fiscal 2008 or 2009 amount. If a state has funds remaining after supporting the three priority areas, any remaining education stabilization funds must be allocated to school systems through the federal Title I formula. To qualify for education stabilization funds, fiscal 2009, 2010, and 2011 state support for primary and secondary education and higher education may not fall below the amounts available in fiscal 2006.

Because Maryland already planned to increase funding for primary and secondary education and higher education beyond the amounts provided in fiscal 2008 and 2009, the State chose to use the education stabilization funds to finance programmed increases to its major State education aid formulas in fiscal 2010 and 2011. In fiscal 2010, $295.9 million in education stabilization funds has been appropriated in support of the formulas, with the largest shares going to the teachers' retirement program ($137.3 million) and the geographic cost of education index ($88.5 million). Current estimates suggest that most of the remaining $425.3 million could be used in fiscal 2011 to again support formula increases, although a small amount may be left. These monies could be distributed through the Title I formula or may be used to support higher education if funding goes below the fiscal 2009 level.

The Governor, in conjunction with the Maryland State Department of Education (MSDE), must apply for funding from SFSF in two phases. Approximately 74% of the funds were made available after the submission of Phase I, and the remaining 26% will be made available after a more comprehensive Phase II application is approved. The Phase I application requires states to track progress, baseline data, and expenditure information for the four key areas of education reform. In the Phase II application, states must provide information on strategies for addressing the four areas of education reform. Specifically, states must provide data or comprehensive plans for 33 descriptors and indicators written by USDE, with each indicator relating to one of the four key reform areas. The completion of this application is a prerequisite for consideration for Race to the Top funds.

Race to the Top Grants

ARRA includes $4.35 billion in RTTT competitive grants in an effort to create incentives for the four areas of school reform. In order to be eligible for the funds, states must have approved Phase I and Phase II applications for SFSF dollars and may not have statutory or regulatory barriers to linking data about student growth and achievement with teacher and principal identifiers. In keeping with the four central areas of reform, $350 million of the total available for RTTT grants has been reserved for assessments based on the Common Core Standards Initiative. Maryland, along with at least 47 other states, has signed on to the initiative. In a joint effort by the National Governors Association and the Council of Chief State School Officers, the initiative aims to develop common core standards in English/language arts and mathematics for students in kindergarten through grade 12. These standards will be research- and evidence-based, internationally benchmarked, and aligned with college and work expectations. The goal is to create standards and assessments that will not vary state-to-state and will ensure college and career readiness for all students.

Maryland is also working to develop a comprehensive statewide data system, a key component of applications for RTTT funds. Maryland's current system includes 4 of the 10 essential components of an effective data system as laid out by the Data Quality Campaign, which will be used to evaluate the system, and MSDE has received a five-year grant to further improve its data systems. The system does not currently contain links to higher education or a unique teacher identifier that would link students to teachers, although Chapter 406 of 2009 provides MSDE with the authority to assign unique teacher identification numbers for use in reporting for educational purposes. A group appointed by the Governor and chaired by the President of the State Board of Education and the Chancellor of the University System of Maryland has made recommendations on a comprehensive Maryland data system. Legislation will be needed this session to implement several of the recommendations, which propose an independent center to house data from primary and secondary education, higher education, and eventually employers.

RTTT funds will be awarded in two rounds. Applications for the first round are due January 19, 2010, and awards will be made in spring 2010. States that receive grants in the first round are not eligible to receive additional funds during the second round of grants. Round two applications are due June 1, 2010, and grantees will be announced by September 30, 2010. Half of any RTTT funds awarded to states must be sub-granted to local school systems.

Title I and IDEA

ARRA includes $21.3 billion to enhance Title I ($10 billion) and IDEA ($11.3 billion). The estimated allocation for Maryland is $136.4 million in Title I funding and $200.2 million in IDEA funding. The funds were made available in two installments: the first 50% on April 1, 2009, and the second beginning in September 2009. In order to receive the second half, states must submit information to USDE that addresses how they will meet the accountability and reporting requirements of ARRA. In addition, current regulatory requirements for IDEA and Title I apply to ARRA funds. However, both Congress and USDE have indicated funding preferences for Title I funds. It is the intent of the Congress that 40% of the Title I funds be directed to middle and high schools, while the U.S. Secretary of Education has indicated a preference for extended time in school. Local school systems are also being encouraged to use the funds for short-term investments in order to manage the depletion of stimulus funds in fiscal 2012.

Education

Impact of the High School Assessments on Graduation Rates

The class of 2009 was the first that was required to meet the State's new high school graduation requirement in order to earn high school diplomas. Only 11 students who would otherwise have graduated did not because of the new rules. Most students (92.5% statewide) met the requirement by passing the High School Assessments, and another 6.3% completed subject-based "bridge" projects to achieve the new standard. As it enters its senior year, the Class of 2010 appears to be in a similar position to meet the requirement by the end of this school year.

High School Assessments Required for the Class of 2009

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 a requirement for high school graduation. In 2004, the State Board of Education voted to make passage of HSAs a graduation requirement beginning with students entering ninth grade in fall 2005 (the class of 2009).

In October 2007, after a significant amount of additional study and discussion, including five public hearings held throughout the State at the request of the General Assembly, the State board voted 8-4 to retain HSAs as a graduation requirement. In the process of reviewing HSAs, the State board made two modifications to the policies that had been in place. The board approved the Bridge Plan for Academic Validation, thus providing a student who is unable to pass HSAs with the option of completing one or more subject-based projects in lieu of passing the assessments. The board also altered the minimum score requirement. Previously, a student was eligible 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 was retained but with no minimum required scores for individual tests.

After receiving additional information about students' progress in meeting HSA requirements in fall 2008, the State board voted again (7-4 this time, with one member absent) to retain HSAs as a graduation requirement for the class of 2009. However, the board adopted an appeals process for students from the class of 2009 with extenuating circumstances at its December 2008 meeting. Emergency regulations were issued to allow a student who has not passed all four HSAs to receive a waiver and graduate if the student (1) has met all other graduation requirements; (2) has taken or will take all four tests; (3) has taken advantage of all extra help; and (4) the circumstances that have prevented the student from passing the test are beyond the student's control.

Impact of HSAs on the Class of 2009 Graduation Rates

Only 11 students did not graduate due solely to inability to meet the new requirement in 2009. An additional 2,280 students did not graduate because they failed to meet local graduation requirements, and of these, 682 students also failed to meet the HSA requirement. The 2009 graduation rate of 84.24%, which counts all graduates, not just those who graduate in four years, is comparable to recent graduation rates, including last year's rate of 85.09%. The percentage of high school seniors who dropped out was the lowest it has been in over 10 years (2.8%).

Most Students Met New Requirement Through Examination

The majority of students, 92.5% (50,683 students), required to pass HSAs did so by passing all four exams or by meeting the combined minimum score. Another 3,481 students (6.3%) completed one or more bridge plan projects to meet the requirement. The number of projects a student needed to complete was based on the student's scores on the HSA exams. An additional 531 students (1.0%) received waivers for one or more of the exams, and another 3,418 students who entered high school prior to 2005 and were not required to meet the HSA requirement graduated in 2009.

The percentage of students who used each method to meet the HSA requirement is shown by county in **Exhibit 1.** Prince George's County and Baltimore City granted the highest percentages of HSA waivers, at 2.8% and 2.6%, respectively. Baltimore City also had the greatest percentage of students, 20.9%, meeting the HSA requirement by completing bridge projects.

Bridge Project Approval Rates Increased Over Year

Bridge projects were designed by the Maryland State Department of Education content specialists and were scored by panels assembled by the local school systems. First time approval rates for projects increased from 68% for projects graded before December 9, 2009, to 85% or 90% from that point until the end of the school year. Coordinators attributed this increase to project monitors becoming more familiar with the projects, their format, and the expectations of scoring panels. Over 90% of resubmitted projects were approved. Some counties only allowed students to resubmit projects for rescoring once, while others allowed multiple submissions. Students working on bridge projects were encouraged to continue retesting, and there were anecdotal reports of students passing HSAs after completing bridge projects.

Most of the Class of 2010 Has Met HSA Requirements

With respect to the State's new graduation requirement, the students from the class of 2010 are on par with the class of 2009 at the end of grade 11. Currently, there are 55,801 students in the class of 2010 who must complete the requirement and are otherwise on pace to graduate in June 2010. Of the total, 47,145 students (84.5%) have already taken and passed all four exams or met the requirement by reaching the combined minimum score; at the same point last year, 83.4% of the class of 2009 had passed the HSAs.

Another 5,477 students (9.8%) have taken all four exams but have not achieved passing scores on all four or the minimum combined score option. This is comparable to the 9.1% of students from last year. These students have begun to work on their bridge plan projects. In addition, there are 3,121 students (5.6%) statewide who have yet to take one or more of the HSAs, which is somewhat less than the 7.5% who were in that position last year. HSA exams are offered four times per year, with two more testing opportunities before June 2010. A third test administration will take place in June and allow for summer 2010 graduation.

Exhibit 1

Method by Which Students Met the High School Assessment Requirement Class of 2009

	% of Students Who Met Requirement Through			
County	**Examination**	**Bridge Projects**	**Waiver**	**Percent Who Did Not Meet Requirement**
Allegany	92.5	7.3	0.0	0.1
Anne Arundel	95.1	4.1	0.8	0.0
Baltimore City	76.1	20.9	2.6	0.3
Baltimore	93.4	6.1	0.5	0.0
Calvert	98.1	1.9	0.0	0.0
Caroline	94.4	5.4	0.0	0.3
Carroll	98.0	1.9	0.1	0.0
Cecil	98.0	2.0	0.0	0.0
Charles	92.4	7.6	0.0	0.0
Dorchester	93.1	6.3	0.0	0.7
Frederick	97.2	2.7	0.1	0.0
Garrett	95.2	4.8	0.0	0.0
Harford	97.4	1.8	0.9	0.0
Howard	98.4	1.4	0.0	0.1
Kent	91.1	8.2	0.0	0.6
Montgomery	95.7	3.0	1.2	0.1
Prince George’s	83.4	13.1	2.8	0.6
Queen Anne’s	94.8	5.2	0.0	0.0
Saint Mary’s	98.1	1.6	0.2	0.1
Somerset	88.8	11.2	0.0	0.0
Talbot	90.8	8.9	0.0	0.3
Washington	97.9	2.0	0.1	0.0
Wicomico	87.7	12.2	0.0	0.1
Worcester	93.6	6.4	0.0	0.0
State	**92.5**	**6.3**	**1.0**	**0.1**

Note: Numbers may not equal 100% due to rounding.
Source: Maryland State Department of Education

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Education

Changes to the Comprehensive Master Plan Process to Be Proposed

As one of the key components of the Bridge to Excellence in Public Schools Act of 2002, the use of strategic planning by local school systems has been found to be instrumental in the success of Maryland schools. The General Assembly approved legislation in 2007 that ensures continuation of the process beyond the Bridge to Excellence implementation period, but effective July 1, 2009, a provision allowing local school systems to submit preexisting comprehensive master plans for the new fall 2010 submissions was repealed. A workgroup reviewing the master plan process has proposed changes that could be enacted in 2010.

Masters Plans Bring Accountability to the Bridge to Excellence Act

The development of a comprehensive master plan by each local school system was one of the major accountability components of the Bridge to Excellence in Public Schools Act of 2002. The Act required significant enhancements to State funding for public elementary and secondary education and gave local school systems broad discretion to use the added revenues for programs, initiatives, and enhancements that would best serve local student populations. The master plans were designed to ensure that the large infusion of funds would be used on focused sets of identified strategies.

MGT of America, Inc. (MGT) submitted an interim report on the evaluation of the Bridge to Excellence program in December 2007 and the final report in December 2008. The evaluation specifically identified strategic planning as the most crucial factor in improving student performance. Local school systems were initially required to develop five-year plans and were required to update the plans annually during implementation of the Bridge to Excellence Act. Chapter 652 of 2007 then added two additional years of mandatory plan updates (fall 2008 and 2009). In addition, the legislation required school systems to develop new five-year master plans by fall 2010 and required annual updates to those plans that would likewise cover five years.

To allow the legislature to review the final report from the Bridge to Excellence evaluators before proceeding with the mandates for 2010 and beyond, Chapter 652 included a provision that required the General Assembly to revisit these decisions in 2009 to determine whether:

- the comprehensive master plan requirement for local school systems could be differentiated to reflect differing levels of progress in improving student achievement; and

- local school systems could use preexisting comprehensive plans to satisfy the master plan requirement.

The General Assembly let the July 1, 2009 expiration date on the authorization to use preexisting comprehensive master plans take effect but gave itself additional time before the fall 2010 submission to continue studying the issue. With no additional action this session, all school systems will be required to submit new five-year comprehensive master plans by October 15, 2010.

Legislative Changes to the Master Plan Process May Be Proposed

A workgroup established by Maryland State Department of Education (MSDE) and including representatives from local school systems has developed recommendations for the master plan process. MSDE is drafting the legislation that would be needed to implement the recommendations. Major recommendations include delaying by two years (to fall 2012) the requirement that local school systems develop new five-year master plans and reestablishing a provision to allow a local school system to submit a preexisting master plan if the State Superintendent of Schools determines that the system's existing plan meets all of the requirements. The requirement for updates to the existing master plans would also be extended by two years.

The delay is proposed out of concern that the reauthorization of the federal Elementary and Secondary Education Act (ESEA) and the national standards movement may change federal education requirements. Differentiating the master plan process is proposed as a way to reduce the administrative burden of developing all new master plans and to reward those systems that have been successful under existing plans.

Planned Use of Federal Stimulus Funds to Be Included in the 2009 Update

A significant amount of the aid from the federal American Recovery and Reinvestment Act (ARRA) is aimed at education. Maryland is using its share of the education stabilization funds (roughly $721 million) to support existing education aid formulas. Local school systems are also receiving $413.8 million in additional Title I of ESEA special education and technology funds. In return for the enhanced federal funding, local school systems are responsible for documenting their planned and actual uses of the funds. To meet this requirement, and to address legislative concerns that local school systems budget one-time ARRA funds with awareness that funding will no longer be available after fiscal 2011, local school systems will be required by MSDE to include this information in the master plan annual updates.

Study Brings MSDE Changes to Master Plan Processes

The MGT evaluation of the Bridge to Excellence program found that local school systems that had used strategic planning processes prior to Bridge to Excellence demonstrated better student performance than those that had not. Furthermore, based on interviews with master planning teams and school district leaders, MGT's interim report concluded that, in a majority of local school systems, the master planning process has enhanced the involvement of and collaboration by key stakeholders, increased strategic planning and use of data for instructional decision making, and helped align expenditures with the systems' goals and strategies.

Participants in the MGT study also identified numerous ways in which the master planning process could be improved. A common observation among respondents was that the process was overly burdensome and redundant and detracted from school system efforts to improve classroom instruction and student achievement. Recommendations for reducing the bureaucratic burden included standardizing formats for submission of data, eliminating redundant data requests, and allowing for electronic submissions of master plans and updates. Participants also noted that the timeline for submission of master plan updates was not aligned with budget processes or the reporting of results from State assessments, meaning the updates were not providing timely performance or financial data. Finally, more than half of assistant superintendents and almost one-third of superintendents suggested that master plan reporting requirements should be differentiated by various factors, including district size, performance, and Bridge to Excellence per-pupil funding levels. One master plan team suggested that updates be provided on a biannual basis.

In response to these concerns, the Maryland State Department of Education (MSDE) instituted mandatory electronic filing of master plan updates using standardized templates. Data fields that contained information already in MSDE databases were pre-populated to save school systems time. Each system is still required to provide 10 hard copies of its master plan, including 1 signed by the superintendent and the board of education president. Also, the elimination of constructed responses on the high school assessments has shortened the time necessary to score the exams, so results are typically available in time for inclusion in the updates submitted by October 15 each year.

Higher Education

Fourth Year of Tuition Freeze Improves Affordability of Higher Education

In-state undergraduate tuition rates have been frozen at fall 2005 rates for four consecutive years at most public four-year institutions, improving Maryland's average tuition and fees ranking from seventh highest in the country to seventeenth. State funds were budgeted to offset the loss in tuition revenues each year, and despite fiscal 2010 cost containment, a mid-year tuition increase has not been proposed. However, need-based financial aid has not kept pace with tuition and fee increases since fiscal 2007, and need-based financial aid applications and wait lists are up significantly in the past year.

Escalating Tuition Leads to a Freeze Supported with State Funds

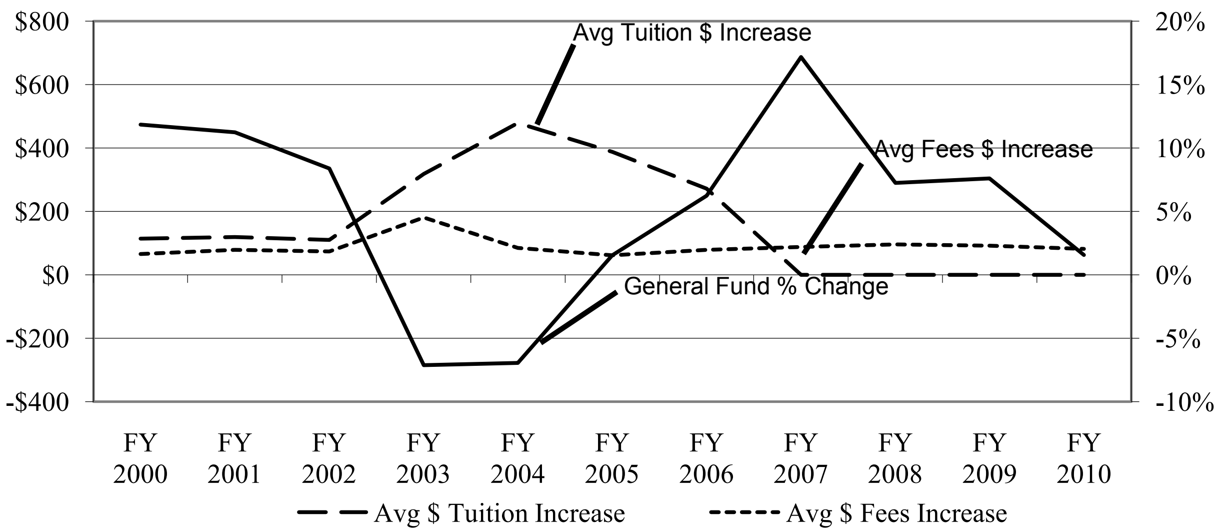
Two factors influencing students' and families' decisions on whether college is affordable and accessible are tuition at a preferred institution and the availability of financial aid to help pay for tuition and other costs associated with attending college. Starting in fiscal 2002, affordability became a concern as State support for the University System of Maryland (USM) institutions and Morgan State University (MSU) declined considerably, leading to a rapid increase in tuition. From fiscal 2002 to 2005, as shown in **Exhibit 1**, State support for USM institutions and MSU decreased 12.3%, coinciding with a sharp increase in tuition of 33.3%. By fiscal 2006, State support increased 6.2%, resulting in moderate tuition growth of 5.7% in the fall 2005. While this tuition increase was less than those in previous years, it was still higher than the 4% average growth in tuition prior to fiscal 2001.

In response to the rising tuition rates, the Tuition Affordability Act of 2006 (Chapters 57 and 58) was enacted, freezing tuition for the 2006-2007 academic year at the fall 2005 rates for in-state undergraduate students attending USM institutions and MSU. The Act also limited the fall 2006 increase at St. Mary's College of Maryland (SMCM) to 4.8%. The Tuition Affordability Act of 2007 (Chapter 294) continued the tuition freeze at USM institutions and MSU for the 2007-2008 academic year. While the tuition freeze was not mandated in fiscal 2009 and 2010, USM and MSU continued to hold tuition at the fall 2005 rates. In return, State funds were included in the budget in each of fiscal 2007 through 2010 to offset the loss of tuition revenue.

How Long Can Tuition Freeze Be Sustained?

While State support for USM and MSU has increased since fiscal 2007, the start of the tuition freeze, the overall growth of State support has slowed as the economy fell into recession. In fiscal 2010, the General Assembly approved a 1.6% increase in State support for USM and MSU, including $45.0 million from the Higher Education Investment Fund in lieu of general funds. However, cost containment actions approved by the Board of Public Works (BPW) in July and August 2009 reduced support by $29.1 million. This does not include transfers from the fund balances of USM and MSU, which will require legislative approval in the 2010 session. Although this year's tuition freeze was not mandated in statute, USM and MSU have not proposed mid-year tuition increases to replace the lost State funds. However, the State's projected structural deficit of over $2 billion for fiscal 2011 raises the question of how long the State can continue to freeze tuition.

Exhibit 1
USM and MSU Dollar Increase in Resident Undergraduate Tuition and Fees and Percentage Change in General Funds
Fiscal 2000-2010



Note: Excludes University of Maryland, Baltimore
Source: Governor's Budget Books; Department of Legislative Services

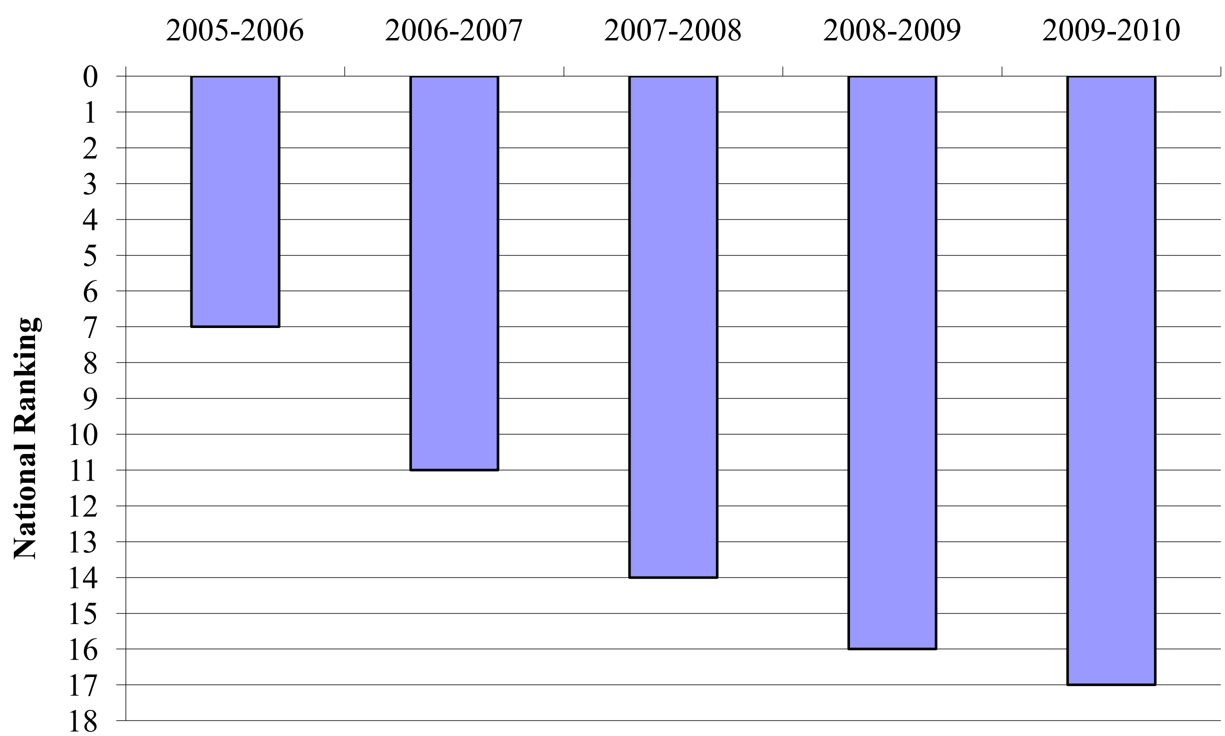
Mandatory Fees Continue to Increase

Even though in-state undergraduate tuition has remained at the fall 2005 level for four consecutive years, mandatory fees continue to rise, thereby increasing the total amount students pay for college. Exhibit 1 also shows the increase in fees since fiscal 2000. In fiscal 2003, a 7.1% reduction in general funds coincided with an average jump in fees of $181. Since the start of the tuition freeze, mandatory fees continued to grow at an average rate of 5.9%, or $357, from fiscal 2007 to 2010.

Tuition Freeze Improves Affordability of Maryland Institutions

The four-year tuition freeze has made USM institutions and MSU more affordable for Maryland students and families. At the start of the tuition freeze, Maryland's average tuition and fees at public four-year institutions ranked seventh among the 50 states, according to The College Board. As shown in **Exhibit 2**, Maryland's ranking has steadily improved to eighteenth in the 2008-2009 academic year. While the tuition freeze cannot continue indefinitely given current budget constraints, holding tuition level has "bent the curve" by reducing the tuition base to which future tuition increases will be added, structurally improving college affordability for Marylanders.

Exhibit 2
National Ranking of Average Tuition and Fees at Public Four-year Institutions in Maryland
Academic Years



Source: The College Board, *Trends in College Pricing*, 2008, 2009

Waiting Lists for Need-based Financial Aid Grow

The amount of available financial aid significantly impacts the affordability of higher education for Maryland students. Aid options include federal programs, aid provided by the State, and financial assistance offered by institutions. The Educational Excellence Award program (EEA), the State's largest need-based financial aid program, was reduced by cost containment actions in fiscal 2008, 2009, and 2010. In fiscal 2009, BPW actions reduced EEA's general fund appropriation 2.0% to $75.5 million, resulting in funding for 551 fewer need-based awards. EEA's fiscal 2010 working appropriation is $77.1 million after accounting for carry-forward funds, additional federal funds, and a $366,906 cost containment reduction. Though the fiscal 2010 appropriation represents a 1.3% increase over 2009, it is still $764,247 less than the fiscal 2008 legislative appropriation. While in-state undergraduate tuition and fees at Maryland's public four-year institutions increased 1.4% on average each year between fiscal 2007 and 2010, EEA's average annual percent increase of 0.3% has not keep pace with tuition, making higher education less affordable for Maryland residents.

From fiscal 2007 to 2010, demand for need-based financial aid increased considerably, particularly between fiscal 2009 and 2010 due to the global financial crisis. Expected family contribution (EFC) is one key measure of student need. In general, the lower a student's EFC, the greater the student's financial need. The Maryland Higher Education Commission (MHEC) reported an 18.0% rise in the number of EEA grants applications received in the 2010 award year compared to the previous year, and a significant increase of students with $0 EFC. To date, MHEC has been able to award EEA grants to students with EFCs up to $6,411, and does not expect to meet last year's awarding level, when students with EFCs up to $10,030 received funds through the program. As of October 16, 2009, 9,449 students were on the EEA waiting list, in comparison to February 14, 2008, when 1,174 students were on the waiting list.

The institutional aid provided by public institutions has also been impacted by State fiscal constraints. Nearly half of all public four-year institutions in Maryland (University of Maryland, College Park (UMCP); Bowie State University; Towson University; University of Baltimore; University of Maryland Eastern Shore (UMES); and University of Maryland Baltimore County) reduced institutional aid as a result of cost containment actions in July and August, cutting between 1.1% and 2.4% of undergraduate institutional aid. Of these, UMCP had the greatest absolute reduction at $500,000 or 1.6%, while UMES reduced the largest percentage of undergraduate institutional aid at 2.4%, or $139,368.

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Higher Education

Graduation from High School Does Not Equal College or Career Readiness

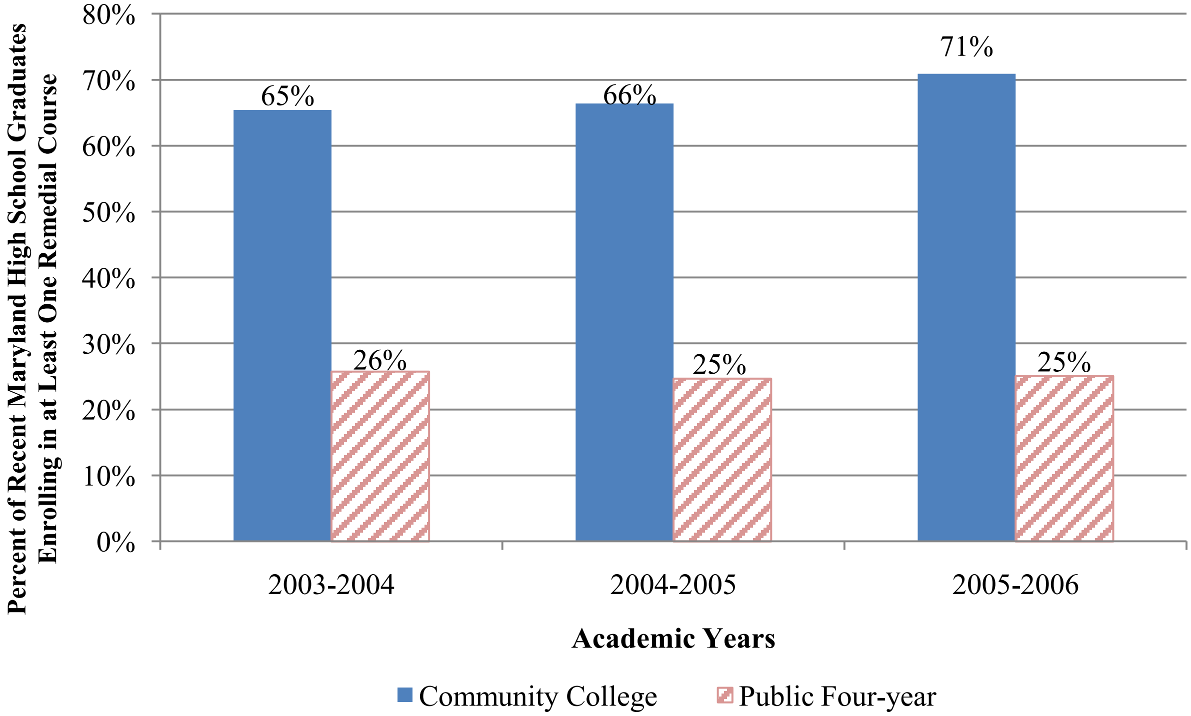
There is a gap in knowledge and skills between graduation from high school and the expectations of postsecondary education, whether in a certificate program, community college, or four-year institution, in nearly all states including Maryland. Remediation rates at Maryland community colleges and public four-year institutions clearly illustrate the readiness gap. The P-20 College Success Task Force is developing a definition of college readiness that is aligned with both P-12 and postsecondary education, and the common core standards movement across the nation will bolster these efforts in Maryland.

Lack of Alignment between High School and Postsecondary Education Leads to Readiness Gap

Although Maryland requires passage of the High School Assessments (HSAs) in some form to graduate from high school, a gap between high school graduation and college or career readiness persists. This gap is manifested in the remediation rates of recent high school graduates at Maryland's community colleges and public four-year institutions. Before matriculating in postsecondary education, a Maryland student must take one or more placement examinations. In Maryland, the community colleges determine a student's need for remedial education – a form of basic college readiness skills training – by the student's results on the COMPASS or ACCUPLACER examination. Other institutions of higher education often use their own tests or the results of the ACT or the SAT for course placement purposes. Unfortunately, these placement examinations are not aligned with the State Curriculum or the HSAs.

Every community college and most public four-year institutions in Maryland offer remedial education, which is delivered as courses, skills labs, learning centers, and/or tutoring. As shown in **Exhibit 1**, about two-thirds of all first-time first-year students attending community colleges in the State required remedial education in math or reading in the 2003-2004 academic year. This rate increased to 71% in the 2005-2006 academic year, the latest year for which data is available. Some public four-year institutions in Maryland do not offer remedial education, but in those that do, one-quarter of students required remediation. The proportion of students at historically black institutions (HBIs) needing remedial education is similar to community college rates, a situation that is likely due to the mission of HBIs to serve students who come from challenging academic and socioeconomic backgrounds.

Exhibit 1
Remediation Rates
Maryland Community Colleges and Public Four-year Institutions



Source: Student Outcome and Achievement Report, MHEC

Collaborative efforts between K-12 and higher education have begun in Maryland to address the difficulty of attaining college readiness. For example, the Community College of Baltimore County (CCBC) and the Baltimore County Public Schools are currently exploring the possibility of middle colleges, which consist of simultaneous matriculation through high school and community college, after which a student earns both a high school diploma and an Associate of Arts degree upon graduation. Three recent CCBC graduates earned this distinction. Additionally, Chesapeake College has an eleventh grade-focused "Mapping Your Future" program. Chesapeake College reports that, of the 105 students recently in the program, 58 changed their schedules for the next semester to take additional math classes because they were inspired by the program.

P-20 College Success Task Force to Define College Ready

In an attempt to address this gap, the Commission to Develop the Maryland Model for Funding Higher Education and the Governor's P-20 (preschool through postsecondary education) Leadership Council both recommended formation of a task force to develop a definition of college and career readiness and pursue alignment of expectations between

P-12 (preschool through high school) and postsecondary education. The P-20 College Success Task Force is chaired by the State Superintendent of Schools and the Secretary of Higher Education and is charged with aligning educational standards, expectations, and student outcomes with particular attention being given to the areas of mathematics, reading, and writing. The task force engaged the Southern Regional Education Board to identify the key components of a college ready definition in P-12 aligned with the expectations of postsecondary education. The task force anticipates concluding its work by March 2010.

Common Core Standards to Be Adopted in 2010

The timing of Maryland's push to align P-20 expectations and standards is fortuitous, as the American Recovery and Reinvestment Act of 2009 (ARRA) has made common core standards a high priority for all states. Since November 2005, Maryland has been a part of the American Diploma Project (ADP) Network sponsored by Achieve, Inc. This network includes 34 other states and represents a commitment by each state to align high school standards, assessments, graduation requirements, and accountability with the expectations of institutions of higher education and employers. In February 2009, Achieve, Inc. released "Closing the Expectations Gap 2009," which reports that Maryland, along with 22 other states, aligns high school (reading and mathematics) standards with the expectations of college and the workplace and that Maryland is planning to align high school graduation requirements with these expectations, develop college and career-ready assessments, and implement a longitudinal data system.

Both continuing and enhancing the efforts that Maryland has made as part of ADP, Maryland has joined the national effort being led by the Council of Chief State School Officers and the National Governors Association to develop common standards in the core curriculums of mathematics, reading, and writing. This initiative has grown out of one of the four components of the competitive Race to the Top funds that will be made available as part of ARRA: the alignment of assessments and standards on a national basis to facilitate international benchmarking. An open comment period regarding a first draft of the standards concluded on October 21, 2009. Following review of the standards and associated comments by a validation committee expected by February 2010, the common core standards will be sent to states for adoption. In order to receive Race to the Top funds, a state must commit to adopting the common core standards and the standards must be adopted by August 2010. In Maryland, the State Board of Education (SBE) has the authority to adopt the common core standards.

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Higher Education

Higher Education Commission Approves Online Program for Out-of-State Students Only

Maryland continues to wait for a decision by the U.S. Office for Civil Rights on compliance with the Partnership Agreement and federal civil rights laws and obligations. Meanwhile, the Maryland Higher Education Commission's decision to approve an online program proposed by University College, and objected to by Morgan State University, for out-of-state students only has again raised issues about Maryland's continuing obligations and the State's academic program approval process. Finally, litigation concerning Maryland's compliance with civil rights laws continues in federal District Court, but no trial date has been set.

Maryland Follows Partnership Agreement While Awaiting OCR Decision

The U.S. Office for Civil Rights (OCR) entered into a partnership agreement with Maryland in December 2000 to further enhance the four public historically black institutions (HBIs) (Bowie State University, Coppin State University, Morgan State University (MSU), and the University of Maryland Eastern Shore) and improve higher educational opportunities for African American students. Maryland had previously submitted to OCR plans to show that the vestiges of its formerly de jure system of segregation in higher education had been adequately dismantled, most recently in 1991. The Partnership Agreement expired December 31, 2005. On June 19, 2006, Maryland submitted a final report on the Partnership Agreement Commitments to OCR, which acknowledged receipt of the report in 2008. OCR has yet to reply or to find Maryland in compliance with the Partnership Agreement and federal civil rights laws.

A 1992 Supreme Court decision in *United States v. Fordice,* 505 U.S. 717 (1992), concerning Mississippi's efforts to desegregate its system of higher education established the standard of "unnecessary duplication," a key measure to which Maryland would be held by OCR in evaluating its efforts to eliminate segregation. The standard set forth by *Fordice* prohibits states from allowing any traditionally white institution (TWI) to duplicate nonbasic bachelor's or graduate level courses that are similar to existing courses at HBIs within close geographic proximity, unless sound educational justification exists.

Among the State's obligations outlined in the OCR Partnership Agreement is a commitment to develop high-demand academic programs at HBIs to promote racial diversity and to avoid duplicating such programs at nearby TWIs. Under State law, the Maryland Higher Education Commission (MHEC) is responsible for reviewing and approving new academic programs in higher education, and the program approval process is designed to ensure that the State satisfies its responsibilities under federal civil rights laws, including the unnecessary duplication standard. Institutions seeking to establish new programs in Maryland must demonstrate to the commission that the program is not "unreasonably duplicative" of existing programs in close proximity; if duplication exists, the institution must demonstrate that the program meets a societal or State need consistent with the State plan. MHEC also circulates new program proposals to provide each campus the opportunity to raise issues like unnecessary duplication. After considering each new program, the Secretary of Higher Education either approves or denies the application. Institutions may appeal the Secretary's decision to MHEC. The commission's decision is final, and there is no further appeal.

MSU Objects to Proposed Online Program

On December 19, 2008, MSU, which offers Maryland's only doctoral program in Community College Leadership, objected to an online doctoral program in Management in Community College Policy and Administration proposed by University of Maryland University College (UMUC), a TWI, on the basis of unnecessary program duplication. MSU's program can be completed by attending weekend classes and is offered at two Regional Higher Education Centers. In contrast, UMUC's proposed program is Internet-based, though it requires two to three days of in-person weekend attendance each trimester.

After analyzing UMUC's proposal, the Secretary determined that the availability of UMUC's proposed Doctorate in Community College Policy and Administration in Maryland would adversely affect recruitment for MSU's existing program, causing it demonstrable harm. In a letter dated September 21, 2009, sent to UMUC's president regarding the decision, Secretary James E. Lyons, Sr. noted that while some Maryland residents may find the UMUC program more convenient due to its online nature, "the statutory test I must apply is demonstrable harm to Morgan." The Secretary denied UMUC's proposal to offer the program to Maryland residents but let stand his previous approval (on June 5, 2009) of the program for out-of-state students, citing UMUC's ability to help immediately address a national workforce shortage of community college administrators. This is the first known case in which a state has prohibited an online program due to the existence of a similar classroom-based program. The ruling has also created an unusual circumstance in which State residents are unable to enroll in a program offered by a Maryland public institution.

UMUC appealed the Secretary's decision to MHEC, which heard the appeal on October 14, 2009. During the hearing, MSU urged MHEC to reconsider the Secretary's approval of UMUC's program for out-of-state students, stating that this too would cause MSU demonstrable harm. On October 22, 2009, the commission sustained Secretary Lyons' ruling, allowing UMUC to offer its program to out-of-state students but not Maryland residents. The commissioners also resolved that an online doctoral program in community college leadership would be offered to State residents by a Maryland institution by September 2011 "either by Morgan State University if it is willing and able, or by another public institution if Morgan State University cannot demonstrate to the Commission by June 1, 2011, that it is prepared to offer the program." MSU has indicated its intention to incrementally move its doctorate in community college leadership online, but the institution has not specified how this will be accomplished. Although there is no appeal process beyond MHEC authorized in State law, both institutions have indicated they will request guidance from the Attorney General's Office on the legality of the decision and the program approval process.

Judicial and Legislative Remedies Sought for Unnecessary Duplication

Prior to its appeal of UMUC's program, MSU objected to a number of programs proposed by Maryland institutions based on unnecessary duplication, including a 2005 decision by the Secretary of Higher Education authorizing Towson University (TU) to offer a joint Masters of Business Administration (MBA) with the University of Baltimore (UB). MSU claimed that the new MBA program would unnecessarily duplicate its existing MBA program, leading to further segregation in Baltimore-area universities. In this case, MHEC affirmed the Secretary's decision, allowing the joint MBA program to proceed.

This decision prompted the introduction of legislation during the 2006-2009 legislative sessions to provide a course of appeal for MHEC decisions regarding program duplication, though none of the bills has become law. In 2007 the Attorney General's Office issued an opinion stating that current law does not allow State institutions of higher education to sue one another in circuit court and that judicial review of a commission decision regarding program duplication is expressly denied, though the U.S. Constitution does not prohibit legislation granting a right of judicial review. As a result, legislative action would be required to permit further challenge of the joint MBA or community college leadership decisions.

Though institutions of higher education cannot sue the State or other institutions regarding unnecessary duplication, a group of current and prospective students and alumni of several Maryland HBIs called the Coalition for Equity and Excellence in Maryland Higher Education is suing the State for failure to comply with federal civil rights laws and constitutional obligations, including elimination of unnecessary program duplication. The suit seeks the elimination of several new academic programs at TWIs, including the joint MBA program at TU and UB. The case has since been moved to the U.S. District Court.

An amended complaint was filed on December 31, 2007, against MHEC seeking declaratory and injunctive relief to require the State to honor its obligations under the OCR Partnership Agreement, Title VI of the Civil Rights Act of 1964, the Equal Protection Clause of the Fourteenth Amendment, *United States v. Fordice,* and any other applicable federal and State law. The court granted MHEC's motion for partial summary judgment, eliminating a third count seeking to enforce the OCR Partnership Agreement. The two remaining counts allege violation of Title VI of the Civil Rights Act and of the Fourteenth Amendment. Another preliminary motion filed by the plaintiffs seeking class action status was later withdrawn, though the court granted a request to maintain the option of refiling the motion at a later date. On October 21, 2009, the court granted a plaintiff's motion to amend the complaint to substitute student and alumni plaintiffs for original plaintiffs that dropped out of the suit. The parties are now in the midst of discovery, though no trial date has been set.

Higher Education

Higher Education Investment Fund

During the 2009 legislative session, the General Assembly extended the Higher Education Investment Fund (HEIF) for a second year. Although HEIF created a dedicated stream of funding to higher education, revenues have been lower than projected due to falling corporate income tax receipts. While HEIF was not intended to be the sole source of higher education funding, recent revenue underattainment demonstrates the risk of tying budgets to a sometimes unstable funding source. In order to extend the fund beyond fiscal 2010, legislation will be required in the upcoming session.

HEIF Created in 2007 Special Session

The funding of higher education in Maryland was altered during the 2007 special session. Although the primary source of State funds remained the general fund, the Higher Education Investment Fund (HEIF) was created to provide a dedicated stream of revenue for higher education. The Tax Reform Act of 2007 increased the corporate income tax from 7.0% to 8.25% and stipulated that beginning in fiscal 2009, 6.0% of this new revenue will be directed to HEIF. The legislation specified fiscal 2008 revenue as $16.0 million and fiscal 2009 revenue was projected to be $54.3 million.

A total of $69.5 million was appropriated in fiscal 2009 from HEIF, which included the fiscal 2008 revenues and estimated fiscal 2009 revenues. HEIF monies were used mainly to fund the resident undergraduate tuition freeze and to support expanded enrollment at most public four-year institutions. Grants through the Maryland Higher Education Commission were also funded for workforce development and regional higher education centers.

HEIF Revenues Below Estimates

However, soon after HEIF began operating, Maryland's economy entered a recession and tax revenues fell. By the end of fiscal 2009, corporate tax revenue to HEIF was $9.1 million lower than projected. These funds were withdrawn by the Governor through budget amendment. **Exhibit 1** shows that actual HEIF spending in fiscal 2009 was $60.4 million, exhausting the fund, and fiscal 2010 and 2011 revenue estimates are below the fiscal 2009 level.

Exhibit 1
Higher Education Investment Fund
Fiscal 2008-2011

Fiscal 2008	Actual Appropriation	$16,000,000
Fiscal 2009	Legislative Appropriation*	69,460,299
	Underattainment	-9,102,729
	Actual	60,357,570
Fiscal 2010	Legislative Appropriation	46,532,000
	Underattainment**	-4,197,000
	Working Appropriation**	42,335,000
Fiscal 2011	Estimated Revenue	40,766,000

*Includes use of HEIF fund balance in lieu of general funds authorized by the General Assembly.
**Data as of October 23, 2009

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

HEIF Reauthorized for Fiscal 2010 Amidst Declining Revenues

When approved in 2007, HEIF was to run through the end of fiscal 2009 and be reauthorized through legislation only if the General Assembly found it fiscally prudent to do so. The final report of the Commission to Develop the Maryland Model for Funding Higher Education in December 2008 recommended making HEIF a permanent dedicated funding source for higher education. Authorization to continue HEIF in fiscal 2010 was included in the Budget Financing and Reconciliation Act of 2009, with revenue projected to be $46.5 million.

Similar to fiscal 2009, HEIF funds were used to extend the tuition freeze for a fourth year. Funds were also used to provide operating funding for public four-year institutions. Due to the weakening economy, HEIF funds were used to offset general fund appropriations, freeing money to be spent on other State priorities.

Since the fiscal 2010 budget was adopted by the General Assembly, corporate tax revenues have declined further. To account for this difference, the Governor approved $42.3 million from HEIF by budget amendment to the institutions, $4.2 million below the amount authorized by the General Assembly in the fiscal 2010 budget. The most recent Department of Legislative Services estimate for fiscal 2010 is $40.3 million, a further reduction of $2.0 million. While HEIF was not intended to be the sole source of funding for higher education in Maryland, the recent revenue underattainment demonstrates the risk of tying budgets to a sometimes unstable funding source.

Fiscal 2011 and Beyond

Like fiscal 2009, HEIF's reauthorization for fiscal 2010 was for only one year. The General Assembly will have to again determine if reauthorization of HEIF is prudent for fiscal 2011. If so, legislation must be enacted to extend it for one or more years. Current revenue projections show fiscal 2011 will generate $40.8 million for HEIF, although as the first three years of HEIF indicate, actual results may vary.

Higher Education

Workgroup to Study the University System of Maryland at Hagerstown Submits Recommendations

The workgroup charged with studying the fiscal and programmatic viability of the University System of Maryland at Hagerstown (USMH) has concluded that the center is functioning well because it has an appropriate governance structure and program approval policy and a strong relationship with the surrounding community. The workgroup does not appear to have considered whether any other governance structures or program approval policies might be more beneficial to USMH, however, and a cost-benefit analysis should be conducted before the workgroup's recommendation to expand USMH is considered.

Disparate Per Student Funding Prompts Creation of Workgroup

Regional higher education centers (RHECs) are designed to ensure access to higher education in areas of the State in which students do not have access to undergraduate and graduate programs due to geographical distance, commute time, or the limited capacity of local four-year institutions. During the past two sessions, the budget committees became concerned that the University System of Maryland at Hagerstown (USMH), one of eight RHECs in the State, was receiving a large proportion of State funding compared to the other RHECs. For example, in fiscal 2009, State funds per full-time equivalent student (FTES) were $7,553 at USMH compared to $4,143 at the Universities at Shady Grove, the only other RHEC governed by the University System of Maryland (USM). The other six centers fall under the coordinating responsibility of the Maryland Higher Education Commission (MHEC) and received an average of $918 per FTES in fiscal 2009.

Consequently, the 2008 *Joint Chairmen's Report* required USMH to submit a five-year business plan and the 2009 *Joint Chairmen's Report* required MHEC, in collaboration with USM, to create a workgroup to study the fiscal and programmatic viability of USMH. The workgroup was comprised of State and local elected officials; local business and community leaders; members of the USMH Advisory Board; and representatives from MHEC, USM, Frederick and Hagerstown community colleges, and Kaplan University Hagerstown Campus. The workgroup was charged with considering the most appropriate governance structure for the center, ensuring the financial and programmatic success of the center, increasing local participation, and expanding programmatic offerings to include non-USM programs and institutions. The workgroup held five meetings during the summer and fall of 2009 and submitted its report in early November 2009. The report made four recommendations.

Workgroup Recommendations

The ultimate goal of the workgroup was to make recommendations to improve the immediate and long-term success of the center. The workgroup concluded that the center has the most appropriate governance structure, has a policy for program approval that is working well, and has a strong relationship with the surrounding community, including support from local officials and active relationships with Frederick and Hagerstown community colleges.

1. **The current organizational structure for USMH under USM is the most appropriate governance structure for the center.** While the USM Board of Regents governs USMH at the highest level, the Hagerstown Governing Council (council) provides overall guidance for USMH, including approving the annual budget and policies affecting the academic program inventory. The USMH Advisory Board (board) also provides guidance to ensure that student, business, local and State government, and community needs are met by USMH. The workgroup noted that this governance structure ensures the success of USMH because it provides opportunities for interactions between the council, which is comprised of provosts of partner institutions, and the board, which is comprised of government, education, business, and community representatives.

2. **The location of USMH within the City of Hagerstown has achieved the economic revitalization component of the center's mission.** The workgroup concluded that USMH should continue to work with the City of Hagerstown to provide programs that continue to attract students, businesses, and economic development.

3. **USMH should continue to develop creative scheduling solutions to maximize use of the facility.** This action will reduce reliance on State funding by helping to increase outside support for the center and by utilizing the facility during off-peak times. The workgroup also concluded that when possible, USM should purchase additional space near the center for expansion. The additional space would include larger rooms and meeting spaces and would provide the opportunity to generate additional revenue, which is currently limited due to the small configuration of rooms available at the center.

4. **The current policy regarding USM institutions' right of first refusal to provide programs at USMH is sound.** The workgroup concluded that the USMH policy is consistent with a broader State policy on program approval established by MHEC in 2004. The workgroup stated that USMH should continue to solicit USM institutions to provide programs at the center; however, if there are no USM institutions that are willing or able to provide the program, USM and USMH should work with MHEC to solicit program delivery from non-USM institutions.

Observations on Workgroup Recommendations

The workgroup does not appear to have considered that any other governance structures or program approval policies at USMH might be more beneficial. For example, under the current policy of giving USM institutions the right of first refusal to provide programs at USMH, a USM program might be more expensive to USMH than a non-USM program; however, if the USM institution agrees to offer the program, USMH cannot refuse and offer the program through the non-USM institution instead. For example, Towson University was given the opportunity to offer a nursing program at USMH before the offer could be made to a non-USM institution even though Towson University required USM to pay approximately $500,000 over five years as an incentive to offer the nursing program at USMH. A non-USM institution located closer to Hagerstown might have been able to offer the nursing program without requiring a fee, but the current policy does not provide the flexibility to consider that alternative. Currently, no non-USM programs are offered at USMH.

In addition, the workgroup does not appear to have considered whether the recommendation to expand USMH will actually reduce costs to the State. While the workgroup concluded that purchasing additional space near the center for expansion will help reduce reliance on State funding, it does not appear to have analyzed the increase in revenue compared to the increase in costs associated with the purchase and operation of a second facility. Prior to acting on this recommendation in the future, a cost-benefit analysis should be conducted.

Health and Health Insurance

Update on the Sale of the Prince George's County Health System

A decision is expected shortly on the future of the Prince George's County Health System. A recent decision by Prince George's County not to fully provide fiscal 2010 operating support to the system as required under statute adds another wrinkle to this long-running story.

Prince George's County Hospital Authority

The Prince George's County Hospital Authority was established by Chapter 680 of 2008. The goal of the authority is to transfer the Prince George's County Health Care System to new ownership. The system, which includes Prince George's Hospital Center, Laurel Regional Hospital, Bowie Health Campus, and two nursing homes, is currently owned by Prince George's County and leased to Dimensions Healthcare System (Dimensions) under a long-term master lease agreement. The system serves over 180,000 patients a year, many of whom are indigent and uninsured. Over the past several years, Dimensions has experienced severe financial difficulties and has required substantial financial support from the State and county. Under Chapter 680, an agreement to transfer the system to new ownership was to be reached during the 2009 session. This did not occur.

Early in the 2009 session, the authority recognized the need for a change in its legislative mandate in order to not lose any momentum on the progress that it had made in the prior months. Legislation passed during the 2009 session to extend the time the authority has to complete its mission of transferring the system to new ownership. Chapters 116 and 117 of 2009 authorized an extension of the bidding process and clarified the duration of State and county funding commitments. The legislation also authorized the Maryland Health Care Commission to issue an exemption from certificate of need and waive the requirements of the State health plan in order to facilitate the transfer of the system and directed several State agencies to advise the authority.

State and County Funding of the System

Short-term Interim Financial 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 support from Prince George's County.

Exhibit 1
Prince George's County Health System – State and County Support
Fiscal 2003-2010
($ in Millions)

	State Support		
Fiscal Year	**Operating**	**Capital**	**County Support Tied to State Support**
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
2008	-	-	-
2009	12.0		12.0
2010	12.0		12.0
Total	**$37.3**	**$13.3**	**$62.0**

Note: Funding for fiscal 2009 and 2010 is required under Chapter 680 of 2008; Prince George's County has indicated it will reduce its support by $3 million for fiscal 2010.

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

More recently, Chapter 680 required the State and the county to provide for short-term, interim financial support for Dimensions of $12 million each for fiscal 2009 and 2010 to sustain operations at the system while the authority searched for new ownership. Both the State and the county met their financial obligations under Chapter 680 for fiscal 2009. The State's fiscal 2010 budget includes the $12 million in operating support for the authority and, thus far, the State has met its obligation to make the 2010 payments. However, the county made the first quarter payment but withheld $1 million of the fiscal 2010 second quarter $3 million payment, despite the statutory requirement. The county indicated that the two remaining quarterly payments for fiscal 2010 would also be short by $1 million, which would spread a total $3 million reduction over the remainder of fiscal 2010. Despite major budget cuts throughout State government, there is no indication as yet that the State will not honor its financial obligation for fiscal 2010.

Long-term Funding Agreement

In July 2008, the State and Prince George's County entered into a memorandum of understanding (MOU) regarding long-term funding for the system. As shown in **Exhibit 2**, in total, the agreement provides $174 million in public support to facilitate the transfer of the system to new ownership. This support is scheduled to begin in fiscal 2011.

Exhibit 2
State and County Long-term Funding Agreement
Fiscal 2011-2015
($ in Millions)

	State Support		
Fiscal Year	**Operating**	**Capital**	**County Support**
2011	$15		$15
2012	15	$8	15
2013	15	8	15
2014	15	8	15
2015	15		15
Total	**$75**	**$24**	**$75**

Source: July 2008 Memorandum of Understanding between Prince George's County and the State of Maryland

Neither the State nor the county has indicated any change in its ability to provide this long-term support. However, the failure of the county to provide the full amount of short-term interim funding owed to the system for the second quarter of fiscal 2010 raises the question whether the county will fulfill its obligation under the long-term funding agreement, if the authority is successful in transferring the system. The 2008 MOU between the State and the county provides that if one of the parties ceases to fulfill its funding obligations under the MOU and Chapter 680, the other party will be relieved of its obligation to provide any outstanding support.

Status of the Proposed Sale

As noted in a summary document regarding its charge, the authority acknowledged anticipating "a challenging process given the long-standing financial and management difficulties of the healthcare system, but crisis in the economy and paralysis in credit markets made the situation worse." Despite the challenges, the authority remains focused on the task of transferring the system to new ownership. The authority set a deadline of September 18, 2009, for the submission of final bids for the hospital system.

Since the bid submission deadline, the authority has spent the majority of its meeting time in executive session, reviewing and comparing bids. While no formal announcements have been made, the media reported that Dimensions has submitted a bid to form a new company (under the name NewCo) and acquire the system in partnership with the State medical system to turn the hospitals into academic medical centers. It was also reported that Dimensions was the only entity that expressed intent to keep the system operating collectively. The authority is expected to finalize its recommendations in mid-November.

Conclusion

The Prince George's County Health Care System has been a topic of legislative discussion for at least a decade, with several workgroups having been formed without resolution. It is generally recognized that it is important for the region that the system become a self-sustaining, high quality health system. It remains to be seen if the authority can begin this transformation process by engineering the sale of the system. The authority is currently set to expire on May 22, 2010.

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Health and Health Insurance

Potential Impact of Federal Health Care Reform on Maryland

Federal health reform proposals currently under discussion in Congress could have a significant impact on the availability of health insurance coverage in Maryland and on the State's budget and insurance regulation.

Introduction

Two major health reform proposals are pending in Congress as of December 2009 – the House Leadership bill (*H.R. 3962, Affordable Health Care for America Act*) and the Senate Leadership bill (*H.R. 3590, Patient Protection and Affordable Care Act)*. H.R. 3962 passed the House of Representatives on November 7, 2009. H.R. 3590 was unveiled by Senate Leadership on November 18, 2009. The outcome of the reform debate remains unknown, although passage (and alternatively failure) of reform efforts will likely have a dramatic impact on Maryland. This issue paper will discuss key components of the reform proposals and their potential impact on the State.

Summary of Reform Proposals

Both health reform bills take the same general approach to expanding coverage – increasing Medicaid eligibility, providing for new health insurance markets (called "exchanges"), providing new premium subsidies for lower middle class families, requiring individuals to purchase health insurance, and creating a number of insurance market reforms. However, the House and Senate bills also have significant differences, including the role of states in operating the exchanges and the financing of health reform. **Exhibit 1** summarizes key components of the two bills under consideration.

Exhibit 1
Key Components of Major Federal Health Reform Bills

	House Leadership Bill	Senate Leadership Bill
Medicaid	• Expands Medicaid to 150% FPL, fully financed with federal funds for two years and with 91% FMAP thereafter.	• Expands Medicaid to 133% FPL, fully financed with federal funds for three years and with enhanced FMAP of 30.3% to 32.2% thereafter.
	• CHIP enrollees must obtain coverage through the exchange.	• CHIP remains unchanged. • Enhanced CHIP FMAP of 23% for federal fiscal 2014 through 2019.
Health Care Subsidies and Exchanges	• Creates a national health insurance exchange for individuals and employers.	• Creates state-based exchanges for the individual and small group market.
	• Creates a public option through the exchange (must meet same requirements as private plans).	• Creates a public option to be offered through the state-based exchanges, unless the states opt out through legislation.
		• Creates a program to foster creation of nonprofit, member-run health insurance companies (CO-OPS).
	• Provides premium credits to individuals with incomes up to 400% FPL that purchase insurance through the exchange, which limit premium contributions to between 1.5% and 12.0% of income.	• Provides premium credits to individuals with incomes between 100% and 400% FPL that purchase insurance through the exchanges, which limit premium contributions to between 2% and 9.8% of income.
	• Provides specified small employers with a tax credit of up to 50% of premium costs paid by the employer.	• Provides specified small employers with a tax credit of up to 50% of premium costs paid by the employer.

	House Leadership Bill	Senate Leadership Bill
Private Insurance Reforms	• Requires individuals to purchase insurance or pay a penalty of up to 2.5% of income.	• Requires individuals to purchase insurance or pay a penalty of approximately $750 per individual per year.
	• Requires guaranteed issue and prohibits pre-existing condition exclusions.	• Requires guaranteed issue and prohibits pre-existing condition exclusions.
	• Insurance rating may be based only on age (2:1 ratio), premium rating area, and family enrollment.	• Insurance rating may be based only on age (3:1 ratio), family size, geography, and tobacco use.
	• Limits medical loss ratios.	
Financing	• Income tax surcharge on higher income individuals.	• Excise tax on high cost employer-sponsored health coverage.
	• Excise tax on medical devices.	• Increases the Medicare payroll tax for individuals earning more than $200,000 and families earning more than $250,000.
		• Various fees on pharmaceutical manufacturers, medical device manufacturers, and health insurance providers based on market share.
		• Excise tax on elective cosmetic medical procedures.
	• Savings from system reforms and payment reductions (including to Disproportionate Share Hospital payments and Medicare).	• Savings from system reforms and payment reductions (including to Disproportionate Share Hospital payments and Medicare).
	• Increases Medicaid drug rebates to states.	• Increases Medicaid drug rebates to states.

CHIP: Children’s Health Insurance Program
Exchange: new health insurance market
FMAP: federal medical assistance percentage (federal matching funds)
FPL: federal poverty level

Source: Department of Legislative Services

Medicaid Expansion

The House bill increases Medicaid eligibility for nonelderly individuals to 150% of the federal poverty level (FPL) (see **Exhibit 2**), while the Senate bill increases eligibility to 133% FPL. States are prohibited from reducing eligibility standards for Medicaid or the State Children's Health Insurance Program (SCHIP) below what they were prior to passage. Under both proposals, an additional 112,000 childless adults with incomes up to 116% FPL that are currently eligible for limited benefits under the Maryland Primary Adult Care (PAC) Program could become eligible for full Medicaid benefits. Beyond the existing PAC-eligible population, expanding Medicaid eligibility to 133% FPL, as proposed in the Senate bill, could make an additional 21,000 Marylanders newly eligible for Medicaid. Expansion to 150% FPL, as proposed in the House bill, would expand Medicaid eligibility to an additional 40,500 Marylanders.

Exhibit 2

Selected 2009 Federal Poverty Levels (FPL)

Family Size	133% FPL	150% FPL	200% FPL	300% FPL	400% FPL
1	$12,563	$16,245	$21,660	$32,490	$43,320
2	16,901	21,855	29,140	43,710	58,280
3	21,240	27,465	36,620	54,930	73,240
4	25,578	33,075	44,100	66,150	88,200
5	29,916	38,685	51,580	77,370	103,160

Source: *Federal Register*, Friday, January 23, 2009

Medicaid expenditures in Maryland are typically split 50% federal funds, 50% State funds. The cost of expansion would be supplemented with enhanced federal matching funds (federal medical assistance percentage) (FMAP). Under the House bill, 100% FMAP is provided in federal fiscal 2013 and 2014, with 91.0% FMAP in subsequent years. Under the Senate bill, 100% FMAP is provided in calendar 2014 through 2016. Maryland would receive 80.3% FMAP in calendar 2017, increasing by 1.0% annually to 82.3% FMAP in calendar 2019 and thereafter. The Senate bill also provides enhanced FMAP for MCHP (88.0% vs. 65.0% for federal fiscal 2014 through 2019).

Preliminary estimates by the Department of Legislative Services (DLS) indicate that expanding Medicaid eligibility to 150% FPL in Maryland, as proposed under the House bill, could cost $1.3 to $1.9 billion in federal fiscal 2014, depending on enrollment. New State expenditures would be zero under the first two years (with annual State savings of $69 to $73 million resulting from an enhanced match on current spending in the PAC program, a Medicaid waiver for childless adults with incomes up to 116% FPL). Beyond the initial two-year period, State expenditures would range from $60 to $155 million annually.

Expansion of Medicaid to 133% FPL, as proposed under the Senate bill, could cost $1.2 to $1.7 billion in calendar 2014, depending on enrollment. New State expenditures would be zero under the first three years (with annual State savings of $131 to $145 million resulting from an enhanced match on current PAC spending and additional enhanced match for MCHP). Beginning in calendar 2017, State expenditures would range from$153 to $270 million annually.

These estimates assume that the enhanced FMAP is available for the PAC population. If that enhanced FMAP is not available, State expenditures will increase significantly under both proposals and could range from a low of $495 million to as much as $1.1 billion annually, depending on enrollment.

Additional savings may be available to help fund Maryland's share of the expansion, including those attributable to a reduction in hospital uncompensated care, the eventual elimination of the Maryland Health Insurance Plan (MHIP), and increased Medicaid prescription drug rebates.

Regarding MCHP, the House bill eliminates the federal Children's Health Insurance Program and instead requires enrollees to obtain coverage through the exchange, while the Senate bill does not alter the current MCHP program.

DLS also notes that the House bill includes a provision that extends enhanced FMAP for existing Medicaid expenditures currently provided under the American Recovery and Reinvestment Act of 2009 for an additional six months. This provision is estimated to provide $384 million in additional federal matching funds (and a corresponding reduction in required State funding) to Maryland in fiscal 2011. The Senate bill does not include this provision.

Health Care Subsidies for Individuals and Small Businesses

Both the House and Senate bills provide subsidies for health insurance premiums and out-of-pocket costs for individuals and families with incomes up to 400% FPL. In addition, the proposals provide tax credits for small employers. The proposals differ in how the subsidies are structured and in the eligibility requirements for the small employer tax credits.

As many as 300,000 currently uninsured Marylanders may be eligible for a subsidy based on family income. Some of these individuals will be ineligible based on their citizenship status, while others could gain access to employer-based coverage under the reform legislation (and would be ineligible unless the cost of the coverage exceeds a certain percentage of income).

Under both the House and Senate bills, in general, employers with 25 or fewer workers and an average wage of less than $40,000 would be eligible for a tax credit. Maryland has approximately 82,144 businesses with fewer than 25 employees. The average wage of these businesses is unknown, but in 2007, the average annual wage for all businesses statewide was $48,239.

Maryland's Health Insurance Partnership program, established by Chapter 7 of the 2007 special session, provides a State subsidy for health insurance to small businesses with two to nine employees and an average annual wage under $50,000. While the federal bills would offer tax credits to all small businesses, including those that already offer insurance to their employees, the partnership program is limited to small businesses that have not previously offered insurance. Should any final reform package include tax credits for small businesses, the General Assembly will need to consider whether or not to continue the partnership program.

Health Insurance Exchanges

Both reform bills provide for establishment of a health insurance exchange, where individuals and small employers could compare plans, purchase health insurance, and if eligible, obtain a subsidy. The House bill creates a national health insurance exchange, while the Senate bill creates state-based exchanges.

One of the more controversial aspects of health care reform is the creation of a public option that would compete with private insurance plans and be offered through an exchange. The House bill creates a public option that must meet the same requirements as private plans as far as benefit levels, provider networks, consumer protections, and cost-sharing. The public option under the House bill would be required to pay hospital rates in accordance with the State's hospital all-payor system. The Senate bill creates a community health insurance option that must meet the same requirements as private plans. States may opt out by enacting a law to do so. The Senate bill also creates the Consumer Operated and Oriented Plan (CO-OP) program to foster the creation of nonprofit, member-run health insurance companies in each state. Under both the House and Senate bills, the government would negotiate rates with health care providers, much as private health plans do.

State responsibilities with regard to a health insurance exchange would vary, depending on whether the exchange is national or state-based. Under a national exchange, the State would primarily monitor and enforce insurer compliance with federal rules. Under a state-based exchange, state responsibilities could be as modest as setting up a web site where consumers could compare products or as complex as determining which insurers may participate, negotiating prices with insurers, enrolling participants in the exchange and assisting them in selecting an appropriate plan, and measuring insurer performance. The Senate bill requires the Secretary of Health and Human Services to consult with the National Association of Insurance Commissioners in adopting regulations for the establishment and operation of state-based exchanges.

Maryland has some experience with exchange-type functions in the State Employee and Retiree Health and Welfare Benefits Program (the State health plan), the Medicaid HealthChoice managed care program, and MHIP.

Other Insurance Reforms

Changes to Individual and Small Group Health Insurance Regulation

Both reform proposals would significantly change the way individual and small group health insurance is regulated. Each bill requires insurance companies to issue insurance to anyone that will pay for it in the individual and small group markets, and prohibits pre-existing condition exclusions. Each bill also sets insurance rating rules that would be the same for the individual and small group markets, with limits on how plans may rate based on age and geography. The Senate leadership bill also allows plans to rate on tobacco use.

Changes to regulation of the individual and small group markets would require changes to State law. Currently, the State generally allows medical underwriting and pre-existing condition exclusions in the individual market. Chapters 577 and 578 of 2009 also allow limited pre-existing condition exclusions in the small group market beginning in 2009 and health underwriting under specified circumstances beginning in July 2010.

Individual Responsibility

In exchange for these insurance market reforms, the bills require individuals to purchase health insurance to ensure that young and healthy lives are in the insurance pool. The bills have varying penalties for not purchasing insurance – the Senate leadership bill has penalties of $750 per individual per year, while the House bill has a penalty of up to 2.5% of income.

Employer Responsibility

Each bill also has some type of "employer responsibility" requirement. The House bill requires employers to offer coverage to their employees and contribute at least 72.5% of the premium cost for single coverage and 65.0% of the premium cost for family coverage of the lowest cost plan that meets the essential benefits package requirements, or pay 8.0% of payroll into a Health Insurance Exchange Trust Fund. Specified small employers would pay either no assessment or a reduced assessment. The Senate bill requires employers with more than 50 full-time employees that do not offer coverage to their employees and have a full-time employee that receives a health insurance subsidy to pay $750 per full time employee. The Senate bill also requires employers with more than 50 employees that do offer coverage but have at least one full-time employee receiving a health insurance subsidy to pay the lesser of $3000 for each employee receiving a tax credit or $750 for each full-time employee.

Impact on the Maryland Health Insurance Plan

Changes in insurance regulation under the reform proposals would eventually eliminate the need for MHIP, the State's high-risk pool. MHIP provides coverage mainly for individuals who cannot obtain individual insurance due to their medical history and do not have access to other coverage. The reform proposals would eventually prohibit denial of health insurance based on medical history and pre-existing condition exclusions and prohibit policy rating based on health factors, therefore providing access to health insurance for most individuals and eliminating the need for MHIP. MHIP is financed primarily with an assessment on hospital rates valued at $111 million in fiscal 2009. This assessment would no longer be necessary and could potentially be redirected to other needs, such as the State's share of Medicaid expansion costs.

However, changes to MHIP may not be needed immediately upon enactment of one of the federal reform proposals. Both the House and Senate bills include $5 billion in funding for high-risk pools to be immediately implemented until the various insurance reforms contained in the bills take effect.

Financing

The reform proposals are financed with a combination of new revenues and savings from alterations to the current health care system. The major revenue sources proposed – an income tax surcharge on high income earners and a 2.5% tax on the sale of medical devices under the House bill and an excise tax on high cost employer-sponsored health coverage, an increase in the Medicare payroll tax, and a 5% excise tax on elective cosmetic surgery under the Senate bill – differ substantially in both application and revenues raised.

Under the House bill, individuals with modified adjusted gross income (MAGI) over $500,000 and families with MAGI over $1.0 million would be subject to a 5.4% income tax surcharge. According to tax year 2006 data, such a surcharge would apply to approximately 2,374 single returns and 6,268 joint returns filed by Maryland residents (out of a total of 2.5 million returns filed).

Under the Senate bill, beginning in calendar 2013, an excise tax would be levied at a rate of 40% of the aggregate value of employer-sponsored insurance that exceeds a defined threshold ($8,500 for an individual policy and $23,000 for a family policy in 2013, indexed annually for inflation, with higher thresholds provided for retirees and employees in high-risk professions). The aggregate value of insurance includes premiums for medical, dental, vision, and prescription coverage, as well as contributions to flexible spending accounts, health reimbursement accounts, and health savings accounts. The tax applies to self-insured plans and plans sold in the group market but not to plans sold in the individual market (except for coverage eligible for the deduction for self-employed individuals).

According to the Department of Budget and Management, the excise tax will result in tax liability for the State with respect to the State health plan, the amount of which cannot be determined at this time. For illustrative purposes, the most popular combination of plans for State employees in fiscal 2010 is valued at $10,843 for individual coverage and $21,746 for family coverage. The aggregate value of these plans is expected to rise by approximately 5% annually by 2013. Some relief will be provided to the 17 states with the highest cost employer-sponsored insurance during the first three years of the tax; however, it is unknown whether Maryland will qualify.

Both bills rely on Medicare system reforms and payment reductions to help offset the costs of additional coverage. While the bills do not specify precisely how these savings will be achieved, it is assumed that some amount will come from hospitals. As Maryland's all-payor hospital rate-setting system depends on keeping the rate of growth in Medicare payments to Maryland hospitals below the national average rate of growth, the State may need to examine new ways of constraining hospital costs.

Conclusion

There is still much work to be done by Congress to achieve final passage of a health reform package. Depending on the outcome, a combination of expansion of Medicaid eligibility, an individual mandate, market reforms, premium subsidies, and tax credits for small businesses could significantly expand access to health insurance in the State. A reform package could also generate State savings from a reduction in hospital uncompensated care, the elimination of MHIP, and an increase in Medicaid prescription drug rebates. However, health care reform will have potentially significant fiscal implications for Maryland, particularly the State's share of expanding Medicaid and tax liability for the State health plan under an excise tax on high value insurance plans.

Alternatively, it should be noted that there are potential economic implications for the State in the absence of federal reforms. According to the Urban Institute, for example, if federal reforms are not enacted and there continues to be slow growth in incomes and continuing high health care inflation, by 2019 the number of uninsured Marylanders could increase by as much as 25%, the rate of employer-sponsored insurance could fall by as much as 10%, employer premium spending could increase by as much as 117%, Medicaid and MCHP expenditures could rise by as much as 116%, and the amount of uncompensated care could more than double.

Health and Health Insurance

Update on Medicaid Population and Financing Trends

Due to the economic downturn, the Medical Assistance Programs experienced significant enrollment growth in fiscal 2009, and enrollment growth is estimated to exceed traditional levels in fiscal 2010 and 2011. Enhanced federal matching funds provided through the American Reinvestment and Recovery Act of 2009 will assist with the cost of the increased enrollment in fiscal 2010. However, the enhanced matching is currently scheduled to end halfway through fiscal 2011. The loss of the enhanced match and one-time special fund sources are expected to increase the general fund portion of Medicaid funding by $672.3 million or 37.3% in fiscal 2011.

Overview

Maryland's Medical Assistance Programs (Medicaid, Maryland Children's Health Program (MCHP), Primary Adult Care, Employed Individuals with Disabilities, etc.) provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50% for Medicaid and 65.0% for MCHP. The federal matching rate has been temporarily increased by the American Recovery and Reinvestment Act of 2009 (ARRA) to 61.6%.

The Medical Assistance Programs accounted for 13.6% of fiscal 2009 general fund expenditures and is one of the fastest growing segments of the State budget. Over the next five years, general fund expenditures for Medical Assistance Programs are expected to rise at a rate of about 15.1% annually compared to expected general fund revenue growth of 5.1%. However, in fiscal 2011 and 2012, general fund expenditures for the Medical Assistance Programs are expected to increase 37.3% and 20.7% for the reasons outlined below.

Fiscal 2010 Outlook

The fiscal 2010 Medical Assistance working appropriation of $5.6 billion ($1.5 billion in general funds) appears to be $513.6 million ($144.8 million in general funds) below anticipated need. This need for additional fiscal 2010 funding is attributed to:

- anticipated budget amendments bringing various special and federal funds into the fiscal 2010 working appropriation due to Budget Reconciliation and Financing Act of 2009 provisions and Board of Public Works July and August reductions, which will increase special funds by $109.0 million and federal funds by $75.0 million;

- Medicaid expansion to parents. Throughout fiscal 2009, the enrollment for the new Medicaid expansion to parents continued to exceed the estimates, and the enrollees were more expensive than anticipated. Together, this amounts to an increase in estimated fiscal 2010 expenditures for the Medicaid expansion to parents of $96.8 million;

- higher than expected enrollment growth. Fiscal 2009 enrollment was higher than expected during the 2009 legislative session which translates into a $90.8 million increase;

- a 5.9% calendar 2010 managed care rate increase ($80.8 million);

- MCHP enrollment is expected to be higher than originally anticipated, increasing expenditures by $20.0 million; and

- the inclusion of substance abuse benefits for the Primary Adult Care program ($6.6 million).

Expenditures for fiscal 2010 services are expected to exceed fiscal 2009 costs by about 9.9% due to medical inflation (4.0%) and enrollment growth (5.5%).

Fiscal 2011 Forecast

As shown in **Exhibit 1**, in fiscal 2011, the expenditures for Medical Care Programs are estimated to be just over $6.2 billion, which is 6.7% over the fiscal 2010 estimate. Factors contributing to the anticipated expenditure growth include enrollment increases of almost 3.3% and changes in medical inflation/utilization (5.0%).

Indeed, the major budgetary change between fiscal 2010 and 2011 is the fund split for the Medical Care Programs, with general fund need expected to grow by $672.3 million or 37.3% over fiscal 2010. Specifically, the fiscal 2010 working appropriation includes special and federal funds that are not expected to be available to fund Medicaid in fiscal 2011. Additional federal funds are available in fiscal 2010 due to the American Recovery and Reinvestment Act of 2009 that provides states with an enhanced federal matching rate for the Medicaid program from October 2008 through December 2010. The loss of the enhanced ARRA match, currently scheduled to end in the middle of fiscal 2011, will increase the general fund need by $354.6 million. It should be noted that amongst the provisions in the health care reform proposals now under consideration by Congress (as of November 2009) is one to extend the enhanced federal matching rate for six months.

Exhibit 1
Enrollment and Service Year Expenditures
Fiscal 2009-2011

Enrollment by Category	FY 2009 Actual	FY 2010 Estimate	FY 2011 Estimate	FY 10-11 % Change
Medicaid	564,637	598,991	618,264	3.22%
Maryland Children's Health Program	108,504	110,428	112,349	1.74%
Medicaid Expansion to Parents	44,209	47,746	51,566	8.00%
Total	**717,350**	**757,165**	**782,179**	**3.30%**
Cost per Enrollee	**$7,372**	**$7,686**	**$7,941**	**3.31%**
Total Funds ($ in Millions)	**$5,289**	**$5,820**	**$6,211**	**6.72%**

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

Source: Department of Legislative Services

Special funds from various fund balances or budget reductions in other State programs have been directed to the Medical Care Programs in fiscal 2010 to reduce the general fund need. However, it is also anticipated that these special funds will no longer be available to reduce the general fund need of the Medical Care Programs Administration after fiscal 2010, which is expected to increase general funds by $193.9 million.

In developing the fiscal 2011 forecast, rate increases to the following providers are also assumed:

- managed care organizations (5.1% increase amounting to $148.4 million);
- nursing homes (2.0% increase amounting to $21.4 million);
- physicians and dentists (2.0% increase amounting to $10.4 million); and
- community providers (2.0% increase amounting to $5.9 million).

Health and Health Insurance

Pandemic Flu Preparation

Maryland, along with the rest of the country, is dealing with continued influenza activity related to the Type A (H1N1) influenza. The Governor signed an executive order Declaration of Emergency for Influenza Response and Mitigation on May 1, 2009, and the President of the United States declared the H1N1 influenza a national emergency on October 24, 2009.

Background

A new influenza virus causing illness in people emerged late-March 2009 in Mexico, and this new virus is the Type A (H1N1) 2009 influenza virus, formerly called the "swine" flu. The Maryland Laboratories Administration identified the first few H1N1 influenza cases in Maryland on April 29, 2009, and the Governor signed an executive order Declaration of Emergency for Influenza Response and Mitigation on May 1, 2009.

The United States is currently in the middle of the second wave of the H1N1 influenza. The first wave of H1N1 influenza hit its highest point at the end of June 2009. While the number of cases decreased in July and August, H1N1 influenza was still present throughout the summer months, which is abnormal because influenza generally has a low transmission rate in the hot and humid days of summer.

In early September, Maryland (along with the rest of the country) began to experience the second wave of the H1N1 influenza. At the present time, the H1N1 activity in Maryland is considered "widespread," which according to the Centers for Disease Control (CDC), is the highest level for influenza activity. Specifically, "widespread" means increased influenza cases and/or institutional outbreaks of respiratory disease reported in at least half of the regions in the State, and there should be recent evidence of lab-confirmed influenza in the affected regions. Maryland has been at the "widespread" level since the week ending September 5, 2009, and as of the week ending October 17, 2009, 45 other states were also at the "widespread" level. The White House declared a national emergency on October 24, 2009, which was designed to give hospitals the flexibility to move patients to satellite facilities if they are overwhelmed in dealing with an H1N1 influenza outbreak.

In Maryland, as of October 29, 12 people had died from the H1N1 virus: 2 children, 10 adults, and 4 of the 12 did not have any underlying health problems.

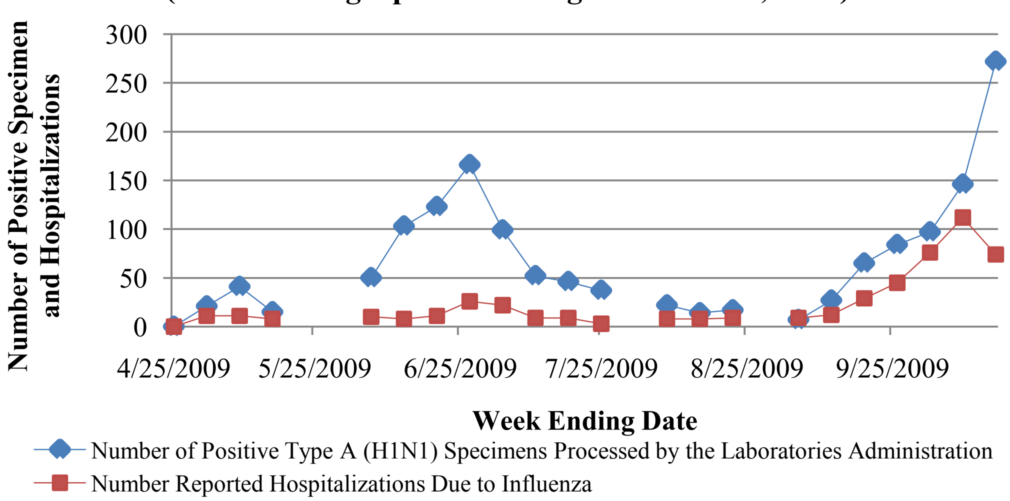
The weekly counts of the number of laboratory tests testing positive for the H1N1 virus from the week ending April 25 through the week ending October 17, 2009, are shown in

Exhibit 1. The exhibit also shows the weekly number of influenza-related hospitalizations over the same time period.

The Department of Health and Mental Hygiene (DHMH) is monitoring the H1N1 influenza with surveillance data from a variety of sources, such as laboratories, outpatient sentinel providers, the Maryland Resident Influenza Tracking Survey, the Electronic Surveillance System for the Early Notification of Community-based Epidemics (ESSENCE), outbreak investigations, the Emerging Infections Program, and the Facility Resource Emergency Database.

In fact, with the outbreak of the H1N1 influenza, DHMH was able to get all of the 46 acute-care hospitals to voluntarily agree to participate in the ESSENCE tracking system. Specifically, hospitals in the State will collect and transmit symptom data, stripped of all patient identifiers, to DHMH where it will then be tested and analyzed. The data can then be compared against other public health databases that track information such as hospital admissions, lab results, patient transport information, and mandatory physician disease reporting. Maryland's ESSENCE system also monitors retail sales of over-the-counter medications at 280 pharmacies throughout the State to help capture data on individuals not seeking emergency care for their symptoms.

Exhibit 1
Number of Positive H1N1 Lab Tests and Influenza-related Hospitalizations Since the H1N1 Flu Arrived in Maryland
(Week Ending April 25 through October 17, 2009)



Note: The Department of Health and Mental Hygiene was unable to provide the Department of Legislative Services with weekly data for the weeks ending May 23, May 30, August 1, and August 29.

Source: Department of Health and Mental Hygiene

H1N1 Vaccine

Federal Public Health Campaign

On September 15, 2009, four influenza vaccine manufacturers received approval from the Food and Drug Administration for use of H1N1 influenza vaccines for the prevention of influenza caused by the 2009 pandemic H1N1 virus. The United States federal government has procured a total of 250 million doses of H1N1 influenza vaccine from these manufacturers for its H1N1 vaccination campaign. The vaccine is being made available as it is produced, so initially it has been available only in limited quantities. Allocations are made in proportion to a jurisdiction's population. The goal of the H1N1 vaccination campaign is to make the H1N1 vaccine available to all Americans. The federal government expects that there will be enough H1N1 influenza vaccine for anyone who chooses to get vaccinated. This is solely a public health vaccination campaign, in that the vaccine is not being sold through commercial channels. Because the federal government is providing the vaccine, there is no charge for the vaccine itself, but a program or provider may charge an administration fee, which generally ranges from $10 to $20.

Target Populations

CDC is recommending that initial administration of the H1N1 influenza vaccine go to people in certain target groups:

- pregnant women (78,000 in Maryland);
- people who live with or provide care for infants younger than 6 months (*e.g.*, parents, siblings, and day care providers) (80,000 in Maryland);
- health care and emergency medical services personnel (187,000 in Maryland);
- people 6 months through 24 years of age (1,825,000 in Maryland); and
- people 25 through 64 years of age who have certain medical conditions that put them at higher risk for influenza-related complications (800,000 in Maryland).

Maryland's total target population is 2,970,000. Because the vaccine is voluntary, not all individuals in the target population will ultimately be vaccinated, despite recommendations from CDC.

CDC has stated that once the demand for vaccine for these target populations has been met at the local level, programs and providers should begin vaccinating everyone from ages 25 through 64 years. Current studies indicate the risk for infection of the H1N1 virus among persons age 65 or older is less than the risk for younger age groups. Therefore, as vaccine supply and demand for vaccine among younger age groups is being met, programs and providers should offer vaccination to people over the age of 65.

Vaccine Formulations

Similar to the seasonal flu vaccine, the H1N1 influenza vaccine comes in two formulations: inactivated vaccine (injectable) and live, attenuated vaccine (the nasal spray vaccine). The inactivated vaccine has killed virus in it and is injected into the muscle, like the annual flu shot. The live, attenuated (weakened) vaccine is sprayed into the nose and is licensed only for people from 2 through 49 years of age who are not pregnant and do not have certain health conditions. Children 0-9 years of age should get two doses of the vaccine, about a month apart. Everyone else needs only one dose.

State and Local Vaccination Campaigns

In mid-October, approximately 2,000 providers, including local health departments, hospitals, clinics, and private providers were registered with DHMH to receive the H1N1 flu vaccine, with 1,000 still waiting to be registered. DHMH has ordered the maximum number of vaccine doses available to the State, and it is arriving in stages, with target populations receiving priority to be vaccinated.

Maryland's vaccination campaign is designed as a public-private partnership that includes local health departments, hospitals, community health centers, physicians, pharmacists, schools, other State agencies, and health insurance companies. For Maryland, the H1N1 influenza vaccine is being distributed solely through DHMH. Each local health department has flexibility in determining its plan for administering the vaccine.

Since the H1N1 influenza outbreak in the spring, local health departments have been working closely with DHMH to plan and respond to the H1N1 virus. It has been a critical component of pandemic preparedness that local health departments and the State coordinate messages, vaccine needs, and personnel issues. Because of the rapidly changing nature of the H1N1 situation, local health departments have had to continually modify their plans for vaccination in response to supply delays and have been challenged in their communications to the public.

Significant Supply Delays

Early estimates of the production of the vaccine have turned out to be overly optimistic. It was reported that Maryland would receive only about half of the amount of the H1N1 influenza vaccine that CDC had initially informed Maryland it could expect in October, as supply dwindled nationwide. DHMH originally expected about 1 million doses of vaccine to be delivered by the end of October. Delay in production of the vaccine saw that projected number drop to 530,000. According to CDC, as of mid-October, the State had only received 229,800 doses of the H1N1 influenza vaccine.

Maryland is still receiving both the injectable and the nasal spray form of the vaccine and sending it to doctors, clinics, and local health departments so it can reach target populations. DHMH reported that it is promptly ordering every dose that is available to Maryland to be shipped out to hospitals, health departments, and physicians. CDC says manufacturers are working as quickly as possible to make more vaccine, while admitting that at present, demand is far exceeding the supply. A potential public health concern is that the epidemic will reach unmanageable proportions before health officials can catch up on the distribution of the vaccine.

Antiviral Treatments

Influenza antiviral drugs are prescription drugs (pill, liquid, or inhaler) that reduce the severity and duration of influenza illness and can reduce the risk of influenza-related complications, including severe illness and death. CDC notes that most healthy people seem to be recovering from the H1N1 influenza without the aid of the antiviral medication. However, the antiviral medication is recommended for use in people with underlying health conditions, pregnant women, and people requiring hospitalization.

Antiviral medications are available in the private sector at a pharmacy with a prescription from a physician, but the State also has a stockpile of antiviral treatments. The federal government has encouraged states to stockpile enough antiviral treatments to cover approximately 25% of each state's population and has assisted in meeting this goal by subsidizing the cost of the treatment. Maryland has successfully purchased all of the antiviral treatments offered at the federally subsidized price, which means there are roughly 580,000 antiviral treatments in the State's stockpile. Also, during the summer, the federal government provided additional antiviral treatments to states for their stockpile in response to the outbreak of the H1N1 influenza.

Tamiflu and Relenza are the two antiviral treatments being recommended in association with H1N1 influenza. Tamiflu is approved for use in children age one and older, while Relenza is only approved for ages seven and older. Nationally, stockpiles and commercial supplies of Tamiflu in the pediatric doses are limited, and in Maryland, commercial supply of the pediatric doses of Tamiflu is currently dwindling. In the absence of the pediatric doses, there is another option to meet the need for a pediatric prescription of Tamiflu: adult dose capsules can be compounded by a pharmacist to create a pediatric formulation. However, pharmacists have been reticent to compound the adult capsules. DHMH released 2,800 pediatric doses from the stockpile and sent 1,400 to pharmacies and 1,400 to local health departments and federally qualified health centers to ease pediatric treatment supply issues. Recently, a major statewide pharmacy has promised to compound the adult capsules of Tamiflu to pediatric doses when necessary.

DHMH Communication Efforts

Since the first outbreak of the H1N1 virus in April 2009, DHMH has been constantly working on enhancing its communication efforts. Maryland has a dedicated H1N1 web site and has set up a toll-free flu hotline to provide information and answer questions about the illness. In addition, DHMH has established a Speaker's Bureau, in conjunction with local health departments, to handle the considerable volume of requests for speaking engagements on H1N1. DHMH is also coordinating with the Office of Minority Health and Health Disparities to utilize an infrastructure network that is already established under the Minority Outreach and Technical Assistance grant program to provide outreach to communities on the H1N1 vaccine. DHMH regularly communicates with federal, State, and local officials; licensed physicians and nurses; school officials; emergency management officials; large employers; nonprofits; universities; hospitals; and federally qualified health centers. As a vehicle to primarily update providers regarding the H1N1 situation, DHMH, in collaboration with the Johns Hopkins Bloomberg School of Public Health, coordinated a web cast entitled "H1N1 Disease and Vaccine in Maryland Update – What Healthcare Providers Need to Know." Links to the web casts are posted on DHMH's H1N1 web site.

Funding

Federal funding from CDC has been provided to states to upgrade H1N1 influenza preparedness and response capacity. These Public Health Emergency Response (PHER) grants were appropriated by Congress in June 2009, and the funding is being distributed in phases.

Phase I of the PHER grant is intended to help states assess their current capabilities in pandemic influenza response and to address remaining gaps in two focus areas. The first focus area relates to vaccination, antiviral distribution/dispensing and administration, and community mitigation activities. The second focus area is laboratory, epidemiology, and surveillance activities. Maryland received $4.8 million under Phase I of the PHER grant.

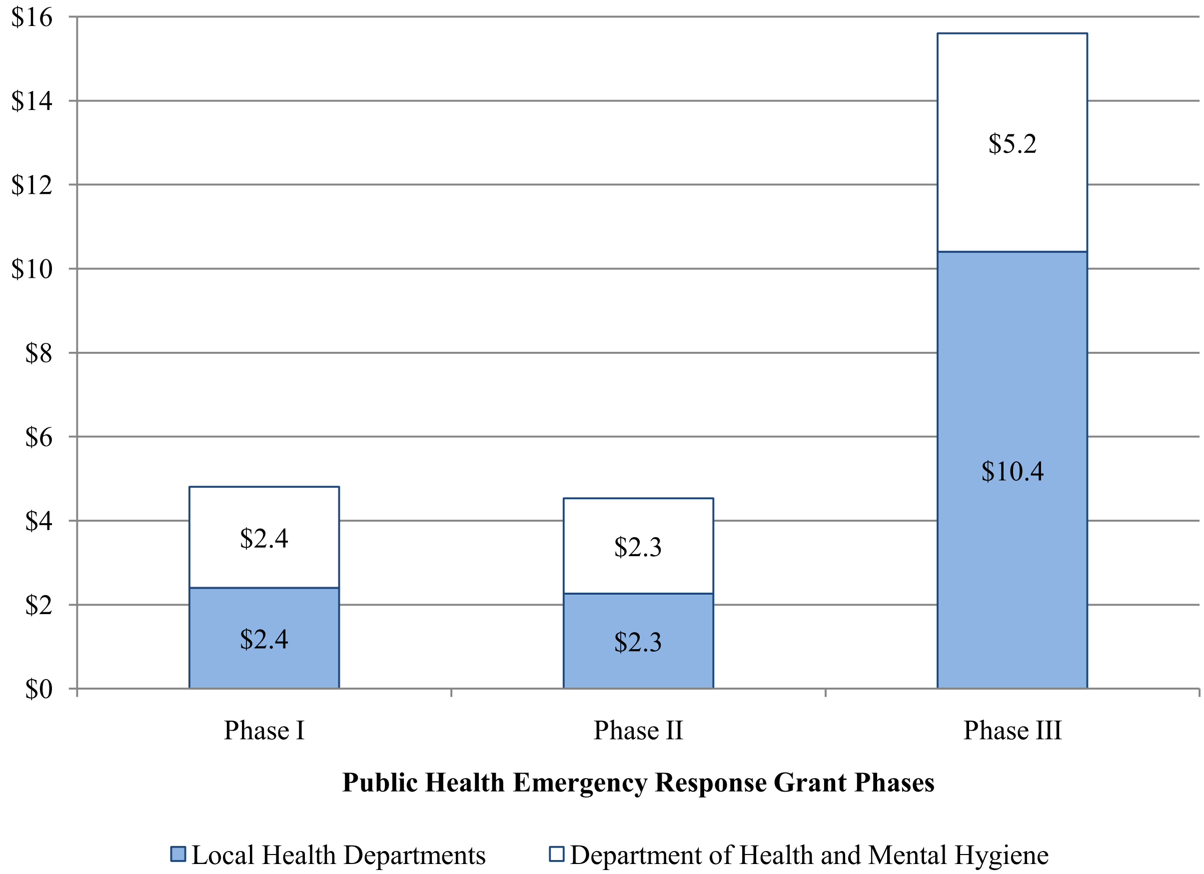
PHER Phase II funding has been awarded to supplement the Phase I funding, and the grant is intended to provide additional resources to states to accelerate mass vaccination planning and implementation preparedness activities. Phase II funding may also be used for vaccine delivery, vaccine administration, and related communications planning and implementation. Maryland received $4.5 million in PHER Phase II funding.

The Phase III funding has been provided to assist with the implementation of the H1N1 influenza mass vaccination campaign. Maryland received $15.6 million for Phase III of the PHER grant.

As shown in **Exhibit 2,** the department is sending 50% of the Phase I and II funding to the local health departments, and two-thirds of the Phase III funding will go to the local health departments. The remaining funding will stay at DHMH to fund the department's activities.

This fund-split benefitting the local health departments comes at a time when they are planning and responding to a public health emergency at the same time as facing substantial budget cuts. For example, in August 2009, the Board of Public Works reduced funding to the local health departments by $20.1 million or 35%.

Exhibit 2
Public Health Emergency Response Funding by Phase
($ in Millions)



Source: Department of Health and Mental Hygiene

Health and Health Insurance

Health Information Technology

Federal Health Information Technology for Economic and Clinical Health Act funding has spurred State actions to implement health information technology.

Broad use of health information technology has the potential to improve health care quality, prevent medical errors, increase efficiency, reduce unnecessary health care costs, decrease paperwork, expand access to affordable care, and improve population health. Despite this potential, the health care sector has lagged in adopting information technology, primarily due to lack of funds.

Federal HITECH Act

The Health Information Technology for Economic and Clinical Health Act (HITECH Act) provisions of the American Recovery and Reinvestment Act of 2009 addressed the funding problem through an infusion of $19 billion in grants and loans for infrastructure and incentive payments to encourage adoption of health information technology.

Under the HITECH Act, approximately $17 billion in Medicare and Medicaid incentive payments is available over five years to health care providers for adoption and meaningful use of electronic health record technology. Eligible physicians and other health care professionals may receive as much as $44,000 in incentive payments under Medicare and $64,000 under Medicaid. Hospitals are eligible to receive a minimum of $2 million. Incentives will be replaced with penalties for those eligible professionals who are not using certified electronic health records by calendar 2015. The federal Department of Health and Human Services is required to adopt standards for the incentive payments and is expected to do so by the end of calendar 2009.

The Medicaid incentive payments are to be administered by the states and are 100% federally funded. States are eligible for a 90% federal match for planning activities and administration of the incentive payments. As of late October, the Department of Health and Mental Hygiene (DHMH) had not yet submitted a request for planning funds but was working on a survey of providers to better understand the scope of Medicaid incentive payments.

In addition to money for incentive payments, the HITECH Act also provides approximately $2 billion in grants and loans to strengthen the health information technology infrastructure.

Maryland Response – 2009 Legislation

Building on the momentum created by the HITECH Act, Chapter 689 of 2009 establishes complementary provisions for health information technology at the State level. The legislation requires the Maryland Health Care Commission (MHCC) and the Health Services Cost Review Commission (HSCRC) to designate a State health information exchange by October 1, 2009. A health information exchange provides the capability for physicians, hospitals, and other health care providers to electronically share clinical information, even if their electronic health records systems are different.

By various deadlines, MHCC also must adopt regulations requiring "state-regulated payors" (*i.e.*, health insurance carriers and the State Employee and Retiree Health and Welfare Benefits Program) to provide incentives to providers to promote the adoption and meaningful use of electronic health records. Additionally, MHCC must designate one or more management service organizations to offer electronic health record services.

Beginning the later of January 1, 2015, or the date established for the imposition of penalties under the HITECH Act, each provider using an electronic health record that seeks payment from a state-regulated payor must use electronic health records that are certified by a national certification organization designated by MHCC and capable of connecting to and exchanging data with the State health information exchange. State-regulated payors may reduce payments to health care providers for noncompliance with these requirements.

Status of Health Information Technology in the State

According to MHCC, about 20% of health care practitioners and 77% of hospitals use an electronic health record. While some limited sharing of information from the electronic health records is occurring among health care providers, a statewide system is just getting underway. Recent developments include the following:

CMS Demonstration Project: Maryland is one of four states selected for a five-year Centers for Medicare and Medicaid Services (CMS) demonstration project to help primary care physicians adopt electronic health records. Beginning in June 2009, CMS is providing a modest initial payment and future incentives based on clinical performance for up to 200 physician practices. A solo practice can earn up to \$58,000 and a larger practice approximately \$290,000 over the five-year period.

Health Information Exchange: In August 2009, MHCC selected the Chesapeake Regional Information System for our Patients (CRISP), a nonprofit collaborative effort among the Johns Hopkins Health System, MedStar Health, University of Maryland Medical System, Erickson Retirement Communities, and Erickson Foundation, to implement a health information exchange statewide. HSCRC is providing funding of \$10 million from the hospital rate system over four years for implementation of the exchange. In October 2009, MHCC also submitted a request to the Office of the National Coordinator for Health Information Technology for a cooperative agreement grant of \$9.4 million in federal HITECH Act funding for the exchange.

Planned capabilities of the health information exchange include e-prescribing, electronic clinical laboratory ordering and results delivery, electronic public health reporting, quality reporting, medication history, electronic eligibility and claims transactions, and clinical summary exchange. The exchange will maintain confidential health care data at the participating providers, with consumers controlling the use of their information. The exchange will serve as a roadmap for properly routing information to the appropriate location and will not be a centralized data bank.

Regional Technology Extension Center: CRISP, in collaboration with MHCC, will submit an application by November 3, 2009, for federal HITECH Act funding to establish a regional technology extension center for the State. Under the grant, CRISP would assist providers in becoming meaningful users of certified electronic health record technology, in accordance with requirements for HITECH Act incentive funding.

Medicaid Management Information System: DHMH is in the preliminary stages of updating the Medicaid Management Information System (MMIS), which is the claims processing and information retrieval system for the Medical Assistance Program. The department submitted an advanced planning document to CMS early in the summer of 2009 and, as of October, is still awaiting approval. The next stage is to develop a request for proposals to design the new system. The new MMIS will interface with the statewide health information exchange. Full implementation is not expected until 2013.

Possible Issues

As the State moves forward with development of a statewide health information exchange and promotion of electronic health records, possible issues include:

- the types and level of incentives required of state-regulated payors in the MHCC regulations adopted in accordance with Chapter 689;

- how those incentives will mesh with federal incentive payments, as well as incentives already offered by individual carriers;

- the ability of providers, particularly in rural areas of the State without broadband access, to meet the ambitious timeline for federal incentive payments and avoid penalties;

- privacy and security concerns of patients and health care providers; and

- the extent to which health information technology will actually live up to its potential to improve quality of care and reduce inefficiency in the health care system.

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Health and Health Insurance

Marketing to Physicians

Nine states and the District of Columbia have enacted legislation regulating the marketing of prescription drugs and medical devices. One of the arguments in favor of this type of regulation is that these marketing efforts can drive up the cost of health care. Opponents of regulation cite the informational value health care professionals receive from marketing efforts.

Background

The pharmaceutical industry, like other health industry businesses, utilizes a variety of marketing strategies. While much of the marketing is directed at health care consumers, companies also market products directly to health care providers. The marketing of prescription drugs to physicians, or "drug detailing," employs about 90,000 drug representatives and costs the pharmaceutical industry about $23 billion a year according to a recent article in *Governing*.

While the industry contends that drug representatives play a valuable role in educating busy doctors about new medications, critics argue that drug detailing encourages physicians to prescribe new, more expensive medications over more tested and cheaper generic alternatives. A key component of drug detailing is the distribution of drug samples to physicians, which accounts for $15 billion of the industry's $23 billion drug detailing budget. Critics argue that samples in particular significantly increase prescription drug costs by enticing doctors to prescribe new and more expensive drugs for which samples are available.

Self-regulation

The medical profession and pharmaceutical industry have attempted to address concerns about drug detailing through voluntary guidelines. For example, the American Medical Association's code of ethics advises physicians to only accept industry gifts that are not of substantial value and primarily benefit patients. The Pharmaceutical Researchers and Manufacturers of America (PhRMA), the industry's trade association, has also created a code of ethics recommending that its members offer only educational gifts and limit the provision of meals. In addition, some large pharmaceutical companies, including Pfizer, Merck, and Eli Lilly, have either made plans or begun to publicly disclose payments made to individual physicians.

Evidence-based Research as a Way to Counteract Industry Detailing

An alternative approach that has been developed to provide physicians and consumers with unbiased information on prescription drugs is to compare the effectiveness and safety of prescription drugs within the same class. This approach, known as evidence-based prescription drug research or comparative effectiveness, relies on the expectation that physicians will apply that information to prescribing decisions. Three examples of this approach include:

- The federal Agency for Health Research and Quality (AHRQ) conducts comparative effectiveness reviews of medications, devices, and other health care interventions through a network of Evidence-based Practice Centers (EPCs). EPCs use the reviews to help public and private-sector organizations improve the quality of health care. The American Recovery and Reinvestment Act of 2009 includes grant funding to be offered through AHRQ for the purpose of disseminating comparative effectiveness research.

- The Center for Evidence-Based Policy within the Oregon Health and Science University operates the Drug Effectiveness Review Project (DERP). DERP obtains the best available evidence to conduct reviews on the effectiveness and safety of drugs in the same class. Many participating states use DERP reviews to shape drug formularies in state programs like Medicaid. Current DERP participants include Arkansas, Idaho, Kansas, Oregon, Michigan, Minnesota, Missouri, Montana, New York, North Carolina, Washington, Wisconsin, Wyoming, and the Canadian Agency for Drugs and Technologies in Health.

- *Consumer Reports* operates a public education project of Consumers Union called *Best Buy Drugs.* The project bases its reports and recommendations, available on its web site, largely on DERP reviews and current drug prices.

State Response

Critics of the drug industry-physician relationship believe that current guidelines and educational efforts, including evidence-based research, insufficiently address industry influence on prescribing behavior. Indeed, nine states (California, Florida, Maine, Massachusetts, Minnesota, New Hampshire, South Carolina, Texas, and Vermont) and Washington DC have passed laws to regulate the marketing of prescription drugs and medical devices.

These laws include banning or mandating public disclosure of gifts to health care professionals by pharmaceutical companies above a specified amount; requiring the registration or licensure of pharmaceutical company representatives; and requiring the confidentiality of any identifying information of patients or prescribers so that the information may not be sold for commercial purposes.

Many more states, including Maryland, have introduced similar legislation that has failed to pass the legislature or has been vetoed by the state's governor. However, challenges remain even in states where laws have been passed. For example, New Hampshire's law prohibiting the sale of confidential prescriber data for marketing purposes was challenged in court, although the First Circuit Court of Appeals upheld the constitutionality of the law in November 2008.

In addition to the passage of laws regulating prescription drug marketing practices, some states, in an effort to counteract the heavy promotion and marketing of drugs to physicians by pharmaceutical companies, have created academic detailing programs. Academic detailing involves utilizing "academic detailers" to educate prescribers with objective information on prescription drugs using evidence-based research (described above). Seven states, Pennsylvania, Vermont, South Carolina, Maine, New Hampshire, New York, and Massachusetts, have either passed legislation or funded academic detailing programs through the state budget. However, to date, such programs and budgets are relatively small and reach only a small fraction of physicians.

Federal Legislation

Building on state action, the Physician Payment Sunshine Act of 2009, re-introduced in the U.S. Senate in January 2009, requires drug and medical device companies to disclose all payments to physicians on a publicly accessible web site. Provisions of the bill are also included in both the House and Senate versions of the federal health care legislation pending (as of November 2009) in Congress. In addition, the Independent Drug and Education Outreach Act of 2009, introduced in both the U.S. House of Representatives and the Senate would offer federal grants to states for academic detailing programs.

Social Programs

Public Assistance Population and Financing Trends

The weakening economy has put increasing pressure on various public assistance programs. It is currently projected that caseloads will peak in fiscal 2010 but remain at the same level in fiscal 2011. These caseloads will require significant additional general fund support.

Background

The poor economy has put increased pressure on public assistance programs, notably Temporary Cash Assistance (TCA), the Supplemental Nutrition Assistance Program (SNAP) (formerly Food Stamps), and the Temporary Disability Assistance Program (TDAP). TCA provides monthly cash grants to needy children and their parents or caretaker relatives. TCA is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections. SNAP helps low-income people buy the food they need for good health. Benefits under SNAP are provided entirely from federal funds. TDAP provides a cash grant to childless adults who are temporarily disabled or who have a long-term disability and are applying for federal Supplemental Security Income benefits. TDAP is funded primarily with general fund dollars.

TCA Caseload Trends

In the early years of welfare reform, efforts to transition individuals from welfare to work and a growing economy lead to a rapid reduction in the number of TCA recipients. After dropping at rates exceeding 20.0% 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 fall 2003 – a policy that requires participation in activities such as up-front job search, orientation, assessment of employability, development of an Independence Plan, training, and subsidized employment – the caseload decline accelerated again, falling by 1.1% in fiscal 2004, 7.2% in fiscal 2005, 12.5% in fiscal 2006, and 12.9% in fiscal 2007. Deteriorating economic conditions reversed this trend and led to increases in the average monthly caseload of 2.4% and 13.5% in fiscal 2008 and 2009, respectively.

As shown in **Exhibit 1**, the Department of Legislative Services assumes that the TCA caseload will again substantially increase in fiscal 2010 with the average monthly enrollment rising to 68,921 and remaining at that level for fiscal 2011. This represents an 18.2% increase in fiscal 2010. The caseload is projected to exceed 74,700 by the end of fiscal 2010 and then begin falling during fiscal 2011, resulting in a flat average monthly caseload between fiscal 2010 and 2011.

Exhibit 1
Temporary Cash Assistance Enrollment and Funding Trends
Fiscal 2009-2011

	2009 Actual	2010 Approp.	2010 Estimate	2011 Estimate	2010-2011 % Change
Average Monthly Enrollment	58,426	59,512	68,921	68,921	0.0%
Average Monthly Grant	$175.70	$179.05	$175.70	$175.70	0.0%
Funds in Millions					
General Funds	$3.6	$6.6	$6.6	$50.6	668.7%
Total Funds	**$123.2**	**$127.9**	**$145.3**	**$145.3**	**0.0%**

Source: Department of Human Resources; Department of Legislative Services

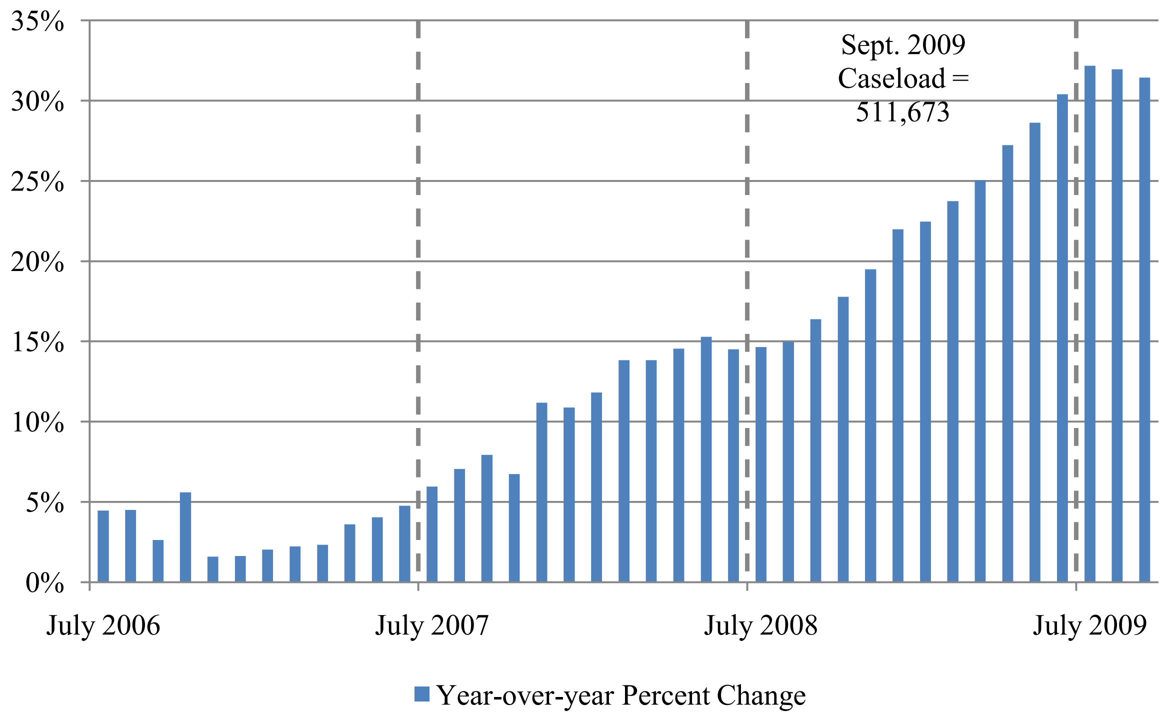
The calculated fiscal 2010 average monthly TCA grant amount increases slightly over fiscal 2009 as an artifact of $17 million in increased funding added via the supplemental budget. In actuality the grant amount is likely to remain unchanged through fiscal 2011. This flat grant amount is made possible because of the increase in the food stamp benefit provided by the American Recovery and Reinvestment Act of 2009. State law provides that the combined value of TCA and food stamp benefits should be no less than 61.0% of the Maryland Minimum Living Level (MML). The bump-up in the food stamp benefit amount will obviate the need to increase the TCA grant amount in order to meet the MML.

The fiscal 2010 budget for TCA is projected to be $17.4 million short of the need based on the estimated caseload increase. It is expected that this shortfall can be covered by TANF funds. The same cannot be said of fiscal 2011. With the projected depletion of the TANF balance by the end of fiscal 2010, general fund support is projected to grow to $50.6 million, an increase of $44.0 million over fiscal 2010.

Supplemental Nutrition Assistance Program Caseload Trends

The worsening economic climate, combined with increased outreach efforts, has led to steady increases in the number of food stamp recipients over the past two and a half years. As shown in **Exhibit 2**, the caseload has been growing at an increasing rate. In July 2006, there were 306,002 people receiving food stamp assistance. By September 2009, this number had grown to 511,673. This 100% federally funded benefit resulted in more than $585 million in spending in Maryland in fiscal 2009.

Exhibit 2
Food Stamp Caseloads
July 2006 – September 2009



Source: Department of Human Resources; Department of Legislative Services

Temporary Disability Assistance Caseload and Funding Trends

The downturn in the economy has also resulted in an increase in the TDAP caseload. It is thought that with the increase in the statewide unemployment rate, many of the disabled adults who were marginally employed have also lost employment and are seeking TDAP benefits as the program of last resort for this population, which is not eligible to receive TCA benefits. Although the program is relatively small compared to TCA, since it is fully funded with State dollars, the increasing caseload only exacerbates the general fund problem facing the State.

Exhibit 3 shows the large increase in TDAP caseload and funding that occurred in fiscal 2009. The caseload is expected to continue to increase throughout fiscal 2010, topping 21,000 by the end of the year. While the caseload is projected to begin declining in fiscal 2011, the average monthly caseload in fiscal 2011 is expected to match that of fiscal 2010. The increased caseload in fiscal 2010 results in an expected general fund deficiency of $16.6 million with the higher level of funding needing to be carried forward into fiscal 2011.

Exhibit 3
TDAP Enrollment and Funding Trends
Fiscal 2006-2011

Fiscal Year	Average Monthly Caseload	Total Funding ($ in Millions)
2006	10,972	$23.8
2007	11,491	24.2
2008	11,645	24.9
2009	15,355	33.4
2010 Est.	19,597	42.6
2011 Est.	19,597	42.6

Source: Department of Human Resources; Department of Legislative Services

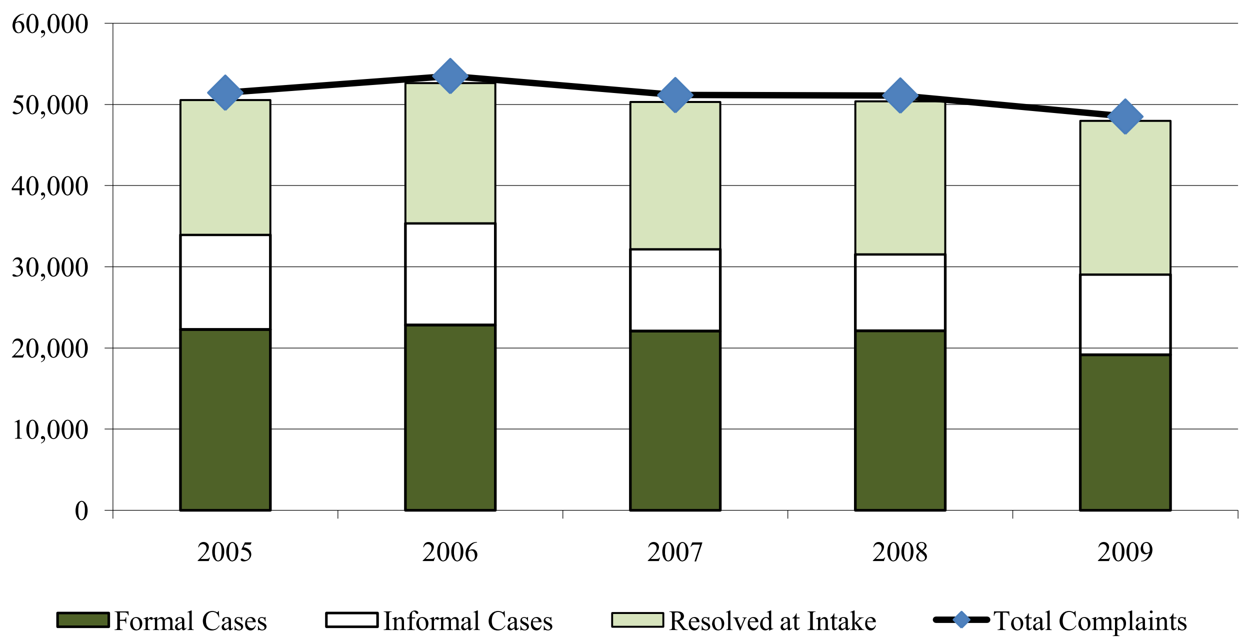
Department of Juvenile Services Population and Financing Trends

The total number of complaints handled by the Department of Juvenile Services is at the lowest level in years. The number of youth served in secure pre-disposition and pending placement shows an increase in the first four months of fiscal 2010, but committed populations decline in the same period. The department's seemingly perennial budget challenges persist.

Population Trends

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

Exhibit 1
Juvenile Complaint and Complaint Disposition
Fiscal 2005-2009



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

Source: Department of Juvenile Services; Department of Legislative Services

As shown in the exhibit:

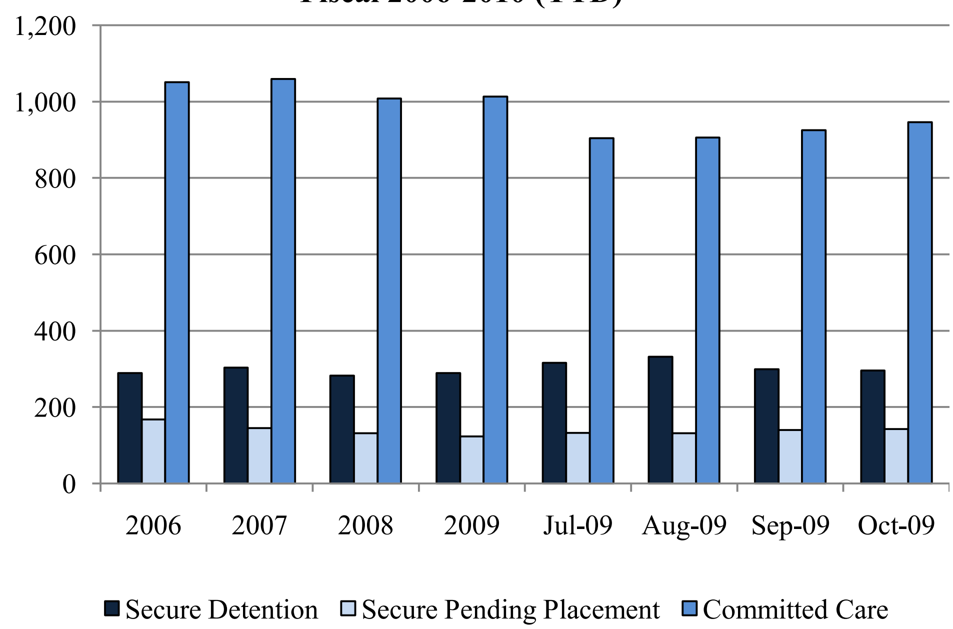
- The total number of complaints handled in fiscal 2009, just over 48,500, is the lowest number for the period shown, and represents a 5.1% drop over fiscal 2008.

- Formal caseloads, those where DJS believes court intervention is required, fell sharply between fiscal 2008 and 2009 (13.4%). As a percent of total case dispositions, at just under 40.0%, formal caseloads are also at their lowest share of total caseload for the period shown.

- Even with the drop in total cases, cases resolved at intake continue to increase in real and relative terms, a trend that has been true for the entire decade. Cases resolved at intake now account for almost 40% of all complaint dispositions. Those cases that are considered to require some form of intervention but do not rise to the level of court intervention (the informal caseload), show a year-over-year increase for the first time since 2006, although they are still well below historic levels (for example, remaining less than half of the informal caseload of the late 1990s).

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

Exhibit 2
Selected Average Daily Population Trends
Department of Juvenile Services
Fiscal 2006-2010 (YTD)



Source: Department of Juvenile Services; Department of Legislative Services

Specific trends identified in the exhibit include:

- The utilization of secure detention facilities for pre-disposition youth fell between fiscal 2007 and 2008 before stabilizing in fiscal 2009. However, in the first four months of fiscal 2010, there has again been an increase in this population.

- Similarly, the number of post-disposition youth held in secure detention facilities pending a permanent residential placement, a number that had been steadily declining, has begun to increase in the first four months of fiscal 2010.

- The average daily population of youth in committed residential placements is sharply lower in fiscal 2010 year-to-date at between 904 to 946 youth compared to 1,013 in fiscal 2009.

Financing Trends

DJS' budget problems continue. The department began fiscal 2010 with a deficit of $1.8 million carried over from fiscal 2009. This deficit is attributed to a variety of operating expenses. Anticipated deficiencies in fiscal 2010 amount to an additional $3.3 million, again in a variety of operating expenses plus residential per diem placements (despite the declining use of these placements). Another unresolved budget problem concerns DJS' claiming of title IV-E funds. DJS, the Department of Human Resources (DHR) and the federal government are currently attempting to resolve issues around DJS' IV-E claims. Although legislation was passed in the 2009 session to address several of the concerns raised by the federal government, other actions required of DJS and DHR had not been approved at the time of this writing. It can be expected that there will be some additional deficiency as a result of the federal government's denial of DJS' IV-E claims (which date back to the second half of fiscal 2008) although the full extent of this deficiency is unknown.

These fiscal problems come at a time when DJS' fiscal 2010 budget, noted during fiscal 2010 budget deliberations as being insufficient, has been further reduced by almost $7 million by the Board of Public Works (BPW) in July and August 2009. In addition, DJS has indicated that it is taking other cost containment measures beyond those required by BPW in order to manage its budget. These cost containment measures have included significant reductions in, or elimination of funding to, a variety of contracts for nonresidential community services.

Transportation

Major Changes in the Draft *Consolidated Transportation Program*

The Maryland Department of Transportation's draft 2010 *Consolidated Transportation Program* lists all capital projects funded in the current fiscal year and those planned for the next five years. The 2010 draft *Consolidated Transportation Program* totals $8.9 billion, a $434.1 million increase from the 2009 *Consolidated Transportation Program*, largely due to federal stimulus funding.

Overview

The Maryland Department of Transportation publishes an annual *Consolidated Transportation Program* (CTP) that lists all transportation capital projects funded in the current fiscal year and those planned for the next five years. **Exhibit 1** compares last year's six-year program with the six-year program contained in the draft 2010 CTP.

Exhibit 1
Comparison of Six-year Capital Programs
($ in Millions)

	2009-2014 CTP	2010-2015 Draft CTP	Change	Percent Change
State Funds				
Special Funds	$4,728.7	$4,707.6	$-21.1	-0.5%
Other Funds *	863.0	1,027.1	164.1	19.0%
Subtotal State Funds	***$5,591.7***	***$5,734.7***	***$143.0***	***2.6%***
Federal Aid	2,888.7	3,179.9	291.2	10.1%
Total Funds	**$8,480.4**	**$8,914.5**	**$434.1**	**5.1%**

* Other funds include 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.

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

Source: Maryland Department of Transportation, 2009 Final *Consolidated Transportation Program*, 2010 Draft *Consolidated Transportation Program*

The total funding level in the 2010 six-year program increases by $434.1 million (5.1%) from the six-year funding level in the 2009 CTP. This increase is due to the following:

- over $300 million in additional federal funds in fiscal 2010 as a result of the American Recovery and Reinvestment Act of 2009 (ARRA);

- a $164.1 million increase in other funds, which includes $82 million in federal funds for the Washington Metropolitan Area Transit Authority (WMATA) as a result of ARRA and a $65.9 million net increase at the Maryland Aviation Administration (MAA), resulting from an undetermined combination of passenger facility charge revenues and bonding, a possible grant from the federal Transportation Security Administration, and/or conduit financing from the Maryland Transportation Authority to fund airfield pavement area improvements, runway safety area improvements, and modernization of the terminal facility; and

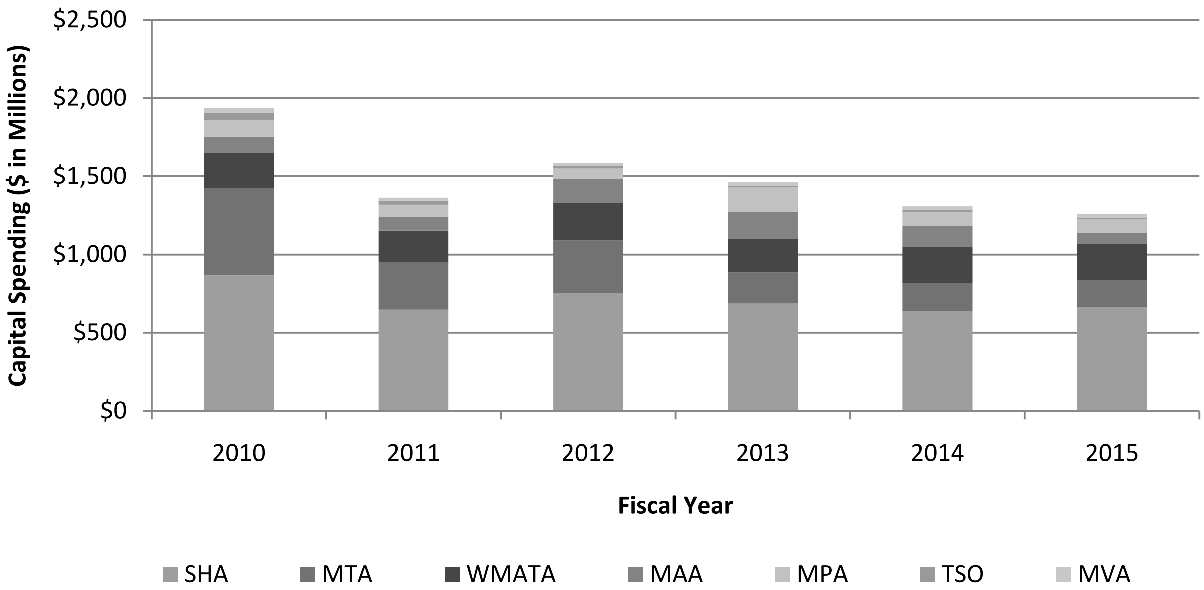
- a $21.1 million net decrease in special funds due to downward revisions in revenue estimates because of the current economic downturn, which was partially offset by increased bond sales.

Exhibit 2 shows total capital funding by year and by mode. Typically, the State Highway Administration (SHA) receives just under half of the department's total annual capital expenditures. The Maryland Transit Administration (MTA) receives about one-fifth of the total capital program, and the other modes receive the remaining funding.

Although federal stimulus funds provided by ARRA were able to help offset reductions to the capital program in the face of a severe economic downturn, the expiration of these funds and the prolonged nature of the recession will be evident in fiscal 2011. The capital program decreases from $1.9 billion in fiscal 2010 to $1.4 billion in fiscal 2011 largely as the result of a decrease of $381.6 million in federal funds and a $72.4 million decrease in federal funds for WMATA due to the expiration of federal stimulus funds.

Capital spending in fiscal 2012 increases by $223.3 million over fiscal 2011 largely due to an increase in special funds due to the economic recovery that the department is forecasting to begin in fiscal 2011 and a higher bond sale. The department assumes that substantial recovery, especially in titling tax revenues, will take place beginning in fiscal 2011 and continuing into fiscal 2012.

Exhibit 2
Capital Spending by Year and by Mode
Fiscal 2010-2015



Source: Maryland Department of Transportation, 2010 Draft *Consolidated Transportation Program*

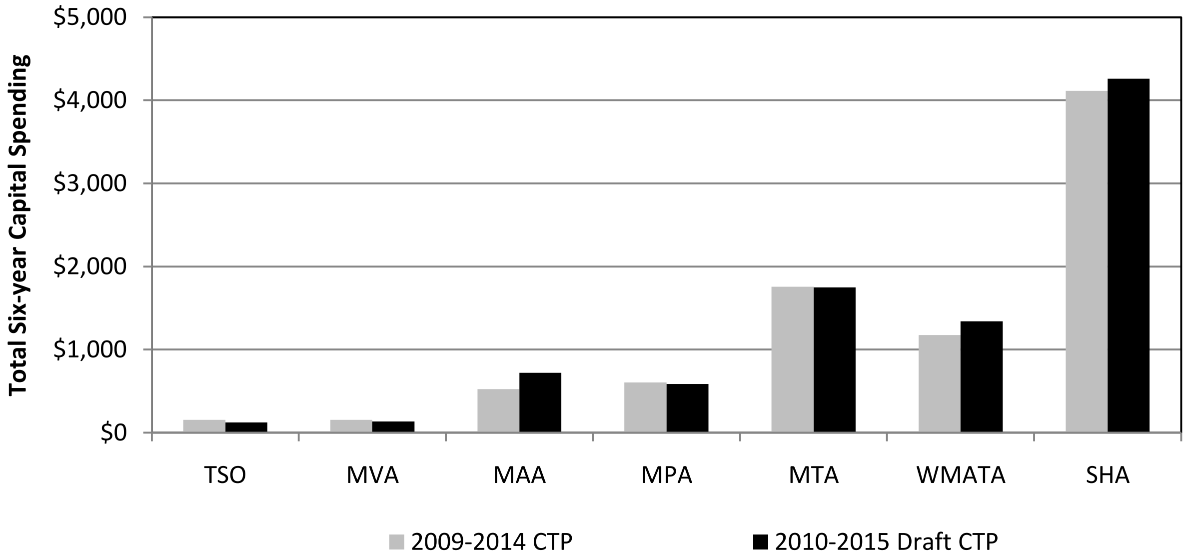
Exhibit 3 compares total capital spending by mode in the final 2009 CTP to the draft 2010 CTP. Minor decreases are seen in The Secretary's Office, the Motor Vehicle Administration, the Maryland Port Administration, and MTA over the six-year period. Large increases take place in the following modes:

- MAA increases by $198.8 million over the six-year period, largely as the result of the airfield pavement area improvements, runway safety area improvements, and terminal modernization projects mentioned above. The estimated cost of these projects is approximately $350 million. Although there is some uncertainty in the funding source of the projects, the airfield pavement and runway safety projects are essential to meeting Federal Aviation Administration requirements, and the terminal modernization program is critical for security enhancements and to comply with building codes;

- WMATA increases by $164.4 million due to an increase of $61.5 million in special funds from Maryland for the State's share of WMATA's capital program and a $102.9 million increase in federal funding for WMATA. The largest portion of this federal fund increase is $72.4 million in fiscal 2010 from ARRA funding to procure replacement buses and support equipment, rehabilitate passenger and maintenance facilities, and upgrade various operational and information technology systems; and

- SHA increases by $147.5 million as the result of ARRA funding in fiscal 2010 and in fiscal 2012 from upward revisions in federal aid estimates. This additional funding is primarily added to the safety, congestion relief, and community enhancements programs.

Exhibit 3
Total Capital Spending by Mode
($ in Millions)



Source: Maryland Department of Transportation, 2009 Final *Consolidated Transportation Program*, 2010 Draft *Consolidated Transportation Program*

Summary of Major Changes to the Capital Program

ARRA funding continues to have a positive impact on the capital program in fiscal 2010. Across the department, eight projects totaling $96.9 million were added to the construction program. These include two projects at MTA totaling $38.8 million and six projects at SHA totaling $58.1 million. Funding for four of these eight projects is the result of ARRA funding, accounting for $72.9 million, or 75.2%, of new project funding. In addition, two projects, one at MTA and one at SHA, were moved from the Development and Evaluation Program to the Construction Program, both as the result of ARRA funding totaling $27.5 million. Additionally, the construction schedules for two MAA projects were advanced as the result of ARRA funding.

Transportation

Outlook for Federal Transportation Funding

Due to funding shortfalls in the federal Highway Trust Fund and a lack of consensus regarding federal transportation funding reauthorization legislation, states face considerable uncertainty with respect to future federal aid for transportation. Because the most recent six-year authorization expired September 30, 2009, and the fiscal 2010 appropriations bill has not been completed, as of November 2009 fiscal 2010 funding is authorized through a continuing resolution.

Background

Federal transportation aid is predominantly derived from an 18.4 cent gasoline and 24.4 cent diesel tax. Revenues are deposited into the Highway Trust Fund (HTF) and then distributed to states for highway and transit spending. Funding levels are set in a six-year authorization bill; the most recent authorization expired on September 30, 2009. In addition, Congress has not yet acted on the fiscal 2010 transportation appropriations bill. As of November 2009, fiscal 2010 funding is authorized through a continuing resolution effective through December 18, 2009. Under the prior authorization, Safe, Accountable, Flexible and Efficient Transportation Act – A Legacy for Users (SAFETEA-LU), Maryland received average annual funding of $720 million ($580 million for highways and $140 million for transit).

Funding Shortfall in the Highway Trust Fund

From 1996 to 2000, receipts to the HTF exceeded outlays and a significant fund balance developed. The past two authorizations set the level of spending above the level of revenues to draw down the fund balance. In recent years revenue did not meet estimates, and a negative cash balance was estimated; however, federal law requires the HTF to maintain a positive cash balance to ensure all prior obligations of funds by states can be met.

In the fall of 2008, it was announced that the funding shortfall was to occur in federal fiscal 2009, sooner than expected. As a temporary measure to avoid reductions in state aid, $8 billion was transferred from the federal general fund to the HTF. An additional funding shortfall was identified in the summer of 2009 for fiscal 2009 and 2010. The Obama Administration proposed a transfer of $18 billion to keep the HTF solvent through fiscal 2010 ($8 billion in 2009 and $10 billion in 2010) and an 18-month reauthorization extension. Congress instead passed a $7 billion transfer from the general fund to keep the HTF solvent through fiscal 2009, leaving the issue of the fiscal 2010 shortfall and the reauthorization unresolved. The lack of funding clarity for fiscal 2010 leaves states uncertain as to how much federal aid can be expected for their capital programs.

Year-end Rescission and the Continuing Resolution

For fiscal 2009, SAFETEA-LU included a rescission, or withdrawal of previously authorized spending, totaling $11.8 billion including $8.7 billion at the end of the fiscal year. The rescission was included so that on paper, expenditures would equal revenues from the HTF. The year-end rescission did result in some states losing federal aid for their capital programs; however, Maryland was not impacted by the rescission. Because the continuing resolution that currently provides funding authorization for fiscal 2010 is based on fiscal 2009 funding levels *after* the year-end rescission, the rescission also affects fiscal 2010 funding. According to *Transportation Weekly*, while the continuing resolution is in effect, Maryland's federal highway aid is reduced by approximately 34% from an annual total of $560.2 million in fiscal 2009 to $369.0 million.

Status and Issues for the Upcoming Transportation Authorization

It is not clear when Congress will act on the six-year transportation reauthorization legislation, in large part due to the number of bills being considered. In addition, there is no consensus as to how to pay for the reauthorization. As of November 1, 2009, the Senate had not yet taken up the transportation reauthorization bill, and the House Transportation and Infrastructure Committee had debated a reauthorization bill in committee. Until reauthorization legislation is enacted, Congress will need to extend the existing authorization or pass another continuing resolution.

The debate on the next transportation authorization is likely to focus primarily on how the HTF is funded and how those funds are distributed, including a discussion of the following:

- **Reducing and simplifying the number of funding programs.** Experts have stated that there are too many disparate funding programs. The House proposal would reduce the number of highway funding programs from 75 to 4 primary programs. Additional funding programs may also be created to fund select metropolitan areas' efforts to address congestion, projects of national significance, and freight movement.

- **How much should be made available and how should we pay for it?** According to *Transportation Weekly*, to maintain fiscal 2009 funding levels, revenues to the HTF would need to be increased by approximately $63 billion over six years. An increase in the gas tax is politically unpopular. Alternative funding methods have been suggested but would represent a shift from the traditional user fee system.

- **How should transportation funds be allocated?** Every reauthorization bill includes a debate on how funding should be distributed between highways and transit. The current Administration has emphasized investments in high speed rail. Another issue that may be addressed is linking allocations to national performance measures such as congestion, traffic fatalities, and bridge rehabilitation.

Business Regulation

Electricity Markets

Significant increases in electric rates following the expiration of rate caps and the lack of new supply in Maryland to meet the growth in demand and alleviate congested transmission lines have sparked continued discussions as to whether to reregulate the electric industry. Retail electric competition is slowly developing in the residential sector, as electricity supplier rate offers have recently been below standard offer service rates. As a way to lower demand, energy efficiency efforts are underway, including programs overseen by the Public Service Commission and the Maryland Energy Administration, as well as weatherization projects implemented by the Maryland Department of Housing and Community Development.

Electric Restructuring and Generation Supply

Effective July 2000, the Maryland Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in the State to allow electric retail customers to potentially shop for electric power from various electricity suppliers. The Act required electric companies to divest themselves of generating facilities or to create a structural separation between the unregulated generation of electricity and the regulated distribution and transmission of electricity. With the elimination of the generation functions from regulation, the Public Service Commission (PSC) no longer determines the need for additional supply sources as it did before restructuring. Electric restructuring was intended to bring increased efficiencies to the electric utility industry, resulting in lower overall costs for industrial, commercial, and eventually residential customers. Growth in demand, coupled with the lack of any substantial new generating capacity in the State, constrained transmission facilities, and little in the way of substantial increase in transmission capacity has led the State to the brink of threatened brownouts during times of peak demand in the ensuing years.

In response to the concern that deregulation had not served the public interest, the General Assembly, through Chapter 549 of 2007 (Senate Bill 400), required PSC to conduct studies on electric industry reregulation and to assess the availability of adequate generation facilities to serve the electrical load demands of all customers in the State. In its December 2008 report, PSC outlined various options for "reregulation" considering tradeoffs among direct costs, risks, and benefits. PSC concluded that it would not recommend that the legislature seek to return the existing generation fleet to full cost-of-service regulation under which the ratepayers bear all prudently incurred costs to own and operate a generation plant, plus a rate of return, in light of the costs, risks, and likely disruptions that might result from acquiring the plants. Instead, PSC recommended incremental, forward-looking reregulation when appropriate.

Plans to Restructure Electricity Markets

Legislation to reregulate the electric industry in some form remains of interest. Senate Bill 844 of 2009 would have established an integrated resource planning process similar to the process that was in place prior to electric restructuring in 1999 and would have required PSC to initiate a proceeding to investigate the electricity needs of the State. In this proceeding, PSC would have been required to consider whether to direct the construction of one or more generation facilities, and if so, the appropriate electric capacity and fuel source. PSC would have had to consider if it should require additional energy efficiency, conservation, and demand response measures. Each electric company would have been required to develop and submit long-range plans regarding electricity needs and the means to meet those needs.

Based on the evaluation of the long-range plans, PSC would have had to order construction of new electric generation facilities if this was deemed to be in the public interest. Any new generation facilities constructed in the State, as directed by PSC, would have been operated under cost-of-service regulation principles. Instead of ordering an electric company to construct an electric generating facility, PSC would have had the option to require an electric company to procure the necessary electricity through (1) a bilateral contract with another person for all or part of the output of a new generation facility; or (2) a competitive bidding process in which the electric company would solicit bids for all or part of the output of a new generation facility. Electricity sold to residential and small commercial customers would have been regulated under cost-of-service regulation principles. PSC would have been required to complete a plan for transitioning residential and small commercial customers to a regulated market for electricity and to implement a program to require electric companies to offer to its residential and small commercial customers the option to purchase green electricity supply.

Plans to Encourage Residential Retail Competition

On the flip side, legislation that encourages residential retail competition has also been proposed. For example, Senate Bill 329/House Bill 1165 of 2008 would have required PSC to establish a Competitive Electricity Supplier Referral Program for residential and small commercial retail electric customers. Qualifying electricity suppliers that would have participated in the program would have made retail offers at a fixed price per kilowatt hour (kWh) of usage for a term of not less than one year. Electric companies would have been required to provide residential and small commercial customers with a list of qualifying offers from participating electricity suppliers on a quarterly basis. Further, electric companies would have been required to provide customers with “opportunities to learn” about electricity suppliers and their ability to contract with electricity suppliers for service. Electric companies would have been required to make available to a customer at no charge both meter and usage data. Customers receiving electricity supply services from standard offer service (SOS) would not have been able to be charged any additional fee to switch a customer from one participating electricity supplier to another or charge a fee for returning a customer back to SOS. Electric companies would have been required to bill customers for the electricity suppliers’ services and pay electricity suppliers the amount due minus a PSC-approved percentage that reflects a measure of realized uncollectible expenses. With respect to credit, collections, and disconnection of service, electric companies would have been required to impose the same terms on customers receiving SOS and from service supplied by electricity suppliers. Several of these items are currently being considered in the regulation process.

Adequacy of Electric Supply

For the past several years, portions of the State east of Frederick have experienced higher electricity prices than most other areas in the Mid-Atlantic region due in part to increasing demand for electricity and a dearth of corresponding increases in the capacity of economically efficient transmission and generating facilities serving central and southern Maryland and the Eastern Shore. Under federally approved tariffs, the regional transmission operator PJM Interconnection (PJM) has imposed surcharges on electricity delivered in these areas in order to stimulate development of new transmission and generating facilities by the private sector.

In Maryland, legislators and regulators have responded by studying options to address the imbalances in the demand for and supply of electricity in three ways – increasing or upgrading transmission facilities serving the region; increasing, upgrading, and recommissioning generating facilities in the region; and implementing demand response, energy efficiency, and conservation measures in the region. Under Chapter 549 of 2007, PSC was required to include, among a number of matters relating to restructuring, a study of the electricity industry's capacity to serve Maryland in coming years, focusing on the available and planned generation and transmission facilities serving the region. PSC responded with options to alter the State's regulatory structure under the general rubric of "reregulation," although that term was purposely expanded to include many different options for enhanced State control over a competitive market as well as a strict return to the former rate regulation regime.

Gap RFP

Following up on the findings of its reports under Chapter 549, PSC instituted Case No. 9149, the "Gap RFP" case, on August 8, 2008, to explore means to cover a then-perceived gap between expected demand in the State and the electrical resources needed to meet that demand. As of 2008, PSC and PJM had both expected a shortfall in the electricity available to be delivered in the State as soon as 2011 – with the possibility of rolling brownouts in the immediately ensuing years. The proceeding developed a model request for proposals (RFP) for utilities to use for procuring generation resources and demand response measures to close the gap in resources needed for reliable electricity delivery. Excluded from bidding were capacity resources and energy efficiency measures already included in the utilities' EmPOWER Maryland filings and those in the PJM reliability pricing mechanism (RPM) auctions for 2010 through 2012.

Adopted on an accelerated schedule, the model RFP was successfully used by the State's investor-owned utilities to procure firm demand-response contracts from curtailment service providers (CSP) through an interruptible load for reliability program. Essentially, a CSP manages the electrical demand of customers, chiefly larger industrial and commercial customers, whose operations are flexible enough to shut down or reduce demand on a temporary basis with one or two days' notice. Based on weather and economic forecasts, PJM and the utilities project electrical demand days in advance. When demand is likely to strain the resources available to supply and deliver electricity in the region, such as a hot summer afternoon in central Maryland, CSP will be notified to decrease electrical uses at the facilities they manage so that all customers whose demand is not interruptible will be able to receive electricity as needed and managed brownouts will not be needed to balance supply and demand.

Transmission Upgrades

Between the resources identified in the Gap RFP process, the subsequent RPM auctions for capacity in later years, and the economic recession that developed in late 2008, PJM now forecasts that reliability gap concerns for central Maryland have been delayed until 2014 or later. That forecast relies on the premise that certain new and upgraded transmission facilities will come online in a timely fashion.

Three major transmission lines are identified in the PJM planning queue and planned to serve central and eastern Maryland – the TrAIL, PATH, and MAPP lines. The TrAIL line is planned to run as a 765 kilovolt (kV) facility from southern Pennsylvania through West Virginia to Loudon County, Virginia, and is now under construction with a scheduled in-service date of 2011. The PATH line is planned at the same 765 kV level to run from the John Amos generating station in West Virginia to a potential substation near Kemptown, Maryland. That line has received partial approvals in West Virginia and Virginia, but must refile its application for a certificate of public convenience and necessity (CPCN) on technical grounds. PJM believes that PATH will be needed in 2014, assuming that the TrAIL line is in service in 2011. The MAPP line, originally planned to run from Virginia through Maryland and up to southern New Jersey, has been scaled back to run only from Virginia to the Eastern Shore, terminating at Indian River, Delaware. Proponents argue that it is needed starting in 2014. Both the PATH and the MAPP lines are encountering opposition at the local level.

Long-term Contracts

At the inception of electric restructuring, many expected acceleration in the development of competitive power plants not tied to a traditional distribution facility, so-called merchant plants. Until recently, however, few merchant plants in Maryland have proceeded beyond obtaining a CPCN. One such plant, fired by natural gas, has been proposed in southern Maryland by Competitive Power Ventures (CPV). Originally expected to be financed by venture capital, the CPV plant has had difficulty in obtaining sufficient private financing to proceed to construction for two reasons – the dearth of capital available in a severely strained economy, and uncertainty in the ability of a merchant plant to remain profitable over the long term needed to finance its construction. The former reason is beyond anyone's control, while the latter reason is peculiar to a deregulated environment. In a deregulated environment, electricity customers are free to move to a less costly supplier at any time. Absent the ability of the generator's owner to include the construction charge in the customers' rate base and so guarantee a long-term income stream, the profitability of a merchant plant is subject to fluctuations in fuel costs and the possibility that a competitor may enter the market with still newer, more efficient plant before the merchant plant is paid off.

In late spring 2009, CPV filed a motion with PSC, asking it to evaluate whether one or more distribution companies should be ordered to enter into a long-term supply contract with the CPV merchant plant, essentially bringing the supply into the companies' distribution rate base, or otherwise blending that supply into the utilities' standard offer service. PSC responded by neither approving nor disapproving the motion, but rather converting it into a more general proceeding asking whether there are any other offers that might compare with the CPV proposal, and setting a December 2009 deadline for responses. Although the concept of long-term contracts had previously been brought up by PSC in its Chapter 567 studies and in development of the Gap RFP proceedings, the contract model had a tepid reception in related legislative proceedings. It remains to be seen whether long-term contracts will resurface in the 2010 General Assembly, or whether some other means to finance merchant plants in a tight economy will garner legislative attention.

Rates, Alternative Suppliers, and Competition

While introducing "customer choice" of supply services, the 1999 restructuring act set a mandated rate reduction and a cap on the reduced rates. Rate cap restrictions have now expired for all customers in the State, with the last to expire in Allegheny's residential service territory on January 1, 2009. With the expiration of price caps, customers are subject to market rates. For residential customers who have not chosen their competitive supply, the price of supply 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. Prices of commodities used to generate electricity have recently stabilized, resulting in recent moderate SOS rate increases.

Exhibit 1 shows the percentage increases for the average annual total bill of a residential consumer from the auctions to procure power during the period from July 1, 2004, to May 31, 2010 for the investor-owned utilities (IOUs). Although electric restructuring has primarily benefited big electricity users, such as industrial customers and State and local government operations, electricity suppliers only slowly started to enter the market for residential customers as the price caps expired in each service territory. As of the end of September 2009, approximately 4% of residential customers were being served by a competitive supplier, as compared with 22% of small commercial, 50% of mid-commercial, and 89% of large commercial/industrial customers being competitively served.

Exhibit 1
Percentage of Rate Increase/Decrease for Average Annual Total Bill[1]
SOS Auctions for Residential Load
July 1, 2004 – May 31, 2010

	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%[2]
Allegheny	Jan. 1, 2009	Not applicable	Not applicable	Not applicable

	2007 Auctions: June 1, 2007-May 31, 2008	2007/08 Auctions: June 1, 2008-May 31, 2009	2008/08 Auctions: June 1, 2009-May 31, 2010	Average Estimated Annual Bill: June 1, 2009 – May 31, 2010
Pepco	6.9%	5.5%[3]	5.3%	$2,021 (at avg. consumption of 950 kWh/mo.)
Delmarva	5.1%	2.7%[3]	(0.6%)	$2,012 (at avg. consumption of 1,100 kWh/mo.)
BGE	50.4%	7.6%[4]	0.8%	$1,979 (at avg. consumption of 1,000 kWh/mo.)
Allegheny	Not applicable	15.7%[5]	5.9%	$1,488 (at avg. consumption of 1,300 kWh/mo.)

(1)Average annual total bill includes distribution, transmission, and SOS costs.
(2)Under Chapter 5 of the 2006 special session, the actual increase billed to customers was limited to 15% for 11 months; the remainder was deferred under Rate Stabilization Plan I.
(3)The impact of recent distribution rate increases is included in the percentage increase.
(4)The impact of charges for recovery of deferred Senate Bill 1 revenue and credits for nuclear decommissioning and reinstatement of the SOS margin in June 2008 are included in the percent increase.
(5)Effective January 1, 2009 through May 31, 2010; includes an estimated rate for the Rate Transition Surcharge associated with the phased-in 15% year-over-year rate increase.
SOS: Standard Offer Service.

Source: Public Service Commission

As of November 2009, five suppliers are offering a total of 22 alternative plans to SOS for Baltimore Gas & Electric Company (BGE) residential customers, at least 11 of which are below SOS rates; three suppliers are offering 12 alternative plans to Delmarva customers, at least 5 of which are below SOS rates; three suppliers are offering 16 alternative plans to Pepco customers, at least 11 of which are below SOS rates; and one supplier is offering 7 alternative plans to Allegheny customers, 2 of which are below SOS rates. Despite that most of these plans have a "green" energy component, many of the offers are lower than SOS rates. As of November 2009, the price to compare for BGE's SOS is $0.1197/kWh, Delmarva's SOS is $0.1111/kWh, Pepco's SOS is $0.1251/kWh, and Allegheny's SOS is $.0971/kWh. With no supplier offers as of November 2009, SMECO's SOS is $.1189 and Choptank is $.0891. As a result of the entry of competitive suppliers in the IOU service territories, over 41,000 BGE residential customers (3.7% of total customers), over 2,000 Delmarva residential customers (1.2%), almost 38,000 Pepco residential customers (7.9% of total customers), and over 1,500 Allegheny residential customers (0.7%) had switched from SOS by the end of October 2009.

Update on EmPower Maryland

The EmPower Maryland Energy Efficiency Act of 2008, known as EmPower Maryland, established the goal to reduce per capita peak demand and electricity consumption 15% below 2007 levels by 2015. PSC is tasked with overseeing the Act's implementation in conjunction with the Maryland Energy Administration, while the State's IOUs must develop the plans to carry out much of the Act's goals. Prior to the enactment of EmPower Maryland, PSC had already begun to undertake various energy efficiency measures in order to satisfy federal goals established in 2005. These early "fast track" measures were designed to take advantage of the quickest and cheapest energy efficiency opportunities such as providing rebates for efficient fluorescent light-bulbs and home appliances and have since been folded into the utilities' EmPower Maryland plans. Nevertheless, despite these early actions, PSC stated in its most recent *Ten Year Plan of Electricity Companies in Maryland* that, of the five utility plans submitted, only two are anticipated to meet their 2015 EmPower Maryland peak demand goal, and no utility is anticipated to meet their electricity consumption goal. While continuing to refine the utilities' EmPower Maryland plans through the hearing process, PSC is also working to fulfill the requirements of EmPower Maryland by studying the models and assumptions used to project economic and energy savings produced by various demand-side management projects, and by analyzing the on-going efforts of utilities to implement Advanced Metering Infrastructure and other "smart grid" investments in energy efficiency.

State Implementation of Weatherization Projects

The Maryland Department of Housing and Community Development (DHCD) implements the Weatherization Assistance Program, a federal-state partnership designed to lower energy costs of low-income and other select homeowners through improved energy efficiency in the home. While this is an ongoing federal initiative first implemented in 1976, the program has received a substantial funding increase from the American Recovery and Reinvestment Act (ARRA) of 2009. For example, DHCD received about $2.6 million from the U.S. Department of Energy (DOE) in the Weatherization Assistance Program funds for fiscal 2009, and about $61.4 million for fiscal 2010.

Another source of weatherization funding for DHCD is the Maryland Strategic Energy Investment Fund (SEIF). The fiscal 2010 legislative appropriation from SEIF, as amended by 2009 budget reconciliation legislation, includes $2.5 million for low-income home weatherization. Further, the fiscal 2010 budget includes a $10.5 million appropriation from SEIF and ARRA for the Maryland Energy Administration to conduct additional low-income home energy retrofits in multi-family housing units, primarily for the benefit of renters who would not benefit from the Weatherization Assistance Program. Together, the State is expected to spend about $73.4 million on weatherization activities, which under statistical assumptions provided by DOE, could be expected to generate about $200 million in eventual savings and other benefits. Currently, DHCD is working with the 18 designated local weatherization agencies in the State to hire and train new weatherization crews and auditors, and to disburse the funds necessary to support the several thousand homes to be retrofitted during fiscal 2010.

Business Regulation

Workers' Compensation Insurance

Several legislative issues governing workers' compensation in the 2010 session may be related to fair and equitable benefits provided to wholly and partially dependent individuals and misclassification of employees as independent contractors. Overall, the workers' compensation system in Maryland continues on a stable course, with a minimal increase in premiums for employers and continued decline in claim frequency; however, some cost drivers and benefit concerns remain.

Workers' Compensation System Is Stable but Costs May Climb

Maryland's pure premium rate filed by the National Council on Compensation Insurance (NCCI) will increase by 3.2% in 2010, meaning employers in the State will pay slightly more in workers' compensation insurance premiums next year; it is the first such increase in four years. Pure premium rates, one component of overall premium rates, are set at a level necessary to prefund projected claim loss payments to injured workers. Despite the 2010 increase, the cumulative rate change between 2005 and 2010 is a slight decline (-0.6 percent), which indicates a relatively stable market in the State. According to an October 2008 study conducted by the Oregon Department of Consumer and Business Services, Maryland employers in the voluntary market pay, on average, the eighth lowest workers' compensation premium rates (out of 51 states) in the nation (up four places from twelfth lowest in its 2006 study). Further, according to a 2008 study by Actuarial & Technical Solutions, Inc., the State ranks tenth lowest in premiums for manufacturing jobs and seventh lowest in premiums for office and clerical operations jobs.

Although the State workers' compensation system is considered one of the more stable functional systems in the country with generally good benefits and low costs as compared to other states, worrisome State and national trends exist that warrant monitoring or discussion. The State's national ranking, twenty-second out of the 46 states included in a NCCI study, for lowest average total benefits (medical and indemnity) per employee is slightly less favorable to injured workers than the State's standing *vis à vis* costs to employers and insurers. However, employers and insurers can expect that medical costs for injuries suffered on the job will follow the nationwide trend and continue to rise. Moreover, the number of workers 45 to 64 years of age will peak in 2010; the injuries incurred by these workers tend to be more severe and sometimes more difficult to treat, with longer recovery periods and corresponding higher costs.

Workers' compensation costs may also trend upward over the coming 12 to 24 months if the current economic recession eases or ends in the near future. Job losses during a recession typically mean that younger, lesser-experienced workers are laid off and fewer claims are filed. It is assumed that these individuals eventually become employed, meaning that the volume of claims – which has been declining steadily in recent years – may increase. Additionally, the economic downturn may be depressing wages and employers' payrolls, on which workers' compensation premiums are based, further limiting costs. Nonetheless, the State's unemployment rate is somewhat lower than the national average, which may limit the extent to which economic changes affect the provision of workers' compensation in the State.

Legislative Issues Likely to Surface in 2010

Workers' compensation-related legislation in the 2010 session will likely include proposals, and follow-ups to proposals, introduced during the 2009 session, as well as issues that have not been addressed in recent years. During the 2009 session, the General Assembly charged the Workers' Compensation Commission (WCC) with the responsibility of studying potential reforms of statutory death benefit provisions. Legislation that would empower WCC to investigate employers suspected of noncompliance is also likely to be reintroduced. Additionally, attempts to reform the "tiered system," which dictates the level of benefits awarded to individuals with permanent partial disabilities based on the percentage of disability, may surface in 2010, as well as legislation to simplify the appellate system. The Workers' Compensation Benefit and Insurance Oversight Committee anticipates reviewing these and other potential issues at its December 2009 meeting.

Death Benefits

Under current law, if an employee dies while receiving permanent total or permanent partial benefits or the employee dies as the result of a compensable injury, the employee's dependents are entitled to a weekly benefit. The benefits vary, depending upon whether the dependents are partial or total dependents. The law does not explicitly define total and partial dependents and instead authorizes WCC to determine dependency on a case-by-case basis. Partial dependents are only eligible for payments if there are no individuals who were wholly dependent on the deceased employee. Partial dependents are entitled to a benefit equal to two-thirds of the deceased employee's average weekly wage, not to exceed the State average weekly wage, for the period of the dependency or until an overall total of $75,000 has been paid (this cap was increased from $60,000 under Chapters 616 and 617 of 2009).

Wholly dependents (a surviving spouse or a child) are entitled to a benefit equal to two-thirds of the deceased employee's average weekly wage, not to exceed the State average weekly wage, up to an overall total of $45,000. If the individual remains wholly dependent after the $45,000 cap is reached, he or she is entitled to continued payments. If the wholly dependent becomes partially self-supporting, the weekly benefit is paid similar to that provided to individuals who were partly self-supporting at the time of death (for the period of the dependency or until an overall total of $75,000 has been paid).

In addition to increasing the maximum benefit to partially dependent or partially self-supporting individuals from $60,000 to $75,000, Chapters 616 and 617 of 2009 requires WCC to conduct a study on statutory provisions related to death benefit payments to individuals dependent on a covered employee to determine how to make these provisions fair and equitable, while providing incentives to encourage dependents to become self-supporting. WCC has assembled representatives of the various stakeholder groups at multiple times during the 2009 interim and anticipates providing recommendations on or before December 1, 2009.

Employer Compliance

In 2002, the Legislative Auditor and the Joint Audit Committee of the General Assembly expressed concern that WCC lacks the authority to proactively identify uninsured employers. Following several years of discussions, in 2006 WCC formed the Task Force to Study Employer Compliance with Workers' Compensation Insurance to review the problem. The task force recommended legislation to clarify WCC's authority to conduct investigations and to enhance penalties for noncompliance. Existing statutory provisions do not clearly vest WCC with the authority to investigate whether an employer has secured insurance for its covered employees. Rather, the law gives WCC the authority to take enforcement action when it becomes aware of an employer who has failed to properly insure employees; this typically occurs in the adjudication of the injured worker's claim.

Senate Bill 987 and House Bill 1436 of 2009 would have enhanced the ability of WCC to preemptively investigate cases of noncompliance and would have raised corresponding penalties. These initiatives were intended to dovetail with Chapter 188 of 2009 which established, for the purpose of enforcement, a presumption that work performed by an individual paid by an employer creates an employer-employee relationship, subject to specified exemptions. Chapter 188 prohibits construction companies and landscaping businesses from failing to properly classify an individual as an employee and establishes investigation procedures and penalties for noncompliance. The investigation procedures are administered and enforced by the Department of Labor, Licensing, and Regulation.

Revision of "Tiered System" for 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 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 in 1987. Each tier progressively expands both the number of weeks over which compensation is paid and the compensation amount. Certain stakeholders who are involved with the determination of benefits in PPD cases advise that disputes over the extent of disability are difficult to compromise because of the tiered system resulting in an unnecessarily high number of WCC hearings.

Simplification of Appellate System

House Bill 1253 of 2009 was intended to simplify one aspect of the appeals process in cases before WCC by allowing an appellee to introduce writings or records of a health care provider without supporting testimony. Statutory language requires that appeals be "informal and summary," but certain stakeholders involved in the adjudication of appeals indicate that the process is cumbersome and does not meet this standard.

Business Regulation

Unemployment Insurance

Maryland employers will pay from the highest tax rate table for calendar 2010 due to the low balance of the Unemployment Insurance Trust Fund. Federal initiatives offer states additional funds in return for expanding eligibility for unemployment insurance benefits, known as a modernization of the unemployment insurance system. The Committee on Unemployment Insurance Oversight will review these initiatives and other proposals prior to the 2010 session.

Background

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

Legislation enacted in Maryland in 2005 (Chapter 169) altered Maryland's UI charging and taxation system by creating a series of experience tax rate tables that are based on the balance in the Maryland UI trust fund. An employer's unemployment experience determines the rate charged within each table. If the balance of the UI trust fund exceeds 5% of total taxable wages in the State (as measured on September 30 of the current year), the lowest tax rate table (Table A) is used to calculate employer rates for the following calendar year. For calendar 2007 and 2008, employers paid from Table A which imposes a minimum tax rate of 0.3% (on the first $8,500 of annual wages of each employee) or $25.50 per employee. However, the UI trust fund balance on September 30, 2008, of $895 million was short by $53 million of the amount needed to remain in the lowest tax table for the following calendar year. Accordingly, employers are paying a higher rate (Table B) in calendar 2009 – a minimum tax rate of 0.6% or $51 per employee.

The UI Trust Fund and Outlook for Employer Taxes in Calendar 2010

The balance of the UI trust fund has fluctuated over the years, growing in good economic times to over $1 billion in each of calendar 2007 and 2008 and diminishing in bad economic times to a little over $300 million as of September 2009. During any calendar year, the UI trust fund balance is at the highest level after the second quarter when most of the employer taxes are paid (UI taxes are paid on the first $8,500 earned by each worker).

On September 30, 2009, the balance in the UI trust fund fell to $302 million. This significant decline, combined with a recent decline of the taxable wage base to $17.8 billion, places the State and Maryland employers in the highest tax table beginning in January 2010. Table F requires employers to pay a minimum of 2.2% and a maximum of 13.5% ($187 to $1,147.50 per employee).

The main driver of the decline of the UI trust fund is the increased claims for UI benefits resulting from the economic downturn. The State's unemployment rate went from 4.5% at this time last year to 7.2% by September 2009. Average monthly payouts from the UI trust fund grew from $35 million in 2007 to $94 million in September 2009. Benefit payouts reached a peak in March 2009 of $24 million per week. Initial claims grew from about 203,000 in calendar 2006 to about 362,000 in calendar 2008 and over 301,000 in calendar 2009 (as of September 30, 2009).

Exhibit 1 shows the balance of the UI trust fund on September 30 of each year since 1999, the annual payout amounts since 1999, and Maryland's seasonally adjusted unemployment rate each year since 1999. The historic high unemployment rate for Maryland was 8.3% in August 1982, and the historical low was 3.3% in March 2000. Also shown in Exhibit 1 are the tax tables employers paid from during calendar 2006 to 2009 and will pay from during calendar 2010.

Exhibit 1
Maryland's Unemployment Rate, UI Trust Fund Balance, and Annual Benefit Payouts
1999-2010

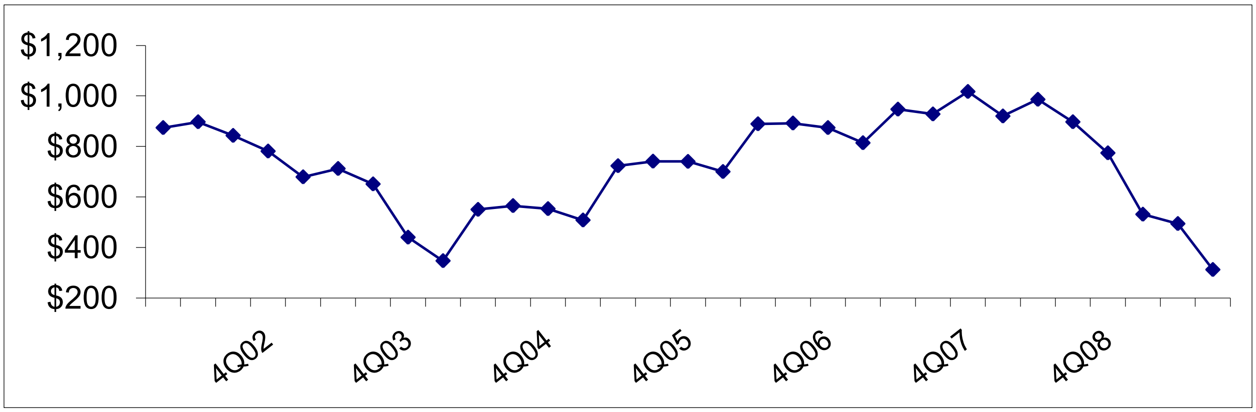
Tax Calendar Year	Percentage Unemployment Rate at End of Year*	UI Trust Fund Balance as of Prior September 30 ($ in Millions)**	Tax Rate Table in Effect	Annual Benefit Payouts*** ($ in Millions)
1999	3.5	$741.6		$265.0
2000	3.7	815.8		261.4
2001	4.5	882.8		394.5
2002	4.4	866.9		498.9
2003	4.5	824.7		512.1
2004	4.2	638.5		430.8
2005	3.9	703.6		384.7
2006	3.6	883.1	B	383.5
2007	3.6	1,032.5	A	433.3
2008	5.4	1,057.8	A	785.2
2009	7.2	895.4	B	834.1
2010	N/A	301.7	F	N/A

*Unemployment rate for 2009 is as of September 2009.
**Calendar 2003 includes $142.9 million of Reed Act funds provided by the federal government.
***2009 payout amount is as of September 2009.

Source: U.S. Department of Labor; Department of Labor, Licensing, and Regulation

Exhibit 2 details quarterly activity in the UI trust fund since the infusion of the federal Reed Act funds in 2002. In the two-year aftermath of September 11, withdrawals from the trust fund significantly outpaced deposits, resulting in a 10-year low in the first quarter of 2004. Conversely, in healthier economic times from calendar 2004 to 2006, deposits to the UI trust fund were greater than withdrawals leading to a steady climb in the UI trust fund balance. The recent economic downturn has manifested itself in the fluctuations in the UI trust fund in calendar 2007, 2008, and the first three quarters of 2009. In general, withdrawals have significantly outpaced deposits, driving down the balance, and triggering a move from Table B in 2009 to Table F in calendar 2010.

Exhibit 2
Unemployment Insurance Trust Fund
Quarterly Ending Balances
Calendar 2002-2009
($ in Millions)



Source: U.S. Department of Treasury

While Maryland's UI trust fund is entering a level of concern, other states are projected to deplete their trust funds during 2009 to cover the cost of benefit payouts. Several states hit bottom during calendar 2008, depleting the balances of their UI trust funds. When funds are fully depleted, states may borrow from the federal government's unemployment trust fund. Approximately 22 states, as of mid-September 2009 have borrowed money to pay benefits. In order to prevent interest from accruing, which must be paid with general funds, loans must be repaid within a year.

Federal Initiatives Offer States Infusion of Funds in Return for Expanding Eligibility for Unemployment Insurance Benefits

The Committee on Unemployment Insurance Oversight is meeting during the 2009 interim to discuss the status of the UI trust fund and its adequacy in this economic downturn. Further, the committee will be discussing the federal initiatives, as provided under the American Recovery and Reinvestment Act, to modernize the UI system.

The federal stimulus legislation includes a total of $7 billion for the UI system across the states. Under this legislation, several thousand more workers in Maryland would be eligible for UI benefits if the State accepts additional Reed Act funds that would only be available if UI benefits are expanded in specified ways. Maryland's allotment of the total funding is estimated at $126.8 million. This is in addition to the additional federal emergency compensation that added $25 in weekly benefits and up to 33 weeks of additional benefits. To receive the $126.8 million in additional federal funding, Maryland would be required to amend its UI statute.

To be eligible for any of the incentive payments, the federal government 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 completed quarters of employment as the base period (known as the traditional approach). The quarter immediately prior to filing a claim is not used because employers do not report those earnings until the following quarter (the quarter in which the claim is filed). Minimum qualifying wages are specified under state law and are used, along with high quarter wages, to determine the weekly benefit amount for a claimant. Under an alternative base period approach, if an individual does not have sufficient wages in the base period to qualify for benefits under the traditional approach, then the alternative base period would be the last four completed calendar quarters immediately preceding the first day of the individual's benefit year.

Once a state adopts the alternative base period approach into their law, 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 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 Workforce Investment Act training benefits for at least 26 weeks in high demand industries; or (4) adding a $15 weekly allowance to UI payments for dependents.

Of the changes suggested in the federal legislation, Maryland already allows part-time workers to be eligible for UI benefits under certain circumstances, as provided under Chapters 5 and 6 of 2009 (although minor changes are necessary for this law to qualify). The Unemployment Insurance Division of the Department of Labor, Licensing, and Regulation has estimated that the part-time legislation has resulted in an additional pay-out of approximately $500,000 in UI benefits since the law took effect in April 2009. Further, Maryland law provides an allowance for dependents under the age of 16; however, the dependents' allowance amount ($8 per week) is below the $15 required by the federal legislation. The estimated cost of the changes would be $6.8 million annually for providing coverage to individuals who separate from work for compelling family reasons; $1.8 million annually for providing training benefits; and $15.6 million for increasing the weekly allowance to UI payments for dependents.

In addition to expanding eligibility for UI benefits, the $126.8 million could be used to increase the balance in the UI trust fund, potentially allowing the State to move to a lower tax rate in calendar 2011. It is anticipated that the Governor will introduce a UI legislative package that will amend Maryland's statute to meet the requirements under the federal legislation during the 2010 session. In order for a state to access its additional federal funds, the required provisions must be in place by August 31, 2011, and the effective date of the legislation must be on or before September 21, 2012.

The committee is also discussing other alternatives, including administrative changes that could contribute to an increase in the balance of the UI trust fund to a level that would lower the tax rate for employers in subsequent years. Several groups, including a workgroup of small businesses organized by the Secretary of Business and Economic Development, are meeting to develop recommendations for review by the committee.

Business Regulation

Regulation of Professional Employer Organizations

Professional employer organizations operating in Maryland are not subject to State regulation, as is the case in 36 other states. It is anticipated that legislation will be re-introduced during the 2010 session to regulate this industry. Issues that need further discussion relate to how workers' compensation insurance coverage would be secured for a company's covered employees when the company uses a professional employer organization to handle the company's human resources management services.

Professional Employer Organizations

A Professional Employer Organization (PEO) is a business that provides outsourced human resource management services to companies that choose not to establish their own human resource departments. According to Staffmarket.com, an online PEO broker, 63 PEOs currently operate in Maryland, including some with out-of-state headquarters. Some PEO firms have multiple offices in the State. Nationwide, approximately 36 states have PEO licensing and registration laws.

A PEO operates by establishing and maintaining an employer relationship with a client's employees through co-employment agreements. The agreement contractually confers certain employer rights, responsibilities, and risks on the PEO that enable the PEO to pay wages and employment taxes and premiums out of its own accounts on behalf of the client. However, under the agreements, a PEO typically reserves the right of direction and control over covered employees and retains the right to hire, reassign, and fire covered employees. This gives the PEO an opportunity to manage the risks it assumes through the co-employment agreement.

State Regulation of PEOs

Except for the purchase of health insurance, PEOs operating in Maryland are not subject to State regulation. House Bill 1056 and Senate Bill 995 of 2009 would have required PEOs to register with the Department of Labor, Licensing, and Regulation by submitting an application, paying a registration fee, and providing specified business documentation, including a financial statement that sets forth the financial condition of the company, and the most recent independent audit.

A PEO found to be operating in the State without valid registration would have been guilty of a misdemeanor and subject to a fine of up to $1,000 for a first offense and up to $5,000 for a second or subsequent offense. A person who engaged in repeated violations of the bill's provisions would also have been guilty of a misdemeanor and subject to a fine of up to $2,500.

If a PEO was found guilty of a violation, the Secretary of Labor, Licensing, and Regulation would have been able to impose a civil fine of up to $1,000 for each day of unlawful action.

Workers' Compensation Laws and PEOs

Employers in Maryland are required to obtain workers' compensation insurance from any insurance company licensed to write workers' compensation insurance, the Injured Workers' Insurance Fund, or by becoming a self-insured employer. A PEO is not exempt from this requirement. House Bill 1056 and Senate Bill 995 would have provided that workers' compensation insurance purchase decisions for covered employees leased out to a client be subject to co-employment agreements but did not stipulate what must be contained in the agreements. Co-employment agreements may not highlight issues related to experience rating and policy types.

Experience Rating

The experience rating of a company is an assessment of the number and cost of the workers' compensation claims a company has been liable for in the past. This rating is used in determining insurance premium rates for a company. A company that has had fewer incidents and lower costing incidents will have a better experience rating and a lower premium rate than a company that has had more incidents with higher costs. But when a company uses a PEO to supply employees, whose rating is used: the client's or the PEO's? The PEO's rating may not be an accurate reflection of the client's experience because the PEO may have a wide array of clients and employees with varying experience ratings. Moreover, clients with higher experience ratings could contract with PEOs to avoid a higher premium.

Type of Policy

The types of policies available to a PEO include a traditional policy, a master policy, and a policy that covers multiple PEOs. The traditional policy would be issued to the PEO for coverage of only one of the PEO's clients. This type of policy more closely resembles what would occur if the PEO did not exist; the client would purchase a policy and that policy would cover only that client's employees. This policy may be purchased by the PEO or on behalf of each client with certain payment obligations and policy communications going through the PEO. A master policy is a single policy that is issued to the PEO and provides coverage for more than one client. The master policy may also cover the PEO's on-site employees. This type of policy would allow stable premium rates for the PEO and its clients but would bring up the experience rating issues highlighted above. The last type of policy is one in which a group of PEOs are covered by one policy. This type of policy would allow multiple PEOs to be covered under a single policy and would also raise experience rating issues. The 2009 legislation did not specify which policies would be allowed and who would bear the burden of paying for workers' compensation insurance in a PEO-client agreement.

Business Regulation

Commission to Study the Title Insurance Industry

The Commission to Study the Title Insurance Industry is expected to recommend strengthening laws relating to theft of funds by a title insurance producer and defining the duties of certain settlement closers and the relationship of the closers to their title insurers. Additional recommendations may include enhanced disclosures of affiliated business relationships and heightened oversight of title insurance rate making.

Background and Creation of the Commission

Title insurance policies are marketed as a method of protecting the financial interests of real property owners and mortgage lenders by insuring against losses that may be suffered due to title defects, liens, or other matters relating to real property titles. In most cases, such policies will defend against lawsuits that attack the title of a property, or reimburse the insured for actual monetary losses associated with title issues. Title insurance exists as a result of the complex land records system currently in use in most jurisdictions across the country. Most state recording systems rely on the person obtaining an interest in a property to record that interest following a transaction. Errors in this recording process can lead to a myriad of legal problems for property owners; the courts are the final arbiters of title matters, including liens, in nonregistration land record systems.

Title insurance regulation and the title insurance industry have come under heightened scrutiny recently, due in large part to a significant rise in property foreclosure rates in many areas, including Maryland. Much of the concern regarding title insurance stems from cases in which title insurers have utilized illegal sales tactics. While property purchasers are free to choose their own title insurance provider, in most cases purchasers defer this decision to their real estate agent or mortgage lender. This has led to situations in which title insurers have sometimes provided kickbacks to these decision makers or developed other conflicts of interest.

The Maryland Insurance Administration (MIA) interacts with the title insurance industry in a variety of ways. For example, MIA investigates consumer complaints and questions concerning insurance companies operating in Maryland and resolves insurance appeals and grievances concerning coverage decisions or claims denials.

Chapters 356 and 357 of 2008 created the Commission to Study the Title Insurance Industry to make recommendations for changes to Maryland law relating to the title insurance industry. In order to develop recommendations, the commission is required to (1) review State laws relating to the title insurance industry; (2) review the mechanisms available to enforce State laws relating to the title insurance industry; (3) identify title insurance industry issues that affect consumers in Maryland; (4) examine the rate-setting factors for title insurance premiums; (5) examine how rates and services in a title plant state compare to those in Maryland;

(6) identify ways to improve consumer education about the title insurance industry; (7) study whether mechanics' liens on properties scheduled for settlement have an impact on the timeliness of settlements or on title insurance premium rates; (8) review the time limits, subsequent to closing, for the issuance of title insurance policies; and (9) study affiliated business arrangements among businesses involved with the settlement of real estate transactions to determine the impact of these arrangements on title insurance premium rates.

Although originally established in 2008, the commission received an expanded charge under Chapter 361 of 2009 to review the adequacy of the bonding and letter of credit requirements that were altered under the 2009 legislation. Specifically, the bill limits control of funds held in trust to only the licensed title insurance producer in that entity and increases the amount of the fidelity bond and the amount of the blanket surety bond or letter of credit that title insurers must maintain as a condition of licensure from $100,000 to $150,000.

Commission Proceedings

Due to late appointments to the commission, the commission first met in December 2008 and also held a meeting in January 2009. During the 2009 interim, the commission continued its work investigating conditions in the industry in Maryland and attempting to ascertain whether additional changes to the State's regulatory regime are warranted.

The commission scheduled six meetings after the 2009 legislative session, including three public hearings to receive public testimony on issues in title insurance and related residential real estate closing practices. Those testifying at public hearings included title insurance providers, settlement closers, attorneys, and consumers. To address matters raised by the members and through public testimony, the commission established three workgroups dealing with the adequacy of the existing regulatory regime, consumer protection, and affiliated business arrangements.

Recommendations

Although the commission has not approved its final recommendations as of November 2009, the recommendations from the workgroups include several proposed legislative and regulatory changes. A number of these recommendations may be introduced as legislation in the 2010 session.

The regulatory workgroup examined the effect of the increased blanket surety bond amounts enacted under Chapter 361 of 2009 but was unable to draw conclusions from the data presented. Instead, the workgroup recommended additional study of customer complaints and the nature and level of theft (defalcation) of funds, with the possible establishment of a guaranty fund as an alternative to higher required bond levels. The workgroup also recommended requiring so-called title insurance producer independent contractors (TIPICs) to be associated with a licensed title insurance producer having an office in the State.

The consumer protection workgroup identified two areas for possible legislative action. First, the workgroup recommended stating explicitly that a title insurer is liable for a theft of funds by a title insurance producer of funds held by the producer in contemplation of or in conjunction with a real estate closing. Second, the workgroup recommended defining in statute the legal responsibility of TIPICs, making them agents of the title insurer rather than independent contractors, and transferring their bonding requirement to the insurer. As a regulatory matter, the workgroup recommended the development of a "consumer's title insurance bill of rights" by the Commissioner of Financial Regulation in the Department of Labor, Licensing, and Regulation and MIA, although this could also be supported by legislation. A final regulatory recommendation, consistent with examination of the current statutory scheme by the regulatory workgroup, is to increase MIA scrutiny of title insurance rates and commissions in light of apparently low loss ratios.

The affiliated business arrangement workgroup made three recommendations. First, it suggested that a State version of the federal Real Estate Settlement Procedures Act (RESPA) be enacted, to the extent that it would not be preempted by federal law or regulations. This would require, on a State level, the disclosure to consumers of affiliated business arrangements, such as those between title insurance producers and lenders or real estate agents. Second, the workgroup recommended making the examination of a good faith estimate part of the market conduct study of title insurance companies, in order to address compliance with federal tolerance rules. Finally, the workgroup recommended requiring the identity and license number of the individual closing the transaction to be stated on closing documents. Additionally, the workgroup expressed concerns about the level of training and education of those who provide settlement services and about the inability of title insurance producers to record mortgage releases after payoffs are made.

Public Safety

Sex Offenders

Statutory changes are needed if Maryland is to comply with the 2006 federal legislation on sex offenders, commonly referred to as the "Adam Walsh Act," and the federal implementing regulations. Failure to substantially comply with federal requirements could result in a loss of 10% of federal Byrne Justice Assistance grant funding.

Background

Following several high-profile murder and sexual assault cases involving child victims, far-reaching State and federal legislation has been enacted to more strongly punish and more closely monitor sex offenders. The federal Sex Offender Registration and Notification Act (SORNA), enacted as Title I of the Adam Walsh Child Protection and Safety Act of 2006 (P.L. 109-248), requires conformity by the states with various aspects of sex offender registration provisions, including registration of specified juvenile offenders, collection of specific information from registrants, verification, duration of registration, access to and sharing of information, and penalties for failure to register. The final guidelines/regulations were issued on July 2, 2008. Although July 27, 2009, was originally established as the deadline for substantial implementation of SORNA's requirements by all jurisdictions, a one-year extension was granted on May 26, 2009, to all jurisdictions required to comply with the provisions of SORNA.

Jurisdictions now have until July 27, 2010, to substantially implement specific requirements for registering and monitoring sex offenders under the SORNA provisions of the Adam Walsh Act. In addition to this extension, jurisdictions may request another one-year extension. Currently, only Ohio has been deemed substantially compliant under the Act.

In addition, in September 2008, Congress passed the Keeping the Internet Devoid of Sexual Predators Act of 2008 (P.L. 100-400), which expands upon SORNA's requirements relating to online identifiers used by sex offenders. Guidelines and regulations for this Act have not yet been developed.

Federal Requirements

Under SORNA's final guidelines/regulations, it appears that the following modifications to current State law, among others, would be needed to comply with SORNA.

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. Although states are not required to mirror the federal tiers, it may be necessary to significantly revamp Maryland's classification system to meet the minimum federal requirements.

Registration Deadlines

SORNA requires an offender to appear in person not later than three business days after each change of name, residence, employment, or student status and inform the jurisdiction in which the person is required to register 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 a juvenile offender 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 18 U.S.C. § 2241 (Aggravated Sexual Abuse) or 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 and certain other juvenile offenders whose offenses were of the most serious variety and who have been determined to be at significant risk of reoffending, after reaching the age of 18.

Registry Information

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

Homeless Persons

Because SORNA 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). Maryland law does not currently account for the homeless offender population.

Retroactivity

The Act applies to all sexual offenders, including those offenders convicted prior to the enactment of SORNA (July 27, 2006) or prior to a particular jurisdiction's implementation of the SORNA requirements. Jurisdictions do not have to seek out pre-SORNA convicted sex offenders and reregister them if their previous registrations have expired. If a person reoffends or reenters the judicial system for any crime, the individual will need to register under SORNA guidelines. Generally, a Maryland offender need not register if he or she was convicted of a qualifying offense and served the associated sentence prior to October 1, 1995.

Compliance Issues

Failure to comply with SORNA puts a state at risk to lose 10% of Byrne Justice Assistance grants, which all states use to pay for such things as drug task forces, anti-gang units, police overtime, and other law enforcement activities. Under the federal American Recovery and Reinvestment Act of 2009 (the federal "Stimulus Bill"), the Byrne formula grants program has been reauthorized from fiscal 2009 through 2011. Maryland will receive an estimated $26.6 million in fiscal 2010 and $18.5 million in fiscal 2011. However, because one-year extensions on compliance have been granted to all states, Indian tribes, territories, and the District of Columbia, no Byrne funds are at risk in fiscal 2010. Unless a second one-year extension is sought and granted, Maryland could be at risk to lose about $1.9 million in Byrne funding in fiscal 2011.

Maryland's federal Byrne grant funding levels are shown in **Exhibit 1** for recent State budget years.

Exhibit 1
Byrne Justice Assistance Grants
($ in Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Byrne Funding	$5.7	$6.5	$2.4	$26.6	$18.5
Amount at risk for SORNA noncompliance				$0.0	$1.9

SORNA: Sex Offender Registration and Notification Act

Source: Governor's Office of Crime Control and Prevention; Department of Legislative Services

During the 2008 session, a departmental bill (House Bill 1538) was introduced at the request of the Department of Public Safety and Correctional Services to conform State sexual offender notification and registration provisions to SORNA. The provisions of the bill were also submitted to the federal Office of Sex Offender Sentencing, Monitoring, Apprehending, Registering, and Tracking (SMART Office) as a proposed compliance submission should the bill pass. The bill did not pass, and the SMART Office found that, while Maryland's proposed changes and efforts were commendable, they would not bring the State into substantial compliance under the Act. Another departmental bill or an Administration bill based on both the 2008 response from the SMART Office and the final federal guidelines is expected to be introduced during the 2010 session.

Public Safety

State Correctional System Update

The Department of Public Safety and Correctional Services continues to face challenges relating to capacity and staffing at State correctional facilities. Proposals are expected to modify management of prison and parolee populations.

Background

The primary focus of the Department of Public Safety and Correctional Services (DPSCS) is the supervision and management of Maryland's criminal population. Three agencies within DPSCS focus on those criminals sentenced to terms of confinement by the courts: the Division of Correction (DOC), the Patuxent Institution, and the Division of Pretrial Detention and Services (DPDS). DPDS also manages those awaiting trial in Baltimore City. The Division of Parole and Probation (DPP) focuses on criminals sentenced to probation by the courts or released from correctional facilities.

Population Trends

Maryland's inmate population achieved a record high of 23,633 inmates in fiscal 2003. From fiscal 2003 through 2006, the number of inmates released from DOC facilities exceeded the number of offenders entering the correctional system. This resulted in a reduction in the prison population of more than 1,200 inmates. Increases in the number of new intakes in fiscal 2007 and the number of parole revocations in fiscal 2008 caused the population to again exceed 23,000; however, fiscal 2009 continued the downward trend with an average daily inmate population of 22,709.

The number of offenders under community supervision has increased since fiscal 2006, from 65,114 to 70,727 active cases. The majority of the growth has been from criminal supervision cases, which account for an average of 76% of all DPP cases, while Drinking Driver Monitoring Program cases account for 24%.

Fiscal Update

Since the start of fiscal 2010, the budget for DPSCS has been reduced by approximately \$51.0 million in general funds and \$863,000 in special funds. Approximately \$28.2 million of this reduction is attributable to Federal Fiscal Stabilization funding originally allocated to various higher education institutions. Employee furloughs reduced the department's budget by \$11.6 million in general funds and approximately \$600,000 in special funds. Operationally, the closure of the Toulson Correctional Facility in Jessup and the west wing of the Metropolitan

Transition Center in Baltimore City resulted in general fund savings of $4.4 million and special fund savings of approximately $259,000. A total of 88 vacant positions were also eliminated as part of the facilities' closure. Employees and inmates previously located at the facilities have been transferred to other locations throughout the State.

Need for Parole and Community Supervision Reform

According to a March 2009 report by the Justice Policy Institute, Maryland could experience significant savings by reforming its parole system in order to increase the number of released offenders. Specific recommendations of the report include:

- increase use of risk assessment tools;
- match supervision with needs and risks; and
- institute early release for parole.

DPSCS has been making an effort to modify parole and community supervision in Maryland in ways that are consistent with these recommendations. In August 2007, DPP began the Violent Offender Initiative to provide enhanced criminal supervision targeted at offenders who demonstrate, through the use of risk assessment tools, a propensity towards violence. The Maryland Parole Commission also implemented new parole guidelines and a revised risk assessment tool to assist in evaluating eligible offenders for parole. An assessment of the impact of these measures is pending. However, as of August 2009, there were more than 1,700 nonviolent offenders in DOC facilities who had served at least 25% of their sentences and been deemed eligible for immediate or delayed release on parole.

The report's recommendation regarding instituting an early release program for supervised offenders involves allowing people to shorten their periods of parole through good behavior and participation in education, employment, and other services, similar to the system already in place for incarcerated offenders. Research shows that people who have not violated their conditions of supervision for long periods of time are unlikely to commit new crimes. This system would provide an incentive for good behavior as well as reduce the amount of time that people are under supervision, thus lowering costs and reducing opportunities for people to return to prison on technical violations.

A number of states have been revising their parole and community supervision systems in order to reduce the number of incarcerated and supervised offenders. For example, in 2007 Nevada passed legislation to allow an individual's term of supervision to be reduced by up to 20 days per month by earning good time credit while on parole. In addition, Arizona awards up to 20 days per month of earned compliance credit for probationers who are making progress toward the goals established in their case plans and are current on court and restitution payments. The estimated fiscal impact of this legislation is savings of approximately $6.9 million.

Implementation of an early release program for community supervised offenders could significantly reduce parole and probation agent caseloads. This would allow the department to focus its resources on those offenders who are identified as being higher risk. In addition, if Maryland were to increase its parole rates at the same time it implements earned compliance credits for community supervised offenders, significant cost savings could result from reducing the prison population enough to close prison facilities while still maintaining adequate agent caseloads.

It is anticipated that such reform measures will be recommended and considered during the upcoming legislative session.

Addressing the Presence of Cell Phones within Prison Facilities

The presence of cell phones within prison facilities is a significant issue, as seen in **Exhibit 1**. More than 1,100 cell phones were recovered from Maryland correctional facilities in fiscal 2009. Cell phones are illegal devices when used inside prisons and are believed to aid inmates in orchestrating violent activities in the community.

Exhibit 1
Department of Public Safety and Correctional Services
Cell Phones Recovered in Prison Facilities

Agency	Fiscal 2008	Fiscal 2009	Fiscal 2010 Projection
DOC	847	1,001	708
DPDS	33	104	30
Patuxent Institution	25	26	0

DOC: Division of Correction
DPDS: Division of Pretrial Detention and Services
Fiscal 2010 projection based on average recoveries from July and August 2009.

Source: Department of Public Safety and Correctional Services, State Stat Report

Under current law, the Federal Communications Commission (FCC) does not permit the jamming of any type of cell phone device or signal for any reason. To help curb the use of cell phones within prison facilities, the Safe Prisons Communications Act of 2009 (S. 251) was introduced in Congress in January 2009. If enacted, the bill would allow states to petition the FCC for permission to install devices that would prevent, jam, or interfere with wireless communication within a correctional facility. The legislation has received the approval of the Senate and is currently under consideration by the House of Representatives.

DPSCS is also considering the use of alternative devices that would detect the presence of cell phones within prison facilities, without prohibiting wireless communication. The department held a demonstration of such devices in September 2009. Presentations were given by six vendors. The majority of the vendors demonstrated devices that were designed to identify wireless signals and assist correctional officers in locating cell phones within the facility, while one vendor had a device that could reroute a cell phone signal if it came from within a prison and was not on a list of allowable phone numbers.

Prison Rape Elimination Act

The Prison Rape Elimination Act (PREA) was passed by Congress in 2003 to study whether inmates are regularly subjected to rape or sexual assaults. In June 2009, the PREA Commission released its final report and proposed standards to address the issue of prison rape and sexual abuse. The U.S. Attorney General's recommendation regarding inclusion of the standards in federal regulations is expected within one year.

The proposed standards allow for reporting of rape or sexual assault to be made to a variety of staff members, not just tier officers, as had previously been the policy. The proposed standards also include requirements for such matters as inmate orientation, staff training, and prevention efforts.

Depending upon the final wording, some of the regulations could be very difficult and costly to implement. Specific issues with the proposed standards include:

- Requiring an increase in supervision to ensure that no sexual abuse occurs. The federal interpretation is that an inmate should never be out of the sight of an officer or staff member, which would require increased staffing or security cameras.

- Prohibiting cross-gender supervision. Currently, 43% of correctional officers in the Jessup Region are female, with only one female facility. Approximately 50% of the correctional officers in the Baltimore Region are female.

It is not yet known whether federal funding will be provided to support compliance with the regulations, once they take effect, or what control the federal government will have to require implementation by the states.

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Criminal Law

Gangs

The Maryland Gang Prosecution Act of 2007 has resulted in few prosecutions, while gangs continue to proliferate throughout the State. Additional proposals are expected during the 2010 session.

Gang Activity in Maryland

The proliferation of gangs and their migration from urban communities to suburban and rural locations, which began more than two decades ago, is a significant problem in most areas of the country, including Maryland. It is estimated that there are over 600 active gangs in the State with over 11,000 members. The most prominent gangs in the State include the Bloods, Crips, MS-13, Black Guerilla Family, and Dead Man Incorporated. **Exhibit 1** illustrates the estimated street gang presence by jurisdiction.

Exhibit 1
Gangs in Maryland

Jurisdiction	Gangs	Members
Baltimore City	54	1,950
Allegany, Frederick, Garrett, Washington counties	50	800
Baltimore, Carroll, Cecil, Harford, Howard counties	170	3,600
Montgomery and Prince George's counties	300	3,800
Anne Arundel, Calvert, Charles, St. Mary's counties	70	650
Caroline, Dorchester, Kent, Queen Anne's, Somerset, Talbot, Worcester, Wicomico counties	50	600
Total		**11,400**

Source: Maryland Coordination and Analysis Center

In addition to traditional street gang activity, the Department of Public Safety and Correctional Services (DPSCS) designates gangs within correctional facilities as Security Threat Groups (STG). DPSCS uses 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 2 to 9 points is considered an "associate" of a gang and an inmate with 10 or more points is considered a validated member. As of

October 2009, DPSCS has identified approximately 3,400 STG members and 500 associates who participate in over 260 different gangs.

Maryland's Response

Agency Initiatives

The Maryland State Police (MSP) has staff devoted to investigating gang-related crime, conducting training, and analyzing gang data in an effort to combat increased gang activity in the State and provide support to local jurisdictions that may not have the resources to deal with gang-related crimes. The Department of Juvenile Services (DJS) regularly meets with law enforcement agencies in order to share information regarding youth gang activity. DJS provides gang awareness training to all new employees and to various community groups and has developed prevention and intervention guides that are written specifically for targeted groups. DJS also utilizes resources within the community to create plans to assist youth formerly involved in gang-related activities in being reintroduced in the community after detention and rehabilitation. These reentry plans include role modeling and mentoring, job training and placement, educational support, tattoo removal, and truancy prevention programs.

The "Kaizen Project" was established by Governor Martin J. O'Malley to develop statewide strategies to combat the State's gang problems. Leaders from five entities (MSP, the Baltimore City Police Department, the Baltimore County Police Department, DJS, and DPSCS) spearheaded the project, which involved over 50 criminal justice stakeholders and resulted in a number of initiatives. These initiatives included the development of the "Gang Intervention and Prevention Resource" brochure, which was designed to provide communities and families with the information, resources, and contacts necessary to identify and address gang activity.

Maryland Gang Prosecution Act of 2007

Concern about reports of increased gang activity led to 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 knowing that the members of the gang engage in an ongoing pattern of criminal gang activity; or (2) knowingly or willfully directing or participating in the commission of an underlying crime, or an 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.

Potential Legislation

As enacted, Chapter 496 of 2007 was not supported by any of the 24 State's Attorneys in the State. Recent testimony indicated that to date, prosecutors have rarely attempted to use the statute. As required by Chapter 496, the Attorney General and the Maryland State Attorneys' Association submitted a report on January 1, 2008, to the General Assembly on their recommendations for additional legislation to assist in the prosecution of gang activity. Although several of the proposals included in the report were introduced in the 2008 and 2009 sessions, none has been enacted. These proposals, which are expected to again be introduced in the upcoming session, include:

- eliminating the requirement that in order to be defined as a gang, there must be an "ongoing" association of three or more people. Prosecutors contend that this definition leaves open for argument that the alleged gang must be "ongoing" even at the time of arrest or trial;

- expanding the list of underlying crimes that are required to be proven to include various misdemeanor crimes that are often associated with gang activity, such as malicious destruction of property *(i.e.,* creating graffiti), second degree assault, receiving earnings of a prostitute, and wagering. Maryland gang law currently restricts the underlying crime to crimes of violence and felony violations of certain laws;

- requiring that, where imposed, the gang offense must be served consecutively to the sentence for the underlying crime. Prosecutors argue that the impact of the Gang Prosecution Act is substantially diminished because, as currently written, a court may order a sentence for a gang violation to run concurrently with the sentence for the underlying crime; and

- expanding the list of factors that may be used by law enforcement statewide to uniformly authenticate and validate gang membership. The current statute requires a showing that the members of an alleged gang "have in common an identifying sign, symbol, name, leader, or purpose." Prosecutors contend that identifiers such as symbols and flags, style or color of dress, tattoos, claims of territory, or self-proclamation are also frequently used by local law enforcement agencies to document and validate gang membership.

Proposals in the area of prevention and intervention are also expected to be introduced during the 2010 session, including measures to facilitate the sharing of information relating to juveniles who may be gang-involved between schools and law enforcement units.

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Criminal Law

Death Penalty

In the wake of legislation significantly restricting the application of the death penalty in Maryland, the Department of Public Safety and Correction Services has proposed regulations establishing the protocols for carrying out executions. The department has been asked to delay final adoption of the regulations, however, until issues regarding implementation of the protocols have been addressed.

2009 Legislation

During the 2009 session, the General Assembly passed legislation altering the application of the death penalty in Maryland. Under Chapter 186 of 2009, the death penalty is restricted to cases in which the State presents the court or jury with (1) biological evidence or DNA evidence that links the defendant with the act of murder; (2) a videotaped, voluntary interrogation and confession of the defendant to the murder; or (3) a video recording that conclusively links the defendant to the murder. A defendant may not be sentenced to death if the State relies solely on evidence provided by eyewitnesses in the case.

While the enacted legislation is not the repeal of the death penalty that was contained in the original version of the Administration bill, it does place significant restrictions on the application of the death penalty in the State.

Maryland Court Decision

Executions in the State have been halted since the December 2006 decision by the Maryland Court of Appeals in *Evans v. State*, 396 Md. 256 (2006). In that case, the court heard arguments on an appeal of a sentence to death by Vernon L. Evans, Jr. Evans's appeal was based on four claims: (1) mitigating evidence about Evans's abusive childhood was not investigated by his previous attorneys or presented at trial; (2) prosecutors improperly used their challenges to dismiss, based on race, 8 of 10 potential jurors who were African American; (3) the application of the death penalty is biased by race and geography, as documented by a University of Maryland study; and (4) the regulatory procedures for carrying out the death sentence, including execution by lethal injection, were adopted without the public input required by the Administrative Procedure Act (APA). While the court did not find merit in the first three claims, it did rule in Evans's favor on his claim that the death penalty regulations did not comply with the APA. The court held that the Division of Correction protocols are ineffective until either (1) the protocols are adopted as regulations under the APA; or (2) the General Assembly exempts the protocols from the procedures required by the APA.

Proposed Death Penalty Regulations

On June 24, 2009, the Department of Public Safety and Correctional Services released the new proposed regulations. Among other things, the regulations:

- require that an inmate with multiple attorneys decide which one, if requested, should witness the execution;
- permit an inmate to receive visitors up to three hours prior to an execution;
- require the Commissioner of Correction to ensure that individuals assigned to the lethal injection team are trained and certified to administer the authorized pharmaceuticals used during the execution process and insert intravenous catheters into the inmate, if required;
- require that two injection sites and two intravenous lines be established and that one extra syringe of each of three drugs administered be prepared as a standby;
- require a certified or contracted paramedic to be present to resuscitate the inmate if a stay of execution is granted;
- require a pre-execution examination of the inmate to determine optimal locations for the insertion of intravenous needles during the execution;
- permit the placement of an injection in an area other than the inmate's arm if a vein cannot be palpated in the arm;
- ban the use of the "cut down" procedure, in which an individual's vein is cut in order to administer an injection; and
- permit the continued use of pancuronium bromide as part of the lethal cocktail of drugs used during executions.

Death penalty opponents have voiced numerous objections to the regulations, particularly over the drugs administered, participation of medical personnel, and lack of specifics.

As previously stated, the regulations permit the continued use of pancuronium bromide, a muscle relaxant, as part of the three-drug cocktail administered to an inmate during an execution. Objections to the drug are centered on the fact that this paralytic agent completely immobilizes an individual to the point that he or she would not be able to express pain or communicate as to the effectiveness of the anesthetic. The chemical is currently prohibited for use in animal euthanasia in Maryland and some other states. The Administrative, Executive, and Legislative Committee (AELR) has also questioned the continued use of three drugs when the relevant statute specifies that two drugs may be used to induce death.

The regulations also require that a physician be present to pronounce death, as well as the presence of trained or certified personnel to administer the drugs. Opponents have raised concerns that the presence of medical personnel may create a conflict with professional ethics, since Opinion 2.06 of the American Medical Association's Code of Medical Ethics states that a physician "should not be a participant in a legally authorized execution." As for the lack of specifics, the regulations do not specify a limit on the time the lethal injection team can take to find an inmate's vein or qualifications for members of the lethal injection team.

In September, AELR formally requested that the Department of Public Safety and Correctional Services delay final adoption of the death penalty procedure regulations so that the committee could conduct a more detailed study of the issues. On October 12, 2009, the AELR Committee placed the regulations on hold for further study. The committee's concerns center on whether the regulations are specific enough on the administration of lethal injections, the use of a three-drug protocol, the training of execution personnel, and whether the regulations ensure that mishandled executions will not take place. The committee's concerns on the training of personnel have taken on even greater relevance after officials in Ohio halted an execution in September after spending two hours trying to find an adequate vein in the inmate.

Criminal Law

Ignition Interlock Systems

Numerous studies have found that it would be possible to reduce the number of traffic accidents due to drunk driving by expanding participation in the Ignition Interlock System Program. Privacy issues, cost, and difficulty in calibration are among the arguments against expanded use of ignition interlock systems.

Overview

With the issuance of the final report of the Task Force to Combat Driving Under the Influence of Drugs and Alcohol in 2008, the problem of drunk driving has been brought into sharper focus in Maryland. Meanwhile, the use of ignition interlock systems has garnered more attention and support as a means for curbing the problem.

An ignition interlock is a small device that connects to a vehicle's ignition system and analyzes breath alcohol content (BAC). A driver must blow into the device before the vehicle will start. The interlock will prevent the vehicle from starting if the BAC is above a certain level. The systems may be set for "running retests" which require a driver to provide breath tests at regular intervals. If a driver fails a retest, the vehicle will continue to operate, but the failure will be recorded as a violation.

Opponents of the use of ignition interlocks cite privacy issues, expense, and the potential for hyper-sensitivity of the device, as reasons why the use of ignition interlock systems should not be more widespread. Also, concern about limitations on judicial and administrative discretion has been raised. As the final report of the task force pointed out, numerous studies have found that ignition interlocks reduce the rate of recidivism and may lead to long-lasting changes in driver behavior. In its final report, the task force recommended that all court-mandated ignition interlock users be required to achieve 6 consecutive violation-free months and that repeat offenders be required to achieve 12 consecutive violation-free months. National surveys have found broad public support for the mandatory use of ignition interlocks in certain instances, and public opinion in Maryland appears consistent with those findings. A recent survey conducted by the University of Maryland School of Public Health found that 86% of Maryland motorists surveyed support making the devices mandatory for repeat offenders and 44% would require installation of the devices after a first conviction.

Maryland's Ignition Interlock System Program

In accordance with the Maryland Vehicle Law, the Motor Vehicle Administration (MVA) has established an Ignition Interlock System Program for alcohol-impaired drivers. Participation in the program is usually not mandatory, but the law establishes strong incentives for drivers to choose ignition interlock. Generally, a person who is eligible for participation in the ignition interlock program is subject to license suspension or revocation due to an alcohol-related driving violation or the accumulation of points due to an alcohol-related driving violation. Very often the person is presented with the choice of program participation or accepting the license suspension or revocation. A court may order a person to participate in the ignition interlock program as a condition of probation or sentencing. Also, a person may participate if the person's driver's license has an alcohol restriction or if MVA modifies a suspension or issues a restricted license to the person. A notice of suspension or revocation for alcohol-related driving offenses must include information about the program and the conditions for participation.

A person who enters the program must pay a fee established by MVA and have an ignition interlock device installed in the vehicle the person will use. The participant must report to the ignition interlock vendor location to have the device serviced and data downloaded every 30 days. MVA monitors participants through the monthly data reports it receives from the vendors. Violations of the program, such as attempting to start or operate a vehicle with a BAC greater than .025%, failing to submit to a retest after starting the vehicle, tampering with the ignition interlock, having another person blow into the device, or operating a vehicle without a device, can result in removal from the program or an extension of the person's required period of participation by 30 days.

According to MVA, as of October 1, 2009, there were 7,930 participants in the program. Between October 2008 and September 2009, 2,168 people successfully completed the program and 2,893 people had to withdraw for failure to complete program requirements.

Laws of Other States

Most states have laws permitting the imposition of ignition interlock devices as sentencing alternatives for drunk drivers. Some states are requiring first-time offenders to use the device. According to Mothers Against Drunk Driving, 10 states (Alaska, Arizona, Arkansas, Hawaii, Illinois, Louisiana, Nebraska, New Mexico, Utah, and Washington) require participation in an ignition interlock program upon any conviction of a drunk driving offense involving a BAC of .08 or greater. (Hawaii's law, however, does not go into effect until 2011.) In addition, Colorado, while not technically mandating ignition interlock use for first-time offenders, has established such a strong incentive to participate that it, in effect, operates as a mandate. Eight states (Delaware, Florida, Kansas, New Hampshire¸ North Carolina, Virginia, West Virginia, and Wyoming) make participation mandatory with a BAC of .15 or greater. Six states require participation upon a repeat conviction and one state requires participation upon reinstatement of a license after an alcohol-related conviction. Finally, three states, (Alabama, South Dakota, and Vermont) have no ignition interlock law at all.

Future Legislative Considerations

During the 2009 legislative session, bills were introduced to require participation in the Ignition Interlock System Program for first-time and other high-risk offenders, to expand the pool of potential participants, and to increase the amounts of time individuals must participate in the program.

Courts and Civil Proceedings

Child Support Guidelines

Maryland's child support guidelines were originally enacted in 1989. Guidelines have not been adjusted to reflect changes in child-rearing costs and income levels since enactment.

Background

In each state, a court is required to use statutory child support guidelines to establish or modify child support. Three child support guideline models are generally used by the states. Twelve states and the District of Columbia use the "Percentage of Obligor's Income" model, which sets child support as a percentage of only the noncustodial parent's income. Three states use the "Melson Formula." This model uses a proportion of income from both parents to establish financial support for the child, provides for each parent's minimal self-support needs and the child's primary support needs, and incorporates a standard-of-living adjustment. The premise of the "Income Shares" model used in 35 states, including Maryland, is that a child should receive the same proportion of parental income as the child would have been received if the parents lived together. The basic child support obligation is determined in accordance with a statutory schedule and is then divided between the parents in proportion to the adjusted actual income of each parent.

Maryland's current guidelines were originally enacted in 1989 in response to federal child support mandates. At least every four years, the Child Support Enforcement Administration (CSEA) of the Department of Human Resources is required to review the guidelines to ensure that their application results in appropriate child support award amounts and to report its findings and recommendations to the General Assembly. During the 2008 interim, CSEA conducted its most recent review of the guidelines and, based on that review, proposed legislation during the 2009 session to update the current child support guidelines.

2009 Legislation

House Bill 1401 of 2009 would have made several significant changes to the guidelines including (1) revisions to reflect changes in child-rearing expenditures and income levels; (2) adjustments relating to "extraordinary medical expenses"; and (3) expansion of the guidelines to include monthly incomes of up to $30,000.

Updated Economic Data

The current schedule is based on economic estimates of child-rearing expenditures as a proportion of household consumption developed in 1988 by Dr. Thomas Espenshade using national data from the *1972-73 Consumer Expenditure Survey* conducted by the U. S. Bureau of Labor Statistics. A congressionally mandated federal study on child-rearing costs was conducted in 1990 by Dr. David Betson using data from 1980 to 1986. In 2001 and 2006, Dr. Betson updated his 1990 estimates using more recent data from the Consumer Expenditure Survey, which surveys about 6,000 households per year. To reflect changes in child rearing costs since the adoption of the current schedule, the revised schedule proposed by House Bill 1401 would have incorporated the Betson data updated to 2008 price levels. Additionally, the bill would have adjusted the schedule to reflect increases in current incomes and to account for Maryland's above average housing costs.

Medical Expenses

After determining the basic child support obligation in accordance with the schedule, child care expenses and extraordinary medical expenses are added to the basic obligation and divided between the parents in proportion to their adjusted actual incomes. Under Maryland law, "extraordinary medical expenses" are defined as uninsured expenses over $100 for a single illness or condition. House Bill 1401 would have revised the definition of "extraordinary medical expenses" to mean uninsured expenses over $250 per year, regardless of the number of illnesses or conditions.

Income Ceiling

The current schedule uses the combined monthly adjusted actual incomes of both parents and the number of children for whom support is required to determine the basic child support obligation. However, the maximum combined monthly income subject to the schedule is $10,000. For parental income above the $10,000 ceiling, the Court of Appeals has stated that the guidelines establish a rebuttable presumption that the maximum support award under the schedule is the minimum amount that should be awarded. Additionally, a court is required to determine the amount of support necessary to ensure the child's standard of living does not suffer because of the parents' separation and to give some consideration to the Income Shares method of apportioning the child support obligation. *See Voishan v. Palma,* 327 Md. 318 (1992). Since the enactment of the guidelines, it is more common for combined monthly incomes to exceed $10,000, causing more cases to fall outside of the current schedule. House Bill 1401 would have increased the combined monthly income ceiling to $30,000 in order to create predictability and uniformity of child support awards in cases in which parental incomes exceed the current schedule.

2009 Interim

During the 2009 interim, the Department of Human Resources briefed the Senate Judicial Proceedings Committee and the House Judiciary Committee on CSEA's review of and recommended changes to the child support guidelines. The department also held public forums around the State on the proposed revisions to the guidelines.

Courts and Civil Proceedings

Medical Malpractice

Medical malpractice insurance rates in Maryland have stabilized since the 2004 special session called to address sharp increases in premiums in 2004 and 2005. A recent case decided in Montgomery County and pending in the Court of Appeals has called into question whether the caps on noneconomic damages enacted during the special session actually apply in most medical malpractice cases in the State.

Background

In a special session in 2004, the General Assembly addressed what many called a medical malpractice "crisis." The Maryland Insurance Commissioner approved rate increases in insurance premiums (28% in 2004 and 33% in 2005) for the Medical Mutual Liability Insurance Society of Maryland (Medical Mutual), which insures between 70% and 75% 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% 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 the availability of health care 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) resumed on January 1, 2009. As discussed below, however, a recent case pending in the Maryland Court of Appeals has called into question whether these caps on noneconomic damages are actually in effect in most medical malpractice cases in the State.

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. Declining amounts were allocated to the fund's Rate Stabilization Account starting in fiscal 2006 and ending in fiscal 2009. In fiscal 2010 and thereafter, all revenue to the fund is allocated to the Medical Assistance Program Account.

Maryland's Medical Liability Climate Remains Calm

Medical malpractice insurance premiums have stabilized and become more affordable since the 2004 special session.

Medical Mutual

In December 2007, Medical Mutual and the Maryland Insurance Commissioner entered into a consent order in which Medical Mutual agreed to an 8% reduction in its base rates for all physicians and surgeons effective January 1, 2008, a dividend being issued to renewing policyholders, repayment to the State of the $84 million in subsidy payments Medical Mutual received from the Rate Stabilization Account, and a waiver of the right to receive any further payments from the Rate Stabilization Account.

Medical Mutual announced in November 2008 that its Board of Directors approved an 11% dividend for 2009. It also received approval from the Commissioner for a 2% rate decrease. The combination of these two actions resulted in no material increase in the premiums paid by Medical Mutual's insureds in 2009. For 2010, base rates were not increased, and an 11% dividend was declared. According to Medical Mutual, "[t]his is the fifth consecutive year that Medical Mutual insureds have had no price increases on what they pay for professional liability insurance."

Availability and Affordability

In its *2009 Report on the Availability and Affordability of Health Care Medical Professional Liability Insurance in Maryland*, the Maryland Insurance Administration indicated that 52 companies wrote malpractice insurance in Maryland in 2008. The top two insurers (Medical Mutual and a Vermont risk retention group) accounted for over 60% of all medical professional liability insurance written in the State. Since 2003, the overall number of companies writing malpractice insurance and their market share remained relatively unchanged, which the report states "is indicative of a stable market for malpractice insurance." Further, after dramatically increasing between 2002 and 2005, premiums began to decrease in 2006. The report concludes that "[t]he steps taken by the General Assembly to stabilize the malpractice insurance market along with the cyclical changes in the market seem to have worked together resulting in more available and affordable malpractice insurance for Maryland health care providers."

Lockshin v. Semsker and the Cap on Noneconomic Damages

In a closely watched case, *Lockshin v. Semsker*, No. 78, Sept. Term 2009, the Maryland Court of Appeals has granted certiorari to review a Montgomery County trial judge's refusal to cap noneconomic damages in a multimillion-dollar medical malpractice verdict. In April 2009, Circuit Court Judge John W. Debelius III ruled that Maryland's cap on such awards applies only to lawsuits that were first submitted to arbitration. Debelius' ruling followed a jury's $5.8 million award in November 2008, in the death of a 47-year-old Bethesda lawyer, Richard Semsker, whose untreated mole turned into a skin cancer that spread to the brain. The jury's award included $3 million in noneconomic damages for Mrs. Semsker, the Semskers' children, and Mr. Semsker's estate. Under the noneconomic damages cap, this amount would have been reduced to $812,500. Judge Debelius, however, after reviewing the provision in the statute that describes the circumstances under which the damage limitation applies, declared that the cap provided in the 2004 Maryland Patient's Access to Quality Health Care Act applies only to awards in arbitrated cases and to the judicial review of cases that have already been arbitrated. Since the disputed provision does not specifically make reference to medical malpractice cases that have not been arbitrated, these are not included in the cap under the "plain language" rule, according to the decision. Judge Debelius noted that, as originally drafted, the Act applied to all medical malpractice cases occurring after January 1, 2005, in the State. The language was changed before final passage, however, and the new language, in the court's view, created the omission that excludes cases that have not been arbitrated. Appellants argued at trial and on appeal that the General Assembly could not have intended to eliminate the cap on noneconomic damages in the majority of medical malpractice cases and that the legislative intent should dictate maintaining the cap in all such cases. Judge Debelius ruled that the court is without authority to amend the statute to reinstate deleted language or insert new words to the same effect, whether consistent with the legislative intent or otherwise.

MedChi, the State medical society, has announced that, if the Court of Appeals does not reverse the decision of the trial court, it will "surely precipitate the instability in the malpractice insurance market which the General Assembly consistently has sought to control." Medical Mutual has warned its members that if the ruling is not overturned on appeal, or the law corrected through legislation by the Maryland General Assembly, "the expectation is that payouts will increase and so will the premiums that are needed to pay for claims."

Oral arguments in the Court of Appeals were heard on November 5, 2009. Legislation to clarify to which class of medical malpractice cases the noneconomic damages cap applies may be necessary, depending on the outcome of the *Semsker* case.

Federal Tort Reform Proposals and Initiatives

In an address to Congress in September, President Obama announced that he was directing the Secretary of Health and Human Services (HHS) to set aside $25 million to support state grants for pilot programs to reduce medical malpractice lawsuits. The funding, which would be up to $3 million over three years for each grant, will go to states to implement and evaluate patient safety and medical liability initiatives. HHS will oversee the process for states to launch and test initiatives that meet the following parameters:

- put patient safety first and work to reduce preventable injuries;
- foster better communication between doctors and their patients;
- ensure that patients are compensated in a fair and timely manner for medical injuries, while reducing the incidence of frivolous lawsuits; and
- reduce liability premiums.

Grant applications for the new funding will be reviewed by HHS' Agency for Healthcare Research and Quality, which will make award decisions by early 2010.

Under one proposed plan, patients who suffer a medical injury could take their cases to a panel of neutral experts. If the experts find that a patient was harmed and that the injury could have been avoided by following clinical guidelines, the panel would offer compensation based on a publicly available schedule.

Calls also have been made to introduce medical malpractice reforms at the federal level. Primary care providers who practice at federally qualified health centers currently do not need to purchase medical malpractice insurance because the government covers any claims against them under the Federal Tort Claims Act. One proposal would expand the Act to cover all primary care providers, regardless of where they practice, and certain specialists where access to care is threatened. Others have proposed federally mandated caps on damages in medical malpractice cases. Federal legislation that reforms medical malpractice laws may be challenged as beyond the constitutional authority of the federal government, however, since malpractice law has traditionally been a matter of state law.

Courts and Civil Proceedings

Same-sex Marriages, Civil Unions, and Domestic Partnerships

In response to, or in anticipation of, an opinion from the Office of the Attorney General regarding the recognition by Maryland of same-sex marriages validly performed in other states, legislation relating to same-sex marriage is likely to be reintroduced in the upcoming legislative session.

Background

"Same-sex marriage" means a legal marriage between two individuals of the same gender. A "civil union" provides to same-sex partners the same legal rights, protections, and responsibilities under state law as married couples. Generally, these rights are recognized only in the state in which the couple resides. A "domestic partnership" extends certain rights under state or local law to unmarried couples, including (but not necessarily limited to) same-sex couples.

State Responses

Same-sex Marriage Legalized

In 2004, Massachusetts became the first state to issue marriage licenses to same-sex couples after the state's highest court ruled that authorizing civil unions for same-sex couples while prohibiting them from marrying was unconstitutional. Same-sex marriage is now legal in three other states: (1) Connecticut (2008); (2) Iowa (April 2009); and (3) Vermont (September 2009). New Hampshire enacted legislation to legalize same-sex marriage that will take effect January 1, 2010. Although Maine legalized same-sex marriage in June 2009, the law was petitioned to referendum, and Maine voters rejected it in the November 2009 election.

Same-sex Marriage Prohibited

Forty-one states (including Maryland) have laws that either prohibit same-sex marriages or deny recognition of same-sex marriages solemnized in another jurisdiction. Because statutory bans have been viewed as providing limited protection against a constitutional challenge, many states have also amended their constitutions to limit marriage to opposite sex couples. To date, 30 states have adopted constitutional amendments that define marriage as a union between a man and a woman.

Civil Unions, Domestic Partnerships, and Partner Benefits

Currently, New Jersey and New Hampshire authorize civil unions. California, Colorado, Hawaii, Nevada, Oregon, Washington, and the District of Columbia have created domestic partnership laws that offer varying subsets of the rights and responsibilities of marriage under the laws of those jurisdictions.

Nineteen states, including Maryland, as well as numerous local jurisdictions, offer benefits for same-sex partners of state or local government employees. As of fiscal 2010, Maryland offers its employees health insurance coverage for their same-sex partners.

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. Attempts to pass an amendment to the U.S. Constitution defining marriage as a union between a man and a woman have been unsuccessful.

Maryland Law

In 1973 Maryland enacted a law providing that only a marriage between a man and a woman is valid in the State. The Court of Appeals recently upheld the constitutionality of this law in *Conaway v. Deane*, 401 Md. 219 (2007). 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 325.

Recognition of Same-sex Marriages 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 recognizes foreign marriages that are validly entered into in another state. *Henderson v. Henderson*, 199 Md. 449 (1952) (recognizing other state's common law marriage). 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").

Some jurisdictions, such as New York, Rhode Island, and the District of Columbia, have recognized same-sex marriages performed in other jurisdictions.

Recently, the Office of the Attorney General of Maryland was asked for a formal opinion as to whether Maryland will recognize valid out-of-state same-sex marriages. If the opinion would be affirmative, the requestor then asked the Attorney General to opine on whether the Governor, through an executive order, could direct the relevant state agencies to recognize these marriages. As of this writing, an opinion has not yet been issued.

Environment and Natural Resources

Chesapeake Bay Restoration: A New Framework Emerges

Efforts to restore the Chesapeake Bay over the past three decades have failed. A new restoration policy framework is emerging that emphasizes stronger federal oversight and shorter term program evaluation and goals. As a result, bay restoration will continue to garner attention during the 2010 session.

Background

In 1999 the U.S. Environmental Protection Agency (EPA) identified the Chesapeake Bay as an impaired water body under the Clean Water Act (CWA). In 2000, the Chesapeake Bay partners (including Maryland, Pennsylvania, Virginia, 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 EPA's List of Impaired Waters by 2010. Although C2K is still in force, its goals will not be met. In fact, due to population growth and related development, conditions have actually deteriorated in some locations in recent years.

Recent Policy Developments

In response to the failure of C2K, a new restoration policy framework is emerging that emphasizes stronger federal oversight over the restoration process. Key elements of this framework include a May 2009 federal executive order on Chesapeake Bay Restoration and Protection, the creation of two-year restoration policy milestones, and the development of a bay-wide Total Maximum Daily Load (TMDL) for pollutants.

Federal Executive Order

On May 12, 2009, President Barack H. Obama signed Executive Order 13508 recognizing the Chesapeake Bay as a national treasure and mobilizing federal agencies to take the lead in renewed efforts to restore the bay and its watershed (http://executiveorder.chesapeakebay.net/). The executive order established a Federal Leadership Committee to oversee the development and coordination of bay restoration activities and set forth the following timeline of requirements:

- Prepare and submit draft action reports that set forth recommendations on specified restoration topics by September 2009;

- Submit final recommendations for a Chesapeake Bay restoration and protection strategy by November 2009;

- Publish a final strategy by May 2010;
- Publish an annual Chesapeake Bay Action Plan, beginning in 2010, describing how federal funding will be used for bay restoration efforts in the next fiscal year, and an Annual Progress Report, that reviews indicators of the health of the bay and assesses progress on the implementation of the previous year's action plan; and
- Require an independent evaluator to submit periodic progress reports.

Two-year Policy Milestones

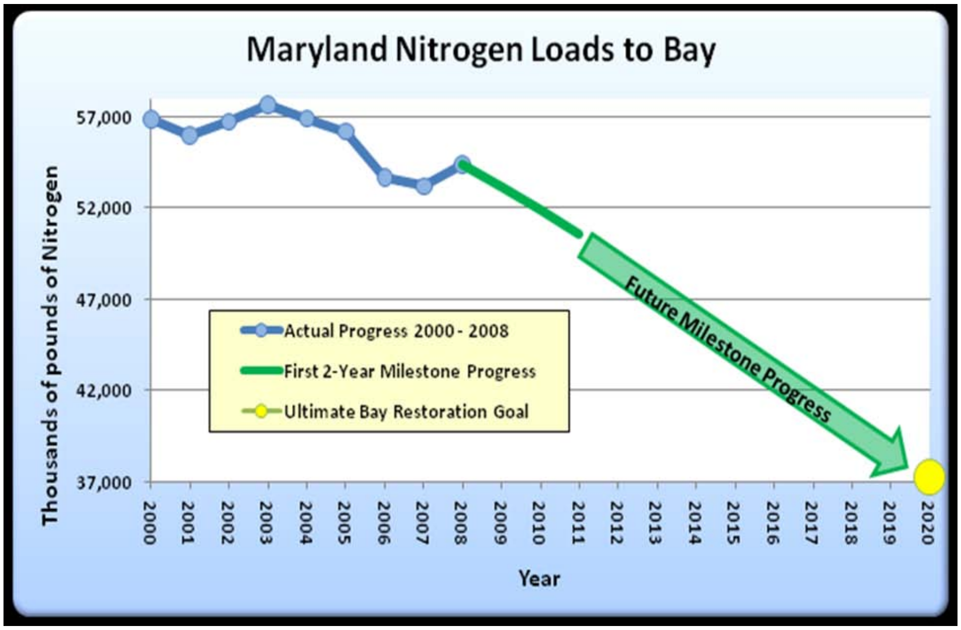
In May 2009 the Chesapeake Bay partners discarded the broad ten-year goal framework used over the past 30 years and committed to new voluntary two-year incremental goals called "milestones" for reducing nitrogen and phosphorus loads to the bay. The first set of milestones is scheduled to be achieved by 2011, and all programs to implement the milestones must be in place by 2025. The first set of milestones requires a watershed-wide nitrogen load reduction of 15.80 million pounds and a phosphorus load reduction of 1.05 million pounds (over 2008 levels). To achieve this goal, Maryland must reduce its nitrogen loads by 3.75 million pounds and its phosphorus loads by 193,000 pounds (from 2008 levels). Subsequent milestones will be tailored to achieve the limits set by the bay-wide TMDL. As shown in **Exhibit 1**, the milestones require a significant increase in the rate of pollution reduction.

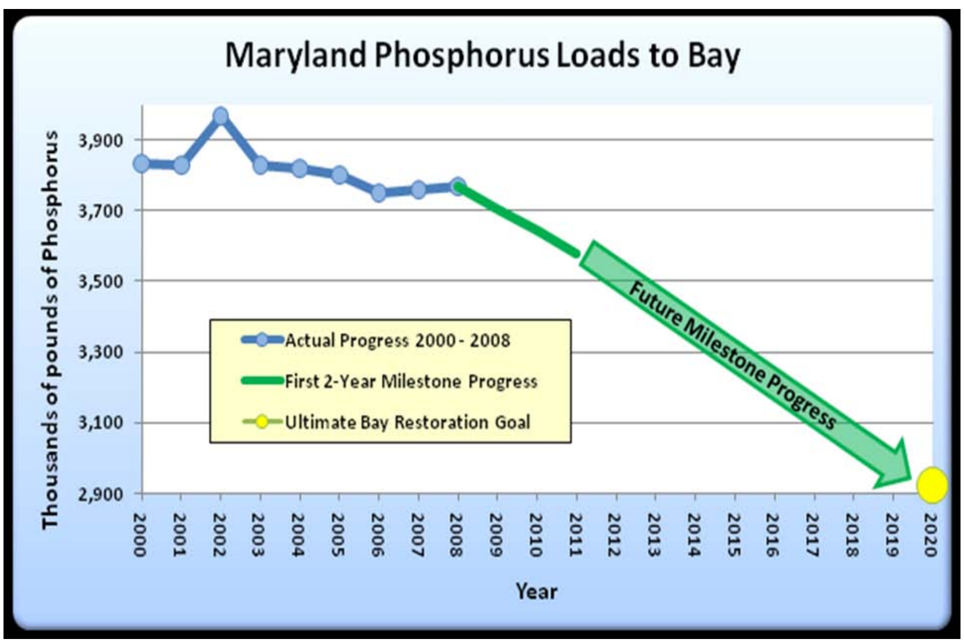
To achieve the first set of milestones, Maryland plans to implement 27 strategies with specific, measurable targets for nitrogen and phosphorus reduction. Most of the actions proposed to date expand on existing programs. BayStat intends to track Maryland's progress toward the milestones and make relevant program information available (http://www.baystat.maryland.gov/).

Chesapeake Bay TMDL

EPA is planning to publish a final TMDL for the Chesapeake Bay by December 2010. The TMDL will address all sources of nitrogen, phosphorus, and sediment pollution and allocate load caps for these pollutants to the District of Columbia and the Chesapeake Bay watershed states. Subsequently, EPA will work with jurisdictions to create individual state implementation plans that seek to achieve restoration objectives. Currently, EPA intends to implement sanctions when jurisdictions exceed their pollution caps. While sanctions have not been finalized, they could include assigning more stringent pollution reduction responsibilities to point sources; objecting to state-issued CWA National Pollutant Discharge Elimination System permits; limiting or prohibiting new or expanded discharges of pollutants; and withholding, conditioning, or reallocating federal grant funds.

Exhibit 1
Maryland's Pollutant Reduction Goals





Note: Nitrogen and phosphorus loads are based on monitoring data.

Source: Maryland Department of Natural Resources

Federal Legislation

On October 20, 2009, the Chesapeake Clean Water and Ecosystem Act of 2009 was introduced in the U.S. Senate (S. 1816) and the U.S. House of Representatives (H.R. 3852). Among other things, this legislation seeks to reauthorize the EPA's Chesapeake Bay Program, authorize a new $1.5 billion urban/suburban stormwater grant program, strengthen state and local government authority under the CWA, and codify President Obama's Chesapeake Bay executive order.

Implications for 2010

The significant attention and momentum at the federal level concerning Chesapeake Bay restoration could prompt State action during the 2010 session. For example, EPA may initiate new rulemakings related to performance goals for concentrated animal feeding operations and stormwater treatment in the near future. If this occurs, the State will likely seek to play a role in developing these new rules. Furthermore, Chesapeake Bay restoration funding levels and strategies will continue to demand attention. Required restoration program costs will likely far exceed available resources, especially given the State's current fiscal problems.

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Environment and Natural Resources

Energy and Climate Change Policy

Energy efficiency, energy conservation, renewable energy, and climate change continue to be major issues at both the federal and State levels. Potential issues include the impact of federal climate change legislation on the Regional Greenhouse Gas Initiative; the allocation of State funds generated under the Regional Greenhouse Gas Initiative; and the impact of federal stimulus funds on Maryland's energy programs.

Recent Policy Developments

In recognition of Maryland's particular vulnerability to global climate change and in response to rising electricity prices, over the past several years the General Assembly has passed several pieces of legislation aimed at improving energy efficiency, promoting renewable energy, and reducing greenhouse gas (GHG) emissions. Most notably, this legislation:

- required Maryland to join the Regional Greenhouse Gas Initiative (RGGI), a regional cap-and-trade system designed to reduce carbon dioxide (CO_2) emissions from specified electric generating units by 10% by 2018 (Chapters 23 and 301 of 2006);

- established the Strategic Energy Investment Fund (SEIF), administered by the Maryland Energy Administration (MEA), to receive auction proceeds generated through participation in RGGI (Chapters 127 and 128 of 2008);

- encouraged clean energy generation by modifying Maryland's Renewable Portfolio Standard to increase the percentage of electricity required to come from renewable energy sources (Chapter 126 of 2008);

- addressed energy efficiency by codifying the EmPOWER Maryland initiative to reduce per capita peak demand and electricity consumption by 15% below 2007 levels by 2015 (Chapter 131 of 2008); and

- requires the State to develop plans, adopt regulations, and implement programs to reduce GHG emissions by 25% from 2006 levels by 2020 (Chapters 171 and 172 of 2009).

More recently, MEA announced its comprehensive plan for its fiscal 2010 programs, the *EmPOWERing Maryland Clean Energy Programs*, aimed at (1) expanding energy efficiency; (2) promoting renewable generation; (3) financing clean energy innovation; and (4) providing consumers with energy information.

Update on RGGI Auctions, Funds, and the SEIF

Maryland is one of 10 states participating in RGGI. To date, the participating states have auctioned over 140 million allowances through five auctions, generating revenues of about $432.8 million. (One allowance provides the right to emit one ton of CO_2.) Maryland has auctioned 27.9 million allowances, generating a total of nearly $84.8 million. Although allowance prices have been within the range expected, prices fell significantly in the most recent auction (September 2009). The next auction is scheduled for December 2, 2009. The fiscal 2010 appropriation of RGGI funds totals $106.3 million but could be reduced to the extent auction proceeds come in lower than expected.

As noted above, auction proceeds are deposited into SEIF. Chapters 127 and 128 of 2008 specified the allocation of funds from SEIF for various purposes including electricity assistance; residential rate relief; energy efficiency, conservation, and demand response; renewable and clean energy; and administrative costs. In order to reduce general fund expenditures for electricity assistance, budget reconciliation legislation adopted during the 2009 session modified the allocation of SEIF funds for fiscal 2010 and 2011, reducing the amount of funding for energy efficiency, energy conservation, and renewable energy programs, and increasing the amount of funding for electricity assistance programs.

Impact of Federal Energy Policy on Maryland

Although 2009 budget reconciliation legislation temporarily reduced the amount of funding available to MEA from SEIF to implement its various programs, the passage of the federal American Recovery and Reinvestment Act (ARRA) of 2009 will provide about $51.8 million for Maryland in funds earmarked for clean energy projects. In fact, MEA indicates that in fiscal 2010 about 71% of its programmatic spending will be supported by federal ARRA funding, with 22% from SEIF revenues and only about 7% from other State and other federal sources.

The flow of federal funds will fall significantly in fiscal 2011 as ARRA expires, however. In addition, SEIF funding could be affected to the extent a federal cap-and-trade system preempts RGGI as part of federal climate change legislation. Currently, based on analysis of the American Clean Energy and Security Act of 2009 (H.R. 2454) that passed the House, the Maryland Department of the Environment anticipates that there is a significant risk of at least some reduction in funds from a future federal cap-and-trade program as compared with the revenues otherwise projected to be generated under RGGI.

Implications for the 2010 Session

Given the continuing interest in energy policy and global climate change at both the State and federal levels, it is likely that legislation related to these issues will resurface during the

2010 session. Of particular interest may be the development of a long-term strategy for offshore wind energy; the generation of wind and solar energy on lands under easement by the Maryland Agricultural Land Preservation Foundation; the allocation of SEIF funds in future years; and the potential impact of federal climate change legislation on RGGI.

Environment and Natural Resources

Paying for a Better Environment

As a result of the fiscal crisis, many states, including Maryland, have had to reduce funding for their environmental programs. Although Maryland has provided a significant amount of funding for its environmental programs, funding needs still exceed available amounts. In a September 2009 report, the Department of Legislative Services highlights several financing options for the General Assembly to consider.

Fiscal Constraints Limit Funding Available for Environmental Programs

As a result of the rapid economic deterioration over the past two years, many states, including Maryland, have been put in the unenviable position of significantly reducing funding for all types of programs – including environmental programs. A major example of the deteriorating funding available for environmental programs in Maryland can be found by examining the Chesapeake and Atlantic Coastal Bays 2010 Trust Fund, which was created to help fund the restoration of the Chesapeake Bay and the Atlantic coastal bays. When this special fund was established during the 2007 special session, it was initially estimated that $50.0 million would be appropriated to it annually from a portion of the existing motor fuel tax and the sales and use tax on short-term vehicle rentals. However, due to revenue underattainment and the State's continuing fiscal crisis, only $10.0 million was appropriated to the trust fund by the General Assembly in fiscal 2010. At the July 22, 2009 meeting of the Board of Public Works, another $2.0 million was transferred from the trust fund to the general fund, leaving only $8.0 million in the fund for fiscal 2010. Thus, the fiscal 2010 funding level is approximately 16% of the funding level initially estimated for this special fund.

By instituting a variety of financing mechanisms, including the bay restoration fee (used to fund upgrades to wastewater treatment plants and septic systems and the planting of cover crops) and the transfer tax (used to fund State land conservation programs such as Program Open Space (POS) and the Maryland Agricultural Land Preservation Foundation), Maryland has been able to provide considerable funding for environmental programs over the years. Despite this, funding needs still exceed amounts available from existing funding sources. For example, a 2008 report by the University of Maryland's Environmental Finance Center (UMEFC), *The Chesapeake Bay Restoration Trust Fund: Implementing a Sustainable Investment Strategy*, noted an estimated budget shortfall of approximately $5.4 billion to meet the State's bay restoration goals. With respect to land conservation, the Department of Natural Resources (DNR) estimates that approximately $11.0 billion is needed to preserve the State's priority natural resource lands identified in DNR's latest inventory and evaluation; this cost far exceeds the amount of funding that will be available through POS. Because existing funding sources cannot bear the cost of all of the State's environmental goals, it is imperative that Maryland continue to identify additional ways to ensure that these programs are adequately funded.

Options for Financing Environmental Programs

In an effort to identify additional steps that may warrant action, the Natural Resources, Environment, and Transportation Workgroup within the Office of Policy Analysis of the Department of Legislative Services (DLS) prepared a report on financing environmental programs in Maryland. In its September 2009 report, *Financing Environmental Programs in Maryland: Many Shades of Green*, DLS recommends a four-step approach to financing environmental programs. First, in an effort to increase collaboration and coordination, DLS suggests that the Office for a Sustainable Future within DNR work with UMEFC, other relevant State agencies, and local governments to engage in a discussion regarding innovative environmental financing strategies.

Second, DLS suggests a number of ways that the agencies involved in the delivery of the State's environmental, natural resources, and energy conservation programs could consider reducing the State's costs, including:

- encouraging more stringent zoning by local governments, encouraging the development of additional transfer development rights (TDR) programs, and authorizing state-level oversight of local TDR programs to achieve greater coordination among the jurisdictions;

- requiring changes through direct regulation rather than merely incentivizing changes;

- implementing a statewide nutrient trading program that incorporates both point and nonpoint sources;

- expanding its effort to encourage the development of local tax lien oriented programs; and

- expanding the use of private sector cooperation, such as the establishment of public-private partnerships.

In its third recommendation, DLS advises that the State should identify the remaining long-term costs associated with its objectives in order to have a clearer picture of the funding gaps that exist. Finally, DLS suggests that the State and local governments identify additional funding sources in order to close those funding gaps. In its report, DLS highlights a number of financing mechanisms the State could consider, including (1) establishing a litter tax or other point-of-sale surcharge; (2) establishing a statewide impervious surface fee; (3) increasing the bay restoration fee; (4) requiring all local governments to establish a pay-as-you-throw fee or establishing a statewide solid waste management fee; (5) and expanding the use of congestion pricing.

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State Government

Voting Rights of Persons under Guardianship for Mental Disability

Laws regulating the voting rights of individuals under guardianship for mental disability are under increased scrutiny by state legislatures and the courts. A federal court has held that Maine's law, which was similar to Maryland's, violated federal law.

Background

Article 1, § 4 of the Maryland Constitution gives the General Assembly the authority to "regulate or prohibit the right to vote of a person ... under care or guardianship for mental disability." The General Assembly exercised this authority through § 3-102(b) of the Election Law Article which states that an individual under guardianship for mental disability is not qualified to be a registered voter. A guardian is generally appointed for an individual when a circuit court determines that the individual cannot make or communicate responsible decisions concerning his or her person, or cannot manage his or her property and affairs effectively, for reasons including mental disability. A person's capacity to vote is not part of the court's determination.

The Governor's Transition Election Work Group Report recommended modifying the voting prohibition regarding individuals under guardianship for mental disability, stating that it "broadly denies a specific group of individuals with disabilities the right to vote without a specific finding that they are not competent to vote." In 2001, a federal district court found that a prohibition in Maine that is roughly similar to Maryland's violated the Due Process and Equal Protection clauses of the U.S. Constitution and that the Maine defendants, in implementing the prohibition, had violated two federal statutes, the Americans with Disabilities Act and the Rehabilitation Act. Senate Bill 984 of 2009 would have established a task force to study whether Maryland's prohibition should be changed. The bill was referred to interim study.

How the Prohibition Is Administered in Maryland

Maryland's voting prohibition regarding individuals under guardianship for mental disability primarily is implemented through the requirement that a voter registration application be signed by an applicant, subject to the penalties of perjury, swearing or affirming that the applicant is, among other things, not under guardianship for mental disability. State law does not require that courts provide information to the State Administrator of Elections regarding individuals for whom a guardian is appointed due to mental disability (as it does for name changes and persons convicted of felonies) and the State and local election boards do not receive information about mental disability status directly from the courts. If an individual is removed from the voter registration list because the individual is under guardianship for mental disability, it apparently is usually the result of a request made by the guardian.

The Law in Other States

The state constitutions and/or the election statutes of 38 of the other states prohibit the mentally disabled from voting. Some states use broad terminology such as "idiot," "non compos mentis," or "mentally incompetent" with no indication that any type of determination is made by a court. Others require some type of determination by a court through the use of terms such as "adjudged" and "adjudicated." Still others limit the prohibition to individuals who are under guardianship. Of the 38 states, a determination regarding the capacity to vote is required in the constitutions or election law provisions in 13 states. Massachusetts also requires a judicial determination regarding the capacity of an individual under guardianship to vote because of an opinion by its Secretary of the Commonwealth. One other state, Tennessee, through its guardianship code, authorizes a court to remove the right to vote if an individual is placed under conservatorship but does not specifically mention mental disability. Of the states that require a determination to be made, 7 states have prescribed the test to be used in statute or in the state constitution. Although each test varies slightly, the tests focus on whether the individual can understand and appreciate the act of voting. The remaining 10 states do not have restrictions on the ability of individuals with a mental disability to vote, although some of the states have the constitutional authority to impose such restrictions.

Relevant Federal Law and Court Cases

Federal Law

There are two provisions of the federal constitution and two provisions of federal law that have been used to challenge the legality of voting prohibitions such as Maryland's. The Equal Protection Clause of the U.S. Constitution prohibits a state from denying the "equal protection of the laws" to any of its citizens. The Due Process Clause prohibits a state from depriving "any person of life, liberty, or property, without the due process of law." The Americans with Disabilities Act (ADA) and the Rehabilitation Act prohibit the exclusion of individuals with disabilities from government services, programs, or activities if the exclusion is based on the fact that the person has a disability.

Court Cases

In the past decade, two cases have challenged states' voting prohibitions relating to the mentally disabled on federal grounds. As noted earlier, in 2001 a federal district court found in *Doe v. Rowe* that Maine's law violated federal law. Maine prohibited individuals under guardianship for reason of mental illness from voting. Under Maine's guardianship law, there was no requirement that a court make an individualized determination regarding whether the individual lacked the capacity to understand the act of voting. Because there was no individualized determination regarding the capacity of the individual to vote, the ban was categorical and unrelated to the state's interest in making sure that individuals who voted understood the act of voting. Also, one of the plaintiffs was successful in having the right to vote restored, while another was not, even though after an examination, both were found to have the capacity to vote. As a result, the court held that the law violated the Equal Protection Clause. The court also found that individuals who were the subject of guardianship proceedings were not informed that an appointment of a guardian would result in their disenfranchisement. In light of that, the court held that law violated the Due Process Clause. Because the individuals were disenfranchised solely because of their disabilities, the court also found that the law violated the ADA and the Rehabilitation Act.

Missouri's law, similar to Maine's law, was challenged in *Missouri Protection and Advocacy Services, Inc. v. Carnahan*. In 2007, the Eighth Circuit of the U.S. Court of Appeals held that there had been no violation of federal law. The ruling was based on the fact that the judge in the guardianship case preserved the plaintiff's right to vote. Therefore, the court determined that individuals under guardianship for mental incapacity were not automatically disenfranchised and that the ban was not categorical.

Conclusion

During the 2009 session, the Education, Health, and Environmental Affairs Committee considered legislation that would have established a Task Force to Study Barriers to Voting Rights for Individuals Under Guardianship. The committee did not pass the legislation but instead asked the Office of Policy Analysis in the Department of Legislative Services to study this issue. The results of the study – which explored in some detail the topics outlined in this issue paper – were reported to the committee in mid-November.

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State Government

Election Administration

As the State gears up for the 2010 elections, State and local election officials prepare for the procurement and deployment of a new optical scan voting system and the application of new federal requirements governing voting by uniformed U.S. service members, their family members, and overseas voters.

Procurement and Implementation of New Voting System

Background

The State Board of Elections (SBE) is in the process of procuring a new optical scan voting system for the 2010 elections. Chapters 547 and 548 of 2007 first prompted the change by establishing additional certification requirements for the State's voting system, including that the system provide a voter-verifiable paper record. Chapter 428 of 2009 amended those requirements and allows continued use of the State's current touchscreen voting machines to provide access for voters with disabilities, even though those machines do not provide a voter-verifiable paper record. Currently, there is no commercially available voting system that meets the requirements of Chapters 547 and 548 relating to accessibility for voters with disabilities.

SBE has issued two separate requests for proposals, one for an optical scan voting system and one for voting system support services. An optical scan voting system uses paper ballots that are scanned into a counting machine, thus providing a voter-verifiable paper record. SBE intends to complete its evaluation of submitted proposals in November 2009 and make a selection in December. All of the State's current touchscreen voting machines will be kept. Those not deployed on election day to ensure access for voters with disabilities will be stored and be available in case of an emergency or a significant problem in the implementation of the optical scan system.

How Many Touchscreen Machines Should Be Deployed

There is disagreement between SBE staff and at least some local boards of elections regarding the number of touchscreen voting machines that should be deployed in polling places. Chapter 428 of 2009 requires that at least one voting machine that is accessible to voters with disabilities be provided in each polling place. The law also requires that those machines be available for use by all voters. At least some local boards of elections believe they need to provide enough touchscreen machines to accommodate both voters with disabilities and those without disabilities that may want to use the machines. However, SBE staff has taken the position that deploying a significant number of touchscreen machines beyond what is needed for voters with disabilities would frustrate the intent of the legislature to establish an optical scan system. SBE staff has stated that it intends to propose to the State board a formula for determining the number of touchscreen machines deployed to a precinct based on the number of voters age 65 or older assigned to the precinct.

ES&S Purchase of Premier Election Solutions

Premier Election Solutions, the provider of the State's touchscreen voting machines, was purchased by Election Systems and Software (ES&S) in September 2009. The voting systems of Premier and ES&S reportedly are used in roughly two-thirds of U.S. voting precincts and antitrust and other questions have arisen about the effect of having one company controlling a significant majority of the U.S. voting system market. Hart Intercivic, another voting system provider, has filed a federal lawsuit to dissolve the sale on antitrust grounds. It does not appear that the purchase of Premier by ES&S will have a significant effect on services received by the State for its touchscreen voting machines. Any effect the consolidation of ES&S and Premier may have on the State with regard to the procurement and implementation of a new optical scan voting system is unclear.

Military and Overseas Voting

Background

The federal Uniformed and Overseas Citizens Absentee Voting Act (UOCAVA) requires states to, among other things, allow absent uniformed services voters[1] (and their spouses and dependents) and overseas voters to use absentee registration procedures and vote by absentee ballot in elections for federal office. "Absent" means those uniformed service members and their spouses or dependents that are absent from their places of residence where they are otherwise qualified to vote by reason of the members being on active duty or on account of the members' service. Though limited comprehensive data on military and overseas voters appears to exist, studies and surveys in recent years have indicated that despite UOCAVA and the efforts of election officials, impediments may still exist for those voters.

Recently enacted federal legislation (discussed further below) makes several changes to UOCAVA aimed at improving access to the voting process for military and overseas voters. One requirement of the legislation – that states send absentee ballots to absent uniformed services and overseas voters no later than 45 days before an election – may be difficult, if not impossible, to comply with for states like Maryland that hold their 2010 gubernatorial primary in close proximity to the gubernatorial general election. However, the legislation does allow states to request a waiver from the requirement if the state's primary election date precludes compliance.

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[1] Along with members of the Army, Navy, Air Force, Marine Corps, and Coast Guard, "absent uniformed services member" includes members of the commissioned corps of the Public Health Services, the commissioned corps of the National Oceanic and Atmospheric Administration, and the merchant marine.

Affected Voters

There is uncertainty regarding the number of voters to whom UOCAVA applies, but that number may be in the range of 5 to 6 million people, according to varying estimates. The Federal Voting Assistance Program, which administers UOCAVA, estimated that prior to the 2008 election, there were just under 100,000 uniformed services members and family members and overseas citizens claiming Maryland as their voting residence. In the 2008 general election, 17,459 absentee ballots were sent out to UOCAVA voters (5,556 to uniformed services voters and 11,903 to non-military overseas voters) and 14,419 ballots were submitted. Of the submitted ballots, 13,184 were counted and 1,235 were rejected for various reasons.

Timing Issues

A primary concern with regard to absent uniformed services and overseas voters is the time it can take for those voters to request, receive, and return an absentee ballot and the possibility that their ballots will not be counted as a result. A January 2009 report by the Pew Center on the States noted that while UOCAVA gives absent uniformed services and overseas voters the ability to vote by absentee ballot for federal offices, state laws and practices, which vary significantly, determine how and when those ballots are cast and how likely they are to be counted. States, for example, may have different policies or practices regarding how far in advance of an election absentee ballots are sent to voters as well as different deadlines for the return of absentee ballots. States also vary in the extent to which they allow all or part of the process to be completed electronically.

The Pew Center on the States report found that a number of states (Maryland was not one) did not provide overseas military voters enough time to vote because they send absentee ballots after the date necessary for military voters to meet required deadlines. The report also noted that aggressive assumptions were used regarding the time needed to complete each step in evaluating each state's absentee process and that all states would benefit from giving their voters additional time to request and return ballots.

In Maryland, the time when absentee ballots are available for distribution can vary depending on the election and can be as close as 18 days prior to election day for a gubernatorial general election. SBE regulations instruct local election directors to give first priority to military and overseas voters once ballots have been received from the printer. Ballots can also be faxed or emailed to voters. Absentee ballots submitted by mail must be mailed on or before election day and be received by a local board office by the second Friday after an election, with the exception of gubernatorial primary elections, when ballots must be received by the second Wednesday after the election.

Federal and Model State Legislation

The recently enacted federal Military and Overseas Voter Empowerment Act (MOVE) amends UOCAVA to, among other things, require states to send absentee ballots to absent uniformed services and overseas voters no later than 45 days before an election if a request has been received prior to that time. As of late October, when the legislation was signed into law, SBE staff were in the process of reviewing the final version of MOVE to identify any specific legislative and regulatory changes that may be needed in order to comply with it.

Given the relatively short period of time between Maryland's gubernatorial primary (September 14) and general (November 2) elections, Maryland will need to request a waiver from the 45-day requirement for the 2010 general election. The 2010 primary election is 49 days prior to the general election and absentee ballots are expected to be ready for distribution *18 days* prior to the general elections, according to SBE's 2010 Gubernatorial Election Calendar. States applying for a waiver need to submit a comprehensive plan to ensure that absent uniformed services voters and overseas voters are able to receive and submit absentee ballots in time to be counted.

The Uniform Law Commission, a nonpartisan organization that drafts uniform legislation for consideration by states, is currently drafting model state legislation for military and overseas absentee voters. Final approval of the model legislation by the commission is expected in the summer of 2010.

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Campaign Finance – Corporate Expenditures

A pending decision by the U.S. Supreme Court could address the constitutionality of state and federal laws that prohibit or otherwise limit the use of corporate general treasury funds for election campaigns.

Introduction

The constitutionality of restrictions on corporate expenditures in elections is at issue in the case of *Citizens United v. Federal Election Commission* (Docket No. 08-205), currently pending before the U.S. Supreme Court. The court could decide to strike down restrictions on the use of corporate general treasury funds to influence federal elections that have stood for over 100 years. It may also rule on the constitutionality of requiring corporations to disclose their independent expenditures in elections. The laws of 24 states could also be invalidated by the court's decision, although Maryland's current campaign finance laws would not be affected.

Federal Regulation of Corporate Election Expenditures

Federal restrictions on corporate election expenditures date from 1907, but the most comprehensive statutes are more recent. The Federal Election Campaign Act of 1971 (FECA) prohibits a corporation from using its general treasury funds to make a contribution to a federal candidate or an independent expenditure that expressly advocates the election or defeat of a federal candidate. A corporation may make contributions to candidates and express advocacy independent expenditures in federal elections only through a separate segregated fund, commonly called a political action committee (PAC). Certain small nonprofit corporations formed for the purpose of political advocacy are not required to use a PAC to make campaign expenditures.

Corporate federal PACs are subject to a variety of restrictions. A corporate PAC may solicit voluntary donations only from the corporation's stockholders, executives and administrative personnel, and their families. Twice yearly, the PAC may also solicit all other employees of the corporation and their families. Contributions to a corporate PAC are limited to $5,000 annually from any one contributor. PAC donations to federal candidates are subject to certain limits, but a PAC may make unlimited express advocacy independent expenditures. Periodic reports of receipts and disbursements must be made to the Federal Election Commission.

Corporations evaded FECA's restriction on the use of general treasury funds to advocate the election or defeat of federal candidates by financing independent advertising campaigns that attacked or praised an identified candidate without explicitly urging a vote for or against the candidate. In response, Congress enacted the Bipartisan Campaign Reform Act of 2002 (BCRA), commonly known as McCain-Feingold. BCRA prohibited a corporation from using general treasury funds to finance an "electioneering communication," defined as a broadcast, cable, or satellite communication that refers to a federal candidate, 30 days before a primary election and 60 days before a general election. Electioneering communications must be financed with PAC money instead. A subsequent Supreme Court decision in *FEC v. Wisconsin Right to Life*, *Inc.*, 127 S. Ct. 2652 (2007), limited the reach of this provision. In that case, the court held that only communications that cannot reasonably be interpreted except as an appeal to vote for or against a specific candidate are covered by the law.

Federal law also requires corporations to disclose independent expenditures in federal elections. BCRA requires a corporation that spends more than $10,000 on an electioneering communication in a year to report to the Federal Election Commission (FEC) the name of the corporation making the disbursement, the amount and date of the disbursement, and the names of all those who contributed $1,000 or more to the corporation for the purpose of electioneering communications. BCRA also requires that an electioneering communication include a disclaimer notice, including the identity of the corporation that paid for the communication.

Citizens United v. Federal Election Commission

Citizens United is an ideologically conservative nonprofit corporation that planned to distribute a film during the 2008 presidential campaign critical of Senator Hillary Rodham Clinton called *Hillary: The Movie*. The film was to be distributed through Video on Demand on digital cable television and by other means. The film and several advertisements promoting it were financed with Citizens United's general treasury funds. Citizens United filed suit claiming that BCRA's prohibition on the use of corporate general treasury funds for "electioneering communications" could not constitutionally be applied to the film and that BCRA's reporting and disclaimer requirements could not constitutionally be applied to the film or the advertisements. A federal District Court upheld the constitutionality of BCRA as it applied to *Hillary: The Movie* and the advertisements. The District Court ruling dealt with narrow issues, such as whether the film was, in fact, an appeal to vote against Senator Clinton.

The Supreme Court agreed to hear the case, and oral arguments were held in March 2009. However, instead of focusing on the specific facts of the case, several members of the court expressed interest in the more fundamental question of whether restrictions on corporate campaign spending are compatible with the First Amendment guarantee of free speech. In a highly unusual move, the court postponed a decision in the case at the end of its term in June and set new oral arguments in September on the issue of whether the court ought to overturn two previous decisions upholding the power of government to restrict corporate spending on elections. Those precedents are *Austin v. Michigan State Chamber of Commerce*, 494 U.S. 652 (1990), (upholding a Michigan law that prohibited corporations from using general treasury funds to make independent expenditures supporting or opposing candidates) and *McConnell v. FEC*, 540 U.S. 93 (2003), (upholding BCRA).

The government made several key arguments before the Supreme Court in defense of laws limiting corporate campaign spending: (1) unrestricted corporate political spending was deemed especially likely to corrupt public officials and create an appearance of corruption, due to the great wealth of corporations and the narrow economic special interests they often represent; (2) shareholders' money should not be spent on political candidates the shareholders may oppose; and (3) requiring corporations to form PACs to spend money in elections addresses these concerns while leaving corporations free to participate in the political process.

Citizens United argued that if the government may suppress a film such as *Hillary: The Movie* because it is funded with corporate treasury dollars and arguably opposes a candidate for office, it could also ban corporate funded books, web sites, and other forms of communication if they advocate for or against candidates. Further, the risk of corruption arising from corporate political expenditures is lessened when those expenditures are made independently of a candidate's campaign. And, finally, it asserted that the government may not constitutionally attempt to equalize political speech by suppressing the speech of wealthy persons, including corporations.

As of this writing, the court had not yet ruled. It is not clear whether the court will use the case to make a far reaching decision about corporate rights under the First Amendment or limit its holding to the particular facts of the case.

Implications for State Law

There are 22 states that prohibit corporations from spending general treasury funds on state elections, and 2 states that limit such expenditures. The Supreme Court's decision could invalidate these laws. However, Maryland law will not be affected because the State currently does not restrict corporate political expenditures. Corporations may contribute directly to candidates and make independent expenditures supporting or opposing candidates without the need to form a PAC for that purpose. There is also no requirement that corporations disclose independent expenditures. The General Assembly did require corporations and other persons to disclose independent expenditures for and against the constitutional amendment legalizing video lottery terminals that was submitted to the voters in 2008. That law, however, applied only to that one ballot question.

Maryland joined an amicus brief in *Citizens United* filed by 26 states that asks the court to decide the case on narrow grounds without reducing the power of states to regulate corporate political activity if they chose to do so.

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State Government

Minority Business Enterprises

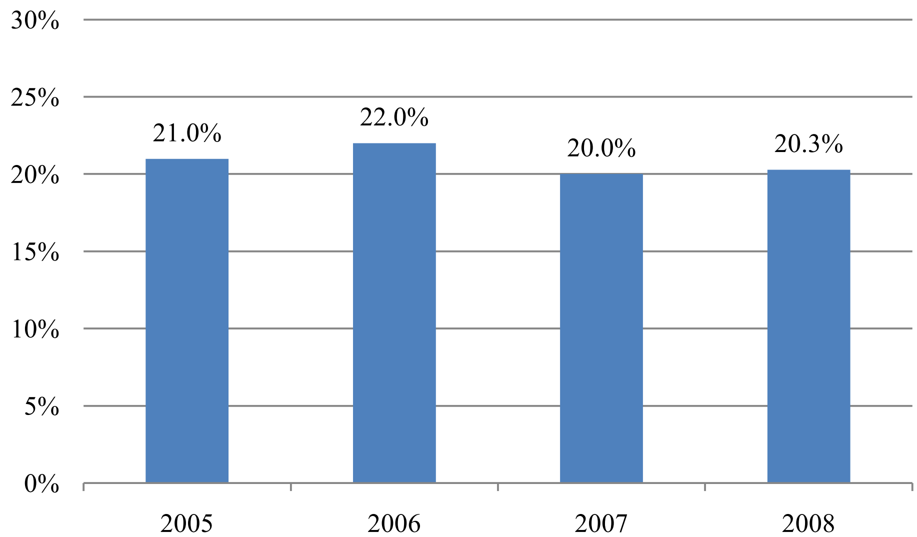
The State still struggles to meet Minority Business Enterprise (MBE) contracting goals established under State law but continues to look for ways to foster greater participation by socially and economically disadvantaged populations covered under the MBE program.

Elusive Progress

In the past four years, the State has made no progress in meeting State Minority Business Enterprise (MBE) contracting goals. The State's MBE program establishes a goal that at least 25% of the total dollar value of each agency's procurement contracts be awarded to certified MBEs, including 7% to African American-owned businesses and 10% to women-owned businesses. There are no penalties for agencies that fail to reach these targets. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurement. Maryland has the highest MBE goal among the 50 states.

Since fiscal 2005, the percentage of total State procurement award dollars going to certified minority business enterprises (MBEs) has remained fairly stable, below the State's statutory goal of 25%. **Exhibit 1** shows that the percentage of procurement contract award dollars going to certified MBEs in fiscal 2008 is below the fiscal 2005 level. A one-time increase in the percentage of procurement contract dollars awarded to certified MBEs from fiscal 2005 to 2006 was not sustained.

Exhibit 1
Percentage of State Procurement Contract Dollars Awarded to MBEs
Fiscal 2005-2008



Source: Governor's Office of Minority Affairs

As shown in **Exhibit 2**, the State has made modest progress over the same time period toward meeting its statutory subgoal of 10% participation for women-owned businesses, but little discernable progress toward meeting the 7% subgoal for African American-owned businesses. After remaining stable for three years, the percentage of procurement contract award dollars going to women-owned businesses grew from 5.7% to 6.1%. The percentage going to African American-owned businesses has increased only slightly from 4.0% to 4.1%.

Overall, State procurement spending has increased 41.9% since fiscal 2005, and MBE contract awards have increased by 37.2%.

Exhibit 2
Percentage of State Procurement Contract Dollars Awarded to MBE Subgroups
Fiscal 2005-2008

	2005	2006	2007	2008
African American	4.0%	4.3%	3.6%	4.1%
Women	5.7	5.7	5.7	6.1
Asian	2.0	1.8	2.3	1.8
Hispanic	1.3	1.0	1.1	1.5
Native American	0.2	0.2	0.3	0.6
Disabled	0.6	2.4	0.1	0.0
Nonprofit (certified)	4.0	3.5	3.4	4.2
Sheltered Workshop	3.1	3.3	3.4	1.9
Total	**21.0%**	**22.0%**	**20.0%**	**20.3%**

Source: Governor's Office of Minority Affairs

Legislative Measures Seek to Aid, Expand MBEs

Chapter 463 of 2008 established the Task Force on the Minority Business Enterprise Program and Equity Investment Capital. The stated rationale for the task force is the disparity in the amount of private capital invested in MBEs and their representation in the business community. MBEs represent 30% of the general population, but receive only between 2 and 3% of available private equity. The task force is charged with studying strategies for facilitating the acquisition of investment equity by Maryland MBEs, recommending modifications to the MBE program to encourage private equity investment in MBEs, and developing draft legislation to implement its recommendations. The task force's final report is due December 1, 2009. The early work of the task force has focused, in part, on a review of State economic development strategies and the extent to which those strategies encourage investment in MBEs. The members have heard presentations from venture capital experts and from small and minority business owners who testified to the difficulties of attracting investment dollars. Further, the task force is also reviewing the parameters of the State's MBE program for fairness and inclusiveness.

Chapters 267 and 268 of 2009 seek to expand the number of eligible MBEs by requiring that the personal net worth cap for eligibility in the State's MBE program be adjusted annually according to the Consumer Price Index. A business owner with a personal net worth above the statutory cap is not considered economically disadvantaged for the purpose of being eligible for MBE certification. The cap had last been increased in 2004, from $750,000 to $1.5 million.

State Government

Public-Private Partnerships

Public-private partnerships are gaining an increasing foothold in Maryland, although the General Assembly has yet to establish explicit policy for evaluating them in State law.

Background

A public-private partnership (P3) is a contractual agreement between a public agency and a private-sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. Each party also shares in the risks and rewards potential in the delivery of the service or facility. P3 agreements may have a varying degree of private-sector involvement. The most limited form of a P3 agreement may entail a service or management contract for a facility. P3 agreements with increased private involvement also may include a design-build agreement or a design-build-finance-operate agreement.

Maryland's Current Process for Legislative Oversight

The Maryland P3 framework is built on a 1996 Attorney General's opinion (81 Op. Att'y. Gen. 261) and regulations of the Maryland Transportation Authority (MDTA). Current law also requires that MDTA notify the General Assembly not less than 45 days both before a solicitation is issued and before a contract is approved by the Board of Public Works and that specified financial information be included in the notifications. However, State law does not set forth a broad statutory framework for P3s or a clear process for legislative oversight and approval. MDTA regulations for the P3 program include provisions for performance milestones and require that the maximum rate of return to the private entity be negotiated as part of the agreement.

Recent Actions to Increase Legislative Oversight of P3s

Over the past few years, the General Assembly has considered or taken several actions designed to increase legislative oversight of P3s, including:

- Legislation in the 2008 and 2009 sessions that would have defined P3s and established stronger legislative oversight of any proposals through either MDTA or the Maryland Department of Transportation (MDOT).

- Including language in the fiscal 2010 operating budget bill that expresses the intent of the General Assembly that a joint legislative and executive workgroup be established to study issues relating to legislative oversight of P3s (Section 53).

- Including language in the fiscal 2010 capital budget bill to require an assessment by the State Treasurer and notice to the General Assembly as to the issuance of a solicitation for a P3 or before entering into a master development agreement (Section 13).

P3 Projects in Maryland

Over the past decade, the State has entered into a number of P3 projects for a variety of facilities and services, including:

- University System of Maryland (USM) Student Housing: USM has used P3s for student housing since 1999. A typical P3 structure involves a ground lease to the Maryland Economic Development Corporation (MEDCO) and the issuance of bonds by MEDCO for construction of student housing. The buildings are not owned by USM and are operated by a private building manager, with whom students sign leases and pay rent.

- Redevelopment of State Center: State Center is an approximately 20-acre campus consisting of four State office buildings and surface parking lots in Baltimore City. The current inventory includes about one million square feet of State office space for roughly 3,500 State employees for many agencies. As currently structured, redevelopment of State Center would have a private developer build a mixed-use development under a 50-year ground lease with the State. Under the proposal, the State would become one of the primary tenants of State Center, with rental rates to be negotiated later.

- Public Health Laboratory: The Department of Health and Mental Hygiene (DHMH) has proposed construction of a new public health laboratory to replace its current outdated facility. DHMH contracted for consultant services to study transaction models for a P3 to finance the new laboratory and the consultants determined that the lowest cost financing option would be State General Obligation (GO) bonds. Rather than funding the project using State GO bonds, the Administration has proposed a financing approach using MEDCO issued lease-revenue bonds in conjunction with a private developer in a form of P3 arrangement.

- Seagirt Marine Terminal: The Maryland Port Administration (MPA) is seeking private partners to lease and operate the Seagirt Marine Terminal and develop an additional berth, which is required in order to service larger container ships. In February 2009, prior notice was sent to the budget committees. In April 2009, MPA released a request for proposals offering the opportunity for a private party to establish long-term maritime terminal operations at Seagirt, including construction and operation of a new Berth IV. A decision is expected regarding a P3 agreement for Seagirt in December 2009.

- I-95 Travel Plazas: MDTA is proposing to redevelop the two travel plazas it owns on I-95. MDTA is considering options that include financing and redevelopment of the travel plazas and intends to seek P3 proposals for a developer/operator to design-build-operate-maintain-finance two new travel plazas in the existing locations.

- Transit-oriented Development (TOD): TOD projects seek to create dense, mixed-use development adjacent to transit stations. Both MDOT and the Washington Metropolitan Area Transit Administration pursue TOD projects. The typical TOD project would involve converting a surface parking lot into a multi-level garage so that the additional land is available to be sold to a private developer for mixed-use development. TOD areas being considered for development by P3 include the Savage MARC Station in Howard County, Owings Mills Metro Station in Baltimore County, Odenton MARC Station in Anne Arundel County, Laurel MARC Station in Prince George's County, and Reisterstown Plaza MARC Station in Baltimore City.

Policy Implications

Since a P3 agreement is a contract executed between the Executive Branch and a private entity, it is important that this type of undertaking be evaluated carefully to ensure that the public interest is served. P3 agreements can be exceedingly complex and vary greatly in structure, representing a wide variety of financial and legal structures. Furthermore, P3 agreements have the potential to have a significant impact on long-term State expenditures and may also have an impact on State debt affordability limits and the State's credit rating.

The General Assembly has not clearly articulated its position regarding the role of P3s as an option for financing transportation projects and other public facilities. Currently, P3s are allowed due to regulations that were reviewed by a joint legislative committee, the 1996 opinion of the Attorney General, and a statutory provision regarding reporting requirements. Combined, these individual components do not represent a clear expression of intent from the State legislature that P3s are an appropriate financing tool for State facilities. Given the complexity, long-term fiscal implications, and long-term uncertainty, the General Assembly might want to consider expressing its policy preferences more explicitly in statute.

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State Government

Base Realignment and Closure

Preparations are underway at both the State and local levels to address the anticipated influx of up to 60,000 new jobs and 25,000 new households as a result of the 2005 Base Realignment and Closure (BRAC) plans and other military growth. Like many states affected by BRAC, Maryland faces significant challenges in completing transportation infrastructure improvements to accommodate this growth.

2005 BRAC Impact on Maryland

In 1990 the U.S. Congress created the Base Realignment and Closure process (BRAC), a procedural mechanism for streamlining the nation's defense infrastructure. The 2005 BRAC plans, which went into effect in November 2005, require the Department of Defense (DOD) to complete the planned base closures and realignments by September 15, 2011.

Significant federal and private-sector job growth in the State is anticipated as a result of the 2005 BRAC plans. An estimated 27,400 new direct jobs are expected to be created through 2011 at Fort Meade, National Naval Medical Center, Andrews Air Force Base, Aberdeen Proving Ground, and Fort Detrick. This estimated job growth, which includes jobs created as a result of BRAC growth as well as non-BRAC military growth, is detailed in **Exhibit 1**. Approximately 1,500 of these BRAC jobs already have relocated to Aberdeen Proving Ground, and most of the remaining BRAC jobs will relocate beginning in the second half of 2010 through September 2011.

To accommodate the new BRAC jobs, major facilities are currently under construction at military installations in the State. The Defense Information Systems Agency (DISA), for example, broke ground on its new headquarters at Fort Meade on April 16, 2008. DISA's new headquarters, a facility of more than 1 million square feet, will house approximately 4,300 personnel. For a summary of major BRAC construction projects underway at military installations in the State, including estimated completion dates and the number of personnel at each facility, see **Exhibit 2**.

In addition to direct job growth, thousands of indirect and induced jobs are expected to be created for an estimated total of up to 60,000 new federal and private-sector jobs statewide through 2020. It is further estimated that Maryland will gain more than 25,000 households as a result of the BRAC process and other military growth. Estimated household growth by county is as follows: 4,500 new households in Anne Arundel County; 3,700 in Baltimore County; 2,000 in Cecil County; 6,500 in Harford County; 1,800 in Howard County; 2,300 in Montgomery County; 2,000 in Prince George's County; and 2,500 in the City of Baltimore.

Exhibit 1
Impact of BRAC and Other DOD Growth on Maryland Estimated Employment Gains in Direct Jobs through 2011

Base	Estimated Employment Change
Aberdeen Proving Ground (Harford County)	Gain of 8,800 jobs
Andrews Air Force Base (Prince George's County)	Gain of 3,000 jobs
Fort Meade (Anne Arundel County)	Gain of 11,800 jobs
Fort Detrick (Frederick)	Gain of 1,400 jobs
National Naval Medical Center (Bethesda)	Gain of 2,400 jobs
Total Job Growth	**27,400**

Source: Department of Business and Economic Development

Coordination and Oversight of Maryland's BRAC Initiatives

A number of State agencies and local governments are actively preparing for BRAC growth. These efforts include, among other things, upgrades to the State's transportation, water, and wastewater infrastructure; expansion of education opportunities to better serve the BRAC mission; Smart Growth initiatives; and homebuyer programs. The Maryland Military Installation Council, the BRAC Subcabinet, and the Joint Committee on Base Realignment and Closure are responsible for coordinating and overseeing these State and local efforts.

The Maryland Military Installation Council

The General Assembly established the Maryland Military Installation Council (MMIC) in 2003 to serve as an advocate for military facilities located in Maryland and to coordinate State agency planning in response to changes caused by BRAC (Chapter 335 of 2003). Originally named the Maryland Military Installation Strategic Planning Council, the General Assembly renamed the council and expanded the membership from 19 to 22 members in 2006 (Chapter 634 of 2006). MMIC members represent various State agencies, military installations, and local liaison organizations. The council is staffed by the Department of Business and Economic Development (DBED), and its annual report is due by December 31 of each year.

Exhibit 2
Major BRAC Construction Projects Underway

Project	Estimated Personnel at Facility	Estimated Completion Date
Aberdeen Proving Ground (Harford County)		
Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR) Campus		
Phase I	5,000	June 2010
Phase II	2,700	December 2010
Andrews Air Force Base (Prince George's County)		
Air National Guard Readiness Center	605	December 2009
Air Force District of Washington Headquarters	2,395	January 2011
Fort Meade (Anne Arundel County)		
Defense Information Systems Agency Headquarters	4,300	October 2010
Adjudication Activities Facility	800	March 2011
Defense Media Activity Headquarters	700	April 2011
National Naval Medical Center (Bethesda)		
Walter Reed National Military Medical Center	2,400	Phase I – October 2010 Phase II – August 2011

Source: Department of Business and Economic Development; BRAC Subcabinet

BRAC Subcabinet

The BRAC Subcabinet, created by Chapter 6 of 2007, is chaired by the Lieutenant Governor and includes eight State secretaries of cabinet departments and the State Superintendent of Schools. The subcabinet 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; and

- collaborating with and reviewing the recommendations of MMIC.

Working in collaboration with local jurisdictions, the subcabinet completed a State action plan in 2007 to identify and guide critical tasks, programs, projects, and initiatives that address the needs created by the arrival of residents and businesses. The subcabinet issued a 2008 progress report and anticipates issuing another progress report in January 2010. The subcabinet also implemented a BRACStat program to compile and analyze statistics relating to BRAC.

Joint Legislative Committee on BRAC

Chapter 469 of 2007 established the Joint Committee on Base Realignment and Closure, which consists of eight members of the House of Delegates and eight 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 held two meetings during the 2009 interim, during which it received updates from the BRAC Subcabinet, the Maryland Department of Transportation (MDOT), the Secretary of Higher Education, and staff to members of Maryland's congressional delegation. The committee also heard from former Governor Parris Glendening on Smart Growth planning.

Preparations by State Agencies

Under the coordination of MMIC, State agencies are taking steps to prepare for a significant influx of military personnel, civilian employees, contractors, and families in the affected areas. For example, 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 has developed a strategy for accommodating and sustaining the incoming BRAC growth consistent with Smart Growth policies; and the Department of Housing and Community Development is promoting its homebuyer programs to relocating families and is aligning community development and rental housing programs to be responsive to BRAC needs in local communities.

MDOT has assessed traffic and other transportation needs in BRAC growth areas and has started work on specific BRAC-related traffic and transit projects. However, Maryland, like many states affected by BRAC, faces significant challenges in completing transportation infrastructure improvements to accommodate BRAC growth. First, major roadway improvements, from initial planning to construction, typically take 10 to 15 years to complete, while the timeframe for BRAC growth is much shorter, occurring over a period of 6 years. Second, recent declines in State transportation revenues have limited the available funding for all State transportation projects, including BRAC-related projects. As a result, MDOT has implemented what it calls a "high/low" investment strategy for BRAC-related transportation projects, targeting lower-cost improvements for potential funding and completion before 2011, while continuing to develop and advance the higher cost long-term projects. MDOT also continues to pursue various sources of funding for transportation improvements, including funding through the U.S. Department of Transportation and DOD's Defense Access Roads Program.

Preparations by Local Governments

The affected local jurisdictions – Anne Arundel, Baltimore, Carroll, Cecil, Frederick, Harford, Howard, Montgomery, Prince George's, Queen Anne's, and Talbot counties; Baltimore City; and the City of Laurel – have been actively engaged in BRAC preparation efforts. They have formed regional alliances, have been meeting and working with MMIC and the subcabinet, have prepared BRAC action plans, and many have applied for and received federal grants to address BRAC-related issues such as transportation, housing, utilities, services, and education.

A number of local governments also have applied to have areas designated as BRAC Zones under the BRAC Community Enhancement Act (Chapter 338 of 2008). As is discussed further below, the benefits of a BRAC Zone designation are primarily tax-related financial incentives. The Secretary of Business and Economic Development has designated seven areas as BRAC Zones.

2009 Legislation

Interstate Compact on Educational Opportunity for Military Children

Chapters 501 and 502 of 2009, Administration measures, made Maryland a member of the Interstate Compact on Educational Opportunity for Military Children. The purpose of the compact is to minimize the barriers that children in military families often face when transferring among schools in different states. As of August 2009, the compact has been ratified by 24 states, including Maryland.

Waiver of Occupational Licensing Requirements

Chapter 731 of 2009, a departmental measure, exempts an individual working as a stationary engineer; plumber; gas fitter; or heating, ventilation, air-conditioning, and refrigeration contractor from the applicable Maryland trade licensing examination if the individual relocated to the State because of a family member's reassignment due to BRAC. Under the Act, an individual is exempt from the State's trade examination requirement if the individual holds a valid trade license issued in New Jersey or Virginia; meets certain other criteria; and provides documentation verifying that the individual's relocation to the State is a direct result of a family member's involvement in the BRAC process.

Amendments to BRAC Community Enhancement Act

Chapter 728 of 2009, a departmental measure, made a number of changes to the BRAC Community Enhancement Act, which was established by Chapter 338 of 2008. Under the BRAC Community Enhancement Act, a local government may apply to have a BRAC Zone located within its jurisdiction. The benefits of a BRAC Zone designation are primarily tax-related financial incentives, including State support of up to 100% of the increase in the State property tax of any qualified property in the BRAC Zone and 50% of the local property tax for any increase in the local tax revenues collected on the increased value of qualified property. Qualified property is commercial or residential property that DBED determines enhances economic development.

The financial incentives available under the BRAC Community Enhancement Act may continue for 10 years. As originally enacted, the 10-year life of a BRAC Zone began when the Secretary of Business and Economic Development first designated an area as a BRAC Zone. Chapter 728, however, provides that the 10-year life of a BRAC Zone begins when the first property in the zone becomes qualified property. The 2009 legislation also made a number of administrative changes to the BRAC Zone application and designation process, including the addition of a requirement that the Secretary, upon receipt of an application for designation or expansion of a BRAC Zone, provide notice of the application to the members of the county delegation to the General Assembly for each county in which the BRAC Zone is proposed.

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Local Government

State Aid to Local Governments

State aid is projected to total $6.7 billion in fiscal 2011, a $420.8 million or 6.7% increase over the prior year. This annual increase is significantly higher than the previous year due to the assumption that State aid programs will be funded at their statutory levels in fiscal 2011. However, due to the State's continued fiscal crisis, State aid to local governments may be reduced in fiscal 2011 below statutory funding levels. In fiscal 2010, State aid programs were reduced by $480.4 million in order to balance the State budget.

State Aid in Fiscal 2011

Local governments are projected to receive $6.7 billion in State aid in fiscal 2011, a 6.7% increase from the prior year resulting in an additional $420.8 million in State support for local programs and services. As in prior years, most of the State aid is targeted to public schools, while funding for counties and municipalities will account for less than 10% of total aid. Local school systems will receive $5.6 billion in State support, or 85% of total aid. Counties and municipalities will receive $629.7 million, community colleges will receive $292.0 million, libraries will receive $66.0 million, and local health departments will receive $40.2 million. In terms of year-over-year funding enhancements, State aid for public schools will increase by $137.3 million (2.5%); library aid will increase by $1.9 million (2.9%); community college aid will increase by $35.9 million (14.0%); and local health aid will increase by $2.9 million (7.8%). County and municipal governments will realize a $242.8 million (62.8%) increase in State aid due to rebasing the aid amounts on statutory funding levels. **Exhibit 1** shows the change in State aid by governmental entity for fiscal 2011.

Exhibit 1
State Aid to Local Governments
($ in Millions)

Governmental Entity	FY 2010	FY 2011	$ Difference	% Difference
Public Schools	$5,507.0	$5,644.3	$137.3	2.5%
Counties/Municipalities	386.9	629.7	242.8	62.8%
Community Colleges	256.2	292.0	35.9	14.0%
Libraries	64.1	66.0	1.9	2.9%
Local Health Departments	37.3	40.2	2.9	7.8%
Total	**$6,251.4**	**$6,672.2**	**$420.8**	**6.7%**

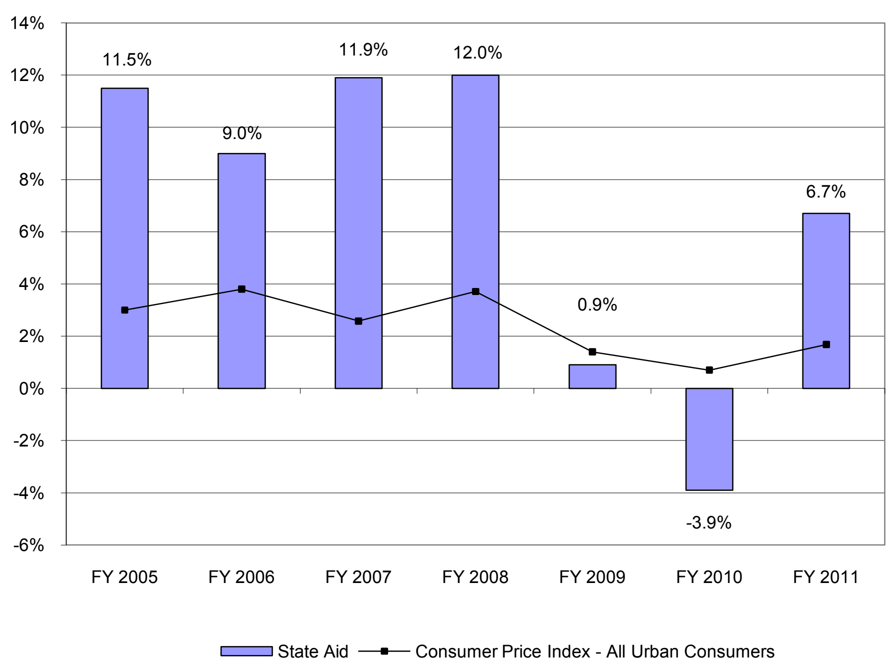
Source: Department of Legislative Services

Mid-year Reductions by Board of Public Works

After several years of record increases in State aid (**Exhibit 2**), the General Assembly adopted measures at the 2007 special session and the 2008 session that reduced funding for several State aid programs beginning in fiscal 2009. Due to the continued fiscal crisis, State aid was reduced by $480.4 million in fiscal 2010. The General Assembly reduced State aid by $268.7 million at the 2009 session, while the Board of Public Works made an additional $211.7 million reduction in August. Reductions made by the board affected local highway user revenues ($159.5 million), police aid ($20.6 million), local health grants ($20.1 million), and community college aid ($10.5 million). The net fiscal effect on State aid to local governments in fiscal 2010 is presented in **Exhibit 3**.

Overall, nearly two-thirds of the State aid reductions in fiscal 2010 ($321.4 million) came from State transportation funding for the local highway user revenues program. This program was originally scheduled to receive $470.4 million in State funding in fiscal 2010; however, as shown in **Exhibit 4**, State funding will only total $149.0 million. Of this amount, Baltimore City will receive $134.8 million, or 90% of the total funding; while the 23 counties will receive $14.2 million, or 10% of the total funding.

Exhibit 2
Annual Growth in State Aid to Local Governments
General and Special Funds



Source: Department of Legislative Services

Exhibit 3
State Aid to Local Governments – Impact of Board of Public Works (BPW) Reduction
Fiscal 2010

County	July 2008	Appropriation	Reduction	Appropriation	Difference
Allegany	72,238	$116,349,091	-$4,757,432	$111,591,659	-4.1%
Anne Arundel	512,790	401,140,460	-14,782,242	386,358,218	-3.7%
Baltimore City	636,919	1,194,485,264	-35,298,228	1,159,187,036	-3.0%
Baltimore	785,618	682,119,600	-23,021,874	659,097,726	-3.4%
Calvert	88,698	109,652,433	-3,391,597	106,260,836	-3.1%
Caroline	33,138	55,532,880	-2,980,322	52,552,558	-5.4%
Carroll	169,353	185,632,627	-7,960,183	177,672,444	-4.3%
Cecil	99,926	124,190,812	-4,459,647	119,731,165	-3.6%
Charles	140,764	188,721,743	-5,543,188	183,178,555	-2.9%
Dorchester	31,998	42,535,031	-3,206,908	39,328,123	-7.5%
Frederick	225,721	263,682,909	-10,067,931	253,614,978	-3.8%
Garrett	29,698	40,196,815	-3,604,878	36,591,937	-9.0%
Harford	240,351	268,590,515	-9,603,141	258,987,374	-3.6%
Howard	274,995	280,345,197	-8,292,265	272,052,932	-3.0%
Kent	20,151	15,685,708	-1,622,466	14,063,242	-10.3%
Montgomery	950,680	718,310,968	-22,518,387	695,792,581	-3.1%
Prince George's	820,852	1,128,082,991	-22,712,418	1,105,370,573	-2.0%
Queen Anne's	47,091	43,109,894	-3,050,713	40,059,181	-7.1%
St. Mary's	101,578	116,259,616	-4,316,471	111,943,145	-3.7%
Somerset	26,119	35,830,791	-2,114,481	33,716,310	-5.9%
Talbot	36,215	19,102,190	-2,067,557	17,034,633	-10.8%
Washington	145,384	178,396,968	-7,064,677	171,332,291	-4.0%
Wicomico	94,046	143,989,851	-5,766,017	138,223,834	-4.0%
Worcester	49,274	31,169,525	-2,589,056	28,580,469	-8.3%
Unallocated		79,966,708	-887,068	79,079,640	-1.1%
Total	**5,633,597**	**$6,463,080,587**	**-$211,679,147**	**$6,251,401,440**	**-3.3%**

Per Capita Reduction	
1. Montgomery	-$24
2. Prince George's	-28
3. Anne Arundel	-29
4. Baltimore	-29
5. Howard	-30
6. Calvert	-38
7. Charles	-39
8. Harford	-40
9. St. Mary's	-42
10. Frederick	-45
11. Cecil	-45
12. Carroll	-47
13. Washington	-49
14. Worcester	-53
15. Baltimore City	-55
16. Talbot	-57
17. Wicomico	-61
18. Queen Anne's	-65
19. Allegany	-66
20. Kent	-81
21. Somerset	-81
22. Caroline	-90
23. Dorchester	-100
24. Garrett	-121
Statewide Average	**-$38**

Percent Difference	
1. Prince George's	-2.0%
2. Charles	-2.9%
3. Baltimore City	-3.0%
4. Howard	-3.0%
5. Calvert	-3.1%
6. Montgomery	-3.1%
7. Baltimore	-3.4%
8. Harford	-3.6%
9. Cecil	-3.6%
10. Anne Arundel	-3.7%
11. St. Mary's	-3.7%
12. Frederick	-3.8%
13. Washington	-4.0%
14. Wicomico	-4.0%
15. Allegany	-4.1%
16. Carroll	-4.3%
17. Caroline	-5.4%
18. Somerset	-5.9%
19. Queen Anne's	-7.1%
20. Dorchester	-7.5%
21. Worcester	-8.3%
22. Garrett	-9.0%
23. Kent	-10.3%
24. Talbot	-10.8%
Statewide Average	**-3.3%**

Source: Department of Legislative Services

Exhibit 4
Highway User Reductions in Fiscal 2010
($ in Thousands)

County	Original Budget	BRFA Reductions $101.9 M	BRFA Reductions $60 M	Legislative Approp.	BPW Reductions	Current Approp.	Percent Reduction
Allegany	$6,278	-$1,832	-$319	$4,127	-$3,714	$413	-93.4%
Anne Arundel	27,406	-7,997	-9,059	10,350	-9,315	1,035	-96.2%
Baltimore City	189,215	-19,871	-2,963	166,381	-31,612	134,769	-28.8%
Baltimore	36,865	-10,757	-8,901	17,207	-15,487	1,721	-95.3%
Calvert	6,092	-1,778	-1,193	3,121	-2,809	312	-94.9%
Caroline	4,360	-1,272	-304	2,784	-2,506	278	-93.6%
Carroll	12,311	-3,592	-1,639	7,080	-6,372	708	-94.2%
Cecil	6,822	-1,991	-1,004	3,828	-3,445	383	-94.4%
Charles	8,836	-2,578	-1,551	4,706	-4,236	471	-94.7%
Dorchester	4,821	-1,407	-320	3,094	-2,785	309	-93.6%
Frederick	16,239	-4,738	-2,573	8,928	-8,035	893	-94.5%
Garrett	5,459	-1,593	-350	3,516	-3,164	352	-93.6%
Harford	14,297	-4,172	-2,150	7,975	-7,178	798	-94.4%
Howard	13,574	-3,961	-3,202	6,411	-5,770	641	-95.3%
Kent	2,450	-715	-239	1,496	-1,347	150	-93.9%
Montgomery	38,505	-11,236	-12,088	15,181	-13,663	1,518	-96.1%
Prince George's	33,545	-9,788	-5,600	18,157	-16,341	1,816	-94.6%
Queen Anne's	5,045	-1,472	-682	2,891	-2,602	289	-94.3%
St. Mary's	6,782	-1,979	-947	3,856	-3,471	386	-94.3%
Somerset	2,913	-850	-108	1,955	-1,759	195	-93.3%
Talbot	4,015	-1,172	-968	1,876	-1,688	188	-95.3%
Washington	10,445	-3,048	-1,349	6,048	-5,444	605	-94.2%
Wicomico	8,141	-2,376	-569	5,197	-4,677	520	-93.6%
Worcester	5,982	-1,746	-1,921	2,316	-2,084	232	-96.1%
Total	**$470,400**	**-$101,920**	**-$59,999**	**$308,481**	**-$159,502**	**$148,979**	**-68.3%**

BRFA – Budget Reconciliation and Financing Act of 2009
BPW – Board of Public Works
Source: Department of Legislative Services

Local Government

Local Tax and Salary Actions

The decline in the State's economy has affected the ability of local governments to provide salary enhancements to their employees. Only six counties and 10 local boards of education granted salary increases in fiscal 2010. However, local governments were able to limit tax increases for the current year, with only one county raising its property tax rate.

Local Government Tax Rates

Local tax rates remained relatively stable in fiscal 2010. As shown in **Exhibit 1**, eight counties changed their local property tax rates, with seven counties decreasing their rates and one county increasing them. Local income tax rates remained constant for tax year 2010, with no county altering its rate. Local recordation, transfer, admission and amusement, and hotel/motel tax rates also remained the same in 2010. A comparison of local tax rates for fiscal 2009 and 2010 is provided in **Exhibit 2**.

Exhibit 1
Number of Counties Changing Local Tax Rates
Fiscal 2008-2010

	Fiscal 2008		Fiscal 2009		Fiscal 2010	
	▲	▼	▲	▼	▲	▼
Real Property	1	5	0	5	1	7
Local Income	1	0	1	0	0	0
Recordation	2	0	2	0	0	0
Transfer	0	0	0	0	0	0
Admissions/Amusement	0	0	0	0	0	0
Hotel/Motel	0	0	1	0	0	0

Source: Department of Legislative Services

Exhibit 2
Local Tax Rates – Fiscal 2009 and 2010

	Real Property		Local Income		Recordation		Transfer		Admissions/ Amusement		Hotel/Motel	
County	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**
Allegany	$0.983	$0.983	3.05%	3.05%	$3.25	$3.25	0.50%	0.50%	7.5%	7.5%	8.0%	8.0%
Anne Arundel	0.888	0.876	2.56%	2.56%	3.50	3.50	1.00%	1.00%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.268	2.268	3.05%	3.05%	5.00	5.00	1.50%	1.50%	10.0%	10.0%	7.5%	7.5%
Baltimore	1.100	1.100	2.83%	2.83%	2.50	2.50	1.50%	1.50%	10.0%	10.0%	8.0%	8.0%
Calvert	0.892	0.892	2.80%	2.80%	5.00	5.00	0.00%	0.00%	1.0%	1.0%	5.0%	5.0%
Caroline	0.870	0.870	2.63%	2.63%	5.00	5.00	0.50%	0.50%	0.0%	0.0%	5.0%	5.0%
Carroll	1.048	1.048	3.05%	3.05%	5.00	5.00	0.00%	0.00%	10.0%	10.0%	5.0%	5.0%
Cecil	0.960	0.940	2.80%	2.80%	4.10	4.10	0.00%	0.00%	6.0%	6.0%	5.0%	5.0%
Charles	1.026	1.026	2.90%	2.90%	5.00	5.00	0.00%	0.00%	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%	6.00	6.00	0.00%	0.00%	5.0%	5.0%	3.0%	3.0%
Garrett	1.000	0.990	2.65%	2.65%	3.50	3.50	1.00%	1.00%	4.5%	4.5%	5.0%	5.0%
Harford	1.082	1.064	3.06%	3.06%	3.30	3.30	1.00%	1.00%	5.0%	5.0%	0.0%	0.0%

	Real Property		Local Income		Recordation		Transfer		Admissions/ Amusement		Hotel/Motel	
County	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**
Howard	1.150	1.150	3.20%	3.20%	2.50	2.50	1.00%	1.00%	7.5%	7.5%	5.0%	5.0%
Kent	0.972	0.972	2.85%	2.85%	3.30	3.30	0.50%	0.50%	4.5%	4.5%	5.0%	5.0%
Montgomery	0.915	0.916	3.20%	3.20%	3.45	3.45	1.00%	1.00%	7.0%	7.0%	7.0%	7.0%
Prince George's	1.319	1.319	3.20%	3.20%	2.50	2.50	1.40%	1.40%	10.0%	10.0%	5.0%	5.0%
Queen Anne's	0.770	0.770	2.85%	2.85%	4.95	4.95	0.50%	0.50%	5.0%	5.0%	5.0%	5.0%
St. Mary's	0.857	0.857	3.00%	3.00%	4.00	4.00	1.00%	1.00%	2.0%	2.0%	5.0%	5.0%
Somerset	0.920	0.900	3.15%	3.15%	3.30	3.30	0.00%	0.00%	4.0%	4.0%	5.0%	5.0%
Talbot	0.449	0.432	2.25%	2.25%	3.30	3.30	1.00%	1.00%	5.0%	5.0%	4.0%	4.0%
Washington	0.948	0.948	2.80%	2.80%	3.80	3.80	0.50%	0.50%	5.0%	5.0%	6.0%	6.0%
Wicomico	0.814	0.759	3.10%	3.10%	3.50	3.50	0.00%	0.00%	6.0%	6.0%	6.0%	6.0%
Worcester	0.700	0.700	1.25%	1.25%	3.30	3.30	0.50%	0.50%	3.0%	3.0%	4.5%	4.5%

Notes: The real property tax rates shown for Charles, Frederick, Howard, Montgomery, and Prince George's counties include special tax rates. Real property tax is per $100 of assessed value. Income is a percentage of taxable income. Recordation tax is per $500 of transaction.

Source: 2009 Local Government Tax Rate and Salary Action Survey, Department of Legislative Services

Property Tax

For fiscal 2010, seven jurisdictions – Anne Arundel, Cecil, Garrett, Harford, Somerset, Talbot, and Wicomico – decreased their real property tax rates. Montgomery County increased its real property tax rate slightly. Real property tax rates range from $0.432 per $100 of assessed value in Talbot County to $2.268 per $100 of assessed value in Baltimore City.

Local Income Tax

No county altered its local income tax rate for calendar 2010. Local income tax rates range from 1.25% in Worcester County to 3.20% in Howard, Montgomery, and Prince George's counties.

Recordation Tax

No county changed its recordation tax rate for fiscal 2010. The range for recordation tax rates is $2.50 per $500 of transaction in Baltimore, Howard, and Prince George's counties to $6.00 per $500 of transaction in Frederick County.

Transfer Tax

No county changed its transfer tax rate for fiscal 2010. Local transfer tax rates range from 0.5% in six counties (Allegany, Caroline, Kent, Queen Anne's, Washington, and Worcester) to 1.5% in Baltimore City and Baltimore County. Seven counties (Calvert, Carroll, Cecil, Charles, Frederick, Somerset, and Wicomico) do not impose a tax on property transfers.

Admissions and Amusement Tax

No county changed its admissions and amusement tax rate for fiscal 2010. Admissions and amusement tax rates range from 0.5% in Dorchester County to 10.0% in six jurisdictions – Baltimore City, and Anne Arundel, Baltimore, Carroll, Charles, and Prince George's counties. Caroline County is the only jurisdiction that does not impose an admissions and amusement tax.

Hotel and Motel Tax

No county altered its hotel and motel tax rate for fiscal 2010. Hotel and motel tax rates range from 3.0% in Frederick County to 8.0% 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% or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation may be overridden by a unanimous vote of all nine county council members. In Prince George's County, the general property tax rate is capped at $0.96 per $100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2% or the increase in the consumer price index.

The charter limit on property taxes in Montgomery County was strengthened at the November 2008 general election, when county voters approved an amendment to the county charter (Question B) that requires a unanimous vote of all nine county council members in order to override the county's property tax limitation provision. Prior to this amendment, the property tax limitation could be overridden by an affirmative vote of seven of the nine council members. Since 1990, when county voters approved the charter limit on property taxes, the county council has set tax rates that exceeded the limit four times. In fiscal 2010, among the State's 24 jurisdictions, Montgomery County has the fourteenth highest property tax rate.

County Salary Actions

Fewer Maryland jurisdictions provided salary enhancements to their employees in fiscal 2010 than the previous year, with many jurisdictions implementing furlough and salary reduction plans to constrain personnel costs. In addition, local governments eliminated nearly 2,000 positions, of which 20% were filled resulting in employee layoffs.

Only 6 county governments provided employees with a cost-of-living adjustment (COLA) in fiscal 2010, compared to 21 counties in fiscal 2009; 8 counties provided step increases in fiscal 2010, compared to 20 counties in fiscal 2009. Moreover, 10 boards of education provided COLAs and 14 boards provided step increases for teachers in fiscal 2010 while 23 boards provided COLAs and all 24 boards provided step increases in 2009. **Exhibit 3** compares local salary actions in fiscal 2009 and 2010, while **Exhibit 4** shows specific local salary actions for fiscal 2010.

Eight jurisdictions adopted employee furloughs, ranging from two to ten days; while one county imposed a 1% salary reduction plan. In addition, one local school system will furlough employees from one to four days depending on their position. Twelve jurisdictions eliminated filled positions resulting in employee layoffs, while 18 jurisdictions eliminated vacant positions. In total, counties eliminated 363 filled and 1,578.5 vacant positions. Local school systems eliminated 717 positions. **Exhibit 5** describes the local government furlough and salary reduction plans in fiscal 2010.

Exhibit 3
Local Government Salary Actions – Summary
Fiscal 2009 and 2010

	County Government		Public Schools	
COLA Amount	**FY 2009**	**FY 2010**	**FY 2009**	**FY 2010**
No COLA	3	18	1	14
0.5% to 2.9%	7	3	7	9
3.0% to 3.9%	10	1	6	1
4.0% to 4.9%	1	0	5	0
5.0% to 5.9%	0	0	3	0
6.0% and Greater	1	0	2	0
Dollar Amount	2	2	0	0
Still Pending	0	0	0	0

	State Government		CPI-Urban Consumers	
	FY 2009	**FY 2010**	**FY 2009**	**FY 2010** [1]
COLA Amount	2.0%	0%	1.4%	0.7%
Furloughs[2]	5 days	10 days		
Effective COLA[3]	0.5%	-2.6%		

COLA: Cost-of-living adjustment
CPI: Consumer Price Index

[1] Forecast of the CPI for 2010 comes from Moody's Economy.com.
[2] Maximum number of furlough and service reduction days based on salary level.
[3] Effective COLA in fiscal 2010 ranges from -1.2% to -3.8% depending on the number of furlough days.

Source: Department of Legislative Services

Exhibit 4
Local Government Salary Actions in Fiscal 2010

	County Government Generally		Board of Education Teachers	
County	**COLA**	**Step**	**COLA**	**Step**
Allegany	0.0%	No	2.0%	Yes
Anne Arundel[1]	0.0%	Varies	0.0%	No
Baltimore City	2.0%	Yes	0.0%	Yes
Baltimore[2]	2.0%	Yes	3.5%	Yes
Calvert	0.5%	No	0.5%	Yes
Caroline	0.0%	No	0.0%	Yes
Carroll	0.0%	No	0.0%	No
Cecil	0.0%	No	1.1%	Yes
Charles	0.0%	No	0.0%	No
Dorchester	0.0%	No	0.0%	No
Frederick[3]	0.0%	No	0.0%	No
Garrett[4]	$750	No	0.0%	Yes
Harford	0.0%	No	0.0%	No
Howard[5]	0.0%	Yes	1.2%	No
Kent	0.0%	Yes	0.5%	Yes
Montgomery	0.0%	Yes	0.0%	Yes
Prince George's	0.0%	No	0.0%	No
Queen Anne's	$900	No	2.0%	Yes
St. Mary's	0.0%	Yes	1.8%	No
Somerset[6]	0.0%	No	0.0%	Yes
Talbot	0.0%	Yes	1.0%	Yes
Washington[7]	3.0%	No	2.0%	Yes
Wicomico	0.0%	No	0.0%	Yes
Worcester	0.0%	No	0.0%	No
Number Granting	**6**	**8**	**10**	**14**

Comments

[1] Anne Arundel County renegotiated COLA amounts with several bargaining units. These units were scheduled to receive a 3% COLA in fiscal 2010; but instead will receive no COLA but will receive a merit increase. For units that did not renegotiate, no funds were budgeted for either COLA or merit increases. Police officers will not receive a COLA but will receive a 3% merit increase, based on their new contract.

[2] Baltimore County COLAs take effect on January 1, 2010. Baltimore County school teachers received a 3.5% COLA and other school employees received a 2.0% COLA, both of which are implemented at mid-year.

[3] Frederick County deputy sheriffs will receive a merit/step increase.

[4] Garrett County employees will receive $750 in December 2009 and an additional increase totaling up to 3% in March 2010; however, these adjustments will not increase employee base salaries. Road department employees represented by AFSCME received a 4% COLA.

[5] Howard County provided a 3.0% merit/step increase for most positions and a 3.5% merit/step increase for police officers.

[6] Somerset County school employees will receive a merit/step increase in January 2010 if sufficient funds are available.

[7] Washington County provided a 2% COLA for teachers and support personnel effective July 1, 2009, and a 3% COLA for school administrators effective January 1, 2010. School administrators did not receive a merit/step increase, while other school employees did.

AFSCME: American Federation of State, County, and Municipal Employees
COLA: cost-of-living adjustment
Source: Department of Legislative Services

Exhibit 5
Local Government Furlough and Salary Reduction Plans in Fiscal 2010

County	Furlough/ Reduction	Layoffs	
Allegany	Yes	No	County employees will receive 2 furlough days or will forfeit 2 paid days off.
Anne Arundel	Yes	No	School employees will receive between 1 and 4 furlough days depending on the position. County eliminated 109 vacant positions.
Baltimore City	Yes	Yes	City employees will receive between 5 to 10 furlough days, while 75 filled and 474 vacant positions were eliminated.
Baltimore	No	No	
Calvert	No	No	
Caroline	Yes	Yes	County employee salaries will be reduced by 1% in fiscal 2010. County eliminated 4 filled and 9 vacant positions.
Carroll	No	No	County eliminated 14 vacant positions and school system reduced its workforce by 32 employees.
Cecil	No	No	County eliminated 6 vacant positions.
Charles	Yes	Yes	County employees will receive 10 furlough days, while 3 filled and 19 vacant positions were eliminated.
Dorchester	No	No	
Frederick	No	Yes	County eliminated 2 filled and 95 vacant positions. Sixty-three school employees received a reduction in work hours.
Garrett	No	No	County eliminated 8 vacant positions.
Harford	Yes	Yes	County employees will receive 5 furlough days, while 34 filled positions were eliminated.
Howard	Yes	Yes	County employees will receive between 4 and 5 furlough days, while 9 filled and 50 vacant positions were eliminated.
Kent	No	No	County eliminated 6.5 vacant positions.

County	**Furlough/ Reduction**	**Layoffs**	
Montgomery	No	Yes	The county eliminated 151 filled and 227 vacant positions.
Prince George's	Yes	Yes	County employees will receive 10 furlough days. County eliminated 50 filled and 495 vacant positions. School system eliminated 685 positions.
Queen Anne's	No	No	County eliminated 15 vacant positions.
St. Mary's	No	Yes	County eliminated 12 filled and 13 vacant positions.
Somerset	No	No	County eliminated 6 vacant positions.
Talbot	Yes	No	County employees will receive between 2 and 5 furlough days, while 4 vacant positions were eliminated.
Washington	No	Yes	The county eliminated 2 filled and 20 vacant positions.
Wicomico	Yes	Yes	County employees will receive between 5 and 10 furlough days depending on salary amount. County eliminated 10 filled positions.
Worcester	No	Yes	County eliminated 11 filled and 8 vacant positions.
Number of Counties	10	12	In total, counties eliminated 363 filled and 1,578.5 vacant positions. School systems eliminated 717 positions.

Source: Department of Legislative Services; Maryland Association of Counties

Local Government

Joint Legislative Workgroup to Study State, County, and Municipal Fiscal Relationships

During the 2009 interim, a joint legislative workgroup reviewed the fiscal relationship between the State and various units of local governments.

Items of Review

The Joint Legislative Workgroup was established in 2009 by the Senate President and Speaker of the House to provide recommendations resulting in a more fair, efficient, and sustainable financial relationship between the State, county and municipal forms of government in Maryland. Several key items to be reviewed by the workgroup include:

- the evolution and current distribution of governmental responsibilities and State funding among units of government, including State assumption or delegation of responsibilities;
- a comparison of the major forms of State aid to county and municipal governments and the manner in which these items are funded or provided for in other states;
- analysis of the revenue structure and the fiscal capacity of State, county, and municipal governments, including an analysis of variation among counties and municipalities;
- analysis of government expenditures and employment among units of government;
- analysis of the comparative benefits of types of municipal forms as compared to special taxing districts within counties to provide specific services to residents of a sub-county area; and
- the impact of spending, tax, and revenue limitations on State and local finance.

Summary of Meetings

At its first meeting, the workgroup received an update on the State's fiscal condition by the Department of Legislative Services (DLS) in addition to presentations on the structure of Maryland local government, local taxing authority and revenue sources, and government finances in Maryland and other states.

At the next meeting, the workgroup heard from the Maryland Association of Counties (MACo) and the Maryland Municipal League (MML). MACo shared its concerns regarding the impact of recent reductions in State funding to local governments, focusing especially on reductions to the local highway user revenues. MACo also expressed concern that protecting education funding from budget cuts results in considerable local reductions to other critical program areas, such as public safety and transportation. MML expressed its hope that the workgroup will recommend ways to stabilize existing State funding for municipalities and to identify additional revenue sources so municipalities can reduce their reliance on property taxes. After hearing from local officials, the workgroup heard presentations from DLS pertaining to county and municipal revenue sources and tax capacity and effort measures for local governments.

At the workgroup's third meeting, DLS presented a series of reports on State aid to local governments, county and municipal expenditures, and the delivery of government services in Maryland. The final informational meeting focused on the maintenance of effort requirement for public school funding. The workgroup heard from local school superintendents and representatives from the Maryland Association of Boards of Education.

Key Findings

Maryland's local government structure is relatively simple compared to other states. Despite being the nineteenth most populous state, Maryland ranks forty-sixth nationwide in terms of the number of local governments. Of the four basic types of local government units – counties, municipalities, townships, and special districts – Maryland does not have townships or independent school districts. Maryland school districts are dependent on the county government for local funding, unlike 90% of school districts nationwide, which operate as a separate unit of local government with independent taxing authority.

Maryland local governments rely more on tax revenue to finance public services than the national average, with 49.7% of local government revenues in Maryland coming from tax sources compared to 35.8% nationally. As shown in **Exhibit 1**, Maryland's local governments ranked first in the nation for reliance on income taxes, while ranking among the lowest in terms of dependence on State aid and service charges. In addition, local governments in Maryland get relatively less of their tax revenues from property taxes and sales taxes than the national average. In terms of local spending, Maryland is ranked thirty-second nationally on a per capita basis and forty-seventh as a percent of personal income. Nearly 50% of local spending in Maryland is for education and libraries compared to 39.4% nationally. County governments account for over 95% of local government expenditures in Maryland, while municipalities account for 5% (**Exhibit 2**). Education accounts for a majority of county expenditures, followed by public safety and public works activities. The majority of municipal expenditures are for public works and public safety activities.

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Exhibit 1
Local Revenues – Comparison of Maryland, Nearby Jurisdictions, and the United States
2005-2006 Revenue by Type as a Percent of Total Revenues

	Income Tax	Property Tax	Sales & Selective Taxes	Other Taxes	Total Taxes	Charges & Utilities	Misc.	Federal Aid	State Aid	Total Revenues
District of Columbia										
Percent	12.4%	12.2%	12.6%	8.4%	45.6%	13.7%	10.0%	30.7%	0.0%	100.0%
Rank	2	49	4	1	9	45	2	1	51	
New Jersey										
Percent	0.0%	51.5%	0.3%	1.0%	52.8%	11.7%	4.5%	2.3%	28.7%	100.0%
Rank	15	3	46	38	4	48	42	47	36	
Maryland										
Percent	16.4%	24.0%	2.2%	7.0%	49.7%	13.6%	5.4%	5.1%	26.2%	100.0%
Rank	1	27	32	2	7	46	33	12	43	
Virginia										
Percent	0.0%	30.5%	7.8%	4.3%	42.5%	17.7%	5.2%	3.1%	31.4%	100.0%
Rank	15	14	16	8	12	36	36	34	25	
Delaware										
Percent	2.1%	19.2%	0.3%	5.8%	27.5%	23.4%	4.9%	2.3%	41.9%	100.0%
Rank	8	39	44	5	42	24	40	46	5	
Pennsylvania										
Percent	6.3%	27.0%	0.9%	3.9%	38.2%	16.4%	6.4%	5.7%	33.3%	100.0%
Rank	5	20	37	10	17	41	23	7	19	
North Carolina										
Percent	0.0%	20.3%	5.7%	1.4%	27.4%	29.2%	6.4%	3.1%	33.9%	100.0%
Rank	15	35	26	29	43	10	22	35	15	
West Virginia										
Percent	0.0%	23.2%	1.3%	4.6%	29.1%	16.6%	7.5%	5.1%	41.7%	100.0%
Rank	15	32	36	7	39	40	11	11	6	
U.S. Average	**1.7%**	**25.6%**	**5.8%**	**2.6%**	**35.8%**	**22.7%**	**6.4%**	**4.0%**	**31.1%**	**100.0%**

Note: For the rankings, 1 indicates the highest and 51 the lowest. The District of Columbia is classified as a local government in the Census Data. See text for notes regarding categories

Source: State & Local Government Finances, U.S. Census Bureau (July 2008)

Exhibit 2

Local Government Expenditures in Maryland in Fiscal 2007
Amounts Exclude Capital Expenses

	Total Local Expenditures	Percent of Total	County Expenditures	Municipal Expenditures	Percent County	Percent Municipal
General Government	$1,311,078,226	5.9%	$1,177,730,095	$133,348,131	89.8%	10.2%
Public Safety						
Police	1,403,596,361	6.3%	1,225,833,776	177,762,585	87.3%	12.7%
Fire	775,980,439	3.5%	735,073,822	40,906,617	94.7%	5.3%
Corrections	303,100,421	1.4%	303,100,421	-	100.0%	0.0%
Other Public Safety	264,528,201	1.2%	238,940,434	25,587,767	90.3%	9.7%
Public Works						
Transportation	773,208,947	3.5%	648,393,585	124,815,362	83.9%	16.1%
Water/Sewer Services	1,728,833,181	7.7%	1,471,444,855	257,388,326	85.1%	14.9%
Other Public Works	100,010,614	0.4%	6,310,173	93,700,441	6.3%	93.7%
Education						
Public Schools	10,270,590,457	46.0%	10,270,590,457	-	100.0%	0.0%
Community Colleges	831,127,085	3.7%	831,127,085	-	100.0%	0.0%
Libraries	250,059,765	1.1%	250,059,765	-	100.0%	0.0%
Health/Social Services	972,191,606	4.4%	972,191,606	-	100.0%	0.0%
Parks and Recreation	513,456,382	2.3%	432,607,350	80,849,032	84.3%	15.7%
Community/Economic Development	554,253,788	2.5%	515,882,460	38,371,328	93.1%	6.9%
Miscellaneous	965,787,719	4.3%	917,683,910	48,103,809	95.0%	5.0%
Debt Service	1,323,665,516	5.9%	1,258,684,251	64,981,265	95.1%	4.9%
Total	**$22,341,468,708**	**100.0%**	**$21,255,654,045**	**$1,085,814,663**	**95.1%**	**4.9%**

Source: Department of Legislative Services

Local Government

2010 Legislative Agenda – Maryland Municipal League

The legislative agenda for the Maryland Municipal League includes protecting State funding to local governments.

Municipal Budget Security

The Maryland Municipal League (MML) this year adopted "Municipal Budget Security" as its sole priority for the 2010 session. MML believes that the recent cuts in State aid to municipal governments together with the $2 billion State general fund budget deficit projected for next fiscal year dictate that MML dedicate its resources to addressing this issue of primary importance to municipal governments. Under this proposal, MML will try to ensure that incorporated cities and towns are protected from further budget cuts, while at the same time working with the legislature to add additional sources of municipal revenue.

In October 2009, representatives from MML addressed the Legislative Workgroup to Study State, County, and Municipal Fiscal Relationships. MML expressed its hope that the workgroup will:

- recommend ways to stabilize existing State shared revenues for municipalities;
- identify and recommend potential additional resources that may be shared with municipal governments; and
- recommend additional revenue sources and revenue raising authority for cities and towns, thereby reducing their reliance on property taxes as their primary general fund revenue source.

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Local Government

2010 Legislative Agenda – Maryland Association of Counties

The legislative agenda for the Maryland Association of Counties includes protecting State funding to local governments, continuing the State's commitment to public school construction funding, and reforming the local maintenance of effort requirement.

Each year, the Maryland Association of Counties (MACo) selects several issues as its legislative initiatives for the upcoming session. This year, in light of the ongoing economic challenges, the first two of MACo's three legislative priorities are carry-overs from the prior year. The remaining priority involves reforming the local maintenance of effort requirement.

County Budget Security

State aid continues to be the largest revenue source for most county governments, representing 25% of total county revenues. Over the last five years, State funding for local governments has increased by $1.5 billion or 29.7%; however, State funding to counties and municipalities has declined by $200.3 million or 24.1%. Most of the increases in State aid were targeted to public schools. The recent slowdown in the State's economy presents new challenges as State revenues continue to fall below projections. Since State aid to local governments represents one of the largest components of the State budget[1], some options have included a shift of funding requirements to the counties for any number of shared responsibilities in education, public safety, public health, and elsewhere – a cost shift that could significantly impact county budgets and taxes. MACo urges the General Assembly to manage State expenditures responsibly and not shift responsibilities to the counties.

School Construction and Renovation Funding

While the State has increased its school construction and renovation efforts in recent years, the need for funding remains high. In addition, the impact of State funding takes on greater significance in light of the fact that every State dollar invested in school projects leverages roughly two county dollars of local funding. MACo urges the General Assembly to continue its commitment by keeping school construction and renovation funding a high priority. **Exhibit 1** shows State funding for public school construction for fiscal 2006 through 2010.

[1] State aid to local governments represents approximately 40% of State general fund revenues and 27% of both general and special fund revenues.

Exhibit 1
State Funding for Public School Construction

FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
$253,766,000	$322,672,000	$401,828,000	$340,010,000	$266,653,000

Source: Public School Construction Program; Department of Legislative Services

School Budget Accountability – Maintenance of Effort Reform

By law, the State and local governments are required to share the cost of providing an education to all elementary and secondary public school students in the State. In order for a county to receive increases in State education funding each fiscal year, the county government must fund its public school system at a level that is at least at the same per pupil level as the previous fiscal year. This is known as "maintenance of effort" (MOE). A county may obtain a full or partial waiver of MOE in a particular fiscal year if the State Board of Education that the county's fiscal condition significantly impedes the county's ability to fund the MOE.

Facing deep State budget cuts and declining local revenues, in April eight counties filed requests for MOE waivers for fiscal 2010; five requests were subsequently withdrawn and the other three were denied. (See separate issue paper under Education for more information.) In light of the fiscal 2010 MOE waiver denials and the high probability that some counties will need to seek MOE waivers for fiscal 2011, MACo plans to pursue legislation to change the waiver process to accommodate better the fiscal realities in which the counties operate. MACo has convened a workgroup to consider a variety of options such as eliminating or replacing the current waiver process; having a different unit, that is more qualified to evaluate local finances, decide a MOE waiver request; or authorizing the General Assembly to grant a blanket MOE waiver for fiscal 2011. MACo urges the General Assembly to make changes to the MOE waiver process to better address the constraints on county governments in times of fiscal distress.

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