HB 1246

Department of Legislative Services

Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 1246 (Delegate Mitchell, *et al.*)
Appropriations

Baltimore City Public School Construction Authority

This bill creates the Baltimore City Public School Construction Authority and gives it the same authority as county school boards to engage in activities related to public school construction. It also requires the State to provide a block grant to the authority each year to pay the cost of public school construction and capital improvement projects in Baltimore City. The grant must be for the greater of 15% of the entire State public school construction capital program or $32.0 million, adjusted annually for inflation.

The bill takes effect July 1, 2012, but enactment is contingent on the passage of a referendum of the qualified voters of Baltimore City at the November 2012 general election.

Fiscal Summary

State Effect: If approved by the voters of Baltimore City, general fund expenditures by the Public School Construction Program (PSCP) increase by $113,200 in FY 2013 to add staff to handle the review and oversight of a larger number of funded school construction projects. Out-year costs reflect full salaries and employee turnover. No effect on total State expenditures on school construction, which is established annually in the capital budget, but State funding for projects outside of Baltimore City likely decrease. Although not reflected below, State debt service expenditures likely increase by at least $300,000 annually, and likely by more in the future, due to the use of taxable debt instead of tax-exempt debt to make the payments to Baltimore City if sufficient pay-as-you-go (PAYGO) funding is not available. **This bill establishes a mandated appropriation beginning in FY 2014.**

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Revenues	$0	$0	$0	$0	$0
GF Expenditure	113,200	128,300	136,800	143,100	149,700
Net Effect	($113,200)	($128,300)	($136,800)	($143,100)	($149,700)

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

Local Effect: The Baltimore City Public School Construction Authority receives a guaranteed minimum annual allocation of $32.0 million for school construction projects, which exceeds the Baltimore City Public Schools' (BCPS) average annual allocation over the past 20 years. To the extent that it must pay its 7% share of the cost of school construction projects funded by the authority, local expenditures to provide the city's share of approved projects increase. Less State funding is available for school construction projects in other counties. It is assumed that the city or BCPS is responsible for the authority's operating expenses; since the bill specifies it is not an agency of the State, and can be handled within the resources that have been pledged to school construction.

Small Business Effect: Potential meaningful for small construction-related businesses.

Analysis

Bill Summary: The purpose of the authority is to improve the condition of the public school facilities within BCPS. The bill establishes membership and procedural requirements for the authority and states that the authority is not an agency of the State.

In addition to having the same powers as the Baltimore City Board of School Commissioners with respect to school construction, the authority may enter into contracts with public or private entities to acquire, construct, reconstruct, equip, maintain, repair, or renovate school facilities. It may act either directly or through another entity acting as the designated agent of the board or the authority.

The factor used to annually inflate the $32.0 million block grant must be the greater of the Consumer Price Index-Urban for the Baltimore Metropolitan area, the implicit price deflator for State and local government expenditures, or 5%. The block grant may not be funded by the proceeds of tax-exempt obligations unless proceeds from nontax-exempt obligations are not available. The block grant may be used to make payments under leases, installment purchases, or other alternative financing arrangements authorized in statute.

Current Law:

PSCP

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 the Interagency Committee on School Construction (IAC) and its staff and subject to the final approval of the Board of Public Works (BPW). Each year, local 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 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.

BCPS Debt

The Baltimore City Board of School Commissioners may issue bonds to finance or refinance all or any part of the costs of school construction projects. The mayor and city council must approve the board's issuance of new debt, but debt issued by the board is solely the board's obligation and does not constitute any indebtedness or obligation of the State, the mayor, or the city council. The aggregate principal amount of bonds outstanding for BCPS cannot exceed $100.0 million as of the date that bonds are issued; however, Chapter 243 of 2010 exempted the full value of Qualified School Construction Bonds (QSCBs) issued by the board from the $100.0 million cap. Chapter 583 of 2011 increased the maximum maturity of bonds issued by the board from 15 to 30 years.

Upon the issuance of bonds by BCPS, the State Comptroller must withhold from State aid to BCPS funds in the amount needed to pay the debt service on the bonds. The funds are withheld in installments and used to pay the debt service until the bonds are no longer outstanding.

Alternative School Financing

State law authorizes county school boards to use alternative financing methods to fund school construction, unless they are prohibited by local law. Projects that qualify for alternative financing methods must meet the educational standards, design standards, and procedural requirements adopted by BPW and also be approved by the county governing body, the State Superintendent of Schools, IAC, and BPW. Alternative financing methods can include:

- sale-leaseback arrangements;
- lease-leaseback arrangements;
- public-private partnership agreements;
- performance-based contracting; and
- design-build arrangements.

Background:

BCPS

BCPS enrolls 84,000 students in 189 regular school facilities, including 33 charter schools, and 6 special education schools. It has a total operating budget of $1.31 billion and outstanding debt totaling $151.8 million, including the QSCBs exempted from the debt ceiling. Debt service payments are $15.9 million in fiscal 2012 and are expected to increase by approximately $882,000 in fiscal 2013. Excluding the QSCBs from the outstanding debt leaves BCPS with approximately $9.0 million in debt capacity. A recent review of BCPS facilities by the American Civil Liberties Union estimated that the system has a maintenance and repair backlog of approximately $2.8 billion.

As noted above, BCPS has virtually no capacity to issue additional debt to finance school construction projects. Legislative Services understands that BCPS may form a 63-20 corporation through which it will issue debt that is not subject to the statutory limit and then use the State block grant in combination with other local sources of revenue to pay the debt service on the corporation's debt. For instance, the mayor has proposed increasing the city's beverage container tax and dedicating the proceeds for school construction (estimated to be $10.0 million). The mayor has also pledged to dedicate 10% of revenues from video lottery terminals in the city to school construction, which is expected to add $1.0 million. Through a combination of State and local resources, BCPS expects to raise approximately $73 million in dedicated revenue annually, which it believes can leverage the issuance of $1.1 billion in debt. BCPS is also seeking authority to raise its debt limit to $250.0 million to supplement the leveraged debt.

State Funding

State school construction funding is almost exclusively financed by tax-exempt general obligation bonds. Federal tax regulations authorize the use of tax-exempt bonds for ongoing costs of capital projects or to reimburse the cost of completed projects, but only within 18 months of the completion of the project. After 18 months, the State can only reimburse counties for eligible project costs with PAYGO cash. PAYGO has been provided for PSCP in the past but is very limited in the State's five-year *Capital Improvement Program* (CIP). It has been the policy of the State to use State debt to pay for long-term capital improvements, not for lease payments, installment purchases, or other forms of payment that retire other outstanding debt.

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 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, including Baltimore City. As a result, 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, and Baltimore City's share of those funds, for the past 20 years. It also shows the total amount proposed by the Governor for fiscal 2013 through 2017 in the five-year CIP.

As the exhibit shows, total funding for BCPS has equaled or exceeded the $32.0 million level in 6 of the last 20 years, when State funding exceeded $250 million. BCPS funding has equaled or exceeded 15.0% of the total in just 2 of the last 20 years. State funding is proposed at the $250 million level in fiscal 2014 to 2017.

Exhibit 1
Public School Construction Program Funding
Fiscal 1993-2017
($ in Millions)

Year	Total State	BCPS	BCPS % of Total
1993	$79.0	$4.8	6.1%
1994	87.0	7.4	8.5%
1995	108.0	7.5	6.9%
1996	118.0	7.3	6.2%
1997	140.2	8.7	6.2%
1998	150.0	10.0	6.7%
1999	225.0	12.5	5.6%
2000	258.0	25.1	9.7%
2001	291.0	44.1	15.2%
2002	286.6	44.1	15.4%
2003	156.5	13.8	8.8%
2004	116.5	11.2	9.6%
2005	125.9	11.5	9.1%
2006	253.8	21.5	8.5%
2007	322.7	39.4	12.2%
2008	401.8	52.7	13.1%
2009	347.0	41.0	11.8%
2010	266.7	27.7	10.4%
2011	263.7	28.6	10.8%
2012	311.6	32.0	10.3%
2013	351.4		
2014	250.0		
2015	250.0		
2016	250.0		
2017	250.0		

Source: Department of Legislative Services

Capital Financing through Nonprofit Corporations

Many public works projects are financed through various types of nonprofit corporations. Authorized by Internal Revenue Service Ruling 63-20, these 63-20 corporations can issue debt that does not inure to any private party. They are often formed to avoid statutory debt limitations and other restrictions. They have been used frequently to finance the development of public hospitals, court houses, and schools, and more recently for public-private transportation projects.

State Fiscal Effect: The bill presents several challenges from the perspective of State finances, including:

- the funding commitment from PSCP exceeds BCPS's traditional share of State funding, and it is made without regard to the relative merit or readiness of the projects to be funded or any guarantee that all the approvals for alternative financing arrangements will be secured;
- the commitment of State funds is open-ended and may prompt bond rating agencies to conclude that the debt issued by the authority and repaid with State funds is State tax-supported debt, which could negatively affect the State's credit rating;
- the use of either taxable or tax-exempt bonds each presents dilemmas; and
- the additional workload strains IAC resources.

Mandated appropriations bills must be enacted one full fiscal year prior to taking effect. Therefore, the bill affects school construction allocations beginning in fiscal 2014. With PSCP funding levels projected to remain constant at $250.0 million for the next four years, the State's commitment to the authority will be $37.5 million (15%) annually, which exceeds State funding for BCPS school construction projects for all but 4 of the past 20 years. This likely means that qualified projects in other jurisdictions will be delayed due to lack of funding.

To the extent that PSCP funding levels drop below $213 million in the future (which yields $32 million), the grant amount is subject to the inflation-adjusted minimum amount of $32 million. However, the annual 5% inflator exceeds the current rate of growth of State revenues. The 5% inflator is assumed to be used because recent past and projected levels of inflation do not approach the 5% level, and the bill requires that the largest inflator be used.

The bill establishes a preference for sources of funding other than tax-exempt debt for the block grant, which generally consist of PAYGO funding or taxable debt. Given the State's ongoing fiscal condition, it has no capacity to provide PAYGO funding in the near term, and therefore must likely rely on taxable debt as a source of funding for the block grant. The State has not typically issued taxable debt, with the last issuance occurring in 2006. Taxable debt carries a higher interest rate for the State, higher transaction costs, and therefore smaller yields. Current estimates are that interest rates on taxable bonds are about 90 basis points higher than for tax-exempt bonds. For a single 10-year issuance of $32.0 million in taxable bonds, this translates into between $200,000 and $300,000 in additional interest payments each year, or $1.7 million in additional interest payments over the life of the bond. The spread between taxable and tax-exempt interest rates, however, is likely to grow as interest rates rise. To the extent the State chooses to use tax-exempt debt, its use is limited for the purposes outlined in the bill, namely payment of debt service or other forms of debt repayment (leases, installment purchases, etc.). As noted earlier, full reimbursement payments must be made within 18 months of project completion, which is not consistent with long-term debt repayments. To the extent that the State must use taxable debt for the block grant rather than the tax-exempt debt that it normally uses for PSCP in order to avoid the issues associated with debt reimbursement, it likely incurs additional liabilities.

Finally, the influx of capital for school construction projects in Baltimore City that results from the bill is expected to increase the number of large funded projects from about 2 to between 15 and 20 each year. The bill retains IAC oversight and monitoring of project procurement and quality, so the increase in project oversight responsibilities for IAC increase substantially beginning in July 2012 (fiscal 2013) when counties, including the city, begin work on fiscal 2014 school construction improvement programs. Also, regulations governing the conditions of the block grant must be developed and approved in time for the authority to receive its first allocation in fiscal 2014.

Therefore, general fund expenditures by PSCP increase by $113,203 in fiscal 2013, which accounts for a 90-day start-up delay from the bill’s June 1, 2012 effective date. This estimate reflects the cost of hiring one assistant program manager and one administrative specialist to handle the program review and monitoring functions associated with an increased number of funded projects. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses

Positions	2
Salaries and Fringe Benefits	$100,347
Operating Expenses	12,856
Total FY 2013 State Expenditures	**$113,203**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

State costs of printing absentee and provisional ballots may increase to the extent inclusion of the proposed Baltimore City ballot referendum on the ballot at the next general election would result in a need for a larger ballot card size or an additional ballot card for a given ballot (the content of ballots varies across the State, depending on the offices, candidates, and questions being voted on). Any increase in costs, however, is expected to be relatively minimal, and it is assumed that the potential for such increased costs will have been anticipated in the State Board of Elections' budget. Pursuant to Chapter 564 of 2001, the State Board of Elections shares the costs of printing paper ballots with the local boards of elections.

Local Fiscal Effect: The authority receives a minimum of $32.0 million each year for school construction projects, which exceeds its average allocation over the past 20 years by a sizable margin. It is not clear in the bill whether the State's PSCP cost-sharing formula applies to projects funded through a block grant. If so, Baltimore City or the authority has to pay 7% of the cost of projects funded through the State grant. If the cost-sharing formula applies to projects funded by the State grant, the city's share of those costs is approximately $2.4 million annually, which is generally more than the city has needed to provide to match State funds.

The large guaranteed allocation of PSCP funds to the authority likely means that fewer State funds are available for school construction projects in other counties, resulting in delays in project completion or necessitating counties to forward fund projects with local funds and seek State reimbursement. To the extent these projects are not reimbursed within 18 months, local reimbursements are delayed until State PAYGO is available.

The provision of the bill that excludes the transfer of a school building lease as part of alternative financing from the State reimbursement requirement relieves Baltimore City and other counties from reimbursing the State for the State's share of a project's cost if it is transferred to another party within 15 years.

The Baltimore City Board of Elections' printing and mailing costs may increase to include information on the proposed ballot referendum with specimen ballots mailed to voters prior to the next general election and to include the proposed referendum absentee and provisional ballots. It is assumed, however, that the potential for such increased costs will have been anticipated in the board's budget.

Small Business Effect: To the extent that the authority uses the funds provided by the bill to launch an ambitious capital improvement campaign, small businesses in the commercial construction industry likely benefit from increased contracting opportunities.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): American Association of State Highway and Transportation Officials, Baltimore City, Board of Public Works, Department of Budget and Management, Maryland State Department of Education, Maryland State Board of Elections, Department of General Services, Public School Construction Program, State Treasurer's Office, Department of Legislative Services

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