Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 376 (Delegate Simmons, *et al.*)
Ways and Means

Video Lottery Terminal Proceeds - School Construction

This bill repeals the Purse Dedication Account (PDA) and the Racetrack Facility Renewal Account (RFRA) established under the Video Lottery Terminal (VLT) Program law. The bill instead directs the proceeds, up to a maximum of $140 million annually, from VLTs currently allocated to PDA and the RFRA to a School Construction Account (SCA) that is established by the bill. The bill places the SCA under the authority of the Interagency Committee on School Construction (IAC). The bill also alters the effective period for Chapter 412 of 2011 such that it is no longer in effect as of July 1, 2012.

The bill takes effect July 1, 2012.

Fiscal Summary

State Effect: VLT program special fund revenues are not affected. Repeal of PDA/RFRA results in equal amounts distributed to SCA. Special fund expenditures increase for school construction.

Local Effect: County tax revenues may decrease minimally in those counties with horse racing facilities and/or a significant horse industry presence. Local governments will benefit from additional State school construction funding but will need to provide the local share of new projects that are funded by the State.

Small Business Effect: Small business horse industry breeders and owners in the thoroughbred and standardbred racing industry may be adversely affected. Some small construction-related businesses may benefit from new school construction or improvements.

Analysis

Bill Summary: The SCA is a special, nonlapsing fund for the purpose of providing funding for school construction in the State. IAC must allocate funds in the SCA to service State debt issued to fund school construction in the State's capital budget, provided that:

- funds allocated in the capital budget for school construction represent an increase over the level of funds allocated in the previous fiscal year;
- the funds dedicated to debt service must be associated with the increase for each year the debt is outstanding; and
- the debt issued for school construction is in accordance with limits established by the Capital Debt Affordability Committee.

However, for a fiscal year with no increase in the level of funds for school construction in the capital budget, the IAC must credit to the general fund no more than the amount credited to the SCA in the prior fiscal year.

Current Law:

VLT Program

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. Chapter 624 of 2010 and Chapter 240 of 2011 made several changes to the VLT program implemented by Chapter 4.

Under Chapter 4, VLT facility operation licenses are awarded by the Video Lottery Facility Location Commission. The State Lottery Commission oversees VLT operations, and owns/leases VLTs and a central monitor and control system. Except for provisions related to the offering of food and beverages at facilities, the commission is required to ensure VLT licensees comply with the regulatory framework of the VLT program.

Chapter 4 allows for a maximum of 15,000 VLTs, 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 (Rocky Gap State Park). Chapter 240 of 2011 reduced the maximum allocation at Rocky Gap State Park to 1,000.

Under current law, except for the Allegany County location, gross VLT proceeds are distributed as follows:

- Business Investment – 1.5% to a small, minority, and woman-owned business investment account;
- Lottery Operations – 2% to the State lottery for administrative costs, with other costs provided for in the State budget;
- Local Impact Grants – 5.5% to local governments in which a video lottery facility is operating, 18% of which would go for 15 years (starting in fiscal 2012 and ending in fiscal 2027) to Baltimore City through the Pimlico Community Development Authority and $1 million annually to Prince George's County for the community surrounding Rosecroft;
- Purse Dedication Account – 7% to enhance horse racing purses and funds for the horse breeding industry, not to exceed $100 million annually;
- Racetrack Facility Renewal Account – 2.5% for an eight-year period to RFRA, not to exceed $40 million annually;
- Licensee (Operator) – no more than 33% to video lottery operation licensees; and
- Education Trust Fund (ETF) – remainder to ETF (48.5%-51.0%).

Chapter 412 of 2011

Chapter 412 of 2011 altered the distributions and uses of PDA and RFRA, which receive revenues from the State's VLT Program, for the purpose of providing operating assistance to the State's thoroughbred and standardbred racetracks, subject to specified requirements.

Chapter 412 specified that up to $1.2 million from PDA may be provided to each of Ocean Downs Race Course and Rosecroft Raceway for operating assistance to support a minimum of 40 live racing days at each facility for calendar 2012 only unless the racing licensee is prevented by weather, acts of God, or other circumstances beyond the racing licensee's control. Chapter 412 also specified that up to $6.0 million in funds from the RFRA may be used by Laurel Park and Pimlico Race Course for operating assistance to support a minimum of 146 annual live racing days in calendar 2012 and 2013, unless the racing licensee is prevented by weather, acts of God, or other circumstances beyond the racing licensee's control.

In addition, Chapter 412 specified that, of the amount provided from the RFRA, the following amount must be provided to the Racecourse at Timonium for racetrack facility capital construction and improvements:

- $1.125 million for fiscal 2012 and 2014;
- $1.25 million for fiscal 2013; and
- $1.0 million for fiscal 2015 and 2016.

Timonium may use up to $350,000 annually from these funds to support a minimum of seven live racing days, subject to the same process and conditions applicable to other racing licensees applying for reimbursement of expenditures.

However, as a condition of operating assistance, Chapter 412 also specified that an agreement must be reached on or by July 1, 2011, between the various tracks and other stakeholders through at least December 31, 2013, as applicable, regarding the sharing of revenues derived from wagering on simulcast races as such issues relate to (1) the Interstate Horseracing Act of 1978, 15 U.S.C. §§ 3001 through 3007; (2) pari-mutuel betting on out-of-state races; and (3) intertrack betting.

If an agreement was not reached by July 1, 2011, a potential party to an agreement would be eligible for funding if the party indicated to the Secretary of Labor, Licensing, and Regulation, in writing, its consent to participate in a mediation and arbitration process. The Secretary of Labor, Licensing, and Regulation was required to conduct a mediation between the parties to reach a fair and equitable simulcasting agreement. If by October 1, 2011, the parties had not reached an agreement through the mediation process, the parties must consent to *de novo* binding arbitration before (1) the American Arbitration Association; or (2) an independent arbitrator, selected by the Secretary with the consent of the parties, conducted in a manner consistent with the American Arbitration Association's commercial dispute resolution rules and procedures.

As of February 2012, arbitration is still ongoing.

Background:

Public School Construction Program

The State pays at least 50% of eligible costs of school construction and renovation projects, based on a funding formula that takes into account numerous factors including each local school system's wealth and ability to pay. The Public School Facilities Act (Chapters 306 and 307 of 2004) requires that the cost-share formulas be recalculated every three years. The first recalculation occurred in 2007, and the second recalculation occurred in 2010; for fiscal 2013 through 2015, the State share of school construction costs in Baltimore City is 93%, the second-highest level of State support in the State.

The awarding of State funds for school construction is a project-based process managed by IAC and its staff, subject to the final approval of the Board of Public Works (BPW). Each year, local school systems develop and submit to IAC a facilities master plan that includes an analysis of future school facility needs based on the current condition of school buildings and projected enrollment. The master plan must be approved by the local school board. Subsequently, each local school system submits a capital improvement plan to IAC that includes projects for which it seeks planning approval, projects for which it seeks funding approval, and projects that the local school system has forward funded. In addition to approval from the local school board, the capital improvement plan must be approved by the county's governing body. Typically, the submission letter to IAC contains signatures of both the school board president and either the county council president or chair of the board of county commissioners.

Based on its assessment of the relative merit of all the project proposals it receives, and subject to the projected level of school construction funds available, IAC determines which projects to recommend to BPW for State funding. By December 31 of each year, IAC recommends to BPW projects comprising 75% of the preliminary school construction allocation projected to be available. Local school districts may then appeal the IAC recommendations directly to BPW. By March 1 of each year, IAC recommends to BPW and the General Assembly projects comprising 90% of the allocation for school construction submitted in the Governor's capital budget. Following the legislative session, IAC recommends projects comprising the remaining school construction funds included in the enacted capital budget for BPW approval.

State Funding of School Construction

State school construction funding is almost exclusively financed by tax-exempt general obligation bonds. PAYGO cash has been provided for the Public School Construction Program (PSCP) in the past but is very limited in the State's five-year *Capital Improvement Program* (CIP).

The Public School Facilities Act established the State's intent to provide $2.0 billion of funding for school construction by fiscal 2013, an average of $250.0 million each year for eight years. As a result, PSCP funding increased from $125.9 million in fiscal 2005 to $253.8 million in fiscal 2006, and has remained above the $250.0 million target each year since, which resulted in significant increases in school construction assistance to the counties and Baltimore City. While the State achieved the $2.0 billion goal ahead of schedule, it is not clear whether that level of funding can or will be sustained in the future.

PSCP funding levels are established annually through the State's capital budget process. **Exhibit 1** shows the State funding levels for PSCP since fiscal 1994. It also shows the total amount proposed by the Governor for fiscal 2013 through 2017 in the five-year CIP. State funding is proposed at the $250 million level in fiscal 2014 to 2017.

Exhibit 1
Public School Construction Program Funding
Fiscal 1994-2017
($ in Millions)

Year	Amount	Year	Amount
1994	$87.0	2006	$253.8
1995	108.0	2007	322.7
1996	118.0	2008	401.8
1997	140.2	2009	347.0
1998	150.0	2010	266.7
1999	225.0	2011	263.7
2000	258.0	2012	311.6
2001	291.0	2013	351.4
2002	286.6	2014	250.0
2003	156.5	2015	250.0
2004	116.5	2016	250.0
2005	125.9	2017	250.0

Note: Fiscal 2012 includes $47.5 million supplementary appropriation.

Source: Department of Legislative Services

Capital Debt Affordability

The Capital Debt Affordability Committee is required to submit to the Governor and the General Assembly each year an estimate of the maximum amount of new general obligation debt that prudently may be authorized for the next fiscal year. The committee is also charged with making a recommendation regarding additional funding for school construction and is required to submit an estimate of the amount of new academic facilities bonds that prudently may be authorized. To evaluate debt affordability, the committee has adopted these two criteria:

- State debt outstanding should be limited to 4% of Maryland personal income.
- State debt service should be limited to 8% of revenues supporting the debt service.

In December 2011, CDAC met and increased the 2012 session GO bond debt limit from $925 million to $1,075 million. To remain within affordability limits, the committee recommended reducing 2017 session GO bond authorizations by $150 million. So instead of increasing $245 million (from $955 million to $1,200 million), the 2017 authorization is projected to increase $95 million. Moving authorizations from calendar 2012 to 2017 is affordable; debt outstanding and debt service costs are below affordability ratios.

VLT Program Implementation

The Location Commission has awarded video lottery operation licenses for VLT facility locations in Anne Arundel, Cecil, and Worcester counties. Penn Cecil in Cecil County opened in late September 2010 with 1,500 VLTs and Ocean Downs in Worcester County opened in January 2011 and currently is operating 800 VLTs. Power Plant Entertainment (PPE) Casino Resorts, LLC was awarded a license in December 2009 to operate a 4,750 VLT facility adjacent to Arundel Mills Mall in Anne Arundel County, contingent upon local zoning approval. County officials subsequently approved zoning legislation, but the legislation was petitioned to a local voter referendum at the November 2010 election. Anne Arundel County voters approved the legislation, allowing the VLT facility to go forward. Phase one of that facility is currently scheduled to open with approximately 3,000 VLTs in June 2012, with the full complement of 4,750 VLTs in operation by October 2012.

The Location Commission plans to make final decisions on the Allegany County and Baltimore City licenses sometime in spring 2012.

Through January 2012, Maryland VLT facilities have generated a total of $196.2 million in revenues. Of this amount, $95.1 million has been distributed to the Education Trust Fund. **Exhibit 2** shows the estimated distribution of VLT revenues through fiscal 2017, under current law. These estimates assume the Baltimore City and Allegany County facilities open in fiscal 2014.

Exhibit 2
Distribution of Estimated VLT Revenues in Maryland
($ in Millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Education Trust Fund (48.5%)	$78.1	$254.4	$386.2	$483.4	$513.3	$523.6
Licensees (33%)	53.1	173.1	265.0	333.5	353.9	361.0
Local Impact Grants (5.5%)	8.9	28.9	43.6	54.4	57.8	58.9
Business Investment (1.5%)	2.4	7.9	11.9	14.8	15.8	16.1
Purse Dedication Account (7%)[1]	11.3	36.7	55.4	69.0	73.3	74.8
Racetrack Renewal (2.5%)[2]	4.0	13.1	19.7	24.5	26.0	26.5
Lottery Operations (2%)	3.2	10.5	16.0	20.0	21.2	21.7
Total (100%)	**$161.0**	**$524.6**	**$797.8**	**$999.6**	**$1,061.3**	**$1,082.6**

[1]Up to $100 million annually.
[2]Up to $40 million annually for eight years, after which the monies accrue to the Education Trust Fund. Chapter 624 of 2010 and Chapter 240 of 2011 altered provisions regarding the authorized VLT facility in Allegany County. Contingent upon the purchase of the Rocky Gap Lodge and Golf Resort by the licensee, the operator will receive for the first 10 years of operations 50% of proceeds, distributions to other funds are decreased correspondingly. For more detail please see the fiscal and policy note for SB 512 of 2011.

Source: Department of Legislative Services

Horse Racing Industry in Maryland

The generally downward trends in attendance, racing days, purses, and wagering, since 1999, combined with an increase in total Gross State Product (GSP) from $153 billion in 1997 to $287 billion in 2009, suggest that it is unlikely that the horse racing industry's contribution to GSP has increased from 0.39% in 1997, the year covered by a University of Maryland report. Indeed it may have declined to less than 0.39% of the Maryland economy.

State Fiscal Effect: Based on estimated VLT revenues (shown in Exhibit 2), a total of $49.8 million will be redirected from the repealed PDA and RFRA to the SCA in fiscal 2013. The amount of redirected funds increases to $101.3 million by fiscal 2017 as shown in **Exhibit 3**.

Exhibit 3
Distribution to the SCA under HB 376
($ in Millions)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
School Construction Account (9.5%)[1]	$49.8	$75.1	$93.5	$99.3	$101.3

[1] Up to $140 million annually.

Source: Department of Legislative Services

As shown in Exhibit 1, planned PSCP funding in the CIP decreases from $351.4 million in fiscal 2013 to $250.0 million in fiscal 2014, and remains at the fiscal 2014 funding amount through fiscal 2017. Assuming CIP funding for this timeframe is consistent with the current plan, special fund expenditures for use on school construction (PAYGO) increase by $49.8 million in fiscal 2013 and by $101.3 million by fiscal 2017. Given the bill's July 1 effective date, after the fiscal 2013 school construction allocations have been approved, it is assumed that fiscal 2013 SCA revenues would be distributed as PAYGO for school construction.

However, if in a given fiscal year budgeted capital expenditures for school construction increase over the prior fiscal year, funds within the SCA will be expended on the increase in the debt service. *For illustrative purposes,* Legislative Services estimates that the debt service on issuance of an additional $100 million in general obligation school construction would amount to $5 million in the first two years, increasing to $10.6 million annually for 13 additional years, or $9.9 million on average over 15 years.

Special fund payments to be made to racetracks under Chapter 412 of 2011 will be discontinued under the bill as of July 1, 2012. The State Racing Commission advises that payments to the Racecourse at Timonium will have priority, and that Timonium will likely receive over $1.0 million through Chapter 412 prior to July 1, 2012.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Board of Public Works; Department of Budget and Management; Maryland State Department of Education; Department of General Services; Comptroller’s Office; Maryland State Lottery Agency; Department of Labor, Licensing, and Regulation; State Racing Commission; Public School Construction Program; Department of Legislative Services

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