HB 1446

Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

House Bill 1446 (Delegate Heller, *et al.*) (Chair, Joint Committee on the Management of Public Funds)

Appropriations

Bonds Supported by the American Recovery and Reinvestment Act

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This bill authorizes the Board of Public Works (BPW) to act as a conduit issuer and issue bonds authorized by the American Recovery and Reinvestment Act of 2009 (ARRA) on behalf of a local government unit. A "local government unit" includes a county, municipality, or local education agency. ARRA bonds issued by BPW on behalf of a local government unit may only be issued at the request of a local government unit and are neither a debt of the State or any unit of the State and are solely the obligation of a local government unit. ARRA bonds that are allocated to the State or local government units can be combined, consolidated, and sold as a single unit. The bill also clarifies that the State can issue ARRA bonds to finance State projects that have been authorized by separate State-enabling acts.

The bill takes effect June 1, 2010, and remains in effect until either the State and local government bond financing subsidies under ARRA or any extension expire; or June 30, 2013.

Fiscal Summary

State Effect: BPW and the State Treasurer can implement the bill with existing budgeted resources.

Local Effect: Local governments may realize some savings if the State issues ARRA bonds on behalf of local governments.

Small Business Effect: None.

Analysis

Bill Summary: By resolution, BPW may authorize the issuance of ARRA bonds and provide for the terms, conditions, security, sale, delivery, payment of, and all other matters pertaining to ARRA bonds. A county, municipality, or local education agency that has received an ARRA bond allocation may request BPW to issue bonds on its behalf. These entities must also authorize issuance of the bonds through an ordinance or resolution in accordance with local governance laws. The bill also specifies the terms under which BPW may issue these bonds, including the requirement that the maturity not exceed a term of 15 years for State allocations. A local government must pledge its full faith and credit or pledge specific revenues as security for the bonds. A local government unit may enter into an agreement with BPW to pledge any money, including a share of income tax revenues that the local government unit is entitled to receive from the State in order to enhance the security or marketability of the ARRA bonds issued on its behalf.

BPW may not issue ARRA bonds for a State project if the project qualifies as private activity bonds under the Act and the Internal Revenue Code. BPW may issue ARRA bonds on behalf of a local government unit to finance local projects if the bonds qualify as private activity, but only if the authorizing ordinance or resolution requests BPW to issue private activity bonds and specifies the revenues to be generated by the private activity project.

The State Treasurer may appoint an agent or other contracting party in order to issue ARRA bonds. ARRA bonds issued for State projects must be authorized by a separate State-enabling Act.

Current Law: BPW is not authorized to issue bonds on behalf of local governments. Chapter 649 of 2009 confirmed BPW authority to issue bonds in a form that qualifies for tax credits, interest subsidies, or other federal tax benefits and also ratified the validity of any tax credit bonds sold prior to the effective date of Chapter 649. This authority includes ARRA bonds.

BPW is comprised of the Governor, the State Comptroller, and the State Treasurer. BPW approves the amount and the timing of State bond sales. BPW also approves the expenditure of all sums appropriated through State loans authorized by the General Assembly and funds appropriated for capital improvements, except construction contracts for State roads, bridges, and highways. BPW approves leases and contracts executed by State agencies and adopts and promulgates rules, regulations, and procedures for the administration of State's procurement law.

Background: In February 2009, President Barack H. Obama signed ARRA into law. In addition to authorizing federal spending and reducing federal taxes, ARRA includes

provisions that affect State and municipal bonds. Specifically, the Act authorized the following debt: Build America Bonds (BABs); Qualified School Construction Bonds (QSCBs); Qualified Zone Academy Bonds (QZABs); Qualified Energy Conservation Bonds (QECBs); Clean Renewable Energy Bonds (CREBs); Recovery Zone Facilities Bonds (RZFBs); and Recovery Zone Economic Development Bonds (RZEDBs). ARRA bonds include taxable bonds with a federal subsidy (BABs, RZEDBs, and RZFBs) and tax-credit bonds (QZABs, QSCBs, QECBs, and CREBs). Chapter 649 of 2009 confirmed BPW authority to issue these bonds.

Federal Subsidy Bonds

Build America Bonds

A new bond program that allows State and local governments to issue taxable bonds in 2009 and 2010, the bonds support projects that qualify for tax-exempt bonds. The bonds are offered with a tax credit or a direct payment option. Under the tax credit option, the taxpayer holding the bond is eligible to receive an income tax credit equal to 35% of the interest paid. Under the direct payment option, the issuer receives federal funds equal to 35% of the interest cost. The federal government did not set a limit on the amount of BABs that can be issued.

Large sums of BABs have already been issued by State and municipalities. The University System of Maryland and the Maryland Transportation Authority have issued BABs. The State Treasurer's Office issued $50.0 million in BABs in August 2009 and another $58.2 million in October 2009. BABs were issued instead of tax-exempt bonds. Legislative Services estimates that, after adjusting for the federal subsidy, the yield of the BABs was 92 basis points (0.92%) less than the cost of 15-year tax-exempt bonds. The State Treasurer's Office plans to issue additional BABs in 2010.

Recovery Zone Economic Development Bonds

RZEDBs are a subset of the BABs and offer a larger credit of 45% compared with 35% offered by BABs. RZEDBs must support economic development purposes, such as projects located in economic development recovery zones or projects supporting job training or educational programs. A recovery zone is defined as an area having significant poverty, unemployment, home foreclosures or general distress, or an area that has already been federally designated as an empowerment zone or renewal community. In addition to federally designated areas, a county or municipality may designate areas within their jurisdiction as recovery zones. The counties and Baltimore City received Maryland's entire $208.9 million allocation; the State did not receive any allocation. If a locality waives its allocation, the State could issue the bonds or give the allocation to another locality. To date, no RZEDBs have been issued.

Recovery Zone Facilities Bonds

RZFBs are tax-exempt bonds which support private activity projects that otherwise do not qualify as tax-exempt. At least 95% of the proceeds must support projects in a recovery zone. The counties and Baltimore City received Maryland's entire $313.3 million allocation; the State did not receive any allocation. If a locality waives its allocation, the State could issue the bonds or give the allocation to another locality. To date, no RZFBs have been issued. The Department of Business and Economic Development advises that they are in discussions with counties and have negotiated some reallocations of the bonds.

Tax Credit Bonds

Qualified Zone Academy Bonds

QZABs were created under the federal Tax Reform Act of 1997 as a new type of debt instrument to finance education projects. 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. Chapter 707 of 2009 expanded the use of previously authorized QZABs for equipment, which is an authorized use under section 1397E of the Internal Revenue Service code. Federal law requires that QZAB projects also receive a 10% private-sector match, which may include cash or in-kind goods and services. The bonds are tax-credit bonds; the buyers receive a federal tax credit and may not receive an interest payment. The State pledges its full faith and credit when issuing QZABs and the bonds are considered State debt. Through December 2009, the State issued $47.6 million in QZABs. In 2008, the State received a $4.5 million allocation, which must be issued before the end of 2010. Legislation (Senate Bill 202 and House Bill 171) authorizing the issuance of the funds has been introduced. ARRA authorized another $15.9 million in QZABs in 2009 and 2010, the last of which must be issued before the end of 2012.

QZABs are attractive to the State because they are less expensive than issuing GO debt. Unlike GO bonds (which retire principal over a period of years), QZABs offer a bullet maturity (whereby the entire principal is retired at once). QZABs debt service costs are annual sinking fund payments for the principal. With some of the earlier QZAB issuances, the sinking fund earned interest that could be applied to the principal. Consequently, the cost of these QZABs was less than the amount borrowed. For example, the first QZAB issuance in 2001 generated $18.1 million in principal for the State, with sinking fund payments totaling $12.4 million. DLS estimates that $18.1 million in GO bonds would have required $26.9 million in debt service costs. In this case, QZABs reduced debt service costs by $14.4 million.

Though the most recent QZAB sale did not yield as much savings as the initial sale, costs were still less than GO bonds. In December 2009, the State issued $5.6 million in QZABs. The bonds included a 1.6% supplemental coupon, requiring $0.7 million in interest payments over the life of the QZABs. This compares favorably to GO bonds, which require $2.7 million in interest payments for $5.6 million issued at 5.0%. QZABs offer the State a cost-effective alternative to GO bond debt and are a useful source of funding for the State's public school needs.

Qualified School Construction Bonds

QSCBs are tax-credit bonds that support the construction, rehabilitation, or repair of public school facilities. Unlike QZABs, QSCBs do not require a 10% private match. These bonds can be issued to support the public school construction program in the place of GO bonds. The State was authorized to issue up to $50.3 million in QSCBs in 2009 and another $50.3 million in 2010.

The buyers of the bonds receive a tax credit, which reduces what the bond buyers will charge for the bonds. Under ideal circumstances, the bonds sell at par without any interest payments (referred to as a supplemental coupon). To date, QSCB sales have required either supplemental coupon payments (such as the Baltimore County sale which included a 1.25% coupon) or have sold at a discount (such as the Virginia Public School sale which generated proceeds equal to 91.0% of the bonds' principal). The State Treasurer's Office advises that all of the nine previous QSCBs sales exceeding $50 million either sold at a discount or required a supplemental coupon. In December 2009, the State sold $50.3 million in QSCBs at par without a supplemental coupon. The bonds will be retired in 2024 (fiscal 2025). The bonds will generate savings by replacing subsequent GO bond issuances that would have supported public school construction.

Since there was no supplemental coupon, the State will not pay any interest on these bonds. This reduces debt service costs by an average of $2.6 million annually, compared to GO bonds' debt service costs. To pay back the bonds, the State will make annual payments into a sinking fund. The State Treasurer's Office advises that the fund will be generating interest, reducing annual payments further. At this point the sinking fund's investment rate of return has not yet been set.

Qualified Energy Conservation Bonds

QECBs were created by the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, with ARRA subsequently increasing the allocation. The bonds are tax credit bonds, and the proceeds can only be used for conservation projects. Maryland's allocation is $58.4 million, of which $51.9 million is for local governments, and the

remaining $6.5 million for the State. The State Treasurer's Office is not aware of any QECB issuances, so marketability may be an issue.

The State Treasurer's Office has proposed to use these funds to support Energy Performance Contracts (EPCs) administered by the Maryland Energy Administration. EPCs provide capital financing for improvements that reduce energy costs with the finance costs supported by the energy savings realized. In the past, financing was provided by a master energy lease. However, this financing has become unreliable in recent years.

Clean Renewable Energy Bonds

CREBS is an existing tax credit bond program that finances renewable energy facilities. Under the program, a 70% tax credit may be allowed. Projects that qualify include electricity generation from wind and hydropower. The bonds can be issued by public power providers, cooperative electrical companies, certain nonprofit electrical utilities, and governmental bodies. No more than one-third of the allocation may support projects owned by public power providers, cooperative electrical companies, and governments. The State Treasurer has not issued any CREBs.

State Fiscal Effect: The State Treasurer can administer the sale of ARRA bonds on behalf of local governments with existing budgeted resources. The costs of issuance of additional ARRA bonds will be paid out of proceeds from the sale of these bonds and will not directly affect State finances.

Local Fiscal Effect: ARRA bonds that have been allocated to local governments allow counties, municipalities, and local education agencies to issue taxable bonds with a federal subsidy or issue tax-credit bonds. These ARRA bonds have a lower initial cost of capital than traditional tax-exempt bonds. ARRA authorizations to local governments for QSABs, QECBs, and RZEDBs range from less than $1 million to $53 million. For those local governments that have relatively small allocations, the costs to issue these bonds (legal and financial advisory fees, rating agency fees, etc.) will likely represent a significant amount of bond proceeds, making the bonds relatively expensive to issue in small amounts. Allowing BPW to aggregate these bonds and issue them through a single bond issuance will reduce the cost of issuance for participating local government units, thereby reducing debt service expenses for these entities.

Additional Information

Prior Introductions: None.

Cross File: SB 1046 (Senator Jones)(Chair, Joint Committee on the Management of Public Funds) - Rules.

Information Source(s): Board of Public Works, Maryland State Department of Education, Department of General Services, Maryland Association of Counties, Maryland Municipal League, Maryland State Treasurer's Office, Department of Legislative Services

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