Analysis of the Maryland Executive Budget

For the Fiscal Year Ending June 30, 2017

Volume V: R30B30 – Legislative Audit Presentations

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Volume V

Analysis of the Maryland Executive Budget – Fiscal 2017

R30B30
University of Maryland University College
University System of Maryland

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Funds	$36,962	$36,798	$39,317	$2,519	6.8%
Deficiencies and Reductions	0	794	-59	-853	
Adjusted General Fund	**$36,962**	**$37,592**	**$39,258**	**$1,666**	**4.4%**
Special Funds	1,732	1,799	1,954	155	8.6%
Adjusted Special Fund	**$1,732**	**$1,799**	**$1,954**	**$155**	**8.6%**
Other Unrestricted Funds	311,743	317,355	323,692	6,337	2.0%
Adjusted Other Unrestricted Fund	**$311,743**	**$317,355**	**$323,692**	**$6,337**	**2.0%**
Total Unrestricted Funds	350,436	355,952	364,963	9,011	2.5%
Deficiencies and Reductions	0	794	-59	-853	
Adjusted Total Unrestricted Funds	**$350,436**	**$356,746**	**$364,904**	**$8,158**	**2.3%**
Restricted Funds	40,763	35,275	42,275	7,000	19.8%
Adjusted Restricted Fund	**$40,763**	**$35,275**	**$42,275**	**$7,000**	**19.8%**
Adjusted Grand Total	**$391,199**	**$392,021**	**$407,178**	**$15,158**	**3.9%**

- A fiscal 2016 deficiency appropriation is provided to the University System of Maryland Office to cover an increase in health insurance, which will be allocated among the institutions, of which the University of Maryland University College's (UMUC) share is estimated to be $0.8 million.

- The General Fund increases $1.7 million, or 4.4%, in fiscal 2017 after adjusting for the fiscal 2016 deficiency and the $59,169 across-the-board reduction in health insurance in fiscal 2017.

- The Higher Education Investment Fund increases $0.2 million, or 8.6%, in fiscal 2017 resulting in an overall growth of 4.6%, or $1.8 million, in State funds above fiscal 2016. The fiscal 2017 allowance also includes funding for increments budgeted in the Department of Budget and Management totaling $0.7 million in general funds. If these are taken into account, State funds increase 6.4%, or $2.5 million.

Note: Numbers may not sum to total due to rounding.

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Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	1,037.71	1,037.71	1,037.71	0.00
Contractual FTEs	1,911.01	1,915.33	1,915.33	0.00
Total Personnel	**2,948.72**	**2,953.04**	**2,953.04**	**0.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	18.89	1.82%
Positions and Percentage Vacant as of 12/31/15	60.00	5.80%

- The allowance does not provide for any new regular or contractual positions.

- The vacancy rate at UMUC, 5.8%, is slightly above the University System of Maryland's average of 5.3%.

Analysis in Brief

Major Trends

Fall Enrollment Grows Again: UMUC's fall 2014 headcount enrollment grew nearly 20%, but this was due to a change in how such enrollment is counted. Fall 2015 is also up, but only by 5%. Overall, UMUC has seen an increase in undergraduate enrollment after a big decline in fall 2013.

Retention and Graduation Rates Improve: UMUC's retention rates for transfer students with at least 61 credits have risen 3.7 percentage points, and the three-year graduation rate has grown 11.0 percentage points, over the last five cohorts.

Expenditures Per Degree: By one measure, UMUC's degrees are nearly 25% less expensive to produce than those of its peers, representing a strong relative cost effectiveness for the State. However, most UMUC peers are not distance education institutions, as there are few truly comparable peers.

Issues

Affordability and Enrollment: About 30% of UMUC students receive Pell grants. Although aid to the neediest students appears to be increasing, recent increases in UMUC's financial aid budget are for merit scholarships, rather than need-based awards. Overall, many students still rely on loans to pay for a UMUC education.

Online Associates Degrees: UMUC operates in the online higher education marketplace, which is very competitive. Although it is accredited to offer two-year degrees online, it does not currently offer this option to Maryland residents even though this could be a tremendous benefit for reverse transfer awards and near completers.

UMUC Spins Off HelioCampus: Following enrollment declines and significant competition from the private sector, UMUC convened a workgroup to suggest new business models. Ultimately, the group favored giving UMUC greater autonomy and also saw UMUC spin off its Office of Analytics.

Recommended Actions

1. Concur with Governor's allowance.

Operating Budget Analysis

Program Description

The University of Maryland University College (UMUC) specializes in providing access to higher education for Maryland's adult learners. Most UMUC students have career or family commitments that lead them to study part time. UMUC services its students through traditional and innovative delivery of undergraduate and graduate degree programs, noncredit professional development programs, and conference services.

UMUC provides courses at 21 locations throughout the State and the Washington metropolitan area and has offered online education programs since 1994. The institution also offers special programs in other states and programs overseas for U.S. service members and their families, U.S. citizens, and international students. UMUC's vision is to be the global university of Maryland.

Academic programs offered by UMUC include Bachelor of Arts and Bachelor of Science degrees with 33 majors and 38 minors. The most extensive offerings are in business and management and computer studies. Master's degrees are offered in management and technology areas that, like bachelor's degree concentrations, represent fields with significant current or anticipated workforce needs. UMUC also offers a Doctor of Management and a noncredit professional program emphasizing management and executive development. The university has a role in renewing and upgrading the skills of an experienced workforce.

Carnegie Classification: Master's L: Master's Colleges and Universities (larger programs)

Fall 2015 Undergraduate Enrollment Headcount		**Fall 2015 Graduate Enrollment Headcount**	
Male	20,069	Male	6,002
Female	17,286	Female	6,891
Total	**37,355**	**Total**	**12,893**
Fall 2015 New Students Headcount		**Campus (Main Campus)**	
First-time	825	Acres	13
Transfers/Others	7,232	Buildings	3
Graduate	2,513	Average Age	28
Total	**10,570**	Oldest	1963
Programs		**Degrees Awarded (2014-2015)**	
Bachelor's	32	Bachelor's	5,146
Master's	17	Master's	3,693
Doctoral	1	Doctoral	36
		Total Degrees	**8,875**

Proposed Fiscal 2017 In-state Tuition and Fees Per Credit Hour*

Undergraduate Tuition	$284
Mandatory Fees	$15

*Contingent on Board of Regents approval.

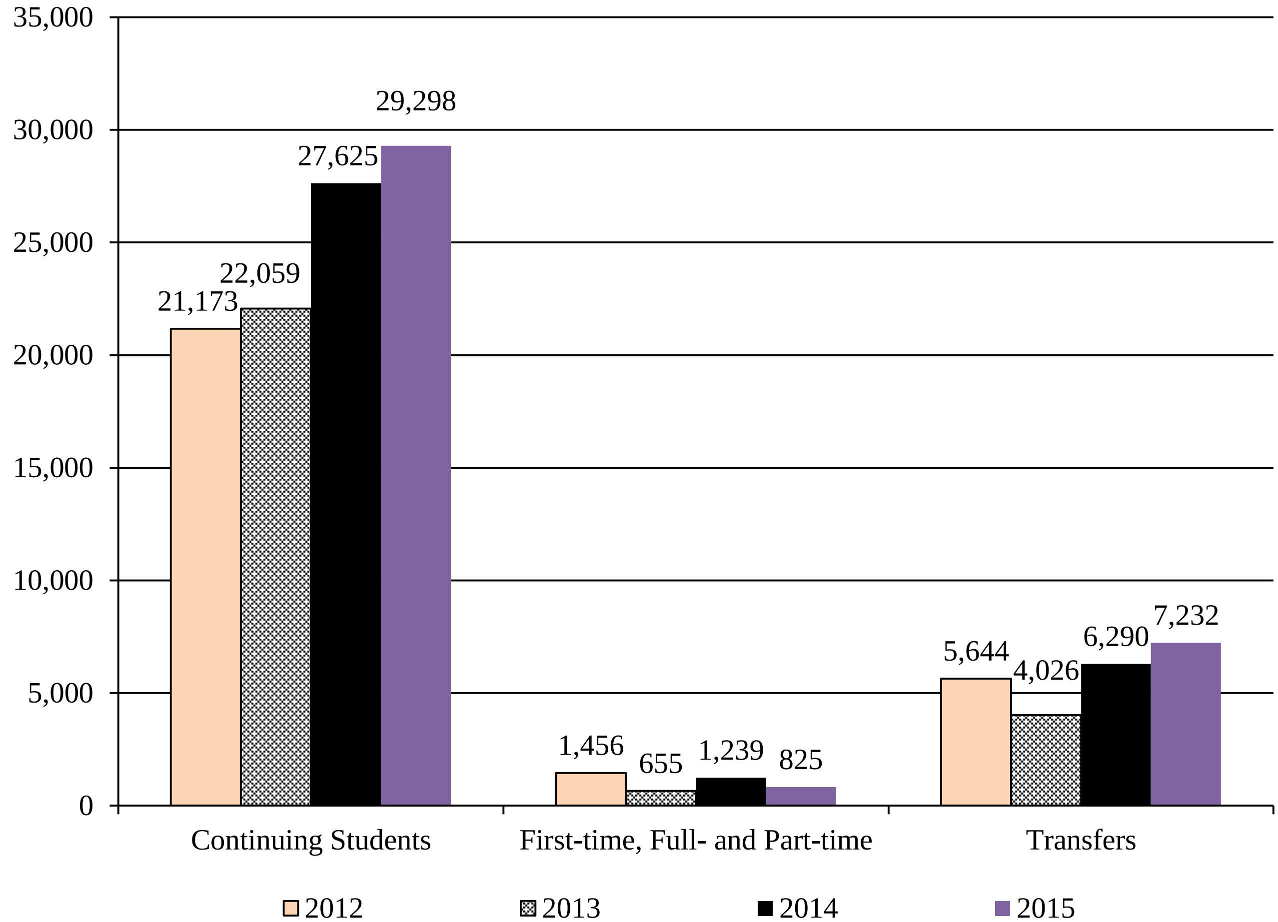
Performance Analysis: Managing for Results

1. Fall Enrollment Grows Again

Undergraduate enrollment grew 4.9%, or 2,300 students, in fall 2015. As shown in **Exhibit 1**, first-time students actually decreased by over 400, or 33.4%, but continuing students grew 6.1% and transfers grew 15.0%. This follows tremendous growth in fall 2014 when continuing students grew 25.0%, and first-time and transfer students grew nearly 90.0% and 60.0%, respectively. As a primarily online institution, UMUC sees more volatility in its enrollments than other Maryland institutions, but the enormous gains in fall 2014 were due to the way that UMUC reports its enrollments. For this reason, the change in fall 2015 is much more meaningful than the changes in fall 2014. Under the new reporting method, total enrollment has grown 18.9% since fall 2012, but the number of graduate students fell 7.9% and first-time, full- and part-time students by 43.3%. Returning students grew 38.4% during this time, suggesting that students are growing more persistent in their studies, an important metric for institutions to monitor.

UMUC reports that about 88.0% of all courses at the institution are taught online. In fiscal 2015, UMUC closed its distance education administrative operations for its Europe and Asia divisions. Now all online enrollments are managed stateside from its Adelphi, Maryland headquarters. According to federal regulations, stateside students are counted in the stateside total, which includes those students taking online courses administered by the Adelphi office. The stateside number did not previously include those students enrolled overseas or those students taking online courses administered by the European or Asian offices. In the future, the official UMUC enrollment number will include all overseas students, not just those in distance education.

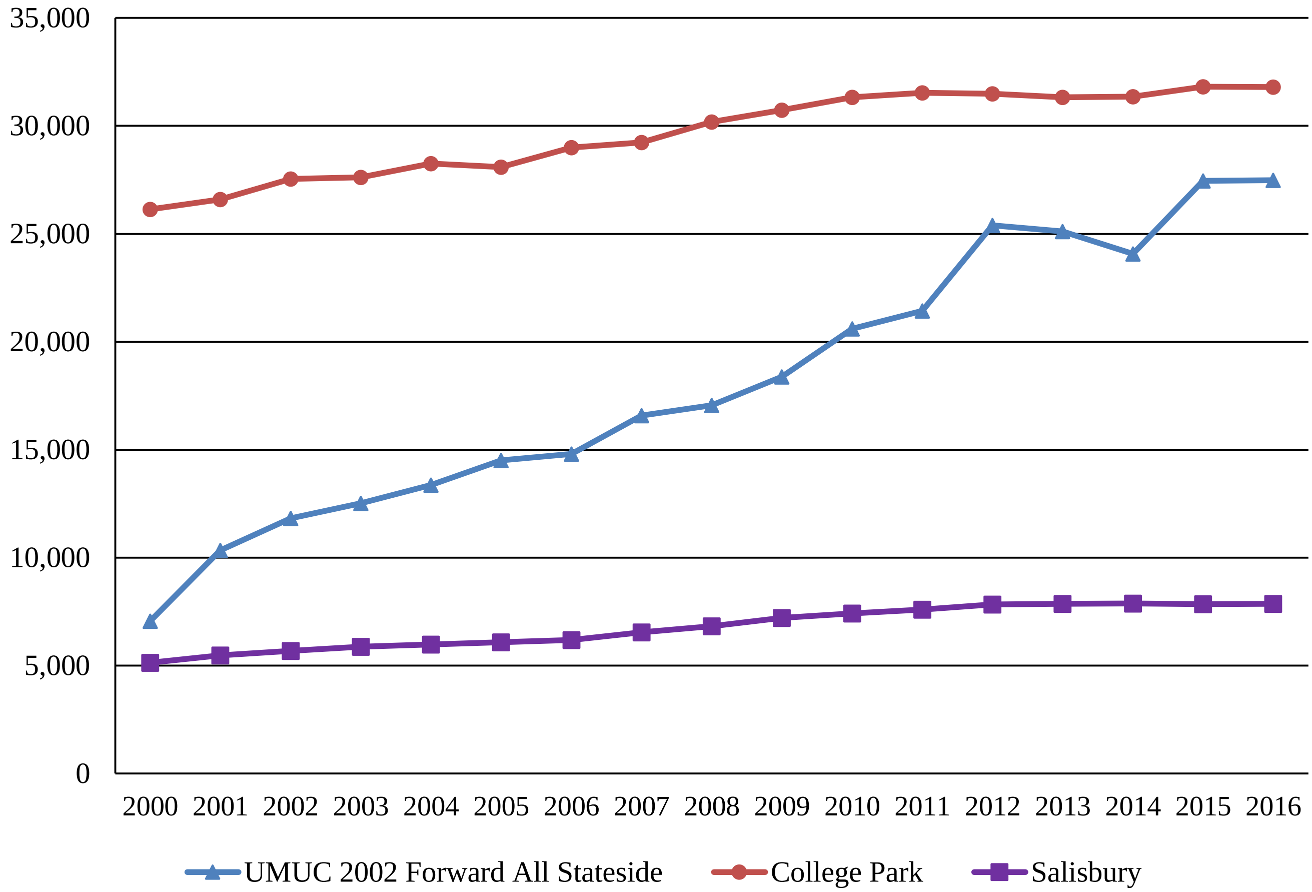
Exhibit 1
Percentage Change in Undergraduate Headcount Enrollment
Fall 2012-2015



Source: University of Maryland University College

Tracking UMUC's enrollment accurately is important. **Exhibit 2** shows UMUC's full-time equivalent student (FTES) enrollment from fiscal 2000 to the 2016 working appropriation. For comparison, the University of Maryland, College Park (UMCP) is shown along the top, the State's largest institution by FTES, which grew steadily over this time period. Along the bottom is Salisbury University (SU), which was the fastest growing university in this time period after UMUC. While UMCP grew 22.0%, SU grew 53.0%, but UMUC grew an astounding 288.0%. While UMUC was only 8.1% of public four-year enrollment in fiscal 2000, it grew to 20.7% in fiscal 2016, leading to UMUC's ability to swing the State's overall change up or down. Fiscal 2013 and 2014 saw the first declines in UMUC's FTES enrollment since fiscal 1999. Again, because of the change in how enrollment was counted in fiscal 2015, it is not necessarily accurate to say enrollment increased in that year.

Exhibit 2
Full-time Equivalent Student Enrollment
Fiscal 2000-2016



UMUC: University of Maryland University College

Note: Includes undergraduate and graduate enrollment.

Source: Department of Budget and Management

Now that fiscal 2015 actual enrollment numbers are available, the President should comment on whether enrollment actually increased in fiscal 2015 after backing out what used to be European- and Asian-based students.

2. Retention and Graduation Rates Improve

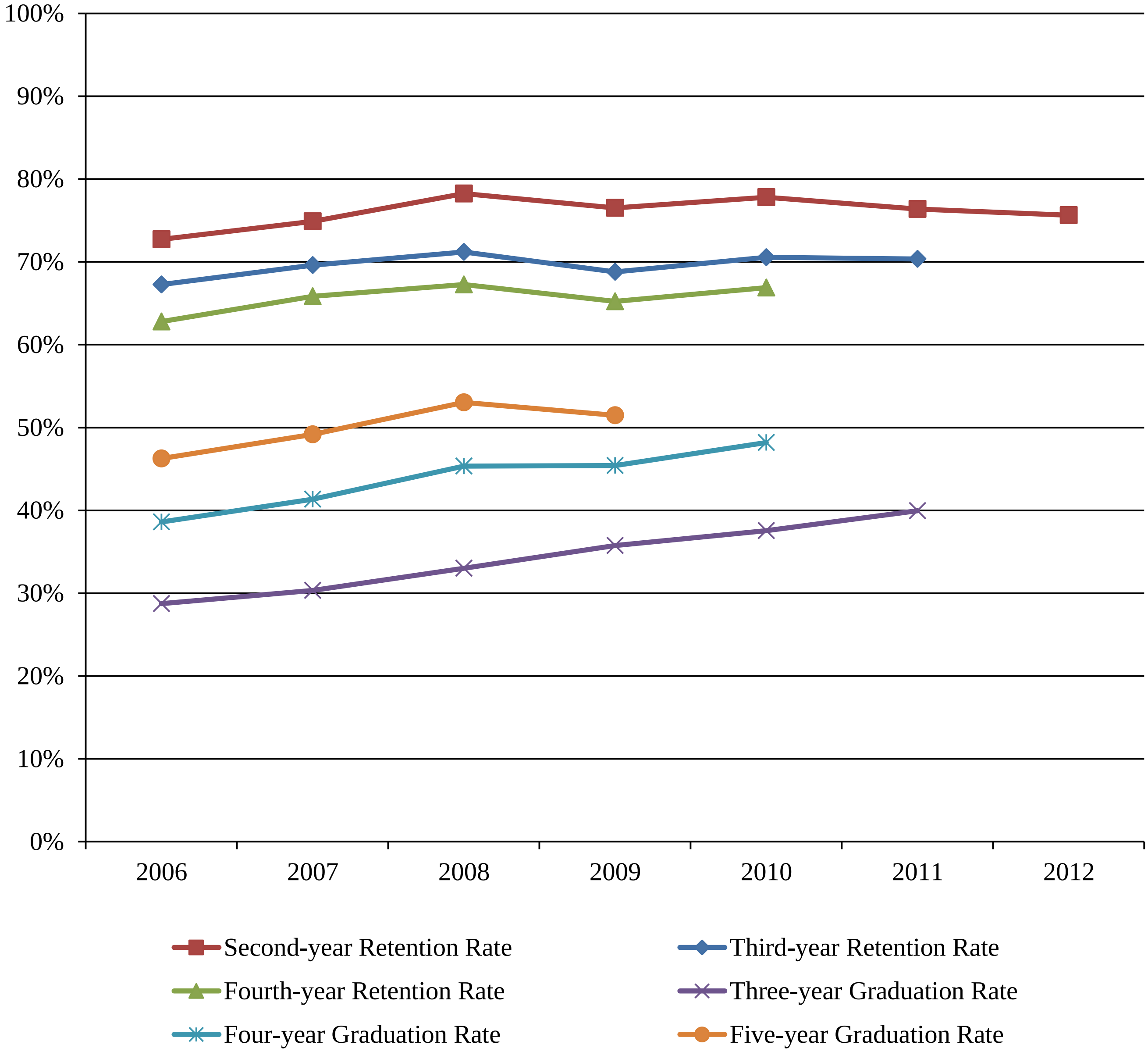
Maintaining and strengthening academic excellence and effectiveness to meet the educational needs of the State is a key strategic goal of the University System of Maryland (USM) and UMUC. The Maryland Higher Education Commission (MHEC) does not report UMUC's retention or graduation rates in its regular annual reporting due to UMUC's mission to serve the adult, part-time population. Because many distance education students take much longer to complete degrees and take time off before graduation, traditional metrics are not reflective of UMUC's success with its target student demographic, namely individuals 25 to 45 years old. In fact, the average age of a UMUC student is 33, 74% work full-time, and 48% have children.

Exhibit 3 shows the most recent data for retention rates and graduation rates for part- or full-time students transferring to UMUC with 61 or more credits by cohort year and reenrolling in the following spring semester. Given UMUC's nontraditional student body, UMUC prefers to use individualized metrics that more accurately account for how the institution best serves students. Since the 2006 cohort, UMUC's second-year retention rate has grown from 73% to 76%, and the third-year retention rate grew 3 percentage points from 67% to 70%. Over this time period, UMUC's three-year graduation rates have risen 11 percentage points from the 2006 cohort to the 2011 cohort, a large gain considering the second-year retention rate increased only 4 percentage points. While a student with at least 60 credits would be expected to complete an undergraduate degree of 120 credits in an additional two years of full-time study, many UMUC students are part-time, or alternate between full and part time. UMUC attributes rising graduation rates in this exhibit to an increased focus on student services and academic support. If retention rates began rising nearly as fast as graduation rates, UMUC would have significantly more graduates.

While UMUC's internal measures in Exhibit 3 do a good job detailing the work of the institution, new external measures have been developed to supplement traditional university graduation metrics. For example, while the traditional six-year graduation rate provides an accurate picture of the total graduation rate of an institution, it does not tell what happened to those who did not graduate nor how transfers perform. To help address this lack of information, the Student Achievement Measures (SAM) was created, which is a voluntary reporting system that tracks the progress of first-time, full-time (FT/FT) and transfer students throughout their college career. All USM institutions participate in SAM.

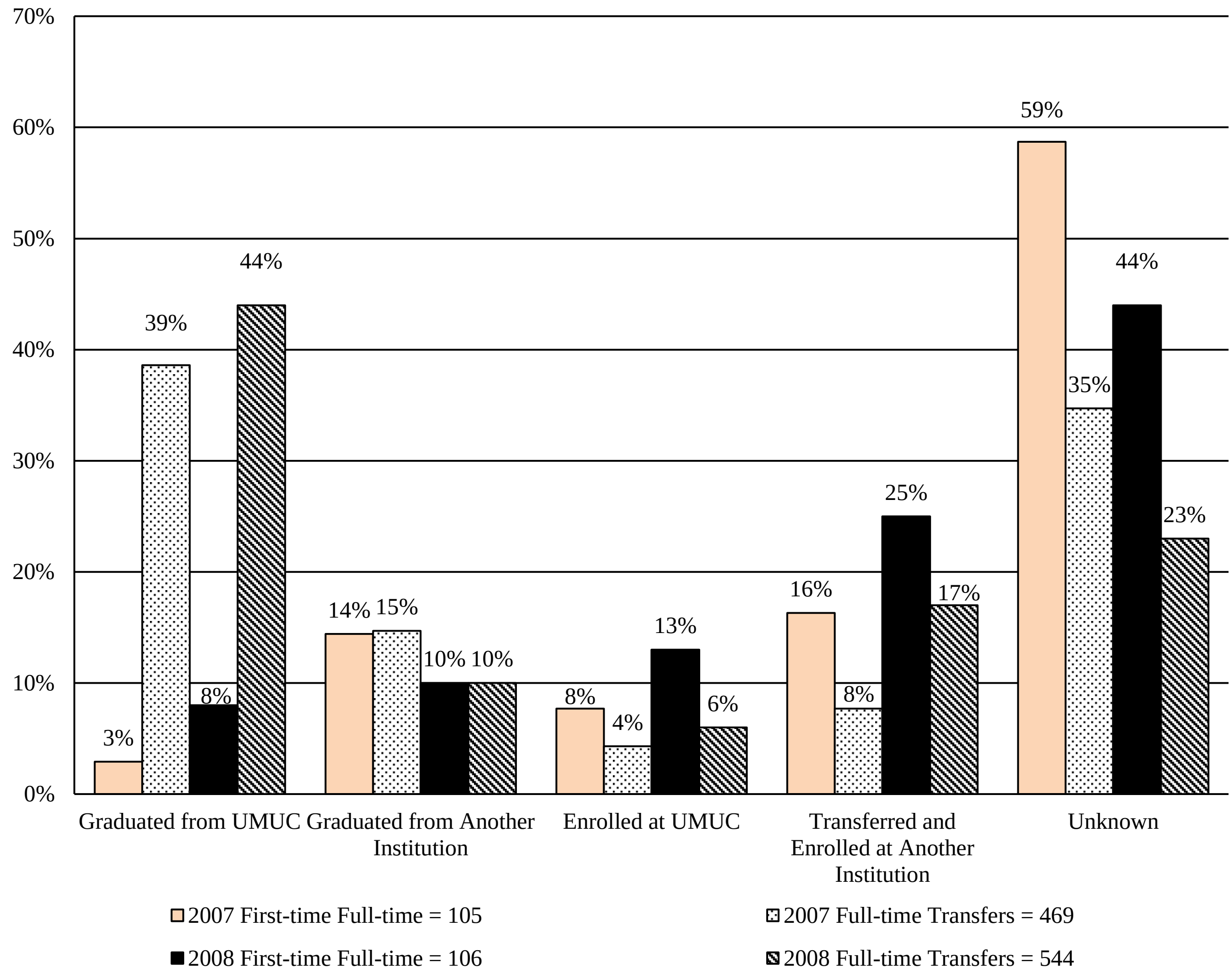
Exhibit 4 shows UMUC's most recent SAM data. Transfer students achieve much greater success than FT/FT students with 44% graduating within six years of enrolling at UMUC compared to only 8% of FT/FT students. The status is not known for 44% of the FT/FT students and for 23% of the transfer students, respectively. In addition, within six years of enrolling at UMUC, 38% and 23% of FT/FT and transfer students are either still enrolled at UMUC or another institution. Broadly speaking, these fall 2008 cohort rates are improvements over the 2007 rates as more students graduated from UMUC and fewer students' outcomes are unknown.

Exhibit 3
Retention and Graduation Rates of Transfer Students
2006-2012 Cohorts



Source: University of Maryland University College

Exhibit 4
Status of First-time, Full-time and Full-time Transfer Students Seeking a Bachelor's Degree within Six Years
Fall 2007 and 2008 Cohort



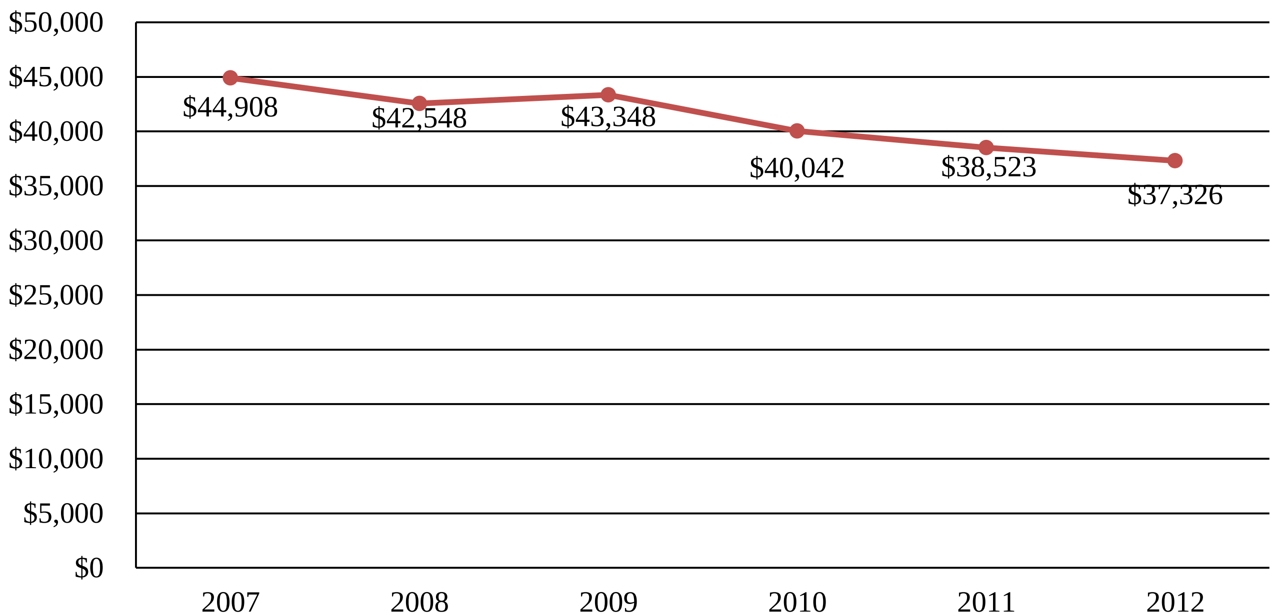
UMUC: University of Maryland University College

Source: Student Achievement Measures

3. Expenditures Per Degree

Ultimately, how well an institution meets its mission is measured by the number of undergraduate degrees awarded. One measure of how effectively institutions translate resources into degrees is the ratio of education and related (E&R) expenditures per degree (undergraduate and graduate). E&R expenditures include total spending on direct educational costs, such as instruction and student services, and the educational share of spending on administrative overhead, such as academic support, institutional support, and operations and maintenance. **Exhibit 5** shows UMUC's E&R expenditures per degree from fiscal 2007 to 2012, the most recent year for which data is available.

Exhibit 5
UMUC Educational and Related Expenditures Per Degree
Academic Year 2007-2012



UMUC: University of Maryland University College

Note: Education and related expenditures include direct spending on instruction and student services and the education share of spending on academic and institutional support and operations and maintenance. All dollar amounts are reported in 2012 dollars (Higher Education Price Index adjusted). Direct educational costs per degree is calculated as the total education and related expenses for all students divided by all degrees (undergraduate, graduate, and professional) awarded in that year.

Source: Delta Project, *Trends in College Spending Online*; Department of Legislative Services

In fiscal 2007, UMUC's E&R expenditures per degree were $44,908, but by fiscal 2012 this had decreased by $7,582, or 16.9%, to $37,326. UMUC's falling spending per degree is likely due to flat State support for the operating budget, as well as a rapid increase in enrollment during these years. Stateside FTES enrollment at UMUC hit a then-record high in fiscal 2012 of 25,390, having grown 53.0% from fiscal 2007 to 2012. Given that enrollment declined in fiscal 2013 and 2014, the cost per degree will likely go up when that data is available. UMUC's designated peer institutions are not shown in this exhibit because none of UMUC's peers offer distance education to the extent that UMUC does, so the comparison of UMUC to other institutions is misleading. UMUC has very few comparable peers in the public sector nationwide.

Fiscal 2016 Actions

Proposed Deficiency

A fiscal 2016 deficiency would provide the University System of Maryland Office with $16.5 million to cover an increase in health insurance costs at all USM institutions (see USM Overview for further discussion). UMUC's estimated portion of the deficiency is $0.8 million.

Cost Containment

Cost containment measures in fiscal 2016 resulted in a 2.0%, or $0.8 million, reduction in State support for UMUC, which was met by enacting its own institutional 0.2% across-the-board reduction across all budget functions. Unlike most other USM institutions, no positions were reduced.

Proposed Budget

After adjusting for the fiscal 2016 deficiency and a back of the bill reduction in health insurance, as shown in **Exhibit 6**, UMUC's total State allowance for fiscal 2017, including general funds and the Higher Education Investment Fund, is $41.2 million, a 4.6% increase over fiscal 2016. Overall, unrestricted funds increase about $8.2 million, or 2.3%, primarily due to increases in public service revenue. Restricted funds grow $7.0 million, or 19.8%, in the allowance due to the university rebasing its estimates for financial aid awards. Despite having the second largest enrollment by FTES in USM, UMUC did not receive any portion of the $6.8 million in enhancement funds in fiscal 2017.

Exhibit 6
Proposed Budget
USM – University of Maryland University College

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Funds	$36,962	$36,798	$39,317	**$2,519**	**6.8%**
Deficiency		794			
Across the Board			-59		
Total General Funds	**$36,962**	**$37,592**	**$39,258**	**$1,666**	**4.4%**
HEIF	$1,732	$1,799	$1,954	$155	8.6%
Total State Funds	**$38,694**	**$39,391**	**$41,212**	**$1,821**	**4.6%**
Other Unrestricted Funds	$311,743	$317,355	$323,692	$6,337	2.0%
Total Unrestricted Funds	**$350,436**	**$356,746**	**$364,904**	**$8,158**	**2.3%**
Restricted Funds	$40,763	$35,275	$42,275	$7,000	19.8%
Total Funds	**$391,199**	**$392,021**	**$407,178**	**$15,158**	**3.9%**

HEIF: Higher Education Investment Fund
USM: University System of Maryland

Note: Fiscal 2017 general funds are adjusted to reflect University of Maryland University College's estimated portion of the deficiency. Fiscal 2017 general funds are adjusted to reflect the across-the-board reduction.

Source: Governor's Budget Books, Fiscal 2017; Department of Legislative Services

Unrestricted budget changes in the allowance by program are shown in **Exhibit 7**. This exhibit considers only unrestricted funds, which are comprised mostly of State funds and tuition and fee revenues.

Exhibit 7
Budget Changes for Unrestricted Funds by Program
Fiscal 2015-2017
($ in Thousands)

	2015 Actual	2016 Working	2015-16 % Change	2017 Allowance	2016-17 Change	2016-17 % Change
Expenditures						
Instruction	$102,629	$105,060	2.4%	$107,072	$2,012	1.9%
Research	365	380	4.2%	386	5	1.4%
Public Service	10,649	12,601	18.3%	16,608	4,007	31.8%
Academic Support	58,208	65,658	12.8%	66,941	1,283	2.0%
Student Services	70,771	75,720	7.0%	76,433	713	0.9%
Institutional Support	44,974	48,438	7.7%	49,295	857	1.8%
Operation and Maintenance of Plant	49,917	36,301	-27.3%	36,224	-77	-0.2%
Scholarships and Fellowships	10,728	9,457	-11.9%	9,668	211	2.2%
Education and General Total	**$348,242**	**$353,616**	**1.5%**	**$362,627**	**$9,011**	**2.5%**
Auxiliary Enterprises	$2,194	$2,336	6.4%	$2,336	$	0.0%
Deficiency/ Across-the-board Reductions		$794		-59		
Grand Total	**$350,436**	**$356,746**	**1.8%**	**$364,904**	**$8,158**	**2.3%**
Revenues						
Tuition and Fees	$304,076	$308,779	1.5%	$310,116	$1,337	0.4%
General Funds	36,962	37,592	1.7%	39,258	1,666	4.4%
Higher Education Investment Fund	1,732	1,799	3.9%	1,954	155	8.6%
Other Unrestricted Funds	17,514	11,213	-36.0%	16,213	5,000	44.6%
Subtotal	***$360,284***	***$359,384***	***-0.2%***	***$367,541***	***$8,158***	***2.3%***
Auxiliary Enterprises	1,248	62	**-95.0%**	62	$	**0.0%**
Transfer to Fund Balance	-11,095	-2,700		-2,700		
Grand Total	**$350,436**	**$356,746**	**1.8%**	**$364,904**	**$8,158**	**2.3%**

Note: Fiscal 2016 general funds are adjusted to reflect the University of Maryland University College's estimated portion of the deficiency, and fiscal 2017 is adjusted to reflect across-the-board reductions.

Source: Governor's Budget Books, Fiscal 2017; Department of Legislative Services

There are a number of very large and interesting changes from fiscal 2015 through 2017. For example, public service in fiscal 2017 grows by $4.0 million, or 31.8%, after growing 18.3% in the prior year. According to UMUC, this mainly represents its Inn and Conference Center (ICC), co-located at UMUC's administrative headquarters. Because ICC features mission-based training and free parking, it is categorized as public service. The increase is due to rapidly growing revenue following lengthy renovations to right-size the budget for actual projected business.

Academic support grew 12.8% in fiscal 2016 and another 2.0% in fiscal 2017 due to continuing academic transformation initiatives such as course redesign and development of new online teaching methods, namely the deployment of the Enhanced Learning Model, which is a new method for determining competency-based education at UMUC. This also accounts for costs related to transitioning the university to Open Education Resources (OER), which will be discussed in Issue 1 of this analysis. Academic support also increases due to further rightsizing of the UMUC budget to actual expenditures. Fiscal 2014 had enrollment underattainment that lead to 70 personnel layoffs in spring 2014, and these lower costs rolled forward into fiscal 2015.

Operations and maintenance of plant decreases 27.3% in fiscal 2016, but is then flat funded in fiscal 2017. This was due to more funding than anticipated being available in the final fiscal 2015 budget, so some funding was transferred to the facilities budget. Because final variable costs were lower than anticipated, these funds then went to the plant fund at the fiscal 2015 closeout. UMUC has a new facility master plan that details and better informs future plant costs. Budgeted scholarship expenditures declined 11.9% in fiscal 2016 due to higher than anticipated use of tuition remission benefits by employees. Other expenditures in instruction, student services, and institutional support all have modest growth projected in fiscal 2017.

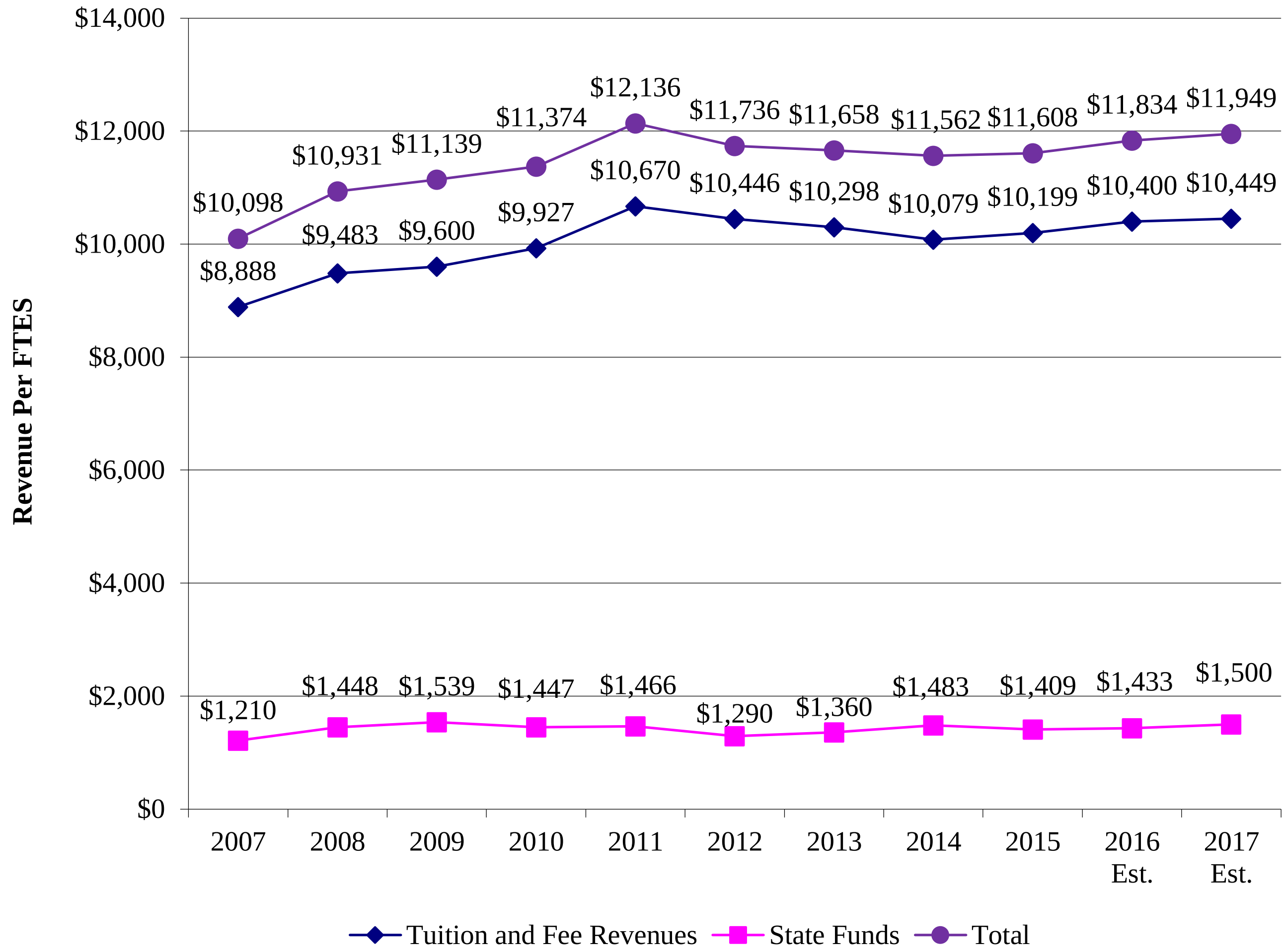
On the revenue side, auxiliary funds plummet 95.0% in fiscal 2016 due to the roll out of OER efforts in fall 2015 semester. Other unrestricted funds grow $5.0 million, or 44.6%, in fiscal 2017 due to projections for events at ICC and to right size the fiscal 2017 budget as the fiscal 2016 budget is low. Finally, UMUC tuition and fees go up 1.7% in fiscal 2017 due to the institution holding its consolidated fee flat and rounding its tuition per credit hour increase to the nearest $1. However, its tuition and fee revenue is only expected to go up 0.4%. Overall, UMUC non-auxiliary revenues fully meet all unrestricted expenditure needs in fiscal 2015 through 2017.

The President should comment on why tuition revenue is only growing by 0.4% in fiscal 2017 if credit hour tuition is growing by 1.7%, and the budgeted enrollment is flat.

Funding Increases Per FTES

Stateside FTES enrollment at UMUC reached a high of 27,460 in fiscal 2015, having surpassed the previous high in fiscal 2012 and having grown over 100% since fiscal 2002. However, enrollment is expected to be flat in fiscal 2016 and 2017, growing only 20 FTES, effectively 0%. **Exhibit 8** shows tuition and fees revenue and State funding per FTES between fiscal 2007 and 2017. Tuition and fee revenue increased moderately from fiscal 2007 to 2011 due to rapid enrollment increases, while State funds remained relatively low but very stable across this entire time period. UMUC receives four times less State funding per student than the next lowest State funded per FTES institution, Towson University, and 11 times less funding per student than Coppin State University (CSU). This relatively low State support makes UMUC very dependent on tuition revenue and, consequently, on meeting enrollment projections and sustaining the subsequent volume of students enrolled. Currently, enrollment is expected to remain level in fiscal 2016, although online enrollments are notoriously volatile, given the easy entry and exit of students from online programs.

Exhibit 8
UMUC Tuition and Fees and State Revenues
Per Full-time Equivalent Student
Fiscal 2007-2017 Est.



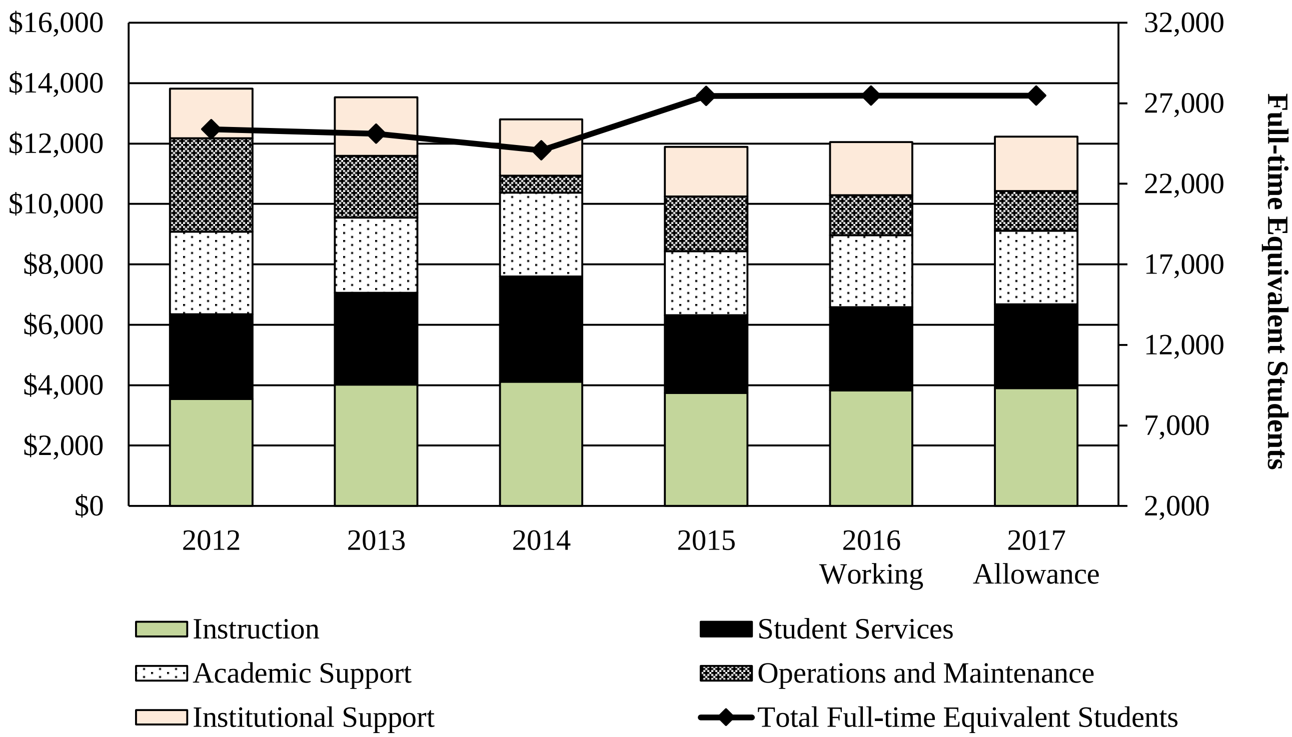
UMUC: University of Maryland University College

Source: Governor's Budget Books, Fiscal 2008-2017

Program Expenditures Per FTES

Expenditures per FTES declined 11.5% between fiscal 2012 and 2017 from $13,813 to $12,226, respectively. As shown in **Exhibit 9**, over half of the decrease is related to spending on operations and maintenance of plant. This can partly be attributed to an enrollment decline in fiscal 2013 and 2014 that lead to institution-level cost containment. If maintenance of plant was removed from these figures, per student spending actually increases 1.8%, or $195. The largest decline in spending per FTES in this exhibit, 7.1%, or $908, occurred in fiscal 2015, likely due to UMUC experiencing $1.3 million in cost containment measures on top of enrollment growth. Overall, since fiscal 2012, expenditures on institutional support grew 9.9% ($161), but expenditures for student services and academic support decreased 0.9% ($24) and 11.0% ($300), respectively, raising concerns about the commitment to quality support and services available for students to help them succeed and graduate.

Exhibit 9
Unrestricted Fund Expenditures Per Full-time Equivalent Student
Fiscal 2012-2017



Note: Does not reflect fiscal 2016 deficiency or fiscal 2017 across-the-board reduction.

Source: Governor's Budget Books; Department of Legislative Services

Issues

1. Affordability and Enrollment

The lack of financial resources frequently contributes to a student's decision to stop or drop out of college. As the costs of a college education continue to escalate, students and families are relying more on various types of financial aid, *e.g.*, federal, State, and institutional to effectively bring down the cost of college. According to the National Center for Education Statistics' College Navigator, the total cost for a FT/FT Maryland undergraduate student at UMUC in fiscal 2014 was $28,737 (based on tuition, mandatory fees, books and supplies, other expenses, and the weighted average of room and board). However, when accounting for the average amount of federal, State, and institutional aid, the average net price was $10,588, a 63.2% reduction in the net cost of attendance. This cost is perhaps not a great measure for UMUC because so many students are pursuing distance education studies while working, so room and board costs would be very different for most UMUC students from FT/FT students at a residential campus like UMCP.

UMUC Ditches Textbooks

Effective beginning in the fall 2015 semester, UMUC will provide all textbooks digitally for undergraduate students at no additional charge beyond the regular cost of tuition and fees. All graduate courses will be covered by fall 2016. The Department of Legislative Services (DLS) could not find another example of an institution going entirely toward OER, or, in other words, textbook-free. UMUC may be the first to do so. UMUC does not use a vendor, but rather manages everything in-house using existing faculty resources and materials that are publically available. This includes electronic textbooks, lectures, websites, and selected documents and media. According to UMUC, program chairs and faculty members may then customize materials to be more relevant to specific courses and to include the latest industry information. A limited number of courses will require the use of specific software or content that cannot be accessed for free, and may still charge for that. UMUC recommends students use Amazon's Kindle application for computers, tablets, and smartphones to access many course materials. Now students can use entirely digital resources provided by course instructors, as well as online reference sources and access to published articles through the university's library.

Part of the reason for this shift is that the military's Tuition Assistance Program does not cover books. Now, any active-duty military member may enroll at UMUC and pay nearly nothing out of pocket for courses. The fiscal 2014 net price calculator for UMUC, mentioned above, estimated "books and supplies" at $1,200 per year. Supplies reflect miscellaneous student materials like notebooks and pens, but textbooks likely make up the vast majority of that $1,200 figure, so students likely saw an actual decrease in the net price of enrolling at UMUC in fiscal 2016. This is very unusual. Other than UMUC, the only Maryland institution to reduce the cost of attendance for Maryland residents was St. Mary's College of Maryland in fall 2014.

The President should comment on how UMUC ensures the quality of its internal course materials (texts, videos, *etc.*) and whether the lack of physical textbooks prevents UMUC from offering some types of courses. For example, teaching a modern literature course would seem to

be very difficult. The President should comment on whether learning outcomes are comparable in the new courses.

Federal and Institutional Aid

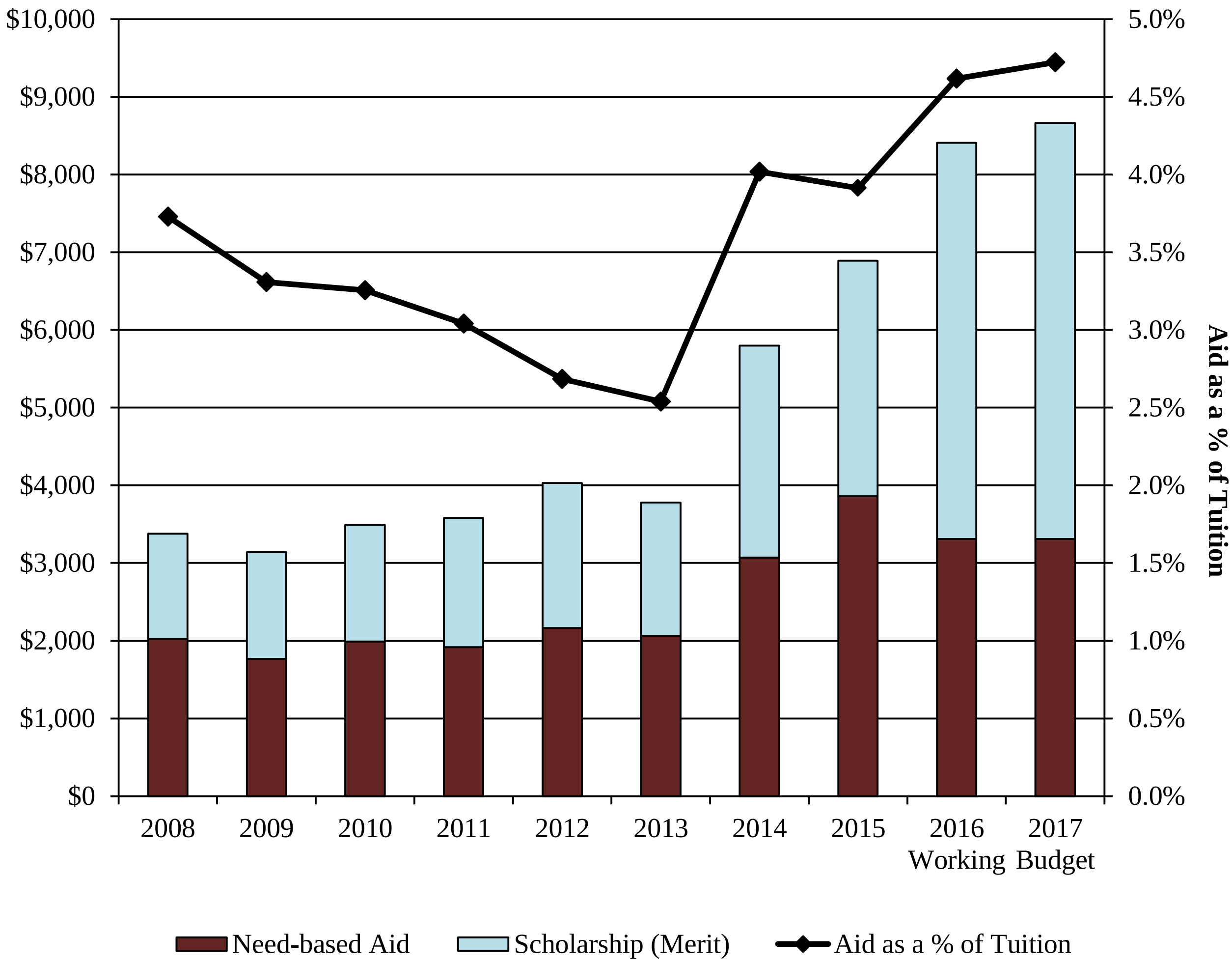
In fiscal 2015, about 30% of UMUC's undergraduate students receive Pell awards, which are given to those who otherwise could not afford college and have an expected family contribution (EFC) of less than a specific amount, which was $5,730 in fiscal 2015. UMUC reports that in fiscal 2015, 49% of students came from economically disadvantaged backgrounds, up from 41% in fiscal 2011. EFC is an indicator of the amount a family is required to contribute to pay for a student's college education: the lower EFC, the greater the financial aid.

Total expenditures on institutional aid were basically flat from fiscal 2008 through 2013, growing only $0.4 million, or 11.8%, while the share of need-based aid declined slightly from 60.0% in fiscal 2008 to 55.0% in fiscal 2013, as illustrated in **Exhibit 10**. The institution's support changed significantly in fiscal 2014 and 2015 due to the inclusion of worldwide institutional financial aid rather than just stateside financial aid. This makes year-over-year comparisons difficult, although the percent of need-based aid in 2015, 56.0%, is very similar to the rate in fiscal 2013, 55.0%, suggesting it is used in the same manner.

For UMUC to succeed, it must offer quality education at an affordable price to generate the student enrollment, or volume, to operate efficiently. Overall, online enrollment growth over the next decade is expected to be lower than in the past decade as the market matures. This makes institutional aid very important. In fiscal 2016, UMUC boosted institutional merit aid by $2.1 million, or 68%, to attract more student interest by making more awards. In particular, this helps UMUC fund its Completion Scholarship for new students who have completed a two-year degree as well as its merit-based Presidential Scholarship. As shown in Exhibit 3, UMUC does a relatively good job retaining and subsequently graduating these students, but as shown in Exhibit 10, the awards for these students skew institutional aid away from strictly need-based awards.

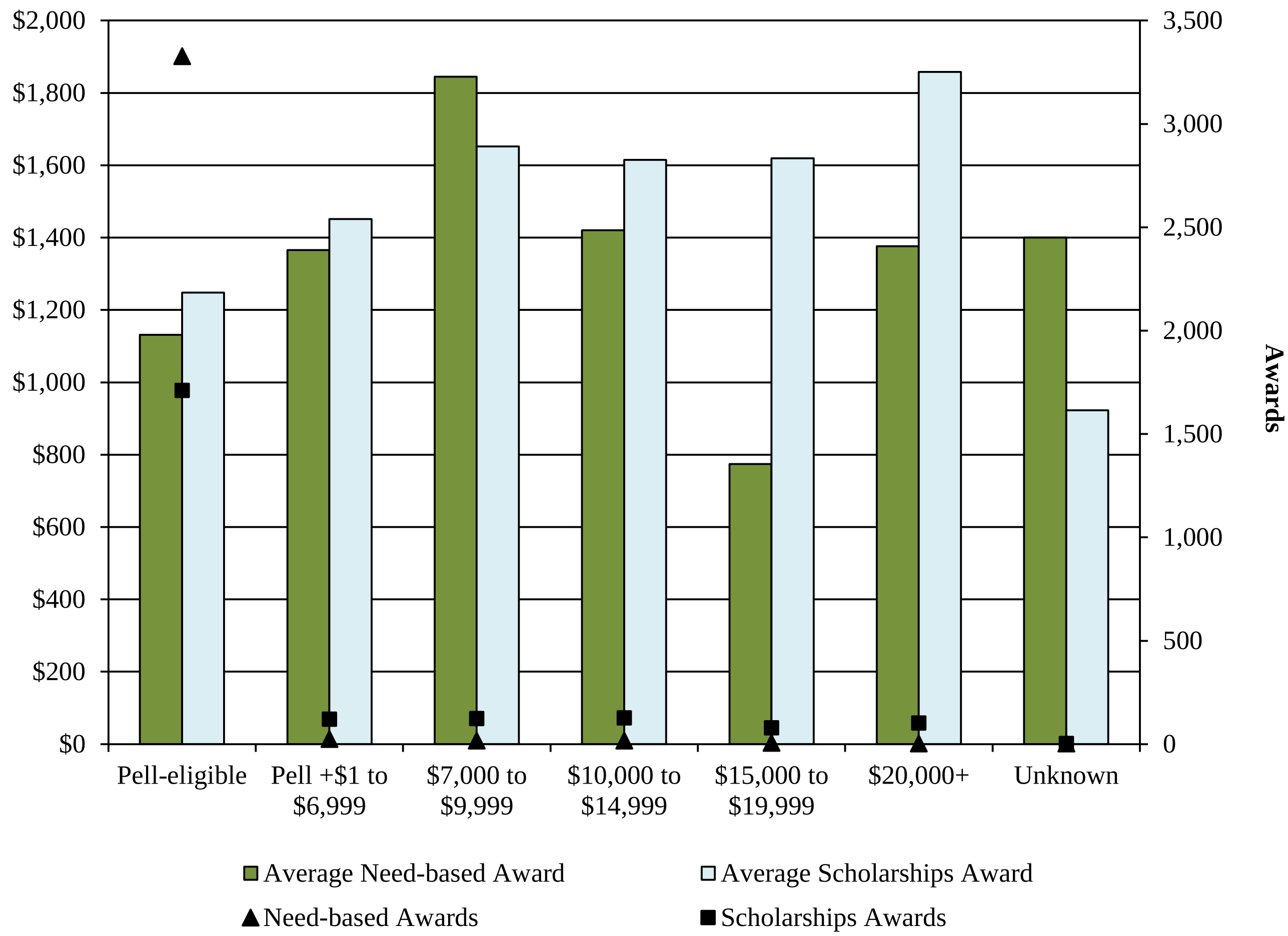
In fiscal 2015, 98.1% of those receiving need-based institutional aid were Pell-eligible students who received an average award of $1,131, as shown in **Exhibit 11**. Students in all EFC categories received institutional scholarships. Of the 2,261 institutional scholarships awarded, 75.6% were Pell-eligible, while only 14.0% went to those with an EFC of $10,000 or higher or had an unknown EFC (these are students who did not file a Free Application for Federal Student Aid). Average awards for the highest EFC groups were much larger than those for Pell-eligible students, about $1,800 versus $1,200. Students in the $7,000 to $9,999 EFC range ended up with the largest need-based awards, possibly because they miss out on most federal need-based aid and rely on institutional aid to enroll.

Exhibit 10
Institutional Aid and Percentage of Undergraduate Tuition
Fiscal 2008-2017
($ in Thousands)



Source: University System of Maryland; Department of Legislative Services

Exhibit 11
Number and Average Amount of Institutional Aid Received Per Recipient
Fiscal 2015



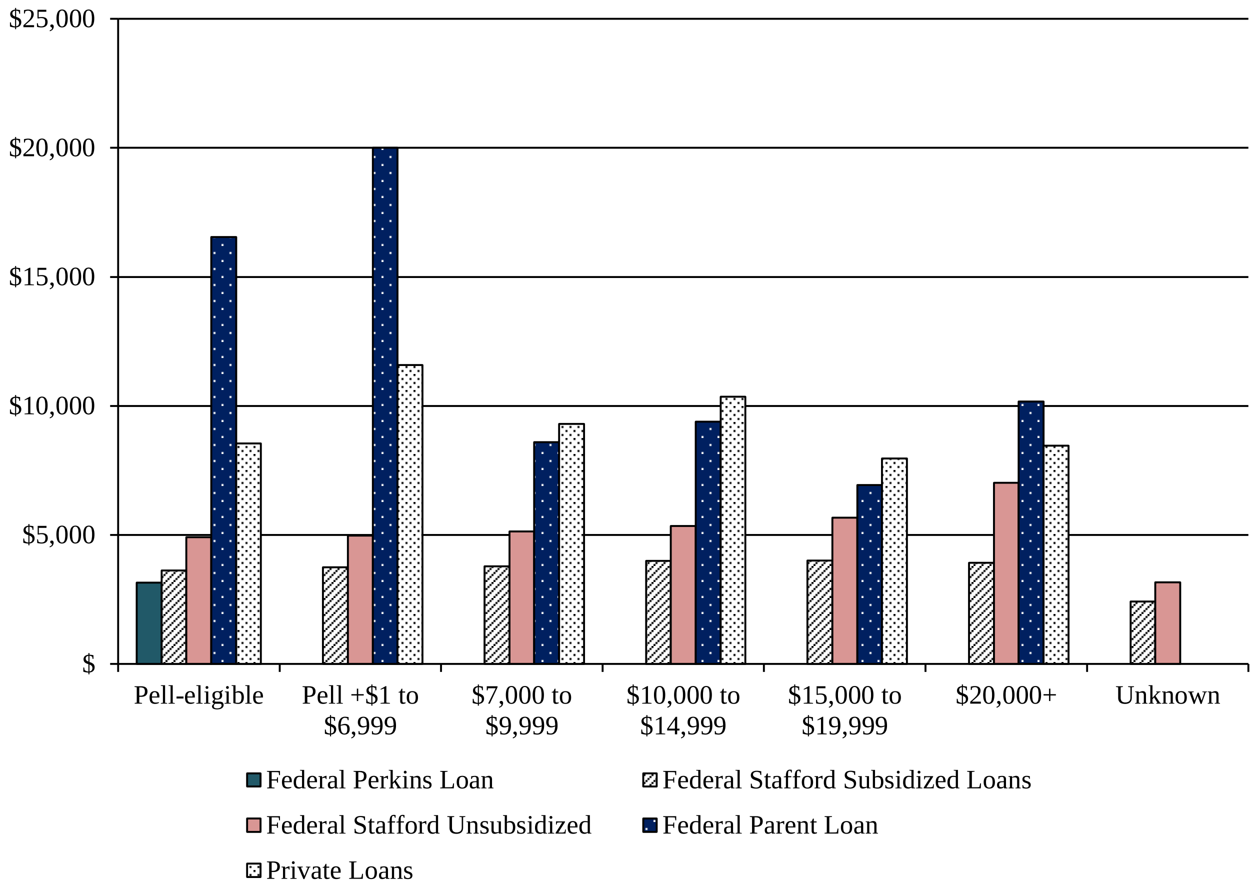
Source: Maryland Higher Education Commission

While the students with the greatest financial need typically receive Pell and institutional aid, it is still not enough to cover the cost of college. As shown in **Exhibit 12**, students in all EFC categories take out various types of loans to finance their education. There are three types of loans:

- federal subsidized loans are based on financial need with the government paying the interest while the student is enrolled in school (Perkins and Stafford loans);

- federal unsubsidized loans generally for those who do not demonstrate financial need with the interest added to the balance of the loan while the student is enrolled in school; and
- private loans.

Exhibit 12
Mean Loan Amount by Type and Expected Family Contribution
Fiscal 2015



Source: University System of Maryland

In fiscal 2015, of the 14,510 Pell-eligible students, 50% and 40% used a Stafford-subsidized and unsubsidized loan, respectively, to help finance their college education with average loans of $3,620 and $4,907. These rates are lower than those seen at four-year institutions largely because UMUC students are mostly part-time and, therefore, have a lower cost of attendance and a reduced need for loans. On average, the federal parent PLUS loans were the highest loans taken out for those students in all EFC categories, with Pell-eligible students taking out the highest loan amount of $16,541. However, this only involved 10 students, and only 29 students took out PLUS loans, indicating that nearly all UMUC students do not need these loans to bridge costs for attendance. Only 224 students turned to private loans, generally regarded as the least favorable loans to use. In comparison, about 10,000 UMUC students took out each type of Stafford loan.

2. Online Associates Degrees

As part of its contracts with the Department of Defense, UMUC offers a variety of degree programs to the uniformed services including associate, bachelor's, master's, and doctoral degrees. Because accreditation is for the higher education institution as a whole, and not for a certain degree program, most Marylanders are unaware that UMUC is in fact fully accredited to offer two-year degrees. This makes the institution comparable to most other large online institutions, such as the University of Phoenix or America Military University. Currently, there are nine two-year programs:

- accounting;
- business management;
- computer studies;
- criminal justice;
- foreign languages;
- legal studies;
- management studies;
- mathematics; and
- women's studies.

UMUC's website only advertises this option for active-duty military service members and their spouses, veterans, reservists, and members of the National Guard. These students may pursue their associate's degree online or in Europe or Asia on-site. The programs listed above are all 60 credits long, per the College and Career Readiness and College Completion Act (CCRCCA) of 2013, although they all predate the existence of MHEC, so no significant changes have been made in 25 years. Currently, at least 15 credits of the two-year degree must be earned at UMUC to receive a UMUC two-year degree.

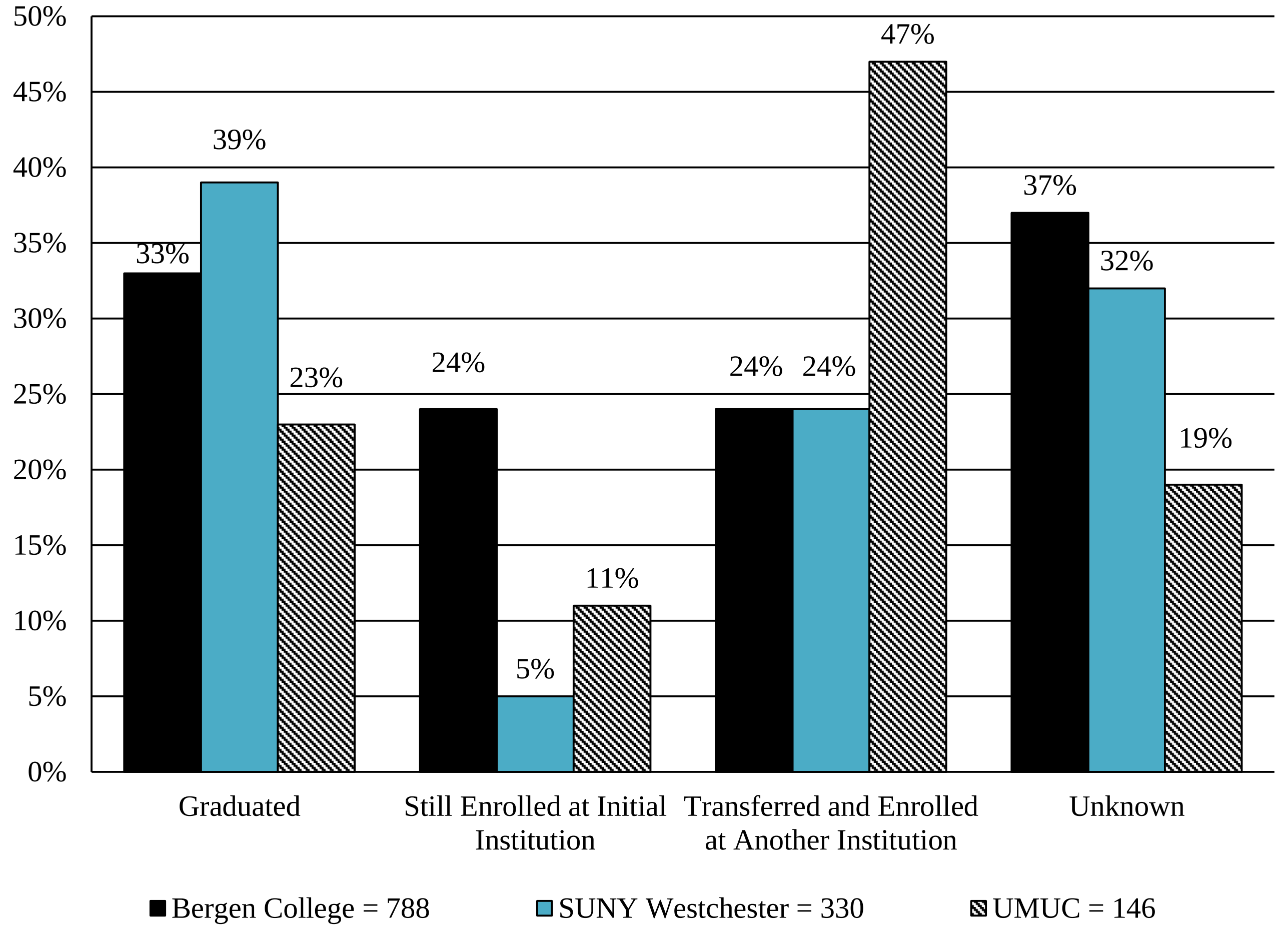
DLS confirmed with the Middle States Commission on Higher Education (MSCHE), that MSCHE reviews each of its member institutions as a whole, rather than the specific programs within the institution. In fact, MSCHE does not approve programs at all, but instead approves the award/credential/degree levels offered by member institutions and these are included within the scope of the institution's accreditation. Therefore, the accreditation process would not change for UMUC if it began offering two-year degrees to Marylanders. Currently, MSCHE accredits many institutions with broad awarding scopes, that is, they have authorization from the appropriate governmental agency within the region in which it operates to award postsecondary degrees (associate, bachelor's, master's, doctorate), which may be delivered in a variety of instructional methods including face-to-face, online, or in combination. MSCHE accreditation applies to the conditions that exist at an institution at the time of any MSCHE action. If a particular institution seeks to begin offering distance education programs (online or hybrid instruction) or add new degree levels to its offerings, it must submit a request for review in accordance with the MSCHE Substantive Change Policy, but UMUC is already approved for both of these conditions.

Because of UMUC's two-year authority, it is actually already reporting two-year degree information annually to MHEC and also to SAM. Unfortunately, none of Maryland's 16 community colleges currently participate in SAM, so there is no local comparison that can be made with UMUC's outcomes. **Exhibit 13** compares UMUC with two other randomly selected community colleges. While UMUC has frequently drawn comparisons to itself and online institutions in competitor states like the State University of New York Empire State College and the Thomas Edison College (New Jersey), the former does not report two-year data to SAM, and the latter is not in SAM at all. For some comparison to be made, two large commuter community colleges were selected from New York and New Jersey.

The exhibit shows that UMUC has lower graduation rates for students pursuing associates degrees than the other two community colleges and that almost half of UMUC's 2008 cohort of two-year students ended up transferring. On the other hand, UMUC has a much lower percentage of students in the unknown category. The comparisons here are interesting to contemplate, but the fact that UMUC's enrollment is almost all military students does raise some challenges as to whether these students are comparable to other two-year-seeking students. Still, the exhibit gives some insight into UMUC's two-year world. The only other source of information on UMUC's two-year degree program is degrees awarded. Production grew from 107 in fiscal 2005 to 295 in fiscal 2010 to 527 in fiscal 2014. Then, in fiscal 2015, awards nearly doubled to 1,095. That is a 10-year growth of 988 degrees, or over 800%, indicating that there is a strong demand for this option. While the jump in fiscal 2015 awards may be due to the way enrollment is counted, the growth from fiscal 2005 through 2014 is real.

The President should comment on the demographics of participants in two-year programs and what has led to the rapid growth in two-year degrees awarded over the past decade.

Exhibit 13
Outcomes of Students Pursuing Associate's Degrees
Fall 2008 Cohort



UMUC: University of Maryland University College
SUNY: State University of New York

Note: First-time, part-time students only.

Source: Student Achievement Measures

Besides opening broad access to two-year degrees, UMUC could leverage its size and expertise in distance education to focus on very specific opportunities for Marylanders such as near completers and reverse transfers. Especially at a time when it is facing stiff competition for online enrollments, these two groups offer UMUC potentially additional enrollments that would boost the State's workforce and student success. On the other hand, if UMUC moves to increase the awarding of two-year degrees in Maryland, it may come at the expense of community colleges. While the two-year institutions have not aggressively pursued distance education in the ways that UMUC has, they still stand to lose some traditional enrollment to an expanding UMUC. However, at a time when 22 states have formally broken down the traditional two- and four-year degree barriers in higher education, the opportunity for UMUC is worth considering.

For near completers, Maryland has pursued an institution-based approach, as was discussed in the Fiscal 2017 Higher Education Overview. UMUC participated in that grant-funded activity with 14 other Maryland institutions, but the end results were mixed. The CCRCCA requires MHEC, in collaboration with institutions, to develop a statewide plan for identifying near completers.

In terms of reverse transfers, some states like Hawaii, Indiana, and Tennessee have a centralized or computerized management system for these students that removes much of the time-intensive work that inhibits the process in Maryland. Two of Maryland's competitor states have large public online universities, Penn State World Campus (Pennsylvania) and UMass Online (Massachusetts), that have two-year degrees in addition to bachelor's and graduate degrees, but it is not clear if they serve a reverse transfer function, as neither was part of the Lumina Foundation's Credit When It's Due grant. While MHEC is slated to rollout a statewide transfer and reverse transfer agreement in summer 2016, this most likely will remain an institution-focused approach. One option for UMUC would be to serve the State as the centralized conduit for reaching near completers and reverse transfer eligible students, presenting them with an affordable and anywhere enrollment option to complete a degree.

The President should comment on whether there are any legal or programmatic barriers preventing UMUC from serving the State as a centralized hub for near completers or reverse transfer.

3. UMUC Spins Off HelioCampus

The 2013-2017 *State Plan for Postsecondary Education* challenged Maryland institutions to embrace technology transfer and commercialization of research and expertise. UMUC is generally not thought of as a research institution, but in September 2015, UMUC spun off its Office of Analytics into a private company as a way to establish a new revenue stream for the institution. The new business, HelioCampus, is a software platform to analyze higher education financial and enrollment data to find ways to improve efficiencies on campuses and increase student success. It will provide clients with reporting models, visualization of big data, and analysis of trends. HelioCampus is a legally distinct entity whose sole shareholder is UMUC. It was borne out of the abrupt end of the enrollment increases UMUC enjoyed in fiscal 2013, which led to UMUC laying off 300 employees and cutting $60.0 million across its entire budget. UMUC turned to its Office of Analytics to get control of its enrollment and turn the institution around.

With approval from the USM Board of Regents, UMUC is transferring $10 million from its own fund balance as startup funding for HelioCampus. UMUC plans to support HelioCampus for the first five-years, but is then open to whatever monetization opportunities present themselves, such as selling HelioCampus or taking it public. UMUC reports that any profits from HelioCampus will go back to UMUC to bolster institutional financial aid programs. One potential program mentioned by UMUC's President is to entirely eliminate tuition for community college transfer students.

UMUC's vice president for data analytics and 15 staff were transferred to HelioCampus, which has corporate offices in Bethesda, rather than in Adelphi. While UMUC credited HelioCampus with the increase in enrollment in fall 2014, DLS attributed that to the shift in how enrollment is counted. Regardless, HelioCampus is well positioned to serve institutions focused on nontraditional students who are more difficult to initially enroll and often require more student services. HelioCampus has stated that it expects an "exponential" return on the initial $10 million invested and annualized revenues already exceed $2 million after two months in operation. HelioCampus believes that it will help client institutions by serving as an outsourced business analytics system. While UMUC asserts HelioCampus is the first entrant into this field, other established education technology corporations offer similar or converging services, including Blackboard Analytics, Civitas, EAB, and PAR Framework. PAR Framework is used by many USM institutions, including UMUC, which was an "implementation partner" with that group. Other USM institutions using PAR Framework include Bowie State University, CSU, and the University of Maryland Eastern Shore. UMUC reports that Frostburg State University is currently under contract with HelioCampus for certain services, and there are 20 more schools in contract discussions. HelioCampus' website has not been updated since its September 2015 launch, nor have any of its social medial accounts been active. Because the business is so new, there is currently not any data to report about what the spinoff itself can do. **The President of UMUC, on behalf of HelioCampus, should comment on what the new business is doing and whether it has secured any clients outside of Maryland.**

The HelioCampus business is also a result of UMUC exploring its governance structure and relationship with Maryland that began more than a year ago. UMUC operates in the very competitive online higher education market. Unlike students at traditional four-year institutions who live on or near campus, it is much easier for UMUC students to transfer to another online institution, such as the University of Phoenix or Liberty University, as well as traditional four-year institutions, which are increasingly moving into or expanding online classes. UMUC must differentiate itself to compete against for-profit institutions that have aggressively moved into its former monopoly on military enrollments.

Following enrollment declines and leadership turnover, UMUC undertook an extensive self-evaluation in calendar 2014. The President convened a group of stakeholders called the Ideation Group to consider any and all proposals to rethink how UMUC should pursue success as a public, online institution. While it had enjoyed a very close relationship with the U.S. Military since its founding in 1949, the increased online competition, military drawdowns, and relatively small population of Maryland, have forced UMUC to reconsider its most central and routine operations to discover more competitive means of operating. UMUC believes that the largest impediment to its success is the slow government procurement process. While private corporations can make rapid decisions, UMUC is dependent upon governmental processes and cannot make quick decisions.

To address how UMUC could secure more autonomy from State regulations on contracting, the Ideation Group considered, but ultimately rejected, spinning UMUC off as an independent nonprofit organization and becoming a USM-affiliated nonprofit organization. The Ideation Group supported a third option originally dubbed the "Bubble Model." In this scenario, UMUC would still need approval from the General Assembly to change its charter with the State, but it would remain a member of USM. The difference would be a unique exemption from procurement laws, similar to how UMUC's overseas operations currently work. UMUC would still undergo regular USM and legislative audits of all finances, but UMUC would be able to make rapid financial transactions independent of the Department of Budget and Management, the legislature, and the Board of Public Works BPW.

The USM Board of Regents voted to support the Bubble Model at its February 2015 meeting to allow UMUC authority to develop its own human resources, faculty, and procurement policies. UMUC would also like additional protection of its competitive and proprietary information from the Freedom of Information Act. Many of these changes would require legislation, but no bills have been submitted in the 2016 legislative session.

The President should comment on the need for any legislation to alter UMUC's governance structure and what steps UMUC will take in fiscal 2017 to make its business practices more competitive.

Recommended Actions

1. Concur with Governor's allowance.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
USM – University of Maryland University College
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Other Unrestricted Fund	Total Unrestricted Fund	Restricted Fund	Total
Fiscal 2015							
Legislative Appropriation	$38,186	$1,732	$0	$368,005	$407,923	$35,275	$443,198
Deficiency Appropriation	0	0	0	0	0	0	0
Cost Containment	-1,499	0	0	0	-1,499	0	-1,499
Budget Amendments	275	0	0	-56,260	-55,985	5,600	-50,385
Reversions and Cancellations	0	0	0	-3	-3	-112	-115
Actual Expenditures	**$36,962**	**$1,732**	**$0**	**$311,743**	**$350,436**	**$40,763**	**$391,199**
Fiscal 2016							
Legislative Appropriation	$36,248	$1,799	$0	$317,355	$355,402	$35,275	$390,677
Budget Amendments	550	0	0	0	550	0	550
Working Appropriation	**$36,798**	**$1,799**	**$0**	**$317,355**	**$355,952**	**$35,275**	**$391,227**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

General funds decrease about $1.2 million due to two rounds of across-the-board cost containment efforts by BPW totaling $1.5 million, which is offset by $0.3 million for the cost-of-living adjustments and salary increments.

Unrestricted funds decreased $56.3 million due to a drop of over 5,000 students in online enrollment and subsequent reorganization of personnel and operations at UMUC. Almost $3,000 in unrestricted funds were canceled at the end of the year to match expenditures with revenues.

Restricted funds increased $5.6 million due to an unexpected increase in Pell grants awards within online enrollment. However, about $0.1 million in restricted funds were canceled as Pell grants were slightly below that estimated increased in awards.

Fiscal 2016

The legislative appropriation increased by about $0.6 million in general funds to reflect restoration of the 2% pay reduction.

Appendix 2

Audit Findings

Audit Period for Last Audit:	March 21, 2011 – June 30, 2014
Issue Date:	June 2015
Number of Findings:	3
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: Security and access controls over certain UMUC systems were not sufficient.

Finding 2: UMUC workstations and servers were not sufficiently protected against malware.

Finding 3: Service level agreements and related independent reports did not address certain security and operational risks.

Object/Fund Difference Report
USM – University of Maryland University College

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	1,037.71	1,037.71	1,037.71	0.00	0%
02 Contractual	1,911.01	1,915.33	1,915.33	0.00	0%
Total Positions	**2,948.72**	**2,953.04**	**2,953.04**	**0.00**	**0%**
Objects					
01 Salaries and Wages	$ 204,455,466	$ 208,915,981	$ 211,916,618	$ 3,000,637	1.4%
02 Technical and Spec. Fees	3,978,574	5,989,399	7,758,551	1,769,152	29.5%
03 Communication	1,802,289	1,908,740	1,908,740	0	0%
04 Travel	2,747,463	3,706,184	3,706,184	0	0%
06 Fuel and Utilities	2,295,405	2,664,022	2,735,670	71,648	2.7%
07 Motor Vehicles	98,413	190,539	190,679	140	0.1%
08 Contractual Services	77,174,807	90,238,328	94,409,382	4,171,054	4.6%
09 Supplies and Materials	3,106,366	5,050,768	5,050,768	0	0%
11 Equipment – Additional	400,513	835,924	835,924	0	0%
12 Grants, Subsidies, and Contributions	51,428,732	44,444,851	51,662,488	7,217,637	16.2%
13 Fixed Charges	7,188,503	7,608,484	7,603,571	-4,913	-0.1%
14 Land and Structures	36,522,541	19,673,441	19,459,037	-214,404	-1.1%
Total Objects	**$ 391,199,072**	**$ 391,226,661**	**$ 407,237,612**	**$ 16,010,951**	**4.1%**
Funds					
40 Unrestricted Fund	$ 350,436,456	$ 355,951,929	$ 364,962,880	$ 9,010,951	2.5%
43 Restricted Fund	40,762,616	35,274,732	42,274,732	7,000,000	19.8%
Total Funds	**$ 391,199,072**	**$ 391,226,661**	**$ 407,237,612**	**$ 16,010,951**	**4.1%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingen reductions.

Fiscal Summary
USM – University of Maryland University College

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Instruction	$ 103,146,217	$ 105,294,114	$ 107,299,828	$ 2,005,714	1.9%
02 Research	365,158	380,366	385,827	5,461	1.4%
03 Public Service	10,649,447	12,601,198	16,607,823	4,006,625	31.8%
04 Academic Support	58,450,999	65,745,155	67,027,717	1,282,562	2.0%
05 Student Services	71,123,299	76,433,931	77,146,718	712,787	0.9%
06 Institutional Support	44,987,291	48,461,873	49,318,965	857,092	1.8%
07 Operation and Maintenance of Plant	49,916,964	36,301,300	36,224,373	-76,927	-0.2%
08 Auxiliary Enterprises	2,194,358	2,335,773	2,335,773	0	0%
17 Scholarships and Fellowships	50,365,339	43,672,951	50,890,588	7,217,637	16.5%
Total Expenditures	**$ 391,199,072**	**$ 391,226,661**	**$ 407,237,612**	**$ 16,010,951**	**4.1%**
Unrestricted Fund	$ 350,436,456	$ 355,951,929	$ 364,962,880	$ 9,010,951	2.5%
Restricted Fund	40,762,616	35,274,732	42,274,732	7,000,000	19.8%
Total Appropriations	**$ 391,199,072**	**$ 391,226,661**	**$ 407,237,612**	**$ 16,010,951**	**4.1%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Appendix 4

University of Maryland Center for Environmental Science

University System of Maryland

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Funds	$20,598	$21,347	$21,691	$344	1.6%
Deficiencies and Reductions	0	119	-34	-153	
Adjusted General Fund	**$20,598**	**$21,466**	**$21,657**	**$191**	**0.9%**
Special Funds	965	1,006	1,096	90	8.9%
Adjusted Special Fund	**$965**	**$1,006**	**$1,096**	**$90**	**8.9%**
Other Unrestricted Funds	5,638	7,146	7,146	0	
Adjusted Other Unrestricted Fund	**$5,638**	**$7,146**	**$7,146**	**$0**	**0.0%**
Total Unrestricted Funds	27,202	29,499	29,933	434	1.5%
Deficiencies and Reductions	0	119	-34	-153	
Adjusted Total Unrestricted Funds	**$27,202**	**$29,618**	**$29,899**	**$281**	**0.9%**
Restricted Funds	18,048	18,115	18,203	88	0.5%
Adjusted Restricted Fund	**$18,048**	**$18,115**	**$18,203**	**$88**	**0.5%**
Adjusted Grand Total	**$45,250**	**$47,733**	**$48,102**	**$369**	**0.8%**

- General funds increase by $0.2 million, or 0.9%, in fiscal 2017 after adjusting for a $0.1 million deficiency in fiscal 2016 for an increase in health insurance and $34,000 for an across-the-board reduction in health insurance in fiscal 2017.

- The Higher Education Investment Fund increases just under $0.1 million, or 8.9%, in fiscal 2017 resulting in an overall growth of $0.3 million, or 1.3%, in State funds above fiscal 2016. The fiscal 2017 allowance also includes funding for increments budgeted in the Department of Budget and Management totaling $0.4 million. If this is taken into account, State funds increase by $0.6 million, or 2.9%.

Note: Numbers may not sum to total due to rounding.

For further information contact: Garret T. Halbach Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	272.86	273.86	273.86	0.00
Contractual FTEs	73.00	73.00	73.00	0.00
Total Personnel	**345.86**	**346.86**	**346.86**	**0.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	8.19	2.99%
Positions and Percentage Vacant as of 12/31/15	13.34	4.90%

- The fiscal 2017 allowance provides no changes in regular or contractual positions for the University of Maryland Center for Environmental Science (UMCES).

- The vacancy rate at UMCES, 4.9%, is slightly below the University System of Maryland average of 5.3%.

Analysis in Brief

Major Trends

Chesapeake Bay Restoration Projects Expected to Increase: UMCES is involved in many annual and one-time environmental projects across the State. The number of projects declined by 15 in fiscal 2015 but is expected to grow in fiscal 2016 and 2017.

Research Expenditures Remain Strong: Research expenditures increased from $40.7 million in fiscal 2007 to $52.0 million in fiscal 2015.

Participation Doubles in Environmental Education Programs: The number of K-12 teachers participating in education programs at UMCES increased to 888 in fiscal 2015, doubling in just two years due to a new grant program from the National Science Foundation.

Issues

UMCES Is Finally Granting Degrees: In January 2012, the Maryland Higher Education Commission approved UMCES's mission, which includes a provision for UMCES to assume an expanded role in graduate and professional education. Chapter 95 of 2013 granted UMCES the ability to award certain joint degrees. This issue explores the changes occurring at UMCES.

Nearly a Century of Bay Research and Advocacy: This issue looks at two initiatives with UMCES. The first is UMCES status as Maryland's Sea Grant College, and the second looks at how UMCES is disseminating environmental data dashboards.

Recommended Actions

1. Concur with Governor's allowance.

University of Maryland Center for Environmental Science

University System of Maryland

Operating Budget Analysis

Program Description

The University of Maryland Center for Environmental Science (UMCES) is a research institution for environmental and natural sciences studies. Its mission is to develop a comprehensive program of environmental research, education, and service. Research focuses on the watersheds, estuaries, and coastal areas of Maryland and the greater Chesapeake Bay region, applying knowledge to help predict conditions in Maryland's ecology. Additionally, UMCES administers the Maryland Sea Grant College (MSGC) program. Funded by the National Oceanic and Atmospheric Administration (NOAA), the Sea Grant program is a network of 30 university-based programs located in the coastal and Great Lakes regions.

UMCES includes four geographically distinct laboratories under a single administration:

- Appalachian Laboratory in Frostburg, founded in 1962 at the headwaters of the Chesapeake Bay watershed with research focusing on landscape and watershed ecology;

- Chesapeake Biological Laboratory (CBL) on Solomon's Island, founded in 1925, conducts marine research and is home to UMCES's research fleet;

- Horn Point Laboratory in Cambridge, founded in 1973, conducts research on biology, chemistry, physics, and ecology of the organisms and ecosystems from wetlands and estuarine water of the Chesapeake Bay; and

- Institute of Marine and Environmental Technology (IMET) in Baltimore is a joint research institute between UMCES; University of Maryland Baltimore County; and the University of Maryland, Baltimore. UMCES at IMET researchers focus on developing biotechnology solutions to protecting coastal and marine environments.

Each of the laboratories serves as a regional center, offering natural science education programs to K-12 teachers and students. Environmental education programs also serve environmental interest groups and institutions within and beyond the University System of Maryland (USM) that are concerned with environmental research, education, and service.

UMCES faculty members contribute to graduate education by advising, teaching, and supervising the research of undergraduate and graduate students within USM degree-granting institutions. These activities further the institution's goals of providing quality research and graduate education and helping to build an educated workforce. UMCES provides advisory services to local

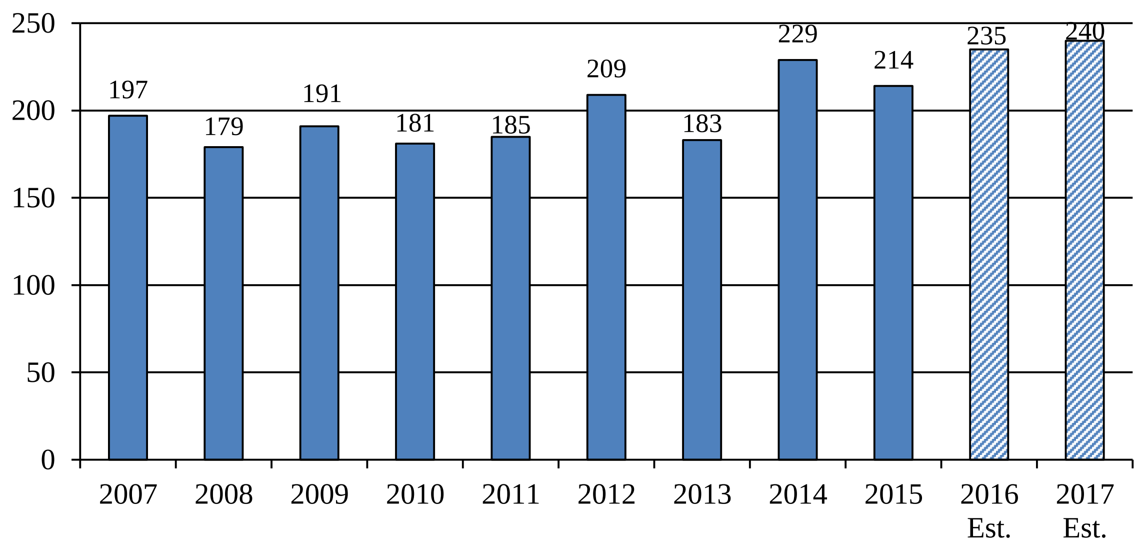
Chesapeake Bay industries and is the principal source of independent scientific information on environmental matters for Maryland's lawmakers, State agencies, and regional and national coastal management programs. UMCES seeks financial support for its services through contract and grant agreements and contributions from private sources.

Performance Analysis: Managing for Results

1. Chesapeake Bay Restoration Projects Expected to Increase

UMCES tracks the number of Chesapeake Bay restoration projects that it participates in as a measure of strengthening what it calls the predictive ecology for Maryland through relevant research programs. Projects focus on the bay and aspects of restoration ranging from research concerning the overall health of the bay down to a specific organism. For example, annual projects include the blue crab survey, which compiles observations from 1,500 locations throughout the bay. The total number of projects is driven mostly by grant funding, and individual project size and scope varies greatly. Since participating in 197 projects in fiscal 2007, the number of projects has fluctuated over the years reaching a low of 179 in fiscal 2008, as shown in **Exhibit 1**. In fiscal 2015, UMCES participated in 214 projects but estimates that projects will increase to over 230 in fiscal 2016 and beyond.

Exhibit 1
Chesapeake Bay Restoration Projects in Progress
Fiscal 2007-2017 Est.



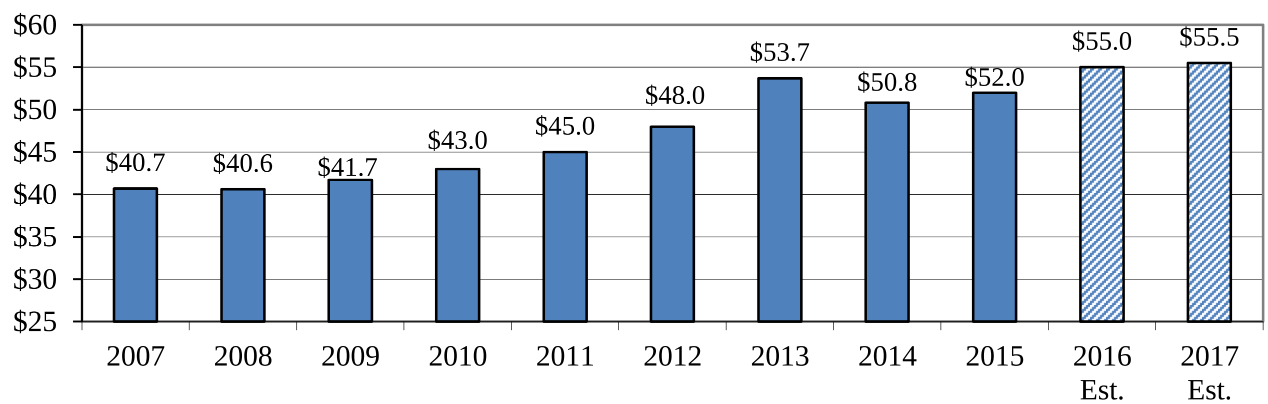
Source: Governor's Budget Books, Fiscal 2007-2016; University of Maryland Center for Environmental Science

2. Research Expenditures Remain Strong

Increasing extramural support from government and private sources is a goal of UMCES. Additionally, USM established a goal of doubling research funding systemwide to $2.4 billion by fiscal 2020 as part of its strategic plan to maintain Maryland as an innovation economy leader by attracting more federal funding to the State. This aligns with the most recent Maryland Higher Education Commission (MHEC) State Plan, from fiscal 2013, to increase innovation and research in higher education. As shown in **Exhibit 2**, UMCES was very successful as research expenditures grew $13.0 million, or 31.9%, from fiscal 2007 to 2013. Since grants are usually multi-year, the year-to-year expenditures do not necessarily reflect the underlying total funding in grants that UMCES has been awarded in a particular year. Most funding is for peer-reviewed general research, rather than applied research.

Exhibit 2 shows research expenditures as categorized by, and reported to, the National Science Foundation (NSF), which includes UMCES's entire budget, as well as some matching funds and facility or personnel funds that may be budgeted elsewhere. All else equal, if State support increases for any purpose at UMCES, NSF will report that UMCES's research expenditures are growing. UMCES has stated that the total impact of federal sequestration, the federal shutdown, and other reductions in federal spending is difficult to quantify, but these actions did lead to the slight decline in research spending in fiscal 2014. However, as evidenced by the uptick in research spending in fiscal 2015, UMCES expects to remain very competitive for federal funding and to actually increase its federal support in fiscal 2016 and beyond.

Exhibit 2
Research Expenditures
Fiscal 2007-2017 Est.
($ in Millions)



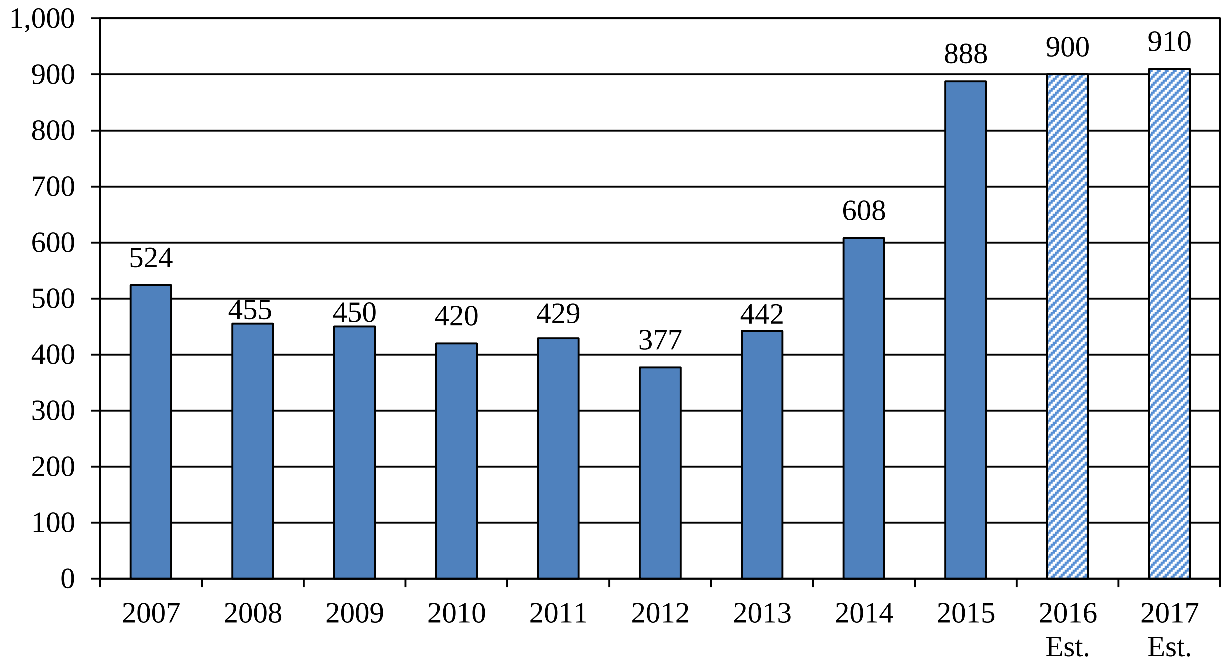
UMCES: University of Maryland Center for Environmental Science

Source: Governor's Budget Books, Fiscal 2007-2016; University of Maryland Center for Environmental Science

3. Participation Doubles in Environmental Education Programs

In addition to research, UMCES strives to strengthen K-12 teacher training in environmental education programs. Starting with only 35 teachers in fiscal 2000, by fiscal 2007, UMCES trained a then record high of 524 K-12 teachers. As shown in **Exhibit 3**, the number of participating teachers in education programs at UMCES mostly declined from fiscal 2007 to 2012, but fiscal 2013 saw the first large year-over-year increase, growing to 442 participants. This number then doubled to 888 teachers in fiscal 2015 due to a new NSF grant for regional climate change education that is jointly managed with the University of Delaware, called Maryland and Delaware Climate Change Education Assessment and Research (MADE CLEAR). The MADE CLEAR funding is focused on middle school and high school teachers, will continue for another two years, and may be renewed. K-12 support also comes from private sources such as Dominion Power, which is currently providing grant support for training workshops for educators in Calvert and St. Mary's counties to develop science lessons with field trips to partner facilities in Southern Maryland.

Exhibit 3
K-12 Teachers Participating in Environmental Education Programs
Fiscal 2007-2017 Est.



Source: Governor's Budget Books, Fiscal 2007-2016; University of Maryland Center for Environmental Science

Fiscal 2016 Actions

Proposed Deficiency

A fiscal 2016 deficiency would provide the University System of Maryland Office with $16.5 million to cover an increase in health insurance costs at all USM institutions (see USM Overview for further discussion). UMCES's estimated portion of the deficiency is $0.1 million.

Cost Containment

Cost containment measures in fiscal 2016 resulted in a 2%, or $449,505, reduction in the appropriation to UMCES. This was met by eliminating 1 vacant accountant position ($70,850) and reducing expenditures in general operations including deferral of equipment purchases and reductions in supplies and contractual services ($378,655).

Proposed Budget

As shown in **Exhibit 4**, total funding for UMCES in the fiscal 2017 allowance is $0.4 million, or 0.8%, higher than in fiscal 2016, after accounting for all deficiencies and back of the bill reductions. The majority of the growth is in State funds, $0.3 million, or 1.3%. However, this is less than half of USM's average increase in State support of 2.9%, partly due to the fact that UMCES receives no portion of the $6.8 million in USM enhancement funds in fiscal 2017, which are focused on undergraduate programs. Fiscal 2017 personnel increments for UMCES, totaling $0.3 million, are budgeted in the Department of Budget and Management. Including that funding, State support for UMCES grows $0.7 million, or 1.5%, in fiscal 2017. Other unrestricted funds at UMCES are flat due to no expected changes in support through contracts and grants. Restricted funds grew 0.4% in fiscal 2016 and are expected to grow 0.5% in fiscal 2017, reflecting the strong competition over the diminishing pool of federal research grants. This is also lower than USM's total increase in restricted funds of 1.6%.

UMCES' State-supported budget by program is shown in **Exhibit 5**. In fiscal 2016, expenditures for plant increase by 11.4%, or approximately $0.6 million, for facility renewal deferred from the prior year and conversion of positions at CBL. Expenditures on research, which account for nearly two-thirds of the budget, grow 8.0%, or $1.4 million, primarily due to new projects and also personnel costs for grant researchers. Institutional support grows $0.4 million in fiscal 2016 due to contract services and USM program enhancements in that year.

In fiscal 2017, research expenditures further increase by $0.2 million, or 1.0%, due to increases in fringe benefit and other costs in the current services budget for UMCES. Plant funds increase by $0.4 million, or 6.4%, due to catching up on facility renewal and more conversions of CBL facilities positions. Expenditures for institutional support decrease by $0.1 million, or 2.0%, due to a reduction in contract services made in order to reduce institutional costs. Public service support is unchanged but will be used for a new exhibit design at the UMCES visitor center. The Higher Education Investment Fund (HEIF) increases due to realignment with expected fiscal 2017 HEIF revenue, and other unrestricted funds decline in fiscal 2016 and are flat in 2017 due to lower private gifts, grants, and contracts.

Exhibit 4
Governor's Proposed Budget
University of Maryland Center for Environmental Science
Fiscal 2015-2017
($ in Thousands)

	2015 Actual	2016 Working	2017 Allowance	2016-17 Change	% Change Prior Year
General Funds	$20,598	$21,466	$21,657	$191	0.9%
Higher Education Investment Fund	965	1,006	1,096	90	8.9%
Total State Funds	21,564	22,472	22,754	281	1.3%
Other Unrestricted Funds	5,638	7,146	7,146	0	0.0%
Total Unrestricted Funds	27,202	29,618	29,899	281	0.9%
Restricted Funds	18,048	18,115	18,203	88	0.5%
Total Funds	**$45,250**	**$47,733**	**$48,102**	**$369**	**0.8%**

Note: Fiscal 2016 general funds are adjusted to reflect the University of Maryland Center for Environmental Sciences estimated portion of the deficiency, and fiscal 2017 is adjusted to reflect the across-the-board reduction. Numbers may not sum to total due to rounding.

Source: Governor's Budget Books, Fiscal 2017; Department of Legislative Services

Exhibit 5
State-supported Budget Changes by Program
Fiscal 2015-2017
($ in Thousands)

	2015	Working 2016	% Change 2015-16	2017	Change 2016-17	% Change 2016-17
Expenditures						
Research	$16,996	$18,352	8.0%	$18,526	$174	1.0%
Plant	5,146	5,732	11.4%	6,101	369	6.4%
Institutional support	5,021	5,377	7.1%	5,267	-110	-2.0%
Public service	39	39	0.0%	39	0	0.0%
Deficiency		119		-34	-153	
Total	**$27,202**	**$29,618**	**8.9%**	**$29,899**	**$281**	**0.9%**
Revenues						

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	2015	Working 2016	% Change 2015-16	2017	Change 2016-17	% Change 2016-17
General Funds	$20,598	$21,466	4.2%	$21,657	$191	0.9%
HEIF	968	1,006	4.0%	1,096	90	8.9%
Other Unrestricted Funds[1]	8,358	7,438	-11.0%	7,438		0.0%
Transfer(to)/from Fund Balance	-2,722	-293		-293		0.0%
Total	**$27,202**	**$29,618**	**8.9%**	**$29,899**	**$281**	**0.9%**

HEIF: Higher Education Investment Fund

[1] Other State support is a component of unrestricted revenue. Other unrestricted revenue considered non-State support includes designated research initiative fund and self-supporting activities.

Note: Fiscal 2016 general funds are adjusted by $0.1 million to reflect the proposed deficiency. Fiscal 2017 general funds are adjusted to reflect a $33,809 across-the-board reduction in health insurance.

Source: University of Maryland Center for Environmental Science

Issues

1. UMCES Is Finally Granting Degrees

After many years of discussion, UMCES now offers a joint degree program with the University of Maryland, College Park (UMCP) toward a Master's in Science and a Doctor of Philosophy in Marine-Estuarine-Environmental Sciences (MEES). The first MEES cohort entirely under the new degree designation enrolled in the 2014-2015 academic year, although students in the 2013-2014 academic year could elect to graduate with the new joint degree. Currently, there are about 80 total graduate students at UMCES, and about 90% are enrolled in MEES. The remaining 10% are in either the Graduate Program in Life Science at the University of Maryland, Baltimore or the graduate program in wildlife and fisheries and applied ecology at Frostburg State University. About 60% of MEES students pursue a master's degree, and the other 40% pursue doctoral degrees. All students complete a research thesis with any of about 70 faculty members who serve as graduate advisors and doctoral committee members. **Exhibit 6** shows the MEES concentrations and degrees awarded, usually about a dozen a year. Total degree output in MEES is fairly low, having produced fewer than 200 degrees from fiscal 2003 through 2014. Additionally, doctoral degree output seems unusually low in fiscal 2014, the first year of joint degrees, at only 2 awards, compared to an average of between 6 and 7 from fiscal 2003 through 2013.

Exhibit 6
MEES Program Outcomes
Fiscal 2003-2014

	Masters		Doctorate		
MEES Concentration	**2003-13**	**2014**	**2003-13**	**2014**	**Total**
Environmental Chemistry	20	1	13	1	35
Ecology	15	3	11	0	29
Environmental Molecular Biology/Biotechnology	4	0	4	0	8
Environmental Science	29	4	12	1	46
Fisheries Science	24	1	13	0	38
Oceanography	17	1	18	0	36
Total	**109**	**10**	**71**	**2**	**192**

MEES: Marine-Estuarine-Environmental Sciences

Note: The 2014 data is the first year in which a student could receive a joint MEES degree.

Source: University of Maryland Center for Environmental Science

The Road to Degree-granting Status

The MEES program is reflected in the 2014 mission statement of UMCES that called for UMCES to "Build on the Center's success in graduate education, including the leadership of the MEES program." While the MEES program was established in 1978 as an interdisciplinary and inter-institutional graduate program, it was intended to be only a UMCP degree. Even with the recent changes, the program remains administratively housed at UMCP for support services including admissions, registration, billing, and financial aid. Additionally, students have access to services provided by the UMCP Graduate School including assistantships and academic mentoring. The MEES director is considered a UMCP employee who has a half-time teaching appointment supported by UMCP and a half-time research appointment funded by UMCES.

In December 2010, the USM Board of Regents (BOR) requested UMCES to revise its mission statement to further elaborate on its role in graduate education. The statement was modified to include a provision that "The USM and UMCES are developing a path for the Center to assume an expanded role in graduate and professional education, including possible accreditation as a graduate degree-granting institution." The mission statement was submitted to MHEC in February 2011 for approval. MHEC approved UMCES's revised mission statement in January 2012, and the statement received approval from BOR in late 2012. There was no change to the mission statement for UMCES that was most recently reviewed in December 2015 by MHEC.

The final step was gaining approval from the General Assembly of Maryland, which was granted in Chapter 95 of 2013. While the authorization from the USM BOR was broad, the General Assembly only gave UMCES authority to award "joint graduate degrees and post baccalaureate certificate programs." Partners are limited to public senior higher education institutions. Current State regulations stipulate that joint degrees show both institutions' names appearing side by side on the diploma. In addition, the 2012 Strategic Plan for UMCES notes that accreditation would enable it to offer professional development courses for credit and certificates in order to reach important and underserved markets, thereby contributing to the development of Maryland's workforce and strengthening relationships with private- and public-sector employers. Currently, for MEES alumni for whom data is available, about 50% go into academia and 35% into public-sector jobs, leaving only 15% going to private industry. If UMCES created certificate programs for working environmental professionals who need additional training or specialized certification, it could make greater inroads in placing alumni in the private sector. In prior testimony on this issue, UMCES mentioned ecosystem restoration, applied environmental statistics, and marine biotechnology as potential programs it may offer.

The President should comment on any decisions regarding offering additional degrees at UMCES, such as those mentioned in prior testimony. The President should also comment on how UMCES is working to build relationships with the private sector.

Full Accreditation Decision Soon

The Middle States Commission on Higher Education (Middle States) is the regional accrediting body that reviews higher education institutions in Maryland and the Mid-Atlantic region. UMCES went through the exploration phase and application phase in 2013 with Middle States and prepared an *Accreditation Readiness Report* in November 2013. UMCES was then admitted to candidacy status, which allowed it to award degrees immediately. In fiscal 2015, UMCES underwent a self-study phase and received provisional accreditation. A final decision, expected to grant full accreditation status, will come at the next Middle States meeting in March 2016. Prior to these actions, UMCES had no relationship with Middle States. As is the case for all institutions, the accreditation readiness process is one-time only and full accreditation is reviewed only every five years thereafter. Although the punishment for loss of accreditation is getting cut off from federal Title IV financial aid, UMCES would lose no such aid as UMCP manages all federal aid programs. UMCES has stated in the past that maintaining accreditation will bolster its reputation and funding opportunities. UMCES has not yet received a Carnegie classification.

The President should comment on what grant funding UMCES has been able to apply for now that it has degree-granting authority.

2. Nearly a Century of Bay Research and Advocacy

In fiscal 2015, UMCES celebrated its ninetieth anniversary as the oldest State-supported marine laboratory on the east coast. This issue will look at two initiatives at UMCES to promote research, understanding, and conservation of the Chesapeake Bay and surrounding environmental systems.

Sea Grant Colleges

Since fiscal 2005, one of the main goals listed in the UMCES mission statement is to "Expand the role of UMCES and MSGC in environmental education and awareness of Maryland's school children and citizens." The National Sea Grant College Program was established by Congress in 1966 to be similar in scope and mission to land-grant colleges in the nineteenth century but with a focus on conservation of marine resources. NOAA has managed Sea Grants since its creation in 1970 and works with 33 member institutions across the United States and certain territories. The nearest neighboring Sea Grant institutions are the University of Delaware, which works with UMCES on MADE CLEAR, and Virginia's College of William and Mary, which also focuses primarily on the Chesapeake Bay. According to the NOAA website, UMCP is the designated Sea Grant College in Maryland, and MSGC website brands itself as located at the University of Maryland (as UMCP is generally marketed). UMCES reports that, while Sea Grant staff work in UMCP offices with UMCP email addresses, they are, in fact, part of UMCES.

Exhibit 7 shows the budget for Sea Grants within the UMCES budget. Overall, it amounts to only 4.9% of funding in the allowance, slightly lower than the 5.1% in the fiscal 2014 and 2015 budgets. Sea Grant funding is used for research and educational purposes very similar to the UMCES mission in general. For example, MSGC distributes research grants for competitive peer-reviewed work and smaller program development grants to address emerging needs. MSGC focuses on several topics in particular, including sustainable fisheries and aquaculture; resilient ecosystem processes and responses; and resilient communities and economies.

Exhibit 7
UMCES Budget Programs
Fiscal 2014-2017
($ in Thousands)

	Actual 2014	Actual 2015	Working 2016	Allowance 2017	% of Allowance
Horn Point Laboratory	$5,872	$6,142	$6,208	$6,329	27.8%
Central Administration	5,380	5,491	5,995	6,111	26.8%
Chesapeake Biological Laboratory	4,332	4,533	4,707	4,799	21.1%
Appalachian Laboratory	2,180	2,336	2,362	2,407	10.6%
Research Fleet Operations	1,113	1,172	1,172	1,195	5.2%
Sea Grant College	1,044	1,092	1,104	1,125	4.9%
Institute for Marine and Environmental Technology	768	797	805	821	3.6%
Total	**$20,690**	**$21,564**	**$22,353**	**$22,787**	**100.0%**

UMCES: University of Maryland Center for Environmental Science

Source: University of Maryland Center for Environmental Science

Given that UMCES works very closely with UMCP and UMCP's extension programs on regional environmental issues in existing research and there is already close collaboration with the MEES program, the lines of distinction between who administers MSGC is blurred. Consistent messaging about the operations of MSGC, especially in NOAA resources, would bring some clarity. Additionally, it appears that in comparing missions and goals of MSGC and UMCES the two are highly redundant as both promote public education and environmental research in Maryland and share personnel. This raises the issue of why UMCES and MSGC are distinct entities.

The President should comment on the marketing of MSGC and whose faculty is conducting the Sea Grant research and how the MSGC organization is distinct from UMCES as a whole.

Environmental Report Cards

Quantifying the health of the bay is a difficult task given the complexity of environmental modeling, but UMCES, with its mission to inform policymakers with predictive ecology, started issuing reports cards for the bay beginning in fiscal 2006. With seven health indicators, the report card looks to summarize a very large amount of information through data dashboards and illustrations. The first report was poor, as the bay received a D+. The two most recent report cards, covering calendar 2013 and 2014, place the bay at a C for "moderate health." The Patapsco River received an F, while the lower bay, in Virginia, received a B-.

UMCES and other State agencies such as the Department of Natural Resources, are currently working to widely disseminate environmental information relating to climate change and the health of the bay to policymakers, stakeholders, and the public at large through existing networks and social media. This includes annual reports and updates, like the bay's report card. More recently, UMCES has moved the bay report card from the UMCES website to a separate website, Eco Health Report Cards, to promote the development of environmental report cards for other nearby regions, such as the Delaware River and Long Island Sound, and international locations, such as the Great Barrier Reef. This will enhance UMCES outreach and data sharing by increasing collaboration with other institutions and scientists from other regions, but also deemphasizes the Maryland roots of UMCES and the bay report card.

The President should comment on how to manage the content for the new website and what UMCES is learning about delivering big data content and visualization through websites and other means.

Recommended Actions

1. Concur with Governor’s allowance.

Appendix 1

Current and Prior Year Budgets

Current and Prior Years Budgets
USM – Univeristy of Maryland Center for Environmental Science
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Other Unrestricted Fund	Total Unrestricted Fund	Restricted Fund	Total
Fiscal 2015							
Legislative Appropriation	$21,294	$965	$0	$6,393	$28,652	$18,115	$46,768
Deficiency Appropriation	0	0	0	0	$0	0	0
Cost Containment	-836	0	0	0	-$836	0	-836
Budget Amendments	139	0	0	500	$639	500	1,139
Reversions and Cancellations	0	0	0	-1,254	-1,254	-567	-1,821
Actual Expenditures	**$20,598**	**$965**	**$0**	**$5,638**	**$27,202**	**$18,048**	**$45,250**
Fiscal 2016							
Legislative Appropriation	$21,068	$1,006	$0	$7,146	$29,220	$18,115	$47,335
Budget Amendments	279	0	0	0	279	0	279
Working Appropriation	**$21,347**	**$1,006**	**$0**	**$7,146**	**$29,499**	**$18,115**	**$47,614**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The fiscal 2015 legislative appropriation for UMCES was reduced by $1.5 million. General funds decrease by about $0.7 million due to two rounds of across-the-board cost containment efforts by the Board of Public Works totaling $0.8 million almost entirely in deferred facility maintenance, which is offset by $0.1 million for cost-of-living adjustments.

Other unrestricted funds increased by $0.5 million to reflect anticipated operating fund spending on a facilities renewal project that was ultimately funded through bonds. Combined with vacant positions and reduced travel, a total of nearly $1.3 million in other unrestricted funds were canceled.

Restricted funds increased by $0.5 million due to an expected increase in research grants and contracts. Final research spending was within the original budget, so $0.6 million in restricted funds were canceled.

Fiscal 2016

To date, the legislative appropriation increased by about $0.3 million in general funds to restore a 2% pay reduction.

Appendix 2

Audit Findings

Audit Period for Last Audit:	December 2, 2011 – November 11, 2014
Issue Date:	May 2015
Number of Findings:	1
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: Required collection efforts were not performed for outstanding grants receivable.

Object/Fund Difference Report
USM – University of Maryland Center for Environmental Science

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	272.86	273.86	273.86	0.00	0%
02 Contractual	73.00	73.00	73.00	0.00	0%
Total Positions	**345.86**	**346.86**	**346.86**	**0.00**	**0%**
Objects					
01 Salaries and Wages	$ 29,300,827	$ 29,694,963	$ 30,479,338	$ 784,375	2.6%
02 Technical and Spec. Fees	321,713	645,500	711,024	65,524	10.2%
03 Communication	292,978	299,889	299,903	14	0%
04 Travel	957,376	777,904	777,904	0	0%
06 Fuel and Utilities	2,219,816	2,311,037	2,274,548	-36,489	-1.6%
07 Motor Vehicles	1,124,947	1,423,042	1,424,784	1,742	0.1%
08 Contractual Services	6,756,016	8,441,452	8,145,024	-296,428	-3.5%
09 Supplies and Materials	2,115,571	1,208,641	1,208,641	0	0%
11 Equipment – Additional	719,122	693,759	693,759	0	0%
12 Grants, Subsidies, and Contributions	58,350	104,997	104,997	0	0%
13 Fixed Charges	1,097,658	858,341	861,409	3,068	0.4%
14 Land and Structures	285,657	1,154,875	1,154,875	0	0%
Total Objects	**$ 45,250,031**	**$ 47,614,400**	**$ 48,136,206**	**$ 521,806**	**1.1%**
Funds					
40 Unrestricted Fund	$ 27,201,861	$ 29,499,031	$ 29,933,093	$ 434,062	1.5%
43 Restricted Fund	18,048,170	18,115,369	18,203,113	87,744	0.5%
Total Funds	**$ 45,250,031**	**$ 47,614,400**	**$ 48,136,206**	**$ 521,806**	**1.1%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Appendix 3

R30B36
University System of Maryland Office
University System of Maryland

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Funds	$21,070	$22,513	$29,630	$7,118	31.6%
Deficiencies and Reductions	0	179	-27	-207	
Adjusted General Fund	**$21,070**	**$22,692**	**$29,603**	**$6,911**	**30.5%**
Special Funds	988	1,055	1,150	95	9.0%
Adjusted Special Fund	**$988**	**$1,055**	**$1,150**	**$95**	**9.0%**
Other Unrestricted Funds	4,869	6,457	5,957	-500	-7.7%
Adjusted Other Unrestricted Fund	**$4,869**	**$6,457**	**$5,957**	**-$500**	**-7.7%**
Total Unrestricted Funds	26,928	30,024	36,737	6,712	22.4%
Deficiencies and Reductions	0	179	-27	-207	
Adjusted Total Unrestricted Funds	**$26,928**	**$30,204**	**$36,709**	**$6,506**	**21.5%**
Restricted Funds	2,467	2,500	2,500	0	
Adjusted Restricted Fund	**$2,467**	**$2,500**	**$2,500**	**$0**	**0.0%**
Adjusted Grand Total	**$29,395**	**$32,704**	**$39,209**	**$6,506**	**19.9%**

- A $16.5 million fiscal 2016 deficiency appropriation is provided to the University System of Maryland Office (USMO) to cover increases in health insurance at University System of Maryland (USM) institutions. The USMO portion is estimated to be $179,000.

- The general fund increases $6.9 million, or 30.5%, in fiscal 2017 after adjusting for the fiscal 2016 deficiency and a $27,381 across-the-board reduction in health insurance in fiscal 2017. It also includes $6.8 million in enhancement funds that will be allocated among institutions. The Higher Education Investment Fund increases $94,795, or 9.0%, in fiscal 2017.

- Overall growth in State funds is $7.0 million, 29.5%. However, after subtracting the enhancement funds not going to regional higher education centers, growth is only $2.2 million, 9.3%.

Note: Numbers may not sum to total due to rounding.

For further information contact: Sara J. Baker Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	110.00	110.00	110.00	0.00
Contractual FTESs	9.00	6.00	6.00	0.00
Total Personnel	**119.00**	**116.00**	**116.00**	**0.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	1.80	1.64%
Positions and Percentage Vacant as of 12/31/15	14.00	12.70%

- The allowance does not provide for any new regular positions.

Analysis in Brief

Major Trends

Maryland Community College Transfers: The number of Maryland community college transfers to USM institutions fell 5.9% to 11,182 in fiscal 2014 while transfers from other institutions *i.e.*, other Maryland public and private four-year institutions and those from out-of-state, rose 21.6%. This is primarily related to changes in how the University of Maryland University College reports its stateside enrollment.

University System of Maryland Regional Higher Education Centers: Over the past five years, enrollment at the Universities at Shady Grove increased 11.2%, with enrollments in Salisbury University's programs growing at the highest rate of 139.9%, or 31.9 full-time equivalent students. During the same time period, enrollment at the University System of Maryland at Hagerstown increased 10.0%.

Issues

Chancellor's Performance Goals and Criteria: Language in the 2015 *Joint Chairmen's Report* restricted funds until USMO submitted a report on the performance criteria and goals that will be used to evaluate the performance of the incoming Chancellor.

Quasi-endowment Fund: Chapter 266 of 2013 authorized the Board of Regents to establish a quasi-endowment fund to enhance advancement efforts at USM institutions. Unlike endowment funds in which the donor typically places restrictions on the use of funds, a quasi-endowment has no such restrictions placed on its use and, therefore, can be used to support fundraising efforts.

Recommended Actions

		Funds
1.	Add language to transfer enhancement funds.	
2.	Increase turnover expectancy.	$ 346,698
3.	Reduce health insurance deficiency.	3,200,000
	Total Reductions to Fiscal 2016 Deficiency Appropriation	**$ 3,200,000**
	Total Reductions to Allowance	**$ 346,698**

Operating Budget Analysis

Program Description

The University System of Maryland Office (USMO) is the staff agency to the University System of Maryland (USM) Board of Regents. The office advocates on behalf of the 11 institutions, 2 regional higher education centers, and 1 research institution; facilitates collaboration and efficiencies among institutions; and provides information to the public. USMO includes the Chancellor, executive, and administrative staff; and the central services of budget, accounting, auditing, information technology, capital planning, advancement, and public and government relations.

The mission of USMO is to provide leadership, planning, and resource management to advance the quality and accessibility of USM services and increase synergies among USM institutions.

The goals of USMO are to:

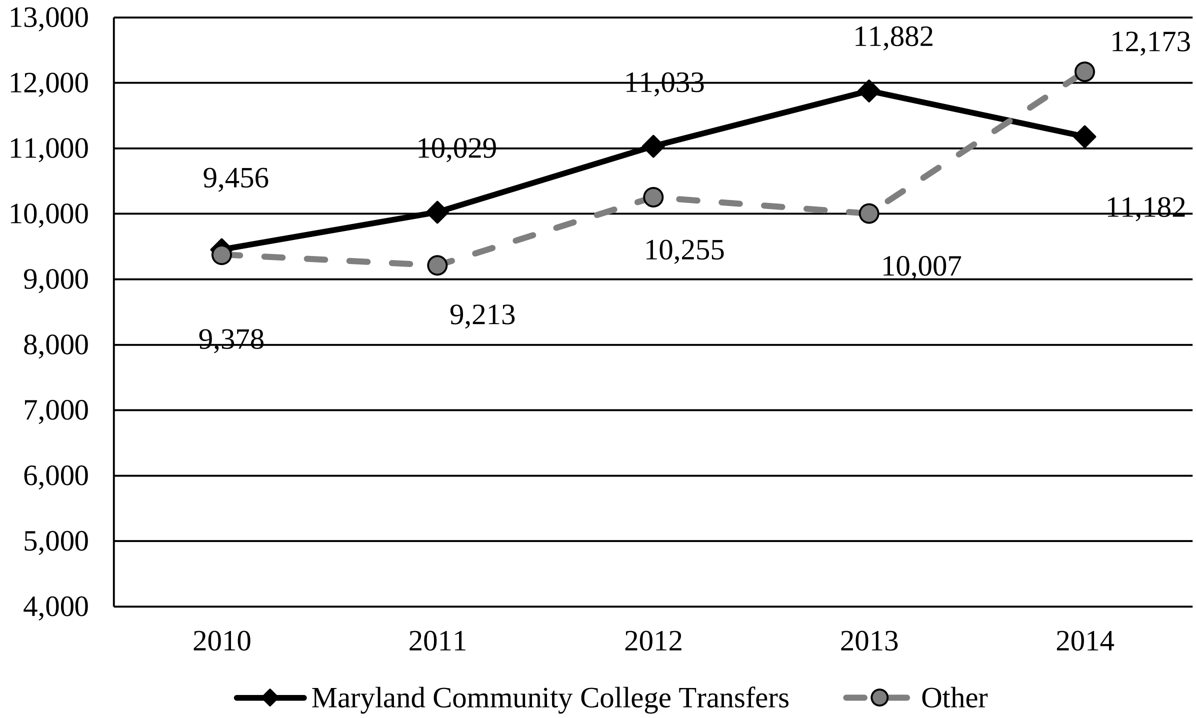
- promote access to USM institutions through cooperation;
- promote regional synergies;
- promote private support for USM; and
- provide financial stewardship to maximize the effectiveness and efficiency of USM operations.

Performance Analysis

1. Maryland Community College Transfers

USMO tracks the number of community college students transferring to USM institutions as a measure of meeting the goal of promoting access to USM institutions. Increasing the number of transfers is a key component to meeting the State's degree completion goal that 55% of Maryland residents ages 25 to 64 years old will hold at least an associate's degree by 2025. After steadily growing to a high of 11,882 in fiscal 2013, the number of Maryland community college transfers fell 5.9% to 11,182 in fiscal 2014, as shown in **Exhibit 1**. This can be attributed to the declining enrollment at the community colleges. Meanwhile the number of transfers from other institutions *i.e.*, other Maryland public and private four-year institutions (including transfers within USM) and those from out-of-state, jumped 21.6% to 12,173, surpassing the number of transfers from Maryland community colleges. This is primarily related to changes in how the University of Maryland University College (UMUC) reports its stateside enrollment due to revisions in federal reporting requirements. Previously, students enrolled in UMUC online courses managed by the European or Asian offices were not included in the stateside numbers. Now all online courses are administered by the Adelphi office; therefore, the students are included in the stateside numbers. In fiscal 2014, 23,355 students transferred to a USM institution, representing 19.4% of all undergraduate students.

Exhibit 1
Transfer Students to the University System of Maryland Institutions
Fiscal 2010-2014

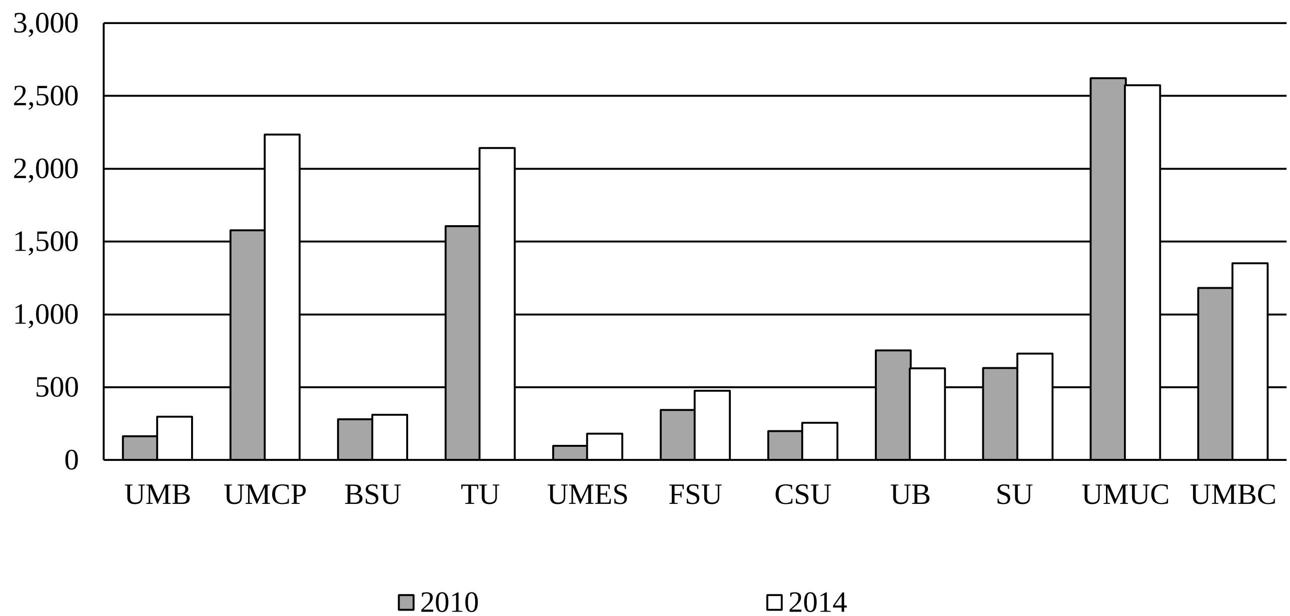


Note: Other includes transfers between public and private four-year institutions and those from out-of-state.

Source: *University System of Maryland Transfer Report*

Four community colleges accounted for 59.9% of transfers to USM institutions in fiscal 2014 – Montgomery College, Community College of Baltimore County, Anne Arundel Community College, and Prince George's Community College. Of the 11,182 community college transfers, 74.2% enrolled at one of four institutions – UMUC; the University of Maryland, College Park (UMCP); Towson University (TU), and the University of Maryland Baltimore County (UMBC) – as depicted in **Exhibit 2**. Between fiscal 2010 and 2014, two institutions – the University of Baltimore and UMUC – experienced declines of 16.3% and 1.8%, respectively, in transfers from community colleges.

Exhibit 2
Institutions Receiving Maryland Community College Transfer Students
Fiscal 2010 and 2014



BSU: Bowie State University
CSU: Coppin State University
FSU: Frostburg State University
SU: Salisbury University
TU: Towson University
UB: University of Baltimore
UMB: University of Maryland, Baltimore
UMBC: University of Maryland Baltimore County
UMCP: University of Maryland, College Park
UMES: University of Maryland Eastern Shore
UMUC: University of Maryland University College

Source: University System of Maryland

2. University System of Maryland Regional Higher Education Centers

USM provides access to its institutions through two regional higher education centers – the Universities at Shady Grove (USG) and the University System of Maryland at Hagerstown (USMH). Over the past five years, enrollment at USG increased 11.2%, or 249.2 full-time equivalent students (FTES), as shown in **Exhibit 3**. Enrollments in Salisbury University's programs grew at the highest rate of 139.9%, or 31.9 FTES, and UMBC had the largest increase in the number of students of 144.1 FTES. However, in the past two years, three institutions – TU, the University of Maryland Eastern Shore (UMES), and University of Baltimore – experienced declines in their enrollment of 38.4%, 13.6%, and 12.2%, respectively.

Exhibit 3
USM Regional Higher Education Centers
Full-time Equivalent Student Enrollment
Fiscal 2010-2015

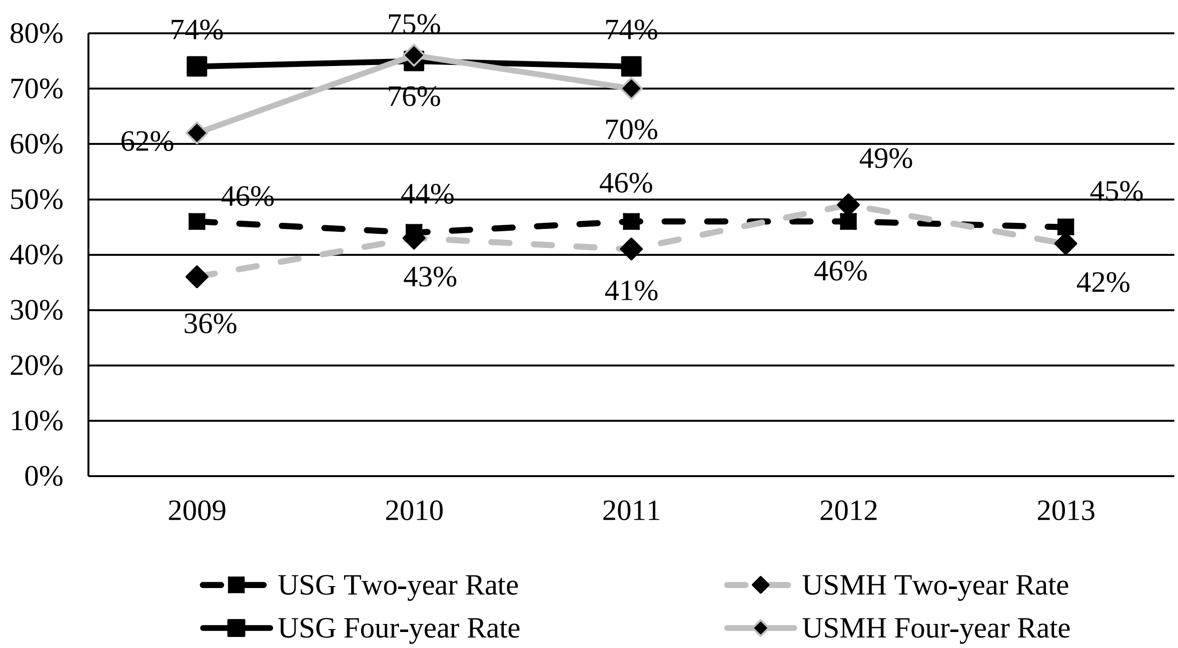
	2010	2011	2012	2013	2014	2015
Universities at Shady Grove						
Bowie State University	15.3	13.0	15.6	11.4	10.0	10.4
Salisbury University	22.8	23.1	19.5	28.3	45.0	54.7
Towson University	108.8	107.8	129	145.3	128.8	89.5
University of Baltimore	61.7	69.4	78.2	78.0	76.8	68.5
University of Maryland, Baltimore	371.9	418.2	428.2	420.3	409.3	458.8
University of Maryland Baltimore County	215.0	243.8	292.5	276.9	331.7	359.1
University of Maryland, College Park	995.8	994.4	999.5	990.0	1,022.7	1,030.3
University of Maryland Eastern Shore	66.7	74.8	79.3	78.9	77.2	68.2
University of Maryland University College	372.2	391.1	383.0	320.1	340.8	339.9
Total	**2,230.2**	**2,335.6**	**2,424.8**	**2,349.2**	**2,442.3**	**2,479.4**
University System of Maryland at Hagerstown						
Frostburg State University	193.6	180.9	160.1	182.9	179.5	186.6
Coppin State University	0.0	0.0	0	0.0	0.0	2.8
Salisbury University	28.5	29.0	33.9	32.5	30.7	41.6
Towson University	47.7	52.7	51.8	61.1	72.4	71.1
University of Maryland, College Park	1.1	7.2	9.0	10.6	9.0	3.0
University of Maryland University College	8.0	10.8	12.2	11.6	10.0	1.6
Total	**278.9**	**280.6**	**267.0**	**298.7**	**301.6**	**306.7**

Source: Universities of Shady Grove; University System of Maryland at Hagerstown

Enrollment at USMH grew 10%, or 27.8 FTES, over the past five years, primarily due to enrollments in TU programs increasing by 23.4 FTES. The decline in the enrollment in the UMCP program is expected as it was offering a doctorate in education leadership in collaboration with Frostburg State University, which is gradually taking over the program. Coppin State University (CSU) began offering two programs in fiscal 2015 – health information science and sports management – which had a total enrollment of 2.8 FTES. It should be noted that classes were originally scheduled for fall 2013 but were cancelled due to a lack of enrollment in either program. Additionally, while CSU received $50,000 of incentive funding from USMH to defray the cost of bringing programs to Hagerstown, it raises concerns if CSU should be expending resources to expand its programs off site given the current challenges it faces at its Baltimore campus.

USM started collecting data on the graduation rates at USG and USMH starting with the 2009 cohort. The two-year graduation at USG has remained fairly stable at around 45%, while that for USMH fluctuated from 36% with the 2009 cohort to 49% with the 2012 cohort, as illustrated in **Exhibit 4**. Both exceeded the average two-year graduation rate of 13% for Maryland community college transfers at USM institutions. The four-year graduation rate at USG is fairly stable around 74% while for USMH, the rate varied from a low of 62% with the 2009 cohort to a high of 76% with the 2010 cohort. However, the rate subsequently dropped to 70% with the subsequent cohort. In general, students at the centers are graduating at the same or higher rates than first-time, full-time new freshmen at USM institutions, for which the comparable six-year rate for the fall 2008 cohort was 62%.

Exhibit 4
Maryland Community College Transfers Graduation Rates
At USM Regional Higher Education Centers
Fall 2009-2013 Cohorts



USMH: University System of Maryland at Hagerstown
USG: Universities at Shady Grove

Note: Rates reflect students graduating at any University System of Maryland institution. Regional center students are and will continue to be included in the overall transfer numbers of the home institution.

Source: University System of Maryland, Transfer Students to the University System of Maryland

Fiscal 2016 Actions

Proposed Deficiency

A fiscal 2016 deficiency provides USMO with $16.5 million to cover an increase in health insurance costs at all USM institutions (see USM Overview for further discussion and allocation among the institutions). The shortfall in health insurance is attributable to how the State calculated retiree health insurance for higher education and not accurately reflecting more employees moving to more expensive health insurance plans. When calculating the amount of the deficiency, the Department of Budget and Management (DBM) included a half-year 3% increase in health insurance expenditures, totaling $3.2 million, assuming costs would increase January 1 due to open enrollment now being based on a calendar year. However, DBM had already anticipated this increase in the rates used to develop the fiscal 2016 budget. **Consequently, the January 1 increase is already reflected in the USM fiscal 2016 budget; therefore, the Department of Legislative Services (DLS) recommends reducing the fiscal 2016 deficiency by $3.2 million.**

Cost Containment

Cost containment measures in fiscal 2016 resulted in a 2%, or $0.5 million, reduction in the UMSO appropriation of which $188,262 was allocated to USG, $39,951 to USMH, and $7,684 to teachers' education. The remaining $240,575 was taken at USMO, which was met by reducing support to expand programs to non-USM regional higher education centers ($100,000), facilities renewal ($100,000), and general operating expenses ($40,575).

Proposed Budget

As shown in **Exhibit 5**, the general fund allowance for fiscal 2017 is 9.3%, $2.1 million, higher than in fiscal 2016 after including the fiscal 2016 deficiency and adjusting the fiscal 2017 allowance for the across-the-board reduction in health insurance and the allocation of enhancement funds not going to USG and USMH to the institutions. The Higher Education Investment Fund (HEIF) increases 9.0%, or $94,795, over fiscal 2016, resulting in an overall growth in State funds of 9.3%, $2.2 million.

The fiscal 2017 allowance includes $6.8 million in enhancement funding that the Chancellor will allocate to institutions (see USM Overview for allocation) of which $2.0 million will remain in the USMO budget with $1.75 million allocated to USG and $0.25 million to USMH. USG will use $750,000 of its enhancement funding to expand enrollment in high-demand programs, specifically the TU education programs and UMES Hospitality and Tourism Management and Construction Management programs. However, as previously discussed, enrollment in TU and UMES programs has declined over the past two years while enrollment increased in programs offered by other institutions. This may indicate the programs offered by TU and UMES are not in as high demand by those transferring to USG. **The Chancellor should comment on the allocation of $750,000 to USG for the purpose of expanding enrollment for high-demand programs offered by TU and UMES when enrollment in those programs has declined over the past two years.**

Exhibit 5
Proposed Budget
University System of Maryland Office
($ in Thousands)

	FY 15 Actual	FY 16 Adjusted	FY 17 Adjusted	FY 16-17 Change	% Change Prior Year
General Funds	$21,070	$22,513	$29,630		
Deficiencies		179			
Across-the-board Reductions			-27		
Allocation of Enhancement Funds			-4,800		
Total General Funds	**$21,070**	**$22,692**	**$24,803**	**$2,111**	**9.3%**
Higher Education Investment Funds	988	1,055	1,150	94,795	9.0%
Total State Funds	22,059	23,747	25,953	2,206	9.3%
Other Unrestricted Funds	4,869	6,457	5,957	-500	-7.7%
Total Unrestricted Funds	26,928	30,204	31,909	1,706	5.6%
Restricted Funds	2,467	2,500	2,500	0	0.0%
Total Funds	**$29,395**	**$32,704**	**$34,409**	**$1,706**	**5.2%**

Note: Fiscal 2016 general funds are adjusted to reflect the University System of Maryland Office estimated portion of the health insurance related deficiency. Fiscal 2017 is adjusted to reflect the across-the-board reduction and the allocation of enhancements funds to other institutions. Numbers may not sum to total due to rounding.

Source: Governor's Budget Books, Fiscal 2017, Department of Legislative Services

USG will also receive $1.0 million in enhancement funds to offer two new science, technology, engineering, and mathematics (STEM) programs – Translational Life Science Technology (UMBC) and Information Science (UMCP). USMH will receive $0.3 million to expand its program offerings by bringing the UMES Hospitality and Tourism program to Hagerstown. USG and USMH will distribute the $2.0 million of enhancement funds to TU, UMES, UMCP, and UMBC. The institutions are responsible for all aspects of program delivery from providing faculty to teach the courses to program quality. In addition, the institutions will only receive the funding for a few years until the program is up and running after which USG and USMH will then use the funds to bring other programs to their location. However, the institutions still bear the financial burden of providing the programs in which the tuition revenue may not cover the costs of operating a program at the center. **Therefore, DLS recommends that the $2.0 million in enhancement funds may not be allocated to USG and USMH but instead the funds be transferred directly to the institutions as follows:**

- **$1.0 million, with the Chancellor determining the allocation, to UMCP to offer the Information Science program and UMBC to offer the Translational Life Science Technology program at USG;**

- **$750,000, with the Chancellor determining the allocations, to institutions experiencing enrollment growth in their programs, and restricting the use of the funds until a report is submitted on the rationale for which programs are to receive funding; and**

- **$250,000 to UMES to offer its Hospitality and Tourism Management program at USMH.**

The allowance also provides for a salary increment, which is included in the DBM budget. The increments total $0.4 million of which the general fund portion is $0.3 million with the remaining $0.1 million to be funded from other current unrestricted and restricted revenues.

Issues

1. Chancellor's Performance Goals and Criteria

Language in the 2015 *Joint Chairmen's Report* restricted funds until USMO submitted a report on the performance criteria and goals that will be used to evaluate the performance of the incoming Chancellor. The USM Board of Regents (BOR) submitted a report on September 1, 2015, identifying seven goals and criteria that will be used to evaluate the performance of the new Chancellor:

- Meet with key internal USM constituencies and external stakeholders and launch a statewide listening tour.

  Criteria: Feedback, data gathered, and press/media coverage.

- Review the structure and organization of BOR committees and workgroups, USM Council of University System Presidents, Chancellor's Council, and USM office.

  Criteria: Information provided on review, decisions rendered, and recommendations made.

- Continue to advance the USM strategic plan, in particular meeting Maryland's 55% completion goal and strengthening Maryland's competitiveness in the innovation economy.

  Criteria: Retention rates, completion rates, STEM enrollments and graduates, and technology transfers and commercialization statistics.

- Significantly enhance and more effectively leverage USM economic development activities.

  Criteria: Regular reports from presidents involved with MPowering and other collaborations on progress.

- Implementation of Effectiveness and Efficiency (E&E) 2.0.

  Criteria: Annual report of E&E dashboard indicators.

- Fully support and enhance closing the achievement gap efforts.

  Criteria: Annual closing the achievement gap institutional reports.

- Build on the standing of USM as a leader by addressing critical issues in the capacity of the USM Chancellor and in affiliation with national associations and advocacy groups.

  Criteria: Major addresses, publications, service on national boards.

BOR may award a performance bonus up to 15% of the Chancellor's base annual salary, which for the first year could total $90,000, based on his performance on the above mentioned criteria.

2. Quasi-endowment Fund

Chapter 266 of 2013 authorized BOR to establish a quasi-endowment fund to enhance advancement efforts at USM institutions. Unlike endowment funds on which the donor typically places restrictions on the use of funds (*e.g.*, endow professorships or chair, or scholarships), a quasi-endowment has no such restrictions placed on its use and, therefore, can be used to support fundraising efforts.

State agencies are generally required to maintain all cash and investments with the State Treasurer who invests and manages all funds. These funds typically yield a lower rate of return since they are conservatively invested. The concept behind the quasi-endowment fund is that by investing in riskier investments, USM can yield a higher rate of return on the principal than it could through the Treasurer's Office. Quasi-endowment funds are generally invested similar to endowment funds, which are invested and managed to last in perpetuity with the interest being used to support advancement activities.

USM established the fund at the end of fiscal 2014 with a one-time $50.0 million transfer from the non-State supported portion if its fund balance – $40.0 million from the institutions and $10.0 million from USMO. Institutions' relative contributions to the fund were based on the size of their budgets compared to the total USM budget with the distribution of annual spendable income, as determined by BOR policy on spendable income (estimated to be $1.7 million annually based on a return of 4.25%), proportionate to their contributions, which is shown in **Exhibit 6**. In fiscal 2015, institutions used $1.7 million to fund a variety of activities including hiring advancement personnel, engaging fundraising consulting firms, establishing websites, sponsoring events, and providing more direct mailings to alumni. It should be noted that the CSU contribution to the fund was $750,198. However, due to nearly depleting its fund balance in order to cover operating expenses in the prior year, USMO provided the funds to CSU so they could participate in the endowment. CSU agreed to reimburse USMO once enrollment returned to more "historical" levels. It was agreed that CSU would pay back USMO within a five-year timeframe.

The $10.0 million contributed by USMO is projected to have an annual return of $425,000, which will be allocated to institutions based on a competitive grant process. Only one grant per institution will be considered each year with a maximum award of $75,000. The funds cannot be used to replace existing or budgeted funds. In fiscal 2016, eight institutions received awards, as shown in **Exhibit 7**.

Exhibit 6
Institutions Share and Project Income of Quasi-endowment

	Allocated Portion	Estimated Annual Income*
University of Maryland, Baltimore	$8,632,485	$366,881
University of Maryland, College Park	14,680,036	623,902
Bowie State University	893,895	37,990
Towson University	3,602,469	153,105
University of Maryland Eastern Shore	1,090,234	46,335
Frostburg State University	872,740	37,091
Coppin State University	750,198	31,883
University of Baltimore	1,044,125	44,375
Salisbury University	1,402,193	59,593
University of Maryland University College	3,555,207	151,096
University of Maryland Baltimore County	3,106,134	132,010
University of Maryland Center for Environmental Science	370,284	15,737
Total	**$40,000,000**	**$1,700,000**

*Projected annual income is based on a 4.25% rate of return on the investment, actual spendable income will be annually determined based on the Board of Regents policy on endowment fund spending rule.

Note: The University System Office's $10.0 million contribution is expected to generate approximately $0.4 million annually in spendable income to be spent at the direction of the Advancement Committee. Numbers may not sum to total due to rounding.

Source: University System of Maryland

Exhibit 7
Fiscal 2016 Grants

Institution	Award	Description
University of Maryland, Baltimore	$22,000	Phone survey, online estate planning seminar, personalized planned giving solicitations
University of Maryland, College Park	30,000	Endowed funds donor recognition website
Bowie State University	75,000	Grant writing initiative, matching gift campaign, alumni engagement and planned giving initiative
University of Maryland Eastern Shore	40,000	Stewardship videos and coordinator
Coppin State University	58,000	Continued support for faith-based and planned giving initiative
University of Baltimore	75,000	Planned giving position
Salisbury University	50,000	Continue partial funding of planned giving position
University of Maryland Center for Environmental Science	75,000	Continue funding assistant director for development position
Total	**$425,000**	

Source: University System of Maryland

Recommended Actions

1. Add the following language to the unrestricted fund appropriation:

    , provided that $1,750,000 of this appropriation made for the purpose of providing enhancement funds to the Universities at Shady Grove (USG) may not be spent for that purpose but may only be transferred as follow: $1,000,000 to the University of Maryland, College Park and the University of Maryland Baltimore County to offer new science, technology, engineering and math courses at USG, the allocation between the institutions to be determined by the Chancellor.

    Further provided that $750,000 of this appropriation made for the purpose of expanding enrollment of Towson University and University of Maryland Eastern Shore programs may not be spent for that purpose but may only be transferred to institutions to support programs at USG experiencing enrollment growth, with the allocation to be determined by the Chancellor. Funding may only be transferred after the Chancellor submits a report to the budget committees on the rationale for those programs to receive funds. The committees shall have 45 days to review and comment on the report prior to the transfer of the funding. Funds not expended for this restricted purpose may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund.

    Further provided that $250,000 of this appropriation made for the purpose of providing enhancement funds to the University System of Maryland, Hagerstown (USMH) may not be spent for that purpose but may only be transferred to the University of Maryland Eastern Shore to provide a new program at USMH. Funds not expended for this restricted purpose may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund.

    Explanation: The language transfers $1.75 million and $0.25 million in enhancement funds for USG and USMH, respectively, to the institutions that will be expanding their program offerings at the sites. The allowance provides the University System of Maryland $6.8 million in enhancement funds, which the Chancellor allocated to institutions to fund student completion initiatives. USG is to receive $1.0 million to support the University of Maryland, College Park and the University of Maryland Baltimore County in offering two new programs. USMH is to receive $0.3 million to support UMES in establishing a new program in Hagerstown. Since USG and USMH will be transferring these funds to the institutions who are responsible for all aspects of offering a program at the sites, the funds should go directly to those institutions providing the programs. In addition, the $750,000 allocated to USG to expand enrollment in high-demand programs offered by Towson University and UMES may only be transferred to institutions to support programs at USG experiencing enrollment growth and requires the Chancellor to submit a report on the rationale of why particular programs were selected.

Information Request	Author	Due Date
Report on institutions to receive enhancement funds to grow enrollment at the Universities at Shady Grove	University System of Maryland Office	45 days before the release of funds

		Amount Reduction	
2.	Increase turnover expectancy to 4.0%. The current vacancy rate is 12.7%, and the budgeted turnover expectancy is 1.64%, requiring 1.8 positions. As of January 1, 2016, the number of vacant positions is 14.0. A turnover of 4.0% requires 4.4 vacant positions.	$ 346,698	UF
3.	Reduce the general fund deficiency related to under budgeting of health insurance costs by $3.2 million. When calculating the deficiency, a 3% increase was included reflecting an assumption costs would increase January 1 due to open enrollment being based on a calendar year. Since this increase was anticipated and included in the health insurance rates when developing the fiscal 2016 budget, it is already reflected in the University System of Maryland budget.	3,200,000	UF
	Total Reductions to Fiscal 2016 Deficiency	**$ 3,200,000**	
	Total Unrestricted Fund Reductions to Allowance	**$ 346,698**	

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
University System of Maryland Office
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Other Unrestricted Fund	Total Unrestricted Fund	Restricted Fund	Total
Fiscal 2015							
Legislative Appropriation	$18,852	$3,933	$0	$5,718	$28,503	$3,595	$32,099
Deficiency Appropriation	0	0	0	0	0	0	0
Cost Containment	-855	0	0	0	-855	0	-855
Budget Amendments	3,073	-2,945	0	0	128	0	128
Reversions and Cancellations	0	0	0	-848	-848	-1,129	-1,977
Actual Expenditures	**$21,070**	**$988**	**$0**	**$4,869**	**$26,928**	**$2,467**	**$29,395**
Fiscal 2016							
Legislative Appropriation	$22,257	$1,055	$0	$5,718	$29,029	$3,595	$32,625
Budget Amendments	256	0	0	739	995	-1,095	-100
Working Appropriation	**$22,513**	**$1,055**	**$0**	**$6,457**	**$30,024**	**$2,500**	**$32,524**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The fiscal 2015 legislative appropriation for USMO decreased by $2.7 million. General funds increased by $2.2 million, which included $0.1 million related to a 2% cost-of-living adjustment and $2.9 million that was offset by a corresponding decrease in the special fund appropriation which is comprised of the HEIF. The increase was partially offset by $0.9 million in cost containment measures, which was met by a reduction in general operating expenses.

Cancellations of unrestricted funds amounted to $0.8 million due to expenditures for the Maryland Research and Education Network (MREN) (which provides network services to K-12, non-USM institutions, and community colleges) being less than anticipated.

Cancellation of restricted funds totaled $1.1 million due to contract and grant expenditures being less than anticipated.

Fiscal 2016

To date in fiscal 2016, the USMO legislative appropriation has been reduced by $0.1 million. General funds increased $0.3 million by a budget amendment to offset a 2% pay reduction. Other unrestricted funds increased $0.7 million due to a $0.5 million transfer from fund balance related to a performance based contractual stipulation with the outgoing Chancellor, $0.2 million from institutions for overhead, and $89,104 for MREN.

Current restricted funds decreased $1.1 million due to aligning federal and private contracts and grants with current projections.

Appendix 2

Audit Findings

Audit Period for Last Audit:	March 31, 2011 – June 30, 2014
Issue Date:	May 2015
Number of Findings:	3
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: Network workstations and servers were not sufficiently protected against malware.

Finding 2: The USMO network was not adequately secured from untrusted traffic.

Finding 3: USMO did not ensure compliance with certain reporting requirements intended to help it monitor affiliated foundations as detailed in the BOR Policy on Affiliated Foundations.

*Bold denotes item repeated in full or part from preceding audit report.

Object/Fund Difference Report
University System of Maryland Office

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	110.00	110.00	110.00	0.00	0%
02 Contractual	9.00	6.00	6.00	0.00	0%
Total Positions	**119.00**	**116.00**	**116.00**	**0.00**	**0%**
Objects					
01 Salaries and Wages	$ 14,839,091	$ 16,303,163	$ 16,727,188	$ 424,025	2.6%
02 Technical and Spec. Fees	27,133	10,000	20,921	10,921	109.2%
03 Communication	561,736	640,738	909,997	269,259	42.0%
04 Travel	168,663	178,646	178,646	0	0%
07 Motor Vehicles	4,728	8,610	8,620	10	0.1%
08 Contractual Services	11,996,557	13,731,012	19,623,536	5,892,524	42.9%
09 Supplies and Materials	198,900	170,961	170,961	0	0%
11 Equipment – Additional	3,576	30,082	30,082	0	0%
12 Grants, Subsidies, and Contributions	925,384	507,515	507,515	0	0%
13 Fixed Charges	383,738	407,224	422,970	15,746	3.9%
14 Land and Structures	285,480	536,405	636,405	100,000	18.6%
Total Objects	**$ 29,394,986**	**$ 32,524,356**	**$ 39,236,841**	**$ 6,712,485**	**20.6%**
Funds					
40 Unrestricted Fund	$ 26,928,194	$ 30,024,356	$ 36,736,841	$ 6,712,485	22.4%
43 Restricted Fund	2,466,792	2,500,000	2,500,000	0	0%
Total Funds	**$ 29,394,986**	**$ 32,524,356**	**$ 39,236,841**	**$ 6,712,485**	**20.6%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions

Appendix 4

Fiscal Summary
University System of Maryland Office

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
04 Academic Support	$ 10,659,162	$ 11,427,696	$ 11,435,319	$ 7,623	0.1%
06 Institutional Support	18,735,824	21,096,660	27,801,522	6,704,862	31.8%
Total Expenditures	**$ 29,394,986**	**$ 32,524,356**	**$ 39,236,841**	**$ 6,712,485**	**20.6%**
Unrestricted Fund	$ 26,928,194	$ 30,024,356	$ 36,736,841	$ 6,712,485	22.4%
Restricted Fund	2,466,792	2,500,000	2,500,000	0	0%
Total Appropriations	**$ 29,394,986**	**$ 32,524,356**	**$ 39,236,841**	**$ 6,712,485**	**20.6%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions

R60H
College Savings Plans of Maryland

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
Nonbudgeted Fund	$2,703	$3,594	$3,773	$178	5.0%
Adjusted Nonbudgeted Fund	**$2,703**	**$3,594**	**$3,773**	**$178**	**5.0%**
Adjusted Grand Total	**$2,703**	**$3,594**	**$3,773**	**$178**	**5.0%**

- The College Savings Plan of Maryland (CSPM) expects expenditures to increase $0.2 million, or 5.0%, in fiscal 2017.

- As a nonbudgeted agency, CSPM was not part of cost containment actions in fiscal 2015 or 2016 and is not part of health insurance reductions or personnel increments in fiscal 2017.

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	21.00	21.00	21.00	0.00
Contractual FTEs	0.20	0.20	0.20	0.00
Total Personnel	**21.20**	**21.20**	**21.20**	**0.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions		0.00	0.00%	
Positions and Percentage Vacant as of 12/31/15		7.00	33.00%	

Note: Numbers may not sum to total due to rounding.

For further information contact: Garret T. Halbach Phone: (410) 946-5530

Analysis in Brief

Major Trends

Continued Growth in Accounts and Unique Holders: The total number of accounts grew 6.5% to 247,504 in fiscal 2015, of which 64.0% were unique account holders. The share of unique account holders has grown about 10 percentage points over the past decade.

Decline in Enrollment and Use of Trust: Enrollment in the trust declined by 2.5% in fiscal 2015, the first decrease since the fiscal 2007 decline of 5.4%. Additionally, in fiscal 2015, for the second time in five years, the number of students attending a Maryland public institution using the trust decreased.

Actuarial Surplus Still Large in the Maryland Prepaid College Trust: The actuarial surplus in the trust significantly increased from $2.5 million in fiscal 2010 to $294.7 million in fiscal 2015, and the trust was 136.0% funded. This is lower than the fiscal 2014 143.0% funding due to a decline in the overall return, falling from 18.5% in fiscal 2014 to 2.4% in fiscal 2015.

Issues

Few Families Participate in 529 Plans: According to the limited available research, families that have a 529 plan have a median income about three times higher than those who did not participate in a plan. This holds true in Maryland as the highest participation rates occur in those counties with higher median incomes. This issue will look at how CSPM is adapting its marketing strategies to reach more Marylanders.

CSPM May Expand for ABLE Program: A workgroup recently submitted legislative recommendations for Maryland to implement the federal Achieving a Better Life Experience savings program. If legislation is passed in Maryland, this would dramatically expand the mission and services of CSPM.

Differential Tuition Issue Resolved: In fall 2015, the University of Maryland, College Park implemented differential tuition for certain students in three academic programs. After consultation, CSPM determined it would cover this new charge for students as it does regular tuition and fees.

Leadership Turnover and Vacancies: In fiscal 2016, CSPM has had 2 interim executive directors and 7 total vacancies out of only 20 positions. Limited personnel and institutional continuity present challenges for effectively managing the plan, expanding efforts, or launching new initiatives.

Recommended Actions

1. Nonbudgeted.

Updates

Investment Plan Again Recognized for Strong Performance: For the fourth year in a row, the Maryland College Investment Plan (MCIP) received a "Gold" rating from Morningstar Investors for demonstrating superior performance on a risk-adjusted basis against peer groups. The MCIP is one of only four state plans recognized nationwide in calendar 2015.

Operating Budget Analysis

Program Description

The College Savings Plans of Maryland (CSPM) offers the Maryland Prepaid College Trust (MPCT) and the Maryland College Investment Plan (MCIP), providing two affordable and flexible options to encourage saving for a child's or adult's future college education. CSPM is an independent agency, originally established during the 1997 session (Maryland Annotated Code, Education Article, Section 18-1901 through 18-1916 and 18-19A-01 through 18-19A-07). A 10-member board administers the trust and oversees the administration of the plans. Five board members serve by virtue of the State office they hold including the State Treasurer, the State Comptroller, the Secretary of the Maryland Higher Education Commission, the State Superintendent of Schools, and the Chancellor of the University System of Maryland. The Governor appoints the 5 remaining members.

Both plans are also known as 529 plans after the section in the Internal Revenue Code (IRC) that permits states to establish and administer tax-deferred college savings plans. Both plans offer federal and State tax benefits including:

- federal and State taxes deferred on growth;
- federal and State tax-free earnings, provided funds are used for qualified higher education expenses; and
- State income tax deduction of contributions to one or both plans up to $2,500 per taxpayer annually per account or beneficiary. Excess annual contributions over $2,500 may be carried forward and deducted in future years.

As of June 30, 2015, the combined assets of both plans were about $5.2 billion.

Maryland Prepaid College Trust

The MPCT allows participants to lock in a current price for future college tuition benefits and is backed by a Maryland legislative guarantee. This guarantee requires the Governor, in instances when the current MPCT prepaid contract obligations exceed the market value of its assets, to include in the annual budget an appropriation in the amount needed to cover the shortfall. The appropriation would then require approval of the General Assembly. Furthermore, if the State appropriation is less than the amount needed for the MPCT to meet its current obligations, the CSPM board may adjust the terms of subsequent or current contracts to ensure continued actuarial soundness for the MPCT. To date, this plan has been adequately funded and the legislative guarantee has never needed support through the State's operating budget.

Participation is open to Maryland and District of Columbia residents. Additionally, people living out-of-state but applying for a child residing in Maryland or the District of Columbia are eligible to participate in the MPCT. Enrollment is open to children from newborns through grade 12, but an account must be opened for at least three years before the payment of benefits. The enrollment period is generally from December to early or mid-April, but newborns may be enrolled year round until their first birthday.

Participants enter into a contract with the MPCT for payment of tuition and mandatory fees for a specified amount of semesters or years of college. Account holders can purchase tuition plans for one or two years of community college; one semester or one to five years of a four-year university; or two years of community college and two years of a four-year university. For a child enrolled in a Maryland public college, the MPCT will pay up to the full in-state or in-county tuition and mandatory fees or a minimum benefit, whichever is greater – either to the college or reimbursed to the account holder upon request. If a child attends an eligible private or out-of-state college, the MPCT will pay up to the weighted average tuition and mandatory fees of Maryland public colleges or a minimum benefit, whichever is greater. The minimum benefit equals the amount of payments to the MPCT plus a reasonable rate of return that is tied to a treasury index. This rate of return has been zero since October 2008. There are four payment options: lump sum, annual, five-year monthly, and extended monthly. For example, the contract price for an infant enrolled in the four-year university plan during the current enrollment period is

- lump sum = $44,300;
- annual = $4,372 (17 payments);
- five-year monthly = $888; or
- extended monthly = $394 (204 payments).

During the 2014-2015 enrollment period, there were approximately 2,200 new enrollments, an increase over the prior year but still slightly below the 2,350 new enrollments during the 2010-2011 enrollment period. Infants comprised the largest group at 16% of new enrollments, and the four-year university plan remained the most popular enrollment option with 28% of new enrollments choosing this option. For the fall 2015 semester, of the 10,184 students eligible to use benefits, approximately 48%, or 4,828 students, claimed them. Of those, 41% are attending a Maryland public institution, compared to 40% for the fall 2011 semester, while the rest attended a private or out-of-state college. The current enrollment period runs from December 1, 2015, through April 20, 2016.

As of June 30, 2015, the investments of the MPCT were valued at $924 million.

Maryland College Investment Plan

The MCIP, which functions similarly to a 401(k) plan, provides more flexibility than the MPCT in that participants choose how much they wish to invest. Funds from MCIP accounts may be used at any eligible college or trade school. Participants select among eight enrollment-based and six fixed investment portfolios, managed by T. Rowe Price. Participants are required to invest a minimum of $250 to open an account, unless they participate with automatic monthly contributions of as little as $25 per month. MCIP participants directly bear the investment risk of the investment option(s) they select when opening their accounts. Effective in fiscal 2015, a new federal law allows participants to move or transfer funds from one investment portfolio to another up to twice per calendar year. The MCIP began in December 2001 and is open to children or adults of any age. Enrollment is open year round, and investors may choose how much and how often they wish to contribute. Contributions and investment earnings are available for qualified higher education expenses including tuition, fees, room and board, and other expenses defined by Section 529 of the IRC. A federal change in December 2015, made retroactive to January 1, 2015, makes personal computers and related peripherals a new category of eligible educational expenses. This plan is not guaranteed by the State.

Approximately 42% of all new beneficiaries enrolled during fiscal 2015 were four years old or younger, and approximately 62% of beneficiaries were nine years old or younger. Trends in investment selections show the enrollment-based portfolios, in which investment mixes automatically adjust to be more conservative over time, continue to be a popular choice with Portfolio 2033 comprising 17% of the new accounts.

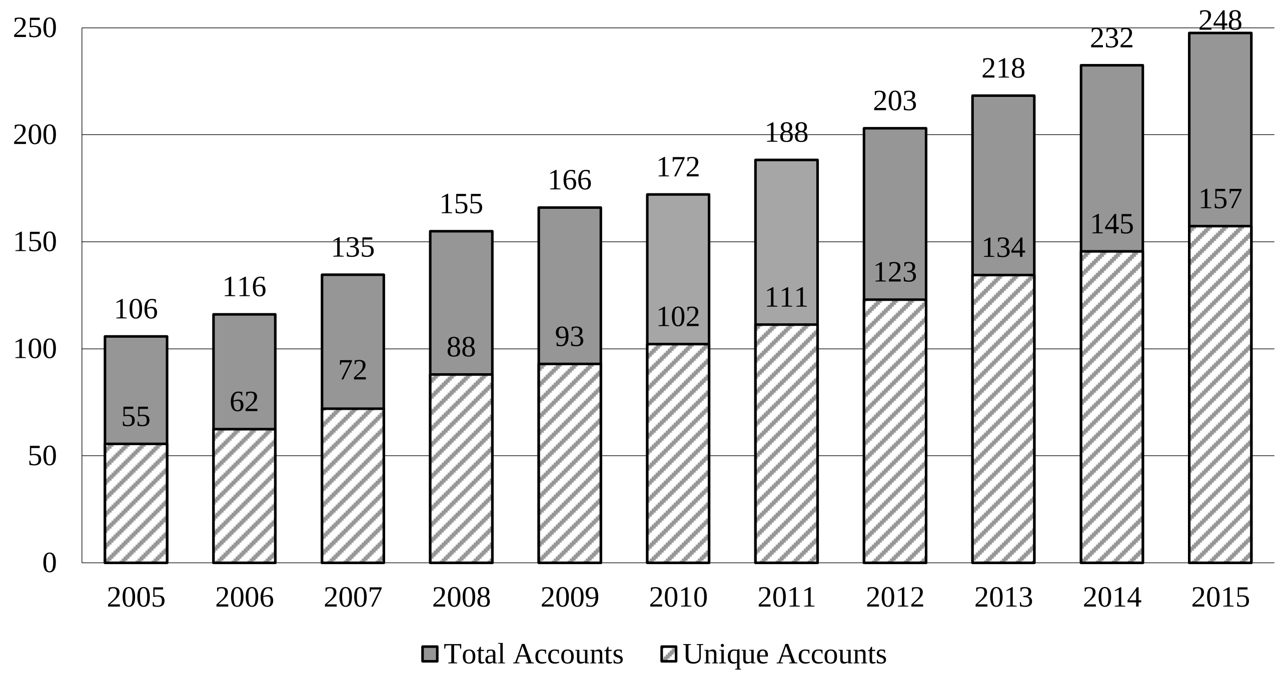
As of June 30, 2015, MCIP investments equaled $4.2 billion.

Performance Analysis: Managing for Results

1. Continued Growth in Accounts and Unique Holders

A goal of CSPM is to create and maintain statewide awareness of the plan, which is reflected in the total number of accounts and the number of unique account holders as shown in **Exhibit 1**. Overall, since fiscal 2005, the total number of accounts has increased over 130.0%, or over 140,000 accounts. The effects of the recent economic recession can be seen as the growth of accounts fell from nearly 16.0% in fiscal 2007 to under 4.0% in fiscal 2010. An improving economy led to growth of about 8.0% to 9.0% in fiscal years 2011 through 2013. Growth in accounts in fiscal 2014 and 2015 slowed to 6.5%, but even so it illustrates that more people have had money to put aside for their children's education since the recession ended. CSPM forecasts growth rates slowing further in fiscal 2016 and 2017 to 5.0% and 5.8%, respectively. Other than the low growth rate in fiscal 2010, these would be the lowest growth rates since at least 2005.

Exhibit 1
Total Accounts and Unique Accounts
Fiscal 2005-2015
(In Thousands)



Source: Department of Budget and Management; College Savings Plan of Maryland

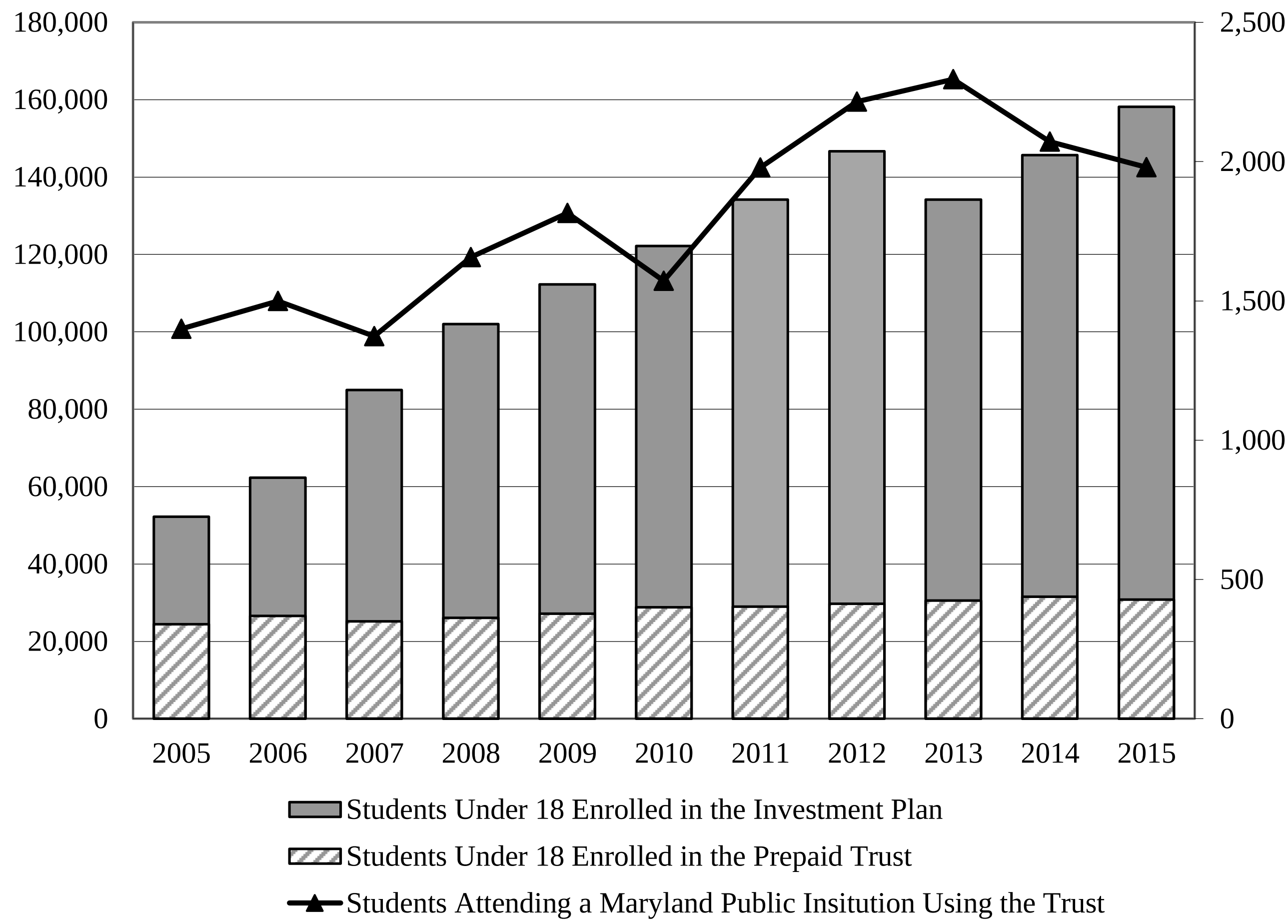
The number of unique account holders has grown over 180.0%, or over 100,000, since fiscal 2005. The percent of unique account holders out of total accounts has grown from 52.5% in fiscal 2005 to 63.5% in fiscal 2014, suggesting that while more Marylanders are participating in the State's 529 plans, more are opting for using only one type of plan for college savings rather than both.

2. Decline in Enrollment and Use of Trust

CSPM offers families many options to save for their children's college education and reduce reliance on loans to pay for college expenses. **Exhibit 2** shows the number of students under the age of 18 enrolled in the prepaid trust and investment plan and students attending Maryland public institutions using the trust to pay for college. Enrollments in the prepaid trust have grown at a moderate rate averaging 4.0% since fiscal 2005. The growth rate slowed considerably from 5.9% in fiscal 2010 to 0.7% in fiscal 2011. Moderate growth from fiscal 2012 through 2014 drove enrollment to an all-time high of almost 31,600 students in fiscal 2014, but fiscal 2015 declined 2.5% to about 30,800 students. This was due to CSPM removing accounts with zero balances, which had not been done in many years.

Meanwhile, enrollments in the investment plan continue to greatly outpace that of the trust, increasing over 200.0%, or about 106,000 enrollments, since fiscal 2005, indicating participants' preference for the flexibility afforded by the investment plan. It is not clear why enrollments in the investment plan actually declined in fiscal 2013 by 8.5%, as it had grown by at least 8.0% in every year before. Enrollments resumed their growth in fiscal 2014 from the lower base. Fiscal 2016 and 2017 have projected growth of at least 7.0%. Overall, the gap between enrollments in the MCIP versus the MPCT has grown from less than 30,000 students in fiscal 2005 to almost 130,000 students in fiscal 2015. This means while in 2005 there were about 2 investment plan students for every trust student, the ratio has increased to about 5 to 1 in fiscal 2015.

Exhibit 2
Students Enrolled in Plans and Using the Prepaid College Trust
Fiscal 2005-2015



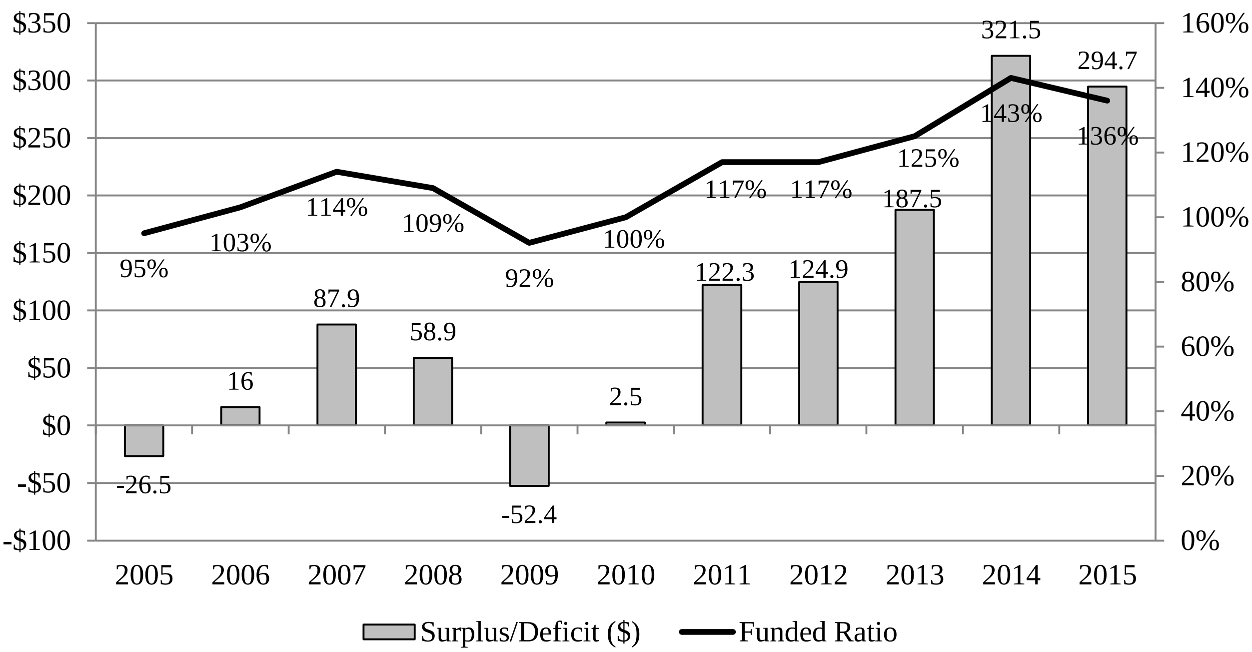
Source: Department of Budget and Management; College Savings Plan of Maryland

The number of students attending Maryland public institutions using the MPCT has fluctuated over the past decade, with notable decreases in fiscal 2007, 2010, 2014, and 2015. In fall 2015 (fiscal 2016), only 1,980 of 4,828 students who claimed tuition benefits attended a Maryland public institution, indicating more students were attending private or out-of-state institutions. CSPM projects an increase in the use of the MPCT by attendees of Maryland public institutions in fiscal 2016 and 2017 (not shown), but these years would still remain below the fiscal 2013 rates.

3. Actuarial Surplus Still Large in the Maryland Prepaid College Trust

The actuarial surpluses and deficits for MPCT from fiscal 2005 to 2015 are shown in **Exhibit 3**. The surplus significantly increased from $2.5 million in fiscal 2010 to $321.5 million in fiscal 2014, before declining slightly to $294.7 million in fiscal 2015. While the MPCT had annual returns of 10.7% in fiscal 2013 and 18.5% in fiscal 2014, it reached only 2.4% in fiscal 2015. This was the second lowest return of the past 5 years. In 9 of the past 10 years, the trust has been 100.0% funded or greater due to overall strong performance of financial markets, despite the decline at the beginning of the Great Recession in fiscal 2009.

Exhibit 3
MPCT Actuarial Surplus/Deficit as of June 30, 2005-2015
($ in Millions)



MPCT: Maryland Prepaid College Trust

Source: College Savings Plan of Maryland

According to statute, if the surplus is 30%, *e.g.*, 130% funded or more, then the CSPM board may provide a rebate, or dividend, to account holders. Investment declines in the trust have been somewhat tempered by the lower than projected increases in tuition and mandatory fees at the University System of Maryland from fiscal 2009 through 2014. Over these years, the average increase in tuition and fees at Maryland public colleges, except for St. Mary's College of Maryland, was only 2.9% versus a projected weighted tuition and fee increase of 7.0% assumption made by the CSPM board. In fiscal 2017, tuition and fees are expected to grow only 2.2% at all of Maryland's four-year institutions. Overall, Maryland compares favorably to other state prepaid plans, as during the recent recession some states actually closed new membership to plans or even phased out plans whereas Maryland's 529 plans have remained very robust.

During fiscal 2015 and 2016, the CSPM board did not provide any rebate to plan investors. Although 2.0% tuition increases were announced in January 2016 at public Maryland universities, this decision reflects caution in the face of financial market volatility that began in fiscal 2016. Because of this, CSPM has revised its expected investment returns from 7.65% to 7.0% in fiscal 2016 and beyond. **The CSPM director should discuss the reasonableness of continuing to assume 6.0% to 7.0% annual growth in tuition and fees given recent tuition moderation in Maryland.**

Current Budget Overview

CSPM revenues from the prepaid trust consist of enrollment fees and other fees occasionally charged depending on the activity of the account holder. The enrollment fee structure is based on the method used to open an account – $75 for using the paper form; $50 for online enrollment; and $20 if purchasing an additional account or if rolling funds over from the investment plan. In addition, the trust charges 2.5% of all contract payments and a $4 payment processing fee per scheduled payment to cover operating expenses. As shown in **Exhibit 4**, fiscal 2017 revenues from trust enrollment fees are expected to be flat when compared to fiscal 2016, although still 13.5% over fiscal 2015. Revenues budgeted for fiscal 2017 are based on a continued goal of 2,000 new enrollments and do not include estimates for early payments from account holders, which led to higher trust revenue in fiscal 2016.

Exhibit 4
College Savings Plans of Maryland Revenues and Expenditures
Fiscal 2015-2017

	2015	Estimated 2016	% Increase 2015-16	Estimated 2017	% Increase 2016-17
Revenues					
Prepaid Trust					
Enrollment Fees	$1,395,391	$1,583,200	13.5%	$1,583,200	0.0%
Total	**$1,395,391**	**$1,583,200**	**13.5%**	**$1,583,200**	**0.0%**

	2015	Estimated 2016	% Increase 2015-16	Estimated 2017	% Increase 2016-17
Investment Plan					
Program Contributions	3,090,282	3,184,000		2,931,987	
Total	**$3,090,282**	**$3,184,000**	**3.0%**	**$2,931,987**	**-7.9%**
Total Revenues	**$4,485,673**	**$4,767,200**	**6.3%**	**$4,515,187**	**-5.3%**
Expenditures					
Salaries, Wages, and Fringe Benefits	$1,376,187	$1,970,701	**43.2%**	$1,955,585	-0.8%
Communication	115,749	138,247	**19.4%**	119,951	-13.2%
Travel	18,265	20,000	**9.5%**	20,000	0.0%
Fiscal and Contractual Services	650,610	732,000	**12.5%**	1,039,824	42.1%
Marketing	217,669	279,800	**28.5%**	288,194	3.0%
Supplies and Materials	31,901	40,685	**27.5%**	40,000	-1.7%
Office Equipment	19,142	50,000	**161.2%**	50,000	0.0%
Fixed Charges	246,758	247,289	**0.2%**	188,977	-23.6%
Software License Fee	26,281	115,500	**339.5%**	70,000	-39.4%
Total Expenditures	**$2,702,562**	**$3,594,222**	**33.0%**	**$3,772,531**	**5.0%**
Excess Revenues	**$1,783,111**	**$1,172,978**	**-34.2%**	**$742,656**	**-36.7%**

Note: The prepaid trust and the investment plan each have a fund for excess revenues. The revenues may only be used to benefit the families that participate in the plans. The salaries line also includes technical and special fees.

Source: College Savings Plans of Maryland

Revenues from the investment plan are projected to increase 3.0% in fiscal 2016 but decrease 7.9% in fiscal 2017. Revenues in the first half of fiscal 2015 were based on the old contract, which required T. Rowe Price to pay CSPM an annual amount equal to the greater of (1) $636,000 or (2) 0.04% of the average monthly net assets of the plan when assets are between $750.0 million and $1.0 billion and an additional 0.06% of average plan assets greater than $1.0 billion. In fiscal 2015, the plan's assets easily exceeded $2.0 billion resulting in total payment of $3.1 million. Total revenues from both plans are expected to be $4.5 million in 2017, a decrease of 5.3% over fiscal 2016.

Effective January 2015, CSPM entered into a new contract which required T. Rowe Price to pay CSPM 0.07% of average net monthly assets with a minimum annual payment of $2 million. The program fee, which is assessed to plan participants, also decreases from 0.2% of assets per year to 0.11% for the Global Equity Market Index Portfolio and 0.13% for all other portfolios. This is a significant fee reduction that makes the CSPM plan more favorable for its investors, who may expect that as plan assets increase, fees for investors should decrease. T. Rowe Price is willing to accept this deal because its revenue will increase as CSPM assets grow in the long run. These actions result in the 7.9% decrease in program contributions shown in Exhibit 4. As fiscal 2015 was a peak year for the investment plan, MCIP revenue was very high. In fiscal 2016, entirely under the new fee contract, fee revenue was projected to increase as plan assets initially remained at record highs, even though the fee on the overall plan assets declined from 0.1% to 0.07% for plan assets over $1 billion. However, the market information and fee structure used in preparation for the fiscal 2016 budget (fall 2014) both ended up being inaccurate. The fee structure changed, as mentioned, and sudden financial market downturns now mean CSPM will almost certainly not hit its revenue target for MCIP fees in fiscal 2016. As market volatility is expected for the near future, CSPM is now budgeting a more cautious fiscal 2017.

On the expenditure side, in fiscal 2016, there are several large changes from the prior year. Salaries and wages increase nearly $600,000, or 43.2%, partly due to filling 2 new positions. These include a new procurement specialist and another administrator to improve customer service. While these positions were added in fiscal 2016, the timing is largely coincidental rather than tied to any particular initiative at CSPM. At the same time, several vacancies arose that greatly reduced salaries in fiscal 2015. This will be discussed in Issue 4. For fiscal 2017, salaries and wages are expected to decline 0.8%.

Fiscal and contractual services jump over 42%, or over $0.3 million, in fiscal 2017, which includes actuarial services, independent audits, banking, financial advisors, database host, records administration, and disaster recovery. This growth is due to CSPM planning to hire a project manager for procurement of new information technology (IT) services to manage account holder records. Also, the program manager contract with T. Rowe Price expires in fiscal 2017. Fixed charges decline almost 24%, or about $58,000, due to reducing liability insurance that is actually covered by the State. The CSPM office rent contract with the Department of General Services will expire soon, and its renewal or relocation will be an important consideration for CSPM leadership in fiscal 2017.

IT maintenance and support are significant expenditures for CSPM as it needs extremely reliable software and disaster recovery tools to manage financial assets. Software license fees decline about 39%, or nearly $50,000, due to a new contract for network services with the Department of the Treasury. This will review all software contracts at CSPM, looking for opportunities for consolidation to reduce costs. Changes in all other budget categories are generally small or flat and reflect nearly constant costs assumed by CSPM in budgeting the next year.

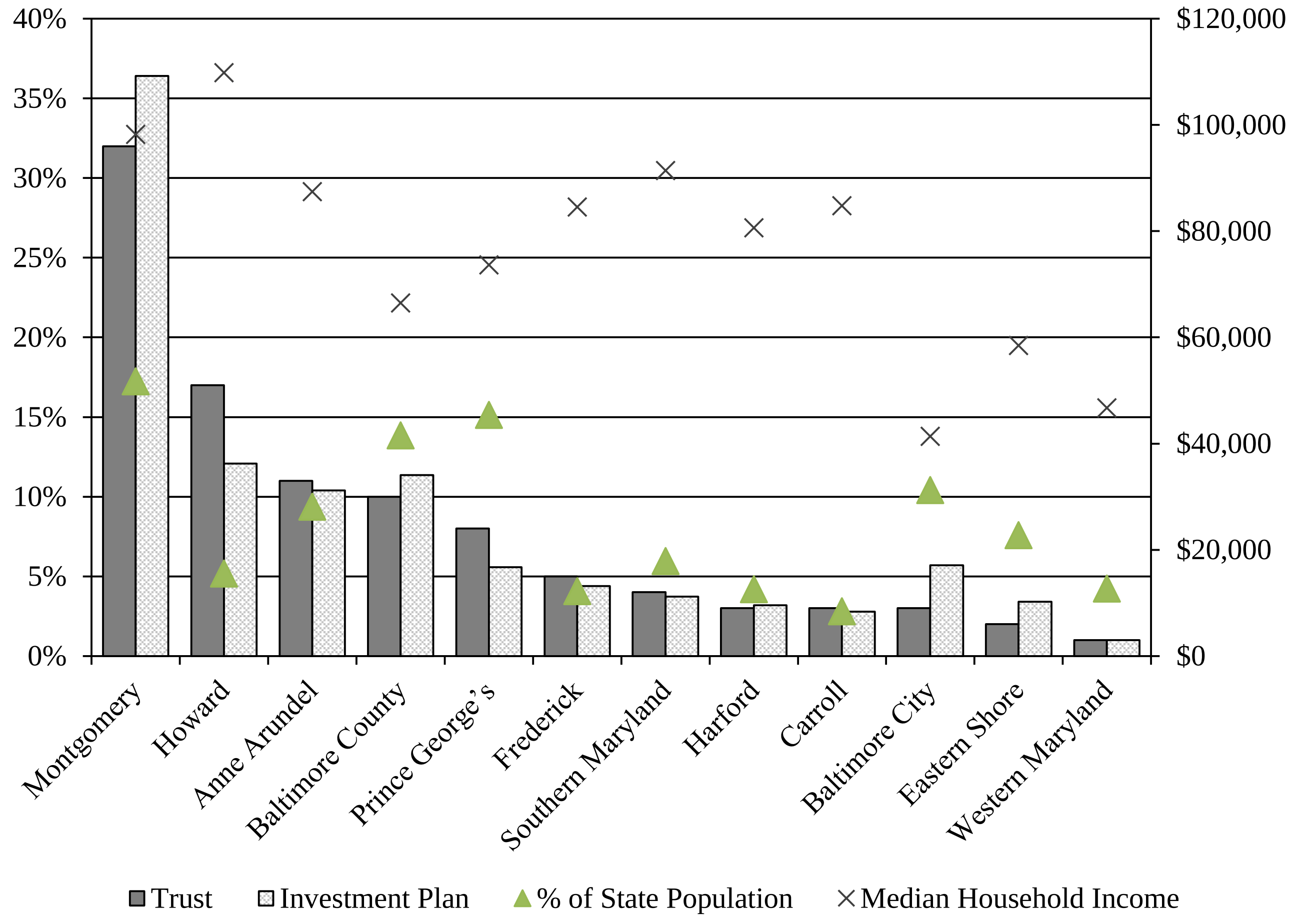
Issues

1. Few Families Participate in 529 Plans

Nationally, not only are few families participating in 529 plans but those who do tend to be wealthier than others according to a December 2012 U.S. Government Accountability Office (GAO) report entitled, *A Small Percentage of Families Save in 529 Plans.* To date, this remains one of very few comprehensive nationwide studies on 529 plans. Forty-nine states offer a variety of 529 plans, and as of July 2012, more than 100 plan options were developed and managed by states and the District of Columbia. In fiscal 2015, there were more than 12 million accounts with total assets of about $258 billion according to the College Savings Plan Network. Although national data is limited, Maryland compares favorably as survey data for CSPM indicates 76% of Maryland families are saving for college compared to 51% nationwide. However, 81% of Maryland families who reported that they were saving for college were not using a 529 plan, but rather some combination of traditional savings accounts, 401(k) plans, or traditional investment vehicles (like stocks, bonds, and certificates of deposit). This shows a tremendous growth opportunity remains for CSPM, but also a need to overcome erroneous beliefs and fears about how money in a 529 plan can be used and by whom.

Echoing the GAO study, a 2010 Survey of Consumer Finances found families using 529 plans had about 25 times the median financial assets and about 3 times the median income as those who did not participate in a 529 plan, $142,400 per year compared to $45,100 per year. While CSPM does not have information on the incomes of individual plan holders, county residence is a rough way to estimate whether this trend also occurs in Maryland. As shown in **Exhibit 5**, Montgomery County residents account for over 30% of the new enrollments in both the trust and investment plans, despite representing only about 17% of the State's population in fiscal 2014 according to U.S. Census Bureau estimates. Howard County is also disproportionately represented among the savings plans, while Anne Arundel, Carroll, and Frederick counties are near expected rates. All other counties and Baltimore City are underrepresented among plan holders as compared to the State's population. Part of this discrepancy may in fact be explained by differences in personal income. Both Montgomery and Howard counties have much higher median household incomes, $98,221 and $109,865 respectively, than the State average of $73,538. Those households likely have not only more discretionary income, but more benefit to derive from 529 plan tax deductions.

Exhibit 5
Profile of New Prepaid College Trust and Investment Plan Enrollment By County/Region of Residence
Fiscal 2015



Note: This chart only reflects plan holders residing in Maryland. The most recent population estimates reflect calendar year 2014.

Source: College Savings Plan of Maryland; Census Bureau

Financial literacy remains a large hurdle for enrollment, as is communicating to families who could transfer savings to 529 plans or begin college savings for the first time. According to CSPM's own survey data, many families who want to save for their children's education are not even aware of 529 plans. Also, due to the number of plans and variations in investment options, those who want to use a 529 plan may believe it is difficult to compare plans. Other factors that may limit participation include federal and state tax benefits that may not be as helpful to low-income families and the limit of only changing an investment option twice a year. *The Survey of Consumer Finances* report cites steps some states have taken to overcome these barriers, specifically for low-income families, such as adopting plans that include less risky investments, having low minimum contributions, and matching a family's contribution. Maine in particular is experimenting with automatic enrolling of all newborns with seed funding to get accounts started growing early.

In Maryland, the CSPM 2014 marketing survey indicated that only 8.3% of MCIP accounts' holders and 11.3% of MPCT accounts' holders were African American residents, despite African Americans making up about 30.0% of Maryland's total population. This survey also indicated that 71.0% of families who are not currently saving for college believe they cannot afford to do so. In response, in fiscal 2015, CSPM produced a new publication with Scholastic Inc. entitled *Smart State: A Family Guide to Saving for College* aimed at dispelling common misconceptions about 529 plans and emphasizing that contributions can start at only $25 per month for the MCIP and/or a one-semester college plan for the MPCT. CSPM is also focusing on more targeted print advertising to reach African American families.

As well as seeking enrollments from more racial and ethnic minorities in Maryland, CSPM is also seeking more geographic diversity. Marketing plan efforts in fiscal 2016 are broadening CSPM advertising and outreach to Western Maryland and the Eastern Shore, which are underrepresented in plan participation rates, as shown in Exhibit 5. The marketing strategy continues to evolve with technology and the ability to target certain groups. For example, CSPM is diverting more resources from radio advertising to television because many people simultaneously browse the internet on connected devices while watching television shows. CSPM is also running advertisements in theaters. This generated nearly 1.4 million impressions, or views, in November and December 2015, although this was mostly occurring in Montgomery, Prince George's, and Anne Arundel counties and the Baltimore metropolitan area. CSPM is currently reviewing the effectiveness of this marketing campaign before continuing further. Finally, CSPM is refocusing on mailings targeted around planned CSPM events at fairs, community gatherings, and sporting events. CSPM sent out about 10,000 mailings in fiscal 2011, but this increased to 45,000 by fiscal 2015. At the same time 529 enrollment kits distributed by mail declined from 25,000 to 16,000 as nearly all new accounts are created online. The new mailings focus on residents within 20 miles of events where CSPM is operating a booth or directly interacting with the audience. CSPM's most high profile marketing partnership, entering its sixth year, is with the Baltimore Ravens football team, but CSPM also works with all four of Maryland's minor league baseball teams.

CSPM launched a new website design in November 2015 with a new layout and a focus toward delivering webinars and downloadable material. Even before the new website, unique web visitors had grown about 25% from fiscal 2011 to 2015. At the same time, the Maryland Higher Education Commission has recently relaunched its own website and Maryland's college access website, MDGo4It, is another avenue to raise awareness of the State's 529 plans. Finally, CSPM has employer payroll deduction programs with the State of Maryland and several counties, which is one of the simplest ways to reach a very large body of employees who are generally familiar with automatic monthly contributions. Currently, the State and Howard and Prince George's counties are enrolled in this, but it often generates a lot of customer support needs on the back end for CSPM to manage due to the expectations of employees to have ready access to live customer support.

The CSPM director should comment on marketing plans in fiscal 2017 to increase the participation of low-income families and other underrepresented demographics in higher

education in 529 college savings plans. In particular, the director should comment on ways to bridge financial literacy hurdles that may limit the understanding of 529 plan benefits and reach the least represented regions: Western Maryland, the Eastern Shore, and Baltimore City.

2. CSPM May Expand for ABLE Program

The Achieving a Better Life Experience (ABLE) Act is a federal law enacted in December 2014 that created 529A plans, similar to 529 college savings plans. Specifically, it allows people who developed qualifying disabilities prior to the age of 26 to save tax-deferred funds for certain expenses so as not to endanger means-tested public benefits. Currently, no state has an operable 529A plan, but at least 34 are looking at expanding existing 529 college savings agencies to include 529A plans as well. Chapter 382 of 2015 formed a workgroup to examine how to implement a 529A plan in Maryland and submitted a final report in December 2015. This report had 9 legislative and 2 implementation recommendations. All of the legislative recommendations were incorporated into HB 431 of 2016. If passed, this bill would:

- require the CSPM Board to establish the Maryland ABLE Program;
- rename the CSPM Board to the Maryland 529 Board and add a new member;
- require consultation between Maryland 529 and the Maryland Department of Disabilities (MDOD) regarding implementation of the Maryland ABLE Program; and
- apply ABLE tax benefits to all years beginning after December 31, 2015, and have them match the college savings income tax deduction.

This bill differs from the ABLE taskforce's December 2015 report in two ways. First, it incorporates a recent federal change that users of a 529A plan no longer need to be a resident of the state in which they create an account. Second, it allows for Maryland's 529A plan to participate in a consortium of states. While the 2015 workgroup estimated as many as 53,000 Marylanders would be eligible for the plan, this is significantly lower than the 180,000 plan holders for college 529 plans. If states banded together, they would likely be able to achieve some economies of scale, such as putting together a more attractive, that is larger, portfolio for a private sector financial program manager. They could also use a uniform disclosure statement. Currently, at least 15 states are exploring this option.

Coincidentally, CSPM and MDOD are on the same floor of an office building in downtown Baltimore City. However, CSPM's lease will expire in fiscal 2017, presenting an opportunity to move to larger office space, which may be necessary if CSPM administers 529A plans.

The CSPM Director should comment on a potential timeline for opening enrollment in 529A plans. The Director should also comment on the need to change marketing features for the two existing 529 plans, such as website domain names, and the impending expiration of the CSPM

lease of office space in downtown Baltimore and the opportunity this presents to relocate to larger offices.

Finally, given these potential changes, the CSPM director should comment on whether now is also an opportunity to launch broker-dealer investment 529 plans, authorized by Chapter 548 of 2008, but never established.

3. Differential Tuition Problem Resolved

In May 2015, the University System of Maryland Board of Regents (BOR) approved a University of Maryland, College Park (UMCP) proposal to establish differential tuition for juniors and seniors in business, engineering, and computer science majors. These students will pay additional tuition in their junior and senior years due to high demand and increased program cost. The differential pricing is phased in, from fiscal 2016 through 2019, as shown in **Exhibit 6**.

Exhibit 6

Proposed Differential Pricing Phase-in for Upper Level Students at the University of Maryland, College Park

Fiscal Year	Student Status	Financial Impact	Percent Increase*
2016	Current Seniors	$700	2%
2016-2017	Current Juniors	$2,100	6%
2017-2018	Current Sophomores	$4,200	11%
2019+	Current Freshmen and Future Students	$5,600	15%

*Based on $38,000 in-state four-year tuition.

Source: University of Maryland, College Park

Differential tuition revenue will go back into the specific degree programs to hire new faculty, enroll additional students, and provide additional financial aid. The proposal indicated that 25% of the total will be reserved for grants for very-low and low-income students as well as full scholarship students, thereby effectively exempting them from the differential. At this time no other public Maryland institutions are pursuing differential tuition. In making its case to BOR in spring 2015, UMCP noted that it was the only Big 10 institution that did not charge differential tuition.

Initially, CSPM declined to pay for differential tuition on the grounds that it was not covered by the statutory definition of tuition and was not part of the assumptions made in managing the MCPT assets. This determination upset account holders. CSPM then reviewed contracts and disclosure statements with the Office of the Attorney General to determine whether this should legally be covered by the plan and also sought an actuarial analysis of the impact of this new cost. In December 2015, satisfied with legal guidance and the actuarial review, the CSPM board determined that it would cover the differential tuition retroactive to the fall 2015 semester. All 236 impacted account holders who submitted benefit claims were notified and will be reimbursed. Spring 2016 payments from CSPM will include differential tuition. **The CSPM director should comment on whether the differential tuition decision represents a new policy for all Maryland institutions going forward.**

4. Leadership Turnover and Vacancies

Since the 2015 legislative session, CSPM has experienced personnel turnover and vacancies at a much higher rate than in previous years. CSPM has had 2 interim executive directors in fiscal 2016 and, out of only 20 positions, there are 7 vacancies as of January 2016, including the chief financial officer position. This is an extraordinarily high vacancy rate of 33%. Some of these vacant positions have been downgraded from the classifications used in fiscal 2016, which is why salaries decrease overall for CSPM. As of February 2016, no job postings are shown for CSPM on the DBM Maryland State Online Employment Center website. CSPM also has a new Attorney General who was recently assigned to the agency. Given the changes in leadership and the loss of so many personnel at such a small organization, there may be challenges in providing effective customer service and other routine support and this will likely hinder any expansion of current operations or launching of new initiatives.

The CSPM director should comment on the timeline for filling the agency's management and regular employee positions and how effectively CSPM has been meeting its obligations during this time of turnover and personnel shortages. Finally, the director of CSPM should comment on the vision and future of CSPM given all of this change.

Recommended Actions

1. Nonbudgeted.

Updates

1. Investment Plan Again Recognized for Strong Performance

For the fourth year in a row, the MCIP was awarded a "Gold" ranking from Morningstar Advisor in fall 2015, one of only four 529 plans recognized nationwide. One of the other four, from Alaska, also uses T. Rowe Price as its program manager. These two plans demonstrated abilities to outperform their relevant benchmark and peer groups and protected consumer assets by adjusting investments quarterly rather than annually. Higher education competitor states California, New York, Ohio, and Virginia each had at least one "Silver" plan. Virginia notably has a direct contribution plan and an advisor plan. Only two plans nationwide received a negative rating overall. Prior to the "Gold" ratings system, the MCIP had received the "Top" rating from Morningstar in 2011 and 2010.

Appendix 1

Audit Findings

Audit Period for Last Audit:	August 3, 2011 – November 17, 2014
Issue Date:	June 2015
Number of Findings:	2
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: CSPM did not determine the disposition of uncashed checks nor did it take action to transfer funds determined to be abandoned to the Comptroller of Maryland as required.

Finding 2: CSPM lacked assurance that certain security controls were addressed by the service provider administering the MCIP.

Object/Fund Difference Report
College Savings Plans of Maryland

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	21.00	21.00	21.00	0.00	0%
02 Contractual	0.20	0.20	0.20	0.00	0%
Total Positions	**21.20**	**21.20**	**21.20**	**0.00**	**0%**
Objects					
01 Salaries and Wages	$ 1,288,570	$ 1,970,701	$ 1,891,136	-$ 79,565	-4.0%
02 Technical and Special Fees	87,617	0	69,846	69,846	n/a
03 Communication	115,749	138,247	119,952	-18,295	-13.2%
04 Travel	18,265	20,000	20,000	0	0%
07 Motor Vehicles	6,261	9,459	9,000	-459	-4.9%
08 Contractual Services	899,176	1,127,300	1,403,669	276,369	24.5%
09 Supplies and Materials	31,166	40,685	40,000	-685	-1.7%
11 Equipment – Additional	19,877	50,000	50,000	0	0%
13 Fixed Charges	235,880	237,830	168,930	-68,900	-29.0%
Total Objects	**$ 2,702,561**	**$ 3,594,222**	**$ 3,772,533**	**$ 178,311**	**5.0%**
Funds					
07 Nonbudgeted Fund	$ 2,702,561	$ 3,594,222	$ 3,772,533	$ 178,311	5.0%
Total Funds	**$ 2,702,561**	**$ 3,594,222**	**$ 3,772,533**	**$ 178,311**	**5.0%**

n/a: not applicable

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Maryland Higher Education Commission

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$56,115	$56,232	$65,831	$9,599	17.1%
Deficiencies and Reductions	0	311	-7	-318	
Adjusted General Fund	**$56,115**	**$56,543**	**$65,824**	**$9,281**	**16.4%**
Special Fund	12,356	20,144	20,433	290	1.4%
Deficiencies and Reductions	0	0	-1	-1	
Adjusted Special Fund	**$12,356**	**$20,144**	**$20,432**	**$288**	**1.4%**
Federal Fund	2,178	2,761	2,462	-298	-10.8%
Deficiencies and Reductions	0	0	0	0	
Adjusted Federal Fund	**$2,178**	**$2,761**	**$2,462**	**-$299**	**-10.8%**
Reimbursable Fund	226	716	481	-236	-32.9%
Deficiencies and Reductions	0	0	0	0	
Adjusted Reimbursable Fund	**$226**	**$716**	**$481**	**-$236**	**-32.9%**
Adjusted Grand Total	**$70,875**	**$80,164**	**$89,199**	**$9,035**	**11.3%**

- After adjusting for back of the bill reductions and deficiencies, general funds increase approximately $9.3 million, or 16.4%, in the fiscal 2017 allowance. Special funds increase by $0.3 million, or 1.4%.

- Overall, funds increase approximately $9.0 million, or 11.3%.

Note: Numbers may not sum to total due to rounding.

For further information contact: Garret T. Halbach Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	57.60	58.60	55.60	-3.0
Contractual FTEs	6.94	13.33	10.33	-3.0
Total Personnel	**64.54**	**71.93**	**65.93**	**-6.0**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions		5.58	10.03%
Positions and Percentage Vacant as of 12/31/15		10.00	17.06%

- Positions shown here include Student Financial Assistance programs and the programs providing State support to community colleges and independent institutions.

- In fiscal 2004, Maryland Higher Education Commission (MHEC) had 73.6 full-time regular positions. From fiscal 2004 to 2017, MHEC regular positions decreased 18.0 positions, or about 25%. Over the same period, contractual positions fluctuated, but overall decreased to 8.3 positions.

- The 2017 allowance removes 3.0 regular positions, including the 2.0 positions gained in the 2016 allowance. Two positions go back to the Department of Labor, Licensing, and Regulation (DLLR), which deals with the Workforce Investment Act, and the other position goes under the purview of the Department of Information Technology (DoIT), although the employee will physically remain at MHEC. The first 2.0 positions reflect the decrease of $236,000 in reimbursable funds on the cover sheet. The allowance also shows the removal of 3.0 contractual positions due to the conclusion of a workforce development grant with DLLR and other expiring grants from the federal government and the Lumina Foundation.

- As of December 31, 2015, the commission had 10.0 vacancies, a rate of 17.1%. Budgeted turnover for fiscal 2017, however, is only 5.6 positions, or 10.0%. Since fiscal 2004, the MHEC mid-fiscal year vacancy rate has fluctuated greatly from a low of 4.2% in fiscal 2007 to a high of 21.8% in fiscal 2012. The average over this time period is about 10.8%. While there appears to be a mismatch between the vacancy rate and the turnover rate, MHEC is one of several agencies transferring its human resources services to the Department of Budget and Management in fiscal 2016 as part of a shared services agreement to speed up its hiring process and ensure it complies with all human resource regulations and best practices. This is similar to how DoIT uses an enterprise system model to manage information technology projects for smaller agencies. A year from now, it is expected that MHEC vacancy issues will be significantly improved.

Analysis in Brief

Major Trends

Achievement Gap in Retention Rates Remains: The achievement gap in retention between all students and Hispanic and African American students can be measured using annual data from MHEC. Overall, Hispanic students, probably due to small enrollment numbers, outperform all students until the most recent cohort. African American students are retained at a significantly lower rate than all students but have shown recent improvements.

Achievement Gap in Graduation Rates Unchanged: Similar to retention rates, the achievement gap in graduation rates for all students and Hispanic and African American students can be measured with MHEC data. While Hispanic students continue to graduate at higher rates than all students in the 2007 cohort, the achievement gap of African American students is mostly unchanged in the most recent cohort.

Meeting the State's Workforce Shortages: In January 2015, a successful program to increase the capacity of nursing programs in Maryland was extended for another five years. Overall, it has successfully driven an increase in nursing credentials.

Issues

Campus Sexual Misconduct Policies and MHEC: New federal regulations on sexual assault policies took effect in summer 2015. This issue will review MHEC's efforts to ensure that all campuses in the State, public and private, will meet these new guidelines and in developing a campus climate survey.

Competitor State Funding Guideline Attainment: Since 1999, MHEC has evaluated State funding for public four-year institutions by comparing Maryland schools to peers in other states. MHEC recently adopted a new model that uses only institutions from competitor states, a model first recommended by the Commission to Develop the Maryland Model for Funding Higher Education in 2008.

College Access and Outreach Plan: Recent legislation has pushed MHEC to develop an outreach plan focused on low-income high school students to make them more aware of opportunities for college enrollment and financial aid. This issue will look at what MHEC will do in 2016 to meet this challenge.

Recommended Actions

		Funds
1.	Reduce general funds for the Sellinger formula grant.	$ 141,204

2.	Add language indicating legislative intent on the transfer of institutional grants.	
3.	Add language restricting enhancement funds for Historically Black Colleges and Universities.	
4.	Modify budget language as a technical amendment to reflect a reduction to educational grants.	
5.	Reduce general fund support for educational grants.	1,133,000
6.	Adopt narrative requesting a report on best practices and progress toward the 55% completion goal.	
7.	Adopt narrative requesting a report on the fiscal 2016 outcomes of Access and Success programs.	
	Total Reductions	**$ 1,274,204**

Updates

Academic Mission Review: This update will review the few changes from the last review of mission statements made four years ago.

Measuring Support for and Outcomes of Nontraditional Students: MHEC has again reviewed annual outcomes of students in Access and Success programs and also drawn attention to better ways that the commission and institutions can track, support, and mark the progress of nontraditional students.

Historically Black Colleges and Universities' Lawsuit Ruling Pending: A lawsuit filed in 2006 alleging that Maryland's system of higher education remains segregated and in violation of the federal equal opportunity laws received a finding of fact from the court in 2015. The court found that Maryland has properly funded its historically black colleges and universities but violated law by duplicating certain degree programs. The court ordered the State and plaintiffs to return to mediation, but mediation again failed.

Maryland Higher Education Commission

Operating Budget Analysis

Program Description

The Maryland Higher Education Commission (MHEC) is the State's coordinating body for the University System of Maryland (USM), Morgan State University (MSU), St. Mary's College of Maryland (SMCM), 16 community colleges, the State's independent colleges and universities, and private career schools and other for-profit institutions. The mission of MHEC is to ensure that Maryland residents have access to a high quality, adequately funded, effectively managed, and capably led system of postsecondary education. The vision of MHEC is to have all Maryland residents equally prepared to be productive, socially engaged, and responsible members of a healthy economy. The Secretary of Higher Education is the agency's head and serves at the 12-member commission's pleasure.

The key goals of MHEC are as follows:

- Maryland will enhance its array of postsecondary education institutions and programs, which are recognized nationally and internationally for academic excellence, and more effectively fulfill the evolving educational needs of its students, the State, and the nation;

- Maryland will achieve a system of postsecondary education that advances the educational goals of all by promoting and supporting access, affordability, and completion;

- Maryland will ensure equitable opportunity for academic success and cultural competency for Maryland's population;

- Maryland will seek to be a national leader in the exploration, development, and implementation of creative and diverse education and training opportunities that will align with State goals, increase student engagement, and improve learning outcomes and completion rates;

- Maryland will stimulate economic growth, innovation, and vitality by supporting a knowledge-based economy, especially through increasing education and training and promoting the advancement and commercialization of research; and

- Maryland will create and support an open and collaborative environment of quality data use and distribution that promotes constructive communication, effective policy analysis, informed decision making, and achievement of State goals.

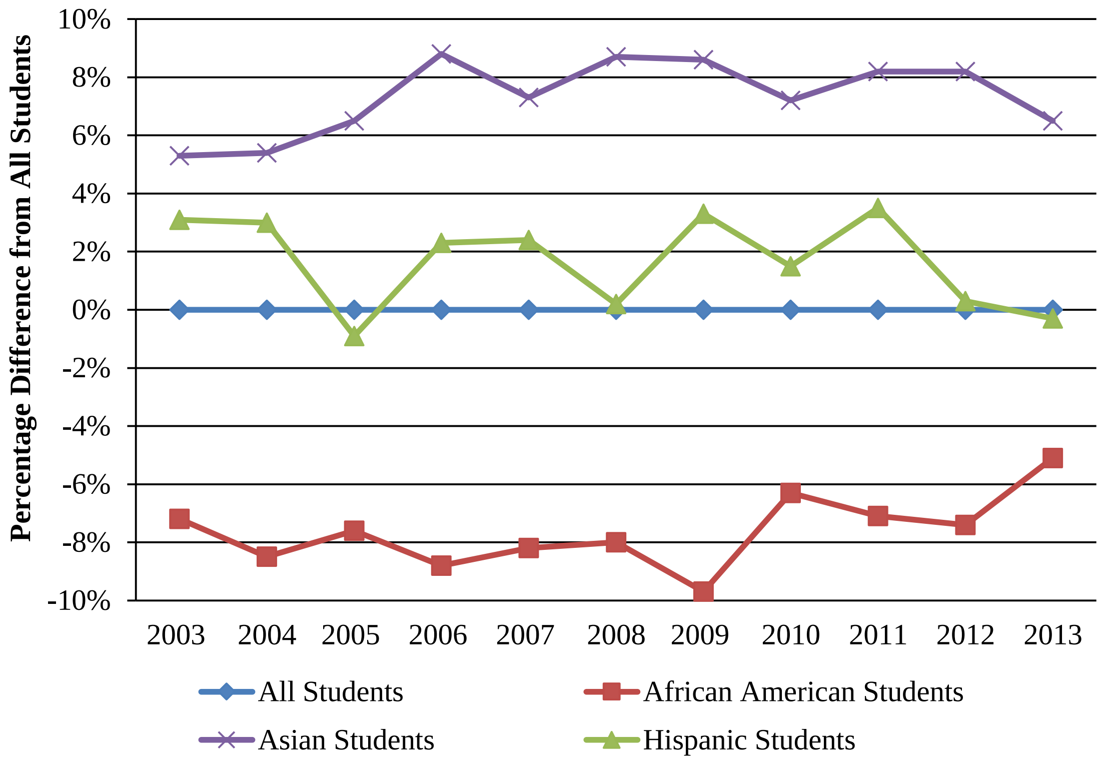
Performance Analysis: Managing for Results

MHEC has outlined several large policy goals in *Maryland Ready*, the 2013 to 2017 *State Plan for Postsecondary Education*. MHEC aims to maintain and strengthen higher education institutions and to ensure accessibility for Maryland's diverse citizenry. Progress in these areas will help achieve the State's college completion agenda to increase degree attainment among Maryland adults to 55% by 2025. To improve outcomes for historically underserved or underrepresented groups, who represent a growing portion of total student enrollment, MHEC works to reduce the achievement gap between minority students and all students; award more degrees to minority students; and target degree growth in high-demand areas.

1. Achievement Gap in Retention Rates Remains

Retention rates indicate how well Maryland's students are progressing toward degree attainment. **Exhibit 1** shows the percentage point difference between the second-year retention rate for all students and African American, Asian, and Hispanic students entering public four-year institutions between 2003 and 2013. The years represent cohorts of first-time, full-time (FT/FT) students entering in the fall semester, *i.e.*, 2010 cohort reflects students enrolling in fall 2010, which is academic year 2010-2011, or fiscal 2011. Although not shown here, the 2013 cohorts reached all-time highs for two-year retention for all Maryland students (85.1%), African American students (80.0%), and Asian students (91.6%). Hispanic students (84.8%) have fallen slightly below the record set by the 2011 cohort (86.0%) and for the first time in eight years, have fallen below all students' retention rates. The performance of Hispanic students is important because these students are the fastest growing demographic, both as residents and as students, in Maryland. MHEC attributed part of the strong performance of Hispanic students from fiscal 2006-2012 to the overall low enrollment of Hispanic students in higher education. Out of roughly 357,000 students across all Maryland institutions in fall 2013, only about 24,000, or about 7.0%, were Hispanic. This was also the first year that Hispanic enrollment surpassed Asian enrollment to become the second largest minority student population. Although not shown in Exhibit 1, from 2003 to 2013, Hispanic students' retention rates at public four-year institutions have been no lower than 78.9%.

Exhibit 1
Achievement Gap in Second-year Retention Rates
2003-2013 Cohorts



Note: Only for public four-year institutions.

Source: Maryland Higher Education Commission, Enrollment and Degree Information Systems

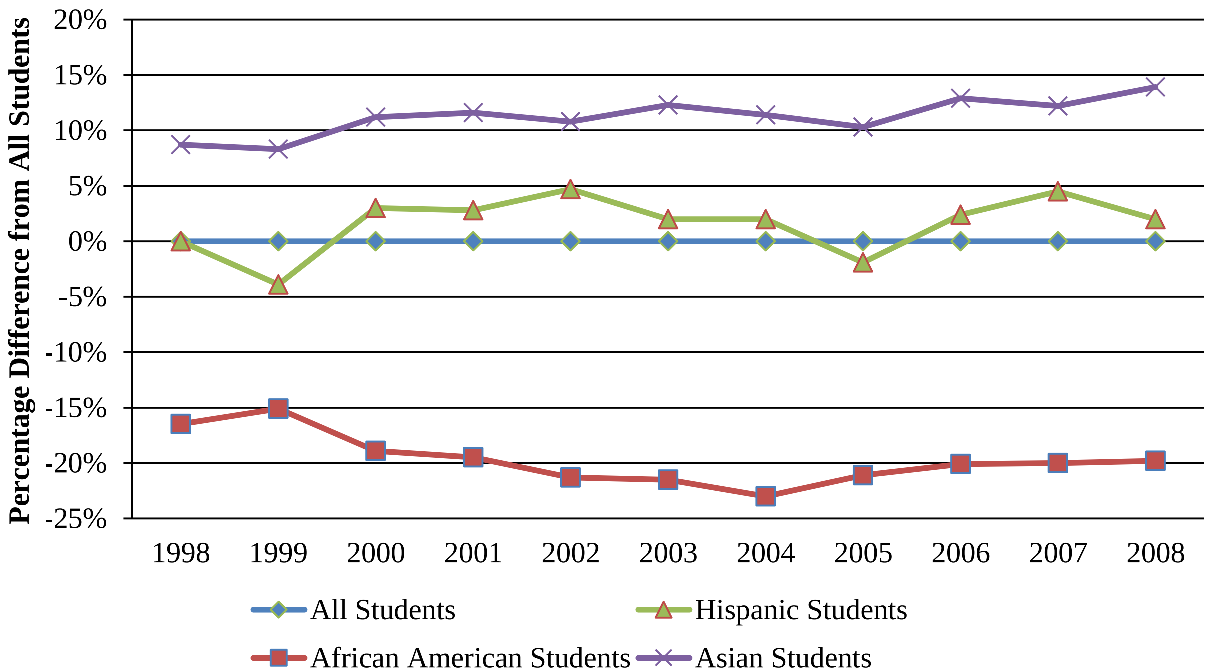
The retention rate for African American students was consistently about 8.0 percentage points below all students from 2003 to 2008, before dropping 2.0 percentage points and then jumping 4.0 percentage points in 2010. It then fell in the 2011 and 2012 cohorts, before jumping up again in 2013. The percentage point gap between all students and African American students in 2013, 5.1, is the smallest achievement gap since the 2000 cohort (not shown in Exhibit 1) , which was 6.6. MHEC has noted that the cohort size for African American students peaked at over 5,100 in 2008, but fell below 4,000 in 2013, so it is important for MHEC to ascertain what proportion of the change in the retention rate is due to variation in cohort size versus actual institutional improvements. While White student cohorts also declined over the same time period, it was not to the same degree and, as mentioned above, the Hispanic cohort has been steadily growing.

MHEC reports that the State's college completion agenda will focus on enrolling and retaining more students of all backgrounds and increasingly more nontraditional students who are not captured in this exhibit because they do not enroll as FT/FT students. (Transfer students, who are also not captured in FT/FT data, represent another rapidly growing demographic on campuses.) More on this topic will be discussed in Issue 4. Specific strategies include redesigning courses in remedial and introductory classes, increasing summer bridge programs, and reaching out to growing or underrepresented demographics, such as Hispanic students, adult students, and military veterans.

2. Achievement Gap in Graduation Rates Unchanged

Retention rates foreshadow graduation rates, which represent the ultimate goal for most students and reflect how effectively public four-year institutions in Maryland educate students. **Exhibit 2** shows the percentage difference between six-year graduation rates for the same student groups shown in Exhibit 1. As data for six-year graduation rates by cohort necessarily lags two-year retention rates by cohort, Exhibit 2 only shows cohort years 1998 to 2008.

Exhibit 2
Achievement Gap in Six-year Graduation Rates
1998-2008 Cohorts



Note: Only for public four-year institutions.

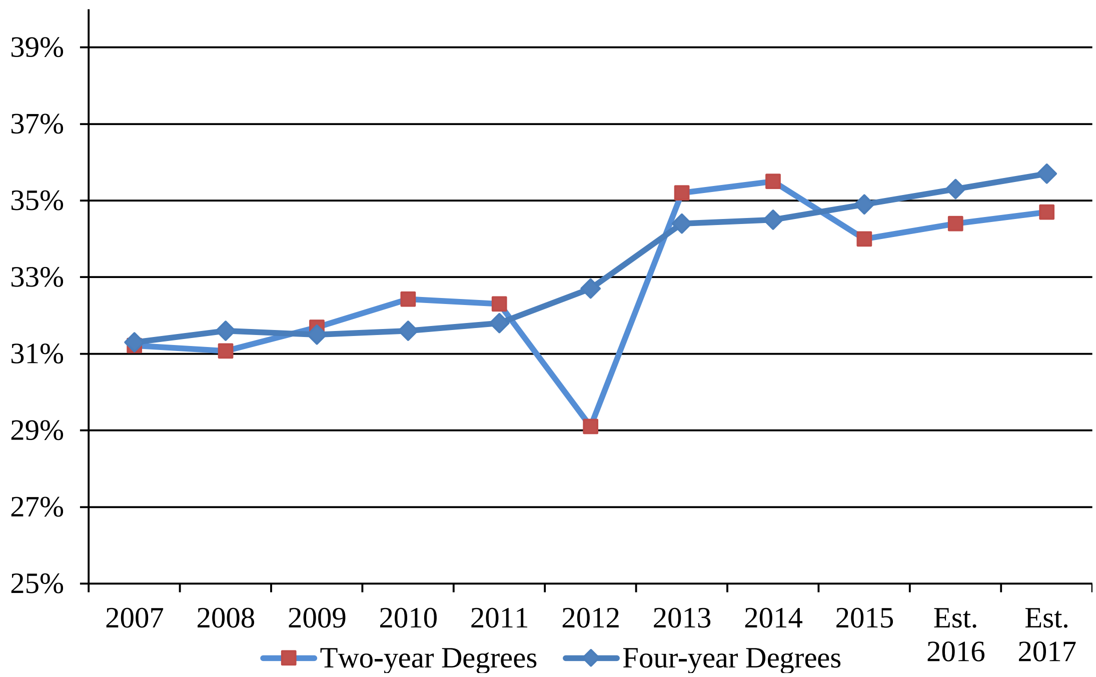
Source: Maryland Higher Education Commission, Enrollment and Degree Information Systems

From 1998 to 2008, Hispanic students have graduated at similar or higher rates than all students in 9 out of 11 years and were below all students in only 2 years. Given that Hispanic students displayed relatively lower retention rates in the 2008 cohort in Exhibit 1, it is not surprising that the graduation rate achievement gap in Exhibit 2 is slightly lower. Since 2000, Asian students have consistently graduated at least 10 percentage points higher than all students.

The achievement gap for African American students generally grew from the 1999 cohort to the 2004 cohort, before shrinking in 2005 and 2006, while 2007 and 2008 were unchanged. However, even with some progress recently, the achievement gap in 2008 was 19.8 percentage points, compared to only 15.0 percentage points in 1999. To ensure educational opportunity for Maryland's diverse citizenry, MHEC had set a cohort year 2007 (fiscal 2013) goal of reducing the six-year graduation rate achievement gap for African American students to 18.0 percentage points. The new goal is to reduce the African American achievement gap to below 16.0 percentage points by cohort year 2012 (fiscal 2018). This, however, is not necessarily progress compared to where the State was with the 1999 cohort's outcomes. Given the volatility in African American retention rates in the 2009 and 2010 cohorts, it may be difficult to predict what the cohorts' six-year graduation rates will be.

The achievement gap effects the percent of bachelor's and associate's degrees awarded to racial and ethnic minorities in Maryland, as shown in **Exhibit 3.** The fastest growing segments of Maryland's population are minorities, and the percent of associate's degrees awarded to minorities increased 3.5 percentage points between fiscal 2007 and the 2017 estimate of 34.7%. This rate dropped to 29.1% in fiscal 2012 because of an unusually large number of students not classified under any racial or ethnic category in that year. MHEC believes that the rate will increase again in future fiscal years, surpassing 40.0% in the next decade. Meanwhile, the percentage of bachelor's degrees awarded to minority students was essentially flat from fiscal 2007 to 2011, before climbing rapidly in fiscal 2012 and 2013, then slowing down in 2014 through 2017. Other than the anomalous 2012 data, more associate's degrees were going to minority students from 2009 through 2014. The switching of the order appears to have more to do with community colleges than four-year institutions, which often have more volatile outcomes. Overall, the data in the exhibit shows the rates appear to move together, with the exception of associate's degrees in 2012. The stagnant rates from fiscal 2007 to 2011 may be the effect of the recession, and MHEC believes minority degree attainment will continue its upward climb as the economy improves and demographic trends continue. This rate may grow even faster if the achievement gaps shown in Exhibits 1 and 2 are reduced.

Exhibit 3
Bachelor's and Associate's Degrees
Percentage Awarded to Racial and Ethnic Minorities
Fiscal 2007-2017 Est.



Source: Governor's Budget Books, Fiscal 2006-2016; Maryland Higher Education Commission

3. Meeting the State's Workforce Shortages

MHEC supports Maryland's economy by coordinating programs related to workforce shortages, particularly in health-related occupations. One such shortage is in graduate-level nursing programs, which may negatively impact the future supply of nurse faculty and limit the ability of nursing programs to increase enrollment capacity. The MHEC Nurse Support Program (NSP) II includes statewide initiatives and competitive institutional grants designed to increase the capacity of nursing programs, particularly in producing master's- and doctoral-level nurses who can serve as nurse educators in associate's degree and bachelor's degree programs.

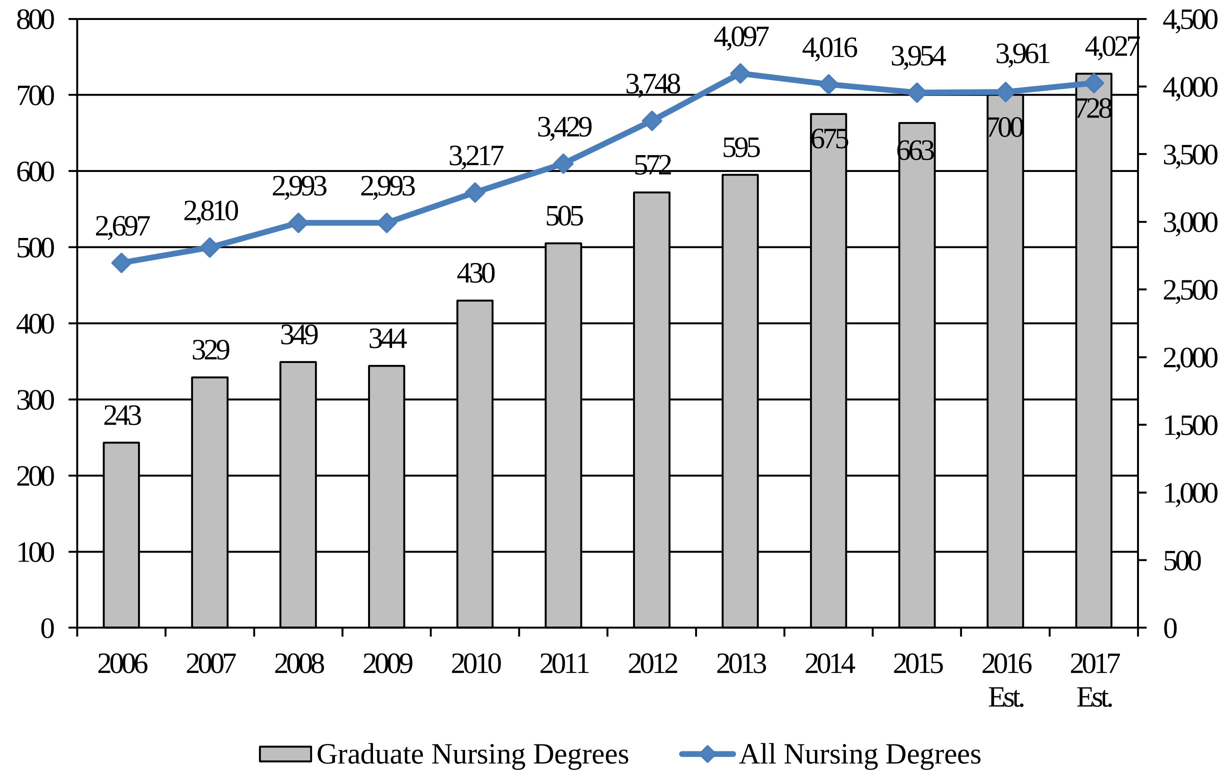
Exhibit 4 shows the number of master's and doctoral degrees awarded in nursing in Maryland from fiscal 2006 to 2017, as well as the total number of nursing graduates produced each year. Since the first round of NSP II grants in fiscal 2006 to 2015 actual, the number of master's and doctoral degrees awarded per year in nursing has increased about 173%, from 243 to 663. This far exceeds the original MHEC goal of 350 graduates by 2013. The new goal set by MHEC is to maintain

600 graduates a year through fiscal 2018. Additionally, while all nursing degrees increased 19.3% over the five-year period of fiscal 2006 to 2010, it grew by another 15.3% over the next five-year period, fiscal 2011 to 2015. Assuming some lag between when NSP II funding could train more nursing faculty and when those nursing faculty could then grow Maryland's nursing programs, it does seem likely that NSP II had an effect in increasing total nursing graduates in Maryland, especially after fiscal 2009. Over this same time period, according to the Maryland Board of Nursing, the National Council Licensure Examination first-time pass rate for nursing associate's degrees declined from 91.6% to 81.7% and the same rate for bachelor's degrees fell from 84.2% to 77.1%, likely due to a greater number of nursing students. The total number of nursing degrees declined slightly in 2015 due to fewer associate's degrees, which is likely part of an industry shift toward requiring bachelor's degrees and higher in nursing. For example, in fiscal 2012, the program began to prioritize doctoral degrees as these are increasingly preferred for nursing faculty, even at the community college level. The funding source for NSP II was renewed in January 2015 for an additional five years.

Exhibit 4

Nursing Degrees Produced

Fiscal 2006-2017 Est.



Source: Maryland Higher Education Commission

Fiscal 2016 Actions

Proposed Deficiencies

There is one proposed deficiency for MHEC administration in the 2017 allowance that increases the fiscal 2016 working appropriation by $0.3 million for legal services required for the ongoing lawsuit with Historically Black Colleges and Universities that is discussed in an update at the end of this analysis. MHEC also has three deficiencies within its Aid to Community Colleges programs and two within its Office of Student Financial Assistance programs, which will be discussed in detail in their respective budget analyses.

Cost Containment

The fiscal 2016 cost containment had an additional 2% across-the-board reduction in general funds for MHEC of $2.1 million and a $6.5 million reduction to Sellinger aid. There was also a contingent transfer of $1.7 million from the fund balance of the Health Personnel Shortage Incentive Grant (HPSIG) to the general fund. Both of the 2% reductions proved to be a great challenge for MHEC as it is primarily a grant pass-through organization, so there simply is not much to reduce in MHEC given that the administrative budget for salaries and other necessary office functions amount to only about $6.0 million. MHEC ended up taking $1.6 million of the 2% reduction within Educational Excellence Awards, the State's largest need-based financial aid program, and for which a deficiency appropriation is provided. The remainder was taken out of personnel and administrative costs mostly by leaving positions vacant.

The Secretary of Higher Education should comment on whether special fund fees have proven sufficient to replace lost general funds.

Proposed Budget

As shown in **Exhibit 5**, after a back of the budget bill reduction to health insurance costs, the fiscal 2017 allowance increases the overall budget of MHEC by $9.0 million, or 11.3%. General funds grow mostly from $8.0 million in Sellinger aid funding formula for independent institutions, a new $1.1 million information technology (IT) grant for SMCM, and about $0.2 million in new funding for outreach programs, while special funds grow slightly due to increased administrative fee revenue. Reimbursable funds decline due to 2.0 positions returning to the Department of Labor, Licensing, and Regulation (DLLR), and 1.0 being transferred to the Department of Information Technology. Federal funds decline due to the conclusion of grants, discussed later in this analysis. Finally, personnel increments, budgeted within Department of Budget and Management (DBM) – Personnel, total $89,000 for MHEC in fiscal 2017. Of that amount, about $79,000 is general funds.

Exhibit 5
Proposed Budget
Maryland Higher Education Commission
($ in Thousands)

How Much It Grows:	**General Fund**	**Special Fund**	**Federal Fund**	**Reimb. Fund**	**Total**
Fiscal 2015 Actual	$56,115	$12,356	$2,178	$226	$70,875
Fiscal 2016 Working Appropriation	56,543	20,144	2,761	716	80,164
Fiscal 2017 Allowance	65,824	20,432	2,462	481	89,199
Fiscal 2016-2017 Amount Change	$9,281	$288	-$299	-$236	$9,035
Fiscal 2016-2017 Percent Change	16.4%	1.4%	-10.8%	-32.9%	11.3%

Where It Goes:	
Personnel Expenses	
Employees' retirement system	$82
Turnover adjustments	50
Employee and retiree health insurance	24
Other fringe benefit adjustments	-12
Regular earnings	-40
Abolished/transferred positions (3.0 full-time equivalent)	-284
Other Changes	
Mandated increase to Sellinger formula	7,990
St. Mary's College of Maryland Information Technology Grant	1,113
College outreach	247
Other adjustments	163
Conclusion of federal grants	-298
Total	**$9,035**

Note: Numbers may not sum to total due to rounding.

In fiscal 2016, MHEC reorganized, changing office and position titles. Most significantly, it is grouping nearly all units into three areas: finance policy and operations (budget and financial aid); external relations and outreach (communications and grants); and program review and compliance (academic affairs). This is intended to improve the internal processes of MHEC and not affect its budget.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency's share of these reductions is about $7,000 in general funds, $1,200 in special funds, and $500 in federal funds. There is an additional across-the-board reduction to abolish vacant positions statewide, but the amounts have not been allocated by agency.

Joseph A. Sellinger Formula

Exhibit 6 shows how total Sellinger aid is appropriated using the statutory formula – the per student general fund support at certain public four-year institutions is multiplied by a percentage set in statute. The Budget Reconciliation and Financing Act (BRFA) of 2014 sets this percentage for fiscal 2017 at 10.1%, an increase of 0.5 percentage points over fiscal 2016. Per full-time equivalent student (FTES) support increases to $11,650, or $1,287 more per student than the effective per student funding in fiscal 2016, as the final total amount of funding was set in the BRFA of 2015. This amount is then multiplied by independent college and university enrollments, which grew by only 140 students in the most recent audited data, fiscal 2015.

Exhibit 6
Sellinger Aid Formula
Fiscal 2016-2017

	Working Appropriation Fiscal 2016	Allowance Fiscal 2017	DLS Proposed Fiscal 2017
Per FTES general funds per selected public institutions[1]	$10,363	$11,650	$11,617
Statutory Sellinger Percentage	9.6%	10.1%	10.1%
General Funds x Percentage	$995	$1,177	$1,173
Independent Enrollment	43,044	43,185	43,185
Sellinger Appropriation	**$42,822,240**	**$50,812,427**	**$50,671,223**

DLS: Department of Legislative Services
FTES: full-time equivalent student

[1] This is based on the allowance without any subsequent changes.

Source: Department of Budget and Management; Department of Legislative Services

The Sellinger appropriation grows to $50.8 million in the 2017 allowance, an increase of $8.0 million, or 18.7%. Because Sellinger aid resets every year, that is, the prior year has no direct impact on the next year's funding formula, the growth after a year of cost containment becomes very pronounced. The growth in fiscal 2017 is due to increased support for public four-year institutions and the increased statutory percentage because, as noted above, independent enrollment grew only 0.3%. Even with this significant increase, Sellinger aid remains $5.2 million, or 9.3%, below its peak of $56.1 million in fiscal 2008. This is due to repeated actions in past BRFAs to reduce the funding percentage.

In addition to base support provided in the budget to the institutions upon which the Sellinger formula is based, the allowance amount for Sellinger was determined by also distributing $6.8 million in enhancement funds at USM in fiscal 2017 in proportion to fiscal 2016 working State support to those same institutions. However, the fiscal 2017 health insurance reduction, although specified for higher education in the budget bill, was not factored into the Sellinger formula. Adjusting Sellinger aid for this action reduces independent support to $50.7 million, a decrease of $0.1 million, or less than 1% versus the allowance.

The Department of Legislative Services (DLS) recommends rerunning the Sellinger Aid formula to account for the statewide health insurance reduction. This reduces Sellinger aid in fiscal 2017 by $141,204.

Exhibit 7 shows the allocation of Sellinger aid by institution. While enrollment information is not shown in this exhibit, only Johns Hopkins University (JHU), Washington Adventist University, and Capitol College had enrollment growth in fiscal 2015, which is used in the allowance formula. Despite this, because of the overall growth in Sellinger aid, every eligible institution receives an increase of at least 7%, with an institutional average of just over 15%, and total funding increasing by 18.3%. JHU, by far the largest eligible institution, has the largest increase and sees its share of total Sellinger aid grow from about 45% in fiscal 2016 to 47% in fiscal 2017.

Exhibit 7

Sellinger Aid Distribution

Fiscal 2016-2017

Institution	Working 2016	Allowance 2017	DLS Proposed 2017	Working to DLS Proposed 2017	
Johns Hopkins University	$19,311,755	$23,749,248	$23,683,251	$4,371,496	22.6%
Loyola University	5,103,994	6,006,224	5,989,533	885,539	17.3%
Stevenson University	3,762,980	4,343,917	4,331,846	568,866	15.1%
Mount St. Mary's College	1,908,600	2,255,564	2,249,296	340,696	17.9%
Maryland Institute College of Art	2,215,577	2,534,849	2,527,805	312,228	14.1%
Goucher College	1,732,344	2,049,371	2,043,676	311,332	18.0%
McDaniel College	2,306,038	2,602,587	2,595,355	289,317	12.5%
Hood College	1,626,732	1,826,918	1,821,841	195,109	12.0%
College of Notre Dame	1,489,006	1,660,966	1,656,350	167,344	11.2%

Institution	Working 2016	Allowance 2017	DLS Proposed 2017	Working to DLS Proposed 2017	
Washington Adventist University	754,685	896,592	894,100	139,415	18.5%
Washington College	1,564,156	1,679,051	1,674,385	110,229	7.0%
Capitol College	486,875	579,055	577,446	90,571	18.6%
St. John's College	559,498	628,085	626,340	66,842	11.9%
Total	**$42,822,240**	**$50,812,427**	**$50,671,223**	**$7,848,983**	**18.3%**

DLS: Department of Legislative Services

Source: Department of Budget and Management; Department of Legislative Services

Sojourner-Douglass College (SDC) closed at the end of the 2014-2015 academic year following accreditation difficulties. The year before, the National Labor College closed. Although both institutions received Sellinger funding, the latter was never a member of the Maryland Independent College and University Association (MICUA), which now represents all 13 Sellinger aid-receiving institutions. Because the General Assembly specified a Sellinger funding level in the BRFA of 2015, the funding that otherwise would have gone to SDC was redistributed to other MICUA institutions.

MICUA reports that, since 1973, the State has distributed over $1 billion through the Sellinger program. MICUA has a stated goal for member institutions to use at least 70% of Sellinger funding for need-based financial aid for Maryland residents. In fiscal 2016, 88% of funding was used this way, about the same as the prior two years. Sellinger funding not used for aid allows some flexibility for private institutions to meet other State priorities, such as education for teacher education, nursing, and diversity goals.

Educational Grants

The Educational Grants program provides financial assistance to State, local, and private entities to enrich the quality of higher education within the goals defined by *Maryland Ready*. **Exhibit 8** shows educational grant appropriations for fiscal 2016 through 2017. While an increase over fiscal 2016, general funds for MHEC education grants in fiscal 2017 are down about 45% from an all-time high in fiscal 2006 of $16.4 million.

Federal funds for educational grants fall $230,000 in fiscal 2017 from fiscal 2016, reflecting the phasing out of several federal fund grants. Although MHEC received funds in the past, the newest award for Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) for $0.4 million in fiscal 2017, is budgeted within the Maryland State Department of Education's (MSDE) Aid to Education. Maryland is using the MHEC College Preparation Intervention Program's $750,000 as matching funds for the GEAR UP six-year grant to support college preparation, access, and outreach initiatives.

Exhibit 8
Maryland Higher Education Commission Educational Grants
Fiscal 2016-2017

Programs	Working 2016	Allowance 2017	$ Difference	% Difference
Federal Funds				
Improving Teacher Quality	$1,000,000	$975,000	-$25,000	-2.5%
College Access Challenge Grant Program	1,200,000	1,000,000	-200,000	-16.7%
John R. Justice Grant	30,000	25,000	-5,000	-16.7%
Subtotal	***$2,230,000***	***$2,000,000***	***-$230,000***	***-10.3%***
General Funds				
Complete College Maryland	250,000	250,000	0	0.0%
OCR Enhancement Funds	4,900,000	4,900,000	0	0.0%
Washington Center for Internships and Academic Seminars	175,000	175,000	0	0.0%
UMB – WellMobile	285,250	285,000	-250	-0.1%
Regional Higher Education Centers	2,150,000	2,150,000	0	0.0%
St. Mary's College of Maryland IT Grant	0	1,133,000	1,133,000	
Subtotal	***$7,760,250***	***$8,893,000***	***$1,132,750***	***14.6%***
Total	**$9,990,250**	**$10,893,000**	**$902,750**	***9.0%***

IT: Information Technology
OCR: United States Office for Civil Rights
UMB: University of Maryland, Baltimore

Source: Maryland Higher Education Commission

The large increase in grants in fiscal 2017 is entirely due to a new IT grant for SMCM. SMCM received tuition stabilization funds in fiscal 2015 from this very same MHEC program. This is an unusual practice and DLS raised issues with whether this was the best way to transfer and budget these funds. For example, MSU received additional State support for financial aid in fiscal 2017, but that funding was placed directly in its budget. While SMCM is formula funded, nothing precludes the allowance from including additional funding for SMCM with language noting that it is not part of the formula. SMCM is using this funding for IT infrastructure, such as Enterprise Resource Planning (ERP) software. The State's other formula-funded institution, Baltimore City Community College (BCCC), is also developing an ERP, but is funding that entire project out of its own fund balance. Moreover, SMCM is already receiving $1.3 million for IT infrastructure as a deficiency appropriation in fiscal 2016 and already charges students a fee for campus facilities. The deficiency is funded within the SMCM budget.

The President of SMCM should comment on why the college needs additional State support outside of its block grant, especially when another formula-funded institution, BCCC, is funding extensive IT development out of its own fund balance.

DLS is concerned this will set a precedent for other institutions seeking IT support outside of the normal routes for operating and capital budget development. Additionally, if SMCM cannot operate with the State support from its operating funding formula, their funding formula should be reviewed. **DLS recommends eliminating the new $1.1 million grant for SMCM in fiscal 2017.**

DLS has also raised issues about fund transfers out of MHEC institutional grants. First, for both the U.S. Office for Civil Rights (OCR) enhancement funds and for a prior SMCM Stabilization Grant, funds are disbursed to State institutions outside of the budget amendment process because they are grants. While the OCR funding is annually restricted by the legislature pending a report on its proposed use, there is never actually confirmation that the funding is disbursed through the budget system. In a similar manner, it is unclear to DLS when the SMCM Stabilization Grant was actually sent to the college. Second, for the same two programs, it appears that funding may be double counted. For example, the fiscal 2015 working appropriation number in the Governor's Budget Books shows $1.5 million for the SMCM grant in MHEC educational grants as current unrestricted revenue for SMCM. Fiscal 2016 budget bill language directed DBM and MHEC to require grant disbursements to institutions be made through budget amendments in order to notify the General Assembly of the transfer and so that such funds are not double counted in the working appropriation of MHEC and the receiving institution.

The Secretary should comment on the ability of MHEC and DBM to ensure that institutional grant funds are not double counted in the budget if the IT grant remains in the MHEC budget and MHEC should use the budget amendment process as directed in 2015 budget bill language when transferring these grants to State institutions to ensure budget transparency.

Regional Higher Education Centers

As shown in **Exhibit 9**, the fiscal 2016 and 2017 budgets fund non-USM Regional Higher Education Centers (RHEC) at $2.2 million. This is $0.4 million, or 15.7%, below the fiscal 2014 funding level. Non-USM RHEC funding is also still below the fiscal 2014 appropriation and the fiscal 2015 legislative appropriation of $2.6 million as it was reduced by $600,000 in fiscal 2015 cost containment.

Exhibit 9
State Support for RHECs
Fiscal 2016-2017

Non-USM RHECs	**Fiscal 2016**	**Fiscal 2017**	**$ Change Fiscal 2016-2017**	**% Change Fiscal 2016-2017**
AACC RHEC at Arundel Mills	$290,585	$294,026	$3,441	1.2%
Eastern Shore Higher Education	321,136	349,688	28,552	8.9%
University Center[1]	416,717	300,595	-116,122	-27.9%
Laurel College	281,513	281,611	98	-0.0%
Southern Maryland	527,340	557,010	29,670	5.6%
Waldorf	312,709	367,070	54,361	17.4%
Non-USM RHECs Total	**$2,150,000**	**$2,150,000**	**$0**	**0.0%**
USM RHECs				
Universities of Shady Grove	$8,634,272	$8,634,272	$0	0.0%
University System of Maryland at Hagerstown	1,832,294	1,832,294	0	0.0%
USM RHECs Total	**$10,466,566**	**$10,466,566**	**$0**	**0.0%**

AACC: Anne Arundel Community College
RHEC: Regional Higher Education Center
USM: University System of Maryland

[1]Formerly called the Higher Education and Applied Technology (HEAT) Center (in Harford County).

Note: USM RHECs do not include their allocation of $6.8 million in enhancement funds in fiscal 2017.

Source: Maryland Higher Education Commission

Exhibit 9 also compares the allocation of funding for USM and non-USM RHECs in fiscal 2017. The MHEC non-USM RHEC funding strategy is for each RHEC to receive $200,000 in base funding and then to allocate the remainder by FTES enrolled in 2+2 and upper division coursework at each RHEC. As non-USM RHECs funding is flat in fiscal 2017, RHECs will redivide the same amount of funding based upon changes in enrollment (which is how Sellinger aid works in years when it is flat funded). Overall, the audited fiscal 2015 enrollments used in the 2017 formula increased by 2 FTES, or 0.3%, after fiscal 2014 had declined by about 199 FTES, or 22.3%. The University Center RHEC lost over half its eligible FTES enrollment in the formula, declining 84.4 FTES, or about 53.0%. Because of this, it loses about 28.0% of its formula funding, or $116,000. The allowance funds non-USM RHECs at $3,097 per FTES versus $3,488 per FTES for USM RHECs (excluding enhancement funds), thus USM RHECs get about 13.0% more funding per student.

Despite the recent decline in enrollment, the intent of RHECs is to expand access to higher education in geographically underserved areas of the State that are not near public four-year institutions. However, the two USM RHECs receive about $8.3 million more in State support than the six non-USM RHECs.

The Secretary should comment on how the RHECs align with the State plan's goals to provide improved opportunity and access to all of Maryland's citizens.

In summer 2014, MHEC released two regional higher education assessments to determine needs in Frederick County and in Northeastern Maryland. The Frederick RHEC report concluded that the region needed more degrees in health profession, engineering, and IT fields. The Northeastern Maryland study group was focused on updating the postsecondary education programs at the existing University Center (formerly called the Higher Education and Applied Technology Center) and concluded that there needs to be a better regional strategy involving communications and marketing between local employers and the University Center and potentially new programs, such as cybersecurity.

The Secretary should comment on the status of a potential new RHEC in Frederick, program updates at the University Center in Northeastern Maryland, and any other notable developments at Maryland RHECs.

Health Professional Shortage Incentive Grants

After NSP II, HPSIG is the other significant health-related grant program operated by MHEC. When the Governor does not appropriate general funds for HPSIG, MHEC collects fees from the Maryland Board of Physicians. Since the first round of awards in fiscal 1992, no general funds have ever been appropriated for this program. Half of the fees collected fund the Loan Assistance Repayment Program for Physicians and Physician Assistants budgeted within the MHEC Office of Student Financial Assistance, and the other half goes to HPSIG. These funds are then distributed to postsecondary institutions to enhance or expand approved academic programs in health occupations experiencing personnel shortages in Maryland.

As shown in **Exhibit 10**, despite receiving over $0.5 million in fiscal 2012 and 2013, MHEC expended no HPSIG funding. In fact, unspent funds from prior years were returned from institutions to MHEC resulting in a higher HPSIG nonreverting fund balance. Due to this inactivity, during cost containment in fiscal 2015 the BRFA of 2015 transferred $1.7 million from the HPSIG fund balance to the General Fund, leaving just $0.4 million. MHEC still received HPSIG funding in fiscal 2015 and expects to receive the next round of funding from the Board of Physicians toward the end of fiscal 2016.

Exhibit 10
HPSIG Funding
Fiscal 2010-2017

Fiscal	Revenue	Expenditures	Annual Balance	Cumulative Balance
2010	$513,947	$507,423	$6,524	$369,490
2011	615,869	400,000	215,869	585,359
2012	523,601	-19,117	542,718	1,128,077
2013	631,372	-4,361	635,733	1,763,810
2014	546,645	573,257	-26,612	1,737,198
2015	678,529	351,000	327,529	2,064,727
2015 BRFA	***-1,700,000***	***0***	***0***	***364,727***
2016*	750,000	750,000	0	364,727
2017*	750,000	750,000	0	364,727

HPSIG: Health Personnel Shortage Incentive Grant

*Budgeted expenditures.

Source: Maryland Higher Education Commission

The HPSIG program's challenges led to a 2015 *Joint Chairmen's Report* (JCR) request for a report entitled *Report on Uses of Physicians' Fee Revenue*. In it, MHEC reviewed the difficulties in spending HPSIG funding. One problem is that the Department of Health and Mental Hygiene (DHMH) must annually approve the list of health personnel shortage areas based on health care occupational projections produced by DLLR. However, the statutory requirement of at least a 7% shortage of positions at hospitals and related institutions does not apply to any current occupations. Additionally, MHEC has raised concerns over the fact that the seven health occupations that can be certified by DHMH in the Health Occupations Article (§ 1-204) never exactly matched the occupations listed in the Education Article (§ 18-803). Of the seven, only three are mentioned in both articles: occupational therapist, physical therapist, and respiratory therapist.

Personnel turnover at both DHMH and MHEC, along with unclear legal guidance on whether the funds should be spent or not, led to the uneven program outlays shown in Exhibit 10. The Board of Physicians has also raised concerns over the categories of workforce shortages that are eligible to receive funding, since many of them are not directly related to physicians, and because this board is the only licensing board to contribute funding toward HPSIG awards. A final concern from the MHEC report is that HPSIG uses a funding formula based on enrollment, so MHEC has no discretionary power to allocate the funds and has little ability to measure the impact of grant funding.

MHEC ultimately recommended several statutory changes to clarify how HPSIG works and who should receive awards.

The Secretary should comment on progress toward resolving the statutory issues with DHMH, DLLR, and the Board of Physicians to maximize the use of HPSIG.

Issues

1. Campus Sexual Misconduct Policies and MHEC

MHEC has had statutory responsibility (§ 11-601 of the Education Article) since 1993 to review sexual assault policies and how those policies should be posted and distributed in Maryland. This includes the right to file criminal charges, designation of the nearest hospital, *etc.* MHEC must also periodically review and make changes to institutional policies to ensure that higher education institutions in Maryland are in compliance with federal regulations and are adopting best practices.

In 2015 MHEC reviewed all the policies of the public and independent institutions in the State to ensure that all are in compliance with federal Title IX of the Education Amendments of 1972 (Title IX), which prohibits discrimination on the basis of sex in all education programs that receive federal financial assistance. A related but distinct federal law from Title IX is the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics (Clery) Act of 1990. This requires all universities to submit, at the beginning of every federal fiscal year (October 1), an Annual Security Report (ASR) providing specific crime statistics, maintain a public crime log that covers the campus and certain areas adjacent to campus, and meet several other requirements.

Language in the fiscal 2016 budget bill (Chapter 310 of 2015) withheld $100,000 in general funds until MHEC submitted a report on higher education institutions' revised sexual misconduct policies. The report required the collection of information from each of Maryland's 55 postsecondary schools on how these institutions had made any necessary changes to be fully in compliance with Chapter 436 of 2015 which, among several changes to State law, required these institutions to conduct periodic campus climate surveys.

A report from MHEC entitled *Report on Higher Education Institutions Revised Sexual Misconduct Policies*, from November 2015, summarized the results of all institutions. Two issues arose. First, five small, private schools did not respond to MHEC or did not respond in a timely manner. Two are vocational schools and three are religious institutions. As MHEC lacks any strong power to compel these institutions to comply in the short term, MHEC will continue to communicate with these institutions and considers their progress toward compliance as "pending." These institutions are:

- Lincoln College of Technology;
- Seafarers Harry Lundberg School of Seamanship;
- Binah Institute of Advanced Judaic Studies for Women;
- Maalot Baltimore Women's Institute of Torah Seminary; and
- Ner Israel Rabbinical College.

The second issue is that although many of the remaining 50 institutions have updated their policies, due to shared governance structures these policies will not be formally adopted until the next convening of their respective governing boards – meaning that these institutions are not yet in compliance with Chapter 436. MHEC reports that many such boards will meet in early 2016 to adopt the revised policies.

The Secretary should comment on the status of all 55 institutions revising and adopting updated sexual assault policies as of February 2016.

It should further be noted that MHEC had some difficulty reviewing policies across 55 institutions due to not having an accredited Title IX coordinator on staff. However, by coincidence, an MHEC student intern was also the Title IX coordinator for the Community College of Baltimore County (and a doctoral candidate at MSU). This was highly fortuitous for MHEC as Title IX training and compliance will be a real ongoing cost for MHEC and all institutions.

MHEC also distributed an internally designed climate survey in October 2015 to all 55 institutions, as required by Chapter 436. Institutions will not submit survey results to MHEC, but will report incidents and how the institutions will use the survey results. This will offer more precise information than what is collected for ASRs, such as degrees of sexual assault. MHEC has a final report due in fall 2016. As it is not collecting much of the quantitative data, its review will be more qualitative in nature. This survey and survey review will be required every two years.

In addition to reviewing policies, MHEC held two workshops for smaller institutions that have had more difficulty finding the time and expertise to revise their policies. The first workshop for community colleges was in January 2015 and the second workshop for private institutions was in November 2015. These meetings covered definitions of key terms, case studies of campus policies, and reporting and adjudicating procedures. Maryland's criminal code does not specifically define some terms frequently used in Title IX and Clery discussions, such as sexual assault, domestic violence, dating violence, or consent, so the workshop was able to assist community colleges in meeting federal intent. This ensures that new policies are more inclusive and will bring institutions into compliance with the next round of federal regulations, which took effect in summer 2015. These changes expand rights afforded to campus survivors of sexual assault, expand reporting for such incidents, and require institutions to provide certain training programs. It also expands the types of crimes covered in the ASR and requires institutions to report the number of withheld crime statistics. Finally, complicating implementation of sexual assault policies has been compliance with the Family Education Rights and Privacy Act (FERPA), which governs access to education records but allows disclosure of criminal conduct. Online federal resources provide materials explaining how institutions are to comply with Title IX, the Clery Act, and FERPA.

This MHEC review of Title IX and Clery policies coincides with an increase in federal Department of Justice (DOJ) investigations into Title IX compliance nationwide. In summer 2014, DOJ confirmed 55 opened cases. By January 2016, this nearly tripled to 197 cases at 161 colleges. Cases are opened by civil rights complaints or proactive compliance review and frequently take more than a year to resolve. For example, in 2015, 106 cases were opened, but only 7 were closed. Nearly all are at traditional four-year campuses with residence halls.

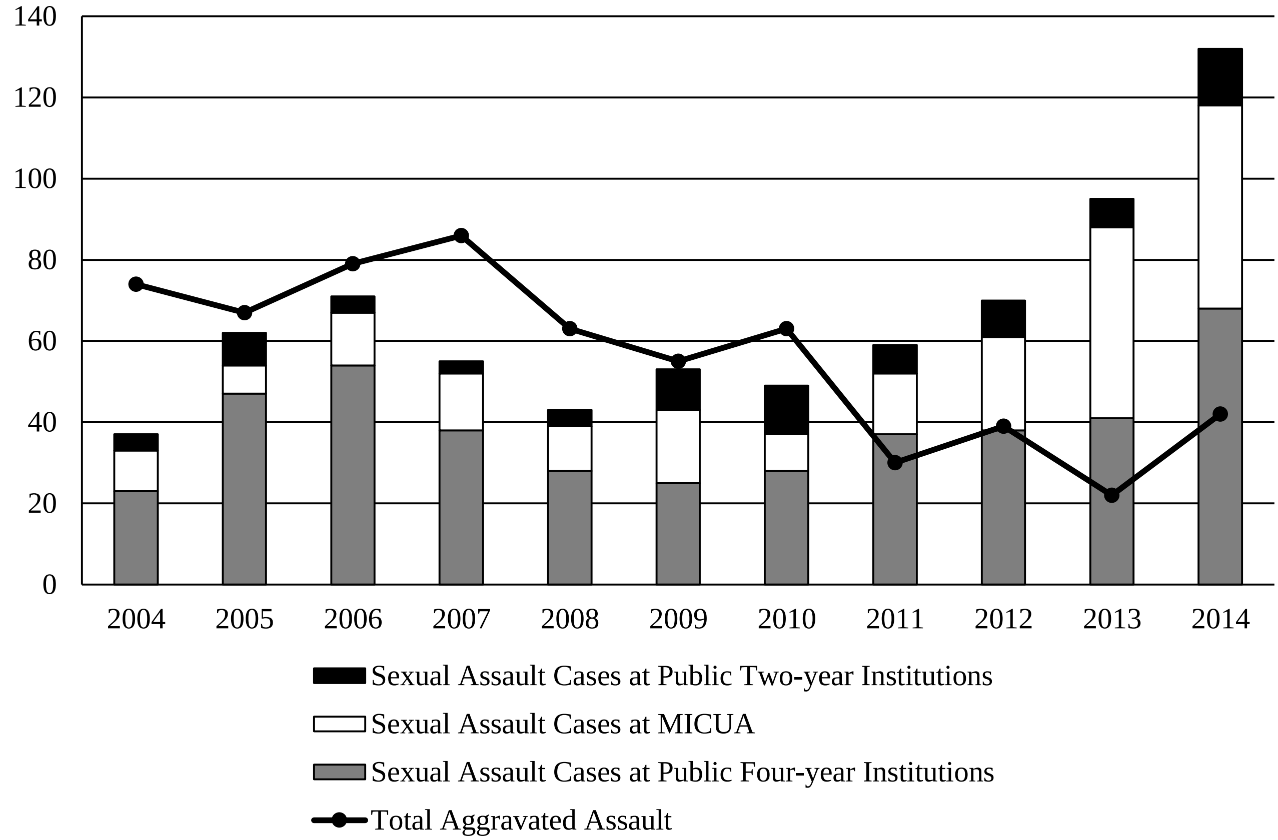
As of January 2016, the following Maryland institutions are under investigation by OCR within the U.S. Department of Education (ED):

- Frostburg State University as of September 2013;
- MSU as of June 2014;
- JHU as of August 2014; and
- SMCM as of June 2012 (one closed and four ongoing).

SMCM is notable for having the most opened investigations, five, at a single institution in the entire country. In addition, in Maryland, the school districts of Prince George's County and Queen Anne's County are also under Title IX investigations. Every state bordering Maryland, as well as the District of Columbia, has institutions under investigation.

Exhibit 11 shows campus crime statistics for sexual assault and aggravated assault for all years currently available from ED. Overall, during this time period reported cases of aggravated assault dropped from around 80 cases per year down to about half that in 2011 through 2014. Meanwhile, reported cases of sexual assault at Maryland campuses increased rapidly from 2010 through 2014, especially at MICUA institutions. Whether this represents an increase in the incidence of possible sexual assaults or an improvement in reporting alleged crimes cannot be determined from this data.

Exhibit 11
Reported Aggravated and Sexual Assault Crimes in Maryland
Reporting Years 2004-2014



MICUA: Maryland Independent College and University Association

Note: Includes alleged criminal offenses whose locations were reported as "campus" or "noncampus." Includes public four-year institutions, community colleges, and Sellinger-eligible institutions.

Source: U.S. Department of Education, *Campus Safety and Security Data Analysis Cutting Tool*

The Secretary, Director of Maryland Association of Community Colleges, and President of MICUA should comment on any next steps for Maryland institutions to come into compliance with federal regulations on sexual assault policies, observations about the development and deployment of the campus climate survey tool, and any other role MHEC may play to facilitate compliance for all postsecondary education institutions in Maryland.

2. Competitor State Funding Guideline Attainment

In fiscal 1999, as required by Chapter 515 of 1999, MHEC developed guidelines for operating funding for the public four-year higher education institutions by identifying peer institutions that are similar to each Maryland institution in size, program mix, enrollment composition, and other characteristics. After this selection process, the financial characteristics of the peer institutions were analyzed to determine the resources available per FTES. The overall goal has been to fund Maryland's institutions at the seventy-fifth percentile of their current peer institutions. The SMCM operating budget was not evaluated through this process because the college receives funding through a statutory formula.

In 2001, MHEC staff, in consultation with representatives from USM, DLS, DBM, and MSU, reviewed the funding guidelines process and established criteria for periodically updating peer groups and for making adjustments to an institution's peer group that is not in the normal cycle. The MHEC schedule calls for an update every three to four years, with the opportunity for reevaluation of any institution's peer group when requested by the Maryland public college or university. In 2006, the Commission to Develop the Maryland Model for Funding Higher Education (Funding Commission) spent two years studying the levels, models, and policies for State funding provided to colleges and universities and for student financial assistance. At the conclusion of this study in 2008, the Funding Commission made several recommendations for modification of State higher education funding policies such as setting State funding of public four-year institutions at the seventy-fifth percentile of funding per student of a group of comparable institutions ("peers") located in states with which Maryland principally competes for employers. These 10 states are referred to as Maryland's competitor states: California, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Virginia, and Washington. Additionally, the HBCU funding goal is raised to the eightieth percentile in recognition of the additional resources needed for HBCUs to compete with other public institutions. However, HBCUs are not to be solely measured against other HBCUs. This method is called the Competitor State Funding Guideline Model. Different methodologies are used for the USM Office and the University of Maryland Center for Environmental Sciences (UMCES).

The peer institutions selected for each Maryland school have similar academic scope, comparable size, and a somewhat similar student financial profile and are reflected in each institution's Carnegie Classification. For the University of Maryland, College Park, an Association of American Universities (AAU) school, other AAU schools in the competitor states have been used; and for University of Maryland, Baltimore (UMB), other institutions within the Carnegie Classification of Special Focus Institutions – Medical Schools and Medical Centers and research institutions with medical schools or freestanding medical centers have been selected. To recognize that institutions can change Carnegie Classifications over time as they offer new programs and award new degrees, MHEC will continue with the established schedule for an update to the peer groups every three to four years and reevaluation of any institution's peer group when requested by the Maryland public college or the university.

The funding guideline for each institution is calculated by determining the seventy-fifth percentile of the sum of State appropriation and tuition and fee revenue per FTES of the competitor state peer institutions. The resulting per student rate is multiplied by the institution's projected enrollment to determine the recommended resources. Projected institutional tuition and fee revenue is then subtracted from the recommended resources. The remainder represents the State investment. Funding guideline attainment is expressed as a percentage with the goal being 100%.

The Competitor State Funding Guideline Methodology was implemented by MHEC in fiscal 2015. Information for each institution, as determined by the peer groups recommended by the Funding Commission in 2008, is provided in **Exhibit 12**. Overall, total State attainment was 72% in the fiscal 2016 legislative appropriation, which does not yet reflect the health insurance deficiency for USM institutions. As in the past, the University of Maryland University College has the lowest funding attainment, 53%, while Coppin State University has the highest, 128%. Compared to the older attainment model used for fiscal 2015, most institutions are down no more than four points.

Exhibit 12

Competitor State Funding Guidelines

Fiscal 2016

Institution	Recommended Resources	Fiscal 2016 Tuition Revenue Estimates	Fiscal 2016 Funding Guideline	Fiscal 2016 State Funds Appropriation	Estimated Attainment
Bowie State University	$83,691,070	$36,810,699	$46,880,371	$41,525,890	89%
Coppin State University	51,399,995	16,538,253	34,861,742	44,755,130	128%
Frostburg State University	82,486,188	37,041,242	45,444,946	38,470,741	85%
Salisbury University	138,932,629	71,939,944	66,992,685	47,533,057	71%
Towson University	361,195,849	183,339,866	177,855,983	107,050,342	60%
University of Baltimore	124,776,344	71,020,250	53,756,094	34,639,444	64%
University of Maryland, Baltimore	437,698,001	19,870,873	317,827,128	215,405,339	68%
University of Maryland Baltimore County	312,161,223	122,572,828	189,588,395	111,151,119	59%
UMCES	[2]	[2]	27,468,459	22,353,347	81%
University of Maryland, College Park	1,164,047,550	519,441,424	644,606,126	480,925,509	75%
University of Maryland Eastern Shore	83,964,928	34,913,460	49,051,468	38,083,911	78%
University of Maryland, University College[1]	215,175,532	142,822,830	72,352,702	38,596,667	53%
USMO	[2]	[2]	[2]	23,567,555	[2]

Institution	Recommended Resources	Fiscal 2016 Tuition Revenue Estimates	Fiscal 2016 Funding Guideline	Fiscal 2016 State Funds Appropriation	Estimated Attainment
University System of Maryland Total	**$3,055,529,309**	**$1,356,311,669**	**$1,726,686,099**	**$1,244,058,051**	**72%**
Morgan State University	$169,851,008	$56,106,433	$113,744,575	$86,134,601	76%
Total	**$3,225,380,317**	**$1,412,418,102**	**$1,840,430,674**	**$1,330,192,652**	**72%**

UMCES: University of Maryland Center for Environmental Sciences
USMO: University System of Maryland Office

(1) University of Maryland University College calculations use only Maryland enrollment and statewide tuition revenue.
(2) Data is not applicable.

Note: Figures reflect fiscal 2016 legislative appropriation plus the cost-of-living adjustment restoration.

Source: Maryland Higher Education Commission

It is not clear how these guidelines are used to inform the budget process. For example, during cost containment in fiscal 2015 and 2016, the guidelines could have been used to suggest which institutions had the least ability to sustain reductions given their size and missions. Instead, institutions that were relatively lower in attainment, like University of Maryland Baltimore County and Salisbury University, implemented midyear tuition increases. Another opportunity lies in the fiscal 2017 budget, as $6.8 million in enhancement funding is budgeted within University System of Maryland Office for new initiatives. Additionally, MHEC also has institutional grants and financial aid programs that flow to higher education institutions.

The Secretary should comment on how funding in the fiscal 2017 budget should be evaluated using the funding guideline model.

3. College Access and Outreach Plan

Despite the availability of need-based financial aid programs at MHEC and institutions, low-income students have a lower college going rate than their wealthier peers. Chapter 201 of 2015 established the MHEC Outreach and College Access Pilot Program, which requires MHEC to target college information to low-income Maryland high school students to promote high school completion and college enrollment. This is broad based and could include promotion of existing State financial aid programs, like the Guaranteed Access Grant, online resources, like MDGo4It, or entirely new initiatives. MHEC was also required to establish a grant to obtain matching funds from nonprofit organizations and determine, after two years, whether its efforts have a significant impact. The 2015 JCR also required MHEC to report on efforts to increase college access and outreach. The JCR response, entitled *College Access Outreach Plan,* also served as a first response to Chapter 201.

The JCR indicated that MHEC annually provides outreach to more than 12,000 students using existing resources and federal grants. For example, the federal College Access Challenge Grant, is budgeted for $1.0 million in fiscal 2017, but expires in that fiscal year. MHEC also receives $0.4 million in GEAR-UP funding from MSDE for administrative costs for raising college awareness among a cohort of middle school students and will receive this funding for another three fiscal years. When the tracked cohort of students graduates high school in fiscal 2021, MHEC will disperse nonbudgeted federal funds, currently in a trust, for financial aid for this cohort. As noted in Exhibit 6, MHEC does have about $250,000 in new general funds for outreach projects to support new efforts. However, MHEC does not currently have a communications staff member in a full-time position and one of its current personnel vacancies is the director of grants management position.

The MHEC response to the 2015 JCR focused on services available to Baltimore City high schools. Currently, MHEC reports it provides brochures and YouTube videos to all such schools and that financial aid presentations are made at more than half of high schools where 75% or more of students are eligible for free and reduced-price meals. However, of sixth to twelfth grade schools, MHEC reports it is only personally visiting 4 of 18 schools. There is a lot of opportunity remaining for MHEC to visit all twelfth grade serving schools in Baltimore, let alone other regions of the State. Furthermore, brochures and YouTube videos establish a good minimum baseline for MHEC outreach, but more needs to be done. MHEC notes that it is:

- launching a redesigned MDGo4IT website in February 2016 with an updated design and new content; it was last reformatted in 2010;

- publishing all four of its brochures online in English and Spanish;

- promoting a November 2015 collaboration with Maryland Public Television called "How to Pay for College" and making DVDs available for schools;

- bringing online what is now a text-messaging service so that that the MHEC Office of Student Financial Assistance can communicate directly with students; this could be pivotal in reducing financial aid award cancelation rates; and

- establishing a new partnership called the Maryland College Access Network (MDCAN) with organizations such as First Generation College Bound.

The initiatives are all positive developments toward a comprehensive outreach plan, but the small staff size and limited budget of MHEC present challenges in managing a truly statewide plan that effectively reaches all potential students in high school, as well as nontraditional students elsewhere. MHEC should use its familiarity with the Governor's P-20 Council, the State's 529 College Savings Plan, and other connections to maximize its outreach potential.

The Secretary should comment on work towards filling the MHEC director of grants management position and new federal or private sources to support MHEC outreach programming. The Secretary should also comment on what the new $250,000 in funding will support in fiscal 2017, especially new web content, and what goals MHEC has to utilize that funding for maximum impact.

Finally, the Secretary should discuss potential partnerships with nonprofits and the timeline for creating and managing MDCAN.

Recommended Actions

		Amount Reduction	
1.	Reduce general funds for the Sellinger formula grant.	$ 141,204	GF

2. Add the following language to the general fund appropriation:

Provided that it is the intent of the General Assembly that institutional grants to a public four-year institution should be transferred only by budget amendment to that institution.

Explanation: This action provides greater clarity to the General Assembly on when an institution receives an institutional grant from the Maryland Higher Education Commission and also prevents funds from being double counted in the working appropriation.

3. Add the following language to the general fund appropriation:

, provided that $4,900,000 in general funds designated to enhance the State's four historically black colleges and universities may not be expended until the Maryland Higher Education Commission submits a report by July 1, 2016 to the budget committees outlining how the funds will be spent. The budget committees shall have 45 days to review and comment on the report. Funds restricted pending receipt of a report may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund if the report is not submitted to the budget committees.

Explanation: This annual language restricts the expenditure of funds until the commission reports to the budget committees on the plans for spending funds designated to enhance the State's four historically black colleges and universities (HBCU).

Information Request	**Author**	**Due Date**
HBCU enhancement expenditure report	Maryland Higher Education Commission	July 1, 2016

4. Modify the following language to the general fund appropriation:

Complete College Maryland	250,000
Improving Teacher Quality	975,000
Office of Civil Rights Enhancement Fund	4,900,000
Regional Higher Education Centers	2,150,000

College Access Challenge Grant Program 1,000,000
Washington Center for Internships and Academic Seminars 175,000
University of Maryland, Baltimore – WellMobile 285,000
John R. Justice Grant 25,000
St. Mary's College of Maryland Information Technology Grant .... ~~1,133,000~~
.... 0

Explanation: This is a technical amendment to reduce educational grants.

	Amount Reduction	
5. Reduce Educational Grants funding by deleting the St. Mary's College of Maryland Information Technology Grant because the institution is already receiving additional State support outside of its funding formula in fiscal 2016 for this purpose.	1,133,000	GF

6. Adopt the following narrative:

Report on Best Practices and Annual Progress Toward the 55% Completion Goal: The committees understand that in order to meet the State's goal to have at least 55% of Maryland's residents age 25 to 64 holding at least one degree credential by 2025, accurate and timely information on degree progression and best practices is needed to ensure that the State is on track to meet the goal. The committees request that the Maryland Higher Education Commission (MHEC) annually collect and analyze student- and transcript-level data on progression, graduation, and other relevant metrics from each public institution of higher education, including community colleges and regional higher education centers. MHEC should submit a report by December 15 each year that analyzes the data and shows each institution's progress toward the State and institutional goals in 2025. The report should also include a summary of best practices and findings on the effectiveness of institutions' programs, as well as any concerns regarding lack of progress or best practices that are not being implemented by institutions.

In addition, the committees request that MHEC, in collaboration with the Governor's Prekindergarten-20 Council, convene a biennial Summit on Completion that provides a forum for representatives of all segments of education (including K-12), economic and workforce development, and other stakeholders to share best practices on college completion that are underway in Maryland and hear from experts on best practices in other states that may be replicated in Maryland. A summary of the summit should be included in the annual report on best practices and progress toward the 55% goal.

Information Request	**Author**	**Due Date**
Report on best practices and progress toward the 55% completion goal	MHEC	December 15, 2016, and annually thereafter

7. Adopt the following narrative:

Report on Outcomes of Students Participating in Access and Success Programs by Cohort: The committees understand that as part of the State's agreement with the federal Office for Civil Rights, the State has provided annual funding to Maryland's public historically black colleges and universities (HBCU) to improve retention and graduation rates. From fiscal 2001 to 2006, the funds were budgeted through the Maryland Higher Education Commission (MHEC) and released after each HBCU submitted proposals to MHEC outlining how the funds would be spent in the coming year. Beginning in fiscal 2007, Access and Success funds were appropriated directly to HBCUs. The committees request that MHEC collect progression, retention, and graduation data from each public HBCU on all students participating in the Access and Success program in fiscal 2016. Data should be analyzed and presented by institution and program. Data should include the throughput completion rate in credit-bearing coursework for required remedial classes and graduation rates. The report should include a summary of fiscal 2016 programs supported by Access and Success funds and a statement from each institution on how findings from the 2015 report have been used to inform and improve programs and student services supported by Access and Success funds. The report shall be submitted by October 15, 2016, and every year thereafter.

Information Request	**Author**	**Due Date**
Report on the fiscal 2016 outcomes by cohort of students participating in Access and Success programs	MHEC	October 15, 2016, and annually thereafter

Total General Fund Reductions **$ 1,274,204**

Updates

1. Academic Mission Review

One of the main responsibilities of MHEC (Education Article, §§ 11-302, 11-303) is the review of mission statements of all public institutions every four years. Each institution's mission statement outlines who the institution teaches, what geographic area the campus serves, admission standards, and academic specializations. The document guides decisions concerning new academic program development and budgets to build on each institution's unique strengths and avoid unnecessary program duplication. MHEC last reviewed mission statements in December 2015 and, before that, last reviewed mission statements in January 2012. While the January 2012 review noted several significant changes, such as UMCES pursuing degree-granting status, recognizing the dissolution of the University of Maryland Biotechnology Institute, and name changes for three institutions, the 2015 review has few notable changes. As was the case in 2012, MHEC completed review of all institutions and concluded it should approve all mission statements as most institutions recommended no changes to their statements. However, a few changes are noteworthy:

- Bowie State University (BSU) reaffirmed its status as a comprehensive institution. BSU had an unusually high doctoral degree output in one year, which would have made the institution eligible for "research" status.

- UMB shortened its mission statement moderately to heighten a focus on interprofessional education to promote multidisciplinary efforts and also a renewed push for community engagement, as the institution borders west Baltimore, which faces many challenges.

2. Measuring Support for and Outcomes of Nontraditional Students

The 2015 JCR included narrative to provide an annual update on the Access and Success Program (A&S) outcomes at HBCUs. For many years, DLS has raised concerns that the funds are not used consistently and that program outcomes have been relatively poor. The JCR also requested MHEC to look at how to better account for measuring the progress of nontraditional students, who are a rapidly growing demographic, even when FT/FT students are in decline. Together, these reports show how some institutions are trying new approaches to reaching, assisting, and measuring success for a diversifying student body.

A&S funding has been provided since fiscal 2001 to improve student retention and graduation rates at HBCUs. Annual committee narrative since fiscal 2010 requires MHEC to collect and analyze progression, retention, and graduation data by cohort to evaluate the impact of A&S programs across HBCUs. The 2015 *Report on Outcomes of Students Participating in Access and Success Programs by Cohort* used 10 indicators to compare A&S students to the general first-year student population. Overall, there is considerable variation in performance, but many A&S students, particularly in the summer bridge programs, outperform other first-year students, although the strong performance varies from school to school. The most recent A&S cohorts are showing improvements in grade point average (GPA), credits earned, and retention rates, all suggesting such students will be on track for graduation and that institutions are finding better methods to serve students. At BSU, for the 2011 and 2014 cohorts, participants earn six to eight more credits in the first year and maintain comparable GPAs. While A&S students at BSU actually had a four-year graduation rate half that of regular students in fall 2008, they surpassed all students in the 2011 cohort, as shown in **Exhibit 13.**

Exhibit 13
Four-year Graduation Rates at Historically Black Colleges and Universities
2008 and 2011 Cohorts

	UMES		BSU		CSU		MSU		
Cohort	**A&S**	**All Others**	**A&S**	**All Others**	**A&S**	**All Others**	**A&S**	**All Others**	**State Average**(1)
2011	19.6%	19.7%	22.2%	15.4%	9.1%	6.1%	16.7%	13.4%	(2)
2008	18.2%	19.2%	3.8%	7.8%	(2)	(2)	7.9%	11.8%	12.5%

A&S: Access and Success
BSU: Bowie State University
CSU: Coppin State University
MSU: Morgan State University
UMES: University of Maryland Eastern Shore

(1) For first-time, full-time African American students at all public four-year universities.
(2) Data not yet available.

Source: Maryland Higher Education Commission, Access and Success, 2015 Report

Enrollment in A&S programs has been challenging. At MSU, A&S summer bridge participation fell from 42 in fall 2011 to only 20 in fall 2013. BSU had only 26 students in fall 2012, but then had enrollment jump to 122 a year later. The University of Maryland Eastern Shore (UMES) does not offer any summer bridge and instead focuses on broad programs intended to promote retention and progression across much of the student body (about one-third to one-half in total, depending on the year), so its outcomes are notably different from the other three institutions which focus more on summer bridges.

The UMES four-year graduation rate for the 2011 A&S cohort is nearly 20%, the second highest of the HBCUs and the most comparable rate to all other students on the same campus. While UMES A&S students' GPAs were slightly lower than their peers, they still earned more credits, indicating that they persisted, even when they were not initially faring as well in the first year of studies. UMES also had similar or lower retention rates compared to the other A&S programs, suggesting something is happening for students after initial enrollment. The key difference between UMES and the other three institutions is that UMES does not fund a bridge program. Given that the three bridge programs each focus on a different population at their respective campus, it is also difficult to evaluate the bridge programs against each other. MHEC did conclude its report by recommending that HBCUs focus on "serving a broader population of students" and that this is a juxtaposition against a recent emphasis to focus on personal services for every student, which is expensive and time consuming.

Understanding how UMES may be reaching higher graduation rates is difficult because there are few good measures for how nontraditional students' progress and even what constitutes a good outcome. This is partially addressed in the MHEC JCR response on nontraditional student metrics wherein MHEC has committed to better understanding the progression of nontraditional students. Such students are a loosely defined group, but often enroll part-time, have children to care for, have a GED rather than a high school diploma, work full-time while enrolled, are a veteran, or are a first generation student. One national study that MHEC cites finds nontraditional enrollment to be 74% of all undergraduates in academic year 2011-2012.

Overall, MHEC notes great success in boosting access and student diversity but notes a lack of developing or implementing new metrics to track these students. MHEC finds data on nontraditional students is much less robust due to FT/FT students being the historical focus of education data analytics. Going forward, the Maryland Longitudinal Data System will be an invaluable tool for MHEC and policymakers in linking workforce status to students, enabling a richer look at student demographics. MHEC notes that degrees awarded per 100 FTES may better reflect part-time student progress and will look for ways to focus new reporting on students 25 years and older, who are considered nontraditional.

MHEC reports institutional best practices include dedicated advising, study spaces, and additional supports for students who may be less familiar with or less ready for a college program. Degree pathways and updated websites are some of the very simple tools that can be used. Many of these steps can be, or already are, incorporated into the A&S programs mentioned above.

3. Historically Black Colleges and Universities' Lawsuit Ruling Pending

In 2006, the Coalition for Equity and Excellence in Maryland Higher Education, Inc. brought suit against the State for alleged violations of the Civil Rights Act of 1964 and the Equal Protection Clause of the U.S. Constitution – both of which protect against discrimination on the basis of race, color, or national origin. In the coalition's lawsuit, three policies of the Maryland system of higher education allegedly traceable to the prior *de jure* system were at issue: (1) limited institutional missions; (2) operational funding deficiencies; and (3) unnecessary program duplication. In October 2013, the court did not find that mission-related policies or practices or current operational funding were traceable to the *de jure* era; however, the court did find that the State has failed to eliminate unnecessary program duplication for Maryland's HBCUs and that this policy is traceable to the *de jure* era.

The court concluded that the coalition proved that unnecessary program duplication continues and is a policy traceable to prior *de jure* segregation in Maryland higher education. The court, applying the law established by the Supreme Court in *United States v. Fordice*, 505 U.S. 717 (1992), defined unnecessary duplication as the offering by two or more institutions of the same nonessential or noncore programs; nonbasic liberal arts and sciences course work at the bachelor's level; and all duplication at the master's level and above. The court cited the MHEC decision to approve a joint University of Baltimore/Towson University Master of Business Administration program, despite the objections of MSU in 2005, as an example of how the State has failed to prevent additional unnecessary duplication. (The joint MBA program was discontinued in fall 2015.)

Despite the findings of fact and conclusions of law included in the memorandum, the court has deferred entry of judgment pending mediation or further proceedings, if necessary, to establish a remedy. The case was referred back for mediation with a court-appointed judge as mediator. As a promising starting point, the court, quoting the coalition's expert, suggests that each HBCU "should develop programmatic niches or areas of excellence in at least two high-demand clusters within the next three to four years." The niche areas identified by the court include Green Sustainability Studies, Computer Sciences, Aging Studies, and Health Care Facilities Management. Additionally, the coalition's expert said it is likely that transfers or merging of programs will be necessary. If mediation is unsuccessful, then one or more of the parties may request an immediate appeal under the Federal Rules of Civil Procedure.

Negotiations continued in 2015, but ultimately failed to resolve the case. The determination of remedies is an ongoing process. Given that this lawsuit is nearly 10 years old, it is very difficult to determine when this case will be resolved.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
MHEC – Administration
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$60,176	$18,210	$3,570	$187	$82,143
Deficiency Appropriation	0	0	0	0	0
Cost Containment	-3,998	0	0	0	-3,998
Budget Amendments	42	467	2	135	645
Reversions and Cancellations	-105	-6,321	-1,394	-95	-7,915
Actual Expenditures	**$56,115**	**$12,356**	**$2,178**	**$226**	**$70,875**
Fiscal 2016					
Legislative Appropriation	$56,358	$8,205	$2,759	$346	$67,668
Budget Amendments	-126	11,939	2	370	12,185
Working Appropriation	**$56,232**	**$20,144**	**$2,761**	**$716**	**$79,853**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The fiscal 2015 legislative appropriation for MHEC Administration was reduced by $11.3 million. General funds decrease about $4.0 million due to two rounds of across-the-board cost containment efforts by the Board of Public Works reducing Sellinger aid ($3.0 million); grants for regional higher education centers ($0.6 million); operating expenses ($0.2 million); and funding administrative positions with a program fee providing special funds ($0.2 million). This was offset by general funds increasing about $37,000 for fiscal 2015 cost-of-living adjustments (COLA) and about $5,000 for telecommunications expenditures alignment. About $0.1 million in general funds were reverted almost entirely due to an ongoing issue with the Office of Legislative Audits regarding administration of financial aid awards.

Special funds increase by about $3,000 for the COLA and $463,000 due to an ongoing, but unspent, Credit When It's Due grant being moved to fiscal 2015 from the prior year. About $6.3 million in special funds were canceled due to a larger appropriation than needed to make all necessary awards in the Nursing Support II ($4.6 million) and the Health Personnel Shortage Incentive Grant ($1.7 million). These funds will be available for awards in future fiscal years.

Federal funds increase almost $2,000 for the COLA while about $1.4 million in federal funds were canceled due to MHEC not spending the entirety of two budgeted federal grants in fiscal 2015 on teacher quality and college outreach.

Reimbursable funds increased about $0.1 million to fulfill a Memorandum of Understanding between MSDE and MHEC for staffing of the Longitudinal Data System, while about $0.1 million were cancelled due to this position being vacant for most of the fiscal year and because some other administrative expenses were lower than anticipated.

Fiscal 2016

To date, the legislative appropriation has increased by $12.2 million. The general fund appropriation has decreased $0.1 million with $0.1 million to restore the 2% pay reduction offset by a decrease of $0.2 million to redistribute cost containment from need-based financial aid programs to the administrative budget program for MHEC. Special funds increased $6,000 to restore the 2% pay reduction and $11.9 million due to the reauthorization of the Nursing Support II Program, which renewed the special fund source for this large annual grant program. Federal funds also increased $2,000 to restore the 2% pay reduction. Finally, reimbursable funds increased $0.4 million from a GEAR-UP grant from MSDE.

Object/Fund Difference Report
Maryland Higher Education Commission

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01Regular	57.60	58.60	55.60	-3.00	-5.1%
02Contractual	6.94	13.33	10.33	-3.00	-22.5%
Total Positions	**64.54**	**71.93**	**65.93**	**-6.00**	**-8.3%**
Objects					
01Salaries and Wages	$ 4,836,021	$ 5,195,957	$ 5,025,548	-$ 170,409	-3.3%
02Technical and Spec. Fees	461,793	585,573	613,486	27,913	4.8%
03Communication	61,863	67,311	63,759	-3,552	-5.3%
04Travel	92,022	58,814	75,284	16,470	28.0%
07Motor Vehicles	71,158	58,620	60,680	2,060	3.5%
08Contractual Services	815,804	495,091	764,040	268,949	54.3%
09Supplies and Materials	29,422	46,307	65,000	18,693	40.4%
10Equipment – Replacement	32,073	12,250	25,750	13,500	110.2%
11Equipment – Additional	5,496	350	15,000	14,650	4185.7%
12Grants, Subsidies, and Contributions	64,267,422	72,909,256	82,040,427	9,131,171	12.5%
13Fixed Charges	202,352	423,228	458,623	35,395	8.4%
Total Objects	**$ 70,875,426**	**$ 79,852,757**	**$ 89,207,597**	**$ 9,354,840**	**11.7%**
Funds					
01General Fund	$ 56,115,204	$ 56,231,971	$ 65,831,206	$ 9,599,235	17.1%
03Special Fund	12,356,310	20,143,752	20,433,279	289,527	1.4%
05Federal Fund	2,177,645	2,760,761	2,462,365	-298,396	-10.8%
09Reimbursable Fund	226,267	716,273	480,747	-235,526	-32.9%
Total Funds	**$ 70,875,426**	**$ 79,852,757**	**$ 89,207,597**	**$ 9,354,840**	**11.7%**

Note: The fiscal 2016 appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Maryland Higher Education Commission

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 General Administration	$ 6,588,476	$ 7,086,152	$ 7,324,446	$ 238,294	3.4%
02 College Prep/Intervention Program	750,000	750,000	750,000	0	0%
03 Joseph A. Sellinger Program	41,422,240	42,822,240	50,812,427	7,990,187	18.7%
07 Educational Grants	10,906,252	9,990,250	10,893,000	902,750	9.0%
38 Nurse Support Program II	10,857,458	18,454,115	18,677,724	223,609	1.2%
39 Health Personnel Shortage Incentive Grant Program	351,000	750,000	750,000	0	0%
Total Expenditures	**$ 70,875,426**	**$ 79,852,757**	**$ 89,207,597**	**$ 9,354,840**	**11.7%**
General Fund	$ 56,115,204	$ 56,231,971	$ 65,831,206	$ 9,599,235	17.1%
Special Fund	12,356,310	20,143,752	20,433,279	289,527	1.4%
Federal Fund	2,177,645	2,760,761	2,462,365	-298,396	-10.8%
Total Appropriations	**$ 70,649,159**	**$ 79,136,484**	**$ 88,726,850**	**$ 9,590,366**	**12.1%**
Reimbursable Fund	$ 226,267	$ 716,273	$ 480,747	-$ 235,526	-32.9%
Total Funds	**$ 70,875,426**	**$ 79,852,757**	**$ 89,207,597**	**$ 9,354,840**	**11.7%**

Note: The fiscal 2016 appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Appendix 3

R62I0005

Aid to Community Colleges

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$290,264	$296,129	$314,335	$18,206	6.1%
Deficiencies and Reductions	0	1,340	0	-1,340	
Adjusted General Fund	**$290,264**	**$297,469**	**$314,335**	**$16,866**	**5.7%**
Adjusted Grand Total	**$290,264**	**$297,469**	**$314,335**	**$16,866**	**5.7%**

- There is a fiscal 2016 deficiency for $1.3 million to supplement the Optional Retirement Program (ORP) for community college personnel in fiscal 2016.

- There are also two proposed deficiencies for prior year unfunded liabilities totaling $4.4 million. The first is $2.7 million for a workforce development grant for community college students and the other is $1.7 million for the ORP.

- After adjusting for the one ORP deficiency that directly impacts fiscal 2016 spending, total general fund support for local community colleges grows $16.9 million, or 5.7%, in fiscal 2017.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Successful Persister Rate Falls to New Low: The successful persister rate for Maryland's community college students declined to 68.6% for the 2010 cohort, the lowest rate since at least the 2002 cohort. Since the majority of community college students require developmental education, raising the number of students who complete developmental education is key to reaching the State's degree completion goals.

Achievement Gap Improves: The gap in the four-year graduation/transfer rate of minority students compared to all students decreased 0.3 percentage points for the 2010 cohort. After fluctuating between 8.8 percentage points and 10.1 percentage points for several years, the gap has remained at 7.5 percentage points or less for the past six years.

Issues

Tuition, Fees, and Student Aid at Community Colleges: Though much more affordable than the State's public four-year institutions, Maryland's community colleges are more expensive than their national peers and are increasingly unaffordable for Marylanders from outside an institution's service area. Additionally, while there is a national push to make community colleges free after financial aid is applied, two institutions in Western Maryland have already done this.

The Decline of Credit Enrollment and Rise of Dual Enrollment: Credit enrollment eligible for the Cade formula peaked in fiscal 2012 and since then almost all institutions have struggled with enrollment declines. One opportunity to increase enrollment in a previously untapped population is the statewide effort to boost dual enrollment opportunities for high school students.

The Separate World of Noncredit Education: About one-quarter of eligible students for the Cade formula take noncredit workforce training rather than traditional academic credit programs. This issue will explore the limitations of federal and State financial aid for these offerings, as well as what the Maryland Higher Education Commission is doing to provide more information on outcomes from these courses.

Recommended Actions

		Funds
1.	Add language restricting Cade formula funding.	
2.	Reduce general fund support for the Cade formula grant.	$ 466,018
3.	Adopt narrative for a report on continuing education outcomes.	
	Total Reductions	**$ 466,018**

Operating Budget Analysis

Program Description

State aid for the 15 local community colleges is provided through the Senator John A. Cade Funding Formula under Section 16-305 of the Education Article. The current formula has been used in determining funding since 1998. The amount of aid is based on a percentage of the current year's State aid per student to selected four-year public higher education institutions and the total number of full-time equivalent students (FTES) at the community colleges. The total is then distributed to each college based on the previous year's direct grant, enrollment, and a small-size factor. Chapter 333 of 2006 phased in a 5 percentage point increase in the formula over five years, ending in fiscal 2013. State fiscal difficulties have delayed the formula enhancement, and full funding is currently expected in fiscal 2023.

Additional grants are provided through the following programs.

- The Small Community College Grants are distributed to the smallest community colleges in order to provide relief from the disproportionate costs they incur. Chapter 284 of 2000 increased the grants distributed by the Maryland Higher Education Commission (MHEC) to seven small community colleges beginning in fiscal 2004. The amount of the unrestricted grants increase annually by the same percentage of funding per FTES at the selected institutions used by the Cade formula. Additional grants are received by Allegany College of Maryland and Garrett College. These Appalachian Mountain grants do not increase annually.

- The Statewide and Health Manpower Grant programs permit some students to attend out-of-county community colleges and pay in-county tuition rates. The grants reimburse colleges for out-of-county tuition waivers. If funding in a single year is not enough to cover the entire program, MHEC prorates funding based on the number of participating students.

- The English for Speakers of Other Languages (ESOL) program provides funding for instructional costs and services for ESOL students. Funding is capped at $800 per eligible FTES and $8 million in total State aid for the program.

- The Garrett County/West Virginia Reciprocity Program allows West Virginia residents to attend Garrett College at in-county tuition rates and provides reimbursement for tuition waivers. The Somerset County Reimbursement Program similarly provides tuition waiver reimbursement to colleges permitting students who reside in a county with no community college to attend at in-county tuition rates.

Certain community college employees are eligible to participate in a defined benefit retirement plan maintained and operated by the State. Alternately, the employees may participate in the Optional Retirement Program (ORP), a defined contribution plan. Under current law, the State funds the costs associated with the various retirement plans, with the exception of State Retirement Agency administration costs.

The goals that MHEC has set for providing State aid to community colleges are:

- to ensure that Maryland community college students are progressing successfully toward their goals;
- to attain diversity reflecting the racial/ethnic composition of the service areas of the community colleges;
- to support regional economic and workforce development by producing graduates and by supplying training to the current employees of businesses; and
- to achieve a competitive ORP to recruit and retain quality faculty.

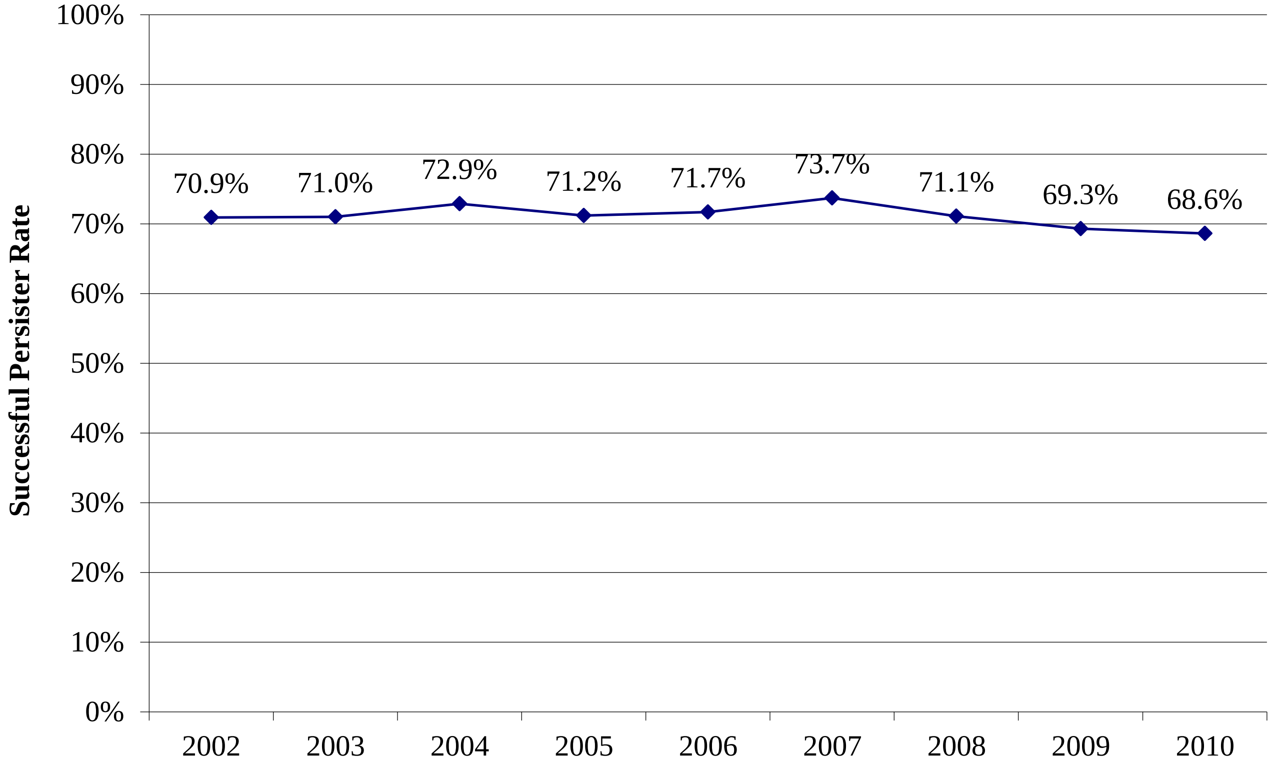
Performance Analysis: Managing for Results

Students enrolling at community colleges often have different goals than those at traditional four-year institutions. Community college students tend to have higher developmental education needs and obtaining an associate's degree may not be the top priority. With these differences, it is difficult to directly compare the outcomes between the two segments. For community college students, successful persister rates are used to measure student performance. A successful persister is a student who attempts at least 18 credits in his or her first two years, and who, after four years, is still enrolled, has graduated, or has transferred.

1. Successful Persister Rate Falls to New Low

The statewide successful persister rate for the 2002 through 2010 cohorts is shown in **Exhibit 1**. The rate declined by 0.7 percentage points to 68.6% from the 2009 to 2010 cohort, making this the lowest rate since at least 2002. Increasing this rate is necessary to meet the State's degree completion goals. However, from the 2007 cohort to the 2010 cohort, the rate has decreased 5.1 percentage points, indicating that the larger cohorts entering during the recession years had poorer outcomes, even when using the broader definition for success within the persistence rate.

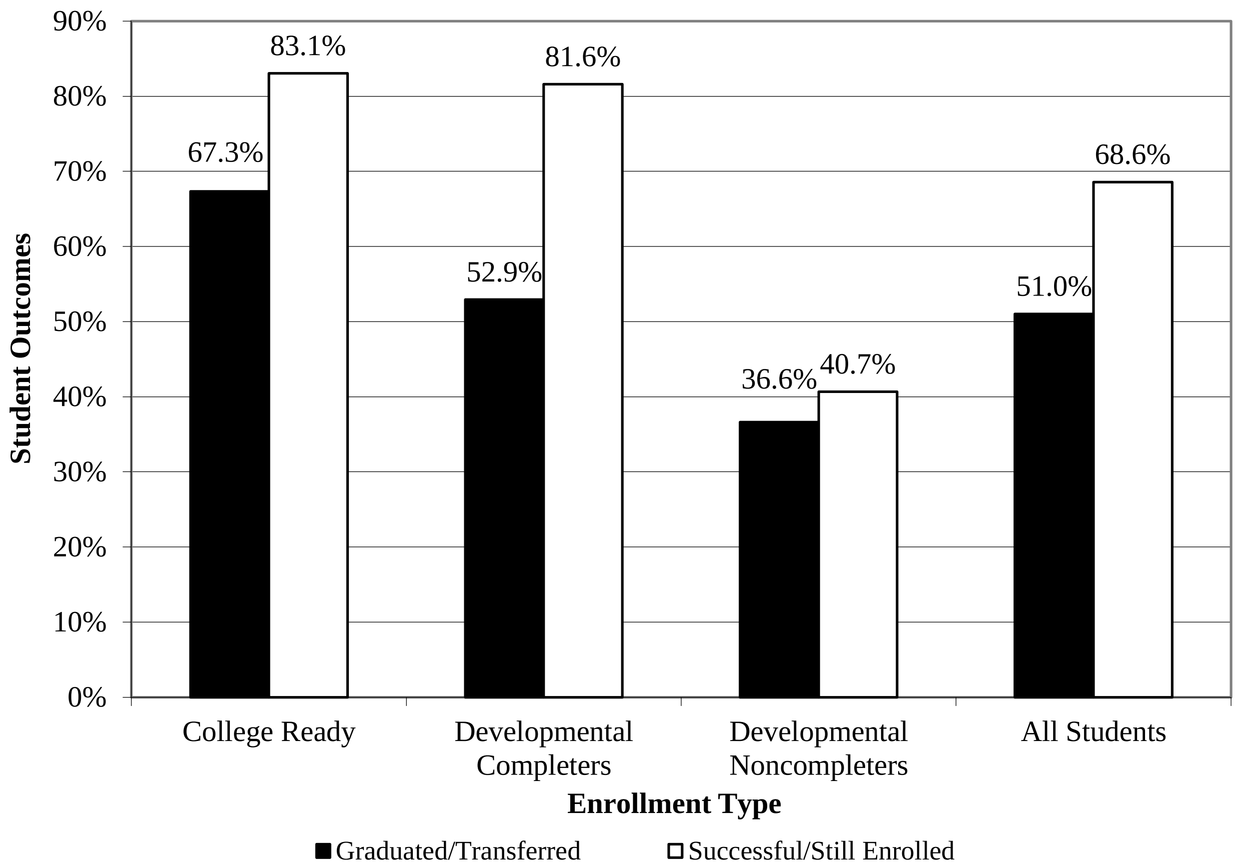
Exhibit 1
Four-year Successful Persister Rate
2002-2010 Cohorts



Source: Maryland Association of Community Colleges

The successful persister rates for three separate subgroups of students are tracked by the Maryland Association of Community Colleges (MACC) – college ready students, developmental completers (students who require developmental education and who complete it within four years), and developmental noncompleters (students who require developmental education and have not completed coursework after four years). **Exhibit 2** shows successful persister rates for those three subgroups and for all students in the 2010 cohort.

Exhibit 2
Degree Progress Four Years after Initial Enrollment
Fall 2010 Cohort



Note: Figures include Baltimore City Community College. The students included in this analysis represent the outcomes of first-time students who attempted at least 18 course hours in their first two years.

Source: Maryland Association of Community Colleges

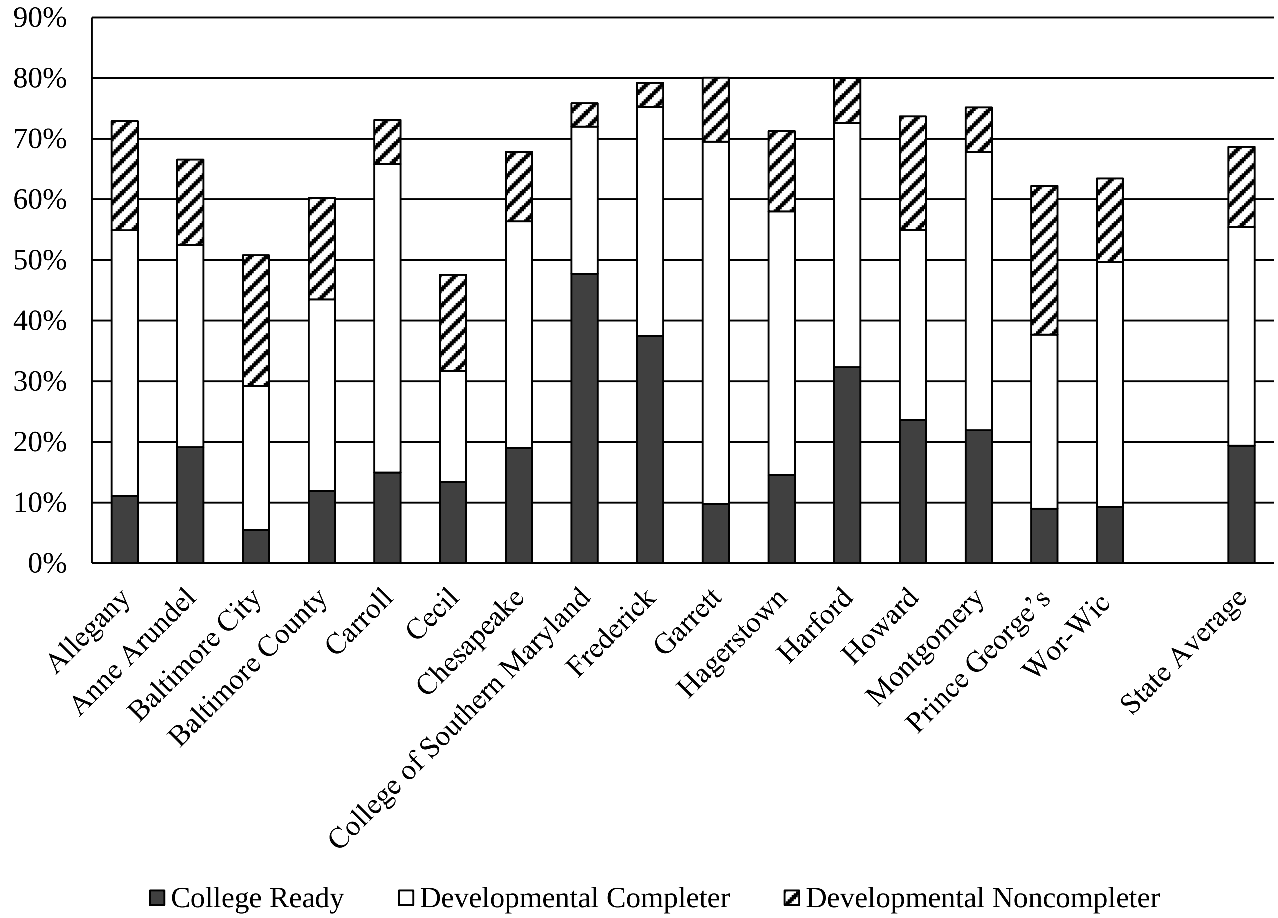
Prior to the 2010 cohort, the highest success rate in the 2005-2009 cohorts had been for developmental completers, or students who required and completed developmental education before beginning credit-bearing coursework. The successful persister rate for this type of student had been between 1.4 percentage points to 2.6 percentage points higher than college ready students. The 2010 cohort represents a shift back to the 2004 cohort in that the college ready students are again outperforming developmental completers. As both the 2004 and 2010 cohorts enrolled during economic recessions, it may be that growth in enrollment during recessions brings more students to community colleges with developmental needs who also persist at lower rates than their peers during nonrecession years.

The rate of students who graduated or transferred increased 0.1 percentage point among college ready students in the 2010 cohort, but declined 5.8 percentage points for developmental completers in the same cohort. Further detail within these types of students, such as how many are graduating versus transferring, would be useful, but this data is not currently reported. While overall persistence is good for successful students, the fact that more students are not transferring or graduating and instead are only persisting is cause for concern.

The declines in the developmental completer rates are discouraging given the important work of community colleges serving as open access institutions where students of all preparedness levels enroll expecting to make progress toward a degree. The majority of students who enter community colleges test into developmental education, but few of them complete the required coursework. Exhibit 2 shows that the students who do complete developmental education are nearly as successful as those who enter college ready. Thus, reducing the number of students in the noncompleters category should be a priority for community colleges and may be a better goal to track than the success of the noncompleters themselves. The 2008 cohort of noncompleters was about 7,500, while the 2010 cohort of noncompleters was only 6,500, a decline of 1,000 students, or about 13.0%, over two years. At the same time, the size of the total cohort under analysis grew by almost 2,000 students, or 10.9%, in the 2010 cohort over the 2008 cohort. Over the same two cohorts, the number of students who are developmental completers, grew by 1,300, or over 17.0%. This suggests more students are completing developmental coursework, but fewer are persisting. While that change in persistence is in the wrong direction, given the increase in community college enrollment during the recession and the expected positive impact of community colleges improving developmental courses, the number of students in each persister category may in fact be much more important than slight changes in the percent persisting. As the College and Career Readiness and College Completion Act (CCRCCA) of 2013 requires students to complete developmental courses within their first 24 credits on campus and transition courses in high school will reduce the need for developmental education in college, the number of students needing developmental education should decrease greatly, but that will not be seen in the persistence data until at least the 2014 cohort, four years from now.

Exhibit 3 shows the college-by-college breakdown of the same three categories of student for the 2010 cohort persister rates. Overall, colleges range from 48.0% at Cecil College and 50.8% at Baltimore City Community College (BCCC) up to 80.0% at Harford Community College and 80.1% at Garrett College. Most schools, 11 of the 16 colleges, have persister raters above 65.0%. Differences are expected given varying demographics and, generally, the colleges with a higher number of students requiring developmental education have lower successful persister rates although 4 community colleges (Allegany, Carroll, Garrett, and Hagerstown) have below average numbers of college ready students and relatively high persister rates. In the 2010 cohort, 11 community colleges saw the successful persister rate decrease by at least 1 percentage point, while 12 had decreased in the prior year. Cecil College, in particular, declined 14 percentage points in the 2010 cohort, partly due to having a very small cohort size of between 350 and 450 students in most years of data. Only Harford and Montgomery colleges saw improvement of at least 1 percentage point in persister rates in the 2010 cohort, both about 2 percentage points.

Exhibit 3
Successful Persister Rates by College
Fall 2010 Cohort



Source: Maryland Association of Community Colleges

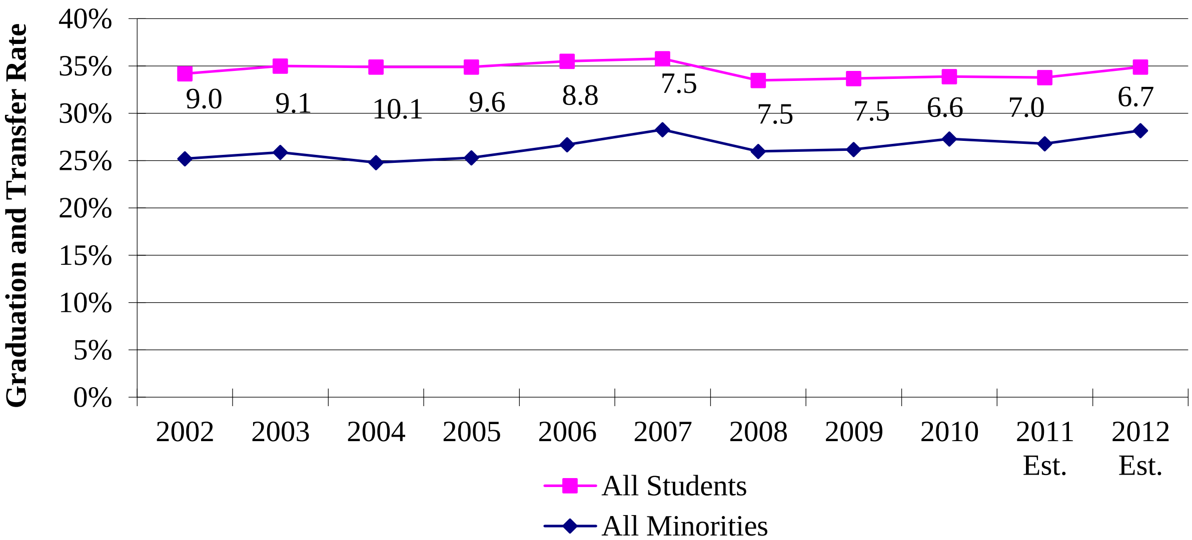
It is interesting to note from Exhibit 3 that the two most successful colleges have relatively different student outcomes: at Garrett College, 75% of the successful persisters are developmental completers, whereas more students enter college ready at Harford Community College. At Prince George's Community College (PGCC) and State-run BCCC, about 40% of all successful persisters are developmental noncompleters. If these students are unlikely to pass credit-bearing courses in English, or, more likely, mathematics, they are either spending their own money or using up financial aid eligibility without a reasonable chance of earning a credential. While there may be a population of students for whom this is an acceptable outcome, it is unlikely that most developmental noncompleters want to "swirl" for so long in postsecondary education.

The director of MACC should comment on what successful outcomes are possible for a developmental noncompleter still enrolled in courses, how likely those are to occur, and why this group of students is considered a successful persister. In addition, MACC should comment on how the requirements in the CCRCCA that students complete required developmental coursework within their first 24 credits is affecting the developmental noncompleters.

2. Achievement Gap Improves

Another goal for the State is to narrow the achievement gap in the four-year graduation/transfer rate of minority students compared to all students. Minority student enrollment grew from 45% of total community college enrollment in fall 2004 to 53% in fall 2012 according to the most recently available MACC data. **Exhibit 4** shows that gap had grown to 10.1 percentage points in the 2004 cohort, but narrowed to 7.5 for the 2007 cohort and was unchanged for two more cohorts. The gap narrowed to 6.6 percentage points in the 2010 cohort, the smallest gap in the period shown, before growing slightly to 6.7 percentage points in the 2012 cohort. Comparing the 2012 cohort to the 2002 cohort, the achievement gap has narrowed by 2.3 percentage points. Many of the initiatives focused on redesigning developmental courses are expected to have a disproportionately positive impact on minority students, as they are more likely to be enrolled in these courses. Other efforts, including expanding dual enrollment opportunities discussed in Issue 2, may also lead to a reduction in the gap as students will enroll with familiarity in higher education.

Exhibit 4
Four-year Graduation and Transfer Achievement Gap
Fall 2002-2012 Cohorts



Note: Figures in the exhibit represent the percentage point gap between rates for all students and minority students.

Source: Governor's Budget Books, Fiscal 2003-2016; Maryland Higher Education Commission

Fiscal 2016 Actions

Proposed Deficiencies

The fiscal 2017 budget provides a $2.7 million deficiency for the Statewide and Health Manpower (SHM) grant programs. These programs have had liabilities since fiscal 2012. The liabilities grew over several years as each year's appropriation did not fully fund the program. The grant reimburses colleges for admitting out-of-county students at in-county rates when they are enrolling in degree programs that are considered a workforce shortage for the State and are not offered at the students' local community college. This grant was changed in the Budget Reconciliation and Financing Act (BRFA) of 2011 from mandated to discretionary spending. Before the change, statute required the Governor to include a deficiency appropriation for the program if the original appropriation did not fully fund the program in that year. The BRFA of 2011 removed that requirement beginning in fiscal 2012 and requires that funds be prorated among the colleges if funding is not sufficient. However, some accumulated liability remains.

Specifically, while the fiscal 2014 budget included a $3.0 million deficiency appropriation for fiscal 2013 to address an accrued liability within the SHM grants, no additional funding was provided in the fiscal 2015 budget or fiscal 2016 budget to reduce outstanding obligations charged by this program. The outstanding liability of the grant reached over $9.0 million in fiscal 2011 but has declined, according to MHEC, to about $2.7 million in fiscal 2015. Because the grants send students to shortage programs mostly at larger colleges, 58% of the funding will go to the Community College of Baltimore County (CCBC), 12% to Anne Arundel Community College, and 11% to Howard Community College. The other 19% of funding will be sent to the remaining dozen colleges per prior billing requests.

The ORP also had an accrued liability as high as $5.9 million in fiscal 2010. Starting in fiscal 2011, the appropriation has been higher than anticipated expenses, which helped to pay down the liability. While MHEC has reported that the liability would be fully paid down by the end of fiscal 2014, this has not occurred. Although excess funds were available to make a final payment in fiscal 2015, the funding was instead reverted to the General Fund. There are two deficiencies for retirement in the fiscal 2017 budget. One is for prior year deficits amounting to $1.7 million and $1.3 million is to supplement the fiscal 2016 budget.

Cost Containment

While MHEC received a 2% across-the-board reduction in general funds in fiscal 2016 cost containment, no cuts were made to State aid for community colleges.

Proposed Budget

Exhibit 5 shows the budget changes for Aid to Community Colleges between the fiscal 2016 working appropriation, adjusted for the ORP deficiency appropriation that directly impacts fiscal 2016 spending, and the fiscal 2017 allowance. Total budget growth is $16.9 million, 5.7%, all in general funds.

Exhibit 5
Proposed Budget
Aid to Community Colleges
($ in Thousands)

How Much It Grows:	**General Fund**	**Total**
Fiscal 2015 Actual	$290,264	$290,264
Fiscal 2016 Working Appropriation	297,469	297,469
Fiscal 2017 Allowance	314,335	314,335
Fiscal 2016-2017 Amount Change	$16,866	$16,866
Fiscal 2016-2017 Percent Change	5.7%	5.7%

Where It Goes:

Changes	
Senator John A. Cade Funding Formula	$11,631
Faculty and staff retirement	4,450
Optional Retirement Program	2,143
Small Community College grants	79
Garrett and Somerset reciprocity grants	4
English for Speakers of Other Languages grants	-101
Removal of fiscal 2016 retirement deficiency	-1,340
Total	**$16,866**

Note: Numbers may not sum to total due to rounding.

There are three components to State support for community colleges. The first and largest source of State support is the Cade formula, calculated based on actual community college enrollments from two years prior and a percentage (20.5% for fiscal 2017) of the proposed per student funding at selected public four-year institutions. Cade formula funding grows $11.6 million, or 5.2%, over the fiscal 2016 working appropriation. This significant growth amongst other things reflects the nearly 10% growth in State funds per FTES in the 2017 allotment. One institution, Chesapeake College, receives hold harmless funding totaling almost $170,000 in the allowance.

The second major component of funding is comprised of the miscellaneous grant programs, such as the SHM grants, Small College grants, and ESOL. Exhibit 5 shows that there are minimal funding changes within these programs and, when combined, they decline slightly more than $18,000, primarily due to a decline of $0.1 million in ESOL. This is the first time since at least fiscal 2005 that ESOL funding has declined, representing a change in the enrollment of the population that uses this service. Finally, State support for both community college employee benefits programs grows $6.6 million.

The Senator John A. Cade Formula

Comparing fiscal 2016 and 2017 funding through the Cade formula is more complicated than a simple comparison of the percentage of per student State funding at selected public four-year institutions used in the formula. **Exhibit 6** shows the Cade formula in the fiscal 2016 allowance and the legislative appropriation. The Governor's BRFA of 2015 reduced aid by $9.0 million and did not include hold harmless funding. The legislative appropriation provided an increase of $4.0 million versus the BRFA that included hold harmless funding. This accounted for fiscal 2016 cost containment actions at the four-year institutions, which lowered the per FTES funding by $819, or 7.2%. This effectively increased Cade's statutory percentage to 20.6% in order for the formula to meet the fiscal 2016 funding specified in the BRFA, $222.7 million. Neither the allowance nor legislative appropriation figure shown here reflect the restoration of cost-of-living adjustment (COLA) funding at the beginning of fiscal 2016, but the fiscal 2017 allowance reflects the annualized COLA.

Exhibit 6 also shows two alternatives for fiscal 2017: the original allowance and the allowance adjusted to reflect the across-the-board health insurance reductions in the back of the budget bill, which reduces funding to the selected public four-year institutions, as well as the final allocation of University System of Maryland enhancement funding (Department of Legislative Services (DLS) proposal). Personnel increments for public universities, while budgeted within the Department of Budget and Management rather than within the institutions, were included in calculating fiscal 2017 Cade formula funding in both alternatives. The exhibit also shows that the audited enrollments used in the 2017 formula, which are from fiscal 2015, decreased by almost 3,200 students, or 3.1%, from fiscal 2014. This is a smaller decline than the prior year, when community colleges lost nearly 4,800 students, or 4.5%.

Exhibit 6
Cade Aid Formula
Fiscal 2016-2017

	2016		2017	
	Allowance[1]	Appropriation	Allowance	DLS Proposal
Per FTES State Funds Per Selected Public Institutions	$11,425	$10,606	$11,650	$11,626
Statutory Cade Percentage	20.00%	20.60%[2]	20.50%	20.50%
General Funds x Percentage	$2,285	$2,185	$2,388	$2,383
Audited Enrollment	101,235	101,235	98,068	98,068
Cade Appropriation	$231,327,495	$221,191,832	$234,207,672	$233,719,295
Hold Harmless	$462,640	1,552,788	167,519	189,878
Total	**$231,790,135**	**$222,744,620**	**$234,375,191**	**$233,909,173**
Difference over 2016 Appropriation			**$11,629,559**	**$11,163,541**
			5.2%	**5.0%**

DLS: Department of Legislative Services
FTES: full-time equivalent student

[1]The Budget Reconciliation and Financing Act (BRFA) of 2015 proposed to reduce the allowance to $218,744,620 in fiscal 2016.
[2]Fiscal 2016 funding was specified in the BRFA of 2015; had the final amount been achieved by running the Cade formula, the percentage in statute would have been 20.6%. The actual percentage in statute was 20.0%.

Source: Governor's Budget Books, Fiscal 2017; Department of Legislative Services

It is the combination of the reduced per student State funding at public four-year institutions in fiscal 2016 and the higher per student State funding in fiscal 2017, coupled with declining community college enrollment, that drives the 9.1% increase in per student Cade funding and overall 5.2% increase in Cade funding in fiscal 2017. Thus, although the percentage in statute does increase 0.5 percentage points, the overall formula growth really occurs due to the increase in per student State funding at selected public four-year institutions. There is no BRFA of 2016, so no modifications to the funding amount or formula are proposed by the Governor in the 2016 legislative session. The DLS proposal reduces the Cade formula by about $470,000, or 0.2%, from the allowance as per FTES funding declines $24, also 0.2%, when including the health insurance reduction. Overall, Cade funding still increases 5.0% in fiscal 2017 under the DLS proposal.

Exhibit 7 shows the resulting college-by-college distribution of funding from the Cade formula in fiscal 2016 and 2017, in addition to each college's change in enrollment. While the Cade formula percentage determines how much is appropriated to community colleges as a whole, the formula distributes funding based on three factors: enrollment, prior year funding, and size, with a hold harmless provision to ensure that no college receives less than it did the prior year. In the fiscal 2017 allowance, Chesapeake College does not receive at least as much as the college did in the prior year, so the college receives hold harmless funding totaling about $170,000. This action holds the school harmless to the fiscal 2016 legislative appropriation. Under the DLS proposal, Allegany College of Maryland would also receive hold harmless funding totaling about $10,000. Anne Arundel Community College grows by less than $25,000 under the DLS proposal, so three colleges are essentially flat funded. The remaining dozen colleges receive increases ranging from 4% to 10.5%.

Exhibit 7

Per Student Funding Analysis of Fiscal 2017 Allowance

Community College Formula
Fiscal 2016-2017
($ in Thousands)

College	Working Approp. 2016	Allowance 2017	DLS Proposal 2017	% Change (DLS) 2016-17	% Change Enrollment 2016-17	% Change $ Per FTES 2016-17
Allegany	$4,850	$4,851	$4,850	0.0%	-3.4%	3.5%
Anne Arundel	28,715	28,800	28,740	0.1%	-4.6%	4.9%
Baltimore County	38,638	40,414	40,330	4.4%	-4.9%	9.8%
Carroll	7,346	7,613	7,597	3.4%	-4.0%	7.7%
Cecil	5,108	5,245	5,234	2.5%	-3.6%	6.2%
CSM	13,018	13,806	13,777	5.8%	-4.0%	10.2%
Chesapeake	6,142	6,142	6,142	0.0%	-17.9%	21.8%
Frederick	8,975	9,644	9,624	7.2%	0.4%	6.8%
Garrett	2,561	2,734	2,728	6.5%	1.5%	4.9%
Hagerstown	7,620	8,129	8,112	6.4%	0.3%	6.2%
Harford	10,866	11,475	11,451	5.4%	-4.0%	9.8%
Howard	15,723	17,412	17,375	10.5%	0.7%	9.7%
Montgomery	40,001	42,264	42,176	5.4%	-4.0%	9.8%
Prince George's	26,073	28,500	28,441	9.1%	0.3%	8.7%
Wor-Wic	7,108	7,347	7,332	3.1%	2.8%	0.4%
Total	**$222,745**	**$234,375**	**$233,909**	**5.0%**	**-3.1%**	**8.4%**

CSM: College of Southern Maryland
DLS: Department of Legislative Services
FTES: full-time equivalent student

Source: Department of Budget and Management; Department of Legislative Services

Overall enrollment declined 3.1% in the most recent audited data, though there is wide variation among the colleges. Nine of 15 local community colleges had declines in Cade-eligible enrollment. Chesapeake College declined nearly 18%, while Garrett College and Wor-Wic Community College had increases of 1.5% and 2.8%, respectively. Because of falling enrollment, overall funding per student grows nearly $200, or 8.4%, in the DLS proposal. While overall enrollment is declining, State support is increasing. Given that opening enrollments were also broadly down in fall 2015, it is likely that State support per community college student will go up again in fiscal 2018.

DLS recommends that the Cade formula be recalculated to include the across-the-board health insurance reduction to public four-year institutions and to include hold harmless funding for all eligible community colleges. This would be a reduction from the allowance of $466,018. This will provide every college with at least as much State funding in fiscal 2017 as they are receiving in fiscal 2016.

Local Maintenance of Effort

A county government is required to maintain or increase the total dollar support for its local community college or risk losing an increase in State support, including a hold harmless grant, a concept known as Maintenance of Effort (MOE). Hold harmless grants were added to the MOE statute for community colleges by the BRFA of 2014 (Chapter 464 of 2014). **Exhibit 8** shows that the local appropriation for each college in fiscal 2016 increased for 11 colleges, was held level at 2 colleges, and decreased at 2 colleges (Chesapeake College and Garrett College). While 3 colleges were effectively level funded by their local governments in fiscal 2014 and 2015, none of them actually lost local support. This is important because local jurisdictions must maintain or increase local support to community colleges for their respective institutions to receive *increases* in State support including hold harmless grants. Chesapeake College and Garrett College have not met MOE in the fiscal 2016 working numbers. However, the colleges received a small increase and hold harmless grant, respectively, in fiscal 2016; Chesapeake College received a Cade formula increase of $1,674, and Garrett College received $12,021 in hold harmless funding. While the 2017 allowance contains the full formula funding for these two institutions, these funds could be reduced from the fiscal 2017 allowance if the local governments do not meet MOE. This will be a much bigger issue for both colleges in fiscal 2017, as Chesapeake College has about $168,000 in hold harmless funding in the allowance and Garrett College receives a $173,000 increase. Although the statute is silent on the responsibility to enforce the MOE requirement, Cade formula funding is budgeted in MHEC's budget and MHEC is responsible for overall coordination of higher education.

Exhibit 8
Local Support of Community Colleges
Fiscal 2011-2016
($ in Thousands)

College	2011	2012	2013	2014	2015	Working 2016	Change 2015-16	% Change 2015-16	Change 2011-16	% Change 2011-16
Allegany	$7,425	$7,425	$7,425	$7,555	$7,555	$7,555	$0	0.0%	$130	1.8%
Anne Arundel	33,823	28,556	32,048	35,820	38,320	38,388	68	0.2%	4,565	13.5%
Baltimore County	38,263	38,463	38,463	38,463	39,363	41,428	2,065	5.2%	3,165	8.3%
Carroll	8,492	8,479	8,542	9,059	9,328	9,544	217	2.3%	1,053	12.4%
Cecil	8,044	8,026	8,025	8,197	8,442	8,803	361	4.3%	760	9.4%
CSM	15,741	16,120	16,947	17,648	17,884	18,450	566	3.2%	2,710	17.2%
Chesapeake	5,886	5,886	5,886	6,236	6,431	6,395	-36	-0.6%	509	8.6%
Frederick	13,533	13,415	13,967	14,206	14,545	15,161	616	4.2%	1,628	12.0%
Garrett	4,293	4,273	4,523	4,559	4,738	4,731	-7	-0.2%	438	10.2%
Hagerstown	9,045	8,865	8,865	8,965	8,965	9,265	300	3.3%	220	2.4%
Harford	14,513	14,962	14,962	14,962	14,962	15,261	299	2.0%	748	5.2%
Howard	25,195	25,951	27,093	29,132	31,000	31,000	0	0.0%	5,805	23.0%
Montgomery	99,590	95,849	96,264	100,530	116,734	129,426	12,692	10.9%	29,836	30.0%
Prince George's	30,245	29,245	29,545	29,545	30,345	31,649	1,304	4.3%	1,404	4.6%
Wor-Wic	4,442	4,346	4,507	5,273	5,535	5,602	67	1.2%	$1,160	26.1%
Total	**$318,529**	**$309,860**	**$317,061**	**$330,149**	**$354,145**	**$372,658**	**$18,513**	**5.2%**	**$54,129**	**17.0%**

Source: Maryland Higher Education Commission

DLS recommends restricting the fiscal 2017 appropriation for Chesapeake College in the amount of $1,674 and Garrett College in the amount of $12,021 pending final fiscal 2016 local support figures, which are expected in October 2016. If these colleges fail to meet the local support MOE requirement, the funds shall revert to the general fund and may not be used for any other purpose.

It is also worth noting that in February 2016, Chesapeake College filed suit against Caroline County, one of its five local Eastern Shore counties, for $51,280 for maintenance and repair costs for which it has not been paid. This raises the issue that the college may be making a good faith effort to perform its mission and work with its local government. For the State to reduce State funding effectively punishes the community college rather than the county or counties that are not contributing to MOE. Prior to 2012, the local MOE requirement for State K-12 funding operated similarly and withheld funds from the school systems rather than the counties. An alternative approach was adopted in Chapter 6 of 2012. Now, the State must intercept a county's local income tax revenue in the amount by which the county is below MOE in the current year and forward the funds directly to the local school board, unless a waiver has been allowed. A similar process could be applied to community colleges, although it would be slightly different as MOE penalties would have to be distributed over a community college's service area, which may include multiple counties.

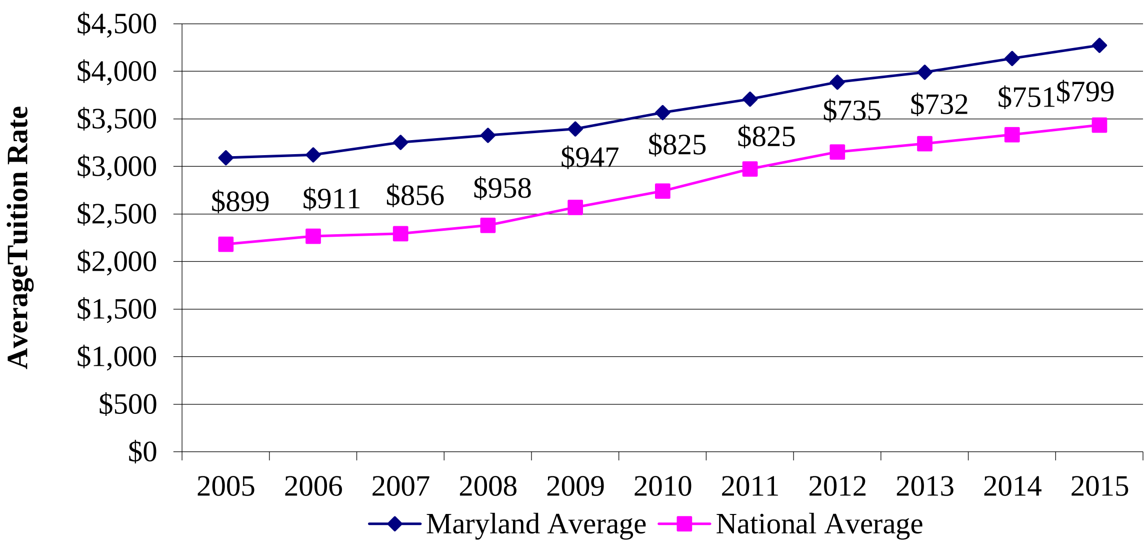
The exhibit also shows changes in funding since fiscal 2011 to show changes since the end of the recession. When the State appropriation was held flat or declined, some local governments chose to reduce appropriations as well, with no risk of losing State funds. From fiscal 2011 to 2012, 11 colleges were either flat funded or had reduced local support. Anne Arundel Community College lost 16% of its local support in just fiscal 2012. However, Anne Arundel County's support bounced back quickly in fiscal 2013. On average, local funding increased only 0.1% between fiscal 2010 and 2014. Almost all of the 17.0% growth from fiscal 2011 to 2016 occurs in fiscal 2015 and 2016. However, Montgomery College's growth distorts these State-level comparisons. Excluding Montgomery College, overall local support grew only 11.1% in this time period. In comparison, State funding increased 14.6% from fiscal 2011 to 2016.

Issues

1. Tuition, Fees, and Student Aid at Community Colleges

Community colleges offer a significantly lower entry cost into higher education compared to four-year institutions for students living within the community college's service area. According to the College Board, the enrollment-weighted average of Maryland public four-year institution's tuition and fee rate was $9,163 in fall 2015, compared to $4,274 at the State's community colleges. This means, on average, community colleges are 53% less expensive based upon tuition and fees. However, the State's community college tuition and fee rates are higher than the national average. **Exhibit 9** shows the difference between the State and national average from fiscal 2006 to 2016 in unadjusted dollars. Although the gap has narrowed from a high of $958 in fiscal 2009, Maryland remains $799 higher than the national average according to the College Board data.

Exhibit 9
Community College Tuition and Fee Rates
Maryland and National Average
Fall 2005-2015

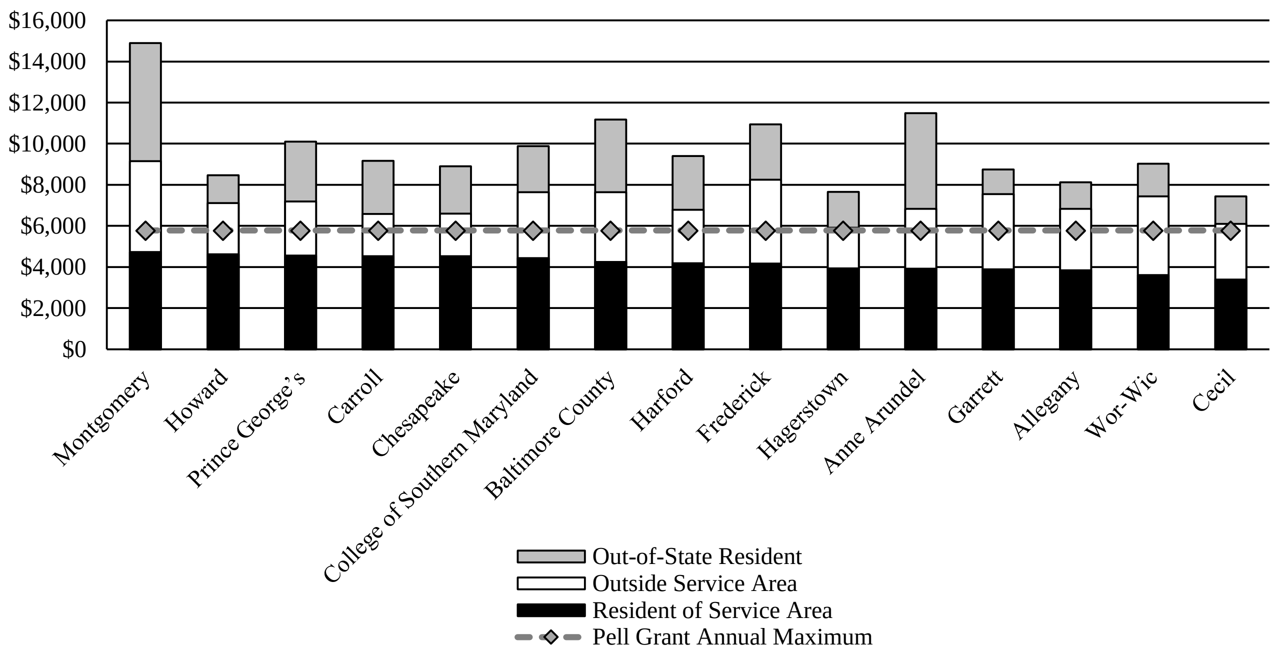


Note: Numbers reflect total enrollment-weighted average tuition and fees paid. Labels reflect the dollar difference between the two points.

Source: The College Board, *Annual Survey of Colleges – Trends in College Pricing 2015*

Exhibit 10 shows that tuition and fee rates in Maryland varied greatly between institutions in fall 2015. Montgomery College is the State's most expensive community college at $4,728 for a full-time annual student taking 30 credits, while Cecil College is only $3,390. State-run BCCC (not shown in Exhibit 10) actually had the lowest tuition and fee rate in fall 2015, but in an unusually timed increase, is raising tuition in spring 2016 to $3,420. BCCC charges the same rate to all in-state students. Including BCCC, the statewide simple average of tuition and fees is $4,094 for a service area resident, $6,911 for all other Marylanders, and $9,519 for out-of-state residents. Fall 2015 is notable as it is the first year in which the maximum annual Pell grant award of $5,775 no longer covers all tuition and mandatory fees for out-of-service area Maryland residents at any community college in the State, creating an additional financial barrier for students looking to pursue certain programs or attend certain colleges in the State. Montgomery College's average out-of-service area tuition of $9,156 is actually higher than the in-state tuition and fees at seven of Maryland's residential public four-year institutions. The same college's unusually high out-of-state tuition, nearly $15,000, puts its costs above two residential public four-year institutions' out-of-state rates. While community colleges may be affordable for students who happen to live in the respective area of service, they increasingly are pricing themselves out of reach of the rest of Marylanders.

Exhibit 10
Community College Tuition and Fee Rates for Three Student Types
Fall 2015



Note: Institutions are ranked from highest to lowest by service area tuition and fees. Most community college students do not enroll in 30 credits per academic year.

Source: Maryland Association of Community Colleges; Department of Legislative Services

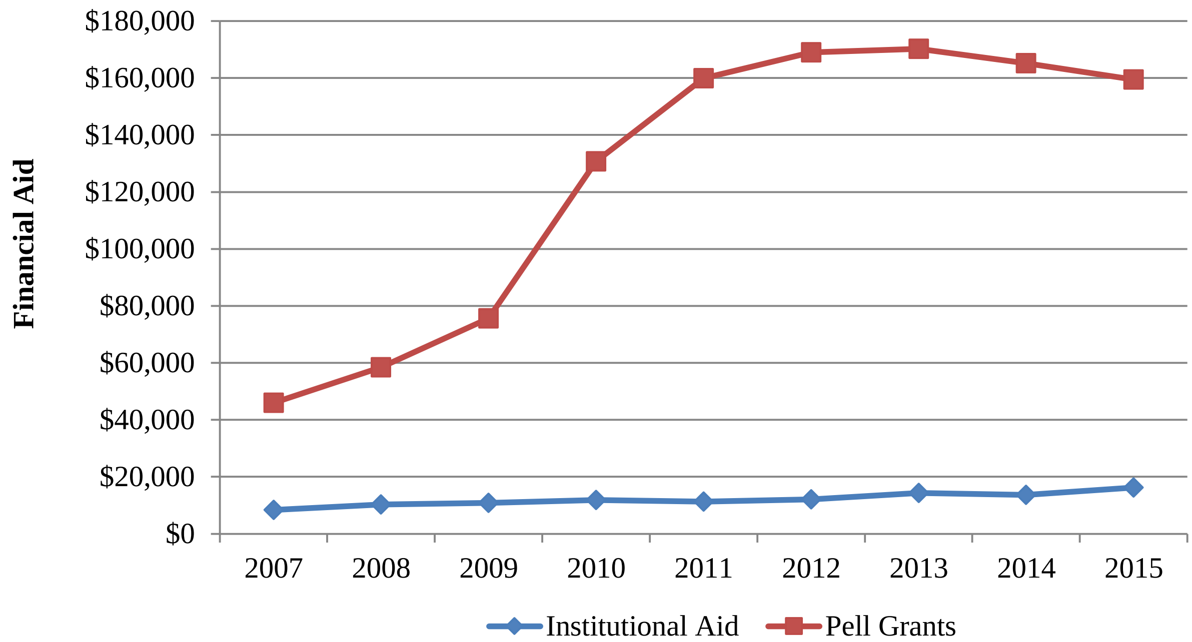
The Secretary and MACC director should comment on the growing unaffordability of out-of-service area tuition and fee rates and what this means for having an open and accessible community college system for all Marylanders given that not all institutions offer all programs.

Institutional Aid Offered to Students

In addition to trying to keep costs low, colleges offer students institutional aid to bring down the "sticker" price, or total cost of tuition, fees, room, board, and other related expenses. Institutional aid awards are usually made to students with few financial resources (need-based aid) or to reward academic achievement or athletic ability (merit and athletic awards). Regardless of aid type, colleges typically require students to complete a Free Application for Federal Student Aid, which determines a student's expected family contribution, *i.e.*, the amount of money a student's family is expected to pay toward the cost of education.

Exhibit 11 shows the total amount of need-based and merit aid awarded by community colleges to students from fiscal 2007 to 2015, in addition to the amount of Pell grants students received. In fiscal 2015, Maryland's community colleges awarded $16.3 million in institutional aid. That amount is dwarfed by Pell grants, a federal low-income student financial aid program that totaled $159.5 million in that same year and still represents over 90% of the aid shown in this exhibit. This is about half of all Pell dollars received in Maryland. Federal funding for Pell grants increased significantly beginning in fiscal 2010 to help low-income individuals pursue a college education. With peak community college enrollment in fiscal 2012, combined with new federal restrictions on Pell grants in fiscal 2013, Pell aid began to decline. Pell aid decreased 3.5% in fiscal 2015, after declining 2.9% in fiscal 2014. In stark contrast, Pell grants had grown at an average annual rate of 26.2% over the preceding five years. Its highest year came in fiscal 2013 at $170.2 million. The maximum annual Pell award in fiscal 2015 was $5,730, for a maximum of 12 semesters at all institutions. As noted in the Exhibit 10 discussion of fiscal 2016 tuition and fee rates, a full Pell grant may cover the full cost of tuition and fees at a community college for service area residents but not students attending outside their service area.

Exhibit 11
Total Need-based and Merit Institutional Aid and Pell Grants
Maryland Community Colleges
Fiscal 2007-2015
($ in Thousands)

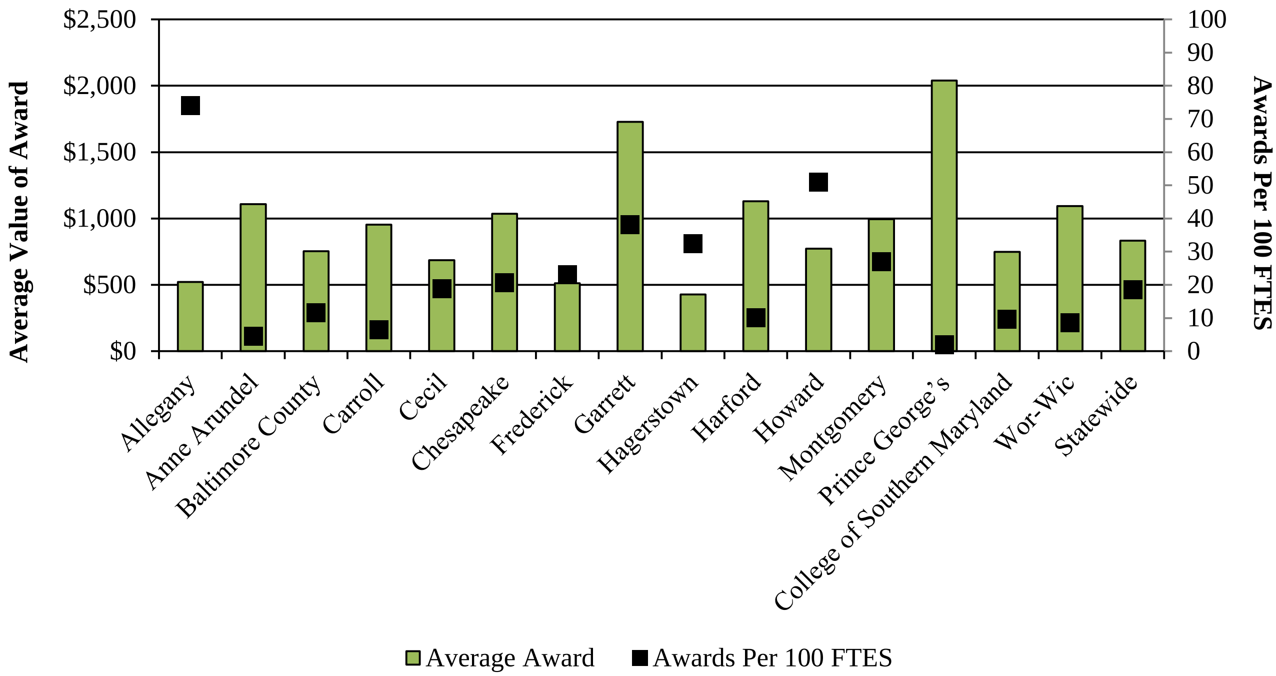


Note: All data is self-reported by the institutions and does not include Baltimore City Community College.

Source: Maryland Association of Community Colleges; Department of Legislative Services

Exhibit 12 shows the average value of institutional aid awards and the average number of awards per 100 FTES by college. There is considerable variation in this data, which was reported to DLS for the fourth time this year, but it is similar to results from prior years. The exhibit may somewhat overstate awards per FTES and understate the amount received by a student, as an individual student may receive both a need-based and merit award, and both awards would be counted separately. In other words, this shows some duplicated headcount data. Allegany College of Maryland is an outlier, awarding many more awards per 100 FTES, 72.8, than any other college. This is even higher than Allegany College of Maryland's number from the prior year, 64.6. There are two reasons for this: first, it has a large dual enrollment program with students from neighboring counties, each of whom are receiving an institutional aid award; and second, it launched the Allegany County Opportunity Scholarship in fiscal 2015 which covers the post-federal aid cost of community college for first-time, full-time students (sometimes called a "last dollar" approach). Garrett College also has a similar program. Both of these will be discussed in more detail below.

Exhibit 12
Average Institutional Aid Awards and Number of Awards Per 100 FTES
Fiscal 2015



FTES: full-time equivalent student

Note: All data is self-reported by the institutions and does not include Baltimore City Community College. Carroll College is adjusted to reflect support from its foundation.

Source: Maryland Association of Community Colleges; Department of Legislative Services

The statewide average institutional aid award is $832, and an average of 18.5 awards is made per 100 FTES. The exhibit shows that colleges vary widely in the amount of aid offered, but most awards average between $700 and $1,000. PGCC has the highest average award, at $2,039, while Garrett College is the second highest at $1,728. Hagerstown Community College and Frederick Community College are the lowest at $428 and $512, while Allegany College of Maryland is the third lowest, at $523. Although PGCC has the highest average award, the college averages only 1.9 awards per 100 FTES, the lowest in the State.

Carroll Community College's data is adjusted because it generally funds fewer than 10 awards per year through its operating budget and instead coordinates aid with the Carroll Community College Foundation. For more meaningful comparisons, foundation awards are shown in Exhibit 12 for Carroll Community College only. With that adjustment, Carroll Community College performs similarly to other colleges of its size, such as Wor-Wic Community College.

Not Just Affordable, but Free

Broadly speaking, higher education can be made affordable by two means: charging low (or no) tuition to all students or by individually tailoring financial aid packages. In recent years, Maryland has made a strong commitment to reducing the upfront cost to four-year schools. However, at the two-year level, Maryland funded the Keeping Community Colleges Affordable grant for one year only, fiscal 2012, which split $5 million among colleges that agreed to keep tuition rate increases to 3% or less. The $5 million was distributed based on Cade-eligible enrollments. Nationally, big support for the "make community colleges free" movement came in January 2015 when the Obama Administration promoted America's College Promise (ACP), which it compared to the expansion of free, public high schools a century ago. ACP would cover the cost of tuition and fees for community college students contingent on 25% matching state funds and a commitment from institutions to pursue best practices. ACP would cover students working towards certificates or associate's degrees. Federal grants would be issued to states, then institutions, on a per-student basis. The goal is to cover the national average cost of community college tuition and fees, which ACP publications have pegged at $3,800, and have the state cover any remaining direct cost to the student. There are many details that remain to be worked out if the plan were to be implemented, but it draws inspiration from efforts already underway in Tennessee and Chicago. The $3,800 limit is problematic given that only three Maryland colleges charge less than that rate, as shown in Exhibit 10.

There are local examples of this strategy in Maryland: Garrett County funds the Garrett County Scholarship Program (GCSP) which covers tuition and fees for recent high school graduates or General Equivalency Diploma recipients who pursue associate's degrees. GCSP began in fall 2006 and expanded to include certificate programs in 2010. The program requires students to apply for federal and State aid and covers any remaining cost from county funds. Allegany County has a similar program, but it only began in fiscal 2015.

For the 2013 GCSP cohort, the most recent data available, the average award was only $1,271. Just under 70% of these students required remedial education, more than the general student population. Despite that, GCSP recipients had grade point averages of 0.2 to 0.4 higher than the general student body in all but one semester. Between 30% and 50% of awardees transferred to another institution prior to receiving an associate's degree, suggesting most students are using GCSP as a stepping stone to a bachelor's degree. Two concerns arise: first, many high school graduates in Garrett County who would benefit from a certificate or associate's degree still do not pursue community college even with GCSP; and second, of those who do enroll, about 30% of students still leave Garrett College without completing a degree or transferring to another institution, representing the downside to truly open admissions. This creates difficulty in predicting whether even more generous financial aid offers will lead to better outcomes given that the cost of dropping out or stopping out is $0. Finally, the total number of GCSP awardees declined from over 130 in the 2007 cohort to only 79 in the 2013 cohort, making it difficult to ascertain what the effects would be of scaling up this program in other parts of the State.

MACC made estimates based on an ACP-style program in Maryland which it named Maryland Invests. MACC took fiscal 2015 numbers to estimate an annual cost of about $55 million in the first year, which would be offset by $25 million in existing federal aid and State financial aid programs. In year two, when the program is fully up and running and existing aid sources are backed out, the annual cost would be $60 million to $70 million in new public support. If this was entirely new State support in fiscal 2015, State funding would be close to surpassing local support for community colleges and would likely surpass it given the longer graduation times generally associated with community college students.

The MACC director should comment on whether Maryland Invests is something that can be accomplished within the existing ramp up of the Cade formula to 29% in statute, given that that would increase State support to over $300.0 million.

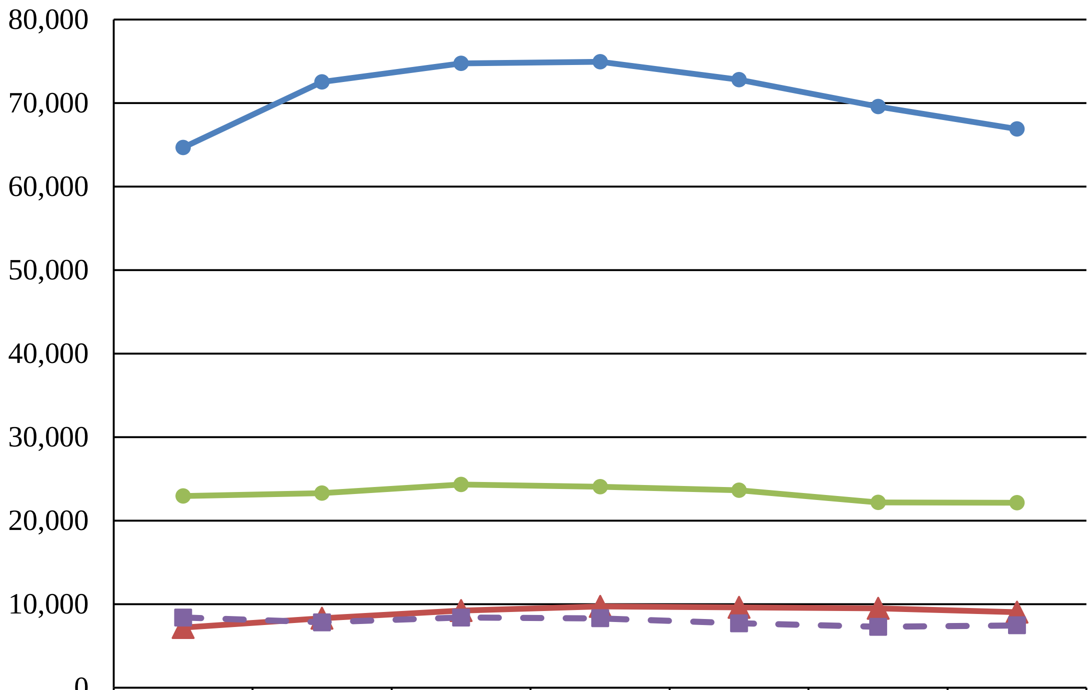
Additionally, since the State and local support split in fiscal 2015 was 43% and 57% respectively, the MACC director should comment on whether the counties are on board for contributing their share, up to $39.9 million, of Maryland Invests. If the counties are not part of this assumption, the MACC director should comment on what it means when the local community college system receives more support from the State than counties, and what the optimal governance system would be in that situation.

The Secretary should comment on the effect free community college would have on access-oriented four-year institutions who are already struggling with enrollment concerns in the current academic year.

2. The Decline of Credit Enrollment and Rise of Dual Enrollment

Over the course of the recession, community colleges experienced a boom in enrollment. **Exhibit 13** shows four different student populations in the two-year segment: resident credit students, out-of-county credit students, noncredit students, and Cade-ineligible students. The final category is mostly composed of out-of-state students. The sum of the three Cade-eligible enrollments in fiscal 2015 is 98,068, the number used in the fiscal 2017 Cade formula allowance shown in Exhibit 6. Overall community college enrollment peaked in fiscal 2012 at about 117,000 total students, with 109,000, or 93%, Cade eligible. That percentage split between eligible and ineligible students differed by less than 1 percentage point from fiscal 2009 through 2015, showing that out-of-state student enrollment was affected identically by the recession. The story behind noncredit enrollment will be discussed further in Issue 3 of this analysis.

Exhibit 13
Types of FTES Enrollment
Maryland Community Colleges
Fiscal 2009-2015



	2009	2010	2011	2012	2013	2014	2015
In-county	64,695	72,529	74,752	74,950	72,789	69,571	66,910
Out-of-county	7,199	8,311	9,221	9,738	9,598	9,493	9,030
Noncredit	22,961	23,277	24,306	24,048	23,628	22,171	22,129
Ineligible	8,379	7,822	8,394	8,299	7,706	7,268	7,446

FTES: Full-time equivalent student

Note: Ineligible students are mostly out-of-state students.

Source: Maryland Higher Education Commission

A great concern for community colleges is the decline in credit enrollment, as this is 75% to 80% of Cade-eligible enrollments in the years shown in the exhibit. The community college segment has seen overall declines in enrollment from fiscal 2012 through 2015 and, as was discussed in the fiscal 2017 *Higher Education Overview*, opening enrollment for fiscal 2016 shows another decline. While the statutory contribution percentage in the Cade formula and anticipated support for public four-year institutions will most likely more than offset the decline in enrollment when the Cade formula is calculated, there are operational challenges facing the community college sector as institutions need enrollment to drive their programs' stability and maintain strong outcomes. As community colleges are open access institutions, there is not an immediate way to increase enrollment as anyone who likely was considering a community college already faces minimal entry requirements and lower tuition compared to the four-year segment.

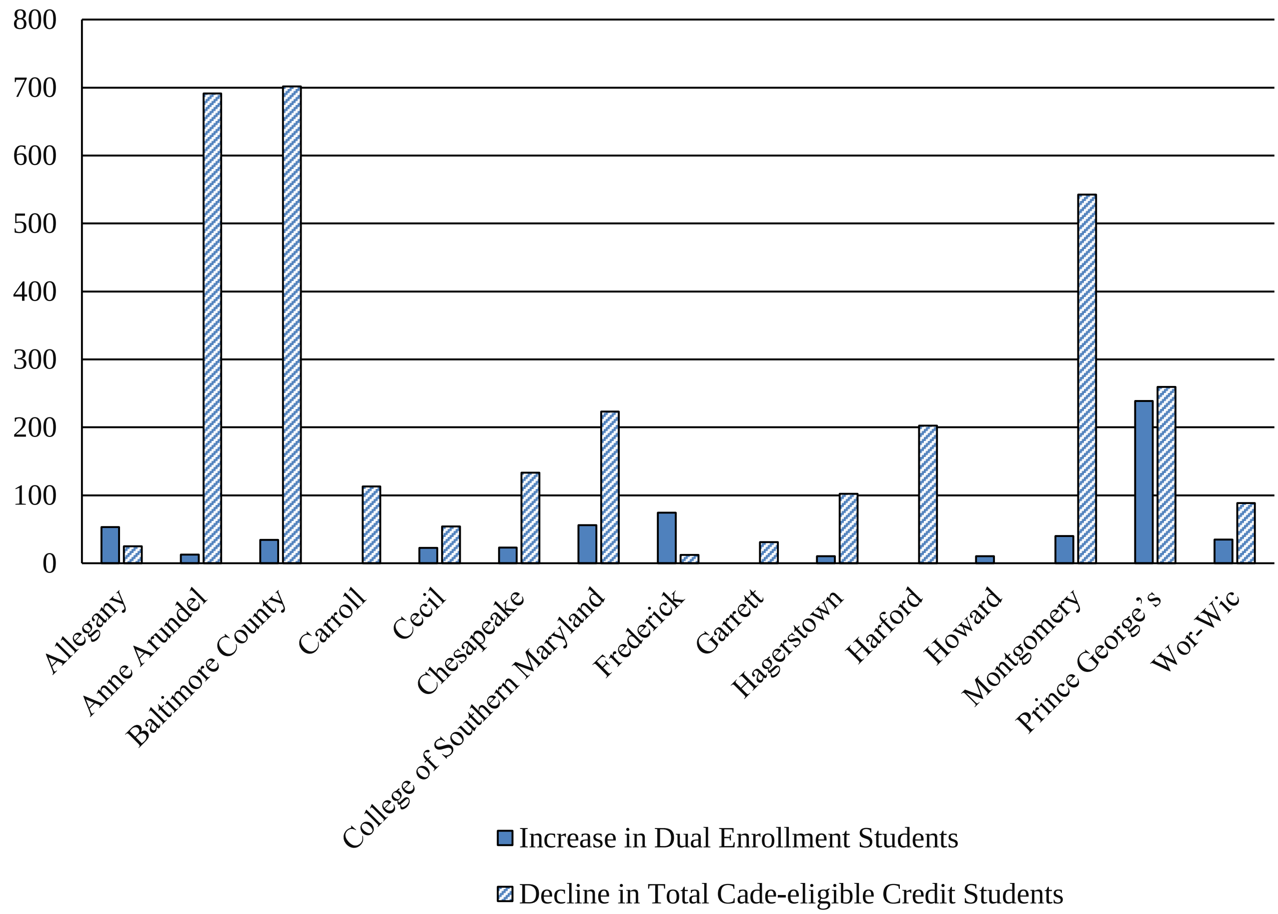
Against this backdrop of declining enrollment, Chapter 533 of 2013, the CCRCCA, explicitly called for standardizing a pathway for high school students to enroll in credit-bearing courses from community colleges, called dual enrollment. While dual enrollment opportunities in Maryland predated the CCRCCA, the legislation made dual enrollment a State goal and codified a way to manage the tuition and fees charged to high school students.

Beginning with the fall 2013 semester, public institutions of higher education may no longer charge tuition to high school students. Instead, each local school system must pay the institution a percentage of the institution's tuition based on how many courses the student takes, and the local school system may charge the student a fee to partially cover these costs. However, the local school system may not charge a fee to students who are eligible to receive free and reduced-price meals (FRPM), and a student's ability to pay must be taken into account when setting any fees.

MACC reports that all colleges have reached a memoranda of understanding with their respective local education agencies and that five school systems are charging students less than authorized by the CCRCCA as a method of encouraging enrollment. Many community colleges are acting as the billing agent for the local school system and collecting fees from the parents of dually enrolled students directly, with the appropriate adjustments being made for the school system to pay for FRPM students while maintaining the confidentiality of students' FRPM status. Similar actions have occurred at the four-year institutions, although about 85% of dual enrollment occurs at community colleges.

Exhibit 14 shows the decline of Cade-eligible credit enrollment side-by-side with the increase in dual enrollment by college in fiscal 2015. Here, dual enrollment headcounts are converted to FTES using the federal method of three part-time students for every FTES. Because dually enrolled students count in the Cade formula as credit-bearing students, they are already incorporated in reported figures, so the enrollment declines in Exhibit 14 are already adjusted for what is, on many campuses, an increase in dual enrollment. What is interesting is that Allegany College of Maryland, Frederick, and PGCC are covering some of their FTES drop with dual enrollment students. At the other end, the largest community colleges, Anne Arundel, Baltimore County, and Montgomery, are enrolling very few dual enrollment students in relation to the total number of FTES those institutions are losing. It would seem to be in the interest of those institutions to increase dual enrollment numbers given both the tuition revenue and classroom space available.

Exhibit 14
Changes in Cade-eligible Credit FTES Enrollment
Maryland Community Colleges
Fiscal 2015



FTES: Full-time equivalent student

Note: Carroll, Garrett, and Harford colleges had declines in dual enrollment in fiscal 2015 but for simplicity are shown only as zero in this exhibit. Likewise, Howard Community College had positive FTES enrollment growth in 2015 and this is also shown as zero. Dual enrollment students count as Cade-eligible credit students.

Source: Maryland Community College Chief Student Affairs Officers; Maryland Higher Education Commission

Challenges to Increasing Dual Enrollment

Currently, the dual enrollment provisions of the CCRCCA do not apply to summer sessions but do apply to winter sessions which fall during the traditional academic year. Additionally, the Maryland

State Department of Education (MSDE) and the Maryland Longitudinal Data System (MLDS) have yet to count workforce apprenticeships, sometimes called career and technical education, as dual enrollment. However, it is possible that MSDE could instruct local school boards to assign the dual enrollment flag to a student in a noncredit apprenticeship program. MHEC has identified as priorities coordinating a statewide dual enrollment outreach campaign that would make all students and parents aware of dual enrollment opportunities and determining whether noncredit certification courses that are part of a Career and Technical Education curriculum or apprenticeship should be included in a dual enrollment program as priorities to be addressed in fiscal 2017.

The Secretary of MHEC and MACC director should comment on whether dual enrollment should be expanded to summer sessions and noncredit opportunities.

3. The Separate World of Noncredit Education

According to the Lumina Foundation in 2015, about 80% of the jobs lost in the recession were those requiring a high school education or less and newly created jobs increasingly require some level of specialized training. The Georgetown University Center for Education and the Workforce agrees, stating that many more jobs now require “middle skills,” that is more than a high school education but less than a postsecondary degree. Such skills are obtained by taking workforce training courses, which are made up of training sequences. These are part of the broader spectrum of noncredit classes offered by community colleges. An entirely different vocabulary helps emphasize the differences between the world of credit programs (associate’s degrees and certificates) and continuing education (training, licensure, and certifications). For-credit students enroll in credit hours, while noncredit students enroll in clock hours. Sequences that are approved by MHEC as meeting a State-approved objective for workforce development may be converted to credit hours and then counted in the Cade formula for State funding. For example, PGCC is currently expanding its Hospitality Express Program in concert with the opening of the MGM Casino at National Harbor to train chefs, hotel managers, casino dealers, and cashiers to meet the expected 3,600 job openings the casino will create. Noncredit enrollment peaked in fiscal 2011, one year before credit enrollment peaked, as shown in Exhibit 13, but it did not experience the enrollment boom during the recession, despite being more workforce oriented. For example, in fiscal 2010, when resident credit enrollment grew 12%, noncredit enrollment grew only 1%.

Financial Aid for Noncredit Courses

While no State aid program may be used for noncredit courses at community colleges, the Tolbert Memorial Student Grant Program is expressly established for noncredit programs at private career schools (PCS), and Delegate Scholarships may also be used for noncredit coursework at PCS. Other State aid programs, like Senatorial Scholarships, the Conroy Memorial Scholarship, and the Cryor Memorial Scholarship, which allow enrollment at a PCS, require the student to be in credit coursework that is transferrable to a degree-granting institution. It is unclear if there are any certificate programs that would meet that criteria. The biggest overall source of aid for noncredit students comes from the federal Workforce Innovation and Opportunity Act, which provides some funding for nearly 500 occupation trainings in Maryland across 75 institutions.

The Secretary should comment on how MHEC ensures that recipients of Senatorial, Conroy, and Cryor awards enrolled at a PCS pursue only transferrable credits, per statute. The Secretary should also comment on whether there is a need for a new scholarship program to provide aid for students enrolled in noncredit workforce training.

While it is technically possible to award federal financial aid, including Pell grants, to students enrolled in noncredit/continuing education sequences, it is extremely difficult for community colleges to meet the federal rules associated with this type of award. Noncredit workforce sequences can become eligible in one of two ways. First, a training sequence must be at least 600 clock hours long over 15 weeks. A clock hour is an actual hour of class, which may include a 10 minute break. This 600-hour rule is very limiting as many workforce trainings do not take this much time. Second, sequences that are 300 to 599 clock hours over at least 10 weeks are also eligible for federal aid, but only loans. However, the college must report extensive completion and placement rates, among other reporting requirements, that many institutions find overly burdensome. Additionally, complicating management of programs of either length is that the enterprise software that community colleges typically use is set up to manage federal financial aid on a semester basis (fall, winter, spring, summer), not on a clock hour basis, which can run any time of year based on the needs of the college.

Because PCS are set up to manage student services entirely from a clock hour perspective, their students may have access to federal financial aid programs if they meet either of the clock hour rules mentioned above. Currently, the only community college in Maryland with continuing education sequences that meet federal regulations to allow Pell grants is CCBC. One wrinkle in this is that MHEC's Financial Aid Information System can only receive financial aid information on a semester basis as well, so CCBC's receipt of federal aid is not captured by MHEC and, subsequently, other data repositories like the MLDS Center.

Coincidentally, CCBC is also part of a pilot program authorized by the federal Department of Education that allows CCBC to award Pell grants to some students in nine continuing education sequences with fewer than 600 clock hours. According to CCBC, students must meet all standard Pell eligibility requirements, but because funding is awarded on a random basis, not all eligible students will be awarded. The assistant financial aid director reports that this experiment began in fall 2012, but that a federal study on program outcomes is not expected until the summer of 2017.

A closely related issue is that starting in academic year 2012-2013, the U.S. Department of Education required students using federal financial aid to have a high school diploma or equivalent. However, this decision was reversed for academic year 2015-2016 so long as the student shows an Ability To Benefit, demonstrated by taking certain tests, and enrolls in an Eligible Career Pathway Program. Such programs contain both workforce training and adult education, but only the former is eligible to be considered part of the cost of attendance that may be covered by federal aid. This opens up Pell grants and federal loans to a wider range of prospective students, but it is unclear whether institutions will cover the adult education cost or if students must pay for that out of pocket. All in all, the situation for federal aid for noncredit courses appears overly complicated and burdensome for institutions and students alike.

General Lack of Information on Noncredit Outcomes

While this raises issues of how the State can measure outcomes for noncredit students since their financial aid is not all tracked, the data issue is actually much bigger. MHEC submitted a *Joint Chairmen's Report* in December 2015 entitled *Report on Credit-free Courses and Programs*. In the report, MHEC stresses that while some continuing education sequences are highly structured, others are not. Because of the minimal regulation of this postsecondary area, there is maximum flexibility for institutions to alter course content and offer it only when needed. Sequences do not have standard lengths or common requirements, while for-credit academic programs do. The corollary to this is that there is almost no data collected on inputs or outcomes, so while it would seem very useful for MLDS to be able to track workforce outcomes of noncredit students, it currently cannot. The only information currently collected is an aggregate headcount and equated credit hours for those eligible to be counted in the Cade formula. In the fiscal 2015 numbers, used in the fiscal 2017 budget, noncredit students accounted for 22.6% of State-funded FTES, nearly identical to the 22.4% of such students in fiscal 2010.

Exhibit 15 shows some of the limited information MHEC does collect on continuing education programs, divided by type of enrollment. Workforce training actually accounts for 51% of noncredit enrollment, as the remainder is made up of basic skills development (not to be confused with remedial education) and recreational classes (generally taken only for personal enjoyment). In terms of course enrollments, the numbers shift slightly more toward the recreational courses, but are still broadly similar, as workforce training is still 46% of enrollments.

Exhibit 15
Types of Noncredit Enrollment
At Maryland Community Colleges
Fiscal 2014

				Financial Aid		
Type	**Unduplicated Annual Headcount**	**Course Enrollments**	**Example**	**Federal**	**State**	**State Support**
Professional licensure or certification	112,951	204,555	real estate, welding	Yes[1]	No	Yes
Basic skills development	38,672	72,224	reading, computer skills	Yes[2]	No	Yes[2]
Recreation or lifelong learning	71,513	170,392	cooking, gardening	No	No	No
Total	**223,136**	**447,171**				

[1] In Maryland, only the Community College of Baltimore County meets regulations to allow federal aid for these sequences.
[2] Only for students taking English for Speakers of Other Languages classes.

Source: Maryland Higher Education Commission

MHEC notes some challenges in collecting more data, as the population of students served by noncredit courses may feel reluctant to respond to requests for more information and it may be difficult to compare data collected in different parts of the State at different times and for trainings conducted in different ways. However, establishing a strong chain of records for students' work is important both for the colleges maintaining accountability and to assist students in workforce placement. To that end, MHEC and the community colleges are working on a more detailed way to report student-level data to MHEC and MLDS by fall 2016. This could include having public and private licensure and certification agencies report information directly to MHEC, rather than have community colleges collect this information from employers.

DLS recommends MHEC submit a report on metrics for noncredit courses, with an emphasis on workforce development sequences; what data is available; and what the State can do to assist in collecting or incentivizing the reporting of any other data.

The Secretary should comment on how MHEC will explore ways of reporting noncredit information.

Recommended Actions

1. Add the following language to the general fund appropriation:

<u>, provided that $13,695 in general funds designated to support the State's local community colleges may not be expended until the Maryland Higher Education Commission (MHEC) submits a report by December 1, 2016, to the budget committees stating whether the counties that support Chesapeake College and Garrett College fulfilled Maintenance of Effort (MOE) requirements for local funding. The report should also provide updates on the other local community colleges. The budget committees shall have 45 days to review and comment on the report. Funds restricted pending receipt of a report may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund if the report is not submitted to the budget committees.</u>

<u>Further provided that if a community college's respective service area county or counties do not meet MOE requirements in fiscal 2016, MHEC shall reduce fiscal 2017 State funding to that college by the amount of any increase in State support received in fiscal 2016, including hold harmless funds.</u>

Explanation: This language restricts the expenditure of funds that gave hold harmless funding to Chesapeake College and an increase in State support to Garrett College in fiscal 2016 until it can be determined in a report from MHEC that the colleges' respective service area counties fulfilled their MOE requirements for community college funding. If the requirement was not met at an institution, MHEC will decrease fiscal 2017 support to colleges by the respective amount that should not have been disbursed in fiscal 2016.

Information Request	**Author**	**Due Date**
Fiscal 2016 Community College Local Aid Report	MHEC	December 1, 2016

	Amount Reduction	
2. Reduce general fund support for the Cade formula grant.	$ 466,018	GF

3. Adopt the following narrative:

Report on Continuing Education Outcomes: The committees are interested in the Maryland Higher Education Commission's (MHEC) work toward developing more outcomes measures for noncredit programs at Maryland's community colleges, especially those oriented toward workforce development. MHEC should submit a report on what new data it will collect, how often, and what assistance it may need from other public or private agencies to provide better information so that this new data may be included in the Maryland Longitudinal Data System.

Information Request	**Author**	**Due Date**
Report on continuing education outcomes	MHEC	December 15, 2016

Total General Fund Reductions **$ 466,018**

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Aid to Community Colleges
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$297,326	$0	$0	$0	$297,326
Deficiency Appropriation	0	0	0	0	0
Cost Containment	-6,800	0	0	0	-6,800
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	-262	0	0	0	-262
Actual Expenditures	**$290,264**	**$0**	**$0**	**$0**	**$290,264**
Fiscal 2016					
Legislative Appropriation	$296,129	$0	$0	$0	$296,129
Budget Amendments	0	0	0	0	0
Working Appropriation	**$296,129**	**$0**	**$0**	**$0**	**$296,129**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The fiscal 2015 legislative appropriation for Aid to Community Colleges was reduced by $7.1 million. General funds decrease exactly $6.8 million due to across-the-board cost containment efforts by the Board of Public Works which reduced Cade formula spending by $6.6 million and miscellaneous grants spending $0.2 million. About $0.3 million in unspent funds in the two reciprocity programs were reverted.

Fiscal 2016

To date, there have been no changes to the legislative appropriation.

Object/Fund Difference Report
Aid to Community Colleges

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Objects					
12 Grants, Subsidies, and Contributions	$ 290,263,726	$ 296,129,133	$ 314,335,016	$ 18,205,883	6.1%
Total Objects	**$ 290,263,726**	**$ 296,129,133**	**$ 314,335,016**	**$ 18,205,883**	**6.1%**
Funds					
01 General Fund	$ 290,263,726	$ 296,129,133	$ 314,335,016	$ 18,205,883	6.1%
Total Funds	**$ 290,263,726**	**$ 296,129,133**	**$ 314,335,016**	**$ 18,205,883**	**6.1%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Aid to Community Colleges

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
05 Senator John A. Cade Funding Formula for Community Colleges	$ 235,670,050	$ 239,390,853	$ 251,003,343	$ 11,612,490	4.9%
06 Aid to Community Colleges - Fringe Benefits	54,593,676	56,738,280	63,331,673	6,593,393	11.6%
Total Expenditures	**$ 290,263,726**	**$ 296,129,133**	**$ 314,335,016**	**$ 18,205,883**	**6.1%**
General Fund	$ 290,263,726	$ 296,129,133	$ 314,335,016	$ 18,205,883	6.1%
Total Appropriations	**$ 290,263,726**	**$ 296,129,133**	**$ 314,335,016**	**$ 18,205,883**	**6.1%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

R62I0010
Student Financial Assistance
Maryland Higher Education Commission

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$98,458	$101,064	$103,143	$2,079	2.1%
Deficiencies and Reductions	0	1,644	0	-1,644	
Adjusted General Fund	**$98,458**	**$102,708**	**$103,143**	**$435**	**0.4%**
Special Fund	6,027	1,665	1,665	0	
Adjusted Special Fund	**$6,027**	**$1,665**	**$1,665**	**$0**	**0.0%**
Reimbursable Fund	400	400	400	0	
Adjusted Reimbursable Fund	**$400**	**$400**	**$400**	**$0**	**0.0%**
Adjusted Grand Total	**$104,885**	**$104,774**	**$105,208**	**$435**	**0.4%**

- General funds increase $0.4 million, or 0.4%, in fiscal 2017 after adjusting for a $1.6 million deficiency restoring need-based financial aid initially reduced by cost containment in fiscal 2016.
- There is no change in special funds or reimbursable funds.
- The second supplemental budget, not shown above, adds $3.0 million for a new merit-based scholarship program.
- There is also a $0.3 million deficiency, also not shown above, for a prior year liability in the Janet L. Hoffman Loan Assistance Repayment Program.

Note: Numbers may not sum to total due to rounding.

For further information contact: Garret T. Halbach Phone: (410) 946-5530

Analysis in Brief

Major Trends

Percentage of Neediest Students with Unmet Need Varies: The percentage of students in the lowest 40% of median family income with unmet need is expected to decline 1 percentage point from fiscal 2016 to 42%. This slight decline comes in spite of very small increases in the federal Pell grant and growing student financial need.

Number of Guaranteed Access Grant Recipients Increases: The number of students receiving Guaranteed Access Grants increased over 25.0% between fiscal 2008 and 2016, although awards fell 10.1% in fiscal 2013. Applications and awards have since rebounded from the unexpected decline in fiscal 2013, but awards are expected to be flat in fiscal 2017.

Issues

State Need-based Aid Reaches Far Fewer Students: Data collected by the Maryland Higher Education Commission (MHEC) on recipients of need-based State financial aid indicates that most aid is awarded to students with the lowest expected family contribution levels. However, the aid is reaching fewer students over time and a lengthy waitlist remains.

Financial Aid and Affordability Examined: During the 2015 interim, the legislative education subcommittees and MHEC examined several issues related to college affordability, student debt, and student completion.

New Advisory Committee Fails to Achieve Consensus: MHEC recently reconvened the Financial Aid Advisory Committee to help create recommendations to improve the administration and outcomes of State financial aid programs, such as changing the definition of a full-time student and proposing more equitable distributions of financial aid each year. But the group did not reach consensus on any actions in the 2015 interim.

Recommended Actions

		Funds
1.	Reduce general funds for Delegate Scholarships.	$ 176,500
2.	Adopt budget bill language transferring funding for a new scholarship program to need-based aid programs.	
	Total Reductions	**$ 176,500**

Updates

Recent Changes to Financial Aid Programs: The 2014 and 2015 legislative sessions brought about a few changes and new programs to MHEC – Student Financial Aid. This update will review modified and new programs.

Net Price Calculators All in One Place: All Maryland institutions have the Net Price Calculators on their website now.

R62I0010

Student Financial Assistance

Maryland Higher Education Commission

Operating Budget Analysis

Program Description

The Office of Student Financial Assistance (OSFA), within the Maryland Higher Education Commission (MHEC), is responsible for the administration of State financial assistance programs. These programs are designed to improve access to higher education for needy students and certain unique populations, and encourage students to major in workforce shortage areas. Maryland students use State financial assistance at community colleges, independent institutions, private career schools, and the State's public four-year campuses.

Financial aid comes in the form of grants, work study, student loans, parent loans, and scholarships from federal, State, private, and institutional sources. Grants and scholarships are aid that students do not have to pay back. Grants are usually given because a student has financial need, while scholarships are usually given to recognize the student's academic achievement, athletic ability, or other talent. Loans must be repaid, usually with interest. **Exhibit 1** shows current financial aid programs offered by OSFA. Update 1 summarizes recent legislative changes to OSFA programs in 2014 and 2015.

This analysis includes MHEC Student Financial Assistance Programs that provide:

- funds directly to institutions of higher education to cover qualified college expenses;
- funds directly to students as reimbursement for the payment of tuition and mandatory fees, and, in some cases, other expenses; and
- assistance for the repayment of student loans.

A separate budget analysis entitled *Maryland Higher Education Commission* covers the personnel associated with administration of these financial aid programs, as well as other educational grant programs administered by the commission.

Exhibit 1
Financial Aid Programs in Fiscal 2016

Need-based

Delegate Howard P. Rawlings Educational Excellence Awards	
Guaranteed Access Grants	Need- and merit-based scholarships intended to meet 100% of financial need for full-time undergraduates from low-income households. Qualified applicants must have a cumulative high school grade point average of at least 2.5 on a 4.0 scale. The commission extended the income limits for renewals to 150% of the federal poverty level to prevent a student who may work in the summertime from exceeding the original 130% income cap.
Educational Assistance Grants	Need-based scholarships intended to meet 40% of financial need at four-year institutions and 60% at community colleges for full-time undergraduates from low- to middle-income families. The maximum award amount authorized by statute is $3,000. The current maximum amount awarded is $3,000.
Campus-based	Need-based grant for full-time undergraduates from low-income families who, for extenuating circumstances, miss the application filing deadline. Funds for the campus-based grant are allocated to eligible institutions that then select recipients.
Part-time Grant Program	Need-based grants provided to institutions to award to qualified part-time undergraduate students.
Graduate and Professional Scholarship Program	Need-based scholarships for those pursuing certain graduate and professional degrees at certain Maryland institutions of higher education.
Early College Access Grant Program	Need-based grants for students dually enrolled in a Maryland high school and a Maryland institution of higher education. (Unfunded.)

Career-based

Charles W. Riley and Emergency Medical Services Tuition Reimbursement Program	Tuition reimbursement for fire, ambulance, and rescue squad workers pursuing a degree in fire services or emergency medical technology. (Chapter 503 of 2013 converted the program to a scholarship effective October 1, 2015, for awards beginning in fiscal 2017.)

Workforce Shortage Student Assistance Grants	Merit- and need-based scholarships for Maryland students pursuing degrees in teaching, nursing, human services, physical or occupational therapy, public service; and other areas to address workforce and regional needs.

Loan Assistance Repayment Programs (LARP)

Janet L. Hoffman	Loan repayment assistance for graduates of an institution of higher education in Maryland who work full-time for the government or the nonprofit sector in a priority field, as determined by the commission. Priority is given to recent graduates who are State residents and employed full-time principally providing legal services to low-income residents, nursing services in nursing shortage areas in the State, or other employment fields where there is a shortage of qualified practitioners for low-income or underserved residents. Recipients must meet income eligibility requirements as determined by the commission.
Nancy Grasmick Teacher Scholars (Part of Hoffman LARP)	Loan repayment assistance for those who currently serve in specified public schools or teach science, technology, engineering, or math and graduated from a Maryland university.
Primary Care Physicians and Physician Assistants	Loan repayment assistance for those who currently serve or who pledge to serve as primary care physicians or physicians assistants.
Maryland Dent-Care	Loan repayment assistance designed to increase access to oral health services for Maryland Medical Assistance Program recipients.

Assistance for Unique Populations

Jack F. Tolbert Memorial	Provides grants to private career schools to award to full-time students based on financial need.
Edward T. Conroy and Jean B. Cryor Memorial	Scholarships for certain military veterans or certain public safety personnel and for dependents of eligible public and nonpublic school employees.
Veterans of the Afghanistan and Iraq Conflicts Scholarship Program	Scholarships for United States Armed Forces personnel who served in the Afghanistan or Iraq conflicts; and their sons, daughters, or spouses attending a Maryland postsecondary institution.
Maryland First Scholarship	Scholarship for first-generation college students with financial need. (Unfunded.)

Teaching Fellows of Maryland Scholarship	Scholarship for those pursuing a degree leading to a Maryland professional teacher's certificate. Requires service obligation. (Unfunded.)
2+2 Transfer Scholarship	Scholarship to provide an incentive for Maryland students to earn an associate's degree from a community college before enrolling in a four-year institution. Recipient must demonstrate financial need. Minimum GPA required.
Legislative Scholarships	
Senatorial Scholarships	Senators select recipients from within their legislative district. Students may be pursuing undergraduate, graduate, or professional degrees.
Delegate Scholarships	Delegates select recipients pursuing undergraduate, graduate, or professional degrees.

Source: Maryland Higher Education Commission

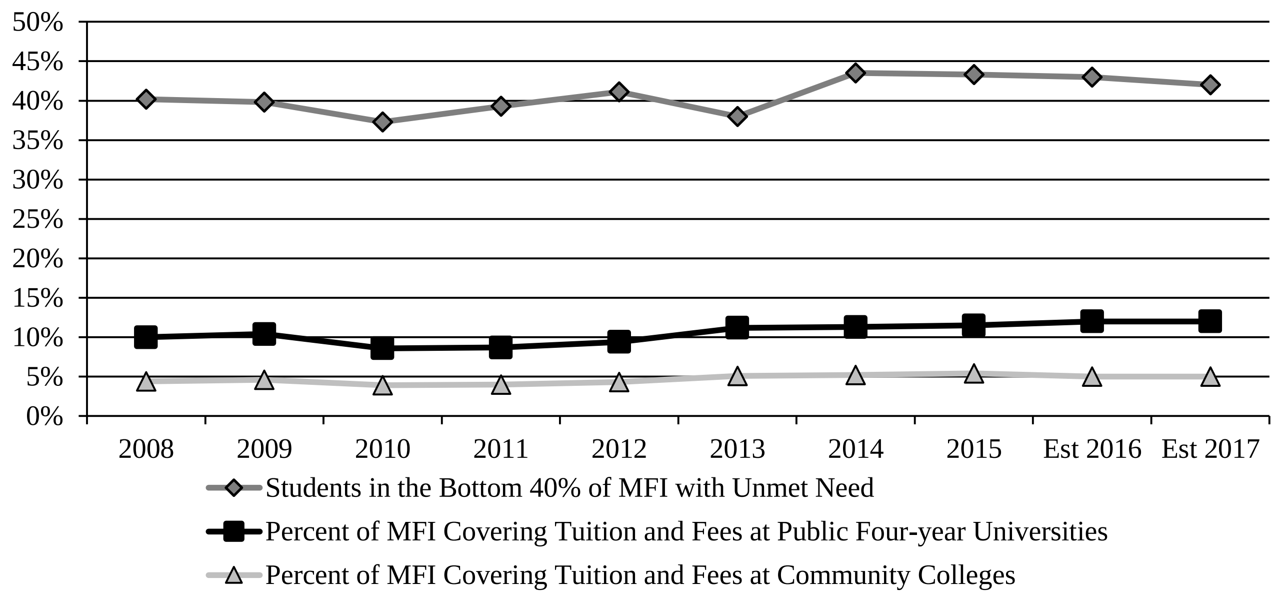
Performance Analysis: Managing for Results

1. Percentage of Neediest Students with Unmet Needs Varies

The State's financial aid programs play a critical role in facilitating access and reducing financial barriers to postsecondary education, especially for students from low- and moderate-income backgrounds. **Exhibit 2** shows the percent of students enrolled in a Maryland higher education institution in the lowest 40.0% of median family income in Maryland that have unmet need after all financial aid sources (including federal loans) are exhausted. Although the percentage of such students with unmet need notably declined by about 3.0 percentage points in both fiscal 2010 and 2013, it jumped 5.5 percentage points in fiscal 2014. The latest actual from fiscal 2015 is down slightly overall to 43.3%, but this remains exactly 6.0 percentage points above the 2010 rate. MHEC expects the percentage to decline in fiscal 2016 and 2017 to 43.0% and 42.0%, respectively, despite evidence of growing student need and an increase of only $45 in the maximum Pell grant in the 2015-2016 academic year, the same as in the prior year. The Pell grant, a federal program, is an extremely important source of need-based aid for many Maryland students. Because State need-based programs are applied to student need after the federal Pell grant is considered, federal funding for the Pell grant program has a significant impact on how far State need-based financial aid will stretch each year. This strategy is called "last dollar" aid.

On the other hand, possible contributors to the expected decline in unmet need among low-income students include an increasing reliance on student loans to finance higher education and deferring enrollment in higher education entirely among the neediest students. An ongoing research question for MHEC is how students with unmet need still manage to enroll. Exhibit 2 also shows the percentage of the median family income necessary to pay for tuition and fees at a Maryland public four-year institution. Due to tuition freezes and buy downs from fiscal 2007 through 2015 and the flat median income growth in Maryland, the rate is very close to 10.0% in all years, most recently at 11.5% in fiscal 2015. Community college costs have been about half as expensive, averaging about 5.0% over the same time period.

Exhibit 2
Percent of Neediest Students with Unmet Need Remaining
Fiscal 2008-2017 Est.



MFI: median family income

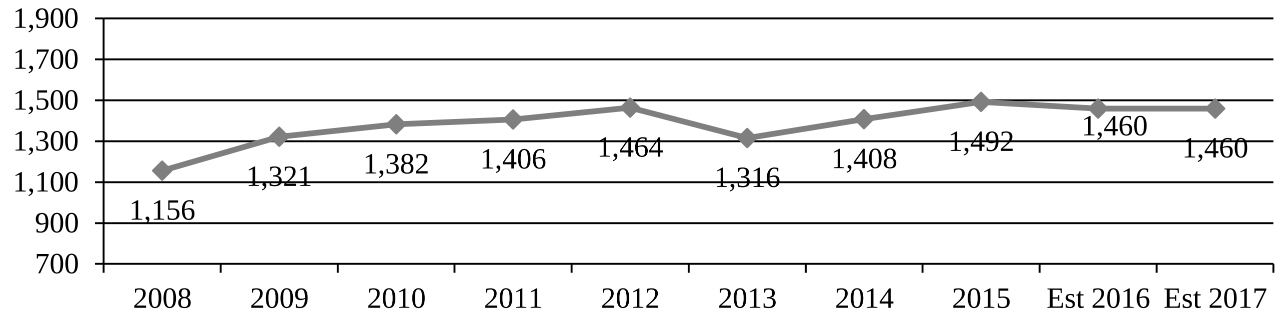
Note: MFI in Maryland was $89,768 in 2014 according to the American Community Survey's one-year estimate.

Source: Governor's Budget Books, Fiscal 2011-2016; Maryland Higher Education Commission

2. Number of Guaranteed Access Grant Recipients Increases

The Guaranteed Access (GA) Grant is a component of the Delegate Howard P. Rawlings Educational Excellence Awards (EEA) program that covers 100.0% of need when combined with a federal Pell grant for the State's lowest income students. The maximum amount is capped at the total cost of attendance (tuition, fees, and room and board) at the highest cost four-year University System of Maryland institution, excluding the University of Maryland, Baltimore and the University of Maryland University College. The maximum award in fiscal 2015 was $16,500, and the maximum award in fiscal 2016 is $17,500. Students that meet all program criteria, such as enrolling directly from high school and having certain family income limits tied to the federal poverty level, are guaranteed funding. **Exhibit 3** shows that the number of GA grants awarded between fiscal 2008 and 2009 increased by 165, or 14.3%, although growth slowed from fiscal 2009 to 2012, before dropping by 148, or 10.1%, in fiscal 2013 for a total of only 1,316 awards. GA grants grew by 6.0% and 7.0%, respectively, over the next two years to reach a new program high of 1,492 awards in fiscal 2015. While one year ago, MHEC had projected awards reaching as high as 1,700 in fiscal 2016, it now projects a slight decline to 1,460 and level awards in fiscal 2017. Despite the drop in fiscal 2013, the total growth from fiscal 2008 to the 2015 actual is just under 30.0%.

Exhibit 3
Guaranteed Access Grants Awarded
Fiscal 2008-2017 Est.



Source: Governor's Budget Books, Fiscal 2011-2016; Maryland Higher Education Commission

Fiscal 2016 Actions

Proposed Deficiency

There are two deficiencies for MHEC – Student Financial Assistance. The first is $0.3 million for the Janet L. Hoffman (Hoffman) Loan Assistance Repayment Program (LARP) for prior year unfunded liabilities. The second is for $1.6 million and backfills EEA funding in fiscal 2016, which was reduced for cost containment. Both programs had lower than anticipated prior year cancellation rates leaving MHEC with not enough funding for the aid commitments it had made.

Cost Containment

The second deficiency discussed above reflects the inability of MHEC to absorb its share of the 2% across-the-board cost containment action in fiscal 2016. As MHEC is primarily a grant pass-through agency, it had great difficulty in allocating a cut of approximately $2.1 million because its administrative budget is only about $6.5 million. MHEC ended up taking $0.2 million in cuts within its administration and the remainder in financial aid programs. Prior to this, direct cost containment actions had not been made to financial aid programs, while other MHEC grant programs, such as the Sellinger formula, were directly reduced.

Proposed Budget

The Governor's proposed fiscal 2017 budget is shown in **Exhibit 4**. Overall, special funds and reimbursable funds do not change in the allowance. After adjusting for the fiscal 2016 deficiency for EEA, general funds increase $0.4 million, or 0.4%. This includes $0.4 million, or a 7.0% increase, for Delegate Scholarships. The other two changes in general funds, which nearly cancel each other out, are within the EEA program. An increase of $1.7 million offsets the deficiency in fiscal 2016 already mentioned. Overall, there is an increase of $22,000 in the EEA program, well under 0.1%. The backfilling of the deficiency is actually significant, given that the statute only requires at least 80.0% of the prior year's funding. Overall, with the notable exception of Delegate Scholarships, this means that all financial aid programs are level funded and thus are not keeping pace with expected tuition increases.

Exhibit 4
Proposed Budget
MHEC – Student Financial Assistance
($ in Thousands)

How Much It Grows:	General Fund	Special Fund	Reimb. Fund	Total
Fiscal 2015 Actual	$98,458	$6,027	$400	$104,885
Fiscal 2016 Working Appropriation	102,708	1,665	400	104,774
Fiscal 2017 Allowance	103,143	1,665	400	105,208
Fiscal 2016-2017 Amount Change	$435	$0	$0	$435
Fiscal 2016-2017 Percent Change	0.4%	0%	0%	0.4%

Where It Goes:	
Other Changes	
Need-based aid increase to offset loss of deficiency funding	$1,666
Delegate Scholarships increase to accommodate undergraduate tuition increase	413
Removal of deficiency for need-based aid	-1,644
Total	**$435**

MHEC: Maryland Higher Education Commission

Note: Numbers may not sum to total due to rounding.

Supplemental Budget and New Scholarship Program

In the second supplemental budget of fiscal 2017, $3.0 million is provided for the Maryland Early Graduation Scholarship (MEGS) Program. MEGS was created by Executive Order 01.01.2016.03 in January 2016 and provides a one-time award of up to $6,000 to public high school students who graduate in three years rather than four, and attend a postsecondary education institution in Maryland. The Maryland State Department of Education (MSDE) reports that about 1,000 students a year are currently graduating high school early in Maryland. The Department of Legislative Services (DLS) has a number of concerns about MEGS. The use of an executive order prevents review by the General Assembly prior to the creation of the program, and no legislation has been introduced to authorize this program. All other OSFA programs are in statute.

As the program was only recently announced, there are currently no regulations for the program, yet it is the intent of the Administration that the program be operable in time for the 2016-2017 academic year. As has been reported in DLS fiscal notes, it will take MHEC several months to modify and test its web portal to accommodate the new scholarship at a cost of around $50,000. Under this accelerated timeline, students will not have much time to choose to graduate high school early, apply to college, and apply for scholarships; in fact, students who want to graduate early this spring, who would be the first students eligible for the scholarship, would have already made that decision well before the scholarship's announcement.

At a time when OSFA programs have grown only $0.3 million, or 0.3%, from fiscal 2015 to 2017 and nearly all financial aid programs have been level funded for many years, it is not clear why the availability of substantial new funding was not instead allocated to existing or currently unfunded programs. Given recent budget constraints, Maryland phased out its merit based scholarship program in fiscal 2015. MEGS has no requirement that students demonstrate financial need, unlike all other current OSFA programs, which is inconsistent with the shift in focus of aid programs toward low-income students or students who demonstrate financial need. In fact, because there is no need required for this award, MHEC will not need to collect a Free Application for Federal Student Aid (FAFSA) and, therefore, MEGS recipients' expected family contribution (EFC) will not be known, unless the recipients happen to file a FAFSA for other forms of aid. This substantially decreases the ability of MHEC and the Maryland Longitudinal Data System to track the effectiveness of a large, new scholarship program over time.

The maximum award of $6,000 for MEGS is quite large relative to other OSFA programs such as Educational Assistance Grant (EAG) ($3,000) and 2+2 Transfer Scholarship (2+2) awards ($2,000). Although encouraging students to use their senior year of high school to earn college credit is certainly in keeping with the College and Career Readiness and College Completion Act of 2013's policy goals, it is not clear how the program incentivizes students to graduate high school early, particularly in the short term. The College Board reports the average tuition and fees paid in fiscal 2016 for a two-year institution in Maryland is $4,274 and for a four-year institution is $9,163. Given the additional costs of books and room and board, a MEGS recipient could face substantial costs beyond the maximum award. Conversely, if the MEGS recipient stayed in high school for twelfth grade, the student could earn college credit through dual enrollment, Advanced Placement courses, or other means with only limited out-of-pocket expenses. The early graduates are already eligible for all OSFA programs, so they do not risk losing any existing State funding.

Given the late timing of the new MEGS program and because no bill has been introduced to authorize MEGS, DLS recommends that $3.0 million in new MEGS funding be transferred to the Educational Excellence Awards Program to make additional need-based awards in fiscal 2017.

MEGS is also unusual in that it does not specify that a student must take credit-bearing, or degree-seeking, coursework. If this is so, it would be the first program to allow Marylanders to take noncredit sequences at community colleges. Finally, for the first round of awardees in fall 2016, such students were already going to graduate from high school in three years, regardless of MEGS. The same may be true of the next awardees in fall 2017 who have to enroll in a particular sequence established by MSDE to graduate early with a high school diploma.

The Secretary should comment on how MEGS would incentivize students to graduate early if they are seeking credit-bearing postsecondary education and how it incentives early high school completers in fall 2016 or 2017. The Secretary should comment on the demographics of students who would be eligible for MEGS, including their potential need for financial aid to enroll in postsecondary education, and on the decision to add $3 million for a new merit-based program when need-based aid is level funded.

Need-based Student Financial Assistance Fund

The Need-based Student Financial Assistance Fund (NBSFAF) was created in 2011 to receive unused scholarship funds at the close of each fiscal year to be used for future need-based and certain unique population awards. Funds from the NBSFAF can be appropriated in the annual State budget or recognized by budget amendment in the following fiscal year, creating a transparent process for MHEC to encumber unexpended scholarship funds.

In an October 2013 audit report for MHEC, the Office of Legislative Audits (OLA) reviewed the NBSFAF for the first time. Finding 1 in the new report raised concerns over the amount of funding built up. In academic year 2012-2013, there were over 16,000 applicants on EEA's waiting list and fund reserves of over $17 million, but little funding was appropriated until deficiencies for fiscal 2013 were included in the fiscal 2014 budget bill. Concerns over funds building up in the NBSFAF were also raised by DLS in operating budget analyses for fiscal 2013 through 2016.

Exhibit 5 shows the current balance of nonlapsing special funds in the NBSFAF in fiscal 2016, as well as fiscal 2014 and 2015. NBSFAF began with nearly $9.9 million in carry forward funds from fiscal 2011 to 2012. While MHEC would like to keep a fund balance at the end of the fiscal year to ensure that it does not over award financial aid in any given year and require a general fund deficiency, as happened in fiscal 2016, MHEC allowed the fund balance to grow significantly in fiscal 2012 through 2014 with transfers totaling $19.2 million. MHEC has since used the fund to backfill a loss of federal funds in fiscal 2012 through 2015 and to make additional awards to certain programs, mainly EEA, Veterans of Afghanistan and Iraq Conflict (VAIC), and Conroy awards.

Exhibit 5
Need-based Student Financial Assistance Fund
Fiscal 2014-2016

	2014	2015	2016	Cumulative Transfers[1]
Opening Balance	**$17,221,338**	**$5,159,196**	**$412,620**	
Transfers Out				
2 + 2 Transfer			$200,000	$200,000
EEA	$12,913,343	$4,159,000		18,320,369
Conroy Memorial	550,000	250,000		1,195,426
VAIC Scholarship	660,177	634,973		1,600,525
Subtotal	**$14,123,520**	**$5,043,973**	**$200,000**	**$21,316,320**
Transfers In	**$2,061,378**	**$297,398**		**$21,528,940**
Closing Balance	**$5,159,196**	**$412,620**	**$212,620**	

EEA: Educational Excellence Awards
VAIC: Veterans of the Afghanistan and Iraq Conflicts

[1] Cumulative totals include numbers from fiscal 2012 through 2016.

Source: Maryland Higher Education Commission

While over $8.0 million had been transferred into NBSFAF in fiscal 2011 and 2012, this declined to $1.0 million and $2.1 million, in fiscal 2013 and 2014, respectively. In fiscal 2015, only $0.3 million was transferred in as MHEC rapidly spent down the fund balance due to the concerns raised by OLA. MHEC reports that about 40% of need-based awards were not accepted in the first awarding round in fiscal 2016, similar to prior years, despite strong evidence of student need in Maryland, as shown in Exhibit 2. While $12.9 million in extra special funds were spent on need-based awards in fiscal 2014, only $4.2 million was transferred for fiscal 2015 awards, and none has been transferred for this purpose in fiscal 2016. With total funds for fiscal 2016 awards below 2015, it is likely that there will be an even smaller amount of fund balance transferred into NBSFAF at the end of fiscal 2016. Assuming there are no further fiscal 2016 transfers, the NBSFAF fiscal 2017 opening fund balance will be only $0.2 million, with $0.2 million budgeted directly in the fiscal 2017 allowance for 2+2 awards.

In the past, MHEC has struggled to get institutions that receive the State awards as payment for the cost of attendance to certify the enrollment of the student awardee. With schools not verifying enrollment rosters in a timely manner, MHEC has unclaimed financial aid awards backing up that could be recycled for more awards, potentially in the same academic year. One ongoing effort of MHEC is solving this roster certification issue, as it will be critical for improving the outcomes of State financial aid. That so little funding was ultimately reverted to the NBSFAF in fiscal 2014 is surprising, given how late in the academic year that additional funding was made available for new awards. The timing of MHEC's awarding cycle and the State's budgeting cycle can create difficulties in ensuring that funding is available at the right times of the year to make awards to students. If a student were to receive an award late in a semester, it is of significantly less use because the student has already decided whether to enroll and, if the student did enroll, that financial need was already covered through other means, such as student loans. Receiving a State award after a loan has already been drawn creates burdens for the student to figure out how to align the State award with other educational finances. The Financial Aid Advisory Committee (FAAC) was reestablished to tackle this issue and is discussed in Issue 3. **The Secretary should comment on resolving award certification issues.**

Loan Assistance Repayment Programs

Although Maryland has not offered student loans since the 1980s, the State funds several LARPs for physicians, dentists, and other occupations, such as teaching and law. LARPs provide loan repayment assistance in exchange for certain service commitments to help ensure that there are sufficient numbers of skilled professionals working in underserved areas of the State or on behalf of low-income families. While most aid is focused on enrolling students, LARPs reward students for completing a degree and subsequently working in designated shortage areas. State funding for LARPs has been relatively flat, at about $3.0 million, for several fiscal years, and the number of students receiving awards has remained relatively low. While MHEC makes about 60,000 financial aid awards per year, LARPs account for only about 200. Additional funding for LARPs could benefit many students due to a new requirement by the General Assembly that recipients must be enrolled in federal Public Service Loan Forgiveness (PSLF). If LARP awards are limited to the minimum payments required for the PSLF, it could stretch State funding even further. Georgetown University uses this strategy to assist its law school graduates.

Current LARP information by program is shown in **Exhibit 6**. The multi-year nature of awards, and that the dental LARP is budgeted within the Hoffman LARP's budget code, can make comparisons difficult. Because the Governor's Budget Books, by convention, show revenues always matching expenditures, it can be difficult to follow fund balances building up in the physicians' LARP program and to follow how many awards have been made. The exhibit shows the three LARPs do not appear to be spending the total appropriations in any given fiscal year. MHEC reports that the number of physician LARP awardees varies from year to year and all students do not receive both federal and State funds through the program, so award amounts may vary. Since funding is provided by both sources, the total appropriation within the program is higher and will only decrease if the number of eligible applicants increases. Also, in fiscal 2015 the maximum award amount was increased from $25,000 to $30,000. This allowed MHEC to expend a little more within the program, which is reflected in fiscal 2015.

Exhibit 6
Loan Assistance Repayment Programs
Fiscal 2013-2016 Est.

		2013	2014	2015	Est. 2016
Janet L. Hoffman					
	Awards Made	$838,700	$1,458,200	$997,300	$941,800
	Annual Funding	$1,136,795	$1,136,795	$992,895	$1,032,795
Physicians					
	Awards Made	$512,500	$672,116	$681,217	$675,000
	Annual Funding	$770,000	$1,282,282	$1,282,282	$1,432,282
Dentists					
	Awards Made	$356,100	$332,360	$356,100	$356,100
	Annual Funding	$356,100	$356,100	$356,100	$356,100
	Total LARP Awards	**$1,707,300**	**$2,462,676**	**$2,034,617**	**$1,972,900**
	Total LARP Funding	**$2,262,895**	**$2,775,177**	**$2,631,277**	**$2,821,177**
	Unused Funding	**$555,595**	**$312,501**	**$596,660**	**$848,277**

Source: Maryland Higher Education Commission, Office of Student Financial Assistance

Prior to fiscal 2014, the amount of unspent funds within the Hoffman program had been modest and composed of cancellations and no waitlist awarding performed. In fiscal 2016, the estimated awards made are lower in comparison to total funding. This is because MHEC took cost containment within the program in fiscal 2015, but the award cancellation rate was lower than anticipated so MHEC covered the fiscal 2015 obligations with fiscal 2016 funds. The prior year deficiency, already mentioned, will cover the fiscal 2015 shortfall and free up the fiscal 2016 funding for awards to be made in fiscal 2016, so the final Hoffman award numbers should be higher than what is shown in Exhibit 6. The dental LARP's expenditures are very close to its appropriation in all years.

2+2 Transfer Scholarship Program Makes First Awards

Chapter 340 of 2014 created the 2+2 Program, which rewards students for completing an associate's degree before transferring to a four-year institution to pursue a bachelor's degree. If the Governor does not provide at least $2.0 million for this program, MHEC is required to transfer up to $2.0 million from NBSFAF to fund it. The fiscal 2016 allowance provided no funding for the 2+2 Program, although MHEC accepted applications for the program. A total of $0.2 million ended up being transferred from NBSFAF to make awards. However, initial results were disappointing, as only 137 awards were offered and 118 accepted in the lone round of awarding. This included 45 science, technology, engineering, and mathematics (STEM) awards and 73 non-STEM awards, totaling $163,000. The Maryland Association of Community Colleges reported in its most recent data book that about 9,300 students were awarded transfer degrees in fiscal 2014 and that over 70,000 community college students were enrolled in transfer degree programs in fall 2014. Assuming figures are similar in fiscal 2016, this suggests the first round of 2+2 awards reached about 1% of eligible students. The fiscal 2017 allowance includes $0.2 million from NBSFAF for the program.

The Secretary should comment on the number of applications for 2+2 awards so far for fiscal 2017 versus the prior year.

Need-based Financial Aid Appropriations Are Not Growing with Tuition Increases at Public Four-year Institutions

For need-based aid in the 2017 allowance, general fund support barely increases over the adjusted 2016 working appropriations, and support from the NBSFAF is level at $0.2 million, exclusively to fund 2+2 awards. As shown in **Exhibit 7**, need-based aid is essentially flat from fiscal 2015 through 2017, well behind the 5% to 7% increase in in-state undergraduate tuition at public four-year institutions in fiscal 2016 and the expected 2% increase budgeted for fiscal 2017. The Commission to Develop the Maryland Model for Funding Higher Education had recommended that need-based financial aid appropriations and average awards at least keep pace with tuition and fee increases. While the new 2013-2017 State Plan recommends further consideration of the Maryland Model, it puts forth no direct guidance or benchmarks for OSFA's programs.

Exhibit 7
State Financial Aid Expenditures
Fiscal 2007 and Fiscal 2014-2017
($ in Thousands)

	2007	2014	2015	Working 2016	Allowance 2017	$ Change 2016-17	% Change 2016-17
Need-based Aid	$83,818	$90,963	$86,094	$86,252	$86,274	$22	0.0%
Merit-based Aid	4,331	1,387	771	0	3,000	3,000	
Career-based Aid	9,124	3,104	3,503	4,409	4,409	0	0.0%
Legislative	11,349	11,945	12,111	12,392	12,805	413	3.3%
Unique Populations	785	2,820	2,405	1,720	1,720	0	0.0%
Total	**$109,408**	**$110,219**	**$104,885**	**$104,774**	**$108,208**	**$3,435**	**3.3%**

Note: Includes $1.6 million in deficiency funding in fiscal 2016 and the Maryland Early Graduation Scholarship in fiscal 2017.

Source: Financial Management Information System; Maryland Higher Education Commission

Over the past decade, overall State aid has declined 1.1%, or $1.2 million, mostly due to changes in merit-based and career-based awards. Need-based aid actually increased by 2.9%, or $2.5 million. Legislative awards grew 12.8%, or $1.5 million, and unique populations grew 119.0%, or $0.9 million. Until MEGS, the State had been shifting its focus to need-based aid from merit-based aid. As also shown in Exhibit 7, need-based aid accounts for about 80.0% of all aid in fiscal 2017 compared to about 77.0% in fiscal 2007. This is due to some small increases in need-based aid but also the conclusion of the State's last merit program in fiscal 2015. All of Maryland's 10 competitor states offer merit scholarships of some kind at the state level, so MEGS will bring back a common type of aid.

Maryland is the only state to fund and operate a legislative scholarships program following the end of a similar program in Illinois in 2012. After accounting for approximately $5.5 million in legislative carry-forward funds in fiscal 2016, both of Maryland's legislative award programs increase $0.4 million, or 3.3%, in the allowance, entirely within the Delegate Scholarship Program which itself grows 7.0% in fiscal 2017. Delegate Scholarships are intended to keep pace with tuition increases at the most expensive public four-year institution. Fiscal 2016 Delegate Scholarships funding was 2 percentage points below the actual increase in tuition from the fall 2014 to fall 2015 semesters and fiscal 2017 funding is 5 percentage points higher than the expected increase in tuition from fall 2015 to fall 2016. Taken together, this means Delegate Scholarships is 3 percentage points higher in fiscal 2017 than is necessary to match tuition increases over the past two years. **DLS recommends reducing the Delegate Scholarships by $176,500 so that this program increases to reflect no more than the actual tuition increase from fall 2014 to fall 2016, including mid-year tuition adjustments.**

Overall, MHEC expects to award aid to almost 52,000 recipients in fiscal 2016, a decrease of over 6,000 students, or 11%, from fiscal 2015, as shown in **Exhibit 8**. About two-thirds of this is due to fewer awards in the EAG program, partially due to flat funding. About one-third is due to a lower use of legislative scholarships, where the number of awards falls, but the average award increases by 13%, or $227. Merit-based programs drop to zero awards in fiscal 2016 to reflect the phasing out of the Distinguished Scholars program. The number of awards made through career programs and unique population awards both decline, driving the average award size up in fiscal 2016. Fiscal 2017 numbers are projections based off of the allowance and generally illustrate trends MHEC expects to see in the coming year.

The Secretary should comment on the cause of the decline in EEA awards from fiscal 2015 to 2016.

Exhibit 8
Recipients of Student Financial Assistance
Fiscal 2015-2017

	2015 Actuals		2016 Working		2017 Governor's Allowance	
Program	**Rec.**	**Avg. Award**	**Proj. Rec.**	**Proj. Avg. Award**	**Proj. Rec.**	**Proj. Avg. Award**
Need-based Aid						
Educational Assistance Grant	28,456	$2,101	24,308	$2,392	27,500	$2,114
Campus-based Educational Assistance Grant	1,125	1,778	1,125	1,778	1,125	1,778
Guaranteed Access Grant	1,492	12,216	1,419	12,896	1,425	12,842
2+2 Transfer Scholarship			115	1,739	200	2,000
Part-time Grant Program	7,134	713	7,000	848	7,000	848
Graduate and Professional Scholarship	533	2,204	530	2,216	530	2,216
Subtotal	**38,740**	**$2,227**	**34,497**	**$2,486**	**37,780**	**$2,275**
Legislative Programs	18,322	$1,335	16,195	$1,402	17,125	$1,315
Merit-based Programs[1]	261	2,954	0	0	500	6,000
Career and Occupational Programs	430	3,517	421	3,717	375	2,865
Unique Population Programs	654	2,625	606	2,508	640	2,427
Loan Assistance Repayment Programs	210	9,014	240	9,370	225	9,408
Total	**58,617**	**$1,789**	**51,959**	**$2,016**	**56,645**	**$1,910**

Rec.: recipients

[1] Includes the Maryland Early Graduation Program in fiscal 2017.

Source: Maryland Higher Education Commission

Issues

1. State Need-based Aid Reaches Far Fewer Students

Need is determined by a student's EFC, which is the amount of money that a family is expected to contribute toward a student's college costs. EFC is determined when a student files a FAFSA and is based on a number of indicators including the family's taxable income, family size, and the number of family members who will attend college during the year. To determine the amount of financial need a student has, OFSA subtracts the student's EFC and certain financial aid the student may have already received (such as the federal Pell grant) from the cost of attendance (including room, board, and tuition and fees) at the institution the student plans to attend. The gap between the cost of attendance and EFC plus other financial aid sources is considered a student's unmet need. In general, the lower a student's EFC, the greater their financial need.

Exhibit 9 shows trends in the EAG appropriations and applicants from fiscal 2011 to 2016. After GA awards are made, about 70% of EEA funding remains for EAGs. While appropriations for EAGs remained fairly constant from fiscal 2007 through 2013, the NBSFAF increased the appropriation significantly in fiscal 2014 to $91 million. At the same time, student need grew significantly over the past decade given increases in tuition and other costs as well as flat or declining family incomes during the Great Recession. The number of EAG applicants increased nearly 40% between fiscal 2010 and 2013, and those applying demonstrated greater financial need due to the economic recession. Total applications have declined substantially since fiscal 2013, from over 178,000 to about 131,000 in both fiscal 2015 and 2016.

Exhibit 9
Educational Assistance Grants
Fiscal 2011-2016

							% Increase	
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2011-2016**	**2015-2016**
Funds Awarded ($ in Millions)	$60.5	$57.9	$55.4	$62.6	$59.6	$58.1	-4.0%	-2.5%
Applicants (on-time FAFSAs)	145,944	170,489	178,603	134,670	131,695	131,196	-10.1%	-0.4%
Initial Applicants with $0 EFC	21,421	30,739	30,644	30,321	28,391	26,086	21.8%	-8.1%
Renewal Applicants with $0 EFC	11,227	13,681	16,006	15,469	16,199	16,482	46.8%	1.7%
EFC Awarded [1]	5,516	1,500	3,750	10,709	2,610	2,860	-48.2%	9.6%
Waitlist [2]	18,504	31,000	30,865	10,196	22,097	19,030	2.8%	-13.9%

EFC: Expected Family Contribution
FAFSA: Free Application for Federal Student Aid

[1] The numbers are maximum for which awards are made and as of the last round of aid awards in December of each year.
[2] As of May 1, students who are eligible for the Educational Excellence Award and are placed on the waitlist for receiving an award if they are full-time students, submit a completed application by the March 1 deadline, and have financial need remaining after their EFC and federal Pell grant award are considered.

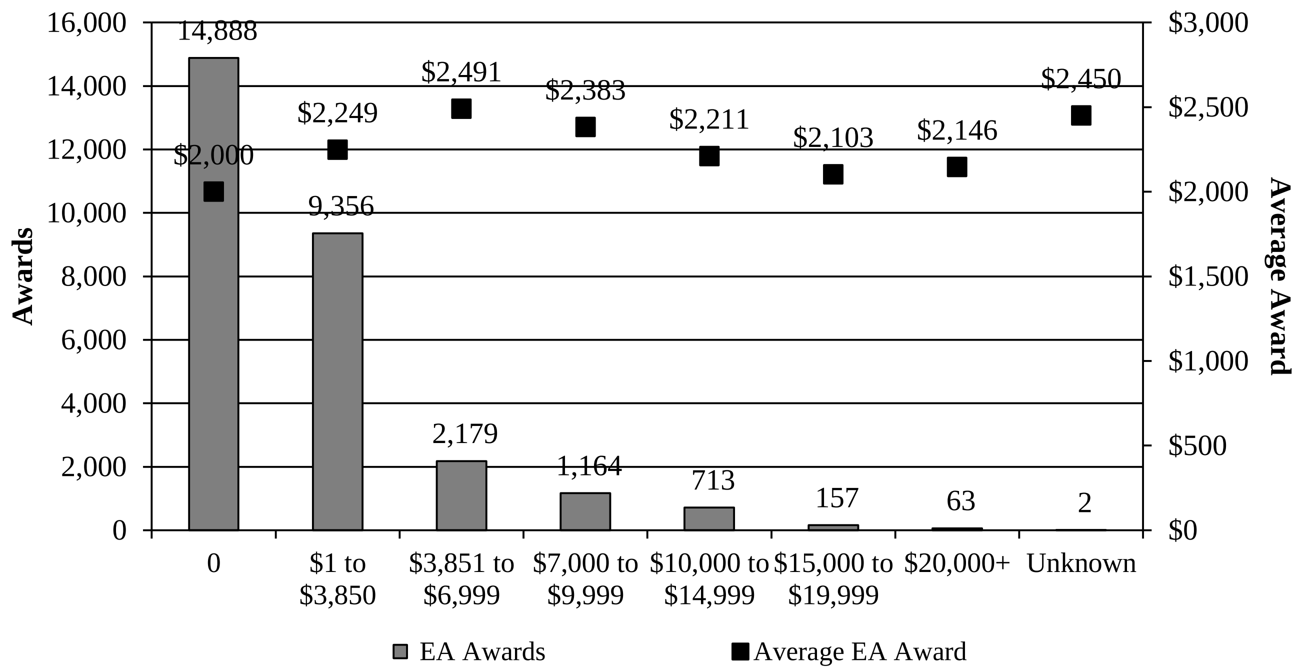
Source: Maryland Higher Education Commission

Currently, over 26,000 students have applied in fiscal 2016 with $0 EFC, which is down from a high of over 30,000 students in fiscal 2012. As a result of growing student need, EAG aid has become concentrated in lower EFCs each year. In fiscal 2016, to date, MHEC has awarded new EAGs to students with EFCs up to $2,860, which is similar to the level reached in fiscal 2015, but well below what the extra special fund money allowed fiscal 2014 to reach.

From fiscal 2010 through 2013, the EFC maximum for which awards were made had dropped to as low as $1,500, with the waitlist growing to over 30,000 students in two years. As of fiscal 2014, the waitlist declined to about 10,000 students due to more aggressive awarding and low cancellation rates, although some students that dropped off the list ceased to qualify for aid because they did not enroll full-time at Maryland institutions. The current waitlist in fiscal 2016 is about 19,000 students, which reflects an EFC cutoff of $17,500, the equivalent of the maximum GA award, which is the cost of attendance at the most expensive public four-year institution. MHEC implemented the EFC cutoff for the first time in 2016 in order to provide a more realistic waitlist of students likely to receive aid. Potential changes to the EAG program will be discussed in Issue 3 of this analysis.

The EAG is designed to meet 40% of financial need at four-year institutions and 60% at community colleges for full-time undergraduate students from low- to middle-income families. The maximum award amount is fixed at $3,000. From fiscal 2010 to 2014, after GA awards, about $55 million to $60 million remained in the EEA appropriation for EAGs. **Exhibit 10** shows the number of recipients and average award in fiscal 2015 by EFC category. The maximum EFC for federal Pell grant eligibility increases periodically, with the maximum EFC in fiscal 2015 being $5,775. Students with EFCs below this level have the greatest need. The greatest number of EAGs were made to students in the $0 EFC category. As EFC increases, the number of EAGs awarded decreases. As shown in Exhibit 9, MHEC was only able make *new* awards to students with EFCs up to $2,610 in fiscal 2015, although Exhibit 10 shows a small number of awards made to students with higher EFCs due to renewal awards from prior years, especially fiscal 2014, which had an EFC cutoff of $10,709.

Exhibit 10
Educational Assistance Awards by Expected Family Contribution
Fiscal 2015



EA: Educational Assistance

Note: Does not include campus-based Educational Excellence Awards and Guaranteed Access Grants awards.

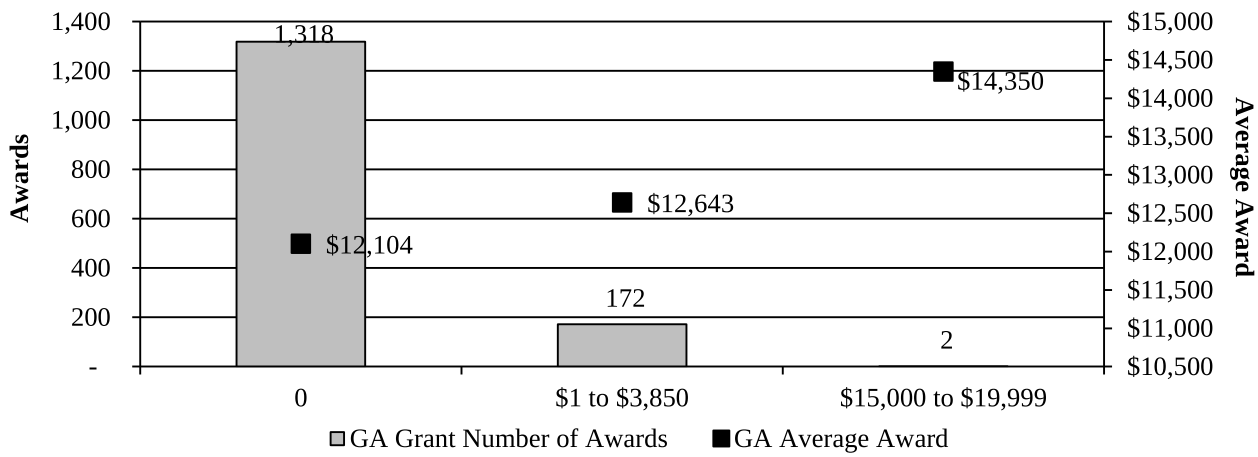
Source: Maryland Higher Education Commission, Maryland College Aid Processing System

Students with $0 EFC, on average, receive $491 less than students with EFCs of $3,851 to $6,999 or more. MHEC attributes this to the federal Pell grant, which students with EFCs below

$5,157 are likely to receive. Because the EAG is based on student need after federal Pell grants are accounted for, those with low EFCs often qualify for smaller EAG awards. However, it is not clear why the highest EFC category shows an increase over the preceding EFC category.

Exhibit 11 shows GA grants, which cover 100% of need when combined with a federal Pell grant for the State's lowest income students. Program eligibility is determined, in part, by a student's total annual family income, which may not exceed 130% of the federal poverty level for initial awardees and 150% of the federal poverty level for renewals. Almost all students receiving aid through this program have EFCs of $3,850 or less. Because the program covers the full cost of attendance, GA grants with $0 EFC are $12,104, compared to $2,000 from EAGs to students with the same EFC. About 52% of EAG recipients had a $0 EFC versus about 88% for GA recipients. The two GA awards made to higher EFCs are likely older awards passing through the system that have seen EFC changes occur and may be the same two that were reported in the fiscal 2014 data.

Exhibit 11
Guaranteed Access Grant Awards by Expected Family Contribution
Fiscal 2015



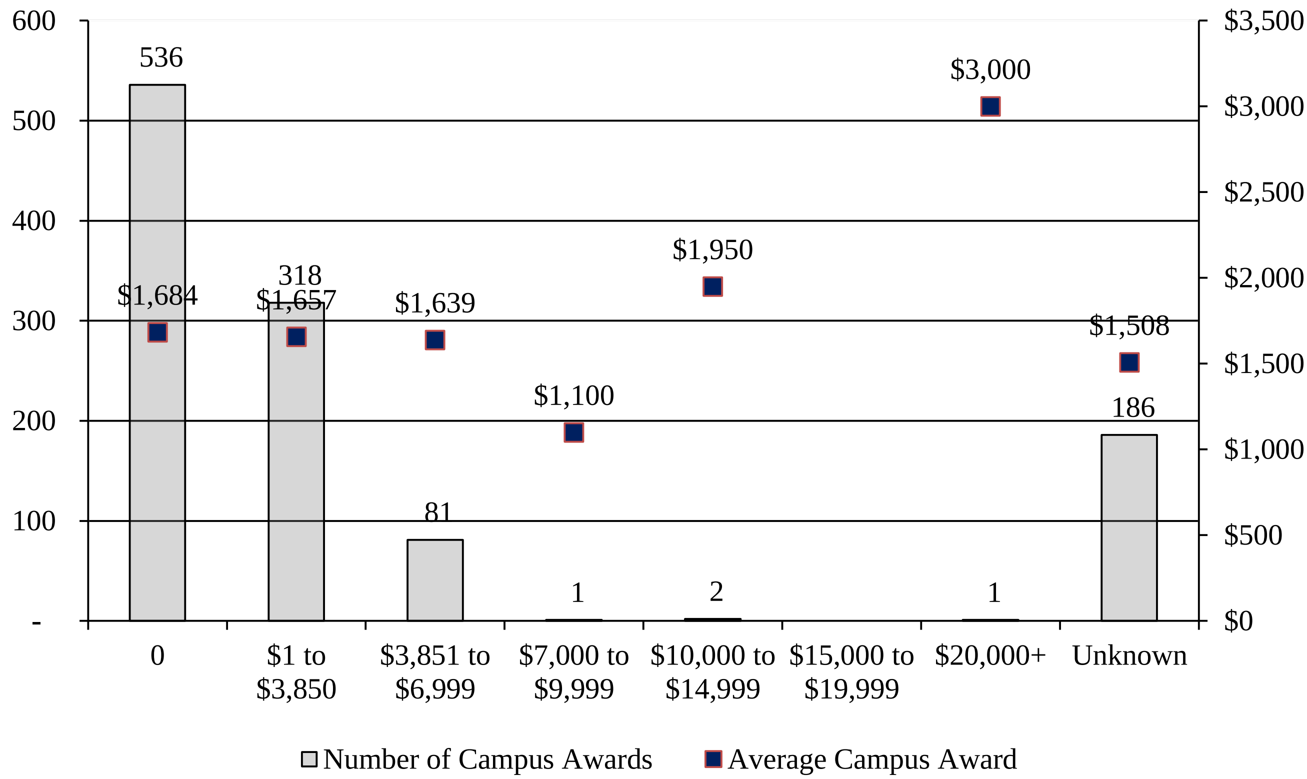
GA: Guaranteed Access

Source: Maryland Higher Education Commission, Maryland College Aid Processing System

Campus-based Awards Serve Students at All Levels of Need

Exhibit 12 shows campus-based EAGs, which are provided with $2.0 million per year out of the total EEA program. This funding is given to campuses for students who apply later than March 1 for financial assistance. Overall, most campus EAGs go to the two lowest EFCs, but there is a notable bump in the unknown EFC category. This is likely due to institutions awarding aid to students whose families have low enough incomes that they do not need to file State or federal tax forms, so while the student technically has an unknown EFC, it is most likely effectively $0. This would make such students Pell eligible, but does not fully account for why the award amounts would be lower for students in the unknown category than those students in the $0 EFC category. Because this funding is awarded later in the cycle, that is, closer to the start of the academic year, it greatly benefits students who make later decisions about enrolling, who are often first-generation students.

Exhibit 12
Campus Educational Assistance Awards by Expected Family Contribution
Fiscal 2015



EA: Educational Assistance

Source: Maryland Higher Education Commission, Maryland College Aid Processing System

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EFC and award outcomes for some other OSFA programs are shown as **Appendices 1** through **3** of this analysis. These programs generally provide more assistance to students with higher EFCs. **The Secretary should comment on the effects of level funding need-based aid in fiscal 2017 and what this means for resolving the waitlist, which remains large even with the new EFC cutoff implemented.**

2. Financial Aid and Affordability Examined

The education subcommittees of the budget and policy committees in the Senate and House held a series of meeting on college affordability during the 2015 interim, including a policy briefing by DLS and national and state experts on financial aid and student debt. The committees focused on making need-based aid more effective by tying it to improved outcomes, such as higher completion rates, and helping financially needy students with excessive student loan debt. Legislation has been introduced – the College Affordability Act of 2016 (SB 676 and HB 1014) that would require students to take 15 credits per academic year (including the summer term) to be considered enrolled full-time. It also establishes a $5,000 tax credit for students with at least $20,000 of student debt. The Governor has also proposed a plan to use State housing program funds to help students refinance student loan debt when purchasing a house (SB 381 and HB 460). In addition, bills have been introduced to establish or study the establishment of a student loan refinancing authority in the State.

In the 2015 interim, MHEC, with the reconstituted FAAC, also examined several financial aid issues on its own and as part of *Joint Chairmen's Reports* (JCR). One response entitled "*Implications of Changing FAFSA Deadline and Distribution of Financial Aid Awards*," considered changing State financial aid award application deadlines. However, in September 2015, a significant change was announced to the FAFSA, so the JCR partly responds to that.

In December 2014, FAAC recommended moving the FAFSA deadline for State awards to sometime later than March 1, the current due date, to provide students more time to decide whether to pursue higher education during their senior year of high school. GA applicants who apply late are eligible for an award as long as funding remains. However, if a GA application is not completed correctly, the student goes into the EAG pool of applicants. Currently, 35% of students miss the State's FAFSA deadline and are then not eligible for State awards, even though they may demonstrate high need. If the due date was pushed back, more students could file for State awards. Complicating this issue, in September 2015, the federal government announced the allowance of prior prior-year data for filling out the FAFSA. This will enable students and families to fill out the FAFSA significantly earlier, in October rather than January or February, which will speed up the financial aid awarding cycle. This should give students more information before regular admissions decisions must be made, generally in April for selective institutions and later for other institutions, but may also significantly increase the number of students applying for State awards. For this reason, FAAC, in responding to the 2015 JCR request decided to wait and see how prior prior-year data affects State financial aid applications before recommending further changes. The concern is that having both due dates move in the same application cycle would cause undue confusion and make awarding more unpredictable, given that more students may file the FAFSA on-time and be eligible for an award.

Before the prior prior-year data announcement, MHEC had contacted five states (Illinois, Indiana, Kansas, Massachusetts, and Minnesota) to inquire about their respective due dates and state aid management systems. Although Illinois has a "first-come, first-serve" process starting on January 1, Maryland has the earliest actual deadline of March 1. Indiana uses March 10, Kansas uses April 1, and Massachusetts uses May 1. Minnesota has a very sophisticated awarding system that allows students to apply for state aid until the thirtieth day of the academic term, many months later than the other states surveyed. How each of these states responds to prior prior-year data was not available in time for the JCR. Ultimately, MHEC recommends no changes to the due date at this time.

Financial Aid, Debt, and Success

Financial aid data from the most recent closed out fiscal year from MHEC's Financial Aid Information System was again not ready for use during the 2016 legislative session. DLS, in the Higher Education Overview, recommended that this information be submitted by July 1, 2016, and for fiscal 2016 information to be submitted by June 30, 2017. MHEC has informed DLS that it is working on additional financial aid reports that build off of prior JCR requests from fiscal 2013 through 2015 that explored the relationship between successful students and their financial aid characteristics. MHEC is conducting a study of per-student debt that will consider first-time, full-time (FT/FT) students enrolled at Maryland public four-year colleges and universities entering in fall 2008 and follows them forward for six academic years, through academic year 2013-2014. The analysis includes students who graduated as well as those who did not graduate. The final report, which will include detailed data and additional analysis, is expected to be released in March 2016. A similar analysis of borrowers at community colleges is expected to follow shortly thereafter.

Exhibit 13 summarizes some of the information MHEC is reviewing. Overall, there were 15,100 FT/FT students in the analysis group. Of that amount, 9,455, or about 5 out of every 8 students (62.6%), had at least some debt. The median debt per borrower was $20,500 and the average debt per borrower was $29,593. However, the average debt for all enrolled students, with or without loans, was $18,530. This is substantially below the number reported by the Project for Student Debt for the class of 2014, which had Maryland at $27,457, although the latter figure only looked at the debt of graduates in a given year rather than all enrolled FT/FT students. This suggests FT/FT students are graduating with less debt, which makes sense as they are enrolled full time. MHEC reports that about 75.0% of borrowers (85.0% of all students) incurred less than $40,000 in debt, and less than 3.0% of borrowers (less than 2.0% of all students) incurred $100,000 or more. This matches national research that students with six-figure debt loads are actually very uncommon at the undergraduate level.

Data from the University System of Maryland (USM) also indicates that six-figure debt is very rare, occurring in only 2% of FT/FT students who enrolled in fall 2008 and had graduated at the end of 2014, the same timeframe as the MHEC study but only graduates. Nearly half or 43% had no debt, while 20% had less than $20,000 in debt, 13% had $20,000 to $30,999 in debt, 11% had between $31,000 and $50,000 in debt, and the remaining 13% had debt over $50,000 (2% over $100,000 debt). USM also looked at transfer students in fiscal 2011 and found many students were still incurring high debt loads from the four-year institution. Overall, about 40% had no debt, 30% had loans of under $20,000, and 30% had loans between $20,000 and $99,999. This suggests financial aid policy may want to focus on low-income full-time students and transfer students to minimize the debt burden on those populations rather than broad aid programs open to anyone.

The Secretary should comment on MHEC's research agenda for the 2016 interim. The Secretary should also comment on how MHEC will contribute to a deeper analysis of the distribution of student loan debt across public and private institutions in Maryland, including transfer students.

Exhibit 13
MHEC Student Loan Study
First-time, Full-time Students Enrolled in Maryland Public Four-year Colleges and Universities
2008 Cohort

Total Student Loan Amount	Number of Students with Loans	% of Students with Loans	% of All Students
$0	0	0%	37.40%
$1-$20,000	4,224	44.70%	28.00%
$20,000-$39,999	2,929	31.00%	19.40%
$40,000-$59,999	1,125	11.90%	7.50%
$60,000-$79,999	612	6.50%	4.10%
$80,000-$99,999	312	3.30%	2.10%
$100,000 or more	253	2.70%	1.70%

MHEC: Maryland Higher Education Commission

Note: Data is preliminary.

Source: Maryland Higher Education Commission

3. New Advisory Committee Fails to Achieve Consensus

The 2013 through 2015 JCRs requested MHEC to examine aspects of financial aid awarding in Maryland, such as the application process, eligibility, number of recipients, award amounts, program expenditures, the waitlist, and due dates. The 2013 and 2014 JCRs in particular asked MHEC to consider how it could improve the management and outcomes of aid programs. MHEC turned to the FAAC to review these issues and to write the 2014 JCR response, which also restricted $100,000 pending the submission of that report.

Although FAAC had not met in about five years, despite its statutory mission, it found agreement across several large issues in OSFA programs that became a series of recommendations in the December 2014 JCR response, written as a consensus of FAAC. FAAC's membership included representatives from two- and four-year institutions, as well as independent institutions.

Reviewing and improving financial aid programs is imperative, because current outcomes from OSFA funding are either uncertain or unsatisfactory. For example, of the 542 GA Grant recipients in 2008, only 30% graduated in four years and 49% in five years, despite the State meeting the full cost of attendance for these students. While lowering the award amount to make more awards was discussed, FAAC did not pursue this option. Rather, FAAC recommended mandatory advising each semester the GA Grant is received, and to have MHEC work with campuses to ensure that GA Grant recipients get connected to work study opportunities which have a positive correlation to on-time graduation rates. In February 2016, independent institutions made a new commitment to fully fund the remaining cost of attendance for GA recipients with the Guaranteed Access Partnership Program and to provide academic support for these students.

FAAC proposed two major changes in its 2014 report. First was a recommendation that 15 credits should be the minimum for achieving full-time enrollment, rather than the 12 credit standard that the federal government and MHEC now use. The problem with the 12 credits per semester standard, what is generally considered full-time equals only 96 credits over four years, whereas 120 are required for a bachelor's degree. Complete College America and some states like Hawaii and Minnesota have pushed a "15 to Finish" campaign to encourage students to stay on time by enrolling in 15 credits per semester. Going forward, students enrolling in 12 credits in Maryland would receive a prorated amount of the State award, just not the maximum amount. This should provide an incentive for 15-credit enrollment and improve completion rates.

The second big change concerned award renewals. Historically, need-based award renewals have used up 60% of the total appropriation, which does not leave much funding for new entering cohorts of students. Currently, EAG renewals are automatic, regardless of the student's EFC after the initial award. FAAC has proposed that a fairer distribution of limited State funds would consider EFCs in *each year*. This would mean a student could lose an EAG if that student's EFC was above the annual final EFC cutoff as determined by MHEC. If MHEC adopted this policy, MHEC could make awards to students on the waitlist no later than July of each year, thus creating an opportunity to have more students from the waitlist awarded and accepted prior to the start of the fall semester. This is a methodology used in West Virginia, one of the states FAAC consulted during the interim. By eliminating automatic renewals, MHEC could create greater consistency within its need-based programs because all students meeting the March 1 deadline for State aid would have an equal opportunity to receive an EAG award, based on the EFC cutoff set by MHEC. The higher amount of EAG awards made in fiscal 2014 created more demand for renewals in fiscal 2015 and later years.

While FAAC was supportive of these two measures one year ago, during the 2015 interim no progress was made. Monthly meetings were held, and discussion involved other states, as noted in the previous issue on the FAFSA due date, but ultimately FAAC could not find a firm consensus across all sectors on changing the full-time definition or modifying the automatic renewal criteria. MHEC did implement a waitlist cutoff, but that was done mostly on its own without FAAC. To date, no significant changes were put in place for the fall 2015 award cycle or the fall 2016 cycle that directly affect students.

One other issue FAAC reviewed was certifying the residency of awardees. A concern from OLA in 2013, besides the buildup of funds in the NBSFAF, is that schools must certify enrollment and residency of awardees in September for the student to receive the award. In this process, MHEC had not been verifying the residency status of awards made, raising the possibility of improper financial aid awards being awarded. In order to meet the residency requirement, MHEC worked with FAAC to better understand why it takes a long time for institutions to certify rosters of awardees and how MHEC can then verify the results that are submitted. In the fall of 2015, MHEC verified the residency status of 5% of all EEAs and will ramp up to 100% verification by fall 2017. In order to receive awards, current statute dictates that institutions must do 100% verification. FAAC worked out new residency guidelines for students in the 2015 interim and will work with MHEC to identify the best process to transition the auditing to institutions beginning in fall 2018.

The Secretary should comment on progress toward implementing any of the recommendations of FAAC from the December 2014 JCR response and what FAAC will consider during the next interim.

Recommended Actions

		Amount Reduction	
1.	Reduce general funds for Delegate Scholarships.	$ 176,500	GF

2. Add the following language to the general fund appropriation:

   <u>, provided that $3,000,000 of this appropriation made for the purpose of the Maryland Early Graduation Scholarship Program may not be expended for that purpose but instead may only be transferred to the Educational Excellence Awards Program for need-based financial aid. Funds not expended for this restricted purpose may not be transferred by budget amendment or otherwise to any other purpose and shall be canceled.</u>

   Explanation: Because of the timing of the creation of the Maryland Early Graduation Scholarship program and because no legislation has been introduced to authorize the program, $3.0 million of funding is transferred to an existing financial aid program in statute with a waitlist that will be able to spend this funding in fiscal 2017.

Total General Fund Reductions	**$ 176,500**

Updates

1. Recent Changes to Financial Aid Programs

The 2014 and 2015 legislative sessions brought about changes to existing programs and brand new programs to MHEC – Student Financial Aid.

- Chapter 340 of 2014 renamed the defunct Community College Transfer Scholarship to be the 2+2 Transfer Scholarship. It requires the award be available to a student transferring to a four-year institution with an associate's degree and that, if the Governor does not provide funding, it will draw resources from the NBSFAF.

- Chapter 543 of 2014 renamed the Maryland Teacher Scholarship to be the Teaching Fellows of Maryland Scholarship and requires institutions to provide matching funds for this program. The maximum award is the full cost of attendance – tuition, fees, room, and board.

- Chapter 647 of 2014 created the Ruth M. Kirk Public Social Work Scholarship, which exists within the Workforce Shortage Student Assistance grant. This makes social workers eligible for such an award.

- Chapter 341 of 2015 created a new waiver at community colleges for victims of human trafficking. Students who meet certain conditions now do not have to pay out-of-county or out-of-region fees.

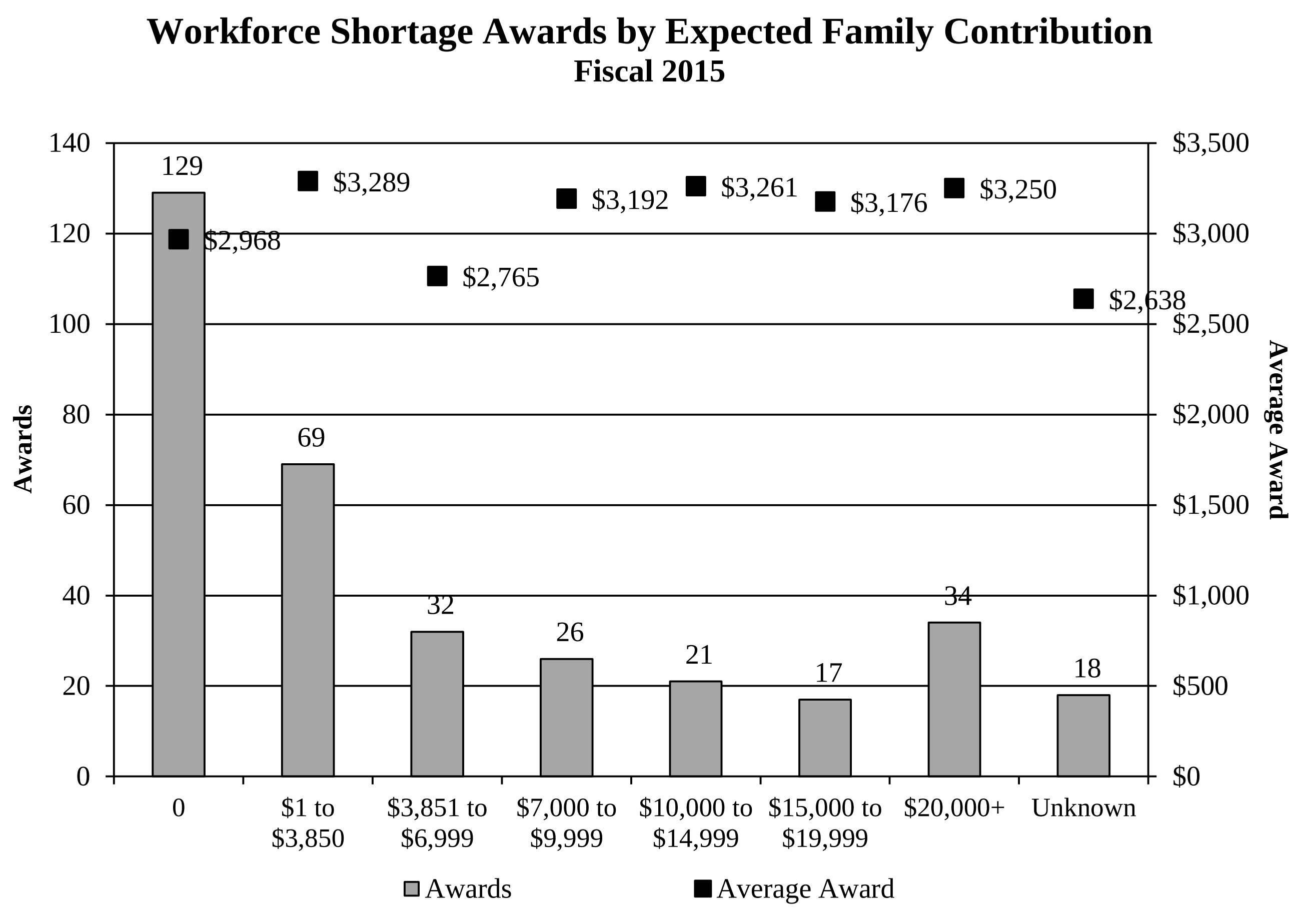
- Chapter 201 of 2015 established the Maryland Higher Education Outreach and College Access Pilot Program. It will encourage low-income Maryland high school students to attend and complete college through several means, including creating an equal matching fund for nonprofit organizations to access in order to increase college outreach services to low-income students. While not directly a financial aid program, it may increase the number of low-income students who apply for OSFA programs.

2. Net Price Calculators All in One Place

Since October 2011, each postsecondary institution that participates in the Title IV federal student aid programs is required to post a net price calculator (NPC) on its website that uses institutional data to provide estimated net price information to current and prospective students and their families, based on a student's individual circumstances. This calculator allows students to estimate the net price of attendance at an institution (defined as cost of attendance minus grant and scholarship aid) based on what similar students paid in a previous year. The NPC is required for all Title IV institutions that enroll full-time, first-time degree- or certificate-seeking undergraduate students.

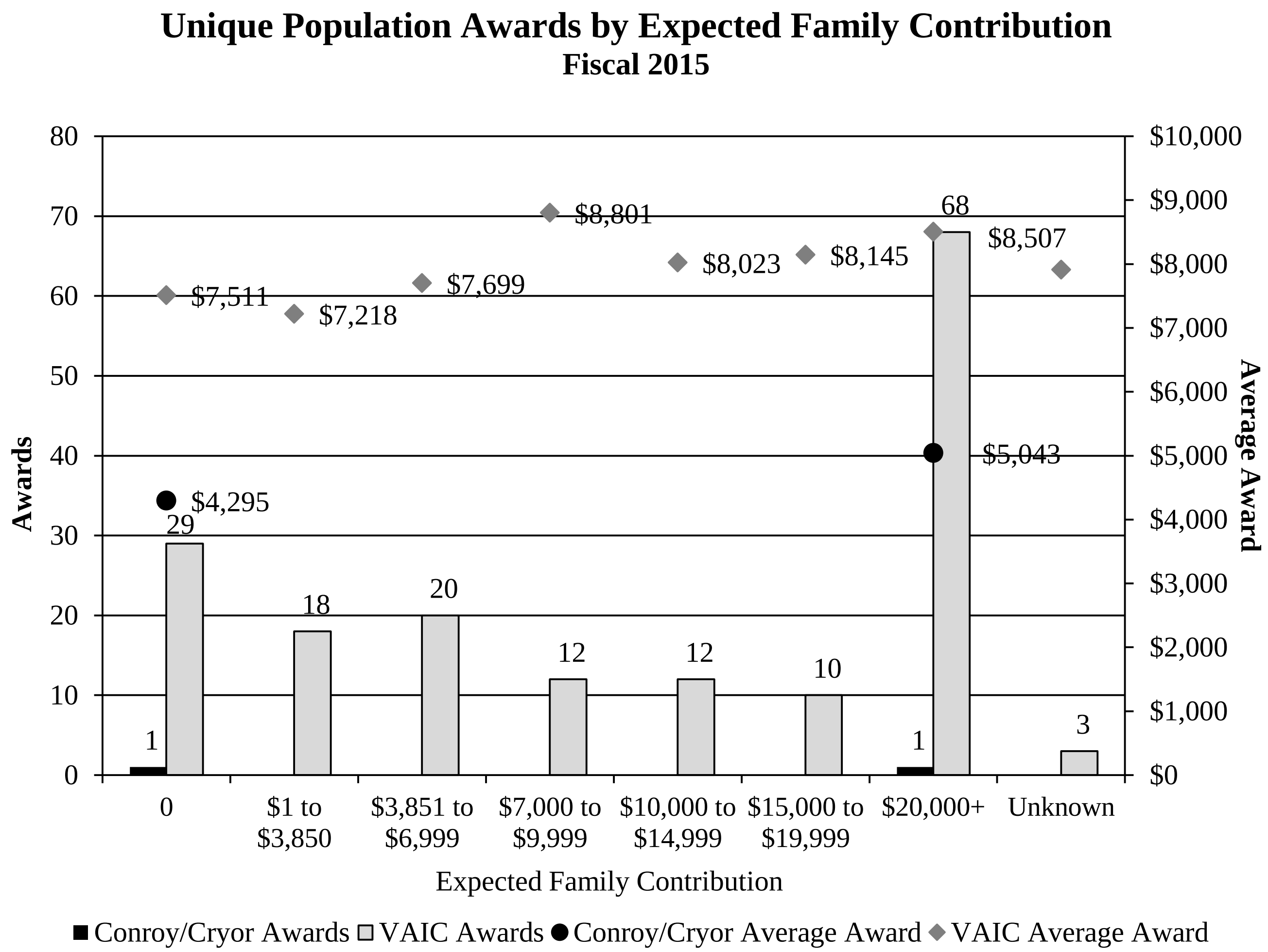
All Maryland institutions have the NPCs on their websites, but implement them in different ways. Bowie State University and Salisbury University send users to websites of external vendors which manage the NPC, whereas Coppin State University and Towson University keep users on the institutions' websites. Previously, it was cumbersome for an individual student to compare all calculators across all Maryland institutions. A JCR charge instructed MHEC to look at whether it could manage a centralized listing of all NPCs for public and independent institutions in Maryland. MHEC's *Consolidated Maryland Net Price Calculator Information*, notes that as of December 2015, all NPCs are shown on the MHEC and MDGo4It websites. Both websites were also recently redesigned, so the NPCs are part of updated content meant to provide faster, more accurate information to prospective students and families. While MHEC can link to these resources, it is up to the institutions to provide timely and accurate information for their respective NPCs. The most recent NPC template issued by the federal Department of Education in January 2016 is meant for academic year 2014-2015 data.

Appendix 1



Source: Maryland Higher Education Commission, Maryland College Aid Processing System

Appendix 2

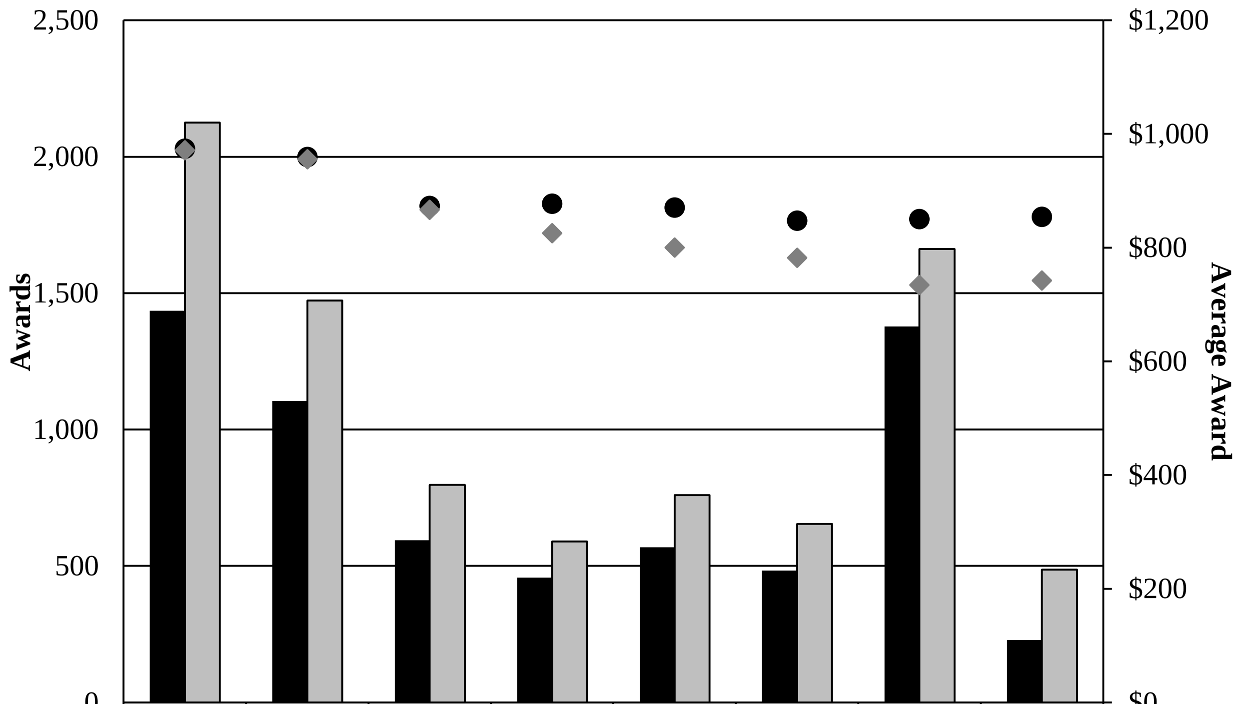


VAIC: Veterans of the Afghanistan and Iraq Conflicts Scholarship Program

Source: Maryland Higher Education Commission, Maryland College Aid Processing System

Appendix 3

Legislative Awards by Expected Family Contribution
Fiscal 2015



	0	$1 to $3,850	$3,851 to $6,999	$7,000 to $9,999	$10,000 to $14,999	$15,000 to $19,999	$20,000+	Unknown
■ Delegate Awards	1,435	1,105	594	457	569	483	1,378	229
□ Senatorial Awards	2,125	1,473	797	590	760	654	1,662	486
● Average Delegate Award	$974	$959	$873	$877	$870	$847	$850	$854
◆ Average Senator Award	$971	$955	$866	$825	$800	$782	$734	$742

Source: Maryland Higher Education Commission, Maryland College Aid Processing System

Appendix 4

Current and Prior Year Budgets

Current and Prior Year Budgets
MHEC – Student Financial Assistance
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$100,421	$1,390	$0	$250	$102,062
Deficiency Appropriation	0	0	0	0	0
Cost Containment	-1,960	0	0	0	-1,960
Budget Amendments	0	5,399	0	150	5,549
Reversions and Cancellations	-3	-763	0	0	-766
Actual Expenditures	**$98,458**	**$6,027**	**$0**	**$400**	**$104,885**
Fiscal 2016					
Legislative Appropriation	$100,864	$1,465	$0	$400	$102,730
Budget Amendments	200	200	0	0	400
Working Appropriation	**$101,064**	**$1,665**	**$0**	**$400**	**$103,130**

MHEC: Maryland Higher Education Commission

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

General funds decrease about $2.0 million due to two rounds of across-the-board cost containment efforts by the Board of Public Works: EEA ($1.3 million); Hoffman ($0.5 million); and Workforce Shortage Assistance Grants ($0.1 million). About $3,000 in general funds were reverted to the NBSFAF to align expenditures with revenues due to canceled awards in the Hoffman program.

The special fund appropriation increased by $5.4 million as carry forward funds were transferred to the current fiscal year: EEA ($4.2 million); VAIC Scholarship ($0.8 million); Edward T. Conroy Memorial Scholarship Program ($0.3 million); and Hoffman ($0.2 million). About $0.8 million in special funds were canceled as the appropriation was larger than the amount of financial aid awards made and accepted.

Reimbursable funds increased $0.2 million to reflect receipt of funds from the Department of Health and Mental Hygiene per an ongoing memorandum of understanding for health field financial aid awards.

Fiscal 2016

To date, the general fund appropriation has increased $0.2 million to redistribute cost containment from need-based financial aid programs to the administrative budget program for MHEC. The special fund appropriation has also increased $0.2 million to fund the new 2+2 Program.

Object/Fund Difference Report
MHEC – Student Financial Assistance

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Objects					
08 Contractual Services	$ 0	-$ 1,868,000	$ 0	$ 1,868,000	-100.0%
12 Grants, Subsidies, and Contributions	104,885,010	104,997,532	105,208,282	210,750	0.2%
Total Objects	**$ 104,885,010**	**$ 103,129,532**	**$ 105,208,282**	**$ 2,078,750**	**2.0%**
Funds					
01 General Fund	$ 98,458,365	$ 101,064,250	$ 103,143,000	$ 2,078,750	2.1%
03 Special Fund	6,026,645	1,665,282	1,665,282	0	0%
09 Reimbursable Fund	400,000	400,000	400,000	0	0%
Total Funds	**$ 104,885,010**	**$ 103,129,532**	**$ 105,208,282**	**$ 2,078,750**	**2.0%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
MHEC – Student Financial Assistance

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
09 2+2 Transfer Scholarship Program	$ 0	$ 200,000	$ 200,000	$ 0	0%
10 Educational Excellence Awards	79,832,243	78,345,525	80,011,525	1,666,000	2.1%
12 Senatorial Scholarships	6,486,000	6,486,000	6,486,000	0	0%
14 Edward T. Conroy Memorial Scholarship Program	820,474	570,474	570,474	0	0%
15 Delegate Scholarships	5,625,000	5,906,250	6,319,000	412,750	7.0%
16 Riley Fire and EMS Tuition Reimbursement Program	358,000	358,000	358,000	0	0%
17 Graduate and Professional Scholarship Program	1,174,473	1,174,473	1,174,473	0	0%
20 Distinguished Scholar Program	771,000	0	0	0	0%
21 Jack F. Tolbert Memorial Student Grant Program	200,000	200,000	200,000	0	0%
26 Hoffman Loan Assistance Repayment Program	1,094,228	1,388,895	1,388,895	0	0%
28 Maryland Loan Assistance Repayment Program for Physicians	920,339	1,432,282	1,432,282	0	0%
33 Part-Time Grant Program	5,087,780	5,087,780	5,087,780	0	0%
36 Workforce Shortage Student Assistance Grants	1,130,500	1,229,853	1,229,853	0	0%
37 Veterans of the Afghanistan and Iraq Conflicts Sch.	1,384,973	750,000	750,000	0	0%
Total Expenditures	**$ 104,885,010**	**$ 103,129,532**	**$ 105,208,282**	**$ 2,078,750**	**2.0%**
General Fund	$ 98,458,365	$ 101,064,250	$ 103,143,000	$ 2,078,750	2.1%
Special Fund	6,026,645	1,665,282	1,665,282	0	0%
Total Appropriations	**$ 104,485,010**	**$ 102,729,532**	**$ 104,808,282**	**$ 2,078,750**	**2.0%**
Reimbursable Fund	$ 400,000	$ 400,000	$ 400,000	$ 0	0%
Total Funds	**$ 104,885,010**	**$ 103,129,532**	**$ 105,208,282**	**$ 2,078,750**	**2.0%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

R95C00
Baltimore City Community College

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Funds	$40,137	$40,776	$40,814	$39	0.1%
Adjusted General Fund	**$40,137**	**$40,776**	**$40,814**	**$39**	**0.1%**
Other Unrestricted Funds	19,946	26,179	26,227	48	0.2%
Adjusted Other Unrestricted Fund	**$19,946**	**$26,179**	**$26,227**	**$48**	**0.2%**
Total Unrestricted Funds	60,083	66,955	67,042	87	0.1%
Adjusted Total Unrestricted Funds	**$60,083**	**$66,955**	**$67,042**	**$87**	**0.1%**
Restricted Funds	22,698	24,308	24,001	-307	-1.3%
Adjusted Restricted Fund	**$22,698**	**$24,308**	**$24,001**	**-$307**	**-1.3%**
Adjusted Grand Total	**$82,780**	**$91,263**	**$91,043**	**-$220**	**-0.2%**

- State support through general funds increases $39,000, or 0.1%, between fiscal 2016 and 2017.
- The total fiscal 2017 allowance declines $0.2 million, or 0.2%, from the fiscal 2016 working appropriation, driven by declines in restricted funds of $0.3 million.

Note: Numbers may not sum to total due to rounding.

For further information contact: Garret T. Halbach Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	444.00	444.00	444.00	0.00
Contractual FTEs	268.18	141.22	164.67	23.45
Total Personnel	**712.18**	**585.22**	**608.67**	**23.45**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions		11.54	2.60%	
Positions and Percentage Vacant as of 12/31/15		42	9.50%	

- Regular positions do not change in the fiscal 2017 allowance.

- Contractual positions increase 23.45 in the fiscal 2017 allowance due to a projected increase in noncredit program enrollment at the Business and Continuing Education Division at Baltimore City Community College (BCCC). As a point of comparison, BCCC had nearly 300 contractual positions as recently as fiscal 2013, but declining credit enrollment forced the institution to reduce its adjunct faculty.

- While BCCC's vacancy rate of 9.5% is relatively high, it is comparable to nearby Coppin State University's 12.0% and the University of Baltimore's 10.3%.

Analysis in Brief

Major Trends

Fall Enrollment Woes Continue: Despite efforts to stem the decline in enrollment, BCCC again reported a steep one-year decline of 11.3% in degree-seeking headcount enrollment in fall 2015. This is the fifth year of declining fall enrollment.

Student Performance Improves: Though the standard measure of success in higher education is graduation, community college students often have different goals compared to those at four-year institutions, and the standard measurement used is the successful persister rate. The successful persister rate of students who complete required developmental education is slightly higher than those who enter as "college-ready." Due to new programs, BCCC's developmental completer rate is on the rise, although it still remains relatively low.

Credit and Noncredit Enrollment Mostly Declines: BCCC's credit and noncredit student enrollment declined, in total, by about 382 eligible full-time equivalent students in fiscal 2015, or 6.6%. BCCC has yet to fully gain control over this ongoing decline.

Issues

Making College Affordable: Colleges offer institutional scholarships to students in need of financial assistance and to reward academic achievement. This issue looks at federal aid available to BCCC students and the recent decision to raise tuition for the first time in seven years.

Credit Enrollment Decline: Although community college enrollment has decreased statewide since fall 2011, the decline at BCCC has been of a much greater magnitude. This issue looks at the decline across different types of students and explores why BCCC is losing its enrollment to the neighboring Community College of Baltimore County.

Noncredit Enrollment Trends – Mixed Story: Although BCCC enrollment decreased since fall 2011, the decline in credit enrollment has been of a much greater magnitude. This issue looks at noncredit offerings and partnerships at BCCC.

With Accreditation Reconfirmed, BCCC Looks to the Future: In June 2015, BCCC's accreditation was reaffirmed, exactly three years after a previous negative accreditation status was removed. This issue explores how BCCC is responding to a *Joint Chairmen's Report* charge to perform a comprehensive review of its organizational structure, mission, and relationship with other institutions in Maryland.

Recommended Actions

1. Add language to correct State support for Baltimore City Community College's English for Speakers of Other Languages grant.

2. Add budget bill language for a comprehensive report.

Updates

Major Information Technology Project Slowly Moving Forward: BCCC determined that a new Enterprise Resource Planning system was needed in fiscal 2009. In December 2015, the Department of Information Technology approved the Project Implementation Request, moving the entire project from the planning phase into the implementation phase.

R95C00
Baltimore City Community College

Operating Budget Analysis

Program Description

Baltimore City Community College (BCCC) is a State-sponsored, two-year degree-granting college on two campuses with more than 60 off-campus sites throughout Baltimore. BCCC offers both credit and continuing education training programs and courses, as well as extensive outreach for educational opportunities. The college's Business and Continuing Education Division works in partnership with local businesses, government agencies, and institutions offering contract customized training, apprenticeships, and other industry-related programs contributing to Baltimore's economic development initiatives. The college's administrative and academic control differs from other community colleges in the State since there is minimal local funding. Baltimore City must provide at least $1,000,000 annually to support education at BCCC, and at least $400,000 of that amount must be allocated to tuition reimbursements and scholarships.

BCCC works toward achieving the following goals:

- improving retention of students to graduation or transfer to a baccalaureate-granting college or university;
- improving responsiveness to Baltimore's workforce needs;
- promoting community college outreach and services; and
- ensuring affordability to Baltimore City residents.

Carnegie Classification: Community College

Fall 2015 Credit Enrollment Headcount	
Male	1,504
Female	3,222
Total	**4,726**

Fall 2015 New Credit Students Headcount	
First-time	937
Transfers/Others	505
Dual Enrollment	117
Total	**1,559**

Credit Programs	
Certificates	16
Associate's	29

Degrees Awarded (2014-2015)	
Certificates	104
Associate's	405

Proposed Fiscal 2017 In-state Tuition and Fees*	
Undergraduate Tuition	$2,880
Mandatory Fees	$540

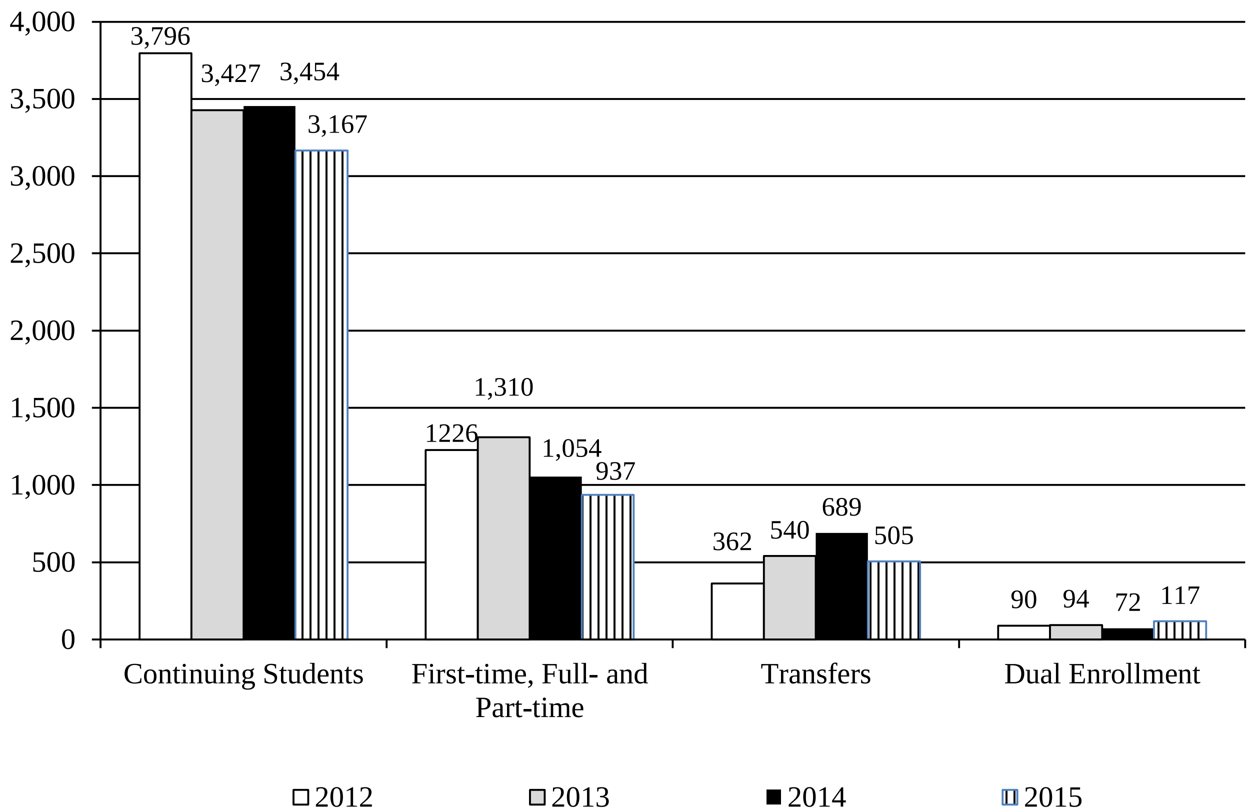
* Contingent on Board of Trustees approval.

Performance Analysis: Managing for Results

1. Fall Enrollment Woes Continue

Degree-seeking headcount enrollment at BCCC decreased 11.3%, from 5,197 in fall 2014 to 4,609 in fall 2015. As shown in **Exhibit 1**, while first-time, full- and part-time students fell by 117, or 11.1%, continuing students decreased by 287, or only 8.3%, but transfer students fell 184, or 26.7%. This broad and deep decline follows upon general enrollment decreases in fall 2012 through 2014. The one positive demographic in fall 2015 was dually enrolled high school students, who grew by 45, or 62.5%. The continuing enrollment decline will be discussed further in Issue 2.

Exhibit 1
Undergraduate Enrollment
Fall 2012-2015



Note: Fall 2015 data is preliminary.

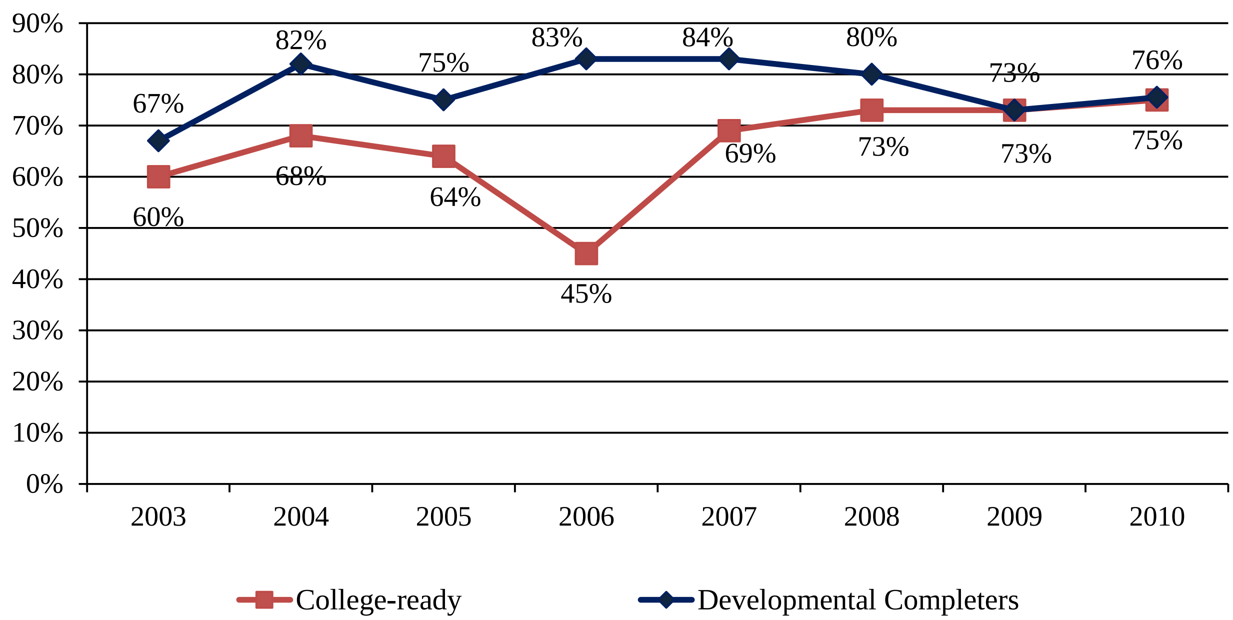
Source: Baltimore City Community College

2. Student Performance Improves

While the standard measure of success at four-year institutions is graduation, Maryland community colleges instead use the successful persister rate. This difference is because community college students are more likely to have work and family commitments than students at traditional four-year colleges, or they may be working toward a certificate rather than a degree. Such students are more likely to be enrolled part time and even "stop-out" for a period of time. Community college students also tend to be somewhat older than the average first-time, full-time college student, and BCCC students, in particular, tend to face greater economic challenges than students at other community colleges in Maryland.

A successful persister is a student who attempts 18 or more credits in his or her first two years, and after four years, is still enrolled, has graduated, or has transferred to another college. BCCC measures this rate for three groups, and **Exhibit 2** shows the rates for two of those: college-ready students and developmental completers.

Exhibit 2
Four-year Successful Persister Rates
Fall 2003-2010 Cohorts



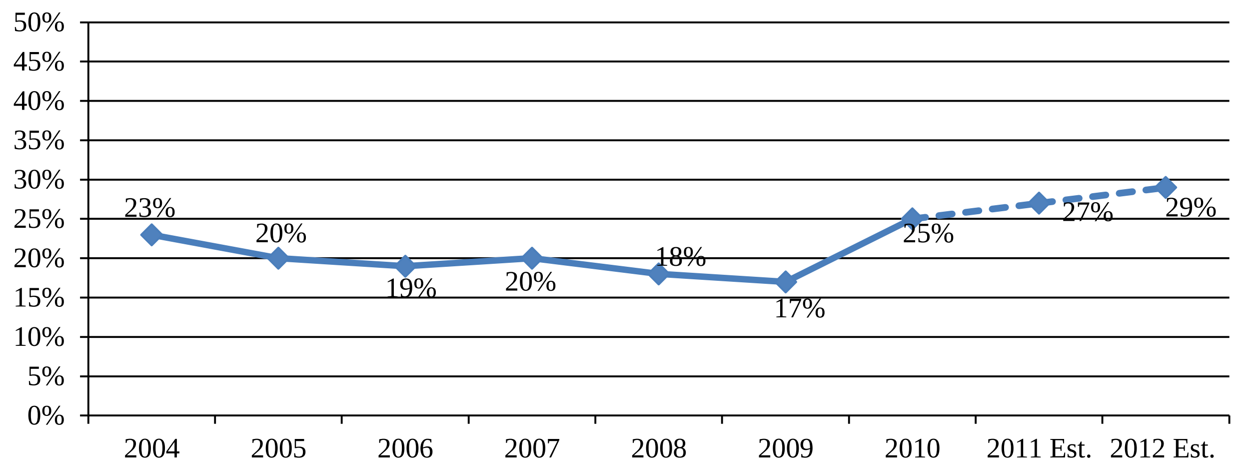
Source: Governor's Budget Books, Fiscal 2011-2016

There are few college-ready students at BCCC, less than 100 in the 2009 and 2010 cohorts, and the data includes students who did not have to take a placement exam but likely would have placed into developmental education. Developmental completers are students who needed developmental education and completed it within four years. These students regularly outperform BCCC's college-ready students, although just barely in the 2009 and 2010 cohorts. This is interesting because this trend ended among the local community colleges in this cohort year. The successful persister rate, as mentioned, is made up of students who have graduated or transferred and students who are successfully persisting, that are still pursuing coursework. While the developmental completers narrowly outperform the college-ready students, the graduation/transfer rate of developmental completers fell from 43.3% in the 2009 cohort to 40.1% in the 2010 cohort. For college-ready students at BCCC, the same rate went from 57.6% to 60.0%. Across all community colleges, the graduation/transfer rate of developmental completers only fell from 58.7% to 52.9%.

The President should comment on how the college is working with developmental completers to ensure that they graduate or are able to transfer to another institution.

The actual number of students who finish developmental education, and thus become developmental completers, is very low. BCCC reports, from fall 2011 through fall 2015, about 90% of incoming students tested into remedial math and 75% tested into remedial English. **Exhibit 3** shows that the developmental completer rate gradually declined for the fall 2004 through 2009 cohorts, from 23% to 17%, but suddenly jumped to a new high, 25%, for the fall 2010 cohort and is expected to grow higher with the 2011 and 2012 cohorts.

Exhibit 3
Developmental Completer Rate
Fall 2004-2012 Est. Cohorts



Note: The developmental completer rate shows the percent of developmental students who have completed recommended coursework within four years.

Source: Governor's Budget Books, Fiscal 2011-2017

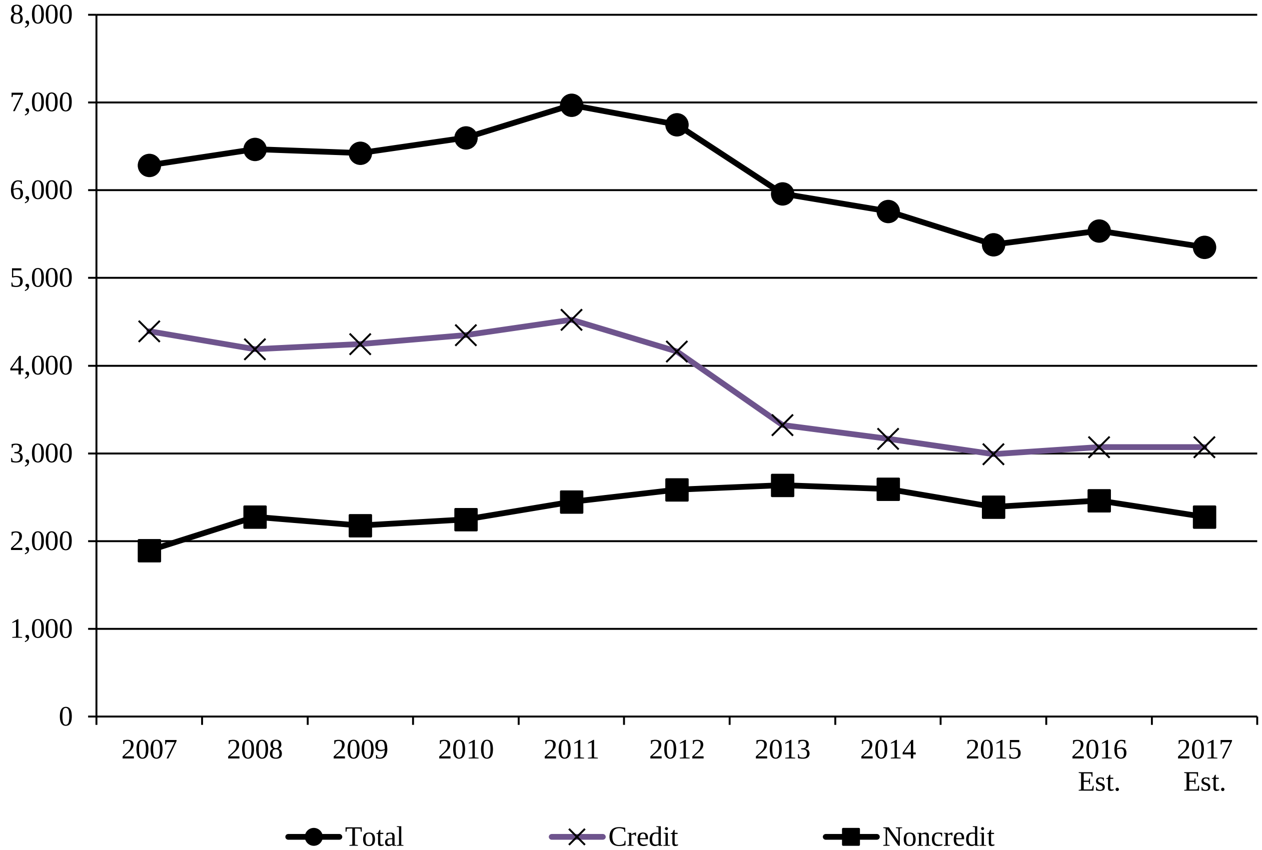
This anticipated increase in developmental completer rates is due to a number of new programs that were started in fall 2010, including a redesign of developmental education and a new intrusive advising program where students must meet with an advisor every 15 credits. The new fall 2010 through 2011 programs differed from the prior 2005 through 2010 programs, under which the rate actually worsened, in two major ways. First, the new programs are in the process of being implemented institutionwide. Second, the new programs cover a wider range of the student experience, from the course level to general student support. The new programs fall into the following four major categories: mandatory orientation; course redesign; Performance Alert and Intervention System (PAIS); and intrusive advising. PAIS is an early alert system designed to identify students who are at risk of failing and offer them services that will help them succeed. Faculty are required to report to the Student Success Center students who receive poor grades, have poor attendance records, or exhibit poor classroom skills. Depending on students' needs, the Student Success Center refers students to tutoring, social service agencies, or elsewhere.

Increasing performance on the measure in Exhibit 3 will have a significant impact on BCCC's completion rates. BCCC has started a number of even newer initiatives that the college hopes will show positive results in the coming years. BCCC is also rolling out a Second Chance Program in math; modular course structures for math classes; embedded tutoring; developmental math for science, technology, engineering, and mathematics programs; and study skills courses. In addition, the college's Center for Academic Achievement has transitioned from prescriptive tutoring to traditional tutorial services allowing students to request services either through walk-ins or appointments. These tutoring services, available at six centers, are offered free of charge to all BCCC students across all levels of the main subject areas of writing, math, science, business, accounting, technology, allied health, and computer-aided drafting and design. This gives reason to think that the turnaround shown by the fall 2010 cohort of developmental completers in Exhibits 2 and 3 may be real and sustainable.

3. Credit and Noncredit Enrollment Mostly Declines

As shown in **Exhibit 4**, BCCC enrollment is made of credit and noncredit enrollments. While most community colleges in Maryland grew consistently from fiscal 2007 to 2011, BCCC remained remarkably level, growing only 3.0% in full-time equivalent student (FTES) in credit enrollment. Total eligible credit enrollment peaked in fiscal 2011, at 4,522 FTES, and has declined in each subsequent year. In fiscal 2015, credit enrollment was 33.9% below the peak, a decrease of 1,532 students. Noncredit tells a much different story, as it broadly increased from fiscal 2007 to 2013, increasing 39.1%, or 742 students, before declining slightly in fiscal 2014 and 2015.

Exhibit 4
State-eligible Full-time Equivalent Student Enrollment
Fiscal 2007-2017 Est.



Source: Governor's Budget Books, Fiscal 2009-2017

Budgeted enrollment is anticipated to decline 1.3%, or 72 FTES in fiscal 2017, the first time BCCC has anticipated an enrollment decline despite five consecutive years of declines. A year ago, BCCC had expected to grow 2.8% in fiscal 2015 and 3.0% in fiscal 2016 but instead declined 6.6% in fiscal 2015 and will likely decline about 8.0% in fiscal 2016. Although both noncredit enrollments and credit enrollments are declining, given the trend in the actual figures from fiscal 2007 through 2015, there is a possibility that BCCC could have more noncredit students than credit students in the near future. It will be an institutional decision to either embrace the shift toward noncredit enrollment or to attempt to increase credit student enrollment again. The gap between the two types of students in the fiscal 2015 actual was 601 students, whereas the gap in fiscal 2006 was nearly 2,800 students. For BCCC to recover credit enrollments will be difficult, as it is currently at the lowest FTES enrollment since fiscal 2000. For historical comparison, BCCC was at 6,205 FTES in fiscal 1991, the year it became a State institution, and had 39.7% of all FTES enrolled in public higher education institutions in Baltimore. By fiscal 2015, BCCC had fallen to 28.0% of all public FTES in Baltimore City, its lowest share of FTES to date with students increasingly seeming to choose to attend other institutions. The abrupt decline in fiscal 2011, a year before the decline at other campuses, may be tied to BCCC eliminating 6 degree programs and 28 certificate programs and combining 21 degrees into broader programs. In total, this impacted 75% of the for-credit programs. This followed on the heels of the Bard Building closing in fiscal 2010, dramatically decreasing academic space and a location for classes in downtown Baltimore.

The Department of Legislative Services (DLS) projects BCCC at only 5,231 FTES in fiscal 2018. BCCC's new mid-year fiscal 2016 strategic plan calls for growing to 6,250 FTES in that year. This would be an increase over the fiscal 2015 actual of 871 FTES, or 16.2%, despite declining or flat enrollment in fiscal 2016 and 2017. **The President should comment on whether this is a realistic goal for BCCC, given the budgeted assumption of declining enrollment in fiscal 2017.**

Fiscal 2016 Actions

Cost Containment

BCCC was not part of fiscal 2016 cost containment actions. The General Assembly did hold BCCC harmless in fiscal 2016 to its actual State support in fiscal 2015, which had been reduced by cost containment in that year. In addition, the Budget Reconciliation and Financing Act (BRFA) of 2015 transferred $4.0 million from BCCC's fund balance to the General Fund due to the college having in excess of $26.9 million on hand. BCCC had to fund the cost-of-living adjustment restoration in fiscal 2016 out of its formula funding.

Proposed Budget

State law ties BCCC's general fund appropriation to a percent of the per student funding at selected public four-year colleges (58.0% in fiscal 2017) and BCCC's most recent audited enrollments. General funds also support the English for Speakers of Other Languages (ESOL) grant. **Exhibit 5** shows BCCC's general fund appropriation increases by $39,000, or 0.1%, due to BCCC receiving an increase in ESOL funding but receiving flat funding through its primary State support formula. Other unrestricted funds increased $53,000, or 0.3%, due to an expected increase in local grants and contracts and miscellaneous sources, while restricted funds, which is about 70.0% federal Pell grants, decrease the most, about $0.3 million, or 1.3%, due to the enrollment decline. Restricted funds declined in both fiscal 2015 from 2014 as well. Unlike large changes seen in prior years, the transfer from the fund balance into the operating budget actually decreases by $5,000, or 0.1% in the 2017 allowance. The use of this funding will be discussed later in the analysis. As a formula-funded institution, BCCC is not part of the across-the-board health insurance reduction in fiscal 2017. Ultimately, the decline in restricted financial aid is enough to shift the entire budget down in fiscal 2017 by $0.2 million, or 0.2%.

Exhibit 5
Proposed Budget
Baltimore City Community College
($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Funds	$40,137	$40,776	$40,814	$39	0.1%
Other Unrestricted Funds	18,104	20,950	21,003	53	0.3%
Fund Balance Reversion	-4,000				
Total Unrestricted Funds	**$54,241**	**$61,726**	**$61,818**	**$92**	**0.1%**
Fund Balance Transfer	5,842	5,229	5,224	-5	-0.1%
Restricted Funds	22,698	24,308	24,001	-307	-1.3%
Total Funds	**$82,780**	**$91,263**	**$91,043**	**-$220**	**-0.2%**

Note: Numbers may not sum to total due to rounding. Fund balance transfer reflect net change of transfers to and from the fund balance each year.

There is a 16%, or $2.8 million, increase in other unrestricted funds in fiscal 2016. This is entirely due to a 13.8%, or $2.8 million, increase in tuition and fee revenue from fiscal 2015 to the 2016 working appropriation. However, as shown in Exhibit 1, opening fall headcount enrollment decreased 11.3% in fall 2015, making the working year tuition and fee revenue number extremely unrealistic. As discussed in Issue 1, tuition and fee rates were increased in the spring 2016 semester but not anywhere near the level necessary to keep tuition and fee revenue level, let alone increase, given actual fall enrollment. While the 2017 allowance number for tuition and fee revenue, a slight decline, originally appears realistic, when accounting for the actual decline in the 2016 working appropriation, it seems that fiscal 2017 will likely need to be revised downward from the allowance. Exhibit 5 also shows the $4.0 million fund balance transfer to the General Fund in fiscal 2015.

BCCC's Funding Formula

Chapters 568 and 569 of 1998 established the funding formula for BCCC that was enhanced in 2006 and further revised several times, most recently by the BRFA of 2012. The fiscal 2017 statutory formula percentage is 58.0% of per student funding at selected public four-year institutions, the same as fiscal 2016, but down from 61.0% in fiscal 2015, as shown in **Exhibit 6**. The previously mentioned decline in enrollment has decreased the formula amount to $36.3 million, which is below the prior year's non-ESOL appropriation of $39.8 million. This triggers the hold harmless clause, which requires the Governor to fund BCCC's formula by at least as much as was in the prior year's appropriation. For this reason, BCCC's total State aid is the sum of the $35.4 million from the prior year's formula plus that year's hold harmless funding plus the ESOL grant amount of approximately $1.0 million in fiscal 2017, which all totals $40.8 million. If BCCC was not held harmless in fiscal 2017, it would lose $3.5 million, or 8.5%, of State support.

Exhibit 6
Baltimore City Community College Formula Funding
Fiscal 2016-2017

	Fiscal 2016 Appropriation	Fiscal 2017 Allowance	Change $	Change %
State Formula Aid Per FTES at BCCC				
State Support Per FTES at Selected Four-year Public Institutions	$10,606	$11,650	$1,044	9.8%
Statutory Formula Percentage	58.0%	58.0%	0	0.0%
BCCC Aid Per FTES	$6,152	$6,757	$605	9.8%
State Formula Aid for BCCC				
Aid Per FTES	$6,152	$6,757	$605	9.8%
Second Year Prior FTES	5,760	5,379	-381	-6.6%
State Aid to BCCC	**$35,436,787**	**$36,345,528**	**$908,741**	**2.6%**
Hold Harmless	4,360,520	3,451,779	-908,741	-20.8%
Subtotal	***$39,797,307***	***$39,797,307***	***0***	***0.0%***
English for Speakers of Other Languages Annual Grant Adjustment	978,336	1,017,135	38,799	4.0%
Total Fiscal Year Working/Allowance	**$40,775,643**	**$40,814,442**	**$38,799**	**0.1%**

BCCC: Baltimore City Community College
FTES: full-time equivalent student

Source: Governor's Budget Books, Fiscal 2017; Department of Legislative Services

If BCCC's formula was rerun with the fiscal 2017 across-the-board reduction in health insurance, which reduces State formula aid per FTES at four-year public institutions, BCCC's State support without hold harmless or ESOL would decline $75,791. With the hold harmless grant, there would be no change in State support; for this reason, while DLS recommended reducing Sellinger and Cade formula support, there is no comparable reduction recommended for the BCCC formula. However, BCCC's ESOL figure did not use the fiscal 2015 actual enrollment number for that student population but rather the target enrollment figure. The correct figure is 1,096, which, when multiplied by $800, yields total fiscal 2017 funding of only $876,568, rather than the $1,017,135 in the allowance. This would be a year-over-year decrease in State support of $0.1 million, or 0.2%, because ESOL grant funding does not have a hold harmless clause.

DLS recommends recalculating the ESOL grant using the fiscal 2015 actual enrollment figure. This reduces the ESOL grant by $140,567 from the allowance.

Expenditures by Program

Exhibit 7 shows unrestricted funding by budget program from fiscal 2015 to 2017. Funding for instruction increases $1 million, or 5.3%, from fiscal 2016 to 2017, despite a decline in enrollment. This is driven by fringe benefits such as health insurance.

Exhibit 7
Baltimore City Community College
Budget Changes for Current Unrestricted Funds by Program
Fiscal 2015-2017
($ in Thousands)

	2015 Actual	2016 Working	2015-16 % Change	2017 Allowance	2016-17 $ Change	2016-17 % Change
Expenditures						
Instruction	$19,919	$19,827	-0.5%	$20,872	$1,045	5.3%
Academic Support	4,560	5,281	15.8%	5,138	-143	-2.7%
Student Services	6,326	7,741	22.4%	7,638	-103	-1.3%
Institutional Support	16,354	19,900	21.7%	19,010	-890	-4.5%
Operation and Maintenance of Plant	8,748	9,875	12.9%	10,045	170	1.7%
Scholarships and Fellowships	43	92	111.6%	92	0	0.0%
Subtotal Education and General	***$55,951***	***$62,716***	***12.1%***	***$62,796***	***$80***	***0.1%***
Auxiliary Enterprises	$4,132	$4,239	2.6%	$4,246	$114	2.7%
Total	**$60,083**	**$66,955**	11.4%	**$67,042**	**$6,959**	**10.4%**
Revenues						
Tuition and Fees	$11,539	$13,125	13.8%	$12,898	-$228	-1.7%
General Funds	40,137	40,776	1.6%	40,814	39	0.1%
Other	2,434	3,825	57.2%	4,106	281	7.3%
Fund Balance Reversion	-4,000					
Subtotal	***$54,109***	***$57,726***	***6.7%***	***$57,818***	***$92***	*0.2%*
Auxiliary Enterprises	$4,132	$4,000	-3.2%	$4,000	$0	0.0%
Transfers from Fund Balance	5,842	5,229	-10.5%	5,224	-5	-0.1%
Total	**$64,083**	**$66,955**	**4.5%**	**$67,042**	**$87**	**0.1%**

Source: Governor's Budget Books, Fiscal 2017

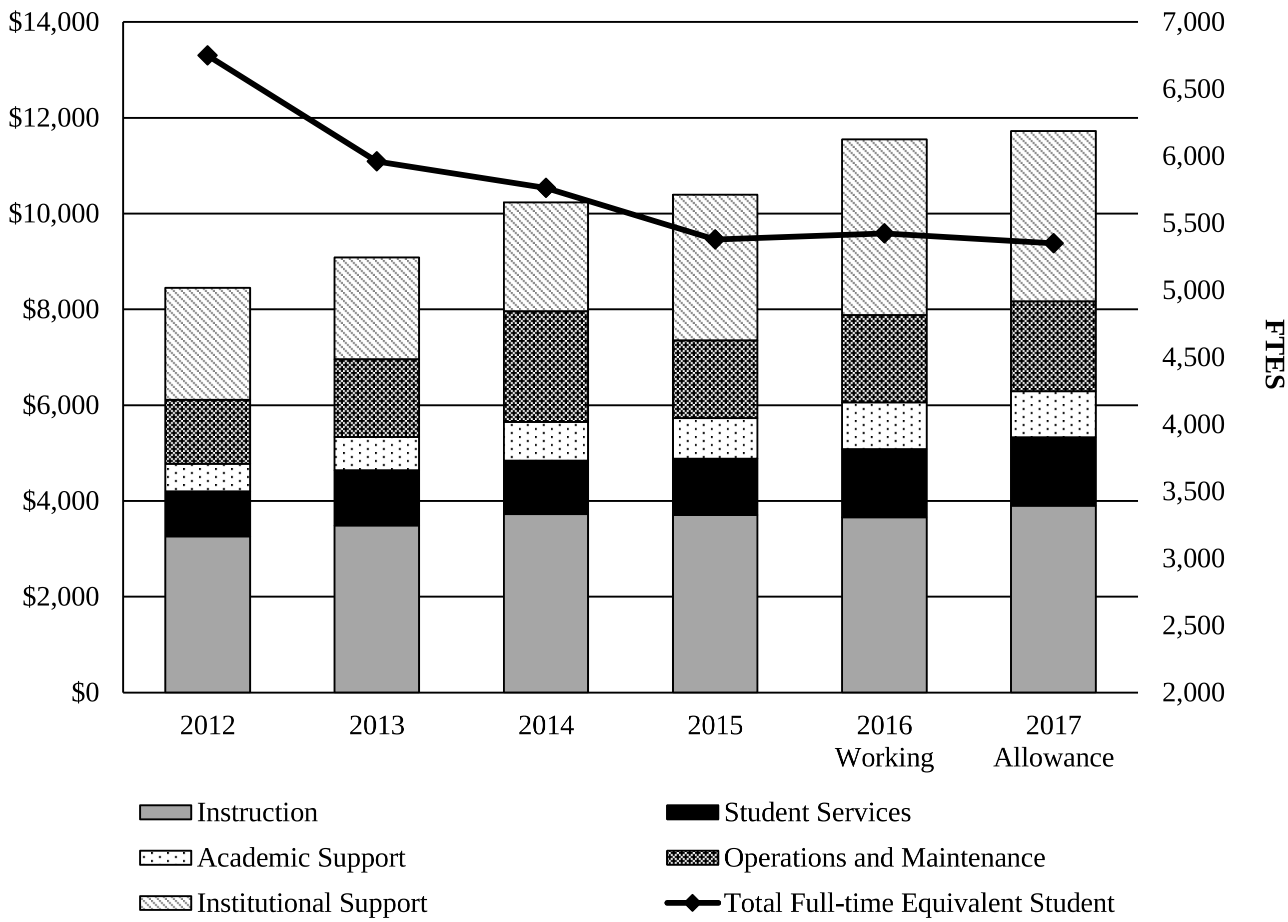
The remaining programmatic changes are fairly small in size. Academic support declines $0.1 million, or 2.7%, and student services also declines $0.1 million, or 1.3%, due to filling personnel vacancies at lower salaries as a means of reducing operational costs at the college. Institutional support in the fiscal 2016 working number is actually higher than instruction, which is a very unusual situation for an educational institution. This is because of $6.0 million in fund balance budgeted for the Enterprise Resource Planning (ERP) information technology (IT) project, which is discussed in the Updates section of this analysis. Adjustments for mandated costs like health insurance reduced institutional support in fiscal 2017. A year ago, auxiliary enterprises expenditures declined due to shrinking enrollment, but in the fiscal 2017 budget, the college expects an increase. Scholarships also remain level, despite declining enrollment.

On the revenue side, the $39,000 increase in State general funds does not offset the $0.2 million decline in tuition and fee revenue, which is due to the college's projected decline in enrollment, and as discussed earlier in the analysis, will likely decrease further. Tuition and fee revenue peaked in fiscal 2011 at $18.2 million and is now below where it was in fiscal 2007, $14.9 million, before the recession began. Other revenue increases $0.2 million, or 7.3%, as BCCC will divert $0.2 million in local support from Baltimore City toward general operating costs rather than restricted student scholarships. Baltimore City is required to provide at least $1.0 million to BCCC annually, and at least $400,000 must be spent on financial aid. Auxiliary enterprise revenue, primarily from rental revenue of a parking garage facility and radio tower, is projected to be level in fiscal 2017. Fund balance use is expected to be essentially flat in fiscal 2017 as the funding in fiscal 2016 is unlikely to be fully spent, which will be discussed later in this analysis.

Program Expenditures Per FTES

Expenditures per FTES grow 38.7% between fiscal 2012 and 2017 from $8,450 to $11,720, respectively. As shown in **Exhibit 8**, the smallest increase in spending is in instruction, which grows 19.8%, compared to the other four categories, which all grow 40.0% to 67.0%. This can be attributed to an enrollment decline of 20.7% over the same period. The largest growth in spending per FTES, 11.3%, $1,156, occurred in fiscal 2016 despite BCCC experiencing flat State growth due to its hold harmless clause. Spending on institutional support and instruction accounted for 66.2% of per FTES support in fiscal 2012 and declines slightly to 63.6% in fiscal 2017. Overall, since fiscal 2012, expenditures on student services and academic support increase 51.5% ($486) and 66.7% ($385), respectively, raising concerns about the benefit of spending so much money per student with such mixed outcomes.

Exhibit 8
Unrestricted Fund Expenditures Per Full-time Equivalent Student
Fiscal 2012-2017



Source: Governor's Budget Books; Department of Legislative Services

Although the college is not subject to any cost containment actions in fiscal 2017, BCCC will likely need to explore cost containment options. Due to its formula funding, it is very likely that the college will not receive increased support from the State in fiscal 2018 due to further declines in enrollment in fall 2016, even though the statutory percentage of the formula will increase to 60%. Assuming forecasts for public four-year support hold, BCCC will need to increase enrollment from 5,766 FTES to 6,393 FTES, or a total of 633 FTES, to escape the same hold harmless scenario in fiscal 2018. The institution reports that it had a 4,726 credit headcount in fall 2015, well short of the FTES required to increase funding in fiscal 2018. Fund balance transfers may be necessary to bridge revenue shortfalls in fiscal 2016 and beyond.

This, however, is unsustainable. In fall 2015, BCCC's financial auditors warned "BCCC had a net decrease in [fund balance] for the past two years. We strongly recommend that management and the Board of Trustees evaluate the reasons why this condition has occurred. Future plans and budgets should then be developed to align expenses with revenue sources and avoid continuing deficits. This situation may very well impact the future ability of BCCC to conduct its affairs in the manner it is accustomed to." Until BCCC can stabilize its enrollment so that it can increase tuition and fee revenue and plan on increases in State support, the budget will force the college to make difficult and unpopular decisions in the near future to align expenditures with revenues.

The President should comment on how BCCC will balance its budget given declining tuition and fee revenue and essentially flat State support in the foreseeable future.

The Many Uses of Fund Balance

Colleges maintain fund balances, what actuaries call net current positions, to help with long-term planning and to provide a buffer for any unexpected budgetary changes. For example, after having saved money for many years, BCCC's major IT project, ERP, and physical plant renovations not funded from the State's capital program, are to be funded through fund balance, and the college has noted it can bridge some revenue loss from the decline in enrollment with fund balance. Fund balance represents cumulative resources derived from student tuition and fees, State appropriations, and sales and services of public service activities and auxiliary enterprises in excess of expenses. These resources are used for transactions relating to the educational and general operations of BCCC and may be used at the discretion of the Board of Trustees to meet current expenses for any purpose. These resources also include auxiliary enterprises, which are substantially self-supporting activities that provide services for students, faculty, and staff.

In fiscal 2016, BCCC adopted new accounting guidance Number 68 from the Governmental Accounting Standards Board (GASB), otherwise known as GASB 68, which requires the college to record its share of the State's net unfunded pension liability in its accounting. This has a significant impact on the financial picture of the college's fund balance as the net pension liability for just BCCC is $23.9 million in fiscal 2015. This leaves only $5.2 million in unrestricted fund balance. Fiscal 2014 fund balance was also restated to conform to GASB 68, which placed fund balance reserves at $11.1 million. However, guidance from the Comptroller's General Accounting Division and the Department of Budget and Management (DBM) guaranteed the college that the GASB 68 line in the actuarial report is a deduction on paper only and the college is free to budget the unrestricted portion of its fund balance as before. Still, BCCC canceled several facilities maintenance programs on campus in fiscal 2016 due to misunderstanding the implications of GASB 68.

The President should comment on when the college will resume previously scheduled facilities maintenance using fund balance.

Large Fund Balance Transfers Are Common

Though the amount that will ultimately be transferred to or from fund balance in fiscal 2016 and 2017 is unknown, BCCC regularly has had sizable transfers. From fiscal 2007 to 2014, fund balance grew sixfold, from $5.0 million to $31.7 million. **Exhibit 9** shows that from fiscal 2007 through 2013, BCCC has regularly transferred a significant percentage of its operating budget to fund balance each year. This totaled $36.0 million into fund balance, with $27.4 million going in from fiscal 2007 to 2011, when enrollment was mostly increasing at the college. Unlike other State agencies, and because BCCC is formula funded, there is no turnover adjustment in the budget to capture some normal amount of lapsed salaries. Unspent unrestricted funds totaled over 10.0% of the college's total unrestricted operating budget in three years, reaching as much as 14.2% in fiscal 2009 when $8.1 million went unspent and was transferred into fund balance.

Fiscal 2014 and 2015 are notable for reversing an eight-year trend as BCCC managed to have a net decrease in fund balance as a percent of unrestricted funds. BCCC had budgeted $5.4 million in fund balance for projects in fiscal 2014 but ended the year spending only $2.6 million from fund balance including all net changes from fund balance revenue and expenditures. For fiscal 2015, the college had budgeted $5.7 million from fund balance, but spent $5.8 million, the first time that the college actually spent more fund balance than initially budgeted.

Exhibit 9
BCCC Fund Balance Transfers and Totals
Fiscal 2007-2015
($ in Thousands)

Fiscal Year	Transfers from Operating Budget	Percent of Unrestricted Funds	Closing Fund Balance Total
2007	$1,597	2.9%	$6,805
2008	6,976	12.4%	12,932
2009	8,090	14.2%	21,279
2010	3,006	4.8%	20,028
2011	7,701	11.6%	19,907
2012	6,036	9.6%	26,201
2013	2,629	4.5%	32,316
2014	-2,591	-4.1%	29,173
2015	-$5,842	-9.7%	$21,803

BCCC: Baltimore City Community College

Source: Governor's Budget Books, Fiscal 2009-2017

At the beginning of fiscal 2016, BCCC reported $21.8 million in total fund balance. Much of this is restricted to particular purposes, such as the reserve for WBJC, the radio station located at BCCC, and various restricted funds categorized into various reserve or purpose funds, such as for ERP and shovel-ready capital improvements. The remainder of the fund is for unspecified strategic priorities. While in prior years BCCC had been able to report the portions of fund balance restricted and unrestricted, it does not anticipate finalizing this information until the March 2016 Board of Trustees meeting due to, according to the college, managing the $4.0 million transfer required under the BRFA of 2015 and because of GASB 68. In regard to ERP in fiscal 2016, the Department of Information Technology (DoIT) recommends that BCCC only spend $1.4 million in total on ERP, meaning that up to another $0.5 million will be spent in the current year, and the remainder of budgeted fund balance will likely revert back at the end of the year.

In regard to the BRFA transfer one year ago, fund balance transfers to the State have occurred at other public higher education institutions in the past during times of fiscal constraints. While BCCC maintained that this would directly impact student services, DBM and DLS disagreed because, as previously mentioned, much of this fund balance accrued through position vacancies, so its growth was not due to purposeful action by the college, but rather from the college repeatedly accruing revenues by not filling its personnel vacancies and receiving hold harmless funds under the State formula.

The President should comment on how much of the planned net $5.2 million fund balance transfer in fiscal 2016 is expected to be spent this fiscal year and for what purpose.

Issues

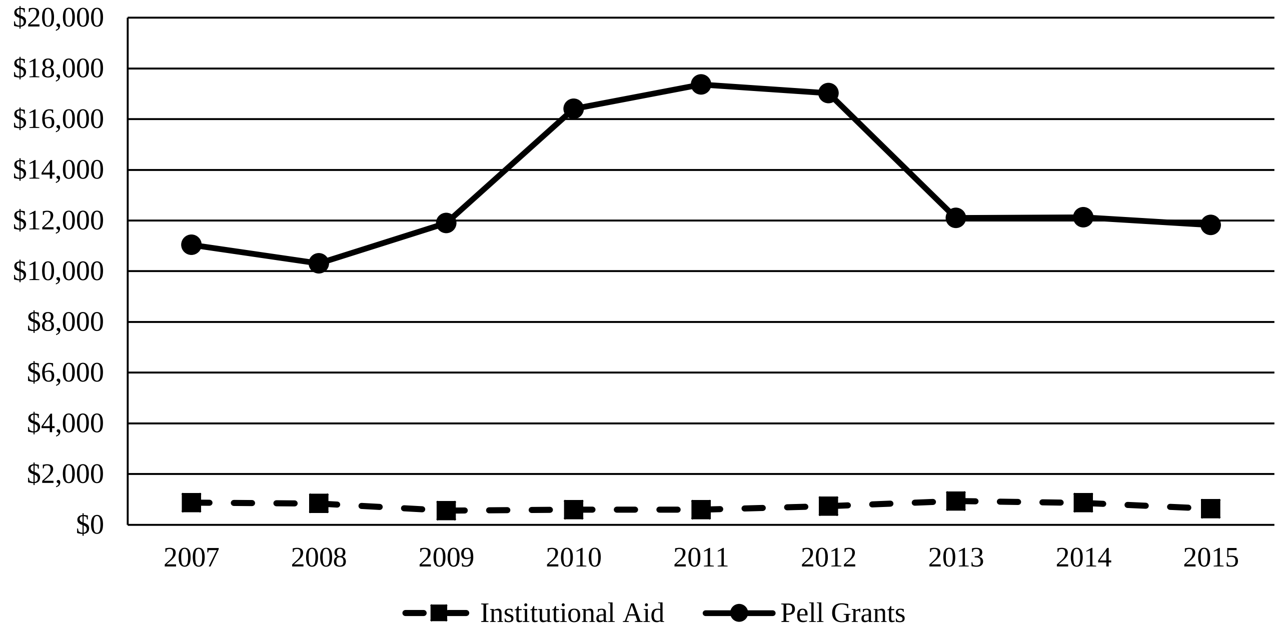
1. Making College Affordable

Community colleges offer a significantly lower entry cost into higher education compared to four-year institutions. The average Maryland community college costs just over $3,900 per year. However, BCCC's spring 2016 tuition and fees total just over $3,000 for a full-time student, over 20% less than the State average. In comparison, a federal Pell grant award can be as high as $5,775 in academic year 2015-2016, well above the average Maryland community college tuition and fee cost. In addition to keeping costs low, BCCC offers students institutional aid to bring down the "sticker" price, or total cost of tuition, fees, and other expenses.

These awards are critical as BCCC serves an extremely disadvantaged population. The median household income for a student applying for financial aid is only $17,900, and over 50.0% of the entire student body are from households with incomes less than 150.0% of the federal poverty level. The average age of a BCCC student is 29, indicating many students may have to balance school with work and family commitments. BCCC reports 62.0% of students received some form of financial aid, and 54.0% received a Pell grant in fiscal 2015. These rates are down from 65.0% and 58.0%, respectively, in fiscal 2012, raising the issue of whether, as the enrollment decline continues, students who remain are less likely to *need* financial assistance or less likely to *apply* for it. As shown in **Exhibit 10**, overall Pell grants received were $11.8 million in fiscal 2015, placing BCCC between Howard and Anne Arundel community colleges in Pell monies received. This is down $5.5 million, or 31.9%, from the peak in fiscal 2011 and back to where Pell grants were prior to the recession. This almost exactly matches the decline in student enrollment across those same years, suggesting that Pell students are well represented in the enrollment decline. While BCCC's institutional aid was only $0.6 million in fiscal 2015, its average institutional award worked out to $842, which is $97 higher than the average award at the 15 local community colleges.

The Free Application for Federal Student Aid (FAFSA) calculates the amount of money that a student's family is expected to pay toward education. Although the exact amount changes from year to year, students with the lowest expected family contribution (EFC) are eligible for Pell grants. While a determination of EFC is not always required to receive a merit award based on academic achievement, such as BCCC's Granville T. Woods Scholarship, it is required for federal and State need-based awards and is generally required to receive need-based institutional aid. BCCC runs a FAFSA Completion Rally every February to ensure that all students continue filing a FAFSA to receive some federal financial aid benefits. Using fiscal 2014 Maryland Higher Education Commission (MHEC) data, the latest available, BCCC has an estimated FAFSA filing rate of 82.2%, the third highest in the State among community colleges. The only institutions higher, Garrett College and Allegany College, have extremely generous county aid programs that likely drive up FAFSA participation. This suggests that BCCC is doing a good job of encouraging students to maximize federal aid.

Exhibit 10
Total Amount of Institutional Aid and Pell Grant Awards
Fiscal 2007-2015
($ in Thousands)



Source: Baltimore City Community College

However, BCCC, along with Chesapeake College, does not allow students who file a FAFSA to draw federal Perkins, Stafford, or PLUS loans. In the past, the college has stated that doing so could lead to very high student loan default rates, which would jeopardize the school's eligibility to receive Pell grants. At a time when the college is raising tuition and the Pell grant is unlikely to increase significantly, it may be an opportunity for the college to increase access to the institution through loans. This may also open doors for students who are not Pell eligible but still want to enroll in a degree or certificate program at BCCC.

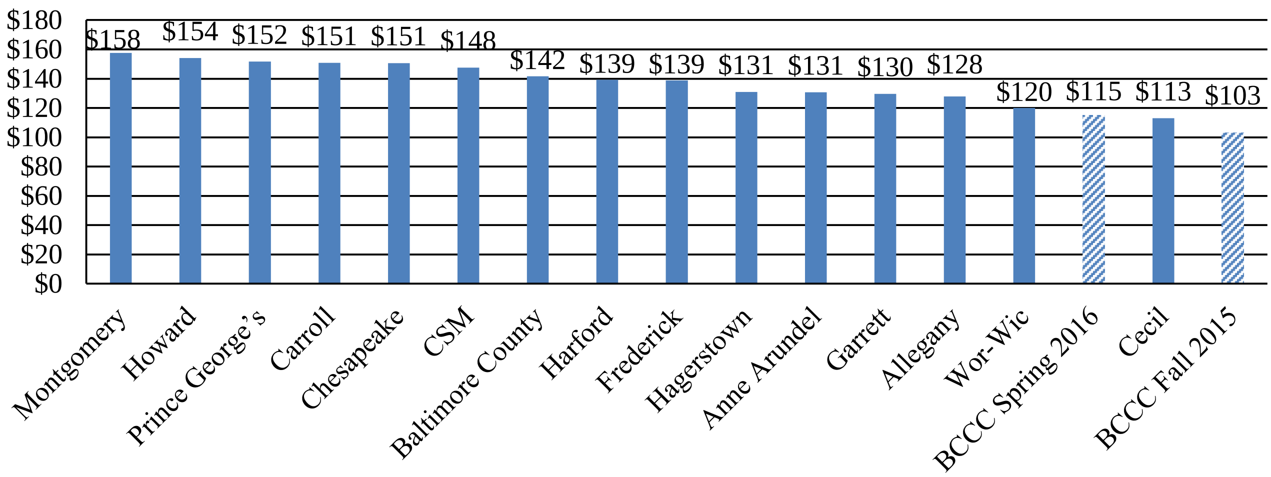
The President should comment on whether the college will allocate more funding to need-based aid, especially now that the college has recognized tuition increases as necessary for balancing the budget and because the college will spend $0.2 million less on institutional aid in fiscal 2017. The President should also comment on whether BCCC will reexamine participation in federal loan programs.

Tuition and Fee Rates Belatedly Go Up

As costs have gone up, enrollment, tuition, and local support from Baltimore City (last adjusted by Chapter 244 of 2006) have not increased and BCCC instead relied on balancing its budget through State support. This finally ended with BCCC enacting a mid-year tuition increase in fiscal 2016. This is the first change in the college's pricing structure since fall 2008, ending a remarkable seven-year run of not increasing direct costs to Maryland residents. Beginning in the spring 2016 semester, credit hour tuition and fees will increase from $103 to $115 for Maryland residents and from $245 to $258 for nonresidents. This is an increase of $11, or 10.7%, for Maryland students. Also, the college will charge a flat rate for students enrolling in 12 to 18 credit hours, incentivizing more students to enroll full time and pursue additional credits. Only about 30.0% of BCCC's students currently enroll full time.

As shown in **Exhibit 11**, even with this rate increase, BCCC remains one of the most affordable community colleges in Maryland. Only Cecil College charges less than BCCC in spring 2016. BCCC still expects tuition and fee revenue to decline 1.7% in fiscal 2017, putting the institution in a bind as it cannot realistically increase tuition rates faster than student enrollment declines. As is true at nearly all institutions, the majority of tuition and fee revenue is received in the fall semester, so it is unclear why the increase was enacted in the spring semester, especially since the decision to enact the increase was made before the true extent of fall 2015's enrollment decline was known. Thus, BCCC will collect less revenue than anticipated.

Exhibit 11
Cost Per Credit Hour at Maryland Community Colleges
Fiscal 2016



BCCC: Baltimore City Community College CSM: College of Southern Maryland

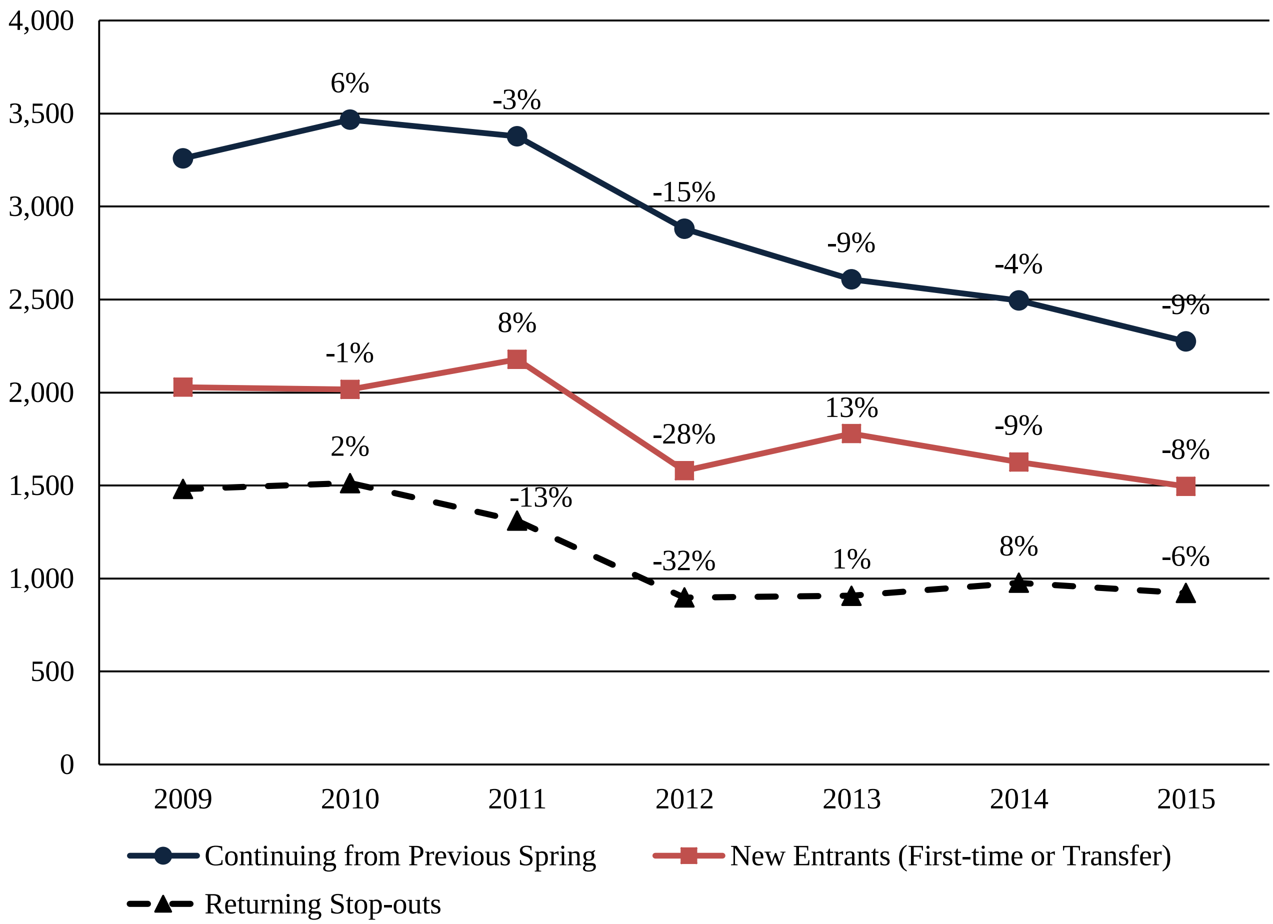
Source: Baltimore City Community College

The President should comment on any plans to change tuition rates again and the amount of unrestricted funding budgeted in institutional aid.

2. Credit Enrollment Decline

As was discussed in the *Fiscal 2017 Higher Education Overview*, community college headcount enrollment declined 2.6% across the State in fall 2015, but BCCC declined by 11.3%. **Exhibit 12** breaks fall headcount enrollment at BCCC into three types of students: students continuing from the previous spring semester, students new to BCCC (either first-time students or transfers), and students returning after taking a leave of absence (stop-outs).

Exhibit 12
BCCC Percent Change in Fall Credit Enrollment Headcount
Fall 2009-2015



Source: Baltimore City Community College

All three categories generally declined from fall 2009 to 2015. The largest decrease by headcount came from continuing students who decreased almost 1,000, or 30.2%. This could be a positive trend if there was data to indicate that such students were graduating in much higher numbers, but because certificates and degrees over this time period grew from 466 to 509 annually, this suggests that there were not nearly enough graduates to account for the decline in enrollment. The largest decrease in percentage terms was in returning stop-outs who declined over 550 by headcount, or 37.7%. New students declined only 530 by headcount, or 26.3%. While all declined over these seven years, returning stop-outs increased slightly from fall 2012 and 2013.

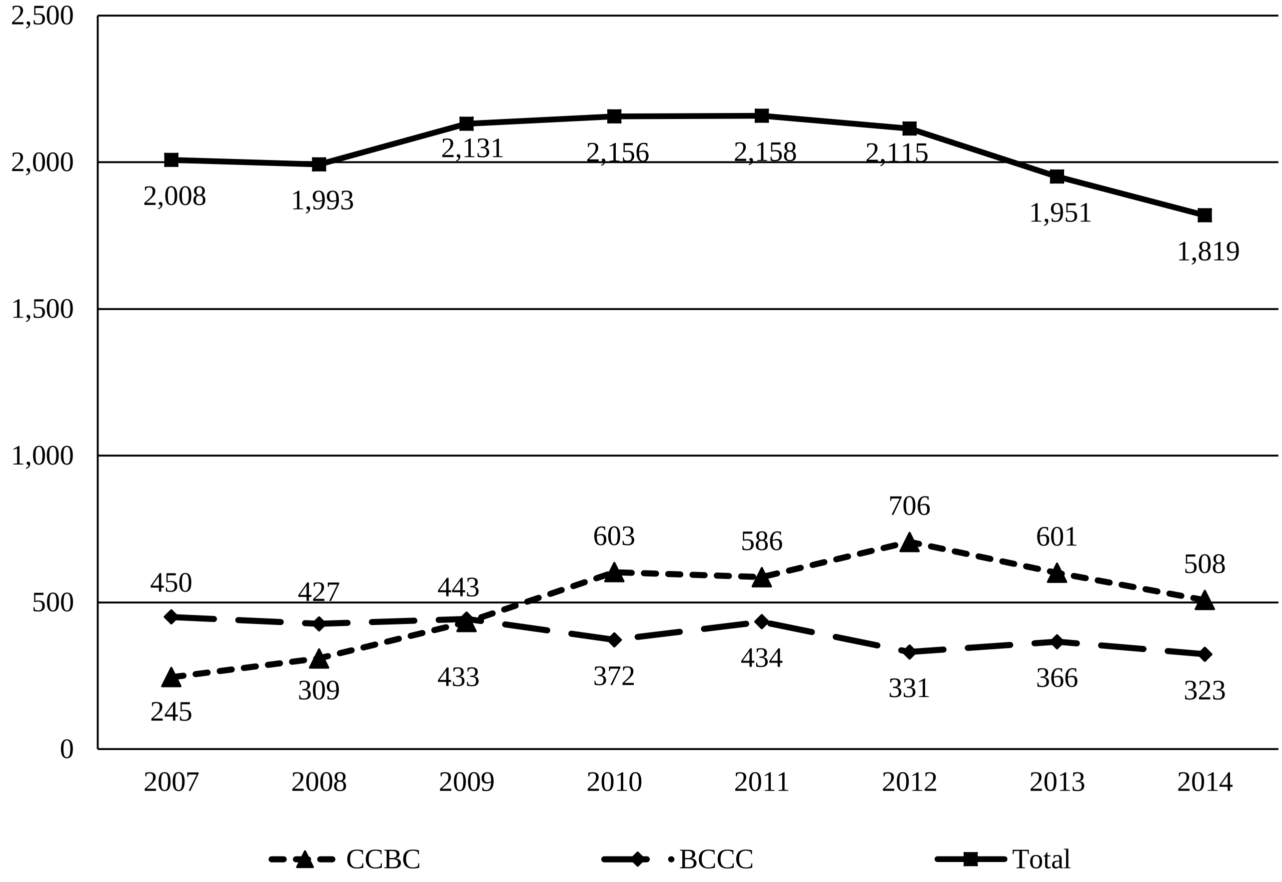
The need to enroll new students would not be as great if BCCC can improve its retention rate of students who are already enrolled. Since fiscal 2012, the retention of first-time, full-time students has not been above 50.0% and for first-time, part-time students, has not been above 30.0%. BCCC must determine why students do not return to campus after the first year of classes. As indicated in discussion of Exhibit 2, the transfer rate of BCCC students is very high. The decline in fall 2015 is all the more serious given that BCCC gained 103 students from Sojourner-Douglass College, which closed in summer 2015, meaning that the ongoing decline is greater.

BCCC has determined that the declines in enrollment are spread out across all regions of the city. Greater declines were seen from students living in northeast Baltimore, which is not near BCCC's main Liberty Heights campus. These students may be drawn to Community College of Baltimore County (CCBC) – Essex or CCBC – Dundalk. Perhaps the biggest concern is the broad nature of the decline. BCCC reports that the characteristics of fall credit students have remained consistent over time in terms of gender, ethnicity, age, full- or part-time status, program enrollment, developmental need, and financial aid awarded. There is no single type of student that is leaving BCCC; it is everyone.

While retention of existing students is a problem, there are other concerns on the student intake side. With regard to new students, BCCC was very successful in increasing applications in fall 2015 by almost 50.0% to 5,796 but only enrolled 2,001 students, a yield of only 34.6%. BCCC reports that students face four enrollment barriers: incomplete admissions materials (such as residency status), placement testing, paying for college, and registration for courses. BCCC reported that over 1,100 applications for fall 2015 were not completed due to the inability of students to pay the $10 application fee, let alone the $20 registration fee per semester. Such pre-enrollment costs are not eligible to be covered by financial aid awards. BCCC is now considering removing these fees. BCCC also has a $25 graduation fee. **The President should comment on whether BCCC will remove the fees as a barrier to student enrollment and graduation.**

To examine intake side further, **Exhibit 13** shows the enrollment destination trends for graduates of Baltimore City high schools who enrolled in postsecondary education within one year of high school graduation. Over this time period, BCCC and CCBC were the top two destinations of recent Baltimore City high school graduates. What is startling is that while the number of Baltimore City's high school class enrolling in postsecondary education peaked in fall 2010 and 2011, the highest number of directly enrolling high school students at BCCC was back in 2007. From fall 2007 to 2010, CCBC increased its first-time Baltimore City resident enrollment from 245 to 706. While this declined greatly in fall 2013 and 2014, CCBC has more than double the city graduate enrollment in fall 2014 than it did in fall 2007, while BCCC's enrollment fell by 28%. It would seem that students expressed a strong preference for CCBC over BCCC during this time period. The next two community colleges enrolling city residents, Anne Arundel Community College and Howard Community College, generally enrolled fewer than 30 students in any year.

Exhibit 13
Enrollment Destinations of Baltimore City High School Graduates within One Year of Graduation
Fall 2007-2014



BCCC: Baltimore City Community College
CCBC: Community College of Baltimore County

Source: Baltimore Education Research Consortium, *Baltimore City Graduates through the Class of 2014*

The President should comment on how BCCC can become a destination of choice for more Baltimore City high school students.

Exhibit 13 indicates that many Baltimore City residents are willing to pay an additional $216 per credit hour to attend CCBC as an out-of-service-area student over BCCC's (then) statewide rate of $88 of tuition per credit. In reverse, based on residency data from MHEC, Baltimore County residents would pay only $88 per credit at BCCC but choose overwhelmingly to pay $113 per credit at CCBC. This suggests that financial decisions are not driving this enrollment preference for CCBC but other factors such as academic offerings, locations, or reputation. In fall 2013, BCCC stated that it would reduce its focus on traditional-aged recruitment and shift some resources toward recruitment of nontraditional-aged students. This may be in response to BCCC largely losing in the competition to recruit recent Baltimore City high school graduates.

A number of internal and external factors have combined to hamper BCCC's enrollment management. Several of the biggest changes include:

- 2010 – Bard Building closes (immediate loss of class space and second location);
- 2011 – Elimination of many degree and certificate programs; accreditation placed on probation;
- 2012 – Retroactive changes to the Pell grant force many students to drop out abruptly;
- 2013 – Broadly improving economy sends many students back to the workforce; and
- 2015 – Accreditation placed on warning.

In response to these compounding issues, BCCC reconstituted its Strategic Enrollment Management and Retention Committee. As part of its Enrollment Management Plan, the college will focus resources on inviting stop-out students back to BCCC. Individual regions of Baltimore City are being explored to learn where BCCC students are coming from and where they are not. Ongoing work with traditional and nontraditional student groups includes new efforts with Baltimore City schools, Year UP, and the federal Job Corps. While these avenues should be explored, BCCC's efforts to date have done little to stem the enrollment decline. Preliminary numbers indicate year-over-year headcount enrollment declined 10% in the winter 2016 session and 16% in the spring 2016 semester, both greater decreases than the fall 2015 semester.

BCCC should consider searching for new student demographics to enroll. One option is dual enrollment, which is important because BCCC will likely not lose these students to CCBC. In fiscal 2017, BCCC reports it will expand dual enrollment outreach to five nearby Baltimore City high schools. At the same time, BCCC is pursuing allowing high school students in Surgical Technology programs to collaborate with BCCC's Surgical Technology program for clinical placements. This will redefine and expand the Memorandum of Understanding that BCCC has with the Baltimore City Public School System (BCPSS). Dual enrollment classes are primarily taught at the Liberty Campus, but there are limited other locations where BCCC instructors teach directly at the high school.

Unfortunately, dual enrollment is very limited as BCPSS is only required to make students aware of the opportunity for dual enrollment, not to fund all eligible and interested students. BCCC reports that based on finite funding from BCPSS to dually enrolled students, BCCC is able to support 25% of tuition and fees for approximately 113 dually enrolled students (based on three credits per student). If additional funding is identified, BCCC could expand enrollment further. It should be noted that the $20 course registration fee also applies to dually enrolled students.

The President should comment on the conversion rate of BCCC's dually enrolled students after high school graduation. The President should also comment on the reasons for the decline in fiscal 2016 enrollment in the fall, winter, and spring semesters and what a reasonable target enrollment is for the college in fall 2016.

3. Noncredit Enrollment Trends – Mixed Story

Workforce development is critical to the Baltimore economy, so the Business and Continuing Education Division's (BCED) ability to provide noncredit resources, workforce training, and educational opportunities that lead to better jobs and careers in very important. **Exhibit 14** shows the most recent data made available by BCED for enrollment, as it is reported to MHEC's annual *Performance Accountability Report*.

While community service and lifelong learning enrollment has declined significantly from fiscal 2011 to 2014, falling 36.5% by course enrollments, all other categories of noncredit enrollment have increased. Basic skills education headcount grew by 2.4%, ESOL grew 5.6%, and workforce certification or licensure grew 51.2%. While the enrollment was much smaller to begin with, it is now comparable in size to general workforce development and community service enrollment. BCED has been very effective in finding and meeting specific occupational needs. The number of businesses and organizations partnering with BCCC to provide training has grown 41.9% over the same time period, underscoring the strong demand for noncredit programs in Baltimore City.

Exhibit 14
Business and Continuing Education Enrollments
Fiscal 2011-2014

	2011	2012	2013	2014	# Change 2011-2014	% Change 2011-2014
ESOL Headcount	3,742	3,787	3,937	3,950	208	5.6%
Community Service and Lifelong Learning						
Headcount	1,659	1,720	1,718	1,232	-427	-25.7%
Course Enrollments	2,711	2,758	2,737	1,721	-990	-36.5%
Basic Skills						
Headcount	7,558	7,703	7,820	7,736	178	2.4%
Course Enrollments	15,445	16,474	17,096	16,644	1,199	7.8%
Workforce Development						
Headcount	1,015	954	1,053	1,061	46	4.5%
Course Enrollments	1,271	1,264	1,248	1,758	487	38.3%
Certification or Licensure						
Headcount	682	1,129	806	1,031	349	51.2%
Course Enrollments	1,245	1,480	1,075	1,683	438	35.2%
Groups Providing Training under Contract	43	53	58	61	18	41.9%
Enrollment in Contract Training						
Headcount	589	806	746	797	208	35.3%
Course Enrollments	903	1,707	1,083	1,522	619	68.5%
Total Headcount	15,245	16,099	16,080	15,807	562	3.7%
Total Course Enrollments	21,575	23,683	23,239	23,328	1,753	8.1%

ESOL: English for Speakers of Other Languages

Note: Headcount enrollments are all unduplicated.

Source: Baltimore City Community College

Workforce Training

Direct agreements with employers, or contract training, is something at which BCED excels. For example, BCED and the State of Maryland Police and Correctional Training Commissions – Correctional Training Unit recently signed an agreement for State corrections employees to receive their mandated in-house training at the Reisterstown Plaza Center, which began in September 2015. MHEC certification of correctional training by the college is underway. When fully implemented, the collaboration will serve approximately 2,000 to 3,000 corrections employees annually and generate approximately 267 FTES. Beginning in March 2016, BCED will also offer national certification training for home inspectors, which could bring in up to 100 FTES. BCED will begin offering online classes for business support services training for truck drivers, which could bring in up to 50 FTES. BCED is also developing a proposal to create five Small Business Development Centers in the city at the request of the Governor's office to promote entrepreneurial training in small business start-up management. Although fiscal 2015 data is not shown in the above exhibit, BCED reported it had trained 515 Horseshoe Casino employees, 323 taxi drivers, and 380 Division of Correction employees, indicating the wide range of employers that BCED works with.

Adult Basic Education

BCED is also working to expand its adult basic education (ABE) partnership with Baltimore City's Enoch Pratt Public Library. BCED now offers programs and courses at five public library locations throughout the city, including 60-hour Basic Skills (pre-general educational development (GED) test) level classes and integrated computer literacy instruction. For ESOL, BCCC has received increased funding from the Refugee Employment Training Program in fiscal 2014 and 2015, providing new courses to meet the needs of the students. Refugee Employment Training Program enrollment rose from less than 120 students per year from fiscal 2010 through 2014 to 308 students in fiscal 2015, and citizenship testing enrollment increased to an all-time high of 186 naturalized citizens in the same year.

BCED and BCCC's Academic Affairs, which oversees credit programs on the Liberty Heights campus, are working together on internal articulation agreements to create a pathway for noncredit students to move into credit programs. Credit faculty will need to review noncredit programs to determine prior learning assessment (PLA) credit. For example, a certified nursing assistant might move on to become a paramedic (certificate) or physical therapy assistant (associate's degree). Currently, there is very limited data on the number of students moving from BCED to credit courses, only covering 43 GED recipients enrolled in fall 2013 and 153 in fall 2014. Most Maryland institutions have not yet made much progress with PLAs, but competency based education is something MHEC will be exploring in the 2016 interim.

While Exhibit 14 only covers data through fiscal 2014, in fiscal 2016, BCED reports decreases in students served in ABE, ESOL, contract training, open enrollment, and other noncredit offerings. A February 2016 enrollment update indicated that BCED had generated 1,272 FTES, or 56.5%, of its fiscal 2016 working goal of 2,253. This is lower than the fiscal 2016 budgeted noncredit FTES goal shown in Exhibit 4 of 2,465 FTES. Either way, noncredit enrollment weathered the recent overall enrollment decline better than credit enrollment.

The President should comment on whether BCED expects to meet its noncredit enrollment goal in fiscal 2016. The President should also comment on whether students are more interested in job placement or credit program credentials after completing noncredit training sequences.

4. With Accreditation Reconfirmed, BCCC Looks to the Future

In June 2015, for the second time in three years, the Middle States Commission on Higher Education (MSCHE) removed a negative status regarding BCCC's accreditation. Accreditation is required by the U.S. Department of Education for students to receive Title IV federal financial aid, like Pell grants. Despite these issues, BCCC has been continuously accredited by MSCHE since 1963.

In the June 2015 decision, MSCHE removed the warning status placed on BCCC because the institution is now in compliance with Standard 2 (Planning, Resource Allocation, and Institutional Renewal), Standard 3 (Institutional Resources), Standard 6 (Integrity), and Standard 7 (Institutional Assessment) and reaffirmed accreditation. MSCHE requested another monitoring report, due September 1, 2016, documenting (1) the continued implementation and assessment of the comprehensive institutional strategic plan particularly annual unit-level goals and objectives (Standard 2); (2) the continued development and implementation of the budget and resource allocation process that incorporates assessment results and integrates with institutional planning (Standard 3); and (3) the continued development and implementation of a comprehensive, organized, and sustained process for the assessment of institutional effectiveness that includes clear and realistic guidelines and a timetable and evidence that assessment information is used to (a) inform budget, planning, and resource allocation decisions; and (b) improve programs, services, and processes, and is shared and discussed with appropriate constituents (Standard 7). A small team visit may follow submission of the monitoring report. The next *Periodic Review Report* is due June 1, 2020.

On top of accreditation concerns, BCCC has undergone significant turnover in leadership. From January 2013 through August 2014, the institution was led by an interim president. In the past year, there have also been a number of interim appointments in key positions including interim vice presidents for student affairs, information, public safety, and institutional research, as well as vacancies in other important positions such as an associate director of admissions. The institution did recently fill its chief financial officer position.

Because of these issues, language in the fiscal 2016 budget bill (Chapter 310 of 2015) withheld $50,000 in general funds until BCCC submitted to the budget committees a comprehensive report on the college's operations from an outside consultant. BCCC notified the budget committees in December 2015 that it had selected the Schaefer Center at the nearby University of Baltimore as the consultant. The Schaefer Center had performed an "environmental scan" of BCCC in 2011 and has some familiarity with BCCC. Due to this late selection, BCCC was unable to deliver a report in December 2015 and requested an extension to May 15, 2016. This necessarily precludes an institutional response that was to be due March 1, 2016, so as to inform the budget committees during the 2016 legislative session.

In February 2016, BCCC again notified the budget committees that it could not meet the 2015 *Joint Chairmen's Report* (JCR) deadline and instead requested an extension to August 1, 2016, for the consultant's report. The Schaefer Center has formed a strong research advisory committee to oversee its work, and an extensive research team to conduct the evaluation. The review is comprehensive and includes facilities; IT; finance, an "opportunity analysis" of occupations, both now and in the future, that will require postsecondary training, certificates, or degrees; and surveys of students, faculty, and staff. It will be important for the research team and advisory committee to be able to condense the vast amount of information it is collecting in order to capture the most relevant and useful recommendations for the institution. **The President should update the committees on the status of the consultant's review, particularly the opportunity analysis that is underway and how the results of the analysis will be used to alter BCCC's academic and noncredit offerings. The President should also discuss whether BCCC is coordinating with Baltimore City and the business community to align its institutional focus and offerings with the needs of Baltimore City and its employers.**

In light of this update, DLS recommends releasing the $100,000 in restricted funding in fiscal 2016 and recommends adopting new budget bill language for this report and the institution's response in fiscal 2017.

Recommended Actions

1. Add the following language to the unrestricted fund appropriation:

   , provided that this appropriation made for the purpose of Baltimore City Community College be reduced by $140,567.

   Explanation: This action recalculates the fiscal 2017 English for Speakers of Other Languages grant in the unrestricted fund appropriation using the correct enrollment figure.

2. Add the following language to the unrestricted fund appropriation:

   , provided that $50,000 of this appropriation made for the purpose of operations at Baltimore City Community College (BCCC) may not be expended until the Board of Trustees of BCCC submits a comprehensive report by the University of Baltimore's Schaefer Center for Public Policy to the budget committees by August 1, 2016. The report shall include an analysis of, and recommendations for, the appropriate niche for BCCC to fill in the Baltimore metropolitan area higher education landscape that will best meet the needs of residents and employers of Baltimore City and the State, including an alignment of BCCC's academic and noncredit offerings with workforce needs. The report shall also include an analysis of the institution's governance structure, relationship with Baltimore City, and role in the city's economic and workforce development plans, and any recommendations to alter or improve them. The report shall also include recommendations for improving the financial situation of the college, including revenue and real estate holdings; and any other topics deemed appropriate by the Schaefer Center.

   Further provided that $50,000 of this appropriation made for the purpose of BCCC operations may not be released until the Board of Trustees submits BCCC's response to the Schaefer Center's report to the budget committees by October 1, 2016. The response should indicate how BCCC will implement the consultant's recommendations and if any are not to be implemented, why not.

   The budget committees shall have 45 days to review and comment from the date of receipt of the reports. Funds restricted pending the receipt of the comprehensive report and the follow-up report may not be transferred by budget amendment or otherwise to any other purpose and shall be reverted if the reports are not submitted to the budget committees.

   Explanation: This language restricts $50,000 in unrestricted funds pending receipt of a comprehensive report on BCCC's operations done by the Schaefer Center and another $50,000 in unrestricted funds pending a response from BCCC on that report. The due dates in this budget bill language reflect extensions to reports that were originally due in fiscal 2016.

Information Request	Authors	Due Date
Comprehensive report on BCCC	University of Baltimore Schaefer Center	August 1, 2016
BCCC's response to the comprehensive report	BCCC	October 1, 2016

Updates

1. Major Information Technology Project Slowly Moving Forward

BCCC uses a number of obsolete computer systems to store campus records, manage human resources, and conduct other services. In September 2009, BCCC received a "technology tactical plan" for the complete reimagining of IT at BCCC. The centerpiece of this technology upgrade is implementing ERP. An ERP "integrates (or attempts to integrate) all data and processes of an organization into a unified system. A typical ERP system will use multiple components of computer software and hardware to achieve the integration." No significant progress was made until December 2012 when DoIT approved an Information Technology Project Request (ITPR), which described BCCC's current IT systems as archaic. Specifically, the ITPR found serious legal deficiencies with required federal reporting under the Family Educational Rights and Privacy Act; the Health Insurance Portability and Accountability Act; and the Higher Education Opportunity Act.

Although funding for ERP was first budgeted with $6 million in fiscal 2013, little funding was spent due to ongoing delays. The first action is to put out a Task Order Request for Proposals (TORFP) to obtain resources to assist BCCC in recording in detail the current business processes and document the business and technical requirements needed for the actual Request for Proposals (RFP) for ERP. This will allow BCCC to solicit the ERP market and make an informed choice for an enterprise system that will run at the college for decades to come. Once the current TORFP for acquiring those resources is approved, it will take four to nine months to prepare the solicitation and update business processes, which will be eventually analyzed and compared with the selected ERP vendor's best practices. During the 2014 legislative session, BCCC stated that the RFP would go out in late fiscal 2015, but in February 2015, it restated that an RFP was still six to nine months away. This proved accurate as the draft RFP went to DoIT in July 2015, and a final RFP was resubmitted in October 2015.

BCCC and DoIT submitted a report (as requested in the 2014 JCR) on the ERP project in December 2014 indicating that the project was progressing consistent with the established schedule and that a vendor-provided full-time project manager began work in September 2014. DoIT continues to maintain oversight of the project via bi-weekly meetings and quarterly portfolio reviews, among other things. According to this JCR response, BCCC should have had a vendor selected by November 1, 2015, but this did not occur because the RFP was only finalized in November, partly because it was resubmitted to include a slightly scaled down approach to reflect the implementation of student services related modules. The TORFP draft had been submitted to DoIT in September 2015 and a final draft resubmitted in October 2015. Due to funding and scope issues, a document imaging subproject is being rolled into the ERP's RFP.

A revised January 2015 estimate of the revised cost for implementing ERP from BCCC puts the total cost at $15.5 million plus additional costs for staffing, DoIT oversight, system certification, contingency funds, and other costs. As of February 2016, the project's total cost remains about $16.8 million. BCCC has approved $6.0 million to be spent in fiscal 2017 and the remaining $10.8 million is in the college's fund balance. To date, about $2.0 million has been spent and the fiscal 2017 Project Implementation Request (PIR) budget is $3.7 million, pending DoIT approval.

BCCC continues to conduct personnel training and hold ERP stakeholder meetings. BCCC attributes the many delays to the project to personnel turnover and conflicting directions from DoIT on deadlines and templates and folding in the document imaging project. The PIR was approved in December 2015 by DoIT, DBM, and DLS, which enabled BCCC to move to Phase 5 of the software development lifecycle process out of 9 total phases. Practically, this means planning is over and implementation of ERP will finally begin.

Additional information is available in **Appendix 2**.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Baltimore City Community College
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Other Unrestricted Fund	Total Unrestricted Fund	Restricted Fund	Total
Fiscal 2015							
Legislative Appropriation	$41,753	$0	$0	$27,180	$68,933	$22,569	$91,501
Deficiency Appropriation	0	0	0	0	0	0	0
Cost Containment	-1,541	0	0	0	-1,541	0	-1,541
Budget Amendments	-75	0	0	0	-75	2,151	2,076
Reversions and Cancellations	0	0	0	-7,234	-7,234	-2,022	-9,256
Actual Expenditures	**$40,137**	**$0**	**$0**	**$19,946**	**$60,083**	**$22,698**	**$82,780**
Fiscal 2016							
Legislative Appropriation	$40,776	$0	$0	$26,179	$66,955	$21,660	$88,615
Budget Amendments	0	0	0	0	0	2,648	2,648
Working Appropriation	**$40,776**	**$0**	**$0**	**$26,179**	**$66,955**	**$24,308**	**$91,263**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The fiscal 2015 legislative appropriation for BCCC decreased by $6.6 million. General funds decrease about $1.6 million. About $0.1 million was due to 2 employees leaving the institution via the Voluntary Separation Program. The remainder is due to two rounds of across-the-board cost containment efforts by the Board of Public Works that reduced spending on adjunct faculty and travel.

At the close of the fiscal year, $7.2 million in other unrestricted funds was canceled. Of that amount, $4.3 million reverted to the college's fund balance due to an ERP IT project that remains behind schedule, and the remaining $2.9 million was a shortfall in tuition and fee revenue from a decline in enrollment.

The current restricted appropriation increased by $2.2 million to reflect new grants and contracts from a variety of sources. Of that amount, about $2.0 million was canceled due to the fiscal year concluding before the funds could be spent. The funds were appropriated in the next year.

Fiscal 2016

To date, the fiscal 2016 legislative appropriation has increased by $2.6 million in current restricted funds to reflect new grants and contracts from a variety of sources, several of which were originally awarded and budgeted in fiscal 2015 but had not then been received or expended.

Baltimore City Community College
Enterprise Resource Planning System

Project Status[1]	Implementation.	**New/Ongoing Project:**	New.
Project Description:	The college's current information technology infrastructure is very antiquated and presents issues when one office has student or institution data that cannot be automatically transmitted to other campus offices. This project is to procure a modern Enterprise Resource Planning (ERP) system that can automate a number of functions that currently must be performed manually and increase efficiency throughout the campus.		
Project Business Goals:	The goal of this project is to increase the efficiency and internal communication throughout the Baltimore City Community College (BCCC) campus.		
Estimated Total Project Cost[1]:	Estimated to be $16,835,000	**Estimated Planning Project Cost[1]:**	$850,000
Project Start Date:	August 2012.	**Projected Completion Date:**	December 2018
Schedule Status:	The project schedule had completion expected in December 2018, although that date may slip due to the amount of planning required before procurement can begin.		
Cost Status:	Funding is in BCCC's fiscal 2015 and 2016 budgets. Note: the total project cost includes personnel, backfill, and Regent software ($4,104,770).		
Scope Status:	The college is currently working with the Department of Information Technology (DoIT) to complete writing a Request for Proposals for the new ERP system.		
Project Management Oversight Status:	The college's chief information officer hired a project manager in November 2013 who has established Project Management Office which is fully functional – it has completed the Project Management Plan which has been approved by DoIT.		
Identifiable Risks:	BCCC has identified a number of risks for this project. They include uncertain budgets from State appropriations, training employees for the new system, cleaning data so that all offices have uniform formats, and ensuring the new system is user friendly for front-line employees.		
Additional Comments:	BCCC has been saving for this project for a long time and has all the funding it should need saved in fund balance. Ensuring the college identifies additional risks as they arise and mitigates those of which it is already aware will be important for this project's success.		

Fiscal Year Funding ($ in Thousands)	**Prior Years**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**Balance to Complete**	**Total**
Personnel Services	$0	$0	$0	$0	$0	$500,000	$0	$500,000
Professional and Outside Services	$1,200,000	$1,383,771	$3,217,048	$3,253,630	$1,178,103	$588,373	$0	$10,820,925
Other Expenditures	0	0	$503,447	$512,694	$281,537	$11,627	0	$1.309,305
Total Funding	**1,200,000**	**$1,383,771**	**$3,720,495**	**$3,766,324**	**$1,459,640**	**$1,200,000**	**$0**	**$12,730,230**

[1] In calendar 2011, a two-step approval process was adopted. Initially, an agency submits a Project Planning Request. After the requirements analysis has been completed and a project has completed all of the planning required through Phase Four of the Systems Development Lifecycle (Requirements Analysis), including a baseline budget and schedule, the agency may submit a Project Implementation Request and begin designing and developing the project when the request is approved. For planning projects, costs are estimated through planning phases. Implementation projects are required to have total development costs

Object/Fund Difference Report
Baltimore City Community College

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	444.00	444.00	444.00	0.00	0%
02 Contractual	268.18	141.22	164.67	23.45	16.6%
Total Positions	**712.18**	**585.22**	**608.67**	**23.45**	**4.0%**
Objects					
01 Salaries and Wages	$ 35,797,284	$ 41,203,271	$ 41,334,494	$ 131,223	0.3%
02 Technical and Spec. Fees	12,592,816	7,129,654	8,812,348	1,682,694	23.6%
03 Communication	589,707	533,232	575,438	42,206	7.9%
04 Travel	528,458	690,828	690,828	0	0%
06 Fuel and Utilities	2,039,608	1,944,727	2,269,224	324,497	16.7%
07 Motor Vehicles	255,511	146,106	146,336	230	0.2%
08 Contractual Services	6,795,106	10,487,815	9,565,781	-922,034	-8.8%
09 Supplies and Materials	4,498,736	4,020,098	4,361,054	340,956	8.5%
10 Equipment – Replacement	57,180	586,369	586,369	0	0%
11 Equipment – Additional	989,447	1,349,947	1,703,930	353,983	26.2%
12 Grants, Subsidies, and Contributions	15,549,426	18,935,915	16,741,593	-2,194,322	-11.6%
13 Fixed Charges	3,085,501	3,425,788	3,446,669	20,881	0.6%
14 Land and Structures	1,431	808,998	808,998	0	0%
Total Objects	**$ 82,780,211**	**$ 91,262,748**	**$ 91,043,062**	**-$ 219,686**	**-0.2%**
Funds					
40 Unrestricted Fund	$ 60,082,675	$ 66,954,798	$ 67,041,783	$ 86,985	0.1%
43 Restricted Fund	22,697,536	24,307,950	24,001,279	-306,671	-1.3%
Total Funds	**$ 82,780,211**	**$ 91,262,748**	**$ 91,043,062**	**-$ 219,686**	**-0.2%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Baltimore City Community College

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Instruction	$ 25,667,339	$ 42,656,568	$ 43,348,321	$ 691,753	1.6%
03 Public Service	1,359,509	1,477,925	1,525,000	47,075	3.2%
04 Academic Support	4,560,190	5,281,260	5,138,021	-143,239	-2.7%
05 Student Services	6,326,707	7,741,079	7,638,327	-102,752	-1.3%
06 Institutional Support	16,353,530	19,900,002	19,010,303	-889,699	-4.5%
07 Operation and Maintenance of Plant	8,748,256	9,875,075	10,044,996	169,921	1.7%
08 Auxiliary Enterprises	4,131,731	4,238,839	4,246,094	7,255	0.2%
17 Scholarships and Fellowships	15,632,949	92,000	92,000	0	0%
Total Expenditures	**$ 82,780,211**	**$ 91,262,748**	**$ 91,043,062**	**-$ 219,686**	**-0.2%**
Unrestricted Fund	$ 60,082,675	$ 66,954,798	$ 67,041,783	$ 86,985	0.1%
Restricted Fund	22,697,536	24,307,950	24,001,279	-306,671	-1.3%
Total Appropriations	**$ 82,780,211**	**$ 91,262,748**	**$ 91,043,062**	**-$ 219,686**	**-0.2%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

R99E
Maryland School for the Deaf

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$30,002	$30,787	$30,955	$168	0.5%
Deficiencies and Reductions	0	0	-91	-91	
Adjusted General Fund	**$30,002**	**$30,787**	**$30,864**	**$77**	**0.2%**
Special Fund	286	326	337	12	3.6%
Adjusted Special Fund	**$286**	**$326**	**$337**	**$12**	**3.6%**
Federal Fund	546	520	575	55	10.6%
Deficiencies and Reductions	0	0	-2	-2	
Adjusted Federal Fund	**$546**	**$520**	**$573**	**$53**	**10.3%**
Reimbursable Fund	3,547	3,748	3,465	-283	-7.6%
Adjusted Reimbursable Fund	**$3,547**	**$3,748**	**$3,465**	**-$283**	**-7.6%**
Adjusted Grand Total	**$34,381**	**$35,381**	**$35,239**	**-$141**	**-0.4%**

- The fiscal 2017 allowance for the Maryland School for the Deaf (MSD) has been decreased by $93,000 due to an across-the-board reduction for employee health insurance.

- The fiscal 2017 allowance for MSD is $141,000 below the fiscal 2016 working appropriation. Funding for fiscal 2017 contractual positions, maintenance, telecommunications, and the loan payment for the Energy Performance Contract represent a decrease of $735,000 from fiscal 2016. This is offset by $593,000 of increased funding for personnel.

Note: Numbers may not sum to total due to rounding.

For further information contact: Kyle D. Siefering Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	319.50	319.50	330.50	11.00
Contractual FTEs	92.50	90.40	77.00	-13.40
Total Personnel	**412.00**	**409.90**	**407.50**	**-2.40**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	2.88	0.90%
Positions and Percentage Vacant as of 12/31/15	0.00	0.00%

- Funding for MSD personnel increases $593,000 above the fiscal 2016 working appropriation. New positions, including 4.0 residential child and youth care professional positions and 7.0 new faculty positions, raise personnel funding by $738,000. These new positions represent a conversion of contractual full-time equivalents (FTE) to full-time staff, leading to an accompanying decrease in FTEs of 13.4. Increased personnel funding for new positions is offset by a decrease in salary and fringe benefits for current staff due to a significant number of long-term administrators and teachers retiring and being replaced by staff at the lower spectrum of the salary scale.

Analysis in Brief

Major Trends

Graduates Going on to College, Work, or Training Remains High: MSD has a goal that 70% of its Essential Curriculum students receive a Maryland State High School Diploma and attend college. In fiscal 2015, 91% of MSD graduates have gone on to attend college. **MSD should consider reviewing this measure to determine whether a higher goal should be established.** Another MSD objective is that at least 70% of students in the Life-Based Education (LBE) curriculum receive a Maryland State Certificate of Program Completion and go on to work or to a training program. MSD had 86% of its LBE graduates go on to work or training in fiscal 2015. However, due to the small number of students in the program, outcomes for individual students can make the rate vary widely year to year. **MSD should comment on other measures that can evaluate whether the LBE curriculum is accomplishing its mission, considering the small number of students in that program. Potential measures could be based on milestones students pass while in the program.**

Issues

Reporting on the Determination of Kindergarten Readiness: MSD had a goal that 75% of its kindergarteners would meet benchmark language/literacy and mathematical thinking as outlined in the Maryland Model for School Readiness (MMSR) Language and Literacy and MMSR Mathematical Thinking checklist by 2016. However, due to the fact that the MMSR was not administered in fall 2014, this data was not provided as part of the Managing for Results data for fiscal 2015. The Kindergarten Readiness Assessment (KRA) is the cornerstone of the Ready for Kindergarten: Maryland's Early Childhood Comprehensive System program. MSD reported that it was able to participate in the field test for the KRA, administering the test for 25 students, and that the only complication experienced with the KRA was how to present the information to students in American Sign Language since the students do not have access to spoken/voiced directions. If KRA results were to be used to compare to the MSD goal, kindergartners performed below 75% for academic year 2014-2015. It is worth noting that kindergartners across the State performed lower on the academic 2014-2015 administration of the KRA when compared to the 2013-2104 administration of the MMSR, with only 47% of children displaying kindergarten readiness in contrast to the previous 83%. **MSD should comment on how it has evaluated its performance in fiscal 2015 regarding its goal for kindergarten readiness. It should also comment on any progress it has made on overcoming complications to administer the KRA for its students, and on setting goals for student performance on the test for future administrations of the KRA.**

Recommended Actions

1. Concur with Governor's allowance.

Maryland School for the Deaf

Operating Budget Analysis

Program Description

The Maryland School for the Deaf (MSD) provides comprehensive prekindergarten through grade 12 (preK-12) education to deaf students through day and residential programs. The school utilizes the Maryland College and Career-Ready Standards. All students follow one of two levels of curriculum: Essential or Life-Based Education (LBE). Each curriculum has different goal levels and requires different levels of student support services, which are directed by the students' Individual Education Plan. The Enhanced Program of Services supports students who have multiple disabilities, are medically fragile, and/or are developmentally disabled. The Family Education/Early Intervention Program provides services for families of children age five or younger in developing early language skills, including American Sign Language (ASL) and English, for the child and family.

The school has two campuses. The Frederick location serves students in preK-12, while the Columbia location serves students through grade 8. The Frederick campus supported 348 students in fiscal 2015. The Columbia campus supported 107 students in fiscal 2015. Students graduating from the Frederick campus are eligible for the Maryland State High School Diploma or a Certificate of Program Completion.

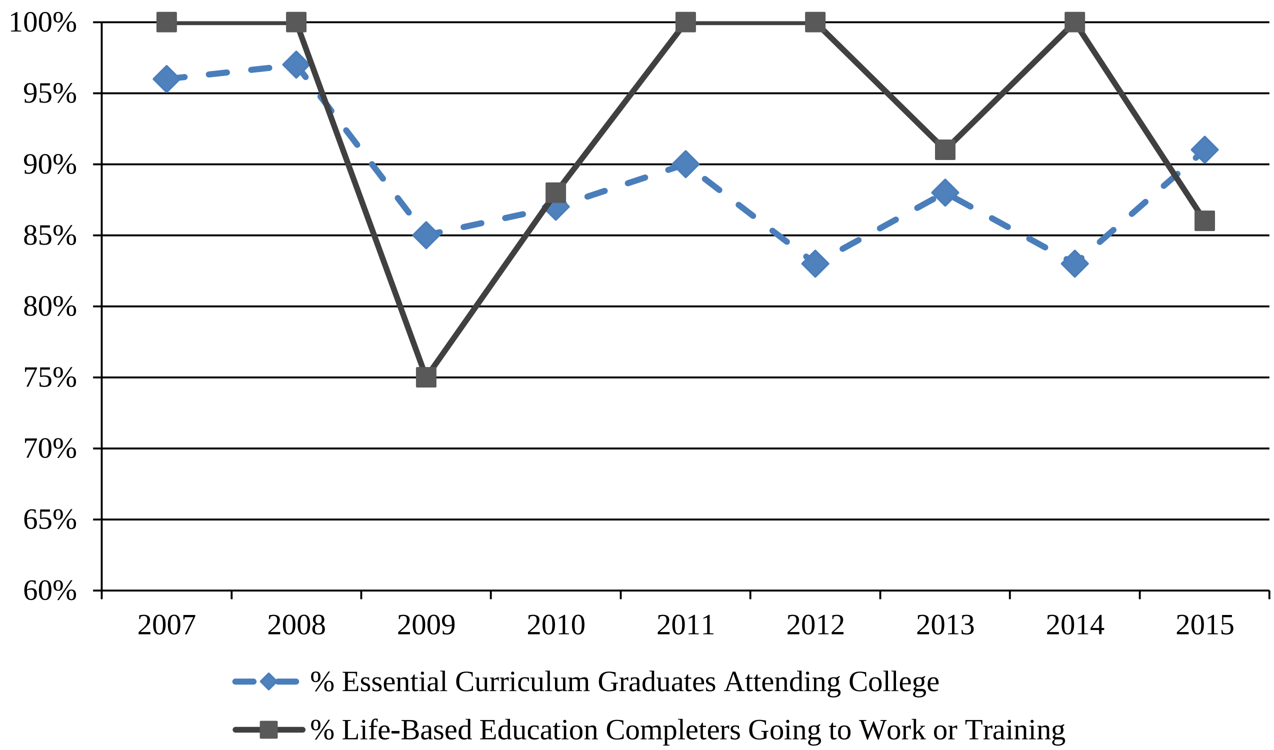
MSD has one overarching goal: to enable students in preK-12 to achieve their developmental potential.

Performance Analysis: Managing for Results

1. Graduates Going on to College, Work, or Training Remains High

MSD has several objectives that guide its measurement of success. The first is for 70% of the Essential Curriculum students to receive a Maryland State High School Diploma and attend college. MSD students may remain at the school until age 21, and the school offers support services to help each Essential Curriculum student earn a diploma. Most of the Essential Curriculum graduates pursue higher education, as shown in **Exhibit 1**. MSD has far surpassed the 70% target in recent years. Since fiscal 2007, the school has had an average of 29 Essential Curriculum graduates, and each year 100% of them have received a diploma. Since fiscal 2007, an average 89% of Essential Curriculum graduates went on to attend college. Graduating students attending college increased by 8 percentage points to 91% in fiscal 2015, far exceeding the goal established by MSD. **MSD should consider reviewing this measure to determine whether a higher goal should be established.**

Exhibit 1
Students Going to College, Work, or Training
Fiscal 2007-2015



Note: Essential Curriculum graduates receive Maryland State High School Diplomas. Maryland School for the Deaf has averaged 29 Essential Curriculum graduates and 7 Life-Based Education completers each year since fiscal 2007.

Source: Governor's Budget Books, Fiscal 2010-2016; Department of Budget and Management, Fiscal 2017

Another MSD objective is that at least 70% of students in the LBE curriculum receive a Maryland State Certificate of Program Completion and go on to work or to a training program. Since fiscal 2007, an average of seven students have received a certificate of program completion each year. Exhibit 1 shows that the percentage going to work or training is at 86% in fiscal 2015. With such a small group of students, the outcome of each student can cause the results to vary widely from year to year; however, over the past eight years, an average of 95% of LBE curriculum graduates have gone on to work or to a training program. **MSD should comment on other measures that can evaluate whether the LBE curriculum is accomplishing its mission, considering the small number of students in that program. Potential measures could be based on milestones students pass while in the program.**

Proposed Budget

As seen in **Exhibit 2**, the fiscal 2017 allowance for MSD decreases by $141,000 when compared to the fiscal 2016 working appropriation.

Exhibit 2
Proposed Budget
Maryland School for the Deaf
($ in Thousands)

How Much It Grows:	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015 Actual	$30,002	$286	$546	$3,547	$34,381
Fiscal 2016 Working Appropriation	30,787	326	520	3,748	35,381
Fiscal 2017 Allowance	30,864	337	573	3,465	35,239
Fiscal 2016-17 Amount Change	$77	$12	$53	-$283	-$141
Fiscal 2016-17 Percent Change	0.2%	3.6%	10.3%	-7.6%	-0.4%

Where It Goes:	
Personnel Expenses	
New positions	$738
Salaries and other compensation	-510
Reclassification	-73
Employee and retiree health insurance	170
Employee retirement system	197
Workers' compensation premium assessment	41
Turnover adjustments	83
Other fringe benefit adjustments	-52
Other Changes	
Decrease of 13.4 full-time equivalent contractuals	-371
Postponed facility maintenance for Frederick campus	-163
Decreased payment for Energy Performance Contract	-146
Department of Budget and Management paid telecommunications	-43
Other	-12
Total	**-$141**

Note: Numbers may not sum to total due to rounding.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency's share of these reductions is $91,119 in general funds and $1,860 in federal funds. There is an additional across-the-board reduction to abolish vacant positions statewide, but the amounts have not been allocated by agency.

Formula Funding and Increments

Formula funding for MSD is based on enrollment and growth in State per pupil funding provided to local school systems. Enrollment in fiscal 2017 is estimated to be 467 students, level with enrollment from the prior year. The formula for MSD has an adjustment that reflects the four-year moving average of student enrollment, which softens the effect of enrollment increases and decreases. The per pupil foundation amount has increased to $6,964, based on an inflationary increase of 0.1%. The impact from this increase on the MSD funding formula provides an increase of approximately $168,000 in general funds over the fiscal 2016 working appropriation.

Funding for employee increments is not included in the MSD budget, but is instead budgeted centrally in the Department of Budget and Management. MSD will receive $461,499 ($407,551 in general funds, $7,327 in federal funds, and $46,621 in reimbursable funds) by budget amendment at the start of the fiscal year. Applying the across-the-board reduction for employee health insurance to MSD reduces funding below the formula-required amount; however, with the $407,551 in general funds for employee increments, MSD will receive $316,432 above the formula-required amount in fiscal 2017.

Converting Contractual Full-time Equivalents to Full-time Positions

Total personnel expenses increase over the fiscal 2016 working appropriation by $593,000. Much of this increase is due to a conversion of contractual full-time equivalents (FTE) into full-time positions. MSD receives 4.0 residential child and youth care professional positions, and 7.0 new faculty positions, while losing 13.4 contractual FTEs. This results in a net decrease of 2.4 in personnel overall. MSD has expressed that converting these contractual FTEs to full-time staff will assist in recruiting and retaining highly qualified staff, a top priority for the school. Spending specifically for new personnel increases by $738,000, while spending for FTE contractuals has decreased by $371,000.

The school is postponing any facility maintenance projects at the Frederick campus to divert those funds to personnel. This has resulted in a $163,000 decrease in contractual spending, funding contractual spending for maintenance at about 50% of both the fiscal 2015 actual amount and the fiscal 2016 working appropriation. **MSD should comment on its strategy to fund maintenance projects in the out-years, considering the increase in costs from the new positions will be ongoing. MSD should also comment on its strategy for funding maintenance projects for the Frederick campus should new maintenance costs occur, including the areas of its budget that could be reduced in such a situation.**

MSD has had a significant number of long-term administrators and teachers retire and become replaced by staff at the lower spectrum of the salary scale. Therefore, though there is no decline in full-time personnel for MSD in fiscal 2017, salaries, employee health insurance, and other fringe benefits decline from fiscal 2016 for current employees.

Issues

1. Reporting on the Determination of Kindergarten Readiness

The Kindergarten Readiness Assessment (KRA) is the cornerstone of the Ready for Kindergarten: Maryland's Early Childhood Comprehensive System program. This assessment has replaced the previously used Maryland Model for School Readiness (MMSR), and was operational for administration in fall 2014. MSD reported that it was able to participate in the field test for the KRA, administering the test for 25 students, and that the only complication experienced with the KRA was how to present the information to students in ASL since the students do not have access to spoken/voiced directions. This included a Language and Literacy section that the majority of MSD students could not access. MSD had stated that it would continue to work on overcoming these challenges. The results from the first administration of the KRA for MSD students are available in **Exhibit 3**.

Exhibit 3
Results from First Administration of the KRA
Maryland School for the Deaf
Academic Year 2014-2015

KRA Area	Demonstrates Readiness	Emerging/Approaching Readiness
Social Foundations	64%	36%
Language and Literacy	16%	84%
Mathematics	52%	48%
Physical Well-being and Motor Development	56%	44%

KRA: Kindergarten Readiness Assessment

Note: Maryland School for the Deaf reports that its subgroups for the KRA were too small to receive statistical data on performance, meaning these results do not truly reflect the students' progress at this point.

Source: Maryland School for the Deaf

MSD had a goal that 75% of its kindergarteners would meet benchmark language/literacy and mathematical thinking as outlined in the MMSR Language and Literacy and the MMSR Mathematical Thinking checklist by 2016. However, due to the fact that the MMSR was not administered in fall 2014, this data was not provided as part of the Managing for Results data for fiscal 2015. As shown in Exhibit 3, if KRA results were to be used to compare to the MSD goal, kindergartners performed below 75% in both Language and Literacy and Mathematics for academic year 2014-2015. It is worth noting that kindergartners across the State performed lower on the academic 2014-2015 administration of the KRA when compared to the 2013-2104 administration of the MMSR, with only 47% of children displaying kindergarten readiness in contrast to the previous 83%. **MSD should comment on how it has evaluated its performance in fiscal 2015 regarding its goal for kindergarten readiness. It should also comment on any progress it has made on overcoming complications to administer the KRA for its students, and on setting goals for student performance on the test for future administrations of the KRA.**

Recommended Actions

1. Concur with Governor's allowance.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Maryland School for the Deaf
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$29,801	$325	$536	$3,121	$33,783
Deficiency Appropriation	0	0	0	0	0
Cost Containment	0	0	0	0	0
Budget Amendments	201	0	25	448	675
Reversions and Cancellations	0	-39	-16	-22	-76
Actual Expenditures	**$30,002**	**$286**	**$546**	**$3,547**	**$34,381**
Fiscal 2016					
Legislative Appropriation	$30,385	$326	$517	$3,748	$34,976
Budget Amendments	402	0	3	0	405
Working Appropriation	**$30,787**	**$326**	**$520**	**$3,748**	**$35,381**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

General fund expenditures totaled $30 million in fiscal 2015, a $201,000 increase from the legislative appropriation. This increase is attributed to a budget amendment increasing personnel expenses for the cost-of-living adjustment (COLA).

The special fund appropriation totaled $286,000, reflecting $39,000 in cancellations from gifts and student activity fees, and a decrease in out-of-state tuition revenue.

The federal fund appropriation closed fiscal 2015 at $546,000, approximately $10,000 more than the legislative appropriation. Budget amendments provided an increase of approximately $25,000. This reflects receipt of additional Ready for Kindergarten and National Center and State Collaborative grants not budgeted in fiscal 2015, and increased personnel funding for the COLA. Nearly $16,000 was canceled due to a decrease in Medical Assistance billing.

Reimbursable fund expenditures totaled over $3.5 million. This reflects an increase of $426,000. $395,000 is reflected in additional funding for the Enhanced Program of Services grant, and $53,000 in additional funding for the Diagnostic Testing Grant. Due to a decrease in a grant from the Maryland State Department of Education Division of Rehabilitation Services, as well as decreased student services for the MSD Enhanced Program, $22,000 was canceled.

Fiscal 2016

The fiscal 2016 general fund working appropriation is approximately $30.8 million, reflecting a $402,000 increase over the legislative appropriation for the 2% State salary adjustment, which restored the funding reduced in Section 20 of the fiscal 2016 budget bill.

The fiscal 2016 federal fund working appropriation is approximately $520,000, which reflects a $3,000 increase over the legislative appropriation for the 2% salary adjustment.

Appendix 2

Audit Findings

Audit Period for Last Audit:	August 9, 2011–March 30, 2015
Issue Date:	December 2015
Number of Findings:	2
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: Corporate purchasing card transactions were not always reviewed and approved by appropriate supervisory personnel and documentation was lacking for a certain aspect of the new card issuance process.

Finding 2: MSD did not accurately maintain detailed records and properly account for all of its equipment.

Object/Fund Difference Report
Maryland School for the Deaf

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	319.50	319.50	330.50	11.00	3.4%
02 Contractual	92.50	90.40	77.00	-13.40	-14.8%
Total Positions	**412.00**	**409.90**	**407.50**	**-2.40**	**-0.6%**
Objects					
01 Salaries and Wages	$ 26,455,943	$ 27,724,116	$ 28,410,254	$ 686,138	2.5%
02 Technical and Spec. Fees	4,090,286	3,889,429	3,518,408	-371,021	-9.5%
03 Communication	260,147	269,253	222,577	-46,676	-17.3%
04 Travel	23,262	4,000	4,000	0	0%
06 Fuel and Utilities	1,262,817	1,273,096	1,104,387	-168,709	-13.3%
07 Motor Vehicles	96,731	80,422	83,073	2,651	3.3%
08 Contractual Services	1,077,748	1,124,304	947,456	-176,848	-15.7%
09 Supplies and Materials	816,832	851,046	848,193	-2,853	-0.3%
10 Equipment – Replacement	232,185	95,500	127,815	32,315	33.8%
13 Fixed Charges	65,313	69,431	66,096	-3,335	-4.8%
Total Objects	**$ 34,381,264**	**$ 35,380,597**	**$ 35,332,259**	**-$ 48,338**	**-0.1%**
Funds					
01 General Fund	$ 30,001,990	$ 30,786,834	$ 30,954,917	$ 168,083	0.5%
03 Special Fund	286,372	325,654	337,436	11,782	3.6%
05 Federal Fund	545,763	519,675	574,886	55,211	10.6%
09 Reimbursable Fund	3,547,139	3,748,434	3,465,020	-283,414	-7.6%
Total Funds	**$ 34,381,264**	**$ 35,380,597**	**$ 35,332,259**	**-$ 48,338**	**-0.1%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Department of Housing and Community Development

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$8,101	$3,423	$4,546	$1,123	32.8%
Adjusted General Fund	**$8,101**	**$3,423**	**$4,546**	**$1,123**	**32.8%**
Special Fund	60,953	84,241	88,739	4,498	5.3%
Deficiencies and Reductions	0	0	-70	-70	
Adjusted Special Fund	**$60,953**	**$84,241**	**$88,669**	**$4,427**	**5.3%**
Federal Fund	236,274	245,335	245,905	570	0.2%
Deficiencies and Reductions	0	0	-25	-25	
Adjusted Federal Fund	**$236,274**	**$245,335**	**$245,880**	**$545**	**0.2%**
Reimbursable Fund	4,325	2,165	2,165	0	
Adjusted Reimbursable Fund	**$4,325**	**$2,165**	**$2,165**	**$0**	**0.0%**
Adjusted Grand Total	**$309,653**	**$335,164**	**$341,260**	**$6,096**	**1.8%**

- The fiscal 2017 allowance grows by $6.1 million, or 1.8%, across all funds.

- General funds increase by $1.1 million, or 32.8%, due to a fund swap in the Emergency Solutions Grant program. Special funds increase by $4.4 million, primarily due to increased funds available from the Strategic Energy Investment Fund for multifamily energy efficiency programs.

Note: Numbers may not sum to total due to rounding.

For further information contact: Jason A. Kramer Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	337.00	337.00	339.00	2.00
Contractual FTEs	51.44	71.00	71.50	0.50
Total Personnel	**388.44**	**408.00**	**410.50**	**2.50**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions		18.54	5.50%
Positions and Percentage Vacant as of 12/31/15		21.00	6.23%

- Regular positions increase by 2.0 positions in the fiscal 2017 allowance compared to the current year working appropriation due to contractual conversions.

- Contractual full-time equivalents increase by 2.5.

- The fiscal 2017 allowance includes a turnover rate of 5.5%, which would require the department to keep 18.54 regular positions vacant throughout the year. There were 21.00 vacant positions as of December 31, 2015.

Analysis in Brief

Major Trends

Homelessness Assistance Grows: The Department of Housing and Community Development (DHCD) provided assistance to nearly 6,000 people who were homeless or at risk of homelessness in fiscal 2014, the first year that the department tracked this count. That number rose to approximately 7,000 people in fiscal 2015, a level that the department expects to maintain through fiscal 2017.

Department Meets Single-family Energy Efficiency Goal: The DHCD goal is to provide assistance for the improvement of 3,000 single-family homes annually. After a spike in assistance in fiscal 2012 followed by a decline in fiscal 2013 due to a switch from federal funding to EmPOWER funding, the department met its goal in fiscal 2014 and 2015, and expects to continue to do so through fiscal 2017.

Issues

Energy Audit Finds Unethical Practices at Weatherization Agencies: In July 2015, the U.S. Department of Energy (DOE) released the results of an audit that found unethical and improper accounting practices by local weatherization agencies. DOE questioned $1.8 million in payments, which equates to up to 100 homes that could have received energy efficiency improvements that did not. Additionally, DOE noted serious shortcomings in the DHCD oversight of the program. **DHCD should comment on the DOE audit findings and provide to the committees any further changes it has made to the operations of any energy programs. DHCD should also comment on the increasing size of its energy efficiency portfolio and its ability to provide energy efficiency services to the State.**

Loan Tracking Software Enters Fourth Decade: DHCD has been using the same software maintenance provider for its single-family loan tracking software since 1985. While the provider – Application Oriented Designs – is the only firm able to provide service for the proprietary software, it is unclear if the more than 30-year-old software is the ideal solution for the agency's needs. DHCD is currently working on determining the necessary scope of services in advance of publishing a Request for Proposal (RFP) for a new system in February 2016. **DHCD should comment on the status of the RFP for new single-family loan tracking software.**

Recommended Actions

		Funds
1.	Adopt narrative that it is the committees' intent that, beginning with the fiscal 2018 budget, the Department of Housing and Community Development should provide every program it operates with its own subprogram code.	
2.	Delete contractual cost increase related to 2.5 new contractual full-time equivalents.	$ 125,000
	Total Reductions	**$ 125,000**

Updates

Foreclosure Rate Remains High: Maryland has the second highest foreclosure rate in the nation; however, foreclosure filings ordered to docket in the State declined by 20.8% in calendar 2015 compared to the prior year.

Department of Housing and Community Development

Operating Budget Analysis

Program Description

The mission of the Department of Housing and Community Development (DHCD) is to work with partners to finance housing opportunities and revitalize great places for Maryland citizens to live, work, and prosper. As shown in **Exhibit 1**, DHCD used nearly $1.2 billion in revenue bonds, mortgage-backed securities, State and federal tax credits, and State and federal funds to finance or provide funding to projects and programs throughout the State.

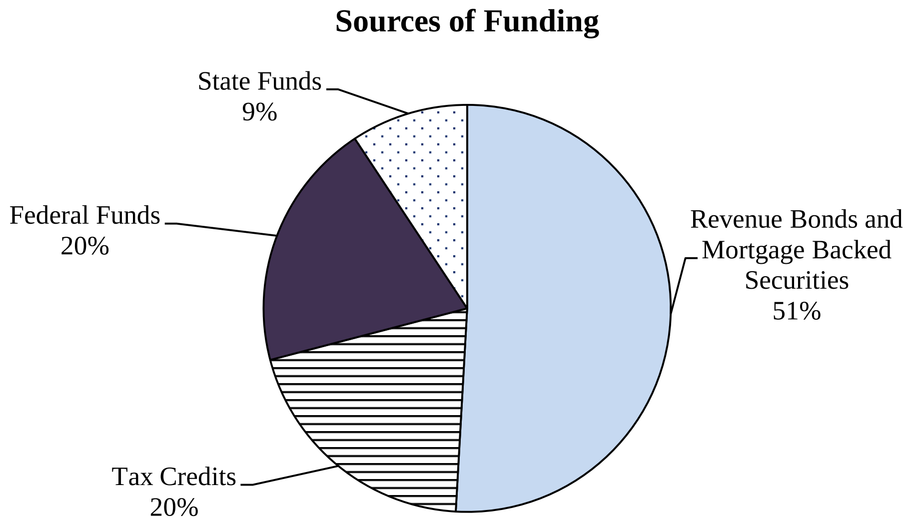
- **Homeownership and Special Needs Housing:** About $446.7 million, or 39%, of fiscal 2015 DHCD funding was used for homeownership and special needs housing programs. Those who meet certain income criteria can access loans with zero interest rates for down payment and settlement expenses to buy homes through programs like the Maryland Mortgage Program and the Down Payment and Settlement Expense Loan Program. Other single-family program activities support grants and loans for lead hazard reduction, indoor plumbing improvements, overall rehabilitation, and group home projects.

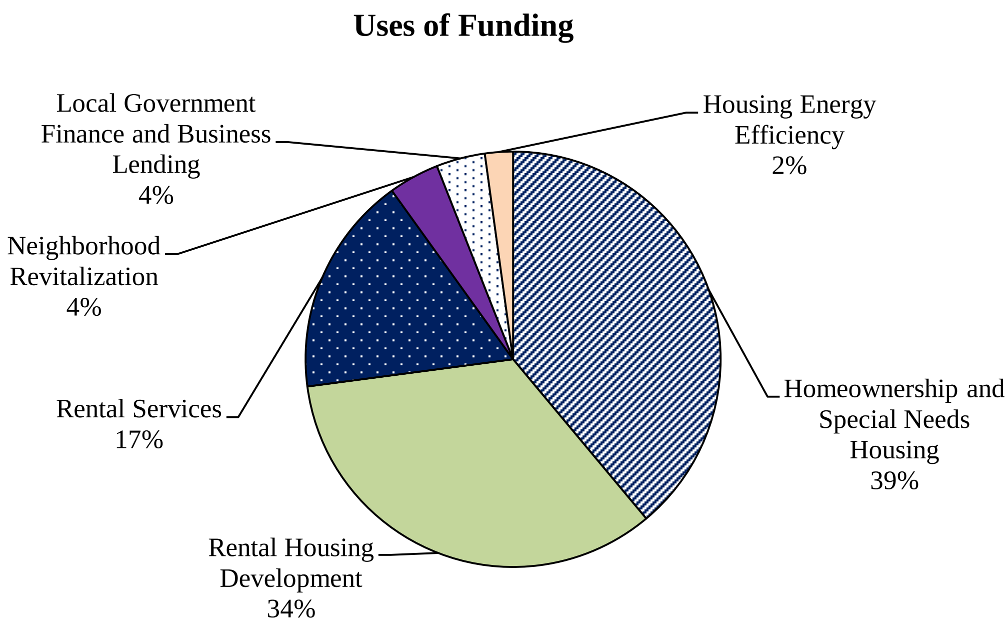
- **Rental Housing Development:** About $407.7 million, or 34%, of DHCD funding in fiscal 2015 was used for the development of affordable rental housing. Nonprofits and for-profit developers and owners may access tax credits and below-market rate loans to help finance multifamily housing projects serving low-income families; some loans are also available to local governments. Federal Low Income Housing Tax Credits are a crucial part of the financing for these projects. The loans are funded with State-appropriated rental housing funds, federal Home Investment Partnership Program funds, and the nonbudgeted proceeds of tax-exempt and taxable bonds.

- **Rental Services:** Rental housing support also includes administration of State and federal rental subsidy programs, including the federal Section 8 Performance Based Contract Administration and Housing Choice Voucher programs and the State Rental Allowance Program (RAP). Under these programs, DHCD provides rental assistance to low-income households through owners of covered units, local governments, or nonprofit subcontractors. DHCD used $205.9 million, or 17%, of its funding and financing for rental services programs in fiscal 2015.

- **Neighborhood Revitalization:** In fiscal 2015, about $47.3 million, or 4%, of the agency's expenditures were related to Neighborhood Revitalization related activities. Local governments, community development nonprofits, and others involved in improving communities may access grants, below-market rate loans, and technical assistance and training. Funds are used for projects such as streetscape and facade improvements, recreational amenities, and improvement of public spaces. Other programs provide funding for small business start-ups and expansions, as well as demolition of derelict buildings, site acquisition, assembly, and development.

Exhibit 1
Sources and Uses of the Department of Housing and Community Development's Operating and Capital Budgets, Budgeted and Nonbudgeted Funds
Fiscal 2015 Total – $1,199 Million





Source: Department of Housing and Community Development

- **Local Government Finance and Business Lending:** In fiscal 2015, about $45.6 million, or 4%, of the agency's financing was related to providing financing to small businesses through the Neighborhood Business Works program and the Local Government Infrastructure Finance Program.

- **Housing Energy Efficiency:** In fiscal 2015, about $26.1 million, or 2%, of the agency's financing was related to improving energy efficiency in housing. The two largest energy efficiency programs are the Low Income Energy Efficiency Program (LIEEP), which allows low-income households to install energy conservation materials in their homes at no charge, and the federally funded Energy Efficiency Community Block Grant program.

The department's programs are administered through three operating divisions: the Division of Development Finance, which includes the Community Development Administration (CDA); the Division of Neighborhood Revitalization; and the Division of Credit Assurance, which includes the Maryland Housing Fund's mortgage insurance activities. CDA issues nonbudgeted tax-exempt and taxable bonds and mortgage backed securities that are a major source of DHCD revenues.

DHCD has three administrative support units: the Office of the Secretary, the Division of Information Technology, and the Division of Finance and Administration.

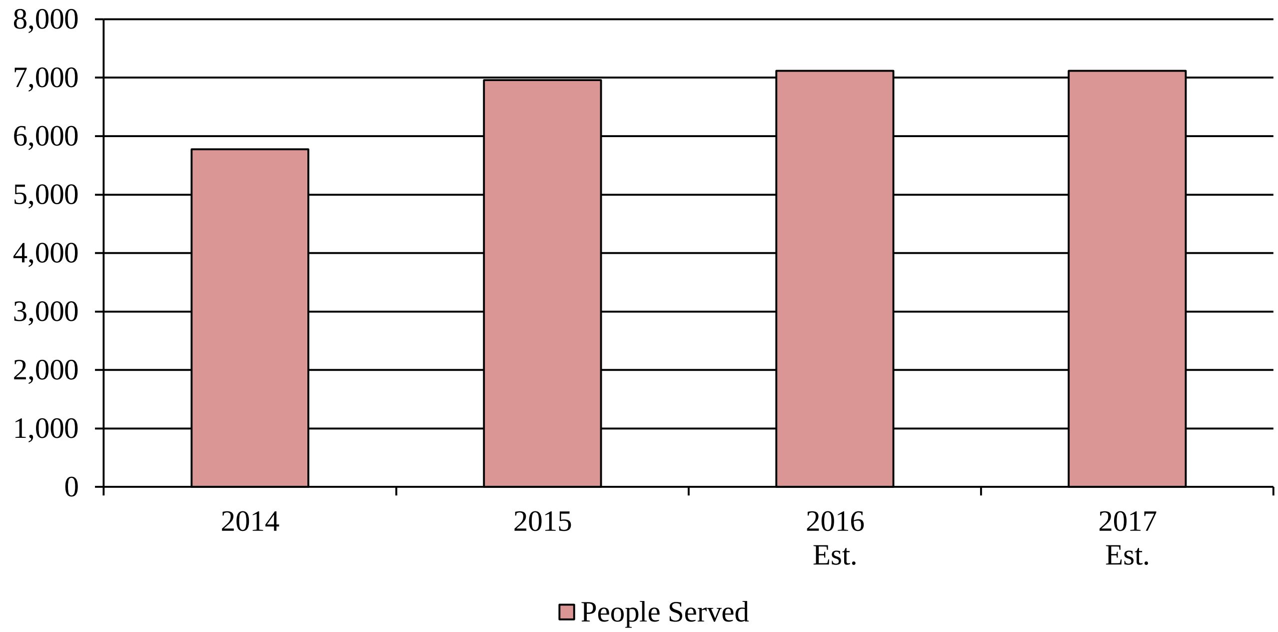
Performance Analysis: Managing for Results

1. Homelessness Assistance Grows

DHCD provides operating assistance to the State's homeless population via three programs. The Emergency Solutions Grant (ESG) program provides funds primarily for operating costs, case management and client services, and administrative costs for homeless shelters and transitional units. The funds mainly go to organizations in rural areas that are not eligible for funds directly from the U.S. Department of Housing and Urban Development. The fiscal 2017 allowance includes $1.7 million in general funds, $284,000 in special funds, and $800,000 in federal funds for the ESG. While the total allowance for the ESG is flat compared to fiscal 2016, there is a $1,122,943 general fund increase paired with a reduction in special funds in the same amount. The Rental Allowance Program (RAP) provides rental subsidies to people who are homeless or are in danger of becoming homeless; DHCD provides grants to local governments or community agencies that administer the program. The fiscal 2017 allowance includes $1.7 million in general funds for the RAP. The Families First program is supported by an initial grant of $400,000 over three years from the Freddie Mac Foundation and matching State funds. It is a pilot program launched in fiscal 2015 in Prince George's County that provides temporary rental assistance and other social services assistance to homeless veterans with families or veterans with families in danger of homelessness.

As shown in **Exhibit 2**, DHCD provided assistance to nearly 6,000 people who were homeless or were at risk of homelessness in fiscal 2014, the first year that the department tracked this count. That number rose to approximately 7,000 people in fiscal 2015, a level that the department expects to maintain through fiscal 2017.

Exhibit 2
Number of Homeless or At-risk of Homelessness People Served
Fiscal 2014-2017 Est.



Source: Department of Budget and Management

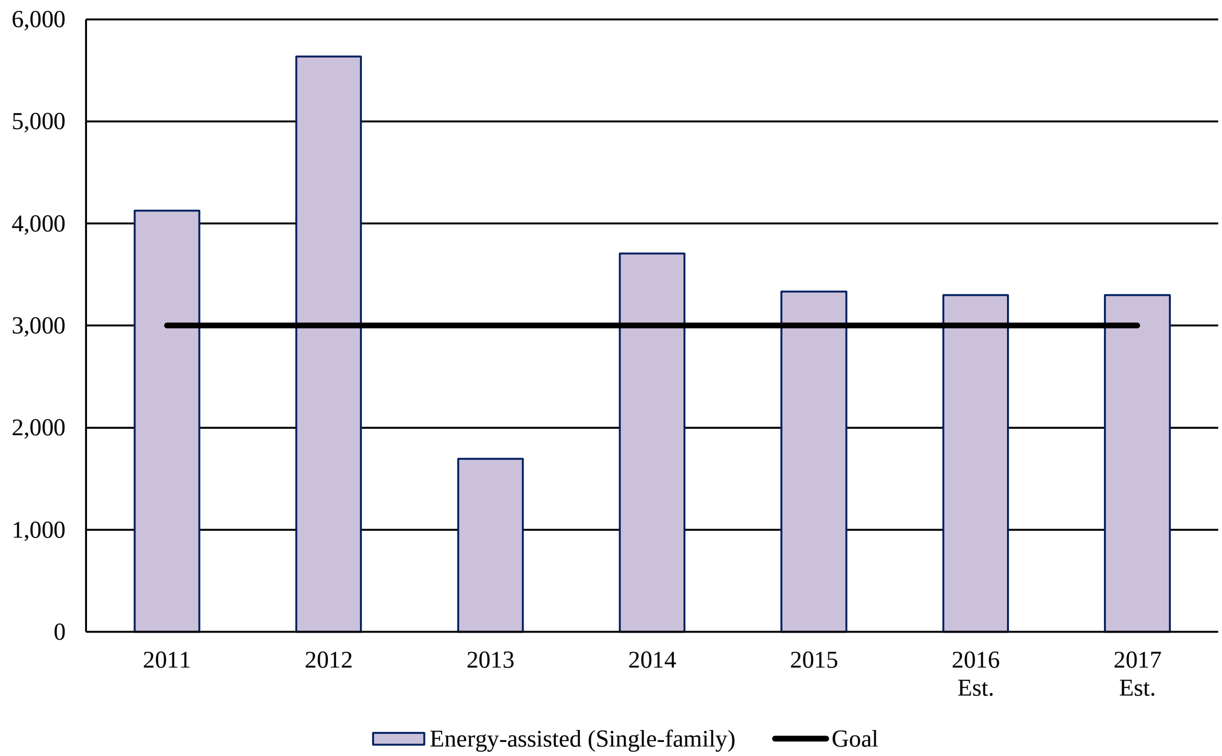
2. Department Meets Single-family Energy Efficiency Goal

Several DHCD operating programs aim to improve the energy efficiency of the homes of single-family households with limited incomes. The department's goal is to assist 3,000 single-family homes with energy efficiency improvements annually through its various energy assistance programs.

The Department of Energy (DOE)-funded Weatherization Assistance Program (WAP) and the EmPOWER-funded LIEEP provide assistance to low-income households for the installation of energy conservation materials, while funds from the Strategic Energy Investment Fund (SEIF) and the Low-Income Home Energy Assistance Program are also used for single-family energy efficiency improvements.

As shown in **Exhibit 3**, after a spike in assistance in fiscal 2012 followed by a decline in fiscal 2013 due to a switch from federal funding to EmPOWER funding, the department met its goal in fiscal 2014 and 2015, and expects to continue to do so through fiscal 2017.

Exhibit 3
Energy Assistance to Single-family Homes
Fiscal 2011-2017 Est.



Source: Department of Budget and Management

Fiscal 2016 Actions

Cost Containment

DHCD reduced its general fund appropriation by $160,000 in the ESG program as part of the 2% across-the-board reduction; $80,000 of that was replaced by special funds.

Proposed Budget

As shown in **Exhibit 4**, the fiscal 2017 allowance increases by $6.1 million, or 1.8%. This includes a $1.1 million increase in general funds due to a fund swap in the ESG program, and a $4.4 million increase in special funds mostly due to newly available SEIF funds for multifamily energy efficiency programs.

Exhibit 4
Proposed Budget
Department of Housing and Community Development
($ in Thousands)

How Much It Grows:	**General Fund**	**Special Fund**	**Federal Fund**	**Reimb. Fund**	**Total**
Fiscal 2015 Actual	$8,101	$60,953	$236,274	$4,325	$309,653
Fiscal 2016 Working Appropriation	3,423	84,241	245,335	2,165	335,164
Fiscal 2017 Allowance	4,546	88,669	245,880	2,165	341,260
Fiscal 2016-2017 Amount Change	$1,123	$4,427	$545	$0	$6,096
Fiscal 2016-2017 Percent Change	32.8%	5.3%	0.2%		1.8%

Where It Goes:	
Personnel Expenses	
Contractual conversions	$48
Regular earnings	-589
Reclassification	179
Turnover adjustments	753
Contractual compensation and fringe benefits less contractual conversions	608
Employee retirement system contributions	529
Employee and retiree health insurance	326
Workers' and unemployment compensation premium assessment	-4
Social Security contributions	-36
Energy Programs	
EmPOWER multifamily less personnel, funded primarily by Cove Point SEIF payment	4,690
Increased SEIF funds available for multifamily energy program	1,000
Decrease in federal Weatherization Assistance Program grants	-2,000
Reduced spending on evaluation and measurement of energy efficiency programs	-480
Energy program training	-185

Where It Goes:	
Other Changes	
Section 8 vouchers and administration less personnel to reflect fiscal 2016 actuals to date.	1,903
Foreclosure mediation and housing counseling decrease due to end of Prince George's County Down Payment Assistance Program	-300
Administrative hearings to reflect fiscal 2015 actuals	-638
Other changes	292
Total	**$6,096**

SEIF: Strategic Energy Investment Fund

Note: Numbers may not sum to total due to rounding.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency's share of these reductions is $70,408 in special funds and $24,957 in federal funds. There is an additional across-the-board reduction to abolish vacant positions statewide, but the amounts have not been allocated by agency.

Salary Increments

The fiscal 2017 budget bill includes funds for a salary increment increase in the Department of Budget and Management. The DHCD portion of the increment increase is $345,559 in special funds and $163,369 in federal funds.

Personnel Changes

The allowance includes several personnel changes totaling $1.8 million, including:

- two contractual conversions, increasing costs by $47,610;
- a decrease of $589,465 in regular earnings due to an error in the personnel database;
- a reclassification of several fiscal services positions to maintain competitive salaries after the department's move to the Washington, DC, metro area, which increased costs by $178,560;
- an increase of $752,923 to reflect a return of the department's turnover rate to 5.5%, after it was at 10% for fiscal 2016 to reflect higher than normal vacancies due to the headquarters move;

- an increase of $608,108 driven by a lower turnover rate for contractual employees as well as 2.5 new contractual FTEs; and

- an increase of $855,195 in health insurance and retirement costs.

Energy Program Changes

There are also several changes in spending in various energy efficiency programs, including:

- an increase of $4.7 million in special funds in the EmPOWER multifamily program. The increased funds are a portion of Cove Point's payment to the SEIF; the DHCD share is $4,625,000. Cove Point made the payment to the SEIF as part of an agreement to be allowed to build an electric generation facility to export liquefied natural gas;

- a decrease of $2.0 million in federal WAP grant funds; and

- an increase of $1.0 million in special funds from the SEIF to supplement existing energy efficiency programs, typically to provide improvements in areas or situations that would not be eligible for EmPOWER, or DOE WAP funds.

Issues

1. Energy Audit Finds Unethical Practices at Weatherization Agencies

The U.S. Department of Energy (DOE) in July 2015 released the results of an audit conducted of the DHCD administration of the DOE-funded WAP. A complaint regarding unethical and improper accounting practices by local weatherization agencies sparked the investigation, which substantiated several serious allegations. DOE questioned $1.8 million in payments, which equates to up to 100 homes that could have received energy efficiency improvements that did not. Additionally, DOE noted serious shortcomings in the DHCD oversight of the program.

DHCD administers the WAP through 11 nonprofit agencies and 8 local governments throughout the State. The local agencies or governments provide weatherization services using WAP funds, as well as funds from other sources, and use in-house crews as well as contractors.

The DOE Office of Inspector General (OIG) investigated allegations against two local agencies – C&O Conservation Inc. (C&O) and Maryland Energy Conservation Inc. (MEC) – as well as one of the MEC contractors, House Warmers. OIG found that between April 2009 and December 2013, C&O and MEC engaged in improper and unethical accounting practices with $1.5 million in reimbursements that were either abusive, unallowable, or potentially unallowable. OIG found $910,000 in unallowed payments above actual costs to C&O, which is prohibited. The unallowed payments included unsupported surcharges, claims above actual costs, and unreasonable labor costs. OIG also found another $291,000 in unallowable or potentially unallowable costs reimbursed to C&O and MEC, and $312,000 in reimbursements that could not be supported by C&O and MEC.

The audit also noted about $275,000 in questionable costs involving related party transactions. Both C&O and MEC made questionable compensation payments to related parties, and C&O had warehouse and vehicle lease arrangements that violated federal regulations regarding less-than-arm's-length transactions. One notable misuse of funds included the use of program funds to perform construction on a C&O board member's home.

While the improper actions found by OIG were the responsibility of the local agencies, the audit found an environment that allowed for the activities to continue. OIG called the DHCD oversight inadequate and found that the department lacked policies for reconciling payments to local agencies to actual labor and material costs. In addition, the subgrantee's accounting deficiencies obscured the use of program funds for personal expenses, which went undetected. OIG also noted that DHCD did not ensure that repeat audit findings from C&O and MEC audits had been resolved, and weaknesses at the agencies were not resolved despite OIG raising nearly identical issues in its prior audit in January 2013.

DOE has removed C&O, House Warmers, and MEC from government contracting and subcontracting for three years. For its part, DHCD made several programmatic changes, including the following:

- DHCD hired an assistant to the compliance auditor, and increased the compliance auditor's salary to improve retention.

- The department sent several staff members to training workshops to improve understanding of the WAP programmatic and fiscal requirements. DHCD also hired a DOE financial training consultant to provide assistance in understanding program requirements.

- DHCD completed the Maryland Weatherization Program Operations Manual in August 2015, which was approved by DOE. The manual implements changes to the grant agreement to require grantees to retain responsibility for all activities, rather than subcontracting tasks.

Finally, DOE required DHCD to perform $1.8 million in weatherization activities in order to reimburse the program. DOE allowed DHCD to use EmPOWER funds to provide to grantees to perform this work. In addition, DHCD conducted an audit of all grantees of the program throughout the program's history and recovered $1.2 million in unsupported costs.

LIEEP Issues

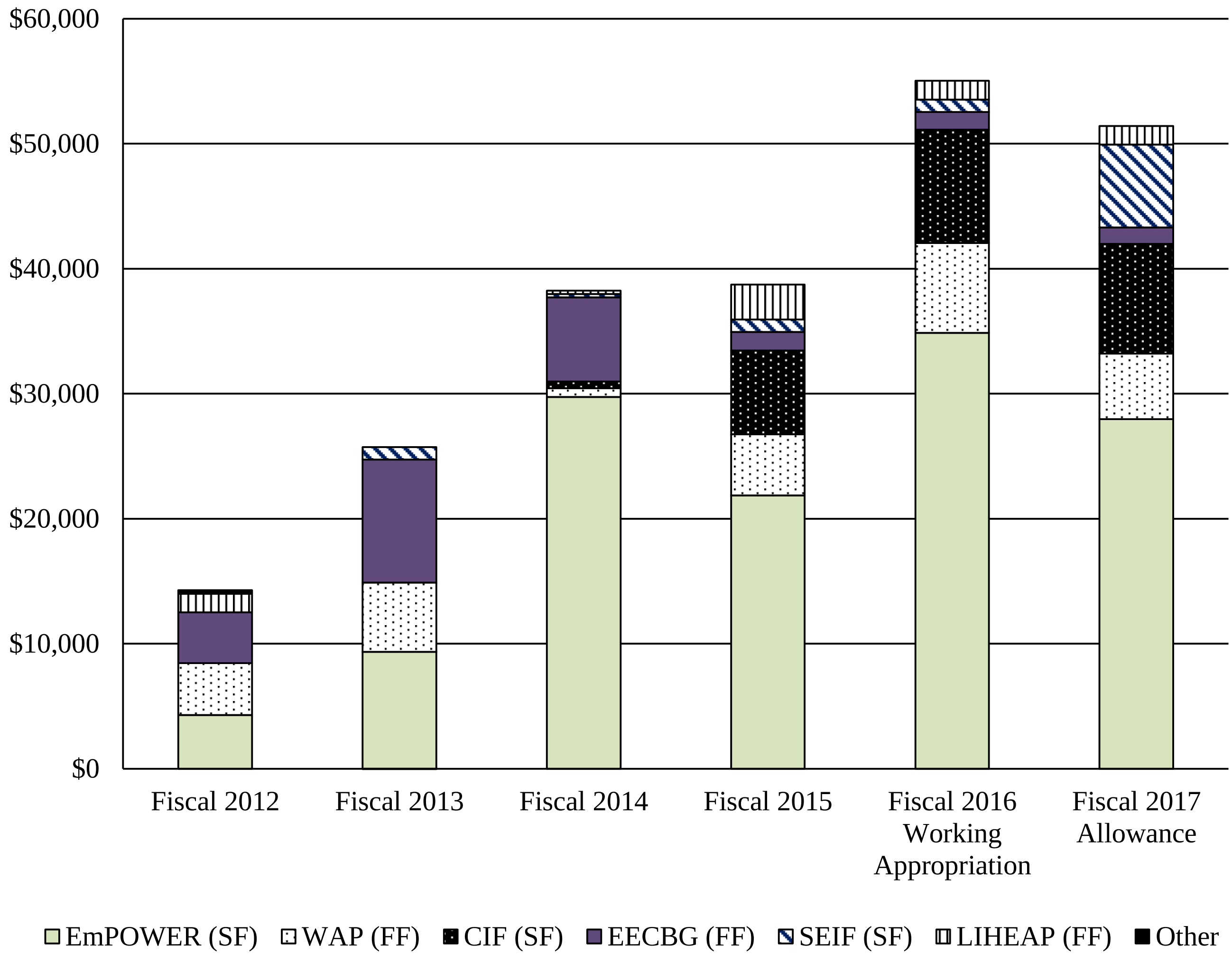
The DOE audit came shortly after Public Service Commission (PSC) staff raised issues about the DHCD operation of the EmPOWER-funded LIEEP. The LIEEP allows for the installation of energy conservation materials in homes at no charge, with eligibility restricted to low-income households (200% of federal poverty level) with electric heating or central cooling systems that are Baltimore Gas and Electric, Delmarva Power, Southern Maryland Electric Cooperative, Pepco, or Potomac Edison customers.

PSC staff noted issues such as a below-forecast number of homes being weatherized, the high cost of weatherization, a lack of billing data, and a conflict of interest with a contractor that evaluated the program's impact. The legislature deleted funding related to the program in the 2015 session and authorized an amendment to return the funding once PSC awarded the funds, which it did in May 2015.

Energy Growth

While energy efficiency programs represent a small portion of the DHCD overall portfolio, funding for energy efficiency programs (both operating and capital) has rapidly expanded from $14.3 million in fiscal 2012 to $51.4 million in the fiscal 2017 allowance, as shown in **Exhibit 5**. New sources such as EmPOWER and the Customer Investment Fund (CIF) provide the bulk of the increase. Both the department and PSC staff have noted implementation issues early in the history of both CIF- and EmPOWER-funded programs, as DHCD saw delays as it ramped up the program to fully utilize available funding.

Exhibit 5
Energy Program Funding Sources
Fiscal 2012-2017 Est.
($ in Thousands)



CIF: Customer Investment Fund
EECBG: Energy Efficiency and Conservation Block Grant
FF: federal funds
LIHEAP: Low-Income Home Energy Assistance Program
SF: special funds
SEIF: Strategic Energy Investment Fund
WAP: Weatherization Assistance Program

Source: Governor's Budget Books, Fiscal 2014-2017

DHCD should comment on the DOE audit findings and provide to the committees any further changes it has made to the operations of any energy programs. DHCD should also comment on the increasing size of its energy efficiency portfolio and its ability to provide energy efficiency services to the State.

2. Loan Tracking Software Enters Fourth Decade

DHCD has been using the same software maintenance provider for its single-family loan tracking software since 1985. While the provider – Application Oriented Designs – is the only firm able to provide service for the proprietary software, it is unclear if the more than 30-year-old software is the ideal solution for the agency's needs. DHCD notes that the current system doesn't place any limitations on the department's operations.

In April 2015, the Board of Public Works (BPW) approved the annual $300,000 contract for maintenance and enhancement of the software. The department has renewed the contract on a sole-source procurement basis, since installation in 1985. A 1999 assessment found that no upgrades were needed to the software, but no review has been performed since. DHCD is currently working on determining the necessary scope of services in advance of publishing a Request for Proposal (RFP) for a new system in February 2016. **DHCD should comment on the status of the RFP for new single-family loan tracking software.**

Recommended Actions

1. Adopt the following narrative:

   Provide Unique Subprogram Codes for All Department Programs: The budget committees are concerned about the Department of Housing and Community Development's budgeting process and a potential lack of transparency due to many programs not having their own eight-digit program and subprogram code. It is the intent of the committees that beginning with the fiscal 2018 budget, the department should provide all programs with a unique, eight-digit program and subprogram code in its budget preparation.

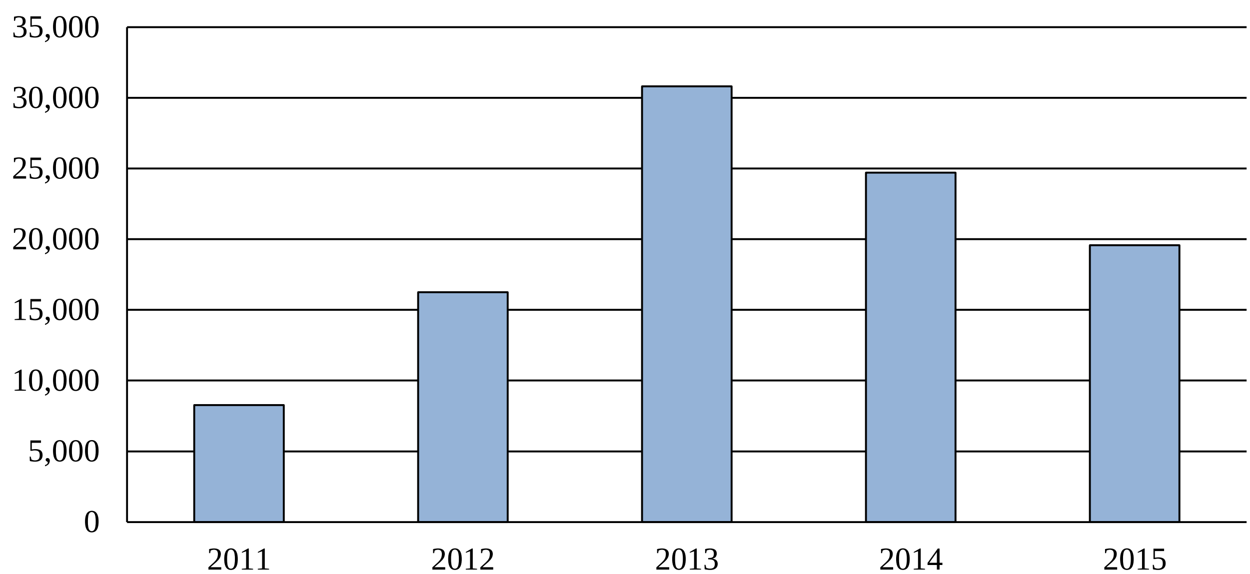
		Amount Reduction	
2.	Delete $125,000 in special funds intended for the increase in Object 2 contractual costs due to 2.5 contractual full-time equivalents that are unjustified.	$ 125,000	SF
	Total Special Fund Reductions	**$ 125,000**	

Updates

1. Foreclosure Rate Remains High

High foreclosure rates in the State continue to be a problem, with recent reports placing Maryland second in the nation in its foreclosure rate. As shown in **Exhibit 6**, there were approximately 19,575 foreclosure filings ordered to docket in the State in calendar 2015, down 20.8% from calendar 2014. The prior low level in the State's foreclosure activity in calendar 2011 and 2012 was in part due to foreclosure moratoriums, the mediation law, and other actions taken by the State to aid homeowners. While some foreclosures were prevented, many others were delayed.

Exhibit 6
Foreclosure Filings Ordered to Docket
Calendar 2011-2015



Source: Department of Housing and Community Development

While funding from the National Attorneys General Mortgage Servicing Settlement ended in fiscal 2015, funds from the Maryland Housing Counseling Fund (MHCF) remain available for housing counseling and legal assistance, with funds awarded to support community-based nonprofit housing counseling and legal support organizations to assist homeowners and renters.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Department of Housing and Community Development
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$9,706	$70,561	$246,297	$525	$327,089
Deficiency Appropriation	0	0	0	0	0
Cost Containment	-1,605	0	0	0	-1,605
Budget Amendments	0	2,253	64	3,815	6,132
Reversions and Cancellations	0	-11,861	-10,087	-15	-21,963
Actual Expenditures	**$8,101**	**$60,953**	**$236,274**	**$4,325**	**$309,653**
Fiscal 2016					
Legislative Appropriation	$3,423	$73,351	$245,221	$2,165	$324,160
Budget Amendments	0	10,890	114	0	11,004
Working Appropriation	**$3,423**	**$84,241**	**$245,335**	**$2,165**	**$335,164**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

DHCD finished fiscal 2015 approximately $17.4 million below its legislative appropriation.

General Funds: The general fund appropriation was reduced by $1.6 million as part of the January 2015 across-the-board BPW reduction, including $1.4 million that was intended to be used to purchase replacement office furniture for the department's new headquarters at New Carrollton. DHCD instead used available special funds originally intended for another purpose (contractual services in energy programs).

Special Funds: The special fund appropriation decreased by $9.6 million compared to the legislative appropriation. Amendments increased the appropriation by $205,498 for the cost-of-living adjustment (COLA), and by $47,141 for the Annual Salary Review (ASR). Another amendment moved $4.5 million from the capital appropriation in the Division of Neighborhood Revitalization to the operating appropriation to be used for a down payment assistance program in Prince George's County, while a later amendment returned $2.5 million to the capital appropriation.

DHCD cancelled $11.9 million in special funds, approximately $7.7 million of which was in energy programs funded by EmPOWER Maryland and the CIF. The EmPOWER-funded programs slowed due to uncertainty about continuation of the programs, while CIF-funded programs were slow to launch. Also cancelled was $1.5 million due to lower than expected relocation costs, mainly furniture and equipment. The department also had cancellations of the following amounts either directly, or indirectly, due to staff shortages:

- $1.6 million due to lower than anticipated expenses for contractual services;
- $837,000 due to lower than expected salary expenses due to higher turnover related to the relocation; and
- $125,000 grants lower than expected due to staff shortages that impeded the awarding of grants.

Federal Funds: The federal fund appropriation decreased by $10 million compared to the legislative appropriation. Amendments increased the appropriation by $57,960 for the COLA and by $6,417 for the ASR.

DHCD cancelled $10.1 million in federal funds, including $6.9 million in lower than expected pass-through payments in the Section 8 rental assistance program due to lower than expected rental rates. Federal grant activity in the WAP and Energy Efficiency and Conservation Block Grant Program was lower than anticipated, resulting in the cancellation of $1.6 million. DHCD also cancelled:

- $891,700 due to lower than anticipated spending related to the Community Development Block Grant program and spending on Hurricane Sandy relief;
- $234,500 due to lower than anticipated expenses for contractual services;

- $113,400 due to salary savings from permanent and contractual vacancies; and

- approximately $400,000 due to other lower than expected costs.

Reimbursable Funds: Reimbursable funds were $3.8 million higher than the legislative appropriation due to the following amendments:

- $2.8 million from the Department of Human Resources Office of Home Energy Program for furnace replacement or repairs that are necessary prior to other weatherization activities in the LIEEP or the WAP, both of which do not allow furnace repair or replacement; and

- $1.0 million from the Department of Health and Mental Hygiene for Project Rental Assistance Demonstration, a housing subsidy for Medicaid recipients.

Fiscal 2016

The fiscal 2016 legislative appropriation increased by $10,890,000 in special funds and $114,000 in federal funds.

The special fund increase included:

- an $8,000,000 increase from EmPOWER Maryland for various energy efficiency programs. The fiscal 2016 allowance included these funds, but as PSC had not yet awarded the funds, the legislature deleted it from the budget and authorized the Governor to process an amendment to restore the appropriation after being awarded by PSC. PSC awarded the funds in May 2015;

- a $2,400,000 increase from the MHCF, to replace a $2,400,000 general fund budget reduction contingent on the enactment of Chapter 489 of 2015 (the Budget Reconciliation and Financing Act (BRFA)). Approval for the transfer from the MHCF was included in the BRFA of 2015; and

- an $80,000 increase from the General Bond Reserve Fund to backfill half of the 2% across-the-board general fund reduction included in the fiscal 2016 budget. The funds will be used in the Emergency Solution Grants program.

The working appropriation also increased by $410,000 in special funds and $114,000 in federal funds for salary increment increase.

Appendix 2

Audit Findings

Audit Period for Last Audit:	March 30, 2011 – June 30, 2014
Issue Date:	November 2015
Number of Findings:	6
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: DHCD did not monitor housing projects to ensure that rental units were reserved for low-income households as required.

Finding 2: Documentation of the proposal evaluation process for certain grants was not maintained.

Finding 3: Written procedures were lacking for performing and documenting program compliance monitoring of certain grants.

Finding 4: Receivable balances were not adequately reconciled with loan servicer records.

Finding 5: Controls over employee access to the single-family loan accounting system were not sufficient.

Finding 6: DHCD did not always comply with State procurement regulations.

Object/Fund Difference Report
Department of Housing and Community Development

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	337.00	337.00	339.00	2.00	0.6%
02 Contractual	51.44	71.00	71.50	0.50	0.7%
Total Positions	**388.44**	**408.00**	**410.50**	**2.50**	**0.6%**
Objects					
01 Salaries and Wages	$ 31,217,116	$ 32,172,528	$ 33,545,314	$ 1,372,786	4.3%
02 Technical and Spec. Fees	2,867,163	3,145,279	3,681,387	536,108	17.0%
03 Communication	411,848	329,218	346,266	17,048	5.2%
04 Travel	201,963	295,117	226,717	-68,400	-23.2%
06 Fuel and Utilities	60,000	253,000	253,000	0	0%
07 Motor Vehicles	187,527	343,971	182,599	-161,372	-46.9%
08 Contractual Services	19,710,281	31,997,076	30,866,294	-1,130,782	-3.5%
09 Supplies and Materials	322,954	290,450	290,450	0	0%
10 Equipment – Replacement	818,250	317,698	396,009	78,311	24.6%
11 Equipment – Additional	2,570,867	25,000	25,000	0	0%
12 Grants, Subsidies, and Contributions	246,847,013	261,383,796	266,924,837	5,541,041	2.1%
13 Fixed Charges	2,985,013	4,611,013	4,617,191	6,178	0.1%
14 Land and Structures	1,452,711	0	0	0	0.0%
Total Objects	**$ 309,652,706**	**$ 335,164,146**	**$ 341,355,064**	**$ 6,190,918**	**1.8%**
Funds					
01 General Fund	$ 8,100,954	$ 3,423,057	$ 4,546,000	$ 1,122,943	32.8%
03 Special Fund	60,952,784	84,241,362	88,739,225	4,497,863	5.3%
05 Federal Fund	236,273,968	245,334,727	245,904,839	570,112	0.2%
09 Reimbursable Fund	4,325,000	2,165,000	2,165,000	0	0%
Total Funds	**$ 309,652,706**	**$ 335,164,146**	**$ 341,355,064**	**$ 6,190,918**	**1.8%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Department of Housing and Community Development

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
20 Office of the Secretary	$ 7,109,229	$ 6,460,063	$ 6,555,890	$ 95,827	1.5%
22 Division of Credit Assurance	6,671,970	6,160,518	6,447,607	287,089	4.7%
24 Division of Neighborhood Revitalization	28,705,703	29,032,213	28,330,395	-701,818	-2.4%
25 Division of Development Finance	252,457,886	279,013,336	284,789,920	5,776,584	2.1%
26 Division of Information Technology	3,988,277	4,121,026	4,486,182	365,156	8.9%
27 Division of Finance and Administration	10,719,641	10,376,990	10,745,070	368,080	3.5%
Total Expenditures	**$ 309,652,706**	**$ 335,164,146**	**$ 341,355,064**	**$ 6,190,918**	**1.8%**
General Fund	$ 8,100,954	$ 3,423,057	$ 4,546,000	$ 1,122,943	32.8%
Special Fund	60,952,784	84,241,362	88,739,225	4,497,863	5.3%
Federal Fund	236,273,968	245,334,727	245,904,839	570,112	0.2%
Total Appropriations	**$ 305,327,706**	**$ 332,999,146**	**$ 339,190,064**	**$ 6,190,918**	**1.9%**
Reimbursable Fund	$ 4,325,000	$ 2,165,000	$ 2,165,000	$ 0	0%
Total Funds	**$ 309,652,706**	**$ 335,164,146**	**$ 341,355,064**	**$ 6,190,918**	**1.8%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Appendix 4

T00
Department of Commerce

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$71,859	$72,166	$92,879	$20,714	28.7%
Deficiencies and Reductions	0	20,000	-49	-20,049	
Adjusted General Fund	**$71,859**	**$92,166**	**$92,831**	**$665**	**0.7%**
Special Fund	84,570	50,002	51,073	1,070	2.1%
Deficiencies and Reductions	0	0	-15	-15	
Adjusted Special Fund	**$84,570**	**$50,002**	**$51,058**	**$1,056**	**2.1%**
Federal Fund	9,958	1,945	9,489	7,544	387.8%
Deficiencies and Reductions	0	0	-2	-2	
Adjusted Federal Fund	**$9,958**	**$1,945**	**$9,487**	**$7,542**	**387.7%**
Reimbursable Fund	298	266	206	-61	-22.8%
Adjusted Reimbursable Fund	**$298**	**$266**	**$206**	**-$61**	**-22.8%**
Adjusted Grand Total	**$166,684**	**$144,379**	**$153,581**	**$9,201**	**6.4%**

- The fiscal 2017 allowance includes a fiscal 2016 deficiency appropriation of $20 million in general funds for the Economic Development Opportunities Program to provide a four-year retention incentive to a division of Northrop Grumman located in Linthicum.

- After adjusting for fiscal 2016 deficiencies and a back of the bill reduction in health insurance, the fiscal 2017 allowance for the Department of Commerce increases by $9.2 million over the fiscal 2016 working appropriation. The increase in general funds is significantly understated due to the one-time fiscal 2016 deficiency appropriation. Absent the deficiency, general funds grow considerably, primarily due to the rebudgeting of the film production incentive program (from an off-budget tax credit program) and to an increase in funds under the Maryland Economic Development Assistance Authority and Fund.

Note: Numbers may not sum to total due to rounding.

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- Special funds increase mainly due to an increase in Video Lottery Terminal revenues dedicated to the Small, Minority, and Women-Owned Business Account. Additionally, federal funds increase due to the last installment of State Small Credit Business Initiative program.

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	217.00	208.00	206.00	-2.00
Contractual FTEs	17.60	17.95	20.40	2.45
Total Personnel	**234.60**	**225.95**	**226.40**	**0.45**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	10.05	4.88%
Positions and Percentage Vacant as of 12/31/15	23.00	11.06%

- The fiscal 2017 allowance reflects the abolition of 2.0 vacant positions in order to achieve budgetary savings: 1.0 administration position under the Office of Policy and Research and 1.0 industrial development supervisor within the Office of Strategic Industries and Entrepreneurship.

- At the end of calendar 2015, the department reported 23.0 full-time equivalent (FTE) vacancies; well above the amount needed to meet budgeted turnover in fiscal 2017 even with the proposed vacant position abolitions.

- Contractual staff increase by 2.45 FTEs, primarily due to the reopening of welcome centers.

Analysis in Brief

Major Trends

Department Reports Jobs Created or Retained: The department aims to develop and maintain a pipeline of projects resulting in facility location decisions and other projects that create or retain jobs. As a result of its actions, the department reports that 11,764 jobs were created or retained in fiscal 2015; an increase of about 9.7% over fiscal 2014.

Effort to Improve Business Friendliness – Difficult to Measure: National surveys of "business friendliness" often rank Maryland in an unfavorable light. There is a statewide effort to counteract this perception, although it is often difficult to measure progress. The department attempts to measure it by reporting on the number of issues that it was able to resolve for businesses. The department reports that it resolves issues related to financing, workforce, environmental concerns, marketing, permitting, and technical issues.

Biotechnology Investment Tax Credit: The Maryland Biotechnology Investment Tax Credit program aims to spur seed and early stage investment in eligible Maryland biotechnology companies. The popularity of the program has remained high, and funds have grown over the life of the program. Job creation is not considered a goal of the program, but rather to stimulate private investment in State businesses.

Issues

Maryland Economic Development and Business Climate Commission and the Newly Reorganized Department of Commerce: In fiscal 2014, the President of the Senate and the Speaker of the House appointed a private-sector commission to examine the structure, funding, and efficacy of the State's current economic development activities. The Maryland Economic Development and Business Climate Commission (Augustine Commission) had the charge to make policy and funding recommendations to improve the State's business climate and competitiveness. In Phase I, the commission recommended structural changes to the Department of Business and Economic Development to streamline its operations and to make it more customer focused. Legislation was enacted to effectuate these recommendations in fiscal 2015. This includes the renaming and the reorganizing of the Department of Commerce. The commission issued a report on the second phase of its work in January 2016 that included a thorough review of the State's tax structure and how it affects the perception of the State's business climate. **The Department of Legislative Services (DLS) recommends that the department brief the budget committees on its new structure and how that structure contributes to a more business-friendly culture. Additionally, DLS recommends that budget language be added that would transfer funds to the Maryland Technology Development Corporation to fund the support services related to the BioMaryland Center as intended by the Augustine Commission and by the General Assembly.**

Department's Efforts to Improve Program Evaluation: Measuring the effectiveness of economic development programs is a difficult task, and the department has often struggled with finding appropriate measures. However, several efforts are underway to improve program effectiveness and accountability. **DLS recommends that the department comment on its recent efforts to improve its program performance and how it has incorporated any changes into its programs.**

Reports on the Small, Minority, and Women-Owned Business Account: At the request of the Senate Budget and Taxation Committee, the department has prepared a report on its process for distributing the funds from the Small, Minority, and Women-Owned Business Account. The committee was concerned with delays in the deployment of funds and how the funds were distributed to fund managers and ultimately to small businesses. Additionally, the Office of Legislative Audits released a performance audit of this program in October 2015 raising some issues related, primarily, to the oversight of the fund managers. **DLS recommends that the department comment on the current status of the program. Further, DLS also recommends restricting funds from the program until the department submits a report on legislative or administrative solutions to better manage the program. The report should consider how to better measure performance of fund managers and of the program itself. Other changes to consider include the appropriate number of fund managers, use of existing regional development staff to administer the financial assistance from the program, the development of a different geographic designation, ways to streamline the Request for Proposal process each year, and a different structure for expense reimbursement.**

Recommended Actions

		Funds	Positions
1.	Add language authorizing the transfer of funds to the Maryland Technology Development Corporation for biotechnology business assistance activities.		
2.	Delete a long-term vacant position. Duties have been transferred to another agency.	$ 195,527	1.0
3.	Add language restricting funds pending a report on improvements to the Small, Minority, and Women-Owned Business Account.		
	Total Reductions	**$ 195,527**	**1.0**

Updates

Report on the State Small Business Credit Initiative: The fiscal 2016 budget bill included language that restricted funds under the department's Office of Finance Programs until the department submits a report on the activities under the State Small Business Credit Initiative (SSBCI). Since the receipt of the federal funds under the SSBCI, the department had been slow to deploy the funds and was at risk of losing the funds to the U.S. Department of the Treasury. However, several issues have been resolved and the program will be allotted its final installment of funding.

Major Grants: The department expects to award close to $21.7 million in various economic development, tourism, and arts related grants in fiscal 2017.

T00
Department of Commerce

Operating Budget Analysis

Program Description

The mission of the Department of Commerce (Commerce), formerly the Department of Business and Economic Development, is to strengthen the Maryland economy. Commerce develops and implements programs that aim to generate new jobs or retain existing jobs, attract business investment in new or expanding companies, and promote the State's strategic assets. The department's primary goals are to increase business investment in Maryland; enhance business success and the competitiveness of businesses in their distinct markets; and develop a diverse economic base and ensure that all jurisdictions share in the State's economic vitality.

The department's divisions include the Office of the Secretary; the Division of Business and Enterprise Development; the Division of Marketing and Communications; and the Division of Tourism, Film, and the Arts. The department's mission and goals are supported by these three divisions:

- ***Office of the Secretary:*** The Office of the Secretary provides leadership and direction to the activities of the department and maintains working relationships with State and federal agencies, county and municipal governments, businesses, and organizations. Included in the program are the offices of the Attorney General, Policy and Research, International Investment and Trade, Administration and Technology, Military and Federal Affairs, and the Division of Marketing and Communication. Also included under the purview of the Secretary is the Maryland Marketing Partnership.

- ***Division of Business and Industry Sector Development:*** This division unites the department's field staff, small business, and finance teams to provide assistance to the Maryland business community and to the department's local economic development partners. This division also includes the offices of Biohealth, Business Development, Strategic Industries and Entrepreneurship, and Cybersecurity and Aerospace. The division provides access to capital markets through a variety of financing programs, worker training assistance for new and expanding businesses, and funding assistance to local jurisdictions to support infrastructure and economic development efforts.

- ***Division of Tourism, Film, and the Arts:*** This division's mission is to strengthen the State's quality of life and encourage economic development by investing in and promoting Maryland's unique historic, cultural, and natural assets.

Business Assistance Programs

Commerce administers several primary business assistance programs. These programs provide resources upon which the Division of Business and Industry Sector Development draws when assembling incentives to help a business expand or locate in Maryland. The following are the five main assistance programs in the operating budget:

- ***Maryland Economic Development Assistance Authority and Fund:*** The Maryland Economic Development Assistance Authority and Fund (MEDAAF) was established by the General Assembly under Chapter 301 of 1999 as a revolving loan fund. The fund provides below market, fixed-rate financing in the form of loans, grants, conditional loans, conditional grants, and direct investment to local jurisdictions and businesses. Businesses, in particular those in growth industries that are locating or expanding in priority funding areas, are targeted. Funds may be used for property acquisition, construction, or renovation of buildings including tenant improvements and capital equipment.

- ***Maryland Small Business Development Financing Authority:*** This program provides financing assistance to socially or economically disadvantaged persons in Maryland. Legislation enacted as Chapter 172 of 2001 broadened the Maryland Small Business Development Financing Authority's (MSBDFA) scope to reach all businesses unable to obtain adequate, reasonable financing through private lending institutions due to credit criteria. A private contractor, currently Meridian Management Group, Inc., reviews the financing applications for presentation to the MSBDFA board. MSBDFA has four programs: Contract Financing Program, Long-Term Guaranty Program, Surety Bond Program, and Equity Participation Investment Program.

- ***Small, Minority, and Women-Owned Business Account:*** This program is designed to provide capital investments and loans for small, minority, and women-owned businesses that are primarily located in areas of the State with gaming facilities. The statute requires that 1.5% of the proceeds of video lottery terminals (VLT) at authorized locations across the State be deposited in the Small, Minority, and Women-Owned Business Account.

- ***Maryland Industrial Development Financing Authority:*** This program is designed to provide financing support to manufacturing, industrial, and technology businesses. The program provides the support by partnering with private-sector financing by issuing bonds and providing credit enhancements that increase access to capital for small and mid-size companies.

- ***Economic Development Opportunities Program Fund (Sunny Day Fund):*** This program provides conditional loans and investments to take advantage of extraordinary economic development opportunities, defined in part as those situations that create or retain substantial numbers of jobs and where considerable private investment is leveraged.

Types of Financing Assistance

Commerce's business assistance may take the form of investments, loans, conditional loans and grants, grants, and tax credits.

- ***Investments:*** Commerce considers investments the primary tool for business assistance. The agency purchases equity from companies to provide capital for them. Investments are made with the hope of an eventual financial return, but the timing and the amount of the return are unknown.

- ***Loans:*** Commerce loans are structured similar to conventional loans, but they have a favorable interest rate. The interest rate may scale down annually if the business is meeting or exceeding the job creation goals as agreed to in the loan documents. Likewise, the rate may scale up if the business is not meeting these goals.

- ***Conditional Loans and Grants:*** With conditional loans, repayment is forgiven if the business achieves employment goals. In effect, conditional loans become grants if conditions are met. Commerce treats conditional grants the same as conditional loans, but in some cases, a company may not want to account for Commerce assistance as debt, and so they receive a conditional grant. In other cases, conditional grants are used if a company must meet a target, such as completing a feasibility study, before the funds are awarded.

- ***Grants:*** With grants, there is no repayment of the funds, and no conditions are attached. Commerce does not often use this form of assistance.

- ***Tax Credits:*** The department administers several tax credit programs including the Biotechnology Investment Tax Credit; the Base Realignment and Closure Revitalization and Incentive Zone Program; the Brownfields Tax Incentive; the Enterprise Zone Tax Credits; the Job Creation Tax Credit; the One Maryland Tax Credit; the CyberMaryland Investment Incentive Tax Credit, the Film Production Activity Tax Credit, and the Research and Development Tax Credit. Only three programs, the Biotechnology Investment Tax Credit, the CyberMaryland Investment Incentive Tax Credit, and the Film Production Activity Tax Credit are budgeted within the department's appropriation.

Performance Analysis: Managing for Results

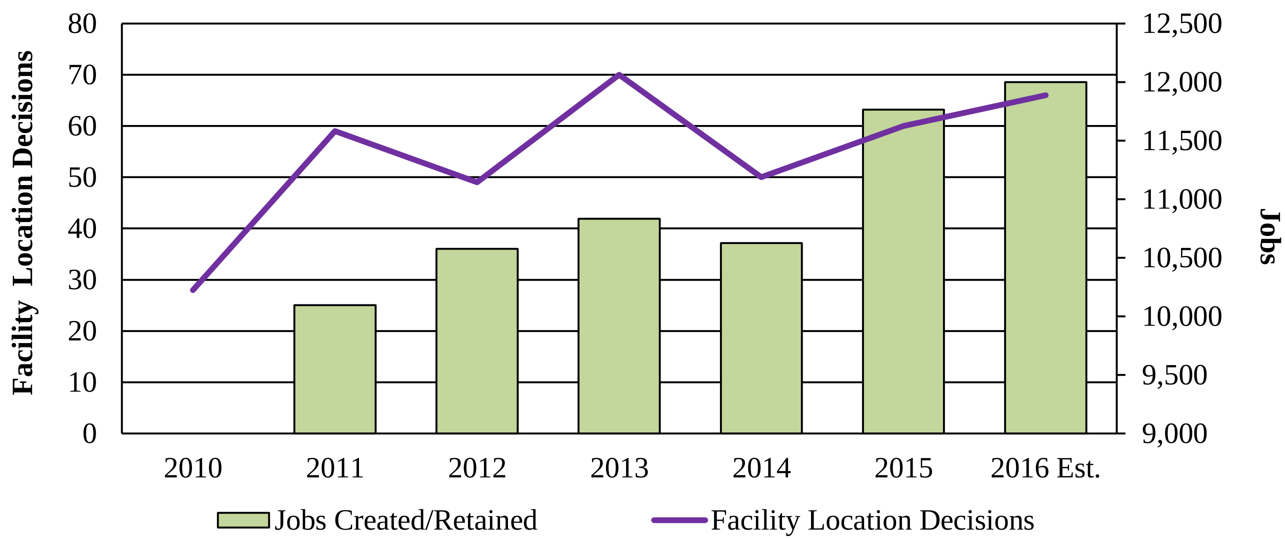
1. Department Reports Jobs Created or Retained

The department aims to develop and maintain a pipeline of projects resulting in facility location decisions and other projects that create or retain jobs. A facility location decision is defined as a statement by a top-level executive indicating a company's intention to locate in Maryland or to remain or expand in Maryland after considering potential locations outside the State and after intervention by the department. That intervention can include assistance related to workforce training, financing, marketing, permitting, or technical assistance.

Historically, the department's attempts to measure the impact of its activities have met with varied success. Many of the department's performance measures only show a few years of data. This is a result of several departmental reorganizations and of prior issues with the data collection and control procedures raised by the Office of Legislative Audits (OLA). Measures continue to evolve but show improvement.

Exhibit 1 shows the number of facility location decisions and the number of jobs created or retained. Data on jobs is not available prior to fiscal 2011. Jobs are counted as created or retained if there is a facility location decision or if the department was able to resolve a major issue for a company. The company must document the number of jobs created or retained before it may be counted. According to the data, the department was able to document a significant increase (10.7%) in jobs created or retained in fiscal 2015. Counted within the fiscal 2015 results are: 558 jobs created or retained at Pandora Jewelry in Howard County; 220 jobs created or retained at Thompson Creek in Prince George's County; and 800 jobs retained at McCormick and Company in Baltimore County. **DLS recommends that the department separately report the number of jobs created and the number of jobs retained, beginning in the fiscal 2018 budget cycle.**

Exhibit 1
Impact of Departmental Assistance
Fiscal 2010-2016 Est.



Source: Governor's Budget Books, Fiscal 2015-2016; Department of Budget and Management

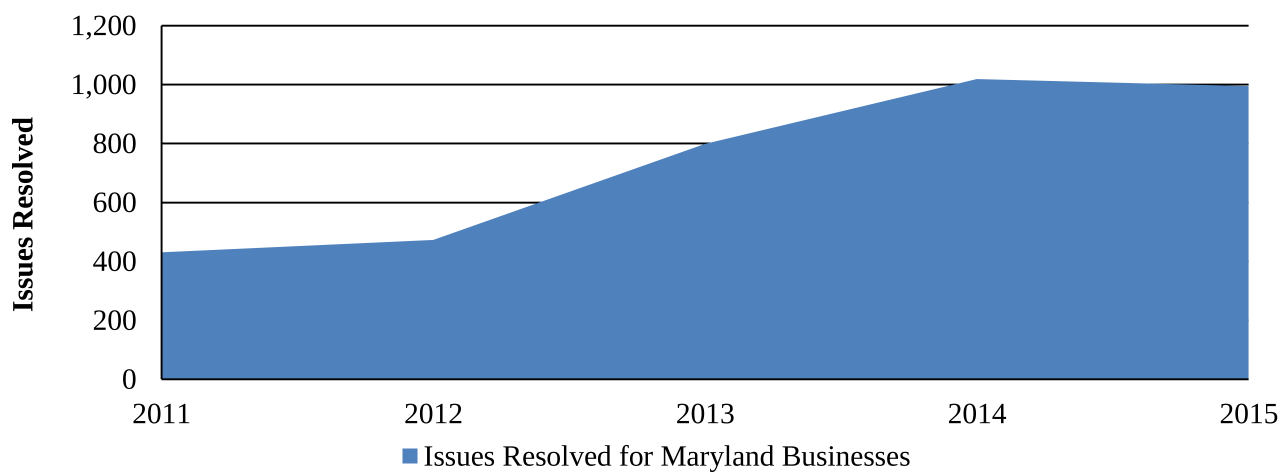
2. Effort to Improve Business Friendliness – Difficult to Measure

Several national surveys (Forbes, CNBC, and Tax Foundation) rank Maryland unfavorably in a variety of measures of friendliness to businesses. The General Assembly, through the work of the Maryland Economic Development and Business Climate Commission (Augustine Commission), and the Administration are attempting to address the issues raised by those surveys. A newly reorganized Commerce has developed an "open for business" marketing campaign and it has instituted customer service measures.

It is hoped that the State's efforts will improve the national standings; however, it may take time to move that needle. Tracking its progress through the Managing for Results (MFR) process is a useful means to ensure that efforts are having a positive impact over time. Currently, there are few measures that directly examine business friendliness. It is a concept that is often difficult to measure; as evidenced by the national surveys that consider dozens of factors. However, one current MFR measure is a reasonable proxy.

As shown in **Exhibit 2**, the department reports on the number of issues that it was able to resolve for businesses. The department reports that it resolves issues related to financing, workforce, environmental concerns, marketing, permitting, and technical issues. The number of issues resolved increased significantly in fiscal 2014 and remained high in fiscal 2015. The department should consider adding other measures to demonstrate how it is "open for business." Other measures could include the results of customer services surveys, outreach efforts, or random business surveys.

Exhibit 2
Measuring Business Friendliness
Fiscal 2011-2015



Source: Governor's Budget Books, Fiscal 2015-2016; Department of Budget and Management

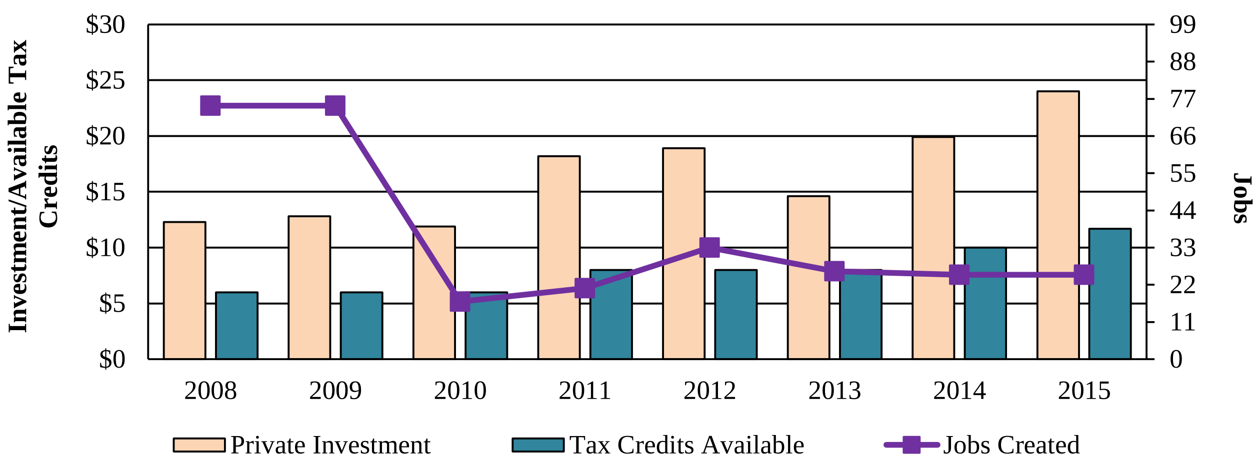
3. Biotechnology Investment Tax Credit

Budget language adopted in the fiscal 2010 budget bill restricted funds under the Maryland Biotechnology Investment Tax Credit program until the department submitted a report on goals, objectives, and outcome measures for the program. Prior to this, the department did not report this data through the MFR process. The language asked that the department consider including in MFR reporting the number of tax credit recipients, the amount of private investment leveraged, any new jobs created, long-term company retention data, and any other measure deemed reflective of the program's mission.

The department reports that the Biotechnology Investment Tax Credit is a highly successful program and a "key industry incentive that supports Maryland's robust Biotechnology industry." Applications for the credit generally exceed the available funding. Despite the popularity of the program, it does not appear that the tax credit has helped to spur many direct jobs. According to the department's MFR submission, in fiscal 2015, for the $11.7 million in appropriations for the credit, qualified companies created 24 jobs. That equates to over $486,000 in State investment per job.

Exhibit 3 shows the history of job creation under the credit. The department advises that job performance is not a precondition for selection or approval of qualified investors or companies. The department further advises that the goal of the program is not job creation but to stimulate the growth of a strategic industry sector. It should be mentioned that the tax credit will be subject to the Tax Credit Evaluation Act in 2016.

Exhibit 3
Selected Performance Measures
Fiscal 2008-2015
($ in Millions)



Source: Governor's Budget Books, Fiscal 2015-2016; Department of Budget and Management

Fiscal 2016 Actions

Proposed Deficiency

The fiscal 2017 allowance includes a fiscal 2016 general fund deficiency of $20 million under the Economic Development Opportunities Program, otherwise known as the Sunny Day Fund. The purported use of the deficiency is to "invest in aerospace and defense research" in the State. The purpose of the deficiency is to provide a retention incentive to Northrop Grumman's mission systems facility in Linthicum. Funds would be allocated in equal installments over four years. The company would be required to commit to capital investment of at least $100 million and the retention of at least 10,000 employees within Maryland. The incentive does not anticipate any new jobs. According to the department, the corporation would be held to these performance benchmarks for 10 years after the first disbursement of funds, scheduled for the current fiscal year. Before the department can disburse this incentive, approval must be obtained from the Legislative Policy Committee (LPC). The Department of Legislative Services (DLS) will prepare a comprehensive analysis on the proposed use of the Sunny Day fund for the benefit of LPC.

It has been several years since the Sunny Day Fund has had a general fund appropriation. **Exhibit 4** shows that, prior to the fiscal 2016 deficiency, the fund has not received general funds since fiscal 2002. Special funds have also declined significantly as most assistance from the fund takes the form of conditional grants or conditional loans, meaning the funds do not need to be repaid if the company meets certain benchmarks, such as employment goals or leveraging private investment.

One new project was approved in fiscal 2012 that required a total of $9.5 million in Sunny Day incentives over seven years. The special fund appropriations for fiscal 2012 through 2014 represent the first three installments for this project (the retention of employees at Bechtel Group Inc. in Frederick County). However, in October 2014, Bechtel announced its intention to move the majority of its employees to its existing facility in Northern Virginia. Chapter 489 of 2015 (the Budget Reconciliation and Financing Act) included a provision that any loan repayment to the Sunny Day Fund in fiscal 2015 and 2016 must instead be deposited into the General Fund. To meet the employment conditions required for the incentive, the corporation reported its employment numbers as of each December 31. Bechtel met several of its benchmarks, and as such, a portion of the incentive it received will be forgiven. However, it was required to repay over $3.1 million to the General Fund.

It should also be noted that Commerce has introduced a departmental bill (SB 1112 of 2016) that would create a new tax credit, narrowly drafted to benefit the corporation. The bill would provide a maximum of $7.5 million in tax credits to a qualified aerospace, electronics, or defense contract project, which creates or retains 10,000 jobs and spends $25.0 million a year on capital expenditures. This benefit would be in addition to the proposed Sunny Day incentive.

Exhibit 4
Sunny Day Fund
Annual Appropriations
Fiscal 2000-2017

Fiscal Years	General Funds	Special Funds
2000	$19,800,000	$24,375,000
2001	5,500,000	16,600,000
2002	11,625,000	4,250,000
2003	0	13,275,000
2004	0	0
2005	0	2,000,000
2006	0	5,690,000
2007	0	12,769,500
2008	0	5,500,000
2009	0	0
2010	0	0
2011	0	0
2012	0	2,000,000
2013	0	1,071,429
2014	0	1,071,429
2015	0	0
2016 Working [1]	20,000,000	0
2017 Allowance	0	5,000,000

[1] 2016 deficiency included in the fiscal 2017 allowance.

Source: Department of Business and Economic Development

The department should comment on the proposed incentive, how it fulfills the program's definition of an extraordinary economic opportunity, and what clawback measures would be tied to the performance benchmarks.

Cost Containment

In fiscal 2016, the Administration implemented an across-the-board cost containment initiative that included a general 2% reduction. Commerce relinquished a total of $1,084,000 in general funds for the initiative. Specifically, the department reduced grants to early stage biotechnology companies by $584,000 and reduced available tax credits to cybersecurity companies by $500,000.

Proposed Budget

After adjusting for fiscal 2016 deficiencies and a back of the bill reduction for health insurance, the fiscal 2017 allowance increases by $9.2 million, or 6.4% as shown in **Exhibit 5**. This increase is understated, however, due the significant one-time general fund deficiency ($20.0 million) in fiscal 2016 that obscures the growth in fiscal 2017.

Exhibit 5
Proposed Budget
Department of Commerce
($ in Thousands)

How Much It Grows:	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015 Actual	$71,859	$84,570	$9,958	$298	$166,684
Fiscal 2016 Working Appropriation	92,166	50,002	1,945	266	144,379
Fiscal 2017 Allowance	92,831	51,058	9,487	206	153,581
Fiscal 2016-2017 Amount Change	$665	$1,056	$7,542	-$61	$9,201
Fiscal 2016-2017 Percent Change	0.7%	2.1%	387.7%	-22.8%	6.4%

Where It Goes:

Personnel Expenses

Employee Retirement System	$324
Employee and retiree health insurance	261
Reclassification	140
Turnover adjustments	88
Other fringe benefit adjustments	-102
Abolished positions (2 full-time equivalents)	-218
Increments and other compensation	-526

Where It Goes:

Other Changes	
Film Production Activity Tax Credit program (to retain House of Cards production)	11,510
State Small Business Credit Initiative – federal fund pass-through to TEDCO	7,829
Second installment of Sunny Day incentive	5,000
Small Minority and Women-Owned Business Account	3,076
Cyber Maryland tax credit – restore mandated funding	1,000
Maryland Marketing Partnership	1,000
Maryland State Arts Council grans	776
Military and Veteran loan program	100
Contractual payroll – largely due to Welcome Centers	99
Net increase in grants, largely to benefit tri-county councils	98
Not-for-profit Development Fund program	-50
Rent	-71
Maryland Economic Adjustment Fund	-100
One-time Office of Tourism Grant	-104
Departmentwide communications and travel	-110
Departmentwide decline in advertising	-238
Fewer international trade shows and grants	-469
Removal of one-time Sunny Day deficiency	-20,000
Other	-112
Total	**$9,201**

TEDCO: Maryland Technology Development Corporation

Note: Numbers may not sum to total due to rounding.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency's share of these reductions is $48,934 in general funds, $14,670 in special funds, and $2,162 in federal funds. There is an additional across-the-board reduction to abolish positions statewide, but the amounts have not been allocated by agency.

Personnel

The fiscal 2017 allowance reflects the abolition of 2 vacant positions in order to achieve budgetary savings: 1 administration position under the Office of Policy and Research and 1 industrial development supervisor within the Office of Strategic Industries and Entrepreneurship. These eliminated positions are in addition to the across-the-board reduction to abolish positions statewide; which have not yet been allocated. The 2 abolished positions result in savings of approximately $218,000.

Partially mitigating the savings in personnel are increases to contractual staff. Overall, contractual staff increases by 2.45 full-time equivalents for an increase in costs of approximately $99,000 in general and special funds. The majority of the increase in contractual staff will be dedicated to staffing the Welcome Centers that are housed in rest stops across the State. Prior to fiscal 2011, the department provided operating funds and staff for the welcome centers as a means to promote tourism. The cost containment initiative of fiscal 2010 resulted in the closure of 6 of the 12 welcome centers in the State. The fiscal 2011 budget, as introduced, assumed the closure of an additional 4 centers. Since then, the department's Office of Tourism Development has taken steps to ensure the operation of as many centers as possible. With the additional contractual staff in the fiscal 2017 allowance, the office plans to open the Youghiogheny Overlook center in Garrett County and the Bay Country center in Queen Anne's County in fiscal 2017. A total of 8 centers will then be operational.

Financial Assistance Programs

Maryland Economic Development Assistance Authority and Fund

The MEDAAF is the department's primary and most flexible tool for business financial assistance. The fiscal 2017 allowance includes $13.7 million in general funds and $6.2 million in special funds. This represents a $6.4 million decline in special funds from fiscal 2016 but an increase of $6.4 million in general funds. It is also the sixth year in which the program has received a general fund infusion. Prior to fiscal 2012, the program had not received any general funds since fiscal 2007. It had operated on its special fund revenue and balance.

Exhibit 6 shows the fund balance summary for the MEDAAF for fiscal 2014 through an estimate for fiscal 2017.

The department is increasing the activity in the fund as the economy has improved. In fiscal 2012, the department committed $11.8 million in program activity, an increase from $8.9 million in activity in fiscal 2011. In fiscal 2013, the department expended $15.0 million for business assistance from the fund, and in fiscal 2014, over $18.3 million was encumbered. Fiscal 2015 marked a recent high level in MEDAAF activity. Several significant deals were closed in fiscal 2015 including conditional loans to MedImmune, McCormick and Co., and Amazon. Conditional loans may be forgiven in full or in part if the company meets certain performance benchmarks, usually related to employment of capital expenditures.

Exhibit 6
Department of Business and Economic Development
Maryland Economic Development Assistance and Authority Fund
Fund Balance Worksheet
Fiscal 2014-2017
($ in Thousands)

	Actual 2014	Actual 2015	Est. 2016	Est. 2017
Beginning Balance	**$23,468**	**$12,217**	**$5,158**	**-$1**
Revenues				
General Funds	$273	$7,423	$7,273	$13,673
Investment Income	498	393	737	534
Interest Income	465	357	286	219
Loan Repayments	2,226	5246	1,999	1,823
Loan Recoveries and Grant Repayments	796	17	2,829	2,633
Cancelled Prior Year Encumbrances	2,655	5449	3,000	3,000
Brownsfield Local Property Tax Cont.	2,754	3186	2,191	1,411
Other Income	498	552	320	319
Total Revenues	**$10,165**	**$22,623**	**$18,635**	**$23,612**
Total Funds Available	**$33,633**	**$34,840**	**$23,793**	**$23,611**
Expenditures				
Encumbrances/Approval Activity – Other	$18,349	$26,500	$19,850	$19,850
Rescissions of New Approvals	0	0	0	0
Operating Expenses	514	539	649	727
Indirect Expenses	2,553	2,643	3,295	3,035
Transfers to Rural Broadband Fund	0	0	0	0
Transfer to Nano-biotechnology Fund	0	0	0	0
Restricted Appropriation	0	0	0	0
Prior Period Operating/Indirect Adjustment	0	0	0	0
Total Expenditures	**$21,416**	**$29,682**	**$23,794**	**$23,612**
Ending Balance	**$12,217**	**$5,158**	**-$1**	**-$1**

Note: Numbers may not sum to total due to rounding.

Source: Governor's Budget Books, Fiscal 2017

As has been the case in recent years, the summary, as provided by the department, shows that the balance in the program is estimated to be depleted. However, the infusions of general funds over the last several years has delayed the depletion.

It should be noted that special funds within MEDAAF are used to defray other departmental operating cost, shown as "indirect expense" in the fund balance summary. The department uses special funds from a variety of its financing programs to pay the centralized costs required to administer the programs. MEDAAF's indirect costs are increasing in fiscal 2016 and 2017. This is because the program's share of department overhead is higher due to the transfer of the Maryland Venture Fund (MVF) from Commerce to the Maryland Technology Development Corporation (TEDCO). The transfer was part of a larger reorganization effort that will be discussed under the Issues section of this analysis.

Economic Development Opportunity Fund

The Sunny Day Fund provides conditional loans and investments to take advantage of extraordinary economic development opportunities, defined, in part, as those situations that create or retain substantial numbers of jobs and where considerable private investment is leveraged. Activity in the fund has fallen significantly in recent years.

The fiscal 2017 allowance includes $5 million in special funds for the program. This reflects a portion of the special fund balance that was augmented by the fiscal 2016 deficiency appropriation of $20 million in general funds. The purported use of the deficiency is to provide a retention incentive to Northrop Grumman.

Maryland Industrial Development Financing Authority

The fiscal 2017 allowance includes $7.8 million in federal funds for the Maryland Industrial Development Financing Authority. The funds are made available to the department due to the U.S. Department of the Treasury's State Small Business Credit Initiative (SSBCI). The allowance represents the third and final phase of a $23.0 million allocation to Maryland from the federal program. These funds will be transferred to TEDCO as a part of the reorganization as discussed under the Issues section of this analysis. Details on the SSBCI are included under an Update discussed further in this analysis and in the analysis for TEDCO.

Small, Minority, and Women-Owned Business Account

Statute requires that 1.5% of the proceeds of VLTs at authorized locations across the State be deposited in the Small, Minority, and Women-Owned Business Account (SMWOBA). The account is designed to provide capital investments and loans for small, minority, and women-owned businesses that are primarily located in areas of the State with gaming facilities. The fiscal 2017 allowance includes $13.7 million in special funds for the program, reflecting the latest estimates of VLT revenue. This represents an approximate $3.1 million increase from the amount budgeted in fiscal 2016.

At the request of the Senate Budget and Taxation Committee, the department has prepared a report on its process for distributing the funds from the SMWOBA. The committee was concerned with delays in the deployment of funds and how the funds were distributed to fund managers and ultimately to small businesses. Additionally, OLA released a performance audit of this program in October 2015 raising some issues related, primarily to the oversight of the fund managers. This is discussed in further detail under the Issues section of this analysis.

E-Nnovation Initiative Program and the Regional Institution Strategic Enterprise Zone Program

Chapter 533 of 2014 established the E-Nnovation Initiative Program under the department to provide matching funds to nonprofit institutions of higher education to create research endowments. Funds may be used to (1) finance research endowments at nonprofit institutions of higher education in scientific and technical fields of study; and (2) pay the related administrative, legal, and actuarial expenses of the department. Endowment proceeds must be expended to further basic and applied research in scientific and technical fields of study that offer promising and significant economic impacts and the opportunity to develop clusters of technological innovation in the State, including but not limited to engineering, health sciences, and cybersecurity. Funding is provided to the program through a portion of the admissions and amusement tax on electronic bingo and electronic tip jars and through general funds. The current fiscal year marks the first year of funding for the program – $8.0 million in special funds and $500,000 in general funds. The department had an ambitious first year and was able to convene the E-Nnovation Initiative Fund Authority, promulgate regulations, and make awards in the following manner:

- Johns Hopkins University – two awards for a total of $2.1 million;
- University of Maryland, Baltimore – two awards for a total award of $2.1 million;
- University of Maryland, College Park – two awards for a total award of $2.1 million;
- Morgan State University – one award of $1.0 million; and
- Washington College – one award of $1.0 million.

According to the department, the program funded fields of study that included mathematics, cybersecurity, virtual reality, environment, water and public health, bioengineering, neurogenetics, and human virology. The fiscal 2017 allowance again provides $8.0 million in special funds and $500,000 in general funds.

Chapter 531 of 2014 established the Regional Institution Strategic Enterprise (RISE) Zone Program. The stated purpose of the RISE Zone Program is to access institutional assets that have a strong and demonstrated history of commitment to economic development and revitalization in the communities in which they are located. A qualified institution may apply with a county, municipal corporation, or the economic development agency of a county or municipal corporation to Commerce for designation of an area as a RISE zone. A business entity that locates in a RISE zone is entitled to a property tax credit, an income tax credit, and priority consideration for assistance from the State's economic development and financial assistance programs.

To date, three institutions have applied to the department for a RISE Zone designation. According to the department, as of December 2015, it has approved one zone around the University of Maryland, Baltimore. No funds are provided in the budget as the benefits are primarily off-budget tax credits.

Other Financial Assistance Programs

The fiscal 2017 allowance includes $2.0 million in general funds for the CyberMaryland Investment Incentive Tax Credit program. This fulfills the mandate for the program. It does, however, represent an increase of $1.0 million. Chapter 489 reduced the mandate to $1.5 million for fiscal 2016. Due to less than expected demand for the program, the department was able to forgo an additional $500,000 for the 2% across-the-board cost containment initiative. To date, the department has committed $900,000 of the remaining fiscal 2016 working appropriation.

The fiscal 2017 allowance includes a small increase ($100,000) in special funds for the Military Personnel and Service Disabled Veteran Loan program. Conversely, there is an offsetting decrease ($100,000) in special funds under the Maryland Economic Adjustment Fund program. There are less special funds available under this program. The department uses this program to provide working capital loans at favorable terms to small and early stage cybersecurity companies that are located in areas affected by defense adjustments.

Tourism, Film, and the Arts

Maryland Tourism Development Board

The Maryland Tourism Development Board is charged with implementing State tourism marketing and development programs, in part, through grants to local and nonprofit tourism organizations. The fiscal 2017 allowance for the board is approximately $8.8 million, a marginal increase from the fiscal 2016 working appropriation. It should be noted that the allowance includes $8.25 million in general funds, well over the general fund mandate of $6 million.

Maryland State Arts Council

By statutory mandate, general funds allocated to the Maryland State Arts Council are required each year to increase by the expected percentage of growth in general fund revenues. Accordingly, the fiscal 2017 allowance increases by approximately $701,000.

The fiscal 2017 budget bill includes contingent language attached to the funds for the Preservation of Cultural Arts program that would transfer the funds ($2 million in special funds) from that program to the Maryland State Arts Council. The transfer is contingent on SB 377 and HB 451. The Special Fund for Preservation of Cultural Arts in Maryland is a special, nonlapsing fund in

Commerce that consists of State admissions and amusement tax revenue from electronic bingo and tip jar machine proceeds and any other money accepted for the benefit of the fund. The fund is intended to be used to provide supplemental grants to cultural arts organizations in the State that qualify for general operating support grants from the Maryland State Arts Council. These grants may not supplant other funding that the organization qualifies to receive. Due to the diversion of funds for cost containment and other budgetary purposes, the special fund has never been used for its intended purpose.

Film Production Activity Tax Credit Program

The fiscal 2017 allowance includes $11.5 million in general funds for the Film Production Activity Tax Credit program. This represents an increase because in fiscal 2016, the incentive was structured as an off-budget tax credit. However, in 2015, the General Assembly enacted Chapter 486, which established a mechanism for including the credits in the annual budget. The bill established a Maryland Film Production Activity Tax Credit Reserve Fund. The total amount of initial credit certificates issued by Commerce in each fiscal year cannot exceed the amount appropriated to this fund in the State budget. Although the legislation did not establish a mandate, it stated the intent of the General Assembly that the appropriation to the fund is equal to the amount that Commerce reports as necessary to (1) maintain the current level of film production activity in the State; and (2) attract new film production activity to the State. Commerce is required to report these amounts to the Governor and General Assembly by July 1 of each year.

The department did submit its report in July 2015. It concluded that it would need $14.4 million in its film incentive program to maintain the current level of film production and $46.75 million in order to attract new productions to the State. However, as mentioned above, the fiscal 2017 allowance includes $11.5 million for the program. This level of funding would be dedicated to one production: Netflix's House of Cards.

Given the level of budgeted funding, the department should comment on how its film office will market the State and what activities it will pursue in fiscal 2017.

Issues

1. Maryland Economic Development and Business Climate Commission and the Newly Reorganized Department of Commerce

In fiscal 2014, the President of the Senate and the Speaker of the House appointed a private-sector commission to examine the structure, funding, and efficacy of the State's current economic development activities. The Augustine Commission had the charge to make policy and funding recommendations to improve the State's business climate and competitiveness. In Phase I, the commission recommended structural changes to the Department of Business and Economic Development to streamline its operations and to make it more customer focused. Legislation was enacted to effectuate these recommendations in fiscal 2015. This includes renaming and the reorganizing of the Department of Commerce. The commission issued a report on the second phase of its work in January 2016, which included a thorough review of the State's tax structure and how it affects the perception of the State's business climate.

Newly Realigned Department

In Phase I, the commission found that Maryland businesses have multiple financial and technical assistance programs available to enable growth and success. However, too often, businesses are unaware of these programs or are confused as to how to apply for or utilize them. A primary finding of the commission was that State economic development agencies are not organized in a manner that (1) reflects the importance of their mission; (2) facilitates accountability; or (3) encourages ease of navigation.

To address this finding, Chapter 141 of 2015 was enacted and made several significant structural changes to the State's economic development agency. Further, the department made several administrative changes to be responsive to the commission's organizational findings and also on the commission's findings related to customer service needs.

Notably, Chapter 141 established a structure that allows the Secretary of the newly named Department of Commerce a place in the Governor's Office in order to provide a centralized focus on the State's economic development efforts and, specifically, to coordinate a Commerce Subcabinet. The subcabinet is designed to provide a forum for multiple State agencies to coordinate its response to business-related issues. The subcabinet consists of the heads of the agencies that most often interact with the business community, such as the Maryland Department of Transportation, the Department of Labor, Licensing, and Regulation; the Department of Housing and Community Development; and the Maryland Department of Planning, as well as the Governor's Office of Minority Affairs. The subcabinet had its inaugural meeting in December 2015 to discuss statewide customer service issues. The subcabinet plans to meet on a regular basis each year.

Additionally, Chapter 141 realigned programs for emerging business within TEDCO, leaving the newly named Department of Commerce to focus on its efforts to recruit new businesses and to retain and grow existing businesses. As such, the Maryland Enterprise Fund and its operating funds, as well as the programmatic grants under the BioMaryland Center, transferred to TEDCO. The department retained the nongrant functions of the center and renamed it the Office of Biohealth. It cites its new responsibilities as coordination and outreach related to the State's life sciences assets. It retained the license and access to four market research databases for Maryland biotech entrepreneurs developing business plans and funding applications. The databases include information regarding licensing opportunities, target markets, completion, federal approval statuses, and clinical trials. However, the department does not intend to either transfer these databases to TEDCO or to renew their licenses. The department intends to reallocate the funding associated with those databases (approximately $120,000) to a different biotechnology-related initiative. Anecdotal evidence before the Augustine Commission suggested that, while the information contained in the databases is helpful, physical access to it was prohibitive and time-consuming. The intent of the Augustine Commission was to transfer the BioMaryland Center to TEDCO, including the grant funding and support resources.

Chapter 141 also established a public-private marketing entity to create a branding strategy for the State; market the State's assets to out-of-state businesses; recruit out-of-state businesses to locate and grow in the State; and foster public-private partnerships that encourage the location and development of new businesses in the State. A board of directors is established, consisting of various members from the State government and private industry. The fiscal 2017 allowance includes $1 million to provide the start-up funding for this initiative. It is expected that the initiative will begin its work after the final appointment of the board members. The board will then be able to set benchmarks for appropriate fundraising levels from the private sector. Further, the department expects that a plan will be in place that will allow it to contract with a creative services and branding agency at the start of the fiscal year. It should be noted that the marketing entity must submit a report to the General Assembly on October 1 of each year to detail the marketing operations and activities.

Administratively, the department has reorganized some of its programs into a Division of Business and Industry Sector Development. This division addresses a recommendation of the Augustine Commission to strengthen regional outreach efforts by increasing the number of regional representatives. It also targets specific industries for growth. For example, the department now has an Office of Strategic Industries and Entrepreneurship and an Office of Cybersecurity and Aerospace. It is understood that it is important for economic development agencies to be nimble and adaptable to changes in the marketplace. However, it is also important to note that frequent reorganizations may make it difficult for the business community to navigate the new structure and to utilize services. It is also difficult for any meaningful long-term performance analysis as goals, objectives, and performance measures change.

Phase II of the Augustine Commission

The commission issued its Phase II report in January 2016. The work of the commission in this phase focused on Maryland tax structure and the components of that structure that contribute or detract from the State's business climate. The findings and recommendations contained in the report primarily relate to tax rates, tax administration and tracking, and other issues that were seen as having an impact on the State's business climate. Among the findings were several that related, at least tangentially, to the department and its programs. Chiefly, the report finds that there are "too many, too small, and often uncoordinated and ineffectual tax credit and incentive programs targeting economic development in the State." The report recommends that tax credits be rigorously evaluated and that changes be made to existing tax credits to assure that the programs are effective. Suggested improvements include simplifying statutes, adequately funding effective programs; assuring program transparency; and developing rational and coherent outcomes. To that end, SB 843 of 2016 has been introduced to expand the evaluations under the current Tax Credit Evaluation Act and to sunset several tax credits in calendar 2021 that are not currently subject to sunset provisions, including the enterprise zone, One Maryland, biotechnology, businesses that create new jobs, and RISE Zone tax credits. The bill aims to improve the evaluation of tax credits and seeks to combat the Augustine Commission's report finding that "evidence that tax credits help businesses create or maintain jobs is mixed."

DLS recommends that the department brief the budget committees on its new structure and how that structure contributes to a more business-friendly culture. Additionally, DLS recommends that budget language be added that would transfer funds to TEDCO to fund the support services related to the BioMaryland Center as intended by the Augustine Commission and by the General Assembly.

2. Department's Efforts to Improve Program Evaluation

Measuring the effectiveness of economic development programs is a difficult task, and the department has often struggled with finding appropriate measures. However, several efforts are underway to improve program effectiveness and accountability.

First, the department is participating in a multistate initiative conducted by The Pew Charitable Trusts and the Center for Regional Economic Competitiveness to review the effectiveness of state business incentive programs. While a final report has yet to be released, the organizations have issued a preliminary assessment of Maryland's programs. In general, that assessment noted that Maryland has a strong system of performance measurement and evaluation in place, but there is room for improvement. Also, the study noted that, based on its count, Maryland has 72 business incentives in place, the second highest state in their database. However, it should be noted that this study counted several programs that are not economic development programs, but in fact have other policy goals. For example, the study includes the Clean Energy Incentive Tax Credit as a business incentive program. Suggested improvements from the early assessment include enhancing data collection and data sharing practices and improving business reporting requirements.

The General Assembly has also sought to improve the department's program evaluation. Chapter 569 of 2012 established a process for evaluating State tax credits through a legislative evaluation committee. To date, the committee has evaluated the One Maryland program and the Enterprise Zone program. The Biotechnology Incentive Tax Credit will be reviewed in fiscal 2016. Chapter 150 of 2013 established the Maryland Jobs Development Act that requires the department to compile data and report annually on specified economic development programs administered by the department. The department has complied with this requirement beginning in fiscal 2013. These reports track the performance of 15 departmental programs and include data on the number of jobs created, the number of jobs retained, and the estimated amount of State revenue generated based on economic models.

Finally, the department is undertaking an internal review, with the assistance of the Maryland Economic Development Corporation, of all their incentive programs and how they can be improved. At the writing of this analysis, the report is yet to be released. However, early reports indicate that it will suggest several significant changes to the department's current programs.

DLS recommends that the department comment on its recent efforts to improve its program performance and how it has incorporated any changes into its programs.

3. Reports on the Small, Minority, and Women-Owned Business Account

At the request of the Senate Budget and Taxation Committee, the department prepared a report on its process for distributing the funds from the SMWOBA. The committee was concerned with delays in the deployment of funds and how the funds were distributed to fund managers and ultimately to small businesses. Additionally, OLA released a performance audit of this program in October 2015 raising some issues, primarily related to the oversight of the fund managers.

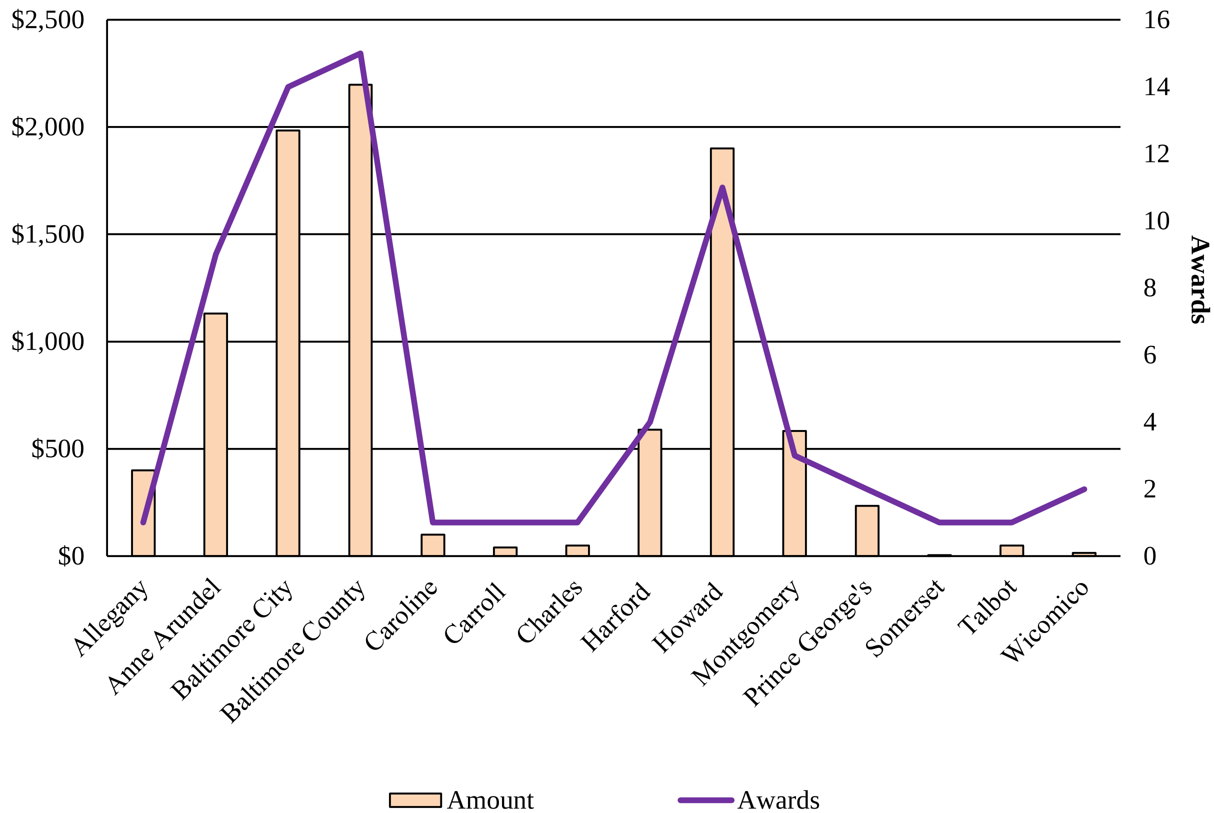
Report on Distribution of Funds

In August 2015, at the request of the Senate Budget and Taxation Committee, the department prepared a report on its process for distributing the funds from the program; primarily related to the geographic distribution of funds. The statute requires that 50% of the funds in the program be allocated to businesses located in the jurisdictions and communities that surround the State's gaming facilities. The statute did not define the parameters of that requirement. The department and the Board of Public Works (BPW) convened a workgroup to determine the legislative intent. The workgroup settled on target areas that are within a 10-mile radius of each of the facilities.

It is important to note that up to 50% of the available funds are not limited to the geographical restrictions outlined by the workgroup. However, it may be limited to the marketing reach of the program's fund managers. **Exhibit 7** shows fiscal 2015 disbursements by the fund by jurisdiction. This exhibit includes only those jurisdictions where an award was made. All other counties received no funding in fiscal 2015.

The report that was submitted to the Senate Budget and Taxation Committee acknowledges concerns about the 10-mile radius limitation. Specifically, it notes that this restriction may not make sense, especially in rural areas of the State. Additionally, the department engaged its fund managers to make a "good faith" effort to contact businesses in rural areas.

Exhibit 7
Small, Minority, and Women-Owned Business Account Distribution by Jurisdiction
Fiscal 2015
($ in Thousands)



Source: Department of Commerce

Legislative Audit

In October 2015, OLA released its performance audit of the SMWOBA program. The audit contained seven findings. In general, the audit revealed that the program lacked both clear established goals, and adequate oversight protocols.

The report notes that there are no goals or expectations of the program beyond the general purpose that is outlined in statute. It is suggested that there should be objectives related to desired economic impact, targeted industries, or types of businesses. It is difficult to assess the success of a program, much less the success of the contracted fund managers, without establishing measurable objectives.

Additionally, the audit raised concerns about the level of financial reporting, contract compliance monitoring, and fund manager performance. The audit notes that fund managers are not required to submit interim financial reports of grant activity. Further, the department did not establish any process to verify that fund managers were complying with their contract requirements. Additionally, contract modifications for an increased payment to a fund manager were made without BPW approval (statute tasks BPW with overall administration of the program).

In general, BPW and the department agreed with the findings in the audit. In fact, some changes have been made. Specifically, the department now requires interim reporting from the fund managers including annual audited financial statements, monthly bank statements and reconciliations, and monthly activity reports through the department's portfolio management services. It should be noted, however, that in testimony before the Joint Committee on Gaming, some fund managers expressed frustration over the amount of reporting requirements.

Other Observations

Components of the administration of the program appear to be overly cumbersome. The department, in a laudable attempt to reach as many small businesses as possible, has issued several Request for Proposals (RFP) for fund managers over several years of program funding. Additionally, the use of multiple fund managers requires the maintenance of several bank accounts and multiple levels of financial reporting. Unfortunately, the use of multiple fund managers does not appear to be resulting in the desired geographic distribution of awards. Finally, fund managers are provided 8% of their award amounts for start-up expenses and are allowed to apply for reimbursement of excess expenses at the end of each calendar year. There appears to be a wide range of reimbursement requests among the contracted managers.

These issues will only be magnified if not resolved soon. The program is expected to grow significantly with the opening of an additional gaming facility and as loan repayments are paid back into the fund. **Exhibit 8** shows the first three years of program funding and the awards made to fund managers.

DLS recommends that the department comment on the current status of the program. Further DLS also recommends restricting funds from the program until the department submits a report on legislative or administrative solutions to better manage the program. The report should consider how to better measure performance of fund managers and of the program itself. Other changes to consider include the appropriate number of fund managers, use of existing regional development staff to administer the financial assistance from the program instead of fund managers, the development of a different geographic designation, ways to streamline the RFP process each year, and a different structure for expense reimbursement.

Exhibit 8
Small, Minority, and Women-Owned Business Account Awards to Fund Managers
Fiscal 2013-2015
($ in Thousands)

	Amount Awarded
Fiscal 2013	
Anne Arundel Economic Development	$3,360
Maryland Capital Enterprises	1,000
Meridian Management Group	3,500
Total	**$7,860**
Fiscal 2014	
Anne Arundel Economic Development	$2,000
Baltimore County	1,500
Baltimore Development Corporation	1,000
Howard County	1,500
Maryland Capital Enterprises	0
Meridian Management Group	2,000
Tri-county Council of Western Maryland	1,100
Total	**$9,100**
Fiscal 2015	
Anne Arundel Economic Development	$2,000
Baltimore County	1,750
Baltimore Development Corporation	1,600
Howard County	1,750
Maryland Capital Enterprises	1,000
Meridian Management Group	2,000
Tri-county Council of Western Maryland	1,000
Total	**$11,100**

Source: Department of Commerce

Recommended Actions

1. Add the following language to the general fund appropriation:

, provided that $400,000 of this appropriation made for the purpose of biotechnology business support may not be expended for that purpose and instead may only be transferred by budget amendment to the Maryland Technology Development Corporation (program T50T01) to fulfil the intent of the General Assembly as established in Chapter 141 of 2015. Funds not used for this restricted purpose may not be expended or otherwise transferred and shall revert to the General Fund.

Explanation: Chapter 141 was legislation that resulted from the report of the Maryland Economic Development and Business Climate Commission (known as the Augustine Commission). It expressed the intent of the General Assembly that the BioMaryland Center, the office within the Department of Commerce that supports the growth of early stage biotechnology companies in Maryland, be transferred to the Maryland Technology Development Corporation on or before January 1, 2016. To date, only the grant funding was transferred to the corporation. This language would transfer sufficient funds to allow the corporation to provide support services to grantees and would allow funding for the licenses of biotechnology market research databases.

		Amount Reduction		Position Reduction
2.	Delete a long-term vacant senior position under the Office of BioHealth (formerly the BioMaryland Center). The duties associated with this long-term vacant position have been fulfilled by existing staff and by the transfer of programmatic funding and functions to the Maryland Technology Development Corporation.	$ 195,527	GF	1.0

3. Add the following language to the special fund appropriation:

, provided that $100,000 of this appropriation made for the purpose of fund manager expense reimbursement may not be expended until the Department of Commerce submits a report to the budget committees on ways to improve the administration of the Small, Minority, and Women-Owned Business Account. The report should consider legislative and administrative changes related to the procurement, oversight, and reimbursement of fund managers; geographic distribution of program assistance; and program performance evaluation. The report shall be submitted by December 1, 2016, and the budget committees shall have 45 days to review and comment. Funds restricted pending the receipt of the report may not be transferred by budget amendment or otherwise to any other purpose and shall be canceled if the report is not submitted to the committees.

Explanation: Based on issues raised in a legislative performance audit and on concerns about geographical distribution of program assistance, the Small, Minority, and Women-Owned Business Account is underperforming. This language requires the Department of Commerce to find solutions to the issues raised on the effectiveness of the program.

Information Request	**Author**	**Due Date**
Report on improvements to the Small, Minority, and Women-Owned Business Account	Department of Commerce	December 1, 2016

Total General Fund Reductions	**$ 195,527**	**1.0**

Updates

1. Report on the State Small Business Credit Initiative

Fiscal 2015 budget bill language restricted funds within the Department of Commerce (previously the Department of Business and Economic Development) until a report was submitted detailing the delayed implementation of the SSBCI. The budget language read as follows:

> , provided that $100,000 of this appropriation made for the purpose of funding the Office of Finance Programs may not be expended until the Department of Business and Economic Development submits a report on its activities under the State Small Business Credit Initiative. The report shall include a discussion on the delayed implementation of the program and a detailed accounting of the administrative cost of the initiative by departmental program.
>
> Further provided that the budget committees shall have 45 days to review and comment from the date of the receipt of the report. Funds restricted pending receipt of the report may not be transferred by budget amendment or otherwise to any other purpose and shall be canceled.

Background

In fiscal 2011, the department was awarded a total of $23.0 million from the U.S. Department of the Treasury in support of the SSBCI Act of 2010. This federal program was designed to utilize existing state economic development programs to increase the capital available to small business. The federal funds were originally made available in three tranches to be utilized in the following programs: the Maryland Industrial Development Financing Authority (MIDFA), MSBDFA, and the MVF. In fiscal 2012, the first tranche, approximately $4.7 million of this award, was included in the department's budget. However, a significant portion of the funds was canceled due to the department's inability to disburse the funds. Similarly, in fiscal 2013, a budget amendment appropriated $19.6 million, the remainder of the tranches, in funds under the program. The department had initially anticipated a speedy disbursement of the funds. However, the department continued to have difficulty in deploying the funds; primarily related to MSBDFA and MIDFA programs. Both programs specialize in loans and loan guarantees. However, the business appetite for this type of assistance has proved limited in the current banking environment. Approximately $18.0 million was subsequently canceled. A similar pattern occurred again in fiscal 2014. As of fiscal 2014, of the total award of $23.0 million, only $6.3 million had been spent.

The U.S. Department of the Treasury expressed dissatisfaction with the slow deployment of the funds. In fact, the department was at risk of forgoing the third tranche of the funds if it did not commit the remainder of the first tranche and the full second tranche by June 2015. An additional complication arose when it was determined that the MVF might not meet the technical definition of "accredited investor," a requirement to deploy venture investments under the SSBCI program.

Additionally, DLS raised concerns regarding how the program allocated the funds used for administrative expenses. It should be noted that administrative expenses under the MSBDFA program are disproportionately high. The expenses account for 197.0% of what was deployed through the program in fiscal 2012 through 2014. This is compared to 7.0% and 0.8% for MIDFA and the MVF, respectively.

Progress Report

To address the issues raised by DLS and the U.S. Department of Treasury, Commerce took several steps. First, it undertook the necessary technical changes that enabled it to meet the federal standard of accredited investor. Second, the department developed an alternative deployment plan that reallocated the bulk of funds to the MVF, the program most likely to commit the funds. The demand for venture funding has far outpaced the demand for loans and loan guarantees. This required the approval of the U.S. Department of Treasury. Third, the department worked to actually commit the funds from the first two tranches and developed a pipeline for the third. By the end of January 2015, the department met the investment threshold (80% of first tranche) to be eligible for the full second tranche. To date, over $12.3 million has been committed. Further, the report detailed a pipeline with a value of $14.4 million in potential future investments.

Related to DLS concerns on the administrative expenses charged by program, the department reports that there were no administrative expenses charged against the SSBCI funds. While there was an initial attempt to allocate expenses by program, the department found the federal reporting requirements too onerous and instead opted to absorb the expenses to manage the program, thereby using all the federal funds for programmatic uses.

Chapter 141 transfers early stage business investment programs, including the MVF, from Commerce to TEDCO. This legislation was based on recommendations from the Maryland Economic Development and Business Climate Commission. As such, the oversight of the remaining funds under the SSBCI will be transferred to TEDCO. The department and TEDCO has entered into an inter-agency agreement to ensure the proper administration and oversight of the program.

2. Major Grants

The department awarded $33.6 million in fiscal 2015 as shown in **Exhibit 9**. The exhibit also shows that another $23.8 million is being disbursed in the current fiscal year. A decrease in grants is budgeted in fiscal 2017.

Exhibit 9
Department of Commerce
Summary of Major Grants
Fiscal 2015-2017

	Actual 2015	Appropriation 2016	Allowance 2017
Office of the Secretary			
Office of International Trade and Development			
Maryland Israel Development Corp.	$275,000	$275,000	$275,000
World Trade Center Institute	275,000	225,000	225,000
Export Maryland – Small Business Foreign Trade Grants	320,574	482,712	244,973
Military/Federal and BRAC Assistance			
Southern Maryland Navy Alliance	26,334	26,334	26,334
Army Alliance	26,334	26,333	26,334
Montgomery County – White Oak	15,333	15,333	15,333
Fort Meade Alliance	26,334	26,334	26,334
Fort Dietrick Alliance	24,583	21,583	24,583
Maryland Maritime Alliance	28,833	28,833	28,833
Indian Head Alliance	21,583	21,583	21,583
Andrews Air Force Base, Business Roundtable of Prince George's County	26,333	26,333	26,333
BRAC Support	0	41,334	23,984
Subtotal	***$1,066,241***	***$1,216,712***	***$964,624***
Division of Business and Industry Sector Development			
Office of Biohealth			
Biotech Translational Research and Commercialization Grants	$1,364,954	$0	$0
Biotech Institute of Maryland			
Other Biotech Grant Support	133,836	21,142	13,978
Workforce Development and Coordination			
Governor's Workforce Investment Board	26,635	26,635	26,635
Small Business			
Small Business Development Center/University of Maryland – Procurement Technical Assistance Program	140,000	140,000	140,000
University of Maryland – Small Business Development Center	85,400	85,400	85,400
National Veterans Institute for Procurement	150,000	150,000	0
Not-for-profit Development Fund Grants	0	87,800	73,900
Department of General Services Not-for-profit Procurement Study	77,200	72,000	36,100

	Actual 2015	Appropriation 2016	Allowance 2017
Community Development			
Appalachian Regional Commission	13,844	15,748	13,844
Tri-County Council of Western Maryland	150,000	150,000	200,000
Tri-County Council of Southern Maryland	150,000	150,000	200,000
Mid-Shore Regional Council	150,000	150,000	200,000
Tri-County Council Lower Shore	150,000	150,000	200,000
Upper Shore Regional Council	150,000	150,000	200,000
Economic Alliance of Greater Baltimore	62,333	75,000	62,000
Technology Development			
Technology Council of Maryland	100,000	60,000	60,000
Greater Baltimore Technology Council	62,500	60,000	55,000
Chesapeake Regional Technology Council	60,000	60,000	55,000
Manufacturing Extension Partnership	250,000	250,000	250,000
Other/TBD	15,500	15,000	15,000
Cybersecurity Industry Support/TBD	30,000	302,500	330,000
Mid-Atlantic Aviation Partnership	50,000	0	0
Cybersecurity Roundtable	250,000	0	0
Advance Maryland	60,000	0	0
Dream-It	50,000	0	0
Subtotal	***$3,732,202***	***$2,171,225***	***$2,216,857***
Division of Tourism, Film, and the Arts			
Tourism			
Capital Region USA, Inc.	$239,500	$400,000	$400,000
Star Spangled 200, Inc.	2,000,000	0	0
Maryland Tourism Education Foundation	0	0	0
Maryland Sportsmen's Foundation	0	0	0
Maryland Tourism Council	35,000	40,000	40000
Maryland Academy of Sciences	450,000	0	0
Living Classrooms Foundation and Friends of Fort McHenry	35,000	0	0
Reginald F. Lewis Museum of Maryland African American History	18,939	0	0
Star Spangled 200, Incorporated	210,764	0	0
Pride of Baltimore	125,000	0	0
National Park Service, Chesapeake Bay	70,321	0	0
Fort McHenry	80,000	0	0
Dundalk Patapsco Neck Historical Society	26,250	0	0
War of 1812 Grants (Various Recipients)	119,259	0	0
County Cooperative Grants (Various Recipients)	2,500,001	2,500,000	2500000
Various Other Tourism Grants	32,000	250,000	250000
Subtotal	***$5,942,033***	***$3,190,000***	***$3,190,000***

	Actual 2015	Appropriation 2016	Allowance 2017
Maryland State Arts Council – Grants for Organization (GFO)			
Academy Art Museum	$102,427	$89,770	$0
Adventure Theatre – Musical Theatre Center	100,000	105,000	0
AFI Silver Theatre and Cultural Center	110,000	115,500	0
American Dance Institute	60,000	85,000	0
American Visionary Art Museum	175,650	201,450	0
Annapolis Chorale	0	25,877	0
Annapolis Symphony Orchestra	81,979	75,556	0
ArtStream, Inc.	0	29,450	0
Avalon Foundation, Inc.	111,646	112,830	0
Ballet Theatre of Maryland, Inc.	54,670	52,218	0
Baltimore Choral Arts Society	41,900	41,044	0
Baltimore Clayworks, Inc.	71,452	71,533	0
Baltimore Symphony Orchestra, Inc.	1,824,061	1,808,590	0
Baltimore's Festival of The Arts, Inc.	62,912	64,643	0
BlackRock Center for the Arts	54,021	73,000	0
Center Stage Associates, Inc.	483,895	535,523	0
Chesapeake Shakespeare Company	0	35,000	0
City of Gaithersburg	33,411	37,557	0
Class Acts Arts, Inc.	66,471	61,999	0
Columbia Center for Theatrical Arts, Inc.	28,000	30,728	0
Columbia Festival, Inc.	32,787	30,000	0
Common Ground on the Hill	33,174	37,573	0
Concert Artists of Baltimore	28,283	27,032	0
Creative Alliance, Inc.	119,584	130,398	0
Dance Exchange, Inc.	45,069	38,439	0
Frostburg State University	40,000	36,608	0
Glen Echo Park Partnership for Arts and Culture, Inc.	90,000	100,000	0
Hippodrome Foundation, Inc.	0	26,010	0
Imagination Stage, Inc.	323,677	325,015	0
Jewish Community Center of Greater Washington	33,560	40,000	0
Jewish Museum of Maryland	54,208	50,350	0
Lumina Studio Theatre	25,663	0	0
Maryland Art Place, Inc.	30,494	27,345	0
Maryland Classic Youth Orchestras, Inc.	37,279	38,036	0
Maryland Hall for the Creative Arts	106,143	135,000	0
Maryland Institute College of Art	30,000	0	0
Maryland-National Capital Park and Planning Commission, Arts and Cultural Heritage	276,202	250,672	0
Metropolitan Center for the Visual Arts (VisArts)	40,000	50,000	0
National Council for the Traditional Arts	45,739	42,218	0

	Actual 2015	Appropriation 2016	Allowance 2017
National Philharmonic	176,355	159,887	0
Olney Theatre Center	230,000	260,000	0
Producer's Club of Maryland – Maryland Film Festival	30,000	0	0
Pyramid Atlantic Art Center	36,423	35,806	0
Round House Theatre	198,963	219,911	0
Shriver Hall Concert Series	32,930	34,222	0
Strathmore Hall Foundation, Inc.	555,607	540,111	0
The Baltimore Museum of Art	875,203	835,013	0
The Delaplaine Visual Arts Education Center	45,000	43,239	0
The Everyman Theatre, Inc.	161,829	205,703	0
The Lyric Foundation, Inc.	200,000	275,000	0
The Maryland-National Capital Park and Planning Commission, Area Operations	45,346	46,000	0
The Maryland Symphony Orchestra, Inc.	89,760	89,023	0
The Puppet Company	38,752	34,586	0
The Walters Art Museum	975,922	892,461	0
The Ward Museum of Wildfowl Art	66,073	66,160	0
The Writer's Center	58,917	68,718	0
University of Maryland Baltimore County – Center for Art, Design, and Visual Culture	26,199	26,062	0
University of Maryland, College Park-David C. Driskell Center	40,000	33,371	0
University of Maryland – Clarice Smith Performing Arts Center	365,000	335,000	0
Washington County Museum of Fine Arts	72,802	76,726	0
Washington Revels, Inc.	27,000	32,000	0
Waterfowl Festival, Inc.	60,000	55,000	0
WBJC-FM	39,267	50,000	0
Weinberg Center for the Arts/City of Frederick	105,919	100,796	0
World Arts Focus dba Joe's Movement Emporium	71,092	63,007	0
Young Audiences of Maryland, Inc.	128,286	138,000	0
Various Other GFO grants	1,092,237	1,941,170	11,940,379
Subtotal	***$10,699,239***	***$11,693,936***	***$11,940,379***
Community Arts Development			
Allegany Arts Council, Incorporated	$97,187	$99,846	$0
Arts and Humanities Council of Montgomery County	137,095	141,158	0
Arts Council of Anne Arundel County, Inc.	117,591	120,866	0
Arts Council of Calvert County	97,904	100,608	0
Baltimore County Commission on Arts and Sciences	128,900	132,377	0
Baltimore Office of Promotion and The Arts	120,399	123,569	0
Caroline County Council of Arts, Inc.	95,459	98,102	0

	Actual 2015	Appropriation 2016	Allowance 2017
Carroll County Arts Council	101,166	103,939	0
Cecil County Arts Council, Inc.	98,388	101,116	0
Charles County Arts Alliance, Inc.	100,544	103,375	0
Dorchester Center for the Arts, Inc.	95,458	98,104	0
Frederick Arts Council, Inc.	104,291	107,212	0
Garrett County Arts Council, Inc.	95,340	97,979	0
Harford County Public Library	104,621	107,489	0
Howard County Arts Council	106,964	110,043	0
Kent County Arts Council	94,920	97,553	0
Prince George's Arts and Humanities Council	131,738	135,721	0
Queen Anne's County Arts Council, Inc.	96,129	98,804	0
Salisbury Wicomico Arts Council	98,345	101,079	0
Somerset County Arts Council	95,187	97,814	0
St. Mary's County Arts Council	98,715	101,461	0
Talbot County Arts Council, Inc.	95,681	98,322	0
Washington County Arts Council, Inc.	100,405	103,152	0
Worcester County Arts Council	96,260	98,928	0
Various Community Arts Development Grants	0	0	2,754,744
Subtotal	***$2,508,687***	***$2,599,730***	***$2,599,730***
Artists in Education			
InterAct Story Theatre Education Association	$133,365	$200,000	$0
Young Audiences of Maryland, Inc.	37,500	37,500	0
Various Artist In Education	449,991	487,500	775,000
Subtotal	***$687,327***	***$725,000***	***$775,000***
Maryland Traditions			
Creative Alliance, Inc.	$38,914	$0	$0
National Council for the Traditional Arts	54,437	70,000	0
University of Maryland Baltimore County (MTA)	34,000	0	0
University of Maryland Baltimore County (MTA)	42,000	0	0
Various Maryland Traditions	104,930	170,000	305,775
Subtotal	***$169,351***	***$240,000***	***$305,775***
Grants to All Other			
Strathmore Hall Foundation	$38,036	$0	$0
Total – Maryland State Arts Council	**$14,102,640**	**$15,258,666**	**$15,315,109**

	Actual 2015	Appropriation 2016	Allowance 2017
Film Production Program			
Knight Takes King Productions LLC	$7,500,000	$0	$0
Preservation of Cultural Arts			
Arena Players, Inc.	$100,000	$25,000	$0
African American Museum and Cultural Center	200,000	25,000	0
Great Blacks in Wax Museum	150,000	0	0
The Maryland School for the Blind	800,000	0	0
Sotterly Plantation	0	50,000	0
Maryland Historical Society	0	125,000	0
Maryland Humanities Council	0	175,000	0
Maryland Science Center	0	467,000	0
Dolman Black Heritage Museum	0	25,000	0
Center Stage	0	200,000	0
Arts Every Day	0	68,080	0
Young Audiences of Maryland	0	50,000	0
Maryland State Arts Council – Grants	0	789,920	$2,000,000
Subtotal	***$1,250,000***	***$2,000,000***	***$2,000,000***
Total Commerce Grants	**$33,593,116**	**$23,836,603**	**$21,686,590**

BRAC: Base Realignment and Closure
GFO: grants for organizations
MTA: Maryland Transit Administration
TBD: to be determined

* The final distribution of Maryland State Arts Council grants to arts organizations for fiscal 2017 is not known at this time.

Source: Department of Commerce

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Department of Commerce
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$79,337	$80,738	$800	$0	$160,875
Deficiency Appropriation	-790	0	0	0	-790
Cost Containment	-5,632	0	0	0	-5,632
Budget Amendments	-943	7,295	9,371	442	16,165
Reversions and Cancellations	-113	-3,464	-213	-144	-3,933
Actual Expenditures	**$71,859**	**$84,570**	**$9,958**	**$298**	**$166,684**
Fiscal 2016					
Legislative Appropriation	$73,015	$65,928	$1,519	$266	$140,728
Budget Amendments	-850	-15,925	426	0	-16,349
Working Appropriation	**$72,166**	**$50,002**	**$1,945**	**$266**	**$124,379**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The fiscal 2015 final appropriation is significantly higher than the original appropriation due primarily to increases in special and federal funds. Conversely, total general funds declined.

The fiscal 2015 cost-of-living adjustment (COLA) increased general funds by $151,378. However, the July and January cost containment actions taken by BPW decreased general funds by over $5.6 million. Additionally, at the direction of budget bill language, $1.0 million in general funds was transferred by budget amendment from Commerce's MEDAAF program to TEDCO to provide the initial funding for the Cybersecurity Investment program. Additionally, the State Employee Voluntary Separation Program further reduced the general fund appropriation by $100,000.

Special funds increased by close to $7.3 million in fiscal 2015. The fiscal 2015 COLA increased special funds by $56,529. Additionally, a budget amendment increased special funds under the Maryland Economic Adjustment Fund (MEAF) by $400,000. Funds were used to provide working capital loans at favorable terms to small and early stage cybersecurity companies that are located in areas affected by defense adjustments. An additional budget amendment added $88,495 in special funds as the final grants for the War of 1812 celebrations. Funds accrued through the sale of commemorative War of 1812 coins. The primary driver of the increase in special funds is a budget amendment that appropriates fund balance under the Sunny Day Fund program and the Preservation of Cultural Arts program to benefit the department's film incentive program. Chapter 464 of 2014 authorized the use of these fund sources to provide grants to supplement tax credits awarded under the film production activity tax credit program.

Despite these increases, the department canceled over $3.4 million in special funds. The main driver of the canceled funds relate to a Sunny Day Fund award that was rescinded in fiscal 2015 due to the recipient company's failure to meet required benchmarks. Similarly, the department was unable to commit the majority of funds budgeted under the MEAF, as discussed above. The department expects to be able to fund the remaining funds in fiscal 2016. Finally, almost $1.0 million under MSBDFA was canceled in fiscal 2015. According to the department, this was largely due to the timing of some line of credit repayments.

Federal funds increased significantly in fiscal 2015. This is primarily due to the reappropriation of funds under the U.S. Small Business Credit Initiative ($7.7 million). This issue is discussed under the Issues section of this analysis. Federal funds also increased in fiscal 2015 for the Office of Military and Federal Affairs to develop strategies to diversify the State's economy in light of federal defense budget reductions. Federal funds also increased by $501,865 and by $66,400 due to two budget amendments that provided funds to the Maryland Tourism Board. This funding is passed through to the nonprofit arm of the Maryland War of 1812 Bicentennial Commission created by an executive order of the Governor. According to the federal regulations, the funding must be matched by private fundraising. Funds were used by the commission to support activities related to the bicentennial celebration of the War of 1812 and in particular, the Battle of Baltimore.

Finally, reimbursable funds increased by $441,706 in fiscal 2015. Funds were provided by the Maryland Department of Transportation through the Scenic Byways programs. Funds were used to enhance marketing efforts related to the War of 1812 celebration. However, the department was unable to commit all of these additional funds, and a small amount was canceled at year's end.

Fiscal 2016

To date, the fiscal 2016 working appropriation is considerably less than the original appropriation. This is due to the transfer of programs from Commerce to TEDCO pursuant to Chapter 141 that reorganized the State's economic development efforts. Specifically, general funds decline by over $1.1 million due to the transfer of early biotechnology company grants. The decline is mitigating, in part, by the restoration of a general 2% salary reduction.

Similarly, special funds decline by approximately $16.4 million to transfer funds associated with the Maryland Enterprise Fund to TEDCO. However, this decline was also partially mitigated by the restoration of the 2% salary reduction. An additional budget amendment increased special funds to the MEAF program. This program was originally established to provide loans to new or existing companies in communities suffering from dislocation due to defense adjustments. The program has expanded and is often used as a source of direct lending assistance to small businesses. Recipient companies do not have to show that they have suffered as a result of declining defense spending, only that they are located in an area suffering from defense adjustments. The department plans in using the funds to provide working capital loans at favorable terms to small and early stage cybersecurity companies that are located in areas affected by defense adjustments.

Additionally, special funds increased by $50,000 due to an increase in available funds for the Maryland Not-for-Profit Development Fund that provides technical assistance to newly formed nonprofits.

Federal funds increase primarily due to a budget amendment for the Office of International Investment and Trade. The funds are made available through a grant from the U.S. Small Business Administration under its State Trade and Export Promotion Grant program. The federal program is designed to provide matching funds for states to assist small business and their export activities. Commerce is using the funds to supplement its existing ExportMD program. This program provides $5,000 grants to Maryland companies to reimburse expenses associated with international marketing efforts. Such expenses include market research, trade show fees, translation of brochures, airfare, and website development. The funds allow the department to increase grant capacity by about 29% in fiscal 2016.

Finally, federal funds increase slightly due to the restoration of the general 2% salary reduction.

Appendix 2

Audit Findings

Audit Period for Last Audit:	November 2, 2010 – June 30, 2014
Issue Date:	October 2015
Number of Findings:	11
Number of Repeat Findings:	1
% of Repeat Findings:	9%
Rating: (if applicable)	n/a

Finding 1: Comprehensive written procedures were not prepared to ensure consistency and compliance with the law in administering the Premium Tax credit auction for the Invest Maryland program, and tax credit certificates issued to winning bidders included incorrect identifying information.

Finding 2: The Department of Business and Economic Development (now Commerce) did not adequately document the selection process and allocation of capital to venture firms, and monitoring efforts over the firms' investment activity were not sufficient.

Finding 3: Commerce did not obtain required approval from the Office of the State Treasurer in advance of opening certain investment bank accounts.

Finding 4: Commerce's process for verifying that recipients met requirements for forgiveness of conditional loans and grant repayments was not effective.

Finding 5: Commerce had not established formal forbearance agreement procedures for its MSBDFA program and did not have an effective mechanism to track and monitor forbearance agreement activity.

Finding 6: **The capabilities of system users on Commerce's automated financing programs monitoring system were not adequately restricted.**

Finding 7: Cash balances for financing programs were not adequately reconciled with the State's records.

Finding 8: Commerce did not sufficiently verify One Maryland applicants' compliance with job creation and associated cost requirements and did not administer the program in accordance with State regulations.

<u>Finding 9:</u> Program regulations were not established as required, and Commerce lacked documentation of supervisory reviews of credits issued under the Film Production Activity Tax Credit.

<u>Finding 10:</u> Procedures and controls over the award and disbursement of Maryland State Arts Council grants were not adequate.

<u>Finding 11:</u> Certain purchasing transactions and access to the State's Financial Management Information System were not sufficiently controlled.

*Bold denotes item repeated in full or part from preceding audit report.

Object/Fund Difference Report
Department of Commerce

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	217.00	208.00	206.00	-2.00	-1.0%
02 Contractual	17.60	17.95	20.40	2.45	13.6%
Total Positions	**234.60**	**225.95**	**226.40**	**0.45**	**0.2%**
Objects					
01 Salaries and Wages	$ 22,562,727	$ 23,050,667	$ 23,082,538	$ 31,871	0.1%
02 Technical and Spec. Fees	860,485	862,715	962,007	99,292	11.5%
03 Communication	570,589	618,504	536,061	-82,443	-13.3%
04 Travel	649,201	720,408	694,415	-25,993	-3.6%
06 Fuel and Utilities	24,826	24,140	25,298	1,158	4.8%
07 Motor Vehicles	293,531	283,531	289,644	6,113	2.2%
08 Contractual Services	11,733,060	12,922,891	13,054,444	131,553	1.0%
09 Supplies and Materials	165,408	177,193	207,982	30,789	17.4%
10 Equipment – Replacement	98,911	35,174	14,350	-20,824	-59.2%
11 Equipment – Additional	48,204	0	0	0	0.0%
12 Grants, Subsidies, and Contributions	62,296,045	49,519,683	73,169,159	23,649,476	47.8%
13 Fixed Charges	2,504,901	2,459,534	2,405,743	-53,791	-2.2%
14 Land and Structures	64,876,420	33,705,000	39,205,000	5,500,000	16.3%
Total Objects	**$ 166,684,308**	**$ 124,379,440**	**$ 153,646,641**	**$ 29,267,201**	**23.5%**
Funds					
01 General Fund	$ 71,859,280	$ 72,165,763	$ 92,879,462	$ 20,713,699	28.7%
03 Special Fund	84,569,598	50,002,302	51,072,747	1,070,445	2.1%
05 Federal Fund	9,957,794	1,945,148	9,488,851	7,543,703	387.8%
09 Reimbursable Fund	297,636	266,227	205,581	-60,646	-22.8%
Total Funds	**$ 166,684,308**	**$ 124,379,440**	**$ 153,646,641**	**$ 29,267,201**	**23.5%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Department of Commerce

Program/Unit	**FY 15 Actual**	**FY 16 Wrk Approp**	**FY 17 Allowance**	**Change**	**FY 16 - FY 17 % Change**
0A Department of Business and Economic Development	$ 17,995,026	$ 17,661,061	$ 17,597,218	-$ 63,843	-0.4%
0F Division of Financial Assistance Programs	108,580,767	74,024,916	91,022,716	16,997,800	23.0%
0G Division of Tourism and Promotion	40,108,515	32,693,463	45,026,707	12,333,244	37.7%
Total Expenditures	**$ 166,684,308**	**$ 124,379,440**	**$ 153,646,641**	**$ 29,267,201**	**23.5%**
General Fund	$ 71,859,280	$ 72,165,763	$ 92,879,462	$ 20,713,699	28.7%
Special Fund	84,569,598	50,002,302	51,072,747	1,070,445	2.1%
Federal Fund	9,957,794	1,945,148	9,488,851	7,543,703	387.8%
Total Appropriations	**$ 166,386,672**	**$ 124,113,213**	**$ 153,441,060**	**$ 29,327,847**	**23.6%**
Reimbursable Fund	$ 297,636	$ 266,227	$ 205,581	-$ 60,646	-22.8%
Total Funds	**$ 166,684,308**	**$ 124,379,440**	**$ 153,646,641**	**$ 29,267,201**	**23.5%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Financial Statement Data

Maryland Economic Development Corporation Financial Statement
Fiscal 2013-2015
($ in Thousands)

	2013	2014	2015	Change 2014-2015
Total Assets	$631,678	$604,463	$625,928	$21,465
Total Liabilities	833,412	825,353	854,245	28,892
Net Assets (Deficit)	**-$201,734**	**-$220,890**	**-$228,317**	**$-7,427**
Total Operating Revenue	$127,855	$128,312	$132,352	$4,040
Total Operating Expenses	115,868	115,541	114,608	-933
Operating Income Subtotal	**$11,987**	**$12,771**	**$17,744**	**$4,973**
Non-operating Revenues and Expenses	$16,041	-$31,926	-$25,171	$6,755
Net Income (Deficit)	**$28,028**	**-$19,155**	**-$7,427**	**$11,728**

Change in Net Assets (Deficit) and Income by Source
Fiscal 2013-2015
($ in Thousands)

	2013	2014	2015	Change 2014-2015
Operating Facilities Net Assets	-$201,191	-$219,944	-$227,051	-$7,107
Other Operations Net Assets	-543	-946	-1,266	-320
Net Assets (Deficit)	**-$201,734**	**-$220,890**	**-$228,317**	**-$7,427**
Operating Facilities Net Income	$39,228	**-$18,752**	**-$7,107**	$11,645
Other Operations Net Income	-11,200	-403	-320	83
Net Income (Deficit)	**$28,028**	**-$19,155**	**-$7,427**	**$11,728**

Note: Other operations are comprised of property and equipment rental and consultant and management fees.

Source: Maryland Economic Development Corporation financial statements

Note: Numbers may not sum to total due to rounding.

- The Maryland Economic Development Corporation (MEDCO) net income deficit improved in fiscal 2015 to -$7.4 million. Also, operating income for fiscal 2015 was positive at $17.7 million, which is a key indicator of economic health. Noncash expenses, such as depreciation, and nonoperating items, such as interest expense, cause the income and asset deficits, and these deficits are not uncommon for real estate projects.

- Each year that a net income deficit persists, the corporation's equity position declines. The net asset deficit grew to -$228.3 million in fiscal 2015. This decline was less marked than it was in fiscal 2014. The corporation increased its assets through a property acquisition, and its income improved through increases in rental income from several of its projects.

Analysis in Brief

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses: Although MEDCO continues to maintain a net asset deficit position, its operating revenues continue to exceed its operating expenses. In fact, the corporation's net operating income increased over the prior year.

MEDCO Net Assets in a Negative Position: The corporation's operating facilities have long posted negative assets due to accumulated annual losses. This is not typically true for the corporation's activities exclusive of its operating facilities. However, MEDCO has posted a third straight year of negative assets in its other activities.

Operating Facilities Financial Position

Six Operating Projects Contribute to Declining Net Assets in Fiscal 2015: After a one-year increase in net assets in fiscal 2013 due to the sale of the Rocky Gap Resort, operating facilities net assets declined in fiscal 2014 and 2015. However, the decline is less pronounced than it was prior to fiscal 2013. In fact, the decline is significantly less marked in fiscal 2015 as fewer projects are posting declining assets.

Operating Income Improved in Fiscal 2015; Four Projects Posted a Loss: Operating facilities' income was \$16.7 million in fiscal 2015; an increase of \$4.3 million, or 35%. However, four projects posted operating losses, and one project was defined as a "watch" project and one as "non-performing" according to the corporation's financial statement.

Other Issues

MEDCO Project Portfolio Expands: Historically, MEDCO has been involved in two types of projects: (1) operating projects – where MEDCO is involved in management decisions and has a hand in ensuring successful daily operations; and (2) conduit projects – where MEDCO generally serves only as an arms-length financing entity. However, recent projects require MEDCO to have property ownership (like operating projects), but no management duties (like conduit projects). These projects appear to negatively affect the corporation's non-operating net assets, but offer new flexible financing options.

Recommended Actions

1. Nonbudgeted.

T00A99
Maryland Economic Development Corporation

Operating Budget Analysis

Program Description

The Maryland Economic Development Corporation (MEDCO) is a nonbudgeted entity that allows the State to own or develop property for economic development purposes. MEDCO was created in 1984 with the mission to help expand, modernize, and retain existing Maryland businesses and to attract new businesses to the State. The stated legislative purpose of the corporation is to (1) relieve the conditions of unemployment; (2) encourage increased business activity and commerce and a balanced economy; (3) assist in the retention and attraction of new business activity; (4) promote economic development; and (5) generally promote the present and prospective health, happiness, safety, right of employment, and general welfare of State residents.

MEDCO purchases or develops property that is leased to others under favorable terms. MEDCO also makes direct loans to companies throughout the State to maintain or develop facilities, and it often serves as the conduit for loans administered by the Department of Commerce. MEDCO issues bonds to raise funds for its loans. The bond debt consists primarily of revenue bonds and notes payable to government agencies such as Commerce. The debt represents nonrecourse obligations because MEDCO is not liable to bondholders and lenders in the event of a project or borrower default. Each project must have self-supporting revenues, and no projects are cross-collateralized. As a result, MEDCO debt is not debt of the State, and there is no implied State guaranty or State obligation to protect bondholders from losses.

MEDCO has been involved in 255 projects through fiscal 2015. Of these, MEDCO currently owns and operates 14 as operating facilities, meaning the corporation is involved in management decisions and has a hand in ensuring successful daily operations. For most other projects, MEDCO generally serves as an arms-length financing entity.

The corporation is governed by statute under the Economic Development Article, Sections 10-101 through 10-132. A 12-member board of directors oversees and approves actions pertaining to the corporation's affairs and appoints the executive director. The Secretary of Commerce and the Secretary of Transportation serve as *ex-officio* voting members. MEDCO activities complement the marketing and financing programs of Commerce. There are currently 8 regular and 1 part-time professional staff members.

Overall Financial Position

Operating Revenues Continue to Exceed Operating Expenses

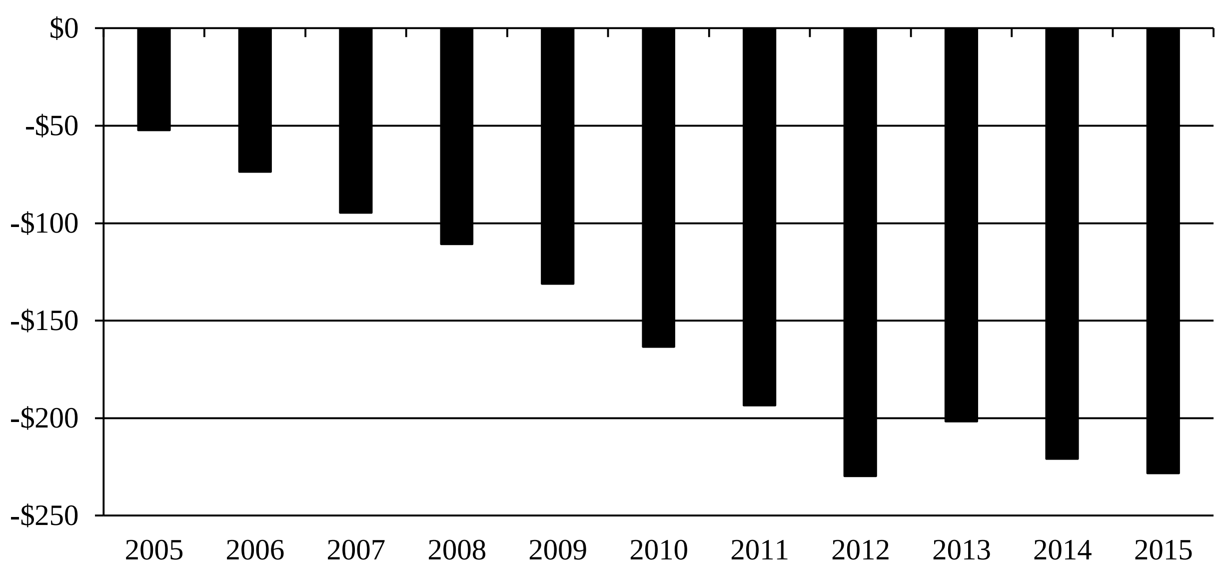
MEDCO operates 14 facilities, and revenue from those facilities contributes to the corporation's bottom line. Operating revenues ($132.4 million) continue to exceed operating expenses ($114.6 million).

Each year, when the corporation experiences a net income deficit, the corporation's equity position declines. This has been the case for at least the last decade of operations. The corporation reports that a growing net asset deficit is not a significant concern as long as operating revenues exceed cash operating expenses. MEDCO reports that net losses and net asset deficits are not uncommon for real estate companies. With these companies, the market value of the assets generally exceeds the book value, and MEDCO says that real estate investors look at market value, or more specifically, cash flow coverage rather than book value. Accordingly, the MEDCO operating position (operating revenues exceeding expenses) continues to be positive.

MEDCO Net Assets in a Negative Position

Exhibit 1 shows the total value of MEDCO net assets. This represents the cumulative effect of year-over-year income deficits. Although the corporation was required to realize losses due to the sale, the sale of the Rocky Gap resort also briefly improved the corporation's financial position. In fiscal 2013, the net asset deficit fell to $201.7 million, as shown in Exhibit 1. This marked the first improvement in net assets since fiscal 2002. However, in fiscal 2014, the net asset deficit again began to increase. The net asset deficit now stands at -$228.3 million.

Exhibit 1
Maryland Economic Development Corporation Net Assets
Fiscal 2005-2015
($ in Millions)



Source: Maryland Economic Development Corporation

The net asset deficit began to grow dramatically in fiscal 2003. It was at this time that MEDCO greatly expanded its operating facility portfolio, including the Chesapeake Bay Conference Center and several university housing projects. The net asset deficit is largely the result of adding new operating real estate projects. MEDCO operating projects often have net income deficits as explained above, and with the addition of each project, a net income deficit is added to the accounts, which in turn adds to the overall net assets deficit. Conversely, the removal of an operating project (Rocky Gap) improves the net asset deficit position.

Operating Facilities Financial Position

Six Operating Projects Contribute to Declining Net Assets in Fiscal 2015

Exhibit 2 shows the increases and decreases in MEDCO net assets by project. Operating facilities net assets declined by $7.1 million in fiscal 2015, and as discussed above, that is not uncommon. However, this decline was significantly less than the decline in fiscal 2014. This is largely due to grants received, but not yet expended, to repurpose the National Cybersecurity Center of Excellence. The center is housed in a MEDCO facility formerly known as the Shady Grove Innovation Center. MEDCO received grant funds through the Department of Commerce, Montgomery County, and the National Institute of Standards and Technology.

Exhibit 2
MEDCO Increase/Decrease in Net Assets by Projects
Fiscal 2013-2015

	2013	2014	2015	Total Net Assets/Deficit at End of 2015
University Student Housing				
Morgan State University	-$270,791	$169,999	$419,282	-$6,983,253
Bowie State University	-396,311	-49,501	451,217	-5,501,747
Frostburg State University	-608,304	11,951	130,461	-4,331,227
Salisbury University	294,175	-674,715	272,916	-4,063,602
Towson West	-221,081	-491,396	-114,755	-4,839,894
University of Maryland, Baltimore	-380,896	-415,702	-596,563	-11,699,094
University of Maryland Baltimore County	152,626	281,042	457,798	-2,317,063
University of Maryland, College Park Housing	-3,044,343	-1,249,917	-1,461,522	-25,051,914
University Village at Sheppard Pratt	-146,973	554,797	459,380	-10,489,951
Subtotal	***-$4,621,898***	***-$1,863,442***	***$18,214***	***-$75,277,745***

	2013	2014	2015	Total Net Assets/Deficit at End of 2015
Other Facilities				
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$15,581,030	-$16,495,684	-$13,844,214	-$165,048,523
Shady Grove Innovation Center	12,135	-192,196	7,184,742	11,980,933
Rockville Innovation Center	-147,757	-210,927	-598,027	-1,175,035
Metro Centre		-1,077,749	-1,092,369	-2,170,118
Rocky Gap Golf Resort	59,970,699	0	0	0
University of Maryland, College Park Energy	607,246	1,059,271	1,196,106	5,272,753
Subtotal	***$44,861,293***	***-$16,917,285***	***-$7,153,762***	***-$151,139,990***
Subtotal Operating Facilities	***$40,239,395***	***-$18,780,727***	***-$7,135,548***	***-$226,417,735***
MEDCO Exclusive of Operating Facilities	**-$11,271,036**	**-$403,190**	**-$319,838**	**-$1,266,285**
Elimination (Accounting Adjustment)	**$28,364**	**$28,364**	**$28,364**	**-$632,675**
Grand Total	**$28,996,723**	**-$19,155,553**	**-$7,427,022**	**-$228,316,695**

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

The corporation added a new operating project to its portfolio in fiscal 2015. It entered into a development and construction agreement with a developer to construct a parking facility at the Metro Centre at Owings Mills. The project is governed by a lease/sublease arrangement between the Maryland Transit Administration, MEDCO, and Baltimore County. MEDCO will operate the facility while under this arrangement. MEDCO financing was issued in a taxable, draw-down mode to be held by the developer for a period of time while the developer completes other mixed-use development in the area. The area is designated as a special taxing district, which will be used to service the debt.

Operating Income Improved in Fiscal 2015; Four Projects Posted a Loss

Exhibit 3 shows MEDCO operating income and loss by project. The data indicates where projects are bringing in enough revenues to cover annual operating expenses. Operating facilities' net income increased to $16.7 million in fiscal 2015 compared to $12.4 million in fiscal 2014. Revenues increased largely due to improvements in occupancy rates at several of the corporation's student housing projects. Additionally, declines in operating expenses at the Chesapeake Bay Conference Center drove the overall decline in operating expenses.

Exhibit 3
MEDCO Operating Income/Loss by Project
Fiscal 2013-2015

	2013	2014	2015
University Student Housing			
Morgan State University	$1,434,152	$1,531,807	$1,743,410
Bowie State University	668,185	998,861	1,721,021
Frostburg State University	355,184	619,670	766,322
Salisbury University	1,448,194	293,709	1,214,666
Towson West	2,027,330	2,013,652	2,140,757
University of Maryland, Baltimore	1,420,285	1,329,044	1,456,664
University of Maryland Baltimore County	1,397,647	1,444,739	1,681,944
University of Maryland, College Park Housing	5,500,544	6,373,669	6,267,049
University Village at Sheppard Pratt	1,293,828	1,709,212	1,566,242
Subtotal	***$15,545,349***	**$16,314,363**	**$18,558,075**
Other Facilities			
Chesapeake Bay Conference Center (Hyatt Cambridge)	-$5,557,686	-$6,104,479	-$3,476,038
Natl. Cybersecurity Center of Excellence	-142,991	-388,158	-228,934
Rockville Innovation Center	-412,810	-374,393	-466,367
Metro Center	0	0	-598,775
Rocky Gap Golf Resort	-279,027	0	0
University of Maryland, College Park Energy	2,948,845	2,950,144	2,945,018
Subtotal	***-$3,443,669***	**-$3,916,886**	**-$1,825,096**
Subtotal Operating Facilities	***$12,101,680***	**$12,397,477**	**$16,732,979**
MEDCO Exclusive of Operating Facilities	**-$143,432**	**$403,756**	**$983,029**
Elimination (Accounting Adjustment)	**$28,364**	**-$30,684**	**$28,364**

MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

According to the corporation's most recent financial statement, one operating project has been identified as "non-performing." This designation was made after the June 2014 debt service payment was only partially made. Further, the project fails to meet the debt coverage ratio as required in the trust indenture covering the bonds.

- **Chesapeake Bay Conference Center:** The Chesapeake Bay Conference Center is located in Dorchester County. It houses a hotel, golf course, and conference facilities. The project has been designated as a "watch" project for the previous five years for failure to meet its debt coverage ratio. At the end of fiscal 2014, the center's financial designation was adjusted downward to "non-performing." Occupancy and associated revenues have been in decline for several years, largely due to the impact of federal sequestration and the general decline of business travel. Additionally, the threat of a summer hurricane in 2015 negatively affected occupancy.

  MEDCO is working with the bondholders on a forbearance agreement regarding principal and interest payments. Additionally, the facility management has worked to curb operating costs in fiscal 2015. Further, a capital reserve fund will be utilized to make improvements to the facility to increase its appeal to visitors.

One additional project has been deemed a "watch" project in fiscal 2015 for failure to meet debt coverage ratios. It should be noted that each project needs to be considered on its own merits because no MEDCO projects are cross-collateralized and each project must support its own revenues.

- **University of Maryland, Baltimore:** This housing facility at the University of Maryland, Baltimore is a project that has been repeatedly designated as a "watch" project. The project is reported to be close to 100% occupancy; however, rental rates continue to be depressed in the vicinity and have failed to meet the original projections. In 2015, MEDCO refunded and reissued the debt associated with this project. It is estimated that the refinancing will reduce annual debt service payments by 25%, saving about $3.5 million over the life of the debt.

It should be noted that another student housing project at Bowie State University is no longer designated a "watch" project in the corporation's financial statements. The recovery is two-fold: (1) occupancy rates have significantly improved; and (2) MEDCO has refunded and reissued the debt associated with the project for an estimated annual debt service savings of about $88,500.

MEDCO became involved in university housing projects in 1999 when the University System of Maryland approached the corporation because the customary owner, the Collegiate Housing Foundation, came under investigation by the Internal Revenue Service. MEDCO studied the cash flow potential of the projects and found it to be solid.

MEDCO believes that university housing is a good fit for its financing, and it plans to continue to become involved in such projects. The corporation reports that the universities, in some instances, do not want to own and operate the facilities themselves; yet, a university campus is not necessarily an ideal environment for a traditional private real estate entity.

MEDCO has explained that it is not unusual for its real estate projects to show deficits, and it cautions that in the case of university housing, deficits are essentially guaranteed. There is a provision in the bond issuances that specifies that excess cash goes back to the university as additional rent or a ground lease rather than into the projects' equity. MEDCO reports that university housing bond issuances usually are structured this way, and it is for this reason that housing bonds are at the low end of investment grade ratings.

The Department of Legislative Services (DLS) recommends that MEDCO comment generally on the status of its operating projects and specifically on the designation of the Chesapeake Bay Conference Center as "non-performing."

Other Issues

MEDCO Project Portfolio Expands

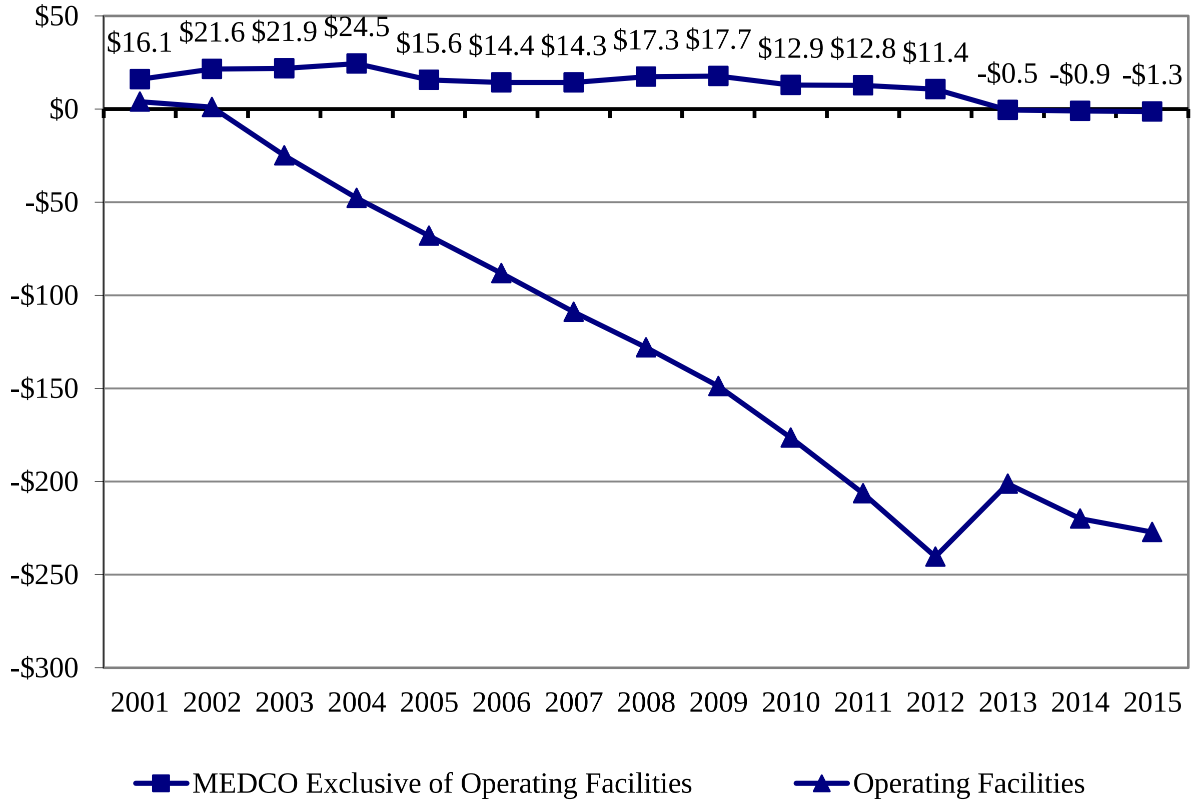
As mentioned above, MEDCO has been involved in 255 projects through fiscal 2015. Of these, MEDCO currently owns and operates 14 as operating facilities, meaning the corporation is involved in management decisions and has a hand in ensuring successful daily operations. For other projects, MEDCO generally serves as an arms-length financing entity. However, recently the corporation has begun to be involved in a third type of project – where the corporation owns a property and collects rent or other fees but is not involved in the management of the facility.

For example, in 2014, MEDCO entered into a property arrangement with the Maryland State Archives (MSA). MSA was in need of additional long-term storage. MEDCO provided the financing to acquire land and a facility previously used by the U.S. Social Security Administration as a record retention facility. MEDCO is the owner of the facility and leases it to MSA. MSA will make payments to MEDCO to cover the debt service and MEDCO expenses. The bonds, which financed the project, are secured by the project and payments under the lease. The archives, and not MEDCO, will be responsible for the day to day operations, unlike MEDCO operating projects. But also unlike its conduit issuances, MEDCO does retain property ownership.

Exhibit 4 shows the value of MEDCO net assets with operating facilities extracted. MEDCO, exclusive of its operating facilities, had negative assets of about $1.3 million in fiscal 2015. This is the third consecutive year of negative assets for MEDCO's other operations. This is inconsistent with the 10-year average of $9.7 million.

This shift in net asset value is largely due to these new types of projects that MEDCO has in its portfolio. As with its operating projects, MEDCO must now account for noncash expenses, such as depreciation, which cause the income and asset deficits. To the extent that MEDCO continues to pursue such projects, net assets will continue to decline. Additionally, this shift is occurring as MEDCO decreases its conduit (arms-length) financing activity. In fiscal 2015, the corporation was involved in only one conduit issuance.

Exhibit 4
MEDCO Net Assets – Operating and Nonoperating
Fiscal 2001-2015
($ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Maryland Economic Development Corporation

It should also be noted that there are other concerns with the increased activity of MEDCO in financing State projects like the MSA facility. MEDCO has significant expertise in the construction and management of projects. As such, it is unsurprising that State agencies would seek to capitalize on that expertise when considering options for financing new facilities. However, some concerns have been raised that this financing mechanism is too far outside the normal State capital budgeting process, thereby missing critical elements of review and input by State policymakers including the Capital Debt Affordability Committee and legislative budget committees. Another concern is that MEDCO financing can add to the long-term cost of the project as compared to financing through the State's general obligation bond capital program. Typically, interest rates are higher, albeit by a slight margin, and MEDCO financing also requires additional issuances to cover capitalized interest reserves and issuances costs. Finally, there are additional concerns about whether these types of projects are structured as capital leases and, therefore, whether they count against the State's debt limits.

DLS recommends that MEDCO comment on the increase in projects that require MEDCO ownership but where MEDCO has no operational role, including the negative impact on the corporation's net assets. MEDCO should also comment on any potential concerns about forgoing its management role in these projects and whether the legislature should expect to see similar projects in the future.

Recommended Actions

1. Nonbudgeted.

Appendix 1

Audit Findings

Audit Period for Last Audit:	May 18, 2012 – June 30, 2015
Issue Date:	January 2016
Number of Findings:	0
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

The audit did not disclose any findings.

T50T01
Maryland Technology Development Corporation

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$18,692	$19,667	$19,467	-$200	-1.0%
Adjusted General Fund	**$18,692**	**$19,667**	**$19,467**	**-$200**	**-1.0%**
Special Fund	0	16,387	7,345	-9,043	-55.2%
Adjusted Special Fund	**$0**	**$16,387**	**$7,345**	**-$9,043**	**-55.2%**
Adjusted Grand Total	**$18,692**	**$36,055**	**$26,812**	**-$9,243**	**-25.6%**

- The fiscal 2017 allowance for the Maryland Technology Development Corporation (TEDCO) includes general funds of approximately $19.5 million, a small decrease of $200,000. There were small reductions to several of the corporation's programs for cost containment purposes.

- Special funds were added to the corporation's budget in fiscal 2016 due to the transfer of the Maryland Venture Fund (MVF) from the Department of Commerce (Commerce). The fiscal 2017 allowance reflects a significant decline in available funds under the MVF.

- The corporation does not report personnel data through the State budget system because its employees are not State employees. However, the corporation reports that it has 21 full-time positions and 6 part-time positions. This includes 6 positions that were added in fiscal 2016 due to the transfer of additional responsibilities to the corporation.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Significant Increase in Follow-on Funding: A measure of success of the corporation's Technology Commercialization Fund is the extent to which recipients can ensure follow-on funding. In fiscal 2015, there was a significant increase in the amount of downstream funding secured by recipients.

Progress under the Maryland Innovation Initiative: The Maryland Innovation Initiative, created by Chapter 450 of 2012, is designed to combine the technology transfer expertise of TEDCO and the research expertise of the State's research universities to speed commercialization opportunities. The corporation tracks the number of start-up companies that are formed as a result of the program's funded projects.

Issues

Expanded Responsibilities and the Maryland Economic Development and Business Climate Commission: Chapter 141 of 2015 codified several actions that were recommended by the Maryland Economic Development and Business Climate Commission. Notably, the legislation transferred MVF to the corporation from Commerce and expressed the intent that the BioMaryland Center be likewise transferred. This action aligns the State's early stage business development efforts under TEDCO. **The Department of Legislative Services (DLS) recommends that TEDCO comment on the status of the transferred programs and how it is integrating the new services into its portfolio. TEDCO should also comment on how it plans to continue the services of the BioMaryland Center given the limited resources. DLS also recommends that TEDCO comment on how it will ensure that the federal funds under the State Small Business Credit Initiative (SSBCI) continue to be deployed in a timely and efficient manner. Finally, DLS recommends budget language that restricts funds until TEDCO submits a report on returns to the MVF; including returns that accrue specifically from the InvestMaryland program and the SSBCI program.**

Maryland Stem Cell Research Program: In fiscal 2015, the Stem Cell Research Program supported 29 research grants that were approved from 179 applications. Funding for the program has consistently fallen over several rounds of cost containment actions. However, interest in the program remains high. **DLS recommends that TEDCO brief the budget committees on the activities under the Maryland Stem Cell Research Program, including the impact of the low award rate.**

Recommended Actions

1. Adopt narrative requesting a report on how to improve the Maryland Innovation Initiative.
2. Add language restricting funds until a report is submitted on investment returns.

Updates

TEDCO Capital Partners: In 2013, the corporation created a series of investment funds designed to provide venture investments for very specific types of recipients. Private fundraising enabled the capitalization of two of the planned funds. However, in 2015, the TEDCO Board of Directors decided to not move forward with this initiative and to concentrate instead on its expanded responsibilities.

Major Grants: Committee narrative, included in the 2008 *Joint Chairmen's Report*, requested a complete listing of award recipients for all deals or projects closed in fiscal 2008. The corporation is continuing to provide this information for subsequent years.

T50T01
Maryland Technology Development Corporation

Operating Budget Analysis

Program Description

The Maryland Technology Development Corporation (TEDCO) was launched in 1998 to help commercialize the results of scientific research and development conducted by higher education institutions, federal laboratories, and private-sector organizations. TEDCO also aims to promote new research activity and investments that lead to business development in Maryland.

To achieve its goals, TEDCO provides nonequity investments to early stage technology businesses, and it funds development and patenting of new technologies at research universities. TEDCO also develops linkages with federal research facilities in the State and helps companies pursue research funds from federal and other sources. The corporation's role was expanded in fiscal 2016 with the enactment of Chapter 141 of 2015 to transfer the operation of the Maryland Venture Fund (MVF) and the biotechnology grant program from the Department of Commerce (Commerce).

In 2001, TEDCO was authorized to create, manage, and provide funds for the statewide Maryland Technology Incubator Program. Technology business incubators offer start-up companies physical office space, research space, and an array of business services in hopes of generating new research and jobs.

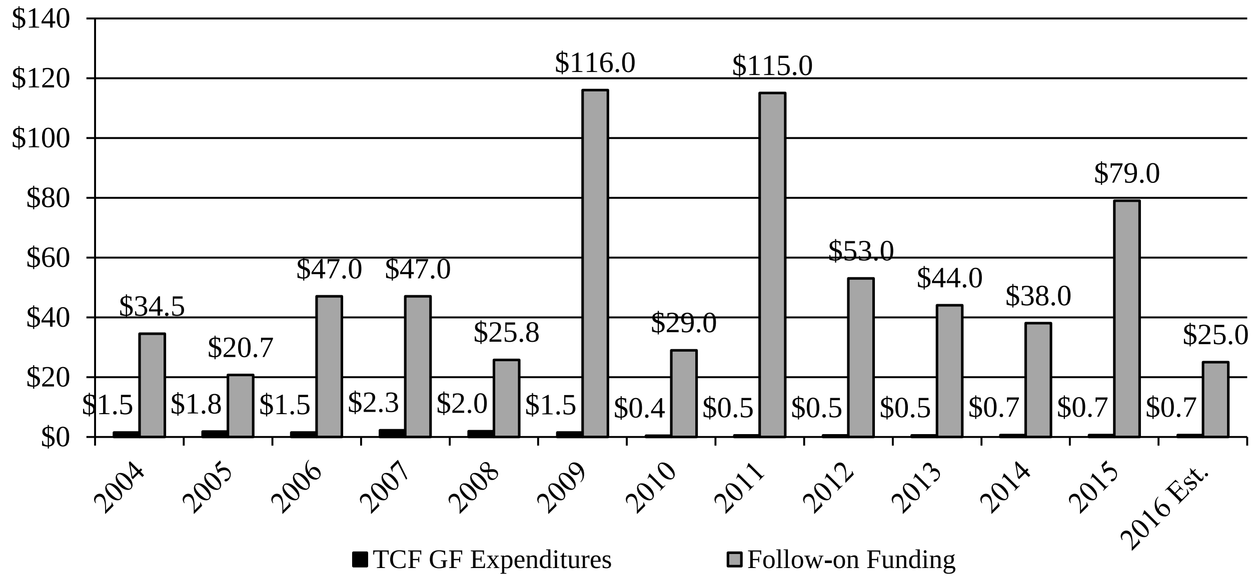
TEDCO supports stem cell research and development at Maryland's research universities and private-sector research corporations in accordance with the Maryland Stem Cell Research Act of 2006. The Maryland Stem Cell Commission established an independent scientific peer review committee to review, evaluate, rank, and rate research based on procedures and guidelines that give consideration to scientific, medical, and ethical implications.

Performance Analysis: Managing for Results

1. Significant Increase in Follow-on Funding

The Technology Commercialization Fund (TCF) provides seed investments to early stage technology companies that are economically viable but do not yet have the scale needed for a venture capital investment. A measure of success for the TCF is the ability of funded start-ups to obtain follow-on funding for commercialization. The primary sources of follow-on funds include federal grants, venture capital and other equity investments. TEDCO tracks leveraged funds for at least five years for each TCF recipient. **Exhibit 1** shows follow-on funding for the TCF recipients relative to the amount of general fund investment in the program.

Exhibit 1
Follow-on Funding for Recipients of TEDCO Investments
Fiscal 2004-2016 Est.
($ in Millions)



GF: general funds
TCF: Technology Commercialization Fund
TEDCO: Maryland Technology Development Corporation

Note: Follow-on funding is measured for companies receiving TCF awards in that fiscal year.

Source: Maryland Technology Development Corporation; Governor's Budget Books, Fiscal 2007-2016

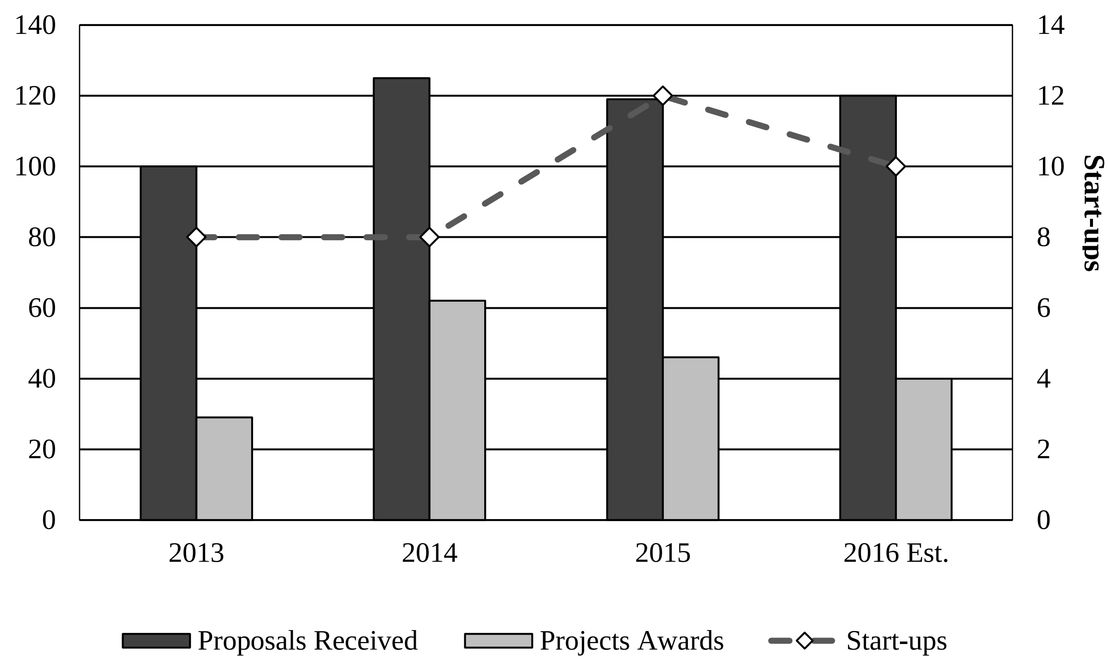
This measure is of particular importance to the corporation because success in raising downstream funding is a key criterion in evaluating second award proposals. It should be noted that the TCF program is supplemented by nonbudgeted funds from the corporation's reserve funds, and that follow-on funding reflects the impact of the entire investment by the corporation. As shown in Exhibit 1, general funds have declined from a high mark of $2.3 million in fiscal 2007 to $662,000 in fiscal 2016. It does not appear that this decline has significantly dampened follow-on funding for the corporation's grantees. In fact, follow-on funding increased significantly in fiscal 2015.

This measure only tracks the cumulative total of downstream funding. This data may be skewed if a small number of grant recipients are inordinately successful in obtaining follow-on funding. It does not necessarily measure the long-term success rate of the companies that benefit from the program's funding. The corporation should consider the inclusion of additional performance measures that would mitigate any distortion of the data, including the number of companies that have stayed in operation in the State for seven or more years.

2. Progress under the Maryland Innovation Initiative

At the suggestion of the Department of Legislative Services (DLS), TEDCO has begun reporting new measures that demonstrate the progress of the Maryland Innovation Initiative (MII). MII, created by Chapter 450 of 2012, is designed to combine the technology transfer expertise of TEDCO and the research expertise of the State's research universities to speed commercialization opportunities. The program is meant to encourage a foundation from which start-up companies may be formed. **Exhibit 2** shows the number of proposals received under the program, the number of proposals that were awarded funds, and the number of start-up companies formed as a result of the funded innovation.

Exhibit 2
Maryland Innovation Initiative
New Performance Measures
Fiscal 2013-2016 Est.



Source: Maryland Technology Development Corporation

As shown, in fiscal 2015, the program was able to increase the number of start-ups formed as a result of the technology research that was funded through the program. It is expected that as the program matures, more innovations will reach the state of commercialization, thereby increasing the number of start-ups. While these measures demonstrate the promise of previously unrealized commercialization, it is again important to understand the long-term success rate of these start-ups. To the extent that the data allows, the corporation should add a measure on the percentage of funded start-ups that remain in business.

Fiscal 2016 Actions

Cost Containment

The corporation participated in the fiscal 2016 across-the-board cost containment initiative. This resulted in a reduction of $307,000, which was taken from the original appropriation for the Maryland Stem Cell Research Program.

Proposed Budget

As shown in **Exhibit 3**, the majority of the fiscal 2017 allowance is budgeted as a general fund grant of $19.5 million. Programmatically, the general fund allowance includes funds for: the TCF, the Maryland Industrial Partnership Program, the Rural Business Initiative, the Cyber Security Investment Fund (CIF), the BioMaryland Grant program, the MII, and the Maryland Stem Cell Research Program. The corporation allocates the remaining general funds across its operational needs. Special funds are included in the corporation's budget for the first time in fiscal 2016 due to the transfer of the MVF. Although not reported through the State budget system, the corporation also has nonbudgeted funds that include investment earnings, event income, and grants.

Exhibit 3
TEDCO Budget
Fiscal 2015-2017
($ in Thousands)

	2015	Working 2016	Allowance 2017	Change
General Funds				
Operations				
Salaries and Wages	$1,757	$1,417	$2,052	$635
Contractual Services	45	45	41	-3
Equipment	12	12	17	5
Other operational costs	887	637	63	-574
Operations Subtotal	***$2,701***	***$2,110***	***$2,173***	***$63***
Programs				
Maryland Technology Commercialization Fund	$490	$663	$600	-$63
Technology Validation Program	0	0	0	0
Maryland Industrial Partnership Program	400	350	300	-50
Rural Business	0	500	500	
Cyber Security Investment Fund	800	900	900	
BioMaryland Grants	0	1,151	1,101	-50
Maryland Innovation Initiative	4,900	4,900	4,800	-100
Stem Cell Research Fund	9,400	9,093	9,093	
Programs Subtotal	***$15,990***	***$17,557***	***$17,294***	***-$263***
General Fund Total	**$18,691**	**$19,668**	**$19,467**	**-$200**
Special Funds				
Enterprise Fund		$15,055	$6,000	-$9,055
Enterprise Fund Administration		1,332	1,345	12
Special Fund Total		**$16,387**	**$7,345**	**-$9,043**
Grand Total	**$18,691**	**$36,055**	**$26,812**	**-$9,243**

Source: Maryland Technology Development Corporation

TEDCO Traditional Programs

The TCF and the Technology Validation Program (TVP) were two of TEDCO's original programs. Funding has fluctuated for the programs; however, the programs remain central to the mission of the corporation.

TCF

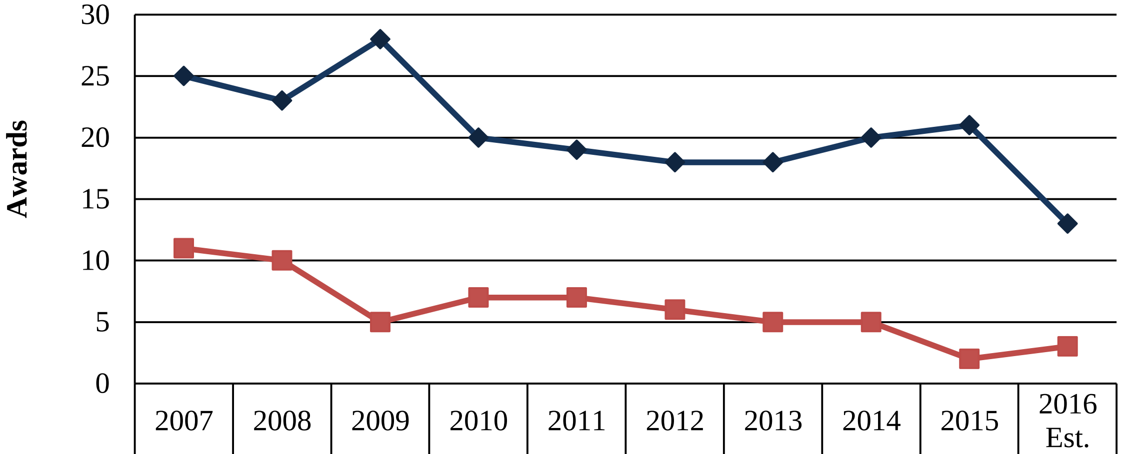
This program awards seed funding to early stage companies that partner with universities or federal laboratories in Maryland, to companies that are tenants in technology incubators, or to participants in TEDCO's Rural Business Innovation Initiative. The $100,000 awards are meant to develop and commercialize technology products of Maryland early stage companies. The fiscal 2017 allowance includes approximately $600,000 in general funds to support the program. However, the corporation advises that it will supplement the State funds with over $1 million of its own nonbudgeted funds. The corporation does not report on its nonbudgeted funds. Therefore, the extent to which it can subsidize its programs is unclear.

TVP

This program provides funds for proof-of-principle studies that confirm the commercial viability of a technology and/or market analyses to establish that a technology meets a significant market need. Initial awards can be up to $50,000. General funds for the program ceased in fiscal 2010; however, the corporation advises that it will support the program with about $170,000 of its own nonbudgeted funds.

Exhibit 4 shows the number of program awards under both of these programs. These two programs represent the traditional TEDCO programs that have been funded with general funds. The corporation has consistently reported the awards from these programs through the State's Managing for Results (MFR) process. Funding is concentrated in the TCF program. A decline in the TVP is evident due to the lack of general funds and due to the advent of the Maryland Innovation Program, which provides similar services to the State's research institutions.

Exhibit 4
TCF and TVP Awards
Fiscal 2007-2016 Est.



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016 Est.
TCF	25	23	28	20	19	18	18	20	21	13
TVP	11	10	5	7	7	6	5	5	2	3

TCF: Technology Commercialization Fund
TVP: Technology Validation Program

Source: Maryland Technology Development Corporation; Governor's Budget Books: Fiscal 2008-2016

Maryland Innovation Initiative

The fiscal 2017 allowance includes $4.8 million in general funds for MII, a reduction of $100,000 from fiscal 2016. MII, created by Chapter 450, is designed to combine the technology transfer expertise of TEDCO and the research expertise of the State's research universities to speed commercialization opportunities. To qualify for participation in the initiative, each university must provide funds annually. Funds may be used to (1) provide grant funding to a qualifying university-based entrepreneur, or other start-up entity to promote the commercialization of technology developed in whole or in part by a qualifying university; (2) pursue grant funding for the initiative or its qualifying universities; (3) develop and implement guidelines for technology transfer; and (4) identify projects at qualifying universities that may be viable for commercialization.

TEDCO began making MII awards in fiscal 2013. As of January 2016, over 164 awards have been made. According to data submitted through the MFR process, awards have resulted in 28 start-up companies with 10 additional start-ups expected in both fiscal 2016 and 2017. Total awards have been dispersed to the participating institutions as follows:

- The Johns Hopkins University (JHU) – 75;
- Morgan State University – 5;
- University of Maryland, College Park (UMCP) – 30;
- University of Maryland, Baltimore – 36; and
- University of Maryland Baltimore County – 18.

There is a marked difference in the distribution of grants among the institutions. JHU commands almost 46% of the grants and over 47% of grant funding. The top three institutions garner 88.7% of program funding.

Maryland Industrial Partnership Program

The fiscal 2017 allowance includes $300,000 in general funds for the Maryland Industrial Partnership program. This reflects a reduction of $50,000 from fiscal 2016. This program is designed to accelerate commercialization by matching funds for university-based research projects that help companies develop new products. Prior to 2010, these funds were budgeted in the Maryland Higher Education Commission and passed through to UMCP. Given TEDCO's expertise with technology commercialization, it was deemed a better fit to be overseen by the corporation. Through the encouragement of intent language in the fiscal 2011 budget bill, TEDCO became more involved in the dissemination of these grants to all State four-year public institutions, not just University System of Maryland (USM) institutions. Two members of the TEDCO staff are included in both the review and approval processes. It should be noted that UMCP contributes about $1 million to the program each year.

Other Programs

The fiscal 2017 allowance includes $900,000 in general funds to be dedicated to the CIF; matching the appropriation from fiscal 2015. The CIF provides up to $225,000 to support projects that advance a technology toward commercialization. Specifically, the funds are meant to move their technology further along the commercialization pathway, increase the company's valuation, and lead to follow-on investment for further growth and sustainability. In fiscal 2015, the corporation made nine awards out of the available funding.

The fiscal 2017 allowance includes $500,000 in general funds to be dedicated to the Rural Business Initiative (RBI). The RBI is designed to provide technical and business assistance to small and early stage technology-based companies that are located in rural Maryland. This assistance is provided by regional mentors that are contractual staff under TEDCO. TEDCO reports that 215 companies received mentoring services through this program in fiscal 2015.

Special Funds: New to TEDCO

The fiscal 2016 working appropriation and the fiscal 2017 allowance reflect the transfer of the MVF to TEDCO from Commerce, pursuant to Chapter 141. Prior to fiscal 2016, the budget of the corporation consisted of a general fund grant from the State and the corporation's own nonbudgeted funds. The addition of special funds will necessitate greater reporting through the State's central budget system.

The fiscal 2016 working appropriation reflects the remaining proceeds from tax credit auctions under the InvestMaryland program, *i.e.*, the State supported venture capital program. The decline in the fiscal 2017 allowance demonstrates that most of the funds under InvestMaryland have been deployed. More information about the transfer of this program is available under the Issues section of this analysis.

Issues

1. Expanded Responsibilities and the Maryland Economic Development and Business Climate Commission

In fiscal 2014, the President of the Senate and the Speaker of the House appointed a private-sector commission to examine the structure, funding, and efficacy of the State's current economic development activities. The Maryland Economic Development and Business Climate Commission (Augustine Commission) had a charge to make policy and funding recommendations to improve the State's business climate and competitiveness. The commission recommended that State programs to assist early stage companies be aligned within TEDCO. Chapter 141 effectuated that recommendation and transferred these programs to TEDCO's purview.

Maryland Venture Fund

Specifically, by budget amendment in fiscal 2016, the MVF (also known as the Enterprise Fund) was transferred from Commerce to TEDCO. The MVF provides capital through equity purchases for start-up companies that are developing innovative technologies. Investments are limited to 25% of the company's total equity and require a three-to-one outside investor match. Individual investments, except those made in venture capital limited liability companies, are limited to $500,000 and may not exceed 15 years in duration. Beginning in fiscal 2013, this program became the means for the implementation of the InvestMaryland program. This is a State-supported venture capital program that was funded through an auction of a tax credit against the insurance premium tax for insurance companies. A portion of these funds are invested in-house and a portion are invested by private venture funds on behalf of the State. To date, no significant returns on these investments have accrued back to the fund. The fund balance worksheet for the program shows equity returns of $1.5 million in fiscal 2016. However, it does not distinguish if these returns are due to the InvestMaryland program or to the legacy investment program of the Enterprise Fund, or, in fact, to any source of funding.

Another source of funds for the program is the State Small Business Credit Initiative (SSBCI). In 2011, Commerce was awarded a total of $23 million from the U.S. Department of the Treasury in support of this initiative. This federal program was designed to utilize existing State economic development programs to increase the capital available to small businesses. The federal funds were originally made available in three tranches to be utilized in the following programs: the Maryland Industrial Development Financing Authority (MIDFA), the Maryland Small Business Development Financing Authority (MSBDFA), and the MVF. However, over several years, Commerce had various difficulties in deploying the funds; especially under the MIDFA and MSBDFA programs. The U.S. Department of the Treasury expressed dissatisfaction with the slow deployment of the funds. In fact, Commerce was at risk of forgoing the third tranche of the funds if it did not commit the remainder of the first tranche and the full second tranche by June 2015. To address this issue, Commerce developed an alternative deployment plan that reallocated the bulk of funds to the MVF, the program most likely to commit the funds. The demand for venture funding far outpaced the demand for loans and loan guarantees. Commerce worked to actually commit the funds from the first two tranches and developed a pipeline for the third. The third installment is provided in the allowance for Commerce.

As a technical matter, it must be first budgeted within Commerce and then transferred to TEDCO and the MVF. Commerce and TEDCO have entered into an inter-agency agreement to ensure the proper administration and oversight of the program.

BioMaryland Center

The Augustine Commission also recommended the transfer of the BioMaryland Center to TEDCO. The focus of the center was to provide resources and grant funding to early stage biotechnology companies. Although not a codified program, Chapter 141 expressed the intent of the General Assembly that the program be transferred to TEDCO. However, only the grant portion of the program was transferred. No funding for support services or staff was transferred. Commerce retained the licenses and access to four market research databases for Maryland biotechnology entrepreneurs developing business plans and funding applications. The databases include information regarding licensing opportunities, target markets, completion, federal approval statuses, and clinical trials. However, Commerce does not intend to transfer these databases to TEDCO, or to renew their licenses. Commerce does intend to reallocate the funding associated with those databases (approximately $120,000) to a different biotechnology related initiative. Anecdotal evidence before the Augustine Commission suggested that, while the information contained in the databases is helpful, physical access to it was prohibitive and time consuming. It is not clear how, or if, TEDCO will continue with the databases, or how it will otherwise provide support services to early stage biotechnology companies as intended by the Augustine Commission.

DLS recommends that TEDCO comment on the status of the transferred programs and how it is integrating the new services into its portfolio. TEDCO should also comment on how it plans to continue the services of the BioMaryland Center given limited resources. DLS also recommends that TEDCO comment on how it will ensure that the federal SSBCI funds continue to be deployed in a timely and efficient manner that would satisfy the U.S. Department of the Treasury. Finally, DLS recommends budget language that restricts funds until TEDCO submits a report on returns to the MVF, including returns that accrue specifically from the InvestMaryland program and the SSBCI program.

2. Maryland Stem Cell Research Program

The Stem Cell Research Fund was established by Chapter 19 of 2006 to support stem cell research and development at Maryland research institutions or private companies. The Stem Cell Research Commission reviews the proposed research process for applicant projects and makes recommendations to the TEDCO board about research grant awards. The research commission includes 15 members, as directed by statute, who include the Attorney General or designee, patient advocates, individuals with experience in biotechnology, scientists who work for USM and JHU and do not engage in stem cell research, bioethicists, and individuals with expertise in biomedical ethics as it relates to religion. Several commission members work at institutions that are applying for funding. Therefore, the commission has adopted conflict of interest guidelines to help members avoid inappropriately influencing commission decisions.

The fiscal 2017 allowance includes $9.1 million in general funds to support grants under the Stem Cell Research Fund. This matches the level for fiscal 2016 adjusted for cost containment. This is the lowest amount of annual funding since the inception of the program. The commission is authorized to award four types of grants, the fourth of which was just introduced in fiscal 2012.

- **Investigator-initiated Research Grants** are designed for investigators with preliminary data and well established research in the stem cell field. The maximum annual grant amount is $200,000 a year, for up to three years.

- **Exploratory Research Grants** are designed for investigators who are new to the stem cell field and for exploratory projects without preliminary data. The maximum annual grant amount is $100,000 a year, for up to two years.

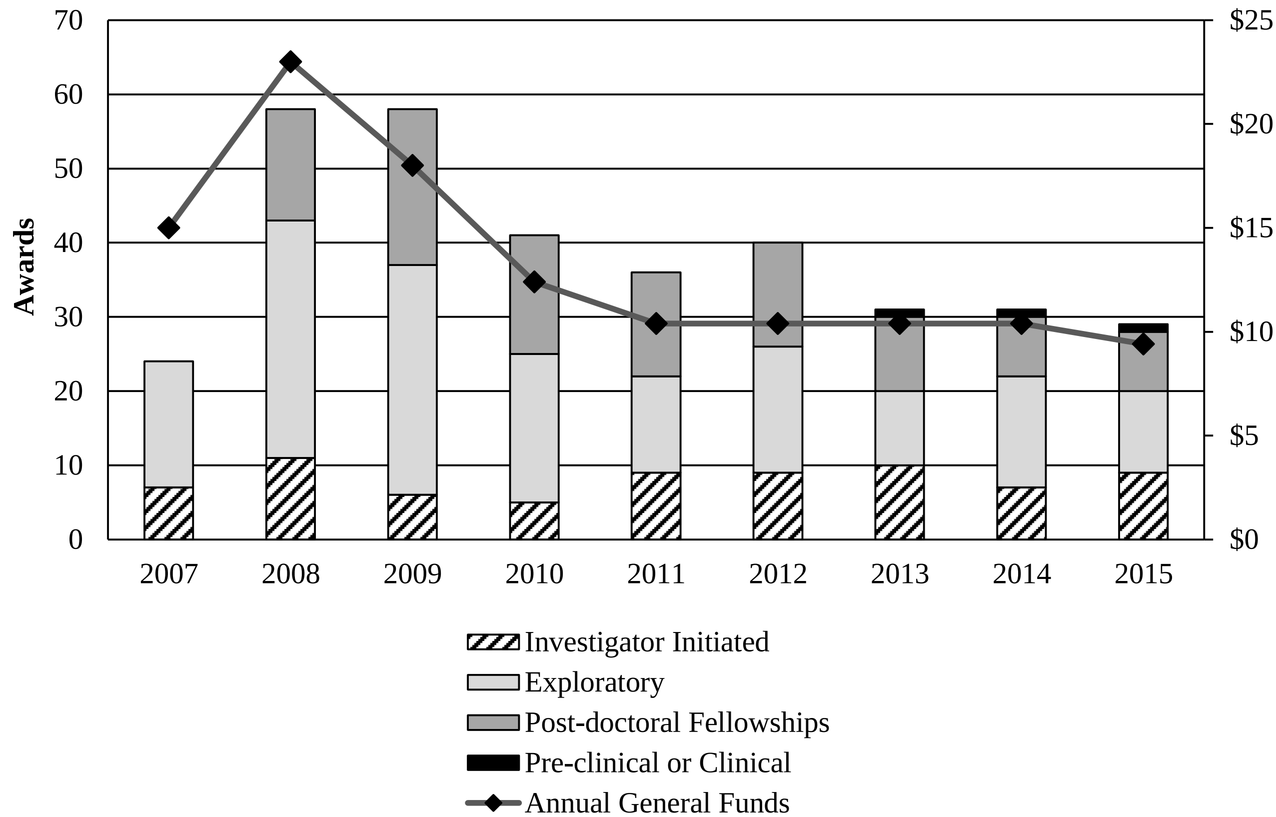
- **Post-doctoral Research Grants** are for exceptional pre-doctoral students and post-doctoral fellows who wish to conduct post-doctoral research on human stem cells in the State with maximum support of $55,000 a year, for up to two years.

- **Pre-clinical or Clinical Research Grants** are for for-profit companies that wish to conduct research using human stem cells to further medical therapies. Applicants for pre-clinical research grant awards may request up to $500,000 of direct costs, for up to three years. Applicants for clinical research grant awards may request up to $750,000 of direct costs, for up to three years.

Exhibit 5 shows the history of the general funds and grant awards under the program. Most of the available funds are granted for exploratory research. However, the number of these grants is declining while the number of post-doctoral grants remains fairly constant. Because the maximum awards for post-doctoral grants are smaller, it allows the corporation to provide more grants with the same or reduced amount of funding. Funding for the program was $9.4 million in fiscal 2015. In that year, the fund received 179 applications for funding and approved 29: 8 investigator-initiated research grants, 11 exploratory research grants, 9 post-doctoral grants, and 1 pre-clinical research grant. The commission was only able to fund 16% of applications, the lowest award rate since the program was created.

DLS recommends that TEDCO brief the budget committees on the activities under the Maryland Stem Cell Research Program, including the impact of the low award rate.

Exhibit 5
Stem Cell Research
History of Funded Awards
Fiscal 2007-2015
($ in Millions)



Source: Maryland Technology Development Corporation

Recommended Actions

1. Adopt the following narrative:

Distribution of the Maryland Innovation Initiative: The Maryland Innovation Initiative is designed to speed commercialization opportunities that develop out of the State's research universities. As of January 2016, the Maryland Technology Development Corporation (TEDCO) has made over 164 awards. According to data submitted to the Managing for Results process, awards have resulted in 28 start-up companies, with 10 additional start-ups expected in both fiscal 2016 and 2017. Total awards have been dispersed to the participating institutions as follows:

- The Johns Hopkins University (JHU) – 75;
- Morgan State University – 5;
- University of Maryland, College Park – 30;
- University of Maryland, Baltimore – 36; and
- University of Maryland Baltimore County – 18.

The committees are concerned that there is a marked difference in the distribution of grants among the institutions. JHU commands almost 46.0% of the grants and over 47.0% of grant funding. The top three institutions garner 88.7% of program funding. The committees, therefore, request that TEDCO, with input from the participating universities, report on potential causes and changes to the program to address the skewed distribution. The report should suggest any legislative or administrative modifications to improve the performance of the program.

Information Request	**Author**	**Due Date**
Report on changes to the Maryland Innovation Initiative	TEDCO	December 1, 2016

2. Add the following language to the special fund appropriation:

<u>, provided that $100,000 of this appropriation made for the purpose of business investments may not be expended until the Maryland Technology Development Corporation submits a report detailing the current and expected equity investment earnings under the Enterprise Investment Fund. The report should include the delineation of the earnings associated with the</u>

InvestMaryland program, including the earnings related to private venture firm investments and in-house investments. The report shall be submitted to the budget committees no later than December 1, 2016, and the budget committees shall have 45 days to review and comment. Funds restricted pending the receipt of the report may not be transferred by budget amendment or otherwise to any other purpose and shall be canceled if the report is not submitted to the budget committees.

Explanation: The State has made significant commitments to its early stage equity investment programs. It is therefore important to have a robust understanding and a comprehensive means of performance measurement of the State investment. This language will establish a new standard for reporting the return on investment under the Maryland Venture Fund.

Information Request	**Authors**	**Due Date**
Report on investment earnings	Maryland Technology Development Corporation in consultation with the Department of Budget and Management	December 1, 2016

Updates

1. TEDCO Capital Partners

In fall/winter 2012/2013, TEDCO issued a series of announcements regarding the creation of a family of investment funds, or TEDCO Capital Partners. The family of funds was meant to offer four different investment funds, capitalized with private funds, which would provide venture capital for very specific types of recipients. Only two of the planned funds raised capital:

- The Propel Baltimore Fund was created through a partnership between TEDCO, the Abell Foundation, and the France-Merrick Foundation. The fund, which has capital commitments of $5.2 million, will provide up to $220,000 as an angel investment in early stage technology companies located in Baltimore City. The fund has made nine investments.

- The Veterans Opportunity Fund is currently raising $10.0 million in private equity capital to provide funds for entrepreneurs who served in the U.S. Armed Forces. To date, the fund has raised $1.5 million and has made two investments.

In summer 2015, the TEDCO Board of Directors made the decision to end this initiative. Instead, the board determined that the corporation should shift its focus and concentrate on the added responsibilities related to the MVF and the biotechnology grant program. The staff of the MVF (and TEDCO's partner venture firm) will continue to manage the existing investments. The corporation is no longer raising private capital toward the funds.

2. Major Grants

Committee narrative included in the 2008 *Joint Chairmen's Report* requested a complete listing of award recipients for all deals closed or projects approved in fiscal 2008. The corporation is continuing to provide this information for subsequent years. **Exhibit 6** shows such awards for all of TEDCO's programs, including those funded with general, federal, or nonbudgeted funds. Some programs, such as the Stem Cell Research Program, award funds over multiple years, therefore, funding levels do not necessarily match appropriation amounts.

Exhibit 6
Maryland Technology Development Corporation
Award Recipients
Fiscal 2015

		Award Amount
Cyber Investment Fund		
	Strajillion Inc.	$100,000
	Protenus Inc.	100,000
	RidgeBack Network Defense Inc.	100,000
	Jedvice LLC	100,000
	Topaz Research Inc.	100,000
	Point3 Security Inc.	100,000
	Efflux Systems	100,000
	Bricata	100,000
	QIP Partners LLC	100,000
		$900,000
Incubator Assistance		
	Towson Global	$10,000
	FITCI	10,000
	Bethesda Green	10,000
	BHI	10,000
	Eastern Shore Entre Ctr. – hotDesks	9,690
	CIC	8,500
	Betamore	10,000
	Montgomery County	30,000
	UMBC	20,000
	Emerging Technology Center	20,000
	Maryland Center for Entrepreneurship	25,000
	UMCP	11,810
		$175,000
Rural Business Innovation Initiative		
	CARE2	$7,365
	AH Pharma	7,000
	Autumn Horizons	4,760
	Autumn Horizons	2,674
	Enterprise 101	7,500
	OPS	6,500
	Nautic Air	7,436
	Automony Engine	7,000
	Gavenlli	7,961
	Chesapeake Plastics	7,900
	Harmonix Lab	7,497
	Elite Image Works	861

		Award Amount
	Phycin	7,724
	RoosterBio	7,426
	Arusha Control	4,326
		$93,930
Joint Technology Transfer		
	Grey Matter LLC	$75,000
	N5 Sensors Inc.	75,000
		$150,000
Maryland Innovation Initiative		
	emocha Mobile Health Inc.	$100,000
	UMB – Coop	100,000
	UMB – Dubowitz	100,000
	AsclepiX Therapeutics LLC	100,000
	UMB – Tropello	99,625
	UMB – Khanna	100,000
	UMCP – Lejuez	100,000
	JHU – Hardaway	15,000
	UMBC – Dusman	150,000
	respEQ Inc	100,000
	JHU – Zachos	100,000
	UMB – Kanstatopoulos	100,000
	JHU – Hartman	100,000
	ITVMD, LLC	14,676
	JHU APL – Rizk	100,000
	UMCP – Chen	100,000
	UMBC – Banerjee	149,399
	Morgan – Aslan	15,000
	GripBoost LLC	100,000
	JHU – Slusher	100,000
	JHU – Sukumar	100,000
	JHU – Pasricha	100,000
	JHU – Benkoski	95,000
	UMCP – Khaligh	100,000
	Tauros Engineering LLC	15,000
	UMB – Xu	100,000
	JHU APL – Torruellas	86,000
	JHU APL – Feldman	99,211
	Revolve Biotechnologies Inc.	100,000
	JHU – Dong	100,000
	JHU – Gordon	100,000

		Award Amount
	UMB – Webb	100,000
	UMB – Zimmer	15,000
	MycoInnovation	15,000
	JHU – Le	100,000
	JHU – Allen	149,955
	MycoMed	100,000
	UMB – ZSX Medical	14,000
	JHU – Sonavex	100,000
	JHU – Walston	15,000
	JHU – Yarema	99,432
	JHU – Luo	100,000
	UMCP – Jewell	150,000
	UMCP – Arencia	100,000
	UMBC – Geddes	100,000
	JHU – Cooney	149,843
	UMCP – Cao	100,000
	Morgan – Lee	100,000
	MF Fire Benefit LLC	100,000
	UMB – Njar	100,000
	JHU – Green	100,000
	JHU – Chatterjee	100,000
	UMBC – Bieberich	15,000
	JHU – Hager	100,000
	GlycoMantra Inc.	150,000
	JHU – Dinglasan	100,000
	Anacrusis Inc.	100,000
		$5,212,141
Patent Assistance Program		
	MycoMed	$10,000
	Vixar	10,000
		$20,000
Technology Commercialization Fund		
	Autonomy Engine LLC	$100,000
	Sol Vista Consulting LLC	100,000
	Kitchenology	100,000
	Opia Holdings Inc.	100,000
	RedShred LLC	100,000
	Vitus Animal Health	100,000
	Lessoncast Learning LLC	100,000
	TenantRex, LLC	100,000

		Award Amount
	Vheda Inc.	100,000
	JPLC Associates LLC	100,000
	Mindoula Health Inc.	100,000
	Avhana LLC	100,000
	Theraly Pharmaceutical	100,000
	Sparks Dynamics LLC	100,000
	Admit Advantage	100,000
	PPMLITE LLC	100,000
	Cobrain Company	100,000
	Cureveda LLC	100,000
	Vixiar Medical Inc.	100,000
	Kinglet Inc	100,000
	Quantified Care LLC	100,000
		$2,100,000
Technology Validation Program		
	UMCES – Li	$40,000
	Manta BioFuels	10,000
	Poseidon Analytics	10,000
	AAS Inc.	9,000
		$69,000
Total		**$8,720,071**
Stem Cell Research Fund		
Investigator-Initiated		
UMB	Feldman	$655,500
UMCP	Fisher	655,500
JHU	Garza	640,000
UMB	Kaetzel	655,500
JHU	Koliatsos	655,500
JHU	Kwon	655,500
JHU	Maragakis	655,353
JHU	Song	655,500
		$5,228,353
Exploratory		
JHU	Burns	$200,000
UMCP	Cao	218,500
JHU	Dawson	218,500
UMB	Gong	218,500

		Award Amount
JHU	Johnston	218,237
JHU	Kraitchman	218,500
Kennedy Krieger	Li	218,500
JHU	Wang	218,500
JHU	Wen	218,500
JHU	Xian	218,500
Kennedy Krieger	Ying	218,500
		$2,384,737
Post-Doctoral Fellowship		
JHU	Chamling	$110,000
JHU	Ehmsen	110,000
UMB	Datla	110,000
JHU	Lorenzini	110,000
UMB	Sharma	110,000
JHU	Uosaki	110,000
JHU	Yoo	110,000
JHU	Yoon	110,000
JHU	Zhu	110,000
		$990,000
Pre-Clinical		
MaxCyte Inc	Schon	$475,000
		$475,000
Stem Cell Totals		**$9,078,090**

JHU: The Johns Hopkins University
Kennedy Krieger: Hugo Moser Kennedy Krieger Research Institute
UMB: University of Maryland, Baltimore
UMBC: University of Maryland Baltimore County
UMCES: University of Maryland Center for Environmental Science
UMCP: University of Maryland, College Park

Source: Maryland Technology Development Corporation

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Maryland Technology Development Corporation
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$19,073	$0	$0	$0	$19,073
Deficiency Appropriation	-1,000	0	0	0	-1,000
Cost Containment	-381	0	0	0	-381
Budget Amendments	1,000	0	0	0	1,000
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	**$18,692**	**$0**	**$0**	**$0**	**$18,692**
Fiscal 2016					
Legislative Appropriation	$18,516	$0	$0	$0	$18,516
Budget Amendments	1,151	16,387	0	0	17,539
Working Appropriation	**$19,667**	**$16,387**	**$0**	**$0**	**$36,055**

Note: Numbers may not sum to total due to rounding.

Fiscal 2015

The original fiscal 2005 appropriation was decreased due to a negative deficiency that reduced funding for the Maryland Stem Cell Research Program by $1 million. TEDCO was also subject to statewide across-the-board cost containment reductions in fiscal 2015. At a meeting of the Board of Public Works in early January 2015, $381,463 of the corporation's general funds were withdrawn.

Conversely, the original fiscal 2015 appropriation increased by $1 million due to a budget amendment that transferred the funds from Commerce (formerly the Department of Business and Economic Development) to TEDCO to fund the newly created CIF. This transfer is a result of language in the fiscal 2015 budget bill that restricted the funds in Commerce's appropriation to be used only by TEDCO to benefit the new program.

Fiscal 2016

The original fiscal 2016 appropriation was altered significantly due to the impact of Chapter 141, which transferred the operation of the MVF ($16.4 million in special funds) and the Maryland Biotechnology grant program ($1.2 million in general funds). The funds were transferred by budget amendment. The fiscal 2017 allowance also reflects the full funding of the programs.

Appendix 2

Audit Findings

Audit Period for Last Audit:	May 22, 2012 – January 6, 2015
Issue Date:	June 2015
Number of Findings:	0
Number of Repeat Findings:	0
% of Repeat Findings:	n/a
Rating: (if applicable)	n/a

The audit did not disclose any findings.

Object/Fund Difference Report
Maryland Technology Development Corporation

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Objects					
08 Contractual Services	$ 0	$ 0	$ 12,093	$ 12,093	N/A
12 Grants, Subsidies, and Contributions	18,691,729	36,054,919	26,799,919	-9,255,000	-25.7%
Total Objects	**$ 18,691,729**	**$ 36,054,919**	**$ 26,812,012**	**-$ 9,242,907**	**-25.6%**
Funds					
01 General Fund	$ 18,691,729	$ 19,667,480	$ 19,467,480	-$ 200,000	-1.0%
03 Special Fund	0	16,387,439	7,344,532	-9,042,907	-55.2%
Total Funds	**$ 18,691,729**	**$ 36,054,919**	**$ 26,812,012**	**-$ 9,242,907**	**-25.6%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Maryland Technology Development Corporation

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Tech. Development, Transfer and Commercialization	$ 3,591,729	$ 4,774,480	$ 4,674,480	-$ 100,000	-2.1%
03 Maryland Stem Cell Research Fund	9,400,000	9,093,000	9,093,000	0	0%
04 Maryland Innovation Initiative	4,900,000	4,900,000	4,800,000	-100,000	-2.0%
05 Cyber Security Investment Fund	800,000	900,000	900,000	0	0%
06 Enterprise Fund Administration	0	1,332,439	1,344,532	12,093	0.9%
07 Enterprise Investment Fund	0	15,055,000	6,000,000	-9,055,000	-60.1%
Total Expenditures	**$ 18,691,729**	**$ 36,054,919**	**$ 26,812,012**	**-$ 9,242,907**	**-25.6%**
General Fund	$ 18,691,729	$ 19,667,480	$ 19,467,480	-$ 200,000	-1.0%
Special Fund	0	16,387,439	7,344,532	-9,042,907	-55.2%
Total Appropriations	**$ 18,691,729**	**$ 36,054,919**	**$ 26,812,012**	**-$ 9,242,907**	**-25.6%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

U00A
Department of the Environment

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$32,212	$32,345	$32,184	-$161	-0.5%
Deficiencies and Reductions	0	0	-82	-82	
Adjusted General Fund	**$32,212**	**$32,345**	**$32,102**	**-$242**	**-0.7%**
Special Fund	61,360	77,363	88,845	11,482	14.8%
Deficiencies and Reductions	0	1,450	-127	-1,577	
Adjusted Special Fund	**$61,360**	**$78,813**	**$88,719**	**$9,905**	**12.6%**
Federal Fund	33,712	34,197	33,523	-674	-2.0%
Deficiencies and Reductions	0	485	-71	-556	
Adjusted Federal Fund	**$33,712**	**$34,682**	**$33,452**	**-$1,230**	**-3.5%**
Reimbursable Fund	3,942	5,370	4,046	-1,323	-24.6%
Adjusted Reimbursable Fund	**$3,942**	**$5,370**	**$4,046**	**-$1,323**	**-24.6%**
Adjusted Grand Total	**$131,225**	**$151,210**	**$158,319**	**$7,109**	**4.7%**

- The Governor has submitted a deficiency appropriation for the fiscal 2016 operating budget, which would increase the Maryland Department of the Environment's (MDE) Land Management Administration special fund appropriation by $1,450,000 to reimburse costs using the Oil Contaminated Site Environmental Cleanup Fund ($750,000) and also to support additional contractual employees working with lead property registrations and improve lead registry databases from the Lead Poisoning Prevention Fund ($700,000); and to increase the Coordinating Offices' federal fund appropriation by $485,000 for a grant to Salisbury to support water system improvements.

- The overall adjusted change in the MDE fiscal 2016 budget is an increase of $7.1 million, or 4.7%. The single largest change in the budget is an $11.5 million increase in Bay Restoration Fund revenue bond debt service.

For further information contact: Andrew D. Gray Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	936.00	939.00	934.00	-5.00
Contractual FTEs	28.15	59.50	40.50	-19.00
Total Personnel	**964.15**	**998.50**	**974.50**	**-24.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	65.38	7.00%
Positions and Percentage Vacant as of 12/31/15	77.00	8.20%

- MDE regular positions decrease by 5.00 between the fiscal 2016 working appropriation and the fiscal 2017 allowance. The abolished positions are all filled and are as follows: 1.0 physician program staff in Science Services Administration, 1.0 regulatory compliance engineer-architect III in Land Management Administration, 2.0 computer specialist II in Coordinating Offices – Office of Information Management and Technology, and 1.0 administrator III in Coordinating Offices – Office of Information Management and Technology.

- MDE has 19.0 positions that have been vacant for more than a year as of December 31, 2015.

- MDE contractual full-time equivalents (FTE) decrease by 19.0 in the fiscal 2017 allowance. The decreases are as follows: 6.0 FTEs in Land Management Administration, 4.0 FTEs in Water Management Administration, 4.0 FTEs in Air and Radiation Management Administration, 3.0 FTEs in Coordinating Offices, and 2.0 FTEs in Operational Services Administration.

- The MDE turnover rate increased from 6.93% in the fiscal 2016 working appropriation to 7.0% in the fiscal 2017 allowance, which reflects an increase from 65.07 necessary vacancies to 65.38 necessary vacancies. The MDE vacancy rate as of December 31, 2015, was 8.20%, or 77.0 vacancies, which is relatively high but will enable MDE to meet its budgeted turnover. The MDE vacancy rate was 11.49% on July 1, 2008, then steadily decreased to 4.02% on January 1, 2010. Since then it has increased to 8.20% as of December 31, 2015. Therefore, the MDE vacancy rate is at the high end of what is normal for the agency.

- The MDE deputy secretary position was deleted and an executive VIII position was added between fiscal 2016 and 2017, which MDE notes is simply a change in classification.

Analysis in Brief

Major Trends

State Agencies Recycling Goals Foiled: State agencies achieved an overall recycling rate of 31.12% in calendar 2014. However, of the 37 State agencies, only 13 met the 30.0% goal and 24 did not. In addition, only 8 agencies have already met the calendar 2015 goal of 40.0%, based on the calendar 2014 data, and 29 have not met the 40.0% goal or appear to be on track to do so. **The Department of Legislative Services (DLS) recommends that MDE comment on how agencies will meet the calendar 2015 40.0% recycling goal and what the preliminary data says about this goal.**

Power Plant Emissions Driven by the Market: The amount of greenhouse gas (GHG) emissions emitted from power plants decreased from 24.5 million tons per year in calendar 2011 to 21.0 million tons in calendar 2012 and has remained at that level. Similarly, the amount of criteria pollutants (sulfur oxides, nitrogen oxides, ground-level ozone, particulate matter, lead and carbon monoxide) decreased from 57,000 tons per year to 44,000 tons per year in calendar 2012 and have changed little since then. MDE notes that the reductions in both criteria pollutants and GHG emissions are linked to the fact that power plants were operated less in calendar 2012 than in calendar 2011 due to market forces and the way in which various plants are called into service by the electrical grid manager. **DLS recommends that MDE comment on what dictates the operating times of plants and how this correlates with GHG and criteria pollutant emissions reductions.**

Childhood Blood Lead Levels Still Declining: Over the fiscal 2011 to 2017 estimated time period, there are approximately 110,000 children tested each year and the reported levels of blood lead, both between 5 and 9 micrograms per deciliter and greater than 10 grams per deciliter (the current standard), have been declining. MDE attributes the decline in blood lead levels to the oversight and enforcement of Maryland's "Reduction of Lead Risk in Housing Act," which requires owners of pre-1978 rental dwelling units to reduce the potential for child exposure to lead paint hazards by performing specific lead risk reduction treatments prior to each change in tenancy. **DLS recommends that MDE comment on the status of the discussion concerning universal testing and the impact on the prevalence of childhood blood lead levels, both between 5 and 9 micrograms per deciliter and greater than 10 micrograms per deciliter.**

Issues

More Fee Reductions on the Way: The Administration implemented fee reductions on September 15, 2015. In addition, the Administration has introduced SB 389 and HB 459 (Fee, Surcharge, and Tax Reduction Act of 2016) in the 2016 session that would modify the allocation of the Strategic Energy Investment Fund and reduce the Wetlands and Waterways Program fee for minor projects or general permits (those impacting less than 5,000 square feet), from $750 to $500. **DLS recommends that MDE comment on the impact on revenues and agency operations of the proposed reduction in the fee for minor projects or general permits, from $750 to $500, and whether MDE has any plans to convene a work group to review and assess the performance of**

the Wetlands and Waterways Program and the adequacy of any amended application fees to support an effective program.

Sediment and Erosion Control Inspection Positions Reclassified: The MDE January 2015 audit completed by the Office of Legislative Audits contained two repeat findings, one of which was the finding that there are insufficient resources to inspect every active construction site for compliance with erosion and sediment control plans on average of once every two weeks in accordance with State regulations. As a result, the General Assembly requested a report on how MDE will meet the inspection requirement, and added budget bill language restricting funding unless 6 positions are reclassified by January 1, 2016, for statewide inspections. The positions have been reclassified and MDE is looking to modify the regulations requiring the inspections every two weeks. **DLS recommends that MDE comment on the timeframe for updating its database to capture reissuance/expiration dates, the response to and current status of expanded delegation to counties, and the status of the meeting to amend the regulatory language mandating that all sites be inspected on average once every two weeks.**

Maryland Energy Administration Co-locating with MDE: The Maryland Energy Administration's website notifies that it co-located with MDE on December 16, 2015. The co-location raises a number of concerns related to the process, timing, cost and savings, and reason for the move. **DLS recommends that MDE comment on (1) the justification for the co-location; (2) the type of costs incurred in the move and reconfiguration of MDE space, when the costs were or will be incurred and by whom; (3) the amount and fund source associated with each cost; and (4) the expected long-term cost savings associated with the move and explanations for how these cost savings will be achieved.**

Lead Paint Issues Linger: Lead poisoning prevention has garnered a substantial amount of interest since the identification that Freddie Gray – who died in Baltimore City after being apprehended by police in April 2015 – had childhood lead poisoning. In addition, the Administration has expanded the universe of children tested for lead paint poisoning, which will potentially increase costs for inspections conducted by either MDE or local health departments. Most recently, MDE announced on January 28, 2016, that it has opened an investigation to determine whether rental properties certified by a private inspector are actually lead free. **DLS recommends that MDE comment on the status of resolving the January 2015 lead paint audit findings and of working with the Department of Information Technology on the upgrade of the lead rental property registration and certification databases; the costs associated with the universal lead testing program for children ages one to two years old; and whether a State contract for inspections, audits and spots checks of lead rental properties is necessary given the potential for fraud reported on January 28, 2016.**

Recommended Actions

1. Concur with Governor's allowance.

U00A
Department of the Environment

Operating Budget Analysis

Program Description

The Maryland Department of the Environment (MDE) was created in 1987 to protect and restore the quality of the State's land, air, and water resources, and safeguard citizens from health risks associated with pollution. It is responsible for planning, monitoring, controlling, and regulating air, solid, and hazardous wastes; radiation, sewage sludge, sediment, and stormwater; toxicities, sewage treatment and water supply facilities; and environmental disease control programs. The department is structured into seven major administrative units.

- ***Office of the Secretary:*** This office provides direction and establishes State environmental policies to be implemented by the operating units.

- ***Operational Services Administration:*** This administration provides general administrative and fiscal services to the department.

- ***Water Management Administration:*** This administration administers the State's water pollution control program; implements Total Maximum Daily Loads (TMDL) for pollutants in impaired waterways; and regulates industrial/municipal wastewater and stormwater discharge.

- ***Science Services Administration:*** This administration develops and promulgates water quality standards; provides technical support and analysis for TMDLs; monitors shellfish; develops environmental and public health risk assessments; implements nonpoint source pollution programs; and develops and issues fish advisories.

- ***Land Management Administration:*** This administration ensures that all types of hazardous and nonhazardous solid wastes are managed in a manner that protects public health and the environment. It regulates solid waste management facilities, scrap tire recycling facilities, above-ground and below-ground petroleum storage facilities, petroleum distribution, hazardous waste transportation, mining, and both concentrated animal feeding operations and Maryland animal feeding operations. In addition, this administration coordinates lead poisoning prevention efforts.

- ***Air and Radiation Management Administration:*** This administration ensures that air quality and radiation levels in Maryland sustain public health, safety, and the environment. It operates an air-monitoring network, licenses asbestos removal contractors, provides oversight of the Vehicle Emissions Inspection Program, and monitors radiation use. Climate change initiatives are a relatively new component of its operations.

- ***Coordinating Offices:*** This office manages budget matters, the Water Quality and Drinking Water Revolving Loan funds and other water pollution control program capital projects, and Board of Public Works (BPW) activities; coordinates public information and outreach; provides hazardous chemical and oil spill emergency response services; provides legal advice; and information technology services.

MDE has four goals that are consistent with efforts to protect and preserve Maryland's natural resources. They are:

- provide excellent customer service and community outreach;
- manage air quality and emissions for maximum protection of human health and the environment;
- reduce Maryland citizens' exposure to hazards; and
- protect water resources and ensure safe and adequate drinking water.

Performance Analysis: Managing for Results

The MDE Managing for Results measures show (1) State agencies facing a steep climb to the statewide agency recycling goal of 40% by calendar 2015; (2) power plant emissions being driven by the market, particularly in calendar 2011; and (3) childhood blood lead levels declining.

1. State Agencies Recycling Goals Foiled

MDE has the goal to provide excellent customer service and community outreach. MDE has an objective of supporting and tracking statewide recycling efforts. The State leads by example with its own Maryland Recycling Act (1988) provision to achieve an overall State agency recycling rate – defined as recycling amount divided by total waste generated – of at least 20%. Subsequently, Chapter 692 of 2012 (Environment – Recycling Rates and Waste Diversion – Statewide Goals) raised the required recycling rate to 30% for calendar 2014, although there is a *proviso* that if the target is determined to not be practical or economically feasible, the bill increases, from 10% to 15%, the minimum required level of recycling that must be achieved. According to the MDE Summer 2015 *All State Agencies Recycle News*, MDE asked all State agencies to set a recycling goal of at least 40% in calendar 2015.

As shown in **Exhibit 1**, State agencies achieved an overall recycling rate of 31.12% in calendar 2014. However, of the 37 State agencies, only 13 agencies met the 30.0% goal and 24 did not. In addition, only 8 agencies met the calendar 2015 goal of 40.0%, based on the calendar 2014 data, and 29 agencies did not meet the 40.0% goal.

Exhibit 1
Maryland State Agencies' 2014 Recycling Rates
Calendar 2014

Agency Name	No. of Sites	No. of Sites Reporting	No. of People	Total MRA Recycling 2014 (Tons)	2014 MRA Recycling Rate (%)	Met 2014 30% Goal	Met 2015 40% Goal Yet
Comptroller of the Treasury	1	1	800	126	81.39	Met	Met
Department of Budget and Management	1	1	185	31	73.63	Met	Met
Maryland Environmental Service	4	4	253	17	62.77	Met	Met
Subsequent Injury Fund	1	1	17	4	60.46	Met	Met
Maryland Insurance Administration	1	1	1,235	24	51.22	Met	Met
Department of the Environment	5	5	970	59	43.47	Met	Met
Department of Transportation	83	83	25,826	9,999	43.19	Met	Met
Maryland Energy Administration	1	1	34	1	40.91	Met	Met
University of Maryland System	17	15	81,978	8,393	39.04	Met	Not Yet
Maryland Automobile Insurance Fund	1	1	250	55	38.61	Met	Not Yet
Department of General Services	23	23	7,803	712	31.49	Met	Not Yet
Maryland Stadium Authority	1	1	1,000	782	31.02	Met	Not Yet
Maryland State Archives	1	1	84	9	30.39	Met	Not Yet
Department of Human Resources	33	11	1,511	114	29.50	Not Met	Not Yet
Department of Veterans Affairs	12	5	800	243	29.08	Not Met	Not Yet
Department of Labor, Licensing, and Regulation	14	13	1,348	236	28.49	Not Met	Not Yet
Department of Education	30	30	1,411	162	28.43	Not Met	Not Yet
Department of Assessments and Taxation	15	13	1,153	18	24.73	Not Met	Not Yet
Department of Public Safety and Correctional Services	35	7	20,961	2,260	24.42	Not Met	Not Yet
Maryland Department of Planning	1	1	35	33	22.60	Not Met	Not Yet
Maryland State Police	27	27	1,715	299	22.21	Not Met	Not Yet
Morgan State University	1	1	9,241	218	21.27	Not Met	Not Yet
Maryland Public Broadcasting Commission	1	1	211	76	21.01	Not Met	Not Yet
Maryland School for the Deaf	2	2	989	51	20.99	Not Met	Not Yet
Department of Juvenile Services	15	15	2,894	498	16.27	Not Met	Not Yet
Department of Agriculture	2	2	216	25	14.68	Not Met	Not Yet
Governor's Office of Crime Control and Prevention	1	1	800	3	12.08	Not Met	Not Yet

Agency Name	No. of Sites	No. of Sites Reporting	No. of People	Total MRA Recycling 2014 (Tons)	2014 MRA Recycling Rate (%)	Met 2014 30% Goal	Met 2015 40% Goal Yet
Department of Housing and Community Development	3	3	431	45	11.04	Not Met	Not Yet
Department of Natural Resources	6	6	529	39	8.84	Not Met	Not Yet
Department of Health and Mental Hygiene	18	11	4,950	428	7.47	Not Met	Not Yet
Maryland Food Center Authority	1	1	1,325	303	5.09	Not Met	Not Yet
Baltimore City Community College	1	1	8,796	4	1.23	Not Met	Not Yet
Maryland Department of Disabilities	1	1	24	0.10	1.16	Not Met	Not Yet
Judiciary of Maryland	1	0	0	0	0	Not Met	Not Yet
Maryland General Assembly	1	0	0	0	0	Not Met	Not Yet
Maryland Military Department	33	0	0	0	0	Not Met	Not Yet
St. Mary's College of Maryland	1	0	0	0	0	Not Met	Not Yet
Total	**395**	**290**	**179,775**	**25,266**	**31.12**	**n/a**	**n/a**

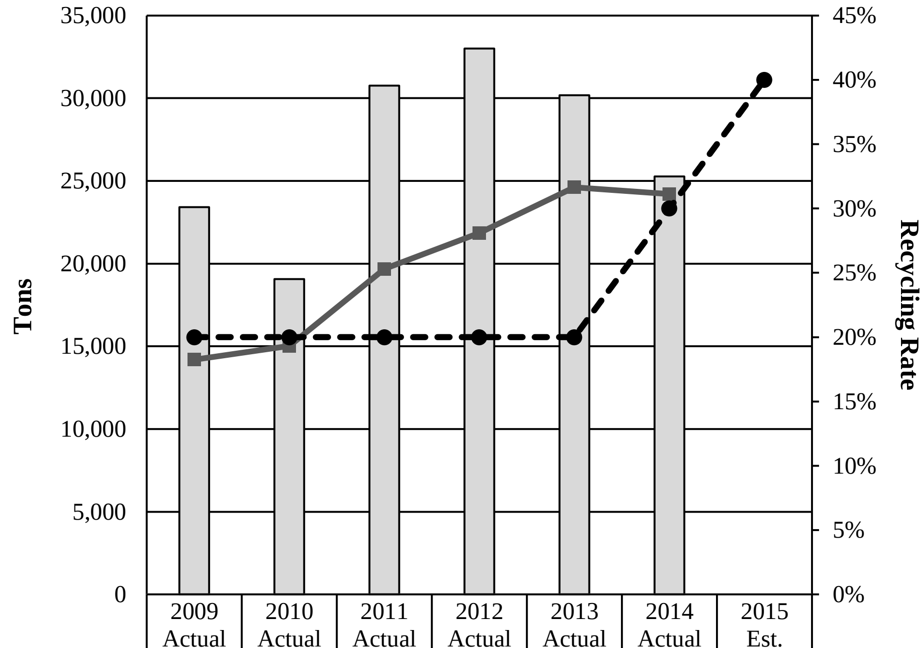
MRA: Maryland Recycling Act

Note: The MRA recycling rate is defined as the total MRA recycling divided by total solid waste generated and multiplied by 100.

Source: Maryland Department of the Environment, *All State Agencies Recycle News*, Summer 2015; Department of Legislative Services

Exhibit 2 shows the recent history for the State agency recycling rate. Between calendar 2009 and 2010, the State agencies were below the 20% recycling rate, but between calendar 2011 and 2014, exceeded the goal. The calendar 2015 goal of 40% appears to be a challenge given the recent trends. **The Department of Legislative Services (DLS) recommends that MDE comment on how agencies will meet the calendar 2015 40% recycling goal and what the preliminary data says about this goal.**

Exhibit 2
Maryland State Agency Recycling Rate
Calendar 2009-2015



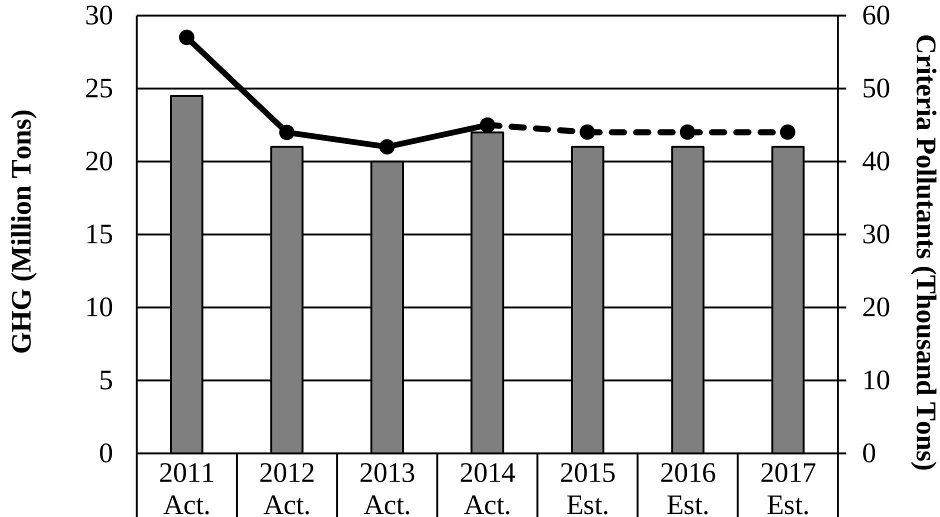
	2009 Actual	2010 Actual	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Est.
Recycling Tonnage	23,413	19,070	30,754	32,998	30,182	25,266	
State Agency Recycling Rate	18.24%	19.31%	25.31%	28.08%	31.64%	31.12%	
Goal	20.00%	20.00%	20.00%	20.00%	20.00%	30.00%	40.00%

Source: Maryland Department of the Environment, *2014 Maryland Solid Waste Management and Diversion Report* (Calendar 2013 Data); *All State Agencies Recycle News*, Summer 2015

2. Power Plant Emissions Driven by the Market

MDE has the goal to manage air quality and emissions for maximum protection of human health and the environment. MDE has objectives to reduce greenhouse gas (GHG) emissions and to reduce emissions of criteria pollutants from power plants. As shown in **Exhibit 3**, the amount of GHG emissions emitted from power plants decreased from 24.5 million tons per year in calendar 2011 to 21.0 million tons per year in calendar 2012, but has remained at that level through calendar 2015. Similarly, over the same time period, the amount of criteria pollutants (sulfur oxides, nitrogen oxides, ground-level ozone, particulate matter, lead and carbon monoxide) decreased from 57,000 tons per year to 44,000 tons per year, but has remained at that level through calendar 2015.

Exhibit 3
Power Plant Emissions
Calendar 2011-2017 Est.



	2011 Act.	2012 Act.	2013 Act.	2014 Act.	2015 Est.	2016 Est.	2017 Est.
Amount of GHG (in million tons per year) emitted from power plants	24.5	21.0	20.0	22.0	21.0	21.0	21.0
Amount of criteria pollutants (in thousand tons per year) emitted from power plants	57	44	42	45	44	44	44

GHG: greenhouse gas

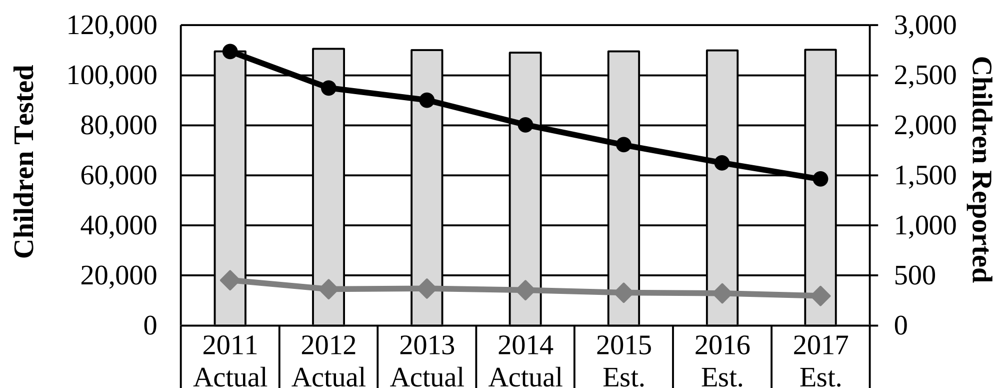
Source: Department of Budget and Management

MDE notes that the reductions in both criteria pollutants and GHG emissions are linked to the fact that power plants were operated less in calendar 2012 than they were in calendar 2011, due to market forces and the way in which various plants are called into service by the electrical grid manager. MDE further notes that there will be reductions in the emissions of nitrogen oxides starting in calendar 2015 as a result of the recently promulgated nitrogen oxides rules, although this will depend on changes in the operating times of plants. **DLS recommends that MDE comment on what dictates the operating times of plants and how this correlates with GHG and criteria pollutant emissions reductions.**

3. Childhood Blood Lead Levels Still Declining

A second objective, under the MDE goal to reduce Maryland citizens' exposure to hazards, is to reduce the number of elevated blood lead levels found in children. **Exhibit 4** shows that from fiscal 2011 to 2015, there have been approximately 110,000 children tested each year and that the number of reported levels of blood lead, both between 5 and 9 micrograms per deciliter and greater than 10 grams per deciliter (the current standard), have been declining. MDE attributes the decline in blood lead levels to the oversight and enforcement of Maryland's "Reduction of Lead Risk in Housing Act," which requires owners of pre-1978 rental dwelling units to reduce the potential for child exposure to lead paint hazards by performing specific lead risk reduction treatments prior to each change in tenancy. In turn, these treatments are verified by an MDE-accredited third-party inspector and submitted to MDE. MDE also notes that it has allocated money for outreach and education through service to educate tenants, property owners, and the accredited lead community about primary prevention. However, the implementation of statewide universal testing will increase the number of children tested in fiscal 2016 and 2017, and presumably the prevalence of childhood blood lead levels, both between 5 and 9 micrograms per deciliter and greater than 10 micrograms per deciliter. **DLS recommends that MDE comment on the status of the discussion concerning universal testing and the impact on the prevalence of childhood blood lead levels, both between 5 and 9 micrograms per deciliter and greater than 10 micrograms per deciliter.**

Exhibit 4
Reported Childhood Blood Lead Levels
Fiscal 2011-2017 Est.



	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Est.	2016 Est.	2017 Est.
Number of children tested for elevated blood lead	109,534	110,539	110,082	109,031	109,576	109,905	110,235
Reported childhood blood lead between 5 and 9 micrograms per deciliter	2,740	2,375	2,251	2,004	1,804	1,624	1,462
Reported exceedances of elevated (10 micrograms per deciliter) blood lead standard	452	364	371	355	327	321	295

Source: Department of Budget and Management; Maryland Department of the Environment

Fiscal 2016 Actions

There are two sets of actions that affect the MDE fiscal 2016 budget. The two actions are proposed deficiencies and cost containment.

Proposed Deficiency

The Governor has submitted deficiency appropriations for the fiscal 2016 operating budget which would increase the MDE Land Management Administration special fund appropriation by $1,450,000 for two purposes and increase Coordinating Offices' federal fund appropriation by $485,000. The funding would be used as follows.

- ***Oil Containment Site Environmental Cleanup Program:*** An increase of $750,000 in special funds in Land Management Administration to provide grants to reimburse costs using the Oil Contaminated Site Environmental Cleanup Fund because the revenue was not available when the fiscal 2016 budget was prepared.

- ***Lead Poisoning Prevention Program Support:*** An increase of $700,000 in special funds in the Land Management Administration in order to support additional contractual employees working with lead property registrations and improve lead registry databases from the Lead Poisoning Prevention Fund.

- ***Salisbury Water System Improvements:*** An increase of $485,000 in federal funds in Coordinating Offices from the U.S. Environmental Protection Agency's Congressionally Mandated Projects from federal fiscal 2010 funding for a one-time grant – on a cost-share basis at 55% of the eligible project cost – to Salisbury to support water systems such as the replacement of cast iron piping in order to improve the reliability of the drinking water system.

Cost Containment

The MDE fiscal 2016 budget is reduced by the 2% across-the-board reduction implemented in the 2015 session. The MDE share of the reduction was $398,000 in general funds in the operating program and $300,000 in general funds in the pay-as-you-go (PAYGO) capital programs as shown in **Exhibit 5**.

Exhibit 5
2% Across-the-board Reductions for MDE
Fiscal 2016

Program	Action	Funding	Position
Operating			
Water Management Administration	Use non-general funds from savings related to the merit increases that were eliminated in fiscal 2016 in-lieu of general funds ($220,405); eliminate vacant contractual staff attorney position and use special funds appropriated for this function in-lieu of general funds ($48,595); and eliminate the Maryland Center for Environmental Training contractor responsible for reviewing plans, designs, and cost estimates during the water and sewer pre-application process and use special funds appropriated for this function in-lieu of general funds ($25,000).	$294,000	0.00
Science Services Administration	Shift support for an information programmer analyst lead/advanced position in the Science Services Administration from general funds to non-general funds and reassign the position to be a geologist III environmental programs position in the Land Management Administration for a contractual conversion.	72,000	0.00
Land Management Administration	Shift support for an office secretary III position in Land Management Administration from general funds to non-general funds and reassign the position to be a designated administrative manager I in Coordinating Offices.	32,000	0.00
	Subtotal	***$398,000***	***0.00***
PAYGO Capital			
Hazardous Substance Clean-Up Program	Reduce the $700,000 appropriation to $400,000.	$300,000	0.00
	Subtotal	***$300,000***	***0.00***
	Total	**$698,000**	**0.00**

MDE: Maryland Department of the Environment
PAYGO: pay-as-you-go

Source: Department of Budget and Management

Proposed Budget

The MDE fiscal 2017 adjusted allowance increases by $7.1 million, or 4.7%, relative to the fiscal 2016 adjusted working appropriation, as shown in **Exhibit 6**. The changes by fund reflect a decrease of $0.2 million in general funds, an increase of $9.9 million in special funds, a decrease of $1.2 million in federal funds, and a decrease of $1.3 million in reimbursable funds. The single largest change in the budget is an increase of $11.5 million in special funds for debt service on Bay Restoration Fund revenue bonds. Changes in personnel funding are discussed first and then other changes.

Employee increments and associated expenses (including Social Security, retirement, unemployment compensation, and turnover) are included in the budget of the Department of Budget and Management (DBM); $1,411,954 in total funds comprised of $307,540 in general funds, $671,085 in special funds, $364,772 in federal funds, and $68,558 in reimbursable funds will be distributed to MDE by budget amendment for the start of the fiscal year.

Exhibit 6
Proposed Budget
Department of the Environment
($ in Thousands)

How Much It Grows:	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015 Actual	$32,212	$61,360	$33,712	$3,942	$131,225
Fiscal 2016 Working Appropriation	32,345	78,813	34,682	5,370	151,210
Fiscal 2017 Allowance	32,102	88,719	33,452	4,046	158,319
Fiscal 2016-2017 Amount Change	-$242	$9,905	-$1,230	-$1,323	$7,109
Fiscal 2016-2017 Percent Change	-0.7%	12.6%	-3.5%	-24.6%	4.7%

Where It Goes:

Personnel Expenses

Employee and retiree health insurance	$1,467
Retirement contribution	1,668
Other fringe benefit adjustments	29
Social Security contribution	-89
Turnover adjustments	-100
Workers' compensation	-155
Abolished/transferred positions	-618
Fiscal 2016 adjustments	-1,042

Where It Goes:	
Other Changes	
Protect Water Resources	
Bay Restoration Fund debt service	11,500
Digital floodplain mapping and wetland habitat conservation	470
Hire inspectors for Energy-Water Infrastructure Program	100
Maryland Center for Environmental Training design/construction activity review	-100
In-lieu fee nontidal wetland projects	-600
Routine Operations	
Utilities – electricity	-103
Net reduction in lease payments for emergency response vehicles and computers	-185
Cloud based data backup	-189
Vehicle expenses	-229
Contractual full-time equivalents decrease by 19.0 and partial one-time deficiency	-363
Environmental Permit Tracking System Modernization Project funding	-1,206
Exposure to Hazards	
Pay-as-you-throw analysis	333
Abandoned mine reclamation projects	216
Grants for blood lead medical and environmental case management	-200
Electronics recycling grants to counties and municipalities	-215
Online Lead Rental Registry	-238
Reduced oil spill investigation/remediation work	-290
One-time deficiency for Salisbury water system improvements	-485
One-time deficiency for oil spill reimbursements	-750
Statewide Waste Audit, Scrap Tire Drop-Off Day, and Rock Hall tire cleanup	-1,130
Manage Air Quality and Emissions	
Other	-79
One-time air monitoring equipment purchase	-128
One-time replacement of gas chromatograph/mass spectrometer and attachments	-180
Total	**$7,109**

Note: Numbers may not sum to total due to rounding.

Personnel

Changes by Category

MDE overall personnel expenditures increase by $1,159,727 in the fiscal 2017 adjusted allowance. Of note, this increase includes an across-the-board reduction that reduces MDE personnel expenses by $279,246. The personnel changes are as follows.

- ***Employee and Retiree Health Insurance:*** There is an increase of $1,466,799.

- ***Retirement Contribution:*** There is an increase of $1,668,427.

- ***Abolished/Transferred Positions:*** There is a decrease of $618,399 for the 5 abolished positions.

- ***Workers' Compensation:*** There is a decrease of $155,423 for workers' compensation.

- ***Turnover Adjustments:*** There is a decrease of $99,660.

- ***Social Security Contribution:*** There is a decrease of $88,552 for Social Security contribution.

Other Changes

Overall, the nonpersonnel portion of the MDE fiscal 2016 adjusted allowance increases by $5,949,487. The areas of change may be broadly categorized as activities related to the protection of water resources, routine operations, exposure to hazards, and managing air quality and emissions. The biggest change is an increase of $11,500,000 in special funds for Bay Restoration Fund revenue bond debt service. Larger changes are as follows.

Protect Water Resources

- ***Bay Restoration Fund Revenue Bond Debt Service:*** There is an increase of $11,500,000 in special funds in Coordinating Offices – Bay Restoration Fund Debt Service that reflects the increased debt service as a result of the November 2015 issuance of $180.0 million in revenue bonds plus $16.9 million in bond premiums for wastewater treatment upgrades to enhanced nutrient removal technology.

- ***Digital Floodplain Mapping and Wetland Habitat Conservation:*** There is an increase of $470,000 comprised of an increase of $500,000 in federal funds, a decrease of $22,500 in reimbursable funds, and a decrease of $7,500 in general funds in the Water Management Administration – Wetlands and Waterways, primarily for additional digital floodplain mapping work both in Montgomery County and statewide by the Maryland Environmental Service (MES) using Cooperating Technical Partners Grant federal funding and for improving habitat conservation in wetlands by the Department of Natural Resources (DNR) using Wetlands Program Development Grant federal funding.

- ***In-lieu Fee Nontidal Wetland Projects:*** There is a decrease of $600,000, comprised of an $800,000 special fund decrease and $200,000 federal fund increase, in the Water Management Administration – Wetlands and Waterways due to a reduction in the funding associated with a Memorandum of Understanding with the Chesapeake Bay Trust for development of an in-lieu fee for nontidal wetland projects within specific services that is offset partially by a new grant for investigating living shoreline projects.

Routine Operations

- ***Environmental Permit Tracking System Modernization Project Funding:*** There is a decrease of $1,206,028 in reimbursable funds that were transferred in fiscal 2016 from the Department of Information Technology (DoIT) Major Information Technology Development Project Fund (MITDF) to the MDE Major Information Technology Development Program for the Environmental Permit Tracking System Modernization Project, which will update how permit data is captured through the use of Dot Net technologies. MDE notes that the fiscal 2016 funding reflects funding from fiscal 2014 and 2015 ($456,028), and 2016 ($750,000). MDE also notes that it is working on two critical deliverables for the planning phase of the project: the Functional Requirements Document and the Task Order Request for Proposals for the implementation phase of the project. Finally, it is noted that there is $1,490,000 in general funds in the DoIT MITDF for fiscal 2017, of which $50,000 is programmed for DoIT oversight of the project.

- ***Contractual Full-time Equivalents Decrease by 19.0 and Partial One-time Deficiency:*** The MDE contractual FTEs complement decrease by 19.0 FTEs, as shown in **Exhibit 7**. MDE notes that the reduction in FTEs reflects a combination of straight reductions, contractual conversions, and vacancies that were determined to be unneeded. Funding decreases by $362,529, which reflects a reduction of $215,319 for the 19.0 FTEs and a reduction of $147,210 since only a portion of the $300,000 fiscal 2016 deficiency for contractual FTEs carries over to fiscal 2017.

Exhibit 7
Contractual Full-time Equivalent Changes
Fiscal 2017 Allowance

Program	Change
Land Management Administration	-6.0
Water Management Administration	-4.0
Air and Radiation Management Administration	-4.0
Coordinating Offices	-3.0
Operational Services Administration	-2.0
Total	**-19.0**

Source: Maryland Department of the Environment

Exposure to Hazards

- ***Statewide Waste Audit, Scrap Tire Drop-Off Day, and Rock Hall Tire Cleanup:*** There is a decrease of $1,130,000 in special funds in the Land Management Administration – Resource Assessment Program due to a statewide waste audit and the Scrap Tire Citizen and Agricultural Drop-Off Day that are not being conducted as well as the end of funding for the Rock Hall scrap tire stockpile cleanup.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. The MDE share of these reductions totals $279,246 and is comprised of $81,574 in general funds, $126,696 in special funds, and $70,976 in federal funds. There is an additional across-the-board reduction to abolish positions statewide, but the amounts have not been allocated by agency.

Issues

1. More Fee Reductions on the Way

The Administration implemented fee reductions on September 15, 2015. In addition, the Administration has introduced SB 389 and HB 459 (Fee, Surcharge, and Tax Reduction Act of 2016) in the 2016 session that would modify the allocation of the Strategic Energy Investment Fund (SEIF) and reduce the Wetlands and Waterways Program fee for minor projects or general permits (those impacting less than 5,000 square feet), from $750 to $500.

Exhibit 8 reflects the impact of the September 15, 2015, fee reductions. MDE notes that the September 15, 2015, reductions will have a nominal impact on agency operations, which is consistent with the projected fiscal 2016 ending balances for the two funds that receive funding from the fees that have been reduced.

Exhibit 8
Fee Reductions
September 15, 2015

Unit	Fees	DLS Estimated Amount of Revenue Reduction	Comment
Air and Radiation Management Administration	Asbestos-related	$20,250	The Maryland Clean Air Fund has a projected fiscal 2016 ending balance of $625,674 and so this revenue reduction appears to be absorbable for the time being.
Land Management Administration	Oil-related	58,470	The fee assessed on oil transferred into the State recently was increased from $0.03 to $0.08 per barrel by Chapter 325 of 2014 (Maryland Oil Disaster Containment, Clean-Up and Contingency Fund and Oil Contaminated Site Environmental Cleanup Fund) and the Maryland Oil Disaster Containment, Clean-Up and Contingency Fund has a projected fiscal 2016 ending balance of $563,774 and so this reduction appears to be absorbable for the time being.
	Total	**$78,720**	

DLS: Department of Legislative Services

Source: Department of Legislative Services

As introduced, SB 389 and HB 459 would eliminate the surcharge on electricity distributed to retail electric customers in Maryland that currently is placed in the Environmental Trust Fund for the purposes of the DNR Power Plant Research Program. Instead, the Power Plant Research Program would be funded by a flat $10 million taken off the top of the Regional Greenhouse Gas Initiative (RGGI) carbon dioxide allowance revenues that are placed in the SEIF. As a result, there would be a reduction in the available revenue for renewable energy and climate change programs in MDE.

In addition, the legislation would reduce the Wetlands and Waterways Program fee for minor projects or general permits (those impacting less than 5,000 square feet), from $750 to $500. This fee was increased by Chapter 142 of 2008 (Environment – Water Management Administration – Wetlands and Waterways Program Fees) in order to be able to fund the work of the Wetlands and Waterways Program. Subsequently, the MDE *Report of the Wetlands and Waterways Program Funding Work Group* from 2012, which was required by Chapter 142, noted that the legislation led to the following accomplishments:

- increased staffing levels by 34 new positions;
- improved permit turnaround time so that the Wetlands and Waterways Program met its published turnaround times over 90% of the time;
- eliminated the permit application backlog; and
- provided enhanced services to the regulated and environmental communities.

In addition, the report noted that the amount of the fees was not adequate to support an effective program and placed financial burden on residential property owners. Finally, the report noted the need to convene a workgroup in 2015 to review and assess the performance of the Wetlands and Waterways Program and the adequacy of any amended application fees to support an effective program. **DLS recommends that MDE comment on the impact on revenues and agency operations of the proposed reduction in the fee for minor projects or general permits from, $750 to $500, and whether MDE has any plans to convene a workgroup to review and assess the performance of the Wetlands and Waterways Program and the adequacy of any amended application fees to support an effective program.**

2. Sediment and Erosion Control Inspection Positions Reclassified

The MDE January 2015 audit completed by the Office of Legislatives Audits contained two repeat findings, one of which was that there are insufficient resources to inspect every active construction site for compliance with erosion and sediment control plans an average of once every two weeks in accordance with State regulations. As a result, the General Assembly requested a report on how MDE will meet the inspection requirement, which was requested to be submitted by September 1, 2015, and added budget bill language restricting funding unless 6 positions are reclassified by January 1, 2016, for statewide inspection, enforcement, compliance, compliance assistance, and permit issuance related to erosion and sediment control in the Water Management Administration – Compliance subprogram. A letter confirming the reclassification of the positions was required by January 15, 2016. The letter and report were received on February 9, 2016.

Sediment and Erosion Control Inspection Report

The committees were concerned that MDE has been unable to conduct the required inspections and thus requested the submission of a report on how MDE will meet this requirement to be coordinated with the construction industry, environmental advocacy stakeholders, and DBM. **Exhibit 9** shows the report findings. MDE notes that the universe of sites and inspections requested in the report were provided based on an annual average of fiscal 2013 and 2014 for MDE, and annual average of calendar 2013 and 2014 for the delegated counties/municipalities as reported to MDE. MDE also notes that Environmental Article section 4-103 authorizes MDE to delegate inspection and enforcement authority for erosion and sediment control to "any county or municipality which is found capable of enforcing compliance" with the provisions of State erosion and sediment control law. Under this authority, erosion and sediment control inspection and enforcement has been delegated or partially delegated to 13 counties, 9 municipalities, and the Washington Suburban Sanitary Commission.

Exhibit 9
Sediment and Erosion Control Report Findings
January 2016

Request	Response	Comment
Universe of inspection sites	17,411	
Number of sites that MDE inspects	11,598	MDE notes that this number is probably overstated because the database cannot capture reissuance/ expiration dates and thus some of the 11,598 sites may no longer be open and actively under construction. MDE is pursuing an updated database.
Number of sites that each delegated authority inspects	5,813	Delegated authorities include counties, the State Highway Administration, the Maryland Transit Administration, and Soil Conservation Districts.
Number of remaining sites that are not inspected	10,273	MDE notes that the number of sites not inspected by the delegated counties and municipalities cannot be quantified based on the information reported to MDE, but that records identify an average of 10,273 sites not inspected.

Request	Response	Comment
Strategies for reducing the remaining sites not inspected to zero; including, but not limited to, lowering the standard in regulation, delegating additional authority for inspections to other entities, fostering greater coordination with local governments, increasing inspection positions, and evaluating the usefulness of surveillance technology, such as unmanned aerial vehicles	As noted below, MDE is pursuing several of these options. Surveillance technology, such as unmanned vehicles, was not discussed in the report.	The number of inspectors in fiscal 2014 was 31.1, which would result in 372.9 erosion and control inspections per inspector per year on average.
Action plan implementing the strategies for reducing the remaining sites not inspected to zero; including funding, positions, programmatic changes, performance measures, and a timeline for implementation to which the fiscal 2016 working appropriation and fiscal 2017 allowance may be compared	MDE intended to reclassify the 6 positions required by budget bill language; increase delegation of authority for inspections to counties; and seek an amendment to the inspection regulatory language.	MDE noted that it will send solicitation letters in fall 2015 to all counties in Maryland and will attempt to fast track delegation to the extent possible. MDE also noted that the regulation meeting would be held in early 2016 before submission to the Joint Subcommittee on Administrative, Executive, and Legislative Review.

MDE: Department of the Environment

Source: Maryland Department of the Environment; Department of Legislative Services

Reclassification Letter

The letter on the reclassification of positions reflects the changes shown in **Exhibit 10**. MDE notes that these positions will be trained to develop and negotiate implementation plans for improvements or corrective actions needed at municipal and industrial, agricultural, resource management, or construction sites; and to assess damage caused by regulatory violations. Furthermore, the positions will learn compliance assistance and pollution prevention strategies; and will learn to perform onsite compliance consultations at municipal and industrial facilities, construction sites, and agricultural operations regarding water pollution control laws and State and federal permits. **DLS recommends that MDE comment on the timeframe for updating its database to capture reissuance/expiration dates, the response to and current status of expanded delegation to counties, and the status of the meeting to amend the regulatory language mandating that all sites be inspected on average once every two weeks.**

Exhibit 10
Sediment and Erosion Control Reclassified Positions
January 2016

PIN	Area	Former Title	Former Unit	Fiscal 2017 Allowance
048676	Western	Office Secretary III	Water Management Administration – Compliance	$35,999
055549	Eastern	Regulatory Compliance Engineer-Architect III	Water Management Administration – Wastewater Permits	62,840
055556	Central	Natural Resources Planner V	Science Services Administration – Field Services	62,840
055561	Eastern	Environmental Specialist IV	Science Services Administration – Field Services	58,949
078554	Central	Environmental Compliance Specialist IV	Land Management Administration – Recycling and Operations	52,001
087546	Western	Regulatory Compliance Engineer-Architect I	Water Management Administration – Sediment, Stormwater, and Dam Safety Program	48,859

PIN: position identification number

Source: Department of Budget and Management, Maryland Department of the Environment

3. Maryland Energy Administration Co-locating with MDE

The Maryland Energy Administration (MEA) website notifies that it co-located with MDE on December 16, 2015. The co-location raises a number of concerns related to the process, timing, cost and savings, and the reason for the move.

The following information was requested of MDE about the move.

- ***Description:*** A description of the type of costs incurred in the move, the reconfiguration of MDE space, and when the costs were or will be incurred and by whom.

- ***Amount:*** The amount and fund source associated with each cost.

- ***Cost Savings:*** The expected long-term cost savings associated with the move and explanations for how these cost savings will be achieved.

MDE notes that the move is still in progress. MEA has moved into temporary space on the fourth floor, within the Water Management Administration's area, and will stay there until the buildout is approved and completed, which involves the Department of General Services. The plan then is for MEA to move to the seventh floor, within the Air and Radiation Management Administration's area, later in fiscal 2016. The actual move cost is around $8,000; MEA eventually will be paying a portion of the rent and utilities based on the final square footage of the space it uses. **DLS recommends that MDE comment on (1) the justification for the move; (2) the type of costs incurred in the move, the reconfiguration of MDE space, and when the costs were or will be incurred and by whom; (3) the amount and fund source associated with each cost; and (4) the expected long-term cost savings associated with the move and explanations for how these cost savings will be achieved.**

4. Lead Paint Issues Linger

Lead poisoning prevention has garnered a substantial amount of interest since the identification that Freddie Gray – who died in Baltimore City after being apprehended by police in April 2015 – had childhood lead poisoning. In addition, the Administration has expanded the universe of children tested for lead paint poisoning, which will potentially increase costs for inspections conducted by either MDE or inspectors hired by rental property owners. Most recently, MDE announced on January 28, 2016, that it has opened an investigation to determine whether rental properties certified by a private inspector are actually lead free.

Concerns about the lead paint program have been raised in the MDE January 2015 audit conducted by the Office of Legislative Audits. As shown in **Exhibit 11**, the MDE databases and policies do not ensure that all affected rental properties are registered and that all registered properties have required inspection certificates.

Exhibit 11
Recent Lead Paint Audit Findings
January 2015

Audit Finding	Description	Recommendation
(1) Procedures were not sufficient to ensure properties with lead paint that were constructed before 1950 were registered and fees paid. (Repeat audit finding)	Did not establish: (1) formal procedures to identify owners who failed to annually renew their property registrations and pay the required registration fees so that follow-up actions could be taken; (2) a consistent, comprehensive follow-up process for owners who were identified and failed to renew property registrations; and (3) a policy specifying when to refer owners to the enforcement unit and when to assess civil and administrative penalties.	(1) Formalize procedures to identify and pursue property owners who fail to register affected lead properties and pay the annual registration fee, including effectively using the pending payment reports; (2) investigate property owners to determine if any fees are owed; (3) establish a policy to determine when to make referrals to enforcement and to assess penalties; and (4) establish a process to track cases referred to enforcement.
(2) MDE did not have a process to ensure that owners who have registered properties affected by lead paint had a required inspection certificate.		(1) Establish procedures to ensure that owners with affected properties have an inspection certificate when required; and (2) investigate the property owners without any recorded inspection certificates and take appropriate action.

Source: Office of Legislative Audits

MDE notes that part of the problem stems from the fact that the original database was based on property owners instead of on property location. As a result, it is difficult to determine whether affected rental properties are still eligible for inclusion in the MDE tracking database. To remedy this situation, MDE is working with MES on the upgrade of two of its databases using Lead Poisoning Prevention Fund special funds and possibly DoIT Major Information Technology Development Project Fund money. The two databases are as follows:

- ***Online Lead Rental Registry Enhancements Project ($0.5 Million):*** MDE intends to enhance the existing Online Lead Rental Registration system for tracking registration and fee payments for lead rental properties through an interagency agreement with MES.

- ***Lead Rental Certification and Accreditation Information System ($1.0 Million):*** MDE intends to develop a new system for tracking certification and accreditation of lead rental properties. The new system will be integrated with the existing Online Lead Rental Registry system and will allow for accepting fee payments online. MDE worked with MES on the business requirements of the project, which were completed.

Universal Testing Regulations

The Administration published regulations in the Maryland Register on January 8, 2016, effectuating the plan announced on October 26, 2015, to expand the definition of childhood blood lead at-risk areas to include the entire State in order to provide for universal testing of children at ages one and two. These regulations align with the U.S. Centers for Disease Control guidelines urging greater scrutiny of lower blood levels and appear to have fairly substantial cost implications for either MDE or local health departments as shown in **Exhibit 12**. The universal testing reflects costs of $1,106,820 based on an estimated 1,548 children requiring inspections at $715 per inspection. There is also an estimated case coordination cost of $56 for one year, which adds another $86,115 to the cost for a total cost of $1,192,935. Funding to cover these costs, if they are borne by MDE, is not reflected in the MDE fiscal 2017 allowance.

Exhibit 12
Possible MDE Costs
Maryland Targeting Plan for Areas At Risk for Childhood Lead Poisoning
October 26, 2015

Targeting Strategy Option	Estimated Number of 1- and 2-year-Old Children to Be Tested	Estimated Number of Children with EBL Greater Than or Equal to 10 mcg/dL(3)	MDE Inspection Cost ($715 One-time x Number of Children)	MDE Case Coordination ($56 One Year)	MDE Total Cost
Option 1 – Target Testing based on the distribution of 2005-2009 test results, by zip code(1)	91,201	1,100	$786,500	$61,193	$847,693
Option 2 – Target testing based on an updated Maryland Targeting Model(2)	108,245	1,148	820,820	63,863	884,683
Option 3 – Universal Testing	146,037	1,548	1,106,820	86,115	1,192,935

EBL: elevated blood lead
MDE: Maryland Department of the Environment

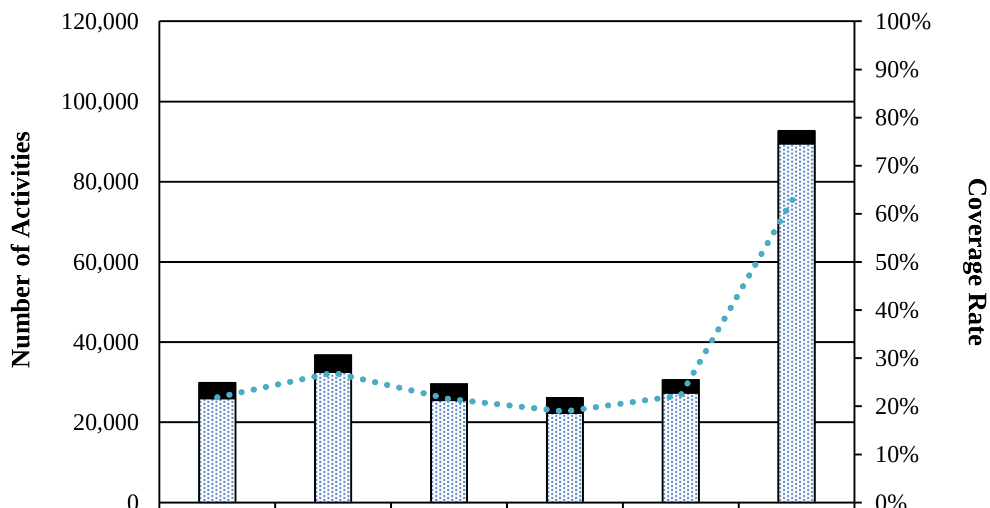
[1] This estimate was prepared considering the area containing 75% of children expected to be "at risk," representing the "middle" estimate.
[2] This estimate was prepared based on model 3, with the modeled outcome of interest "risk area" defined as a census tract with greater than or equal to 9% of tests at or above the reference level.
[3] Represents venous test results and confirmed capillary results. Ninety percent of capillary results are assumed to be true positives in these analyses.

Source: Department of Health and Mental Hygiene, *Maryland Targeting Plan for Areas At Risk for Childhood Lead Poisoning*, October 2015

Rental Property Certification Concerns

On January 28, 2016, MDE announced that it has opened a joint investigation with the U.S. Environmental Protection Agency and Department of Health and Mental Hygiene to determine whether a private inspector fraudulently certified rental properties as being lead free. MDE is sending letters to residents of 384 properties that were certified lead free by the inspector between calendar 2010 and 2014 in order to encourage testing of children for lead exposure and encourage retesting of the properties for lead paint. The investigation was spurred by the receipt of a complaint concerning the validity of a lead-free certificate issued by the private inspector, which led to the invalidation of seven lead-free certificates issued by the private inspector. **Exhibit 13** shows that MDE relies heavily on accredited lead paint services providers doing inspections. Between fiscal 2010 and 2014, on average MDE conducted 3,755 inspections, audits, and spot checks per year, or 12% of the total, while accredited lead paint services providers conducted 26,790 inspections, audits, and spot checks, or 88% of the total. In fiscal 2015, the accredited lead paint services providers conducted 89,482 inspections, audits, and spot checks, or 97% of the total; however, this may be due to the increased number of properties required to be inspected as a result of Chapter 387 of 2012 (Environment – Reducing the Incidence of Lead Poisoning), which expanded the definition of an affected rental property to include properties built between 1950 and 1978.

Exhibit 13
Lead Poisoning Prevention Program Measures
Fiscal 2010-2015



	2010	2011	2012	2013	2014	2015
Number of Enforcement Actions	660	884	978	666	480	5,748
Number of Inspections, Audits, and Spot Checks – MDE	3,866	4,110	3,954	3,679	3,168	3,131
Number of Inspections, Audits, and Spot Checks – Accredited Lead Paint Service Providers	25,983	32,617	25,557	22,394	27,397	89,482
Coverage Rate	22%	27%	22%	19%	22%	64%

MDE: Maryland Department of the Environment

Source: Maryland Department of the Environment, Annual Enforcement and Compliance Reports, Fiscal 2010-2015

DLS recommends that MDE comment on the status of resolving the January 2015 lead paint audit findings and of working with DoIT on the upgrade of the lead rental property registration and certification databases; the costs associated with the universal lead testing

program for children ages one to two years old; and whether a State contract for inspections, audits, and spots checks of lead rental properties is necessary given the potential for fraud reported on January 28, 2016.

Recommended Actions

1. Concur with Governor's allowance.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Maryland Department of the Environment
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$35,484	$65,178	$34,396	$4,307	$139,364
Deficiency Appropriation	-300	300	0	0	0
Cost Containment	-2,954	0	0	0	-2,954
Budget Amendments	5	4,692	824	908	6,430
Reversions and Cancellations	-23	-8,810	-1,508	-1,274	-11,615
Actual Expenditures	**$32,212**	**$61,360**	**$33,712**	**$3,942**	**$131,225**
Fiscal 2016					
Legislative Appropriation	$31,575	$76,829	$33,835	$4,164	$146,403
Budget Amendments	770	534	362	1,206	2,872
Working Appropriation	**$32,345**	**$77,363**	**$34,197**	**$5,370**	**$149,275**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

The MDE general fund appropriation decreased by $3,271,434. The changes are as follows.

- ***Deficiency Appropriation:*** A decrease of $300,000 in the Air and Radiation Management Administration, which has a corresponding special fund appropriation to backfill the reduction.

- ***Cost Containment:*** A decrease of $2,954,041 due to July 2, 2014 BPW actions that reduced general funds as a result of the availability of Maryland Oil Disaster Containment, Clean-Up, and Contingency Fund special funds in the Land Management Administration and reduced funding for equipment to support a new position related to shellfish water quality monitoring in the Science Services Administration ($2,019,042); January 2015 BPW-specified reductions for operating expenses to be substituted with special funds available in the Oil Control Program, and funding for lease purchase payments for computer upgrades ($261,000); and the January 2015 2% reduction for contractual services across the agency ($673,999).

- ***Budget Amendments:*** A net increase of $5,485 due to the allocation of the cost-of-living adjustment (COLA), effective January 1, 2015 ($235,485), which was offset partially by a decrease to reflect the State Employee Voluntary Separation Program as authorized by Section 22 of the fiscal 2016 operating budget bill ($210,000), and a realignment of funding for the Hazardous Substance Clean-Up Program, which is reflected in the MDE PAYGO capital budget and thus is a reduction in the operating budget ($20,000).

- ***Reversions:*** A decrease of $22,878 primarily due to a reduction of $22,876 in the Operational Services Administration.

The MDE special fund appropriation decreased by $3,818,110. The changes are as follows.

- ***Deficiency Appropriation:*** An increase of $300,000 to backfill the Air and Radiation Administration $300,000 general fund reduction. The special funds come from the SEIF, which in turn receives revenues from the sale of carbon dioxide allowances as part of Maryland's involvement in the nine-state RGGI.

- ***Budget Amendments:*** An increase of $4,692,367 due to budget amendments for replacement of July 2, 2014 BPW general fund reductions in the Oil Control Program ($2,000,000); reimbursement of agreements with local environmental health departments to administer the septic program per Chapter 379 of 2014 (Bay Restoration Fund – Authorized Uses – Local Entities) ($1,500,000); reimbursement of oil contamination costs for heating oil tank owners in the Oil Control Program ($825,000); allocating the COLA, effective January 1, 2014 ($267,367); and unanticipated exterminator costs ($100,000).

- ***Cancellations:*** A decrease of $8,810,477 as a result of cancellations primarily in the Land Management Administration ($3,303,625); the Coordinating Offices ($2,459,296); Bay Restoration Fund Debt Service, due to an unneeded appropriation based on the current revenue bond issuance schedule ($1,451,823); the Water Management Administration ($972,472); and the Air and Radiation Management Administration ($500,884).

The MDE federal fund appropriation decreased by $684,384. The changes are as follows.

- ***Budget Amendments:*** An increase of $823,591 due to budget amendments establishing web services and thus allowing programs such as Geographic Information System (ArcGIS) Desktop and ArcGIS Online to access Ambient Water Quality Monitoring System data directly using Environmental Information Exchange Network Grant Program funding ($442,000); funding equipment, supplies, and related services to establish near-road monitoring sites to measure short-term, near-road nitrogen dioxide (NO_2) concentrations near heavily trafficked roads to assess the impact on vulnerable and susceptible populations using surveys, studies, research, investigations, demonstrations, and special purpose activities relating to the Clean Air Act funding ($200,000); and allocating the COLA, effective January 1, 2015 ($181,591).

- ***Cancellations:*** A decrease of $1,507,975 as a result of cancellations primarily in the Science Services Administration ($553,398), Coordinating Offices ($536,682), Land Management Administration ($179,853), and Air and Radiation Management Administration ($114,772).

The MDE reimbursable fund appropriation decreased by $365,352. The changes are as follows.

- ***Budget Amendments:*** An increase of $908,278 is reflected due to funding transferred from the DoIT MITDF from new and unencumbered prior year funding for the Environmental Permit Tracking System Modernization Project, which will update how permit data is captured through the use of Dot Net technologies.

- ***Cancellations:*** A decrease of $1,273,630 primarily due to cancellations in Major Information Technology Development Projects ($456,028), Water Management Administration ($390,044), and Air and Radiation Management Administration ($272,118).

Fiscal 2016

The MDE general fund appropriation increases by $770,000 due to budget amendments. The budget amendments allocate the funding in Section 48 of the fiscal 2016 budget bill that restored the 2% State salary reduction ($470,000), and reallocate a portion of the 2% cost containment reductions in Section 19 of the fiscal 2016 from the operating budget to the Hazardous Substance Clean-Up Program PAYGO capital program and thus is reflected as an appropriation increase in the budget amendment ($300,000).

The MDE special fund appropriation increases by $534,000 to allocate the funding in Section 48 of the fiscal 2016 budget bill that restored the 2% State salary reduction.

The MDE federal fund appropriation increases by $362,000 to allocate the funding in Section 48 of the fiscal 2016 budget bill that restored the 2% State salary reduction.

The MDE reimbursable fund appropriation increases by $1,206,028 due to a budget amendment. The budget amendment provides funding transferred from the DoIT MITDPF for the Environmental Permit Tracking System Modernization Project to reflect fiscal 2014 and 2015 funding ($456,028), as well as fiscal 2016 funding ($750,000) for updating the existing PowerBuilder user interface with one developed using current Dot Net technologies.

Appendix 2

Audit Findings

Audit Period for Last Audit:	July 1, 2010 – July 29, 2013
Issue Date:	January 2015
Number of Findings:	6
Number of Repeat Findings:	2
% of Repeat Findings:	33.3%
Rating: (if applicable)	n/a

Finding 1: **Procedures were not sufficient to ensure properties with lead paint that were constructed before 1950 were registered and fees paid.**

Finding 2: MDE did not have a process to ensure that owners who have registered properties affected by lead paint had a required inspection certificate.

Finding 3: Local jurisdictions were not required to submit critical documentation concerning Bay Restoration Fund-funded septic system installations and certain monitoring processes were insufficient.

Finding 4: MDE had not performed documented verifications to ensure that all annual operations and maintenance reports for Bay Restoration Fund-funded septic system installations were submitted.

Finding 5: **Inspections of construction activity that disturbs more than 5,000 square feet of land or that results in more than 100 cubic yards of earth movement were not being performed as required.**

Finding 6: Monitoring, access, and update controls over the Tools for Environmental Management and Protection of Organizations and Public and Private Drinking Water Information System databases were not sufficient.

Note: The Office of Legislative Audits was unable to review the status of the following prior finding: "A process was not established to verify hazardous material facilities are in compliance with security standards." This is because federal regulations developed by the U.S. Department of Homeland Security deny access to certain documentation critical to the finding. The Office of Legislative Audits notes that this documentation is considered to be chemical-terrorism vulnerability information, which requires special training and approval to be obtained through the Department of Homeland Security.

*Bold denotes item repeated in full or part from preceding audit report.

Maryland Department of the Environment

Environmental Permit Tracking System Modernization

Project Status	Planning	**New/Ongoing Project:**	Ongoing
Project Description:	The Environmental Permit Tracking System Modernization project is intended to modernize how the Maryland Department of the Environment (MDE) captures permit data by transferring the existing system from a legacy PowerBuilder user interface to Dot Net technologies. The project will also support the Web Revamp Project by making ePermitting and eCommerce available to citizens and businesses.		
Project Business Goals:	The project will reduce the level of effort required to enter data in the MDE centralized permit tracking system and ensure that the technologies that support the mission are cost effective and sustainable.		
Estimated Total Project Cost:	n/a	**Estimated Planning Project Cost:**	$3,340,000
Project Start Date:	The project began in February 2013 with the development of the task order request for proposals.	**Projected Completion Date:**	Permit modernization go live on February 18, 2017.
Schedule Status:	MDE is working on the Functional Requirements Document and the Task Order for Proposals for the implementation phase of the project. Overall, it looks like the project schedule has slipped about a year, given that in the fiscal 2016 budget analysis the permit modernization go-live date was February 18, 2016, and now the permit modernization go-live date is February 18, 2017. There is no mention of a new eCommerce go-live date.		
Cost Status:	MDE has received appropriations of $500,000 in fiscal 2014, $450,000 in fiscal 2015, and $750,000 in fiscal 2016. In each of these years, an additional $50,000 was reflected in the Department of Information Technology's (DoIT) budget for project oversight. MDE has only spent $493,972, so $1,206,028 in reimbursable funds is reflected in fiscal 2016 ($456,028 from fiscal 2014 and 2015 funding and $750,000 from fiscal 2016 funding). For fiscal 2017, there is $1,440,000 budgeted in the DoIT budget for MDE and an additional $50,000 for project oversight by DoIT.		
Scope Status:	The scope is a plan at this stage.		
Project Management Oversight Status:	DoIT has approved the information technology request.		
Identifiable Risks:	Funding is the only medium-level risk. MDE notes that the technology is proven, but that it is new to MDE.		
Additional Comments:	Special funds may be used instead of general funds in the future if they become available.		

Fiscal Year Funding ($ in Thousands)	**Prior Years**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**	**Balance to Complete**	**Total**
Personnel Services	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Professional and Outside Services	1.8	1.5	0.0	0.0	0.0	0.0	0.0	3.3
Other Expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Funding	**$1.8**	**$1.5**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$3.3**

Object/Fund Difference Report
Department of the Environment

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	936.00	939.00	934.00	-5.00	-0.5%
02 Contractual	28.15	59.50	40.50	-19.00	-31.9%
Total Positions	**964.15**	**998.50**	**974.50**	**-24.00**	**-2.4%**
Objects					
01 Salaries and Wages	$ 84,908,504	$ 87,540,995	$ 88,979,968	$ 1,438,973	1.6%
02 Technical and Spec. Fees	1,460,488	2,082,589	1,867,270	-215,319	-10.3%
03 Communication	675,347	728,627	722,731	-5,896	-0.8%
04 Travel	210,615	70,060	56,101	-13,959	-19.9%
06 Fuel and Utilities	468,649	573,966	482,346	-91,620	-16.0%
07 Motor Vehicles	1,475,155	1,541,218	1,310,664	-230,554	-15.0%
08 Contractual Services	14,376,489	22,462,090	20,948,867	-1,513,223	-6.7%
09 Supplies and Materials	1,075,929	1,133,678	1,116,037	-17,641	-1.6%
10 Equipment – Replacement	964,190	1,507,273	1,048,066	-459,207	-30.5%
11 Equipment – Additional	391,808	84,937	158,270	73,333	86.3%
12 Grants, Subsidies, and Contributions	12,219,721	12,139,963	10,989,926	-1,150,037	-9.5%
13 Fixed Charges	4,749,979	4,909,566	4,918,176	8,610	0.2%
14 Land and Structures	8,248,177	14,500,000	26,000,000	11,500,000	79.3%
Total Objects	**$ 131,225,051**	**$ 149,274,962**	**$ 158,598,422**	**$ 9,323,460**	**6.2%**
Funds					
01 General Fund	$ 32,212,121	$ 32,344,831	$ 32,183,920	-$ 160,911	-0.5%
03 Special Fund	61,359,708	77,363,394	88,845,284	11,481,890	14.8%
05 Federal Fund	33,711,527	34,197,064	33,522,830	-674,234	-2.0%
09 Reimbursable Fund	3,941,695	5,369,673	4,046,388	-1,323,285	-24.6%
Total Funds	**$ 131,225,051**	**$ 149,274,962**	**$ 158,598,422**	**$ 9,323,460**	**6.2%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Department of the Environment

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Office Of The Secretary	$ 2,470,521	$ 2,421,758	$ 2,292,534	-$ 129,224	-5.3%
02 Operational Services Administration	9,325,091	9,047,625	8,927,453	-120,172	-1.3%
04 Water Management Administration	31,424,895	30,840,286	31,070,235	229,949	0.7%
05 Science Services Administration	12,551,854	13,016,327	12,857,145	-159,182	-1.2%
06 Land Management Administration	28,010,777	34,558,351	34,009,233	-549,118	-1.6%
07 Air and Radiation Management Administration	19,405,003	20,114,336	20,265,039	150,703	0.7%
10 Coordinating Offices	28,036,910	39,276,279	49,176,783	9,900,504	25.2%
Total Expenditures	**$ 131,225,051**	**$ 149,274,962**	**$ 158,598,422**	**$ 9,323,460**	**6.2%**
General Fund	$ 32,212,121	$ 32,344,831	$ 32,183,920	-$ 160,911	-0.5%
Special Fund	61,359,708	77,363,394	88,845,284	11,481,890	14.8%
Federal Fund	33,711,527	34,197,064	33,522,830	-674,234	-2.0%
Total Appropriations	**$ 127,283,356**	**$ 143,905,289**	**$ 154,552,034**	**$ 10,646,745**	**7.4%**
Reimbursable Fund	$ 3,941,695	$ 5,369,673	$ 4,046,388	-$ 1,323,285	-24.6%
Total Funds	**$ 131,225,051**	**$ 149,274,962**	**$ 158,598,422**	**$ 9,323,460**	**6.2%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

V00A
Department of Juvenile Services

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$274,769	$279,147	$285,327	$6,179	2.2%
Deficiencies and Reductions	0	0	-576	-576	
Adjusted General Fund	**$274,769**	**$279,147**	**$284,751**	**$5,604**	**2.0%**
Special Fund	3,658	4,906	3,864	-1,042	-21.2%
Adjusted Special Fund	**$3,658**	**$4,906**	**$3,864**	**-$1,042**	**-21.2%**
Federal Fund	7,889	7,361	4,840	-2,521	-34.2%
Deficiencies and Reductions	0	0	-5	-5	
Adjusted Federal Fund	**$7,889**	**$7,361**	**$4,836**	**-$2,525**	**-34.3%**
Reimbursable Fund	165	220	247	27	12.1%
Adjusted Reimbursable Fund	**$165**	**$220**	**$247**	**$27**	**12.1%**
Adjusted Grand Total	**$286,480**	**$291,635**	**$293,698**	**$2,063**	**0.7%**

- The fiscal 2017 allowance for the Department of Juvenile Services (DJS) increases by nearly $2.1 million, or 0.7%, over the fiscal 2016 working appropriation. Growth in personnel and maintenance expenditures is offset by significant reductions in funding for residential per diems and other facility operation costs due to declining populations. Included in those reductions is the closure of the William Donald Schaefer House in Baltimore City, as a cost containment measure. Special fund revenue generated from local education agency reimbursements is budgeted more in line with prior year actual expenditures, reflecting a $1.0 million decrease in fiscal 2017. Federal funds decline by $2.5 million due to a regulatory change that prohibits DJS from billing Medicaid for residential rehabilitative services.

Note: Numbers may not sum to total due to rounding.

For further information contact: Rebecca J. Ruff Phone: (410) 946-5530

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	2,055.05	2,055.05	2,051.05	-4.00
Contractual FTEs	159.07	142.00	141.50	-0.50
Total Personnel	**2,214.12**	**2,197.05**	**2,192.55**	**-4.50**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions		146.45	7.14%
Positions and Percentage Vacant as of 12/31/15		242.20	11.79%

- Four positions are abolished in the fiscal 2017 allowance for DJS. Two of these positions are associated with the closure of the William Donald Schaefer House and are currently filled positions. Those employees will be transferred into existing vacant positions at other DJS facilities. The remaining 2 positions are vacant information technology (IT) positions and are part of the new statewide initiative to consolidate IT functions in the Department of Information Technology.

- DJS has nearly 96 more vacant positions than what will be required to meet fiscal 2017 budgeted turnover. The department's point-in-time vacancy rate of 11.79% vacancy rate as of December 31, 2015, is the highest reported vacancy rate since prior to fiscal 2012.

Analysis in Brief

Major Trends

Maryland Juvenile Arrest Data: Arrest rates for juveniles between the ages of 10 and 17 continue to decline, falling 37.3% over the past five years, with a decrease of 13.8% in the most recent year-over-year change. A slightly more than 8.0% decrease in property crimes is outweighing a 1.0% increase in violent crimes in calendar 2014, to have an overall reduction of approximately 6.1% for Part 1 crimes.

DJS Complaint Totals and Complaint Disposition: Approximately 23,400 complaints were referred to the department in fiscal 2015, reflective of a 6.6% decrease from the previous year. Nearly half of the complaints referred to the department did not require court intervention. Formal cases declined by 11.0% in fiscal 2015, to just below 12,000 cases. Of those cases receiving a formal recommendation for court intervention, approximately 27.2% received a probation disposition and 10.4% received a committed disposition.

Nonresidential Placement Trends: Fiscal 2015 and 2016 year-to-date data reflects a continued drop in overall nonresidential placements consistent with the population declines experienced throughout the department. Probation cases account for approximately 50% of the average monthly nonresidential caseload. **DJS should comment on how the current caseloads for each of these nonresidential populations compare to staffing ratios and workload for community supervision and case management staff. In addition, the department should discuss efforts to improve reentry programming and transition services for youth returning from out-of-home placement.**

Secure Detention and Pending Placement Trends: There were nearly 300 fewer pre-adjudication and pending placement youth detained in DJS facilities in fiscal 2015 compared to a decade ago, reflecting a 56% decrease since fiscal 2006. Comparing year-over-year change, the detention population decreased by 8% between fiscal 2014 and 2015, despite a nearly 38% increase in the adult court authorized detention population. The fiscal 2015 pending placement average daily population (ADP) was 66 youth, marking the second consecutive year that the pending placement population was below 100 youth, and a 24% reduction from the previous fiscal year. This decrease is largely attributable to implementation of the department's continuum of care, which is scheduled to sunset at the close of fiscal 2016. SB 81 proposes to repeal the termination date for the continuum of care provision. **DJS should update the committees on the status of the proposed legislation and the potential operational and fiscal impacts that would result if the legislation is not successful.**

Adult Court Authorized Detention Population Trends: Effective October 1, 2015, courts are required to order a youth charged as an adult who is eligible for transfer to the juvenile system to be held in a juvenile detention facility, while pending that transfer decision, with a few exceptions. DJS has seen a significant increase in its youth charged as adult population since fiscal 2014, increasing from an ADP of 31 to 70 youth in the past two years. These youth have significantly longer lengths of stay than other detention populations. **DJS should discuss its future population projections for the adult court authorized detention population and the impact this population has on capacity and facility**

operations. The department should also comment on whether this population requires unique services, and if so, whether those services are being provided.

Committed Population Trends: In fiscal 2015, an ADP of 712 youth were in committed residential programs. Data through the first six months of fiscal 2016 shows a significant decline of nearly 16% to an ADP of 599 youth. DJS is modifying its State-operated facility complement in fiscal 2017. The department is closing the William Donald Schaefer House, a 19-bed substance abuse treatment facility for male youth in Baltimore City, due to cost containment. In addition, DJS is implementing physical plant changes to increase the security level at the Savage Mountain Youth Center, located in the Western Region, to hardware secure. **DJS should comment on its decision to increase the security level at Savage Mountain Youth Center and the impact this change will have on departmental operations and services provided to committed youth.**

Recidivism Rates: DJS has revised its recidivism methodology, primarily to exclude technical violations and other nondelinquent offenses from the recidivism rate. Fiscal 2012 releases are now the only year of data available with a three-year recidivism rate. For those youth, nearly three-quarters (71.4%) were rearrested within three years of release. Approximately 40.0% were reconvicted and 35.0% were reincarcerated.

Issues

Juvenile Services Education Needs Improvement: As a result of legislation enacted by the General Assembly in 2003, the Maryland State Department of Education (MSDE) began the process of assuming responsibility for the provision of education services to all State-operated DJS detention and committed care facilities in fiscal 2005. The last of 14 facilities was transferred in fiscal 2013. The assumption at the time the legislation was enacted was that MSDE, being the overseer of education services for the State, was better positioned to ensure the provision of adequate education services to the population of youth under the care of DJS. With the takeover of each facility, MSDE repeatedly indicated that additional resources were needed to improve the delivery of education services to DJS youth. In most instances, however, the department received the equivalent of the resources previously budgeted in DJS with no increase. Concerns have again been raised questioning whether MSDE is providing the appropriate level of services to students in DJS facilities. **DLS recommends budget language requiring MSDE and DJS to submit biannual monitoring reports to the budget committees on the advancements made toward addressing the concerns raised in this issue, the level of communication between the agencies and with local school systems, and how the additional resources provided in the fiscal 2017 allowance will be utilized. In addition, DLS recommends MSDE and DJS develop measures evaluating the performance of the program, in addition to student performance.**

Recommended Actions

		Funds
1.	Reduce the increase in funding for contractual evaluations.	$ 201,000
2.	Add language requiring submission of biannual reports on progress made toward addressing juvenile education services concerns.	
	Total Reductions	**$ 201,000**

Operating Budget Analysis

Program Description

Functionally, the Department of Juvenile Services (DJS) is broken down into two major areas:

- **Leadership Support**, which is essentially headquarters operations that provide guidance and centralized services to the other part of the agency. It consists of two areas:

  - Office of the Secretary; and

  - Departmental Support, which includes such functions as human resources, capital planning, property management, procurement, information technology, professional development and training, and professional responsibility and accountability (for example, audits, professional standards, and quality assurance).

- **Residential, Community, and Regional Operations**, which incorporates the actual delivery of services to youth in community and residential settings. A leadership division provides direction to regional operations and programs that are organized around six regions:

  - Baltimore City;

  - Central (Baltimore, Carroll, Harford, and Howard counties);

  - Western (Allegany, Frederick, Garrett, and Washington counties);

  - Eastern (Caroline, Cecil, Dorchester, Kent, Queen Anne's, Somerset, Talbot, Wicomico, and Worcester counties);

  - Southern (Anne Arundel, Calvert, Charles, and St. Mary's counties); and

  - Metro (Montgomery and Prince George's counties).

The key goals of the department are public safety, juvenile offender accountability, and the development of a level of competency in juvenile offenders to reduce the risk of recidivism.

Performance Analysis: Managing for Results

1. Maryland Juvenile Arrest Data

Exhibit 1 presents Maryland juvenile arrest data for calendar 2010 through 2014. The data uses distinctions found in the *Uniform Crime Reports*. Part 1 arrests are those for murder, manslaughter, rape, robbery, felonious assault, breaking and entering, larceny theft, motor vehicle theft, and arson. Part 2 arrests are all other arrests, including offenses such as vandalism, drug abuse violations, weapons offenses, and fraud. The exhibit also distinguishes Part 1 arrests between violent and serious property crimes.

Exhibit 1
Juvenile Arrest Data (Ages 10-17)
Calendar 2010-2014

	2010	2011	2012	2013	2014	% Change 2010-2014	% Change 2013-2014
Total Arrests	39,642	35,219	29,987	28,048	24,230	-38.9%	-13.6%
Arrest Rate	6,377	5,733	4,922	4,639	4,000	-37.3%	-13.8%
Part 1 Arrests	12,626	11,096	9,397	8,905	8,379	-33.6%	-5.9%
Part 1 Arrest Rate	2,031	1,806	1,542	1,473	1,383	-31.9%	-6.1%
Part 1 Arrests:							
a. Violent Crimes	2,953	2,227	1,900	2,064	2,089	-29.3%	1.2%
Violent Crime Rate	475	363	312	341	345	-27.4%	1.2%
b. Property Crimes	9,673	8,869	7,497	6,841	6,290	-35.0%	-8.1%
Property Crime Rate	1,556	1,444	1,231	1,131	1,038	-33.3%	-8.2%
Part 2 Arrests	27,016	24,123	20,590	19,143	15,851	-41.3%	-17.2%
Part 2 Arrest Rate	4,346	3,927	3,379	3,166	2,617	-39.8%	-17.3%

Note: Rates are per 100,000 juveniles, ages 10 through 17.

Source: Department of Legislative Services; U.S. Census; *Uniform Crime Reports*

Total arrests have experienced dramatic declines since calendar 2004. Compared to the number of youth arrested a decade ago, the 24,230 arrests in calendar 2014 are 53.1% below calendar 2004. More recently, calendar 2014 is the third consecutive year where total juvenile arrests are below 30,000 and the first time in more than 20 years that total arrests are below 25,000. Accounting for any changes to the statewide juvenile population (all youth ages 10 through 17), which has fallen by 2.5% since calendar 2010, the juvenile arrest rate per 100,000 youth has decreased 37.3% over the past 5 years.

Part 1 arrests declined 33.6% over the past five years, with property crimes decreasing at a slightly higher rate than violent crimes. In looking at the year-over-year change, the 5.9% reduction in Part 1 arrests between calendar 2013 and 2014 is solely driven by an 8.1% decrease in property crime arrests. In fact, arrests for violent crimes actually increased by 1.2%. This includes arrests for murder, rape, robbery, and felonious assault. Part 2 arrests also declined by nearly 41.3% between calendar 2010 and 2014, with the most recent year-over-year change of -17.2%.

2. DJS Complaint Totals and Complaint Disposition

Mirroring the trends in juvenile arrests, **Exhibit 2** reflects the dramatic decrease in the total number of complaints received by DJS in recent years and the disposition of those cases. As shown in the exhibit:

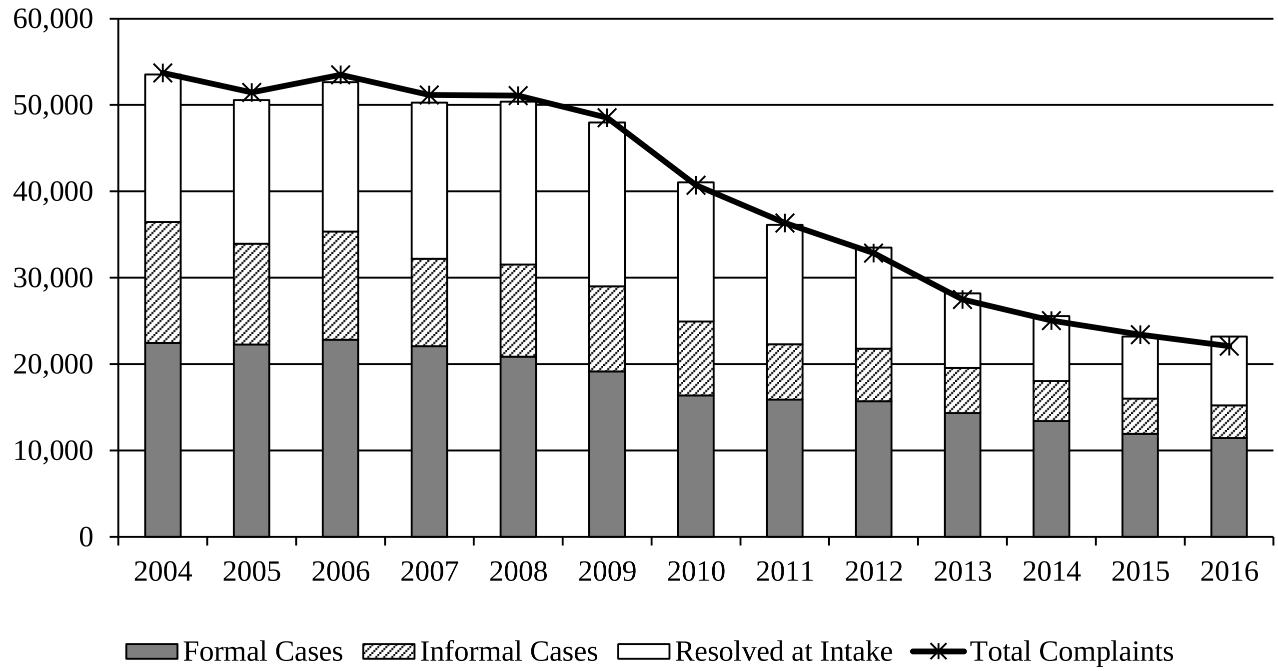
- Approximately 23,400 complaints were referred to the department in fiscal 2015, reflective of a 6.6% decrease from the previous year. The magnitude of the decrease has continued to slow down; however, fiscal 2015 is the first year in more than a decade that DJS has handled fewer than 25,000 complaints. Since the most recent peak of approximately 53,500 complaints in fiscal 2006, total complaints have fallen by more than 56.0%. Annualized data for fiscal 2016, based on actual data from the first six months of the fiscal year, project the decrease in complaints to continue.

- Approximately 48.5% of the cases received in fiscal 2015 did not require court intervention. The number of cases resolved at intake experienced a slight decrease (4.1%), falling to slightly more than 7,200 cases. Similarly, the number of cases that require some form of intervention but not court intervention (the informal caseload) continued to decline, falling by 12.2% from the prior fiscal year. Based on year-to-date data for fiscal 2016, cases resolved at intake are projected to increase by 10.2%, while the informal caseload is expected to continue its decline below 4,000 cases annually.

- The formal caseload, cases where court intervention is required, account for slightly more than half of complaints received. The 11.0% decline experienced in fiscal 2015 reduced total formal cases to 11,919, nearly half the formal complaints received a decade ago. Of those cases receiving a formal recommendation for court intervention in fiscal 2015, approximately 27.2% received a probation disposition, and 10.4% received a committed disposition. An additional 27.7% of cases were dismissed or closed. In comparing disposition data from previous years, probation dispositions have remained constant for fiscal 2013 through 2015, while commitments to DJS and the percent of cases dismissed have decreased. The percent of formal cases with a continuance has increased from 9.0% to 14.2% over the three-year period.

- In examining complaints by region, between fiscal 2013 and 2015, the Central Region had the highest number of complaints, with an average of over 6,500 complaints each year. In fiscal 2015, the Central Region accounted for 25.0% of total complaints, followed by the Southern Region (19.0%) and the Metro Region (18.0%). In the past three fiscal years, the Metro Region has experienced the most significant decrease, with complaints falling 25.0% since fiscal 2013. Baltimore City accounted for 14.0% of total complaints in fiscal 2015, and experienced a 15.0% decrease in complaints since fiscal 2013.

Exhibit 2
Juvenile Complaint and Complaint Disposition
Fiscal 2004-2016 Projected



Note: Total complaints typically vary from the sum of those resolved at intake and the informal and formal caseload. The difference relates to jurisdictional issues or when a decision is not recorded.

Source: Department of Juvenile Services

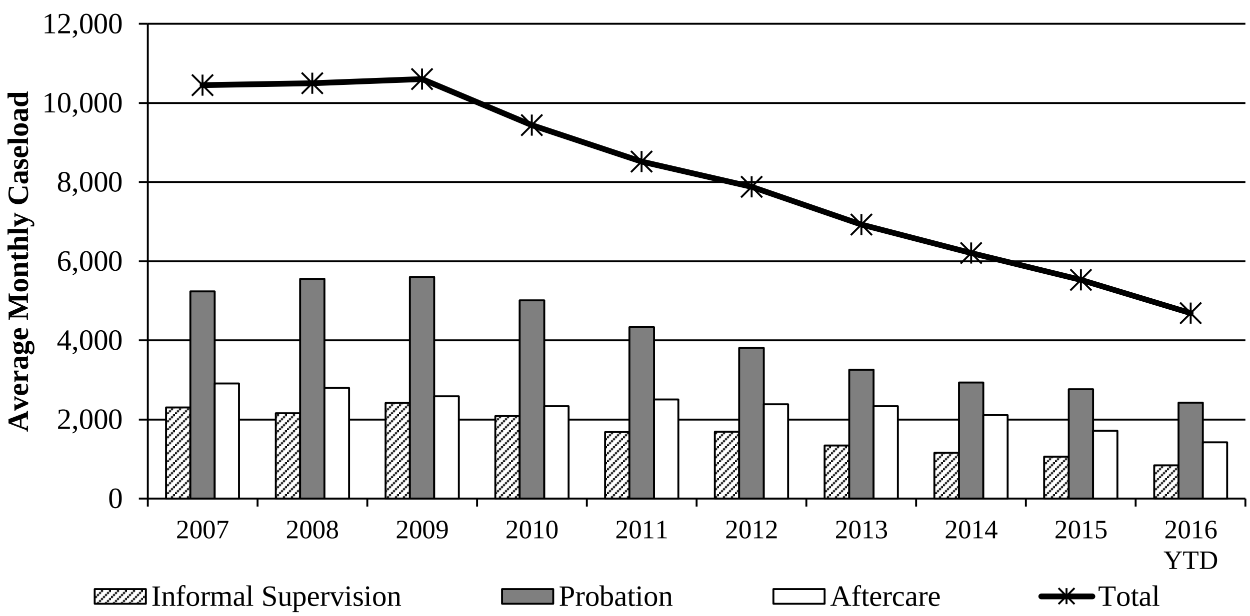
3. Placement Trends

Nonresidential Placement Trends

The nonresidential placement population includes youth who are receiving informal supervision, are on probation, or are in aftercare programming. Informal (or pre-court) supervision is an agreement between DJS and a youth and family to enter into counseling and/or DJS monitoring without court involvement. Youth on probation are receiving court-ordered supervision in the community that requires the youth to meet court-ordered probation conditions, which may include school attendance, employment, community service, restitution, counseling, *etc*. Aftercare programming provides supervision and individualized treatment services to youth in the community following discharge from a residential program.

As shown in **Exhibit 3**, fiscal 2015 and 2016 year-to-date data reflects a continued drop in overall nonresidential placements consistent with the population declines experienced throughout the department. Since the most recent peak in fiscal 2009, the average monthly caseload for nonresidential placements has fallen by nearly 5,100 cases, or 48%. Probation cases account for approximately 50% of the average monthly nonresidential caseload. Over the past decade, DJS has been utilizing informal supervision less, as proportionally these cases have decreased from 22% of total caseloads in fiscal 2007 to 19% in fiscal 2015. During that same time period, aftercare caseloads as a proportion of total nonresidential caseloads have grown from a low point of 24% to consistently accounting for at least 30% of total caseloads.

Exhibit 3
Nonresidential Caseload Trends
Fiscal 2007-2016 Year-to-date



YTD: year-to date

Note: Fiscal 2016 data is through December 2015. Aftercare caseloads include youth in residential and community-based programs.

Source: Department of Juvenile Services

The year-over-year change from fiscal 2014 to 2015 reflects an 11% decline in the average monthly caseload for all nonresidential placements, with the aftercare population decreasing most significantly (19%). Data from the first six months of fiscal 2016 shows a continuing decline of 15% for all three populations. The fiscal 2016 year-to-date average monthly caseloads for youth receiving informal supervision or probation are approximately 839 and 2,425 cases, respectively. The average monthly aftercare caseload through the first six months of fiscal 2016 is approximately 1,422 cases, which reflects a nearly 17% decline from fiscal 2015.

The department has continued to realign its community supervision and case management staff to account for the declining populations, but to also enhance the nonresidential services provided to DJS youth, in particular those services that support transition back to the community. **DJS should comment on how the current caseloads for each of these nonresidential populations compare to staffing ratios and workload for community supervision and case management staff. In addition, the department should discuss efforts to improve reentry programming and transition services for youth returning from out-of-home placement.**

Secure Detention and Pending Placement Trends

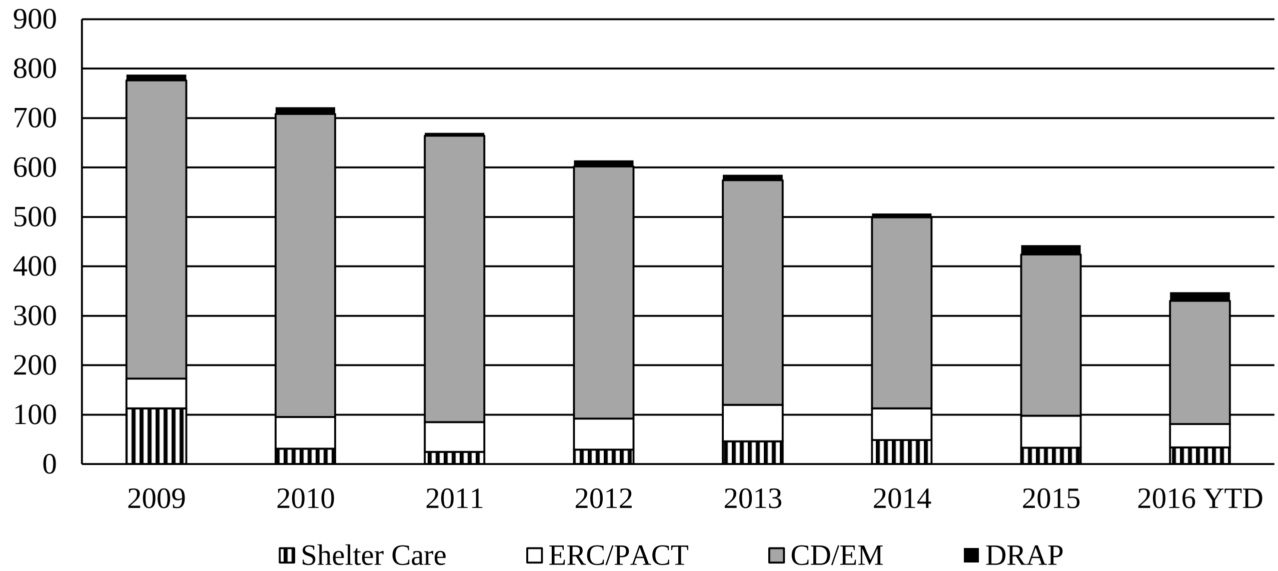
Youth who are in either pre-adjudication or pending placement status include those youth who receive services in the community as an alternative to detention (ATD), are awaiting adjudication in secure detention, or those who are pending placement in a secure detention facility (youth who have been adjudicated delinquent and are held in secure detention pending a permanent committed placement).

ATD programming primarily includes shelter care, day and evening reporting center participation, and community detention/electronic monitoring. DJS also partners with private providers in Baltimore City to utilize additional alternative programs, such as the Pre-adjudication Coordination and Transition Center and the Detention Reduction Advocacy Program. **Exhibit 4** shows population trends by type of ATD since fiscal 2009.

- The use of ATDs peaked in fiscal 2009 with an average daily population (ADP) of 785 youth participating in an ATD program. Since fiscal 2009, the use of ATDs has been steadily declining. Between fiscal 2009 and 2015, the population of youth in ATD programming decreased by 44%, to an ADP of 443 youth. Fiscal 2016 year-to-date data indicates that the downward trend will continue, with an ADP of less than 350 youth participating in ATD programming in the first six months of the fiscal year. Approximately 75% of youth who participate in alternatives to detention were on community detention/electronic monitoring in fiscal 2015. This reflects a decline from previous years, as DJS has increased the use of evening reporting centers and shelter care.

- As a percentage of the total population of youth either in an ATD program or in secure detention (pre-adjudication and pending placement), the ATD population accounted for 65% of the total population in fiscal 2015. This calculation excludes the population of youth who are detained in a DJS facility pending action from the adult court system. Preliminary data from fiscal 2016 indicates that this population will remain consistent at 65% of the overall population.

Exhibit 4
Alternative to Detention Programming
By Type of Program
Fiscal 2009-2016 Year-to-date



CD/EM: Community Detention/Electronic Monitoring
DRAP: Detention Reduction Advocacy Program
ERC/PACT: Evening Reporting Center/Pre-adjudication Coordination and Transition Center
YTD: year-to-date

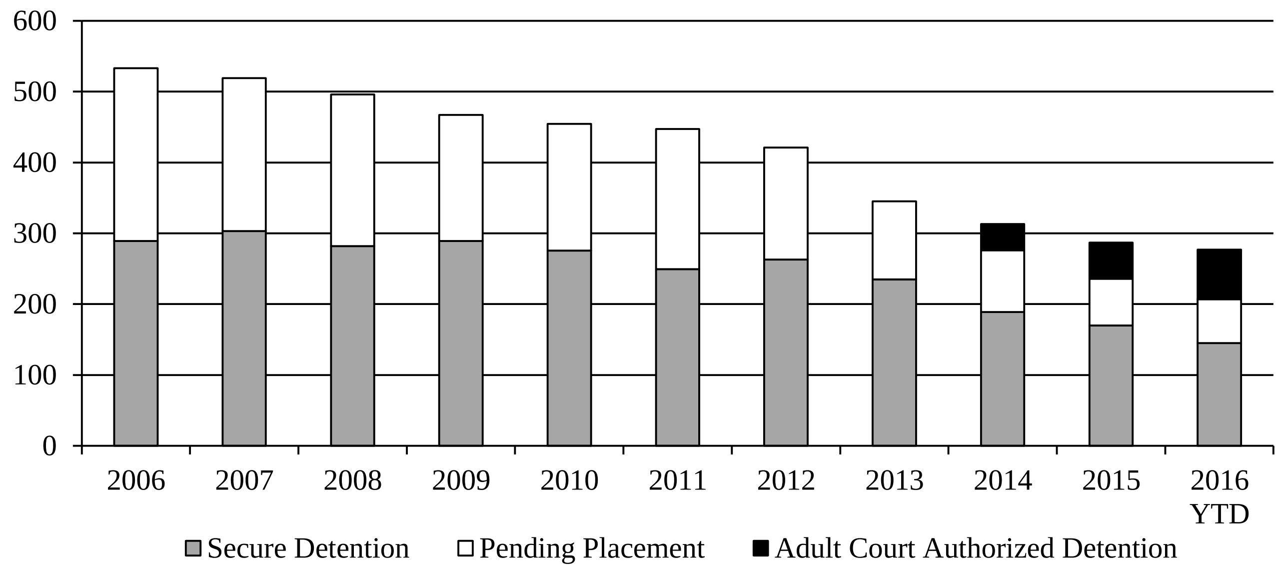
Note: Fiscal 2016 data is through December 2015.

Source: Department of Juvenile Services

Exhibit 5 shows the population trends for all youth held in DJS detention facilities since fiscal 2006. This includes pre-adjudicated youth in secure detention, those who are pending placement in a committed program, and those youth whose detention is authorized by the adult court system. As seen in the exhibit:

- The overall population of youth in DJS detention facilities has declined significantly since fiscal 2006, when the population of pre-adjudicated and pending placement youth exceeded 530 children. In fiscal 2015, the ADP of 287 youth includes 51 individuals awaiting action from the adult courts. Excluding this population, there were nearly 300 fewer youth detained in DJS facilities in fiscal 2015 compared to a decade ago, reflecting a 56% decrease since fiscal 2006. Comparing year-over-year change, the detention population decreased by 8% between fiscal 2014 and 2015, despite a nearly 38% increase in the adult court authorized detention population. Absent the youth-charged-as-adult population, the detention population declined by 15% in fiscal 2015. Data through the first six months of fiscal 2016 suggests that the decrease will continue, even as the youth-charged-as-adult population continues to rise. The ADP for fiscal 2016 year-to-date is at a historic low of 277 youth. The decrease is attributable to flow-through from the decline in referrals and formal cases, in addition to reductions in the pending placement population.

Exhibit 5
Average Daily Population of Youth in DJS Detention Facilities
Fiscal 2006-2016 Year-to-date



DJS: Department of Juvenile Services
YTD: year-to-date

Note: Fiscal 2016 data is through December 2015.

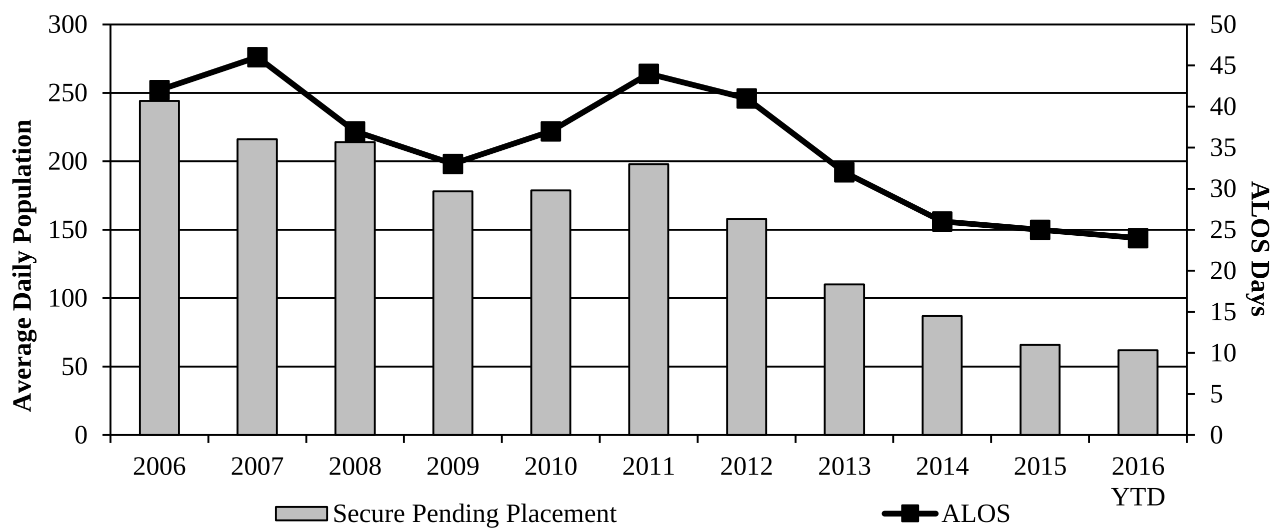
Source: Department of Juvenile Services

- The ADP of pre-adjudicated youth held in secure detention fell below 200 for the first time in more than a decade in fiscal 2014 and that trend has continued for fiscal 2015, when an average of 170 youth were held in secure detention while awaiting action from the juvenile court system. Compared to the peak of 303 youth held in secure detention in fiscal 2007, the pre-adjudication detention population has declined by nearly 44%. Preliminary fiscal 2016 data reflects a pre-adjudication ADP of 145 youth, an approximate decrease of 15% from fiscal 2015.

- The pending placement population has decreased in number, as well as proportion, since fiscal 2006. Historically, pending placement youth accounted for more than 40% of the detention population. In fiscal 2015, however, the proportion of detained youth pending placement was approximately 28%. The fiscal 2015 pending placement ADP was 66 youth, marking the second consecutive year that the pending placement population was below 100 youth. This reflects a 24% reduction from the previous fiscal year. Data from the first six months of fiscal 2016 shows the pending placement population continuing to decline by nearly 6% to an ADP of 62 youth.

- As shown in **Exhibit 6**, changes in the secure pending placement population are closely linked with trends in the average length of stay (ALOS). Between fiscal 2009 and 2011, when the ALOS for pending placement youth increased by 33%, the ADP increased by 11%. At that time, an ADP of 198 youth were held in detention facilities pending placement for an average of 44 days. Since fiscal 2011, the ALOS for pending placement youth has declined by 43% and the population by 67%. In fiscal 2015, an ADP of 66 youth were held pending placement for an average of 25 days. This trend appears to continue in fiscal 2016, with preliminary data indicating an ALOS below 30 days for the third consecutive year.

Exhibit 6
Pending Placement Population
Average Daily Population and Length of Stay
Fiscal 2006-2016 Year-to-date



ALOS: average length of stay
YTD: year-to-date

Note: Fiscal 2016 data is through December 2015.

Source: Department of Juvenile Services

- The significant decline in the pending placement population since fiscal 2011 is largely attributed to legislation enacted by the General Assembly during the 2012 session. Chapter 198 of 2012 established provisions authorizing DJS to transfer youth between committed placements without court intervention. Prior to Chapter 198, if DJS believed that a facility with higher security than what was initially designated by the court was necessary, a juvenile had to be kept in detention until another court hearing could be scheduled to have the type of placement modified. During that time, the juvenile was not receiving the specific treatment services that may be required for rehabilitation. The enacted legislation was scheduled to sunset at the end of fiscal 2015; however, legislation passed during the 2014 session extended the sunset for an additional two years. SB 81 again proposes to repeal the termination date for the continuum of care. If this provision were allowed to sunset, it would likely have a significant impact on DJS operations, leading to increased detention populations, limited capacity, and higher costs. **DJS should update the committees on the status of the proposed legislation and the potential operational and fiscal impacts that would result if the legislation is not successful.**

Adult Court Authorized Detention Population Trends

In fiscal 2014, DJS entered into an agreement with Baltimore City to have the department house qualified juveniles who have been charged as adults and who would otherwise be held in the city's adult pretrial detention center. During the 2015 session, the law regarding pre-transfer detention for youth charged as adults was amended to create a presumption that youth charged as adults should be held in a juvenile detention facility. Effective October 1, 2015, the court must order a youth charged as an adult who is eligible for transfer to the juvenile system to be held in a juvenile detention facility while pending that transfer decision unless (1) the youth is released on bail, recognizance, or other pretrial condition; (2) there is no capacity in the secure juvenile facility; or (3) the court finds that detention in a secure juvenile facility would pose a risk of harm to the child or others, and states the reasons for the finding on the record.

As seen in **Exhibit 7**, the adult court authorized detention population has increased significantly as a result of the Baltimore City agreement and subsequent legislation. In fiscal 2014, DJS had an ADP of 37 youth charged as adults held in its facilities. That number has increased to an ADP of 70 youth for the first six months of fiscal 2016, an increase of 89%. Given the significant decreases in other DJS detention population, the department has been able to absorb this increase; however, the new legislation has been in effect for less than six months. The full extent of the impact on the DJS detention population is not fully known; however, the potential exists for significantly increasing the ADP. For example, DJS estimated that the total statewide youth charged as adult population in fiscal 2015 was an ADP of 128 youth, of which 51 were held in DJS facilities. Under the new legislation, it is anticipated that DJS will house the majority of these youth. The projected population for fiscal 2017 is 160 youth, which would mean a 129% increase over the current fiscal 2016 level.

Exhibit 7
Adult Court Authorized Detention
Average Daily Population
Fiscal 2014-2016 Year-to-date

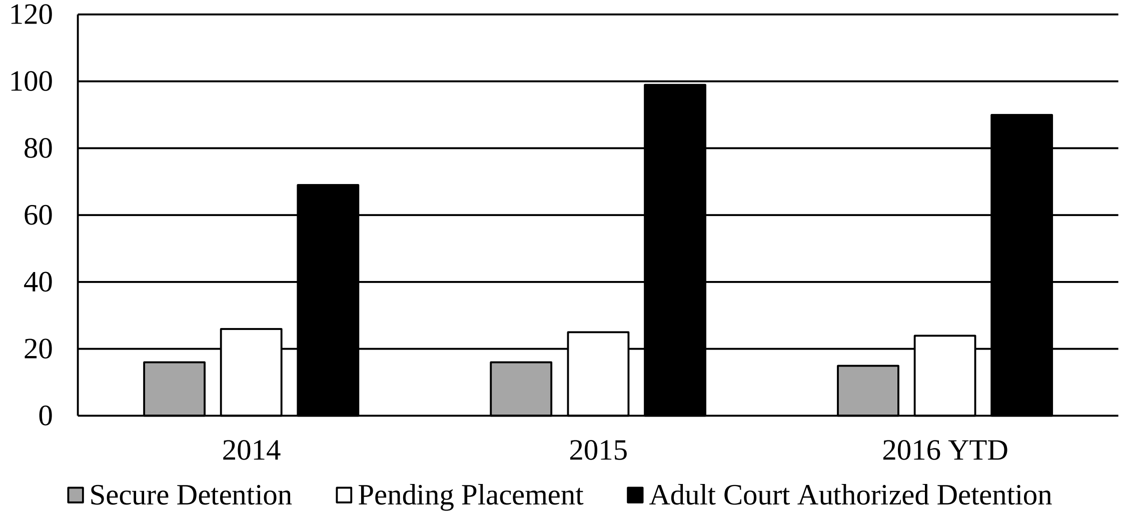
YTD: year-to-date

Note: Fiscal 2016 data is through December 2015.

Source: Department of Juvenile Services

In addition to impacting capacity, the youth-charged-as-adult population also impacts agency operations, in that these youth have a much longer ALOS, as evidenced in **Exhibit 8**. The average length of stay for a youth in secure (pre-adjudication) detention was 16 days in fiscal 2015. With improvements to the pending placement population through the continuum of care, DJS lowered the ALOS for pending placement youth to 25 days. The ALOS for the youth charged as adult population, however, was at 99 days in fiscal 2015, which is more than two months longer than other populations.

Exhibit 8
Average Length of Stay for Youth in DJS Detention Facilities
Fiscal 2014-2016 Year-to-date



YTD: year-to-date

Note: Fiscal 2016 data is through December 2015.

Source: Department of Juvenile Services

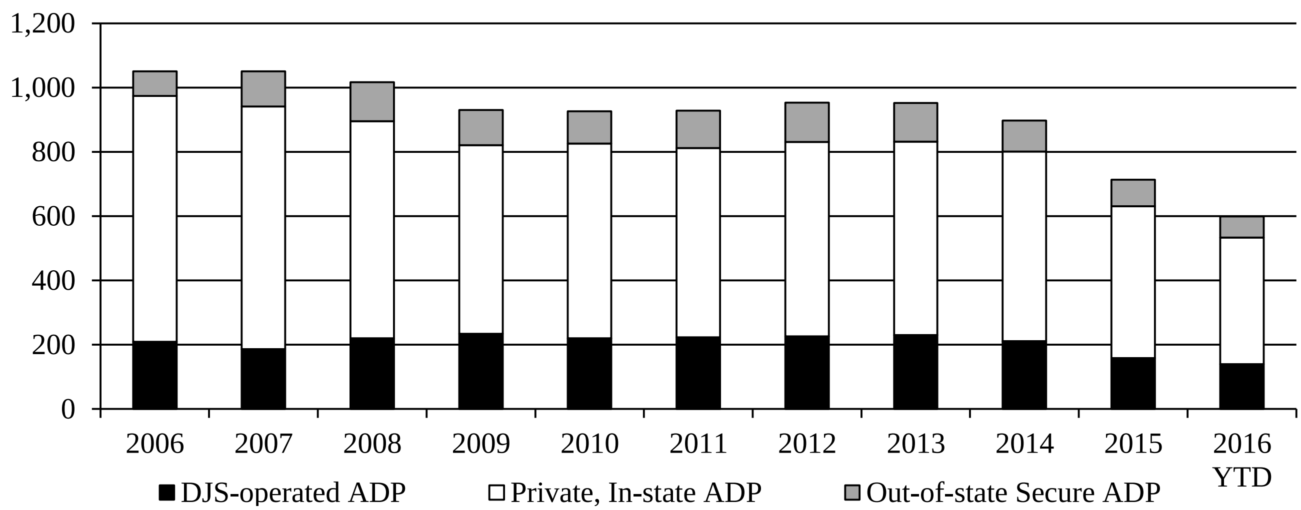
DJS should discuss its future population projections for the adult court authorized detention population and the impact this population has on capacity and facility operations. The department should also comment on whether this population requires unique services, and if so, whether those services are being provided.

Committed Population Trends

DJS has established three levels of residential program placements based largely on the level of program restrictiveness. Level I includes all programs where youth reside in a community setting and attend community schools. Level II includes programs where education programming is provided on grounds, and youth movement and freedom is restricted primarily by staff monitoring or supervision. Level III programs provide the highest level of security by augmenting staff supervision with physical attributes of the facility, *e.g.*, locks, bars, and fences. State-run committed residential facilities do not provide adequate capacity to accommodate the number of youth requiring out-of-home placements, nor do they provide the full complement of programming required to address the variety of treatment needs for the committed population. As such, DJS also contracts with private in-state as well as out-of-state vendors to provide services to committed youth.

Exhibit 9 illustrates the ADP of youth in all types of committed residential programs. The out-of-home committed population declined for the second consecutive year in fiscal 2015. The population rose slightly between fiscal 2011 and 2013 (3%), as the department increased its efforts to move youth out of pending placement status and into committed residential programs more quickly. Since then, as the effects of declining populations in other areas of the juvenile justice system have flown through, the out-of-home committed ADP has declined by 240 youth, or 25%. In fiscal 2015, an ADP of 711 youth were in committed residential programs. Data through the first six months of fiscal 2016 shows a significant decline of nearly 16% to an ADP of 599 youth.

Exhibit 9
Committed Residential Population
Fiscal 2006-2016 Year-to-date



ADP: average daily population
YTD: year-to-date

Note: Fiscal 2016 data is through December 2015.

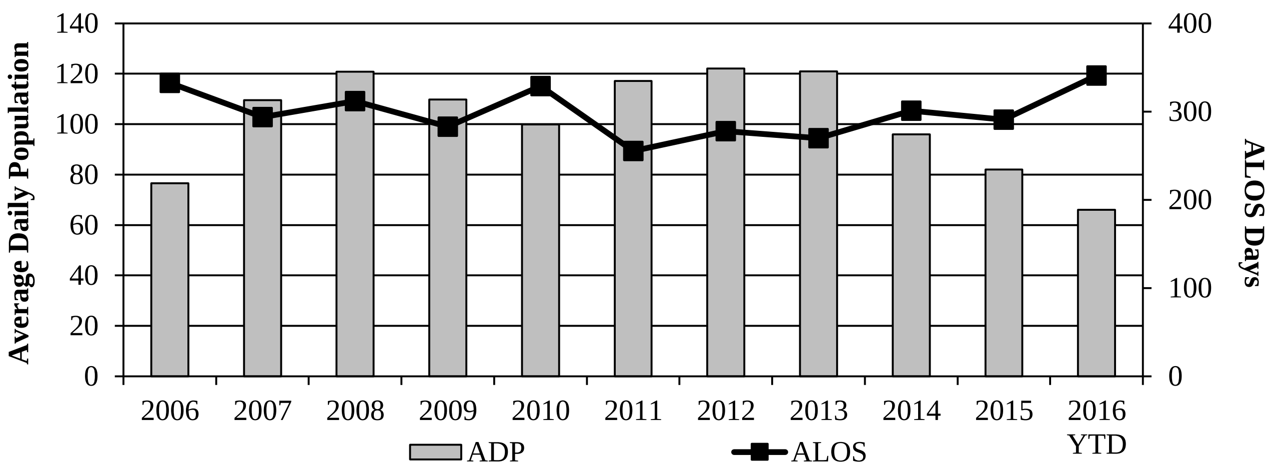
Source: Department of Juvenile Services

Of all youth in committed residential placements, slightly less than 90% remain in-state. The number of youth committed to out-of-state residential programs had been increasing over the past decade, from approximately 7% to nearly 13% of the total committed population. With the fiscal 2014 expansion of the Silver Oak Academy, located in Carroll County, from 48 to 96 beds, the number of youth able to be placed at an in-state staff-secure facility increased significantly. Since fiscal 2014, the percent of youth placed in out-of-state commitments represents approximately 11% of the total committed population. This expansion also contributed to the reduction in the pending placement population.

Nearly three-quarters of youth committed to in-state residential placements are placed in private per diem facilities (a mix of foster care, group homes, substance abuse, mental health treatment programs, residential treatment centers, and staff secure facilities). This has been consistent for the past decade, as the department has not made any additions to its residential capacity, despite capital funding for residential facilities being included in the State *Capital Improvement Program*. In fiscal 2015, an average of 631 youth was committed to an in-state residential placement, with 393 of those youth placed in privately operated programs.

The overall decline in all facets of the DJS population and the increased in-state capacity also has a demonstrated impact on the number of out-of-state placements, as shown in **Exhibit 10**. The department was successful in reducing out-of-state placements in fiscal 2009 and 2010, experiencing a decline of 17% in the out-of-state population. Between fiscal 2010 and 2013, the population of youth placed out-of-state increased 21%, as DJS increased efforts to reduce the pending placement population by placing youth in any appropriate committed program to begin treatment, regardless of the location. Since fiscal 2013, the out-of-state population has declined by an ADP of 39 youth, or 32%. Preliminary data from fiscal 2016 shows a continued decline to an out-of-state ADP of 66 youth. This is likely the result of more available in-state capacity due to the population declines experienced across all aspects of the juvenile justice system.

Exhibit 10
Out-of-state Committed Residential Population
Average Daily Population and Length of Stay
Fiscal 2006-2016 Year-to-date



ADP: average daily population
ALOS: average length of stay
YTD: year-to-date

Note: Fiscal 2015 data is through December 2014.

Source: Department of Juvenile Services

DJS is modifying its State-operated facility complement in fiscal 2017. The department is closing the William Donald Schaefer House (WDSH), a 19-bed substance abuse treatment facility for male youth in Baltimore City, due to cost containment. The closure of this facility is discussed in further detail in the budget section of this analysis. In addition, DJS is implementing physical plant changes to increase the security level at the Savage Mountain Youth Center, located in the Western Region. With the anticipated addition of a fence around the facility's perimeter, Savage Mountain Youth Center will upgrade to a hardware secure facility. In order to achieve the appropriate youth-to-staff ratio for a hardware secure facility, the rated capacity will be reduced from 36 to 24 beds. Total State-operated hardware secure beds will increase to 72 beds. Operating Savage Mountain Youth Center as a hardware secure facility provides the department with an additional in-state option to accommodate youth who pose a flight risk at a less secure facility. **DJS should comment on its decision to increase the security level at Savage Mountain Youth Center and the impact this change will have on departmental operations and services provided to committed youth.**

4. Recidivism Rates

Exhibit 11 presents recidivism rates for youth released from residential placements within two and three years. Recidivism is only one measure of the impact of a residential placement on a youth; however, it is a widely used measure. Recidivism includes returns to both the juvenile and adult criminal justice system and represents the fuller picture of recidivism for those older youth who age out of the juvenile justice system. Data reflects the most serious subsequent penetration of the juvenile or criminal system by a youth.

Exhibit 11

Recidivism Rates to the Juvenile Justice and Criminal Justice System for Youth Released from Residential Placements within Two and Three Years of Release

Fiscal 2012-2013 (%)

	2012		2013	
	2 Years	3 Years	2 Years	3 Years
Rearrest Juvenile/Adult	64	71	62	
Readjudication/Conviction	34	40	32	
Recommitment/Incarceration	28	35	26	

Note: Beginning with fiscal 2012 data, the Department of Juvenile Services refined recidivism methodology to include only misdemeanor and felony offense toward recidivism count.

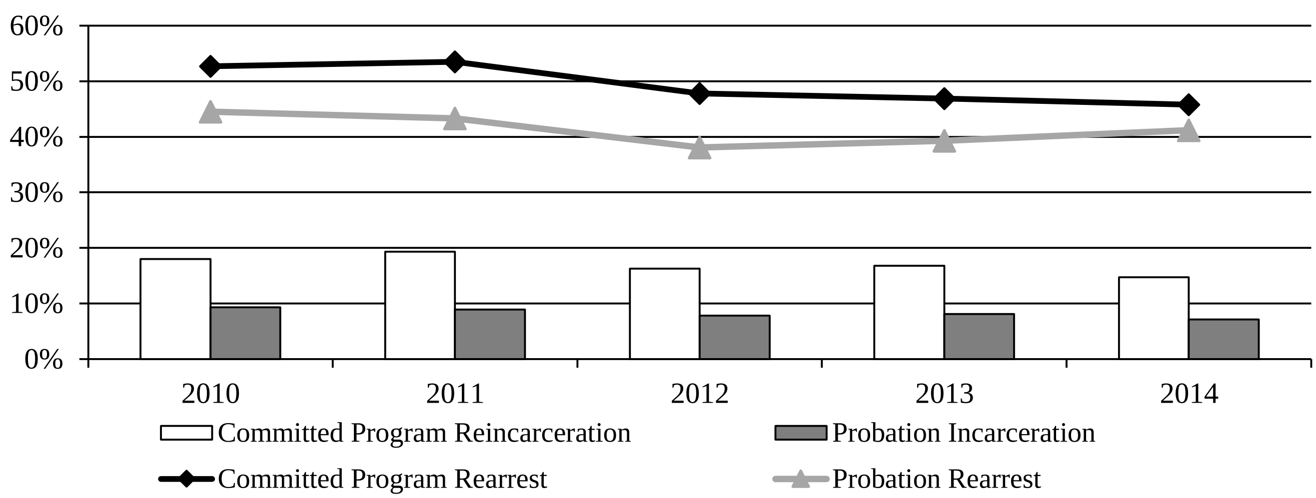
Source: Department of Juvenile Services; Department of Legislative Services

Beginning with fiscal 2012 releases, DJS has revised its recidivism methodology. First, the date used to report the event is now based on the date of offense (for juvenile offenses) or arrest (for adult charges), rather than the date of any resulting court decision or placement. Previously, the department used the date of court action or placement for reporting recidivism beyond the offense level. In addition, recidivism data now only includes misdemeanor and felony offenses. Technical violations, citations, and other nondelinquent referrals are no longer counted. As a result of these changes, recidivism data prior to fiscal 2012 is no longer comparable.

Fiscal 2012 releases are now the only year of data available with a three-year recidivism rate. For those youth, nearly three-quarters (71.4%) were rearrested within three years of release. Approximately 40.0% were reconvicted and 35.0% were reincarcerated. When comparing the reoffending pattern at 24 months for youth released in fiscal 2012 and 2013, the fiscal 2013 releases had the lowest recidivism rates in all three categories.

Exhibit 12 illustrates the percentage of youth who are rearrested or incarcerated within 12 months of being released from a committed residential program or receiving services in the community via probation or a committed community placement. For the purpose of analyzing long-term trends, DJS recalculated one-year recidivism rates beginning with fiscal 2010 releases. Recidivism for the "probation" cohort is measured from the disposition date, as opposed to the release date for youth in committed residential placements. In addition, since youth on probation or in a community placement were not previously placed in a committed out-of-home program, the "incarceration" rate reflects the first commitment to an out-of-home placement or incarceration in the adult system.

Exhibit 12
One-year Recidivism Rate for Committed Program Releases and Probation Placements
Fiscal 2010-2014



Source: Department of Juvenile Services, *Fiscal 2015 Data Resource Guide*

Youth released from committed residential programs are rearrested and reincarcerated at a higher rate than youth under supervision in the community. For fiscal 2014 releases, 46% of youth released from a committed residential placement were rearrested within 12 months of release versus 41% of youth placed on probation. Similarly, the one-year reincarceration rate for committed youth was 15% compared to 7% for probationers. Lower recidivism rates for youth on probation should be expected, as these youth often have less history of DJS involvement and are lower risk offenders.

In comparing year-to-year changes, recidivism rates by all measures have been generally declining since fiscal 2011, with fiscal 2014 having the lowest recidivism rates overall. In looking further, recidivism data reported by DJS in its *Data Resource Guide* indicates that males have a higher recidivism rate than females, and black youth had the highest rates for all recidivism measures. Not surprisingly, youth identified as higher risk according to the department's assessment tool also had higher recidivism rates for rearrest, reconviction, and reincarceration. In terms of recidivism by type of program, for fiscal 2014 releases, State-operated facilities had the highest rearrest and reconviction rates, followed closely by out-of-state programs. The rankings were reversed for reincarceration rates.

Fiscal 2016 Actions

Assumed Reversions

The Governor's fiscal 2017 budget submission includes an assumed fiscal 2016 general fund reversion of $3 million from DJS. Funds appropriated in fiscal 2015 were encumbered by the department for the upgrade of its Automated Statewide System of Information Support Tools (ASSIST) client database; however, oversight of the project has been transferred to the Department of Information Technology (DoIT), with funding for the project flowing through the State's Major Information Technology fund. As such, the department never had a specific contract in place requiring commitment of the $3 million and the funds will, therefore, be reverted in fiscal 2016.

This was part of a larger issue brought to light in an Office of Legislative Audits' (OLA) special report dated February 2, 2016, covering the *Statewide Review of Budget Closeout Transactions for Fiscal Year 2015*. According to the OLA report, DJS inappropriately recorded encumbrances instead of cancelling unspent general fund appropriations totaling approximately $9.7 million, including the $3.0 million for the ASSIST project. This practice violated the yearly closing instructions of the Comptroller of Maryland – General Accounting Division, since the encumbrances did not represent actual fiscal year-end commitments by the State for goods and services and consequently would not qualify as valid encumbrances. As of June 30, 2015, DJS was in the process of completing a number of procurements but did not have approved contracts in place to support the encumbrance of these appropriations. Consequently, the encumbrances should not have been recorded, and the related appropriations should have been canceled so that the funds could revert to the General Fund. **DLS recommends DJS revert the entire $9.7 million in inappropriately encumbered fiscal 2015 funds**.

Cost Containment

The fiscal 2016 budget included a 2% across-the-board reduction to ongoing general fund operating expenses. For DJS, this reduction totaled nearly $5.9 million. These savings were achieved by reducing funding for residential per diems in line with population declines. As illustrated in the previously discussed population data, fewer youth are being placed out-of-home by courts. As such, the reduction in per diem funding did not impact DJS operations.

Proposed Budget

Exhibit 13 illustrates how the department's fiscal 2017 allowance increases by nearly $2.1 million, or 0.7%, when compared to the fiscal 2016 working appropriation.

Exhibit 13
Proposed Budget
Department of Juvenile Services
($ in Thousands)

How Much It Grows:	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015 Actual	$274,769	$3,658	$7,889	$165	$286,480
Fiscal 2016 Working Appropriation	279,147	4,906	7,361	220	291,635
Fiscal 2017 Allowance	284,751	3,864	4,836	247	293,698
Fiscal 2016-2017 Amount Change	$5,604	-$1,042	-$2,525	$27	$2,063
Fiscal 2016-2017 Percent Change	2.0%	-21.2%	-34.3%	12.1%	0.7%

Where It Goes:	
Personnel Expenses	
Employees' Retirement System	$3,511
Employee and retiree health insurance	3,120
Overtime expenses	1,510
Salaries and other compensation	1,169
Other fringe benefit adjustments	677
Workers' compensation premium assessment	-144
Turnover adjustments	-323
Abolished/transferred positions	-355
Programmatic Changes	
Community-based programming	1,923

Where It Goes:	
Contractual mental health evaluations	201
Behavioral health services	-239
Evidence-based services programs	-741
Residential per diem placements	-10,127
Other Changes	
Building repairs and maintenance	1,071
Contractual employment	552
Education facility enhancements	457
Case management system programming and upgrades	457
Other	310
GPS equipment rental based on population decline	-179
LEA reimbursement for education services provided to youth in DJS facilities	-256
Closure of William Donald Schaefer House (nonpersonnel expenditures)	-531
Total	**$2,063**

DJS: Department of Juvenile Services
GPS: global positioning system
LEA: local education agencies

Note: Numbers may not sum to total due to rounding.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency's share of these reductions is $575,868 in general funds and $4,501 in federal funds. There is an additional across-the-board reduction to abolish positions statewide, but the amounts have not been allocated by agency.

Personnel Expenses and Staffing Issues

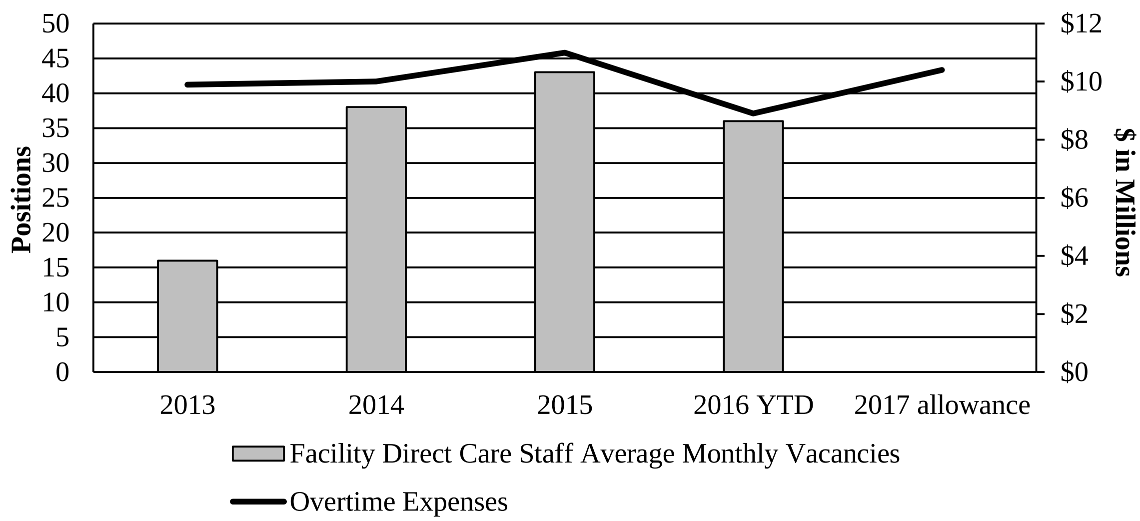
Personnel expenses grow by a net $9.2 million in fiscal 2017. Employee increments, totaling $2.8 million, are currently budgeted in the Department of Budget and Management. The primary drivers of the increase in the DJS allowance are payments for health insurance and retirement costs, which increase $3.1 million and $3.5 million, respectively. In addition, the department receives an additional $1.2 million for employee salaries resulting from efforts by the department to retain contractual facility direct care and case management staff through the probationary period and convert them to above entry-level regular positions.

Four regular positions are abolished in the fiscal 2017 allowance. Those positions have associated costs totaling approximately $355,000. Two of the positions are associated with the closure of WDSH in Baltimore City. Those positions are currently filled; however, the employees in those positions will be transferred to existing vacant positions at other facilities. The remaining 2 positions are abolished due a new statewide initiative to consolidate information technology (IT) services within DoIT. This new shared services initiative is discussed in greater detail in the DoIT analysis. **DJS should comment on how the loss of the two IT positions will impact departmental operations.**

At the close of calendar 2015, DJS had 242 regular positions vacant, nearly 12.0% of its total personnel complement. This is approximately 96 positions more than what will be required to meet a fairly high budgeted turnover rate of 7.1% in fiscal 2017. High vacancy rates, particularly among facility direct care employees, have a number of negative consequences for the department, including increased overtime expenses and employee morale issues. Funding for employee overtime increases by approximately $1.5 million in fiscal 2017, indicative of staffing issues returning to the department.

Exhibit 14 compares vacancy data for facility direct care employees to overtime expenses since fiscal 2013. When direct care vacancies increase, overtime expenses rise as well. Between fiscal 2014 and 2015, the average number of direct care positions vacant each month increased by 13.2%, requiring an additional $1.0 million in overtime spending. Through the first six months of fiscal 2016, average monthly vacancies have fallen back to slightly below fiscal 2014 levels, allowing for a similar decrease in overtime funding. The fiscal 2017 overtime budget is based on the most recent year of actual spending, fiscal 2015. **DJS should comment on whether the increased vacancies and overtime costs experienced in fiscal 2015 were an anomaly or the start of a growing trend.**

Exhibit 14
Facility Direct Care Staff Vacancies and Overtime Expenditures
Fiscal 2013-2017

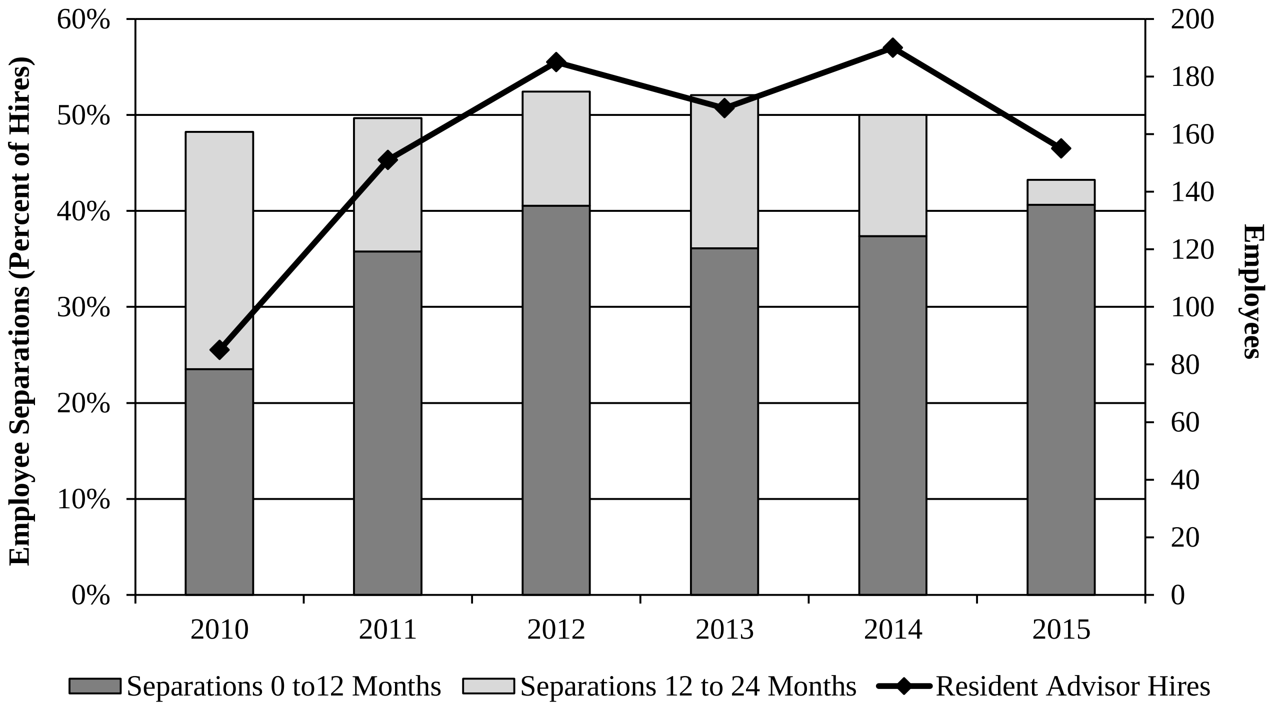


YTD: year-to-date

Source: Department of Juvenile Services

Retention of direct care employees continues to be the most significant staffing issue faced by the department. **Exhibit 15** compares the number of resident advisor positions hired each year to the percent leaving DJS service within 12 and 24 months. Through improvements in advertising and outreach, coupled with streamlining the hiring process, DJS has greatly improved its recruitment. Despite recent fluctuations, the 155 individuals hired in fiscal 2015 reflects an 82% increase over the number of new hires in fiscal 2010. Unfortunately, over 40% of those new hires have already left the department. This has a direct correlation with the changes in overtime illustrated in Exhibit 14.

Exhibit 15
Direct Care Facility Staff
Employee Hires vs. Separations within 12 and 24 Months
Fiscal 2010-2015



Source: Department of Juvenile Services

Programmatic Changes

In total, fiscal 2017 funding for residential and community-based programs decreases by nearly $9.0 million. General fund spending decreases by a net 8.9%, or $6.5 million, to $66.6 million when compared with fiscal 2016. The special fund allowance reflects a $584,000 decrease to bring budgeted revenue collected from local education agency reimbursements in line with historical actual expenditures. Federal funds decline by 48.1%, or $2.4 million, due to lost Medicaid revenue.

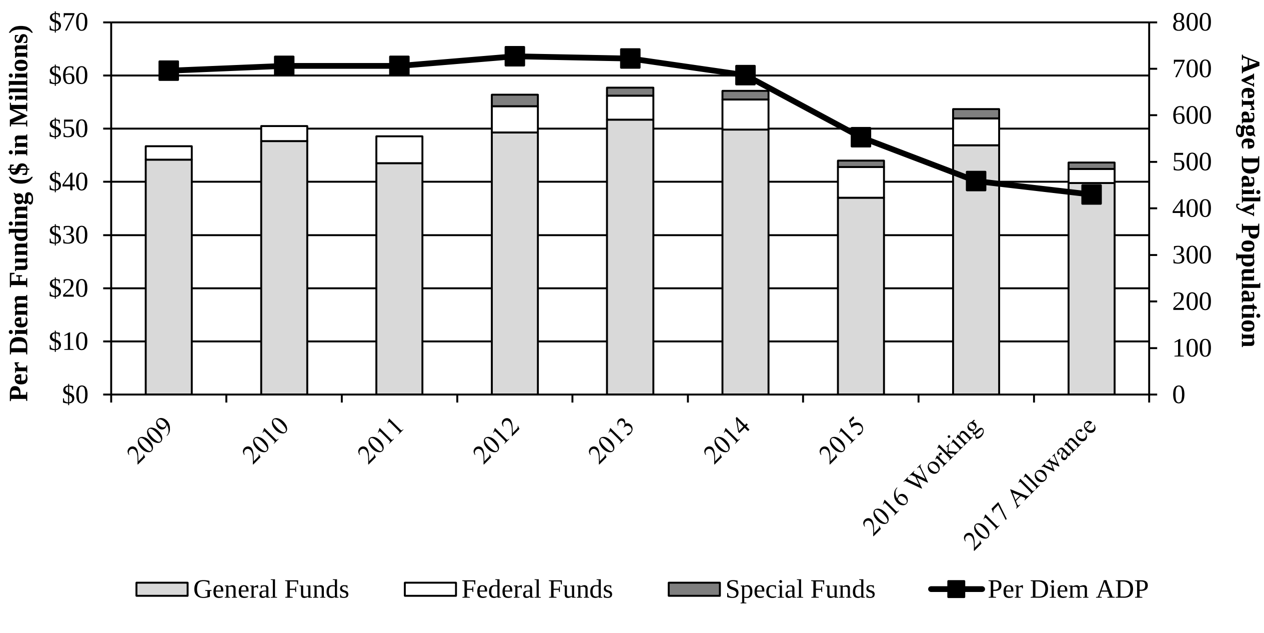
Residential Per Diems

Exhibit 16 provides funding and population detail for residential per diem placements since fiscal 2009. In fiscal 2015, DJS spent $44.0 million to place an average of 553 youth in contractual residential programming each day. The fiscal 2016 working appropriation is approximately $53.7 million, including $46.9 million in general funds. This reflects an increase of approximately $9.6 million above fiscal 2015 actual expenditures, despite a decrease in the per diem ADP of 94 youth. Per diem placements have declined dramatically since fiscal 2012. As the declines experienced in other parts of the juvenile justice system have trickled through to out-of-home placements, the need for contractual residential programs has declined. If this downward trend remains, as the department has assumed in its fiscal 2017 budget, the fiscal 2016 appropriation for residential per diems would appear to be overfunded. **The Department of Legislative Services (DLS) would anticipate DJS to revert as much as $10.0 million in general funds at the close of fiscal 2016, unless some portion of this funding is required to support increased overtime expenses for facility staff due to the previously discussed staffing issues.**

Exhibit 16

Residential Per Diem Placement Funding and Per Diem Average Daily Population

Fiscal 2009-2017



ADP: average daily population

Source: Governor's Fiscal 2017 Allowance; Department of Juvenile Services

The fiscal 2017 allowance is budgeted at $43.6 million, an increase of approximately $400,000 above fiscal 2015 actual expenditures; however, DJS is anticipating only needing to fund a per diem ADP of 430 youth, which is more than 120 youth below the actual ADP of 553 youth in fiscal 2015. This would indicate that the fiscal 2017 allowance for residential per diems is also slightly overfunded; however, there are arguments for maintaining fiscal 2017 per diem funding at its budgeted level. As previously discussed, DJS is absorbing a growing population of youth who are pending action from the adult court system in its detention centers. In addition, despite the fact that fiscal 2015 and year-to-date data for fiscal 2016 reflect population levels across all aspects of the DJS system at historically low levels, it is reasonable to suspect that at some point, the decline will cease. At that point, additional resources may be necessary. **DJS should comment on whether there are any indicators suggesting the downward trends will continue or if populations are expected to increase in the near future.**

DJS Prohibited from Claiming Federal Residential Rehabilitation Funds

The Department of Health and Mental Hygiene notified DJS in March 2015 of a new Medicaid regulation that would prohibit DJS from claiming residential rehabilitation funds for DJS youth in therapeutic group homes and treatment foster care. This change is necessitated by a 2008 federal audit that required the State to revamp its residential rehabilitation program. To date, sufficient progress has not been made by the State to improve the rate-setting process. The resulting impact from the change in regulation is the loss of $2.4 million in federal funding in fiscal 2016 and future years.

As evidenced in the population discussion earlier in this analysis, out-of-home commitments experienced a substantial decrease in fiscal 2015, with preliminary fiscal 2016 data indicating a continued decline. Because of the unanticipated drop in committed placements, DJS is able to absorb the loss of federal revenue in fiscal 2016 and 2017 without the need for additional general funds.

The Interagency Rates Committee (IRC), continuing work that began with committee narrative from the 2013 *Joint Chairmen's Report*, is preparing for a change in the rate structure that will go into effect for rates set for fiscal 2017. One of the recommendations that resulted from the request to review the rate-setting process was to develop a new rate structure that (1) allows for flexibility and innovation in order to meet the needs of the child; (2) establishes a link between rates and performance; and (3) maximizes federal financial participation. The continued work on this issue, through the Rate Reform Workgroup, has led to plans to unbundle clinical and family supports from the room/board/supervision rate. It is believed that the unbundling of the rates will allow for billing of Medicaid rehabilitative services to resume in the future. The rate methodology is expected to be finalized by early April 2016. It is not clear how this new rate structure, when finalized, will impact the fiscal 2017 payments to providers and the budgets of State agencies that pay the rates set by IRC.

Community- and Evidence-based Programming and Services

Funding for evidence-based services (EBS) decreases by approximately $741,000 in fiscal 2017. A total of $3.5 million is provided to support 268 treatment slots assuming a 90% utilization rate. The reduction in funding in the allowance reflects efforts to align the budget with actual expenditures and demand for program services.

Offsetting the reduction in EBS programs is a $1.9 million increase in funding for other community-based per diem programming. Unlike funding for residential per diems, budgeting for nonresidential programming is not based on a specific population statistic. The department's goal is to identify and address treatment needs of youth in the community using whatever proven programs are available. The increase in fiscal 2017 is due to programs being added to address more specific needs as DJS attempts to improve its aftercare resources. Specifically, the fiscal 2017 allowance provides for increased funding to the Institute for Family Centered Services, the Youth Advocate Program, Detention Risk Alternative Program, and Living Classrooms.

Mental Health Evaluations

The fiscal 2017 allowance includes $1 million for contractual mental health evaluations, an increase of approximately $201,000 compared to fiscal 2016 and $422,000 above fiscal 2015 actual expenditures. This increase is in contrast to the expectation that spending for evaluation contracts would decline once DJS fully implemented its Multi-Disciplinary Assessment Staffing Team (MAST) initiative to provide in-house staff to complete comprehensive assessments to youth who are committed to DJS and are being considered for out-of-home placement. The increase in fiscal 2017 brings funding for contractual evaluations up to the pre-MAST level. According to DJS, current projections put fiscal 2016 expenditures just above fiscal 2015 due to an increase in psychiatric evaluations for sex offenders and Certificates of Need, which cannot be done by MAST personnel. **DLS recommends reducing funding for contractual evaluation in line with anticipated fiscal 2016 expenditures.**

Other Significant Changes

Facility Improvements

DJS receives an additional $1.1 million in fiscal 2017 to fund building repairs and maintenance projects. According to the department, facility maintenance has been historically underfunded, which has created an annual maintenance backlog in excess of $2.0 million. The additional funding provided in fiscal 2017 increases the department's maintenance budget to $2.5 million. Projects slated to receive funding in fiscal 2017 are related to safety and security enhancements or address programming space needs. In addition, the allowance includes $457,000 to fund additional education trailers for use by the Maryland State Department of Education (MSDE). The purpose of this funding is discussed in greater detail in the Issues section of this analysis.

Closure of William Donald Schaefer House

Offsetting this increase is a $531,000 reduction in nonpersonnel expenses that results from the permanent closure of WDSH. When combined with the 2 abolished positions associated with the closure, anticipated savings total approximately $800,000. WDSH is a residential substance abuse treatment program for up to 19 male youth. The treatment program lasts up to 120 days and serves male youth between the ages of 13 and 18. The treatment program is accredited by the Alcohol and Drug Abuse Administration. In addition to substance abuse treatment services, youth residing at WDSH attend school in an onsite classroom and a classroom located in a building next to the facility. Youth attend school year round, five days a week for six hours a day, with services provided by MSDE.

The ADP for the facility in fiscal 2015 was 12 youth. DJS intends to provide the same services to those youth through the existing substance abuse treatment program at Meadow Mountain Youth Camp in the Western Region. With WDSH having opened in 1972 as the Group Home for Boys, the aging facility and small capacity made the continued operation of the program fiscally inefficient. From a financial perspective, closure of the facility may be the appropriate action; however, closing WDSH does limit available committed bed space in Baltimore City, a jurisdiction that accounted for 20% of total committed placements in fiscal 2015.

DJS should discuss the decision to close WDSH in fiscal 2017, including the timeline for closure and how this will impact facility staff and youth participants, as well as available drug treatment and other committed bed space throughout the department.

Issues

1. Juvenile Services Education Needs Improvement

As a result of legislation enacted by the General Assembly in 2003, MSDE began the process of assuming responsibility for the provision of education services to all State-operated DJS detention and committed care facilities in fiscal 2005. The last of 14 facilities was transferred in fiscal 2013. The assumption at the time the legislation was enacted was that MSDE, being the overseer of education services for the State, was better positioned to ensure the provision of adequate education services to the population of youth under the care of DJS. With the takeover of each facility, MSDE repeatedly indicated that additional resources were needed to improve the delivery of education services to DJS youth. In most instances, however, the department received the equivalent of the resources previously budgeted in DJS with no increase. Concerns have again been raised questioning whether MSDE is providing the appropriate level of services to students in DJS facilities.

Concerns

Evaluation of whether services have improved under MSDE has been an ongoing issue throughout the decade of transition. Past attempts at analysis have focused on student performance outcomes as a means of evaluation. This has proven difficult, however, as both MSDE and DJS are unable to provide comparable data measures. The recent concerns focus more on program operation and whether students are getting the proper services and educational support. Specific concerns raised repeatedly by the Juvenile Justice Monitoring Unit, within the Attorney General's Office, and other sources include:

- lack of postsecondary, vocational, and work opportunities;
- grouping classes by living unit as opposed to skill level;
- high vacancy rates and turnover for facility staff and a lack of a substitute system;
- space limitations due to the physical plant and age of the DJS facilities;
- adherence to students' Individualized Education Programs (IEP); and
- recordkeeping and transition services between DJS facility schools and local school systems.

MSDE has acknowledged the validity of these concerns, although the department does note improvements have been made since the assumption of DJS education programs was complete. For example, all 14 DJS facilities have Internet access and provide at least 3 Career Technology Education programs leading toward an industry recognized certification. Youth at Backbone Mountain Youth Center have long had the opportunity to complete postsecondary education coursework through Garrett Community College, and MSDE is looking to expand those opportunities to other community colleges.

Additional Resources Provided

Addressing some of these concerns may, ultimately, prove difficult due to the nature of the population. Security concerns for the students and staff, the short length of stay for some students, and having a State agency operate the equivalent of a local school system are a few of the obstacles acknowledged by both departments as impeding the delivery of education services. The fiscal 2017 allowance does, however, provide additional resources in both the MSDE and DJS budgets to address the concerns.

DJS receives an additional $457,000 to improve the educational facilities. Funding for the MSDE Juvenile Services Education (JSE) unit increases by $3 million in fiscal 2017, of which $2 million is specifically provided to enhance staffing to address the identified concerns. The increased funding will provide 20 new positions and turnover relief, allowing MSDE to hire an additional 40 staff. MSDE anticipates that the additional staff and resources will allow it to:

- double the number of IT staff dedicated to JSE schools;
- eliminate turnover expectancy for all teacher positions to allow for improved hiring;
- provide 4 new special education teachers;
- provide every school with at least 1 counselor;
- hire 12 instructional assistants to help teachers provide individualized instruction as students are coming from different grades, schools, and classrooms;
- hire substitutes so that classes are not canceled due to teacher leave/illness;
- provide JSE administration with one budget person to help them manage the finances of 14 schools; and
- replace two vehicles and buy one new vehicle to help transport students.

The goal is to utilize the additional IT staff to help improve communications regarding student records. Filling existing vacancies and enhancing teaching staff through additional special education teachers and instructional assistants will help improve adherence to IEPs. Retaining substitute teachers will ensure better continuation of coursework without lost class time for students. Addressing these facility and staffing issues is a key first step to improving the other areas of concern and ultimately improving student performance and the level of services provided. In addition, better communication between MSDE and DJS and the local school systems is a necessity.

DLS recommends budget language requiring MSDE and DJS to submit biannual monitoring reports to the budget committees on the advancements made toward addressing the

concerns raised in this issue, the level of communication between the agencies and with local school systems, and how the additional resources provided in the fiscal 2017 allowance have been utilized. In addition, DLS recommends MSDE and DJS develop measures evaluating the performance of the program, in addition to student performance. Example measures could include average length of time to transition student records between a JSE school and a local school; teacher vacancy rates and length of tenure; contacts with local school system liaisons to support student transition into the community; students participating in postsecondary opportunities, ***etc.***

Recommended Actions

	Amount Reduction	
1. Reduce funding for contractual evaluations in line with fiscal 2016 budgeted amount.	$ 201,000	GF

2. Add the following section:

SECTION XX. AND BE IT FURTHER ENACTED, That $100,000 of the general fund appropriation within the Department of Juvenile Services (DJS) and $100,000 of the general fund appropriation within the Juvenile Services Education (JSE) unit of the Maryland State Department of Education (MSDE) may not be expended until:

(A) DJS and MSDE jointly submit a report to the budget committees on:

(1) The advancements made toward addressing the following concerns with DJS education services:

(a) lack of postsecondary, vocational, and work opportunities;

(b) grouping classes by living unit as opposed to skill level;

(c) high vacancy rates and turnover for facility staff and a lack of a substitute system;

(d) space limitations due to the physical plant and age of the DJS facilities;

(e) adherence to students' Individualized Education Programs (IEP); and

(f) recordkeeping and transition services between DJS facility schools and local school systems.

(2) The mechanisms for ensuring proper communication between MSDE, DJS, and local school systems, particularly when a lack of services has been identified or a complaint has been lodged.

(3) A detailed accounting of how the additional resources provided in the fiscal 2017 allowance have been utilized and the impact those resources have had on the delivery of education services.

(4) The development of measures evaluating the performance of the JSE program, to include but not be limited to the following measures:

(a) average length of time to transition student records between a JSE school and a local school system;

(b) teacher vacancy rates and length of tenure;

(c) contacts with local school system liaisons to support student transition into the community;

(d) students participating in postsecondary opportunities and vocational opportunities; and

(e) the number of classroom hours canceled due to the unavailability of a teacher or substitute.

Provided that the report shall be submitted to the budget committees no later than November 15, 2016, with follow-up reports submitted biannually; and

(B) Data for the identified performance measures shall be included in the Department of Juvenile Services annual Managing for Results performance measure submission beginning with the fiscal 2018 allowance submitted in January 2017.

The budget committees shall have 45 days to review and comment from the date of each submission. It is the intent of the budget committees that $50,000 be released to each agency upon receipt and approval of the November 2016 report. The remaining $50,000 shall be released from each agency upon satisfactory submission of the performance measure data with the fiscal 2018 allowance. Funds restricted pending the receipt of a report may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund if the report is not submitted to the budget committees.

Explanation: Concerns have been raised questioning whether MSDE is providing the appropriate level of services to students in DJS facilities, particularly to students with special education needs. This language requires DJS and MSDE to work jointly to report on a regular basis to the budget committees regarding progress made toward addressing the deficiencies in the provision of education services to youth in DJS facilities. It also requires the development of performance measures to evaluate how well the program is functioning, as opposed to only evaluating student performance. The report is due by November 15, 2016, and every six months, thereafter.

Information Request	**Authors**	**Due Date**
Improving education services for DJS youth and proposed performance measures	MSDE DJS	November 15, 2016, and biannually, thereafter
Juvenile Services Education program performance measure data	MSDE DJS	January 2017 and annually, thereafter

Total General Fund Reductions **$ 201,000**

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Department of Juvenile Services
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$285,697	$4,966	$7,133	$140	$297,936
Deficiency Appropriation	-202	0	0	0	-202
Cost Containment	-9,630	0	0	0	-9,630
Budget Amendments	1,092	0	760	63	1,915
Reversions and Cancellations	-2,188	-1,308	-3	-38	-3,538
Actual Expenditures	**$274,769**	**$3,658**	**$7,890**	**$165**	**$286,481**
Fiscal 2016					
Legislative Appropriation	$276,773	$4,906	$7,343	$220	$289,243
Budget Amendments	2,374	0	18	0	2,392
Working Appropriation	**$279,147**	**$4,906**	**$7,361**	**$220**	**$291,635**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

DJS expended nearly $286.5 million in fiscal 2015, a decrease of approximately $11.5 million from the legislative appropriation.

General fund expenditures totaled nearly $274.8 million in fiscal 2015, reflecting a decrease of approximately $10.9 million when compared to the legislative appropriation.

- A negative deficiency appropriation reduced the legislative appropriation by $202,000 to reflect the level funding of residential provider rates at the fiscal 2014 amount.

- Cost containment actions further decreased the legislative appropriation by $9.6 million. This included a 2% reduction in agency operating expenses ($5.7 million); decreased funding for contractual programs, services, and residential per diems based on a decrease in population ($3.0 million); and the elimination of 12 vacant positions ($900,000).

- Budget amendments provided a net increase of nearly $1.1 million. A $2.3 million increase for cost-of-living adjustments (COLA) and an annual salary review for direct care workers was offset by the loss of $1.1 million through the Voluntary Separation Program and $88,000 from the statewide realignment of telecommunication funding.

- The department reverted nearly $2.2 million in general funds at the close of fiscal 2015. Unexpended funding for community-based programs and residential per diems due to population declines accounted for the majority of the reversion.

Special fund expenditures totaled $3.7 million in fiscal 2015, a decrease of approximately $1.3 million from the legislative appropriation. The department canceled $1.3 million at the close of fiscal 2015 based on actual collections from local education agencies for youth receiving education services while in a DJS facility.

Federal fund expenditures totaled $7.9 million in fiscal 2015, an increase of $757,000 from the legislative appropriation. Budget amendments provided an additional $9,619 for the employee COLA and $750,000 in recognition of additional federal revenue from Title IV-E and Medicaid based on projected billings. At the close of fiscal 2015, DJS canceled approximately $3,000 in federal funds.

Reimbursable fund expenditures totaled $165,000 at the close of fiscal 2015. The department received an additional $63,000 in grant funding from the Governor's Office of Crime Control and Prevention to fund the implementation of the Prison Rape Elimination Act. This was offset by the cancellation of approximately $38,000 in unexpended grant funds.

Fiscal 2016

The fiscal 2016 working appropriation reflects an increase of nearly $2.4 million in general funds and $18,000 in federal funds over the legislative appropriation. This increase is attributable to the redistribution of funds to restore employee salaries, from funds restricted by Section 48 of the fiscal 2016 budget bill.

Object/Fund Difference Report
Department of Juvenile Services

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	2,055.05	2,055.05	2,051.05	-4.00	-0.2%
02 Contractual	159.07	142.00	141.50	-0.50	-0.4%
Total Positions	**2,214.12**	**2,197.05**	**2,192.55**	**-4.50**	**-0.2%**
Objects					
01 Salaries and Wages	$ 160,982,883	$ 163,957,971	$ 173,703,679	$ 9,745,708	5.9%
02 Technical and Spec. Fees	5,968,419	5,413,436	5,965,736	552,300	10.2%
03 Communication	2,960,910	2,736,991	2,789,215	52,224	1.9%
04 Travel	1,087,471	975,628	1,062,671	87,043	8.9%
06 Fuel and Utilities	4,497,022	4,712,195	4,680,049	-32,146	-0.7%
07 Motor Vehicles	1,872,403	2,093,241	2,081,230	-12,011	-0.6%
08 Contractual Services	94,031,305	96,771,080	88,511,838	-8,259,242	-8.5%
09 Supplies and Materials	7,037,296	6,831,952	6,751,013	-80,939	-1.2%
10 Equipment – Replacement	1,387,678	817,379	1,059,659	242,280	29.6%
11 Equipment – Additional	505,981	347,271	17,812	-329,459	-94.9%
12 Grants, Subsidies, and Contributions	2,514,053	3,159,405	2,910,231	-249,174	-7.9%
13 Fixed Charges	3,593,827	3,779,467	4,249,167	469,700	12.4%
14 Land and Structures	41,221	38,798	495,707	456,909	1177.7%
Total Objects	**$ 286,480,469**	**$ 291,634,814**	**$ 294,278,007**	**$ 2,643,193**	**0.9%**
Funds					
01 General Fund	$ 274,768,951	$ 279,147,495	$ 285,326,909	$ 6,179,414	2.2%
03 Special Fund	3,657,541	4,906,381	3,864,096	-1,042,285	-21.2%
05 Federal Fund	7,889,190	7,360,726	4,840,172	-2,520,554	-34.2%
09 Reimbursable Fund	164,787	220,212	246,830	26,618	12.1%
Total Funds	**$ 286,480,469**	**$ 291,634,814**	**$ 294,278,007**	**$ 2,643,193**	**0.9%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Department of Juvenile Services

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Office of the Secretary	$ 4,419,266	$ 3,521,058	$ 4,018,949	$ 497,891	14.1%
02 Departmental Support	28,094,695	25,822,910	26,378,480	555,570	2.2%
01 Residential Operations	4,697,222	5,093,905	5,630,334	536,429	10.5%
01 Baltimore City Region Operations	59,548,818	62,394,820	60,332,313	-2,062,507	-3.3%
01 Central Region Operations	36,660,126	37,698,355	37,715,688	17,333	0%
01 Western Region Operations	48,623,706	46,568,996	50,265,637	3,696,641	7.9%
01 Eastern Region Operations	21,174,736	23,155,416	23,065,996	-89,420	-0.4%
01 Southern Region Operations	24,402,512	26,452,613	25,483,910	-968,703	-3.7%
01 Metro Region Operations	58,859,388	60,926,741	61,386,700	459,959	0.8%
Total Expenditures	**$ 286,480,469**	**$ 291,634,814**	**$ 294,278,007**	**$ 2,643,193**	**0.9%**
General Fund	$ 274,768,951	$ 279,147,495	$ 285,326,909	$ 6,179,414	2.2%
Special Fund	3,657,541	4,906,381	3,864,096	-1,042,285	-21.2%
Federal Fund	7,889,190	7,360,726	4,840,172	-2,520,554	-34.2%
Total Appropriations	**$ 286,315,682**	**$ 291,414,602**	**$ 294,031,177**	**$ 2,616,575**	**0.9%**
Reimbursable Fund	$ 164,787	$ 220,212	$ 246,830	$ 26,618	12.1%
Total Funds	**$ 286,480,469**	**$ 291,634,814**	**$ 294,278,007**	**$ 2,643,193**	**0.9%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

W00A
Department of State Police

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$245,218	$245,501	$268,051	$22,550	9.2%
Deficiencies and Reductions	0	5,226	-610	-5,836	
Adjusted General Fund	**$245,218**	**$250,727**	**$267,441**	**$16,713**	**6.7%**
Special Fund	94,743	94,215	96,556	2,341	2.5%
Deficiencies and Reductions	0	0	-149	-149	
Adjusted Special Fund	**$94,743**	**$94,215**	**$96,407**	**$2,192**	**2.3%**
Federal Fund	7,333	8,217	9,701	1,484	18.1%
Adjusted Federal Fund	**$7,333**	**$8,217**	**$9,701**	**$1,484**	**18.1%**
Reimbursable Fund	14,647	12,401	5,718	-6,683	-53.9%
Adjusted Reimbursable Fund	**$14,647**	**$12,401**	**$5,718**	**-$6,683**	**-53.9%**
Adjusted Grand Total	**$361,941**	**$365,561**	**$379,268**	**$13,706**	**3.7%**

- The Governor's fiscal 2017 allowance includes two deficiency appropriations totaling nearly $9.8 million in general funds. The deficiencies include (1) $4.5 million to cover fiscal 2015 overspending on operating expenses; and (2) $5.2 million to reduce turnover expectancy. Both of these deficiencies are provided to backfill the 2.0% across-the-board reductions adopted mid-year in fiscal 2015 and for fiscal 2016. The fiscal 2016 deficiency will be used to fund two trooper classes, of approximately 45 to 75 troopers in each class.

- General fund expenditures increase by approximately $16.7 million, or 6.7%. This increase largely reflects growth in personnel expenditures, which includes additional funding to fill sworn and civilian vacancies. In addition to enhanced personnel expenses, the department receives funding increases for computer equipment, grounds maintenance, and covert investigation vehicles.

Note: Numbers may not sum to total due to rounding.

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- Special fund expenditures grow by approximately $2.2 million in the fiscal 2017 allowance. Additional Maryland Emergency Medical System Operations Fund funds allocated to support the Aviation Command account for 95.0% of the increase. Personnel expenses, along with higher than expected fuel and maintenance costs for the helicopter fleet, are driving the Aviation Command's need for additional resources.

- The fiscal 2017 federal fund allowance increases by nearly $1.5 million. This reflects efforts by the department to anticipate more accurate federal fund expenditures in order to reduce the need to appropriate federal funds via budget amendment throughout the fiscal year. The Department of State Police (DSP) receives routine federal funding, primarily in the form of Asset Seizure funds, which were not adequately captured at the time of budget submission in previous years.

- Reimbursable funds decrease by approximately $6.7 million, or 53.9%, when compared to the fiscal 2016 working appropriation. This decrease is largely due to reduced funding for Major information technology (IT) projects; however, the fiscal 2017 allowance includes $2.1 million for the Automated Licensing and Registration Tracking System project and $9.5 million for the 700 MegaHertz System radios budgeted in the Major Information Technology Development Project Fund. These funds will be transferred to the department via budget amendment at a later date.

- Supplemental Budget No. 2 provides $275,000 in general funds to implement recommendations from the Governor's Heroin and Opioid Emergency Task Force that pertain to DSP. Approximately $200,000 will be used to establish a multi-jurisdictional Heroin Investigation Unit and $75,000 will be used to establish the High Intensity Drug Trafficking Area (HIDTA) Case Explorer database as the central repository for Maryland drug intelligence through the funding of a DSP liaison at the HIDTA office building in Greenbelt.

Personnel Data

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change
Regular Positions	2,437.50	2,437.50	2,435.50	-2.00
Contractual FTEs	27.64	70.08	66.49	-3.59
Total Personnel	**2,465.14**	**2,507.58**	**2,501.99**	**-5.59**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	101.56	4.17%
Positions and Percentage Vacant as of 12/31/15	281.00	11.53%

- The department loses 2.0 regular positions and approximately 3.6 full-time equivalents in the fiscal 2017 allowance. The abolished positions are both IT related and are part of the statewide consolidation of IT services within the Department of Information Technology.

- DSP vacancies equate to nearly 12% of its workforce. The fiscal 2017 budgeted turnover rate of 4% leaves nearly 180 funded vacancies for the department to fill in the upcoming fiscal year.

Analysis in Brief

Major Trends

Crime in Maryland Continues to Decline: In calendar 2014, Maryland's crime rate of 2,960 offenses for every 100,000 inhabitants was nearly even with the national average of 2,962 offenses for every 100,000 inhabitants. This is the lowest Part 1 crime reported since 1975 when the *Uniform Crime Report* program began. Since the most recent peak in calendar 2008, the crime rate has fallen by nearly 29%. The most recent year-over-year change reflects a 5% decrease.

Maryland's Murder Rate Decreases; Exceeds National Average: In calendar 2014, Maryland's murder rate decreased slightly to 6.1 murders per 100,000 persons from the prior year's 6.5 murders per 100,000 persons. This reflects the lowest murder rate in over 15 years, however, the State's murder rate still greatly exceeds the national average, which remained constant at 4.5 murders per 100,000 persons in calendar 2014.

Issues

New Collective Bargaining Agreement for Sworn Police Officers: The Department of Budget and Management (DBM) has reached agreement with the State Law Enforcement Officers Labor Alliance, which bargains for sworn police officers. The agreement provides for regular increments, a general salary increase in fiscal 2017, step increases for officers employed in the recent four years (fiscal 2010 to 2013) in which State employees did not receive step increases, and other enhancements. Analysis of the fiscal 2017 allowance indicates that most of the provisions within the new agreement have not been properly funded. **DSP and DBM should comment on whether all aspects of the new collective bargaining agreement are fully funded in the fiscal 2017 allowance. If certain components are not funded, cost estimates of the funding required and a plan for appropriating those funds should be provided.**

Department of State Police Staffing Issues: The fiscal 2017 allowance includes a significant amount of additional resources to help the department achieve full staffing in both its sworn and civilian workforce. A closer look at the DSP personnel complement reveals questions pertaining to the appropriate size of the trooper workforce for the State, whether certain positions or responsibilities could be civilianized in order to lessen the administrative burden on existing troopers, and whether internal and external hiring processes could be streamlined or altered to reduce vacancies. **The Department of Legislative Services (DLS) recommends the adoption of committee narrative directing DSP to evaluate the current size of the sworn workforce, and DSP and DBM to collaboratively evaluate how to improve hiring policies and practices in order to expedite the filling of vacancies.**

Reopening the Annapolis Barrack: The Annapolis Barrack reopened in November 2015 after closing in 2008 due to cost containment. To date, approximately $650,000 has been spent on minor renovations and start-up costs to improve the facility to the point of partial operations. A building assessment, completed in January 2016, has determined that additional renovation is required. The fiscal 2017 allowance includes $2.45 million in the Department of General Services' Facilities Renewal program for the upgrade; however, it is not clear whether this will completely cover the entire cost of the upgrade, including IT and equipment needs. If the cost of the project were to exceed $2.5 million, it would be over the limit for projects eligible to be funded through the program. **DLS recommends language prohibiting the use of the Facilities Renewal Fund appropriation on the renovation of the Annapolis Barrack. The department should instead pursue the proper procedure for funding a capital project of this nature, including submission of Part I and II program plans for review by DBM. The recommended language can be found in the Board of Public Works capital analysis.**

Fiscal 2015 Closeout Audit: In February 2016, the Office of Legislative Audits released its closeout audit report for fiscal 2015. Two findings pertain to the department, one of which is a continuation of findings highlighted in the department's November 2015 fiscal compliance audit. **DSP should provide an update on its work to resolve the November 2015 audit findings pertaining to the use of special funds. In addition, the department should identify how it will absorb the $1.1 million in fiscal 2015 overspending identified in the fiscal 2015 closeout audit that is not covered by the fiscal 2016 deficiency appropriation.**

Recommended Actions

1. Adopt narrative requesting a review of internal and external hiring policies in an effort to expedite the Department of State Police hiring process.
2. Adopt narrative directing the Department of State Police to evaluate the current size of the State's sworn workforce.
3. Adopt committee narrative requesting that an appendix continue to be provided in the Maryland Budget Highlights book consolidating budgetary resources that the Maryland Coordination and Analysis Center receives from State agency appropriations.
4. Add budget bill language restricting $1,000,000 of the general fund appropriation until the Department of State Police submits the 2015 Uniform Crime Report.

Updates

Final Report on Cannabimimetic Agent Enforcement: The 2014 *Joint Chairmen's Report* required DSP to submit reports on cannabimimetic agent enforcement. The final report was submitted on July 1, 2015. From March 1, 2013, to June 15, 2015, DSP has investigated 1,282 cross border cases of illegal substances, including synthetic narcotics. From January 1, 2013, to June 15, 2015, DSP and law enforcement partners seized 3,126 pounds of synthetic narcotics.

Final Sale of Dauphin Helicopters: The Maryland State Police Aviation Command operated a fleet of 12 Dauphin helicopters, most of which were purchased between 1989 and 1994. These helicopters were reaching the end of their useful lives, and it was determined that the fleet needed to be replaced. The 11 operational Dauphin helicopters have been sold. Proceeds from the sale total approximately $2.8 million. Approximately $4.0 million was also received from an insurance settlement for the helicopter that was destroyed in an air accident in 2008.

Department of State Police

Operating Budget Analysis

Program Description

The Department of State Police (DSP) exists to safeguard persons within the State, protect property, and assist in providing all persons equal protection under the law. The department's operating structure is composed of the following programs:

- the Office of the Superintendent;
- the Field Operations Bureau;
- the Criminal Investigation Bureau; and
- the Support Services Bureau.

Within these functions, the department recruits and hires employees; addresses retention issues; provides services in procurement and distribution of supplies and equipment; works to improve the critical error rate of law enforcement agencies that enter civil protective orders into the Maryland Interagency Law Enforcement Agency/National Crime Information Center systems; serves as a catalyst for the interagency exchange of criminal justice, homeland security, and intelligence information at the federal, State, and local levels; and provides timely and efficient access to public information and records. The department also includes the Vehicle Theft Prevention Council, the Fire Prevention Commission, and Office of the State Fire Marshal, which are charged with safeguarding life and property from the hazards of fire and explosion.

Performance Analysis: Managing for Results

1. Crime in Maryland Continues to Decline

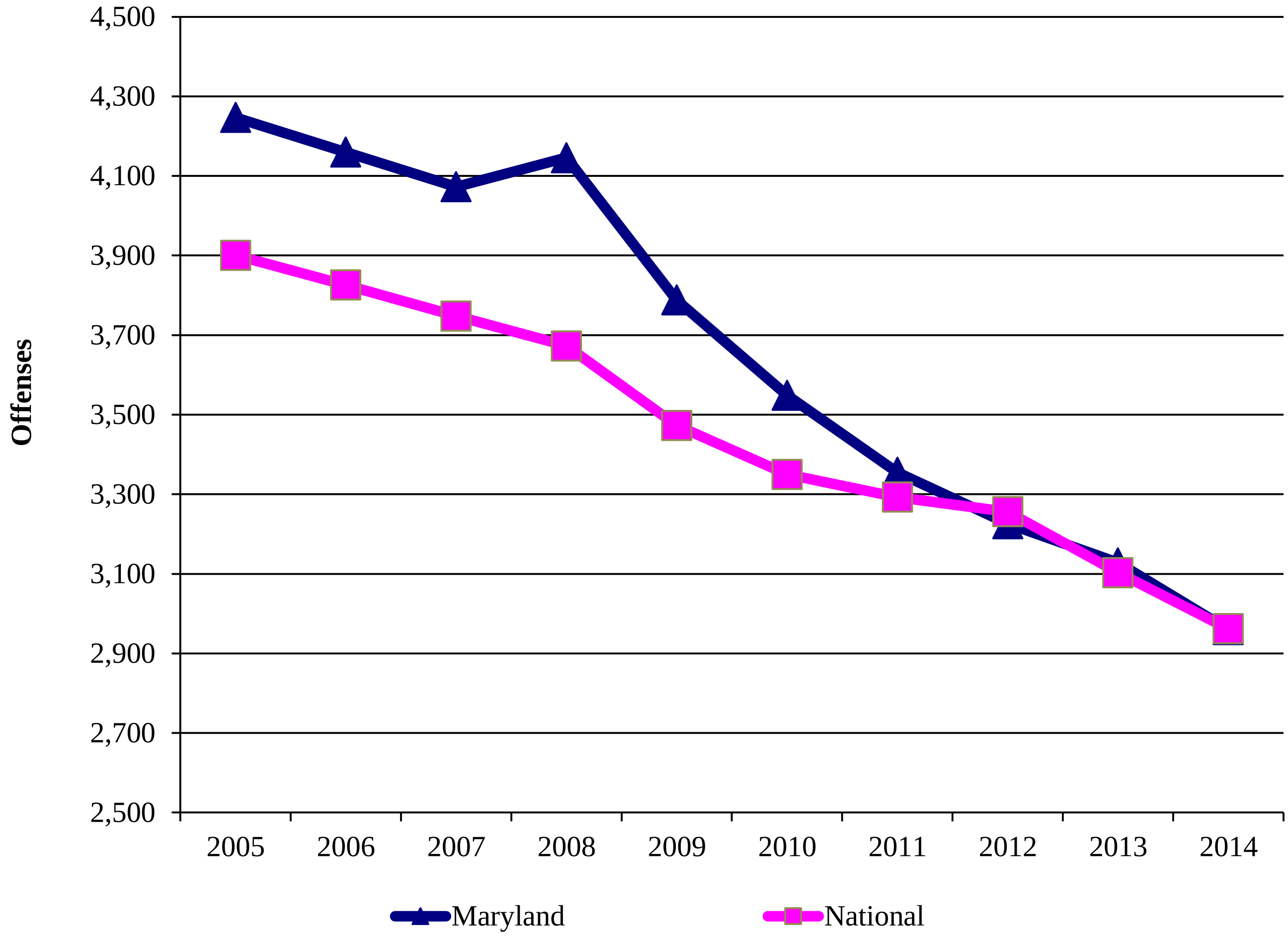
In 1975, by statute, Maryland instituted a program to require all local law enforcement agencies to submit standardized crime reports based on the federal reporting system to ensure consistency. Data for the reports is gathered from each agency's record of complaints, investigations, and arrests. DSP compiles the information by calendar year, which is published as *Crime in Maryland, Uniform Crime Report* (UCR). The methodology for these reports follows guidelines and definitions of crimes as provided by the National Uniform Crime Reporting Program, which is administered by the Federal Bureau of Investigation.

The UCR measures the incidence, arrests, and trends for the following eight crimes, referred to as Part I offenses:

- murder and voluntary manslaughter;
- forcible rape;
- robbery;
- aggravated assault;
- breaking and entering (burglary);
- larceny-theft;
- motor vehicle theft; and
- arson.

Based upon reported offenses, a crime rate is calculated for the number of offenses per 100,000 inhabitants. In calendar 2014, Maryland's crime rate of 2,960 offenses for every 100,000 inhabitants was nearly even with the national average of 2,962 offenses for every 100,000 inhabitants. This is the lowest Part 1 crime reported since 1975 when the UCR program began. Since the most recent peak in calendar 2008, the crime rate has fallen by nearly 29%. The most recent year-over-year change reflects a 5% decrease (see **Exhibit 1**).

Exhibit 1
Maryland and National Crime Rate Trends
Offenses Per 100,000 of Population
Calendar 2005-2014

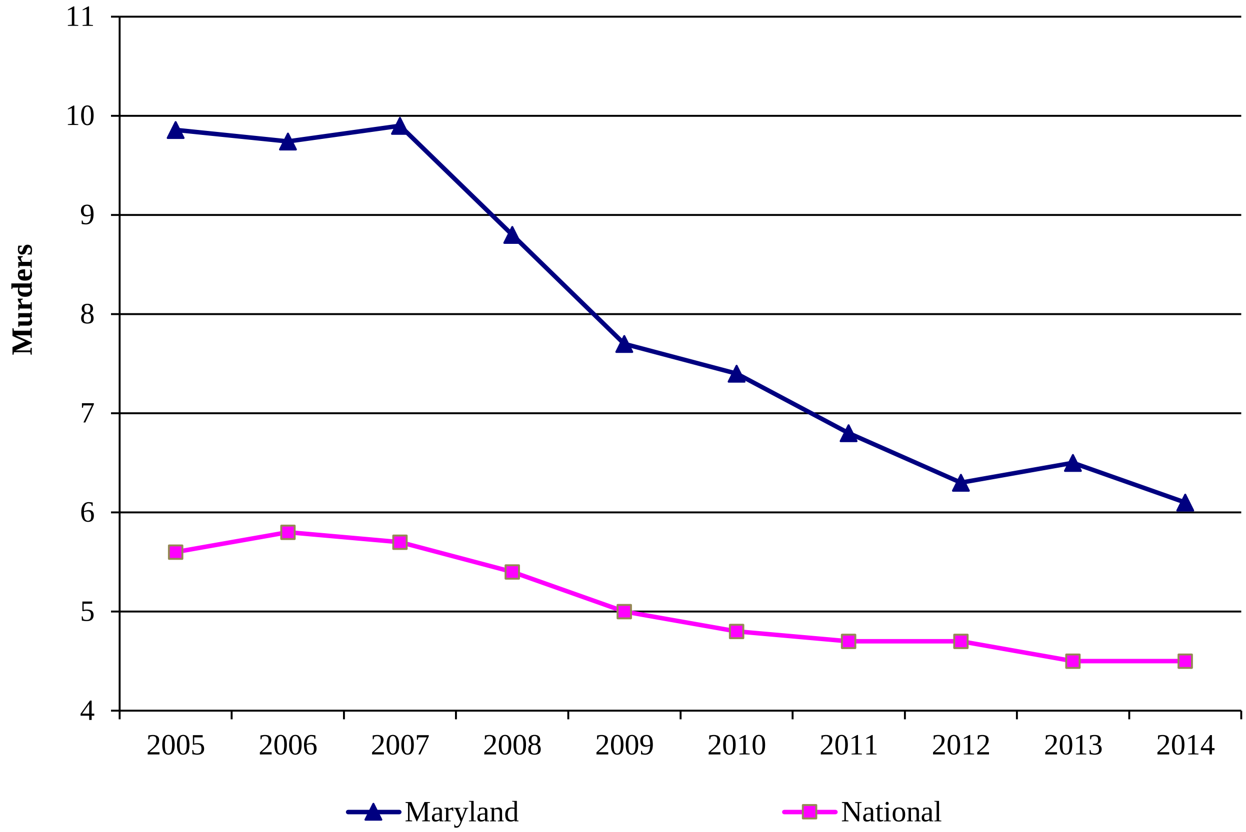


Source: *Crime in Maryland, 2014 Uniform Crime Report*; Federal Bureau of Investigation

2. Maryland's Murder Rate Decreases; Exceeds National Average

In calendar 2014, Maryland's murder rate decreased slightly to 6.1 murders per 100,000 persons from the prior year's 6.5 murders per 100,000 persons (see **Exhibit 2**). This reflects the lowest murder rate in over 15 years, however, the State's murder rate still greatly exceeds the national average, which remained constant at 4.5 murders per 100,000 persons in calendar 2014. Total murders reported to law enforcement agencies in Maryland decreased from 387 to 363 in calendar 2014, or a 6% decrease.

Exhibit 2
Maryland and National Trends
Murders Per 100,000 of Population
Calendar 2005-2014



Source: *Crime in Maryland, 2014 Uniform Crime Report*; Federal Bureau of Investigation

Fiscal 2016 Actions

Proposed Deficiency

The Governor's fiscal 2017 allowance includes two deficiency appropriations totaling nearly $9.8 million in general funds. Approximately $4.5 million is provided to cover fiscal 2015 overspending on operating expenses. DSP was given a 2% across-the-board reduction of $5.0 million midway through fiscal 2015. Despite efforts to meet the reduction in funds by minimizing spending, closing purchase orders, reducing overtime, *etc.*, there was a deficit of $4.5 million. Carryover from fiscal 2014 expenditures, payouts through the Voluntary Separation Program (VSP), a legal settlement and retirement payouts contributed to the cost overages. As a result, in order to close fiscal 2015, the General Accounting Division accrued this balance into fiscal 2016. As discussed in the Issues section of this analysis, the Office of Legislative Audits (OLA) actually estimates fiscal 2015 overspending to total $5.6 million.

In addition, the department receives $5.2 million to reduce turnover expectancy in fiscal 2016. This deficiency backfills the 2% across-the-board reduction adopted for the current fiscal year. The fiscal 2016 deficiency will be used to fund two trooper classes, of approximately 45 to 75 troopers in each class, and support start-up operating costs associated with the reopening of the Annapolis Barrack.

The fiscal 2017 budget also includes a $2.5 million deficiency appropriation budgeted within the Department of Budget and Management (DBM) to fund the provisions of a new collective bargaining agreement (CBA) with the State Law Enforcement Officers Labor Alliance (SLEOLA), which bargains for sworn police officers, that takes effect in fiscal 2016. The $1.8 million that represents the DSP share of these funds will be transferred via budget amendment at a later date. The details of the SLEOLA agreement are discussed further under the Issues section of the analysis.

Cost Containment

The fiscal 2016 budget included a 2% across-the-board reduction to ongoing general fund operating expenses. For DSP, this reduction totaled $5.2 million. The full amount of the reduction is being restored to the department through a fiscal 2016 deficiency appropriation.

Proposed Budget

Exhibit 3 illustrates how the Governor's fiscal 2017 allowance grows by $13.7 million, or 3.7%, above the fiscal 2016 working appropriation.

Exhibit 3
Proposed Budget
Department of State Police
($ in Thousands)

How Much It Grows:	**General Fund**	**Special Fund**	**Federal Fund**	**Reimb. Fund**	**Total**
Fiscal 2015 Actual	$245,218	$94,743	$7,333	$14,647	$361,941
Fiscal 2016 Working Appropriation	250,727	94,215	8,217	12,401	365,561
Fiscal 2017 Allowance	267,441	96,407	9,701	5,718	379,268
Fiscal 2016-2017 Amount Change	$16,713	$2,192	$1,484	-$6,683	$13,706
Fiscal 2016-2017 Percent Change	6.7%	2.3%	18.1%	-53.9%	3.7%

Where It Goes:	
Personnel Expenses	
Employee retirement	$5,360
Employee and retiree health insurance	5,276
Two trooper classes with the goal of hiring 100+ troopers	3,329
Turnover adjustments (including fiscal 2016 deficiency)	1,345
Other fringe benefit adjustments	392
Abolished/transferred positions	-132
Workers' compensation premium assessment	-134
Salaries and other compensation	-1,681
Overtime	-2,077
Aviation Command and Helicopter Fleet Costs	
Aircraft fuel	219
Maintenance and repair	191
Reduced travel costs for flight simulator training	-326
Other Changes	
Increased anticipated grant funding	3,987
IT equipment replacement	2,044
Telecommunications – reallocation of costs among users of 700 MHz System	1,992
Grounds maintenance	1,100
Covert investigation vehicle purchases	700
Advertising expenses in compliance with Chapter 249 of 2014	100
IT shared services initiative	78
Other	-613
Vehicle fuel and oil expenses	-1,221
Major IT funds – ALRTS and 700 MHz radios	-6,223
Total	**$13,706**

ALRTS: Automated Licensing and Registration Tracking System
IT: information technology
MHz: MegaHertz

Note: Numbers may not sum to total due to rounding.

Across-the-board Reductions

The fiscal 2017 budget bill includes an across-the-board reduction for employee health insurance, based on a revised estimate of the amount of funding needed. This agency's share of these reductions is $610,389 in general funds and $148,943 in special funds. There is an additional across-the-board reduction to abolish positions statewide, but the amounts have not been allocated by agency.

Personnel Expenses

Personnel expenses increase by a net $11.7 million in fiscal 2017. Not reflected in the DSP allowance is approximately $5.7 million in general funds and $1.3 million in special funds budgeted within DBM for fiscal 2017 employee increments. Enhancements provided to sworn police officers through the new CBA with SLEOLA, discussed further in the Issues section of this analysis, do not appear to be funded in the fiscal 2017 allowance.

Growth in retirement ($5.4 million) and health insurance payments ($5.3 million) account for the majority of the increase in personnel expenses. The State's contribution rate into the State Police Retirement System increases in fiscal 2017 to 83.73%. This includes a 2.49 percentage point increase in the actuarial rate, as well as the plan's share of all supplemental and extra contributions being paid by the State in fiscal 2017. In addition, the department receives approximately $3.3 million in additional funding to support two new trooper classes with the goal of hiring 100 troopers or more to address existing sworn officer vacancies. As of February 2016, the department had 114 trooper vacancies. As is discussed in the Issues section, DSP has significant turnover among both its sworn and civilian positions. This requires a minimum of two trooper classes each year to maintain status quo. In addition, the allowance provides $1.3 million in additional funding, accounting for the fiscal 2016 deficiency appropriation, to reduce the fiscal 2017 budgeted turnover rate to approximately 4.2%. This additional funding will be predominately targeted toward filling existing civilian vacancies, which outnumber the total number of trooper vacancies.

Offsetting these increases is a $1.7 million reduction in salaries and a $2.1 million decrease in overtime expenses. As positions become vacant, in many instances due to retirement, they are reclassified to the base salary. This results in an overall net decrease to salaries. On average, the department has more than 165 sworn and civilian separations each year. The reduced overtime funding is in anticipation of reducing the number of vacancies within the department. More filled positions, both sworn and civilian, should lessen the need for employees to work overtime. It is worth noting, however, that overtime funding in fiscal 2016 and 2017 is budgeted below fiscal 2015 actual spending by $5.8 million and $7.9 million, respectively. To the extent that the department is less successful in filling vacancies, the additional turnover funding would be available to expend on overtime.

DSP also loses 2 regular positions in the fiscal 2017 allowance, for a total reduction of $132,000. These are information technology (IT) positions being consolidated within the Department of Information Technology (DoIT) through the statewide shared IT services initiative. This initiative is discussed further within the DoIT analysis. There is an offsetting charge of $78,000 budgeted elsewhere within the DSP allowance to fund the cost of the shared services.

Aviation Command

Funding for the Maryland State Police Aviation Command (MSPAC) increases by $2.7 million, or 7.3%, in fiscal 2017. Special funds from Maryland Emergency Medical System Operations Fund (MEMSOF) support the medically oriented mission of MSPAC, as required by statute. General funds support law enforcement and homeland security functions. The funding split for MSPAC has remained at 80.0% in special funds and 20.0% in general funds since fiscal 2003.

In calendar 2014, MSPAC took delivery of the tenth, and final AgustaWestland (AW) 139 helicopter to be used for medical evacuation, Medevac, and law enforcement missions. As of January 2015, all seven helicopter sections in the State had fully transitioned to 24/7 operations of the AW-139 helicopter, officially retiring the Dauphin helicopter fleet. Fiscal 2016 will be the first full fiscal year of expenditures for the new fleet. Additional funding was provided for fuel and maintenance to support the new aircraft in fiscal 2016. Funding for these items further increases in fiscal 2017. The allowance shows increases of $219,000 in gas and oil and $191,000 in maintenance and repair for the new helicopters. This reflects an 8.3% increase over the fiscal 2016 working appropriation. Fiscal 2017 anticipated maintenance costs for the fleet reflect a 116.1% increase ($1.8 million) over fiscal 2015 actual expenditures. An analysis completed by MSPAC estimated that from the time of delivery for the first helicopter through May 2015, approximately $7.5 million has been spent on maintenance, with $6.5 million covered through warranties. The original maintenance warranties for the entire fleet will expire by the end of calendar 2017, meaning all maintenance costs will be funded through the MEMSOF or the use of general funds in fiscal 2018.

Offsetting the increase in helicopter fuel and maintenance costs is a $326,000 reduction in travel costs for pilot training. As part of the purchase of 10 AW-139 helicopters, the State also authorized general obligation (GO) bonds to acquire a flight training simulator to conduct recurrent pilot training. The flight training device (FTD) will allow up to 75% of mandatory pilot training to be conducted in the FTD and require at least 25% to be conducted in the helicopters. Training using the FTD will save flight hours on the new fleet, as well as create a safer environment for training. The FTD is anticipated to be operational by December 2016. MSPAC currently sends pilots to New Jersey to train on a full motion simulator. Funding for this training is reduced in fiscal 2017 since, once the FTD is operational, only newly hired pilots will require training with the full motion simulator.

Purchasing the FTD required renovation of an appropriate facility to house the device. Approximately $4.8 million in GO bonds was authorized to renovate a facility at Martin State Airport. The FTD building project has been awarded, with approval of the contract anticipated for March 2016. Construction is to be completed 180 days from the Notice to Proceed, which would have the facility ready in September 2016. The FTD is scheduled for delivery in July 2016, approximately two months before the anticipated completion of the facility.

MSPAC should comment on how the discrepancy in the timeline for constructing the FTD facility and delivery of the device will impact pilot training and whether the delay will have a fiscal impact.

Other Changes

Other significant changes in the fiscal 2017 allowance provide a net increase of $1.9 million. Anticipated grant funding is budgeted nearly $4.0 million above the fiscal 2016 working appropriation in an effort to reduce the need to process multiple budget amendments for funds received on an annual basis. DSP also receives an increase of approximately $2.0 million to refresh computers and other IT equipment throughout the department. Telecommunications costs increased by nearly $2.0 million, or 161.9%, as DoIT realigned its method for charging users of the statewide 700 megahertz (MHz) public safety communication system. Assigned charges are now based on the number of radios assigned to each user, of which DSP has a significant number. Ground maintenance increases by $1.1 million to address deficiencies within DSP facilities, and an additional $700,000 is provided to purchase undercover vehicles used for investigations. Statute pertaining to the use of speed camera revenue refers to the special funds being used for roadside enforcement activities. DSP has determined that speed camera revenues used for vehicles may only be used for patrol cars. As such, general funds are provided for the investigative vehicles.

Offsetting these increases is a $6.2 million decrease in Major IT funding for the Automated Licensing and Registration Tracking System (ALRTS) and the ongoing purchase of radios for the statewide 700 MHz public safety wireless communication system. The fiscal 2017 allowance includes $2.1 million for the ALRTS project and $9.5 million for the 700 MHz System radios budgeted in the Major Information Technology Development Project Fund (MITDPF). These funds will be transferred to the department via budget amendment at a later date.

Supplemental Budget No. 2

Supplemental Budget No. 2 provides $275,000 in general funds to implement recommendations from the Governor's Heroin and Opioid Emergency Task Force that pertain to DSP. Approximately $200,000 will be used to establish a multi-jurisdictional Heroin Investigation Unit. Specifically, the funds will be used for equipment to support investigations, intelligence gathering with the High Intensity Drug Trafficking Area (HIDTA), training, and manpower overtime.

The remaining $75,000 will be used to support DSP's HIDTA intelligence gathering and data sharing efforts by establishing the Case Explorer database as the central repository for Maryland drug intelligence and through the funding of a DSP liaison at the HIDTA office building in Greenbelt.

Issues

1. New Collective Bargaining Agreement for Sworn Police Officers

DBM has reached agreement with SLEOLA, which bargains for sworn police officers. The agreement provides for regular increments, a general salary increase in fiscal 2017, and provides step increases for officers employed in the recent four years (fiscal 2010 to 2013) in which State employees did not receive step increases. DBM advises that the contract includes the following:

- three-year contract from July 1, 2016, to June 30, 2019;
- increments in fiscal 2016 and 2017;
- on January 1, 2017, one step for all who missed steps;
- on January 1, 2018, one step for all who missed steps;
- increase starting salary for police officer scale to $36,800;
- one grade increase for the Department of Public Safety and Correctional Services (DPSCS) officers Warrant Apprehension Unit;
- no shift differential would be paid for any hours that are designated as a scheduled day shift, so that all hours worked from 2:00 p.m. to 7:00 a.m. qualify for shift differential;
- 2% general salary increase in fiscal 2017;
- bonuses for fitness, education, and clothing; and
- limited reopener language, which allows the union and State to negotiate again depending on economic conditions.

Allowance May Not Provide Adequate Funding

Within the DBM budget, the fiscal 2017 allowance provides a $2.5 million fiscal 2016 deficiency appropriation to support the agreement, of which the DSP share is approximately $1.8 million. This provides funding for a fiscal 2016 increment, shift differential, uniform allowance, fitness bonus, and education bonus. The only funding provided in fiscal 2017 is approximately $6.9 million budgeted within DBM to provide the standard fiscal 2017 increment for all State employees. Given the timing of when the agreement was signed versus when the budget was submitted, the fiscal 2017 allowance does not appear to fund the new CBA provisions, including the 2% general salary increase, shift differential, the additional step on January 1, 2017, for all who missed steps, and the clothing, education, and fitness bonuses. The Department of Legislative Services (DLS) estimates the cost of these provisions to be approximately $6.6 million, assuming only 50% of employees are eligible for the additional step increase.

DSP and DBM should comment on whether all aspects of the new CBA are fully funded in the fiscal 2017 allowance. If certain components are not funded, cost estimates of the funding required and a plan for appropriating those funds should be provided.

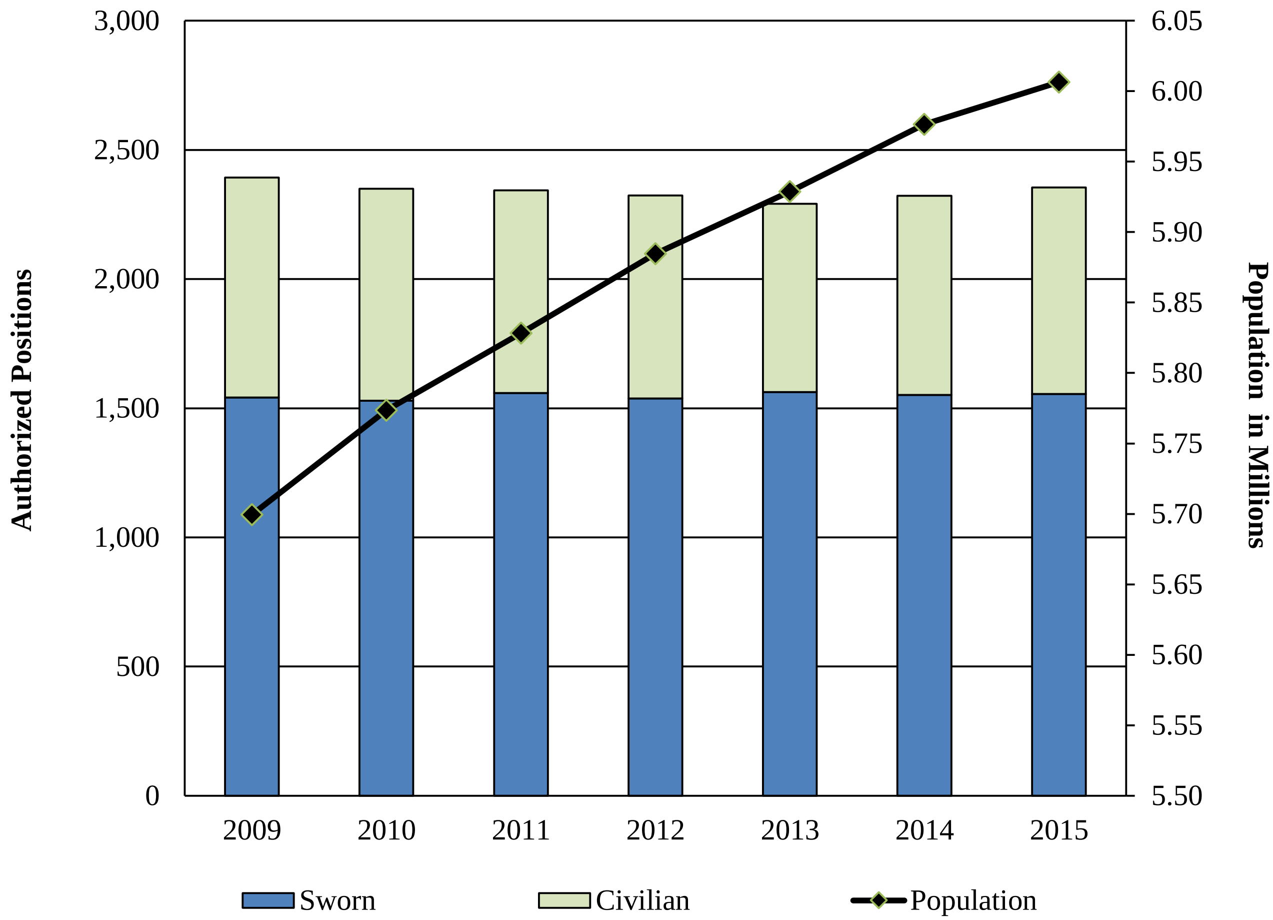
2. Department of State Police Staffing Issues

The fiscal 2017 allowance provides a significant amount of additional resources to assist DSP in achieving the goal of maintaining close to 100% staffing levels for both sworn and civilian positions. Since fiscal 2015, the Administration has provided nearly $10.0 million to fund the hiring of new troopers. An additional $1.3 million is provided in the allowance for turnover relief to fill existing civilian positions. These additional resources may be warranted; however, the department's existing staffing issues are not new and resolutions may need to go beyond providing resources to fund new trooper classes.

Authorized Positions Remain Level Despite Significant Population Increases

For nearly a decade, the number of authorized positions assigned to the department has remained relatively flat **(Exhibit 4)**. Between fiscal 2009 and 2015, DSP lost a net of 26 positions. During the same time period, the State's population increased by 307,000 people, or by 5.4%. In comparison to the size of the DSP workforce in the early 1990s, the current personnel complement is over 100 positions less than it was 20 years ago.

Exhibit 4
Department of State Police
Authorized Positions
Fiscal 2009-2015



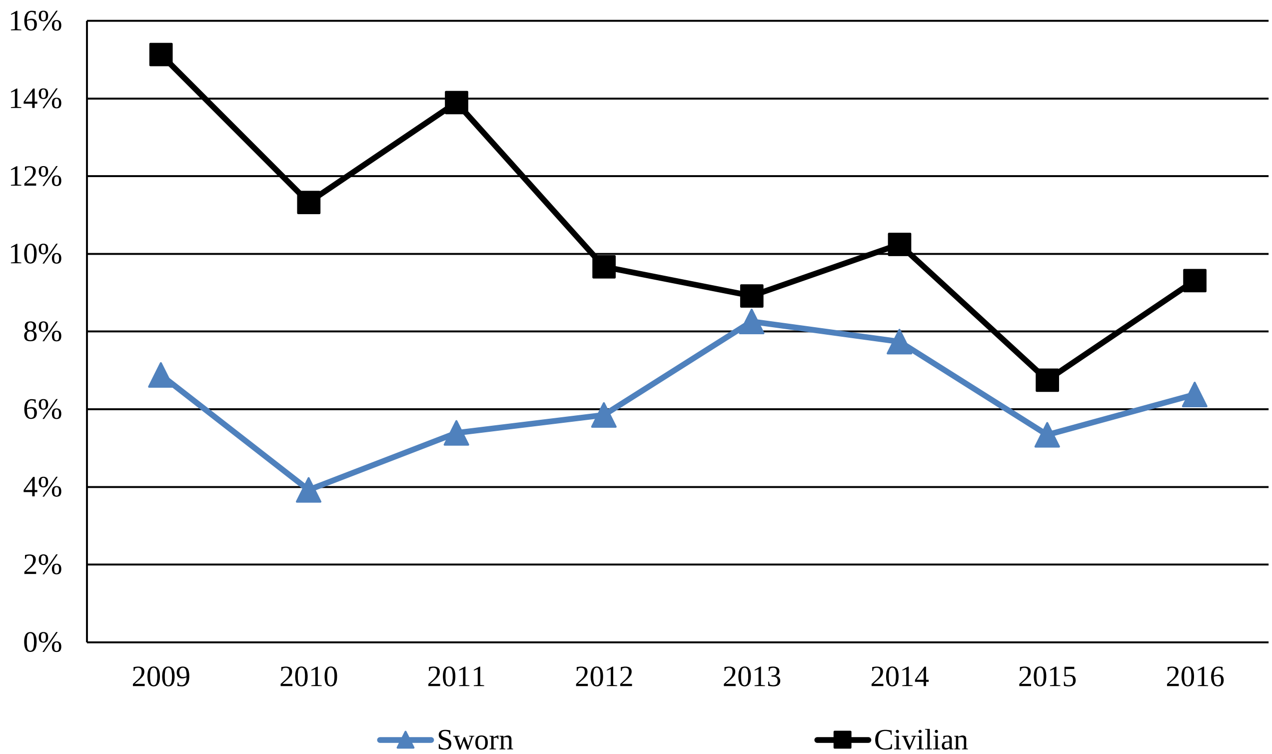
Source: Department of State Police; Department of Legislative Services; Maryland Department of Planning

Loss of Civilian Positions, Obstacles to Hiring, and High Vacancy Rates Impact Operations

All of the positions lost since fiscal 2009 were within the civilian workforce. Sworn personnel actually increased by 10 positions over the seven-year period, while civilian positions decreased by 36 positions. In addition, DSP has a more difficult time filling vacant civilian positions once they occur due to hiring freezes and other obstacles to overcome in the hiring process. This means that once a position is vacant, there can be an extensive amount of time before a replacement is hired. For example, DSP has had a capital project manager position frozen since July 2013. The department currently lacks an updated facility master plan and operates 22 barracks, in addition to other facilities. The department just received approval to begin recruiting for this position in February 2016. This is the only position within the department dedicated to its capital program.

The problems created by the level-staffing since fiscal 2009 is exacerbated by the agency's high vacancy rates, as evidenced in **Exhibit 5**. Since fiscal 2009, the department has maintained an average vacancy rate of 7.7%. Vacancy rates for civilian positions have declined recently; however, this is more reflective of vacant civilian positions being abolished through cost containment rather than improved hiring. As of February 2016, the department had 114 trooper vacancies and 125 civilian vacancies – a combined vacancy rate of 10.1%.

Exhibit 5
Department of State Police
Sworn Officer and Civilian Vacancy Rates
Fiscal 2009-2016

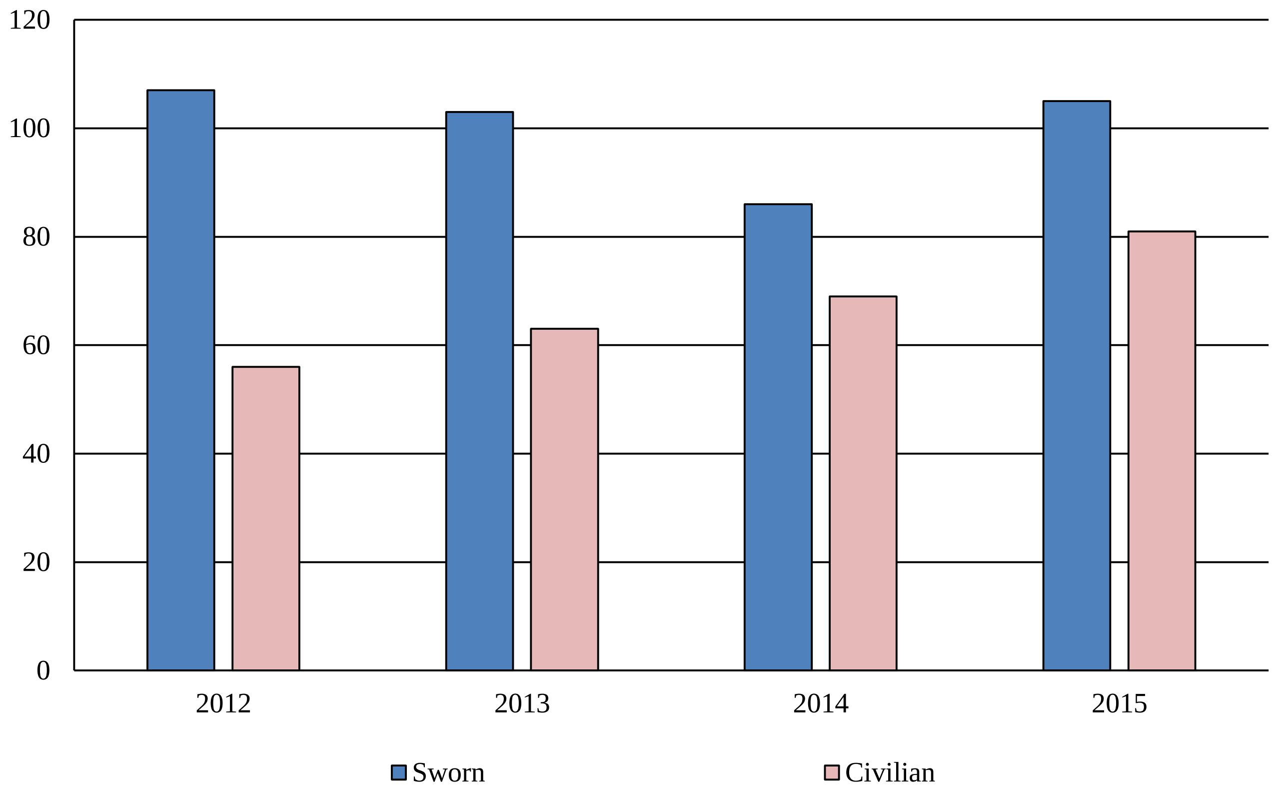


Note: Vacancy data is point-in-time from the start of each fiscal year.

Source: Department of State Police

The provision of funding for trooper classes is helping to drive down the sworn vacancy rate; however, separation data provided by DSP (**Exhibit 6**) shows that the department has to hire an average of 100 new troopers annually to maintain status quo. With over 100 troopers leaving annually, primarily through retirements, DSP will have to hire more than 100 troopers each year to begin to improve its vacancy rates. In addition, the number of civilian staff leaving DSP service has increased by 44.6% since fiscal 2012.

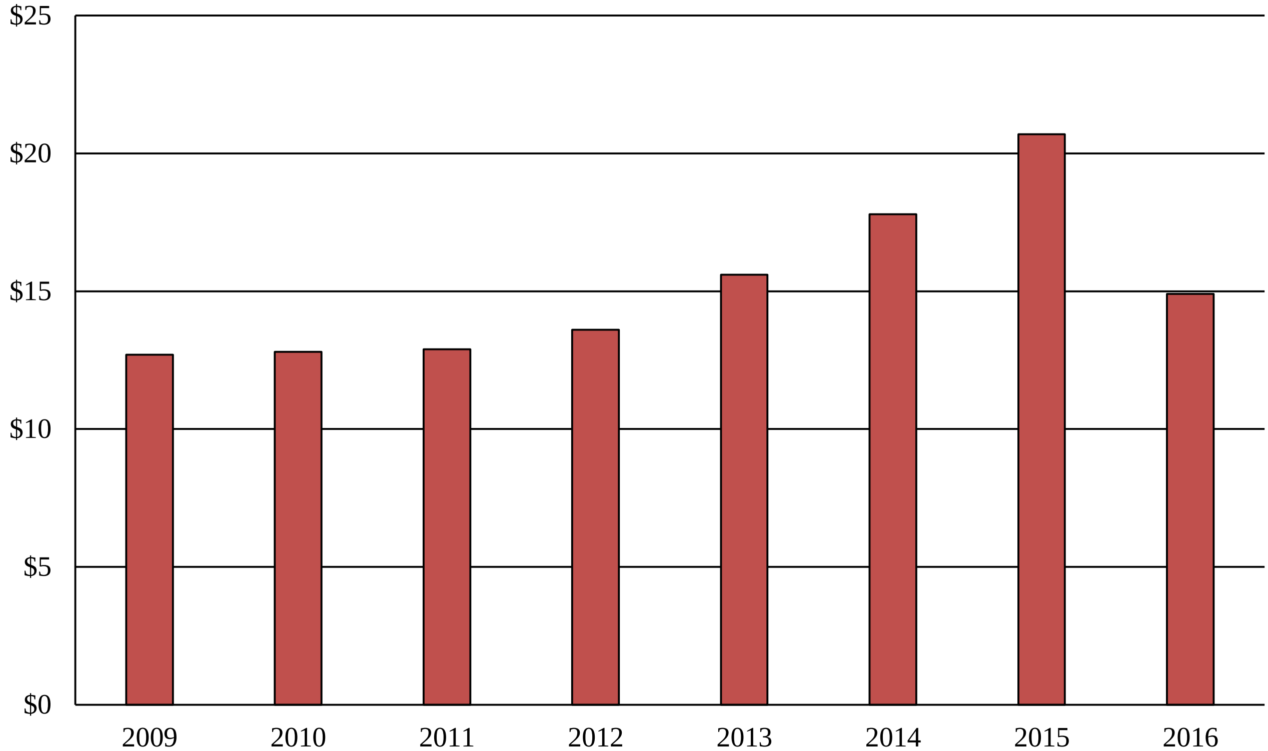
Exhibit 6
Department of State Police
Sworn and Civilian Separations
Fiscal 2012-2015



Source: Department of State Police

These staffing issues have significant impacts on departmental operations, and particularly the ability of the trooper workforce to focus on law enforcement duties. With less civilian support, through the loss of positions and higher vacancy rates, troopers are having to dedicate increased time to administrative functions. This staffing environment also contributes to increased overtime. Between fiscal 2009 and 2015, overtime expenses increased by $8 million, or 63%, as shown in **Exhibit 7**.

Exhibit 7
Department of State Police
Overtime Expenses
Fiscal 2009-2016



Source: Department of State Police

Comprehensive Review of DSP Staffing Is Needed

Additional funding has been provided to begin to address these staffing issues, particularly the high vacancy rates; however, larger questions remain. A comprehensive review of DSP staffing would help determine whether the current number of authorized troopers is adequate to appropriately fulfill the department's law enforcement mission. In addition, the current allocation of sworn versus civilian positions should be reviewed to determine whether certain duties currently performed by troopers could be reassigned to civilian positions for a lesser expense, thus increasing the number of troopers available for law enforcement duties. Finally, internal and external hiring processes should be evaluated to determine how best to improve and expedite the filling of DSP vacancies, particularly among the civilian workforce.

DLS recommends the adoption of committee narrative directing DSP to evaluate the current size of the sworn workforce, and DSP and DBM to collaboratively evaluate how to improve hiring policies and practices in order to expedite fulfillment of vacancies.

3. Reopening the Annapolis Barrack

The Annapolis Barrack reopened in November 2015 after closing in July 2008 due to cost containment. Functionally, the Annapolis Barrack merged with the Glen Burnie Barrack to provide a single base of operations in Glen Burnie. The building was vacated by DSP and operated by the Department of General Services (DGS). Most recently, the facility had been used by Annapolis City's public works department. The reopening of the facility for DSP use will allow response and prisoner transport times from southern Anne Arundel County to be reduced by half.

To date, approximately $650,000 has been spent on minor renovations and start-up costs to improve the facility to the point of partial operations. These funds have been budgeted within the DSP and DGS budgets, as DGS has been the lead agency to perform the mostly cosmetic improvements. A building assessment, completed in January 2016, has determined that additional renovation of the facility is required, including a new roof; heating, ventilation, and air conditioning (HVAC); electrical upgrades; wireless and other IT/connectivity improvements; and Americans with Disabilities Act accessibility upgrades.

Currently, the Annapolis Barrack is staffed with 13 sworn troopers (5 sergeants and 8 patrol troopers). The Gang Unit (6 troopers) is scheduled to move into the barrack; however, the move is pending completion of work on HVAC and Internet connectivity. The CRASH Team is also expected to occupy office space on the third floor of the barrack. By the end of calendar 2016, the barrack will be staffed by 1 first sergeant, 5 sergeants, and 15 patrol troopers. The department's goal is to have it staffed with 1 lieutenant, 1 first sergeant, 5 sergeants, 5 corporals, 15 patrol troopers, and an administrative aide by the end of calendar 2017. Excluding personnel costs, the estimated operating cost for the facility in fiscal 2017 is $130,000.

The fiscal 2017 allowance includes $2.45 million for the project from the State's Facilities Renewal Fund; however, it is not clear whether this fully funds all aspects of the upgrade, including IT and equipment needs. If the cost of the project were to exceed $2.5 million, it would be over the limit for projects eligible to be funded within the Facilities Renewal appropriation. In addition, the Facilities Renewal program may not be the appropriate avenue for funding this project, particularly given the backlog of more traditional State facility repair projects. This renovation is needed to open a facility that had not been in State use for multiple years. This is not a project to provide repair to an existing State-used property.

DLS recommends language prohibiting the use of the Facilities Renewal Fund appropriation on the renovation of the Annapolis Barrack. The department should instead pursue the proper procedure for funding a capital project of this nature, including submission of Part I and II program plans for review by DBM. The recommended language can be found in the Board of Public Works capital analysis.

4. Fiscal 2015 Closeout Audit

In February 2016, OLA released its closeout audit report for fiscal 2015. In the audit, OLA identifies agencies with large unprovided for payables and other major issues. Findings pertaining to DSP include:

- $5.6 million in fiscal 2015 overspending; and
- $5.4 million in special funds retained at the close of fiscal 2015, even though fund balances for multiple programs were being accounted for under the same appropriation and could not be differentiated.

The first finding, as previously discussed, is the result of the 2% across-the-board reduction implemented midway through fiscal 2015, combined with carryover from fiscal 2014 expenditures, payouts through the VSP, a legal settlement, and retirement payouts. A $4.5 million general fund deficiency appropriation is provided to cover the overspending in fiscal 2015; however, this leaves $1.1 million in overspending identified by OLA unaddressed.

The second finding is an extension of issues pertaining to the accounting of special funds raised in the department's November 2015 fiscal compliance audit. OLA found that DSP did not establish separate accounts to identify individual fund balances for special fund incomes received and did not properly track activity pertaining to those special funds. This resulted in inconsistent fund balances and improper charges for expenditures. In addition, OLA found that some of the special fund revenues would be better budgeted as reimbursable funds, given that the source of funds is another State agency. With regard to this last issue, DSP and DBM determined that all funds would remain budgeted as special funds.

DSP should provide an update on its work to resolve the November 2015 audit findings pertaining to the use of special funds. In addition, the department should identify how it will absorb the $1.1 million in fiscal 2015 overspending identified in the fiscal 2015 closeout audit that is not covered by the fiscal 2016 deficiency appropriation.

Recommended Actions

1. Adopt the following narrative:

Improving Department of State Police Hiring: The Department of State Police (DSP) has maintained an average vacancy rate of nearly 8% over the past seven years. These vacancies, particularly among civilian positions, contribute to increased overtime expenses, neglected administrative functions, and fewer troopers available for law enforcement duties. DSP should work collaboratively with the Department of Budget and Management (DBM) to review both the internal and external hiring policies and procedures to identify potential areas that could be streamlined or modified in order to expedite filling existing vacancies and improve overall hiring within the department. The report is due to the budget committees no later than November 15, 2016.

Information Request	Authors	Due Date
Improving DSP hiring	DSP DBM	November 15, 2016

2. Adopt the following narrative:

Trooper Strength Assessment: For nearly a decade, the number of authorized positions assigned to the department has remained relatively flat. In comparison to the size of the sworn workforce in the early 1990s, the current personnel complement is over 100 positions less than it was 20 years ago. The budget committees direct the Department of State Police (DSP) to evaluate the adequacy of Maryland's current authorized trooper workforce. In completing its assessment, the department should provide information on the number of local jurisdictions that have added a local law enforcement unit in the past decade, and the impact of the role that technology has played on law enforcement responsibilities. In addition, DSP should compare the size, roles, and responsibilities of Maryland's State troopers to neighboring or similar states. The report should be submitted to the budget committees no later than December 15, 2016.

Information Request	Author	Due Date
Trooper strength assessment	DSP	December 15, 2016

3. Adopt the following narrative:

Maryland Coordination and Analysis Center Budget Appendix: It is the intent of the budget committees that the Department of State Police, in conjunction with the Maryland Coordination and Analysis Center (MCAC) and the Department of Budget and Management, continue to submit budget information that consolidates State budgetary resources to MCAC in the form of an appendix in the Maryland Budget Highlights book in fiscal 2018 and subsequent fiscal years. Budget information and the resulting appendix should include more comprehensive personnel expenditure information, including position counts, from each State agency assigned at MCAC.

4. Add the following section:

SECTION XX. AND BE IT FURTHER ENACTED, THAT $1,000,000 of the General Fund appropriation within the Department of State Police (DSP) may not be expended until DSP submits the Crime in Maryland, 2015 Uniform Crime Report (UCR) to the budget committees. The budget committees shall have 45 days to review and comment following receipt of the report. Funds restricted pending the receipt of the report may not be transferred by budget amendment or otherwise to any other purpose and shall revert to the General Fund if the report is not submitted to the budget committees.

Further, provided that, if DSP encounters difficulty obtaining necessary crime data on a timely basis from local jurisdictions who provide the data for inclusion in the UCR, DSP shall notify the Governor's Office of Crime Control and Prevention (GOCCP). GOCCP shall withhold a portion, totaling at least 15%, but no more than 50%, of that jurisdiction's State Aid for Police Protection (SAPP) grant for fiscal 2017 upon receipt of notification from DSP. GOCCP shall withhold SAPP funds until such a time that the jurisdiction submits its crime data to DSP. DSP and GOCCP shall submit a report to the budget committees indicating any jurisdiction from which crime data was not received on a timely basis and the amount of SAPP funding withheld from each jurisdiction.

Explanation: The annual language was originally added because DSP had not been submitting its annual crime report in a timely manner due to issues related to receiving crime data from the local jurisdictions. As such, this language withholds a portion of the general fund appropriation until the budget committees receive the 2015 UCR. The language also specifies that GOCCP, upon receipt of notification from DSP, must withhold a portion of a delinquent jurisdiction's SAPP grant until certain crime data is received by DSP. Finally, DSP and GOCCP must submit a report to the budget committees that includes information on any jurisdiction that did not report crime data on a timely basis and the amount of SAPP funding that was withheld from each jurisdiction.

Information Request	**Author**	**Due Date**
2015 UCR	DSP	45 days prior to the expenditure of funds

Updates

1. Final Report on Cannabimimetic Agent Enforcement

Cannabimimetic agents are chemical substances that are not derived from the marijuana plant but are designed to affect the body in ways similar to tetrahydrocannabinol, the primary ingredient in marijuana. Chapter 442 of 2013 added cannabimimetic agents to the State's list of Schedule I controlled dangerous substances and defined several chemical substances that are considered cannabimimetic agents. The 2014 *Joint Chairmen's Report* required DSP to submit interim and final reports on cannabimimetic enforcement as a result of the changes enacted by Chapter 442. The final report was submitted July 1, 2015.

DSP's strategy to enforce Chapter 442 is to identify, investigate, and dismantle major drug trafficking organizations (DTO) regardless of the type of illegal substances involved. DSP's goal is to target DTOs that are supplying local dealers by focusing on major DTOs involved in cross border (state to state) and interjurisdictional (county to county) criminal enterprise. From March 1, 2013, to June 15, 2015, DSP has investigated 1,282 cross border cases of illegal substances, including synthetic narcotics. From January 1, 2013, to June 15, 2015, DSP and law enforcement partners seized 3,126 pounds of synthetic narcotics. **Exhibit 8** compares drug arrests for sale or manufacture of synthetic drugs to arrests for possession of synthetic drugs from calendar 2013 to 2014. Arrests in both categories fell in fiscal 2014. Prince George's County had the highest number of arrests for sale or manufacturing in both fiscal 2013 and 2014, while Anne Arundel County had the highest number of arrests for possession in both years.

Since enactment of Chapter 442, DSP notes a significant decrease in synthetic narcotics distribution in all regions of the State. At the time the report was submitted, there were no active narcotic investigations. DSP maintains a good working relationship with the Washington/Baltimore HIDTA, which will only increase through the collaborative effort funded with the $275,000 provided in the supplemental budget

Exhibit 8
Synthetic Marijuana Arrests
Calendar 2013-2014

	Sales/Manufacturer				Possession			
	2013	**2014**	**Change**	**% Change**	**2013**	**2014**	**Change**	**% Change**
Allegany	1	1	0	0.0%	11	3	-8	-72.7%
Anne Arundel	30	35	5	16.7%	**699**	**389**	-310	-44.3%
Baltimore	127	79	-48	-37.8%	157	145	-12	-7.6%
Baltimore City	7	5	-2	-28.6%	0	2	2	200.0%
Calvert	34	33	-1	-2.9%	238	185	-53	-22.3%
Caroline	2	3	1	50.0%	29	19	-10	-34.5%
Carroll	5	4	-1	-20.0%	13	7	-6	-46.2%
Cecil	8	8	0	0.0%	39	41	2	5.1%
Charles	19	10	-9	-47.4%	75	50	-25	-33.3%
Dorchester	4	10	6	150.0%	10	13	3	30.0%
Frederick	5	9	4	80.0%	25	15	-10	-40.0%
Garrett	4	4	0	0.0%	20	2	-18	-90.0%
Harford	12	18	6	50.0%	75	51	-24	-32.0%
Howard	0	0	0	0.0%	32	24	-8	-25.0%
Kent	0	0	0	0.0%	11	0	-11	-100.0%
Montgomery	14	31	17	121.4%	31	83	52	167.7%
Prince George’s	**134**	**104**	-30	-22.4%	234	224	-10	-4.3%
Queen Anne’s	0	4	4	400.0%	13	6	-7	-53.8%
St. Mary’s	6	12	6	100.0%	102	125	23	22.5%
Somerset	4	0	-4	-100.0%	1	5	4	400.0%
Talbot	4	4	0	0.0%	2	7	5	250.0%
Washington	13	18	5	38.5%	13	7	-6	-46.2%
Wicomico	12	20	8	66.7%	16	33	17	106.3%
Worcester	14	19	5	35.7%	110	76	-34	-30.9%
Statewide Agencies*	13	1	-12	-92.3%	34	24	-10	-29.4%
Total	**472**	**432**	**-40**	**-8.5%**	**1,990**	**1,536**	**-454**	**-22.8%**

*Statewide agencies report offenses but do not identify county of occurrence.

Source: *2014 Uniform Crime Report*

2. Final Sale of the Dauphin Helicopters

MSPAC operated a fleet of 12 Dauphin helicopters, most of which were purchased between 1989 and 1994. These helicopters were reaching the end of their useful lives, and it was determined that the fleet needed to be replaced. Chapter 464 of 2014 directed proceeds from the sale of the Dauphin helicopters to the General Fund. The 11 operational helicopters have been sold. Proceeds from the sale total approximately $2.8 million. DSP also received $4.0 million from an insurance settlement for the helicopter that was destroyed in an air accident in 2008.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Department of State Police
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$248,303	$92,324	$1,795	$3,009	$345,430
Deficiency Appropriation	2,000	0	0	0	2,000
Cost Containment	-7,482	0	0	0	-7,482
Budget Amendments	2,407	3,677	7,427	13,737	27,248
Reversions and Cancellations	-10	-1,257	-1,890	-2,099	-5,256
Actual Expenditures	**$245,218**	**$94,744**	**$7,332**	**$14,647**	**$361,941**
Fiscal 2016					
Legislative Appropriation	$241,955	$93,048	$1,172	$3,015	$339,191
Budget Amendments	3,546	1,167	7,045	9,387	21,145
Working Appropriation	**$245,501**	**$94,215**	**$8,217**	**$12,401**	**$360,335**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

In fiscal 2015, the total budget for the department increased by approximately $16.5 million. The general fund appropriation decreased by a net $3.1 million. The department received an increase of $2.0 million via a deficiency appropriation to hire a new trooper cadet class and an additional $2.4 million from budget amendments. The amendments provided funding for employee cost-of-living adjustments (COLA) and overtime. Those increases were offset by nearly $7.5 million in cost containment reductions, which included a 2% across-the-board reduction to agency operating expenses ($5.0 million); personnel savings generated from holding positions vacant ($1.8 million); the loss of 12 contractual full-time equivalents ($300,000); and reductions for vehicle maintenance and IT-related expenditures ($450,000). DSP reverted approximately $10,000 at the close of the fiscal year.

The fiscal 2015 special fund appropriation increased by $2.4 million from the legislative appropriation. Budget amendments provided nearly $3.7 million in additional funding for the employee COLA and to cover various agency operating expenses. The sources for the additional special funds included revenue from the Vehicle Salvage Inspection Program ($111,000); MEMSOF ($735,788); and speed monitoring ($1,000,000). The department also received approximately $1.3 million from the Contingent Fund to cover costs incurred while responding to civil unrest in Baltimore City. A total of $1.3 million was canceled, primarily due to less than anticipated expenditures for IT-related projects.

The federal fund appropriation increased by $5.5 million over the legislative appropriation. Budget amendments appropriating federal grants and reimbursements for the Maryland Coordination and Analysis Center, IT upgrades, body armor, DNA backlog efforts, intelligence analysis, mobile videos for first responders, and a variety of other equipment and programs resulted in an increase of $7.4 million. A federal fund cancellation reduced the appropriation by $1.9 million due to unspent federal grants.

The reimbursable fund appropriation increased by $11.6 million. Budget amendments increased the appropriation by $13.7 million for the Major Information Technology Development Project (MITDP) ($10.4 million) and to carry forward or appropriate grant funds ($3.3 million). A total of $2.1 million in reimbursable funds was canceled due to the timing of grant funds and to back-out MITDP spending.

Fiscal 2016

The fiscal 2016 working appropriation reflects an increase of $21.1 million when compared to the legislative appropriation. Restoration of the 2% salary increase for State employees accounts for the entire $3.5 million general fund increase, as well as $1.0 million of the special fund increase. Special fund expenditures also increased by $125,000 from additional revenue generated through the Vehicle Salvage Inspection Program.

The federal fund working appropriation reflects an increase of slightly more than $7.0 million in asset seizure funds to support departmental operations. The reimbursable fund working appropriation reflects an increase of nearly $9.4 million. Approximately $6.2 million is funds transferred from the MITDPF to purchase 700 MHz radios and support the implementation of the new automated firearm licensing system. The remaining $3.2 million increase appropriates grant funding from the Maryland Emergency Management Agency, the Governor's Office of Crime Control and Prevention, the Maryland Department of Transportation, and DPSCS.

Appendix 2

Audit Findings

Audit Period for Last Audit:	December 20, 2011 – December 31, 2014
Issue Date:	November 2015
Number of Findings:	12
Number of Repeat Findings:	1
% of Repeat Findings:	8%
Rating: (if applicable)	n/a

Finding 1: DSP did not properly account for certain special fund activity.

Finding 2: DSP lacked adequate controls over special fund collections and accounts receivable.

Finding 3: Certain year-end closing transactions were not adequately supported and reporting discrepancies were noted.

Finding 4: DSP did not include or could not support approximate quantities of services in certain solicitations.

Finding 5: Procedural and documentation deficiencies were noted regarding the evaluation of vendor bids for certain service contracts.

Finding 6: DSP's procedures for processing handgun qualification licenses and handgun registration applications lacked certain controls.

Finding 7: Quality control procedures were not comprehensive.

Finding 8: Controls over handgun registration application fees and related accounts receivable records were not sufficient.

Finding 9: DSP's network was not properly secured.

Finding 10: Procedures for maintaining and securing DSP's workstations were not sufficient.

Finding 11: DSP lacked assurance that adequate security and operational controls existed over its record management system.

Finding 12: **DSP did not establish adequate controls over its equipment.**

*Bold denotes item repeated in full or part from preceding audit report.

Department of State Police
Automated Licensing and Registration Tracking System

Project Status	Implementation.	**New/Ongoing Project:**	Ongoing.
Project Description:	The Firearm Safety Act of 2013 added to existing firearm laws the requirement that individuals wishing to purchase a firearm in Maryland request and receive a Handgun Qualification License (HQL), requiring background checks, fingerprinting, and firearm safety training. The Department of State Police (DSP) has been charged with automating and streamlining the process by which a citizen of Maryland requests approval to purchase a firearm. This will involve automating the entire firearm application process, from dealers applying to DSP to sell firearms in the State, to a web-accessible form submitted electronically to the agency, processing of the application, billing, and reconciliation of fees, to providing real time or near real time reporting metrics.		
Project Business Goals:	Currently, firearm applications are received at DSP headquarters in hardcopy only. Implementation of the automated system will reduce turnaround time needed for review and approval, reduce the amount of manual data entry needed for each application, provide easier file transfers, reduce hardcopy record storage, and ultimately save time and money for State taxpayers. DSP requires that the system proposed integrate with current licensing processes and the functionality and processes developed as part of automating the background check queries.		
Estimated Total Project Cost:	$7,284,600	**Estimated Planning Project Cost:**	n/a
Project Start Date:	March 2013	**Projected Completion Date:**	June 2017
Project Status:	The project is currently in the implementation phase. DSP is currently using the recently deployed interim system for the receipt and processing of 77R image files. Seminars and demonstrations were conducted to ensure user readiness and stakeholder awareness. The user portal and dealer portal are in the testing phases and are expected to be complete by the end of calendar 2016. The licensing portal, which will provide full automation of the 77R process is expected to be released by the end of calendar 2016, as well.		
Project Management Oversight Status:	The fiscal 2017 allowance includes $100,000 for oversight.		
Identifiable Risks:	Resource availability continues to be the most significant risk to the project. DSP is mitigating the potential risks by adhering to project management best practices and maintaining regular communication with all stakeholders.		

Fiscal Year Funding ($ in Thousands)	Prior Years	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Balance to Complete	Total
Personnel Services	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Professional and Outside Services	4.234	2.100	0.950	0.0	0.0	0.0	0.0	7.284
Other Expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Funding	**$4.234**	**$2.100**	**$0.950**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$7.284**

Object/Fund Difference Report
Department of State Police

Object/Fund	FY 15 Actual	FY 16 Working Appropriation	FY 17 Allowance	FY 16 - FY 17 Amount Change	Percent Change
Positions					
01 Regular	2,437.50	2,437.50	2,435.50	-2.00	-0.1%
02 Contractual	27.64	70.08	66.49	-3.59	-5.1%
Total Positions	**2,465.14**	**2,507.58**	**2,501.99**	**-5.59**	**-0.2%**
Objects					
01 Salaries and Wages	$ 294,674,202	$ 289,732,747	$ 307,404,731	$ 17,671,984	6.1%
02 Technical and Spec. Fees	1,737,110	1,980,886	2,172,192	191,306	9.7%
03 Communication	3,299,927	2,981,387	5,115,047	2,133,660	71.6%
04 Travel	681,932	1,023,302	729,618	-293,684	-28.7%
06 Fuel and Utilities	3,127,587	2,906,299	3,160,148	253,849	8.7%
07 Motor Vehicles	21,737,682	24,316,179	24,373,928	57,749	0.2%
08 Contractual Services	10,637,764	15,035,745	12,865,805	-2,169,940	-14.4%
09 Supplies and Materials	4,773,742	3,561,225	3,086,652	-474,573	-13.3%
10 Equipment – Replacement	11,143,490	4,288,903	2,363,750	-1,925,153	-44.9%
11 Equipment – Additional	3,839,239	1,150,554	919,524	-231,030	-20.1%
12 Grants, Subsidies, and Contributions	4,419,086	11,653,947	15,718,337	4,064,390	34.9%
13 Fixed Charges	1,869,484	1,703,988	2,117,119	413,131	24.2%
Total Objects	**$ 361,941,245**	**$ 360,335,162**	**$ 380,026,851**	**$ 19,691,689**	**5.5%**
Funds					
01 General Fund	$ 245,218,490	$ 245,501,349	$ 268,050,938	$ 22,549,589	9.2%
03 Special Fund	94,743,309	94,215,112	96,556,023	2,340,911	2.5%
05 Federal Fund	7,332,609	8,217,387	9,701,450	1,484,063	18.1%
09 Reimbursable Fund	14,646,837	12,401,314	5,718,440	-6,682,874	-53.9%
Total Funds	**$ 361,941,245**	**$ 360,335,162**	**$ 380,026,851**	**$ 19,691,689**	**5.5%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Fiscal Summary
Department of State Police

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Maryland State Police	$ 354,012,791	$ 352,360,243	$ 371,799,998	$ 19,439,755	5.5%
02 Fire Prevention Commission and Fire Marshal	7,928,454	7,974,919	8,226,853	251,934	3.2%
Total Expenditures	**$ 361,941,245**	**$ 360,335,162**	**$ 380,026,851**	**$ 19,691,689**	**5.5%**
General Fund	$ 245,218,490	$ 245,501,349	$ 268,050,938	$ 22,549,589	9.2%
Special Fund	94,743,309	94,215,112	96,556,023	2,340,911	2.5%
Federal Fund	7,332,609	8,217,387	9,701,450	1,484,063	18.1%
Total Appropriations	**$ 347,294,408**	**$ 347,933,848**	**$ 374,308,411**	**$ 26,374,563**	**7.6%**
Reimbursable Fund	$ 14,646,837	$ 12,401,314	$ 5,718,440	-$ 6,682,874	-53.9%
Total Funds	**$ 361,941,245**	**$ 360,335,162**	**$ 380,026,851**	**$ 19,691,689**	**5.5%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Appendix 5

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Public Debt

Operating Budget Data

($ in Thousands)

	FY 15 Actual	FY 16 Working	FY 17 Allowance	FY 16-17 Change	% Change Prior Year
General Fund	$140,000	$252,400	$283,000	$30,600	12.1%
Adjusted General Fund	**$140,000**	**$252,400**	**$283,000**	**$30,600**	**12.1%**
Special Fund	875,608	866,978	892,640	25,662	3.0%
Adjusted Special Fund	**$875,608**	**$866,978**	**$892,640**	**$25,662**	**3.0%**
Federal Fund	11,483	11,477	11,539	62	0.5%
Adjusted Federal Fund	**$11,483**	**$11,477**	**$11,539**	**$62**	**0.5%**
Adjusted Grand Total	**$1,027,091**	**$1,130,855**	**$1,187,179**	**$56,324**	**5.0%**

- General obligation (GO) bond debt service costs increase by $56 million in fiscal 2017. The increase is attributable to increased authorizations in recent years.

Note: Numbers may not sum to total due to rounding.

For further information contact: Patrick S. Frank Phone: (410) 946-5530

Analysis in Brief

Major Trends

Debt Service Costs Increase at a Higher Rate Than the Revenues Supporting Them: GO bond debt service is supported by the Annuity Bond Fund (ABF). The primary source of revenues is State property taxes, which provide funds sufficient to support 65.3% of GO debt service costs. The remaining costs are supported by general funds, bond sale premiums, and other minor revenues. From fiscal 2016 to 2021, debt service costs are projected to increase by 3.8% while State property tax revenues are projected to increase by 1.9%.

Issues

The Budget Relies on Premiums Realized after the Legislature Adjourns: In the ABF forecast, the Administration estimates that the next bond sale, in May 2016, will generate $77.6 million in bond sale premiums. The forecast ends fiscal 2017 with a $2.0 million fund balance. This fund balance provides a small hedge if the full amount of premium is not realized. **The State Treasurer should be prepared to brief the committees on the use of bond sale premiums for GO bond debt service costs. The Administration should brief the committees on what action it will take if estimated bond premiums are insufficient to pay debt service for fiscal 2017.**

Reducing Taxable Debt Authorizations Reduces Interest Payments: The federal government limits the amount of private activity projects in tax-exempt bonds. The State has been increasing its authorizations of private activity projects in the GO program. From fiscal 2013 to 2016, the State issued $163 million in taxable bonds, and more issuances are anticipated. Data from the bond sale shows that taxable bonds are more expensive than tax-exempt bonds. **Insofar as taxable debt is more expensive than tax-exempt debt, the Department of Legislative Services recommends that authorizations for taxable loan authorizations be deleted and that general fund pay-as-you-go appropriations support these programs and projects instead.**

Beginning of a New Era: The Administration Proposes a Flat Capital Program: Since fiscal 1995, the State capital program has been increasing. Some periods, such as fiscal 1995 to 2000, saw modest increases. Fiscal 2001 to 2009 was a period of substantial growth. The new Administration is the first to propose a decade without growth. Based on the affordability criteria developed by the Capital Debt Affordability Committee, modest growth is affordable. The issue compares the Administration's program with recommendations made by the Spending Affordability Committee (SAC) in December 2015 and December 2014. **The State Treasurer should be prepared to brief the committees on the effects of the Administration's and the SAC recommended level of debt authorizations.**

Recommended Actions

1. Concur with Governor's allowance.

Operating Budget Analysis

Program Description

The Public Debt program appropriates funds for general obligation (GO) bonds' debt service payments. This includes principal and interest payments. GO bonds support the State's general construction program, such as prisons, office buildings, higher education facilities, school construction, and mental health facilities. GO bonds do not pledge specific revenues but rather pledge the State's full faith and credit. Issuances include:

- tax-exempt bonds sold to institutional investors;
- tax-exempt bonds sold to retail investors;
- taxable bonds sold to institutional investors;
- Build America Bonds (BAB) that were taxable bonds for which the State receives a direct subsidy from the federal government;
- Qualified Zone Academy Bonds (QZAB) that support specific education projects. Depending on the date of issuance, these bonds have received federal tax credits or direct federal subsidies;
- Qualified School Construction Bonds (QSCB) that supported specific education projects. Depending on the date of issuance, these bonds have received federal tax credits or direct federal subsidies; and
- Qualified Energy Conservation Bonds (QECB) that are direct federal subsidy bonds that support energy efficiency capital expenditures in public buildings, renewable energy production, and other related projects.

GO bond debt service payments are supported by the Annuity Bond Fund (ABF). The ABF revenues include State property tax revenues; federal subsidies; bond sale premiums; and repayments from certain State agencies, subdivisions, and private organizations. General funds may subsidize debt service if these funds are insufficient.

The State usually issues tax-exempt GO bonds to institutional investors twice a year. Other bonds are issued as they become authorized (BABs, QZABs, QSCBs, and QECBs), as needed (taxable), or as they are in demand (retail bonds). The goal is to minimize the bonds' debt service costs.

Fiscal 2016 Actions

Exhibit 1 shows that debt service costs are $9.9 million less than budgeted. Savings realized from the March and July 2015 bond sales were slightly offset by issuing QZABs. In this analysis, the revised debt service amount will be used.

Exhibit 1
Fiscal 2016 Debt Service Adjustments to Legislative Appropriation
($ in Thousands)

	Amount
Appropriation	
Legislative Appropriation	$1,109,255
Budget Amendment 009-16	21,600
Working Appropriation	**$1,130,855**
Adjustments	
Savings from March 2015 New Debt Issuance	-$3,521
Savings from March 2015 Refunding	-3,616
Savings from July 2015 New Debt Issuance	-3,032
Qualified Zone Academy Bond Issuance	308
Total Adjustments	**-$9,861**
Revised Debt Service	**$1,120,994**

Source: Public Financial Management, Inc.; State Treasurer's Office; Department of Budget and Management; Department of Legislative Services

Proposed Budget

The fiscal 2017 allowance totals $1.2 billion. This continues the steady increase in GO bond debt service costs experienced in recent years. These increases are attributable to higher GO bond authorizations and issuances. For example, the amount of new GO bonds issued increased from just over $400 million annually in fiscal 2001 and 2002, to approximately $700 million from fiscal 2005 to 2008, and $1 billion from fiscal 2010 to 2014.

Debt Service Costs Increase at a Higher Rate Than the Revenues Supporting Them

Most of the revenues supporting GO bond debt service are derived from State property taxes. **Exhibit 2** shows that for fiscal 2017, State property taxes provide $775.6 million, which represents 65.3% of the appropriation. The Department of Legislative Services (DLS) projects that the May 2016, summer 2016, and winter 2017 bonds will sell at a premium. DLS projects that the May 2016 premium will be less than the budget assumes but that additional premiums in fiscal 2017 will be sufficient to support debt service fiscal 2017 costs. Issue 1 discusses the implications of budgeting bond sale premiums. Even with bond premiums, the current State property tax rate (at $0.112 per $100 of assessable base) and the ABF balance is insufficient to fully fund debt service costs. To support debt service without raising State property taxes, the allowance includes $283.0 million in general fund appropriations.

Exhibit 2
Annuity Bond Fund Revenues Debt Service Expenditures
Fiscal 2015-2017
($ in Thousands)

	2015 Expenditures	2016 Appropriation	2017 Allowance
Annuity Bond Fund Activity			
Beginning Balance	$127,729	$86,990	$72,641
Property Tax Receipts	730,694	750,154	775,555
Interest and Penalties on Property Taxes	2,425	2,425	2,425
Other Repayments and Receipts	907	668	681
Bond Premium	94,573	83,098	48,226
Transfer to Reserve	-86,990	-72,641	-13,402
ABF Special Fund Appropriations	**$869,338**	**$850,694**	**$886,126**
General Fund Appropriations	$140,000	$252,400	$283,000
Transfer Tax Special Fund Appropriations	6,270	6,422	6,575
Federal Fund Appropriations	11,483	11,477	11,477
Projected Total Debt Service Expenditures	**$1,027,091**	**$1,120,994**	**$1,187,179**
Fiscal 2016 Changes to the Legislative Appropriation			
Excess Appropriations Attributable to March and July 2015 Bond Sale Savings	$0	$9,861	$0
Budgeted Debt Service Appropriations	**$1,027,091**	**$1,130,855**	**$1,187,179**

Source: Public Financial Management, Inc.; State Treasurer's Office; Department of Budget and Management; Department of Legislative Services

Exhibit 3 provides a breakdown of debt service costs projected in the fiscal 2017 allowance. The allowance includes $1,148.9 million in debt service from bonds that have already been issued and $25.9 million in debt service from issuances projected in May 2016. Bonds sold in summer 2016 are estimated to require $12.5 million in debt service payments in fiscal 2017. Since bonds pay debt service approximately six months after they are issued, bonds sold in fiscal 2017 after January 1 do not have any effect on fiscal 2017 debt service costs.

Exhibit 3
Fiscal 2017 Debt Service Costs
($ in Millions)

Type of Debt	Principal	Interest	Sinking Fund	Total
GO Bonds Sold to Institutional Investors	$674.5	$314.2	$0.0	$988.7
Retail Bonds	51.2	10.2	0.0	61.4
Taxable Bonds	58.8	1.4	0.0	60.1
Build America Bonds	0.0	25.3	0.0	25.3
Qualified Zone Academy Bonds	1.4	1.4	1.9	4.8
Qualified School Construction Bonds	0.0	2.0	6.4	8.3
Qualified Energy Conservation Bonds	0.0	0.3	0.0	0.3
Subtotal	***$785.8***	***$354.8***	***$8.3***	***$1,148.9***
Debt Issued after Allowance Submitted				
May 2016 Bond Sale	$0.0	$25.9	$0.0	$25.9
Summer 2016 Bond Sale	0.0	12.5	0.0	12.5
Subtotal	***$0.0***	***$38.4***	***$0.0***	***$38.4***
Total	**$785.8**	**$393.2**	**$8.3**	**$1,187.2**

GO: general obligation

Note: Numbers may not sum to total due to rounding.

Source: Comptroller's Office; Department of Budget and Management; Department of Legislative Services.

Prior to fiscal 2001, State debt service was comprised of traditional GO bonds (tax-exempt debt issued to institutional investors). The exhibit identifies debt service payments attributable to the new kinds of debt and methods of issuance that have been added since 2001.

Effect of Federal Sequestration

The Budget Control Act (BCA) of 2011 included automatic across-the-board spending reductions if Congress and the President failed to enact a Joint Select Committee bill by January 15, 2012. The bill was required to reduce the federal budget deficit by at least $1.2 trillion over 10 years. Congress was unable to enact the bill, and the BCA required that automatic spending reductions, referred to as sequestration, take effect. A number of federal programs, such as Social Security and Medicaid, were exempt from these reductions. The Murray-Ryan Bipartisan Budget Act raised sequestration budget caps in federal fiscal 2014 and 2015 but also extended sequestration for two more years from federal fiscal 2022 to 2023. Similarly, the Bipartisan Budget Act of 2015 raised caps in federal fiscal 2016 and 2017. The Act also extended sequestration to federal fiscal 2025.

Federal subsidies on State and local bonds are not deemed to be exempt from sequestration. Reductions to federal grants are also influenced by the timing of the transfer of the subsidy. **Exhibit 4** shows that sequestration reduces federal funds by approximately $900,000 annually.

Exhibit 4
Issuances Receiving Federal Fund Appropriations and Reductions Attributable to Federal Sequestration
Fiscal 2015-2017
($ in Thousands)

	2015	**2016**	**2017**	**Total**
July 2009 Build America Bonds	$796	$796	$796	$2,389
October 2009 Build America Bonds	942	942	942	2,825
February 2010 Build America Bonds	6,036	6,036	6,036	18,108
July 2010 Build America Bonds	1,094	1,094	1,094	3,281
July 2010 Qualified School Construction Bonds	1,965	1,965	1,965	5,895
December 2010 Qualified Zone Academy Bonds	228	228	228	684
August 2011 Qualified Zone Academy Bonds	660	660	660	1,980
August 2011 Qualified Energy Conservation Bonds	234	234	234	703
August 2012 Qualified Zone Academy Bonds	426	426	426	1,279
Less Sequestration	-904	-904	-904	-2,711
Total	**$11,477**	**$11,477**	**$11,477**	**$34,432**

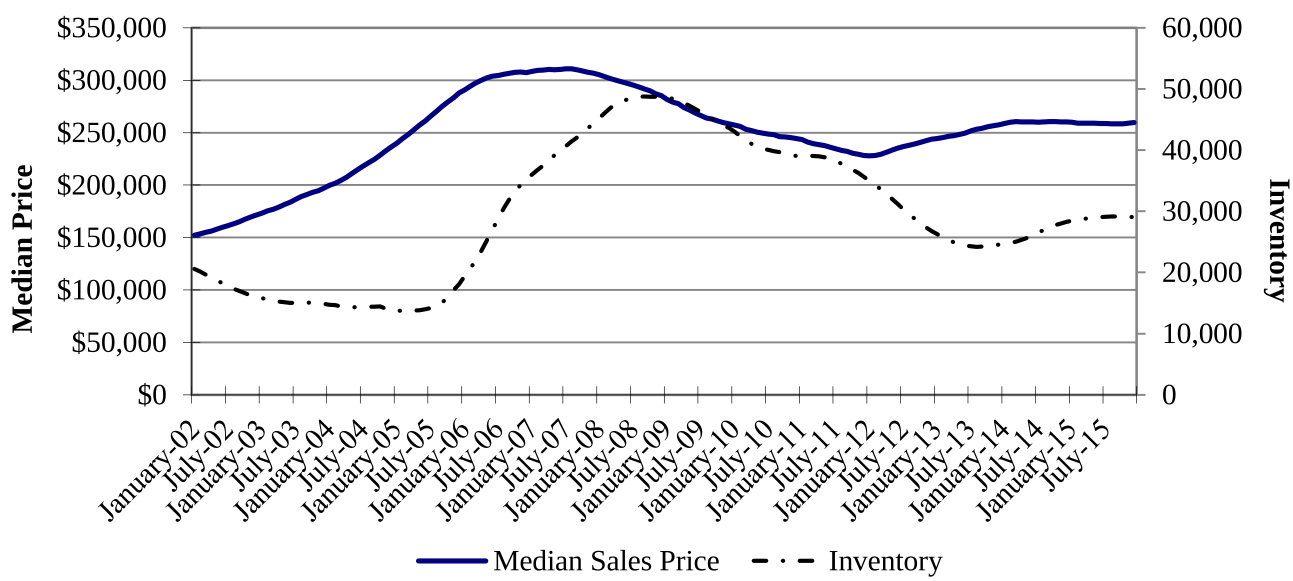
Source: Comptroller's Office; State Treasurer's Office; Department of Budget and Management, Department of Legislative Services

Annuity Bond Fund Six-year Forecast

GO bond debt service costs are supported by the ABF. The fund's largest revenue source is the State property tax. In April 2006, the State property tax rate was set at $0.112 per $100 of assessable base and has remained at that level since fiscal 2007. Other revenue sources include proceeds from bond sale premiums, interest and penalties on property taxes, and repayments for local bonds. When the ABF has not generated sufficient revenues to fully support debt service, general funds have subsidized debt service payments.

State property tax collections are influenced by trends in the housing market. **Exhibit 5** shows that there was a substantial increase in real estate values, which peaked in summer 2007, followed by a decline in values. The year-over-year decline began in July 2007 and continued until February 2012. That is 55 straight months of year-over-year declines in median home values. From February 2012 to March 2014, year-over-year prices increased. Since April 2014, results have been mixed with some months seeing increases in values and others realizing decreases. Inventories went through a similar increase and decline. However, they lagged behind the pattern seen in home prices.

Exhibit 5
Maryland Housing – Median Prices and Inventory
12-month Moving Average
January 2002 to December 2015

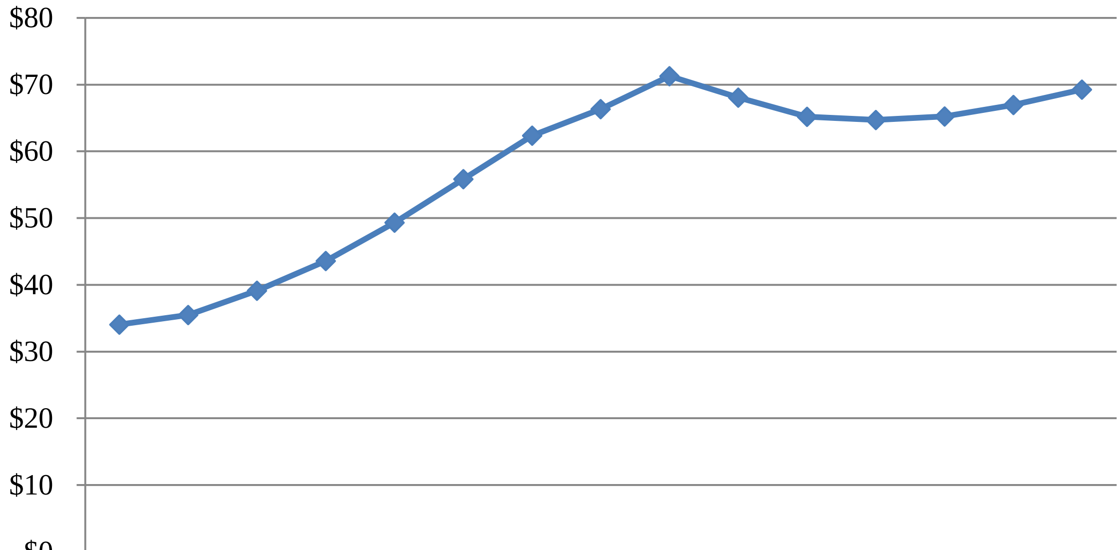


Note: Inventory represents housing units for sale according to Metropolitan Regional Information Systems, Inc. and Coastal Association of Realtors

Source: Maryland Association of Realtors; Department of Legislative Services

As expected, the rising property values from fiscal 2002 to 2007 increased State property tax receipts. **Exhibit 6** shows how much revenue one cent on the State property tax has generated since fiscal 2003. In fiscal 2003, there was a modest increase, and from fiscal 2004 to 2011, the increases were quite steep. Revenues declined from fiscal 2011 to 2014 and increased in fiscal 2015. Recent estimates expected revenues to increase about 1% in the out-years. The State Department of Assessments and Taxation revised its estimates in November 2015. Revenues are now expected to increase at a rate of 2% annually between fiscal 2016 and 2021.

Exhibit 6
Revenues Generated by One Cent of State Property Taxes
Fiscal 2003-2017
($ in Millions)



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenues	$34	$35	$39	$44	$49	$56	$62	$66	$71	$68	$65	$65	$65	$67	$69

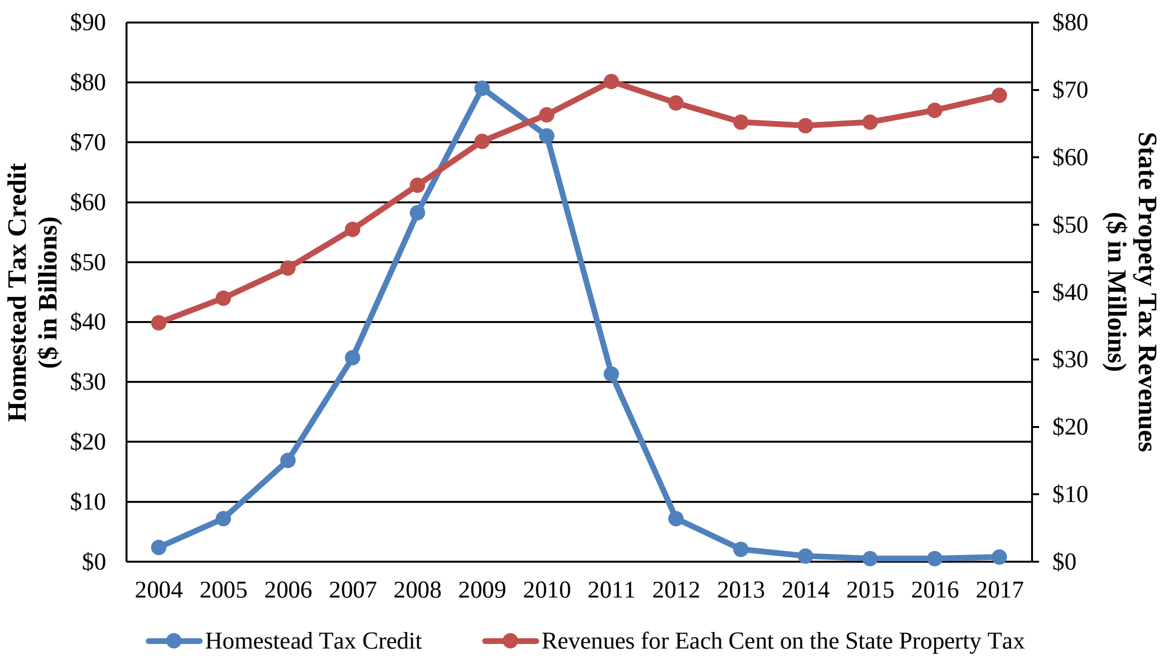
Source: State Department of Assessments and Taxation; Department of Budget and Management; Department of Legislative Services

Assessment policies and the Homestead Tax Credit account for the lag between changes in the real estate market and tax receipts. Property values are assessed every three years, and increases are phased in over three years. For example, if a value increases by 9%, the increase would be 3% in the first year, 6% in the second year, and 9% in the third year.

The Homestead Tax Credit limits the annual increase in State property assessments subject to the property tax to 10%. If reassessing a resident's assessed property value results in an increase that exceeds 10%, the homeowner receives a credit for any amount above 10%. This limits revenue growth when property values rise quickly. Taken together, the three-year assessment process and Homestead Tax Credit slowed the revenue increases and delayed the peak until after the decline in property values.

The homestead credit also provides the State with a hedge against declining property values. As home values declined, the homestead credit declined, and revenues continued to slowly increase. The result was to smooth State revenues; State property tax revenue growth was slower as home values increased, and there was no decline in revenues when home values decreased. **Exhibit 7** shows that State credits increased to $79 billion in fiscal 2009 in response to increases in assessments. Since fiscal 2014, the aggregate homestead credits are projected to be under $1 billion each year.

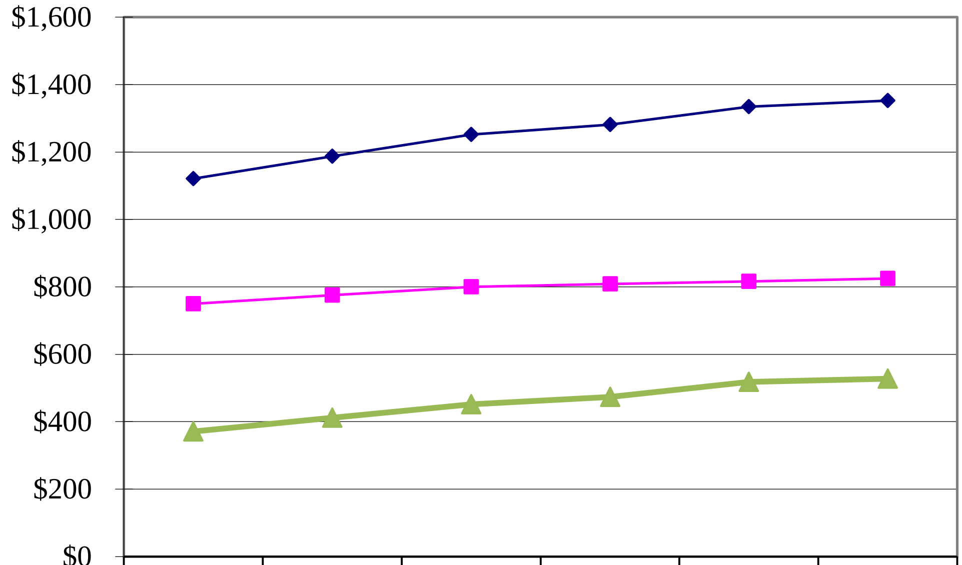
Exhibit 7
State Property Tax Homestead Tax Credits
Fiscal 2004-2017



Source: State Department of Assessments and Taxation

Over the next few years, State property tax revenues are estimated to remain fairly flat, increasing at a rate of 1.9% annually from fiscal 2016 to 2021. This contrasts with debt service costs, which are expected to increase at a rate of 3.8% annually over the same period. **Exhibit 8** shows how State property tax revenues, which are $371 million less than debt service costs in fiscal 2016, are expected to be $528 million less than debt service costs in fiscal 2021.

Exhibit 8
GO Bond Debt Service Costs and State Property Tax Revenue Collections
Fiscal 2016-2021
($ in Millions)



	2016	2017	2018	2019	2020	2021
State Property Tax Receipts	$750	$776	$800	$808	$816	$825
GO Bond Debt Service Costs	$1,121	$1,187	$1,252	$1,282	$1,334	$1,352
Difference	$371	$412	$452	$473	$518	$528

GO: general obligation

Source: Department of Legislative Services, January 2016

Before fiscal 2014, the shortfall in State property tax receipts was not a problem because the ABF had a large fund balance. This fund balance was largely attributable to the low interest rates offered for AAA-rated State and municipal bonds. These low interest rates have reduced GO bonds' true interest cost, resulting in higher bond sale premiums. These premiums have been deposited into the ABF to support debt service costs.

Exhibit 9 shows that general fund appropriations are required for fiscal 2017 despite the availability of $73 million in fund balance at the end of fiscal 2016 and an estimated $48 million in bond sale premiums in fiscal 2017. General fund appropriations increase from $252 million in fiscal 2016 to $506 million in fiscal 2021. **Appendix 2** shows the level of general fund support for GO bonds since fiscal 1979.

Exhibit 9
Revenues Supporting Debt Service
Fiscal 2016-2021
($ in Millions)

	2016	2017	2018	2019	2020	2021
Special Fund Revenues						
State Property Tax Receipts	$750	$776	$800	$808	$816	$825
Bond Sale Premiums	83	48	18	1	1	1
Other Revenues	3	3	3	3	3	3
Prior Year Balance	87	73	13	10	2	2
Subtotal Special Fund Revenues	***$923***	***$900***	***$835***	***$822***	***$823***	***$831***
General Funds	252	283	409	443	496	506
Transfer Tax Special Funds[1]	6	7	7	7	7	7
Federal Funds[2]	11	11	11	11	11	10
Total Revenues	**$1,194**	**$1,201**	**$1,262**	**$1,284**	**$1,336**	**$1,354**
Debt Service Expenditures	**$1,121**	**$1,187**	**$1,252**	**$1,282**	**$1,334**	**$1,352**
ABF End-of-year Fund Balance	**$73**	**$13**	**$10**	**$2**	**$2**	**$2**

ABF: Annuity Bond Fund

[1] This supports $70 million of general obligation bonds issued in 2010 for Program Open Space.
[2] This includes federal interest subsidies for Build America Bonds, Qualified Zone Academy Bonds, Qualified School Construction Bonds, and Qualified Energy Conservation Bonds.

Source: Department of Legislative Services, January 2016

Issues

1. The Budget Relies on Premiums Realized after the Legislature Adjourns

This is the first budget proposed by an Administration that relies on bond sale premiums realized after the legislative session to fund the debt service payment in the allowance.[1] In fall 2015, the State planned to issue $518 million in GO bonds in winter 2016. This sale has now been delayed to May 2016.

The budget assumes that the bond sale will generate $77.6 million in premiums to support debt service payments. The Department of Budget and Management (DBM) advises that this estimate was prepared by the State's financial advisor. DBM projects that the ABF will end fiscal 2017 with a $2.0 million fund balance. This is a small hedge for a revenue source as volatile as bond sale premiums.

This issue examines why bonds generate premiums, why the State must be careful, and what the State can do with premiums. The issue also examines if it is likely that the funds appropriated will not be sufficient to support debt service payments.

Bond Sale Premiums: Why the State Gets Them, Why the State Must Be Careful, and What the State Can Do with Them

When bonds are sold, they have a par value (principal) and a coupon rate (interest rate paid to the bondholder based on par value). When the bonds are bid, the Treasurer's Office determines how many bonds are sold (par value of the bonds) and when the bonds mature.[2] The underwriter determines the coupon rate (interest rate the issuer pays) and the sale price of the bonds, which is awarded to the underwriter with the lowest interest cost.[3] If the coupon rate is greater than the market rate, the bonds sell at a premium and the State's bonds proceeds exceed par value of the bonds.

For example, at the most recent bond sale in July 2015, the State issued $450 million in tax-exempt GO bonds (par value). The average coupon was 3.92% and the true interest cost (TIC) (market interest rate) was 2.83%. Since the coupon rate exceeded the market interest rate, the bonds sold at a premium, and total bond proceeds totaled $494 million (after deducting the underwriters discount and cost of issuance expenses). This additional $44 million is the bond premium.

Why Do Bonds Sell at a Premium?

Economic theory tells us that in a world without uncertainty, there will be no difference in value between bonds selling at a high coupon rate or bonds selling at a low coupon rate. If bonds sell at a high coupon rate, the seller receives a large premium that offsets the high interest cost.

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[1] In the fiscal 2007 and 2016 budgets enacted by the General Assembly, premiums were assumed to support capital projects.

[2] Section 34 of Article III of the Constitution of Maryland limits State debt to 15 years.

[3] Appendix 4 includes a discussion of factors that influence the true interest cost of Maryland's GO bonds.

However, we do live in an uncertain world. Investors may see advantages in purchasing bonds at a premium. For investors of Maryland bonds, the primary risk is that the bonds will lose value if interest rates rise. Since Maryland bonds offer a fixed interest rate, the value of Maryland bonds decline if interest rates rise.

How investors value bonds is relative and depends on what interest rates the market offers. If low-risk rates such as U.S. government bonds are low, the State will be able to issue bonds at a lower rate than if these interest rates are high. In other words, a 2% interest rate can be a good deal if everyone else is offering less than 2%, but it is not such a good deal if everyone else is offering 3% or more.

In the current environment, interest rates are more likely to increase than decrease. Current interest rates are historically low. According to data from the Federal Reserve Board, the yield on 10-year treasury notes on Friday, July 31, 2015 (the time of the most recent bond sale), was among the lowest since 1962. In fact, only 135 out of 2,796 weeks had lower interest costs; 96% of the time, interest rates were higher than at the time of the last bond sale. In this environment, it certainly makes sense for investors to protect themselves against rising interest rates, and this is done by purchasing bonds at a premium.

Exhibit 10 examines a tranche of $36,125,000 in bonds sold with an eight-year maturity in the July 2015 bond sale. The top half of the exhibit compares the return if you buy bonds at par and at a premium. It shows that paying $6,080 and getting a 5.0% interest rate yields the same return as paying $5,000 and getting a 2.06% interest rate, since the TIC for both is 2.06%.

The bottom half shows what happens if market interest rates increase. In both examples, the bonds are worth less. The difference is that bonds sold at a premium lost 17.8% of their value while bonds selling at par lost 19.2% of their value. For investors that are intent on preserving wealth or cash, this matters.

In conclusion, why do bonds sell at a premium? Because buying bonds at a premium is a hedge against increasing interest rates, and it looks like interest rates are going to increase.

Exhibit 10

Effect of Higher Interest Rates on the Value of Bonds

Data from Bond Sale from July 2015 Bond Sale

	Premium Bonds	**Sold at Par**	**Explanation**
Par Value of Bonds	$5,000	$5,000	This is the principal you get back
Coupon Rate	5.00%	2.06%	This is the interest rate on the bond's par value
Premium	$1,080	$0	This is what you pay extra for the higher rate
Value at Sale	$6,080	$5,000	This is what you pay
Yield or TIC	2.06%	2.06%	This is what matters, rate of return

If the Market Interest Rate Increases to 5%

Value at Sale	$6,080	$5,000	This is what you paid for the bonds
Value after Interest Rates Increase	$5,000	$4,038	This is what your bonds are now worth
Total Loss	-$1,080	-$962	This is how much you lose due to rate change
Percent Loss	-17.8%	-19.2%	This is what matters, value lost

TIC: true interest cost

Source: Public Financial Management, July 2015; Department of Legislative Services, November 2015

Why Should the State Budget Premiums Carefully?

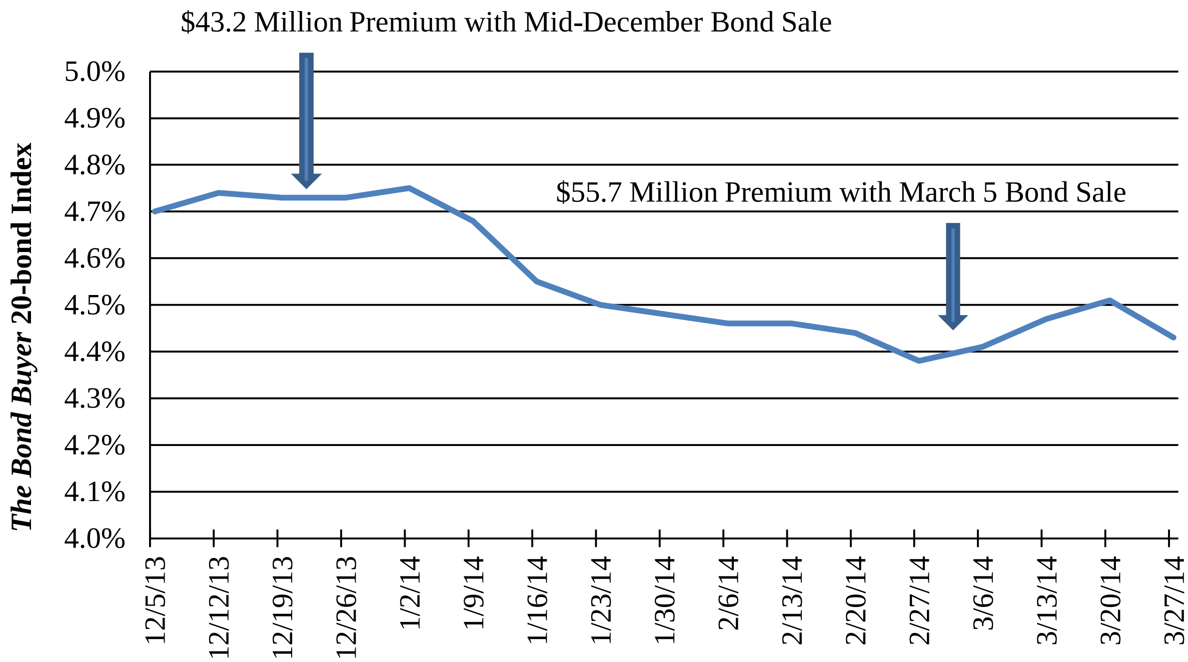
In recent years, bond premiums have been substantial. From fiscal 2012 to 2015, bond sale premiums have generated over $100 million annually. Although premiums are expected to diminish, DLS anticipates that bond sales will continue to generate premiums in fiscal 2017.

A concern with budgeting premiums in advance is that small changes in interest rates can generate substantial changes in the amount of premiums realized. Interest rates have been highly volatile, and rates have climbed or plummeted in a matter of weeks. For example, from April 9 to May 7, 2015, *The Bond Buyer* 20-bond Index increased by 25 percentage points, from 3.49% to 3.74%. Such an increase substantially decreases a bond sale premium.

Most of this volatility cannot be foreseen. This means that the key variables used to estimate premiums is impossible to predict with any precision. An example of this is the March 6, 2014 bond sale. The State projected a $40.8 million premium. This forecast was prepared in December 2013 and used in the Governor's fiscal 2015 budget. Using interest rates from December 2013, DLS forecasted a $43.2 million premium. DLS concluded that the premium in the budget was entirely reasonable, based on the data that was available when the budget was prepared.

However, the actual bond sale premium for the March sale was $55.7 million. This is $14.9 million more than DBM projected. The reason for this difference is a sudden decline in interest rates. **Exhibit 11** shows that *The Bond Buyer* 20-bond Index declined from over 4.70% in December 2013 to approximately 4.40% in early March 2014. The State benefited from the change by receiving a larger premium.

Exhibit 11
Timing of Bond Sale Influences Interest Rates and Premiums
December 2013-March 2014



Note: The mid-December bond sale premium is estimated based on the interest rate generated using the statistical equation in Appendix 4. The amount of bonds sold and the coupon rate are assumed to be the same as the March sale.

Source: Department of Legislative Services, November 2014

This volatility goes both ways. For example, the State issued bonds on July 24, 2013. There was a sharp increase in interest rates during July 2013. From July 3 to July 25, 2015, the index interest rates increased from 4.39% to 4.77%. This increase of 38 basis points could have substantially decreased a forecasted premium. At the time, premiums were not forecast beyond the spring sale, so it cannot be determined to what extent the higher rates resulted in a smaller premium or higher debt service costs. But the lesson is that large changes in interest rates can happen suddenly.

In answer, why should the State budget premiums carefully? Because interest rates in this environment are volatile and even estimates prepared weeks before a bond sale are routinely off by millions of dollars.

What Can the State Do with Bond Sale Premiums?

Bonds are sold at a premium because investors want to buy them at a premium. If the State were to dictate the coupon rate (instead of the underwriters), the State could eliminate the premium by offering low coupon rates. However, if the State were to set the coupon rate instead of the underwriter, the TIC would be expected to increase. Underwriters are purchasing bonds at a premium because of current market conditions. Eliminating the premium would make Maryland bonds less attractive, which increases borrowing costs and State spending. To keep costs down, the State has accepted that it will receive premiums. With respect to premiums, here are three options:

- ***Deposit Premiums in the ABF to Pay Debt Service Costs:*** This approach has been taken with most of the premiums realized. The State is paying higher interest costs for these premiums. Depositing the premium into the ABF reduces the short-term general fund requirements.

- ***Support Capital Programs:*** Premiums are bond sale proceeds. Bonds are sold so that the proceeds support capital projects. The State has authorized premiums for capital projects in the past. For example, premiums supported capital projects in fiscal 2007 and 2016. Sections 8-125 and 8-132 of the State Finance and Procurement Article require that premiums are deposited into the ABF, so any authorization for capital projects would require capital budget bill authorization.

- ***Resize the Bond Sale:*** If the objective is to generate a specific level of bond proceeds, the amount of bonds sold can be reduced and bond sale premiums can be used to support capital projects. This is referred to as resizing the bond sale. This has been done by the Maryland Department of Transportation as recently as its December 2015 bond sale. For example, if the State determines that $500 million in bond proceeds are needed and a $45 million premium is anticipated, the State could reduce the par value of the bonds by $40 million and use any premiums to support projects. This would need to be authorized in the State's capital budget. Bond documents, such as the Preliminary Official Statement, would need to clarify that bonds could be resized prior to opening the bids.

Premiums Support Fiscal 2017 Debt Service Payments

The budget assumes that premiums totaling $77.6 million will be realized at the May 2016 bond sale. **Exhibit 12** shows that the largest bond sale premium totaled $77.9 million and was realized in

March 2013. The May bond sale is the largest sold to date, which tends to increase the total premium received. However, interest rates may not be as favorable. While it is quite possible that the State will realize the premium projected, the estimate does appear optimistic and probably is high.

Exhibit 12
Bond Sale Premiums Since 2011
($ in Millions)

Date of Sale	Fiscal Year	Issuance	Par Value of Tax-exempt Bonds to Institutional Investors	Premium	Yield or True Interest Cost
March 9, 2011	2011	2011 1st	$354.2	$26.1	3.49%
July 27, 2011	2012	2011 2nd	418.3	52.4	3.08%
March 7,2012	2012	2012 1st	543.9	65.6	2.42%
August 1, 2012	2013	2012 2nd	478.7	70.1	2.16%
March 6, 2013	2013	2013 1st	500.0	77.9	2.36%
July 24, 2013	2014	2013 2nd	435.0	49.0	3.15%
March 3, 2014	2014	2014 1st	450.0	55.7	2.84%
July 23, 2014	2015	2014 2nd	449.6	64.0	2.67%
March 4, 2015	2015	2015 1st	518.0	72.6	2.65%
July 17, 2015	2016	2015 2nd	450.0	43.7	2.83%
May 2016	*2016*	*2016 1st*	*518.0*	*77.6*	*n/a*

Note: May 2016 sale is estimated. All other sales' data is actual data. Boxes are placed around the largest sale, largest premium, and lowest interest rate.

Source: Public Financial Management, Inc.; Department of Legislative Services

In addition to the May bond sale, the State is expected to issue two more series of bonds before the end of fiscal 2017. The first sale is in summer 2016 and another is in winter 2017. This means that the State has two more opportunities to realize bond sale premiums if the May 2016 premium is insufficient to fully fund debt service. Should these premiums be insufficient to support debt service costs, a State deficiency appropriation would be required at the 2017 legislative session.[4]

Moody's Analytics and IHS Global Insights have provided DLS with 10-year federal treasury notes' interest estimates through the end of fiscal 2021 (the ABF forecast period). The estimates diverge sharply from the first quarter of calendar 2017 to the second quarter of calendar 2018. For example, during the third quarter of calendar 2017, the Moody's rate (4.58%) is 107 basis points greater than the IHS rate (3.51%).

With these estimates, DLS has prepared three series of bond sale premium estimates; a high, average, and low series. Moody's provides the high rate, an average of the two provides the average rate, and IHS provides the low rate. Also, for the low rate, DLS assumes that coupon rates also remain low; for the other two estimates, they are the average rate of recent bond sales. When the projected interest rate reaches the coupon rate, the State no longer receives a large premium. DLS includes a small incidental premium since bonds sales usually do not sell exactly at par. **Exhibit 13** shows that if Moody's rates are correct, the State should expect $65 million in premiums. The average rate generates $88 million in premiums, and the low rate generates $141 million in premiums. In the ABF forecast, DLS uses the average premium estimate.

The concern is that if interest rates begin to increase this spring, as Moody's expects, there may not be sufficient premiums to support fiscal 2017 debt service costs. The analysis shows that this is possible. **Exhibit 14** shows that if Moody's interest rate forecast is correct, the ABF could be $9.5 million underfunded in fiscal 2017. Interest rate projections tend to be unreliable. (The fact that the two services that DLS uses are so far apart suggests that there is little consensus.) This means that it is impossible to make a premium estimate with any certainty. But it is clear that realizing the premium estimated in the fiscal 2017 budget is far from certain. The State should be prepared to appropriate additional funds in the ABF if actual premiums are below estimates.

The State Treasurer should be prepared to brief the committees on the use of bond sale premiums for GO bond debt service costs. The Administration should brief the committees on what action it will take if estimated bond premiums are insufficient to pay debt service for fiscal 2017.

[4] Since the deficiency appropriation is not available until the budget is enacted, this could result in the ABF temporarily not having sufficient funds to support debt service. Maryland issues its winter bonds in February and March. Consequently, there are substantial debt service payments, including principal payments, in February, March, and early April. All these payments are due before the budget is enacted.

Exhibit 13
High and Low Premium Estimates
May 2016 to Winter 2021 Bond Sales
($ in Millions)

	Low Interest Rate Estimate	Average Interest Rate Estimate	High Interest Rate Estimate
Fiscal 2017 Budget Premiums			
May 2016	$51.2	$39.3	$38.5
Summer 2016	46.0	29.2	22.7
Winter 2017	43.8	19.0	3.6
Subtotal	***$141.0***	***$87.6***	***$64.7***
Out-year Premiums			
Summer 2017	$41.9	$11.8	$0.5
Winter 2018	30.9	6.6	0.5
Summer 2018	11.7	0.5	0.5
Winter 2019	0.5	0.5	0.5
Summer 2020	0.5	0.5	0.5
Winter 2021	0.5	0.5	0.5
Subtotal	***$86.0***	***$20.4***	***$3.0***
Total Premiums	**$226.9**	**$108.0**	**$67.7**

Source: Moody's Analytics, IHS Global Insights; Department of Legislative Services

Exhibit 14
Effect of Different Interest Rate Assumptions on the Fiscal 2017 Annuity Bond Fund Balance
($ in Millions)

	DBM Forecast	DLS Low Estimate	DLS Average Estimate	DLS High Estimate
Fund Balance without Premiums	-$75.6	-$74.2	-$74.2	-$74.2
Premiums	77.6	141.0	87.6	64.7
End-of-year Fund Balance	**$2.0**	**$66.8**	**$13.4**	**-$9.5**

DBM: Department of Budget and Management
DLS: Department of Legislative Services

Source: Department of Budget and Management; Department of Legislative Services

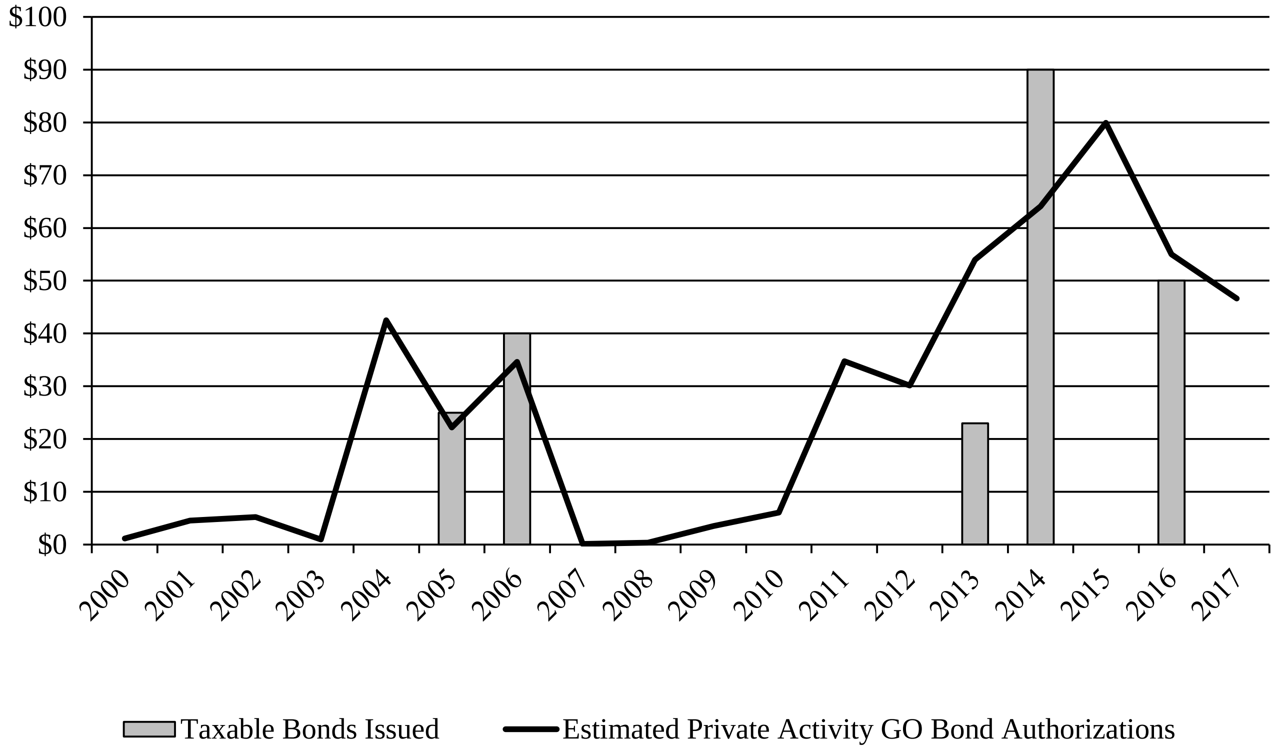
2. Reducing Taxable Debt Authorizations Reduces Interest Payments

The State's capital program supports a number of different public policy areas, such as health, environment, public safety, education, housing, and economic development. Federal government regulations allow the State to issue debt that does not require the buyer to pay federal taxes on interest earnings. In cases where investors do not pay federal income taxes, they are willing to settle for lower returns. Investors in taxable debt require higher returns to offset their tax liabilities. Consequently, the State can offer lower interest rates on tax-exempt bonds.

Federal laws and regulations limit the kinds of activities that the proceeds from tax-exempt bonds can support. One such requirement limits private activities or private purposes of the bond proceeds to 5% of the bond sales proceeds. Another requirement limits the bonds to $15 million for business use projects and $5 million for business loans. Examples of programs that support private activities or uses include the Partnership Rental Housing and Neighborhood Business Development programs of the Department of Housing and Community Development (DHCD); the Hazardous Substance Cleanup Program of the Maryland Department of the Environment (MDE); and Brendan Iribe Center for Computer Science and Innovation at the University of Maryland, College Park.

To avoid exceeding the private activity limits imposed in the federal regulations, the State has previously appropriated funds in the operating budget instead of issuing debt for private purpose programs and projects. Recent years' fiscal constraints have limited the amount of operating funds available for capital projects. To continue these programs, the State authorized GO bonds. In fiscal 2011, the State began migrating private purpose programs from the operating budget into the capital budget. **Exhibit 15** shows that the State has authorized over $300 million in private activity bonds since fiscal 2011. To support these projects, the State issued $23 million in taxable debt in fiscal 2013, $90 million in fiscal 2014, and $50 million in fiscal 2016. Insofar as the State has recently authorized private activity, projects exceed taxable debt issuance by over $150 million, and additional taxable bond sales are expected.

Exhibit 15
Private Activity Authorizations and Taxable Bond Issuances
Fiscal 2000-2017
($ in Millions)



GO: general obligation

Source: Department of Budget and Management's *Capital Improvement Program*; Financial Advisor's *Report on Bond Sales*

Taxable Bonds Cost More and Taxable Bonds' Costs Are Expected to Increase

In August 2012, the State sold $23 million in taxable GO bonds to institutional investors with three- and four-year maturities. The issuance's TIC was 0.45%, and the State did not realize a premium. At the same bond sale, the State also issued $4 million in tax-exempt bonds to institutional investors. The tax-exempt bond sale had a TIC of 0.33%. In other words, the difference between the two bonds, which were both issued on the same day, was 0.12% (12 basis points). DLS estimates that if the taxable issuance had sold at a TIC of 0.33%, instead of 0.45%, the bonds would have generated a premium totaling approximately $500,000.

In the out-years, the additional costs for issuing taxable debt are likely to increase. The current low interest rate environment is probably suppressing the additional costs paid by issuers of taxable debt. For example, the State issued taxable debt in fiscal 2005 and 2006. At the time, interest rates were higher, and DLS estimates that taxable bonds added $2.8 million in debt service costs for the $65.0 million issued. This is roughly twice the cost differential of the August 2012 bond sale.

Another factor that could add to the cost of taxable debt is increasing tax rates for higher income earners and corporations. The value of tax-exempt bonds is greatest when tax rates are highest. Recently enacted federal tax rate increases may well have an effect on the spread between taxable and tax-exempt bonds.

The bottom line is that there is a measurable difference between the cost of taxable and tax-exempt debt. The additional price paid by issuers of taxable debt is more likely to increase than decrease when compared to tax-exempt debt.

Reliance on GO Bonds for Private Use and Activities Continues after Budget Improves

It is not unusual for the State to move pay-as-you-go (PAYGO) capital projects and programs into the GO bond program when State finances deteriorate. Usually, the projects and programs are moved back out of the GO bond program after finances have improved. For example, after the rise in private use authorizations from fiscal 2004 to 2006, in fiscal 2007, there was a decline in private activity authorizations.

This is not the case in the current *Capital Improvement Program*. **Exhibit 16** shows that the fiscal 2017 capital budget includes $47 million in private activity authorizations. This includes $4 million for private business use and $43 million for private loans. The university projects are private business use. They are large projects with some incidental private activity included in these projects. The exemption was made for these kinds of projects. It is the $43 million in private loans that was traditionally funded with PAYGO appropriations. Out-year private loan authorizations range from $41 million in fiscal 2018 to $39 million in fiscal 2021. Though there is a decline in authorizations, there is still a substantial reliance on GO bond funds to support projects and programs that are traditionally supported in the PAYGO capital funding. It also appears as though there is no attempt to reduce the reliance of GO bonds and appropriate general funds instead for MDE or DHCD programs.

Exhibit 16
General Obligation Bond Private Activity Authorizations by Department
Fiscal 2017-2021
($ in Thousands)

	2017	2018	2019	2020	2021	Total
Private Business Use						
State Agency						
Morgan State University	$714	$56	$0	$0	$0	$770
University System of Maryland	2,866	3,994	2,244	2,316	0	11,420
Subtotal	***$3,580***	***$4,049***	***$2,244***	***$2,316***	***$0***	***$12,190***
Private Loans						
State Agency						
Department of Housing and Community Development	$33,100	$33,800	$32,900	$33,100	$31,600	$164,500
Maryland Department of the Environment	9,795	7,510	7,510	7,510	7,510	39,835
Department of Planning	150	150	150	150	150	750
Subtotal	***$43,045***	***$41,460***	***$40,560***	***$40,760***	***$39,260***	***$205,085***
Total	**$46,625**	**$45,509**	**$42,804**	**$43,076**	**$39,260**	**$217,275**

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management, *Capital Improvement Program*, January 2016

The fiscal 2017 capital budget includes $43 million authorizations for private loan projects that do not qualify for tax-exempt financing. **Insofar as taxable debt is more expensive than tax-exempt debt, DLS recommends that authorizations for taxable loan authorizations be deleted and that general fund PAYGO appropriations support these programs and projects instead.**

3. Beginning of a New Era: The Administration Proposes a Flat Capital Program

In September 2015, the Administration proposed to the Capital Debt Affordability Committee (CDAC) that fiscal 2017 GO bond authorizations be limited to $995 million and that there be no growth in authorizations for the next decade. CDAC adopted this recommendation. This is a major shift in policy. No recent Administration has proposed going a decade without increasing the GO bond program. Prior to this shift, there were four trends since fiscal 1995.

Historical GO Bond Authorization Trends Since Fiscal 1995

The four trends since fiscal 1995 are:

- from fiscal 1995 to 2000, the State increased authorizations at a moderate level and did not deviate from its rule to provide for moderate growth each year;

- from fiscal 2001 to 2009, the State regularly increased authorizations in excess of what was previously planned;

- since fiscal 2009, the State has attempted to maximize authorizations and keep debt service under 8% of revenues; and

- in December 2013 and December 2014, the legislature's Spending Affordability Committee (SAC) recommended debt limits that differed from the limits recommended by CDAC.

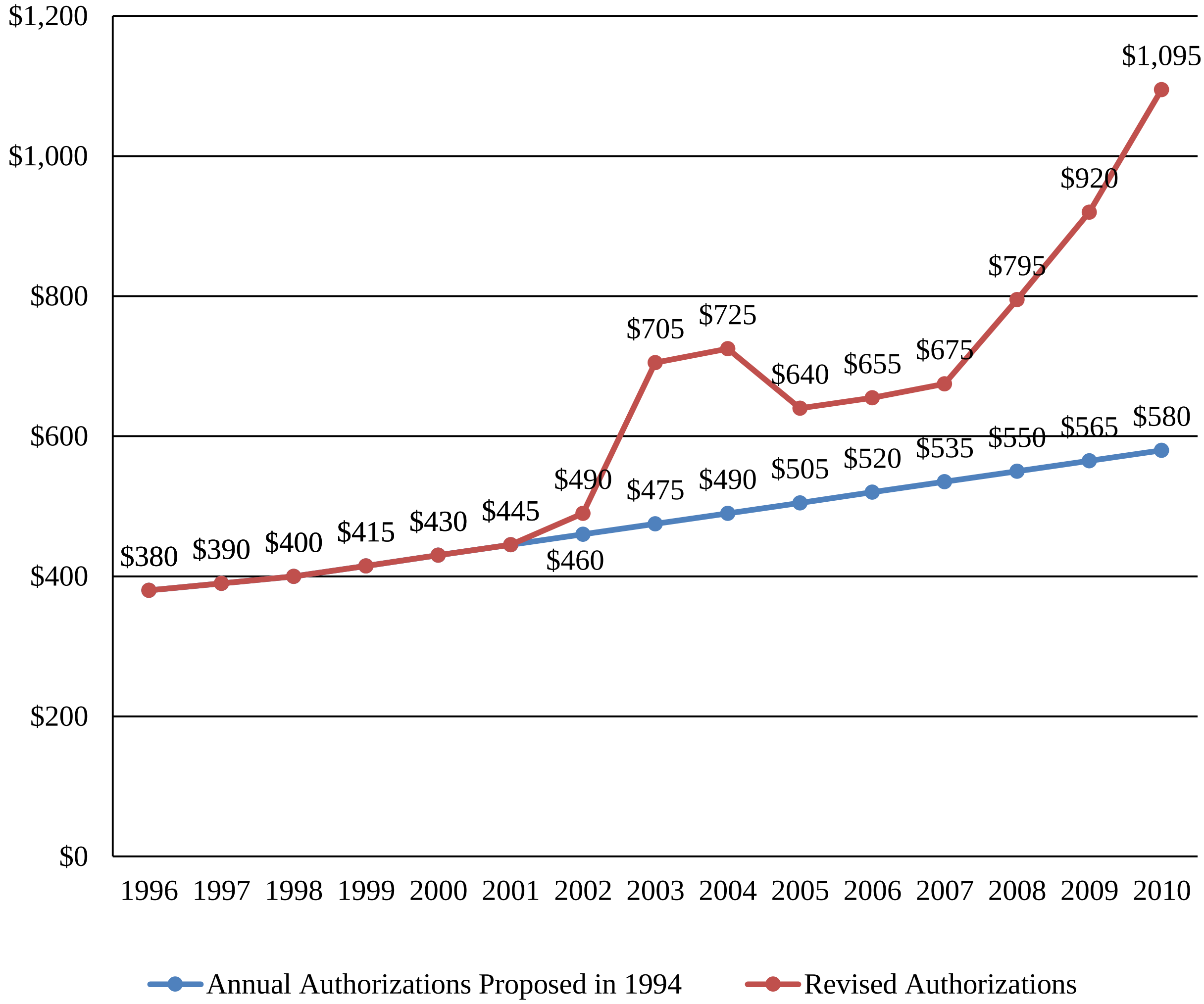
Moderate and Steady Increases in Authorizations: Fiscal 1995 to 2000

In the 1990s, the annual debt limit increased $10 million to $15 million each year. The fiscal 1996 debt limit was $380 million. This increased to $430 million in fiscal 2000. The affordability ratios were also well below their limits. In fiscal 1996, debt service was 6.35% of revenues. Fiscal 2000 debt service was 6.25% of revenues.

Increasing Authorizations: Fiscal 2001 to 2010

The State began deviating from slow and steady increases in GO bond authorizations in the 2001 legislative session. **Exhibit 17** shows that after fiscal 2001 all authorizations exceeded the 1990s trend.

Exhibit 17
General Obligation Bond Authorizations
Fiscal 1996-2010
($ in Millions)



Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*

Examples of specific increases in authorizations from fiscal 2001 to 2009 include:

- increasing the State capital program by $30 million annually beginning in fiscal 2002;
- adding a one-time $200 million increase to fiscal 2003 and again in fiscal 2004 to support PAYGO projects that had lost general fund support;

- increasing authorizations by $100 million a year for five years beginning in fiscal 2005, which became permanent in fiscal 2007;
- increasing the annual escalation from a fixed $15 million per year to 3% per year by CDAC in their 2005 report;
- adding $100 million to each year beginning in fiscal 2008; and
- adding $100 million to each year beginning in fiscal 2009.

The cumulative effect of increasing authorizations before 2009 was to increase the debt service to revenue ratio from 5.43% in fiscal 2001 to the 8% limit by September 2009.

Managing Authorizations: Fiscal 2011 to 2015

The third trend begins with the Great Recession. The State was about to exceed debt limits, so CDAC reduced out-year authorizations. Since December 2009, CDAC has been managing debt authorizations to maximize them without exceeding the limit.

The Great Recession's impact on Maryland's bonds was considerable. General fund revenues declined in fiscal 2009 and 2010 and did not reach fiscal 2008 levels until fiscal 2012. In response to the Great Recession, the Board of Revenues Estimates (BRE) reduced general fund revenue projections in December 2009. Consequently, the level of bond authorizations recommended by CDAC two months earlier would have pushed out-year debt service costs in excess of 8% of revenues. To avoid breeching this criterion, CDAC removed $960 million in GO bond authorizations from fiscal 2012 to 2017. No changes were proposed to authorizations beginning in fiscal 2018. Consequently, CDAC plans included a substantial increase in fiscal 2018.

By fiscal 2012, general fund revenues were improving, and additional debt capacity was available. CDAC responded by increasing authorizations. For example, the capital program was increased by $150 million annually from fiscal 2014 to 2018 by CDAC in September 2012.

In September 2013, CDAC again recommended increasing GO bond authorizations. The recommendation was to increase the program by $75 million annually from fiscal 2015 to 2019. SAC did not concur with this recommendation. Though SAC did support the additional $75 million in fiscal 2015, the committee recommended that no additional authorizations be provided from fiscal 2016 to 2019.

Differing SAC and CDAC Recommendations in Fiscal 2013 and 2014

The fourth trend is that SAC and CDAC have had differing recommendations. As mentioned in the previous section, SAC did not concur with the CDAC recommendation to increase fiscal 2016 to 2019 GO bond authorizations by $75 million annually.

CDAC proposed increasing annual authorizations again in October 2014. It proposed to incorporate the additional $75 million in annual increases. In December 2014, SAC rejected this increase and instead recommended the same level of debt it had recommended in December 2013.

SAC was concerned that the level of debt was not affordable. In December 2014, BRE reduced general fund revenue projections. At that time, the State Treasurer advised SAC that the size of the capital program that was proposed was no longer affordable. SAC was concerned about exceeding the debt limits and recommended that the fiscal 2016 GO bond program be limited to $1,095 million instead of $1,170 million recommended by CDAC.

New Administration Implements Policy Shift to Keep the Capital Program Spending Flat

On September 30, 2015, CDAC recommended that fiscal 2017 GO debt authorizations be limited to $995 million and that this level of authorizations be maintained through fiscal 2025. The fiscal 2017 authorization is $110 million less than the maximum amount that was affordable in December 2014. Over the five-year planning period (fiscal 2017 to 2021), this reduces capital spending by $1,170 million.

The reduction was proposed by the Secretary of Budget and Management and reflects the new Administration's policy to reduce State debt authorizations. The Secretary noted that debt service is too high; therefore, the State needs to reduce planned GO bond authorizations. The Secretary also expressed concerns that the debt service to revenue ratio is too close to the limit and that the State could breech this limit if revenues were to underattain and out-year revenues were to be revised downward.

Past Policies Recognized Inflation and Population Growth

Past capital budgets have recognized that capital project costs are subject to mild inflationary pressures and that the population of Maryland tends to increase over time. The inflationary pressures can erode capital spending, while additional population tends to increase the demand for projects. When CDAC increased the capital program's annual escalation to 3% in its 2006 report, it did so to recognize a 2% increase to offset inflation and a 1% increase to provide for increased demand attributable to population growth. DLS estimates that 2% inflation erodes the value of $995 million in fiscal 2021, the last year of the ABF forecast period, to $919 million, a loss of $76 million.

Comparing Recent SAC Recommendations to the CDAC Recommendation

In December 2014, SAC recommended that fiscal 2016 GO debt be limited to $1,095 million in fiscal 2016. Since this recommendation was made, the legislature authorized $1,045 million for fiscal 2016. Using this as a basis, SAC recommended 1% out-year growth and a debt limit totaling $1,055 million in fiscal 2017. This section compares the effect of the 2014 SAC recommendation with the 2015 SAC recommendation (1% growth) to the September 2015 CDAC authorizations. **Exhibit 18** shows GO bond authorizations under these three options.

Exhibit 18
Comparison of General Obligation Bond Authorizations
Fiscal 2017-2021
($ in Millions)

Year	Administration	1% Growth	2014 SAC
2017	$995	$1,055	$1,105
2018	995	1,065	1,200
2019	995	1,075	1,240
2020	995	1,085	1,280
2021	995	1,095	1,320

SAC: Spending Affordability Committee

Source: Spending Affordability Committee; Department of Legislative Services

The CDAC debt service affordability limit requires that debt service costs not exceed 8% of the State revenues supporting them. **Exhibit 19** shows that all options are affordable. CDAC also has a criterion that debt outstanding not exceed 4% of personal income. The State is well below this criterion.

Exhibit 19
Debt Service to Revenue Ratios for Options
Fiscal 2017-2021

Year	Administration	1% Growth	2014 SAC
2017	7.51%	7.51%	7.51%
2018	7.79%	7.79%	7.80%
2019	7.57%	7.59%	7.61%
2020	7.53%	7.56%	7.60%
2021	7.51%	7.57%	7.65%

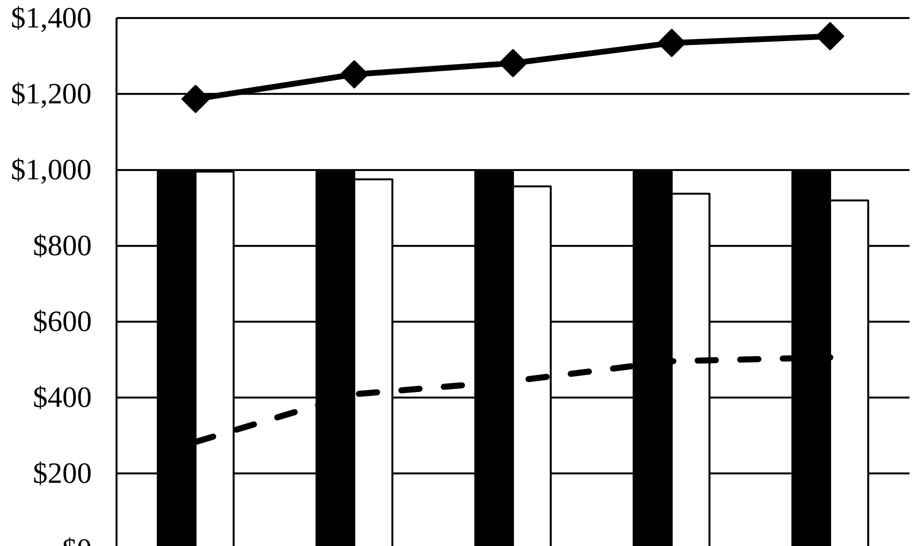
SAC: Spending Affordability Committee

Source: Spending Affordability Committee; Capital Debt Affordability Committee; Department of Legislative Services

Analysis of Administration's Flat Capital Program

The level of authorizations proposed by the Administration and recommended by CDAC in September 2015 is $995 per year. **Exhibit 20** shows that this reduces the purchasing power of the program to $919 million in fiscal 2021. Debt service appropriations increase by $165 million, and general fund appropriations increase by $223 million.

Exhibit 20
Bond Authorizations and Debt Service Costs for the Administration's Capital Program
Fiscal 2017-2021
($ in Millions)



	2017	2018	2019	2020	2021
Program Size	$995	$995	$995	$995	$995
In 2017 Dollars	995	975	956	938	919
Debt Service	1,187	1,252	1,282	1,334	1,352
General Funds	283	409	443	496	506

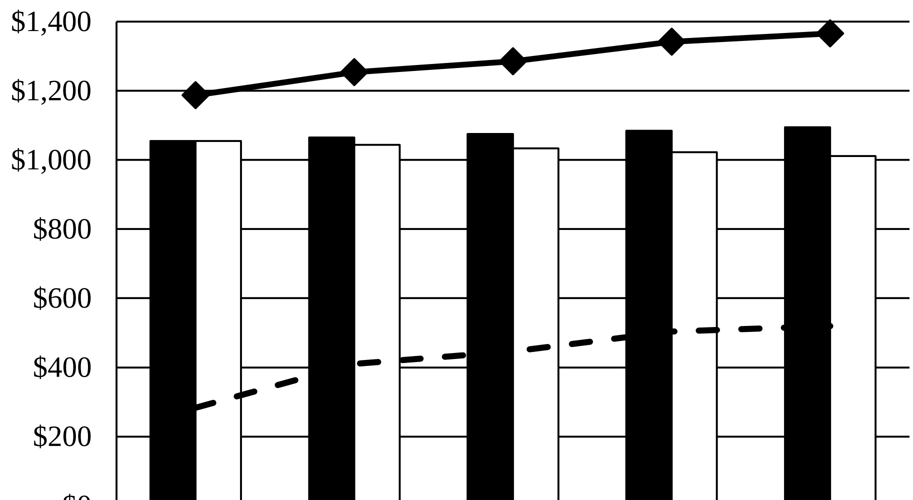
Source: Department of Legislative Services, January 2016

Analysis of 2015 SAC Recommendation: 1% Annual Growth Added to the Fiscal 2016 Authorization

Another approach is to allow for growth but limit it to growth in the primary revenue source supporting spending. State property taxes are dedicated for GO bond debt service. Annual growth is expected to be 1% over the forecast period.

Exhibit 21 shows that this provides $1,055 million in fiscal 2017, which increases to $1,095 million by fiscal 2021. The program does not keep up with inflation but does lose ground slower than a no-growth option. The fiscal 2021 program is $1,012 million in fiscal 2017. Debt service and general fund appropriations increase at a faster rate than the Administration's plan. While there is no noticeable increase in fiscal 2017, fiscal 2021 costs are $519 million, which is $13 million greater than the Administration's plan.

Exhibit 21
Bond Authorizations and Debt Service Costs for
2015 Spending Affordability Committees' 1% Annual Growth Program
Fiscal 2017-2021
($ in Millions)



	2017	2018	2019	2020	2021
Program Size	$1,055	$1,065	$1,075	$1,085	$1,095
In 2017 Dollars	1,055	1,044	1,033	1,022	1,012
Debt Service	1,187	1,254	1,285	1,342	1,366
General Funds	283	410	447	504	519

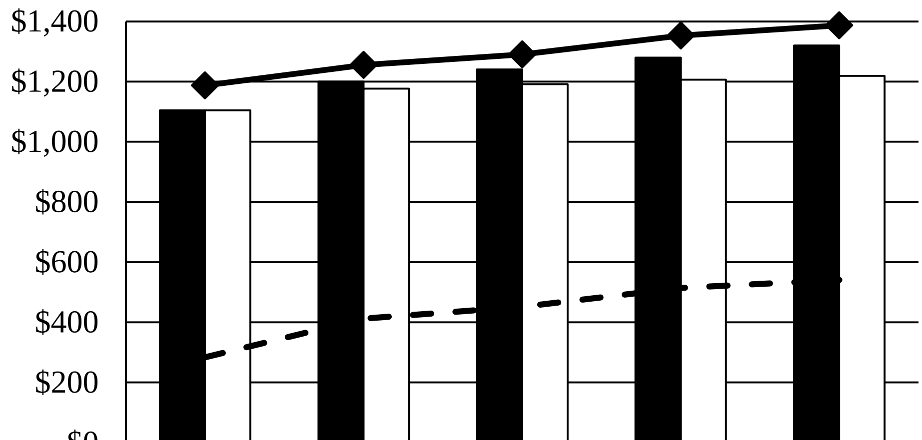
Source: Department of Legislative Services, January 2016

Analysis of December 2014 SAC Recommendations

The level of authorizations proposed by SAC in December 2014 is $1,105 million in fiscal 2017. In fiscal 2018, authorizations increase by almost 9%. This moves the capital program back to the level of authorizations recommended by CDAC for fiscal 2018 in September 2009. In December 2009, recommended fiscal 2012 to 2017 authorizations were reduced by $960 million. The fiscal years beginning in 2018 were unaffected by these reductions.

Exhibit 22 shows that this option provides $1,105 million in fiscal 2017, which increases to $1,320 million by fiscal 2021. The program keeps up with inflation and recognizes some increase in demand. The fiscal 2021 program is $1,219 million in fiscal 2017. Debt service and general fund appropriations increase at a faster rate than the Administration's plan. While there is no noticeable increase in fiscal 2017, fiscal 2021 costs are $540 million, which is $34 million greater than the Administration's plan.

Exhibit 22
Bond Authorizations and Debt Service Costs for
2014 Spending Affordability Committee's Recommended Program
Fiscal 2017-2021
($ in Millions)



	2017	2018	2019	2020	2021
Program Size	$1,105	$1,200	$1,240	$1,280	$1,320
In 2017 Dollars	1,105	1,176	1,192	1,206	1,219
Debt Service	1,187	1,255	1,290	1,353	1,387
General Funds	284	412	451	514	540

Source: Department of Legislative Services, January 2016

Requests Exceed Debt Capacity

In Maryland, State agencies prepare capital project requests and submit them to DBM. DBM reviews the agencies' requests and prepares the capital budget. Each year, the amount requested exceeds debt capacity. **Exhibit 23** shows that fiscal 2017 requests exceed the Administration's limit by $817 million, which is 82% more than the limit. The demand for projects far exceeds the State's ability to pay for projects.

Exhibit 23
General Obligation Bond Request
Fiscal 2017-2021
($ in Millions)

	2017	2018	2019	2020	2021	Total	Category Totals
State Facilities							**$636.8**
Board of Public Works	$64.1	$72.2	$104.5	$113.5	$141.8	$496.0	
Veterans Affairs	0.0	0.0	0.0	1.5	9.9	11.4	
Military	6.1	20.8	2.0	11.3	5.9	46.0	
Disabilities	1.6	1.6	1.6	1.6	1.6	8.0	
Maryland Public Broadcasting	0.2	1.0	6.5	4.6	0.0	12.2	
Information Technology	28.5	20.2	14.5	0.0	0.0	63.2	
Health and Social Services							**$395.7**
Health and Mental Hygiene	$9.6	$23.2	$37.0	$24.3	$10.0	$104.1	
University of Maryland Medical System	15.3	15.6	2.0	0.0	0.0	32.9	
Senior Citizen Activity Center	1.6	1.6	1.6	1.6	1.6	8.0	
Juvenile Services	33.0	32.0	0.5	9.7	13.3	88.5	
Private Hospital Grant Program	4.2	5.0	6.0	6.0	6.0	27.2	
Prince George's County Hospital	45.0	90.0	0.0	0.0	0.0	135.0	
Environment							**$391.4**
Natural Resources	$23.5	$24.0	$24.5	$19.9	$15.1	$107.0	
Agriculture	8.5	19.5	6.0	6.0	6.0	46.0	
Environment	47.8	41.5	20.5	20.5	20.5	150.8	
Maryland Environmental Service	22.6	24.6	12.4	14.6	13.4	87.6	
Education							**$3,329.4**
Education	$28.2	$30.3	$20.9	$7.0	$6.7	$93.0	
Maryland School for the Deaf	3.5	0.0	0.1	3.4	0.0	7.1	
Public School Construction	652.7	632.7	664.3	665.7	614.0	3,229.3	

	2017	2018	2019	2020	2021	Total	Category Totals
Higher Education							**$3,135.7**
University System of Maryland*	$338.0	$366.4	$465.5	$368.9	$356.6	$1,895.3	
Baltimore City Community College	0.3	3.9	18.4	17.6	0.0	40.2	
St. Mary's College	2.7	8.7	9.6	34.5	35.0	90.5	
Morgan State University	45.4	63.7	68.1	74.6	141.0	392.8	
Community Colleges	123.6	106.7	139.5	171.5	117.6	658.8	
Private Facilities Grant Program	10.0	12.0	12.0	12.0	12.0	58.0	
Public Safety							**$420.9**
Public Safety	$15.4	$46.8	$129.4	$115.9	$57.5	$365.1	
State Police	5.8	16.0	14.7	0.5	0.0	36.9	
Local Jails	2.9	6.0	5.0	5.0	0.0	18.9	
Housing and Economic Development							**$523.9**
Housing and Community Development	$97.1	$97.2	$97.3	$97.0	$96.8	$485.4	
Historic St. Mary's City	0.0	0.5	14.3	6.0	0.0	20.8	
Planning	7.5	4.6	1.8	2.2	1.8	17.8	
Transportation							**$285.0**
Transportation	$85.0	$100.0	$100.0	$0.0	$0.0	$285.0	
							$247.0
Legislative Initiatives**	$35.0	$35.0	$35.0	$35.0	$35.0	$175.0	
Miscellaneous	46.9	8.9	5.6	5.3	5.3	72.0	
Subtotal Request	***$1,811.6***	***$1,932.2***	***$2,040.8***	***$1,857.0***	***$1,724.2***	***$9,365.9***	***$9,365.9***
Debt Affordability Limits 2015 CDAC	**$995.0**	**$995.0**	**$995.0**	**$995.0**	**$995.0**	**$4,975.0**	
Variance 2015 CDAC	**$816.6**	**$937.2**	**$1,045.8**	**$862.0**	**$729.2**	**$4,390.9**	

CDAC: Capital Spending Affordability Committee
SAC: Spending Affordability Committee

*In addition to the general obligation bond request, the University System of Maryland has requested academic revenue bond funding of $22 million in fiscal 2017 and 2018 and $32 million in fiscal 2019-2021.
**Figures represent an estimated average of the total funding requests received through legislative local bond bills.

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

Each Capital Budget Is a One-year Decision

For planning purposes, the State provides six-year forecasts of revenues and capital spending. This allows the State to assess how financially sound its actions are. But as a practical matter, the General Assembly passes an annual budget. This year, the Administration proposes $995 million in GO bond authorizations. SAC proposed $1,055 million in December 2015. Keeping with the December 2014 SAC recommendation would have resulted in $1,105 million in authorizations. **Exhibit 24** compares the total costs of these three options.

Exhibit 24
Cost of the Fiscal 2017 General Obligation Bond Authorization
Comparing the Administration Plan with Recent
Spending Affordability Committee Recommendations
($ in Millions)

	Administration Plan	December 2015 SAC (1% Increase)	December 2014 SAC
Total Principal Payments	$995	$1,055	$1,105
Total Interest Payments	482	511	535
Total Debt Service Payments	**$1,477**	**$1,566**	**$1,640**
Percent Increase		**6%**	**11%**
Additional Principal		$60	$110
Additional Interest		29	53
Total Additional		**$89**	**$163**

SAC: Spending Affordability Committee

Source: Department of Legislative Services

The State Treasurer should be prepared to brief the committees on the effects of the Administration's and the SAC recommended level of debt authorizations.

Recommended Actions

1. Concur with Governor's allowance.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Public Debt
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$140,000	$887,932	$11,490	$0	$1,039,422
Deficiency Appropriation	0	0	0	0	0
Cost Containment	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	-12,325	-7	0	-12,331
Actual Expenditures	**$140,000**	**$875,608**	**$11,483**	**$0**	**$1,027,091**
Fiscal 2016					
Legislative Appropriation	$252,400	$845,378	$11,477	$0	$1,109,255
Budget Amendments	0	21,600	0	0	21,600
Working Appropriation	**$252,400**	**$866,978**	**$11,477**	**$0**	**$1,130,855**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

Fiscal 2015 actual Public Debt spending was $12.3 million less than the appropriations. This was almost entirely attributable to special fund spending. Major changes include:

- interest costs from the July 2013 bond sale of new bonds were $1.1 million less than budgeted;
- the July 2014 refunding bond sale reduced fiscal 2014 debt service costs by $8.7 million; and
- costs associated with the March 2013 bond sale were $2.5 million less than budgeted.

Fiscal 2016

The March 2014 bond sale interest costs were less than budgeted, and the bond sale premium realized from that sale also exceeded projections. In response, the General Assembly reduced general fund appropriations by $21.6 million, and authorized a budget amendment to appropriate additional special funds. Budget amendment 009-16 appropriates these funds.

Fiscal Summary
Public Debt

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Redemption and Interest on State Bonds	$ 1,027,090,614	$ 1,130,855,189	$ 1,187,178,826	$ 56,323,637	5.0%
Total Expenditures	**$ 1,027,090,614**	**$ 1,130,855,189**	**$ 1,187,178,826**	**$ 56,323,637**	**5.0%**
General Fund	$ 140,000,000	$ 252,400,000	$ 283,000,000	$ 30,600,000	12.1%
Special Fund	875,607,745	866,977,926	892,639,657	25,661,731	3.0%
Federal Fund	11,482,869	11,477,263	11,539,169	61,906	0.5%
Total Appropriations	**$ 1,027,090,614**	**$ 1,130,855,189**	**$ 1,187,178,826**	**$ 56,323,637**	**5.0%**

Note: The fiscal 2016 appropriation does not include deficiencies. The fiscal 2017 allowance does not include contingent reductions.

Appendix 3

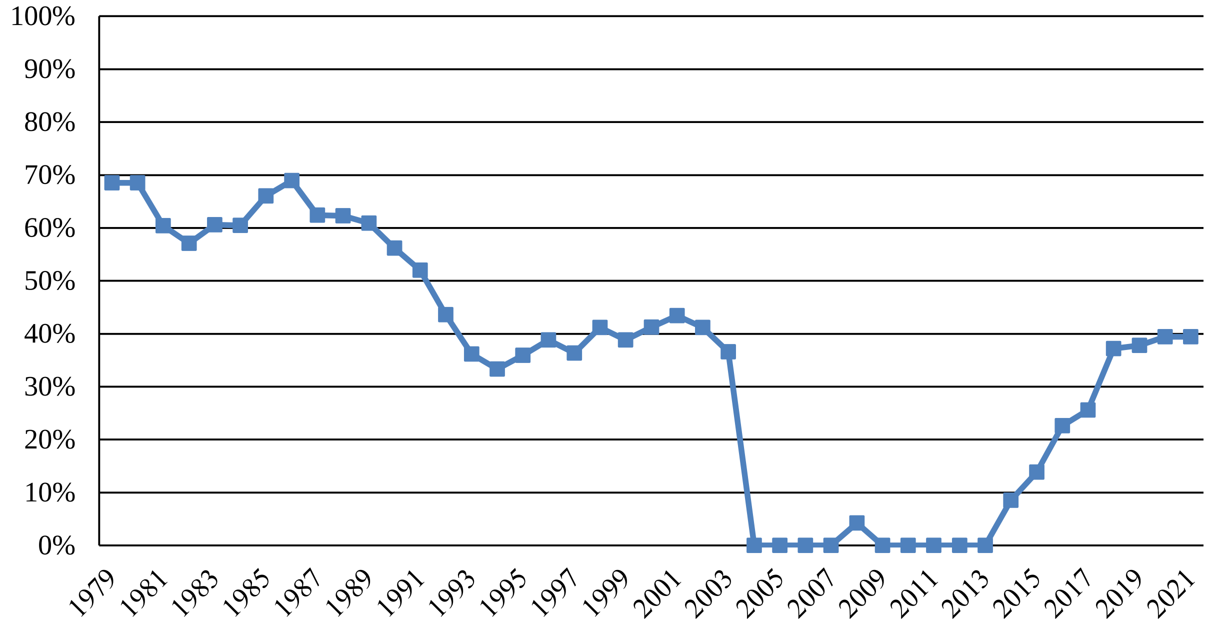
General Fund Appropriations for Debt Service and State Property Tax Rates

General obligation (GO) bond debt service costs are supported by the Annuity Bond Fund. Currently, the fund's primary revenue source is State property tax revenues. When these revenues are insufficient, the State appropriates general funds. Prior to fiscal 2004, reimbursable funds were also appropriated into the fund. The source of these funds was general funds appropriated into the Maryland State Department of Education budget to support local school construction debt service.

The chart shows that the Department of Legislative Services projects that general fund appropriations for debt service will approach 40% of debt service appropriations by fiscal 2020. Since the affordability process began in fiscal 1979, the level of general fund support has varied considerably; general fund support peaked at 69% in fiscal 1986, while no support was provided from fiscal 2004 to 2007 and from fiscal 2009 to 2013. From fiscal 1979 to 1989, general fund support exceeded 60% in all but one year. From fiscal 1992 until the State property tax rate was increased in fiscal 2004, the general fund share hovered around 40%. Insofar as there is little support to increase property tax rates, the State appears to be heading into a period in which general fund support could again be 40% of GO bond debt service appropriations.

State property taxes were \$0.084 per \$100 of assessable base from fiscal 1979 to 2003, \$0.132 from fiscal 2003 to 2006, and \$0.112 since fiscal 2004.

General Funds as a Percent of Debt Service Appropriations And State Property Tax Rates
Fiscal 1979-2021



Notes: Fiscal 1985 to 2003 includes general funds appropriated in the Maryland State Department of Education for capital school construction. Fiscal 2002 and 2003 adjusted to remove proceeds from refunding bonds.

Source: Department of Budget and Management; State Treasurer's Office

Appendix 4

Analysis of General Obligation Bonds' True Interest Costs

The interest rate that Maryland pays for the bonds it sells is referred to as the true interest cost (TIC). This rate is derived by calculating a bond sale's internal rate of return. The TIC is calculated at each bond sale, and the bidder with the lowest TIC is awarded the bid.

Financial theory suggests factors that could influence Maryland's general obligation (GO) bond's TIC. Research has confirmed a number of significant influences in other states and in national studies that included Maryland. To build the least squares regression equation, data was collected and analyzed for the 63 bond issuances since March 1991 (refunding sales are excluded): 51 competitively bid, tax-exempt bond issuances; 8 negotiated, retail bond issuances; and 4 Build America Bond (BAB) issuances.

The sum of least squares regression analysis dependent variable is the TIC. All the other variables are independent variables that are included to control the factors that could influence the TIC. The question that the regression equation addresses is which of the independent variables influence the dependent variable (TIC). The regression equation examines the variables previously listed and identifies five statistically significant variables at the 95% confidence level that affect the TIC and they are:

- ***Bond Buyer 20-bond Index:*** The key variable is the 20-bond index. This is an estimate of the market rate for 20-year, AA-rated State and municipal bonds. The Department of Legislative Services (DLS) has collected the estimated yields since 1991.

- ***Ratio of Maryland Total Personal Income to the U.S. Total Personal Income:*** One perspective on interest rates is to consider them as a return for risk. The higher the risk, the higher interest rate investors will expect. One factor of risk is the fiscal health of the entity selling the debt. In the DLS regression equation, State personal income is used as a proxy for fiscal health. The equation uses a ratio that compares State personal income to U.S. personal income. If the ratio increases, Maryland is doing relatively better than the rest of the United States, and a GO bond issuance's TIC tends to decline.

- ***Years to Maturity:*** Under normal economic conditions, bonds with shorter maturities have lower interest costs than bonds with longer maturities. This is referred to as a positive yield curve. The analysis estimates that every year adds 0.26% (26 basis points) to the TIC.

- ***Post-financial Crisis:*** This is a variable that indicates if a bond was sold before or after Lehman Brothers collapsed in September 2008. The equation estimates that Maryland bond yields are 0.62% (62 basis points) less since September 2008. This is consistent with the "flight to quality" that some believe has resulted since the financial crisis of 2008. The average bond in the index is a lower quality bond than Maryland bonds. The negative coefficient projects that the yield on higher rated bonds has been reduced when compared to AA-rated bonds. This variable was not necessary in previous years. The analysis used an index of AAA-rated bonds which would not identify an increasing spread between higher and lower rated bonds. Now that an AA-rated index is used, a variable measuring the increasing spread between AAA and AA bonds results in an improved equation.

- ***BABs:*** In February 2009, the American Recovery and Reinvestment Act authorized the issuance of BABs. The bonds are taxable bonds that support the same types of projects that traditional tax-exempt bonds support. The difference is that the buyers do not receive any federal tax credits or deductions so that the interest earnings are subject to federal taxes. Instead, Maryland receives a subsidy equal to 35% of the interest costs from the federal government. In concept, the bonds expand the number of buyers of State and municipal debt since the bonds are also attractive to individuals and institutions that do not pay federal taxes. Because the tax-exempt bonds' benefit is greater for shorter maturities, the State issued tax-exempt bonds with shorter maturities and BABs with longer maturities.

  The following table shows the data for the statistically significant variables.

TIC Regression Equation – Evaluating the Independent Variables

Ind. Variable	Coefficient	Std. Error	Beta	t-test	Sig.	Tol.	Comment
The Bond Buyer 20-bond Index	0.871	0.044	0.62	19.620	0.000	0.58	Highest t-test suggests with confidence that the index is significant.
MD PI/US PI	-1.859	0.771	-0.08	-2.413	0.019	0.52	Negative coefficient suggests that as the Maryland economy strengthens, compared to the United States, the TIC declines.
Years to Maturity	0.259	0.027	0.34	9.697	0.000	0.46	Positive coefficient means that longer maturities tend to have higher TICs.
Post-financial Crisis	-0.639	0.099	-0.27	-6.435	0.000	0.34	Maryland bonds' yields are reduced since the crisis.
BAB	-1.111	0.180	-0.23	-6.168	0.000	0.42	Negative coefficient suggests BABs are less expensive.
Constant	1.528						

BAB: Build America Bonds
Ind.: independent
MD PI/US PI: Maryland Total Personal Income to U.S. Personal Income
Sig.: significance or confidence interval
Std.: standard
TIC: true interest cost
Tol. tolerance, a test of multicollinearity

Source: Department of Legislative Services, October 2015

In addition to estimating and evaluating the specific variables, a proper statistical analysis must also incorporate an analysis of the equation as a whole, such as:

- how confident are we in the equation (confidence interval);
- what is the equation's margin of error;
- how close are the equation's estimates to the actual data; and
- is there a dependence between successive dependent variables (serial or autocorrelation)?

The regression equation has a high level of explanatory power and suggests that the determinants of Maryland's TIC are well understood and account for almost all of the variations that are seen in the TIC. The following table shows the equation's statistics.

TIC Regression Equation – Evaluating the Entire Equation

What Is Measured	Statistic Used to Measure	Value of Statistic	Explanation
Confidence in the equation	F Statistic	331.5	We are over 99.9% confident that the independent variables influence the dependent variable.
Margin of error	Standard error of the estimate	0.227	We expect the actual TIC to be within 0.23% (23 basis points) of the estimate.
Estimate in relation to actual data	Adjusted R Square	0.964	The model's estimates explain 96.4% of the actual data.
Serial or autocorrelation	Durbin-Watson	1.537	The ideal value is 2.0. If the number deviates too far from 2.0, it suggests that there are patterns in the errors, and a key independent variable is missing.

TIC: true interest cost

Source: Department of Legislative Services, October 2015

Y01A
State Reserve Fund

Operating Budget Data

($ in Thousands)

	FY 15 Actual	**FY 16 Working**	**FY 17 Allowance**	**FY 16-17 Change**	**% Change Prior Year**
General Fund	$14,786	$81,435	$235,336	$153,901	189.0%
Deficiencies and Reductions	0	-8,935	0	8,935	
Adjusted General Fund	**$14,786**	**$72,500**	**$235,336**	**$162,836**	**224.6%**
Adjusted Grand Total	**$14,786**	**$72,500**	**$235,336**	**$162,836**	**224.6%**

- The fiscal 2017 appropriation into the State Reserve Fund totals $235.3 million.

- Although the Revenue Stabilization Account balance is less than the 7.5% target, it increases from 5.0% to 6.3%. As required by law, the Administration's budget appropriates $235.3 million. This is equal to the amount required by the general fund sweeper.

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Major Trends

Rainy Day Fund Balance Increases to 6.3% of Revenues: If the fund balance is below 7.5%, the Governor is required to appropriate at least $50.0 million into the fund. In addition, the Governor is required to appropriate an amount equal to the general fund sweeper, which is $235.3 million in fiscal 2017. No transfers are planned out of the fund in fiscal 2017, which increases the fund balance from 5.0% to 6.3%.

Issues

Review of Rainy Day Fund Laws and Practices: The issue examines the adequacy of the 7.5% fund balance target, how to replenish the fund after it is used, recent uses of the Rainy Day Fund, withdrawal guidelines, and over-use of other fund balances during recessions. **The Department of Legislative Services (DLS) recommends that the committees adopt committee narrative that a study group be formed to examine how to improve Rainy Day Fund statutes and practices.**

Dedicating Unanticipated Revenues to Replenish the Rainy Day Fund or Reduce Unfunded Liabilities: The issue discusses two sources of unanticipated revenues. One is limiting nonwithholding income tax revenues and another is limiting capital gains revenues. **DLS recommends that the committees adopt narrative that requires that the Department of Budget and Management, Comptroller's Office, and DLS examine approaches for calculating unanticipated revenues and dedicating these revenues for the Rainy Day Fund or an unfunded liability. The report should recommend a specific approach that the General Assembly could use to enact legislation.**

Use of Unassigned General Fund Surplus: Prior to the 2015 session, State law required that an amount equal to the unassigned general fund surplus in excess of $10 million be appropriated into the Rainy Day Fund. The equation was changed last session to dedicate a portion of surplus funds to the Pension Fund in fiscal 2017 through 2020. The Attorney General's Office advises that the Program Open Space transfer takes precedence over the pension sweeper. **DLS recommends that legislation be considered if the legislature wishes to establish a different order of priorities relating to the application of surplus funds at closeout.**

Recommended Actions

1. Adopt narrative to request a report to examine general fund revenue volatility.

Operating Budget Analysis

Program Description

The State Reserve Fund provides a means to designate monies for future use. It comprises four individual accounts:

- Revenue Stabilization Account (Rainy Day Fund);
- Dedicated Purpose Account (DPA);
- Catastrophic Event Account; and
- Economic Development Opportunities Account (Sunny Day Fund).

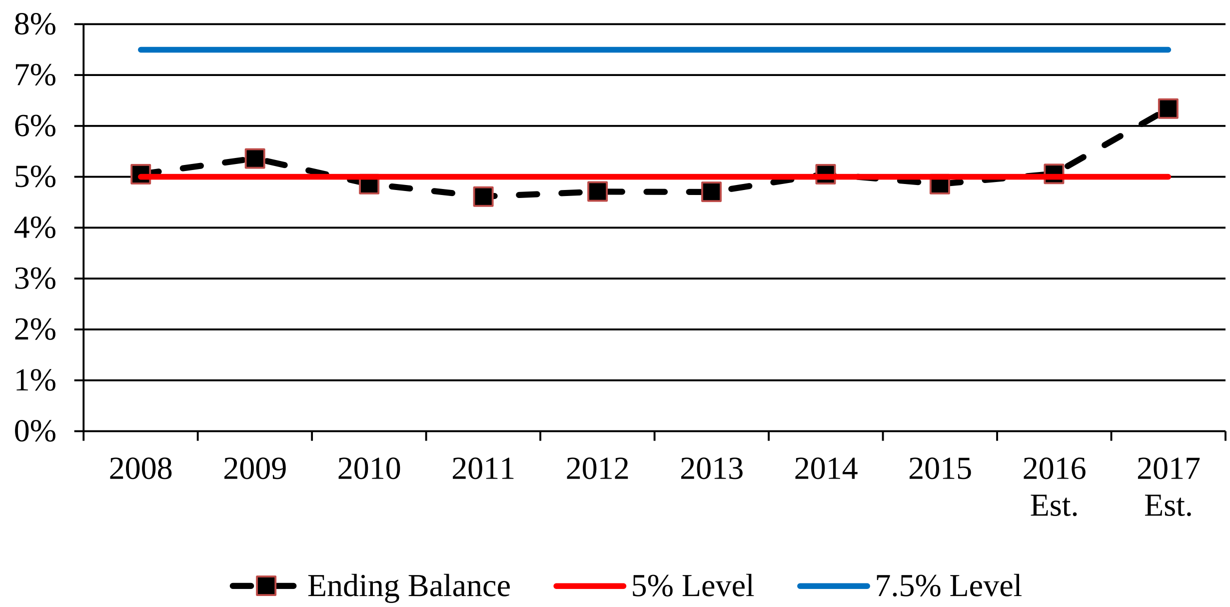
The purpose and status of three of these accounts is discussed in more detail in this analysis. Discussion of the Sunny Day Fund can be found in the analysis of the Department of Commerce.

Performance Analysis: Managing for Results

1. Rainy Day Fund Balance Increases to 6.3% of Revenues

Section 7-311 of the State Finance and Procurement Article establishes a target reserve balance of 7.5% of estimated general fund revenues. Except for fiscal 2017 and 2018, the Governor is authorized to expend balances down to 5.0% in the annual budget bill, which was the case from fiscal 2008 to 2016, as the State grappled with structural deficits. **Exhibit 1** provides the actual and estimated closing balances in the Rainy Day Fund since fiscal 2008. The fiscal 2017 budget does not rely on Rainy Day Fund transfers to the General Fund, so the Rainy Day Fund balance is expected to increase to $1,083 million. This is 6.3% of fiscal 2017 ongoing general fund revenues.

Exhibit 1
Rainy Day Fund End-of-year Balances
Fiscal 2008-2017 Est.



Source: Department of Budget and Management, January 2016

Fiscal 2016 Actions

Proposed Deficiency

The budget bill includes two deficiencies, $10.0 million for the Catastrophic Event Account and $2.5 million for the DPA. The Catastrophic Event Account fund balance is $0.2 million, which is insufficient to provide much help. Over the last 15 years, the account has provided relief from hurricanes, tornadoes, snowstorms, and droughts. The deficiency should provide a balance that is sufficient to support these typical events. **The Department of Legislative Services (DLS) recommends approving this deficiency appropriation.**

The budget also includes a $2.5 million deficiency appropriation for information technology upgrades. This replaces hardware, mostly personal computers and servers, in approximately 20 agencies. Most of the equipment is six to nine years old. These funds will be matched by agency funds. The Department of Information Technology expects that agencies will provide almost $12.0 million in additional appropriations to support these upgrades. The budget anticipates that all of the $2.5 million will be spent in fiscal 2017. **It is recommended that this deficiency appropriation be approved.**

Proposed Budget

Exhibit 2 shows that the fiscal 2017 allowance is $235.3 million. This is the amount required by law. State law requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of $10.0 million into the Rainy Day Fund. This appropriation is made to the budget two years after the unassigned general fund surplus is realized. This appropriation to the Rainy Day Fund is referred to as the "sweeper." The Budget Reconciliation and Financing Act (BRFA) of 2015 (Chapter 489) amended the sweeper requirement so that the Rainy Day Fund receives only 50% of any unassigned general fund surplus for fiscal 2017 to 2020. The other 50% is appropriated to reduce the State's unfunded pension liability. The pension appropriation is limited to $50.0 million.

Exhibit 2
Proposed Budget
State Reserve Fund
($ in Thousands)

How Much It Grows:	**General Fund**	**Total**
Fiscal 2015 Actual	$14,786	$14,786
Fiscal 2016 Working Appropriation	72,500	72,500
Fiscal 2017 Allowance	235,336	235,336
Fiscal 2016-2017 Amount Change	$162,836	$162,836
Fiscal 2016-2017 Percent Change	224.6%	224.6%

Where It Goes:	
Personnel Expenses	
Rainy Day Fund	
Remove fiscal 2016 appropriation	-$50,000
Sweeper appropriation	235,336
Dedicated Purpose Account	
Remove Local Income Tax Reserve Account transfer	-10,000
Remove deficiency appropriation for information technology upgrades	-2,500
Catastrophic Event Account	
Remove fiscal 2016 deficiency appropriation	-10,000
Total	**$162,836**

Note: Numbers may not sum to total due to rounding.

Fiscal 2015 closed with an unassigned surplus totaling $295.3 million. By law, the Administration was required to:

- keep $10.0 million in the General Fund;
- appropriate $235.3 million for the Rainy Day Fund; and
- appropriate $50.0 million for the pension fund.

The allowance includes the required sweeper amount. The Administration also adjusted the pension contribution rates so that an additional $75 million ($65 million in general funds) was appropriated into the pension fund. This action technically satisfies the pension sweeper requirement.

The State maintains a Local Income Tax Reserve Account. According to generally accepted accounting principles (GAAP), the State is supposed to maintain a sufficient fund balance to pay future refunds in case the income tax is no longer collected. Recently, the State has transferred funds from this account to balance the State budget. The fiscal 2016 appropriation included $10 million to reduce the unfunded liability in the Local Income Tax Reserve Account. There is no appropriation in fiscal 2017. The plan is to increase credits into the account when revenues are collected to reduce the liability.

Exhibit 3 provides an overview of State Reserve Fund activity between fiscal 2016 and 2017. Detail for each account may be found in **Appendix 3** (Rainy Day Fund), **Appendix 4** (DPA), and **Appendix 5** (Catastrophic Event Account).

Exhibit 3
State Reserve Fund Activity
Fiscal 2016-2017
($ in Millions)

	Rainy Day Fund	Dedicated Purpose Account	Catastrophic Event Account
Balances 6/30/15	**$773.5**	**$0.0**	**$0.2**
Fiscal 2016 Appropriations	50.0	152.5	10.0
Transfer to Local Income Tax Reserve Account	0.0	-10.0	0.0
Section 48 Initiatives Restored by Administration	0.0	-118.6	0.0
General Fund Reversion	0.0	-21.4	0.0
Interest	8.1	0.0	0.0
Estimated Balances 6/30/16	**$831.5**	**$2.5**	**$10.2**
Fiscal 2017 Appropriations	235.3	0.0	0.0
Information Technology Upgrades	0.0	-2.5	0.0
Interest	16.1	0.0	0.0
Estimated Balances 6/30/17	**$1,083.0**	**$0.0**	**$10.2**
Percent of Revenues in Reserve	**6.3%**		

Source: Department of Budget and Management, January 2016

In fiscal 2016, the General Assembly restricted $140.0 million of the appropriations into the DPA so that the funds could only be used to restore reductions that the Administration made to specific programs and purposes. In addition to the DPA, appropriations totaling $26.6 million in Medicaid (M00QA01.03), $10.2 million in the Public School Capital Appropriation (D06E02.02), $13.0 million in the Department of Human Resources' (DHR) Assistance Payments (N00G00.08), and $11.9 million in the Maryland State Department of Education's (MSDE) Foundation Program (R00A02.10) were also restricted. If the Administration chose not to fund these programs or purposes, the funds would revert to the General Fund.

The Administration restored all funds except those supporting the Geographic Cost of Education Index and Prince George's County Hospital. All of the restricted funds in Medicaid, public school capital, DHR, and MSDE will revert to the General Fund. In addition, $21.4 million from the DPA will also revert. **Exhibit 4** details how fiscal 2016 DPA appropriations were spent in accordance with legislative intent as expressed in Section 48 of the FY 2016 budget bill.

Exhibit 4
Fiscal 2016 Dedicated Purpose Account Section 48 Allocations
($ in Millions)

Agency	Description	Amount
Restoration		
Personnel		
Statewide	General Salary Increase	$68.7
Medicaid and Entitlements		
Medicaid	Community Mental Health Provider Rates	$6.5
BHA	Substance Abuse Heroin Addiction Treatment	2.0
Medicaid	Adult Day Care	2.1
Medicaid	Pregnant Women and Family Planning	4.8
Medicaid	Home and Community Based Services	4.8
Medicaid	Primary Care and Physician Specialty Rates	15.5
Medicaid	Nursing Home Rates	4.0
Medicaid	Psychiatrists Reimbursement Rates	1.1
Subtotal		***$40.8***
State Agencies		
MSB	Additional Support	$1.8
DDA	Purchase of Care for Individual and Family Support	2.2
PHPA	Children’s Medical Day Care	0.1
MSDE	Charter School Funding Report	0.3
DDA	Crisis Intervention	3.0
Subtotal		***$7.4***
Local Aid		
MSDE	Nonpublic Placement Rates	$1.7
Total Restorations		**$118.6**
Reverted to the General Fund		**$21.4**
Transferred to Local Income Tax Reserve Account		**$10.0**
Total Appropriation		**$150.0**

BHA: Behavioral Health Administration
DDA: Developmental Disabilities Administration
MSB: Maryland School for the Blind
MSDE: Maryland State Department of Education
PHPA: Prevention and Health Promotion Administration

Source: Department of Budget and Management, January 2016

Issues

1. Review of Rainy Day Fund Laws and Practices

Since 1986, the State has had a Rainy Day Fund. The purpose of the fund is to retain revenues that can be transferred to the General Fund to provide short-term liquidity when revenues underperform. Originally, the fund was required to maintain a balance of 2.0% of estimated general fund revenues. This was increased to 5.0% at the 1993 session, then 7.5% at the 2006 session.

State law requires the Governor to appropriate funds into the account if the balance is below 7.5%. Specifically, repayment to the fund requires annual appropriations of $100 million if the balance falls below 3.0% and $50 million if the balance is below 7.5%. An amount equal to unappropriated general funds above $10 million at closeout are also required to be appropriated into the fund. Maryland has no requirement for a minimum general fund balance.

For fiscal 2017 and 2018, the Administration can only transfer funds out of the Rainy Day Fund through legislation other than the State budget. Beginning in fiscal 2019, the Administration can withdraw funds above 5.0% from the Rainy Day Fund and transfer them to the General Fund in the annual budget bill. However, if the Rainy Day Fund balance falls below 5% of general fund revenues, the Administration must submit separate legislation (such as a BRFA) to transfer funds to the General Fund.

This issue examines Rainy Day Fund statutes and practices. Specifically, the issue examines:

- general fund revenue volatility;
- purpose of a Rainy Day Fund;
- how recessions put pressure on spending;
- replenishing the fund if the balance is less than the 7.5% target;
- recent uses of the Rainy Day Fund;
- withdrawal guidelines; and
- overuse of other fund balances during recessions.

General Fund Revenue Volatility and the 7.5% Rainy Day Fund Target

DLS has examined actual general fund revenues collected from fiscal 1980 to 2015. To measure the underlying changes in base revenues, revenues are adjusted to remove revenue changes attributable to changes in tax laws. Also, inflation rates varied over the period. During the 1980s, inflation averaged about 5%. From calendar 2006 to 2015, inflation averaged less than 2%. Without adjusting for inflation, swings in the 1980s tended to be more pronounced due to inflation. To minimize this, the data has also been adjusted for inflation.

Exhibit 5 shows that the average percent change over the period was a 2.5% increase. The standard deviation was 3.9%. Over the 35 years, 23 years had annual revenue changes that were within one standard deviation. The data are slightly skewed; there were 7 years in which revenues increased by more than one standard deviation above the average and 5 years in which revenue decreases were more than one standard deviation below the average.

Exhibit 5
Inflation Adjusted General Fund Revenue Volatility
Fiscal 1980-2015

Statistic	Result	Exceptional Years
Number of Years in Sample	35	n/a
Average Percent Change	2.5%	n/a
Median Percent Change	3.0%	n/a
Standard Deviation	3.9%	n/a
Number of Years Below Average	17	n/a
Number of Years with Changes That Were within One Standard Deviation	23	n/a
Increases More Than One Standard Deviation Greater Than Average	7	1984, 1985, 1987, 1988, 1999, 2000, 2005
Decreases More Than One Standard Deviation Below Average	5	1981, 1992, 2002, 2003, 2009
Year-on-year Revenue Decreases More Than 5.0%	3	1992, 2002, 2009
Year-on-year Revenue Decreases More Than 7.5%	1	2009
Largest Increase	8.9%	1987
Largest Decrease	-8.4%	2009

Note: To measure the underlying revenue changes, revenues are adjusted to remove the effect of changes to tax law. Revenues are adjusted for inflation.

Source: Comptroller's Office; Department of Legislative Services

The change in growth rates (or year-on-year revenues) declined by more than 5% in three years, when compared to the previous year. Specifically:

- revenues declined from 4.3% growth in fiscal 1991 to -2.3% growth in fiscal 1992, a 6.6% swing;

- revenues declined from 4.3% growth in fiscal 2001 to -3.2% growth in fiscal 2002, a 7.5% swing; and

- revenues declined from 0.3% growth in fiscal 2008 to -8.4% growth in fiscal 2009, an 8.7% swing.

Of these changes in revenue growth, the only year in which year-on-year revenues declined more than 7.5% was fiscal 2009. That was during the Great Recession, which was the most severe recession since the Great Depression.

The data measures the full impact of three recessions; the first recession was from July 1990 to March 1991, the second from March 2001 to November 2001, and the third from December 2007 to June 2009 (the Great Recession). All three recessions have a different impact on revenues. Not surprisingly, the Great Recession was the deepest and the longest. But the other two recessions had markedly different effects on revenues. The revenue decline from fiscal 1992 was initially milder, but the recovery was slower. The revenue decline in fiscal 2002 was more severe, but revenues bounced back more quickly. **Exhibit 6** compares the initial decline and number of years until revenues bounced back in real and nominal terms. Higher inflation masked the severity of the fiscal 1992 decline, since actual revenues increased that year. Inflation also masked the slow recovery. The table also shows how deep the Great Recession was and how weak the recovery has been.

Exhibit 6

Revenue Decline and Recovery in Real and Nominal Terms for Last Three Recessions

	Real Revenues		Nominal Revenues	
Fiscal Year of Initial Revenue Loss	**Initial Decline**	**Number of Years to Recover**	**Initial Decline**	**Number of Years to Recover**
1992	-2.32%	4	0.35%	1
2002	-3.16%	2	-1.42%	2
2009	-8.42%	7+	-6.91%	4

Note: To measure the underlying revenue changes, revenues are adjusted to remove the effect of changes to tax law.

Source: Comptroller's Office; Department of Legislative Services

Except for the Great Recession, 7.5% seems to be enough to maintain revenues for the first year of a recession. But 7.5% of general fund revenues does not appear to be enough to maintain revenue growth until a recovery is fully underway. The year after revenues declined in fiscal 1992, 2002, and 2009, inflation-adjusted revenues continued to shrink (fiscal 2003 and 2010) or revenues barely increased (in fiscal 1993 revenues increased by 0.84%). The conclusion is that having a 7.5% fund balance is sufficient to support one year of revenue declines in all but the worst recessions, but also that this will require some restructuring of revenues or spending in the second year.

Purpose of the Rainy Day Fund

There is a debate about the purpose of a Rainy Day Fund. One position is that a Rainy Day Fund should have sufficient revenues to insulate a State from the effects of a recession. Another perspective is that a Rainy Day Fund provides short-term relief while a State restructures its revenues and spending. Maryland has adopted this second approach. The State's Rainy Day Fund provides relief, but as the revenue volatility analysis will show, the fund does not have a fund balance sufficient to insulate the State from the adverse effects of a recession.

As previously discussed, inflation-adjusted general fund revenues in fiscal 2015 were still below fiscal 2008 levels, seven years after they peaked. To maintain services at the level that they were in fiscal 2007 would have required a Rainy Day Fund that is nearly as large as the entire General Fund budget. **Exhibit 7** compares actual inflation-adjusted revenues with inflation-adjusted revenues increasing at a rate of 2.46%, which is the average growth rate since fiscal 1981. Replacing these revenues requires providing at least $1.5 billion each year. Over the seven years, it requires $15.5 billion, which is more than fiscal 2008 revenues. Maintaining a Rainy Day Fund that is sufficient to replace all revenues is not practical.

Exhibit 7
Comparing Actual Revenues to Revenues Increasing at the Average Growth Rate
Fiscal 2008-2015
($ in Millions)

Fiscal Year	Actual Revenues	Revenues Increasing 2.46%	Difference
2008	$14,052	$14,052	$0
2009	12,870	14,398	1,529
2010	12,808	14,753	1,945
2011	13,206	15,117	1,911
2012	13,385	15,489	2,104
2013	13,390	15,871	2,481
2014	13,461	16,262	2,800
2015	13,959	16,662	2,703
Total	**$107,130**	**$122,603**	**$15,473**

Source: Comptroller's Office; Department of Legislative Services

While fully replacing lost revenues during a recession is impractical, it does appear that one lesson from the Great Recession is that more reserves are needed. In response to the last recession, a number of states have increased their Rainy Day Fund limits. **Exhibit 8** shows that the number of states with limits above 6% increased from 22 in fiscal 2008 to 31 in fiscal 2016.

Exhibit 8
Changes in Other States' Rainy Day Fund Limits

Limit	Number in Fiscal 2008	Number in Fiscal 2016	States' Limits in Fiscal 2016
No Fund/Unreported	7	4	Colorado, Illinois, Kansas, Montana
Dollar Limit	1	2	Arkansas ($125 million), Minnesota ($811 million)
1%-4%	3	2	**Iowa (2.5%)**, Louisiana (4%)
5.0%	11	8	**Delaware**, Kentucky, New Jersey, New York, Rhode Island, South Carolina, Vermont, Wisconsin
6%-9%	7	12	Pennsylvania (6%), Arizona (7%), Indiana (7%), Maryland (7.5%), Mississippi (7.5%), Oregon (7.5%), New Mexico (8%), **North Carolina** (8%), Tennessee (8%), Ohio (8.5%), **Utah** (9%), North Dakota (9.5%)
10%	12	11	Alabama, California, Florida, Hawaii, Idaho, Michigan, **Missouri**, New Hampshire, South Dakota, **Texas**, Washington
11%-20%	3	8	West Virginia (13%), Connecticut (15%), **Georgia (15%)**, Massachusetts (15%), Oklahoma (15%), **Virginia (15%)**, Maine (18%), Nevada (20%)
No Limit	6	3	Alaska, Nebraska, Wyoming
Total	**50**	**50**	

Note: Bold indicates states with "AAA" bond rating from all three rating agencies.

Source: National Conference of State Legislatures; Pew Charitable Trusts

Recessions Also Put Pressure on State Spending

Another concern is that the cost of programs that support the indigent tend to increase during recessions. For example, Medicaid expenditures increased from $4.7 billion to $5.5 billion from fiscal 2007 to 2009. This is a total increase of 17.4% and an annual increase of 8.3%. The changes were even more pronounced as caseloads (excluding Maryland Children's Health Program and Primary Adult Care) increased at an annual rate of 15.4% (33.2% total growth) over the same period. While this period did include a health care expansion, much of this increase was likely due to the economic downturn. This means that even if revenues are fully replaced, they are insufficient since costs are higher. Similar trends were also experienced in the Temporary Cash Assistance program, another component of the State's social safety net. Caseloads increased from approximately 51,400 in fiscal 2008 to 72,200 in fiscal 2011.

Replenishing the Rainy Day Fund

If the Rainy Day Fund balance is less than 7.5% of general funds, the Administration is required to appropriate $50 million (when the balance is less than 3.0%, the minimum appropriation is $100 million). The State also has a sweeper, which requires that the Administration make an appropriation equal to an unassigned general fund end-of-year balance in excess of $10 million. This appropriation is made two years after the unassigned balance is realized.

In fiscal 2017, 7.5% of general fund revenues is $1,281.1 million and 5.0% of revenues is $854.1 million. The $50.0 million minimum appropriation is quite low; $50.0 million is only 3.9% of $1.3 billion. The minimum requirement was set at $50.0 million in 1993. Since it was introduced, the economy and State budget have increased. Inflation has also eroded the value of $50.0 million. The State should consider increasing the minimum Rainy Day Fund appropriation required when the fund balance falls below the 7.5% target.

Recent Rainy Day Fund Uses

Another aspect to examine is the State laws and practices regarding withdrawing funds from the Rainy Day Fund. To transfer funds from the Rainy Day Fund requires specific authorization by an Act of the General Assembly or specific authorization in the budget bill if the transfer results in a Rainy Day Fund balance that is at least 5% of projected general fund revenue. To transfer an amount that would reduce the Rainy Day Fund balance below 5% requires the transfer to be authorized in an Act of the General Assembly other than the budget bill. For fiscal 2017 and 2018 only, transferring any funds out of the Rainy Day Fund require an Act of the General Assembly other than the budget bill.

Recent State Practices Suggest That Maryland Is Not Fully Taking Advantage of Its Rainy Day Fund

Rainy Day Funds were transferred to the General Fund during the first recession after the fund was created. In response to the 1991 recession, the fund was depleted. The General Fund received $127 million in fiscal 1991 and $15 million in fiscal 1992. After the recession, funds were appropriated and funds as a share of general fund revenues increased so that they exceeded 5% by fiscal 1996.

Since fiscal 1996, the end-of-year Rainy Day Fund balance has been at least 5% of general fund revenues each year. The fund balance increased over time, and by fiscal 2001, the end-of-year fund balance was 9% of revenues. To manage cash flows during a recession, funds were transferred to the General Fund and by fiscal 2004 the balance had been reduced to 5% of revenues. Similarly, the fund balance reached 11% of revenues in fiscal 2007 before the Great Recession began. In fiscal 2008, funds were transferred to the General Fund, which reduced the balance to 5% of revenues.

Because the State did not reduce the balance below 5%, the State did not take full advantage of the Rainy Day Fund during the Great Recession. Maryland went into the recession with a balance that was equal to 11% of revenues in fiscal 2007. This balance was quickly spent down to 5%. After reaching the 5% threshold, the State no longer used the Rainy Day Fund.

This approach is different than those taken by other AAA-rated states. When the Great Recession began, there were seven states with AAA ratings from all three major rating agencies (Fitch, Moody's, and Standard and Poor's). In addition to Maryland, the states were Delaware, Georgia, Missouri, North Carolina, Utah, and Virginia. All these states have Rainy Day Funds.

Exhibit 9 shows that three of the states, Georgia, North Carolina, and Virginia, aggressively used their balances to mitigate the short-term effects of the Great Recession. Rating agencies have said that this approach is appropriate. Using the balance from the Rainy Day Fund has not resulted in a loss of AAA ratings for states that have transferred fund balances.

Exhibit 9

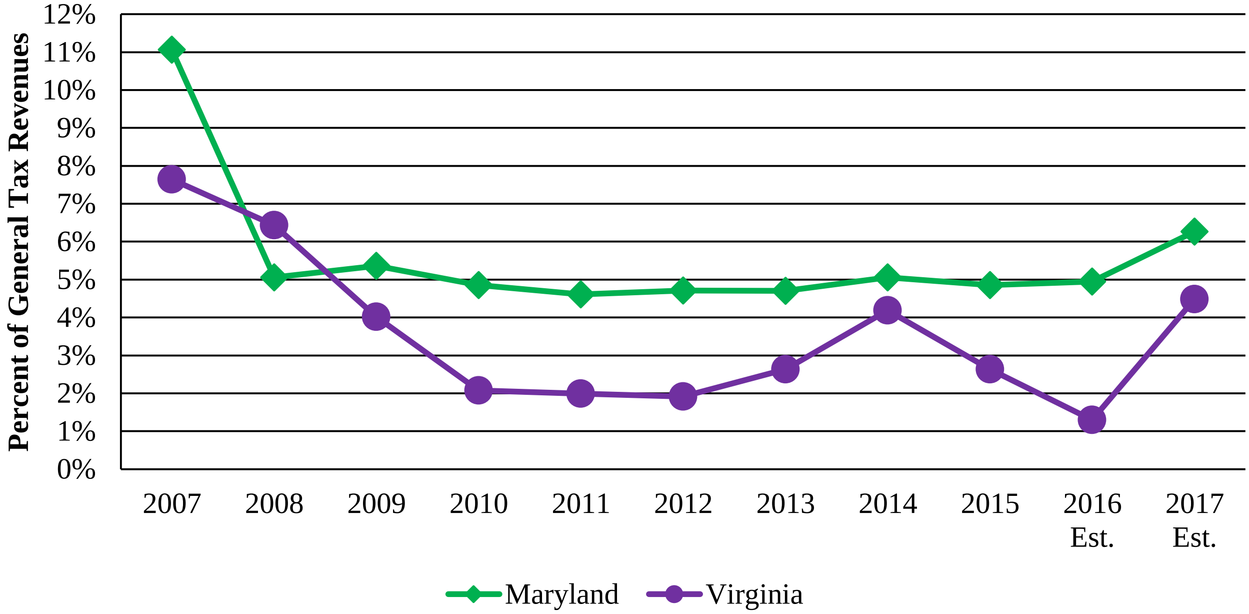
AAA-rated States' Rainy Day Fund Responses to Great Recession

State	Pre-recession Balance	Response to Recession	Assessment
Delaware	5.0% of revenues in fiscal 2007 and 2008	Maintained 5.0% of revenues in fiscal 2009 and 2010	No Rainy Day Fund actions taken
Georgia	9.0% of revenues in fiscal 2007	Withdrew funds and reduced balance to 1.0% of revenues by fiscal 2009	Aggressively used funds to manage recession cash flows
Missouri	7.5% of general fund revenue	Small withdrawals but maintained balance near Statutory limit	No substantial Rainy Day Fund actions taken
North Carolina	4.0% of revenues in fiscal 2008	Withdrew funds and reduced balance to 1.0% of revenues by fiscal 2009	Aggressively used fund to manage recession cash flows
Utah	8.0% of revenues in fiscal 2008	Withdrew funds and reduced balance to 5.0% of revenues in fiscal 2009 and 2010	Moderate use of fund to manage recession cash flows
Virginia	8.0% of revenues in fiscal 2007	Withdrew funds and reduced balance to 2.0% of revenues by fiscal 2010	Aggressively used funds to manage recession cash flows

Source: State Budget Offices; State Legislative Fiscal Offices

Even more recently, the State has not fully taken advantage of the fund. Since fiscal 2006, Virginia's approach has been to withdraw Rainy Day Funds during times of fiscal stress and replenish the fund as the economy improves. **Exhibit 10** shows that Virginia's fund balances have fluctuated from approximately 8% of revenues in fiscal 2007 to 2% by fiscal 2010 and were replenished to reach 4% again in fiscal 2014. Withdrawals were made in fiscal 2015 and 2016. By contrast, Maryland's fund balance has hovered near 5% since fiscal 2008, after an initial withdrawal.

Exhibit 10
Maryland and Virginia's Rainy Day Fund Balances
As a Percent of General Tax Revenues
Fiscal 2007-2017 Est.



Note: Excludes transportation-related tax revenues.

Source: Maryland Department of Budget and Management; Virginia Department of Budget and Planning

How Much Should Be Withdrawn and How Soon Should It Be Withdrawn When Revenues Underattain?

One reason that Maryland does not use the Rainy Day Fund more is that it is concerned about losing its AAA rating if fund balances are too low. Another reason may be that there are not any guidelines concerning the use of the funds. As discussed earlier, the Rainy Day Fund provides revenues sufficient to replace revenues in the first year of a downturn in all recent recessions except the Great Recession. The problem is that revenues did not fully recover in the second year, so additional actions are necessary. It can be difficult to decide when to go into savings if it is unclear how long the State will need to rely on savings.

Providing some guidelines regarding appropriate withdrawal levels could be helpful. One approach could be to develop a policy that limits how much can be withdrawn each year so that there are funds available if the economy recovers slowly. For example, the amount withdrawn cannot exceed the lessor of half of the Rainy Day Fund balance or half of the projected shortfall. Though this approach is unlikely to provide funds sufficient to replace the entire revenue loss during most recessions, it provides short-term support without depleting the fund in the first year. This also provides some relief while the State restructures spending and revenues.

Using the Rainy Day Fund Can Result in Reduced Fund Transfers When Revenues Decline

Instead of using the Rainy Day Fund to manage cash flow, the State has transferred revenues from other funds. Approaches taken include transferring funds from GAAP accounts, transferring funds from special funds, and ending general fund appropriations for some programs. Housing programs no longer receive operating budget support; instead general obligation bonds are authorized. As discussed in more detail in the Public Debt analysis, taxable bonds are issued for housing programs at a greater cost than the tax-exempt bonds generally used for the State's capital program. Special funds dedicated for capital programs, like Program Open Space (POS), were transferred to the General Fund, and were partially repaid through the capital program. Doing this crowds out other capital projects (such as education and State facilities) and also adds to the already significant pressure to continuously increase capital spending. **Exhibit 11** lists these transfers.

Exhibit 11
Fund Balance Transfers to the General Fund
Fiscal 2009-2011
($ in Millions)

Source	Amount	Percent of Total
Local Income Tax Reserve Account	$916.8	34%
Rainy Day Fund Over 5%	405.0	15%
Program Open Space	369.4	14%
Highway User Revenues	263.8	10%
Agencies	262.3	10%
Pay-as-you-go Capital	213.7	8%
Higher Education Fund Balances	179.5	7%
Dedicated Purpose Account and Other Sources	85.4	3%
Total	**$2,695.9**	**100%**

Source: Department of Legislative Services

The legislature has responded to this practice by enacting legislation that restricts the transfer of special funds into the General Fund. Examples include creating a lockbox around the Transportation

Trust Fund (TTF) and requiring the repayment of transfer tax revenues diverted from POS. Chapter 422 of 2013 proposed a constitutional amendment, which was approved by voters in fiscal 2014. The amendment prohibits the transfer or diversion of funds from the TTF to the General Fund or a special fund unless the transfer or diversion is approved through legislation passed by a three-fifths majority of specified full standing committees in each of the two houses of the General Assembly and then enacted into law. The bill creates exceptions to the prohibition on TTF transfers but only if the State is invaded or a major catastrophe occurs and the Governor proclaims a state of emergency and declares that TTF funds are necessary for the immediate preservation of public health or safety. Similarly, Section 13-209 of the Tax-Property Article requires that any transfer tax funds diverted from POS should be reimbursed. In recent years, the State circumvented this by exempting POS transfers from repayment. A concern about these measures is that it results in a loss of flexibility during recessions.

By using the Rainy Day Fund more effectively, there would be less pressure to transfer these funds into the General Fund, though the Rainy Day Fund is not large enough to entirely resolve revenue shortfalls following an economic downturn.

Conclusions

In conclusion, DLS recommends changes to the State's Rainy Day Fund laws and practices. Issues to examine include:

- increasing the $50 million minimum appropriation if the fund balance is less than 7.5% of revenues;

- developing guidelines that encourage the use of the Rainy Day Fund during recessions instead of transferring other fund balances to the General Fund when revenues underattain; and

- considering increasing the 7.5% Rainy Day Fund balance requirement.

DLS recommends that the committees examine how to improve Rainy Day Fund statutes and practices during the 2016 interim so that legislation can be introduced at the 2017 legislative session.

2. Dedicating Unanticipated Revenues to Replenish the Rainy Day Fund or Reduce Unfunded Liabilities

Revenue volatility is a concern. Overestimating revenues shortly before the beginning of a recession, particularly at the height of a revenue bubble, can inflate expectations and make it more difficult to make adjustments during a recession. Another issue is that volatility can lead to a reliance on revenues that decline sharply during recessions, which also makes it more difficult to make adjustments during a recession.

Reducing revenue volatility and transferring excess revenues into a Rainy Day Fund may make it easier to manage recessions by reducing the reliance on one-time revenues and increasing available reserves. DLS has identified two options that can be used to reduce revenue volatility and increase reserves. They are:

- ***Limiting the Nonwithholding Income Tax Revenue Estimate and Transferring Fund to the Rainy Day Fund:*** To deal with volatility in income tax collections, Virginia, in its fiscal 2015 budget, capped the estimate for nonwithheld revenue sources. This involved capping projected nonwithholding collections at the average share to total general fund revenues comprised by that revenue source over a 10-year period. In fiscal 2016, for example, the prior 10-year average was 16.1% of total revenue. Nonwithholding income tax collections include quarterly estimated payments, payments from fiduciaries, and final payments with returns. Nonwithholding income tax revenue tends to be volatile and this approach could provide a cushion by restraining the revenue estimate when this source is growing strongly. An advantage of this approach is that the data is available soon after the fiscal year ends and can easily be calculated before the next legislative session. In years that sources from nonwithholding revenues are above the capped estimate, the State can appropriate a share of this into the Rainy Day Fund; and

- ***Transferring Unanticipated Capital Gains to the Rainy Day Fund:*** Capital gains are among the most volatile revenue sources. From fiscal 2007 to 2009, taxable capital gains declined from $15.6 billion to $3.7 billion. The standard deviation of revenue increases is over eight times greater than that of total general funds. Since this is such a volatile revenue source, this is an excellent candidate to be segregated from ongoing revenues. Since tax year 2014, the Comptroller's Office has been receiving capital gains data from State tax forms. Tax year 2015 data becomes available at the end of calendar 2016. This should be enough time to determine an amount to be transferred in time for the 2017 session and fiscal 2018 budget. This does result in a lag, compared to a collar on nonwithholding income. There will also only be two data points in 2017, which complicates estimating how much is unanticipated.

These excess revenues can be substantial in some years. Another option would be to credit these volatile revenue sources into other accounts with unfunded liabilities, such as employee pensions, other postemployment benefits (retiree health insurance), Local Income Tax Reserve Account, and workers' compensation.

DLS recommends that the committees adopt narrative that requires that the Department of Budget and Management, Comptroller's Office, and DLS examine approaches for calculating unanticipated revenues and dedicating these revenues for the Rainy Day Fund or an unfunded liability. The report should recommend a specific approach that the General Assembly could consider as legislation at the 2017 session.

3. Use of Unassigned General Fund Surplus

Section 7-311 of the State Finance and Procurement Article requires that the Administration appropriate an amount equal to any unassigned general fund balance two years after the balance is realized. For example, fiscal 2008 closed with an unassigned surplus totaling $185.7 million, thus the Administration's fiscal 2010 allowance included a $175.7 million appropriation to the Rainy Day Fund. This appropriation to the Rainy Day Fund is referred to as the "sweeper."

In addition to the sweeper, Section 13-209(g) of the Tax-Property Article requires that any Transfer Tax revenues transferred to the General Fund after fiscal 2005 be repaid starting in fiscal 2012. The only transfer to which this applies was made in fiscal 2006, for $90 million. No part of the $90 million has yet to be paid as mandate relief in budget reconciliation legislation led to no appropriation in fiscal 2012 and funds were cut from the fiscal 2013 allowance to ensure a sufficient general fund balance. Chapter 489 (the BRFA of 2015) delayed the earliest repayment until fiscal 2019.

A third claim on unassigned budget surpluses was added last year. Chapter 489 stipulates that for unassigned balances over $10 million, an amount equal to the first $100 million is split 50/50 between the Rainy Day Fund and the State Pension Fund. Any surplus above $110 million is allocated to the Rainy Day Fund. The Attorney General's Office advises that the Program Open Space transfer takes precedence over the pension sweeper. Repayment of the $90 million transfer tax would occur for any unassigned balance over $110 million at closeout for fiscal 2017. **If there is concern about the priority of payments equal to unassigned balances at closeout, legislation would need to be enacted to reorder how funds are appropriated in fiscal 2019.**

Recommended Actions

1. Adopt the following narrative:

   Review of General Fund Revenue Volatility: The Department of Legislative Services, Comptroller's Office, and Department of Budget and Management should examine approaches for calculating unanticipated revenues and dedicating these revenues to either the Rainy Day Fund or an unfunded liability. The review should include nonwithholding income tax revenues and capital gains tax revenues. The agencies should submit a report to the budget committees by November 1, 2016. The report should recommend an approach and offer legislation that can be considered during the 2017 legislative session.

Information Request	Authors	Due Date
Review of General Fund Revenue Volatility	DLS DBM Comptroller's Office	November 1, 2016

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
State Reserve Fund
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2015					
Legislative Appropriation	$19,714	$0	$0	$0	$19,714
Deficiency Appropriation	0	0	0	0	0
Cost Containment	-4,928	0	0	0	-4,928
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	**$14,786**	**$0**	**$0**	**$0**	**$14,786**
Fiscal 2016					
Legislative Appropriation	$200,000	$0	$0	$0	$200,000
Budget Amendments	-118,565	0	0	0	-118,565
Working Appropriation	**$81,435**	**$0**	**$0**	**$0**	**$81,435**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

Fiscal 2015

Reductions to the fiscal 2015 appropriation were taken in January 2015. The Board of Public Works reduced the Rainy Day Fund appropriation by $4.9 million.

Fiscal 2016

The fiscal 2016 appropriation totals $200.0 million, $50.0 million for the Rainy Day Fund and $150.0 million for the Dedicated Purpose Account. Dedicated Purpose Account budget amendments transfer funds to State agencies, specifically:

- budget amendment 001-16 transferring $68.7 million to agency budgets to restore a 2% general salary increase given to State employees in January 2015; and

- budget amendment 002-16 transferring an additional $49.9 million to agency budgets consistent with Section 48 of the Budget Bill.

Fiscal Summary
State Reserve Fund

Program/Unit	FY 15 Actual	FY 16 Wrk Approp	FY 17 Allowance	Change	FY 16 - FY 17 % Change
01 Revenue Stabilization Account	$ 14,785,500	$ 50,000,000	$ 235,335,792	$ 185,335,792	370.7%
02 Dedicated Purpose Account	0	31,435,000	0	-31,435,000	-100.0%
Total Expenditures	**$ 14,785,500**	**$ 81,435,000**	**$ 235,335,792**	**$ 153,900,792**	**189.0%**
General Fund	$ 14,785,500	$ 81,435,000	$ 235,335,792	$ 153,900,792	189.0%
Total Appropriations	**$ 14,785,500**	**$ 81,435,000**	**$ 235,335,792**	**$ 153,900,792**	**189.0%**

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.

Appendix 3

Revenue Stabilization Account (Rainy Day Fund)
Section 7-311 State Finance and Procurement Article

Account Characteristics

- ***Purpose:*** The account was established in 1986 to retain State revenues to meet future short-term funding needs and to reduce the need for future tax increases by moderating revenue growth.

- ***Appropriations:*** The account consists of direct appropriations in the budget bill and interest earned from all reserve fund accounts.

- ***Required Appropriations If Account Balance Is Less Than 7.5% of General Fund Revenues:*** Current law requires that if the fund balance is between 3.0% and 7.5% of projected general fund revenues, annual appropriations of at least $50.0 million must be made until the account balance reaches 7.5% of estimated general fund revenues. If the account balance is below 3.0%, State law requires an appropriation of at least $100.0 million.

- ***Sweeper Provision:*** State law requires that the Administration appropriate an amount equal to any unassigned general fund balance at closeout in excess of $10.0 million into the Rainy Day Fund. This appropriation is made to the budget two years after the unassigned general fund surplus is realized. For example, fiscal 2008 closed with an unassigned surplus totaling $185.7 million, thus the Administration's fiscal 2010 allowance included a $175.7 million appropriation to the Rainy Day Fund. This appropriation to the Rainy Day Fund is referred to as the "sweeper." The Budget Reconciliation and Financing Act of 2015 (Chapter 489) amended the sweeper requirement so that the Rainy Day Fund receives 50% of any unassigned general fund surplus over $10 million for fiscal 2017 to 2020 up to $110 million, and any amount above $110 million. One-half of the surplus between $10 million and $110 million is appropriated to reduce the State's unfunded pension liability.

- ***Transfer Tax Repayment:*** Section 13-209(g) of the Tax-Property Article requires that any Transfer Tax revenues transferred to the General Fund after fiscal 2005 be repaid starting in fiscal 2012. The only transfer to which this applies was made in fiscal 2006, for $90 million. No part of the $90 million has yet to be paid as mandate relief in budget reconciliation legislation led to no appropriation in fiscal 2012 and funds were cut from the fiscal 2013 allowance to ensure a sufficient general fund balance. The fiscal 2015 Budget Reconciliation and Financing Act delayed the earliest repayment until fiscal 2019.

Mechanisms for Transferring and Spending Funds

Except for fiscal 2017 and 2018, to transfer funds from the Rainy Day Fund requires specific authorization by an Act of the General Assembly or specific authorization in the budget bill if the transfer results in a Rainy Day Fund balance that is at least 5% of projected general fund revenue. To transfer an amount that would reduce the Rainy Day Fund balance below 5% requires the transfer to be authorized in an Act of the General Assembly other than the budget bill. The use of any balance below 7.5% requires separate legislation for fiscal 2017 and 2018.

Rainy Day Fund Activity

The following table illustrates fiscal 2013 through 2017 activity in the Rainy Day Fund. Appropriations totaling $27.8 million in fiscal 2013 and $55.3 million in fiscal 2014 were made to ensure a minimum 5.0% fund balance. The Budget Reconciliation and Financing Act of 2012 authorized the transfer of $5.0 million to fully fund Teacher Retirement Supplemental grants. In fiscal 2015, the Board of Public Works withdrew $4.9 million of the appropriation to the fund. This amount is withdrawn because the Administration anticipates that this is the amount above the 5.0% fund balance target. The fiscal 2017 allowance includes the required sweeper appropriation, which totals $235.3 million. The end of fiscal 2017 balance is projected to be 6.3% of ongoing general fund revenues.

Revenue Stabilization Account Status
Fiscal 2013-2017 Est.
($ in Millions)

	2013	2014	2015	2016 Est.	2017 Est.
Beginning Balance	**$671.5**	**$700.4**	**$763.6**	**$773.5**	**$831.5**
Appropriation	27.8	55.3	19.7	50.0	235.3
BPW Reduction	0.0	0.0	-4.9	0.0	0.0
Transfer to BPW Contingent Fund	0.0	0.0	-13.1	0.0	0.0
Fund Projects and Programs	-5.0	0.0	0.0	0.0	0.0
Interest Earnings	6.1	7.9	8.1	8.1	16.1
Ending Balance	**$700.4**	**$763.6**	**$773.5**	**$831.5**	**$1,083.0**

BPW: Board of Public Works

Note: Numbers may not sum due to rounding.

Source: Department of Budget and Management, January 2016

Governor's Out-year Forecast

In the out-years, the Administration's Rainy Day Fund forecast projects that the fund balance increase to 7.0% through fiscal 2021. Since the fund balance is projected to be less than 7.5% of general fund revenues, a minimum $50 million appropriation is assumed from fiscal 2018 to 2021. The Adminstration's plan is to keep these appropriations in the fund. Fiscal 2021 ends with an estimated balance of $1,384 million.

Appendix 4

Dedicated Purpose Account
Section 7-310 State Finance and Procurement Article

Account Characteristics

- ***Purpose:*** The account was established in 1986 to retain appropriations for major, multi-year expenditures where the magnitude and timing of cash needs are uncertain and to meet expenditure requirements that may be affected by changes in federal law or fiscal policies, or other contingencies.

- ***Appropriations:*** The account consists of direct appropriations in the budget bill committed to a specific purpose. Interest earnings generated by the account are credited to the Rainy Day Fund.

- ***Other:*** The unspent balance of an appropriation reverts to the Rainy Day Fund four years after the end of the fiscal year for which the appropriation was made.

Mechanisms for Transferring and Spending Funds

To transfer funds from the Dedicated Purpose Account (DPA):

- funds may be reflected in the State budget subject to appropriation;

- after submission to the budget committees and review and approval by the Legislative Policy Committee (LPC) funds may be transferred by budget amendment to the appropriate Executive Branch agency; or

- the Governor may declare appropriations to the DPA surplus and may transfer funds by budget amendment to the Rainy Day Fund following review by the budget committees and LPC.

Dedicated Purpose Account Activity

The following table illustrates the activity in the DPA from fiscal 2013 through 2017. The account ends the period with no fund balance. In fiscal 2013, $10 million was appropriated to offset lost revenues attributable to federal sequestration. Funds were transferred in fiscal 2014 to the following agencies: $4.1 million to Maryland State Department of Education (MSDE) Head Start programs, $1.6 million to Department of Health and Mental Hygiene substance abuse programs, $1.4 million for Department of Aging nutrition and employment support, $1.2 million to support Department of Human Resources social service block grants, $0.8 million to support MSDE vocational rehabilitation services, $0.5 million to support Department of Labor, Licensing, and Regulations (DLLR) training and job placement programs, and $0.4 million to support DLLR adult education programs.

In fiscal 2016, $152.5 million is appropriated. This includes $140.0 million to fund legislative priorities, $10.0 million to reduce an unfunded liability in the Local Income Tax Reserve Account, and $2.5 million for information technology upgrades. In fiscal 2016, $118.6 million was restored and the remaining $21.4 million will revert to the General Fund. Information technology upgrades are expected to be made in fiscal 2017.

Dedicated Purpose Account Status
Fiscal 2013-2017
($ in Millions)

	2013	2014	2015	2016	2017
Beginning Balance	**$0.0**	**$10.0**	**$0.0**	**$0.0**	**$2.5**
Appropriation:	**$10.0**	**$0.0**	**$0.0**	**$152.5**	**$0.0**
Information Technology Upgrades				2.5	
Local Income Tax Reserve Repayment				10.0	
Section 48 Appropriations Restored by Administration				140.0	
Transfers:	**$0.0**	**-$10.0**	**$0.0**	**-$150.0**	**-$2.5**
Local Reserve Account Repayment				-10.0	
Federal Sequestration		-10.0			
Information Technology Upgrades					-2.5
Section 48 Initiatives Funded by Administration				-118.6	
General Fund Reversion				-21.4	
Ending Balance	**$10.0**	**$0.0**	**$0.0**	**$2.5**	**$0.0**

Source: Department of Budget and Management, January 2016

Governor's Out-year Forecast

The Administration does not have any plans to appropriate any funds into the DPA through fiscal 2021.

Appendix 5

Catastrophic Event Account
Section 7-324 State Finance and Procurement Article

Account Characteristics

- ***Purpose:*** The account was established in 1990 to enable the State to respond quickly to a natural disaster or catastrophe that could not be addressed within existing State appropriations.

- ***Appropriations:*** The account consists of direct appropriations in the budget bill. Interest earnings generated by the account are credited to the Rainy Day Fund.

Mechanisms for Transferring and Spending Funds

Prior to transferring funds by budget amendment to the appropriate Executive Branch agency, the Administration must notify the Legislative Policy Committee of the proposed amendment and allow the committee 45 days to review and approve the proposed amendment.

Catastrophic Event Purpose Account Activity

The following table shows that the account's balance was $1,000,000 at the start of fiscal 2013. In fiscal 2013, $432,313 was transferred to provide relief for victims of Hurricane Sandy and the Derecho Storm. In fiscal 2014, $394,750 was provided to support the Military Department's deployment during severe snowstorms in February 2014. In fiscal 2016, the Administration's budget includes a $10,000,000 deficiency appropriation. The account is expected to close fiscal 2017 with a $10,172,937 balance.

Catastrophic Event Account
Fiscal 2013-2017
($ in Thousands)

	2013	2014	2015	2016 Est.	2017 Est.
Beginning Balance	**$1,000**	**$568**	**$173**	**$173**	**$10,173**
Appropriation	0	0	0	10,000	0
Snowstorms	0	-395	0	0	0
Hurricane Sandy and Derecho Storm Relief	-432	0	0	0	0
Ending Balance	**$568**	**$173**	**$173**	**$10,173**	**$10,173**

Source: Department of Budget and Management, January 2016

Department of Human Resources

Local Department Operations

Report Dated July 24, 2015

Audit Overview

- Local Department Operations (LDO) is one of seven budgetary units in the Department of Human Resources (DHR). It consists of funds for activities (e.g., Temporary Cash Assistance) administered by the 24 local departments of social services (LDSS).
- The LDO's fiscal year 2014 expenditures totaled approximately $2.2 billion, which included $1.7 billion in assistance program expenditures and $500 million in operating expenditures (primarily employee salaries and benefits).
- State law requires DHR to audit each LDSS every three years. Audits are performed by DHR's Office of the Inspector General (OIG). OLA reviewed this work and concluded that it could be relied upon, and thus we did not conduct audits of the LDSSs.
- The prior OLA audit report contained 6 findings, and our current audit disclosed that 1 was satisfactorily addressed by DHR. The remaining 5 findings are repeated in this report as Findings 1, 4, 5, 7 and 8, based on our review of OIG's LDSS audits.

Key Audit Issues

- The audit reports issued by the OIG indicated that the LDSSs continued to have a significant number of audit deficiencies in critical areas of operations, including a number of repeat findings. We summarized the findings contained in the most recently issued OIG audit report for each of the 24 LDSSs as of December 31, 2014, and grouped the findings into one of five critical functional areas.

- DHR's executive management had not established a formal process to provide oversight and monitoring to help ensure that the findings were corrected.

- The OIG's corrective action monitoring process was not effectively followed to help ensure that findings were corrected, and the OIG did not distribute its LDSS reports to all appropriate governing authorities and to local oversight boards, as required by State law.

Key Audit Issues

Overview of the 299 OIG Findings by Functional Area
(Reports Issued as of December 2014)

Functional Area	Number of	
	LDSSs	Findings
Fiscal Management (e.g., bank accounts and procurement)	23	97
Family Investment Administration (e.g., Supplemental Nutrition Assistance Program)	22	70
Social Services Administration (e.g. out of home placement program)	19	63
Computer Systems Security (e.g., access to benefit systems)	21	40
Other (e.g., Medicaid eligibility determinations)	16	29

OIG Audit Findings and Oversight

DHR executive management had not established a formal process to provide oversight and monitoring of LDSS corrective actions, which if in place, could help ensure that audit findings are addressed **(Finding 1)**.

The 24 LDSSs OIG audit reports issued as of December 2014 contained a significant number of deficiencies in five critical areas, including a number of repeat findings.

- OIG audit reports collectively contained 299 findings, including 89 deemed to be repeat conditions from the preceding OIG reports. The number of findings in each report ranged from 5 (two LDSS) to 30 (one LDSS), with five reports containing at least 20 findings.

- While the number of findings has decreased (from 373) since our preceding audit report, the number deemed by the OIG to be repeated has increased (from 77).

OIG LDSS Audit Report Related Processes

- The OIG had a corrective action monitoring process for the LDSS findings, but it was not effectively followed to help ensure that corrective actions were taken and that DHR executive management was provided periodic LDSS progress reports, as required (Finding 2).

  For example, OLA's review of the actions taken by 5 LDSSs to address 106 OIG findings disclosed 36 findings that the OIG either determined the finding had been resolved based on insufficient evidence or did not adequately follow-up to obtain information when not provided by the LDSS.

- OIG reports were not distributed to the members of the applicable City or county council and to the LDSS oversight boards, as required by State law (Finding 3). Further, the OIG's audit reports were not available to the public through DHR's website. Although not required nor precluded by law, OLA believes public reporting would provide greater transparency and could result in increased LDSS accountability.

LDSS Audit Findings by Critical Area

Fiscal Management

The OIG reports for 23 LDSSs contained 97 findings pertaining to fiscal management such as bank accounts, procurement, and prepaid gift cards **(Finding 4)**. For example:

- Bank accounts maintained by the LDSSs to pay for certain administrative and program expenditures were not reconciled timely and had outstanding checks for extended periods.
- State procurement regulations were not always followed. For example, payments were made to vendors without written contracts and formal procurement processes were circumvented.
- Accountability of prepaid gift cards (provided to recipients in urgent need of support) was not established, as physical inventories of gift cards were not documented.

LDSS Audit Findings by Critical Area (continued)

Family Investment Administration (FIA)

The OIG reports for 22 LDSSs contained 70 findings related to FIA programs including the Supplemental Nutrition Assistance Program (SNAP) and Temporary Cash Assistance (TCA) **(Finding 5).** For example:

- Critical duties were not properly segregated for the electronic debit cards used by recipients to access SNAP and TCA benefits. As a result, there was a lack of assurance that the benefits were being used by the intended recipient(s).

- The required number of public assistance case files were not subject to supervisory review, in accordance with FIA quality assurance policies. These reviews help ensure the accuracy and the propriety of assistance payments and reduce errors.

FY 2014 SNAP disbursements were $1.2 billion (federal) and TCA payments were $203 million (federal and State).

LDSS Audit Findings by Critical Area (continued)

Social Services Administration (SSA)

The OIG reports for 19 LDSSs contained 63 findings related to SSA activities, primarily related to the out-of-home placement and adoption programs (**Finding 6**). For example:

- Out-of-home placement program case files did not always have documentation that a caseworker had monthly contact with the child, as required, so there was a lack of assurance that all services were provided. The program provides short-term care and support to children who are unable to live at home because of abuse/neglect.
- Adoptions expenses were paid without any documented support justifying the expenditure and without obtaining partial reimbursement from federal funding.

As of June 2014, there were 5,339 children in the out-of-home placement program and 337 adoption cases, and FY 2014 expenditures totaled $303 million.

LDSS Audit Findings by Critical Area (continued)

<u>Computer Systems Security</u>

OIG reports for 21 LDSSs contained 40 findings related to computer systems security for critical systems, such as the system used to record, authorize, and disburse SNAP and TCA benefits **(Finding 7)**. For example:

- Controls over granting of user access to critical systems needed improvement, as documents authorizing employee access were missing or not completed, and certain employees had access capabilities that were not required for their duties.
- Employees' assigned access capabilities were not properly monitored. Logonids of certain former employees were not deleted and employee access was not periodically reviewed for appropriateness.

Based on these conditions, assurance was lacking that employee access was necessary and appropriate and unnecessary system access could result in unauthorized changes to data without detection.

Medicaid Eligibility Determinations

Medicaid eligibility determinations for long-term care recipients were not always proper (Finding 8) .

- Through an interagency agreement between DHR and the Department of Health and Mental Hygiene, the LDSSs perform the eligibility determination for the majority of Medicaid recipients.

- The OIG conducted a review of the Medicaid long-term care eligibility determinations at the Anne Arundel County, Baltimore City, Baltimore County, and Prince George's County LDSSs.

- In its July 2014 report, the OIG noted that cases could not be located, eligibility documentation was missing, and real property searches were not conducted to assist in determining whether financial resources were within the limits established by State regulations. For example, OIG's review of 42 case files disclosed 12 cases with inadequate eligibility determinations or lien documentation.

Conclusions

DHR, including the Office of the Secretary and the management of the DHR administrations, as applicable, should:

- establish a process to actively monitor corrective actions taken to address OIG audit findings;
- ensure that the OIG's corrective action monitoring process is effectively followed;
- distribute the OIG audit reports to all appropriate parties;
- ensure that the LDSSs establish appropriate accountability and controls over their financial processes and information systems;
- ensure that the LDSSs comply with all FIA and SSA program requirements; and
- ensure that the LDSSs properly perform Medicaid long-term care eligibility determinations.

Department of Public Safety and Correctional Services Office of the Secretary and Other Units

Report Dated November 18, 2015

Audit Overview

- The Office provides overall executive direction and coordination for the activities of the operating units of DPSCS and provides central support services, oversight, and accountability to those units.

- The Office also has statewide responsibility for the supervision and rehabilitation of incarcerated and paroled individuals. The Office absorbed certain functions from the Division of Parole and Probation (DPP) after DPP ceased to exist as a budgetary unit following a departmental reorganization effective July 1, 2012.

- In FY 2014, The Office's expenditures totaled approximately $218 million.

- The audit report included 9 findings, 2 of which (Findings 7 and 9) were repeated from the preceding audit reports of the Office and the DPP.

Key Audit Issues

- Issues were found with the procurement and oversight of various contractual agreements, as the Office structured an inmate services procurement in a way that may have limited competition, resulting in only one contractor bidding on the contract.
- The Office augmented its information technology staff beyond its budgeted positions through an interagency agreement with a State university, and did not assess liquidated damages totaling $840,000 against an inmate health care contractor when required staffing levels were not met for fiscal years 2013 and 2014.
- Security and control deficiencies were noted over the Office's new Offender Case Management System (OCMS), as the Office did not ensure that certain inmate release date information was transferred to OCMS and certain sensitive personally identifiable information was not appropriately safeguarded.

Inmate Services Procurement

- The Office structured an inmate services procurement in a manner that may have limited competition, resulting in only one contractor bidding on the contract, and did not ensure the State received the best value **(Finding 1).**

  - The Office combined into a single contract, the procurement of three unrelated goods and services, including (1) commissary operations (a revenue producing contract), (2) the design and implementation of an inmate banking information technology system (MOBSII), and (3) the procurement of inmate welfare kits.

  - The sole bidder was not required to identify the MOBSII development costs, but rather to present proposed commissary rates net of those costs. Consequently, the Office was estimated to receive $17.3 million in commissions over the full 5 year contract term, but the true expected commissary revenue and MOBSII costs were unknown.

Inmate Services Procurement (continued)

- The Office did not consult with the Department of Information Technology (DoIT) to determine if the MOBSII development project should have been subject to its oversight. DoIT advised OLA that because the costs were unknown it could not conclude if it should have been involved.
- The contract had no provisions for liquidated damages to protect the State's interest in the event MOBSII requirements were not meet. When launched in August 2014, MOBSII could not provide the required system reports needed for DPSCS facilities to perform inmate bank account reconciliations.
- The contract included the purchase of inmate welfare kits, which were available under a State procurement preference from Blind Industries and Services. This purchase from a private vendor and the related costs were not clearly conveyed when presented to the Board Public Works.

Interagency Agreement

- The Office entered into interagency agreements with a unit of a State University that enabled the Office to augment its information technology staff beyond its budgeted positions and enhance related salaries. Also, the work performed by these contractual employees did not appear consistent with the unit's mission (Finding 2).

  - This arrangement has existed for a number of years, and the FY 2015 agreement effectively created an additional 30 positions, at a cost of $3.4 million, beyond the 214 positions authorized in the budget for the Office's Information Technology and Communications Division (ITCD).

  - These university employees were integrated into the ITCD organizational and management structure, and OLA observed them functioning as regular ITCD personnel with similar roles and responsibilities.

Interagency Agreement (continued)

- ITCD advised that the agreements allowed ITCD to hire staff at enhanced salaries. The university performed no oversight or monitoring of these employees and its involvement was generally limited to hiring the employees and paying their salaries. ITCD was responsible for the employees' daily oversight, including assigning projects and tasks, and employees completed university timesheets, which were approved by their ITCD supervisors.
- The services provided by the university unit did not appear to directly relate to its mission, which was to support science-based crime-related initiatives. The FY 2015 agreement described the services as relating to assisting ITCD with 5 major IT projects.
- ITCD management advised these services were outside the unit's normal mission, but the agreement allowed ITCD to obtain IT employees at salaries higher than DPSCS salaries and to expand and contract for its staff as needed.

Inmate Mental Healthcare Contract

- The Office did not assess liquidated damages against its inmate mental healthcare contractor when required staffing levels were not met and the Office authorized an increase in staffing levels without a formal contract modification or seeking required Board of Public Works (BPW) approval **(Finding 3).**

  - The inmate health services contract required certain monthly staffing levels and provided for liquidated damages if those levels were not met; however, damages were not assessed. For example, the Office did not asses damages, estimated at $840,000, for staffing levels that were not met at individual service delivery areas for October 1, 2012 through June 30, 2014.

  - The Office authorized additional staffing services beginning in November 2012, but did not prepare a formal contract modification nor seek BPW approval until April 2014. The additional services were estimated to cost $1.1 million through June 30, 2017.

Offender Case Management System (OCMS)

- The Office did not ensure that the correct Division of Correction inmate release date information was transferred to its current Offender Case Management System (OCMS) from the preceding system (OBSCIS I), and testing disclosed that almost 2,500 release date discrepancies between the two systems had not been resolved **(Finding 4).**

  During the audit, we were advised that the discrepancies would not be individually researched and resolved. Rather, the Office would continue to rely on a manual release date review process prior to each inmate's scheduled release.

OCMS (continued)

- Sensitive personally identifiable information (PII) in OCMS was not appropriately safeguarded, as PPI was stored in clear text for 370,067 individuals and was not protected by other substantial mitigating controls **(Finding 5).**

- Account, password, and monitoring controls over OCMS were not sufficient **(Finding 6).** For example, account lockout for repeated unsuccessful logon attempts did not exist and password length, complexity, aging, history, and sharing provisions did not meet minimum requirements of the State of Maryland *Information Security Policy*.

Other Issues

- The Office had certain control deficiencies over fines, costs, fees, and restitution (FCFR).
  - The Office did not adequately reconcile its cash balance of FCFR funds with the State's accounting records **(Finding 7).**
  - The Office had not established adequate procedures and controls over refunds made to offenders for FCFR overpayments and changes to restitution recipient addresses. Output reports of these transactions were not reviewed for propriety **(Finding 8).**
- Equipment maintained by the Office's ITCD was not adequately controlled, including a failure to periodically reconcile its control account and detail records and report missing equipment valued at $3.2 million that had not been located from 1 to 7 years **(Finding 9).**

Conclusions

The Office should

- ensure future procurements are structured to promote maximum competition, comply with State law when purchasing supplies available from preferred vendors, and consult with DoIT on future IT projects;
- refrain from entering into interagency agreements to augment its budgeted positions;
- assess liquidated damages to the extent permitted;
- investigate OCMS inmate release date discrepancies, take the recommended actions to ensure data transfers are properly controlled, and improve information systems security and controls; and
- improve controls over FCFR transactions and equipment inventory.

Department of Legislative Services
Office of Legislative Audits

Maryland Health Benefit Exchange
Fiscal Compliance Audit

Report Dated October 2, 2015

Audit Overview

- The Maryland Health Benefit Exchange (MHBE) was created by the Maryland Health Benefit Exchange Act of 2011 as a public corporation and independent unit of state government to implement certain federal legislation. The primary purpose of MHBE is to reduce the number of Maryland residents who have no health insurance.

- The Act mandated a 9-member board be responsible for governing and managing MHBE. Board members include the Secretary of the Department of Health and Mental Hygiene (DHMH), the Maryland Insurance Commissioner, the Executive Director of Maryland Health Care Commission, and 6 persons appointed by the Governor.

- MHBE is exempt from a number of State rules and regulations, including procurement and inventory control. The Board is responsible for establishing various policies and procedures governing MHBE operations.

Audit Overview (continued)

- MHBE worked with DHMH, the Department of Human Resources, and the Maryland Insurance Administration to establish Maryland's state-based health insurance exchange. The original exchange system launched October 1, 2013 and after a troubled launch was replaced with the State of Connecticut's system retrofitted for Maryland needs. The replacement exchange system was implemented in November 2014.

- MHBE's expenditures from July 1, 2011 to June 30, 2014 totaled approximately $264.3 million (State funds $29.0 million and federal funds $235.3million). Expenditures during the period related primarily to Information Technology development, outreach and consumer assistance, and agency operations necessary to implement the state-based health insurance exchange.

- This is OLA's first audit of MHBE (for the period beginning June 1, 2011 and ending July 23, 2014) and the audit report included 10 findings.

MHBE Performance Audit

- The fiscal compliance audit was conducted concurrently with an Office of Legislative Audits performance audit of the troubled launch of the original Exchange System at the direction of the Maryland General Assembly's Joint Audit Committee to address concerns of the Joint Oversight Committee on the Maryland Health Benefit Exchange.

- The audit report on the results of the performance audit has not yet been issued due to concerns raised by the Office of the Attorney General.

- Although during the fiscal compliance audit we reviewed and tested MHBE contracts for procurement and monitoring, we specifically excluded 13 contract awards totaling $209.0 million that pertained exclusively to the development of the original Exchange System. Those results are not included in these findings or presentation.

Key Fiscal Compliance Audit Issues

- MHBE did not comply with its procurement policy when purchasing certain goods and services under the sole source and emergency procurement methods.
- MHBE made certain payments for contractual services without routinely obtaining or evidencing its review of documentation supporting vendor billings.
- MHBE did not verify that 6 entities receiving grants totaling $23.4 million during FY 2014 had spent the funds for appropriate purposes.
- Several security and control issues were noted regarding MHBE's information systems.

Federal Audit of MHBE

- Federal Audit on Establishment Grant Funds
  - A federal Department of Health and Human Services Inspector General's audit report issued in March 2015, concluded that DMHM, which processes grant allocation and reimbursements for MHBE, did not allocate $28.4 million in costs to establishment grants and Medicaid funding in accordance with federal requirements and its cost allocation plan.
  - The audit recommended MHBE refund the $28.4 million, however with federal approval, MHBE would be allowed to claim a portion of costs through the Medicaid program.
  - MHBE disagreed with the finding. As of our report date, the issue, including MHBE reimbursement to the federal government was unresolved. Depending upon how it is resolved, additional State funds may be needed to cover past costs.

Procurement

- MHBE did not comply with its procurement policy when purchasing certain goods and services under the emergency and sole source methods. Also, MHBE did not always retain relevant procurement documentation **(Finding 1)**.
  - For two sole source contracts, totaling $5.9 million, the sole source justification did not substantiate that only one vendor was available to provide services as required by MHBE policy.
  - Another contract totaling $1.6 million and a task order under another contract for $1.2 million included five and four-year terms, respectively, even though they were made under the emergency procurement method, which MHBE policy states shall not be used to meet long-term requirements.
  - For all 5 contracts tested, sufficient documentation relating to the MHBE Board's approval process was lacking and MHBE could not provide certain relevant documentation such as documentation to support negotiation of pricing and contract terms.

Disbursements and Grants

- MHBE made certain payments for contractual services without routinely obtaining or evidencing its review of documentation supporting vendor billings **(Finding 2)**. For example, our test of 15 payments totaling $18.1 million to 5 vendors between November 2013 and August 2014 found MHBE did not receive adequate documentation, such as time records, to support 8 payments made to 3 vendors totaling $8.2 million.

- MHBE had not verified the propriety of grant expenditures for 6 entities related to the Connector Program, which totaled $23.4 million in FY 2014 ($9 million in general funds and $14.4 million in federal funds) **(Finding 3)**. Although the entities submitted quarterly expenditure reports, MHBE did not have a process in place to verify the propriety of expenditures being reported. Specifically, detailed support for expenditures was not obtained and reviewed.

Information Systems (IS) Security & Control

- MHBE inappropriately stored sensitive personally identifiable information (PII) and federal tax information (FTI) in clear text **(Finding 7)**. For example, as of April 28, 2015, the replacement Exchange System database contained sensitive PII and FTI for 591,858 individuals in clear text. This included, but was not limited to, full name, date of birth, social security number, and household income.

- Administrative access to the MHBE network was excessive and access to critical replacement Exchange System files was not properly restricted **(Finding 8)**. For example, many users could perform critical functions that were not needed to perform their job duties, including 55 accounts assigned to 50 unique users that were improperly classified as domain administrators. Also, access to certain enrollment and report files, containing unencrypted sensitive PII, was not properly restricted.

IS Security & Control (continued)

- MHBE lacked assurance as to the security over critical data on servers hosted by contractors (Finding 9).
  - MHBE lacked assurance that the original Exchange System servers still in the custody of the parent company of the primary contractor were properly secured. These servers hosted enrollment data containing sensitive PII and FTI.
  - The contract between MHBE and the contractor responsible for hosting the network and servers for the replacement Exchange System did not provide adequate assurances that the network and servers were properly secured. The contract did not require that the independent security review be structured to provide proper assurances with respect to controls addressing for example, security, availability, and confidentiality.
- The MHBE network was not properly secured at the hosting datacenter for the replacement Exchange System (Finding 10) as required by the State's *Information Security Policy*.

Other Findings

- Federal fund reimbursements requests were not made timely resulting in a loss of interest income of $199,000 (**Finding 4**).
- MHBE did not maintain adequate inventory records nor properly account for its equipment (**Finding 5**).
  - An equipment inventory control account was not maintained as required by MHBE policy.
  - MHBE could not provide complete detailed records for its equipment at locations other than its headquarters and could not provide a total value of all equipment owned. We reviewed four major contracts that included purchase of approximately $48.4 million in equipment by MHBE.
  - MHBE did not establish a process to ensure hardware purchases from April 2012 to December 2013 totaling $33 million were actually provided by the vendor prior to payment.
- The MHBE Board was found to have violated the State's Open Meetings Act (**Finding 6**).

Conclusions

MHBE should

- ensure its procurement policies and requirements are followed for sole source and emergency purchases and retain relevant documentation;
- obtain and review documentation to support vendor billings for labor hours;
- establish procedures to verify grant expenditures were proper;
- take the recommended actions to improve security and controls over its information system;
- ensure future requests for federal fund reimbursements are made in a timely manner;
- establish procedures and properly maintain its equipment records, to account for and control its equipment inventory; and
- ensure future compliance with the Open Meetings Act.

Department of Legislative Services
Office of Legislative Audits

Performance Audit

Certain Operational Aspects of the Blind Industries and Services of Maryland

Report dated February 1, 2016

Audit Request

- The Joint Audit Committee directed the Office of Legislative Audits (OLA) to conduct an audit of certain operational aspects of the Blind Industries and Services of Maryland (BISM).

- The audit objectives included an evaluation of BISM's
  - employment and training policies and practices,
  - State vendor preference, and
  - executive compensation.

BISM - Background

- BISM was established in 1908 as Maryland Workshop for the Blind by the General Assembly to provide vocational rehabilitation, employment, and other resources to blind adults of Maryland.

- BISM is a nonprofit organization that conducts manufacturing and retail operations and provides employment for blind persons in Maryland and other states, and provides rehabilitation and training programs primarily to blind adults of Maryland.

- BISM's mission is to "provide stable career opportunities, innovative rehabilitation programs, quality products and services, and to develop resources for training and education."

BISM - Business Operations

- BISM 's revenue is primarily derived from product sales, which totaled $84 million during FY 2015.
  - $47.1 million textile sales to the federal government
  - $20.4 million retail sales at federal installations
  - $10.5 million sales to State agencies
  - $6.0 million sales to private entities

- To help support rehabilitation and training services costing $1.58 million during FY 2015, BISM also received funding from the State consisting of:
  - $581,000 in grants, and
  - $295,000 in fee-for-service payments.

- As of June 30, 2015, BISM employed 578 associates (216 blind and 362 sighted) working at locations within and outside of Maryland.

BISM – Rehabilitation and Training

- The Rehabilitation Division provides rehabilitation and life skills training throughout Maryland to the blind and visually-impaired that leads to self-reliance and independence.

- As of June 30, 2015, the Division had a staff of 27 persons.

- During FY 2015, BISM provided a total of 71,462 hours of education and training to 768 persons.

- Most BISM clients are referred by the Maryland State Department of Education – Division of Rehabilitation Services.

BISM – State Procurement Preferences

- BISM has two procurement preferences established by State law.

  - A State or State aided or State controlled entity shall buy supplies and services available from BISM, unless they are available from the Maryland Correctional Enterprises.

  - To the extent practicable, for State contracts that include housekeeping or janitorial services, the prime contractor and its subcontractors must procure janitorial products from BISM, when available.

- Current State law further requires that the prices to be charged under the preferences shall be set by a committee consisting of five State officials, and should reflect fair market prices, which by regulation is defined as the current average market prices.

Advice of Counsel

We sought formal advice from counsel to the General Assembly regarding the applicability and intent of certain laws, including those governing BISM and its operations. The advice concluded:

- BISM has broad authority under the law to further its mission of providing training and employment opportunities for the blind.

  Previous legal opinions had concluded that BISM was a quasi-governmental entity that could operate like a private entity, and could purchase and own investments and properties regardless of where located and could legally operate businesses outside of Maryland and employ and train blind persons who were not Maryland residents.

Advice of Counsel (continued)

- In order for BISM to receive the State procurement preference, the products must be manufactured or assembled using 75 percent blind direct labor. The requirement does not apply to janitorial products sold to State contractors performing housekeeping or janitorial services.

  BISM disagrees that it must meet the blind direct labor threshold requirement based on a 1995 Baltimore City Circuit Court ruling. The court ruled BISM was a State agency and therefore exempt. Absent other court action or legislation to clarify the matter, no further action to resolve the legal disagreement is likely (See Finding 2.3).

- The existing laws pertaining to BISM business practices, such as the types of work that would qualify for the direct labor hours requirement, are open to interpretation (See Finding 2.3).

Employment and Training Strategies

- **Objective 1**
  To determine whether BISM has established employment and training strategies that promote work, career and training opportunities, and services for blind and visually-impaired persons in Maryland.

  Findings:

  - BISM had established organizational goals in 2013 to be accomplished by 2020 but only recently set strategies and had not developed action plans or measures to assess its efforts. Action plans are essential if BISM hopes to achieve its 2020 goals, including almost tripling sales and increasing employment by 67 percent (Finding 1.1).
  - BISM conducts outreach programs to inform Maryland residents throughout the State of its rehabilitation and training programs and services. OLA contacted several State and local officials and found that the needs of blind persons requesting services appear to be met (Finding 1.2).

Employment and Training Strategies (cont'd)

- Since FY 2000, BISM has assumed more financial responsibility for funding its rehabilitation and training programs. FY 2015 State grant funds were used for the benefit of blind Maryland residents **(Finding 1.3)**.
- Many former BISM students completing its Comprehensive Orientation, Rehabilitation, and Empowerment (CORE) program have reported successful post-training outcomes, such as obtaining employment, enrolling in college, or being able to live independently. However, BISM had not established mechanisms to evaluate the success of some of its rehabilitation and training programs **(Finding 1.4)**.

Recommendations

- Develop action plans and performance measures related to its strategic initiatives.
- Establish a formal process for tracking student/client satisfaction for all of its training and rehabilitation services.

Pricing Policies for BISM Products

- **Objective 2**
  To determine whether pricing policies and practices provide assurance that Maryland State agencies are paying the fair market value for BISM-produced supplies and services.

  Findings

  - The pricing committees established by law to set the fair market prices for BISM supplies (products) and services offered for sale to State agencies under the State procurement preference have not performed a comprehensive review of the prices for all such products and services (**Finding 2.1**).

    Due to the lack of documentation, the extent to which the prices for 415 products sold to the State had been approved is undeterminable.

    If a price review had been performed for individual products, the committees relied on BISM pricing information.

Pricing Policies for BISM Products (cont'd)

- Based on Internet price surveys we conducted, we concluded that on an overall basis, BISM prices for 14 products typically purchased by the State during FY 2015 were competitive with the prices of similar competitor products offered for sale (Finding 2.2).

  For example, our comparison of the average BISM unit prices paid by the State during FY 2015 (after discounts from BISM list prices) to the average Internet prices offered by vendors disclosed that 12 of 14 items were priced lower by BISM, translating to a State savings of $1.05 million based on FY 2015 quantity purchases.

  Such pricing comparisons have limitations. Reliable price comparisons are difficult to perform due to timing, methodology, and unknown factors such as shipping costs, product quality, and potential volume discounts from vendors.

Pricing Policies for BISM Products (cont'd)

- Differing legal opinions and a court ruling, call into question the applicability of statutory direct blind labor requirements for certain BISM products sold under the procurement preference (**Finding 2.3**).

  Counsel to the General Assembly reaffirmed a 1993 Attorney General's Opinion that only products meeting the blind 75 percent direct labor hour threshold qualify for the State non-janitorial procurement preference. A 1995 Baltimore City Circuit Court ruling concluded the threshold did not apply because, unlike the Opinion which deemed BISM a quasi-public corporation, the court ruled BISM was a State agency within the context of the applicable law.

  As a result, BISM does not maintain records that would be needed to demonstrate that direct blind labor hours constituted at least 75 percent of the total manufacturing and assembling hours for each product.

Pricing Policies for BISM Products (cont'd)

Recommendations

- The State Pricing and Selection Committee should set the fair market value prices of all BISM products and services for sale to the State, maintain a current list of those products and services, and make timely revisions to the list as necessary. The Committee should also send the list to the Department of General Services (DGS).
- DGS should make the Committee approved list, with prices, available to State agencies.
- BISM should retain documentation of initial product pricing and maintain complete records of items submitted for pricing to the Committee.
- BISM take necessary actions to ensure compliance with provisions in State law concerning direct blind labor requirements.

Executive Compensation Processes

- **Objective 3**
  To determine whether BISM has established reasonable processes and standards for setting executive compensation and appropriate ethics requirements for BISM management and its board.

  Findings

  - The annual performance evaluation of the chief executive officer (CEO), which is an important aspect in setting compensation, was not directly linked to specific measurable BISM goals (Finding 3.1).

    The CEO performance bonus program was not defined or documented, even though the bonus for FY 2016 was approximately one-half of the CEO's salary and bonus compensation of $472,500.

    Nevertheless, based on a survey of CEO compensation, the BISM CEO's total compensation was comparable to that of the CEOs of three other similarly-sized blind industries organizations.

Executive Compensation Processes (cont'd)

- BISM has not established a formal compensation review policy for its non-CEO executive-level positions to ensure that they are evaluated based on measurable goals and objectives and to demonstrate the reasonableness of those positions' salaries **(Finding 3.2)**.

  BISM could not demonstrate that these individuals' salaries were reasonable based on market surveys and analyses. However, OLA's comparison of 2013 salaries paid to three BISM non–CEO executives to individuals in similar positions in like entities, suggests the BISM salaries for those employees are comparable.

- BISM had established a comprehensive code of ethics and appropriate financial disclosure requirements that were found to be comparable with a certain published guide for non-profits and the Maryland Public Ethics law. Also, compliance with the policy was monitored **(Finding 3.3)**.

Executive Compensation Processes (cont'd)

Recommendations

- Enhance the CEO annual evaluation process by incorporating attributes pertaining to achieving specific measurable goals.
- Develop a Board approved written performance bonus plan that includes a description of the purpose and methodology for determining the CEO's bonus and retain documentation supporting all compensation determinations.
- Develop a formal Board approved compensation review policy for non-CEO executive staff that includes measurable goals tailored for those positions.
- Ensure compensation for non-CEO executive staff is reasonable based on market surveys and analysis.

Department of Legislative Services
Office of Legislative Audits

Department of Public Safety and Correctional Services – Division of Parole and Probation

Probation Intake and Fee Assessment Processes

Report Dated November 30, 2015

Audit Overview

- We conducted an audit based on an allegation received through our fraud hotline related to possible deficiencies in the recording and abatement of certain fees paid by offenders under the Drinking Driver Monitor Program (DDMP) administered by the Division of Parole and Probation (DPP).
- DPP supervises offenders on parole and probation to ensure they are upholding requirements set by the courts and the Parole Commission.
- The objectives of the audit were (1) to evaluate procedures and controls over the intake process when offenders are sentenced to probation, including the assessment of fees and restitution; and (2) to identify DDMP cases for which applicable monthly fees may have not been properly assessed.
- As of July 2015, there were approximately 14,000 open DDMP cases.

Probation Intake Process

- Offenders report to one of 44 DPP field offices per the probation order from the courts. Twenty DPP field offices handle DDMP cases.
- DPP staff record offender information into the Offender Case Management System (OCMS) and the Offender-Based State Correctional Information System II (OBSCIS II).
- OCMS is a case management system used to monitor the offenders, and OBSCIS II is used to account for fines, costs, fees, and restitution (FCFR) due and payments received from offenders.
- OCMS was implemented in December 2012. While certain OCMS offender demographic data interface with OBSCIS II, FCFR data do not, and must be manually entered into OBSCIS II.
- Offenders pay a monthly supervision fee and DDMP fee (if a DDMP case). Fees are manually calculated at intake by DPP staff. Supervision fees collected during FY 2014 totaled $7.5 million and DDMP fees collected totaled $6 million.

DDMP Fund - Background

- State law, effective July 2005, created the DDMP fund as a special, non-lapsing fund to be used for all DDMP costs, and imposed a $45 monthly fee on all DDMP offenders.
- The DDMP fund had a deficit balance at June 30, 2008, requiring a $1.5 million deficiency appropriation, and in June 2009 the monthly fee was raised to $55.
- DDMP revenues exceeded expenditures during FYs 2010 and 2011; however, beginning with FY 2012, expenditures have exceeded revenues each year through FY 2015.
- During FY 2014, general funds of $447,248 and a deficiency appropriation of $400,000 funded expenditures of $847,248 in excess of the DDMP fund balance.
- During FY 2015 only payroll costs were charged to the DDMP fund. Non-payroll costs (typically $880,000 a year) were charged to general funds, leaving a balance of $223,451 in the DDMP fund.

DDMP Fund - FY Financial Activity

DDMP Fund Activity Fiscal Years 2010-2015

Fiscal Year	DDMP Revenues	DDMP Expenditures	Fund Balance at Fiscal Year End
2010	$7,428,761	$6,448,788	$979,973
2011	$7,272,784	$6,448,788	$1,470,462
2012	$6,884,040	$7,032,325	$1,322,177
2013	$6,667,599	$7,335,883	$653,893
2014	$6,045,344	$7,546,485	$0
2015	$6,729,282	$6,505,831	$223,451

Source: State Budgetary Records

Key Findings

- DPP did not revise its offender intake processing policies and procedures manual when a new automated case management system (OCMS) was implemented in December 2012. OCMS substantially changed and added more complexity to the intake process. Our review of intake processes in 6 field offices (responsible for 40% of probation cases) found certain inconsistencies.
- Procedures and controls at the field offices were insufficient to ensure all fees and restitution were properly calculated, assessed, and recorded. OLA tests found errors in both over and under-assessments of fees or restitution.
- User access in OCMS was not properly controlled and many users had excessive access.
- An OLA match identified 3,983 cases in which DDMP fees were potentially under-assessed by a total of $2.1 million. OLA tests found data errors in 32 of 45 cases tested. Because of certain data limitations, a reasonable estimate of total DDMP fee under-assessments is not determinable.

Probation Intake Process

- DPP did not revise its offender intake processing policies and procedures manual when a new automated case management system was implemented in December 2012 **(Finding 1).**

  - After OCMS was implemented, DPP's Operations Manual was not revised and adequate training was not provided to guide intake staff on the new multi-step data entry process, and we noted inconsistencies between field offices. For example, staff at 2 of 6 field offices we reviewed were unaware that DDMP exemptions (for disabled offenders) should be recorded in OCMS, which led to inconsistencies with OBSCIS II when the fees were not recorded.

  - DPP did not have a formal policy stating whether to reduce DDMP fees when a case is abated by the courts after certain probation terms were met. A policy exists for supervision fees but not DDMP fees. Three of 6 field offices reviewed were reducing DDMP fees, while the others were not.

Probation Intake Process (continued)

- DPP had not established adequate procedures and controls to ensure that all fees and restitution were properly assessed to offenders and recorded at four field offices reviewed **(Finding 2).**
  - Initial accountability was not established over probation orders (such as court orders) received to ensure that all orders were processed and recorded.
  - As of May 2015, none of the field offices reviewed had established a documented supervisory review for the intake process to ensure that all fees and restitution were properly calculated, assessed, and recorded in OBSCIS II, including those cases transferred from other field offices.
  - OLA testing found clerical errors in 9 of 20 cases opened at these four field offices in FY 2015. These errors included not assessing DDMP fees, over-assessing DDMP fees or supervision fees, and over-assessing court-ordered restitution.

OCMS User Access

- Procedures and controls over user access in OCMS were not sufficient. Many users had excessive access, defined system roles were not appropriately restricted, and data input controls were not comprehensive. As of May 2015, there were 1,696 users with access **(Finding 3).**
  - There was no documented supervisory approval for granting and modifying user access in OCMS, including access granted upon implementation.
  - DPP did not periodically review the propriety of access for the 1,359 users who had OCMS edit access. We noted that 11 of 14 users tested had improper or unnecessary access, which could allow errors in criminal records. Because changes to critical OCMS data were not recorded, these errors could remain undetected.
  - Controls were not comprehensive to ensure all critical information was properly entered into OCMS. For example, until June 2015, probation period ending date was not a required field.

Data Match Test Results

- We conducted a targeted match of OCMS and OBSCIS II data which identified 3,983 cases in which DDMP fees were potentially under-assessed by $2.1 million. We tested 45 of these cases for which DDMP fees totaling $6,600 and supervision fees totaling $15,210 had been recorded. Our tests found that DDMP fees totaling $42,625 and supervision fees totaling $11,300 were not properly assessed in OBSCIS II for 32 cases (Finding 4).
  - For 21 of 45 cases tested, DDMP fees and/or supervision fees totaling $38,360 were not assessed.
  - For 7 cases, DDMP fees totaling $10,230 were incorrectly recorded as either supervision fees or testing fees.
  - For 1 case, DDMP fees were mistakenly waived rather than supervision fees of $1,980.
  - For 3 cases, DDMP fees were under-assessed by $3,355.

Data Match Test Results (continued)

- For the remaining 13 of the 45 cases tested, although the fees assessed were correctly recorded in OBSCIS II, the cases were identified by our match due to other data problems, including the failure to record a DDMP exemption flag or an inaccurately recorded probation period.

- Based on our review of 5 of the 32 cases with errors that had subsequently closed, processes in place to identify fee assessment errors at case closure were ineffective. Corrections to the assessed fees had not been made in OBSCIS II in any of these cases. The review at case closure represents the last chance to assess fees prior to closing the case and referring any recorded owed fees to the Central Collection Unit.

- Because of data reliability problems in OCMS and OBSCIS II, and certain limitations in our match, the extent to which DDMP fees were actually under-assessed is unknown.

Data Match Test Results (continued)

- The proper assessment and collection of DDMP fees are important since DDMP collections are credited to the DDMP fund which, as previously mentioned, has not been sufficient to fund the full costs of DDMP.

- As a result of this review, DPP initiated a review in June 2015 of all open cases to ensure that fees and restitution were properly recorded in OBSCIS II.

Conclusions

DPP should

- establish comprehensive intake guidance and training that addresses all critical processes, and establish a formal policy on the handling of DDMP fees when a case is abated;
- establish initial accountability for all probation orders and an independent supervisory review of the intake process to ensure all fees and restitution are properly assessed and recorded in OBSCIS II;
- establish a formal, documented process for granting, modifying, and reviewing OCMS user access, restrict access for users with improper access, enhance input validation controls, and produce reports of critical data changes for review;
- take immediate corrective action on cases identified in our audit for which fees were not properly assessed; and
- consider performing data matches between OCMS and OBSCIS II to identify errors and inconsistencies.

Department of Legislative Services
Office of Legislative Audits

Performance Audit

Video Lottery Operations Revenue Small, Minority, and Women-Owned Businesses Account

Report Dated October 23, 2015

Audit Overview

- State Law generally requires that 1.5 percent of video lottery terminal (VLT) proceeds be paid into the Small, Minority, and Women-Owned Businesses Account (the Account).
- The purpose of the Account is to provide investment capital and loans to small, minority, and women-owned businesses in the State. At least 50 percent of such activity must be allocated to eligible businesses in the jurisdictions and communities surrounding a video lottery facility (referred to as 'targeted areas').
- The Board of Public Works (BPW) has authority over the Account and under State law, BPW was to develop criteria to define "fund managers" (managers) to whom BPW would make grants, and who would use the grant funds to provide investment capital and loans to businesses.
- Current State law requires OLA to annually evaluate the use of these funds. This report covers FY 2014.

DBED Responsibility

- On August 22, 2012, BPW entered into a Memorandum of Understanding (MOU) with the Department of Business and Economic Development (DBED), for DBED to serve as BPW's agent to administer the Program (the awarding of the grant funds and subsequent loan activity).
- The MOU delegated certain responsibilities to DBED, including the authority to conduct the procurement of fund managers, recommend approval of managers to BPW, enter into agreements with managers on BPW's behalf and, pursuant to those agreements, disburse grants in amounts approved by BPW to the managers.
- DBED is also responsible for monitoring fund manager reporting and submitting an annual report to BPW that details Program activities, including an itemized list of businesses receiving investment capital or loans.

Fund Managers

- DBED executed similar agreements with 3 fund managers effective May 1, 2013 describing manager services and responsibilities, including loan origination and underwriting, advertising, identifying potential borrowers, and community outreach. Each manager was also to establish (and have custody of) a checking account for all Program activity in the name of the State of Maryland and submit to DBED an annual report detailing its use of the funds during the preceding calendar year, and annual audited financial statements for the funds.
- A manager may request grant funds from available VLT proceeds, which with any repaid loan principal, are available for new investment capital and loans.
- Managers were compensated for their Program costs by origination and transaction fees paid by the businesses, interest earned on loans, and an expense fee paid from the Account (which was not to exceed 8% of their initial first year grant funds).

Businesses Targeted by the Program

- Managers were required to make loans to minority businesses and women-owned businesses certified by the Maryland Department of Transportation, or small businesses as defined by the U.S. Small Business Administration. They were also encouraged to make loans and investments in microenterprises, which are businesses that employ fewer than 10 persons with annual revenue not exceeding $2 million.

- Managers were required to allocate at least 50 percent of their grant funds to businesses in three targeted areas, which generally consisted of a ten mile radius surrounding the facilities operating at that time in Hanover, Berlin, and Perryville, MD.

- There were certain prohibited business types, loan purposes, and investment transactions.

Key Findings

- The appropriate amount of VLT proceeds was distributed to the Account for fiscal year 2014 and the loans issued by managers we tested appeared to be made to eligible businesses. Also, fund managers awarded at least 50 percent of its grants funds as loans to eligible businesses in targeted areas in accordance with State law.
- Although BPW and DBED had established certain protocols and processes for awarding grants, and directing and monitoring manager activities, oversight and controls could be improved by establishing Program goals, objectives, and related measures to direct the lending and investing activities and to measure and evaluate the success of the Program and manager performance.
- DBED oversight of the managers needs to be improved in the areas of financial reporting, contract compliance monitoring, and manager performance.

Summary of Relevant Financial Activity

- During this audit (FY 2014) we determined that the Account has been properly credited with VLT proceeds as specified by law, which totaled $8.4 million. FY 2014 disbursements to the 3 managers totaled $6.8 million, and a $50,000 transfer was made to DBED for administrative costs as provided for in the MOU.

- In FY 2014, managers provided 66 loans to eligible businesses totaling $6.4 million and collected $168,000 in interest and fees on these loans. DBED reimbursed the managers $744,000 for Program administrative costs.

- Subsequent to our audit period, BPW approved 4 new managers and authorized disbursements totaling approximately $9.1 million to the now 7 managers. During fiscal year 2015, 64 loans totaling $8.4 million were made by the 7 managers, and this activity will be subject to review during our next audit of the Account.

Projection of Account Revenue

- As of June 30, 2014, on a cumulative basis (since inception), approximately $21 million had been deposited into the Account from VLT revenues and the Account balance was approximately $12.5 million.

- Based on DBED reports and the Bureau of Revenue Estimates, during the next five years, VLT revenue allocated to the Account is projected to increase annually, with cumulative revenues reaching $92.3 million by fiscal year 2019.

- The most significant increase in annual VLT revenue is expected to occur during fiscal 2017, with the commencement of gaming operations at the MGM National Harbor Casino in Prince George's County.

Program Goals and Objectives

- Formal goals, objectives, and related measures had not been established for directing the lending and investment activities and for evaluating Program and manager performance (**Finding 1**).
  - Neither BPW nor DBED had specified the overall expectations as to what should be achieved by the Program and the managers, beyond meeting the requirements of State law.
  - Managing For Results performance data had been established for a number of DBED programs, but not for the Program.
  - The establishment of goals, objectives and related outcome measures could help ensure DBED and fund managers are working together to achieve the desired results. For example, goals, objectives, and measures could be established that address: 1) desired economic impact, 2) targeted industries (such as manufacturing and new technologies), and 3) geographic distribution (for example, 12 counties were not served in FY 2014).

Monitoring of Fund Managers

- DBED did not establish interim financial reporting requirements and did not ensure managers submitted audited financial statements of grant activity in accordance with the contract requirements (**Finding 2**).
  - Although managers were required annually to submit audited financial statements by March 31 and an annual report detailing the use of Program monies by January 31, no formal interim grant reporting requirement had been established.
  - One of the three managers had not met the audit requirement for calendar year 2013. Specifically, the manager's audited financial statements comingled its Program activity with its other business operations. Additionally, the financial statement reporting period for that manager ended as of September 30, 2013, instead of December 31, 2013, as required.

Monitoring of Fund Managers (continued)

- DBED had not established a formal process to verify manager compliance with key Program contractual requirements (**Finding 3**).
  - A documented process was not in place to review manager activity to ensure that loans and investments were only made to eligible businesses, as defined in the contract.
  - DBED did not sufficiently verify that businesses receiving loans were actually located in the targeted areas. DBED did determine that borrowers' reported zip codes matched the targeted areas, but did not verify the businesses were actually located in those zip codes.
  - Managers' underwriting processes were not reviewed and DBED did not ensure that loans were properly underwritten to reduce the risk of default.
  - DBED did not verify that managers had met the insurance requirements established in the agreements prior to the May 1, 2013 contract award and commencement of the services.

Monitoring of Fund Managers (continued)

- DBED had not established a formal evaluation process to assess the performance of managers, including whether desired results were achieved (Finding 4).
  - Such evaluations could be used by DBED to recommend actions to improve manager performance, and to help make decisions regarding subsequent year grant fund distributions and manager retention.
  - Requirements in manager agreements could be used to evaluate fund manager performance. For example, the managers were required to provide specific plans for assuring geographic and demographic distribution of the funds.
  - Other performance attributes could be evaluated, including operational efficiency (the percentage of grant funding spent on administrative expenses) and lending and collection effectiveness (such as percentage of loan delinquencies, loan loss ratios).

Monitoring of Fund Managers (continued)

- DBED authorized a contract modification for one manager without the necessary BPW approval (Finding 5).
  - The contract modification in question increased the one-time fund establishment fee from 8 percent of the initial grant funds to 12 percent, without BPW approval (this fee represented the amount of grant funds to be used to pay expenses for administrative, actuarial, legal, and technical services). Only BPW is authorized by law to set the maximum amount of grant money that each fund manager may use to pay expenses.
  - DBED approved the increase of $145,000 based on a schedule of budgeted expenses, without any support to justify the need. DBED did not question why this one manager required a greater percentage of grant funds to cover the initial Program start-up costs than what was needed by the other two managers. This reduced the amount of funds available for loans.

State Checking Accounts

- DBED had not established effective oversight of the transactions processed through the State checking accounts maintained by the managers (**Finding 6**).
  - DBED began transferring grant funds to the managers' accounts in July 2013, but did not establish account monitoring procedures until January 2014 and monthly bank account reconciliations were not required.
  - DBED did not obtain copies of cancelled checks for the managers' accounts directly from the issuing bank to verify the reported payees.
  - One manager paid certain of its expenses from its account totaling $75,611 without DBED's knowledge or required advanced approval.
  - DBED authorized payments for two managers' expenses totaling $130,000 even though the requests were untimely in accordance with the manager agreements.

State Checking Accounts (continued)

- DBED had not established comprehensive policies governing the process for managers to request additional grant funds to replenish their State checking accounts (Finding 7).

  - Managers were not required to provide adequate support to substantiate that they had fulfilled DBED's mandate that 80 percent of the funds previously received had been loaned or committed. Our test of 4 manager requests totaling $2.75 million found that lists of closed and pending loans were included, but not supporting documents, such as loan closing and commitment documents and cancelled checks.

  - DBED had not established a policy stipulating the period of time within which pending loans had to be closed before funds can be requested. Consequently, fund managers could have access to funds well in advance of actual need.

Conclusions

BPW and DBED should

- establish comprehensive Program goals, objectives, and related measures;
- enhance manager financial reporting requirements and enforce compliance;
- verify manager compliance with key contractual requirements;
- establish a formal process to annually evaluate manager performance;
- ensure that all manager contract modifications are submitted to BPW for its review and approval;
- establish effective manager checking account monitoring procedures and controls;
- determine the appropriateness of certain DBED financial transactions with the managers in accordance with the manager agreements; and
- establish comprehensive formal procedures governing manager requests for grant funds.

Department of State Police

Report dated November 23, 2015

Audit Overview

- The Department of State Police (DSP) comprises the Maryland State Police, the Office of the State Fire Marshal, and the State Fire Prevention Commission.
- DSP is responsible for
  - safeguarding the lives of all persons within the State,
  - protecting property, and
  - assisting in securing to all persons the equal protection of the law.
- FY 2014 operating expenditures totaled approximately $319.3 million.
- Report included 12 findings, 1 of which was repeated from the preceding audit report (current Finding 12).

Key Audit Issues

- DSP did not properly account for financial activity pertaining to certain special funds for which the related year-end balances at June 30, 2014 appeared questionable. DSP could not support revenues totaling $28.2 million recorded at FYE 2014 to cover expenditures.
- For four service contracts totaling $9 million, DSP either did not include or could not support the expected levels of service needed in the related procurement solicitations, which in some cases raises questions about the award decisions.
- DSP procedures over handgun qualification licenses and registration applications were not sufficiently comprehensive and DSP did not ensure the accuracy of handgun serial numbers recorded in its automated systems.

Special Funds

Background

DSP received revenue from various sources (such as speed camera fees) that was used to support certain field operations. DSP also received reimbursements from other governmental units and private entities for the cost of providing certain services. During FY 2014, DSP billed approximately $50.5 million for these services, of which $36.7 million was billed to

- MDOT for operations of the Commercial Vehicle Enforcement Division (CVED) and Automotive Safety Enforcement Division (ASED), and for patrol and criminal enforcement on the JFK Memorial Highway,
- public and private entities for services such as police patrols stationed at construction zones (Reimbursable Overtime), and
- local jurisdictions for providing police enforcement (Resident Trooper Program).

Special Funds (continued)

- DSP did not properly account for financial activity pertaining to certain special funds for which the related year-end balances appeared questionable (Finding 1).
  - The financial activity for five different services was combined and reflected in two special fund balances, and certain activity was not properly recorded. DSP was unable to readily determine whether it recovered all costs charged for these activities.
  - Both special fund balances at June 30, 2014 appeared questionable. One fund used to account for three services had a deficit balance of $44.2 million (an amount that exceeded the FY 2014 DSP costs related to these services) and the other fund had a positive balance of $34.4 million.
  - DSP had not identified and investigated the aforementioned inconsistencies and could not determine if the positive and negative balances in these funds were related.

Budgetary and Year-End Closing

- DSP's budgetary year-end closing transactions for FY 2014 were not always adequately supported or accurately reported (**Finding 3**).
  - DSP did not maintain adequate documentation to support that $28.2 million in revenues recorded during the FY 2014 budgetary closeout were available to cover incurred expenditures. For any revenues that are not available, general fund or deficiency appropriations may be needed to eliminate any resulting deficits.
  - DSP neither accurately reported nor had valid legal justification for retaining certain special funds at year-end. DSP reported that it retained special fund balances as of June 30, 2014 in four budgetary programs totaling $22.9 million. However, the legal justification for retaining $15.7 million of these funds did not substantiate that these funds could be retained.

Procurements

OLA tested the procurement of 5 contracts collectively valued at $16.1 million.

- For 4 of the contracts, totaling $9 million, DSP did not include or could not support the approximate quantities of services needed in its solicitations, as required by State regulations, impeding DSP's ability to determine whether it received the most favorable bids, made the appropriate award decisions, and established reasonable contract values (**Finding 4**).
  - For example, for one contract for transmission repairs totaling $1.6 million, DSP solicited unit prices for the repair of 39 different types of DSP vehicles without providing any estimate of the expected transmission repair activity for each vehicle type. The award was made based on the sum of these unit prices without regard to the expected activity.

Procurements (continued)

- Procedural and documentation deficiencies were noted regarding the evaluation of vendor bids for certain service contracts (**Finding 5**).
  - The technical evaluations were not completed and adequately documented for 2 of the contracts totaling $5.4 million. For example, for one contract, all of the evaluation attributes were not addressed by the evaluators.
  - For 2 contracts totaling $6.6 million, the proposals were evaluated based on a sum of price quotes for each type of service, without considering the corresponding estimated quantities needed.
  - DSP awarded a portion of one contract to a vendor that did not meet all required specifications.
  - The award amount for another contract ($400,000) was almost double the value of the services based on DSP estimated quantities and the vendor's bid.

Handgun Registration

Background

- Obtaining and registering a handgun is a multi-step process with specific procedural and documentation requirements for handgun dealers, DSP, and applicants.
- Effective October 1, 2013, a handgun dealer or any other person may not sell, rent, or transfer a handgun unless the individual receiving the handgun first obtains and presents to the dealer or other person a valid Handgun Qualification License (HQL) issued by DSP. Certain individuals, such as former police officers, are exempt from the HQL requirement.
- Once an HQL is obtained (or is exempt as noted above) the individual may submit a handgun registration application to the dealer (or individual if a private sale), which is then forwarded to DSP for evaluation. If the application is not disapproved by DSP, the handgun can be transferred.

Handgun Registration (continued)

- DSP procedures over HQLs and handgun registration applications lacked certain controls (**Findings 6**).
  - DSP did not require handgun dealers to submit a copy of an applicant's HQL with the handgun registration application, as required by State law.
  - DSP did not have a procedure to ensure that dealers submitted finalized handgun registration applications within 7 days of delivery of the handguns to the applicants, as required. Ten of 40 finalized applications tested were received 20 – 201 days after the handguns were transferred.
  - Numerous individuals had unnecessary system access allowing them to approve handgun applications even though they did not require that capability.

Handgun Registration (continued)

- Certain quality control procedures were not comprehensive to ensure the accuracy of handgun registration information (such as registrant name, gun make, and serial number). Although quality control reviews were conducted of selected registrations, these verification procedures do not appear to be sufficient **(Finding 7)**.
  - OLA's automated comparison of 27,500 applications found different handgun serial numbers for about 4,000 registered handguns in the two automated systems used to record the initial handgun registration application and the completed registration information.
  - Certain applications were excluded from DSP's independent quality control reviews that are performed to ensure the proper evaluation and disposition of HQL and handgun applications.

Other Findings

- DSP lacked adequate controls over collections and the related accounts receivable for external services provided to other governmental units and private entities, and for handgun registration application fees (Finding 2 & 8).

- Numerous security and control issues were noted regarding DSP's information systems and critical data. Specifically, DSP's network and numerous workstations were not properly maintained and secured, and assurance was lacking that critical data hosted by a third-party service provider were adequately safeguarded (Findings 9, 10, & 11).

- DSP did not complete annual physical inventories of its sensitive equipment and did not always record equipment purchases. Similar conditions have been commented upon in six preceding audit reports dating back to January 1998 (Finding 12).

Conclusion

DSP should ensure that

- all special fund activity is properly accounted for, and related special fund balances are investigated and the necessary corrections made;
- all revenue transactions recorded to cover expenditures are accurate and supported, proper legal justification exists for all funds retained at year-end, and any deficits are resolved;
- procurement solicitations contain supportable quantity of services needed, evaluation documents are complete, and the methodologies used to evaluate vendors' proposals are reasonable;
- procedures are implemented to improve controls over HQL and handgun registration applications, and all critical information is recorded accurately in its automated systems; and
- recommended actions are made to improve security and controls, including for information systems, cash receipts, accounts receivable, and equipment.