

Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE

Senate Bill 738 (Senator Middleton, *et al.*)
Budget and Taxation and Education, Health, and Environmental Affairs

Governor's Budget - Land Preservation Programs - Funding

This bill requires, beginning in fiscal 2007, repayment of recent transfers totaling \$390 million in State transfer tax revenues to the general fund by including the transfer tax special fund in the provisions relating to the disposition of any unappropriated general fund surplus. The bill also establishes provisions regarding the future transfer of State transfer tax revenues to the general fund and provides for the replacement of any transferred funds.

The bill takes effect June 1, 2005.

Fiscal Summary

State Effect: Potential repayment from the unappropriated general fund surplus of up to \$50 million annually beginning in FY 2007 until a total of \$390 million has been repaid. Special fund revenues and expenditures would increase correspondingly. General fund revenues could increase significantly beginning in FY 2007 due to the bill's provisions regarding future transfers; replacement of transferred funds could result in an increase in general fund expenditures and bond revenues and expenditures. Depending on the timing and amount of repayments, special fund revenues and expenditures could decrease. General fund expenditures would also increase to pay the debt service on any general obligation (GO) bonds issued.

Local Effect: For every \$50 million that is repaid, State aid to local governments under Program Open Space (POS) would increase by an estimated \$17.8 million. Local governments could also be affected by the bill's provisions regarding future transfers.

Small Business Effect: Meaningful.

Analysis

Bill Summary: A transfer of State transfer tax revenues to the general fund may occur only in a fiscal year immediately following a report of the Spending Affordability Committee (SAC) that states that State expenditures exceed State revenues. No more than 50% of the revenues in the special fund may be transferred to the general fund. If State transfer tax revenues are transferred to the general fund, the funds must be replaced with GO bonds backed with general funds, or the funds must be replaced by a combination of GO bonds backed with general funds and a reasonable three-year repayment plan submitted by the Governor. A transfer of revenues from the special fund to the general fund must be submitted as an individual bill and may not be part of a budget reconciliation and financing act. A transfer is limited to two consecutive years.

Current Law: The Rainy Day Fund's sweeper provision provides that when there is a surplus of unappropriated funds in the general fund at the close of a fiscal year, the first \$10 million of any such surplus will be retained by the general fund, while the next \$11 million to \$60 million will be transferred to the Transportation Trust Fund (TTF), until such time as a specified amount has been repaid to the TTF. Any surplus amount exceeding \$60 million will be appropriated to the Rainy Day Fund.

The State transfer tax funds several programs in the Department of Natural Resources (DNR) and the Maryland Department of Agriculture. A portion of State transfer tax revenues (3%) is earmarked to defray administrative costs within DNR, the Department of General Services, and the Maryland Department of Planning. The remainder of the revenue is dedicated to various programs including POS, the Maryland Agricultural Land Preservation Fund (MALPF), Rural Legacy, and the Heritage Conservation Fund. **Exhibit 1** shows the normal distribution of State transfer tax revenues after administrative costs are deducted.

Exhibit 1 Distribution of State Transfer Tax Revenues

POS	75.15%
POS Land Acquisition	1.00%
MALPF	17.05%
Rural Legacy	5.00%
Heritage Conservation Fund	<u>1.80%</u>
Total	100.0%

Of the transfer tax revenues distributed to POS, \$1 million may be transferred by an appropriation in the State budget or by budget amendment to the Maryland Heritage Areas Authority Financing Fund within the Department of Housing and Community Development. Of the remaining funds, half is allocated for State acquisition and half is allocated to local governing bodies for acquisition and development of land for recreation and open space purposes.

Background: While the State’s land preservation programs enjoyed healthy funding through 2002, in recent years the General Assembly has used transfer tax revenues as a means to balance the State’s operating budget. As shown in **Exhibit 2**, budget reconciliation legislation enacted in each of the previous three sessions has diverted approximately \$390 million of transfer tax revenues to the general fund. To compensate, other funding sources, primarily bond funds, have played an important role in funding land preservation activities.

Exhibit 2
Transfer Tax Revenues
Fiscal 2002 – 2005
(\$ in Millions)

<u>Fiscal Year</u>	<u>Budgeted Transfer Tax Revenues¹</u>	<u>Amount to Programs</u>	<u>Amount to General Fund</u>	<u>Replacement GO Funds</u>
2002	\$117.4	\$114.4	\$0.0	\$0.0
2003	108.7	47.3	58.5	0.0
2004	136.8	9.9	141.5 ²	58.3
2005	176.2	6.8	189.3 ³	23.6
Total	\$495.7	\$178.4	\$389.3	\$81.9

Note: Amount to programs does not include 3% for administrative costs. Amount to general fund does not include unencumbered balances transferred by budget reconciliation legislation (\$39.8 million).

¹Reflects estimated revenues plus revenue over attainment from the second prior year.

²Includes \$18 million in fiscal 2003 revenue over attainment that would have been budgeted in fiscal 2005.

³Includes \$42 million in fiscal 2004 revenue over attainment that would have been budgeted in fiscal 2006.

Source: Department of Natural Resources

As introduced, the Budget Reconciliation Act of 2005 (HB 148/SB 127) would redirect a decreasing percentage of transfer tax revenues to the general fund for fiscal 2006 through

2009 and would permanently redirect any over attainment to the general fund. **Exhibit 3** shows the proposed transfers of transfer tax revenues to the general fund, as documented in *Appendix F* of the Governor’s proposed fiscal 2006 budget and updated based on information provided by the Bureau of Revenue Estimates.

Exhibit 3
Proposed Transfers of Transfer Tax Revenues
Budget Reconciliation Act (HB 148/SB 127)
Fiscal 2006 – 2010
(\$ in Millions)

	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>
Transfer to GF	\$163.3	\$208.3	\$98.0	\$52.0	\$0

Note: Transfers for fiscal 2006 and fiscal 2007 include over attainment from fiscal 2004 and estimated over attainment from fiscal 2005, respectively. Over attainment in future years cannot be reliably estimated at this time.

Source: *Appendix F*, Governor’s Proposed Fiscal 2006 Budget; Bureau of Revenue Estimates

Exhibit 4 shows the estimated transfer tax revenues from fiscal 2006 through 2010, as estimated by the Bureau of Revenue Estimates in December 2004.

Exhibit 4
Estimated Transfer Tax Revenues
Fiscal 2006 – 2010
(\$ in Millions)

	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>
Revenues	\$194.5	\$194.6	\$202.4	\$214.4	\$221.8

Note: Estimates do not include over attainment.

Source: Bureau of Revenue Estimates

State Fiscal Effect:

Repayment Provisions

Under the bill, if the unappropriated general fund surplus as of June 30 of the second preceding fiscal year is sufficient, up to \$50 million annually beginning in fiscal 2007 would be directed to the transfer tax special fund until a total of \$390 million has been repaid.

Based on the general fund forecast for fiscal 2004 through 2010 as shown in the Governor’s proposed fiscal 2006 budget, the fiscal 2005 closing balance is estimated at \$680 million. However, all but \$17.5 million of that balance is designated for use in the Governor’s proposed fiscal 2006 budget. Accordingly, it is not likely that the bill’s repayment provision would be triggered in fiscal 2007. Based on the current general fund forecast for future years, the bill’s repayment provision also would not be triggered between fiscal 2008 and 2010. Nevertheless, if revenue attainment improves and/or if spending is less than anticipated, some repayment could occur. Special fund revenues would increase correspondingly. **Exhibit 5** shows the distribution of funds for each \$50 million repaid.

Exhibit 5
Distribution of Transfer Tax Revenue per \$50 Million Repayment

<u>Amounts Distributed to Special Funds</u>	<u>Percentage</u>	<u>Amount</u>
POS	75.15%	\$35,575,000
POS Land Acquisition	1.00	500,000
MALPF	17.05	8,525,000
Rural Legacy	5.00	2,500,000
Heritage Conservation Fund	1.80	<u>900,000</u>
Total		\$50,000,000

Provisions Regarding Future Transfers

In addition to repayments, the bill provides that a transfer of revenues from the special fund to the general fund could only occur in a fiscal year immediately following a SAC report that states that State expenditures exceed State revenues. In such a circumstance, the bill provides for a transfer of not more than 50% of the revenues in the fund and requires the replacement of such funds with GO bonds or a combination of GO bonds and

a three-year repayment plan submitted by the Governor. Further, a transfer would be limited to two consecutive years. The transfer provisions would apply beginning in fiscal 2007.

Under the State Constitution, the budget must be balanced and State expenditures cannot exceed revenues; however, if the SAC provisions were interpreted to apply to ongoing general fund revenues versus ongoing general fund expenditures, expenditures have exceeded revenues for several years and are forecast to exceed revenues for the foreseeable future.

Under the latter interpretation of the bill, compared to current law, and assuming a bill is introduced to effectuate such a transfer, the bill could result in future transfers of not more than 50% of the revenues in the special fund to the general fund in any given year. Under current law, no such transfer is authorized; recent transfers have been enabled due to budget reconciliation legislation; this bill would provide the Governor with flexibility to use 50% of transfer tax revenues for other purposes. Accordingly, general fund revenues could increase significantly, with a corresponding decrease in special fund revenues and expenditures. Any such transfer would be limited to two consecutive years, however. So after two consecutive years of transfers, current law would prevail the following year; the Governor could then resume transfers in the fourth year.

Although the bill provides for the replacement of funds transferred, the Department of Legislative Services (DLS) notes that it does not provide for immediate replacement, so the net effect on land preservation funding is unclear. If the replacement of funds were provided each year in the full amount of any transfer, there would be no net effect on the affected special funds. However, if the replacement is not immediate, special fund revenues and expenditures could decrease.

The replacement of transferred funds could result in an increase in general fund expenditures and bond revenues and expenditures. General fund expenditures could increase to pay the debt service on any GO bonds issued as a result of the bill. DLS advises that an increase in GO bond issuances could result in a decrease or delay in other capital projects if the capital debt affordability limit is not increased to account for the bill.

DLS notes that, based on the Governor's long-term plan as outlined in **Exhibit 3**, which proposes to transfer a specific percentage of funds from the special fund to the general fund through fiscal 2009 and to permanently transfer all over attainment to the general fund, the bill could result in a decrease in general fund revenues and a corresponding increase in special fund revenues and expenditures.

Local Fiscal Effect: Because local governments receive funding from POS, any repayments under the bill would result in an increase in State aid. For every \$50 million repaid, State aid to local governments under POS would increase by an estimated \$17.8 million annually. Local governments could also be affected by the provisions regarding future transfers, depending on the net effect to the special funds.

Small Business Effect: Any repayment of transfer tax revenues would benefit farmers, most of which are small businesses. For every \$50 million repaid, funding for MALPF would increase by approximately \$8.5 million. This additional funding could leverage the purchase of easements on an additional 3,875 acres (based on an average purchase price of \$2,200 per acre). In addition, repayment of POS funds could benefit small businesses to the extent that additional recreation and conservation areas increase tourism. Small businesses could also be affected by the provisions regarding future transfers, depending on the net effect to the special funds.

Additional Information

Prior Introductions: Legislation addressing the repayment of State transfer tax revenues was introduced as HB 880 of 2004. The Appropriations Committee held a hearing on the bill, but no further action was taken.

Cross File: HB 1533 (Delegate Cane, *et al.*) – Rules and Executive Nominations.

Information Source(s): Department of Natural Resources, Maryland Department of Agriculture, Department of Budget and Management, Comptroller's Office, Bureau of Revenue Estimates, State Department of Assessments and Taxation, Department of Legislative Services

Fiscal Note History: First Reader - March 7, 2005
mam/rhh

Analysis by: Lesley G. Cook

Direct Inquiries to:
(410) 946-5510
(301) 970-5510