Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

House Bill 86 (The Speaker)(By Request - Administration)
Appropriations Budget and Taxation

Creation of a State Debt - Qualified Zone Academy Bond

This Administration bill authorizes the Board of Public Works to issue $15,902,000 in interest-free Qualified Zone Academy Bonds (QZABs) by December 31, 2011, and grant the proceeds to the Interagency Committee on School Construction (IAC) and the Maryland State Department of Education (MSDE) for the renovation, repair, and capital improvements of qualified zone academies, including public charter schools, as defined in the federal Internal Revenue Code. Proceeds from the sale of QZABs must be spent no later than three years after the issuance of the bonds.

The bill takes effect June 1, 2011.

Fiscal Summary

State Effect: Bond revenues and expenditures increase by $15.9 million in FY 2012 from the issuance of QZABs. Annuity Bond Fund expenditures increase by an estimated $530,000 in FY 2012 and then by $1.06 million for 14 years, with one additional payment of $530,000 in the sixteenth year to pay off the principal on the QZABs. Special fund expenditures by the Public School Construction Program increase by $46,400 to continue employment of a contractual QZAB program manager for most of FY 2012.

(in dollars)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Bond Rev.	$15,902,000	$0	$0	$0	$0
SF Expenditure	$576,400	$1,060,000	$1,060,000	$1,060,000	$1,060,000
Bond Exp.	$15,902,000	$0	$0	$0	$0
Net Effect	($576,400)	($1,060,000)	($1,060,000)	($1,060,000)	($1,060,000)

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

Local Effect: Local school revenues for school renovation increase by $15.9 million in FY 2012 from the distribution of QZAB proceeds.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: IAC and MSDE may use QZAB proceeds provided by the Board of Public Works for the following purposes, in accordance with criteria established under the Aging Schools Program:

1. for competitively awarded grants by IAC to eligible school systems for qualified academies, including public charter schools; and
2. for targeted grants awarded by MSDE to eligible school systems for qualified academies, including public charter schools, under the Breakthrough Center Program.

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, which included $1.4 billion of additional QZAB authorization. Under current federal guidelines, QZAB funds may be used only to rehabilitate or repair school facilities, provide equipment, develop course materials, or train teachers and other school personnel. They can be used only for qualified zone academies, which are defined as public schools that (1) are designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and prepare students for college and the workforce; and (2) require students to meet the same academic standards and assessments as other students in the same school system. Qualified zone academies must either be located in a federal Enterprise or Empowerment Zone or have at least 35% of their student population qualify for free or reduced price meals.

Maryland has 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. However, Chapter 707 of 2009 expanded the use of *previously* authorized QZABs to include equipment, which is an authorized use under Section 1397E (revised and recodified as Section 54E by the federal Tax Extenders and Alternative Minimum Tax Relief Act of 2008) of the Internal Revenue Code. Chapter 707 also authorized MSDE to allocate QZAB funds to local education agencies. 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.

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, Chapter 585 of 2007, and Chapter 523 of 2010.

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, for previously authorized QZABs, equipment, federal law also allows spending on curriculum development and training for teachers and other school personnel.

Maryland has three federal QZAB allocations that have not been issued. In 2009, Maryland's allocation was $15.9 million, and bonds for these funds must be issued by December 31, 2011; this bill authorizes bond sales for that allocation. In 2010, Maryland's allocation is $15.3 million, and bonds for these funds must be issued by December 31, 2012. In 2011, the QZAB allocation is $4.5 million, and the bonds must be sold by December 31, 2013.

To date, Maryland's allocation under the federal program has totaled $52.2 million from six prior-year bills that authorized the sale of the bonds; including interest earned on QZAB proceeds brings total proceeds for the State to $54.9 million as shown in **Exhibit 1**. Omitting the 2010 sale, which was just held in December 2010, 73.2% of QZAB proceeds had been spent as of December 31, 2010.

Even though almost three-quarters of the QZAB proceeds have been spent, a small number of local school systems have poor track records in spending their allocations. **Exhibit 2** provides the February 28, 2011, unexpended balances for each county for the first six QZAB sales (and therefore does not include the most recent sale in December 2010).

Exhibit 1
QZAB Proceeds and Expenditures as of December 31, 2010

Year of Sale	Proceeds	Interest Income	Proceeds + Interest	Expenditures	Unexpended Balance	% Expended
2001	$18,097,984	$1,320,934	$19,418,918	$19,319,816	$99,102	99.5%
2004	9,043,000	941,477	9,984,477	7,499,518	2,484,959	75.1%
2006	4,378,000	322,972	4,700,972	1,517,702	3,183,270	32.3%
2007	4,986,000	124,561	5,110,561	2,489,638	2,620,923	48.7%
2008	5,563,000	-16,167	5,546,833	2,835,950	2,710,883	51.1%
2009	5,563,000	7,314	5,570,314	3,177,208	2,393,106	57.0%
2010	4,543,000	0	4,543,000	52,500	4,490,500	1.2%
Total	**$52,173,984**	**$2,701,091**	**$54,875,075**	**$36,892,332**	**$17,982,743**	

Source: Interagency Committee on School Construction

Exhibit 2
Unexpended QZAB Proceeds, as of February 28, 2011

Allegany	$0
Anne Arundel	89,000
Baltimore	577,913
Baltimore City	6,845,887
Caroline	0
Cecil	0
Charles	0
Dorchester	30,000
Frederick	0
Garrett	30,000
Kent	0
Montgomery	79,905
Prince George’s	1,412,355
Washington	114,131
Wicomico	0
Worcester	0
Unallocated	915,703
Total	**$10,094,894**

Source: Interagency Committee on School Construction

The large unexpended balances in some jurisdictions have prompted IAC to propose ending the practice of awarding QZAB funds based on the Aging Schools Program statutory need-based formula and instead using a competitive grant process to award the funds to eligible schools with projects that are ready to go.

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, with the program returning to its base funding level of $10.37 million in fiscal 2012 and inflationary adjustments set to return in fiscal 2013. The 2010 BRFA (Chapter 484) permanently rebased the program at $6.1 million with no annual adjustment.

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.

Breakthrough Center

The Breakthrough Center's primary focus is to efficiently coordinate MSDE's resources for 16 schools and their 20 feeder schools in Baltimore City and Prince George's

County. Without the center, schools and districts have to work with different MSDE divisions to access different resources. Furthermore, the Breakthrough Center coordinates resources from government and private-sector partners and provides funding for supplemental instructional support, such as job-embedded professional development for teachers. To provide long-term support, the Breakthrough Center develops multi-year memoranda of understanding signed by the participating schools, districts, and MSDE that specify the roles and responsibilities of each.

While the center's focus is on low-performing schools, it is launching voluntary statewide initiatives and will offer webinars and e-learning communities, all centered on what works in school improvement. The center plans to develop evaluation mechanisms, and the results will be an important measure of MSDE's targeted assistance. The center's pilot phase was completed in summer 2010 and its activities are scaling up during fiscal 2011. A portion of the previously authorized QZABs, approximately $2.9 million, was allocated through the Breakthrough Center to eligible schools with MSDE helping to identify corporate opportunities to raise the 10% match. The State budget for fiscal 2012 includes $1.1 million from federal Race to the Top funds for the center. IAC is working with MSDE to identify large projects in schools that are targeted for intervention by the Breakthrough Center so that eligible capital costs associated with the improvement efforts can be funded with QZAB proceeds. Therefore, in addition to the competitive grant process described above, a portion of the QZAB proceeds will be distributed to schools being assisted by the Breakthrough Center.

Public Charter Schools

Public charter schools are public schools that provide alternative approaches to learning to improve student academic performance. They operate under the supervision of a local board of education or the State Board of Education and, with certain exceptions, in accordance with the laws and regulations that govern other public schools. Local school boards must give public charter schools a per-student amount of county, State, and federal money that is commensurate to the amount given to other public schools in the same jurisdiction. The State Board of Education or a local board may give surplus educational materials, supplies, furniture, and other equipment to a public charter school. Public charter schools do not receive a specific allocation for capital facilities.

There are currently 44 public charter schools in the State: 34 in Baltimore City; 5 in Prince George's County; 2 in Anne Arundel County; and 1 each in Baltimore, Frederick, and St. Mary's counties. Many public charter schools are located in former public school buildings, especially in Baltimore City. Some public charter schools lease space in private buildings. Under the bill, any public charter school in Maryland could be eligible to receive QZAB funds if it meets the qualifications.

State Fiscal Effect: Bond revenues and expenditures increase by up to $15.9 million in fiscal 2012 from the issuance of QZABs, with the funding distributed to local school systems, either through competitive grants or the Breakthrough Center, for eligible school renovation and repair projects, including public charter schools. 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 $1.06 million into the Annuity Bond Fund with the intent of paying off the full $15.9 million at the end of the 15-year period. However, in fiscal 2012, only one of two annual payments is made, due to the timing of the sale of the bonds, so fiscal 2012 Annuity Bond Fund expenditures are only $530,000. 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 2011 budget nor the fiscal 2012 State budget includes general funds to supplement annuity bond funds.

The QZAB allocation authorized by this bill is more than three times larger than the most recent allocations, and the distribution of funds through a competitive grant process will require significantly more staff time by IAC than the formula-based distribution of past allocations. Also, the process of monitoring project status and ensuring that projects will expend all funds within the three-year timeframe required by the last three QZAB allocations has proven to be very intensive, as reflected by the large unspent allocations in several jurisdictions. Over the past couple of years, IAC has experienced staff cutbacks due to cost containment measures that have left it inadequately staffed to carry out the distribution and monitoring of QZAB funds envisioned by the bill.

In February 2011, IAC received approval of a $23,000 special fund budget amendment to hire a contractual position to manage the QZAB program for one year. The special funds are available from QZAB issuances prior to 2008, of which under federal law up to 5% may be used for administrative costs. Therefore, special fund expenditures increase by $46,350 in fiscal 2012, which provides for the continuation of the QZAB manager through most of fiscal 2012. This estimate reflects the cost of maintaining a contractual QZAB program manager to oversee the distribution of the QZAB proceeds and monitor project status and assumes that the QZAB manager ends employment in March 2012. It includes a salary, fringe benefits, and ongoing operating expenses.

Contractual Position	1.0
Salary and Fringe Benefits	$46,000
Operating Expenses	350
Total FY 2012 State Expenditures	**$46,350**

Local Fiscal Effect: Local school revenues for public school renovation and repair increase by up to $15.9 million in fiscal 2012. Distribution of the QZAB proceeds among local school systems will be determined by a competitive grant process administered by IAC and also by the Breakthrough Center. 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 122 (The President)(By Request - Administration) - Budget and Taxation.

Information Source(s): Maryland State Department of Education, Public School Construction Program, Board of Public Works, Department of General Services, Department of Legislative Services

Fiscal Note History: First Reader - February 7, 2011
ncs/rhh Revised - House Third Reader - March 28, 2011
Revised - Clarification - April 28, 2011

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Creation of a State Debt – Qualified Zone Academy Bond

BILL NUMBER: HB 86 (SB 122)

PREPARED BY: Kwame Kwakye, Department of Budget and Management

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

____ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

__X__ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

Yes. The legislation may create additional contracting opportunities for small businesses. In the past, the average value of QZAB projects was $115,000 and total funding ranged from $5 to 11 million. Based on the increase in funding to $15.9 million, the new average is likely to be substantially higher.