

Department of Legislative Services
 Maryland General Assembly
 2010 Session

FISCAL AND POLICY NOTE
Revised

House Bill 171 (The Speaker)(By Request - Administration)
 Appropriations

Creation of a State Debt - Aging School Program - Qualified Zone Academy Bonds

This Administration bill authorizes the Board of Public Works to issue \$4,543,000 in interest-free Qualified Zone Academy Bonds (QZABs) and grant the proceeds to the Interagency Committee on School Construction (IAC) to be used for the State’s Aging Schools Program.

The bill takes effect June 1, 2010.

Fiscal Summary

State Effect: Bond revenues and expenditures increase by up to \$4.5 million in FY 2011 from the issuance of QZABs. Annuity Bond Fund expenditures increase by an estimated \$302,900 annually for 15 years beginning in FY 2011 to pay off the principal on the QZABs.

(in dollars)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Bond Rev.	\$4,543,000	\$0	\$0	\$0	\$0
SF Expenditure	\$302,900	\$302,900	\$302,900	\$302,900	\$302,900
Bond Exp.	\$4,543,000	\$0	\$0	\$0	\$0
Net Effect	(\$302,900)	(\$302,900)	(\$302,900)	(\$302,900)	(\$302,900)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local school revenues for school renovation increase by up to \$4.5 million from the distribution of QZAB proceeds.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

Analysis

Current Law: The federal Tax Reform Act of 1997 created QZABs as a new type of debt instrument to finance education projects. Financial institutions, insurance companies, and investment houses are the only entities allowed to purchase the bonds, which provide for a federal tax credit instead of interest earnings. The program has been extended several times, most recently under the American Recovery and Reinvestment Act of 2009 (ARRA), which included \$1.4 billion of additional QZAB authorization. QZAB funds may be used only either in schools located in a federal Enterprise or Empowerment Zone, or in which at least 35% of the student population qualifies for free or reduced price meals.

Through fiscal 2009, Maryland allowed QZAB proceeds to be used only for renovation and repair (brick-and-mortar) projects as part of the Aging Schools Program administered by IAC. Chapter 707 of 2009 expanded the use of *previously* authorized QZABs to include equipment, which is an authorized use under Section 1397E of the Internal Revenue Service code. Chapter 707 also authorized the Maryland State Department of Education (MSDE) to allocate QZAB funds to local education agencies. However, this bill does not authorize the allocation of *newly* issued QZABs by MSDE or for equipment. QZABs are issued with the full faith and credit of the State. Therefore, QZABs are considered State debt. For purposes of calculating State debt affordability, QZABs are included in the State's general obligation bond debt outstanding and debt service.

The State's Aging Schools Program provides funds to local school systems for improvements, repairs, and deferred maintenance of public school buildings and building systems that are more than 15 years old. Grant amounts for each school system are specified in statute and increase annually with inflation beginning in fiscal 2013. The allocation of QZAB funds is based on each school system's percentage of the State's pre-1970 public school square footage and the number of Maryland public school students eligible for free and reduced price meals in each school.

Background:

QZABs

Maryland first authorized the sale of QZABs in Chapter 322 of 2000. Additional issuances were authorized by Chapter 139 of 2001, Chapter 55 of 2003, Chapter 431 of 2005, and Chapter 585 of 2007.

Federal law requires that QZAB projects receive a 10% private-sector match, which may be in the form of cash, in-kind goods such as equipment or technology, services such as help developing curriculum, and internships or field trips. While Maryland law authorizes QZABs to be spent on brick-and-mortar projects and equipment, federal law also allows spending on curriculum development and training for teachers and other school personnel.

Maryland has two federal QZAB allocations that have not been issued. In 2008, the State received an allocation of \$4.5 million, and this allocation will expire if it is not issued by December 31, 2010. This bill authorizes the issuance of those funds. In 2009, Maryland's allocation was \$15.9 million, and bonds for these funds must be issued by December 31, 2011. The 2009 allocations were higher nationwide because of the additional authorization contained in ARRA.

To date, Maryland's allocation under the federal program has totaled \$47.6 million from five prior-year bills that authorized the sale of the bonds; including interest earned on QZAB proceeds brings total proceeds for the State to \$50.3 million. Of that amount, \$29.0 million (57.7%) has been spent, as shown in **Exhibit 1**.

Aging Schools Program

The Aging Schools Program was initially established by the Baltimore City-State Partnership legislation, which provided \$4.4 million for the program and specific allocations for local school systems. The following year, the School Accountability Funding for Excellence legislation increased the annual funding level by \$6.0 million to \$10.4 million. In both Acts, the Aging Schools Program was scheduled to terminate after fiscal 2002; however, the date was later altered to give the Task Force to Study Public School Facilities time to consider maintaining or changing the program.

In response to task force recommendations, bills were enacted in 2003 and 2004 to eliminate the termination date on the Aging Schools Program and reallocate program funds to more closely reflect the statewide distribution of older school buildings. The statutory allocations are based on each county's share of statewide pre-1970 square footage. In addition, the 2004 capital budget bill (Chapter 432) included General Assembly intent language to add fiscal 2006, 2007, and 2008 "hold harmless" funding to the statutory grant levels in order to lessen the impact of the reallocation recommended by the task force and enacted in Chapters 306 and 307 of 2004. Chapter 252 of 2006 added an annual inflationary adjustment to the Aging Schools Program beginning in fiscal 2008. The Budget Reconciliation and Financing Act (BRFA) of 2009 (Chapter 487) "rebased" the program at \$6.1 million in fiscal 2010 and 2011. The fiscal 2010 capital budget as enacted and the Governor's proposed fiscal 2011 capital budget include \$6.1 million in general obligation (GO) bonds for the program. Under the 2009 BRFA, the Aging Schools Program returns to its base funding level of \$10.37 million in fiscal 2012, with inflationary adjustments set to return in fiscal 2013.

Exhibit 1
Use of QZAB Bond Proceeds through December 31, 2009
By Local Education Agency
(\$ in Thousands)

	<u>Current</u> <u>Appropriation⁽¹⁾</u>	<u>Expenditures⁽²⁾</u>	<u>Unexpended</u> <u>Balance</u>
Allegany County	\$1,055	\$828	\$227
Anne Arundel County	2,686	2,184	502
Baltimore County	9,272	6,002	3,270
Calvert County	0	0	0
Caroline County	378	299	79
Carroll County	0	0	0
Cecil County	437	437	0
Charles County	649	618	31
Dorchester County	855	125	730
Frederick County	914	871	43
Garrett County	241	211	30
Harford County	621	621	0
Howard County	485	485	0
Kent County	1,230	198	1,032
Montgomery County	5,327	5,126	201
Prince George's County	8,917	3,886	5,031
Queen Anne's County	0	0	0
St. Mary's County	339	339	0
Somerset County	61	61	0
Talbot County	202	202	0
Washington County	1,287	616	671
Wicomico County	261	261	0
Worcester County	175	175	0
Baltimore City	14,707	5,349	9,357
State Bond Sale Expense	112	112	0
Unencumbered Funds	94	0	94
Totals	\$50,306	\$29,008	\$21,298

QZAB: Qualified Zone Academy Bond

1) As of fiscal 2010, the Maryland State Department of Education is authorized to award QZAB funds for equipment. Current appropriations include the following amounts approved by MSDE as of December 2009: \$1 million for Baltimore County, \$700,000 for Dorchester County, and \$1 million for Kent County.

2) Includes expenditures of interest earnings.

Source: Interagency Committee on School Construction

Eligible Aging Schools Program expenditures include asbestos and lead paint abatement; upgrade of fire protection systems and equipment; painting; plumbing; roofing; upgrade of heating, ventilation, and air conditioning systems; site redevelopment; wiring schools for technology; and renovation projects related to education programs and services. Projects must cost at least \$10,000 to be funded through the program. MSDE and the Public School Construction Program review aging schools project requests submitted by local school systems, approve eligible projects, and determine if additional review of any construction documents will be required.

State Fiscal Effect: Bond revenues and expenditures increase by up to \$4.5 million in fiscal 2011 from the issuance of QZABs, with the funding distributed to local school systems for eligible school renovation and repair projects. The State is required to repay the principal on the bonds within 15 years after the date of issuance. As QZABs are tax-credit bonds, the State is responsible for repaying only the principal. However, federal arbitrage rules prohibit the State from earning interest on the proceeds of tax-credit bonds. Therefore, debt service payments consist of annual payments of \$302,867 into the Annuity Bond Fund with the intent of paying off the full \$4.5 million at the end of the 15-year period. When the Annuity Bond Fund is unable to fully fund the debt service on bonds issued by the State, general funds are used to pay the remaining amount. Neither the fiscal 2010 budget nor the Governor's proposed fiscal 2011 budget includes general funds to supplement annuity bond funds.

Local Fiscal Effect: Local school revenues for public school renovation and repair increase by up to \$4.5 million in fiscal 2011. There is no local match for QZABs, although local school systems must raise private entity matches equal to 10% of their QZAB distributions in order to receive the QZAB funds.

Additional Information

Prior Introductions: None.

Cross File: SB 202 (The President)(By Request - Administration) - Budget and Taxation.

Information Source(s): Public School Construction Program, Department of Legislative Services

Fiscal Note History: First Reader - January 29, 2010
mpc/rhh Revised - Updated Information - February 2, 2010

Analysis by: Michael C. Rubenstein

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

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Qualified Zone Academy Bonds

BILL NUMBER: HB 171

PREPARED BY: Kwame Kwakye

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

The historical average size of a project funded with Qualified Zone Academy Bond is \$112,000. Based on the proposed \$4,543,000 authorization, this would create 41 projects for small business contractors. There is no local match for QZABs, although local school systems have to generate private entity matches equal to 10% of their QZAB distributions. The 10% contribution requirement could also potentially affect small businesses.