

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 867 (Delegate Hubbard)

Appropriations and Ways and Means

Education - Public School Construction Funding and Children's Indoor Environmental Health

This bill (1) includes nonprofit partnership agreements in the definition of alternative financing methods for school construction; (2) requires county school boards to adopt written policies that require the use of green product cleaning supplies; (3) requires the Board of Public Works (BPW) to adopt regulations that establish an integrated design process that protects the health and safety of the occupants of a school building during a public school construction or capital improvement project; and (4) expands the statutory definition of “high-performance building” to include requirements related to indoor environmental quality credits.

Fiscal Summary

State Effect: General fund expenditures by the Public School Construction Program (PSCP) increase by \$160,400 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. Fewer school construction and other capital projects may be funded each year due to higher costs to meet high-performance building requirements. State debt service expenditures increase by more than \$1 million annually beginning in FY 2014 to the extent the State uses taxable debt instead of tax-exempt debt to fund block grant payments to school boards. BPW and the Maryland State Department of Education (MSDE) can carry out the bill’s requirements with existing budgeted resources. No effect on revenues.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	160,400	199,600	212,800	222,600	232,900
SF Expenditure	0	1,000,000	1,000,000	1,000,000	1,000,000
Net Effect	(\$160,400)	(\$1,199,600)	(\$1,212,800)	(\$1,222,600)	(\$1,232,900)

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

Local Effect: County school boards may have to pay more for cleaning supplies to satisfy the requirement to purchase green cleaning supplies, but the overall cost differential is not expected to be significant. The local share of school construction projects may increase to provide the local share for block grant-funded projects and carry out the bill's requirement to earn all high-performance building credits for interior environmental quality (IEQ), but any effect can be mitigated if efforts to earn points in other design categories are redirected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary:

Nonprofit Partnership Arrangements and Block Grants

Alternative financing methods include nonprofit partnership arrangements that allow a county board to establish an independent nonprofit entity or to enter into contracts with nonprofit entities to acquire, construct, reconstruct, equip, maintain, repair, or renovate public school facilities. These arrangements also allow the county board to receive its share of State school construction funds as a block grant to make payments for bonds issued or for leases, installment purchase agreements, or other similar agreements to finance public school facilities.

Green Cleaning Supplies

The statutory definition of green cleaning supplies is amended to specify that it applies to products that are intended for routine maintenance and must have positive health attributes, including lesser or reduced effects on human health and the environment when compared with competing products that serve the same purpose. The bill lists numerous examples of cleaning supplies that are included in the definition, and explicitly excludes room deodorizers, air fresheners, and toilet deodorizers. County school boards are given more flexibility to select green cleaning products that are certified by any nationally recognized independent third party.

The written policy that county school boards are required to develop must, by July 1, 2014, establish guidelines for purchasing green cleaning supplies that meet the bill's requirements. The policy must also establish green cleaning practices governing the storage, application, frequency of use, and disposal of the supplies, as well as require staff training on the implementation of the policy. By June 30 of each year, a county school board that does not procure green cleaning supplies because doing so is not practicable or economically feasible must notify MSDE in writing.

Indoor Air Quality

BPW must adopt regulations by July 1, 2013. The integrated design process established by BPW in regulation must achieve environmental and building performance goals established by a county school board while ensuring that all of the components and materials used for the project do not detract from the health and safety of the building's occupants. It must include standards related to at least 10 items specified in the bill, including indoor air quality, noise management plans, erosion and sediment control, and integrated pest management (IPM).

High-performance Buildings

A high-performance building must meet or exceed *all* of the current Leadership in Energy and Environmental Design (LEED) silver certification or equivalent certification, including selecting all available IEQ credits and any LEED credits unique to schools.

Current Law:

Alternative School Financing Methods

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 funding process is project-based, with funding provided only to projects that have been reviewed by the Interagency Committee on School Construction (IAC) and approved for funding by BPW. The IAC review is based on an assessment of the relative merit of all project proposals it receives, the priority given to particular projects by county school boards, and the State funding available for school construction through PSCP.

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 currently authorized in statute include:

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

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.

Green Cleaning Supplies

Chapter 454 of 2009 requires local boards of education to procure, to the extent practicable and economically feasible, green product cleaning supplies for use in schools. Green product cleaning supplies are defined as those that have positive environmental attributes, including biodegradability, low toxicity, low volatile organic compound content, reduced packaging, and low life-cycle energy use. Local school systems must draft specifications that provide a clear and accurate description of the functional characteristics or nature of the cleaning products to be purchased. Multiple avenues of green product cleaning supplies certification must be permitted, including the U.S. Environmental Protection Agency's (EPA) Design for the Environment Program, Green Seal, Green Label, Environmental Choice, or the U.S. Green Building Council.

High-performance Buildings

Chapter 124 of 2008 required most new or renovated State buildings and new school buildings to be constructed as high-performance buildings, subject to waiver processes established by the Department of Budget and Management (DBM), Department of General Services (DGS), and BPW. Between fiscal 2010 and 2014, the State funds 50% of the local share of increased school construction costs associated with high-performance buildings. Chapters 527 and 528 of 2010 added new community college capital projects that receive State funds to the requirement.

Chapter 124 defines a high-performance building as one that:

- meets or exceeds the U.S. Green Building Council's (USGBC) LEED criteria for a silver rating; or
- achieves a comparable numeric rating according to a nationally recognized, accepted, and appropriate rating system, guideline, or standard approved by DBM and DGS.

Only new or renovated buildings that are at least 7,500 square feet and are built or renovated entirely with State funds, or in the case of public schools are new schools, and in the case of community colleges are projects that receive any State funds, are subject to the high-performance requirement. Additionally, building renovations must include the replacement of heating, ventilation, air conditioning, electrical, and plumbing systems and must retain the building shell. Unoccupied buildings are exempt from the

high-performance mandate, including warehouses, garages, maintenance facilities, transmitter buildings, and pumping stations.

For State buildings and community colleges, the waiver process must include a review by the Maryland Green Building Council and approval by DGS, DBM, and the Maryland Department of Transportation. The waiver process established by BPW for public school buildings must include review and approval by IAC.

Indoor Air Quality

State statutes and regulations address factors affecting indoor air quality in schools only minimally. County boards of education are currently required to have IPM systems approved by the Maryland Department of Agriculture (MDA) for schools and school grounds. IPM is a managed pest control program used to keep pests from causing economic, health related, or aesthetic injury. It uses site or pest inspections, pest population monitoring, and use of one or more pest control methods including sanitation, structural repair, nonchemical methods, and, when nontoxic options are unreasonable or have been exhausted, pesticides. EPA and/or the Maryland Department of the Environment regulate the use of chlorofluorocarbon-based refrigerants, asbestos-based materials, and lead-based paint.

Background:

PSCP

PSCP is funded almost exclusively 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 must use pay-as-you-go (PAYGO) funds to reimburse a county for eligible costs. 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.

LEED's rating scale has a maximum score of 110 possible points; silver certification requires 50 to 59 points. IEQ is one of seven design categories used in the LEED assessment, and it currently offers 14 different credits and a maximum of 19 points. Under State law, high-performance buildings are not required to earn all the credits or points under the IEQ category, but only to achieve enough points across all seven design categories to earn the silver certification.

State Fiscal Effect: Tax-exempt debt, which is normally used to fund PSCP, is limited in its use 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. By comparison, taxable debt is more flexible but carries a higher interest rate for the State, has higher transaction costs, and therefore results in smaller yields. Current estimates are that interest rates on taxable bonds are about 90 basis points higher than for tax-exempt bonds, and the spread between taxable and tax-exempt interest rates is likely to grow as interest rates rise. To the extent that the State must use taxable debt for block grant payments to county school boards rather than the tax-exempt debt that it normally uses for PSCP in order to avoid the issues associated with debt reimbursement, the State incurs additional liabilities. The size of those liabilities varies based on the number and size of block grant payments the State makes to county school boards. If the entire PSCP program, as currently funded, were funded with taxable debt assuming sufficient PAYGO would not be available, annual interest payments on the debt would increase by more than \$1.0 million at current interest rates. State debt service is paid out of property tax revenues dedicated to the Annuity Bond Fund (ABF). To the extent sufficient ABF revenues are not available, general fund expenditures increase to cover debt service.

The bill likely results in a substantial influx of capital for county boards of education to carry out school construction projects. The bill allows the boards to leverage the State funds to secure financing through 63-20 corporations or other similar entities. IAC and BPW review and oversight is maintained in the bill, so a large increase in the number of funded projects is anticipated, possibly even doubling in size. This will undoubtedly strain the resources of PSCP which has recently experienced loss of staff due to cost containment. PSCP will also be very involved in the development of regulations to implement the expansion of alternative financing arrangements.

Therefore, general fund expenditures by PSCP increase by \$160,383 in fiscal 2013, which accounts for the bill's October 1, 2012 effective date. This estimate reflects the cost of hiring two assistant program managers 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	3
Salaries and Fringe Benefits	\$141,360
Operating Expenses	<u>19,023</u>
Total Fiscal 2013 State Expenditures	\$160,383

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

The green cleaning requirements and indoor air quality provisions of the bill have limited effect on State operations or finances. MSDE is required to receive notices from counties that do not purchase green cleaning supplies; it can carry out that task with existing budgeted resources. BPW is charged with developing regulations for an integrated

design process for school construction projects; with the assistance of IAC, which is receiving additional staff support through PSCP, BPW can carry out that task with existing resources.

Finally, the provisions related to high-performance buildings may have a limited fiscal effect on the State. As noted above, PSCP pays 50% of the additional local costs attributable to achieving the LEED silver certification through fiscal 2014. To the extent that local costs for school construction projects that need to earn all 14 IEQ credits increase, the State will be responsible for 50% of that cost. Given the bill's effective date, the fiscal effect for the State is applicable only to school construction projects funded in fiscal 2014, which have not yet been determined. Therefore, an estimate of the LEED provisions' effect on PSCP expenditures cannot be calculated.

Local Fiscal Effect: County school boards must develop plans to purchase green cleaning supplies by fiscal 2014, and they are required to purchase green cleaning supplies or notify MSDE that they are not doing so. Legislative Services is not aware of any comprehensive analyses of cost differences between regular and green cleaning, but anecdotal evidence collected for an analysis of Chapter 454 of 2009 found that the purchase of green cleaning supplies can increase total school board expenditures by between \$6,000 and \$200,000 annually, depending on the size of the school district. However, Legislative Services believes that the cost differential between regular and green supplies is less pronounced now that green supplies are more prevalent than they were three years ago.

As noted above, the high-performance building requirements may raise the cost of new school construction projects and large renovation projects. The effect may be minimal if the projects can redirect their efforts to achieve a LEED silver certification from other design categories because they are getting more credits for IEQ. Through fiscal 2014, the State pays half of any increase in construction costs caused by a project's efforts to achieve the LEED silver rating.

It is not clear in the bill whether the State's PSCP cost-sharing formula applies to block grant-funded projects. If so, local expenditures may increase to pay the local share of total project costs funded through the block grant if the total project costs under the block grant are higher than under the current law.

Small Business Effect: To the extent that the alternative school construction financing arrangements authorized by the bill lead to significant growth in the resources available for school construction, small commercial construction firms may benefit from increased contracting opportunities.

Additional Comment: Authorizing county boards of education to opt for block grants instead of project-specific funding, as school construction funding is currently allocated, presents other administrative and financial issues. While total State expenditures for

public school construction projects would not be impacted, other than the increased cost of debt service for taxable debt, how much each county would receive as a block grant would need to be determined by IAC as well as disbursement and financial compliance procedures. Legislative Services advises that, in order for a nonprofit entity to leverage State block grant funds for additional debt, the bond market will likely need to see a predictable stream of revenue that would support debt service. It is not clear in the bill how block grant funds would be allocated to jurisdictions each year. Some counties may receive more than they would otherwise under current law, and other counties may receive less.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Kent County, Department of Budget and Management, Maryland State Department of Education, Department of General Services, Public School Construction Program, Department of Legislative Services

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ncs/rhh

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